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Strictly Confidential (FR) Class II FOMC

Part 1

December 11, 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

December 11, 1997

SUMMARY AND OUTLOOK

Prepared for the Federal Open Market Committee
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Domestic Developments

Overview

Virtually all signs point to a continuation this quarter of the economic pattern we have been witnessing for some time: strong growth of real GDP, huge gains in jobs, and--despite some pickup in wage increases--low price inflation. Not surprisingly in these circumstances, consumer sentiment has remained extraordinarily upbeat, and U.S. financial markets have been relatively lightly touched by the storms originating abroad.

Looking ahead, however, it seems doubtful that the economy will escape the Asian turmoil unscathed. While the uncertainties in this sphere remain vast, events to date suggest that the adjustment in train across the Pacific will be substantially deeper and more prolonged than we allowed for in our prior forecast. Moreover, the dollar has experienced renewed strength of late against a wide range of currencies; if sustained, this change in the terms of trade will reinforce the drag on U.S. production stemming from the lower level of economic activity abroad. All told, these considerations have led us to mark down significantly our projection of net exports for the next two years, by enough to slice several more tenths of a percentage point off real GDP.

At the same time, recent developments point to a noticeably lower path for oil prices, and the strength of dollar should reduce prices for other imported goods as well. These factors, along with the greater negative impact of the foreign sector on domestic activity and a downward revision to our estimates of plant utilization, suggest a more benign outlook for U.S. inflation. Thus, we have eliminated our previous assumption of monetary policy tightening, and we now assume that the federal funds rate will be flat over the projection period. Although we believe that earnings disappointments will lead to lower share prices over time, the stock-market correction anticipated in this forecast is slower and ultimately smaller than that in the November forecast. This lower trajectory for interest rates and the higher path for equity prices provide some additional support for the domestic components of final demand.

Putting together the pieces, we project a path of real GDP growth that is lower than the one in our last forecast--with activity decelerating more abruptly and with growth averaging a little more than 1-1/2 percent in the next two years. Reported core CPI inflation is now expected to be about the same in 1998 and 1999 as this year--in the 2 to 2-1/4 percent range. This projection reflects our assumption that upcoming technical changes to the index will trim the acceleration between 1997 and 1999 by 0.3 to 0.4 percentage point.

Key Background Factors

Domestic financial conditions have been quite favorable since the time of the last projection and appear to be imposing little restraint on real activity. Despite renewed nervousness this week about the implications of the Asian slump for the earnings of some firms, most major indexes of U.S. stock prices have moved higher, on net, since the last FOMC meeting. Treasury bond yields are lower than we anticipated in the last forecast, partly because of a flight to safety by some investors but probably also because of a growing confidence that aggregate demand and inflation will remain sufficiently subdued to obviate Fed tightening.

As noted above, a more favorable inflation outlook has led us to base this forecast on a flat trajectory for the funds rate. Treasury bond yields and mortgage rates are expected to move down a little in the next several months, as the economy slows and hopes of Fed easing are aroused, and to drift back up thereafter--but these movements are not of great economic significance. In the business sector, an added measure of restraint is likely to come from a widening of risk premia on corporate bonds and less aggressive bank lending. Our prediction of a decline in corporate profits contrasts with the optimism of market analysts and underlies our expectation that share prices will decline substantially by 1999--raising the cost of equity capital for corporations and taking back a good part of the wealth gains enjoyed by households this year.

Since the last FOMC meeting, the dollar has appreciated noticeably against the currencies of our major trading partners, including those in Asia. In part, this rise in the dollar reflects increased concern about the implications of the intensified distress in the Korean economy and doubts about the willingness and ability of the Japanese authorities to deal forcefully with their financial sector problems. Looking ahead, we anticipate that the dollar will hold its higher level, on average, over the forecast period. Meanwhile, we have marked down our forecast for foreign growth 1/4 percentage point in 1998 and in 1999. On an export-weighted basis, foreign real GDP is now projected to increase 2-1/2 percent in 1998 and 3-1/4 percent in 1999; as recently as the September Greenbook, these numbers were 4 percent and 3-1/2 percent, respectively.

At the end of November, OPEC announced an increase of 2-1/2 million barrels per day in its production ceiling. Although the adjustment constitutes mainly a recognition of recent production levels, the new quotas will provide room for Saudi Arabia and some other large producers to raise their output, perhaps by around 3/4 million barrels per day. At the same time, the demand for oil is being damped by weakness in Asian economies. Against this backdrop, we have lowered our projection of the price of West Texas intermediate oil by an average of about $2 per barrel over the forecast period.

As in recent Greenbooks, federal fiscal policy is projected to be an essentially neutral influence on aggregate demand. We continue to assume that caps on discretionary spending will be binding and that no new tax-cut or spending proposals will be enacted over the forecast period. However, our projection for the unified deficits in fiscal 1998 and 1999 has been cut noticeably. Incoming figures have led us to raise the "effective" tax rates in the forecast; at the same time, spending has remained relatively weak and will be damped by the lower interest rates we are now anticipating. We now project deficits of about $10 billion in both fiscal 1998 and 1999, versus roughly $25 billion in the November Greenbook.

Recent Developments and Outlook for the Current Quarter

Our guess is that real GDP will increase around a 4 percent annual rate in the current quarter, a bit more than our November projection. The labor market report for November might argue for an even higher figure. In particular, aggregate hours of private production workers surged last month, and even allowing for a decline in December, the fourth-quarter average will be up sharply--perhaps around 4 percent (annual rate). Tacking on a labor productivity gain remotely approaching the pace of recent quarters would imply an enormous increase in output. However, such an outcome seems a stretch at this point, given the available spending indicators.

Data on retail sales through November indicate that sales of goods got off to a slow start this quarter; however, in light of favorable fundamentals, we are anticipating a strong holiday sales pace. In addition, spending for services has been robust recently. Overall, we are projecting that real personal consumption expenditures will rise 3-1/2 percent (annual rate) in the current quarter--well off the 5-3/4 percent pace in the summer quarter but still enough to hold the personal saving rate at a low level even in the face of strong growth of labor income.

After a tremendous surge in the past two quarters, growth of real business fixed investment appears to have moderated somewhat this quarter. The statistical basis for this assessment is skimpy because we have the crucial data on manufacturers' shipments of nondefense capital goods only through October. Those shipments were weak, and despite solid uptrends in orders, the increase in spending on producers' durable equipment should slow in the current quarter. Similarly, an October decline in construction put-in-place points to a fourth-quarter dropoff in real business outlays for nonresidential structures. Overall, real BFI is expected to increase at an annual rate of about 7-1/2 percent this quarter.

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

Measure	1997:Q3			1997:Q4	
	Nov. GB	BEA prelim.	Dec. GB	Nov. GB	Dec. GB
Real GDP	**3.5**	**3.3**	**3.4**	**3.5**	**3.9**
Private domestic final purchases	6.9	7.2	7.1	3.7	4.2
Personal consumption expenditures	5.7	5.8	5.7	3.0	3.5
Residential investment	1.9	3.7	3.8	5.2	8.4
Business fixed investment	16.8	18.1	17.4	8.0	7.5
Government outlays for consumption and investment	1.0	1.1	1.2	.8	1.1
	Change, billions of chained (1992) dollars				
Inventory investment	-22.2	-28.1	-25.8	-2.3	11.6
Net exports	-23.8	-26.3	-25.3	5.6	-9.6

Both single-family and multifamily starts came in higher in October than we had anticipated. Although the key single-family component dropped back from the elevated September level, the decline was surprisingly moderate--and permits actually rose. Meanwhile, indicators of single-family housing demand remain impressively robust, including a high volume of applications to finance home purchases, upbeat ratings of new home sales by builders, and very positive consumer attitudes toward home-buying conditions. In this light, we have revised up our projection of housing activity in the fourth quarter, and we anticipate that residential construction expenditures will increase at an 8-1/2 percent annual rate.

Among other components of final demand, net exports are expected to fall \$9-1/2 billion in the fourth quarter; the lesser decline than that registered in the third quarter reflects, in important part, the residual seasonality in this component of GDP. Given the sizable gain in industrial production that appears to be under way (we are predicting that factory output will be up around 6 percent, annual rate), we expect a hefty rate of inventory accumulation this quarter that accounts for more than 1/2 percentage point of GDP growth.

Incoming data on prices have been broadly consistent with what was anticipated in the November Greenbook. We project that the CPI excluding food and energy will increase at an annual rate of about 2-1/4 percent this quarter and that the total CPI will increase the same amount.[1] At earlier stages of processing, the core intermediate goods component of the PPI has changed little in the past several months. Most recently, prices of a wide range of industrial commodities--along with major indexes of commodity prices--have retreated, reflecting ample supplies and, perhaps, an expectation of softer demand on world markets. Average hourly earnings increases averaged 1/2 percent in the past two months. These larger increases likely reflect, in part, the recent minimum wage hike, as well as the technical problems with the measure in November that are discussed in Part 2. Nevertheless, we believe that wage rates have been responding to tight labor markets, as indicated by anecdotal reports in the Beige Book and elsewhere.

The Outlook for 1998 and 1999

The revision for the current quarter has moved the projected growth of real GDP for this year close to 4 percent. We are predicting a marked deceleration in the near term, with growth over the course of 1998 amounting to 1-3/4 percent. The major factors explaining the slowing of aggregate demand growth are: (1) a slackening in world economic expansion that, along with the appreciation of the dollar, should substantially restrain export sales; (2) a moderation of the current rapid growth in household and business investment, which will be encouraged by the substantial decline in share prices; and (3) a diminution in the desired rate of inventory accumulation as businesses perceive that sales trends have weakened appreciably. As indicated above, this projection assumes no monetary policy actions over the forecast period, but short-term real interest rates may rise somewhat further as inflation expectations move closer to the prevailing low rate of price increase.

With the long-term outlook for real activity weaker than in the previous projection, our forecast for the unemployment rate is a shade higher than that in the

1. The GDP chain price index is projected herein to increase 1.9 percent in the current quarter. However, in arriving at this number, we failed to take account of the announcement that federal employees will be given the day after Christmas off as a paid holiday. If BEA follows its usual procedures, this will boost the increase in the index by 0.1 percentage point at an annual rate and would reduce real growth commensurately. This effect would be reversed in the first quarter.

last Greenbook, edging up two tenths from its current level by the end of 1998 before rising to about 5-1/4 percent by the end of the forecast period. The tightness of the labor market points to continuing upward pressure on real compensation, but recent and prospective favorable price performance should help to restrain nominal pay increases. Firms certainly still seem to be focused on containing costs as the route to profitability; and in the manufacturing sector, generally healthy supplies of plant capacity, lower energy costs, and strong competition from imports appear likely to put a damper on goods price inflation. All told, both the core and the overall CPIs are projected to register only mild accelerations, adjusted for technical changes in the index.

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

Measure	1997	1998	1999
Real GDP	**3.9**	**1.7**	**1.4**
Previous	3.8	2.2	1.5
Final sales	3.4	2.2	1.5
Previous	3.5	2.5	1.7
PCE	3.8	3.4	1.7
Previous	3.7	3.2	1.8
Residential investment	5.7	-1.6	-1.0
Previous	4.4	-2.5	-1.2
BFI	10.8	7.6	5.6
Previous	10.8	7.5	5.8
Government purchases	1.2	.4	.9
Previous	1.1	.6	.8
	Change, billions of chained (1992) dollars		
Inventory change	30.5	-40.8	-11.1
Previous	20.2	-21.5	-19.0
Net exports	-65.9	-85.1	-40.5
Previous	-49.2	-45.4	-29.1

Consumer spending. After rising 3-3/4 percent this year, real PCE is projected to increase 3-1/2 percent in 1998 and 1-3/4 percent in 1999. In part, this slowing reflects an expected slackening of income growth, as business investment and exports lose steam and generate fewer new jobs. In addition, household wealth is projected to become a less positive factor for real consumption than it has been over the past 2-1/2 years. With share prices not falling as much as in the previous forecast, the lagged effects of the gains in wealth to date should dominate in 1998 and push the saving rate down further. But we estimate that lower stock prices will be a slightly negative factor, on net, for consumer demand in 1999.

