Prefatory Note

The attached document represents the most complete and accurate version available based on original copies culled from the files of the FOMC Secretariat at the Board of Governors of the Federal Reserve System. This electronic document was created through a comprehensive digitization process which included identifying the best-preserved paper copies, scanning those copies,[1] and then making the scanned versions text-searchable.[2] Though a stringent quality assurance process was employed, some imperfections may remain.

Please note that this document may contain occasional gaps in the text. These gaps are the result of a redaction process that removed information obtained on a confidential basis. All redacted passages are exempt from disclosure under applicable provisions of the Freedom of Information Act.

---

[1] In some cases, original copies needed to be photocopied before being scanned into electronic format. All scanned images were deskewed (to remove the effects of printer- and scanner-introduced tilting) and lightly cleaned (to remove dark spots caused by staple holes, hole punches, and other blemishes caused after initial printing).

[2] A two-step process was used. An advanced optimal character recognition computer program (OCR) first created electronic text from the document image. Where the OCR results were inconclusive, staff checked and corrected the text as necessary. Please note that the numbers and text in charts and tables were not reliably recognized by the OCR process and were not checked or corrected by staff.

Strictly Confidential (FR) Class II FOMC

Part 1

November 6, 1997

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

November 6, 1997

SUMMARY AND OUTLOOK

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

Domestic Developments

Overview

The performance of the U.S. economy has continued to be outstanding. Spurred by exceptional strength in domestic final demand, real GDP growth in the third quarter kept pace with the rapid trend of the previous year and a half. Substantial increases in productivity more than offset what little cost pressure was coming from the wage side, and profitability thus improved while price increases remained subdued.

The question of the moment, of course, is whether the vigor of the expansion will be materially diminished by an Asian flu bug that threatens to infect the economies of many of our important trading partners. It obviously is too early to render a firm judgment. At this point, although we have marked down our projection of growth for the rest of the world, we think that the hit to U.S. production and the disinflationary influence of the current turmoil most likely will be less dramatic than many commentators have suggested. Relative to our previous forecast, the recent depreciation of the dollar against other G-10 currencies offsets some of the influence of weaker foreign activity and a deterioration in competitiveness relative to some Asian currencies. For all the recent gyrations, stock prices have declined only slightly on net over the intermeeting period and are close to the level anticipated in the last Greenbook.

The bottom line is that we are presenting a projection of GDP growth through 1999 that looks much like that prepared for the September FOMC meeting. We foresee a marked deceleration in activity on the assumption that the System will act to raise real short-term rates next year, a consequence of which is a notable stock market correction. Nevertheless, resource utilization rates remain high, and inflation creeps up from here--though recent favorable price news, along with our interpretation of the implications of continued strong investment for the growth of capacity and productivity, have led us to chip another tenth or two off the projected price index increases for 1998 and 1999.

Key Background Factors

The current financial environment does not appear to be exerting restraint on domestic demand. Credit supplies remain ample, and we doubt that the recent financial turbulence will precipitate a marked shift in liquidity conditions. The net declines in U.S. stock markets over the intermeeting period have trimmed only a smidgen from the huge run-up earlier in the year; the household wealth-income ratio is still up smartly, and the cost of equity capital remains low.

We continue to think that the stock markets will have to struggle with an increasing number of earnings disappointments in coming quarters, but that a marked downturn is not likely to come soon in the absence of further shocks. In this forecast, as in the last, such a shock comes in the form of a sequence of hikes in the federal funds rate beginning early next year, which will raise real short-term rates somewhat relative to their current levels. No such tightening appears to be anticipated at present, and it is assumed to occur before a pickup in inflation is generally apparent. We anticipate that long-term rates will turn up as well, but that the term structure will flatten. The upturn in yields on Treasury notes and bonds could be muted to the degree that diminished investor confidence leads to an enlargement of the equity premium--building on what seems to have occurred in the past couple of weeks. Risk spreads on corporate bonds relative to Treasuries are likely to widen--perhaps appreciably in the junk sector--as the outlook for business profitability becomes shakier; banks and other lenders also may become a bit more cautious in extending credit to businesses.

While we think that some tightening of monetary policy will be needed in the near term to check an upswing of inflation, it is quite conceivable that the projected level of real rates is higher than may be necessary to stabilize the economy over the longer run. In that regard, we have assumed just a slight retracing of the 1998 increase in the funds rate in the latter part of 1999 and a modest easing of bond yields. Share prices turn up in 1999, but not very much--and not enough to reverse any significant portion of the steep decline in the household wealth-income ratio that is projected for 1998.

Since the September Greenbook, the dollar has appreciated considerably against many Asian and some Latin American currencies but has depreciated, on average, against the currencies of the other major industrial countries--at least in part because of revised expectations about U.S. monetary policy. Further variations in exchange rates may well be ahead in light of monetary policy actions here and abroad and of the ongoing deterioration in our current-account position. But the case for a sizable and persistent movement in one direction or the other is not compelling, and given our inability to predict the short-term twists and turns, it seems better simply to assume that the dollar will remain around the current level on a G-10 trade-weighted basis. Doing so places the G-10 exchange rate, on average, about 2-1/2 percent lower in 1998 and 1-1/2 percent lower in 1999 than in the last Greenbook. Largely as a consequence of the damage to Asian economies, we have marked down our forecast for growth abroad about 1/4 percentage point in 1997, 1.1 point in 1998, and 0.1 point in 1999. On an export-weighted basis, foreign growth is projected to fall to about 3-3/4 percent this year and 2-3/4 percent in 1998 before moving back up to 3-1/2 percent in 1999. Because of production disruptions in Colombia and the Mideast, we have raised our projection for the spot price of West Texas intermediate oil in the current quarter about $1.70, to $20.40 per barrel. Oil prices are assumed to move down more than $1 per barrel in the first half of next year, reflecting expanding supply, easing tensions in the Mideast, and weaker demand due in part to the effect of El Niño on weather in the northeastern United States. Prices are then expected to trend up as non-OPEC producers are unable to gear up output fast enough to meet rising demand, with the WTI spot price rising to $21 per barrel by the end of the forecast period.

As in our previous projection, federal fiscal policy is expected to be an essentially neutral influence on aggregate demand over the forecast period. At $23 billion, the unified deficit for fiscal 1997 was not far from what we anticipated in September. We continue to assume that discretionary spending will be limited by the caps established in the 1997 budget reconciliation bill and that none of the tax cut or spending proposals that have surfaced with the talk of future budget surpluses will be enacted over the forecast period.[1] This restraint contributes to projected deficits of only $26 billion in fiscal 1998 and $25 billion in fiscal 1999; these figures are down from predictions of closer to $50 billion in the September Greenbook, in large part because the latest data suggest that the unusual strength in receipt growth may persist longer than we had thought.

Recent Developments and Outlook for the Current Quarter

Real GDP grew 3-1/2 percent at an annual rate in the third quarter, according to the BEA's advance estimate.[2] This estimate is 3/4 percentage point above our forecast in the September Greenbook. Moreover, the mix of output was tilted toward significantly more final sales (largely consumption) and less inventory investment than

---

1. As of Greenbook publication, nine of the thirteen regular appropriations bills for fiscal 1998 had been passed by the Congress, and all satisfied the budget reconciliation guidelines. Seven bills have been signed by the President. The issues delaying enactment of the remaining bills are not related to the reconciliation guidelines. The programs covered by these bills are being funded by a continuing resolution that expires November 7.

2. Data that became available since the advance report would suggest a slight downward revision to GDP. However, in light of the strength in industrial production and income, we anticipate that upcoming source data reports will bring the GDP figure back up to 3-1/2 percent. Unless otherwise indicated, the third-quarter figures cited below refer to our updated numbers.

we had anticipated then--reinforcing the impression of a greater underlying thrust in domestic demand.

We have raised our forecast of GDP growth in the fourth quarter from 3 percent to 3-1/2 percent. Of course, with scarcely any data in hand for the current quarter, this figure really is pure projection. Friday's labor market report for October should provide a hint as to whether we are on the right track. We expect some solid numbers for employment growth--although the smaller job gains in August and September against a similar backdrop of low initial claims for unemployment insurance and robust hiring plans suggest that labor supply limits may be becoming a more significant constraint.

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

Measure	1997:Q3			1997:Q4	
	Sept. GB	BEA advance	Nov. GB	Sept. GB	Nov. GB
Real GDP	**2.8**	**3.5**	**3.5**	**3.0**	**3.5**
Private domestic final purchases	5.9	7.2	6.9	3.7	3.7
Personal consumption expenditures	4.1	5.7	5.7	3.4	3.0
Residential investment	-4.6	2.8	1.9	1.3	5.2
Business fixed investment	22.9	18.7	16.8	6.6	8.0
Government outlays for consumption and investment	-.1	1.0	1.0	.9	.8
	Change, billions of chained (1992) dollars				
Inventory investment	-19.4	-26.1	-22.2	-12.5	-2.3
Net exports	-20.0	-23.4	-23.8	7.9	5.6

Private domestic final sales are projected to increase at an annual rate of 3-3/4 percent this quarter--a hefty pace, but one down substantially from last quarter's outsized 7 percent gain. Even though the downshift in stockbuilding this summer was faster than we had anticipated, the rate of increase in nonfarm inventories in last quarter's advance GDP estimate was still quite strong. Nonetheless, with current stock-sales ratios low and final demand carrying substantial momentum, we do not see a drop-off in inventory investment in the near term.[3]

Real personal consumption expenditures surged at a 5-3/4 percent annual rate in the third quarter. On a monthly basis, however, PCE growth slowed through the summer, and neither the data on motor vehicle sales nor private surveys of chain stores point to anything more than a modest pickup in spending in October. Nonetheless, the fundamentals--income, wealth, sentiment--all still look to be very supportive of demand, and we are projecting a healthy 3 percent annual rate of increase in PCE this quarter.

The increase in real business fixed investment that we are now estimating for the third quarter--nearly 17 percent at an annual rate--matches the largest gains recorded during the current expansion. The recent trends in orders for nondefense capital goods point to another sizable increase in real outlays for equipment this quarter. The main exceptions are in the transportation sector. Spending there is expected to fall because of a payback from a bunching of motor vehicle fleet sales and deliveries of aircraft to domestic carriers into the third quarter and some delay in aircraft deliveries due to production and certification problems at Boeing.[4] All told, we see total real PDE increasing at an annual rate of 11-1/4 percent in the fourth quarter. On the nonresidential structures side, the recent weak data on construction-put-in-place and a flattening trend in contracts suggest little change in expenditures after last quarter's 3 percent annual rate increase.

Housing starts bounced back sharply in September from their surprisingly low August reading; the estimates for starts in July and August were revised up somewhat as well. We are projecting that this quarter single-family and multifamily starts will average about 1.12 million units and 310,000 units, respectively, close to their averages over the past year or so. Adding in the lagged effects of earlier starts, we expect residential construction expenditures to advance at about a 5-1/4 percent annual rate in the fourth quarter.

---

3. The forecast assumes only a small further reduction in the pace of inventory investment in the current quarter. We would have forecast a small pickup in stockbuilding if not for a technical adjustment we make in offsetting the regular fourth-quarter increase in net exports that results from their imperfect seasonal adjustment. (We have found no corresponding residual seasonality in overall GDP, and so we attempt to offset the net export bulge elsewhere--mainly inventories.)

4. The disruption to production at Boeing in the fourth quarter is related to parts and labor shortages that are delaying completion of planes; work on the planes is continuing, however, so that the net effect on value added--and hence on GDP--should be quite small. In terms of spending components, lower readings for PDE and exports should be offset by a higher accumulation of inventories.

An increase in net exports is expected to boost real GDP growth about 1/3 percentage point in the current quarter. In large part, this gain reflects the imperfect seasonal adjustment of net exports. By our rough reckoning, the effects of events in Asia on U.S. net exports will reduce real GDP by a small amount in the current quarter, but their influence on growth will be somewhat larger--perhaps on the order of 1/4 percentage point--in 1998.

Price increases have remained subdued. Although the 0.4 percent rise in the core PPI for finished goods in September produced a bit of an inflation scare, it largely reflected idiosyncratic developments that did not carry over to consumer prices. Furthermore, price pressures were absent in the PPIs for earlier stages of processing. The 0.2 percent increase in the September CPI excluding food and energy was a bit less than we had anticipated; there was an unusually small increment to owners' equivalent rent. We are expecting similar-sized monthly increases in the core CPI in the current quarter, with the index rising a shade under 2-1/2 percent at an annual rate; the total CPI also is expected to rise at about that rate. On the wage front, the 3.4 percent annual rate of increase in the ECI for total compensation in the third quarter was just a bit above our expectations, and we are looking for a comparable rise in compensation in the current period as the minimum wage hike continues to show through.

The Longer-Run Outlook

Our forecast for activity over the long run is essentially unchanged from the September Greenbook: After increasing 3-3/4 percent in 1997, real GDP is expected to rise 2-1/4 percent in 1998 and 1-1/2 percent in 1999. The sources of the slower growth also are the same as in earlier forecasts: Domestic demand is expected to decelerate with rising interest rates, sharply reduced equity values, and slower growth in investment from levels that are already high enough to generate sizable increases in productive capacity. We continue to assume that net exports will decline further as a result of lagged effects of earlier appreciation in the dollar; in addition, demands from abroad now are expected to be weakened by lower growth in overall foreign activity.

Although we have raised the projected level of the unemployment rate, it remains low enough to place upward pressure on real wages. Furthermore, we doubt that we shall see a repeat of some of the beneficial influences--notably smaller health insurance costs and dollar appreciation--that have reduced inflation over the past two years. Accordingly, we are projecting that inflation will increase over the forecast period, although ample expansion of factory capacity should prevent production bottlenecks from developing in the goods sector and help keep the rise in prices gradual. Overall, after adding back in the estimated effects of the technical changes in the CPI, the acceleration in GDP prices cumulates to a bit less than 1/2 percentage point between 1997 and 1999; the pickup in core CPI inflation is somewhat larger.

