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May 9, 1990

SUMMARY AND OUTLOOK

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

Overview

As in previous forecasts, the current projection depicts an economy growing slowly, with aggregate demand damped by a monetary policy aimed at reducing inflation. The staff's assessment of the underlying strength of the demand for goods and services during the forecast period as a whole has not changed materially since the March Greenbook, although we now expect a greater proportion of the impetus to activity to be derived from domestic sources. Where this projection differs most importantly from the last is that monetary assumptions have been made somewhat more restrictive, with an eye toward securing a more meaningful disinflationary trend in 1991; the result is a noticeably slower advance in real GNP next year.

Near-term Economic Conditions

Data received since the March FOMC meeting have been in line with our earlier expectation that real GNP growth in the first half of this year would run at an annual rate of 2 percent or so. The Commerce Department's advance estimate of first-quarter real GNP growth was essentially the same as had been predicted in the last Greenbook, albeit with offsetting compositional differences: Final sales were stronger than expected, while inventory investment was weaker. At this point, with manufacturing and wholesale stocks down on net in March rather than up as BEA had anticipated, the staff's best guess--in light of the labor market indicators--is that overall GNP growth in the next revision will hold in the area of 2 percent, but probably with a greater fall in inventory investment.

Given the adjustment that has occurred, stocks now appear reasonably lean overall. The correction thus has been a bit faster than anticipated in previous forecasts, and inventories should be no impediment to growth in production in the near term. Indeed, with dealers' stocks of motor vehicles having moved to relatively low levels, the biggest source of strength in the current quarter should be a pickup in motor vehicle production. On its own, the rebound in assemblies of cars and light trucks should contribute more than a percentage point to total GNP growth. If domestic sales remain near the recent pace of 6.7 million units at an annual rate--an assumption that appears reasonable given current incentive programs--the scheduled level of production should keep dealer stocks at a comfortable level in coming months.

Outside of motor vehicles, there are few signs of any current pickup in activity. Recent trends in income and indicators of sentiment point neither to a surge nor to a retrenchment in consumer spending; one plus in the second quarter, however, should be a recovery in energy expenditures from the depressed first-quarter pace. Recent increases in new orders for nondefense capital goods also point to a moderate rise in equipment purchases. Conditions are less favorable in other areas. Construction activity is likely to fall off because of tighter credit conditions and a pay-back for earlier weather-related strength, while merchandise exports have decelerated from the very rapid growth of recent years as a result of the flagging effects of pre-1988 dollar depreciation. Taking into account the April employment report, which was weaker than we had expected, total output growth this quarter appears likely to be about the same as in the first quarter. This level of activity is consistent with an average unemployment rate of 5.4 percent and a continuing slide in payroll employment in the goods-producing sector.

On the inflation front, key measures of hourly compensation and prices in the first quarter both turned out somewhat worse than the staff had anticipated. Consumer prices rose at an annual rate of 8.2 percent, 1/2 percentage point faster than projected in the March Greenbook. The March employment cost index also showed compensation increasing a little faster than expected, particularly in the benefits category. Given the noise inherent in the statistics, as well as some identifiable transitory factors, these upside surprises have had only a limited carry-forward in the present forecast. A large fall in crude oil prices since March, as well as an easing in wholesale prices of fresh vegetables, suggests that changes in the overall CPI are likely to be small in the next few months. In addition, a partial reversal of the recent jump in apparel prices seems probable, and some other first-quarter increases are unlikely to be repeated. However, when all is said and done, the recent data have reinforced the view long embodied in our forecast that restoration of a disinflationary trend is unlikely at current levels of resource utilization.

<u>Longer-term Outlook</u>

As noted in the overview, a central change in the staff projection through 1991 is the assumption that monetary policy will move more forcefully toward the restoration of a disinflationary trend within the next year and a half. The March Greenbook already had anticipated that money market conditions would firm to a degree by early 1991; but, in the current forecast, that tightening is greater, and it results not only in a substantial rise in interest rates but also contributes to a small increase in the trade-weighted exchange value of the dollar. As for fiscal policy, although discussions between the Administration and the Congress raise the possibility of a major budgetary accord, the staff, for the time being, has retained its prior assumptions, which already included a substantial deficit-reduction package for FY1991.

Under these circumstances, while real GNP still is projected to grow 2 percent in 1990, the same as in the March Greenbook, growth in 1991 is now put at less than 1-1/2 percent, versus 2 percent last time. With output expanding less rapidly than it did in 1990, the unemployment rate moves up more sharply, reaching about 6-1/4 percent in the fourth quarter of 1991. Although the core inflation rate, as represented by the CPI excluding food and energy, has been moved up a touch in 1990 (to 5 percent), prices decelerate more quickly in 1991, to less than 4-1/2 percent by the latter part of the year. If this greater degree of slack persists through 1992, the pace of inflation--absent significant supply shocks or a substantial depreciation of the dollar--could reasonably be expected to drop to about 4 percent by the end of that year. The longer-term improvement in price performance could be even more substantial if a prolonged period of monetary restraint were to yield significant "credibility" dividends.

In terms of the behavior of the monetary aggregates, the faster rise in interest rates contained in this projection suggests that growth in M2 and M3 is likely to be slower over the forecast period than was previously anticipated. Nevertheless, M2 should remain above the midpoint of its annual target range this year, before slowing somewhat in 1991. M3, reflecting what would be, under these circumstances, even greater pressures on thrift asset expansion, might be near the bottom of its range in 1990 and remain damped in 1991. Short-term interest rates are projected to ease considerably in the latter half of 1991 as inflationary pressures abate, but the effects on monetary velocity would appear with a lag, so that M2 and M3 growth would tend to be boosted only toward the end of the year.

An obvious concern is the possibility that, in present circumstances, the interest rate path does not adequately capture the overall restraint on aggregate demand imposed by credit market conditions. Our assessment is that, apart from the real estate sector, credit availability has contracted only mildly in most parts of the country. However, the projected movement in rates, which could be expected to leave its mark on share prices and other asset values, likely would exacerbate the strains now present in the financial system and create greater stress for many highly leveraged households and businesses. Consequently, the forecast anticipates a continuation of the recently greater credit stringency through next year, with the most notable effect remaining on the construction sector--especially commercial building.

In broad terms, the growth of economic activity is expected to be buoyed by consumer spending, whose momentum, especially in the service category, we now judge to be somewhat greater than was embodied in prior forecasts. Recent indicators also have suggested somewhat greater strength in near-term business fixed investment; but, while growth in BFI has been revised upward a bit for 1990, the more adverse financial environment we now foresee is reflected in a sharper deceleration in capital spending next year. In light of financial considerations, residential construction in coming quarters also has been revised downward. Net exports of goods and services now show only a modest increase in real terms over the forecast period, largely because of the effects of the change in the exchange rate projection on both exports and imports.

Consumer spending and income. Real personal consumption expenditures are expected to rise at an annual rate of nearly 2-1/2 percent in the second half of 1990, providing support to overall GNP growth. Most of the strength in consumer outlays is likely to be for services, and the staff projects spending for this category to climb at a 3-1/4 percent annual rate. Though brisk, such growth would mark a deceleration from the 4 percent average pace experienced in recent quarters.

Consumer spending is projected to decelerate to a 1-3/4 percent rate in 1991. This slowdown largely reflects an adjustment by households to the reduced pace of income growth that is expected to prevail over the projection period. Moreover, the adverse influence of higher interest rates on the value of household assets such as stocks and real estate, together with increased financing costs on purchases of consumer durables, also should damp demand. Consumption is not expected to adjust fully in the short-run to the slower growth in personal income, and this is reflected in some decline in the personal saving rate.