Although we anticipate that all broad categories of PCE will decelerate in the next two years, the projected slowing is especially visible in the durable goods category, where purchases tend to be the most cyclically sensitive and spending has been robust for some time. In particular, sales of light motor vehicles are expected to slip to about 14-1/2 million units in 1999, down from the 15 million unit pace that has prevailed for the last four years or so. Services also slow considerably from their elevated rate of increase this year as households--feeling less flush--trim their discretionary outlays.

Residential investment. Demand for single-family housing has remained strong, and we have raised our projection a little to reflect the lower path for mortgage rates in this forecast. Nevertheless, residential construction should move down somewhat over the next two years as slower growth in employment and income, along with the loss of stock market wealth, holds back activity; single-family starts fall from 1.14 million units in 1997 to 1.12 million in 1998 and 1.10 million in 1999.

In the multifamily sector, vacancy rates have edged down a touch lately, on net, while real rents have edged up. Even so, with a slower pace of economic activity, we expect multifamily starts to slip back below 300,000 units in 1999. In total, we anticipate that real residential investment will decline 1-1/2 percent in 1998 and 1 percent in 1999.

Business fixed investment. We are projecting capital spending to continue rising briskly next year, reflecting the lagged response to this year's more rapid output growth, a low cost of capital, and ready access to financing. Over time, however, the positive "accelerator" effects on investment will wane, and we foresee a weakening of corporate cash flows and a deterioration in external financing conditions. Consequently, we now project that capital spending, which increased 10-3/4 percent this year, will rise 7-1/2 percent in 1998 and 5-1/2 percent in 1999.

This deceleration of spending occurs primarily in equipment purchases. Real outlays for computers and communications equipment should post robust growth, though at a slower pace than this year. For computers and peripherals, price declines and product innovation will tend to offset the general cyclical forces damping demand. Sales of communications equipment will be supported by these factors as well as by growing demands related to exploding Internet use and structural changes in the telephone market. The pace of aircraft purchases by domestic carriers should pick up next year as Boeing overcomes its recent production difficulties. We anticipate that demand for other broad categories of equipment will soften as activity decelerates.

Nonresidential construction expenditures are expected to rise about 3 percent per year in 1998 and 1999. We believe that this projection balances the flattening trend in contracts for new construction with the more favorable outlook suggested by other evidence, including lower vacancy rates for office space and firmer prices for retail and office buildings. Financing conditions are also expected to remain favorable on the whole.

Inventory investment. With booming sales, nonfarm inventory stocks rose substantially during the first three quarters of this year. We are predicting fairly hefty accumulation this quarter as well--raising stocks at an annual rate of about 4-3/4 percent. As final sales begin to increase less rapidly over the next couple of years, businesses will curb their pace of inventory additions accordingly. Whether they are able to keep stocks in synch with sales will be important in determining the smoothness of the GDP deceleration; in our forecast, no jarring imbalances arise. The pattern of inventory investment trims about 1/2 percentage point from GDP growth in 1998 and about a tenth in 1999.

In the farm sector, harvests appear to have been large enough this year to permit some rebuilding of agricultural stocks, and further moderate stockpiling is anticipated in 1998 and 1999. We have not built any effects of El Niño into the outlook for the farm sector, and at this point, futures markets appear to reflect the same agnosticism.

Government spending. After remaining flat this year, real federal purchases are expected to decline at an average annual pace of about 2-1/2 percent in 1998 and 1999. Real defense purchases fall about 3-1/2 percent per year, on average, over the forecast period, with the sharper decline occurring next year. As discretionary spending caps begin to bind in fiscal 1998, we project that nondefense purchases will increase just 3/4 percent in 1998 and then drop back 1-1/4 percent in 1999.

Real purchases by state and local governments are anticipated to increase a little more than 2-1/4 percent per year over the forecast period, continuing the moderate expansion of recent years. Overall, the fiscal position of states and localities is quite sound, and we see no reason for this to change in the next couple of years. Tax cuts will be enacted, but they are likely to be modest. And, labor markets are expected to remain relatively tight, suggesting little upward pressure on spending from welfare reform during the projection period.

Net exports. We have marked down our projection of net exports, largely because of our more pessimistic view of prospects for the Asian economies. We now think that exports will rise just 3-3/4 percent in 1998 and 5-3/4 percent in the following year. On the import side, weaker growth in domestic demand in the next two years brings down the pace of increase in imports to 7-3/4 percent by 1999, about half the rate of growth expected this year. Overall, anticipated declines in net exports reduce real GDP growth nearly 1 percentage point in 1998 and about 1/3 percentage point in 1999. (A more detailed discussion of the outlook 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	2.4	.7	1.3
Previous	1.2	2.3	.7	.9
Nonfarm payroll employment	2.1	2.5	1.1	.6
Previous	2.1	2.3	1.6	.8
Household employment survey	2.1	2.1	1.0	.5
Previous	2.1	2.0	1.4	.6
Labor force participation rate[1]	66.9	67.0	67.1	67.1
Previous	66.9	67.1	67.2	67.2
Civilian unemployment rate[1]	5.3	4.6	4.8	5.3
Previous	5.3	4.8	4.7	5.1

1. Percent, average for the fourth quarter.

Labor markets. The BLS has estimated that output per hour in the nonfarm business sector jumped about 4 percent at an annual rate in the third quarter--an even larger gain than we had expected in the November Greenbook. As discussed in Part 2, the third-quarter productivity figure was boosted by an unusual plunge in hours of self-employed and unpaid family workers, and the unwinding of this factor should damp productivity growth in coming quarters. More fundamentally, the projected deceleration of output next year leads us to expect a slackening in productivity growth; we foresee an increase of just 3/4 percent in output per hour in 1998. By 1999, we expect productivity growth to be closer to its trend pace, with a 1-1/4 percent advance.[2]

As output growth slows over the next two years, employment gains also become smaller, moving down from the average pace over the past six months of about 275,000 per month to something less than 100,000 per month by 1999. In such an environment, the labor force participation rate might be expected to edge off if not for the small boost from welfare reform.

Wages and prices. Measures of resource utilization suggest a bit less upward pressure on wages and prices compared with the November Greenbook. On average, the unemployment rate is projected to be marginally higher, and the downward revision to capacity utilization figures suggests more slack in the manufacturing sector. Inflation will also be restrained by lower prices for oil and non-oil imports.

Although the wage component of worker compensation has been accelerating since 1995, we anticipate that nominal wage gains will diminish somewhat in lagged response to the marked slowing of price increases that has occurred this year. Also, no further increases in the minimum wage are scheduled. On the other hand, we continue to anticipate a pickup in the cost of benefits, partly because of higher expenses for health care as insurers and providers struggle to boost diminished profit margins. In addition, anecdotal reports suggest large year-end bonuses; just like a year ago, we expect that many of these will be picked up in the ECI for the first quarter of 1998. But over 1998 as a whole, the acceleration in benefits is more than offset by the reduced wage gains, and we expect hourly compensation--as measured by the ECI--to increase 3.1 percent in 1998, a tenth less than the increase expected for this year. For 1999, we expect the ECI to increase another 3.1 percent, as the upward pressure on compensation from tight labor markets is offset by lower inflation expectations.

We have lowered the forecast of core CPI inflation 0.3 percentage point in both 1998 and 1999. The core CPI now is expected to increase just 2.1 percent in 1998.

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2. As in the last Greenbook, we are assuming that the trend rate of productivity growth increased from 0.8 percent in the first half of this decade to 1.2 percent in the second half, on a consistently measured basis. On a published basis, the productivity trend will move up from 1.2 percent in late 1995 and 1996 because of technical changes in the CPI that will lower reported inflation and raise published real output growth. Given these changes, we expect the productivity trend, on a measured basis, to be 1.3 percent in 1997 and 1998 and 1.5 percent in 1999. In terms of real GDP, our growth rate for potential output is 2.1 percent in 1995, averages 2.4 percent in 1996-98, and is 2.5 percent in 1999.

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

Measure	1996	1997	1998	1999
Consumer price index	3.2	1.9	1.8	2.2
Previous	3.2	2.0	2.2	2.5
Food	4.2	1.9	1.9	2.1
Previous	4.2	1.8	2.1	2.4
Energy	7.6	-.9	-1.8	1.7
Previous	7.6	-1.2	.4	2.0
Excluding food and energy	2.6	2.2	2.1	2.2
Previous	2.6	2.3	2.4	2.5
PCE chain-weighted price index	2.7	1.6	1.6	2.0
Previous	2.7	1.6	2.0	2.2
Excluding food and energy	2.3	1.7	1.8	2.0
Previous	2.3	1.7	2.1	2.3
GDP chain-weighted price index	2.3	1.9	1.8	1.9
Previous	2.3	1.8	2.0	2.1
ECI for compensation of private industry workers[1]	3.1	3.2	3.1	3.1
Previous	3.1	3.2	3.2	3.4
Prices of core non-oil merchandise imports	-.8	-1.8	-1.9	.8
Previous	-.8	-1.2	-.3	.8
	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.

Apart from the more favorable forecast of labor costs and lower capacity utilization estimates, this changed outlook for next year reflects the sizable near-term revisions to the path for core non-oil import prices and some pass-through of the rapid drop in energy prices to production and transportation costs. By 1999, core import prices and energy prices are rising again, and core CPI inflation ticks up to 2.2 percent. Of course, these very modest figures for inflation represent what we think BLS will publish, and they are held down by upcoming technical changes to the CPI.[3] If not for these changes, we would project a 0.3 to 0.4 percentage point acceleration in the core CPI between 1997 and 1999.

Tracking the lower path for oil prices, the CPI for energy now is expected to fall 1-3/4 percent next year and to increase moderately in 1999. In addition to the beneficial effect of low oil prices, electricity deregulation should help to restrain energy prices over the forecast period. Food prices are expected to increase a little less than the core CPI. Adding in food and energy prices, the total CPI is expected to rise 1.8 percent in 1998 and 2.2 percent in 1999. Increases in the chain price index for GDP are expected to run a little under 2 percent during the next two years, about the same as in 1997; this measure also would accelerate slightly if not for technical changes to the CPI.

Money and Credit Flows

The total debt of domestic nonfinancial sectors of the economy appears on track to expand about 4-1/2 percent this year, and our forecast is that debt will expand at a slightly stronger average pace over the next two years. This implies a small but noticeable rise in the debt-to-GDP ratio.

The growth of debt will be paced by the nonfinancial corporate sector, where--given an erosion of profit margins as productivity increases slow--internally generated funds are projected to fall increasingly short of the level of spending on inventories and fixed capital. Despite the pressures on cash flow, share repurchases should remain high, and we do not see merger and acquisition activity grinding to a halt either. Thus, with a softening stock market making new share issues less attractive, net equity retirements will remain sizable and contribute to business-sector borrowing needs.

