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Strictly Confidential (FR) Class II FOMC

December 14, 1994

SUMMARY AND OUTLOOK

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

Overview

Echoing 1992 and 1993, the U.S. economy is apparently ending the year with a bang. From the information available now, we estimate that real GDP is increasing somewhere around 5 percent at an annual rate in the current quarter, with an even sharper gain in the manufacturing sector. Business fixed investment and exports appear to be pacing the expansion, but consumer demand is also increasing briskly as households seem to be more confident and quite willing to spend the income generated by the rapid growth in jobs. Inventories, though growing at a fast clip through the early fall, evidently remain comfortable, if not lean, in most sectors.

These developments would appear to call into question our previous judgments about the underlying strength of expansionary forces in the economy and the restraining effects of the changes in the financial environment that have occurred over the past year. Indeed, the upside risks noted in the last Greenbook seem to be materializing. Nevertheless, even though we have revised up our forecast of growth over the next couple of quarters, we still anticipate that a substantial deceleration will occur in 1995. This forecast reflects in part the inevitable moderation of inventory investment--though the timing of that swing obviously is uncertain. In addition, we have raised the assumed path for the federal funds rate so as to impose the further restraint that will probably be needed to reverse the recent overshooting of non-inflationary levels of resource utilization. The pace of output growth is projected to slow well below potential by the middle of next year and to remain there for several quarters.

Obviously, our assessment of the inflationary risks in the outlook remains something of a conjecture at this point. On balance, incoming price data have been more favorable than we had expected, and we have marked down our CPI projection for 1995. Nonetheless, the recent surge in resource utilization is still expected to lead to some deterioration in price performance in the near term. After mid-1995, though, with an easing of pressures on resources and with the bulge in materials costs having been largely passed through to prices of final goods, core inflation should drop back to a rate just a little above the recent trend.

Key Assumptions

Short-term interest rates are assumed to rise appreciably over the next several months and to ease only a little from those higher levels over the remainder of the projection period. Thus, as indicated above, short rates are somewhat higher in 1995 and 1996 than was assumed in the last Greenbook. Nonetheless, we have lowered the near-term path for long rates a little; the recent behavior of the bond market seems to support our previous view about the likelihood of a significant flattening of the yield curve. Bond and mortgage rates are projected to fluctuate near recent levels through early 1995 and then to move lower as economic activity moderates and fears about inflation subside.

Members of the Congress are talking about a variety of changes in the federal budget, and the prospect of tax and spending cuts may already be affecting expectations throughout the economy and the financial markets. President Clinton is slated to reveal some of his plans on December 15. The fiscal outlook is thus in flux. Any changes that occur, however, are likely to be spread over several years, and given the constraints within which the Congress and the Administration will be working, we have assumed that the budget deficit will not be affected greatly at the aggregate level within the next two years. Under our present assumptions, the unified deficit is projected to total $186 billion in FY1995 and $204 billion in FY1996. These estimates are essentially the same as those in the November Greenbook.

With respect to the external sector, recovery has continued apace in key industrial economies, and we have raised our projection for the increase in total foreign real GDP (on an export-weighted basis) in 1994 from 4 percent to 4-1/4 percent. We expect healthy growth to continue in 1995 and 1996. Meanwhile, the trade-weighted value of the dollar in terms of other G-10 currencies has risen since the last FOMC meeting, and it is projected to remain around current levels over the forecast period. The spot price for WTI crude oil has dropped to around $17 per barrel, partly because of unseasonably warm weather. Nonetheless, we still expect it to move up to about $18.50 per barrel by late next spring--the same level as in last month's Greenbook--and to remain in that area through 1996.

Current-quarter Economic Activity

The data set for the current quarter still contains gaping holes, but the available information suggests that real GDP will probably register a gain somewhere around 5 percent at an annual rate--roughly a percentage point above the point-estimate in the November Greenbook. The predicted pace is broadly consistent with the strong indicators for the labor market in October and November and the still low level of initial claims for unemployment insurance into early December. Industrial production is also rising briskly this quarter, especially in the manufacturing sector, where output appears to be increasing at an annual rate of almost 7 percent.

SUMMARY OF THE NEAR-TERM OUTLOOK
(Percent change, at annual rates, unless otherwise noted)

	1994 Q3	1994 Q4
Real GDP	3.9	5.0
Previous	3.4	4.1
Final sales	4.2	6.0
Previous	3.1	4.8
Unemployment rate (level, percent)	6.0	5.6
Previous	6.0	5.7

The incoming data on spending and inventories are also consistent with a big gain in real GDP this quarter. The spending figures in hand appear to be consistent with final sales growth at an annual rate of around 6 percent. As for inventories, we think our forecast of a moderate falloff in the pace of stockbuilding represents a sensible balancing of the impetus to accumulation from firms' desire to maintain adequate buffer stocks against the run-offs associated with stronger-than-expected growth in final sales.

The surge in final sales this quarter is being paced by continued rapid growth in business fixed investment. At this stage, we estimate that real BFI will grow at an annual rate of close to 20 percent, with broad-based advances likely for both producers' durable equipment and nonresidential construction. Orders and shipments of computing equipment posted large gains through early autumn, and reports in the trade press suggest that demand for these items continues to surge.[1] Bookings for other types of equipment (excluding aircraft) have also remained robust, the October level

1. We do not expect the difficulties with the Pentium chip to have much effect on outlays in the current quarter. The problem was not made public until late November, and Pentium-based machines account for only a small share of business computer purchases. Moreover, any drop in sales is likely to be largely offset in GDP by movements in inventories. Looking ahead, we have trimmed $2 billion (annual rate) from real computer outlays in the first quarter of 1995.

being nearly 2 percent (not at an annual rate) above the average for the third quarter. In addition, the gains in construction-put-in-place in September and October set the stage for a sizable increase in real outlays for nonresidential construction this quarter.

Strong growth in real disposable income, combined with a marked upturn in sentiment, appears to be providing considerable impetus to consumer spending this quarter. We look for an increase in consumption of 5-1/2 percent at an annual rate, compared with growth averaging about 3 percent at an annual rate over the first three quarters of the year. A jump in sales of autos and light trucks, when measured using BEA seasonal factors, accounts for roughly a percentage point of the increase in consumption.[2] But the incoming data for retail sales imply that outlays for goods other than motor vehicles are posting hefty gains as well; we estimate that, in real terms, they rose 1/2 percent in November to a level nearly 2 percent (not at an annual rate) above the third-quarter average.

By contrast, real outlays for residential construction are expected to decline moderately this quarter, mainly because of the drop in single-family starts. The evidence--statistical and anecdotal--on this sector continues to be ambiguous and, frankly, somewhat puzzling. However, perhaps because of our priors about how activity "should" respond to the rise in mortgage rates this year, we expect single-family starts in November and December to match, on average, the October pace of 1.14 million units (annual rate)--down materially from the 1.21 million rate of the third quarter.

In the government sector, federal purchases should drop markedly in the fourth quarter, after having been boosted by a fluky

2. Using BEA seasonals, sales increased from 14.6 million units (annual rate) in the third quarter to 15.4 million units, on average, in October and November. On FRB seasonals, the increase was only from 15.1 million units to 15.3 million units.

jump in defense spending in the third quarter. The Monthly Treasury Statement for October suggests that defense spending is moving back toward the path implied by the underlying trends in appropriations. Meanwhile, real purchases by state and local governments are likely to post another sizable rise this quarter, in part because of a jump in construction outlays in October. In addition, even allowing for the hiring of poll workers, payrolls in November stood moderately above the third-quarter average.

Although we have no hard data, we expect real net exports to flatten out, after having subtracted nearly a percentage point, on average, from real GDP growth over the first three quarters of the year. All reports point to brisk growth of exports, but the vigorous expansion of domestic demand suggests that imports will be up strongly as well.

Although the rapid growth of manufacturing here and abroad has been pushing up the prices of industrial materials and components, inflation at the consumer level has remained subdued. The CPI increased 0.3 percent in November, in part because of a spurt in energy prices.[3] The core component rose just 0.2 percent for a third month, and the twelve-month change slipped back to 2.8 percent. Average hourly earnings fell 0.2 percent last month after leaping 0.6 percent in October; over the past twelve months, hourly earnings rose only 2.6 percent, helping to hold increases in unit labor costs to moderate proportions as productivity growth slowed.

The Outlook for the Economy in 1995 and 1996

We expect the current surge in activity to provide some momentum for growth in early 1995. In particular, the continuing

3. As discussed in Greenbook Part 2, the mandated reformulation of gasoline will add to pump prices over the near term. However, the BLS intends to treat this mandate as a "quality improvement," thus eliminating any direct effect on the CPI.

strength of sales appears to be motivating many firms to seek additional workers and to expand their facilities, and firms in some industries may need to rebuild inventories. Real short-term credit costs are not prohibitive at this point, and credit availability does not appear to be an issue for either consumers or businesses: Banks have yet to curb the trend toward easier nonprice lending terms and standards that has been in place for a couple of years now. Under the circumstances, we have added 1/2 percentage point to the real GDP growth rate we had previously projected for the first half of next year.

Nonetheless, the pace of activity expected for the first half of next year--2-1/2 percent (annual rate)--marks a noticeable deceleration from 1994, and we anticipate growth to slow further, to a 1-1/4 percent rate in the second half. To a substantial degree, this pattern simply reflects the lagged effects of the earlier increases in interest rates on private domestic final purchases, which are magnified by the dynamics of inventory adjustments and by multiplier effects on income and spending. The further tightening of money market conditions will impose additional restraint by making new short-term loans more expensive and by increasing the burden of servicing existing floating-rate debt. Moreover, higher real short rates, and the greater concerns that are likely to arise about the sustainability of economic expansion, should put some downward pressure on the values of shares and other assets. Finally, we doubt that bank lending practices will continue to ease in an environment of slower economic growth and less certainty about the prospect of repayment. All told, we now project that growth in real GDP will remain well below potential into 1996, with only a slight firming in the latter part of that year as the easing in nominal interest rates stimulates a mild pickup in homebuilding and other final demand.

SUMMARY OF STAFF PROJECTIONS[1]
(Percent change at annual rates, except as noted)

	1994	1995 H1	1995 H2	1996
Real GDP	4.1	2.5	1.3	1.8
Previous	3.8	1.9	1.2	2.2
Private domestic final purchases[2]	4.9	3.9	2.1	2.1
Previous	4.2	2.9	1.8	2.4
Civilian unemployment rate (percent)[3]	5.6	5.5	5.7	6.1
Previous	5.7	5.8	6.1	6.3

1. Percent change from final quarter of previous period to final quarter of period indicated, unless otherwise indicated.
2. Personal consumption expenditures plus business fixed investment plus residential investment.
3. Average level for the final quarter of period indicated.

Consumer spending. Our forecast now has real consumer spending growing at an annual rate of nearly 3-1/2 percent in the first quarter of 1995, a percentage point more than in the November Greenbook. The fourth-quarter surge in wages and salaries is likely to produce a whopping 6-1/2 percent (annual rate) gain in real disposable personal income in the fourth quarter. And, indications of hiring plans (for example, from Manpower Inc.) suggest that job growth will remain brisk in the first quarter, increasing income and buoying sentiment in the face of what we anticipate will be less favorable financial market conditions.

As we move through 1995, however, the underlying pace of income growth slows, and we expect to see increases in consumption drop into the area of 1-1/2 percent at an annual rate in the second half of the year. Finance charges on auto and other consumer loans will rise appreciably over the coming year, in lagged adjustment to the increases in market rates that have already occurred and to the assumed further rise in short rates; this increase will affect many existing floating-rate loans as well as new borrowings. We also anticipate that weak asset prices will contribute to a negative wealth effect on consumer demand, offsetting any stimulus to spending that might be associated with the higher interest earnings many households are enjoying. These influences are expected to push up the saving rate over the next two years--to a level of about 4-1/2 percent in 1996, 1/2 percentage point above that in 1993-94.

Outlays for durables tend to be more discretionary or deferrable than some other types of consumption and, thus, are likely to be especially sensitive to the slowing of income growth. In particular, sales of light vehicles are projected to drop from well above 15 million units at an annual rate in the past few months to 14-1/2 million units in late 1995 and 1996, a pace below longer-term trends and well below current industry hopes.

