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## **Part 1**

November 12, 1998

# **CURRENT ECONOMIC AND FINANCIAL CONDITIONS**

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## **Summary and Outlook**

Strictly Confidential (FR) Class II FOMC

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November 12, 1998

## **SUMMARY AND OUTLOOK**

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

## Domestic Developments

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### Overview

The last Greenbook described a turbulent financial environment that raised some significant questions about the prospects for sustained economic expansion. Our forecast anticipated that, even with a near-term Fed easing, things might get worse in financial markets before they got better--especially in the case of equities. Consequently, we predicted that real GDP growth would slow to a very meager pace in early 1999 and remain subpar into 2000.

Things not only got worse in the latter part of September and early October, they got downright horrible in some respects, with fear increasingly dominating greed in many financial sectors. The quarter-point cut in the federal funds target announced on the day of the FOMC meeting proved a weak palliative for the markets' concerns, with the craving for safety and liquidity becoming, if anything, more intense for a time. However, the second quarter-point trimming of the funds rate, announced along with an equal cut in the discount rate on October 15, came sooner than expected by the market and proved a powerful elixir. Convinced that the Fed meant to do whatever it might take to buoy the economy, participants in the stock market turned an incipient upturn into a roaring rally that has brought the major indexes most of the way back toward their earlier highs. With confidence bolstered as well by signs that the world community is mobilizing to support the Brazilian economy, many--but not all--segments of the capital markets have begun to reopen for new issuance business, and risk spreads have narrowed to some degree.

Meanwhile, the incoming data on the real economy have been mixed. Third-quarter GDP growth was stronger than we estimated in September; on the other hand, that upside surprise was largely in inventory investment, and indications of softening labor demand and an increasingly negative tone to the news from the manufacturing sector seem to point to an economy in transition to a lower growth path. We now are predicting that real GDP growth in the fourth quarter will be somewhere around 2 percent, and we continue to foresee a further notching down of growth in early 1999. However, the projected pace of expansion next year is a little higher than in the last forecast, owing mainly to three, partly interrelated, considerations that suggest a somewhat more positive trajectory for aggregate demand: the more aggressive easing of monetary conditions, the resurgence of share prices, and a sharper depreciation of the dollar than we anticipated in the last Greenbook. Real GDP is now projected to

grow a little more than 1-1/2 percent over the course of 1999, a few tenths more than last time, and then 2-1/4 percent in 2000.

The upward revision to the GDP path implies that the unemployment rate will rise less; now, we do not have it breaching the 5 percent mark until the end of 1999. That fact, along with an earlier and more substantial depreciation of the dollar, might suggest that the inflation outlook would be less favorable. However, those factors have been largely offset in our updated projection by a reassessment of the outlook for wages and by another trimming of energy prices. Thus, we are still predicting that overall CPI increases will barely exceed 2 percent in the next two years, damped a couple of tenths by the adoption of "geo-means" for calculating the index starting in January.

### **Key Background Factors**

The easing of monetary policy has occurred faster than we anticipated in the last Greenbook, and we have extrapolated that tendency in a small way by assuming that the last leg of the assumed moderate easing process also will occur fairly soon. In the longer-term markets, we are expecting that Treasury yields will remain somewhere in the vicinity of the current levels, but that private rates will drift down, narrowing the unusually wide spreads over Treasuries still prevailing today. That said, a key element in our forecast of a notable deceleration in domestic spending is our view that the overall financial environment will restrain activity going forward, despite the decline in real short-term rates.

In the credit markets, banks have tightened their terms and standards further, especially for business and commercial real estate loans. And although we expect that some of the pressures affecting bank lending will ease in the coming months, we do not think it likely that availability and pricing will return soon to the *status quo ante*; banks that rely heavily on purchased money to fund on-balance-sheet lending or on the capital markets to resell loans will likely be inclined to maintain a tighter posture. In the bond markets, too, we would be surprised to see a quick return to the previous norms of liquidity and minuscule risk spreads. While high-rated firms have regained access to the primary market, lower-rated corporate bonds have only begun to resume selling and only for some select borrowers. We are anticipating that markets will serve a wider range of borrowers by early next year, averting what might otherwise be a serious constraint on capital expenditures.

We also expect that the public equity markets will reopen more fully before long, both to seasoned issuers and to IPOs. But our forecast suggests that some

reverses are ahead for equity investors. Although our assumed funds rate path is not at odds with the prevailing expectation, our projection of corporate earnings is: We see profits falling in 1999, whereas most Wall Street strategists and securities analysts still are talking about moderate to huge increases in earnings per share. Consequently, we anticipate that there will be a partial retracing of the recent rally and that the major indexes will average appreciably below the current levels in both 1999 and 2000. The stock price path is higher than in the last Greenbook, but it still implies an appreciable decline in the ratio of household wealth to income. Once again, we would suggest that the historically high price-earnings ratios in our forecast represent a downside risk to share prices and the outlook for demand; however, a more immediate risk is perhaps that the momentum of the current rally will carry equity values well above the levels embedded in this GDP projection.

In the external sector, recent developments have had opposing but, on balance, positive effects on the prospects for U.S. activity. The dollar has fallen since the last FOMC meeting, most markedly against the yen. As measured by the real broad index of 35 currencies, the value of the dollar is expected to average almost 3-1/2 percent less in the current quarter than anticipated in the last Greenbook. The index is expected to edge down only slightly further over the next two years. This revision implies a more favorable competitive position for U.S. producers, although the effects on our trade balance are lessened by some negative news on foreign economic activity. Japan looks to be even weaker than we had thought, and the outlook for European growth appears a bit less positive as well. The announcement of an impending support package for Brazil is assumed to head off some of the scarier outcomes for that country, but the accompanying shift to fiscal restraint there is projected to result in a significant downturn in economic activity through 1999. All told, foreign real GDP now is projected to rise about 1-1/2 percent in 1999 and 2-1/4 percent in 2000--somewhat less than forecast in September.

Crude oil prices have been revised down slightly in the current quarter, and the spot price of West Texas intermediate now is projected to average about \$14 per barrel. However, the price still is projected to firm to \$16 per barrel in 1999 and to \$16.50 in 2000, reflecting moderate restraint on production and some recovery in world economic activity.

We have modified our fiscal assumptions to reflect the recently passed budget--which contained some surprises for us. As part of the compromise between the Administration and the Congress, \$14 billion in additional spending was approved for fiscal 1999--split about equally between agricultural subsidies and other spending--and

\$5 billion for fiscal 2000. The classification of the additional spending as “emergency” funding allows the level of outlays to exceed the caps on discretionary spending, and we are assuming that small amounts of additional emergency spending will be enacted over the forecast period. As a result, the stance of fiscal policy has eased slightly relative to the September Greenbook, though it can still be characterized as essentially neutral.

### **Recent Developments and the Outlook for the Current Quarter**

Based on data received since BEA’s advance release, we estimate that real GDP increased at a 3.6 percent annual rate in the third quarter--a percentage point faster than forecast in the September Greenbook. A larger accumulation of nonfarm inventories accounted for the bulk of our revision.

Our forecast of 2.1 percent growth in real GDP in the fourth quarter is weaker than last time, based in part on the modest net increase in hours worked in September and October revealed in the latest labor market report. We expect the post-strike upturn in motor vehicle production to boost growth by around 1 percentage point in the current quarter, and real final sales (excluding motor vehicles) are projected to grow briskly. Growth is held down, in our forecast, however, by a sharp cutback in the pace of non-auto, nonfarm inventory investment.

Real personal consumption expenditures continued to rise rapidly in the third quarter--albeit at well below the breakneck speed of the first half of the year--and we are projecting another hefty advance this quarter. PCE rose 0.6 percent in real terms in September, and light vehicle sales surged in October, responding to the favorable pricing produced by the automakers’ competition for market share. Income gains have been moderate on average in recent months, and the personal saving rate has continued to trend downward (turning negative, to some fanfare, in September). Although the recent deterioration in consumer sentiment indexes might raise some doubts about demand prospects in the near term, we expect that the mortgage refinancing wave and the resurgence of the stock market will buttress both confidence and purchasing power--and that spending will hold up well during the holiday shopping season.

Activity in the housing market slowed a bit over the third quarter. After surging in July, single-family housing starts slipped back to 1.25 million units at an annual rate in August and September; a similar pattern also was evident in the sales of new and existing homes. However, indicators of the demand for homes perked up in October, after interest rates plummeted, and though mortgage rates have firmed of late,

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

Measure	1998:Q3		1998:Q4	
	Sept.	Oct.	Sept.	Oct.
	GB	GB	GB	GB
<b>Real GDP</b>	2.6	3.6	2.6	2.1
Private domestic final purchases	3.4	3.6	4.9	4.3
Personal consumption	3.5	3.9	3.4	3.8
Residential investment	10.9	7.7	5.3	5.1
Business fixed investment	.3	-.5	14.2	7.3
Government outlays for consumption and investment	2.1	1.6	1.5	4.2
	Change, billions of chained (1992) dollars			
Inventory investment	6.7	27.2	-7.9	-25.2
Net exports	-20.7	-20.8	-30.2	-21.0

we are expecting starts in the current quarter to be well maintained. In the multifamily segment, starts retreated from an unsustainably high July level, but to a level still above the average of the second quarter. Given the lags from starts to construction outlays, we are projecting that real residential investment will rise further this quarter, though at a shade slower annualized pace of about 5 percent.

After a lull this summer, real business fixed investment appears to be poised for a considerable rebound in the current quarter. Orders for nondefense capital goods (excluding aircraft) moved up sharply in August and September; long-lead-time turbines reportedly accounted for a good portion of the strength, but other categories of equipment showed significant gains as well. Although shipments of commercial aircraft to domestic airlines are slated to decline in the current quarter, sales of heavy trucks have continued to boom, and business purchases of light vehicles appear to be rebounding from the strike-depressed level of the third quarter. On balance, real PDE is projected to rise at an annual rate of 12 percent--a gain that should far offset a further decline in investment in nonresidential structures.

A faster pace of government spending is expected to add to growth in the fourth quarter. Real federal purchases are forecast to bounce back at an annual rate of 6 percent in the fourth quarter, after a 1-1/2 percent decline in the third quarter that largely reflected the sale of the United States Enrichment Corporation. In addition, the



faster pace of spending growth in the fourth quarter reflects the front-loaded nature of the recent budget deal. In the state and local sector, real purchases are projected to rise at a 3-1/4 percent annual rate in the current quarter--paced by further substantial gains in construction spending.

Net exports may decline at about the same pace as in the third quarter. Exports are still trending downward, outside the computer/semiconductor segment, as activity in Asia and Latin America continues to sag. Import growth was surprisingly moderate last quarter; with the end of the auto strike, shipments of autos from Canada are rebounding, and the influx of goods from the other side of the Pacific is growing.

Data on inventory investment beyond September are sparse at this time. Given our sales and production projections, inventories of motor vehicles appear unlikely to rise much this quarter, keeping dealer stocks fairly lean at year-end. Outside the motor vehicle sector, however, we are projecting a sizable step-down in the rate of stock accumulation--enough to trim around 1-1/2 percentage points from GDP growth, even though the predicted pace of accumulation (amounting to 2-1/2 percent at an annual rate) would probably leave some businesses with more on hand than they would like (steel vendors being a prominent example).

Recent readings on wage and price trends have been distinctly mixed. On the wage side, the ECI for wages and for total compensation surged in the third quarter, paced by a run-up in finance, insurance, and real estate (FIRE) sector (when sliced by industry), and by sales workers (when diced by occupation). However, the last two months have seen relatively modest increments to average hourly earnings, which have reduced the twelve-month change in that series to the lowest level in a couple of years. On balance, although the tightness of the labor market suggests an ongoing pressure on real wages, we are expecting the rate of compensation inflation to drop back substantially this quarter and next, with a topping out in FIRE commissions and bonuses playing a big part.

Declining energy prices held down the overall CPI in September and brought the twelve-month change down to 1.5 percent; the pattern for the core index was less favorable, with another increase of a couple of tenths holding the year-on-year change at a relatively elevated 2.5 percent. In contrast, core PCE prices were even more subdued in the third quarter than we had expected, producing a stable and considerably lower trend of inflation in that measure. We are projecting that the core CPI will rise just under 0.2 percent per month during the fourth quarter, bringing the increase for the year down to 2.4 percent, while the total CPI rises 1.5 percent.

### The Outlook for the Economy in 1999 and 2000

As noted earlier, our forecast for economic activity over the next two years has been raised slightly from the September Greenbook. Nonetheless, the story remains qualitatively the same. Although the drag from the international sector, as measured by changes in real net exports, is expected to diminish from what we have experienced over the past several quarters, this influence is more than offset by a loss of strength in domestic demand. In the business sector, a simple accelerator model--taking account of the stability of GDP growth over the past few years and the rapid buildup of capacity, especially in manufacturing--would point to a moderation of the demand for plant and equipment. But, in addition, despite the recent and prospective decline

#### Summary of Staff Projections

(Percent change, compound annual rate)

Measure	1998:H2	1999:H1	1999:H2	2000
<b>Real GDP</b>	<b>2.9</b>	<b>1.4</b>	<b>1.7</b>	<b>2.3</b>
Previous	2.6	.9	1.6	2.4
Final sales	2.8	1.7	1.7	2.1
Previous	2.7	1.2	1.6	2.2
PCE	3.8	2.7	2.2	2.4
Previous	3.4	2.5	2.2	2.4
Residential investment	6.4	-1.6	-1.8	.4
Previous	8.0	-6.1	-1.5	1.4
BFI	3.3	4.6	2.8	5.4
Previous	7.0	4.3	3.0	5.4
Government purchases	2.8	1.0	1.5	1.4
Previous	1.8	1.0	1.3	1.5
Exports	-1.9	1.5	3.2	4.7
Previous	-2.3	.1	2.6	4.7
Imports	5.4	6.9	5.4	6.5
Previous	6.6	6.8	5.3	6.6
	Change, billions of chained (1992) dollars			
Inventory change	2.0	-13.5	2.9	10.7
Previous	-1.2	-14.9	.3	14.8
Net exports	-41.7	-35.1	-19.0	-39.8
Previous	-50.9	-41.9	-21.7	-41.7

in short-term rates, the financial circumstances confronting many firms--including both weaker profits and less receptive debt and equity markets--are less favorable to an expansion of investment than was the case earlier. And the outlook for household expenditure has something in common with that for business fixed investment, with purchases of homes and consumer durables having run at high levels for a while now and with the stock market projected no longer to add to wealth.

