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Strictly Confidential (FR) Class II FOMC

March 21, 1996

SUMMARY AND OUTLOOK

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

Overview

The economy appears to have ended 1995 on a weaker note than we thought at the time of the January Greenbook, with real GDP barely rising in the fourth quarter. However, the shortfall from our expectation reflected a much slower pace of inventory accumulation, and the greater progress in correcting the stock overhang has laid the groundwork for stronger output growth in early 1996. In fact, the latest indicators of activity have been quite upbeat on the whole, confirming that the economy has maintained appreciable momentum in the face of a series of adverse natural and manmade shocks. We now feel more confident that activity will remain on a moderate uptrend over the course of 1996 and 1997. We expect that real GDP will rise somewhat more than 2 percent this year and slow only minimally in 1997.

The GM strike has created some short-run turbulence; however, we see no existing imbalances or exogenous forces that point compellingly to a persistent deviation from essentially trend growth of output over the forecast period. To be sure, bond yields have soared in the past few weeks, but we still believe that financial conditions overall pose no serious impediment to expansion. The fiscal situation has remained static, with the probability of a multiyear budget compromise seemingly still small; under the circumstances, there appears little prospect of much further fiscal restraint beyond that imposed by the notching down of discretionary spending that has already occurred. On the external front, domestic firms are in a healthy competitive position at prevailing exchange rates, and activity abroad appears to be moving in a direction conducive to a continuation of substantial growth in U.S. exports.

The projected path of output implies that resource utilization is likely to remain in the range observed for a while now--a circumstance that we think implies a gradual deterioration in underlying wage and price trends. The risk of noticeable acceleration in the near term appears greatest on the labor cost side, where scattered "shortages" of qualified labor may result in some bidding up of compensation. On the price side, any pressures from increased labor costs are likely to be damped by flatness in prices of imported merchandise. We thus expect core consumer price inflation to rise only marginally over the next two years from the 2.9 percent pace of the past twelve months. We are not anticipating any sustained impulses to inflation from the food or energy sectors, but the risks are not negligible, given the uncertainties attending supply conditions in those markets.

Key Assumptions

In the last Greenbook, we assumed that the FOMC would hold the federal funds rate target at 5-1/2 percent at least well into 1997. Instead, the Committee cut the rate another 25 basis points. This came as no shock to the markets, and the action had little immediate effect on bond prices. Then, mainly in response to the incoming news on the economy, long-term interest rates moved up sharply.

These developments have led to only relatively modest adjustments to the financial elements of our forecast. We had expected that bond yields would rise as markets came to realize that the economy was not as weak as data early in the year were read as indicating. In the event, bond rates increased more rapidly and to a slightly higher level than projected; although tamer economic data may have a constructive effect on bond market psychology in the near term, we are not anticipating that bond yields will deviate greatly from the current level over the forecast period; because we are now

also assuming maintenance of federal funds at or near the current 5-1/4 percent level, this implies a somewhat steeper yield curve than before. These conditions suggest, if anything, a more favorable environment for banks, and we expect that any tightening of lending terms and standards will be quite limited. More generally, credit should remain readily available to all but the lowest-quality borrowers.

Meanwhile, equity prices have managed to rise further, on net, in the face of the bond yield backup and are noticeably higher than we had anticipated they would be at this point. Indeed, market valuations may be somewhat extended relative to "fundamentals," and we have allowed for a modest near-term "correction"--to be followed by a comparatively subdued uptrend through next year. On average, though, equity prices are higher in this forecast than in the last-- a plus for aggregate demand.

We revised our fiscal assumptions in January because efforts to enact a balanced budget plan had foundered. The current forecast is again predicated on the view that the Congress and the President will remain stalemated on major changes in mandatory spending programs and taxes. (Although there is talk of possible deals on welfare and Medicaid, any changes enacted are unlikely to have significant effects on the budget before 1998.) We continue to expect that discretionary spending will be held down by lower appropriations or a series of continuing resolutions. However, updated estimates of the amount of restraint in legislated appropriations and the current continuing resolution suggest that discretionary outlays will be only \$16 billion below the OBRA-93 baseline in fiscal 1996 and fiscal 1997; our previous assumption was a \$20 billion reduction each year. Broadly speaking, much of the notch-down in spending has already been felt through the actions

taken since last fall (including the shutdowns), and little further fiscal contraction is expected in the coming quarters.

A few other details of the fiscal outlook have been revised. The enactment of a farm bill is likely to increase farm subsidies about \$2 billion in both fiscal 1996 and fiscal 1997. Under current law, failure to pass a farm bill would result in substantially higher subsidies--an alternative that is undesirable to both the Administration and the Congress. Also, the budget stalemate allowed certain excise taxes to expire at the beginning of 1996, the largest being the 10 percent tax on airline tickets. We feel that in the absence of a broad budget bill, actions to restore these taxes are unlikely in the near term. This development is expected to reduce receipts by a few billion dollars in fiscal 1996 and by \$5 billion in fiscal 1997. However, technical adjustments to our outlays and receipts forecasts have offset these policy developments in our deficit projection. Under our policy and economic assumptions, we put the unified budget deficit at \$160 billion in fiscal 1996 and \$192 billion in fiscal 1997, about the same as in the previous Greenbook.

With respect to the external sector, the trade-weighted dollar in terms of other G-10 currencies has changed little on net since January, and we have retained the assumption that the dollar will remain near recent levels. The outlook for foreign economic activity is also little changed, with foreign real GDP (on a U.S. export-weighted basis) projected to increase about 3-1/2 percent in each of the next two years, compared with 2 percent in 1995. The price of crude oil has firmed recently as a result of the unseasonably cold winter; it has been buffeted as well by shifting views on the likelihood that Iraq will resume exporting oil. Last Greenbook, we had expected that the spot price of WTI would hold

steady in the first half of this year at its fourth-quarter average of about \$18 per barrel. In the interim, the spot price has moved above \$19 per barrel on average this quarter, and we now expect it to rise slightly above \$20 per barrel early next quarter. The longer-term outlook for oil prices has not been revised, however: We still expect that the spot price will settle at \$18.50 by midyear--with a downside risk associated with possible resumption of oil exports by Iraq.

Recent Developments

Our forecast of real GDP growth in the first quarter now stands at 1-1/2 percent--about 3/4 percentage point higher than in the January Greenbook. All of the upward revision is in final sales, which are now expected to increase at a 2-1/4 percent rate. The pickup in GDP this quarter would have been stronger if not for the GM strike, which we estimate to slice almost 3/4 percentage point from real growth, assuming that production returns to normal in the next few days.¹

SUMMARY OF THE NEAR-TERM OUTLOOK (Percent change, at annual rates, unless otherwise noted)

	1995:Q4			1996:Q1	
	Jan GB	BEA adv	Mar GB	Jan GB	Mar GB
Real GDP	1.9	0.9	0.3	0.8	1.5
Final sales	1.5	1.8	1.9	1.4	2.2
<i>Change in billions of chained (1992) dollars</i>					
Nonfarm inventory inv.	4.6	-14.7	-25.6	-11.7	-13.8

Of course, a great deal of uncertainty attaches to these estimates--probably even more than is usual at this point in a

1. If the tentative strike settlement were not ratified or there were other delays in resuming production, GDP growth would be reduced by about 1/3 percentage point for each additional week of lost GM output.

quarter, owing to weather-related distortions of the data. Importantly, the weakness in employment and hours reported for the survey week in January almost certainly was unrepresentative of the month as a whole. However, in light of other labor market indicators, the strength in employment reported for February is hard to credit. We thus anticipate that the next employment report will be weak and are interpreting the labor input picture as consistent with moderate output growth for the quarter.

We project that, among components of final demand, real personal consumption expenditures will bounce back to a 2-1/2 percent rate of growth this quarter after a very modest increase in the fourth quarter. Retail sales were soft in January but advanced strongly in February, paced by brisk motor vehicle sales.

Outlays for producers' durable equipment (PDE) in real terms are expected to grow at a 4 percent annual rate in the first quarter. Nominal shipments and orders for computing equipment rose in January and point to a solid advance in real outlays this quarter--albeit one likely to pale by comparison with the almost 80 percent annual rate recorded in the fourth quarter. Aircraft shipments should be up, and available data suggest a bounce-back of purchases of motor vehicles by businesses after a large decline in the fourth quarter. As for the remainder of PDE, we expect a small decline in spending.

Housing market activity has strengthened further this quarter in both the single-family and multifamily segments. Real residential investment should advance at about a 7 percent rate, in light of the increase in housing starts to a 1.47 million unit average in January and February from a 1.41 million unit average in the fourth quarter.

Although we foresee--as in the last Greenbook--a decline in the rate of inventory investment this quarter that reduces GDP growth $3/4$ percentage point, the picture with regard to inventory-sales ratios is much improved. Firms evidently made surprising progress late last year in correcting inventory imbalances, especially outside of the motor vehicle sector. This quarter, our projected slowdown in inventory accumulation is confined to motor vehicles. Some reduction in auto inventories was in train even before the GM strike; with the strike, dealer stocks will be drawn down sharply. Setting aside vehicles, data for January show substantial jumps in manufacturing and wholesale stocks. Viewing these increases as augmented by weather-induced delays in shipments, we anticipate little or no accumulation, on net, of non-auto stocks in February and March. Overall, nonfarm inventory stocks are expected to decline slightly in the first quarter.

One sign that inventory problems are limited is the firmness of manufacturing production. Although the net gain in output over the first two months of the year was disproportionately concentrated in the aircraft and computer sectors, the pattern of developments in other industries was suggestive of only mild and localized inventory overhangs. It appears that manufacturing output will post a $1-1/4$ percent annual rate gain this quarter, despite being reduced by about $1-1/2$ percentage points by the GM strike.

The three CPI reports received since the January Greenbook have revealed no clear change in inflation trends. The first-quarter increase in the CPI excluding food and energy is expected to be $2-3/4$ percent--close to the average pace over 1995. The rise in crude oil prices has boosted the energy component of the CPI, and some further pass-through is likely over the next few months. We anticipate that energy price increases will push overall CPI

inflation above 3 percent in the first and second quarters. As noted earlier, though, crude oil prices are expected to subside somewhat by midyear, paving the way for slightly lower retail energy prices.

Hourly compensation in the employment cost index accelerated to a 3-1/2 percent annual rate of increase in the final three months of 1995, as health insurance costs jumped. Even so, the increase in private industry compensation for the year ended December was just 2.8 percent--an all-time low for this series, which began in 1980. Average hourly earnings for production or nonsupervisory workers bounced around in January and February but recorded a net rise of only 0.3 percent--lowering the twelve-month change to a tad under 3 percent.

The Longer-Run Outlook for the Economy

In broad terms, the current forecast for 1996 and 1997 is essentially the same as the last. Real GDP growth fluctuates around the 2 percent trend of potential output; the unemployment rate holds in its recent range; and CPI inflation runs at roughly 3 percent. Compared with the 1-1/4 percent increase in real output last year, the projected pickup in the pace of activity largely reflects a cessation of restraint from inventories. Indeed, inventories should add slightly to growth in 1996, with the rebuilding of agricultural stocks and the swing in nonfarm inventory investment each contributing positively.

With regard to the outlook for final sales, the overall thrust of fiscal policy is expected to be closer to neutral in the coming quarters than was the case in the past several years, and financial conditions appear to be consistent with output growth near trend. The rise in longer-term interest rates should bring a halt to the recent surge in residential construction, but the high level of

equity prices should help sustain consumer spending. Real final sales are projected to advance about 2 percent in 1996 and 1997, close to the pace seen last year. However, the predicted composition of spending involves a step-up of growth in consumer outlays that offsets a further cyclical moderation of growth in business fixed investment.

