Prefatory Note

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Class II FOMC - Restricted (FR)

Part 1

June 20, 2007

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

Class II FOMC - Restricted (FR)

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Summary and Outlook

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Domestic Developments

The recent economic data have been a little stronger, on balance, than we were anticipating at the time of the last Greenbook. Although consumer spending has decelerated about in line with our previous forecast, the level of personal income was revised up in recent quarters and employment gains have continued apace, suggesting that households will have a bit more wherewithal to spend in the period ahead. Businesses also seem to be on firmer footing overall: The softness in fixed investment that began late last year appears to have diminished, and businesses have made noticeable progress in addressing their inventory imbalances. To be sure, the residential construction sector remains weak; but in contrast to the situation in so many of our recent forecasts, the ongoing decline in residential investment has not outstripped our expectations. In addition, the fallout from problems in the subprime lending market does not look to have spread.

Financial market participants appear to have interpreted this incoming news as having reduced the downside risk to activity. Investors no longer expect a significant easing of monetary policy over the next year, and bond rates have moved up considerably in recent weeks on the change in policy expectations and on a rise in term premiums. However, this recent rise in rates mostly brings forward the increases that we had previously expected to occur later in the forecast period and thus imparts only a small drag on growth. Indeed, because of the greater momentum that we see in economic activity, slightly higher equity prices, and a slightly lower path for the exchange value of the dollar in this forecast, we have nudged up our projection for real GDP growth to an annual rate of roughly 2½ percent over the forecast period. With this small upward revision to growth, we now show a bit less easing of resource utilization in this projection, and the unemployment rate moves up to only 4¾ percent next year, compared with 5 percent in the May Greenbook.

Core inflation in April and May came in lower than expected, and we now estimate that core PCE inflation will average an annual rate of only 1.9 percent over the first two quarters of this year. We view much of the recent favorable news as transitory, and we project that core PCE inflation will move back up to an annual pace of 2.2 percent in the second half. Even so, we have taken some signal that inflation will run a little lower than we had thought, and we have reduced our core PCE inflation projection over the forecast period 0.1 percentage point below that in the May Greenbook; our projection for 2008 is now 2 percent. Total PCE prices are projected to rise almost 3 percent this year, pushed

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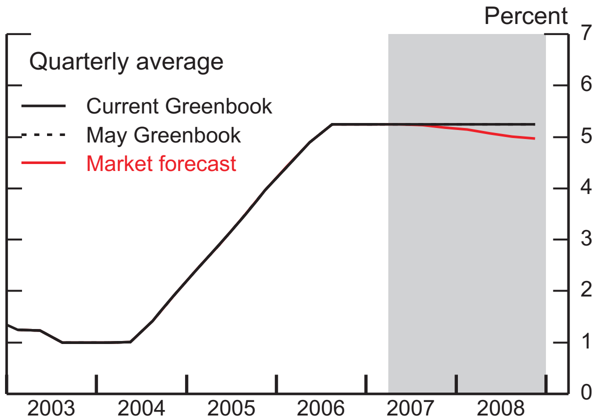
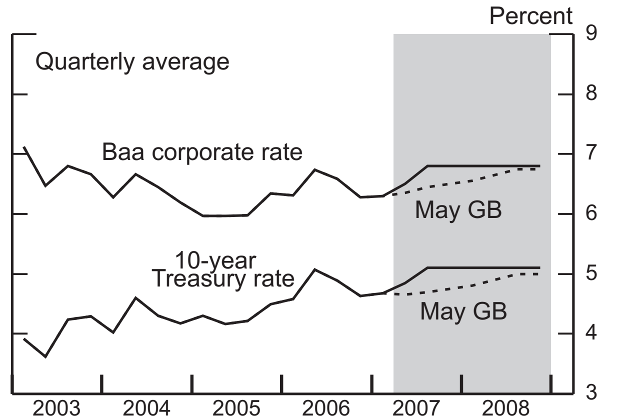
Key Background Factors Underlying the Baseline Staff Projection

Federal Funds Rate

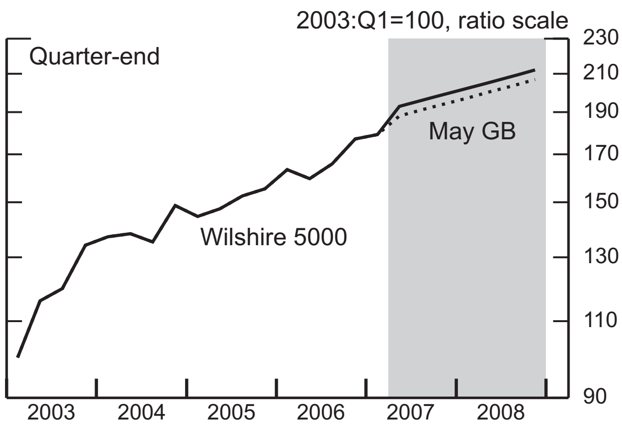


Note. The assumed federal funds rate is unchanged from the May Greenbook.

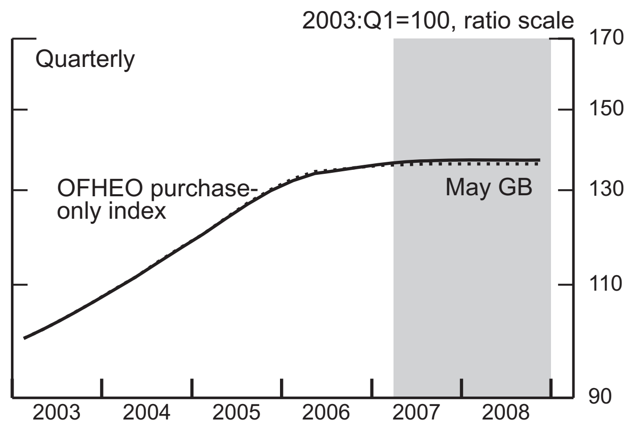
Long-Term Interest Rates



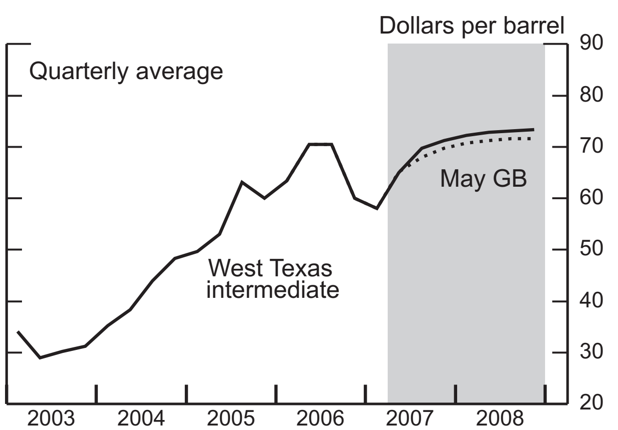
Equity Prices



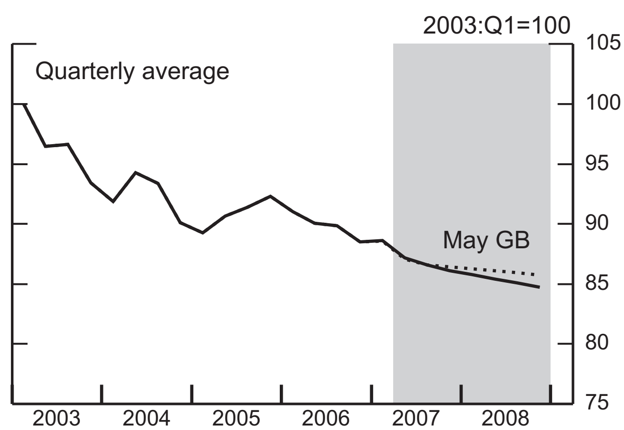
House Prices



Crude Oil Prices



Broad Real Dollar



Note. In each panel, shading represents the projection period.

up both by sharp increases in energy prices and by sizable increases in food prices. In 2008, we project headline inflation to rise the same 2 percent as core inflation.

Key Background Factors

We continue to assume that the Committee will hold the federal funds rate at 5¼ percent through the end of 2008. At the time of the last Greenbook, market participants had been expecting a policy easing of more than 75 basis points by the end of next year, but they have since revised their expectations and now anticipate only a small change in policy over the forecast period. Reflecting both this revision to policy expectations and an increase in term premiums, ten-year Treasury yields have risen almost 50 basis points since the time of the May Greenbook (or about 40 basis points more than we had anticipated); corporate yields and mortgage rates have risen similar amounts. Because the market path for the federal funds rate has come much closer to our assumptions and because we assume no further appreciable change in term premiums, we now expect long-term yields to hold about steady at the higher rates over the forecast period. This flat pattern contrasts with the updrift we had previously projected. Thus, at the end of 2008, long rates exceed those in our previous forecast by only about 10 basis points.

Broad equity indexes are currently about 2½ percent above the level that we had assumed in the May Greenbook. As is our usual practice, we assume that equity prices will increase from their current level at an annual rate of 6½ percent, a pace that roughly maintains risk-adjusted parity with the return on Treasury securities. Regarding house prices, the purchase-only version of the OFHEO price index posted a small increase in the first quarter that was about in line with our expectations. We continue to expect this index to be essentially unchanged through the end of 2008.