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

Measure	1997:H1	1997:H2	1998	1999
Real GDP	**4.1**	**3.5**	**2.2**	**1.5**
Previous	4.3	2.9	2.3	1.5
Final sales	2.8	4.2	2.5	1.7
Previous	3.0	3.8	2.5	1.6
PCE	3.1	4.3	3.2	1.8
Previous	3.2	3.8	2.8	1.7
Residential investment	5.3	3.6	-2.5	-1.2
Previous	5.4	-1.7	-2.6	-2.2
BFI	9.2	12.3	7.5	5.8
Previous	9.6	14.5	7.9	5.6
Government purchases	1.3	.9	.6	.8
Previous	1.4	.4	.7	.7
	Change, billions of chained (1992) dollars			
Inventory change	44.7	-24.5	-21.4	-19.0
Previous	43.8	-31.8	-15.2	-11.2
Net exports	-31.0	-18.2	-45.4	-29.1
Previous	-27.3	-12.1	-30.0	-22.4

Consumer spending. Real PCE growth is expected to come in at 3-3/4 percent this year. We believe that consumer spending has received an important boost from the massive gains in stock market wealth, reflected in the forecast of a 1/2 percentage point decline in the saving rate between 1996 and 1997. The gains in wealth probably also have contributed to the extraordinary level of consumer confidence.

Real PCE is projected to rise about 3-1/4 percent in 1998 and 1-3/4 percent in 1999. Income trends are expected to soften as more moderate demands from the business sector and the continued decline in net exports slow growth in employment.

Furthermore, household wealth is assumed to turn from a marked positive factor for consumer demand in 1996 and 1997 to a relatively neutral influence by the end of 1998. As we have discussed before, our various econometric models suggest that no more than two-thirds of the effect on consumption of an increase in stock market wealth might be expected within a year. In our forecast for 1998, the boost to PCE from earlier gains in wealth offsets the effects of the retrenchment in the stock market assumed for that year. By 1999, however, the net wealth effects on PCE from the stock market turn to a small negative.

The slackening in demand growth is likely to be broad-based, but durable goods--typically the most cyclically sensitive--are projected to register the sharpest deceleration as the economy moves into a period of subpar growth. Durables expenditures have been boosted in part by declining relative prices, and the prospects are good for a continuation of that pattern. However, households have been buying these items at a brisk clip for some time now, and some stretching-out of purchase plans would be a natural response to a shortfall in income relative to recent trends. In particular, sales of light motor vehicles are projected to fall off to about 14-1/2 million units in 1999--a modest drop, at least by cyclical standards, from the 15 million unit pace of the past four years or so.

Residential investment. Given that we foresee little change in the fundamental determinants of housing demand in the near term, we are expecting new construction to remain fairly stable over the next few quarters. By late 1998, however, the moderation in income growth and the upcreep in mortgage rates are projected to damp residential construction. Still, the decline in single-family starts--from 1.14 million units in 1997 to 1.11 million in 1998 and 1.09 million in 1999--is not very deep, as the income and mortgage rate movements in our forecast are not large enough to push measures of housing affordability far from their current extremely favorable readings.

In the multifamily sector, the stability in vacancy rates and only a modest pickup in rents suggest that there is little pressure currently in the pipeline for starts to move much from the 320,000 unit pace that they have averaged over the past year. Still, the slower pace of economic activity and the rise in rates should have at least a small effect on this sector, and we expect that multifamily starts will edge down to a shade below the 300,000 mark by the end of the forecast period.

Business fixed investment. The momentum of output and generally good access to financing are expected to boost capital spending substantially over the next few quarters. This increase will push the growth of the capital stock up further, expanding capacity and raising the capital-labor ratio. However, as external financing conditions turn less favorable and sales expectations tone down, firms presumably will want to reduce the growth of investment. We see real BFI, which appears headed toward a 10-3/4 percent gain in 1997, rising 7-1/2 percent in 1998 and 5-3/4 percent in 1999.

The projected deceleration largely is the result of slower growth in outlays for equipment. Although the slackening occurs broadly, real outlays for computing and telecommunications equipment are expected to maintain impressive rates of expansion. Demand for computers will continue to be lifted by technological advances and declining prices. Much the same can be said for telecommunications equipment, although in that case the changing regulatory environment is an extra contributing factor. The ramp-up in commercial aircraft output has further to go, but its steepness is diminishing. Although orders for heavy trucks have been rising impressively and point to continued strong production in the near term, demand tends to be highly sensitive cyclically and is likely to drop off as business activity decelerates.

Nonresidential construction expenditures are projected to increase about 3 percent in 1998 and 1999. We believe that this forecast balances the flattening trend in contracts for new construction with the more favorable outlook suggested by the relatively low vacancy rates and firming prices for office buildings. Financing conditions also appear to be remain favorable, which, in conjunction with the long lags between commitment and expenditures in this sector, likely means that the moderately rising interest rates in this forecast will not greatly affect activity in 1998-99.

Inventory investment. Even after the substantial stockbuilding during the first three quarters of the year, inventories appear quite lean in a number of industries. Given the momentum that final demand appears to be carrying, the 4 percent annual rate of increase in nonfarm inventories projected for the fourth quarter, although above longer-run trends, is not particularly aggressive. Increases in nonfarm stocks are projected to average about a 3-1/2 percent annual rate through most of 1998, a pace that causes some unexpected accumulation of inventories as the growth of sales begins to slacken. But we anticipate that towards the end of next year businesses will succeed in gearing down inventory growth appreciably further.

Farm inventory investment has been quite sizable thus far this year, according to BEA's NIPA estimates. These numbers are always a bit shaky because they involve guesswork about prospective crop yields, among other things. Statistical issues aside, harvests appear to have been large enough this year to permit some rebuilding of inventories. We do not anticipate a comparable GDP contribution in

1998 or 1999. Of course, prediction in this area is extremely difficult, and the uncertainties are made greater in this instance by the El Niño event that has captured so much attention. History suggests that an El Niño can have a substantial effect on U.S. agricultural output, but the patterns are not so clear as to compel us to make it a factor in our baseline forecast of farm production or inventories. Indeed, despite all the concerns that have been expressed, the futures markets appear to have not yet built significant El Niño effects into the forward price structure.

Government spending. After dropping 3/4 percent in 1997, real federal purchases are projected to fall in the 2 to 2-1/2 percent range in 1998 and 1999. Real defense purchases should decline at about a 3 percent rate, on average, over the forecast period; the lumpiness in procurements will likely make the declines a bit larger in 1998 than in 1997 and 1999. Nondefense purchases probably will increase 2-1/4 percent this year, but with discretionary spending caps expected to be binding by fiscal 1998, nondefense purchases are projected to rise just 3/4 percent in calendar 1998 and then fall 1-1/4 percent in 1999.

Real purchases by state and local governments are projected to rise at a rate of about 2-1/4 percent over the forecast period, in line with the trend through most of the current expansion. In general, the fiscal position of the state and local sector is sound, and we project it to remain so over the forecast period. If recent behavior is a guide, most states and localities will likely prefer to salt away budget surpluses in rainy day funds and the like rather than to boost growth in outlays or make major tax cuts. Furthermore, given the strong labor market in our forecast, we doubt that welfare reform will boost outlay growth much over the forecast period. Thus, we do not see much upside risk to spending coming from a more relaxed fiscal stance by state and local governments.

Net exports. After increasing more than 12 percent in 1997, real exports of goods and services are projected to rise about 7 percent, on average, in 1998 and 1999. The gain in exports is expected to be held back some by the more sluggish pace of growth abroad, as well as the lagged effects of the appreciation of the dollar over the past year. The more subdued growth of domestic demand will help reduce the increase in imports of goods and services from 15-3/4 percent in 1997 to 7-3/4 percent in 1999. All told, declining net exports are projected to reduce real GDP growth 1/2 percentage point in 1998 and about half that amount by 1999. (A fuller discussion of the prospects for the external sector is contained in the *International Developments* section.)

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

Measure	1996	1997	1998	1999
Output per hour, nonfarm business	1.2	2.3	.7	.9
Previous	1.2	1.8	1.0	.9
Nonfarm payroll employment	2.1	2.3	1.6	.8
Previous	2.1	2.3	1.7	.8
Household employment survey	2.1	2.0	1.4	.6
Previous	2.1	2.2	1.5	.7
Labor force participation rate[1]	66.9	67.1	67.2	67.2
Previous	66.9	67.2	67.4	67.3
Civilian unemployment rate[1]	5.3	4.8	4.7	5.1
Previous	5.3	4.7	4.5	4.9

1. Percent, average for the fourth quarter.

Labor markets. The above-trend growth in output over the next few quarters is projected to edge the unemployment rate down from its 4.9 percent average in the third quarter of 1997 to 4.6 percent by mid-1998. As growth slips below potential, the unemployment rate is projected to move up, edging above the 5 percent mark by the end of the forecast period. Despite little change in the forecast for GDP, the unemployment rate is a little higher throughout the next two years than in the September Greenbook. This change largely reflects the incorporation of a somewhat higher productivity growth trend into our forecast for potential output.

Labor productivity increased more than we had expected in the third quarter, and we now look for output per hour to rise an impressive 2-1/4 percent in 1997. Productivity is projected to decelerate over the next two years, with a rise in output per hour of 3/4 percent in 1998 and about 1 percent in 1999. The drop largely reflects the typical lags in firms' adjustments of employment and hours to swings in the pace of output growth.

This overall productivity growth forecast is not substantially different from that in the September Greenbook. We have, however, attempted to refine our view of the trend/cycle relationship that underlies the projected path of labor productivity. One way to think about the pattern of slow productivity growth in the early 1990s and subsequent pickup in mid-decade is to view the unevenness as mere variations around an extension of the 1 percent or so trend-line that can be drawn through the cycle of the 1980s. Given economists' inadequate understanding of productivity behavior, that simple application of the ruler has much to commend it. However, we believe that the overall high growth-low inflation performance of the macroeconomy in recent years is more consistent with an uptilt in the trend in output per hour. An examination of estimates of the growth of capital inputs shows that the ratio of capital to labor rose quite slowly in the late 1980s and first half of the 1990s before accelerating sharply in the past couple of years. Accordingly, the current forecast assumes that, on a consistently measured basis, the trend growth in labor productivity has moved up from a rate of 0.8 percent per year in the first half of the decade to a 1.2 percent rate in the second; the higher productivity trend also translates into a corresponding upward revision in our assumption for potential GDP growth.[5]

We also have been surprised that the labor force has expanded so slowly in the past couple of quarters, in the face of abundant job opportunities and rising real wages. As has been noted, the percentage of the population that is not in the labor force but wants jobs is historically quite low, which suggests that the pool of potentially available workers is not substantial. Consequently, we have trimmed our projection of the rise in the participation rate to only a small uptick from its recent average, which reflects the influence of welfare reform as opposed to any further cyclical response.

Wages and prices. We continue to project a gradual acceleration of prices over the next two years. Were we to focus only on the unemployment rate as an index of resource pressures, we would be predicting a more adverse price trend. However, the strong pace of investment has been contributing to a surge in the growth of manufacturing capacity. Although recent large gains in production have elevated the factory utilization rate to a level somewhat above past non-inflationary norms, we are expecting those pressures to subside over coming quarters. Thus, bottlenecks of the sort that have exacerbated the pressure on prices in previous cycles are unlikely to be a significant factor over the projection period.[6]

---

5. Because technical changes in the CPI will lower reported inflation and raise published real output growth, the measured productivity trend is boosted further to 1.3 percent in 1997 and 1998 and 1.5 percent in 1999. In terms of GDP, our growth rate in potential output is now 2.1 percent in 1995, 2.4 percent in 1996-98, and 2.5 percent in 1999.

6. The main bottleneck today, by most reports, is in the transportation sector. For some time now, long-haul truck drivers have been reported to be in short supply. Despite one widely reported, rather startling case, we see no evidence that large pay increases have been widespread in trucking. Meanwhile, a dropback in motor fuel prices over the past year has helped to contain overall costs. More recently, the disruption of rail freight service in the western part of the country has been much discussed.

(continued...)

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

Measure	1996	1997	1998	1999
Consumer price index	3.2	2.0	2.2	2.5
Previous	3.2	2.1	2.3	2.7
Food	4.2	1.8	2.1	2.4
Previous	4.2	1.8	2.2	2.5
Energy	7.6	-1.2	.4	2.0
Previous	7.6	-1.5	.0	2.2
Excluding food and energy	2.6	2.3	2.4	2.5
Previous	2.6	2.4	2.6	2.8
PCE chain-weighted price index	2.7	1.6	2.0	2.2
Previous	2.7	1.7	2.2	2.5
Excluding food and energy	2.3	1.7	2.1	2.3
Previous	2.3	1.8	2.3	2.5
GDP chain-weighted price index	2.3	1.8	2.0	2.1
Previous	2.3	1.9	2.1	2.2
ECI for compensation of private industry workers[1]	3.1	3.2	3.2	3.4
Previous	3.1	3.1	3.2	3.3
Prices of core non-oil merchandise imports	-.8	-1.2	-.3	.8
Previous	-.7	-.5	.6	1.9
	Percentage points			
MEMO: *Adjustments for technical changes to the CPI*[2]				
Core CPI	.2	.2	.4	.6
Core PCE	.1	.1	.1	.3
GDP chain price index	.0	.1	.1	.2

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

The recent report on the Employment Cost Index for September seems to point toward less optimism about inflation prospects. The twelve-month change in compensation for private industry came in at 3.2 percent, a couple of tenths above our

6. (...continued)
Difficulties in the merging of the Union Pacific and Southern Pacific rail lines are at least part of the story. This should be a temporary phenomenon, with only modest price implications.

expectation. The upside surprise was entirely on the wage side, as benefit costs remained subdued. On the face of it, the acceleration of compensation over the past year would seem to be due in large part to the hikes in the minimum wage; sectors with many low-paid workers have seen a sizable wage rise, while those in which prevailing wages are high enough to be little affected directly by the federal minimum have exhibited slight or no wage acceleration. We suspect, however, that the ECI data may understate the true rise in the labor costs of many employers: Among other things, there are many reports of increased use of equity interests, hiring bonuses, and other types of compensation not captured by the ECI to attract and retain workers with "hot skills."

Wages have accelerated noticeably since 1995. However, we have not carried through that uptilt in wage growth into 1998. We expect that wage gains will be damped next year by a lagged response to the marked deceleration of inflation that has occurred in 1997; this has lowered inflation expectations and will affect formal and informal COLAs. In abstract terms, the shift in the short-run Phillips curve associated with the decline in inflation expectations offsets the effect of a movement along the curve as the unemployment rate falls. In addition, no further increases in the minimum wage are scheduled.

Meanwhile, the incoming evidence on the prospects for the health insurance market point to a step-up in benefit costs. Not long after we went to press with the September forecast, the Federal Employees Health Benefit (FEHB) program announced increases in total premiums that averaged a whopping 8-1/2 percent in 1998. Reports of building pressures on premiums have been heard for some time--to be sure, there were some alarming forecasts from a year ago that proved to be exaggerated. But the FEHB increase constitutes a more tangible indication that the pricing cycle in the medical insurance sector is turning up. In addition, there has been mounting evidence of diminished profit margins for health insurers and providers. Accordingly, we have raised our benefits forecast somewhat, though we have tempered the acceleration on the basis that employers will attempt to shift the cost burden to workers in one way or another.