SUMMARY OF STAFF PROJECTIONS
(Percent change, at annual rates, unless otherwise noted)

	1995	1996	1997
Real GDP	1.2	2.2	2.0
<i>Previous</i>	1.5	1.8	2.0
Final sales	1.9	2.1	2.0
<i>Previous</i>	1.9	2.0	2.1
PCE	2.0	2.5	2.4
BFI	7.3	3.0	3.8
Civilian unemployment rate ¹	5.5	5.6	5.6
<i>Previous</i>	5.6	5.6	5.6

1. Average level in the final quarter of the year indicated.

Personal consumption expenditure. We are projecting that the rate of growth of real consumer outlays will move up from 2 percent in 1995 to 2-1/2 percent in 1996 and 1997--a forecast that has spending advancing a bit faster than disposable income. In contrast, consumption grew considerably more slowly than income in 1995.

Given the rise in household net worth associated with the soaring stock market, it might have been expected that the personal saving rate would have fallen, not risen, last year. Although there is a danger of overanalyzing noisy data that have yet to undergo the usual sequence of annual revisions, some interpretation of this surprise is necessary in thinking about the outlook. Several possible drags on consumer demand can be readily suggested: (1) The

widely reported anxiety about job security may have prompted greater precautionary saving, although such anxiety was not reflected in any obvious way in the conventional indexes of consumer sentiment.

(2) Increased focus on the shaky finances of social security and Medicare/Medicaid may have raised households' targets for retirement saving. (3) High returns on stocks may have elevated the expected future yields on saving and encouraged the deferral of consumption. (4) An increasing number of households may have encountered limitations on their borrowing capacity.

We do not have a firm scientific basis for sorting out the importance of the aforementioned hypotheses. Still, the possibility that one or more of them does capture a significant force currently at work has led us to project that consumption will grow only a bit more quickly than disposable income; given the positive surprise in the personal saving rate in the fourth quarter, this places the path of the saving rate a few tenths of a percent above that in the January Greenbook and above the annual average for 1995. Although this seems to us a reasonable place to be, we think there may be an upside bias to the risks attending the consumption forecast; we have assumed only a small effect of stock market wealth on consumption, but a response more in line with some econometric estimates would significantly augment the predicted growth of spending. Moreover, consumers are likely to continue enjoying ready access to credit, despite some signs of greater concern on the part of lenders in light of rising delinquencies; and the latest readings on consumer sentiment have had a more bullish tone that could foretell near-term strength in demand.

Residential investment. Housing starts are projected to turn down in coming months in response to the backup in mortgage interest rates. In light of the forecast that income will continue growing

moderately and the expectation that mortgage rates will remain relatively attractive by the standards of the past few decades, only a modest decline of starts is expected. Single-family starts are projected to fall from a 1.16 million unit rate this quarter to a bit below 1.1 million units in 1997. In the multifamily market, activity is expected to continue its gradual recovery from the extraordinarily low levels of building earlier this decade. Starts should edge up from 300,000 units this year to 310,000 units next year. Credit for construction and permanent financing of income properties reportedly is readily available.

Business fixed investment. The cyclical rebound in business capital spending probably has run its course. Real growth of business fixed investment is projected to average 3 percent this year and 4 percent next, a pace just a little below that in recent quarters; growth averaged near 10 percent in 1993 and 1994. The most important cyclical factor--the output "accelerator," which posits a relationship between the level of investment spending and lags of the growth of output--is expected to restrain investment slightly over the projection period. Notably, declines in capacity utilization over the past year indicate less need for additions to plant and equipment in the industrial sector.

Real spending for producers' durable equipment is expected to advance 3 percent in 1996 and 5 percent in 1997. With technology advancing rapidly and computer prices continuing to fall (encouraged in the near term by the recent sharp declines in semiconductor costs), demand for computers is likely to remain robust; we are projecting annual percentage increases in the teens for real computer outlays. This rate of growth would be well below the pace of the past few years, reflecting our belief that computers are

likely to share in the general deceleration of equipment spending-- and also reflecting a sense that computer penetration in the business market has reached the point at which demand is increasingly determined by decisions to replace existing machines. (A caveat: No matter how high we forecast computer sales in the past few years, our predictions quite consistently turned out to have been too low!) Business outlays for motor vehicles are expected to decline a bit this year, though not as much as they did in 1995, and then to turn up modestly in 1997. Outside of computers and motor vehicles, investment in producers' durable equipment is expected to be lackluster, with growth averaging only about 1 percent in real terms--despite an upturn in purchases of aircraft.

In the nonresidential construction area, a cyclical slowing of outlays is also expected, reducing growth from 6 percent in 1995 to 3 percent in 1996 and 1 percent in 1997. The recent downturn in contracts and permits might be signaling a more pronounced softening, but there are a number of indicators pointing convincingly toward some buoyancy in building activity: Vacancy rates have been falling and rents firming in a number of sectors; financing for commercial construction reportedly is in abundant supply; and although the general view is that existing retail space is excessive, many of the expanding chains continue to prefer building new "big boxes."

Business inventories. A slowing pace of inventory accumulation restrained real GDP growth 3/4 of a percentage point over 1995, as firms acted to bring stocks into better alignment with slower growing final sales. As noted earlier, the lower-than-expected rate of inventory accumulation in the fourth quarter appears to have brought stocks considerably closer to desired levels, especially outside of the motor vehicle sector, while the drawdown of auto

stocks this quarter is likely to result in a lean aggregate inventory level in that sector. After an expected resumption of stockbuilding in the second quarter--which adds 1-1/4 percentage points to GDP growth that quarter--we are projecting that inventories will be a neutral factor for output growth. The ratio of stocks to sales is projected to edge down gradually as efforts to economize on inventory costs continue.

Government. Assumptions regarding federal purchases are little changed from the previous Greenbook: Real consumption and investment expenditures are expected to decline 2-1/2 percent in 1996 and 1997. The defense and nondefense components are projected to decline at similar rates.

The fiscal position of state and local governments appears to be relatively healthy in the aggregate. Although pressure to cut taxes may cause effective tax rates to edge down over the next two years, these governmental entities should be able to increase real purchases 2-1/2 percent in 1996 and 1997--close to the average so far in the current expansion--without causing budgetary strains. Of course, reforms in welfare or Medicaid, which would alter patterns of grants to states considerably, could have effects on finances within the sector; but at the moment, it is hard to see changes being enacted that would have significant macro consequences within the forecast period.

Net exports. Although real exports are expected to grow fairly rapidly, the high propensity to import in conjunction with the projected step-up in GDP growth suggests that import growth will be fast enough to cause some deterioration of our real net export balance. The trade sector is expected to directly reduce real GDP growth about 1/4 percentage point in 1996 and somewhat less in

1997.² (See the International Developments section for a more complete discussion.)

Labor markets. The overall contour of the labor projection has productivity advancing close to its trend rate of 1.0 percent and the unemployment rate holding at around 5.6 percent. After March, monthly gains in payroll employment should average about 100,000. Last year, although real GDP growth fell short of potential, the unemployment rate was little changed as the participation rate fell. We expect the participation rate to retrace that decline this year--indeed, in January-February, it rose close to our estimate of its "equilibrium" level--thus enabling real GDP growth to be a bit above trend without putting downward pressure on the unemployment rate. Also, the expected rebound of farm output adds a small positive wedge this year between growth rates of GDP and labor input.

Wages and prices. Perhaps the biggest news in data about labor costs and prices received since the January Greenbook was the sharp increase in health insurance expenses contained in the employment cost index (ECI) for the three months ending in December. Overall benefit costs jumped to a 5-1/2 percent annual rate of increase from an average annual rate of growth of 1-1/2 percent in the first three quarters of 1995. We had been expecting that benefit costs would accelerate from the very low rates of growth that prevailed earlier in 1995, but the increment was well above our forecast. Given the variability of the quarterly numbers (and the possibility that the

2. The outlook for real exports could be a bit weaker than our forecast if BEA's estimates of prices of exported semiconductors are similar to figures used in 1995. We have found it puzzling that BEA estimated that prices of semiconductor exports rose in 1995 following years of annual declines of at least 20 percent based on hedonic indexes. If these prices would have declined, say, 15 percent in 1995, real exports would have risen an additional \$13 billion (or nearly 2 percent) over the year. Prices of imported semiconductors declined in 1995, as they had in prior years. Over the forecast period, we have approximately neutralized the net effect of diverging prices for exported and imported semiconductors by projecting the same rate of decline for both series.

delay in the survey, owing to the government shutdowns, might have distorted the results), we have reacted cautiously to the surprise and raised our projection of the growth rate of ECI benefits less than 1/2 percentage point. Overall, we expect that the tightness of the labor markets--and some pickup in consumer price inflation (see below)--will be reflected in a modest elevation of compensation gains. The ECI index for compensation of private industry workers is expected to accelerate from growth of 2.8 percent in 1995 to 3.0 percent in 1996 and 3.3 percent in 1997.

SUMMARY OF STAFF INFLATION PROJECTIONS
(Percent change, Q4 to Q4, except as noted)

	1995	1996	1997
Consumer price index	2.7	3.1	3.0
<i>Previous</i>	2.7	3.0	2.9
Excluding food and energy	3.1	2.9	3.1
<i>Previous</i>	3.1	2.8	3.0
Employment cost index ¹	2.8	3.0	3.3
<i>Previous</i>	2.6	2.8	3.1

1. Compensation of private industry workers, percent change from final month of previous year to final month of year indicated.

On the view that firms' profit margins are ample, only part of the upward revision in the projection for labor costs has been passed through to prices. The core CPI is expected to increase 2.9 percent in 1996 and 3.1 percent in 1997, up a tenth of a point each year compared with the January Greenbook. Core inflation in 1996 is expected to be held down by more-favorable import prices and the pass-through of recent declines in prices of raw materials and intermediate goods.

The overall CPI is projected to increase about 3 percent in both 1996 and 1997, up somewhat from the pace of the past couple of years. Because of the increases that have occurred in grain and oilseed prices, we are anticipating that--even on the assumption of

normal crop yields--retail food prices will move up a little faster than they have in recent years, at a pace about in line with core inflation. Apart from the uncertainties associated with the crop outlook, a wild card in the food price projection is the potential volatility of meat prices that could be set off by producers' decisions about herd sizes and slaughter rates. Although changes in agricultural technology may have altered the timing and dimension of livestock supply adjustments from what has been observed in the past, we suspect that the squeeze on margins will prompt producers to trim their herds this year after several years of buildup. Indeed, if the anticipated selloff of herds turns out to be heavy, increases in meat prices this year could be smaller than we are forecasting--but with the twist that price increases farther down the road might then turn out to be larger than we currently are predicting.

As noted previously, developments in the oil market have already left their mark on the CPI and will tend to boost the CPI for a few more months. Although we expect retail energy prices to flatten out in the second half of the year, the less-favorable Q4/Q4 change in these prices is the biggest factor in our forecast of an acceleration of the total CPI in 1996. In 1997, the assumed stability of the price of crude oil makes retail energy prices a slight favorable factor in the overall consumer inflation outlook.

