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

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Strictly Confidential (FR) Class II FOMC

Part 1

March 25, 1998

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

March 25, 1998

SUMMARY AND OUTLOOK

Prepared for the Federal Open Market Committee
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Domestic Developments

Overview

Although we think it likely that real GDP has decelerated somewhat this quarter, the evidence on that score is scarcely compelling. Our assessment hinges on expected declines in inventory investment and net exports for which there is only fragmentary statistical support at this point. Meanwhile, it is quite clear that domestic final demand has surged once again. In particular, the continued confidence of households and businesses in the prospects for sustained prosperity has been reflected in big increases in consumer spending, residential construction, and equipment investment. Under the circumstances, employers seem to be hiring just about every qualified--or at least trainable--worker they can grab in a tight labor market, and increases in payrolls and hours worked have outstripped all predictions. Fortunately, although the pressures on labor supplies have produced an acceleration in wages over the past year, price inflation has remained low--indeed, it has been virtually nil overall in the past couple of months as a result of plummeting crude oil costs.

Favorable financial market conditions have encouraged the growth in aggregate demand. Although bond yields have risen a touch in recent weeks, they have remained low enough to encourage private and public borrowers to seek funding for new outlays and to refinance old debts. Meanwhile, share prices have soared to new highs, in the face of some trimming of near-term earnings projections; a sense of relief that the worst may be avoided in Asia, partly based on the progress made in dealing with Korea's financial problems, has helped to embolden equity investors.

These financial conditions should provide ongoing support for domestic demand in the near term, but we nonetheless continue to expect a more significant deceleration of activity. We believe that, consistent with many anecdotal reports, the effects of the Asian economic slump and a high dollar exchange rate on the U.S. trade position have yet to play out fully. In addition, the pace of inventory accumulation appears to have remained much higher than would be expected in the steady state. Importantly, over time, equity investors are likely to discover that their expectations for profit growth have been unrealistic, and we have built a modest decline in share prices into the forecast--albeit from a considerably higher level than before. All told, we are looking for a slowing of real GDP growth to an average rate of around 2 percent per annum over the next few quarters, with only a little pickup in 1999. That path for output implies that resource utilization rates should ease to some degree. However, with the labor market remaining relatively tight--and oil prices, the dollar, and other "special factors" less favorable going forward than they have been recently--we anticipate that there will be an upcreep in the underlying trend of inflation.

Key Background Factors

We have maintained our assumption of a steady federal funds rate in this projection. Regarding longer-term interest rates, we are not anticipating any major departures from the range of recent months, but we continue to think that the predicted softening of economic indicators in the next few months may provide the basis for at least a brief penetration of the recent lows for Treasury bond yields. The sizable run-off of Treasuries in the second quarter should also be constructive for the market, although we expect that these supply effects will be modest for fixed-income securities prices as a whole.

On the equities side, sentiment will be tested once again by the upcoming round of quarterly corporate reports, which we expect will show a considerable deterioration of earnings momentum. However, with all the warnings that have already been issued by companies, especially in the "high-tech" sector, the reports may not supply enough negative surprises to trigger a major market reversal. We are projecting a path for corporate profits over coming quarters that suggests a considerable shortfall from what analysts are talking about currently. But we are not sure that such an outcome will alone be sufficient to prompt investors, now convinced that a buy-and-hold equity strategy will almost guarantee returns well into double digits, to turn to what they perceive to be low-yielding fixed-income instruments. Consequently, we have built into our forecast only a modest slippage in the market, one that will leave share prices through next year well above those anticipated in the last Greenbook and price-earnings multiples at historically high levels.

Fiscal policy is expected to remain about neutral in terms of the impetus to aggregate demand over the next two years. Although the prospect of budget surpluses has sparked much talk of tax cuts or increases in spending, we expect that the Congress will include offsets to the deficit effects of any such measures it enacts. In this Greenbook, we have incorporated supplemental appropriations for fiscal year 1998 to fund ongoing military operations in Bosnia and the Persian Gulf as well as an increase in grants in fiscal 1999 to state and local governments to finance highway construction and mass transit. The stronger outlook for economic growth and some technical reassessments have caused us also to boost our forecast of receipts, and we are now projecting budget surpluses of $9 billion in fiscal 1998 and $5 billion in fiscal 1999.

Prospects for economic activity abroad are little changed from the January Greenbook. Incoming information has been softer than projected for Japan, but the evolution of activity in most other Asian economies--Indonesia being the notable, and negative, exception--has been in line with our expectations. We are projecting that foreign real GDP will rise about 2 percent in 1998 before strengthening to nearly 3 percent in 1999. The foreign exchange value of the dollar has continued to firm in early 1998, but by a little less than we projected in January. We still anticipate that the *real* value of the dollar will have peaked in the first quarter and that it will decline about 3 percent on a broad import-weighted basis over the forecast period, as higher inflation in Asia erodes some of the recent competitive gains of these currencies.

The projection for crude oil prices has been marked down considerably. Crude prices have fallen sharply this quarter in response to unusually mild winter temperatures, the UN accord with Iraq, weak Asian demand, and greater world oil production. Major oil producers have now acted to curtail production, and prices have firmed from their recent lows. But the likely prospect of increased Iraqi exports has caused us to cut our longer-term crude oil forecast by $1 to $2 per barrel. We now are projecting that spot WTI, which traded as low as $13.25 in the first quarter, will stabilize at $16.50 per barrel in the second quarter and remain at that level over the balance of the forecast period.

Recent Developments and the Outlook for the Current Quarter

Real GDP is projected to rise at a 3 percent annual rate in the current quarter--as compared with the 3-3/4 percent growth pace registered in 1997. The incoming data from the labor market provide no hint of even this modest slowing: Nonfarm payrolls increased sharply in the first two months of this year, initial claims have remained low this month, and hours worked likely will advance at an annualized pace of around 4 percent in the current quarter (even after, as discussed in Part 2, an adjustment for an overstatement of the workweek in the reported figures). Our estimate thus anticipates a dip in labor productivity, after a run of relatively hefty gains.

Growth of industrial production has slowed this quarter. The demands on utilities have been depressed by warm weather, while growth in manufacturing output is projected to slow to a 4 percent rate, from almost twice that pace in the second half of 1997. Motor vehicle assemblies have fallen--shaving half a point from the growth of real GDP--and output has decelerated across a wide range of other industries.

On the expenditure side, private domestic final purchases are booming, while a deterioration in net exports looks to be the most significant drag on production. Real personal consumption expenditures likely increased at more than a 5 percent annual rate in the first quarter. Light vehicle sales continued to run at about a 15 million unit annual pace in the first two months of the year, but sales of other goods surged. With the exception of the weather-related drop in energy consumption, expenditures on services have also advanced rapidly.

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

Measure	1997:Q4		1998:Q1	
	Jan. GB	Mar. GB	Jan. GB	Mar. GB
Real GDP	**3.9**	**3.9**	**2.7**	**3.1**
Private domestic final purchases	2.7	2.7	5.4	6.2
Personal consumption expenditures	2.9	3.1	4.7	5.3
Residential investment	8.1	9.5	1.7	14.2
Business fixed investment	-.4	-2.2	11.7	9.3
Government outlays for consumption and investment	.9	.4	-1.1	.0
	Change, billions of chained (1992) dollars			
Inventory investment	17.9	24.5	-3.1	-7.5
Net exports	10.8	4.4	-30.2	-35.2

Housing markets were hot this winter. Stimulated by falling mortgage rates and by briskly rising income and wealth, sales of single-family homes have skyrocketed, and new starts averaged 1.24 million units (annual rate) in January and February--well above the already healthy pace of the fourth quarter. Unusually warm weather in northern areas likely contributed to these increases, but we believe that underlying demand trends were a major element in the strength of building. After having surged in the latter part of 1997, multifamily starts dropped back to 346,000 units in the first two months of this year--a pace more in line with the fundamentals in this market. On net, real residential investment expenditures are estimated to have risen at a 14-1/4 percent pace in the first quarter.

Business fixed investment is rebounding from its decline in the fourth quarter. On the equipment side, orders and shipments were up sharply, on balance, over the December-to-February period and are consistent with a return to a double-digit growth rate for equipment spending. The acceleration was particularly impressive in office and computing equipment, for which large nominal increases in shipments, coupled with very marked price declines, imply extraordinary real growth in the current quarter. The demand for communications equipment appears robust, but domestic deliveries of aircraft are expected to fall sharply this quarter, as a greater share of planes is exported. Despite anecdotal reports of a building boom and considerable financing activity, the available data on construction point to little change in investment in nonresidential structures in the current quarter.[1]

After adding slightly to growth in the fourth quarter, a deterioration in real net exports is projected to subtract 1-1/2 percentage points from the increase in real GDP in the current quarter. The January trade report provides evidence that the economic difficulties in Asia are starting to depress U.S. exports. The weakness we see this quarter on the export side reflects a softening in services and in shipments of agricultural products; the projected rise in import volumes is expected to occur mainly in non-oil merchandise imports.

Inventory accumulation in manufacturing and trade excluding motor vehicles was quite moderate in January. We have built in substantial increases for the ensuing two months to keep our GDP estimate in reasonably comfortable alignment with the indications from the labor input side. The resultant 4-3/4 percent growth rate of nonfarm inventories implies some rise in the stock-sales ratio, for which there is little corroborative information--but the tension is not great enough to set off any alarms that we are on the wrong track.

The PPI has continued to decline, and the overall CPI has barely increased thus far this year, thanks to the decline in energy prices. Meanwhile, the core CPI increased about 1/4 percent per month on average in January and February--a smidge faster than in 1997. Higher tobacco prices accounted for much of this pickup; excise taxes have increased and producers have raised wholesale prices--nominally to finance the cost of various legal settlements and awards. The only broad statistics on pay developments this year are on average hourly earnings through February; the figures suggest a continuation of the roughly 4 percent pace of production-worker wage increase that has prevailed for some time--implying an acceleration of real wages. Anecdotal reports of labor market conditions certainly point to tight supplies of workers, but the compensation picture nonetheless remains quite mixed across

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1. Construction put-in-place was up in January, but real NRS will be depressed as spending returns to more normal levels after the purchase of the Elk Hills petroleum reserve from the federal government in the fourth quarter.

industries and occupations; pay hikes are often rather precisely targeted at key workers with "hot skills," and many of the increased employment costs that firms are incurring do not show up in wages or benefits, as conventionally measured.

The Outlook for the Economy Beyond the Current Quarter

The further rise in equity prices and evidence of greater momentum in private demand has prompted us to raise our forecast of real GDP growth in 1998 by ½ percentage point, to 2-1/4 percent, and growth holds at that pace in 1999. We continue to expect that developments in the external sector will be an important restraint on the economy, although their influence has been cushioned somewhat in this forecast by the lower price of imported oil. Some correction in equity values is expected to induce a softening in consumer demand over the projection period, and business investment also is forecast to decelerate as expansion needs ebb and profitability declines. A slower pace of inventory investment is expected to be a drag on production, as companies bring their stockbuilding into line with the projected pace of sales. The unemployment rate is expected to move up to about 5 percent by the end of next year--a smaller increase than in the January Greenbook, owing to the faster output growth in this forecast. Price trends deteriorate somewhat more in this projection as the result of tighter labor markets and slightly higher non-oil import prices.

Consumer spending. We would be surprised if consumer spending were to maintain the growth pace of the first quarter into the spring. That said, though, we expect that gains will remain impressive on average for a while longer, and indeed in this forecast, real PCE increases several tenths of a percent faster this year than does real disposable income. This pattern is mainly a reflection of the wealth effect associated with the huge run-up in share values over the past few years. But other financial conditions also are supportive of consumer demand, and should remain so. At prevailing interest rates, many households are reaping the benefits of refinancing mortgages--lowering their debt-service burdens, reducing risk by shifting from ARMs to FRMs, or taking out larger loans to liquify some accumulated equity. Consumer lenders appear to be expanding the availability of credit with somewhat less fervor than they displayed before delinquency and bankruptcy rates soared a couple of years ago. Nonetheless, there are signs that the selective tightening measures they instituted--along with a robust economy--have brought a halt to the deterioration in repayment performance. Consequently, credit access should not be a problem for most households.

