Prefatory Note

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Class II FOMC - Restricted (FR)

Part 1

January 25, 2006

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 underlying pace of economic activity appears to be well maintained. Although the increase in real GDP last quarter seems to have been a fair bit smaller than we had anticipated in the December Greenbook, the unexpected weakness was concentrated in categories—exports, federal spending, and inventory investment—in which a first-quarter rebound is likely. Elsewhere, motor vehicle sales have already turned up after their dip in the fall, and consumer outlays for other goods have been advancing briskly. Other timely indicators—including consumer sentiment and initial claims for unemployment insurance—are consistent with solid near-term growth. That said, information on housing activity has been supportive of our view that a cooling in that sector is under way. All told, we now project that real GDP will rise at an annual rate of 4 percent in the current quarter after a 2½ percent advance last quarter.

Looking further ahead, we expect real GDP to increase 3¾ percent in 2006 as a whole and 3 percent in 2007. Reduced impetus from monetary and fiscal policy, as well as smaller gains in household wealth, should restrain economic growth relative to its pace in recent years. These forces will be partly offset by a diminished drag from increases in oil prices and, in 2006, by the recovery and rebuilding associated with last year's hurricanes. With only modest changes in our conditioning assumptions, the contour of output growth is similar to that in the previous Greenbook. The projected pace of expansion is expected to keep the unemployment rate close to its fourth-quarter average of 5 percent during the next two years.

The recent data on core consumer price inflation have, on balance, been quite close to our expectations. However, an increase in spot and futures prices for crude oil and an upward revision to our projected path for nonfuel import prices imply somewhat greater cost pressures than we had anticipated. In response, we have nudged up our forecast of core consumer price inflation 0.1 percentage point this year. We now project that core PCE prices will increase 2.2 percent in 2006 and 1.8 percent in 2007; as in our previous forecast, core inflation falls back next year as the indirect effects of previous increases in energy and nonfuel import prices diminish.

Key Background Factors

With inflationary pressures a touch higher in this forecast, we have built in a slightly more restrictive monetary policy than in the last Greenbook. Our projection is now conditioned on the assumption that the Committee will raise the target federal funds rate 25 basis points at both the January and March meetings. The target rate is assumed to remain at 4¾ percent through the middle of 2007 and then to step down 25 basis points in response to a decline in inflation and a slight widening of the output gap. This path for the federal funds rate is a little higher than that implied by futures quotes, which suggest that market participants expect the funds rate to start reversing course late this year and to be back to 4¼ percent by the end of 2007.

Long-term Treasury yields have moved down about 10 basis points since the December Greenbook. We anticipate that yields will edge up during the next two years as investors' expectations for monetary policy come in line with the staff's assumption. Corporate yields and long-term mortgage rates are also expected to creep up over the forecast period.

Broad equity price indexes are little changed, on net, since our last projection. We continue to assume that stock prices will increase at an annual rate of 6½ percent, a pace that would roughly maintain risk-adjusted parity with the returns on long-term Treasury securities. Regarding house prices, we still expect the OFHEO repeat-transactions index to decelerate from an 11½ percent increase in 2005 to a 5½ percent rise in 2006 and a 2½ percent gain in 2007.

We currently estimate that last year's hurricanes depressed real GDP growth in 2005 about 0.3 percentage point and will boost growth this year roughly 0.5 percentage point. Both of these figures are a little larger than in the last Greenbook. Exports of chemicals and petroleum products have not recovered as quickly as we had anticipated, and we have not seen a compensating bulge in inventory accumulation. The process of replacing the lost housing stock also seems to be off to a slower start than we had expected. These factors imply greater restraint in 2005 and greater stimulus in 2006. In addition, the Bureau of Economic Analysis raised its estimate of the real value of housing lost because of the hurricanes by about one-fifth, and we have increased the total amount of rebuilding in our forecast.

Our outlook for fiscal policy over the next two years remains largely the same. As in the December Greenbook, we assume that federal outlays and tax cuts related to the hurricanes will total $85 billion, of which $70 billion will occur during the forecast period. Real defense spending should rise at a moderate pace in 2006 and then flatten out in 2007 as outlays in Iraq decline and other defense spending continues to expand slowly. On the nondefense side, real purchases excluding hurricane relief are projected to increase about 1 percent in 2006 and to be unchanged in 2007. Notwithstanding the complications surrounding the launch of the new Medicare drug benefit, we believe that spending on this program will ramp up quickly this year. All told, we expect the unified budget deficit to increase from $318 billion in fiscal year 2005 to $347 billion in fiscal 2006 and $353 billion in fiscal 2007.[1] These amounts are very close to those in the December Greenbook. Under our assumptions, fiscal policy imparts a 0.4 percentage point impetus to real GDP growth in 2006 and is roughly neutral in 2007.

Brisk growth in tax receipts is easing the budget pressures faced by state and local governments. As a result, we expect spending to rise more rapidly over the projection period than in the past several years.

The foreign exchange value of the dollar has declined, on net, since the December Greenbook, and we have reduced our projection for the level of the broad real dollar in the current quarter by 1¾ percent. From this lower level, we are projecting the broad real dollar to depreciate 1⅓ percent per year. Incoming data on economic growth abroad have been a shade stronger than we had expected, and we have marked up our projection accordingly. We now anticipate that foreign economic activity will expand 3½ percent on average in 2006 and 2007.

The spot price of West Texas intermediate (WTI) crude oil has jumped about $7 per barrel since early December, and futures prices for oil over the next two years have moved up roughly $6 per barrel on average. Against a backdrop of strong world oil demand, concerns about the reliability of oil supply from several countries—in particular, Iran, Iraq, Nigeria, and Russia—seem to have provoked the recent price increases. Consistent with futures quotes, we expect the price of WTI to edge up from its current level of $67 per barrel to $69 per barrel by the end of the year and then to remain close to that level through 2007.

Recent Developments and the Near-Term Outlook

We estimate that real GDP rose at an annual rate of just 2½ percent in the fourth quarter, below our December Greenbook projection of 3½ percent. Incoming data on exports, federal spending, and inventory investment outside the motor vehicle sector have been notably weaker than we had anticipated. However, we see little reason to carry this weakness forward; indeed, we have taken the lower levels of spending in these areas in the fourth quarter as reason to expect somewhat faster growth in the first quarter. More-

[1] As in past Greenbooks, we assume that the Congress will extend most of the provisions of the tax code due to expire during the forecast period, including individual AMT relief and the research and experimentation tax credit.

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

Measure	2005:Q4 Dec. GB	2005:Q4 Jan. GB	2006:Q1 Dec. GB	2006:Q1 Jan. GB
Real GDP	**3.4**	**2.4**	**3.7**	**4.1**
Private domestic final purchases	1.8	1.9	5.2	4.5
Personal consumption expenditures	0.7	1.1	4.8	4.5
Residential investment	9.3	7.6	2.7	-.4
Business fixed investment	4.8	4.0	9.1	7.3
Government outlays for consumption and investment	1.6	.2	3.7	4.1
	Contribution to growth (percentage points)			
Inventory investment	2.2	2.1	-1.0	-.6
Net exports	-.7	-1.4	-.4	.0

over, data on consumer spending and business fixed investment have come in fairly close to our projection. Putting the pieces together, we are now looking for real GDP growth of 4 percent in the first quarter, a touch above the December Greenbook forecast of 3¾ percent.

Private payrolls increased 188,000 on average in November and December, a gain nearly in line with our projection in the December Greenbook. Our forecast calls for further gains of this magnitude in the first quarter, as is consistent with the low readings on initial claims for unemployment insurance.

Industrial production advanced at a rapid rate in both November and December, spurred by recovery from the disruptions caused by the hurricanes, especially in the energy sector. In the factory sector, motor vehicle assemblies dropped in the last two months of the year as automakers tried to keep their inventories in check, but other manufacturing output rose nearly 1 percent in November and nearly ½ percent in December.

On the spending side, we now estimate that real consumer outlays moved up at an annual rate of just 1 percent last quarter, held down by a payback for the spike in motor vehicle purchases caused by last summer's employee pricing programs. Excluding motor vehicles, consumer outlays appear to have increased about 3¾ percent in the fourth quarter, close to their third-quarter pace. For the current quarter, we expect that real disposable income will move ahead smartly and support continued solid growth in spending; preliminary January readings on consumer sentiment and chain-store sales are consistent with this view. In addition, motor vehicle sales rebounded late last year, and our industry contacts anticipate sales to decline just a little in January. All told, we project that consumer spending will increase at an annual rate of 4½ percent this quarter.

After running at an average annual rate of about 1.74 million units between May and November, single-family housing starts fell sharply in December to 1.58 million units. Existing home sales also turned down notably in December. The declines in these series were larger than we had expected. However, starts can be quite volatile, and worse-than-normal weather in many parts of the country appears to have contributed to the low reading; favorable weather in January likely will spur construction relative to its underlying fundamentals. Moreover, anecdotes and other indicators of housing demand are more consistent with a moderate cooling in this market than a pronounced downturn. We project that real residential investment will be little changed in the first quarter after increasing rapidly in the fourth quarter.

Real investment in equipment and software appears to have increased at an annual rate of just 3½ percent in the fourth quarter, and we are projecting a pickup to 6¾ percent in the first quarter. Business purchases of light motor vehicles declined last quarter, reversing part of their surge earlier in the year, and we are forecasting a small increase this quarter. Outlays for aircraft are also likely to increase because Boeing plans to step up deliveries of its 737 model. Meanwhile, the data on orders and shipments of durable goods through November are consistent with moderate first-quarter gains for other equipment. We estimate that real outlays for nonresidential structures rose at a 5½ percent pace in the fourth quarter and will increase briskly again in the first quarter on the strength of a continued surge in drilling and mining activity.

On the basis of only partial data, we think that real inventory investment outside the motor vehicle sector remained low in the fourth quarter. With no backup evident in inventory-sales ratios and few reports of discomfort regarding firms' inventory positions, we suspect that the low level of stockbuilding in the fall may reflect hurricane-related production disruptions. Accordingly, we are looking for non-motor-vehicle inventory accumulation to perk up in the current quarter. As for motor vehicles, inventories appear to be a touch on the high side, and we project that automakers will run off stocks a bit this quarter.

Real federal defense spending slumped in the fourth quarter, but, given the level of appropriations, we expect this decline to be reversed in the first quarter. On the nondefense side, outlays spiked last quarter because of the hurricanes and are expected to retreat somewhat this quarter. Putting these pieces together, we are looking for total real federal purchases to decrease at an annual rate of nearly 3 percent in the fourth quarter and to climb more than 6 percent in the first quarter. We project that real spending by state and local governments will increase moderately in both the fourth and first quarters.

We estimate that net exports deducted nearly 1½ percentage points from real GDP growth in the fourth quarter and will be a neutral influence in the first quarter. Given the hurricanes' disruption of domestic production of oil, chemicals, and related products, imports of these items surged last quarter, and export growth was held down. The recovery of domestic output in these sectors should have the reverse effect on net exports in the current quarter, restraining import growth and spurring a rebound on the export side.

Core consumer price inflation was close to our expectations, on balance, in November and December. The core CPI for November rose a touch more than we had anticipated, but core PCE prices came in a bit below our projection, with the difference stemming largely from the BEA's estimate of prices that are not based on market transactions. Core CPI inflation in December matched our forecast. All told, we have edged up our projection of core CPI inflation in the first quarter 0.2 percentage point, to an annual rate of 2.6 percent, but we have trimmed our forecast for core PCE price inflation 0.2 percentage point, to 2.0 percent. Meanwhile, consumer energy prices have climbed more rapidly than we had expected. We now project that overall PCE prices will rise at an annual rate of 2.1 percent this quarter.

The Longer-Run Outlook for the Economy

We expect real GDP to increase 3¾ percent in 2006 and 3 percent in 2007. Compared with the past several years, economic growth will be damped by tighter monetary policy, more-modest increases in household wealth, and reduced stimulus from fiscal policy. These forces will be offset, in part, by a diminished drag on growth from the enormous increase in oil prices since early 2004. The hurricanes depressed economic activity in 2005, but recovery and rebuilding should provide a boost to growth this year; apart from this effect, we project that real GDP would increase a little more than 3 percent in both 2006 and 2007, down from 3¾ percent in the past two years.

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

Measure	2005: H2	2006: H1	2006	2007
Real GDP	**3.3**	**3.9**	**3.7**	**3.0**
Previous	3.9	3.6	3.5	3.0
Final sales	2.4	4.4	3.8	2.8
Previous	2.9	4.3	3.5	2.8
PCE	2.6	4.0	3.5	3.3
Previous	2.4	4.0	3.6	3.4
Residential investment	7.4	1.2	2.0	-1.1
Previous	8.5	2.1	.7	.1
BFI	6.2	7.8	7.6	5.5
Previous	6.9	9.6	8.3	5.5
Government purchases	1.5	2.8	2.1	1.5
Previous	2.4	2.7	2.1	1.5
Exports	3.6	6.5	6.4	5.3
Previous	6.1	4.3	4.9	4.8
Imports	7.0	3.1	4.4	5.4
Previous	6.8	3.7	5.0	6.0
	Contribution to growth (percentage points)			
Inventory change	.8	-.4	-.1	.2
Previous	.9	-.7	-.1	.2
Net exports	-.7	.2	-.1	-.3
Previous	-.5	-.1	-.3	-.5

Our outlook for economic growth over the next two years is a little stronger than in the December Greenbook. The stimulative effects of a lower dollar and greater hurricane-related contributions to spending growth are only partly offset by the negative effect of the upward revision to oil prices.

Household spending. With labor income advancing at a solid pace and energy prices flattening out, real disposable income is projected to climb at an average annual rate of nearly 4½ percent in 2006 and 2007 after just edging up in 2005. Consumption should increase somewhat less rapidly than income, as households partially reverse the decline in the personal saving rate that occurred last year when they smoothed spending in the face of weak real income growth. We also expect that the increase in interest rates will restrain outlays and that smaller gains in equity and house prices than in recent years will imply a waning impetus to consumption from wealth. Altogether, we are expecting real consumer spending to increase at an average annual rate of nearly 3½ percent during the next two years and the saving rate to rise to 1½ percent by the end of 2007.

As noted, we continue to expect that housing activity will decelerate this year. The effect of the step-up in mortgage rates relative to the low levels of recent years is likely to be offset only in part by rising household income and the repair or replacement of houses damaged or destroyed by the hurricanes. Real outlays in the residential sector, which surged almost 9 percent last year, are expected to rise 2 percent in 2006 and to edge down in 2007. We are expecting single-family housing starts to hover in the neighborhood of 1.70 million units.

Business spending. We anticipate that real business investment in equipment and software will increase 7½ percent this year and 6¼ percent in 2007, compared with an 8¼ percent rise in 2005. In the high-tech category, our outlook for moderate spending growth is consistent with investment plans by telecom service providers and market analysts' earnings expectations for producers of high-tech equipment and software. Outside of high-tech, favorable investment fundamentals should support a significant increase in spending in 2006, but gains are likely to be smaller in 2007 as the growth of business output diminishes.

Real outlays for nonresidential structures are expected to rise 7¾ percent this year and 3½ percent in 2007. Recent increases in the prices of oil and natural gas should generate another jump in spending for drilling and mining this year; however, with energy prices roughly flat going forward, outlays in this category should decelerate in 2007. Meanwhile, declining vacancy rates and somewhat more-encouraging anecdotes suggest that the long-awaited pickup in other nonresidential construction may finally get under way this year.

With inventories reasonably well aligned with sales, inventory investment is a roughly neutral influence on real GDP growth over the forecast period. The projected trajectory of stockbuilding implies a continued gradual downtrend in the inventory-sales ratio over the next two years.

