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

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Strictly Confidential (FR) Class II FOMC

Part 1

May 16, 1996

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Summary and Outlook

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

Strictly Confidential (FR) Class II FOMC

May 16, 1996

SUMMARY AND OUTLOOK

Prepared for the Federal Open Market Committee
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BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF RESEARCH AND STATISTICS

Date: May 16, 1996

To: Greenbook Part 1 readers

From: Mike Prell MAP

Subject: Changes in the May edition

In this edition of Part 1, we have eliminated the former domestic financial section and integrated some of that material into what formerly was the domestic nonfinancial section and is now titled "Domestic Developments." In the process, we think we have eliminated some unproductive redundancy that existed among the old Part 1 and Part 2 financial sections and the Bluebook. We undertook this change with the notion that we would reverse course if we found it didn't work; we're satisfied at this point, but please let me know if you feel otherwise.

Incidentally, we are also seeking to lighten your load by streamlining Part 2 a bit, leaving out some less essential material. We hope that we have not left out anything to which you had become attached. Again, let me know if you have any problems with what has been done.

Overview

Earlier this year, a number of analysts were drafting obituaries for the economic expansion. The prevailing expectation was that there would be several more cuts in the federal funds rate, and the yield on the long Treasury bond was heading below 6 percent. The obituaries have been shelved: The cyclical upswing is now widely perceived to have entered its sixth year with considerable forward thrust, and renewed market concerns about inflationary pressures--and Fed responses--have been reflected in a run-up in bond yields that briefly lifted the thirty-year rate above 7 percent for the first time since last spring.

We did not subscribe to the previous recession scenario, and we also think the swing in sentiment to the other side may be exaggerated. But we don't dismiss the fears of inflation pressures entirely. We have thought for some time that the economy is operating without a broad cushion of untapped resources to absorb inflationary shocks. With real GDP apparently having increased at a 2-1/2 percent annual rate in the first quarter, and on track to meet or beat that gain in the second, labor markets remain tight. Add to this the adverse developments in agricultural and energy markets, stir in possible governmental action like a hike in the minimum wage, and the potential for a substantial deterioration in consumer price trends is readily apparent.

At this stage, however, we have made only a mild alteration to our baseline forecast. Thanks in part to the run-up in bond yields, we are still projecting a moderation of real GDP growth after the current quarter, and we continue to expect that the unemployment rate will remain near 5-1/2 percent. Such a pattern of resource utilization probably would in itself imply only a gradual acceleration in wages and prices. However, in light of the deterioration in the food and energy price picture, we have raised our forecast of overall CPI inflation to 3.3 percent, on average, in 1996 and 1997--1/4 percentage point more than in the March Greenbook and 1/2 percentage point above the 1995 pace. The inflation outlook would be still worse had we incorporated the enactment of a minimum wage increase in this projection; recognizing the obvious risk in that regard, we have included a brief analysis of the effects of a rise in the wage floor at the end of this section.

Key Background Factors in the Forecast

We have retained our assumption that the federal funds rate will be held at or near 5-1/4 percent at least well into 1997. Against the backdrop of higher inflation in this forecast, this should be perceived as implying a slightly lower real funds rate than before. Although we had previously thought that long-term rates would back up as the solidity of the expansion became apparent and some speculative positions were unwound, the recent rise has outstripped our expectation. In light of the more inflationary cast of the current projection, we have carried forward the rate surprise. Thus, we anticipate that bond yields will continue to fluctuate in the higher range observed since the last FOMC meeting.

Meanwhile, equity prices have risen further, on net, since mid-March and thus are somewhat higher than we had expected in the last Greenbook. The ability of the bull market to sustain itself in the face of such a sharp run-up in bond yields would seem remarkable at first blush. One obvious factor is the continuation of favorable corporate earnings reports. But we believe that there is some froth in the market, and we view overall share valuations as a bit rich relative to "fundamentals." Consequently, we have again allowed for a small price correction in coming months--to be followed by a recovery in 1997. Still, given where the market is now, equity prices are higher on average in this forecast than in the last.

Neither real short-term nor long-term interest rates seem particularly high by the standards of the past decade and a half. Moreover, the recent performance of the economy may have bolstered the confidence of households and businesses that might be considering making major purchases. With equity financing readily available for both young and established firms, and with banks maintaining an accommodative lending posture, we see financial conditions as posing no impediment to continued solid growth in spending.

On the fiscal front, our policy assumptions remain essentially unchanged. We are anticipating that discretionary spending will be held in check in fiscal 1997, keeping such outlays $10 billion below the levels implied by allowing fiscal 1996 spending to grow with inflation; we have not assumed the reduction in the gasoline tax now under consideration in the Congress. This path would not imply any incremental restraint beyond that imposed in the current fiscal year by the series of actions that was completed by the passage last month of the Omnibus Appropriations Act.

The incoming news on the federal budget deficit has been extremely favorable. We now expect that the deficit will total "only" $121 billion in fiscal 1996 and $158 billion in fiscal 1997; the projections in the March Greenbook were $160 billion and $192 billion. The surprise has been in receipts, where corporate payments in March and nonwithheld individual payments in April were both well above expectations; in addition, refunds in the closing weeks of the tax filing season were lower than we had anticipated.[1] Moreover, corporate profits appear to be on a substantially higher track than we forecast in March; the higher profits, in turn, provide a further boost to our projection of corporate tax revenues. Finally, we have raised our estimate of the proceeds from auctioning portions of the broadcast spectrum $4 billion in 1996 and $10 billion in 1997; this revision reflects both a higher estimate of auction bids and the shift to the new CBO/OMB budget accounting method for recording such transactions.[2]

With respect to the external sector, the trade-weighted dollar in terms of other G-10 currencies has risen about 2 percent, on net, since March, and we assume that it will remain near recent levels through the end of 1997. The outlook for foreign economic activity is about the same as in the last Greenbook, with real GDP (on a U.S. export-weighted basis) projected to increase about 3-1/2 percent per year in 1996 and 1997, compared with an increase of less than 2 percent in 1995. Reflecting recent market developments, we have raised the projection for oil prices: We now expect the spot price of WTI crude to average about $22 per barrel this quarter, $2-1/2 higher than in the March Greenbook. The spot price has fallen appreciably since peaking at $25 in mid-April and currently

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1. With these revisions, our 1996 deficit estimate is now about $25 billion below the latest official figures from OMB and CBO, and our 1997 estimate is between OMB's $140 billion and CBO's $171 billion. However, the comparison may be misleading because the OMB and CBO estimates were prepared before the recent surge in tax payments was fully apparent, and substantial downward revisions to their deficit projections could also be in the offing. For the time being, however, we understand that CBO's May 23 report will use the same budget estimates as were released in April.

2. Installment payments for the licenses were previously recorded in the unified budget when the payments were received. They are now recorded on a net present-value basis when the license is issued.

stands at around $21; it is expected to drift down to $19.50 by the end of the third quarter and to remain around that level through 1997, about $1 higher than in our previous forecast.

Recent Developments and the Prospects for the Current Quarter

Updating BEA's advance first-quarter estimate as best as we can in light of the more recent source data, real GDP appears to have grown a bit less than the published figure of 2.8 percent--perhaps in the vicinity of 2-1/2 percent. The important March figure on the U.S. trade balance is still to come. But the key point almost certainly will remain the same: The economy achieved a quite respectable gain in the face of the January blizzard and the March GM strike. Moreover, that growth involved a hefty gain in household and business spending, while inventories were little changed in the aggregate.

REAL GDP AND SELECTED COMPONENTS IN THE NEAR TERM

		1996:Q1			1996:Q2	
	1995:Q4	March GB	BEA Adv	May GB	March GB	May GB
	Percentage change at annual rate					
Real GDP	.5	1.5	2.8	2.5	3.4	3.5
Final sales	1.6	2.2	3.3	3.6	2.1	2.6
Priv. domestic	1.5	2.9	4.7	5.0	2.5	3.3
Government	-4.1	.7	1.8	1.8	.7	1.4
	Level, billions of chained (1992) dollars					
Inventory invest.	16.5	-2.7	7.9	-0.8	20.0	13.5
Net exports	-96.6	-102.0	-111.0	-112.3	-104.9	-118.6

Coming off that first-quarter performance, the odds favor another solid advance in the current period. Our point estimate for GDP growth is 3.5 percent, but the paucity of data makes the assessment very tentative. A reason for caution is the ambiguity of recent labor market data. According to the published figures, aggregate hours of private production workers last month were substantially above the first-quarter average; however, after making a crude adjustment for the effects of the blizzard on the January reading, we estimate that hours in April were little changed from the first-quarter average. On the other hand, the lower level of initial claims of late points to appreciable employment growth.

Looking further at the production side of the ledger, rebounding auto output will result in a sizable gain in industrial activity this quarter. IP rose about 1 percent in April and with small increments in May and June would rise at a 5 percent annual rate for the quarter as a whole, after having increased 2-1/2 percent in the first quarter.

The major pieces of expenditure information now in hand for the current quarter relate mainly to the household sector. The advance report on retail sales in April indicates that real outlays for non-automotive consumer goods were 3/4 percent (not annualized) above the upward-revised first-quarter average. Unit sales of light motor vehicles dropped last month--with the decline exaggerated by reporting anomalies and a payback after a first-quarter boost from incentives. Together, these data suggest that real PCE may be growing somewhere between 2 percent and 3 percent (annual rate) this quarter, after having risen an estimated 4 percent in the first quarter.

The increase in mortgage rates over the past few months has as yet had no perceptible effect on construction activity: Single-family starts and permits both rose considerably in April. And although we are anticipating declines in starts in May and June, real residential investment should post another sizable gain this quarter.

Real business fixed investment appears likely to decelerate noticeably in the near term--although continuing to grow well in excess of overall GDP. The recent data on orders and production suggest that shipments of nondefense capital goods will be strong this quarter, but a repetition of the double-digit jump in real purchases of producers' durables probably is not in the cards. And the weakening of contracts points to a slowing in the advance of investment in nonresidential structures.