Business fixed investment. The staff has strengthened its estimate of capital spending in 1990, and we now project real outlays on plant and equipment to rise at an annual rate of more than 2 percent during the remainder of this year, compared with no growth in the March Greenbook. This change is largely based on indications that firms are more willing to invest than we previously thought: Surveys of 1990 investment intentions show upward revisions to spending plans, and recent orders data are consistent with a moderate pace of investment in new equipment. Near-term strength does not appear to include structures, however; office construction activity is in a decided downswing.

The longer-run outlook for business investment is not very favorable. Sales are projected to slow and capacity utilization to fall. Rising interest rates will boost the cost of financing projects with external sources of funds, and internal cash flow is expected to be weak. In addition, overbuilding remains a problem in many commercial real estate markets around the country, and credit has become more difficult to obtain. For these reasons, we project that investment will decelerate further in 1991. Although spending for information-processing equipment is likely to continue to rise at a moderate pace, buoyed by declines in relative prices, outlays for motor vehicles and other equipment are expected to soften markedly. At the same time, building activity is likely to continue on its downward trend.

Housing. Residential construction was quite strong in the first quarter, but underlying conditions in the housing market point to a decline in investment into the second half of next year. Mortgage interest rates already have risen somewhat since the turn of the year, and they are expected to rise more during the latter half of 1990 and into early 1991. Supply considerations also are adverse and seem likely to remain so for a while longer: Vacancy rates are high for multifamily units; there is an overhang of single-family houses, especially in the Northeast; and the availability of credit to builders has tightened.[1]

1. Overall ADC lending has been curtailed, not only by FIRREA-mandated capital requirements and loan limits at thrifts, but also by heightened concern over asset quality at banks. These problems could intensify under conditions of higher interest rates.

Government sector. The staff continues to expect fiscal policy to exert moderate restraint on aggregate demand through next year. At the federal level, a package of expenditure cuts and revenue increases amounting to $30 billion has been assumed for FY1991. Real purchases are projected to trend downward, led by a contraction in defense spending.

The staff estimate of the unified federal budget deficit for FY1990 has been revised up $28 billion to $196 billion. This revision is based, in part, on the 1989 tax returns processed to date, which suggest that final payments will run about $5 billion less than we had expected. However, most of the revision derives from increases in advances of working capital to the Resolution Trust Corporation. At present, greater advances are projected primarily for the current fiscal year. Nonetheless, the staff's estimate of next year's unified deficit has also been raised $9 billion to $157 billion, largely because of weaker economic growth and higher interest payments.

In the state and local sector, the NIPA budget deficit (excluding social insurance funds) has widened considerably in recent quarters and has reached record levels. In light of the effect on revenues of the projected slowing in economic growth, the staff expects these governments to respond by raising taxes and holding down the growth in outlays. However, the need to improve roads and other public facilities, as well as to provide for a growing school population, probably will prevent growth in real expenditures from falling much below a 2 percent annual rate.

Net exports. The growth of exports has slowed noticeably since mid-1989 from the high rates recorded earlier, but is expected to continue at a faster pace than that for the rest of the economy over the projection period. The staff projects exports of nonagricultural goods to continue to expand at a rapid pace, while growth in other categories of exports should be slower. We have raised the growth of non-oil imports relative to the previous forecast (owing to the stronger dollar), but expect these imports to decelerate over the balance of the forecast period as U.S. growth slows. On balance, the expected net contribution of the external sector to GNP growth has been reduced significantly from that in the March Greenbook, as is discussed in more detail in the International Developments section below.

Labor costs and prices. The staff expects the rise in hourly compensation to remain close to current rates in the near term before growing labor market slack begins to curtail increases in labor costs in 1991. The employment cost index measure of compensation per hour rose 5-1/4 percent over the year ending in March, about 1/2 percentage point more than in the preceding year and about 1/4 percentage point more than the staff had anticipated. Benefit increases--led by a hike in the social security tax rate, higher medical insurance costs, and large lump-sum payments to workers--were especially rapid, while wage increases appear to have flattened out at around 4-1/4 percent.

There appears to be little prospect of any appreciable lessening of pressures on compensation inflation in the near term. In the current quarter, the increase in the minimum wage that went into effect on April 1 is likely to push up wage increases.[2] More broadly, the continued

2. Evidence on the effect of the minimum wage is quite limited at this point. The principal monthly indicator of wage increases, average hourly earnings, rose just 0.3 percent in April, somewhat less than we had expected. In part, the surprise reflected the compositional effect of a drop of 100,000 highly paid construction workers from nonfarm payrolls. In the areas most likely to be affected by an increase in the minimum wage, the picture is mixed; wages in the services industry jumped 0.8 percent, but wages in trade increased 0.4 percent, about in line with recent trends.

tightness in labor markets that is expected to persist into late this year, and the jump in consumer price inflation that already has occurred, seem likely to sustain gains in hourly compensation at, or slightly above, the rates observed over the past year. All told, we have boosted our projection for ECI hourly compensation by about 1/4 percentage point to 5-1/4 percent over the four quarters of 1990.

Moving into 1991, an increase in the social security tax base and another hike in the minimum wage again provide some boost to hourly compensation in the first half of next year. However, the projected slowing in activity next year raises the unemployment rate appreciably, creating enough slack in labor markets so that by the latter half of the year hourly compensation is decelerating appreciably along with prices and, presumably, price expectations. By the end of the year, gains in ECI compensation per hour are projected to recede to just above 4-1/4 percent, about 1/2 percentage point less than the increase projected for the fourth quarter of 1990.

The staff projects consumer price inflation to drop back substantially over the next two quarters, into the 3-1/4 to 3-3/4 percent range. Although the news on inflation is expected to improve significantly over the remainder of the year, we anticipate only a partial offset to the first-quarter jump; for the year as a whole, we project the CPI to rise nearly 5 percent.

In 1991, the easing of product and labor market pressures that is projected to accompany slow growth should begin to make a noticeable mark on price inflation. Moreover, the lagged effects of the projected appreciation of the dollar later this year should hold down import price inflation next year and help restrain domestic consumer price inflation. Food prices are projected to decelerate considerably, on the assumption that growing conditions permit some improvement in food supplies. The supply-demand balance in the international market, however, is anticipated to produce a rise in energy prices roughly in line with the general price level. On balance, consumer price inflation is projected to slow to 4-1/2 percent over the four quarters of 1991, about 1/2 percentage point less than the increase expected for this year--and a shade below the pace projected in the last Greenbook, despite the recent bad news.

