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Part 1

August 18, 1999

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

August 18, 1999

SUMMARY AND OUTLOOK

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Domestic Developments

The developments of the past couple of months have contained hints that the economy might be encountering, as the *Wall Street Journal* recently put it, some "growing pains" after a remarkable run. The BEA's advance estimate of second-quarter GDP came in lower than generally anticipated, while tight labor markets seem to be generating increases in pay rates beyond what businesses perhaps can be expected to offset in greater productivity. With Chairman Greenspan having emphasized in his Humphrey-Hawkins testimony that the Fed should attempt to deal preemptively with inflationary pressures, the fixed-income markets have reversed the rally that followed the June 30 announcement that although the funds rate was being raised, the FOMC had no predilection toward further hikes.

But fundamental economic concerns and monetary policy fears are not the only factors that have weighed on these markets in the past few weeks. Participants evidently have been suffering from a bout of Y2K jitters, with many borrowers rushing to issue bonds on the assumption that dealers and institutions will retreat to more conservative positions as the year draws to a close. However, with memories of the 1998 liquidity crisis still fresh, the depth of the markets has been limited, and a variety of rate spreads have widened markedly in response to the current and expected supply. Even rates on high-grade corporates and home mortgages have suffered, moving up sharply to levels not seen in two years. In these circumstances, only a considerable upside surprise in second-quarter earnings reports has held share prices within hailing distance of the record highs registered in mid-July. And with many foreign economies beginning to look healthier, the dollar has turned weaker--exacerbating concerns about domestic inflation and interest rate pressures.

While recent developments on the external side point to some greater improvement in net exports in coming quarters, the backup in intermediate- and long-term interest rates--unless reversed soon--suggests a less buoyant outlook for domestic demand than contemplated in the last Greenbook. We do anticipate that the recent liquidity tensions will largely dissipate once the century date change is behind us, but the declines in interest rates are expected to be limited by a further moderate firming of monetary policy. On that assumption, the output path in our current projection is little changed from that last time, with real GDP increasing at an annual rate of 3-3/4 percent over the second half of 1999 and 2-3/4 percent in 2000. As before, the unemployment rate is expected to remain in the vicinity of 4-1/4 percent.

Although the projected levels of resource utilization are essentially the same as last time, we have elevated our inflation forecast a little. This change reflects not only the upside surprises on the wage front of late but also indications that somewhat greater pressures may be in train from materials costs and lessened restraint on import prices. All told, we still expect the core CPI to rise a touch more than 2 percent in 1999, while the surge in energy prices helps to lift total CPI inflation to 2-1/2 percent. Assuming that energy prices ease next year, we expect overall CPI inflation to drop to 2-1/4 percent even as core inflation moves above 2-1/2 percent. Once again, we would note that an extension of our forecast beyond 2000 would show a further escalation of inflation.

Key Background Factors

In light of this more inflationary tilt, we have assumed a notch more firming of money market conditions than in our last forecast. Nonetheless, the increase in the federal funds rate is less than forward rates would suggest that markets currently are anticipating--although the reading of market expectations is more problematic right now because of the extra liquidity premiums that seem to be built into yields. In any event, we are not projecting any sustained or substantial departures of longer-term Treasury rates from the range of recent weeks. And, foreseeing a significant reversal of the spread widening that has occurred of late, we expect that private long-term rates next year will generally be somewhat lower than they are now.

Equity prices have exhibited considerable volatility since late June but, on balance, they are now close to the level in our last projection. As before, we think that Y2K anxieties may lead to some further shakiness in the latter part of this year, but we have anticipated only modest fluctuations around an essentially flat trend line through 2000. Given our forecast for profits, the sustained high price-earnings multiples that are implied by our path for share prices suggest an ongoing vulnerability to a major downturn if investors were to lose some of their remarkable exuberance.

On the fiscal front, the appropriations legislation now making its way through the Congress implies higher federal spending than we assumed in the June Greenbook. We have increased discretionary outlays $20 billion in fiscal 2000, including $7 billion for agricultural subsidies, $5 billion for national defense, and $9 billion for a variety of other programs. If the entire $20 billion is given the "emergency" designation, emergency spending in fiscal 2000 would total $32 billion (including the supplemental appropriations that were passed in late 1998 and early 1999). We have not incorporated any tax changes at this time: President Clinton has promised to veto the tax cut bill passed by the Congress, and our assumed spending package would more than use up the $14 billion surplus in the on-budget accounts that CBO is now projecting under current policies for fiscal 2000.

In sum, we expect the unified budget to register surpluses of $124 billion in fiscal 1999 and $167 billion in fiscal 2000; the on-budget accounts are expected to show a small deficit in fiscal 1999 and a $17 billion surplus in fiscal 2000.

Our projection for the surplus in 1999 is about the same as the one CBO released on July 1, but our number for 2000 is about $25 billion higher, after taking account of the differences in policy assumptions.

As regards the external sector, we have raised our forecast for growth abroad, with foreign GDP now expected to rise 3 percent over the forecast period. The revision of about 1/2 percentage point per year on average is concentrated in the developing Asian nations (except China) where recent growth has been considerably stronger than anticipated and the downside risks seem to be diminishing; prospects for growth in Europe and Mexico also look a little better than they did in June. As noted, the dollar has depreciated slightly, on net, since the last Greenbook; a considerable slippage against the euro and the yen having been largely offset by an appreciation against the currencies of several emerging market economies. Looking ahead, we expect the inflation-adjusted value of the dollar against a broad range of currencies to edge down over the forecast period, consistent with the decline in U.S. growth relative to that of our trading partners and the large and growing U.S. current account deficit.

Crude oil prices are running about $3 per barrel above the June Greenbook path, mainly because OPEC has been more successful in restraining production than we had anticipated. The spot price of WTI is currently about $21.50 per barrel and is expected to change little through year-end as OPEC maintains production around current levels and the oil companies build a little extra inventory in anticipation of possible Y2K demands. The WTI price is still projected to drift down next year as supply pressures ease, but our current projection for the fourth quarter of 2000--$18.50 per barrel--is $1 higher than we had anticipated in June, the result of both lower production and stronger global demand.

The Current Quarter

According to the advance release, real GDP growth slowed to an annual rate of 2.3 percent in the second quarter, held down in part by a sharp drop in the rate of inventory investment. Based on the information that has come in since that report, we estimate that real GDP growth will be revised down a few tenths, mainly because inventory investment appears to have been even less than the BEA had assumed; the BEA may also make a small downward adjustment to consumer spending. (The monthly source data for the domestic spending categories are now complete, apart from future revisions, but the June figures for merchandise trade will not be released until August 19.)

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

Measure	1999:Q2 June GB	1999:Q2 BEA[1]	1999:Q2 Aug. GB	1999:Q3 June GB	1999:Q3 Aug. GB
Real GDP	**2.9**	**2.3**	**1.9**	**3.5**	**3.5**
Private domestic final purchases	5.6	4.9	4.8	3.7	3.2
Personal consumption expenditures	4.4	4.0	3.8	3.9	3.6
Residential investment	2.1	5.1	8.0	-1.5	-4.8
Business fixed investment	15.2	10.8	10.4	4.9	4.5
Government outlays for consumption and investment	-1.4	-1.2	-1.7	3.1	2.8
	Change, billions of chained (1992) dollars				
Inventory investment	-8.6	-19.4	-23.8	24.3	23.8
Net exports	-27.8	-19.4	-20.9	-32.2	-22.0

1. Advance release, published on July 29.

We have only a few data for the current quarter. We are projecting that real GDP will increase at around a 3-1/2 percent annual rate, the same as in the June Greenbook. That outcome would be broadly consistent with the labor market results for July, after taking account of both the sizable increase in aggregate hours and the flat unemployment rate. Industrial production rose 3/4 percent in July after a weak June and is projected to rise at an annual rate of nearly 5 percent for the quarter as a whole.

Growth in private domestic final sales slowed somewhat in the second quarter, and our forecast is for a further slowing in the current quarter--to an annual rate of 3-1/4 percent. One reason is that consumer spending seems to have decelerated after having soared earlier in the year. Unit sales of new light vehicles (adjusting for shifts in reporting periods) were a sizzling 16-3/4 million units (annual rate) in July, but that only matched the pace of the second quarter. Moreover, the advance report on retail sales indicated that real outlays for non-automotive consumer goods were about unchanged last month at a level less than 1/2 percent above the second-quarter average. We expect stronger retail sales figures in the next couple of monthly reports, given the buoyant consumer sentiment and positive fundamentals; in addition, heavy air conditioning use should give an extra boost to the services component of spending. Even so, real PCE seems likely to grow a touch less this quarter than last.

Residential investment should weaken substantially this quarter. We expect that sales transactions will fall off in the coming months, as the higher cost of mortgage finance bites. Starts on an unadjusted basis should hold up better than seasonally as builders work on a backlog of projects that have been delayed by short supplies of labor and materials. The 4-1/2 percent rebound in seasonally adjusted single-family starts last month, to 1.33 million units (annual rate), actually involved an appreciable decline in unadjusted starts. Nonetheless, the drop-off in seasonally adjusted starts during the spring will translate into a decline in real construction outlays, as estimated by the BEA, in the third quarter.

Outlays for business investment probably will rise only moderately after having surged in the second quarter. Recent softness in nominal computer orders and shipments suggests that growth in spending for such equipment may be slowing somewhat--perhaps the result of the Y2K considerations we have been citing. Weak trends in orders for industrial, agricultural, and construction equipment would seem to presage subdued shipments in those categories, and outlays for motor vehicles are unlikely to match their spectacular second-quarter level. Meanwhile, outlays for nonresidential construction may slip further, dragged down especially by the ongoing contraction of industrial building.

In the government sector, real federal purchases should rise slightly this quarter, mainly because of a spurt in defense outlays related to operations in the Balkans. An appreciable gain in state and local spending also seems likely: Employment continued to rise through July, and construction outlays appear poised to resume an uptrend after the weather-induced gyrations of the first half.

Prospects for the external sector seem a little more favorable than we anticipated in June, mainly because the stronger growth abroad bodes well for U.S. exports. Nonetheless, with no reason to think that the steep rise in imports will abate in the near term, we still expect the ongoing drop in real net exports to shave, all else equal, nearly a percentage point from real GDP growth this quarter.

In contrast to the slowing in final sales, we expect inventory investment to pick up considerably this quarter--indeed, enough to add more than a percentage point to real GDP growth. Admittedly, although inventory-sales ratios have plummeted over the past few quarters, there is little anecdotal evidence that businesses are dissatisfied with their stock levels--and the orders information for recent months does not indicate that a major inventory building effort is under way. Under the circumstances, we have trimmed the level of stock accumulation considerably relative to our last forecast, but--starting from the much lower second-quarter pace--the swing is essentially the same.

We now expect the total CPI to increase at an annual rate of 2-1/2 percent in the current quarter, 3/4 percentage point above our previous projection. The revision is accounted for by energy prices, which rose 2 percent in July, and, judging from surveys of gasoline prices, are increasing about as fast in August. Our forecast of core CPI inflation is 1-3/4 percent, a little less than in the June Greenbook. As for hourly compensation, we expect the ECI to rise at an annual rate of 3-1/2 percent this quarter, slightly above the trend of the past year; we have only a little information on wages this quarter, but the recent increases in average hourly earnings have been on the high side.

The Outlook for Economic Activity beyond the Current Quarter
Our forecast shows real GDP growth running a little more than 3 percent per year, on average, between now and the end of 2000.[1] As in our previous forecasts, domestic final demand is expected to decelerate appreciably, mainly reflecting our assumption that the surge in stock prices is behind us; some additional restraint is expected to come from the rise in longer-term interest rates this year. At the same time, we continue to anticipate some offset to the slowing in domestic final demand from a lessening of the drag from net exports and a pickup in the rate of inventory investment. The basic story of the inflation forecast also is the same as in the June Greenbook, although, as noted, we have raised the projection a little, mainly to take account of recent developments in commodities markets and some indications that the pressures on wages may be somewhat greater than we had thought.

Consumer spending. We have made only small changes to the projection for consumer spending beyond the current quarter. We still expect real PCE to rise at an annual rate of about 4-1/2 percent in the fourth quarter (about 4 percent excluding Y2K-related purchases) and 3-1/4 percent in 2000. As has been true for some time, our projection hinges on the waning of the wealth effect, which should evaporate by early next year, given the behavior of the stock market over

1. The quarterly pattern of real GDP growth exhibits considerable bumpiness, mainly because of our assumed Y2K effects. These effects, which are the same as in the June Greenbook, include a little precautionary stocking by consumers and businesses in the third and especially the fourth quarters and a slowing in computer purchases toward the end of the year. We also have assumed some minor disruptions of activity in early 2000 as computer glitches surface. Excluding Y2K considerations, we expect real GDP to rise 3.3 percent in the third quarter of 1999, 3.5 percent in the fourth quarter of 1999, 2.9 percent in the first quarter of 2000, 2.9 percent in the second quarter of 2000, and 2.9 percent in the third quarter of 2000. The Y2K-adjusted four-quarter changes in real GDP would be 3.3 percent in 1999 and 3.0 percent in 2000. (We also think that concerns about Y2K provided enough of a boost to spending on computers in 1998 to have added about 0.1 percentage point to that year's growth in real GDP.)

Projections of Real GDP
(Percent change, compound annual rate)

Measure	1999:H1	1999:H2	2000
Real GDP	**3.1**	**3.8**	**2.8**
Previous	3.7	3.6	2.6
Final sales	3.8	2.8	2.9
Previous	4.1	2.7	2.8
PCE	5.2	4.1	3.3
Previous	5.6	4.1	3.3
Residential investment	11.6	-4.3	-3.4
Previous	8.8	.4	-3.9
BFI	9.4	4.1	7.4
Previous	11.7	3.6	7.5
Government purchases	1.2	2.6	2.7
Previous	1.5	2.1	2.2
Exports	-.8	6.0	5.3
Previous	-1.3	3.8	4.7
Imports	11.5	10.0	7.7
Previous	11.8	9.8	7.6
	Change, billions of chained (1992) dollars		
Inventory change	-14.6	20.3	-12.5
Previous	-7.2	18.4	-12.5
Net exports	-37.3	-17.7	-52.6
Previous	-39.6	-22.6	-58.2

the past few quarters and our projection of essentially flat stock prices from here on. Moreover, the wave of mortgage refinancings--which, we suspect, provided extra impetus to consumption earlier this year--has ended as mortgage rates have climbed. The personal saving rate is expected to bounce around over the next year and a half, in part because of Y2K effects, but to remain around the level of the second quarter of 1999 (that is, about -1 percent on the current NIPA definition).[2]

2. This fall, in the benchmark revision of the NIPA, government retirement plans will be included in the personal saving figures, as private plans have long been treated; this should add about 1-3/4 percentage points to the level of the saving rate in 1998, although other changes to the income and expenditure data could obscure the effect.