The story regarding our inflation forecast also is basically unchanged. We have altered a few components of the picture, but the bottom line is still that overall inflation is likely to rise somewhat over the next year in light of the persistence of tight labor markets and the effects of a firming of world oil prices.

**Consumer spending.** One of the critical elements in our forecast of a slowing of economic expansion in 1999 is a moderation in the growth of consumption. In our view, the extraordinary strength in real PCE in recent years reflects the run-up in stock prices. A mere stabilization of the stock market at its high point would have implied a gradual shrinkage in the wealth-income ratio and a damping effect on spending. With our anticipation that the market will give some ground as earnings reports prove disappointing early next year, the wealth effect should go into reverse even faster. In fact, were it not for the offsetting consideration that spending patterns and perceptions of permanent income will exhibit some inertia in the face of the weakening of asset values and current income, we would project a greater drop-off in consumer demand--and an increase in the saving rate--over the projection period.

After increasing 5 percent in 1998, real PCE is projected to rise at half that pace in 1999 and 2000. Although growth in spending on electronic equipment should continue to rise as new products appear and relative prices keep falling at a fast clip, light vehicle sales are forecast to fall from the 15.3 million units currently expected for 1998 to an average of just over 14-1/2 million units in 1999 and 2000. We also are projecting a fairly substantial moderation in the growth of consumer nondurables and services, where demand in some categories clearly has been boosted enormously by the accretion of capital gains in the past couple of years.

**Housing.** Residential construction activity should slacken over next few quarters, as employment growth slows and households begin to feel less flush. After totaling 1.25 million units in 1998, single-family housing starts are projected to ease to 1.22 million units in 1999 and to 1.20 million units in 2000. This level of activity would still be high, exceeding that of every recent year save the current one. But this seems reasonable to us, given the extraordinarily good conditions of affordability at sub-7 percent interest rates on conventional 30-year fixed-rate mortgages. (We are

anticipating a narrowing of the recent relatively wide spreads between home mortgage rates and relevant Treasury yields.)

Financing conditions are a bit murkier issue with respect to the multifamily segment of the housing market. The anecdotal evidence to date suggests that the financing of apartment investments has not been greatly affected by the recent turmoil; among other things, the residential sector benefits from the participation of the sponsored agencies. In all likelihood, however, a generally more cautious attitude on the part of lenders will put something of a damper on the more adventurous building projects. Multifamily starts are projected to average better than 300,000 units per year in 1999 and 2000, compared with about 340,000 units in 1998.

**Business fixed investment.** After a double-digit increase in 1998, real business fixed investment is projected to decelerate sharply to 3-3/4 percent in 1999 but to pick up to a pace of 5-1/2 percent in 2000. Capacity growth has been brisk in recent years, particularly in manufacturing, and we do not think firms will want to continue to expand so quickly in an environment of weaker economic growth and declining profitability. The availability of external finance also should be less favorable than earlier this year, as banks and capital market investors remain more cautious.

The lion's share of the deceleration in capital spending is expected to occur in producers' durable equipment. Business purchases of motor vehicles are projected to decline in 1999 as fleet sales ebb, the growth in consumer leases slows, and the market for heavy trucks sours somewhat. The volume of spending on commercial aircraft also should decline next year, as Boeing production schedules show a shift toward smaller (and less expensive) planes. Outside transportation equipment, growth in outlays is expected to slow in 1999, after very large gains this year. Business purchases of computers probably will remain robust through the first half of next year, as replacement needs associated with Y2K preparations buoy demand; growth in computer purchases is expected to tail off later in 1999 as businesses suspend major upgrades of their systems immediately before the millennium. Industry restructuring and ongoing technological developments should help to sustain the rate of increase in communications equipment, but we look for very little growth in the more "traditional" types of capital equipment in 1999 and 2000.

After declining 4 percent in 1998, real investment in nonresidential structures is projected to fall somewhat further next year and to be little changed in 2000. Industrial construction should continue to fall, with manufacturers' expansion needs lessened by the weaker economic environment. Construction of commercial structures

also is expected to decline, owing in part to scarcer financing for riskier projects. The low level of crude oil prices already has prompted cutbacks in drilling activity, and we expect this trend to continue into 1999. In contrast, the need for additional generating capacity is expected to stimulate some spending by public utilities; and in the office sector, projects already under way will provide some momentum for spending while low vacancy rates in some locales should support a considerable number of new starts even in a tighter financing environment.

**Business inventories.** Although inventories in some sectors clearly have piled up to uncomfortable levels, on the whole the economy does not appear to be afflicted with a significant inventory overhang. Nonetheless, maintenance of the rapid third-quarter pace of accumulation outside the motor vehicle industry would not be compatible with the slower pace of sales growth we see going forward, and we expect that businesses will respond quickly to signs of any emerging misalignment. As noted earlier, we are projecting a marked slowing in non-auto inventory investment this quarter, and we expect that there will be a significant further step-down in early 1999. This process reverses in 2000, as firms see demand growth picking up and move to expand inventories more quickly to maintain adequate ratios of stocks to sales.

The one wrinkle in this otherwise simple story is our allowance for the likelihood that many firms will wish to have some extra stocks on hand at the end of 1999, as a hedge against supply disruptions that could be precipitated by Y2K glitches. We have incorporated a zig-zag in inventory investment in late 1999 and early 2000 in recognition of the phenomenon, but without much conviction about the magnitude. We hope to gather some additional information in the coming weeks about firms' plans, but we suspect that the Y2K-related inventory build is something we are going to have difficulty pinning down in advance and that we shall end up having to interpret as it actually develops.

Farm inventory investment has been substantial this year as the result of reduced foreign demand for U.S. agricultural products and favorable weather conditions in the major crop-producing regions of the country. Given the associated weakness of farm prices that has ensued, we think that farmers will be cutting back on acreage by at least a small amount in 1999, but with yields continuing to trend upward, those cutbacks are projected to bring only a flattening of farm output, rather than a decline. As a result, the rate of farm inventory accumulation slows only gradually from this year's elevated pace. Under the "Freedom to Farm" legislation of 1996, the government can no longer attempt to coordinate, as it once did, farm production adjustments through various types of acreage restrictions. However, some

efforts are being made to deal with the buildup of stocks through such channels as increased food aid, of which the November 6 agreement to provide commodity donations and loans to Russia is the most notable recent example.

**Government spending.** As noted above, the additional spending authorized by the budget deal is expected to occur quickly, with the bulk of the additional stimulus taking place in 1998. Thereafter, real federal purchases are expected to decline 1-1/2 percent in 1999--a bit slower than in the September Greenbook--and 1 percent in 2000, with the largest declines in defense spending. The unified budget surplus is projected to narrow from the \$70 billion level in fiscal 1998 to \$55 billion in fiscal 1999, but then to move back to \$73 billion in fiscal 2000.

The November elections did little to change the fundamental political landscape in the state and local sector. Despite further improvement in their finances, most states and localities have pursued relatively cautious spending programs, preferring to sock away their surpluses in rainy day funds and enact selective tax relief rather than committing to major new spending initiatives. We expect such caution to continue, particularly as revenue growth slows along with economic activity next year. As a result, the growth rate in real state and local purchases is projected to remain between 2-1/2 percent and 2-3/4 percent in 1999 and 2000.

**Net exports.** The outlook for real net exports is somewhat less negative in this projection. Exports have declined in each of the past three quarters and may slip a bit further in the near term, but we expect them to start a gradual acceleration during 1999 in response to more favorable exchange rate effects and improving foreign economic growth; after declining 3-1/2 percent this year, real exports are forecast to rise 2-1/4 percent next year and 4-3/4 percent in 2000. Increases in real imports should be damped by the slower pace of U.S. expansion but are still expected to run around 6 percent to 6-1/2 percent over the next two years. Taken together, these numbers point to a sizable further widening of the U.S. trade deficit, but at a less dramatic pace than we have witnessed this year: Real net exports are projected to subtract 1-1/2 percentage points from GDP growth in 1998, 1/2 percentage point in 1999, and 1/3 percentage point in 2000. (A fuller discussion of the forecast for net exports is contained in the *International Developments* section.)

**Labor markets.** The unemployment rate still is projected to increase over the next two years, as the economy expands at less than its potential pace. We now expect the unemployment rate to average just over 4-1/2 percent in the current quarter but to move up to 5 percent by the end of next year and to 5-1/4 percent in the second half of 2000.

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

Measure	1997	1998	1999	2000
Output per hour, nonfarm business	1.7	1.7	1.0	2.0
Previous	1.7	1.5	1.0	2.0
Nonfarm payroll employment	2.7	2.2	.8	.9
Previous	2.7	2.3	.7	.9
Household employment survey	2.1	1.0	.5	.6
Previous	2.1	.9	.3	.6
Labor force participation rate <sup>1</sup>	67.1	67.0	66.9	66.8
Previous	67.1	66.9	66.8	66.8
Civilian unemployment rate <sup>1</sup>	4.7	4.6	5.0	5.3
Previous	4.7	4.5	5.2	5.4

1. Percent, average for the fourth quarter.

We expect that employers will move fairly quickly to reduce the pace of hiring as output growth slows. Indeed, there already has been a perceptible pickup in the number of companies announcing plans to lay off or fire workers, especially in the troubled manufacturing and financial sectors. In our forecast, payroll employment gains average 130,000 per month in the current quarter--well below the 230,000 pace in the first nine months of 1998; job gains are projected to average only 90,000 per month in 1999 and 100,000 in 2000.

We now expect output per hour in the nonfarm business sector to rise 1-3/4 percent this year--1/4 percentage point more than in the last Greenbook, reflecting the upside surprise in the third quarter. Labor productivity is projected to record a below-trend increase of 1 percent in 1999 as the economy decelerates sharply, but to rise 2 percent in 2000--a pickup that is exaggerated to a degree by the removal of the drag on efficiency from Y2K work. As in previous forecasts, our projection has incorporated an assumption that efforts to address Y2K problems are subtracting one- or two-tenths of a percentage point from productivity increases this year and next.

**Wages and prices.** Despite the third-quarter's upside surprise and the lesser rise now projected for the unemployment rate, the ECI is projected to decelerate to a 3.1 percent pace in 1999 and 2000. Several considerations underlie this forecast.

First, a dissection of the acceleration of ECI compensation over the past year reveals the important role played by sales commissions and nonproduction bonuses (especially in the FIRE sector); these components of pay are likely to be quite flexible to the downside as well, when activity moderates, as we expect it will. Second, the recent

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

Measure	1997	1998	1999	2000
Consumer price index	1.9	1.5	2.2	2.1
Previous	1.9	1.6	2.1	2.0
Food	1.7	2.0	1.4	1.7
Previous	1.7	1.8	1.3	1.5
Energy	-1.0	-8.6	3.7	1.4
Previous	-1.0	-8.0	4.1	1.6
Excluding food and energy	2.2	2.4	2.2	2.2
Previous	2.2	2.3	2.1	2.1
PCE chain-weighted price index	1.5	.8	1.6	1.6
Previous	1.5	.9	1.6	1.5
Excluding food and energy	1.6	1.2	1.6	1.6
Previous	1.6	1.3	1.5	1.5
GDP chain-weighted price index	1.7	.9	1.5	1.6
Previous	1.7	1.0	1.5	1.5
ECI for compensation of private industry workers <sup>1</sup>	3.4	3.5	3.1	3.1
Previous	3.4	3.4	3.2	2.9
Prices of core non-oil merchandise imports	-7	-2.2	1.1	1.2
Previous	-7	-2.7	.6	1.4
Percentage points				
<i>MEMO: Adjustments for technical   changes to the CPI<sup>2</sup></i>				
Core CPI	.2	.4	.6	.6

1. December to December.

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



slowing in the advance of average hourly earnings--even with due allowance for the statistical limitations of the series--provides at least some counterweight to the bad ECI news. And, finally, the recent low rates of price inflation should be pulling down nominal pay increases even in the face of continued low unemployment; indeed, our forecast remains above the projections of our "wage-price" models, which reflect this influence.<sup>1</sup>

After increasing 1.5 percent in 1998, the CPI is forecast to rise 2.2 percent in 1999 and 2.1 percent in 2000. Comparable accelerations are predicted for the GDP and PCE chain price indexes.

The outlook for consumer food prices continues to be one of moderate increases. Although we have nudged up our 1998 food price forecast by a couple of tenths, the 2 percent rise we are projecting for the year still would leave food price inflation on the low side of CPI core inflation, a pattern that has held in seven of the last eight years. Moreover, we do not foresee that relationship changing in either 1999 or 2000. Although meat prices seem likely to pick up, prices in some other food categories--such as dairy products and fresh produce--should be more favorable to consumers than they have been this past year. As in the past two years, we have not built into the food price forecast any special assumptions about potential threats from the El Niño-La Niña weather cycle in the Pacific. The markets seem to concur with this judgment, as there is little evidence of unusual risk premiums in the prices of futures contracts, some of which now go to the end of the year 2000.

After declining over 1998, CPI energy prices are projected to firm again over the forecast period. The pickup reflects higher prices for refined petroleum products as a result of the expected increases in crude oil prices. These increases are tempered, however, by a modest rise in natural gas prices and falling charges for electricity. We have enlarged the magnitude of the effect built into the forecast for deregulation of electricity markets; potential barriers to already approved deregulation in California and Massachusetts were removed in the November elections, and several additional states have recently announced rate cuts. On net, the CPI for energy is projected to increase 3.7 percent in 1999 and 1.4 percent in 2000, only partially offsetting a total decline of 9.6 percent over 1997 and 1998.

