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Strictly Confidential (FR) Class II FOMC

Part 1

September 18, 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

September 18, 1996

SUMMARY AND OUTLOOK

Prepared for the Federal Open Market Committee
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Overview

Data that have become available in the brief period since the last Greenbook have not taken us very far toward pinning down the current rate of economic expansion. Information from the labor market has been uniformly strong and, taken in isolation, might have caused us to revise up the forecast of current-quarter real GDP growth. However, indicators of spending have been much less robust and, in the end, have persuaded us to nudge our GDP forecast down a touch, to just under 2-1/2 percent at an annual rate.

This pace, though well below that reported for the first half, still is a little above our 2 percent estimate of trend growth in potential output, and we have seen resource utilization rise a bit further. Labor markets in particular seem quite taut, with overall compensation rates evidently having accelerated somewhat this year. Although "core" price inflation has remained in check to date, a continuation of that pattern would likely require a period of markedly subpar growth of aggregate demand, and we see no clear grounds for anticipating such an outcome--absent a significant tightening of financial market conditions.

Assuming an unchanged monetary policy, we are projecting an output path that holds the jobless rate a little below 5-1/2 percent, resulting in a gradual but sustained acceleration in hourly compensation. A further increment to wage growth will come from increases in the federal minimum next month and in September of 1997. The faster rise in labor costs is mirrored in a pickup in core CPI inflation--from the 2.6 percent increase of the past twelve months to 3.1 percent over the course of 1997. Overall CPI inflation is projected to jump to 3-1/4 percent this year because of a more rapid rise of food and energy prices; on the assumption of an eventual arrival of Iraqi oil on the market, we expect the increase in the CPI next year to drop back into line with its core component. A tentative assessment of prospects for 1998 suggests that overall inflation, as measured by the CPI, might edge off. New CPI weights that will be introduced at the start of 1998 should shave a couple of tenths from the year's annual price rise, and we are assuming that a sequence of better harvests will relieve the pressure on food prices.

Key Background Factors in the Forecast

Our forecast is still based on the assumption that the nominal federal funds rate will hold steady. Bond rates have moved up a little, on net, since mid-August, in line with our previous forecast. Looking ahead, we have bond rates holding in their recent range, with our predicted path for the economy coming as no surprise to the bond markets.

Further selective tightening of credit availability is quite possible in the consumer area in coming months, given that lenders seem to have been surprised at the frequency with which consumers have recently been failing to meet their obligations. Nonetheless, with the economy growing moderately and employment on the rise, most household and business borrowers should continue to enjoy ready access to credit, with little or no widening in interest rate spreads.

The major stock price indexes have risen noticeably on net since the August FOMC meeting. As before, market valuations look high to us in view of our forecast of more moderate growth in corporate profits, and we are sticking with the prediction of a modest correction in share prices, assumed to occur within the next couple of quarters. The market decline would raise the cost of equity finance only a little overall but probably meaningfully for some of the more speculative enterprises, and it would trim the currently high wealth-to-income ratio of the household sector. After the correction, stock prices are projected to recover gradually.

We continue to assume that federal budget policy will exert a mild degree of restraint on the economy over the forecast period. Various initiatives being discussed in the presidential campaign raise the possibility that more expansionary fiscal policies could be put in place in the future. So far, however, the likelihood of significant change does not seem so great as to prompt anticipatory decisions by households or businesses, and we have not made any allowance in our budget assumptions for the proposals being floated. Meanwhile, more favorable trends in outlays for health care and the effects of income growth on tax revenues continue to translate into a reduced forecast of the unified deficit: We have nudged down our prediction of the unified deficit for fiscal 1996 to $115 billion, and our deficit forecast for fiscal 1997 has been lowered to $133 billion. These estimates are down $3 billion and $7 billion respectively from those in the last Greenbook.

Our forecast of economic activity in the rest of the world has been revised only marginally since the last Greenbook. Foreign GDP growth is projected to be about 3-1/4 percent over the four quarters of 1996 and almost 4 percent next year. The dollar's average exchange value has moved up slightly on net since the last Greenbook, but we expect this rise to be retraced as market expectations of a Federal Reserve tightening unwind; consequently, the average exchange value moving forward follows essentially the same flat path as in the last Greenbook.

Our assumption about oil prices has been altered in reaction to the recent turmoil in Iraq and another delay in implementing the UN agreement to allow a limited amount of Iraqi oil back into the market. The posted price of West Texas intermediate now averages $21 per barrel in the fourth quarter of 1996, exceeding by about $4 the level in the last Greenbook. By next April, however, about 800,000 barrels a day from Iraq are assumed to be entering the world market, and by the middle of next year posted prices are back to the same level as in the last forecast--$18.50 per barrel.

Recent Developments and Prospects for the Current Quarter

The BEA's preliminary estimate of second-quarter GDP growth--at an annual rate of 4-3/4 percent--turned out to be appreciably stronger than we were forecasting in the last Greenbook. The categories in which the surprises were largest were net exports and federal outlays for consumption and investment. The revision to net exports was explained by receipt of trade data for June, but we were perplexed by the change in the estimate of federal spending. Federal purchases already had been showing a larger gain in the advance GDP report than seemed consistent with the unified budget and expenditure data from the Monthly Treasury Report, and the revision exacerbated the difference.

How to react in the forecast to the revision to federal purchases and to the apparent inconsistencies in the data was one of the murkier issues with which we have had to contend in the current round. Although discussions with analysts from the BEA have by no means resolved all the uncertainties in this part of the forecast, the bottom line of our knowledge at present is that a sizable drop in real federal purchases still appears likely this quarter.[1]

Apart from the uncertainties related to federal spending, source data for the current quarter are still so incomplete and contradictory as to make impossible precise estimation of the rate of growth in activity. Our best guess is that real GDP growth will be in a range of 2 to 3 percent.

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

	1996:Q2			1996:Q3	
	Aug. GB	BEA prel.	Sept. GB	Aug. GB	Sept. GB
Real GDP	3.7	4.8	4.7	2.6	2.4
Private domestic final sales	4.2	4.1	4.0	2.6	2.4
Change in billions of chained (1992) dollars					
Inventory investment	6.6	10.2	9.0	25.7	24.0
Government outlays for consumption and investment	19.6	25.1	24.9	-11.3	-8.5
Net exports	-20.5	-11.2	-10.4	-6.1	-8.3

The August gain in private payrolls of 173,000, while less than in previous months, was sizable. Moreover, the low level of initial claims into early September and other favorable labor market indicators point to ongoing strength in hiring. All told, aggregate production worker hours will likely be up around 2 percent at an annual rate this quarter; implicit in our output forecast is a

1. We feel reasonably certain at this point that real defense expenditures will decline sharply this quarter. The bigger uncertainty has to do with nondefense purchases. These expenditures exhibited surprising strength over the first half of the year, outpacing by a considerable margin the levels that seemed to be implied by data from the unified budget. Our concern has been that the BEA might force fiscal year NIPA data into compliance with the unified budget data, a step that would require an extraordinary drop in nondefense expenditures in the current quarter. However, the BEA recently told us that they would follow strictly their normal "best change" procedures, leaving any fiscal year inconsistencies that might persist to be ironed out at the time of the next annual revision. We have written down a current-quarter forecast that shows no change in nondefense expenditures for consumption and investment in nominal terms and a moderate decline in real terms.

somewhat smaller gain in nonfarm productivity this quarter than occurred on average in the first two quarters of the year.

Industrial production is on track for another large gain this quarter--probably around 5 percent at an annual rate--despite the drag of cool weather on electricity generation. Assemblies of motor vehicles likely will contribute about a percentage point to the rate of IP growth (and about 1/2 percentage point to GDP growth). But, even excluding vehicles, growth of manufacturing output has been quite strong.

In contrast to labor market and production indicators, the incoming data on spending have been rather soft. We are predicting that real consumer spending will increase at an annual rate of about 1-3/4 percent this quarter, well short of the brisk first-half pace of about 3-1/2 percent. Sales of light vehicles appear to have slowed, and the available data on retail sales suggest that the third-quarter rise in real expenditures for other goods has been quite small. The marked softening of demand seems somewhat at odds with the ongoing increases in jobs and income and high levels of consumer confidence. Although this tension could be resolved by subsequent upward revisions of the current retail sales estimates, we are assuming mainly that spending will catch up in the fourth quarter.

We expect that residential investment will decline slightly this quarter after a year of strong increases. Starts of single-family houses turned down in July, and most other recent indicators have pointed to some softening of demand. The major exception is a Census-reported surge in sales of new homes in July, but the initial readings for this series have been subject to such huge revisions that their information value has proved to be almost nil.

We are pegging the third-quarter gain in real business fixed investment at about 8 percent (annual rate), roughly the same as the average rate of growth in the first half of the year. As was true in the first half, a large portion of the current gain in investment outlays is expected to come in office and computing equipment. However, trends in orders through July suggest that outlays for other equipment will also post a considerable advance. Real outlays for nonresidential construction are expected to edge down a bit further this quarter; monthly data on construction put in place have been extremely volatile of late but left the July reading below the second-quarter average.

Inventory data are currently available only through July. Stockbuilding picked up appreciably in that month, and our inventory prediction allows for moderate gains in August and September. Given the scarcity of actual data, this pattern may be viewed as merely a means of bridging the gap between the strength in the recent indicators of production and the slower rate of growth that seems to be implied by the available evidence on final sales. But fundamentally, businesses almost surely will wish to add to their stocks before long unless they perceive the prospects for sales to be substantially weaker than we do. Thus, the issue seems to be largely one of timing. Recognizing the noisiness of quarterly GDP, we have no difficulty envisioning an alternative scenario in which recorded growth of real GDP is weaker in the current period, with the boost from inventory investment coming later.

The CPI excluding food and energy rose just 0.1 percent in August and now is projected to rise at an annual rate of 2.6 percent this quarter, about the same as the increases in the first two quarters of the year; we previously had projected 3.0 percent. Food prices appear to be headed for their largest quarterly increase since 1990, but energy prices have dropped sharply, reversing part of their first-half surge. Summing the pieces, the total CPI is expected to rise slightly less than 2-1/2 percent at an annual rate this quarter, versus a first-half average of about 3-1/2 percent. However, the 0.5 percent August increase in average hourly earnings reinforced the impression that sustained acceleration of wages is under way.

The Outlook for the Economy beyond the Current Quarter

The forecast has GDP growth slowing a bit further in the fourth quarter to a rate of about 2-1/4 percent, and growth is expected to be maintained at close to that pace in 1997. Although the tenor of recent labor market data would suggest some upside risk to the forecast over the near term, fundamental reasons for expecting the economy to slow appear to be just as valid at present as they seemed to be a few weeks ago. Financial conditions do not appear to be either highly stimulative or highly restrictive at present, fiscal policy is mildly restrictive, and stocks of household and business durables already have been boosted to high levels.

As in the last Greenbook, our current forecast has growth of final sales picking up in the fourth quarter but to a pace far short of the robust increases seen in the first half of the year. Fourth-quarter accumulation of nonfarm inventories is projected to proceed at a somewhat slower pace than in the third quarter; this slowdown is a reflection of a slight decline in stocks of motor vehicles, after a sizable third-quarter rise. Production of vehicles is projected to fall enough to trim about 1/2 percentage point from GDP growth. We have not made allowance in the near-term forecast for strikes by autoworkers; although the tentative agreement between Ford and the United Auto Workers contains provisions that would be difficult for GM to accept, the union also has signaled some willingness to tailor agreements to the particular circumstances of the different companies.