One remarkable aspect of consumption lately has been the sustained strength in light vehicle sales, which has prompted us to revise up our forecast again. Although the growth of the stock of vehicles may have been tempered by a pickup in the rate at which old vehicles are being scrapped, demand seems unlikely to hold at the recent pace without a considerable further escalation of household wealth. Moreover, we expect the automakers to shift their focus a bit from market share to profits, so that promotional efforts may diminish and effective prices may firm. All told, we expect the pace of sales to drop over the remainder of the year and run a bit above 15-1/2 million units in 2000. In general, a deceleration in outlays on consumer durables would appear to be in store, after the steep run-up to high levels in recent years.

Residential investment. We have trimmed the housing forecast to reflect the higher mortgage rates in the current Greenbook. The decline in starts should be gradual, however, in part because this year's shortages of skilled labor and materials have resulted in backlogs that should help buoy construction in the near term. Moreover, employment and income conditions should generally remain supportive of demand. And given our assumption that at least some of the recent spike in mortgage rates will be reversed by early next year, homes are likely to remain fairly affordable--barring a greater surge in home prices than we have seen to date. We now expect single-family starts to average 1.31 million units (annual rate) in the second half of 1999 before slipping to 1.27 million units next year.

Constraints on the availability of labor and materials evidently have produced some backlog of projects in the multifamily sector as well. But we still expect multifamily starts to edge lower through the end of next year. With many people moving into single-family residences, the need for additional multifamily units likely is diminishing in many locales--and lenders probably will be increasingly sensitive to signs of excess supply, adding to the financial restraint associated with the higher interest rates.

Business fixed investment. Real business fixed investment appears to be decelerating appreciably in the current quarter, and we expect it to remain on a slower growth track into early next year, in part because of a Y2K-related lull in computer purchases. Investment is expected to regain some momentum thereafter as computer purchases re-accelerate. On average, real BFI is expected to rise about 6-1/2 percent per year between mid-1999 and the end of 2000, only a little more than half the pace of the preceding year and a half. The reasons for this slowing are familiar: the deceleration in business output, the less favorable financial conditions, and weakening profitability--all at a time when the capital stock (particularly of equipment) is already expanding rapidly.

We shall not belabor our story of how we expect preparations for the century date change to affect computer expenditures. Suffice it to say that, while this remains a decidedly uncertain element in our forecast, nothing has happened during the intermeeting period to alter our thinking--aside from the aforementioned recent downturn in computer orders and shipments, which has led us to accentuate the near-term deceleration in real outlays a bit. Advances in technology and declines in prices continue to be dramatic, and they underpin our expectation that real computer investment will be very strong, on average, over the projection period. The same can be said for communications equipment, as the rapidly evolving market for voice and data transmission services drives huge increments in outlays through 2000.

We anticipate a considerable slackening in outlays for transportation equipment over the projection period. The backlog of orders for medium and heavy trucks appears to be sufficient to a sustain a hefty pace of production in the near term, but we expect to see a substantial decline in vehicle shipments as the economic expansion remains more moderate. And, given Boeing's schedules, deliveries of planes to domestic carriers almost certainly will drop significantly next year.

Outside the IT and transportation categories, demand for equipment has been notably soft over the past year, in part because manufacturers have sought to avoid a greater buildup of excess capacity as world economic growth has fallen well short of trends prevailing before the Asian shock. Looking ahead, the strengthening of world demand now under way and the need to stay current technologically should produce a moderate pickup in investment in industrial machinery. A bottoming out of the recent slump in spending for farm and construction equipment also seems a reasonable prospect.

Our forecast for investment in nonresidential structures remains essentially flat through the end of next year. Consolidation in heavy manufacturing no doubt will continue to depress industrial construction during this period. In the commercial sector, property values and space-rents continued to move up through the first quarter, but contracts for new construction have fallen sharply. Credit generally remains available for commercial projects, although at higher interest rates than we had foreseen in the June Greenbook.

Business inventories. Nonfarm inventory investment has fallen well short of our expectations in recent quarters, and the aggregate inventory-sales ratio has plunged. The strength of sales over this period must have caught at least some firms by surprise and left them with unexpectedly lean stocks. But there is a noticeable absence of reports of concern about potential stock-outs, and it may be that the adoption of better inventory management techniques has enabled firms to lower their target inventory-sales ratios more rapidly then we had anticipated. On this interpretation of the recent behavior, we are projecting a relatively flat overall inventory-sales ratio through the end of next year, in contrast to the upward drift in the ratio that characterized our past forecasts. Nonetheless, even a return to levels of investment that would stabilize the ratio implies a swing at some point to a positive GDP contribution from this component of expenditure. In our projection, that swing occurs in the second half of this year, exaggerated for a time by Y2K hedging. But, as always, this is a highly uncertain element of the forecast.

Movements in farm inventories have negligible effects on forecast GDP growth in 1999 and 2000. Taken at face value, the USDA's August crop report would have led us to raise our forecast of farm inventory accumulation to some degree. However, crop conditions in the Midwest have been reflecting increased drought damage in the first half of August, and we therefore expect the USDA production estimates to be revised down somewhat in September. We have nudged down our forecast of farm inventory investment as well. Even so, farm stocks seem likely to remain at levels that are ample to excessive in the coming year.

Government spending. Reflecting the change to our fiscal assumption, we have raised our forecast of real federal expenditures on consumption and gross investment. Nondefense purchases are now expected to rise 2-1/2 percent in real terms in 1999 and 1 percent in 2000; the June Greenbook had shown no net change in these programs over the two years. Real defense spending is now expected to be about flat over the four quarters of 2000, after having fallen nearly 2-1/2 percent in 1999.

Real purchases by state and local governments are expected to rise at a annual rate of 3-1/2 percent in the second half of 1999 and nearly 4 percent in 2000. The increases would be more than a percentage point larger, on average, than those of the past three years. However, some pickup seems likely in light of the continuing hefty revenue inflows to these governments and the exceptionally strong financial condition of the sector as a whole.

External sector. In response to the firming of economic activity abroad, we have raised the projection for growth of real exports between mid-1999 and the end of 2000 to an annual rate of 5-1/2 percent. With little change to the outlook for imports, the negative contribution of net exports to real GDP growth now amounts to about 3/4 percentage point, on average, in the second half of this year and 1/2 percentage point in 2000, well below the figures for the past year and a half. (A more detailed discussion of the outlook for net exports is contained in the international developments section.)

Labor markets. We have made only modest changes to our projection of labor productivity growth despite the sharp slowing registered in the second quarter. That drop-off followed a string of sizable increases and coincided with a marked deceleration in output. We expect productivity to post another relatively small increase in the current quarter, but to resume a faster pace of growth in the fourth quarter. On average, we expect productivity to rise about 2 percent per year between mid-1999 and the end of 2000; this would be about 1/2 percentage point below the average gain over the preceding six quarters. Firms surely will continue to seek efficiency gains through capital deepening and innovative uses of technology; however, productivity will no longer be getting a lift from output growth that not only is above trend but also is above many prevailing expectations (as we believe has been the case in the past couple of years).

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

Measure	1998	1999	2000
Output per hour, nonfarm business	2.6	1.9	2.2
Previous	2.7	2.4	1.9
Nonfarm payroll employment	2.4	2.1	1.2
Previous	2.4	2.0	1.3
Household employment survey	1.3	1.5	.9
Previous	1.3	1.6	1.0
Labor force participation rate[1]	67.1	67.2	67.1
Previous	67.1	67.2	67.2
Civilian unemployment rate[1]	4.4	4.2	4.3
Previous	4.4	4.1	4.2

1. Percent, average for the fourth quarter.

Indeed, we expect that employers may not wish to cut back payroll growth commensurately with the deceleration of output in the near term. We continue to hear that firms have intensified their efforts to fill the many jobs that have gone vacant for a while--in some cases offering higher pay especially, but not exclusively, to individuals with special skills. We anticipate that, as a result, payrolls will grow somewhere around 200,000 per month, on average, over the remainder of the year. In 2000, with firms having caught up to some degree in their hiring, payroll growth is projected to slow to about 130,000 per month, on average.

Despite the strong demand for workers over the past few years, the labor force participation rate has essentially moved sideways; we assume that it will stay within this narrow range through the end of next year. Thus, given the outlook for labor demand, we expect the unemployment rate to remain around 4-1/4 percent.

Prices and wages. The leitmotif of the inflation forecast is the same as that in the June Greenbook--namely, with labor markets expected to remain extremely tight and import prices turning up, wages and prices are likely to show some tendency to accelerate. And in light of the less favorable tone of the recent readings on wages and the adverse developments in the markets for energy and industrial materials, we have nudged up the projected inflation rates.

The employment cost index for private industry rose at an annual rate of 4-1/2 percent in the second quarter; this rebound from the first quarter's implausibly low number was larger than we had anticipated and brought the four-quarter change to 3-1/4 percent. Arguably, much of the error in our second-quarter ECI forecast may reflect merely an inaccurate guess on timing; after all, our assumption in the last Greenbook, that the make-up for the first-quarter "shortfall" would be spread over the remainder of the year, was rather arbitrary. But other pay indicators, including the measure of compensation per hour in the productivity and cost (P&C) release for the second quarter and the readings on average hourly earnings through July, have also been on the high side of our expectations. And, in light of the upward revisions to our price forecast, the pressures for cost-of-living catch-ups will be a tad greater over the projection period. Finally, we have delayed the first stage of our assumed increase in the minimum wage from October to January--a change that shifts a tenth from this year's ECI forecast to next year's.[3] On balance, we still expect ECI compensation to rise 3-1/4 percent in 1999. But by next year, with labor markets remaining very tight, the minimum wage rising, and price inflation having turned up in 1999, the ECI is expected to be increase 3-3/4 percent-- 1/4 percentage point more than we anticipated in the June Greenbook.

3. In the June Greenbook, we assumed that the minimum wage would go up by $1 in three equal steps, the first in October of this year, the second next October, and the third in October of 2001. We have retained our assumption of a $1 hike, but given the lack of movement in the Congress on this issue, we now expect the minimum wage to rise 50 cents per hour in January of 2000 and another 50 cents in January of 2001. Under our new assumptions, the rise in the minimum wage has no effect in 1999 but is expected to boost the ECI by 0.2 percentage point in 2000.

Inflation Projections

(Percent change, Q4 to Q4, except as noted)

Measure	1998	1999	2000
Consumer price index	1.5	2.6	2.3
Previous	1.5	2.3	2.3
Food	2.2	2.0	2.3
Previous	2.2	1.9	2.1
Energy	-9.2	9.9	-1.7
Previous	-9.2	6.3	.8
Excluding food and energy	2.4	2.1	2.6
Previous	2.4	2.1	2.5
PCE chain-weighted price index	.8	1.9	1.9
Previous	.8	1.6	1.8
Excluding food and energy	1.2	1.4	2.0
Previous	1.2	1.4	1.8
GDP chain-weighted price index	.9	1.5	1.9
Previous	.9	1.5	1.7
ECI for compensation of private industry workers[1]	3.5	3.3	3.8
Previous	3.5	3.3	3.6
Prices of core non-oil merchandise imports	-2.1	.4	1.8
Previous	-2.1	-.3	1.6
	Percentage points		
MEMO: *Adjustments for technical changes to the CPI*[2]			
Core CPI	-.2	.0	.0

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

The P&C measure of hourly compensation in the nonfarm business sector increased 4-1/4 percent over the past four quarters, according to the published data.[4] This measure and the ECI may diverge for several reasons, including mix shifts and coverage differences, and frequently have done so. The recent divergence may be occurring in part because the P&C measure includes--albeit, imperfectly--compensation in the form of stock options whereas the ECI by design does not. The P&C measure, which follows the NIPA accounting conventions, includes the value of stock options when they are exercised, and this has been a sizable quantity in recent years. While it is unclear how deferred compensation in general--and this kind in particular--should be treated analytically, we strongly suspect that the P&C measure is overstating the extent of labor cost pressures on pricing while the ECI, which excludes options and most other equity considerations entirely, is probably understating them.[5]

On the price side of the ledger, we are now projecting that retail energy prices will rise at an annual rate of about 9 percent, on average, in the second half of 1999 before easing a bit in 2000. In the June Greenbook, we had anticipated that retail energy prices would rise only moderately, on net, in the second half of 1999 and edge up further in 2000.

We are predicting increases in consumer food prices of 2 percent in 1999 and 2-1/4 percent in 2000; these forecasts are slightly higher than last time. Recent indications that the drought will bring a slightly less favorable supply-demand balance in crude food markets are one factor in this adjustment. In addition, given the heavy weight of processing and distribution expenses, the changes in the labor and energy cost picture are a consideration. The fact is that only in circumstances of extreme fluctuations in commodity prices do CPI food prices deviate markedly from the rate of core inflation--even the sizable farm price declines over the past couple of years have not been great enough to produce a marked deviation.

Although the incoming data for the core CPI have remained tame, we have edged up the forecast. The change mainly reflects the higher labor costs now projected and the indirect effects of the higher energy prices. In addition, we have raised the projection for prices of imports, and prices of intermediate

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4. As is discussed in Part II of the Greenbook, we expect a substantial upward revision to the increase in hourly compensation for 1998. Once this revision is made, we expect P&C compensation to show a pattern of gradual deceleration over the past year or so similar to the one indicated by the ECI, presumably reflecting the petering out of the effects of the previous hike in the minimum wage and the restraining effect of good inflation news on wage demands.

5. Our crude estimates, which are based on information from financial statements of a small sample of firms, suggest that, had the value of stock option grants been included in the ECI, that measure of compensation would have increased about 1/4 percentage point per year faster, on average, over the past four years. Including the value of stock options at exercise would have added an average of about 3/4 percentage point per year.

materials are running higher than we had anticipated. Past patterns suggest that the increases in materials prices will be passed through to the consumer level quickly, but that their effect is likely to be limited by the ample margins of unused capacity in the manufacturing sector.

The CPI is not alone in signaling a pickup in overall inflation this year: Broad NIPA-based measures of inflation also have turned upward. For core consumer prices, however, the picture remains somewhat ambiguous: The rate of increase in the core CPI over the first half of this year was somewhat smaller than that over 1998 as a whole while core PCE prices accelerated a bit--narrowing the extraordinarily wide gap that emerged between the two last year.

