Prefatory Note

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

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

---

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

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

Strictly Confidential (FR) Class II FOMC

Part 1

May 14, 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

May 14, 1998

SUMMARY AND OUTLOOK

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

Domestic Developments

Overview

The U.S. economy has continued to power ahead, much more forcefully than we anticipated. Real GDP growth in the first quarter may well have exceeded the Commerce Department's advance estimate of 4.2 percent, and the unemployment rate plunged to 4.3 percent in April. Although the tightness of the labor market has resulted in an acceleration of wages, price inflation has remained subdued to date--a product of, among other things, good productivity performance, favorable oil and non-oil import prices, and ample domestic manufacturing capacity.

As best we can tell, the high dollar and the Asian economic slump have had the expected effect on the U.S. trade balance; the available data through February point to a sizable decline in net exports. Thus, the story behind the economy's surprisingly rapid growth lies in the remarkable robustness of domestic final demand. Although the effects of Asia's troubles on oil prices and interest rates have been a plus in that regard, the sustained bull market in equities has also been important. The resultant run-up in wealth has provided substantial impetus to household demand, and the reduced cost of equity finance has helped stimulate business investment.

Our forecasts of moderating growth of demand have long been premised on an assumption that some reversal of stock prices would be precipitated by a failure of corporate earnings to meet unrealistic expectations. However, we have also warned repeatedly that, given the prevailing psychology of investors, a greater shock--perhaps a significant tightening in monetary policy--might be required to put a damper on the market's uptrend. That concern appears to have been fully warranted, as disappointing earnings for some firms have only caused investors to turn to other companies, and aggregate price-earnings ratios have reached new heights in recent weeks. We still think that the market is vulnerable, but with our forecast based on a steady federal funds rate, we have projected only a modest setback over the forecast period--enough simply to stem the uptrend in the market PE. That projection holds stock prices well above the path we previously had anticipated, and helps to explain the sustained higher level of activity going forward in this forecast.

We are projecting that real GDP growth will average 2-1/4 percent at an annual rate from the current quarter through 1999. This rate is more than 1-1/2 percentage points slower than the trend of the past year. The moderation in growth reflects not only the waning effects of the easing of financial conditions that has occurred since last spring but also the abatement of favorable accelerator effects on investment.

This growth scenario implies that the labor market will remain taut, and despite some good news on benefits costs in the first-quarter ECI report, we foresee hefty increases ahead for real hourly compensation. At the same time, though, we continue to think that the downswing in actual and expected price inflation over the past year will tend to restrain nominal wage hikes in the near term. We've raised our compensation forecast only marginally, and a reassessment of productivity trends suggests to us that businesses can accommodate slightly larger real wage gains. Meanwhile in the goods markets, ample factory capacity will tend to hold down prices; this should help to offset the upward pressure on the prices of tradable goods associated with the moderate real depreciation of the dollar anticipated in this forecast. On a consistently measured basis that takes account of technical changes to the index, core CPI inflation is projected to show a clear upward tilt from the 2.1 percent pace of the past twelve months; the rate of increase in the overall CPI is expected to move closer to that in the core as a result of a firming in oil prices.

As with any forecast, substantial uncertainties attend the present projection. On the negative side, in terms of the prospects for aggregate demand, the Asian story continues to play out. The important structural--and potentially political--adjustments still confronting some of the major players pose an obvious risk to the currently fragile financial situation. It is not difficult to imagine a deterioration of conditions in that part of the world that would put a bigger dent in U.S. activity and inflation. Domestically, a shift in sentiment among stock market investors could trigger a much deeper correction in share prices than we have anticipated. But on the other side of the ledger, there is a possibility that the stock market will move higher on sheer momentum--and that the "Bubble Economy" story may become still more compelling. Even without that boost to demand, the pressures in the labor market pose a risk that nominal compensation will accelerate beyond our expectations, possibly leading to greater inflation or to a more serious profit squeeze--the makings of a rockier performance for the real economy. Of course, these risks are not mutually exclusive, and one can conceive of combinations that would push events in directions we have not contemplated.

Key Background Factors

As noted above, the forecast continues to be conditioned on a steady federal funds rate. Longer-term interest rates have fluctuated pretty narrowly in recent weeks, rather than easing a bit as we had thought likely in light of our earlier expectation of a softer economic picture. Although the incoming economic news has been mixed from the perspective of bond traders, the perceived warnings of possible Fed tightening have tended to weigh on market sentiment. We have not anticipated any substantial departure from the recent yield range in the current forecast; persuasive signs of a slackening in growth might yet spark a rally in the bond markets, but it likely would take a considerable downside surprise to sustain a much flatter yield curve than has generally prevailed in recent months.

With real interest rates anticipated to be fairly stable, our expectation of some small slippage in equity prices rests on the notion that the market will not be able to entirely shrug off the failure of corporate profits to resume a brisk uptrend in coming months. Bullish analysts to date have found ways of explaining away the violation of traditional valuation benchmarks--and while some of those arguments may well have some merit, many of them seem strained to us. However, a bubble market requires no rigorous logic--just a belief that what has gone up probably will go up further and that one can bail out quickly enough to protect one's capital should gravity reassert itself. Consequently, in the absence of any dramatic shock, we have assumed a smaller decline of equity prices in this projection, and one that starts from a higher level.

With regard to fiscal policy, the incoming data on expenditures and on withheld and nonwithheld taxes have all pointed to the likelihood that the budget surplus for fiscal year 1998 will considerably exceed our previous estimate; we are now looking for the government to be in the black upwards of $50 billion. Part of the revision is attributable to our stronger economic forecast, but the continuing revenue surprises also seem to reflect higher effective tax rates. Although it will be some time before we have the data necessary to sort out the causes of those higher rates, a review of the usual suspects suggests that it would be unwise to look for a substantial reversal; consequently, we have also raised our forecast of the fiscal 1999 surplus to more than $40 billion.

In the aggregate, the outlook for economic growth abroad has changed little since the March Greenbook. On an export-weighted basis, we expect that foreign real GDP will increase about 2 percent in 1998 and 3 percent in 1999. On a broad import-weighted basis, the *real* exchange value of the dollar has moved down, on balance, since the March Greenbook. A projected pickup in foreign inflation, largely due to exchange rate developments in Asia, implies a further real depreciation of the dollar over the projection period. On net, by the end of 1999 the real value of the dollar is assumed to be roughly 3 percent below its level in the first quarter of 1998; this depreciation is a shade less than that in the March Greenbook.

To date, the cuts in production engineered in March by the world's major oil exporters have held; nonetheless, oil prices have moved down somewhat, on net, since March Greenbook. At $15.65 per barrel, our assumption for the average spot price of West Texas intermediate crude this quarter is $0.85 below that in our previous projection. We are assuming that the spot WTI price will move to $16.50 by next quarter and remain near this level over the course of the projection period.

Recent Developments and the Outlook for the Current Quarter

Although the international trade figures for March are not yet available and many source data for the first quarter are still subject to revision, the information in hand suggests that real GDP growth could be revised up about 1 percentage point from the 4.2 percent annual rate published in BEA's advance estimate.[1] Growth last quarter was held down by a large decline in net exports, but domestic final sales increased at a 6 percent annual rate. Recent data suggest that a pickup in the pace of inventory accumulation boosted GDP growth about 1-1/2 percentage points--considerably more than anticipated in the advance estimate.

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

Measure	1998:Q1		1998:Q2	
	Mar. GB	May GB	Mar. GB	May GB
Real GDP	**3.1**	**5.2**	**2.1**	**2.5**
Private domestic final purchases	6.2	8.0	4.7	6.1
Personal consumption expenditures	5.3	5.8	4.2	5.2
Residential investment	14.2	17.6	0.8	12.7
Business fixed investment	9.3	17.7	9.6	9.0
Government outlays for consumption and investment	.0	-2.8	1.1	3.7
	Change, billions of chained (1992) dollars			
Inventory investment	-7.5	29.0	-18.7	-45.3
Net exports	-35.2	-48.8	-24.1	-17.7

1. Unless otherwise indicated, the references to data for the first quarter of 1998 will be the staff's current estimates of the revised NIPA figures.

The economy likely has carried a good deal of momentum into the spring, and we are projecting that real GDP will increase around 2-1/2 percent at an annual rate in the second quarter, 1/2 percentage point above our forecast in the March Greenbook. Although a variety of statistical problems have muddled many of the data from the monthly payroll survey, the quarter-million increase in nonfarm employment last month was probably a fairly true reading on current labor demand. Barring a setback in productivity this quarter, the jobs figures seem to point to another solid advance in output. The drop in the unemployment rate, even discounted somewhat, might suggest more than "solid" growth, based on the usual Okun's law evaluation.

Briskly rising labor income and financial wealth--and optimism that these trends will be sustained--have provided a powerful impetus to household spending. Last month's further gain of nearly 1/2 percent in nominal retail sales of non-auto consumer goods and an uptick in unit sales of new light vehicles suggest that spending on consumer goods is on track for another large quarterly increase. Meanwhile, outlays for services should be up sharply after having been damped this winter by unusually warm weather. Our guess is that overall real PCE will register a rise on the order of a 5 percent annual rate this quarter after having increased at a 5-3/4 percent pace in the first.

All indicators of demand in housing markets point to ongoing strength at the beginning of the spring building season. We do not think that weather was the predominant factor in the first-quarter advance in single-family starts, and we expect that the recent level will be equaled or exceeded this quarter--even with tight supplies of workers perhaps imposing some constraint on construction activity. With the multifamily sector also looking solid for the near term, we are projecting nearly a 13 percent (annual rate) increase in total real residential investment in the current period--enough to contribute about a half point to GDP growth.

Weakness in orders from Asian customers has been noted by many capital goods producers, but the overall figures reported by U.S. equipment manufacturers continued to be quite positive through March. We infer that demand from domestic firms has remained fairly robust, and we are anticipating that real spending on producers' durables will rise at around a 13 percent pace this quarter--a hefty figure, even if it does pale by comparison with the outsized 30 percent rate burst in the first three months of the year. Much of the deceleration is likely to occur in the computer sector, where real purchases rose at an amazing annual rate of more than 90 percent in the first quarter. Motor vehicle purchases should be robust, reflecting not only booming shipments of heavy trucks, but also strong leasing activity in the light vehicle market; in contrast, aircraft purchases likely will drop back after a bunching of Boeing deliveries to domestic carriers in the first quarter. Construction put in place was at a low level in March, and we are looking for a small decline in real investment in nonresidential structures in the current quarter.

Real federal government purchases fell very sharply in the first quarter as a result of a pothole in the erratic defense component. We are anticipating that purchases will retrace more than half their decline this quarter, rising at about a 5 percent annual rate. Real state and local purchases edged up just 1/2 percent at an annual rate in the first quarter, as spending was held back by a large decline in construction expenditures; purchases had been trending up at something around a 2 percent rate, and we expect some catch-up this period.

Real exports of goods and services, which fell for the first time in four years last quarter, are expected to record a small gain this spring, while the strong growth in domestic demand and the lagged effects of past appreciation of the dollar are projected to boost imports at an 8 percent annual rate. The resulting drop in net exports reduces real GDP growth by roughly 3/4 percentage point.