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STAFF GNP PROJECTIONS

Percent changes, annual rate

		Nominal GNP		Real GNP		GNP fixed-weight price index		Consumer Price Index <1>		Unemployment rate (percent)	
		3/21/90	5/9/90	3/21/90	5/9/90	3/21/90	5/9/90	3/21/90	5/9/90	3/21/90	5/9/90
Annual changes:											
1987	<2>	6.9	6.9	3.7	3.7	3.6	3.6	3.7	3.7	6.2	6.2
1988	<2>	7.9	7.9	4.4	4.4	4.2	4.2	4.1	4.1	5.5	5.5
1989	<2>	7.2	7.2	3.0	3.0	4.5	4.5	4.8	4.8	5.3	5.3
1990		6.2	6.4	2.0	2.0	4.4	4.5	4.8	4.9	5.5	5.5
1991		6.1	5.9	1.9	1.6	4.3	4.2	4.4	4.3	5.9	6.0
Quarterly changes:											
1988	Q1 <2>	6.5	6.5	4.0	4.0	3.8	3.8	3.5	3.5	5.7	5.7
	Q2 <2>	8.6	8.6	3.7	3.7	4.8	4.8	4.2	4.2	5.5	5.5
	Q3 <2>	7.5	7.5	3.2	3.2	5.2	5.2	5.2	5.2	5.5	5.5
	Q4 <2>	7.5	7.5	2.7	2.7	4.3	4.3	4.1	4.1	5.3	5.3
1989	Q1 <2>	7.9	7.9	3.7	3.7	4.8	4.8	5.4	5.4	5.2	5.2
	Q2 <2>	7.1	7.1	2.5	2.5	5.0	5.0	6.0	6.0	5.3	5.3
	Q3 <2>	6.2	6.2	3.0	3.0	2.9	2.9	2.9	2.9	5.3	5.3
	Q4 <2>	4.4	4.6	.9	1.1	3.6	3.6	3.9	3.9	5.3	5.3
1990	Q1 <2>	7.6	7.8	2.0	2.1	6.3	6.5	7.7	8.2	5.3	5.2
	Q2	6.1	6.8	2.6	2.2	3.7	4.3	3.0	3.3	5.4	5.4
	Q3	5.9	6.0	1.7	2.0	3.9	3.7	4.2	3.8	5.6	5.5
	Q4	5.9	6.1	1.7	1.8	4.2	4.1	4.5	4.3	5.7	5.6
1991	Q1	6.2	6.3	1.7	1.5	4.7	4.7	4.7	4.6	5.8	5.7
	Q2	6.0	5.2	1.8	1.1	4.3	4.1	4.5	4.4	5.9	5.9
	Q3	6.3	5.3	2.2	1.4	4.2	3.9	4.5	4.3	6.0	6.1
	Q4	6.2	5.5	2.2	1.7	4.2	3.9	4.5	4.3	6.0	6.2
Two-quarter changes: <3>											
1988	Q2 <2>	7.5	7.5	3.9	3.9	4.2	4.2	3.9	3.9	-.3	-.3
	Q4 <2>	7.5	7.5	2.9	2.9	4.8	4.8	4.6	4.6	-.2	-.2
1989	Q2 <2>	7.5	7.5	3.1	3.1	5.0	5.0	5.7	5.7	.0	.0
	Q4 <2>	5.3	5.4	1.9	2.0	3.3	3.3	3.4	3.4	.0	.0
1990	Q2	6.8	7.3	2.3	2.2	5.0	5.4	5.3	5.7	.1	.1
	Q4	5.9	6.0	1.7	1.9	4.1	3.9	4.3	4.1	.3	.2
1991	Q2	6.1	5.7	1.8	1.3	4.5	4.4	4.6	4.5	.2	.3
	Q4	6.3	5.4	2.2	1.6	4.2	3.9	4.5	4.3	.1	.3
Four-quarter changes: <4>											
1987	Q4 <2>	8.6	8.6	5.4	5.4	4.0	4.0	4.5	4.5	-1.0	-1.0
1988	Q4 <2>	7.5	7.5	3.4	3.4	4.5	4.5	4.3	4.3	-.5	-.5
1989	Q4 <2>	6.4	6.4	2.5	2.6	4.1	4.1	4.6	4.6	.0	.0
[illegible]	Q4	6.4	6.7	2.0	2.1	4.5	4.6	4.8	4.9	.4	.3
[illegible]	Q4	6.2	5.6	2.0	1.5	4.4	4.2	4.6	4.4	.3	.6

<1> For all urban consumers.
<2> Actual.
<3> Percent change from two quarters earlier.
<4> Percent change from four quarters earlier.

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GROSS NATIONAL PRODUCT AND RELATED ITEMS
(Seasonally adjusted; annual rate)

	Units	1983	1984	1985	1986	1987	1988	1989	Projection 1990	Projection 1991
EXPENDITURES										
Nominal GNP	Billions of $	3405.7	3772.2	4014.9	4231.6	4524.3	4880.6	5234.0	5570.6	5897.1
Real GNP	Billions of 82$	3279.1	3501.4	3618.7	3717.9	3853.7	4024.4	4144.1	4228.9	4297.8
Real GNP	Percent change*	6.5	5.1	3.6	1.9	5.4	3.4	2.6	2.1	1.5
Gross domestic purchases		8.4	6.4	4.3	2.1	4.6	2.4	1.9	1.9	1.1
Final sales		3.7	4.7	4.6	2.7	3.3	4.4	2.5	2.1	1.6
Private dom. final purchases		7.7	5.6	4.6	2.9	2.7	3.8	2.1	2.1	1.4
Personal consumption expend.		5.4	4.1	4.6	3.8	2.2	3.8	2.5	2.2	1.7
Durables		14.7	10.8	7.0	11.5	-2.0	8.0	.0	3.3	1.2
Nondurables		4.4	2.3	3.3	2.9	1.1	2.1	1.0	.0	.7
Services		3.9	3.5	5.0	2.1	4.4	3.6	4.4	3.5	2.5
Business fixed investment		10.8	13.8	3.7	-5.5	8.5	4.2	3.7	3.4	.9
Producers' durable equipment		20.9	14.9	4.6	.4	11.1	7.0	5.2	5.6	2.5
Nonresidential structures		-4.8	11.8	1.9	-17.7	1.9	-3.4	-.9	-3.6	-4.7
Residential structures		38.1	6.1	5.8	11.6	-4.2	3.2	-7.0	-3.3	-2.0
Exports		5.8	5.9	-2.4	10.6	19.1	13.9	10.0	4.9	7.5
Imports		23.8	17.4	4.5	10.0	9.6	5.3	4.6	4.0	5.0
Government purchases		-2.7	7.9	8.6	3.1	2.1	1.8	.5	1.4	.7
Federal		-8.1	13.0	13.3	.5	.7	-.3	-3.1	.5	-.9
Defense		5.1	6.5	7.1	6.0	4.3	-1.9	-2.3	-3.9	-3.3
State and local		1.5	4.4	4.9	5.2	3.1	3.4	3.1	2.1	1.8
Change in business inventories	Billions of 82$	-6.4	62.3	9.1	5.6	23.7	27.9	21.9	11.8	18.7
Nonfarm	Billions of 82$	-.1	57.8	13.4	8.0	25.8	30.7	17.7	9.2	15.9
Net exports	Billions of 82$	-19.9	-84.0	-104.3	-129.7	-115.7	-74.9	-52.6	-43.1	-35.3
Nominal GNP	Percent change*	10.4	8.6	6.6	4.6	8.6	7.5	6.4	6.7	5.6
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employment	Millions	90.2	94.5	97.5	99.5	102.2	105.6	108.6	110.6	111.5
Unemployment rate	Percent	9.6	7.5	7.2	7.0	6.2	5.5	5.3	5.5	6.0
Industrial production index	Percent change*	11.3	4.7	1.9	1.4	6.5	4.5	1.1	1.7	.7
Capacity utilization rate-mfg.	Percent	74.9	80.4	79.5	79.0	81.4	83.9	83.9	82.2	80.6
Housing starts	Millions	1.70	1.75	1.74	1.81	1.62	1.49	1.38	1.31	1.24
Auto sales	Millions	9.19	10.35	11.03	11.45	10.23	10.65	9.89	9.55	9.24
Domestic	Millions	6.82	7.92	8.22	8.22	7.06	7.55	7.06	6.82	6.76
Foreign	Millions	2.37	2.43	2.82	3.23	3.18	3.10	2.83	2.72	2.48
INCOME AND SAVING										
Nominal personal income	Percent change*	7.8	8.4	6.6	5.8	8.6	7.1	8.4	6.9	6.4
Real disposable income	Percent change*	5.1	4.3	2.7	3.3	3.0	4.0	3.6	1.5	1.6
Personal saving rate	Percent	5.4	6.1	4.4	4.1	3.2	4.2	5.4	5.2	5.1
Corp. profits with IVA & CCAdj	Percent change*	70.1	7.4	9.2	-5.6	12.0	10.4	-16.0	7.3	-8.5
Profit share of GNP	Percent	6.3	7.1	7.0	6.7	6.6	6.7	5.8	5.5	4.9
Federal govt. surplus/deficit	Billions of $	-176.0	-169.6	-196.9	-206.9	-161.4	-145.8	-148.5	-137.7	-122.7
State and local govt. surplus		47.5	64.6	65.1	62.8	51.3	49.7	44.0	40.1	54.3
Exc. social insurance funds		4.4	19.8	13.8	5.6	-12.4	-21.4	-34.1	-44.5	-36.3
PRICES AND COSTS										
GNP implicit deflator	Percent change*	3.6	3.4	2.9	2.6	3.0	4.0	3.7	4.5	4.0
GNP fixed-weight price index		3.9	3.7	3.3	2.6	4.0	4.5	4.1	4.6	4.2
Cons. & fixed invest. prices		3.3	3.3	3.4	2.5	4.7	4.2	4.4	4.7	4.2
CPI		3.2	4.2	3.5	1.3	4.5	4.3	4.6	4.9	4.4
Exc. food and energy		4.2	5.0	4.3	3.9	4.3	4.5	4.3	5.0	4.5
ECI hourly compensation		5.7	4.9	3.9	3.2	3.3	4.8	4.8	5.2	4.8
Nonfarm business sector										
Output per hour		3.4	1.5	1.6	1.3	2.4	1.6	.7	.7	1.1
Compensation per hour		3.1	4.2	4.6	5.0	4.0	4.8	5.5	5.3	4.7
Unit labor costs		-.4	2.6	3.0	3.6	1.5	3.1	4.8	4.5	3.6