As the prospects for business profitability begin to look less rosy, corporate bond buyers likely will want extra compensation for risk, and banks and other lenders probably will tighten their standards a bit. We do not foresee a major swing in credit market conditions, however, and the availability of funding will not be an issue for most firms. The bond markets will continue to be a preferred source of credit for many, given the still relatively low nominal long-term interest rates we are predicting. This could be especially so in the near term, when the markets may be lifted by signs

3. For 1998, these anticipated technical changes include an update of the market basket and adoption of a hedonic index to quality adjust computer prices. In 1999, BLS plans to modify its sample-rotation procedures, and we expect BLS to adopt a geometric-means formula for calculating price changes within some strata.

of substantial slowing in economic growth and hopes for Fed easing. Bank business loan portfolios should register substantial growth as well over the next two years, in part reflecting the ongoing lending in support of corporate acquisition activity.

Household debt growth is expected to be moderate. Consumer loans will likely increase at a relatively slow pace by the standards of recent years--extending the trend of deceleration visible over this year. As noted above, purchases of autos and other durable goods are projected to be the component of consumer spending that softens most; this factor, along with the continuing use of home equity loans as a substitute for traditional consumer loans, should slow the increase in consumer credit. A slackening in the level of home sales should tend to damp overall mortgage debt formation, although a good many households might take advantage of any substantial decline in loan rates to refinance their existing mortgages and cash out some accumulated equity in the process.

We see most households encountering little in the way of major new credit supply restraints over the forecast period. Recent loan delinquency data suggest that lenders may have gotten control of the credit-quality problem that was manifest especially in the credit card area--though it is still too early to draw a firm conclusion on that score. The recent aggressiveness of some "sub-prime" lending does pose risks, but the steady, if more modest, economic growth and low unemployment that we are projecting does not seem the kind of environment that will test severely the soundness of this type of lending.

Federal government borrowing will rise a bit but remain modest, given the low budget deficits that appear to be in the offing. Borrowing by state and local governments has picked up this year and is projected to continue growing near its current pace on out, with low bond rates encouraging some additional advance refunding activity. Cautious budgetary policies by these units should prevent significant financial dislocations from arising as the growth of revenues is damped by a slackening in the pace of economic expansion.

Growth of M2 is projected to slow over the forecast period as GDP decelerates. With little change in market interest rates and heightened concerns about stock market weakness, there may be some impetus for investors to move into safer M2 assets instead of equity and bonds--however, we saw little evidence of such a shift in the recent period. M3 is expected to continue expanding more rapidly than M2, with the growing gap reflecting the shift by banks from foreign to domestic sources of funding and the continued popularity of money market mutual funds as a tool of corporate cash management.

Alternative Simulations

Our alternative simulations show the implications of different assumptions about the federal funds rate. In the first simulation, the funds rate rises 25 basis points per quarter over the course of 1998, cumulating to an increase of 100 basis points; the higher level is then maintained throughout 1999. Under this assumption, growth of real GDP in 1998 is 0.3 percentage point less than in the baseline forecast, and in 1999 it is 0.7 percentage point less than in the baseline. The unemployment rate at the end of 1999 is 1/2 percentage point higher than in the baseline forecast. The additional slack reduces CPI inflation by a small amount in 1998 and a more substantial amount in 1999. The second simulation assumes that the funds rate is lowered 100 basis points during 1998 and then held steady in 1999. Economic effects of this alternative are symmetric.

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	3.9	1.7	1.4
Higher funds rate	3.2	3.9	1.4	.7
Lower funds rate	3.2	3.9	2.0	2.1
No stock price decline	3.2	3.9	1.9	1.8
Civilian unemployment rate[1]				
Baseline	5.3	4.6	4.8	5.3
Higher funds rate	5.3	4.6	4.9	5.8
Lower funds rate	5.3	4.6	4.7	4.8
No stock price decline	5.3	4.6	4.7	5.1
CPI excluding food and energy				
Baseline	2.6	2.2	2.1	2.2
Higher funds rate	2.6	2.2	2.0	1.8
Lower funds rate	2.6	2.2	2.2	2.6
No stock price decline	2.6	2.2	2.1	2.3

1. Average for the fourth quarter.

We have also run a simulation that holds the value of equities constant relative to income over the forecast period, in contrast to the decline in the wealth-to-income ratio in the baseline forecast. In this alternative, the federal funds rate is maintained at 5-1/2 percent. Relative to the baseline, real GDP growth is boosted about 0.2 percentage point in 1998 and 0.4 percentage point in 1999. Even though the unemployment rate in this alternative simulation is lower than in the baseline, the effect on inflation is small. According to the model, actual inflation remains low because inflation expectations do not move much in response to the acceleration in prices during the forecast period. Households and businesses have come to believe that the Fed will tighten to head off a pickup in inflation, and it is not until 1999 that the public realizes that this expectation will not be realized in this scenario. If the simulation were extended to 2000, the pickup in inflation would be more noticeable.

Strictly Confidential <FR>
Class II FOMC

December 11, 1997

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

Interval		Nominal GDP		Real GDP		GDP chain-weighted price index		Consumer price index[1]		Unemployment rate[2]	
		11/06/97	12/11/97	11/06/97	12/11/97	11/06/97	12/11/97	11/06/97	12/11/97	11/06/97	12/11/97
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		5.9	5.9	3.8	3.8	2.0	2.1	2.4	2.4	5.0	4.9
1998		4.8	4.4	2.8	2.4	1.9	1.8	2.1	1.8	4.6	4.7
1999		3.8	3.2	1.6	1.4	2.1	1.8	2.4	2.1	4.9	5.1
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	3.3	3.3	1.8	1.8	1.0	1.0	4.9	4.9
	Q3	4.9	4.9	3.5	3.4	1.4	1.5	2.0	2.0	4.9	4.9
	Q4	5.4	6.1	3.5	3.9	1.7	1.9	2.4	2.2	4.8	4.6
1998	Q1	5.0	4.2	2.7	2.0	2.2	2.2	2.0	1.5	4.7	4.6
	Q2	4.5	3.4	2.5	1.7	2.0	1.7	2.2	1.6	4.6	4.6
	Q3	4.0	3.3	2.0	1.6	2.0	1.6	2.3	2.0	4.6	4.7
	Q4	3.7	3.2	1.7	1.4	2.0	1.8	2.4	2.1	4.7	4.8
1999	Q1	3.8	3.3	1.5	1.2	2.3	2.0	2.5	2.2	4.7	4.9
	Q2	3.6	3.1	1.5	1.3	2.1	1.8	2.5	2.2	4.8	5.1
	Q3	3.6	3.3	1.4	1.4	2.1	1.8	2.5	2.2	5.0	5.2
	Q4	3.5	3.4	1.4	1.5	2.1	1.9	2.5	2.2	5.1	5.3
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	4.1	4.1	2.1	2.1	1.7	1.7	-0.4	-0.4
	Q4	5.1	5.5	3.5	3.6	1.6	1.7	2.2	2.1	-0.1	-0.3
1998	Q2	4.7	3.8	2.6	1.8	2.1	2.0	2.1	1.6	-0.2	0.0
	Q4	3.8	3.2	1.8	1.5	2.0	1.7	2.4	2.0	0.1	0.2
1999	Q2	3.7	3.2	1.5	1.2	2.2	1.9	2.5	2.2	0.1	0.3
	Q4	3.6	3.4	1.4	1.5	2.1	1.9	2.5	2.2	0.3	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	5.7	5.9	3.8	3.9	1.8	1.9	2.0	1.9	-0.5	-0.7
1998	Q4	4.3	3.5	2.2	1.7	2.0	1.8	2.2	1.8	-0.1	0.2
1999	Q4	3.6	3.3	1.5	1.4	2.1	1.9	2.5	2.2	0.4	0.5

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)

December 11, 1997

Item	Units[1]							- - - Projected	- - -	
		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	8087.2	8440.1	8714.0
Real GDP	Bill. Ch. $	6079.4	6244.4	6389.6	6610.7	6742.1	6928.4	7192.0	7367.3	7468.6
Real GDP	% change	0.4	3.6	2.4	3.3	1.6	3.2	3.9	1.7	1.4
Gross domestic purchases		0.0	4.0	3.0	3.6	1.2	3.6	4.6	2.5	1.7
Final sales		-0.4	3.9	2.1	2.7	2.2	3.1	3.4	2.2	1.5
Priv. dom. final purchases		-0.8	4.9	3.7	3.7	2.5	3.8	4.8	3.7	2.1
Personal cons. expenditures		-0.2	4.2	2.7	3.1	2.2	2.7	3.8	3.4	1.7
Durables		-3.1	9.4	7.4	6.3	3.0	3.9	6.9	4.9	2.2
Nondurables		-1.0	3.4	1.6	3.0	1.0	1.8	2.0	2.9	1.6
Services		0.9	3.6	2.3	2.5	2.7	2.8	4.1	3.3	1.6
Business fixed investment		-6.0	5.5	9.9	7.6	6.5	11.7	10.8	7.6	5.6
Producers' dur. equipment		-2.6	9.6	12.2	10.2	8.3	12.2	15.6	9.3	6.4
Nonres. structures		-12.5	-3.4	4.5	1.1	2.0	10.3	-1.2	2.9	3.2
Residential structures		1.1	16.9	7.8	4.2	-1.9	3.9	5.7	-1.6	-1.0
Exports		8.6	4.1	4.6	10.0	10.3	9.3	10.5	3.8	5.8
Imports		4.1	7.4	10.2	12.3	5.6	11.8	15.9	10.5	7.8
Gov't. cons. & investment		-0.7	1.7	-1.4	0.1	-1.4	2.0	1.2	0.4	0.9
Federal		-3.1	1.3	-6.1	-3.9	-6.0	1.5	0.0	-3.1	-1.8
Defense		-5.3	-1.3	-6.9	-6.0	-5.9	1.1	-1.0	-5.0	-2.2
State & local		1.0	2.0	2.0	2.7	1.4	2.2	1.9	2.4	2.3
Change in bus. inventories	Bill. Ch. $	-3.0	7.0	22.1	60.6	27.3	25.0	64.1	40.0	18.9
Nonfarm		-1.2	2.0	29.5	49.0	35.7	22.5	56.5	34.9	15.0
Net exports		-22.3	-29.5	-70.2	-104.6	-98.8	-114.4	-149.1	-228.7	-287.3
Nominal GDP	% change	3.8	6.3	5.0	5.8	4.0	5.6	5.9	3.5	3.3
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employment	Millions	108.3	108.6	110.7	114.1	117.2	119.5	122.2	124.4	125.3
Unemployment rate	%	6.8	7.5	6.9	6.1	5.6	5.4	4.9	4.7	5.1
Industrial prod. index	% change	-0.0	3.7	3.3	6.5	3.3	4.2	5.6	1.0	1.3
Capacity util. rate - mfg.	%	77.9	79.4	80.5	82.5	82.8	81.4	81.6	80.5	79.6
Housing starts	Millions	1.01	1.20	1.29	1.46	1.35	1.48	1.46	1.43	1.39
Light motor vehicle sales		12.52	12.85	13.87	15.02	14.73	15.05	15.05	14.74	14.47
North Amer. produced		9.74	10.51	11.71	12.88	12.82	13.34	13.11	12.94	12.74
Other		2.77	2.34	2.15	2.13	1.90	1.71	1.94	1.80	1.73
INCOME AND SAVING										
Nominal GNP	Bill. $	5932.4	6255.5	6576.8	6955.2	7270.6	7637.7	8067.2	8407.6	8673.9
Nominal GNP	% change	3.5	6.2	5.1	5.7	4.1	5.5	5.5	3.4	3.2
Nominal personal income		3.7	7.3	4.2	5.1	5.2	5.8	5.9	4.0	3.7
Real disposable income		0.8	4.0	1.5	2.4	2.4	2.0	3.5	2.6	1.9
Personal saving rate	%	6.0	6.2	5.1	4.2	4.8	4.3	3.7	3.3	3.3
Corp. profits, IVA & CCAdj.	% change	4.5	11.3	19.0	14.1	11.0	9.1	12.1	-2.7	-0.9
Profit share of GNP	%	6.9	6.8	7.5	8.2	8.9	9.6	10.1	9.8	9.3
Excluding FR Banks		6.6	6.6	7.2	7.9	8.6	9.3	9.8	9.6	9.0
Federal surpl./deficit	Bill. $	-196.0	-280.9	-250.7	-186.7	-174.4	-110.5	-26.7	-6.0	-23.0
State & local surpl./def.		75.8	86.3	87.4	96.8	103.1	105.3	110.0	116.4	111.1
Ex. social ins. funds		11.5	18.3	19.7	27.9	32.5	34.1	38.6	44.9	39.5
Gross natl. saving rate	%	15.7	14.5	14.4	15.5	16.0	16.6	17.3	17.0	16.4
Net natl. saving rate		4.8	3.7	3.7	4.7	5.5	6.4	7.3	7.1	6.3
PRICES AND COSTS										
GDP chn.-wt. price index	% change	3.3	2.6	2.6	2.5	2.4	2.3	1.9	1.8	1.9
Gross Domestic Purchases chn.-wt. price index		2.7	2.7	2.3	2.5	2.3	2.3	1.4	1.5	1.8
CPI		3.0	3.1	2.7	2.7	2.6	3.2	1.9	1.8	2.2
Ex. food and energy		4.4	3.5	3.1	2.8	3.0	2.6	2.2	2.1	2.2
ECI, hourly compensation[2]		4.4	3.5	3.6	3.1	2.6	3.1	3.2	3.1	3.1
Nonfarm business sector										
Output per hour		2.2	3.5	-0.2	-0.1	0.4	1.2	2.4	0.7	1.3
Compensation per Hour		4.8	4.5	1.8	1.9	2.8	3.3	3.9	3.4	3.4
Unit labor cost		2.5	1.0	2.0	2.0	2.4	2.1	1.5	2.8	2.1