We expect nonfarm inventory investment, after having risen at around $90 billion at an annual rate in the first quarter, to drop back to a $50 billion pace in the current quarter; this downshift in the level of inventory *investment* lowers real GDP growth by 2-1/4 percentage points, even though the *stock* of inventories is still rising at a robust 4 percent annual pace. About one-quarter of the projected decline in the rate of stockbuilding this quarter reflects a swing in motor vehicles as incentives boost sales of domestically produced cars and light trucks above production and imports fall back from their very strong first-quarter level. We also are assuming that inventories of crude oil and refined products will rise at a much more moderate pace this quarter after accumulating well above trend last winter; but with prices remaining relatively low, we see no incentive for refiners and distributors to shed stocks quickly. Outside of motor vehicles and petroleum, stockbuilding was heavy last quarter, but the strong pickup in sales left most book-value inventory-sales ratios well within their recent ranges. With the momentum of final demand likely to be well maintained, we expect that stockbuilding of these items can continue at an above-trend pace in the current quarter.

Although tight labor markets have generated some big pay increases here and there, the available data still suggest that nominal compensation gains on the whole have been trending upward quite gradually. We are not anticipating any sudden breakout--in part because workers already are enjoying substantial gains in real wages. Meanwhile, the combination of falling import prices and the absence of capacity pressure is restraining prices. The total CPI increased 0.2 percent in April after being essentially unchanged over the first three months of the year. With energy prices firming, we expect the CPI to pick up a bit, rising at a 1-1/2 percent annual rate for the second quarter as a whole. Excluding food and energy, the CPI increased 0.3 percent last month and, in the current quarter, is expected to rise at a 2.3 percent annual rate.

The Outlook for the Economy Beyond the Current Quarter

We currently are projecting that real GDP growth will slow to a shade below a 2 percent annual rate in the second half of 1998. The incremental decline in net exports should diminish as time passes. However, we expect this favorable contribution to growth to be more than offset by a moderation in domestic demand. The spur to household and business spending that has come from declining interest rates should fade over coming quarters, and a weakening in the stock market should also help to take the bloom off of demand, especially in 1999. In general, the already high levels of accumulation of consumer durables, houses, and business equipment point to the likelihood of a significant "decelerator" effect as activity slows. Stockbuilding is expected to move down to a sustainable level by the end of this year; with the drag from inventory investment completed, GDP growth is then projected to pick up to around 2-1/4 percent next year.

The moderation in growth that we see ahead will yield only modest relief from the current pressures on labor supplies. This suggests that there will be an underlying tendency toward higher inflation--probably exacerbated by a turn toward moderate real dollar depreciation. However, that tendency should be offset to a significant degree, especially in goods markets, by the competitive force of excess capacity in a number of manufacturing industries. Thus, although we believe that overall CPI inflation is likely to move back above the 2 percent mark next year, that is largely a reflection of our expectations regarding developments in the oil market.

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

Measure	1997	1998	1999
Real GDP	**3.7**	**2.8**	**2.3**
Previous	3.8	2.3	2.2
Final sales	3.1	3.5	2.3
Previous	3.2	3.0	2.1
PCE	3.6	4.6	2.6
Previous	3.7	4.0	2.4
Residential investment	5.6	6.2	-2.4
Previous	5.7	3.0	-1.8
BFI	9.0	10.0	6.9
Previous	8.6	9.5	6.2
Government purchases	1.0	.8	.9
Previous	1.0	.8	.9
Exports	10.2	1.2	5.0
Previous	10.2	1.3	4.8
Imports	14.4	9.2	7.0
Previous	14.5	9.1	6.7
	Change, billions of chained (1992) dollars		
Inventory change	41.1	-52.2	0.2
Previous	39.1	-52.7	6.6
Net exports	-53.6	-94.1	-37.7
Previous	-54.1	-91.9	-35.4

Consumer spending. We expect that growth in personal consumption expenditures will remain impressive through most of this year, with spending fueled by further strong gains in income and by the lagged effects of earlier increases in stock market wealth. For 1998 as a whole, real PCE is projected to increase 4-1/2 percent, 1/2 percentage point more than in our March forecast. Sales should remain strong for many categories of goods, among them electronics, where prices continue to fall rapidly, and household furnishings, where the rise in home sales will be providing a lift. We also expect that the demand for services will be robust; many reports suggest that consumers are applying appreciable portions of their added income and wealth to the purchase of recreational and personal services. The motor vehicle sector may prove something of an exception to this pattern of strength, however.

Luxury and sport utility vehicles should continue to benefit from favorable consumer finances, but automakers will probably have to offer still greater price concessions if they wish to prevent light vehicle sales from falling below the high 15 million unit plateau of the past several years.

Real PCE growth is projected to slow to 2-1/2 percent in 1999--not a weak performance relative to longer-term trends but a considerable slackening from what we have seen recently and expect to see in the coming months. A key factor behind this deceleration is the projected slippage in the stock market, which will cause a significant decline in the household wealth-income ratio over the projection period.

Looking at the changes in this forecast, the saving rate averages 2.9 percent in 1998 and 2.7 percent in 1999, about 1/2 percentage point below the figures in the March Greenbook. Much of the revision is accounted for by the higher path for the stock market, but the change also reflects the effects on disposable income of the higher tax collections that we have carried through the projection period. We have not made a commensurate reduction in the spending forecast because we think that the larger share of these additional tax payments is being made by high-income individuals who are not cash constrained. In many instances the taxes are being paid on capital gains or employee stock options, for which the individuals have discretion in timing the income realization and presumably have been taking the prospective liability into account all along in assessing their ability to spend.

Residential investment. We expect that single-family construction will remain very high through the summer. Although the impetus from the *decline* in mortgage rates should wane, the *level* of rates is expected to remain low enough to keep the cash flow affordability of home ownership close to levels that are the most favorable in decades. In addition, the current slender backlog of unsold new units and the upward movement in prices should reduce the risks builders perceive in speculative projects, providing some momentum for construction in the near term. Eventually, however, the deceleration in income growth and slippage in stock market wealth will begin to show through in a reduction in construction activity. We see single-family starts dropping off about 10 percent by the latter part of 1998, to around a 1.15 million unit rate by year-end. This is still a high level historically, and one that would leave the total for the year, at 1.22 million units, the best for this expansion. Starts are projected to run somewhere between 1.10 million and 1.15 million units during 1999.

In the multifamily sector, although the firming of market conditions has not been dramatic, apartment vacancy rates have been drifting down since the end of 1996 and real rents have been rising. Construction activity probably also is receiving a boost from a generous supply of financing, both from traditional lenders and from REITs, which are shifting increasingly from investing in existing properties to funding new construction. We expect multifamily starts will average 340,000 units this year, about the same rate as in 1997 and more than twice the pace of construction during the early 1990s. As we move through next year, multifamily starts may edge off with the projected slowing in overall economic activity, but we do not foresee them falling below the 300,000 unit mark on a sustained basis during the forecast period.

Business fixed investment. Real business fixed investment is projected to increase 10 percent in 1998, above the already strong pace of growth recorded last year. The lagged effects of the acceleration in business output over the past couple of years should buttress investment for a time, and a low cost of capital will be a plus for many projects. However, as we move through the forecast period, accelerator effects should wane. Furthermore, our forecast of some cyclical slowdown in productivity growth suggests that businesses may begin to feel a pinch on profitability and cash flow. In combination, these factors are projected to reduce real BFI growth to 7 percent in 1999.

The cyclical influences just noted surely will affect the demand for computing equipment, but changes in technology and prices probably will remain important drivers of both the short-run swings and the longer-run trends in sales. Indeed, the huge surge in sales in the first quarter seems to have been attributable in part to opportunities to pick up some bargains as computer makers cleared out inventories of older models and shifted to more streamlined production techniques. Consequently, we expect a marked deceleration in sales in the near term. However, with the price of computers likely to continue falling at a good clip, we are projecting that business purchases will still end up registering a gain this year of about 50 percent in real terms. With growth in business activity remaining on a more moderate track next year, we expect real computer outlays to rise a "mere" 30 percent. Outlays on other high-technology items, most notably communications equipment, also are expected to advance at very impressive rates this year and then decelerate somewhat in 1999. In contrast, for some categories of equipment outside of high-tech, outright declines in purchases could lie ahead.

In the manufacturing sector, we see firms as currently being on an unsustainable path of capacity growth; absent something like a major depreciation of the dollar that bolsters our trade prospects and shifts the composition of activity in their direction, manufacturers will find utilization rates falling to less profitable levels. Under the circumstances, we believe that they will trim investment appreciably. We have heard a few anecdotes that suggest some firms already have cut back their spending plans, and the latest semiannual survey of the National Association of Purchasing Managers has provided further evidence. We have yet to see this in the data on orders booked by domestic capital goods producers, but we expect that it will become evident in the months ahead.

In contrast to PDE, we are projecting that nonresidential construction expenditures will post a small decline in 1998 and then increase at a modest pace in 1999. Real NRS has fallen about 2-3/4 percent over the past year, and the recent data on contracts and construction completions point to another decline this quarter. A weakening is quite understandable in some sectors--for example, for industrial buildings, owing to the considerations just noted in the discussion of manufacturing capacity. But it is at odds with apparent market developments in others, such as the office segment. Available data point to rising space rents and prices in many locales for offices and some other commercial properties, and anecdotal reports of new construction projects seem to have increased in number. We have puzzled over how to deal with what may be a statistical disconnect from reality and have decided, for now, to give the numbers the benefit of the doubt and assume that actual building activity simply is lagging behind the anecdotes. Thus, while we expect spending to remain weak this quarter, we are projecting that real investment in nonresidential structures will rise at about a 3 percent pace over the second half of 1998 and in 1999.

Business inventories. Real nonfarm inventories grew at roughly a 7 percent annual rate, on average, over the past two quarters, roughly twice the rate of increase in business final sales. Even with these high rates of accumulation, however, we hear only scattered reports of concerns about excess stocks. But with ample industrial capacity and no pressure on prices or lead times, firms may not want to run with yet-higher stock-sales ratios. Accordingly, we are anticipating that they will be very sensitive to any deceleration of sales and will act promptly to hold down inventories. As noted in the discussion of the current quarter, we expect that inventory accumulation will drop off some in the near term but remain well above the pace of trend sales. We thus are looking for a substantial further decline in inventory investment over the second half of this year. In 1999, nonfarm stocks are expected to grow at a bit under a 2 percent pace.

We are projecting that farm inventories will increase again in 1998, extending the rebuilding of stocks from the lows of late 1995 and early 1996. This forecast reflects the expectation of sluggish demand for farm exports, a reduced rate of liquidation of cattle inventories, and a harvest that is reasonably close to its long-run trend. At this point, of course, the annual crop production cycle still is in a very early phase, and as often happens during spring planting, variability in the weather has made the futures markets a bit edgy. Nonetheless, with planting making good progress overall, and a further build of stocks in prospect, futures prices for crops are lower, on balance, than they were at the time of the March Greenbook

Government spending. Real federal consumption and gross investment expenditures are projected to fall 1-1/2 percent in 1998 and 2 percent in 1999; with the exception of some near-term changes in timing, this forecast is essentially the same as that in the March Greenbook. Defense purchases are expected to decline between 2 percent and 4 percent this year and next, while, excluding special factors, nondefense purchases are projected to be relatively flat.[2]

Real purchases by state and local governments are projected to rise 2.2 percent in 1998 and 2.4 percent in 1999. Spending in this sector has been on the soft side in recent quarters, particularly in the case of construction, where we estimate that expenditures have fallen about 4 percent since their peak in the first quarter of last year. This weakness seems somewhat surprising given the improved positions of most state budgets and the demand for spending on infrastructure, and so we are looking for a moderate bounceback in construction activity over the forecast period. On the tax front, we continue to assume that large surpluses will prompt many state governments to enact minor tax cuts. Although their fiscal positions have improved, we expect less action on the part of localities: Most of these governments appear less flush, largely because they rely more on property taxes than on revenues that rise more directly with incomes.