Government spending. Real federal consumption plus investment is projected to rise 1¾ percent in 2006 and to be flat in 2007. As noted, we expect defense spending to post a moderate gain in 2006 and then to flatten as a downturn in Iraq-related outlays offsets continued slow growth in other areas. After its hurricane-related pop at the end of 2005, nondefense spending is likely to decline in 2006 and hold steady in 2007. We project that real purchases by state and local governments will increase 2½ percent both this year and next.

Net exports. We expect that net exports will make a deduction from real GDP growth averaging less than ¼ percentage point in 2006 and 2007—comparable to the drag in 2005 and a somewhat smaller negative effect than in the December Greenbook. Supported by solid economic growth abroad, real exports should expand at an average annual rate of about 5¾ percent in the next two years; this pace is somewhat above that in our previous projection owing primarily to the lower projected path for the dollar and a somewhat delayed recovery from the hurricanes (which deferred some export growth from late last year into early this year). Real imports are projected to increase nearly 5 percent on average during the next two years; we have trimmed our forecast for real import growth principally because of an upward revision to import prices. *(These topics are discussed in more detail in the International Developments section of Part 1.)*

Aggregate Supply, the Labor Market, and Inflation

As in the December Greenbook, we project that potential output will increase 3¼ percent in both 2006 and 2007.[2] We estimate that the level of actual output was 0.6 percentage point below the level of potential output at the end of last year. We expect this gap to narrow in 2006 as GDP growth exceeds the growth of potential and then to widen in 2007 as GDP growth slows. On balance, the output gap finishes the projection period at 0.4 percentage point, a touch wider than in the previous Greenbook.

Productivity and the labor market. Output per hour in the nonfarm business sector increased 2¾ percent last year, less than our estimate of structural productivity growth. As a result, the levels of actual and structural productivity are now nearly aligned. For 2006 and 2007, we expect that productivity will increase at close to its structural rate—

[2] The Census Bureau estimate of population growth in 2005 came in slightly above the Census projection, as has been the case for several years. In light of these data, we revised up slightly our projection of population growth; this, in turn, implies slightly higher potential output growth.

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

Measure	1974-95	1996-2000	2001-04	2005	2006	2007
Structural labor productivity	1.5	2.5	3.3	3.2	3.1	3.0
Previous	1.5	2.5	3.3	3.2	3.1	3.0
Contributions[1]						
Capital deepening	.7	1.4	.7	1.0	.9	1.0
Previous	.7	1.4	.7	1.0	1.0	1.0
Multifactor productivity	.5	.8	2.3	2.0	1.9	1.8
Previous	.5	.8	2.3	2.0	1.9	1.8
Labor composition	.3	.3	.2	.3	.2	.2
MEMO						
Potential GDP	3.0	3.4	3.2	3.1	3.2	3.3
Previous	3.0	3.4	3.2	3.1	3.2	3.2

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.

about 3 percent per year. Monthly increases in private payrolls should average 130,000 this year and then decline to 55,000 next year as economic growth slows.[3]

The average unemployment rate of 5.0 percent in the fourth quarter of last year was lower than would be consistent with the historical relationship between the output and unemployment-rate gaps. Therefore, we expect the rate to stay at its fourth-quarter level through this year despite the narrowing of the output gap. As the output gap widens again in 2007, we project that the unemployment rate will tick up, to 5.1 percent, a level just above our estimate of the NAIRU. The labor force participation rate drifts down a few tenths of a percentage point during the projection period and finishes next year at 65.8 percent, in line with our estimate of its trend.

Prices and labor costs. Since the December Greenbook, we have boosted our forecast for nonfuel import prices in response to the lower dollar, higher non-energy commodity

[3] We estimate that trend payroll growth is currently in the neighborhood of 100,000 per month and that trend private payroll growth is near 85,000 per month. These figures are below recent norms because changing demographics appear to be causing the trend labor force participation rate to tilt downward.

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

Measure	2004	2005	2006	2007
Output per hour, nonfarm business	2.6	2.7	3.1	2.8
Previous	2.6	3.2	2.7	2.8
Nonfarm private payroll employment	1.8	1.6	1.4	.6
Previous	1.8	1.6	1.4	.6
Household survey employment	1.3	1.9	1.1	.7
Previous	1.3	1.8	1.1	.7
Labor force participation rate[1]	66.0	66.1	66.0	65.8
Previous	66.0	66.1	66.0	65.8
Civilian unemployment rate[1]	5.4	5.0	5.0	5.1
Previous	5.4	5.0	5.0	5.0
MEMO				
GDP gap[2]	-.9	-.6	-.1	-.4
Previous	-.9	-.3	.0	-.3

1. Percent, average for the fourth quarter.
2. Percent difference between actual and potential GDP in the fourth quarter of the year indicated. A negative number indicates that the economy is operating below potential. (In previous Greenbooks, we expressed the GDP gap with the opposite sign, so that a positive number indicated that actual output fell short of potential.)

prices, and our revised view that the expiration of the Multifibre Arrangement is not exerting much restraint on prices of imported apparel and textiles. The higher path for nonfuel import prices and the indirect effects of higher oil prices have led us to nudge up our projection of core consumer price inflation 0.1 percentage point this year. We now anticipate that core PCE prices will increase 2.2 percent this year and 1.8 percent next year. As in our previous forecast, core inflation slows in 2007, reflecting diminished indirect effects of earlier increases in energy prices and nonfuel import prices.

We project that overall PCE prices will rise 2.3 percent this year and 1.8 percent next year. These figures are 0.2 percentage point and 0.1 percentage point above their December Greenbook counterparts owing to higher energy price inflation in both years and slightly higher core inflation in 2006.

Our forecast calls for the employment cost index to move up nearly 4¼ percent in both 2006 and 2007 after a projected 3 percent rise in 2005. We are also expecting the productivity and costs measure of compensation per hour to rise more rapidly in the next few years than in 2005. The increase in nominal compensation last year fell short of the

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

Measure	2004	2005	2006	2007
PCE chain-weighted price index	3.1	2.9	2.3	1.8
Previous	3.1	2.8	2.1	1.7
Food and beverages	2.9	2.1	2.4	2.2
Previous	2.9	2.1	2.4	2.1
Energy	17.9	21.5	3.6	.6
Previous	17.9	19.4	1.4	-.6
Excluding food and energy	2.2	1.8	2.2	1.8
Previous	2.2	1.8	2.1	1.8
Consumer price index	3.4	3.7	2.6	2.0
Previous	3.4	3.5	2.3	1.9
Excluding food and energy	2.1	2.1	2.5	2.2
Previous	2.1	2.1	2.4	2.1
GDP chain-weighted price index	2.9	2.9	2.2	2.0
Previous	2.9	2.7	2.3	1.9
ECI for compensation of private industry workers[1]	3.8	3.0	4.2	4.1
Previous	3.8	3.0	4.2	4.0
Compensation per hour, nonfarm business sector	5.8	3.3	5.3	5.2
Previous	5.8	3.6	5.3	5.1
Prices of core nonfuel imports	3.7	2.3	2.9	1.1
Previous	3.7	2.3	1.7	.8

1. December to December.

pace that we would expect given previous years' increases in consumer prices and labor productivity, and we anticipate that compensation growth going forward will be more in line with our reading of fundamentals.

Financial Flows and Conditions

The growth of domestic nonfinancial debt is projected to step down from 9 percent in 2005 to 7½ percent this year and then to slow a little further next year. This contour, which is quite similar to that in the December Greenbook, mainly reflects our forecast of a reduced pace of borrowing by households and by state and local governments.

We continue to expect that the growth of mortgage debt will decrease notably over the course of the projection as house price appreciation slows and mortgage rates remain close to their current levels. Even though we expect growth of consumer credit to pick up slightly from last year's subdued pace, the projected deceleration of mortgage debt shows through to the top line. All told, overall household debt is forecast to expand 8 percent this year and 6¾ percent next year, rates significantly below last year's pace of 10½ percent.

The debt of state and local governments expanded nearly 11 percent in 2005 on a steady pace of issuance for capital projects and a surge in advance refunding issues. With interest rates up from their lows and with fewer opportunities for additional advance refundings, we expect debt growth in this sector to decline to 4½ percent in 2006 and to edge down further to 3¼ percent in 2007. By contrast, our outlook for a slightly wider federal budget deficit this year and next leads us to expect that federal debt will expand a bit faster over the projection period than in 2005.

The debt of nonfinancial corporations is projected to grow at roughly last year's pace, expanding at an average rate of about 7 percent in both 2006 and 2007. We expect that the pace of debt growth will be tempered by firms drawing upon the large stocks of liquid assets that they have accumulated in recent years.

In 2006, we expect M2 to expand 5½ percent, a little below the projected growth of nominal GDP, because of the lagged effects of previous increases in opportunity cost. These effects are expected to taper off, and in 2007, growth of M2 is anticipated to match the 5 percent increase in nominal GDP.

Alternative Simulations

In this section we evaluate several risks to the staff forecast using simulations of the FRB/US model. In the first scenario, long-term interest rates rise substantially as the term premium reverses its decline over the past year and a half. In the second, aggregate demand proves unexpectedly robust. The third simulation addresses the downside risks to aggregate spending presented by a more rapid increase in the saving rate. We then consider two scenarios relating to the staff's inflation outlook: The first assesses the implications of a NAIRU of 4¼ percent, and the second examines the consequences of a set of adverse cost shocks. We explore each of these five risks first under the assumption that the federal funds rate is held at its Greenbook path and then under the assumption

Alternative Scenarios

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

Measure and scenario	2005		2006		2007
	H1	H2	H1	H2	
Real GDP					
Baseline	**3.6**	**3.3**	**3.9**	**3.4**	**3.0**
Higher term premium	3.6	3.3	3.6	1.8	1.3
With monetary policy response	3.6	3.3	3.6	2.0	1.8
Stronger aggregate demand	3.6	3.3	4.7	4.1	4.3
With monetary policy response	3.6	3.3	4.7	3.9	4.0
Higher saving rate	3.6	3.3	3.4	2.9	2.6
With monetary policy response	3.6	3.3	3.4	3.1	2.9
Low NAIRU	3.6	3.3	4.0	3.5	3.1
With monetary policy response	3.6	3.3	4.0	3.5	3.2
Adverse cost shocks	3.6	3.3	3.8	3.3	3.1
With monetary policy response	3.6	3.3	3.8	3.3	2.8
Market-based funds rate	3.6	3.3	3.9	3.5	3.2
Civilian unemployment rate[1]					
Baseline	**5.1**	**5.0**	**5.0**	**5.0**	**5.1**
Higher term premium	5.1	5.0	5.0	5.3	6.2
With monetary policy response	5.1	5.0	5.0	5.3	6.0
Stronger aggregate demand	5.1	5.0	4.9	4.7	4.3
With monetary policy response	5.1	5.0	4.9	4.8	4.4
Higher saving rate	5.1	5.0	5.1	5.2	5.5
With monetary policy response	5.1	5.0	5.1	5.2	5.4
Low NAIRU	5.1	5.0	5.0	5.0	5.0
With monetary policy response	5.1	5.0	5.0	5.0	5.0
Adverse cost shocks	5.1	5.0	5.0	5.0	5.2
With monetary policy response	5.1	5.0	5.0	5.1	5.3
Market-based funds rate	5.1	5.0	5.0	5.0	5.0
PCE prices excluding food and energy					
Baseline	**2.1**	**1.6**	**2.2**	**2.2**	**1.8**
Higher term premium	2.1	1.6	1.9	2.0	1.5
With monetary policy response	2.1	1.6	1.9	2.0	1.6
Stronger aggregate demand	2.1	1.6	2.0	2.1	1.9
With monetary policy response	2.1	1.6	2.0	2.1	1.8
Higher saving rate	2.1	1.6	2.2	2.2	1.7
With monetary policy response	2.1	1.6	2.2	2.2	1.8
Low NAIRU	2.1	1.6	2.1	2.0	1.5
With monetary policy response	2.1	1.6	2.1	2.0	1.5
Adverse cost shocks	2.1	1.6	2.2	2.5	2.4
With monetary policy response	2.1	1.6	2.2	2.5	2.3
Market-based funds rate	2.1	1.6	2.2	2.2	1.9

1. Percent, average for the final quarter of the period.

that monetary policy responds to changes in the outlook as suggested by the Taylor rule.[4] A final simulation traces out the consequences of a path for the federal funds rate consistent with current readings from the futures market.

Higher term premium. We expect bond yields to edge up over the projection period but recognize the risk of a more substantial jump in yields given the unusually low level of the term premium. In this scenario, the term premium increases sharply over the first half of this year, reversing the decline seen since mid-2004 and boosting Treasury yields a full percentage point relative to baseline. Yields on private securities rise even more as risk spreads increase in response to weaker economic activity. Higher interest rates reduce consumption and investment, causing real GDP growth under the baseline path for monetary policy to slow to 2¾ percent in 2006 and 1¼ percent in 2007. The unemployment rate rises to 6¼ percent by late 2007, and core PCE inflation falls to 1½ percent. If monetary policy responds to weaker activity along the lines indicated by the Taylor rule, the federal funds rate—starting from the middle of this year—declines steadily to about 2¼ percent by the end of 2007. Under this more-accommodative stance, real GDP expands 1¾ percent in 2007, the unemployment rate climbs to 6 percent, and the decline in inflation is a bit less pronounced.

Stronger aggregate demand. Aggregate spending may grow more rapidly than we have projected for any of several reasons: The predicted slowing in residential investment may not materialize; E&S spending may step up rather than decelerate; and households may be less inclined than we expect to boost their saving. Regardless of the source, such outcomes would imply a higher equilibrium real federal funds rate than is currently assumed in the staff projection. In this scenario, we boost all categories of private domestic spending enough to imply a short-term equilibrium rate that is 1½ percentage points higher than in the baseline forecast. Under the baseline monetary policy, these assumptions cause real GDP to grow 4½ percent in 2006 and 4¼ percent in 2007 and reduce the unemployment rate to 4¼ percent by the end of 2007. The strong pace of growth is accompanied by a 1 percentage point rise in the yield on ten-year Treasury notes as investors come to anticipate a substantially tighter monetary policy beyond the forecast period. This in turn prompts a modest appreciation of the dollar, which initially restrains core PCE inflation. However, this effect is more than offset later by tighter labor and product markets, and inflation ends up a touch above baseline. Under the

[4] In the Taylor-rule scenarios, the federal funds rate is assumed to move 1 percentage point relative to baseline for each percentage point deviation of the output gap from baseline and to move 1½ percentage points for each percentage point deviation of the four-quarter average of core PCE inflation from baseline.

Taylor rule, the federal funds rate increases to 6 percent by late 2007, which prevents the unemployment rate from falling appreciably below 4½ percent and keeps inflation close to baseline.

Higher saving rate. The staff projects that the saving rate will increase to 1½ percent by the end of 2007, a level consistent with our assessment of the historical relationship between consumption, income, interest rates, and wealth. Nonetheless, considerable uncertainty continues to surround the outlook for consumption, and other factors could further boost household saving over the projection period. For example, the staff's projected slowing in housing activity and equity extraction could restrain household spending more than we have assumed; alternatively, households could reverse the recent decline in the saving rate more aggressively than in our baseline projection. In this scenario, the saving rate rises to 2½ percent by the end of next year, 1 percentage point above the Greenbook baseline. Under the baseline monetary policy, real GDP decelerates to 3¼ percent in 2006 and 2½ percent in 2007, and the unemployment rate climbs to 5½ percent by the end of next year. Reflecting increased slack, core PCE inflation is a touch below baseline next year. Under the Taylor rule, the federal funds rate drifts down to 3¾ percent by the end of 2007; this monetary easing raises aggregate spending enough to return GDP growth to baseline by 2007, thereby leaving core PCE inflation little changed.