* Percent changes are from fourth quarter to fourth quarter.

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CLASS II FOMC

GROSS NATIONAL PRODUCT AND RELATED ITEMS
(Seasonally adjusted; annual rate)

	Units	1989 Q3	1989 Q4	1990 Q1	Projection 1990 Q2	Projection 1990 Q3	Projection 1990 Q4	Projection 1991 Q1	Projection 1991 Q2	Projection 1991 Q3	Projection 1991 Q4
EXPENDITURES											
Nominal GNP	Billions of $	5281.0	5340.2	5441.2	5532.1	5612.9	5696.2	5783.4	5857.5	5934.0	6013.6
Real GNP	Billions of 82$	4162.9	4174.1	4195.8	4219.1	4240.6	4260.0	4276.4	4288.5	4303.9	4322.5
Real GNP	Percent Change	3.0	1.1	2.1	2.2	2.0	1.8	1.5	1.1	1.4	1.7
Gross domestic purchases		3.5	.1	1.5	2.5	2.0	1.8	1.3	.8	1.0	1.5
Final sales		2.7	1.1	4.0	1.7	1.3	1.4	1.5	1.3	1.7	1.7
Private dom. final purchases		4.7	-.5	3.5	1.6	1.7	1.7	1.4	1.1	1.3	1.7
Personal consumption expend.		5.6	.5	2.5	2.1	2.4	2.0	1.7	1.5	1.6	1.8
Durables		11.3	-14.0	17.0	-5.2	1.2	1.4	.1	1.0	1.4	2.1
Nondurables		5.0	.1	-3.8	1.7	1.3	.9	.7	.7	.6	.6
Services		4.3	5.9	2.5	4.9	3.6	2.9	2.9	2.3	2.3	2.5
Business fixed investment		5.2	-5.4	7.6	1.3	2.7	2.2	1.5	.9	.6	.7
Producers' durable equipment		4.6	-6.9	8.2	4.1	5.5	4.5	3.5	2.5	2.0	2.0
Nonresidential structures		8.0	-.3	5.1	-7.4	-6.1	-5.6	-5.5	-4.9	-4.3	-4.1
Residential structures		-9.2	-1.1	8.5	-4.9	-11.3	-4.5	-3.3	-5.4	-1.2	1.9
Exports		3.9	9.4	.9	2.8	6.9	9.3	8.9	7.7	6.8	6.5
Imports		7.4	2.2	-2.8	4.4	6.4	8.3	6.8	5.2	3.6	4.5
Government purchases		-2.4	2.6	2.8	3.4	-.4	-.1	.5	.7	.9	.6
Federal		-8.4	-3.3	2.3	6.0	-3.2	-2.9	-1.3	-.9	-.4	-.8
Defense		6.9	-6.6	.3	-6.4	-4.7	-4.7	-3.7	-3.1	-2.9	-3.3
State and local		2.2	6.8	3.3	1.7	1.7	1.8	1.8	1.8	1.8	1.6
Change in business inventories	Billions of 82$	21.9	22.2	2.6	8.0	15.9	20.8	21.4	19.5	16.8	16.9
Nonfarm	Billions of 82$	16.2	18.0	-2.5	7.1	13.7	18.6	19.1	17.1	13.7	13.5
Net exports	Billions of 82$	-57.1	-47.2	-41.2	-44.0	-44.0	-43.4	-40.9	-37.6	-32.8	-29.9
Nominal GNP	Percent change	6.2	4.6	7.8	6.8	6.0	6.1	6.3	5.2	5.3	5.5
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	108.9	109.4	110.2	110.7	110.7	111.0	111.2	111.4	111.6	111.8
Unemployment rate	Percent*	5.3	5.3	5.2	5.4	5.5	5.6	5.7	5.9	6.1	6.2
Industrial production index	Percent change	-1.2	.2	-.4	3.6	2.4	1.4	.8	.6	.6	1.0
Capacity utilization rate-mfg.	Percent*	83.7	82.9	82.4	82.3	82.2	81.8	81.3	80.9	80.4	80.0
Housing starts	Millions	1.34	1.35	1.45	1.30	1.28	1.27	1.26	1.24	1.24	1.25
Auto sales	Millions	10.18	9.09	10.00	9.44	9.40	9.35	9.20	9.20	9.25	9.30
Domestic	Millions	7.36	6.56	7.11	6.68	6.75	6.75	6.70	6.70	6.80	6.85
Foreign	Millions	2.83	2.53	2.90	2.75	2.65	2.60	2.50	2.50	2.45	2.45
INCOME AND SAVING											
Nominal personal income	Percent change	5.2	7.3	9.1	6.1	5.8	6.7	7.7	6.1	5.4	6.4
Real disposable income	Percent change	4.4	2.4	1.8	1.5	1.2	1.7	3.0	1.2	.7	1.7
Personal saving rate	Percent*	5.1	5.6	5.4	5.3	5.0	5.0	5.2	5.2	5.0	4.9
Corp. profits with IVA & CCAdj	Percent change	-15.4	-12.0	17.6	10.3	.3	1.7	-4.9	-15.6	-5.5	-7.5
Profit share of GNP	Percent*	5.6	5.4	5.5	5.5	5.4	5.4	5.2	5.0	4.8	4.7
Federal govt. surplus/deficit	Billions of $	-144.7	-156.5	-155.0	-144.6	-127.6	-123.8	-126.9	-124.4	-116.9	-122.6
State and local govt. surplus		44.9	34.7	34.4	38.8	41.6	45.5	47.9	51.9	55.7	61.6
Exc. social insurance funds		-34.3	-45.7	-47.9	-45.0	-43.7	-41.3	-40.4	-37.9	-35.6	-31.2
PRICES AND COSTS											
GNP implicit deflator	Percent change	3.2	3.2	5.7	4.4	3.8	4.1	4.6	4.0	3.8	3.7
GNP fixed-weight price index		2.9	3.6	6.5	4.3	3.7	4.1	4.7	4.1	3.9	3.9
Cons. & fixed invest. prices		2.3	4.4	7.0	3.7	3.8	4.3	4.4	4.2	4.1	4.0
CPI		2.9	3.9	8.2	3.3	3.8	4.3	4.6	4.4	4.3	4.3
Exc. food and energy		3.8	4.4	6.2	4.7	4.5	4.5	4.8	4.5	4.4	4.4
ECI hourly compensation**		4.9	5.0	5.8	5.7	4.8	4.8	5.1	5.2	4.5	4.3
Nonfarm business sector											
Output per hour		2.4	.5	-1.0	1.7	1.2	1.1	.9	.9	1.2	1.3
Compensation per hour		5.3	6.0	3.9	6.4	5.3	5.6	3.6	5.7	4.6	4.9
Unit labor costs		2.8	5.5	4.9	4.6	4.1	4.5	2.7	4.8	3.4	3.6