Business fixed investment. We think that 1995 will see substantial further growth in spending on business equipment, but, as the year progresses, outlays should decelerate considerably. Overall, real purchases of producers' durable equipment are expected to rise 9-1/2 percent over the four quarters of the year, down from 16 percent over 1994. Spending on office and computing machines will continue to be spurred by technological innovations that expand computing capabilities and push down prices; we look for an increase in real outlays in 1995 close to the 19 percent gain we are projecting for this year. The recent trends in orders also point to continued sizable gains in spending for other types of equipment in the near term.

After the next few quarters, however, the deceleration in business output should restrain capital expenditures across the board; in addition, with profits squeezed and little further growth in cash flow, firms will have to rely increasingly on external sources to finance their expenditures. In particular, we foresee spending on equipment other than computers (and motor vehicles) falling in the first half of 1996 and then flattening out later in that year.

With construction permits for most major building categories on decided uptrends, we project that real investment in nonresidential structures will rise more than 7-1/2 percent in 1995 and about 6-1/2 percent in 1996, both figures being somewhat higher than we expect for 1994. The strong growth we are projecting might look anomalous in the context of a weakening economic environment, but the climb is occurring from a deeply depressed level, and lags in adjustment in this sector traditionally have been long. Among the key sectors, the sharp rise in factory operating rates this year is currently providing considerable impetus to industrial construction; and firms producing computer chips, as well as other manufacturers, are reportedly planning substantial expansions of plant capacity over the next couple of years. In addition, outlays for office and other commercial construction should continue to be bolstered by the greater availability of financing for such projects. The rise in interest rates this year has, at the margin, had a negative effect on the valuation of properties; however, anecdotal evidence suggests that--despite a fall-off in REIT activity from the pace earlier this year--prices are quite firm in many markets and interest in real estate deals remains high. Thus, despite the assumed further tightening in the money market, our construction forecast may well have an upside risk.

Residential investment. We continue to project a softening in single-family housing activity in 1995, but the decline is now expected to be smaller than projected in the November Greenbook. To some extent, we attribute the surprising resiliency of housing activity to date to the strong income gains in recent quarters, and we have allowed the higher projected level of income in the current forecast to buoy housing demand in the period ahead. In addition, even at current levels of mortgage rates, houses remain highly affordable by historical standards (gauged on a cash-flow basis), a factor that may be providing a greater offset to the influence of rising rates than we anticipated. All told, we expect single-family starts to drop from 1.18 million units in 1994 to 1.10 million units in 1995 and to increase only slightly in 1996 in response to a moderate easing of nominal mortgage rates.

Multifamily starts are projected to remain on the gradual uptrend that has been evident over the past couple of years. Activity in this sector should continue to be bolstered by emerging demand pressures in some markets as well as by the improved availability of financing for these projects.

Business inventories. We expect inventory investment to remain elevated a while longer, as firms remain concerned about the availability of supplies and as sales expectations remain high. Over the longer run, however, current rates of accumulation are clearly unsustainable. The experience of the past several years suggests that firms will be aggressive in trimming orders and production when confronted with flagging sales, and any overhangs that develop are likely to be short-lived. Inventory investment thus is expected to slow in the second quarter of 1995 and to fall considerably further over the second half of the year, shaving more than 1/2 percentage point off the real GDP growth rate, on average, during that latter period. Inventories are not expected to have much effect on real GDP growth in 1996.

Government purchases. As noted above, the unwinding of the third-quarter bulge in defense spending is producing a steep drop in real federal purchases in the current quarter; we expect this process to extend into the first half of 1995. Consistent with the requirements of OBRA-1993, we have built in moderate further decreases in federal purchases after mid-1995: Real defense spending is expected to decline at an annual rate of about 6 percent in the second half of 1995 and 4-1/2 percent over the four quarters of 1996, while real nondefense purchases are expected to edge down over the period as a whole.

Real state and local purchases of goods and services are projected to remain on the moderate uptrend that has been evident over the past two years: The projected growth rates for 1995 and 1996--close to 2-1/2 percent per year, on average--are a little below the average for 1993 and 1994. Even though the general funds budgets of many states now seem to be in better shape, significantly higher outlays for public services and infrastructure improvements do not seem likely, given the political pressures to hold the line on--or to cut--taxes.

Net exports. After having increased substantially in 1993 and 1994, the deficit in real net exports is projected to change little, on balance, over the next two years. The anticipated leveling out is partly attributable to the lagged effects of the weak dollar in 1994; but more important, the robust pace of economic activity abroad should bolster exports while the moderation in the growth of U.S. GDP should help to restrain imports. (A complete discussion of these developments is contained in the International Developments section.)

Labor markets. Businesses will no doubt continue to look for ways to economize on labor expenses. However, the easiest organizational and technological improvements have already been adopted, and further outsized gains in labor productivity do not appear likely. Thus, to meet the growth in sales and production that we are forecasting into early 1995, businesses will need to maintain a brisk pace of hiring.

The rapid pace of job creation of late appears to be spurring an uptick in the participation rate, and further improvements in job prospects should stimulate somewhat faster growth of the labor force in the first part of next year. On balance, the unemployment rate is projected to remain at around 5-1/2 percent through mid-1995.

With output growth dropping to an annual rate of only about 1-1/4 percent in the second half of 1995 and remaining below potential in 1996, employment gains taper off and the unemployment rate backs up noticeably. Nonetheless, the projected unemployment rate at the end of 1996--at 6.1 percent--is a shade below that in the November Greenbook. As for productivity, we now expect to see an increase of only about 3/4 percent over 1995 as whole. Productivity growth is expected to improve a little in 1996--but still to fall a bit short of its long-run trend of close to 1-1/2 percent.

SUMMARY OF STAFF INFLATION PROJECTIONS
(Percent change at annual rates)

		1995		
	1994	H1	H2	1996
ECI for compensation of private industry workers[1]	3.3	3.7	3.7	3.7
Previous	3.3	3.8	3.7	3.6
Consumer price index[2]	2.7	3.1	2.9	2.9
Previous	2.9	3.5	3.0	2.9
Excluding food and energy	2.9	3.4	3.0	3.1
Previous	3.1	3.7	3.1	3.1

1. Percent change from final month of previous period to final month of period indicated.
2. Percent change from final quarter of previous period to final quarter of period indicated.

Wages and prices. The incoming data still provide no indication that a broad acceleration of wages and prices is under way. Nonetheless, with the economy growing rapidly and resource utilization now exceeding levels that we believe are consistent with stable inflation, we continue to forecast an upturn in wage and price inflation in early 1995.

Reports of labor "shortages" and wage pressures seem to be multiplying of late--a pattern consistent with our notion that the unemployment rate has dropped below the "NAIRU." Although cost-of-living trends have been stable recently, we expect that tighter labor markets are leading to a pickup in wages. The ECI for private industry workers is expected to increase 3.7 percent in each of the next two years, compared with an estimated increase of 3.3 percent in 1994. The acceleration in 1995 is likely to be concentrated in wages, which are forecast to rise 3-1/2 percent over the year, while increases in benefits are expected to continue to run at about the 4 percent pace now estimated for 1994. Judging from survey information and press reports, the fierce competition in the medical marketplace seems to be exerting a powerful restraint on health insurance premiums for 1995. At the same time, we expect firms with underfunded pension plans to continue to step up the pace of contributions.

The price information received since the last FOMC meeting has contained some pleasant surprises, and we have lowered our CPI forecast for both the current quarter and 1995. Nonetheless, we continue to expect an uptick in inflation in early 1995, with the core CPI rising at a 3-1/2 percent annual rate. This pickup reflects our expectation that past and prospective large increases in the prices of materials and components will be passed through more fully into finished goods prices in the near term. The upward pressures on materials prices reflect both the so-called "speed effect" associated with rising rates of resource utilization and the acceleration of non-oil import prices that has followed the drop in the exchange rate earlier this year. We are allowing for a concentrated bulge in the inflation rate because anecdotal reports point to the possibility of a bunching of price hikes just after the turn of the year.

With economic growth slowing and pressures on resource utilization easing in the latter part of next year, we should see some reversal of the speed effects. And, the projected stability in the exchange rate should lead to a moderation in the increases in non-oil import prices over the course of 1995. In 1996, the core CPI is expected to rise just over 3 percent, about a quarter percentage point more than projected for this year. With increases in food and energy prices expected to remain on the moderate side in 1995 and 1996, the total CPI is expected rise a bit less than the core measure.

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

December 14, 1994

Interval	Nominal GDP		Real GDP		GDP fixed-weight price index		Consumer price index[1]		Unemployment rate (level except as noted)	
	11/09/94	12/14/94	11/09/94	12/14/94	11/09/94	12/14/94	11/09/94	12/14/94	11/09/94	12/14/94
ANNUAL										
1992[2]	5.2	5.2	2.3	2.3	3.2	3.2	3.0	3.0	7.4	7.4
1993[2]	5.4	5.4	3.1	3.1	3.0	3.0	3.0	3.0	6.8	6.8
1994	6.1	6.2	3.9	4.1	2.7	2.7	2.6	2.7	6.1	6.1
1995	5.1	5.6	2.5	3.1	3.1	3.1	3.3	3.0	5.9	5.6
1996	4.3	4.2	1.8	1.6	2.9	2.9	3.0	2.9	6.2	6.0
QUARTERLY										
1993 Q1[2]	4.4	4.4	1.2	1.2	4.2	4.2	2.8	2.8	7.0	7.0
Q2[2]	4.2	4.2	2.4	2.4	2.4	2.4	3.1	3.1	7.0	7.0
Q3[2]	3.8	3.8	2.7	2.7	2.0	2.0	2.0	2.0	6.7	6.7
Q4[2]	7.7	7.7	6.3	6.3	2.4	2.4	3.1	3.1	6.5	6.5
1994 Q1[2]	6.1	6.1	3.3	3.3	3.1	3.1	1.9	1.9	6.6	6.6
Q2[2]	7.2	7.2	4.1	4.1	2.9	2.9	2.8	2.8	6.2	6.2
Q3[2]	5.2	5.9	3.4	3.9	2.7	2.8	3.6	3.6	6.0	6.0
Q4	6.1	6.9	4.1	5.0	3.0	2.7	3.1	2.3	5.7	5.6
1995 Q1	5.7	6.3	2.5	3.0	3.7	3.6	3.7	3.1	5.7	5.5
Q2	4.2	4.7	1.4	2.0	3.1	3.0	3.3	3.2	5.8	5.5
Q3	3.6	3.9	1.0	1.3	2.9	2.9	3.1	3.0	6.0	5.6
Q4	3.8	3.6	1.5	1.2	2.8	2.7	2.9	2.8	6.1	5.7
1996 Q1	4.5	4.1	1.8	1.4	3.1	3.2	2.9	2.9	6.2	5.9
Q2	4.6	4.3	2.2	1.8	2.8	2.9	2.9	2.9	6.2	6.0
Q3	4.7	4.6	2.3	2.0	2.9	2.9	2.9	2.9	6.2	6.1
Q4	4.8	4.7	2.4	2.1	2.9	2.9	2.9	2.9	6.3	6.1
TWO-QUARTER[3]										
1993 Q2[2]	4.3	4.3	1.8	1.8	3.3	3.3	3.1	3.1	-.3	-.3
Q4[2]	5.7	5.7	4.5	4.5	2.2	2.2	2.4	2.4	-.5	-.5
1994 Q2[2]	6.6	6.6	3.7	3.7	3.0	3.0	2.4	2.4	-.3	-.3
Q4	5.7	6.4	3.8	4.5	2.8	2.8	3.3	2.9	-.5	-.6
1995 Q2	4.9	5.5	1.9	2.5	3.4	3.3	3.5	3.2	.1	-.1
Q4	3.7	3.7	1.2	1.3	2.9	2.8	3.0	2.9	.3	.2
1996 Q2	4.6	4.2	2.0	1.6	3.0	3.0	2.9	2.9	.1	.3
Q4	4.8	4.6	2.4	2.1	2.9	2.9	2.9	2.9	.1	.1
FOUR-QUARTER[4]										
1992 Q4[2]	6.4	6.4	3.7	3.7	3.2	3.2	3.1	3.1	.3	.3
1993 Q4[2]	5.0	5.0	3.1	3.1	2.8	2.8	2.7	2.7	-.8	-.8
1994 Q4	6.2	6.5	3.8	4.1	2.9	2.9	2.9	2.7	-.8	-.9
1995 Q4	4.3	4.6	1.5	1.9	3.1	3.1	3.3	3.0	.4	.1
1996 Q4	4.7	4.4	2.2	1.8	2.9	3.0	2.9	2.9	.2	.4