In the public sector, current-quarter data are sparse, but--looking at the special factors behind the first-quarter gyrations--total government expenditures on consumption and investment seem likely to rise slightly in real terms. State and local purchases should increase considerably from their weather-depressed first-quarter level. In contrast, federal purchases are expected to reverse the fluky surge of the first quarter. A strict translation of the appropriations legislation might imply an even steeper drop in federal expenditures than we've forecast, but the projected decline is muted by an unwinding of the effects on first-quarter spending of the blizzard and the government shutdown.

In the external sector, real exports are projected to rebound after an unusually small increase in the first quarter, while real imports are expected to post another robust gain, boosted in part by efforts to rebuild oil inventories. On balance, real net exports are expected to edge down, after having dropped markedly in the first quarter--a plus for GDP growth.

The other major positive swing expected in the current quarter is a pickup in inventory investment. Motor vehicle stocks plummeted in the first quarter, and current production schedules should at least stabilize inventories. Motor vehicle output is expected to add 1 percentage point to GDP growth after having subtracted 1/2 point in the first quarter. Outside of motor vehicles, the rate of accumulation in the first quarter was higher than we would think sustainable, and efforts to trim stocks in some sectors should yield a slower pace of investment--but not enough of a drop to offset the boost from the auto sector.

We have raised the forecast for the increase in the total CPI to an annual rate of more than 4 percent in the current quarter, about 3/4 percentage point above our previous projection. Almost all of the revision is in energy prices, which surged in April and, judging from surveys of gasoline prices, are rising further in May. Our forecast of the increase in the CPI excluding food and energy remains at 2-3/4 percent, as we anticipate a return to monthly increases of roughly a quarter percent after the 0.1 percent rise in April.

The Longer-Range Outlook for the Economy

After averaging 3 percent at an annual rate in the first half of 1996, growth in real GDP is projected to run generally a shade above 2 percent through 1997--paralleling the expansion of potential output. Although the buoyancy of the stock market does suggest some upside risk, we expect domestic final demand to moderate as a result of the recent rise in long-term interest rates and the absence of accelerator effects that might drive additions to capacity. Moreover, while better economic growth in other industrial countries will tend to bolster exports, the high U.S. propensity to import will inhibit improvement in our trade balance. Basically, our longer-range forecast continues to be shaped by the sense that there are no major forces in view that would push the economy persistently away from trend growth.

It is, of course, arguable that the updrift in inflation that we have forecast does itself signal an imbalance that could have adverse consequences for the economy. We have not assumed a monetary policy tightening to curb the acceleration in prices. To be sure, some of the predicted pickup in inflation is the result of what might be one-time shocks. However, preventing those impulses from embedding themselves in expectations and otherwise worsening the ongoing inflation trend presumably would require some temporary weakening of activity. The econometric simulations reported at the end of the section go some way in addressing that policy issue.

SUMMARY OF STAFF PROJECTIONS
(Percentage change at annual rate except as noted)

	1995	1996 H1	1996 H2	1997
Real GDP	1.3	3.0	2.0	2.2
Previous	1.2	2.4	2.0	2.0
Private domestic final purchases[1]	2.4	4.2	2.5	2.6
Previous	2.4	2.7	2.4	2.5
Civilian unemployment rate (percent)[2]	5.5	5.5	5.5	5.5
Previous	5.5	5.6	5.6	5.6

Note. Percentage change from final quarter of previous period to final quarter of period indicated except as noted.
1. Personal consumption expenditures plus business fixed investment plus residential investment.
2. Average level for the final quarter of period indicated.

Consumer spending. Consumer spending appears to be back on track after a weak performance in late 1995; we expect it to grow at about a 2-1/2 percent rate over the next year-and-a-half. This spending path would essentially mirror the trend in income, and the saving rate would average 4-1/2 percent in both 1996 and 1997, the same as in 1995.

Outlays for durables should be the strongest component of spending, extending the longstanding uptrend in the share of durables in total real PCE. Declining relative prices and the availability of innovative products will continue to lift demand for home electronic equipment and software products, especially. However, we see little prospect for further growth in sales of light motor vehicles. Indeed, the 14-3/4 million unit pace we are forecasting for coming quarters is a shade below the average thus far this year, which we believe was lifted above trend by larger incentives and perhaps by the burst of mortgage refinancings.

Our consumption projection balances a number of considerations. On the plus side, consumer sentiment measures are quite positive, and the recent strengthening in consumer demand suggests that the effects of the stock market rally may finally be showing through. Looking ahead, we have assumed a slight further boost to consumption from stock market wealth, but a response more in line with some econometric estimates would significantly augment the predicted growth of spending. Meanwhile, as noted in the last Greenbook, the list of factors cited as possibly raising desired saving is long and includes such items as concerns about retirement income and medical coverage. The most frequently mentioned negative for spending is debt burdens. Higher levels of indebtedness may constrain effective demand, but we think their role will be a minor one because--even with increased delinquencies and defaults--consumer lending is sufficiently profitable that banks and other institutions will not sharply curb credit availability.

Residential investment. Although it is not yet apparent in the data, we believe that the rise in mortgage rates will prompt a downturn in homebuilding. The decline should be moderate, however, because cash-flow affordability remains relatively high by the standards of the past couple of decades and because we expect employment and income conditions to remain supportive. Single-family starts are projected to peak this quarter at a 1.18 million unit annual rate and then to slide to between 1.05 and 1.10 million units in the second half of this year; our projection for 1997 has single-family starts in the lower part of that range. Meanwhile, we see multifamily starts remaining in the neighborhood of 300,000 units per year. The predicted 1996-97 average pace of total starts is about 1.4 million units, about the same as in the past two years.

Business fixed investment. The incoming data for BFI have generally been stronger than we had expected, and our analysis of that surprise has led us to raise our forecast for coming quarters. As a result, we now expect investment growth in 1996 to match the 1995 gain of 6-3/4 percent, with a deceleration to 4-1/2 percent next year.

The upward revision to BFI is concentrated in expenditures on equipment, which are now projected to grow 8 percent in 1996, little different than the increase in 1995, and 5-1/2 percent in 1997. General cyclical considerations--such as accelerator effects--argue for some deceleration in capital spending; in manufacturing, the rate of plant utilization has fallen to around the long-term average, and the pace of investment has already risen to a level consistent with substantial capacity growth. Our expectation is that spending on more traditional machinery and equipment will be virtually flat, but the rapid pace of product innovation and declining prices of computers and communications gear will continue to produce strong gains in real outlays for these items. In particular, we are projecting that real computer investment will grow at a pace of roughly 15 percent to 20 percent over coming quarters. Though impressive on the face of it, this rate pales by comparison with recent experience, and the risks in our forecast could well have an upside bias. Notably, many industry analysts expect even larger gains as businesses acquire the state-of-the-art equipment needed to take full advantage of popular new software and opportunities for information transfer.

Our forecast for nonresidential construction is essentially the same as last time--with growth slowing from 5 percent in 1995 to 3 percent in 1996 and to 1/2 percent in 1997. To be sure, contracts are pointing down, but we anticipate a relatively soft landing for the sector. We have not seen the kind of construction boom that led to busts in the past, and vacancy rates were still falling and rents firming in some segments of the market in early 1996. In addition, financing for commercial construction reportedly remains abundant, although banks report some further snugging of underwriting standards in the most recent Senior Loan Officer Opinion Survey.

Business inventories. As noted, we expect inventory investment to pick up somewhat in the current quarter as a positive swing in motor vehicle stocks more than offsets a slowing in the pace of accumulation elsewhere. Looking ahead, we expect little further change in motor vehicle stocks, while accumulation elsewhere increases only modestly from its predicted second-quarter pace. This would be consistent with a slight decrease in the aggregate stock-sales ratio, which seems reasonable in light of the continuing efforts of firms to minimize inventory expense.

Government. Although, as we've seen recently, federal consumption and investment expenditures can move erratically from quarter to quarter, the basic direction currently is one of significant decline. As spending returns to the trend dictated by appropriations, real purchases are likely to fall at an annual rate of close to 5 percent in the near term and then about 3-1/2 percent in 1997. Defense and nondefense purchases are expected to shrink at similar rates.

The financial position of the state and local sector still appears to be relatively healthy on the whole. Thus, we expect these governments to keep real purchases on a moderate uptrend, with growth rates for 1996 and 1997 averaging around 2-1/4 percent per year. The sector should continue to run sizable surpluses in its operating accounts.

External sector. The firming of economic activity abroad should provide considerable impetus to real export growth in 1996. However, imports are projected to rise even faster than exports, in part because of the improvement in U.S. economic activity. On net, the trade sector is expected to directly reduce real GDP growth about 1/2 percentage point this year. In 1997, exports are expected to grow a bit faster than imports, and thus the external sector is a roughly neutral influence, on net, on U.S. real GDP growth. (A fuller discussion of these developments is contained in the International Developments section.)

Labor markets. The labor market data for the past several months have been bounced around by weather and other distortions. But looking ahead, we expect key labor market variables between now and the end of 1997 to follow patterns consistent with an economy growing at about its potential rate. In particular, we expect the gains in nonfarm payroll employment to slow from a relatively rapid 165,000 per month so far this year to about 110,000 per month, on average. As for productivity, we expect output per hour in the nonfarm business sector to rise a bit more than 1 percent, on average, in 1996 and 1997.[3] The labor force participation rate

3. Our estimate of trend growth in productivity on a true chain-weight basis is 1 percent per year. However, in the National Income and Product Accounts (NIPA), output actually is currently being measured on a fixed-weight 1994 dollar basis (that is, we are in the so-called Laspeyres tail). As a result, shifts in the composition of output--toward computers, in particular--impart an upward bias to the growth rates reported here that is conceptually the same as the bias in the 1987-based output measures BEA previously featured. We estimate that mix shifts are currently causing the fixed-weight and chain-weight growth rates of productivity and potential GDP to differ 0.1 or 0.2 percentage points per year. The base weights will be moved forward to 1995 when the NIPA are revised in July.

is expected to rise only marginally, and unemployment is projected to remain around its current 5-1/2 percent level.

Wages and prices. The general theme of the inflation forecast is the same as that in the March Greenbook--namely, with resource utilization projected to remain near current levels, wages and prices are likely to show some tendency to accelerate. However, with the shade higher level of economic activity in the current forecast and the recent adverse developments in the food and energy sectors, we have nudged up the projected inflation rates.