Core inflation (measured consistently) is projected to be essentially unchanged over the forecast period. Although the decline in the dollar and the accompanying

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1. We also have incorporated a relatively moderate, 50 cent increase in the federal minimum wage, but not until the latter part of 2000; this contributes just a tenth of a point to the ECI increase in that year.

pickup in the prices of competing imported goods will reduce the competition from foreign producers somewhat, falling utilization rates are likely to intensify pricing pressures from domestic competitors. On balance, we are projecting that the core CPI will rise 2.2 percent on a published basis in 1999 and 2000, after increasing 2.4 percent this year.

### **Money and Credit Flows**

Despite the recent turmoil in financial markets, domestic nonfinancial sector debt growth appears to have fallen off rather little in the second half of this year. Indeed, largely reflecting the surprisingly large gains in mortgage and consumer borrowing, we have revised upward our forecast of nonfinancial debt growth in 1998 to about 6 percent. Credit conditions for households evidently have been little affected by the stresses that have been manifest in the capital markets. Meanwhile, nonfinancial corporations have found capital markets to be somewhat more receptive of late, and bond issuance has picked up. We still see many business borrowers tending to favor bank lines, however--especially as year-end pressures make commercial paper relatively costly. Bank loan officers report that they have become somewhat more restrictive toward C&I and commercial real estate borrowers--more so toward the larger ones--but they do not appear to be precipitating a "crunch" in credit availability.

We are projecting that domestic debt growth will slow substantially--to 4-1/2 percent in 1999 and to 3-1/2 percent in 2000. This would raise the ratio of debt to nominal GDP further in 1999 but trim it slightly over the course of the following year. With federal debt continuing to run off at a pretty steady but modest clip, the deceleration of debt growth occurs in the other sectors--households, businesses, and state and local government.

The receptivity of investors to corporate debt issues is expected to improve further. However, risk premiums are likely to remain somewhat above the skimpy spreads of earlier this year, and some lower-rated firms, along with sponsors of commercial real estate projects, may still find it difficult to arrange market financing. The somewhat firmer terms and standards of bank lending to businesses of late are expected to remain in place, reflecting the soft picture for corporate earnings and the repricing of risk in financial markets. Businesses that are drawing heavily on outstanding bank lines this quarter are likely to face higher rates and fees as current lines are repriced. The corporate financing gap is forecast to widen over the next two years, despite sluggish capital spending, as corporate profits contract. The increased borrowing needs associated with the wider gap should be more than offset by a

slackening of share buybacks and merger-related transactions from the extraordinary pace of recent quarters. Equity retirements associated with such activities still are expected to be sizable, however.

The expansion of household debt, which has been brisk this year, is expected to moderate gradually in the quarters ahead. The demand for mortgage loans should diminish as home sales weaken and as the current wave of refinancings draws to a close. And a softening of demand for autos and other durables is likely to damp the demand for consumer credit. Developments on the supply side of the household credit market should curb borrowing only to a small degree. The residuum of the recent turbulence is unlikely to be significant in the case of standard first mortgages, but the subprime segment, which is relatively small, is expected to be restrained by lenders pulling back some in response to the less-hospitable market for asset-backed securities. Moreover, banks and other consumer lenders are likely to tighten their terms and standards only modestly as income growth slows and unemployment edges higher.

The debt of state and local governments is expected to grow at a slower pace over the next two years. Borrowing to finance capital spending is likely to remain rather strong for a while, but refunding activity should remain low, as opportunities for additional advance refundings are limited.

The growth rates of the broad monetary aggregates will probably exceed their ranges by several percentage points this year. However, we expect that the extraordinary boost to the aggregates from the recent heightened demand for safe and liquid assets, and from the temporary parking of investment balances in money funds, will unwind over time. With the projected slowing of nominal spending next year and the waning effects from monetary policy easings, we expect a sharp deceleration of M2, although the aggregate is likely to continue growing faster than nominal GDP. M3 should continue to expand faster than M2, but growth is likely to moderate substantially in 1999, in part because of a slowing in bank credit expansion. The velocities of the broad monetary aggregates are expected to continue to trend down through the year 2000, but at a diminishing rate.

### **Alternative Simulations**

Our alternative simulations present the implications of a more aggressive easing of monetary policy in the near term and of higher equity prices than in the baseline forecast. In the easier-money scenario, the federal funds rate is cut to 4 percent over the next several meetings and is held at that level from the second quarter of 1999 onward. Under these assumptions, real GDP growth is stronger by about

1/2 percentage point in 1999 and almost 1 percentage point in 2000. The unemployment rate edges up to just over 4-3/4 percent, and inflation is 1/2 percentage point higher by the end of the projection period.

In the higher stock market scenario, equity prices hold near current levels, rather than declining as in the baseline forecast. The federal funds path is the same as in the baseline forecast. The higher stock prices raise real GDP growth by about 1/2 percentage point in both 1999 and in 2000. The increase in the unemployment rate is somewhat less than in the baseline, and price inflation is slightly higher.

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

Measure	1998	1999	2000
<i>Real GDP</i>			
Baseline	3.3	1.6	2.3
Lower funds rate	3.3	2.0	3.2
Higher stock prices	3.3	2.0	2.8
<i>Civilian unemployment rate<sup>1</sup></i>			
Baseline	4.6	5.0	5.3
Lower funds rate	4.6	4.9	4.8
Higher stock prices	4.6	4.9	5.0
<i>CPI excluding food and energy</i>			
Baseline	2.4	2.2	2.2
Lower funds rate	2.4	2.3	2.7
Higher stock prices	2.4	2.2	2.3

1. Average for the fourth quarter.

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Class II FOMC

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

November 12, 1998

Interval	Nominal GDP		Real GDP		GDP chain-weighted price index		Consumer price index <sup>1</sup>		Unemployment rate <sup>2</sup>		
	09/23/98	11/12/98	09/23/98	11/12/98	09/23/98	11/12/98	09/23/98	11/12/98	09/23/98	11/12/98	
<b>ANNUAL</b>											
1996	5.4	5.4	3.4	3.4	1.9	1.9	3.0	3.0	5.4	5.4	
1997	5.9	5.9	3.9	3.9	1.9	1.9	2.3	2.3	4.9	4.9	
1998	4.6	4.7	3.5	3.6	1.1	1.0	1.6	1.6	4.5	4.5	
1999	3.0	3.2	1.6	1.9	1.4	1.3	2.1	2.1	4.9	4.8	
2000	3.4	3.5	1.9	1.9	1.5	1.6	2.0	2.1	5.4	5.2	
<b>QUARTERLY</b>											
1997	Q1	7.2	7.2	4.2	4.2	2.8	2.8	2.0	2.0	5.3	5.3
	Q2	5.6	5.6	4.0	4.0	1.7	1.7	1.5	1.5	4.9	4.9
	Q3	5.4	5.4	4.2	4.2	1.2	1.2	1.8	1.8	4.9	4.9
	Q4	4.2	4.2	3.0	3.0	1.1	1.1	2.3	2.3	4.7	4.7
1998	Q1	6.4	6.4	5.5	5.5	0.9	0.9	0.5	0.5	4.7	4.7
	Q2	2.7	2.7	1.9	1.8	0.8	0.9	2.0	2.0	4.4	4.4
	Q3	4.2	4.5	2.6	3.6	1.5	0.8	1.9	1.7	4.5	4.6
	Q4	3.6	3.2	2.6	2.1	1.0	1.1	1.9	1.8	4.5	4.6
1999	Q1	2.7	3.1	0.9	1.4	1.8	1.7	2.4	2.2	4.7	4.6
	Q2	2.3	2.8	0.9	1.4	1.4	1.3	2.1	2.3	4.8	4.7
	Q3	2.8	3.0	1.4	1.5	1.4	1.5	2.0	2.1	5.0	4.8
	Q4	3.3	3.4	1.9	1.9	1.4	1.4	2.0	2.1	5.2	5.0
2000	Q1	2.9	2.9	1.3	0.9	1.6	1.9	2.0	2.1	5.3	5.1
	Q2	4.3	4.4	2.9	2.9	1.4	1.5	2.0	2.1	5.4	5.2
	Q3	4.1	4.2	2.7	2.6	1.4	1.5	2.0	2.1	5.4	5.2
	Q4	4.2	4.3	2.7	2.7	1.5	1.5	2.0	2.1	5.4	5.3
<b>TWO-QUARTER<sup>3</sup></b>											
1997	Q2	6.4	6.4	4.1	4.1	2.2	2.2	1.8	1.8	-0.4	-0.4
	Q4	4.8	4.8	3.6	3.6	1.2	1.2	2.0	2.0	-0.2	-0.2
1998	Q2	4.5	4.6	3.7	3.7	0.8	0.9	1.2	1.2	-0.3	-0.3
	Q4	3.9	3.9	2.6	2.9	1.3	1.0	1.9	1.8	0.1	0.2
1999	Q2	2.5	2.9	0.9	1.4	1.6	1.5	2.2	2.2	0.3	0.1
	Q4	3.0	3.2	1.6	1.7	1.4	1.4	2.0	2.1	0.3	0.3
2000	Q2	3.6	3.6	2.1	1.9	1.5	1.7	2.0	2.1	0.2	0.2
	Q4	4.2	4.2	2.7	2.6	1.4	1.5	2.0	2.1	0.1	0.1
<b>FOUR-QUARTER<sup>4</sup></b>											
1996	Q4	5.8	5.8	3.9	3.9	1.8	1.8	3.2	3.2	-0.3	-0.3
1997	Q4	5.6	5.6	3.8	3.8	1.7	1.7	1.9	1.9	-0.6	-0.6
1998	Q4	4.2	4.2	3.2	3.3	1.0	0.9	1.6	1.5	-0.2	-0.1
1999	Q4	2.8	3.1	1.3	1.6	1.5	1.5	2.1	2.2	0.6	0.4
2000	Q4	3.9	3.9	2.4	2.3	1.5	1.6	2.0	2.1	0.3	0.3

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

November 12, 1998

Item	Units <sup>1</sup>	- - - Projected - - -								
		1992	1993	1994	1995	1996	1997	1998	1999	2000
<b>EXPENDITURES</b>										
Nominal GDP	Bill. \$	6244.4	6558.1	6947.0	7269.6	7661.6	8110.9	8490.1	8762.9	9070.8
Real GDP	Bill. Ch. \$	6244.4	6389.6	6610.7	6761.7	6994.8	7269.8	7533.5	7674.9	7820.6
Real GDP	% change	3.6	2.4	3.3	2.1	3.9	3.8	3.3	1.6	2.3
Gross domestic purchases		4.0	3.0	3.6	1.6	4.2	4.4	4.8	2.1	2.6
Final sales		3.9	2.1	2.7	2.7	3.7	3.4	3.7	1.7	2.1
Priv. dom. final purchases		4.9	3.7	3.7	2.9	4.4	4.5	5.9	2.4	2.7
Personal cons. expenditures		4.2	2.7	3.1	2.6	3.3	3.7	4.9	2.4	2.4
Durables		9.4	7.4	6.3	4.5	5.8	7.4	9.5	1.6	4.4
Nondurables		3.4	1.6	3.0	1.7	2.8	2.0	4.1	2.0	1.8
Services		3.6	2.3	2.5	2.6	3.0	3.8	4.4	2.9	2.3
Business fixed investment		5.5	9.9	7.6	7.3	11.7	9.8	10.1	3.7	5.4
Producers' dur. equipment		9.6	12.2	10.2	9.1	11.8	12.7	15.8	5.8	7.1
Nonres. structures		-3.4	4.5	1.1	2.7	11.6	2.5	-4.0	-2.4	0.4
Residential structures		16.9	7.8	4.2	-1.4	5.4	4.2	10.8	-1.7	0.4
Exports		4.1	4.6	10.0	10.5	10.3	9.6	-3.6	2.3	4.7
Imports		7.4	10.2	12.3	5.6	11.8	14.0	8.9	6.1	6.5
Gov't. cons. & investment		1.7	-1.4	0.1	-0.9	2.1	1.4	1.9	1.3	1.4
Federal		1.3	-6.1	-3.9	-5.6	1.1	-0.6	0.5	-1.5	-1.1
Defense		-1.3	-6.9	-6.0	-5.0	-0.1	-1.4	-1.8	-2.0	-1.3
State & local		2.0	2.0	2.7	2.1	2.8	2.6	2.6	2.7	2.6
Change in bus. inventories	Bill. Ch. \$	7.0	22.1	60.6	27.7	30.0	63.2	58.8	27.8	32.1
Nonfarm		2.0	29.5	49.0	37.7	23.2	58.8	51.3	23.6	30.2
Net exports		-29.5	-70.2	-104.6	-96.5	-111.2	-136.1	-249.1	-325.4	-366.3
Nominal GDP	% change	6.3	5.0	5.8	4.2	5.8	5.6	4.2	3.1	3.9
<b>EMPLOYMENT AND PRODUCTION</b>										
Nonfarm payroll employment	Millions	108.6	110.7	114.1	117.2	119.6	122.7	125.8	127.3	128.4
Unemployment rate	%	7.5	6.9	6.1	5.6	5.4	4.9	4.5	4.8	5.2
Industrial prod. index	% change	3.7	3.3	6.5	3.3	4.2	5.8	1.0	1.0	2.7
Capacity util. rate - mfg.	%	79.4	80.5	82.5	82.8	81.4	81.7	80.4	78.7	78.8
Housing starts	Millions	1.20	1.29	1.46	1.35	1.48	1.47	1.59	1.53	1.53
Light motor vehicle sales		12.85	13.86	15.01	14.72	15.05	15.03	15.31	14.78	14.38
North Amer. produced		10.51	11.71	12.88	12.82	13.35	13.11	13.33	12.88	12.54
Other		2.34	2.15	2.13	1.90	1.70	1.92	1.98	1.89	1.84
<b>INCOME AND SAVING</b>										
Nominal GNP	Bill. \$	6255.5	6576.8	6955.2	7287.1	7674.0	8102.9	8467.7	8725.1	9021.5
Nominal GNP	% change	6.2	5.1	5.7	4.4	5.6	5.2	4.1	2.9	3.9
Nominal personal income		7.2	4.0	5.2	4.6	5.9	5.4	4.8	3.4	3.9
Real disposable income		4.0	1.2	2.5	2.1	2.7	2.9	3.1	2.4	2.3
Personal saving rate	%	5.7	4.4	3.5	3.4	2.9	2.1	0.4	0.3	0.3
Corp. profits, IVA & CCAdj.	% change	11.3	19.0	14.1	14.6	7.7	7.7	-1.1	-6.0	3.5
Profit share of GNP	%	6.8	7.5	8.2	9.2	9.8	10.1	9.7	8.9	8.5
Excluding FR Banks		6.6	7.2	7.9	8.9	9.5	9.8	9.4	8.6	8.3
Federal surpl./deficit	Bill. \$	-280.9	-250.7	-186.7	-174.4	-110.3	-21.1	78.3	56.8	65.8
State & local surpl./def.		86.3	87.4	96.8	111.7	122.6	134.1	145.4	149.8	148.5
Ex. social ins. funds		18.3	19.7	27.9	37.0	52.2	66.0	77.7	82.1	80.8
Gross natl. saving rate	%	14.5	14.4	15.5	16.3	16.6	17.4	17.3	16.3	16.1
Net natl. saving rate		3.7	3.7	4.7	5.8	6.3	7.3	7.3	6.2	6.0
<b>PRICES AND COSTS</b>										
GDP chn.-wt. price index	% change	2.6	2.6	2.5	2.1	1.8	1.7	0.9	1.5	1.6
Gross Domestic Purchases		2.7	2.3	2.5	2.0	1.8	1.3	0.5	1.4	1.5
chn.-wt. price index		3.1	2.7	2.7	2.6	3.2	1.9	1.5	2.2	2.1
CPI		3.5	3.1	2.8	3.1	2.6	2.2	2.4	2.2	2.2
Ex. food and energy										
ECI, hourly compensation <sup>2</sup>		3.5	3.6	3.1	2.6	3.1	3.4	3.5	3.1	3.1
Nonfarm business sector										
Output per hour		3.5	-0.4	0.1	1.2	2.1	1.7	1.7	1.0	2.0
Compensation per Hour		4.5	1.6	2.1	2.8	3.7	3.9	4.0	3.3	3.2
Unit labor cost		1.0	2.0	2.0	1.6	1.6	2.1	2.2	2.3	1.2

