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Class II FOMC - Restricted (FR)

Part 1

April 28, 2005

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

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Domestic Developments

The economic reports that we have received over the past six weeks have been decidedly softer than we had expected. After increasing moderately, on net, in January and February, most indicators of economic activity slowed substantially in March: Payroll gains were modest, manufacturing output edged down, orders and shipments of capital goods posted a second month of decline, and both homebuilding and real retail sales of goods other than motor vehicles contracted.

The weakness in March might prove to be temporary—the result of the inherent noisiness of economic data. Yet the widespread nature of the slowing suggests that the recent softness in the data should not be readily dismissed. Higher energy prices and the tightening of monetary policy may be taking a greater toll on domestic demand than we had anticipated. Lacking much information on economic activity early in the second quarter that could help identify whether the slowdown will prove to be temporary or persistent, we have taken on board the data for March and tempered our projection for the pace of economic activity in the near term. However, we still believe that the economy has considerable momentum behind it, and after the slowdown in the first quarter to an annual growth rate of 3 percent, we are projecting real GDP to rise at an average annual rate of 3¾ percent for the remainder of this year.

Financial markets have reacted to the recent string of downbeat readings on the economy by reducing the amount of monetary tightening that is expected over the next few years. We, too, have trimmed a bit from our projected path for the federal funds rate. Equity prices also are lower in this forecast, and we have incorporated a higher foreign exchange value of the dollar and a higher level of oil prices beyond the near term. Given these influences, we expect real GDP growth to slow to 3½ percent in 2006. Although real output is projected to rise, on average, a bit above the pace of its potential, the unemployment rate is projected to hold at 5¼ percent as the persistent improvement in job prospects lures more workers back into the labor force.

The incoming news on inflation has been mildly disappointing. Although the latest data on core PCE prices have come in just a touch above our earlier expectations, sizable unforeseen increases in energy and import costs have led us to mark up slightly our projection of inflation going forward. Nonetheless, we continue to expect core consumer price inflation to moderate next year as energy prices decline and import prices nearly flatten out. Core PCE prices are projected to increase 1.9 percent this year and 1.7 percent in 2006.

Key Background Factors

As noted above, our forecast incorporates a federal funds rate path that is lower than in the March Greenbook: We have shaved ¼ percentage point from our funds rate assumption starting in the fourth quarter of this year. According to futures quotes, financial market participants have scaled back their expected policy tightening by a similar amount, which leaves the staff's assumed path for the funds rate only slightly below the market's. Reflecting the revision to the market's outlook, long-term Treasury yields have fallen about 30 basis points since the March Greenbook. However, with the back-up in corporate bond spreads, yields on BAA corporate bonds have declined only about 10 basis points. We have revised down the initial levels of both corporate and Treasury rates accordingly, and, as in previous Greenbooks, we assume that long-term rates will remain close to their current levels over the forecast period.

Concerns about the strength of economic activity have also weighed on broad equity price indexes, which currently stand about 4 percent below the level we had assumed in the last Greenbook. We have shifted down our starting level for stock prices by this amount, but we continue to assume that prices will increase at a 6½ percent pace going forward, a rate roughly consistent with risk-adjusted parity with the yield on long-term Treasury securities. As in the last Greenbook, we expect house price increases to slow; after a gain of 11¼ percent in 2004, the OFHEO repeat-transactions index is projected to rise 5¼ percent this year and 3½ percent in 2006.

Our fiscal assumptions are also unchanged from the March Greenbook. After having generated a sizable stimulus to real GDP growth in recent years, fiscal policy is expected to provide a more modest impetus to growth this year as the lagged effects from previous tax cuts wane. Next year, the influence of the tax cuts is expected to fade further, and increases in real defense spending are likely to be smaller than in recent years. However, we expect that the introduction of the Medicare drug benefit will largely offset these factors and that the overall fiscal boost to growth will be about the same as this year's. We project the unified federal budget deficit to be $370 billion in fiscal years 2005 and 2006, roughly the same as in the March Greenbook. Final tax payments and refunds have been coming in quite close to our expectations and thus have had little influence on the fiscal outlook.

The foreign exchange value of the dollar has risen since the March Greenbook, and we have raised our assumption for the level of the real trade-weighted dollar in the current quarter nearly 2 percent. We continue to assume that the value of the dollar will edge down over the forecast period at an annual rate of about 1½ percent. Our outlook for foreign economic activity is little changed since March. We are looking for foreign GDP growth of about 3¼ percent in 2005 and 2006.

The spot price of West Texas intermediate (WTI) crude oil moved above $57 per barrel earlier this month but has since fallen back to below $52 per barrel, somewhat lower than its level at the time of the March Greenbook. The decline in spot prices primarily reflects higher crude oil inventories that have resulted from solid OPEC production. In contrast, prices of futures contracts for delivery late this year and next year have moved up since mid-March, and our longer-term oil price forecast has risen with them. We now project the spot price of WTI to increase somewhat during the summer driving season and then to edge back down to near current levels by the end of 2006. Thus, the downward-sloping path for crude oil prices that has been a feature of our projection for many months has been replaced by a much flatter trajectory.

Recent Developments and the Near-Term Outlook

The BEA estimates that real GDP increased at a 3 percent annual rate in the first quarter—down from the 4 percent pace of the second half of last year. As noted above, most signals of activity flagged in March, and we have carried some of the weakness into the second quarter. We are now projecting that real GDP will rise at an annual rate of 3½ percent in the second quarter, down ½ percentage point from the March Greenbook.

After a sizable gain in February, private nonfarm payroll employment rose just 101,000 in March. Still, for the first quarter as a whole, private payrolls increased at an average monthly rate of 142,000—about the same pace as in the second half of last year—and the unemployment rate moved lower. In mid-April, a decline in the four-week moving average of initial claims for unemployment insurance reversed about half of March's steep run-up, and we project modest further improvement in private payrolls, with job gains of 175,000 per month in the current quarter.

Manufacturing-sector IP edged down 0.1 percent in March as the production of motor vehicles plunged and output gains in other industries were lackluster. We are anticipating only a modest rebound in April: Motor vehicle assemblies appear to have fallen again this month, regional surveys of purchasing managers in the manufacturing sector have been mixed, and the recent data on durable goods orders were not encouraging. For the second quarter as a whole, we are forecasting manufacturing IP to increase at an annual rate of 2½ percent, down from 3½ percent in the first quarter.

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

Measure	2005:Q1		2005:Q2	
	Mar. GB	Apr. GB	Mar. GB	Apr. GB
Real GDP	**4.3**	**3.1**	**4.1**	**3.6**
Private domestic final purchases	4.2	3.8	4.8	3.7
Personal consumption expenditures	3.9	3.5	3.9	3.2
Residential investment	6.3	5.7	5.8	3.6
Business fixed investment	4.8	4.7	10.4	7.2
Government outlays for consumption and investment	3.3	.6	2.6	4.0
	Contribution to growth (percentage points)			
Inventory investment	.7	1.0	-1.1	-.9
Net exports	-.6	-1.3	.6	.6

According to the advance estimate from the BEA, real consumer outlays rose at an annual rate of about 3½ percent in the first quarter, a considerably slower pace than in the preceding two quarters. Motor vehicle purchases dropped sharply last quarter, and increases in sales in the retail control category slowed from their heady pace around the turn of the year. Despite the first-quarter slowing, we continue to believe that the fundamentals are consistent with solid, though not spectacular, increases in consumer outlays. Although consumer confidence has slipped recently, real disposable income has increased 3 percent over the past four quarters. What little evidence we have for second-quarter spending is consistent with this projection: Carmakers report that they are on pace to record a robust sales figure in April.

Although residential investment spending rose at an annual rate of 5¾ percent in the first quarter, single-family housing starts dropped off sharply in March to an annual rate of 1.54 million units. However, both permit issuance and new home sales in March point to a rebound in starts in April. For the second quarter, we have penciled in starts at a rate of 1.64 million units. Although this figure is below the first-quarter pace, it still exceeds the robust 1.61 million units started last year. Real spending on residential investment is expected to increase about 3½ percent at an annual rate in the current quarter.

In the business sector, real expenditures on equipment and software increased at an annual rate of 7 percent in the first quarter, less than half the pace of 2004. The step-down in the growth rate of spending mainly reflected a decline in business purchases of transportation equipment. Excluding this volatile category, the increase in outlays was roughly unchanged from last year's robust pace. In the current quarter, we look for only a modest rebound. Although motor vehicle sales are expected to bounce back, orders of nondefense capital goods slid in both February and March. All told, we expect real E&S spending to increase about 8½ percent at an annual rate in the second quarter.

Real spending on nonresidential structures fell in the first quarter, reversing the fourth-quarter gain. Real outlays in the drilling and mining category, which surged last year along with the prices of oil and natural gas, declined in the first quarter; we expect sizable increases in drilling and mining expenditures to resume in the current quarter in response to the elevated level of energy prices. For other types of nonresidential structures, spending has continued to decline. All in all, we project real outlays to increase at an annual rate of 3¼ percent in the second quarter.

We are forecasting federal spending to rise at an annual rate of 8 percent in the second quarter after having recorded a negligible increase in the first quarter. The acceleration in the current quarter should bring the first-half average growth rate up above the pace in the second half of last year. This step-up, which we expect to be led by a surge in defense spending, is consistent with the higher payments to defense vendors that have been reported in recent Monthly and Daily Treasury Statements. In the state and local sector, spending edged up at an annual rate of ½ percent in the first quarter, as it had in the fourth quarter. Despite improvements in their fiscal positions, state and local governments have continued to increase expenditures only cautiously. We expect spending to begin to rise more rapidly in the current quarter and are forecasting an increase of 1¾ percent at an annual rate in the second quarter.

In the first quarter, imports rose swiftly, with purchases of consumer goods showing particular strength; exports posted a smaller gain. The decline in net exports subtracted about 1¼ percentage points from the growth of real GDP last quarter. In the current quarter, we expect import growth to cool while exports maintain solid growth, supported by the continuing effects of last year's dollar depreciation. As a result, net exports are projected to make a ½ percentage point positive contribution to GDP growth.

The BEA reports that nonfarm inventories rose $78 billion at an annual rate in the first quarter, much more than in the preceding quarter. We believe that at least part of this large accumulation was unintended, as firms were likely surprised, as we were, by the slowing in final sales growth. We do not expect a buildup of this size to be repeated, and we are looking for more-modest inventory investment in the current quarter.

The core PCE price index rose at an annual rate of 2¼ percent in the first quarter, a step-up from the average quarterly increase recorded in 2004. Core PCE prices jumped in January, but rose more moderately in February and, it appears, in March. We expect core inflation to move down to an annual rate of less than 2 percent in the second quarter. Overall PCE prices rose 2 percent in the first quarter, but they are projected to accelerate to 3¼ percent this quarter in response to the surge in energy prices in March and April.

The Longer-Run Outlook for the Economy

The unexpected slowing in economic activity in the first quarter and our reading of its implications for income and output over the remainder of the year have led us to mark down our forecast for the increase in real GDP in 2005 by about ½ percentage point. Although the interest rate assumptions underpinning our projection are less restrictive than in the March Greenbook, the positive effect of this revision on real activity has been overshadowed by the decline in the stock market, the appreciation of the dollar, and the absence of expected oil price declines. We now forecast that real GDP growth will slow from nearly 4 percent in 2004 to 3½ percent in 2005 and 2006.

Household spending. Our forecast calls for real consumer spending to rise at an annual rate of 3½ percent in both 2005 and 2006, a slower pace than during the preceding two years. The moderation primarily reflects the fading stimulus from earlier tax cuts as well as the limited stock market gains since last spring that followed the striking equity price run-up in the preceding twelve months. These factors outweigh the boost to consumption from real pre-tax income, which should rise smartly compared with the middling gains of the past couple of years. With consumption growth falling short of the increases in disposable personal income, the saving rate is projected to rise from ¼ percent in the first quarter of 2005 to 2¼ percent by the end of 2006.

Brisk gains in real disposable income, in concert with low mortgage rates, should support a high level of residential construction over the forecast period. We anticipate that builders will start construction on 1.65 million single-family homes this year, even more

Projections of Real GDP
(Percent change at annual rate from end of preceding period except as noted)

Measure	2005 H1	2005 H2	2006
Real GDP	**3.4**	**3.7**	**3.5**
Previous	4.2	3.8	3.6
Final sales	3.4	4.0	3.5
Previous	4.4	4.0	3.7
PCE	3.4	3.6	3.4
Previous	3.9	3.8	3.6
Residential investment	4.6	1.8	.4
Previous	6.0	-.7	.2
BFI	6.0	10.1	8.7
Previous	7.6	10.4	8.9
Government purchases	2.3	2.5	2.2
Previous	3.0	2.5	2.3
Exports	8.0	8.5	6.7
Previous	8.3	9.1	7.5
Imports	7.3	6.9	6.4
Previous	5.5	6.9	6.8
	Contribution to growth (percentage points)		
Inventory change	.0	-.2	.0
Previous	-.2	-.2	-.0
Net exports	-.3	-.2	-.3
Previous	.0	-.2	-.3

than the breakneck pace of 2004. Next year, we expect single-family starts to moderate only a touch, to 1.59 million units.

Business investment. After a few years of circumspect capital spending, businesses rapidly expanded their investment in 2004. Supported by rising sales, robust profits, and a favorable financial environment, real business spending on equipment and software is projected to increase 9½ percent in 2005 and 10 percent in 2006. We also expect business construction spending to rise at a decent clip this year as high energy prices drive up drilling and mining expenditures. Outlays for other types of structures, which have been flat for the past three years, should move up at a moderate pace over the next year and a half as the business-cycle recovery finally spills over to this sector.

After having rebuilt inventory stocks substantially in 2004 and added to the accumulation in the first quarter of this year, businesses no longer appear to have inventory positions that are too lean. Thus, nonfarm inventory investment should slow in the second half of this year to a rate consistent with the gradual decline in the ratio of stocks to sales that we expect to accompany continued improvements in inventory practices. We anticipate that this step-down will exert only a slight drag on real GDP growth this year. Next year, we expect inventory investment to be a neutral influence on growth.

Government spending. We project that real federal spending will rise 3½ percent this year, as another sizable increase in defense spending, in part reflecting procurement to replace equipment and materials used in Iraq, is tempered by a very small advance in nondefense expenditures. We expect the increase in federal spending to slow to 2 percent next year as Iraq-related expenditures level off. At the state and local level, the improving budget situation in many states should permit a modest pickup in government spending. After a meager increase in 2004, we expect outlays to increase 1½ percent in this sector in 2005 and 2½ percent in 2006.