SUMMARY OF STAFF INFLATION PROJECTIONS
(Percentage change at annual rate)

		1996			
	1995	Q1	Q2	H2	1997
Employment cost index for compensation of private industry workers[1]	2.8	2.9	2.9	3.4	3.5
Previous	2.8	2.9	3.0	3.1	3.3
Consumer price index[2]	2.7	3.2	4.2	3.1	3.2
Previous	2.7	3.2	3.4	2.9	3.0
Food	2.6	1.8	4.3	4.8	4.0
Previous	2.6	1.3	3.3	3.8	3.0
Energy	-1.7	12.9	21.7	-1.2	1.5
Previous	-1.5	13.9	12.0	.1	1.7
Excluding food and energy	3.0	2.7	2.7	3.1	3.2
Previous	3.1	2.7	2.8	3.0	3.1

1. Percentage change from final month of previous period to final month of period indicated.
2. Percentage change from final quarter of previous period to final quarter of period indicated.

The increase in hourly compensation in the first quarter, as measured by the employment cost index for private industry, was 2.9 percent at an annual rate, a rise consistent with our expectations and about the same as the increase in 1995. Nonetheless, we continue to anticipate that the tightness of the labor market--and some pickup in consumer price inflation--will be reflected in greater compensation increases in the quarters ahead.[4] Indeed, with the CPI now expected to rise a bit more

4. We have not incorporated the private health insurance reform legislation being considered by the Congress. The provisions that limit the ability of insurers to cancel policies or restrict coverage of pre-existing conditions, for example, could affect (Footnote continues on next page)

rapidly than we had expected in March, we have edged up our ECI forecast to show compensation growth increasing from 2.8 percent in 1995 to 3.1 percent in 1996 and to 3.5 percent in 1997.

We have made a number of changes to the price forecast. First, we have raised the projection of energy prices in 1996. Whereas the last Greenbook showed retail energy prices increasing about 12 percent (annual rate) in the current quarter and holding steady thereafter, they now appear to be rising at a rate of more than 20 percent this quarter and are expected to drop only a bit over the second half. We continue to expect a slight rise in retail energy prices in 1997.

In the food sector, increases in retail prices have been relatively moderate, on balance, so far this year. However, with recent developments in grain markets pointing to a greater risk of higher food prices down the road, we have raised the food price forecast substantially; it now shows increases of more than 4-1/2 percent at an annual rate in the second half of 1996, with the rate of rise tapering off gradually over the course of 1997.

Moreover, even this forecast could turn out to be too optimistic if additional crop problems develop over the course of the summer. Damage to the winter wheat crop has been extensive, but we still are counting on normal yields for the crops that currently are being planted. Commodity traders seem to be anticipating this outcome as well, but the market view--and ours--could change significantly if the weather takes another bad turn in coming weeks. Another uncertainty in the process is the speed of pass-through of grain price increases to the retail level. Although we've not been able to discover any way to pinpoint the timing of this pass-through, we're assuming that sizable increases for some products--such as cereals, poultry, and pork--will be showing up in the second half of this year. The bulk of the anticipated rise in beef prices does not come until 1997.

(Footnote continued from previous page)

insurance premiums, and the required parity for mental health benefits in the Senate bill has stirred particular controversy. According to a CBO analysis, requiring mental health parity would impose direct costs on the private sector equal to 4 percent of total private health insurance premiums. However, CBO expects that employers would offset much of the increase by trimming other health benefits and that any remaining increases in premiums would be passed on to workers in the form of lower wages or reductions in other fringe benefits.

Finally, we have edged up the forecast for the core CPI to reflect the higher labor costs now projected; it is expected to increase 2.9 percent in 1996 and 3.2 percent in 1997. The upward revision would have been greater had we not made a downward adjustment to account for the technical changes BLS will introduce within the next few months to deal with the so-called formula bias that arises from the way items are phased in and out of the CPI sample; when fully implemented, these changes are expected to reduce CPI inflation 0.1 percentage point per year.

Money and Credit Flows. With the earlier decline in the opportunity cost of retail deposits no longer boosting M2 and with the yield curve having steepened, growth of this aggregate is expected to remain below its strong first-quarter pace over the projection period. On balance, M2 is projected to rise about 5 percent this year and next, about the same as nominal GDP; this would match the upper end of the 1996 target range. M3 likely will slow a bit, with moderate growth in bank credit, and move into a more traditional relationship with M2 (M3 velocity tending to fall relative to M2 velocity). M3 growth is projected at 5-1/2 percent in 1996 and 1997, just below the upper bound of its current target range. M1 may continue to post declines driven by sweep activity.

The debt of domestic nonfinancial sectors is projected to expand 4-3/4 percent this year and next, roughly the same as nominal GDP. This projection anticipates some slowing in household and business borrowing, with federal sector debt rising only slightly faster than the subdued 1995 pace; state and local debt is expected to continue to run off, on net, as earlier advance refundings are completed.

Nonfinancial businesses in the aggregate are expected to borrow somewhat less this year but to gradually increase their borrowing next year, as growth in corporate cash flow begins to fall short of the rise in capital outlays. The volume of merger activity involving debt financing is expected to stay below the brisk first-quarter pace. To date, there have been no signs to suggest that credit availability is constraining business activity, nor is it expected to be a factor in the outlook. Bank profits and capital positions are strong, and, although banks are no longer easing standards, reports and surveys suggest that they continue to compete aggressively for business customers. The higher level of bond rates in the projection may encourage some short-term borrowing, but the bond market is expected to remain an important source of funds.

Net borrowing by households is projected to trend down gradually through 1997. Consumer credit growth is expected to slow, with tightening loan policies only a minor factor. The strong borrowing in recent years has left a legacy of rising repayments; and growth in nominal durable expenditures, which are often financed by credit, is expected to be moderate. Home mortgage debt growth is expected to edge down from its pace of recent years, restrained by the effects of higher interest rates and the associated falloff in home sales.

The Minimum Wage

Although we have not incorporated a hike in the minimum wage in the current projection, we have examined the effects of a 90 cent per hour increase from $4.25 per hour to $5.15 per hour, with half coming in July 1996 and the remainder in July 1997. Using both macroeconometric models and detailed data on the distribution of wages, we estimate that such a hike would have a direct effect on the level of hourly compensation of about 0.4 percent.[5]

The pass-through to prices, of course, would depend on the conduct of monetary policy. If the federal funds rate were held at its current level, the higher minimum wage would probably be passed gradually into prices and tend to get built into expectations; under this assumption, we estimate CPI inflation would be higher by about 0.3 percentage point in 1997 and a bit more than that in 1998. Simulations of the staff's quarterly econometric model suggest that the federal funds rate would have to be raised roughly 3/4 percentage point immediately and held at the higher level through 1997 to offset the potential effect on inflation of the higher minimum wage.

Alternative Simulations

Setting aside the minimum wage question, we have run two model simulations in which the funds rate is symmetrically raised or lowered relative to the assumption in the Greenbook. Deviations

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5. Data from the household survey indicate that there are about 7 million hourly workers now earning between $4.25 and $5.15 per hour, and another 7-1/2 million hourly workers who currently earn between $5.15 and $6.00 per hour and whose wages would probably be raised to preserve at least some of the differential between them and their lesser-paid colleagues. In addition, there are 1-1/2 million hourly workers in the household survey who currently earn less than the minimum wage and whose wages also might be lifted by competitive pressures.

from baseline start at 10 basis points in the current quarter and increase to 50 basis points in the third quarter and to 100 basis points in the fourth quarter and beyond. In the lower-rate scenario, real GDP growth is little different this year and 0.6 percentage point higher in 1997. The unemployment rate is reduced 0.2 percentage point by the end of 1997, and core CPI inflation is 0.2 percentage point higher than in the baseline forecast. The effects of the tighter policy scenario are symmetric.

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

	1996	1997
Real GDP		
Baseline	2.5	2.2
Lower funds rate	2.6	2.8
Higher funds rate	2.4	1.6
Civilian unemployment rate (percent)[1]		
Baseline	5.5	5.5
Lower funds rate	5.5	5.3
Higher funds rate	5.5	5.7
CPI excluding food and energy		
Baseline	2.9	3.2
Lower funds rate	2.9	3.4
Higher funds rate	2.9	3.0

