

May 10, 1989

SUMMARY AND OUTLOOK

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

REAL GNP AND THE DROUGHT
 (Percent change, annual rate)

	1988		1989		1990		1988	
	Q4	Q1	Q2	H2	H1	H2	Q4/Q4	
Real GNP	2.4	5.5	2.3	1.8	.9	1.3	2.8	2.8
Real GNP, excluding effects of the drought ¹	3.5	3.0	2.3	1.8	.9	1.3	3.5	2.2

1. The staff's methodology for calculating drought effects has been altered this month in light of new information from the BEA. Previously, we had counted all of the projected rise in farm output this year as a rebound from the drought, taking account of acreage increases as well as a return to normal yields. However, the BEA is counting as drought effects only the return to normal yields and is assuming that the rebound was completed in the first quarter.

Inflation recently has been somewhat higher than projected, owing to rising food and energy prices. The staff forecasts of wage and price inflation, however, have been revised downward slightly for later this year and for 1990, reflecting the slower-than-anticipated increase in labor costs in recent months and the higher average value of the dollar. But the trend in hourly compensation is still upward, as labor markets are expected to remain tight well into 1990, and employers will be faced with additional costs early next year by the scheduled increase in social security taxes--1-1/2 percentage points at an annual rate in the first quarter--and the likely hike in the minimum wage.

The rise in consumer food prices is projected to slow from the current rate of around 6 percent to a 3-1/4 percent annual pace in the second half of 1989; this forecast assumes normal weather conditions in the current growing season. Projections of energy prices were raised slightly, increasing 5 percent over this year. The runup in crude oil costs has been

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STAFF GNP PROJECTIONS

Percent changes, annual rate

	Nominal GNP	Real GNP		GNP fixed-weighted price index		GNP deflator		Unemployment rate (percent)				
	3/22/89	5/10/89	3/22/89	5/10/89	3/22/89	5/10/89	3/22/89	5/10/89	3/22/89	5/10/89		
Annual changes:												
1987	<1>	6.8	6.8	3.4	3.4	3.6	3.6	3.3	3.3	6.2	6.2	
1988	<1>	7.4	7.5	3.8	3.9	4.2	4.2	3.4	3.4	5.5	5.5	
1989		7.8	7.8	3.1	3.1	4.7	4.8	4.6	4.6	5.3	5.3	
1990		5.8	5.9	1.2	1.3	4.8	4.6	4.5	4.5	5.9	5.8	
Quarterly changes:												
1988	Q1	<1>	5.4	5.4	3.4	3.4	3.5	3.5	1.7	1.7	5.7	5.7
	Q2	<1>	8.7	8.7	3.0	3.0	5.0	5.0	5.5	5.5	5.5	5.5
	Q3	<1>	7.3	7.3	2.5	2.5	5.3	5.3	4.7	4.7	5.5	5.5
	Q4	<1>	7.2	7.6	2.0	2.4	4.2	4.2	5.3	5.3	5.3	5.3
1989	Q1	<1>	9.4	9.7	5.2	5.5	4.8	5.0	3.9	3.9	5.2	5.2
	Q2		7.8	7.3	3.0	2.3	4.8	5.2	4.7	4.8	5.2	5.3
	Q3		6.3	6.2	2.0	2.0	4.6	4.3	4.3	4.1	5.3	5.3
	Q4		5.9	5.6	1.6	1.6	4.4	4.1	4.2	3.9	5.4	5.4
	Q1		5.6	6.4	.4	1.2	5.3	5.1	5.2	5.1	5.6	5.5
	Q2		5.2	5.2	.8	.6	4.7	4.6	4.4	4.5	5.8	5.7
	Q3		5.6	5.5	1.2	1.0	4.6	4.6	4.4	4.5	6.0	5.9
	Q4		6.0	5.9	1.7	1.6	4.5	4.4	4.3	4.3	6.1	6.1
Two-quarter changes: <2>												
1988	Q2	<1>	7.0	7.0	3.2	3.2	4.2	4.2	3.6	3.6	-.4	-.4
	Q4	<1>	7.2	7.4	2.2	2.4	4.8	4.8	5.0	5.0	-.2	-.2
1989	Q2		8.6	8.5	4.1	3.9	4.8	5.2	4.3	4.4	-.1	.0
	Q4		6.1	5.9	1.8	1.8	4.5	4.2	4.2	4.0	.2	.1
1990	Q2		5.4	5.8	.6	.9	5.0	4.9	4.8	4.8	.4	.3
	Q4		5.8	5.7	1.4	1.3	4.6	4.5	4.3	4.4	.3	.4
Four-quarter changes: <3>												
1987	Q4	<1>	8.3	8.3	5.0	5.0	4.0	4.0	3.1	3.1	-.9	-.9
1988	Q4	<1>	7.1	7.2	2.7	2.8	4.5	4.5	4.3	4.3	-.6	-.6
1989	Q4		7.3	7.2	2.9	2.8	4.7	4.7	4.3	4.2	.1	.1
1990	Q4		5.6	5.8	1.0	1.1	4.8	4.7	4.6	4.6	.7	.7

<1> Actual.

<2> Percent change from two quarters earlier.

<3> Percent change from four quarters earlier.