Low NAIRU. Taken together, the evidence from a range of wage and price models is consistent with the staff's NAIRU of 5 percent, but the confidence interval around our estimate is wide. The relatively low readings on the employment cost index for the first three quarters of 2005 could be read as suggesting a greater degree of labor market slack than is assumed in the baseline projection. Moreover, many of the structural changes to the labor market that contribute to the decline in the staff's current estimate of the NAIRU between the mid-1980s and 2000 have arguably continued to put downward pressure on the natural rate of unemployment.[5] In this scenario we assume that the NAIRU is, and for some time has been, 4¼ percent—roughly one standard error below the staff estimate. Under the baseline monetary policy, real GDP growth is a touch stronger than in the staff projection because the lower NAIRU implies higher long-run levels of household income and corporate earnings, which boost consumption and investment spending. Reflecting the larger margin of slack in this scenario, core PCE inflation is 2 percent in 2006 and falls to 1½ percent in 2007. In implementing the

[5] For example, the share of the population receiving disability payments through the Social Security program has continued to rise, and the real minimum wage has declined further.

scenario under the Taylor rule, we assume that the Committee considers the NAIRU to be 5 percent, which means that it perceives labor and product markets to be tighter than they actually are. As a result, even though inflation in this scenario is lower than the Greenbook forecast, the federal funds rate averages only 12 basis points below the baseline path in 2007. Accordingly, the change in monetary policy has little incremental effect on the economy. By contrast, if the Committee quickly comes to recognize that the NAIRU is 4¼ percent, the federal funds rate under the Taylor rule will average about 60 basis points below its baseline path. This results in GDP growth of 4 percent in 2006 and almost 3½ percent in 2007, while core PCE inflation in 2007 is a little over 1½ percent.

Adverse cost shocks. The surprising persistence and magnitude of recent adverse cost shocks (most notably increases of energy and import prices) raise the possibility of a continued deterioration in this component of the inflation outlook. This scenario explores the implications of further adverse cost surprises arising from three sources: an additional $10 per barrel increase in the price of oil, an exogenous 4 percent jump in the level of core intermediate materials prices, and 2 additional percentage points in the average rate of change of nonfuel import prices over 2006 and 2007. In broad terms, these shocks are similar in magnitude to those that affected the supply side of the economy during 2004. Under the baseline monetary policy assumption, core PCE inflation runs close to 2½ percent in both 2006 and 2007. Real household income and real corporate earnings increase more slowly than in the baseline projection, which in turn depresses domestic spending; however, the higher inflation rate also reduces the real interest rate and thereby the real exchange rate, which stimulates spending. On balance, real GDP is about the same as in the baseline. Under the Taylor rule, the federal funds rate increases to 5 percent by the end of 2006 and remains there through 2007. Relative to baseline, this less accommodative policy subtracts about ¼ percentage point from real GDP growth in 2007, thereby limiting somewhat the pickup in inflation.

Market-based funds rate. Quotes from futures markets imply a path for the federal funds rate that is about 20 basis points lower, on average, than the baseline path through 2007. Taking on board the market’s path for the funds rate modestly boosts real activity in the second half of this year and in 2007; as a result, the unemployment rate ends up at 5 percent late next year, and inflation is a touch stronger.

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

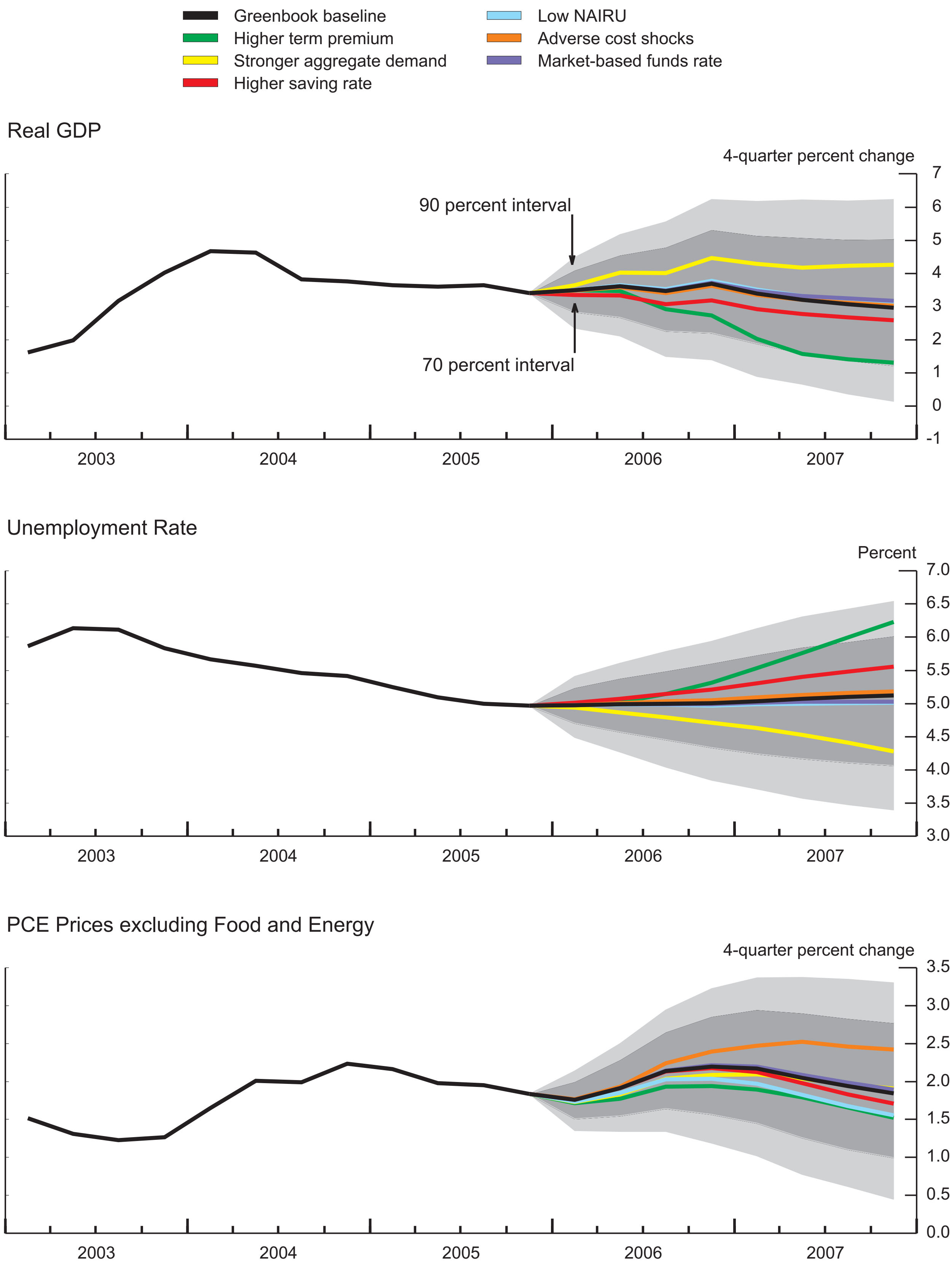
Measure	2005	2006	2007
Real GDP			
(percent change, Q4 to Q4)			
Projection	3.4	3.7	3.0
Confidence interval			
Greenbook forecast errors[1]	3.2–3.6	2.1–5.3	1.3–4.7
FRB/US stochastic simulations	3.2–3.6	2.2–5.3	1.2–5.0
Civilian unemployment rate			
(percent, Q4)			
Projection	5.0	5.0	5.1
Confidence interval			
Greenbook forecast errors[1]	5.0–5.0	4.5–5.5	4.2–6.0
FRB/US stochastic simulations	4.9–5.0	4.3–5.6	4.1–6.0
PCE prices			
excluding food and energy			
(percent change, Q4 to Q4)			
Projection	1.8	2.2	1.8
Confidence interval			
Greenbook forecast errors[2]	1.7–1.9	1.6–2.8	.9–2.8
FRB/US stochastic simulations	1.8–1.9	1.6–2.9	1.0–2.8

NOTE. Shocks underlying stochastic simulations are randomly drawn from the 1978–2004 set of model equation residuals.

1. 1978–2004.
2. 1981–2004.

Forecast Confidence Intervals and Alternative Scenarios

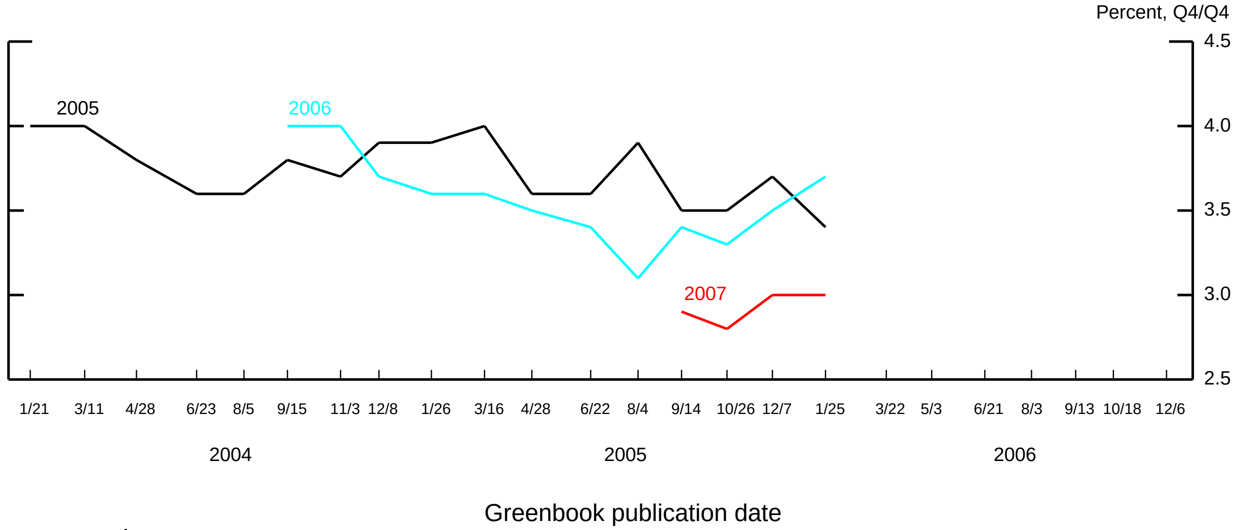
Confidence Intervals Based on FRB/US Stochastic Simulations
(Scenarios assume baseline federal funds rate
except in the case of the market-based funds rate)



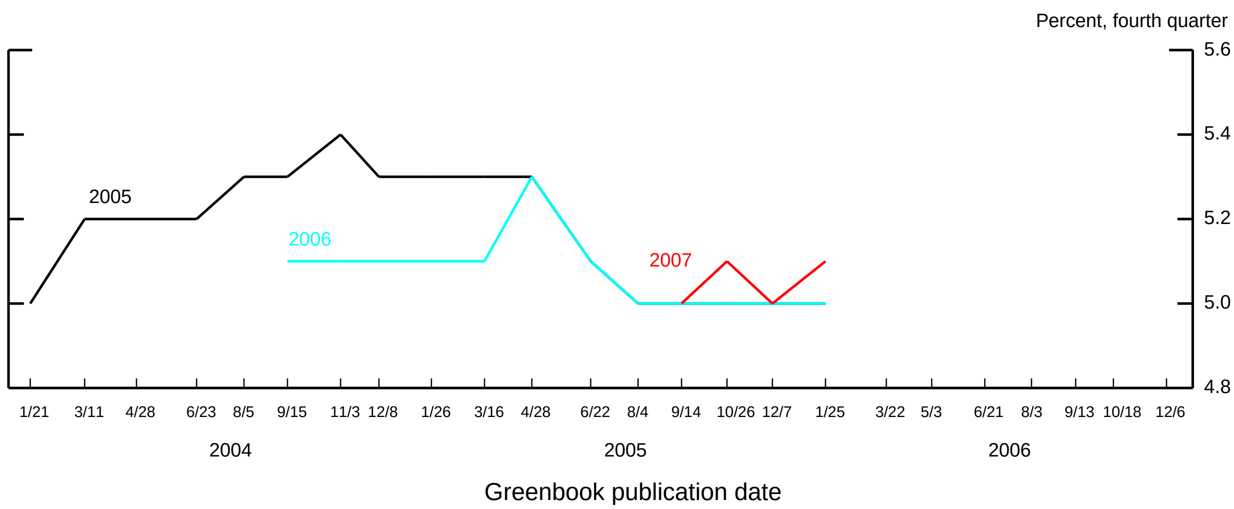
Class II FOMC - Restricted (FR)

Evolution of the Staff Forecast

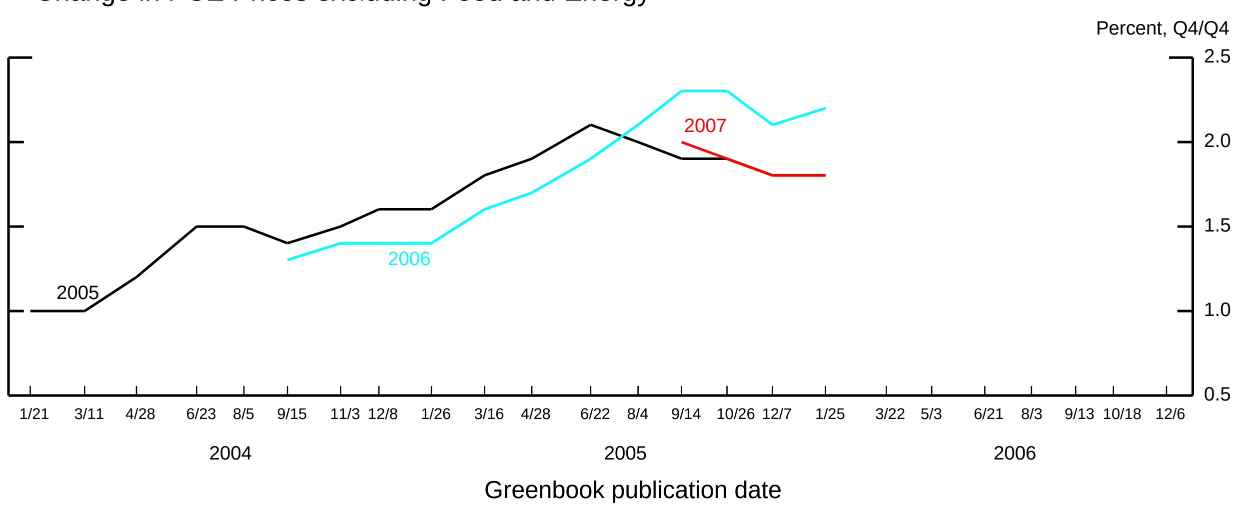
Change in Real GDP



Unemployment Rate



Change in PCE Prices excluding Food and Energy



Changes in GDP, Prices, and Unemployment
(Percent, annual rate except as noted)

	Nominal GDP		Real GDP		PCE price index		Core PCE price index		Unemployment rate[1]	
Interval	12/7/05	1/25/06	12/7/05	1/25/06	12/7/05	1/25/06	12/7/05	1/25/06	12/7/05	1/25/06
Quarterly										
2005:Q1	7.0	7.0	3.8	3.8	2.3	2.3	2.4	2.4	5.3	5.2
Q2	6.0	6.0	3.3	3.3	3.3	3.3	1.7	1.7	5.1	5.1
Q3	7.6	7.6	4.3	4.1	3.6	3.7	1.2	1.4	5.0	5.0
Q4	5.6	5.1	3.4	2.4	2.1	2.4	2.1	1.9	5.0	5.0
2006:Q1	6.5	6.3	3.7	4.1	1.9	2.1	2.2	2.0	5.0	5.0
Q2	6.0	6.3	3.5	3.8	2.5	2.7	2.2	2.3	5.0	5.0
Q3	5.7	5.8	3.4	3.6	2.1	2.3	2.1	2.3	5.0	5.0
Q4	5.3	5.4	3.2	3.3	2.0	2.1	2.0	2.1	5.0	5.0
2007:Q1	5.3	5.2	3.1	3.0	1.8	1.9	1.9	1.9	5.0	5.0
Q2	4.9	5.0	3.0	3.0	1.7	1.8	1.8	1.9	5.0	5.1
Q3	4.8	4.9	2.9	3.0	1.7	1.8	1.8	1.8	5.0	5.1
Q4	4.8	4.8	2.9	2.9	1.6	1.7	1.8	1.8	5.0	5.1
Two-quarter[2]										
2005:Q2	6.5	6.5	3.6	3.6	2.8	2.8	2.1	2.1	-.3	-.3
Q4	6.6	6.3	3.9	3.3	2.9	3.1	1.6	1.6	-.1	-.1
2006:Q2	6.3	6.3	3.6	3.9	2.2	2.4	2.2	2.2	.0	.0
Q4	5.5	5.6	3.3	3.4	2.1	2.2	2.1	2.2	.0	.0
2007:Q2	5.1	5.1	3.0	3.0	1.8	1.9	1.8	1.9	.0	.1
Q4	4.8	4.9	2.9	2.9	1.6	1.7	1.8	1.8	.0	.0
Four-quarter[3]										
2004:Q4	6.8	6.8	3.8	3.8	3.1	3.1	2.2	2.2	-.5	-.4
2005:Q4	6.5	6.4	3.7	3.4	2.8	2.9	1.8	1.8	-.4	-.4
2006:Q4	5.9	6.0	3.5	3.7	2.1	2.3	2.1	2.2	.0	.0
2007:Q4	5.0	5.0	3.0	3.0	1.7	1.8	1.8	1.8	.0	.1
Annual										
2004	7.0	7.0	4.2	4.2	2.6	2.6	2.0	2.0	5.5	5.5
2005	6.4	6.4	3.7	3.6	2.8	2.8	2.0	2.0	5.1	5.1
2006	6.2	6.1	3.6	3.6	2.4	2.6	2.0	2.0	5.0	5.0
2007	5.2	5.3	3.1	3.2	1.9	2.0	1.9	2.0	5.0	5.1

1. Level, except for two-quarter and four-quarter intervals.
2. Percent change from two quarters earlier; for unemployment rate, change is in percentage points.
3. Percent change from four quarters earlier; for unemployment rate, change is in percentage points.