1. Average for the fourth quarter.

Strictly Confidential <FR>
Class II FOMC

May 16, 1996

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

Interval		Nominal GDP		Real GDP		GDP Chain-weighted price index		Consumer price index[1]		Unemployment rate[2]	
		03/21/96	05/16/96	03/21/96	05/16/96	03/21/96	05/16/96	03/21/96	05/16/96	03/21/96	05/16/96
ANNUAL											
1993		4.9	4.9	2.2	2.2	2.6	2.6	3.0	3.0	6.8	6.8
1994		5.8	5.8	3.5	3.5	2.3	2.3	2.6	2.6	6.1	6.1
1995		4.5	4.5	2.0	2.0	2.5	2.5	2.8	2.8	5.6	5.6
1996		4.3	4.4	1.9	2.2	2.7	2.5	2.9	3.1	5.6	5.5
1997		4.8	4.7	2.1	2.2	2.8	2.9	3.0	3.3	5.6	5.5
QUARTERLY											
1994	Q1	5.4	5.4	2.5	2.5	2.8	2.8	1.9	1.9	6.6	6.6
	Q2	6.8	6.8	4.8	4.8	1.9	1.9	2.8	2.8	6.2	6.2
	Q3	6.1	6.1	3.6	3.6	2.4	2.4	3.6	3.6	6.0	6.0
	Q4	5.4	5.4	3.2	3.2	2.2	2.2	2.4	2.4	5.6	5.6
1995	Q1	3.9	3.9	0.6	0.6	3.3	3.3	2.7	2.7	5.5	5.5
	Q2	2.8	2.8	0.5	0.5	2.5	2.5	3.5	3.5	5.7	5.7
	Q3	5.8	5.8	3.6	3.6	2.2	2.2	2.1	2.1	5.6	5.6
	Q4	2.1	2.3	0.3	0.5	2.1	2.2	2.4	2.4	5.5	5.5
1996	Q1	4.5	4.8	1.5	2.5	3.6	2.5	3.2	3.2	5.6	5.6
	Q2	5.9	5.6	3.4	3.5	2.4	2.5	3.4	4.2	5.6	5.5
	Q3	4.4	4.7	1.8	2.0	2.8	3.2	2.9	3.1	5.6	5.5
	Q4	4.9	4.5	2.3	1.9	2.7	2.9	2.9	3.0	5.6	5.5
1997	Q1	4.9	5.0	2.1	2.3	3.1	3.1	3.0	3.3	5.6	5.5
	Q2	4.8	4.6	2.1	2.1	2.8	2.8	3.0	3.3	5.6	5.5
	Q3	4.3	4.3	1.8	1.8	2.9	2.9	3.0	3.2	5.6	5.5
	Q4	5.1	4.9	2.3	2.4	2.9	2.9	3.0	3.2	5.6	5.5
TWO-QUARTER[3]											
1994	Q2	6.1	6.1	3.7	3.7	2.3	2.3	2.3	2.3	-0.4	-0.4
	Q4	5.7	5.7	3.4	3.4	2.3	2.3	2.9	2.9	-0.6	-0.6
1995	Q2	3.3	3.3	0.5	0.5	2.9	2.9	3.2	3.2	0.1	0.1
	Q4	3.9	4.0	1.9	2.0	2.3	2.2	2.2	2.2	-0.2	-0.2
1996	Q2	5.2	5.2	2.4	3.0	3.0	2.5	3.3	3.7	0.1	-0.0
	Q4	4.6	4.6	2.1	2.0	2.8	3.1	2.9	3.1	0.0	0.0
1997	Q2	4.9	4.8	2.1	2.2	3.0	3.0	3.0	3.3	0.0	0.0
	Q4	4.7	4.6	2.0	2.1	2.9	2.9	3.0	3.2	0.0	-0.0
FOUR-QUARTER[4]											
1993	Q4	4.7	4.7	2.2	2.2	2.5	2.5	2.7	2.7	-0.8	-0.8
1994	Q4	5.9	5.9	3.5	3.5	2.3	2.3	2.6	2.6	-1.0	-1.0
1995	Q4	3.6	3.7	1.2	1.3	2.5	2.6	2.7	2.7	-0.1	-0.1
1996	Q4	4.9	4.9	2.2	2.5	2.9	2.8	3.1	3.4	0.1	-0.0
1997	Q4	4.8	4.7	2.0	2.2	2.9	2.9	3.0	3.2	-0.0	-0.0

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

Strictly Confidential <FR> Class II FOMC

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

May 16, 1996

Item	Units[1]	1989	1990	1991	1992	1993	1994	1995	- Projected - 1996	1997
EXPENDITURES										
Nominal GDP	Bill. $	5438.7	5743.8	5916.7	6244.4	6550.2	6931.4	7245.8	7567.6	7926.6
Real GDP	Bill. Ch. $	6060.4	6138.7	6079.0	6244.4	6383.8	6604.2	6739.0	6887.9	7037.2
Real GDP	% change	2.4	-0.2	0.4	3.7	2.2	3.5	1.3	2.5	2.2
Gross domestic purchases		1.7	-0.8	-0.0	4.0	2.8	3.7	1.1	2.9	2.2
Final sales		2.3	0.6	-0.4	3.9	2.0	3.0	1.9	2.4	2.1
Priv. dom. final purchases		1.4	-0.6	-0.8	4.9	3.5	4.0	2.4	3.3	2.6
Personal cons. expenditures		1.6	0.5	-0.2	4.2	2.5	3.0	2.0	2.9	2.5
Durables		-0.1	-3.2	-3.1	9.4	7.3	7.0	1.8	5.3	4.4
Nondurables		1.6	-0.5	-1.0	3.4	1.5	3.6	1.1	2.6	2.1
Services		2.1	2.0	0.9	3.6	2.1	1.9	2.6	2.5	2.2
Business fixed investment		2.8	-2.5	-6.0	5.5	8.5	10.1	6.7	6.8	4.4
Producers' dur. equipment		2.3	-2.0	-2.6	9.6	11.5	12.6	7.3	8.1	5.6
Nonres. structures		3.7	-3.5	-12.6	-3.4	1.6	3.6	5.0	3.1	0.6
Residential structures		-7.0	-15.1	1.0	16.9	8.1	5.7	-1.4	1.0	-0.9
Exports		10.8	7.2	8.6	4.1	5.0	10.2	6.5	6.8	8.4
Imports		2.6	0.5	4.1	7.4	11.4	11.6	4.6	9.7	7.9
Gov't. cons. & investment		2.5	2.6	-0.7	1.7	-0.5	0.1	-1.3	0.4	0.4
Federal		0.8	1.6	-3.1	1.3	-5.5	-3.1	-6.6	-2.3	-3.4
Defense		-1.0	0.2	-5.3	-1.3	-6.9	-5.6	-6.6	-2.3	-3.3
State & local		3.9	3.3	1.0	2.0	3.1	2.2	2.1	2.0	2.5
Change in bus. inventories	Bill. Ch. $	33.3	10.4	-3.0	7.3	19.1	58.9	33.7	15.3	25.8
Nonfarm		33.5	7.7	-1.2	1.9	26.4	46.8	37.4	16.2	23.0
Net exports		-82.7	-61.9	-22.3	-29.5	-74.4	-108.1	-114.2	-122.7	-132.5
Nominal GDP	% change	6.4	4.4	3.8	6.3	4.7	5.9	3.7	4.9	4.7
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employment	Millions	107.9	109.4	108.3	108.6	110.7	114.0	116.6	118.3	119.7
Unemployment rate	%	5.3	5.6	6.9	7.5	6.8	6.1	5.6	5.5	5.5
Industrial prod. index	% change	-0.1	-0.2	0.2	4.0	3.2	6.6	1.6	3.5	3.2
Capacity util. rate - mfg.	%	83.2	81.3	78.0	79.5	80.6	83.3	83.0	81.7	81.7
Housing starts	Millions	1.38	1.19	1.01	1.20	1.29	1.46	1.35	1.43	1.36
Light motor vehicle sales		14.66	14.05	12.52	12.85	13.87	15.02	14.74	14.85	14.79
North Amer. produced		11.20	10.85	9.74	10.51	11.72	12.88	12.82	13.14	13.03
Other		3.46	3.20	2.77	2.34	2.15	2.13	1.91	1.70	1.76
INCOME AND SAVING										
Nominal GNP	Bill. $	5452.8	5764.9	5932.4	6255.5	6560.0	6922.4	7237.5	7556.3	7906.0
Nominal GNP	% change	6.5	4.6	3.5	6.2	4.6	5.7	3.9	4.7	4.6
Nominal personal income		6.8	6.4	3.7	7.3	3.6	5.1	5.4	5.5	5.2
Real disposable income		1.6	1.0	0.8	4.0	0.9	2.6	3.0	2.4	2.5
Personal saving rate	%	4.8	5.0	5.7	5.9	4.5	3.8	4.5	4.5	4.5
Corp. profits, IVA & CCAdj.	% change	-9.9	6.2	3.9	12.7	19.9	10.9	8.7	4.0	3.0
Profit share of GNP	%	6.5	6.4	6.4	6.4	7.1	7.6	8.1	8.5	8.3
Federal surpl./deficit	Bill. $	-113.4	-154.7	-196.0	-280.9	-254.7	-189.9	-162.6	-132.8	-134.0
State & local surpl./def.		95.1	80.1	75.8	86.3	94.9	99.7	95.0	88.5	88.8
Ex. social ins. funds		34.9	20.2	11.5	18.3	28.0	36.9	36.8	32.0	33.3
PRICES AND COSTS										
GDP implicit deflator	% change	3.9	4.6	3.4	2.6	2.5	2.3	2.4	2.4	2.5
GDP chn.-wt. price index		3.9	4.6	3.4	2.6	2.5	2.3	2.6	2.8	2.9
Gross Domestic Purchases chn.-wt. price index		4.1	5.2	2.7	2.6	2.3	2.4	2.4	2.6	2.8
CPI		4.6	6.3	3.0	3.1	2.7	2.6	2.7	3.4	3.2
Ex. food and energy		4.4	5.3	4.4	3.5	3.1	2.8	3.0	2.9	3.2
ECI, hourly compensation[2]		4.8	4.6	4.4	3.5	3.6	3.1	2.8	3.1	3.5
Nonfarm business sector										
Output per hour		0.1	-0.6	2.1	3.7	-0.5	0.7	0.7	1.3	1.1
Compensation per Hour		2.8	5.9	4.8	4.6	1.7	2.5	4.1	3.8	4.0
Unit labor cost		2.7	6.5	2.6	0.9	2.2	1.8	3.4	2.4	3.0