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

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Class II FOMC

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

November 12, 1998

Item	Units	1996	1996	1996	1996	1997	1997	1997	1997	1998	1998
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
<b>EXPENDITURES</b>											
Nominal GDP	Bill. \$	7495.3	7629.2	7703.4	7818.4	7955.0	8063.4	8170.8	8254.5	8384.2	8440.6
Real GDP	Bill. Ch. \$	6882.0	6983.9	7020.0	7093.1	7166.7	7236.5	7311.2	7364.6	7464.7	7498.6
Real GDP	% change	3.3	6.1	2.1	4.2	4.2	4.0	4.2	3.0	5.5	1.8
Gross domestic purchases		4.5	7.0	3.4	1.8	5.5	4.4	4.6	3.2	7.8	3.9
Final sales		3.6	5.4	0.9	5.1	2.9	2.7	5.8	2.1	4.3	4.6
Priv. dom. final purchases		5.1	6.1	3.1	3.3	4.6	3.3	7.2	2.9	8.5	7.4
Personal cons. expenditures		3.7	4.7	1.8	2.9	4.3	1.6	6.2	2.8	6.1	6.1
Durables		5.8	12.7	-1.9	7.2	12.3	-1.5	16.8	3.1	15.8	11.2
Nondurables		2.2	4.8	1.2	2.9	3.6	-0.2	5.1	-0.4	7.4	5.3
Services		4.0	3.0	3.0	2.0	3.1	3.2	4.7	4.3	3.5	5.4
Business fixed investment		13.1	11.0	14.2	8.8	7.0	14.0	17.0	1.8	22.2	12.8
Producers' dur. equipment		15.7	12.3	16.2	3.2	8.3	22.8	18.8	2.2	34.3	18.8
Nonres. structures		6.4	7.4	8.9	24.5	3.9	-6.2	12.4	0.9	-4.9	-2.3
Residential structures		9.3	19.5	-1.7	-3.9	3.1	6.1	-0.4	8.2	15.6	15.0
Exports		3.7	5.8	2.1	32.0	8.3	15.5	10.6	4.4	-2.8	-7.7
Imports		13.1	13.5	13.6	7.0	18.6	17.9	13.5	6.3	15.7	9.3
Gov't. cons. & investment		3.2	7.1	-1.6	0.0	2.1	2.1	1.4	0.1	-1.9	3.7
Federal		8.0	8.1	-4.7	-6.3	-2.7	3.6	-1.2	-2.1	-8.8	7.3
Defense		7.2	8.1	-6.3	-8.3	-9.9	9.1	-1.8	-2.0	-18.5	9.9
State & local		0.5	6.5	0.3	3.8	4.9	1.3	2.9	1.3	2.1	1.8
Change in bus. inventories	Bill. Ch. \$	14.4	26.1	47.5	32.1	56.3	79.0	51.0	66.5	91.4	38.2
Nonfarm		10.4	15.2	38.6	28.7	56.2	72.1	44.0	62.7	85.9	29.9
Net exports		-95.5	-113.5	-140.1	-95.9	-121.5	-131.6	-142.4	-149.0	-198.5	-245.2
Nominal GDP	% change	5.7	7.3	3.9	6.1	7.2	5.6	5.4	4.2	6.4	2.7
<b>EMPLOYMENT AND PRODUCTION</b>											
Nonfarm payroll employment	Millions	118.5	119.3	120.0	120.7	121.5	122.3	123.0	123.9	124.8	125.5
Unemployment rate	%	5.6	5.4	5.3	5.3	5.3	4.9	4.9	4.7	4.7	4.4
Industrial prod. index	% change	2.0	7.5	3.6	3.8	5.2	4.6	6.0	7.2	1.2	1.7
Capacity util. rate - mfg.	%	81.0	81.6	81.5	81.4	81.6	81.5	81.6	82.2	81.6	80.7
Housing starts	Millions	1.47	1.49	1.49	1.42	1.47	1.46	1.45	1.53	1.58	1.57
Light motor vehicle sales		15.10	15.18	15.00	14.91	15.32	14.54	15.19	15.07	15.02	16.08
North Amer. produced		13.44	13.46	13.33	13.16	13.41	12.68	13.20	13.13	13.07	14.09
Other		1.66	1.72	1.68	1.76	1.92	1.86	1.99	1.94	1.95	1.99
<b>INCOME AND SAVING</b>											
Nominal GNP	Bill. \$	7515.0	7643.3	7708.6	7829.0	7952.4	8062.3	8162.0	8234.9	8369.4	8421.8
Nominal GNP	% change	5.6	7.0	3.5	6.4	6.5	5.6	5.0	3.6	6.7	2.5
Nominal personal income		6.6	6.9	5.5	4.6	7.3	4.7	4.7	5.0	5.9	4.5
Real disposable income		2.9	2.1	4.4	1.3	3.3	2.9	2.4	2.9	4.0	2.6
Personal saving rate	%	3.2	2.6	3.1	2.6	2.4	2.6	1.7	1.7	1.2	0.4
Corp. profits, IVA & CCAdj.	% change	16.9	6.9	3.8	3.5	18.1	11.1	13.1	-9.2	4.2	-4.1
Profit share of GNP	%	9.8	9.8	9.8	9.7	10.0	10.1	10.3	10.0	9.9	9.7
Excluding FR Banks		9.5	9.5	9.5	9.5	9.7	9.8	10.0	9.7	9.6	9.5
Federal surpl./deficit	Bill. \$	-150.1	-112.6	-100.1	-78.3	-51.2	-34.8	-0.3	2.2	58.8	74.4
State & local surpl./def.		117.3	129.1	122.3	121.7	128.4	130.1	136.6	141.4	140.2	141.3
Ex. social ins. funds		45.3	58.2	52.5	52.9	59.8	61.6	68.7	73.8	72.7	73.6
Gross natl. saving rate	%	16.4	16.4	16.8	16.7	17.0	17.6	17.5	17.3	17.7	17.2
Net natl. saving rate		6.0	6.2	6.6	6.5	7.0	7.6	7.5	7.3	7.8	7.2
<b>PRICES AND COSTS</b>											
GDP chn.-wt. price index	% change	2.2	1.4	1.8	1.6	2.8	1.7	1.2	1.1	0.9	0.9
Gross Domestic Purchases		2.1	1.4	1.5	2.1	2.2	0.9	1.1	1.0	-0.2	0.4
chn.-wt. price index		3.2	3.7	2.6	3.3	2.0	1.5	1.8	2.3	0.5	2.0
CPI		2.5	2.5	2.7	2.7	2.2	2.6	1.9	2.1	2.4	2.6
Ex. food and energy		2.5	3.5	2.8	2.8	2.5	3.7	3.4	4.3	2.7	3.6
ECI, hourly compensation <sup>1</sup>		2.5	3.5	2.8	2.8	2.5	3.7	3.4	4.3	2.7	3.6
Nonfarm business sector		4.1	3.0	0.0	1.2	0.5	1.8	3.6	0.9	3.5	0.3
Output per hour		2.6	5.2	3.7	3.3	4.0	2.6	3.9	4.9	4.6	4.0
Compensation per hour		-1.5	2.2	3.7	2.1	3.6	0.7	0.3	4.0	1.1	3.7

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)

November 12, 1998

Item	Units	----- Projected -----									
		1998 Q3	1998 Q4	1999 Q1	1999 Q2	1999 Q3	1999 Q4	2000 Q1	2000 Q2	2000 Q3	2000 Q4
<b>EXPENDITURES</b>											
Nominal GDP	Bill. \$	8533.8	8601.8	8667.8	8727.2	8791.6	8855.0	8927.7	9024.8	9117.1	9213.5
Real GDP	Bill. Ch. \$	7565.2	7605.4	7631.1	7658.1	7686.7	7723.6	7741.0	7796.5	7846.3	7898.8
Real GDP	% change	3.6	2.1	1.4	1.4	1.5	1.9	0.9	2.9	2.6	2.7
Gross domestic purchases		4.6	3.0	2.0	2.1	1.9	2.1	1.2	3.3	3.0	2.8
Final sales		2.2	3.4	1.9	1.6	1.6	1.7	1.3	2.5	2.2	2.6
Priv. dom. final purchases		3.6	4.3	3.1	2.4	2.1	2.0	1.9	2.9	2.9	3.0
Personal cons. expenditures		3.9	3.8	3.0	2.4	2.3	2.1	1.8	2.7	2.5	2.5
Durables		-0.0	11.8	2.0	1.2	1.3	1.9	3.3	4.2	4.9	5.2
Nondurables		2.3	1.4	2.2	2.0	2.0	1.7	1.7	1.7	1.9	1.9
Services		5.5	3.3	3.6	2.8	2.6	2.4	1.6	2.9	2.3	2.3
Business fixed investment		-0.5	7.3	5.1	4.1	2.8	2.7	3.2	5.1	6.3	7.0
Producers' dur. equipment		0.5	12.1	8.3	6.5	4.4	4.3	4.7	6.8	8.2	8.9
Nonres. structures		-3.5	-5.3	-3.5	-2.6	-1.8	-1.8	-1.1	0.2	0.8	1.6
Residential structures		7.7	5.1	-0.7	-2.4	-2.0	-1.6	-0.8	0.3	1.0	1.3
Exports		-3.7	-0.1	0.9	2.2	2.9	3.4	3.4	4.7	5.2	5.5
Imports		3.8	6.9	6.4	7.4	6.0	4.7	4.9	7.5	7.6	6.0
Gov't. cons. & investment		1.6	4.2	0.1	1.9	1.6	1.4	0.2	2.9	1.1	1.4
Federal		-1.6	5.9	-4.7	0.5	-0.6	-1.0	-4.5	3.4	-1.9	-1.1
Defense		4.1	-0.3	-7.6	0.8	-0.7	-0.3	-8.6	0.6	-0.8	4.2
State & local		3.3	3.3	2.8	2.7	2.7	2.7	2.6	2.6	2.7	2.6
Change in bus. inventories	Bill. Ch. \$	65.4	40.2	30.2	26.7	24.8	29.6	20.7	29.7	37.9	40.3
Nonfarm		57.2	32.3	23.8	21.8	21.3	27.3	18.7	27.7	35.9	38.3
Net exports		-265.9	-286.9	-304.3	-322.0	-334.1	-341.0	-348.6	-361.7	-374.3	-380.8
Nominal GDP	% change	4.5	3.2	3.1	2.8	3.0	3.4	2.9	4.4	4.2	4.3
<b>EMPLOYMENT AND PRODUCTION</b>											
Nonfarm payroll employment	Millions	126.1	126.6	126.9	127.1	127.4	127.6	127.9	128.4	128.6	128.8
Unemployment rate	%	4.6	4.6	4.6	4.7	4.8	5.0	5.1	5.2	5.2	5.3
Industrial prod. index	% change	-0.0	1.0	0.3	0.2	0.9	2.4	0.4	3.0	3.6	3.9
Capacity util. rate - mfg.	%	79.7	79.4	79.0	78.7	78.6	78.7	78.4	78.6	78.9	79.3
Housing starts	Millions	1.63	1.57	1.56	1.54	1.52	1.51	1.52	1.52	1.53	1.53
Light motor vehicle sales		14.55	15.58	15.19	14.87	14.61	14.43	14.30	14.31	14.39	14.51
North Amer. produced		12.55	13.61	13.25	12.96	12.73	12.59	12.47	12.49	12.55	12.66
Other		2.01	1.97	1.94	1.91	1.88	1.84	1.83	1.82	1.84	1.85
<b>INCOME AND SAVING</b>											
Nominal GNP	Bill. \$	8506.4	8573.4	8635.6	8692.0	8752.0	8820.6	8880.4	8978.0	9067.0	9160.4
Nominal GNP	% change	4.1	3.2	2.9	2.6	2.8	3.2	2.7	4.5	4.0	4.2
Nominal personal income		4.2	4.8	3.7	3.1	3.6	3.4	4.4	4.0	3.6	3.6
Real disposable income		2.6	3.1	5.4	1.1	1.8	1.5	3.7	2.1	1.7	1.7
Personal saving rate	%	0.1	0.0	0.6	0.3	0.2	0.0	0.5	0.4	0.2	-0.0
Corp. profits, IVA & CCAdj.	% change	0.3	-4.7	-10.4	-5.5	-4.7	-3.2	-10.0	11.3	7.5	6.6
Profit share of GNP	%	9.7	9.5	9.1	9.0	8.8	8.6	8.4	8.5	8.6	8.6
Excluding FR Banks		9.4	9.2	8.9	8.7	8.5	8.4	8.1	8.3	8.3	8.4
Federal surpl./deficit	Bill. \$	97.1	82.9	50.0	56.0	59.6	61.6	52.4	60.1	72.9	77.7
State & local surpl./def.		145.7	154.2	151.6	151.0	148.9	147.9	147.7	148.3	148.7	149.2
Ex. social ins. funds		78.1	86.5	83.9	83.3	81.2	80.2	80.0	80.6	81.0	81.5
Gross natl. saving rate	%	17.3	16.9	16.7	16.4	16.2	16.0	16.0	16.1	16.1	16.0
Net natl. saving rate		7.3	6.9	6.6	6.3	6.1	5.9	5.9	5.9	6.0	6.0
<b>PRICES AND COSTS</b>											
GDP chn.-wt. price index	% change	0.8	1.1	1.7	1.3	1.5	1.4	1.9	1.5	1.5	1.5
Gross Domestic Purchases											
chn.-wt. price index		0.5	1.0	1.7	1.4	1.3	1.3	1.9	1.4	1.4	1.4
CPI		1.7	1.8	2.2	2.3	2.1	2.1	2.1	2.1	2.1	2.1
Ex. food and energy		2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
ECI, hourly compensation <sup>1</sup>		4.4	3.3	3.1	3.1	3.0	3.0	3.0	3.0	3.0	3.4
Nonfarm business sector											
Output per hour		2.7	0.5	0.8	0.9	0.9	1.4	0.1	2.6	2.5	2.6
Compensation per hour		4.0	3.3	3.6	3.2	3.2	3.2	3.3	3.0	3.0	3.4
Unit labor cost		1.3	2.8	2.8	2.3	2.3	1.8	3.2	0.4	0.5	0.8