Our fiscal policy assumptions are little changed from the last Greenbook. The $120 billion supplemental appropriations bill that passed last month was in line with our expectations, and it included $100 billion of additional budget authority for defense spending. We continue to assume that real defense purchases will move up modestly next year and that nondefense purchases will hold steady in real terms. On the tax side, we expect that relief from the alternative minimum tax will be extended through 2008. In all, we project federal fiscal policy to provide an impetus to real GDP growth of about ¼ percentage point both this year and next, close to the forecast in the May Greenbook. We also expect that state and local governments, in the aggregate, will provide around ¼ percentage point of impetus to real GDP growth both this year and next. Finally, our federal deficit projections are little changed from the last forecast, with the federal unified budget expected to post deficits of $170 billion in the current fiscal year and about $230 billion in fiscal 2008.

With bond rates now presumed to remain flat in this projection rather than to rise as we had earlier assumed, we now expect interest rates to provide less support to the dollar over the forecast period. As a result, we project the real trade-weighted dollar to decline at an average annual rate of about 2 percent over the forecast period, compared with a 1 percent average pace of depreciation in the May Greenbook. In addition, we have maintained our view that foreign real GDP will expand at an annual rate of roughly 3½ percent through the end of 2008.

Oil prices have moved up a little more than we had expected, on net, since early May. The spot price of West Texas intermediate (WTI) crude oil stands at about $69 per barrel, about $5 per barrel above its level at the time of the May Greenbook, and prices for other grades of oil have moved up a bit more. Consistent with futures markets, our projection calls for the average price of imported oil to rise from $63 per barrel in the second quarter of this year to about $69 per barrel—$1.70 above our previous projection—at the end of the forecast period.

Recent Developments and the Near-Term Outlook

Real GDP is estimated to have risen at an annual rate of 1 percent in the first quarter, ¼ percentage point slower than we had anticipated at the time of the last Greenbook. Incoming data for the current quarter, however, point to a larger rebound in growth than we had been expecting—to a pace of 3 percent. A larger swing in inventory investment associated with the greater progress that businesses appear to have made in reining in excess stocks contributes importantly to this pattern of revisions. Moreover, final sales are running stronger than we had anticipated in our May forecast, and personal income has revised up. Therefore, even though we have not revised our earlier projection for growth to average an annual pace of 2 percent in the first half of this year, conditions appear to be in place for faster growth after the current quarter than we had previously expected.

Labor demand has been increasing at a moderate pace, with private payroll gains averaging 115,000 over the past three months. Although this pace of hiring is down from net monthly gains in excess of 160,000 in the second half of last year, it is still somewhat greater than we think sustainable given the recent and prospective pace of output growth. As a result, we look for private payrolls to decelerate further, to increases of 100,000 in

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

Measure	2007:Q1 May GB	2007:Q1 June GB	2007:Q2 May GB	2007:Q2 June GB
Real GDP	**1.3**	**1.0**	**2.6**	**3.0**
Private domestic final purchases	2.5	2.8	.7	.9
Personal consumption expenditures	3.8	4.3	1.9	1.6
Residential investment	-14.1	-15.8	-18.5	-12.2
Business fixed investment	2.8	3.3	2.9	2.8
Government outlays for consumption and investment	1.4	1.0	4.9	4.7
	Contribution to growth (percentage points)			
Inventory investment	-.4	-.9	.2	.3
Net exports	-.8	-.7	.8	1.0

June and 60,000 per month, on average, in the third quarter. We should note, however, that initial claims for unemployment insurance have yet to provide any convincing evidence that the smaller projected employment gains are in the offing. With this slower pace of hiring going forward, we expect the unemployment rate to start edging up in the coming months.

Manufacturing output has firmed, on balance, in recent months after declining in the fourth quarter and in the early part of this year, when firms in many industries restrained production to bring inventories back toward desired levels. Accordingly, we expect factory output to increase at a modest annual pace of about 3¼ percent in the current quarter. Part of that increase is in motor vehicles, where inventories have come into better alignment with sales after a sustained period of reduced assemblies. Vehicle production has stepped up this quarter, and we have taken on board as well some of the automakers’ higher scheduled assemblies in the third quarter.

As expected, consumer spending has decelerated markedly in recent months following sizable gains in the fall and winter. Data on retail sales through May point to only a small increase in outlays for goods other than motor vehicles this quarter, and expenditures on vehicles appear to have moved a bit lower after rising sharply in the first quarter. Factoring in continued growth in outlays for services, we now look for real PCE to rise at an annual rate of about 1½ percent in the second quarter following an upward-revised 4¼ percent rate of increase in the first quarter.

The residential construction sector has remained weak. Sales in recent months have averaged well below their pace in the second half of last year, and we are expecting a bit more deterioration in coming months (partly in response to the recent rise in mortgage rates). Moreover, inventories of unsold new homes remain quite high, suggesting that homebuilders will need to cut production further to work off these excess stocks. Although single-family starts moved up in the early spring and fell back only a bit in May, their level seems surprising against the backdrop of further declines in permit issuance—historically a more reliable indicator. We therefore expect starts to move down to an annual pace of around 1.05 million units in the third quarter, bringing them more in line with permits.

Business spending on equipment and software (E&S) is projected to be about flat this quarter, held down by a further decline in outlays for transportation equipment—especially medium and heavy trucks, which are experiencing a payback from the pull-forward of sales into 2005 and 2006 before the introduction of new EPA regulations. Elsewhere, E&S spending looks more solid than it did at the time of the May Greenbook. In particular, orders and shipments for nondefense capital goods picked up in March and April following their weakness in earlier months, and indexes from surveys of business conditions have improved as well. Consistent with these indicators, we project that E&S spending outside transportation equipment will rise at a pace of 6¼ percent this quarter.

Construction of nonresidential structures appears to have rebounded from its lull around the turn of the year. Incoming monthly data on construction activity suggest that outlays for nonresidential buildings will surge at an annual rate above 14 percent this quarter. Recent readings on architectural billings point to additional growth going forward, albeit at a pace well below that seen since this sector began to rebound in late 2005. Spending in the drilling and mining sector is expected to edge lower this quarter after a sharp decline in the first quarter. However, with prices of oil and natural gas likely to remain high, we expect the weakness in this industry to be short lived.

Real nonfarm inventories declined at an annual rate of about $5 billion in the first quarter following a modest $20 billion accumulation in the fourth quarter of last year; that swing subtracted nearly 1 percentage point from first-quarter GDP growth. We expect stockbuilding to turn positive in the current quarter and to contribute about ¼ percentage point to GDP growth. We estimate that inventories of motor vehicles edged a little lower this quarter, but with days' supply at comfortable levels, inventories were reduced more slowly than in the first quarter. Outside motor vehicles, the pace of inventory investment stepped down appreciably to $14 billion in the first quarter, and we expect a similar rate of accumulation in the current quarter. With this lower pace of stockbuilding, businesses appear to have made substantial progress in eliminating the excess inventories that had been built up around the turn of the year.

Real federal purchases declined at an annual rate of 4 percent in the first quarter, primarily because of a drop in defense outlays. However, data from the April and May issues of Monthly Treasury Statement have been consistent with our expectation of a sharp rebound in defense purchases this quarter. We expect real nondefense spending to edge up at a pace of 1 percent this quarter. In the state and local sector, expenditures rose at a brisk pace of 4 percent in the first quarter, boosted by sizable gains in construction spending; this quarter they are projected to rise at an annual rate of 3 percent.

We estimate that net exports subtracted ¾ percentage point from real GDP growth in the first quarter as oil imports surged and exports flattened out after exceptionally rapid growth late last year. In the second quarter, we look for oil imports to fall back, for non-oil imports to extend their previous weakness, and for exports to resume growing at more typical rates; as a result, the arithmetic contribution of net exports is expected to swing to (positive) 1 percentage point. This contribution is somewhat larger than we had anticipated in the May Greenbook and reflects news from the April trade report.

A sharp run-up in gasoline prices boosted headline consumer price inflation in recent months. Part of that run-up stems from the updrift in oil prices so far this year, but more important are higher wholesale margins associated with refinery outages and low inventories of gasoline. In the period ahead, as those outages end and inventories are rebuilt, we expect fuel prices to move lower. By contrast, core PCE inflation was below our expectations in April and, judging from the latest readings on the CPI and the PPI, also in May. Indeed, we now project that the core PCE price index will increase at an annual rate of only 1.4 percent this quarter, down ¾ percentage point from the May Greenbook.[1]

[1] We estimate that the core PCE price index rose at an annual rate of 2.4 percent in the first quarter. Our current estimate is 0.2 percentage point higher than is currently reported by the BEA, reflecting an expected revision to medical prices in January as indicated by last week's PPI release. This anticipated revision to the first quarter implies an offsetting adjustment in the second quarter and thus accounts for 0.2 percentage point of the downward revision to our projection of core inflation this quarter.