All told, then, we are looking for real PCE to grow 4 percent this year--a little more than in 1997. In the near term, a return to normal levels of energy use for heating and cooling should add to a strong uptrend in services consumption. Although we see sales of new light vehicles only remaining on the 15 million unit plateau of the past several years, the prospects appear good for substantial growth in purchases of other consumer goods. Rapidly declining relative prices are boosting the demand for computers and other electronic goods, and the current strength in home sales likely will translate into increased spending on furniture, appliances, and other household durables.

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

Measure	1997	1998	1999
Real GDP	**3.8**	**2.3**	**2.2**
Previous	3.8	1.7	1.9
Final sales	3.2	3.0	2.1
Previous	3.3	2.4	1.8
PCE	3.7	4.0	2.4
Previous	3.7	3.5	2.1
Residential investment	5.7	3.0	-1.8
Previous	5.4	.6	-.3
BFI	8.6	9.5	6.2
Previous	9.1	7.7	5.4
Government purchases	1.0	.8	.9
Previous	1.1	.6	.9
Exports	10.2	1.3	4.8
Previous	10.5	.5	4.1
Imports	14.5	9.1	6.7
Previous	14.1	7.9	6.5
	Change, billions of chained (1992) dollars		
Inventory change	39.1	-52.7	6.6
Previous	32.5	-52.3	12.2
Net exports	-54.1	-91.9	-35.4
Previous	-47.7	-86.2	-40.0

Growth in real PCE is projected to slow to around 2-1/2 percent in 1999. Our forecast anticipates that share prices will begin slipping this spring, and that the lagged effects of that reversal on consumer demand in 1999 will neutralize the effects of the earlier market rise. The projected softening of the economy is rather mild, with unemployment remaining quite low; even with the disappointing performance of household equity portfolios, the scenario we are outlining does not suggest a drastic deterioration in consumer confidence and a shift toward much more cautious spending attitudes. Lenders may become a bit more concerned about credit risks, but probably not enough to prompt more than a selective tightening of underwriting standards. Given the extended period of strong purchases of durables, that category of expenditure is likely to register the sharpest deceleration--but not a downturn overall.

Residential investment. Housing construction is forecast to hold at a relatively high level over the projection period. In the next few months, building starts should drop back from the February pace, in part owing to a weather-related "payback." But we still expect total starts generally to remain above the 1.5 million unit mark for most of this year.

In the single-family market, with mortgage rates in the recent range, the cash-flow affordability of home ownership will remain exceptionally good; we expect that the relative price of houses will rise gradually, but the negative effects on demand from that movement probably will be offset by the bolstering of the investment incentive in those locales where real estate has slumped in the past decade. Moreover, accumulated stock market gains should provide an ongoing boost to demand, especially in the trade-up and second home segments of the market. Lower-income buyers will continue to benefit from innovative programs of the GSEs and other lenders to provide "affordable" financing. As a result, we expect single-family housing starts to total 1.18 million units this year--up from the already substantial volume of 1.14 million in 1997. With job growth slowing next year, single-family starts are projected to slip to 1.13 million units.

Having retreated recently from the lofty level reached last fall, multifamily starts are projected to average about 330,000 units (annual rate) over the forecast period. Demand for multifamily units has been bolstered by the overall strength in the economy, which undoubtedly has enabled more people to form households. Vacancy rates are falling, and rents are rising again--but not enough to warrant a widespread pickup in building. A risk in the outlook would be that the enthusiasm for REIT stocks and other securities backed by such properties will create a supply of finance that tempts developers to undertake more projects than are economically viable, resulting in more construction during the projection period and a slump later.

Business fixed investment. Growth in real business fixed investment is expected to pick up to a 9-1/2 percent pace in 1998 before slowing to 6-1/4 percent in 1999. Lagged accelerator effects are projected to stimulate capital spending for much of this year, but investment growth should slow in 1999--declining absolutely in the case of the manufacturing sector, where the weakening U.S. position in international trade will have an especially marked effect. An increasing number of firms are likely to find that they are less flush with internally generated cash, as rising unit labor costs reduce profit margins and squeeze the internal funds available for investment. Lenders may become a bit more concerned about credit quality, but the expected deterioration in corporate income and balance sheet strength should not be great enough to prompt more than a modest widening of risk premiums.

Equipment spending is forecast to grow 12-1/4 percent in 1998--the same as the 1997 pace--but to decelerate to 7-1/2 percent in 1999. The deceleration should be broad based, but sales of "high-tech" items for which product improvement is dramatic and prices are falling rapidly are expected to maintain brisk growth. The boom in real purchases of office and computing equipment shows no sign yet of letting up despite warning signs by some major firms in the industry that earnings have leveled off. These earnings disappointments have been attributed in some instances to excess inventories as firms make the transition to new products or manufacturing processes; they are expected to be temporary as overall demand for computers still is reported to be very strong. Retooling associated with solutions to the Year 2000 problem may give a little extra lift to sales. Similarly, the demand for communications equipment is expected to grow at a double-digit pace over the next two years, spurred by deregulation and the rapid increases in markets for Internet access and mobile phone service.

Outside of the high-tech area, purchases of many types of equipment may level out or decline over the next year or so. As suggested earlier, investment in basic industrial equipment should be damped by a slide in factory capacity utilization and pressure on profit margins. Orders for heavy trucks have skyrocketed in the past year, and shipments are constrained at this point by production capacity; demand is likely to flag as economic growth--and shipping traffic--moderates. Deliveries of new jet aircraft to domestic airlines are expected to level off later this year and next, following rapid growth in 1997.

In contrast to the anticipated slowdown in real PDE, investment in nonresidential structures is expected to accelerate over the projection horizon. Spending on new construction leveled off in 1997, but many indicators of prospects for this sector are flashing decidedly positive signals. The strength in spending should come from the office and other commercial markets, where vacancy rates have fallen further and rents reportedly are moving up sharply in some areas. REITS and other financial intermediaries are moving rapidly to finance new projects, and anecdotal reports in the Beige Book and elsewhere suggest that speculative building is on the rise. As a result, we are projecting that real NRS will increase 2-1/2 percent this year and 3 percent in 1999.

Business inventories. After running at a high level in 1997, nonfarm inventory investment is expected to downshift this year, reducing real GDP growth 2/3 percentage point. Overhangs are apparent in only a few industries at present, but many businesses--especially those that are sensitive to international trade--project sales to slow over the course of this year, and they are expected to cut the pace of their inventory investment to hold stocks in close alignment with sales. Other firms simply will be surprised and will have to catch up. This adjustment is expected to be complete by the end of this year, though, and inventory investment is an essentially neutral influence on economic growth in 1999.

As a result of favorable harvests, farm inventories were rebuilt somewhat last year. It is still too early to make any meaningful judgment on the state of this year's crops, and the forecast assumes that farm production will move in line with long-run trends. Thus, we are not anticipating any major swings in farm stocks, although some liquidation of livestock herds is likely as the year progresses.

Government spending. Real federal consumption and investment expenditures are projected to decline slowly over the next two years. Real defense spending is expected to fall 4-1/4 percent this year and another 2-1/4 percent in 1999. The rate of decline is about the same as in the January Greenbook, as higher expenditures associated with military operations in the Persian Gulf and Bosnia are offset by some retreat in other spending following strength in the fourth quarter. Nondefense consumption and investment expenditures are projected to rise 3-1/2 percent this year before declining 1 percent in 1999.[2]

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2. The growth of real federal nondefense consumption and investment expenditures in 1998 was revised upward by 2 percentage points in this forecast. The upward revision largely reflects the sale of (continued...)

The projection of real state and local purchases is similar to the last Greenbook. We have revised down the path for construction expenditures in 1998 to better reflect softer trends in this sector: Construction expenditures rose less than ½ percent in 1997 and appear to have declined in the first quarter of 1998. However, construction growth is expected to rise in 1999, spurred by the additional federal funds coming from the anticipated passage of new highway legislation. Rising state surpluses have prompted many governors to propose tax cuts, and we expect numerous small to moderate-sized tax cuts again this year. In addition, many state legislatures are likely to salt away part of any revenue windfalls in "rainy day" funds. Thus, real state and local government consumption and investment expenditures are projected to increase 2.2 percent in 1998 and 2.4 percent in 1999--broadly in line with long-term trends in this sector.

Net exports. Incoming data on international trade have been largely consistent with our view that the downturn in key Asian economies would lead to a more pronounced deterioration in our external balances. Real exports of goods and services now are forecast to rise 1-1/4 percent this year and 4-3/4 percent in 1999. Export growth is held down by the slowdown in foreign economic activity projected for 1998 and by the lagged effects of the appreciation of the dollar. Given the improved competitive position of foreign products, imports of goods and services are projected to increase 9 percent in 1998 and 6-3/4 percent in 1999. (A more detailed discussion of the outlook for net exports is contained in the *International Developments* section.)

Labor markets. With the current tightness in the labor market, many employers report difficulties filling vacancies with qualified workers. Indeed, some positions--especially for IT professionals--are going unfilled, and businesses are simply making do with their existing staffs. This backlog of demand for workers is expected to support hiring in the near term, even as domestic economic activity begins to slow. Payroll employment gains are projected to average a little less than 200,000 per month in the second quarter--below the 310,000 per month pace estimated for the first quarter but still well above trend growth. However, as profit margins are squeezed and stock prices decline, we expect corporate managements to feel extra heat to tighten down to

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2. (...continued)
the Elk Hills petroleum reserve, which was not incorporated in the January Greenbook. This sale temporarily depressed spending in the fourth quarter of 1997, and the 1998 growth rate is boosted as the level of purchases returns to normal.

constrain costs, and employment gains slow to around 130,000 per month in the second half of this year and to 110,000 in 1999.

In this environment, we are forecasting a slowdown in the growth of labor productivity this year. Output per hour is projected to increase 0.3 percent in 1998 and 1.4 percent next year--in line with our estimates of the longer-term trend.[3] In addition to the pent-up demand for labor noted above, labor productivity probably will be held down by ongoing efforts to solve the Year 2000 problem. As we have noted previously, getting a handle on the timing and size of the Y2K work is quite difficult, but it seems obvious that resources are being devoted to this task, with little or no payoff in terms of greater output. The allowance we have made in this forecast is on the order of a tenth or two of a percentage point on growth in output per hour.

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

Measure	1997	1998	1999
Output per hour, nonfarm business	2.2	.3	1.4
Previous	2.3	.8	1.5
Nonfarm payroll employment	2.5	2.0	1.0
Previous	2.5	1.3	.8
Household employment survey	2.1	1.3	.8
Previous	2.1	1.0	.7
Labor force participation rate[1]	67.1	67.2	67.2
Previous	67.1	67.1	67.1
Civilian unemployment rate[1]	4.7	4.7	4.9
Previous	4.7	4.8	5.2

1. Percent, average for the fourth quarter.

Given the greater strength in economic activity in this forecast, the unemployment rate is projected to rise to only about 5 percent by the end of 1999--several tenths less than in the last forecast. We expect the labor force participation rate to edge off a tenth of point after jumping early this year and to hold near 67.2 percent over the forecast period. The pool of people still wanting a job has

3. We continue to assume trend growth in labor productivity of 1.2 percent *on a consistently measured basis.* Allowing for technical changes in the CPI, the trend estimates are 1.3 percent in 1998 and 1.5 percent in 1999.

become quite shallow, making significant further increases unlikely--even with a nudge from welfare reform.

Wages and Prices. We are projecting a bit more inflation than in the January Greenbook. Core consumer prices are forecast to increase 2-1/4 percent in both 1998 and 1999--an upward revision of 1/4 percentage point. Adjusting for technical changes, the core CPI accelerates almost 1/2 percentage point over the forecast period. Rates of resource utilization are higher in this round, and the slowdown in productivity growth also is expected to add to firms' costs. While, in general, we think that shifts in the trend growth of labor productivity are the more important influence, empirical results suggest that shorter-term productivity movements also play some role in business pricing decisions. In addition to these domestic cost pressures, higher core non-oil import prices give a slightly larger boost to inflation than in the January Greenbook. We have not at this juncture incorporated any price hikes associated with some form of national tobacco settlement. While there appears to be a strong desire among the interested parties to reach an agreement this year, a compromise settlement has yet to emerge. The possibility of a tobacco agreement that quickly raises cigarette prices is an important upside risk to our price forecast--one that could potentially raise the price of cigarettes by $1.50 per pack over the next two years and thereby add directly 1/2 percentage point to core inflation in both 1998 and 1999.