Changes in Real Gross Domestic Product and Related Items
(Percent, annual rate except as noted)

Item	2005 Q1	2005 Q2	2005 Q3	2005 Q4	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2005[1]	2006[1]	2007[1]
Real GDP	3.8	3.3	4.1	2.4	4.1	3.8	3.6	3.3	3.0	3.0	3.0	2.9	3.4	3.7	3.0
Previous	3.8	3.3	4.3	3.4	3.7	3.5	3.4	3.2	3.1	3.0	2.9	2.9	3.7	3.5	3.0
Final sales	3.5	5.6	4.6	.3	4.7	4.0	3.4	2.9	2.4	3.4	2.9	2.4	3.5	3.8	2.8
Previous	3.5	5.6	4.7	1.1	4.8	3.9	3.1	2.5	2.5	3.3	3.0	2.6	3.7	3.5	2.8
Priv. dom. final purch.	4.1	4.5	4.8	1.9	4.5	3.9	3.7	3.6	3.4	3.3	3.2	3.1	3.8	3.9	3.2
Previous	4.1	4.5	5.0	1.8	5.2	3.9	3.5	3.3	3.5	3.5	3.4	3.4	3.9	4.0	3.5
Personal cons. expend.	3.5	3.4	4.1	1.1	4.5	3.4	3.1	3.1	3.3	3.3	3.3	3.3	3.0	3.5	3.3
Previous	3.5	3.4	4.2	.7	4.8	3.2	3.2	3.2	3.5	3.4	3.4	3.4	2.9	3.6	3.4
Durables	2.6	7.9	9.3	-14.6	18.1	8.0	5.7	5.3	5.5	5.3	5.2	5.0	.8	9.1	5.2
Nondurables	5.3	3.6	3.5	5.3	5.2	3.7	3.7	3.7	3.9	3.9	3.9	3.9	4.4	4.0	3.9
Services	2.8	2.3	3.3	2.4	1.8	2.4	2.4	2.4	2.6	2.6	2.6	2.6	2.7	2.2	2.6
Residential investment	9.5	10.8	7.3	7.6	-.4	2.8	2.6	2.9	.8	-.5	-2.2	-2.6	8.8	2.0	-1.1
Previous	9.5	10.8	7.7	9.3	2.7	1.4	-1.1	-.3	-.4	.6	.3	-.2	9.3	.7	.1
Business fixed invest.	5.7	8.8	8.5	4.0	7.3	8.3	7.8	6.9	5.4	5.9	5.7	5.0	6.7	7.6	5.5
Previous	5.7	8.8	8.9	4.8	9.1	10.1	7.8	6.3	6.2	5.5	5.3	5.0	7.0	8.3	5.5
Equipment & software	8.3	10.9	10.6	3.5	6.7	8.1	8.0	7.2	5.9	6.9	6.5	5.8	8.3	7.5	6.3
Previous	8.3	10.9	10.9	2.2	7.7	10.4	7.7	6.8	7.4	6.8	6.4	6.0	8.0	8.2	6.7
Nonres. structures	-2.0	2.7	2.2	5.5	9.0	8.9	7.1	6.1	4.2	3.5	3.6	3.0	2.1	7.8	3.6
Previous	-2.0	2.7	3.1	12.8	12.8	9.1	7.9	5.0	3.0	2.2	2.5	2.5	4.0	8.7	2.5
Net exports[2]	-645	-614	-617	-655	-654	-645	-645	-659	-681	-675	-680	-696	-633	-651	-683
Previous[2]	-645	-614	-621	-639	-651	-647	-653	-673	-698	-699	-708	-728	-630	-656	-708
Exports	7.5	10.7	2.5	4.8	7.2	5.9	5.5	7.2	3.2	5.4	5.3	7.3	6.3	6.4	5.3
Imports	7.4	-.3	2.4	11.9	4.4	1.9	3.6	7.7	6.8	2.3	4.5	8.2	5.3	4.4	5.4
Govt. cons. & invest.	1.9	2.5	2.9	.2	4.1	1.5	1.3	1.7	1.5	1.5	1.5	1.5	1.8	2.1	1.5
Previous	1.9	2.5	3.2	1.6	3.7	1.7	1.4	1.7	1.5	1.5	1.5	1.5	2.3	2.1	1.5
Federal	2.4	2.4	7.4	-2.9	6.2	.1	-.2	.6	.0	.0	.0	.0	2.3	1.7	.0
Defense	3.0	3.7	10.0	-11.7	11.5	1.9	1.2	.5	.0	.0	.0	.0	.9	3.7	.0
Nondefense	1.1	-.2	2.4	17.6	-3.4	-3.6	-2.9	.9	.0	.0	.0	.0	5.0	-2.3	.0
State & local	1.6	2.6	.2	2.0	2.9	2.3	2.1	2.3	2.4	2.4	2.4	2.4	1.6	2.4	2.4
Change in bus. inventories[2]	58	-2	-13	43	28	21	25	37	51	41	45	61	22	28	50
Previous[2]	58	-2	-13	50	21	10	21	43	62	52	52	63	23	24	57
Nonfarm[2]	62	3	-8	45	27	20	24	36	51	40	44	60	25	27	49
Farm[2]	-2	-4	-5	-1	0	1	1	1	1	1	1	1	-3	1	1

1. Change from fourth quarter of previous year to fourth quarter of year indicated.
2. Billions of chained (2000) dollars.

Changes in Real Gross Domestic Product and Related Items
(Percent, annual rate except as noted)

Item	1999[1]	2000[1]	2001[1]	2002[1]	2003[1]	2004[1]	2005[1]	2006[1]	2007[1]
Real GDP	4.7	2.2	.2	1.9	4.0	3.8	3.4	3.7	3.0
Previous	4.7	2.2	.2	1.9	4.0	3.8	3.7	3.5	3.0
Final sales	4.2	2.9	1.5	.8	4.0	3.6	3.5	3.8	2.8
Previous	4.2	2.9	1.5	.8	4.0	3.6	3.7	3.5	2.8
Priv. dom. final purch.	5.3	4.3	1.0	1.1	4.4	4.8	3.8	3.9	3.2
Previous	5.3	4.3	1.0	1.1	4.4	4.8	3.9	4.0	3.5
Personal cons. expend.	4.9	4.1	2.8	1.9	3.8	3.8	3.0	3.5	3.3
Previous	4.9	4.1	2.8	1.9	3.8	3.8	2.9	3.6	3.4
Durables	7.3	4.7	10.8	1.2	9.2	5.2	.8	9.1	5.2
Nondurables	4.9	3.0	1.9	2.1	4.1	4.6	4.4	4.0	3.9
Services	4.4	4.5	1.6	1.9	2.5	3.1	2.7	2.2	2.6
Residential investment	3.6	-1.9	1.4	7.0	11.8	6.6	8.8	2.0	-1.1
Previous	3.6	-1.9	1.4	7.0	11.8	6.6	9.3	.7	.1
Business fixed invest.	7.7	7.8	-9.6	-6.5	5.6	10.9	6.7	7.6	5.5
Previous	7.7	7.8	-9.6	-6.5	5.6	10.9	7.0	8.3	5.5
Equipment & software	10.8	7.5	-9.0	-3.4	7.2	13.8	8.3	7.5	6.3
Previous	10.8	7.5	-9.0	-3.4	7.2	13.8	8.0	8.2	6.7
Nonres. structures	-.9	8.8	-11.1	-14.9	1.2	2.7	2.1	7.8	3.6
Previous	-.9	8.8	-11.1	-14.9	1.2	2.7	4.0	8.7	2.5
Net exports[2]	-296	-379	-399	-471	-521	-601	-633	-651	-683
Previous[2]	-296	-379	-399	-471	-521	-601	-630	-656	-708
Exports	5.6	6.5	-11.9	3.8	6.0	6.1	6.3	6.4	5.3
Imports	12.1	11.2	-7.6	9.7	5.1	10.6	5.3	4.4	5.4
Govt. cons. & invest.	4.2	.4	5.0	4.0	1.9	2.1	1.8	2.1	1.5
Previous	4.2	.4	5.0	4.0	1.9	2.1	2.3	2.1	1.5
Federal	4.2	-2.2	6.4	7.8	5.5	4.2	2.3	1.7	.0
Defense	4.3	-3.5	6.5	8.4	7.5	4.9	.9	3.7	.0
Nondefense	4.1	.3	6.3	6.8	1.6	2.8	5.0	-2.3	.0
State & local	4.2	1.7	4.2	2.1	.0	.9	1.6	2.4	2.4
Change in bus. inventories[2]	69	56	-32	12	15	52	22	28	50
Previous[2]	69	56	-32	12	15	52	23	24	57
Nonfarm[2]	72	58	-32	15	15	50	25	27	49
Farm[2]	-3	-1	0	-2	0	2	-3	1	1

1. Change from fourth quarter of previous year to fourth quarter of year indicated.
2. Billions of chained (2000) dollars.

Contributions to Changes in Real Gross Domestic Product
(Percentage points, annual rate except as noted)

Item	2005 Q1	2005 Q2	2005 Q3	2005 Q4	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2005[1]	2006[1]	2007[1]
Real GDP	3.8	3.3	4.1	2.4	4.1	3.8	3.6	3.3	3.0	3.0	3.0	2.9	3.4	3.7	3.0
Previous	3.8	3.3	4.3	3.4	3.7	3.5	3.4	3.2	3.1	3.0	2.9	2.9	3.7	3.5	3.0
Final sales	3.5	5.5	4.6	.3	4.7	4.0	3.4	2.9	2.4	3.4	2.8	2.4	3.5	3.8	2.8
Previous	3.5	5.5	4.7	1.2	4.7	3.8	3.1	2.5	2.5	3.3	3.0	2.6	3.7	3.5	2.8
Priv. dom. final purch.	3.6	3.9	4.2	1.7	3.9	3.4	3.2	3.1	2.9	2.9	2.8	2.7	3.3	3.4	2.8
Previous	3.6	3.9	4.4	1.6	4.4	3.4	3.0	2.9	3.0	3.0	3.0	2.9	3.3	3.4	3.0
Personal cons. expend.	2.4	2.4	2.9	.8	3.2	2.4	2.2	2.2	2.3	2.3	2.3	2.3	2.1	2.5	2.3
Previous	2.4	2.4	3.0	.5	3.3	2.2	2.3	2.2	2.4	2.4	2.4	2.4	2.1	2.5	2.4
Durables	.2	.6	.8	-1.3	1.3	.6	.5	.4	.4	.4	.4	.4	.1	.7	.4
Nondurables	1.1	.7	.7	1.1	1.1	.8	.8	.8	.8	.8	.8	.8	.9	.8	.8
Services	1.2	1.0	1.4	1.0	.8	1.0	1.0	1.0	1.1	1.1	1.1	1.1	1.1	.9	1.1
Residential investment	.5	.6	.4	.5	.0	.2	.2	.2	.0	.0	-.1	-.2	.5	.1	-.1
Previous	.5	.6	.5	.6	.2	.1	-.1	.0	.0	.0	.0	.0	.5	.0	.0
Business fixed invest.	.6	.9	.9	.4	.8	.9	.8	.7	.6	.6	.6	.5	.7	.8	.6
Previous	.6	.9	.9	.5	.9	1.1	.8	.7	.7	.6	.6	.6	.7	.9	.6
Equipment & software	.6	.8	.8	.3	.5	.6	.6	.6	.5	.5	.5	.5	.6	.6	.5
Previous	.6	.8	.8	.2	.6	.8	.6	.5	.6	.5	.5	.5	.6	.6	.5
Nonres. structures	-.1	.1	.1	.1	.2	.3	.2	.2	.1	.1	.1	.1	.1	.2	.1
Previous	-.1	.1	.1	.3	.3	.3	.2	.2	.1	.1	.1	.1	.1	.2	.1
Net exports	-.4	1.1	-.1	-1.4	.0	.3	.0	-.5	-.8	.2	-.2	-.6	-.2	-.1	-.3
Previous	-.4	1.1	-.2	-.7	-.4	.1	-.2	-.7	-.9	.0	-.3	-.7	-.1	-.3	-.5
Exports	.7	1.1	.3	.5	.7	.6	.6	.8	.3	.6	.6	.8	.6	.7	.6
Imports	-1.1	.0	-.4	-1.9	-.7	-.3	-.6	-1.3	-1.1	-.4	-.8	-1.4	-.8	-.7	-.9
Govt. cons. & invest.	.4	.5	.5	.0	.8	.3	.2	.3	.3	.3	.3	.3	.4	.4	.3
Previous	.4	.5	.6	.3	.7	.3	.3	.3	.3	.3	.3	.3	.4	.4	.3
Federal	.2	.2	.5	-.2	.4	.0	.0	.0	.0	.0	.0	.0	.2	.1	.0
Defense	.1	.2	.5	-.6	.5	.1	.1	.0	.0	.0	.0	.0	.0	.2	.0
Nondefense	.0	.0	.1	.4	-.1	-.1	-.1	.0	.0	.0	.0	.0	.1	-.1	.0
State & local	.2	.3	.0	.2	.4	.3	.3	.3	.3	.3	.3	.3	.2	.3	.3
Change in bus. inventories	.3	-2.1	-.4	2.1	-.6	-.2	.1	.4	.5	-.4	.2	.5	.0	-.1	.2
Previous	.3	-2.1	-.4	2.2	-1.0	-.4	.4	.7	.6	-.3	.0	.4	.0	-.1	.2
Nonfarm	.4	-2.1	-.4	1.9	-.6	-.3	.1	.4	.5	-.4	.2	.5	-.1	-.1	.2
Farm	-.1	-.1	.0	.2	.0	.0	.0	.0	.0	.0	.0	.0	.0	.0	.0

1. Change from fourth quarter of previous year to fourth quarter of year indicated.

Changes in Prices and Costs
(Percent, annual rate except as noted)

