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Strictly Confidential (FR) Class II FOMC

Part 1

August 15, 1996

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Summary and Outlook

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

Strictly Confidential (FR) Class II FOMC

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SUMMARY AND OUTLOOK

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Overview

The staff's baseline forecast has taken on a somewhat more inflationary cast this month, primarily because of the passage of federal minimum wage legislation. As we anticipated in the last Greenbook, growth in real GDP was fairly strong in the first half, and the tightness of labor markets was reflected in an acceleration of wages. Looking forward, we continue to think it most likely that growth in aggregate nominal demand will moderate, but not enough to relieve the pressures on resources. Real GDP is projected to increase just a little faster than 2 percent per annum, on average, through 1997, while the trend of inflation, as proxied by the CPI excluding food and energy, moves discernibly above 3 percent by the end of next year.

The pickup in activity over the first half of this year was paced by large increases in demand for consumer durables, housing, and business equipment. At this stage of the cycle, stock-flow relationships argue against a continuation of those thrusts. In addition, we continue to expect that the backup in intermediate- and long-term interest rates this year will have a lagged effect on aggregate demand, as will a less vibrant stock market. A return to more normal rates of inventory investment probably will provide some lift to production in the near term, but there are no signs of the circumstances that typically trigger aggressive accumulation of stocks. The expected moderation of GDP growth is attributable entirely to the slackening in domestic demand, for the cost-competitiveness of U.S. producers and the firming of activity abroad point to more sizable increases in exports ahead.

We are projecting that the unemployment rate will remain in the vicinity of 5-1/2 percent through 1997; unfortunately, both the anecdotal reports of difficulty in finding qualified workers and the acceleration of the employment cost index for compensation over the past couple of quarters suggest that this level is not consistent with stable inflation. Moreover, we expect that the 21 percent hike in the minimum wage will add a few tenths of a percentage point to compensation inflation by the end of 1997. The lack of strain on physical plant in the industrial sector and the healthy profit margins currently enjoyed by firms in some parts of the economy may limit the reaction of prices for a time, but it would seem excessively optimistic to think that the underlying trend of inflation will not ultimately deteriorate. With food and energy prices also rising appreciably in our forecast, overall CPI inflation is expected to come in at about 3-1/4 percent both this year and next.

Key Background Factors in the Forecast

We have retained our assumption that the federal funds rate will remain at or near the 5-1/4 percent mark over the course of the projection period. A few weeks ago, such a path would have come as a considerable surprise to the markets, but there now appears to be little anticipation of Fed tightening over the next year or so. That said, the bond markets may be more sanguine about the inflation outlook than we are, and so we are projecting that long rates will back up a bit from their current levels as the bad news sinks in.

Given our inflation projection, a steady funds rate probably would imply a modest easing of real short-term rates. On the credit supply side, we are expecting that concerns about consumer debt-servicing performance will lead to some further movement by banks toward tighter lending standards on consumer loans. However, the projected economic environment is not one in which we would expect to see a marked deterioration of credit access for either households or businesses or a substantial widening of yield spreads on bonds.

Although the brief plunge in stock prices last month may have sapped some of the speculative energy from the equity markets, valuation levels still seem to us rich on the whole--at least against the backdrop of sluggish profit growth that we foresee. Consequently, we are anticipating that share prices will undergo a further modest "correction" in the next couple of quarters and then recover only gradually over the remainder of the projection period. This raises equity financing costs and trims the ratio of household net worth to income.

We continue to anticipate only a modest degree of restraint on aggregate demand coming from fiscal policy. Discretionary spending is likely to run somewhat above the level specified in the fiscal year 1997 budget resolution (the usual pattern). Cuts in mandatory spending and taxes will remain under discussion, but it seems improbable anything will happen that would affect the budget materially before fiscal 1998. The welfare and health insurance reforms and the new small business tax provisions connected to the minimum wage hike should have only a small macroeconomic impact during the projection period: in terms of their fiscal dimensions, CBO's estimates indicate that the three bills together will reduce the deficit $4 billion in fiscal 1997 and $8 billion in fiscal 1998. The most notable changes in the deficit outlook arise from our forecast of greater compensation growth and our trimming of outlays for health and income security, in light of recent trends. All told, we project the unified budget deficit will be $118 billion in fiscal 1996 and $141 billion in fiscal 1997, down $10 billion and $22 billion, respectively, from the June Greenbook.

On balance, the trade-weighted value of the dollar against other G-10 currencies has declined since early July. We have assumed that the dollar will remain at this lower level through the end of 1997, putting the exchange rate roughly 2 percent below the path in the June Greenbook. On a U.S. export-weighted basis, foreign GDP is projected to rise about 3-1/2 percent in 1996 and 3-3/4 percent in 1997, essentially the same as in the previous projection. We expect the spot price of West Texas intermediate to average roughly $20.50 per barrel in the third quarter, compared with about $19 in the June Greenbook--and to drop to $18 per barrel as Iraqi exports hit the market this fall. But increased demand associated with the pickup in world economic growth is projected to boost oil prices back to $19.50 per barrel by next spring.

Recent Developments and Outlook for the Current Quarter

Real GDP appears to have increased about 3-3/4 percent at an annual rate last quarter, somewhat below BEA's advance estimate but in line with our projection in the June Greenbook. The statistical information available at this point for the third quarter is skimpy and doesn't go very far in narrowing the forecast uncertainties. We are still expecting a considerable deceleration in GDP, to about 2-1/2 percent. This pace is a touch above that in the last Greenbook; our forecast for final sales has been revised down a bit, but inventory investment is expected to make a more substantial contribution to near-term GDP expansion after a surprisingly modest accumulation in the second quarter.

The early-quarter labor market indicators present an ambiguous picture regarding the extent of the deceleration in production. In July, private nonfarm payrolls rose 156,000--a hefty increase when gauged against labor force trends but 63,000 below the average monthly gains in the first half. More strikingly, with the workweek dropping back to the low end of its recent range, aggregate private production worker hours fell 1.2 percent, returning to the second-quarter average. However, initial claims for unemployment insurance have been quite low of late; this may be at least partly an aberration associated with changing seasonal patterns, but when viewed in the context of anecdotal and survey reports of labor market conditions, it is hard to shake the suspicion that job growth is holding up better than we had anticipated. Indeed, we have written in private payroll increases averaging about 160,000 in August and September--enough, we think, to produce a quarterly gain in private hours on the order of 2 percent at an annual rate. With government output likely to decline from its surprisingly high second-quarter level, such growth in private hours might be expected to translate into a real GDP increase in the 2 percent to 3 percent range. This would also be consistent with unemployment remaining near July's 5.4 percent rate.

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

	1996:Q2			1996:Q3	
	June GB	BEA adv.	Aug. GB	June GB	Aug. GB
Real GDP	3.8	4.2	3.7	2.3	2.6
Private domestic final sales	3.5	3.9	4.2	2.8	2.6
Change in billions of chained (1992) dollars					
Inventory investment	17.3	13.3	6.6	17.2	25.7
Government purchases	8.4	21.7	19.6	-9.4	-11.3
Net exports	-10.7	-17.7	-20.5	-9.1	-6.1

Growth in consumer spending appears to have hit a lull in the past couple of months. Sales of light vehicles fell noticeably in July, and even with a projected bounceback over the rest of the summer, we expect only a relatively modest increase in expenditures on new cars and trucks for the quarter as a whole. Sluggish retail sales on balance in June and July also point to a moderation in real PCE growth this quarter--perhaps to around a 2-1/2 percent annual rate, versus 3-1/2 percent in the first half.

Real business fixed investment is projected to rise 4-3/4 percent at an annual rate this quarter, up somewhat from the 3-1/2 percent pace we estimate for the second quarter (based on source data that became available after the weaker BEA advance number was issued). The actual performance of computer shipments over the first half belied reports of faltering demand; with prices trending lower, we expect that real outlays for such equipment will register a further sizable advance this summer. Meanwhile, declining fleet sales likely will reduce outlays for motor vehicles this quarter; on the plus side, though, deliveries of aircraft to domestic carriers should recover from a low spring level, and the orders figures point to a moderate increase in spending on other types of equipment.

Housing demand remained more robust than we expected through June. And surveys of homebuilders, consumers, and mortgage lenders hint at only a modest weakening by early August. Consequently, we have raised our forecast of housing starts in the third quarter, although we still are expecting a substantial decline--50,000 units at an annual rate--from the second quarter. Owing to the lags between starts and expenditures, residential investment will probably be little changed, but this still would constitute a considerable deceleration from the rapid growth of the first half.

Motor vehicle production is projected to rise to somewhere between 12-1/2 and 12-3/4 million units at an annual rate this quarter, enough to contribute about 1/2 percentage point to real GDP growth. Continued high assembly rates will permit a rebuilding of dealers' stocks--a desire likely enhanced by the possibility of a strike. Apart from motor vehicles, we estimate that nonfarm inventory investment ran at a quite modest $6 billion annual rate in the second quarter, leaving stocks in quite good shape overall; we are expecting the pace of nonfarm inventory investment excluding motor vehicles to pick up this quarter to a little above $20 billion and to account for more than 3/4 percentage point of GDP growth.

After providing an unexpected boost to growth in the first half of 1996, federal government expenditures for consumption and investment are expected to drop, reducing real GDP growth by about 3/4 percentage point this quarter. However, we have been puzzled by the strength of BEA's estimates of nondefense purchases, given the unified budget data, and consequently the uncertainty attending our forecast is unusually high. State and local purchases are expected to register only a slight increase this quarter after the spring make-up for winter storm shutdowns.

Growth in real imports is projected to slow from a 14-1/2 percent annual rate in the second quarter to a 5-1/2 percent pace in the current quarter. We are not expecting a repeat of the large increase in oil imports that occurred last quarter, and the gains in imports of automotive products and consumer goods should be more moderate this summer. Nonetheless, with exports rising at just a 3-1/4 percent annual rate, net exports are projected to drop further this quarter, reducing real GDP growth by about a third of a percentage point.

All told, the outlook for activity suggests no near-term relief from pressures on productive resources. Employers are likely to find that they need to bid up wages somewhat to attract the kinds of workers they want to hire, and we expect that the upcreep in ECI compensation gains will continue in the third quarter. At this point, actual data on wage developments in the current quarter are limited to the erratic average hourly earnings series, which fell 0.2 percent in July after surging 0.8 percent in June.

With the CPI excluding food and energy up 0.3 percent last month, we are projecting that this measure of inflation will rise at a 3 percent annual rate in the third quarter following four consecutive quarters of core inflation around the 2-3/4 percent mark. The total CPI is expected to rise at a 2-3/4 percent annual rate this quarter; a drop in the energy index due to the pass-through of last spring's decline in crude oil prices should more than offset another large increase in food prices.

The Outlook for the Economy beyond the Current Quarter

Our forecast for real GDP growth in late 1996 and in 1997 also is little changed from that in the June Greenbook. Growth is projected to moderate further in the fourth quarter, with real GDP growth dropping back to about 2 percent then--essentially our estimate of the trend rate of increase in potential output. Economic expansion is projected to continue at about this pace during 1997, maintaining a stable unemployment rate. Our forecast for labor costs has been revised up, however, reflecting the recent minimum wage legislation. By the end of 1997, core CPI inflation on a twelve-month change basis is predicted to be 3.2 percent, versus 2-3/4 percent in the year that ended last month--and about 1/4 percentage point more than in the last Greenbook.

SUMMARY OF STAFF PROJECTIONS
(Percentage change at annual rate except as noted)

	1995	1996 H1	1996 H2	1997
Real GDP	1.3	2.8	2.3	2.1
Previous	1.3	3.0	2.1	2.2
Final sales	1.9	3.2	1.6	2.1
Previous	1.9	3.1	1.7	2.2
PCE	1.9	3.5	2.6	2.5
Previous	2.0	3.2	2.7	2.5
BFI	6.4	7.4	5.2	4.3
Previous	6.7	9.7	4.8	4.2
Residential investment	-1.5	12.1	-2.5	-1.5
Previous	-1.4	6.7	-3.1	-.2
Civilian unemployment rate[1]	5.5	5.4	5.4	5.4
Previous	5.5	5.5	5.5	5.5

Note. Percentage change from final quarter of previous period to final quarter of period indicated except as noted.
1. Average level for the final quarter of period indicated.