Net exports. Overall, the forecast for U.S. international trade has changed little since the March Greenbook; importantly, the influence of the Asian crisis is unfolding broadly as we anticipated. Real exports of goods and services are projected to rise just 1-1/4 percent in 1998; as foreign growth picks up and the effects of past dollar appreciation diminish, the increase in exports rises to 5 percent in 1999.

---

2. The 3-1/2 percent increase in federal nondefense purchases projected for the four quarters of 1998 is an artifact of reduced spending in the fourth quarter of 1998 because of the sale of the Elk Hills Petroleum Reserve (a negative purchase in the national accounts) and the extra day off given federal employees on the day after Christmas.

Reflecting strong U.S. activity and the lagged effects of the dollar's appreciation, real imports are projected to rise 9-1/4 percent in 1998 and then slow to a 7 percent gain in 1999. All told, net exports are projected to reduce real U.S. GDP growth by about 1 percentage point in 1998 and 1/3 percentage point in 1999, virtually the same as forecast in the March Greenbook. (A more detailed discussion of the outlook for net exports is contained in the *International Developments* section.)

Labor markets. The large drop in the unemployment rate last month seems outsized to us, and, even though we see no smoking guns in the details, we have leaned toward the notion that some of the decline is simply an artifact of the statistical noise inherent in the data. Accordingly, we are assuming that the unemployment rate will back up some over the remainder of the quarter. With output growth running below potential in late 1998 and early 1999, the unemployment rate is projected to move up to 4-3/4 percent by the middle of next year. In both 1998 and 1999, the unemployment rate is a tenth of a percentage point lower than in our previous forecast.

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

Measure	1997	1998	1999
Output per hour, nonfarm business[1]	2.3	1.0	1.6
Previous	2.4	.3	1.4
Nonfarm payroll employment	2.5	1.7	1.2
Previous	2.5	2.0	1.0
Household employment survey	2.1	1.3	.9
Previous	2.1	1.3	.8
Labor force participation rate[2]	67.1	67.2	67.2
Previous	67.1	67.2	67.2
Civilian unemployment rate[2]	4.7	4.5	4.8
Previous	4.7	4.7	4.9

1. Corrected by FRB staff for length-of-pay-period problem.
2. Percent, average for the fourth quarter.

We have revised our view of the underlying trend in labor productivity, again, partly in light of the recently released BLS estimates of multifactor productivity. Most important, these data suggest that the educational and job experience composition of the workforce and the gains in total factor productivity were more positive than we had assumed. Accordingly, we have revised our estimate of the growth in trend labor productivity since mid-1995 up to 1-1/2 percent per year (on a consistently measured basis), 1/4 percentage point higher than our previous estimate and twice the pace of earlier in the decade. We also have raised our estimate of potential GDP growth by a like amount--to about 2-3/4 percent over the projection period.[3] Actual productivity growth, however, is expected to fall short of trend, especially in the latter part of this year as activity decelerates and employers do not cut payrolls enough at first. All told, we now are projecting that output per hour will rise 1.0 percent in 1998 and 1.6 percent in 1999. Our projection continues to include a negative effect of a tenth or so on productivity growth this year and next to reflect resources diverted to solving Year 2000 computer problems.[4]

Wages and prices. Tight labor markets continue to put upward pressure on compensation, and in light of the changes in our projected path for the unemployment rate, we have raised our forecast for the growth in hourly compensation slightly from the March Greenbook. We currently are projecting a virtually flat path for the growth of compensation; in the area of 3-1/2 percent per annum for the ECI.

The expected path of compensation reflects several partially offsetting influences. On the one hand, declines in actual and expected price inflation will tend to reduce nominal wage hikes. Furthermore, after surging last year, bonuses and commissions in the finance, insurance, and real estate industries--an important contributor to the acceleration in the ECI over the past year--likely will rise less dramatically if activity in these markets cool off as we expect. We also are assuming that no further increase in the minimum wage will be legislated over the forecast period. On the other hand, rising health insurance costs are expected to hold up the rate of compensation growth. These costs increased at a somewhat faster pace in the latest ECI, and both anecdotal evidence and information from the premium negotiations by large health insurance pools such as the federal government and the

3. Relative to the consistently measured basis, both published and trend productivity also are boosted by changes in CPI methodology; these are worth roughly 0.1 percentage point from mid-1996 through the end of 1998 and 0.3 percentage point in 1999. The higher productivity trend translates directly into the upward revision to our estimate of trend real GDP growth since mid-1995, from 2-1/4 percent to 2-1/2 percent per year on a consistently measured basis. Adjusted for changes in CPI methodology, trend GDP growth is now estimated at 2.6 percent in 1997 and 1998 and 2.8 percent in 1999.

4. The text table shows output per hour adjusted for the staff's estimates of the length of pay period bias in the hours data (discussed in the appendix in Part 2 of the Greenbook). The figures shown in the Greensheets, however, are not bias-adjusted. On an adjusted basis, growth in output per hour would be 3.0 percent at an annual rate in 1998:Q1 and 0.0 percent in 1998:Q2, compared with the 1.5 percent and 1.7 percent annual rate figures in the Greensheets. Historical differences in the published and adjusted growth rates are shown in Part 2.

state of California point to a marked acceleration in health insurance premiums over the forecast period.

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

Measure	1997	1998	1999
Consumer price index	1.9	1.6	2.1
Previous	1.9	1.7	2.2
Food	1.7	1.3	1.7
Previous	1.7	1.5	1.8
Energy	-1.0	-4.4	1.1
Previous	-1.0	-4.6	1.2
Excluding food and energy	2.2	2.2	2.2
Previous	2.2	2.3	2.3
PCE chain-weighted price index	1.5	1.4	1.8
Previous	1.5	1.5	2.0
Excluding food and energy	1.5	1.7	1.8
Previous	1.6	1.9	2.1
GDP chain-weighted price index	1.8	1.5	1.7
Previous	1.8	1.6	1.8
ECI for compensation of private industry workers[1]	3.4	3.4	3.4
Previous	3.4	3.4	3.3
Prices of core non-oil merchandise imports	-.8	-1.7	1.3
Previous	-.8	-1.5	1.8
	Percentage points		
MEMO: *Adjustments for technical changes to the CPI*[2]			
Core CPI	.2	.4	.7
Core PCE	.1	.1	.4
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.

Trend unit labor costs are somewhat more favorable in this projection than in the last, as the upward adjustment to the productivity trend more than offsets the slightly higher compensation path. Broad measures of business output prices are projected to rise somewhat less than trend unit labor costs, on average, over the forecast period, as ample factory capacity keeps pricing conditions in goods markets highly competitive. While we see little cost pressure on the prices of items that we produce domestically, we are anticipating an acceleration in the prices of items that we purchase from abroad, with the change in the prices of core non-oil imports projected to swing from a decline of about 1-3/4 percent this year to an increase of 1-1/4 percent in 1999.

After having risen 1.9 percent in 1997, the total CPI is projected to increase 1.6 percent in 1998 and 2.1 percent in 1999. Most of the acceleration in the CPI results from the direct effect of the swing in energy prices from a sharp decline in 1998 to a modest increase in 1999. Food prices are expected to rise less than overall inflation both this year and next, reflecting the weak foreign demand and the likelihood of ample supplies of farm products. The CPI excluding food and energy is projected to continue trending up at just a bit more than a 2 percent annual rate in 1998 and 1999. However, after accounting for technical changes in the CPI, on a consistently measured basis this path represents a roughly 1/2 percentage point acceleration in the core CPI between 1997 and 1999.

Money and Credit Flows

Growth of the monetary and debt aggregates appears to have slowed recently from the exceptional pace of earlier in the year, and moderate growth is projected over the balance of 1998 and into 1999. Even so, nonfinancial debt is forecast to expand 5-1/2 percent this year--above nominal income growth--before slowing to a 4-1/2 percent pace in 1999.

The exceptionally brisk business sector debt growth in the first quarter apparently included some "advance borrowing" to lock in low levels of long-term interest rates. Although projected to slow, business borrowing remains strong through next year, reflecting a wide gap between capital spending and internally generated funds as well as the need to finance continuing heavy merger activity. Many of these mergers are relatively small deals in which cash financing often is more important than stock swaps. The most recent senior loan officer opinion survey suggests that lending terms and standards continue to be very accommodative to business borrowers. In capital markets, low benchmark interest rates and a continued willingness to assume--or ignore--risk have encouraged outsized issuance of the very lowest grade bonds. Junk bond spreads have remained narrow even in the face of this heavy volume. Funding out of short-term debt with the proceeds of capital market financing has strengthened many business balance sheets.

In the household sector, mortgage debt growth is projected to remain at a high, albeit slowly diminishing, pace through the end of next year because of continued favorable financing conditions and a strong housing market. Consumer debt continues to expand at a relatively subdued rate, in part owing to paydowns of installment loans with the proceeds of home equity loans and "cash out" mortgage refinancing. Available evidence suggests that the quality of consumer debt may be stabilizing. Signs of tightening of consumer credit terms and standards seem to have lessened, and credit availability should remain good for most borrowers. Although household debt is projected to continue to expand faster than income, low interest rates and heavy mortgage refinancing are estimated to have lowered the household debt burden in the first quarter; a small further decline is expected this year, but debt burdens could rise slightly in 1999.

Surpluses in the federal budget will result in declines in federal debt outstanding this year and next. In contrast, state and local government debt is expected to expand moderately through the forecast period after growing rapidly earlier in the year owing to advance refundings as well as issuance to support infrastructure spending.

M2, which grew very rapidly in the first quarter, seems to be decelerating in the current quarter. M2 growth is projected to move into rough alignment with the growth of nominal income in the second half of this year and into 1999. M3 growth also has been very strong in the early months of this year, partly reflecting the funding of a rapid advance in bank credit and the increasing use of institutional money funds for corporate cash management. M3 is also expected to moderate over the projection period, but its growth should remain well above that of income.

Alternative Simulations

Our alternative, model-based simulations assess the implications of different assumptions about interest rates and the stock market. In the first alternative, the federal funds rate rises 25 basis points per quarter from the current period through the first quarter of 1999 and remains a constant 100 basis points above the baseline thereafter. The tighter policy reduces real GDP growth by 0.2 percentage point in 1998 and 3/4 percentage point in 1999; the unemployment rate rises to 5-1/4 percent by the end of next year, 0.4 percentage point above the baseline projection. The reduced pressure on resources brings the increase in the core CPI down 0.4 percentage point by the end of next year, essentially eliminating the uptilt in inflation in our forecast, once adjustment is made for technical changes in the index. The second, symmetric, alternative assumes a decline of 25 basis points per quarter in the funds rate between now and the first quarter of 1999; under this alternative, the unemployment rate remains in the neighborhood of 4-1/2 percent throughout the projection period, and core consumer price inflation picks up to a bit above 2-1/2 percent by 1999.

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

Measure	1997	1998	1999
Real GDP			
Baseline	3.7	2.8	2.3
Higher funds rate	3.7	2.6	1.5
Lower funds rate	3.7	3.0	3.1
No stock price decline	3.7	2.9	2.6
Civilian unemployment rate[1]			
Baseline	4.7	4.5	4.8
Higher funds rate	4.7	4.6	5.2
Lower funds rate	4.7	4.4	4.4
No stock price decline	4.7	4.5	4.7
CPI excluding food and energy			
Baseline	2.2	2.2	2.2
Higher funds rate	2.2	2.2	1.8
Lower funds rate	2.2	2.2	2.6
No stock price decline	2.2	2.2	2.2

1. Average for the fourth quarter.

The third alternative assumes that we are yet again wrong about the stock market. Instead of the modest decline in equity prices assumed in the baseline forecast, this alternative assumes that the stock market rises at the same pace as disposable income--still a marked deceleration from the recent trends. Under this scenario, real GDP growth is boosted to roughly 3 percent in 1998 and 2-1/2 percent in 1999. The higher growth path lowers the unemployment rate by a tenth of a percentage point by the end of 1999; consumer price inflation is essentially the same as in the baseline projection. As we have noted before, the effect on prices under this alternative is small because the unemployment rate change is minor and because, in the FRB/US model, inflation expectations move slowly in the absence of a significant change in the stance of monetary policy. Furthermore, because of the higher baseline path for equity prices, the effects of the alternative stock market path on growth and inflation are smaller in this scenario than in the alternative presented in the March Greenbook.