Alternative Simulations

We have run two model simulations in which the funds rate is symmetrically raised or lowered relative to the assumption in the Greenbook. Deviations from baseline start at 50 basis points in the second quarter of this year and increase to 100 basis points in the third quarter and beyond. In the lower-rate scenario, real GDP growth is 1/4 percentage point higher this year and 3/4 percentage

point higher in 1997. The unemployment rate is reduced 0.3 percentage point by the end of 1997, and core CPI inflation is 0.3 percentage point higher than in the baseline forecast. The effects of the tighter policy scenario are symmetric.

ALTERNATIVE FEDERAL FUNDS RATE ASSUMPTIONS
(Percent change, Q4 to Q4, except as noted)

	1996	1997
Real GDP		
Baseline	2.2	2.0
Lower funds rate	2.4	2.7
Higher funds rate	2.0	1.3
Civilian unemployment rate ¹		
Baseline	5.6	5.6
Lower funds rate	5.5	5.3
Higher funds rate	5.7	5.9
CPI excluding food and energy		
Baseline	2.9	3.1
Lower funds rate	2.9	3.4
Higher funds rate	2.9	2.8

1. Average for the fourth quarter.

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CLASS II FOMCSTAFF PROJECTIONS OF CHANGES IN GDP, PRICES, AND UNEMPLOYMENT
(Percent, annual rate)

March 21, 1996

Interval	Nominal GDP		Real GDP		Consumer price index		Unemployment rate (level)		
	01/26/96	03/21/96	01/26/96	03/21/96	01/26/96	03/21/96	01/26/96	03/21/96	
ANNUAL									
1993	4.9	4.9	2.2	2.2	3.0	3.0	6.8	6.8	
1994	5.8	5.8	3.5	3.5	2.6	2.6	6.1	6.1	
1995	4.7	4.5	2.1	2.0	2.8	2.8	5.6	5.6	
1996	4.5	4.3	1.8	1.9	2.8	2.9	5.6	5.6	
1997	4.6	4.8	2.1	2.1	2.9	3.0	5.6	5.6	
QUARTERLY									
1994	Q1	5.4	5.4	2.5	2.5	2.2	2.2	6.6	6.6
	Q2	6.8	6.8	4.8	4.8	2.5	2.5	6.2	6.2
	Q3	6.1	6.1	3.6	3.6	3.6	3.6	6.0	6.0
	Q4	5.4	5.4	3.2	3.2	2.2	2.2	5.6	5.6
1995	Q1	3.9	3.9	0.6	0.6	3.2	3.2	5.5	5.5
	Q2	2.8	2.8	0.5	0.5	3.2	3.2	5.7	5.7
	Q3	5.7	5.8	3.2	3.6	2.1	2.1	5.6	5.6
	Q4	4.6	2.1	1.9	0.3	2.3	2.1	5.6	5.5
1996	Q1	4.3	4.5	0.8	1.5	3.3	3.2	5.6	5.6
	Q2	4.5	5.9	2.0	3.4	3.0	3.4	5.6	5.6
	Q3	4.6	4.4	2.0	1.8	3.0	2.9	5.6	5.6
	Q4	4.9	4.9	2.5	2.3	2.9	2.9	5.6	5.6
1997	Q1	4.6	4.9	1.9	2.1	2.9	3.0	5.6	5.6
	Q2	4.6	4.8	2.1	2.1	2.9	3.0	5.6	5.6
	Q3	4.2	4.3	1.6	1.8	2.9	3.0	5.6	5.6
	Q4	4.9	5.1	2.3	2.3	2.9	3.0	5.6	5.6
TWO-QUARTER									
1994	Q2	6.1	6.1	3.7	3.7	2.3	2.3	-0.3	-0.4
	Q4	5.7	5.7	3.4	3.4	2.9	2.9	-0.6	-0.6
1995	Q2	3.3	3.3	0.5	0.5	3.2	3.2	0.1	0.1
	Q4	5.1	3.9	2.6	1.9	2.2	2.2	-0.1	-0.2
1996	Q2	4.4	5.2	1.4	2.4	3.1	3.3	0.0	0.1
	Q4	4.8	4.6	2.2	2.1	2.9	2.9	0.0	0.0
1997	Q2	4.6	4.9	2.0	2.1	2.9	3.0	0.0	0.0
	Q4	4.6	4.7	2.0	2.0	2.9	3.0	0.0	0.0
FOUR-QUARTER									
1993	Q4	4.6	4.6	2.2	2.2	2.7	2.7	-0.8	-0.8
1994	Q4	5.7	5.7	3.5	3.5	2.6	2.6	-0.9	-1.0
1995	Q4	4.2	3.6	1.5	1.2	2.7	2.7	0.0	-0.1
1996	Q4	4.6	4.9	1.8	2.2	3.0	3.1	0.0	0.1
1997	Q4	4.6	4.8	2.0	2.0	2.9	3.0	0.0	0.0

STRICTLY CONFIDENTIAL <FR>
CLASS II FOMCREAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS, QUARTERLY VALUES
(Seasonally adjusted, annual rate except as noted)

March 21, 1996

Item	Units	1993 Q1	1993 Q2	1993 Q3	1993 Q4	1994 Q1	1994 Q2	1994 Q3	1994 Q4	1995 Q1	1995 Q2
EXPENDITURES											
Nominal GDP	Bill. \$	6442.8	6503.2	6571.3	6683.7	6772.8	6885.0	6987.6	7080.0	7147.8	7196.5
Real GDP	Bill. Ch. \$	6327.0	6353.7	6390.4	6463.9	6504.6	6581.5	6639.5	6691.3	6701.6	6709.4
Real GDP	% change	0.0	1.7	2.3	4.7	2.5	4.8	3.6	3.2	0.6	0.5
Gross domestic purchases		0.9	2.4	3.7	4.4	3.4	5.4	3.6	2.7	1.4	0.9
Final sales		-0.8	1.5	2.3	4.8	1.2	2.8	4.2	3.6	0.7	1.8
Private dom. final purch.		1.4	2.8	4.4	5.4	3.7	4.5	3.6	4.1	2.1	2.6
Personal cons. expend.		0.7	2.7	3.8	2.8	2.6	3.6	2.5	3.3	0.8	3.4
Durables		0.8	11.2	7.3	10.2	5.8	4.3	5.6	12.6	-8.7	7.0
Nondurables		-0.9	2.3	2.9	1.7	3.8	3.3	4.0	3.2	2.4	1.9
Services		1.6	1.3	3.6	1.9	1.4	3.6	1.2	1.4	2.1	3.4
Business fixed invest.		6.0	6.3	4.7	17.5	7.3	7.1	13.7	12.2	15.3	3.6
Producers' dur. equip.		7.1	11.4	6.3	21.7	15.6	4.1	19.3	11.9	17.4	3.7
Nonres. structures		3.5	-5.3	0.8	7.5	-11.8	15.7	0.2	13.0	9.9	3.4
Res. structures		2.1	-5.1	13.2	24.3	12.8	12.7	-1.8	-0.1	-6.3	-13.3
Exports		0.4	7.9	-7.9	21.5	-0.6	14.8	12.2	15.3	2.6	4.6
Imports		9.6	14.5	4.9	17.0	7.5	19.1	11.0	9.3	8.7	7.7
Government purchases		-4.7	0.2	1.0	1.5	-4.2	-0.8	7.0	-1.4	-1.1	0.9
Federal		-13.1	-4.9	-2.9	-0.7	-11.1	-5.3	11.5	-5.9	-6.3	-1.1
Defense		-15.6	-5.2	-5.8	-0.5	-17.0	0.7	13.3	-16.1	-7.0	0.9
State and local		1.7	3.9	3.8	3.0	0.7	2.2	4.2	1.6	2.3	2.1
Change in bus. invent	Bill. Ch. \$	19.4	21.6	20.1	18.0	40.8	75.1	64.9	57.9	54.5	30.6
Nonfarm		26.0	26.7	30.9	22.1	29.8	54.1	50.1	53.3	58.1	33.8
Net exports		-55.2	-67.0	-89.1	-86.2	-101.3	-112.2	-113.3	-105.8	-119.0	-126.8
Nominal GDP	% change	3.8	3.8	4.3	7.0	5.4	6.8	6.1	5.4	3.9	2.8
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employ.	Millions	109.7	110.4	111.0	111.8	112.7	113.6	114.5	115.3	116.1	116.4
Unemployment rate	%	7.2	7.1	6.8	6.6	6.6	6.2	6.0	5.6	5.5	5.7
Industrial prod. index	% change	3.7	0.5	3.2	5.5	8.4	7.0	4.6	6.4	3.9	-1.4
Capacity util. rate-mfg	%	80.6	80.3	80.4	81.1	82.2	83.2	83.4	84.3	82.9	82.6
Housing starts	Millions	1.16	1.25	1.31	1.47	1.36	1.44	1.47	1.51	1.31	1.28
Light motor vehicle sales		13.23	14.11	13.69	14.53	15.45	14.76	14.65	15.44	14.90	14.35
INCOME AND SAVING											
Nominal GNP	Bill. \$	6458.4	6512.3	6584.8	6684.5	6773.6	6876.3	6977.6	7062.2	7140.5	7187.0
Nominal GNP	% change	4.3	3.4	4.5	6.2	5.4	6.2	6.0	4.9	4.5	2.6
Nominal personal income		-5.7	8.8	2.9	8.3	-3.3	13.6	4.2	6.5	7.1	4.5
Real disposable income		-8.1	5.2	1.1	5.0	-5.3	10.1	2.1	4.0	3.6	0.0
Personal saving rate	%	4.2	4.8	4.2	4.7	2.8	4.2	4.1	4.2	4.8	4.0
Corp. profits, IVA & CCAadj	% change	-1.2	22.9	19.7	42.2	-37.5	84.7	14.5	14.6	-6.4	1.1
Profit share of GNP	%	6.6	6.9	7.1	7.7	6.7	7.7	7.9	8.1	7.8	7.8
Federal govt. surpl./def.	Bill. \$	-283.7	-249.2	-253.5	-232.4	-212.9	-169.9	-186.3	-190.4	-173.3	-160.5
State/local surpl./def.		80.5	89.1	94.9	115.0	94.8	105.2	99.6	99.3	99.0	99.0
Ex. social ins. funds		13.3	22.0	28.1	48.5	29.0	41.1	37.9	39.4	40.2	40.9
PRICES AND COSTS											
GDP implicit deflator	% change	3.8	2.1	1.9	2.2	2.8	1.9	2.4	2.2	3.2	2.3
CPI		3.1	2.8	1.7	3.4	2.2	2.5	3.6	2.2	3.2	3.2
Ex. food and energy		3.5	3.5	2.4	2.9	2.9	2.9	3.1	2.3	3.3	3.6
ECI, hourly compensation		4.2	3.5	3.4	3.4	3.0	3.4	3.3	2.6	2.3	2.9
Nonfarm business sector											
Output per hour		-3.9	-1.7	2.1	1.6	-2.5	1.9	2.6	0.9	-1.1	3.0
Compensation per hour		1.0	2.7	2.0	1.1	3.3	2.1	1.2	3.3	3.7	5.4
Unit labor cost		5.1	4.5	-0.1	-0.5	5.9	0.2	-1.4	2.4	4.9	2.3

STRICTLY CONFIDENTIAL <FR>
CLASS II FOMCREAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS, QUARTERLY VALUES
(Seasonally adjusted, annual rate except as noted)