All told, at 3.2 percent, the projected increase in the ECI for total compensation in 1998 is the same as that for 1997. But we are expecting a pickup to 3.4 percent in 1999. Despite a rise in the unemployment rate, the labor markets remain quite tight, and price inflation has turned up. The tendency for inflation expectations to rise, should be damped, however, to the degree that the assumed, largely preemptive, monetary policy action reinforces the notion that the Federal

Reserve is willing to do what it takes to prevent any sustained reversal of the progress toward price stability. On the benefits side, we have not anticipated a further step-up in the size of medical insurance premium increases beyond the pace predicted for 1998.

This path for compensation puts little upward pressure on the trend in unit labor costs. However, with productivity growth slowing sharply, the rise in actual unit labor costs in 1998 and 1999 will be substantially steeper than it has been over the past couple of years. Furthermore, as mentioned earlier, actual employment costs probably are rising faster than reflected in the ECI measures. As firms attempt to limit the resulting erosion of profit margins, the increase in output prices, as measured by the gross domestic product chain index, is projected to move up from 1.8 percent in 1997 to 2.1 percent in 1999.[7]

Inflation also is expected to be boosted by the end of the transitory effect of the past dollar appreciation on the prices of imported goods: Core import prices are projected to change little in 1998 and to rise only modestly in 1999, but the swing from declines in 1996-97 contributes to the acceleration of domestic prices. Import prices affect GDP prices indirectly--through competing goods effects or input costs--but they have a more direct influence on consumption prices. And, while the core CPI is expected to accelerate a quarter percentage point between now and 1999, we estimate that the pickup would be about 3/8 percentage point greater if not for the technical changes to the index that will be implemented in the next two years.

Falling relative prices for food and energy are expected to hold overall CPI inflation below core by about 1/4 percentage point in 1997 and 1998 and then to be a relatively neutral influence in 1999. Food price inflation currently is being held back by a favorable harvest, although we are expecting a brief transitory kick to the CPI for food--largely in the restaurant category--reflecting the pass-through of higher labor costs due to the minimum wage increase. Looking ahead, retail food prices should tend to accelerate somewhat over the next two years as the restraining effects of the past year's declines in farm commodity prices dissipate; CPI food inflation, which is on track for an increase of perhaps 1-3/4 percent this year, is expected to rise to nearly 2-1/2 percent by 1999. Despite the upward revisions to our near-term oil price path and a remarkable surge in natural gas prices, the energy price forecast has been

7. We estimate that the acceleration in GDP prices between 1997 and 1999 would be 0.1 percentage point greater if not for technical adjustments to the CPI. Note that the acceleration in unit labor costs is the primary explanation for the projected weakening of corporate earnings in our forecast, although profits earned abroad and rising interest rates also will be slightly negative factors for earnings.

marked up only a touch. Incoming data suggest a substantial narrowing of oil refiners' margins in October, and the tightness in natural gas supplies should be short-lived. Over the medium term, energy prices are expected to rise less than the core CPI; in small part, the favorable forecast reflects the influence of deregulation of the electric utility industry.

Monetary and Credit Flows

The growth of nonfinancial debt is projected to pick up a bit in the near term, bringing its expansion over the year to about 4-1/2 percent; growth is projected to remain in the 4-1/2 percent to 5 percent range over the next two years. Reflecting the small federal deficit, borrowing by the Treasury will be light over the forecast period, with federal debt rising only around 1 percent per year. The state and local sector recently has engaged in heavy advance refunding to take advantage of the low level of long-term interest rates. Borrowing in this sector should continue to be substantial over the balance of this year but then slow over 1998 as interest rates move up to higher levels.

Growth of household debt is anticipated to move down over the next two years. Demand for consumer credit is expected to slow along with growth in nominal consumption, while mortgage debt is projected to decelerate with the moderation in housing activity. Meanwhile, credit conditions at lenders are not expected to tighten very much over the forecast period. Problems at lenders that have aggressively marketed home equity loans to subprime borrowers over the last couple of years should have only a limited effect on overall credit availability. At commercial banks, the number of Fed survey respondents reporting tighter standards and terms on consumer loans may continue to decline for a time, especially if the recent leveling off of delinquency rates on consumer receivables proves a real turning point. Even with the projected slowing, household debt continues to rise relative to income over the next two years, but at a reduced rate.

Business borrowing has picked up in recent months, and we anticipate further increases in the period ahead. By late next year, the growth of nonfinancial business debt is expected to exceed 7 percent at an annual rate, the strongest reading in almost a decade. The major driving force behind this growth is the widening gap between capital expenditures, which are projected to continue rising, and cash flow, which is expected to weaken with the fall-off in profitability. The financing of share retirements in connection with mergers and acquisitions also should remain an important source of business demand for credit. Growth in business debt is expected to move down a little by the end of the forecast period. In addition to the moderate rise in Treasury interest rates, debt growth may be slowed by a widening of quality spreads on corporate bonds and a movement to less accommodative lending standards and terms as banks take note of slowing growth in business income and profits.

M2 is expected to grow about 5 percent in 1997, the upper end of its annual range. Growth of M2 should slow appreciably over the forecast period, owing to weaker nominal GDP growth and rising interest rates associated with the projected monetary tightening; however, increased skittishness about stock market investments should provide a partial offset. M3 is expected to expand 8 percent this year, well above the upper end of its growth range. M3's strength over the past year was associated with fairly strong loan demands and resulting brisk bank credit growth, some shifting of bank funding from foreign to domestic markets, and a continued expansion of the use of money mutual market funds in corporate cash management. M3 growth is projected to soften overall over the next two years as loan demands and bank credit slow and as banks stabilize their funding patterns.

Alternative Simulations

We have included two alternative simulations this month that depict the implications of differing assumptions regarding the federal funds rate. The first alternative holds the funds rate at its current 5-1/2 percent level through the end of 1999. These lower rates boost real GDP growth relative to our baseline forecast about 1/4 percentage point in 1998 and a bit less than 1/2 percentage point in 1999. Given the higher output growth, the unemployment rate is projected to be 4-3/4 percent at the end of the forecast period, and consumer price inflation is nearly 1/2 percentage point higher by 1999.

The second scenario contemplates a tighter policy than in our baseline forecast. The funds rate is assumed to rise to 7 percent by next summer, is held at that level until mid-1999, and then is eased 50 basis points in the second half of that year. In this scenario, output growth falls nearly 1/2 percentage point relative to baseline, on average, in 1998 and 1999. The unemployment rate moves up to 5-1/2 percent by the end of 1999. The greater slack in the economy results in some deceleration in consumer prices, at least as published with the anticipated technical changes. Adjusted for these factors, the CPI in 1999 would still be a shade higher than in 1997. Further cuts in the funds rate likely would be necessary in 2000 if it were desired to prevent a substantial further rise in the jobless rate.

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

Measure	1996	1997	1998	1999
Real GDP				
Baseline	3.2	3.8	2.2	1.5
No further change	3.2	3.8	2.4	1.9
Tighter policy	3.2	3.8	1.8	1.0
Higher stock market	3.2	3.8	2.5	2.1
Civilian unemployment rate[1]				
Baseline	5.3	4.8	4.7	5.1
No further change	5.3	4.8	4.6	4.8
Tighter policy	5.3	4.8	4.9	5.5
Higher stock market	5.3	4.7	4.6	4.8
CPI excluding food and energy				
Baseline	2.6	2.3	2.4	2.5
No further change	2.6	2.3	2.5	2.9
Tighter policy	2.6	2.3	2.2	2.1
Higher stock market	2.6	2.3	2.4	2.6

1. Average for the fourth quarter.

We also have run an alternative that holds the value of equities relative to disposable personal income constant over the forecast period; this contrasts with the large decline in the wealth-to-income ratio in the baseline forecast. The federal funds rate is maintained at the baseline assumptions. In this scenario, output growth is boosted 1/3 percentage point in 1998 and twice that amount in 1999. Although the unemployment rate is in the neighborhood of 4-3/4 percent by the end of the forecast period, inflation is only a touch higher than in the baseline. The effect on prices is small because, according to the model, inflation expectations remain low; in essence, households and businesses have come to expect that monetary policy will respond to prevent an acceleration in prices. It is only in 1999 that the public begins to revise their expectations in light of the lack of response of the nominal funds rate to the stronger economy, and inflation would pick up more noticeably if the simulation were extended to 2000.

Strictly Confidential <FR>
Class II FOMC

November 6, 1997

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

Interval		Nominal GDP 09/24/97	Nominal GDP 11/06/97	Real GDP 09/24/97	Real GDP 11/06/97	GDP chain-weighted price index 09/24/97	GDP chain-weighted price index 11/06/97	Consumer price index[1] 09/24/97	Consumer price index[1] 11/06/97	Unemployment rate[2] 09/24/97	Unemployment rate[2] 11/06/97
ANNUAL											
1995		4.6	4.6	2.0	2.0	2.5	2.5	2.8	2.8	5.6	5.6
1996		5.1	5.1	2.8	2.8	2.3	2.3	3.0	3.0	5.4	5.4
1997		5.8	5.9	3.7	3.8	2.0	2.0	2.4	2.4	4.9	5.0
1998		4.8	4.8	2.7	2.8	2.0	1.9	2.2	2.1	4.5	4.6
1999		3.8	3.8	1.6	1.6	2.2	2.1	2.6	2.4	4.7	4.9
QUARTERLY											
1996	Q1	4.7	4.7	1.8	1.8	2.8	2.8	3.2	3.2	5.6	5.6
	Q2	7.7	7.7	6.0	6.0	1.9	1.9	3.4	3.4	5.4	5.4
	Q3	3.6	3.6	1.0	1.0	2.7	2.7	2.8	2.8	5.3	5.3
	Q4	6.2	6.2	4.3	4.3	1.9	1.9	3.3	3.3	5.3	5.3
1997	Q1	7.4	7.4	4.9	4.9	2.4	2.4	2.3	2.3	5.3	5.3
	Q2	5.2	5.2	3.6	3.3	1.6	1.8	1.0	1.0	4.9	4.9
	Q3	4.5	4.9	2.8	3.5	1.5	1.4	2.1	2.0	4.8	4.9
	Q4	5.0	5.4	3.0	3.5	2.0	1.7	2.7	2.4	4.7	4.8
1998	Q1	5.3	5.0	3.0	2.7	2.2	2.2	2.1	2.0	4.6	4.7
	Q2	4.8	4.5	2.6	2.5	2.1	2.0	2.3	2.2	4.5	4.6
	Q3	4.0	4.0	1.9	2.0	2.0	2.0	2.4	2.3	4.5	4.6
	Q4	3.6	3.7	1.5	1.7	2.0	2.0	2.5	2.4	4.5	4.7
1999	Q1	3.9	3.8	1.5	1.5	2.4	2.3	2.7	2.5	4.6	4.7
	Q2	3.6	3.6	1.4	1.5	2.1	2.1	2.8	2.5	4.7	4.8
	Q3	3.6	3.6	1.4	1.4	2.1	2.1	2.7	2.5	4.8	5.0
	Q4	3.7	3.5	1.5	1.4	2.1	2.1	2.7	2.5	4.9	5.1
TWO-QUARTER[3]											
1996	Q2	6.2	6.2	3.8	3.8	2.3	2.3	3.4	3.4	-0.2	-0.2
	Q4	4.9	4.9	2.7	2.7	2.3	2.3	3.0	3.0	-0.1	-0.1
1997	Q2	6.3	6.3	4.3	4.1	2.0	2.1	1.7	1.7	-0.4	-0.4
	Q4	4.8	5.1	2.9	3.5	1.7	1.6	2.4	2.2	-0.2	-0.1
1998	Q2	5.0	4.7	2.8	2.6	2.1	2.1	2.2	2.1	-0.2	-0.2
	Q4	3.8	3.8	1.7	1.8	2.0	2.0	2.5	2.4	0.0	0.1
1999	Q2	3.7	3.7	1.4	1.5	2.3	2.2	2.8	2.5	0.2	0.1
	Q4	3.6	3.6	1.5	1.4	2.1	2.1	2.7	2.5	0.2	0.3
FOUR-QUARTER[4]											
1995	Q4	4.0	4.0	1.6	1.6	2.4	2.4	2.6	2.6	0.0	0.0
1996	Q4	5.6	5.6	3.2	3.2	2.3	2.3	3.2	3.2	-0.3	-0.3
1997	Q4	5.5	5.7	3.6	3.8	1.9	1.8	2.1	2.0	-0.6	-0.5
1998	Q4	4.4	4.3	2.3	2.2	2.1	2.0	2.3	2.2	-0.2	-0.1
1999	Q4	3.7	3.6	1.5	1.5	2.2	2.1	2.7	2.5	0.4	0.4

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)