Consumer spending. Consumer expenditures appear to be settling back to a more moderate growth path after spurting earlier this year. Sales of light motor vehicles are projected to run a little under 15 million units at an annual rate through 1997--off somewhat from the pace of the first half. Overall spending on non-auto durables should decelerate considerably from the hectic pace of the first half, although large price declines and the availability of new products likely will continue to boost sales of consumer electronics and related goods. Outlays for nondurable goods and services are projected to continue growing at a pace close to that in the first half of the year. Overall, real PCE is expected to increase at about a 2-1/2 percent annual rate, a pace roughly matching disposable income growth and thus consistent with the saving rate holding in the 4-1/2 to 4-3/4 percent range.

The financial crosscurrents in the consumption picture haven't changed much--and suggest, on net, no major impetus or restraint on demand. A sustained high-employment environment conceivably could make households less worried about maintaining precautionary savings, but concerns about education bills and retirement needs reportedly are causing many people to want to build their nest eggs. Rising loan delinquencies and bankruptcies are signaling a deterioration in the financial well-being of a good many households; however, those indicators may be overstating the degree of stress in the sector compared with past periods, owing to changes in lending practices and bankruptcy laws. Furthermore, current efforts by banks to lower their risk exposure from consumer lending appear to be selective and unlikely to make credit access a serious constraint on aggregate spending. Meanwhile, the recent erosion of stock market values has taken only a small bite out of what has been an enormous buildup of household wealth; even with our moderately pessimistic share price forecast, the sector's net worth position looks healthy.

Residential investment. The seemingly greater acceptance of adjustable-rate loans in recent years and the lowering of transactions costs on mortgage refinancings may have altered the responses of housing activity to increases in long-term interest rates, perhaps lengthening the lags somewhat. That said, the sustained strength of homebuilding through June surprised us. To some extent, this undoubtedly reflects the fact that employment growth has persistently exceeded our expectations, bolstering household income and confidence and thereby helping to buttress the demand for housing units in the face of higher financing costs.

Nonetheless, we expect that the higher rates will finally take a perceptible toll on demand this quarter and that single-family housing starts will fall from almost 1.2 million units at an annual rate in the second quarter of this year to a little under 1.1 million units by early 1997. In the multifamily sector, starts are expected to remain in the neighborhood of 0.3 million units (annual rate) over the forecast period.

Overall, the projected decline in residential investment is rather modest. The direct effects on real GDP growth are non-negligible only in the last quarter of this year and the first part of 1997--and they amount then to less than a quarter percentage point. That contrasts, however, with an almost half point positive contribution to growth during the first half of 1996.

Business fixed investment. Real BFI growth is projected to average about 4-1/2 percent at an annual rate over coming quarters, little changed from the forecast in the June Greenbook. Financial market conditions would not appear to be pushing spending very much one way or the other: Equity costs are expected to increase only moderately, increases in borrowing costs have not been large enough to date to make a substantial dent in firms' spending plans, and we expect that banks and other lenders will continue to pursue lending opportunities among small and mid-sized businesses. Other traditional cyclical determinants of capital spending also appear to be fairly neutral. Accelerator effects point to little movement in capital outlays; the capacity utilization rate in manufacturing is close to its long-run average, and recent levels of investment are sufficient to prevent bottlenecks from developing in an economy trending near potential. And the minimal growth in corporate profits that we are projecting will reduce the impetus to capital spending that has come in the past few years from flush cash positions.

Demand for computers, communications equipment, and some other high-tech equipment probably will continue to be enhanced by rapid technological change (and thus rapid obsolescence) and by large price declines. It is widely expected that desires to upgrade equipment to take advantage of new software will provide considerable lift to computer purchases in coming months. We project that real computer expenditures will increase at about a 25 percent annual rate in the second half of 1996 and between 15 and 20 percent in 1997--impressive increases, but well short of the huge gains in 1995 and early 1996.

Growth in other categories of expenditure for producers' durables is expected to be negligible after the current quarter. Heavy truck sales probably have farther to fall before they level out, while commercial aircraft deliveries are expected to ramp up significantly late this year. Higher farm income this year is giving a transitory lift to sales of agricultural equipment, but the demand for industrial machinery is likely to rise no further, given the already ample capacity expansion in many segments of manufacturing.

After a small gain this summer, nonresidential construction activity is expected to be little changed over the remainder of the projection period. Contracts for nonresidential construction--particularly those for industrial building--have dropped off considerably in recent months, suggesting a downside risk to the projection. However, the contracts data are quite volatile, and although they have some predictive power, they are far from a perfect indicator of future construction activity. Other indicators, such as vacancy rates and prices for office and other commercial structures, are more favorable than contracts, and anecdotal reports paint an upbeat picture of building prospects in many locales.

Inventory investment. The 3 percent annual rate of increase projected for nonfarm inventories in the current quarter is expected to be sufficient to restore stocks to more comfortable positions in those industries in which inventories have fallen to the lean side. Thereafter, inventory investment is projected to maintain a moderate pace. Nothing in the outlook suggests the emergence of delivery problems or incentives for speculative accumulation of stocks--but inventories appear low enough at this point that, if final demand were to run to the high side of our projection, the impetus to output growth could well be reinforced by efforts to raise stock-to-sales ratios (as evidently occurred in 1994).

In the farm sector, we anticipate that the inventory change will swing from the sharp decumulation seen recently to slight accumulation by early next year. Nonetheless, with corn production evidently falling short of earlier expectations, the levels of grain stocks seem almost certain to remain on the lean side for another year. On the livestock side, we expect liquidation of herds to slow from the rapid pace seen in the first half of 1996, but producers are likely to be cautious in rebuilding herds until there are indications of more profitable relationships between feed prices and livestock prices.

Government. Persistently higher-than-expected expenditures have caused us to revise our view of the level of federal consumption and investment that is consistent with our assumptions for outlays on a unified budget basis. Real federal purchases now are projected to change little over the four quarters of the year, as compared with the 2-1/2 percent decline projected in the June Greenbook. In 1997, federal purchases are projected to fall 3 percent; this decline is a touch less than in the June Greenbook, reflecting a less pronounced drop in nondefense purchases.

The projection for state and local government spending is little changed from the June Greenbook, with purchases growing at about a 2-1/4 percent annual rate over the forecast period. State and local governments are, by and large, in pretty good fiscal condition, but it is unclear what pressures may be in store as a result of welfare reform. In the aggregate, states are expected to receive about the same federal funding for family support payments, Medicaid, and child nutrition programs as they would have under existing provisions in fiscal 1997 and fiscal 1998. However, they could find themselves in a budgetary bind if they decide to offset a substantial portion of the reductions in direct federal transfers for food stamps and supplemental security income contained in the legislation; these reductions become sizable by fiscal 1998.

Net exports. While the prospects for foreign activity have not changed materially since the last Greenbook, the depreciation of the dollar is a modest plus for the trade outlook. Real exports of goods and services are projected to expand at a 6-1/2 percent annual rate in the second half of 1996 and 8-1/2 percent in 1997. In contrast, with domestic growth moderating, imports are expected to decelerate from the double-digit growth rates of recent quarters to an 8 percent pace over the next year and a half. The resulting path for net exports subtracts about 1/3 percentage point from GDP growth in the second half of 1996 but has little effect on growth in 1997. (A fuller discussion of these developments is contained in the International Developments section.)

Labor markets. Given our projected output path, we expect that monthly job gains will drop off to the 115,000-120,000 range in the fourth quarter of this year and remain there in 1997. When an economy presses on resource constraints, productivity can suffer as businesses are forced to turn to less-skilled workers or to less-efficient equipment to meet increases in demand. In this instance, however, we probably are not overshooting full employment to the degree that has occurred during the advanced stages of prior business cycles, so the lack of skilled labor likely will not be as acute as it has been during other episodes. And the high level of manufacturing investment in the past few years has left firms with a healthy supply of up-to-date capital. As a result, labor productivity growth is projected to run close to trend this year and next.

The labor force participation rate has been quite erratic from month to month this year but has averaged 66.8 percent in the past several months--close to the level that had prevailed before the unexplained drop in 1995 and more in line with our notion of the underlying trend. We expect that from here the labor force will grow at a pace similar to that of the working age population--roughly 1 percent per year.[1] With projected job growth sufficient to absorb such increases in the labor force, the unemployment rate is forecast to remain near 5-1/2 percent over the projection period.

Wages and prices. The ECI report for the second quarter has reinforced our view that the current level of resource utilization is incompatible with stable compensation inflation. Factoring in a sizable minimum wage increase and some adverse developments in the food and energy sectors, the scene would seem to be set for a deterioration in the trend of price inflation.

Although the first-quarter ECI report had indicated that the labor scarcities mentioned in the Beige Book and elsewhere were beginning to leave their mark on wages, it was somewhat suspect because of delays in processing caused by the shutdowns of the federal government. In fact, the latest report contained some unusual corrections of the earlier data, but it left a pattern that is fairly persuasive. Over the past couple of quarters, private compensation accelerated moderately, but noticeably, lifted by a sizable step-up in the pace of wage and salary growth, as the trend of benefits remained benign. On a twelve-month change basis, compensation was up 2.9 percent as of June; the comparable number in December was 2.6 percent.

Barring an elevation of inflation expectations or an adverse exogenous shock, we would expect the current and anticipated tautness of the labor markets to yield only a quite gradual acceleration of compensation rates. But, the former element is a distinct possibility, given our price forecast, and the latter element--the adverse shock--is about to become a certainty in the form of the forthcoming two-step increase in the minimum wage. We have concluded that, for a fixed differential between actual unemployment and the NAIRU, the immediate effect of the scheduled increases would be to add between 0.1 and 0.2 percentage point to compensation inflation in 1996 and a like amount in 1997. Given the probability that the sharp elevation of the minimum wage will

1. The welfare reform bill requires states to develop programs that limit the amount of time a welfare recipient can draw benefits without working. The programs, however, do not have to be submitted until July 1997, and waivers for special programs push this date back even further in some states. Accordingly, the labor force implications of the welfare legislation should be minor over the forecast period.

displace some low-skill workers, there is also likely to be an increase over time in the natural rate of unemployment--probably no more than a tenth of a percentage point by the end of the projection period, though.

SUMMARY OF STAFF INFLATION PROJECTIONS
(Percentage change at an annual rate)

	1996				
	H1	H2	1995	1996	1997
Employment cost index[1]	3.0	3.6	2.6	3.3	3.7
Previous	2.8	3.2	2.8	3.0	3.3
Consumer price index[2]	3.5	2.9	2.7	3.2	3.3
Previous	3.6	2.7	2.7	3.1	3.2
Food	3.0	5.4	2.6	4.2	4.0
Previous	2.8	4.5	2.6	3.7	3.8
Energy	15.6	-3.3	-1.7	5.7	3.3
Previous	16.5	-5.5	-1.7	4.9	3.7
Excluding food and energy	2.7	3.0	3.0	2.9	3.2
Previous	2.7	3.0	3.0	2.9	3.0
PCE chain-weight price index[2]	2.7	2.5	2.1	2.6	2.9
Previous	2.9	2.4	2.2	2.6	2.9
Excluding food and energy	1.8	2.3	2.3	2.1	2.7
Previous	2.1	2.6	2.4	2.4	2.7
GDP chain-weight price index[2]	2.3	2.7	2.5	2.5	2.9
Previous	2.2	2.7	2.5	2.5	2.8

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

Unless some greater slack in the economy were to offset the "impact" effects, the minimum wage hike could be expected to have some additional influence on compensation growth to the extent that higher labor costs are passed on to prices, which in turn would likely boost the inflation expectations that become embedded in the wage-bargaining process. Such an offset does not occur in our forecast: To the contrary, the unemployment rate path is a bit lower than in the previous projection. Consequently, at 3-1/4 percent in 1996 and 3-3/4 percent in 1997, our forecast for growth in the ECI for total compensation is about 1/3 percentage point higher than our projection in the June Greenbook.