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)

December 11, 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	5.9	1.6	4.5	1.1	2.0	7.5	3.6	3.8	5.2	4.6
Capacity util. rate - mfg.	%	83.8	82.9	82.6	81.8	81.0	81.6	81.5	81.4	81.6	81.5
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
Gross natl. saving rate	%	15.8	15.7	16.0	16.6	16.3	16.5	16.9	16.7	16.8	17.4
Net natl. saving rate		5.4	5.1	5.5	6.0	6.0	6.4	6.7	6.6	6.7	7.4
PRICES AND COSTS											
GDP chn.-wt. price index	% change	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	2.4
Compensation per hour		2.6	3.1	2.7	2.9	2.8	4.4	2.9	3.3	4.5	3.3
Unit labor cost		4.2	2.3	1.6	1.3	0.9	2.1	3.9	1.5	3.1	0.9

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)

December 11, 1997

Item	Units	1997 Q3	1997 Q4	1998 Q1	1998 Q2	1998 Q3	1998 Q4	1999 Q1	1999 Q2	1999 Q3	1999 Q4
		- - - Projected - - -									
EXPENDITURES											
Nominal GDP	Bill. $	8130.2	8250.7	8336.8	8407.3	8474.8	8541.7	8610.2	8677.0	8747.6	8821.1
Real GDP	Bill. Ch. $	7218.9	7288.1	7323.5	7354.2	7382.8	7408.8	7430.4	7454.3	7480.7	7508.9
Real GDP	% change	3.4	3.9	2.0	1.7	1.6	1.4	1.2	1.3	1.4	1.5
Gross domestic purchases		4.5	4.2	2.9	2.6	3.0	1.6	1.8	1.5	2.1	1.4
Final sales		4.8	3.3	2.2	2.7	1.7	2.2	1.0	1.7	1.2	2.1
Priv. dom. final purchases		7.1	4.2	4.2	4.2	3.5	2.8	2.0	2.1	1.9	2.2
Personal cons. expenditures		5.7	3.5	4.1	3.8	3.2	2.5	1.7	1.6	1.7	1.7
Durables		17.8	2.6	4.5	6.4	4.9	3.9	1.9	1.9	2.3	2.5
Nondurables		4.3	1.2	4.1	3.0	2.5	2.0	1.9	1.6	1.4	1.4
Services		4.1	4.7	3.9	3.8	3.2	2.5	1.6	1.6	1.7	1.6
Business fixed investment		17.4	7.5	7.3	9.3	7.6	6.3	5.3	6.2	4.7	6.0
Producers' dur. equipment		21.6	12.0	9.1	11.5	9.3	7.5	6.1	7.3	5.2	7.1
Nonres. structures		6.8	-4.2	2.4	3.2	3.2	3.0	3.3	3.3	3.2	3.2
Residential structures		3.8	8.4	-0.7	-2.4	-1.4	-1.9	-1.5	-0.8	-1.2	-0.4
Exports		4.7	9.3	3.6	6.0	-1.2	6.9	2.8	8.0	2.8	9.7
Imports		13.9	11.6	11.0	12.7	10.4	7.9	7.6	8.7	7.6	7.2
Gov't. cons. & investment		1.2	1.1	-1.6	0.7	1.7	0.9	0.1	1.2	1.5	0.6
Federal		-1.0	0.7	-8.7	-2.3	0.4	-1.7	-3.8	-0.9	-0.0	-2.6
Defense		1.3	0.2	-13.7	-3.9	0.1	-2.0	-5.2	-0.8	0.7	-3.3
State & local		2.4	1.4	2.5	2.4	2.3	2.3	2.3	2.3	2.3	2.3
Change in bus. inventories	Bill. Ch. $	51.8	63.4	59.2	40.6	37.6	22.6	25.4	16.9	21.7	11.4
Nonfarm		42.8	54.6	52.3	35.3	33.2	18.7	21.5	13.1	17.9	7.7
Net exports		-161.9	-171.5	-193.7	-215.3	-249.2	-256.5	-273.4	-280.7	-298.3	-297.0
Nominal GDP	% change	4.9	6.1	4.2	3.4	3.3	3.2	3.3	3.1	3.3	3.4
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	122.6	123.4	124.0	124.3	124.6	124.8	125.0	125.2	125.4	125.5
Unemployment rate	%	4.9	4.6	4.6	4.6	4.7	4.8	4.9	5.1	5.2	5.3
Industrial prod. index	% change	6.2	6.2	2.2	0.8	0.3	0.7	1.1	1.1	1.2	1.7
Capacity util. rate - mfg.	%	81.6	81.8	81.2	80.6	80.2	79.9	79.8	79.7	79.5	79.4
Housing starts	Millions	1.46	1.47	1.45	1.43	1.42	1.41	1.39	1.39	1.38	1.38
Light motor vehicle sales		15.34	15.07	14.83	14.79	14.71	14.61	14.50	14.46	14.45	14.45
North Amer. produced		13.31	13.11	13.01	12.95	12.94	12.86	12.77	12.73	12.72	12.72
Other		2.03	1.96	1.82	1.84	1.77	1.75	1.73	1.73	1.73	1.73
INCOME AND SAVING											
Nominal GNP	Bill. $	8109.2	8226.7	8308.5	8376.6	8441.0	8504.1	8572.7	8637.7	8707.4	8777.7
Nominal GNP	% change	4.9	5.9	4.0	3.3	3.1	3.0	3.3	3.1	3.3	3.3
Nominal personal income		4.7	5.9	4.8	3.9	3.8	3.5	4.4	3.6	3.5	3.4
Real disposable income		2.6	3.8	5.2	2.1	1.7	1.5	3.8	1.4	1.2	1.3
Personal saving rate	%	3.5	3.6	3.9	3.5	3.1	2.9	3.4	3.3	3.2	3.1
Corp. profits, IVA & CCAdj.	% change	19.6	3.2	-1.2	-2.6	-3.9	-3.2	-4.1	-1.3	0.7	1.2
Profit share of GNP	%	10.3	10.2	10.1	9.9	9.7	9.6	9.4	9.3	9.3	9.2
Excluding FR Banks		10.0	9.9	9.8	9.6	9.5	9.3	9.2	9.1	9.0	9.0
Federal surpl./deficit	Bill. $	-11.4	-3.3	-11.7	-4.3	-0.1	-8.0	-24.9	-22.4	-19.1	-25.8
State & local surpl./def.		111.5	118.9	117.2	116.8	115.4	115.9	113.8	111.7	110.0	108.9
Ex. social ins. funds		40.1	47.5	45.8	45.3	43.9	44.4	42.2	40.1	38.4	37.3
Gross natl. saving rate	%	17.4	17.5	17.5	17.2	16.9	16.5	16.6	16.5	16.4	16.2
Net natl. saving rate		7.4	7.7	7.6	7.3	6.9	6.5	6.5	6.4	6.3	6.1
PRICES AND COSTS											
GDP chn.-wt. price index	% change	1.5	1.9	2.2	1.7	1.6	1.8	2.0	1.8	1.8	1.9
Gross Domestic Purchases chn.-wt. price index		1.3	1.4	1.3	1.3	1.6	1.7	2.0	1.7	1.8	1.8
CPI		2.0	2.2	1.5	1.6	2.0	2.1	2.2	2.2	2.2	2.2
Ex. food and energy		1.7	2.2	2.0	2.0	2.2	2.2	2.2	2.2	2.2	2.2
ECI, hourly compensation[1]		3.4	3.8	3.2	3.1	3.1	3.1	2.8	3.2	3.2	3.3
Nonfarm business sector											
Output per hour		4.2	1.5	-0.0	0.9	0.9	0.9	1.0	1.2	1.3	1.5
Compensation per hour		3.9	3.9	3.6	3.4	3.4	3.4	3.4	3.4	3.4	3.4
Unit labor cost		-0.3	2.4	3.6	2.5	2.5	2.5	2.4	2.2	2.1	1.9