Although we have taken some signal from the recent data, we think that a large portion of the low core PCE readings will prove transitory. Some of the recent softness in core PCE inflation stems from the nonmarket component of prices, which we think provides little signal of underlying inflation trends. Some other categories of prices that have been soft, including apparel and tobacco products, also tend to be erratic, and the recent low readings in these categories followed relatively large increases in preceding months. The rent components have also decelerated somewhat more rapidly than we had anticipated, but part of that deceleration apparently reflects the effects of a standard adjustment made by the BLS to strip the cost of utilities out of owners' equivalent rent. Because we expect the downward pressure from this source to be temporary, we think that tenants' rent is providing the truer reading on housing prices at the moment.

The Longer-Run Outlook for the Economy

Real GDP is projected to step up from an annual rate of 2 percent in the first half of this year to 2¼ percent in the second half and 2½ percent in 2008. As in past Greenbooks, a diminishing drag from the residential construction sector contributes importantly to the strengthening of GDP growth over the forecast period.

Household spending. We project real consumer spending to increase at an average annual rate of 2¼ percent in the second half of this year and to accelerate slightly to a gain of 2½ percent in 2008. This year's increase is a bit faster than we projected in the May Greenbook, largely because of the upward revision to personal income starting in the fourth quarter of last year; the recent backup in interest rates, which is likely to restrain some consumer purchases going into next year, provides an offset to this upward revision. As in earlier Greenbooks, a diminishing impetus to outlays from wealth holds down the growth of consumer spending going forward, whereas spending is supported by the larger gains in real disposable income that occur as headline consumer price inflation decreases in the period ahead. With this pace of consumption growth, the personal saving rate is projected to move higher over the forecast period—albeit only to zero.

Our projection for residential construction is little changed from the May Greenbook. Although we have been surprised by the recent level of housing starts, the incoming data on permits and home sales have been about in line with our expectations. In our

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

Measure	2007 H1	2007 H2	2008
Real GDP	**2.0**	**2.3**	**2.5**
Previous	1.9	2.0	2.4
Final sales	2.3	1.9	2.6
Previous	2.0	1.8	2.4
PCE	3.0	2.3	2.5
Previous	2.9	2.1	2.5
Residential investment	-14.1	-16.7	-1.3
Previous	-16.3	-13.6	-1.1
BFI	3.1	4.0	4.6
Previous	2.8	3.5	3.8
Government purchases	2.8	3.2	1.9
Previous	3.1	2.9	1.9
Exports	3.3	6.0	5.7
Previous	3.2	6.2	5.7
Imports	1.4	3.8	3.8
Previous	2.1	3.6	4.2
	Contribution to growth (percentage points)		
Inventory change	-.3	.5	-.1
Previous	-.1	.2	-.1
Net exports	.1	.1	.0
Previous	.0	.1	.0

projection, sales stabilize in the second half of this year at a pace only a little below recent levels, and as noted earlier, we look for single-family starts to move down in the second half as well and to average a pace just under 1.05 million units; this combination should make a noticeable dent in the stock of unsold new homes by the end of this year. In 2008, with housing demand expected to firm a bit, single-family starts are projected to edge up to about 1.1 million units. Meanwhile, starts of multifamily units should be maintained at recent levels. In sum, real residential investment is projected to decline about another 17 percent at an annual rate over the second half of 2007 and to be roughly flat in 2008.

Business investment. We expect investment in equipment and software to rise at an annual pace of a little more than 5 percent over the next six quarters. A gradual strengthening of business output growth (though to only a middling rate of change), favorable financial conditions, and improving business attitudes all are expected to contribute to spending gains. With most of the payback in sales of medium and heavy trucks now behind us, we expect truck outlays to bottom out and then start to increase in coming quarters. Growth of spending on high-tech equipment, which has held up reasonably well in recent quarters, is expected to moderate somewhat going forward but to remain fairly solid; this projection is consistent with business surveys of anticipated high-tech spending. Outlays for equipment other than transportation and high-tech are projected to rise at an annual rate of about 2 percent in the second half of this year and in 2008—about in line with their long-run average pace.

We expect the growth of real spending in the nonresidential construction sector to ease from the rapid increases seen during the past year and a half. For buildings, those increases probably reflected some catch-up from several years of stagnant activity. As that catch-up wanes, and with a higher cost of capital and slower employment growth, construction spending should decelerate. However, we expect a rebound from the recent weakness in the drilling and mining sector to partially offset the projected deceleration in outlays on buildings. In all, we project nonresidential construction spending to increase 5 percent this year and 2¼ percent in 2008.

As discussed above, we believe that businesses in most industries have largely worked off their inventory imbalances. Accordingly, we expect both motor vehicle producers and other manufacturers to step up the pace of stockbuilding a little in the second half of this year. We project that inventory investment in 2008 will be a relatively neutral factor for real GDP growth, with the inventory-sales ratio trending lower.

Government spending. Our projection for real government purchases is little changed from the May Greenbook. We expect real defense purchases to rise 4 percent over the four quarters of 2007 and 2½ percent next year, as expenditures for operations in Iraq and Afghanistan are anticipated to rise at a slower pace next year while other real defense outlays move only modestly higher from current levels. Nondefense spending is projected to remain about flat in real terms throughout the projection period. With generally favorable budget conditions in the state and local sector, we expect real spending in this area to rise 3 percent this year and another 2 percent in 2008.

Net exports. After the current quarter, our projections for both imports and exports are not much changed from those in the May Greenbook. The steeper depreciation of the dollar in this projection implies slightly stronger export growth and weaker import growth, but these effects are mostly offset by other factors, including the effect on imports of faster U.S. GDP growth. In all, we continue to expect net exports to be a roughly neutral influence on GDP growth both this year and next. *(The International Developments section provides more detail on the outlook for the external sector.)*

Aggregate Supply, the Labor Market, and Inflation

We have made no changes to our supply side assumptions in this Greenbook. We continue to project that structural labor productivity will increase a little less than 2¼ percent this year and next. This projection, together with our estimates of trend increases in hours worked, corresponds to potential GDP growth near 2½ percent. With our projection for actual GDP growth only a bit below the rate of potential in the second half of this year, we expect the gap between actual and potential output to be little changed over the forecast period.

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

Measure	1974-95	1996-2000	2001-04	2005	2006	2007	2008
Structural labor productivity	**1.5**	**2.5**	**3.0**	**2.3**	**2.3**	**2.2**	**2.1**
Previous	1.5	2.5	3.0	2.3	2.3	2.2	2.1
Contributions[1]							
Capital deepening	.7	1.4	.7	.6	.7	.6	.6
Previous	.7	1.4	.7	.6	.7	.6	.6
Multifactor productivity	.5	.7	2.1	1.5	1.4	1.4	1.4
Previous	.5	.7	2.1	1.5	1.4	1.4	1.4
Labor composition	.3	.3	.3	.3	.2	.2	.2
MEMO							
Potential GDP	3.0	3.3	2.9	2.5	2.6	2.6	2.5
Previous	3.0	3.3	2.9	2.5	2.6	2.6	2.5

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

1. Percentage points.

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

Measure	2005	2006	2007	2008
Output per hour, nonfarm business	2.1	1.6	2.1	2.5
Previous	2.1	1.5	1.9	2.6
Nonfarm private payroll employment	2.0	1.8	1.0	.6
Previous	2.0	1.8	.8	.3
Household survey employment	1.9	2.1	.4	.7
Previous	1.9	2.1	.6	.5
Labor force participation rate[1]	66.1	66.3	65.9	65.8
Previous	66.1	66.3	66.1	65.8
Civilian unemployment rate[1]	5.0	4.5	4.7	4.8
Previous	5.0	4.5	4.8	5.0
MEMO				
GDP gap[2]	.2	.7	.3	.3
Previous	.2	.7	.1	.0

1. Percent, average for the fourth quarter.
2. Actual less potential GDP in the fourth quarter of the year indicated as a percent of potential GDP. A negative number thus indicates that the economy is operating below potential.

Productivity and the labor market. We estimate that labor productivity rose at an annual rate of 1¾ percent in the first half of this year, up from the tepid pace seen in the latter part of 2006. Still, this pace is below our estimate of structural productivity growth, and we expect to see productivity growth pick up to an annual rate of 2½ percent in the second half of 2007 and in 2008 as employers bring payrolls into better alignment with production. Accordingly, private employment gains are projected to average only about 60,000 per month over the rest of the forecast period, about half the pace of hiring seen in the first half of this year. The subpar pace of job gains causes the unemployment rate to edge up to about 4¾ percent by the end of next year; this path averages about 0.1 percentage point below that in our May projection and leaves the unemployment rate a couple of tenths below our estimate of the NAIRU by the end of the forecast period.