Net exports. Supported by solid growth abroad and the effects of past and prospective dollar depreciation, real exports are expected to increase at an annual rate of 8½ percent in the second half of this year and 6¾ percent in 2006. Real imports are also expected to rise rapidly over the next year and a half, but at a slower rate than in 2004. As a consequence, the external sector, which exerted a sizable drag on GDP growth last year, holds down growth only ¼ percentage point this year and next. (*The International Developments section provides a more extensive discussion of the outlook for the external sector*.)

Aggregate Supply, the Labor Market, and Inflation

Our estimates of structural productivity and potential output are essentially unchanged from the March Greenbook. We expect structural labor productivity to rise about 3 percent per year over the forecast period and potential output to increase 3¼ percent. Because our forecast for actual output growth exceeds our assumed pace of potential output growth, the output gap narrows a bit over the projection period. However, by the

Decomposition of Structural Labor Productivity
(Percent change, Q4 to Q4, except as noted)

Measure	1974-95	1996-2001	2002	2003	2004	2005	2006
Structural labor productivity	**1.5**	**2.7**	**3.3**	**3.7**	**3.4**	**2.9**	**3.1**
Previous	1.5	2.7	3.3	3.7	3.4	2.9	3.0
Contributions[1]							
Capital deepening	.7	1.3	.6	.7	.8	1.0	1.1
Previous	.7	1.3	.6	.7	.8	1.0	1.1
Multifactor productivity	.5	1.1	2.4	2.8	2.4	1.7	1.7
Previous	.5	1.1	2.4	2.8	2.4	1.7	1.7
Labor composition	.3	.3	.3	.3	.3	.3	.2
MEMO							
Potential GDP	3.0	3.4	3.3	3.6	3.7	3.3	3.3
Previous	3.0	3.4	3.3	3.6	3.7	3.3	3.3

NOTE. Components may not sum to totals because of rounding. For multiyear periods, the percent change is the annual average from Q4 of the year preceding the first year shown to Q4 of the last year shown.
1. Percentage points.

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

Measure	2003	2004	2005	2006
Output per hour, nonfarm business	5.5	2.8	2.2	2.7
Previous	5.5	2.9	2.3	2.5
Nonfarm private payroll employment	-.1	1.8	1.7	1.3
Previous	-.1	1.8	2.1	1.6
Household survey employment	1.2	1.3	1.1	1.2
Previous	1.2	1.3	1.4	1.5
Labor force participation rate[1]	66.1	66.0	65.9	65.9
Previous	66.1	66.0	66.0	66.1
Civilian unemployment rate[1]	5.9	5.4	5.3	5.3
Previous	5.9	5.4	5.3	5.1
MEMO				
GDP gap[2]	1.4	1.3	1.0	.9
Previous	1.5	1.2	.5	.2

1. Percent, average for the fourth quarter
2. Percent difference between potential and actual GDP in the fourth quarter of the year indicated. A positive number indicates that the economy is operating below potential.

end of 2006, we expect the output gap to still be nearly 1 percent of GDP, noticeably above that in the March Greenbook.

Productivity and the labor market. We expect gains in payrolls to average about 170,000 per month this year and then to slow to 145,000 per month in 2006. We anticipate that this pace of job creation will be sufficient to absorb the flow both of new workers joining the labor force and of reentrants returning because of improved employment prospects. However, we do not expect the net job gains in this forecast to push the unemployment rate down below its current level of 5¼ percent.

Increases in productivity have slowed in recent quarters. We estimate that in the first quarter of this year, output per hour in the nonfarm business sector rose at just a 1¾ percent rate, slower than the pace of structural labor productivity growth. We believe actual productivity gains will continue to fall short of underlying structural productivity growth for a while, as firms relieve some of the pressure on their workers that has built up in recent years and as less-efficient workers and facilities become employed. By the second half of 2006, however, we look for actual and structural productivity to rise at roughly the same rate.

Prices and labor costs. The latest information on prices points to a slightly higher rate of underlying inflation than we had been assuming. The incoming data on core PCE prices have come in only a little above our expectations. Nonetheless, we have been surprised by the size of increases in nonfuel import prices and consumer energy prices; the latter recently moved up much more sharply than we had anticipated because of a jump in retail gasoline margins. We expect these cost shocks to pass through into core inflation to some extent. Taking all of these factors into account, we have marked up our projection for the increase in core PCE prices 0.1 percentage point in both 2005 and 2006.

Despite the upward revisions, the overall contour of the projection is similar to that of previous Greenbooks: The rise in the core PCE price index is expected to slow from nearly 2 percent this year to 1¾ percent in 2006. Although we estimate that the downward pressure on inflation from the underutilization of resources has abated some from recent years, we expect slack to exert a small but steady restraint on inflation through the end of the forecast period. Moreover, the pass-through of declining energy prices and less rapidly rising import prices should push inflation lower next year.

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

Measure	2003	2004	2005	2006
PCE chain-weighted price index	1.7	2.6	2.1	1.6
Previous	1.7	2.6	1.9	1.4
Food and beverages	2.7	2.9	1.9	2.1
Previous	2.7	2.9	2.1	2.0
Energy	7.2	18.5	4.5	-1.3
Previous	7.2	18.5	2.1	-2.0
Excluding food and energy	1.2	1.6	1.9	1.7
Previous	1.2	1.6	1.8	1.6
Consumer price index	1.9	3.4	2.5	1.8
Previous	1.9	3.4	2.1	1.7
Excluding food and energy	1.2	2.1	2.4	2.1
Previous	1.2	2.1	2.2	2.0
GDP chain-weighted price index	1.7	2.4	2.1	1.8
Previous	1.7	2.4	1.8	1.7
ECI for compensation of private industry workers[1]	4.0	3.8	4.5	4.6
Previous	4.0	3.8	4.4	4.5
NFB compensation per hour	5.3	4.3	4.4	4.7
Previous	5.3	4.2	4.3	4.6
Prices of core nonfuel imports	1.6	3.7	3.1	.6
Previous	1.6	3.7	2.2	.5

1. December to December.

The upward revision to our forecast of headline price inflation has led us to raise the increase in labor compensation as well. We now project that the employment cost index will increase 4.5 percent this year and 4.6 percent next year, up 0.1 percentage point in each year compared with our previous projection.

Financial Flows and Conditions

After having increased 8½ percent in 2004, domestic nonfinancial debt is projected to expand 7½ percent this year and 6½ percent in 2006. The projection calls for slower debt growth than last year for households and state and local governments, which more than offsets an uptick in the rate of business borrowing.

Household debt is expected to increase 8 percent this year and 7 percent next year, down from 11 percent last year. The moderation reflects a projected slowdown in mortgage borrowing as the pace of home-price appreciation slows. In contrast, we expect consumer debt to expand a bit faster than last year's rate as households rely less on home equity extraction to finance their spending.

Buoyed by a turnaround in short-term borrowing, nonfinancial business debt rose 5¾ percent last year, and we expect its pace to pick up a bit further this year. The projected acceleration of business debt mainly reflects the increased need to finance capital expenditures as profits level off; in addition, robust merger and acquisition activity provides some impetus to borrowing. Despite these drivers, demand for external finance is tempered in the forecast by the unusually large stock of liquid assets that firms have accumulated over the past few years.

Federal debt, which grew 9 percent last year, is expected to increase at an 8¼ percent pace through the end of 2006, a rate consistent with little change in the budget deficit. Because we expect state and local borrowing to be held down by reduced opportunities for advance refunding, we project debt growth in this sector to decline from last year's pace of 7½ percent to 5¼ percent this year and 3 percent in 2006.

After having expanded 5¼ percent in 2004, M2 is projected to increase only 2½ percent this year and 3½ percent during 2006. We look for money demand to expand considerably less than nominal income over the forecast period because of the rising opportunity costs associated with policy tightening.

Alternative Simulations

In this section we evaluate five risks to the baseline forecast using simulations of the FRB/US model. The first simulation explores the possibility that the weak tone of recent incoming data may be a harbinger of a more pronounced slowing in real activity, and the second simulation layers on to it the possible adverse consequences of such a slowing for financial markets. The third scenario considers the opposite risk—that aggregate spending, aided by stronger business investment, will rebound faster than we anticipate. The final two scenarios primarily concern risks to the inflation outlook. In the first of these two simulations, recent price increases for energy, imports, and commodities pass through into core prices and inflation expectations to a greater extent than in the baseline. In the final simulation, structural productivity turns out to be stronger than we project and thus damps cost pressures. In all of these scenarios, the federal funds rate is held at its baseline path.

Sentiment slump. Consumer sentiment has deteriorated in recent weeks, but we expect confidence to recover over time and to help support spending and hiring. However, we cannot rule out the possibility that we are on the cusp of a greater and more persistent decline in confidence that will perhaps be triggered by a growing recognition that the elevated level of energy prices is likely to be a persistent feature of the economic landscape. In this scenario, consumer sentiment continues to decline through the start of the summer and thereafter remains low; that slump restrains household outlays and gradually adds 1 percentage point to the personal saving rate. The greater reluctance to spend is accompanied by increased business caution in hiring and stockbuilding: Over the remaining three quarters of 2005, private payroll gains average only 75,000 per month, compared with 150,000 in the baseline; in addition, inventory stocks accumulate at an annual rate of $18 billion, on average, rather than the $37 billion pace in the baseline projection. Under these assumptions, long-term Treasury yields are held down about 10 basis points while risk premiums on private securities widen modestly. With real GDP increasing only 3 percent in both 2005 and 2006, the unemployment rate rises to 5¾ percent by late next year. More-pronounced economic slack causes core inflation to slow to 1½ percent in 2006.

Sentiment slump with financial spillover. If, as in the previous scenario, the expansion were to slow markedly and economic slack to rise, market participants would likely become less sanguine about the riskiness of bonds and equities. This simulation maintains the assumptions of the previous one and further assumes that investors demand increased compensation for holding long-term financial assets. This market reassessment causes yields on BAA corporate bonds to increase 70 basis points relative to baseline; equity prices, rather than rising at the baseline rate of 6½ percent per year, are flat. Higher borrowing costs and lower household wealth exacerbate the weakness in aggregate spending; as a result, real GDP growth slows to 2¼ percent next year, and the unemployment rate rises to 6¼ percent by late 2006. Core inflation moves below 1½ percent next year and would be expected to fall further in 2007 in the absence of any monetary offset.

Alternative Scenarios
(Percent change, annual rate, from end of preceding period,
except as noted)

Measure and scenario	2004	2005		2006
	Q4	H1	H2	
Real GDP				
Baseline	**3.8**	**3.4**	**3.7**	**3.5**
Sentiment slump	3.8	3.0	3.1	3.1
With financial spillover	3.8	3.0	2.8	2.3
Stronger underlying demand	3.8	3.9	4.7	4.2
More pass-through	3.8	3.4	3.5	3.7
Faster productivity growth	3.8	3.9	4.7	4.5
Civilian unemployment rate[1]				
Baseline	**5.4**	**5.3**	**5.3**	**5.3**
Sentiment slump	5.4	5.4	5.7	5.8
With financial spillover	5.4	5.4	5.8	6.2
Stronger underlying demand	5.4	5.2	5.0	4.7
More pass-through	5.4	5.3	5.4	5.3
Faster productivity growth	5.4	5.4	5.4	5.3
PCE prices excluding food and energy				
Baseline	**1.7**	**2.1**	**1.8**	**1.7**
Sentiment slump	1.7	2.1	1.7	1.5
With financial spillover	1.7	2.1	1.7	1.4
Stronger underlying demand	1.7	2.1	1.8	1.8
More pass-through	1.7	2.4	2.6	2.3
Faster productivity growth	1.7	1.9	1.4	1.2

1. Average for the final quarter of the period.

Stronger underlying demand. Although real activity now appears to be running a little weaker than previously expected, we may be underestimating the strength of final demand. In this scenario, the pace of real E&S investment—led by a return of high-tech spending gains similar to those seen during the second half of the 1990s—rebounds more sharply than in the baseline, so that average growth in 2005 and 2006 ends up matching last year's robust rate. Consumer spending later this year also snaps back more than anticipated in the baseline, fully reversing the downward surprises of the late winter. As a result, real GDP increases 4¼ percent both this year and next, pulling the unemployment rate down to 4¾ percent by late 2006. Despite tighter labor and product markets, core inflation is only a touch higher than in the baseline, in part because faster capital deepening boosts structural labor productivity.

More pass-through. Over the past year, the prices of oil and non-energy commodities have surged, and the dollar has depreciated almost 6 percent. We estimate that these cost increases have raised core prices an appreciable amount and will continue to do so for a while. However, firms may ultimately pass on more of these costs than is assumed in the baseline. In this scenario, we address this risk by assuming that the direct pass-through into core prices cumulates to an effect that is twice as great as in the baseline. With no offsetting monetary policy action, the resultant surge in core prices causes longer-run inflation expectations to move up markedly, ratcheting up the underlying level of core inflation next year. All told, core PCE inflation climbs above 2½ percent in the second half of this year. In 2006, as the direct pass-through of costs into consumer prices is completed, core PCE inflation moderates to 2¼ percent but remains higher than in the baseline because of the legacy of higher inflation expectations. Real output and employment are little affected by the surge in inflation: Although higher consumer prices reduce real wages and restrain consumer spending, lower real interest rates provide an offsetting stimulus.

Faster productivity growth. We have interpreted the past few years' outsized increases in output per hour as partly reflecting a series of one-time efficiency gains. As a result, we expect structural labor productivity to increase only 3 percent in 2005 and 2006, down from an estimated 3½ percent rise in the preceding three years. However, we may have understated the ongoing pace of technological innovation, and in this scenario we instead assume that structural productivity will rise 3¾ percent both this year and next. We further assume that this faster growth is already anticipated by market participants and so is already built into asset prices. The rosier outlook for potential output boosts households' estimates of permanent income and firms' expectations of future sales and leads to higher consumption and investment spending. Consequently, real GDP growth is about 4¼ percent in both 2005 and 2006. Because nominal wages respond only sluggishly to changes in trend labor productivity, unit labor costs rise more slowly than in the baseline. Competitive pressures force firms to pass most of these cost savings onto customers, and so core inflation moves down to 1¼ percent by next year.