We have not passed on to prices all of the increment to labor costs. Pressures on capacity are not great in the manufacturing sector, and some of the increase in labor expenses is likely to be absorbed in profit margins for a while. And we do not foresee a substantial enough firming in non-oil import prices to lift input costs appreciably or greatly ease competitive restraints on domestic pricing. Incorporating these considerations into our outlook for consumer prices, the CPI excluding food and energy is projected to increase 2.9 percent in 1996 and 3.2 percent in 1997 as compared with increases of 2.9 percent and 3.0 percent in the June Greenbook.

The changes in the oil price path and the incoming data have altered the near-term monthly pattern of our consumer energy price forecast somewhat, and the 3-1/4 percent annual rate of decline projected for the second half of 1996 is about 2 percentage points less than the drop in the June Greenbook. Consumer energy prices are projected to rise 3-1/4 percent in 1997, reflecting a firming in oil prices as world consumption catches up with the additions to supply from Iraq and elsewhere.

CPI food prices are projected to rise about 4 percent in both 1996 and 1997. Our food price forecast has been revised up a bit this month, in part because of the larger increases in labor costs, which should be of particular importance in prices at restaurants and fast food outlets. Also, the most recent crop estimates came in on the low side of our expectations--and those of most market participants. Futures prices have surged this week, reversing some of the downdrift we had seen earlier in the summer. In addition, futures prices for cattle and hogs have risen further in recent weeks.

Taking account of the developments on the food and energy front, the total CPI is projected to increase 3-1/4 percent in both 1996 and 1997. These rates of increase, however, understate the true acceleration from prior years, owing to the anticipated effects of technical revisions. We have assumed that these changes--addressing problems of "formula bias" and medical service price measurement--will trim 0.05 percentage point from the CPI inflation rate this year and 0.15 percentage point from the rate for 1997.

Monetary and credit flows. M2 is expected to grow broadly in line with nominal GDP over the remainder of this year and next, while M3 would expand somewhat faster in financing depository credit. This would put M2 and M3 slightly below their annual ranges for this year and around the upper end of their ranges for 1997.

Debt of the domestic nonfinancial sectors probably will grow about 4-1/2 percent both this year and next. State and local government debt should continue to run off (although not as much as in recent years) and federal debt is projected to continue growing at about a 4 percent pace over the forecast period.

Growth of nonfinancial business sector debt is projected to remain at about the 4-1/2 percent pace recorded during the first half of this year. Corporate borrowing is buoyed by a moderate financing gap--the excess of capital outlays over internal funds--and continued large share retirements. Banks are expected to remain eager lenders: Bank capital and earnings remain quite healthy and loan officers report that they continue to be accommodative toward business borrowers. If bond rates do not rise greatly from current levels--which is our expectation--borrowing likely will be concentrated in the bond market. However, we expect that business loans will pick up a bit on net from their subdued second-quarter pace, and net issuance of commercial paper, which has been held down lately by repayment of some merger-related bridge financing, is expected to increase somewhat next year.

Growth in household debt is anticipated to slow to about a 6 percent rate in the second half of the year and then continue at around this pace in 1997. Home mortgage debt growth should weaken in step with the projected slowdown in residential construction. Growth of consumer credit is expected to be held back by slackening growth in demand for durables and rising repayments of outstanding loans; these influences will be reinforced to a modest degree by some further tightening of consumer lending standards.

Alternative Simulations

We have run two model simulations in which the funds rate is symmetrically raised or lowered relative to the assumption in the Greenbook. Deviations from the baseline start with 25 basis points at the upcoming FOMC meeting, mounting gradually to 100 basis points by the spring of 1997. The changes in the funds rate come too late in the year to have much effect on activity or prices in 1996. By the end of 1997, however, under the higher rate scenario real GDP is 3/4 percentage point lower than in the baseline forecast, while the unemployment rate is raised 0.3 percentage point and CPI inflation is reduced 0.2 percentage point. The effects of the easier policy scenario are symmetric.

ALTERNATIVE FEDERAL FUNDS RATE ASSUMPTIONS
(Percent change, Q4 to Q4, except as noted)

	1996	1997
Real GDP		
Baseline	2.6	2.1
Lower funds rate	2.6	2.8
Higher funds rate	2.6	1.4
Civilian unemployment rate[1]		
Baseline	5.4	5.4
Lower funds rate	5.4	5.1
Higher funds rate	5.4	5.7
CPI		
Baseline	3.2	3.3
Lower funds rate	3.2	3.5
Higher funds rate	3.2	3.1

1. Average for the fourth quarter.

Strictly Confidential <FR>
Class II FOMC

August 15, 1996

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

Interval		Nominal GDP		Real GDP		GDP Chain-weighted price index		Consumer price index[1]		Unemployment rate[2]	
		06/26/96	08/15/96	06/26/96	08/15/96	06/26/96	08/15/96	06/26/96	08/15/96	06/26/96	08/15/96
ANNUAL											
1993		4.9	4.9	2.2	2.3	2.6	2.6	3.0	3.0	6.9	6.9
1994		5.8	5.8	3.5	3.5	2.3	2.3	2.6	2.6	6.1	6.1
1995		4.5	4.6	2.0	2.0	2.5	2.5	2.8	2.8	5.6	5.6
1996		4.3	4.3	2.2	2.2	2.3	2.3	3.0	3.0	5.5	5.5
1997		4.5	4.8	2.2	2.2	2.7	2.8	3.1	3.2	5.5	5.4
QUARTERLY											
1994	Q1	5.4	5.3	2.5	2.5	2.8	2.9	1.9	1.9	6.6	6.6
	Q2	6.8	6.9	4.8	4.9	1.9	1.9	2.8	2.8	6.2	6.2
	Q3	6.1	6.1	3.6	3.5	2.4	2.4	3.6	3.6	6.0	6.0
	Q4	5.4	5.3	3.2	3.0	2.2	2.1	2.4	2.4	5.6	5.6
1995	Q1	3.9	3.8	0.6	0.4	3.3	3.3	2.7	2.7	5.5	5.5
	Q2	2.8	3.1	0.5	0.7	2.5	2.4	3.5	3.5	5.7	5.7
	Q3	5.8	6.0	3.6	3.8	2.2	2.1	2.1	2.1	5.6	5.6
	Q4	2.3	2.3	0.5	0.3	2.2	2.1	2.4	2.4	5.5	5.5
1996	Q1	4.5	4.2	2.2	2.0	2.3	2.3	3.2	3.2	5.6	5.6
	Q2	5.4	5.6	3.8	3.7	2.1	2.2	4.0	3.9	5.5	5.4
	Q3	4.5	4.5	2.3	2.6	2.6	2.3	2.6	2.7	5.5	5.4
	Q4	4.4	4.8	1.9	2.0	2.7	3.0	2.7	3.1	5.5	5.4
1997	Q1	4.4	4.8	2.1	2.0	2.8	3.0	3.2	3.3	5.5	5.4
	Q2	4.6	4.7	2.2	2.1	2.8	2.8	3.4	3.5	5.5	5.4
	Q3	4.4	4.8	2.0	2.2	2.8	2.8	3.1	3.2	5.5	5.4
	Q4	4.6	4.8	2.3	2.2	2.7	2.8	3.0	3.2	5.5	5.4
TWO-QUARTER[3]											
1994	Q2	6.1	6.1	3.7	3.7	2.4	2.4	2.3	2.3	-0.4	-0.4
	Q4	5.7	5.7	3.4	3.3	2.3	2.2	2.9	2.9	-0.6	-0.6
1995	Q2	3.3	3.5	0.5	0.6	2.9	2.9	3.2	3.2	0.1	0.1
	Q4	4.0	4.1	2.0	2.0	2.2	2.1	2.2	2.2	-0.2	-0.2
1996	Q2	5.0	4.9	3.0	2.8	2.2	2.3	3.6	3.5	0.0	-0.1
	Q4	4.4	4.6	2.1	2.3	2.7	2.7	2.7	2.9	-0.0	0.0
1997	Q2	4.5	4.8	2.1	2.1	2.8	2.9	3.3	3.4	0.0	-0.0
	Q4	4.5	4.8	2.2	2.2	2.7	2.8	3.1	3.2	-0.0	-0.0
FOUR-QUARTER[4]											
1993	Q4	4.7	4.8	2.2	2.2	2.5	2.5	2.7	2.7	-0.8	-0.8
1994	Q4	5.9	5.9	3.5	3.5	2.3	2.3	2.6	2.6	-1.0	-1.0
1995	Q4	3.7	3.8	1.3	1.3	2.5	2.5	2.7	2.7	-0.1	-0.1
1996	Q4	4.7	4.8	2.5	2.6	2.5	2.5	3.1	3.2	-0.0	-0.1
1997	Q4	4.5	4.8	2.2	2.1	2.8	2.9	3.2	3.3	-0.0	0.0