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CLASS II FOMCGROSS NATIONAL PRODUCT AND RELATED ITEMS
(Seasonally adjusted; annual rate)

	Units	Projection									
		1988		1989				1990			
		Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
EXPENDITURES											
Nominal GNP	Billions of \$	4909.0	4999.7	5116.8	5207.6	5286.3	5358.4	5442.5	5511.3	5585.8	5666.6
Real GNP	Billions of 82\$	4009.4	4033.4	4088.2	4111.2	4131.7	4148.3	4160.8	4167.4	4178.0	4194.4
Nominal GNP	Percent change	7.3	7.6	9.7	7.3	6.2	5.6	6.4	5.2	5.5	5.9
Real GNP		2.5	2.4	5.5	2.3	2.0	1.6	1.2	.6	1.0	1.6
Gross domestic product		2.0	2.3	5.8	2.3	1.9	1.5	1.3	.7	.9	1.5
Gross domestic purchases		2.5	3.5	4.4	2.0	1.5	1.2	1.1	.4	.3	.8
Final sales		2.0	3.5	3.0	2.8	2.8	1.8	1.4	1.1	1.4	1.9
Private dom. final purchases		3.9	2.9	2.2	2.7	2.4	1.4	1.4	.9	.8	1.1
Personal consumption expend.		3.9	3.5	1.3	3.1	2.4	1.4	1.6	.9	.8	1.1
Durables		-.2	6.1	-3.2	7.3	2.5	-3.4	-.2	-1.5	-1.4	.9
Nondurables		5.0	1.3	2.0	1.1	1.7	1.8	1.2	.8	.7	.7
Services		4.5	4.2	2.4	3.1	2.8	2.7	2.5	1.7	1.5	1.4
Business fixed investment		4.0	-2.9	9.6	6.6	5.5	3.0	1.9	1.5	.8	.5
Producers' durable equipment		4.6	-3.5	10.2	7.5	6.4	4.5	3.3	2.7	2.0	1.5
Nonresidential structures		2.6	-1.0	7.9	3.9	2.9	-1.5	-2.1	-2.1	-2.8	-2.8
Residential structures		4.3	10.9	-3.6	-11.6	-4.6	-2.9	-2.5	-2.2	1.0	2.8
Exports		14.5	6.5	10.6	14.2	6.5	7.4	5.3	4.4	6.2	8.2
Imports		13.1	13.5	2.3	10.2	2.7	4.1	4.0	2.3	1.2	2.1
Government purchases		-5.2	11.9	1.1	1.9	1.7	1.3	.6	.6	.5	.8
Federal		-13.2	20.7	-2.7	1.3	1.1	.4	-1.2	-1.3	-1.6	-.7
Defense		-10.5	9.9	-9.7	-3.1	-1.7	-5.0	-2.9	-2.7	-3.1	-2.6
State and local		1.1	6.0	4.0	2.3	2.2	2.0	2.0	2.0	1.9	1.9
Change in business inventories	Billions of 82\$	39.5	29.1	53.8	48.4	40.7	39.4	37.5	32.6	28.5	25.7
Nonfarm	Billions of 82\$	40.4	37.6	41.1	39.1	31.0	33.1	31.1	25.8	21.4	18.3
- exports	Billions of 82\$	-93.9	-105.4	-95.6	-93.0	-88.5	-85.1	-84.1	-81.7	-74.7	-66.4
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	106.5	107.3	108.3	108.8	109.2	109.5	109.8	109.9	110.0	110.2
Unemployment rate	Percent*	5.5	5.3	5.2	5.3	5.3	5.4	5.5	5.7	5.9	6.1
Industrial production index	Percent change	7.1	4.6	3.0	1.5	1.8	1.2	1.0	.4	.8	2.0
Capacity utilization rate-mfg.	Percent*	84.0	84.4	84.6	84.2	83.9	83.5	83.0	82.4	81.9	81.7
Housing Starts	Millions	1.47	1.56	1.52	1.44	1.42	1.40	1.39	1.40	1.41	1.42
Auto sales	Millions	10.32	11.00	9.71	10.46	10.57	9.90	9.75	9.50	9.30	9.30
Domestic	Millions	7.20	7.89	6.90	7.41	7.60	7.00	6.90	6.80	6.70	6.70
Foreign	Millions	3.12	3.11	2.82	3.05	2.97	2.90	2.85	2.70	2.60	2.60
INCOME AND SAVING											
Nominal personal income	Percent change	7.3	8.7	13.2	7.3	6.3	6.4	7.7	6.2	5.5	6.5
Real disposable income	Percent change	5.6	4.1	7.7	-.9	1.4	1.3	2.7	.6	-.2	1.0
Personal saving rate	Percent*	4.2	4.3	5.7	4.8	4.6	4.5	4.8	6.7	4.4	4.4
Corp. profits with IVA & CCAdj	Percent change	4.4	13.9	-10.6	-3.6	.2	-12.6	-19.3	-15.2	-2.1	-6.0
Profit share of GNP	Percent*	6.7	6.8	6.5	6.3	6.2	5.9	5.5	5.2	5.1	5.0
Federal govt. surplus/deficit	Billions of \$	-123.5	-157.5	-146.1	-131.4	-130.2	-128.0	-124.5	-121.8	-110.6	-105.7
State and local govt. surplus		56.0	52.6	50.6	55.2	58.4	59.5	61.8	62.0	64.3	66.9
Exc. social insurance funds		-13.3	-18.2	-21.9	-18.2	-15.9	-15.6	-14.1	-14.7	-13.2	-11.4
PRICES AND COSTS											
GNP implicit deflator	Percent change	4.7	5.3	3.9	4.8	4.1	3.9	5.1	4.5	4.5	4.3
GNP fixed-weight price index		5.3	4.2	5.0	5.2	4.3	4.1	5.1	4.6	4.6	4.4
Cons. & fixed invest. prices		4.5	4.4	5.0	5.8	4.3	4.2	4.8	4.9	4.8	4.7
I		4.5	4.4	5.4	6.1	4.7	4.2	5.1	5.1	5.0	5.0
Ex. food and energy		4.0	4.9	5.1	5.0	5.1	5.4	5.6	5.6	5.4	5.4
Avg. business sector		2.0	1.0	.5	-.8	1.6	.5	.5	.4	.9	1.2
Output per hour		5.7	5.2	5.7	5.1	5.4	5.5	6.9	5.4	5.3	5.3
Compensation per hour		3.7	4.1	5.2	5.9	3.7	5.0	6.4	5.0	4.4	4.1
Unit labor costs											

* Not at an annual rate.