November 6, 1997

								- - - Projected - - -		
Item	Units[1]	1991	1992	1993	1994	1995	1996	1997	1998	1999
EXPENDITURES										
Nominal GDP	Bill. $	5916.7	6244.4	6558.1	6947.0	7265.4	7636.0	8084.4	8469.2	8788.2
Real GDP	Bill. Ch. $	6079.4	6244.4	6389.6	6610.7	6742.1	6928.4	7191.1	7390.6	7511.0
Real GDP	% change	0.4	3.6	2.4	3.3	1.6	3.2	3.8	2.2	1.5
Gross domestic purchases		0.0	4.0	3.0	3.6	1.2	3.6	4.3	2.6	1.7
Final sales		-0.4	3.9	2.1	2.7	2.2	3.1	3.5	2.5	1.7
Priv. dom. final purchases		-0.8	4.9	3.7	3.7	2.5	3.8	4.6	3.5	2.2
Personal cons. expenditures		-0.2	4.2	2.7	3.1	2.2	2.7	3.7	3.2	1.8
Durables		-3.1	9.4	7.4	6.3	3.0	3.9	6.5	5.0	1.8
Nondurables		-1.0	3.4	1.6	3.0	1.0	1.8	2.2	3.1	1.8
Services		0.9	3.6	2.3	2.5	2.7	2.8	3.9	2.9	1.9
Business fixed investment		-6.0	5.5	9.9	7.6	6.5	11.7	10.8	7.5	5.8
Producers' dur. equipment		-2.6	9.6	12.2	10.2	8.3	12.2	15.6	9.2	6.6
Nonres. structures		-12.5	-3.4	4.5	1.1	2.0	10.3	-1.1	3.1	3.3
Residential structures		1.1	16.9	7.8	4.2	-1.9	3.9	4.4	-2.5	-1.2
Exports		8.6	4.1	4.6	10.0	10.3	9.3	12.2	7.2	6.6
Imports		4.1	7.4	10.2	12.3	5.6	11.8	15.8	10.2	7.8
Gov't. cons. & investment		-0.7	1.7	-1.4	0.1	-1.4	2.0	1.1	0.6	0.8
Federal		-3.1	1.3	-6.1	-3.9	-6.0	1.5	-0.7	-2.5	-2.0
Defense		-5.3	-1.3	-6.9	-6.0	-5.9	1.1	-2.1	-4.1	-2.3
State & local		1.0	2.0	2.0	2.7	1.4	2.2	2.1	2.3	2.3
Change in bus. inventories	Bill. Ch. $	-3.0	7.0	22.1	60.6	27.3	25.0	62.4	43.0	23.7
Nonfarm		-1.2	2.0	29.5	49.0	35.7	22.5	54.8	37.8	19.8
Net exports		-22.3	-29.5	-70.2	-104.6	-98.8	-114.4	-144.5	-187.0	-223.1
Nominal GDP	% change	3.8	6.3	5.0	5.8	4.0	5.6	5.7	4.3	3.6
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employment	Millions	108.3	108.6	110.7	114.1	117.2	119.5	122.2	124.6	125.8
Unemployment rate	%	6.8	7.5	6.9	6.1	5.6	5.4	5.0	4.6	4.9
Industrial prod. index	% change	-0.0	3.9	3.0	5.7	1.8	3.9	5.3	2.3	1.3
Capacity util. rate - mfg.	%	78.0	79.5	80.8	83.1	83.1	82.1	82.9	82.8	81.9
Housing starts	Millions	1.01	1.20	1.29	1.46	1.35	1.48	1.45	1.41	1.38
Light motor vehicle sales		12.52	12.85	13.87	15.02	14.73	15.05	15.02	14.92	14.53
North Amer. produced		9.74	10.51	11.71	12.88	12.82	13.34	13.09	13.09	12.76
Other		2.77	2.34	2.15	2.13	1.90	1.71	1.93	1.83	1.77
INCOME AND SAVING										
Nominal GNP	Bill. $	5932.4	6255.5	6576.8	6955.2	7270.6	7637.7	8062.6	8433.2	8741.6
Nominal GNP	% change	3.5	6.2	5.1	5.7	4.1	5.5	5.3	4.1	3.5
Nominal personal income		3.7	7.3	4.2	5.1	5.2	5.8	5.7	4.6	4.1
Real disposable income		0.8	4.0	1.5	2.4	2.4	2.0	3.4	2.7	2.0
Personal saving rate	%	6.0	6.2	5.1	4.2	4.8	4.3	3.8	3.5	3.6
Corp. profits, IVA & CCAdj.	% change	4.5	11.3	19.0	14.1	11.0	9.1	9.5	-1.6	-1.6
Profit share of GNP	%	6.9	6.8	7.5	8.2	8.9	9.6	10.0	9.7	9.1
Excluding FR Banks	%	6.6	6.6	7.2	7.9	8.6	9.3	9.7	9.4	8.9
Federal surpl./deficit	Bill. $	-196.0	-280.9	-250.7	-186.7	-174.4	-110.5	-30.3	-5.8	-20.1
State & local surpl./def.		75.8	86.3	87.4	96.8	103.1	105.3	109.1	114.1	111.0
Ex. social ins. funds		11.5	18.3	19.7	27.9	32.5	34.1	37.7	42.7	39.4
PRICES AND COSTS										
GDP implicit deflator	% change	3.4	2.6	2.6	2.5	2.4	2.2	1.9	2.0	2.1
GDP chn.-wt. price index		3.3	2.6	2.6	2.5	2.4	2.3	1.8	2.0	2.1
Gross Domestic Purchases chn.-wt. price index		2.7	2.7	2.3	2.5	2.3	2.3	1.4	1.9	2.1
CPI		3.0	3.1	2.7	2.7	2.6	3.2	2.0	2.2	2.5
Ex. food and energy		4.4	3.5	3.1	2.8	3.0	2.6	2.3	2.4	2.5
ECI, hourly compensation[2]		4.4	3.5	3.6	3.1	2.6	3.1	3.2	3.2	3.4
Nonfarm business sector										
Output per hour		2.2	3.5	-0.2	-0.1	0.4	1.2	2.3	0.7	0.9
Compensation per Hour		4.8	4.5	1.8	1.9	2.8	3.3	4.0	3.5	3.6
Unit labor cost		2.5	1.0	2.0	2.0	2.4	2.1	1.6	2.8	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)

November 6, 1997

Item	Units	1995 Q1	1995 Q2	1995 Q3	1995 Q4	1996 Q1	1996 Q2	1996 Q3	1996 Q4	1997 Q1	1997 Q2
EXPENDITURES											
Nominal GDP	Bill. $	7168.9	7209.5	7301.3	7381.9	7467.5	7607.7	7676.0	7792.9	7933.6	8034.3
Real GDP	Bill. Ch. $	6703.7	6708.8	6759.2	6796.5	6826.4	6926.0	6943.8	7017.4	7101.6	7159.6
Real GDP	% change	0.9	0.3	3.0	2.2	1.8	6.0	1.0	4.3	4.9	3.3
Gross domestic purchases		1.3	0.2	1.9	1.3	3.1	6.5	2.4	2.5	5.9	3.7
Final sales		1.8	1.9	3.3	2.0	2.6	5.2	0.2	4.5	3.0	2.5
Priv. dom. final purchases		2.5	2.2	2.7	2.5	4.4	5.5	2.1	3.2	5.1	2.9
Personal cons. expenditures		1.5	2.9	2.6	1.8	3.1	3.7	0.5	3.3	5.3	0.9
Durables		-3.0	3.9	9.3	2.0	4.8	9.7	-1.9	3.5	14.1	-5.4
Nondurables		1.7	0.9	0.7	0.7	1.7	2.6	0.6	2.1	4.7	-2.1
Services		2.4	3.7	2.2	2.3	3.5	3.1	1.0	3.9	3.9	3.9
Business fixed investment		14.2	5.7	1.6	4.9	11.7	13.0	16.5	5.9	4.1	14.6
Producers' dur. equipment		16.1	6.2	2.0	9.4	13.1	14.9	19.1	2.6	6.7	23.0
Nonres. structures		9.5	4.3	0.7	-5.8	8.2	7.9	10.0	15.3	-2.1	-4.7
Residential structures		-7.0	-15.5	8.4	8.5	8.3	17.9	-4.5	-4.3	3.3	7.4
Exports		7.2	9.3	13.5	11.5	1.7	9.6	1.9	25.5	9.9	18.4
Imports		10.0	7.7	2.3	2.4	13.1	14.1	13.2	6.8	17.9	20.5
Gov't. cons. & investment		0.6	-0.1	-0.7	-5.4	1.8	7.2	-1.1	0.1	-0.4	3.1
Federal		-1.1	-4.5	-1.3	-16.4	7.5	8.8	-4.2	-5.2	-5.8	6.6
Defense		-1.1	-1.6	-4.0	-15.9	6.1	11.0	-4.6	-7.1	-11.8	7.5
State & local		1.7	2.6	-0.4	1.9	-1.4	6.3	0.7	3.3	2.7	1.2
Change in bus. inventories	Bill. Ch. $	48.5	21.6	17.0	22.2	8.0	21.3	37.9	32.9	63.7	77.6
Nonfarm		54.7	34.0	29.6	24.4	14.5	17.3	31.6	26.5	58.3	70.1
Net exports		-113.5	-112.8	-92.9	-76.1	-100.8	-112.6	-138.9	-105.6	-126.3	-136.6
Nominal GDP	% change	4.2	2.3	5.2	4.5	4.7	7.7	3.6	6.2	7.4	5.2
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	116.5	116.9	117.4	117.9	118.5	119.2	119.9	120.5	121.1	121.9
Unemployment rate	%	5.5	5.6	5.7	5.6	5.6	5.4	5.3	5.3	5.3	4.9
Industrial prod. index	% change	3.9	-0.7	3.2	0.8	1.6	6.2	3.3	4.5	4.4	4.3
Capacity util. rate - mfg.	%	84.2	83.1	82.9	82.3	81.7	82.1	82.3	82.3	82.5	82.5
Housing starts	Millions	1.32	1.29	1.42	1.41	1.46	1.50	1.49	1.42	1.47	1.46
Light motor vehicle sales		14.67	14.42	14.86	14.96	15.04	15.13	15.08	14.95	15.26	14.51
North Amer. produced		12.66	12.46	13.00	13.18	13.38	13.43	13.38	13.18	13.34	12.67
Other		2.01	1.96	1.86	1.78	1.66	1.70	1.70	1.76	1.92	1.85
INCOME AND SAVING											
Nominal GNP	Bill. $	7175.1	7220.6	7298.3	7388.5	7475.3	7610.5	7669.1	7796.1	7919.2	8013.6
Nominal GNP	% change	4.5	2.6	4.4	5.0	4.8	7.4	3.1	6.8	6.5	4.9
Nominal personal income		7.4	4.1	4.3	5.1	6.8	6.6	5.1	4.8	8.0	5.0
Real disposable income		4.5	0.2	2.6	2.5	3.5	1.1	2.7	0.7	4.6	3.1
Personal saving rate	%	5.3	4.6	4.5	4.6	4.7	4.1	4.5	3.9	3.7	4.2
Corp. profits, IVA & CCAdj.	% change	-2.9	10.0	31.7	7.9	20.0	12.1	0.6	4.5	18.1	8.2
Profit share of GNP	%	8.5	8.7	9.2	9.3	9.6	9.7	9.6	9.6	9.8	9.9
Excluding FR Banks	%	8.2	8.4	8.9	9.0	9.3	9.4	9.4	9.3	9.6	9.6
Federal surpl./deficit	Bill. $	-191.5	-179.5	-176.5	-150.2	-153.6	-111.6	-99.5	-77.1	-55.5	-36.8
State & local surpl./def.		107.7	105.6	101.1	97.8	104.1	114.4	102.6	100.4	104.7	104.9
Ex. social ins. funds		37.7	35.3	30.3	26.8	33.2	43.1	31.1	28.9	33.5	33.3
PRICES AND COSTS											
GDP implicit deflator	% change	3.3	2.0	2.1	2.2	2.9	1.7	2.6	1.9	2.4	1.8
GDP chn.-wt. price index		3.3	2.1	2.0	2.1	2.8	1.9	2.7	1.9	2.4	1.8
Gross Domestic Purchases chn.-wt. price index		3.0	2.5	1.7	1.9	2.7	1.8	2.4	2.4	1.9	0.8
CPI		2.7	3.5	2.1	2.6	3.2	3.4	2.8	3.3	2.3	1.0
Ex. food and energy		3.3	3.3	2.8	2.7	2.7	2.7	2.4	2.7	2.2	2.9
ECI, hourly compensation[1]		2.9	2.6	2.6	2.9	2.5	3.5	2.8	2.8	2.5	3.4
Nonfarm business sector											
Output per hour		-1.6	0.8	1.1	1.6	1.9	2.2	-1.0	1.8	1.4	2.7
Compensation per hour		2.6	3.1	2.7	2.9	2.8	4.4	2.9	3.3	4.5	3.2
Unit labor cost		4.2	2.3	1.6	1.3	0.9	2.1	3.9	1.5	3.1	0.5