Favorable trends in food prices are expected to be a slightly moderating influence on inflation over the projection period. The CPI for food is forecast to rise 1-1/2 percent this year and 1-3/4 percent in 1999. Weather-related disruptions to supplies of fresh fruits and vegetables could cause some near-term run-up in the prices of these items, but such pressures are expected to be largely offset by the effects of recent weakness in farm commodity prices. Futures prices for both crops and livestock have declined further since the week of the last Greenbook, pushed lower by ongoing concern about the prospects for exports and, in recent days, by talk of large acreage increases for corn and soybeans. The markets remain relatively unperturbed by El Nino as best we can tell. At this point, we are assuming that aggregate crop production will increase roughly in line with longer-term trends, but a reduction in beef supplies due to an inventory cycle in the cattle industry is projected to cause some firming in meat prices later this year and in 1999.

Following the projected path of crude oil prices, the CPI for energy is forecast to decline 4-1/2 percent this year and to increase 1-1/4 percent in 1999. Rate reductions associated with electric power deregulation in California and Massachusetts are expected to depress electricity prices in the first quarter of this year; we expect price increases in this sector to remain below overall inflation over the projection period, as more competition for electric power develops in other states.

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

Measure	1997	1998	1999
Consumer price index	1.9	1.7	2.2
Previous	1.9	1.6	2.0
Food	1.7	1.5	1.8
Previous	1.7	1.3	1.8
Energy	-1.0	-4.6	1.2
Previous	-1.0	-3.0	2.5
Excluding food and energy	2.2	2.3	2.3
Previous	2.2	2.1	2.0
PCE chain-weighted price index	1.5	1.5	2.0
Previous	1.6	1.6	1.9
Excluding food and energy	1.6	1.9	2.1
Previous	1.7	1.9	1.8
GDP chain-weighted price index	1.8	1.6	1.8
Previous	1.9	1.7	1.7
ECI for compensation of private industry workers[1]	3.4	3.4	3.3
Previous	3.4	3.2	3.1
Prices of core non-oil merchandise imports	-.8	-1.5	1.8
Previous	-1.6	-1.5	1.1
	Percentage points		
MEMO: *Adjustments for technical changes to the CPI*[2]			
Core CPI	.2	.4	.6
Core PCE	.1	.1	.3
GDP chain price index	.1	.1	.2

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

Regarding compensation trends, recent anecdotal reports certainly indicate that many employers are offering more sizable pay increases in order to attract and retain needed workers. This may suggest some upside bias to the risks surrounding our forecast that increases in the ECI for hourly compensation--at 3.4 percent in 1998 and 3.3 percent in 1999--will differ little from that recorded in 1997. We believe that this projection embodies a reasonable balancing of some important crosscurrents. With the unemployment rate remaining so low, tightness in labor markets should be putting upward pressure on *real* pay gains. However, this influence is expected to be offset with respect to *nominal* compensation by the very favorable downward trend in price inflation that has lowered workers' expectations of inflation significantly and will hold down demands for cost-of-living catch-ups. In addition, we have assumed that there will be no further significant hike in the minimum wage, a factor that raised labor costs last year; there clearly is some non-negligible possibility that, although congressional support appears limited at this point for the proposals that have been put on the table, a boost will become part of some package deal later in this election year.

Growth in compensation per hour probably will be buoyed in the current quarter by heavy payouts of commissions and bonuses in the booming financial and real estate sectors, but that impulse will not be repeated quarter after quarter. Indeed, with the expected slowdown in the economy and the associated deterioration in corporate profits, we anticipate a decline in commissions, bonuses, and other forms of supplemental pay in general. However, this moderating influence is offset by rising costs for employer-provided health insurance. As has been noted in previous Greenbooks, a turning point appears to have been reached in the underwriting cycle in the health insurance industry. Profit margins have been squeezed significantly over the past few years by rising costs and greater competition, and insurers are again raising premiums. In response, some businesses will switch to managed care plans or shift more of the cost burden to their employees. But in the aggregate, we still are expecting employers' health insurance costs to rise noticeably this year and next.

As noted above, with compensation rising at a fairly steady pace but labor productivity growth weakening, unit labor costs will be rising more rapidly and squeezing profit margins. This is likely to be especially manifest in the manufacturing sector, but other industries probably will suffer as well. We foresee a net decline in NIPA economic profits on the order of 3 percent over the course of 1998 and 1999. Translating this into numbers comparable to those cited in conventional EPS measures is not a simple exercise, but we believe that our projection implies a noteworthy shortfall relative to the predictions of both "top-down" and "bottom-up" analysts in the investment community, who are talking about moderate to sizable gains in earnings over the projection period.

Money and Credit Flows

The total debt of domestic nonfinancial sectors of the economy is expected to grow about 5-1/2 percent this year and 4-3/4 percent in 1999. These increases exceed the projected rise in nominal GDP in each year, putting the debt-to-GDP ratio on an upward path after almost a decade of little net change. The uptrend would be sharper still if not for the modest paydown of federal debt, which reflects the small budget surpluses that we project through 1999. Among the other sectors, nonfinancial businesses are expected to be recording the most rapid debt growth, but we anticipate that the debt of households and state and local governments will also increase rather briskly.

Nonfinancial corporate debt is estimated to have increased at an annual rate of 12 percent in the current quarter, the biggest bulge since 1986. In part, the recent borrowing likely has been fueled by bond issues that were deferred last fall because of turbulent market conditions. However, the heavy demand for credit, from both banks and the markets, also reflects longer-term influences. In particular, merger activity shows no sign of abating, and we anticipate that borrowing will remain brisk to finance the equity retired through these deals. Also, given our forecast of a sharp deceleration in corporate earnings, firms will need more outside funding to bridge the widening gap between capital outlays and internal funds. Based on these considerations, we expect nonfinancial business debt to expand 8-1/4 percent over 1998 as a whole and 6-1/2 percent next year.

Corporate credit quality has given hints of weakening a bit in recent months, and we anticipate that this trend will continue as firms face somewhat heavier debt burdens. In this environment, lenders may selectively tighten their standards, and borrowing costs for lower-rated firms probably will move up. However, given our projection of moderate economic growth and little change in interest rates, we do not envision any severe deterioration in corporate financial positions or a material restriction in credit supply.

Total household debt is expected to rise 7 percent this year, matching the increase last year, and then to advance 6-1/4 percent in 1999. Mortgage debt has grown briskly of late, reflecting the robust pace of home sales and what appears to be a fair amount of "cash-out" refinancing. The growth of this debt should edge lower over the forecast period as housing activity moderates and the pace of refinancing returns to more normal levels. Even so, mortgage debt is projected to increase at an average annual rate in excess of 7 percent through the end of 1999. This pace is more than double the growth expected for consumer credit, which will be held down, in part, by the ongoing shift to mortgage borrowing and, in 1999, by the slower rise in purchases of consumer durables.

Although household debt is projected to grow more rapidly than disposable income, the debt-service burden, while already elevated, is not expected to move higher over the forecast period. Households will realize interest savings from mortgage refinancing and will benefit from the shift toward mortgage debt, which stretches out the period for debt repayment and carries lower rates than consumer credit. Although lenders may become still more cautious in taking on exposure to the riskiest borrowers, we do not foresee the kind of adverse shock that would prompt a wholesale tightening of credit conditions.

The debt of state and local governments is projected to grow 5 percent this year, a bit below the rise in 1997, and then to slow further next year. These governments will be borrowing in large part to finance infrastructure projects, but we also expect that low interest rates will continue to spur a considerable volume of issuance to be used to advance refund existing debt.

The growth of M2 this quarter has far exceeded our estimate of the advance in nominal GDP. We cannot fully explain the strength in M2, but the aggregate likely has received a temporary lift from the high level of mortgage refinancing and the faster payment of tax refunds resulting from electronic filing. Also, the flattening of the yield curve late last year may have spurred inflows to money funds and other M2 assets. Looking ahead, we expect M2 growth to slow quite a bit, coming into rough alignment with that of nominal GDP. We anticipate that M3 also will decelerate, though it will continue to outpace M2. The relative strength of M3 reflects the same factors we have cited for some time: the growing use of money funds for corporate cash management, along with solid growth in bank credit.

Alternative Simulations

Our alternative, model-based simulations assess the implications of different assumptions about interest rates and the stock market. They may also be used to gauge the implications of certain obvious risks in the outlook. In the first alternative, the federal funds rate rises 25 basis points per quarter through the first quarter of 1999 and remains a constant 100 basis points above the baseline forecast thereafter. The higher interest rates pull down real GDP growth 1/4 percentage point in 1998 and 3/4 percentage point in 1999. The unemployment rate rises to 5-1/4 percent by the end of 1999, ½ percentage point higher than in the baseline projection, and consumer price inflation comes in ½ percentage point lower than baseline in 1999--virtually a flat path for inflation, adjusted for technical changes to the index. Another way of looking at this simulation is that, if one felt that the staff forecast has once again understated the underlying momentum of aggregate demand--and that GDP growth might remain around potential over the projection period--a prompt and substantial tightening of policy might be needed simply to achieve the results in the staff baseline forecast.

We have consistently underestimated the power of the bull market for equities, and recent events have reinforced our concerns that a major and lasting correction might not occur in the absence of a serious exogenous shock--such as a surprising shift in monetary policy. Another alternative simulation assumes that the value of equities remains constant relative to disposable income; this contrasts with an appreciable decline in the wealth-to-income ratio in the baseline forecast, but it still falls far short of anything like a continuation of recent stock market trends. The federal funds rate is maintained at 5-1/2 percent. In this scenario, real GDP growth is 1/4 percentage point higher in 1998 and 1/2 percentage point higher in 1999; the unemployment rate is 1/4 percentage point lower by the end of 1999.[4] The effect on the CPI is slight not only because of the small unemployment effect, but also because long-term inflation expectations remain low. In the FRB/US model, these expectations are quite sluggish unless there is a significant change in the stance of monetary policy; in essence, people have come to expect that policymakers will move to prevent an acceleration in prices.

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4. To carry out this simulation, we adjusted the FRB/US model to boost the speed with which changes in wealth influence personal consumption expenditures, matching that used in the judgmental projection; this provides a closer estimate of what the staff projection would look like under this alternative stock-market scenario. Without such an adjustment, the FRB/US model would have projected a delay of a large portion of these effects until 2000.

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

Measure	1997	1998	1999
Real GDP			
Baseline	3.8	2.3	2.2
Higher funds rate	3.8	2.1	1.4
Lower funds rate	3.8	2.5	3.0
No stock price decline	3.8	2.5	2.7
Civilian unemployment rate[1]			
Baseline	4.7	4.7	4.9
Higher funds rate	4.7	4.8	5.3
Lower funds rate	4.7	4.6	4.5
No stock price decline	4.7	4.6	4.7
CPI excluding food and energy			
Baseline	2.2	2.3	2.3
Higher funds rate	2.2	2.2	1.9
Lower funds rate	2.2	2.4	2.7
No stock price decline	2.2	2.3	2.4

1. Average for the fourth quarter.

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Class II FOMC

March 25, 1998

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]	
		01/28/98	03/25/98	01/28/98	03/25/98	01/28/98	03/25/98	01/28/98	03/25/98	01/28/98	03/25/98
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	5.8	3.8	3.8	2.1	2.0	2.3	2.3	4.9	4.9
1998		4.2	4.4	2.5	2.8	1.7	1.5	1.5	1.6	4.7	4.6
1999		3.5	3.9	1.7	2.1	1.7	1.8	2.1	2.2	5.0	4.8
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	3.7	5.4	5.4
	Q3	3.6	3.6	1.0	1.0	2.7	2.7	2.8	2.6	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	2.0	5.3	5.3
	Q2	5.2	5.2	3.3	3.3	1.8	1.8	1.0	1.5	4.9	4.9
	Q3	4.6	4.6	3.1	3.1	1.4	1.4	2.0	1.8	4.9	4.9
	Q4	5.9	5.4	3.9	3.9	1.9	1.5	2.3	2.3	4.7	4.7
1998	Q1	4.4	4.5	2.7	3.1	1.8	1.4	0.5	0.5	4.6	4.6
	Q2	2.6	3.6	1.0	2.1	1.6	1.5	1.7	1.5	4.7	4.6
	Q3	3.1	3.8	1.5	2.0	1.6	1.8	2.1	2.3	4.7	4.6
	Q4	3.4	3.8	1.7	2.0	1.7	1.8	2.2	2.2	4.8	4.7
1999	Q1	3.7	4.1	1.8	2.0	1.9	2.0	2.1	2.2	4.9	4.7
	Q2	3.5	3.8	1.9	2.1	1.6	1.7	2.0	2.2	5.0	4.8
	Q3	3.7	4.0	2.0	2.2	1.7	1.7	2.0	2.2	5.1	4.8
	Q4	3.8	4.1	2.1	2.3	1.7	1.7	2.0	2.2	5.2	4.9
TWO-QUARTER[3]											
1996	Q2	6.2	6.2	3.8	3.8	2.3	2.3	3.4	3.5	-0.2	-0.2
	Q4	4.9	4.9	2.7	2.7	2.3	2.3	3.0	2.9	-0.1	-0.1
1997	Q2	6.3	6.3	4.1	4.1	2.1	2.1	1.7	1.8	-0.4	-0.4
	Q4	5.2	5.0	3.5	3.5	1.7	1.4	2.1	2.0	-0.2	-0.2
1998	Q2	3.5	4.1	1.8	2.6	1.7	1.4	1.1	1.0	-0.0	-0.1
	Q4	3.3	3.8	1.6	2.0	1.7	1.8	2.1	2.3	0.1	0.1
1999	Q2	3.6	3.9	1.8	2.0	1.8	1.9	2.1	2.2	0.2	0.2
	Q4	3.7	4.1	2.0	2.3	1.7	1.7	2.0	2.2	0.2	0.1
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	5.8	5.6	3.8	3.8	1.9	1.8	1.9	1.9	-0.6	-0.6
1998	Q4	3.4	3.9	1.7	2.3	1.7	1.6	1.6	1.7	0.1	-0.0
1999	Q4	3.7	4.0	1.9	2.2	1.7	1.8	2.0	2.2	0.4	0.2

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.