March 21, 1996

Item	Units	Projected									
		1995 Q3*	1995 Q4	1996 Q1	1996 Q2	1996 Q3	1996 Q4	1997 Q1	1997 Q2	1997 Q3	1997 Q4
EXPENDITURES											
Nominal GDP	bill. \$	7298.5	7335.9	7416.7	7523.0	7603.8	7695.2	7788.5	7880.1	7962.6	8061.7
Real GDP	bill. Ch. \$	6768.3	6773.3	6797.9	6855.3	6885.6	6925.2	6960.6	6996.3	7026.7	7066.7
Real GDP	% change	3.6	0.3	1.5	3.4	1.8	2.3	2.1	2.1	1.8	2.3
Gross domestic purchases		2.8	-0.8	1.8	3.5	2.3	2.0	2.0	2.2	2.3	2.2
Final sales		3.4	1.9	2.2	2.1	1.6	2.4	2.1	2.0	1.7	2.4
Private dom. final purch.		3.3	1.8	2.9	2.5	2.5	2.3	2.5	2.4	2.5	2.5
Personal cons. expend.		2.8	1.1	2.5	2.4	2.7	2.5	2.5	2.3	2.4	2.5
Durables		9.4	2.1	9.5	3.4	4.8	3.4	2.9	2.4	3.3	3.5
Nondurables		0.5	-0.7	-0.7	1.8	2.2	2.2	2.2	2.2	2.2	2.2
Services		2.6	1.8	2.7	2.5	2.5	2.5	2.5	2.4	2.4	2.4
Business fixed invest.		5.2	5.4	4.2	1.9	2.9	2.9	4.0	3.8	3.7	3.5
Producers' dur. equip.		4.8	6.2	3.9	2.2	3.1	3.2	4.8	4.7	4.6	4.8
Nonres. structures		6.2	3.4	5.2	1.0	2.3	2.0	1.7	1.1	1.1	-0.2
Res. structures		9.2	4.4	6.6	6.7	-2.8	-2.5	-1.2	0.0	0.8	0.4
Exports		8.0	10.5	5.1	9.5	4.1	11.6	7.0	10.8	5.0	11.3
Imports		1.0	0.6	7.4	9.8	7.6	7.9	6.2	10.7	8.3	9.2
Government purchases		-0.7	-3.7	0.7	0.7	0.2	1.1	0.3	0.9	0.5	1.0
Federal		-5.9	-11.9	-3.2	-1.9	-3.4	-0.9	-3.5	-2.0	-3.1	-2.3
Defense		-8.1	-11.6	0.5	-5.2	-3.6	-1.3	-3.9	-2.5	-2.9	-1.6
State and local		2.7	1.7	3.0	2.2	2.2	2.1	2.5	2.5	2.5	2.7
Change in bus. invent.	bill. Ch. \$	33.2	9.5	-2.7	20.0	23.9	22.1	21.3	22.0	23.5	22.4
Nonfarm		38.3	12.7	-1.1	19.1	21.5	19.6	18.7	19.4	20.8	19.6
Net exports		-114.3	-95.9	-102.0	-104.9	-113.6	-108.6	-108.8	-111.4	-120.6	-118.8
Nominal GDP	% change	5.8	2.1	4.5	5.9	4.4	4.9	4.9	4.8	4.3	5.1
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employ.	Millions	116.8	117.2	117.6	118.0	118.3	118.7	119.0	119.3	119.7	120.0
Unemployment rate	%	5.6	5.5	5.6	5.6	5.6	5.6	5.6	5.6	5.6	5.6
Industrial prod. index	% change	3.2	0.4	0.9	5.3	2.7	3.1	2.7	2.7	2.2	3.2
Capacity util. rate-mfg	%	82.6	82.0	81.4	81.7	81.5	81.4	81.5	81.5	81.4	81.6
Housing starts	Millions	1.42	1.41	1.47	1.44	1.40	1.39	1.39	1.39	1.38	1.38
Light motor vehicle sales		15.04	14.91	15.00	14.60	14.65	14.70	14.74	14.75	14.77	14.80
INCOME AND SAVING											
Nominal GNP	bill. \$	7283.0	7334.9	7414.7	7514.3	7596.1	7682.6	7778.6	7865.0	7950.6	8043.1
Nominal personal income	% change	5.5	2.9	4.4	5.5	4.4	4.6	5.1	4.5	4.4	4.7
Real disposable income		5.0	5.3	6.3	4.8	4.9	4.6	5.7	4.7	5.0	5.5
Personal saving rate	%	4.5	3.8	3.8	0.1	3.5	1.6	3.2	1.7	2.3	2.3
Personal saving rate	%	4.4	4.9	5.2	4.7	4.9	4.7	4.9	4.7	4.7	4.7
Corp. profits, IVA & CCAadj	% change	44.1	-12.6	-5.5	14.7	-0.2	7.7	5.3	4.1	1.8	0.4
Profit share of GNP	%	8.4	8.1	7.9	8.1	8.0	8.0	8.0	8.0	8.0	7.9
Federal govt. surpl./def.	bill. \$	-161.6	-159.7	-187.8	-147.5	-162.2	-171.7	-176.8	-175.9	-174.4	-184.8
State/local surpl./def.		93.9	88.1	84.5	85.2	85.3	87.0	88.3	90.8	89.2	92.0
Ex. social ins. funds		35.8	30.5	27.2	28.3	28.7	30.7	32.3	35.0	33.6	36.6
PRICES AND COSTS											
GDP implicit deflator	% change	2.2	1.8	3.0	2.4	2.5	2.5	2.8	2.7	2.5	2.7
CPI		2.1	2.1	3.2	3.4	2.9	2.9	3.0	3.0	3.0	3.0
Ex. food and energy		2.5	2.5	2.7	2.8	3.0	3.0	3.1	3.1	3.1	3.1
ECI, hourly compensation		2.3	3.5	2.9	3.0	3.0	3.1	3.2	3.2	3.3	3.3
Nonfarm business sector											
Output per hour		1.7	-1.0	2.1	-0.4	0.6	1.4	1.1	1.1	0.6	1.3
Compensation per hour		4.3	3.0	6.4	0.8	3.7	3.6	3.9	3.8	3.8	3.9
Unit labor cost		2.5	3.5	4.2	1.2	3.1	2.1	2.8	2.6	3.1	2.5

* Published

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

March 21, 1996

Item	Projected										Projected		
	1995 Q3*	1995 Q4	1996 Q1	1996 Q2	1996 Q3	1996 Q4	1997 Q1	1997 Q2	1997 Q3	1997 Q4	95Q4/ 94Q4	96Q4/ 95Q4	97Q4/ 96Q4
Real GDP	3.6	0.3	1.5	3.4	1.8	2.3	2.1	2.1	1.8	2.3	1.2	2.2	2.0
Gross domestic purchases	2.8	-0.8	1.8	3.6	2.3	2.0	2.1	2.2	2.3	2.2	1.1	2.4	2.2
Final sales	3.4	1.8	2.2	2.1	1.6	2.4	2.1	2.0	1.7	2.4	1.9	2.1	2.0
Private dom. final purch.	2.7	1.4	2.4	2.1	2.0	1.9	2.1	2.0	2.1	2.1	2.0	2.1	2.1
Personal cons. expend.	1.9	0.8	1.7	1.6	1.8	1.7	1.7	1.6	1.7	1.7	1.4	1.7	1.7
Durables	0.8	0.2	0.8	0.3	0.4	0.3	0.3	0.2	0.3	0.3	0.2	0.5	0.3
Nondurables	0.1	-0.1	-0.1	0.4	0.5	0.5	0.5	0.5	0.4	0.5	0.2	0.3	0.5
Services	1.1	0.7	1.0	1.0	1.0	1.0	1.0	0.9	0.9	0.9	0.9	1.0	0.9
Business fixed invest.	0.5	0.6	0.5	0.2	0.3	0.3	0.4	0.4	0.4	0.4	0.7	0.3	0.4
Producers' dur. equip.	0.4	0.5	0.3	0.2	0.2	0.3	0.4	0.4	0.4	0.4	0.6	0.3	0.4
Nonres. structures	0.2	0.1	0.1	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.1	0.1	0.0
Res. structures	0.3	0.2	0.3	0.3	-0.1	-0.1	-0.0	0.0	0.0	0.0	-0.1	0.1	-0.0
Change in bus. invent.	0.2	-1.4	-0.7	1.4	0.2	-0.1	-0.0	0.0	0.1	-0.1	-0.7	0.2	0.0
Nonfarm	0.3	-1.5	-0.8	1.2	0.1	-0.1	-0.1	0.0	0.1	-0.1	-0.6	0.1	-0.0
Farm	-0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	-0.1	0.1	0.0
Net exports	0.7	1.1	-0.4	-0.2	-0.5	0.3	-0.0	-0.2	-0.5	0.1	0.1	-0.2	-0.1
Exports	0.9	1.2	0.6	1.1	0.5	1.4	0.8	1.3	0.6	1.4	0.7	0.9	1.1
Imports	0.1	0.1	1.0	1.3	1.0	1.1	0.9	1.5	1.2	1.3	0.6	1.1	1.2
Government purchases	-0.1	-0.7	0.1	0.1	0.0	0.2	0.1	0.2	0.1	0.2	-0.2	0.1	0.1
Federal	-0.4	-0.9	-0.2	-0.1	-0.2	-0.1	-0.2	-0.1	-0.2	-0.1	-0.5	-0.2	-0.2
Defense	-0.4	-0.6	0.0	-0.2	-0.2	-0.1	-0.2	-0.1	-0.1	-0.1	-0.3	-0.1	-0.1
Nondefense	-0.0	-0.3	-0.2	0.1	-0.1	-0.0	-0.1	-0.0	-0.1	-0.1	-0.1	-0.1	-0.1
State and local	0.3	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
GDP Residual	-0.0	-0.2	-0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

* Published
Components may not sum to total due to rounding.

Item	Fiscal year				1995				1996				1997			
	1994 ^a	1995 ^a	1996	1997	Q1 ^a	Q2 ^a	Q3 ^a	Q4 ^b	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
UNIFIED BUDGET																
Not seasonally adjusted																
Receipts ¹	1257	1351	1417	1463	307	404	333	324	316	423	354	338	317	441	367	348
Outlays ¹	1461	1514	1577	1655	380	381	373	380	397	396	404	415	419	407	414	433
Surplus/deficit ¹	-203	-164	-160	-192	-73	23	-40	-56	-81	27	-50	-77	-102	34	-47	-86
On-budget	-259	-226	-228	-248	-85	-11	-43	-69	-92	-13	-54	-81	-113	-4	-50	-87
Off-budget	56	62	68	56	12	34	2	14	11	40	3	4	11	38	3	2
Surplus excluding deposit insurance ²	-210	-181	-169	-195	-79	18	-42	-59	-84	25	-52	-78	-103	33	-47	-86
Means of financing																
Borrowing	185	171	162	193	66	26	20	33	59	-2	73	55	74	12	52	64
Cash decrease	17	-2	-22	0	8	-42	23	17	6	-27	-18	25	20	-45	0	25
Other ³	1	-5	20	0	0	-7	-2	5	17	3	-5	-3	9	-1	-5	-3
Cash operating balance, end of period	36	38	60	60	18	61	38	20	15	42	60	35	15	60	60	35
NIPA FEDERAL SECTOR																
Seasonally adjusted, annual rate																
Receipts	1354	1459	1519	1590	1449	1483	1487	1489	1502	1543	1544	1563	1581	1600	1617	1636
Expenditures	1554	1630	1685	1764	1623	1644	1648	1650	1692	1691	1706	1735	1757	1773	1789	1817
Consumption expend.	450	455	447	446	455	456	453	451	449	444	443	445	447	447	446	447
Defense	307	304	298	299	303	305	301	299	299	297	296	298	299	299	299	300
Nondefense	143	151	149	148	152	151	152	152	150	147	147	147	148	148	147	146
Other expenditures	1104	1175	1238	1317	1168	1188	1195	1198	1242	1247	1264	1290	1310	1326	1343	1371
Current account surplus	-200	-171	-165	-174	-173	-161	-162	-160	-190	-148	-163	-172	-176	-174	-172	-181
Gross investment	67	65	61	61	65	67	63	57	62	62	62	61	61	61	61	61
Current and capital account surplus	-267	-237	-226	-235	-238	-227	-225	-217	-252	-210	-225	-234	-238	-235	-233	-242
FISCAL INDICATORS ⁴																
High-employment (HEB) surplus/deficit	-263	-262	-252	-269	-265	-248	-253	-243	-274	-238	-253	-265	-272	-271	-270	-282
Change in HEB, percent of potential GDP	-.6	0	-.1	.2	-.3	-.2	.1	-.1	4	-.5	.2	.2	.1	0	0	.2
Fiscal impetus (FI), percent, cal. year	-6.4	-5.6	-7.7	-2.7	-1.9	-.8	-1.4	-4.6	-2.2	-1.7	-.1	-1	-1.1	-.7	-9	-.7