Prices and labor costs. As discussed above, we believe that much of the recent low readings on core inflation will prove transitory, but we have also taken some signal that inflation is likely to run a bit lower than we had thought; at the same time, energy and import price increases are slightly higher in this projection relative to the May Greenbook, and labor and product markets are slightly tighter. In all, we have revised down our projection for core PCE price inflation 0.3 percentage point this year and

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

Measure	2005	2006	2007	2008
PCE chain-weighted price index	3.1	1.9	2.9	2.0
Previous	3.1	1.9	2.9	2.1
Food and beverages	2.1	2.3	3.6	2.2
Previous	2.1	2.3	3.4	2.2
Energy	21.2	-3.7	13.5	1.2
Previous	21.2	-3.7	11.0	.8
Excluding food and energy	2.1	2.2	2.0	2.0
Previous	2.1	2.2	2.3	2.1
Consumer price index	3.7	1.9	3.4	2.2
Previous	3.7	1.9	3.3	2.2
Excluding food and energy	2.1	2.7	2.2	2.2
Previous	2.1	2.7	2.4	2.3
GDP chain-weighted price index	3.1	2.5	2.5	2.2
Previous	3.1	2.5	2.6	2.3
ECI for compensation of private industry workers[1]	2.9	3.2	3.4	4.0
Previous	2.9	3.2	3.4	4.0
Compensation per hour, nonfarm business sector	3.7	5.6	4.0	4.9
Previous	3.7	4.9	3.9	4.9
Prices of core nonfuel imports	2.2	2.7	3.5	1.6
Previous	2.2	2.7	3.2	1.3

1. December to December.

0.1 percentage point in 2008. In terms of the contour, we expect core PCE inflation to step back up from the recent unusually low readings to an annual rate of 2.2 percent in the second half of this year before moving down to 2 percent next year. Next year’s decline in inflation (relative to the second half of this year) stems from the same factors discussed in previous projections—namely, a waning of the impetus to core inflation from increases in energy and import prices and the continuation of well-anchored inflation expectations. Factoring in this year’s sharp rise in energy prices, together with increases in food prices that are greater than core inflation, our projection for headline PCE inflation is 2.9 percent this year; for 2008, we project that headline inflation will equal core inflation.

The aforementioned upward revisions to labor income imply that nonfarm compensation per hour—a notoriously erratic series—increased more rapidly than initially estimated in the fourth quarter of 2006 and the first quarter of 2007. In the second quarter, incoming data on average hourly earnings point to only a moderate increase in hourly compensation, in line with our previous projection. Looking forward, we continue to expect past productivity gains and price increases to lead to a further pickup in compensation increases, and thus we project nonfarm compensation per hour to accelerate from a gain of 4 percent this year to 5 percent in 2008. Our projection for increases in the ECI is unchanged at 3½ percent this year and 4 percent next year.[2]

Financial Flows and Conditions

The pace of domestic nonfinancial debt growth slowed from 8 percent in 2006 to 7¼ percent in the first quarter of 2007; it is expected to decline further to 6¼ percent over the remainder of 2007 and 5¾ percent in 2008. The projected deceleration in domestic nonfinancial debt holds for all sectors except the federal government.

Household debt growth has already slowed considerably and is expected to taper down a bit further over the forecast period. The 5 percent increase in debt anticipated for 2008 would be the slowest pace of household borrowing since 1991. The slowdown to date and the expected further moderation mainly reflect actual and projected declines in the growth of mortgage debt, driven by the deceleration of house prices and rising mortgage interest rates. Consumer credit is also projected to expand more slowly, in line with more-modest growth in spending on consumer durable goods. Weak growth in home prices and higher mortgage interest rates will likely weigh on the credit quality of some households, particularly subprime borrowers with variable-rate mortgages, but the overall credit quality of the household sector is expected to remain solid.

Nonfinancial business debt expanded 9½ percent in 2006 and has continued to rise briskly so far this year. We expect the pace of debt growth to slow somewhat in coming quarters and to be 7 percent in 2008. The projected slowdown reflects an anticipated reduction both in cash-financed merger and acquisition activity and in share repurchases from recent extraordinarily high levels. We view corporate defaults as likely to move up through 2008 from their recent near-zero levels, as profits flatten out and leverage rises toward historical norms.

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[2] Recently enacted legislation calls for the minimum wage to increase from $5.15 an hour currently to $5.85 on July 24, to $6.55 in July 2008, and to $7.25 in July 2009. Because the increase will affect the wages of relatively few workers, the effect on hourly compensation is expected to be less than 0.1 percentage point per year.

Federal government debt, which increased 4 percent in 2006, is expected to rise only a shade more rapidly this year and next, as the federal deficit is projected to remain relatively narrow. Growth of state and local government debt is projected to slow from last year's pace of 8¼ percent to 7¾ percent this year and 6½ percent in 2008, reflecting reduced opportunities for advance refunding.

After having expanded 5 percent in 2006 and 8 percent in the first quarter of 2007, M2 is expected to increase at a pace of 4½ percent for the remainder of 2007 and 5 percent in 2008. The pace for 2008 is a bit faster than the growth rate projected for nominal GDP and is consistent with a gradual decline in opportunity costs over the forecast period.

Alternative Simulations

In this section, we evaluate alternatives to the staff forecast using simulations of the FRB/US model. The first three scenarios address downside risks to the staff's forecast for the underlying strength of aggregate demand—specifically, unexpectedly adverse developments in the housing market, in capital spending, and in financial markets. In contrast, the fourth scenario allows for the possibility that we have underestimated the underlying strength of aggregate demand. Moving away from the demand side, the next two scenarios consider opposing risks to the baseline outlook for aggregate supply and inflation; the first addresses the possibility that the NAIRU is lower than the staff's estimate, and the second explores the implications of rising inflation expectations. In all these scenarios, we assume that monetary policy responds to the change in the outlook as suggested by an estimated version of the Taylor rule.

Greater housing correction. The baseline forecast for the housing market could be too optimistic in several ways: The pace of home sales may fall further; builders may cut back on new construction more than we expect in an attempt to reduce the backlog of unsold homes more quickly; and home prices may decline appreciably rather than merely level out as in the baseline. In this scenario, production adjusts more quickly and to a lower level of sales. Thus, the level of real residential investment falls 10 percent below baseline by the middle of 2008. In addition, home prices fall 10 percent both this year and next, lowering household net worth $4½ trillion relative to baseline and eliminating most of the current overvaluation in the housing market that is suggested by some models that we follow. The reductions in employment and income implied by the falloff in construction activity, combined with the loss in wealth, directly damp consumer spending and indirectly depress business investment. As a result, real GDP rises only 2 percent this year and next, causing the unemployment rate to climb above 5 percent by late 2008;

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

Measure and scenario	2006	2007		2008	
		H1	H2	H1	H2
Real GDP					
Greenbook baseline	2.2	2.0	2.3	2.5	2.5
Greater housing correction	. . .	2.0	1.9	1.9	2.0
Flat business investment	. . .	2.0	1.9	1.8	1.8
Tighter financial markets	. . .	2.0	2.0	1.3	1.5
Stronger aggregate demand	. . .	2.0	2.8	3.7	3.9
Lower NAIRU	. . .	2.0	2.4	2.7	2.7
Drifting inflation expectations	. . .	2.0	2.3	2.5	2.6
Unemployment rate[1]					
Greenbook baseline	4.5	4.5	4.7	4.8	4.8
Greater housing correction	. . .	4.5	4.8	5.0	5.1
Flat business investment	. . .	4.5	4.7	4.9	5.0
Tighter financial markets	. . .	4.5	4.7	5.0	5.2
Stronger aggregate demand	. . .	4.5	4.6	4.6	4.3
Lower NAIRU	. . .	4.5	4.7	4.8	4.7
Drifting inflation expectations	. . .	4.5	4.7	4.8	4.8
Core PCE inflation					
Greenbook baseline	2.0	1.9	2.2	2.1	2.0
Greater housing correction	. . .	1.9	2.2	2.1	2.0
Flat business investment	. . .	1.9	2.2	2.2	2.1
Tighter financial markets	. . .	1.9	2.0	2.0	1.9
Stronger aggregate demand	. . .	1.9	2.2	2.1	2.0
Lower NAIRU	. . .	1.9	2.0	1.9	1.7
Drifting inflation expectations	. . .	1.9	2.2	2.4	2.4
Federal funds rate[1]					
Greenbook baseline	5.2	5.3	5.3	5.3	5.3
Greater housing correction	. . .	5.3	5.1	4.8	4.5
Flat business investment	. . .	5.3	5.2	4.9	4.7
Tighter financial markets	. . .	5.3	5.2	4.5	3.9
Stronger aggregate demand	. . .	5.3	5.5	6.0	6.7
Lower NAIRU	. . .	5.3	5.3	5.1	4.9
Drifting inflation expectations	. . .	5.3	5.3	5.4	5.6

1. Percent, average for the final quarter of the period.
. . . Not applicable.

the unemployment rate would rise further in 2009. In response to weaker real activity, the federal funds rate falls to 4½ percent by late next year. Inflation is unchanged from baseline because the additional amount of slack is small over this period and because the easing in monetary policy leads to a lower dollar and somewhat higher import prices.

Flat business investment. The recent improvement in business spending indicators could be misleading us about the underlying strength of capital spending. In particular, firms may be more reluctant to invest than we assume, given the continued housing slump and a marked step-down in the projected pace of consumer spending. In this scenario, real outlays for both E&S and nonresidential investment are flat through the end of next year at their levels in the second quarter of this year; in addition, firms are more cautious about expanding their payrolls. With no growth in business spending, real GDP expands at an annual rate of a little less than 2 percent over the remainder of this year and in 2008. The accompanying slower pace of job creation causes the unemployment rate to move up a bit faster than in the baseline. A reduced pace of capital deepening in this scenario restrains the growth of trend labor productivity and so boosts structural unit labor costs; as a result, core inflation is a touch above baseline despite the additional slack in labor and product markets. Using our estimated Taylor rule, the implications of weaker real activity in this scenario outweigh those of the higher inflation, and the federal funds rate falls to 4¾ percent by the end of next year.