Selected Greenbook Projections and 70 Percent Confidence Intervals Derived from Historical Forecast Errors and FRB/US Simulations

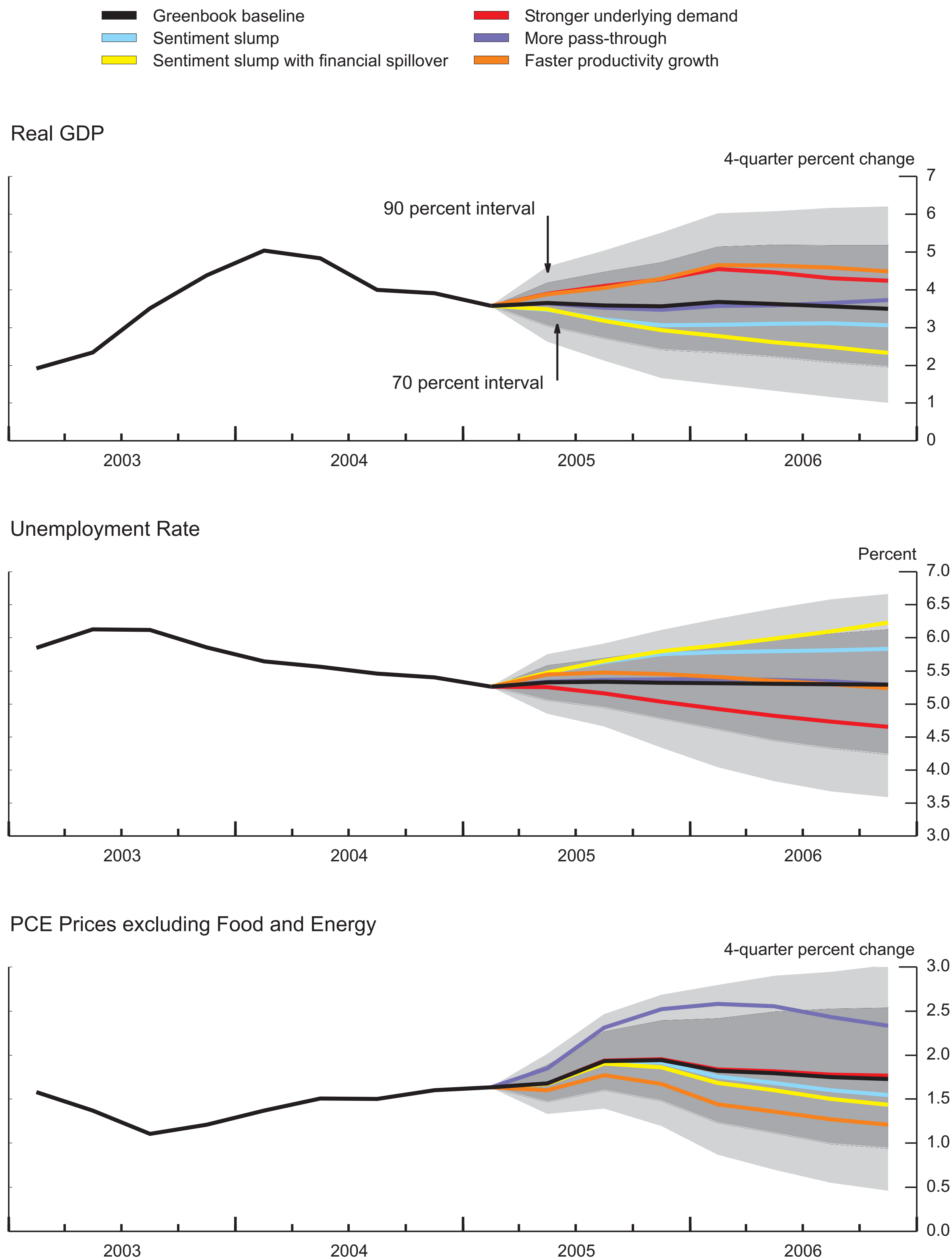
Measure	2005	2006
Real GDP (percent change, Q4 to Q4)		
Projection	3.6	3.5
Confidence interval		
Greenbook forecast errors[1]	2.2–4.9	1.6–5.4
FRB/US stochastic simulations	2.4–4.8	1.9–5.2
Civilian unemployment rate (percent, Q4)		
Projection	5.3	5.3
Confidence interval		
Greenbook forecast errors[1]	4.9–5.8	4.5–6.1
FRB/US stochastic simulations	4.8–5.8	4.2–6.1
PCE prices excluding food and energy (percent change, Q4 to Q4)		
Projection	1.9	1.7
Confidence interval		
Greenbook forecast errors[2]	1.5–2.4	.9–2.6
FRB/US stochastic simulations	1.5–2.4	.9–2.6

NOTE. Shocks underlying stochastic simulations are randomly drawn from the 1978–2003 set of model equation residuals.

1. 1978–2003.
2. 1981–2003.

Forecast Confidence Intervals and Alternative Scenarios

Confidence Intervals Based on FRB/US Stochastic Simulations



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

Interval		Nominal GDP		Real GDP		PCE price index		Core PCE price index		Unemployment rate[1]	
		3/16/05	4/28/05	3/16/05	4/28/05	3/16/05	4/28/05	3/16/05	4/28/05	3/16/05	4/28/05
ANNUAL											
2002		3.5	3.5	1.9	1.9	1.4	1.4	1.8	1.8	5.8	5.8
2003		4.9	4.9	3.0	3.0	1.9	1.9	1.3	1.3	6.0	6.0
2004		6.7	6.6	4.5	4.4	2.2	2.2	1.5	1.5	5.5	5.5
2005		6.2	6.0	4.1	3.6	2.1	2.3	1.7	1.8	5.3	5.3
2006		5.4	5.4	3.7	3.6	1.5	1.7	1.6	1.8	5.2	5.3
QUARTERLY											
2003	Q1	4.9	4.9	1.9	1.9	3.2	3.2	1.5	1.5	5.8	5.8
	Q2	5.3	5.3	4.1	4.1	0.7	0.7	1.1	1.1	6.1	6.1
	Q3	8.8	8.8	7.4	7.4	1.6	1.6	0.9	0.9	6.1	6.1
	Q4	5.7	5.7	4.2	4.2	1.2	1.2	1.3	1.3	5.9	5.9
2004	Q1	7.4	7.4	4.5	4.5	3.3	3.3	2.1	2.1	5.6	5.6
	Q2	6.6	6.6	3.3	3.3	3.1	3.1	1.7	1.7	5.6	5.6
	Q3	5.5	5.5	4.0	4.0	1.3	1.3	0.9	0.9	5.5	5.5
	Q4	6.6	6.2	4.3	3.8	2.6	2.7	1.6	1.7	5.4	5.4
2005	Q1	7.2	6.5	4.3	3.1	2.1	2.1	2.1	2.2	5.3	5.3
	Q2	6.0	6.3	4.1	3.6	2.8	3.2	1.8	1.9	5.3	5.3
	Q3	5.2	5.0	3.9	3.7	1.2	1.4	1.7	1.9	5.3	5.3
	Q4	5.2	5.3	3.8	3.7	1.3	1.6	1.7	1.8	5.3	5.3
2006	Q1	5.6	5.7	3.7	3.6	1.4	1.6	1.6	1.8	5.2	5.3
	Q2	5.3	5.3	3.6	3.5	1.4	1.6	1.6	1.7	5.2	5.3
	Q3	5.3	5.3	3.6	3.5	1.4	1.6	1.6	1.7	5.2	5.3
	Q4	5.2	5.3	3.6	3.5	1.5	1.6	1.5	1.7	5.1	5.3
TWO-QUARTER[2]											
2003	Q2	5.1	5.1	3.0	3.0	2.0	2.0	1.3	1.3	0.2	0.2
	Q4	7.2	7.2	5.8	5.8	1.4	1.4	1.1	1.1	-0.2	-0.2
2004	Q2	7.0	7.0	3.9	3.9	3.2	3.2	1.9	1.9	-0.3	-0.3
	Q4	6.0	5.9	4.1	3.9	1.9	2.0	1.2	1.3	-0.2	-0.2
2005	Q2	6.6	6.4	4.2	3.4	2.4	2.6	1.9	2.1	-0.1	-0.1
	Q4	5.2	5.1	3.8	3.7	1.3	1.5	1.7	1.8	0.0	0.0
2006	Q2	5.5	5.5	3.6	3.5	1.4	1.6	1.6	1.8	-0.1	0.0
	Q4	5.3	5.3	3.6	3.5	1.5	1.6	1.5	1.7	-0.1	0.0
FOUR-QUARTER[3]											
2002	Q4	3.8	3.8	2.3	2.3	1.8	1.8	1.5	1.5	0.4	0.4
2003	Q4	6.2	6.2	4.4	4.4	1.7	1.7	1.2	1.2	0.0	0.0
2004	Q4	6.5	6.4	4.0	3.9	2.6	2.6	1.6	1.6	-0.5	-0.5
2005	Q4	5.9	5.8	4.0	3.6	1.9	2.1	1.8	1.9	-0.2	-0.1
2006	Q4	5.4	5.4	3.6	3.5	1.4	1.6	1.6	1.7	-0.1	-0.0

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

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

Item	Units[1]	1998	1999	2000	2001	2002	2003	2004	- - - Projected - - - 2005	2006
Expenditures										
Nominal GDP	Bill. $	8747.0	9268.4	9817.0	10128.0	10487.0	11004.0	11735.0	12441.9	13117.3
Real GDP	Bill. Ch. $	9066.9	9470.3	9817.0	9890.7	10074.8	10381.3	10841.9	11231.8	11634.8
Real GDP	% change	4.5	4.7	2.2	0.2	2.3	4.4	3.9	3.6	3.5
Gross domestic purchases		5.5	5.5	3.0	0.4	3.1	4.3	4.5	3.6	3.6
Final sales		4.8	4.2	2.9	1.5	1.2	4.5	3.6	3.7	3.5
Priv. dom. final purchases		6.4	5.3	4.3	1.0	1.7	4.9	4.8	4.0	3.9
Personal cons. expenditures		5.4	4.9	4.1	2.8	2.5	3.8	3.8	3.5	3.4
Durables		14.4	7.3	4.7	10.8	1.5	9.9	5.5	4.9	5.9
Nondurables		4.7	4.9	3.0	1.9	2.3	4.6	4.3	4.2	4.1
Services		3.8	4.4	4.5	1.6	2.9	2.2	3.1	2.8	2.6
Business fixed investment		10.9	7.7	7.8	-9.6	-6.0	9.4	11.0	8.0	8.7
Equipment & Software		13.5	10.8	7.5	-9.0	-2.2	12.1	14.5	9.4	9.9
Nonres. structures		4.0	-0.9	8.8	-11.1	-16.1	1.5	-0.1	3.4	4.7
Residential structures		10.3	3.6	-1.9	1.4	6.9	12.0	6.5	3.2	0.4
Exports		2.6	5.6	6.5	-11.9	3.5	6.1	5.9	8.3	6.7
Imports		11.0	12.1	11.2	-7.6	9.7	4.9	9.8	7.1	6.4
Gov't. cons. & investment		3.3	4.2	0.4	5.0	3.8	2.2	1.6	2.4	2.2
Federal		0.1	4.2	-2.2	6.4	8.2	5.5	3.9	3.6	1.9
Defense		-1.2	4.3	-3.5	6.5	8.5	8.5	5.4	5.0	2.3
State & local		5.1	4.2	1.7	4.2	1.6	0.4	0.2	1.6	2.4
Change in bus. inventories	Bill. Ch. $	72.6	68.9	56.5	-31.7	11.7	-0.8	45.7	46.5	33.3
Nonfarm		71.2	71.5	57.8	-31.8	13.5	-1.1	42.4	45.5	31.4
Net exports		-203.7	-296.2	-379.5	-399.1	-472.1	-518.5	-583.7	-647.1	-671.3
Nominal GDP	% change	5.7	6.3	4.6	2.7	3.8	6.2	6.4	5.8	5.4
GDP Gap[2]	%	-1.5	-2.3	-2.5	0.1	1.5	2.0	1.3	1.2	0.9
Employment and Production										
Nonfarm payroll employment	Millions	125.9	129.0	131.8	131.8	130.3	130.0	131.5	133.6	135.4
Unemployment rate	%	4.5	4.2	4.0	4.7	5.8	6.0	5.5	5.3	5.3
Industrial prod. index	% change	4.2	5.2	1.9	-5.1	1.5	1.2	4.3	4.4	3.8
Capacity util. rate - mfg.	%	81.8	81.1	80.6	74.5	73.5	73.7	76.7	78.7	80.7
Housing starts	Millions	1.62	1.64	1.57	1.60	1.70	1.85	1.96	2.01	1.94
Light motor vehicle sales		15.56	16.91	17.35	17.13	16.76	16.64	16.83	16.91	17.24
North Amer. produced		13.52	14.41	14.48	14.05	13.47	13.33	13.44	13.45	13.75
Other		2.04	2.50	2.87	3.08	3.28	3.31	3.39	3.46	3.50
Income and Saving										
Nominal GNP	Bill. $	8768.3	9302.2	9855.9	10171.6	10514.1	11059.2	11778.9	12464.4	13104.8
Nominal GNP	% change	5.5	6.5	4.7	2.9	3.5	6.5	5.9	5.6	5.1
Nominal personal income		7.0	5.5	7.1	2.2	1.9	4.6	6.7	5.4	6.5
Real disposable income		5.6	2.8	4.4	1.2	2.9	3.9	4.1	2.8	4.7
Personal saving rate	%	4.3	2.4	2.3	1.8	2.0	1.4	1.2	0.6	1.9
Corp. profits, IVA & CCAdj.	% change	-10.0	9.6	-8.6	-0.2	15.4	23.4	12.4	4.2	0.3
Profit share of GNP	%	9.1	9.2	8.3	7.5	8.3	9.2	10.0	10.6	10.1
Excluding FR Banks		8.9	8.9	8.0	7.3	8.1	9.1	9.9	10.4	10.0
Federal surpl./deficit	Bill. $	38.8	103.6	189.5	46.7	-254.5	-364.5	-375.6	-292.2	-352.1
State & local surpl./def.		52.0	50.4	50.0	4.8	-25.0	-3.2	17.6	17.4	24.7
Ex. social ins. funds		50.3	48.7	47.9	2.2	-26.6	-4.3	16.2	16.4	23.7
Gross natl. saving rate	%	18.2	18.0	18.0	16.3	14.1	13.5	13.8	13.8	14.0
Net natl. saving rate		7.4	6.9	6.7	4.2	2.0	1.4	2.1	2.5	2.8
Prices and Costs										
GDP chn.-wt. price index	% change	1.1	1.6	2.2	2.4	1.6	1.7	2.4	2.1	1.8
Gross Domestic Purchases chn.-wt. price index		0.7	2.0	2.4	1.6	1.8	1.8	2.9	2.3	1.6
PCE chn.-wt. price index		0.9	2.1	2.3	1.7	1.8	1.7	2.6	2.1	1.6
Ex. food and energy		1.4	1.6	1.5	2.2	1.5	1.2	1.6	1.9	1.7
CPI		1.5	2.6	3.4	1.8	2.2	1.9	3.4	2.5	1.8
Ex. food and energy		2.3	2.0	2.6	2.7	2.1	1.2	2.1	2.4	2.1
ECI, hourly compensation[3]		3.5	3.4	4.4	4.2	3.2	4.0	3.8	4.5	4.6
Nonfarm business sector										
Output per hour		2.7	3.4	2.1	3.3	3.5	5.5	2.8	2.2	2.7
Compensation per Hour		5.5	5.2	6.4	3.6	2.9	5.3	4.3	4.4	4.7
Unit labor cost		2.7	1.7	4.3	0.3	-0.6	-0.2	1.4	2.1	1.9

1. Changes are from fourth quarter to fourth quarter.
2. Percent difference between potential and actual. A positive number indicates that the economy is operating below potential.
3. Private-industry workers.