1. Private-industry workers.

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

Item	1995 Q3	1995 Q4	1996 Q1	1996 Q2	1996 Q3	1996 Q4	1997 Q1	1997 Q2	1997 Q3	95Q4/ 94Q4	96Q4/ 95Q4	97Q4/ 96Q4
Real GDP	3.0	2.2	1.8	6.0	1.0	4.3	4.9	3.3	3.4	1.6	3.2	3.9
Gross dom. purchases	1.9	1.3	3.1	6.6	2.4	2.5	6.0	3.7	4.6	1.2	3.6	4.6
Final sales	3.3	1.9	2.6	5.2	0.2	4.5	3.0	2.5	4.7	2.2	3.1	3.4
Priv. dom. final purchases	2.3	2.0	3.6	4.5	1.8	2.7	4.2	2.4	5.8	2.0	3.1	3.9
Personal cons. expenditures	1.8	1.2	2.1	2.5	0.4	2.2	3.6	0.6	3.8	1.5	1.8	2.6
Durables	0.7	0.2	0.4	0.8	-0.2	0.3	1.1	-0.5	1.3	0.2	0.3	0.6
Nondurables	0.1	0.1	0.4	0.5	0.1	0.4	0.9	-0.4	0.8	0.2	0.4	0.4
Services	0.9	0.9	1.4	1.2	0.4	1.5	1.5	1.5	1.6	1.0	1.1	1.7
Business fixed investment	0.2	0.5	1.1	1.3	1.6	0.6	0.4	1.4	1.7	0.6	1.1	1.1
Producers' dur. equip.	0.1	0.6	0.9	1.0	1.3	0.2	0.5	1.6	1.5	0.6	0.9	1.1
Nonres. structures	0.0	-0.2	0.2	0.2	0.3	0.4	-0.1	-0.1	0.2	0.1	0.3	-0.0
Residential structures	0.3	0.3	0.3	0.7	-0.2	-0.2	0.1	0.3	0.2	-0.1	0.2	0.2
Net exports	1.1	1.0	-1.3	-0.6	-1.4	1.8	-1.0	-0.4	-1.2	0.4	-0.4	-0.8
Exports	1.4	1.2	0.2	1.1	0.2	2.7	1.1	2.0	0.5	1.1	1.0	1.2
Imports	-0.2	-0.3	-1.5	-1.7	-1.6	-0.8	-2.1	-2.5	-1.7	-0.7	-1.4	-2.0
Government cons. & invest.	-0.1	-1.0	0.3	1.3	-0.2	0.0	-0.1	0.6	0.2	-0.3	0.4	0.2
Federal	-0.1	-1.2	0.5	0.6	-0.3	-0.4	-0.4	0.4	-0.1	-0.4	0.1	0.0
Defense	-0.2	-0.8	0.3	0.5	-0.2	-0.3	-0.6	0.3	0.1	-0.3	0.0	-0.0
Nondefense	0.1	-0.4	0.2	0.1	-0.1	0.0	0.2	0.1	-0.1	-0.2	0.1	0.0
State and local	0.0	0.2	-0.2	0.7	0.1	0.4	0.3	0.1	0.3	0.2	0.3	0.2
Change in bus. inventories	-0.2	0.3	-0.8	0.7	0.8	-0.2	1.8	0.8	-1.3	-0.6	0.1	0.4
Nonfarm	-0.2	-0.3	-0.6	0.1	0.8	-0.2	1.8	0.7	-1.4	-0.5	0.0	0.4
Farm	0.0	0.6	-0.2	0.5	0.1	-0.1	0.0	0.1	0.1	-0.1	0.1	0.0

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

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

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	3.9	2.0	1.7	1.6	1.4	1.2	1.3	1.4	1.5	3.9	1.7	1.4
Gross dom. purchases	4.3	2.9	2.6	3.1	1.7	1.9	1.5	2.1	1.4	4.6	2.6	1.7
Final sales	3.3	2.2	2.7	1.7	2.2	1.0	1.7	1.2	2.1	3.4	2.2	1.5
Priv. dom. final purchases	3.5	3.5	3.5	2.9	2.3	1.7	1.8	1.6	1.8	3.9	3.0	1.7
Personal cons. expenditures	2.3	2.7	2.6	2.2	1.7	1.2	1.1	1.2	1.2	2.6	2.3	1.2
Durables	0.2	0.4	0.5	0.4	0.3	0.2	0.2	0.2	0.2	0.6	0.4	0.2
Nondurables	0.2	0.8	0.6	0.5	0.4	0.4	0.3	0.3	0.3	0.4	0.6	0.3
Services	1.9	1.6	1.5	1.3	1.0	0.7	0.7	0.7	0.7	1.7	1.4	0.7
Business fixed investment	0.8	0.8	1.0	0.8	0.7	0.6	0.7	0.5	0.7	1.1	0.8	0.6
Producers' dur. equip.	0.9	0.7	0.9	0.7	0.6	0.5	0.6	0.4	0.6	1.1	0.7	0.5
Nonres. structures	-0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	-0.0	0.1	0.1
Residential structures	0.3	-0.0	-0.1	-0.1	-0.1	-0.1	-0.0	-0.0	-0.0	0.2	-0.1	-0.0
Net exports	-0.4	-1.0	-0.9	-1.5	-0.3	-0.7	-0.2	-0.7	0.1	-0.8	-0.9	-0.4
Exports	1.1	0.4	0.7	-0.1	0.8	0.3	0.9	0.3	1.1	1.2	0.4	0.7
Imports	-1.5	-1.4	-1.6	-1.3	-1.0	-1.0	-1.2	-1.0	-1.0	-2.0	-1.3	-1.0
Government cons. & invest.	0.2	-0.3	0.1	0.3	0.2	0.0	0.2	0.3	0.1	0.2	0.1	0.2
Federal	0.0	-0.6	-0.1	0.0	-0.1	-0.2	-0.1	-0.0	-0.2	0.0	-0.2	-0.1
Defense	0.0	-0.6	-0.2	0.0	-0.1	-0.2	-0.0	0.0	-0.1	-0.0	-0.2	-0.1
Nondefense	0.0	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	0.2	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	0.6	-0.2	-1.0	-0.2	-0.8	0.1	-0.4	0.3	-0.5	0.4	-0.5	-0.1
Nonfarm	0.6	-0.1	-0.9	-0.1	-0.8	0.1	-0.4	0.3	-0.5	0.4	-0.5	-0.1
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.

Strictly Confidential (FR)
Class II FOMC

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

December 11, 1997

Item	Fiscal year[5]				1997				1998				1999			
	1996[a]	1997[b]	1998	1999	Q1[a]	Q2[a]	Q3[b]	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
UNIFIED BUDGET					Not seasonally adjusted											
Receipts[1]	1453	1579	1663	1713	349	496	387	378	369	519	397	391	372	531	419	389
Outlays[1]	1560	1601	1671	1726	401	396	399	424	417	413	417	466	401	427	431	446
Surplus/deficit[1]	-107	-22	-8	-14	-52	100	-11	-46	-48	106	-20	-75	-29	103	-12	-57
On-budget	-174	-103	-97	-114	-69	61	-19	-71	-62	62	-26	-73	-76	55	-20	-86
Off-budget	67	81	89	100	17	39	8	24	13	45	6	-2	46	48	8	30
Surplus excluding deposit insurance[2]	-116	-37	-13	-17	-56	97	-13	-47	-49	105	-21	-76	-30	102	-13	-57
Means of financing																
Borrowing	130	38	28	29	48	-69	11	30	50	-88	36	42	43	-84	28	42
Cash decrease	-6	1	4	0	-1	-18	8	17	5	-13	-5	20	0	-15	-5	10
Other[3]	-16	-16	-19	-15	5	-13	-7	-1	-6	-2	-11	13	-14	-4	-10	5
Cash operating balance, end of period	44	44	40	40	33	51	44	27	22	35	40	20	20	35	40	30
NIPA FEDERAL SECTOR					Seasonally adjusted annual rate											
Receipts	1550	1692	1782	1815	1675	1709	1742	1773	1771	1786	1799	1809	1805	1817	1830	1842
Expenditures	1679	1737	1787	1834	1731	1746	1754	1776	1783	1790	1799	1817	1830	1839	1850	1868
Consumption expend.	447	460	465	469	458	464	465	464	465	464	466	466	470	470	472	471
Defense	302	309	308	308	306	311	312	310	308	306	307	306	307	308	309	308
Nondefense	145	151	157	162	152	153	153	154	157	158	160	160	162	162	162	163
Other expenditures	1232	1277	1322	1364	1273	1282	1289	1312	1318	1326	1333	1350	1360	1369	1378	1397
Current account surplus	-129	-45	-5	-19	-56	-37	-11	-3	-12	-4	0	-8	-25	-22	-19	-26
Gross investment	69	61	60	58	58	62	61	64	58	58	58	58	57	57	58	57
Current and capital account surplus	-197	-106	-65	-76	-114	-99	-72	-67	-70	-62	-58	-66	-82	-80	-77	-83
FISCAL INDICATORS[4]																
High-employment (HEB) surplus/deficit	-220	-168	-155	-141	-170	-167	-150	-159	-163	-153	-144	-145	-151	-140	-128	-126
Change in HEB, percent of potential GDP	-.6	-.7	-.2	-.2	-.2	0	-.2	.1	0	-.1	-.1	0	.1	-.1	-.1	0
Fiscal impetus (*FI*), percent, cal. year	-2.3	-1.6	-2.2	-1.2	-1.1	1.5	.2	-.7	-1.2	-.8	.1	-1.5	1	-.5	-.3	-1.4

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.
b--Preliminary.

Change in Debt of the Domestic Nonfinancial Sectors
(Percent)

			Nonfederal						Memo:
				Households					
Period [1]	Total [2]	Federal government [3]	Total [4]	Total	Home mortgages	Consumer credit	Business	State and local governments	Nominal GDP
Year									
1987	9.2	8.0	9.6	11.9	15.9	4.6	6.9	12.1	7.4
1988	8.8	8.0	9.1	9.1	10.7	6.3	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	1.5	3.3	5.1	4.4
1991	4.3	11.1	2.3	4.9	6.6	-1.3	-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	7.6	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	14.1	6.2	-3.8	4.0
1996	5.2	4.0	5.6	7.4	7.9	7.9	4.6	1.2	5.6
1997	4.5	0.5	5.9	5.6	6.2	4.8	6.4	5.0	5.9
1998	5.0	0.9	6.3	6.0	6.6	5.0	7.1	4.9	3.5
1999	4.6	0.8	5.8	5.4	6.1	3.8	6.5	4.8	3.3
Quarter									
1997:1	4.8	2.1	5.7	6.4	6.6	5.7	5.5	3.2	7.4
2	3.8	-2.6	6.1	5.5	5.8	4.7	6.3	7.7	5.2
3	4.4	1.1	5.5	4.5	5.8	3.4	6.8	4.6	4.8
4	4.7	1.4	5.8	5.7	6.1	5.0	6.4	4.3	6.1
1998:1	5.1	2.1	6.1	5.8	6.3	5.1	6.7	4.7	4.2
2	3.5	-4.5	6.1	5.9	6.3	5.1	6.8	4.8	3.4
3	5.6	3.6	6.3	6.0	6.5	5.0	7.0	4.8	3.3
4	5.4	2.5	6.3	6.0	6.5	4.6	7.0	4.8	3.2

Note. Quarterly data are at seasonally adjusted annual rates.
1. Data after 1997:Q3 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 4.4 percent in 1997, 4.9 percent in 1998, and 4.6 percent in 1999.
3. On a monthly average basis, federal debt rose 0.6 percent in 1997, 0.9 percent in 1998, and 1.0 percent in 1999.
4. On a monthly average basis, nonfederal debt increased 5.8 percent in 1997, 6.3 percent in 1998, and 5.8 percent in 1999.