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

	Units	1982	1983	1984	1985	1986	1987	1988	1989	1990	Projection
EXPENDITURES											
Nominal GNP	Billions of \$	3166.0	3405.7	3772.2	4014.9	4240.3	4526.7	4864.3	5242.3	5551.6	
Real GNP	Billions of 82\$	3166.0	3279.1	3501.4	3618.7	3721.7	3847.0	3996.1	4119.9	4175.2	
Real GNP	Percent change*	-1.9	6.5	5.1	3.6	2.0	5.0	2.8	2.8	1.1	
Gross domestic product		-1.6	6.6	5.3	3.8	2.3	5.1	2.9	2.9	1.1	
Gross domestic purchases		-.8	8.4	6.4	4.3	2.4	4.4	2.2	2.3	.6	
Final sales		.3	3.7	4.7	4.6	2.5	3.0	3.9	2.6	1.5	
Private dom. final purchases		.8	7.7	5.6	4.6	2.8	2.4	3.9	2.2	1.1	
Personal consumption expend.		2.9	5.4	4.1	4.6	4.2	1.8	3.7	2.0	1.1	
Durables		9.0	14.7	10.8	7.0	11.5	-2.4	7.5	.7	-.5	
Nondurables		1.8	4.4	2.3	3.3	3.1	.6	1.9	1.6	.8	
Services		2.3	3.9	3.5	5.0	2.7	4.2	3.9	2.7	1.8	
Business fixed investment		-11.3	10.8	13.8	3.7	-7.3	8.8	5.7	6.2	1.2	
Producers' durable equipment		-12.5	20.9	14.9	4.6	-2.4	9.6	10.0	7.2	2.4	
Nonresidential structures		-9.1	-4.8	11.8	1.9	-17.4	6.7	-5.0	3.2	-2.4	
Residential structures		4.9	38.1	6.1	5.8	11.3	-3.5	2.0	-5.8	.3	
Exports		-13.8	5.8	5.9	-2.4	5.6	18.4	13.7	9.6	6.0	
Imports		-5.9	23.8	17.4	4.5	7.6	10.4	7.2	4.8	2.4	
Government purchases		3.8	-2.7	7.9	8.6	2.9	2.3	.4	1.5	.7	
Federal		8.2	-8.1	13.0	13.3	.0	2.1	-3.5	.0	-1.2	
Defense		8.8	5.1	6.5	7.1	4.8	6.0	-2.1	-4.9	-2.8	
State and local		.6	1.5	4.4	4.9	5.3	2.5	3.4	2.6	2.0	
Change in business inventories	Billions of 82\$	-24.5	-6.4	62.3	9.1	15.4	34.4	42.5	45.6	31.1	
Nonfarm	Billions of 82\$	-23.1	-.1	57.8	13.4	17.9	36.9	40.0	36.1	24.2	
Net exports	Billions of 82\$	26.3	-19.9	-84.0	-104.3	-137.5	-128.9	-100.2	-90.6	-76.7	
Nominal GNP	Percent change*	3.1	10.4	8.6	6.6	4.8	8.3	7.2	7.2	5.8	
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	89.6	90.2	94.5	97.5	99.5	102.3	106.0	109.0	110.0	
Unemployment rate	Percent	9.7	9.6	7.5	7.2	7.0	6.2	5.5	5.3	5.8	
Industrial production index	Percent change*	-7.7	14.3	6.6	1.7	1.0	5.8	5.0	1.9	1.0	
Capacity utilization rate-mfg.	Percent	70.3	73.9	80.5	80.1	79.7	81.1	83.5	84.0	82.3	
Housing Starts	Millions	1.06	1.71	1.77	1.74	1.81	1.63	1.49	1.44	1.41	
Auto sales	Millions	8.01	9.23	10.38	11.06	11.47	10.26	10.69	10.16	9.46	
Domestic	Millions	5.78	6.82	7.92	8.22	8.22	7.06	7.55	7.23	6.78	
Foreign	Millions	2.23	2.41	2.46	2.84	3.25	3.21	3.14	2.94	2.69	
INCOME AND SAVING											
Nominal personal income	Percent change*	5.3	7.8	8.4	6.6	5.9	8.5	7.0	8.3	6.5	
Real disposable income	Percent change*	1.0	5.1	4.3	2.7	3.4	3.0	3.6	2.3	1.0	
Personal saving rate	Percent	6.8	5.4	6.1	4.4	4.0	3.2	4.2	4.9	4.6	
Corp. profits with IVA & CCAdj	Percent change*	-19.1	70.1	7.4	9.2	.9	7.6	7.8	-6.8	-10.9	
Profit share of GNP	Percent	4.7	6.3	7.1	7.0	7.0	6.9	6.8	6.2	5.2	
Federal govt. surplus/deficit	Billions of \$	-145.9	-176.0	-169.6	-196.9	-205.6	-157.8	-142.3	-133.9	-115.7	
State and local govt. surplus		35.1	47.5	64.6	65.1	61.2	52.9	55.2	55.9	63.8	
Exc. social insurance funds		-1.7	4.4	19.8	13.8	5.0	-9.2	-13.3	-17.9	-13.3	
PRICES AND COSTS											
GNP implicit deflator	Percent change*	5.2	3.6	3.4	2.9	2.8	3.1	4.3	4.2	4.6	
GNP fixed-weight price index		5.0	3.9	3.7	3.3	2.7	4.0	4.5	4.7	4.7	
Cons. & fixed invest. prices		4.4	3.3	3.3	3.4	2.5	4.7	4.1	4.8	4.8	
CPI		4.4	3.2	4.2	3.5	1.3	4.4	4.3	5.1	5.1	
Exc. food and energy		5.2	4.2	5.0	4.3	3.9	4.2	4.6	5.1	5.5	
Nonfarm business sector		1.0	3.6	1.5	1.5	1.2	1.9	1.0	.5	.7	
Output per hour		7.3	3.3	4.2	4.5	4.2	4.1	4.7	5.5	5.7	
Compensation per hour		6.2	-.3	2.6	2.9	3.0	2.1	3.6	5.0	4.9	
Unit labor costs											