Money and Credit Flows

Growth of domestic nonfinancial sector debt has decelerated in line with our expectations. The slowdown reflects some moderation in borrowing by businesses and households while the federal government has continued to pay down its debt with the proceeds from budget surpluses. Overall debt growth is projected to decline further, on balance, over the forecast period, as private credit demands ebb along with the downshift in the pace of economic expansion and as paydowns of federal debt strengthen, on net. Over the next several months, however, credit flows and interest rate relationships could be noticeably distorted by shifts in behavior in anticipation of the century date change.

In the business sector, total borrowing has been sizable so far in the third quarter. Business credit needs are projected to remain substantial over the second half of the year, as capital expenditures continue to expand rapidly while growth of internal funds languishes and equity retirements are buoyed by brisk merger activity. Next year, we expect some abatement in share repurchases and merger-related equity retirements, but business borrowing will remain substantial, to fund a growing financing gap.

Corporate credit demands recently have been focused particularly on the bond market, as firms have attempted to lock in fixed-rate financing in view of expectations of a rise in interest rates and potential market disruptions associated with the century date change. Partly reflecting recent heavy issuance, corporate yield spreads over Treasuries have widened, as have spreads in the interest-rate swap market, which in recent years has been used increasingly heavily by debt issuers and dealers as a hedge vehicle. The widening reportedly has not been driven primarily by credit concerns. Still, in our view, some worsening of credit quality over the forecast period is likely, given the prospective pressures on profits and cash flows.

Household debt growth is forecast to edge lower this year and next, as residential investment falls off and the expansion of spending on durables slows. Nonetheless, debt growth is expected to outpace gains in personal income. Given the implied increase in debt-income ratios, and with interest rates on the stock of household debt projected to rise in response to climbing market rates, debt-service burdens are projected to increase. The resulting deterioration in credit quality could trigger a modest tightening in terms and standards on loans to households.

The expansion of state and local government debt is expected to remain moderate. Infrastructure spending will require a considerable amount of bond issuance, but the anticipated level of interest rates suggests that advance refundings will remain relatively light. Given the positive fiscal outlook for most states and localities, credit quality should not become an issue in this sector during the forecast period.

In the federal sector, the runoff of Treasury debt is projected to steepen as the budget surplus widens. Over the next six quarters, federal debt in the hands of the public is forecast by the staff to decline more than $200 billion. To address the market liquidity problems arising as a consequence of this shrinking supply, the Treasury recently announced that it would issue long-term bonds less frequently and said that it was considering reducing the frequency of certain other issues as well. It also released for public comment plans to buy back some of its debt. By purchasing older, "off-the-run" issues, which require a yield premium, and financing those purchases with new issues, which are more actively traded and therefore trade at lower yields, the Treasury hopes to reduce its overall interest cost. To avoid the need to implement new systems in the next few months, however, the Treasury would not begin its buy-backs until some time next year. With supplies of on-the-run issues still limited over the rest of the year and demands for the liquidity of on-the-run issues probably rising, liquidity spreads within the Treasury market could well widen further in coming months.

Growth of the monetary aggregates has remained close to the more moderate rates of this spring, following the rapid advance of last fall and winter that resulted from unusual demands for liquidity and monetary policy easings. Both M2 and M3 are projected to grow a little above the FOMC ranges this year and to post another year of declining velocities. The two aggregates could be boosted somewhat in the period around year-end, as both liquid balances and credit demands shift, on balance, into the banking system. To date, however, little sign of heightened retail demand for liquid balances has been evident. Currency growth was unusually strong early in the year, and appeared to reflect a pickup in domestic rather than foreign demands, but it has cooled off somewhat recently. In 2000, the broad monetary aggregates should decelerate with the slowing in nominal spending, and, with M2 also restrained by a further tightening of policy, the declines in its velocity observed since mid-1997 could about cease.

Alternative Simulations
We have developed four alternative, model-based simulations for this forecast. The first two simulations present the implications of alternative paths for the federal funds rate; the other two consider the effects of alternative paths for stock prices, where the deviations from the baseline are generated autonomously, without policy changes.

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

Measure	1999	2000
Real GDP		
Baseline	3.4	2.8
Flat funds rate	3.4	3.2
Tighter monetary policy	3.4	1.9
15,000 Wilshire	3.4	3.7
20 percent stock price decline	3.2	1.6
Civilian unemployment rate[1]		
Baseline	4.2	4.3
Flat funds rate	4.2	4.1
Tighter monetary policy	4.2	4.6
15,000 Wilshire	4.2	4.1
20 percent stock price decline	4.2	4.7
CPI excluding food and energy		
Baseline	2.1	2.6
Flat funds rate	2.1	2.7
Tighter monetary policy	2.1	2.3
15,000 Wilshire	2.1	2.6
20 percent stock price decline	2.1	2.5

1. Average for the fourth quarter.

The first simulation assumes that the FOMC holds the federal funds rate flat over the forecast interval. Relative to baseline, this alternative path for the funds rate would have little effect on real GDP, unemployment, or inflation in 1999. In 2000, however, the growth of real GDP would be noticeably stronger and the unemployment rate nearly 1/4 percentage point lower by the end of the year. Inflation would be only slightly higher than in the baseline forecast in 2000. But if this simulation were extended out to 2001, inflation would rise noticeably further, even if the funds rate were moved upward to avoid a still greater decline in the real short-term rate.

The other alternative monetary policy simulation is designed to avert a further deterioration in the inflation trend as we move beyond the year 2000: It assumes that the FOMC raises the federal funds rate 100 basis points by next March--considerably more than in the baseline forecast and beyond prevailing market expectations. In this scenario, the higher path for the funds rate does not visibly affect the economy in 1999. In 2000, however, real GDP growth is much weaker than in the baseline, and the unemployment rate is 1/3 percentage point higher by the end of the year. The core inflation rate would move up 1/4 percentage point less than in the baseline forecast next year and would tend to rise only a little further in 2001. This rough extension assumes a modest depreciation of the dollar and stable real oil price.

The third simulation has the Wilshire 5000 rising to a level of 15,000 by the fourth quarter of next year--a gain of almost 25 percent from the current level. The increase is assumed to occur because of a reduction in the equity risk premium required by investors. Under this alternative, real GDP growth is considerably stronger than in the baseline next year, and the unemployment rate is lower. Core inflation would be the same as in the baseline forecast. But, as we have noted in previous Greenbooks, expectations of inflation in the FRB/US model respond relatively slowly to movements in resource utilization that are not accompanied by changes in the perceived stance of monetary policy. Over time, consumers and firms would deduce that the Fed's inflation target had been relaxed, and inflation expectations ultimately would begin to move upward. Indeed, by 2001, the inflationary consequences of the stronger stock market would start to become more visible.

The simulation with the bearish view of the stock market assumes that the Wilshire index falls 20 percent by the end of this year and then flattens out at that lower level. This correction is assumed to be set off by a sudden upward shift in the equity premium. In this scenario, real GDP growth is considerably lower than in the baseline forecast--dipping to about 1-1/2 percent in 2000--and the unemployment rate approaches 4-3/4 percent by the end of next year. As in the other stock market simulation, inflation in 2000 differs only slightly from the baseline forecast, again because of lagging expectations adjustments.

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Class II FOMC

August 18, 1999

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

Interval		Nominal GDP 6/23/99	Nominal GDP 8/18/99	Real GDP 6/23/99	Real GDP 8/18/99	GDP chain-weighted price index 6/23/99	GDP chain-weighted price index 8/18/99	Consumer price index[1] 6/23/99	Consumer price index[1] 8/18/99	Unemployment rate[2] 6/23/99	Unemployment rate[2] 8/18/99
ANNUAL											
1996		5.4	5.4	3.4	3.4	1.9	1.9	3.0	3.0	5.4	5.4
1997		5.9	5.9	3.9	3.9	1.9	1.9	2.3	2.3	4.9	4.9
1998		4.9	4.9	3.9	3.9	1.0	1.0	1.6	1.6	4.5	4.5
1999		5.4	5.2	4.0	3.8	1.3	1.3	2.1	2.2	4.2	4.2
2000		4.4	4.7	2.7	2.8	1.7	1.8	2.3	2.4	4.1	4.2
QUARTERLY											
1997	Q1	7.2	7.2	4.2	4.2	2.8	2.8	2.5	2.5	5.2	5.2
	Q2	5.6	5.6	4.0	4.0	1.7	1.7	1.3	1.3	5.0	5.0
	Q3	5.4	5.4	4.2	4.2	1.2	1.2	1.8	1.8	4.9	4.9
	Q4	4.2	4.2	3.0	3.0	1.1	1.1	2.0	2.0	4.7	4.7
1998	Q1	6.4	6.4	5.5	5.5	0.9	0.9	1.0	1.0	4.6	4.6
	Q2	2.7	2.7	1.8	1.8	0.9	0.9	1.7	1.7	4.4	4.4
	Q3	4.7	4.7	3.7	3.7	1.0	1.0	1.7	1.7	4.5	4.5
	Q4	6.9	6.9	6.0	6.0	0.8	0.8	1.7	1.7	4.4	4.4
1999	Q1	6.0	6.0	4.5	4.3	1.5	1.6	1.5	1.5	4.3	4.3
	Q2	4.7	3.5	2.9	1.9	1.7	1.6	3.6	3.4	4.2	4.3
	Q3	4.8	5.0	3.5	3.5	1.3	1.4	1.8	2.5	4.1	4.2
	Q4	5.4	5.8	3.7	4.1	1.6	1.6	2.4	2.8	4.1	4.2
2000	Q1	2.2	2.6	0.1	0.4	2.1	2.2	2.1	2.1	4.1	4.2
	Q2	6.0	6.3	4.4	4.4	1.6	1.8	2.3	2.2	4.1	4.2
	Q3	4.7	5.1	2.9	3.2	1.7	1.9	2.4	2.4	4.2	4.3
	Q4	4.7	5.1	3.0	3.1	1.7	1.9	2.5	2.5	4.2	4.3
TWO-QUARTER[3]											
1997	Q2	6.4	6.4	4.1	4.1	2.2	2.2	1.9	1.9	-0.3	-0.3
	Q4	4.8	4.8	3.6	3.6	1.2	1.2	1.9	1.9	-0.3	-0.3
1998	Q2	4.6	4.6	3.7	3.7	0.9	0.9	1.4	1.4	-0.3	-0.3
	Q4	5.8	5.8	4.8	4.8	0.9	0.9	1.7	1.7	0.0	0.0
1999	Q2	5.4	4.7	3.7	3.1	1.6	1.6	2.5	2.5	-0.2	-0.1
	Q4	5.1	5.4	3.6	3.8	1.5	1.5	2.1	2.7	-0.1	-0.1
2000	Q2	4.1	4.4	2.2	2.4	1.8	2.0	2.2	2.2	-0.0	-0.0
	Q4	4.7	5.1	3.0	3.1	1.7	1.9	2.5	2.4	0.1	0.1
FOUR-QUARTER[4]											
1996	Q4	5.8	5.8	3.9	3.9	1.8	1.8	3.1	3.1	-0.3	-0.3
1997	Q4	5.6	5.6	3.8	3.8	1.7	1.7	1.9	1.9	-0.6	-0.6
1998	Q4	5.2	5.2	4.3	4.3	0.9	0.9	1.5	1.5	-0.3	-0.3
1999	Q4	5.2	5.1	3.7	3.4	1.5	1.5	2.3	2.6	-0.3	-0.2
2000	Q4	4.4	4.7	2.6	2.8	1.7	1.9	2.3	2.3	0.1	0.1

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

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

August 18, 1999

Item	Units[1]	1992	1993	1994	1995	1996	1997	1998	- Projected - 1999	2000
EXPENDITURES										
Nominal GDP	Bill. $	6244.4	6558.1	6947.0	7269.6	7661.6	8110.9	8511.0	8951.5	9371.5
Real GDP	Bill. Ch. $	6244.4	6389.6	6610.7	6761.7	6994.8	7269.8	7551.9	7839.8	8061.0
Real GDP	% change	3.6	2.4	3.3	2.1	3.9	3.8	4.3	3.4	2.8
Gross domestic purchases		4.0	3.0	3.6	1.6	4.2	4.4	5.3	4.5	3.1
Final sales		3.9	2.1	2.7	2.7	3.7	3.4	4.6	3.3	2.9
Priv. dom. final purchases		4.9	3.7	3.7	2.9	4.3	4.6	6.5	4.9	3.4
Personal cons. expenditures		4.2	2.7	3.1	2.6	3.3	3.7	5.3	4.7	3.3
Durables		9.4	7.4	6.3	4.5	5.8	7.4	13.2	7.2	4.3
Nondurables		3.4	1.6	3.0	1.7	2.8	2.0	4.7	5.1	2.5
Services		3.6	2.3	2.5	2.6	3.0	3.8	4.0	3.9	3.4
Business fixed investment		5.5	9.9	7.6	7.3	11.7	9.8	11.9	6.7	7.4
Producers' dur. equipment		9.6	12.2	10.2	9.1	11.8	12.7	16.8	9.1	10.1
Nonres. structures		-3.4	4.5	1.1	2.7	11.6	2.5	-0.3	0.3	-0.3
Residential structures		16.9	7.8	4.2	-1.4	5.4	4.2	12.6	3.3	-3.4
Exports		4.1	4.6	10.0	10.5	10.3	9.6	1.1	2.5	5.3
Imports		7.4	10.2	12.3	5.6	11.8	14.0	9.7	10.8	7.7
Gov't. cons. & investment		1.7	-1.4	0.1	-0.9	2.1	1.4	1.6	1.9	2.7
Federal		1.3	-6.1	-3.9	-5.6	1.1	-0.6	0.9	-0.6	0.5
Defense		-1.3	-6.9	-6.0	-5.0	-0.1	-1.4	-1.3	-2.3	0.3
State & local		2.0	2.0	2.7	2.1	2.8	2.6	2.1	3.4	3.9
Change in bus. inventories	Bill. Ch. $	7.0	22.1	60.6	27.7	30.0	63.2	57.4	37.0	38.4
Nonfarm		2.0	29.5	49.0	37.7	23.2	58.8	50.1	34.2	37.7
Net exports		-29.5	-70.2	-104.6	-96.5	-111.2	-136.1	-238.2	-333.6	-396.5
Nominal GDP	% change	6.3	5.0	5.8	4.2	5.8	5.6	5.2	5.1	4.7
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employment	Millions	108.6	110.7	114.1	117.2	119.6	122.7	125.8	128.6	130.7
Unemployment rate	%	7.5	6.9	6.1	5.6	5.4	4.9	4.5	4.2	4.2
Industrial prod. index	% change	3.6	3.3	6.5	3.5	5.3	6.6	1.9	3.7	2.4
Capacity util. rate - mfg.	%	79.5	80.5	82.5	82.7	81.4	82.0	80.8	79.8	79.6
Housing starts	Millions	1.20	1.29	1.46	1.35	1.48	1.47	1.62	1.66	1.58
Light motor vehicle sales		12.85	13.86	15.01	14.72	15.05	15.02	15.50	16.37	15.69
North Amer. produced		10.51	11.71	12.88	12.82	13.35	13.09	13.47	14.04	13.54
Other		2.34	2.15	2.13	1.90	1.70	1.92	2.04	2.34	2.15
INCOME AND SAVING										
Nominal GNP	Bill. $	6255.5	6576.8	6955.2	7287.1	7674.0	8102.9	8490.5	8928.1	9341.5
Nominal GNP	% change	6.2	5.1	5.7	4.4	5.6	5.2	5.2	5.0	4.7
Nominal personal income		7.2	4.0	5.2	4.6	5.9	5.4	5.1	5.7	5.1
Real disposable income		4.0	1.2	2.5	2.1	2.7	2.9	3.5	3.4	3.1
Personal saving rate	%	5.7	4.4	3.5	3.4	2.9	2.1	0.5	-0.9	-0.9
Corp. profits, IVA & CCAdj.	% change	11.3	19.0	14.1	14.6	7.7	7.7	0.1	5.0	2.9
Profit share of GNP	%	6.8	7.5	8.2	9.2	9.8	10.1	9.7	9.7	9.2
Excluding FR Banks		6.6	7.2	7.9	8.9	9.5	9.8	9.4	9.4	8.9
Federal surpl./deficit	Bill. $	-280.9	-250.7	-186.7	-174.4	-110.3	-21.1	72.8	148.6	174.9
State & local surpl./def.		86.3	87.4	96.8	111.7	122.6	134.1	150.2	171.0	178.9
Ex. social ins. funds		18.3	19.7	27.9	37.0	52.2	66.0	82.5	103.2	111.1
Gross natl. saving rate	%	14.5	14.4	15.5	16.3	16.6	17.4	17.3	17.1	16.9
Net natl. saving rate		3.7	3.7	4.7	5.8	6.3	7.3	7.3	7.3	7.2
PRICES AND COSTS										
GDP chn.-wt. price index	% change	2.6	2.6	2.5	2.1	1.8	1.7	0.9	1.5	1.9
Gross Domestic Purchases chn.-wt. price index		2.7	2.3	2.5	2.0	1.8	1.3	0.4	1.6	1.7
CPI		3.1	2.7	2.6	2.7	3.1	1.9	1.5	2.6	2.3
Ex. food and energy		3.5	3.1	2.8	3.1	2.6	2.2	2.4	2.1	2.6
ECI, hourly compensation[2]		3.5	3.6	3.1	2.6	3.1	3.4	3.5	3.3	3.8
Nonfarm business sector										
Output per hour		3.5	-0.4	0.1	1.2	2.0	1.6	2.6	1.9	2.2
Compensation per Hour		4.5	1.6	2.1	2.9	3.6	3.7	4.1	4.5	4.5
Unit labor cost		1.0	2.0	2.0	1.6	1.6	2.1	1.5	2.6	2.2