Tighter financial conditions. Despite the recent back-up in bond yields, term premiums remain unusually low. In this scenario, term premiums on Treasury securities and other bonds climb an additional 100 basis points relative to baseline over the second half of this year and into early 2008, bringing the slope of the yield curve closer to its historical average by the turn of the year. In addition, the weaker economic climate implied by these tighter financial conditions causes an increase in risk spreads on private securities and corporate equity over Treasury yields. These financial market developments—which also include a 15 percent decline in stock prices relative to baseline and a somewhat higher path for the dollar—markedly restrain spending by households and businesses. All told, real GDP expands only 1½ percent next year, causing the unemployment rate to rise to 5¼ percent by late 2008. Monetary policy responds to the weaker real activity by taking the federal funds rate below 4 percent by the end of next year. This easing, in turn, partially offsets the rise in term and risk premiums, so that on net the yield on ten-year Treasury notes is up only 60 basis points relative to baseline over the second half of 2008. Inflation edges down in response to both greater economic slack and the restraint on import prices associated with the higher path of the dollar.

Stronger aggregate demand. Contrary to the implication of the previous three scenarios, we may have overestimated the extent to which real activity will be restrained by slower consumer spending and by moderate growth in business investment. In this scenario, the personal saving rate remains close to negative 1 percent (roughly its average rate over the past year) instead of moving up to zero as in the baseline. In addition, business fixed investment as a share of nominal GDP continues the upward climb seen since the end of the last recession instead of leveling out as in the baseline. As a result, real GDP increases almost 4 percent in 2008, and the unemployment rate edges down to 4¼ percent by late next year. Inflation is nonetheless little changed from the baseline, in part because tighter labor and product markets have only modest price effects in the short run provided that long-run inflation expectations remain well anchored. The response of monetary policy in the scenario helps to ensure that this is the case, as the federal funds rate moves up to 6¾ percent by late next year. Beyond 2008, inflation would move up more noticeably in this scenario.

Lower NAIRU. Inflation over the past two years has run somewhat below what many of our forecasting models would have predicted. Although our judgmental projection calls for inflation to remain below these model forecasts, we may have underestimated the extent to which structural changes may be holding down inflation. For example, the NAIRU may be lower than we estimate. In this scenario, we assume that over the past few years the NAIRU has declined to 4¼ percent rather than holding steady at 5 percent as in the baseline. The additional slack in resource utilization allows core PCE inflation to fall to 1¾ percent by the end of next year. In response to both more-favorable inflation developments and the gradual recognition by policymakers that the NAIRU is lower, the federal funds rate moves below 5 percent. Lower interest rates, in turn, provide a mild stimulus to real activity, causing real GDP to expand 2¾ percent in 2008.

Drifting inflation expectations. An extended run of elevated readings on headline prices risks causing inflation expectations to drift up. In this scenario, long-run inflation expectations rise ½ percentage point relative to baseline by the end of this year on the misperception that the Fed’s inflation goal has increased by this amount. Over time, this upward drift leads to an increase in actual inflation, and in 2008 core PCE inflation averages nearly 2½ percent. In response, monetary policy—which under the estimated policy rule responds gradually to readings on actual inflation and not to indicators of future inflation—starts to tighten only by the middle of next year. However, nominal bond yields show a more rapid and larger response to the change in inflation expectations and its implications for the stance of monetary policy over the longer run. On net, these financial developments imply little change to real activity relative to baseline.

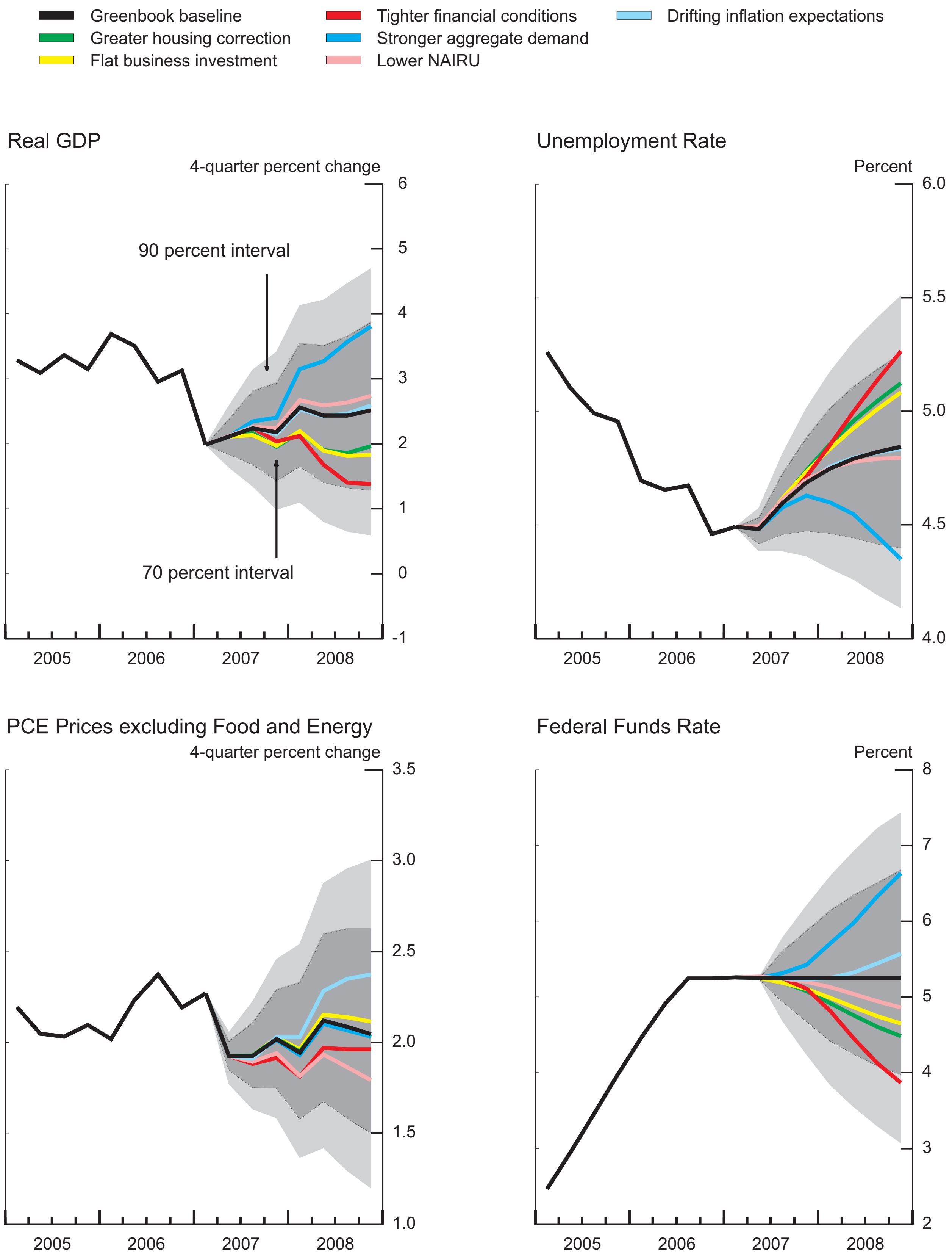
Selected Greenbook Projections and 70 Percent Confidence Intervals Derived from Historical Forecast Errors and FRB/US Simulations

Measure	2007	2008
Real GDP		
(percent change, Q4 to Q4)		
Projection	2.2	2.5
Confidence interval		
Greenbook forecast errors	1.0–3.3	1.0–4.1
FRB/US stochastic simulations	1.4–2.9	1.3–3.9
Civilian unemployment rate		
(percent, Q4)		
Projection	4.7	4.8
Confidence interval		
Greenbook forecast errors	4.4–5.0	4.1–5.6
FRB/US stochastic simulations	4.5–4.9	4.4–5.3
PCE prices		
excluding food and energy		
(percent change, Q4 to Q4)		
Projection	2.0	2.0
Confidence interval		
Greenbook forecast errors	1.6–2.5	1.2–2.8
FRB/US stochastic simulations	1.8–2.3	1.5–2.6
Federal funds rate		
(percent, Q4)		
Projection	5.3	5.3
Confidence interval		
FRB/US stochastic simulations	4.7–5.9	4.0–6.7

Note. Shocks underlying FRB/US stochastic simulations are randomly drawn from the 1986-2005 set of model equation residuals. Intervals derived fromGreenbook forecast errors are based on the 1986-2005 set of Greenbook historical errors.