2.6.3 FOF

Strictly Confidential Class II FOMC
December 11, 1997

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	650.0	583.9	648.5	636.2	612.9	472.4	586.2	664.3	680.3	425.7	753.3	734.6
2 Net equity issuance	-64.2	-68.2	-107.1	-89.2	-78.8	-90.4	-60.4	-43.2	-92.4	-108.4	-117.2	-110.4
3 Net debt issuance	714.2	652.1	755.6	725.4	691.7	562.8	646.6	707.5	772.7	534.1	870.5	845.0
Borrowing sectors												
Nonfinancial business												
4 Financing gap [1]	7.6	52.8	87.6	122.5	35.2	80.3	32.0	63.7	82.1	82.0	92.8	93.5
5 Net equity issuance	-64.2	-68.2	-107.1	-89.2	-78.8	-90.4	-60.4	-43.2	-92.4	-108.4	-117.2	-110.4
6 Credit market borrowing	193.7	281.5	329.3	324.2	242.3	280.6	308.4	294.9	313.3	323.8	337.2	342.9
Households												
7 Net borrowing [2]	362.9	296.3	335.4	315.3	333.3	295.1	245.9	310.9	323.9	329.1	339.8	348.8
8 Home mortgages	264.2	223.7	250.8	249.2	236.3	211.5	216.2	230.8	242.4	245.9	254.3	260.4
9 Consumer credit	88.8	58.2	64.0	50.3	69.6	57.8	42.7	62.6	65.1	65.0	64.5	61.3
10 Debt/DPI (percent) [3]	90.5	91.6	92.6	94.1	91.3	91.7	91.9	91.9	91.8	92.3	92.8	93.4
State and local governments												
11 Net borrowing	12.7	54.7	55.4	56.9	35.0	84.2	51.3	48.2	53.9	54.9	55.9	56.9
12 Current surplus [4]	126.1	112.4	126.4	120.3	115.9	84.9	117.4	131.6	127.7	127.0	125.4	125.7
Federal government												
13 Net borrowing	145.0	19.7	35.5	29.0	81.2	-97.1	40.9	53.6	81.6	-173.6	137.6	96.5
14 Net borrowing (quarterly, n.s.a.)	145.0	19.7	35.5	29.0	48.0	-69.2	10.6	30.2	49.9	-91.5	35.6	41.6
15 Unified deficit (quarterly, n.s.a.)	110.9	9.4	37.1	-4.7	52.0	-100.1	11.3	46.3	48.4	-106.3	19.8	75.1
Depository institutions												
16 Funds supplied	233.2	261.1	286.7	284.2	321.2	358.7	177.9	186.7	289.0	288.0	268.8	301.2
Memo (percentage of GDP)												
17 Domestic nonfinancial debt [5]	185.2	183.3	184.0	186.7	183.8	183.5	183.2	182.5	182.9	183.3	183.9	185.0
18 Domestic nonfinancial borrowing	9.4	8.1	9.0	8.3	8.7	7.0	8.0	8.6	9.3	6.4	10.3	9.9
19 Federal government [6]	1.9	0.2	0.4	0.3	1.0	-1.2	0.5	0.6	1.0	-2.1	1.6	1.1
20 Nonfederal	7.5	7.8	8.5	8.0	7.7	8.2	7.5	7.9	8.3	8.4	8.6	8.8

Note. Data after 1997:Q3 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.

2.6.4 FOF

International Developments

Recent Developments

Global financial markets continued to be turbulent over the intermeeting period. Intense exchange rate and external financing pressures spread to Korea. Increased attention was also focussed on financial market difficulties in Japan. Stock markets in the industrial countries generally rebounded from their declines in October and early November while those in Asia declined further. Long-term interest rates edged down in most of the major foreign industrial countries. On balance, the dollar appreciated during the intermeeting period in terms of the currencies of most of our trading partners.

Since the November FOMC meeting, the dollar has appreciated 4 percent against the yen and 3-1/2 percent against the mark.[1] The dollar was supported against the mark and other continental European currencies by data indicating slow money growth and subdued price pressures in Germany and by statements from officials suggesting that, in advance of the start of EMU, European interest rates are likely to move down to the low levels currently seen in Germany and France rather than to converge at, say, an average of German and Italian rates. Stress in the Japanese financial sector, concerns about spillovers in Japan from events elsewhere in Asia, and signs of faltering Japanese economic expansion put downward pressure on the yen. The dollar also rose in terms of sterling (2 percent) and the Canadian dollar (1-1/4 percent) despite a tightening move by the Bank of Canada and continued vigorous output growth in the United Kingdom and Canada.

The dollar also strengthened against the currencies of many of our developing-country trading partners during the intermeeting period. After falling sharply in November, the Korean won stabilized temporarily following approval of the IMF-led support package for Korea.[2] Near the end of the period, the won again fell precipitously in response to concerns that the planned financial support would prove insufficient for Korea's near-term financing needs; on balance, the won has fallen 42 percent since the November FOMC meeting. The Thai baht and Malaysian ringgit declined about 12 percent against the dollar whereas the Indonesian rupiah dropped 28 percent. The Hong Kong dollar was essentially unchanged although it came under

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1. Rates quoted are changes from November 10 through Thursday morning, December 11, EST.
2. The IMF package provides for $57 billion of support split among the IMF, the IBRD, the ADB, and bilateral second-line-of-defense assistance from several countries, including the United States. The program calls for restructuring of the troubled Korean financial sector, liberalization of capital flows in order to ease restrictions on foreign purchases of Korean stocks, passage of legislation to make the Bank of Korea autonomous, and a modest tightening of monetary and fiscal policies.

renewed pressure late in the period. In contrast, the Mexican peso moved up in terms of the dollar 3/4 percent.

Stock markets in most industrial countries largely recovered their October and early-November declines during the intermeeting period. Equity prices rose 7 percent in Germany and 5 percent in the United Kingdom. In Japan, stock prices remained volatile as news suggested a moribund economy and deepening problems in the financial sector intensified market concerns about forthcoming government policy measures; on balance, equity prices rose 2-1/2 percent during the period. Korean stock prices declined 28 percent through early December and changed little on balance subsequently. Equity prices in Thailand on balance fell 24 percent since the November FOMC meeting whereas those in Malaysia and Indonesia were down almost 15 percent. In contrast, stock prices moved up 5 percent in Hong Kong and 1-1/4 percent in the Philippines over the period.

Yields on ten-year securities have moved down in all the major foreign industrial countries other than Canada since the November FOMC meeting. Declines were as large as 44 basis points in Italy. Canadian rates rose 19 basis points as economic activity remained robust and the Bank of Canada raised its official lending rate. Changes in short-term market rates were mixed for these countries but, on average, changed little.

. The Desk did not intervene.

In most of the foreign G-7 countries, economic expansion remained brisk in the third quarter and, based on the few indicators available, in the fourth quarter as well. Real GDP rose at an annual rate of 3.2 percent in Germany in the third quarter with net exports again contributing most of the stimulus. Industrial production rose in October after falling during the two previous months, and business confidence moved down some but remains high. In the United Kingdom, real GDP growth was 3.6 percent at an annual rate in the third quarter; retail sales rebounded in October, and manufacturing orders rose further through November. Economic activity continues to be robust in Canada, with housing starts increasing strongly in October and employment growth resuming in November after having paused during the previous two months. In Japan, GDP growth resumed in the third quarter as private consumption and nonresidential investment grew moderately, but residential investment plunged. Housing starts appear to have recovered a bit in the most recent months through October, but industrial production declined in October, and new car registrations fell in October and November. On balance, Japanese economic activity appears to be lackluster.

Consumer price inflation (over twelve months) remains at 2 percent or less in all the foreign G-7 countries except the United Kingdom. Japanese CPI inflation has moved back to 2 percent, but underlying inflation is near zero. Only in the United Kingdom is inflationary pressure evident, with retail prices excluding mortgage interest rates rising 2.8 percent in November, somewhat above the 2-1/2 percent target rate.

The financial turmoil in the developing countries of Asia has led to a significant slowdown in output growth in the region, although in Korea the intensification of its financial crisis in November has yet to be reflected in published data. Higher interest rates and uncertainty associated with the crisis are slowing domestic demand growth in Malaysia, the Philippines, and Thailand. Output growth has remained robust in Taiwan through October and has moderated only slightly in China so far this year from rapid rates in 1996. Real output growth in Mexico and Argentina remained vigorous through the third quarter. In both countries, strong growth of domestic demand and thus imports led to deterioration of trade balances through September.

The U.S. current account deficit widened to $169 billion (annual rate) in the third quarter from $151 billion in the second quarter. Most of the change was accounted for by an increase in the trade deficit; net investment income and unilateral transfers changed little. The nominal U.S. trade deficit on goods and services widened in September as exports declined and imports rose, contributing to the sizeable decline in the trade balance for the quarter. Exports in the third quarter were only marginally higher than those in the second quarter. Stronger exports of machinery and industrial supplies and higher service receipts were nearly offset by sharp drops in exports of aircraft and gold. U.S. exports to Japan and other countries in Asia declined slightly. Imports of goods and services rose 1-1/2 percent as most trade categories recorded increases. The quantity of oil imported during the third quarter rose at a 5 percent seasonally adjusted annual rate from the second quarter. Oil imports were driven by extremely strong consumption in the second and third quarters--up more than 3 percent from rates observed a year ago. Preliminary Department of Energy statistics indicate that continued high consumption demand resulted in strong imports and a substantial drawdown of stocks in October.

The price of imported oil rose sharply in October but retraced part of that increase in November. Tensions in the Middle East that led to a buildup of U.S. forces in the Persian Gulf contributed to the jump in prices during October. Spot WTI rose $1.47 per barrel in October, to average $21.26 per barrel. Prices declined $1.09 per barrel in November, when the risk of U.S. armed conflict with Iran lessened. Spot WTI dropped further when the Persian Gulf coalition partners announced that force would be used against Iraq only as a last resort. Prices continued to decline in December in reaction to OPEC's announcement of an increase of nearly 10 percent in its production quota. Spot WTI is currently trading below $19 per barrel for the first time since January 1996.

Non-oil import prices declined 2 percent (annual rate) on average in October and November, continuing a general trend that began two years ago. Prices in most end-use categories moved lower; one important exception was automotive products, where prices increased at about the same rate as in the second quarter. Prices of U.S. nonagricultural exports declined nearly 2 percent (annual rate) on average in October and November after falling slightly in the third quarter; prices of industrial supplies, computers, and semiconductors accounted for much of the decline. Agricultural export prices fell in October and November by about half the rate recorded in the third quarter.

Outlook

We project that growth of total foreign real GDP (weighted by U.S. nonagricultural export shares) will average about 3 percent at an annual rate in the fourth quarter after expanding nearly 5 percent in the third quarter. Foreign output growth is projected to slow further, to 2-1/2 percent, next year and to recover to 3-1/4 percent in 1999. This projection reflects a downward revision since November to our forecast for foreign growth of about 1/4 percentage point in each year as the financial turmoil in Asia results in lower growth in that region that spills over to slower growth in other regions as well.

The dollar is projected to remain near recent levels in terms of most industrial-country and developing-country currencies. Compared with the November Greenbook, the outlook for the dollar is stronger throughout the forecast period, reflecting recent dollar appreciation.