1. For all urban consumers.
2. Actual.
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.

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

Item	Unit[1]	1988	1989	1990	1991	1992	1993	Projected 1994	1995	1996
EXPENDITURES										
Nominal GDP	Bill. $	4900.4	5250.8	5546.1	5724.8	6020.2	6343.3	6737.8	7116.2	7412.6
Real GDP	Bill. 87$	4718.6	4838.0	4897.3	4867.6	4979.3	5134.5	5342.9	5506.3	5594.3
Real GDP	% change	3.3	1.6	.2	.3	3.7	3.1	4.1	1.9	1.8
Gross domestic purchases		2.5	.9	-.4	-.1	4.1	3.9	4.7	1.9	1.8
Final sales		4.2	1.5	1.2	-.4	3.8	3.0	3.4	2.4	1.9
Private dom. final purch.		4.2	.5	-.1	-.8	5.1	5.0	4.9	3.0	2.1
Personal cons. expend.		4.2	1.2	.7	.0	4.2	3.0	3.7	2.2	1.8
Durables		8.5	-.5	-.8	-1.3	9.6	9.0	8.4	.1	.4
Nondurables		3.2	1.2	-.1	-1.6	3.2	1.3	3.3	2.2	1.8
Services		3.7	1.7	1.7	1.2	3.5	2.5	2.6	2.7	2.2
Business fixed invest.		5.5	-.4	.7	-6.2	6.7	16.0	13.2	9.1	3.6
Producers' dur. equip.		9.1	-1.7	2.9	-3.2	11.0	21.3	15.8	9.5	2.7
Nonres. structures		-1.2	2.3	-3.9	-12.4	-3.4	1.6	4.8	7.7	6.6
Res. structures		.9	-7.7	-15.2	.7	17.0	8.1	1.6	-2.9	1.4
Exports		13.5	11.3	6.7	8.1	5.0	5.8	9.5	8.3	8.7
Imports		3.6	2.6	.4	4.0	8.6	12.4	13.5	7.3	7.2
Government purchases		.2	2.0	3.3	-.8	.7	-1.0	.0	-.5	.3
Federal		-3.4	-.6	2.8	-3.2	.8	-6.9	-3.9	-5.9	-3.2
Defense		-3.2	-1.5	1.5	-7.0	-1.3	-9.0	-5.1	-8.2	-4.5
State and local		2.9	4.0	3.6	.8	.6	3.0	2.4	2.5	2.2
Change in bus. invent.	Bill. 87$	19.9	29.8	5.7	-1.1	2.5	15.3	46.5	30.7	15.9
Nonfarm		26.9	29.9	3.2	-1.3	-2.0	18.5	38.9	27.1	13.6
Net exports		-104.0	-73.7	-54.7	-19.5	-32.3	-73.9	-113.9	-122.3	-117.3
Nominal GDP	% change	7.7	6.0	4.7	3.5	6.4	5.0	6.5	4.6	4.4
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employ.	Millions	105.2	107.9	109.4	108.3	108.6	110.5	113.4	116.1	117.2
Unemployment rate	%	5.5	5.3	5.5	6.7	7.4	6.8	6.1	5.6	6.0
Industrial prod. index	% change	3.2	-.1	-.2	.2	4.0	3.6	5.8	2.5	1.8
Capacity util. rate-mfg.	%	83.6	83.2	81.3	78.0	79.2	80.9	83.3	84.2	82.4
Housing starts	Millions	1.49	1.38	1.19	1.01	1.20	1.29	1.42	1.39	1.41
Light Motor Vehicle Sales		15.43	14.53	13.85	12.31	12.80	13.89	15.09	15.23	14.51
Auto sales in U.S.		10.63	9.91	9.50	8.39	8.35	8.72	9.20	9.26	8.68
North American prod.		7.54	7.08	6.90	6.14	6.26	6.75	7.23	7.43	6.93
Other		3.10	2.83	2.60	2.25	2.10	1.97	1.97	1.83	1.75
INCOME AND SAVING										
Nominal GNP	Bill. $	4908.2	5266.8	5567.8	5740.8	6025.8	6347.8	6729.5	7089.7	7375.8
Nominal GNP	% change	7.8	6.1	4.9	3.2	6.1	5.0	6.3	4.3	4.4
Nominal personal income		7.1	6.5	6.5	3.7	8.1	2.8	6.7	5.7	5.1
Real disposable income		3.2	1.1	1.1	.9	5.0	.5	4.1	2.4	2.2
Personal saving rate	%	4.4	4.0	4.2	5.0	5.5	4.1	4.0	4.2	4.6
Corp. profits, IVA&CCAdj	% change	10.2	-6.3	2.3	8.8	9.6	23.4	4.6	-3.5	4.4
Profit share of GNP	%	7.4	6.9	6.8	6.8	6.7	7.7	8.1	7.8	7.5
Federal surpl./def.	Bill. $	-136.6	-122.3	-163.5	-202.9	-282.7	-241.4	-162.3	-158.3	-189.5
State/local surpl./def.		38.4	44.8	25.1	17.0	24.8	26.3	25.8	27.5	27.8
Ex. social ins. funds		-18.4	-17.5	-35.6	-46.5	-41.6	-40.0	-39.8	-37.0	-36.2
PRICES AND COSTS										
GDP implicit deflator	% change	4.2	4.4	4.5	3.3	2.6	1.8	2.4	2.6	2.5
GDP fixed-wt. price index		4.2	4.4	4.6	3.6	3.2	2.8	2.9	3.1	3.0
Gross domestic purchases fixed-wt. price index		4.1	4.4	5.2	2.9	3.2	2.5	3.0	3.0	2.9
CPI		4.3	4.6	6.3	3.0	3.1	2.7	2.7	3.0	2.9
Ex. food and energy		4.5	4.4	5.3	4.4	3.5	3.1	2.9	3.2	3.1
ECI, hourly compensation[2]		4.8	4.8	4.6	4.4	3.5	3.6	3.3	3.7	3.7
Nonfarm business sector										
Output per hour		.5	-1.4	.4	2.3	3.2	1.8	1.2	.8	1.2
Compensation per hour		3.8	3.1	6.2	4.7	5.1	2.4	3.4	4.0	4.0
Unit labor cost		3.3	4.6	5.7	2.3	1.9	.6	2.1	3.1	2.8

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

Strictly Confidential (FR)
Class II FOMC

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

December 14, 1994

Item	Unit	1992 Q1	1992 Q2	1992 Q3	1992 Q4	1993 Q1	1993 Q2	1993 Q3	1993 Q4	1994 Q1	1994 Q2
EXPENDITURES											
Nominal GDP	Bill. $	5896.8	5971.3	6043.6	6169.3	6235.9	6299.9	6359.2	6478.1	6574.7	6689.9
Real GDP	Bill. 87$	4918.5	4947.5	4990.5	5060.7	5075.3	5105.4	5139.4	5218.0	5261.1	5314.1
Real GDP	% change	3.1	2.4	3.5	5.7	1.2	2.4	2.7	6.3	3.3	4.1
Gross domestic purchases		3.2	3.7	3.9	5.7	2.7	3.3	4.0	5.8	5.0	4.6
Final sales		4.8	1.5	3.5	5.6	.2	2.4	3.2	6.4	2.2	1.5
Private dom. final purch.		5.7	4.2	3.9	6.7	3.5	3.7	5.3	7.4	5.8	2.7
Personal cons. expend.		5.8	1.7	3.9	5.6	1.6	2.6	3.9	4.0	4.7	1.3
Durables		15.5	.4	10.0	13.2	3.2	9.8	7.7	15.5	8.8	.4
Nondurables		4.2	-.7	2.7	6.9	-1.6	1.6	2.8	2.4	3.8	2.2
Services		4.5	3.4	3.2	3.0	3.1	1.4	3.6	2.0	4.0	1.1
Business fixed invest.		-.1	15.0	5.0	7.5	15.1	15.6	12.2	21.1	10.9	9.2
Producers' dur. equip.		-1.3	22.7	11.0	12.9	20.0	21.6	16.2	27.5	18.6	6.1
Nonres. structures		2.9	-1.6	-8.9	-5.5	2.5	.3	.5	3.3	-11.8	20.6
Res. structures		22.4	22.7	.8	23.8	5.3	-7.6	9.4	28.2	10.0	7.0
Exports		6.1	1.5	5.3	7.2	-1.0	7.7	-3.2	21.7	-3.5	16.6
Imports		6.6	13.0	8.4	6.5	11.6	14.9	7.4	16.0	9.5	18.9
Government purchases		1.5	-3.0	3.4	.9	-5.9	1.2	1.1	-.1	-4.9	-1.2
Federal		-1.3	-4.8	8.6	1.1	-15.4	-3.6	-3.0	-5.0	-10.3	-7.9
Defense		-7.2	-5.1	11.5	-3.3	-20.0	-2.2	-9.2	-3.6	-16.0	-4.1
State and local		3.3	-1.8	.1	.8	.9	4.4	3.7	2.9	-1.4	2.9
Change in bus. invent.	Bill. 87$	-6.3	4.2	5.2	6.6	18.5	18.9	13.0	10.8	25.4	59.2
Nonfarm		-14.3	-1.9	1.8	6.3	19.7	22.8	20.9	10.7	22.1	51.7
Net exports		-17.9	-34.1	-38.9	-38.5	-57.6	-69.3	-86.3	-82.2	-104.0	-111.8
Nominal GDP	% change	7.1	5.2	4.9	8.6	4.4	4.2	3.8	7.7	6.1	7.2
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employ.	Millions	108.1	108.4	108.7	109.1	109.7	110.3	110.8	111.4	112.0	113.0
Unemployment rate[1]	%	7.3	7.5	7.5	7.3	7.0	7.0	6.7	6.5	6.6	6.2
Industrial prod. index	% change	.9	5.8	3.4	6.2	5.1	.7	3.3	5.3	7.1	6.0
Capacity util. rate-mfg.[1]	%	78.4	79.1	79.4	80.1	80.8	80.6	80.7	81.4	82.3	83.1
Housing starts	Millions	1.24	1.15	1.19	1.24	1.15	1.24	1.31	1.48	1.37	1.44
Light Motor Vehicle Sales		12.46	12.81	12.71	13.22	13.23	14.11	13.69	14.53	15.45	14.76
Auto sales in U.S.		8.33	8.41	8.24	8.43	8.32	8.93	8.65	8.97	9.45	9.15
North American prod.		6.12	6.25	6.25	6.40	6.36	6.87	6.68	7.08	7.44	7.16
Other		2.21	2.16	1.99	2.03	1.96	2.07	1.97	1.89	2.00	1.99
INCOME AND SAVING											
Nominal GNP	Bill. $	5907.7	5979.1	6049.4	6167.0	6243.9	6303.3	6367.8	6476.2	6574.0	6682.5
Nominal GNP	% change	6.8	4.9	4.8	8.0	5.1	3.9	4.2	7.0	6.2	6.8
Nominal personal income		8.2	5.6	3.7	15.3	-5.8	8.6	2.4	6.7	5.3	7.7
Real disposable income		5.9	2.1	1.7	10.6	-7.4	4.7	.8	4.3	3.4	3.5
Personal saving rate[1]	%	5.3	5.5	5.0	6.2	4.0	4.6	3.9	4.0	3.6	4.1
Corp. profits, IVA&CCAdj	% change	18.8	.5	-40.0	101.1	9.6	30.7	18.4	37.0	-17.9	33.6
Profit share of GNP[1]	%	7.0	6.9	6.0	7.0	7.1	7.5	7.7	8.2	7.7	8.2
Federal govt. surpl./def.	Bill. $	-279.9	-284.8	-293.9	-272.1	-283.5	-237.0	-224.9	-220.1	-176.2	-145.1
State/local surpl./def.		19.9	25.9	20.4	33.1	21.6	25.3	23.9	34.5	25.2	27.0
Ex. social ins. funds		-45.7	-40.5	-46.3	-33.8	-44.7	-41.1	-42.4	-31.7	-40.7	-38.9
PRICES AND COSTS											
GDP implicit deflator	% change	3.8	2.7	1.3	2.7	3.3	1.6	1.0	1.3	2.9	2.9
GDP fixed-wt. price index		3.9	3.3	2.7	2.8	4.2	2.4	2.0	2.4	3.1	2.9
Gross domestic purchases fixed-wt. price index		3.6	3.4	3.2	2.5	3.3	2.6	1.6	2.4	2.5	3.2
CPI		2.6	3.5	2.9	3.5	2.8	3.1	2.0	3.1	1.9	2.8
Ex. food and energy		3.7	3.6	3.0	3.6	3.5	3.5	2.4	2.9	2.6	3.4
ECI, hourly compensation[2]		3.6	3.2	3.2	3.5	3.9	3.8	3.4	3.4	2.7	3.7
Nonfarm business sector											
Output per hour		4.2	1.9	2.8	3.8	-2.0	.4	4.0	4.9	2.9	-2.1
Compensation per hour		5.7	4.6	5.8	4.5	2.1	2.4	2.8	2.4	6.1	.7
Unit labor cost		1.4	2.6	2.9	.6	4.1	2.0	-1.2	-2.4	3.1	2.9