1. Private-industry workers.



CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

November 12, 1998

Item	1996 Q3	1996 Q4	1997 Q1	1997 Q2	1997 Q3	1997 Q4	1998 Q1	1998 Q2	1998 Q3	96Q4/ 95Q4	97Q4/ 96Q4	98Q4/ 97Q4
Real GDP	2.1	4.2	4.2	4.0	4.2	3.0	5.5	1.8	3.6	3.9	3.8	3.3
Gross dom. purchases	3.5	1.9	5.5	4.4	4.7	3.2	7.9	4.0	4.6	4.2	4.4	4.9
Final sales	0.9	5.1	2.9	2.7	5.7	2.1	4.3	4.6	2.2	3.7	3.3	3.6
Priv. dom. final purchases	2.5	2.7	3.8	2.7	5.9	2.4	7.0	6.1	3.0	3.6	3.7	4.9
Personal cons. expenditures	1.3	2.0	2.9	1.1	4.2	1.9	4.1	4.1	2.6	2.2	2.5	3.3
Durables	-0.2	0.6	1.0	-0.1	1.3	0.3	1.2	0.9	-0.0	0.5	0.6	0.8
Nondurables	0.2	0.6	0.7	-0.0	1.0	-0.1	1.4	1.0	0.4	0.6	0.4	0.8
Services	1.2	0.8	1.2	1.3	1.9	1.7	1.4	2.1	2.2	1.2	1.5	1.8
Business fixed investment	1.4	0.9	0.7	1.4	1.7	0.2	2.2	1.4	-0.1	1.2	1.0	1.1
Producers' dur. equip.	1.1	0.2	0.6	1.6	1.3	0.1	2.4	1.4	0.0	0.8	0.9	1.2
Nonres. structures	0.2	0.6	0.1	-0.2	0.4	0.0	-0.2	-0.1	-0.1	0.3	0.1	-0.1
Residential structures	-0.1	-0.2	0.1	0.2	-0.0	0.3	0.6	0.6	0.3	0.2	0.2	0.4
Net exports	-1.3	2.4	-1.2	-0.5	-0.5	-0.3	-2.2	-2.1	-0.9	-0.3	-0.6	-1.6
Exports	0.2	3.2	1.0	1.8	1.2	0.5	-0.3	-0.9	-0.4	1.2	1.1	-0.4
Imports	-1.6	-0.9	-2.2	-2.2	-1.7	-0.8	-1.9	-1.2	-0.5	-1.4	-1.7	-1.1
Government cons. & invest.	-0.3	0.0	0.4	0.4	0.3	0.0	-0.3	0.6	0.3	0.4	0.3	0.3
Federal	-0.3	-0.4	-0.2	0.2	-0.1	-0.1	-0.6	0.4	-0.1	0.1	-0.0	0.0
Defense	-0.3	-0.4	-0.5	0.4	-0.1	-0.1	-0.8	0.4	0.2	-0.0	-0.1	-0.1
Nondefense	0.0	0.0	0.3	-0.2	0.0	-0.1	0.3	0.1	-0.3	0.1	0.0	0.1
State and local	0.0	0.4	0.6	0.2	0.3	0.2	0.2	0.2	0.4	0.3	0.3	0.3
Change in bus. inventories	1.2	-0.8	1.3	1.3	-1.4	0.9	1.2	-2.7	1.3	0.2	0.5	-0.3
Nonfarm	1.3	-0.5	1.5	0.9	-1.5	1.0	1.2	-2.8	1.4	0.1	0.5	-0.4
Farm	-0.1	-0.3	-0.2	0.4	0.1	-0.1	0.0	0.1	-0.0	0.0	0.0	0.1

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

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

November 12, 1998

Item	1998 Q4	1999 Q1	1999 Q2	1999 Q3	1999 Q4	2000 Q1	2000 Q2	2000 Q3	2000 Q4	98Q4/ 97Q4	99Q4/ 98Q4	0Q4/ 99Q4
Real GDP	2.1	1.4	1.4	1.5	1.9	0.9	2.9	2.6	2.7	3.3	1.6	2.3
Gross dom. purchases	3.0	2.1	2.2	2.0	2.2	1.2	3.4	3.0	2.9	4.9	2.1	2.6
Final sales	3.4	1.9	1.6	1.6	1.7	1.3	2.5	2.2	2.6	3.6	1.7	2.1
Priv. dom. final purchases	3.6	2.6	2.0	1.8	1.7	1.6	2.4	2.5	2.6	4.9	2.0	2.3
Personal cons. expenditures	2.6	2.0	1.6	1.6	1.5	1.3	1.9	1.7	1.8	3.3	1.7	1.7
Durables	0.9	0.2	0.1	0.1	0.2	0.3	0.3	0.4	0.4	0.8	0.1	0.4
Nondurables	0.3	0.4	0.4	0.4	0.3	0.3	0.3	0.4	0.4	0.8	0.4	0.3
Services	1.3	1.5	1.1	1.1	1.0	0.7	1.2	1.0	1.0	1.8	1.2	1.0
Business fixed investment	0.8	0.6	0.4	0.3	0.3	0.3	0.5	0.7	0.7	1.1	0.4	0.6
Producers' dur. equip.	0.9	0.7	0.5	0.4	0.3	0.4	0.5	0.6	0.7	1.2	0.5	0.6
Nonres. structures	-0.2	-0.1	-0.1	-0.1	-0.0	-0.0	0.0	0.0	0.0	-0.1	-0.1	0.0
Residential structures	0.2	-0.0	-0.1	-0.1	-0.1	-0.0	0.0	0.0	0.1	0.4	-0.1	0.0
Net exports	-0.9	-0.7	-0.7	-0.5	-0.3	-0.3	-0.5	-0.5	-0.2	-1.6	-0.5	-0.4
Exports	-0.0	0.1	0.2	0.3	0.4	0.4	0.5	0.5	0.6	-0.4	0.3	0.5
Imports	-0.9	-0.8	-1.0	-0.8	-0.6	-0.6	-1.0	-1.0	-0.8	-1.1	-0.8	-0.9
Government cons. & invest.	0.7	0.0	0.3	0.3	0.3	0.0	0.5	0.2	0.2	0.3	0.2	0.2
Federal	0.4	-0.3	0.0	-0.0	-0.1	-0.3	0.2	-0.1	-0.1	0.0	-0.1	-0.1
Defense	-0.0	-0.3	0.0	-0.0	-0.0	-0.3	0.0	-0.0	0.2	-0.1	-0.1	-0.1
Nondefense	0.4	0.0	-0.0	-0.0	-0.0	0.1	0.2	-0.1	-0.2	0.1	-0.0	-0.0
State and local	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Change in bus. inventories	-1.2	-0.5	-0.2	-0.1	0.2	-0.4	0.4	0.4	0.1	-0.3	-0.1	0.1
Nonfarm	-1.2	-0.4	-0.1	-0.0	0.3	-0.4	0.4	0.4	0.1	-0.4	-0.1	0.1
Farm	0.0	-0.1	-0.1	-0.1	-0.1	-0.0	-0.0	-0.0	-0.0	0.1	-0.1	-0.0

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

Item	Fiscal year <sup>5</sup>				1998				1999				2000			
	1997 <sup>a</sup>	1998 <sup>b</sup>	1999	2000	Q1 <sup>a</sup>	Q2 <sup>a</sup>	Q3 <sup>b</sup>	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
UNIFIED BUDGET																
Not seasonally adjusted																
Receipts <sup>1</sup>	1579	1721	1769	1827	378	544	412	407	400	534	429	420	414	552	441	430
Outlays <sup>1</sup>	1601	1651	1714	1754	409	407	409	464	398	424	428	442	449	434	429	448
Surplus/deficit <sup>1</sup>	-22	70	55	73	-30	137	3	-56	2	109	1	-22	-35	118	12	-17
On-budget	-103	-29	-66	-58	-51	87	1	-59	-52	57	-12	-60	-58	61	-1	-58
Off-budget	81	99	121	131	21	50	2	2	54	52	12	38	23	57	13	41
Surplus excluding deposit insurance <sup>2</sup>	-36	66	51	70	-31	136	2	-57	1	108	0	-23	-36	117	11	-18
Means of financing																
Borrowing	38	-51	-57	-77	26	-82	-29	20	7	-92	7	11	24	-90	-22	2
Cash decrease	1	5	-1	0	4	-45	33	16	1	-13	-5	10	10	-25	5	20
Other <sup>3</sup>	-17	-24	2	4	0	-10	-8	20	-11	-5	-3	1	1	-3	6	-5
Cash operating balance, end of period	44	39	40	40	28	72	39	23	22	35	40	30	20	45	40	20
NIPA FEDERAL SECTOR																
Seasonally adjusted annual rate																
Receipts	1687	1818	1871	1910	1809	1838	1860	1882	1858	1867	1879	1890	1896	1917	1936	1955
Expenditures	1728	1759	1809	1848	1750	1764	1760	1799	1808	1811	1819	1829	1844	1857	1863	1877
Consumption expend.	458	458	470	479	451	464	459	466	470	472	472	472	478	483	482	480
Defense	306	301	305	306	293	303	303	304	304	305	305	305	306	307	306	309
Nondefense	152	157	165	173	158	161	156	162	166	167	167	166	172	177	175	171
Other expenditures	1270	1301	1339	1369	1299	1300	1302	1333	1337	1339	1347	1357	1366	1373	1381	1397
Current account surplus	-41	59	62	62	59	74	100	83	50	56	60	62	52	60	73	78
Gross investment	61	59	60	58	61	57	60	61	59	59	59	59	58	58	58	59
Current and capital account surplus	-102	-1	3	4	-2	18	39	22	-9	-3	0	2	-5	2	15	19
FISCAL INDICATORS <sup>4</sup>																
High-employment (HEB) surplus/deficit	-163	-99	-89	-53	-102	-85	-68	-83	-105	-90	-77	-67	-61	-51	-35	-29
Change in HEB, percent of potential GDP	-.8	-.8	-.1	-.4	-.5	-.2	-.2	.2	3	-.2	-.2	-.1	-.1	-.1	-.2	-.1
Fiscal impetus (FI), percent, cal. year	-2.1	-2.1	1.6	-1.5	-2.1	1.1	-.4	1	1.3	-.1	-.4	-1.1	-.8	.8	-.5	-.3

1. OMB's May 1998 surplus estimates (assuming the enactment of the President's proposals) are \$39 billion in FY98, \$54 billion in FY99 and \$61 billion in FY00. CBO's August 1998 baseline surplus estimates are \$63 billion in FY98, \$80 billion in FY99 and \$79 billion in FY00. 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, \$51 billion in FY99 and \$58 billion in FY00, and CBO's August baseline estimates are \$59 billion in FY98, \$76 billion in FY99 and \$76 billion in FY00.

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.  
h--Preliminary.

Change in Debt of the Domestic Nonfinancial Sectors  
(Percent)

Period <sup>1</sup>	Total <sup>2</sup>	Federal government <sup>3</sup>	Nonfederal						Memo: Nominal GDP
			Total <sup>4</sup>	Households			Business	State and local governments	
				Total	Home mortgages	Consumer credit			
<i>Year</i>									
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	0.8	2.2	6.3
1993	5.0	8.3	3.8	5.3	4.3	7.6	1.6	6.0	5.0
1994	4.6	4.7	4.6	7.5	5.8	14.5	4.0	-4.0	5.8
1995	5.4	4.1	5.9	7.8	5.5	14.1	6.6	-4.6	4.2
1996	5.3	4.0	5.8	7.8	8.0	7.9	5.1	-0.6	5.8
1997	5.3	0.6	7.0	6.8	7.5	4.3	7.6	5.3	5.6
1998	5.9	-1.7	8.5	8.9	9.6	5.4	8.5	6.6	4.2
1999	4.3	-1.8	6.1	6.4	6.9	3.4	6.0	4.9	3.1
2000	3.4	-2.4	5.1	4.9	5.3	2.0	5.7	3.3	3.9
<i>Quarter</i>									
1997:3	5.6	0.8	7.3	6.9	9.1	4.1	7.8	6.7	5.4
4	6.4	1.1	8.2	7.3	8.2	3.0	9.1	8.4	4.2
1998:1	6.1	-0.8	8.4	8.0	8.6	4.5	8.8	8.4	6.4
2	6.2	-1.8	8.8	8.6	9.3	5.1	9.5	6.5	2.7
3	5.6	-3.6	8.5	9.1	10.0	5.7	8.6	5.5	4.5
4	5.4	-0.5	7.3	8.7	9.3	5.9	6.2	5.1	3.2
1999:1	4.6	-3.2	6.9	7.7	8.3	4.6	6.2	6.0	3.1
2	4.4	-1.5	6.1	6.5	7.0	3.9	5.8	4.8	2.8
3	4.1	-0.7	5.5	5.6	6.1	2.8	5.7	4.3	3.0
4	3.7	-1.7	5.3	5.2	5.6	2.2	5.7	4.1	3.4

Note. Quarterly data are at seasonally adjusted annual rates.