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

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Class II FOMC

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

August 18, 1999

Item	Units	1996 Q1	1996 Q2	1996 Q3	1996 Q4	1997 Q1	1997 Q2	1997 Q3	1997 Q4	1998 Q1	1998 Q2
EXPENDITURES											
Nominal GDP	Bill. $	7495.3	7629.2	7703.4	7818.4	7955.0	8063.4	8170.8	8254.5	8384.2	8440.6
Real GDP	Bill. Ch. $	6882.0	6983.9	7020.0	7093.1	7166.7	7236.5	7311.2	7364.6	7464.7	7498.6
Real GDP	% change	3.3	6.1	2.1	4.2	4.2	4.0	4.2	3.0	5.5	1.8
Gross domestic purchases		4.5	7.0	3.4	1.8	5.5	4.4	4.6	3.2	7.8	3.9
Final sales		3.6	5.4	0.9	5.1	2.9	2.7	5.8	2.1	4.3	4.6
Priv. dom. final purchases		5.1	6.2	2.8	3.3	4.6	3.3	7.5	2.9	8.5	7.4
Personal cons. expenditures		3.7	4.7	1.8	2.9	4.3	1.6	6.2	2.8	6.1	6.1
Durables		5.8	12.7	-1.9	7.2	12.3	-1.5	16.8	3.1	15.8	11.2
Nondurables		2.2	4.8	1.2	2.9	3.6	-0.2	5.1	-0.4	7.4	5.3
Services		4.0	3.0	3.0	2.0	3.1	3.2	4.7	4.3	3.5	5.4
Business fixed investment		13.1	11.0	14.2	8.8	7.0	14.0	17.0	1.8	22.3	12.8
Producers' dur. equipment		15.7	12.3	16.2	3.2	8.3	22.8	18.8	2.2	34.3	18.8
Nonres. structures		6.4	7.4	8.9	24.5	3.9	-6.2	12.4	0.9	-4.9	-2.3
Residential structures		9.3	19.5	-1.7	-3.9	3.1	6.1	-0.4	8.2	15.6	15.0
Exports		3.7	5.8	2.1	32.0	8.3	15.5	10.6	4.4	-2.8	-7.7
Imports		13.1	13.5	13.6	7.0	18.6	17.9	13.5	6.3	15.7	9.3
Gov't. cons. & investment		3.2	7.1	-1.6	0.0	2.1	2.1	1.4	0.1	-1.9	3.7
Federal		8.0	8.1	-4.7	-6.3	-2.7	3.6	-1.2	-2.1	-8.8	7.3
Defense		7.2	8.1	-6.3	-8.3	-9.9	9.1	-1.8	-2.0	-18.5	9.9
State & local		0.5	6.5	0.3	3.8	4.9	1.3	2.9	1.3	2.1	1.8
Change in bus. inventories	Bill. Ch. $	14.4	26.1	47.5	32.1	56.3	79.0	51.0	66.5	91.4	38.2
Nonfarm		10.4	15.2	38.6	28.7	56.2	72.1	44.0	62.7	85.9	29.9
Net exports		-95.5	-113.5	-140.1	-95.9	-121.5	-131.6	-142.4	-149.0	-198.5	-245.2
Nominal GDP	% change	5.7	7.3	3.9	6.1	7.2	5.6	5.4	4.2	6.4	2.7
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	118.5	119.3	120.0	120.7	121.4	122.3	123.0	123.9	124.8	125.5
Unemployment rate	%	5.5	5.5	5.3	5.3	5.2	5.0	4.9	4.7	4.6	4.4
Industrial prod. index	% change	2.8	9.6	5.5	3.5	6.6	6.0	7.2	6.6	1.6	2.8
Capacity util. rate - mfg.	%	80.9	81.6	81.8	81.3	81.6	81.7	82.1	82.5	81.8	81.2
Housing starts	Millions	1.46	1.50	1.50	1.42	1.46	1.47	1.46	1.52	1.59	1.57
Light motor vehicle sales		15.10	15.18	15.00	14.91	15.32	14.54	15.19	15.02	15.08	16.07
North Amer. produced		13.44	13.46	13.33	13.16	13.41	12.68	13.20	13.08	13.13	14.07
Other		1.66	1.72	1.68	1.76	1.92	1.86	1.99	1.94	1.95	1.99
INCOME AND SAVING											
Nominal GNP	Bill. $	7515.0	7643.3	7708.6	7829.0	7952.4	8062.3	8162.0	8234.9	8369.4	8421.8
Nominal GNP	% change	5.6	7.0	3.5	6.4	6.5	5.6	5.0	3.6	6.7	2.5
Nominal personal income		6.6	6.9	5.5	4.6	7.3	4.7	4.7	5.0	5.9	4.5
Real disposable income		2.9	2.1	4.4	1.3	3.3	2.9	2.4	2.9	4.0	2.6
Personal saving rate	%	3.2	2.6	3.1	2.6	2.4	2.6	1.7	1.7	1.2	0.4
Corp. profits, IVA & CCAdj.	% change	16.9	6.9	3.8	3.5	18.1	11.1	13.1	-9.2	4.2	-4.1
Profit share of GNP	%	9.8	9.8	9.8	9.7	10.0	10.1	10.3	10.0	9.9	9.7
Excluding FR Banks		9.5	9.5	9.5	9.5	9.7	9.8	10.0	9.7	9.6	9.5
Federal surpl./deficit	Bill. $	-150.1	-112.6	-100.1	-78.3	-51.2	-34.8	-0.3	2.2	58.8	74.4
State & local surpl./def.		117.3	129.1	122.3	121.7	128.4	130.1	136.6	141.4	140.2	141.3
Ex. social ins. funds		45.3	58.2	52.5	52.9	59.8	61.6	68.7	73.8	72.7	73.6
Gross natl. saving rate	%	16.4	16.4	16.8	16.7	17.0	17.6	17.5	17.3	17.7	17.2
Net natl. saving rate		6.0	6.2	6.6	6.5	7.0	7.6	7.5	7.3	7.8	7.2
PRICES AND COSTS											
GDP chn.-wt. price index	% change	2.2	1.4	1.8	1.6	2.8	1.7	1.2	1.1	0.9	0.9
Gross Domestic Purchases chn.-wt. price index		2.1	1.4	1.5	2.1	2.2	0.9	1.1	1.0	-0.2	0.4
CPI		3.2	3.7	2.3	3.3	2.5	1.3	1.8	2.0	1.0	1.7
Ex. food and energy		2.5	2.7	2.4	2.7	2.2	2.9	1.4	2.4	2.4	2.6
ECI, hourly compensation[1]		2.5	3.5	2.8	2.8	2.5	3.7	3.4	4.3	3.0	3.6
Nonfarm business sector											
Output per hour		4.2	3.0	-0.2	1.0	0.0	1.7	3.5	1.0	3.2	0.4
Compensation per hour		2.8	5.1	3.4	3.2	3.8	2.3	3.7	5.2	4.6	3.9
Unit labor cost		-1.4	2.1	3.6	2.1	3.8	0.5	0.2	4.1	1.4	3.5

1. Private-industry workers.

Strictly Confidential <FR>
Class II FOMC

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

August 18, 1999

Item	Units	1998 Q3	1998 Q4	1999 Q1	1999 Q2	1999 Q3 (Projected)	1999 Q4 (Projected)	2000 Q1 (Projected)	2000 Q2 (Projected)	2000 Q3 (Projected)	2000 Q4 (Projected)
EXPENDITURES											
Nominal GDP	Bill. $	8537.9	8681.2	8808.7	8884.2	8992.8	9120.2	9178.3	9319.0	9435.7	9552.9
Real GDP	Bill. Ch. $	7566.5	7677.7	7759.6	7795.6	7862.3	7941.8	7949.3	8035.8	8098.7	8160.2
Real GDP	% change	3.7	6.0	4.3	1.9	3.5	4.1	0.4	4.4	3.2	3.1
Gross domestic purchases		4.2	5.4	6.6	2.6	4.2	4.5	0.7	5.3	3.6	3.0
Final sales		2.8	6.6	4.6	3.0	2.4	3.3	1.8	3.7	3.0	3.2
Priv. dom. final purchases		3.7	6.5	7.4	4.8	3.2	4.0	1.8	4.9	3.6	3.5
Personal cons. expenditures		4.1	5.0	6.7	3.8	3.6	4.6	2.0	4.8	3.2	3.0
Durables		2.4	24.5	12.9	4.8	6.8	4.3	4.4	3.7	4.4	4.6
Nondurables		2.1	4.2	9.5	2.5	2.3	6.1	-1.1	6.1	3.0	2.2
Services		5.4	1.7	4.1	4.2	3.6	3.9	3.1	4.4	3.1	3.1
Business fixed investment		-0.7	14.6	8.5	10.4	4.5	3.7	2.8	9.7	8.5	8.8
Producers' dur. equipment		-1.0	17.8	9.5	14.8	6.7	5.5	4.1	13.4	11.4	11.7
Nonres. structures		0.2	6.0	5.7	-1.1	-1.9	-1.1	-1.0	-0.6	0.1	0.4
Residential structures		9.9	10.0	15.4	8.0	-4.8	-3.9	-4.3	-3.8	-3.2	-2.4
Exports		-2.8	19.7	-5.1	3.7	4.8	7.2	0.1	6.0	6.0	9.4
Imports		2.3	12.0	13.5	9.6	10.6	9.5	2.6	12.5	8.4	7.6
Gov't. cons. & investment		1.5	3.3	4.2	-1.7	2.8	2.4	3.6	3.2	2.5	1.5
Federal		-1.4	7.3	-1.9	-3.2	2.3	0.3	3.2	2.0	-0.1	-2.9
Defense		4.3	1.3	-6.6	-3.3	4.0	-2.9	0.5	-1.1	1.2	0.4
State & local		3.1	1.3	7.7	-0.9	3.4	3.5	3.9	3.8	3.9	3.9
Change in bus. inventories	Bill. Ch. $	55.7	44.2	38.7	14.9	38.7	55.5	25.2	40.5	45.0	43.0
Nonfarm		47.0	37.5	35.1	11.4	36.3	54.2	24.5	39.7	44.2	42.3
Net exports		-259.0	-250.0	-303.6	-324.5	-346.5	-360.0	-368.7	-395.4	-409.4	-412.5
Nominal GDP	% change	4.7	6.9	6.0	3.5	5.0	5.8	2.6	6.3	5.1	5.1
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	126.1	126.9	127.6	128.2	129.0	129.6	130.0	130.7	130.8	131.1
Unemployment rate	%	4.5	4.4	4.3	4.3	4.2	4.2	4.2	4.2	4.3	4.3
Industrial prod. index	% change	0.9	2.2	1.3	3.8	4.8	5.1	-2.5	4.5	3.7	4.1
Capacity util. rate - mfg.	%	80.2	80.1	79.5	79.5	79.8	80.2	79.1	79.5	79.8	80.1
Housing starts	Millions	1.64	1.70	1.77	1.61	1.64	1.62	1.60	1.59	1.58	1.57
Light motor vehicle sales		14.55	16.31	16.22	16.73	16.48	16.07	15.90	15.71	15.62	15.53
North Amer. produced		12.54	14.11	13.95	14.31	14.12	13.77	13.67	13.55	13.50	13.44
Other		2.01	2.20	2.27	2.42	2.36	2.30	2.23	2.16	2.12	2.09
INCOME AND SAVING											
Nominal GNP	Bill. $	8510.9	8660.0	8788.4	8863.2	8967.6	9093.3	9149.4	9289.0	9405.7	9521.8
Nominal GNP	% change	4.3	7.2	6.1	3.4	4.8	5.7	2.5	6.2	5.1	5.0
Nominal personal income		4.5	5.5	5.1	5.6	5.7	6.2	4.8	5.9	4.8	4.7
Real disposable income		3.2	4.3	3.5	2.9	3.6	3.7	3.9	3.7	2.5	2.5
Personal saving rate	%	0.2	0.0	-0.7	-0.9	-0.9	-1.1	-0.6	-0.8	-1.0	-1.1
Corp. profits, IVA & CCAdj.	% change	3.2	-2.5	25.0	2.6	-8.4	3.4	-15.0	10.3	9.4	9.5
Profit share of GNP	%	9.7	9.5	9.9	9.9	9.5	9.5	9.1	9.1	9.2	9.3
Excluding FR Banks		9.4	9.2	9.6	9.6	9.3	9.2	8.8	8.9	9.0	9.1
Federal surpl./deficit	Bill. $	92.0	65.8	122.7	142.1	165.5	164.2	142.7	166.0	189.0	202.0
State & local surpl./def.		148.7	170.5	169.7	170.8	166.4	177.1	176.0	179.2	180.0	180.4
Ex. social ins. funds		81.3	102.6	101.9	102.8	98.6	109.3	108.2	111.4	112.2	112.6
Gross natl. saving rate	%	17.3	16.9	17.2	17.2	17.1	17.0	16.8	16.9	17.0	17.0
Net natl. saving rate		7.3	7.0	7.4	7.3	7.3	7.3	7.0	7.2	7.3	7.4
PRICES AND COSTS											
GDP chn.-wt. price index	% change	1.0	0.8	1.6	1.6	1.4	1.6	2.2	1.8	1.9	1.9
Gross Domestic Purchases chn.-wt. price index		0.7	0.9	1.2	2.1	1.5	1.7	2.0	1.6	1.6	1.7
CPI		1.7	1.7	1.5	3.4	2.5	2.8	2.1	2.2	2.4	2.5
Ex. food and energy		2.3	2.1	1.6	2.5	1.8	2.5	2.5	2.6	2.7	2.8
ECI, hourly compensation[1]		4.1	2.9	1.4	4.6	3.6	3.6	4.1	3.7	3.8	3.8
Nonfarm business sector											
Output per hour		2.7	4.1	3.6	0.7	1.2	2.1	-0.1	3.5	2.7	2.7
Compensation per hour		4.1	3.8	4.4	5.0	4.7	4.2	4.7	4.3	4.4	4.4
Unit labor cost		1.3	-0.4	0.8	4.3	3.5	2.1	4.8	0.8	1.7	1.7