* Not at an annual rate.
** Private industry workers; seasonally adjusted by Board staff.

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May 9, 1990

GROSS NATIONAL PRODUCT AND RELATED ITEMS
(Net changes, billions of 1982 dollars)

	1989		1990 (Projection)				1991 (Projection)				1988	1989	1990 (Projection)	1991 (Projection)
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	(fourth quarter to fourth quarter, net change)			
Real GNP	30.4	11.2	21.7	23.3	21.4	19.4	16.4	12.1	15.3	18.6	133.8	104.7	85.9	62.5
Gross domestic purchases	36.3	1.3	15.7	26.1	21.4	18.9	13.9	8.8	10.5	15.7	97.8	78.1	82.1	49.0
Final sales	27.5	10.9	41.3	17.9	13.5	14.5	15.8	14.0	18.0	18.5	172.0	100.9	87.3	66.4
Private dom. final purchases	38.4	-4.1	29.6	13.8	14.3	14.3	12.2	9.3	11.4	14.3	121.7	70.3	72.0	47.2
Personal consumption expend.	36.4	3.6	16.4	14.4	16.3	13.5	11.7	10.6	11.0	12.6	95.4	66.0	60.5	45.9
Durables	11.5	-16.1	16.8	-5.8	1.3	1.5	.1	1.0	1.6	2.3	31.1	-.2	13.9	5.1
Nondurables	11.1	.3	-8.9	3.7	2.9	2.0	1.6	1.6	1.4	1.4	19.1	9.1	-.3	6.0
Services	13.9	19.3	8.5	16.5	12.1	9.9	10.0	7.9	8.1	8.9	45.2	57.0	47.0	34.9
Business fixed investment	6.5	-7.1	9.4	1.7	3.5	2.8	1.9	1.2	.8	.9	20.0	18.1	17.5	4.9
Producers' durable equipment	4.4	-7.0	7.8	4.0	5.4	4.5	3.6	2.6	2.1	2.1	24.3	19.3	21.7	10.3
Nonresidential structures	2.3	-.1	1.5	-2.3	-1.9	-1.7	-1.6	-1.4	-1.2	-1.2	-4.3	-1.1	-4.4	-5.4
Residential structures	-4.5	-.5	3.8	-2.4	-5.5	-2.1	-1.5	-2.4	-.5	.8	6.2	-13.8	-6.1	-3.6
Change in business inventories	2.8	.3	-19.6	5.4	7.9	4.9	.6	-1.9	-2.7	.1	-38.3	3.9	-1.4	-3.9
Nonfarm	-3.3	1.8	-20.5	9.6	6.6	4.9	.5	-2.0	-3.4	-.2	-23.7	-13.9	.6	-5.1
Farm	6.1	-1.4	.9	-4.2	1.3	.0	.1	.1	.7	.3	-14.6	17.8	-2.0	1.2
Net exports	-5.9	9.9	6.0	-2.8	.0	.6	2.4	3.4	4.8	2.9	36.0	26.6	3.8	13.5
Exports	5.6	13.5	1.4	4.2	10.2	14.0	13.7	12.2	11.0	10.7	67.3	55.2	29.8	47.5
Imports	11.5	3.6	-4.6	7.0	10.2	13.4	11.2	8.8	6.1	7.8	31.3	28.6	26.0	34.0
Government purchases	-5.0	5.1	5.7	6.9	-.8	-.3	1.1	1.4	1.9	1.3	14.3	4.0	11.6	5.7
Federal	-7.5	-2.8	1.9	4.9	-2.8	-2.5	-1.1	-.8	-.3	-.7	-1.0	-10.6	1.6	-2.9
Defense	4.3	-4.4	.2	-4.2	-3.0	-3.0	-2.3	-1.9	-1.8	-2.0	-5.1	-5.9	-10.0	-8.0
Nondefense	-11.8	1.7	1.7	9.0	.2	.5	1.2	1.1	1.5	1.3	4.1	-4.6	11.5	5.1
State and local	2.5	7.8	3.9	2.0	2.0	2.2	2.2	2.2	2.2	2.0	15.3	14.5	10.1	8.6

FEDERAL SECTOR ACCOUNTS[1]
(Billions of dollars)

	Fiscal years				1989				1990				1991			
	1988a	1989a	1990	1991	Ia	IIa	IIIa	IVa	I	II	III	IV	I	II	III	IV
BUDGET					Not seasonally adjusted											
Budget receipts[2]	908	991	1047	1129	219	308	242	229	230	324	265	246	256	343	284	259
Budget outlays[2]	1063	1143	1243	1286	280	285	288	299	310	317	316	332	319	318	318	332
Surplus/deficit(-)[2]	-155	-152	-196	-157	-61	23	-46	-71	-80	7	-52	-86	-63	25	-33	-73
(On-budget)	-194	-204	-254	-228	-77	0	-54	-77	-94	-16	-68	-94	-82	-1	-50	-81
(Off-budget)	39	52	58	71	16	23	7	6	14	22	16	8	19	27	17	8
Surplus excluding RTC working capital[3]	-155	-152	-150	-125	-61	23	-46	-71	-77	26	-27	-75	-54	32	-28	-70
Means of financing:																
Borrowing	166	140	229	156	38	10	39	63	90	29	47	83	41	7	25	65
Cash decrease	-8	3	4	2	19	-29	3	14	8	-18	-1	12	10	-30	10	10
Other[4]	-3	8	-37	-1	4	-4	5	-7	-18	-18	5	-9	12	-2	-2	-2
Cash operating balance, end of period	44	41	37	35	15	44	41	27	18	37	37	25	15	45	35	25
NIPA FEDERAL SECTOR					Seasonally adjusted annual rates											
Receipts	958	1032	1100	1185	1036	1053	1043	1056	1096	1114	1135	1155	1181	1195	1209	1225
Expenditures	1103	1183	1246	1308	1184	1199	1188	1213	1251	1259	1262	1279	1308	1319	1326	1348
Purchases	377	404	414	425	399	406	403	405	413	420	419	418	425	427	429	431
Defense	297	302	305	303	299	301	308	301	309	305	303	301	304	304	303	303
Nondefense	80	101	110	122	100	105	95	104	104	115	116	117	121	123	126	128
Other expend.	726	780	832	883	785	793	785	808	838	839	843	861	883	892	897	917
Surplus/deficit	-145	-151	-146	-123	-148	-145	-145	-157	-155	-145	-128	-124	-127	-124	-117	-123
FISCAL INDICATORS[5]																
High-employment (HEB) surplus/deficit(-)	-150	-167	-154	-111	-165	-162	-162	-168	-165	-151	-131	-123	-120	-109	-93	-93
Change in HEB, percent of potential GNP	.3	.4	-.3	-.8	-.3	-.1	.0	.1	-.1	-.3	-.4	-.1	.0	-.2	-.3	.0
Fiscal impetus measure (FI), percent	.2 *	-3.4 *	-5.4 *	-3.4 *	-2.7	-.2	.5	-2.3	-2.6	-.4	-.9	-2.2	-1.1	-.1	-.1	-.2

a--actual *--calendar year

Note: Details may not add to totals due to rounding.

