STRICTLY CONFIDENTIAL (FR) CLASS II-FOMC

Materials for

Staff Presentation to the Federal Open Market Committee

July 7, 1987

Principal Assumptions

Monetary Policy

- Interest rates rise appreciably over the projection period.
- M2 grows at around a 5 percent annual rate and M3 at about a 7 percent rate over the next six quarters.

Fiscal Policy

- Deficit-reducing actions of about $25 billion in FY1988.

Other

- Foreign exchange value of the dollar declines at somewhat less than a 10 percent annual rate.
- Little further change in the price of crude oil.

Chart 2

Federal Budget

	FY86 (actual)	FY87 Staff	FY88 Staff	FY88 Congressional Resolution
Outlays	990	1014	1054	1041
Receipts	769	845	886	933
Deficit	221	169	168	108
memo:				
Gramm-Rudman Target	172	144	108	

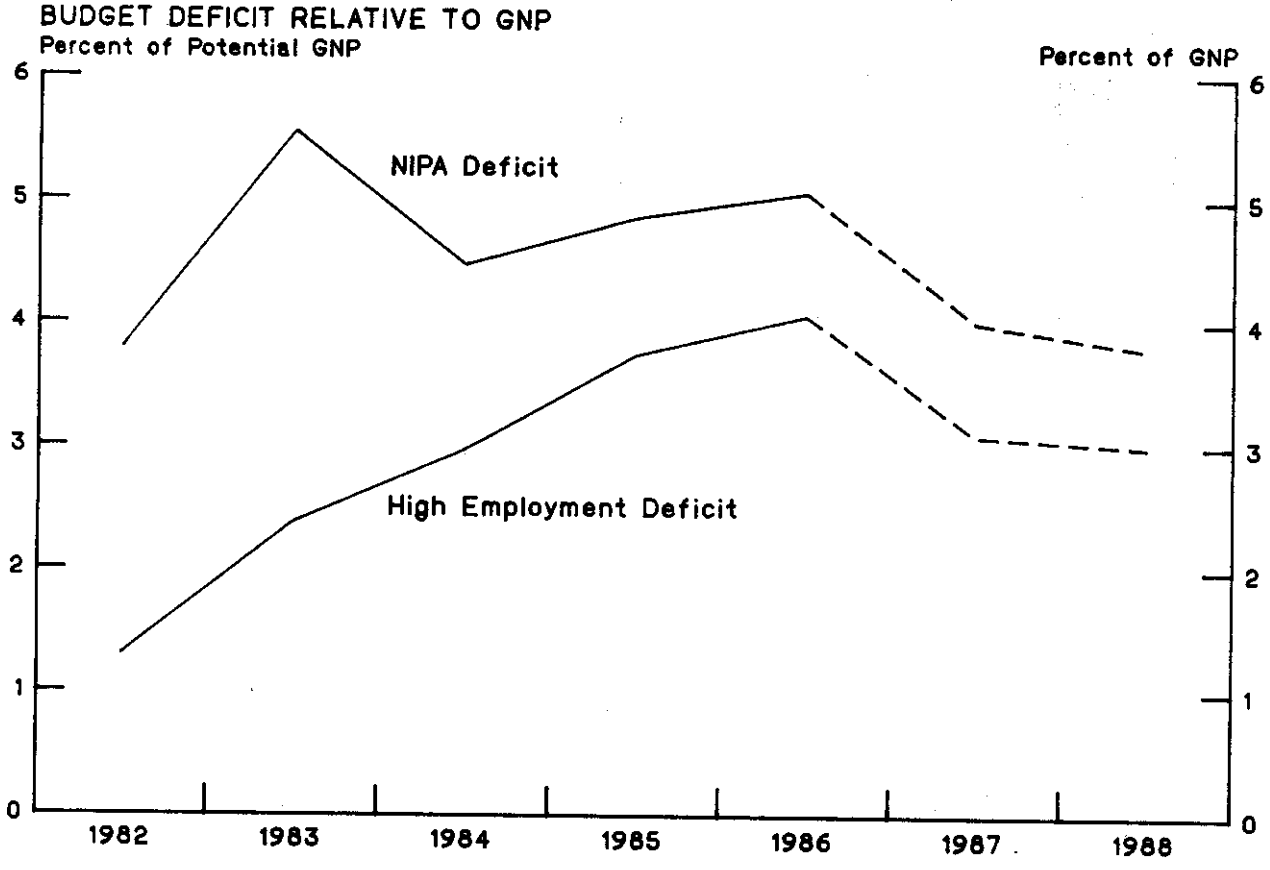
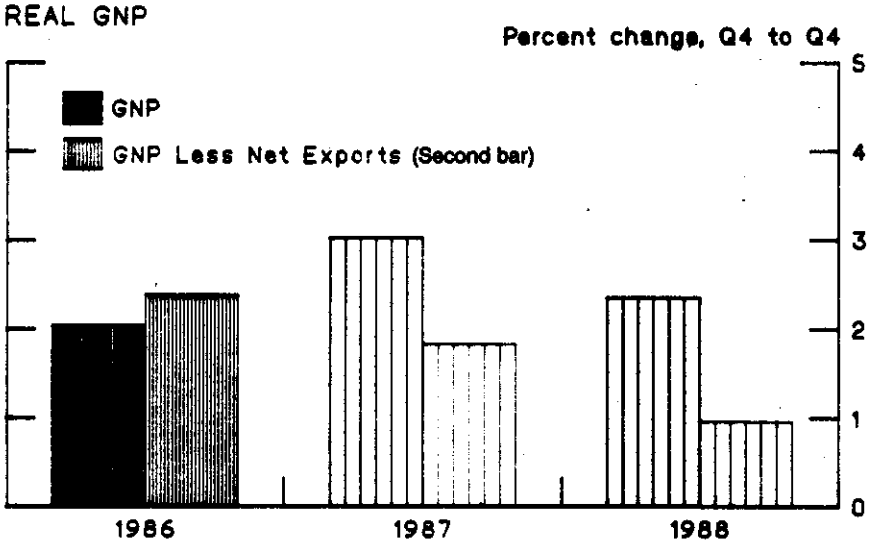


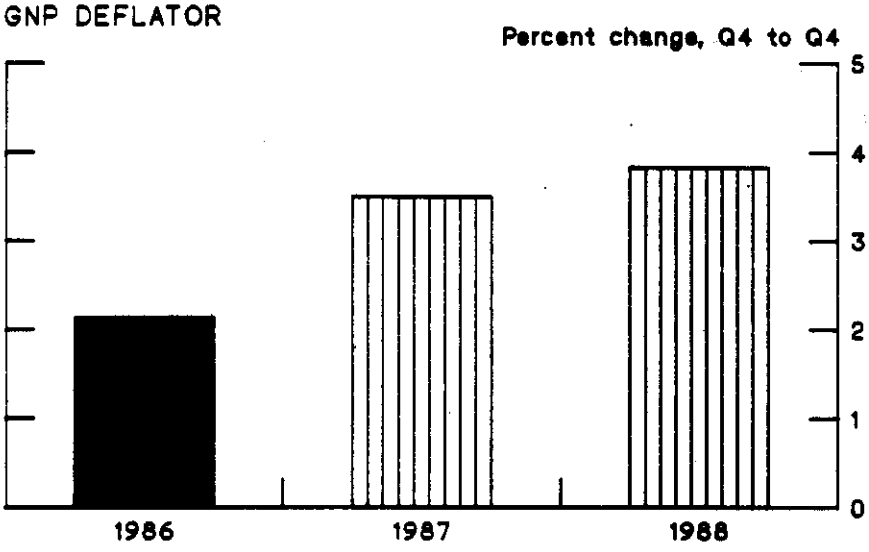
Chart 3

REAL GNP



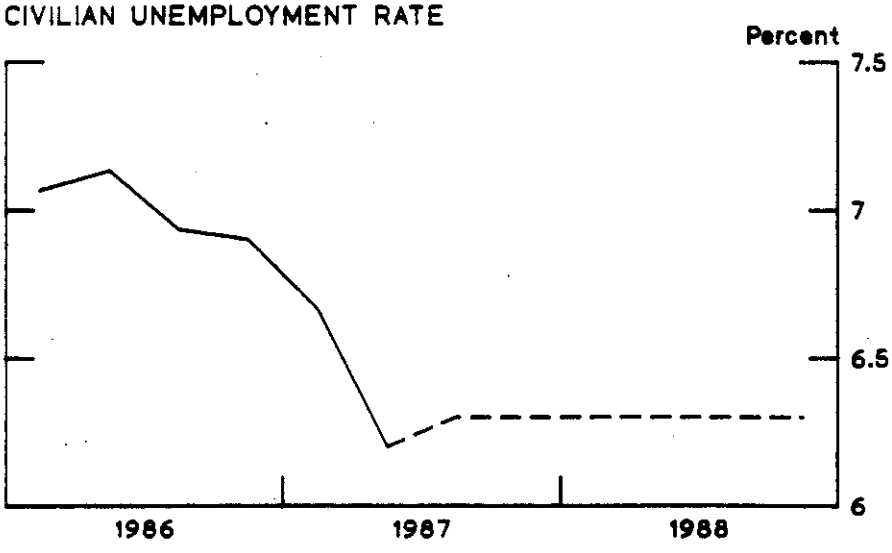
	Real GNP	Less Net Exports
1986	2.0	2.4
1987	3.0	1.8
1988	2.3	1.0