1. Data after 1998:Q2 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 6.1 percent in 1998 and 4.5 percent in 1999.
3. On a monthly average basis, federal debt is projected to grow -1.3 percent in 1998 and -1.7 percent in 1999.
4. On a monthly average basis, nonfederal debt is projected to grow 8.6 percent in 1998 and 6.3 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			
	1997	1998	1999	2000	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<i>Net funds raised by domestic nonfinancial sectors</i>														
1 Total	653.7	654.3	575.8	503.9	705.6	810.8	785.5	857.9	650.5	323.2	614.9	599.3	558.0	531.2
2 Net equity issuance	-114.6	-250.3	-111.2	-72.7	-124.0	-144.1	-139.2	-93.5	-226.6	-542.0	-122.4	-111.2	-125.2	-86.0
3 Net debt issuance	768.4	904.6	687.0	576.6	829.6	954.9	924.7	951.4	877.0	865.2	737.3	710.5	683.2	617.2
<i>Borrowing sectors</i>														
<i>Nonfinancial business</i>														
4 Financing gap <sup>1</sup>	73.8	105.8	117.7	139.8	50.8	82.8	118.5	96.1	109.9	98.8	107.2	113.9	118.8	130.7
5 Net equity issuance	-114.6	-250.3	-111.2	-72.7	-124.0	-144.1	-139.2	-93.5	-226.6	-542.0	-122.4	-111.2	-125.2	-86.0
6 Credit market borrowing	337.6	407.3	310.6	311.1	358.4	425.7	420.2	463.0	429.2	316.6	321.1	308.1	306.7	306.7
<i>Households</i>														
7 Net borrowing <sup>2</sup>	351.6	488.2	383.9	310.3	368.3	396.2	441.5	483.1	520.2	508.0	464.1	399.2	347.9	324.4
8 Home mortgages	261.3	362.9	286.7	232.1	326.9	302.0	322.2	359.1	393.7	376.7	344.7	295.7	262.7	243.7
9 Consumer credit	52.5	68.4	45.6	27.8	50.3	37.8	57.3	65.1	73.6	77.5	61.3	52.6	38.1	30.2
10 Debt/DPI (percent) <sup>3</sup>	91.9	95.5	98.4	100.0	92.1	92.8	93.7	94.8	96.0	97.1	97.4	98.4	99.1	99.6
<i>State and local governments</i>														
11 Net borrowing	56.1	73.4	58.2	41.9	72.6	92.3	94.3	74.9	64.2	60.4	71.5	58.3	52.9	50.3
12 Current surplus <sup>4</sup>	135.6	183.1	185.3	188.9	117.6	171.5	179.1	180.9	181.5	190.8	188.7	178.7	187.2	186.8
<i>Federal government</i>														
13 Net borrowing	23.1	-64.3	-65.7	-86.7	30.3	40.8	-31.3	-69.6	-136.5	-19.7	-119.3	-55.0	-24.2	-64.2
14 Net borrowing (quarterly, n.s.a.)	23.1	-64.3	-65.7	-86.7	10.6	33.7	25.6	-81.5	-28.8	20.4	7.5	-91.8	7.3	11.4
15 Unified deficit (quarterly, n.s.a.)	2.4	-53.4	-89.6	-78.0	10.9	39.7	30.2	-136.9	-3.0	56.3	-1.9	-109.3	-0.5	22.1
<i>Depository institutions</i>														
16 Funds supplied	336.9	286.6	236.7	240.4	204.4	472.9	323.4	160.9	292.8	369.3	246.5	231.1	231.7	237.4
<i>Memo (percentage of GDP)</i>														
17 Domestic nonfinancial debt <sup>5</sup>	182.8	184.5	187.8	188.4	182.0	182.8	182.8	184.3	185.0	186.1	187.0	187.8	188.4	188.6
18 Domestic nonfinancial borrowing	9.5	10.7	7.8	6.4	10.2	11.6	11.0	11.3	10.3	10.1	8.5	8.1	7.8	7.0
19 Federal government <sup>6</sup>	0.3	-0.8	-0.7	-1.0	0.4	0.5	-0.4	-0.8	-1.6	-0.2	-1.4	-0.6	-0.3	-0.7
20 Nonfederal	9.2	11.4	8.6	7.3	9.8	11.1	11.4	12.1	11.9	10.3	9.9	8.8	8.0	7.7

Note. Data after 1998:Q2 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.

## International Developments

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### Recent Developments

Prospects for U.S. real net exports have changed only slightly since the September Greenbook. The sharp net decline in the value of the dollar against the yen and several Asian emerging market currencies during the intermeeting period have led us to project a weaker path for the dollar, which imparts greater stimulus to our outlook for U.S. real net exports. This stimulus has been largely offset by a weaker outlook for growth in our trading partners. Signs of financial stress in emerging market countries, though still apparent, have diminished over the intermeeting period, and equity markets globally have rallied after the cuts in U.S. interest rates. That said, we still expect a significant slowdown in Latin America, and although the letter of intent for Brazil's IMF program is expected shortly, that country's prospects remain an important risk to our forecast.

**International financial markets.** Since the September FOMC meeting, the dollar has depreciated 1-3/4 percent against a broad weighted average of 35 currencies. Much of this decrease is accounted for by a net decline of 9 percent against the yen, which moved from 136 to 112 during a three-day period in early October. Improved prospects for Japanese bank reform and fiscal stimulus were cited as a source of yen strength at the time, but the yen's sharp rise appears to have been associated primarily with an unwinding of large leveraged positions involving borrowing in yen. The yen has retraced some of its gain since early October and is currently trading at nearly 124 per dollar. Japanese stock prices rose somewhat, but the Japan premium and Japanese corporate credit spreads have widened further as the outlook for the Japanese economy has soured.

The dollar was little changed on balance against the mark. While German official interest rates remained unchanged, the central banks of Ireland, Italy, Spain, and Portugal made substantial cuts in their rates, as was anticipated, in line with the final stages of EMU convergence. Signs of flight to safety eased in Europe as long-term rates on German Bunds rose nearly 20 basis points despite indications of weakening economic activity. Equity prices in continental Europe rose 4 to 10 percent over the period.

The dollar rose nearly 3 percent against the pound as the Bank of England cut rates 75 basis points in two steps. The Bank of Canada moved in tandem with the Fed, cutting rates by 50 basis points, and the Canadian dollar depreciated 2-1/2 percent amid signs of weakening activity.

Bolstered by the rise in the yen, currencies of many of the ASEAN countries and Korea strengthened 2 to 7 percent against the dollar. The Indonesian rupiah rose

26 percent, reversing some of its earlier, exceptionally large decline against the dollar as some signs of progress in economic restructuring have been noted and interest rates have been kept high. Stock markets in these countries have rallied strongly since the September FOMC meeting, and both their domestic interest rates and spreads on their off-shore dollar interest rates over U.S. Treasuries have declined.

Financial market developments in the major Latin American countries have been mixed. Stock markets have rebounded, especially since the U.S. rate cut in mid-October. Domestic short-term interest rates have receded somewhat, but remain high in real terms (over 30 percent in Brazil). Brady bond spreads declined slightly further on balance during the period; these spreads—now in a range of 8 percent to 12 percent for Argentina, Mexico, and Brazil—are well below the peaks reached in September but are still nearly double their relatively low levels at the beginning of August. The Mexican peso rose slightly against the dollar on balance during the period.

The Brazilian *real* continued under pressure for much of the period, although the rate of reserve loss slowed substantially. Brazil's reserves fell another \$2 billion and stood at \$44 billion at the end of the period. Cardoso emerged from Brazil's presidential election victorious as expected, but the outcome of congressional and gubernatorial elections pointed to mixed support for his legislative agenda. In connection with its IMF program, the Brazilian government has unveiled a fairly ambitious fiscal agenda, which aimed to raise the primary budget balance by about 4 percent of GDP in 1999, relative to baseline projections, to a surplus of 2-1/2 percent of GDP. The funding of the international support package for Brazil is expected to amount to a little over \$40 billion, including \$18 billion from the IMF, \$9 billion from multilateral development banks, and nearly \$15 billion in bilateral support from 20 participating countries and the BIS (including \$5 billion from the United States).<sup>1</sup> Given uncertainties about Brazil's ability to deliver on its fiscal plans, the risks associated with this program are high. The markets' reaction in anticipation of the program has been generally favorable so far, but patience over delays in concluding the letter of intent may be wearing thin.

. The Desk did not intervene during the period for the accounts of the System or the Treasury.

**Economic activity abroad.** Early signs for the third quarter suggest that growth of foreign real GDP remained near zero. Activity in major industrial countries appears to

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1. The IMF Executive Board is not expected to vote on approval of the Brazilian package for as much as two weeks after the letter of intent is signed.

have weakened somewhat from its pace in the first half, but the downturn in Asian developing countries on average has slowed. Nearly all indicators in Japan, including another plunge in business confidence, point to a significant further decline in output in the third quarter. The sole bright spot was a surge in public works contracts in September, suggesting that fiscal stimulus is finally beginning to come on line. A large amount of funding was approved for recapitalization of Japan's weak banks, but without clear provisions for the removal of bad debts from the banks' balance sheets, the question remains as to whether these funds will actually stimulate bank lending.

In continental Europe, growth of industrial production picked up in July-August compared with the second quarter, but orders and measures of business sentiment were down in the third quarter, especially in Germany. U.K. GDP continued to grow moderately in the third quarter, but business and consumer confidence dropped sharply further in October. In Canada too, recent weakness in retail sales and in consumer confidence points to a slowing of growth. Inflation remains subdued in the major industrial countries, with the most recent 12-month rates running around zero in Japan, 1 percent in continental Europe and Canada, and 2-1/2 percent in the United Kingdom.

The rate of decline of industrial production in Korea and ASEAN countries slowed in the third quarter, and in China official statistics indicate that the growth of GDP from a year earlier picked up to close to its target rate of 8 percent. Twelve-month inflation has been stable or declining in these countries in recent months, at rates ranging from minus 1-1/2 percent in China to 80 percent in Indonesia, with most countries in a range of 2 to 10 percent. External balances in these economies have remained strongly in surplus or continued to move in that direction.

In Latin America, industrial production in the third quarter continued to grow at a robust pace in Mexico in the third quarter, but negative growth was recorded in Brazil (through August) and Argentina. Twelve-month inflation has been running a bit more than 15 percent in Mexico, around 1 percent in Argentina, and in negative territory in Brazil as food prices fell. All three countries have continued to run large current account deficits.

**U.S. net exports and prices.** The U.S. nominal trade deficit in goods and services widened to \$188 billion (annual rate) in July-August from \$174 billion in the second quarter. Imports and exports both declined, in part reflecting the effects of the GM strike on automotive trade with Canada and Mexico. Exports of industrial supplies fell and service receipts were off noticeably. Most of the decline in exports was to Canada, but shipments to Europe and Asia edged down as well.



Based on two months of trade data, real net exports of goods and services are estimated to have subtracted 0.9 percentage point from GDP growth in the third quarter, less than half as much as during the first half of 1998.

Prices of goods exports declined 4 percent at an annual rate in the third quarter, relative to the second quarter, with declines concentrated in agricultural commodities, industrial materials, and computers. Prices of non-oil imports fell 4-1/2 percent at an annual rate, about the same rate as in the first half of the year. These declines were widespread across commodity categories, especially industrial supplies, computers, and semiconductors. Prices of imports from key Asian economies (whose exports are heavily weighted toward computers and semiconductors) declined, whereas those from Europe and Canada were little changed.<sup>2</sup> In the third quarter, the price of imported oil fell about 25 percent at an annual rate because of earlier declines in spot prices that were driven by reports of unexpectedly high levels of oil stocks and by downward revisions in estimates of Asian oil consumption. The spot price for WTI has been trading between \$13 and \$14 per barrel during October and early November, a bit below its third-quarter average.

### **Outlook**

The staff expects that foreign GDP (weighted by U.S. nonagricultural export shares), which showed zero growth in the first half of this year, has continued flat in the second half. Over the next two years, we see growth resuming with a gradual pickup to about 2-1/2 percent by the end of 2000, still well below the average rate during 1992-96. Relative to the September forecast, we have added a couple of tenths to foreign growth in the second half of 1998, largely because of the surprisingly strong third-quarter number released for China, and we have subtracted a couple of tenths for 1999 and 2000, primarily because of a weaker outlook for Japan. We project that U.S. real net exports will decline enough to subtract nearly 1 percentage point from the rate of U.S. GDP growth in the fourth quarter and about 1/2 percentage point in 1999 and 2000. The amount subtracted is less than in the September forecast, especially in the near term, largely because the substantial decline in the dollar against the yen and several other Asian currencies in recent weeks has led us to mark down the path for the dollar in terms of a broad set of currencies by an average of about 3 percent over the forecast period.

Our forecast assumes that the international support package for Brazil, combined with Brazil's own internal efforts, will succeed in stabilizing financial markets in Latin America. We see a significant downside risk to this baseline forecast and therefore also

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2. The Asian economies covered by these data include Hong Kong, Korea, Singapore, and Taiwan.

consider a scenario in which Brazil is forced off its peg with attendant disruptions to other emerging market countries.