1. Staff projections. The FY90 and FY91 deficits in OMB's FY1991 Budget (January 1990) are $124 billion and $63 billion, respectively. These estimates incorporate approximately $39 billion of cuts from the adjusted Gramm-Rudman-Hollings baseline in FY1991. CBO's FY90 and FY91 baseline deficits (March 1990) are $159 billion and $161 billion, respectively.
2. Budget receipts, outlays, and surplus/deficit include social security (OASDI) receipts, outlays and surplus, respectively. The OASDI surplus is excluded from the "on-budget" deficit and shown separately as "off-budget", as classified under current law.
3. The Administration's deficit projections exclude RTC working capital. CBO's March deficit estimates, excluding RTC working capital, are $140 billion and $136 billion in 1990 and 1991, respectively.
4. Other means of financing are checks issued less checks paid, accrued items, and changes in other financial assets and liabilities.
5. HEB is the NIPA measure in current dollars with cyclically-sensitive receipts and outlays adjusted to a 6 percent unemployment rate and 2.7% potential output growth. Quarterly figures for change in HEB and FI are not at annual rates. Change in HEB, as a percent of nominal potential GNP, is reversed in sign. FI is the weighted difference of discretionary federal spending and tax changes (in 1982 dollars), scaled by real federal purchases. For change in HEB and FI, (-) indicates restraint.

Recent Developments

Federal funds continued to trade in a narrow range around 8-1/4 percent during the intermeeting period, but most other market interest rates fluctuated widely in response to changing perceptions of the strength of the economic expansion, underlying price pressures, and the odds of a near-term tightening of monetary policy. Initially, rates were pushed sharply higher, especially at longer maturities, by reports indicating that inflation might be picking up as the economy continued to expand at a moderate pace. However, a good portion of this rise in rates was reversed with the release late in the period of surprisingly weak employment data for April, which caused market participants to reevaluate their views both of the current pace of economic activity and of the likely timing of the next monetary policy move. Money market rates are now near their levels at the time of the March FOMC meeting, but bond yields remain as much as 35 basis points higher.

Restrained by the rise in market interest rates since late last year, expansion of the monetary aggregates generally has eased in recent months. With deposit rates lagging the increase in market rates, growth of the retail-type components of M2 has slowed from the 8 percent rate in the second half of last year to just under a 5 percent pace in April. In combination with declines in demand deposits and overnight RPs, this reduced the rate of overall M2 growth to 3 percent last month. So far in 1990, M2 has increased at a 5-3/4 percent pace from its fourth-quarter base, somewhat above the midpoint of its target range.

M3 growth has remained subdued, at a 2 percent rate in April and at 2-3/4 percent for the year to date. Funding needs at thrift institutions have continued to shrink, apparently reflecting pressure on the industry to reduce its assets. Retail deposits at thrifts remain below their year-end levels, and managed liabilities have dropped markedly. In April, commercial banks, too, exhibited little need to raise additional funds, as bank credit growth slowed to roughly a 4 percent rate--less than half that in the preceding two months.

The slowing of bank credit in April is of particular note in the context of recent discussions of a credit crunch. Anecdotal and survey information have supported the view that credit availability has been tightened on a selective basis for borrowers in particular regions or industries. The bank credit data by themselves do not allow us to disentangle demand and supply influences, but they indicate that loan growth has weakened so far in 1990, with the softening evident in each of the three major loan categories--C&I, real estate, and consumer. New England has accounted for a disproportionate share of the weakening in loan growth, especially in real estate lending, as a slowdown in the local economy and concerns about the adequacy of bank capital positions have combined to limit credit extensions in that region. Business loans in April were restrained by an absence of new bank lending to support mergers and other major financial restructurings.

With financial sector profits under pressure and downgradings by major rating agencies becoming more common, financial corporations appear to have faced some greater constraints on their ability to raise funds. In this atmosphere, financial institutions reduced their commercial paper outstanding last month, and their bond issuance has slowed markedly this year. This trend has been especially pronounced for bank holding companies; prices of their stocks and bonds have been hard-hit, with rates on some BHC debt reaching junk bond levels.

For investment-grade nonfinancial corporations, there is little evidence of any reduction in credit availability. Commercial paper issuance by nonfinancial firms continued to soar last month, and bond issuance, while still running below the pace of recent years, picked up in March and April. In the market for below-investment-grade debt, by contrast, activity has tailed off; new issues in the junk bond and junk commercial paper markets have been few and far between. Aggregated over all nonfinancial business borrowers, borrowing by this sector apparently strengthened in March and April: Gross bond issuance was up, and the sum of bank C&I loans and commercial paper grew at an average annual rate of nearly 15 percent each month.

Household debt growth, by contrast, has shown signs of weakening. Consumer installment credit increased at a 2-3/4 percent rate in the first quarter, and, in April, bank loans to consumers, after adjusting for the effect of loan securitizations, slowed to just a 4 percent rate. In addition, the rise in mortgage rates so far this year, along with softness in some housing markets, appears to be cutting into the growth of mortgage debt, as suggested by the slowdown in real estate lending at commercial banks.

Federal credit demands, which were surprisingly large in the first quarter, are set to expand again in the current quarter. The extent of the expansion, however, is quite uncertain because it depends heavily on the pace of thrift resolutions by the RTC, which has an ambitious goal for the next two months. In view of the current estimate by the Board staff that the RTC will require nearly $20 billion from the Treasury during the quarter, the government's accounts should show only a small surplus (not seasonally adjusted), despite the influx of April tax payments.

In the municipal market, borrowing for new capital has been well maintained, while refunding volume has been depressed to a low level by the rise in rates, suggesting that aggregate state and local borrowing will be modest during the quarter.

Outlook

As indicated in the previous section of this document, the staff's projection assumes that interest rates will move up substantially in coming quarters and will not ease back until the second half of next year. With the rise in rates driven primarily by a progressive tightening of monetary policy, the yield curve is expected to flatten--if not invert--as short-term rates rise.

Higher rates and sluggish economic growth are expected to trim credit demands in the period ahead, and continued caution on the part of lenders also is likely to restrain credit growth. As a result, growth of domestic nonfinancial sector debt in 1990 is projected to slacken to 7-1/4 percent from last year's 8 percent increase, despite a sharp rise in borrowing by the federal government. A further ebbing in overall debt growth, to around 6-1/2 percent, is forecast for 1991. In both years, the rise in debt is expected to exceed that in nominal GNP.

The federal deficits this year and next will be boosted substantially by the need to provide working capital for the RTC. The staff forecast assumes that RTC will receive around $50 billion from the Treasury in 1990 and an additional $30 billion to $40 billion in 1991. Working capital increases of this magnitude would contribute roughly 1/2 percentage point to total debt growth this year and 1/4 point next year.

Borrowing by nonfinancial business is expected to slow in 1990, as the effect of a wider gap between capital outlays and internal funds is more than offset by a further dropoff in merger and restructuring activity. With lenders focusing increasingly on credit quality, highly leveraged transactions have become more difficult to finance. As a result of this reluctance by lenders and the inhibiting effects of higher interest rates, the staff expects net equity retirements to continue to diminish, bringing the 1990 total to about half that in 1989.