1. Not at an annual rate. 2. Private-industry workers.

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

December 14, 1994

Item	Units	1994		Projected							
				1995				1996			
		Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
EXPENDITURES											
Nominal GDP	Bill. $	6786.5	6900.2	7006.1	7086.6	7154.4	7217.5	7291.0	7368.9	7452.4	7538.1
Real GDP	Bill. 87$	5365.0	5431.5	5472.3	5500.0	5518.3	5534.8	5553.8	5579.0	5607.3	5637.0
Real GDP	% change	3.9	5.0	3.0	2.0	1.3	1.2	1.4	1.8	2.0	2.1
Gross domestic purchases		4.5	4.8	3.2	2.2	1.3	1.0	1.2	1.6	2.0	2.2
Final sales		4.2	6.0	3.2	2.6	2.1	1.7	1.7	1.8	1.9	2.1
Private dom. final purch.		4.3	7.0	4.3	3.5	2.5	1.7	1.7	2.0	2.2	2.4
Personal cons. expend.		3.3	5.5	3.4	2.4	1.6	1.3	1.5	1.8	1.9	2.0
Durables		6.3	18.9	6.7	.8	-3.6	-3.4	-1.2	.2	1.2	1.5
Nondurables		3.3	4.0	2.6	2.2	2.1	1.8	1.8	1.8	1.8	1.8
Services		2.4	3.0	2.9	2.9	2.8	2.2	2.2	2.2	2.2	2.2
Business fixed invest.		14.4	18.6	12.4	11.6	7.9	4.6	3.0	3.0	3.7	4.5
Producers' dur. equip.		18.0	21.2	13.5	12.7	8.0	4.0	2.0	2.0	3.0	4.0
Nonres. structures		2.9	10.0	8.5	7.6	7.6	7.0	6.8	6.7	6.5	6.3
Res. structures		-6.5	-3.1	-5.7	-3.3	-1.5	-.9	.6	1.4	1.4	2.0
Exports		12.2	13.7	9.0	8.5	7.8	7.9	8.4	8.8	8.8	9.0
Imports		15.6	10.4	9.0	8.4	6.3	5.5	6.3	6.5	7.6	8.2
Government purchases		7.1	-.5	-1.2	-1.0	-.1	.2	.2	.1	.3	.7
Federal		12.5	-8.1	-7.4	-7.1	-4.8	-4.2	-3.6	-3.9	-3.2	-2.3
Defense		13.6	-11.3	-10.2	-10.1	-6.7	-5.7	-4.7	-5.3	-4.3	-3.7
State and local		4.2	4.1	2.5	2.5	2.5	2.5	2.2	2.2	2.2	2.2
Change in bus. invent.	Bill. 87$	56.1	45.1	43.2	35.5	25.1	18.8	15.2	15.1	16.5	17.0
Nonfarm		46.3	35.6	36.7	32.0	23.1	16.5	12.9	12.8	14.1	14.6
Net exports		-120.8	-118.8	-121.6	-123.9	-123.1	-120.6	-118.7	-116.5	-116.6	-117.5
Nominal GDP	% change	5.9	6.9	6.3	4.7	3.9	3.6	4.1	4.3	4.6	4.7
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employ.	Millions	113.9	114.7	115.4	116.0	116.4	116.7	116.8	117.0	117.3	117.7
Unemployment rate[1]	%	6.0	5.6	5.5	5.5	5.6	5.7	5.9	6.0	6.1	6.1
Industrial prod. index	% change	5.0	5.1	5.4	2.8	1.1	.8	1.1	1.8	2.1	2.3
Capacity util. rate-mfg[1]	%	83.6	84.3	84.7	84.6	84.0	83.4	82.9	82.5	82.3	82.1
Housing starts	Millions	1.47	1.42	1.40	1.39	1.38	1.38	1.39	1.41	1.42	1.43
Light Motor Vehicle Sales		14.65	15.49	15.74	15.58	15.00	14.60	14.50	14.50	14.50	14.55
Auto sales in U.S.		9.09	9.12	9.62	9.55	9.06	8.80	8.70	8.63	8.66	8.71
North American prod.		7.09	7.23	7.62	7.65	7.36	7.07	6.95	6.88	6.91	6.96
Other		2.01	1.89	2.00	1.90	1.70	1.73	1.75	1.75	1.75	1.75
INCOME AND SAVING											
Nominal GNP	Bill. $	6775.9	6885.8	6988.5	7059.5	7127.6	7183.3	7256.9	7330.9	7417.9	7497.3
Nominal GNP	% change	5.7	6.6	6.1	4.1	3.9	3.2	4.2	4.1	4.8	4.4
Nominal personal income		5.1	8.8	7.9	5.3	4.0	5.7	6.0	4.5	4.3	5.7
Real disposable income		2.9	6.5	3.7	1.3	1.6	2.9	3.3	.7	1.9	2.7
Personal saving rate[1]	%	4.0	4.2	4.3	4.0	4.0	4.4	4.8	4.5	4.5	4.7
Corp. profits, IVA&CCAdj	% change	8.1	1.0	1.2	-5.2	.5	-10.0	-.8	5.1	10.4	3.2
Profit share of GNP[1]	%	8.2	8.1	8.0	7.8	7.8	7.5	7.4	7.4	7.5	7.5
Federal govt. surpl./def.	Bill. $	-155.1	-172.6	-158.5	-147.2	-149.0	-178.4	-192.9	-181.8	-181.0	-202.3
State/local surpl./def.		24.1	26.7	29.1	29.0	27.3	24.6	24.8	25.9	29.7	30.9
Ex. social ins. funds		-41.2	-38.5	-35.8	-35.6	-37.0	-39.6	-39.3	-38.1	-34.3	-33.1
PRICES AND COSTS											
GDP implicit deflator	% change	1.9	1.7	3.1	2.6	2.5	2.4	2.7	2.5	2.5	2.5
GDP fixed-wt. price index		2.8	2.7	3.6	3.0	2.9	2.7	3.2	2.9	2.9	2.9
Gross domestic purchases fixed-wt. price index		3.4	2.7	3.5	3.0	2.9	2.7	3.1	2.8	2.8	2.8
CPI		3.6	2.3	3.1	3.2	3.0	2.8	2.9	2.9	2.9	2.9
Ex. food and energy		2.8	2.6	3.5	3.3	3.0	2.9	3.0	3.1	3.1	3.1
ECI, hourly compensation[2]		3.3	3.6	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Nonfarm business sector											
Output per hour		2.9	1.3	1.0	.8	.7	.7	1.1	1.4	1.2	1.1
Compensation per hour		3.0	3.8	4.1	3.8	3.9	4.0	4.3	3.9	3.9	3.9
Unit labor cost		.0	2.5	3.0	3.0	3.2	3.3	3.1	2.5	2.7	2.7

1. Not at an annual rate. 2. Private-industry workers.

Strictly Confidential (FR)
Class II FOMC

NET CHANGES IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS[1]
(Billions of 1987 dollars)

December 14, 1994

Item	1992				1993				1994					Projected
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	1991	1992	1993	1994
Real GDP	37.7	29.0	43.0	70.2	14.6	30.1	34.0	78.6	43.1	53.0	13.6	179.9	157.3	213.5
Gross domestic purchases	38.8	45.1	47.9	69.8	33.7	41.8	51.1	74.4	64.9	60.7	-6.4	201.6	201.0	250.1
Final sales	57.5	18.4	42.1	68.8	2.7	29.7	40.0	80.7	28.5	19.2	-20.7	186.8	153.1	179.1
Private dom. final purch.	55.1	41.7	39.1	66.3	35.9	38.6	54.5	76.9	61.9	29.8	-32.6	202.2	205.9	215.4
Personal cons. expend.	46.1	14.0	32.2	45.8	13.8	22.0	33.0	34.0	40.1	11.5	-.6	138.1	102.8	128.9
Durables	15.7	.4	10.7	14.3	3.7	11.2	9.0	18.1	10.9	.5	-5.5	41.1	42.0	42.9
Nondurables	10.7	-1.8	7.1	17.8	-4.2	4.3	7.4	6.3	10.3	6.0	-17.1	33.8	13.8	36.2
Services	19.7	15.3	14.4	13.7	14.4	6.4	16.6	9.6	18.9	5.1	22.1	63.1	47.0	49.9
Business fixed invest.	-.1	18.0	6.4	9.7	19.4	20.7	16.9	29.3	16.4	14.3	-33.3	34.0	86.3	82.9
Producers' dur. equip.	-1.2	18.6	9.9	11.8	18.4	20.7	16.6	28.2	20.9	7.5	-11.9	39.1	83.9	75.8
Nonres. structures	1.1	-.6	-3.5	-2.1	.9	.1	.2	1.2	-4.6	6.9	-21.4	-5.1	2.4	7.1
Res. structures	9.2	9.8	.4	10.8	2.7	-4.1	4.7	13.5	5.4	3.9	1.2	30.2	16.8	3.6
Change in bus. invent.	-19.8	10.5	1.0	1.4	11.9	.4	-5.9	-2.2	14.6	33.8	34.4	-6.9	4.2	34.3
Nonfarm	-28.9	12.4	3.7	4.5	13.4	3.1	-1.9	-10.2	11.4	29.6	33.3	-8.3	4.4	24.9
Farm	9.1	-1.8	-2.8	-3.1	-1.5	-2.7	-4.0	8.0	3.2	4.2	1.0	1.4	-.2	9.4
Net exports	-1.0	-16.2	-4.8	.4	-19.1	-11.7	-17.0	4.1	-21.8	-7.8	19.9	-21.6	-43.7	-36.6
Exports	8.4	2.1	7.4	10.2	-1.5	11.0	-4.9	29.9	-5.6	24.3	42.2	28.1	34.5	59.1
Imports	9.4	18.3	12.3	9.9	17.5	22.8	12.0	25.8	16.2	32.0	22.2	49.9	78.1	95.7
Government purchases	3.4	-7.1	7.8	2.1	-14.1	2.8	2.5	-.3	-11.6	-2.8	-8.0	6.2	-9.1	.3
Federal	-1.2	-4.6	7.7	1.0	-15.4	-3.3	-2.7	-4.5	-9.4	-7.0	-12.4	2.9	-25.9	-13.6
Defense	-4.9	-3.4	7.1	-2.2	-14.2	-1.4	-5.9	-2.2	-10.2	-2.4	-19.9	-3.4	-23.7	-12.2
Nondefense	3.8	-1.2	.6	3.2	-1.3	-1.8	3.2	-2.3	.8	-4.5	7.4	6.4	-2.2	-1.4
State and local	4.5	-2.5	.1	1.1	1.3	6.1	5.2	4.2	-2.1	4.1	4.6	3.2	16.8	13.9