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

March 25, 1998

Item	Units[1]	1991	1992	1993	1994	1995	1996	1997	1998 (Projected)	1999 (Projected)
EXPENDITURES										
Nominal GDP	Bill. $	5916.7	6244.4	6558.1	6947.0	7265.4	7636.0	8081.1	8437.9	8767.8
Real GDP	Bill. Ch. $	6079.4	6244.4	6389.6	6610.7	6742.1	6928.4	7189.5	7393.2	7544.8
Real GDP	% change	0.4	3.6	2.4	3.3	1.6	3.2	3.8	2.3	2.2
Gross domestic purchases		0.0	4.0	3.0	3.6	1.2	3.6	4.4	3.2	2.4
Final sales		-0.4	3.9	2.1	2.7	2.2	3.1	3.2	3.0	2.1
Priv. dom. final purchases		-0.8	4.9	3.7	3.7	2.5	3.8	4.4	4.6	2.7
Personal cons. expenditures		-0.2	4.2	2.7	3.1	2.2	2.7	3.7	4.0	2.4
Durables		-3.1	9.4	7.4	6.3	3.0	3.9	6.8	6.9	2.9
Nondurables		-1.0	3.4	1.6	3.0	1.0	1.8	1.4	3.0	1.6
Services		0.9	3.6	2.3	2.5	2.7	2.8	4.2	3.9	2.7
Business fixed investment		-6.0	5.5	9.9	7.6	6.5	11.7	8.6	9.5	6.2
Producers' dur. equipment		-2.6	9.6	12.2	10.2	8.3	12.2	12.3	12.2	7.4
Nonres. structures		-12.5	-3.4	4.5	1.1	2.0	10.3	-0.6	2.5	2.9
Residential structures		1.1	16.9	7.8	4.2	-1.9	3.9	5.7	3.0	-1.8
Exports		8.6	4.1	4.6	10.0	10.3	9.3	10.2	1.3	4.8
Imports		4.1	7.4	10.2	12.3	5.6	11.8	14.5	9.1	6.7
Gov't. cons. & investment		-0.7	1.7	-1.4	0.1	-1.4	2.0	1.0	0.8	0.9
Federal		-3.1	1.3	-6.1	-3.9	-6.0	1.5	-0.7	-1.8	-1.8
Defense		-5.3	-1.3	-6.9	-6.0	-5.9	1.1	-0.7	-4.3	-2.3
State & local		1.0	2.0	2.0	2.7	1.4	2.2	2.0	2.2	2.4
Change in bus. inventories	Bill. Ch. $	-3.0	7.0	22.1	60.6	27.3	25.0	65.2	42.1	30.9
Nonfarm		-1.2	2.0	29.5	49.0	35.7	22.5	57.3	35.5	25.9
Net exports		-22.3	-29.5	-70.2	-104.6	-98.8	-114.4	-146.7	-228.6	-281.9
Nominal GDP	% change	3.8	6.3	5.0	5.8	4.0	5.6	5.6	3.9	4.0
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employment	Millions	108.3	108.6	110.7	114.1	117.2	119.5	122.3	125.3	126.8
Unemployment rate	%	6.8	7.5	6.9	6.1	5.6	5.4	4.9	4.6	4.8
Industrial prod. index	% change	-0.0	3.7	3.3	6.5	3.3	4.2	5.7	1.8	2.1
Capacity util. rate - mfg.	%	77.9	79.4	80.5	82.5	82.8	81.4	81.7	80.9	78.8
Housing starts	Millions	1.01	1.20	1.29	1.46	1.35	1.48	1.48	1.51	1.44
Light motor vehicle sales		12.52	12.85	13.87	15.02	14.73	15.05	15.06	14.89	14.59
North Amer. produced		9.74	10.51	11.71	12.88	12.82	13.34	13.12	13.02	12.86
Other		2.77	2.34	2.15	2.13	1.90	1.71	1.93	1.86	1.73
INCOME AND SAVING										
Nominal GNP	Bill. $	5932.4	6255.5	6576.8	6955.2	7270.6	7637.7	8061.2	8398.5	8719.5
Nominal GNP	% change	3.5	6.2	5.1	5.7	4.1	5.5	5.3	3.7	4.0
Nominal personal income		3.7	7.3	4.2	5.1	5.2	5.8	6.0	4.3	3.9
Real disposable income		0.8	4.0	1.5	2.4	2.4	2.0	3.7	2.8	2.4
Personal saving rate	%	6.0	6.2	5.1	4.2	4.8	4.3	3.8	3.4	3.1
Corp. profits, IVA & CCAdj.	% change	4.5	11.3	19.0	14.1	11.0	9.1	10.0	-5.2	2.5
Profit share of GNP	%	6.9	6.8	7.5	8.2	8.9	9.6	10.0	9.3	9.1
Excluding FR Banks		6.6	6.6	7.2	7.9	8.6	9.3	9.7	9.1	8.8
Federal surpl./deficit	Bill. $	-196.0	-280.9	-250.7	-186.7	-174.4	-110.5	-28.8	10.2	-2.0
State & local surpl./def.		75.8	86.3	87.4	96.8	103.1	105.3	107.8	116.0	116.4
Ex. social ins. funds		11.5	18.3	19.7	27.9	32.5	34.1	36.4	44.5	44.8
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	7.0	6.4
PRICES AND COSTS										
GDP chn.-wt. price index	% change	3.3	2.6	2.6	2.5	2.4	2.3	1.8	1.6	1.8
Gross Domestic Purchases chn.-wt. price index		2.7	2.7	2.3	2.5	2.3	2.3	1.4	1.2	1.8
CPI		3.0	3.1	2.7	2.7	2.6	3.2	1.9	1.7	2.2
Ex. food and energy		4.4	3.5	3.1	2.8	3.1	2.6	2.2	2.3	2.3
ECI, hourly compensation[2]		4.4	3.5	3.6	3.1	2.6	3.1	3.4	3.4	3.3
Nonfarm business sector										
Output per hour		2.2	3.5	-0.2	-0.1	0.6	1.7	2.2	0.3	1.4
Compensation per Hour		4.8	4.5	1.8	1.9	3.1	3.9	4.1	3.6	3.3
Unit labor cost		2.5	1.0	2.0	2.0	2.4	2.2	1.9	3.3	1.9

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)

March 25, 1998

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	5.7	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	1.42	1.47	1.49	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	2.4	3.2	3.7	2.6	3.3	2.0	1.5
Ex. food and energy		3.3	3.3	2.8	3.0	2.5	2.5	2.7	2.7	2.2	2.6
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		-1.8	0.8	1.4	2.2	2.8	2.9	-0.7	1.9	1.1	2.3
Compensation per hour		2.3	3.1	3.1	3.7	3.9	5.1	3.3	3.4	4.3	3.2
Unit labor cost		4.2	2.3	1.7	1.4	1.0	2.2	4.0	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)

March 25, 1998

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. $	8124.3	8232.1	8323.6	8397.2	8475.3	8555.7	8641.0	8722.9	8808.8	8898.5
Real GDP	Bill. Ch. $	7214.0	7282.9	7338.0	7375.5	7411.4	7447.7	7484.1	7522.8	7564.1	7608.1
Real GDP	% change	3.1	3.9	3.1	2.1	2.0	2.0	2.0	2.1	2.2	2.3
Gross domestic purchases		4.3	3.6	4.7	3.1	3.2	2.0	2.7	2.3	2.9	1.9
Final sales		4.7	2.6	3.5	3.1	2.3	3.0	1.3	2.3	1.8	2.9
Priv. dom. final purchases		7.1	2.7	6.2	4.7	4.2	3.4	2.5	2.6	2.7	2.8
Personal cons. expenditures		5.6	3.1	5.3	4.2	3.7	2.7	2.3	2.4	2.5	2.5
Durables		18.4	1.9	15.9	5.3	3.8	3.0	2.4	2.9	3.1	3.2
Nondurables		4.3	-1.1	3.2	3.2	3.4	2.2	1.5	1.6	1.7	1.7
Services		3.9	5.4	4.3	4.5	3.8	2.9	2.6	2.6	2.7	2.7
Business fixed investment		19.2	-2.2	9.3	9.6	9.6	9.7	6.0	6.4	6.0	6.3
Producers' dur. equipment		24.1	-2.3	12.8	11.9	12.0	12.2	7.2	7.7	7.1	7.6
Nonres. structures		6.7	-2.0	0.4	3.3	3.2	3.1	2.9	2.9	2.9	3.0
Residential structures		2.7	9.5	14.2	0.8	-1.5	-1.0	-2.3	-2.2	-1.8	-1.0
Exports		4.4	8.6	-3.5	3.0	-1.6	7.5	1.1	7.1	1.6	9.8
Imports		14.6	5.7	9.5	11.1	8.8	6.8	6.7	8.1	6.7	5.2
Gov't. cons. & investment		1.1	0.4	0.0	1.1	1.0	1.1	-0.2	1.7	1.3	0.8
Federal		-1.1	-2.1	-3.2	-1.2	-1.4	-1.3	-4.8	0.4	-0.8	-2.1
Defense		1.2	1.3	-10.5	-2.2	-2.5	-1.5	-6.7	0.7	-1.2	-1.8
State & local		2.3	1.9	1.9	2.3	2.3	2.4	2.4	2.4	2.4	2.4
Change in bus. inventories	Bill. Ch. $	47.5	72.0	64.5	45.9	38.8	19.3	32.0	28.6	37.0	25.9
Nonfarm		38.3	62.4	55.5	38.9	33.3	14.4	26.9	23.6	31.9	21.0
Net exports		-164.1	-159.7	-194.9	-219.0	-248.9	-251.6	-269.4	-277.0	-294.2	-286.9
Nominal GDP	% change	4.6	5.4	4.5	3.6	3.8	3.8	4.1	3.8	4.0	4.1
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	122.6	123.5	124.5	125.2	125.6	126.0	126.3	126.6	127.0	127.3
Unemployment rate	%	4.9	4.7	4.6	4.6	4.6	4.7	4.7	4.8	4.8	4.9
Industrial prod. index	% change	6.0	7.2	2.8	2.8	0.5	1.3	2.1	1.9	2.0	2.5
Capacity util. rate - mfg.	%	81.6	82.2	81.9	81.5	80.5	79.8	79.3	78.9	78.6	78.4
Housing starts	Millions	1.45	1.53	1.56	1.51	1.50	1.48	1.46	1.45	1.43	1.43
Light motor vehicle sales		15.34	15.10	15.08	15.02	14.77	14.68	14.59	14.59	14.58	14.58
North Amer. produced		13.31	13.14	13.09	13.13	12.96	12.92	12.86	12.86	12.85	12.85
Other		2.03	1.94	1.99	1.90	1.81	1.76	1.73	1.73	1.73	1.73
INCOME AND SAVING											
Nominal GNP	Bill. $	8103.5	8208.5	8290.5	8360.3	8433.5	8509.6	8596.0	8676.2	8759.6	8846.0
Nominal GNP	% change	4.6	5.3	4.1	3.4	3.5	3.7	4.1	3.8	3.9	4.0
Nominal personal income		4.6	6.4	6.7	3.7	3.6	3.3	4.1	3.9	3.9	3.7
Real disposable income		2.6	4.5	6.8	2.0	1.3	1.0	4.8	1.6	1.6	1.5
Personal saving rate	%	3.5	3.8	4.2	3.7	3.2	2.7	3.3	3.2	3.0	2.7
Corp. profits, IVA & CCAdj.	% change	17.2	-2.2	-11.8	-8.6	-3.6	3.7	2.3	1.3	2.3	4.3
Profit share of GNP	%	10.2	10.0	9.6	9.3	9.2	9.2	9.1	9.1	9.0	9.0
Excluding FR Banks		9.9	9.8	9.4	9.1	8.9	8.9	8.9	8.8	8.8	8.8
Federal surpl./deficit	Bill. $	-10.8	-12.3	-0.9	8.7	17.9	15.2	-10.1	-5.2	3.5	3.7
State & local surpl./def.		111.4	110.3	118.2	114.8	113.5	117.4	116.1	116.8	116.0	116.9
Ex. social ins. funds		40.0	38.8	46.7	43.3	42.0	45.9	44.5	45.2	44.4	45.3
Gross natl. saving rate	%	17.4	17.5	17.7	17.2	16.7	16.4	16.5	16.4	16.4	16.2
Net natl. saving rate		7.5	7.5	7.8	7.2	6.7	6.4	6.5	6.4	6.3	6.2
PRICES AND COSTS											
GDP chn.-wt. price index	% change	1.4	1.5	1.4	1.5	1.8	1.8	2.0	1.7	1.7	1.7
Gross Domestic Purchases chn.-wt. price index		1.3	1.4	0.4	1.1	1.7	1.7	2.0	1.7	1.7	1.7
CPI		1.8	2.3	0.5	1.5	2.3	2.2	2.2	2.2	2.2	2.2
Ex. food and energy		1.9	2.1	2.5	2.2	2.3	2.3	2.3	2.3	2.3	2.3
ECI, hourly compensation[1]		3.4	4.9	3.5	3.4	3.4	3.4	3.2	3.3	3.3	3.3
Nonfarm business sector											
Output per hour		3.6	1.8	-2.2	0.7	1.1	1.6	1.0	1.3	1.4	1.8
Compensation per hour		3.8	5.2	4.1	3.5	3.5	3.4	3.3	3.3	3.3	3.3
Unit labor cost		0.2	3.4	6.3	2.8	2.4	1.8	2.3	2.0	1.9	1.5

