<u>Prefatory Note</u>

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Strictly Confidential (FR) Class II FOMC

Part 1

August 13, 1998

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Summary and Outlook

Prepared for the Federal Open Market Committee
by the staff of the Board of Governors of the Federal Reserve System

Strictly Confidential (FR) Class II FOMC

August 13, 1998

SUMMARY AND OUTLOOK

Prepared for the Federal Open Market Committee
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Domestic Developments

Overview

The period since the last FOMC meeting has been an eventful one in many respects, and we have responded to developments by making some small, but notable, changes in our economic projection. That said, however, we would emphasize the constancy of the basic message between the last Greenbook and this edition: Real GDP growth slowed markedly in the second quarter, and at current monetary policy settings, output expansion over the next year and a half is likely to remain subpar on average; even so, inflation will creep upward.

We are currently guessing that GDP grew in the second quarter at close to the 1.4 percent (annual rate) estimated by the BEA in its advance release--somewhat short of the June Greenbook prediction. Domestic final sales exceeded our expectations, but the difference was more than offset by sharper declines in net exports and inventory investment than we had forecast.

The marked drop-back in inventory accumulation is probably a plus, on balance, for future economic activity. We previously had seen a significant further downshift in stocking as an appreciable drag on output growth over the second half of this year. This is no longer the case: Although inventory accumulation should diminish further outside the auto sector, the efforts of General Motors to restock its dealers will provide an offsetting increase in investment. In contrast, however, the recent disappointing performance of net exports appears to reflect a deeper slump in the Asian economies than we had anticipated, and we do not see a quick turnaround; indeed, we have trimmed our forecast of growth in that part of the world further, especially in the near term. This situation, in combination with the additional recent appreciation of the dollar, spells a weaker outlook for net exports. On net, however, we are now looking for real GDP to expand at an annual rate of a little over 2-1/4 percent in this half-year, about half a point more than in the last Greenbook. That upward revision is then reversed during 1999, owing to the less favorable outlook for U.S. trade, a greater fall-off in motor vehicle assemblies from what promises to be a very high level this autumn, and some caution in computer purchases as the year 2000 draws near. Real GDP growth in 1999 is projected at just 1-3/4 percent.

To achieve this sort of sustained deceleration in activity, domestic final demand will have to taper off substantially. We expect that in the near term the lagged multiplier-accelerator effects of the inventory adjustment and of the slide in net exports will drain some momentum from employment and income growth. But a key factor in our forecast of demand continues to be the stock market, which we believe has played a major role in the household spending boom. Although, given our track record, we hesitate at this point to count our chickens, the recent "correction" in share prices has at least made more credible a scenario in which disappointing corporate earnings lead to an abatement of stock market gains and the related wealth effects.

With the weaker output forecast, we expect that resource utilization will decline more appreciably by the end of 1999. The unemployment rate is projected to inch above 4-1/2 percent by the end of this year and above the 5 percent mark in the latter part of next year. With lower rates of resource utilization and greater softness in non-oil import prices, we are presenting a more optimistic view of the trajectory of core inflation and nominal compensation rates over the next six quarters. Given the upcoming technical changes in the index, overall CPI inflation is projected to be just 2 percent over that period, nearly 1/4 percentage point less than last forecast.

Key Background Factors

Once again, we are assuming that the federal funds rate will remain around 5-1/2 percent through next year. Intermediate- and long-term yields are projected to move back up a bit from the current level as the rest of the world begins to look more solid and safe-haven demands for Treasuries and other liquid dollar assets diminish; however, we expect that, in the projected economic environment, concerns about Fed tightening will be largely absent, and the yield curve will remain quite flat.

Up to now, any restraint on aggregate demand that might have been implied by a fairly high and rising real short-term interest rate has been overridden by the stunning advance of share prices. Our last forecast anticipated a moderate setback for the market in the near term. Early in the intermeeting period, the market seemed to be defying our analysis for the umpteenth time, but worries about deteriorating corporate earnings trends did eventually bite. We expect that continued pressure on profit margins will prevent the markets from sustaining a renewed advance over the projection period. If anything, valuations still seem rich, and the market thus vulnerable. However, in the absence of a monetary tightening or any other major new shock, we have hesitated to include a significant further decline in equity prices in our baseline forecast. That risk is addressed in the alternative simulations in a later section.

Our fiscal policy assumptions have not changed. There doubtless will be some election-year squabbling about the details of appropriations bills, but we do not anticipate any significant delays in the passage of bills or breaches of discretionary spending caps. Nor do we foresee any tax cuts that are not "paid for" with offsets elsewhere in the budget. On those assumptions, we expect the budget surplus for fiscal year 1998 to be $67 billion; the surplus should be about $62 billion in fiscal 1999. Notwithstanding the considerable magnitude of these surpluses, we gauge that changes in discretionary fiscal policy will be exerting no more than a modest drag on the growth of aggregate demand.

We have marked down our projection of foreign economic growth 1/2 percentage point in both 1998 and 1999. We now expect real GDP in the rest of the world, on an export-weighted basis, to increase 3/4 percent (annual rate) in the latter half of 1998 and 2 percent next year, as economies in Asia and Latin America begin to recover. While we believe that this forecast balances the risks overall, uncertainty about Japan and the continuing difficulties in a number of other countries--including Russia and Brazil--suggest that those risks are considerable.

The dollar has moved higher recently--with especially large increases against the yen and the Canadian dollar. On a nominal basis, the trade-weighted dollar is up about 2 percent against the major foreign currencies since the last FOMC meeting, but we continue to expect some depreciation over the forecast period. Compared with the earlier projection, the level of the dollar is nearly 2-1/2 percent higher in the near term and about 1-1/4 percent higher in late 1999. In terms of the broad exchange-rate index adjusted for relative inflation, we anticipate that the dollar will decline about 2-3/4 percent by the end of next year, a bit more than in the June Greenbook.

In response to continued weakness in prices, OPEC agreed to an additional round of production cuts just after we closed the June Greenbook. Although recent press reports have raised questions about the effectiveness of the cuts to date, it takes a bit of time to reduce production in an orderly manner, and we believe that some analysts have been too quick to dismiss the significance of the agreement. Although there are risks to this forecast, too, we expect the supply-demand balance ultimately to shift more in favor of producers. Consequently, we expect WTI spot prices--currently just under $13 per barrel--to rise to $17 per barrel by early 1999, about $1 higher than in the last projection. In the very near term, however, prices are expected to remain on the low side, restrained by the vast amounts of oil sloshing around in world markets.

Recent Developments and the Outlook for the Current Quarter

We have raised our prediction of third-quarter real GDP growth from 2 percent to 2-1/4 percent, despite the prolongation of the GM strike. Importantly, last week's employment report pointed to continued underlying strength in labor demand. Were it not for the strike, the rise in payrolls last month probably would have been in line with the robust first-half pace. Similarly, the stable unemployment rate in July, despite the strike, along with the low level of initial claims for unemployment insurance this month, indicate sustained firmness of labor demand.

On the expenditure side, the data for the current quarter are quite thin, with just a few pieces available for the month of July. Sales of new light vehicles slid last month after the termination of large incentives at midyear and as shrinking inventories at GM dealers became a constraint; underlying demand appears to have remained quite substantial, however. And today's retail sales report indicates that consumer spending on other goods continued to trend upward on a steep trajectory into the early summer. Owing to the sizable decline in auto sales this quarter, real PCE likely will decelerate markedly, but we are projecting a still considerable 3-1/2 percent rate of advance. Likewise, residential investment should post a less hefty increase this quarter, given the leveling out of housing starts this spring; new home sales have continued to trend upward, but widespread reports suggest that shortages of skilled construction workers have inhibited a fuller production response in the short run.

Our predictions for other components of GDP are even more inferential. As regards business investment, orders received through June by U.S. equipment manufacturers are consistent with further strong gains in shipments, but real outlays for producers' durables are likely to be held down this quarter by a drop-back in the share of commercial aircraft deliveries going to domestic airlines and by a decline in sales of light motor vehicles to businesses (both fleet sales and consumer leases). We also expect that investment in nonresidential structures will increase only slightly, with strength in office building offset in part by slipping factory construction.

As for inventories, the buildup of stocks evidently remained fairly sizable outside the auto sector in the second quarter. Taken together, the incoming figures on manufacturing and wholesale inventories through June were considerably below BEA's assumptions. However, we have largely offset that shortfall by assuming that the accumulation of retail stocks in June will be greater than the skimpy figure anticipated by BEA, thereby holding total nonfarm inventory investment in the second

Summary of the Near-Term Outlook
(Percent change at annual rate except as noted)

Measure	1998:Q2			1998:Q3	
	June GB	BEA[1]	Aug. GB	June GB	Aug. GB
Real GDP	2.0	1.4	1.3	2.0	2.2
Private domestic final purchases	6.2	6.9	7.2	4.0	3.3
Personal consumption expenditures	5.2	5.8	5.7	3.8	3.6
Residential investment	12.1	13.2	13.2	-.5	8.5
Business fixed investment	10.2	11.4	14.1	6.8	-.6
Government outlays for consumption and investment	6.1	3.7	3.2	-.7	1.4
	Change, billions of chained (1992) dollars				
Inventory investment	-51.1	-46.7	-48.6	-3.8	7.6
Net exports	-35.0	-54.4	-57.3	-23.3	-26.1

1. Advance.

quarter within hailing distance of the $37 billion figure in the advance release.[1] Anecdotal reports of desires to trim stocks in some industries and the relatively tepid performance of indicators of manufacturing activity recently (with due allowance for the GM strike) suggest that we may be seeing a considerable further moderation of inventory investment this quarter outside autos.

That inventory adjustment likely will be reflected partly in import volumes, but we believe that exports will continue to decline, at least somewhat, this quarter. Consequently, net exports are expected to fall further, albeit not so sharply as in the first half of the year. We have projected a negative contribution of about 1 percentage point (annual rate) to GDP growth this quarter, less than half the recent magnitude.

Real federal purchases are expected to fall 2-3/4 percent at an annual rate in the third quarter; this decrease is a bit larger than the current trend rate of decline and mostly reflects quarter-to-quarter lumpiness in defense spending. With a projected increase of 3-1/2 percent in the third quarter, purchases by state and local

1. One of our motivations for building in this offset is that--given our forecast of corporate profits in the second quarter--our estimate of the increase in gross domestic income substantially exceeds that of gross domestic product, raising the possibility of a subsequent upward revision to GDP.

governments are expected to make up for slower-than-usual expenditure growth in the first half of the year.

On the price side, the incoming data for June were a touch more favorable than we had anticipated for the core CPI, and we now project that these prices will rise at a 2 percent annual rate in the third quarter, down about 1/4 percentage point relative to our previous forecast. The projection for energy prices for the quarter also has been revised down, reflecting news on gasoline and natural gas. However, the near-term forecast for food prices has been bumped up, owing to some temporarily higher costs for those products most affected by the heat and drought in the South. Overall, the total CPI is expected to increase 1-3/4 percent in the third quarter, about 1/4 percentage point less than projected in the June Greenbook. As for wages, the recent moderation in monthly average hourly earnings provides a hopeful sign that wage inflation is leveling off, although the pattern of twelve-month changes certainly does not let us say decisively that the upward trend has broken. The more comprehensive Employment Cost Index for total compensation rose about 3-1/2 percent at an annual rate last quarter, matching the pace of the preceding year.

The Outlook for the Economy beyond the Current Quarter

The aftermath of the General Motors strike will leave its mark on the GDP growth figures for the next couple of quarters. GM has set ambitious plans for production in the near term. Given the likely problems of ramping up assemblies, though, we expect that some shortfall will occur at first and that the motor vehicle sector will subtract about 1/4 percentage point from GDP growth this quarter. But with vehicle production reaching a very high level in the fourth quarter, we are looking for a sizable positive contribution in that period--almost 1-1/2 percentage points--bringing the overall GDP increase to about 2-1/2 percent. Still, we are expecting that GDP growth will be held back by an underlying softening in demand trends that shows through more clearly in 1999.

Our projection of the supply side of the economy is little changed from the June Greenbook. The revised data now confirm that labor productivity increased somewhat more rapidly over the past few years, although some of that is merely the result of the adoption of geometric means in the calculation of price indexes (which affects earlier measured trends as well). All told, we think it reasonable to adhere to our previous hypothesis that, based on considerations such as the increased pace of capital deepening, potential output growth has picked up since the middle of the

Summary of Staff Projections
(Percent change, compound annual rate)

Measure	1998:H1	1998:H2	1999
Real GDP	**3.4**	**2.3**	**1.7**
Previous	3.7	1.8	2.0
Final sales	4.1	2.4	1.8
Previous	4.2	2.4	2.1
PCE	5.9	3.3	2.6
Previous	5.7	3.6	2.6
Residential investment	14.4	5.5	-3.6
Previous	14.3	-.8	-2.8
BFI	18.1	5.6	4.8
Previous	14.1	6.7	6.1
Government purchases	.6	2.1	1.1
Previous	1.4	.6	.9
Exports	-5.8	-1.4	3.0
Previous	-2.2	1.0	3.8
Imports	13.9	7.5	6.5
Previous	13.0	7.7	6.5
	Change, billions of chained (1992) dollars		
Inventory change	-23.7	-.6	-14.0
Previous	-21.4	-20.7	-9.5
Net exports	-106.9	-52.0	-53.2
Previous	-83.8	-41.2	-45.0

decade to a rate in the vicinity of 2-3/4 percent per year.[2] Real GDP is projected to increase appreciably less rapidly than potential next year, implying a slowing of payroll growth and a significant rise in the jobless rate.

Despite this uptilt in unemployment, labor will remain in short supply, and we anticipate fairly hefty increases in real compensation. But, with price increases restrained by falling import prices this year and by below-average factory utilization

2. Adjusting for the methodological changes made by BEA, this figure is essentially equivalent to the growth rate of potential output used in the last Greenbook. Also, note that, because of these methodological changes, potential output is measured on a consistent basis from 1995 forward.

rates beyond that, these real pay gains are likely to be realized in the context of diminishing nominal compensation increases. We now expect the ECI to increase 3.4 percent this year and 3.2 percent next year, the latter figure rising 0.3 percentage point less than in the June Greenbook. We have also marked down our core CPI projection, by 0.2 percentage point in 1999.

Consumer spending. The outlook for consumption has changed little since the last Greenbook. Growth in real PCE is expected to slow markedly from its torrid 6 percent pace of the first half, to about 2-1/2 percent in 1999. We continue to believe that wealth effects are a key factor behind the strength of consumption to date and the associated decline in the personal saving rate. The recent drop in the stock market should lead to an abatement of the positive wealth effects next year, resulting in a further slackening in consumer demand.