1. Annual changes are from Q4 to Q4.

Strictly Confidential (FR)
Class II FOMC

NET CHANGES IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS[1]
(Billions of 1987 dollars)

December 14, 1994

Item	1994		Projected									Projected		
			1995				1996							
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	1993	1994	1995	1996
Real GDP	50.9	66.5	40.9	27.6	18.4	16.4	19.1	25.2	28.3	29.7	157.3	213.5	103.3	102.3
Gross domestic purchases	60.1	64.4	43.6	29.9	17.6	13.9	17.2	23.0	28.3	30.6	201.0	250.1	105.0	99.2
Final sales	54.1	77.3	42.8	35.3	28.7	22.8	22.6	25.4	26.9	29.1	153.1	179.1	129.6	104.0
Private dom. final purch.	47.2	76.5	48.3	39.9	28.3	19.8	20.4	23.0	26.2	28.4	205.9	215.4	136.3	98.0
Personal cons. expend.	28.6	48.7	30.5	21.5	14.7	11.5	14.3	16.4	18.1	18.5	102.8	128.9	78.3	67.3
Durables	8.0	23.5	9.1	1.1	-5.1	-4.8	-1.6	.2	1.7	2.1	42.0	42.9	.3	2.4
Nondurables	8.9	11.0	7.2	6.3	6.1	5.2	5.1	5.2	5.1	5.1	13.8	36.2	24.8	20.5
Services	11.6	14.3	14.2	14.1	13.8	11.1	10.7	11.0	11.3	11.4	47.0	49.9	53.2	44.5
Business fixed invest.	22.5	29.7	21.0	20.3	14.4	8.7	5.8	5.8	7.3	8.7	86.3	82.9	64.5	27.6
Producers' dur. equip.	21.4	26.0	17.8	17.4	11.5	5.9	3.0	3.0	4.5	6.0	83.9	75.8	52.6	16.5
Nonres. structures	1.1	3.7	3.2	2.9	3.0	2.8	2.8	2.8	2.8	2.7	2.4	7.1	11.9	11.1
Res. structures	-3.9	-1.8	-3.3	-1.9	-.8	-.5	.3	.8	.8	1.1	16.8	3.6	-6.5	3.0
Change in bus. invent.	-3.1	-11.0	-1.9	-7.7	-10.4	-6.3	-3.6	-.2	1.4	.6	4.2	34.3	-26.3	-1.8
Nonfarm	-5.4	-10.7	1.1	-4.7	-8.9	-6.6	-3.6	-.2	1.3	.6	4.4	24.9	-19.1	-1.9
Farm	2.3	-.3	-3.0	-3.0	-1.5	.3	.0	.0	.1	.0	-.2	9.4	-7.2	.1
Net exports	-9.0	2.0	-2.7	-2.3	.7	2.6	1.8	2.2	.0	-.9	-43.7	-36.6	-1.7	3.1
Exports	18.8	21.6	14.8	14.5	13.5	14.0	15.1	16.1	16.4	17.1	34.5	59.1	56.9	64.7
Imports	27.9	19.6	17.6	16.7	12.8	11.4	13.2	13.9	16.5	18.0	78.1	95.7	58.6	61.7
Government purchases	15.9	-1.2	-2.7	-2.3	-.3	.4	.4	.2	.8	1.6	-9.1	.3	-4.9	3.0
Federal	10.0	-7.2	-6.4	-6.0	-4.0	-3.4	-2.9	-3.1	-2.5	-1.8	-25.9	-13.6	-19.8	-10.3
Defense	7.3	-6.9	-6.0	-5.8	-3.7	-3.1	-2.5	-2.8	-2.2	-1.9	-23.7	-12.2	-18.6	-9.4
Nondefense	2.5	-.2	-.4	-.2	-.3	-.3	-.4	-.3	-.3	.1	-2.2	-1.4	-1.2	-.9
State and local	6.0	5.9	3.7	3.7	3.7	3.8	3.3	3.3	3.3	3.4	16.8	13.9	14.9	13.3

1. Annual changes are from Q4 to Q4.

Strictly Confidential (FR)
Class II FOMC

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

December 14, 1994

Item	Fiscal year				1994				1995				1996			
	1993[a]	1994[a]	1995	1996	Q1[a]	Q2[a]	Q3[b]	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
UNIFIED BUDGET					Not seasonally adjusted											
Receipts[1]	1153	1257	1349	1414	289	363	318	302	295	415	337	320	304	437	354	327
Outlays[1]	1409	1461	1535	1618	348	363	372	381	393	376	385	402	409	403	404	423
Surplus/deficit[1]	-255	-203	-186	-204	-59	0	-53	-79	-98	39	-48	-82	-105	34	-50	-97
On-budget	-301	-259	-250	-269	-66	-33	-55	-86	-107	-1	-56	-88	-114	-6	-60	-102
Off-budget	46	56	64	65	8	33	2	6	9	40	7	6	9	40	10	5
Surplus excluding deposit insurance[2]	-283	-210	-203	-216	-65	3	-57	-82	-104	37	-54	-83	-110	32	-55	-96
Means of financing																
Borrowing	249	185	184	208	51	8	37	55	80	11	39	61	88	14	45	67
Cash decrease	6	17	-24	0	5	-6	15	9	16	-49	0	25	20	-45	0	25
Other[3]	0	1	26	-5	2	-2	1	15	3	-2	10	-4	-3	-3	5	5
Cash operating balance, end of period	53	36	60	60	45	51	36	27	11	60	60	35	15	60	60	35
NIPA FEDERAL SECTOR					Seasonally adjusted, annual rate											
Receipts	1242	1355	1461	1523	1338	1381	1388	1416	1458	1482	1488	1496	1511	1538	1549	1568
Expenditures	1497	1529	1618	1707	1514	1526	1544	1589	1617	1630	1637	1674	1703	1720	1730	1770
Purchases	447	439	437	430	438	435	444	441	441	435	432	429	432	430	429	428
Defense	307	296	290	280	292	292	301	295	293	287	284	281	282	280	278	277
Nondefense	140	144	147	150	146	144	144	146	148	148	148	148	150	150	150	151
Other expenditures	1049	1090	1181	1277	1076	1091	1099	1148	1176	1195	1205	1245	1272	1290	1302	1342
Surplus/deficit	-254	-174	-157	-183	-176	-145	-155	-172	-158	-147	-149	-178	-193	-182	-181	-202
FISCAL INDICATORS[4]																
High-employment (HEB) surplus/deficit	-210	-164	-185	-196	-158	-141	-161	-196	-189	-179	-177	-201	-206	-190	-186	-206
Change in HEB, percent of potential GDP	-.1	-.7	.3	.1	-.6	-.3	.3	.5	-.1	-.1	0	.3	.1	-.2	-.1	.3
Fiscal impetus (FI), percent, cal. year	-4.1	-6.8	-6.2	-5.1	-4.2	-4.3	3.8	-2.6	-2.8	-2.5	-.5	-.8	-2.3	-1.7	.1	-.4

1. Excluding health reform, OMB's July 1994 deficit estimates are $220 billion in FY94, $167 billion in FY95, and $179 billion in FY96. CBO's August 1994 deficit estimates of the budget are $202 billion in FY94, $162 billion in FY95, and $176 billion in FY96. 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 July 1994 deficit estimates, excluding deposit insurance spending, are $224 billion in FY94, $185 billion in FY95, and $187 billion in FY96. CBO's August 1994 deficit estimates, excluding deposit insurance spending, are $207 billion in FY94, $180 billion in FY95, and $188 billion in FY96.

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 measure in current dollars, with cyclically sensitive receipts and outlays adjusted to the level of potential output generated by 2.3 percent real growth and an associated unemployment rate of 6 percent. 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 1987 dollars), scaled by real federal purchases. For change in HEB and FI, negative values indicate restraint.

a--Actual.
b--Preliminary.

Recent Developments

Short-term interest rates rose over much of the intermeeting period, initially in response to the 3/4 percentage point increase in the discount and federal funds rates at the time of the last FOMC meeting, and subsequently in reaction to the surprising strength of incoming economic data. The full amount of the tightening was reflected in a hike in the prime rate to 8-1/2 percent from 7-3/4 percent. In early December, Orange County's announcement that its investment fund had suffered a large loss prompted some flight to quality and a reassessment of the likelihood of a further monetary tightening at the December FOMC meeting, causing short-term Treasury rates to give back some of their increases. On net, short-term rates have risen between 1/2 and 3/4 percentage point since the November meeting. In contrast, long term rates have moved down a bit since the last meeting; the System's action evidently inspired some increased confidence that it would act aggressively to contain inflation.

Ramifications of the Orange County situation have disturbed financial markets on a broad front. The county fund, which had made a highly leveraged bet that interest rates would hold steady or fall, came a cropper as rising interest rates severely eroded its value. The county filed for bankruptcy when dealers balked at rolling over maturing RPs, and it subsequently defaulted on a $110 million taxable pension bond issue. Prices of tax-exempt issues generally came under some downward pressure on the news, but declines were particularly deep on debt issued by the units directly involved. Although tax-exempt mutual fund managers were braced for a sharp investor reaction, to date unusual liquidation activity reportedly has been confined to money funds specializing in

California paper; some investment advisers to money funds purchased or enhanced the value of their funds' affected paper in order to prevent share values from falling below a dollar.

Despite strong and generally better than-expected corporate earnings reports, stock markets were down appreciably over the intermeeting period. Shares of FNMA and FHLMC and of the investment banks closest to the Orange County situation were hit hard, but stock price declines were widespread and mostly preceded the Orange County developments, perhaps further evidence that markets now anticipate monetary tightenings to bite.

M2 posted a slight expansion in November, the first since July, bringing its growth since the fourth quarter of last year to a 1 percent rate, the lower bound of its annual growth range. Higher short-term rates further increased the already elevated opportunity costs of holding the liquid deposit components in M2, which continued to run off in November. Small time deposits and MMMFs, by contrast, accelerated. M2 may also have been boosted in November by a redeployment of funds from bond and, to a lesser extent, stock mutual funds, although the strength of noncompetitive tenders suggests some shift toward direct holding of securities,

M3 growth slipped a bit last month, to a 2 percent rate, mainly because of a sharp deceleration of institution-only money market mutual funds. The growth of large time deposits also slowed, albeit to a still rapid pace. Nevertheless, banks reduced their managed liabilities overall last month, as they had in October, mostly by reversing some of the large borrowings from foreign offices made earlier this year. On the year, M3 has expanded at a 1-1/4 percent rate, well within its 0-to-4 percent target growth range.

Bank lending grew at a brisk pace in November, extending the broad-based advance of business, real estate, and consumer loans that began in the spring. This strength appears to owe, in part, to a continued easing of standards and terms on many loans. In November, as in October, banks funded credit extensions, in part, by liquidating holdings of securities, although some of the reported drop in these assets resulted from marking a portion of them to market.

Public bond issuance of nonfinancial firms increased somewhat in November but remained well below the pace of 1993. Higher long-term rates have not only depressed issuance in favor of borrowing at commercial banks and finance companies but also have reduced somewhat the average maturity of bonds issued. Quality spreads generally remain narrow but have widened on lower-rated bonds, and several planned junk bond issues have been withdrawn in recent weeks.

Equity issuance by nonfinancial firms picked up in November, despite the market downturn. The outstanding volume of equity is expected to contract in the fourth quarter, however, owing to merger-related share retirements. So far this year, the value of large nonfinancial mergers has cumulated to $70 billion, more than three times the total for all of last year. Much of the rapid expansion of commercial paper in recent months has supported merger activity.

Acting to boost business borrowing recently has been the strength of commercial real estate loans, which edged up again in the third quarter after three years of declines. At domestic commercial banks, such loans expanded for the fifth consecutive quarter, jumping to an annual rate of 6 percent. The rapid runoffs of commercial real estate loans at foreign banks, however, have shown little sign of abating.

Household credit demands continue to be strong overall. Residential mortgage growth picked up in the third quarter, particularly at domestic commercial banks, where growth spurted to nearly a 15 percent annual rate, a pace that is unlikely to be sustained in the current quarter. Growth of consumer installment debt has picked up a bit from the third-quarter pace, advancing at a 16 percent rate in October. Strength apparently continues to owe, in part, to incentives tied to the volume of credit generated on "premium" credit cards but also reflects aggressive lending by banks, as evidenced by the unusually sluggish response of auto loan rates to the upward movement in market rates this year.