1. OMB's March 1996 baseline deficit estimates (assuming discretionary spending at OBRA93 caps, and an extension of the expired trust fund excise taxes) are \$161 billion in FY96 and \$144 billion in FY97. CBO's December 1995 baseline deficit estimates (including the fiscal dividend from assumed enactment of congressional budget program) are \$172 billion in FY96 and \$182 billion in FY97. Budget receipts, outlays, and surplus/deficit include corresponding Social Security (OASDI) categories. The OASDI surplus is excluded from the on-budget deficit and shown separately as off-budget, as classified under current law. The Postal Service deficit is included in off-budget outlays beginning in FY90.

2. OMB's March 1996 baseline deficit estimates (assuming discretionary spending at OBRA93 caps, and an extension of the expired trust fund excise taxes), excluding deposit insurance spending, are \$169 billion in FY96 and \$148 billion in FY97. CBO's December 1995 baseline deficit estimates (including the fiscal dividend from assumed enactment of congressional budget program), excluding deposit insurance spending, are \$180 billion in FY96 and \$186 billion in FY97.

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 generated by 1.8 percent real growth and an associated unemployment rate of 5 percent. Quarterly figures for change in HEB and FI are not at annual rates. Change in HEB, as a percent of nominal potential GDP, is reversed in sign. FI is the weighted difference of discretionary changes in federal spending and taxes (in chained 1992 dollars), scaled by real federal consumption plus investment. For change in HEB and FI, negative values indicate restraint.

a--Actual.
b--Preliminary.

Summary

The announcement of an easing in monetary policy after the January FOMC meeting led to further declines in short-term interest rates, and market participants seemed to expect additional reductions in the funds rate by early summer. In recent weeks, however, interest rates have risen sharply as incoming information dashed the notion that the economy was lapsing into a period of seriously subpar performance and the prospects for a broad fiscal agreement continued to fade. Three-month bill rates are up 2 basis points since late January, and the short-term rate curve indicates that no policy easing is expected. In the coupon sector, interest rates on Treasury notes and bonds have climbed 55 to 65 basis points, on net, despite some decline in recent days. The rise in rates on private market bonds has about matched that on Treasuries, keeping quality spreads historically low.

Equity prices have run counter to bond prices, with most major stock indexes advancing 3 percent to 5-1/2 percent over the intermeeting period in active and volatile trading. On Friday, March 8, after the unexpectedly strong employment report was released, the broader indexes fell an extraordinary 3 percent; there were no signs of panic, however, and the market turned up nicely in the following week.

The resilience of equity prices in the face of rising bond yields has been all the more surprising given that over the past several weeks securities analysts have, if anything, revised down their estimates of corporate earnings for 1996. Price-to-earnings ratios, whether measured with backward-looking earnings or analysts' expectations of future profits, now appear somewhat elevated compared with readings over the past year or two. However, these

and other measures of relative returns on equities have not been particularly helpful in the past in foreshadowing significant declines in stock prices--that is, apparent "overvaluations" have often persisted until a major shock, often a substantial tightening of monetary policy, triggered a correction.

The broad monetary aggregates have grown swiftly of late. M2 expanded at a 5-1/4 percent annual rate in February following a 4-3/4 percent rise in January; M3 advanced at a 10 percent pace last month, up from a 7-1/4 percent pace in January. Both aggregates have gotten a lift from money market mutual funds, which became more attractive as their returns lagged the drop in short-term market yields. Data for early March point to an acceleration of M2 and continued rapid growth of M3, pushing both aggregates further above their respective annual ranges.

In contrast, bank credit expansion slowed to a 3-1/2 percent rate in February, as weaker loan growth more than offset a rise in securities purchases. Consumer loans were about flat, and real estate lending slowed. Demand by investors for paper backed by consumer receivables, home equity loans, and fixed-rate mortgages has remained strong, inducing banks to securitize these types of credits. However, even after adjusting for securitizations, consumer loans at banks expanded at just over half the average rate recorded in the past year. Business loans at banks rose at a 6 percent rate last month, down from January but about the same pace registered in late 1995. Moderate growth of business loans does not appear to reflect supply constraints: Banks reportedly have continued to compete aggressively for commercial and industrial loans, and in February the average spread over the federal funds rate was the narrowest in a decade.

Gross public offerings of corporate bonds were strong until mid-February, when the backup in interest rates prompted postponements or outright cancellations. Even so, bond issuance for nonfinancial firms last month was up from January and about matched the elevated pace in the fourth quarter of 1995. Financing for corporate restructuring has been an important factor boosting issuance of bonds and adding to the growth of nonfinancial commercial paper.

Gross equity issuance also increased in February and remained high in early March. The strong stock market has provided a particularly favorable environment for initial public offerings by young firms; IPOs have accounted for about half the nonfinancial equity issued since late 1995. Nonetheless, share retirements resulting from mergers and acquisitions and from share repurchases continued to exceed new issues by a substantial margin.

Available data for the household sector suggest that borrowing has been well maintained in recent months. Growth of total consumer credit in January was about unchanged from the pace in the second half of 1995, although lending at banks implies there was some slowing in February. Mortgage borrowing appears to have risen during the current quarter; however, loan applications--especially those for refinancing rather than home purchase--declined sharply in response to the recent backup in rates. The latest readings on consumer and mortgage loan delinquencies, covering the closing months of 1995, show some further deterioration, but there are no signs that this worsening in loan quality has resulted in major shifts in overall credit demand or supply.

State and local governments, like corporations, had been taking advantage of lower interest rates by refinancing higher-cost debt, and gross issuance of tax-exempt bonds dropped sharply in

mid-February when potential interest savings evaporated. Overall, state and local debt continues to contract owing to the large volume of pre-refunded securities now being retired as call dates arrive.

The enactment of legislation temporarily resolving the debt-ceiling impasse allows the Treasury to meet its financing needs through March 29, and borrowing is expected to total nearly \$60 billion in the first quarter.

Outlook

The staff's economic projection assumes no change in the federal funds rate over the forecast period. Bond yields are expected to change little, possibly retracing a touch more of their recent run-up in yields in coming weeks. Although moderate economic growth and inflation should be compatible with further gains in corporate profits, current share valuations seem optimistic, and we expect that the stock market will face difficulty in extending its uptrend.

The recent easings of monetary policy, which have narrowed the spread of short-term market interest rates over the deposit interest rates offered to households, are likely to continue to boost M2 for a while longer; growth in 1996 is expected to be somewhat above its annual growth range. As in 1995, M2 velocity seems likely to post a small decline. The strong expansion of M3 in 1995 should be sustained this year, although bank credit growth is likely to remain moderate. Banks are anticipated to put greater emphasis on deposit funding, in part owing to the absence of insurance premiums. With market interest rates assumed stable in 1997, the rates of expansion of the broad monetary aggregates are projected to ease off slightly and velocity to flatten out.

Growth of domestic nonfinancial debt, which was 5-1/2 percent in 1995, is projected to be 5 percent in 1996 and 4-3/4 percent in

1997. The reduction reflects a slowing of growth in credit to households and businesses. A pickup in federal debt growth, owing to a rise in the deficit, will somewhat offset the moderation in nonfederal debt.

Growth of business debt is projected to slow to 4-1/2 percent next year and 4-1/4 percent in 1997, compared with 6-1/2 percent last year. We are not anticipating a significant slackening in the pace of equity share retirements, but borrowing demands are likely to be less robust as a consequence of reduced inventory accumulation and slower growth of business fixed investment.

Although the rise in bond yields has deterred issuance in recent weeks, we expect that borrowers will return as market conditions stabilize. Meanwhile, banks most likely will remain eager lenders over the period ahead as nothing in the outlook suggests the emergence of severe credit quality problems that would prompt a significant tightening of standards or terms for business borrowers. Banks are likely to remain highly profitable, and the additional capital will tend to encourage lending.

In the household sector, home mortgage debt growth is expected to remain close to its current levels, in line with our expectations of a moderate rise in nominal outlays for residential construction. Growth of consumer credit is projected to slow, in part because repayment volumes will be rising in reflection of the rapid rise of borrowing in the past few years; the subdued growth of outlays for big ticket items points to relatively modest increases in extensions. Already high debt levels may limit the potential for borrowers to qualify for additional credit, and rising delinquency rates are likely to make banks and other lenders more cautious; however, we think this will prove to be a limited shift in availability, affecting mainly a small segment of primarily lower

income households. Total household debt is projected to rise about 6-3/4 percent in 1996 and 6 percent in 1997 down from the 8 percent rate of 1995 but still faster than the projected rise in nominal personal income.

State and local debt outstanding is expected to continue to contract in 1996 and 1997 but at a slower pace than in 1994 and 1995. The volume of scheduled retirements of pre-refunded bonds is estimated to be shrinking. Nonetheless, retirement volume remains sizable and should more than offset an expected increase in issuance of tax-exempt securities to fund a rise in governmental construction.