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

Item	Units	2002 Q1	2002 Q2	2002 Q3	2002 Q4	2003 Q1	2003 Q2	2003 Q3	2003 Q4	2004 Q1	2004 Q2
Expenditures											
Nominal GDP	Bill. $	10338.2	10445.7	10546.5	10617.5	10744.6	10884.0	11116.7	11270.9	11472.6	11657.5
Real GDP	Bill. Ch. $	9993.5	10052.6	10117.3	10135.9	10184.4	10287.4	10472.8	10580.7	10697.5	10784.7
Real GDP	% change	3.4	2.4	2.6	0.7	1.9	4.1	7.4	4.2	4.5	3.3
Gross domestic purchases		4.4	2.8	2.9	2.4	1.7	4.4	6.4	4.7	5.0	4.2
Final sales		0.3	1.8	2.0	0.7	2.4	5.2	6.8	3.7	3.3	2.5
Priv. dom. final purchases		0.7	1.7	2.4	1.9	2.6	5.1	7.2	4.8	4.2	3.7
Personal cons. expenditures		1.8	2.8	2.9	2.5	2.7	3.9	5.0	3.6	4.1	1.6
Durables		-8.5	4.4	14.0	-2.4	-0.1	20.6	16.5	3.9	2.2	-0.3
Nondurables		3.8	0.8	-0.6	5.3	5.0	1.6	6.9	5.1	6.7	0.1
Services		3.3	3.5	2.4	2.2	2.1	1.8	1.9	2.8	3.3	2.7
Business fixed investment		-9.7	-9.6	-1.1	-3.2	-0.1	11.8	15.7	11.0	4.2	12.5
Equipment & Software		-6.3	-4.5	4.6	-2.0	4.5	11.0	21.7	12.0	8.0	14.2
Nonres. structures		-18.5	-22.6	-16.0	-6.6	-13.0	14.5	-1.3	7.9	-7.6	6.9
Residential structures		9.3	11.3	2.8	4.2	7.5	9.1	22.4	9.6	5.0	16.5
Exports		4.7	11.0	3.1	-4.2	-1.5	-1.6	11.3	17.5	7.3	7.3
Imports		12.5	11.4	5.4	9.6	-2.0	2.5	2.8	17.1	10.6	12.6
Gov't. cons. & investment		4.7	4.4	2.1	4.0	0.2	7.2	0.1	1.6	2.5	2.2
Federal		8.2	12.8	2.9	9.1	0.3	22.1	-3.3	4.8	7.1	2.7
Defense		5.8	11.5	3.4	13.5	-2.7	38.4	-7.7	11.6	10.6	1.9
State & local		2.9	0.3	1.7	1.4	0.1	-0.4	2.2	-0.1	-0.0	1.9
Change in bus. inventories	Bill. Ch. $	-7.4	7.9	22.7	23.8	9.6	-17.6	-3.5	8.6	40.0	61.1
Nonfarm		-11.9	16.1	24.6	25.3	9.6	-15.7	-2.7	4.6	34.5	58.8
Net exports		-444.9	-458.1	-469.8	-515.4	-511.7	-525.2	-508.7	-528.3	-550.1	-580.3
Nominal GDP	% change	4.5	4.2	3.9	2.7	4.9	5.3	8.8	5.7	7.4	6.6
GDP Gap[1]	%	1.1	1.3	1.5	2.1	2.5	2.4	1.6	1.4	1.2	1.3
Employment and Production											
Nonfarm payroll employment	Millions	130.5	130.3	130.3	130.3	130.1	129.8	129.9	130.2	130.5	131.3
Unemployment rate	%	5.7	5.8	5.7	5.9	5.8	6.1	6.1	5.9	5.6	5.6
Industrial prod. index	% change	2.3	4.4	1.7	-2.3	-0.7	-4.0	4.1	5.7	5.6	4.3
Capacity util. rate - mfg.	%	73.0	73.6	74.0	73.5	73.5	73.0	73.7	74.8	75.6	76.5
Housing starts	Millions	1.72	1.68	1.70	1.74	1.74	1.75	1.88	2.04	1.94	1.92
Light motor vehicle sales		16.57	16.50	17.37	16.57	16.09	16.39	17.24	16.82	16.51	16.54
North Amer. produced		13.26	13.29	14.06	13.28	12.72	13.11	13.90	13.58	13.26	13.15
Other		3.31	3.22	3.32	3.29	3.37	3.28	3.34	3.24	3.26	3.39
Income and Saving											
Nominal GNP	Bill. $	10361.7	10461.6	10571.7	10661.2	10781.3	10929.0	11168.3	11358.1	11546.1	11693.6
Nominal GNP	% change	2.4	3.9	4.3	3.4	4.6	5.6	9.0	7.0	6.8	5.2
Nominal personal income		2.2	4.3	-0.1	1.1	3.8	4.7	4.6	5.3	5.0	6.4
Real disposable income		10.8	2.7	-1.7	0.2	1.8	4.3	8.2	1.4	2.4	2.8
Personal saving rate	%	2.7	2.7	1.6	1.2	1.0	1.1	1.9	1.3	1.0	1.3
Corp. profits, IVA & CCAdj.	% change	24.9	15.2	3.6	19.1	-1.4	36.7	32.0	30.2	13.6	2.9
Profit share of GNP	%	8.1	8.3	8.3	8.6	8.5	9.0	9.5	9.9	10.1	10.0
Excluding FR Banks		7.9	8.1	8.1	8.4	8.3	8.8	9.3	9.8	9.9	9.9
Federal surpl./deficit	Bill. $	-208.5	-251.6	-255.1	-302.7	-281.6	-364.4	-433.0	-379.2	-391.0	-380.0
State & local surpl./def.		-28.8	-23.6	-21.3	-26.3	-49.0	-5.7	6.5	35.3	11.8	18.3
Ex. social ins. funds		-30.8	-25.3	-22.8	-27.6	-50.1	-6.7	5.4	34.1	10.6	16.9
Gross natl. saving rate	%	15.0	14.6	13.7	13.2	12.8	13.1	13.6	14.3	13.6	13.8
Net natl. saving rate		2.9	2.5	1.5	0.9	0.4	0.9	1.6	2.5	2.1	2.3
Prices and Costs											
GDP chn.-wt. price index	% change	1.4	1.5	1.7	2.0	2.7	1.1	1.4	1.6	2.8	3.2
Gross Domestic Purchases chn.-wt. price index		1.2	2.5	1.8	1.9	3.7	0.4	1.7	1.4	3.4	3.5
PCE chn.-wt. price index		0.9	2.9	2.0	1.4	3.2	0.7	1.6	1.2	3.3	3.1
Ex. food and energy		1.2	2.0	2.0	0.9	1.5	1.1	0.9	1.3	2.1	1.7
CPI		1.6	3.2	2.0	2.2	4.0	0.4	2.2	0.9	4.0	4.4
Ex. food and energy		2.4	2.1	2.1	1.7	1.3	0.8	1.7	1.0	1.9	2.5
ECI, hourly compensation[2]		3.6	4.4	2.5	3.3	5.5	3.4	4.4	3.1	4.3	4.0
Nonfarm business sector											
Output per hour		6.9	1.3	4.3	1.5	4.0	6.7	8.7	2.8	3.8	3.9
Compensation per hour		5.4	3.7	1.2	1.2	5.6	5.7	5.7	4.1	2.1	5.9
Unit labor cost		-1.4	2.3	-2.9	-0.3	1.6	-1.0	-2.7	1.2	-1.6	1.9

1. Percent difference between potential and actual. A positive number indicates that the economy is operating below potential.
2. Private-industry workers.

Strictly Confidential <FR>
Class II FOMC

April 28, 2005

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

Item	Units	2004 Q3	2004 Q4	2005 Q1	2005 Q2	2005 Q3	2005 Q4	2006 Q1	2006 Q2	2006 Q3	2006 Q4
				Projected							
EXPENDITURES											
Nominal GDP	Bill. $	11814.9	11994.8	12184.1	12372.7	12524.2	12686.6	12863.1	13031.5	13201.7	13372.7
Real GDP	Bill. Ch. $	10891.0	10994.3	11079.6	11179.2	11282.2	11386.3	11486.3	11584.3	11683.9	11784.8
Real GDP	% change	4.0	3.8	3.1	3.6	3.7	3.7	3.6	3.5	3.5	3.5
Gross domestic purchases		3.9	5.0	4.2	2.8	3.6	3.9	3.9	3.1	3.6	3.9
Final sales		5.0	3.4	2.1	4.6	4.2	3.7	3.3	4.0	3.5	3.1
Priv. dom. final purchases		5.8	5.4	3.8	3.7	4.4	4.2	4.0	3.9	3.9	3.8
Personal cons. expenditures		5.1	4.2	3.5	3.2	3.6	3.5	3.5	3.4	3.4	3.4
Durables		17.2	3.9	0.0	5.9	6.8	7.0	5.7	5.5	6.4	5.8
Nondurables		4.7	5.9	4.9	2.9	4.6	4.5	4.2	4.2	4.1	4.1
Services		3.0	3.4	3.6	2.8	2.6	2.4	2.7	2.7	2.5	2.5
Business fixed investment		13.0	14.5	4.7	7.2	10.5	9.7	9.3	8.7	9.0	7.9
Equipment & Software		17.5	18.4	6.9	8.4	11.9	10.5	10.3	9.6	10.6	9.2
Nonres. structures		-1.1	2.1	-2.6	3.2	6.0	7.3	6.1	5.6	3.8	3.3
Residential structures		1.6	3.4	5.7	3.6	2.3	1.3	-0.6	0.3	0.8	1.0
Exports		6.0	3.2	7.9	8.2	8.0	9.1	5.7	6.8	6.6	7.7
Imports		4.6	11.4	13.7	1.2	5.6	8.1	7.1	3.0	6.5	9.0
Gov't. cons. & investment		0.7	0.9	0.6	4.0	2.7	2.3	2.1	2.3	2.2	2.3
Federal		4.8	1.2	0.6	7.9	3.9	2.4	1.7	1.9	1.8	2.0
Defense		10.1	-0.6	0.2	11.4	5.3	3.4	2.0	2.3	2.3	2.7
State & local		-1.7	0.6	0.5	1.7	2.0	2.2	2.4	2.5	2.5	2.5
Change in bus. inventories	Bill. Ch. $	34.5	47.2	75.3	45.1	31.8	33.9	41.9	26.1	26.2	38.8
Nonfarm		30.4	45.9	77.6	42.3	30.0	32.1	40.1	24.3	24.3	37.0
Net exports		-583.2	-621.1	-656.6	-639.2	-641.4	-651.3	-666.5	-660.2	-670.0	-688.6
Nominal GDP	% change	5.5	6.2	6.5	6.3	5.0	5.3	5.7	5.3	5.3	5.3
GDP Gap[1]	%	1.3	1.3	1.3	1.2	1.1	1.0	1.0	0.9	0.9	0.9
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	131.7	132.3	132.8	133.3	133.8	134.3	134.8	135.2	135.7	136.1
Unemployment rate	%	5.5	5.4	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3
Industrial prod. index	% change	2.7	4.5	3.6	2.5	6.3	5.3	4.3	3.7	3.7	3.7
Capacity util. rate - mfg.	%	77.0	77.6	78.1	78.2	79.0	79.7	80.2	80.5	80.8	81.1
Housing starts	Millions	1.97	1.98	2.09	2.02	1.97	1.97	1.95	1.94	1.94	1.93
Light motor vehicle sales		17.07	17.20	16.41	16.95	17.11	17.16	17.22	17.23	17.25	17.26
North Amer. produced		13.81	13.56	13.10	13.38	13.65	13.68	13.73	13.74	13.75	13.76
Other		3.27	3.65	3.31	3.57	3.46	3.48	3.49	3.49	3.50	3.50
INCOME AND SAVING											
Nominal GNP	Bill. $	11853.0	12022.8	12217.9	12397.2	12542.9	12699.6	12865.5	13023.8	13186.3	13343.6
Nominal GNP	% change	5.6	5.9	6.7	6.0	4.8	5.1	5.3	5.0	5.1	4.9
Nominal personal income		4.6	10.9	2.4	6.7	6.4	6.3	7.6	6.2	6.1	5.9
Real disposable income		2.9	8.3	-1.3	3.4	4.6	4.6	6.1	4.5	4.3	4.1
Personal saving rate	%	0.7	1.6	0.3	0.4	0.7	0.9	1.5	1.8	2.0	2.2
Corp. profits, IVA & CCAdj.	% change	-17.7	65.9	10.8	7.2	-1.1	0.1	2.8	-0.6	0.8	-1.8
Profit share of GNP	%	9.4	10.6	10.7	10.7	10.5	10.4	10.3	10.2	10.1	9.9
Excluding FR Banks		9.3	10.4	10.5	10.5	10.4	10.3	10.2	10.1	10.0	9.8
Federal surpl./deficit	Bill. $	-375.0	-356.2	-297.1	-287.5	-290.5	-293.9	-360.2	-351.0	-353.3	-343.8
State & local surpl./def.		4.5	35.6	20.9	16.2	15.4	17.1	25.2	22.9	24.7	26.1
Ex. social ins. funds		3.0	34.2	20.0	15.2	14.4	16.1	24.2	21.9	23.7	25.1
Gross natl. saving rate	%	13.8	13.8	13.7	13.8	13.8	13.8	13.8	14.0	14.0	14.1
Net natl. saving rate		1.3	2.5	2.4	2.5	2.6	2.6	2.6	2.7	2.8	2.9
PRICES AND COSTS											
GDP chn.-wt. price index	% change	1.4	2.3	3.3	2.6	1.2	1.5	2.1	1.8	1.8	1.7
Gross Domestic Purchases chn.-wt. price index		1.9	2.9	3.0	3.0	1.6	1.7	1.9	1.6	1.6	1.5
PCE chn.-wt. price index		1.3	2.7	2.1	3.2	1.4	1.6	1.6	1.6	1.6	1.6
Ex. food and energy		0.9	1.7	2.2	1.9	1.9	1.8	1.8	1.7	1.7	1.7
CPI		1.7	3.4	2.5	4.2	1.5	1.9	1.8	1.8	1.8	1.8
Ex. food and energy		1.8	2.3	2.6	2.5	2.3	2.2	2.2	2.1	2.0	2.0
ECI, hourly compensation[2]		3.5	3.0	4.4	4.5	4.5	4.5	4.5	4.5	4.6	4.6
Nonfarm business sector											
Output per hour		1.3	2.3	1.8	2.1	2.4	2.5	2.6	2.7	2.8	2.9
Compensation per hour		5.4	3.8	4.1	4.3	4.5	4.6	4.6	4.7	4.7	4.7
Unit labor cost		4.0	1.5	2.2	2.1	2.1	2.1	2.0	1.9	1.8	1.8

1. Percent difference between potential and actual. A positive number indicates that the economy is operating below potential.
2. Private-industry workers.