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

Strictly Confidential <FR>
Class II FOMC

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

August 15, 1996

Item	Units[1]	1989	1990	1991	1992	1993	1994	1995	- Projected - 1996	1997
EXPENDITURES										
Nominal GDP	Bill. $	5438.7	5743.8	5916.7	6244.4	6553.0	6935.7	7253.8	7567.0	7928.7
Real GDP	Bill. Ch. $	6060.4	6138.7	6079.0	6244.4	6386.4	6608.7	6742.9	6891.7	7045.8
Real GDP	% change	2.4	-0.2	0.4	3.7	2.2	3.5	1.3	2.6	2.1
Gross domestic purchases		1.7	-0.8	-0.0	4.0	2.9	3.8	1.0	3.2	2.2
Final sales		2.3	0.6	-0.4	3.9	2.0	2.9	1.9	2.4	2.1
Priv. dom. final purchases		1.4	-0.6	-0.8	4.9	3.5	4.0	2.3	3.6	2.5
Personal cons. expenditures		1.6	0.5	-0.2	4.2	2.5	3.1	1.9	3.0	2.5
Durables		-0.1	-3.2	-3.1	9.4	7.3	7.0	1.3	8.1	4.0
Nondurables		1.6	-0.5	-1.0	3.4	1.5	3.5	1.1	2.4	2.2
Services		2.1	2.0	0.9	3.6	2.1	2.0	2.4	2.3	2.3
Business fixed investment		2.8	-2.5	-6.0	5.5	8.5	10.1	6.4	6.3	4.3
Producers' dur. equipment		2.3	-2.0	-2.6	9.6	11.5	12.6	6.9	7.5	5.5
Nonres. structures		3.7	-3.5	-12.5	-3.4	1.6	3.6	5.1	3.1	0.6
Residential structures		-7.0	-15.1	1.1	16.9	8.1	5.7	-1.5	4.5	-1.5
Exports		10.8	7.2	8.6	4.1	4.8	9.9	7.4	5.1	8.5
Imports		2.6	0.5	4.1	7.4	10.5	11.8	4.2	10.2	8.1
Gov't. cons. & investment		2.5	2.6	-0.7	1.7	-0.5	0.0	-1.3	1.1	0.5
Federal		0.8	1.6	-3.1	1.3	-5.4	-3.1	-6.7	-0.6	-3.1
Defense		-1.0	0.3	-5.3	-1.3	-6.8	-5.7	-6.8	-1.6	-4.2
State & local		3.9	3.3	1.0	2.0	3.1	2.2	2.1	2.1	2.5
Change in bus. inventories	Bill. Ch. $	33.3	10.4	-3.0	7.3	19.1	58.9	33.1	13.9	27.4
Nonfarm		33.5	7.8	-1.2	1.9	26.4	46.8	37.2	17.6	25.1
Net exports		-82.7	-61.9	-22.3	-29.5	-72.0	-105.7	-107.6	-123.4	-138.2
Nominal GDP	% change	6.4	4.4	3.8	6.3	4.8	5.9	3.8	4.8	4.8
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employment	Millions	107.9	109.4	108.3	108.6	110.7	114.2	117.2	119.5	121.3
Unemployment rate	%	5.3	5.6	6.9	7.5	6.9	6.1	5.6	5.5	5.4
Industrial prod. index	% change	-0.1	-0.2	0.2	4.0	3.2	6.6	1.6	3.3	3.0
Capacity util. rate - mfg.	%	83.2	81.3	78.0	79.5	80.6	83.3	83.0	81.9	82.0
Housing starts	Millions	1.38	1.19	1.01	1.20	1.29	1.46	1.35	1.45	1.37
Light motor vehicle sales		14.66	14.05	12.52	12.85	13.87	15.02	14.74	15.01	14.85
North Amer. produced		11.20	10.85	9.74	10.51	11.72	12.88	12.82	13.30	13.07
Other		3.46	3.20	2.77	2.34	2.15	2.13	1.91	1.71	1.77
INCOME AND SAVING										
Nominal GNP	Bill. $	5452.8	5764.9	5932.4	6255.5	6563.5	6931.9	7246.7	7557.9	7908.9
Nominal GNP	% change	6.5	4.6	3.5	6.2	4.7	5.7	3.9	4.7	4.7
Nominal personal income		6.8	6.4	3.7	7.3	3.6	5.2	5.6	5.2	5.1
Real disposable income		1.6	1.0	0.8	4.0	0.9	2.7	3.1	2.3	2.5
Personal saving rate	%	4.8	5.0	5.7	5.9	4.5	3.8	4.7	4.6	4.7
Corp. profits, IVA & CCAdj.	% change	-9.9	6.2	3.9	12.7	19.9	11.3	7.2	3.4	3.0
Profit share of GNP	%	6.5	6.4	6.4	6.4	7.1	7.6	8.1	8.4	8.2
(excluding FR banks)	%	6.2	6.0	6.1	6.1	6.8	7.4	7.8	8.2	7.9
Federal surpl./deficit	Bill. $	-113.4	-154.7	-196.0	-280.9	-255.6	-190.2	-161.7	-131.1	-122.9
State & local surpl./def.		95.1	80.1	75.8	86.3	94.9	99.7	95.0	92.0	86.2
Ex. social ins. funds		34.9	20.2	11.5	18.3	28.0	36.9	36.8	35.7	30.9
PRICES AND COSTS										
GDP implicit deflator	% change	3.9	4.6	3.4	2.6	2.5	2.3	2.5	2.1	2.6
GDP chn.-wt. price index		3.9	4.7	3.3	2.6	2.5	2.3	2.5	2.5	2.9
Gross Domestic Purchases chn.-wt. price index		4.0	5.2	2.7	2.7	2.3	2.4	2.3	2.3	2.8
CPI		4.6	6.3	3.0	3.1	2.7	2.6	2.7	3.2	3.3
Ex. food and energy		4.4	5.3	4.4	3.5	3.1	2.8	3.0	2.9	3.2
ECI, hourly compensation[2]		4.8	4.6	4.4	3.5	3.6	3.1	2.6	3.3	3.7
Nonfarm business sector										
Output per hour		0.1	-0.6	2.2	3.6	-0.3	0.5	0.3	0.8	1.0
Compensation per Hour		2.8	5.9	4.7	4.6	1.8	2.5	4.1	3.8	3.9
Unit labor cost		2.7	6.5	2.5	1.0	2.1	2.0	3.8	2.8	2.8

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

Strictly Confidential <FR>
Class II FOMC

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

August 15, 1996

Item	Units	1993 Q1	1993 Q2	1993 Q3	1993 Q4	1994 Q1	1994 Q2	1994 Q3	1994 Q4	1995 Q1	1995 Q2
EXPENDITURES											
Nominal GDP	Bill. $	6442.6	6506.2	6574.4	6688.6	6776.0	6890.5	6993.1	7083.2	7149.8	7204.9
Real GDP	Bill. Ch. $	6326.4	6356.5	6393.4	6469.1	6508.5	6587.6	6644.9	6693.9	6701.0	6713.5
Real GDP	% change	-0.1	1.9	2.3	4.8	2.5	4.9	3.5	3.0	0.4	0.7
Gross domestic purchases		0.9	2.4	3.7	4.4	3.5	5.3	3.7	2.5	1.4	0.7
Final sales		-0.9	1.7	2.3	5.0	1.2	3.0	4.2	3.5	0.6	2.1
Priv. dom. final purchases		1.4	2.8	4.4	5.4	3.9	4.4	3.8	4.0	2.3	2.3
Personal cons. expenditures		0.7	2.7	3.8	2.8	2.8	3.5	2.8	3.1	1.0	3.1
Durables		0.8	11.2	7.3	10.2	5.8	4.3	5.6	12.4	-8.9	7.0
Nondurables		-0.9	2.3	2.9	1.8	3.9	3.2	3.8	3.2	2.4	1.8
Services		1.5	1.3	3.6	1.9	1.6	3.5	1.6	1.2	2.4	3.0
Business fixed investment		6.0	6.3	4.6	17.6	7.3	7.1	13.8	12.2	15.4	3.5
Producers' dur. equipment		7.1	11.4	6.3	21.7	15.5	4.1	19.4	11.9	17.4	3.5
Nonres. structures		3.5	-5.3	0.8	7.5	-11.8	15.7	0.2	13.0	9.9	3.4
Residential structures		2.0	-5.1	13.2	24.4	12.8	12.7	-1.8	-0.1	-6.3	-13.4
Exports		-1.3	8.3	-8.5	23.4	-1.5	15.9	9.7	16.5	2.6	5.9
Imports		8.4	12.7	4.1	17.5	8.2	18.4	10.7	10.3	11.2	4.5
Gov't. cons. & investment		-4.6	0.2	1.0	1.5	-4.3	-0.8	7.0	-1.4	-1.2	0.8
Federal		-12.7	-4.9	-2.9	-0.7	-11.4	-5.3	11.5	-5.9	-6.5	-1.4
Defense		-15.2	-5.1	-5.8	-0.5	-17.4	0.7	13.5	-16.1	-7.4	0.6
State & local		1.7	3.9	3.7	3.0	0.7	2.2	4.2	1.6	2.3	2.1
Change in bus. inventories	Bill. Ch. $	18.5	20.8	19.5	17.4	40.5	74.5	64.5	56.1	54.5	30.5
Nonfarm		26.0	26.7	30.9	22.1	29.7	54.0	50.5	53.0	57.4	33.7
Net exports		-56.0	-64.4	-86.2	-81.5	-99.3	-107.3	-111.7	-104.3	-122.5	-121.4
Nominal GDP	% change	3.8	4.0	4.3	7.1	5.3	6.9	6.1	5.3	3.8	3.1
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	109.7	110.3	111.0	111.8	112.6	113.7	114.7	115.6	116.5	117.0
Unemployment rate	%	7.2	7.1	6.8	6.6	6.6	6.2	6.0	5.6	5.5	5.7
Industrial prod. index	% change	3.7	0.5	3.2	5.5	8.4	7.0	4.6	6.4	3.9	-1.4
Capacity util. rate - mfg.	%	80.6	80.3	80.4	81.1	82.2	83.2	83.4	84.3	84.3	83.0
Housing starts	Millions	1.17	1.27	1.30	1.43	1.38	1.47	1.46	1.48	1.31	1.29
Light motor vehicle sales		13.04	14.12	13.82	14.51	15.07	14.85	14.99	15.16	14.56	14.44
North Amer. produced		10.87	11.87	11.69	12.45	12.94	12.69	12.79	13.12	12.52	12.46
Other		2.17	2.25	2.14	2.06	2.13	2.16	2.20	2.05	2.04	1.97
INCOME AND SAVING											
Nominal GNP	Bill. $	6458.6	6516.5	6587.1	6691.9	6781.0	6888.3	6987.0	7071.4	7146.8	7202.4
Nominal GNP	% change	4.3	3.6	4.4	6.5	5.4	6.5	5.9	4.9	4.3	3.1
Nominal personal income		-4.8	8.5	3.1	8.2	-3.4	13.3	4.9	6.7	7.1	4.7
Real disposable income		-7.1	4.9	1.5	5.0	-5.4	9.7	2.9	4.2	3.7	0.3
Personal saving rate	%	4.2	4.8	4.2	4.7	2.7	4.0	4.1	4.3	4.9	4.1
Corp. profits, IVA & CCAdj.	% change	-0.3	20.5	20.9	42.2	-35.4	82.5	14.8	13.5	-7.4	1.7
Profit share of GNP	%	6.6	6.9	7.1	7.7	6.8	7.8	7.9	8.1	7.8	7.8
(excluding FR banks)	%	6.4	6.6	6.9	7.4	6.5	7.5	7.7	7.8	7.5	7.5
Federal surpl./deficit	Bill. $	-284.5	-250.2	-254.4	-233.3	-212.7	-169.6	-188.5	-190.1	-172.6	-161.1
State & local surpl./def.		80.5	89.1	94.9	115.0	94.8	105.2	99.6	99.3	99.0	99.0
Ex. social ins. funds		13.3	22.0	28.1	48.5	29.0	41.1	37.9	39.4	40.2	40.9
PRICES AND COSTS											
GDP implicit deflator	% change	3.8	2.1	1.9	2.2	2.8	1.9	2.5	2.2	3.4	2.4
GDP chn.-wt. price index		3.8	2.2	1.8	2.3	2.9	1.9	2.4	2.1	3.3	2.4
Gross Domestic Purchases chn.-wt. price index		3.1	2.4	1.3	2.2	2.4	2.3	3.0	2.0	2.8	2.8
CPI		3.1	2.8	1.7	3.4	1.9	2.8	3.6	2.4	2.7	3.5
Ex. food and energy		3.5	3.5	2.4	2.9	2.9	2.9	3.1	2.3	3.3	3.3
ECI, hourly compensation[1]		4.2	3.5	3.4	3.4	3.0	3.4	3.3	2.3	2.9	2.9
Nonfarm business sector											
Output per hour		-3.7	-1.8	1.6	2.7	-2.0	1.0	2.0	0.9	-1.6	2.0
Compensation per hour		1.3	2.1	1.7	1.9	2.8	1.4	2.1	3.9	3.7	4.6
Unit labor cost		5.2	4.0	0.1	-0.8	4.8	0.3	0.1	2.9	5.4	2.6