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

Strictly Confidential <FR>
Class II FOMC

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

May 16, 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	4.9	1.2	2.8	4.2	3.6	0.7	1.8
Priv. dom. final purchases		1.4	2.8	4.4	5.4	3.7	4.5	3.6	4.1	2.1	2.6
Personal cons. expenditures		0.7	2.7	3.8	2.8	2.7	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	2.4	2.9	1.7	3.8	3.2	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 investment		6.0	6.3	4.6	17.6	7.3	7.1	13.7	12.2	15.3	3.6
Producers' dur. equipment		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
Residential structures		2.0	-5.1	13.2	24.4	12.8	12.7	-1.9	0.0	-6.4	-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	7.6	19.0	11.0	9.2	8.7	7.7
Gov't. cons. & investment		-4.7	0.2	1.0	1.5	-4.2	-0.8	7.0	-1.4	-1.1	0.9
Federal		-13.0	-4.9	-3.0	-0.7	-11.2	-5.2	11.5	-5.9	-6.2	-1.2
Defense		-15.6	-5.2	-5.7	-0.5	-17.0	0.8	13.2	-16.0	-7.0	1.0
State & local		1.7	3.9	3.7	3.0	0.7	2.2	4.2	1.6	2.3	2.1
Change in bus. inventories	Bill. Ch. $	18.5	20.8	19.5	17.4	40.1	74.1	64.0	57.3	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 employment	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	84.3	83.0
Housing starts	Millions	1.17	1.27	1.30	1.43	1.38	1.47	1.46	1.48	1.31	1.29
Light motor vehicle sales		13.04	14.12	13.82	14.51	15.07	14.85	14.99	15.16	14.56	14.44
North Amer. produced		10.87	11.87	11.69	12.45	12.94	12.69	12.79	13.12	12.52	12.46
Other		2.17	2.25	2.14	2.06	2.13	2.16	2.20	2.05	2.04	1.97
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		-4.8	8.5	3.1	8.1	-3.3	13.6	4.2	6.5	7.1	4.5
Real disposable income		-7.1	4.8	1.4	4.9	-5.3	10.1	2.1	4.0	3.6	0.0
Personal saving rate	%	4.3	4.8	4.3	4.7	2.8	4.2	4.1	4.2	4.8	4.0
Corp. profits, IVA & CCAdj.	% 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 surpl./deficit	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
GDP chn.-wt. price index		3.8	2.2	1.8	2.3	2.8	1.9	2.4	2.2	3.3	2.5
Gross Domestic Purchases chn.-wt. price index		3.1	2.4	1.3	2.2	2.3	2.3	3.0	2.1	2.9	2.9
CPI		3.1	2.8	1.7	3.4	1.9	2.8	3.6	2.4	2.7	3.5
Ex. food and energy		3.5	3.5	2.4	2.9	2.9	2.9	3.1	2.3	3.3	3.3
ECI, hourly compensation[1]		4.2	3.5	3.4	3.4	3.0	3.4	3.3	2.3	2.9	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

1. Private-industry workers.

Strictly Confidential <FR>
Class II FOMC

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

May 16, 1996

				- - - - - - - - - - - - - - Projected - - - - - - - - - - - - - -							
Item	Units	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	7340.4	7426.9	7528.5	7615.1	7699.9	7794.2	7882.9	7967.0	8062.4
Real GDP	Bill. Ch. $	6768.3	6776.5	6819.2	6877.4	6910.8	6944.2	6983.3	7019.7	7051.8	7093.9
Real GDP	% change	3.6	0.5	2.5	3.5	2.0	1.9	2.3	2.1	1.8	2.4
Gross domestic purchases		2.8	-0.5	3.4	3.8	2.6	1.8	2.1	2.2	2.3	2.2
Final sales		3.4	1.6	3.6	2.6	1.3	1.9	2.2	2.1	1.8	2.5
Priv. dom. final purchases		3.3	1.6	5.0	3.3	2.8	2.3	2.5	2.6	2.6	2.6
Personal cons. expenditures		2.8	1.2	3.9	2.5	2.7	2.6	2.6	2.4	2.4	2.4
Durables		9.3	0.3	8.3	3.0	5.4	4.7	4.8	4.2	4.3	4.2
Nondurables		0.5	-0.3	4.1	2.5	1.9	2.1	2.1	2.1	2.1	2.1
Services		2.6	2.2	2.9	2.3	2.5	2.3	2.3	2.2	2.2	2.2
Business fixed investment		5.2	3.1	11.9	6.0	5.3	4.0	4.2	4.3	4.5	4.5
Producers' dur. equipment		4.9	4.0	14.2	6.8	6.3	5.2	5.5	5.5	5.6	5.7
Nonres. structures		6.2	0.9	5.8	3.7	2.3	0.6	0.3	0.6	1.0	0.6
Residential structures		9.2	6.4	5.0	9.4	-1.9	-7.5	-3.5	-0.3	0.1	0.2
Exports		8.0	11.0	4.4	10.5	2.1	10.6	6.8	10.6	5.0	11.4
Imports		1.0	1.3	11.3	12.1	7.0	8.7	5.0	10.2	7.8	8.7
Gov't. cons. & investment		-0.7	-4.1	1.8	1.4	-1.5	-0.1	0.1	0.5	0.5	0.6
Federal		-5.9	-12.8	6.7	-6.1	-5.3	-4.1	-4.0	-3.1	-3.1	-3.2
Defense		-8.1	-12.0	7.4	-6.5	-5.2	-4.5	-4.4	-2.9	-2.9	-3.0
State & local		2.7	1.5	-1.0	6.0	0.7	2.2	2.4	2.5	2.5	2.7
Change in bus. inventories	Bill. Ch. $	33.2	16.5	-0.8	13.5	24.1	24.4	25.3	25.5	26.5	25.7
Nonfarm		38.3	19.5	4.1	15.5	23.1	22.0	22.6	22.8	23.7	22.8
Net exports		-114.3	-96.6	-112.3	-118.6	-130.5	-129.4	-127.3	-129.5	-138.0	-135.3
Nominal GDP	% change	5.8	2.3	4.8	5.6	4.7	4.5	5.0	4.6	4.3	4.9
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	116.8	117.2	117.7	118.2	118.5	118.8	119.2	119.5	119.9	120.2
Unemployment rate	%	5.6	5.5	5.6	5.5	5.5	5.5	5.5	5.5	5.5	5.5
Industrial prod. index	% change	3.2	0.6	2.5	5.0	3.2	3.4	3.5	3.1	2.6	3.5
Capacity util. rate - mfg.	%	82.6	82.0	81.6	81.9	81.7	81.5	81.7	81.7	81.6	81.7
Housing starts	Millions	1.42	1.41	1.47	1.48	1.40	1.36	1.36	1.36	1.35	1.35
Light motor vehicle sales		15.04	14.92	15.17	14.75	14.75	14.71	14.75	14.77	14.80	14.82
North Amer. produced		13.18	13.13	13.48	13.10	13.02	12.98	13.00	13.02	13.04	13.06
Other		1.86	1.79	1.69	1.66	1.73	1.73	1.75	1.75	1.76	1.76
INCOME AND SAVING											
Nominal GNP	Bill. $	7283.0	7339.6	7423.3	7516.8	7603.7	7681.4	7778.3	7861.3	7948.0	8036.4
Nominal GNP	% change	5.4	3.1	4.6	5.1	4.7	4.2	5.1	4.3	4.5	4.5
Nominal personal income		5.0	5.2	5.1	6.7	5.3	4.8	5.7	5.0	5.0	5.1
Real disposable income		4.5	3.8	2.7	1.2	3.8	1.8	3.8	2.0	2.1	2.1
Personal saving rate	%	4.4	4.9	4.6	4.3	4.6	4.4	4.7	4.6	4.5	4.4
Corp. profits, IVA & CCAdj.	% change	44.2	2.4	21.0	-4.2	0.7	0.3	5.5	-0.1	3.7	2.8
Profit share of GNP	%	8.4	8.4	8.7	8.5	8.5	8.4	8.4	8.3	8.3	8.2
Federal surpl./deficit	Bill. $	-161.6	-154.9	-156.3	-118.8	-126.4	-129.6	-136.1	-133.3	-129.9	-136.7
State & local surpl./def.		93.9	88.1	86.4	88.3	90.0	89.2	90.0	90.1	87.6	87.6
Ex. social ins. funds		35.8	30.5	29.5	31.7	33.7	33.2	34.2	34.5	32.2	32.4
PRICES AND COSTS											
GDP implicit deflator	% change	2.2	1.8	2.3	2.1	2.7	2.5	2.7	2.5	2.5	2.4
GDP chn.-wt. price index		2.2	2.2	2.5	2.5	3.2	2.9	3.1	2.8	2.9	2.9
Gross Domestic Purchases chn.-wt. price index		1.7	2.1	2.5	2.5	2.8	2.7	3.0	2.8	2.8	2.8
CPI		2.1	2.4	3.2	4.2	3.1	3.0	3.3	3.3	3.2	3.2
Ex. food and energy		2.8	2.7	2.7	2.7	3.1	3.1	3.2	3.2	3.2	3.2
ECI, hourly compensation[1]		2.6	3.2	2.9	2.9	3.3	3.4	3.4	3.5	3.5	3.5
Nonfarm business sector											
Output per hour		1.7	-1.0	2.5	0.9	0.8	0.9	1.3	1.0	0.6	1.4
Compensation per hour		4.3	2.8	3.3	3.9	4.0	4.0	4.2	4.1	3.9	3.9
Unit labor cost		2.5	3.8	0.8	3.0	3.2	3.1	2.9	3.1	3.3	2.5

1. Private-industry workers.

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

May 16, 1996

Item	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	0.5	2.5	3.5	2.0	1.9	2.3	2.1	1.8	2.4	1.3	2.5	2.2
Gross dom. purchases	-0.5	3.4	3.8	2.7	1.9	2.2	2.2	2.3	2.2	1.1	2.9	2.2
Final sales	1.6	3.5	2.6	1.3	1.9	2.2	2.1	1.8	2.5	1.9	2.3	2.1
Priv. dom. final purchases	1.3	4.1	2.7	2.3	1.9	2.1	2.1	2.2	2.2	2.0	2.8	2.1
Personal cons. expenditures	0.8	2.7	1.7	1.8	1.7	1.7	1.7	1.7	1.7	1.4	2.0	1.7
Durables	0.0	0.7	0.3	0.5	0.4	0.4	0.4	0.4	0.4	0.2	0.5	0.4
Nondurables	-0.1	0.8	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.2	0.6	0.4
Services	0.9	1.1	0.9	0.9	0.9	0.9	0.8	0.8	0.8	1.0	1.0	0.9
Business fixed investment	0.3	1.2	0.6	0.6	0.4	0.5	0.5	0.5	0.5	0.7	0.7	0.5
Producers' dur. equip.	0.3	1.1	0.5	0.5	0.4	0.5	0.5	0.5	0.5	0.6	0.6	0.5
Nonres. structures	0.0	0.2	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.0
Residential structures	0.2	0.2	0.4	-0.1	-0.3	-0.1	-0.0	0.0	0.0	-0.1	0.0	-0.0
Net exports	1.0	-0.9	-0.4	-0.7	0.1	0.1	-0.1	-0.5	0.2	0.1	-0.5	-0.1
Exports	1.2	0.5	1.2	0.2	1.2	0.8	1.3	0.6	1.4	0.7	0.8	1.0
Imports	0.2	1.4	1.6	0.9	1.2	0.7	1.4	1.1	1.2	0.6	1.3	1.1
Government cons. & invest.	-0.8	0.3	0.3	-0.3	-0.0	0.0	0.1	0.1	0.1	-0.2	0.1	0.1
Federal	-0.9	0.4	-0.4	-0.4	-0.3	-0.3	-0.2	-0.2	-0.2	-0.5	-0.2	-0.2
Defense	-0.6	0.3	-0.3	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1	-0.3	-0.1	-0.1
Nondefense	-0.4	0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.1	-0.1
State and local	0.2	-0.1	0.7	0.1	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.3
Change in bus. inventories	-1.1	-1.0	0.8	0.6	0.0	0.1	0.0	0.1	-0.0	-0.6	0.1	0.0
Nonfarm	-1.1	-0.9	0.7	0.4	-0.1	0.0	0.0	0.1	-0.1	-0.5	0.0	0.0
Farm	0.1	-0.1	0.2	0.2	0.1	0.0	0.0	0.0	0.0	-0.1	0.1	0.0
GDP residual	-0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.0	0.0	0.0

Components may not sum to total due to rounding.