* Percent changes are from fourth quarter to fourth quarter.

CONFIDENTIAL - FR
CLASS II FOMC

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

	Projection												Projection			
	1988		1989				1990				1987	1988	1989	1990	(fourth quarter to fourth quarter, net change)	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4						
Real GNP	24.2	24.0	54.8	23.0	20.5	16.5	12.6	6.6	10.6	16.4	188.3	110.4	114.9	46.2		
Gross domestic product	20.0	22.6	56.7	23.2	19.5	15.6	13.0	7.6	9.6	15.1	188.3	113.3	115.0	45.3		
Gross domestic purchases	25.5	35.5	45.0	20.5	16.0	13.1	11.6	4.1	3.6	8.1	171.9	89.8	94.6	27.5		
Final sales	20.0	34.5	30.1	28.3	28.2	17.8	14.5	11.5	14.7	19.2	110.7	148.5	104.5	59.9		
Private dom. final purchases	31.6	24.0	18.1	22.1	20.3	11.8	12.2	7.8	6.7	9.2	76.2	125.0	72.2	35.9		
Personal consumption expend.	24.8	22.4	8.6	19.9	15.6	9.3	10.8	5.9	5.2	7.3	45.5	94.5	53.4	29.3		
Durables	-.2	6.1	-3.4	7.4	2.6	-3.7	-.2	-1.6	-1.4	1.0	-9.7	28.9	2.8	-2.3		
Nondurables	10.9	2.9	4.4	2.5	3.9	4.1	2.8	1.8	1.6	1.6	5.2	16.9	14.9	7.8		
Services	14.1	13.3	7.7	10.0	9.1	8.9	8.3	5.7	5.0	4.7	50.0	48.6	35.8	23.7		
Business fixed investment	4.8	-3.6	11.4	8.1	6.9	3.8	2.5	2.0	1.1	.6	37.5	26.6	30.2	6.2		
Producers' durable equipment	4.1	-3.3	9.0	6.9	6.0	4.3	3.2	2.6	2.0	1.5	29.2	33.2	26.2	9.3		
Nonresidential structures	.8	-.3	2.4	1.2	.9	-.5	-.7	-.7	-.9	-.9	8.3	-6.6	4.1	-3.1		
Residential structures	2.0	5.0	-1.8	-5.9	-2.2	-1.4	-1.2	-.1	.5	1.3	-7.0	3.9	-11.3	.5		
Change in business inventories	4.2	-10.4	24.7	-5.4	-7.7	-1.3	-1.9	-4.9	-4.1	-2.8	77.6	-38.0	10.3	-13.7		
Nonfarm	10.3	-2.8	3.5	-2.0	-8.1	2.1	-2.0	-5.3	-4.4	-3.1	67.0	-30.6	-4.5	-14.8		
Farm	-6.1	-7.7	21.1	-3.3	.4	-3.4	.1	.4	.3	.3	10.6	-7.4	14.8	1.1		
Net exports	-1.3	-11.5	9.8	2.6	4.5	3.5	1.0	2.5	6.9	8.3	16.4	20.6	20.3	18.7		
Exports	17.1	8.1	13.3	18.1	8.8	10.1	7.4	6.3	8.8	11.9	71.4	62.9	50.4	34.4		
Imports	18.4	19.5	3.6	15.6	4.4	6.6	6.4	3.8	1.9	3.6	55.0	42.2	30.1	15.8		
Government purchases	-10.3	22.0	2.2	3.7	3.4	2.6	1.3	1.3	1.0	1.7	18.1	2.9	12.0	5.3		
Federal	-11.5	15.4	-2.3	1.1	.9	.3	-1.0	-1.1	-1.3	-.6	7.2	-12.2	.1	-4.0		
Defense	-7.2	6.1	-6.6	-2.0	-1.1	-3.2	-1.8	-1.7	-1.9	-1.6	15.1	-5.7	-12.9	-7.0		
Nondefense	-4.2	9.2	4.4	3.1	2.0	3.5	.8	.6	.6	1.0	-7.9	-6.6	13.1	3.0		
State and local	1.2	6.6	4.5	2.6	2.5	2.3	2.3	2.4	2.3	2.3	10.9	15.1	11.9	9.3		

May 10, 1989

FEDERAL SECTOR ACCOUNTS
(Billions of dollars)