The forecast for 1997 is essentially the same as that in the last Greenbook and has real GDP growing at a pace about in line with potential. The unemployment rate is expected to move up a little over the next couple of months and then flatten out at 5.4 percent. We see the upturn in wage inflation to date as the initial phase of an inflationary process that is likely to quicken--albeit gradually--unless the current tautness is alleviated.

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

		1996		
	1995	H1	H2	1997
Real GDP	1.3	3.3	2.3	2.1
Previous	1.3	2.8	2.3	2.1
Final sales	1.9	3.6	1.7	2.1
Previous	1.9	3.2	1.6	2.1
PCE	1.9	3.4	2.5	2.7
Previous	1.9	3.5	2.6	2.5
BFI	6.4	7.7	7.5	5.1
Previous	6.4	7.4	5.2	4.3
Residential investment	-1.5	11.8	-3.0	-2.2
Previous	-1.5	12.1	-2.5	-1.5
Civilian unemployment rate[1]	5.5	5.4	5.4	5.4
Previous	5.5	5.4	5.4	5.4

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. After a sluggish third quarter, growth of personal consumption outlays is projected to rebound in the fourth quarter. An uptick in the personal saving rate this quarter is reversed in the process. Outlays then rise moderately over the course of 1997, in fairly close alignment, on average, with gains in income.

The annual saving rate in 1997 is projected to be 4.8 percent, about the same as the annual averages for 1995 and 1996. In keeping the saving rate on a generally flat trajectory, we are in effect still giving about equal weight to the positives and negatives in the household financial picture: Rising debt-service burdens and increasing efforts of households to build nest eggs for education or retirement may prompt some deferral of consumption, while the high level of stock market wealth (even with our anticipated correction) may lead some households to spend more freely. Although some further tightening of consumer credit availability is likely, it should put no more than a modest dent in spending.

Household spending on consumer electronics has risen rapidly in in recent years, and we expect it to continue doing so as buyers are enticed by attractive prices on innovative products. Spending gains in other categories probably will be less impressive: Unit sales of new light vehicles are expected to hold essentially flat at a high level in 1997, and outlays for furniture and other household appliances are expected to rise moderately after a brisk gain in 1996.

Residential investment. We have made only small adjustments this month to our forecast of housing activity. By and large, the recent data finally seem to be signaling the downshift in demand for single-family homes that we have been anticipating as a consequence of the increase in mortgage interest rates this year. Still, affordability remains quite good, and we are projecting only a gradual decline in starts over the next few months; residential investment drifts lower as the weakening of starts shows through to the flow of expenditures on construction. For all of 1997, single-family starts are expected to amount to around 1.08 million units, down from a 1996 total of 1.15 million units.

The monthly numbers on starts of multifamily units have been quite volatile this year, around a basically flat trend. Credit availability does not appear to be a limiting factor to further expansion of new construction in this segment of the market.

Rather, with vacancy rates on multifamily rental units drifting back up in recent quarters, new construction is probably being restrained by diminished perceptions of future profitability on these units in some locales.

Business fixed investment. The underlying trend in growth of business fixed investment appears to be gradually slowing. Four-quarter increases in investment generally exceeded 10 percent from mid-1994 to mid-1995. We are forecasting that this year's rise in BFI will be about 7-1/2 percent and that next year's will be about 5 percent. Growth of investment will likely be damped a bit in coming quarters by this year's step-up in long-term interest rates and by a slackening in the growth of corporate cash flow.

Real investment in computers and other high-tech equipment will likely proceed at a relatively rapid pace, driven by technological progress and ongoing price declines. We are predicting that real outlays for office and computing equipment will rise at an annual rate of about 30 percent in the second half of this year; next year's increase is projected to be smaller--a bit less than 20 percent. We are also anticipating large increases in real outlays for communications equipment, stimulated by rapid growth and innovation in the provision of information and entertainment services.

Moderate increases are anticipated, on balance, for other types of equipment, with some variation in the mix. Business outlays for motor vehicles are expected to decline somewhat, pulled lower, at least over the near term, by further reductions in purchases of heavy trucks. But, commercial aircraft will probably be an area of increased strength in coming quarters, given the scheduled step-up of production. Investment in industrial equipment is projected to rise moderately in real terms.

Nonresidential investment will likely eke out only a small net rise between mid-1996 and the end of 1997. The recent weakness of contracts for new construction may pose some downside risk to this forecast, but anecdotal reports on market conditions have been relatively upbeat and suggest that the risks are not tilted entirely to the downside.

Inventory investment. Nonfarm inventories rose at an annual rate of only 3/4 percent in the first half of 1996, and this restrained rate of accumulation has left stocks quite lean. We think it likely that inventory investment will proceed at a moderate pace in coming quarters, roughly in line with the growth of sales.

Our view of the outlook for farm inventories has changed little since the last Greenbook. In recent quarters these stocks have been falling rapidly because of declines for both crops and livestock. Looking ahead, however, increased crop production this year--and next, if the vagaries of weather permit--should lead to some rebuilding of inventories, and reductions in the cattle herd are not likely to continue at the exceptionally rapid pace seen in recent quarters. Still, the farm inventory decline of the past couple of years is not expected to be fully reversed by the end of 1997.

Government. As noted above, real federal expenditures for consumption and gross investment are expected to turn down sharply in the third quarter after two quarters of sizable increases. A further decline in spending that is predicted for the fourth quarter leaves real federal outlays up slightly on net over the four quarters of 1996. Next year, federal purchases are projected to resume the downward trend that was evident before 1996; outlays drop 3-1/2 percent over the year, with the bulk of the decline coming in the defense category.

Real purchases by state and local governments are projected to move up at an annual rate of about 2-1/2 percent over the five quarters starting in 1996:Q4. This rate of growth is a bit faster than the gains seen in most other recent years but is not particularly fast by broader historical standards. As before, effects of welfare reform still are not expected to be a big factor in state and local spending over the next few quarters.

Net exports of goods and services. Our export forecast has been lowered somewhat this month, and our forecast of imports has been marked down as well. Overall, however, we still anticipate a noticeable pickup in exports, with next year's increase pegged at 7-1/4 percent after a 1996 rise of about 4-1/2 percent. Imports are projected to slow somewhat, in conjunction with the downshifting in the U.S. economy. Net exports, in total, continue to decline in 1997, but at a much slower rate than they have this past year. Consequently, the contribution of net exports to real GDP growth becomes less negative--a deduction of about 1/4 percentage point is expected in 1997 after a subtraction of more than 1/2 percentage point over the four quarters of 1996. (A more detailed discussion of the prospects for net exports is contained in the International Developments section.)

Employment and productivity. The predicted gains in real GDP of roughly 2 percent at an annual rate over the next few quarters are accompanied by an expected rise in payroll employment of a little more than 1 percent at an annual rate--or about 120,000 jobs per month.

Our projection of labor demand is sensitive to our assumptions about the prospects for productivity growth, about which considerable uncertainty currently exists. Even with an upward revision to the second-quarter gain, increases in output per hour have generally been disappointing over the past year or so. Part of the shortfall in productivity may be a result of measurement error; most notably, output as measured from the product side--which is the basis for the labor productivity figures--rose a full percentage point less than real gross domestic income over the last four quarters. In addition, we are at a point in the business cycle at which employers may be facing some cyclical problems with respect to labor quality. The possibility that the trend in productivity is falling short of our estimate is less likely: We find it hard to believe that productivity growth would actually have deteriorated in the 1990s, given ongoing business restructuring and the high levels of capital investment in recent years. Obviously, if productivity growth were to continue to disappoint, we risk a mix of output and inflation that might prove more adverse than we are anticipating in coming quarters.

Wages and prices. The chief mechanism taking us toward increased inflation is the same as in our last forecast--tight labor markets leading to higher compensation increases that eventually are passed through in increasing measure to prices. Adverse developments in food and energy markets have already boosted consumer prices; this boost is creating a slightly worse backdrop for wage decisions. Anecdotal reports of labor market conditions suggest that the phenomenon of firms raising pay to attract or retain desired workers is far from pervasive, but the frequency of such reports seems to give some credence to the pickup in compensation rates registered in the ECI through June--and the acceleration in the narrower average hourly earnings series through August. The pressures on labor costs from taut markets will be exacerbated by the impending sequence of minimum wage hikes.[2] In total, we see the ECI for private hourly compensation accelerating from a rise of 2.9 percent in the year that ended this June to 3.3 percent over the twelve months ended this coming December. Next year, compensation is projected to rise 3.6 percent.

Firms appear to have been absorbing some of the increase in labor costs, probably out of concern that raising prices apace would jeopardize market share. However, we doubt that this process will persist much longer: Factory utilization has edged back up, to a level somewhat above its long-term average. Given our projection for exchange rates, non-oil import prices record only a small decline in coming quarters after a much larger drop over the past year. We see no basis for assuming that firms will find it easier than they have to offset rising wages through gains in efficiency, so a tendency for higher compensation rates will likely be reflected in an acceleration of prices.

This month's revision to the assumptions about the oil market led us to raise the fourth-quarter forecast of retail energy prices. Consequently, this year's rise in energy prices is larger than it was projected to be in the last forecast, but with oil prices dropping back to the previously predicted path by mid-1997, next year's increase in retail energy prices has been marked down by a roughly equivalent amount.

We have lowered the food price forecast by a small amount this month: Grain prices have retreated somewhat further in recent weeks, as the risk of significant damage to crops from the weather has diminished. Nonetheless, we continue to anticipate that food prices will rise faster than core inflation over the next few quarters. Based on the USDA's September crop report, stocks of grain and soybeans still appear likely to be tight at least until next year's harvest. Contraction continues to be apparent in most parts of the livestock industry.

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2. The two-stage rise in the minimum is expected to leave the ECI for hourly compensation at the end of 1997 more than 0.3 percent higher than it otherwise would have been. This estimate is at the low end of the range that we cited in the last Greenbook and is a tenth smaller than our previous point estimate--the change stems from use of more detailed data on the wage distribution than we previously had available.

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

	1996 H1	1996 H2	1995	1996	1997
Employment cost index[1]	3.0	3.6	2.6	3.3	3.6
Previous	3.0	3.6	2.6	3.3	3.7
Consumer price index[2]	3.5	3.0	2.7	3.2	3.1
Previous	3.5	2.9	2.7	3.2	3.3
Food	3.0	5.3	2.6	4.1	3.7
Previous	3.0	5.4	2.6	4.2	4.0
Energy	15.6	.4	-1.7	7.6	1.6
Previous	15.6	-3.3	-1.7	5.7	3.3
Excluding food and energy	2.7	2.7	3.0	2.7	3.1
Previous	2.7	3.0	3.0	2.9	3.2

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.

With energy prices decelerating sharply in 1997 and food price increases slowing a little, the rise in the total CPI next year--3.1 percent--is a little less than the increase projected for 1996. However, it remains a bit above the increases of about 2-3/4 percent recorded in each year from 1993 through 1995. Moreover, increases in the CPI are being damped by methodological changes that the BLS has already implemented or will be undertaking; had methodology been held constant since the start of 1995, our 1996 forecast of the rise in the CPI would be about two tenths higher, and our 1997 forecast would be about three-tenths higher.