With no long-term bond issuance this quarter, the Treasury will raise $31 billion of its total marketable borrowing of $55 billion through bill issuance; to achieve this, the weekly bill auction has been raised $4 billion since September, to $27 billion. Another $9 billion of the quarter's projected $79 billion deficit will be financed by a decrease in the Treasury's cash balance.

Gross issuance of tax-exempt debt continued to be weak in November, held down by anemic refunding activity. The outstanding stock of long-term tax-exempt debt likely was little changed last month, after having declined an estimated $5 billion this year as pre-refunded issues were retired.

Outlook

The increase in short-term interest rates assumed necessary in the near term to check inflationary pressures has been raised in light of the recent evidence of surprising economic strength and resource utilization. The further tightening is projected to push bond yields up a bit. But as economic activity slows over the next year and inflation moderates after a brief spurt, the bond market rally is expected to resume, carrying yields below current levels.

Monetary policy is assumed to move slightly in the direction of ease in late 1995 or early 1996, but real short rates are expected to remain above their levels today.

Both M2 and M3 are expected to accelerate somewhat next year. The outlook is unchanged from that of November, as the impact of additional economic growth is offset by restraint from the higher opportunity costs implicit in the more aggressive policy restraint. In 1996, M2 accelerates a bit further as opportunity costs decline. M3 growth stays unchanged, however, as bank credit growth remains subdued.

Overall debt growth is projected to be virtually unchanged in the next two years from the 1994 pace of 5 percent. The expansion of federal government debt, which is expected to be 4-1/2 percent this year, likely will rise by a percentage point in 1995, largely owing to technical factors relating to the timing of expenditures and receipts. This acceleration moves the growth of federal debt back above that of nonfederal debt and nominal GDP in 1995. This faster pace is maintained in 1996 as well. Growth of nonfederal debt is projected to slow gradually from the current quarter's 5-1/4 percent rate to 4-3/4 percent in 1996, broadly in line with the slowing in nominal GDP.

Consumer credit expansion should ease somewhat from its current elevated pace as consumer durable expenditures are damped by slower income growth and the impact of the recent and projected firming of interest rates on consumer loan rates. Home mortgage growth slows only a bit, with the higher short-term rates expected to reduce the share accounted for by ARMs. The recent trend toward greater accommodation in bank lending is likely to begin to reverse over the projection period as a slower economy and rising interest rate burdens cause household delinquency rates to edge up from their current low levels.

Despite a projected reduction in inventory accumulation, a widening of the corporate financing gap next year, attributable in part to sluggish profits, helps to sustain borrowing by nonfinancial businesses. Nonetheless, the pace of business borrowing is expected to slow after the current quarter as the hectic pace of merger activity abates. With bond yields dropping and the yield curve flattening, an increasing share of business credit needs over the next two years will be met in longer-term markets. This shift is likely to be further encouraged by a halt--if not some reversal--of the current swing toward easier nonprice terms and standards in bank business lending as the slowing of the marked economic expansion and higher interest expenses heighten perceived credit risks.

We are assuming that concerns raised by Orange County will subside soon and that there will be no ongoing disruption of municipal markets. Gross debt issuance of the state and local sector is expected to remain unchanged next year and to pick up only slightly in 1996. Owing to a slowing pace of retirements, however, the stock of this debt outstanding, which is expected to contract 2-1/2 percent this year, expands slightly next year and posts moderate growth in 1996.

Confidential FR Class II
December 14, 1994

CHANGE IN DEBT OF THE DOMESTIC NONFINANCIAL SECTORS[1]
(Percent)

			Nonfederal						MEMO	
				Households						
	Total[2]	Federal govt.	Total	Total	Home mtg.	Cons. credit	Business	State and local govt.	Private financial assets	Nominal GDP
Year										
1982	9.8	19.7	7.4	5.5	4.7	4.4	8.8	9.3	10.1	3.2
1983	11.9	18.9	10.1	11.8	10.8	12.6	8.7	9.7	12.5	11.0
1984	14.6	16.9	13.9	13.0	11.7	18.7	15.6	9.1	12.8	9.1
1985	15.5	16.5	15.2	15.3	13.2	15.8	12.1	31.6	12.4	7.0
1986	12.3	13.6	11.9	12.0	14.3	9.6	12.2	9.8	7.3	4.7
1987	9.4	8.0	9.8	11.4	14.9	5.0	7.9	12.1	8.1	8.0
1988	8.9	8.0	9.2	10.5	12.7	7.2	8.7	6.0	8.6	7.7
1989	7.8	7.0	8.1	9.2	10.8	6.2	6.9	9.3	5.8	6.0
1990	6.3	11.0	5.0	6.5	7.9	2.0	3.4	5.7	4.7	4.7
1991	4.4	11.1	2.4	4.7	6.5	-1.8	-1.0	7.4	-1.0	3.5
1992	4.8	10.9	2.8	5.8	6.7	0.7	-0.1	1.8	0.7	6.4
1993	5.4	8.3	4.3	7.1	6.4	7.8	0.6	7.1	-0.4	5.0
1994	5.0	4.5	5.1	7.7	6.2	12.7	4.1	-2.6	5.2	6.5
1995	5.0	5.5	4.9	6.4	5.7	9.7	4.0	0.8	1.0	4.6
1996	5.0	5.8	4.7	5.8	5.5	7.9	3.8	3.4	1.0	4.4
Quarter (seasonally adjusted annual rates)										
1993:1	4.1	7.8	2.8	4.2	4.1	2.5	-0.3	9.2	-2.9	4.4
2	6.2	10.7	4.6	6.5	6.7	5.1	0.7	11.9	1.5	4.2
3	5.1	5.4	5.0	9.0	8.0	9.3	0.6	4.8	-2.2	3.8
4	5.6	8.4	4.5	8.0	6.1	13.3	1.3	1.7	1.9	7.7
1994:1	5.3	6.3	4.9	7.1	6.3	8.4	3.5	1.0	9.1	6.1
2	4.5	3.6	4.8	7.3	5.6	13.8	3.8	-2.8	6.4	7.2
3	4.9	3.9	5.2	8.4	6.5	13.9	4.1	-4.9	3.0	5.9
4	4.8	3.9	5.2	7.3	5.9	12.7	4.8	-3.6	1.7	6.9
1995:1	6.3	9.4	5.2	6.8	5.6	11.3	4.6	-0.2	1.5	6.3
2	4.4	3.8	4.6	6.2	5.6	9.4	3.7	0.4	0.6	4.7
3	4.4	3.8	4.6	6.1	5.6	8.7	3.6	1.3	0.7	3.9
4	4.6	4.4	4.7	6.0	5.6	8.0	3.8	1.8	1.0	3.6

1. Data after 1994:3 are staff projections. Changes are measured from end of the preceding period to end of period indicated except annual nominal GDP growth, which is Q4 to Q4.
2. On a quarterly average basis, total debt growth is projected to be 5.3 percent in 1994, 4.9 in 1995, and 5.0 in 1996. Federal debt rises 5.7 percent in 1994, 5.0 percent in 1995, and 5.8 percent in 1996. Nonfederal debt rises 5.1 percent in 1994, 4.9 percent in 1995, and 4.8 percent in 1996.

2.6.3 FOF

Confidential FR Class II
December 14, 1994

FLOW OF FUNDS PROJECTIONS: HIGHLIGHTS[1]
(Billions of dollars)

		Calendar year				1994				1995			
		1993	1994	1995	1996	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
						Seasonally Adjusted Annual Rates							
	Net funds raised by domestic nonfinancial sectors												
1	Total	649.4	580.8	637.4	677.5	647.6	556.4	565.3	554.1	788.5	570.4	579.6	610.9
2	Net equity issuance	21.3	-31.7	-13.5	-8.0	-9.6	-2.0	-50.0	-65.0	-30.0	-8.0	-8.0	-8.0
3	Net debt issuance	628.1	612.5	650.9	685.5	657.2	558.4	615.3	619.1	818.5	578.4	587.6	618.9
	Borrowing sectors												
	Nonfinancial business												
4	Financing gap[2]	28.9	56.7	121.7	120.5	13.5	62.1	64.6	86.5	111.4	126.2	123.0	126.2
5	Net equity issuance	21.3	-31.7	-13.5	-8.0	-9.6	-2.0	-50.0	-65.0	-30.0	-8.0	-8.0	-8.0
6	Credit market borrowing	21.9	154.5	154.5	152.6	131.4	144.7	156.4	185.5	177.4	145.4	143.5	151.6
	Households												
7	Net borrowing, of which:	284.5	332.6	297.7	286.0	305.4	318.6	373.5	333.0	314.8	293.7	293.5	288.8
8	Home mortgages	178.2	184.2	180.5	184.0	186.3	168.9	199.5	182.0	177.7	179.1	181.4	183.8
9	Consumer credit	62.3	110.5	94.4	84.2	72.7	121.9	127.1	120.2	110.0	94.2	89.2	84.2
10	Debt/DPI (percent)[3]	88.4	90.0	90.6	91.5	90.4	90.5	91.1	90.8	90.9	91.3	91.6	91.7
	State and local governments												
11	Net borrowing	65.7	-25.5	8.0	32.8	9.9	-27.8	-48.8	-35.2	-2.2	3.8	12.8	17.8
12	Current surplus[4]	-56.3	-56.5	-44.0	-44.5	-49.8	-63.2	-67.6	-45.3	-41.7	-42.3	-44.4	-47.7
	U.S.government												
13	Net borrowing	256.1	150.8	190.6	214.1	210.6	122.9	134.1	135.7	328.5	135.5	137.8	160.8
14	Net borrowing;quarterly, nsa	256.1	150.8	190.6	214.1	51.2	7.7	37.0	54.9	79.8	11.0	38.7	61.1
15	Unified deficit;quarterly, nsa	226.3	191.2	188.6	218.3	58.6	-0.2	53.5	79.3	97.9	-39.5	48.3	81.9
	Funds supplied by												
16	depository institutions	140.2	204.5	164.6	191.8	198.2	154.8	228.1	237.1	171.4	155.1	160.6	171.3
	MEMO: (percent of GDP)												
17	Dom. nonfinancial debt[3]	189.8	188.0	186.9	188.5	190.5	189.3	188.9	188.0	188.1	188.0	188.3	188.8
18	Dom. nonfinancial borrowing	9.9	9.1	9.1	9.2	10.0	8.3	9.1	9.0	11.7	8.2	8.2	8.6
19	U.S. government[5]	4.0	2.2	2.7	2.9	3.2	1.8	2.0	2.0	4.7	1.9	1.9	2.2
20	Private	5.9	6.9	6.5	6.4	6.8	6.5	7.1	7.0	7.0	6.3	6.3	6.3

1. Data after 1994:3 are staff projections.
2. For corporations: Excess of capital expenditures over U.S. internal funds.
3. Annuals are average debt levels in the year (computed as the average of year-end debt positions) divided by nominal GDP.
4. NIPA surplus, net of retirement funds.
5. Excludes government-insured mortgage pool securities.

Recent Developments

Since the November FOMC meeting, the weighted average foreign exchange value of the dollar in terms of the other G-10 currencies has risen 2 percent. The dollar has appreciated by similar amounts in terms of the yen and the mark. The larger-than-expected increase in U.S. short-term rates on November 15 reassured markets that potential U.S. inflation pressures would be contained and contributed to the dollar's rise early in the period. Subsequent economic news showing continuing strength in the economy was a factor in additional firming of the dollar.

During the intermeeting period, three-month interest rates in Canada rose 170 basis points, substantially more than the 50 basis point increase in the Bank of Canada's overnight rate. Much of the increase was in the past week as the Canadian currency came under pressure in response to concerns about central and provincial government fiscal deficits. In addition, the Bank of Canada is concerned about further stimulus to the economy, including that from the exchange rate, given that economic activity in Canada has continued to expand briskly. Elsewhere abroad, three-month rates rose much less. U.K. rates rose nearly 20 basis points as the Bank of England also raised short-term official rates 50 basis points in an effort to prevent a reemergence of inflation from threatening the recovery. Short-term rates in Germany and France were up 30 and 50 basis points, respectively; those in Japan were little changed.