GNP DEFLATOR



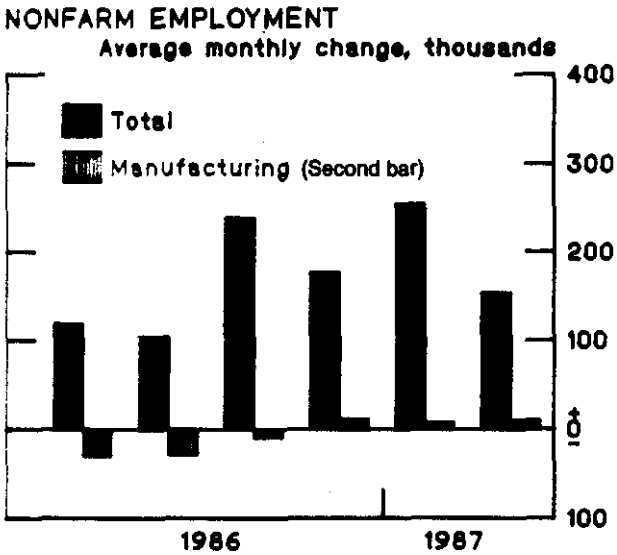
1986	2.1
1987	3.5
1988	3.8

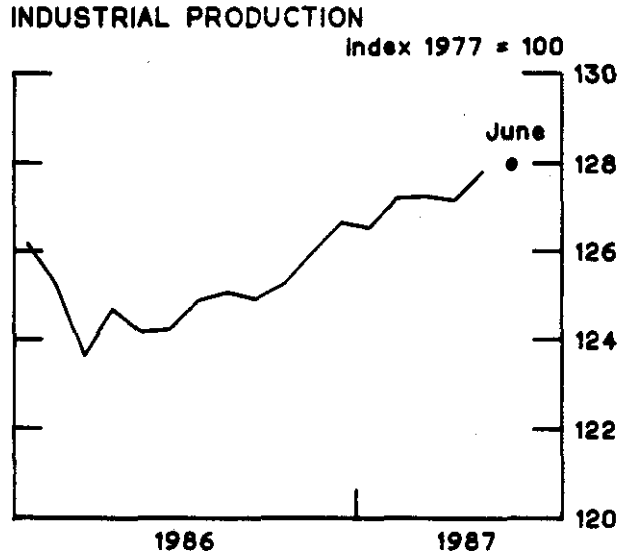
CIVILIAN UNEMPLOYMENT RATE

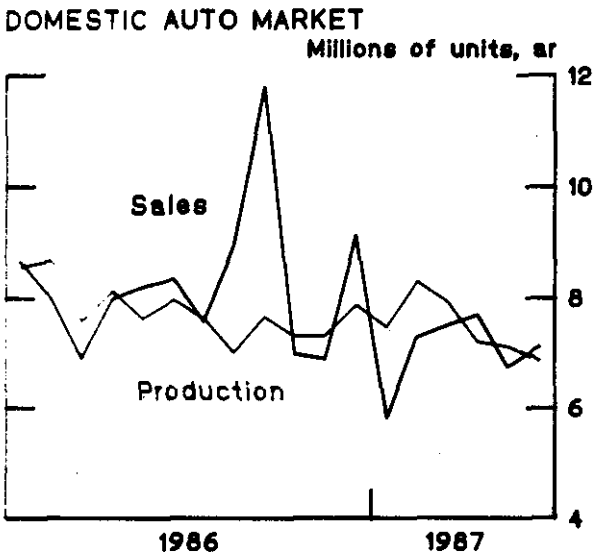


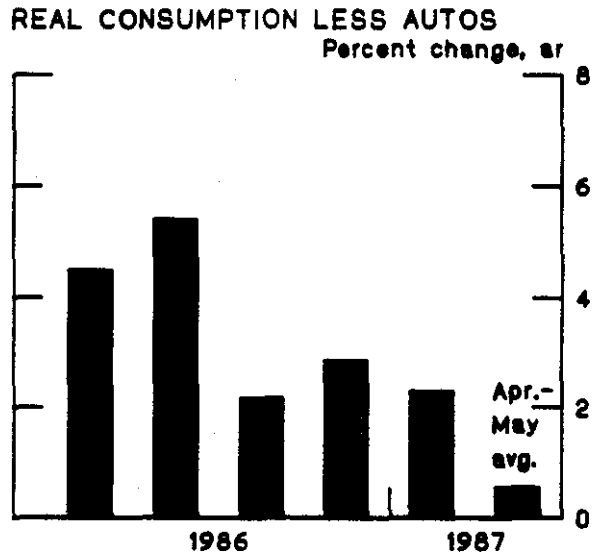
	Q4 Level
1986	6.9
1987	6.3
1988	6.3

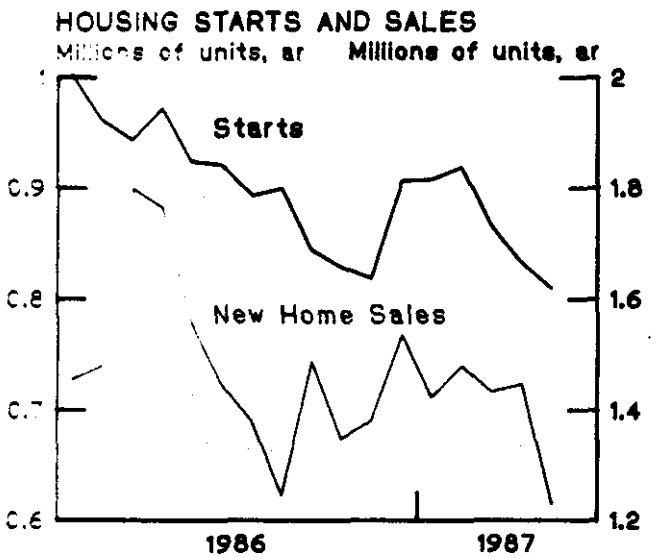
Chart 4

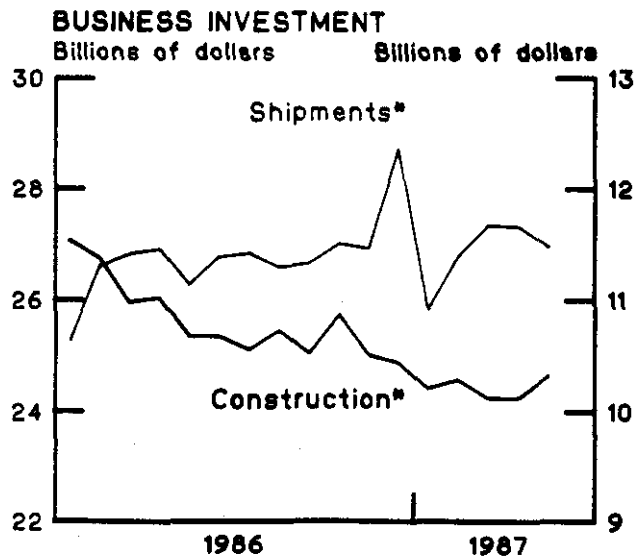






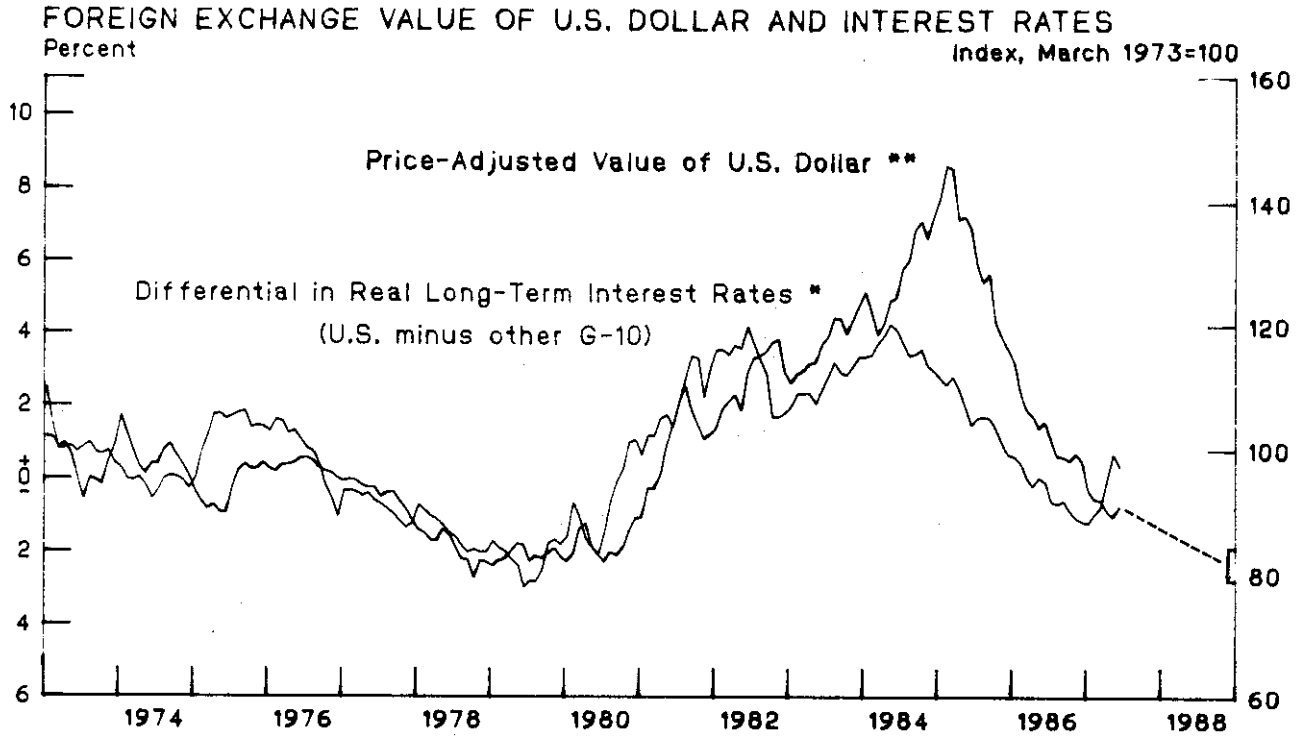


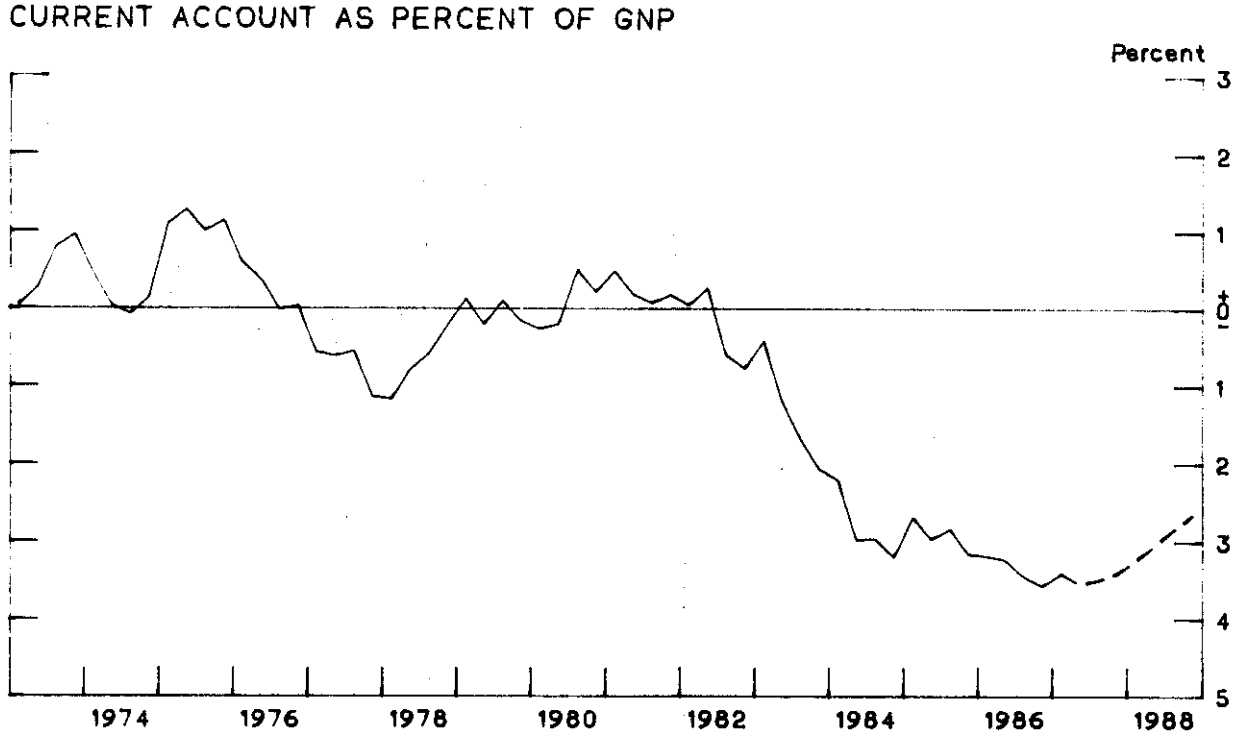




* Shipments of nondefense capital goods.
• Nonresidential construction put in place.