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	3.1	1.6	3.2	3.8
Gross dom. purchases	1.9	1.3	3.1	6.6	2.4	2.5	6.0	3.7	4.4	1.2	3.6	4.4
Final sales	3.3	1.9	2.6	5.2	0.2	4.5	3.0	2.5	4.7	2.2	3.1	3.2
Priv. dom. final purchases	2.3	2.0	3.6	4.5	1.7	2.7	4.2	2.4	5.8	2.0	3.1	3.6
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	2.5
Durables	0.7	0.2	0.4	0.8	-0.2	0.3	1.1	-0.5	1.4	0.2	0.3	0.5
Nondurables	0.1	0.1	0.4	0.5	0.1	0.4	0.9	-0.4	0.8	0.2	0.4	0.3
Services	0.9	0.9	1.4	1.2	0.4	1.5	1.5	1.5	1.5	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	1.9	0.6	1.1	0.9
Producers' dur. equip.	0.1	0.6	0.9	1.0	1.3	0.2	0.5	1.6	1.7	0.6	0.9	0.9
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	0.1	-0.1	0.2	0.2
Net exports	1.1	1.0	-1.3	-0.6	-1.4	1.8	-1.0	-0.4	-1.3	0.4	-0.4	-0.6
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	-1.8
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	-1.6	-0.6	0.1	0.5
Nonfarm	-0.2	-0.3	-0.6	0.1	0.8	-0.2	1.8	0.7	-1.7	-0.5	0.0	0.5
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	3.1	2.1	2.0	2.0	2.0	2.1	2.2	2.3	3.8	2.3	2.2
Gross dom. purchases	3.6	4.7	3.1	3.3	2.0	2.7	2.4	2.9	2.0	4.4	3.3	2.5
Final sales	2.6	3.5	3.0	2.3	3.0	1.3	2.3	1.8	2.9	3.2	2.9	2.1
Priv. dom. final purchases	2.3	5.1	3.9	3.5	2.8	2.1	2.2	2.3	2.4	3.6	3.8	2.2
Personal cons. expenditures	2.1	3.6	2.9	2.5	1.9	1.6	1.6	1.7	1.7	2.5	2.7	1.7
Durables	0.2	1.2	0.4	0.3	0.2	0.2	0.2	0.2	0.2	0.5	0.5	0.2
Nondurables	-0.2	0.6	0.6	0.7	0.4	0.3	0.3	0.3	0.3	0.3	0.6	0.3
Services	2.1	1.7	1.8	1.6	1.2	1.1	1.1	1.1	1.1	1.7	1.6	1.1
Business fixed investment	-0.2	0.9	1.0	1.0	1.0	0.6	0.7	0.6	0.7	0.9	1.0	0.7
Producers' dur. equip.	-0.2	0.9	0.9	0.9	0.9	0.6	0.6	0.6	0.6	0.9	0.9	0.6
Nonres. structures	-0.2	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	-0.0	0.1	0.1
Residential structures	0.4	0.6	0.0	-0.1	-0.0	-0.1	-0.1	-0.1	-0.0	0.2	0.1	-0.1
Net exports	0.3	-1.6	-1.0	-1.3	-0.1	-0.7	-0.3	-0.7	0.4	-0.6	-1.0	-0.3
Exports	1.0	-0.4	0.3	-0.2	0.8	0.1	0.8	0.2	1.1	1.2	0.1	0.5
Imports	-0.7	-1.2	-1.4	-1.1	-0.9	-0.9	-1.0	-0.9	-0.7	-1.8	-1.2	-0.9
Government cons. & invest.	0.1	0.0	0.2	0.2	0.2	-0.0	0.3	0.2	0.1	0.2	0.1	0.2
Federal	-0.1	-0.2	-0.1	-0.1	-0.1	-0.3	0.0	-0.0	-0.1	-0.0	-0.1	-0.1
Defense	0.1	-0.5	-0.1	-0.1	-0.1	-0.3	0.0	-0.0	-0.1	-0.0	-0.2	-0.1
Nondefense	-0.2	0.3	0.0	0.0	-0.0	-0.0	0.0	0.0	-0.1	-0.0	0.1	-0.0
State and local	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.3	0.3
Change in bus. inventories	1.2	-0.4	-0.9	-0.4	-1.0	0.6	-0.2	0.4	-0.5	0.5	-0.7	0.1
Nonfarm	1.3	-0.4	-0.8	-0.3	-0.9	0.6	-0.2	0.4	-0.5	0.5	-0.6	0.1
Farm	0.0	-0.0	-0.1	-0.1	-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)

March 25, 1998

Item	Fiscal year[5]				1997				1998				1999			
	1996[a]	1997[a]	1998	1999	Q1[a]	Q2[a]	Q3[a]	Q4[b]	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
UNIFIED BUDGET					Not seasonally adjusted											
Receipts[1]	1453	1579	1679	1725	349	496	387	386	381	516	396	406	375	523	421	412
Outlays[1]	1561	1601	1670	1721	401	396	398	426	414	414	417	464	400	426	431	443
Surplus/deficit[1]	-107	-22	9	5	-52	100	-11	-40	-33	102	-20	-58	-25	98	-10	-30
On-budget	-174	-103	-85	-112	-69	61	-19	-66	-50	58	-27	-59	-76	45	-22	-67
Off-budget	67	81	95	117	17	39	8	26	17	44	7	1	52	52	12	37
Surplus excluding deposit insurance[2]	-116	-36	4	1	-56	97	-12	-41	-34	101	-22	-59	-26	97	-11	-31
Means of financing																
Borrowing	130	38	-5	-11	48	-69	11	34	22	-89	28	24	30	-80	16	16
Cash decrease	-6	1	4	0	-1	-18	8	12	6	-10	-4	20	0	-15	-5	10
Other[3]	-16	-17	-8	6	5	-13	-7	-6	4	-4	-3	14	-5	-2	-1	4
Cash operating balance, end of period	44	44	40	40	33	51	44	32	26	36	40	20	20	35	40	30
NIPA FEDERAL SECTOR					Seasonally adjusted annual rate											
Receipts	1550	1692	1791	1832	1675	1709	1742	1767	1783	1798	1814	1832	1815	1831	1850	1867
Expenditures	1679	1737	1787	1831	1731	1746	1753	1779	1784	1789	1796	1817	1825	1836	1846	1863
Consumption expend.	447	460	468	471	458	464	465	469	467	467	468	468	470	472	473	472
Defense	302	309	311	310	306	311	312	315	311	310	309	309	309	310	310	310
Nondefense	145	151	156	161	152	153	153	154	156	157	158	159	161	162	163	162
Other expenditures	1232	1277	1319	1360	1273	1282	1288	1311	1317	1322	1328	1349	1355	1364	1373	1391
Current account surplus	-129	-45	3	1	-56	-37	-11	-12	-1	9	18	15	-10	-5	3	4
Gross investment	69	61	59	58	58	62	61	59	60	60	59	59	58	58	58	58
Current and capital account surplus	-197	-106	-56	-58	-114	-99	-72	-71	-61	-51	-42	-44	-68	-63	-55	-54
FISCAL INDICATORS[4]																
High-employment (HEB) surplus/deficit	-221	-169	-154	-150	-171	-169	-150	-163	-159	-152	-141	-142	-161	-153	-143	-141
Change in HEB, percent of potential GDP	-.6	-.7	-.2	-.1	-.2	0	-.2	.2	0	-.1	-.1	0	.2	-.1	-.1	0
Fiscal impetus (FI), percent, cal. year	-2.3	-1.9	-.7	-1.1	-1.1	1.5	.2	-1.6	.9	-.5	-.4	-1.4	.9	-.2	-.5	-1.1

1. OMB's February 1998 surplus estimates (assuming the enactment of the President's proposals) are -$10 billion in FY98 and $10 billion in FY99. CBO's March 1998 baseline surplus estimates are $8 billion in FY98 and $9 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 February 1998 surplus estimates (assuming the enactment of the President's proposals), excluding deposit insurance spending, are -$15 billion in FY98 and $5 billion in FY99. CBO's March 1998 baseline surplus estimates, excluding deposit insurance, are $3 billion in FY98 and $5 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									
1989	7.3	7.0	7.3	8.5	9.9	6.0	6.7	5.7	6.4
1990	6.4	11.0	5.2	7.5	9.6	1.5	3.1	5.1	4.4
1991	4.3	11.1	2.3	4.8	6.4	-1.3	-1.7	8.4	3.8
1992	4.6	10.9	2.6	4.5	5.2	0.5	0.7	2.0	6.3
1993	5.0	8.3	3.8	5.6	4.3	7.6	1.4	5.7	5.0
1994	4.6	4.7	4.6	7.8	5.8	14.5	3.8	-3.9	5.8
1995	5.4	4.1	5.9	8.1	5.6	14.1	6.3	-4.4	4.0
1996	5.2	4.0	5.7	7.9	7.9	7.9	4.6	0.1	5.6
1997	5.3	0.6	6.9	7.0	7.2	4.4	7.1	5.6	5.6
1998	5.4	-0.4	7.3	7.0	7.9	3.4	8.3	5.0	3.9
1999	4.7	-0.5	6.2	6.3	7.0	3.1	6.6	4.5	4.0
Quarter									
1997:3	4.9	1.1	6.2	6.0	7.0	4.3	7.0	3.8	4.6
4	6.5	1.8	8.1	7.8	8.3	2.5	8.8	6.9	5.4
1998:1	6.0	-0.7	8.3	7.3	7.9	3.2	10.1	5.8	4.5
2	4.2	-4.3	7.0	6.8	7.8	3.3	7.8	4.9	3.6
3	5.7	2.8	6.7	6.4	7.6	3.4	7.4	4.6	3.8
4	5.2	0.7	6.6	6.7	7.5	3.4	7.0	4.5	3.8
1999:1	4.9	0.0	6.4	6.5	7.1	3.4	6.7	4.5	4.1
2	3.9	-3.4	6.2	6.3	6.9	3.3	6.5	4.5	3.8
3	5.0	1.6	6.0	6.0	6.7	2.9	6.3	4.4	4.0
4	4.5	-0.1	5.9	5.9	6.6	2.6	6.2	4.4	4.1

Note. Quarterly data are at seasonally adjusted annual rates.
1. Data after 1997:Q4 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 4.9 percent in 1997, 5.6 percent in 1998, and 4.8 percent in 1999.
3. On a monthly average basis, federal debt rose 0.6 percent in 1997, -0.2 percent in 1998, and -0.2 percent in 1999.
4. On a monthly average basis, nonfederal debt increased 6.5 percent in 1997, 7.5 percent in 1998, and 6.3 percent in 1999.