Long-term interest rates declined a bit over the intermeeting period in the United States and were about unchanged in most of the major foreign industrial countries. In Italy, long-term rates rose 45 basis points, reflecting continued political turmoil for the Berlusconi government.

The Desk did not intervene.

In the major foreign industrial countries, economic activity continued to expand rapidly in the third quarter, and indicators for the current quarter generally suggest further gains. In Japan, real GDP grew 3.7 percent, annual rate, in the third quarter after a small increase in the previous quarter. All components of domestic demand contributed strongly to the third-quarter outcome. Indicators for the current quarter are somewhat mixed, but the November Tankan report registered further gains in business sentiment. In western Germany, real GDP expanded 5.3 percent, annual rate, in the third quarter, with significant gains in all components of domestic demand except inventories. Industrial production rose further in October, and orders for manufactured goods changed little in October from their high September level. In France, Canada, and the United Kingdom, growth of real GDP, while slowing from previous very high rates, continued above estimates of potential growth rates in the third quarter. In October, U.K. industrial production and retail sales were moderately above their respective averages for the third quarter. Canadian employment grew strongly through November.

Consumer price inflation remains low in the major foreign industrial countries. Price increases have blipped up in Japan and the United Kingdom as a result of higher food prices while inflation has edged down further in Germany and has remained about steady in France and Canada.

The U.S. nominal trade deficit in goods and services widened a bit in September. For the third quarter, the deficit was substantially greater than it was for the second quarter. Exports were 3 percent higher in the third quarter than in the second quarter, with the largest increases in machinery, industrial supplies, and consumer goods. Most of the increase went to developing countries in Asia and Latin America. Imports were 4.5 percent higher in the third quarter than the second-quarter rate. Increases were spread among all major trade categories. The quantity of oil imports remained high through September as the pace of inventory accumulation quickened. Preliminary data for October and November suggest some easing of oil imports in the current quarter as consumption is met, in part, by stock drawdowns.

In October, prices of U.S. non-oil imports and of nonagricultural exports each rose somewhat more than they had in September, boosted in both cases by higher prices of industrial supplies. Prices of imported foods also rose sharply. Prices of agricultural exports fell slightly in October. While the price of imported oil in October remained near the September average, the price should average $15.40 in the fourth quarter, about 85 cents per barrel below the third-quarter average, as world oil production has rebounded in recent months. Spot oil prices have fallen further since mid-November.

Outlook

The staff projects that real GDP in foreign industrial and developing countries will increase at an annual rate of about 4 percent over the forecast period, a rate essentially unchanged from that projected in the previous Greenbook and well above the rate of real growth forecast for the United States in 1995 and 1996. The dollar is projected to remain about unchanged from current levels. As a result of these developments and the lagged effects of the decline in the dollar that occurred during 1994, real exports of goods and services are forecast to grow at a slightly faster rate than real imports through 1996. Consequently, with the level of real imports currently exceeding real exports, real net exports are projected to remain little changed over the forecast period.

The dollar. We project that the foreign exchange value of the dollar in terms of the other G-10 currencies will remain about unchanged from current levels through the end of the forecast period. This projected path is somewhat higher than that in the November Greenbook and reflects the rise in the dollar over the intermeeting period. Our projection is that the CPI-adjusted value of the dollar in terms of the currencies of key developing countries will show a moderate depreciation on average through the end of the forecast period, little changed from the November Greenbook. We expect the Mexican peso to depreciate about 4 percent in nominal terms against the dollar through the end of 1995, with the peso remaining close to the lower limit of its steadily depreciating band as currently set by the Bank of Mexico.

Foreign G-7 countries. Real GDP growth in the foreign G-7 countries (weighted by U.S. exports) is projected to average about 3-1/2 percent through the end of the forecast period. This forecast on balance is little changed from that in the November Greenbook. However, the level of GDP is slightly higher in this forecast as a result of upward revisions to 1994 projections, especially for Japan, Germany, and the United Kingdom.

In Germany, real output growth is expected to remain quite strong in the current quarter and then to slow to about 3 percent over the remainder of the forecast period, as the income tax surcharge scheduled to take effect in January is expected to slow consumption growth next year. In France, some further slowing from the rapid growth seen in the first half of this year is expected in the current quarter as the growth of consumption appears to be slowing. Real GDP growth should rebound to 3-1/4 percent next year and then strengthen slightly more in 1996 in response to greater investment spending. In the United Kingdom, the rate of real output growth is expected to slow to about 3-1/4 percent, annual rate, in the current quarter, to remain at that rate in 1995, and then to slow further to 2-3/4 percent in 1996 as current and prospective monetary tightening has an effect. With some monetary tightening already in place and with U.S. output growth projected to slow next year, output growth in Canada is forecast to slow from 5 percent in 1994 to 4 percent in 1995 and then to slow a bit more in 1996. The strong Japanese growth recorded for the third quarter suggests that recovery there is becoming established. After some slowing in the current quarter as consumption spending returns to a more sustainable pace, we project growth to increase gradually over the forecast period, reaching 2-3/4 percent in 1995 and nearly 3-1/2 percent in 1996.

Consumer price inflation in the foreign G-7 countries is projected to remain low but to rise somewhat over the forecast period as continued stronger activity reduces the amount of slack in those economies. On average, inflation in these six countries (weighted by U.S. import shares) is projected to increase from about 1-1/4 percent this year to about 1-3/4 percent in 1995 and 1996.

The staff forecast incorporates the assumption that foreign short-term interest rates on average will move up further as most central banks abroad react to the stronger activity in their respective economies; short-term rates are expected to move up on average nearly 100 basis points over the forecast period, with rates moving up substantially more in the United Kingdom and less in Canada, where significant rate increases have already occurred. This assumed path for short-term interest rates is somewhat above that in the previous Greenbook.

Foreign long-term rates, on average, are expected to change little through the end of the forecast period in light of the persistence of favorable inflation performance.

Other countries. The real GDP of developing countries that are major U.S. trading partners (weighted by bilateral nonagricultural export shares) is forecast to increase about 5-3/4 percent per year over 1995-96. The external sectors of Asian developing countries should benefit from the strengthening recovery in the foreign industrial countries and from the appreciation of the yen. In Latin America, a progressive dismantling of trade barriers, large-scale privatization efforts, and continued domestic and foreign investment should facilitate growth in 1995-96.

The aggregate growth forecast for developing countries has been revised upward by about 1/4 percentage point for 1995-96 since the previous Greenbook, mainly because of improved growth prospects in Mexico. The growth forecast for Mexico has been revised upward by 3/4 percentage points, reflecting stronger-than-anticipated growth during the third quarter that suggests a sustainable economic recovery is taking hold. Investment is expected to pick up markedly as political uncertainty associated with President Zedillo's transition diminishes.

U.S. real net exports. Real net exports of goods and services are expected to fluctuate narrowly over the forecast period and to show little net change from current levels through the end of 1996.

Rapid growth of real exports of goods and services will be sustained by the strong pace of foreign output growth and the lagged effects of the decline in the dollar during 1994. Growth of computer exports is expected to remain rapid through the forecast period. The growth rates of other nonagricultural exports and of services are projected to lie in the 5-6 percent range in 1995 and 1996.

QUANTITIES of GOODS and SERVICES*
(percent change from end of previous period, saar)

	1993	1994 H1	1994 Q3	1994 Q4	Projection 1995	Projection 1996
Exports of G&S:	5.8	6.1	12.2	13.7	8.3	8.7
of which:						
Services	5.0	2.7	-3.7	7.5	5.1	5.2
Computers	23.1	14.8	38.3	33.5	28.6	26.2
Other goods 1/	4.5	7.3	12.0	12.0	5.5	5.9
Imports of G&S	12.4	14.1	15.6	10.4	7.3	7.2
of which:						
Services	8.7	-0.4	6.9	5.1	3.2	2.9
Oil	10.0	7.7	30.1	-26.6	2.7	1.2
Computers	38.3	27.7	35.8	33.6	25.6	21.6
Other goods 2/	9.3	15.7	11.7	12.2	4.2	4.5

* NIPA basis, 1987 dollars.
1. Nonagricultural exports of goods exluding computers
2. Non-oil imports of goods excluding computers

In the near term, growth of total imports of goods and services reflects the stronger outlook for U.S. real GDP growth. In 1995 and 1996, the growth of non-oil imports other than computers slows to about 4-1/2 percent. This rate reflects the projected slowing of U.S. GDP growth over this period, the tendency for these imports to grow about twice as fast as income, and the lagged effects of higher import price inflation in the near term. Service imports are also expected to slow through 1996. The very rapid growth of computer imports, which currently have a weight in total real imports of about 20 percent, boosts the growth of total imports. We expect the quantity of oil imports to fall in the current quarter as winter consumption is met in part by seasonal stock draws and inventories return to more normal levels. In 1995, oil imports are projected to remain on a moderate upward trend as U.S. oil consumption continues to increase in line with economic activity.

SELECTED PRICE INDICATORS
(percent change from end of previous period except as noted, ar)

	1993	1994 H1	1994 Q3	1994 Q4	Projection 1995	Projection 1996
US PPI 1/	0.9	2.8	5.6	3.1	3.5	2.1
Nonag. exports 2/	0.7	3.2	6.1	3.8	2.7	1.7
Non-oil imports 2/	1.3	2.1	6.2	5.7	2.5	1.1
Oil imports (Q4 level, $/bl.)	14.09	14.67	16.24	15.37	16.00	16.00

1. Selected categories (ex computers) weighted by U.S. exports.
2. Excluding computers.

Oil prices. For the current quarter and the first quarter of next year, assumptions for the oil import unit value have been revised down $0.40 and $0.90 per barrel, respectively. With inventories ample and the weather unseasonably warm, the twelve-month extension of OPEC's quota has not supported prices. We expect near-term WTI spot oil price to average $17.25 per barrel in January and to reach $18.50 per barrel by June 1995, consistent with continued global economic expansion. By the end of the second quarter, the oil import unit value is projected to rise to $16.00 per barrel and remain at that level through 1996. This price forecast assumes that members will not strictly comply with the twelve-month extension of the current quota; if OPEC countries were to adhere to their quota, the oil price path would be roughly $3.00 per barrel higher, an upside risk to the forecast. Meanwhile, we continue to assume that Iraq will return to the world oil market in 1996.

Prices of non-oil imports and exports. The prices of non-oil imports excluding computers are expected to increase nearly 6 percent, annual rate, in the current quarter as rising world commodity prices and the lagged effects of dollar depreciation earlier in the year continue to be felt. With the waning of these effects, import prices are expected to decelerate in 1995 and 1996. For 1995-96, nonagricultural export price increases are expected to slow in line with the slowing of U.S. producer price inflation.

Nominal trade and current account balances. The trade deficit on goods and services is projected to narrow somewhat over the forecast period. The deficit on net investment income is projected to widen, reflecting the path of interest rates and rising U.S. net international indebtedness. We expect that, as a result of these developments, the current account deficit will average about $185 billion in 1995 and 1996, 2.5 percent of GDP and approximately $30 billion larger than our estimate for 1994.