Although the saving rate was revised down considerably in the annual NIPA revision, our view of the magnitude and timing of wealth effects was not changed by the new data. The revision mainly reflected an accounting change that removed distributions of capital gains by mutual funds from personal dividend income--a difference without much significance, as we see it, in terms of how households probably perceive their spendable resources.[3]

Real PCE growth is projected to average something under 3-1/2 percent over the second half of this year. We expect to see considerable deceleration in outlays for durables, particularly for motor vehicles; boosted by extra incentives, light vehicle sales in the second quarter were at the highest level in this expansion. Given the reduction in incentives and the limited supply of GM cars, we have light vehicle sales dropping back to about a 14-1/4 million unit annual pace in the third quarter. Sales should move up appreciably in the fourth quarter of this year and first quarter of next year (though much of the increase will show up in business purchases) before drifting down to an annual rate of roughly 14-1/2 million units by the end of 1999. Outlays for nondurables and services are expected to increase more slowly in the second half than in the first, as a stock market correction and a slowing economy begin to make consumers a bit more cautious about discretionary spending on items like recreation and travel, which have skyrocketed recently.

Looking ahead to next year, we anticipate that consumption growth will slow to a 2-1/2 percent pace, as all major categories of spending decelerate. With an end

3. Distributions of capital gains by mutual fund companies were taken out of personal income, but were added to corporate retained earnings. On empirical grounds, the FRB/US and other econometric models have long included retained earnings in the income measure driving consumption.

to the rapid gains in share prices--and the absence of another slug of cash from mortgage refinancings--spending should run much more in line with the growth of income than it has in recent years. Demands for furniture, appliances, and other household durables might moderate, especially given an expected tapering in the pace of home purchases.

Residential investment. Residential investment has been a continued source of strength, reflecting hefty gains in labor income and household wealth as well as extremely attractive mortgage rates. This constellation of factors should provide some momentum for building in the next few months; moreover, constraints on construction have led to a backlog of demand that probably will continue to buoy housing starts even as the demand fundamentals weaken.

By early next year, however, residential investment should begin to decline in response to slower employment growth and diminished consumer confidence. In the single-family sector, starts are projected to ease off from their current annualized pace of 1.24 million units to a rate of 1.15 million units by the end of next year. The implied increments to the supply of houses are sizable but, we suspect, not great enough to prevent house prices from rising further relative to the CPI.

In the multifamily sector, we project that starts will slip only marginally from their recent pace of 330,000 units at an annual rate. Even though the economy is slowing, permits have been running above starts in this sector for some time, indicating a backlog of projects waiting to be built. Declining vacancies and readily available financing should also help to buttress activity.

Business fixed investment. Real business fixed investment is expected to decelerate from an 11-3/4 percent increase in 1998 to a 4-3/4 percent pace next year. Although in the near term the GM strike and variation in Boeing deliveries to domestic airlines give rise to some quarterly noise, the underlying contour is one of slowing in response to the deceleration of business output and weakening profitability.

After increasing at an annual rate of nearly 28 percent in the first half of the year, real outlays for producers' durable equipment are projected to grow at a 7 percent pace in the second half and about 6 percent next year. Real spending for computers is expected to decelerate from its 79 percent growth pace for the first half to around half that over the rest of the year. Next year, growth in computer outlays should step down somewhat further. Computer spending will continue to draw strength from rapid declines in prices, a stream of new features and capabilities, and an ongoing drive by many firms to improve efficiency. We expect the Year 2000 problem to give a boost to purchases this year and in early 1999 as some firms seek to solve their potential problems by replacing equipment. However, later in 1999 many businesses may want to postpone purchases so that their IT staff can focus fully on making last minute checks and fixes on existing systems. In other equipment categories, the story of deceleration in spending also should hold, although the swing in growth rates will be less dramatic than in the computer category. Spending on communications equipment may be one of the best-maintained components of investment, owing to the momentum of multi-year projects to update infrastructure and the growing demand for the widening range of wireless communication services that are becoming economically feasible. Outside of high-tech equipment, the deceleration in business investment should be more clearly evident, with the demand for many types of industrial equipment weakening substantially as a result of efforts by manufacturers to curb the expansion of domestic capacity.

Although real outlays for nonresidential structures are reported to have declined in the first half of this year, we continue to anticipate expansion in this sector, with expenditures projected to increase at an annual rate of 1-3/4 percent in the second half of this year and 2 percent next year. Among the major categories, office construction is the fastest-growing in our forecast, as building responds to the increases in rents and prices that have occurred in the past few years and the ample availability of financing. In contrast, industrial construction is expected to continue declining at a noticeable clip.

Business inventories. Even with a sizable step-down in the second quarter, the pace of inventory accumulation outside the auto sector remained well above what is consistent with sustainable growth in sales. Moreover, anecdotal reports suggest that, owing in part to the sharp deterioration in international trade flows, stocks have risen to uncomfortable levels in a few industries. In the fourth quarter, we expect a further notch-down in inventory investment outside of motor vehicles that will be partly offset by a positive swing in motor vehicle stocks. On net, nonfarm inventories are expected to be an appreciable drag in the fourth quarter and a slight negative on average in 1999. As an aside, we should note that some of the downside risk from the inventory sector that seemed present in our previous forecast has been eliminated by the recent revision of the NIPAs: Although inventory investment was trimmed only a little, the higher level of final sales produced much less of a backup in the aggregate inventory-sales ratios over the past year or so than was previously reported.

Patterns of farm inventory change also were altered in the NIPA revision. However, the data still show substantial accumulation during 1996 and 1997, and there were further sizable additions to stocks in the first half of 1998. Inventories of grain are headed toward the highest levels of recent years. In the past, this kind of inventory buildup would have prompted government action to coordinate a downward adjustment of production by the nation's several hundred thousand commercial farmers. Farmers this year, responding on their own to market signals, did reduce their aggregate plantings by a small amount, and with adverse weather having trimmed yields in some regions, crop production overall appears likely to decline modestly. But, with farm exports sluggish, this decline in production has not been sufficient to head off additional accumulation of stocks or to forestall the downward pressures on farm prices. On the assumption that farmers will move toward greater restraint on production, we are anticipating an appreciable slowing of inventory accumulation next year. Absent a meaningful slowdown in stockpiling, pressure for modification of the Freedom-to-Farm experiment, which now is in its third year of seven, almost surely will continue to build.

Government spending. Real federal consumption and investment spending is projected to decline at a 1-1/2 percent annual rate, on average, over the next six quarters. Real defense purchases should fall at an annual rate of about 1-3/4 percent over this period, while real nondefense purchases are expected to edge down, roughly in line with the discretionary caps that allow nominal spending to increase a little.

In the state and local sector, real purchases are expected to increase at an annual rate of about 3 percent over the next year and a half. Such an advance should not strain government finances because state and local coffers have been filling up with tax revenues. Even with these resources in hand, states have thus far been relatively conservative about enlarging spending programs and, rather, have been saving in "rainy day" funds or enacting small tax decreases. In the election campaigns this fall, there could be some pressure for added spending increases or tax cuts, but we have not yet seen any compelling evidence that state and local governments will throw fiscal caution to the wind. As for the recent federal highway legislation, the big step-up in the amount of money going to states is not likely to occur until after 1999; thus, we do not anticipate a sizable effect on state highway spending during the forecast period.

Net exports. With an upward revision to the dollar and a downward revision to foreign growth, exports are expected to grow more slowly over the next six quarters than in the last Greenbook. Exports drop at an annual rate of 1-1/2 percent in the second half of this year--considerably less than the decline in the first half--and then are expected to increase 3 percent next year as foreign growth picks up and the dollar moves back down somewhat in real terms. Imports are projected to increase

The Outlook for the Labor Market
(Percent change, Q4 to Q4, except as noted)

Measure	1997	1998	1999
Output per hour, nonfarm business	1.7	1.1	1.3
Previous	1.8	1.3	1.4
Nonfarm payroll employment	2.7	2.2	.8
Previous	2.7	2.0	.9
Household employment survey	2.1	.9	.4
Previous	2.1	1.4	.5
Labor force participation rate[1]	67.1	67.0	66.9
Previous	67.1	67.1	67.1
Civilian unemployment rate[1]	4.7	4.6	5.1
Previous	4.7	4.4	4.9

1. Percent, average for the fourth quarter.

close to 7 percent (annual rate) over the next six quarters, about the same as anticipated in the June Greenbook. Overall, net exports are now forecast to hold down real GDP growth by something over 1 percentage point in the second half of this year and approximately 1/2 percentage point next year. (A more detailed discussion is contained in the *International Developments* section.)

Labor markets. With the benchmark revision of the labor productivity figures now in hand, we have reviewed our assessment of the current trend. We remain as comfortable as ever with our assertion that, while the acceleration of GDP in the past couple of years played a key role in the resurgence of output per hour in the nonfarm business sector, significant structural improvements played a role as well. Therefore, we have retained our assumption that the cyclically adjusted productivity trend is 1-3/4 percent for 1995-1999, up from just over 1-1/4 percent in the first half of the decade.

Over the next six quarters, actual labor productivity should increase at well below its trend pace, as firms adjust employment with a lag to slowing output growth. In addition, productivity growth is expected to be hampered a little as employees are shifted to work on Year 2000 problems.

Parsing out the GM strike effects, we believe that the current underlying pace of payroll employment changes remained near its robust first-half pace through July. We expect hiring to hold up well in the near term, owing to the efforts of some employers to catch up with staffing needs that they have found difficult to fulfill to date. However, as the economy remains on a more moderate expansion path, we expect employers to scale back, with job growth slowing to about 150,000 per month by the end of this year and to a little less than 100,000 per month in 1999.

Our projection for the unemployment rate is 0.2 percentage point higher, on average, over the forecast period than in the last Greenbook. Unemployment rate figures for June and July suggested a little more firming in that rate than we had expected in the last Greenbook and, with essentially the same growth of output relative to potential, the higher level of the unemployment rate carries forward.

Wages and prices. The incoming data on wages and prices since the last FOMC meeting have, on balance, been a hair more favorable than we had anticipated, and the further appreciation of the dollar implies greater disinflationary pressures from falling import prices in the months ahead. In addition, as noted, the unemployment rate path is slightly higher than in the last forecast. All these considerations have encouraged us to trim our inflation forecast. The core CPI--on a consistently measured basis--is now projected to increase at about the same pace next year as in 1998, rather than accelerating somewhat as in the June Greenbook.[4]

Outside the core, the food price outlook has not changed materially, but energy prices rise somewhat faster next year than in the last projection, reflecting the larger expected rebound in oil prices. Consequently, the downward revision to the forecast for the total CPI has been less than that for the core component, and the index accelerates to just over a 2 percent rate of increase, from 1-1/2 percent this year. That acceleration would be a couple of tenths greater still, if not for the forthcoming technical changes to the index.

The core PCE price index has been giving a much more favorable reading on the trend of inflation in the past year. Indeed, it rose at an annual rate of just 1-1/4 percent over the first half of 1998--roughly half the pace of the increase for the core CPI. On average over time, the PCE index tends to rise somewhat more slowly than the CPI measure, reflecting the damping effects of ("upper level") substitution in response to relative price movements that are not captured in the fixed-weight CPI. But the two measures also differ in almost innumerable other ways, relating to coverage and source data, making an insightful reconciliation of the shorter-term

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4. At the beginning of 1999, the BLS will incorporate indexes aggregated with "geometric mean" formulas in the official CPI. This methodology takes account of "lower-level" substitution possibilities within narrowly defined product categories. BEA adopted this methodology in the July annual revision of the NIPAs, which reduced increases in the PCE chain price index by an average of 1/4 percentage point per year over the 1995-1997 period. As a result, PCE prices are now methodologically consistent from 1995 onward.

Staff Inflation Projections
(Percent change, Q4 to Q4, except as noted)

Measure	1997	1998	1999
Consumer price index	1.9	1.5	2.1
Previous	1.9	1.7	2.2
Food	1.7	1.7	1.3
Previous	1.7	1.4	2.0
Energy	-1.0	-7.2	3.9
Previous	-1.0	-5.3	1.7
Excluding food and energy	2.2	2.3	2.1
Previous	2.2	2.3	2.3
PCE chain-weighted price index	1.5	.9	1.6
Previous	1.5	1.3	1.9
Excluding food and energy	1.6	1.3	1.5
Previous	1.5	1.7	1.9
GDP chain-weighted price index	1.7	1.1	1.5
Previous	1.8	1.5	1.7
ECI for compensation of private industry workers[1]	3.4	3.4	3.2
Previous	3.4	3.6	3.5
Prices of core non-oil merchandise imports	-.7	-2.9	1.1
Previous	-.8	-2.3	1.6
	Percentage points		
MEMO: *Adjustments for technical changes to the CPI*[2]			
Core CPI	.2	.4	.6

1. December to December.
2. Adjustments are calculated relative to the methodological structure of the CPI in 1994.

relative movements almost impossible. Our inspection of the components has not yielded a strong signal about where things might go from here, although there are some hints that erratic changes have tended to pull down the rate of increase in the PCE index recently. However, that is sufficiently conjectural that we did not give it much weight in our projection. Giving primary attention to the macro fundamentals, we arrived at our prediction of a 1-1/2 percent rise in core PCE prices in 1999, leaving a gap between that measure and the core CPI that is still relatively large by historical standards.

Although our price forecast would appear optimistic relative to most private predictions, we see it as reasonably balancing the risks at this point, given the expected levels of resource utilization. The projection we are presenting actually is slightly above what is predicted by our core set of models that use the unemployment rate as a measure of slack, if one begins the simulation in the third quarter of this year. Those models have tended to overpredict inflation in the past few years, and we have in effect allowed for the possibility that there could be some reversal of this pattern. Among other things, it may be that elements exogenous to the models have worked in a favorable direction to date and could turn adverse in the period ahead--for example, the effects of structural changes in the medical care market. On the other hand, the pattern of overprediction may reflect a misspecification that could cause the models to continue erring in the same direction--implying that our forecast is too high. For example, as we've noted previously, it may be that the factory utilization rate is more important than we have allowed for; indeed, a model using capacity utilization instead of unemployment as the slack variable would have done a better job of predicting prices in the most recent period and would point to a slowing of inflation through next year.

As regards the labor market, as noted earlier, recent developments have not contradicted our prediction that compensation increases would level out, despite the continued low level of the unemployment rate. The central thesis was that a low level of price inflation would mute the pressures on nominal wages, while real wages would continue to climb at a rate well in excess of labor productivity. In this projection, we have tilted a bit further in the direction of this logic by eliminating the previously predicted pickup in the ECI this year and having the index decelerate in 1999. Relative to the models embodying this relationship, we have been quite conservative: They point to a sharper deceleration. Not only the overall changes in the ECI but also their composition have provided some grounds for optimism with respect to the outlook. A disproportionate amount of the acceleration in the ECI over the past year has reflected a huge step-up in pay in the finance, insurance, and real estate sector, where compensation has been boosted in part by commissions and bonuses associated with soaring activity. There is likely to be some reversal of this pattern in the projected economic environment. And, more generally, we see flexible pay devices as having taken on a greater importance in the economy, suggesting that slowing growth and weakening profitability could damp workers' compensation appreciably in 1999.