2.6.3 FOF

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

Category	Calendar year				Seasonally adjusted annual rates									
					1997		1998				1999			
	1996	1997	1998	1999	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Net funds raised by domestic nonfinancial sectors														
1 Total	655.5	678.9	719.7	653.7	661.9	886.1	816.0	560.1	788.4	714.4	680.6	542.1	730.5	661.4
2 Net equity issuance	-64.2	-79.9	-100.5	-92.0	-60.4	-90.0	-100.0	-94.0	-106.0	-102.0	-98.0	-98.0	-86.0	-86.0
3 Net debt issuance	719.7	758.8	820.2	745.7	722.3	976.1	916.0	654.1	894.4	816.4	778.6	640.1	816.5	747.4
Borrowing sectors														
Nonfinancial business														
4 Financing gap [1]	6.5	45.2	84.0	104.5	25.1	42.6	74.2	82.8	92.2	86.8	98.2	101.4	113.0	105.5
5 Net equity issuance	-64.2	-79.9	-100.5	-92.0	-60.4	-90.0	-100.0	-94.0	-106.0	-102.0	-98.0	-98.0	-86.0	-86.0
6 Credit market borrowing	190.3	311.7	390.3	334.4	317.3	405.9	473.5	377.0	363.4	347.1	338.1	335.1	333.1	331.1
Households														
7 Net borrowing [2]	383.0	364.1	387.6	375.7	322.2	425.8	404.6	383.3	372.0	390.5	385.1	380.1	370.6	367.1
8 Home mortgages	258.2	251.0	297.5	284.2	254.6	304.8	298.4	297.9	296.8	296.9	287.4	284.4	281.4	283.4
9 Consumer credit	88.8	53.8	42.7	40.1	53.0	31.5	41.1	42.5	43.5	43.8	44.0	43.0	38.5	35.0
10 Debt/DPI (percent) [3]	89.6	91.5	93.3	95.4	91.8	92.1	92.1	92.9	93.7	94.5	94.5	95.2	95.8	96.3
State and local governments														
11 Net borrowing	1.3	59.9	56.9	53.9	41.8	77.0	65.9	55.9	52.9	52.9	53.9	53.9	53.9	53.9
12 Current surplus [4]	123.2	96.4	106.0	105.6	89.9	95.1	98.5	94.9	113.5	117.1	115.6	106.1	115.1	85.8
Federal government														
13 Net borrowing	145.0	23.1	-14.4	-18.2	40.9	67.4	-27.9	-162.0	106.2	26.0	1.6	-128.9	59.0	-4.6
14 Net borrowing (quarterly, n.s.a.)	145.0	23.1	-14.4	-18.2	10.6	33.7	22.5	-88.6	27.7	24.0	29.9	-80.4	15.9	16.4
15 Unified deficit (quarterly, n.s.a.)	110.9	2.4	9.2	-32.4	10.9	39.7	32.8	-102.1	20.4	58.0	24.9	-97.6	9.9	30.4
Depository institutions														
16 Funds supplied	232.9	332.2	280.2	254.4	183.4	465.5	337.7	254.7	260.5	267.9	258.9	245.9	262.9	249.9
Memo (percentage of GDP)														
17 Domestic nonfinancial debt [5]	184.4	183.3	184.9	186.9	182.9	183.1	183.9	184.6	185.2	186.0	186.5	186.7	187.0	187.3
18 Domestic nonfinancial borrowing	9.4	9.4	9.7	8.5	8.9	11.9	11.0	7.8	10.6	9.5	9.0	7.3	9.3	8.4
19 Federal government [6]	1.9	0.3	-0.2	-0.2	0.5	0.8	-0.3	-1.9	1.3	0.3	0.0	-1.5	0.7	-0.1
20 Nonfederal	7.5	9.1	9.9	8.7	8.4	11.0	11.3	9.7	9.3	9.2	9.0	8.8	8.6	8.5

Note. Data after 1997:Q4 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

Imports in the countries that have been the focus of the Asian financial crises have fallen appreciably, causing a significant improvement in external balances. Economic growth has also slowed sharply in those countries. But policy reforms are moving ahead in most of the affected economies, and financial markets in Asian and other emerging market economies have stabilized somewhat since the last FOMC meeting. Japanese economic activity remains weak, with confidence further undermined by the financial turmoil in the region and falling exports to Asia. Economic activity in continental Europe appears to have picked up following a weak fourth quarter.

The dollar has appreciated 2-3/4 percent against the yen since the last FOMC meeting, reflecting weakening growth and continued uncertainty about fiscal policy in Japan. The legislative approval of the FY 1998-99 budget is almost complete, but the terms of the much-anticipated supplemental stimulus package have yet to be set. Interest rates are down 15 to 30 basis points in Japan.

The dollar has risen modestly against the mark and other continental European currencies over the intermeeting period. Declining inflation in foreign industrial countries, due in part to lower oil prices, and anticipated spillovers from the Asian financial crises have contributed to declines in foreign long-term interest rates. On average, long-term interest rates in foreign industrial countries are down 25 basis points over the intermeeting period while comparable U.S. rates are little changed. The dollar is down 2 percent against sterling on prospects of a further increase in U.K. official interest rates. In spite of an expected slowdown in growth, the Bank of England concluded in its February Inflation Report that a further modest rise in interest rates this year "is more likely than not." The Canadian dollar has moved up against the U.S. dollar since the increase of 50 basis points in the Bank of Canada's Bank Rate on January 30. European stock prices have reached all-time highs as the prospects of good economic growth this year have seemed more certain and long-term interest rates have fallen.

Preparations for next year's launch of Stage III of EMU are on track. In a report released today, the European Commission formally recommended that eleven countries participate from the start.[1] According to official estimates, these countries had 1997 fiscal deficits equal to or less than the 3 percent of GDP reference value. In

1. The eleven countries that have been recommended to participate in the single currency from the start are Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal, and Spain.

mid-March, the Irish punt was revalued, and the Greek drachma joined the ERM. Interest rates in the European countries continue to converge. Italian short-term rates fell 90 basis points over the intermeeting period while those of "core" EMU countries changed little. Italian and Spanish long-term interest rates are now less than 20 basis points above comparable German rates.

Exchange rates in most Asian emerging market economies have appreciated against the dollar over the intermeeting period, and prices in their financial markets have increased. This reflects substantial progress in several areas. The "exchange offer" to restructure Korea's short-term foreign currency bank debts appears to have been a success. Korea has closed ten of fourteen suspended merchant banks, and significant progress has been made in labor market reform. The IMF approved the release of the third tranche of Thailand's standby arrangement and commended the Thai authorities for their progress in implementing reforms. Speculative pressures on the Hong Kong dollar and the Chinese renminbi have subsided. The only major exception to this pattern of improving financial performance is Indonesia. Suharto's choice of a new cabinet has reinforced doubts about the path of economic and financial policy in Indonesia, although some progress appears to have been made in talks with IMF staff. While up on balance over the intermeeting period, the foreign exchange value of the rupiah continues to be highly volatile.

The speculative pressures against currencies of emerging market economies outside Asia have also subsided over the intermeeting period. Yield spreads on Brady bonds issued by Argentina, Brazil, Mexico, and Poland, adjusted for the effects of credit enhancements, declined 25 to 100 basis points over the intermeeting period. Domestic interest rates have generally moved lower in these countries in response to slowing economic activity and easing pressure on their currencies. One exception to this pattern is Mexico, where the domestic interest rates have moved up as falling oil prices have put downward pressure on the peso. In Russia, President Yeltsin dismissed Prime Minister Chernomyrdin and the rest of his cabinet on Monday. Russian financial markets initially sold off on the news, but most of the move has been reversed. Yield spreads on Russian Brady bonds are down more than 170 basis points since the beginning of February.

. The Desk did not intervene.

Japanese GDP contracted slightly during the fourth quarter, and economic indicators for the first quarter suggest that the economy remains weak. Auto registrations have continued to decline, and housing starts remain near ten-year lows. The effects of the Asian crises are now clearly visible in Japan's external trade, with exports to Korea and Thailand down 40 percent in January and February from the same period a year earlier, while exports to other Asian countries declined almost 5 percent.

For most other industrial countries the available data for the first quarter suggest a modest pickup in activity led by domestic demand. In Germany, industrial production jumped 2.5 percent in January, and orders for manufactured goods increased 3.3 percent led by domestic orders. The unemployment rate has edged down since December. Consumption of French manufactured products in January and other recent indicators suggest that domestic demand remains robust in France. Indicators for the British economy are mixed. Industrial production fell in January, but business sentiment remains positive, as the outlook for domestic orders continues to offset weakness in export orders. The Canadian economy appears to have recovered quickly from the severe ice storm in January. Employment surged in February. On average employment growth in 1998 has been as robust as it was at the end of last year.

Inflationary pressures have been subdued or nearly nonexistent in all foreign G-7 countries except the United Kingdom. Falling prices of oil and other imports have helped to hold down inflation. CPI inflation is near 1 percent in France, Germany, and Canada and is just under 2 percent in Italy. After netting out the effects of tax increases, inflation remains near zero in Japan. In the United Kingdom, however, consumer price inflation remains slightly above the government's 2-1/2 percent target.

Growth continues to decline and external balances improve sharply in the countries that have been directly affected by the Asian financial crises. We estimate that Korean real GDP fell at a 1-3/4 percent annual rate in the fourth quarter, and the Korean unemployment rate has nearly doubled since December. In January and February, with imports falling 35 percent, Korea had a current account surplus of $6.9 billion compared with a deficit of $5.5 billion in the same period last year. In Thailand, industrial production was 13 percent below its year-earlier level in December. Thailand's trade surplus widened somewhat further in January after a substantial increase in the fourth quarter. Indonesia's trade surplus rose substantially in the fourth quarter.

Inflation in most of the Asian economies affected by the financial crises has increased, driven in large part by the sharp depreciations of their currencies. The effect is most significant in Indonesia where consumer prices in February were

32 percent higher than the year-earlier level. In recent months consumer price inflation has picked up noticeably in Korea, the Philippines, Malaysia, and Thailand, but in all of these countries year/year inflation rates remain below 10 percent.

Economic activity appears to be slowing in several other developing countries that have been adversely affected by speculative pressures related to the Asian financial crises. In Brazil, tighter fiscal policy and elevated interest rates have contributed to an increase in the unemployment rate from 4.8 percent in December to 7.3 percent in January. In early March, the Bank of Mexico tightened monetary policy, hoping to contain upward pressures on Mexican prices from further depreciation of the peso. In addition, government spending in Mexico may have to fall, or taxes increase, to offset the impact of lower oil prices on government revenues.

In January, the U.S. trade deficit in goods and services widened to $12 billion from an average monthly rate of $8.3 billion in the fourth quarter, as exports declined more than imports. Exports were 2-1/2 percent lower in January than in December. Most of the decrease was in civilian aircraft, reversing much of the sharp increase recorded in December, and other capital goods. We estimate that exports to both Korea and Indonesia in January were more than 30 percent below their fourth quarter average on a seasonally adjusted basis. The decrease in imports in January was concentrated in oil, capital goods, and automotive imports from Canada.[2]

Early in the intermeeting period spot oil prices fell as the prospect of greater supply, from OPEC and Iraq, confronted weak demand, due to the economic slowdown in Asia and warm weather in the Northern Hemisphere. But spot WTI rebounded to $16-1/2 per barrel on news in late-March that an agreement had been reached among both OPEC and non-OPEC producers to cut production.