Item	2005				2006				2007						
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2005[1]	2006[1]	2007[1]
GDP chain-wt. price index	3.1	2.6	3.3	2.6	2.1	2.5	2.2	2.0	2.2	1.9	1.9	1.9	2.9	2.2	2.0
Previous	3.1	2.6	3.1	2.2	2.7	2.4	2.2	2.0	2.2	1.9	1.8	1.8	2.7	2.3	1.9
PCE chain.-wt. price index	2.3	3.3	3.7	2.4	2.1	2.7	2.3	2.1	1.9	1.8	1.8	1.7	2.9	2.3	1.8
Previous	2.3	3.3	3.6	2.1	1.9	2.5	2.1	2.0	1.8	1.7	1.7	1.6	2.8	2.1	1.7
Energy	3.6	28.6	50.0	8.9	3.0	7.5	2.7	1.3	1.1	.7	.4	.0	21.5	3.6	.6
Previous	3.6	28.6	49.8	2.0	-2.8	6.1	1.7	.8	-.2	-.4	-.8	-1.3	19.4	1.4	-.6
Food	1.0	3.5	1.3	2.6	2.1	2.5	2.5	2.4	2.3	2.2	2.1	2.1	2.1	2.4	2.2
Previous	1.0	3.5	1.3	2.6	2.5	2.5	2.4	2.3	2.2	2.1	2.1	2.1	2.1	2.4	2.1
Ex. food & energy	2.4	1.7	1.4	1.9	2.0	2.3	2.3	2.1	1.9	1.9	1.8	1.8	1.8	2.2	1.8
Previous	2.4	1.7	1.2	2.1	2.2	2.2	2.1	2.0	1.9	1.8	1.8	1.8	1.8	2.1	1.8
CPI	2.5	4.0	5.3	3.1	2.5	3.0	2.6	2.3	2.2	2.1	2.0	1.9	3.7	2.6	2.0
Previous	2.5	4.0	5.3	2.5	2.0	2.8	2.3	2.1	2.0	1.9	1.8	1.8	3.5	2.3	1.9
Ex. food & energy	2.6	2.0	1.4	2.4	2.6	2.5	2.5	2.4	2.3	2.2	2.1	2.1	2.1	2.5	2.2
Previous	2.6	2.0	1.4	2.2	2.4	2.4	2.4	2.3	2.2	2.1	2.1	2.1	2.1	2.4	2.1
ECI, hourly compensation[2]	2.5	2.5	3.2	3.7	4.1	4.2	4.2	4.3	4.2	4.1	4.1	4.1	3.0	4.2	4.1
Previous[2]	2.5	2.5	3.2	3.7	4.1	4.2	4.2	4.2	4.1	4.0	4.0	4.0	3.0	4.2	4.0
Nonfarm business sector															
Output per hour	3.2	2.1	4.4	1.0	3.5	2.7	3.1	2.9	2.8	2.8	2.8	2.7	2.7	3.1	2.8
Previous	3.2	2.1	4.6	2.8	2.4	2.4	3.0	2.9	3.0	2.8	2.8	2.7	3.2	2.7	2.8
Compensation per hour	5.5	.9	4.1	3.0	4.3	5.4	5.6	5.6	5.4	5.2	5.2	5.1	3.3	5.3	5.2
Previous	5.5	.9	3.7	4.4	4.6	5.3	5.5	5.5	5.3	5.1	5.1	5.0	3.6	5.3	5.1
Unit labor costs	2.2	-1.2	-.3	2.0	.8	2.6	2.5	2.6	2.6	2.3	2.3	2.3	.6	2.1	2.4
Previous	2.2	-1.2	-.9	1.5	2.2	2.9	2.5	2.6	2.3	2.3	2.2	2.3	.4	2.5	2.3

1. Change from fourth quarter of previous year to fourth quarter of year indicated.
2. Private-industry workers.

Other Macroeconomic Indicators

Item	2005 Q1	2005 Q2	2005 Q3	2005 Q4	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2005[1]	2006[1]	2007[1]
Employment and production															
Nonfarm payroll employment[2]	.5	.6	.5	.3	.6	.5	.4	.3	.3	.3	.3	.3	2.0	1.8	1.0
Unemployment rate[3]	5.2	5.1	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.1	5.1	5.1	5.0	5.0	5.1
Previous[3]	5.3	5.1	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
GDP gap[4]	-.7	-.7	-.4	-.6	-.4	-.2	-.1	-.1	-.2	-.3	-.3	-.4	-.6	-.1	-.4
Previous[4]	-.7	-.6	-.4	-.3	-.2	-.1	.0	.0	.0	-.1	-.2	-.3	-.3	.0	-.3
Industrial production[5]	3.8	1.6	1.4	3.8	6.3	7.5	5.7	4.5	3.4	2.7	2.7	2.7	2.7	6.0	2.9
Previous[5]	3.8	1.6	.9	3.1	8.3	6.4	5.0	3.7	2.9	2.7	2.8	2.9	2.4	5.9	2.8
Manufacturing industr. prod.[5]	4.5	1.3	2.0	7.9	5.6	5.5	5.1	4.4	3.6	2.9	3.0	3.0	3.9	5.2	3.1
Previous[5]	4.5	1.3	1.9	6.1	5.5	6.0	4.7	3.8	3.1	3.0	3.2	3.4	3.4	5.0	3.2
Capacity utilization rate - mfg.[3]	78.7	78.5	78.5	79.6	80.2	80.8	81.2	81.5	81.7	81.7	81.7	81.7	79.6	81.5	81.7
Previous[3]	78.7	78.5	78.5	79.2	79.8	80.4	80.8	81.0	81.1	81.1	81.1	81.3	79.2	81.0	81.3
Housing starts[6]	2.1	2.0	2.1	2.0	2.1	2.1	2.1	2.1	2.1	2.1	2.0	2.0	2.1	2.1	2.0
Light motor vehicle sales[6]	16.5	17.2	17.9	15.8	16.7	16.9	17.0	17.0	17.0	17.0	17.0	17.1	16.9	16.9	17.0
Income and saving															
Nominal GDP[5]	7.0	6.0	7.6	5.1	6.3	6.3	5.8	5.4	5.2	5.0	4.9	4.8	6.4	6.0	5.0
Real disposable pers. income[5]	-3.4	.2	-2.0	7.4	4.5	4.7	4.4	4.3	4.8	4.2	3.9	4.0	.4	4.5	4.2
Previous[5]	-3.4	.2	-.7	6.7	5.1	4.4	4.3	4.2	4.6	4.0	4.0	4.0	.6	4.5	4.2
Personal saving rate[3]	.5	-.2	-1.8	-.2	-.2	.1	.4	.7	1.0	1.3	1.4	1.6	-.2	.7	1.6
Previous[3]	.5	-.2	-1.5	.0	.1	.4	.6	.9	1.2	1.3	1.4	1.6	.0	.9	1.6
Corporate profits[7]	24.5	19.7	-15.2	46.8	21.8	7.3	1.8	-5.2	-4.4	-4.0	-3.2	1.9	16.7	6.0	-2.4
Profit share of GNP[3]	10.5	10.9	10.2	11.1	11.5	11.5	11.4	11.2	10.9	10.7	10.5	10.4	11.1	11.2	10.4
Excluding FR Banks[3]	10.3	10.6	10.0	10.9	11.3	11.3	11.2	11.0	10.7	10.5	10.3	10.2	10.9	11.0	10.2
Net federal saving[8]	-298	-297	-415	-306	-353	-344	-339	-329	-361	-356	-359	-351	-329	-341	-357
Net state & local saving[8]	7	21	-6	3	21	26	28	31	30	30	28	30	6	27	30
Gross national saving rate[3]	13.4	13.1	13.4	13.2	13.1	13.4	13.5	13.6	13.4	13.4	13.4	13.3	13.2	13.6	13.3
Net national saving rate[3]	1.7	1.6	-1.6	1.5	1.7	2.1	2.3	2.3	2.0	2.1	2.0	2.1	1.5	2.3	2.1

1. Change from fourth quarter of previous year to fourth quarter of year indicated, unless otherwise indicated.
2. Change, millions.
3. Percent, annual values are for the fourth quarter of the year indicated.
4. Percent difference between actual and potential GDP; a negative number indicates that the economy is operating below potential. (In previous Greenbooks, we expressed the GDP gap with the opposite sign, so that a positive number indicated that actual output fell short of potential.) Annual values are for the fourth quarter of the year indicated.
5. Percent change, annual rate.
6. Level, millions, annual values are annual averages.
7. Percent change, annual rate, with inventory valuation and capital consumption adjustments.
8. Billions of dollars, annual values are annual averages.

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

Item	Fiscal year				2005				2006				2007			
	2004[a]	2005[a]	2006	2007	Q1[a]	Q2[a]	Q3[a]	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Unified budget					Not seasonally adjusted											
Receipts[1]	1880	2153	2294	2409	452	665	549	530	481	719	564	550	508	761	590	579
Outlays[1]	2293	2472	2641	2762	628	620	618	650	681	662	649	686	716	690	670	727
Surplus/deficit[1]	-413	-318	-347	-353	-177	45	-69	-119	-200	57	-85	-136	-209	71	-79	-147
Previous	*-413*	*-318*	*-346*	*-352*	*-177*	*45*	*-69*	*-123*	*-197*	*60*	*-85*	*-131*	*-201*	*56*	*-75*	*-141*
On-budget	-568	-494	-509	-534	-202	-37	-84	-170	-219	-24	-96	-196	-231	-14	-93	-208
Off-budget	155	175	161	181	25	83	15	51	19	81	11	59	23	85	14	61
Means of financing																
Borrowing	378	297	355	365	165	-43	73	112	183	-34	93	126	193	-42	88	137
Cash decrease	-1	1	1	0	2	-11	-2	-1	21	-19	0	10	15	-25	0	10
Other[2]	36	21	-8	-12	10	8	-1	8	-4	-4	-8	-0	0	-4	-8	-0
Cash operating balance, end of period	36	36	35	35	22	33	36	37	16	35	35	25	10	35	35	25
NIPA federal sector					Seasonally adjusted annual rates											
Receipts	1933	2157	2370	2498	2197	2228	2149	2309	2356	2392	2426	2456	2491	2511	2535	2565
Expenditures	2348	2503	2706	2849	2495	2525	2564	2615	2708	2735	2764	2785	2852	2867	2894	2915
Consumption expenditures	711	760	804	834	760	763	783	783	806	811	815	820	834	838	842	846
Defense	474	510	537	561	509	512	529	516	538	544	548	552	561	564	567	569
Nondefense	237	250	267	273	251	251	254	266	267	267	267	268	273	274	275	276
Other spending	1637	1742	1902	2016	1735	1762	1781	1832	1903	1925	1949	1965	2018	2029	2052	2069
Current account surplus	-415	-346	-335	-351	-298	-297	-415	-306	-353	-344	-339	-329	-361	-356	-359	-351
Gross investment	99	106	111	113	101	107	109	107	112	112	112	113	113	113	113	113
Gross saving less gross investment[3]	-421	-354	-344	-357	-302	-307	-425	-313	-363	-353	-346	-336	-367	-361	-363	-354
Fiscal indicators[4]																
High-employment (HEB) surplus/deficit	-378	-334	-336	-352	-280	-288	-414	-298	-354	-349	-344	-336	-364	-355	-354	-341
Change in HEB, percent of potential GDP	0.7	-0.5	-0.1	-0.0	-0.6	0.0	1.0	-1.0	0.4	-0.1	-0.1	-0.1	0.2	-0.1	-0.0	-0.1
Fiscal impetus (FI) percent of GDP	0.8	0.3	0.4	0.0	0.0	0.1	0.1	-0.0	0.2	0.1	0.0	0.0	-0.0	-0.0	0.0	-0.0
Previous	*0.8*	*0.3*	*0.4*	*0.0*	*0.0*	*0.1*	*0.1*	*0.1*	*0.2*	*0.1*	*0.0*	*0.0*	*-0.0*	*-0.0*	*0.0*	*-0.0*

1. 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

Class II FOMC
Restricted (FR)

January 25, 2006

Change in Debt of the Domestic Nonfinancial Sectors
(Percent)

Period [1]	Total	Households: Total	Households: Home mortgages	Households: Consumer credit	Business	State and local governments	Federal government	Memo: Nominal GDP
Year								
2000	4.8	8.6	8.2	10.8	9.3	1.3	-8.0	4.6
2001	6.1	8.6	9.5	7.6	6.0	8.9	-.2	2.7
2002	6.9	9.7	11.9	4.7	2.6	11.1	7.6	3.6
2003	8.1	9.9	12.3	4.5	4.4	8.2	10.9	6.1
2004	8.7	11.1	13.5	4.5	5.9	7.6	9.0	6.8
2005	9.0	10.5	13.1	2.6	7.6	10.8	7.0	6.4
2006	7.4	8.1	9.4	3.9	6.8	4.5	7.8	6.0
2007	6.6	6.8	7.6	4.1	6.6	3.2	7.4	5.0
Quarter								
2005:1	9.6	9.1	11.3	2.7	7.0	12.0	14.4	7.0
2	8.1	11.2	13.3	4.3	9.1	6.1	.1	6.0
3	9.1	11.5	14.0	5.3	7.4	12.6	5.1	7.6
4	7.8	8.6	11.5	-2.0	6.1	11.0	7.8	5.1
2006:1	9.2	8.6	10.1	3.5	7.5	5.2	15.0	6.3
2	6.3	8.3	9.3	5.0	6.9	5.0	.9	6.3
3	6.6	7.5	8.7	3.4	6.2	3.7	6.4	5.8
4	6.8	7.1	8.1	3.6	6.1	3.7	8.4	5.4
2007:1	7.9	6.8	7.7	3.8	6.4	3.4	14.7	5.2
2	5.2	6.7	7.5	3.9	6.5	3.4	.2	5.0
3	6.1	6.5	7.2	4.1	6.4	3.0	5.6	4.9
4	6.6	6.4	7.0	4.2	6.4	3.0	8.6	4.8

Note. Quarterly data are at seasonally adjusted annual rates.
1. Data after 2005:Q3 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

Flow of Funds Projections: Highlights

(Billions of dollars at seasonally adjusted annual rates except as noted)

					2005		2006				2007			
Category	2004	2005	2006	2007	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Domestic nonfinancial sectors														
Net funds raised														
Total	1769.0	1794.7	1688.2	1686.5	1813.1	1637.0	2064.3	1440.5	1580.2	1668.0	2050.2	1326.9	1598.7	1770.3
Net equity issuance	-157.0	-362.0	-253.0	-168.0	-481.1	-378.6	-340.0	-240.0	-226.0	-206.0	-168.0	-168.0	-168.0	-168.0
Net debt issuance	1926.0	2156.7	1941.2	1854.5	2294.2	2015.6	2404.3	1680.5	1806.2	1874.0	2218.2	1494.9	1766.7	1938.3
Borrowing indicators														
Debt (percent of GDP) [1]	197.0	201.6	205.4	208.7	201.9	203.7	204.8	205.6	206.0	206.7	207.8	208.6	209.1	209.9
Borrowing (percent of GDP)	16.4	17.3	14.7	13.3	18.2	15.8	18.6	12.8	13.5	13.9	16.2	10.8	12.6	13.7
Households														
Net borrowing [2]	1011.6	1068.7	911.5	823.8	1233.6	946.5	968.7	951.8	879.8	845.7	832.2	823.4	820.5	819.2
Home mortgages	887.3	979.6	792.2	699.3	1106.8	947.8	854.9	808.4	771.3	734.1	715.5	701.6	692.3	687.6
Consumer credit	90.9	55.3	86.1	92.5	114.4	-43.2	77.3	109.8	76.9	80.5	85.3	90.0	96.0	98.9
Debt/DPI (percent) [3]	111.4	118.5	121.4	122.5	120.3	120.5	121.1	121.4	121.8	122.0	122.1	122.3	122.6	122.9
Business														
Financing gap [4]	47.0	-97.2	15.0	193.2	-234.8	-149.4	-126.3	25.6	54.0	106.6	155.5	170.8	200.0	246.7
Net equity issuance	-157.0	-362.0	-253.0	-168.0	-481.1	-378.6	-340.0	-240.0	-226.0	-206.0	-168.0	-168.0	-168.0	-168.0
Credit market borrowing	434.3	599.1	577.9	591.8	608.0	511.0	636.3	591.7	541.3	542.2	574.3	596.3	595.4	601.3
State and local governments														
Net borrowing	118.2	181.9	83.2	62.8	220.7	199.0	96.4	94.8	70.8	70.8	66.8	66.8	58.8	58.8
Current surplus [5]	181.3	199.4	195.3	204.3	208.2	167.7	187.0	194.1	197.7	202.4	202.4	203.6	203.7	207.4
Federal government														
Net borrowing	361.9	306.9	368.7	376.1	231.9	359.0	703.0	42.2	314.3	415.3	745.0	8.4	292.0	459.0
Net borrowing (n.s.a.)	361.9	306.9	368.7	376.1	72.8	112.2	182.7	-33.7	93.4	126.3	193.2	-42.2	87.8	137.3
Unified deficit (n.s.a.)	400.7	319.7	364.2	364.1	69.0	119.3	200.0	-57.0	85.0	136.2	208.6	-71.1	79.4	147.2
Depository institutions														
Funds supplied	796.9	826.2	572.7	560.1	884.7	503.8	507.6	569.9	664.8	548.4	649.6	504.3	574.9	511.5

Note. Data after 2005:Q3 are staff projections.
1. Average debt levels in the period (computed as the average of period-end debt positions) divided by nominal GDP.
2. Includes change in liabilities not shown in home mortgages and consumer credit.
3. Average debt levels in the period (computed as the average of period-end debt positions) divided by disposable personal income.
4. For corporations, excess of capital expenditures over U.S. internal funds.
5. NIPA state and local government saving plus consumption of fixed capital and net capital transfers.
n.s.a. Not seasonally adjusted.