Chart 5

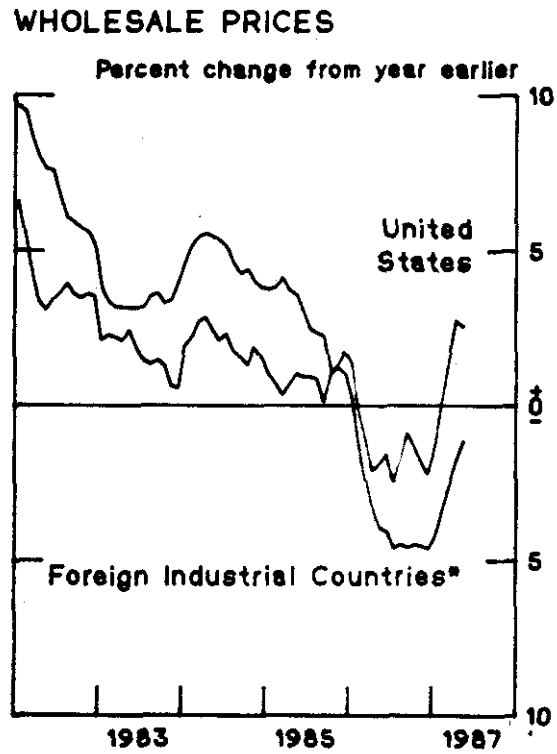


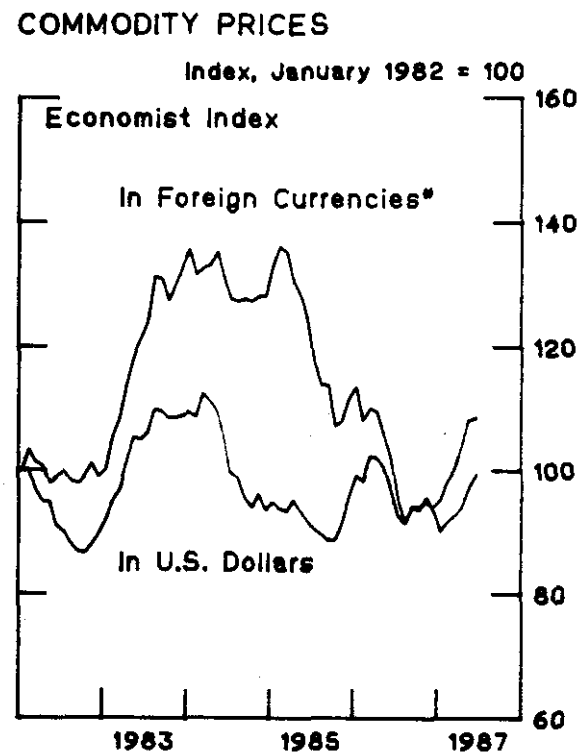


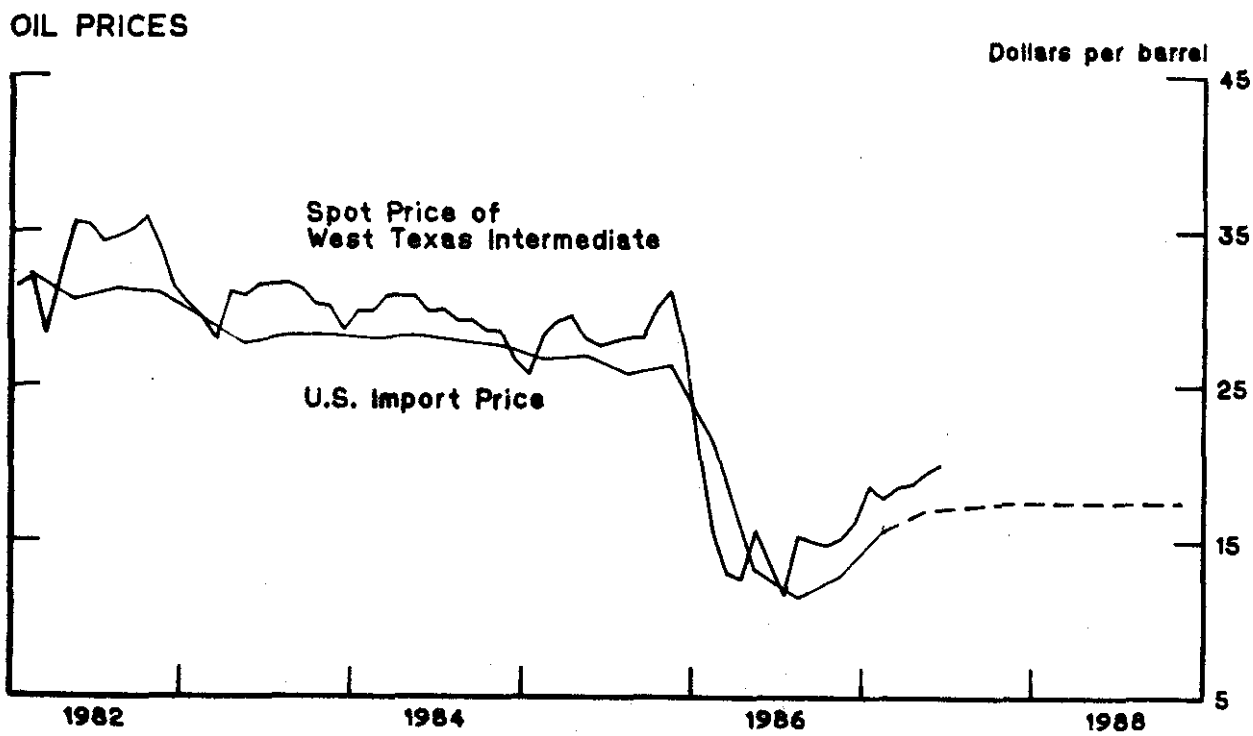
* Real interest rates are calculated using a 36-month centered moving average of inflation rates, using staff forecasts where necessary.

**Weighted average dollar against other G-10 currencies using total 1972-76 average trade adjusted by relative consumer prices.

Chart 6



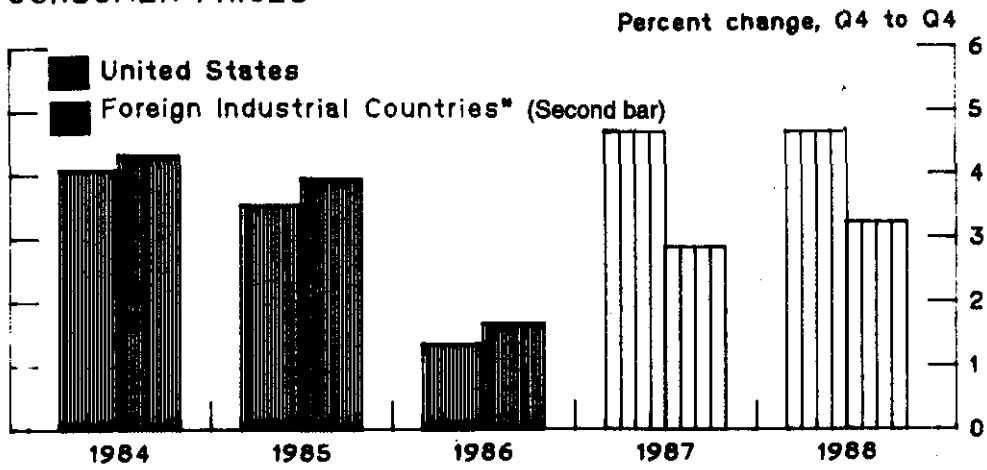




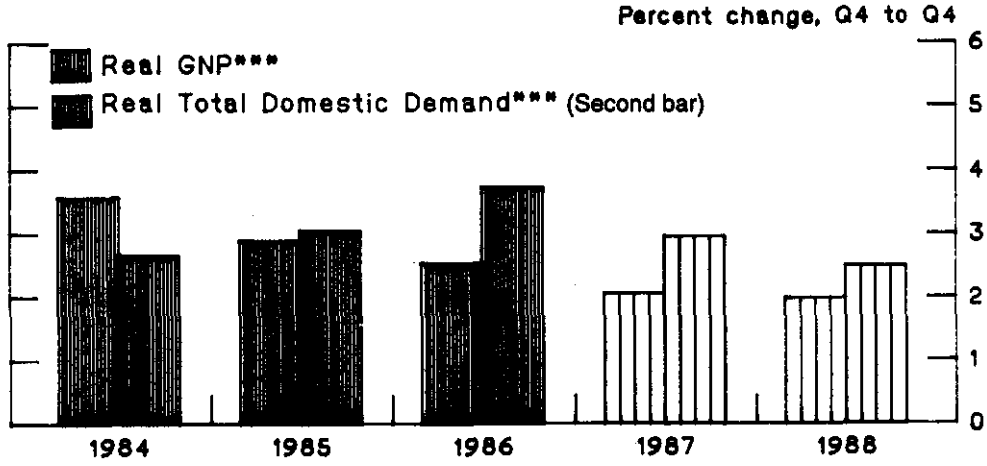
*Weighted average of the six major foreign industrial countries using total 1972-76 average trade.

Chart 7

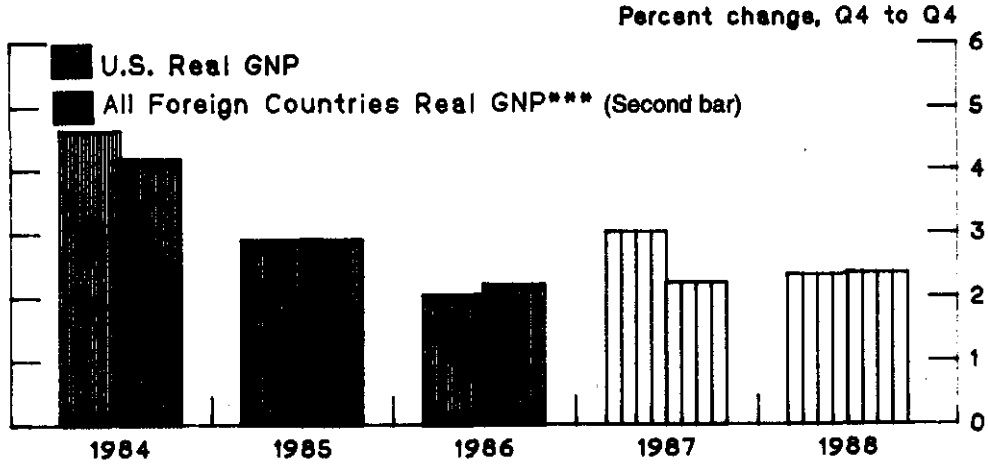
CONSUMER PRICES



ECONOMIC ACTIVITY: JAPAN AND EUROPE**



ECONOMIC ACTIVITY: WORLD



* Weighted average of the six major foreign industrial countries using total 1972-76 average trade.
** Germany, France, Italy, and the United Kingdom.
***Weighted average using U.S. non-agricultural exports, 1978-83.