1. Private-industry workers.

Strictly Confidential <FR>
Class II FOMC

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

August 18, 1999

Item	1996 Q3	1996 Q4	1997 Q1	1997 Q2	1997 Q3	1997 Q4	1998 Q1	1998 Q2	1998 Q3	96Q4/ 95Q4	97Q4/ 96Q4	98Q4/ 97Q4
Real GDP	2.1	4.2	4.2	4.0	4.2	3.0	5.5	1.8	3.7	3.9	3.8	4.3
Gross dom. purchases	3.5	1.9	5.5	4.4	4.7	3.2	7.9	4.0	4.3	4.2	4.4	5.4
Final sales	0.9	5.1	2.9	2.7	5.7	2.1	4.3	4.6	2.8	3.7	3.3	4.5
Priv. dom. final purchases	2.3	2.7	3.8	2.7	6.1	2.4	7.0	6.1	3.1	3.6	3.8	5.4
Personal cons. expenditures	1.3	2.0	2.9	1.1	4.2	1.9	4.1	4.1	2.8	2.2	2.5	3.6
Durables	-0.2	0.6	1.0	-0.1	1.3	0.3	1.2	0.9	0.2	0.5	0.6	1.1
Nondurables	0.2	0.6	0.7	-0.0	1.0	-0.1	1.4	1.0	0.4	0.6	0.4	0.9
Services	1.2	0.8	1.2	1.3	1.9	1.7	1.4	2.1	2.2	1.2	1.5	1.6
Business fixed investment	1.4	0.9	0.7	1.4	1.7	0.2	2.2	1.4	-0.1	1.2	1.0	1.3
Producers' dur. equip.	1.1	0.2	0.6	1.6	1.3	0.1	2.4	1.4	-0.1	0.8	0.9	1.3
Nonres. structures	0.2	0.6	0.1	-0.2	0.4	0.0	-0.2	-0.1	0.0	0.3	0.1	-0.0
Residential structures	-0.1	-0.2	0.1	0.2	-0.0	0.3	0.6	0.6	0.4	0.2	0.2	0.5
Net exports	-1.3	2.4	-1.2	-0.5	-0.5	-0.3	-2.2	-2.1	-0.6	-0.3	-0.6	-1.1
Exports	0.2	3.2	1.0	1.8	1.2	0.5	-0.3	-0.9	-0.3	1.2	1.1	0.1
Imports	-1.6	-0.9	-2.2	-2.2	-1.7	-0.8	-1.9	-1.2	-0.3	-1.4	-1.7	-1.2
Government cons. & invest.	-0.3	0.0	0.4	0.4	0.3	0.0	-0.3	0.6	0.3	0.4	0.3	0.3
Federal	-0.3	-0.4	-0.2	0.2	-0.1	-0.1	-0.6	0.4	-0.1	0.1	-0.0	0.1
Defense	-0.3	-0.4	-0.5	0.4	-0.1	-0.1	-0.8	0.4	0.2	-0.0	-0.1	-0.1
Nondefense	0.0	0.0	0.3	-0.2	0.0	-0.1	0.3	0.1	-0.3	0.1	0.0	0.1
State and local	0.0	0.4	0.6	0.2	0.3	0.2	0.2	0.2	0.4	0.3	0.3	0.2
Change in bus. inventories	1.2	-0.8	1.3	1.3	-1.4	0.9	1.2	-2.7	0.9	0.2	0.5	-0.3
Nonfarm	1.3	-0.5	1.5	0.9	-1.5	1.0	1.2	-2.8	0.9	0.1	0.5	-0.3
Farm	-0.1	-0.3	-0.2	0.4	0.1	-0.1	0.0	0.1	0.0	0.0	0.0	0.0

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

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

Item	1998 Q4	1999 Q1	1999 Q2	1999 Q3	1999 Q4	2000 Q1	2000 Q2	2000 Q3	2000 Q4	98Q4/ 97Q4	99Q4/ 98Q4	0Q4/ 99Q4
Real GDP	6.0	4.3	1.9	3.5	4.1	0.4	4.4	3.2	3.1	4.3	3.4	2.8
Gross dom. purchases	5.5	6.7	2.7	4.4	4.6	0.7	5.5	3.7	3.1	5.4	4.5	3.2
Final sales	6.6	4.6	2.9	2.4	3.3	1.8	3.7	3.0	3.2	4.5	3.3	2.9
Priv. dom. final purchases	5.4	6.2	4.1	2.7	3.4	1.5	4.2	3.0	2.9	5.4	4.1	2.9
Personal cons. expenditures	3.5	4.6	2.6	2.5	3.1	1.4	3.3	2.3	2.1	3.6	3.2	2.3
Durables	1.9	1.1	0.4	0.6	0.4	0.4	0.3	0.4	0.4	1.1	0.6	0.4
Nondurables	0.8	1.8	0.5	0.5	1.2	-0.2	1.2	0.6	0.4	0.9	1.0	0.5
Services	0.7	1.7	1.7	1.4	1.6	1.2	1.8	1.3	1.3	1.6	1.6	1.4
Business fixed investment	1.5	0.9	1.1	0.5	0.4	0.3	1.0	0.9	0.9	1.3	0.7	0.8
Producers' dur. equip.	1.4	0.8	1.1	0.5	0.4	0.3	1.0	0.9	0.9	1.3	0.7	0.8
Nonres. structures	0.2	0.2	-0.0	-0.1	-0.0	-0.0	-0.0	0.0	0.0	-0.0	0.0	-0.0
Residential structures	0.4	0.7	0.4	-0.2	-0.2	-0.2	-0.2	-0.1	-0.1	0.5	0.1	-0.2
Net exports	0.5	-2.2	-0.8	-0.9	-0.5	-0.3	-1.0	-0.5	-0.0	-1.1	-1.1	-0.5
Exports	2.0	-0.6	0.4	0.5	0.8	0.0	0.6	0.6	1.0	0.1	0.3	0.6
Imports	-1.5	-1.7	-1.2	-1.4	-1.3	-0.4	-1.7	-1.1	-1.0	-1.2	-1.4	-1.1
Government cons. & invest.	0.6	0.7	-0.3	0.5	0.4	0.6	0.6	0.4	0.3	0.3	0.3	0.5
Federal	0.4	-0.1	-0.2	0.1	0.0	0.2	0.1	-0.0	-0.2	0.1	-0.0	0.0
Defense	0.1	-0.2	-0.1	0.2	-0.1	0.0	-0.0	0.0	0.0	-0.1	-0.1	0.0
Nondefense	0.4	0.1	-0.1	-0.0	0.1	0.2	0.2	-0.1	-0.2	0.1	0.1	0.0
State and local	0.2	0.8	-0.1	0.4	0.4	0.4	0.4	0.4	0.4	0.2	0.4	0.4
Change in bus. inventories	-0.5	-0.3	-1.1	1.1	0.8	-1.4	0.7	0.2	-0.1	-0.3	0.1	-0.1
Nonfarm	-0.5	-0.1	-1.1	1.2	0.8	-1.3	0.7	0.2	-0.1	-0.3	0.2	-0.1
Farm	-0.1	-0.1	0.0	-0.1	-0.1	-0.0	0.0	0.0	0.0	0.0	-0.1	-0.0

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

Staff Projections of Federal Sector Accounts and Related Items
(Billions of dollars except as noted)

Item	Fiscal year[1]				1998				1999				2000			
	1997[a]	1998[a]	1999	2000	Q1[a]	Q2[a]	Q3[a]	Q4[a]	Q1[a]	Q2[p]	Q3	Q4	Q1	Q2	Q3	Q4
Unified budget					Not seasonally adjusted											
Receipts[2]	1579	1722	1824	1925	378	544	412	413	401	564	446	435	428	598	464	452
Outlays[2]	1601	1653	1700	1758	409	407	410	467	396	421	416	443	448	436	431	454
Surplus/deficit[2]	-22	69	124	167	-30	137	2	-55	6	143	29	-8	-20	162	33	-2
On-budget	-103	-30	-4	17	-53	87	2	-58	-49	88	15	-49	-46	97	15	-47
Off-budget	81	99	127	150	22	50	-.1	3	55	55	15	41	27	64	18	45
Surplus excluding deposit insurance	-36	65	118	163	-31	136	.8	-57	5	142	28	-9	-21	161	32	-3
Means of financing																
Borrowing	38	-51	-84	-178	26	-82	-29	32	7	-108	-16	27	-37	-129	-39	-.9
Cash decrease	.6	5	-14	13	4	-45	33	21	-4	-31	.2	-27	60	-25	5	10
Other[3]	-17	-23	-25	-2	.0	-10	-7	.8	-9	-4	-13	8	-3	-8	1	-7
Cash operating balance, end of period	44	39	53	40	28	72	39	18	22	53	53	80	20	45	40	30
NIPA federal sector					Seasonally adjusted annual rates											
Receipts	1687	1818	1927	2031	1809	1838	1859	1870	1915	1948	1973	2005	2007	2041	2072	2101
Expenditures	1728	1761	1802	1866	1750	1764	1767	1805	1792	1805	1808	1841	1864	1875	1883	1899
Consumption expenditures	458	458	472	492	451	464	459	471	472	470	476	477	493	498	498	495
Defense	306	301	304	311	293	303	303	307	304	300	307	305	313	313	314	315
Nondefense	152	157	168	181	158	161	156	164	168	170	169	173	180	185	185	181
Other expenditures	1270	1303	1330	1374	1299	1300	1308	1334	1320	1335	1332	1363	1371	1377	1384	1403
Current account surplus	-41	57	124	165	59	74	92	66	123	143	165	164	143	166	189	202
Gross investment	61	60	62	63	61	57	61	60	65	64	61	62	64	63	64	64
Current and capital account surplus	-102	-3	62	102	-2	18	31	6	58	80	104	102	79	103	125	138
Fiscal indicators[4]																
High-employment (HEB) surplus/deficit	-163	-99	-64	-27	-101	-81	-70	-112	-71	-47	-26	-35	-43	-26	-4	9
Change in HEB, percent of potential GDP	-.9	-.8	-.4	-.4	-.5	-.2	-.1	.4	-.5	-.2	-.2	.0	.0	-.1	-.2	-.1
Fiscal impetus (FI) percent, calendar year	-2.1	-1.5	3.5	2.4	-2.1	1.1	.4	2.0	1.5	-1.1	.5	2.0	.6	.4	-.0	-.6

1. 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.
2. OMB's June 1999 surplus estimates (assuming the enactment of the President's proposals) are \$99 billion in FY1999 and \$143 billion in FY2000. CBO's July 1999 baseline surplus estimates are \$120 billion in FY1999 and \$161 billion in FY2000. 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 FY1990.
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 be 3.3 percent beginning 1998:Q1. 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. 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.
a--Actual p--Preliminary

Change in Debt of the Domestic Nonfinancial Sectors
(Percent)

			Nonfederal						
				Households					
Period [1]	Total [2]	Federal government [3]	Total [4]	Total	Home mortgages	Consumer credit	Business	State and local governments	Memo: Nominal GDP
Year									
1990	6.4	11.0	5.2	7.3	9.3	1.5	3.3	5.0	4.4
1991	4.3	11.1	2.3	4.6	6.2	-1.3	-1.6	8.6	3.8
1992	4.6	10.9	2.6	4.4	5.3	0.5	0.8	2.2	6.3
1993	5.0	8.3	3.8	5.4	4.5	7.6	1.4	6.0	5.0
1994	4.6	4.7	4.6	7.7	6.0	14.5	3.9	-4.0	5.8
1995	5.4	4.1	5.8	7.9	5.7	14.1	6.5	-4.6	4.2
1996	5.1	4.0	5.4	7.2	7.3	7.9	4.9	-0.6	5.8
1997	5.0	0.6	6.6	6.4	6.6	4.3	7.1	5.3	5.6
1998	6.2	-1.4	8.7	8.7	9.7	5.4	9.1	7.2	5.2
1999	5.3	-2.4	7.6	8.8	9.7	6.0	7.0	4.2	5.1
2000	4.1	-5.6	6.8	7.3	8.4	3.7	6.7	4.3	4.7
Quarter									
1998:3	5.4	-3.6	8.3	7.7	8.7	6.3	9.4	6.2	4.7
4	6.9	0.7	8.8	9.7	11.0	4.9	8.3	6.4	6.9
1999:1	6.2	-3.2	9.1	9.4	10.1	9.5	9.6	5.6	6.0
2	4.5	-3.2	6.7	8.9	9.7	4.7	5.3	2.3	3.5
3	4.8	-3.2	7.1	8.0	8.8	4.9	6.6	4.5	5.0
4	5.2	-0.0	6.6	7.7	8.8	4.3	5.9	4.4	5.8
2000:1	3.7	-8.1	7.0	7.4	8.6	4.1	7.1	4.3	2.6
2	4.0	-5.7	6.6	7.2	8.3	3.6	6.4	4.3	6.3
3	3.9	-5.9	6.5	7.0	8.0	3.5	6.4	4.3	5.1
4	4.4	-3.3	6.3	6.8	7.8	3.4	6.3	4.2	5.1

Note. Quarterly data are at seasonally adjusted annual rates.