1. Private-industry workers.

Strictly Confidential <FR>
Class II FOMC

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

November 6, 1997

		Projected									
Item	Units	1997 Q3	1997 Q4	1998 Q1	1998 Q2	1998 Q3	1998 Q4	1999 Q1	1999 Q2	1999 Q3	1999 Q4
EXPENDITURES											
Nominal GDP	Bill. $	8131.3	8238.3	8339.0	8431.3	8514.9	8591.7	8672.9	8749.4	8826.5	8903.7
Real GDP	Bill. Ch. $	7220.7	7282.3	7331.2	7376.0	7412.4	7442.9	7470.4	7498.0	7524.3	7551.4
Real GDP	% change	3.5	3.5	2.7	2.5	2.0	1.7	1.5	1.5	1.4	1.4
Gross domestic purchases		4.6	3.1	3.1	3.0	3.1	1.4	1.9	1.7	2.1	1.1
Final sales		4.7	3.6	3.0	2.8	1.7	2.5	1.5	1.9	1.3	2.2
Priv. dom. final purchases		6.9	3.7	4.3	3.7	3.1	2.7	2.3	2.2	2.1	2.1
Personal cons. expenditures		5.7	3.0	3.7	3.5	3.0	2.5	2.0	1.9	1.7	1.7
Durables		16.7	2.0	6.5	5.9	5.0	2.8	2.7	2.0	1.1	1.5
Nondurables		4.7	1.8	3.8	3.3	2.8	2.5	2.0	1.8	1.6	1.6
Services		4.1	3.8	3.1	3.1	2.7	2.5	1.9	1.9	1.9	1.8
Business fixed investment		16.8	8.0	10.6	7.2	6.1	6.3	6.5	6.1	5.2	5.2
Producers' dur. equipment		22.4	11.2	13.4	8.7	7.2	7.5	7.7	7.1	5.9	5.9
Nonres. structures		2.9	-0.2	3.2	3.2	3.1	3.0	3.3	3.3	3.3	3.3
Residential structures		1.9	5.2	-0.9	-1.7	-3.1	-4.2	-3.5	-2.4	0.2	1.0
Exports		5.5	15.3	7.2	9.1	1.9	10.8	4.3	8.6	3.0	10.5
Imports		14.1	10.9	10.1	12.4	10.3	7.9	7.2	9.2	7.8	7.1
Gov't. cons. & investment		1.0	0.8	-1.0	1.3	1.6	0.4	0.1	1.1	1.4	0.5
Federal		-1.2	-2.0	-6.6	-0.6	0.4	-3.0	-3.9	-1.1	-0.2	-2.7
Defense		1.1	-4.1	-10.7	-1.5	0.0	-3.9	-5.3	-1.0	0.5	-3.5
State & local		2.2	2.4	2.3	2.3	2.3	2.3	2.3	2.2	2.2	2.3
Change in bus. inventories	Bill. Ch. $	55.4	53.1	49.1	43.1	48.0	31.7	31.3	24.2	26.5	12.7
Nonfarm		46.4	44.4	42.3	37.8	43.6	27.8	27.4	20.4	22.7	8.9
Net exports		-160.4	-154.8	-165.5	-178.4	-203.7	-200.2	-211.3	-217.3	-234.4	-229.3
Nominal GDP	% change	4.9	5.4	5.0	4.5	4.0	3.7	3.8	3.6	3.6	3.5
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	122.5	123.2	123.8	124.4	124.9	125.2	125.5	125.8	125.9	126.2
Unemployment rate	%	4.9	4.8	4.7	4.6	4.6	4.7	4.7	4.8	5.0	5.1
Industrial prod. index	% change	7.0	5.7	3.7	2.6	1.7	1.0	1.5	1.4	0.9	1.4
Capacity util. rate - mfg.	%	83.2	83.4	83.2	83.0	82.7	82.2	82.1	82.0	81.8	81.7
Housing starts	Millions	1.45	1.43	1.43	1.42	1.40	1.39	1.37	1.37	1.38	1.38
Light motor vehicle sales		15.34	14.98	15.04	14.99	14.88	14.75	14.65	14.55	14.47	14.44
North Amer. produced		13.31	13.03	13.18	13.15	13.06	12.95	12.87	12.78	12.71	12.67
Other		2.03	1.94	1.86	1.84	1.82	1.80	1.78	1.77	1.76	1.77
INCOME AND SAVING											
Nominal GNP	Bill. $	8107.6	8209.9	8308.2	8397.9	8476.8	8550.0	8629.9	8705.4	8778.9	8852.4
Nominal GNP	% change	4.8	5.1	4.9	4.4	3.8	3.5	3.8	3.5	3.4	3.4
Nominal personal income		4.8	5.3	5.7	4.5	4.3	3.9	5.1	3.8	3.7	3.7
Real disposable income		2.9	3.1	5.2	2.2	1.9	1.6	4.4	1.3	1.1	1.3
Personal saving rate	%	3.5	3.6	3.9	3.6	3.4	3.2	3.8	3.6	3.5	3.4
Corp. profits, IVA & CCAdj.	% change	11.3	1.0	1.2	0.1	-3.5	-3.9	-3.0	-1.3	-0.6	-1.5
Profit share of GNP	%	10.1	10.0	9.9	9.8	9.6	9.4	9.3	9.2	9.1	9.0
Excluding FR Banks	%	9.8	9.7	9.6	9.5	9.3	9.2	9.0	8.9	8.8	8.7
Federal surpl./deficit	Bill. $	-20.7	-8.1	-14.0	-4.3	1.1	-6.0	-23.2	-18.8	-15.3	-23.1
State & local surpl./def.		113.2	113.6	114.3	114.4	113.5	114.3	113.2	111.7	110.1	108.9
Ex. social ins. funds		41.8	42.2	42.9	42.9	42.0	42.8	41.6	40.1	38.5	37.3
PRICES AND COSTS											
GDP implicit deflator	% change	1.4	1.9	2.2	2.0	2.0	2.0	2.3	2.1	2.1	2.1
GDP chn.-wt. price index		1.4	1.7	2.2	2.0	2.0	2.0	2.3	2.1	2.1	2.1
Gross Domestic Purchases chn.-wt. price index		1.2	1.5	1.8	1.8	1.9	1.9	2.2	2.0	2.0	2.0
CPI		2.0	2.4	2.0	2.2	2.3	2.4	2.5	2.5	2.5	2.5
Ex. food and energy		1.7	2.4	2.4	2.4	2.4	2.5	2.5	2.5	2.5	2.6
ECI, hourly compensation[1]		3.4	3.5	3.3	3.2	3.3	3.2	3.0	3.5	3.6	3.6
Nonfarm business sector											
Output per hour		3.0	1.8	0.8	0.7	0.5	0.6	0.6	0.9	1.1	1.2
Compensation per hour		4.3	3.7	3.6	3.5	3.5	3.6	3.6	3.6	3.7	3.7
Unit labor cost		1.3	1.8	2.7	2.8	3.0	2.9	3.0	2.7	2.5	2.5

1. Private-industry workers.

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

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	4.3	4.9	3.3	3.5	3.5	2.7	2.5	2.0	1.7	3.2	3.8	2.2
Gross dom. purchases	2.5	6.0	3.7	4.6	3.1	3.2	3.0	3.1	1.4	3.6	4.3	2.7
Final sales	4.5	3.0	2.5	4.7	3.6	2.9	2.8	1.7	2.5	3.1	3.4	2.5
Priv. dom. final purchases	2.7	4.2	2.4	5.6	3.1	3.6	3.1	2.6	2.2	3.1	3.8	2.9
Personal cons. expenditures	2.2	3.6	0.6	3.8	2.0	2.5	2.4	2.0	1.7	1.8	2.5	2.2
Durables	0.3	1.1	-0.5	1.3	0.2	0.5	0.5	0.4	0.2	0.3	0.5	0.4
Nondurables	0.4	0.9	-0.4	0.9	0.3	0.7	0.6	0.5	0.5	0.4	0.4	0.6
Services	1.5	1.5	1.5	1.6	1.5	1.3	1.3	1.1	1.0	1.1	1.6	1.2
Business fixed investment	0.6	0.4	1.4	1.7	0.8	1.1	0.8	0.7	0.7	1.1	1.1	0.8
Producers' dur. equip.	0.2	0.5	1.6	1.6	0.8	1.0	0.7	0.6	0.6	0.9	1.1	0.7
Nonres. structures	0.4	-0.1	-0.1	0.1	-0.0	0.1	0.1	0.1	0.1	0.3	-0.0	0.1
Residential structures	-0.2	0.1	0.3	0.1	0.2	-0.0	-0.1	-0.1	-0.2	0.2	0.2	-0.1
Net exports	1.8	-1.0	-0.4	-1.1	0.3	-0.4	-0.5	-1.1	0.2	-0.4	-0.6	-0.5
Exports	2.7	1.1	2.0	0.6	1.7	0.8	1.1	0.2	1.3	1.0	1.4	0.9
Imports	-0.8	-2.1	-2.5	-1.8	-1.4	-1.3	-1.6	-1.3	-1.0	-1.4	-1.9	-1.3
Government cons. & invest.	0.0	-0.1	0.6	0.2	0.1	-0.2	0.2	0.3	0.1	0.4	0.2	0.1
Federal	-0.4	-0.4	0.4	-0.1	-0.1	-0.4	-0.0	0.0	-0.2	0.1	-0.0	-0.2
Defense	-0.3	-0.6	0.3	0.0	-0.2	-0.5	-0.1	0.0	-0.2	0.0	-0.1	-0.2
Nondefense	0.0	0.2	0.1	-0.1	0.1	0.0	0.0	0.0	-0.0	0.1	0.0	0.0
State and local	0.4	0.3	0.1	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.3
Change in bus. inventories	-0.2	1.8	0.8	-1.1	-0.1	-0.2	-0.3	0.3	-0.9	0.1	0.3	-0.3
Nonfarm	-0.2	1.8	0.7	-1.2	-0.1	-0.1	-0.2	0.3	-0.8	0.0	0.2	-0.2
Farm	-0.1	0.0	0.1	0.1	-0.0	-0.1	-0.1	-0.0	-0.0	0.1	0.0	-0.1

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

Strictly Confidential <FR>
Class II FOMC

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

November 6, 1997

Item	1997 Q4	1998 Q1	1998 Q2	1998 Q3	1998 Q4	1999 Q1	1999 Q2	1999 Q3	1999 Q4	97Q4/ 96Q4	98Q4/ 97Q4	99Q4/ 98Q4
Real GDP	3.5	2.7	2.5	2.0	1.7	1.5	1.5	1.4	1.4	3.8	2.2	1.5
Gross dom. purchases	3.1	3.2	3.0	3.1	1.4	1.9	1.7	2.1	1.2	4.3	2.7	1.7
Final sales	3.6	2.9	2.8	1.7	2.5	1.5	1.9	1.3	2.2	3.4	2.5	1.7
Priv. dom. final purchases	3.1	3.6	3.1	2.6	2.2	1.9	1.9	1.7	1.8	3.8	2.9	1.8
Personal cons. expenditures	2.0	2.5	2.4	2.0	1.7	1.4	1.3	1.2	1.2	2.5	2.2	1.3
Durables	0.2	0.5	0.5	0.4	0.2	0.2	0.2	0.1	0.1	0.5	0.4	0.1
Nondurables	0.3	0.7	0.6	0.5	0.5	0.4	0.4	0.3	0.3	0.4	0.6	0.3
Services	1.5	1.3	1.3	1.1	1.0	0.8	0.8	0.8	0.7	1.6	1.2	0.8
Business fixed investment	0.8	1.1	0.8	0.7	0.7	0.7	0.7	0.6	0.6	1.1	0.8	0.6
Producers' dur. equip.	0.8	1.0	0.7	0.6	0.6	0.6	0.6	0.5	0.5	1.1	0.7	0.5
Nonres. structures	-0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	-0.0	0.1	0.1
Residential structures	0.2	-0.0	-0.1	-0.1	-0.2	-0.1	-0.1	0.0	0.0	0.2	-0.1	-0.0
Net exports	0.3	-0.4	-0.5	-1.1	0.2	-0.4	-0.2	-0.7	0.3	-0.6	-0.5	-0.3
Exports	1.7	0.8	1.1	0.2	1.3	0.5	1.0	0.4	1.3	1.4	0.9	0.8
Imports	-1.4	-1.3	-1.6	-1.3	-1.0	-1.0	-1.2	-1.1	-1.0	-1.9	-1.3	-1.1
Government cons. & invest.	0.1	-0.2	0.2	0.3	0.1	0.0	0.2	0.2	0.1	0.2	0.1	0.1
Federal	-0.1	-0.4	-0.0	0.0	-0.2	-0.2	-0.1	-0.0	-0.2	-0.0	-0.2	-0.1
Defense	-0.2	-0.5	-0.1	0.0	-0.2	-0.2	-0.0	0.0	-0.1	-0.1	-0.2	-0.1
Nondefense	0.1	0.0	0.0	0.0	-0.0	-0.0	-0.0	-0.0	-0.0	0.0	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	-0.1	-0.2	-0.3	0.3	-0.9	-0.0	-0.4	0.1	-0.7	0.3	-0.3	-0.2
Nonfarm	-0.1	-0.1	-0.2	0.3	-0.8	-0.0	-0.4	0.1	-0.7	0.2	-0.2	-0.2
Farm	-0.0	-0.1	-0.1	-0.0	-0.0	0.0	0.0	0.0	0.0	0.0	-0.1	0.0

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

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

November 6, 1997

Item	Fiscal year[5]				1997				1998				1999			
	1996[a]	1997	1998	1999	Q1[a]	Q2[a]	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
UNIFIED BUDGET					Not seasonally adjusted											
Receipts[1]	1453	1579	1654	1716	349	496	387	372	368	516	398	392	373	529	422	392
Outlays[1]	1560	1602	1681	1741	401	396	399	425	419	416	420	470	406	430	436	450
Surplus/deficit[1]	-107	-23	-26	-25	-52	100	-12	-53	-51	100	-22	-77	-32	99	-15	-57
On-budget	-174	-103	-118	-130	-69	61	-19	-76	-66	54	-31	-72	-81	48	-25	-85
Off-budget	67	81	92	105	17	39	8	23	14	46	9	-5	48	51	11	27
Surplus excluding deposit insurance[2]	-116	-37	-31	-29	-56	97	-13	-54	-52	99	-24	-78	-33	98	-15	-58
Means of financing																
Borrowing	130	38	41	38	48	-69	11	38	47	-82	38	44	46	-81	29	41
Cash decrease	-6	1	4	0	-1	-18	8	15	10	-16	-5	20	0	-15	-5	10
Other[3]	-16	-16	-18	-12	5	-13	-7	0	-6	-3	-10	14	-14	-3	-10	6
Cash operating balance, end of period	44	44	40	40	33	51	44	29	19	35	40	20	20	35	40	30
NIPA FEDERAL SECTOR					Seasonally adjusted annual rate											
Receipts	1550	1690	1783	1829	1675	1709	1735	1764	1770	1790	1808	1819	1818	1832	1848	1859
Expenditures	1679	1738	1789	1845	1731	1746	1756	1772	1784	1794	1807	1825	1841	1851	1863	1882
Consumption expend.	447	460	465	471	458	464	465	462	465	466	469	467	471	472	473	472
Defense	302	309	307	308	306	311	312	307	307	307	308	307	308	309	310	309
Nondefense	145	151	158	162	152	153	153	154	158	159	160	161	163	163	163	163
Other expenditures	1232	1278	1324	1374	1273	1282	1291	1310	1319	1328	1338	1358	1370	1380	1390	1410
Current account surplus	-129	-48	-6	-16	-56	-37	-21	-8	-14	-4	1	-6	-23	-19	-15	-23
Gross investment	69	61	59	57	58	62	60	63	58	58	58	58	57	57	57	57
Current and capital account surplus	-197	-109	-66	-73	-114	-99	-81	-71	-72	-62	-57	-64	-80	-76	-73	-80
FISCAL INDICATORS[4]																
High-employment (HEB) surplus/deficit	-220	-170	-159	-155	-170	-167	-160	-159	-164	-159	-154	-157	-166	-155	-144	-143
Change in HEB, percent of potential GDP	-.6	-.7	-.1	0	-.2	0	-.1	0	.1	-.1	-.1	0	.1	-.1	-.1	0
Fiscal impetus (FI), percent, cal. year	-2.3	-1.8	-2.1	-1.4	-1.1	1.5	.3	-1.7	-.6	-.4	0	-1.8	1	-.6	-.4	-1.5

1. OMB's September 1997 deficit estimates (assuming the enactment of the President's proposals) are $58 billion in FY98 and $57 billion in FY99. CBO's September 1997 baseline deficit estimates are $57 billion in FY98 and $52 billion in FY99. Budget receipts, outlays, and surplus/deficit include corresponding social security (OASDI) categories. The OASDI surplus is excluded from the on-budget deficit and shown separately as off-budget, as classified under current law. The Postal Service deficit is included in off-budget outlays beginning in FY90.

2. OMB's September 1997 deficit estimates (assuming the enactment of the President's proposals), excluding deposit insurance spending, are $63 billion in FY98 and $59 billion in FY99. CBO's September 1997 baseline deficit estimates, excluding deposit insurance, are $61 billion in FY98 and $56 billion in FY99.

3. Other means of financing are checks issued less checks paid, accrued items, and changes in other financial assets and liabilities.