CHANGE IN DEBT OF THE DOMESTIC NONFINANCIAL SECTORS ¹
(Percent)

Year	Total	Nonfederal						MEMO Nominal GDP	
		Federal govt.	Households			State and local govt.			
		Total	Total	Home mtg.	Cons. credit	Business			
1986	12.2	13.6	11.8	11.5	13.8	9.6	12.2	10.8	5.0
1987	9.2	8.0	9.6	12.1	16.3	5.0	6.7	12.1	7.4
1988	8.8	8.0	9.1	9.3	10.9	7.2	9.7	6.5	7.6
1989	7.6	7.0	7.8	8.8	10.1	6.2	7.5	5.7	6.4
1990	6.6	11.0	5.3	7.9	10.1	2.0	3.1	4.9	4.4
1991	4.4	11.1	2.4	5.0	6.6	-1.8	-1.7	8.2	3.8
1992	4.8	10.9	2.8	5.3	6.1	0.9	0.5	2.0	6.3
1993	5.3	8.3	4.2	6.1	5.4	7.3	1.6	5.7	4.7
1994	4.9	4.7	5.0	8.4	6.6	14.0	3.8	-3.7	5.9
1995	5.4	4.1	5.9	8.1	6.5	13.3	6.4	-4.6	3.6
1996	5.0	5.1	4.9	6.7	6.5	9.0	4.6	-2.4	4.9
1997	4.7	5.3	4.5	6.1	6.3	6.4	4.2	-2.1	4.8
Quarter (seasonally adjusted annual rates)									
1995:1	6.4	7.6	5.9	6.6	5.8	9.5	8.1	-4.3	3.9
2	6.6	5.7	6.9	8.3	6.3	15.7	7.6	-1.5	2.8
3	3.9	1.8	4.6	8.4	7.5	10.5	4.4	-10.6	5.8
4	4.5	1.2	5.7	8.1	5.9	15.0	5.0	-2.4	2.1
1996:1	5.3	5.6	5.2	6.7	6.4	9.7	5.1	-1.3	4.5
2	5.0	3.5	5.6	6.8	6.4	9.0	4.8	2.5	5.9
3	5.0	7.4	4.1	6.4	6.3	8.4	4.2	-7.5	4.4
4	4.2	3.4	4.5	6.3	6.3	7.8	4.2	-3.2	4.9
1997:1	5.3	8.0	4.4	6.2	6.2	6.6	4.0	-2.9	4.9
2	4.3	3.8	4.5	6.1	6.2	6.5	4.1	-1.9	4.8
3	4.5	4.8	4.3	5.9	6.1	6.0	4.1	-3.3	4.3
4	4.4	4.1	4.6	5.8	6.0	5.9	4.1	-0.6	5.1

1. Data after 1995:q4 are staff projections. Changes are measured from end of the preceding period to end of period indicated except annual nominal GDP growth, which is Q4 to Q4. On a quarterly average basis, total debt grows 5.5 percent in 1995, 4.9 percent in 1996, and 4.7 percent in 1997. Federal debt rises 4.4 percent in 1995, 4.5 percent in 1996, and 5.3 percent in 1997. Nonfederal debt increases 5.9 percent in 1995, 5.0 percent in 1996, and 4.5 percent in 1997.

2.6.3 FOF

FLOW OF FUNDS PROJECTIONS: HIGHLIGHTS ¹
(Billions of dollars)

	Calendar year				1995		1996				1997	
	1994	1995	1996	1997	Q3	Q4	Q1	Q2	Q3	Q4	H1	H2
	Seasonally Adjusted Annual Rates											
Net funds raised by domestic nonfinancial sectors												
1 Total	572.1	640.7	623.9	628.7	430.8	541.2	639.0	656.1	645.0	555.4	650.3	607.1
2 Net equity issuance	-44.9	-76.0	-65.8	-60.0	-98.8	-77.2	-95.6	-50.4	-64.4	-52.8	-59.3	-60.8
3 Net debt issuance	617.0	716.7	689.7	688.7	529.6	618.4	734.6	706.5	709.4	608.2	709.6	667.8
Borrowing sectors												
Nonfinancial business												
4 Financing gap ²	4.1	58.9	9.7	15.0	66.5	6.5	1.9	10.3	15.5	11.0	9.1	20.8
5 Net equity issuance	-44.9	-76.0	-65.8	-60.0	-98.8	-77.2	-95.6	-50.4	-64.4	-52.8	-59.3	-60.8
6 Credit market borrowing	144.3	250.8	193.9	181.9	178.3	205.5	211.1	204.6	180.3	179.5	179.4	184.4
Households												
7 Net borrowing, of which:	360.3	373.1	336.9	327.7	401.8	396.5	335.2	346.0	333.8	332.6	329.2	326.2
8 Home mortgages	196.7	207.1	219.0	225.8	246.0	196.3	216.0	218.0	220.0	222.0	224.8	226.8
9 Consumer credit	121.2	130.8	100.5	78.0	109.6	161.8	108.7	102.7	97.7	92.7	80.5	75.5
10 Debt/DPI (percent) ³	88.7	90.8	92.6	93.7	91.0	91.7	91.8	92.6	92.7	93.2	93.4	93.9
State and local governments												
11 Net borrowing	-43.4	-51.5	-25.2	-22.2	-116.2	-26.1	-13.7	26.3	-80.2	-33.2	-24.7	-19.7
12 Current surplus ⁴	107.4	104.7	98.8	105.9	106.9	89.0	97.4	98.0	98.5	101.3	104.7	107.1
U.S. government												
13 Net borrowing	155.9	144.4	184.1	201.3	65.8	42.4	202.0	129.7	275.5	129.3	225.7	176.9
14 Net borrowing (quarterly, nsa)	155.9	144.4	184.1	201.3	19.9	33.3	58.8	-2.4	72.6	55.2	85.7	115.6
15 Unified deficit (quarterly, nsa)	185.2	146.4	181.5	200.8	40.2	55.9	81.2	-26.9	50.1	77.0	68.4	132.4
16 Funds supplied by depository institutions	198.3	284.0	200.4	205.7	284.5	155.2	196.7	194.7	202.7	207.7	209.7	201.7
MEMO: (percent of GDP)												
17 Domestic nonfinancial debt ³	185.4	186.6	188.1	188.2	187.1	188.1	188.3	188.1	188.4	188.3	188.2	188.3
18 Domestic nonfinancial borrowing	8.9	9.9	9.1	8.7	7.3	8.4	9.9	9.4	9.3	7.9	9.1	8.3
19 U.S. government ⁵	2.2	2.0	2.4	2.5	0.9	0.6	2.7	1.7	3.6	1.7	2.9	2.2
20 Private	6.7	7.9	6.7	6.2	6.4	7.9	7.2	7.7	5.7	6.2	6.2	6.1

1. Data after 1995:q4 are staff projections.

2. For corporations: Excess of capital expenditures over U.S. internal funds.

3. Average debt levels in the period (computed as the average of period-end debt positions) divided by nominal GDP.

4. NIPA surplus less retirement funds plus consumption of fixed capital.

5. Excludes government-insured mortgage pool securities.

2.6.4 FOF

INTERNATIONAL DEVELOPMENTS

Recent Developments

The weighted-average foreign exchange value of the dollar in terms of the other G-10 currencies depreciated 1-1/4 percent, on balance, since the January FOMC. The dollar weakened 3/4 percent against the German mark and most other ERM currencies, 1-3/4 percent against sterling, and about 1/4 percent in terms of the yen. The Mexican peso declined 1-1/4 percent against the dollar.

During the first half of the intermeeting period, the dollar moved down as market participants came to believe that further monetary easing in Germany, and thus in most other European countries, was unlikely in the near term. Data showing rapid growth in German M3 and moves by Bundesbank officials to hold their repo rate fixed at 3.30 percent contributed to expectations of no further cuts in official rates soon. Evidence that Japanese economic activity was recovering enhanced prospects for monetary tightening sometime soon in Japan and contributed to the downward pressure on the dollar. In late February, signs that the U.S. economy was generally stronger than had been expected and that economic developments abroad were less positive than they had seemed fed a rebound in the dollar. In addition, the dollar may have been supported by very heavy intervention purchases by the Bank of Japan in February.

Long-term interest rates rose over the intermeeting period in most of the major foreign industrial countries, but less than the U.S. ten-year Treasury rate increased. Exceptions were Japan and Switzerland, where long-term rates were about unchanged on balance. The rise in rates in continental Europe is somewhat surprising in light of indicators suggesting that economic activity remains sluggish. On average, short-term interest rates abroad are little

changed. Rates moved down in France, the United Kingdom, Canada, and Sweden in response to reductions in official lending rates.

The Desk did not intervene in foreign exchange markets over the intermeeting period.

Economic growth remained subdued in most major foreign industrial countries toward the end of last year with the exception of Japan; recent indicators suggest divergent performance this quarter. Real GDP declined during the fourth quarter in Germany and France, as domestic demand fell in both countries. In Germany, industrial production recovered somewhat in January, but orders fell. Unemployment rose further through February. In France, a bounceback in economic activity from the fourth-quarter strikes can be seen in the rebound in January of consumption of manufactured products. In the United Kingdom, real GDP rose moderately in the final quarter of last year. Although overall industrial production fell in January, manufacturing output increased. The unemployment rate edged down through February from its end-1995 level.

In contrast, indicators of economic activity in Japan are generally positive. Real GDP grew briskly in the fourth quarter, led by stronger public and private investment. After rising in the fourth quarter, manufacturing orders and housing starts increased further in January. The Bank of Japan's February survey (Tankan) was slightly less negative than the previous November survey. In Canada, real GDP rose slightly during the fourth quarter. More recent indicators suggest a pickup in growth as manufacturing orders and shipments and retail sales rose in January; employment growth was buoyant from November through February.

Inflation in the major foreign industrial countries remains low. Prices have declined further in Japan. In Germany, France,

and Canada, the most recent increases in consumer prices from a year earlier have been 2 percent or less whereas in the United Kingdom inflation has been under 3 percent. Italian inflation remains considerably higher than that in the other countries, but has improved recently.

The U.S. nominal trade balance in goods and services was about the same in December as in November. Both exports and imports rose 1 percent from November to December. For the fourth quarter, the deficit narrowed substantially. Exports rose 2.2 percent from the third quarter while imports declined 0.5 percent. The current account deficit also narrowed sharply in the fourth quarter. In addition to the lower trade deficit, a reduced deficit on net investment income contributed to the improvement in the current account.

After remaining unchanged in the fourth quarter of last year, the average price of U.S. exports rose sharply in January, as prices of agricultural exports continued an upward trend that began early last year and prices of nonagricultural exports stopped falling. Prices of non-oil imports declined somewhat in January, as they had in the fourth quarter. The price of imported oil rose sharply in December and January, reflecting the colder-than-normal weather in the northern hemisphere and political uncertainties in Saudi Arabia. The spot price of WTI fell back more than \$2 per barrel during January on news that Iraq would proceed to negotiate with the United Nations for a limited sale of oil. Since the end of January, spot oil prices have become more volatile as markets await the outcome of those talks. Unusually low inventories have contributed to the volatility in prices as refiners seek to avoid restocking ahead of a possible decline in prices. The price of spot WTI has risen, on balance, in February and March and is currently \$20.95 per barrel,

with the July futures contract for WTI trading at \$18.80 per barrel.

Outlook

The staff projects that total foreign real GDP growth (weighted by U.S. bilateral exports) will average about 3-1/2 percent this year and next, up slightly from the final quarter of last year and faster than the growth projected for U.S. real output. The dollar is expected to remain near current levels over the forecast period. With imports more responsive to U.S. income growth than are exports to foreign income growth, real imports are projected to grow a bit faster than real exports this year and at about the same rate as exports next year. Because the level of imports is larger than that of exports, this outlook results in a decline in real net exports (as measured in chained 1992 dollars). After being essentially neutral during 1995, real net exports are expected to make a small negative contribution to real GDP growth during 1996-1997.

The dollar. We project that the foreign exchange value of the dollar in terms of the other G-10 currencies will remain little changed from its recent levels throughout the forecast period. This is the same level projected in the previous Greenbook. We expect that the CPI-adjusted value of the dollar in terms of the currencies of key developing countries will depreciate at a moderate rate both this year and next. In particular, from current levels the Mexican peso is expected to appreciate in real terms over the forecast period, as its nominal value against the dollar depreciates more slowly than the rate by which Mexican inflation exceeds U.S. inflation.

Foreign G-7 countries. The staff projects that real GDP growth in the foreign G-7 countries (weighted by bilateral U.S. export shares) will strengthen from an annual rate of 1 percent

during the final quarter of 1995 to about 2-1/2 percent during 1996 and 1997. The rebound in activity is expected to be widespread.