	Fiscal Year 1989p				FY1990p				1988 IVA	FRB Staff Projection				
	Admin	CBO	FRB Staff	Admin	CBO	FRB Staff	I	II	III	IV	I	II	III	IV
BUDGET														
Budget receipts	909	979.	983	992	1066	1069	1077	222	220	305	245	235	251	325
Budget outlays	1064	1143	1142	1140	1157	1215	1189	289	280	290	280	299	298	301
Surplus/deficit (-) to be financed (On-budget)	-155	-164	-159	-148	-91	-146	-112	-68	-61	15	-35	-63	-47	24
(Off-budget)	-194	-220	-215	-203	-162	-214	-177	-73	-77	-6	-47	-73	-66	2
	39	56	56	55	69	68	66	6	16	21	12	9	19	22
Means of financing:														
Borrowing	162	n.a.	n.a.	129	n.a.	n.a.	111	54	38	11	26	51	31	3
Cash decrease	-8	n.a.	n.a.	10	n.a.	n.a.	-6	11	19	-20	0	16	3	-20
Other	1	n.a.	n.a.	9	n.a.	n.a.	7	3	4	-7	9	-4	12	-7
Cash operating balance, end of period	44	n.a.	n.a.	34	n.a.	n.a.	40	34	15	34	34	18	15	35
NIPA FEDERAL SECTOR														
Receipts	964	n.a.	1037	1039	n.a.	1133	1128	992	1030	1059	1074	1090	1123	1139
Expenditures	1107	n.a.	1177	1180	n.a.	1255	1249	1149	1176	1191	1205	1218	1248	1261
Purchases	380	n.a.	395	399	n.a.	416	412	396	395	402	404	406	413	415
Defense	298	n.a.	302	300	n.a.	311	301	302	299	300	300	298	302	301
Nondefense	82	n.a.	93	99	n.a.	105	112	94	96	102	104	108	111	113
Other expend.	727	n.a.	782	781	n.a.	839	837	753	781	789	800	812	835	846
Surplus/deficit	-143	n.a.	-140	-141	n.a.	-122	-121	-158	-146	-131	-130	-128	-125	-122
FISCAL INDICATORS														
High-employment (HEB) surplus/deficit (-)	-151	n.a.	n.a.	-162	n.a.	n.a.	-129	-170	-170	-155	-152	-146	-138	-126
Change in HEB, percent of potential GNP	.2	n.a.	n.a.	.2	n.a.	n.a.	-.6	.7	0	-.3	-.1	-.1	-.2	-.2
Fiscal impetus measure (FI), percent	.3 *	n.a.	n.a.	-4.1 *	n.a.	n.a.	-6.7 *	1.7	-2.5	-.4	-.4	-2.9	-3.7	-.4

a--actual

p--projection

*--calendar year

n.a.--not available

Notes:

- The Administration figures are the proposals in Building a Better America (February 9, 1989), with a minor revision from the Budget Director's testimony. The bipartisan agreement for FY1990 projects receipts of \$1066 billion, outlays of \$1165 billion, and a deficit of \$99 billion.
- The CBO figures are baseline budget estimates from An Analysis of President Reagan's Budgetary Proposals for Fiscal Year 1990 (February 1989).
- Budget receipts, outlays, and surplus/deficit include social security (OASDI) receipts, outlays and surplus, respectively. The OASDI surplus is excluded from the "on-budget" deficit and shown separately as "off-budget", as classified under current law.
- Other means of financing are checks issued less checks paid, accrued items and changes in other financial assets and liabilities.
- HEB is the NIPA measure in current dollars with cyclically-sensitive receipts and outlays adjusted to a 6 percent unemployment rate. Quarterly figures for change in HEB and FI are not at annual rates. Change in HEB, as a percent of nominal potential GNP, is reversed in sign. FI is the weighted difference of discretionary federal spending and tax changes (in 1982 dollars), scaled by real federal purchases. For change in HEB and FI, (-) indicates restraint.
- Details may not add to total due to rounding.