Money and credit flows. Incoming data on the monetary aggregates and bank credit have run below staff expectations of late, and we foresee no reason for any catch-up over the balance of the year. M2 is now forecast to expand at a pace just below that of nominal GDP, ending the year in the upper portion of its annual range. However, the implied modest uptrend to M2 velocity is not expected to carry beyond 1996. In 1997, M2 is projected to grow in rough alignment with nominal GDP. Such an outcome next year would place the aggregate near the upper end of its provisional range. Growth of M3 is expected to outstrip that of M2 by about 1 percentage point, leaving that aggregate near the upper ends of its annual range for 1996 and its provisional range for 1997.

The debt of the domestic nonfinancial sectors is now seen as growing at a 5 percent rate in 1996, up 1/2 percentage point from the forecast in the August Greenbook; the revision was prompted by additional information on the pace of borrowing over the first half of this year--mortgage debt, in particular, came in stronger than anticipated. Growth at the projected rate would place the debt aggregate at the midpoint of its monitoring range. Smoothing through quarterly gyrations, debt growth is projected to edge lower next year, to 4-3/4 percent, again close to the growth of nominal GDP.

The staff anticipates that the capital outlays of nonfinancial corporations will outstrip internally generated funds over the forecast period and that firms will continue to retire equity, while seeking moderate amounts of credit. Bond markets are anticipated to remain quite receptive, with most credit spreads staying on the thin side by historical standards. As long as bond yields remain in their recent range--as they do in the forecast--businesses should rely on capital markets for much of their financing. Still, there are no signs that banks are about to curtail their efforts to attract business borrowers; and with inventory investment expected to rise significantly above the pace thus far this year, some of the business borrowing should fall to banks.

The recent rise in consumer loan delinquency and charge-off rates is unlikely to be reversed appreciably over the projection period, especially given the more moderate growth of employment that we are predicting. Consequently, the tightening of terms and standards, which has been most notable in the case of credit cards, may yet have some way to go. Such restraint will help to diminish credit use--but probably not dramatically: We expect the focus of banks to be on more surgical approaches to limiting risk exposures rather than on broad-based retrenchment, so as to preserve the still profitable bulk of the consumer lending business. Growth in consumer debt is thus expected to continue to outpace that of nominal income, though that gap should narrow further as repayments pick up on loans made in the past few years. Although appreciation of house prices has picked up in many areas of the country of late, residential construction and home sales are projected to slow. Accordingly, home mortgage debt should rise at a more moderate pace than it has recently.

<u>A first look at the prospects for 1998</u>. This Greenbook extends the projection through 1998. With monetary and fiscal conditions not leaning strongly in one direction or another and foreign growth providing only a moderate lift to demand for U.S. exports, we see little reason at this point to anticipate a significant departure from trend GDP growth. Consequently, labor markets would likely remain on the tight side, and underlying inflation would be expected to creep upward. However, if Mother Nature cooperates, price problems in the food area should have started to fade by 1998. Moreover, the scheduled introduction of a reweighted CPI will go further toward removing some of the upward biases that have been present in that measure in the past--and further complicate comparisons between past and projected inflation rates. We are predicting that the published CPI will slow a bit in 1998 and that the rate of rise in the core CPI will hold steady; but for the updating of weights, we would be forecasting a steady inflation rate for the total and slight acceleration of the core.

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

	1996	1997	1998
Real GDP			
Baseline	2.8	2.1	2.1
Higher funds rate	2.8	1.6	1.5
Lower funds rate	2.8	2.6	2.7
Civilian unemployment rate[1]			
Baseline	5.4	5.4	5.4
Higher funds rate	5.4	5.6	5.9
Lower funds rate	5.4	5.2	4.9
CPI			
Baseline	3.2	3.1	2.9
Higher funds rate	3.2	2.9	2.4
Lower funds rate	3.2	3.3	3.4

1. Average for the fourth quarter.

<u>Alternative simulations</u>. The two alternative scenarios that we have formulated this month depict the implications of changed assumptions regarding the federal funds rate. One scenario has increases in the funds rate starting immediately and cumulating to 100 basis points by the third quarter of 1997, after which the nominal funds rate is held steady. The higher rate holds growth of real GDP below its potential rate in 1997 and 1998; the unemployment

rate at the end of 1998 is 0.5 percentage point higher than in the baseline. Increases in consumer prices slow substantially: A 1998 rise of 2.4 percent is 0.5 percentage point less than in the baseline. The alternative scenario with lower interest rates has symmetric effects: GDP growth exceeds potential, unemployment at the end of 1998 is 0.5 percentage point lower than in the baseline, and inflation in 1998 is 0.5 percentage point higher.

Strictly Confidential <FR>
Class II FOMC

September 18, 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]	
		08/15/96	09/18/96	08/15/96	09/18/96	08/15/96	09/18/96	08/15/96	09/18/96	08/15/96	09/18/96
ANNUAL											
1994		5.8	5.8	3.5	3.5	2.3	2.3	2.6	2.6	6.1	6.1
1995		4.6	4.6	2.0	2.0	2.5	2.5	2.8	2.8	5.6	5.6
1996		4.3	4.4	2.2	2.4	2.3	2.2	3.0	3.0	5.5	5.4
1997		4.8	4.7	2.2	2.3	2.8	2.6	3.2	3.1	5.4	5.4
1998			4.6		2.1		2.7		2.9		5.4
QUARTERLY											
1995	Q1	3.8	3.8	0.4	0.4	3.3	3.3	2.7	2.7	5.5	5.5
	Q2	3.1	3.1	0.7	0.7	2.4	2.4	3.5	3.5	5.7	5.7
	Q3	6.0	6.0	3.8	3.8	2.1	2.1	2.1	2.1	5.6	5.6
	Q4	2.3	2.3	0.3	0.3	2.1	2.1	2.4	2.4	5.5	5.5
1996	Q1	4.2	4.2	2.0	2.0	2.3	2.3	3.2	3.2	5.6	5.6
	Q2	5.6	6.6	3.7	4.7	2.2	2.2	3.9	3.9	5.4	5.4
	Q3	4.5	4.2	2.6	2.4	2.3	2.1	2.7	2.4	5.4	5.3
	Q4	4.8	4.5	2.0	2.2	3.0	2.6	3.1	3.5	5.4	5.4
1997	Q1	4.8	5.0	2.0	2.1	3.0	3.0	3.3	3.4	5.4	5.4
	Q2	4.7	4.6	2.1	2.1	2.8	2.7	3.5	2.9	5.4	5.4
	Q3	4.8	4.6	2.2	2.2	2.8	2.6	3.2	2.8	5.4	5.4
	Q4	4.8	4.6	2.2	2.2	2.8	2.7	3.2	3.1	5.4	5.4
1998	Q1		4.7		2.1		2.9		2.9		5.4
	Q2		4.6		2.1		2.7		2.9		5.4
	Q3		4.5		2.1		2.8		2.9		5.4
	Q4		4.6		2.1		2.8		2.9		5.4
TWO-QUARTER[3]											
1995	Q2	3.5	3.5	0.6	0.6	2.9	2.9	3.2	3.2	0.1	0.1
	Q4	4.1	4.1	2.0	2.0	2.1	2.1	2.2	2.2	-0.2	-0.2
1996	Q2	4.9	5.4	2.8	3.3	2.3	2.3	3.5	3.5	-0.1	-0.1
	Q4	4.6	4.3	2.3	2.3	2.7	2.4	2.9	3.0	0.0	-0.0
1997	Q2	4.8	4.8	2.1	2.1	2.9	2.8	3.4	3.2	-0.0	-0.0
	Q4	4.8	4.6	2.2	2.2	2.8	2.6	3.2	3.0	-0.0	-0.0
1998	Q2		4.6		2.1		2.8		2.9		0.0
	Q4		4.5		2.1		2.8		2.9		-0.0
FOUR-QUARTER[4]											
1994	Q4	5.9	5.9	3.5	3.5	2.3	2.3	2.6	2.6	-1.0	-1.0
1995	Q4	3.8	3.8	1.3	1.3	2.5	2.5	2.7	2.7	-0.1	-0.1
1996	Q4	4.8	4.9	2.6	2.8	2.5	2.3	3.2	3.2	-0.1	-0.1
1997	Q4	4.8	4.7	2.1	2.1	2.9	2.7	3.3	3.1	0.0	-0.0
1998	Q4		4.6		2.1		2.8		2.9		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)

September 18, 1996

Item	Units[1]	1990	1991	1992	1993	1994	1995	- - - Projected - - - 1996	1997	1998
EXPENDITURES										
Nominal GDP	Bill. $	5743.8	5916.7	6244.4	6553.0	6935.7	7253.8	7575.9	7935.7	8301.8
Real GDP	Bill. Ch. $	6138.7	6079.0	6244.4	6386.4	6608.7	6742.9	6903.3	7064.1	7214.8
Real GDP	% change	-0.2	0.4	3.7	2.2	3.5	1.3	2.8	2.1	2.1
Gross domestic purchases		-0.8	-0.0	4.0	2.9	3.8	1.0	3.4	2.3	2.3
Final sales		0.6	-0.4	3.9	2.0	2.9	1.9	2.7	2.1	2.2
Priv. dom. final purchases		-0.6	-0.8	4.9	3.5	4.0	2.3	3.6	2.7	2.8
Personal cons. expenditures		0.5	-0.2	4.2	2.5	3.1	1.9	2.9	2.7	2.4
Durables		-3.2	-3.1	9.4	7.3	7.0	1.3	6.9	4.5	3.5
Nondurables		-0.5	-1.0	3.4	1.5	3.5	1.1	2.4	2.4	2.2
Services		2.0	0.9	3.6	2.1	2.0	2.4	2.4	2.4	2.2
Business fixed investment		-2.5	-6.0	5.5	8.5	10.1	6.4	7.6	5.1	5.6
Producers' dur. equipment		-2.0	-2.6	9.6	11.5	12.6	6.9	9.9	6.6	7.2
Nonres. structures		-3.5	-12.5	-3.4	1.6	3.6	5.1	1.3	0.7	0.6
Residential structures		-15.1	1.1	16.9	8.1	5.7	-1.5	4.1	-2.2	1.0
Exports		7.2	8.6	4.1	4.8	9.9	7.4	4.6	7.2	7.9
Imports		0.5	4.1	7.4	10.5	11.8	4.2	8.8	7.9	8.6
Gov't. cons. & investment		2.6	-0.7	1.7	-0.5	0.0	-1.3	1.5	0.3	0.7
Federal		1.6	-3.1	1.3	-5.4	-3.1	-6.7	0.6	-3.5	-2.7
Defense		0.3	-5.3	-1.3	-6.8	-5.7	-6.8	-0.9	-4.7	-3.2
State & local		3.3	1.0	2.0	3.1	2.2	2.1	2.1	2.5	2.5
Change in bus. inventories	Bill. Ch. $	10.4	-3.0	7.3	19.1	58.9	33.1	14.5	27.4	25.0
Nonfarm		7.8	-1.2	1.9	26.4	46.8	37.2	17.6	24.9	21.8
Net exports		-61.9	-22.3	-29.5	-72.0	-105.7	-107.6	-116.8	-134.7	-153.4
Nominal GDP	% change	4.4	3.8	6.3	4.8	5.9	3.8	4.9	4.7	4.6
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employment	Millions	109.4	108.3	108.6	110.7	114.2	117.2	119.6	121.3	122.8
Unemployment rate	%	5.6	6.9	7.5	6.9	6.1	5.6	5.4	5.4	5.4
Industrial prod. index	% change	-0.2	0.2	4.0	3.2	6.6	1.6	4.3	3.3	3.4
Capacity util. rate - mfg.	%	81.3	78.0	79.5	80.6	83.3	83.0	82.0	82.1	82.3
Housing starts	Millions	1.19	1.01	1.20	1.29	1.46	1.35	1.45	1.37	1.37
Light motor vehicle sales		14.05	12.52	12.85	13.87	15.02	14.74	15.07	14.91	14.80
North Amer. produced		10.85	9.74	10.51	11.72	12.88	12.82	13.37	13.14	13.07
Other		3.20	2.77	2.34	2.15	2.13	1.91	1.70	1.77	1.73
INCOME AND SAVING										
Nominal GNP	Bill. $	5764.9	5932.4	6255.5	6563.5	6931.9	7246.7	7567.3	7917.3	8276.3
Nominal GNP	% change	4.6	3.5	6.2	4.7	5.7	3.9	4.8	4.6	4.5
Nominal personal income		6.4	3.7	7.3	3.6	5.2	5.6	5.3	4.8	4.7
Real disposable income		1.0	0.8	4.0	0.9	2.7	3.1	2.4	2.6	2.1
Personal saving rate	%	5.0	5.7	5.9	4.5	3.8	4.7	4.7	4.8	4.7
Corp. profits, IVA & CCAdj.	% change	6.2	3.9	12.7	19.9	11.3	7.2	4.9	3.3	3.3
Profit share of GNP	%	6.4	6.4	6.4	7.1	7.6	8.1	8.5	8.3	8.2
(excluding FR banks)	%	6.0	6.1	6.1	6.8	7.4	7.8	8.2	8.0	7.9
Federal surpl./deficit	Bill. $	-154.7	-196.0	-280.9	-255.6	-190.2	-161.7	-135.0	-124.6	-114.2
State & local surpl./def.		80.1	75.8	86.3	94.9	99.7	95.0	93.0	85.7	79.9
Ex. social ins. funds		20.2	11.5	18.3	28.0	36.9	36.8	36.7	30.4	25.4
PRICES AND COSTS										
GDP implicit deflator	% change	4.6	3.4	2.6	2.5	2.3	2.5	2.0	2.5	2.4
GDP chn.-wt. price index		4.7	3.3	2.6	2.5	2.3	2.5	2.3	2.7	2.8
Gross Domestic Purchases chn.-wt. price index		5.2	2.7	2.7	2.3	2.4	2.3	2.3	2.5	2.6
CPI		6.3	3.0	3.1	2.7	2.6	2.7	3.2	3.1	2.9
Ex. food and energy		5.3	4.4	3.5	3.1	2.8	3.0	2.7	3.1	3.1
ECI, hourly compensation[2]		4.6	4.4	3.5	3.6	3.1	2.6	3.3	3.6	3.8
Nonfarm business sector										
Output per hour		-0.6	2.2	3.6	-0.3	0.5	0.3	0.9	0.9	1.0
Compensation per Hour		5.9	4.7	4.6	1.8	2.5	4.1	3.8	3.9	3.8
Unit labor cost		6.5	2.5	1.0	2.1	2.0	3.8	3.0	2.9	2.7