All told, our compensation forecast has been revised down about 1/4 percentage point relative to the June Greenbook both this year and next. We believe that this lower trajectory better balances the risks to the outlook as articulated by many of the models of wage determination that we follow. Our forecast continues to be below the projections of so-called "wage-wage" models in which lags of compensation inflation serve as proxies for shifts in wage aspirations. In contrast, our ECI forecast lies well above projections from standard "wage-price" specifications where lags of price inflation seek to model the evolution of price expectations.

Money and Credit Flows

The total debt of the domestic nonfinancial sectors is expected to advance at about an annual rate of 5 percent over the second half of this year and to decelerate further in 1999 to about a 4-1/4 percent pace. The federal government is expected to end this year with a significant surplus and to record another surplus next year. As a result, federal debt is expected to contract by about 1 percent this year and a little more next. The deceleration in total debt going forward is driven mainly by the outlook for the nonfederal components, with slower growth anticipated in the business, household, and state and local sectors.

Sizable merger-related financing needs and a widening gap between business capital expenditures and internally generated funds are expected to drive continued strong borrowing by nonfinancial corporations through the forecast period. However, this borrowing is expected to run well below the breakneck pace of the first half. Responses to the August Bank Lending Practices Survey suggest that domestic banks have not yet tightened their underwriting standards and have reduced further the rate spreads on C&I loans. We would expect to see some move toward greater caution as business profits continue to sag. In the junk bond market, credit spreads have already widened a bit in light of disappointing earnings news and a modest uptick in defaults.

The anticipated trajectory of household borrowing in the forecast is similar to that for the business sector. The waning effects of the runup in household wealth, a slowing in personal income growth, and a weaker labor market are expected to trim the growth of household debt over the forecast period in keeping with the slowdown in consumption spending and some cooling of the housing market. In the near term, credit supply conditions are expected to remain generally favorable. Recent readings on household financial conditions, including declines in various measures of delinquency rates and a leveling off in personal bankruptcy filings, suggest an easing in the financial strains among some households. Responses to the August BLPS suggest that domestic respondents have remained quite willing to extend credit to households on balance, although they have tightened terms and standards a bit further on credit card loans. However, as employment and income growth slows next year, lenders may become more cautious. As in the business sector, credit restraints will likely be most pronounced for lower-rated household borrowing in the "subprime" credit markets.

In the state and local sector, advance refundings and new debt issued to finance capital expenditures were exceptionally strong over the first half of this year, largely in response to falling interest rates. However, given the rate outlook embodied in this forecast as well as prohibitions on multiple advance refundings, borrowing in this sector is projected to slow markedly.

The rapid growth in M2 evident over the first half of this year is not expected to continue. Evidently, the combined effects of a flatter yield curve and efforts by households to rebalance their portfolios in light of the runup in equity prices helped spur the acceleration in M2 over the first half of this year and the accompanying sizable decline in M2 velocity. Such portfolio shifts are expected to keep M2 velocity moving downward over the balance of this year and in 1999 but not nearly so steeply as over the first half of this year.

The slower projected expansion of household and business credit demands in the forecast is expected to result in more subdued growth in bank credit. Moreover, the assets of the branches and agencies of Japanese banks operating in the United States are projected to continue contracting. The deceleration in bank assets is expected to be mirrored in a more sluggish expansion of bank wholesale liabilities included in M3. As a result, M3 growth is expected to taper off over the second half of this year and to slow somewhat relative to M2 growth over the forecast period.

Alternative Simulations

Our alternative, model-based simulations assess the implications of different assumptions about interest rates and the stock market. In the first alternative, the federal funds rate rises 25 basis points per quarter beginning in the third quarter of this year, reaching 100 basis points above the baseline in the second quarter of 1999; the funds rate is assumed to remain at that level thereafter. This tightening of policy reduces real GDP growth 0.1 percentage point in 1998 and 0.8 percentage point in 1999. Consequently, the unemployment rate rises to about 5-1/2 percent by the end of next year, reducing pressures on resources. The increase in the core CPI next year is 0.3 percentage point below the baseline forecast. The second, symmetric,

Alternative Federal Funds Rate and Stock Market Assumptions
(Percent change, Q4 to Q4, except as noted)

Measure	1997	1998	1999
Real GDP			
Baseline	3.8	2.9	1.7
Higher funds rate	3.8	2.8	.9
Lower funds rate	3.8	3.0	2.5
Constant stock market wealth-to-income ratio	3.8	3.0	2.2
10 percent lower stock prices	3.8	2.8	1.3
Civilian unemployment rate[1]			
Baseline	4.7	4.6	5.1
Higher funds rate	4.7	4.6	5.4
Lower funds rate	4.7	4.6	4.8
Constant stock market wealth-to-income ratio	4.7	4.6	4.9
10 percent lower stock prices	4.7	4.6	5.2
CPI excluding food and energy			
Baseline	2.2	2.3	2.1
Higher funds rate	2.2	2.3	1.8
Lower funds rate	2.2	2.3	2.4
Constant stock market wealth-to-income ratio	2.2	2.3	2.1
10 percent lower stock prices	2.2	2.3	2.1

1. Average for the fourth quarter.

alternative assumes a 100-basis point decline in the funds rate between now and the second quarter of 1999. In this scenario, the unemployment rate reaches only 4-3/4 percent by the end of next year, and core consumer price inflation moves up to 2.4 percent in 1999.

The third alternative assumes that the ratio of stock market wealth to income holds steady over the projection period, rather than declining as we are anticipating in the baseline forecast. In this scenario, real GDP growth is 0.1 percentage point higher than the baseline forecast this year and 0.5 percentage point higher in 1999. The unemployment rate is a bit lower next year in this simulation, while core CPI inflation is little changed. As we have noted before, the effect on prices under this type of alternative is small because the unemployment rate change is modest and because, in the FRB/US model, inflation expectations move slowly in the absence of a significant change in the stance of monetary policy.

For this Greenbook, we have added a fourth simulation that considers the impact of a 10 percent lower path for stock prices relative to the baseline. In this simulation, real GDP growth is 0.1 percentage point lower than the baseline forecast this year and 0.4 percentage point lower next year. The unemployment rate is a touch higher next year than in the baseline, while core CPI inflation differs little from the baseline for the same reason as in the other stock market simulation.

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Class II FOMC

August 13, 1998

STAFF PROJECTIONS OF CHANGES IN GDP, PRICES, AND UNEMPLOYMENT
(Percent, annual rate)

Interval		Nominal GDP		Real GDP		GDP chain-weighted price index		Consumer price index[1]		Unemployment rate[2]	
		06/24/98	08/13/98	06/24/98	08/13/98	06/24/98	08/13/98	06/24/98	08/13/98	06/24/98	08/13/98
ANNUAL											
1995		4.6	4.6	2.0	2.3	2.5	2.3	2.8	2.8	5.6	5.6
1996		5.1	5.4	2.8	3.4	2.3	1.9	3.0	3.0	5.4	5.4
1997		5.8	5.9	3.8	3.9	2.0	1.9	2.3	2.3	4.9	4.9
1998		4.8	4.5	3.3	3.4	1.4	1.1	1.6	1.6	4.4	4.6
1999		3.5	3.2	1.8	1.7	1.7	1.4	2.2	2.1	4.7	4.9
QUARTERLY											
1996	Q1	4.7	5.7	1.8	3.3	2.8	2.2	3.2	3.2	5.6	5.6
	Q2	7.7	7.3	6.0	6.1	1.9	1.4	3.7	3.7	5.4	5.4
	Q3	3.6	3.9	1.0	2.1	2.7	1.8	2.6	2.6	5.3	5.3
	Q4	6.2	6.1	4.3	4.2	1.9	1.6	3.3	3.3	5.3	5.3
1997	Q1	7.4	7.2	4.9	4.2	2.4	2.8	2.0	2.0	5.3	5.3
	Q2	5.2	5.6	3.3	4.0	1.8	1.7	1.5	1.5	4.9	4.9
	Q3	4.6	5.4	3.1	4.2	1.4	1.2	1.8	1.8	4.9	4.9
	Q4	5.2	4.2	3.7	3.0	1.4	1.1	2.3	2.3	4.7	4.7
1998	Q1	6.5	6.4	5.4	5.5	1.0	0.9	0.5	0.5	4.7	4.7
	Q2	3.7	2.2	2.0	1.3	1.7	0.9	2.0	2.0	4.3	4.4
	Q3	3.6	3.6	2.0	2.2	1.6	1.4	2.0	1.7	4.3	4.5
	Q4	3.4	3.9	1.7	2.5	1.7	1.4	2.2	2.0	4.4	4.6
1999	Q1	3.4	3.0	1.5	1.2	1.9	1.7	2.4	2.4	4.6	4.7
	Q2	3.4	2.8	1.8	1.4	1.6	1.4	2.2	2.1	4.7	4.9
	Q3	3.9	3.2	2.2	1.8	1.6	1.4	2.2	2.0	4.8	5.0
	Q4	4.0	3.6	2.3	2.2	1.7	1.4	2.2	2.0	4.9	5.1
TWO-QUARTER[3]											
1996	Q2	6.2	6.5	3.8	4.7	2.3	1.8	3.5	3.5	-0.2	-0.2
	Q4	4.9	5.0	2.7	3.2	2.3	1.7	2.9	2.9	-0.1	-0.1
1997	Q2	6.3	6.4	4.1	4.1	2.1	2.2	1.8	1.8	-0.4	-0.4
	Q4	4.9	4.8	3.4	3.6	1.4	1.2	2.0	2.0	-0.2	-0.2
1998	Q2	5.1	4.3	3.7	3.4	1.4	0.9	1.3	1.2	-0.4	-0.3
	Q4	3.5	3.8	1.8	2.3	1.6	1.4	2.1	1.9	0.1	0.3
1999	Q2	3.4	2.9	1.6	1.3	1.8	1.6	2.3	2.2	0.3	0.3
	Q4	4.0	3.4	2.3	2.0	1.6	1.4	2.2	2.0	0.2	0.3
FOUR-QUARTER[4]											
1995	Q4	4.0	4.2	1.6	2.1	2.4	2.1	2.6	2.6	0.0	0.0
1996	Q4	5.6	5.8	3.2	3.9	2.3	1.8	3.2	3.2	-0.3	-0.3
1997	Q4	5.6	5.6	3.7	3.8	1.8	1.7	1.9	1.9	-0.6	-0.6
1998	Q4	4.3	4.0	2.7	2.9	1.5	1.1	1.7	1.5	-0.3	-0.1
1999	Q4	3.7	3.1	2.0	1.7	1.7	1.5	2.2	2.1	0.5	0.5

1. For all urban consumers.
2. Level, except as noted.
3. Percent change from two quarters earlier; for unemployment rate, change in percentage points.
4. Percent change from four quarters earlier; for unemployment rate, change in percentage points.

Strictly Confidential <FR> Class II FOMC

REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS, ANNUAL VALUES
(Seasonally adjusted annual rate)

August 13, 1998

Item	Units[1]	1991	1992	1993	1994	1995	1996	1997	1998 (Projected)	1999 (Projected)
EXPENDITURES										
Nominal GDP	Bill. $	5916.7	6244.4	6558.1	6947.0	7269.6	7661.6	8110.9	8476.2	8748.3
Real GDP	Bill. Ch. $	6079.4	6244.4	6389.6	6610.7	6761.7	6994.8	7269.8	7515.0	7646.3
Real GDP	% change	0.4	3.6	2.4	3.3	2.1	3.9	3.8	2.9	1.7
Gross domestic purchases		0.0	4.0	3.0	3.6	1.6	4.2	4.4	4.6	2.1
Final sales		-0.4	3.9	2.1	2.7	2.7	3.7	3.4	3.2	1.8
Priv. dom. final purchases		-0.8	4.9	3.7	3.7	2.9	4.4	4.5	5.8	2.6
Personal cons. expenditures		-0.2	4.2	2.7	3.1	2.6	3.3	3.7	4.6	2.6
Durables		-3.1	9.4	7.4	6.3	4.5	5.8	7.4	7.9	3.4
Nondurables		-1.0	3.4	1.6	3.0	1.7	2.8	2.0	4.3	1.8
Services		0.9	3.6	2.3	2.5	2.6	3.0	3.8	4.0	2.8
Business fixed investment		-6.0	5.5	9.9	7.6	7.3	11.7	9.8	11.7	4.8
Producers' dur. equipment		-2.6	9.6	12.2	10.2	9.1	11.8	12.7	16.9	5.9
Nonres. structures		-12.6	-3.4	4.5	1.1	2.7	11.6	2.5	-1.4	2.0
Residential structures		1.0	16.9	7.8	4.2	-1.4	5.4	4.2	9.9	-3.6
Exports		8.6	4.1	4.6	10.0	10.5	10.3	9.6	-3.7	3.0
Imports		4.1	7.4	10.2	12.3	5.6	11.8	14.0	10.7	6.5
Gov't. cons. & investment		-0.7	1.7	-1.4	0.1	-0.9	2.1	1.4	1.3	1.1
Federal		-3.1	1.3	-6.1	-3.9	-5.6	1.1	-0.6	-0.9	-1.9
Defense		-5.3	-1.3	-6.9	-6.0	-5.0	-0.1	-1.4	-3.1	-2.4
State & local		1.0	2.0	2.0	2.7	2.1	2.8	2.6	2.6	2.7
Change in bus. inventories	Bill. Ch. $	-3.0	7.0	22.1	60.6	27.7	30.0	63.2	56.7	31.7
Nonfarm		-1.2	2.1	29.5	49.0	37.7	23.2	58.8	49.2	27.1
Net exports		-22.3	-29.5	-70.2	-104.6	-96.5	-111.2	-136.1	-261.1	-346.8
Nominal GDP	% change	3.8	6.3	5.0	5.8	4.2	5.8	5.6	4.0	3.1
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employment	Millions	108.3	108.6	110.7	114.1	117.2	119.6	122.7	125.8	127.3
Unemployment rate	%	6.8	7.5	6.9	6.1	5.6	5.4	4.9	4.6	4.9
Industrial prod. index	% change	-0.0	3.7	3.3	6.5	3.3	4.2	5.8	1.7	1.3
Capacity util. rate - mfg.	%	77.9	79.4	80.5	82.5	82.8	81.4	81.7	80.5	79.4
Housing starts	Millions	1.01	1.20	1.29	1.46	1.35	1.48	1.47	1.57	1.49
Light motor vehicle sales		12.53	12.86	13.88	15.03	14.74	15.06	15.04	15.12	14.79
North Amer. produced		9.74	10.51	11.71	12.88	12.82	13.34	13.11	13.13	12.87
Other		2.78	2.35	2.16	2.14	1.91	1.71	1.94	1.99	1.93
INCOME AND SAVING										
Nominal GNP	Bill. $	5932.4	6255.5	6576.8	6955.2	7287.1	7674.0	8102.9	8451.8	8707.3
Nominal GNP	% change	3.5	6.2	5.1	5.7	4.4	5.6	5.2	3.9	3.0
Nominal personal income		3.5	7.2	4.0	5.2	4.6	5.9	5.4	4.4	3.5
Real disposable income		0.7	4.0	1.2	2.5	2.1	2.7	2.9	2.8	2.3
Personal saving rate	%	5.6	5.7	4.4	3.5	3.4	2.9	2.1	0.5	0.2
Corp. profits, IVA & CCAdj.	% change	4.5	11.3	19.0	14.1	14.6	7.7	7.7	-1.3	-2.9
Profit share of GNP	%	6.9	6.8	7.5	8.2	9.2	9.8	10.1	9.7	9.0
Excluding FR Banks		6.6	6.6	7.2	7.9	8.9	9.5	9.8	9.4	8.8
Federal surpl./deficit	Bill. $	-196.0	-280.9	-250.7	-186.7	-174.4	-110.3	-21.1	71.0	50.6
State & local surpl./def.		75.8	86.3	87.4	96.8	111.7	122.6	134.1	142.2	148.9
Ex. social ins. funds		11.5	18.3	19.7	27.9	37.0	52.2	66.0	74.6	81.2
Gross natl. saving rate	%	15.7	14.5	14.4	15.5	16.3	16.6	17.4	17.2	16.2
Net natl. saving rate		4.8	3.7	3.7	4.7	5.8	6.3	7.3	7.2	6.1
PRICES AND COSTS										
GDP chn.-wt. price index	% change	3.3	2.6	2.6	2.5	2.1	1.8	1.7	1.1	1.5
Gross Domestic Purchases chn.-wt. price index		2.7	2.7	2.3	2.5	2.0	1.8	1.3	0.6	1.4
CPI		3.0	3.1	2.7	2.7	2.6	3.2	1.9	1.5	2.1
Ex. food and energy		4.4	3.5	3.1	2.8	3.1	2.6	2.2	2.3	2.1
ECI, hourly compensation[2]		4.4	3.5	3.6	3.1	2.6	3.1	3.4	3.4	3.2
Nonfarm business sector										
Output per hour		2.2	3.5	-0.4	0.1	1.2	2.1	1.7	1.1	1.3
Compensation per Hour		4.7	4.5	1.6	2.1	2.8	3.7	3.9	3.9	3.2
Unit labor cost		2.5	1.0	2.0	2.0	1.6	1.6	2.1	2.8	2.0