1. Data after 1999:Q1 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 estimated to have grown 6.1 percent in 1998 and is projected to grow 5.5 percent in 1999 and 4.2 percent in 2000.

3. On a monthly average basis, federal debt is estimated to have grown -1.2 percent in 1998 and is projected to grow -2.1 percent in 1999 and -5.3 percent in 2000.

4. On a monthly average basis, nonfederal debt is estimated to have grown 8.6 percent in 1998 and is projected to grow 7.9 percent in 1999 and 6.8 percent in 2000.

2.6.3 FOF

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

Category	Calendar year				Seasonally adjusted annual rates									
					1998		1999				2000			
	1997	1998	1999	2000	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Net funds raised by domestic nonfinancial sectors														
1 Total	608.2	670.1	674.1	614.3	535.3	597.7	936.3	372.7	697.7	689.8	484.2	607.0	634.1	731.7
2 Net equity issuance	-114.4	-267.0	-170.9	-77.0	-308.4	-491.3	-65.7	-354.0	-90.0	-174.0	-146.0	-78.0	-46.0	-38.0
3 Net debt issuance	722.6	937.1	845.1	691.3	843.6	1089.0	1002.0	726.7	787.7	863.8	630.2	685.0	680.1	769.7
Borrowing sectors														
Nonfinancial business														
4 Financing gap [1]	62.7	85.6	92.2	134.0	67.8	93.3	63.0	68.4	112.2	125.4	118.2	137.0	140.7	139.9
5 Net equity issuance	-114.4	-267.0	-170.9	-77.0	-308.4	-491.3	-65.7	-354.0	-90.0	-174.0	-146.0	-78.0	-46.0	-38.0
6 Credit market borrowing	316.8	436.7	364.6	375.7	471.4	425.5	498.1	281.7	356.7	321.7	396.4	365.4	369.4	371.4
Households														
7 Net borrowing [2]	326.6	472.7	518.9	467.1	436.0	561.2	556.3	536.8	494.6	488.2	475.3	468.7	466.8	457.7
8 Home mortgages	229.5	359.6	392.6	375.5	336.9	435.3	411.1	401.7	375.9	381.7	381.7	378.7	372.7	368.7
9 Consumer credit	52.5	67.6	79.6	52.2	81.7	64.1	126.2	64.6	67.6	60.0	57.9	51.3	50.4	49.3
10 Debt/DPI (percent) [3]	90.8	94.0	97.3	99.7	94.3	95.1	96.2	97.1	97.9	98.4	98.9	99.4	100.0	100.6
State and local governments														
11 Net borrowing	56.1	80.3	50.9	54.4	72.6	75.4	66.8	27.9	54.5	54.4	54.4	54.4	54.4	54.4
12 Current surplus [4]	135.1	182.8	193.8	202.5	182.2	201.7	198.7	185.8	189.9	201.0	200.3	202.9	203.0	203.9
Federal government														
13 Net borrowing	23.1	-52.6	-89.3	-205.8	-136.5	26.9	-119.2	-119.7	-118.0	-0.4	-295.8	-203.4	-210.4	-113.7
14 Net borrowing (quarterly, n.s.a.)	23.1	-52.6	-89.3	-205.8	-28.8	32.1	7.5	-108.0	-16.2	27.3	-36.7	-128.9	-39.3	-1.0
15 Unified deficit (quarterly, n.s.a.)	2.4	-55.2	-170.2	-173.1	-3.0	54.5	-5.8	-143.1	-29.4	8.1	19.7	-161.6	-33.0	1.9
Depository institutions														
16 Funds supplied	336.3	361.9	239.6	269.4	296.0	674.4	193.4	195.9	299.7	269.4	262.9	267.9	272.9	273.9
Memo (percentage of GDP)														
17 Domestic nonfinancial debt [5]	182.1	183.3	184.2	184.2	183.8	183.5	183.8	184.7	184.6	184.3	185.1	184.1	183.6	183.3
18 Domestic nonfinancial borrowing	8.9	11.0	9.4	7.4	9.9	12.5	11.4	8.2	8.8	9.5	6.9	7.4	7.2	8.1
19 Federal government [6]	0.3	-0.6	-1.0	-2.2	-1.6	0.3	-1.4	-1.3	-1.3	-0.0	-3.2	-2.2	-2.2	-1.2
20 Nonfederal	8.6	11.6	10.4	9.6	11.5	12.2	12.7	9.5	10.1	9.5	10.1	9.5	9.4	9.2

Note. Data after 1999:Q1 are staff projections.
1. For corporations: Excess of capital expenditures over U.S. internal funds.
2. Includes change in liabilities not shown in lines 8 and 9.
3. Average debt levels in the period (computed as the average of period-end debt positions) divided by disposable personal income.
4. NIPA surplus less changes in retirement fund assets plus consumption of fixed capital.
5. Average debt levels in the period (computed as the average of period-end debt positions) divided by nominal GDP.
6. Excludes government-insured mortgage pool securities.

2.6.4 FOF

International Developments

The global economy's rebound from its recent slowdown continues, led by a burgeoning recovery in the Asian emerging market economies. Recent information also suggests a pickup in Mexico and Brazil. However, although the improvement in activity is fairly widespread among countries, there are some notable exceptions. In particular, Japanese prospects are still uncertain, and several other Latin American economies remain weak.

Recent information suggests that the pace of the overall rebound exceeds our previous expectations. Export-weighted foreign real GDP is estimated to have increased at an annual rate of 3½ percent in the first half of 1999, more than 1 percentage point higher than previously projected. We have also revised up our projection for growth over the forecast period to an average rate of 3 percent, almost ½ percentage point higher than previously projected. Consequently, we have raised our forecast for U.S. net exports and lowered our path for the dollar a small amount. We have also revised up our projected path for oil prices in response to recent developments, primarily continued production discipline among OPEC countries.

Recent Developments

International financial markets. Since the June FOMC meeting, the weighted average foreign exchange value of the dollar, as measured by the staff's broad nominal index, has dropped about 1 percent on balance. The two major components of the index have moved in opposite directions, with the dollar falling 2½ percent relative to the major foreign currencies while rising almost 1 percent in terms of the currencies of our other important trading partners.

The decline in the major foreign currency index occurred in response to information suggesting a pickup in activity in Europe and the possibility of light at the end of the tunnel for Japan.

Japanese monetary policy has remained on hold, and government bond yields have been stable over the period. The Nikkei index has declined slightly in response to concerns about the effect of the stronger yen on the economy. Japanese monetary authorities intervened to restrain the rise in the yen three times in July,

. Since the latest operation on July 21, the yen has appreciated another 5 percent.

In the euro area, ten-year government bond yields have risen more than 30 basis points since the June FOMC, narrowing the spread relative to comparable U.S. Treasuries. Long-term interest rates have also moved up somewhat in the United Kingdom and Canada. These movements apparently reflected some increase in market perceptions of the likelihood of official interest rate hikes over the next year. Share prices in the major foreign industrial countries changed little over the period.

The appreciation of the dollar relative to the currencies of other major trading partners reflects increased uncertainty in both Asian and Latin American financial markets. Over the intermeeting period, the dollar appreciated about 4 percent in terms of the Thai baht, the Korean won, and the Philippine peso, and 10 percent against the Indonesian rupiah. Tensions between China and Taiwan, as well as a heightened perception of a possible devaluation of the renminbi, contributed to falling equity prices in much of the region.

Latin American financial markets appeared particularly sensitive to prospects for rising interest rates in the United States. The Mexican peso moved up slightly on balance over the period, supported in part by rising crude oil prices, but the Brazilian *real* depreciated 6 percent. Concerns over the future of Argentina's currency board persist, as the recession has appeared to deepen and political uncertainty before this fall's presidential election has increased. Equity prices fell 13 percent in Brazil, 8 percent in Argentina and 6 percent in Mexico. Brady yield spreads over Treasuries widened appreciably on balance during the intermeeting period, with the Emerging Market Bond Index spread increasing 100 basis points.

. The Desk did not intervene during the period for the accounts of the System or the Treasury.

Economic activity abroad. Recent indicators for economic activity in the foreign industrial economies suggest that the recovery in Europe is gaining momentum in the current quarter, while the Japanese contraction shows tenuous signs of bottoming out. Meanwhile, the Canadian economy continues to thrive.

Second-quarter data for Japan indicate a reversal of some of the surprising jump in GDP in the first quarter. Both production and orders have fallen, and the unemployment rate has continued to climb. One of the few bright spots is housing construction, which has continued to rise, largely reflecting government incentives. Forward-looking indicators are mixed. Machinery orders have fallen sharply, more than reversing their first-quarter rise, but the June Tankan survey showed some improvement in business confidence.

In contrast, recent indicators for the euro area point to a brightening outlook. Although euro-zone industrial production in April and May was below the first-quarter average, forward-looking indicators such as orders and business and consumer sentiment have turned decidedly positive.

GDP growth in the United Kingdom accelerated in the second quarter after stagnating over the previous two quarters, and both business and consumer confidence are at high levels, signaling continued improvement. The Canadian economy continued to expand briskly in the second quarter, and recent gains in new orders as well as a sharp jump in employment in July suggest further robust expansion in the current quarter.

Inflationary pressures remain quiescent in the major foreign industrial economies. Japanese prices were unchanged in the twelve months ended in July, as higher oil prices offset continued deflationary pressure. Higher oil prices have also resulted in an uptick in prices in some euro-zone countries, but aggregate year-over-year inflation for the area is still around 1 percent, well below the ECB's 2 percent ceiling. U.K. inflation, at 2¼ percent in July, is also comfortably below the target rate of 2½ percent. Canadian inflation moved up to 1¾ percent in July, just below the midpoint of the Bank of Canada's 1 to 3 percent target range.

The situation is mixed in the developing countries. The Asian countries except China and Hong Kong posted robust growth in the first half of this year, although the level of output remains below 1997 peaks in most of these countries. In contrast, Chinese growth has slowed sharply. Hong Kong's economy also remains weak, although a dip in the unemployment rate in the second quarter suggests that some improvement may be occurring.

The recent performance of the Latin American countries has also been uneven. Growth in Mexico appears to have accelerated this year to a nearly 8 percent pace in the second quarter. The Brazilian economy has also perked up following last year's recession, posting growth of about 4 percent at an annual rate in both the first and second quarters of this year. However, the Argentine economy appears to have continued to contract in the second quarter, which would be the fourth consecutive quarterly decline in real GDP. Several other Latin American economies also remain weak.

Inflation rates remain low in most developing countries. Consumer prices were down from a year earlier in the most recent data for China, Taiwan, Hong Kong, and Thailand and were little changed in Korea and Singapore. Inflation rates are positive but declining in the other Asian developing countries. In Latin America, weak activity in Argentina has contributed to a drop in prices over the past year. Inflation rates are still in double digits in Mexico and Venezuela but have declined somewhat this year. Year-over-year inflation has picked up to about 4½ percent in Brazil recently, largely reflecting hikes in administered fuel prices.

U.S. net exports and prices. In May, the nominal U.S. trade deficit was $21.3 billion, up $2.7 billion from April. The widening deficit reflected a small drop in the value of exports along with a sharp rise in imports. For April-May combined the deficit was $240 billion at an annual rate, up from $215 billion in the first quarter. Data for June will be released on August 19 and will be reviewed in the Greenbook Supplement.

The value of exports fell ¾ percent in May with declines widespread among major categories. However, for April-May combined the value of exports was up a bit over the first quarter. Imports were up 2 percent in May and were 2¾ percent above the first-quarter level for April and May on average, with much of the increase resulting from higher oil prices.

Oil prices have continued to rise as OPEC sticks to its production restraint agreements. The monthly average spot price of WTI increased from $17.75 in May to more than $20 per barrel in July, and the spot price is now trading around $21.50. Supply disruptions in Nigeria and strengthening world economic activity have also contributed to higher prices.

Prices of non-oil imports decreased 2 percent at an annual rate in the second quarter and fell slightly further in July. Prices of core goods imports (which exclude oil, computers, and semiconductors) declined a little more than 1 percent at an annual rate in the second quarter after two quarters of virtually no price change. In July, the price index of core goods was very slightly higher than the second-quarter average, largely as a result of rising prices of industrial supplies. Prices of exports were down a little in the second quarter on average, and also in July, primarily reflecting substantial declines in prices of agricultural exports.

Outlook

Growth of foreign real GDP (weighted by U.S. nonagricultural export shares) is projected to average about 3 percent (annual rate) over the forecast period. This is somewhat stronger than our previous projection, with the bulk of the upward revision in the outlook for the Asian developing countries. The forecasts for Canada and Europe are also marginally stronger.

As in the June forecast, we assume that Y2K effects will raise foreign growth in the second half of 1999 because of inventory accumulation and reduce it in the first half of 2000 as stocks are run down. The dollar is expected to depreciate a small amount in real terms relative to our broad index of trading-partner currencies over the forecast period. The trajectory for the dollar is similar to the previous projection, although the level is lower as a result of the recent depreciation.

Summary of Staff Projections
(Percent change, seasonally adjusted annual rate)

Measure	1998	Projection			
		1999			2000
		H1	Q3	Q4	
Foreign output	0.5	3.5	2.5	3.4	3.0
June GB	*0.6*	*2.3*	*2.1*	*3.0*	*2.7*
Real exports	1.1	-0.8	4.8	7.2	5.3
June GB	*1.1*	*-1.3*	*1.3*	*6.3*	*4.7*
Real imports	9.7	11.5	10.6	9.5	7.7
June GB	*9.7*	*11.8*	*11.1*	*8.5*	*7.6*

NOTE. Changes for years are measured as Q4/Q4; for half-years, Q2/Q4 or Q4/Q2; and for quarters, from previous quarter.