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)

September 18, 1996

Item	Units	1994 Q1	1994 Q2	1994 Q3	1994 Q4	1995 Q1	1995 Q2	1995 Q3	1995 Q4	1996 Q1	1996 Q2
EXPENDITURES											
Nominal GDP	Bill. $	6776.0	6890.5	6993.1	7083.2	7149.8	7204.9	7309.8	7350.6	7426.8	7545.6
Real GDP	Bill. Ch. $	6508.5	6587.6	6644.9	6693.9	6701.0	6713.5	6776.4	6780.7	6814.3	6892.7
Real GDP	% change	2.5	4.9	3.5	3.0	0.4	0.7	3.8	0.3	2.0	4.7
Gross domestic purchases		3.5	5.3	3.7	2.5	1.4	0.7	2.6	-0.7	3.0	5.2
Final sales		1.2	3.0	4.2	3.5	0.6	2.1	3.6	1.4	3.0	4.2
Priv. dom. final purchases		3.9	4.4	3.8	4.0	2.3	2.3	3.0	1.4	4.7	4.0
Personal cons. expenditures		2.8	3.5	2.8	3.1	1.0	3.1	2.4	1.1	3.5	3.3
Durables		5.8	4.3	5.6	12.4	-8.9	7.0	9.3	-1.0	8.2	11.5
Nondurables		3.9	3.2	3.8	3.2	2.4	1.8	0.5	-0.4	3.7	1.4
Services		1.6	3.5	1.6	1.2	2.4	3.0	2.0	2.3	2.4	2.5
Business fixed investment		7.3	7.1	13.8	12.2	15.4	3.5	4.9	2.5	11.6	4.0
Producers' dur. equipment		15.5	4.1	19.4	11.9	17.4	3.5	4.3	3.0	13.1	6.2
Nonres. structures		-11.8	15.7	0.2	13.0	9.9	3.4	6.3	1.0	7.7	-1.8
Residential structures		12.8	12.7	-1.8	-0.1	-6.3	-13.4	9.2	6.4	7.4	16.5
Exports		-1.5	15.9	9.7	16.5	2.6	5.9	10.7	10.7	1.8	5.8
Imports		8.2	18.4	10.7	10.3	11.2	4.5	-0.0	1.6	10.6	10.0
Gov't. cons. & investment		-4.3	-0.8	7.0	-1.4	-1.2	0.8	-0.6	-4.3	1.6	8.2
Federal		-11.4	-5.3	11.5	-5.9	-6.5	-1.4	-5.6	-13.2	6.0	10.7
Defense		-17.4	0.7	13.5	-16.1	-7.4	0.6	-7.6	-12.3	4.1	11.6
State & local		0.7	2.2	4.2	1.6	2.3	2.1	2.7	1.5	-0.9	6.7
Change in bus. inventories	Bill. Ch. $	40.5	74.5	64.5	56.1	54.5	30.5	33.0	14.6	-3.0	6.0
Nonfarm		29.7	54.0	50.5	53.0	57.4	33.7	38.6	19.0	2.9	10.6
Net exports		-99.3	-107.3	-111.7	-104.3	-122.5	-121.4	-101.6	-84.9	-104.0	-114.4
Nominal GDP	% change	5.3	6.9	6.1	5.3	3.8	3.1	6.0	2.3	4.2	6.6
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	112.6	113.7	114.7	115.6	116.5	117.0	117.4	117.9	118.5	119.3
Unemployment rate	%	6.6	6.2	6.0	5.6	5.5	5.7	5.6	5.5	5.6	5.4
Industrial prod. index	% change	8.4	7.0	4.6	6.4	3.9	-1.4	3.2	0.6	3.0	6.5
Capacity util. rate - mfg.	%	82.2	83.2	83.4	84.3	84.3	83.0	82.6	82.0	81.6	82.2
Housing starts	Millions	1.38	1.47	1.46	1.48	1.31	1.29	1.42	1.41	1.47	1.49
Light motor vehicle sales		15.07	14.85	14.99	15.16	14.56	14.44	15.04	14.92	15.18	15.13
North Amer. produced		12.94	12.69	12.79	13.12	12.52	12.46	13.18	13.13	13.49	13.41
Other		2.13	2.16	2.20	2.05	2.04	1.97	1.86	1.79	1.69	1.72
INCOME AND SAVING											
Nominal GNP	Bill. $	6781.0	6888.3	6987.0	7071.4	7146.8	7202.4	7293.4	7344.3	7426.6	7537.9
Nominal GNP	% change	5.4	6.5	5.9	4.9	4.3	3.1	5.1	2.8	4.6	6.1
Nominal personal income		-3.4	13.3	4.9	6.7	7.1	4.7	4.9	5.8	4.8	6.7
Real disposable income		-5.4	9.7	2.9	4.2	3.7	0.3	4.3	4.4	2.0	1.5
Personal saving rate	%	2.7	4.0	4.1	4.3	4.9	4.1	4.5	5.2	4.8	4.4
Corp. profits, IVA & CCAdj.	% change	-35.4	82.5	14.8	13.5	-7.4	1.7	40.8	-0.5	23.6	4.4
Profit share of GNP	%	6.8	7.8	7.9	8.1	7.8	7.8	8.4	8.3	8.7	8.7
(excluding FR banks)	%	6.5	7.5	7.7	7.8	7.5	7.5	8.1	8.0	8.4	8.4
Federal surpl./deficit	Bill. $	-212.7	-169.6	-188.5	-190.1	-172.6	-161.1	-158.5	-154.5	-155.2	-130.9
State & local surpl./def.		94.8	105.2	99.6	99.3	99.0	99.0	93.9	88.1	91.0	100.5
Ex. social ins. funds		29.0	41.1	37.9	39.4	40.2	40.9	35.8	30.5	34.1	44.1
PRICES AND COSTS											
GDP implicit deflator	% change	2.8	1.9	2.5	2.2	3.4	2.4	2.1	2.0	2.2	1.7
GDP chn.-wt. price index		2.9	1.9	2.4	2.1	3.3	2.4	2.1	2.1	2.3	2.2
Gross Domestic Purchases chn.-wt. price index		2.4	2.3	3.0	2.0	2.8	2.8	1.6	1.9	2.3	2.1
CPI		1.9	2.8	3.6	2.4	2.7	3.5	2.1	2.4	3.2	3.9
Ex. food and energy		2.9	2.9	3.1	2.3	3.3	3.3	2.8	2.7	2.7	2.7
ECI, hourly compensation[1]		3.0	3.4	3.3	2.3	2.9	2.9	2.6	2.6	2.9	3.2
Nonfarm business sector											
Output per hour		-2.0	1.0	2.0	0.9	-1.6	2.0	2.0	-1.1	1.8	0.6
Compensation per hour		2.8	1.4	2.1	3.9	3.7	4.6	4.0	4.1	3.3	3.7
Unit labor cost		4.8	0.3	0.1	2.9	5.4	2.6	1.9	5.2	1.5	3.1

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)