Given this outlook for foreign growth and for exchange rates, we have lowered projected real export growth from the rate forecast in the previous Greenbook. Real net exports are projected to reduce output growth nearly 1/2 percentage point in the fourth quarter, a substantial downward revision from the positive contribution of 1/4 percentage point expected in November. In 1998 and 1999, real net exports are projected to subtract nearly 1 percentage point and about 1/3 percentage point, respectively, from GDP growth, somewhat more drag on output than expected in the previous Greenbook.[3]

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

Measure	1997			1998	1999
	H1	Q3	Q4		
Foreign output	4.2	4.8	3.0	2.5	3.2
November	3.8	4.0	3.3	2.8	3.5
September	3.8	4.0	4.1	3.9	3.7
Real exports	14.1	4.7	9.3	3.8	5.8
November	14.1	5.5	15.3	7.2	6.6
September	14.9	4.9	14.7	7.6	6.1
Real imports	19.2	13.9	11.6	10.5	7.8
November	19.2	14.1	10.9	10.2	7.8
September	19.2	12.0	9.6	9.2	7.0

The dollar. In light of the deepening economic and financial problems faced by Japan, Korea, and other east Asian countries and the appreciation of the dollar over the intermeeting period, we have revised upward our projection of the dollar's foreign exchange value over the forecast period. The dollar is projected to remain near current levels against the mark and other continental European currencies but to decline against the Canadian dollar, as policy tightening returns that currency to the middle of its recent trading range. Sluggish growth in Japan, financial system difficulties, and competitive pressures from other Asian countries are forecast to weigh on the yen throughout the forecast period, although it is projected to strengthen somewhat in 1999. Against the currencies of Korea, Indonesia, Malaysia, and Thailand, the dollar is forecast to remain at current--substantially appreciated--levels in nominal terms, but future price-level increases in these Asian countries should erode some of the dollar's appreciation in real terms during the forecast period. On balance, the U.S. trade-weighted average value of the dollar against twenty key currencies (the G-10 currencies plus ten developing-country currencies) is projected to be nearly 3-1/2

3. Compared with the September Greenbook forecast: Total foreign GDP growth in this forecast is 1-1/2 percentage points lower in 1998 and 1/2 percentage point lower in 1999. The dollar is slightly stronger, less than 1 percent, in the current forecast. As a result, real net exports subtract an additional 0.6 percentage point and 0.2 percentage point from GDP growth in 1998 and 1999, respectively.

percent stronger in real terms over the forecast period than in the November Greenbook forecast.

Foreign G-7 countries. When weighted by U.S. nonagricultural export shares, average real GDP growth in the foreign G-7 countries is projected to slow from 3-1/4 percent (annual rate) in the fourth quarter to 2-1/2 percent next year and a bit less in 1999. This outlook is only slightly weaker than that in the November Greenbook as the effects of the weaker outlook for Asia and Eastern Europe have been counterbalanced by exchange rate changes, lower oil prices, and somewhat easier macroeconomic policies. After growing 2-1/2 percent in the fourth quarter, Japanese real GDP is expected to decelerate to 1-1/2 percent expansion in 1998 and 1-3/4 percent in 1999. We expect that Japan's exports to its Asian trading partners will be significantly reduced by the ongoing crisis and that net exports will subtract marginally from output growth in 1998-99. Stresses within the Japanese financial sector and faltering confidence will restrain domestic demand growth. Unlike November's, this forecast incorporates no further fiscal tightening in 1998 by Japan as current plans for government expenditure cuts are assumed to be either cancelled or offset later in the year. As a consequence of all these factors, the projection of real output growth in Japan has been reduced 1/2 percentage point in 1998 and in 1999 from the rates forecast in November.

Real GDP in Germany is expected to expand at an annual rate of about 2-1/2 percent through the end of 1998 and to accelerate to 3 percent in 1999. The contribution of domestic demand is projected to rise, while that of net exports wanes, as private investment responds to monetary stimulus already in place and consumption strengthens. In the United Kingdom, real GDP growth is expected to slow from about 3-1/2 percent currently to 1-3/4 percent in 1998-99, reducing the gap of actual GDP over potential GDP. Monetary tightening that began last spring, as well as fiscal contraction, should slow domestic demand growth while net exports deteriorate over the forecast period. Real GDP growth in Canada is also projected to slow over the forecast period from its very vigorous current pace. We have revised up projected output growth about 1/4 percentage point in each year, to a bit more than 3 percent in 1998 and 2-1/2 percent in 1999. Domestic demand should slow as deceleration of private spending offsets the continuing lessening of the drag from government spending. The contribution of net exports to growth is projected to remain negative but to diminish in size over the forecast period.

Average consumer price inflation in the foreign G-7 countries (weighted by U.S. bilateral import shares) is projected to decline to 1-1/4 percent in 1998-99, the rate recorded in 1996. The drop in inflation is entirely accounted for by a return to zero measured inflation in Japan as the effect of the excise tax increase in April 1997 disappears from twelve-month calculations of price change and as sluggish economic activity in Japan restrains price pressures.

Our forecast incorporates the assumption that short-term market interest rates in Germany, France, and most other continental European countries will move down somewhat by the end of 1998. Contrary to current market expectations, we are assuming that the Bundesbank holds official interest rates unchanged. In 1999, short-term market rates will rise about 1/2 percentage point as the European Central Bank responds to some firming of growth. Short-term rates in Italy are an exception; they are assumed to decline significantly to match German rates by the end of next year before rising in 1999 along with other euro short-term rates. Short-term rates in Canada are assumed to rise another 3/4 percentage point over the forecast period as the Bank of Canada tightens further. Rates in Japan are assumed to remain near current very low levels. Long-term rates abroad are generally expected to rise slightly over the forecast period as excess capacity is reduced in most of these countries. The levels of both short-term and long-term rates are somewhat below those assumed in the November Greenbook.

Other countries. In the developing countries that are major trading partners of the United States, real GDP (weighted by U.S. bilateral export shares) is projected to increase on average about 2-1/3 percent during 1998, a decline of nearly 1 percentage point from our forecast in the November Greenbook and more than 3 percentage points weaker than in the September Greenbook. This downward revision almost entirely reflects a further marking down of our forecasts for Asian countries. Our view is that further weaknesses in their financial sectors along with tightening of macroeconomic policies in some cases will exert a substantial drag on domestic demand next year. Continued volatility in currency and equity markets in these countries during 1998 is a risk and may weaken growth even more. The magnitude of the downward revisions to output growth since November has been largest (about 3 percentage points) for Korea, where a major financial crisis has emerged. Growth forecasts for most of the other Asian economies have also been lowered from our November projections, but by lesser amounts. We project that growth in most of these countries will recover in 1999, but to below-trend rates. We have revised our inflation forecasts further upward for the Asian countries to reflect the continued substantial depreciation of their currencies over the past month.

Our forecast for real growth in Latin America during 1998 has been marked down only slightly, reflecting some limited spillover effects from the Asian crisis on the financial markets in these countries. Mexican real GDP is still expected to grow at about an annual rate of 4-1/2 percent in 1998-99, whereas the forecast for Brazil has been moved down further, to 3/4 percent for both years.

Real exports and imports of goods and services. Exports of nonagricultural goods other than computers and semiconductors ("core" exports) are projected to rise at an annual rate of 8-1/2 percent in the fourth quarter but to slow to 1/2 percent in 1998 and in 1999. Fourth-quarter growth is supported by residual seasonality in the data. Over the forecast period, lower average foreign growth in 1998-99 than in 1997 and the lagged effects of dollar appreciation account for the deceleration in core exports. This downward revision in the forecast from that in the November Greenbook, with export growth revised more in the near term than later in the forecast period, reflects our estimate of the impact of developments in Asia directly on demand for U.S. exports and indirectly on income growth in our other trading partners. Exports of computers and semiconductors are again projected to grow rapidly in real terms. Agricultural exports are projected to remain near the high level expected in the fourth quarter, and service exports are projected to be flat in 1998 in response to the stronger dollar and weaker foreign growth but to resume growing moderately in 1999. Taken together, these elements result in growth of total exports of goods and services that slows to 3-3/4 percent in 1998 and firms to 5-3/4 percent in 1999.

Growth of non-oil imports of goods and services other than computers and semiconductors ("core" imports) is projected to decrease from 11-1/4 percent (annual rate) in the fourth quarter to 8-3/4 percent in 1998 and to 4-1/2 percent in 1999. This path reflects the projected slowing of U.S. real GDP expansion and the lagged effects of dollar appreciation. Relative to the forecast in the November Greenbook, core imports are boosted in the near term by the stronger dollar. Rapid projected growth for real imports of computers and semiconductors and a slight upward trend in oil imports result in projected growth for total imports of goods and services that slows to 10-1/2 percent in 1998 and 7-3/4 percent in 1999. We estimate that the quantity of oil imports remained near the surprisingly high second-quarter rate during the second half of this year and will rise over the remainder of the forecast period in line with increases in consumption. We have increased the level of our forecast path of oil imports roughly 0.2 mb/d because of the shift down in the projected path of oil prices. U.S. oil production should rise slightly next year, rather than continue its trend decline, as a result of increased production expected from offshore fields in the Gulf of Mexico. However, the lower projected level of oil prices will depress onshore oil production in the lower 48 states, leading to a decline in liftings in 1999.

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

Trade category	Projection				
	1997			1998	1999
	H1	Q3	Q4		
Exports					
Nonagricultural (core)	0.9	0.8	-1.3	-0.7	1.1
Agricultural	0.1	-6.7	0.9	-3.7	1.9
Imports					
Non-oil (core)	-1.3	0.2	-4.9	-1.9	0.8
Oil (level, dollars per barrel)	18.00	17.57	17.81	15.00	16.00

NOTE. Prices for exports and non-oil imports of goods, excluding computers and semiconductors, are on a NIPA chain-weighted basis.
The price of imported oil for multiquarter periods is the price for the final quarter of the period.

Oil prices. We have lowered our projected path for the price of imported oil by roughly $2 per barrel since the November Greenbook. We project that import prices will fall to $15.88 per barrel during the first quarter of next year because of anticipated increases in production of 0.75 mb/d by Saudi Arabia, Kuwait, and the United Arab Emirates beginning in January. After declining a bit more during the middle of next year, we project the WTI spot price and the oil import unit value to rise to $18.50/b and $16.00/b, respectively, by the end of 1999.

While we see a relatively weak oil market in 1998--an unexpectedly large increase in OPEC production that may well crowd out half of the industry's plans for a 1.0 mb/d increase in non-OPEC production--we see the oil market beginning to tighten during 1999. Absent any further surprises from OPEC (or increased production rates allocated to Iraq under the oil-for-food plan), the market will tighten because non-OPEC producers are having difficulty bringing new fields under development into production within their planned time frame.

The increase in oil production anticipated in January by the three key Persian Gulf oil producers may lead to more volatile oil prices in the forecast period as well. The 0.75 mb/d increase in production reduces the excess capacity in the industry by nearly one-third and limits the ability of these three producers to increase production in the short run to offset supply shocks to the market from other regions.

Prices of non-oil imports and exports. Prices of non-oil imports of core goods are projected to decline through the middle of next year and then to rise slowly. The projected ending of dollar appreciation and the waning of lagged effects of declines in non-oil global commodity prices account for the reversal in import prices. Relative to the November Greenbook, the strength in the dollar results in deeper near-term declines in core import prices. Prices of core exports of nonagricultural goods are projected to decline slightly in the near term and subsequently to rise slowly, in line with comparable U.S. domestic prices.

Nominal trade and current account balances. The nominal trade deficit on goods and services is projected to widen from $118 billion in the third quarter to $195 billion by the end of 1999. The deficit on net investment income is expected to deteriorate over the forecast period as well. Accordingly, we project that the current account deficit will widen from $170 billion in the third quarter to an average of $260 billion, or 3 percent of GDP, in 1999.