Non-oil import prices declined nearly 4-1/2 percent (annual rate) in the January and February, compared with a decrease of 2-3/4 percent in the fourth quarter. Prices moved lower in all major end-use categories, with the exception of automotive products. Export prices dropped back more than 4-1/4 percent (annual rate) in January and February, led by falling prices of agricultural products, industrial supplies, computers, and semiconductors.

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2. There was a small decline in quantity of oil imports, and the price dropped to about $15 per barrel from an average of nearly $17.50 per barrel in the fourth quarter.

Outlook

We project that growth of total foreign real GDP (weighted by shares of U.S. nonagricultural exports) slowed again in the first quarter of 1998 to just less than 1-3/4 percent at an annual rate. Foreign output growth is projected to remain around 2 percent this year, before recovering to nearly 3 percent in 1999. The projected pace of foreign growth is essentially unchanged from the January forecast (see table).

The dollar, in nominal terms, is projected to remain near recent levels in terms of the currencies of most of our industrial- and developing-country trading partners. Inflation is projected to rise during 1998 and recede somewhat during 1999. Accordingly, the dollar, adjusted for changes in prices, is expected to depreciate somewhat over the forecast period. Compared to the January Greenbook, the level of the dollar is, on average, modestly lower throughout the forecast period.

In light of new data and the changes to our outlook for foreign growth and for exchange rates, we have increased the rate of real export growth from that projected in the January forecast. Real non-oil imports are also expected to increase more rapidly. We project that real net exports will subtract 1-1/2 percentage points from GDP growth in the first quarter; this is a somewhat more negative contribution than that in the January Greenbook. For 1998 and 1999 as a whole, real net exports are projected to shave nearly 1 percentage point and about 1/3 percentage point, respectively, from GDP growth, a somewhat lower projection than that in the previous Greenbook, particularly in 1999.

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

Measure	1997	Projection			
		1998		1998: H2	1999
		Q1	Q2		
Foreign output	3.8	1.7	2.1	2.3	2.9
January	*3.2*	*2.0*	*2.1*	*2.3*	*2.9*
Real exports	10.2	-3.5	3.0	2.8	4.8
January	*10.5*	*-3.1*	*.0*	*2.6*	*4.1*
Real imports	14.5	9.5	11.1	7.8	6.7
January	*14.1*	*8.1*	*10.0*	*6.8*	*6.5*

The dollar. As in the January Greenbook, the average real value of the dollar, weighted by shares of non-oil imports and measured relative to the currencies of a broad set of our trading partners, is projected to depreciate more than 4 percent over the forecast period from its current level. The projected path for the dollar is 1 to 1-1/2 percent lower than in January, chiefly reflecting the appreciations of the Asian currencies (other than the yen) against the dollar during the intermeeting period. We expect the dollar to show little movement against the yen throughout the rest of this year, before declining somewhat in 1999 as the Japanese economy improves and concern over the magnitudes of the Japanese and U.S. external imbalances is manifested. The same pattern is forecast against the mark, with the dollar weakening slightly in 1999, in part because of rising interest rates on euro-denominated assets. The dollar is expected to reverse some of its recent gains against the Canadian dollar throughout the forecast period. Against other key Asian currencies, the dollar is forecast to remain at current levels in nominal terms, but inflation in these Asian countries is expected to erode some of the dollar's earlier appreciation in real terms.

Foreign G-7 countries. Real GDP in the foreign G-7 countries, weighted by shares in U.S. nonagricultural exports, is expected to grow at a 2-1/4 percent (annual rate) on average in the first quarter of 1998 and to grow roughly at that pace for the remainder of the forecast period. The growth rate of foreign G-7 GDP is slightly higher than was projected in the last Greenbook, reflecting faster growth in European economies in1998.

Japanese GDP is expected to be little changed in the current quarter but to grow thereafter at an annual rate of about 1-3/4 percent. We now expect fiscal policy to add about 1/2 percentage point to growth in 1998, compared to our assumption of neutral fiscal policy in the last Greenbook.[3] The additional fiscal stimulus is expected to offset a downward revision to our forecast for private domestic demand.

Real GDP growth in Germany is expected to increase to 2-1/2 percent this year and 3 percent during 1999. The contribution of domestic demand is projected to rise as investment spending continues to be spurred by stimulative monetary conditions, whereas the contribution of net exports tapers off. We expect a significant slowing in the pace of activity in the United Kingdom over the next two years because of past increases in interest rates, the strength of sterling, and considerably slower growth in disposable income.

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3. We assume that the Japanese government will enact a additional government spending measures that will generate a fiscal stimulus in 1998 equal to about 1/2 percent of GDP

Average consumer price inflation in the foreign G-7 countries (weighted by shares of U.S. bilateral imports) is projected to decline from 1-3/4 percent in 1997 to a little more than 1 percent in 1998 and 1999. The drop in inflation between 1997 and 1998 is entirely accounted for by a return to zero measured inflation in Japan. This primarily reflects the end of the transitory effect of the excise tax increase in April 1997 on twelve-month calculations of price change. The forecasts for inflation in Germany and France in 1998 have been lowered by about 1/2 and 1/4 percentage points respectively in response to data for January and February.

Our forecast incorporates the assumption that short-term market interest rates in Germany, France, and most other continental European countries will edge down slightly further over the course of 1998. Although market expectations regarding the magnitude of the expected increase in short-term German interest rates have diminished since early February, market participants continue to assume that the Bundesbank will raise official interest rates slightly over the near term. In contrast, we assume that the Bundesbank will hold official rates unchanged in 1998 and that short-term interest rates in those European countries headed for monetary union will converge to the current level of German rates by year-end. In 1999, short-term interest rates in euro-area countries are expected to rise about 1/2 percentage point as the European Central Bank responds to some firming of growth. Rates in Japan are assumed to remain near current very low levels. With economic slack diminishing in the foreign G-7 over the forecast period, we anticipate a slight increase in long-term interest rates.

Other countries. The real GDP of major developing-country trading partners of the United States is projected to increase about 1-1/4 percent on average during 1998, down from 5-1/4 percent in 1997. We project a slight decline in GDP for the Asian developing countries on average in 1998, including significant declines in output in Indonesia, Thailand, and Korea. Our view is that currency and equity markets in the Asian developing countries will remain volatile in 1998 and that further weaknesses in their financial sectors will become apparent. We expect both factors, along with tightening of macroeconomic policies in some cases, to exert a substantial drag on domestic demand this year that will be only partially offset by improvements in net export positions. We project that growth in these countries will recover in most cases next year, but only to substantially below-trend rates. Inflation in the Asian developing countries is projected to rise significantly in 1998, but by somewhat less than forecast in the January Greenbook, reflecting the partial recovery of their currencies on average since January.

Our forecast for real growth in Latin America in 1998 also remains virtually unchanged since the January Greenbook. We continue to expect growth in Mexico to be a relatively robust 4-1/2 percent this year.

Oil prices. The staff has left its projected path for the price of imported oil about unchanged in 1998 and lowered it $1-1/2 per barrel in 1999 since the January Greenbook. We project that import prices will fall to $14 per barrel during the first quarter because of the 0.75 mb/d increase in production by Saudi Arabia, Kuwait, and the United Arab Emirates that began in January. However, we expect a set of OPEC and non-OPEC producers will cut back production sufficiently that the market will be able to absorb additional exports from Iraq at a price for WTI near $16.50 per barrel.[4] There is considerable risk to this forecast. If producers fail to restrain production as agreed, then spot WTI could fall once again below $13.00 per barrel in the near term. On the other hand, if Iraqi oil exports are interrupted again, spot WTI could rise above $20 per barrel.

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

Trade category	1997	Projection			
		1998		1998: H2	1999
		Q1	Q2		
Exports					
Nonagricultural (core)	0.5	-3.1	-1.4	.5	1.3
Agricultural	-3.1	-15.1	-2.8	-1.7	.9
Imports					
Non-oil (core)	-.8	-3.7	-2.9	.3	1.8
Oil (level, dollars per barrel)	17.70	14.11	13.80	13.99	14.00

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.

Prices of non-oil imports and exports. Prices of imports of core goods are projected to decline through the third quarter of this year before reversing course and increasing at an annual rate of 1 to 2 percent thereafter. The path for core import

4. We assume Iraqi exports will reach 1.8 mb/d by the end of the year.

prices reflects the leveling out of the dollar's exchange value and the waning of the lagged effects of declines in non-oil commodity prices. Relative to the January Greenbook, core import prices are projected to decline somewhat more rapidly in 1998 despite a modestly weaker dollar. This adjustment reflects our ongoing reassessment of the empirical relationship between exchange rates--particularly for currencies of developing countries--and U.S. non-oil import prices.[5] The pickup in core import prices in 1999 is somewhat greater than in our previous projection. This reflects a stronger forecast for commodity prices in 1999. Prices of core exports of goods are forecast to decline slightly over the near term and to rise slowly thereafter, in line with comparable U.S. domestic prices.

Real exports and imports of goods and services. We project that exports of nonagricultural goods other than computers and semiconductors ("core" exports) will be about unchanged this year and expand about 2 percent during 1999, a significant slowing from the 12 percent rise during 1997. The lagged effects of the dollar's appreciation and lower foreign growth over the forecast period than in 1997 account for much of the projected deceleration in core exports. The pace of core export growth is somewhat higher in this forecast than in the January Greenbook primarily because of the weaker dollar. We continue to project rapid growth of real exports of computers and semiconductors. Putting all the pieces together, the growth of total exports of goods and services is expected to slow to 1-1/4 percent this year and to pick up to 4-3/4 percent in 1999.

Growth of non-oil imports of goods and services other than computers and semiconductors ("core" imports) is projected to slow to 8-1/4 percent in 1998 and 5-1/4 percent in 1999. This path reflects the projected slowing of the U.S. economy and the lagged effects of dollar appreciation. Relative to the January Greenbook, core import growth is somewhat greater in 1998 due to higher-than-expected imports in January and somewhat stronger U.S. growth. Real imports of computers and semiconductors are expected to continue to grow rapidly. We expect the quantity of imported oil, after declining slightly in the current quarter, to rise over the forecast period in line with increases in consumption. As a result, total imports of goods and services should grow 9 percent this year and 6-3/4 percent in 1999.

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5. Further work on our model suggests that the passthrough to import prices of the appreciation of the dollar vis-a-vis Asian currencies will take longer than previously thought and be somewhat larger.

Nominal trade and current account balances. The nominal trade deficit on goods and services is expected to deteriorate from $115 billion in the fourth quarter of 1997 to about $200 billion by the end of 1999. Over this period, the deficit on net investment income is projected to widen by nearly $30 billion. As a result, we project that the current account deficit will widen from about $180 billion in the fourth quarter of last year to an average of roughly $280 billion, or 3-1/4 percent of GDP, in 1999.

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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	-0.3	0.9	3.1	4.5	0.8	2.0	4.2	3.0	2.6
Japan	2.5	0.1	0.5	0.8	2.4	3.4	-0.2	1.3	1.7
United Kingdom	-1.6	0.4	2.7	4.9	2.0	2.9	2.9	1.9	1.8
EU-11 Average (1)	2.1	0.1	-0.1	3.5	1.5	1.9	2.9	2.6	2.9
of which:									
France	1.4	-0.0	-0.7	4.3	0.3	2.3	3.2	2.1	2.5
Germany (2)	3.3	0.9	-0.2	3.4	0.7	2.1	2.3	2.5	3.0
Italy	1.9	-0.8	0.1	2.5	2.6	-0.2	2.8	1.9	2.9
Foreign G-7 Average weighted by 1991 GDP	1.7	0.2	0.6	2.8	1.6	2.3	1.9	1.9	2.3
Average weighted by share of U.S. nonagricultural exports									
Total foreign	3.3	2.3	3.5	5.0	1.9	4.1	3.8	2.1	2.9
Foreign G-7	0.8	0.5	1.9	3.6	1.3	2.3	2.8	2.4	2.4
Developing Countries	6.7	5.2	6.4	7.1	2.6	6.7	5.2	1.3	3.5
CONSUMER PRICES									
Canada	4.1	1.8	1.8	0.0	2.1	2.0	1.0	1.6	1.8
Japan	3.2	0.9	1.2	0.8	-0.8	0.1	2.1	0.0	0.0
United Kingdom (3)	5.7	3.7	2.7	2.2	2.9	3.2	2.8	2.8	2.9
EU-11 Average (4)	NA	NA	NA	NA	2.7	2.0	1.4	1.9	2.0
of which:									
France	3.0	1.8	2.1	1.6	1.9	1.7	1.2	1.2	1.6
Germany (2)	4.0	3.4	4.2	2.6	1.7	1.4	1.8	1.9	1.8
Italy	6.1	4.9	4.1	3.8	5.9	2.7	1.6	2.1	2.5
Foreign G-7 Average weighted by 1991 GDP	4.1	2.4	2.5	1.8	1.6	1.5	1.8	1.3	1.4
Average weighted by share of U.S. non-oil imports	3.9	1.9	2.0	1.0	1.1	1.3	1.7	1.1	1.2

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.