Chart 8

Prices of Non-oil Imports*

Percent change

	1986Q1 / 1985Q1	1987Q1 / 1986Q1
1. Food	5	–1
2. Industrial Supplies	–4	1
3. Capital Goods	2	10
4. Automotive	8	8
5. Consumer Goods	3	8
6. Total Non-oil	**2**	**6**

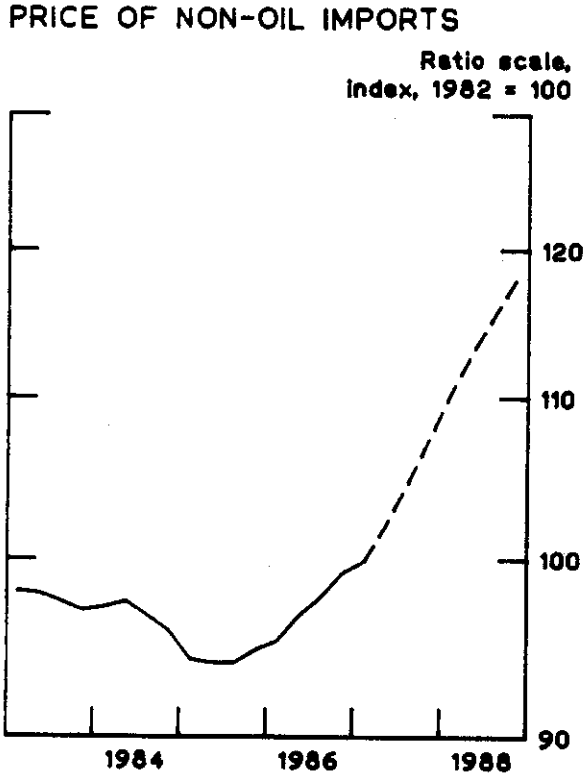
* NIPA fixed-weight indexes

Volumes of Non-oil Imports*

Percent change, annual rate

	1986Q3 / 1985Q3	1987Q1 / 1986Q3
1. Food	10	– 1
2. Industrial Supplies	8	8
3. Capital Goods	24	1
4. Automotive	10	0
5. Consumer Goods	14	6
6. Total Non-oil	**13**	**4**

*Excluding gold



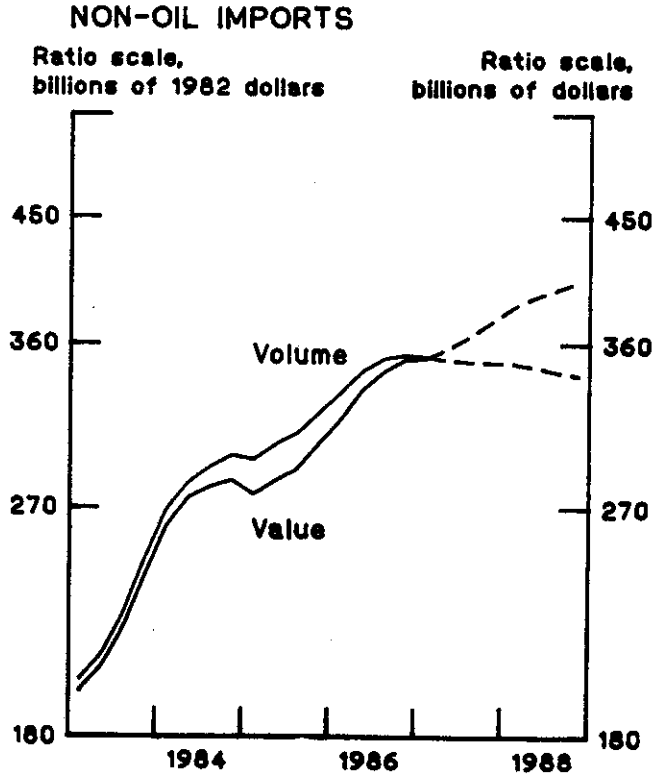
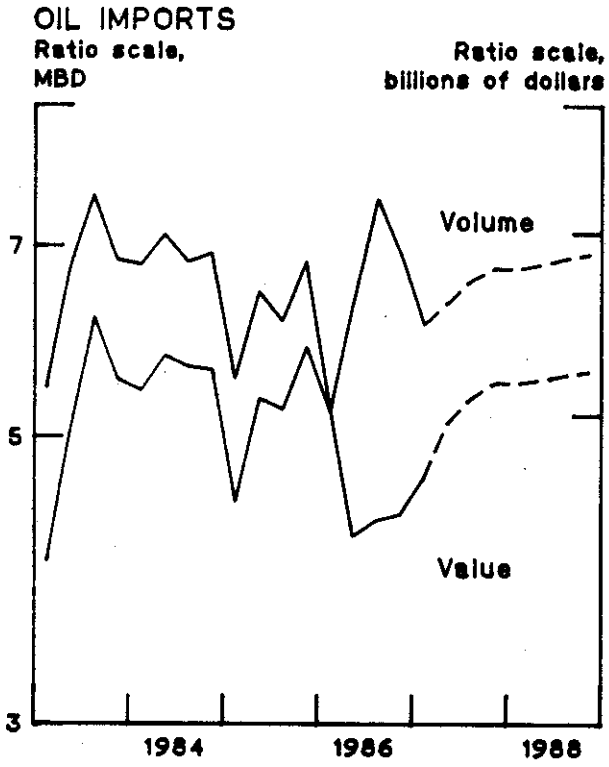
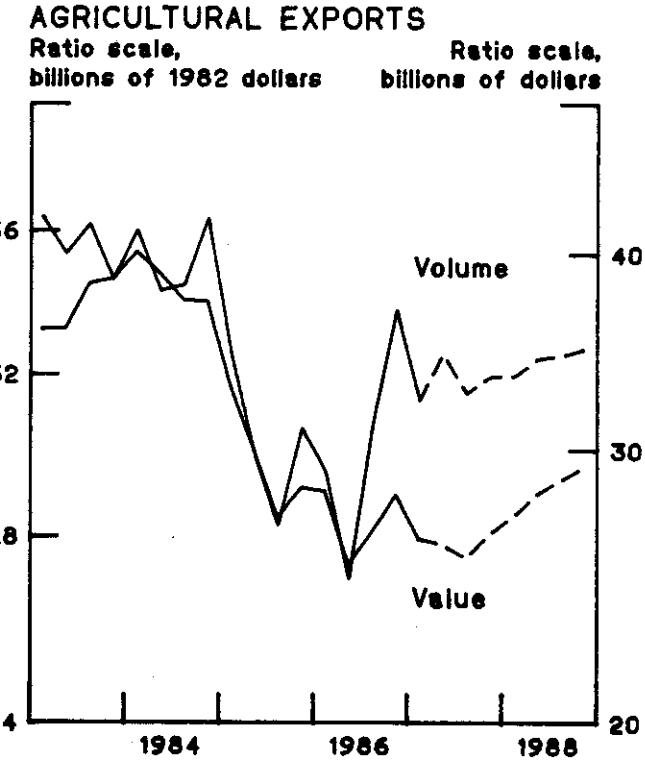


Chart 9





Volumes of Nonagricultural Exports*

	Percent change	
	1986Q1 / 1985Q1	1987Q1 / 1986Q1
1. Industrial Supplies	−1	9
2. Capital Goods (ex. aircraft)	4	10
3. Automotive	−4	7
4. Consumer Goods	−1	17
5. All Other	13	11
6. Total Nonagricultural	**2**	**10**

* Excluding gold

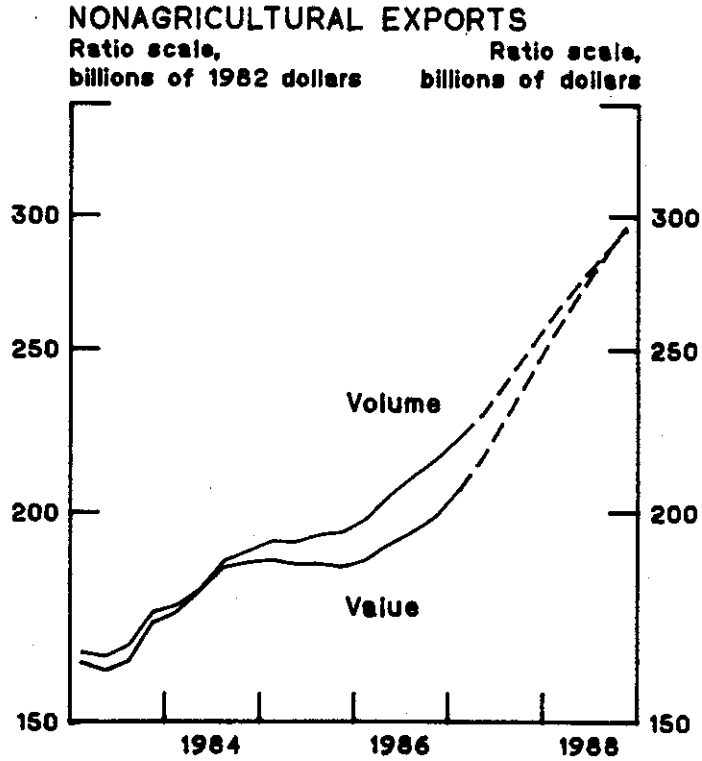
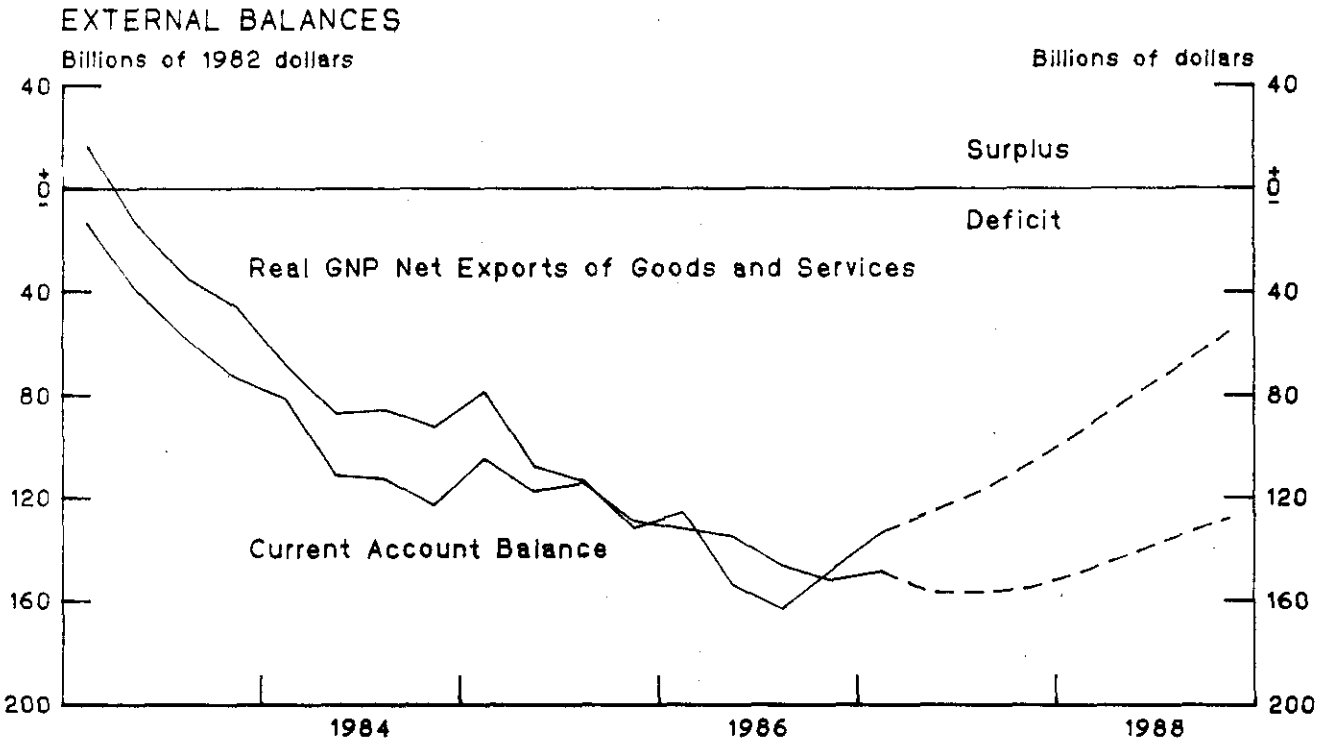