### Summary of Staff Projections

(Percentage change from end of previous period)

Measure	1997	-----Projection-----				
		1998			1999	2000
		H1	Q3	Q4		
Foreign output	4.1	0.0	0.2	0.0	1.4	2.2
<i>September</i>	3.9	0.1	-0.3	+0.1	1.5	2.4
Real exports	9.6	-5.3	-3.7	-0.1	2.3	4.7
<i>September</i>	9.6	-5.2	-1.7	-2.8	1.3	4.7
Real imports	14.0	12.5	3.8	6.9	6.1	6.5
<i>September</i>	14.0	12.4	5.5	7.7	6.1	6.6

**The dollar.** We project that the trade-weighted exchange value of the dollar against the major foreign currencies will decline from current levels. The dollar is expected to depreciate slightly against the euro-area currencies as U.S. economic activity slows relative to that in continental Europe. We project that the dollar will decline at a bit faster pace against the Canadian dollar as global recovery eventually helps that currency regain some of the ground it has lost since the beginning of the year. As in the previous forecast, there is considerable uncertainty about the factors that will affect the dollar/yen exchange rate. We have chosen to hold the dollar path near its current level against the yen throughout the forecast period. This path is seen as balancing the risk of dollar appreciation against the yen resulting from a significant further deterioration in economic activity in Japan against the risk of dollar depreciation in reaction to burgeoning current account imbalances.

Our forecast has the real exchange value of the dollar against a broad group of 35 currencies edging down slowly, as dollar depreciation against the major currencies and most Asian emerging-market currencies is nearly offset by appreciation against Latin American currencies. In Asia, inflationary pressures resulting from the sharp net currency depreciations over the past year and half are expected to dominate real exchange rate movements against the dollar in those regions. A notable exception to that forecast

scenario is China, where we expect authorities to begin allowing some modest depreciation of the renminbi over the forecast period. In Latin America, while we assume some moderate real depreciation of the dollar against the Mexican peso, the dollar is projected to rise against the Brazilian *real* in nominal and price-adjusted terms as macroeconomic policy adjustments in Brazil and external financial assistance allow Brazil to maintain its crawling currency peg with no resurgence of inflation. We continue to assume that the Argentine and Hong Kong currency pegs will hold also.

**Activity in foreign industrial countries.** The staff projects that real GDP growth in total foreign industrial countries will rise from 1¼ percent in the third quarter, to 1-1/2 percent in the fourth quarter and in 1999, and to 2 percent in 2000. These rates of growth are 1/4 percent to 1/2 percent lower than those in the September forecast, reflecting downward revisions for Japan and to a lesser extent Europe and Canada.

**Japan.** We now expect that Japanese GDP will decline at an annual rate of about 1/2 percent in the fourth quarter and will continue to decline at a similar rate well into 2000, a significant downward revision from the September forecast. Our forecast assumes that the government will inject fiscal stimulus equal to 1-1/2 percent of GDP in 1999 and 1/2 percent of GDP in 2000 through a combination of spending increases and tax cuts. Weakness in private domestic demand should more than offset this stimulus over the next six quarters or so. There are three reasons for the weaker GDP outlook: (1) further worsening of Japanese economic indicators; (2) the strong appreciation of the yen, which our forecast assumes will be sustained, will depress net exports; and (3) the deficiencies in the recently announced bank reform plan are greater and should weigh more heavily on the economy than we had assumed previously.

**Europe and Canada.** Real output growth in Euroland is expected to remain near 2-1/4 percent through the forecast period. Strength in domestic demand (supported by accommodative monetary policy) accounts for continued expansion as net exports are projected to make a negative contribution over the forecast period. Real GDP growth in Canada and especially the United Kingdom is projected to slow in the near term but to pick up moderately later next year and in 2000 in response to recent and projected interest rate cuts.

**Inflation.** Consumer price inflation in the major foreign industrial countries (on a four-quarter basis and weighted by U.S. non-oil import shares) is projected to fall to around 1/2 percent in the fourth quarter and much of next year as Japanese prices fall at a rate of 1 percent or more. We project the foreign average to rise to positive 1 percent by 2000 as Japanese deflation ends. Inflation is expected to be very low just about everywhere in the major countries. U.K. inflation is anticipated to remain near 2-1/2 percent, although on a

harmonized basis consistent with Euroland inflation measures, it should be closer to 1-1/2 percent.

**Interest rates.** This forecast incorporates the assumption that short-term market interest rates in Japan will remain very low. In coming weeks, interest rates in the euro area will decline somewhat further on average as rates finish converging to the current level of German rates before the start of EMU. In light of the weaker outlook for growth in Europe, we have revised our previous assumption that the ECB will leave interest rates unchanged next year, and we now assume that a modest monetary policy easing will occur early in 1999. We also assume that U.K. and Canadian interest rates will decline by another 75 to 100 basis points over the next year as growth slows in those countries.

**Other countries.** The real GDP of major developing-country trading partners of the United States is projected to decline about 1-1/2 percent at an annual rate during the second half of 1998, about a 1 percentage point smaller decline than forecast in the September Greenbook. We project that growth in most of the Asian developing countries will bottom out by the first half of next year and expand 1 percent for 1999 as a whole, and 3 percent in 2000, still substantially below the trend of recent years. We now expect real GDP in Latin America to decline in the second half of 1998 at an annual rate of 1 percent and to recover to 1¼ percent in 1999 and 2-1/2 percent in 2000. Fiscal contraction and some lingering elevation of real interest rates will depress GDP in Brazil (we are projecting a 2-1/2 percent decline in 1999, about the same as in the September forecast). This downturn will have a depressing effect on the region. At the same time a successful defense of Brazil's exchange regime may stave off a much sharper decline in GDP. This should also help relieve financial market pressures and support growth in other Latin American countries, particularly Argentina, which should face fewer difficulties in maintaining its exchange rate peg.

**Real exports and imports of goods and services.** Recent monthly trade data and a revised estimate of aircraft deliveries have led us to raise the projected growth of real exports of goods and services in the fourth quarter. We now project the decline in real net exports will subtract a bit less than 1 percentage point from GDP growth for the quarter at an annual rate. Beyond the fourth quarter, we have revised up the growth of exports. Stimulus to export growth from the lower projected path of the dollar has more than offset the depressing effect of moderately slower GDP growth abroad. Exports of nonagricultural goods other than computers and semiconductors (core exports) are now projected to decline at a 5 percent rate in the fourth quarter, to increase a bit in the second half of 1999, and to show moderate positive growth in 2000 as foreign economic activity begins to pick up. Previously, with a stronger dollar and modestly weaker growth abroad, we projected that

core exports would continue to decline through the end of 1999. With exports of computers and semiconductors expected to continue growing at a much more rapid pace than other exports in real terms, total exports of goods and services should grow 2 to 3 percentage points faster than core exports over the forecast period.

We expect that the growth of imports of goods and services will slow noticeably over the year ahead from its rapid pace over the past several years as U.S. real GDP growth declines. Real imports of non-oil goods other than computers and semiconductors (core imports) should decelerate from an annual rate of growth of 7 percent during the second half of this year to 4-1/2 percent growth in 1999 and 2000. Growth of imports of computers and semiconductors in real terms should remain rapid. The quantity of oil imports should decline this quarter and the next as inventories are drawn down from unusually high levels. We project that oil imports will thereafter rise a bit faster than consumption as U.S. oil production is adversely affected by low oil prices.

**Oil prices.** We have lowered the projected path for the price of imported oil in the near term to reflect the recent path of spot oil prices. We project that the oil import price will increase from \$11.62 per barrel in the third quarter to about \$11.90 per barrel in the

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

Trade category	1997	-----Projection-----				
		1998			1999	2000
		H1	Q3	Q4		
<i>Exports</i>						
Nonagricultural (core)	0.4	-2.1	-2.4	-0.4	1.5	1.3
Agricultural	-3.2	-11.0	-7.6	-2.0	4.1	2.0
<i>Imports</i>						
Non-oil (core)	-0.8	-2.6	-3.3	-0.3	1.1	1.2
Oil (level, dollars per barrel)	17.72	12.51	11.62	11.90	13.50	14.00

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.

fourth quarter and to about \$12.50 per barrel in the first quarter of 1999. The longer-term path remains unchanged from the previous forecast with oil prices averaging about \$13.50 per barrel in 1999 and \$14.00 per barrel in 2000.

**Prices of non-oil imports and exports.** We expect that the recent depreciation of the dollar will end the decline in core import prices that has occurred over the past year. We project core import prices to be flat in the fourth quarter and to begin to rise slowly during 1999, reaching a 1 percent rate of increase by the second half of the year and during 2000. Nonagricultural export prices for core goods, too, are projected to be flat in the fourth quarter and to begin rising slowly in 1999 and 2000, in line with comparable domestic prices.

**Nominal trade and current account balances.** The nominal trade deficit for goods and services is projected to widen significantly further over the forecast period, from about \$190 billion in the third quarter of this year to about \$280 billion in the fourth quarter of 2000. The deficit for net investment income also is projected to widen over the forecast period. As a result, the current account deficit is expected to grow from \$250 billion in the third quarter (nearly 3 percent of GDP) to an average of more than \$350 billion for the year 2000 (almost 4 percent of GDP, noticeably above the previous peak for this ratio that was reached in 1987).

### **Alternative Scenario for Brazil**

The risks surrounding the international outlook are substantial. In this alternative scenario we focus on the implications of failure of Brazil's IMF program based on simulations with the FRB/Global model. In this case, Brazil is unable to hold its exchange rate regime, and we assume that the *real* depreciates 30 percent in real terms against the dollar over the next several months relative to the Greenbook baseline and Brazil's GDP growth falls 8 percentage points relative to baseline during 1999 and 2 percentage points during 2000. Contagion to other countries in Latin America forces the Argentine peso off its peg and other currencies to depreciate significantly. Financial disruption causes GDP to decline several percentage points in other Latin American countries as well and by considerably smaller amounts elsewhere. Total foreign GDP growth is reduced by about 1 percentage point in 1999 and the dollar appreciates nearly 3 percent against a broad set of currencies.

Assuming the federal funds rate is held unchanged from its baseline path, the combined effect of this scenario (labeled "pessimistic Brazil" in the table below) on U.S. real net exports is enough to reduce U.S. real GDP growth by a bit less than 1/2 percentage point in 1999. The model predicts only a small negative effect on domestic financial variables including the U.S. stock market. To capture the effect of likely broader financial dislocations, we have also combined the pessimistic Brazil scenario with an additional 10 percent sustained drop in the U.S. stock market relative to baseline. In this case, U.S. GDP growth falls somewhat more than 1/2 percentage point in 1999 relative to baseline. This is

by no means a “worst case” concerning the potential effects of a meltdown in Brazil on both global and U.S. GDP.

Measure	1998	1999	2000
<i>U.S. CPI ex. food and energy</i>			
Baseline	2.4	2.2	2.2
Pessimistic Brazil	2.4	2.1	1.9
<b>Pessimistic Brazil + Stock Market*</b>	<b>2.4</b>	<b>2.1</b>	<b>1.8</b>

\* U.S. stock market falls 10 percent more.

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

Measure and country	1992	1993	1994	1995	1996	1997	-----Projected-----		
							1998	1999	2000
<b>REAL GDP</b>									
Canada	0.9	2.9	5.5	1.1	1.7	4.4	2.0	2.0	2.3
Japan	0.1	0.5	0.8	2.4	3.4	-0.4	-3.0	-0.7	-0.3
United Kingdom	0.7	3.2	4.6	1.9	2.6	4.0	1.9	1.3	2.2
Euro-11 Average (1)	0.1	-0.1	3.4	1.3	1.9	3.0	2.5	2.2	2.2
of which:									
France	-0.1	-0.5	4.1	0.3	2.4	3.0	2.3	1.8	1.8
Germany (2)	0.9	-0.2	3.4	0.0	2.1	2.3	2.4	2.0	2.2
Italy	-0.8	0.1	2.5	2.6	-0.2	2.8	1.4	1.9	2.1
Foreign G-7 Average weighted by 1991 GDP	0.2	0.7	2.8	1.5	2.3	1.9	0.3	1.0	1.3
Average weighted by share of U.S. nonagricultural exports									
Total foreign	2.2	3.3	5.1	2.0	4.0	4.1	0.1	1.4	2.2
Foreign G-7	0.6	1.8	4.1	1.4	2.2	3.1	1.0	1.4	1.8
Developing Countries	4.6	5.4	6.8	2.5	6.3	5.1	-1.8	1.1	2.7
<b>CONSUMER PRICES</b>									
Canada	1.8	1.8	-0.0	2.1	2.0	1.0	1.1	1.3	1.5
Japan	0.9	1.2	0.8	-0.8	0.1	2.1	-1.0	-1.0	0.0
United Kingdom (3)	3.7	2.7	2.2	2.9	3.2	2.8	2.5	2.5	2.5
Euro-11 Average (4)	NA	NA	NA	2.7	2.0	1.4	1.3	1.4	1.5
of which:									
France	1.8	2.1	1.6	1.9	1.7	1.2	0.9	1.0	1.0
Germany (2)	3.4	4.2	2.6	1.7	1.4	1.8	0.8	1.2	1.3
Italy	4.9	4.1	3.8	5.9	2.7	1.6	1.7	1.8	1.8
Foreign G-7 Average weighted by 1991 GDP	2.4	2.5	1.8	1.6	1.5	1.8	0.6	0.7	1.1
Average weighted by share of U.S. non-oil imports	1.9	2.0	1.0	1.1	1.3	1.7	0.4	0.5	0.9

1. Includes all of the European Union countries except the United Kingdom, Denmark, Sweden, and Greece; weighted by GDP.
2. CPI excluding mortgage interest payments which is the targeted inflation rate.
3. 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.