4. HEB is the NIPA current and capital account surplus in current dollars, with cyclically sensitive receipts and outlays adjusted to the level of potential output associated with an unemployment rate of 6 percent. Real potential GDP growth is assumed to rise from 2.2 percent in 1996 to 2.5 percent in 1999, reflecting CPI modifications. Quarterly figures for change in HEB and FI are not at annual rates. Change in HEB, as a percent of nominal potential GDP, is reversed in sign. FI is the weighted difference of discretionary changes in federal spending and taxes in chained (1992) dollars, scaled by real federal consumption plus investment. For change in HEB and FI, negative values indicate restraint.

5. Fiscal year data for the unified budget come from OMB; quarterly data come from the Monthly Treasury Statement and may not sum to OMB fiscal year totals.

a--Actual.

Strictly Confidential Class II FOMC
November 6, 1997

Change in Debt of the Domestic Nonfinancial Sectors
(Percent)

Period [1]	Total [2]	Federal government [3]	Nonfederal: Total [4]	Nonfederal: Households: Total	Nonfederal: Households: Home mortgages	Nonfederal: Households: Consumer credit	Nonfederal: Business	Nonfederal: State and local governments	Memo: Nominal GDP
Year									
1987	9.2	8.0	9.6	12.0	15.9	5.1	6.9	12.1	7.4
1988	8.9	8.0	9.2	9.5	10.7	8.6	9.8	6.5	7.6
1989	7.6	7.0	7.8	8.5	9.9	6.0	7.7	5.7	6.4
1990	6.5	11.0	5.3	7.5	9.6	1.9	3.3	5.1	4.4
1991	4.3	11.1	2.3	4.9	6.6	-1.7	-1.8	8.4	3.8
1992	4.8	10.9	2.8	5.1	6.0	0.5	0.6	2.0	6.3
1993	5.2	8.3	4.1	6.2	5.3	7.7	1.5	5.7	5.0
1994	4.8	4.7	4.8	8.2	6.4	14.5	3.7	-4.0	5.8
1995	5.3	4.1	5.8	7.8	6.0	14.2	6.2	-3.8	4.0
1996	5.2	4.0	5.6	7.4	7.9	7.6	4.7	1.2	5.6
1997	4.6	0.7	6.0	6.1	6.4	5.4	6.1	5.3	5.7
1998	4.9	1.2	6.1	5.7	6.2	5.1	7.0	4.5	4.3
1999	4.4	0.9	5.5	5.0	5.8	3.7	6.5	3.7	3.6
Quarter									
1997:1	4.7	2.1	5.6	6.4	6.5	7.1	5.3	3.2	7.4
2	3.7	-2.6	5.9	5.5	5.4	4.2	6.0	7.7	5.2
3	4.6	1.1	5.8	6.0	6.6	4.4	6.1	3.9	4.9
4	5.2	2.2	6.2	5.9	6.5	5.4	6.6	5.9	5.4
1998:1	4.9	1.9	5.9	5.7	6.2	5.4	6.6	3.8	5.0
2	3.8	-3.5	6.3	5.6	6.1	5.2	6.7	7.7	4.5
3	5.4	3.8	5.9	5.5	5.9	4.9	7.0	3.6	4.0
4	5.1	2.7	5.9	5.4	5.9	4.6	7.2	2.5	3.7

Note. Quarterly data are at seasonally adjusted annual rates.
1. Data after 1997:Q2 are staff projections. Changes are measured from end of the preceding period to end of period indicated except for annual nominal GDP growth, which is calculated from Q4 to Q4.
2. On a monthly average basis, total debt grew 4.5 percent in 1997, 4.9 percent in 1998, and 4.5 percent in 1999.
3. On a monthly average basis, federal debt rose 0.7 percent in 1997, 1.2 percent in 1998, and 1.2 percent in 1999.
4. On a monthly average basis, nonfederal debt increased 5.8 percent in 1997, 6.2 percent in 1998, and 5.6 percent in 1999.

2.6.3 FOF

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

Category	Calendar year				Seasonally adjusted annual rates 1997				1998			
	1996	1997	1998	1999	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Net funds raised by domestic nonfinancial sectors												
1 Total	651.1	588.9	626.8	611.3	600.0	461.1	590.1	704.7	647.5	485.7	702.7	671.4
2 Net equity issuance	-64.2	-83.4	-116.0	-91.0	-86.2	-83.6	-92.4	-71.2	-94.0	-102.0	-138.0	-130.0
3 Net debt issuance	715.3	672.3	742.8	702.3	686.2	544.7	682.5	775.9	741.5	587.7	840.7	801.4
Borrowing sectors												
Nonfinancial business												
4 Financing gap [1]	8.4	55.8	101.1	136.3	36.1	82.6	42.3	62.1	89.8	95.4	110.5	108.6
5 Net equity issuance	-64.2	-83.4	-116.0	-91.0	-86.2	-83.6	-92.4	-71.2	-94.0	-102.0	-138.0	-130.0
6 Credit market borrowing	193.9	269.1	327.5	325.5	234.5	266.4	273.0	302.6	306.8	315.3	335.5	352.5
Households												
7 Net borrowing [2]	363.8	318.2	317.3	296.6	335.5	291.1	324.6	321.7	319.7	318.9	316.6	314.3
8 Home mortgages	263.9	229.7	235.8	235.4	233.0	195.9	244.0	245.8	237.4	235.9	234.3	235.4
9 Consumer credit	86.3	65.2	65.7	50.3	85.9	52.4	55.0	67.6	69.1	68.0	64.5	61.3
10 Debt/DPI (percent) [3]	90.5	91.9	92.6	93.4	91.3	91.8	92.1	92.3	92.1	92.4	92.8	93.2
State and local governments												
11 Net borrowing	12.7	57.5	51.3	44.6	35.0	84.2	44.0	66.8	44.0	88.4	42.8	30.0
12 Current surplus [4]	126.1	124.1	124.3	120.3	115.8	123.7	130.5	126.4	124.9	124.8	123.5	124.2
Federal government												
13 Net borrowing	145.0	27.5	46.7	35.6	81.2	-97.1	40.9	84.8	71.1	-134.9	145.9	104.7
14 Net borrowing (quarterly, n.s.a.)	145.0	27.5	46.7	35.6	48.0	-69.2	10.6	38.0	47.2	-81.9	37.6	43.7
15 Unified deficit (quarterly, n.s.a.)	110.9	16.4	50.7	5.5	52.0	-100.1	11.5	53.0	51.2	-100.3	22.5	77.3
Depository institutions												
16 Funds supplied	233.2	255.9	275.8	275.7	330.6	370.2	166.4	156.7	262.0	267.0	272.8	301.4
Memo (percentage of GDP)												
17 Domestic nonfinancial debt [5]	185.2	183.5	183.6	185.1	183.9	183.5	183.2	183.0	183.1	183.0	183.3	184.1
18 Domestic nonfinancial borrowing	9.4	8.3	8.8	8.0	8.6	6.8	8.4	9.4	8.9	7.0	9.9	9.3
19 Federal government [6]	1.9	0.3	0.6	0.4	1.0	-1.2	0.5	1.0	0.9	-1.6	1.7	1.2
20 Nonfederal	7.5	8.0	8.2	7.6	7.6	8.0	7.9	8.4	8.0	8.6	8.2	8.1

Note. Data after 1997:Q2 are staff projections.
1. For corporations: Excess of capital expenditures over U.S. internal funds.
2. Includes change in liabilities not shown in lines 8 and 9.
3. Average debt levels in the period (computed as the average of period-end debt positions) divided by disposable personal income.
4. NIPA surplus less changes in retirement fund assets plus consumption of fixed capital.
5. Average debt levels in the period (computed as the average of period-end debt positions) divided by nominal GDP.
6. Excludes government-insured mortgage pool securities.

International Developments

Recent Developments

Turmoil in financial markets, which had previously been confined to southeast Asian countries, has spread since the September 30 FOMC meeting. Equity prices in all areas--especially Asia--have fallen substantially, albeit in many cases from levels that might have been viewed as inflated. Currency movements have been mixed. Most Asian and some major Latin American currencies have depreciated against the dollar, while European currencies have appreciated on balance. The effects of unrest in financial markets have begun to show through to reduced growth in Thailand and are expected to depress activity substantially elsewhere in Asia and to a lesser extent in Latin America, but only modestly in industrial countries on the whole.

Since the September FOMC meeting, the foreign exchange value of the dollar has risen sharply against several Asian and Latin American currencies--most notably against the Thai baht, the Taiwan dollar, and the Korean won (about 6 to 10 percent on balance), and the Mexican peso (about 5-1/2 percent). At the same time, the dollar has depreciated about 2 percent in terms of the mark and other European currencies as the Bundesbank tightened monetary conditions while expectations of a Fed tightening eased. Further resolution of uncertainties surrounding EMU may also have contributed to the firming of European currencies. On balance, the dollar has depreciated 1-1/2 percent on average against the currencies of other G-10 countries, despite a 1-1/2 percent appreciation against the yen, but it has appreciated more than 1-1/2 percent against a broader weighted average of 20 currencies, including those of the key emerging market countries.

Early in the period, the financial turmoil in Thailand and elsewhere in southeast Asia spread to Indonesia, and the Indonesian rupiah fell sharply. By mid-October, pressures on currency and stock markets in Taiwan had grown to the point where monetary authorities chose to end their practice of managing the currency. The resulting depreciation of the Taiwan dollar undercut confidence in the resolve of Hong Kong authorities to maintain their currency peg, and led to increasing pressures on the Hong Kong dollar. On October 23, the Hong Kong Monetary Authority countered the exchange market pressure, briefly pushing overnight rates to more than 250 percent. This move triggered a sharp fall in the Hang Seng stock index, which, in turn, sparked a global selloff in equity markets. In late October, currency pegs in Brazil and Argentina came under attack, and pressures on their equity markets, as well as on Korea's, were especially intense. Toward the end of the period, following the announcement of an IMF-led support package for Indonesia and after coordinated exchange market intervention by Asian central banks, the rupiah reversed its earlier decline amid a general strengthening of financial markets in emerging market economies. For the entire intermeeting period, net declines in stock markets ranged from 0.6 percent in the United States (NYSE) and 5-1/2 to 6 percent in major European exchanges to 11 percent in Korea, more than 14 percent in Brazil and Argentina, and nearly 30 percent in Hong Kong. In some cases, these moves at least partially reversed sharp increases in price-earnings ratios that had occurred in recent years.

Short-term interest rates in the major foreign industrial countries have risen about 20 basis points on average since the September FOMC, reflecting moderate tightening by the Bundesbank (with other continental European central banks following suit) and the Bank of Canada early in the period and a 25-basis-point tightening by the Bank of England today. Long-term rates were little changed on average, as rates fell 25 basis points in Japan and 15 basis points in Canada but rose somewhat in Europe. Interest rates rose more substantially in developing countries, reflecting both widening risk spreads and, in some cases, monetary tightening. The spreads of Brady bonds over U.S. Treasury securities had doubled in Latin America in Brazil and Argentina (although to well below the peak during the Mexican crisis), but have since rectraced half those increases. On balance, these spreads have risen about 200 basis points during the intermeeting period. Increases in Asian Yankee bond spreads were somewhat more subdued, ranging from less than 50 basis points in some countries to more than 100 basis points in the Philippines and Korea. Short-term (1-month) interest rates in countries that have thus far defended currency pegs have risen sharply--up 22 percentage points for the period in Brazil, 9 in Argentina, and 5 in Hong Kong.

. The Desk did not intervene.

Indicators of economic activity in the third quarter showed robust expansion in the major foreign industrial countries except Japan, in some cases above our expectations. Preliminary U.K. GDP was up 4 percent for the quarter, and Canadian monthly data on GDP and employment suggest a second consecutive quarter of expansion around 5 percent. In Germany, industrial production rose at an annual rate of about 6 percent in the third quarter and orders continued on an upward trend through. French industrial production rose strongly in July-August, and consumption of manufactured goods rose at rate of 10 percent in the third quarter. Italy's successful resolution of a budget crisis appears to have ensured its charter membership in the European Monetary Union, while the United Kingdom made it clear that it would not be joining the first wave of membership.

Japanese indicators for the third quarter are mixed, but on balance point to a modest rebound in activity from the sharp second-quarter decline, a rise about in line with our expectations. Household expenditures and new auto registrations were up, but industrial production edged down, housing starts fell, and the September Tankan survey suggested further weakness.

The latest inflation data show rates of CPI inflation below 2 percent in most of the foreign G-7 countries. U.K. 12-month inflation edged down to 2.7 percent in September as import prices fell further, but it was still above the government's target of 2-1/2 percent. Japanese inflation rose to 2-1/4 percent in September and October on a hike in health-insurance payments; underlying inflation pressures in Japan are quiescent, however.

Outside of Thailand, it is still too early to have seen signs that the turbulence in the financial markets of developing countries has had an appreciable effect on real activity. Elsewhere in Asia, industrial production continued to advance briskly through August in China, Hong Kong, Korea, and Singapore, and through September in Taiwan. Growth in Latin America in the third quarter appears to have continued at a robust pace, although growth in Brazil may have slowed from the very rapid rate in the second quarter.

The nominal U.S. deficit in trade of goods and services widened substantially in July-August from its second-quarter average. Exports remained strong near the second-quarter level, as sizable declines in aircraft and gold were about offset by increases in computers, other capital goods, and industrial supplies. Imports rose at an annual rate of 5 percent from the second quarter, with the largest increases in automotive products and aircraft. In real terms, BEA has estimated that net exports declined in the third quarter, subtracting about 1 percentage point at an annual rate from GDP growth.

Export prices fell at a rate of 1.3 percent in the third quarter, reflecting a sizable drop for agricultural exports and a slight decline for nonagricultural exports. Non-oil import prices declined at a rate of 1-1/2 percent; while prices for most categories decreased, prices for autos and industrial supplies showed modest increases. The price of imported oil was unchanged in September at about the level that had prevailed since the spring. The price of spot WTI rose $1.50 in October, to about $21.25 per barrel. A confrontation between the United States and Iran, intensified fighting between Kurdish factions in northern Iraq, and continued problems between Iraqi defense agencies and U.N. inspectors contributed to the increase in prices. WTI has been trading in the $20-$21 per barrel range in recent days.