1. Private-industry workers.

Strictly Confidential <FR>
Class II FOMC

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

August 15, 1996

Item	Units	1995 Q3	1995 Q4	1996 Q1	- - - 1996 Q2	- - - 1996 Q3	- Projected 1996 Q4	- - - 1997 Q1	- - - 1997 Q2	- - - 1997 Q3	- - - 1997 Q4
EXPENDITURES											
Nominal GDP	Bill. $	7309.8	7350.6	7426.8	7528.7	7611.6	7701.0	7791.4	7881.9	7974.1	8067.5
Real GDP	Bill. Ch. $	6776.4	6780.7	6814.3	6876.4	6921.2	6955.1	6989.2	7026.2	7064.2	7103.4
Real GDP	% change	3.8	0.3	2.0	3.7	2.6	2.0	2.0	2.1	2.2	2.2
Gross domestic purchases		2.6	-0.7	3.0	4.8	2.9	2.2	1.8	2.2	2.7	2.1
Final sales		3.6	1.4	3.0	3.4	1.1	2.2	2.1	2.0	1.8	2.4
Priv. dom. final purchases		3.0	1.4	4.7	4.2	2.6	2.9	2.5	2.5	2.6	2.6
Personal cons. expenditures		2.4	1.1	3.5	3.4	2.4	2.8	2.6	2.5	2.4	2.4
Durables		9.3	-1.0	8.2	13.0	5.6	6.0	4.3	3.8	3.9	3.8
Nondurables		0.5	-0.4	3.7	1.9	2.0	2.2	2.3	2.2	2.1	2.1
Services		2.0	2.3	2.4	2.2	2.0	2.4	2.4	2.3	2.3	2.3
Business fixed investment		4.9	2.5	11.6	3.4	4.8	5.7	3.8	4.3	4.5	4.4
Producers' dur. equipment		4.3	3.0	13.1	4.8	5.2	7.3	5.0	5.6	5.8	5.7
Nonres. structures		6.3	1.0	7.7	-0.1	3.8	1.1	0.5	0.5	0.8	0.8
Residential structures		9.2	6.4	7.4	17.1	-1.1	-4.0	-4.2	-2.0	-0.4	0.5
Exports		10.7	10.7	1.8	5.4	3.2	10.2	6.6	10.4	5.1	11.8
Imports		-0.0	1.6	10.6	14.5	5.5	10.5	4.6	10.1	8.2	9.6
Gov't. cons. & investment		-0.6	-4.3	1.6	6.4	-3.5	0.2	-0.6	0.6	0.9	0.9
Federal		-5.6	-13.2	6.0	6.8	-11.0	-3.2	-5.6	-2.8	-2.0	-2.1
Defense		-7.6	-12.3	4.1	8.0	-12.2	-4.9	-6.4	-4.3	-2.9	-3.2
State & local		2.7	1.5	-0.9	6.1	1.2	2.2	2.4	2.5	2.5	2.6
Change in bus. inventories	Bill. Ch. $	33.0	14.6	-3.0	3.6	29.3	25.7	23.7	25.4	32.0	28.6
Nonfarm		38.6	19.0	2.9	9.2	32.8	25.5	22.2	23.4	29.5	25.1
Net exports		-101.6	-84.9	-104.0	-124.5	-130.6	-134.6	-132.1	-134.6	-143.8	-142.5
Nominal GDP	% change	6.0	2.3	4.2	5.6	4.5	4.8	4.8	4.7	4.8	4.8
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	117.4	117.9	118.5	119.3	119.9	120.3	120.7	121.1	121.5	121.8
Unemployment rate	%	5.6	5.5	5.6	5.4	5.4	5.4	5.4	5.4	5.4	5.4
Industrial prod. index	% change	3.2	0.6	3.0	6.0	3.0	1.4	3.0	3.0	3.0	3.0
Capacity util. rate - mfg.	%	82.6	82.0	81.6	82.1	82.0	82.0	82.0	82.0	82.0	82.0
Housing starts	Millions	1.42	1.41	1.47	1.48	1.43	1.40	1.38	1.37	1.37	1.37
Light motor vehicle sales		15.04	14.92	15.18	15.13	14.77	14.96	14.80	14.83	14.87	14.88
North Amer. produced		13.18	13.13	13.49	13.41	13.08	13.21	13.04	13.06	13.09	13.10
Other		1.86	1.79	1.69	1.72	1.69	1.75	1.76	1.77	1.78	1.78
INCOME AND SAVING											
Nominal GNP	Bill. $	7293.4	7344.3	7426.6	7520.0	7598.4	7686.6	7773.9	7863.1	7953.6	8044.9
Nominal GNP	% change	5.1	2.8	4.6	5.1	4.2	4.7	4.6	4.7	4.7	4.7
Nominal personal income		4.9	5.8	4.8	6.6	4.9	4.6	5.1	4.9	5.3	4.9
Real disposable income		4.3	4.4	2.0	1.5	4.2	1.6	3.8	1.8	2.3	1.9
Personal saving rate	%	4.5	5.2	4.8	4.4	4.8	4.5	4.8	4.7	4.7	4.5
Corp. profits, IVA & CCAdj.	% change	40.8	-0.5	23.6	-3.4	-4.3	0.2	5.2	4.4	0.6	1.7
Profit share of GNP	%	8.4	8.3	8.7	8.5	8.3	8.2	8.2	8.2	8.2	8.1
(excluding FR banks)	%	8.1	8.0	8.4	8.2	8.0	8.0	8.0	8.0	7.9	7.8
Federal surpl./deficit	Bill. $	-158.5	-154.5	-155.2	-132.8	-122.8	-113.6	-127.1	-123.2	-119.3	-122.1
State & local surpl./def.		93.9	88.1	91.0	99.5	89.8	87.9	87.5	87.3	85.2	84.8
Ex. social ins. funds		35.8	30.5	34.1	43.1	33.7	32.1	31.9	31.9	30.0	29.8
PRICES AND COSTS											
GDP implicit deflator	% change	2.1	2.0	2.2	1.8	1.8	2.8	2.7	2.5	2.5	2.5
GDP chn.-wt. price index		2.1	2.1	2.3	2.2	2.3	3.0	3.0	2.8	2.8	2.8
Gross Domestic Purchases chn.-wt. price index		1.6	1.9	2.3	2.1	2.2	2.6	2.9	2.8	2.7	2.7
CPI		2.1	2.4	3.2	3.9	2.7	3.1	3.3	3.5	3.2	3.2
Ex. food and energy		2.8	2.7	2.7	2.7	3.0	3.0	3.0	3.1	3.2	3.2
ECI, hourly compensation[1]		2.6	2.6	2.9	3.2	3.3	4.0	3.5	3.5	4.0	3.7
Nonfarm business sector											
Output per hour		2.0	-1.1	1.8	-0.6	1.3	0.8	0.8	1.0	1.0	1.2
Compensation per hour		4.0	4.1	3.3	3.7	3.8	4.5	3.9	3.7	4.0	4.0
Unit labor cost		1.9	5.2	1.5	4.3	2.5	3.7	3.1	2.7	2.9	2.8

1. Private-industry workers.

Strictly Confidential <FR>
Class II FOMC

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

August 15, 1996

Item	1995 Q4	1996 Q1	1996 Q2	1996 Q3	1996 Q4	1997 Q1	1997 Q2	1997 Q3	1997 Q4	95Q4/ 94Q4	96Q4/ 95Q4	97Q4/ 96Q4
Real GDP	0.3	2.0	3.7	2.6	2.0	2.0	2.1	2.2	2.2	1.3	2.6	2.1
Gross dom. purchases	-0.7	3.1	4.9	3.0	2.2	1.8	2.3	2.7	2.2	1.0	3.3	2.2
Final sales	1.4	3.0	3.4	1.1	2.2	2.1	2.0	1.8	2.4	1.9	2.4	2.1
Priv. dom. final purchases	1.2	3.9	3.4	2.1	2.4	2.0	2.1	2.2	2.2	1.8	2.9	2.1
Personal cons. expenditures	0.7	2.4	2.3	1.7	1.9	1.8	1.7	1.7	1.7	1.3	2.1	1.7
Durables	-0.1	0.7	1.1	0.5	0.5	0.4	0.3	0.4	0.3	0.1	0.7	0.4
Nondurables	-0.1	0.7	0.4	0.4	0.5	0.5	0.5	0.4	0.4	0.2	0.5	0.5
Services	0.8	0.9	0.8	0.8	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Business fixed investment	0.2	1.1	0.4	0.5	0.6	0.4	0.5	0.5	0.5	0.7	0.7	0.5
Producers' dur. equip.	0.2	0.9	0.4	0.4	0.6	0.4	0.5	0.5	0.5	0.5	0.6	0.5
Nonres. structures	0.0	0.2	-0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.0
Residential structures	0.2	0.3	0.6	-0.0	-0.2	-0.2	-0.1	-0.0	0.0	-0.1	0.2	-0.1
Net exports	0.9	-1.1	-1.2	-0.4	-0.2	0.1	-0.1	-0.5	0.1	0.3	-0.7	-0.1
Exports	1.1	0.2	0.6	0.4	1.2	0.8	1.2	0.6	1.4	0.8	0.6	1.0
Imports	-0.2	-1.3	1.8	0.7	1.4	0.6	1.4	1.2	1.4	0.5	1.3	1.1
Government cons. & invest.	-0.8	0.3	1.2	-0.7	0.0	-0.1	0.1	0.2	0.2	-0.3	0.2	0.1
Federal	-0.9	0.4	0.5	-0.8	-0.2	-0.4	-0.2	-0.1	-0.1	-0.5	-0.0	-0.2
Defense	-0.6	0.2	0.4	-0.6	-0.2	-0.3	-0.2	-0.1	-0.1	-0.3	-0.1	-0.2
Nondefense	-0.3	0.2	0.1	-0.2	0.0	-0.1	0.0	-0.0	-0.0	-0.2	0.0	-0.0
State and local	0.2	-0.1	0.7	0.1	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.3
Change in bus. inventories	-1.0	-1.0	0.4	1.5	-0.2	-0.1	0.1	0.4	-0.2	-0.6	0.2	0.0
Nonfarm	-1.2	-0.9	0.4	1.4	-0.4	-0.2	0.1	0.3	-0.3	-0.5	0.1	-0.0
Farm	0.1	-0.1	0.0	0.1	0.2	0.1	0.0	0.0	0.1	-0.1	0.1	0.1
GDP residual	-0.0	0.0	-0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Components may not sum to total due to rounding.

Strictly Confidential (FR)
Class II FOMC

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

August 15, 1996

Item	Fiscal year[5]				1995				1996				1997			
	1994[a]	1995[a]	1996	1997	Q1[a]	Q2[a]	Q3[a]	Q4[a]	Q1							
UNIFIED BUDGET					Not seasonally adjusted											
Receipts[1]	1258	1355	1452	1507	307	404	333	324	321	445	361	349	328	456	374	365
Outlays[1]	1461	1519	1570	1648	380	381	373	380	394	392	404	414	411	410	413	431
Surplus/deficit[1]	-203	-164	-118	-141	-73	23	-40	-56	-72	53	-43	-64	-84	46	-38	-65
On-budget	-259	-226	-181	-208	-85	-11	-43	-69	-84	14	-41	-72	-96	5	-45	-75
Off-budget	56	62	63	68	12	34	2	14	12	39	-1	8	13	41	6	9
Surplus excluding deposit insurance[2]	-211	-182	-126	-144	-80	18	-42	-59	-75	51	-44	-65	-85	45	-39	-66
Means of financing																
Borrowing	185	171	133	156	66	26	20	33	80	-23	43	52	65	-5	43	44
Cash decrease	17	-2	-6	-16	8	-42	23	17	-1	-16	-6	14	10	-40	0	25
Other[3]	1	-5	-9	1	-1	-7	-2	5	-7	-14	6	-1	8	-1	-5	-3
Cash operating balance, end of period	36	38	44	60	18	61	38	20	22	38	44	30	20	60	60	35
NIPA FEDERAL SECTOR					Seasonally adjusted, annual rate											
Receipts	1354	1459	1539	1616	1449	1483	1487	1495	1523	1567	1572	1595	1604	1622	1641	1661
Expenditures	1555	1629	1681	1736	1622	1644	1645	1649	1678	1700	1694	1709	1731	1745	1761	1783
Consumption expend.	451	455	454	451	455	456	454	451	454	461	451	450	451	451	452	452
Defense	308	304	301	297	303	305	301	300	299	306	299	297	298	297	297	297
Nondefense	143	151	153	154	152	151	152	151	155	155	152	153	154	154	155	155
Other expenditures	1105	1175	1226	1285	1167	1189	1192	1198	1225	1240	1243	1259	1280	1294	1309	1331
Current account surplus	-201	-171	-141	-121	-173	-161	-158	-155	-155	-133	-123	-114	-127	-123	-119	-122
Gross investment	67	65	62	62	65	67	63	56	65	65	63	64	62	62	62	62
Current and capital account surplus	-268	-236	-204	-183	-238	-228	-222	-211	-220	-198	-186	-177	-189	-185	-181	-184
FISCAL INDICATORS[4]																
High-employment (HEB) surplus/deficit	-269	-268	-242	-230	-265	-250	-251	-236	-246	-237	-228	-222	-236	-235	-233	-239
Change in HEB, percent of potential GDP	-.7	0	-.4	-.2	-.3	-.2	0	-.2	.1	-.1	-.1	-.1	.2	0	0	.1
Fiscal impetus (FI), percent, cal. year	-6.4	-5.6	-3.7	-4.3	-2	-.8	-1.6	-3.7	1.3	1.5	-3.7	-1.6	-.4	-.8	-.6	-1.6

1. OMB's July 1996 baseline deficit estimates (assuming the enactment of the President's proposals) are $117 billion in FY96 and $126 billion in FY97. CBO's April 1996 baseline deficit estimates are $144 billion in FY96 and $171 billion in FY97. 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 1996 baseline deficit estimates (assuming the enactment of the President's proposals), excluding deposit insurance spending, are $127 billion in FY96 and $134 billion in FY97. CBO's April 1996 baseline deficit estimates, excluding deposit insurance spending, are $154 billion in FY96 and $176 billion in FY97.