Forecast Confidence Intervals and Alternative Scenarios under the Assumption that Monetary Policy Follows an Estimated Taylor Rule

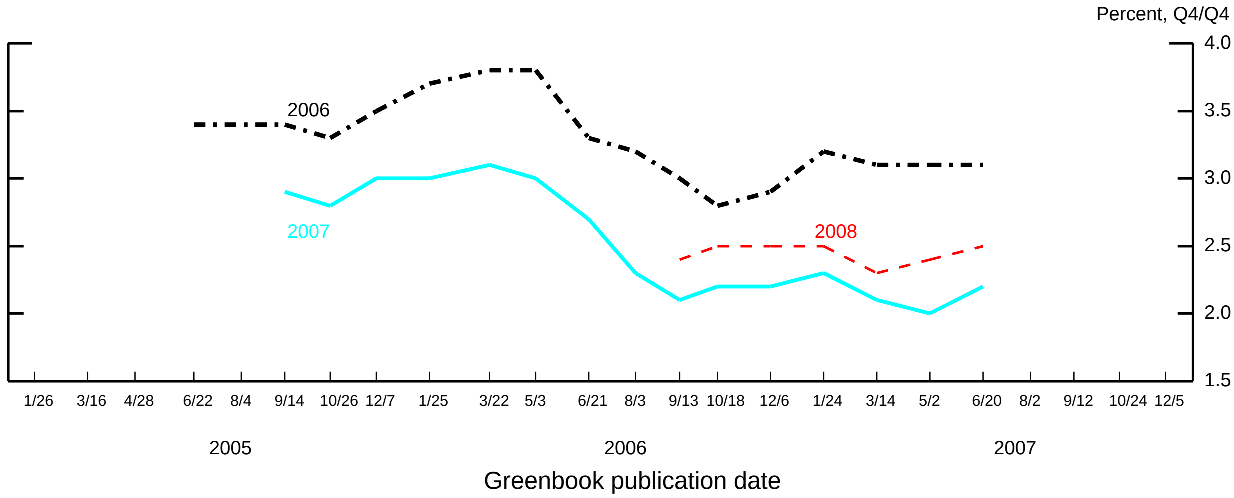
Confidence Intervals based on FRB/US Stochastic Simulations



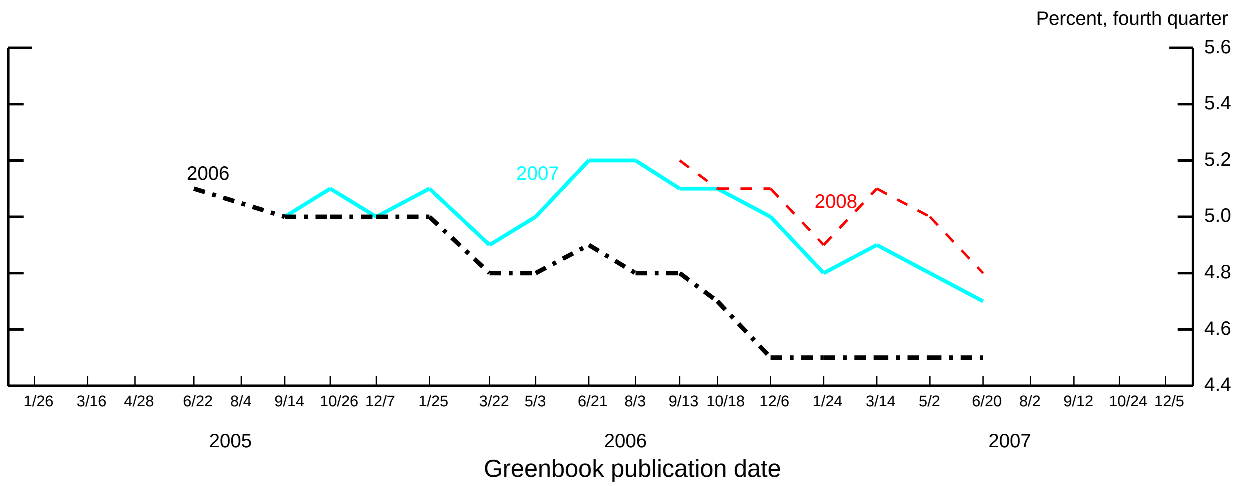
Class II FOMC - Restricted (FR)

Evolution of the Staff Forecast

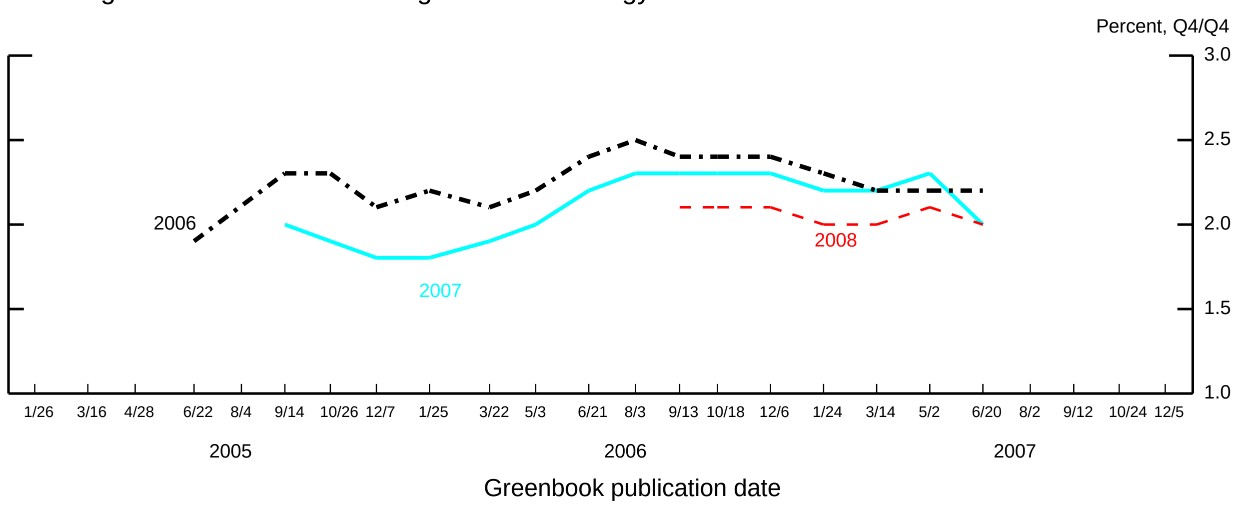
Change in Real GDP



Unemployment Rate



Change in PCE Prices excluding Food and Energy



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

Interval	Nominal GDP		Real GDP		PCE price index		Core PCE price index		Unemployment rate[1]	
	05/02/07	06/20/07	05/02/07	06/20/07	05/02/07	06/20/07	05/02/07	06/20/07	05/02/07	06/20/07
Quarterly										
2006:Q1	9.0	9.0	5.6	5.6	2.0	2.0	2.1	2.1	4.7	4.7
Q2	5.9	5.9	2.6	2.6	4.0	4.0	2.7	2.7	4.7	4.7
Q3	3.8	3.8	2.0	2.0	2.4	2.4	2.2	2.2	4.7	4.7
Q4	4.1	4.1	2.5	2.5	-1.0	-1.0	1.8	1.8	4.5	4.5
2007:Q1	5.2	5.1	1.3	1.0	3.3	3.5	2.2	2.4	4.5	4.5
Q2	5.5	6.0	2.6	3.0	4.2	4.4	2.2	1.4	4.6	4.5
Q3	3.7	3.8	2.0	2.5	2.0	1.8	2.3	2.2	4.7	4.6
Q4	4.2	4.1	2.1	2.2	2.2	1.9	2.3	2.2	4.8	4.7
2008:Q1	4.7	4.8	2.4	2.5	2.1	2.0	2.2	2.1	4.8	4.7
Q2	4.8	4.9	2.4	2.5	2.1	2.1	2.2	2.1	4.9	4.8
Q3	4.7	4.7	2.4	2.5	2.0	2.0	2.1	2.0	4.9	4.8
Q4	4.5	4.6	2.4	2.5	2.0	2.0	2.1	2.0	5.0	4.8
Two-quarter[2]										
2006:Q2	7.5	7.5	4.1	4.1	3.0	3.0	2.4	2.4	-.3	-.3
Q4	4.0	4.0	2.2	2.2	.7	.7	2.0	2.0	-.2	-.2
2007:Q2	5.3	5.6	1.9	2.0	3.7	3.9	2.2	1.9	.1	.0
Q4	4.0	4.0	2.0	2.3	2.1	1.9	2.3	2.2	.2	.2
2008:Q2	4.8	4.8	2.4	2.5	2.1	2.0	2.2	2.1	.1	.1
Q4	4.6	4.7	2.4	2.5	2.0	2.0	2.1	2.0	.1	.0
Four-quarter[3]										
2005:Q4	6.4	6.4	3.1	3.1	3.1	3.1	2.1	2.1	-.4	-.4
2006:Q4	5.7	5.7	3.1	3.1	1.9	1.9	2.2	2.2	-.5	-.5
2007:Q4	4.6	4.8	2.0	2.2	2.9	2.9	2.3	2.0	.3	.2
2008:Q4	4.7	4.8	2.4	2.5	2.1	2.0	2.1	2.0	.2	.2
Annual										
2005	6.3	6.3	3.2	3.2	2.9	2.9	2.1	2.1	5.1	5.1
2006	6.3	6.3	3.3	3.3	2.7	2.7	2.2	2.2	4.6	4.6
2007	4.7	4.8	2.0	2.1	2.4	2.4	2.2	2.0	4.6	4.6
2008	4.5	4.6	2.3	2.5	2.2	2.1	2.2	2.0	4.9	4.8