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Class II FOMC

April 28, 2005

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

Item	2002 Q3	2002 Q4	2003 Q1	2003 Q2	2003 Q3	2003 Q4	2004 Q1	2004 Q2	2004 Q3	02Q4/ 01Q4	03Q4/ 02Q4	04Q4/ 03Q4
Real GDP	2.6	0.7	1.9	4.1	7.4	4.2	4.5	3.3	4.0	2.3	4.4	3.9
Gross dom. purchases	3.0	2.4	1.8	4.6	6.8	4.9	5.3	4.4	4.1	3.2	4.5	4.7
Final sales	2.0	0.7	2.4	5.1	6.8	3.7	3.3	2.5	5.0	1.2	4.5	3.6
Priv. dom. final purchases	2.1	1.6	2.2	4.3	6.2	4.1	3.6	3.2	4.9	1.4	4.2	4.1
Personal cons. expenditures	2.0	1.7	1.8	2.7	3.6	2.5	2.9	1.1	3.6	1.8	2.7	2.6
Durables	1.2	-0.2	-0.0	1.6	1.4	0.3	0.2	-0.0	1.4	0.1	0.8	0.5
Nondurables	-0.1	1.0	1.0	0.3	1.4	1.0	1.3	0.0	0.9	0.5	0.9	0.9
Services	1.0	0.9	0.9	0.8	0.8	1.2	1.4	1.1	1.3	1.2	0.9	1.3
Business fixed investment	-0.1	-0.3	-0.0	1.1	1.5	1.1	0.4	1.2	1.3	-0.6	0.9	1.1
Equipment & Software	0.3	-0.2	0.3	0.8	1.5	0.9	0.6	1.1	1.3	-0.2	0.9	1.1
Nonres. structures	-0.5	-0.2	-0.3	0.3	-0.0	0.2	-0.2	0.2	-0.0	-0.5	0.0	-0.0
Residential structures	0.1	0.2	0.4	0.4	1.1	0.5	0.3	0.9	0.1	0.3	0.6	0.4
Net exports	-0.4	-1.7	0.1	-0.5	0.6	-0.7	-0.8	-1.1	-0.1	-0.9	-0.1	-0.8
Exports	0.3	-0.4	-0.2	-0.2	1.0	1.6	0.7	0.7	0.6	0.3	0.6	0.6
Imports	-0.7	-1.3	0.3	-0.3	-0.4	-2.2	-1.5	-1.8	-0.7	-1.3	-0.7	-1.4
Government cons. & invest.	0.4	0.8	0.1	1.4	0.0	0.3	0.5	0.4	0.1	0.7	0.4	0.3
Federal	0.2	0.6	0.0	1.4	-0.2	0.3	0.5	0.2	0.3	0.5	0.4	0.3
Defense	0.1	0.5	-0.1	1.5	-0.4	0.5	0.5	0.1	0.5	0.3	0.4	0.2
Nondefense	0.1	0.0	0.2	-0.1	0.1	-0.2	0.0	0.1	-0.1	0.2	-0.0	0.0
State and local	0.2	0.2	0.0	-0.1	0.3	-0.0	0.0	0.2	-0.2	0.2	0.1	0.0
Change in bus. inventories	0.6	0.1	-0.5	-1.0	0.6	0.5	1.2	0.8	-1.0	1.1	-0.1	0.4
Nonfarm	0.4	0.1	-0.5	-0.9	0.5	0.3	1.1	0.9	-1.0	1.0	-0.2	0.4
Farm	0.2	0.0	0.1	-0.1	0.1	0.2	0.1	-0.1	0.1	0.0	0.1	-0.0

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

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April 28, 2005

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

Item	2004 Q4	2005 Q1	2005 Q2	2005 Q3	2005 Q4	2006 Q1	2006 Q2	2006 Q3	2006 Q4	04Q4/ 03Q4	05Q4/ 04Q4	06Q4/ 05Q4
		- - - - - -	- - Projected	- - - -	- - - -	- - - -	- - - -	- - - -	- - - -		- - Projected	- -
Real GDP	3.8	3.1	3.6	3.7	3.7	3.6	3.5	3.5	3.5	3.9	3.6	3.5
Gross dom. purchases	5.2	4.4	3.0	3.8	4.1	4.1	3.3	3.8	4.1	4.7	3.8	3.8
Final sales	3.4	2.1	4.6	4.2	3.7	3.3	4.0	3.5	3.1	3.6	3.6	3.5
Priv. dom. final purchases	4.6	3.3	3.2	3.8	3.6	3.4	3.4	3.4	3.3	4.1	3.5	3.4
Personal cons. expenditures	2.9	2.5	2.3	2.6	2.5	2.5	2.4	2.4	2.4	2.6	2.4	2.4
Durables	0.3	0.0	0.5	0.6	0.6	0.5	0.5	0.5	0.5	0.5	0.4	0.5
Nondurables	1.2	1.0	0.6	0.9	0.9	0.9	0.8	0.8	0.8	0.9	0.9	0.8
Services	1.4	1.5	1.2	1.1	1.0	1.1	1.1	1.0	1.0	1.3	1.2	1.1
Business fixed investment	1.5	0.5	0.8	1.1	1.0	1.0	0.9	1.0	0.9	1.1	0.9	0.9
Equipment & Software	1.4	0.6	0.7	1.0	0.9	0.8	0.8	0.9	0.8	1.1	0.8	0.8
Nonres. structures	0.1	-0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.1	-0.0	0.1	0.1
Residential structures	0.2	0.3	0.2	0.1	0.1	-0.0	0.0	0.0	0.1	0.4	0.2	0.0
Net exports	-1.4	-1.3	0.6	-0.1	-0.4	-0.5	0.2	-0.3	-0.6	-0.8	-0.3	-0.3
Exports	0.3	0.8	0.8	0.8	0.9	0.6	0.7	0.7	0.8	0.6	0.8	0.7
Imports	-1.7	-2.1	-0.2	-0.9	-1.3	-1.1	-0.5	-1.0	-1.4	-1.4	-1.1	-1.0
Government cons. & invest.	0.2	0.1	0.7	0.5	0.4	0.4	0.4	0.4	0.4	0.3	0.4	0.4
Federal	0.1	0.0	0.5	0.3	0.2	0.1	0.1	0.1	0.1	0.3	0.3	0.1
Defense	-0.0	0.0	0.5	0.2	0.2	0.1	0.1	0.1	0.1	0.2	0.2	0.1
Nondefense	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
State and local	0.1	0.1	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.0	0.2	0.3
Change in bus. inventories	0.5	1.0	-0.9	-0.5	0.1	0.3	-0.5	0.0	0.4	0.4	-0.1	0.0
Nonfarm	0.5	1.1	-1.3	-0.4	0.1	0.3	-0.5	0.0	0.4	0.4	-0.1	0.0
Farm	-0.1	-0.1	0.3	-0.0	0.0	0.0	-0.0	0.0	0.0	-0.0	0.0	0.0

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

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

Item	Fiscal year				2004				2005				2006			
	2003[a]	2004[a]	2005	2006	Q1[a]	Q2[a]	Q3[a]	Q4[a]	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Unified budget					Not seasonally adjusted											
Receipts[1]	1782	1880	2085	2217	410	550	479	487	452	629	518	523	470	672	551	538
Outlays[1]	2159	2293	2456	2589	581	576	565	605	628	609	613	635	668	647	638	662
Surplus/deficit[1]	-377	-413	-370	-372	-171	-26	-86	-118	-177	20	-96	-112	-198	24	-87	-125
On-budget	-538	-568	-536	-552	-194	-99	-96	-171	-202	-56	-107	-155	-236	-60	-101	-171
Off-budget	161	155	166	179	23	73	10	53	25	76	12	43	38	84	14	47
Means of financing																
Borrowing	374	378	363	382	136	41	83	102	165	-17	113	99	182	5	95	115
Cash decrease	26	-1	4	-3	12	-23	8	12	2	-14	4	7	15	-25	0	10
Other[2]	-22	36	4	-7	23	8	-6	4	10	11	-22	5	0	-4	-8	-0
Cash operating balance, end of period	35	36	32	35	21	45	36	25	22	37	32	25	10	35	35	25
NIPA federal sector					Seasonally adjusted annual rates											
Receipts	1863	1933	2148	2288	1915	1949	1966	2032	2157	2187	2214	2243	2275	2302	2331	2359
Expenditures	2209	2314	2456	2627	2306	2329	2341	2389	2454	2475	2505	2537	2636	2653	2684	2703
Consumption expenditures	646	694	740	785	691	700	713	714	737	751	761	767	785	791	797	804
Defense	425	469	506	542	465	474	487	484	501	515	523	529	541	546	552	558
Nondefense	221	225	235	243	226	227	226	230	235	236	237	238	243	244	245	246
Other spending	1563	1620	1715	1842	1615	1629	1628	1675	1718	1723	1744	1769	1851	1862	1887	1899
Current account surplus	-345	-381	-308	-340	-391	-380	-375	-356	-297	-287	-290	-294	-360	-351	-353	-344
Gross investment	92	102	111	118	102	104	104	111	105	112	115	116	117	118	120	121
Gross saving less gross investment[3]	-347	-391	-322	-356	-402	-391	-386	-373	-306	-302	-306	-310	-376	-367	-369	-360
Fiscal indicators[4]																
High-employment (HEB) surplus/deficit	-275	-346	-283	-324	-360	-350	-345	-332	-265	-263	-270	-276	-345	-336	-339	-330
Change in HEB, percent of potential GDP	1.2	0.5	-0.7	0.2	0.2	-0.1	-0.1	-0.1	-0.6	-0.0	0.0	0.0	0.5	-0.1	-0.0	-0.1
Fiscal impetus (FI) percent of GDP	0.9	0.8	0.4	0.3	0.2	0.1	0.1	0.1	0.0	0.2	0.1	0.0	0.1	0.1	0.1	0.0

1. CBO's March 2005 baseline surplus estimates are -$412 billion in FY 2004, -$365 billion in FY 2005 and -$298 billion in FY 2006. Budget receipts, outlays, and surplus/deficit include corresponding social security (OASDI) categories. The OASDI surplus and the Postal Service surplus are excluded from the on-budget surplus and shown separately as off-budget, as classified under current law.
2. Other means of financing are checks issued less checks paid, accrued items, and changes in other financial assets and liabilities.
3. Gross saving is the current account surplus plus consumption of fixed capital of the general government as well as government enterprises.
4. HEB is gross saving less gross investment (NIPA) of the federal government in current dollars, with cyclically sensitive receipts and outlays adjusted to the staff's measure of potential output and the NAIRU. Quarterly figures for change in HEB and FI are not at annual rates. The sign on Change in HEB, as a percent of nominal potential GDP, is reversed. FI is the weighted difference of discretionary changes in federal spending and taxes in chained (2000) dollars, scaled by real GDP. The annual FI estimates are on a calendar year basis. Also, for FI and the change in HEB, positive values indicate aggregate demand stimulus.
a--Actual

Change in Debt of the Domestic Nonfinancial Sectors
(Percent)

			Nonfederal						
				Households					
Period[1]	Total	Federal government	Total	Total	Home mortgages	Consumer credit	Business	State and local governments	Memo: Nominal GDP
Year									
1999	6.4	-1.9	8.9	8.3	9.2	7.8	10.7	3.4	6.3
2000	4.8	-8.0	8.3	8.7	8.3	10.7	9.4	1.3	4.6
2001	6.2	-0.2	7.6	8.8	9.6	8.0	6.1	8.9	2.7
2002	6.8	7.6	6.7	9.6	11.8	4.4	2.7	11.1	3.8
2003	8.1	10.9	7.5	10.0	12.4	4.5	4.3	8.2	6.2
2004	8.6	9.0	8.5	11.0	13.3	4.9	5.7	7.4	6.4
2005	7.4	8.2	7.2	8.1	9.3	4.9	6.4	5.2	5.8
2006	6.6	8.4	6.2	6.9	7.5	5.2	6.0	3.0	5.4
Quarter									
2004:1	9.3	12.0	8.7	11.8	13.8	6.3	4.6	10.3	7.4
2	7.4	10.7	6.7	9.7	11.5	2.0	3.7	3.5	6.6
3	8.3	4.8	9.1	11.5	14.4	6.3	5.9	9.4	5.5
4	8.3	7.2	8.5	9.4	11.2	4.8	8.0	5.6	6.2
2005:1	9.4	13.6	8.4	8.8	10.3	3.9	6.9	13.2	6.5
2	6.3	4.7	6.7	8.3	9.4	5.3	5.8	0.9	6.3
3	6.7	7.1	6.6	7.6	8.5	5.1	5.9	3.3	5.0
4	6.3	6.4	6.3	7.0	7.7	5.1	6.1	3.1	5.3
2006:1	7.6	14.1	6.1	6.8	7.5	5.1	5.8	3.1	5.7
2	6.1	6.1	6.1	6.7	7.3	5.1	5.8	3.1	5.3
3	5.9	5.1	6.1	6.6	7.2	5.1	6.0	2.8	5.3
4	6.2	7.2	6.0	6.5	7.1	5.1	5.9	2.8	5.3

Note. Quarterly data are at seasonally adjusted annual rates.
1. Data after 2004:Q4 are staff projections. Changes are measured from end of the preceding period to end of period indicated except for annual nominal GDP growth, which is calculated from Q4 to Q4.