Chart 10



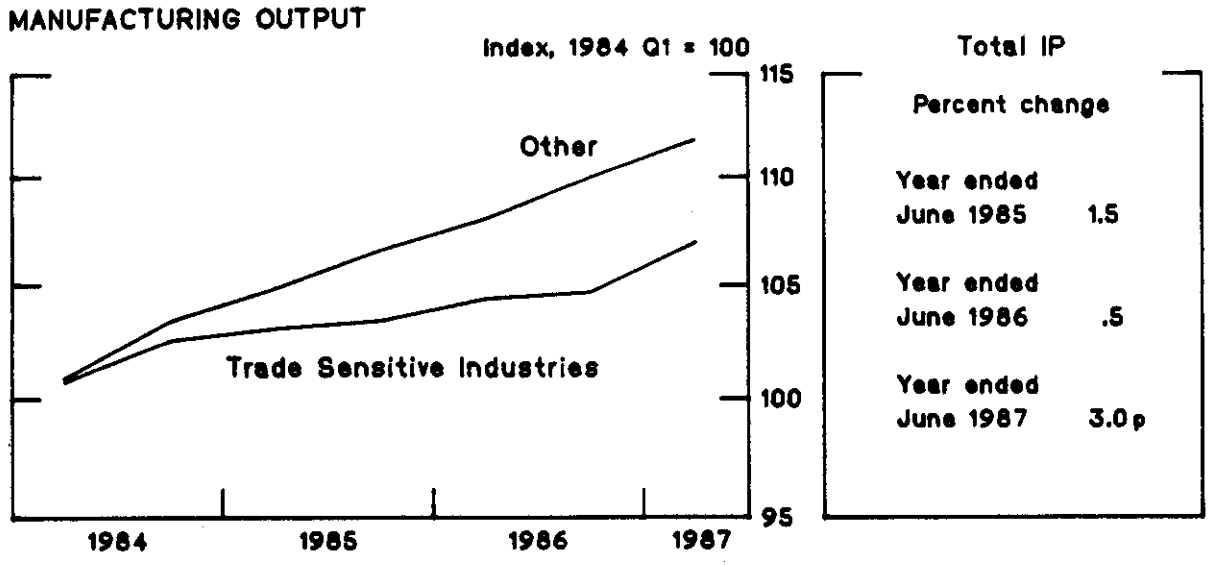
U.S. Capital Transactions

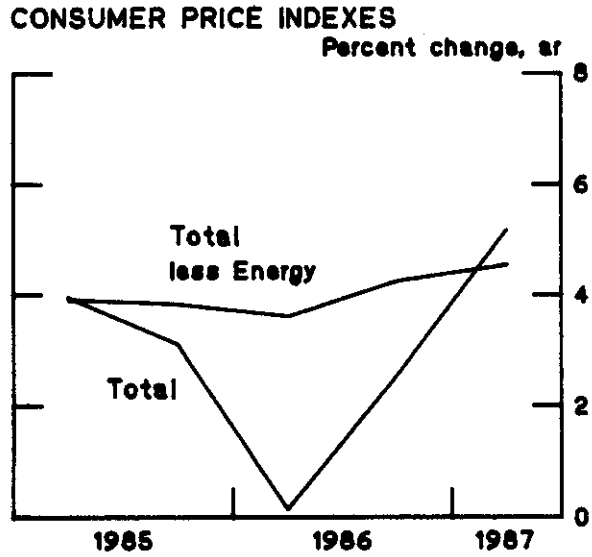
Billions of Dollars, Net Inflows = +

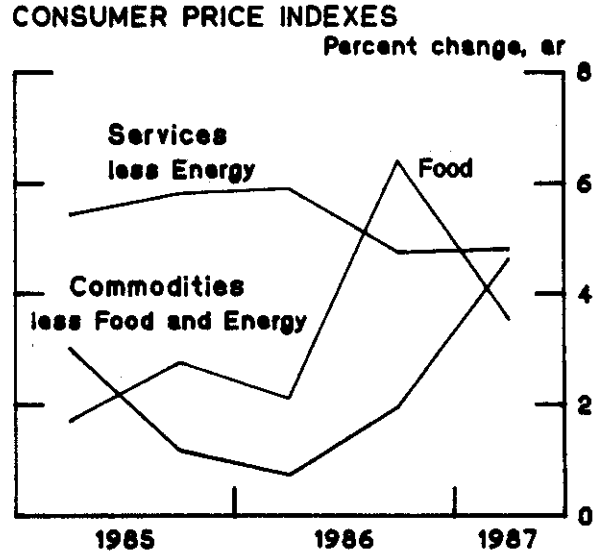
	1984	1985	1986	1987Q1 **	1987p
1. Net Private and Official Capital	80	98	117	38	133
2. Private Capital	86	106	84	22	84
3. U.S. and Foreign Official Capital	−6	−8	33	16	49
4. United States*	−9	−7	−2	2	2
5. G-10 Countries	3	0	31	15	45
6. Other	0	−1	4	−1	2
7 Statistical Discrepancy	27	18	24	−1	21
Memo:					
8. Current Account	−107	−116	−141	−37	−154
Intervention					
9. U.S. Purchases of Dollars	0	−4	0	2	n.a.
10. G-10 Purchases of Dollars	−4	−14	21	35	n.a.

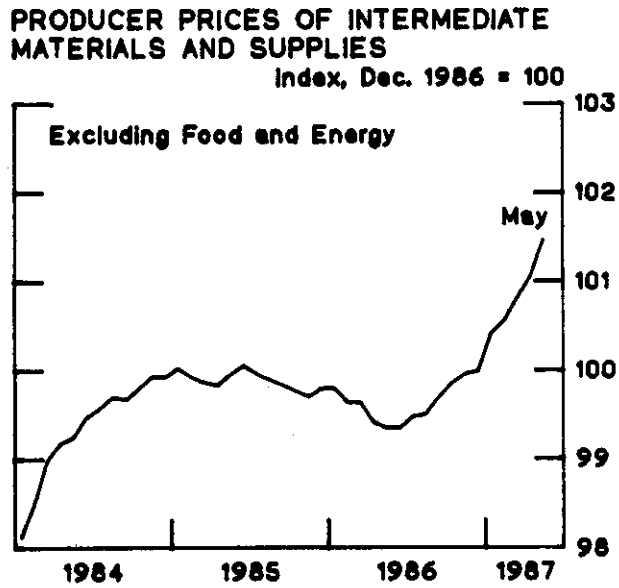
p Projected
* Includes U.S. official reserve assets and other U.S. government assets.
** Differs from data published by the Department of Commerce on June 16 because of later data revisions.

Chart 11


MANUFACTURING OUTPUT
Index, 1984 Q1 = 100
Other
Trade Sensitive Industries
115
110
105
100
95
1984
1985
1986
1987
Total IP
Percent change
Year ended
June 1985 1.5
Year ended
June 1986 .5
Year ended
June 1987 3.0p


CONSUMER PRICE INDEXES
Percent change, ar
Total
less Energy
Total
8
6
4
2
0
1985
1986
1987


CONSUMER PRICE INDEXES
Percent change, ar
Services
less Energy
Food
Commodities
less Food and Energy
8
6
4
2
0
1985
1986
1987


PRODUCER PRICES OF INTERMEDIATE
MATERIALS AND SUPPLIES
Index, Dec. 1986 = 100
Excluding Food and Energy
May
103
102
101
100
99
98
1984
1985
1986
1987

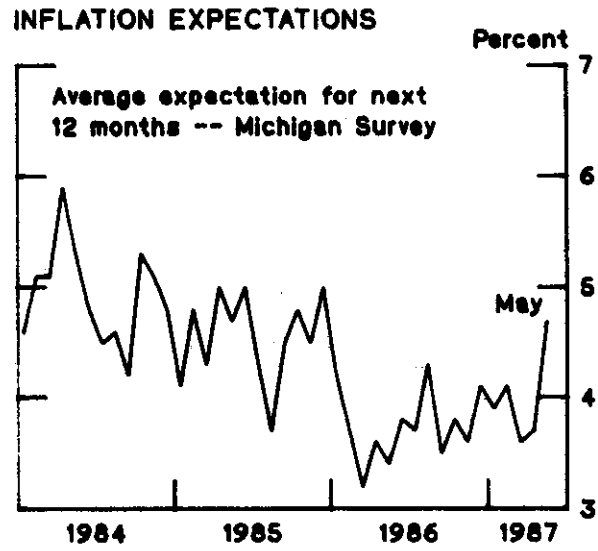
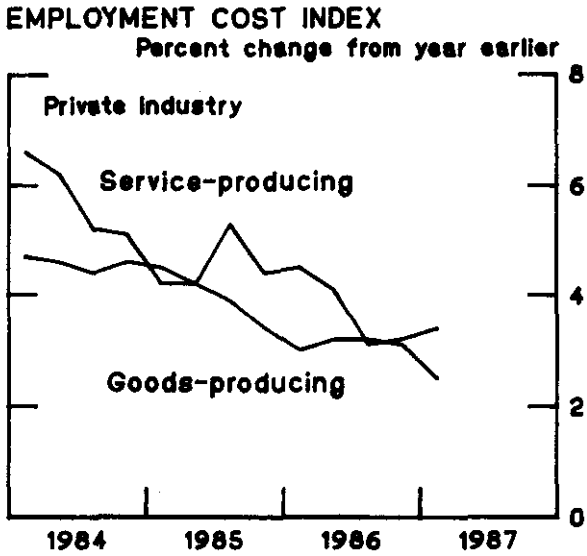
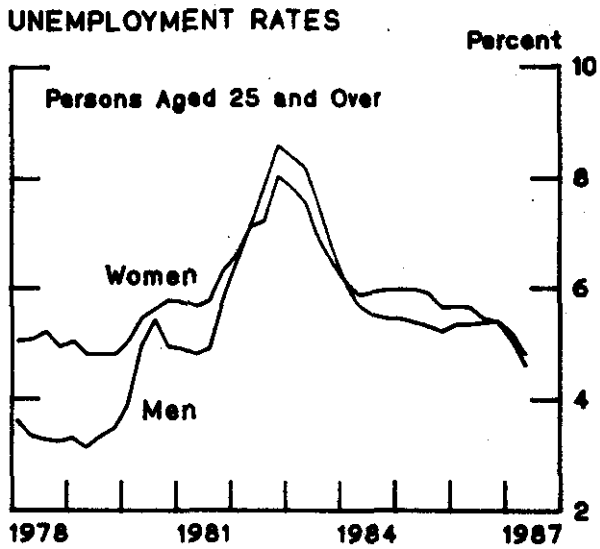
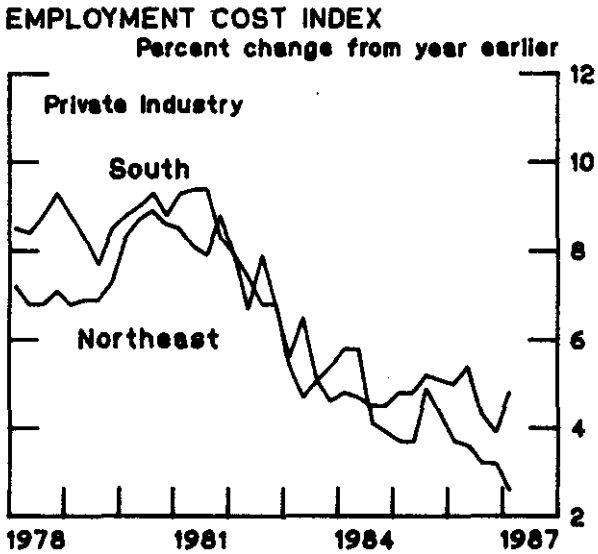
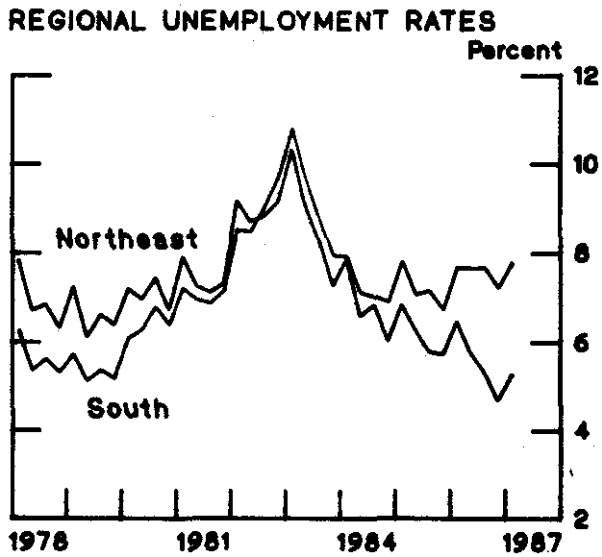