Strictly Confidential <FR>
Class II FOMC

May 14, 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]	
		03/25/98	05/14/98	03/25/98	05/14/98	03/25/98	05/14/98	03/25/98	05/14/98	03/25/98	05/14/98
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		5.8	5.8	3.8	3.8	2.0	2.0	2.3	2.3	4.9	4.9
1998		4.4	4.8	2.8	3.4	1.5	1.4	1.6	1.6	4.6	4.5
1999		3.9	3.8	2.1	2.1	1.8	1.7	2.2	2.1	4.8	4.7
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	3.7	3.7	5.4	5.4
	Q3	3.6	3.6	1.0	1.0	2.7	2.7	2.6	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	2.0	2.0	5.3	5.3
	Q2	5.2	5.2	3.3	3.3	1.8	1.8	1.5	1.5	4.9	4.9
	Q3	4.6	4.6	3.1	3.1	1.4	1.4	1.8	1.8	4.9	4.9
	Q4	5.4	5.2	3.9	3.7	1.5	1.4	2.3	2.3	4.7	4.7
1998	Q1	4.5	6.1	3.1	5.2	1.4	0.9	0.5	0.5	4.6	4.7
	Q2	3.6	4.2	2.1	2.5	1.5	1.6	1.5	1.6	4.6	4.4
	Q3	3.8	3.6	2.0	1.8	1.8	1.7	2.3	2.3	4.6	4.5
	Q4	3.8	3.5	2.0	1.8	1.8	1.7	2.2	2.1	4.7	4.5
1999	Q1	4.1	4.0	2.0	2.0	2.0	1.9	2.2	2.1	4.7	4.6
	Q2	3.8	3.8	2.1	2.2	1.7	1.6	2.2	2.1	4.8	4.7
	Q3	4.0	4.0	2.2	2.3	1.7	1.6	2.2	2.1	4.8	4.7
	Q4	4.1	4.1	2.3	2.4	1.7	1.6	2.2	2.1	4.9	4.8
TWO-QUARTER[3]											
1996	Q2	6.2	6.2	3.8	3.8	2.3	2.3	3.5	3.5	-0.2	-0.2
	Q4	4.9	4.9	2.7	2.7	2.3	2.3	2.9	2.9	-0.1	-0.1
1997	Q2	6.3	6.3	4.1	4.1	2.1	2.1	1.8	1.8	-0.4	-0.4
	Q4	5.0	4.9	3.5	3.4	1.4	1.4	2.0	2.0	-0.2	-0.2
1998	Q2	4.1	5.1	2.6	3.9	1.4	1.3	1.0	1.1	-0.1	-0.3
	Q4	3.8	3.5	2.0	1.8	1.8	1.7	2.3	2.2	0.1	0.1
1999	Q2	3.9	3.9	2.0	2.1	1.9	1.7	2.2	2.1	0.2	0.2
	Q4	4.1	4.0	2.3	2.4	1.7	1.6	2.2	2.1	0.1	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	5.6	5.6	3.8	3.7	1.8	1.8	1.9	1.9	-0.6	-0.6
1998	Q4	3.9	4.3	2.3	2.8	1.6	1.5	1.7	1.6	-0.0	-0.2
1999	Q4	4.0	4.0	2.2	2.3	1.8	1.7	2.2	2.1	0.2	0.3

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

Strictly Confidential <FR>
Class II FOMC

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

May 14, 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	8079.9	8470.4	8794.7
Real GDP	Bill. Ch. $	6079.4	6244.4	6389.6	6610.7	6742.1	6928.4	7188.8	7432.8	7588.6
Real GDP	% change	0.4	3.6	2.4	3.3	1.6	3.2	3.7	2.8	2.3
Gross domestic purchases		0.0	4.0	3.0	3.6	1.2	3.6	4.3	3.8	2.6
Final sales		-0.4	3.9	2.1	2.7	2.2	3.1	3.1	3.5	2.3
Priv. dom. final purchases		-0.8	4.9	3.7	3.7	2.5	3.8	4.3	5.3	2.9
Personal cons. expenditures		-0.2	4.2	2.7	3.1	2.2	2.7	3.6	4.6	2.6
Durables		-3.1	9.4	7.4	6.3	3.0	3.9	6.8	7.1	3.4
Nondurables		-1.0	3.4	1.6	3.0	1.0	1.8	1.4	4.4	1.7
Services		0.9	3.6	2.3	2.5	2.7	2.8	4.0	4.1	2.9
Business fixed investment		-6.0	5.5	9.9	7.6	6.5	11.7	9.0	10.0	6.9
Producers' dur. equipment		-2.6	9.6	12.2	10.2	8.3	12.2	12.9	14.4	8.3
Nonres. structures		-12.5	-3.4	4.5	1.1	2.0	10.3	-0.7	-1.6	2.9
Residential structures		1.1	16.9	7.8	4.2	-1.9	3.9	5.6	6.2	-2.4
Exports		8.6	4.1	4.6	10.0	10.3	9.3	10.2	1.2	5.0
Imports		4.1	7.4	10.2	12.3	5.6	11.8	14.4	9.2	7.0
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	-1.5	-1.9
Defense		-5.3	-1.3	-6.9	-6.0	-5.9	1.1	-0.8	-3.9	-2.4
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	65.7	57.0	29.5
Nonfarm		-1.2	2.0	29.5	49.0	35.7	22.5	57.8	48.8	22.8
Net exports		-22.3	-29.5	-70.2	-104.6	-98.8	-114.4	-146.5	-235.3	-284.5
Nominal GDP	% change	3.8	6.3	5.0	5.8	4.0	5.6	5.6	4.3	4.0
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employment	Millions	108.3	108.6	110.7	114.1	117.2	119.5	122.3	125.1	126.5
Unemployment rate	%	6.8	7.5	6.9	6.1	5.6	5.4	4.9	4.5	4.7
Industrial prod. index	% change	-0.0	3.7	3.3	6.5	3.3	4.2	5.8	1.8	2.3
Capacity util. rate - mfg.	%	77.9	79.4	80.5	82.5	82.8	81.4	81.7	80.7	79.7
Housing starts	Millions	1.01	1.20	1.29	1.46	1.35	1.48	1.47	1.56	1.45
Light motor vehicle sales		12.52	12.85	13.87	15.02	14.73	15.05	15.06	15.01	14.66
North Amer. produced		9.74	10.51	11.71	12.88	12.82	13.34	13.12	13.12	12.87
Other		2.77	2.34	2.15	2.13	1.90	1.71	1.94	1.89	1.79
INCOME AND SAVING										
Nominal GNP	Bill. $	5932.4	6255.5	6576.8	6955.2	7270.6	7637.7	8060.1	8429.2	8746.4
Nominal GNP	% change	3.5	6.2	5.1	5.7	4.1	5.5	5.2	4.1	3.9
Nominal personal income		3.7	7.3	4.2	5.1	5.2	5.8	6.0	4.5	4.1
Real disposable income		0.8	4.0	1.5	2.4	2.4	2.0	3.7	2.5	2.9
Personal saving rate	%	6.0	6.2	5.1	4.2	4.8	4.3	3.9	2.9	2.7
Corp. profits, IVA & CCAdj.	% change	4.5	11.3	19.0	14.1	11.0	9.1	9.4	-3.4	2.5
Profit share of GNP	%	6.9	6.8	7.5	8.2	8.9	9.6	10.0	9.5	9.2
Excluding FR Banks		6.6	6.6	7.2	7.9	8.6	9.3	9.7	9.3	8.9
Federal surpl./deficit	Bill. $	-196.0	-280.9	-250.7	-186.7	-174.4	-110.5	-28.8	48.9	29.3
State & local surpl./def.		75.8	86.3	87.4	96.8	103.1	105.3	107.8	115.3	119.0
Ex. social ins. funds		11.5	18.3	19.7	27.9	32.5	34.1	36.3	43.5	47.1
Gross natl. saving rate	%	15.7	14.5	14.4	15.5	16.0	16.6	17.3	17.1	16.5
Net natl. saving rate		4.8	3.7	3.7	4.7	5.5	6.4	7.3	7.2	6.5
PRICES AND COSTS										
GDP chn.-wt. price index	% change	3.3	2.6	2.6	2.5	2.4	2.3	1.8	1.5	1.7
Gross Domestic Purchases chn.-wt. price index		2.7	2.7	2.3	2.5	2.3	2.3	1.3	1.1	1.6
CPI		3.0	3.1	2.7	2.7	2.6	3.2	1.9	1.6	2.1
Ex. food and energy		4.4	3.5	3.1	2.8	3.1	2.6	2.2	2.2	2.2
ECI, hourly compensation[2]		4.4	3.5	3.6	3.1	2.6	3.1	3.4	3.4	3.4
Nonfarm business sector										
Output per hour		2.2	3.5	-0.2	-0.1	0.6	1.7	2.1	1.0	1.6
Compensation per Hour		4.8	4.5	1.8	1.9	3.1	3.9	4.1	3.8	3.4
Unit labor cost		2.5	1.0	2.0	2.0	2.4	2.2	2.0	2.7	1.8

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

Strictly Confidential <FR>
Class II FOMC

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

May 14, 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	2.8	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	3.7
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)