Declines in U.S. real net exports are expected to subtract ¾ percentage point from U.S. real GDP growth in the second half of 1999 and ½ percentage point in 2000, as the rebound in exports and continued slowing of import growth lessen the negative contribution of the external sector.

The dollar. The nominal exchange value of the dollar against the index of major foreign currencies is still expected to decline moderately from its current level. We continue to assume that the dollar will move lower against the euro, partly in response to widespread current account imbalances, and partly as a result of the expected pickup in European growth. We also expect partial reversal of the recent appreciation relative to the Canadian dollar, as the continuing recovery of commodity prices provides some near-term support for the Canadian currency. This forecast assumes that the Bank of Canada will match any U.S. interest rate increases. Against the yen, we project that the dollar strengthens a little from its current level in the near term. The continued accommodative stance of Japanese monetary policy and market participants' likely disappointment with the pace of recovery in Japan should lend support to the dollar. However, the dollar remains vulnerable to a downward correction against the yen owing to the persistence of the widening current account imbalances of the two countries.

The real exchange value of the dollar against the currencies of a wider group of U.S. trading partners, as measured by the staff's broad index, is projected to edge down over the forecast period. U.S. consumer price inflation, which is expected to outstrip inflation in most of the foreign industrial countries, offsets a part of the nominal decline against the major foreign currencies. In addition, we continue to expect the dollar to appreciate in real terms against all major Latin American currencies except the Brazilian *real*. As before, we are projecting that the Chinese renminbi will be devalued at some point during the forecast period, a view held with somewhat more confidence owing to the recent slowing in Chinese growth as well as recent regional political tensions. In contrast, we assume that the Argentine and Hong Kong currency pegs will hold, although they confront more downside risk than they may have previously.

Activity in foreign industrial countries. Real export-weighted GDP in the foreign industrial countries is projected to grow at an annual rate of about 2¼ percent over the forecast period. Absent the assumed Y2K effect, which shifts ¼ percentage point of growth from 2000 into 1999, the forecast would have a modest upward trajectory.

The Japanese economy is expected to contract in the second half of 1999, reflecting payback for unsustainably strong first-quarter growth, further declines in business investment, and weakness in the consumer sector owing to declining compensation and uncertainty about employment prospects. Moving into next year, we expect that the economy will register modestly positive growth, as exports to other Asian countries continue to recover and domestic demand stabilizes. We assume that the Bank of Japan will maintain its current monetary policy stance through the end of the forecast period and that the fiscal impulse will remain modestly positive.

We are projecting euro-area GDP growth to average 2½ percent at an annual rate over the forecast period. The relatively competitive value of the euro, despite its recent appreciation versus the dollar, and the low level of interest rates should both be important in supporting activity going forward.

U.K. GDP is projected to grow at a rate of about 2¼ percent over the forecast period as recent monetary easing is expected to help keep economic growth on an upward path. Canadian growth is projected to average about 3 percent over the forecast period, with some slowing next year as the U.S. economy decelerates and export growth is restrained by the assumed rise in the Canadian dollar.

Inflation. Consumer price inflation in the foreign industrial countries, weighted by U.S. non-oil import shares, is projected to average about 1 percent on a year-over-year basis over the forecast period. This is little changed from the June Greenbook, as the higher path for oil prices is offset by a greater amount of exchange rate appreciation.

Interest rates. Short-term interest rates in Japan are assumed to remain near zero throughout the forecast period. Euro-area short-term rates are assumed to remain unchanged this year and to increase 25 basis points in the second half of next year as the expansion gains momentum. The Bank of England is expected to tighten monetary policy in the middle of next year as U.K. inflation rises toward the target rate. With diminishing economic slack in Canada, we project that the Bank of Canada will raise interest rates by 25 basis points by the end of this year and another 25 basis points next year.

Other countries. Real export-weighted GDP in the developing countries is expected to expand at an average pace of about 4 percent, a rate nearly ¾ percentage point above that in the June forecast. The upward revision is entirely in the outlook for developing Asia; the aggregate projection for Latin America is little changed.

We now project real GDP growth of about 5 percent on average for developing Asia over the forecast period, about 1½ percentage points higher than in the June Greenbook. The upward revisions have been greatest among the ASEAN countries, which appear to be rebounding much more quickly than previously anticipated, partly reflecting a pickup in the global electronics market. This suggests that economic activity in these countries may be returning to capacity sooner than we had expected; the still-unresolved problems in the banking sectors of some of these countries do not appear at this time to be as much of a hindrance to growth as we had assumed. Export-weighted growth in these countries is now expected to average about 5½ percent over the forecast period, up 3 percentage points from the June Greenbook forecast. In contrast, we have revised down our projection for average growth in China about ¾ percentage point, to 5¼ percent.

Real GDP in the Latin American developing countries is expected to expand at an average pace of 3¼ percent over the forecast period, a forecast little changed from that in the last Greenbook, as a small upward revision to projected growth in Mexico in response to recent information has been offset by a more pessimistic outlook for Argentina and Chile. The outlook for Brazilian growth is little changed.

Century date change. We continue to assume that Y2K will affect the quarterly pattern of GDP growth abroad in the second half of 1999 and the first half of 2000. We know very little about the likely magnitude of these effects across countries, but although many countries are less prepared than the United States to deal with these problems, they are also generally less dependent than the U.S. economy on computers.

Real exports and imports of goods and services. Real net exports are estimated to have weakened in the second quarter. However, the negative contribution to real GDP growth, ¾ percentage point at an annual rate, was only about one-third the size of that in the first-quarter. Growth in net exports is expected to subtract ¾ percentage point from GDP growth in the second half of the year and ½ percentage point next year.

Real exports of goods and services are expected to grow at a 5½ percent annual rate over the remaining six quarters of the forecast period after changing little during the first half of 1999. The improvement relative to the first half of this year is primarily in core exports (goods other than agricultural products, computers, and semiconductors) and reflects both the pickup in foreign economic activity as well as the fading impact of past increases in the foreign exchange value of the dollar. This projection calls for total export growth to be higher than in the June Greenbook by about 2 percentage points (annual rate) for the second half of this year and about ½ percentage point next year.

Growth of real imports of goods and services is projected to average 10 percent at an annual rate in the second half of the year, a little below the first-half pace, and to slow to a little less than 8 percent in 2000. The pattern largely reflects the behavior of core imports. The projected slowing results from both moderating growth in U.S. activity as well as increasing import prices.

The quantity of imported oil is expected to increase more rapidly than consumption over the forecast period as domestic production continues to decline in response to the past year's low level of oil prices. Because of the recent run-up in prices, however, domestic production is not expected to fall as rapidly as we previously anticipated. The assumed precautionary increase in stocks because of Y2K increases oil imports about 3 percent during the fourth quarter of this year and decreases imports by the same volume during the first quarter of 2000.

Oil prices. The staff has raised its forecast for the price of imported oil $2.25 per barrel for the second half of 1999 and the first half of 2000 and about $1.50 per barrel for the second half of 2000. These revisions reflect lower projections for OPEC production in accord with recent relatively high compliance with its production targets, stronger predicted world economic activity, declining inventories, and a weaker exchange value of the dollar. We now anticipate that OPEC will hold production at current levels through the third quarter of this year. The price of imported oil is expected to increase to around $18.50 per barrel in the fourth quarter of this year and then to decline gradually to around $16 per barrel by the end of 2000 as OPEC loosens its production constraints and non-OPEC production increases in response to the higher prices.

Selected Trade Prices
(Percent change except as noted; seasonally adjusted annual rate)

Trade category	1998	1999 H1	Projection 1999 Q3	Projection 1999 Q4	Projection 2000
Exports					
Nonagricultural (core)	-1.9	0.5	1.4	1.5	1.2
Agricultural	-9.9	-9.1	2.0	2.0	2.4
Imports					
Non-oil (core)	-2.0	-0.5	0.7	1.7	1.8
Oil (level, dollars per barrel)	11.40	14.69	17.40	18.61	16.22

NOTE. Prices for exports and non-oil imports of goods, excluding computers and semiconductors, are on a NIPA chain-weighted basis.
Changes for years are measured as Q4/Q4; for half-years, Q2/Q4 or Q4/Q2; and for quarters, from previous quarter.
The price of imported oil for multi-quarter periods is the price for the final quarter of the period.

Prices of non-oil imports and exports. Prices of core imports are projected to increase in the second half of the year following three and a half years of decline as commodity prices pick up with the rebound in foreign activity and the lagged effects of earlier dollar gains dissipate. Core import prices are projected to rise just under 2 percent in 2000. Core export prices are forecast to rise moderately in line with comparable U.S. domestic prices.

Nominal trade and current account balances. The nominal trade deficit for goods and services is projected to widen substantially from an estimated annual rate of $246 billion in the second quarter of 1999 to $312 billion in the fourth quarter of 2000. The deficit for net investment income is expected to widen somewhat this year and next. Accordingly, the current account deficit, which was $220 billion (2.6 percent of GDP) in 1998, is projected to rise to about $375 billion in 2000, 4.0 percent of projected GDP. The previous peak level of the current-account-deficit-to-GDP ratio was 3.5 percent in 1987.

Weaker U.S. dollar. Although there are always considerable risks to the exchange rate forecast in both directions, we continue to believe that one of the most significant is that the large and growing U.S. current account deficit will become a more central focus of attention to market participants. Questions about the longer-term sustainability of that deficit could result in a significant depreciation of the dollar. In the scenario summarized in the following table, we have considered the effects of a dollar path that is 10 percent weaker than our current forecast throughout the projection period.[1] In this case, both U.S. real GDP growth and CPI inflation are substantially higher in 2000, assuming no change in U.S. monetary policy.

Impact of Weaker Dollar Alternative
(Percent change, Q4 to Q4)

Measure	1999	2000
U.S. real GDP		
Baseline	3.4	2.8
Alternative	3.4	3.7
U.S. CPI excluding food and energy		
Baseline	2.1	2.6
Alternative	2.1	3.2

NOTE. Simulation assumes nominal federal funds rate unchanged from baseline.

1. More precisely, the exogenous shock to each bilateral exchange rate is in the form of a change in the risk premium that is calibrated so that the U.S. dollar would depreciate by 10 percent in the absence of any changes in bilateral long-term real interest rate differentials. In response to the dollar depreciation, foreign monetary authorities reduce short-term interest rates, leading to a fall in long-term real rates as well. However, with the federal funds rate held at the baseline path over the simulation period, higher expected inflation causes U.S. long-term real interest rates to fall slightly more than corresponding foreign rates, leading to a further ¾ percent dollar depreciation by the end of 2000.

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

Measure and country	1992	1993	1994	1995	1996	1997	1998	-Projected- 1999	2000
REAL GDP (1)									
Total foreign	2.3	3.1	5.2	2.2	4.3	4.1	0.5	3.3	3.0
Industrial Countries	0.6	1.9	4.0	1.8	2.9	3.3	1.7	2.5	2.2
of which:									
Canada	0.9	2.9	5.5	1.4	2.4	4.4	2.8	3.6	2.7
Japan	0.1	0.5	0.9	2.5	5.1	-0.8	-3.0	0.3	0.4
United Kingdom	0.7	3.2	4.6	1.9	2.9	3.4	1.6	1.9	2.2
Euro-11	0.1	0.0	3.0	1.5	1.6	3.1	1.9	2.2	2.4
Germany	0.8	-0.2	2.8	0.9	1.5	1.8	1.3	2.0	2.5
Developing Countries	4.8	4.9	6.9	2.9	6.3	5.2	-1.0	4.3	4.0
Asia	7.1	7.5	8.8	7.3	6.9	4.9	-2.7	5.9	4.7
Korea	3.9	6.3	9.4	7.2	6.8	3.7	-5.3	7.0	4.9
China	14.6	6.1	16.3	12.6	9.2	8.2	9.5	3.4	5.4
Latin America	2.8	2.6	5.5	-4.0	6.3	6.3	0.8	3.0	3.4
Mexico	2.5	1.9	5.1	-7.3	7.5	7.2	2.9	4.3	4.0
Brazil	0.1	4.4	9.6	-1.5	4.9	2.0	-1.9	3.0	2.5
CONSUMER PRICES (2)									
Industrial Countries	2.0	2.1	1.1	1.3	1.5	1.6	1.0	0.8	1.1
of which:									
Canada	1.8	1.8	-0.0	2.1	2.0	1.0	1.1	1.8	2.1
Japan	0.9	1.2	0.8	-0.8	0.1	2.1	0.7	-1.4	-1.1
United Kingdom (3)	3.7	2.7	2.2	2.9	3.2	2.8	2.6	2.2	2.5
Euro-11 (4)	NA	NA	NA	2.7	2.0	1.4	0.9	1.8	1.5
Germany	3.4	4.3	2.6	1.5	1.4	2.1	0.4	0.9	1.3
Developing Countries	21.6	24.7	23.0	17.0	11.2	6.9	8.9	5.4	6.1
Asia	5.5	7.7	10.7	6.4	4.8	2.8	4.6	0.9	3.1
Korea	4.7	5.5	5.8	4.4	5.1	5.1	6.0	0.4	3.5
China	8.2	17.1	26.9	11.1	7.0	1.0	-1.1	0.2	2.4
Latin America	71.7	74.2	54.3	42.2	26.0	15.8	15.5	13.4	11.1
Mexico	13.2	8.6	6.9	48.8	28.1	17.2	17.6	14.7	11.9
Brazil	1118.8	2287.6	1216.3	23.1	10.8	5.3	1.8	7.8	6.3

1. Foreign GDP aggregates calculated using shares of U.S. non-agricultural exports.
2. Foreign CPI aggregates calculated using shares of U.S. non-oil imports.
3. CPI excluding mortgage interest payments, which is the targeted inflation rate.
4. Harmonized CPI's, weighted by shares in final consumption of households converted to a common currency using estimated PPP exchange rates.