Strictly Confidential (FR)
Class II FOMC

STAFF PROJECTIONS OF FEDERAL SECTOR ACCOUNTS AND RELATED ITEMS
(Billions of dollars except as noted)

May 16, 1996

Item	Fiscal year[5]				1995				1996				1997			
	1994[a]	1995[a]	1996	1997	Q1[a]	Q2[a]	Q3[a]	Q4[a]	Q1[b]	Q2	Q3	Q4	Q1	Q2	Q3	Q4
UNIFIED BUDGET					Not seasonally adjusted											
Receipts[1]	1258	1355	1452	1496	307	404	333	324	321	448	359	346	324	452	375	355
Outlays[1]	1461	1519	1574	1655	380	381	373	380	394	396	404	412	415	412	415	432
Surplus/deficit[1]	-203	-164	-121	-158	-73	23	-40	-56	-72	52	-45	-66	-92	40	-40	-76
On-budget	-259	-226	-190	-220	-85	-11	-43	-69	-84	12	-49	-71	-104	1	-45	-80
Off-budget	56	62	68	61	12	34	2	14	12	40	3	5	12	39	5	4
Surplus excluding deposit insurance[2]	-210	-181	-131	-162	-79	18	-42	-59	-75	49	-47	-67	-93	39	-41	-77
Means of financing																
Borrowing	185	171	134	175	66	26	20	33	80	-37	57	60	64	6	45	55
Cash decrease	17	-2	-6	-16	8	-42	23	17	-1	-14	-8	9	20	-45	0	25
Other[3]	1	-6	-7	-1	-1	-7	-2	5	-7	-1	-4	-3	8	-1	-5	-3
Cash operating balance, end of period	36	38	44	60	18	61	38	20	22	36	44	35	15	60	60	35
NIPA FEDERAL SECTOR					Seasonally adjusted, annual rate											
Receipts	1354	1459	1537	1609	1449	1483	1487	1495	1519	1566	1569	1586	1599	1617	1635	1654
Expenditures	1554	1630	1676	1741	1623	1644	1648	1650	1676	1684	1695	1715	1735	1749	1764	1790
Consumption expend.	450	455	450	443	455	456	453	451	456	448	444	442	444	443	442	441
Defense	307	304	300	297	303	305	301	300	303	299	297	296	297	297	297	297
Nondefense	143	151	150	146	152	151	152	151	153	149	147	146	147	146	145	144
Other expenditures	1104	1175	1226	1298	1168	1188	1195	1198	1219	1236	1250	1273	1291	1306	1322	1349
Current account surplus	-200	-171	-139	-132	-173	-161	-162	-155	-156	-119	-126	-129	-136	-133	-129	-136
Gross investment	67	65	61	61	65	67	63	56	63	62	61	61	61	60	60	60
Current and capital account surplus	-267	-237	-200	-192	-238	-227	-225	-211	-219	-180	-187	-190	-196	-193	-190	-196
FISCAL INDICATORS[4]																
High-employment (HEB) surplus/deficit	-268	-267	-240	-234	-265	-248	-253	-235	-255	-217	-225	-231	-240	-239	-237	-247
Change in HEB, percent of potential GDP	-.7	0	-.4	-.1	-.3	-.2	.1	-.2	.3	-.5	.1	.1	.1	0	0	.1
Fiscal impetus (FI), percent, cal. year	-6.3	-5.5	-6.4	-4.8	-1.9	-.8	-1.7	-3.6	1.1	-4.3	-.5	-1.1	-1.2	-1	-1	-1

1. OMB's March 1996 baseline deficit estimates (assuming the enactment of the President's proposals) are $146 billion in FY96 and $140 billion in FY97. CBO's April 1996 baseline deficit estimates are $144 billion in FY96 and $171 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 the enactment of the President's proposals), excluding deposit insurance spending, are $159 billion in FY96 and $144 billion in FY97. CBO's April 1996 baseline deficit estimates, excluding deposit insurance spending, are $154 billion in FY96 and $176 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 6 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.

5. Historical fiscal year data for the unified budget come from OMB, quarterly data come from the Monthly Treasury Statement and may not sum to fiscal year totals.

a--Actual.
b--Preliminary.

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

			Nonfederal						MEMO
				Households					
	Total	Federal govt.	Total	Total	Home mtg.	Cons. credit	Business	State and local govt.	Nominal GDP
Year									
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	3.7
1996	4.7	4.4	4.8	6.6	6.1	9.1	4.7	-3.2	4.9
1997	4.5	4.5	4.6	5.9	5.9	6.6	4.6	-2.2	4.7
Quarter (seasonally adjusted annual rates)									
1995:1	6.7	7.6	6.3	7.4	5.8	13.6	8.1	-4.3	3.9
2	6.6	5.7	6.9	8.3	6.3	15.5	7.6	-1.5	2.8
3	3.9	1.8	4.6	8.3	7.5	10.4	4.4	-10.6	5.8
4	4.2	1.2	5.3	7.3	5.9	11.2	5.0	-2.4	2.3
1996:1	6.1	7.9	5.4	7.0	6.2	10.1	5.6	-2.7	4.8
2	3.7	-0.2	5.1	6.5	6.0	9.0	4.4	1.1	5.6
3	4.4	5.8	3.9	6.1	5.9	8.4	4.2	-8.7	4.7
4	4.4	4.0	4.5	6.0	5.9	7.8	4.4	-2.7	4.5
1997:1	5.1	6.9	4.4	5.9	5.9	6.6	4.4	-2.9	5.0
2	4.2	3.2	4.5	5.8	5.8	6.5	4.5	-1.9	4.6
3	4.3	4.2	4.4	5.7	5.7	6.4	4.5	-3.3	4.3
4	4.3	3.2	4.6	5.6	5.6	6.3	4.5	-0.6	4.9

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 monthly average basis, total debt grows 5.5 percent in 1995, 4.6 percent in 1996, and 4.6 percent in 1997. Federal debt rises 4.4 percent in 1995, 3.8 percent in 1996, and 4.7 percent in 1997. Nonfederal debt increases 5.9 percent in 1995, 4.9 percent in 1996, and 4.5 percent in 1997.

2.6.3 FOF

Confidential FR Class II
May 16, 1996

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	572.8	591.2	430.8	501.2	728.8	462.4	543.9	556.3	606.5	575.8
2 Net equity issuance	-44.9	-76.0	-79.7	-68.7	-98.8	-77.2	-115.2	-56.4	-76.8	-70.4	-72.6	-64.8
3 Net debt issuance	617.0	716.7	652.5	659.9	529.6	578.4	844.0	518.8	620.7	626.7	679.1	640.6
Borrowing sectors												
Nonfinancial business												
4 Financing gap [2]	4.1	60.1	21.2	44.2	66.5	11.2	-3.9	18.8	32.4	37.4	39.0	49.5
5 Net equity issuance	-44.9	-76.0	-79.7	-68.7	-98.8	-77.2	-115.2	-56.4	-76.8	-70.4	-72.6	-64.8
6 Credit market borrowing	144.3	250.8	196.8	199.5	178.3	205.5	232.4	185.0	181.4	188.2	196.0	202.9
Households												
7 Net borrowing, of which:	360.3	373.1	329.1	313.2	401.8	356.5	350.9	331.2	317.8	316.6	313.9	312.6
8 Home mortgages	196.7	207.1	206.3	210.6	246.0	196.3	209.0	204.2	205.0	207.0	211.3	210.0
9 Consumer credit	121.2	130.8	101.5	80.5	109.6	121.8	112.8	102.7	97.7	92.7	80.5	80.5
10 Debt/DPI (percent) [3]	88.7	90.8	92.7	93.3	91.2	91.8	92.3	92.8	92.8	93.1	93.1	93.5
State and local governments												
11 Net borrowing	-43.4	-51.5	-34.4	-22.2	-116.2	-26.1	-28.2	11.2	-92.0	-28.4	-24.7	-19.7
12 Current surplus [4]	107.4	104.4	104.4	110.6	106.9	87.9	100.8	103.2	106.5	107.1	110.3	110.8
U.S. government												
13 Net borrowing	155.9	144.4	161.0	169.4	65.8	42.4	288.9	-8.6	213.5	150.3	193.9	144.9
14 Net borrowing (quarterly, nsa)	155.9	144.4	161.0	169.4	19.9	33.3	80.5	-37.0	57.1	60.4	69.8	99.6
15 Unified deficit (quarterly, nsa)	185.2	146.4	131.6	168.3	40.2	55.9	72.3	-52.3	45.2	66.4	52.0	116.3
16 Funds supplied by depository institutions	198.3	284.0	200.9	211.7	284.5	155.2	196.5	190.7	200.7	215.7	215.7	207.7
MEMO: (percent of GDP)												
17 Domestic nonfinancial debt [3]	185.4	186.6	187.7	187.5	187.3	188.1	188.3	188.0	187.7	187.7	187.5	187.5
18 Domestic nonfinancial borrowing	8.9	9.9	8.6	8.3	7.3	7.9	11.4	6.9	8.2	8.1	8.7	8.0
19 U.S. government [5]	2.2	2.0	2.1	2.1	0.9	0.6	3.9	-0.1	2.8	2.0	2.5	1.8
20 Private	6.7	7.9	6.5	6.2	6.4	7.3	7.5	7.0	5.3	6.2	6.2	6.2

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.