2.6.4 FOF

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International Developments

The expansion abroad is forecast to continue at a healthy pace, a touch higher than in the previous Greenbook. Recent data suggest that foreign inflation dipped in the fourth quarter of 2005, as oil prices eased back a bit. Although foreign inflation is projected to move back up somewhat, we expect it to remain contained, as tighter monetary policies and stronger foreign currencies weigh on prices and the latest rebound in dollar oil prices tails off.

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

Indicator	2005		Projection				
				2006			
	H1	Q3	2005: Q4	Q1	Q2	H2	2007
Foreign output	3.2	4.4	3.9	3.6	3.6	3.5	3.4
December GB	3.0	4.5	3.3	3.4	3.5	3.4	3.3
Foreign CPI	1.9	3.4	2.0	2.6	2.7	2.6	2.5
December GB	1.9	3.4	2.4	2.5	2.5	2.5	2.4

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 has risen sharply since the December FOMC meeting to around $67 per barrel, largely because of concerns about supply. Futures prices for delivery of oil throughout the forecast period have also moved significantly higher.

The trade-weighted foreign exchange value of the dollar depreciated about 1¾ percent over the intermeeting period. We again project that the broad real dollar will decline at a moderate rate over the forecast period, reflecting the need to finance the large and growing U.S. current account deficit.

Net exports of real goods and services are estimated to have made a negative arithmetic contribution to the growth of U.S. GDP of nearly 1½ percentage points in the fourth quarter, as rapid import growth—boosted by hurricane-related disruptions to domestic production of refined petroleum, chemicals, and related products—swamped moderate export growth. Our forecast for the contribution of net exports is neutral in the first quarter of 2006 as the recovery of domestic refinery and chemicals production restrains imports and boosts exports. Net exports are projected to make a roughly neutral arithmetic contribution to growth this year and a negative contribution of about ⅓ percentage point in 2007.

The U.S. current account deficit was reported at just over $780 billion at an annual rate in the third quarter and is estimated to have ballooned to about $895 billion, or 7 percent of GDP, in the fourth quarter. The fourth-quarter rise in the current account deficit primarily reflects the widening of the trade deficit but also a swing of the investment income balance into negative territory and an increase in net unilateral transfers abroad; foreign payments of hurricane-related insurance claims depressed net transfers in the third quarter, and they likely returned to normal in the fourth. The deficit is expected to widen to more than $1 trillion, or about 7½ percent of GDP, in 2007.

Oil Prices

The spot price of West Texas intermediate (WTI) crude oil closed at $66.75 per barrel on January 24, an increase of roughly $7 per barrel since the time of the December Greenbook. With data on inventories in the United States coming in at unseasonably high levels, this upswing is believed to reflect primarily fears of supply disruptions. The spot price moved up at the start of the year as the natural gas dispute between Russia and Ukraine raised concerns about the reliability of Russia as an energy supplier. Later in January, the spot price jumped higher on escalating tensions over Iran's nuclear program and a disruption by rebel activity of Nigerian oil supplies of around 200,000 barrels per day (about 10 percent of Nigeria's normal exports). Also, Iraq's oil production fell in December to 1.55 million barrels per day, continuing the gradual downward slide from pre-war production of around 2.5 million barrels per day.

In addition to these recent developments, nearly 400,000 barrels per day of oil production in the Gulf of Mexico remain shut in because of as-yet unrepaired damage from last year's hurricanes. Although the growth of world demand for oil slowed last year, analysts expect relatively robust growth this year, given the continued solid outlook for the world economy. The demand outlook combined with intensified concerns that production capacity may struggle to keep pace have led market participants to expect much of the recent increase in oil prices to persist: The price of the far-dated futures contract (currently for delivery in December 2012) settled at $62.58 per barrel on January 24, about $6 per barrel higher than at the time of the December Greenbook.

In line with NYMEX futures prices, our projection calls for the spot price of WTI to edge up, to more than $69 per barrel in the first quarter of 2007, and then to remain relatively flat through the rest of the forecast period. Relative to the oil price outlook in the December Greenbook, the current projection averages about $6 per barrel higher in 2006 and $6.50 per barrel higher in 2007. The projected path of the oil import price has been revised up a similar amount.

International Financial Markets

The trade-weighted exchange value of the dollar against the major currencies declined 2 percent on net over the intermeeting period. The dollar fell about 3½ percent against the Japanese yen, with much of that decline coming in mid-December amid market reports that investors were liquidating speculative positions in some assets, including gold, that had been financed by borrowing in yen. The dollar depreciated about 3 percent versus the euro, reflecting increasing expectations of ECB tightening, but was down only 1 percent on net against sterling and was little changed against the Canadian dollar.

The dollar also depreciated about 1½ percent against the currencies of our other important trading partners. The dollar fell 3 percent to 5 percent against a number of Asian currencies, including the Korean won, Taiwan dollar, Singapore dollar, and Thai baht.

The dollar depreciated about 1 percent on net versus the Mexican peso and somewhat less against the Brazilian *real*.

On the basis of these developments, we have decreased the first-quarter value of the broad real dollar 1¾ percent relative to the projection in the December Greenbook. As noted, we continue to project that the broad real dollar will depreciate over the forecast period, reflecting downward pressure on the dollar stemming from the need to finance the increasing U.S. current account deficit. We have slightly reduced the projected rate of real depreciation, to an annual rate of about 1⅓ percent, in light of our anticipation that market expectations of U.S. interest rates will rise to come in line with the staff's financial assumptions.

The European Central Bank, the Bank of England, and the Bank of Japan kept their monetary policy stances unchanged over the intermeeting period. Comments by officials of the European Central Bank over the period were generally viewed as signaling an increased likelihood of tightening in the next few months, which was reflected in a small increase in euro short-term interest rates. In contrast, comments from the Bank of England heightened market expectations for a cut in its policy rate in the near term. The Bank of Canada increased its target for the overnight rate 25 basis points on January 24, to 3.5 percent.

Benchmark ten-year yields were little changed on balance in the euro area. These rates declined about 10 basis points in Japan and Canada and about 20 basis points in the United Kingdom. Headline equity indexes rose 2 percent to 6 percent in the euro area, United Kingdom, and Canada. Japanese equity prices were little changed on net. They rose early in the period to multiyear highs but dropped sharply in mid-January on news of an investigation of the financial reporting practices of the Japanese corporation Livedoor. Equity indexes also rose over the period in most markets in Latin America and emerging Asia.

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

Foreign Industrial Countries

Real GDP growth in the advanced foreign economies is estimated to have remained around 2½ percent in the fourth quarter. We project that growth will move up slightly in the first half of this year before edging back down to 2½ percent for the remainder of the forecast period. Our projection is slightly higher in the fourth quarter and in 2006 compared with the December Greenbook, in part because data showing continued strength into the fourth quarter have improved our view of the prospects of some industrial countries, especially in Europe. The four-quarter change in consumer prices is expected to be pushed up by the path of energy prices in the near-term, rising to 1¾ percent in the current quarter, and to slow somewhat later in the year. Inflation in 2007 picks up a bit, boosted chiefly by developments in the euro area and Japan.

We estimate that euro-area real GDP rose just over 1½ percent in the fourth quarter. Recent forward-looking indicators, such as sentiment and new orders, have been quite positive. Accordingly, we project growth to strengthen to just above 2 percent during 2006, a pace almost ½ percentage point faster than in the previous Greenbook, before slowing in 2007. An anticipated increase of 3 percentage points in the German value-added tax starting in 2007 will shift demand and production into late 2006 from early 2007 and will also push up euro-area inflation about ¼ percentage point in 2007, to around 2 percent. We assume that the European Central Bank will raise its official interest rates 50 basis points during the first half of this year on concerns about inflation.

GDP in the United Kingdom rose 2.6 percent (annual rate) in the fourth quarter, a pickup of around 1 percentage point from the third quarter. We estimate that a good portion of this pickup in growth is the result of a strong upswing in net exports. Some stronger data on consumption and house prices have led us to mark up our forecast of GDP growth; it now rises from around 2½ percent in the current quarter to just under 3 percent by the end of the forecast period as consumption and investment growth improve. Twelve-month inflation is projected to drop below 2 percent in the second half of this year and remain there for the rest of the forecast. We assume that this moderation in inflation will allow the Bank of England to keep its policy rates steady through the forecast period.

We estimate that Japanese GDP increased 2 percent in the fourth quarter. Positive incoming data and a downward revision to the level of inventories have caused us to raise our forecast a touch, to just above 1½ percent this year and next. We still do not expect headline inflation to turn positive on a sustained basis until the second half of 2006. Given recent statements by the Bank of Japan and Japanese government officials, we now assume that the central bank will wait to raise interest rates until late this year.

The Canadian economy continues to expand at a robust pace. Real GDP growth is projected to return to a 3½ percent pace in the first half of this year after an estimated dip to 3 percent in the fourth quarter that mainly reflected transitory inventory movements. We assume that the Bank of Canada will raise its target for the overnight interest rate another 50 basis points by mid-year, causing growth to moderate slightly over the rest of the forecast period. Headline twelve-month CPI inflation declined to 2.2 percent in December. We forecast that inflation will remain above 2 percent during the first half of this year, consistent with higher energy prices, and then inch down to around 2 percent and remain there for the rest of the forecast period.

Emerging Market Economies

We project that output growth in the emerging market economies will moderate further from the estimated 5¾ percent pace in the fourth quarter to about 4¾ percent in the current quarter and remain near that rate for the rest of the forecast period. This growth path is slightly stronger than that in the previous Greenbook and reflects recent data and large revisions to Chinese GDP statistics.

Output in emerging Asia is estimated to have grown about 7¾ percent in the fourth quarter, with the strength widespread across the region. We project that economic growth will moderate somewhat to around a still-healthy 6 percent rate over the forecast period, a touch higher than in the December Greenbook. Chinese real GDP growth for the last twelve years was revised up about ½ percentage point, on average, and we have carried that adjustment forward into the forecast period, raising our forecast for growth a comparable amount. We still expect policy measures aimed at slowing investment to be put in place soon. Accordingly, Chinese GDP growth is expected to moderate to around 8 percent over the forecast period. GDP in the rest of the region is projected to grow at about a 5 percent annual rate over the forecast period, a projection supported by a robust outlook for high-tech goods and solid growth in the United States and China.

Growth in Latin American output is estimated to have been 3¾ percent in the fourth quarter, down considerably from the third-quarter pace of 6½ percent, which was boosted by a rebound in Mexican growth after a weak second quarter. We project growth in Latin America to edge up to close to 4 percent in 2006 and 2007. Mexican real GDP is forecast to grow about 3¾ percent during this period, as service-sector output stays solid, manufacturing output recovers from its recent weakness, and monetary conditions are eased further. We expect Brazilian output to expand about 3 percent in each of the next two years as monetary policy in that economy eases further as well.

Recent data for the emerging market economies point to a continuation of twelve-month inflation at close to 3 percent in the fourth quarter. However, the pass-through of recent oil price increases, declining fuel subsidies in Asia, and reduced slack in emerging markets in general are expected to put upward pressure on prices. Accordingly, inflation for the emerging market economies is expected to pick up, to near 4 percent by late 2006, before dropping back to about 3½ percent by the end of 2007.

Prices of Internationally Traded Goods

Core import price inflation increased sharply in the fourth quarter, to an estimated 6½ percent at an annual rate, as sizable increases in the prices of natural gas and other commodities early in the quarter more than offset the restraining effect of a stronger dollar. As reported by the BLS, prices of imported natural gas increased at an annual rate of 319 percent in the fourth quarter, although starting in mid-December, spot prices fell sharply from record levels. Prices of imported core goods excluding natural gas rose at a 2¾ percent annual rate in the fourth quarter, following a slight decline in the third quarter; this acceleration largely reflects run-ups in prices of imported food and nonfuel industrial supplies, particularly metals and chemicals. Prices for core imports increased ¾ percentage point more than had been projected in the December Greenbook because of the unexpected strength of imported natural gas prices, but prices for core imports excluding natural gas came in slightly weaker than we expected.

For the first quarter of 2006, we project that core import price inflation will drop to ¾ percent at an annual rate because of the recent decline in the price of natural gas. Prices of core imports excluding natural gas are projected to rise 3 percent, slightly above the fourth-quarter rate of increase. For the remainder of 2006, core import price inflation will move back up to about 2¾ percent on the assumption of continued upward pressure from nonfuel commodity prices and no further large price declines for natural gas. Furthermore, the dollar, which had restrained core import prices as it strengthened in 2005, now boosts those prices somewhat as it returns to a depreciating path. In 2007, core import prices decelerate as commodity prices flatten and the dollar depreciates only gradually. Our projection for core import price inflation is somewhat higher than in the December Greenbook because of a weaker dollar and an upward shift in the projected path of commodity prices. In addition, we no longer assume that the expiration of the Multifibre Arrangement (MFA) will exert downward pressure on core import prices over the forecast period. Although the sources of imported apparel and textiles have shifted largely towards China in response to the expiration of the MFA, the apparent price effects have so far been muted.

Price inflation of core exports increased sharply in the fourth quarter, largely as a result of a run-up in prices for exports of intermediate materials and nonagricultural commodities. According to monthly BLS price data, prices surged in September and October. In November and December, however, price changes have been subdued, with declines in prices of exported nonagricultural industrial supplies and agricultural products. Given these monthly data, we have revised our projection for the first quarter of 2006 down a bit to 3 percent. However, we have revised up our projection for the rest of the year in response to higher projected prices for intermediate materials and commodities. All told, core export price inflation, which was 4 percent in 2005, is expected to average 3 percent in 2006 before declining even further, to 1 percent, in 2007. This pattern arises from a deceleration in projected producer prices of petroleum products and intermediate materials.