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

				---------- Projected	----------	----------	----------	----------	----------	----------	----------	----------
	1997				1998				1999			
Measure and country	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
REAL GDP												
Canada	4.7	5.2	3.9	3.0	3.1	3.2	2.9	2.9	2.6	2.7	2.6	2.6
Japan	8.3	-10.6	3.2	-0.7	-0.2	1.9	1.7	1.6	1.5	1.7	1.8	1.8
United Kingdom	2.1	3.5	3.6	2.5	2.8	1.8	1.6	1.6	1.6	1.6	1.9	2.0
EU-11 Average (1)	1.5	5.0	3.2	2.0	2.6	2.4	2.7	2.7	2.7	2.8	3.0	3.0
of which:												
France	1.3	4.7	3.7	3.1	2.3	2.0	2.2	2.1	2.4	2.5	2.6	2.6
Germany	1.5	3.8	2.9	1.1	2.8	1.9	2.6	2.7	2.8	2.8	3.2	3.1
Italy	0.1	7.8	2.6	0.7	1.8	1.8	2.0	2.0	2.5	2.5	3.3	3.3
Foreign G-7 Average weighted by 1991 GDP	3.8	-0.5	3.2	1.0	1.6	2.0	2.1	2.0	2.1	2.2	2.4	2.4
Average weighted by share of U.S. nonagricultural exports												
Total foreign	4.6	3.9	4.5	2.3	1.7	2.1	2.2	2.5	2.6	2.8	3.0	3.2
Foreign G-7	4.6	1.3	3.6	1.9	2.3	2.5	2.4	2.4	2.3	2.4	2.4	2.4
Developing Countries	5.5	7.3	5.9	2.4	0.5	1.2	1.5	2.3	3.0	3.4	3.7	4.0
CONSUMER PRICES (2)												
Canada	2.1	1.6	1.7	1.0	1.3	1.4	1.5	1.6	1.7	1.7	1.8	1.8
Japan	0.0	1.5	1.7	2.1	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	2.6	2.6	2.7	2.8	2.9	3.0	2.9	2.9
EU-11 Average (4)	1.7	1.2	1.5	1.4	1.4	1.7	1.8	1.9	1.9	1.9	2.0	2.0
of which:												
France	1.5	0.9	1.3	1.2	0.8	1.1	1.3	1.2	1.4	1.5	1.6	1.6
Germany	1.7	1.6	1.9	1.8	1.1	1.8	1.8	1.9	2.0	1.8	1.8	1.8
Italy	2.4	1.6	1.5	1.6	2.0	2.0	2.1	2.1	2.3	2.3	2.5	2.5
Foreign G-7 Average weighted by 1991 GDP	1.4	1.6	1.8	1.8	1.7	1.4	1.3	1.3	1.4	1.4	1.4	1.4
Average weighted by share of U.S. non-oil imports	1.3	1.6	1.8	1.7	1.6	1.2	1.1	1.1	1.2	1.2	1.2	1.2

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.

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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	-0.6	-1.0	-0.3
Exports of G&S	0.8	0.4	0.5	1.0	1.1	1.0	1.2	0.1	0.5
Imports of G&S	-0.4	-0.8	-1.1	-1.4	-0.7	-1.4	-1.8	-1.2	-0.9
	Percentage change, Q4/Q4								
Exports of G&S	8.6	4.1	4.6	10.0	10.3	9.3	10.2	1.3	4.8
Services	7.1	-0.9	4.1	6.0	9.0	4.7	2.2	-0.9	3.4
Agricultural Goods	10.1	10.4	-5.5	16.6	-3.4	5.7	2.5	-4.0	1.9
Computers	21.7	25.2	23.7	32.0	55.7	33.8	48.1	26.1	31.0
Semiconductors	41.8	64.8	32.9	66.9	80.4	45.9	21.5	25.3	31.9
Other Goods 1/	7.0	2.3	3.6	6.9	5.7	7.7	11.7	-0.5	1.9
Imports of G&S	4.1	7.4	10.2	12.3	5.6	11.8	14.5	9.1	6.7
Services	-2.7	1.4	3.2	1.4	7.3	5.0	10.9	3.6	2.6
Oil	8.1	12.1	10.1	-0.2	1.5	8.3	7.4	1.0	2.3
Computers	35.9	45.1	39.3	44.8	46.2	23.6	44.4	36.6	25.7
Semiconductors	55.3	42.0	34.2	54.5	92.7	57.9	32.7	18.6	32.3
Other Goods 2/	2.5	5.4	9.5	12.2	-1.3	10.6	12.8	8.3	5.2
	Billions of chained 1992 dollars								
Net Goods & Services	-22.3	-29.5	-70.2	-104.6	-98.8	-114.4	-146.7	-228.6	-281.9
Exports of G&S	599.9	639.4	658.2	712.4	791.2	857.0	962.9	992.6	1029.8
Imports of G&S	622.2	669.0	728.4	817.0	890.1	971.5	1109.5	1221.2	1311.7
	Billions of dollars								
US CURRENT ACCOUNT BALANCE	-5.7	-56.4	-90.8	-133.5	-129.1	-148.2	-166.4	-230.2	-281.4
Net Goods & Services (BOP)	-31.0	-39.2	-72.3	-104.4	-101.9	-111.0	-113.6	-153.2	-195.5
Exports of G&S (BOP)	581.2	617.5	643.5	699.6	794.6	848.8	931.6	933.5	962.8
Imports of G&S (BOP)	612.2	656.7	715.8	804.1	896.5	959.9	1045.2	1086.7	1158.3
Net Investment Income	20.3	18.0	19.7	9.7	6.8	2.8	-14.3	-35.3	-44.2
Direct, Net	55.6	51.6	55.7	50.8	60.0	66.8	67.7	56.6	61.2
Portfolio, Net	-35.4	-33.6	-36.0	-41.0	-53.2	-63.9	-82.0	-92.0	-105.5
Net Transfers	5.1	-35.2	-38.1	-38.8	-34.0	-40.0	-38.5	-41.8	-41.8

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

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Class II FOMC

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OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1994				1995				1996			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-1.0	-0.3	-0.4	0.3	-0.4	0.1	1.2	1.0	-1.3	-0.6	-1.4	1.8
Exports of G&S	-0.2	1.7	1.1	1.5	0.8	1.0	1.4	1.3	0.2	1.1	0.2	2.6
Imports of G&S	-0.8	-2.0	-1.5	-1.2	-1.2	-0.9	-0.3	-0.3	-1.5	-1.7	-1.6	-0.8
Percentage change from previous period, SAAR												
Exports of G&S	-1.8	17.7	10.6	14.7	7.2	9.3	13.5	11.5	1.7	9.6	1.9	25.5
Services	2.4	12.9	2.0	6.9	6.0	3.8	20.3	6.6	-3.8	9.7	0.3	13.5
Agricultural Goods	-25.2	8.1	45.3	57.2	-1.3	-17.5	19.7	-10.7	12.5	-34.3	13.1	49.2
Computers	21.4	24.3	35.5	48.4	34.9	41.0	89.6	63.1	46.2	31.8	29.2	28.7
Semiconductors	111.8	23.4	65.9	79.1	72.0	97.0	100.3	56.2	19.9	28.3	37.6	113.8
Other Goods 1/	-6.8	20.3	7.4	8.6	2.9	8.1	0.9	10.9	-1.3	13.2	-2.9	24.2
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/	6.8	19.6	10.3	12.5	7.3	2.2	-10.0	-3.7	14.5	11.1	12.4	4.6
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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OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1997				Projected 1998				Projected 1999			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-1.0	-0.4	-1.3	0.3	-1.6	-1.0	-1.3	-0.1	-0.7	-0.3	-0.7	0.4
Exports of G&S	1.1	2.0	0.5	1.0	-0.4	0.3	-0.2	0.8	0.1	0.8	0.2	1.1
Imports of G&S	-2.1	-2.5	-1.8	-0.7	-1.2	-1.4	-1.1	-0.9	-0.9	-1.0	-0.9	-0.7
Percentage change from previous period, SAAR												
Exports of G&S	9.9	18.4	4.4	8.6	-3.5	3.0	-1.6	7.5	1.1	7.1	1.6	9.8
Services	3.7	3.2	7.2	-5.0	-5.7	-0.4	0.7	2.0	2.9	3.5	3.6	3.6
Agricultural Goods	-27.6	-4.2	20.6	31.8	-21.5	-0.8	8.2	0.7	-5.5	-1.0	10.6	4.5
Computers	72.3	84.3	61.5	-6.3	8.4	31.1	33.5	33.5	31.0	31.0	31.0	31.0
Semiconductors	39.0	15.7	38.8	-2.3	13.7	26.2	31.1	31.1	31.6	32.1	32.1	32.1
Other Goods 1/	12.4	25.0	-4.6	16.2	-2.4	1.6	-8.0	7.4	-3.3	6.2	-4.6	10.2
Imports of G&S	17.9	20.5	14.6	5.7	9.5	11.1	8.8	6.8	6.7	8.1	6.7	5.2
Services	24.2	8.9	10.1	1.3	5.7	4.0	2.7	2.1	2.6	2.4	2.5	2.8
Oil	-10.8	44.5	6.3	-3.0	-15.8	31.0	8.8	-13.3	-8.5	34.0	7.6	-17.1
Computers	51.3	71.1	53.0	9.8	51.8	36.0	31.1	28.7	27.4	25.1	25.1	25.1
Semiconductors	71.2	19.3	44.3	5.1	-7.8	23.9	31.1	32.3	32.3	32.3	32.3	32.3
Other Goods 2/	15.3	17.1	11.8	7.4	10.4	8.9	7.5	6.7	6.0	5.3	4.9	4.7
Billions of chained 1992 dollars												
Net Goods & Services	-126.3	-136.6	-164.1	-159.7	-194.9	-219.0	-248.9	-251.6	-269.4	-277.0	-294.2	-286.9
Exports of G&S	922.7	962.5	973.0	993.3	984.5	991.9	988.0	1005.9	1008.7	1026.1	1030.1	1054.3
Imports of G&S	1048.9	1099.1	1137.1	1153.0	1179.4	1210.9	1236.8	1257.5	1278.1	1303.1	1324.3	1341.3
Billions of dollars												
US CURRENT ACCOUNT BALANCE	-159.7	-151.2	-172.5	-182.5	-197.5	-215.3	-246.4	-261.7	-264.7	-272.8	-290.9	-297.3
Net Goods & Services (BOP)	-117.3	-102.7	-119.6	-115.0	-129.5	-143.6	-169.7	-169.8	-184.9	-191.3	-206.8	-199.0
Exports of G&S (BOP)	896.3	938.2	938.6	953.1	933.3	932.8	926.0	942.0	944.0	959.8	962.6	984.9
Imports of G&S (BOP)	1013.6	1040.9	1058.2	1068.1	1062.8	1076.4	1095.7	1111.8	1128.8	1151.1	1169.4	1183.8
Net Investment Income	-8.1	-13.1	-16.5	-19.4	-29.0	-32.7	-37.7	-41.9	-40.8	-42.6	-45.0	-48.3
Direct, Net	69.3	70.9	66.1	64.5	59.2	57.4	55.4	54.5	58.9	60.6	62.2	63.3
Portfolio, Net	-77.4	-84.0	-82.6	-83.9	-88.2	-90.1	-93.1	-96.4	-99.7	-103.1	-107.3	-111.7
Net Transfers	-34.3	-35.4	-36.3	-48.1	-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.