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	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2008 Q1	2008 Q2	2008 Q3	2008 Q4	2006[1]	2007[1]	2008[1]
Real GDP	5.6	2.6	2.0	2.5	1.0	3.0	2.5	2.2	2.5	2.5	2.5	2.5	3.1	2.2	2.5
Previous	5.6	2.6	2.0	2.5	1.3	2.6	2.0	2.1	2.4	2.4	2.4	2.4	3.1	2.0	2.4
Final sales	5.6	2.1	1.9	3.7	1.9	2.7	2.2	1.6	2.0	3.4	2.8	2.3	3.3	2.1	2.6
Previous	5.6	2.1	1.9	3.7	1.6	2.4	1.8	1.9	2.0	2.9	2.6	2.3	3.3	1.9	2.4
Priv. dom. final purch.	5.5	1.8	2.1	1.6	2.8	.9	1.3	1.5	2.2	2.6	2.8	2.8	2.7	1.6	2.6
Previous	5.5	1.8	2.1	1.6	2.5	.7	.9	1.8	2.2	2.4	2.6	2.6	2.7	1.5	2.5
Personal cons. expend.	4.8	2.6	2.8	4.2	4.3	1.6	2.3	2.3	2.5	2.5	2.6	2.5	3.6	2.6	2.5
Previous	4.8	2.6	2.8	4.2	3.8	1.9	2.1	2.2	2.4	2.4	2.6	2.5	3.6	2.5	2.5
Durables	19.8	-.1	6.4	4.4	8.5	.7	2.5	3.8	3.2	3.3	3.5	3.0	7.4	3.8	3.3
Nondurables	5.9	1.4	1.5	5.9	3.3	-.1	2.0	2.2	2.5	2.5	2.5	2.5	3.7	1.8	2.5
Services	1.6	3.7	2.8	3.4	4.0	2.7	2.4	2.1	2.4	2.4	2.4	2.4	2.9	2.8	2.4
Residential investment	-.3	-11.1	-18.7	-19.8	-15.8	-12.2	-18.3	-15.0	-9.5	-1.3	2.0	4.1	-12.8	-15.4	-1.3
Previous	-.3	-11.1	-18.7	-19.8	-14.1	-18.5	-19.2	-7.7	-6.0	-1.2	1.1	2.1	-12.8	-15.0	-1.1
Business fixed invest.	13.7	4.4	10.0	-3.1	3.3	2.8	4.4	3.6	5.2	4.8	4.5	3.9	6.1	3.6	4.6
Previous	13.7	4.4	10.0	-3.1	2.8	2.9	3.5	3.5	4.4	4.0	3.5	3.4	6.1	3.2	3.8
Equipment & software	15.6	-1.4	7.7	-4.8	2.8	-.2	5.3	4.0	5.8	5.7	5.8	5.6	4.0	2.9	5.7
Previous	15.6	-1.4	7.7	-4.8	1.7	1.4	4.1	4.1	4.9	4.4	4.6	4.8	4.0	2.8	4.7
Nonres. structures	8.7	20.3	15.7	.8	4.7	10.0	2.6	2.8	3.8	2.9	1.7	.4	11.2	5.0	2.2
Previous	8.7	20.3	15.7	.8	5.3	6.3	2.1	2.3	3.2	2.9	1.3	.4	11.2	4.0	2.0
Net exports[2]	-637	-624	-629	-583	-604	-574	-564	-570	-579	-557	-555	-564	-618	-578	-564
Previous[2]	-637	-624	-629	-583	-606	-582	-574	-575	-584	-572	-570	-576	-618	-584	-576
Exports	14.0	6.2	6.8	10.6	1.2	5.4	6.2	5.9	5.8	5.7	5.6	5.6	9.4	4.6	5.7
Imports	9.1	1.4	5.6	-2.6	5.4	-2.4	2.1	5.5	5.9	-.2	3.4	6.0	3.3	2.6	3.8
Govt. cons. & invest.	4.9	.8	1.7	3.4	1.0	4.7	3.4	2.9	2.2	2.1	1.7	1.7	2.7	3.0	1.9
Previous	4.9	.8	1.7	3.4	1.4	4.9	3.6	2.2	2.2	2.1	1.7	1.6	2.7	3.0	1.9
Federal	8.8	-4.5	1.3	4.6	-3.9	7.8	5.2	3.7	1.8	1.6	1.6	1.4	2.4	3.1	1.6
Defense	8.9	-2.0	-1.2	12.3	-7.3	11.4	7.7	5.5	2.7	2.4	2.3	2.1	4.3	4.1	2.4
Nondefense	8.5	-9.3	6.5	-9.6	3.6	.9	.0	.0	.0	.0	.0	.0	-1.4	1.1	.0
State & local	2.7	4.0	1.9	2.7	3.9	3.0	2.4	2.4	2.4	2.4	1.8	1.8	2.8	2.9	2.1
Change in bus. inventories[2]	41	54	55	22	-2	6	16	32	47	23	15	21	43	13	27
Previous[2]	41	54	55	22	12	16	24	28	40	26	19	19	43	20	26
Nonfarm[2]	37	52	53	20	-5	5	15	32	48	22	14	20	41	12	26
Farm[2]	4	2	2	2	3	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	2000[1]	2001[1]	2002[1]	2003[1]	2004[1]	2005[1]	2006[1]	2007[1]	2008[1]
Real GDP	2.2	.2	1.9	3.7	3.4	3.1	3.1	2.2	2.5
Previous	2.2	.2	1.9	3.7	3.4	3.1	3.1	2.0	2.4
Final sales	2.9	1.5	.8	3.7	3.1	3.2	3.3	2.1	2.6
Previous	2.9	1.5	.8	3.7	3.1	3.2	3.3	1.9	2.4
Priv. dom. final purch.	4.3	1.0	1.1	4.1	4.4	3.6	2.7	1.6	2.6
Previous	4.3	1.0	1.1	4.1	4.4	3.6	2.7	1.5	2.5
Personal cons. expend.	4.1	2.8	1.9	3.4	4.0	2.9	3.6	2.6	2.5
Previous	4.1	2.8	1.9	3.4	4.0	2.9	3.6	2.5	2.5
Durables	4.7	10.8	1.2	8.3	5.6	2.5	7.4	3.8	3.3
Nondurables	3.0	1.9	2.1	3.9	3.8	4.4	3.7	1.8	2.5
Services	4.5	1.6	1.9	2.2	3.7	2.3	2.9	2.8	2.4
Residential investment	-1.9	1.4	7.0	11.7	6.1	9.0	-12.8	-15.4	-1.3
Previous	-1.9	1.4	7.0	11.7	6.1	9.0	-12.8	-15.0	-1.1
Business fixed invest.	7.8	-9.6	-6.5	4.9	6.9	5.6	6.1	3.6	4.6
Previous	7.8	-9.6	-6.5	4.9	6.9	5.6	6.1	3.2	3.8
Equipment & software	7.5	-9.0	-3.4	6.6	8.3	7.0	4.0	2.9	5.7
Previous	7.5	-9.0	-3.4	6.6	8.3	7.0	4.0	2.8	4.7
Nonres. structures	8.8	-11.1	-14.9	.2	2.7	1.8	11.2	5.0	2.2
Previous	8.8	-11.1	-14.9	.2	2.7	1.8	11.2	4.0	2.0
Net exports[2]	-379	-399	-471	-519	-591	-619	-618	-578	-564
Previous[2]	-379	-399	-471	-519	-591	-619	-618	-584	-576
Exports	6.5	-11.9	3.8	5.8	7.0	6.7	9.4	4.6	5.7
Imports	11.2	-7.6	9.7	4.8	10.6	5.2	3.3	2.6	3.8
Govt. cons. & invest.	.4	5.0	4.0	1.7	1.1	1.2	2.7	3.0	1.9
Previous	.4	5.0	4.0	1.7	1.1	1.2	2.7	3.0	1.9
Federal	-2.2	6.4	7.8	5.5	2.3	2.1	2.4	3.1	1.6
Defense	-3.5	6.5	8.4	7.5	2.5	1.9	4.3	4.1	2.4
Nondefense	.3	6.3	6.8	1.9	1.8	2.4	-1.4	1.1	.0
State & local	1.7	4.2	2.1	-.4	.4	.8	2.8	2.9	2.1
Change in bus. inventories[2]	56	-32	12	14	53	20	43	13	27
Previous[2]	56	-32	12	14	53	20	43	20	26
Nonfarm[2]	58	-32	15	14	47	20	41	12	26
Farm[2]	-1	0	-2	0	6	0	3	1	1

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

Class II FOMC
Restricted (FR)