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 generated by 1.8 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 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 fiscal year totals.

a--Actual.
b--Preliminary.

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

			Nonfederal						MEMO
				Households					
	Total	Federal govt.	Total	Total	Home mtg.	Cons. credit	Business	State and local govt.	Nominal GDP
Year									
1986	12.2	13.6	11.8	11.5	13.8	9.6	12.2	10.8	5.0
1987	9.2	8.0	9.6	12.1	16.3	5.0	6.7	12.1	7.4
1988	8.8	8.0	9.1	9.3	10.9	7.2	9.7	6.5	7.6
1989	7.6	7.0	7.8	8.7	10.1	6.0	7.5	5.7	6.4
1990	6.6	11.0	5.3	7.9	10.1	2.0	3.1	4.9	4.4
1991	4.4	11.1	2.4	5.0	6.6	-1.7	-1.7	8.2	3.8
1992	4.8	10.9	2.8	5.2	6.1	0.6	0.5	2.0	6.3
1993	5.3	8.3	4.2	6.2	5.4	7.7	1.6	5.7	4.8
1994	4.9	4.7	5.0	8.5	6.5	14.5	3.8	-3.7	5.9
1995	5.6	4.1	6.1	8.3	6.4	14.5	6.4	-4.1	3.8
1996	4.6	4.2	4.7	6.6	6.3	8.4	4.3	-2.2	4.8
1997	4.6	3.9	4.8	6.2	6.0	7.3	4.7	-2.1	4.8
Quarter (seasonally adjusted annual rates)									
1995:1	6.7	7.6	6.3	7.7	6.0	14.0	7.7	-4.0	3.8
2	6.6	5.7	7.0	8.3	6.4	15.3	7.6	-1.0	3.1
3	4.3	1.8	5.2	9.3	7.9	14.9	4.5	-10.0	6.0
4	4.2	1.2	5.3	6.8	4.9	10.7	5.3	-1.5	2.3
1996:1	6.2	7.9	5.6	7.8	7.7	10.5	4.6	-0.3	4.2
2	3.7	1.2	4.6	6.5	6.4	7.2	3.8	-1.0	5.6
3	4.0	4.2	3.9	5.8	5.4	7.4	4.2	-6.4	4.5
4	4.1	3.1	4.5	5.7	5.3	7.4	4.3	-1.2	4.8
1997:1	5.2	7.1	4.5	5.9	5.6	7.3	4.8	-3.4	4.8
2	4.0	2.1	4.7	6.1	5.9	7.2	4.7	-2.4	4.7
3	4.5	4.1	4.7	6.1	6.0	7.1	4.6	-2.5	4.8
4	4.2	2.1	4.9	6.0	6.0	7.0	4.6	0.1	4.8

1. Data after 1996:Q1 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. On a monthly average basis, total debt grows 5.6 percent in 1995, 4.5 percent in 1996, and 4.5 percent in 1997. Federal debt rises 4.4 percent in 1995, 3.9 percent in 1996, and 3.7 percent in 1997. Nonfederal debt increases 6.1 percent in 1995, 4.7 percent in 1996, and 4.7 percent in 1997.

2.6.3 FOF

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

	Calendar year					1995	1996				1997	
	1993	1994	1995	1996	1997	Q4	Q1	Q2	Q3	Q4	H1	H2
Net funds raised by domestic nonfinancial sectors												
1 Total	649.8	574.0	658.7	564.3	569.5	505.4	759.6	510.1	488.8	498.6	579.3	559.7
2 Net equity issuance	21.3	-44.9	-74.2	-73.8	-92.1	-72.8	-106.8	-16.8	-78.0	-93.6	-94.6	-89.6
3 Net debt issuance	628.5	618.9	732.9	638.1	661.6	578.2	866.4	526.9	566.8	592.2	673.9	649.3
Borrowing sectors												
Nonfinancial business												
4 Financing gap [2]	3.8	3.8	57.7	22.8	36.3	13.7	5.3	10.7	41.1	34.0	30.4	42.1
5 Net equity issuance	21.3	-44.9	-74.2	-73.8	-92.1	-72.8	-106.8	-16.8	-78.0	-93.6	-94.6	-89.6
6 Credit market borrowing	61.0	144.3	250.6	179.3	206.6	217.4	190.7	160.8	178.8	186.6	208.0	205.2
Households												
7 Net borrowing, of which:	249.1	362.2	383.5	331.0	329.2	334.5	390.7	330.9	300.3	302.1	321.5	336.9
8 Home mortgages	152.1	194.5	203.8	213.8	216.0	162.9	259.4	220.0	190.0	186.0	207.6	224.5
9 Consumer credit	61.5	124.9	142.9	94.9	90.0	118.2	118.8	83.2	87.7	89.7	90.0	90.0
10 Debt/DPI (percent) [3]	86.6	88.7	90.7	92.8	93.8	91.7	92.4	93.0	93.1	93.5	93.5	94.0
State and local governments												
11 Net borrowing	62.3	-43.4	-45.7	-23.8	-21.5	-16.0	-3.7	-10.4	-68.1	-13.0	-30.2	-12.7
12 Current surplus [4]	109.9	107.4	106.8	108.0	107.1	101.5	105.9	114.5	106.1	105.5	107.0	107.2
U.S. government												
13 Net borrowing	256.1	155.9	144.4	151.6	147.3	42.4	288.7	45.5	155.7	116.4	174.6	120.0
14 Net borrowing (quarterly, nsa)	256.1	155.9	144.4	151.6	147.3	33.3	80.5	-23.5	42.7	51.9	60.1	87.1
15 Unified deficit (quarterly, nsa)	226.3	185.0	146.4	126.1	141.6	55.9	72.3	-53.2	42.6	64.4	37.8	103.8
16 Funds supplied by depository institutions	140.4	198.3	275.0	145.5	210.4	110.8	131.7	147.1	130.7	172.7	205.3	215.5
MEMO: (percent of GDP)												
17 Domestic nonfinancial debt [3]	186.4	185.3	186.5	187.9	187.5	188.1	188.6	188.3	188.1	187.8	187.6	187.4
18 Domestic nonfinancial borrowing	9.6	8.9	10.1	8.4	8.3	7.9	11.7	7.0	7.4	7.7	8.6	8.1
19 U.S. government [5]	3.9	2.2	2.0	2.0	1.9	0.6	3.9	0.6	2.0	1.5	2.2	1.5
20 Private	5.7	6.7	8.1	6.4	6.5	7.3	7.8	6.4	5.4	6.2	6.4	6.6

1. Data after 1996:Q1 are staff projections.
2. For corporations: Excess of capital expenditures over U.S. internal funds.
3. Average debt levels in the period (computed as the average of period-end debt positions) divided by nominal GDP.
4. NIPA surplus less retirement funds plus consumption of fixed capital.
5. Excludes government-insured mortgage pool securities.

Recent Developments

The weighted-average foreign exchange value of the dollar in terms of the other G-10 currencies has depreciated almost 1-1/2 percent since the July FOMC meeting. Indicators that suggested somewhat less strength in the U.S. economy lessened market expectations of a near-term tightening of Federal Reserve policy and diminished support for the dollar.

The dollar has declined about 2 percent in terms of the yen, 2-1/4 percent in terms of the mark, and 3-1/2 percent in terms of the Swiss franc during the intermeeting period. The yen was supported by data showing that the Japanese current account surplus was again widening. The decision of the Bundesbank Council on July 25 to leave the repurchase rate unchanged at 3.30 percent contributed to upward pressure on the mark as previous statements by officials that there was scope for an easing move had led market participants to expect such a move. The Swiss franc appreciated in terms of the mark and even further in terms of the dollar as financial markets' response to renewed uncertainties about European Monetary Union and concerns about the health of Russian President Boris Yeltsin led to inflows into that currency, which has typically been a safe haven.

Over the period, the dollar has risen about 1/2 percent against sterling and 1 percent against the Canadian dollar. Data suggesting weakness in the Canadian economy triggered downward pressure on that currency.

Three-month interbank interest rates in Japan, Germany and several European countries--and in the G-10 countries on average--were about unchanged over the intermeeting period. In contrast, the three-month rate has dropped nearly 60 basis points in Canada as the Bank of Canada continued to lower official rates. Long-term market interest rates abroad have declined nearly 20 basis points on average since the July FOMC meeting. Rates in Japan are about unchanged while rates in Germany are 25 basis points lower. Canadian long-term rates have decreased about 40 basis points.

Equity prices have declined on balance over the period in the major industrial countries although in several cases they ended the period somewhat above earlier lows. Equity prices have declined the most in Italy (nearly 8-1/2 percent) and Japan (6-1/4 percent); they have risen about 2-1/2 percent in the United Kingdom.

The dollar has declined nearly 1-1/2 percent in terms of the Mexican peso since the July FOMC meeting. In early August, Mexican officials repaid $7 billion of the remaining $10.5 billion debt to the Treasury's Exchange Stabilization Fund, along with repayment of $1 billion to the International Monetary Fund, from funds that included the proceeds of a five-year syndicated commercial bank loan that was more successful than originally expected. On August 7, Mexican authorities began a new policy of a monthly auction of dollar put options on the peso to build international reserves without disrupting the day-to-day peso market.

. The Desk did not intervene during the intermeeting period; it last did so on August 15, 1995.

The pace of economic activity has varied considerably across the major industrial countries in recent months. In Japan, while industrial production fell slightly, other indicators, such as housing starts and machinery orders, increased in the second quarter. Labor market conditions improved as the ratio of job offers to vacancies moved up somewhat through June. In Germany, real activity appears to be rebounding strongly from the contraction experienced in the first quarter. Industrial production and manufacturing orders both rose sharply in the second quarter. Unemployment remained high but edged down in July. Preliminary GDP data for the United Kingdom show real growth of 2 percent, annual rate, during the second quarter. In France and Italy, industrial production data through May suggest possible contraction in the second quarter. In Canada, industrial production and manufacturing shipments and orders strengthened in April and May, in part a rebound from the effects of the GM strike in March; retail sales have been flat, and employment growth was sluggish.

Inflationary pressures have remained well-contained in the major foreign industrial countries. Consumer prices have risen only about 1-1/2 percent over the past twelve months in Germany (through July) and Canada (through June). Inflation in Italy has declined further to near 3-1/2 percent in July. In Japan, prices rose slightly in the second quarter and a bit further in July in response to past depreciation of the yen.

The nominal deficit in U.S. international trade in goods and services widened in May from its April level. For April and May combined, the deficit was substantially larger than in the first quarter. Exports of goods and services were 1-1/2 percent higher on average in April and May than in the first quarter, with most of the increase occurring in deliveries of aircraft and shipments of gold abroad.[1] However, imports of goods and services were 4 percent higher. The increase was largely accounted for by a jump in imports of oil and gold. The rise in the quantity of oil imports reflected restocking that offset the seasonal decline in oil consumption. Imports of automotive products and consumer goods rose as well, while imported semiconductors fell sharply. (Trade data for June will be released on the morning of the FOMC meeting, August 20.)

Prices of export goods declined slightly in June as agricultural prices moved down somewhat. For the second quarter, export prices rose at an annual rate of 2-1/4 percent; increases in prices of agricultural exports outweighed declines in prices of other traded goods. Prices of non-oil imports fell sharply in June, bringing the second-quarter annual rate of decline to 2-1/4 percent. The price of imported oil also decreased sharply in June, following a modest decline in May. The decline in oil prices since April reflects an unwinding of temporary shocks to the oil market (weather-related increases in demand and disruptions to supply) that had driven up prices. Spot WTI declined more than $0.80 per barrel in June, averaging $20.45 per barrel. Although Iraq reached an agreement with the United Nations early in July to export a limited quantity of oil (estimated to be 800,000 b/d) under U.N. supervision, oil prices have remained firm because of uncertainty regarding the timing of these flows. Prices rose nearly a dollar in July and are little changed to date in August. Spot WTI is now trading around $22.00 per barrel.