September 18, 1996

Item	Units	1996 Q3	1996 Q4	1997 Q1	1997 Q2	1997 Q3	1997 Q4	1998 Q1	1998 Q2	1998 Q3	1998 Q4
		Projected									
EXPENDITURES											
Nominal GDP	Bill. $	7623.2	7708.0	7802.0	7890.9	7979.4	8070.4	8163.9	8255.5	8346.9	8441.0
Real GDP	Bill. Ch. $	6934.0	6972.2	7008.5	7044.5	7082.3	7120.9	7158.3	7195.7	7233.4	7271.8
Real GDP	% change	2.4	2.2	2.1	2.1	2.2	2.2	2.1	2.1	2.1	2.1
Gross domestic purchases		2.8	2.4	2.0	2.3	2.8	2.2	2.2	2.3	2.7	2.1
Final sales		1.0	2.5	2.1	2.1	1.9	2.5	2.2	2.2	1.8	2.5
Priv. dom. final purchases		2.4	3.4	2.7	2.7	2.8	2.8	2.7	2.7	2.8	2.8
Personal cons. expenditures		1.7	3.3	2.8	2.7	2.6	2.5	2.4	2.4	2.4	2.4
Durables		2.3	5.7	5.3	4.6	4.3	3.9	3.5	3.5	3.4	3.5
Nondurables		0.9	3.8	2.4	2.4	2.4	2.3	2.2	2.2	2.2	2.2
Services		1.9	2.6	2.5	2.4	2.3	2.3	2.2	2.2	2.2	2.2
Business fixed investment		8.3	6.7	4.8	5.0	5.3	5.2	5.5	5.4	5.8	5.7
Producers' dur. equipment		11.6	9.1	6.3	6.5	6.8	6.6	7.1	7.0	7.4	7.4
Nonres. structures		-0.3	-0.1	0.5	0.5	0.8	0.9	0.6	0.6	0.6	0.6
Residential structures		-1.4	-4.7	-5.4	-3.8	-0.2	0.9	1.1	1.1	1.0	1.0
Exports		1.3	9.8	5.7	9.5	3.6	10.3	6.2	10.2	4.5	11.0
Imports		4.8	10.0	4.8	10.1	7.9	8.9	6.6	10.4	8.2	9.4
Gov't. cons. & investment		-2.6	-0.7	-0.8	0.4	0.8	0.8	0.5	0.7	0.7	0.7
Federal		-7.6	-5.6	-6.1	-3.2	-2.2	-2.4	-3.2	-2.5	-2.5	-2.5
Defense		-10.1	-7.7	-8.6	-4.2	-2.8	-3.1	-3.2	-3.2	-3.3	-3.2
State & local		0.5	2.3	2.4	2.5	2.5	2.6	2.5	2.5	2.4	2.4
Change in bus. inventories	Bill. Ch. $	29.9	25.3	25.8	26.1	31.2	26.5	25.1	23.5	28.5	23.0
Nonfarm		32.4	24.6	23.8	24.1	28.7	23.0	21.6	20.0	25.5	20.0
Net exports		-122.8	-126.0	-125.7	-130.0	-141.4	-141.6	-144.7	-148.7	-159.9	-160.1
Nominal GDP	% change	4.2	4.5	5.0	4.6	4.6	4.6	4.7	4.6	4.5	4.6
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	120.0	120.5	120.8	121.1	121.5	121.9	122.3	122.6	123.0	123.4
Unemployment rate	%	5.3	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.4
Industrial prod. index	% change	4.9	2.9	3.3	3.1	3.2	3.3	3.4	3.3	3.3	3.4
Capacity util. rate - mfg.	%	82.4	82.0	82.1	82.1	82.1	82.2	82.2	82.3	82.4	82.4
Housing starts	Millions	1.43	1.40	1.38	1.37	1.37	1.37	1.37	1.37	1.37	1.37
Light motor vehicle sales		14.99	14.98	14.90	14.88	14.92	14.93	14.88	14.82	14.77	14.72
North Amer. produced		13.34	13.25	13.14	13.11	13.14	13.15	13.12	13.08	13.05	13.02
Other		1.66	1.73	1.76	1.77	1.78	1.78	1.76	1.74	1.72	1.70
INCOME AND SAVING											
Nominal GNP	Bill. $	7610.0	7694.9	7786.9	7873.2	7959.7	8049.4	8141.2	8231.1	8321.2	8411.8
Nominal GNP	% change	3.9	4.5	4.9	4.5	4.5	4.6	4.6	4.5	4.4	4.4
Nominal personal income		5.0	4.7	5.2	4.7	4.6	4.7	5.1	4.8	4.6	4.5
Real disposable income		4.3	1.7	3.9	2.2	2.3	2.0	3.0	2.0	1.7	1.8
Personal saving rate	%	5.0	4.7	5.0	4.9	4.8	4.7	4.8	4.7	4.6	4.5
Corp. profits, IVA & CCAdj.	% change	-5.2	-0.9	3.8	3.9	2.9	2.6	4.3	3.8	3.3	1.7
Profit share of GNP	%	8.5	8.3	8.3	8.3	8.3	8.2	8.2	8.2	8.2	8.1
(excluding FR banks)	%	8.2	8.1	8.0	8.0	8.0	8.0	8.0	8.0	7.9	7.9
Federal surpl./deficit	Bill. $	-132.9	-120.9	-131.7	-126.5	-119.2	-121.1	-120.7	-116.9	-108.8	-110.5
State & local surpl./def.		90.8	89.6	88.7	87.3	84.1	82.6	81.3	80.4	79.1	78.8
Ex. social ins. funds		34.7	33.8	33.1	31.9	28.9	27.6	26.5	25.8	24.7	24.6
PRICES AND COSTS											
GDP implicit deflator	% change	1.7	2.3	2.8	2.5	2.3	2.4	2.5	2.4	2.3	2.4
GDP chn.-wt. price index		2.1	2.6	3.0	2.7	2.6	2.7	2.9	2.7	2.8	2.8
Gross Domestic Purchases chn.-wt. price index		2.1	2.6	2.8	2.3	2.3	2.5	2.7	2.6	2.6	2.6
CPI		2.4	3.5	3.4	2.9	2.8	3.1	2.9	2.9	2.9	2.9
Ex. food and energy		2.6	2.8	2.9	3.0	3.1	3.2	3.0	3.0	3.1	3.2
ECI, hourly compensation[1]		3.3	3.9	3.5	3.4	3.9	3.6	3.7	3.8	3.8	3.8
Nonfarm business sector											
Output per hour		0.9	0.5	0.9	0.9	0.9	1.0	1.0	1.0	1.1	1.1
Compensation per hour		3.8	4.3	3.9	3.7	3.8	4.0	3.7	3.8	3.8	3.8
Unit labor cost		2.8	3.8	3.0	2.7	2.8	3.0	2.7	2.7	2.7	2.7

1. Private-industry workers.

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Class II FOMC

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

September 18, 1996

Item	1996 Q4	1997 Q1	1997 Q2	1997 Q3	1997 Q4	1998 Q1	1998 Q2	1998 Q3	1998 Q4	96Q4/ 95Q4	97Q4/ 96Q4	98Q4/ 97Q4
Real GDP	2.2	2.1	2.1	2.2	2.2	2.1	2.1	2.1	2.1	2.8	2.1	2.1
Gross dom. purchases	2.4	2.1	2.3	2.8	2.2	2.3	2.3	2.7	2.1	3.4	2.4	2.4
Final sales	2.5	2.1	2.1	1.9	2.5	2.2	2.2	1.8	2.5	2.7	2.1	2.2
Priv. dom. final purchases	2.8	2.2	2.2	2.4	2.3	2.3	2.3	2.3	2.3	3.0	2.3	2.3
Personal cons. expenditures	2.2	1.9	1.8	1.8	1.7	1.6	1.6	1.6	1.6	2.0	1.8	1.6
Durables	0.5	0.5	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.6	0.4	0.3
Nondurables	0.8	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Services	1.0	0.9	0.9	0.9	0.9	0.8	0.8	0.8	0.8	0.9	0.9	0.8
Business fixed investment	0.7	0.5	0.6	0.6	0.6	0.6	0.6	0.7	0.7	0.8	0.6	0.6
Producers' dur. equip.	0.7	0.5	0.5	0.6	0.6	0.6	0.6	0.7	0.7	0.8	0.6	0.6
Nonres. structures	-0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Residential structures	-0.2	-0.2	-0.1	-0.0	0.0	0.0	0.0	0.0	0.0	0.2	-0.1	0.0
Net exports	-0.2	0.0	-0.2	-0.6	-0.0	-0.2	-0.2	-0.6	-0.0	-0.6	-0.2	-0.3
Exports	1.1	0.7	1.1	0.4	1.2	0.8	1.3	0.6	1.4	0.5	0.9	1.0
Imports	1.3	0.7	1.4	1.1	1.3	0.9	1.5	1.2	1.4	1.2	1.1	1.3
Government cons. & invest.	-0.1	-0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.1	0.1
Federal	-0.4	-0.4	-0.2	-0.1	-0.2	-0.2	-0.2	-0.2	-0.1	0.0	-0.2	-0.2
Defense	-0.4	-0.4	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.0	-0.2	-0.1
Nondefense	-0.0	-0.0	-0.0	-0.0	-0.0	-0.1	-0.0	-0.0	-0.0	0.1	-0.0	-0.0
State and local	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.3	0.3
Change in bus. inventories	-0.3	0.0	0.0	0.3	-0.3	-0.1	-0.1	0.3	-0.3	0.2	0.0	-0.1
Nonfarm	-0.5	-0.0	0.0	0.3	-0.3	-0.1	-0.1	0.3	-0.3	0.1	-0.0	-0.0
Farm	0.2	0.1	0.0	0.0	0.1	0.0	0.0	-0.0	0.0	0.1	0.0	-0.0
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.

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

Item	Fiscal year[5]				1996				1997				1998			
	1995[a]	1996	1997	1998	Q1[a]	Q2[a]	Q3[a]	Q4[a]	Q1[a]							
UNIFIED BUDGET					Not seasonally adjusted											
Receipts[1]	1355	1452	1505	1564	321	445	362	350	326	454	374	365	340	470	389	386
Outlays[1]	1519	1567	1638	1702	394	392	402	411	409	407	410	428	421	428	426	447
Surplus/deficit[1]	-164	-115	-133	-138	-72	53	-40	-61	-83	47	-37	-63	-80	42	-37	-62
On-budget	-226	-181	-201	-211	-84	14	-42	-69	-96	6	-43	-72	-93	-2	-44	-74
Off-budget	62	66	68	73	12	39	1	8	13	41	6	9	13	44	7	12
Surplus excluding deposit insurance[2]	-182	-124	-137	-142	-75	51	-41	-62	-84	46	-38	-64	-81	41	-38	-63
Means of financing																
Borrowing	171	124	144	148	80	-23	34	61	68	-24	39	58	68	-19	40	49
Cash decrease	-2	4	-6	0	-1	-16	4	-6	19	-15	-5	0	20	-15	-5	0
Other[3]	-6	-13	-4	-9	-7	-14	2	6	-5	-8	2	5	-8	-8	2	13
Cash operating balance, end of period	38	34	40	40	22	38	34	39	20	35	40	40	20	35	40	40
NIPA FEDERAL SECTOR					Seasonally adjusted, annual rate											
Receipts	1459	1542	1615	1691	1523	1573	1576	1599	1602	1620	1641	1662	1680	1699	1721	1742
Expenditures	1629	1685	1740	1808	1678	1704	1709	1719	1734	1746	1760	1783	1801	1816	1830	1853
Consumption expend.	455	458	455	457	454	465	464	455	456	455	455	455	458	458	457	457
Defense	304	304	298	298	299	308	308	299	298	297	297	297	299	299	298	298
Nondefense	151	155	158	159	155	156	156	156	158	158	158	158	159	159	159	159
Other expenditures	1175	1227	1285	1351	1225	1239	1245	1264	1278	1292	1305	1328	1343	1359	1373	1395
Current account surplus	-171	-143	-125	-117	-155	-131	-133	-121	-132	-126	-119	-121	-121	-117	-109	-110
Gross investment	65	62	63	62	65	66	59	64	62	62	62	62	62	62	61	61
Current and capital account surplus	-236	-205	-187	-178	-220	-197	-192	-185	-194	-189	-181	-183	-182	-178	-170	-172
FISCAL INDICATORS[4]																
High-employment (HEB) surplus/deficit	-268	-243	-242	-243	-246	-238	-239	-236	-248	-244	-240	-245	-244	-242	-237	-241
Change in HEB, percent of potential GDP	0	-.4	0	0	.1	-.1	0	0	.2	0	-.1	.1	0	0	-.1	.1
Fiscal impetus (FI), percent, cal. year	-5.6	-2.3	-4.5	-3.4	1.3	2.1	-1.5	-1.9	-1.7	-.8	-.6	-1.6	-.8	-.6	-.6	-.8

1. OMB's July 1996 baseline deficit estimates (assuming the enactment of the President's proposals) are $117 billion in FY96, $126 billion in FY97, and $94 billion in FY98. CBO'S August 1996 baseline deficit estimate is $116 billion in FY96. CBO did not reestimate FY97 and FY98 in August; its April 1996 baseline deficit estimates are $144 billion in FY96, $171 billion in FY97, and $194 billion in FY98. 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, $134 billion in FY97 and $96 billion in FY98. CBO'S August 1996 baseline deficit estimate, excluding deposit insurance, is $126 billion in FY96. CBO did not reestimate FY97 and FY98 in August; its April 1996 baseline deficit estimates, excluding deposit insurance, are $154 billion in FY96, $176 billion in FY97 and $196 billion in FY98.