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

	ANNUAL			1988		1989				1990			
	1988-	1989-P	1990-P	Q3-	Q4-	Q1	Q2-P	Q3-P	Q4-P	Q1-P	Q2-P	Q3-P	Q4-P
1. GNP Exports and Imports 1/													
Current \$, Net	-94.7	-90.5	-80.8	-80.0	-96.1	-90.5	-94.8	-90.2	-86.6	-85.9	-85.4	-79.8	-72.2
Exports of G+G	519.8	597.7	653.7	536.1	548.0	570.3	593.9	606.3	620.1	632.9	644.3	659.3	678.2
Imports of G+G	614.4	688.2	734.5	616.0	644.0	660.8	688.7	696.6	706.7	718.8	729.7	739.1	750.3
Constant 82 \$, Net	-100.2	-90.6	-76.7	-93.9	-105.4	-95.6	-93.0	-88.5	-85.1	-84.1	-81.7	-74.7	-66.4
Exports of G+G	504.8	555.9	592.0	514.0	522.1	535.4	553.5	562.4	572.5	579.8	586.1	595.0	606.9
Imports of G+G	605.0	646.5	668.7	607.9	627.4	631.0	646.6	650.9	657.5	664.0	667.8	669.7	673.3
2. Merchandise Trade Balance 2/	-126.5	-127.6	-123.7	-116.7	-128.1	-124.7 ^P	-130.7	-128.5	-126.5	-126.2	-126.3	-123.4	-118.9
Exports	319.9	361.2	390.2	326.7	334.6	348.3 ^f	361.3	364.4	370.9	377.4	384.3	393.4	405.5
Agricultural	38.3	43.7	47.3	40.9	38.4	42.6 ^f	45.4	42.7	44.1	45.3	46.5	47.9	49.6
Non-Agricultural	281.6	317.5	342.8	285.8	296.2	305.7 ^f	315.9	321.7	326.8	332.1	337.8	345.5	355.9
Imports	446.4	488.8	513.9	443.4	462.7	473.0 ^f	492.0	493.0	497.4	503.7	510.5	516.8	524.4
Petroleum and Products	39.3	47.6	48.2	39.4	36.9	42.8 ^f	53.5	47.8	46.5	47.4	48.0	48.3	49.3
Non-Petroleum	407.1	441.2	465.6	404.0	425.7	430.2 ^f	438.5	445.2	450.9	456.3	462.5	468.5	475.2
3. Other Current Account Transactions													
Capital Gains and Losses 3/	-2.3	-2.0	2.6	-12.0	11.3	-4.2 ^f	-3.7	-0.0	-0.0	2.6	2.6	2.6	2.6
Other D.I. Income, Net	33.2	34.5	38.9	36.6	37.4	32.7 ^f	32.9	35.2	37.2	37.3	37.0	39.3	41.9
Portfolio Income, Net	-28.3	-34.3	-46.6	-29.6	-30.0	-30.5 ^f	-32.6	-35.3	-38.7	-41.9	-45.1	-48.3	-51.1
Other Current Account, Net	-11.4	-10.3	-6.6	-8.8	-18.4	-11.4 ^f	-9.7	-8.8	-11.6	-7.9	-6.2	-5.3	-7.2
4. U.S. Current Account Balance													
Including Capital G/L	-135.3	-139.7	-135.5	-130.4	-127.6	-138.1 ^f	-143.6	-137.5	-139.6	-136.1	-138.1	-135.0	-132.8
Excluding Capital G/L	-133.1	-137.7	-138.1	-118.5	-139.0	-133.9 ^f	-140.0	-137.5	-139.6	-138.7	-140.7	-137.6	-135.4
5. Foreign Outlook 4/													
Real GNP--Ten Industrial 5/	3.8	2.8	2.5	4.5	2.3	3.1	2.9	2.6	2.4	2.3	2.3	2.6	2.7
Real GNP--NonOPEC LDC 6/	3.9	3.5	3.7	3.7	3.6	3.5	3.4	3.3	3.3	3.3	3.8	4.4	5.0
Consumer Prices--Ten Ind. 5/	2.6	3.9	3.4	2.5	3.8	4.2	5.4	3.0	3.2	3.0	4.5	2.4	2.9

1/ National Income and Product Account data.

2/ International accounts basis.

3/ The net of gains (+) or losses (-) on foreign-currency denominated assets due to their revaluation at current exchange rates and other valuation adjustments.

4/ Percent change, annual rates.

5/ Weighted by multilateral trade-weights of G-10 countries plus Switzerland; prices are not seasonally adjusted.

6/ Weighted by share in NonOPEC LDC GNP.

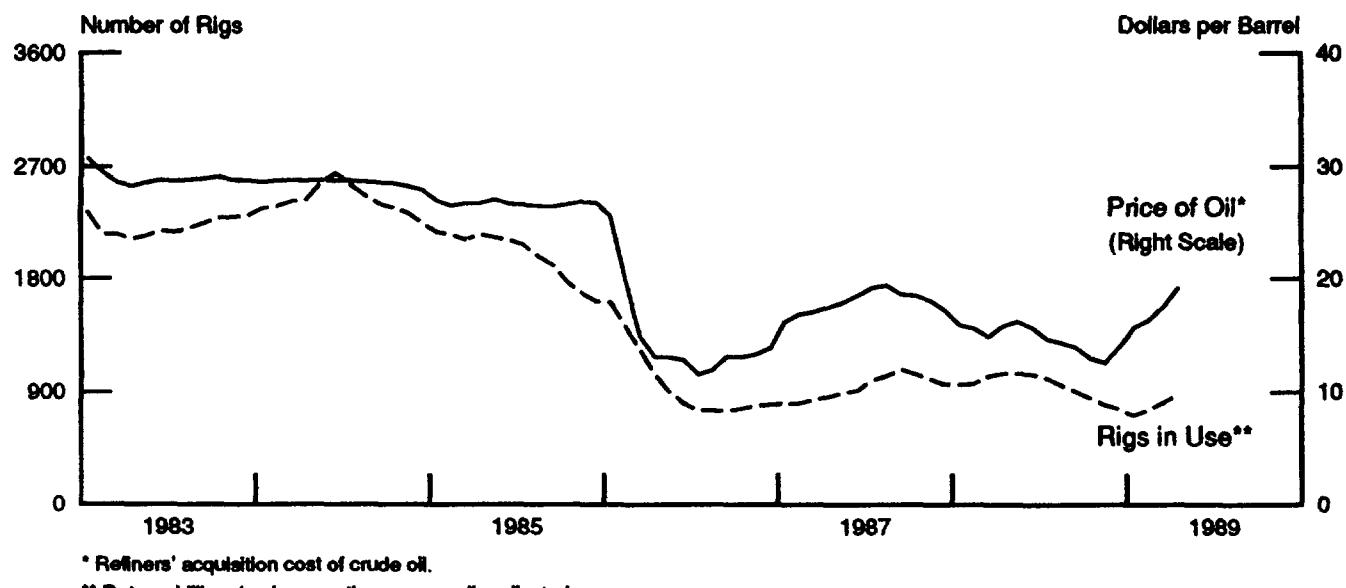
P/ Projected

May 10, 1989

RECENT DEVELOPMENTS

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

The Price of Oil and Rigs in Use



* Refiners' acquisition cost of crude oil.