In Japan, recovery is already under way, owing to past monetary easing and fiscal stimulus, and is expected to continue at about a 2-1/2 percent rate this year and next.

In Germany, activity is expected to remain quite weak during the first half of this year but then to grow at an annual rate of about 2-1/4 percent during the remainder of the forecast period. Past declines in short-term interest rates and a small projected further decline, along with depreciation of the mark during the second half of 1995 and early 1996, should strengthen German economic activity.

In France, real output growth is forecast to rebound to a 2 percent annual rate during the first half of this year as the disruptive effects of public sector strikes in November and December are reversed. Output growth is projected to strengthen further, to 2-1/2 percent late this year and during 1997, as domestic demand responds to lower interest rates.

In the United Kingdom, real output growth remained moderate during 1995 and is expected to continue this year at about the 2 percent annual rate observed in the fourth quarter before strengthening slightly next year.

Canadian real GDP growth is projected to rise from less than 1 percent during the fourth quarter of last year to about 2-1/2 percent at an annual rate over the forecast period. Improved economic performance in the United States and the monetary easing that began last year are expected to contribute to the stronger pace of expansion.

The staff outlook for inflation in the foreign G-7 countries has been lowered slightly. When weighted by bilateral U.S. import

shares, consumer price inflation is projected to rise only very slightly, from 1 percent in 1995 to 1-1/4 percent in 1996 and 1997.

The staff forecast incorporates the assumption that short-term interest rates abroad will move down slightly further, on average, through mid-1996 before rising over the subsequent six quarters. German short-term market interest rates are assumed to move down with some further easing of official rates in the near term before rising as the pace of economic expansion increases later in the forecast period. Japanese short-term market rates are assumed to be near their trough and to rise next year as the economy strengthens. On average, long-term interest rates abroad are expected to retrace much of their intermeeting rise in the near term, with the assumed easing of short-term rates in Europe. Long-term rates are assumed to remain fairly stable through the rest of 1996 before moving back up a bit by the end of 1997.

Other countries. The real GDP of major developing-country trading partners of the United States (weighted by U.S. nonagricultural export shares) is projected to increase about 5-1/2 percent per year during 1996-97, compared with an estimated 3-1/2 percent growth during 1995 (on a Q4/Q4 basis). The pickup in growth in 1996-97 largely reflects recovery in Mexico.

Real GDP in Mexico fell 6.6 percent in 1995, substantially less than was expected. The marked expansion of activity in the fourth quarter, following a slight expansion in the third quarter, is consistent with our previous forecast that Mexico had passed its recession trough and has begun to recover. We project that real GDP in Mexico will grow at an average rate of about 5 percent per year during 1996-97, recovering to its pre-recession level by mid-1997.

Our major trading partners in Asia are expected to continue to experience strong growth over the forecast period, although growth is projected to decline from an average rate of about 7-1/2 percent

in 1995 to 7 percent in 1996-97. Recent trade data seem consistent with our projection that the yen's depreciation during the second half of last year will lead to a considerable deceleration in the exports of these countries.

U.S. real exports and imports of goods and services. The growth of total real exports was boosted during the fourth quarter of last year by extremely rapid increases in the quantities of computer and semiconductor exports.¹ We project that the rates of growth of those categories of exports will remain robust but will fall back from those recorded last year. The quantities of other goods exports (excluding agricultural products) should grow moderately, at an average annual rate of 3 percent, during 1996-97, largely reflecting the expected recovery in total foreign real output growth. Prices of U.S. exports relative to foreign prices are projected to rise slightly over the forecast period and, on balance, make a small negative contribution to export growth during 1997.

Total real imports of goods and services, which were essentially flat during the second half of last year, are projected to expand a bit more rapidly than total exports over the forecast period. The growth in the quantities of imported computers and semiconductors is expected to drop back toward more-normal, but still quite elevated, rates. Growth of other non-oil goods imports is projected to average about 4-1/2 percent this year and next, reflecting the expected improvement in U.S. real output growth and a small boost beginning late this year as domestic prices rise relative to import prices. We expect the quantity of oil imports to rise this quarter and next, and to continue to expand on balance

¹Note that the category "other" on the table excludes semiconductors as well as computers and agricultural products.

during the remainder of the forecast period, as consumption rises and U.S. production declines.

QUANTITIES OF GOODS AND SERVICES
(Percent change from end of previous period, SAAR)

	-----Projection-----				
	1995	1996			1997
	Q4	Q1	Q2	H2	
Exports of G&S	10.5	5.1	9.5	7.8	8.5
Services	4.5	2.6	2.6	3.8	3.5
Computers	60.0	28.9	28.6	30.9	31.1
Semiconductors	48.1	28.8	28.6	28.4	28.7
Other goods ¹	3.1	-0.4	9.8	2.0	2.7
Imports of G&S	0.6	7.4	9.8	7.7	8.6
Services	7.2	4.2	4.9	2.3	3.0
Oil	-17.2	7.8	31.8	-5.0	5.8
Computers	52.9	24.8	21.6	21.5	21.6
Semiconductors	51.8	26.2	31.0	30.9	31.0
Other goods ²	-9.8	3.3	4.5	5.4	4.5

Note: NIPA basis, chained (1992) dollars.

1. Merchandise exports excluding agriculture, computers and semiconductors.

2. Merchandise imports excluding oil, computers, and semiconductors.

Oil prices. Given recent increases in spot oil prices, the projected prices of imported oil for the first and second quarters have been revised up \$0.89 and \$1.80 per barrel, to \$16.80 and \$17.33 per barrel respectively. The staff forecast continues to assume that Iraq will not resume selling oil on world markets until 1997. Our projections for WTI spot price and the oil import unit value in 1997 are \$18.50 and \$16.00 per barrel respectively, unchanged from the January Greenbook. If Iraq reaches an agreement to sell a limited amount of oil under the supervision of the United Nations starting this year, the additional 700 thousand to 800 thousand barrels of oil per day on the world oil market would likely depress prices by \$3-\$4 per barrel. (See below for a discussion of

the implications of such a change in the oil price on the staff forecast.)

Prices of non-oil imports and exports. Prices of non-oil imports (including computers and semiconductors) are expected to move up slightly this year and next as foreign inflation remains low and the dollar is stable. Prices of nonagricultural exports (including computers and semiconductors) are projected to decelerate through the middle of this year and then to rise moderately during the second half of this year and somewhat faster next year.

SELECTED PRICE INDICATORS
(Percent change from end of previous period except as noted, AR)

	-----Projection-----				1997
	1995 Q4	1996			
		Q1	Q2	H2	
Nonag. exports ¹	-3.1	1.9	0.6	1.3	2.2
Non-oil imports ¹	-1.5	-0.3	0.6	0.7	0.3
Oil Imports (Q4 level, \$bl)	16.01	16.80	17.33	16.05	16.00

1. NIPA chain-weighted basis, including computers and semiconductors.

Nominal trade and current account balances. The nominal trade deficit on goods and services is projected to widen only slightly over the forecast period from its unusually low value in the fourth quarter of last year to more than \$90 billion at an annual rate at the end of 1997. The deficit on net investment income is projected to increase somewhat over the forecast period. The current account deficit is projected to average about \$145 billion in both 1996 and 1997, just under 2 percent of GDP.

Alternative oil-price scenario. We estimate that if Iraq were to reach agreement with the United Nations to sell a limited amount of oil this year, with no offset in production by other OPEC members, spot oil prices would likely fall on world markets by \$3 to \$4 per barrel. In order to judge the impact of such a change on the U.S. economy, we used the staff's econometric models to simulate a

decline in the price of oil of \$3.50 starting in the second quarter of this year; the price remains at that lower level through the second quarter of next year and then gradually returns to baseline. The baseline forecast incorporates the assumption that Iraq resumes exporting oil in 1997. In the simulation, it is assumed that the U.S. short-term interest rate remains on its baseline path. Under this monetary policy assumption, lower inflation results in higher real short-term interest rates. Consumers benefit from higher real disposable income with the lower oil price, and GDP initially rises relative to baseline. By the second year, the impact of higher real short-term interest rates offsets the stronger consumption and depresses real GDP.

ALTERNATIVE OIL PRICE ASSUMPTION
(Percent change, Q4 to Q4)

	1996	1997
Real GDP		
Baseline	2.2	2.0
Lower oil price	2.4	1.9
CPI excluding food and energy		
Baseline	2.9	3.1
Lower oil price	2.6	2.9

REAL GDP AND CONSUMER PRICES, SELECTED COUNTRIES, 1994-97
(Percent; quarterly change at an annual rate except as noted)

Measure and country	1994	1995	Projected		1995			Projected			
			1996	1997	Q2	Q3	Q4	1996			
								Q1	Q2	Q3	Q4
REAL GDP											
Canada	5.4	0.6	2.6	2.5	-0.8	1.2	0.8	2.6	2.6	2.5	2.5
France	4.3	0.7	2.1	2.6	0.6	0.7	-1.3	2.0	1.8	2.3	2.5
Germany	3.7	1.0	1.5	2.3	4.4	0.4	-1.6	-0.1	1.5	2.3	2.3
Italy	2.9	2.4	2.8	2.2	-0.4	8.0	-3.9	3.5	3.3	2.4	2.2
Japan	0.4	2.2	2.6	2.4	2.6	2.3	3.6	2.5	2.7	2.6	2.7
United Kingdom	4.2	1.9	2.0	2.5	1.6	1.8	2.1	1.6	1.8	2.2	2.5
Average, weighted by 1987-89 GDP	2.8	1.6	2.3	2.4	1.7	2.4	0.5	2.0	2.3	2.4	2.5
Average, weighted by share of U.S. nonagricultural exports											
Total foreign	4.5	1.9	3.4	3.3	NA	NA	NA	NA	NA	NA	NA
Foreign G-7	3.9	1.2	2.4	2.4	0.8	1.7	1.0	2.2	2.4	2.4	2.5
Developing countries	6.0	2.7	5.2	5.6	NA	NA	NA	NA	NA	NA	NA
CONSUMER PRICES(1)											
Canada	0.0	2.1	1.7	2.0	3.1	0.9	0.1	1.4	1.6	1.8	1.8
France	1.6	1.9	1.8	1.8	2.1	1.2	2.3	2.1	1.8	1.8	1.6
Western Germany	2.5	1.6	1.6	2.0	2.2	1.5	-0.5	2.6	2.4	1.8	-0.2
Italy	3.8	5.9	4.2	3.7	8.0	4.1	5.1	3.3	6.8	3.6	3.1
Japan	0.8	-0.8	-0.0	0.0	0.7	-1.0	-0.5	-1.6	2.0	-0.2	-0.1
United Kingdom(2)	2.2	2.9	2.5	2.8	6.4	0.8	1.4	1.5	6.4	0.8	1.5
Average, weighted by 1987-89 GDP	1.7	1.7	1.6	1.7	3.1	0.8	1.0	1.0	3.3	1.3	1.0
Average, weighted by share of U.S. non-oil imports	1.0	1.1	1.2	1.3	2.4	0.4	0.2	0.5	2.4	1.0	0.9

Note. Annual values are measured from Q4 to Q4.

1. Not seasonally adjusted.

2. CPI excluding mortgage interest payments; the targeted inflation rate. Previously the CPI including mortgage interest payments was shown.