Household credit demands are expected to decelerate over the forecast period. Slowing real income growth and consumption expenditures are likely to constrain consumer credit expansion, while mortgage borrowing is expected to be damped by the rise in interest rates and softness in many real estate markets. A larger share of mortgages likely will be securitized, as thrift industry assets continue to decline and commercial banks face the phase-in of risk-based capital requirements, which give more favorable treatment to government agency mortgage-backed securities than to mortgage loans.

Growth of municipal debt is expected to remain subdued for the remainder of 1990 and through 1991. Higher interest rates will make it unattractive to issue new refunding bonds at the same time that a large number of already advance-refunded bonds are likely to be retired.

Recent Developments

The trade-weighted foreign exchange value of the dollar against the other G-10 currencies has declined about 2-3/4 percent since the March FOMC meeting. Much of the dollar's decline occurred late in the period after the release of U.S. employment data that were weaker than expected. Short-term interest rates in major foreign countries have fallen somewhat, on average. Japanese short-term rates are down and German rates are little changed; bond yields in both countries have been flat. Interest rates have declined in several other EMS countries, which took advantage of the mark's continued weakness in the currency grid to lower their official rates.

. The Desk sold $100 million against yen, half in late March and half after the G-7 meeting.

Growth continued fairly robust during the first quarter in Germany, most other major European countries, and Japan. Construction and other investment in Germany were buoyed by mild weather, the prospects for German economic and monetary union, and EC-1992. Recent declines in Japanese share values and earlier increases in Japanese interest rates appear to have had no significant effect in slowing the rapid pace of the Japanese expansion. In contrast to activity in these countries, which has been relatively strong, economic growth has slowed noticeably in the United Kingdom and Canada.

Monetary restraint abroad has blunted inflation more slowly than expected. Although measured inflation does appear to have stabilized in foreign industrial economies on average, underlying pressures have been masked in some cases by temporary factors, particularly in Japan and Germany. Efforts to bring U.K. inflation under control with tight monetary policy have been unavailing so far, and it has moved above an 8 percent annual rate in recent months. Price pressures have eased in France, however, contributing to a strengthening of the franc and allowing authorities to reduce official interest rates in April. Inflation also has ebbed in Italy and Canada, though it is still high in both countries.

Economic growth in developing countries slowed last year. Improvement in growth in the oil-producing regions in the Middle East and Africa was more than offset by a sharp slowdown in growth in Asia. Growth in Latin America changed little last year, but economic activity in Argentina and Brazil has been depressed more recently as a result of the disinflation programs implemented in those countries earlier this year.

The nominal U.S. merchandise trade deficit narrowed in February, as imports declined and exports were essentially unchanged from January levels. For January and February combined, exports (on a balance of payments basis) were moderately above their fourth-quarter rate, led by a rebound in aircraft shipments. Non-oil imports fell more than 3 percent in value in January/February from their fourth-quarter rate. The decline was widespread across commodity categories, with imports of automotive products from Canada and consumer goods showing especially sharp declines. Both the quantity and price of oil imports rose strongly. Fixed-weight non-oil import prices rose

5-1/4 percent in the first quarter, and export prices rose 1-1/2 percent (both at annual rates).

Outlook

Compared with the March forecast, the current staff projection incorporates a stronger outlook for the dollar, somewhat weaker growth abroad this year, slightly stronger growth abroad in 1991, and, as a result, a significantly smaller improvement in the U.S. external balance over the projection period.

The Dollar. The staff forecast now shows a small appreciation of the foreign exchange value of the dollar against the G-10 currencies in the second half of 1990 and no change thereafter. The dollar strengthens slightly more in real terms, since U.S. inflation is expected to be slightly higher than foreign inflation, on average, over the next six quarters. By the end of next year, the level of the dollar is noticeably higher than it was in the March projection, which had the dollar depreciating slowly through 1991.

The stronger outlook for the dollar reflects two factors. First, the long-term real interest rate differential in favor of dollar assets is expected to widen noticeably over the balance of this year, and to remain essentially unchanged during 1991. As discussed below, nominal interest rates in major foreign countries, on average, are expected to change little through the rest of this year, and to edge down next year. Second, the staff has reassessed its view about the extent to which the persistence of the U.S. external deficits causes concern to market participants, at least in the near term; the trade and current account deficits have narrowed and, in light of official dollar sales over the past year, have been "over-financed" by net private capital inflows.

The risks to this forecast for the dollar are probably weighted more heavily towards the downside. If the projected tightening of U.S. monetary conditions were less than envisioned, the dollar would be unlikely to appreciate later this year and remain strong in 1991. In addition, the staff's assessment that markets will be relatively unconcerned about the external deficit could be mistaken.

Against the currencies of eight major developing countries, on average, the dollar is expected to appreciate modestly in 1990 and to remain unchanged in real terms in 1991. Real appreciation against the Latin American currencies is largely offset by real depreciation against the Asian currencies.

Foreign Industrial Countries. Real growth in foreign industrial countries, which was about 3-1/2 percent in 1989, is projected to slow to 3 percent in 1990 as these economies continue to adjust to higher interest rates. Growth is then projected to recover to about 3-1/2 percent in 1991. This projection shows somewhat lower growth in 1990 and slightly higher growth in 1991 than forecast in March; some of the previously projected impetus to growth from German unification has been shifted from this year to 1991 and beyond. Nevertheless, inflationary pressures appear to have intensified, and the staff now projects that inflation in foreign industrial countries will remain at about 4-1/4 to 4-1/2 percent on average through 1991, nearly 1/2 percentage point above the projection made in March for both 1990 and 1991.

The projected pickup in output growth abroad in 1991 is concentrated in continental Europe, where the effects of German unification are expected to help boost German growth to near 4-3/4 percent. German inflation is expected to rise to the 3-1/2 percent range in the latter part of this year and during 1991, resulting in some further increase in German short-term interest rates. This outlook assumes that there will be a move in German official rates in the late summer or early fall this year. In other EMS countries, spillover effects from events in Eastern Europe are expected to be much smaller, and interest rates are projected to move up less. Japanese growth is expected to slow to about 4 percent in 1991 from an average of nearly 5 percent over the past two years, as the effects of tighter monetary policy are felt. Japanese short-term interest rates are expected to rise somewhat further this year to counter increases in inflationary pressure but then to ease in 1991. Interest rates in the United Kingdom are expected to decline substantially from their very high recent levels by the end of the forecast period, as progress is made in reducing inflation. Canadian interest rates are also expected to decline from their current high levels. The external surplus of other G-10 countries as a group is expected to widen this year and next, with Japan's surplus increasing and the U.K. deficit narrowing.

Developing Countries. The outlook for developing countries is somewhat weaker than the projection in the March Greenbook, as the recent disinflation programs in Brazil and Argentina are curtailing activity more than had been anticipated. Nevertheless, growth in developing countries on average is expected to recover this year from last year's slowdown, led by increases in growth in Latin America and Asia. A further pickup in activity is expected in 1991, particularly in Latin America, as recovery in Brazil and Argentina takes hold. Additional growth in Asia, however, is expected to be restrained by continuing real appreciation of key Asian currencies and monetary tightening in several countries.