INFLATION EXPECTATIONS
Percent
Average expectation for next
12 months -- Michigan Survey
May
7
6
5
4
3
1984
1985
1986
1987

Chart 12


EMPLOYMENT COST INDEX
Percent change from year earlier
Private Industry
Service-producing
Goods-producing
8
6
4
2
0
1984
1985
1986
1987


UNEMPLOYMENT RATES
Percent
Persons Aged 25 and Over
Women
Men
10
8
6
4
2
1978
1981
1984
1987


EMPLOYMENT COST INDEX
Percent change from year earlier
Private Industry
South
Northeast
12
10
8
6
4
2
1978
1981
1984
1987


REGIONAL UNEMPLOYMENT RATES
Percent
Northeast
South
12
10
8
6
4
2
1978
1981
1984
1987

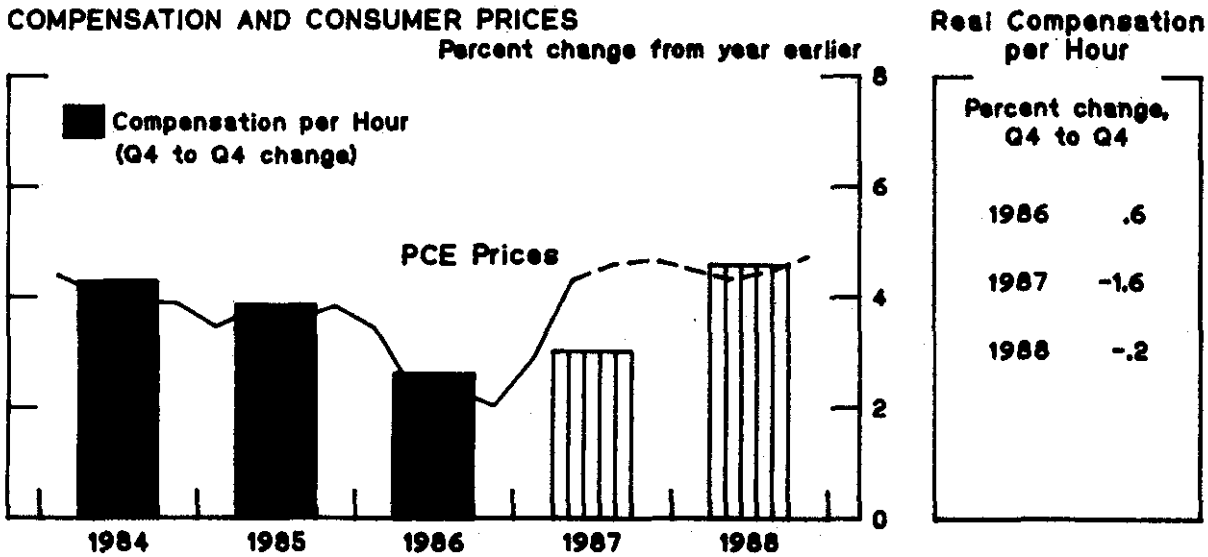
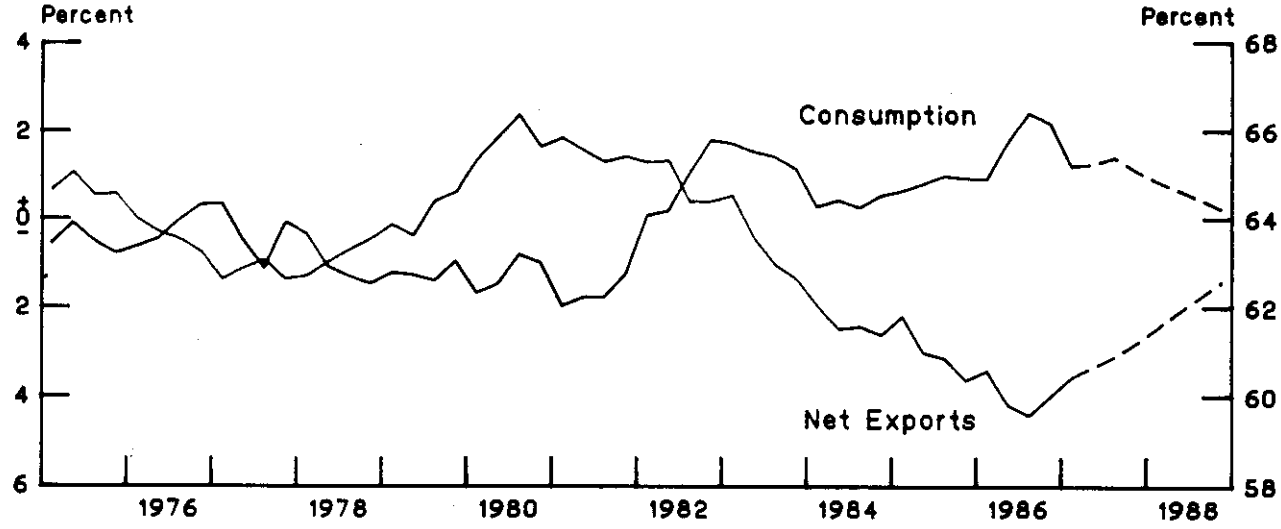
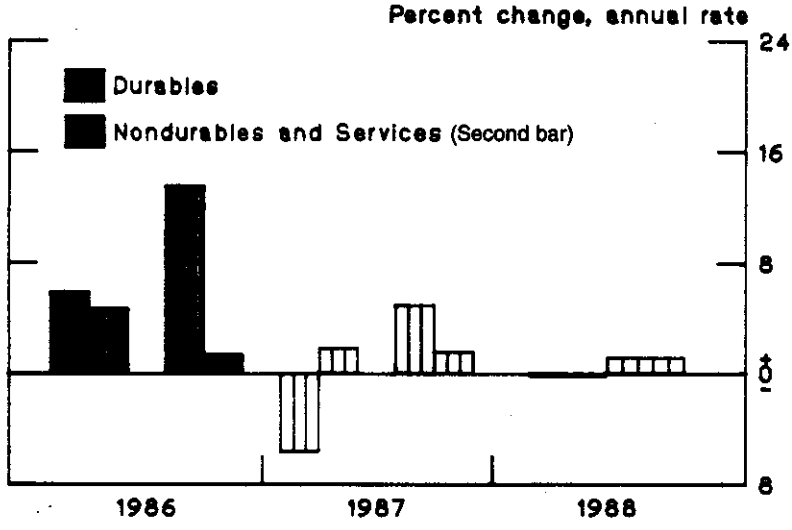

COMPENSATION AND CONSUMER PRICES
Percent change from year earlier
Compensation per Hour
(Q4 to Q4 change)
PCE Prices
8
6
4
2
0
1984
1985
1986
1987
1988
Real Compensation per Hour
Percent change, Q4 to Q4
1986 .6
1987 -1.6
1988 -.2

Chart 13

RATIO OF REAL CONSUMPTION AND NET EXPORTS TO GNP



REAL CONSUMPTION EXPENDITURES



Spending and Income

Percent change, annual rate
1982 dollars

	PCE	DPI
1986		
H1	4.9	6.8
H2	3.1	-2.3
1987		
H1	0.7	-0.6
H2	2.1	4.7
1988	1.0	1.1

PERSONAL SAVING AND HOUSEHOLD NET WORTH RELATIVE TO DPI

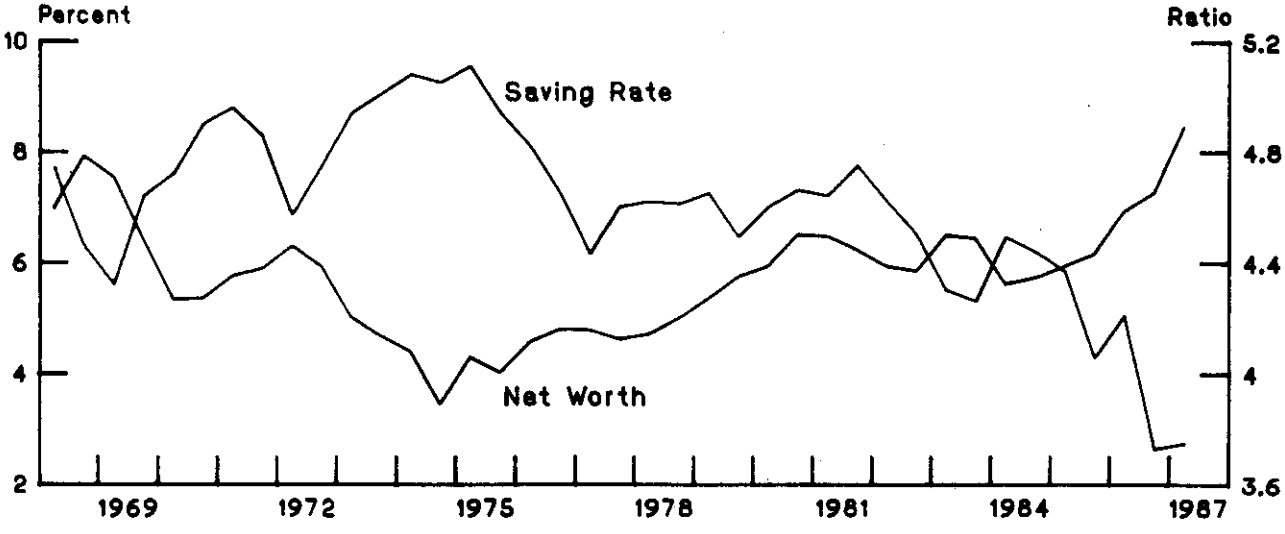
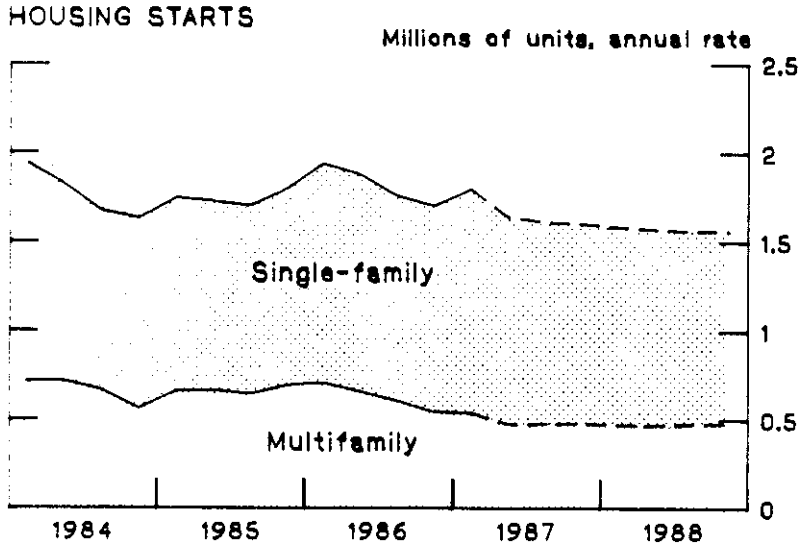