Recent Developments

The weighted-average foreign exchange value of the dollar in terms of the other G-10 currencies has appreciated 2 percent on balance since the March FOMC meeting. The dollar has risen 4 percent in terms of the mark but only slightly in terms of the yen. The dollar has declined 1-1/2 percent in terms of the Mexican peso over the intermeeting period.

The dollar strengthened as economic indicators suggested more robust economic activity in the United States, shifting market expectations of U.S. monetary policy toward tightening. At the same time, data from Germany indicated continued weakness in the pace of economic activity and increased expectations of additional monetary easing by the Bundesbank. In contrast to developments in continental Europe, indicators of economic activity in Japan suggested further expansion and fueled beliefs that monetary conditions there might soon be tightened. Late in the period, statements by Japanese officials countered the perception that tightening is imminent.

Short-term market interest rates declined on balance over the intermeeting period in most of the major foreign industrial countries. The principal exception was in Japan, where rates were about unchanged. Lower official lending rates in Canada, France, the Netherlands, and Sweden were accompanied by declines in market rates. On average, long-term interest rates abroad fell slightly over the period. Long-term rates rose about 20 basis points in Canada, where economic activity is firming, but moved up slightly in Japan and were about unchanged in Germany. Rates fell about 100 basis points in Italy, as market participants responded positively to the outcome of the April 21 election.

. The Desk did not intervene.

The outcome for real economic activity has varied across the major foreign industrial countries so far in 1996. In Japan, recovery appears to be continuing. Industrial production, machinery orders, and housing starts expanded further, on balance, during the first quarter. The unemployment rate improved in February and March after having reached a postwar high of 3.4 percent in January. In contrast, economic indicators suggest that activity contracted during the first quarter in Germany, as unusually severe weather depressed construction. The unemployment rate moved up to 10.4 percent in March and improved only marginally in April. Despite an increase in March, manufacturing orders declined on average in the first quarter. Economic activity is expected to recover somewhat in the current quarter, however, as construction rebounds. In France, real output growth in the first quarter was positive, but much of the increase represented a rebound from the strikes in the fourth quarter of last year. In the United Kingdom and Canada, preliminary data show further moderate expansion of economic activity in the first quarter.

Inflation abroad on average remains low. The latest measures of consumer and wholesale prices moved up in Japan from their levels twelve months earlier in response to the impact of past yen depreciation on import prices. In April, German consumer prices were only 1.3 percent above their level one year earlier. Inflation remains higher in Italy than in the other foreign G-7 countries, but in the twelve months through April moved down to 4.5 percent.

The nominal U.S. trade deficit on goods and services widened sharply in January and February. On average in those two months, exports were about unchanged from their fourth-quarter level, while imports grew by more than 2 percent. Imports of automotive products and consumer goods recorded large increases from their depressed levels during the second half of last year. The quantity of oil imported during January/February continued at about its fourth-quarter rate. (A larger-than-normal seasonal inventory drawdown partially offset strong increases in oil consumption.)

Prices of merchandise exports increased at an average annual rate of 0.5 percent in the first quarter after having remained flat in the fourth quarter of last year. Prices of nonagricultural exports continued to fall moderately, but agricultural export prices, primarily grain prices, rose sharply again. Prices of non-oil merchandise imports decreased at an annual rate of 1 percent on average in the first quarter, about the same decline as in the fourth quarter.

The price of imported oil increased substantially in the first quarter owing to a sharp rise in March. Spot WTI prices rose more than $2 per barrel in April, averaging $23.57 per barrel. Spot prices have moved back down to date in May and are currently around $21 per barrel. Unusually cold weather in North America and Japan and weather-related production disruptions in the North Sea and Australia have kept prices firm. Prices have also been more volatile because inventories are reported to be at very low levels. Refiners are reluctant to build inventories because of the possibility of a sharp price decline if negotiations between Iraq and the United Nations for a limited oil sale result in an additional 700,000 barrels per day of oil on world markets.

Outlook

Total foreign real GDP growth (weighted by U.S. bilateral export shares) is projected to strengthen from its 3-1/4 percent, annual rate, pace during the first half of 1996 to average about 3-3/4 percent, annual rate, over the remainder of the forecast period. U.S. real GDP is projected to expand more slowly than foreign real GDP, but its growth has been revised up for the first half of this year from the March Greenbook outlook. The dollar is projected to remain near recent levels through the end of 1997, a path that is about 2 percent higher than in the March Greenbook. As a consequence, real imports now are projected to grow significantly more rapidly during the first half of this year than was projected in the March Greenbook. Real import growth slows somewhat next year. Real net exports are projected to make a negative contribution to GDP growth of 0.5 percent in 1996 and to be about neutral in 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 higher levels throughout the forecast period, in line with the stronger outlook for U.S. GDP and interest rates. 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 peso is expected to appreciate in real terms over the forecast period, as its nominal exchange rate against the dollar depreciates at a slower pace than the extent to 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 U.S. bilateral export shares) will average about 2-1/2 percent this year and next, about the same outlook as in the March Greenbook.

In Japan, projected real output growth for this year has been revised up, to 3 percent, in line with strong production and orders data. Next year, growth is expected to slow to about 2-1/2 percent as fiscal policy shifts toward being contractionary.

In Germany, real growth is projected to rebound this quarter as construction spending is expected to recover. For the remainder of the forecast period, real GDP is expected to expand at an annual rate of about 2-1/4 percent, supported by past monetary ease and the lagged effects of the depreciation of the mark during the second half of 1995 and early 1996. In addition, recent gains in real disposable incomes should boost consumption spending.

In the United Kingdom, real output growth is expected to strengthen a bit from its first-quarter pace, to average 2 percent this year and then to move up to 2-1/2 percent in 1997. Real growth should improve as inventory investment stops declining and consumption expands.

In Canada, real GDP growth is projected to strengthen somewhat during the current quarter in line with the robust expansion observed in employment and the improved economic performance in the United States. Growth is expected to average 2-1/2 percent this year and 2-3/4 percent next year in response to past reductions in interest rates and improvement in consumer confidence.

The outlook for inflation in the foreign G-7 countries remains low. On average, consumer price inflation in these countries (weighted by U.S. bilateral import shares) is projected to rise from 1-1/4 percent this year to 1-1/2 percent next year. After remaining about flat this year, consumer prices in Japan should rise 1 percent next year (Q4/Q4), the result of an increase in the consumption tax in the second quarter of 1997.

Our outlook for the foreign G-7 countries incorporates the assumption that short-term market interest rates on average are about at their trough and will rise about 50 basis points over the forecast period. Rates are assumed to move down slightly further in Germany and in some other continental European countries through the end of this year before rising moderately next year. In Japan, short-term market rates are assumed to increase late this year as the Bank of Japan tightens and to change little in 1997. Long-term rates abroad are expected to rise only slightly over the forecast period.

Other countries. The real GDP of major developing country trading partners of the United States (weighted by U.S. export shares) is projected to increase 5 percent to 6 percent per year during 1996-97, compared with 3-1/4 percent growth during 1995 (Q4/Q4). The pickup in growth in 1996-97 largely reflects the recovery in Mexico.

We continue to project that real GDP in Mexico will grow at an average rate of about 5 percent per year in 1996-97, as risks and uncertainties about the macroeconomy and policy continue to be reduced. We now project that real GDP in Venezuela will fall around 3 percent in 1996, a substantial downward revision from the March Greenbook. The stabilization plan announced in mid-April is expected to have a significantly contractionary effect on output this year, as the positive effect of a depreciation of the bolivar on net exports is more than offset by fiscal contraction and a tightening of credit conditions. Some recovery is likely in 1997. Real output in Brazil is now projected to expand only 2 percent in 1996, reflecting indications of slower-than-expected growth during the first quarter and continued high real interest rates, but it should accelerate to more than 3 percent growth during 1997.

Our major trading partners in Asia are expected to experience strong growth in 1996-97, although growth is projected to decline from an average rate of around 7-1/2 percent in 1995 to 7 percent in 1996-97. 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. Real exports of goods and services are projected to increase this year at about their 1995 pace and somewhat faster next year. Exports of computers are expected to have grown very rapidly in real terms during the first quarter, near the extremely high pace seen during the second half of last year, and are projected to expand at a slower but still substantial pace over the remainder of the forecast period. Real semiconductor exports are projected to rebound from a decline during the first quarter. The quantities of other goods exports (excluding agricultural products) are projected to bounce back in the current quarter from their decline in the first quarter, in part a make-up of automobile shipments following the resolution of the GM strike, and to average about 3 percent annual growth this year and next. The projected recovery in economic activity abroad underlies the sustained growth in these exports.

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

	1995	Projection 1996 Q1	1996 Q2	1996 H2	1997
Exports of G&S	6.5	4.4	10.5	6.2	8.4
Services	1.6	7.9	4.1	2.8	3.1
Computers	48.0	66.0	26.3	26.2	31.1
Semiconductors	30.0	-9.7	21.6	23.5	31.1
Other goods[1]	2.5	-4.8	13.8	1.5	2.8
Imports of G&S	4.6	11.3	12.1	7.8	7.9
Services	3.9	16.6	9.4	2.6	2.5
Oil	-0.5	-0.7	30.1	12.0	2.2
Computers	43.5	28.6	26.3	22.9	21.6
Semiconductors	57.9	-16.8	21.5	26.1	31.0
Other goods[2]	-3.0	11.6	7.7	4.2	4.5

Note: NIPA basis, chained (1992) dollars.
1. Merchandise exports excluding agriculture, computers and semiconductors.
2. Merchandise imports excluding oil, computers, and semiconductors.

Real imports of goods and services are projected to have bounced back sharply in the first quarter from their weakness during the second half of last year. Real import growth is expected to slow a bit from the first-quarter pace but to remain moderately strong during the second half of this year and 1997. Imported computers are projected to grow rapidly over the forecast period in real terms, as are imported semiconductors. Imports of other non-oil goods are projected to decelerate from their double-digit growth in the first-quarter and to expand in line with U.S. real GDP over the remainder of the forecast period. These imports are boosted a bit late this year and in 1997 by the lagged effects of the stronger dollar. We expect the quantity of oil imports to rise sharply this quarter, after several quarters of no net growth, and then to expand over the remainder of the forecast period, as consumption increases, inventories are rebuilt, and U.S. production declines.