** Rotary drilling rigs in operation, seasonally adjusted.

SURVEYS OF PLANT AND EQUIPMENT EXPENDITURES (Percent change from previous year, current dollars)

	1988 ¹	Planned for 1989	
		Commerce (Oct.-Nov.)	Commerce (Jan.-Mar.)
All business	10.3	6.0	9.1
Manufacturing	13.6	4.3	7.8
Durable	10.0	2.0	5.8
Nondurables	17.0	6.4	9.6
Nonmanufacturing	8.3	7.0	9.9
 Memo: ²			
Mean error		-.4	.4
Mean absolute error		2.6	2.9

1. As estimated in the January-March Commerce Department Survey.

2. Estimated from 1970 to the present.

strengthened tax enforcement would yield a further \$0.5 billion. Taken together with the spending constraints, the plan calls for \$28 billion of deficit reduction, measured from the CBO baseline.

Within the broad outlines of the bipartisan agreement, the Senate and the House each have passed budget resolutions that ratify the levels of spending for defense and international affairs, distribute domestic spending across the other budget functions, and incorporate the planned increases in revenues. The domestic spending priorities reflected in these resolutions are indicated in table 3 by the pattern of small changes in domestic discretionary spending from baseline levels. Both houses aim to raise spending on science and to hold spending increases for such broad areas as energy, resource management, transportation, and community development below the rate of inflation. The House assigns higher priority to education, while the Senate would put greater emphasis on criminal justice. Both resolutions contain reconciliation instructions, directing other committees of the Congress to formulate legislation that would reduce costs of farm price supports and Medicare and raise user fees and general revenue.

Table 1

BUDGET PLANS FOR FY90
(Billions of dollars)

	Bush plan (Feb. 9)	Bipartisan agreement (OMB est.)	CBO estimates	
			Bipartisan agreement	Change from baseline ¹
Receipts	1065.6	1065.7	1074.4	+5.8
Outlays, total¹	1156.7	1168.7	1193.8	-22.2
Defense	300.3	299.2	299.2	-4.2
International	17.2	16.7 ²	16.7 ²	.0
Interest	173.3	173.2	181.0	-1.1
All other	665.9	679.6	696.9	-16.9
Deficit, before adj.	-91.1	-103.0	-119.4	+28.0
less: estimating adjustments	n.a.	3.5		
Deficit	<u>-91.4</u>	<u>-99.4</u>		
Memo:				
Deficit, ex. asset sales	-94.8	-105.1		

n.a.--not applicable.

1. With asset sales.
2. Includes estimated effects of loan repayments; discretionary component of spending specified in agreement is \$17.0 billion.

Passage of a single resolution by both houses of the Congress--once a conference compromises the differences--will set the stage for enactment of regular appropriation bills and of a reconciliation bill that will implement aspects of the budget agreement. Achievement of an agreement at this time is permitting the budget process to proceed more expeditiously than has been the case in a number of recent years. However, several hurdles remain before the intended deficit reduction is actually achieved and the budget process for FY90 is completed. First, appropriations must be held within bounds if budget targets are to be realized. The Congress has given some recent indication of being serious about budget restraint by sending back to committee a costly supplemental appropriation bill for FY89. Second, agreement must be achieved on specific measures to meet the objective of raising \$5.3 billion of additional revenue. Third, specific steps must be legislated to reduce entitlement spending and other types of outlays.

These steps may vary considerably in their economic consequences. Putting the Postal Service off-budget is one action planned in the agreement that will have no fundamental economic effect (and will not change the NIPA accounts). Some reports have suggested that a significant proportion of the remaining spending constraint also could be implemented by changes in timing or accounting that would have little fundamental or lasting economic effect;

Table 2

COMPOSITION OF FY90 DEFICIT REDUCTION
 (Deficit effect compared with CBO baseline, billions of dollars)

<u>Outlay reductions from baseline</u>	
Defense	4.2
International affairs	.0
Interest	1.1
Entitlements and mandatory spending (gross)	
Medicare	2.7
Agriculture	1.9
Pension and miscellaneous reforms	.7
Other entitlements	1.1
Discretionary programs (gross)	.3
User fees and offsetting collections	2.7
Asset sales	5.7
Postal service off-budget	1.8
Subtotal, outlays	22.2
 <u>Revenue measures and improved collections</u>	 5.8
 <u>Total deficit reduction</u>	 28.0

however, the exact nature of these measures will remain uncertain until the legislative process is further advanced.

The bipartisan agreement specifies that \$5.7 billion of deficit reduction is to be achieved by further sales of assets; these sales, which have tended to fall short of plans in the past, are a one-time deficit reduction that does not count toward achieving Gramm-Rudman deficit targets. Thus, the deficit foreseen in the current budget compromise, calculated on a Gramm-Rudman accounting basis, is about \$105 billion. This estimate implies only a \$5 billion margin for error in achieving legislative goals for budget restraint--or for any upward reestimates in the August sequester report--if the \$110 billion trigger for sequester is to be avoided.

On balance, the bipartisan agreement seems likely to provide a small amount of additional fiscal restraint in 1990. (Some restraint already had been set in place by the lagged effects of previous declines in real defense

Table 3

FY90 DOMESTIC SPENDING PRIORITIES¹
(Discretionary spending, billions of dollars)

	<u>Change from CBO baseline</u>	
	<u>Senate</u>	<u>House</u>
Science	+ .4	+ .6
Energy, natural resources, and agriculture (excluding entitlements)	- .6	- .7
Commerce, transportation, and community development	- .3	- .2
Education, health, income security, and veterans (all excluding entitlements)	+ .1	+ .7
Justice and general government	<u>+ .2</u>	<u>- .5</u>
Total	<u>- .3</u>	<u>- .3</u>

Memo:

	<u>FY89</u>	<u>FY90</u>
Level of budget authority for domestic discretionary programs	142.8	157.5
Level of outlays for these programs	170.2	181.3

1. Details may not add to totals because of rounding. Increases in budget authority considerably exceed changes in outlays provided for transportation, education, health, and justice in the Senate, and for education, health, and income security in the House.