Outlook

We project that the growth of total foreign real GDP (weighted by U.S. export shares) will slow from an average rate of 3-3/4 percent during the first three quarters of 1997 to 3-1/4 percent in the fourth quarter and to 3 percent next year, before picking up again in 1999. The near-term slowing is primarily because of a sharp deceleration among Asian developing countries as a result of the turmoil in financial markets. We anticipate that offsetting influences will keep the dollar from moving appreciably from its recent level against other G-10 currencies. However, the net appreciation of the dollar over the past year will continue to depress real net exports. Although the growth projected for U.S. real income remains less than that of foreign real income, we continue to expect that imports will expand faster than exports. As a consequence, our outlook has net exports subtracting 1/2 percentage point from annual real GDP in 1998 and 1/3 percentage point in 1999. Developments directly associated with financial market turbulence in Asia have depressed the growth in real net exports over the forecast period, especially during the year ahead; these effects are partly offset by stimulus resulting from the recent decline in the dollar against European currencies.

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

Measure	1997			1998	1999
	H1	Q3	Q4		
Foreign output	3.8	4.0	3.3	2.8	3.5
Previous	3.8	4.0	4.0	3.9	3.6
Real exports	14.1	5.5	15.3	7.2	6.6
Previous	14.9	4.9	14.7	7.6	6.1
Real imports	19.2	14.1	10.9	10.2	7.8
Previous	19.2	12.0	9.6	9.2	7.0

Effects of turmoil in emerging financial markets. Rising interest rates, fiscal contraction, financial-sector weakness, and the likely disruption of investment in many emerging markets in Asia have led us to revise down the average rate of GDP growth for Asian developing countries through the end of 1998 by nearly 4 percentage points relative to the projection in the September Greenbook.[1] This drop in growth, along with recent currency depreciations will produce a substantial improvement--on the order of $50 billion--in the combined current account balance of these countries in 1998. We assume that the financial winds sweeping emerging markets will have a more moderate effect on Latin America, with GDP growth rates trimmed by 1/2 percentage point on average and external balances rising somewhat. Given the pattern of world trade, we expect that the adjustment in Asia and Latin America will reduce Japanese net exports by 2/3 percent of GDP; the magnitude of the impact on the United States and Europe will be about half as large. In 1999, we project growth in Asia to return to near trend rates in most cases, although the level of GDP will remain significantly below its previously projected path.[2]

The dollar. In light of recent exchange rate changes, we have lowered the starting point of our forecast of the dollar's value in terms of foreign G-10 currencies by 2-1/2 percent. Looking ahead, we see various influences that could move the dollar either higher or lower against these currencies. On the one hand, we are assuming that U.S. interest rates will move above levels currently expected by the market, and we project a lower path of interest rates abroad than the market sees. On the other hand, continuing unrest in emerging financial markets could weigh more heavily on the dollar and the yen than on European currencies, and the widening U.S. external deficit will tend to depress the dollar. Given our uncertainty about the timing and effects of these influences, we have chosen to project a flat path of the dollar in terms of the G-10 currencies on average. The dollar's starting point against the developing country currencies, on average, has been raised about 5 percent. We expect that the CPI-adjusted value of the dollar in terms of the currencies of key developing countries will decline over the forecast period as inflation rates in those countries rise in response to their recent currency depreciations and as nominal exchange rates respond positively to the external adjustment in those countries.

Foreign G-7 countries. Real GDP growth in the foreign G-7 countries (weighted by U.S. export shares) is projected to average 3-1/4 percent at an annual rate in the fourth quarter and to slow to 2-1/2 percent next year and to a bit less in 1999. The outlook for the second-half is 1/2 percentage point stronger than in

1. This average refers to major U.S. trading partners among Asian developing countries, weighted by their importance to U.S. exports.

2. This is clearly not a worst-case scenario inasmuch as we assume that Argentina and Brazil, as well as Hong Kong, will be able to hold their currency pegs, that other emerging market currencies will appreciate significantly in real terms during 1998, that Latin America will be only moderately affected, and that GDP growth rates will recover in 1999.

September, reflecting the positive surprises in recent data, particularly in France, Canada, and the United Kingdom. However, the outlook for 1998 is 1/4 percentage point weaker, reflecting the influence of developments in Asia.

In Japan, real GDP should continue to recover in the fourth quarter from its sharp second-quarter decline as domestic demand improves. Growth is expected to average a little over 2 percent over the next two years, leaving GDP well below potential at the end of the period. The positive contribution of net exports will lessen over the forecast period while domestic demand will strengthen as fiscal policy becomes less contractionary. Similarly, in Germany, the boost to GDP growth from net exports is projected to abate somewhat over the forecast period while domestic demand will gradually strengthen. German output growth should slow in the fourth quarter from its recent rapid pace and average about 2-1/2 percent next year.[3] In the United Kingdom, domestic demand should decelerate in response to past and prospective monetary and fiscal tightening. These developments should slow U.K. real GDP growth to less than 2 percent next year from well over 3 percent during the second half of this year. In Canada, growth of both private consumption and investment spending are projected to slow some from their recent rapid pace over the forecast period as monetary policy tightens. Real output growth moves from nearly 4 percent during the second half of 1997 to a little over 3 percent in 1998.

Consumer price inflation is projected to remain low over the forecast period in the foreign G-7 countries. U.K. inflation is expected to continue to benefit in the near term from the effects of recent strength in sterling but to edge up in 1998 as this effect fades and domestic labor markets remain tight. Inflation in Japan is projected to drop back to less than 1 percent per year once the anniversary of the April 1997 tax hike has passed; as a consequence, average inflation in the G-7 countries (weighted by U.S. bilateral import shares) should move down to around 1-1/2 percent in 1998 and 1999.

Our assumptions about interest rates in several countries reflect the timetable for EMU and our perception of the constraints that schedule will place upon the central banks involved. We expect that additional tightening in Europe, led by the Bundesbank, will notch up short-term interest rates again before next spring. Rates in the other EU-11 countries are assumed to converge to German rates by the end of 1998. We have incorporated in the forecast an assumption that the European Central Bank will tighten somewhat during 1999 as the European expansion gathers momentum, leading to a rise in market rates. We also expect some further tightening

3. The pattern for the EU-11 region as a whole is similar to that for Germany.

by the Bank of England by the end of this year but have postponed until 1999 the assumed tightening by the Bank of Japan. Long-term market interest rates abroad are assumed to move up gradually over the forecast period as slack in these economies is reduced.

Other countries. The real GDP of major developing-country trading partners of the United States is projected to increase about 3-1/4 percent during 1998, a marked decline from our forecast in the September Greenbook. The downward revision largely reflects an across-the-board marking down of our forecasts for Asian countries. Our view is that the volatility in currency and equity markets in these countries is likely to continue into 1998, and that further weaknesses in their financial sectors will become apparent; we expect both factors, along with tightening of macroeconomic policies in some cases, to exert a substantial drag on domestic demand next year. The magnitude of the downward revisions is larger (roughly 4 to 5 percentage points) in the case of Korea, Indonesia, Malaysia, and the Philippines--economies which we perceive already to be in the midst of a crisis--and in Hong Kong, which remains vulnerable to additional financial pressures.[4] For other Asian economies (China, Singapore, and Taiwan), we have marked growth down less--2 to 3 percentage points. We project that growth rates in these countries will recover to near trend rates in most cases in 1999. We have revised our inflation forecasts upward for the Asian countries to reflect the substantial depreciation of their currencies over the last month relative to our forecasts.

Our forecast for real GDP growth in Latin America during 1997 also has been marked down a bit as a result of spillover effects from the Asian crisis on the financial markets in these countries. Mexico's growth forecast for 1998 has been nudged down to 4-1/2 percent. In the case of Brazil, we now project growth of 1 percent--2 percentage points lower than in the previous Greenbook, a change that reflects the risks to Brazil's outlook from the real appreciation of its currency and large current account and fiscal deficits. The downturn in these countries, particularly in Brazil, is likely to exert spillover effects on Argentina, and as a result we have lowered Argentina's growth forecast 1/2 percentage point to about 5-1/2 percent.

U.S. real exports and imports. Our forecast for the growth of real nonagricultural exports excluding computers and semiconductors (core exports) has been revised down 1-1/2 percentage points in the second half of 1997 and 3/4

4. Thailand, too, is viewed as being in a financial crisis, but its growth had been revised down sharply in the September forecast; this time we have marked it down further, from 2-1/2 percent to 0 percent growth in 1998.

percentage point in 1998 and 1999 as a result of incoming data and developments in Asia and Latin America and their effects on Japan and Europe.[5] Core exports are projected to grow at an average annual rate of 6-1/2 percent over the second half of this year and to slow to 4-1/2 percent in 1998 and 2-1/4 percent in 1999. The slowdown in core export growth also results from the lagged effects of dollar appreciation since 1995 and, most importantly, our assumption that unidentified factors that have caused these exports to grow well in excess of the rate warranted by their fundamental determinants over the past two years will diminish over time. When the forecast for core export growth is combined with that of continued rapid growth in the volumes of computers and semiconductors and moderate growth of services, real exports of total goods and services are projected to grow at an annual rate of 10-1/4 percent over the second half of this year and to slow to 7-1/4 percent in 1998 and 6-1/2 percent in 1999.

Our forecast for growth of real non-oil imports other than computers and semiconductors (core imports) has been increased since the September Greenbook, reflecting the recent appreciation of the dollar against currencies of countries that figure importantly in U.S. imports. These imports are projected to grow at an annual rate of 11 percent in the second half of this year, slowing to 8 percent in 1998 and 4-1/2 percent in 1999. The projected slowing of U.S. output growth contributes to the deceleration of core imports. Imports of computers and of semiconductors are projected to continue to grow rapidly. We expect the quantity of oil imports to decline in the fourth quarter from surprisingly high rates in recent months and then to rise during the remainder of the forecast period in line with increases in consumption. We project U.S. oil production to remain flat, rather than to decline, because of our expectations of increased production from offshore fields in the Gulf of Mexico. Total imports of goods and services are forecast to expand at an annual rate of 12-1/2 percent during the second half of this year, 10-1/4 percent next year, and 7-3/4 percent in 1999.

Oil prices. We have raised the projected path for the price of imported oil slightly in the near term (to about $18.00 per barrel) in light of the recent runup in spot prices. We project the WTI spot price to decline in the near term as tensions in the Middle East abate and growth of demand for oil declines in Asia (due to slower growth) and North America (due to the effect of El Niño on demand for heating oil).

5. The full negative effects of the Asian currency crisis on core exports via lower GDP growth abroad and appreciation of the dollar against the currencies of developing countries are partly offset by the positive effects of the lower projected path of the dollar against G-10 currencies.

Prices should then rise to $21.00 per barrel (consistent with an import price of $18.50 per barrel) by the end of 1999 as consumption demand grows and supply is restrained by difficulties non-OPEC producers face bringing new fields on line within their planned time frame.

Prices of non-oil imports and exports. The prices of non-oil imports of core goods are expected to begin rising over the forecast period at a rate that will increase over time. The projected acceleration in core import prices results in part from the switch from dollar appreciation earlier this year to a flat dollar over the period ahead. In addition, projected declines in non-oil commodity prices through 1998 hold down core import prices in the near term but not in late 1998 and 1999. Prices of core nonagricultural exports are also projected to decline in the near term and to rise subsequently at an increasing rate in line with comparable U.S. domestic prices.

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

Trade category	1997: H1	Projection			
		1997		1998	1999
		Q3	Q4		
Exports					
Nonagricultural (core)	.9	.8	-.9	.8	1.4
Agricultural	.1	-6.3	-7.9	-3.6	2.2
Imports					
Non-oil (core)	-1.3	.3	-2.6	-.3	.8
Oil (level, dollars per barrel)	18.00	17.50	17.90	17.19	18.50

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

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

Nominal trade and current account balances. The nominal trade deficit on goods and services is expected to widen from $107 billion in the second quarter of 1997 to $155 billion at the end of 1999. The deficit on net investment income is projected to increase by $30 billion over that same interval. We project that the current account deficit will average $170 billion, or 2.1 percent of GDP, this year but will widen to $235 billion, or 2.7 percent of GDP, in 1999.

November 6, 1997

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

Measure and country	1991	1992	1993	1994	1995	1996	1997	1998	1999
							---- Projected ----		
REAL GDP									
Canada	0.0	0.5	3.1	4.9	0.7	2.3	4.3	2.9	2.3
Japan	2.5	0.1	0.4	0.8	2.6	3.0	-0.2	2.0	2.3
United Kingdom	-1.6	0.4	2.7	4.9	2.0	2.9	3.5	1.7	1.6
EU-11 Average (1)	2.1	0.1	-0.1	3.5	1.4	1.9	2.9	2.5	3.0
of which:									
France	1.3	-0.0	-0.5	4.2	0.3	2.2	2.8	2.3	2.5
Germany (2)	3.3	0.9	-0.2	3.4	0.7	2.1	2.8	2.4	3.2
Italy	1.9	-0.8	0.1	2.7	2.3	0.3	2.5	2.2	3.0
Foreign G-7 Average weighted by 1991 GDP	1.7	0.2	0.6	2.8	1.7	2.3	1.9	2.2	2.5
Average weighted by share of U.S. nonagricultural exports									
Total foreign	2.9	1.9	3.2	5.1	2.0	4.1	3.7	2.8	3.5
Foreign G-7	0.8	0.3	1.8	3.9	1.3	2.4	3.0	2.5	2.3
Developing Countries	6.4	5.1	5.9	7.0	2.6	6.7	4.7	3.2	5.4
CONSUMER PRICES									
Canada	4.1	1.8	1.8	0.0	2.1	2.0	1.8	2.0	2.0
Japan	3.2	0.9	1.2	0.8	-0.8	0.1	2.0	0.6	0.8
United Kingdom (3)	5.7	3.7	2.7	2.2	2.9	3.2	2.6	2.8	2.9
EU-11 Average (4)	NA	NA	NA	NA	2.7	2.0	1.6	2.0	2.1
of which:									
France	3.0	1.8	2.1	1.6	1.9	1.7	1.4	1.8	1.9
Germany (2)	4.0	3.4	4.2	2.6	1.7	1.4	2.0	2.1	2.2
Italy	6.1	4.9	4.1	3.8	5.9	2.7	1.8	2.0	2.5
Foreign G-7 Average weighted by 1991 GDP	4.1	2.4	2.5	1.8	1.6	1.5	1.9	1.6	1.8
Average weighted by share of U.S. non-oil imports	3.9	1.9	2.0	1.0	1.1	1.3	1.9	1.5	1.6