Oil prices. Although spot oil prices have partially retraced their recent spike, the projected prices of imported oil have been revised up $2.49 per barrel for the second quarter (to $19.82/b) and $1.63 per barrel for the third quarter (to $17.83/b). Our long-run projections for WTI and the oil import unit value are $19.50/b and $17.00/b, respectively. This long-run outlook incorporates the assumption that in 1997 Iraqi sales of oil will take place under UN direction.

Prices of non-oil imports and exports. Prices of non-oil imports are projected to increase only slightly during 1996-1997 as foreign inflation remains low. Prices of nonagricultural exports (including computers and semiconductors) are projected to change little on balance this year and then to rise somewhat next year.

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

		Projection			
	1995	1996			1997
		Q1	Q2	H2	
Nonag. exports[1]	1.6	-2.0	1.6	0.4	1.5
Non-oil imports[1]	1.0	-0.4	0.0	1.0	0.8
Oil imports (Q4 level, $/bl)	16.02	17.50	19.82	16.88	17.00

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

Nominal trade and current account balances. The nominal trade balance on goods and services is expected to widen somewhat over the forecast period, from its first-quarter rate of about $105 billion to $120 billion in the fourth quarter of 1997. While net earnings from direct investment are projected to continue to expand, that gain will be more than offset by an increasing deficit on portfolio income. Accordingly, the current account balance is projected to deteriorate over 1996-97, reaching about $175 billion in 1997, 2-1/4 percent of GDP.

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

			Projected		1995			Projected 1996			
Measure and country	1994	1995	1996	1997	Q2	Q3	Q4	Q1	Q2	Q3	Q4
REAL GDP											
Canada	5.4	0.6	2.5	2.7	-0.8	1.2	0.8	2.1	2.8	2.7	2.6
France	4.1	0.3	2.1	2.6	0.2	0.2	-1.7	1.6	1.1	3.1	2.8
Germany	3.7	1.0	1.5	2.3	4.4	0.4	-1.6	-1.1	2.6	2.3	2.3
Italy	2.6	2.3	2.5	2.2	-0.2	7.6	-3.6	0.6	2.5	3.5	3.3
Japan	0.4	2.2	3.1	2.4	2.6	2.3	3.6	3.1	3.2	2.9	3.1
United Kingdom	4.1	1.9	2.1	2.5	2.0	2.0	2.0	1.6	2.0	2.2	2.5
Average, weighted by 1987-89 GDP	2.7	1.6	2.4	2.4	1.8	2.3	0.5	1.5	2.5	2.8	2.8
Average, weighted by share of U.S. nonagricultural exports											
Total foreign	4.8	1.8	3.5	3.7	NA	NA	NA	NA	NA	NA	NA
Foreign G-7	3.9	1.2	2.5	2.5	0.8	1.7	1.0	1.8	2.6	2.7	2.7
Developing countries	6.0	3.2	4.9	5.8	NA	NA	NA	NA	NA	NA	NA
CONSUMER PRICES(1)											
Canada	0.0	2.1	1.6	1.8	3.1	0.9	0.1	1.7	1.6	1.6	1.6
France	1.6	1.9	1.7	1.9	2.1	1.2	2.3	2.9	1.9	0.5	1.8
Western Germany	2.5	1.6	1.6	1.8	2.2	1.5	-0.5	2.5	2.5	1.8	-0.2
Italy	3.8	5.9	4.1	3.7	8.0	4.1	5.1	2.9	5.5	3.7	4.3
Japan	0.8	-0.8	-0.0	1.0	0.7	-1.0	-0.5	-0.4	0.7	-0.2	-0.1
United Kingdom(2)	2.2	2.9	2.7	2.8	6.4	0.8	1.4	3.0	5.8	0.8	1.4
Average, weighted by 1987-89 GDP	1.7	1.7	1.6	1.9	3.1	0.8	1.0	1.7	2.6	1.1	1.1
Average, weighted by share of U.S. non-oil imports	1.0	1.1	1.2	1.6	2.4	0.4	0.2	1.2	1.8	0.9	0.9

Note. Annual values are measured from Q4 to Q4.
1. Not seasonally adjusted.
2. CPI excluding mortgage interest payments, which is the targeted inflation rate. Previously the CPI including mortgage interest payments was shown.

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	-108.2
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	735.1	823.3
Goods	577.3	598.6	605.1	629.1	643.0	676.5	698.1	718.6	732.8	750.5	544.9	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.

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

	1995		Projection 1996				Projection 1997				Projection ANNUAL		
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	1995	1996	1997
NIPA Real Net Exports (Chained 1992 dollars)	-114.3	-96.6	-112.3	-118.6	-130.5	-129.4	-127.3	-129.5	-138.0	-135.3	-114.2	-122.7	-132.5
Exports of G&S	779.1	799.8	808.4	828.8	833.0	854.3	868.5	890.6	901.5	926.2	774.8	831.1	896.7
Goods	570.7	589.8	594.3	612.6	615.6	635.2	647.4	667.8	677.1	700.3	566.8	614.4	673.2
Agricultural	50.0	49.4	50.5	47.6	47.9	49.1	49.2	49.5	49.9	50.2	49.7	48.8	49.7
Computers	65.2	73.4	83.3	88.3	93.6	99.2	106.2	113.6	121.6	130.1	61.8	91.1	117.9
Semiconductors	57.0	61.3	59.8	62.8	65.9	69.8	74.7	80.0	85.6	91.6	55.6	64.6	83.0
Other Goods	398.5	405.7	400.8	413.9	408.2	417.0	417.3	424.7	420.0	428.5	399.7	410.0	422.6
Services	209.4	211.1	215.2	217.3	218.5	220.3	222.1	223.9	225.6	227.0	208.9	217.8	224.7
Imports of G&S	893.4	896.4	920.6	947.4	963.5	983.8	995.8	1020.2	1039.6	1061.5	889.0	953.8	1029.2
Goods	752.2	752.8	771.4	794.8	809.9	829.2	840.4	864.2	882.5	903.1	747.1	801.3	872.6
Oil	60.7	57.9	57.8	61.7	66.6	65.3	62.8	68.2	71.1	66.7	58.1	62.8	67.2
Computers	88.0	98.0	104.4	110.6	116.7	122.6	128.7	135.1	141.9	149.0	83.5	113.6	138.7
Semiconductors	53.0	58.3	55.7	58.5	62.0	65.7	70.3	75.2	80.5	86.1	49.0	60.5	78.0
Other Goods	550.5	538.6	553.5	563.9	564.7	575.7	578.7	585.7	589.0	601.3	556.4	564.4	588.7
Services	141.6	143.9	149.5	152.9	153.9	154.9	155.7	156.3	157.3	158.7	142.2	152.8	157.0
Memo: (Percent change 1/)													
Exports of G&S	8.0	11.1	4.4	10.5	2.1	10.6	6.8	10.6	5.0	11.4	6.5	6.8	8.4
Agricultural	15.8	-4.7	9.2	-21.3	2.6	10.4	0.8	2.5	3.3	2.4	-3.5	-0.7	2.2
Computers	87.7	60.6	66.0	26.3	26.3	26.3	31.1	31.1	31.1	31.1	48.0	35.2	31.1
Semiconductors	31.3	33.3	-9.7	21.6	21.6	26.3	31.1	31.1	31.1	31.1	30.0	13.9	31.1
Other Goods	-2.0	7.5	-4.8	13.8	-5.4	8.9	0.3	7.3	-4.4	8.3	2.5	2.8	2.8
Services	3.9	3.3	7.9	4.1	2.2	3.2	3.4	3.3	3.0	2.5	1.6	4.3	3.1
Imports of G&S	1.0	1.3	11.3	12.1	7.0	8.7	5.0	10.2	7.8	8.7	4.6	9.7	7.9
Oil	25.1	-17.2	-0.7	30.1	35.1	-7.6	-14.3	38.8	18.6	-22.7	-0.5	12.7	2.2
Computers	76.9	53.8	28.6	26.3	23.9	21.6	21.6	21.6	21.6	21.6	43.5	25.1	21.6
Semiconductors	86.9	46.8	-16.8	21.5	26.2	26.2	31.0	31.0	31.1	31.1	57.9	12.7	31.0
Other Goods	-13.9	-8.4	11.6	7.7	0.5	8.0	2.1	4.9	2.3	8.6	-3.0	6.9	4.5
Services	1.4	6.7	16.6	9.4	2.6	2.5	2.0	1.7	2.6	3.6	3.9	7.6	2.5
Current Account Balance	-161.0	-124.6	-151.3	-157.4	-162.7	-175.9	-161.6	-170.1	-176.8	-191.6	-153.0	-161.8	-175.0
Goods & Serv (BOP), net	-109.2	-87.8	-104.1	-111.5	-117.1	-112.8	-111.4	-114.3	-123.6	-120.9	-111.5	-111.4	-117.5
Goods (BOP), net	-173.3	-152.5	-168.9	-176.5	-183.1	-180.1	-180.7	-185.6	-196.5	-194.9	-174.6	-177.1	-189.4
Services (BOP), net	64.1	64.6	64.8	65.0	66.0	67.3	69.3	71.3	72.9	74.0	63.0	65.8	71.9
Investment Income, net	-20.7	-6.1	-8.8	-16.9	-16.6	-23.7	-21.2	-26.8	-24.2	-31.2	-11.4	-16.5	-25.9
Direct, net	52.7	68.1	64.2	61.7	60.6	59.9	62.1	62.0	62.8	62.9	59.1	61.6	62.4
Portfolio, net	-73.4	-74.2	-73.0	-78.6	-77.2	-83.6	-83.3	-88.8	-87.0	-94.1	-70.5	-78.1	-88.3
Unilateral Transfers, net	-31.1	-30.7	-38.4	-29.0	-29.0	-39.5	-29.0	-29.0	-29.0	-39.5	-30.1	-34.0	-31.6

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