December 14, 1994

REAL GDP AND CONSUMER PRICES, SELECTED COUNTRIES, 1993-96
(Percent; quarterly change at an annual rate except as noted)

		Projected			1994			Projected 1995			
Measure and country	1993	1994	1995	1996	Q2	Q3	Q4	Q1	Q2	Q3	Q4
REAL GDP											
Canada	3.2	5.0	4.1	3.8	6.7	4.7	4.5	4.4	4.1	3.9	4.0
France	-0.5	3.3	3.2	3.6	4.6	3.0	2.1	2.8	3.2	3.3	3.5
Germany	-0.1	4.1	2.9	3.2	4.5	5.3	3.7	3.0	2.7	2.8	3.1
W. Germany	-0.5	3.6	2.5	2.6	4.0	5.3	3.0	2.4	2.3	2.4	2.7
Italy	0.4	2.1	4.0	3.0	5.7	3.6	-2.4	4.0	5.0	4.0	3.0
Japan	-0.5	2.5	2.7	3.4	0.7	3.7	2.3	2.5	2.4	2.9	2.8
United Kingdom	2.7	4.1	3.1	2.8	5.5	3.8	3.2	3.2	3.2	3.0	3.0
Average, weighted by 1987-89 GDP	0.4	3.2	3.2	3.3	3.7	3.9	2.2	3.1	3.2	3.2	3.1
Average, weighted by share of U.S. nonagricultural exports											
Total foreign	2.7	4.3	4.0	4.1	NA	NA	NA	NA	NA	NA	NA
Foreign G-7	1.7	4.1	3.5	3.5	4.9	4.3	3.4	3.6	3.5	3.5	3.4
Developing countries	4.8	5.6	5.3	5.6	NA	NA	NA	NA	NA	NA	NA
CONSUMER PRICES(1)											
Canada	1.8	-0.0	1.8	2.1	-1.4	2.2	1.2	1.6	1.6	2.0	2.0
France	2.1	1.7	1.5	1.5	2.5	0.5	2.0	1.6	1.5	1.5	1.4
Western Germany	3.7	2.7	2.3	2.5	2.7	1.4	1.0	4.5	2.8	1.0	1.0
Italy	4.1	3.8	4.2	4.0	3.4	3.0	4.4	4.5	4.5	3.6	4.1
Japan	1.2	1.2	0.8	0.7	1.3	-0.9	3.8	1.1	0.7	0.4	1.1
United Kingdom	1.6	2.7	3.6	3.9	7.4	0.1	2.8	3.1	7.4	1.5	2.5
Average, weighted by 1987-89 GDP	2.2	2.0	2.1	2.1	2.6	0.6	2.8	2.5	2.7	1.4	1.8
Average, weighted by share of U.S. non-oil imports	1.9	1.2	1.7	1.8	1.1	0.7	2.5	2.0	1.9	1.3	1.6

Note. Annual values are measured from Q4 to Q4.
1. Not seasonally adjusted.

U.S. INTERNATIONAL TRANSACTIONS IN GOODS, SERVICES, AND THE CURRENT ACCOUNT

(Billions of dollars, seasonally adjusted annual rates)

	1992				1993				1994		ANNUAL		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	1991	1992	1993
NIPA Real Net Exports of Goods & Services (87$)	-17.9	-34.1	-38.9	-38.5	-57.6	-69.3	-86.3	-82.2	-104.0	-111.8	-19.5	-32.3	-73.9
Exports of G&S	571.0	573.1	580.5	590.7	589.2	600.2	595.3	625.2	619.6	643.9	542.6	578.8	602.5
Goods	416.0	421.5	427.4	441.1	433.9	443.3	438.5	468.1	464.4	484.6	397.1	426.5	445.9
Agricultural	38.9	38.4	40.5	41.3	39.1	39.3	36.9	39.1	36.6	37.5	35.5	39.8	38.6
Computers	47.1	52.3	56.2	60.1	60.9	62.9	68.5	74.0	76.9	79.3	41.4	53.9	66.6
Other Goods	330.0	330.8	330.7	339.8	333.9	341.1	333.1	355.1	350.9	367.8	320.2	332.8	340.8
Services	154.9	151.6	153.1	149.6	155.3	156.9	156.7	157.1	155.2	159.2	145.5	152.3	156.5
Imports of G&S	588.8	607.1	619.4	629.3	646.8	669.6	681.6	707.4	723.6	755.6	562.1	611.1	676.3
Goods	489.5	509.7	521.7	530.2	546.6	567.4	577.1	599.9	615.2	648.3	464.4	512.8	572.8
Oil	47.2	51.6	53.1	52.8	53.4	57.7	56.7	58.1	56.5	60.3	49.2	51.2	56.5
Computers	51.2	57.5	64.7	68.4	73.3	80.0	87.8	94.6	99.7	106.9	41.6	60.5	83.9
Other Goods	391.1	400.6	403.9	409.0	419.9	429.7	432.6	447.2	458.9	481.0	373.7	401.2	432.4
Services	99.3	97.4	97.7	99.0	100.1	102.2	104.5	107.6	108.5	107.4	97.7	98.3	103.6
Memo:(Percent change 1/)													
Exports of G&S	6.1	1.5	5.3	7.2	-1.0	7.7	-3.2	21.7	-3.5	16.6	8.1	5.0	5.8
Agricultural	13.4	-5.0	23.7	8.1	-19.7	2.1	-22.3	26.1	-23.2	10.2	10.9	9.5	-5.3
Computers	24.4	52.0	33.3	30.8	5.4	13.8	40.7	36.2	16.6	13.1	26.7	34.8	23.1
Other Goods	3.1	1.0	-0.1	11.5	-6.8	8.9	-9.1	29.2	-4.6	20.7	7.2	3.8	4.5
Services	5.9	-8.3	4.0	-8.8	16.1	4.2	-0.5	1.0	-4.8	10.7	4.7	-2.0	5.0
Imports of G&S	6.6	13.0	8.4	6.5	11.6	14.9	7.4	16.0	9.5	18.9	4.0	8.6	12.4
Oil	0.9	42.8	12.1	-2.2	4.6	36.3	-6.8	10.2	-10.6	29.7	8.3	12.1	10.0
Computers	53.5	59.1	60.3	24.9	31.9	41.9	45.1	34.8	23.4	32.2	45.6	48.7	38.3
Other Goods	2.4	10.1	3.3	5.1	11.1	9.7	2.7	14.2	10.9	20.7	2.9	5.2	9.3
Services	7.2	-7.4	1.2	5.4	4.5	8.7	9.3	12.4	3.4	-4.0	-6.2	1.4	8.7
Current Account Balance	-33.4	-66.2	-74.4	-97.5	-79.4	-102.4	-111.4	-122.3	-129.3	-147.3	-6.9	-67.9	-103.9
Goods & Serv (BOP), net	-15.5	-41.5	-51.1	-53.4	-57.7	-76.3	-89.0	-79.9	-97.3	-107.5	-28.5	-40.4	-75.7
Goods (BOP), net	-72.3	-97.3	-109.4	-105.3	-116.8	-134.9	-145.9	-132.7	-147.8	-166.5	-74.1	-96.1	-132.6
Services (BOP), net	56.8	55.8	58.3	52.0	59.1	58.6	56.9	52.8	50.5	59.0	45.6	55.7	56.8
Investment Income, net	9.7	6.5	4.9	-2.9	7.4	2.7	8.1	-2.4	-3.2	-10.0	14.8	4.5	4.0
Direct, net	50.8	51.0	47.1	42.0	54.6	50.8	55.9	48.4	45.9	43.0	55.4	47.7	52.4
Portfolio, net	-41.1	-44.5	-42.2	-44.9	-47.2	-48.1	-47.8	-50.8	-49.1	-53.0	-40.5	-43.2	-48.5
Unilateral Transfers, net	-27.7	-31.1	-28.2	-41.2	-29.1	-28.8	-30.5	-40.1	-28.7	-29.9	6.7	-32.0	-32.1

1/ Percent change (AR) from previous period; percent changes for annual data are calculated Q4/Q4.

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OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS IN GOODS, SERVICES, AND THE CURRENT ACCOUNT

(Billions of dollars, seasonally adjusted annual rates)

			Projection								Projection		
	1994		1995				1996				ANNUAL		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	1994	1995	1996
NIPA Real Net Exports of Goods & Services (87$)	-120.8	-118.8	-121.6	-123.9	-123.1	-120.6	-118.7	-116.5	-116.6	-117.5	-113.9	-122.3	-117.3
Exports of G&S	662.7	684.3	699.1	713.6	727.1	741.2	756.2	772.3	788.8	805.9	652.6	720.3	780.8
Goods	505.0	523.7	536.7	549.1	560.5	572.4	585.4	599.3	613.5	628.4	494.4	554.7	606.6
Agricultural	40.6	42.0	42.7	42.8	42.6	42.8	42.9	43.1	43.2	43.4	39.2	42.7	43.1
Computers	86.0	92.4	98.9	105.8	112.2	118.9	126.1	133.6	141.6	150.1	83.7	109.0	137.9
Other Goods	378.4	389.2	395.0	400.5	405.7	410.7	416.4	422.6	428.6	434.9	371.6	403.0	425.6
Services	157.7	160.6	162.5	164.5	166.6	168.8	170.9	173.1	175.3	177.5	158.2	165.6	174.2
Imports of G&S	783.5	803.1	820.7	837.4	850.3	861.7	875.0	888.9	905.4	923.4	766.5	842.5	898.1
Goods	674.4	692.7	708.8	724.5	736.7	747.7	760.2	773.4	789.0	806.0	657.6	729.4	782.2
Oil	64.4	59.6	57.8	60.0	60.8	61.2	62.0	61.6	61.6	62.0	60.2	60.0	61.8
Computers	115.4	124.1	132.7	140.7	148.4	155.9	163.7	171.8	180.4	189.5	111.5	144.4	176.4
Other Goods	494.5	508.9	518.1	523.7	527.4	530.5	534.5	539.9	546.8	554.5	485.8	524.9	543.9
Services	109.2	110.6	112.0	113.0	113.6	114.2	114.8	115.5	116.5	117.5	108.9	113.2	116.1
Memo:(Percent change 1/)													
Exports of G&S	12.2	13.7	9.0	8.5	7.8	7.9	8.4	8.8	8.8	9.0	9.5	8.3	8.7
Agricultural	37.4	15.0	6.5	0.4	-1.2	1.2	1.4	1.4	1.4	1.4	7.5	1.7	1.4
Computers	38.3	33.5	31.1	31.1	26.2	26.2	26.2	26.2	26.2	26.2	24.9	28.6	26.2
Other Goods	12.0	12.0	6.1	5.7	5.3	5.0	5.7	6.1	5.8	6.0	9.6	5.5	5.9
Services	-3.7	7.5	4.8	5.1	5.3	5.3	5.0	5.3	5.2	5.2	2.2	5.1	5.2
Imports of G&S	15.6	10.4	9.0	8.4	6.3	5.5	6.3	6.5	7.6	8.2	13.5	7.3	7.2
Oil	30.1	-26.6	-11.4	15.7	5.6	2.8	5.0	-2.3	0.1	2.1	2.6	2.7	1.2
Computers	35.8	33.6	31.1	26.3	23.9	21.6	21.5	21.6	21.5	21.6	31.1	25.6	21.6
Other Goods	11.7	12.2	7.5	4.4	2.8	2.4	3.1	4.1	5.2	5.7	13.8	4.2	4.5
Services	6.9	5.1	5.3	3.8	2.2	1.8	2.4	2.5	3.2	3.5	2.8	3.2	2.9
	Projection												
Current Account Balance	-164.6	-180.7	-174.8	-186.1	-184.1	-195.9	-182.6	-181.5	-175.0	-188.7	-155.5	-185.2	-181.9
Goods & Serv (BOP), net	-123.8	-123.3	-122.8	-124.5	-122.7	-118.2	-113.5	-108.6	-105.5	-104.0	-113.0	-122.1	-107.9
Goods (BOP), net	-178.5	-180.9	-182.1	-185.9	-186.7	-184.9	-182.8	-180.4	-179.8	-180.7	-168.4	-184.9	-180.9
Services (BOP), net	54.7	57.6	59.3	61.3	63.9	66.7	69.3	71.8	74.3	76.7	55.5	62.8	73.0
Investment Income, net	-9.8	-17.0	-20.0	-29.6	-29.3	-36.7	-36.5	-40.4	-37.0	-43.2	-10.0	-28.9	-39.3
Direct, net	45.9	48.3	48.6	48.5	49.6	50.8	52.0	53.8	55.8	57.6	45.8	49.4	54.8
Portfolio, net	-55.7	-65.2	-68.6	-78.1	-78.9	-87.6	-88.5	-94.2	-92.8	-100.8	-55.8	-78.3	-94.1
Unilateral Transfers, net	-31.0	-40.5	-32.0	-32.0	-32.0	-41.0	-32.5	-32.5	-32.5	-41.5	-32.5	-34.2	-34.8

1/ Percent change (AR) from previous period; percent changes for annual data are calculated Q4/Q4.