U.S. Merchandise Trade Volumes. The quantity of U.S. nonagricultural exports is projected to continue to expand at a rapid pace (roughly 9 percent per year) this year and next, stimulated primarily by the expected continuation of robust growth in most U.S. export markets. The results of the special theme report prepared at Reserve Banks, while mixed, tend to support this robust outlook for exports. Nevertheless, several factors have led the staff to reduce its forecast of both the level and the growth of nonagricultural exports through 1991. The two most important factors are that exports were weaker than expected during the first two months of 1990 and that the projected path for the foreign exchange value of the dollar has been raised. The downward revision in the outlook for growth abroad in 1990 also contributed slightly to the weakening in expected export growth. The quantity of agricultural exports is expected to grow slowly this year and next.

The quantity of non-oil imports is projected to rebound in the second quarter from its decline during January/February, and then to decelerate through mid-1991 as U.S. growth slows. The projected path of non-oil imports has been lowered because these imports have been weaker than expected in recent months. From a lower starting point, however, the projected growth rate for non-oil imports in the second half of 1990 and for the year 1991 has been raised as a result of the loss in U.S. price competitiveness associated with the stronger outlook for the dollar. This effect is partly offset in 1991 by the downward revision to U.S. GNP growth.

Oil imports are expected to decline in the current quarter from the unusually high rate in the first quarter, which was induced in part by the cold weather last December. Over the balance of the forecast, these imports are projected to expand noticeably faster than U.S. GNP, reflecting a continuing gradual downtrend in U.S. oil production.

On balance, real net exports of goods alone are projected to change little for the rest of this year from a significantly improved level in the first quarter, and to improve only moderately next year. The expected increase in net exports of goods over the next seven quarters is substantially less (by nearly $25 billion, annual rate, 1982 dollars) than was projected in March. Most of this revision can be accounted for by the stronger outlook for the dollar.

Merchandise Trade Prices. Fixed-weight nonagricultural export prices are expected to rise moderately this year and next, roughly in line with domestic producer prices. Non-oil import prices are projected to rise somewhat less than prices abroad, largely as a result of the stronger dollar. The revision in the dollar forecast reduced the projected price of non-oil imports, compared with the previous forecast. This effect was partly offset by the outlook for higher inflation abroad.

The price of oil imports is expected to fall in the current quarter, to about $17.25 per barrel, in line with recent declines in spot prices. Thereafter, the price is projected to rise gradually to about $19.50 per barrel in the fourth quarter of 1991. The projected increase assumes that OPEC will succeed in restraining production, although in the near term by only half the amount that was officially agreed to at the recent OPEC meeting.

Net Services and Nominal Balances. The merchandise trade balance is projected to remain roughly unchanged in nominal terms over the balance of this year, at an annual rate of a little over $100 billion; it is expected to improve somewhat during 1991, edging below $100 billion by the end of the forecast period. Net portfolio investment income payments are expected to grow significantly over the forecast period, because of rising U.S. international indebtedness and increases in dollar interest rates. This rise in net portfolio payments is now expected to be less than fully offset by increases in net direct investment income receipts and further improvements in other net services, so that total net services deteriorate modestly in nominal terms over the projection period. As a result, the current account balance (excluding capital gains and losses) worsens slightly over the next few quarters, and then improves slightly during 1991, ending that year at about $85 billion at an annual rate. The current account deficit is more than $15 billion greater at the end of 1991 then was projected in the previous Greenbook.

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Outlook for U.S. Net Exports and Related Items
(Billions of Dollars, Seasonally Adjusted Annual Rates)

	ANNUAL			1989		1990				1991			
	1989	1990-P	1991-P	-Q3	-Q4	Q1	-Q2-P	-Q3-P	-Q4-P	Q1-P	-Q2-P	-Q3-P	-Q4-P
1. GNP Exports and Imports 1/													
Current $, Net	-47.1	-39.2	-29.3	-45.1	-38.8	-40.1	-38.8	-39.4	-38.4	-35.6	-31.8	-26.7	-22.9
Exports of G+S	625.9	665.5	734.9	628.5	643.5	646.7	655.2	670.2	689.8	709.9	727.6	743.3	758.9
Imports of G+S	673.0	704.6	764.1	673.6	682.3	686.7	693.9	709.6	728.2	745.4	759.3	770.0	781.6
Constant 82 $, Net	-52.6	-43.1	-35.3	-57.1	-47.2	-41.2	-44.0	-44.0	-43.4	-40.9	-37.6	-32.8	-29.9
Exports of G+S	589.2	619.8	667.4	593.1	606.6	608.0	612.2	622.4	636.4	650.1	662.3	673.2	683.9
Imports of G+S	641.8	662.9	702.7	650.2	653.8	649.2	656.2	666.4	679.8	691.1	699.9	706.0	713.8
2. Merchandise Trade Balance 2/	-113.2	-103.0	-101.8	-114.2	-115.2	-103.9	-100.2	-103.5	-104.5	-103.9	-103.1	-101.1	-99.1
Exports	361.9	390.5	429.7	362.8	368.5	377.6	385.6	394.3	404.6	414.4	423.8	434.2	446.5
Agricultural	41.4	42.3	43.5	38.7	40.4	42.7	41.9	41.6	43.1	43.5	43.5	43.3	43.6
Non-Agricultural	320.4	348.2	386.3	324.0	328.1	334.9	343.7	352.7	361.4	370.9	380.4	390.9	402.9
Imports	475.1	493.5	531.5	477.0	483.7	481.5	485.8	497.7	509.1	518.3	527.0	535.3	545.6
Petroleum and Products	50.2	57.3	61.4	52.1	51.9	64.0	51.7	55.0	58.2	59.2	60.4	61.6	64.2
Non-Petroleum	424.9	436.3	470.2	424.9	431.8	417.5	434.0	442.7	450.9	459.0	466.5	473.7	481.4
3. Other Current Account Transactions													
Capital Gains and Losses 3/	-2.1	0.7	-0.1	10.4	16.0	8.1	1.0	-3.5	-2.6	-0.1	-0.1	-0.1	-0.1
Other D.I. Income, Net	38.3	42.7	45.6	36.1	45.8	43.3	41.1	42.9	43.5	43.8	45.1	46.4	46.9
Portfolio Income, Net	-35.1	-39.9	-45.9	-35.1	-34.8	-37.8	-39.2	-40.5	-42.1	-43.8	-45.3	-46.6	-47.8
Other Current Account, Net	6.3	11.0	15.5	11.2	5.9	10.7	11.2	12.1	10.2	14.4	15.4	16.9	15.1
4. U.S. Current Account Balance													
Including Capital G/L	-105.9	-88.4	-86.7	-91.6	-82.3	-79.6	-86.1	-92.5	-95.6	-89.6	-87.9	-84.5	-84.9
Excluding Capital G/L	-103.7	-89.2	-86.6	-102.1	-98.3	-87.6	-87.0	-89.0	-93.0	-89.5	-87.8	-84.4	-84.8
5. Foreign Outlook 4/													
Real GNP--Ten Industrial 5/	3.5	3.1	3.3	3.1	3.7	3.8	2.2	3.1	3.5	3.2	3.4	3.4	3.5
Real GNP--LDC 6/	3.2	3.4	4.2	3.1	3.2	3.4	3.6	3.7	3.9	4.1	4.5	4.8	5.2
Consumer Prices--Ten Ind. 5/	4.0	4.4	4.2	2.3	4.3	4.8	5.4	3.4	3.9	3.9	5.1	4.0	4.2

1/ National Income and Product Account data.
2/ International accounts basis.
3/ The net of gains (+) or losses (-) on foreign-currency denominated assets due to their revaluation at current exchange rates and other valuation adjustments.
4/ Percent change, annual rates.
5/ Weighted by multilateral trade-weights of G-10 countries plus Switzerland; prices are not seasonally adjusted.
6/ Weighted by share in LDC GNP.
P/ Projected