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.

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

			Nonfederal						Memo:
				Households					
	Total	Federal government	Total	Total	Home mortgages	Consumer credit	Business	State and local governments	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	6.3	5.4	7.7	1.5	5.7	4.8
1994	4.9	4.7	5.0	8.6	6.5	14.6	3.7	-3.7	5.9
1995	5.5	4.1	6.0	8.2	6.2	14.3	6.2	-4.1	3.8
1996	5.0	4.5	5.3	7.2	7.1	8.5	4.6	-1.4	4.9
1997	4.6	3.7	5.0	6.0	5.9	7.3	5.1	-1.1	4.7
1998	4.6	3.5	5.0	5.8	5.8	6.8	5.0	0.5	4.6
Quarter (seasonally adjusted annual rates)									
1995:1	6.4	7.1	6.2	7.9	6.0	13.8	7.3	-4.9	3.8
2	6.5	5.2	7.0	8.5	6.4	15.1	7.3	-0.8	3.1
3	4.3	2.4	5.0	8.6	6.8	14.8	4.6	-9.4	6.0
4	4.3	1.6	5.3	6.9	4.9	10.7	5.1	-1.5	2.3
1996:1	6.3	7.9	6.1	8.7	8.8	11.5	5.0	-1.2	4.2
2	4.9	1.7	6.0	7.6	7.2	7.0	4.7	3.5	6.7
3	3.7	3.8	3.6	6.0	5.9	7.2	3.8	-8.4	4.1
4	4.7	4.4	4.8	5.8	5.7	7.4	4.6	0.6	4.5
1997:1	4.8	4.6	4.8	6.0	6.0	7.3	5.2	-2.9	5.0
2	4.3	2.5	4.9	5.9	5.8	7.2	5.1	-1.7	4.6
3	4.5	3.9	4.7	5.8	5.8	7.1	4.9	-2.8	4.6
4	4.8	3.8	5.2	5.8	5.7	6.9	4.9	2.9	4.6

1. Data after 1996:Q2 are staff projections. Changes are measured from end of the preceding period to end of period indicated except for annual nominal GDP growth, which is calculated from Q4 to Q4.
On a monthly average basis, total debt grows 4.9 percent in 1996, 4.6 percent in 1997, and 4.7 percent in 1998.
Federal debt rises 3.6 percent in 1996, 3.8 percent in 1997, and 3.7 percent in 1998.
Nonfederal debt increases 5.3 percent in 1996, 4.9 percent in 1997, and 5.0 percent in 1998.

2.6.3 FOF

Confidential FR Class II
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FLOW OF FUNDS PROJECTIONS: HIGHLIGHTS [1]
(Billions of dollars)

	Calendar year						1996				1997	
	1993	1994	1995	1996	1997	1998	Q1	Q2	Q3	Q4	H1	H2
Net funds raised by domestic nonfinancial sectors												
1 Total	649.8	575.5	648.0	616.3	600.5	625.0	763.0	672.6	421.5	608.1	586.2	614.8
2 Net equity issuance	21.3	-44.9	-74.2	-74.3	-77.2	-75.3	-106.8	-16.8	-102.8	-70.8	-74.6	-79.8
3 Net debt issuance	628.5	620.4	722.3	690.6	677.7	700.3	869.8	689.4	524.3	678.9	660.8	694.6
Borrowing sectors												
Nonfinancial business												
4 Financing gap [2]	3.8	3.8	57.7	20.5	42.3	55.6	2.5	1.5	41.9	36.0	37.7	47.0
5 Net equity issuance	21.3	-44.9	-74.2	-74.3	-77.2	-75.3	-106.8	-16.8	-102.8	-70.8	-74.6	-79.8
6 Credit market borrowing	55.5	139.3	242.9	191.2	223.1	227.6	206.6	199.1	160.8	198.1	225.0	221.2
Households												
7 Net borrowing, of which:	254.6	368.7	380.6	363.0	324.8	328.7	435.9	391.0	314.5	310.6	325.1	324.6
8 Home mortgages	152.1	194.5	195.9	237.9	213.7	220.2	296.3	247.5	205.2	202.5	213.2	214.2
9 Consumer credit	61.5	126.3	141.6	96.3	90.0	90.0	129.7	81.1	84.7	89.7	90.0	90.0
10 Debt/DPI (percent) [3]	86.6	88.9	90.9	93.3	94.5	95.5	92.7	93.5	93.7	94.1	94.2	94.8
State and local governments												
11 Net borrowing	62.3	-43.4	-45.7	-15.0	-11.8	5.5	-12.5	36.8	-90.6	6.2	-24.0	0.4
12 Current surplus [4]	109.9	107.4	106.8	107.6	106.6	104.2	99.0	116.9	107.2	107.2	107.6	105.6
Federal government												
13 Net borrowing	256.1	155.9	144.4	163.7	141.6	138.4	288.7	62.4	139.6	163.9	134.7	148.4
14 Net borrowing (quarterly, n.s.a.)	256.1	155.9	144.4	163.7	141.6	138.4	80.5	-23.5	33.9	60.5	44.0	97.5
15 Unified deficit (quarterly, n.s.a.)	226.3	185.0	146.4	120.1	135.5	137.3	72.3	-53.2	40.1	60.9	35.9	99.6
16 Funds supplied by depository institutions	140.4	198.3	274.6	163.4	211.4	216.9	123.9	229.5	126.7	173.7	206.3	216.5
Memo: (percent of GDP)												
17 Domestic nonfinancial debt [3]	186.4	185.3	186.5	187.8	188.0	188.0	188.4	188.0	188.1	188.0	187.9	187.9
18 Domestic nonfinancial borrowing	9.6	8.9	10.0	9.1	8.5	8.4	11.7	9.1	6.9	8.8	8.4	8.7
19 Federal government [5]	3.9	2.2	2.0	2.2	1.8	1.7	3.9	0.8	1.8	2.1	1.7	1.8
20 Nonfederal	5.7	6.7	8.0	7.1	6.8	6.8	8.5	8.3	5.0	6.7	6.7	6.8

1. Data after 1996:Q2 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 changes in retirement fund assets plus consumption of fixed capital.
5. Excludes government-insured mortgage pool securities.

2.6.4 FOF

Recent Developments

The weighted-average foreign exchange value of the dollar in terms of the other G-10 currencies has appreciated, on balance, about 1/2 percent since the August FOMC meeting. The dollar has appreciated about 3/4 percent in terms of the yen over the period. Early in the period, the somewhat disappointing August Tankan survey led market participants to revise down the likelihood of a near-term increase in Bank of Japan rates; data showing a decline in activity in the second quarter and the increased probability of an election in October supported the change in expectations. The rise in oil prices also weighed on the yen. The yen recovered somewhat on release of data that showed a jump in the U.S. trade deficit for July.

Against the mark, the dollar has risen about 1-1/4 percent since the August FOMC meeting. The Bundesbank surprised markets by lowering its repo rate 30 basis points, to 3.00 percent, on August 22, and subsequent statements by officials have left open the possibility of additional easing if growth of M3 continues to slow. The dollar has declined slightly in terms of sterling and the Canadian dollar as recent indicators have suggested some strengthening of economic activity in the United Kingdom and Canada.

Long-term market interest rates abroad rose slightly early in the period but have since declined, for an average net decrease of about 15 basis points over the intermeeting period. Rates in Canada are an exception and have increased slightly. After a sharp rise early in the period, the yield on U.S. ten-year securities moved back down to show a net increase of about 25 basis points over the period. Short-term market rates abroad have moved down about 25 basis points on average since the August FOMC meeting. Rates decreased most in continental Europe, in line with reductions in official rates in some of these countries.

Since the August FOMC meeting, the dollar has changed little in terms of the Mexican peso as 28-day peso interest rates have been about flat.

. The Desk did not intervene during the period.

Economic activity in the major foreign industrial countries has generally strengthened this year relative to the second half of 1995. In Japan, real GDP declined at a seasonally adjusted annual rate of 2.9 percent in the second quarter, but a substantial part of that decline is accounted for by the leap-year day in the first quarter. Industrial production, machinery orders, and housing starts expanded in July. Labor market conditions improved in July as well. German real GDP rebounded sharply in the second quarter as both domestic demand and net exports contributed to growth. Industrial production and orders expanded further in July. However, the unemployment rate has remained flat at 10.3 percent this year through August. In the United Kingdom, although second-quarter GDP growth was sluggish, a sharp slowdown in inventory accumulation was responsible, and final domestic demand was quite robust. The unemployment rate moved down in July and August. In Canada, real GDP growth in the second quarter was low, but employment gains in July and August suggest an acceleration of activity. Recent indicators in both France and Italy point to little, if any, real growth since early this year.

Consumer price inflation in the foreign G-7 countries remains generally low. For August, the twelve-month change in consumer prices was less than 1-1/2 percent in Germany and Canada. Inflation in Italy continues to be higher than in the other G-7 countries, but it dipped below 3-1/2 percent in August. In Japan, consumer prices in August were little changed from their year-earlier level.

The nominal deficit in U.S. international trade in goods and services widened in July. Exports were 3-1/2 percent lower than in June while imports rose 1-1/4 percent. It appears that a portion of the overall decline in exports in July may reflect a residual seasonal in the data. In addition, there was a continuation of the downward trend in semiconductors.

In the second quarter, the deficit in net exports of goods and services was substantially larger than it had been in the first quarter, reflecting a sizable rise in imports. The increase in imports was widespread across major trade categories and reflected the strength in U.S. economic activity. One exception was imports of semiconductors, which dropped significantly for the second quarter in a row. About half of the second-quarter rise in the value of imports was in oil, as inventories were partially rebuilt from historically low levels. The U.S. current account deficit widened in the second quarter. The increase in the trade deficit and a return to deficit on net investment income more than offset lower net unilateral transfers.

Prices of exports declined again in July, primarily because of lower prices for agricultural exports. The decreases in June and July in agricultural prices partially reversed sharp increases in these prices over the preceding year. Prices of non-oil imports also moved down again in July, with declines in all major end-use categories except automotive products. The price of imported oil increased slightly in July, following substantial price declines during the previous two months. Even after declines in May and June, the price of imported oil was 11 percent higher in the second quarter than in the first. Spot WTI rose nearly $0.90 per barrel in July, averaging $21.32 per barrel, and rose another $0.70 per barrel in August. Following the recent political upheaval in northern Iraq, spot WTI has remained volatile, trading in the $22-24 per barrel range; on September 18, it was quoted at $23.35 per barrel. Although Iraq reached an agreement in July with the United Nations to export a limited quantity of oil (estimated to be 800,000 b/d) under U.N. supervision, oil prices have remained firm since then because of uncertainty regarding the timing of these oil flows. On September 1, the U.N. Secretary General announced that the oil sales would be postponed.