May 14, 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	8227.4	8350.8	8436.1	8510.2	8584.5	8668.3	8750.4	8835.6	8924.4
Real GDP	Bill. Ch. $	7214.0	7280.0	7372.8	7419.1	7452.9	7486.4	7524.0	7565.5	7609.4	7655.4
Real GDP	% change	3.1	3.7	5.2	2.5	1.8	1.8	2.0	2.2	2.3	2.4
Gross domestic purchases		4.3	3.4	7.4	3.3	3.0	1.7	2.7	2.5	3.1	2.0
Final sales		4.7	2.3	3.5	5.0	2.5	3.0	1.5	2.4	2.0	3.1
Priv. dom. final purchases		7.1	2.3	8.0	6.1	4.2	3.2	2.6	2.9	3.0	3.1
Personal cons. expenditures		5.6	2.5	5.8	5.2	4.0	3.2	2.7	2.6	2.6	2.7
Durables		18.4	1.9	17.9	4.8	3.1	3.1	2.8	3.8	3.4	3.6
Nondurables		4.3	-1.2	5.9	5.5	4.0	2.4	1.8	1.7	1.7	1.8
Services		3.9	4.4	3.5	5.1	4.3	3.6	3.0	2.8	2.9	2.9
Business fixed investment		19.2	-0.8	17.7	9.0	7.3	6.4	6.9	6.9	6.8	6.9
Producers' dur. equipment		24.1	-0.3	29.4	13.1	8.7	7.6	8.3	8.3	8.2	8.3
Nonres. structures		6.7	-2.3	-9.8	-2.1	3.3	2.9	2.9	2.9	2.9	3.0
Residential structures		2.7	9.1	17.6	12.7	-0.2	-4.0	-7.8	-3.1	0.4	1.2
Exports		4.4	8.3	-4.3	2.2	-1.5	9.0	1.6	7.0	1.5	10.2
Imports		14.6	5.3	13.8	8.0	8.5	6.7	6.7	8.5	7.2	5.6
Gov't. cons. & investment		1.1	0.3	-2.8	3.7	1.2	1.4	0.1	1.5	1.2	0.7
Federal		-2.1	-2.3	-8.3	5.0	-1.5	-0.9	-4.1	0.0	-0.9	-2.4
Defense		1.2	1.0	-16.7	6.1	-2.7	-0.8	-5.7	-0.0	-1.5	-2.2
State & local		2.3	1.8	0.4	3.0	2.7	2.6	2.4	2.3	2.4	2.4
Change in bus. inventories	Bill. Ch. $	47.5	74.0	103.0	57.7	45.5	21.8	31.3	28.9	35.9	22.0
Nonfarm		38.3	64.5	92.9	49.0	38.2	15.2	24.6	22.2	29.1	15.4
Net exports		-164.1	-159.1	-208.0	-225.7	-254.4	-253.3	-269.9	-279.0	-298.0	-291.0
Nominal GDP	% change	4.6	5.2	6.1	4.2	3.6	3.5	4.0	3.8	4.0	4.1
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	122.6	123.5	124.4	125.0	125.3	125.6	125.9	126.3	126.7	127.1
Unemployment rate	%	4.9	4.7	4.7	4.4	4.5	4.5	4.6	4.7	4.7	4.8
Industrial prod. index	% change	6.0	7.2	1.0	1.9	1.9	2.4	2.4	2.2	2.3	2.4
Capacity util. rate - mfg.	%	81.6	82.2	81.5	80.7	80.3	80.1	79.9	79.7	79.6	79.6
Housing starts	Millions	1.45	1.53	1.59	1.60	1.56	1.48	1.45	1.45	1.45	1.45
Light motor vehicle sales		15.34	15.10	15.01	15.50	14.82	14.70	14.64	14.66	14.66	14.68
North Amer. produced		13.31	13.14	13.05	13.57	12.97	12.89	12.85	12.87	12.87	12.89
Other		2.03	1.96	1.97	1.93	1.85	1.81	1.79	1.79	1.79	1.79
INCOME AND SAVING											
Nominal GNP	Bill. $	8103.5	8204.2	8315.3	8396.3	8467.2	8538.1	8623.2	8703.6	8786.5	8872.2
Nominal GNP	% change	4.6	5.1	5.5	4.0	3.4	3.4	4.1	3.8	3.9	4.0
Nominal personal income		4.6	6.3	6.6	3.0	4.3	4.0	4.1	4.0	4.2	4.1
Real disposable income		2.6	4.5	5.2	1.4	1.8	1.8	5.5	2.0	2.1	2.1
Personal saving rate	%	3.5	3.9	3.8	3.0	2.5	2.2	2.8	2.7	2.6	2.5
Corp. profits, IVA & CCAdj.	% change	17.2	-4.4	-3.0	0.5	-6.4	-4.6	2.1	2.5	3.7	2.0
Profit share of GNP	%	10.2	10.0	9.8	9.7	9.4	9.3	9.2	9.2	9.2	9.1
Excluding FR Banks		9.9	9.7	9.5	9.4	9.2	9.0	9.0	8.9	8.9	8.9
Federal surpl./deficit	Bill. $	-10.8	-12.1	37.7	45.5	58.7	53.6	18.9	25.2	35.6	37.6
State & local surpl./def.		111.4	110.1	109.9	116.7	116.3	118.4	117.7	119.1	118.9	120.3
Ex. social ins. funds		40.0	38.6	38.1	44.9	44.5	46.6	45.8	47.2	47.0	48.4
Gross natl. saving rate	%	17.4	17.5	17.8	17.2	16.9	16.5	16.5	16.5	16.5	16.4
Net natl. saving rate		7.5	7.5	8.0	7.4	6.9	6.5	6.6	6.5	6.5	6.4
PRICES AND COSTS											
GDP chn.-wt. price index	% change	1.4	1.4	0.9	1.6	1.7	1.7	1.9	1.6	1.6	1.6
Gross Domestic Purchases chn.-wt. price index		1.3	1.4	0.1	1.0	1.7	1.6	1.8	1.5	1.5	1.5
CPI		1.8	2.3	0.5	1.6	2.3	2.1	2.1	2.1	2.1	2.1
Ex. food and energy		1.9	2.1	2.4	2.3	2.1	2.1	2.2	2.2	2.2	2.2
ECI, hourly compensation[1]		3.4	4.3	2.7	3.7	3.7	3.7	3.4	3.4	3.4	3.4
Nonfarm business sector											
Output per hour		3.6	1.4	1.5	1.7	0.1	0.8	1.6	1.7	1.6	1.6
Compensation per hour		3.8	5.2	4.1	3.7	3.7	3.6	3.4	3.4	3.4	3.4
Unit labor cost		0.2	3.8	2.6	2.0	3.6	2.8	1.8	1.7	1.8	1.8

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	3.7
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	3.1
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	2.4
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	1.6
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.

Strictly Confidential <FR>
Class II FOMC

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

May 14, 1998

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	3.7	5.2	2.5	1.8	1.8	2.0	2.2	2.3	2.4	3.7	2.8	2.3
Gross dom. purchases	3.4	7.5	3.3	3.1	1.7	2.7	2.6	3.1	2.1	4.4	3.9	2.6
Final sales	2.3	3.4	4.9	2.5	3.0	1.5	2.3	2.0	3.1	3.1	3.5	2.3
Priv. dom. final purchases	1.9	6.5	5.0	3.5	2.7	2.2	2.4	2.6	2.6	3.6	4.4	2.5
Personal cons. expenditures	1.7	3.9	3.5	2.7	2.2	1.8	1.8	1.8	1.8	2.4	3.1	1.8
Durables	0.2	1.4	0.4	0.3	0.3	0.2	0.3	0.3	0.3	0.5	0.6	0.3
Nondurables	-0.2	1.1	1.0	0.8	0.5	0.4	0.3	0.3	0.3	0.3	0.9	0.3
Services	1.8	1.4	2.0	1.7	1.4	1.2	1.2	1.2	1.2	1.6	1.7	1.2
Business fixed investment	-0.1	1.8	0.9	0.8	0.7	0.7	0.7	0.7	0.7	0.9	1.0	0.7
Producers' dur. equip.	0.0	2.1	1.0	0.7	0.6	0.7	0.7	0.6	0.7	0.9	1.1	0.7
Nonres. structures	-0.1	-0.3	-0.1	0.1	0.1	0.1	0.1	0.1	0.1	-0.0	-0.0	0.1
Residential structures	0.4	0.7	0.5	-0.0	-0.2	-0.3	-0.1	0.0	0.1	0.2	0.3	-0.1
Net exports	0.3	-2.2	-0.8	-1.2	0.1	-0.7	-0.3	-0.8	0.4	-0.6	-1.0	-0.4
Exports	1.0	-0.5	0.3	-0.2	1.0	0.2	0.8	0.2	1.1	1.2	0.1	0.6
Imports	-0.7	-1.7	-1.0	-1.1	-0.9	-0.9	-1.1	-0.9	-0.7	-1.8	-1.2	-0.9
Government cons. & invest.	0.1	-0.5	0.6	0.2	0.2	0.0	0.3	0.2	0.1	0.2	0.1	0.2
Federal	-0.1	-0.5	0.3	-0.1	-0.1	-0.3	0.0	-0.1	-0.1	-0.0	-0.1	-0.1
Defense	0.0	-0.8	0.2	-0.1	-0.0	-0.2	-0.0	-0.1	-0.1	-0.0	-0.2	-0.1
Nondefense	-0.2	0.2	0.1	0.0	-0.0	-0.0	0.0	0.0	-0.1	-0.0	0.1	-0.0
State and local	0.2	0.0	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.3
Change in bus. inventories	1.4	1.5	-2.3	-0.6	-1.2	0.5	-0.1	0.3	-0.7	0.5	-0.7	0.0
Nonfarm	1.4	1.5	-2.2	-0.5	-1.2	0.5	-0.1	0.3	-0.7	0.5	-0.6	0.0
Farm	0.0	0.0	-0.0	-0.1	-0.0	0.0	0.0	0.0	0.0	0.0	-0.0	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)

May 14, 1998

Item	Fiscal year[5]				1997				1998				1999			
	1996[a]	1997[a]	1998	1999	Q1[a]	Q2[a]	Q3[a]	Q4[a]	Q1[b]	Q2	Q3	Q4	Q1	Q2	Q3	Q4
UNIFIED BUDGET					Not seasonally adjusted											
Receipts[1]	1453	1579	1709	1765	349	496	387	386	378	542	402	416	383	537	429	422
Outlays[1]	1561	1601	1657	1721	401	396	398	426	409	408	415	464	400	426	431	441
Surplus/deficit[1]	-107	-22	52	44	-52	100	-11	-40	-30	135	-12	-48	-17	111	-2	-19
On-budget	-174	-103	-46	-73	-69	61	-19	-66	-51	90	-19	-49	-68	58	-14	-56
Off-budget	67	81	98	117	17	39	8	26	21	44	7	1	51	53	12	36
Surplus excluding deposit insurance[2]	-116	-36	48	40	-56	97	-12	-41	-31	133	-14	-49	-18	110	-3	-20
Means of financing																
Borrowing	130	38	-43	-45	48	-69	11	34	26	-94	-9	14	25	-93	10	7
Cash decrease	-6	1	3	1	-1	-18	8	12	4	-34	21	21	0	-15	-5	10
Other[3]	-16	-17	-12	0	5	-13	-7	-6	0	-6	-1	14	-8	-3	-3	3
Cash operating balance, end of period	44	44	41	40	33	51	44	32	28	62	41	20	20	35	40	30
NIPA FEDERAL SECTOR					Seasonally adjusted annual rate											
Receipts	1550	1692	1813	1860	1675	1709	1742	1767	1805	1829	1849	1866	1841	1858	1878	1896
Expenditures	1679	1737	1780	1827	1731	1746	1753	1780	1767	1784	1790	1812	1822	1832	1842	1859
Consumption expend.	447	460	465	470	458	464	465	468	458	466	466	467	469	471	472	471
Defense	302	309	308	309	306	311	312	314	303	309	308	308	308	309	309	309
Nondefense	145	151	156	161	152	153	153	154	156	157	158	159	161	162	163	162
Other expenditures	1232	1277	1316	1357	1273	1282	1288	1311	1309	1318	1324	1346	1352	1361	1370	1388
Current account surplus	-129	-45	32	33	-56	-37	-11	-12	38	45	59	54	19	25	36	38
Gross investment	69	61	59	59	58	62	61	59	59	60	60	60	59	59	59	59
Current and capital account surplus	-197	-106	-27	-26	-114	-99	-72	-71	-21	-15	-1	-6	-40	-34	-23	-21
FISCAL INDICATORS[4]																
High-employment (HEB) surplus/deficit	-220	-164	-128	-129	-167	-164	-144	-155	-122	-124	-112	-115	-143	-134	-123	-120
Change in HEB, percent of potential GDP	-.7	-.7	-.5	0	-.2	0	-.2	.1	-.4	0	-.2	0	.3	-.1	-.1	0
Fiscal impetus (FI), percent, cal. year	-2.3	-1.9	-1.6	-.4	-1.1	1.5	.2	-1.7	-1.9	2.2	-.4	-1.3	1.1	-.3	-.5	-1.4

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. In May 1998, CBO revised its surplus estimates to a range of $43 billion to $63 billion for FY98 and a range of $30 billion to $40 billion for 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.
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 2.3 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	5.2	-1.7	7.5	7.3	8.1	3.4	8.0	6.5		4.3
1999	4.5	-1.4	6.3	6.5	7.4	3.1	6.5	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		5.2
1998:1	6.6	-0.4	8.9	7.7	8.1	3.5	10.2	9.7		6.1
2	4.2	-4.8	7.1	7.2	8.0	3.3	7.2	7.0		4.2
3	4.7	-1.0	6.6	6.7	7.8	3.4	7.0	4.3		3.6
4	4.9	-0.4	6.6	6.8	7.6	3.4	6.8	4.2		3.5
1999:1	4.8	-0.5	6.4	6.7	7.4	3.4	6.6	4.5		4.0
2	3.7	-4.8	6.3	6.5	7.2	3.3	6.4	4.4		3.8
3	4.9	0.9	6.1	6.2	7.0	2.9	6.3	4.4		4.0
4	4.4	-1.1	5.9	6.1	7.0	2.6	6.1	4.3		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 is projected to grow 5.4 percent in 1998 and 4.6 percent in 1999.