TREASURY AND AGENCY FINANCING¹
(Total for period; billions of dollars)

	1989				
	Q1	Q2 ^e	Apr. ^P	May ^e	June ^e
<u>Treasury financing</u>					
Total surplus/deficit (-)	-60.8	15.3	30.6	-17.4	2.1
Means of financing deficit:					
Net cash borrowing from the public	37.9	8.9	-1.8	8.0	2.7
Marketable borrowings/ repayments (-)	32.0	6.9	-2.6	7.4	2.1
Bills	3.0	-17.3	-7.0	-4.1	-6.2
Coupons	29.0	24.2	4.4	11.5	8.3
Nonmarketable	6.0	2.0	.8	.6	.6
Other borrowing ²	-.2	.0	.0	.0	.0
Decrease in the cash balance	19.0	-17.8	-38.9	26.3	-5.2
Memo: Cash balance at end of period	14.7	32.4	53.5	27.2	32.4
Other ³	4.0	-6.4	10.1	-16.9	.4
<u>Federally sponsored credit agencies, net cash borrowing</u>					
	13.5 ^P	-	-	-	-
FHLBs	14.1	-	4.2 ^P	-	-
FNMA	-.8	-	-	-	-
Farm Credit Banks	-1.1	-	-.4 ^P	-	-
FAC ⁴	.0	-	.2	-	-
FHLMC	-1.1 ^P	-	-	-	-
FICO	.6	-	.5	-	-
SLMA	1.7	-	-	-	-

- 1. Data reported on a not seasonally adjusted, payment basis.
- 2. Securities issued by federal agencies under special financing authorities (primarily FSLIC).
- 3. Includes checks issued less checks paid, accrued items and other transactions.
- 4. Excludes mortgage pass-through securities issued by FNMA and FHLMC.
- 5. Financial Assistance Corporation, an institution within Farm Credit System, was created in January 1988 by Congress to provide financial assistance to Farm Credit Banks. It first issued bonds in July 1988.

e--staff estimate.

p--preliminary.

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

CONFIDENTIAL (FR)
CLASS III - FOMC

May 12, 1989

SUPPLEMENT

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff
Board of Governors
of the Federal Reserve System

BUDGET PLANS FOR FY90
(Billions of dollars)

	Bush plan (Feb. 9)	Bipartisan agreement (OMB est.)	CBO estimates	
			Bipartisan agreement	Change from baseline
Receipts	1065.6	1065.7	1074.4	+5.8
Outlays, total¹	1156.7	1168.7	1193.8	-22.2
Defense	300.3	299.2	299.2	-4.2
International	17.2	16.7 ²	16.7 ²	.0
Interest	173.3	173.2	181.0	-1.1
All other	<u>665.9</u>	<u>679.6</u>	<u>696.9</u>	<u>-16.9</u>
Deficit, before adj.	-91.1	-103.0	-119.4	+28.0
less: estimating adjustments ³	n.a.	3.5	19.9	n.a.
Deficit	<u>-91.4</u>	<u>-99.4</u>	<u>-99.4</u>	n.a.
Memo:				
Deficit, ex. asset sales	-94.8	-105.1	105.1	n.a.

n.a.--not applicable.

1. With asset sales.

2. Includes estimated effects of loan repayments; discretionary component of spending specified in agreement is \$17.0 billion.

3. As shown in the document releasing the agreement, the accepted deficit is the OMB estimate lowered by \$3.5 billion to incorporate slower defense spend-out rates; the net difference between this estimate and one using CBO's economic and technical assumptions is shown to be \$19.9 billion.

GRAMM-RUDMAN-HOLLINGS DEFICIT TARGETS AND PROCEDURES

A. Fiscal Year Targets

	1986	1987	1988	1989	1990	1991	1992	1993
----- Billions of dollars -----								
Original target ¹	172	144	108	72	36	0	n.a.	n.a.
Amended law ²	n.a.	n.a.	144	136	100	64	28	0
Actual deficit	212	221	150	155	n.a.	n.a.	n.a.	n.a.

B. FY1990 Budget Procedures

- July 15: Office of Management and Budget issues its Mid-session Review of the FY1990 Budget, with new outlay and revenue estimates for FY1989 and the FY90-FY94 period. The updated economic and technical assumptions in this report will be used for subsequent OMB Gramm-Rudman reports.
- August 20: Congressional Budget Office issues an "advisory" report with updated budget estimates. The report is designed to provide a benchmark with which Congress and others may assess the forthcoming OMB compliance report.
- August 25: OMB issues an initial compliance report stating whether or not the FY1990 deficit will exceed \$110 billion (the \$100 billion target plus a \$10 billion margin for error). The budget estimate uses the economic and technical assumptions from the Mid-session Review, legislation enacted by August 15, and other special G-R-H rules. If it appears that the deficit limit is exceeded, then an initial sequestration order is also issued. The order specifies the across-the-board cuts in authority needed to reduce the deficit to the \$100 billion target. Congress has until October 10 to pass legislation that would reduce the deficit without a sequestration.
- October 10: CBO issues a revised advisory report.
- October 15: OMB issues a revised G-R-H compliance report taking account of legislation enacted through October 15. The economic and technical assumptions may not be changed. The final order canceling budgetary resources is issued, if the deficit exceeds the \$110 billion trigger.

-
1. The law allowed a \$10 billion "margin for error" in every year except 1991.
 2. The law allows a \$10 billion "margin for error" in every year except 1993.