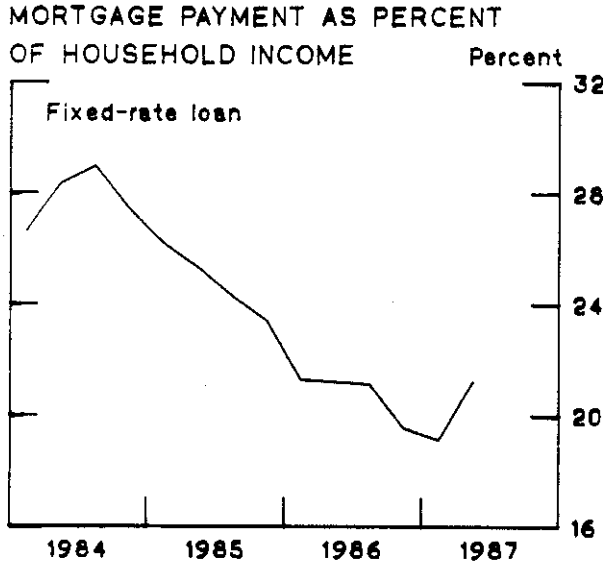
Chart 14

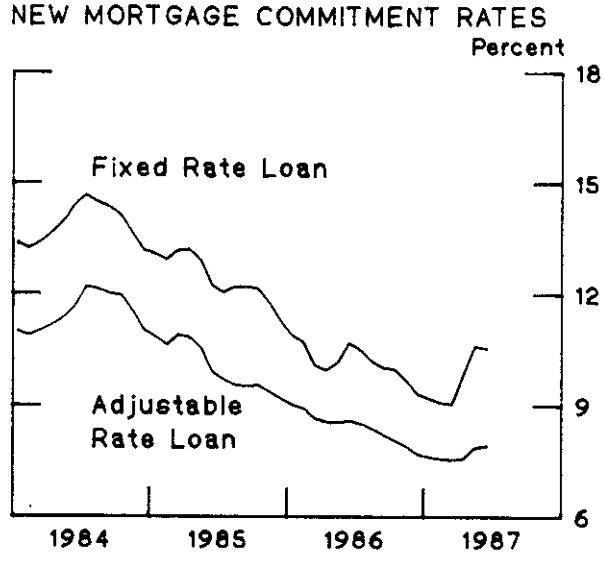


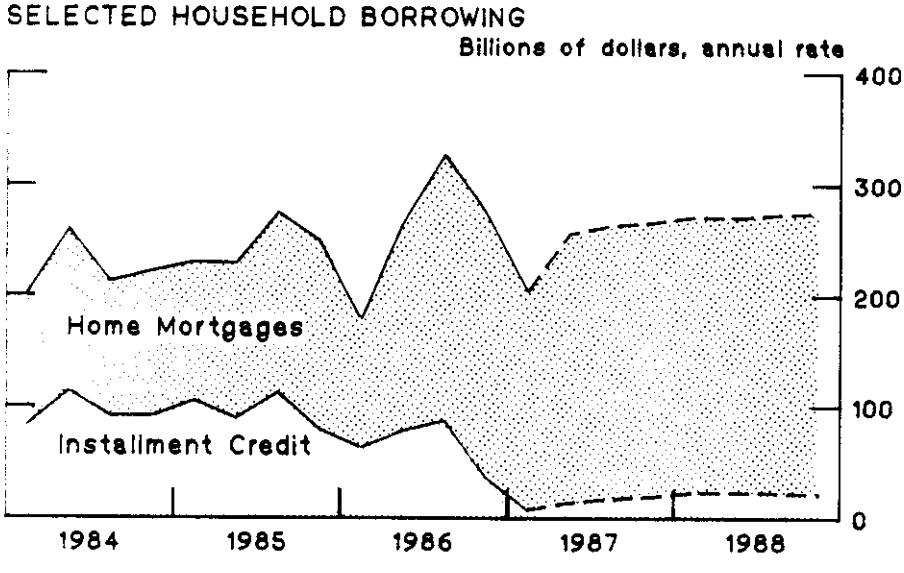
Total Housing Starts

Millions of units

	Total	Single	Multi
1986	1.82	1.19	.63
1987	1.66	1.17	.49
1988	1.57	1.10	.47







Household Sector
Debt Growth

Percent

1984	13.0
1985	14.2
1986	11.9
1987	9.6
1988	9.9

Chart 15

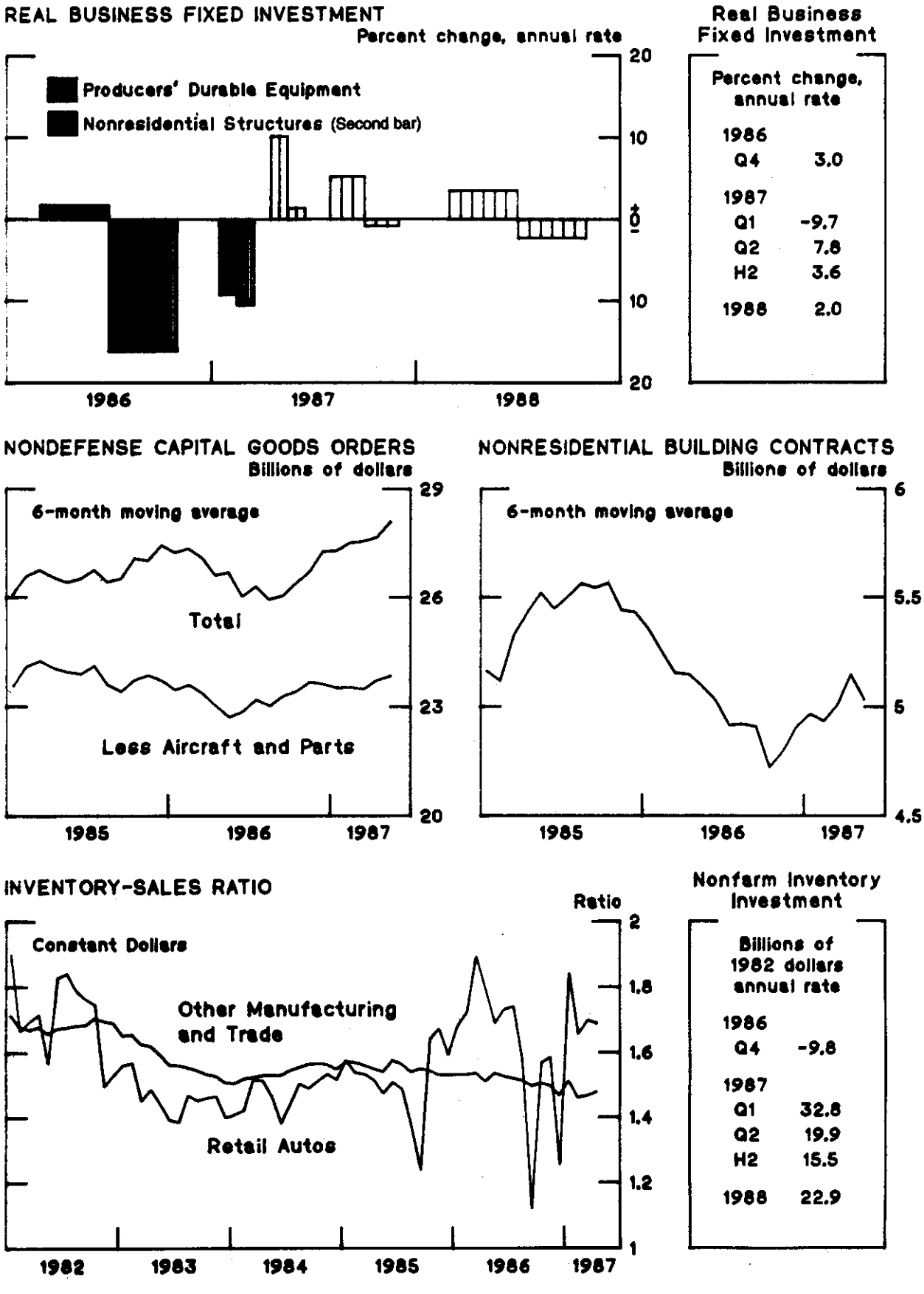
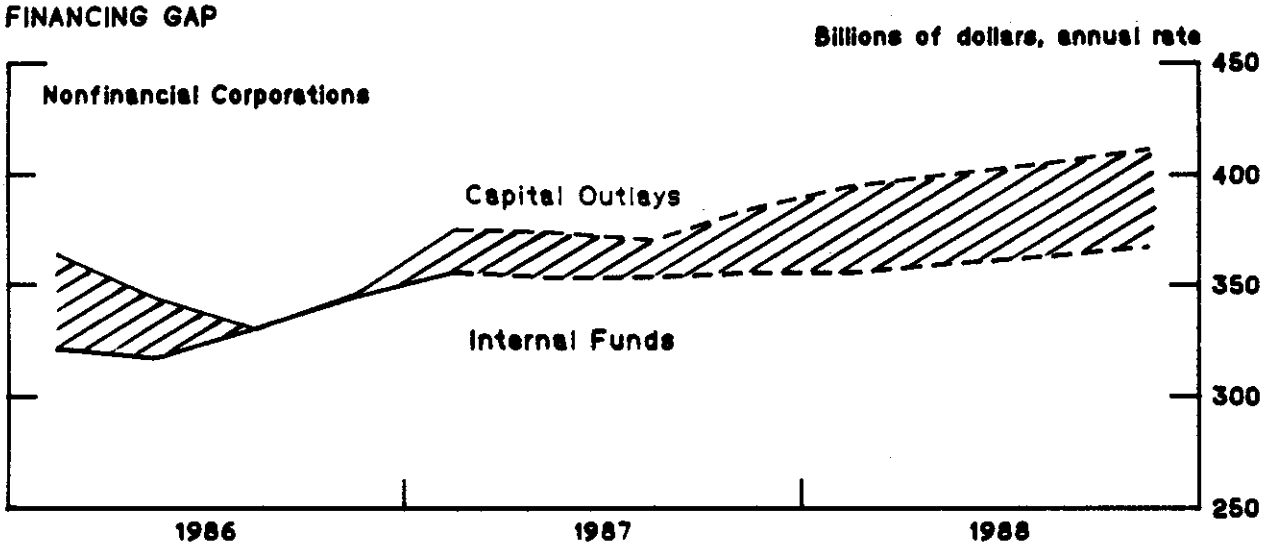
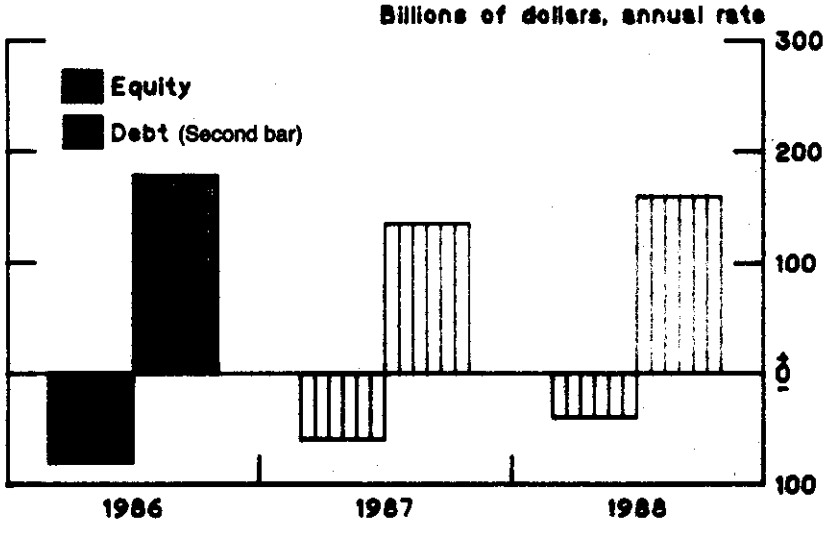