3. On a monthly average basis, federal debt is projected to grow -1.3 percent in 1998 and -1.0 percent in 1999.

4. On a monthly average basis, nonfederal debt is projected to grow 7.7 percent in 1998 and 6.4 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	649.0	677.8	639.5	639.1	852.0	913.2	546.2	598.9	653.2	676.4	513.3	724.7	643.6
2 Net equity issuance	-64.2	-109.8	-113.5	-83.0	-83.2	-124.1	-89.6	-102.0	-140.0	-122.4	-90.8	-87.6	-77.6	-76.0
3 Net debt issuance	719.7	758.8	791.3	722.5	722.3	976.1	1002.8	648.2	738.9	775.6	767.2	600.9	802.3	719.6
Borrowing sectors														
Nonfinancial business														
4 Financing gap [1]	6.5	44.3	92.7	91.3	25.1	39.1	110.0	89.2	95.3	76.2	83.7	87.5	-97.3	96.8
5 Net equity issuance	-64.2	-109.8	-113.5	-83.0	-83.2	-124.1	-89.6	-102.0	-140.0	-122.4	-90.8	-87.6	-77.6	-76.0
6 Credit market borrowing	190.3	311.7	376.0	329.4	317.3	405.9	478.6	344.0	340.4	341.1	333.1	330.1	328.1	326.1
Households														
7 Net borrowing [2]	383.0	364.1	405.5	390.7	322.2	425.8	428.5	406.3	387.0	400.5	400.1	395.1	385.6	382.1
8 Home mortgages	258.2	251.0	305.0	299.2	254.6	304.8	303.4	307.9	306.8	301.9	302.4	299.4	296.4	298.4
9 Consumer credit	88.8	53.8	43.5	40.1	53.0	31.5	44.3	42.5	43.5	43.8	44.0	43.0	38.5	35.0
10 Debt/DPI (percent) [3]	89.6	91.6	93.9	96.0	91.8	92.1	92.6	93.7	94.4	95.1	95.0	95.7	96.3	96.9
State and local governments														
11 Net borrowing	1.3	59.9	72.9	53.9	41.8	77.0	110.0	81.4	50.2	49.9	53.9	53.9	53.9	53.9
12 Current surplus [4]	123.2	96.3	94.4	107.2	89.9	94.7	89.2	95.9	95.4	97.2	116.2	107.4	117.1	88.1
Federal government														
13 Net borrowing	145.0	23.1	-63.1	-51.4	40.9	67.4	-14.3	-183.4	-38.7	-15.9	-19.8	-178.2	34.8	-42.4
14 Net borrowing (quarterly, n.s.a.)	145.0	23.1	-63.1	-51.4	10.6	33.7	25.9	-94.0	-8.5	13.6	24.5	-92.7	9.9	6.9
15 Unified deficit (quarterly, n.s.a.)	110.9	2.4	-44.0	-72.8	10.9	39.7	30.2	-134.6	12.4	48.1	16.8	-110.6	1.5	19.5
Depository institutions														
16 Funds supplied	232.9	332.2	281.4	280.4	183.4	465.5	281.6	221.7	295.5	326.9	278.9	277.9	282.9	281.9
Memo (percentage of GDP)														
17 Domestic nonfinancial debt [5]	184.4	183.4	184.1	185.9	182.9	183.2	183.5	184.0	184.5	185.1	185.5	185.7	185.9	186.2
18 Domestic nonfinancial borrowing	9.4	9.4	9.3	8.2	8.9	11.9	12.0	7.7	8.7	9.0	8.9	6.9	9.1	8.1
19 Federal government [6]	1.9	0.3	-0.7	-0.6	0.5	0.8	-0.2	-2.2	-0.5	-0.2	-0.2	-2.0	0.4	-0.5
20 Nonfederal	7.5	9.1	10.1	8.8	8.4	11.0	12.2	9.9	9.1	9.2	9.1	8.9	8.7	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.

International Developments

Recent Developments

Developments since the March FOMC meeting point to a weakening of foreign economic activity on average, as we had expected. Output has declined substantially in Japan and several Asian developing countries but continued to expand robustly in continental Europe and Canada. The dollar, having risen against the yen and declined against European currencies over the intermeeting period, is unchanged on average in terms of major currencies.[1] It has appreciated slightly against a broad set of currencies including those of emerging market economies. Reflecting the combined effects of the downturn in Asia, past appreciation of the dollar, strong U.S. domestic demand, and some residual seasonal variation in trade flows, U.S. real net exports subtracted an estimated 2-1/4 percentage points from GDP growth in the first quarter.

Over the intermeeting period, the dollar declined almost 4 percent against the mark, which was bolstered by signs of robust German economic activity and by prospects for a smooth launch of the euro following the EU summit in early May. Although the eleven countries selected to join the currency union came as no surprise, the continued above-trend expansion of these economies supported the view that German interest rates may rise before the end of the year. German short-term and long-term interest rates rose about 8 basis points over the intermeeting period, and French rates rose slightly more. Italian short-term rates declined further, narrowing their gap with German rates to 140 basis points. Equity markets in continental Europe rose from 1 to 7 percent over the period, to new highs in most cases, bringing their total rise since the turn of the year to between 23 and 46 percent. For the most part, these increases have led to declines in earnings/price ratios that have been roughly matched by comparable declines in long-term real interest rates.

The dollar rose 1-1/4 percent against the yen as news of further weakening in Japanese economic activity more than offset the effects of the announcement of a large fiscal stimulus package and massive intervention by the Bank of Japan in support of the yen. On April 9-10, the BOJ sold $21.8 billion dollars against yen,

. (The Desk did not intervene

.)

Japanese interest rates fell 10 to 28 basis points along the yield curve, and the Nikkei equity price index fell almost 6 percent over the period. The dollar also firmed more than 3 percent against the pound, as U.K. GDP growth slowed and expectations of a

1. This new "narrow" index, along with the new "broad" index mentioned below, is described in the appendix to Part 2 of the May Greenbook.

further monetary tightening diminished. The Canadian dollar depreciated nearly 2 percent partly on indications late in the period from the Bank of Canada that monetary policy has shifted from a bias toward tightening to neutral for the near term. Equity prices are up in the United Kingdom (4 percent) and Canada (2 percent).

The dollar also rose against the currencies of several key Asian emerging market economies. Indonesia reached agreement with the IMF on a revised program that temporarily boosted the rupiah, and the implementation of economic and financial reforms has progressed in Korea, Thailand, and the Philippines. However, the rupiah fell 21 percent on balance, as social unrest in Indonesia spread following cuts in subsidies for fuel and other commodities. The dollar also moved up somewhat against the won as labor tensions increased in Korea. The dollar has risen less in *real terms* against the currencies of Asian emerging market economies because of increases in inflation rates in those economies induced by currency depreciations since last fall. Equity prices in Korea, Hong Kong, and most ASEAN countries have declined 17 to 25 percent since the March FOMC meeting. The Mexican peso has changed little on balance relative to the dollar, but equity prices are down nearly 6 percent. Overall, the dollar rose slightly against a weighted average of the currencies of a broad set of industrial and emerging market economies.

Economic activity in Japan turned down in the first quarter more sharply than generally anticipated, with industrial production contracting 5-1/2 percent (AR), unemployment rising to a record high of 3.9 percent, and business sentiment continuing to plummet. The details of the fiscal package announced in late April amount to an effective stimulus equal to nearly 1-1/2 percent of GDP in 1998, largely in the form of public works expenditures, with another 1/2 percent of GDP coming in 1999. The first stage of Japan's "Big Bang" financial reforms took effect on April 1, including the implementation of legislation to enhance the independence of the BOJ and abolish restrictions on capital movements.

In contrast to the bleak picture in Japan, German industrial production, orders, and business confidence rose strongly in the first quarter, and the unemployment rate fell to 11.4 percent in April. The unemployment rate in France fell during the first quarter, and French consumption of manufactured products rose strongly. Business sentiment soared in Italy with the removal of any remaining doubt about EMU membership, but both industrial output and unemployment were little changed during the first quarter. In the United Kingdom, GDP growth slowed substantially in the first quarter. Although much of the slowing had been expected because of the strength of sterling, the warm weather held down utility output somewhat more than anticipated.

Consumer price inflation has been running well under 2 percent in most foreign G-7 countries, as falling prices of oil and other imports have helped damp inflation. The United Kingdom is an exception, where inflation has been slightly above the Government's target of 2-1/2 percent.

In the front-line Asian crisis countries, growth continued to decline and external balances to rise sharply during the first quarter. Industrial production fell abruptly in Korea, Thailand, and Malaysia. For the three-month period December-February, these three countries plus the Philippines (reliable data are not yet available for Indonesia) were running a combined trade surplus of $35 billion (annual rate), an increase of $88 billion from the deficit recorded a year earlier. Roughly one-fourth of this swing came in trade with the United States.[2] Growth has slowed elsewhere in Asia as well, with Chinese GDP decelerating to a 7.2 growth rate of percent in the first quarter from nearly 9 percent in 1997; however, China's sizable trade surplus remained little changed. In March, twelve-month inflation rose to near double-digit rates in Korea and to nearly 40 percent in Indonesia. Inflation in China remained very low.

Among the major Latin American countries, growth in Mexico and Argentina early this year appears to have receded a bit from last year's very robust pace, and in Brazil and Venezuela growth appears to have slowed more noticeably. Negative effects of declining oil prices have been felt in Venezuela and to a lesser extent in Mexico. Inflation has been little changed in Brazil and Argentina but has risen somewhat in Mexico. After moving into positive territory last year, output growth in Russia slowed early this year in large part because of financial repercussions from the Asian currency crises. Russia's new cabinet under Prime Minister Kiriyenko retains a reformist orientation, but it will have to grapple with low tax revenues and a persistently very wide budget deficit.

The U.S. nominal trade deficit in goods and services widened $27 billion (annual rate) in January-February relative to the fourth quarter. Exports fell substantially, with Asia accounting for most of the drop; imports rose modestly despite a sharp decline in the value of oil imports due to lower prices. Strong U.S. domestic demand boosted non-oil imports; increases were recorded in all major trade categories.

2. U.S. trade data and data of the front-line Asian economies showed a swing of around $20 billion (annual rate) toward deficit in the U.S. trade balance with these four countries in December-February compared with a year earlier. Asian data suggested the swing was a bit more than $20 billion, U.S. data bit less.