2.6.3 FOF

Strictly Confidential (FR)
Class II FOMC

Flow of Funds Projections: Highlights
(Billions of dollars at seasonally adjusted annual rates except as noted)

April 28, 2005

					2004		2005				2006			
Category	2003	2004	2005	2006	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Net funds raised by domestic nonfinancial sectors														
1 Total	1604.0	1705.7	1575.7	1600.9	1721.2	1570.4	2036.5	1337.3	1479.9	1449.0	1816.6	1499.7	1487.3	1600.1
2 Net equity issuance	-57.8	-210.0	-206.0	-113.0	-203.2	-395.2	-226.0	-228.0	-197.0	-173.0	-151.0	-111.0	-95.0	-95.0
3 Net debt issuance	1661.7	1915.7	1781.7	1713.9	1924.4	1965.6	2262.5	1565.3	1676.9	1622.0	1967.6	1610.7	1582.3	1695.1
Borrowing sectors														
Nonfinancial business														
4 Financing gap [1]	-14.3	30.5	-1.9	121.6	-28.6	145.1	87.4	-50.9	-36.1	-8.1	16.8	130.1	150.3	189.0
5 Net equity issuance	-57.8	-210.0	-206.0	-113.0	-203.2	-395.2	-226.0	-228.0	-197.0	-173.0	-151.0	-111.0	-95.0	-95.0
6 Credit market borrowing	308.6	420.5	498.6	502.0	445.6	618.2	543.8	466.8	480.1	503.9	482.2	494.7	513.5	517.7
Households														
7 Net borrowing [2]	839.4	1017.9	836.4	761.8	1120.3	943.4	898.7	869.6	814.1	763.3	760.1	760.5	763.0	763.5
8 Home mortgages	733.6	884.9	699.7	616.8	1017.2	820.1	780.4	724.3	672.9	621.5	616.8	616.8	616.8	616.8
9 Consumer credit	88.4	101.3	106.4	117.8	132.7	101.3	84.6	114.8	112.4	113.8	116.1	116.6	119.0	119.5
10 Debt/DPI (percent) [3]	107.8	112.9	117.2	118.2	114.2	114.2	116.6	117.1	117.7	118.1	117.9	118.1	118.3	118.6
State and local governments														
11 Net borrowing	117.8	115.4	86.8	52.8	151.8	92.0	220.8	14.8	57.8	53.8	54.8	54.8	50.8	50.8
12 Current surplus [4]	176.2	196.0	181.9	195.6	198.4	193.8	183.0	179.8	180.7	184.0	193.6	192.9	196.4	199.4
Federal government														
13 Net borrowing	396.0	361.9	359.8	397.3	206.7	312.1	599.2	214.1	324.8	301.0	670.5	300.7	255.0	363.2
14 Net borrowing (n.s.a.)	396.0	361.9	359.8	397.3	83.3	102.1	164.7	-17.0	112.8	99.3	182.5	4.6	95.4	114.8
15 Unified deficit (n.s.a.)	399.1	400.7	363.8	385.3	85.7	118.1	176.6	-20.1	95.7	111.7	197.9	-24.3	87.0	124.8
Depository institutions														
16 Funds supplied	476.4	824.0	631.8	585.5	424.1	1003.2	1199.2	291.7	514.5	521.8	668.0	515.0	614.2	545.0
Memo (percentage of GDP)														
17 Domestic nonfinancial debt [5]	194.4	197.8	201.5	204.5	198.4	199.5	200.8	201.6	202.4	203.0	203.7	204.5	204.9	205.4
18 Domestic nonfinancial borrowing	15.1	16.3	14.3	13.1	16.3	16.4	18.6	12.7	13.4	12.8	15.3	12.4	12.0	12.7
19 Federal government [6]	3.6	3.1	2.9	3.0	1.7	2.6	4.9	1.7	2.6	2.4	5.2	2.3	1.9	2.7
20 Nonfederal	11.5	13.2	11.4	10.0	14.5	13.8	13.7	10.9	10.8	10.4	10.1	10.1	10.1	10.0

Note. Data after 2004:Q4 are staff projections.
1. For corporations: Excess of capital expenditures over U.S. internal funds.
2. Includes change in liabilities not shown in lines 8 and 9.
3. Average debt levels in the period (computed as the average of period-end debt positions) divided by disposable personal income.
4. NIPA state and local government saving plus consumption of fixed capital and net capital transfers.
5. Average debt levels in the period (computed as the average of period-end debt positions) divided by nominal GDP.
6. Excludes government-insured mortgage pool securities.
n.s.a. Not seasonally adjusted.

2.6.4 FOF

International Developments

Despite some diversity of performance across our trading partners, recent data suggest that foreign economic growth averaged 3 percent at an annual rate in the first quarter, about the same as in the fourth quarter. We expect foreign growth to strengthen to nearly 3½ percent in the current quarter and to roughly maintain that rate for the rest of the year. Our outlook for aggregate foreign output is little changed from the March Greenbook projection. However, we have nudged down projected growth in the foreign industrial countries in response to some weakness in recent indicators, an upwardly revised path for oil prices, and the somewhat softer outlook for U.S. GDP. Offsetting this is a more buoyant outlook for the emerging economies this year, driven chiefly by surprisingly strong growth in China. After dipping in the first quarter, foreign CPI inflation is expected to rise to 2½ percent in the current quarter, in part because of increases in the prices of oil and other commodities, and remain at about that rate thereafter.

Summary of Staff Projections
(Percent change from end of previous period, s.a.a.r.)

Indicator	2004		Projection			
			2005			2006
	H1	H2	Q1	Q2	H2	
Foreign output	4.2	2.9	3.0	3.4	3.5	3.3
March GB	*4.1*	*2.9*	*3.0*	*3.3*	*3.4*	*3.4*
Foreign CPI	2.8	2.7	1.2	2.6	2.6	2.4
March GB	*2.9*	*2.6*	*1.1*	*2.5*	*2.3*	*2.3*

Note. Changes for years are measured as Q4/Q4; for half-years, Q2/Q4 or Q4/Q2.

The spot price of West Texas intermediate (WTI) crude oil reached a new high in early April but, in volatile trading, has since fallen below $52 per barrel. Over the intermeeting period, the spot price of WTI declined more than $2 per barrel on balance, but prices of futures contracts for delivery next year and beyond moved noticeably higher. In addition, futures quotes indicate that the price of WTI will move up somewhat from its current level before retracing a bit next year. Prices of non-fuel primary commodities have firmed in recent weeks, led mainly by higher prices for some industrial metals. Based on spot and futures markets, non-fuel commodity prices are projected to increase a bit further in the current quarter and to remain flat over the rest of the forecast period.

The dollar appreciated against the major foreign currencies over the intermeeting period, and much of the move came soon after the March FOMC meeting. We have revised upward the starting point for our projection of the broad real dollar by nearly 2 percent. Thereafter, the dollar depreciates in real terms at an annual rate of roughly 1½ percent, a rate about unchanged from that in the previous Greenbook.

We estimate that real net exports subtracted 1¼ percentage point from U.S. real GDP growth in the first quarter. This subtraction is substantially larger than previously projected and reflects a surprisingly large trade deficit in February. A projected drop in oil imports should lower import growth considerably in the current quarter, which, along with a modest acceleration of exports, results in a positive contribution to real GDP of about ½ percentage point. The contribution then moves back into negative territory and averages around minus ¼ percentage point over the remainder of the forecast period. The current account deficit is projected to widen to about $900 billion, or about 6¾ percent of GDP, by the end of 2006. This projection is little changed from that in the previous Greenbook, as a somewhat wider trade deficit is largely offset by stronger net investment income.

Oil Prices

The spot price of WTI soared to a new high of more than $57 per barrel in early April. Since then, spot WTI has retreated as U.S. crude oil inventories have moved above average levels for this time of year and, amidst considerable volatility, closed at $51.62 per barrel on April 27. Futures quotes call for the spot price of WTI to rise through this year, as market participants expect demand to pick up later this year; futures prices for 2006 tilt down to $52.70 per barrel by year end. Compared with the March Greenbook, this projection for WTI is about $0.70 per barrel higher in the fourth quarter of this year and $3.20 per barrel higher in the fourth quarter of 2006. Our projection for the price of imported oil shows a similar pattern, rising through this year and remaining about flat thereafter; it has been revised up nearly $1 per barrel in the fourth quarter of this year and almost $2 per barrel in the fourth quarter of next year.

Although worldwide growth in the demand for oil appears to have moderated recently, demand remains strong and continues to put upward pressure on oil prices, particularly given OPEC's relatively low spare production capacity. Concerns about the security of supply in a number of countries have also contributed to higher prices. Most recently, business conditions in Russia and Venezuela have deteriorated further, thereby worsening the outlook for the expansion of oil production. Unlike the spike in oil prices last October, which in large part reflected a higher premium for light, sweet varieties of crude oil, the recent rise has been more broadly based. In addition, the elevated level of oil prices is expected to show greater persistence; the price of the far-dated futures contract (for delivery in December 2011) currently stands at $47.60 per barrel, up $11 per barrel since the beginning of the year.

International Financial Markets

The trade-weighted exchange value of the dollar against the major foreign currencies rose 2¼ percent on balance over the intermeeting period. On net, the dollar appreciated more than 4 percent against the Canadian dollar and about 2 percent against the euro but less than 1 percent against the yen and depreciated slightly against sterling.

Following the March FOMC meeting, the dollar appreciated broadly, and interest rate differentials widened in favor of the dollar. Market participants generally interpreted the Committee's statement as signaling heightened concerns over inflation and the possibility of more policy tightening than had been anticipated. Disappointing economic data in several industrial countries, along with heightened political uncertainty in Canada, also supported the dollar. In April, weaker-than-expected U.S. economic data led to an unwinding of the earlier increases in interest rate spreads along with some depreciation of the dollar. The dollar declined against sterling following the release of the minutes of the April 7 meeting of the Bank of England's Monetary Policy Committee, which revealed that two of the nine members had voted for policy tightening. Against the currencies of our other important trading partners, the dollar was little changed on balance over the intermeeting period; depreciations against the Mexican peso and the Brazilian *real* were offset by appreciations against the currencies of several Asian economies.

On the basis of these intermeeting developments and on some appreciation of the dollar between the completion of the March Greenbook and the March FOMC meeting, we have raised the projected value of the broad real dollar in the second quarter by nearly 2 percent. We project that the broad real dollar will depreciate over the remainder of the forecast period at an annual rate of roughly 1½ percent, the same rate as in the March Greenbook. Our projection for real dollar depreciation, as in past Greenbooks, is predicated on the view that investor concerns about the financing burden of the large and growing U.S. current account deficit will exert downward pressure on the dollar.

Three-month interest rates in the foreign industrial countries changed little on net. Medium- and long-term nominal yields rose early in the intermeeting period (though not as much as yields on comparable U.S. Treasuries), but subsequently declined in reaction to weaker-than-expected economic data. On balance, yields on European ten-year government bonds dropped about 30 basis points, the Canadian benchmark yield fell 25 basis points, and the yield on the ten-year JGB declined more than 15 basis points. Headline equity indexes dropped 7 percent in Japan and about 3½ percent in other foreign industrial countries as investors reacted to mixed earnings reports. Share prices in the emerging markets of Latin America and East Asia tumbled 4 to 10 percent. Yield spreads over Treasuries of most emerging market sovereign debt rose slightly on balance over the intermeeting period.

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

Foreign Industrial Countries

We estimate that GDP growth in the foreign industrial countries rose from an annual rate of 1½ percent in the fourth quarter to 2 percent in the first quarter. In several countries, incoming data for January were quite strong, but more recent indicators have suggested some sluggishness. These developments, along with the downward revision to U.S. growth and the higher path of oil prices, have led us to mark down slightly our growth outlook for the remainder of the year. We expect the average pace of expansion to edge up to roughly 2½ percent in the second half of this year and remain there in 2006. Twelve-month headline inflation in the foreign industrial countries is projected to remain near 1½ percent over the forecast period.

In Japan, we estimate that first-quarter GDP growth rose to just above 1½ percent at an annual rate, as industrial production and household spending rose briskly on average. We expect growth in the second quarter to be slightly weaker, as recent indicators of consumption have suggested some softness. Growth is then expected to firm a bit by the end of the forecast period, as improving labor market conditions help support household demand and growing private investment offsets lower public investment. Twelve-month CPI inflation is projected to turn positive on a sustained basis in 2006, and we have penciled in a slight rise in short-term market interest rates in the second half of that year, when we assume that the Bank of Japan will begin its exit from quantitative easing.

In the euro area, we estimate that growth moved up to about 1½ percent in the first quarter, and we see growth continuing at this pace for the rest of the year. Recent indicators point to positive but sluggish growth in Germany and Italy but show continued moderate expansion in France and Spain. Strong corporate balance sheets should help euro-area investment to recover somewhat, and the pace of euro-area growth is projected to edge up next year. We project twelve-month inflation to be below 2 percent over the forecast period.[1] We assume that the European Central Bank will not change its policy rates over the forecast period, despite pronouncements from the ECB that rates need to be raised to more-neutral levels.

First-quarter GDP in the United Kingdom rose at an annual rate of 2.2 percent according to the preliminary estimate. The service sector continued to expand at a brisk pace, and industrial production contracted further. We project that house price inflation will remain subdued and that GDP growth will inch up to just over 2½ percent for the rest of this year, before softening slightly in 2006 as fiscal policy becomes more contractionary. The Bank of England is assumed to raise rates another 25 basis points in coming months. We project that inflation will remain around the target rate of 2 percent.

In Canada, we estimate that output grew 2½ percent in the first quarter. Continued strong growth in final domestic demand more than offset a slowdown in inventory accumulation and weakness in the external sector stemming from an appreciated Canadian dollar. We project that waning negative contributions from net trade and inventories will bring growth up to around 3½ percent early next year. We assume a further 100 basis points of monetary policy tightening over the forecast period starting in the second half of this year. This stance appears consistent with keeping inflation around the 2 percent midpoint of the Bank of Canada's inflation target range.

Other Countries

After rising 5½ percent last year, we expect real GDP in the emerging market economies, on average, to rise 5 percent this year and 4½ percent in 2006. This year's moderation in growth largely reflects the effects of tighter monetary policy in some Latin American countries aimed at curbing inflationary pressures. Growth in emerging Asia is projected to remain robust this year but to ease back next year as China's expansion cools to a more sustainable pace. With the exception of the first quarter, we have marked up our outlook for growth in the emerging market economies this year from that in the March Greenbook, largely because of an upward revision for China. For 2006, we have slightly tempered the growth outlook.

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[1] In 2006, euro-area inflation will be depressed 0.2 percentage point by a change in the measurement of Dutch inflation. Insurance premiums for basic healthcare services in the Netherlands will be re-classified as social insurance expenditures, and the prices for those services in the Dutch CPI will be set to zero.

In emerging Asia, we estimate that real GDP grew at an annual rate of 4¾ percent in the first quarter, down from the fourth-quarter pace and a touch weaker than projected in the March Greenbook. In China, real GDP surprised on the upside, rising an estimated 14 percent at an annual rate on robust exports and investment. We project Chinese growth to continue at a double-digit pace through the third quarter of this year before settling back to about 7½ percent, as authorities are expected to take further measures to slow investment. The roaring Chinese economy is also expected to lift activity this year in the rest of developing Asia, particularly Hong Kong and Taiwan.