REAL BUSINESS FIXED INVESTMENT
Percent change, annual rate
Producers' Durable Equipment
Nonresidential Structures (Second bar)
20
10
0
10
20
1986
1987
1988
Real Business Fixed Investment
Percent change, annual rate
1986
Q4 3.0
1987
Q1 -9.7
Q2 7.8
H2 3.6
1988 2.0
NONDEFENSE CAPITAL GOODS ORDERS
Billions of dollars
6-month moving average
Total
Less Aircraft and Parts
29
26
23
20
1985
1986
1987
NONRESIDENTIAL BUILDING CONTRACTS
Billions of dollars
6-month moving average
6
5.5
5
4.5
1985
1986
1987
INVENTORY-SALES RATIO
Ratio
Constant Dollars
Other Manufacturing and Trade
Retail Autos
2
1.8
1.6
1.4
1.2
1
1982
1983
1984
1985
1986
1987
Nonfarm Inventory Investment
Billions of 1982 dollars annual rate
1986
Q4 -9.8
1987
Q1 32.8
Q2 19.9
H2 15.5
1988 22.9

Chart 16

FINANCING GAP



NET FUNDS RAISED BY NONFINANCIAL CORPORATIONS



Equities

Billions of dollars

	Gross issues	Retirements
1986	38	119
1987	44	104
1988	40	80

COMPOSITION OF BORROWING

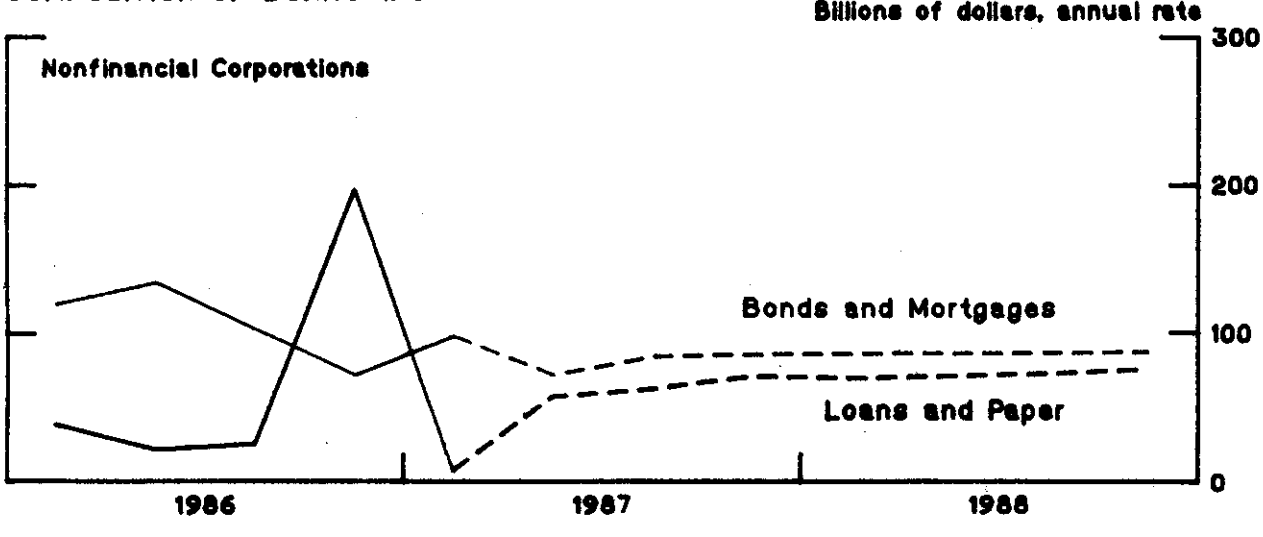
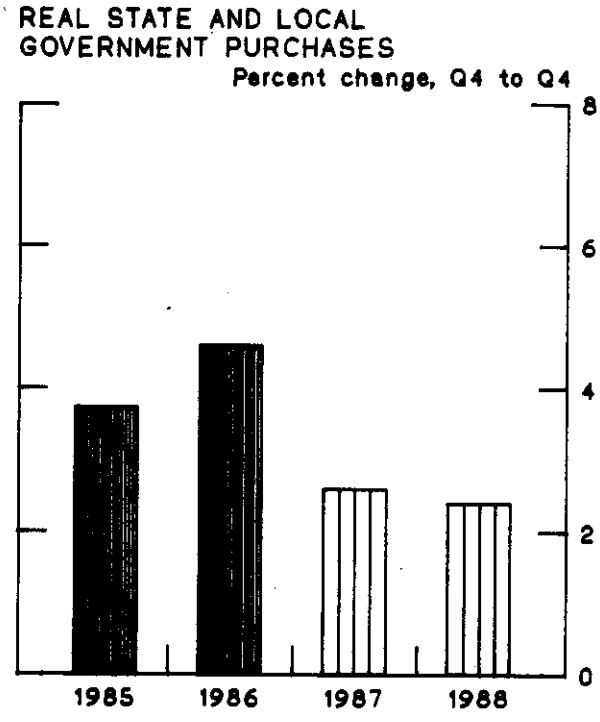
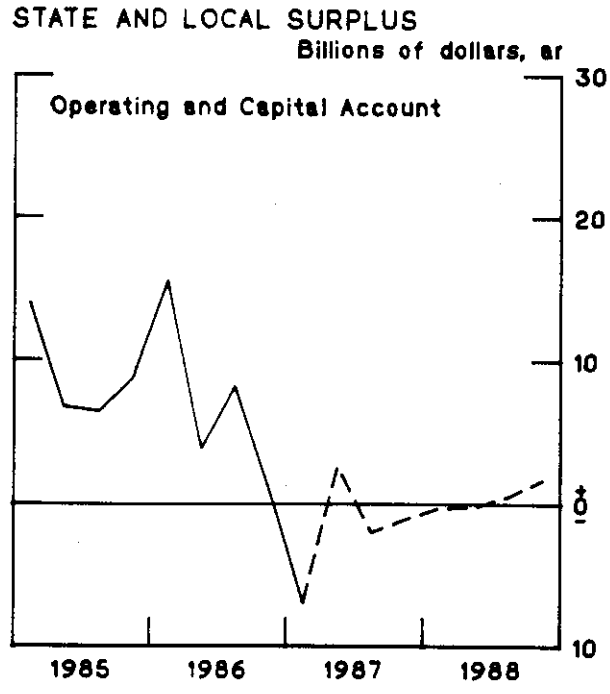
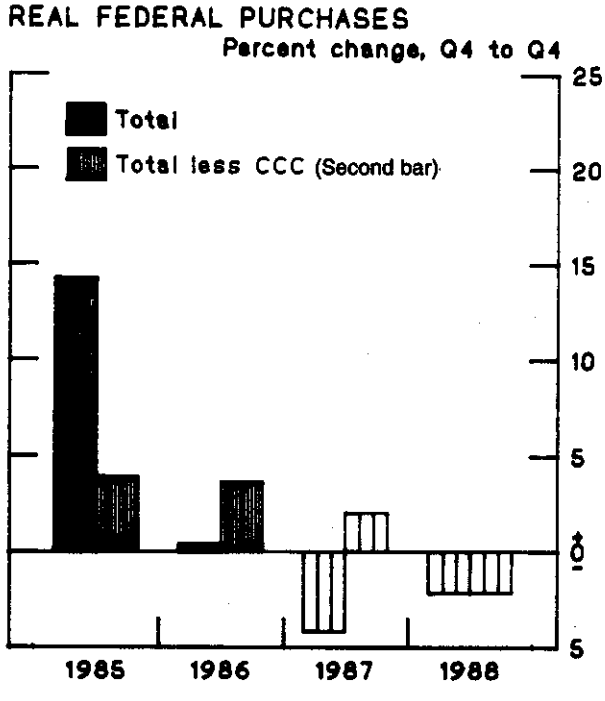
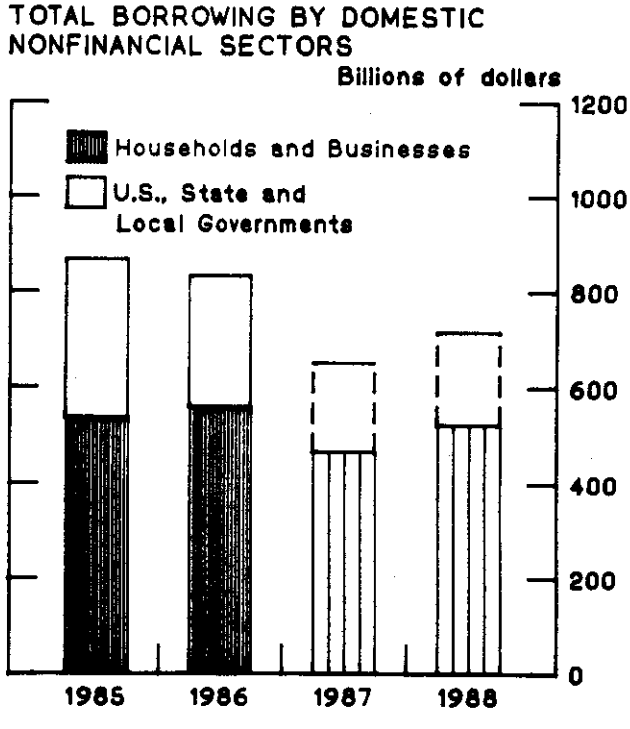


Chart 17


REAL STATE AND LOCAL GOVERNMENT PURCHASES
Percent change, Q4 to Q4
8
6
4
2
0
1985
1986
1987
1988


STATE AND LOCAL SURPLUS
Billions of dollars, ar
Operating and Capital Account
30
20
10
0
10
1985
1986
1987
1988


REAL FEDERAL PURCHASES
Percent change, Q4 to Q4
Total
Total less CCC (Second bar)
25
20
15
10
5
0
5
1985
1986
1987
1988


TOTAL BORROWING BY DOMESTIC NONFINANCIAL SECTORS
Billions of dollars
Households and Businesses
U.S., State and Local Governments
1200
1000
800
600
400
200
0
1985
1986
1987
1988

Forecast Summary

	Board Members		Presidents		Staff
Percent change, Q4 to Q4	Range	Median	Range	Median	
Nominal GNP					
1987	5¾ to 7¼	6	6¼ to 7¼	6¾	6½
1988	5 to 7	5½	5¾ to 8	7	6¼
Real GNP					
1987	2 to 3¾	2¾	2½ to 3	2¾	3
1988	1 to 3	3	2 to 3	2½	2¼
GNP Deflator					
1987	3 to 4	3¼	3½ to 4¼	3¾	3½
1988	2½ to 4	3¼	3¾ to 5	4¼	3¾
Average level, Q4, percent					
Unemployment Rate					
1987	6.1 to 6.5	6.2	6.2 to 6.5	6.4	6.3
1988	5.9 to 6.8	6.4	6.0 to 6.7	6.2	6.3

Previous FOMC Projections for 1987

Reported to Congress Feb. 19, 1987

	Range	Central Tendency
Percent change, Q4 to Q4		
Nominal GNP	4½ to 7½	5¾ to 6½
Real GNP	2 to 4	2½ to 3
GNP Deflator	2½ to 4	3 to 3½
Average level, Q4, percent		
Unemployment Rate	6½ to 6¾	6½ to 6¾