1. Changes are from fourth quarter to fourth quarter.
2. Private-industry workers.

Strictly Confidential <FR>
Class II FOMC

REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS, QUARTERLY VALUES
(Seasonally adjusted, annual rate except as noted)

August 13, 1998

Item	Units	1995 Q1	1995 Q2	1995 Q3	1995 Q4	1996 Q1	1996 Q2	1996 Q3	1996 Q4	1997 Q1	1997 Q2
EXPENDITURES											
Nominal GDP	Bill. $	7170.8	7210.9	7304.8	7391.9	7495.3	7629.2	7703.4	7818.4	7955.0	8063.4
Real GDP	Bill. Ch. $	6717.5	6724.2	6779.5	6825.8	6882.0	6983.9	7020.0	7093.1	7166.7	7236.5
Real GDP	% change	1.7	0.4	3.3	2.8	3.3	6.1	2.1	4.2	4.2	4.0
Gross domestic purchases		1.9	0.7	1.7	2.0	4.5	7.0	3.4	1.8	5.5	4.4
Final sales		2.2	2.3	3.7	2.5	3.6	5.4	0.9	5.1	2.9	2.7
Priv. dom. final purchases		2.9	2.9	2.7	3.1	5.1	6.2	3.1	3.3	4.6	3.3
Personal cons. expenditures		1.9	3.4	2.6	2.3	3.7	4.7	1.8	2.9	4.3	1.6
Durables		-1.0	5.9	8.3	4.8	5.8	12.7	-1.9	7.2	12.3	-1.5
Nondurables		2.3	1.6	0.7	2.0	2.2	4.8	1.2	2.9	3.6	-0.2
Services		2.3	3.8	2.4	1.9	4.0	3.0	3.0	2.0	3.1	3.2
Business fixed investment		16.1	6.9	0.9	6.1	13.1	11.0	14.2	8.8	7.0	14.0
Producers' dur. equipment		18.1	7.6	1.4	10.1	15.7	12.3	16.2	3.2	8.3	22.8
Nonres. structures		10.7	5.1	-0.4	-3.8	6.4	7.4	8.9	24.5	3.9	-6.2
Residential structures		-8.8	-15.0	10.1	10.6	9.3	19.5	-1.7	-3.9	3.1	6.1
Exports		9.2	5.4	17.8	10.2	3.7	5.8	2.1	32.0	8.3	15.5
Imports		9.8	7.2	2.0	3.5	13.1	13.5	13.6	7.0	18.6	17.9
Gov't. cons. & investment		0.1	1.2	-0.8	-4.1	3.2	7.1	-1.6	0.0	2.1	2.1
Federal		-2.6	-2.0	-2.6	-14.7	8.0	8.1	-4.7	-6.3	-2.7	3.6
Defense		-1.6	0.1	-5.4	-12.5	7.2	8.1	-6.3	-8.3	-9.9	9.1
State & local		1.8	3.2	0.4	2.8	0.5	6.5	0.3	3.8	4.9	1.3
Change in bus. inventories	Bill. Ch. $	54.3	21.7	14.7	20.1	14.4	26.1	47.5	32.1	56.3	79.0
Nonfarm		62.5	36.7	30.6	20.8	10.4	15.2	38.6	28.7	56.2	72.1
Net exports		-109.5	-114.7	-86.8	-74.8	-95.5	-113.5	-140.1	-95.9	-121.5	-131.6
Nominal GDP	% change	4.3	2.3	5.3	4.9	5.7	7.3	3.9	6.1	7.2	5.6
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	116.5	116.9	117.4	117.9	118.5	119.3	120.0	120.7	121.5	122.3
Unemployment rate	%	5.5	5.7	5.7	5.6	5.6	5.4	5.3	5.3	5.3	4.9
Industrial prod. index	% change	5.9	1.6	4.5	1.1	2.0	7.5	3.6	3.8	5.2	4.6
Capacity util. rate - mfg.	%	83.8	82.9	82.6	81.8	81.0	81.6	81.5	81.4	81.6	81.5
Housing starts	Millions	1.32	1.29	1.42	1.42	1.47	1.49	1.49	1.42	1.47	1.46
Light motor vehicle sales		14.71	14.45	14.78	15.00	15.11	15.17	15.00	14.94	15.32	14.54
North Amer. produced		12.69	12.46	12.93	13.22	13.44	13.45	13.32	13.18	13.40	12.67
Other		2.02	2.00	1.85	1.78	1.67	1.73	1.68	1.77	1.93	1.87
INCOME AND SAVING											
Nominal GNP	Bill. $	7189.3	7233.3	7313.2	7412.6	7515.0	7643.3	7708.6	7829.0	7952.4	8062.3
Nominal GNP	% change	5.3	2.5	4.5	5.5	5.6	7.0	3.5	6.4	6.5	5.6
Nominal personal income		4.7	3.4	4.3	6.1	6.6	6.9	5.5	4.6	7.3	4.7
Real disposable income		2.6	-0.6	2.7	3.9	2.9	2.1	4.4	1.3	3.3	2.9
Personal saving rate	%	4.1	3.1	3.1	3.3	3.2	2.6	3.1	2.6	2.4	2.6
Corp. profits, IVA & CCAdj.	% change	7.7	16.6	30.3	5.4	16.9	6.9	3.8	3.5	18.1	11.1
Profit share of GNP	%	8.8	9.0	9.6	9.5	9.8	9.8	9.8	9.7	10.0	10.1
Excluding FR Banks		8.5	8.7	9.2	9.3	9.5	9.5	9.5	9.5	9.7	9.8
Federal surpl./deficit	Bill. $	-189.6	-177.9	-176.9	-153.0	-150.1	-112.6	-100.1	-78.3	-51.2	-34.8
State & local surpl./def.		110.4	112.6	113.0	110.7	117.3	129.1	122.3	121.7	128.4	130.1
Ex. social ins. funds		37.6	37.7	37.3	35.5	45.3	58.2	52.5	52.9	59.8	61.6
Gross natl. saving rate	%	16.2	16.0	16.3	16.8	16.4	16.4	16.8	16.7	17.0	17.6
Net natl. saving rate		5.7	5.4	5.7	6.2	6.0	6.2	6.6	6.5	7.0	7.6
PRICES AND COSTS											
GDP chn.-wt. price index	% change	2.5	2.0	1.9	2.0	2.2	1.4	1.8	1.6	2.8	1.7
Gross Domestic Purchases chn.-wt. price index		2.2	2.4	1.6	1.8	2.1	1.4	1.5	2.1	2.2	0.9
CPI		2.7	3.5	2.1	2.4	3.2	3.7	2.6	3.3	2.0	1.5
Ex. food and energy		3.3	3.3	2.8	3.0	2.5	2.5	2.7	2.7	2.2	2.6
ECI, hourly compensation[1]		2.9	2.6	2.6	2.9	2.5	3.5	2.8	2.8	2.5	3.7
Nonfarm business sector											
Output per hour		-0.4	0.9	1.8	2.6	4.1	3.0	0.0	1.2	0.5	1.8
Compensation per hour		2.0	2.8	3.1	3.5	2.6	5.2	3.7	3.3	4.0	2.6
Unit labor cost		2.5	1.8	1.2	0.9	-1.5	2.2	3.7	2.1	3.6	0.7

1. Private-industry workers.

Strictly Confidential <FR>
Class II FOMC

REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS, QUARTERLY VALUES
(Seasonally adjusted, annual rate except as noted)

August 13, 1998

Item	Units	1997 Q3	1997 Q4	1998 Q1	1998 Q2	1998 Q3	1998 Q4	1999 Q1	1999 Q2	1999 Q3	1999 Q4
					---------- Projected						----------
EXPENDITURES											
Nominal GDP	Bill. $	8170.8	8254.5	8384.2	8429.2	8504.8	8586.7	8649.4	8709.0	8778.1	8856.6
Real GDP	Bill. Ch. $	7311.2	7364.6	7464.7	7489.3	7530.0	7576.1	7598.6	7625.0	7659.6	7702.0
Real GDP	% change	4.2	3.0	5.5	1.3	2.2	2.5	1.2	1.4	1.8	2.2
Gross domestic purchases		4.6	3.2	7.8	4.0	3.3	3.5	1.9	2.1	2.2	2.4
Final sales		5.8	2.1	4.3	3.8	1.8	2.9	1.5	1.6	2.0	2.3
Priv. dom. final purchases		7.2	2.9	8.5	7.2	3.3	4.2	2.6	2.4	2.5	2.7
Personal cons. expenditures		6.2	2.8	6.1	5.7	3.6	3.1	2.6	2.5	2.6	2.7
Durables		16.8	3.1	15.8	10.9	1.0	4.6	3.6	2.4	3.1	4.3
Nondurables		5.1	-0.4	7.4	5.2	2.6	2.1	1.7	1.7	1.8	1.9
Services		4.7	4.3	3.5	4.8	4.6	3.2	2.9	2.9	2.8	2.8
Business fixed investment		17.0	1.8	22.2	14.1	-0.6	12.2	5.3	4.5	4.7	4.8
Producers' dur. equipment		18.8	2.2	34.3	21.3	-1.1	15.8	6.3	5.4	5.8	5.9
Nonres. structures		12.4	0.9	-4.9	-4.1	0.9	2.6	2.4	2.0	1.7	1.7
Residential structures		-0.4	8.2	15.6	13.2	8.5	2.7	-3.7	-4.4	-3.6	-2.8
Exports		10.6	4.4	-2.8	-8.9	-2.3	-0.5	1.2	2.7	3.8	4.4
Imports		13.5	6.3	15.7	12.1	6.9	8.2	6.9	7.6	6.4	5.0
Gov't. cons. & investment		1.4	0.1	-1.9	3.2	1.4	2.7	0.2	1.8	1.5	1.1
Federal		-1.2	-2.1	-8.8	7.0	-2.8	1.6	-4.4	0.0	-0.9	-2.1
Defense		-1.8	-2.0	-18.5	9.4	-4.1	3.0	-6.3	0.0	-1.3	-1.8
State & local		2.9	1.3	2.1	1.3	3.6	3.3	2.8	2.7	2.7	2.7
Change in bus. inventories	Bill. Ch. $	51.0	66.5	91.4	42.8	50.5	42.2	36.4	32.2	29.8	28.3
Nonfarm		44.0	62.7	85.9	34.6	42.2	34.1	29.7	26.9	25.9	25.8
Net exports		-142.4	-149.0	-198.5	-255.9	-281.9	-307.9	-326.4	-344.1	-355.5	-361.1
Nominal GDP	% change	5.4	4.2	6.4	2.2	3.6	3.9	3.0	2.8	3.2	3.6
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	123.0	123.9	124.8	125.5	126.1	126.7	127.0	127.2	127.4	127.7
Unemployment rate	%	4.9	4.7	4.7	4.4	4.5	4.6	4.7	4.9	5.0	5.1
Industrial prod. index	% change	6.0	7.2	1.2	1.9	0.1	3.8	1.2	1.3	1.3	1.6
Capacity util. rate - mfg.	%	81.6	82.2	81.6	80.9	79.8	79.8	79.6	79.4	79.3	79.3
Housing starts	Millions	1.45	1.53	1.58	1.56	1.58	1.54	1.51	1.49	1.48	1.47
Light motor vehicle sales		15.21	15.10	15.02	16.07	14.24	15.14	15.03	14.81	14.69	14.64
North Amer. produced		13.21	13.15	13.07	14.06	12.23	13.17	13.08	12.87	12.77	12.75
Other		2.00	1.95	1.96	2.01	2.02	1.97	1.95	1.94	1.92	1.89
INCOME AND SAVING											
Nominal GNP	Bill. $	8162.0	8234.9	8369.4	8408.0	8475.2	8554.8	8613.7	8669.6	8734.6	8811.2
Nominal GNP	% change	5.0	3.6	6.7	1.9	3.2	3.8	2.8	2.6	3.0	3.6
Nominal personal income		4.7	5.0	5.9	4.2	3.9	3.7	3.6	3.4	3.5	3.4
Real disposable income		2.4	2.9	4.0	2.6	2.6	1.9	4.3	1.7	1.8	1.7
Personal saving rate	%	1.7	1.7	1.2	0.6	0.3	0.1	0.5	0.3	0.1	-0.1
Corp. profits, IVA & CCAdj.	% change	13.1	-9.2	4.2	-1.8	-8.7	1.4	-8.3	-5.6	-0.6	3.2
Profit share of GNP	%	10.3	10.0	9.9	9.8	9.5	9.5	9.2	9.0	8.9	8.9
Excluding FR Banks		10.0	9.7	9.6	9.6	9.3	9.2	8.9	8.8	8.7	8.7
Federal surpl./deficit	Bill. $	-0.3	2.2	58.8	77.6	76.2	71.3	47.1	48.7	53.9	52.5
State & local surpl./def.		136.6	141.4	140.2	131.8	145.1	151.6	151.4	148.8	146.4	148.9
Ex. social ins. funds		68.7	73.8	72.7	64.1	77.5	83.9	83.7	81.1	78.7	81.2
Gross natl. saving rate	%	17.5	17.3	17.7	17.2	17.0	16.7	16.6	16.3	16.1	15.9
Net natl. saving rate		7.5	7.3	7.8	7.2	7.0	6.7	6.5	6.2	6.0	5.8
PRICES AND COSTS											
GDP chn.-wt. price index	% change	1.2	1.1	0.9	0.9	1.4	1.4	1.7	1.4	1.4	1.4
Gross Domestic Purchases chn.-wt. price index		1.1	1.0	-0.2	0.5	0.9	1.1	1.8	1.4	1.3	1.3
CPI		1.8	2.3	0.5	2.0	1.7	2.0	2.4	2.1	2.0	2.0
Ex. food and energy		1.9	2.1	2.4	2.7	2.0	2.1	2.1	2.1	2.2	2.2
ECI, hourly compensation[1]		3.4	4.3	2.7	3.6	3.7	3.7	3.2	3.2	3.2	3.2
Nonfarm business sector											
Output per hour		3.6	0.9	3.5	-0.4	0.3	1.1	0.7	1.1	1.5	1.8
Compensation per hour		3.9	4.9	4.6	3.8	3.7	3.7	3.6	3.2	3.2	3.1
Unit labor cost		0.3	4.0	1.1	4.2	3.3	2.5	2.9	2.1	1.6	1.3