Strictly Confidential (FR)
Class II FOMC

December 11, 1997

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

Measure and country	1991	1992	1993	1994	1995	1996	---- Projected ---- 1997	1998	1999
REAL GDP									
Canada	0.0	0.5	3.1	4.9	0.7	2.3	4.3	3.1	2.5
Japan	2.5	0.1	0.5	0.8	2.4	3.4	0.5	1.5	1.8
United Kingdom	-1.6	0.4	2.7	4.9	2.0	2.9	3.6	1.6	1.8
EU-11 Average (1)	2.1	0.1	-0.1	3.5	1.4	2.0	2.8	2.6	2.9
of which:									
France	1.3	-0.0	-0.5	4.2	0.3	2.2	2.9	2.3	2.5
Germany (2)	3.3	0.9	-0.2	3.4	0.7	2.1	2.8	2.4	3.0
Italy	1.9	-0.8	0.1	2.7	2.3	0.3	2.2	2.2	3.0
Foreign G-7 Average weighted by 1991 GDP	1.7	0.2	0.6	2.9	1.6	2.4	2.2	2.0	2.3
Average weighted by share of U.S. nonagricultural exports									
Total foreign	3.0	1.9	3.3	5.1	1.9	4.1	4.0	2.5	3.2
Foreign G-7	0.8	0.3	1.8	3.9	1.3	2.5	3.2	2.4	2.3
Developing Countries	6.5	5.1	6.3	7.0	2.6	6.7	5.4	2.4	4.3
CONSUMER PRICES									
Canada	4.1	1.8	1.8	0.0	2.1	2.0	1.6	2.0	2.0
Japan	3.2	0.9	1.2	0.8	-0.8	0.1	2.0	0.0	0.0
United Kingdom (3)	5.7	3.7	2.7	2.2	2.9	3.2	2.8	2.8	3.0
EU-11 Average (4)	NA	NA	NA	NA	2.7	2.0	1.5	1.9	2.1
of which:									
France	3.0	1.8	2.1	1.6	1.9	1.7	1.2	1.8	1.9
Germany (2)	4.0	3.4	4.2	2.6	1.7	1.4	1.9	2.0	2.1
Italy	6.1	4.9	4.1	3.8	5.9	2.7	1.7	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	1.4	1.5
Average weighted by share of U.S. non-oil imports	3.9	1.9	2.0	1.0	1.1	1.3	1.9	1.3	1.3

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.

Strictly Confidential (FR)
Class II FOMC

December 11, 1997

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

	1997				Projected 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	3.3	3.0	3.1	2.8	2.6	2.7	2.5	2.3
Japan	8.3	-10.6	3.1	2.4	1.5	1.5	1.5	1.5	1.8	1.8	1.8	1.8
United Kingdom	3.4	4.0	3.6	3.3	2.0	1.6	1.5	1.5	1.6	1.6	1.9	2.0
EU-11 Average (1)	1.2	4.7	2.9	2.5	2.5	2.6	2.6	2.5	2.9	2.8	3.0	2.8
of which:												
France	1.2	4.5	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	3.2	2.7	2.3	2.3	2.5	2.6	3.0	2.9	3.0	2.9
Italy	-1.1	6.7	1.6	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	3.6	-0.6	3.2	2.6	2.0	2.0	2.0	2.0	2.3	2.2	2.4	2.4
Average weighted by share of U.S. nonagricultural exports												
Total foreign	3.8	4.5	4.8	3.0	2.4	2.4	2.5	2.7	2.9	3.1	3.3	3.4
Foreign G-7	4.1	1.4	4.0	3.2	2.6	2.4	2.5	2.3	2.3	2.4	2.3	2.3
Developing Countries	4.2	8.4	6.6	2.6	1.7	2.2	2.5	3.2	3.6	4.1	4.5	4.9
CONSUMER PRICES (2)												
Canada	2.1	1.6	1.7	1.6	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	0.0	0.0	0.0	0.0	0.0	0.0
United Kingdom (3)	2.9	2.6	2.8	2.8	2.8	2.8	2.9	2.8	2.8	3.0	3.0	3.0
EU-11 Average (4)	1.7	1.2	1.5	1.5	1.8	1.8	2.0	1.9	2.0	2.1	2.1	2.1
of which:												
France	1.5	0.9	1.3	1.2	1.4	1.5	1.8	1.8	1.9	1.9	1.9	1.9
Germany	1.7	1.6	1.9	1.9	1.9	1.9	2.0	2.0	2.0	2.1	2.1	2.1
Italy	2.4	1.6	1.5	1.7	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	1.4	1.4	1.5	1.5	1.5	1.5
Average weighted by share of U.S. non-oil imports	1.3	1.6	1.8	1.9	2.0	1.4	1.3	1.3	1.3	1.3	1.3	1.3

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

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OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

						------ Projected	------	------
	1991	1992	1993	1994	1995	1996	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	-0.8	-0.9	-0.4
Exports of G&S	0.8	0.4	0.5	1.0	1.1	1.0	1.2	0.4	0.7
Imports of G&S	-0.4	-0.8	-1.1	-1.4	-0.7	-1.4	-2.0	-1.3	-1.0
	Percentage change, Q4/Q4								
Exports of G&S	8.6	4.1	4.6	10.0	10.3	9.3	10.5	3.8	5.8
Services	7.1	-0.9	4.1	6.0	9.0	4.7	2.9	-0.4	3.2
Agricultural Goods	10.1	10.4	-5.5	16.6	-3.4	5.7	2.5	-2.1	1.9
Computers	21.7	25.2	23.7	32.0	55.7	33.8	64.2	43.5	42.5
Semiconductors	41.8	64.8	32.9	66.9	80.4	45.9	32.6	38.6	38.6
Other Goods 1/	7.0	2.3	3.6	6.9	5.7	7.6	10.0	0.4	0.6
Imports of G&S	4.1	7.4	10.2	12.3	5.6	11.8	15.9	10.5	7.8
Services	-2.7	1.4	3.2	1.4	7.3	5.0	12.7	3.6	1.7
Oil	8.1	12.1	10.1	-0.2	1.5	8.3	3.4	2.3	3.0
Computers	35.9	45.1	39.3	44.8	46.2	23.6	53.6	39.6	38.1
Semiconductors	55.3	42.0	34.2	54.5	92.7	57.9	42.3	38.6	38.6
Other Goods 2/	2.5	5.4	9.5	12.2	-1.2	10.5	13.7	8.7	4.6
	Billions of chained 1992 dollars								
Net Goods & Services	-22.3	-29.5	-70.2	-104.6	-98.8	-114.4	-149.1	-228.7	-287.3
Exports of G&S	599.9	639.4	658.2	712.4	791.2	857.0	963.5	1018.0	1065.1
Imports of G&S	622.2	669.0	728.4	817.0	890.1	971.5	1112.6	1246.7	1352.4
	Billions of dollars								
US CURRENT ACCOUNT BALANCE	-5.7	-56.4	-90.8	-133.5	-129.1	-148.2	-165.5	-209.3	-262.5
Net Goods & Services (BOP)	-31.0	-39.2	-72.3	-104.4	-101.9	-111.0	-113.6	-142.7	-188.4
Exports of G&S (BOP)	581.2	617.5	643.5	699.6	794.6	848.8	933.2	966.3	1004.1
Imports of G&S (BOP)	612.2	656.7	715.8	804.1	896.5	959.9	1046.8	1109.0	1192.6
Net Investment Income	20.3	18.0	19.7	9.7	6.8	2.8	-12.6	-24.8	-32.3
Direct, Net	55.6	51.6	55.7	50.8	60.0	66.8	70.2	68.8	76.6
Portfolio, Net	-35.4	-33.6	-36.0	-41.0	-53.2	-63.9	-82.8	-93.5	-108.9
Net Transfers	5.1	-35.2	-38.1	-38.8	-34.0	-40.0	-39.3	-41.8	-41.8

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

Strictly Confidential (FR) December 11, 1997
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OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1994 Q1	1994 Q2	1994 Q3	1994 Q4	1995 Q1	1995 Q2	1995 Q3	1995 Q4	1996 Q1	1996 Q2	1996 Q3	1996 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	-145.4	-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	-111.7	-113.2	-123.2	-95.5	-75.5	-98.1	-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.

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Class II FOMC

December 11, 1997

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1997				1998				1999			
				---- Projected	----	----	----	----	----	----	----	----
	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	-1.2	-0.4	-1.0	-0.9	-1.5	-0.3	-0.7	-0.2	-0.7	0.1
Exports of G&S	1.1	2.0	0.5	1.1	0.4	0.7	-0.1	0.8	0.3	0.9	0.3	1.1
Imports of G&S	-2.1	-2.5	-1.7	-1.5	-1.4	-1.6	-1.3	-1.0	-1.0	-1.2	-1.0	-1.0
Percentage change from previous period, SAAR												
Exports of G&S	9.9	18.4	4.7	9.3	3.6	6.0	-1.2	6.9	2.8	8.0	2.8	9.7
Services	3.7	3.2	7.0	-2.1	-4.8	-0.9	1.4	2.7	3.3	3.3	3.2	3.1
Agricultural Goods	-27.6	-4.2	20.9	31.3	-13.0	-2.5	7.9	0.5	-5.6	-1.0	10.3	4.4
Computers	72.3	84.3	59.4	43.8	43.8	43.8	43.3	43.3	42.7	42.7	42.2	42.2
Semiconductors	39.0	15.7	38.7	38.6	38.6	38.6	38.6	38.6	38.6	38.6	38.6	38.6
Other Goods 1/	12.4	25.0	-4.0	8.4	4.2	4.8	-10.0	3.6	-3.5	5.0	-5.6	7.1
Imports of G&S	17.9	20.5	13.9	11.6	11.0	12.7	10.4	7.9	7.6	8.7	7.6	7.2
Services	24.2	8.9	9.4	8.8	7.1	4.2	2.0	1.4	1.5	1.6	1.7	1.9
Oil	-10.8	44.5	5.1	-15.7	-19.4	41.7	12.0	-14.5	-6.2	23.7	2.7	-5.6
Computers	51.3	71.1	52.4	41.2	41.2	39.9	38.6	38.6	38.1	38.1	38.1	38.1
Semiconductors	71.2	19.3	44.8	38.6	38.6	38.6	38.6	38.6	38.6	38.6	38.6	38.6
Other Goods 2/	15.3	17.1	11.2	11.3	10.9	9.0	8.1	6.8	5.4	4.5	4.4	4.1
Billions of chained 1992 dollars												
Net Goods & Services	-126.3	-136.6	-161.9	-171.5	-193.7	-215.3	-249.2	-256.5	-273.4	-280.7	-298.3	-297.0
Exports of G&S	922.7	962.5	973.5	995.5	1004.2	1019.0	1015.9	1032.9	1040.0	1060.2	1067.5	1092.5
Imports of G&S	1048.9	1099.1	1135.4	1166.9	1197.9	1234.3	1265.1	1289.4	1313.3	1340.9	1365.8	1389.6
Billions of dollars												
US CURRENT ACCOUNT BALANCE	-159.9	-151.4	-168.6	-182.2	-177.5	-190.9	-224.6	-244.1	-248.0	-253.7	-269.3	-279.0
Net Goods & Services (BOP)	-117.2	-102.6	-118.5	-116.0	-118.0	-129.0	-159.6	-164.3	-179.2	-183.2	-197.9	-193.4
Exports of G&S (BOP)	897.0	939.0	940.0	957.0	959.2	968.0	961.5	976.3	982.1	1000.2	1005.9	1028.3
Imports of G&S (BOP)	1014.2	1041.5	1058.5	1073.0	1077.2	1097.1	1121.1	1140.6	1161.3	1183.4	1203.8	1221.7
Net Investment Income	-8.0	-13.0	-13.3	-16.2	-20.5	-22.8	-26.0	-29.8	-29.8	-31.5	-32.4	-35.6
Direct, Net	69.3	70.9	69.5	71.1	69.1	68.7	68.5	68.8	72.9	75.5	78.4	79.6
Portfolio, Net	-77.3	-83.9	-82.8	-87.3	-89.5	-91.6	-94.5	-98.5	-102.6	-106.9	-110.9	-115.1
Net Transfers	-34.7	-35.8	-36.8	-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.