Elsewhere in emerging Asia, growth in the first quarter, on average, is estimated to be somewhat weaker than projected in the March Greenbook. The downward revision in large part reflects a preliminary 6 percent decline in Singapore's GDP as a result of maintenance-related shutdowns in the biomedical sector. Output in that economy is expected to bounce back in the current quarter. Real GDP growth also is estimated to have been weak in India in the first quarter as a result of poor performance in the agricultural sector, but activity should pick up later this year in response to what is expected to be a favorable monsoon season. In Korea, consumption is projected to continue to strengthen over the forecast period as consumer debt burdens slowly lessen. For emerging Asia as a whole, growth is projected to decline from 5¾ percent this year to about 5 percent next year, largely because of the projected slowing in China.

In Latin America, we estimate that real GDP grew at a 4 percent annual rate in the first quarter, after growth of 5½ percent in the fourth quarter. The slowdown in large part reflects diminished growth in Mexico, where activity appears to be responding to the tightening of monetary policy over the past year. Our projection that growth in Latin America will continue to average about 4 percent this year and next reflects continued tight monetary policy in Mexico and Brazil and somewhat less robust U.S. growth.

Consumer price inflation in emerging market economies is expected to decline from about 4 percent in 2004 to about 3½ percent this year as the tighter policy in Latin America brings average inflation in that region down from 5½ percent last year to about 4¼ percent. Inflation in developing Asia is projected to remain near 3 percent over the forecast period.

Prices of Internationally Traded Goods

According to the advance NIPA data released this morning, core import prices rose at an annual rate of 4¾ percent in the first quarter. Within core imports, all major categories of goods, with the exception of automotive products, registered substantial price gains. The rise was a bit larger than we anticipated in the March Greenbook and was somewhat stronger than movements in the dollar, foreign prices, and commodity prices would suggest. In the fourth quarter, however, core import prices rose less than these factors would predict. Smoothing through these fluctuations, recent changes in core import prices appear to be in line with the historical relationships that underpin our projections.

Staff Projections of Selected Trade Prices
(Percent change from end of previous period excepted as noted, s.a.a.r.)

Indicator	2004		Projection			
			2005			2006
	H1	H2	Q1	Q2	H2	
Exports						
Core goods	6.9	3.4	6.0	4.5	2.7	2.7
March GB	6.9	3.4	5.4	3.8	2.1	2.2
Imports						
Non-oil core goods	5.2	3.3	4.7	3.0	2.3	.7
March GB	5.2	3.2	4.4	2.2	2.2	.6
Oil (dollars per barrel)	34.55	40.91	39.87	43.20	46.90	46.86
March GB	34.55	40.91	40.28	45.59	45.99	44.97

Note. Prices for core exports and non-oil core imports, which exclude computers and semiconductors, are on a NIPA chain-weighted basis.
The price of imported oil for multiquarter periods is the price for the final quarter of the period.

We project that core import price inflation will moderate to 3 percent in the current quarter. The step-down from the first quarter is largely a reflection of the recent appreciation of the dollar. Nevertheless, we have marked up our projection for core import price inflation in the current quarter ¾ percentage point from the March Greenbook to reflect a noticeable rise in primary commodity prices. In the second half of the year, core import price inflation should remain near 2¼ percent as the effects of recent increases in commodity prices persist. In 2006, with futures quotes calling for flat commodity prices and with only modest changes projected for the dollar, core import price inflation drops below 1 percent.

We have maintained our assumption that the expiration of the multifiber arrangement at the end of last year will have only a small effect on core import prices over the forecast period. Uncertainty about protectionist measures, including the possibilities of U.S. trade actions as well as of additional taxes levied by China on its apparel exports, will likely slow the downward adjustment of imported apparel prices. Nonetheless, there is a risk that these prices could fall more quickly than we anticipate.

Core export prices rose an estimated 6 percent at an annual rate in the first quarter after a 5 percent rise in the fourth quarter. The continued strength in prices of exported core goods primarily reflects higher prices for materials and other industrial supplies. In the current quarter, we project that core export prices will increase 4½ percent. For the rest of 2005 and 2006, core export price inflation is projected to average close to 2¾ percent as producer prices for materials decelerate.

Trade in Goods and Services

In February, nominal imports of goods and services rose sharply, boosted by large increases in imports of oil and consumer goods. The import gain in February was larger than had been expected. As a consequence, and consistent with the rapid increase indicated by this morning's advance NIPA report, we have raised our estimate of growth of real imports in the first quarter to 13¾ percent, more than 4 percentage points higher than in the March Greenbook. We estimate that imports of core goods rose 18 percent at an annual rate, well above what would be consistent with the evolution of U.S. activity and the dollar. No special factors appear to explain this strength.

In the current quarter we expect the growth of real imports to slow dramatically to around 1¼ percent. This deceleration results in part from a projected steep drop in the volume of oil imports, which in turn is due largely to a quirky seasonal pattern in the data. In addition, after two very strong quarters, core import growth steps down to a pace more in line with the projected path of relative prices and U.S. GDP. The slowing of U.S. growth from last year and higher import prices weigh on core imports as well. The growth of imported services also is projected to slow after a strong first quarter, despite some reduced drag from the previous depreciation of the dollar. In contrast to core goods and services, imports of computers and semiconductors are expected to pick up, following a lackluster first quarter.

In the second half of 2005 and in 2006, real import growth is projected to average about 6½ percent at an annual rate as imports of oil bounce back and other categories maintain their pace of expansion. Amidst steady support from U.S. GDP growth, imports of core goods accelerate, as the restraint exerted by import prices wanes. Imports of computers and semiconductors are projected to rise steadily, whereas growth of imported services eases. Compared with the March Greenbook, our projection for overall real import growth (excluding the first quarter) is a bit weaker on average; notwithstanding the stronger dollar, we have marked down the projected path of imported core goods in response to lower U.S. GDP growth and somewhat higher core import prices.

Summary of Staff Projections
for Trade in Goods and Services
(Percent change from end of previous period, s.a.a.r.)

Indicator	2004		Projection			
			2005			2006
	H1	H2	Q1	Q2	H2	
Real exports	7.3	4.6	7.9	8.2	8.5	6.7
March GB	*7.3*	*4.6*	*7.9*	*8.8*	*9.1*	*7.5*
Real imports	11.6	7.9	13.7	1.2	6.9	6.4
March GB	*11.6*	*7.7*	*9.3*	*1.9*	*6.9*	*6.8*

Note. Changes for years are measured as Q4/Q4; for half-years, Q2/Q4 or Q4/Q2.

In February, nominal exports were unchanged for the second consecutive month. Exports of services, computers, and semiconductors came in below our expectations, whereas exports of core goods were somewhat stronger. We estimate that real exports of goods and services rose at an annual rate of 8 percent in the first quarter, the same as projected in the March Greenbook. Real exports of services increased only marginally in the first quarter, much less than movements in foreign income and relative prices would have suggested. Moreover, real exports of semiconductors appear to have decreased for the fourth consecutive quarter. In contrast, real exports of core goods look to have been a good bit stronger than previously projected; we now estimate that exports of core goods rose 11¼ percent in the first quarter, up sharply from the fourth quarter's anemic pace. In the current quarter, we expect overall exports to rise 8¼ percent as services exports recover, exports of semiconductors resume growth, and sales of core goods declerate. This projection is ½ percentage point weaker than in the March Greenbook and reflects the effects of the recent strengthening of the dollar on core goods and services.

In the second half of 2005, export growth is projected to maintain a solid pace, as exports of core goods and services continue to be supported by ongoing foreign growth and the stimulus from previous dollar depreciation. In 2006, we expect real export growth to slow to 6¾ percent as the positive effect of previous dollar depreciation on core goods and services wanes. Exports of computers and semiconductors are projected to rise throughout the forecast period, as global high-tech demand is expected to firm. Our projection for exports in the second half of 2005 and in 2006 is a bit lower than in the March Greenbook, as we have moderated the expected growth rate of core goods and services in response to the recent appreciation of the dollar.

Alternative Simulations

In our first alternative simulation, we used the FRB/Global model to assess the possibility that foreign activity will expand more briskly than we anticipate. In particular, we consider the effects of an autonomous increase in foreign demand that boosts spending by 2 percent of GDP in developing Asia and 1 percent of GDP in the other foreign economies. The larger shock to developing Asia is intended to capture the possibility of a rebound in investment rates which, except in China, have remained depressed since the 1997-98 financial crisis. We also considered a simulation in which stronger foreign demand is accompanied by a rise in the energy intensity of activity in developing Asia, implying much stronger pressure on global oil supplies. This represents a plausible risk, considering that energy usage in some developing Asian economies has risen sharply in recent years, even in the face of soaring oil prices.

In the first scenario, the rise in foreign demand stimulates U.S. real net exports directly through higher foreign demand for U.S.-produced goods and indirectly through a modest depreciation of the dollar. As a result, U.S. GDP growth rises 0.3 percentage point relative to baseline in the second half of this year and about 0.4 percentage point in 2006. Core PCE inflation increases ¼ percentage point above baseline in 2006. The increase in the core PCE price index reflects several factors: a rise in import prices due to dollar depreciation, the effects of higher aggregate demand on domestic prices, and an increase in oil prices (not shown) of more than $5 per barrel above baseline by end-2006 associated with stronger world activity. Although the trade balance initially shows little response to the shock due to J-curve effects, it improves by 0.1 percentage point of GDP in the second half of 2006 relative to baseline (and improves by a considerably larger magnitude at longer horizons).

In the second scenario, in which the foreign demand shock is accompanied by an additional shock to oil demand in developing Asia, oil prices rise roughly $15 per barrel above baseline by the end of 2006. The increase in oil prices is not permanent, as adjustments in demand and supply eventually bring oil prices back to baseline. U.S. GDP growth rises a bit less than in the first scenario, as the boost coming from foreign demand is offset by higher oil prices. Core PCE inflation is slightly higher than in the first scenario by the end of the forecast period. Beyond our projection period, however, the combined shocks put noticeably more upward pressure on core PCE prices; with the nominal federal funds rate unchanged, the higher energy prices slowly feed through to inflation expectations and wages. The shocks induce the trade balance to deteriorate relative to baseline over the remainder of the forecast period, as the effects of higher oil prices show through more quickly than the pickup in foreign demand; over somewhat longer periods, the latter effect dominates, and the trade balance shows a slight improvement relative to baseline.

Alternative Simulations:
Stronger Foreign Aggregate Demand
and Higher Oil Demand
(Percent change from previous period, annual rate, except as noted)

Indicator and simulation	2005		2006	
	H1	H2	H1	H2
U.S. real GDP				
Baseline	3.4	3.7	3.5	3.5
Stronger foreign aggregate demand	3.5	4.0	3.9	3.9
With additional shock to oil demand	3.5	3.9	3.9	3.8
U.S. PCE prices excluding food and energy				
Baseline	2.1	1.8	1.8	1.7
Stronger foreign aggregate demand	2.1	1.9	2.0	2.0
With additional shock to oil demand	2.1	1.9	2.0	2.1
U.S. trade balance (percent share of GDP)				
Baseline	-5.8	-5.9	-5.9	-5.8
Stronger foreign aggregate demand	-5.8	-5.9	-5.9	-5.7
With additional shock to oil demand	-5.9	-6.1	-6.1	-5.9

Note. H1 is Q2/Q4; H2 is Q4/Q2. In these simulations, the nominal federal funds rate remains unchanged from baseline, and the monetary authorities in major foreign economies adjust their policy rates according to a Taylor rule.

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

Measure and country	1998	1999	2000	2001	2002	2003	2004	Projected 2005	Projected 2006
REAL GDP (1)									
Total foreign	1.5	5.0	4.2	0.3	3.0	2.8	3.6	3.3	3.3
Industrial Countries	2.7	4.4	3.5	0.8	2.6	1.7	2.3	2.3	2.5
of which:									
Canada	4.4	5.9	4.1	1.4	3.8	1.7	3.0	2.9	3.2
Japan	-1.1	0.2	3.2	-2.0	1.4	2.1	1.0	1.4	1.7
United Kingdom	2.8	3.3	3.0	2.2	1.9	2.7	2.9	2.5	2.4
Euro Area (2)	1.9	3.9	2.8	0.8	1.2	0.8	1.6	1.5	1.7
Germany	0.7	3.3	1.9	0.5	0.5	0.0	0.6	1.0	1.4
Developing Countries	-0.3	6.0	5.3	-0.5	3.6	4.5	5.5	4.9	4.5
Asia	-1.9	8.5	5.8	1.0	5.9	6.5	5.9	5.7	5.1
Korea	-5.4	11.4	4.5	4.7	7.7	4.1	3.0	4.0	4.0
China	9.8	7.0	7.6	6.9	8.3	10.0	9.5	10.4	7.5
Latin America	1.2	4.4	4.5	-1.3	1.5	2.4	5.1	4.0	4.0
Mexico	2.9	5.5	4.8	-1.3	2.0	2.1	4.9	4.1	4.1
Brazil	-1.7	3.5	3.9	-0.9	4.2	0.8	4.8	2.5	2.7
CONSUMER PRICES (3)									
Industrial Countries	0.9	1.1	1.7	0.9	2.1	1.3	1.8	1.1	1.5
of which:									
Canada	1.1	2.4	3.1	1.1	3.8	1.7	2.3	1.7	2.0
Japan	0.7	-1.1	-1.2	-1.3	-0.5	-0.5	0.4	-0.6	0.2
United Kingdom (4)	1.4	1.2	1.0	1.0	1.6	1.3	1.4	2.1	2.0
Euro Area (2)	0.9	1.5	2.5	2.1	2.3	2.1	2.3	1.6	1.6
Germany	0.3	1.1	1.7	1.5	1.2	1.2	2.1	1.0	1.4
Developing Countries	9.0	4.6	4.1	2.8	2.9	3.1	3.9	3.6	3.5
Asia	4.9	0.1	1.9	1.2	0.8	2.2	3.2	3.2	3.1
Korea	5.8	1.2	2.6	3.4	3.4	3.5	3.4	3.8	4.2
China	-1.2	-1.0	1.0	-0.1	-0.5	2.7	3.3	2.8	3.0
Latin America	15.4	12.5	8.4	5.3	6.4	5.0	5.6	4.2	4.4
Mexico	17.3	13.5	8.7	5.1	5.3	3.9	5.3	3.6	4.0
Brazil	2.0	8.4	6.4	7.5	10.7	11.5	7.2	6.7	5.0

1. Foreign GDP aggregates calculated using shares of U.S. exports.
2. Harmonized data for euro area from Eurostat.
3. Foreign CPI aggregates calculated using shares of U.S. non-oil imports.
4. CPI excluding mortgage interest payments, which is the targeted inflation rate.