The staff estimates that in the first quarter, net exports fell substantially more in real terms than in nominal terms because of a sharp decline in import prices.[3]

Oil import prices fell nearly $4 dollar per barrel during the first quarter because of increases in OPEC production, weak demand in Asia, relatively warm weather in the northern hemisphere, and the resumption of oil exports by Iraq. After having dropped below $13 per barrel during March, WTI spot prices have risen and are now trading near $15 per barrel largely as a result of an agreement among major oil exporters to restrain crude oil production by about 1-1/2 million barrels per day. Non-oil import prices fell 5 percent (annual rate) in the first quarter and somewhat further in April, partly because of the substantial further appreciation of the dollar and partly because of declines in non-oil commodity prices. Nevertheless, over the past several quarters, non-oil import prices have fallen less than historical relationships would have suggested. Export prices fell at a similar rate over the first four months of the year, somewhat more than the prices of comparable domestic goods partly as a consequence of the appreciation of the dollar.

Outlook

We estimate that growth of total foreign real GDP (weighted by shares of U.S. nonagricultural exports) slowed further in the first quarter of 1998 to 1-1/2 percent at

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

Measure	1997	Projection			
		1998			1999
		Q1	Q2	H2	
Foreign output	4.0	1.5	2.2	2.5	3.0
March	*3.8*	*1.7*	*2.1*	*2.3*	*2.9*
Real exports	10.2	-4.3	2.2	3.6	5.0
March	*10.2*	*-3.5*	*3.0*	*2.8*	*4.8*
Real imports	14.4	13.8	8.0	7.6	7.0
March	*14.5*	*9.5*	*11.1*	*7.8*	*6.7*

3. A portion of the decline in real net exports in the first quarter can be attributed to residual seasonality in real exports. Of the 4 percent decline in real exports, we estimate that 1 percentage point stemmed from seasonal variation.

annual rate, slightly less than forecast in the March Greenbook. Foreign output growth is projected to rise to 2-1/4 in the second quarter, nearly 2-1/2 percent in the second half of the year, and nearly 3 percent in 1999 (slightly more than in the March forecast) as economic activity in Japan and later in the rest of Asia begins to recover. We project that the dollar will depreciate a little in real terms against the currencies of the United States' major trading partners on average. The path of the dollar is a bit lower than in the March Greenbook forecast. We continue to expect that the drag from net exports will diminish over time; export growth will pick up and import growth will slow as the effects of the strong dollar wear off and growth rises abroad and slows here. As a result, the negative contribution of net exports to U.S. GDP growth should decline from about 1 percentage point this year (Q4/Q4) to 1/3 percentage point in 1999.

The dollar. We project that the dollar will depreciate 2 percent on balance against the 16 foreign currencies in the staff's new narrow exchange-rate index.[4] Against the yen, the dollar is forecast to remain roughly constant at its recent level of 133 yen per dollar during the forecast period, compared with our previous forecast of a depreciation of the dollar against the yen in 1999. We now expect that support for the yen coming from the growing Japanese and U.S. external imbalances will be offset by disappointment with the lack of sustained progress in restoring health to the Japanese banking system and growth to the economy. Against the mark and the other continental European currencies, the dollar is expected to remain at its current level in the near term and to depreciate somewhat next year. The near-term forecast is based on the netting of two opposing developments. On the one hand, we expect that the prospective euro currencies will benefit from a further unwinding of risk premiums as EMU developments continue on track. On the other hand, we are projecting that those currencies will come under some downward pressure as market expectations for near-term tightening of monetary policy fail to materialize. We assume there will be no policy tightening until next year when the new ECB is expected to raise rates by 50 basis points as activity in Europe continues to pick up.

The dollar's exchange value against the 29 currencies in the staff's new broad exchange-rate index is projected to depreciate about 2-3/4 percent in real terms over the forecast period, as inflation rates move higher in the Asian countries most affected by the crises that erupted last year. We are projecting the Chinese renminbi to be flat

4. These are the major currencies trading on global markets plus those to be linked with the DM in the new euro.

through most of this year, but then to depreciate in nominal terms, in line with a relative increase in China's inflation rate. We assume that the Hong Kong dollar's peg will hold, however. We also see the Mexican peso depreciating this year and next in nominal terms but remaining about unchanged in real terms.

Foreign industrial countries. We estimate that real GDP in the foreign G-7 countries, weighted by shares in U.S. nonagricultural exports, grew at a 1-3/4 percent annual rate on average in the first quarter of 1998, about ½ percentage point less than previously projected because of markdowns for Japan and the United Kingdom. For the balance of 1998, we project that growth will recover to a rate of nearly 3 percent largely because of the effects of fiscal stimulus in Japan. This growth is a bit faster than that in the previous forecast because the magnitude of Japan's fiscal package is greater than we had expected. G-7 growth should settle back to between 2-1/4 percent and 2-1/2 percent in 1999 as the effects of fiscal stimulus in Japan recedes.

Japanese GDP is expected to rebound from a 2 percent annual rate of decline in the first quarter to a rate of increase of nearly 3 percent for the balance of 1998 and then to expand at a 1 percent rate in 1999. This "muddling through" outlook largely follows the contours of the recent fiscal package. It assumes no change in the structural fiscal balance in 1999 relative to 1998 levels; it also assumes that failure to implement either a decisive restoring of health to Japan's banking sector or a significant further deregulation of its nonfinancial sectors will weigh on consumer and business confidence over the forecast period.

Real GDP growth in Germany, France, and Italy is expected to increase to around 2-1/2 percent this year and 3 percent in 1999; the contribution of domestic demand is projected to rise as investment spending is spurred by stimulative monetary conditions and as consumption strengthens with stabilization of the labor market. In contrast, the contribution of net exports diminishes. We expect the pace of activity in the United Kingdom to continue to be restrained over the forecast period by past increases in interest rates and the strength of sterling. Similarly, Canadian growth should slow (but remain above potential rates) in response to the firming of interest rates over the past year.

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, about the same as forecast in March. The drop in inflation between 1997 and 1998 is entirely due to a return to zero measured inflation in Japan with the ending of the transitory effect of the excise tax increase in April 1997. Average inflation for the euro-11 countries is expected to remain a little less than 2 percent, about in line with the rate for Germany. We project U.K. inflation to be in the vicinity of 3 percent in the near term, somewhat above target, but to edge down by late 1999.

Our forecast incorporates the assumption that short-term market interest rates in foreign industrial countries on average will move down during 1998 as rates in several continental European countries, most prominently in Italy, converge to Germany's rates. We project rates elsewhere to remain about unchanged this year--including, contrary to market expectations, in Germany. In 1999, short-term interest rates in euro-11 countries are expected to rise about ½ percentage point as the ECB responds to a further firming of growth. Rates in the United Kingdom should recede somewhat as the economy slows, and rates in Japan and Canada should remain around current levels. With economic slack diminishing in the foreign industrial countries over the forecast period, we anticipate a slight increase in long-term interest rates.

Other countries. The real GDP of major emerging market trading partners of the United States is projected to increase about 1-1/2 percent during 1998, down slightly from our forecast in the March Greenbook. We continue to project about zero growth in the Asian developing economies on average in 1998 (Q4/Q4), including declines of output in Indonesia (6-1/4 percent), Thailand (4-1/4 percent), and Korea (3-1/2 percent). Our view is that volatility in currency and equity markets in these countries is likely to continue in 1998 and that the weaknesses in their financial sectors, along with some tightening of macroeconomic policies, will exert a substantial drag on domestic demand this year that will be only partially offset by improvements in their net exports. We project that growth in these countries will recover somewhat in 1999, but to below-trend rates. Inflation rates in the Asian developing countries are projected to rise significantly in 1998 because of the substantial depreciations of their currencies late last year and early this year; they should begin to recede in 1999.

This scenario for the Asian economies is based in part on the assumption that recent social, political, and labor unrest in Indonesia and Korea does not intensify to the extent that it significantly inhibits their governments' ability to achieve the basic macroeconomic and financial restructuring goals of their IMF programs. The recent escalation of social and political unrest in Indonesia has increased the downside risks to the outlook for Indonesia, with the potential for negative spillovers to other economies in the region.

Our forecast for real GDP growth in Latin America during 1998 has been marked down about ½ percentage point to about 3 percent, reflecting lower growth in Venezuela and Mexico due mainly to lower oil revenues. We project growth in this region to return to above 4 percent in 1999. Inflation in the region should trend down over the forecast period.

Oil prices. The recent weakness in oil prices has led us to mark down the import price $1 per barrel, to just under $13 per barrel for the second quarter. However, we project that the import price will return in the second quarter to nearly $14 per barrel (consistent with a WTI spot price of $16.50 per barrel) for the balance of the forecast period. This projection assumes that OPEC and non-OPEC producers will cut back production sufficiently to offset most of the expected rise in Iraqi exports to as much as 2 mb/d by the end of this year. There is considerable risk to this forecast. If producers cannot sustain the lower rate of production, then spot WTI could fall below $13.00 per barrel in the near term. On the other hand, if Iraqi oil is again withheld from or prevented from coming to the market and other producers restrain output, 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			1999
		Q1	Q2	H2	
Exports					
Nonagricultural (core)	.5	-2.4	-2.0	.7	1.2
Agricultural	-3.1	-16.6	-18.4	2.0	2.0
Imports					
Non-oil (core)	-.7	-3.5	-3.3	.0	1.3
Oil (level, dollars per barrel)	17.70	14.01	12.87	13.94	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 non-oil goods other than computers and semiconductors (core imports) are projected to decline through the third quarter of this year before reversing course and increasing at an annual rate of 1 to 1-1/2 percent thereafter. The outlook for core import prices reflects the recent past and projected path of the dollar's exchange value and the waning of the lagged effects of declines in non-oil commodity prices. This projection is about the same as that in the March Greenbook. Prices of core exports of goods are forecast to decline somewhat further in the current quarter 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 on balance over remainder of the year because of relatively weak growth abroad on average and lagged effects of past appreciation of the dollar. Nevertheless, residual seasonality will yield some quarterly fluctuations in exports.[5] Core export growth should pick up to an annual rate of about 2-3/4 percent during 1999 as foreign GDP growth increases and exchange rate effects diminish. Exports of services should pick up for the same reasons. We also continue to project rapid growth of real exports of computers and semiconductors and a modest pickup of agricultural shipments. Overall, the growth of total exports of goods and services is expected to be about 1-1/4 percent this year (Q4/Q4) and 5 percent in 1999.

Growth of non-oil imports of goods other than computers and semiconductors (core imports) is projected to slow to a rate of 7 percent over the final three quarters of 1998 and 5-3/4 percent in 1999. This path reflects the projected slowing of the U.S. economy and diminishing lagged effects of past dollar appreciation. Relative to the March Greenbook, the level of core imports is slightly higher in the first half of 1998 because of stronger U.S. domestic demand; but beyond the current quarter, real import growth is about the same as we had projected previously. We expect that real imports of computers and semiconductors will grow rapidly, the quantity of imported oil will rise moderately over the forecast period in line with increases in domestic oil consumption, and imports of services will slow in line with total domestic aggregate demand. As a result, total imports of goods and services should grow at a rate of 8 percent over the next three quarters and 7 percent in 1999.

Nominal trade and current account balances. The nominal trade deficit in 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 in 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 almost $300 billion, or 3-1/4 percent of GDP, by the end of 1999.

---

5. Residual seasonal variation tends to depress exports in the first and third quarters and to raise them in the second and fourth quarters.