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

Measure and country	1998				1999				2000			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<b>REAL GDP</b>												
Canada	3.1	1.3	1.6	2.0	1.8	1.8	2.0	2.5	1.6	2.4	2.6	2.8
Japan	-5.2	-3.3	-3.0	-0.5	-0.2	-1.0	-0.5	-1.0	-1.6	-0.2	0.3	0.3
United Kingdom	3.1	1.9	2.0	0.5	0.4	1.3	1.7	1.9	1.5	2.3	2.5	2.5
Euro-11 Average (1)	3.4	2.0	2.8	1.7	2.0	2.2	2.2	2.5	1.7	2.4	2.4	2.4
of which:												
France	2.9	2.6	1.8	1.8	1.7	1.7	1.8	2.1	1.3	2.0	2.0	2.0
Germany	5.9	0.4	2.3	0.9	1.4	2.0	2.1	2.4	1.7	2.3	2.4	2.4
Italy	-0.5	1.7	3.5	1.0	1.8	1.8	1.9	2.2	1.6	2.3	2.3	2.3
Foreign G-7 Average weighted by 1991 GDP	0.3	-0.1	0.5	0.6	0.9	0.8	1.1	1.2	0.5	1.4	1.7	1.7
Average weighted by share of U.S. nonagricultural exports												
Total foreign	-0.5	0.5	0.2	-0.0	0.7	1.2	1.6	2.1	1.5	2.3	2.5	2.6
Foreign G-7	1.5	0.5	0.8	1.2	1.2	1.2	1.5	1.7	1.0	1.8	2.1	2.2
Developing Countries	-3.8	-0.3	-1.1	-2.0	-0.3	0.8	1.6	2.5	2.1	2.7	3.0	3.2
<b>CONSUMER PRICES (2)</b>												
Canada	1.0	1.0	0.9	1.1	1.2	1.2	1.3	1.3	1.4	1.4	1.5	1.5
Japan	2.1	0.6	-0.1	-1.0	-1.3	-1.5	-1.3	-1.0	-0.7	-0.5	-0.2	0.0
United Kingdom (3)	2.5	3.0	2.6	2.5	2.6	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Euro-11 Average (4)	1.2	1.5	1.2	1.3	1.3	1.3	1.4	1.4	1.4	1.5	1.5	1.5
of which:												
France	0.7	1.0	0.7	0.9	0.9	0.9	0.9	1.0	1.0	1.0	1.0	1.0
Germany	1.2	1.3	0.8	0.8	0.9	1.0	1.1	1.2	1.2	1.3	1.3	1.3
Italy	1.7	1.8	1.8	1.7	1.7	1.7	1.7	1.8	1.8	1.8	1.8	1.8
Foreign G-7 Average weighted by 1991 GDP	1.6	1.3	0.9	0.6	0.5	0.4	0.5	0.7	0.8	0.9	1.0	1.1
Average weighted by share of U.S. non-oil imports	1.6	1.1	0.6	0.4	0.3	0.2	0.3	0.5	0.6	0.7	0.9	0.9

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.

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1992	1993	1994	1995	1996	1997	----- 1998	Projected 1999	----- 2000
<b>NIPA REAL EXPORTS and IMPORTS</b>									
Percentage point contribution to GDP growth, Q4/Q4									
Net Goods & Services	-0.4	-0.6	-0.4	0.5	-0.3	-0.6	-1.6	-0.5	-0.4
Exports of G&S	0.4	0.5	1.0	1.1	1.2	1.1	-0.4	0.3	0.5
Imports of G&S	-0.8	-1.1	-1.4	-0.7	-1.4	-1.7	-1.1	-0.8	-0.9
Percentage change, Q4/Q4									
Exports of G&S	4.1	4.6	10.0	10.5	10.3	9.6	-3.6	2.3	4.7
Services	-0.9	4.1	6.0	9.8	7.5	1.5	-2.2	2.1	1.8
Agricultural Goods	10.4	-5.5	16.6	-4.3	4.8	2.8	-6.8	-4.7	0.0
Computers	25.2	23.7	32.0	55.5	35.9	40.7	9.0	26.6	28.3
Semiconductors	64.8	32.9	66.9	79.6	46.2	21.0	3.7	20.7	23.6
Other Goods 1/	2.3	3.6	7.0	5.8	8.0	11.6	-5.5	0.1	3.5
Imports of G&S	7.4	10.2	12.3	5.6	11.8	14.0	8.9	6.1	6.5
Services	1.4	3.2	1.4	6.1	5.5	12.4	1.3	1.6	3.1
Oil	12.1	10.1	-0.2	2.4	7.9	4.0	-0.4	3.8	6.1
Computers	45.1	39.3	44.8	48.1	24.4	30.3	23.1	30.2	29.9
Semiconductors	42.0	34.2	54.5	92.4	57.6	32.7	0.9	26.2	26.2
Other Goods 2/	5.4	9.5	12.2	-1.2	10.4	13.0	10.4	4.6	4.6
Billions of chained 1992 dollars									
Net Goods & Services	-29.5	-70.2	-104.6	-96.5	-111.2	-136.1	-249.1	-325.4	-366.3
Exports of G&S	639.4	658.2	712.4	792.6	860.0	970.0	972.4	974.2	1011.9
Imports of G&S	669.0	728.4	817.0	889.0	971.2	1106.1	1221.5	1299.6	1378.2
Billions of dollars									
US CURRENT ACCOUNT BALANCE	-51.4	-86.1	-123.8	-115.3	-134.9	-155.2	-235.5	-314.7	-356.1
Net Goods & Services (BOP)	-38.7	-71.9	-100.9	-99.9	-108.6	-110.2	-177.7	-240.6	-270.5
Exports of G&S (BOP)	617.3	643.2	703.8	795.6	850.8	937.6	918.8	912.8	949.0
Imports of G&S (BOP)	656.0	715.2	804.7	895.5	959.3	1047.8	1096.5	1153.4	1219.5
Net Investment Income	22.5	23.9	16.5	19.3	14.2	-5.3	-16.7	-32.3	-43.8
Direct, Net	51.6	55.7	51.8	63.0	66.2	63.7	57.3	49.5	55.4
Portfolio, Net	-29.1	-31.7	-35.3	-43.7	-51.9	-69.1	-74.0	-81.9	-99.2
Net Transfers	-35.2	-38.1	-39.4	-34.6	-40.6	-39.7	-41.1	-41.8	-41.8

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1995				1996				1997			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<b>NIPA REAL EXPORTS and IMPORTS</b>												
	Percentage point contribution to GDP growth											
Net Goods & Services	-0.2	-0.3	1.6	0.7	-1.1	-1.0	-1.4	2.4	-1.3	-0.4	-0.5	-0.3
Exports of G&S	1.0	0.6	1.9	1.1	0.4	0.6	0.2	3.2	0.9	1.7	1.2	0.5
Imports of G&S	-1.2	-0.9	-0.3	-0.4	-1.5	-1.6	-1.6	-0.9	-2.2	-2.2	-1.7	-0.8
	Percentage change from previous period, SAAR											
Exports of G&S	9.2	5.4	17.8	10.2	3.7	5.8	2.1	32.0	8.3	15.5	10.6	4.4
Services	9.1	2.9	21.7	6.4	-4.0	10.3	-9.9	39.8	-6.7	11.8	5.9	-4.0
Agricultural Goods	1.8	-13.4	5.0	-9.4	22.6	-32.8	-1.6	48.7	-16.1	-7.8	8.7	32.8
Computers	36.4	33.8	86.6	71.6	57.6	24.7	27.7	35.9	70.2	78.7	41.9	-9.2
Semiconductors	72.0	100.8	96.2	53.6	23.8	29.7	30.2	118.6	41.3	17.3	32.3	-2.2
Other Goods 1/	4.3	1.4	9.4	8.1	0.1	6.0	5.7	21.3	13.8	15.6	9.2	8.0
Imports of G&S	9.8	7.2	2.0	3.5	13.1	13.5	13.6	7.0	18.6	17.9	13.5	6.3
Services	20.5	-3.3	3.1	5.5	9.2	4.3	9.9	-1.1	17.8	10.6	15.8	5.8
Oil	-11.4	15.4	31.4	-18.2	-9.8	68.9	3.5	-14.0	-8.2	37.0	6.0	-12.2
Computers	15.4	51.6	62.7	69.3	22.5	22.9	18.8	33.8	54.5	39.0	30.6	2.9
Semiconductors	37.1	105.5	128.2	113.3	38.7	8.9	50.1	172.1	89.0	16.0	20.3	17.6
Other Goods 2/	7.2	1.5	-8.8	-3.8	13.9	10.5	13.5	4.2	16.2	16.1	11.8	8.1
	Billions of chained 1992 dollars, SAAR											
Net Goods & Services	-109.5	-114.7	-86.8	-74.8	-95.5	-113.5	-140.1	-95.9	-121.5	-131.6	-142.4	-149.0
Exports of G&S	763.9	774.0	806.3	826.1	833.6	845.5	849.9	911.1	929.4	963.6	988.1	998.8
Imports of G&S	873.4	888.7	893.1	900.9	929.1	958.9	990.0	1007.0	1050.9	1095.2	1130.5	1147.8
	Billions of dollars, SAAR											
US CURRENT ACCOUNT BALANCE	-123.7	-134.2	-115.5	-87.7	-112.9	-132.0	-161.6	-133.2	-148.0	-140.4	-152.4	-180.2
Net Goods & Services (BOP)	-109.3	-125.8	-90.0	-74.5	-92.4	-112.8	-132.3	-96.8	-112.5	-106.1	-108.4	-113.8
Exports of G&S (BOP)	765.4	782.0	809.7	825.6	833.6	845.3	837.5	886.7	904.7	936.1	951.7	957.8
Imports of G&S (BOP)	874.7	907.7	899.7	900.1	926.0	958.2	969.8	983.5	1017.3	1042.1	1060.1	1071.7
Net Investment Income	20.1	24.0	10.2	22.7	21.4	15.9	6.9	12.7	0.1	1.8	-6.2	-17.0
Direct, Net	59.9	67.2	56.5	68.3	64.8	64.4	61.9	73.6	64.2	69.6	65.5	55.6
Portfolio, Net	-39.8	-43.2	-46.2	-45.5	-43.3	-48.5	-55.0	-60.9	-64.2	-67.8	-71.7	-72.6
Net Transfers	-34.5	-32.4	-35.8	-35.9	-41.9	-35.1	-36.2	-49.1	-35.5	-36.1	-37.8	-49.3

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1998				1999				2000			
	-----				-----				-----			
	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	-2.3	-2.1	-0.9	-0.9	-0.7	-0.7	-0.5	-0.3	-0.3	-0.5	-0.5	-0.2
Exports of G&S	-0.3	-0.9	-0.4	-0.0	0.1	0.2	0.3	0.4	0.4	0.5	0.5	0.6
Imports of G&S	-1.9	-1.2	-0.5	-0.9	-0.8	-1.0	-0.8	-0.6	-0.6	-1.0	-1.0	-0.8
Percentage change from previous period, SAAR												
Exports of G&S	-2.8	-7.7	-3.7	-0.1	0.9	2.2	2.9	3.4	3.4	4.7	5.2	5.5
Services	-1.2	1.7	-9.3	0.4	2.4	2.4	1.8	1.6	0.9	2.0	2.0	2.2
Agricultural Goods	-9.9	-23.4	-7.8	18.8	-13.3	-4.2	-0.9	0.0	0.0	0.0	0.0	0.0
Computers	-15.5	8.7	21.5	26.2	26.2	26.2	26.7	27.2	27.7	28.2	28.6	28.6
Semiconductors	-2.0	-18.7	21.6	19.3	19.3	20.4	21.6	21.6	22.7	23.9	23.9	23.9
Other Goods 1/	-1.6	-11.0	-3.8	-5.2	-1.6	-0.4	0.7	1.7	1.9	3.4	4.2	4.7
Imports of G&S	15.7	9.3	3.8	6.9	6.4	7.4	6.0	4.7	4.9	7.5	7.6	6.0
Services	9.3	-0.6	-2.4	-0.8	0.1	0.9	2.4	2.9	1.5	3.8	3.5	3.5
Oil	8.8	41.4	-17.6	-22.4	-5.9	39.7	8.1	-18.3	5.1	29.7	12.7	-17.7
Computers	38.8	22.4	7.0	26.2	33.5	31.1	28.6	27.4	26.2	31.1	31.1	31.1
Semiconductors	9.9	-28.0	-0.0	31.1	26.2	26.2	26.2	26.2	26.2	26.2	26.2	26.2
Other Goods 2/	16.1	10.7	6.8	8.3	5.7	4.5	4.1	4.2	3.1	4.3	5.6	5.5
Billions of chained 1992 dollars, SAAR												
Net Goods & Services	-198.5	-245.2	-265.9	-286.9	-304.3	-322.0	-334.1	-341.0	348.6	-361.7	374.3	-380.8
Exports of G&S	991.9	972.1	962.9	962.7	964.7	970.0	976.9	985.2	993.6	1004.9	1017.7	1031.4
Imports of G&S	1190.4	1217.3	1228.8	1249.6	1269.0	1292.0	1311.0	1326.3	342.2	1366.6	391.9	1412.2
Billions of dollars, SAAR												
US CURRENT ACCOUNT BALANCE	-186.9	-224.5	-249.9	-280.5	-288.4	-308.5	-320.9	-341.0	-338.5	-348.5	-360.3	-377.0
Net Goods & Services (BOP)	-140.0	-174.3	-188.9	-207.6	-222.6	-239.9	-247.8	-252.1	-257.7	-268.3	-276.7	-279.4
Exports of G&S (BOP)	946.2	921.1	906.1	901.9	903.3	908.6	915.8	923.6	931.7	942.5	954.4	967.3
Imports of G&S (BOP)	1086.2	1095.4	1095.0	1109.5	1125.9	1148.5	1163.6	1175.8	1189.5	1210.7	1231.1	1246.7
Net Investment Income	-9.0	-13.0	-22.0	-22.9	-26.7	-29.7	-34.1	-38.9	-41.8	-41.3	-44.6	-47.6
Direct, Net	62.4	61.0	53.8	52.0	49.1	49.5	49.6	49.8	51.4	55.7	56.7	57.9
Portfolio, Net	-71.3	-74.0	-75.8	-74.9	-75.9	-79.2	-83.7	-88.7	-93.1	-97.0	-101.3	-105.5
Net Transfers	-37.9	-37.3	-39.0	-50.0	-39.0	-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.