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

	2004				Projected 2005				Projected 2006			
Measure and country	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
REAL GDP (1)	Quarterly changes at an annual rate											
Total foreign	4.8	3.7	2.7	3.1	3.0	3.4	3.5	3.4	3.4	3.3	3.3	3.3
Industrial Countries	3.3	2.8	1.6	1.4	2.0	2.1	2.4	2.5	2.6	2.5	2.5	2.5
of which:												
Canada	2.8	4.5	2.9	1.7	2.5	2.6	3.2	3.2	3.4	3.2	3.1	3.0
Japan	6.0	-1.0	-1.1	0.5	1.6	1.3	1.1	1.4	1.6	1.7	1.7	1.8
United Kingdom	2.7	3.9	2.2	2.8	2.2	2.6	2.6	2.6	2.4	2.4	2.4	2.4
Euro Area (2)	2.9	1.8	1.0	0.6	1.5	1.4	1.4	1.5	1.6	1.7	1.7	1.7
Germany	2.0	1.4	0.1	-0.9	1.3	0.8	1.0	1.2	1.3	1.4	1.4	1.4
Developing Countries	7.0	4.9	4.4	5.6	4.4	5.2	5.1	4.8	4.5	4.5	4.5	4.5
Asia	7.8	4.6	5.7	5.6	4.8	6.4	6.1	5.5	5.1	5.1	5.1	5.1
Korea	2.6	2.4	3.3	3.8	4.2	4.0	4.0	4.0	4.0	4.0	4.0	4.0
China	14.4	2.8	10.1	11.2	14.0	10.0	10.0	7.5	7.5	7.5	7.5	7.5
Latin America	6.3	5.0	3.8	5.4	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Mexico	5.6	4.5	3.8	5.5	4.1	4.1	4.1	4.1	4.1	4.1	4.1	4.1
Brazil	7.3	6.0	4.4	1.7	2.5	2.5	2.5	2.5	2.7	2.7	2.7	2.7
CONSUMER PRICES (3)	Four-quarter changes											
Industrial Countries	0.9	1.5	1.5	1.8	1.4	1.3	1.3	1.1	1.4	1.5	1.5	1.5
of which:												
Canada	0.9	2.2	2.0	2.3	2.1	1.7	1.9	1.7	2.0	2.0	2.0	2.0
Japan	-0.3	-0.2	-0.1	0.4	-0.3	-0.3	-0.2	-0.6	-0.0	0.1	0.2	0.2
United Kingdom (4)	1.2	1.4	1.3	1.4	1.7	2.0	2.2	2.1	2.0	1.9	1.9	2.0
Euro Area (2)	1.7	2.3	2.3	2.3	2.0	1.8	1.7	1.6	1.8	1.8	1.7	1.6
Germany	1.0	1.9	2.0	2.1	1.7	1.3	1.2	1.0	1.4	1.4	1.4	1.4
Developing Countries	3.1	3.6	4.5	3.9	3.5	3.6	3.3	3.6	3.8	3.7	3.6	3.5
Asia	2.4	3.3	4.2	3.2	2.9	2.9	2.6	3.2	3.4	3.3	3.3	3.1
Korea	3.2	3.4	4.3	3.4	3.1	3.4	2.9	3.8	4.3	4.6	4.5	4.2
China	3.0	4.3	5.2	3.3	2.8	2.4	2.1	2.8	3.0	3.0	3.0	3.0
Latin America	4.7	4.6	5.2	5.6	4.9	5.2	4.8	4.2	4.7	4.5	4.4	4.4
Mexico	4.3	4.3	4.8	5.3	4.4	4.7	4.3	3.6	4.2	4.1	4.1	4.0
Brazil	6.8	5.5	6.8	7.2	7.4	7.7	7.0	6.7	6.0	5.5	5.2	5.0

1. Foreign GDP aggregates calculated using shares of U.S. exports.
2. Harmonized data for euro area from Eurostat.
3. Foreign CPI aggregates calculated using shares of U.S. non-oil imports.
4. CPI excluding mortgage interest payments, which is the targeted inflation rate.

Strictly Confidential (FR)
Class II FOMC

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OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1998	1999	2000	2001	2002	2003	2004	Projected 2005	Projected 2006
NIPA REAL EXPORTS and IMPORTS									
Percentage point contribution to GDP growth, Q4/Q4									
Net Goods & Services	-1.1	-1.0	-0.9	-0.2	-0.9	-0.1	-0.8	-0.3	-0.3
Exports of G&S	0.3	0.6	0.7	-1.3	0.3	0.6	0.6	0.8	0.7
Imports of G&S	-1.4	-1.6	-1.6	1.1	-1.3	-0.7	-1.4	-1.1	-1.0
Percentage change, Q4/Q4									
Exports of G&S	2.6	5.6	6.5	-11.9	3.5	6.1	5.9	8.3	6.7
Services	4.4	5.3	1.8	-8.9	9.8	3.8	4.4	5.2	5.8
Computers	7.3	13.4	22.7	-23.5	-1.0	11.2	5.9	16.6	14.4
Semiconductors	9.5	34.6	27.6	-34.6	9.9	38.8	-5.8	19.3	29.1
Other Goods 1/	1.2	3.3	5.9	-10.2	0.4	5.0	7.5	8.7	5.7
Imports of G&S	11.0	12.1	11.2	-7.6	9.7	4.9	9.8	7.1	6.4
Services	10.4	6.6	10.6	-5.9	8.9	3.7	2.2	5.3	4.4
Oil	4.1	-3.4	13.3	3.7	4.3	1.7	10.3	-5.3	0.4
Computers	26.4	26.0	13.9	-13.6	13.4	16.9	22.3	13.4	17.5
Semiconductors	-7.7	34.2	22.8	-51.1	10.0	0.3	9.2	19.3	29.1
Other Goods 2/	11.2	12.9	10.5	-6.5	9.9	4.9	10.6	9.0	6.7
Billions of Chained 2000 Dollars									
Net Goods & Services	-203.7	-296.2	-379.5	-399.1	-472.1	-518.5	-583.7	-647.1	-671.3
Exports of G&S	966.5	1008.2	1096.3	1036.7	1012.3	1031.8	1120.3	1197.4	1283.8
Imports of G&S	1170.3	1304.4	1475.8	1435.8	1484.4	1550.2	1704.0	1844.6	1955.2
Billions of dollars									
US CURRENT ACCOUNT BALANCE	-209.6	-296.8	-413.5	-385.7	-473.9	-530.7	-665.9	-812.0	-887.1
Current Acct as Percent of GDP	-2.4	-3.2	-4.2	-3.8	-4.5	-4.8	-5.7	-6.5	-6.8
Net Goods & Services (BOP)	-164.9	-263.3	-378.4	-362.7	-421.7	-496.5	-617.1	-725.7	-763.3
Investment Income, Net	8.3	18.4	25.3	28.7	12.6	38.8	29.8	8.8	-26.2
Direct, Net	65.5	78.2	94.9	115.9	100.8	118.9	132.3	166.1	179.6
Portfolio, Net	-57.2	-59.8	-69.7	-87.2	-88.2	-80.1	-102.5	-157.3	-205.8
Other Income & Transfers,Net	-53.0	-52.0	-60.4	-51.7	-64.8	-72.9	-78.7	-95.1	-97.6

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

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OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2001 Q1	2001 Q2	2001 Q3	2001 Q4	2002 Q1	2002 Q2	2002 Q3	2002 Q4	2003 Q1	2003 Q2	2003 Q3	2003 Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-0.0	0.5	-0.6	-0.7	-1.1	-0.5	-0.4	-1.7	0.1	-0.5	0.6	-0.7
Exports of G&S	-0.6	-1.4	-2.0	-1.1	0.4	1.0	0.3	-0.4	-0.2	-0.2	1.0	1.6
Imports of G&S	0.6	1.9	1.5	0.5	-1.5	-1.4	-0.7	-1.3	0.3	-0.3	-0.4	-2.2
Percentage change from previous period, s.a.a.r.												
Exports of G&S	-5.3	-12.7	-18.2	-10.8	4.7	11.0	3.1	-4.2	-1.5	-1.6	11.3	17.5
Services	-5.0	-0.7	-13.7	-15.3	21.7	4.5	3.5	10.4	-12.7	-3.4	14.1	20.6
Computers	-9.8	-35.7	-24.9	-21.3	-20.4	11.9	-3.8	12.3	-4.5	-3.4	38.2	19.8
Semiconductors	-30.0	-54.0	-45.3	3.7	24.9	38.8	11.4	-24.4	40.9	28.0	40.8	45.9
Other Goods 1/	-2.5	-11.5	-17.6	-8.6	-2.1	12.6	2.8	-10.3	2.4	-2.4	6.6	13.9
Imports of G&S	-3.7	-12.6	-10.3	-3.4	12.5	11.4	5.4	9.6	-2.0	2.5	2.8	17.1
Services	-5.0	12.8	-18.3	-10.4	24.7	-5.8	2.8	16.6	-2.6	-9.4	17.9	11.1
Oil	63.6	-33.8	-28.2	48.9	-5.6	-17.6	-10.7	70.0	-6.1	-2.7	0.6	16.5
Computers	-22.6	-23.3	-13.4	8.4	50.2	7.2	2.6	0.2	7.0	15.9	12.0	34.2
Semiconductors	-43.9	-70.1	-55.4	-23.7	42.3	33.9	-6.7	-17.6	-4.0	2.4	-1.5	4.4
Other Goods 2/	-5.5	-10.6	-3.7	-5.9	8.3	19.4	8.5	4.2	-1.8	5.5	-0.9	17.9
Billions of Chained 2000 Dollars, s.a.a.r.												
Net Goods & Services	-398.2	-385.2	-398.4	-414.5	-444.9	-458.1	-469.8	-515.4	-511.7	-525.2	-508.7	-528.3
Exports of G&S	1097.2	1060.6	1008.7	980.3	991.6	1017.8	1025.5	1014.5	1010.6	1006.5	1033.8	1076.2
Imports of G&S	1495.4	1445.8	1407.1	1394.9	1436.5	1475.9	1495.3	1529.8	1522.3	1531.7	1542.5	1604.5
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-426.8	-390.2	-367.6	-358.3	-440.8	-471.6	-476.0	-507.4	-552.8	-535.5	-526.5	-507.8
Current Account as % of GDP	-4.3	-3.9	-3.6	-3.5	-4.3	-4.5	-4.5	-4.8	-5.1	-4.9	-4.7	-4.5
Net Goods & Services (BOP)	-389.3	-356.1	-357.1	-348.3	-375.0	-413.5	-427.7	-470.7	-501.5	-493.5	-489.0	-502.0
Investment Income, Net	23.9	29.8	1.5	59.7	9.2	1.8	10.6	28.8	21.5	29.1	34.5	70.1
Direct, Net	106.2	116.1	95.0	146.2	100.6	95.1	94.9	112.8	101.3	105.4	114.6	154.2
Portfolio, Net	-82.3	-86.3	-93.5	-86.6	-91.4	-93.2	-84.3	-84.0	-79.8	-76.3	-80.1	-84.1
Other Inc. & Transfers, Net	-61.3	-63.9	-12.0	-69.7	-75.0	-59.9	-59.0	-65.4	-72.8	-71.0	-72.0	-76.0

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

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OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2004				Projected 2005				Projected 2006			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-0.8	-1.1	-0.1	-1.4	-1.3	0.6	-0.1	-0.4	-0.5	0.2	-0.3	-0.6
Exports of G&S	0.7	0.7	0.6	0.3	0.8	0.8	0.8	0.9	0.6	0.7	0.7	0.8
Imports of G&S	-1.5	-1.8	-0.7	-1.7	-2.1	-0.2	-0.9	-1.3	-1.1	-0.5	-1.0	-1.4
Percentage change from previous period, s.a.a.r.												
Exports of G&S	7.3	7.3	6.0	3.2	7.9	8.2	8.0	9.1	5.7	6.8	6.6	7.7
Services	3.4	10.2	-1.8	6.2	1.8	6.6	6.4	6.1	5.9	5.9	5.7	5.6
Computers	-8.3	-1.8	22.4	14.0	17.3	20.4	14.3	14.3	14.4	14.4	14.4	14.4
Semiconductors	12.5	-10.1	-20.7	-1.7	-4.1	26.3	29.2	29.2	29.1	29.1	29.1	29.1
Other Goods 1/	10.1	7.7	11.1	1.5	11.2	7.3	7.3	9.2	4.0	5.8	5.5	7.3
Imports of G&S	10.6	12.6	4.6	11.4	13.7	1.2	5.6	8.1	7.1	3.0	6.5	9.0
Services	1.2	10.6	2.8	-5.2	7.5	4.0	4.7	5.1	4.7	4.4	4.4	4.3
Oil	39.1	-33.1	2.0	56.1	3.8	-32.4	-3.3	18.6	7.9	-24.5	-0.2	24.7
Computers	12.8	38.6	29.9	10.1	4.7	14.8	17.3	17.4	17.5	17.5	17.5	17.5
Semiconductors	42.2	21.2	7.4	-23.2	-3.8	26.3	28.9	29.2	29.1	29.1	29.1	29.1
Other Goods 2/	8.9	19.7	3.7	10.6	18.1	5.9	6.2	6.3	6.4	6.7	6.9	7.0
Billions of Chained 2000 Dollars, s.a.a.r.												
Net Goods & Services	-550.1	-580.3	-583.2	-621.1	-656.6	-639.2	-641.4	-651.3	-666.5	-660.2	-670.0	-688.6
Exports of G&S	1095.4	1114.8	1131.1	1140.0	1162.0	1185.0	1208.0	1234.6	1251.8	1272.7	1293.3	1317.5
Imports of G&S	1645.5	1695.1	1714.3	1761.2	1818.6	1824.2	1849.5	1886.0	1918.4	1932.8	1963.3	2006.1
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-589.9	-658.8	-663.4	-751.6	-797.1	-791.4	-815.1	-844.2	-881.4	-869.9	-886.2	-910.9
Current Account as % of GDP	-5.1	-5.7	-5.6	-6.3	-6.5	-6.4	-6.5	-6.7	-6.9	-6.7	-6.7	-6.8
Net Goods & Services (BOP)	-555.3	-605.3	-623.5	-684.2	-714.6	-712.1	-728.2	-747.8	-764.3	-752.6	-759.2	-777.0
Investment Income, Net	53.9	25.9	25.3	14.2	20.2	10.8	5.0	-0.7	-11.4	-21.4	-29.1	-42.8
Direct, Net	138.7	124.7	125.5	140.4	154.9	164.7	170.5	174.3	174.6	176.5	183.0	184.3
Portfolio, Net	-84.8	-98.7	-100.2	-126.3	-134.7	-154.0	-165.5	-175.0	-186.0	-198.0	-212.1	-227.1
Other Inc. & Transfers, Net	-88.4	-79.5	-65.3	-81.6	-102.6	-90.1	-91.9	-95.6	-105.7	-95.8	-97.9	-91.1

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