1. Private-industry workers.

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

Item	1995 Q3	1995 Q4	1996 Q1	1996 Q2	1996 Q3	1996 Q4	1997 Q1	1997 Q2	1997 Q3	95Q4/ 94Q4	96Q4/ 95Q4	97Q4/ 96Q4
Real GDP	3.3	2.8	3.3	6.1	2.1	4.2	4.2	4.0	4.2	2.1	3.9	3.8
Gross dom. purchases	1.7	2.1	4.5	7.1	3.5	1.9	5.5	4.4	4.7	1.6	4.2	4.4
Final sales	3.7	2.5	3.6	5.4	0.9	5.1	2.9	2.7	5.7	2.7	3.7	3.3
Priv. dom. final purchases	2.2	2.6	4.2	5.0	2.5	2.7	3.8	2.7	5.9	2.4	3.6	3.7
Personal cons. expenditures	1.8	1.6	2.5	3.2	1.3	2.0	2.9	1.1	4.2	1.7	2.2	2.5
Durables	0.7	0.4	0.5	1.0	-0.2	0.6	1.0	-0.1	1.3	0.4	0.5	0.6
Nondurables	0.2	0.4	0.4	1.0	0.2	0.6	0.7	0.0	1.0	0.3	0.6	0.4
Services	1.0	0.8	1.6	1.2	1.2	0.8	1.2	1.3	1.8	1.0	1.2	1.5
Business fixed investment	0.1	0.6	1.3	1.1	1.4	0.9	0.7	1.4	1.7	0.7	1.2	1.0
Producers' dur. equip.	0.1	0.7	1.1	0.9	1.1	0.2	0.6	1.6	1.3	0.6	0.8	0.9
Nonres. structures	0.0	-0.1	0.2	0.2	0.2	0.6	0.1	-0.2	0.3	0.1	0.3	0.1
Residential structures	0.4	0.4	0.4	0.7	-0.1	-0.2	0.1	0.2	0.0	-0.1	0.2	0.2
Net exports	1.6	0.7	-1.1	-0.9	-1.3	2.4	-1.2	-0.4	-0.5	0.5	-0.3	-0.6
Exports	1.8	1.1	0.4	0.7	0.2	3.2	0.9	1.8	1.2	1.1	1.2	1.1
Imports	-0.2	-0.4	-1.5	-1.6	-1.6	-0.9	-2.2	-2.2	-1.7	-0.7	-1.4	-1.7
Government cons. & invest.	-0.1	-0.8	0.6	1.3	-0.3	0.0	0.4	0.4	0.2	-0.2	0.4	0.3
Federal	-0.2	-1.1	0.5	0.5	-0.3	-0.4	-0.2	0.2	-0.1	-0.4	0.1	-0.0
Defense	-0.3	-0.6	0.3	0.4	-0.3	-0.4	-0.5	0.4	-0.1	-0.2	-0.0	-0.1
Nondefense	0.1	-0.5	0.2	0.2	0.0	0.0	0.3	-0.1	0.0	-0.2	0.1	0.0
State and local	0.0	0.3	0.1	0.7	0.0	0.4	0.6	0.2	0.3	0.2	0.3	0.3
Change in bus. inventories	-0.4	0.3	-0.3	0.6	1.2	-0.8	1.3	1.3	-1.4	-0.6	0.2	0.5
Nonfarm	-0.4	-0.6	-0.5	0.3	1.3	-0.5	1.5	0.9	-1.5	-0.6	0.1	0.5
Farm	-0.0	0.8	0.2	0.3	-0.1	-0.3	-0.2	0.4	0.1	-0.0	0.0	0.0

Note. Components may not sum to totals because of rounding.

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

Item	1997 Q4	1998 Q1	1998 Q2	1998 Q3	1998 Q4	1999 Q1	1999 Q2	1999 Q3	1999 Q4	97Q4/ 96Q4	98Q4/ 97Q4	99Q4/ 98Q4
Real GDP	3.0	5.5	1.3	2.2	2.5	1.2	1.4	1.8	2.2	3.8	2.9	1.7
Gross dom. purchases	3.2	7.9	4.1	3.4	3.6	2.0	2.1	2.3	2.4	4.4	4.7	2.2
Final sales	2.1	4.3	3.8	1.8	2.9	1.5	1.6	2.0	2.3	3.3	3.2	1.8
Priv. dom. final purchases	2.4	7.0	6.0	2.7	3.5	2.2	2.0	2.1	2.3	3.7	4.8	2.2
Personal cons. expenditures	1.9	4.1	3.8	2.4	2.1	1.8	1.7	1.8	1.9	2.5	3.1	1.8
Durables	0.3	1.2	0.9	0.1	0.4	0.3	0.2	0.3	0.4	0.6	0.6	0.3
Nondurables	-0.1	1.4	1.0	0.5	0.4	0.3	0.3	0.3	0.4	0.4	0.8	0.3
Services	1.7	1.4	1.9	1.8	1.3	1.2	1.2	1.2	1.2	1.5	1.6	1.2
Business fixed investment	0.2	2.2	1.5	-0.1	1.3	0.6	0.5	0.5	0.5	1.0	1.2	0.5
Producers' dur. equip.	0.1	2.4	1.6	-0.1	1.2	0.5	0.4	0.5	0.5	0.9	1.3	0.5
Nonres. structures	0.0	-0.1	-0.1	0.0	0.1	0.1	0.1	0.1	0.0	0.1	-0.0	0.1
Residential structures	0.3	0.6	0.5	0.4	0.1	-0.2	-0.2	-0.2	-0.1	0.2	0.4	-0.2
Net exports	-0.3	-2.2	-2.6	-1.1	-1.1	-0.8	-0.7	-0.4	-0.2	-0.6	-1.8	-0.5
Exports	0.5	-0.3	-1.1	-0.3	-0.1	0.1	0.3	0.4	0.5	1.1	-0.4	0.3
Imports	-0.8	-1.9	-1.5	-0.9	-1.0	-0.9	-1.0	-0.8	-0.7	-1.7	-1.4	-0.8
Government cons. & invest.	0.0	-0.3	0.6	0.2	0.5	0.0	0.3	0.3	0.2	0.3	0.2	0.2
Federal	-0.1	-0.6	0.4	-0.2	0.1	-0.3	0.0	-0.1	-0.1	-0.0	-0.1	-0.1
Defense	-0.1	-0.8	0.4	-0.2	0.1	-0.3	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Nondefense	-0.1	0.3	0.1	-0.0	-0.0	-0.0	0.0	0.0	-0.1	0.0	0.1	-0.0
State and local	0.2	0.2	0.1	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Change in bus. inventories	0.8	1.2	-2.4	0.4	-0.4	-0.3	-0.2	-0.1	-0.1	0.5	-0.3	-0.2
Nonfarm	1.0	1.2	-2.6	0.4	-0.4	-0.2	-0.1	-0.1	-0.0	0.5	-0.4	-0.1
Farm	-0.1	0.0	0.1	0.0	0.0	-0.1	-0.1	-0.1	-0.1	0.0	0.1	-0.1

Note. Components may not sum to totals because of rounding.

Strictly Confidential (FR)
Class II FOMC

STAFF PROJECTIONS OF FEDERAL SECTOR ACCOUNTS AND RELATED ITEMS
(Billions of dollars except as noted)

August 13, 1998

Item	Fiscal year[5]				1997				1998				1999			
	1996[a]	1997[a]	1998	1999	Q1[a]	Q2[a]	Q3[a]	Q4[a]	Q1[a]	Q2[b]	Q3	Q4	Q1	Q2	Q3	Q4
UNIFIED BUDGET					Not seasonally adjusted											
Receipts[1]	1453	1579	1719	1780	349	496	387	386	378	544	410	411	391	548	430	414
Outlays[1]	1561	1601	1652	1718	401	396	398	426	409	407	411	467	399	424	429	445
Surplus/deficit[1]	-107	-22	67	62	-52	100	-11	-40	-30	137	0	-55	-8	124	2	-31
On-budget	-174	-103	-39	-56	-69	61	-19	-66	-51	87	-9	-54	-62	71	-11	-66
Off-budget	67	81	106	118	17	39	8	26	21	50	9	-1	54	53	12	35
Surplus excluding deposit insurance[2]	-116	-36	62	58	-56	97	-12	-41	-31	136	-2	-56	-9	123	1	-32
Means of financing																
Borrowing	130	38	-50	-47	48	-69	11	34	26	-82	-28	34	18	-104	6	21
Cash decrease	-6	1	8	-5	-1	-18	8	12	4	-45	37	15	0	-15	-5	10
Other[3]	-16	-17	-25	-11	5	-13	-7	-6	0	-10	-9	6	-10	-5	-3	1
Cash operating balance, end of period	44	44	35	40	33	51	44	32	28	72	35	20	20	35	40	30
NIPA FEDERAL SECTOR					Seasonally adjusted annual rate											
Receipts	1548	1687	1820	1876	1671	1704	1740	1766	1809	1843	1863	1881	1862	1873	1887	1901
Expenditures	1677	1728	1766	1821	1722	1738	1740	1763	1750	1763	1787	1810	1815	1824	1833	1848
Consumption expend.	447	458	459	465	457	465	460	460	451	465	459	462	464	466	466	466
Defense	301	306	300	302	304	310	306	305	293	304	299	302	302	302	302	302
Nondefense	146	152	159	163	153	154	154	155	158	161	160	160	163	163	164	164
Other expenditures	1230	1270	1307	1356	1266	1274	1280	1303	1299	1298	1328	1348	1351	1359	1366	1383
Current account surplus	-129	-45	34	35	-56	-37	-11	-12	48	43	58	56	21	26	35	36
Gross investment	68	61	59	59	60	58	61	60	61	55	59	60	59	59	59	58
Current and capital account surplus	-197	-106	-25	-24	-114	-99	-72	-71	-11	-18	-1	-3	-37	-33	-24	-22
FISCAL INDICATORS[4]																
High-employment (HEB) surplus/deficit	-225	-163	-100	-83	-167	-160	-138	-141	-102	-76	-81	-84	-95	-83	-69	-64
Change in HEB, percent of potential GDP	-.6	-.8	-.8	-.2	-.3	-.1	-.3	0	-.5	-.3	.1	0	.1	-.1	-.2	-.1
Fiscal impetus (FI), percent, cal. year	-2	-2.1	-1.9	.5	-.3	.8	.1	-1.6	-2.1	.8	1.4	-.7	1	-.3	-.5	-1.3

1. OMB's May 1998 surplus estimates (assuming the enactment of the President's proposals) are $39 billion in FY98 and $54 billion in FY99. CBO's July 1998 baseline surplus estimates are $63 billion in FY98 and $80 billion in FY99. Budget receipts, outlays, and surplus/deficit include corresponding social security (OASDI) categories. The OASDI surplus is excluded from the on-budget deficit and shown separately as off-budget, as classified under current law. The Postal Service deficit is included in off-budget outlays beginning in FY90.
2. OMB's May 1998 surplus estimates (assuming the enactment of the President's proposals), excluding deposit insurance spending, are $35 billion in FY98 and $51 billion in FY99 and CBO's July baseline estimates are $59 billion in FY98 and $76 billion in FY99.
3. Other means of financing are checks issued less checks paid, accrued items, and changes in other financial assets and liabilities.
4. HEB is the NIPA current and capital account surplus in current dollars, with cyclically sensitive receipts and outlays adjusted to the level of potential output associated with an unemployment rate of 6 percent. Real potential GDP growth is assumed to be 2.8 percent beginning 1995:Q3. Quarterly figures for change in HEB and FI are not at annual rates. Change in HEB, as a percent of nominal potential GDP, is reversed in sign. FI is the weighted difference of discretionary changes in federal spending and taxes in chained (1992) dollars, scaled by real federal consumption plus investment. For change in HEB and FI, negative values indicate restraint.
5. Fiscal year data for the unified budget come from OMB; quarterly data come from the Monthly Treasury Statement and may not sum to OMB fiscal year totals.

a--Actual.
b--Preliminary.