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

Indicator	2005		Projection				
	H1	Q3	2005: Q4	2006 Q1	2006 Q2	2006 H2	2007
Exports							
Core goods	4.9	1.9	4.6	3.0	4.4	2.6	1.1
December GB	4.9	2.0	5.6	3.2	3.0	2.0	1.0
Imports							
Non-oil core goods	3.4	1.0	6.5	0.7	2.5	2.7	1.1
December GB	3.4	.9	5.7	2.1	1.2	1.5	.7
Excluding natural gas	3.3	-.2	2.8	3.0	3.1	2.7	1.1
December GB	3.3	-.3	3.1	1.5	1.9	1.7	.8
Oil (dollars per barrel)	46.30	55.24	55.50	59.72	61.60	63.19	63.41
December GB	46.30	55.15	56.17	54.74	56.22	57.22	56.88

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. Imported oil includes both crude oil and refined products.

Trade in Goods and Services

Real net exports are estimated to have made a negative arithmetic contribution to real GDP growth of nearly 1½ percentage points in the fourth quarter, as rapid import growth outweighed a moderate increase in exports. In the first quarter, real net exports are projected to be unchanged, as import growth falls back from the rapid pace of the previous quarter and exports rebound from their earlier weakness. After making a negative arithmetic contribution to growth of about ¼ percentage point in 2005 as a whole, net exports are projected to be about neutral for growth in 2006 and then subtract about ⅓ percentage point in 2007. Compared with the December Greenbook, we have significantly revised down (made more negative) our projection of the contribution of real net exports in the fourth quarter and revised up our projection for the first quarter. These changes primarily reflect our reaction to the October and November trade data, which led us, among other things, to revise our estimates of the timing of hurricane effects on exports and imports.

We estimate that, following subdued growth of 2½ percent at an annual rate in the third quarter, real imports of goods and services jumped almost 12 percent in the fourth quarter, as imports of oil and other industrial supplies were boosted by hurricane-related disruptions to domestic production and services imports rebounded from a third-quarter dip. Imports of chemicals were particularly robust in October and November; the Gulf region has substantial concentrations of chemicals production, and these sites were hit hard by Hurricanes Katrina and Rita. Our estimate for fourth-quarter import growth is about the same as in the December Greenbook, as stronger-than-expected imports of industrial supplies in the October and November data more than offset weaker-than-expected imports of some capital goods and consumer goods.

In the current quarter, growth of real imports of goods and services is projected to decline to 4½ percent, largely because of a recovery in domestic refinery production. Likewise, a recovery in the domestic production of chemicals and other industrial supplies should reduce imports of these products. Conversely, imports of services are expected to grow robustly, boosted by licensing payments related to the Winter Olympics. The small downward revision in our projection for import growth in the first quarter mainly reflects a reversal of the stronger-than-expected imports of industrial supplies observed in the fourth quarter.

Beyond the first quarter, hurricane-related effects become negligible. After being held back in the second quarter by a quirky seasonal adjustment factor for oil, total import growth should recover to 5½ percent in both the second half of 2006 and in 2007. Core imports are projected to grow about 5¾ percent in the second half 2006 and in 2007, as the negative impact of diminishing U.S. growth is balanced by the positive impetus of decelerating core import prices. Imports of computers and semiconductors expand at rates in line with historical experience during the forecast period, while services decelerate in line with U.S. activity. Our projections for total import growth for 2006 and 2007 are about ½ percentage point lower than in the December Greenbook, largely because of a markdown in growth of core imports as a response to the increase in our projection of core import prices.

We estimate that growth of real exports of goods and services rose to 4¾ percent at an annual rate in the fourth quarter, following an increase of just 2½ percent in the third quarter. A rebound in aircraft exports, after the end of the September strike at Boeing, accounted for the bulk of the fourth-quarter growth. After falling sharply in September, exports of industrial supplies, particularly chemicals and petroleum products, remained weak through October and November, likely as a result of hurricane-related production disruptions. Growth of services exports increased slightly after a weak third quarter but remained subdued. Since the December Greenbook, we have revised down our estimate of fourth-quarter export growth 6¾ percentage points. This substantial downward revision primarily reflects our reaction to the weakness in the October and November trade data.

In the current quarter, real export growth is expected to rise to 7¼ percent, as exports of industrial supplies rebound. The pick-up should also be supported by stronger exports of both services and computers after weak growth for both categories in the previous quarter. This projection is 3½ percentage points higher than in the December Greenbook, largely because of our expectation of a rebound following the unexpected weakness of exports in the October and November trade data.

After the first quarter, we expect export growth to moderate to a more normal pace in the remainder of 2006 and to be supported by continued expansion abroad. In 2007, we project export growth to slow further as the positive impact of pre-2005 dollar depreciation on exports of core goods wanes. By contrast, services exports, which respond to exchange rates with shorter lags than core exports, accelerate a bit going forward as the negative effects of the dollar's pick-up in 2005 wear off. Exports of computers and semiconductors continue to move up at their historical pace. Our projection for the remainder of 2006 and 2007 is about ½ percentage point higher than in the December Greenbook, largely because of the effect on exports of core goods of slightly higher foreign growth and a lower projected path for the dollar.

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

Indicator	2005		Projection				
				2006			
	H1	Q3	2005: Q4	Q1	Q2	H2	2007
Real exports	9.1	2.5	4.8	7.2	5.9	6.3	5.3
December GB	9.1	0.8	11.5	3.6	5.0	5.5	4.8
Real imports	3.5	2.4	11.9	4.4	1.9	5.6	5.4
December GB	3.5	2.1	11.8	4.9	2.4	6.4	6.0

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

Alternative Simulations

In our alternative simulations, we use the FRB/Global model to assess the possibility that real investment abroad will expand more briskly than we anticipate, perhaps because of some unwinding of the global corporate savings glut. In particular, we examine the effects of an autonomous increase in investment demand of 2 percent of GDP in the major foreign economies. This shock induces modest dollar depreciation as monetary policy tightens abroad, but we also consider a second simulation in which the stronger foreign demand is accompanied by additional downward pressure on the dollar. This additional dollar depreciation could arise from an improved investment climate abroad and an associated rise of investor confidence in assets denominated in foreign currencies.

In the first scenario, this very large autonomous increase in foreign investment is phased in gradually over the year beginning in 2006:Q1. This shock stimulates U.S. real net exports directly through higher foreign demand for U.S.-produced goods and indirectly through a depreciation of the dollar. Under the assumption that the federal funds rate is unchanged from its baseline path, U.S. GDP growth rises about ½ percentage point relative to baseline in the second half of this year and in 2007. Core PCE inflation increases about ¼ percentage point above baseline in the second half of this year and about ½ percentage point in 2007. This increase in core inflation reflects a rise in import prices due to dollar depreciation of roughly 5 percent and the effects of higher aggregate demand on domestic prices. Although the trade balance deteriorates initially due to J-curve effects, it improves by ½ percent of GDP relative to baseline in the second half of 2007.

In the second scenario, the foreign demand shock is accompanied by a risk premium shock that is also phased in over the year and would induce the dollar to depreciate 10 percent by 2006:Q4 in the absence of an endogenous adjustment of interest rates. The combined shocks generate a larger expansion in real net exports than in the first scenario, and the resulting stimulus to U.S. GDP growth in 2007 is more than twice as large. Core PCE inflation rises about ½ percentage point above baseline in 2007, and the trade balance improves by almost 1 percent of GDP in the second half of 2007.

Alternative Scenarios:
Higher Investment Abroad With and Without Weaker Dollar

(Percent change from previous period, annual rate, except as noted)

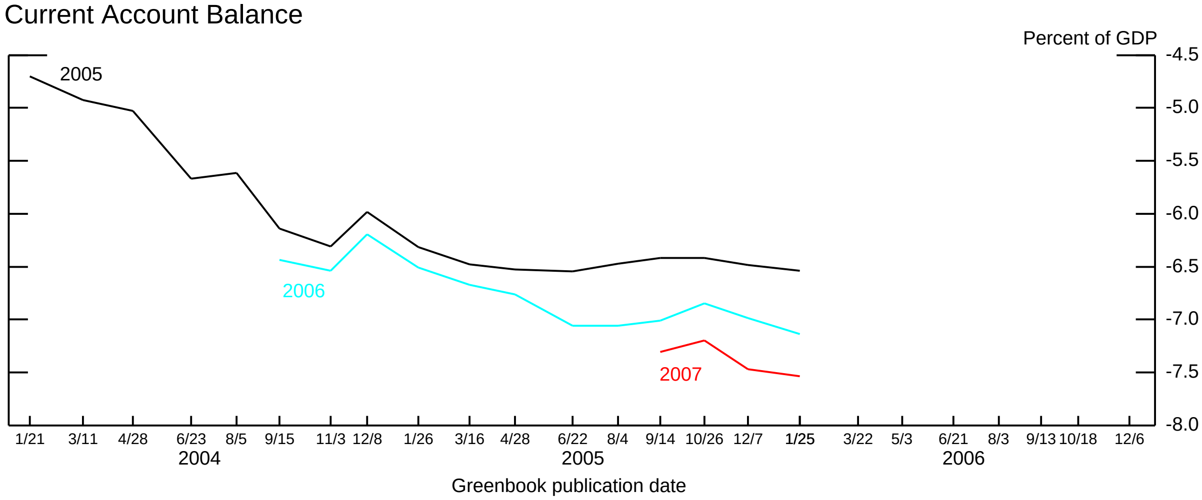
Indicator and simulation	2006		2007	
	H1	H2	H1	H2
U.S. real GDP				
Baseline	3.9	3.4	3.0	2.9
Higher investment abroad	4.2	3.9	3.5	3.4
Higher investment abroad With weaker dollar	4.3	4.3	4.2	4.0
U.S. PCE prices excluding food and energy				
Baseline	2.2	2.2	1.9	1.8
Higher investment abroad	2.2	2.4	2.5	2.3
Higher investment abroad With weaker dollar	2.3	2.6	2.6	2.4
U.S. trade balance (percent share of GDP)				
Baseline	-6.2	-6.1	-6.3	-6.2
Higher investment abroad	-6.5	-6.5	-6.2	-5.6
Higher investment abroad With weaker dollar	-6.6	-6.6	-6.0	-5.3

Note. H1 is Q2/Q4; H2 is Q4/Q2. The federal funds rate is held unchanged from its baseline path, and the monetary authorities in major foreign economies adjust their policy rates according to a Taylor rule.

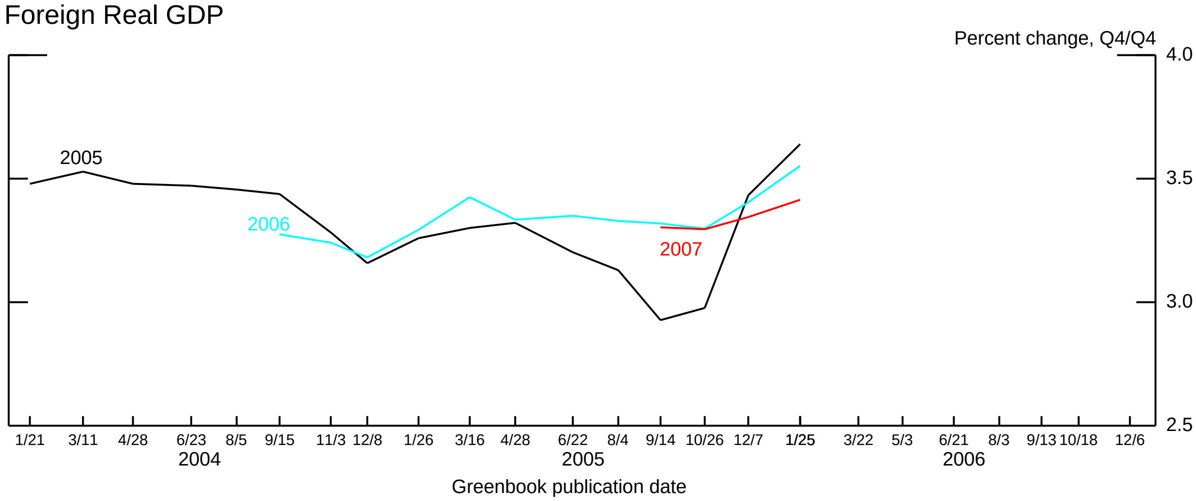
Class II FOMC -- Restricted (FR)

Evolution of the Staff Forecast

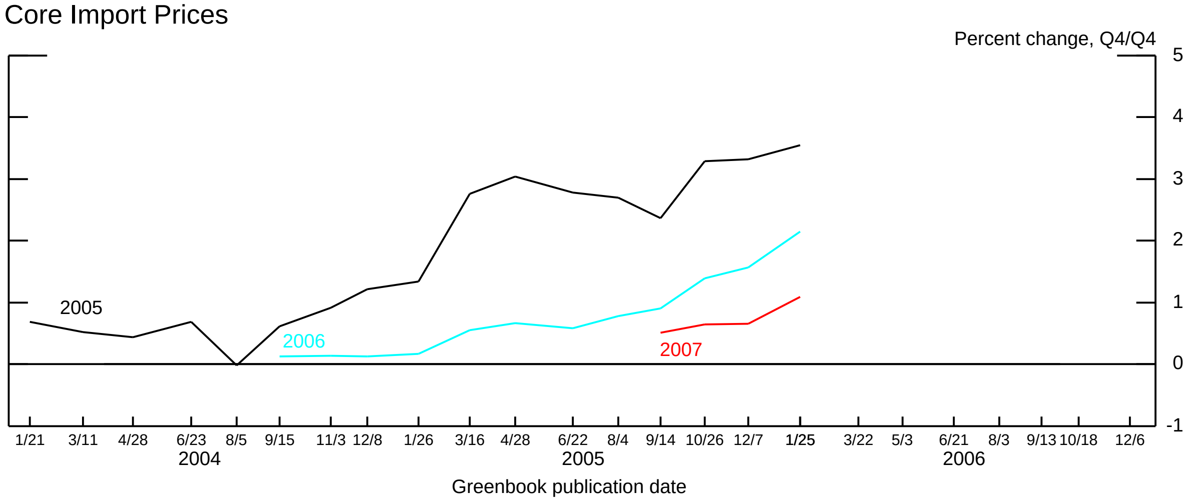
Current Account Balance



Foreign Real GDP



Core Import Prices



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

Measure and country	1999	2000	2001	2002	2003	2004	2005	2006	2007
							-----Projected----		
REAL GDP (1)									
Total foreign	5.1	4.2	0.4	3.1	3.0	3.7	3.6	3.6	3.4
Industrial Countries	4.4	3.5	0.9	2.6	1.8	2.4	2.6	2.7	2.4
of which:									
Canada	5.9	4.1	1.3	3.6	1.7	3.3	3.0	3.2	3.1
Japan	0.2	3.3	-1.5	2.0	2.6	0.6	3.4	1.6	1.6
United Kingdom	3.4	3.2	2.0	2.1	3.1	2.7	1.8	2.6	2.8
Euro Area (2)	4.1	3.2	1.1	1.2	1.0	1.6	1.8	2.1	1.6
Germany	3.5	2.3	1.1	0.2	0.2	0.5	1.7	2.3	0.9
Developing Countries	6.2	5.2	-0.3	3.8	4.7	5.6	5.1	4.8	4.8
Asia	8.7	5.8	1.2	6.2	6.6	6.0	7.1	5.7	5.8
Korea	11.5	4.5	4.6	7.8	4.2	3.0	5.4	4.2	4.2
China	7.7	8.2	7.8	9.2	10.5	10.1	9.9	7.7	8.0
Latin America	4.4	4.4	-1.3	1.5	2.4	5.2	3.1	3.9	3.8
Mexico	5.5	4.8	-1.3	2.0	2.1	4.9	2.8	3.7	3.7
Brazil	3.4	3.8	-0.9	4.1	0.9	4.8	0.9	3.0	3.0
CONSUMER PRICES (3)									
Industrial Countries	1.2	1.8	0.9	2.1	1.3	1.8	1.6	1.5	1.7
of which:									
Canada	2.4	3.1	1.1	3.8	1.7	2.3	2.2	1.9	2.0
Japan	-0.9	-0.9	-1.0	-0.6	-0.3	0.6	-0.7	0.2	0.4
United Kingdom (4)	1.2	1.0	1.0	1.5	1.3	1.4	2.1	1.8	1.6
Euro Area (2)	1.5	2.5	2.1	2.3	2.0	2.3	2.3	1.8	2.0
Germany	1.1	1.7	1.5	1.2	1.2	2.1	2.3	1.6	2.6
Developing Countries	4.6	4.1	2.8	2.8	3.1	3.9	3.1	3.9	3.5
Asia	0.1	1.9	1.2	0.7	2.2	3.2	2.7	3.7	3.2
Korea	1.2	2.5	3.3	3.4	3.5	3.4	2.5	4.2	3.2
China	-1.0	1.0	-0.1	-0.5	2.7	3.3	1.4	3.3	2.9
Latin America	12.5	8.4	5.3	6.4	4.9	5.7	3.8	4.2	4.0
Mexico	13.4	8.7	5.1	5.2	3.9	5.3	3.1	3.8	3.7
Brazil	8.4	6.4	7.5	10.7	11.5	7.2	6.1	4.6	4.0