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OUTLOOK FOR FOREIGN REAL GDP AND CONSUMER PRICES: SELECTED COUNTRIES
(Percent changes)

Measure and country	1998 Q1	1998 Q2	1998 Q3	1998 Q4	1999 Q1	1999 Q2	1999 Q3	1999 Q4	2000 Q1	2000 Q2	2000 Q3	2000 Q4
						Projected						
REAL GDP (1)	Quarterly changes at an annual rate											
Total foreign	-0.7	0.4	1.0	1.4	3.7	3.4	2.5	3.4	1.1	3.8	3.5	3.5
Industrial Countries	1.7	1.1	1.8	2.1	3.7	1.9	1.8	2.7	0.2	3.5	2.8	2.5
of which:												
Canada	2.8	1.1	2.6	4.8	4.2	3.5	3.0	3.6	0.4	4.2	3.4	3.0
Japan	-4.8	-2.9	-1.2	-3.3	8.1	-3.0	-3.1	-0.3	-1.1	1.6	0.5	0.7
United Kingdom	2.2	1.9	2.2	0.2	0.5	2.0	2.4	2.8	0.5	3.1	2.9	2.4
Euro-11	2.4	2.2	2.1	1.1	1.9	2.0	2.4	2.7	0.4	3.6	3.0	2.7
Germany	4.1	0.0	1.8	-0.6	1.8	1.5	2.2	2.7	0.7	3.4	3.1	3.0
Developing Countries	-3.8	-0.6	0.0	0.7	3.8	5.3	3.6	4.5	2.4	4.3	4.6	4.8
Asia	-10.6	-3.6	-0.1	4.1	6.9	6.3	4.9	5.6	2.3	5.1	5.6	6.0
Korea	-23.0	-5.3	4.0	6.0	14.7	3.5	5.0	5.3	3.0	5.7	5.0	5.9
China	7.0	6.5	11.0	13.8	2.2	1.1	4.7	5.5	2.2	5.2	7.0	7.3
Latin America	4.0	2.5	0.3	-3.6	0.5	5.3	2.5	3.8	2.7	3.8	3.7	3.7
Mexico	5.1	2.6	3.8	0.1	1.3	7.7	3.8	4.7	3.9	4.1	3.9	3.9
Brazil	-0.4	5.7	-6.0	-6.6	4.1	3.8	1.2	3.1	0.6	3.2	3.2	3.2
CONSUMER PRICES (2)	Four-quarter changes											
Industrial Countries	1.5	1.1	0.8	1.0	0.6	0.9	1.0	0.8	0.9	1.0	1.1	1.1
of which:												
Canada	1.0	1.0	0.9	1.1	0.8	1.6	1.7	1.8	1.9	2.0	2.1	2.1
Japan	2.1	0.6	-0.1	0.7	-0.2	-0.4	-0.5	-1.4	-1.1	-1.1	-1.1	-1.1
United Kingdom (3)	2.5	3.0	2.6	2.6	2.6	2.3	2.2	2.2	2.3	2.3	2.4	2.5
Euro-11 (4)	1.2	1.4	1.2	0.9	0.9	1.0	1.5	1.8	1.6	1.6	1.5	1.5
Germany	1.2	1.4	0.6	0.4	0.3	0.5	0.7	0.9	1.0	1.1	1.2	1.3
Developing Countries	7.4	7.6	7.9	8.9	7.8	6.5	5.8	5.4	5.6	6.0	6.2	6.1
Asia	4.2	4.7	4.6	4.6	2.6	0.8	0.4	0.9	1.5	2.4	2.9	3.1
Korea	8.9	8.2	7.0	6.0	0.7	0.6	0.1	0.4	1.2	1.8	3.3	3.5
China	0.4	-0.9	-1.4	-1.1	-1.4	-2.2	-1.0	0.2	1.0	1.8	2.1	2.4
Latin America	14.1	14.1	14.2	15.5	16.3	15.4	14.5	13.4	12.2	11.6	11.3	11.1
Mexico	15.3	15.1	15.6	17.6	18.6	17.9	16.5	14.7	13.3	12.5	12.1	11.9
Brazil	4.6	3.7	2.6	1.8	2.3	3.3	5.6	7.8	7.5	7.0	6.6	6.3

1. Foreign GDP aggregates calculated using shares of U.S. non-agricultural exports.
2. Foreign CPI aggregates calculated using shares of U.S. non-oil imports.
3. CPI excluding mortgage interest payments, which is the targeted inflation rate.
4. Harmonized CPI's, weighted by shares in final consumption of households converted to a common currency using estimated PPP exchange rates.

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OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1992	1993	1994	1995	1996	1997	1998	Projected 1999	Projected 2000
NIPA REAL EXPORTS and IMPORTS									
	Percentage point contribution to GDP growth, Q4/Q4								
Net Goods & Services	-0.4	-0.6	-0.4	0.5	-0.3	-0.6	-1.1	-1.1	-0.5
Exports of G&S	0.4	0.5	1.0	1.1	1.2	1.1	0.1	0.3	0.6
Imports of G&S	-0.8	-1.1	-1.4	-0.7	-1.4	-1.7	-1.2	-1.4	-1.1
	Percentage change, Q4/Q4								
Exports of G&S	4.1	4.6	10.0	10.5	10.3	9.6	1.1	2.5	5.3
Services	-0.9	4.1	6.0	9.8	7.5	1.5	-0.6	2.8	3.0
Agricultural Goods	10.4	-5.5	16.6	-4.3	4.8	2.8	-1.2	-5.8	2.2
Computers	25.2	23.7	32.0	55.5	35.9	40.7	6.4	27.4	29.5
Semiconductors	64.8	32.9	66.9	79.6	46.2	21.0	7.8	31.1	24.6
Other Goods 1/	2.3	3.6	7.0	5.8	8.0	11.6	1.3	-0.6	3.3
Imports of G&S	7.4	10.2	12.3	5.6	11.8	14.0	9.7	10.8	7.7
Services	1.4	3.2	1.4	6.1	5.5	12.4	2.4	7.5	3.5
Oil	12.1	10.1	-0.2	2.4	7.9	4.0	5.9	10.6	2.1
Computers	45.1	39.3	44.8	48.1	24.4	30.3	28.3	44.5	36.7
Semiconductors	42.0	34.2	54.5	92.4	57.6	32.7	-7.8	33.3	28.9
Other Goods 2/	5.4	9.5	12.2	-1.1	10.4	13.0	10.9	7.9	5.8
	Billions of chained 1992 dollars								
Net Goods & Services	-29.5	-70.2	-104.6	-96.5	-111.2	-136.1	-238.2	-333.6	-396.5
Exports of G&S	639.4	658.2	712.4	792.6	860.0	970.0	984.7	1013.7	1060.7
Imports of G&S	669.0	728.4	817.0	889.0	971.2	1106.1	1222.9	1347.3	1457.2
	Billions of dollars								
US CURRENT ACCOUNT BALANCE	-50.6	-50.6	-85.3	-121.7	-113.6	-129.3	-220.6	-318.4	-377.4
Net Goods & Services (BOP)	-37.0	-37.0	-69.9	-98.4	-97.5	-104.3	-164.3	-253.6	-306.0
Net Income	22.3	22.3	23.2	15.9	19.4	17.2	-12.2	-21.9	-28.6
Direct, Net	54.7	54.7	58.6	54.4	63.8	67.7	59.4	60.9	71.3
Portfolio, Net	-29.1	-29.1	-31.7	-34.1	-39.9	-46.0	-66.4	-77.3	-94.3
Employee Comp., Net	-3.3	-3.3	-3.7	-4.4	-4.5	-4.5	-5.2	-5.6	-5.6
Net Transfers	-35.9	-35.9	-38.5	-39.2	-35.4	-42.2	-44.1	-42.8	-42.8

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

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OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1995				1996				1997			
	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	-0.2	-0.3	1.6	0.7	-1.1	-1.0	-1.4	2.4	-1.3	-0.4	-0.5	-0.3
Exports of G&S	1.0	0.6	1.9	1.1	0.4	0.6	0.2	3.2	0.9	1.7	1.2	0.5
Imports of G&S	-1.2	-0.9	-0.3	-0.4	-1.5	-1.6	-1.6	-0.9	-2.2	-2.2	-1.7	-0.8
Percentage change from previous period, SAAR												
Exports of G&S	9.2	5.4	17.8	10.2	3.7	5.8	2.1	32.0	8.3	15.5	10.6	4.4
Services	9.1	2.9	21.7	6.4	-4.0	10.3	-9.9	39.8	-6.7	11.8	5.9	-4.0
Agricultural Goods	1.8	-13.4	5.0	-9.4	22.6	-32.8	-1.6	48.7	-16.1	-7.8	8.7	32.8
Computers	36.4	33.8	86.6	71.6	57.6	24.7	27.7	35.9	70.2	78.7	41.9	-9.2
Semiconductors	72.0	100.8	96.2	53.6	23.8	29.7	30.2	118.6	41.3	17.3	32.3	-2.2
Other Goods 1/	4.3	1.4	9.4	8.1	0.1	6.0	5.7	21.3	13.8	15.6	9.2	8.0
Imports of G&S	9.8	7.2	2.0	3.5	13.1	13.5	13.6	7.0	18.6	17.9	13.5	6.3
Services	20.5	-3.3	3.1	5.5	9.2	4.3	9.9	-1.1	17.8	10.6	15.8	5.8
Oil	-11.4	15.4	31.4	-18.2	-9.8	68.9	3.5	-14.0	-8.2	37.0	6.0	-12.2
Computers	15.4	51.6	62.7	69.3	22.5	22.9	18.8	33.8	54.5	39.0	30.6	2.9
Semiconductors	37.1	105.5	128.2	113.3	38.7	8.9	50.1	172.1	89.0	16.0	20.3	17.6
Other Goods 2/	7.2	1.5	-8.8	-3.8	13.9	10.5	13.4	4.1	16.2	16.1	11.8	8.1
Billions of chained 1992 dollars, SAAR												
Net Goods & Services	-109.5	-114.7	-86.8	-74.8	-95.5	-113.5	-140.1	-95.9	-121.5	-131.6	-142.4	-149.0
Exports of G&S	763.9	774.0	806.3	826.1	833.6	845.5	849.9	911.1	929.4	963.6	988.1	998.8
Imports of G&S	873.4	888.7	893.1	900.9	929.1	958.9	990.0	1007.0	1050.9	1095.2	1130.5	1147.8
Billions of dollars, SAAR												
US CURRENT ACCOUNT BALANCE	-122.1	-132.9	-112.3	-87.1	-122.1	-132.9	-112.3	-87.1	-107.0	-125.8	-153.3	-131.1
Net Goods & Services (BOP)	-107.2	-123.6	-87.2	-72.1	-89.4	-105.9	-125.9	-96.1	-106.4	-96.8	-102.9	-112.8
Net Income	20.6	24.3	10.3	22.4	20.6	24.3	10.3	22.4	26.1	16.8	10.6	15.3
Direct, Net	61.7	68.4	57.0	68.1	61.7	68.4	57.0	68.1	68.5	64.3	63.6	74.5
Portfolio, Net	-36.7	-39.6	-42.2	-41.1	-36.7	-39.6	-42.2	-41.1	-38.2	-43.0	-48.5	-54.3
Employee Comp., Net	-4.4	-4.5	-4.5	-4.6	-4.4	-4.5	-4.5	-4.6	-4.3	-4.5	-4.5	-4.9
Net Transfers	-35.5	-33.6	-35.3	-37.3	-43.7	-36.7	-38.0	-50.3	-37.4	-38.0	-40.4	-52.1

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1998				1999				2000			
						Projected						
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-2.3	-2.1	-0.6	0.5	-2.3	-0.8	-0.9	-0.5	-0.3	-1.0	-0.5	-0.0
Exports of G&S	-0.3	-0.9	-0.3	2.0	-0.6	0.4	0.5	0.8	0.0	0.6	0.6	1.0
Imports of G&S	-1.9	-1.2	-0.3	-1.5	-1.7	-1.2	-1.4	-1.3	-0.4	-1.7	-1.1	-1.0
Percentage change from previous period, SAAR												
Exports of G&S	-2.7	-7.7	-2.8	19.7	-5.1	3.7	4.8	7.2	0.1	6.0	6.0	9.4
Services	-1.2	1.6	-10.3	8.3	4.3	3.6	0.8	2.6	0.9	4.1	3.5	3.6
Agricultural Goods	-9.6	-23.5	-14.3	61.1	-37.9	21.4	2.2	2.2	2.2	2.2	2.2	2.2
Computers	-15.4	8.5	20.7	15.7	0.2	46.8	43.1	25.0	27.4	29.8	29.8	31.0
Semiconductors	-2.0	-14.3	23.9	29.9	34.2	41.1	25.3	24.4	24.4	24.4	24.8	24.8
Other Goods 1/	-1.7	-10.9	-1.2	21.9	-8.8	-3.0	2.8	7.4	-4.4	3.9	4.2	10.2
Imports of G&S	15.7	9.4	2.3	12.0	13.5	9.6	10.6	9.5	2.6	12.5	8.4	7.6
Services	9.3	-0.7	-0.5	1.9	11.9	2.0	10.1	6.2	1.0	5.1	4.2	3.9
Oil	8.8	41.6	-5.8	-13.4	7.0	28.2	9.6	-0.3	-21.9	42.2	3.5	-5.2
Computers	38.7	22.6	9.6	45.3	43.8	66.9	43.8	26.2	31.1	38.6	38.6	38.6
Semiconductors	9.9	-27.8	-3.0	-6.4	17.5	55.7	36.0	26.7	28.2	28.6	29.1	29.6
Other Goods 2/	16.1	10.8	3.5	13.9	11.6	4.3	7.0	9.0	2.1	9.0	6.4	6.0
Billions of chained 1992 dollars, SAAR												
Net Goods & Services	-198.5	-245.2	-259.0	-250.0	-303.6	-324.5	-346.5	-360.0	-368.7	-395.4	-409.4	-412.5
Exports of G&S	991.9	972.1	965.3	1009.6	996.5	1005.6	1017.4	1035.2	1035.6	1050.7	1066.2	1090.4
Imports of G&S	1190.4	1217.3	1224.3	1259.6	1300.1	1330.1	1363.9	1395.2	1404.3	1446.1	1475.6	1503.0
Billions of dollars, SAAR												
US CURRENT ACCOUNT BALANCE	-172.1	-209.6	-253.9	-246.7	-274.3	-305.3	-333.4	-360.7	-356.2	-376.7	-383.6	-393.0
Net Goods & Services (BOP)	-133.4	-167.8	-182.9	-173.1	-215.0	-245.7	-269.6	-284.2	-288.7	-308.1	-315.0	-312.3
Net Income	1.0	-2.2	-27.9	-19.7	-18.9	-19.6	-23.7	-25.5	-27.5	-28.6	-28.6	-29.7
Direct Net	67.3	64.7	47.3	58.2	58.1	61.2	60.8	63.5	65.3	68.3	73.6	78.0
Portfolio, Net	-61.3	-61.8	-69.9	-72.5	-71.4	-75.2	-79.0	-83.5	-87.2	-91.3	-96.7	-102.1
Employee Comp, Net	-5.1	-5.2	-5.3	-5.4	-5.6	-5.6	-5.6	-5.6	-5.6	-5.6	-5.6	-5.6
Net Transfers	-39.7	-39.5	-43.1	-53.9	-40.4	-40.0	-40.0	-51.0	-40.0	-40.0	-40.0	-51.0

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