Change in Debt of the Domestic Nonfinancial Sectors
(Percent)

Period [1]	Total [2]	Federal government [3]	Nonfederal: Total [4]	Nonfederal: Households: Total	Nonfederal: Households: Home mortgages	Nonfederal: Households: Consumer credit	Nonfederal: Business	Nonfederal: State and local governments	Memo: Nominal GDP
Year									
1989	7.3	7.0	7.3	8.6	9.9	6.0	6.7	5.6	6.4
1990	6.4	11.0	5.2	7.5	9.6	1.5	3.1	5.0	4.4
1991	4.3	11.1	2.3	4.7	6.4	-1.3	-1.7	8.6	3.8
1992	4.6	10.9	2.6	4.3	5.2	0.5	0.7	2.9	6.3
1993	5.0	8.3	3.8	5.2	4.3	7.6	1.4	6.7	5.0
1994	4.6	4.7	4.6	7.5	5.8	14.5	3.7	-2.7	5.8
1995	5.4	4.1	5.9	7.8	5.5	14.1	6.3	-3.1	4.2
1996	5.3	4.0	5.8	7.8	8.0	7.9	4.7	1.3	5.8
1997	5.3	0.6	6.9	6.8	7.5	4.3	7.1	7.0	5.6
1998	5.5	-1.3	7.8	7.4	8.5	3.6	8.3	7.7	4.0
1999	4.2	-1.6	6.0	5.8	6.9	2.1	6.5	5.0	3.1
Quarter									
1997:3	5.3	0.8	6.9	7.2	9.4	4.1	6.9	5.4	5.4
4	6.2	1.1	8.0	7.2	8.2	2.3	8.8	8.3	4.2
1998:1	6.4	-0.8	8.8	8.3	8.9	4.9	8.9	10.3	6.4
2	5.5	-1.9	7.9	7.1	8.3	3.2	8.1	10.8	2.2
3	4.5	-3.5	7.1	6.9	8.0	3.1	8.0	4.5	3.6
4	5.3	0.9	6.6	6.6	7.6	3.0	7.2	4.4	3.9
1999:1	4.3	-2.1	6.2	6.2	7.2	2.5	6.6	5.3	3.0
2	4.0	-2.8	6.0	5.7	6.8	2.1	6.5	5.1	2.8
3	4.3	-0.8	5.8	5.5	6.5	1.9	6.3	4.8	3.2
4	4.2	-0.7	5.6	5.3	6.3	1.8	6.2	4.4	3.6

Note. Quarterly data are at seasonally adjusted annual rates.
1. Data after 1998:Q1 are staff projections. Changes are measured from end of the preceding period to end of period indicated except for annual nominal GDP growth, which is calculated from Q4 to Q4.
2. On a monthly average basis, total debt is projected to grow 5.7 percent in 1998 and 4.3 percent in 1999.
3. On a monthly average basis, federal debt is projected to grow -1.0 percent in 1998 and -1.8 percent in 1999.
4. On a monthly average basis, nonfederal debt is projected to grow 8.0 percent in 1998 and 6.1 percent in 1999.

2.6.3 FOF

Flow of Funds Projections: Highlights
(Billions of dollars except as noted)

Category	Calendar year				Seasonally adjusted annual rates									
					1997		1998				1999			
	1996	1997	1998	1999	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Net funds raised by domestic nonfinancial sectors														
1 Total	663.6	649.4	623.3	593.1	703.7	789.2	862.8	723.6	569.3	337.5	591.4	547.0	622.6	611.2
2 Net equity issuance	-64.2	-114.8	-219.7	-87.1	-83.2	-144.1	-109.6	-126.8	-141.2	-501.2	-96.8	-94.0	-79.6	-78.0
3 Net debt issuance	727.8	764.2	843.0	680.2	786.9	933.4	972.4	850.4	710.5	838.7	688.2	641.0	702.2	689.2
Borrowing sectors														
Nonfinancial business														
4 Financing gap [1]	23.0	78.3	108.1	126.7	55.3	87.4	123.1	93.5	104.5	111.4	116.5	125.4	130.9	134.1
5 Net equity issuance	-64.2	-114.8	-219.7	-87.1	-83.2	-144.1	-109.6	-126.8	-141.2	-501.2	-96.8	-94.0	-79.6	-78.0
6 Credit market borrowing	195.8	311.3	390.3	333.4	311.5	405.9	419.6	388.5	391.2	361.9	334.2	337.0	331.2	331.0
Households														
7 Net borrowing [2]	372.7	350.3	409.5	341.8	381.5	388.1	458.3	398.8	395.4	385.7	364.0	341.9	335.5	325.9
8 Home mortgages	261.0	262.3	318.9	280.7	337.8	303.5	333.7	320.0	315.2	306.7	294.7	281.7	276.7	269.7
9 Consumer credit	88.8	52.5	45.4	27.8	50.5	28.8	62.0	40.5	39.9	39.0	33.0	28.1	25.7	24.5
10 Debt/DPI (percent) [3]	89.8	91.8	94.8	97.0	91.9	92.7	93.6	94.5	95.3	96.1	96.2	96.8	97.4	97.9
State and local governments														
11 Net borrowing	14.3	79.5	93.1	65.1	63.6	98.6	124.6	134.0	57.4	56.5	68.8	67.5	64.4	59.9
12 Current surplus [4]	141.4	134.9	158.7	162.1	116.8	170.7	157.8	147.5	161.3	168.3	168.7	156.7	164.9	158.0
Federal government														
13 Net borrowing	145.0	23.1	-49.9	-60.1	30.3	40.8	-30.0	-70.9	-133.5	34.7	-78.7	-105.4	-28.8	-27.5
14 Net borrowing (quarterly, n.s.a.)	145.0	23.1	-49.9	-60.1	10.6	33.7	25.9	-81.8	-28.0	34.0	17.6	-104.4	6.1	20.6
15 Unified deficit (quarterly, n.s.a.)	110.9	2.4	-51.1	-86.4	10.9	39.7	30.2	-136.9	0.2	55.4	8.0	-124.0	-1.7	31.3
Depository institutions														
16 Funds supplied	232.9	336.9	272.7	252.4	188.9	476.0	321.7	215.9	271.9	281.5	259.5	244.3	249.1	256.9
Memo (percentage of GDP)														
17 Domestic nonfinancial debt [5]	183.8	182.8	184.4	187.4	182.1	182.9	182.9	184.6	185.2	185.7	186.6	187.2	187.7	188.0
18 Domestic nonfinancial borrowing	9.5	9.4	9.9	7.8	9.6	11.3	11.6	10.1	8.4	9.8	8.0	7.4	8.0	7.8
19 Federal government [6]	1.9	0.3	-0.6	-0.7	0.4	0.5	-0.4	-0.8	-1.6	0.4	-0.9	-1.2	-0.3	-0.3
20 Nonfederal	7.6	9.1	10.5	8.5	9.3	10.8	12.0	10.9	9.9	9.4	8.9	8.6	8.3	8.1

Note. Data after 1998:Q1 are staff projections.
1. For corporations: Excess of capital expenditures over U.S. internal funds.
2. Includes change in liabilities not shown in lines 8 and 9.
3. Average debt levels in the period (computed as the average of period-end debt positions) divided by disposable personal income.
4. NIPA surplus less changes in retirement fund assets plus consumption of fixed capital.
5. Average debt levels in the period (computed as the average of period-end debt positions) divided by nominal GDP.
6. Excludes government-insured mortgage pool securities.

2.6.4 FOF

International Developments

Recent Developments

International financial markets again turned volatile toward the end of the intermeeting period as concerns about developments in Asia, particularly in Japan, intensified and exacerbated problems in Russia and other emerging-market economies. Since the June-July FOMC meeting, the foreign exchange value of the dollar in terms of the other major currencies has increased about 2 percent on balance. The dollar has moved up against the yen, the Canadian dollar, and sterling but has declined slightly against the continental European currencies.

The dollar's rise against the yen, more than 4¾ percent, reflected market skepticism that the new LDP-led government is likely to resolve Japan's chronic problems soon. The additional proposals for resolution of the troubled banking system and the announcement of new fiscal initiatives failed to convince market participants that the economy was about to recover. Data releases during the period indicated that a further sharp decline in economic activity had occurred in the second quarter.

The dollar has appreciated 3 percent against the Canadian dollar since the FOMC meeting as weakness in global commodity prices continued to weigh on the currency.

Signs of weakening activity and the market's sense that the likelihood of tightening by the Bank of England had decreased contributed to the fall in the pound against the dollar during the period. In contrast, the dollar has depreciated about 1 percent against the mark and other euro-area currencies as economic prospects for those countries appear favorable for the rest of the year and the transition to Stage III of European Economic and Monetary Union seems to be proceeding smoothly.

Three-month and ten-year market interest rates moved lower over the period in most of the major foreign industrial countries. The notable exceptions were Canadian rates, which rose on expectations that the weakening of the Canadian dollar exchange rate may prompt a tightening of monetary policy. The lower rates in Japan likely reflect market pessimism about economic prospects. Declines in European rates in part suggest further shifts in market preferences away from assets in emerging market economies and toward those perceived to be safer. In addition, some rates trended down as convergence proceeded within the euro-area ahead of the shift on January 1, 1999, to a single currency. Prices of equities in most industrial countries moved lower over the period. Canadian equities fell the most, more than 11 percent, whereas German equities dropped nearly 5 percent and Japanese equity prices changed little on balance.

In terms of our broad index for the dollar's value against 29 currencies, the dollar moved up 1½ percent over the intermeeting period. Against the currencies of other Asian and Latin American countries included in the broad index, the dollar rose more than ½ percent. A sizable decline in the dollar against the Indonesian rupiah (11 percent) and a smaller decline against the Korean won (2½ percent) were offset by small increases against other Asian and Latin American currencies. Enlargement of Indonesia's international financing package along with a rise in short-term interest rates contributed to the stronger rupiah. Pressures on the Hong Kong dollar (which remained pegged to the U.S. dollar) led to higher short-term interest rates there also. Stability in exchange rates allowed short-term domestic interest rates to move lower elsewhere in Asia, particularly in Thailand and Korea. However, spreads on most dollar-denominated instruments moved up. Except in Korea, equity prices in the region moved down, ranging from a 28 percent drop in Malaysia to a 2½ percent decline in Taiwan. Korean equity prices moved up nearly 2 percent. The Mexican peso moved down toward the end of the period, registering a net decline of 2½ percent since the previous FOMC meeting. Mexican short-term interest rates were up about 2 percentage points from mid-July lows, and equity prices fell nearly 17 percent. In Brazil, short-term interest rates are down on balance in response to monetary easing, but spreads on Brady bonds are up.

Pressure on asset prices in Russia intensified again late in the period, with the ruble falling outside its daily band. In response, Russian authorities announced on August 12 the imposition of foreign exchange restrictions on domestic banks. The announcement led to a sharp sell-off in government debt; rates on short-term ruble-denominated government bills increased 40 to 140 percentage points. Over the intermeeting period, the yield on Russian dollar-denominated debt rose 9 percentage points. Russian equity prices tumbled more than 33 percent over the period.

. The Desk did not intervene.

Real economic activity continued to expand in the second quarter in most of the major foreign industrial countries, albeit at a slower pace than during the first quarter. The notable exception was Japan, where indicators such as industrial production and household expenditures suggest that output declined further while the labor market continued to deteriorate.

In contrast, activity apparently expanded further in Euroland, and business and consumer confidence remained high. Industrial production slipped back in Germany and Italy in the second quarter but was up in France on average in April and May. Capacity utilization was high in all three countries.

Preliminary data show that in the United Kingdom real GDP grew 2 percent in the second quarter, down slightly from the first quarter, as manufacturing output changed little. Business confidence has declined to its lowest levels in six years, reflecting concerns about both export and domestic orders. Data for Canada also suggest some slowing of growth to a more sustainable pace. Average GDP at factor cost was up a little more than 2 percent at an annual rate in April and May from the first quarter, down from more vigorous growth in recent quarters, and new orders have leveled off in recent months. Employment was down on balance from April through July, partly as a result of the GM strike.

Inflation pressures in most of the major foreign industrial countries continue to be quiescent. Japanese consumer prices in July were about unchanged from their year-earlier level. In Germany and France, the inflation rate moved below 1 percent for the year to July. Consumer price inflation remains near 1 percent in Canada. Only in the United Kingdom are wages and prices tending to accelerate.

In most of the Asian emerging market countries, economic activity has remained weak or has declined further. Output declined sharply in the second quarter in Korea and Indonesia, and partial data suggest further contraction in Malaysia and Thailand as well. In response to these developments, the targeted stance of fiscal policy has been eased, with the approval of the IMF, in Korea and Indonesia while Thailand is seeking to relax its fiscal stance further as well. Real output in China registered a 7 percent increase in the first half of the year (from its year-earlier level), the slowest growth since 1991. Consumer prices accelerated sharply through July in Indonesia and, to a lesser extent, in the Philippines, but inflation remained low through June in Taiwan.

External adjustment in Korea and the ASEAN countries most affected by the Asian crisis continued through the second quarter, with most of the adjustment occurring through reduced imports rather than increased exports. For these countries, the improvement in their trade balances has been primarily with respect to trade with the United States, Japan, and Europe.[1]

In Mexico and Argentina, indicators suggest some deceleration of economic activity. Weak oil prices have undercut growth of nominal exports in Mexico and, along with greater volatility in global financial markets generally, have put pressure on Mexican financial markets. In response, the Bank of Mexico has tightened monetary policy, and additional fiscal cuts have been announced to offset losses in government revenue. In Brazil, economic activity apparently strengthened during the second quarter, but disappointing news on retail sales in recent weeks prompted the government to enact compensatory measures. Consumer price inflation decreased, but remained high (12 percent, twelve-month change), in Mexico in July; inflation is declining to low levels in Brazil (4 percent) and remains well contained in Argentina (1 percent).

The U.S. nominal trade deficit in goods and services widened further in May. For April and May on average, the deficit was substantially larger than in the first quarter. Exports of goods and services declined noticeably in April-May from the first quarter, with capital goods and agricultural products accounting for much of the drop. Exports to all major areas except Canada declined; the largest decreases were to Asia and western Europe. Imports of goods and services rose moderately on average in April-May from the first quarter, as those of consumer goods and aircraft were particularly strong. In real terms, exports of goods and services declined again in the second quarter, whereas real imports again rose at an annual rate of more than 10 percent. As a consequence, real net exports of goods and services subtracted 2½ percentage points from the annual rate of growth for the quarter.[2]

The quantity of imported oil rose in April and May to a rate of nearly 12 mb/d, primarily because of an acceleration in stockbuilding in apparent anticipation of a recovery in oil prices; surprisingly strong consumption also contributed to the rise. Preliminary Department of Energy statistics indicate that oil imports remained strong in June and July, although below the April-May average.

The average price of imported oil rose slightly in April and May, following five consecutive months of large declines, and then fell nearly sharply in June. On

1. For January-May 1998 compared with January-May 1997, the aggregate trade balances of Korea, Thailand, Malaysia, and the Philippines improved $22 billion with the United States and $20 billion each with Japan and Europe out of a total improvement of about $100 billion.

2. These preliminary second-quarter NIPA data contain a staff estimate for June that is slightly weaker than BEA's. June trade data will be released on August 18.

average in the second quarter, the price of oil imports declined at an annual rate of about 30 percent. The drop in June reflected the effects of the high levels of global oil stocks and the reaction to the announcement of a sharp downward revision in the figures for oil consumption in Asia during 1998:Q1. In July, the price of imported oil fell significantly further. The spot WTI price rose $0.42 per barrel in July, declined on balance through August 13, and is currently at $13.45 per barrel. The announcement by OPEC of further planned cuts in crude oil production contributed to the rebound in prices during the intermeeting period.

Non-oil import prices declined during the second quarter at an annual rate of more than 3½ percent, with decreases recorded in all major trade categories. In July, the price of non-oil imports fell sharply. Prices of nonagricultural exports declined at an annual rate of nearly 3 percent in the second quarter and moved down somewhat further in July.

Outlook

The staff projects that total foreign output (weighted by U.S. nonagricultural export shares), which was about flat during the first half of this year, will resume growing at an annual rate of about ¾ percent during the second half of the year and will accelerate to growth of 2 percent next year. Foreign output was significantly weaker in the second quarter than we had expected, and financial markets abroad remained volatile. In light of these developments, we have revised down foreign growth for industrial and developing countries over the six quarters of the forecast period.