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[1] Gold transferred from foreign holdings at the Federal Reserve Bank of New York is recorded first as an import into the United States and shows up as an export when gold is shipped out of the country.

Outlook

The staff projects that real GDP in our foreign trading partners (weighted by bilateral nonagricultural export shares) will grow at an average annual rate of 3 percent during the final three quarters of this year and will accelerate to 3-3/4 percent next year. This outlook is marginally softer in the near term than that in the June Greenbook. The dollar is projected to remain near current levels, a path a bit lower than that projected last time. With U.S. GDP growth projected to slow somewhat through the end of 1997 from the pace estimated for the second quarter, we expect that real import growth will shift from being significantly above real export growth to being slightly below it. As a consequence, real net exports are expected to make a negative contribution to real GDP growth during 1996 but to be about neutral in 1997.

The Dollar. We project that the foreign exchange value of the dollar in terms of the other G-10 currencies will remain little changed from its recent levels throughout the forecast period. This projection is down slightly from the level forecast in the previous Greenbook, reflecting the depreciation of the dollar since then. We expect that the CPI-adjusted value of the dollar in terms of the currencies of key developing countries will fall at a moderate rate both this year and next. In particular, the peso is expected to appreciate in real terms over the forecast period, as it depreciates in nominal terms against the dollar more slowly than the extent to which Mexican inflation exceeds U.S. inflation.

Foreign G-7 countries. We project that real GDP in the foreign G-7 countries (weighted by U.S. bilateral nonagricultural export shares) will grow on average at about a 2-1/2 percent annual rate over the second half of this year and next year, about the same rate as that estimated for the first half.[2] Japanese real GDP is projected to grow at an annual rate of 2-1/2 percent over the remainder of this year as continued strength in private spending helps to offset reduced growth of government expenditure. An

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[2]Part of the strength of G-7 growth in the first quarter and slowing in the second reflects the absence in Japan, France and Italy of working-day adjustment for leap year effects as part of seasonal adjustment.

increase in the consumption tax rate scheduled for April 1, 1997, should boost consumption spending and GDP growth in the first quarter of next year but restrain output growth later in the year. In Germany, real GDP growth is estimated to have rebounded to an annual rate of 2-3/4 percent in the second quarter as construction spending recovered from depressed winter levels and exports picked up. Over the remainder of the forecast period, real GDP growth is projected to average 2-1/4 percent at an annual rate, supported by investment spending. After growing at an annual rate of 2 percent during the second quarter, real GDP in the United Kingdom is projected to accelerate a bit for the remaining six quarters of the forecast period, supported by domestic demand. In Canada, real output growth is projected to average 2-1/2 percent at an annual rate in the near term and to rise a bit in 1997 as investment remains strong and net exports contribute positively.

Our outlook for average inflation in the foreign G-7 countries (weighted by U.S. bilateral import shares) calls for prices to rise only 1-1/4 percent over the four quarters of this year and 1-3/4 percent next year. Consumer prices in Japan are projected to increase only slightly this year but to rise about 1-1/2 percent next year in response to the increase in the consumption tax. Projected inflation in Italy has been lowered about 1/2 percent in 1996 and in 1997 since the June Greenbook to 3-1/2 percent this year and 3 percent next year. Our projection for Canadian inflation has been revised down slightly, to 1-1/2 percent this year and 1-1/4 percent next year.

Our forecast for the foreign G-7 countries incorporates the assumption that on average short-term market interest rates will move down slightly further over the remainder of this year and will begin to rise somewhat by the end of 1997. We assume that a move toward ease by the Bundesbank in the near term will permit German market rates and those of several other European countries to decline a bit and that stronger economic activity will begin to move rates up late in 1997. We also assume a small further decline in Canadian official and market rates. Long-term market interest rates abroad are assumed to be little changed over the forecast period.

Other countries. Real GDP in the major developing-country trading partners of the United States (weighted by U.S.

nonagricultural export shares) is projected to increase at a 5 to 6 percent annual rate over the 1996-97 forecast period, compared with 2-1/2 percent growth during 1995 (on a Q4/Q4 basis). The pickup in growth in 1996-97 largely reflects recovery in Mexico.

We project that real GDP in Mexico will expand at an average annual rate of 3 percent during the final three quarters of 1996 and of 5 percent during 1997. Greater financial market stability, improved access to international capital markets, and lower real interest rates are expected to continue to promote a moderately strong, but sustainable, recovery. Our projection that, among our other major Latin American trading partners, Argentina is experiencing renewed growth beginning this year has not been affected by the departure of Economy Minister Cavallo, and we continue to assume that Argentina will be able to maintain its fixed exchange rate regime through at least the end of our forecast period. However, widening fiscal deficits and possible social unrest due to a continued very high rate of unemployment pose important risks to our forecast for Argentina. We project that in Brazil an overvalued real exchange rate and tight credit policy will restrain growth to 2 percent per year or less over the forecast period.

Real output in our major trading partners in Asia is expected to expand at an annual rate of about 6-1/2 percent this year and 6-3/4 percent next. A strong appreciation of the currencies of these economies against the yen during the past year is expected to reduce their export growth, especially in 1996. However, we project that some acceleration of domestic demand--in part due to more accommodative credit policies in some economies--will allow them to grow on average at close to their 1995 pace, with some pickup in growth in Hong Kong and Taiwan roughly offsetting somewhat slower growth in the other economies.

U.S. real exports and imports of goods and services. Real exports of goods and services are projected to grow at a somewhat stronger pace over the second half of 1996 than during the first half and to accelerate to 8-1/2 percent growth during 1997. A resumption of positive growth in the volume of semiconductor exports accounts in part for the strengthening of real exports over the forecast period, and computer exports are projected to continue at annual growth rates of 25 to 30 percent. The quantities of nonagricultural exports other than computers and semiconductors are estimated to have rebounded during the second quarter and are projected to grow at an annual rate of about 3-1/2 percent in the second half of the year; these exports are projected to grow faster in 1997 in response to more robust real GDP growth, on average, in our trading partners.

QUANTITIES OF GOODS AND SERVICES
(Percent change from end of previous period, SAAR)

	1996 Q1	Projection 1996 Q2	Q3	Q4	1997
Exports of G&S	1.8	5.4	3.2	10.2	8.5
Services	2.7	1.4	3.3	3.0	3.4
Computers	58.7	24.0	26.3	26.3	29.9
Semiconductors	0.0	-23.6	12.6	17.0	23.9
Other goods[1]	-7.7	14.7	-1.5	9.2	4.3
Imports of G&S	10.6	14.5	5.5	10.5	8.1
Services	13.0	5.0	2.2	2.2	2.8
Oil	-22.2	62.6	6.0	10.2	2.0
Computers	27.7	31.7	31.1	28.6	24.5
Semiconductors	4.6	-28.4	17.0	17.0	23.9
Other goods[2]	11.7	15.0	0.7	8.5	5.0

Note: NIPA basis, chained (1992) dollars.
1. Merchandise exports excluding agriculture, computers and semiconductors.
2. Merchandise imports excluding oil, computers, and semiconductors.

Real imports of goods and services are estimated to have risen strongly in the first half of 1996 but are projected to moderate somewhat over the forecast period, slowing to an 8 percent annual rate of growth in 1997. Computer imports continue to exhibit very strong rates of growth, whereas semiconductors, which have declined recently, are projected to turn up during the second half of the year. The quantity of non-oil imports other than computers and semiconductors is estimated to have expanded rapidly again in the second quarter. During the remaining half of 1996 and 1997, growth of these imports is projected to slow to about a 5 percent annual pace as growth of U.S. real GDP slows.

After rising extremely sharply in the second quarter, with the rebuilding of stocks, the quantity of oil imports is projected to grow moderately this quarter and over the remainder of the forecast period, as consumption rises with the increase in U.S. economic activity and U.S. production declines.

Oil prices. We assume that under its agreement with the United Nations, Iraq will begin to export some oil in September and will be shipping 800,000 b/d by October. This is roughly one month later than we had assumed in June. Given the later entry of Iraqi oil on the market and the increased political tension in the Middle East, the projected prices of imported oil for the third and fourth quarters have been revised up $1.41 and $1.37 per barrel to $18.39 and $16.00 per barrel respectively. Our long-run projections for WTI and the oil import unit value are $19.50/b and $17.00/b respectively, unchanged from the June Greenbook.

SELECTED PRICE INDICATORS
(Percent change from end of previous period except as noted, AR)

		-------Projection-------			
	1996				1997
	Q1	Q2	Q3	Q4	
Ag. exports[1]	9.5	31.0	5.4	-3.9	-2.9
Nonag. exports[1]	-2.2	-2.5	-1.1	-0.3	1.3
Non-oil imports[1]	-3.1	-3.3	1.2	0.8	0.3
Oil imports (Q4 level, $/bl)	17.53	19.53	18.39	16.00	17.00

1. NIPA chain-weighted basis, including computers and semiconductors.

Prices of non-oil imports and exports. After declining again in the second quarter, prices of non-oil imports are projected to rise slightly over the remainder of the forecast period as the deflationary effects of past dollar appreciation on import prices wane. Prices of nonagricultural exports are projected to decrease slowly through the end of this year, reflecting primarily materials prices, and to rise only slightly next year. Prices of agricultural exports are projected to increase somewhat further on average this quarter but then to retrace some of their upward movement later this year and during 1997.

<u>Nominal trade and current account balances</u>. The nominal trade deficit on goods and services is projected to widen from its first-quarter rate of $97 billion, reaching about $125 billion by the end of next year. The deficit on net investment income is projected to increase over the forecast period as well. As a consequence, the current account deficit should increase over the forecast period and average about $175 billion in 1997, 2-1/4 percent of GDP.

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REAL GDP AND CONSUMER PRICES, SELECTED COUNTRIES, 1994-97
(Percent, quarterly change at an annual rate except as noted)

						Projected					
			Projected		1995	1996				1997	
Measure and Country	1994	1995	1996	1997	Q4	Q1	Q2	Q3	Q4	Q1	Q2
REAL GDP											
Canada	4.9	0.7	2.2	2.7	0.9	1.2	2.5	2.5	2.6	2.6	2.7
France	4.2	0.4	2.0	2.4	-1.7	4.8	-1.0	2.2	2.0	2.3	2.4
Germany	3.7	1.0	1.4	2.3	-0.6	-1.5	2.7	2.3	2.2	2.2	2.4
Italy	2.6	2.3	1.6	2.2	-4.3	2.0	-1.0	2.8	2.7	2.5	2.3
Japan	0.4	2.5	4.4	2.5	4.8	12.7	0.4	2.0	2.9	3.7	1.3
United Kingdom	4.3	1.8	2.1	2.5	1.6	1.6	2.0	2.4	2.5	2.5	2.5
Average weighted by 1987-89 GDP	2.7	1.7	2.7	2.4	0.9	5.0	0.8	2.3	2.5	2.8	2.1
Average weighted by share of U.S. nonagricultural exports											
Total foreign	5.0	1.7	3.4	3.8	3.5	4.2	2.6	3.1	3.6	3.8	3.7
Foreign G-7	3.8	1.2	2.5	2.6	1.3	3.5	1.7	2.4	2.6	2.8	2.3
Developing Countries	6.9	2.4	5.2	6.0	7.4	6.7	4.1	4.6	5.7	6.0	6.0
CONSUMER PRICES (1)											
Canada	0.0	2.1	1.6	1.3	0.1	1.7	3.1	1.0	0.4	1.0	1.8
France	1.6	1.9	1.8	1.9	2.3	2.9	3.2	0.7	0.2	2.1	1.9
W. Germany	2.5	1.6	1.5	2.0	-0.5	2.5	1.9	1.6	0.0	3.1	2.4
Italy	3.8	6.0	3.5	3.0	5.1	2.9	5.0	1.4	4.7	2.5	4.4
Japan	0.8	-0.8	0.4	1.5	-0.5	-0.4	2.5	-0.4	-0.1	-0.4	6.9
United Kingdom (2)	2.2	2.9	2.5	2.7	1.4	3.0	6.1	0.6	0.5	3.0	6.3
Average weighted by 1987-89 GDP	1.7	1.7	1.6	2.0	1.0	1.7	3.4	0.6	0.8	1.5	4.5
Average weighted by share of U.S. non-oil imports	1.0	1.1	1.3	1.7	0.2	1.2	3.0	0.5	0.4	1.0	4.2

Note: Annual values are measured from Q4 to Q4.
1. Not seasonally adjusted.
2. CPI excluding mortgage interest payments, which is the targeted inflation rate. Previously the CPI including mortgage interest payments was shown.