Outlook

The staff projects that growth of real output in our major trading partners (weighted by U.S. nonagricultural export shares) will rise, reaching nearly 4 percent in 1997. This outlook is little changed from that in the August Greenbook. The projected path of the dollar is unchanged from August. Our projections for real exports and real imports have been revised down somewhat, largely as a result of changes in our outlook for semiconductors. Net exports are now projected to make a negative contribution of 1/3 percentage point to real GDP growth, annual rate, during the second half of 1996 and about 1/4 percentage point in 1997.

SUMMARY OF STAFF PROJECTIONS
(Percent change from end of previous period)

	1995	1996 H1	1996 H2	1997
Foreign output	1.7	3.1	3.4	3.9
Previous	*1.7*	*3.3*	*3.4*	*3.8*
Real exports	7.4	3.8	5.5	7.2
Previous	*7.4*	*3.6*	*6.6*	*8.5*
Real imports	4.2	10.3	7.4	7.9
Previous	*4.2*	*12.5*	*8.0*	*8.1*

The dollar. Our forecast of the foreign exchange value of the dollar in terms of the other G-10 currencies is unchanged from the flat path in the previous Greenbook. The slight appreciation of the dollar that has taken place since the August FOMC meeting, which reflected, at least in part, market expectations of a near-term tightening by the Federal Reserve, is assumed to unwind when, consistent with the Greenbook assumptions, no such tightening materializes. We expect that the CPI-adjusted value of the dollar in terms of the currencies of key developing countries will depreciate at a moderate rate throughout the forecast period.

Foreign G-7 countries. We project that real GDP in the foreign G-7 countries (weighted by U.S. nonagricultural export shares) will expand at an annual rate of about 2-3/4 percent during the second half of this year and next year and then will decelerate a bit in 1998. Real output growth in Japan is expected to strengthen later this year as consumers spend in anticipation of the planned increase in the consumption tax on April 1, 1997; growth should subsequently slow as the tax takes effect. We expect Japanese net exports to shift from subtracting from output growth to contributing positively during the second half of this year and to continue to do so over the remainder of the forecast period. German real GDP growth is projected to average 2 percent, annual rate, during the second half of 1996 and to increase over the forecast period as investment picks up. In the United Kingdom, we expect that the strength in final domestic demand will hold up over the forecast period whereas inventories will no longer significantly depress growth. In Canada, a positive inventory swing and robust investment should boost output growth sharply during the second half of this year. Over the remainder of the forecast period, investment and net exports sustain moderate growth.

We forecast that average consumer price inflation for the foreign G-7 countries (weighted by bilateral U.S. import shares) will rise to about 1-1/2 percent next year, from 1-1/4 percent this year, as Japanese inflation spikes following the rise in the consumption tax. Inflation abroad is expected to move back to 1-1/4 percent in 1998. Inflation in the other G-7 countries is projected to remain low; our forecast for Italian inflation has been revised down to 3 percent for this year and holds in that vicinity over the forecast period.

We continue to assume that Stage Three of EMU will start as scheduled on January 1, 1999.

We assume that short-term market interest rates in the major foreign industrial countries will remain about unchanged, on average, through the middle of next year and then will rise about 50 basis points by the end of 1998. One exception is Italy, where rates are assumed to fall. Rates in Japan begin rising before the middle of 1997 and move up a total of about 200 basis points by the end of 1998, while rates in the other countries rise more slowly and less. Long-term rates abroad are assumed to edge down on average over the forecast period, as a consequence of decreases in continental European countries in response to fiscal contraction.

Other countries. Average real GDP in the major developing-country trading partners of the United States (weighted by U.S. nonagricultural export shares) is projected to increase 5 percent during 1996 and about 6 percent during 1997-98.

We project that real GDP in Mexico will expand at an annual rate of 3-1/2 percent during the second half of 1996 and 4 to 5 percent per year during 1997-98. Greater financial market stability, improved access to international capital markets, and lower real interest rates are expected to promote continued moderate recovery. Among our other major Latin American trading partners, we project that growth in Argentina will be about 5 percent per year over the forecast period. However, widening fiscal deficits and possible social unrest pose risks for Argentina for 1997-98. In Brazil, we project that an overvalued currency and tight credit policy will restrain growth to about 2 percent per year 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 during the second half of 1996. Compared with the August Greenbook, our forecast for Korea has been reduced, partly as a result of a tighter monetary policy stance than was anticipated. However, we project that some acceleration of domestic demand, resulting in part from more accommodative credit policies in some Asian economies, will allow annual growth in the region to rise to about 6-3/4 percent during 1997-98.

<u>U.S. real exports and imports of goods and services</u>. We estimate that real net exports in the current quarter will be slightly weaker than we projected previously as exports were reduced more than imports. We judge that the substantial decline in exports recorded in July reflected not only a temporary drop in some goods (e.g., aircraft) but also some residual seasonality that held down recorded shipments. We expect that exports will rebound in August and September, with the exception of exports of semiconductors, largely offsetting the decline in July.

We project that growth of exports of real goods and services will strengthen from the nearly 4 percent, annual rate, seen in the first half of this year to 7 percent in 1997 and nearly 8 percent in 1998. Our forecast has been lowered about 1 percentage point since the August Greenbook, largely as a result of downward revision to exports of semiconductors. Those exports, which fell sharply in real terms in the first half of this year, are projected to decline further in the current quarter and then to resume growing at increasing rates over the forecast period. This downward adjustment of the forecast for exports of semiconductors (and a similar adjustment to the forecast for imports of semiconductors) reflects the sizable, but temporary, inventory adjustment that is currently taking place in the semiconductor industry. Exports of computers are projected to continue growing very rapidly in real terms. Growth in the quantity of nonagricultural exports other than computers and semiconductors is expected to average about 4 percent, annual rate, over the forecast period, little changed from the August Greenbook.

Growth of real imports of goods and services is projected to slow somewhat during the remainder of this year and next from the very rapid rate observed in the first half of 1996; imports should rebound a bit in 1998. Our outlook for imports of semiconductors has been revised down, as noted. Imports of computers in real terms are projected to remain robust. The quantity of non-oil imports other than computers and semiconductors is projected to grow rapidly, but at declining rates, as U.S. output growth slows. We expect the quantity of oil imports to rise this quarter and during the remainder of the forecast period, as consumption expands with the increase in U.S. economic activity and U.S. production continues to decline.

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

		Projection			
	1996			1997	1998
	H1	Q3	Q4		
Exports of G&S	3.8	1.3	9.8	7.2	7.9
Services	2.8	4.6	1.7	3.4	2.4
Computers	37.2	17.0	28.7	28.7	28.7
Semiconductors	-13.1	-13.3	8.2	9.8	16.4
Other goods[1]	3.6	-2.0	10.3	4.3	4.2
Imports of G&S	10.3	4.8	10.0	7.9	8.6
Services	7.2	5.3	-0.6	3.1	3.3
Oil	11.6	11.0	7.2	2.4	6.5
Computers	23.5	26.2	28.6	24.5	23.9
Semiconductors	-19.5	-31.4	6.1	9.8	16.4
Other goods[2]	12.1	4.1	9.9	6.1	5.8

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

Oil prices. In view of the postponement of oil sales by Iraq, we now assume that these sales will begin next April, seven months later than we had assumed in August. We also assume that Iraqi shipments will be limited to 800,000 b/d during the remainder of 1997 but will be unconstrained thereafter. Given the later entry of Iraqi oil on the market and the increased political tension in the Middle East and other key oil-exporting regions, the projected prices of imported oil for the third and fourth quarters have been revised up a bit less than \$1 and about \$3.50 per barrel respectively. We have increased our projections for 1997:Q1 and Q2 to \$19.50 and \$18.00 per barrel. The oil price path returns to our long-run projections for WTI and the oil import unit value of \$19.50/b and \$17.00/b respectively in 1997:Q3.

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

		-------Projection-------			
	1996			1997	1998
	H1	Q3	Q4		
Ag. exports	18.3	-8.3	-5.0	-1.5	3.7
Nonag. exports[1]	-2.2	-0.5	0.9	1.0	1.4
Non-oil imports[1]	-3.3	-0.7	-0.1	-0.2	0.4
Oil imports (Q4 level, \$/bl)	19.52	19.25	19.59	17.00	17.00

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

Prices of non-oil imports and exports. Prices of agricultural exports are projected to decline moderately during the fourth quarter and to fall a bit further in 1997 before rising in 1998. Prices of nonagricultural exports are projected to be little changed over the second half of this year and to rise only slightly over the remainder of the forecast period, held down by price declines for computers and semiconductors. We project that the prices of non-oil imports will be about flat over the forecast period as inflation abroad remains very low and the dollar is unchanged.

Nominal trade and current account balances. The nominal trade deficit on goods and services is projected to widen from its second-quarter level of \$111 billion to about \$125 billion by the end of 1998. The balance on net investment income is projected to deteriorate slightly as well. Accordingly, the current account balance should move from a deficit of about \$155 billion in the second quarter to average \$165 billion in 1997 and \$180 billion in 1998, but it should remain about 2-1/4 percent of GDP.

REAL GDP AND CONSUMER PRICES, SELECTED COUNTRIES, 1995-98
(Percent, quarterly change at an annual rate except as noted)

Measure and Country	1995	1996	1997 (Projected)	1998 (Projected)	1995 Q4	1996 Q1	1996 Q2	1996 Q3 (Projected)	1996 Q4 (Projected)	1997 Q1 (Projected)	1997 Q2 (Projected)
REAL GDP											
Canada	0.7	2.5	3.0	2.8	0.9	1.3	1.3	4.1	3.2	3.2	3.2
France	0.4	1.7	2.2	2.1	-1.8	4.5	-1.5	2.2	1.5	2.0	2.3
Germany	1.1	2.0	2.1	2.5	0.0	-1.9	6.1	1.8	2.2	2.1	2.1
Italy	2.3	1.0	2.2	1.8	-4.3	2.0	-2.0	1.5	2.7	2.5	2.3
Japan	2.5	3.2	2.6	2.2	4.8	12.2	-2.9	1.4	2.7	4.3	1.5
United Kingdom	1.9	2.1	2.7	2.3	1.6	1.6	1.5	2.6	2.8	2.8	2.7
Average weighted by 1987-89 GDP	1.7	2.3	2.5	2.3	1.0	4.8	-0.2	2.0	2.5	3.0	2.2
Average weighted by share of U.S. nonagricultural exports											
Total foreign	1.7	3.3	3.9	3.6	3.6	4.2	1.9	3.3	3.7	4.0	3.8
Foreign G-7	1.3	2.4	2.7	2.5	1.3	3.4	0.6	2.9	2.8	3.2	2.6
Developing Countries	2.4	5.1	6.0	5.7	7.6	6.9	3.5	4.6	5.7	6.0	6.0
CONSUMER PRICES (1)											
Canada	2.1	1.6	1.3	1.4	0.1	1.7	3.1	0.6	0.8	1.0	1.8
France	1.9	1.8	1.9	1.9	2.3	2.9	3.2	-0.3	1.3	2.1	1.9
W. Germany	1.6	1.5	1.6	1.7	-0.5	2.5	1.9	1.6	-0.1	2.6	2.0
Italy	5.8	3.0	3.0	2.8	5.1	2.9	4.9	0.7	3.5	2.3	6.6
Japan	-0.8	0.3	1.5	0.5	-0.4	-0.3	1.9	-0.0	-0.4	-0.3	6.8
United Kingdom (2)	2.9	2.6	2.7	2.8	1.4	3.0	6.1	0.8	0.6	2.6	6.5
Average weighted by 1987-89 GDP	1.7	1.5	1.9	1.6	1.0	1.7	3.2	0.5	0.7	1.4	4.8
Average weighted by share of U.S. non-oil imports	1.1	1.2	1.6	1.3	0.3	1.2	2.8	0.5	0.4	0.9	4.3

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.