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)

Measure and country	2005 Q1	2005 Q2	2005 Q3	2005 Q4	Projected 2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4
REAL GDP (1)	Quarterly changes at an annual rate											
Total foreign	2.4	3.9	4.4	3.9	3.6	3.6	3.5	3.5	3.3	3.4	3.4	3.4
Industrial Countries	2.0	3.2	2.6	2.5	2.8	2.8	2.5	2.5	2.3	2.5	2.5	2.5
of which:												
Canada	2.0	3.4	3.6	3.0	3.6	3.5	2.9	2.8	3.1	3.1	3.1	3.1
Japan	5.7	5.0	1.0	2.0	1.6	1.7	1.7	1.7	1.6	1.5	1.6	1.5
United Kingdom	0.9	1.9	1.7	2.6	2.5	2.6	2.6	2.7	2.8	2.8	2.8	2.9
Euro Area (2)	1.3	1.7	2.6	1.6	2.1	2.2	2.1	2.2	1.0	1.8	1.7	1.7
Germany	2.4	0.9	2.5	1.0	2.0	2.3	2.1	2.7	-0.8	1.7	1.4	1.4
Developing Countries	3.1	4.8	6.9	5.8	4.7	4.8	4.9	4.8	4.8	4.8	4.8	4.8
Asia	4.7	8.3	7.7	7.7	5.6	5.6	5.8	5.8	5.8	5.8	5.8	5.8
Korea	1.5	5.0	8.0	7.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2
China	11.9	7.2	8.9	11.5	7.2	7.2	8.2	8.2	8.0	8.0	8.0	8.0
Latin America	1.4	0.9	6.5	3.7	3.8	3.9	3.9	3.9	3.8	3.8	3.8	3.8
Mexico	0.7	-1.3	8.9	3.4	3.6	3.8	3.8	3.8	3.7	3.7	3.7	3.7
Brazil	0.8	4.6	-4.7	3.3	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
CONSUMER PRICES (3)	Four-quarter changes											
Industrial Countries	1.5	1.4	1.8	1.6	1.8	1.7	1.4	1.5	1.7	1.7	1.7	1.7
of which:												
Canada	2.1	1.9	2.6	2.2	2.3	2.2	1.7	1.9	2.0	2.0	2.0	2.0
Japan	-0.2	-0.1	-0.3	-0.7	-0.1	0.1	0.2	0.2	0.3	0.3	0.4	0.4
United Kingdom (4)	1.7	1.9	2.4	2.1	2.1	2.0	1.6	1.8	1.6	1.6	1.6	1.6
Euro Area (2)	2.0	2.0	2.3	2.3	2.5	2.3	1.9	1.8	2.1	2.1	2.1	2.0
Germany	1.7	1.6	2.1	2.3	2.7	2.4	1.8	1.6	2.7	2.7	2.6	2.6
Developing Countries	3.6	3.2	3.1	3.1	3.4	3.7	3.7	3.9	3.8	3.7	3.6	3.5
Asia	2.9	2.4	2.3	2.7	3.0	3.5	3.4	3.7	3.6	3.5	3.3	3.2
Korea	3.1	3.0	2.4	2.5	2.8	3.2	3.5	4.2	4.3	4.0	3.6	3.2
China	2.8	1.7	1.3	1.4	1.6	2.5	2.6	3.3	3.3	3.2	3.1	2.9
Latin America	4.9	5.1	4.5	3.8	4.2	4.0	4.1	4.2	4.0	4.0	4.0	4.0
Mexico	4.4	4.5	4.0	3.1	3.7	3.5	3.6	3.8	3.6	3.6	3.7	3.7
Brazil	7.4	7.7	6.2	6.1	5.4	4.7	5.1	4.6	4.4	4.2	4.2	4.0

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 U.S. INTERNATIONAL TRANSACTIONS

	1999	2000	2001	2002	2003	2004	2005 (Projected)	2006 (Projected)	2007 (Projected)
NIPA REAL EXPORTS and IMPORTS									
Percentage point contribution to GDP growth, Q4/Q4									
Net Goods & Services	-1.0	-0.9	-0.2	-0.9	-0.1	-0.9	-0.2	-0.1	-0.3
Exports of G&S	0.6	0.7	-1.3	0.4	0.6	0.6	0.6	0.7	0.6
Imports of G&S	-1.6	-1.6	1.1	-1.3	-0.7	-1.5	-0.8	-0.7	-0.9
Percentage change, Q4/Q4									
Exports of G&S	5.6	6.5	-11.9	3.8	6.0	6.1	6.3	6.4	5.3
Services	5.3	1.8	-8.9	10.2	4.5	4.6	3.9	5.1	5.9
Computers	13.4	22.7	-23.5	-1.1	11.0	6.3	14.3	15.8	14.4
Semiconductors	34.6	27.6	-34.6	10.1	38.8	-6.1	12.7	17.2	17.0
Other Goods 1/	3.3	5.9	-10.2	0.7	4.5	7.8	6.7	6.0	3.9
Imports of G&S	12.1	11.2	-7.6	9.7	5.1	10.6	5.3	4.4	5.4
Services	6.6	10.6	-5.9	8.8	4.2	7.7	2.4	4.5	3.8
Oil	-3.4	13.3	3.7	3.8	1.5	9.7	2.6	-7.0	2.0
Computers	26.0	13.9	-13.6	13.2	16.8	22.2	11.0	17.6	17.5
Semiconductors	34.2	22.8	-51.1	11.0	-0.2	9.4	7.8	17.6	17.0
Other Goods 2/	12.9	10.5	-6.5	10.1	5.1	10.5	5.7	5.9	5.6
Billions of Chained 2000 Dollars									
Net Goods & Services	-296.2	-379.5	-399.1	-471.3	-521.4	-601.3	-633.1	-650.8	-682.7
Exports of G&S	1008.2	1096.3	1036.7	1013.3	1031.2	1117.9	1195.1	1265.6	1333.2
Imports of G&S	1304.4	1475.8	1435.8	1484.6	1552.6	1719.2	1828.1	1916.4	2015.9
Billions of dollars									
US CURRENT ACCOUNT BALANCE	-300.1	-416.0	-389.5	-475.2	-519.7	-668.1	-816.5	-945.6	-1050.8
Current Acct as Percent of GDP	-3.2	-4.2	-3.8	-4.5	-4.7	-5.7	-6.5	-7.1	-7.5
Net Goods & Services (BOP)	-263.4	-378.3	-362.7	-421.2	-494.8	-617.6	-726.3	-816.1	-872.8
Investment Income, Net	19.1	25.7	30.3	15.5	51.8	36.2	1.3	-22.5	-69.0
Direct, Net	78.2	94.9	115.9	99.8	121.8	127.9	123.0	144.2	166.7
Portfolio, Net	-59.1	-69.2	-85.5	-84.3	-70.0	-91.7	-121.7	-166.7	-235.7
Other Income & Transfers,Net	-55.8	-63.5	-57.1	-69.5	-76.7	-86.7	-91.5	-107.0	-109.0

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2002 Q1	2002 Q2	2002 Q3	2002 Q4	2003 Q1	2003 Q2	2003 Q3	2003 Q4	2004 Q1	2004 Q2	2004 Q3	2004 Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-1.0	-0.6	-0.5	-1.5	0.1	-0.7	0.5	-0.5	-1.2	-1.4	-0.2	-1.0
Exports of G&S	0.5	1.0	0.3	-0.3	-0.3	-0.2	1.0	1.7	0.5	0.7	0.5	0.7
Imports of G&S	-1.4	-1.6	-0.8	-1.2	0.4	-0.5	-0.6	-2.2	-1.6	-2.0	-0.7	-1.7
Percentage change from previous period, s.a.a.r.												
Exports of G&S	5.2	10.6	2.9	-3.1	-2.9	-2.1	11.5	19.1	5.0	6.9	5.5	7.1
Services	22.9	2.7	4.6	11.7	-11.9	-6.6	17.2	23.7	-0.4	4.8	-0.6	15.5
Computers	-21.1	14.7	-6.0	12.6	-5.7	0.2	35.9	18.2	-7.4	1.6	21.7	11.5
Semiconductors	22.3	42.1	12.6	-25.0	34.8	33.9	43.7	43.2	7.0	-4.8	-19.4	-5.5
Other Goods 1/	-1.6	12.5	2.0	-9.1	0.0	-2.0	5.5	15.4	8.6	9.2	9.5	3.8
Imports of G&S	11.7	12.5	5.7	9.0	-2.5	3.3	4.1	16.5	12.0	14.5	4.7	11.3
Services	24.7	-3.0	1.7	14.0	-2.2	-10.2	21.4	10.7	10.0	13.7	4.6	3.1
Oil	-9.8	-10.3	-12.7	64.3	-9.0	7.8	-1.3	9.5	35.7	-26.0	-0.5	45.0
Computers	52.2	5.3	2.8	-0.2	11.5	12.4	8.7	36.4	21.2	34.3	25.3	9.5
Semiconductors	39.8	34.8	-6.2	-14.0	-6.7	1.5	-3.7	8.9	42.6	20.2	4.7	-20.3
Other Goods 2/	7.6	19.4	9.5	4.3	-2.6	5.8	0.7	17.7	8.4	20.4	4.0	9.7
Billions of Chained 2000 Dollars, s.a.a.r.												
Net Goods & Services	-441.3	-458.9	-472.2	-513.0	-510.7	-528.4	-516.2	-530.2	-563.0	-601.7	-606.5	-634.1
Exports of G&S	992.8	1018.0	1025.2	1017.2	1009.7	1004.5	1032.2	1078.4	1091.8	1110.2	1125.0	1144.5
Imports of G&S	1434.0	1476.9	1497.4	1530.2	1520.4	1532.9	1548.4	1608.6	1654.8	1711.9	1731.5	1778.6
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-440.4	-477.1	-480.3	-503.0	-546.6	-515.2	-515.9	-501.0	-584.4	-666.5	-667.9	-753.4
Current Account as % of GDP	-4.3	-4.6	-4.6	-4.7	-5.1	-4.8	-4.7	-4.5	-5.1	-5.7	-5.7	-6.3
Net Goods & Services (BOP)	-372.7	-413.8	-430.3	-467.9	-499.3	-491.4	-490.8	-497.7	-555.4	-608.2	-629.9	-676.9
Investment Income, Net	11.4	1.8	14.1	34.5	29.3	50.6	50.9	76.5	65.8	29.6	30.8	18.8
Direct, Net	100.5	91.4	95.0	112.2	102.3	117.4	119.9	147.8	140.3	116.3	121.4	133.7
Portfolio, Net	-89.2	-89.6	-80.9	-77.7	-72.9	-66.8	-69.0	-71.3	-74.6	-86.7	-90.6	-114.9
Other Inc. & Transfers, Net	-79.0	-65.1	-64.2	-69.6	-76.6	-74.4	-76.0	-79.7	-94.7	-88.0	-68.8	-95.3

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2005				Projected 2006				Projected 2007			
	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	-0.4	1.1	-0.1	-1.4	0.0	0.3	-0.0	-0.5	-0.8	0.2	-0.2	-0.6
Exports of G&S	0.7	1.1	0.3	0.5	0.7	0.6	0.6	0.8	0.3	0.6	0.6	0.8
Imports of G&S	-1.1	0.0	-0.4	-1.9	-0.7	-0.3	-0.6	-1.3	-1.1	-0.4	-0.8	-1.4
Percentage change from previous period, s.a.a.r.												
Exports of G&S	7.5	10.7	2.5	4.8	7.2	5.9	5.5	7.2	3.2	5.4	5.3	7.3
Services	12.5	-0.4	1.0	3.1	4.7	5.1	5.1	5.3	5.3	6.0	6.1	6.2
Computers	12.6	26.9	18.5	0.8	20.2	14.4	14.4	14.4	14.4	14.4	14.4	14.4
Semiconductors	-12.9	26.7	24.4	17.7	17.6	17.0	17.0	17.0	17.0	17.0	17.0	17.0
Other Goods 1/	6.1	14.9	1.2	5.1	7.2	5.1	4.6	7.2	1.0	4.0	3.9	6.9
Imports of G&S	7.4	-0.3	2.4	11.9	4.4	1.9	3.6	7.7	6.8	2.3	4.5	8.2
Services	3.7	4.4	-3.2	5.1	7.5	2.4	4.3	4.1	3.7	3.9	3.8	3.7
Oil	3.4	-24.5	-3.1	46.2	-6.5	-23.1	-13.4	19.8	13.6	-17.8	-5.2	22.4
Computers	11.3	13.7	15.2	4.1	18.0	17.5	17.5	17.5	17.5	17.5	17.5	17.5
Semiconductors	-7.9	8.3	18.0	14.8	19.3	17.0	17.0	17.0	17.0	17.0	17.0	17.0
Other Goods 2/	9.1	2.3	3.7	7.9	5.1	6.9	6.2	5.5	5.2	5.4	5.7	5.9
Billions of Chained 2000 Dollars, s.a.a.r.												
Net Goods & Services	-645.4	-614.2	-617.5	-655.1	-654.1	-645.2	-645.1	-658.8	-680.7	-674.6	-679.5	-695.9
Exports of G&S	1165.3	1195.4	1202.7	1216.9	1238.3	1256.0	1272.9	1295.3	1305.6	1322.9	1340.2	1363.9
Imports of G&S	1810.7	1809.6	1820.2	1872.0	1892.3	1901.2	1918.0	1954.1	1986.4	1997.5	2019.8	2059.9
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-794.7	-791.1	-783.3	-896.8	-933.6	-925.6	-945.5	-977.7	-1037.0	-1032.7	-1054.2	-1079.2
Current Account as % of GDP	-6.5	-6.4	-6.2	-7.0	-7.2	-7.0	-7.1	-7.2	-7.6	-7.4	-7.5	-7.6
Net Goods & Services (BOP)	-692.2	-694.4	-731.2	-787.3	-807.3	-805.8	-813.5	-837.7	-868.1	-862.9	-870.2	-890.1
Investment Income, Net	8.3	-0.4	8.1	-10.8	-11.2	-14.6	-24.7	-39.5	-51.8	-62.8	-74.6	-86.6
Direct, Net	113.5	114.0	138.8	125.8	134.0	142.6	148.6	151.4	157.4	164.1	170.0	175.4
Portfolio, Net	-105.2	-114.4	-130.7	-136.6	-145.2	-157.2	-173.3	-190.9	-209.2	-226.9	-244.7	-262.0
Other Inc. & Transfers, Net	-110.7	-96.3	-60.3	-98.7	-115.1	-105.2	-107.3	-100.5	-117.0	-107.0	-109.3	-102.5

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