Summary of Staff Projections
(Percentage change from end of previous period)

Measure	1997	Projection				
		1998				1999
		Q1	Q2	Q3	Q4	
Foreign output	3.9	-0.5	0.2	0.5	1.1	2.1
June	*3.8*	*-0.3*	*0.8*	*1.4*	*1.9*	*2.6*
Real exports	9.6	-2.8	-8.9	-2.3	-0.5	3.0
June	*10.2*	*-1.2*	*-3.2*	*0.3*	*1.7*	*3.8*
Real imports	14.0	15.7	12.1	6.9	8.2	6.5
June	*14.4*	*16.9*	*9.3*	*8.1*	*7.3*	*6.5*

Our current forecast for the trade-weighted average foreign exchange value of the dollar against the major currencies is higher in the near term than it was in the June forecast, reflecting recent appreciation. We now expect the dollar to depreciate at a slightly faster rate over the forecast period, but the projected path for the dollar nevertheless remains above that in the June Greenbook through the end of 1999.

As a consequence of these elements, our projection for real export growth has been revised down, with real exports projected to fall further during the remainder of this year and to rise moderately next year. With U.S. GDP growth expected to slow, we continue to project that real import growth will moderate from its recent very high rates. Real net exports are now projected to subtract a bit more than 1 percentage point from the annual rate of growth of real GDP in the second half of this year and ½ percentage point next year, slightly more drag from net exports in both periods than in the June Greenbook.

The dollar. We project that the trade-weighted exchange value of the dollar against the major foreign currencies will remain near recent levels through this year but will decline nearly 4 percent in 1999. Compared with the previous forecast, the dollar's path in terms of this index is about 2½ percent higher in the near term, reflecting the dollar's recent moves up against the yen, the Canadian dollar, and sterling; but this difference shrinks to 1¼ percent by the end of 1999, consistent with the view that at least part of the dollar's current strength is transitory. We expect that the dollar will strengthen somewhat further against the yen this year as additional uncertainties about the pace of resolution of difficulties in the Japanese banking sector and additional fiscal stimulus weigh on that currency. Next year, however, the dollar is forecast to give up those gains and to decline nearly 7 percent against the yen as economic activity in Japan turns up and enlarged Japanese and U.S. external imbalances begin to attract the attention of investors. The dollar is forecast to decline moderately against the Canadian dollar, as the Bank of Canada raises interest rates before the end of the year and as the severity of the effects of the Asian crisis diminish next year. We continue to assume that the dollar will depreciate somewhat against the mark and the other continental European currencies over the forecast period as EMU developments continue on track and the European Central Bank (ECB) tightens monetary policy in 1999.

The dollar's exchange value against the 29 currencies in the staff's broad exchange rate index is projected to depreciate less than 3 percent in real terms over the forecast period. Nominal dollar depreciation more than accounts for the real adjustment against the major currencies, whereas for the Latin American and Asian currencies in general, higher inflation is the source of real dollar depreciation. We continue to project that the nominal renminbi/dollar rate will remain unchanged this year but that the Chinese authorities will allow a gradual decline in that rate next year and that the Hong Kong dollar peg will remain unchanged over the entire forecast period. The Mexican peso is forecast in real terms to stay near current levels through 1999.

Foreign industrial countries. The staff projects that real GDP growth in the foreign industrial countries (weighted by U.S. nonagricultural export shares) will edge up to an annual rate of 2¼ percent over the forecast period from the estimated 1¾ percent growth recorded during the first half of this year, a somewhat weaker outlook than in the June Greenbook. Most of the downward revision for this group of countries is accounted for by Japan.

We now expect Japanese output to be flat on balance over the second half of the year, following two quarters of decline at an annual rate of 5 percent or more. Our expectation that Japan will reach the trough of its current slump later this year depends critically on assumed large increases in government spending associated with the fiscal policy measures announced earlier this year; other components of domestic demand are expected to contract further, especially private investment spending. In 1999, Japanese real GDP is expected to grow at a low, ¾ percent annual rate as fiscal stimulus makes a positive but diminishing contribution over the course of the year. Net exports are projected to add only a few tenths to Japanese real GDP growth over the forecast period as the positive effects of the weak yen are largely offset by the effects of depressed activity in Japan's Asian trading partners. The substantial downward revision to our forecast for Japan reflects our attempts to weigh several factors. The surprising results of the election led to a new government and increased uncertainty about the future course of policy. New initiatives have been announced, including those for the banking sector, that have the potential to help resolve long-standing problems. However, doubts abound about the political will to implement these initiatives promptly and comprehensively.

Real output growth in Euroland is expected to strengthen a bit during the second half of this year and to average 2¾ percent at an annual rate over the forecast period. Strength in domestic demand (supported by accommodative monetary policy) accounts for the continued expansion in continental Europe as net exports are projected to make negative contributions throughout the remainder of the forecast period in all the major continental European countries. One downside risk to our outlook for Euroland is a worsening of financial market turmoil in Russia that could impair its ability to meet foreign-currency obligations and spill over elsewhere in eastern Europe.

Real GDP growth is projected to moderate over the forecast period in the United Kingdom (average annual rate of 1¾ percent) and Canada (average annual rate of 2¾ percent) from the more vigorous rates observed last year and earlier this year. The effects of past and prospective monetary tightening and some continuing drag from net exports explain the slowing.

Consumer price inflation in the major foreign industrial countries (weighted by U.S. non-oil import shares) is projected to slip below 1 percent at an annual rate for the second half of this year and to average about 1 percent next year. Projected price declines in Japan and low inflation elsewhere explain this remarkably low average rate of inflation. However, in the United Kingdom, where inflation is expected to remain a bit above the government's target of 2½ percent, inflation pressures are evident.

This forecast incorporates the assumption that short-term market interest rates in Japan will remain very low over the forecast period. The ECB is assumed to tighten somewhat next year, moving the stance of monetary policy from accommodative toward neutral, as economic slack diminishes further; market rates are assumed to rise about 50 basis points in response. Monetary conditions are expected to tighten in the near term in Canada as official rates are raised 50 basis points to counter the easing imparted by depreciation of the currency. One more upward move of 25 basis points by the Bank of England is assumed later this year, followed by a move toward ease late next year. Long-term market interest rates are assumed to rise slightly over the forecast period in response to the strengthening of activity.

Other countries. Average real GDP of our major developing-country trading partners is projected to decline somewhat more over the second half of 1998, with output in the Asian developing countries contracting at an annual rate of about 3 percent. We revised down our outlook in light of the negative developments during the intermeeting period and with the expectation that the continued effects from shocks to currency and equity markets in these countries, along with the weaknesses in their financial sectors, will exert a substantial drag on domestic demand that will be only partially offset by improvements in their net exports. Our forecasts might have been marked down even further but for the growing evidence that many of the Asian crisis countries are easing monetary and fiscal policies in an attempt to cushion output declines. We project that growth in most of these countries will resume in 1999, but only at substantially below-trend rates. Inflation in the Asian developing countries is projected to rise in 1998, reflecting the substantial depreciations of their currencies since mid-1997.

We have also revised down our outlook for growth of real GDP in our Latin American trading partners; output should expand slowly over the remainder of 1998 and accelerate to growth of 2¾ percent in 1999 as recovery begins in other emerging market economies and as global commodity prices, including oil prices, rise.

Real net exports of goods and services. We have reduced further our projection for growth of real exports of goods and services over the forecast period. Weaker-than-expected export growth in the second quarter, projections of slower growth abroad, and a higher level for the real value of the dollar over the next six quarters produce both a lower level and a slower growth rate for the projected path of real exports. Nonagricultural goods other than computers and semiconductors (core exports) are now projected to drop at an annual rate of 4½ percent during the second half of this year and to be about flat on balance next year. In the near term, projected growth in real terms for computers and semiconductors has been lowered as well. Total exports of goods and services are projected to decline at an annual average rate of about 1½ percent over the remainder of this year and to rise 3 percent next year.

We continue to expect that the growth of imports of goods and services will slow as U.S. real GDP growth moderates over the next six quarters. Imports of non-oil goods other than computers and semiconductors (core imports) should decelerate to an annual rate of growth of about 8½ percent during the second half of this year from double-digit rates earlier and then slow to about 5½ percent growth in 1999. Growth of imports of computers and semiconductors should remain rapid. The quantity of oil imports should decline during the second half of this year as inventories retreat from the current unusually high levels. We project that oil imports will rise in line with increases in consumption next year. Overall, real imports of goods and services are projected to expand at an annual rate of 7½ percent during the second half of this year and about 6½ percent next year.

Oil prices. The staff has lowered its projected path for the price of imported oil about $0.10 per barrel in 1998 owing to the reassessment of our near-term outlook. We have raised the projected price about $0.70 per barrel in 1999 in response to planned cuts in oil production by OPEC that are greater than we had assumed in the last Greenbook. After declining to an estimated $12.52 per barrel during the second quarter, the oil import unit value is projected to rise above $14.00/b by early next year and to remain around that level during 1999. Our outlook for a $14.33/b oil import unit value in 1999 is consistent with the price of WTI spot crude oil of $17.00/b.

Although we see a weaker outlook for oil demand (ex ante) this year and next, we are projecting that a group of OPEC and non-OPEC producers will cut back production sufficiently that the market will be able to absorb additional barrels from Iraq at a price for WTI near $17.00 per barrel next year. There is considerable risk to this forecast. On the one hand, if producers are unable to sustain lower rates of production, the spot WTI price could fall once again below $13.00 per barrel in the near term. On the other hand, if Iraqi oil is withheld from the market again--especially if this occurs near the end of the year when Iraq is expected to be exporting as much as 2.0 mb/d--spot WTI could rise above $20 per barrel.

Prices of non-oil imports and exports. With the dollar at a higher level currently and throughout the forecast than in the June Greenbook, we now project that non-oil import prices of core goods will decline a bit more during the remainder of this year than we did in June. The restraining effects of past dollar appreciation should fade during the first half of next year, and non-oil commodity prices are expected to flatten. As a consequence, non-oil import prices for core goods should reach a trough around the end of this year and begin rising moderately next year. Nonagricultural export prices for core goods are projected to decline slightly further this quarter but to begin rising very slowly over the remainder of the forecast period, in line with comparable domestic prices.

Selected Trade Prices
(Percentage change from end of previous period
except as noted; seasonally adjusted)

Trade category	1997	Projection				
		1998				1999
		Q1	Q2	Q3	Q4	
Exports						
Nonagricultural (core)	0.5	-2.4	-1.7	-2.2	0.3	1.6
Agricultural	-3.2	-16.2	-5.9	-11.5	-4.0	2.1
Imports						
Non-oil (core)	-0.7	-3.3	-1.9	-4.1	-2.3	1.1
Oil (level, dollars per barrel)	17.72	13.89	12.52	11.75	12.20	14.33

NOTE. Prices for exports and non-oil imports of goods, excluding computers and semiconductors, are on a NIPA chain-weighted basis.

The price of imported oil for multiquarter periods is the price for the final quarter of the period.

Nominal trade and current account balances. The nominal trade deficit on goods and services is projected to widen significantly further over the forecast period, from an estimated $185 billion in the second quarter of this year to about $260 billion in the fourth quarter of next year. The deficit on net investment income also is projected to widen over the next six quarters. As a result, the current account deficit is expected to widen from about $240 billion in the second quarter (2¾ percent of GDP) to an average of about $330 billion for 1999 (3¾ percent of GDP, a bit above the previous peak for this ratio that was reached in 1987).

August 13, 1998

OUTLOOK FOR FOREIGN REAL GDP AND CONSUMER PRICES: SELECTED COUNTRIES
(Percent, Q4 to Q4)

Measure and country	1991	1992	1993	1994	1995	1996	1997	Projected 1998	Projected 1999
REAL GDP									
Canada	-0.3	0.9	3.1	4.5	0.8	2.0	4.0	3.0	2.7
Japan	2.5	0.1	0.5	0.8	2.4	3.4	-0.4	-2.6	0.7
United Kingdom	-1.6	0.4	2.7	4.9	2.0	2.6	3.0	2.0	1.9
Euro-11 Average (1)	2.1	0.1	-0.1	3.4	1.5	1.9	3.0	2.5	2.8
of which:									
France	1.4	-0.1	-0.5	4.1	0.3	2.3	3.1	2.4	2.6
Germany (2)	3.3	0.9	-0.2	3.4	0.7	2.1	2.3	2.5	2.7
Italy	1.9	-0.8	0.1	2.5	2.6	-0.2	2.6	1.6	2.7
Foreign G-7 Average weighted by 1991 GDP	1.7	0.2	0.6	2.8	1.7	2.3	1.8	0.6	1.9
Average weighted by share of U.S. nonagricultural exports									
Total foreign	3.3	2.2	3.4	5.0	1.8	4.1	3.9	0.3	2.1
Foreign G-7	0.8	0.5	1.9	3.6	1.3	2.3	2.8	1.7	2.2
Developing Countries	6.6	5.2	6.1	7.2	2.5	6.8	5.3	-2.2	1.8
CONSUMER PRICES									
Canada	4.1	1.8	1.8	-0.0	2.1	2.0	1.0	1.2	1.6
Japan	3.2	0.9	1.2	0.8	-0.8	0.1	2.1	-1.0	0.0
United Kingdom (3)	5.7	3.7	2.7	2.2	2.9	3.2	2.8	2.5	2.7
Euro-11 Average (4)	NA	NA	NA	NA	2.7	2.0	1.4	1.7	1.8
of which:									
France	3.0	1.8	2.1	1.6	1.9	1.7	1.2	1.3	1.5
Germany (2)	4.0	3.4	4.2	2.6	1.7	1.4	1.8	1.5	1.8
Italy	6.1	4.9	4.1	3.8	5.9	2.7	1.6	1.8	2.0
Foreign G-7 Average weighted by 1991 GDP	4.1	2.4	2.5	1.8	1.6	1.5	1.8	0.8	1.3
Average weighted by share of U.S. non-oil imports	3.9	1.9	2.0	1.0	1.1	1.3	1.7	0.5	1.1

1. Includes all of the European Union countries except the United Kingdom, Denmark, Sweden, and Greece; weighted by GDP.
2. West German data through 1991; all Germany thereafter.
3. CPI excluding mortgage interest payments which is the targeted inflation rate.
4. Harmonized CPI's for the Euro-11, weighted by shares in final consumption of households converted to a common currency using estimated PPP exchange rates.