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

	1994				1995				1996		ANNUAL		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2-p	1993	1994	1995
NIPA Real Net Exports (Chained 1992 dollars)	-99.3	-107.3	-111.7	-104.3	-122.5	-121.4	-101.6	-84.9	-104.0	-114.4	-72.0	-105.7	-107.6
Exports of G&S	677.6	703.1	719.6	747.6	752.3	763.2	783.0	803.1	806.7	818.2	658.2	712.0	775.4
Goods	481.9	502.9	517.8	543.4	548.8	557.7	568.1	588.8	590.9	600.9	464.5	511.5	565.8
Agricultural	40.6	41.2	45.1	50.9	50.8	48.1	50.0	49.4	50.5	45.5	43.1	44.4	49.6
Computers	40.7	42.3	45.0	49.6	53.3	56.9	65.9	74.2	83.3	86.9	35.0	44.4	62.6
Semiconductors	34.2	35.5	39.0	46.8	51.2	53.6	57.1	60.7	60.7	56.6	24.1	38.9	55.6
Other Goods	366.4	383.9	388.8	396.0	393.4	399.0	395.2	404.6	396.5	411.9	362.3	383.8	398.1
Services	195.9	200.5	202.2	204.9	204.3	206.4	215.4	215.3	216.7	218.3	193.7	200.9	210.4
Imports of G&S	777.0	810.4	831.3	851.9	874.9	884.6	884.5	888.0	910.7	932.6	730.3	817.6	883.0
Goods	644.5	675.6	697.1	719.3	735.4	747.7	745.6	750.0	768.3	789.7	602.6	684.1	744.7
Oil	57.0	60.6	65.1	58.2	57.8	58.6	61.6	58.7	55.2	62.0	56.7	60.2	59.2
Computers	54.4	58.2	61.5	68.1	72.6	77.9	88.2	97.9	104.1	108.8	44.4	60.6	84.1
Semiconductors	28.0	28.5	31.2	36.5	40.3	45.4	52.3	57.3	57.9	51.4	21.9	31.1	48.8
Other Goods	505.0	528.3	539.2	556.5	564.7	565.9	543.5	536.1	551.2	567.5	479.5	532.3	552.5
Services	132.6	135.0	134.5	133.1	139.8	137.4	139.4	138.5	142.8	143.4	127.7	133.8	138.8
Memo:(Percent change 1/)													
Exports of G&S	-1.6	15.9	9.7	16.5	2.6	5.9	10.7	10.7	1.8	5.8	4.8	9.9	7.4
Agricultural	-24.5	6.8	43.0	62.9	-0.6	-19.8	16.4	-4.9	9.3	-34.1	-5.4	17.1	-3.1
Computers	25.0	16.6	27.6	48.6	33.0	30.1	79.0	61.0	58.7	18.6	22.6	29.0	49.4
Semiconductors	131.4	16.2	45.8	106.7	43.6	19.9	28.8	27.6	-0.0	-24.3	45.1	68.7	29.7
Other Goods	-9.1	20.4	5.2	7.7	-2.6	5.9	-3.8	9.8	-7.7	16.5	3.0	5.5	2.2
Services	0.8	9.7	3.4	5.5	-1.1	4.0	18.7	-0.3	2.7	2.9	3.9	4.8	5.1
Imports of G&S	8.2	18.4	10.7	10.3	11.2	4.5	-0.0	1.6	10.6	10.0	10.5	11.8	4.2
Oil	-8.5	27.2	33.5	-36.2	-2.4	5.3	22.0	-17.2	-22.2	59.4	10.0	-0.2	0.9
Computers	45.0	30.9	24.8	49.9	29.6	31.9	64.7	51.8	27.7	19.6	38.9	37.3	43.8
Semiconductors	65.3	7.3	43.4	85.8	49.3	61.0	76.4	43.6	4.6	-38.0	44.9	47.4	57.1
Other Goods	6.4	19.8	8.6	13.4	6.0	0.9	-14.9	-5.4	11.7	12.4	9.0	11.9	-3.7
Services	1.8	7.5	-1.6	-4.0	21.7	-6.7	5.8	-2.4	13.0	1.6	3.6	0.8	4.1
Current Account Balance	-118.8	-144.1	-160.0	-170.6	-156.2	-163.9	-150.8	-121.7	-139.5	-155.1	-99.9	-148.4	-148.2
Goods & Serv (BOP), net	-90.8	-103.5	-113.8	-109.4	-118.1	-127.3	-97.3	-77.6	-96.9	-111.5	-72.0	-104.4	-105.1
Goods (BOP), net	-147.4	-164.3	-177.7	-175.1	-179.7	-191.7	-170.2	-152.1	-170.9	-187.3	-132.6	-166.1	-173.4
Services (BOP), net	56.5	60.8	63.9	65.7	61.6	64.4	72.9	74.5	74.0	75.8	60.6	61.7	68.4
Investment Income, net	4.7	-2.5	-6.4	-12.4	-3.6	-3.4	-17.4	-7.6	1.0	-6.4	9.7	-4.2	-8.0
Direct, net	49.5	46.0	47.4	46.9	57.4	59.9	51.3	61.3	66.1	62.1	55.9	47.4	57.5
Portfolio, net	-44.8	-48.5	-53.7	-59.3	-61.0	-63.3	-68.7	-68.9	-65.0	-68.6	-46.2	-51.6	-65.5
Unilateral Transfers, net	-32.7	-38.0	-39.9	-48.9	-34.6	-33.2	-36.0	-36.6	-43.6	-37.2	-37.6	-39.9	-35.1

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		
	1996		1997				1998				ANNUAL		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	1996	1997	1998
NIPA Real Net Exports (Chained 1992 dollars)	-122.8	-126.0	-125.7	-130.0	-141.4	-141.6	-144.7	-148.7	-159.9	-160.1	-116.8	-134.7	-153.4
Exports of G&S	820.9	840.4	852.1	871.6	879.4	901.2	914.9	937.4	947.8	972.8	821.5	876.1	943.2
Goods	601.2	619.8	629.6	647.1	653.1	673.3	685.6	706.7	715.8	739.7	603.2	650.8	711.9
Agricultural	46.3	47.8	48.4	49.1	49.7	50.3	50.9	51.5	52.2	52.7	47.5	49.4	51.8
Computers	90.4	96.3	102.5	109.2	116.3	123.8	131.9	140.5	149.6	159.3	89.2	113.0	145.3
Semiconductors	54.6	55.7	56.8	57.9	59.4	61.2	63.3	65.9	68.5	71.2	56.9	58.8	67.2
Other Goods	409.9	420.1	421.9	430.9	427.7	438.0	439.5	448.8	445.5	456.5	409.6	429.6	447.6
Services	220.7	221.7	223.6	225.7	227.6	229.2	230.6	232.1	233.5	234.6	219.4	226.5	232.7
Imports of G&S	943.7	966.4	977.9	1001.6	1020.8	1042.9	1059.6	1086.2	1107.7	1132.9	938.4	1010.8	1096.6
Goods	798.9	821.9	832.3	855.1	873.1	894.0	909.5	934.9	955.2	979.2	794.7	863.6	944.7
Oil	63.6	64.7	62.2	67.5	70.4	66.3	66.6	71.8	74.8	70.6	61.4	66.6	70.9
Computers	115.4	122.9	130.2	137.4	145.0	152.9	161.3	170.2	179.6	189.4	112.8	141.4	175.1
Semiconductors	46.8	47.5	48.4	49.4	50.6	52.1	53.9	56.1	58.4	60.7	50.9	50.1	57.3
Other Goods	573.1	586.8	591.5	600.8	607.1	622.7	627.6	636.8	642.6	658.5	569.7	605.5	641.4
Services	145.2	145.0	146.0	147.0	148.2	149.4	150.7	151.9	153.1	154.3	144.1	147.7	152.5
Memo: (Percent change 1/)													
Exports of G&S	1.3	9.8	5.7	9.5	3.6	10.3	6.2	10.2	4.5	11.0	4.6	7.2	7.9
Agricultural	7.8	13.0	5.5	5.4	5.0	5.2	5.1	5.0	5.0	4.1	-3.2	5.2	4.8
Computers	17.0	28.7	28.7	28.7	28.7	28.7	28.7	28.7	28.7	28.7	29.8	28.7	28.7
Semiconductors	-13.3	8.2	8.2	8.2	10.4	12.6	14.8	17.0	17.0	17.0	-8.2	9.8	16.4
Other Goods	-2.0	10.3	1.7	8.9	-2.9	10.0	1.3	8.8	-2.9	10.2	3.8	4.3	4.2
Services	4.6	1.7	3.6	3.8	3.4	2.8	2.5	2.6	2.4	2.0	3.0	3.4	2.4
Imports of G&S	4.8	10.0	4.8	10.1	7.9	8.9	6.6	10.4	8.2	9.4	8.8	7.9	8.6
Oil	11.0	7.2	-14.8	39.1	18.3	-21.7	2.3	34.7	17.7	-20.5	10.2	2.4	6.5
Computers	26.2	28.6	26.2	23.9	23.9	23.9	23.9	23.9	23.9	23.9	25.5	24.5	23.9
Semiconductors	-31.4	6.1	8.2	8.2	10.4	12.6	14.8	17.0	17.0	17.0	-17.1	9.8	16.4
Other Goods	4.1	9.9	3.2	6.4	4.3	10.6	3.2	6.0	3.7	10.3	9.5	6.1	5.8
Services	5.3	-0.6	2.9	2.8	3.1	3.4	3.3	3.2	3.2	3.3	4.7	3.1	3.3
Current Account Balance	-162.0	-173.6	-158.9	-158.9	-167.1	-176.0	-168.5	-171.5	-182.6	-193.1	-157.6	-165.2	-178.9
Goods & Serv (BOP), net	-117.1	-118.9	-115.1	-112.6	-118.7	-116.4	-117.1	-118.5	-128.2	-125.3	-111.1	-115.7	-122.2
Goods (BOP), net	-194.1	-197.9	-196.1	-195.3	-203.2	-202.3	-204.3	-206.9	-217.8	-216.0	-187.6	-199.2	-211.3
Services (BOP), net	77.0	79.0	80.9	82.8	84.5	85.9	87.2	88.5	89.7	90.7	76.5	83.5	89.0
Investment Income, net	-11.9	-11.7	-13.8	-16.4	-18.3	-19.7	-21.4	-23.0	-24.4	-27.9	-7.2	-17.0	-24.2
Direct, net	62.0	65.8	66.4	66.0	66.3	67.4	67.6	67.7	68.5	67.4	64.0	66.5	67.8
Portfolio, net	-73.8	-77.5	-80.2	-82.4	-84.7	-87.0	-88.9	-90.7	-92.9	-95.3	-71.2	-83.6	-92.0
Unilateral Transfers, net	-33.0	-43.0	-30.0	-30.0	-30.0	-40.0	-30.0	-30.0	-30.0	-40.0	-39.2	-32.5	-32.5

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