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

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

	----------	----------	Projected	----------	----------	----------	----------	----------	----------	----------	----------	----------
	1997				1998				1999			
Measure and country	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
REAL GDP												
Canada	3.7	4.9	4.8	3.8	3.2	3.0	2.8	2.6	2.5	2.5	2.3	2.1
Japan	5.7	-11.2	2.4	3.2	2.1	1.9	2.0	2.0	2.3	2.3	2.3	2.3
United Kingdom	3.4	4.0	4.0	2.6	1.9	1.8	1.7	1.6	1.8	1.6	1.6	1.5
EU-11 Average (1)	0.9	4.8	3.3	2.4	2.4	2.4	2.5	2.5	3.0	2.9	3.1	2.9
of which:												
France	1.3	4.1	3.7	2.2	2.2	2.2	2.4	2.5	2.5	2.5	2.5	2.5
Germany	1.2	4.1	3.4	2.3	2.4	2.3	2.5	2.5	3.2	3.2	3.3	3.2
Italy	-1.1	6.7	2.5	2.0	2.1	2.1	2.3	2.3	2.6	2.6	3.5	3.5
Foreign G-7 Average weighted by 1991 GDP	2.8	-0.8	3.2	2.7	2.2	2.1	2.2	2.2	2.5	2.5	2.6	2.5
Average weighted by share of U.S. nonagricultural exports												
Total foreign	3.3	4.3	4.0	3.3	2.7	2.7	2.8	3.0	3.5	3.5	3.5	3.6
Foreign G-7	3.6	1.2	4.0	3.3	2.6	2.5	2.4	2.3	2.4	2.4	2.3	2.2
Developing Countries	3.8	7.7	4.2	3.4	2.6	3.0	3.2	3.8	4.9	5.3	5.5	5.9
CONSUMER PRICES (2)												
Canada	2.1	1.6	1.7	1.8	1.9	1.9	2.0	2.0	2.0	2.0	2.0	2.0
Japan	0.0	1.5	1.7	2.0	2.0	0.5	0.2	0.6	0.8	0.8	0.8	0.8
United Kingdom (3)	2.9	2.6	2.8	2.6	2.6	2.7	2.7	2.8	2.8	2.9	2.9	2.9
EU-11 Average (4)	1.7	1.2	1.5	1.6	1.9	1.8	2.0	2.0	2.1	2.1	2.2	2.1
of which:												
France	1.5	0.9	1.3	1.4	1.6	1.5	1.8	1.8	1.9	1.9	1.9	1.9
Germany	1.7	1.6	1.9	2.0	2.0	2.0	2.1	2.1	2.1	2.1	2.2	2.2
Italy	2.4	1.6	1.5	1.8	2.0	2.0	2.1	2.0	2.3	2.3	2.5	2.5
Foreign G-7 Average weighted by 1991 GDP	1.4	1.6	1.8	1.9	2.0	1.5	1.5	1.6	1.7	1.8	1.8	1.8
Average weighted by share of U.S. non-oil imports	1.3	1.6	1.8	1.9	2.0	1.4	1.4	1.5	1.6	1.6	1.6	1.6

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

Strictly Confidential (FR)
Class II FOMC

November 6, 1997

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1991	1992	1993	1994	1995	1996	------ Projected ------ 1997	1998	1999
NIPA REAL EXPORTS and IMPORTS									
	Percentage point contribution to GDP growth, Q4/Q4								
Net Goods & Services	0.4	-0.4	-0.6	-0.4	0.4	-0.4	-0.6	-0.5	-0.3
Exports of G&S	0.8	0.4	0.5	1.0	1.1	1.0	1.4	0.9	0.8
Imports of G&S	-0.4	-0.8	-1.1	-1.4	-0.7	-1.4	-1.9	-1.3	-1.1
	Percentage change, Q4/Q4								
Exports of G&S	8.6	4.1	4.6	10.0	10.3	9.3	12.2	7.2	6.6
Services	7.1	-0.9	4.1	6.0	9.0	4.7	3.4	2.3	2.8
Agricultural Goods	10.1	10.4	-5.5	16.6	-3.4	5.7	1.7	0.5	2.4
Computers	21.7	25.2	23.7	32.0	55.7	33.8	71.0	45.8	42.6
Semiconductors	41.8	64.8	32.9	66.9	80.4	45.9	33.8	41.2	41.2
Other Goods 1/	7.0	2.3	3.6	6.9	5.7	7.6	12.4	4.6	2.2
Imports of G&S	4.1	7.4	10.2	12.3	5.6	11.8	15.8	10.2	7.8
Services	-2.7	1.4	3.2	1.4	7.3	5.0	11.3	2.8	2.3
Oil	8.1	12.1	10.1	-0.2	1.5	8.3	0.8	3.2	1.7
Computers	35.9	45.1	39.3	44.8	46.2	23.6	59.5	40.5	38.6
Semiconductors	55.3	42.0	34.2	54.5	92.7	57.9	44.9	41.2	41.2
Other Goods 2/	2.5	5.4	9.5	12.2	-1.2	10.5	13.5	8.1	4.4
	Billions of chained 1992 dollars								
Net Goods & Services	-22.3	-29.5	-70.2	-104.6	-98.8	-114.4	-144.5	-187.0	-223.1
Exports of G&S	599.9	639.4	658.2	712.4	791.2	857.0	967.9	1055.0	1123.6
Imports of G&S	622.2	669.0	728.4	817.0	890.1	971.5	1112.4	1241.9	1346.7
	Billions of dollars								
US CURRENT ACCOUNT BALANCE	-4.5	-55.4	-90.5	-133.5	-129.1	-148.2	-169.3	-198.5	-233.5
Net Goods & Services (BOP)	-29.9	-38.3	-72.0	-104.4	-101.9	-111.0	-114.1	-127.4	-151.9
Exports of G&S (BOP)	580.7	617.7	643.0	699.7	794.6	848.8	935.2	1004.6	1068.8
Imports of G&S (BOP)	610.6	655.9	715.0	804.1	896.5	959.9	1049.2	1132.0	1220.7
Net Investment Income	20.3	18.0	19.7	9.7	6.8	2.8	-15.3	-29.4	-39.9
Direct, Net	55.6	51.6	55.7	50.8	60.0	66.8	68.4	67.4	72.7
Portfolio, Net	-35.4	-33.6	-36.0	-41.0	-53.2	-63.9	-83.7	-96.8	-112.6
Net Transfers	5.1	-35.2	-38.1	-38.8	-34.0	-40.0	-40.0	-41.8	-41.8

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

Strictly Confidential (FR)
Class II FOMC

November 6, 1997

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1994				1995				1996			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-1.0	-0.3	-0.4	0.3	-0.4	0.1	1.2	1.0	-1.3	-0.6	-1.4	1.8
Exports of G&S	-0.2	1.7	1.1	1.5	0.8	1.0	1.4	1.3	0.2	1.1	0.2	2.6
Imports of G&S	-0.8	-2.0	-1.5	-1.2	-1.2	-0.9	-0.3	-0.3	-1.5	-1.7	-1.6	-0.8
Percentage change from previous period, SAAR												
Exports of G&S	-1.8	17.7	10.6	14.7	7.2	9.3	13.5	11.5	1.7	9.6	1.9	25.5
Services	2.4	12.9	2.0	6.9	6.0	3.8	20.3	6.6	-3.8	9.7	0.3	13.5
Agricultural Goods	-25.2	8.1	45.3	57.2	-1.3	-17.5	19.7	-10.7	12.5	-34.3	13.1	49.2
Computers	21.4	24.3	35.5	48.4	34.9	41.0	89.6	63.1	46.2	31.8	29.2	28.7
Semiconductors	111.8	23.4	65.9	79.1	72.0	97.0	100.3	56.2	19.9	28.3	37.6	113.8
Other Goods 1/	-6.8	20.3	7.4	8.6	2.9	8.2	1.0	11.0	-1.2	13.3	-3.1	23.9
Imports of G&S	7.6	19.0	13.1	9.9	10.0	7.7	2.3	2.4	13.1	14.1	13.2	6.8
Services	2.7	4.1	-0.4	-0.9	24.4	-4.0	8.4	2.2	14.6	2.7	1.2	2.1
Oil	-8.6	27.2	33.5	-36.2	-8.1	12.5	28.0	-19.7	-7.6	67.2	10.6	-19.6
Computers	32.9	48.3	42.3	57.0	8.1	57.3	65.8	61.8	6.4	30.7	26.9	32.0
Semiconductors	60.7	23.7	74.4	64.3	29.6	108.0	157.1	98.8	30.4	10.3	75.5	146.4
Other Goods 2/	6.9	19.6	10.3	12.5	7.3	2.2	-10.0	-3.6	14.5	11.1	12.2	4.3
Billions of chained 1992 dollars												
Net Goods & Services	-97.6	-103.9	-111.1	-105.9	-113.5	-112.8	-92.9	-76.1	-100.8	-112.6	-138.9	-105.6
Exports of G&S	676.0	704.1	722.1	747.3	760.4	777.4	802.4	824.6	828.2	847.4	851.4	901.1
Imports of G&S	773.6	808.0	833.2	853.2	873.9	890.3	895.4	900.7	929.0	960.0	990.2	1006.6
Billions of dollars												
US CURRENT ACCOUNT BALANCE	-104.6	-128.0	-145.5	-156.1	-138.8	-142.8	-132.5	-102.2	-131.5	-142.3	-171.3	-147.5
Net Goods & Services (BOP)	-90.6	-101.5	-114.0	-111.6	-113.2	-123.2	-95.5	-75.5	-98.2	-111.1	-130.1	-104.8
Exports of G&S (BOP)	662.5	688.4	710.9	736.8	761.5	785.9	806.4	824.6	828.4	848.6	840.3	878.0
Imports of G&S (BOP)	753.1	789.9	824.9	848.4	874.7	909.1	901.9	900.1	926.6	959.7	970.4	982.8
Net Investment Income	17.9	10.6	7.2	3.3	8.2	12.9	-1.6	7.8	8.2	3.5	-5.5	5.0
Direct, Net	51.7	48.9	51.0	51.5	57.6	64.1	53.9	64.5	66.2	64.2	60.3	76.4
Portfolio, Net	-33.8	-38.3	-43.8	-48.2	-49.4	-51.3	-55.5	-56.7	-57.9	-60.7	-65.7	-71.4
Net Transfers	-31.9	-37.1	-38.7	-47.7	-33.8	-32.5	-35.4	-34.5	-41.6	-34.8	-35.8	-47.7

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

Strictly Confidential (FR)
Class II FOMC

November 6, 1997

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	Projected											
	1997				1998				1999			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
	Percentage point contribution to GDP growth											
Net Goods & Services	-1.0	-0.4	-1.1	0.3	-0.4	-0.5	-1.1	0.2	-0.4	-0.2	-0.7	0.3
Exports of G&S	1.1	2.0	0.6	1.7	0.8	1.1	0.2	1.3	0.5	1.0	0.4	1.3
Imports of G&S	-2.1	-2.5	-1.8	-1.4	-1.3	-1.6	-1.3	-1.0	-1.0	-1.2	-1.1	-1.0
	Percentage change from previous period, SAAR											
Exports of G&S	9.9	18.4	5.5	15.3	7.2	9.1	1.9	10.8	4.3	8.6	3.0	10.5
Services	3.7	3.2	5.5	1.1	1.0	2.2	2.7	3.1	3.2	2.8	2.5	2.6
Agricultural Goods	-27.6	-4.2	13.1	36.6	-6.5	-3.3	4.4	8.3	2.3	-5.2	4.5	8.4
Computers	72.3	84.3	70.9	57.4	49.1	46.4	43.8	43.8	43.2	42.7	42.2	42.2
Semiconductors	39.0	15.7	41.2	41.2	41.2	41.2	41.2	41.2	41.2	41.2	41.2	41.2
Other Goods 1/	12.4	25.0	-2.0	15.7	6.0	8.4	-5.0	9.5	-1.6	6.8	-4.2	8.4
Imports of G&S	17.9	20.5	14.1	10.9	10.1	12.4	10.3	7.9	7.2	9.2	7.8	7.1
Services	24.2	8.9	6.7	6.1	4.1	2.7	2.3	2.1	2.3	2.3	2.3	2.2
Oil	-10.8	44.5	0.3	-20.3	-16.1	44.0	10.7	-15.4	-11.3	26.1	2.7	-6.8
Computers	51.3	71.1	58.9	57.4	43.8	39.9	39.9	38.6	38.6	38.6	38.6	38.6
Semiconductors	71.2	19.3	50.1	43.8	41.2	41.2	41.2	41.2	41.2	41.2	41.2	41.2
Other Goods 2/	15.3	17.1	12.0	10.0	9.5	8.5	7.7	6.6	4.9	4.6	4.2	3.9
	Billions of chained 1992 dollars											
Net Goods & Services	-126.3	-136.6	-160.4	-154.8	-165.5	-178.4	-203.7	-200.2	-211.3	-217.3	-234.4	-229.3
Exports of G&S	922.7	962.5	975.5	1010.9	1028.6	1051.2	1056.3	1083.8	1095.2	1118.1	1126.3	1154.9
Imports of G&S	1048.9	1099.1	1135.9	1165.7	1194.1	1229.6	1260.0	1284.0	1306.5	1335.4	1360.7	1384.2
	Billions of dollars											
US CURRENT ACCOUNT BALANCE	-159.9	-156.9	-177.9	-182.5	-176.0	-185.3	-211.8	-221.0	-220.0	-224.5	-241.2	-248.3
Net Goods & Services (BOP)	-117.2	-106.6	-121.7	-110.7	-112.8	-119.5	-141.3	-135.9	-144.6	-148.1	-161.2	-153.6
Exports of G&S (BOP)	897.0	936.2	939.3	968.2	981.2	1001.1	1004.8	1031.3	1042.0	1064.0	1071.2	1098.0
Imports of G&S (BOP)	1014.2	1042.8	1061.0	1078.9	1093.9	1120.6	1146.1	1167.3	1186.6	1212.1	1232.4	1251.6
Net Investment Income	-8.0	-14.1	-17.2	-21.8	-24.2	-26.8	-31.5	-35.1	-36.4	-37.5	-41.0	-44.7
Direct, Net	69.3	69.5	68.2	66.7	67.1	67.4	67.0	68.2	69.2	72.4	73.7	75.2
Portfolio, Net	-77.3	-83.6	-85.3	-88.5	-91.3	-94.2	-98.5	-103.3	-105.6	-109.9	-114.8	-120.0
Net Transfers	-34.7	-36.3	-39.0	-50.0	-39.0	-39.0	-39.0	-50.0	-39.0	-39.0	-39.0	-50.0

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