Strictly Confidential (FR) Class II-FOMC

U.S. INTERNATIONAL TRANSACTIONS IN GOODS, SERVICES, AND THE CURRENT ACCOUNT
(Billions of dollars, seasonally adjusted annual rates)

	1993				1994				1995		ANNUAL		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	1992	1993	1994
NIPA Real Net Exports (Chained 1992 dollars)	-55.2	-67.0	-89.1	-86.2	-101.3	-112.2	-113.3	-105.8	-119.0	-126.8	-29.5	-74.4	-108.1
Exports of G&S	649.8	662.3	648.9	681.4	680.4	704.3	724.8	751.0	755.8	764.3	639.4	660.6	715.1
Goods	454.2	465.8	453.3	484.6	481.5	501.8	518.3	543.9	548.9	557.7	448.7	464.5	511.4
Agricultural	43.8	43.9	41.0	43.4	40.7	41.0	44.8	51.2	51.3	48.2	44.1	43.0	44.4
Computers	32.3	33.1	35.9	38.6	40.7	41.8	44.9	49.6	52.9	55.7	28.7	35.0	44.2
Semiconductors	20.6	22.3	25.5	28.2	33.5	35.4	39.5	47.2	50.7	53.3	16.0	24.1	38.9
Other Goods	357.5	366.5	350.9	374.4	366.6	383.6	389.1	395.9	394.0	400.5	359.9	362.3	383.8
Services	195.5	196.5	195.6	197.0	199.0	202.7	206.8	207.7	207.6	207.4	190.8	196.2	204.1
Imports of G&S	705.1	729.4	738.1	767.6	781.7	816.5	838.1	856.8	874.9	891.2	668.9	735.0	823.3
Goods	577.3	598.6	605.1	629.1	643.0	676.5	698.1	718.6	732.8	750.5	544.8	602.5	684.0
Oil	53.7	57.9	56.9	58.3	57.0	60.6	64.6	58.2	56.5	57.4	51.4	56.7	60.1
Computers	38.9	42.3	46.5	49.9	53.9	57.3	61.8	68.3	71.7	76.3	31.7	44.4	60.3
Semiconductors	19.2	21.2	22.4	25.0	27.3	28.5	31.6	36.9	39.4	45.3	15.5	22.0	31.1
Other Goods	465.5	477.2	479.3	495.9	504.8	530.1	540.1	555.2	565.2	571.5	446.3	479.5	532.6
Services	127.8	130.8	133.0	138.5	138.8	140.2	140.2	138.5	142.4	141.1	124.1	132.5	139.4
Memo: (Percent change 1/)													
Exports of G&S	0.4	7.9	-7.9	21.6	-0.6	14.8	12.2	15.3	2.6	4.6	4.1	5.0	10.2
Agricultural	-17.8	0.9	-23.9	25.6	-22.7	3.0	42.6	70.6	0.8	-22.1	10.6	-5.7	18.0
Computers	12.0	10.3	38.4	33.7	23.6	11.3	33.1	48.9	29.4	22.9	25.1	22.9	28.5
Semiconductors	34.4	39.3	68.4	50.1	100.8	23.7	55.5	103.3	33.5	22.1	64.8	47.5	67.4
Other Goods	-7.4	10.4	-15.9	29.6	-8.1	20.0	5.8	7.2	-1.9	6.8	2.6	2.7	5.7
Services	16.4	2.1	-1.8	2.9	4.1	7.6	8.3	1.8	-0.2	-0.4	-0.8	4.7	5.4
Imports of G&S	9.6	14.5	4.9	17.0	7.6	19.0	11.0	9.2	8.7	7.7	7.4	11.4	11.6
Oil	5.4	35.2	-6.7	10.2	-8.6	27.8	29.1	-34.1	-11.2	6.5	12.1	10.0	-0.2
Computers	41.0	39.8	46.0	32.6	36.1	27.7	35.3	49.2	21.4	28.2	45.1	39.8	36.9
Semiconductors	61.1	48.4	24.9	53.3	42.8	18.4	51.6	87.1	29.9	74.4	42.0	46.3	48.0
Other Goods	8.5	10.4	1.8	14.7	7.4	21.6	7.7	11.6	7.4	4.5	5.5	8.8	11.9
Services	1.3	9.7	6.9	17.6	0.9	4.1	0.0	-4.8	11.7	-3.6	1.4	8.7	-0.0
Current Account Balance	-69.5	-97.4	-108.1	-124.7	-121.1	-151.9	-158.9	-173.1	-153.8	-172.6	-61.5	-99.9	-151.2
Goods & Serv (BOP), net	-54.3	-75.2	-88.0	-82.0	-92.1	-107.7	-115.2	-109.9	-115.6	-133.4	-39.5	-74.8	-106.2
Goods (BOP), net	-115.8	-134.4	-146.4	-133.9	-146.0	-166.0	-178.5	-174.0	-177.8	-194.6	-96.1	-132.6	-166.1
Services (BOP) net	61.5	59.2	58.5	51.9	53.9	58.3	63.3	64.1	62.2	61.3	56.6	57.8	59.9
Investment Income, net	14.8	8.3	12.8	0.1	0.5	-9.1	-10.1	-18.3	-8.1	-10.7	10.1	9.0	-9.3
Direct, net	61.1	55.3	59.2	49.7	46.2	43.9	44.6	45.7	57.0	58.7	51.6	56.3	45.1
Portfolio, net	-46.2	-47.0	-46.5	-49.6	-45.7	-53.0	-54.7	-64.0	-65.1	-69.5	-41.5	-47.3	-54.4
Unilateral Transfers, net	-30.1	-30.4	-32.9	-42.9	-29.5	-35.1	-33.5	-45.0	-30.1	-28.5	-32.1	-34.1	-35.8

1/ Percent change (AR) from previous period; percent changes for annual data are calculated Q4/Q4.

Strictly Confidential (FR) Class II-FOMC

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS IN GOODS, SERVICES, AND THE CURRENT ACCOUNT
(Billions of dollars, seasonally adjusted annual rates)

	Projection										Projection		
	1995		1996				1997				ANNUAL		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	1995	1996	1997
NIPA Real Net Exports (Chained 1992 dollars)	-114.3	-95.9	-102.0	-104.9	-113.6	-108.6	-108.8	-111.4	-120.6	-118.8	-114.0	-107.3	-114.9
Exports of G&S	779.1	798.7	808.8	827.4	835.8	859.1	873.6	896.3	907.3	931.9	774.5	832.8	902.3
Goods	570.7	588.0	596.7	613.9	620.3	641.6	654.0	674.6	683.8	706.8	566.3	618.1	679.8
Agricultural	50.0	50.3	50.4	48.7	49.6	50.7	51.0	51.3	51.6	51.8	49.9	49.9	51.5
Computers	65.2	73.3	78.1	83.2	89.0	95.2	101.9	109.0	116.7	124.8	61.8	86.4	113.1
Semiconductors	57.0	62.9	67.0	71.4	76.0	80.9	86.2	91.8	97.8	104.1	56.0	73.8	95.0
Other Goods	398.5	401.5	401.1	410.6	405.7	414.7	414.9	422.5	417.7	426.0	398.6	408.0	420.3
Services	209.4	211.7	213.1	214.5	216.5	218.5	220.6	222.7	224.5	226.1	209.0	215.6	223.5
Imports of G&S	893.4	894.7	910.8	932.3	949.4	967.6	982.4	1007.7	1027.9	1050.8	888.5	940.0	1017.2
Goods	752.2	751.0	765.6	785.3	801.7	818.9	832.6	856.8	876.0	897.5	746.6	792.9	865.7
Oil	60.7	57.9	59.0	63.2	66.3	61.6	61.6	67.0	69.9	65.2	58.1	62.5	65.9
Computers	88.0	97.9	103.4	108.6	114.1	119.7	125.7	132.0	138.6	145.6	83.5	111.5	135.5
Semiconductors	53.0	58.8	62.3	66.7	71.3	76.3	81.6	87.4	93.5	100.0	49.1	69.1	90.6
Other Goods	550.5	536.5	540.9	546.8	550.1	561.3	563.7	570.4	574.0	586.7	555.9	549.8	573.7
Services	141.6	144.1	145.6	147.4	148.1	149.1	150.2	151.3	152.3	153.7	142.3	147.5	151.9
Memo: (Percent change 1/)													
Exports of G&S	8.0	10.5	5.1	9.5	4.1	11.6	7.0	10.8	5.0	11.3	6.4	7.6	8.5
Agricultural	15.8	2.3	1.2	-12.9	7.6	9.2	2.4	2.4	2.4	1.6	-1.8	0.9	2.2
Computers	87.7	60.0	28.9	28.6	31.0	31.0	31.1	31.0	31.1	31.1	47.8	29.9	31.1
Semiconductors	31.0	48.1	28.8	28.6	28.6	28.6	28.6	28.6	28.6	28.7	33.4	28.7	28.7
Other Goods	-2.0	3.1	-0.4	9.8	-4.7	9.2	0.2	7.5	-4.4	8.2	1.4	3.3	2.7
Services	3.9	4.5	2.6	2.6	3.8	3.7	4.0	3.8	3.3	2.9	1.9	3.2	3.5
Imports of G&S	1.0	0.6	7.4	9.8	7.6	7.9	6.2	10.7	8.3	9.2	4.4	8.2	8.6
Oil	25.1	-17.2	7.8	31.8	20.9	-25.5	-0.1	40.2	18.7	-24.4	-0.5	6.4	5.8
Computers	76.9	52.9	24.8	21.6	21.6	21.5	21.6	21.6	21.5	21.6	43.3	22.4	21.6
Semiconductors	86.4	51.8	26.2	31.0	31.1	31.1	31.0	31.1	31.0	31.0	59.1	29.8	31.0
Other Goods	-13.9	-9.8	3.3	4.5	2.4	8.4	1.7	4.8	2.6	9.2	-3.4	4.6	4.5
Services	1.4	7.2	4.2	4.9	2.0	2.9	2.9	3.0	2.6	3.7	4.0	3.5	3.0
Current Account Balance	-161.0	-124.3	-138.9	-139.4	-143.6	-152.2	-137.1	-141.9	-146.5	-159.5	-152.9	-143.5	-146.3
Goods & Serv (BOP), net	-109.2	-87.5	-89.4	-92.5	-97.7	-91.0	-89.1	-88.7	-96.3	-92.3	-111.4	-92.6	-91.6
Goods (BOP), net	-173.3	-152.1	-155.8	-159.5	-166.5	-161.6	-161.6	-163.0	-172.5	-169.8	-174.5	-160.8	-166.7
Services (BOP), net	64.1	64.6	66.4	67.0	68.9	70.6	72.5	74.3	76.2	77.5	63.0	68.2	75.1
Investment Income, net	-20.7	-6.1	-7.1	-13.9	-12.9	-17.7	-15.0	-20.2	-17.2	-23.8	-11.4	-12.9	-19.0
Direct, net	52.7	68.1	65.6	64.1	63.5	65.0	67.1	67.2	68.0	68.2	59.1	64.5	67.6
Portfolio, net	-73.4	-74.2	-72.7	-77.9	-76.4	-82.7	-82.1	-87.4	-85.2	-91.9	-70.5	-77.4	-86.7
Unilateral Transfers, net	-31.1	-30.7	-42.4	-33.0	-33.0	-43.5	-33.0	-33.0	-33.0	-43.5	-30.1	-38.0	-35.6

1/ Percent change (AR) from previous period; percent changes for annual data are calculated Q4/Q4.