Strictly Confidential (FR) August 13, 1998
Class II FOMC

OUTLOOK FOR FOREIGN REAL GDP AND CONSUMER PRICES: SELECTED COUNTRIES
(Percent, quarterly change at an annual rate)

							------------ Projected					
	1997				1998				1999			
Measure and country	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
REAL GDP												
Canada	4.8	4.2	4.3	2.8	3.7	2.8	2.6	3.0	2.8	2.8	2.7	2.7
Japan	8.3	-10.6	3.2	-1.5	-5.3	-5.1	-1.3	1.4	0.7	0.7	0.7	0.7
United Kingdom	2.3	3.5	3.6	2.5	2.2	2.0	1.7	1.8	1.8	1.8	1.9	2.0
Euro-11 Average (1)	1.5	5.0	3.3	2.2	2.6	2.0	3.0	2.6	2.7	2.8	2.8	2.8
of which:												
France	1.0	4.6	3.7	3.0	2.2	2.6	2.3	2.3	2.4	2.6	2.6	2.7
Germany	1.3	3.9	2.9	1.2	3.9	0.6	2.7	3.0	2.7	2.8	2.7	2.7
Italy	0.2	8.0	1.9	0.7	-0.4	1.5	4.0	1.5	2.5	2.5	3.0	3.0
Foreign G-7 Average weighted by 1991 GDP	3.7	-0.5	3.1	0.8	-0.3	-0.6	1.4	2.0	1.9	1.9	2.0	2.0
Average weighted by share of U.S. nonagricultural exports												
Total foreign	5.2	3.7	4.4	2.4	-0.5	0.2	0.5	1.1	1.6	2.1	2.4	2.5
Foreign G-7	4.5	1.1	3.8	1.7	1.5	0.9	1.8	2.5	2.2	2.2	2.2	2.2
Developing Countries	6.5	6.5	5.6	2.7	-4.3	-1.9	-1.6	-0.9	0.5	1.6	2.5	2.7
CONSUMER PRICES (2)												
Canada	2.1	1.6	1.7	1.0	1.0	1.0	1.1	1.2	1.3	1.4	1.5	1.6
Japan	0.0	1.5	1.7	2.1	2.1	0.6	0.0	-1.0	-1.0	-0.5	0.0	0.0
United Kingdom (3)	2.9	2.6	2.8	2.8	2.5	3.0	2.6	2.5	2.6	2.5	2.8	2.7
Euro-11 Average (4)	1.7	1.2	1.5	1.4	1.2	1.4	1.6	1.7	1.8	1.8	1.8	1.8
of which:												
France	1.5	0.9	1.3	1.2	0.7	1.0	1.3	1.3	1.4	1.5	1.5	1.5
Germany	1.7	1.6	1.9	1.8	1.2	1.3	1.4	1.5	1.7	1.8	1.8	1.8
Italy	2.4	1.6	1.5	1.6	1.7	1.8	1.8	1.8	2.0	2.0	2.0	2.0
Foreign G-7 Average weighted by 1991 GDP	1.4	1.6	1.8	1.8	1.6	1.3	1.1	0.8	0.9	1.1	1.3	1.3
Average weighted by share of U.S. non-oil imports	1.3	1.6	1.8	1.7	1.6	1.1	0.8	0.5	0.6	0.8	1.1	1.1

1. Includes all of the European Union countries except the United Kingdom, Denmark, Sweden, and Greece; weighted by GDP.
2. Percent change from same period a year earlier.
3. CPI excluding mortgage interest payments which is the targeted inflation rate.
4. Harmonized CPI's for the Euro-11, weighted by shares in final consumption of households converted to a common currency using estimated PPP exchange rates.

Strictly Confidential (FR)
Class II FOMC

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OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1991	1992	1993	1994	1995	1996	1997	Projected 1998	1999
NIPA REAL EXPORTS and IMPORTS									
	Percentage point contribution to GDP growth, Q4/Q4								
Net Goods & Services	0.4	-0.4	-0.6	-0.4	0.5	-0.3	-0.6	-1.8	-0.5
Exports of G&S	0.8	0.4	0.5	1.0	1.1	1.2	1.1	-0.4	0.3
Imports of G&S	-0.4	-0.8	-1.1	-1.4	-0.7	-1.4	-1.7	-1.4	-0.8
	Percentage change, Q4/Q4								
Exports of G&S	8.6	4.1	4.6	10.0	10.5	10.3	9.6	-3.7	3.0
Services	7.1	-0.8	4.1	6.0	9.8	7.5	1.5	0.2	3.1
Agricultural Goods	10.1	10.6	-5.5	16.6	-4.3	4.8	2.8	-6.7	1.6
Computers	21.8	25.1	23.7	32.0	55.5	35.9	40.7	3.9	27.0
Semiconductors	41.8	64.8	32.9	66.9	79.6	46.2	21.0	-2.7	26.5
Other Goods 1/	7.0	2.3	3.6	7.0	5.8	8.0	11.6	-6.0	-0.2
Imports of G&S	4.1	7.4	10.2	12.3	5.6	11.8	14.0	10.7	6.5
Services	-2.6	1.4	3.2	1.4	6.1	5.5	12.4	4.2	1.5
Oil	8.2	12.1	10.0	-0.2	2.4	7.9	4.0	1.2	2.2
Computers	35.9	45.1	39.4	44.8	48.1	24.4	30.3	31.6	25.9
Semiconductors	55.3	42.0	34.2	54.5	92.4	57.6	32.7	-0.6	26.8
Other Goods 2/	2.5	5.4	9.4	12.2	-1.2	10.4	13.0	11.6	5.4
	Billions of chained 1992 dollars								
Net Goods & Services	-22.3	-29.5	-70.2	-104.6	-96.5	-111.2	-136.1	-261.1	-346.8
Exports of G&S	599.9	639.4	658.2	712.4	792.6	860.0	970.0	971.7	977.0
Imports of G&S	622.2	668.9	728.4	817.0	889.0	971.2	1106.1	1232.8	1323.8
	Billions of dollars								
US CURRENT ACCOUNT BALANCE	-4.4	-51.4	-86.1	-123.8	-115.3	-134.9	-155.2	-246.9	-330.4
Net Goods & Services (BOP)	-30.9	-38.7	-71.9	-100.9	-99.9	-108.6	-110.2	-183.6	-250.0
Exports of G&S (BOP)	581.2	617.3	643.2	703.8	795.6	850.8	937.6	917.7	919.8
Imports of G&S (BOP)	612.2	656.0	715.2	804.7	895.5	959.3	1047.8	1101.3	1169.8
Net Investment Income	21.5	22.5	23.9	16.5	19.3	14.2	-5.3	-22.1	-38.7
Direct, Net	55.6	51.6	55.7	51.8	63.0	66.2	63.7	55.0	50.2
Portfolio, Net	-34.1	-29.1	-31.7	-35.3	-43.7	-51.9	-69.1	-77.1	-88.9
Net Transfers	5.0	-35.2	-38.1	-39.4	-34.6	-40.6	-39.7	-41.2	-41.8

1. Merchandise exports excluding agricultural products, computers, and semiconductors.
2. Merchandise imports excluding oil, computers, and semiconductors.

Strictly Confidential (FR)
Class II FOMC

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OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1994				1995				1996			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-1.0	-0.3	-0.4	0.3	-0.2	-0.3	1.6	0.7	-1.1	-1.0	-1.4	2.4
Exports of G&S	-0.2	1.7	1.1	1.5	1.0	0.6	1.9	1.1	0.4	0.6	0.2	3.2
Imports of G&S	-0.8	-2.0	-1.5	-1.2	-1.2	-0.9	-0.3	-0.4	-1.5	-1.6	-1.6	-0.9
Percentage change from previous period, SAAR												
Exports of G&S	-1.8	17.7	10.6	14.7	9.2	5.4	17.8	10.2	3.7	5.8	2.1	32.0
Services	2.4	12.9	2.0	6.9	9.1	2.9	21.7	6.4	-4.0	10.3	-9.9	39.8
Agricultural Goods	-25.2	8.1	45.3	57.2	1.8	-13.4	5.0	-9.4	22.6	-32.8	-1.6	48.7
Computers	21.4	24.3	35.5	48.4	36.4	33.8	86.6	71.6	57.6	24.7	27.7	35.9
Semiconductors	111.8	23.4	65.9	79.1	72.0	100.8	96.2	53.6	23.8	29.7	30.2	118.6
Other Goods 1/	-6.8	20.3	7.5	8.7	4.3	1.4	9.4	8.1	0.1	6.0	5.7	21.3
Imports of G&S	7.6	19.0	13.1	9.9	9.8	7.2	2.0	3.5	13.1	13.5	13.6	7.0
Services	2.7	4.1	-0.4	-0.9	20.5	-3.3	3.1	5.5	9.2	4.3	9.9	-1.1
Oil	-8.6	27.2	33.5	-36.2	-11.4	15.4	31.4	-18.2	-9.8	68.9	3.5	-14.0
Computers	32.9	48.3	42.3	57.0	15.4	51.6	62.7	69.3	22.5	22.9	18.8	33.8
Semiconductors	60.7	23.7	74.4	64.3	37.1	105.5	128.2	113.3	38.7	8.9	50.1	172.1
Other Goods 2/	6.8	19.6	10.3	12.6	7.2	1.5	-8.8	-3.8	13.9	10.5	13.5	4.2
Billions of chained 1992 dollars, SAAR												
Net Goods & Services	-97.6	-103.9	-111.1	-105.9	-109.5	-114.7	-86.8	-74.8	-95.5	-113.5	-140.1	-95.9
Exports of G&S	676.0	704.1	722.1	747.3	763.9	774.0	806.3	826.1	833.6	845.5	849.9	911.1
Imports of G&S	773.6	808.0	833.2	853.2	873.4	888.7	893.1	900.9	929.1	958.9	990.0	1007.0
Billions of dollars, SAAR												
US CURRENT ACCOUNT BALANCE	-97.3	-118.5	-135.9	-143.7	-123.7	-134.2	-115.5	-87.7	-112.9	-132.0	-161.6	-133.2
Net Goods & Services (BOP)	-85.9	-97.3	-111.2	-109.2	-109.3	-125.8	-90.0	-74.5	-92.4	-112.8	-132.3	-96.8
Exports of G&S (BOP)	668.0	693.1	714.3	739.9	765.4	782.0	809.7	825.6	833.6	845.3	837.5	886.7
Imports of G&S (BOP)	753.9	790.5	825.5	849.1	874.7	907.7	899.7	900.1	926.0	958.2	969.8	983.5
Net Investment Income	20.8	16.3	14.6	14.2	20.1	24.0	10.2	22.7	21.4	15.9	6.9	12.7
Direct, Net	52.3	49.5	52.2	53.2	59.9	67.2	56.5	68.3	64.8	64.4	61.9	73.6
Portfolio, Net	-31.5	-33.1	-37.5	-39.0	-39.8	-43.2	-46.2	-45.5	-43.3	-48.5	-55.0	-60.9
Net Transfers	-32.1	-37.5	-39.2	-48.7	-34.5	-32.4	-35.8	-35.9	-41.9	-35.1	-36.2	-49.1

1. Merchandise exports excluding agricultural products, computers, and semiconductors.
2. Merchandise imports excluding oil, computers, and semiconductors.

Strictly Confidential (FR)
Class II FOMC

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OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1997				Projected 1998				1999			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-1.3	-0.4	-0.5	-0.3	-2.3	-2.6	-1.1	-1.1	-0.8	-0.7	-0.4	-0.2
Exports of G&S	0.9	1.7	1.2	0.5	-0.3	-1.1	-0.3	-0.1	0.1	0.3	0.4	0.5
Imports of G&S	-2.2	-2.2	-1.7	-0.8	-1.9	-1.5	-0.9	-1.0	-0.9	-1.0	-0.8	-0.7
Percentage change from previous period, SAAR												
Exports of G&S	8.3	15.5	10.6	4.4	-2.8	-8.9	-2.3	-0.5	1.2	2.7	3.8	4.4
Services	-6.7	11.8	5.9	-4.0	-1.2	3.1	-1.1	0.1	1.2	3.2	4.1	3.8
Agricultural Goods	-16.1	-7.8	8.7	32.8	-9.9	-25.7	11.5	1.6	1.6	1.6	1.6	1.6
Computers	70.2	78.7	41.9	-9.2	-15.5	2.6	10.4	21.5	26.2	26.7	27.2	27.7
Semiconductors	41.3	17.3	32.3	-2.2	-2.0	-22.6	-2.0	20.4	24.4	25.8	27.2	28.6
Other Goods 1/	13.8	15.6	9.2	8.0	-1.6	-12.7	-5.1	-4.0	-2.2	-0.8	0.5	1.6
Imports of G&S	18.6	17.9	13.5	6.3	15.7	12.1	6.9	8.2	6.9	7.6	6.4	5.0
Services	17.8	10.6	15.8	5.8	9.3	0.4	3.5	3.7	1.7	0.9	1.3	2.2
Oil	-8.2	37.0	6.0	-12.2	8.8	41.1	-15.9	-18.7	-9.5	36.0	9.2	-18.9
Computers	54.5	39.0	30.6	2.9	38.8	31.7	28.6	27.4	27.4	27.4	25.1	23.9
Semiconductors	89.0	16.0	20.3	17.6	9.9	-26.8	-0.0	21.6	25.1	26.2	27.4	28.6
Other Goods 2/	16.2	16.1	11.8	8.1	16.1	13.8	7.9	9.0	6.8	5.1	4.9	4.9
Billions of chained 1992 dollars, SAAR												
Net Goods & Services	-121.5	- 31.6	-142.4	-149.0	-198.5	-255.9	-281.9	-307.9	-326.4	-344.1	-355.5	-361.1
Exports of G&S	929.4	63.6	988.1	998.8	991.9	969.2	963.6	962.3	965.0	971.4	980.4	991.1
Imports of G&S	1050.9	1 95.2	1130.5	1147.8	1190.4	1225.0	1245.5	1270.2	1291.5	1315.5	1335.9	1352.2
Billions of dollars, SAAR												
US CURRENT ACCOUNT BALANCE	-148.0	-140.4	-152.4	-180.2	-188.8	-242.0	-262.7	-294.0	-304.6	-324.6	-337.8	-354.7
Net Goods & Services (BOP)	-112.5	-106.1	-108.4	-113.8	-139.4	-184.1	-196.4	-214.5	-232.3	-248.5	-257.6	-261.7
Exports of G&S (BOP)	904.7	936.1	951.7	957.8	945.6	917.8	905.0	902.4	906.8	914.0	923.7	934.8
Imports of G&S (BOP)	1017.3	1042.1	1060.1	1071.7	1085.1	1101.8	1101.4	1116.8	1139.1	1162.5	1181.3	1196.5
Net Investment Income	0.1	1.8	-6.2	-17.0	-12.5	-18.9	-27.3	-29.6	-33.4	-37.1	-41.2	-43.0
Direct, Net	64.2	69.6	65.5	55.6	61.7	56.7	50.8	50.8	49.0	49.3	49.9	52.6
Portfolio, Net	-64.2	-67.8	-71.7	-72.6	-74.2	-75.6	-78.1	-80.4	-82.4	-86.4	-91.0	-95.6
Net Transfers	-35.5	-36.1	-37.8	-49.3	-36.9	-39.0	-39.0	-50.0	-39.0	-39.0	-39.0	-50.0

1. Merchandise exports excluding agricultural products, computers, and semiconductors.
2. Merchandise imports excluding oil, computers, and semiconductors.