U.S. INTERNATIONAL TRANSACTIONS IN GOODS, SERVICES, AND THE CURRENT ACCOUNT
(Billions of dollars, seasonally adjusted annual rates)

	1993				1994				1995		ANNUAL		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	1992	1993	1994
NIPA Real Net Exports (Chained 1992 dollars)	-56.0	-64.4	-86.2	-81.5	-99.3	-107.3	-111.7	-104.3	-122.5	-121.4	-29.5	-72.0	-105.7
Exports of G&S	647.1	660.0	645.5	680.3	677.6	703.1	719.6	747.6	752.3	763.2	639.4	658.2	712.0
Goods	454.2	465.9	452.7	485.0	481.9	502.9	517.8	543.4	548.8	557.7	448.7	464.5	511.5
Agricultural	43.8	43.9	41.0	43.5	40.6	41.2	45.1	50.9	50.8	48.1	44.1	43.1	44.4
Computers	32.3	33.4	35.9	38.5	40.7	42.3	45.0	49.6	53.3	56.9	28.8	35.0	44.4
Semiconductors	20.8	22.5	25.5	27.7	34.2	35.5	39.0	46.8	51.2	53.6	16.0	24.1	38.9
Other Goods	357.3	366.1	350.3	375.3	366.4	383.9	388.8	396.0	393.4	399.0	359.9	362.3	383.8
Services	192.7	194.0	192.7	195.5	195.9	200.5	202.2	204.9	204.3	206.4	190.8	193.7	200.9
Imports of G&S	703.1	724.4	731.7	761.8	777.0	810.4	831.3	851.9	874.9	884.6	668.9	730.3	817.6
Goods	578.4	598.0	604.1	629.8	644.5	675.6	697.1	719.3	735.4	747.7	544.9	602.6	684.1
Oil	53.7	57.9	56.9	58.3	57.0	60.6	65.1	58.2	57.8	58.6	51.4	56.7	60.2
Computers	39.1	42.8	46.2	49.6	54.4	58.2	61.5	68.1	72.6	77.9	31.7	44.4	60.6
Semiconductors	19.6	21.2	22.3	24.7	28.0	28.5	31.2	36.5	40.3	45.4	15.5	21.9	31.1
Other Goods	466.0	476.1	478.7	497.2	505.0	528.3	539.2	556.5	564.7	565.9	446.3	479.5	532.3
Services	124.7	126.5	127.6	132.0	132.6	135.0	134.5	133.1	139.8	137.4	124.1	127.7	133.8
Memo: (Percent change 1/)													
Exports of G&S	-1.2	8.2	-8.5	23.4	-1.6	15.9	9.7	16.5	2.6	5.9	4.1	4.8	9.9
Agricultural	-17.8	0.9	-23.9	26.7	-24.5	6.8	43.0	62.9	-0.6	-19.8	10.5	-5.4	17.1
Computers	12.0	14.3	33.5	32.3	25.0	16.6	27.6	48.6	33.0	30.1	25.2	22.6	29.0
Semiconductors	40.5	36.2	65.3	40.1	131.4	16.2	45.8	106.7	43.6	19.9	64.8	45.1	68.7
Other Goods	-7.7	10.3	-16.2	31.7	-9.1	20.4	5.2	7.7	-2.6	5.9	2.6	3.0	5.5
Services	9.9	2.7	-2.7	5.9	0.8	9.7	3.4	5.5	-1.1	4.0	-0.9	3.9	4.8
Imports of G&S	8.4	12.7	4.1	17.5	8.2	18.4	10.7	10.3	11.2	4.5	7.4	10.5	11.8
Oil	5.4	35.2	-6.7	10.2	-8.5	27.2	33.5	-36.2	-2.4	5.3	12.2	10.0	-0.2
Computers	43.9	43.6	35.8	32.8	45.0	30.9	24.8	49.9	29.6	31.9	44.9	38.9	37.3
Semiconductors	72.5	39.5	20.6	52.1	65.3	7.3	43.4	85.8	49.3	61.0	42.0	44.9	47.4
Other Goods	9.1	8.9	2.3	16.3	6.4	19.8	8.6	13.4	6.0	0.9	5.5	9.0	11.9
Services	-8.2	5.9	3.5	14.5	1.8	7.5	-1.6	-4.0	21.7	-6.7	1.5	3.6	0.8
Current Account Balance	-72.7	-96.9	-109.7	-120.5	-118.8	-144.1	-160.0	-170.6	-156.2	-163.9	-62.6	-99.9	-148.4
Goods & Serv (BOP), net	-54.2	-72.1	-84.8	-77.0	-90.8	-103.5	-113.8	-109.4	-118.1	-127.3	-38.3	-72.0	-104.4
Goods (BOP), net	-116.8	-133.5	-146.0	-134.1	-147.4	-164.3	-177.7	-175.1	-179.7	-191.7	-96.1	-132.6	-166.1
Services (BOP), net	62.6	61.4	61.2	57.1	56.5	60.8	63.9	65.7	61.6	64.4	57.8	60.6	61.7
Investment Income, net	15.1	9.4	12.0	2.6	4.7	-2.5	-6.4	-12.4	-3.6	-3.4	11.2	9.7	-4.2
Direct, net	61.3	53.6	58.9	49.8	49.5	46.0	47.4	46.9	57.4	59.9	51.6	55.9	47.4
Portfolio, net	-46.2	-44.2	-46.9	-47.3	-44.8	-48.5	-53.7	-59.3	-61.0	-63.3	-40.4	-46.2	-51.6
Unilateral Transfers, net	-33.5	-34.1	-36.9	-46.1	-32.7	-38.0	-39.9	-48.9	-34.6	-33.2	-35.5	-37.6	-39.9

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		
	1995		1996				1997				ANNUAL		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	1995	1996	1997
NIPA Real Net Exports (Chained 1992 dollars)	-101.6	-84.9	-104.0	-124.5	-130.6	-134.6	-132.1	-134.6	-143.8	-142.5	-107.6	-123.4	-138.3
Exports of G&S	783.0	803.1	806.7	817.5	824.0	844.2	857.9	879.4	890.5	915.6	775.4	823.1	885.8
Goods	568.1	588.8	590.9	601.0	605.8	624.4	636.2	655.8	665.1	688.6	565.8	605.6	661.4
Agricultural	50.0	49.4	50.5	46.1	45.5	47.0	47.6	48.2	48.7	49.3	49.6	47.3	48.5
Computers	65.9	74.2	83.3	87.9	93.1	98.7	105.2	112.0	119.8	128.2	62.6	90.8	116.3
Semiconductors	57.1	60.7	60.7	56.7	58.4	60.8	63.8	67.0	71.0	75.3	55.6	59.1	69.3
Other Goods	395.2	404.6	396.5	410.4	408.8	417.9	419.6	428.6	425.5	435.8	398.1	408.4	427.4
Services	215.4	215.3	216.7	217.5	219.2	220.9	222.8	224.8	226.7	228.3	210.4	218.6	225.6
Imports of G&S	884.5	888.0	910.7	942.0	954.6	978.8	989.9	1014.0	1034.3	1058.2	883.0	946.5	1024.1
Goods	745.6	750.0	768.3	797.9	809.8	833.1	843.3	866.5	885.7	908.4	744.7	802.3	876.0
Oil	61.6	58.7	55.2	62.3	63.2	64.7	61.9	67.3	70.2	66.0	59.2	61.3	66.4
Computers	88.2	97.9	104.1	111.5	119.3	127.1	134.7	142.1	149.9	158.1	84.1	115.5	146.2
Semiconductors	52.3	57.3	57.9	53.3	55.4	57.6	60.5	63.5	67.3	71.4	48.8	56.0	65.7
Other Goods	543.5	536.1	551.2	570.8	571.9	583.7	586.2	593.6	598.3	612.9	552.5	569.4	597.8
Services	139.4	138.5	142.8	144.5	145.3	146.1	147.1	148.1	149.1	150.3	138.8	144.7	148.6
Memo: (Percent change 1/)													
Exports of G&S	10.7	10.7	1.8	5.4	3.2	10.2	6.6	10.4	5.1	11.8	7.4	5.1	8.5
Agricultural	16.4	-4.9	9.3	-30.6	-5.1	14.6	5.0	5.0	4.2	5.0	-3.1	-4.7	4.8
Computers	79.0	61.0	58.7	24.0	26.3	26.3	28.7	28.7	31.1	31.1	49.4	33.1	29.9
Semiconductors	28.8	27.6	-0.0	-23.6	12.6	17.0	21.6	21.6	26.2	26.2	29.7	0.1	23.9
Other Goods	-3.8	9.8	-7.7	14.7	-1.5	9.2	1.6	8.9	-2.9	10.0	2.2	3.3	4.3
Services	18.7	-0.3	2.7	1.4	3.3	3.0	3.6	3.6	3.4	2.9	5.1	2.6	3.4
Imports of G&S	-0.0	1.6	10.6	14.5	5.5	10.5	4.6	10.1	8.2	9.6	4.2	10.2	8.1
Oil	22.0	-17.2	-22.2	62.6	6.0	10.2	-16.2	39.2	18.3	-21.7	0.9	10.2	2.0
Computers	64.7	51.8	27.7	31.7	31.1	28.6	26.2	23.9	23.9	23.9	43.8	29.8	24.5
Semiconductors	76.4	43.6	4.6	-28.4	17.0	17.0	21.6	21.6	26.2	26.2	57.1	0.6	23.9
Other Goods	-14.9	-5.4	11.7	15.0	0.7	8.5	1.7	5.1	3.2	10.1	-3.7	8.9	5.0
Services	5.8	-2.4	13.0	5.0	2.2	2.2	2.7	2.7	2.8	3.2	4.1	5.5	2.8
Current Account Balance	-150.8	-121.7	-142.4	-163.8	-169.3	-175.8	-162.0	-166.9	-177.3	-187.3	-148.2	-162.8	-173.4
Goods & Serv (BOP), net	-97.3	-77.6	-97.4	-120.8	-121.7	-117.1	-113.2	-116.8	-125.5	-123.3	-105.1	-114.3	-119.7
Goods (BOP), net	-170.2	-152.1	-171.0	-194.0	-196.2	-193.2	-191.1	-196.7	-207.2	-206.5	-173.4	-188.6	-200.4
Services (BOP), net	72.9	74.5	73.5	73.2	74.4	76.1	78.0	79.9	81.7	83.2	68.4	74.3	80.7
Investment Income, net	-17.4	-7.6	-1.6	-10.1	-14.6	-15.7	-18.8	-20.2	-21.8	-24.0	-8.0	-10.5	-21.2
Direct, net	51.3	61.3	63.3	60.7	59.8	62.1	61.7	62.6	63.4	63.8	57.5	61.5	62.9
Portfolio, net	-68.7	-68.9	-64.8	-70.8	-74.4	-77.8	-80.5	-82.8	-85.3	-87.8	-65.5	-72.0	-84.1
Unilateral Transfers, net	-36.0	-36.6	-43.4	-33.0	-33.0	-43.0	-30.0	-30.0	-30.0	-40.0	-35.1	-38.1	-32.5

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