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

								--Projected--	
Measure and country	1991	1992	1993	1994	1995	1996	1997	1998	1999
REAL GDP									
Canada	-0.3	0.9	3.1	4.5	0.8	2.0	4.2	3.2	2.7
Japan	2.5	0.1	0.5	0.8	2.4	3.4	-0.2	1.6	1.1
United Kingdom	-1.6	0.4	2.7	4.9	2.0	2.9	2.9	1.9	1.9
Euro-11 Average (1)	2.1	0.1	-0.1	3.5	1.5	1.9	2.9	2.7	2.9
of which:									
France	1.4	-0.0	-0.7	4.3	0.3	2.3	3.0	2.5	2.7
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	2.2	2.9
Foreign G-7 Average weighted by 1991 GDP	1.7	0.2	0.6	2.8	1.6	2.3	1.8	2.1	2.2
Average weighted by share of U.S. nonagricultural exports									
Total foreign	3.3	2.3	3.5	5.0	1.9	4.1	4.0	2.1	3.0
Foreign G-7	0.8	0.5	1.9	3.6	1.3	2.3	2.9	2.6	2.3
Developing Countries	6.7	5.2	6.4	7.1	2.6	6.7	5.3	1.3	3.6
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	2.9	2.8
Euro-11 Average (4)	NA	NA	NA	NA	2.7	2.0	1.4	1.8	1.9
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	1.8	2.0
Foreign G-7 Average weighted by 1991 GDP	4.1	2.4	2.5	1.8	1.6	1.5	1.8	1.3	1.3
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 Euro-11, weighted by shares in final consumption of households converted to a common currency using estimated PPP exchange rates.

Strictly Confidential (FR)
Class II FOMC

May 14, 1998

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	2.8	3.6	3.2	3.1	2.8	2.8	2.7	2.7
Japan	8.3	-10.6	3.2	-0.7	-2.1	2.7	3.1	2.7	2.1	0.6	0.9	0.9
United Kingdom	2.1	3.5	3.6	2.5	2.0	1.9	1.9	1.9	1.8	1.9	2.0	2.0
Euro-11 Average (1)	1.5	5.0	3.3	2.0	2.7	2.5	2.8	2.8	2.8	2.8	3.1	3.1
of which:												
France	0.8	4.6	3.5	3.0	2.8	2.5	2.3	2.3	2.6	2.7	2.8	2.8
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	2.3	2.4	2.4	2.5	2.5	3.3	3.3
Foreign G-7 Average weighted by 1991 GDP	3.7	-0.5	3.2	1.0	0.9	2.4	2.6	2.5	2.3	1.9	2.2	2.2
Average weighted by share of U.S. nonagricultural exports												
Total foreign	4.7	4.1	4.7	2.4	1.5	2.2	2.3	2.5	2.7	2.8	3.1	3.2
Foreign G-7	4.4	1.6	3.6	2.0	1.7	3.0	2.9	2.8	2.5	2.2	2.3	2.3
Developing Countries	5.5	7.1	6.2	2.6	0.7	1.1	1.4	2.1	3.0	3.5	3.9	4.1
CONSUMER PRICES (2)												
Canada	2.1	1.6	1.7	1.0	1.0	1.2	1.4	1.6	1.7	1.7	1.8	1.8
Japan	0.0	1.5	1.7	2.1	2.1	0.5	0.0	0.0	-0.1	0.0	0.0	0.0
United Kingdom (3)	2.9	2.6	2.8	2.8	2.5	2.9	2.9	2.9	3.1	3.0	2.9	2.8
Euro-11 Average (4)	1.7	1.2	1.5	1.4	1.2	1.6	1.7	1.8	1.9	1.8	1.9	1.9
of which:												
France	1.5	0.9	1.3	1.2	0.7	1.1	1.3	1.2	1.4	1.5	1.6	1.6
Germany	1.7	1.6	1.9	1.8	1.2	1.8	1.8	1.9	1.9	1.8	1.8	1.8
Italy	2.4	1.6	1.5	1.6	1.7	1.8	1.8	1.8	2.1	2.0	2.0	2.0
Foreign G-7 Average weighted by 1991 GDP	1.4	1.6	1.8	1.8	1.6	1.4	1.2	1.3	1.3	1.3	1.3	1.3
Average weighted by share of U.S. non-oil imports	1.3	1.6	1.8	1.7	1.6	1.1	1.0	1.1	1.1	1.1	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 Euro-11, weighted by shares in final consumption of households converted to a common currency using estimated PPP exchange rates.

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1991	1992	1993	1994	1995	1996	1997	-- Projected -- 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	-0.4
Exports of G&S	0.8	0.4	0.5	1.0	1.1	1.0	1.2	0.1	0.6
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	1.2	5.0
Services	7.1	-0.9	4.1	6.0	9.0	4.7	2.1	1.0	3.0
Agricultural Goods	10.1	10.4	-5.5	16.6	-3.4	5.7	2.5	-4.9	1.0
Computers	21.7	25.2	23.7	32.0	55.7	33.8	48.0	27.8	31.0
Semiconductors	41.8	64.8	32.9	66.9	80.4	45.9	21.4	19.7	31.7
Other Goods 1/	7.0	2.3	3.6	6.9	5.7	7.7	11.6	-1.2	2.7
Imports of G&S	4.1	7.4	10.2	12.3	5.6	11.8	14.4	9.2	7.0
Services	-2.7	1.4	3.2	1.4	7.3	5.0	10.6	4.8	2.7
Oil	8.1	12.1	10.1	-0.2	1.5	8.3	5.5	0.5	2.4
Computers	35.9	45.1	39.3	44.8	46.2	23.6	44.5	36.0	25.7
Semiconductors	55.3	42.0	34.2	54.5	92.7	57.9	32.6	19.9	32.3
Other Goods 2/	2.5	5.4	9.5	12.2	-1.3	10.6	12.9	8.3	5.7
	Billions of chained 1992 dollars								
Net Goods & Services	-22.3	-29.5	-70.2	-104.6	-98.8	-114.4	- 46.5	-235.3	-284.5
Exports of G&S	599.9	639.4	658.2	712.4	791.2	857.0	62.7	989.3	1030.2
Imports of G&S	622.2	669.0	728.4	817.0	890.1	971.5	1 09.2	1224.7	1314.6
	Billions of dollars								
US CURRENT ACCOUNT BALANCE	-5.7	-56.4	-90.8	-133.5	-129.1	-148.2	-166.5	-238.7	-282.0
Net Goods & Services (BOP)	-31.0	-39.2	-72.3	-104.4	-101.9	-111.0	-113.7	-159.6	-195.9
Exports of G&S (BOP)	581.2	617.5	643.5	699.6	794.6	848.8	931.4	930.9	963.4
Imports of G&S (BOP)	612.2	656.7	715.8	804.1	896.5	959.9	1045.1	1090.6	1159.2
Net Investment Income	20.3	18.0	19.7	9.7	6.8	2.8	-14.3	-37.3	-44.4
Direct, Net	55.6	51.6	55.7	50.8	60.0	66.8	67.7	54.8	61.2
Portfolio, Net	-35.4	-33.6	-36.0	-41.0	-53.2	-63.9	-82.0	-92.1	-105.7
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.

Strictly Confidential (FR)
Class II FOMC

May 14, 1998

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, SAAR												
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, SAAR												
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.

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1997 Q1	1997 Q2	1997 Q3	1997 Q4	Projected 1998 Q1	Projected 1998 Q2	Projected 1998 Q3	Projected 1998 Q4	Projected 1999 Q1	Projected 1999 Q2	Projected 1999 Q3	Projected 1999 Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-1.0	-0.4	-1.3	0.3	-2.2	-0.8	-1.2	0.1	-0.7	-0.3	-0.8	0.4
Exports of G&S	1.1	2.0	0.5	1.0	-0.5	0.3	-0.2	1.0	0.2	0.8	0.2	1.1
Imports of G&S	-2.1	-2.5	-1.8	-0.7	-1.7	-1.0	-1.1	-0.9	-0.9	-1.1	-0.9	-0.7
Percentage change from previous period, SAAR												
Exports of G&S	9.9	18.4	4.4	8.3	-4.3	2.2	-1.5	9.0	1.6	7.0	1.5	10.2
Services	3.7	3.2	7.2	-5.1	0.8	-0.8	1.5	2.6	2.9	3.0	3.0	2.9
Agricultural Goods	-27.6	-4.2	20.6	31.9	-23.4	-12.8	4.2	17.6	-3.9	-3.9	8.4	4.1
Computers	72.3	84.3	61.5	-6.5	14.0	31.1	33.5	33.5	31.0	31.0	31.0	31.0
Semiconductors	39.0	15.7	38.8	-2.6	2.1	21.5	27.4	29.9	31.1	31.6	32.1	32.3
Other Goods 1/	12.4	25.0	-4.6	15.7	-6.5	2.0	-7.6	8.2	-2.6	6.7	-4.1	11.5
Imports of G&S	17.9	20.5	14.6	5.3	13.8	8.0	8.5	6.7	6.7	8.5	7.2	5.6
Services	24.2	8.9	10.1	0.3	18.6	-2.3	2.3	1.6	2.6	2.6	2.7	2.8
Oil	-10.8	44.5	6.3	-9.5	-7.0	18.9	4.1	-11.3	-9.4	36.2	8.5	-17.9
Computers	51.3	71.1	53.0	10.0	46.4	38.6	31.1	28.7	27.4	25.1	25.1	25.1
Semiconductors	71.2	19.3	44.3	5.0	-4.7	28.6	28.6	31.1	32.3	32.3	32.3	32.3
Other Goods 2/	15.3	17.1	11.8	7.6	13.0	6.5	7.6	6.4	6.1	5.8	5.5	5.4
Billions of chained 1992 dollars, SAAR												
Net Goods & Services	-126.3	-136.6	-164.1	-159.1	-208.0	-225.7	-254.4	-253.3	-269.9	-279.0	-298.0	-291.0
Exports of G&S	922.7	962.5	973.0	992.7	981.7	987.2	983.6	1004.9	1008.9	1026.2	1030.1	1055.4
Imports of G&S	1048.9	1099.1	1137.1	1151.8	1189.7	1212.9	1238.0	1258.1	1278.8	1305.3	1328.1	1346.4
Billions of dollars, SAAR												
US CURRENT ACCOUNT BALANCE	-159.7	-151.2	-172.5	-182.6	-212.2	-224.2	-253.8	-264.6	-265.2	-273.5	-292.1	-297.4
Net Goods & Services (BOP)	-117.3	-102.7	-119.6	-115.1	-141.6	-149.3	-175.7	-172.0	-185.0	-191.5	-207.8	-199.1
Exports of G&S (BOP)	896.3	938.2	938.6	952.3	933.6	927.0	921.8	941.3	944.5	960.2	962.8	986.0
Imports of G&S (BOP)	1013.6	1040.9	1058.2	1067.4	1075.3	1076.3	1097.4	1113.3	1129.5	1151.7	1170.6	1185.1
Net Investment Income	-8.1	-13.1	-16.5	-19.4	-31.6	-35.9	-39.2	-42.6	-41.2	-43.0	-45.2	-48.3
Direct, Net	69.3	70.9	66.1	64.5	56.7	54.5	54.2	53.8	58.5	60.3	62.3	63.8
Portfolio, Net	-77.4	-84.0	-82.6	-83.9	-88.2	-90.5	-93.3	-96.4	-99.7	-103.3	-107.5	-112.1
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.

Strictly Confidential (FR)
Class II FOMC

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF RESEARCH AND STATISTICS

Date: May 15, 1998

To: Federal Open Market Committee

From: Division of Research and Statistics

Subject: Greenbook Erratum

On page 14 of Part I of the Greenbook, the final sentence in footnote 3 should read: Adjusted for changes in CPI methodology, trend real GDP growth is now estimated at 2.6 percent in 1997 and 1998 and 2.7 percent in 1999.