June 20, 2007

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

Item	2006				2007				2008				2006[1]	2007[1]	2008[1]
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Real GDP	5.6	2.6	2.0	2.5	1.0	3.0	2.5	2.2	2.5	2.5	2.5	2.5	3.1	2.2	2.5
Previous	5.6	2.6	2.0	2.5	1.3	2.6	2.0	2.1	2.4	2.4	2.4	2.4	3.1	2.0	2.4
Final sales	5.6	2.1	1.9	3.6	1.9	2.7	2.2	1.6	2.0	3.4	2.8	2.3	3.3	2.1	2.6
Previous	5.6	2.1	1.9	3.6	1.6	2.4	1.8	1.9	2.0	2.8	2.6	2.3	3.3	1.9	2.4
Priv. dom. final purch.	4.7	1.5	1.8	1.4	2.4	.8	1.2	1.3	1.9	2.2	2.4	2.4	2.3	1.4	2.2
Previous	4.7	1.5	1.8	1.4	2.2	.6	.8	1.5	1.9	2.1	2.2	2.2	2.3	1.3	2.1
Personal cons. expend.	3.4	1.8	2.0	2.9	3.0	1.2	1.6	1.6	1.8	1.8	1.8	1.8	2.5	1.9	1.8
Previous	3.4	1.8	2.0	2.9	2.7	1.3	1.4	1.5	1.7	1.7	1.8	1.8	2.5	1.7	1.7
Durables	1.5	.0	.5	.4	.7	.1	.2	.3	.3	.3	.3	.2	.6	.3	.3
Nondurables	1.2	.3	.3	1.2	.7	.0	.4	.4	.5	.5	.5	.5	.7	.4	.5
Services	.7	1.5	1.1	1.4	1.6	1.1	1.0	.9	1.0	1.0	1.0	1.0	1.2	1.2	1.0
Residential investment	.0	-.7	-1.2	-1.2	-.9	-.6	-1.0	-.7	-.4	-.1	.1	.2	-.8	-.8	-.1
Previous	.0	-.7	-1.2	-1.2	-.8	-1.0	-1.0	-.4	-.3	-.1	.0	.1	-.8	-.8	.0
Business fixed invest.	1.4	.5	1.0	-.3	.3	.3	.5	.4	.5	.5	.5	.4	.6	.4	.5
Previous	1.4	.5	1.0	-.3	.3	.3	.4	.4	.5	.4	.4	.4	.6	.3	.4
Equipment & software	1.1	-.1	.6	-.4	.2	.0	.4	.3	.4	.4	.4	.4	.3	.2	.4
Previous	1.1	-.1	.6	-.4	.1	.1	.3	.3	.4	.3	.3	.3	.3	.2	.3
Nonres. structures	.3	.6	.5	.0	.1	.3	.1	.1	.1	.1	.1	.0	.3	.2	.1
Previous	.3	.6	.5	.0	.2	.2	.1	.1	.1	.1	.0	.0	.3	.1	.1
Net exports	.0	.4	-.2	1.6	-.7	1.0	.3	-.2	-.3	.7	.1	-.4	.5	.1	.0
Previous	.0	.4	-.2	1.6	-.8	.8	.3	-.1	-.3	.4	.0	-.2	.5	.1	.0
Exports	1.4	.7	.7	1.1	.1	.6	.7	.7	.7	.7	.7	.7	1.0	.5	.7
Imports	-1.5	-.2	-.9	.5	-.9	.4	-.3	-.9	-1.0	.0	-.6	-1.0	-.5	-.4	-.6
Govt. cons. & invest.	.9	.2	.3	.6	.2	.9	.7	.6	.4	.4	.3	.3	.5	.6	.4
Previous	.9	.2	.3	.6	.3	.9	.7	.4	.4	.4	.3	.3	.5	.6	.4
Federal	.6	-.3	.1	.3	-.3	.5	.4	.3	.1	.1	.1	.1	.2	.2	.1
Defense	.4	-.1	-.1	.6	-.4	.5	.4	.3	.1	.1	.1	.1	.2	.2	.1
Nondefense	.2	-.2	.2	-.2	.1	.0	.0	.0	.0	.0	.0	.0	.0	.0	.0
State & local	.3	.5	.2	.3	.5	.4	.3	.3	.3	.3	.2	.2	.3	.4	.3
Change in bus. inventories	.0	.4	.1	-1.2	-.9	.3	.3	.6	.5	-.8	-.3	.2	-.2	.1	-.1
Previous	.0	.4	.1	-1.2	-.4	.2	.3	.1	.4	-.5	-.2	.0	-.2	.1	-.1
Nonfarm	.0	.5	.1	-1.2	-.9	.3	.3	.6	.5	-.8	-.3	.2	-.2	.1	-.1
Farm	.0	-.1	.0	.0	.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	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2008 Q1	2008 Q2	2008 Q3	2008 Q4	2006[1]	2007[1]	2008[1]
GDP chain-wt. price index	3.3	3.3	1.9	1.7	4.1	2.9	1.3	1.9	2.2	2.3	2.2	2.1	2.5	2.5	2.2
Previous	3.3	3.3	1.9	1.7	3.9	2.8	1.7	2.1	2.3	2.3	2.3	2.1	2.5	2.6	2.3
PCE chain-wt. price index	2.0	4.0	2.4	-1.0	3.5	4.4	1.8	1.9	2.0	2.1	2.0	2.0	1.9	2.9	2.0
Previous	2.0	4.0	2.4	-1.0	3.3	4.2	2.0	2.2	2.1	2.1	2.0	2.0	1.9	2.9	2.1
Energy	.1	29.7	3.7	-36.0	16.1	52.9	-3.9	-2.8	1.0	1.5	1.3	.9	-3.7	13.5	1.2
Previous	.1	29.7	3.7	-36.0	16.1	35.7	-3.7	.2	1.0	1.0	.7	.4	-3.7	11.0	.8
Food	2.7	1.7	2.9	1.9	4.8	4.5	2.7	2.4	2.3	2.3	2.2	2.2	2.3	3.6	2.2
Previous	2.7	1.7	2.9	1.9	4.8	3.8	2.6	2.4	2.3	2.2	2.1	2.1	2.3	3.4	2.2
Ex. food & energy	2.1	2.7	2.2	1.8	2.4	1.4	2.2	2.2	2.1	2.1	2.0	2.0	2.2	2.0	2.0
Previous	2.1	2.7	2.2	1.8	2.2	2.2	2.3	2.3	2.2	2.2	2.1	2.1	2.2	2.3	2.1
CPI	1.8	5.1	3.0	-2.0	3.8	6.0	1.9	1.9	2.2	2.2	2.1	2.1	1.9	3.4	2.2
Previous	1.8	5.1	3.0	-2.0	3.8	5.1	1.9	2.3	2.3	2.3	2.2	2.0	1.9	3.3	2.2
Ex. food & energy	2.4	3.2	3.2	1.8	2.3	1.9	2.4	2.4	2.3	2.3	2.2	2.2	2.7	2.2	2.2
Previous	2.4	3.2	3.2	1.8	2.3	2.4	2.5	2.5	2.4	2.4	2.3	2.2	2.7	2.4	2.3
ECI, hourly compensation[2]	2.8	3.2	3.6	3.2	2.3	3.8	3.8	3.8	4.0	4.0	4.0	4.0	3.2	3.4	4.0
Previous[2]	2.8	3.2	3.6	3.2	2.3	3.8	3.8	3.8	4.0	4.0	4.0	4.0	3.2	3.4	4.0
Nonfarm business sector															
Output per hour	3.5	1.2	-.5	2.1	1.4	2.0	2.8	2.2	2.6	2.5	2.4	2.4	1.6	2.1	2.5
Previous	3.5	1.2	-.5	1.9	1.5	1.4	2.3	2.4	2.6	2.6	2.6	2.6	1.5	1.9	2.6
Compensation per hour	12.9	-1.4	.6	11.2	2.7	3.9	4.7	4.9	4.9	4.8	4.9	4.8	5.6	4.0	4.9
Previous	12.9	-1.4	.6	8.2	1.7	4.0	4.8	4.9	4.9	4.8	4.9	4.8	4.9	3.9	4.9
Unit labor costs	9.1	-2.5	1.1	8.9	1.3	1.8	1.9	2.6	2.2	2.3	2.4	2.3	4.0	1.9	2.3
Previous	9.1	-2.5	1.1	6.2	.2	2.6	2.5	2.5	2.2	2.2	2.2	2.2	3.3	1.9	2.2

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

Other Macroeconomic Indicators

Item	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2008 Q1	2008 Q2	2008 Q3	2008 Q4	2006[1]	2007[1]	2008[1]
Employment and production															
Nonfarm payroll employment[2]	.7	.5	.5	.5	.5	.4	.3	.2	.2	.2	.3	.3	2.3	1.4	1.0
Unemployment rate[3]	4.7	4.7	4.7	4.5	4.5	4.5	4.6	4.7	4.7	4.8	4.8	4.8	4.5	4.7	4.8
Previous[3]	4.7	4.7	4.7	4.5	4.5	4.6	4.7	4.8	4.8	4.9	4.9	5.0	4.5	4.8	5.0
GDP gap[4]	.9	.9	.7	.7	.3	.4	.4	.3	.3	.3	.3	.3	.7	.3	.3
Previous[4]	.9	.9	.7	.7	.4	.4	.3	.1	.1	.1	.1	.0	.7	.1	.0
Industrial production[5]	5.0	6.5	4.0	-1.5	.8	2.8	3.2	2.4	2.8	2.4	2.9	4.1	3.5	2.3	3.1
Previous[5]	5.0	6.5	4.0	-1.5	1.4	4.0	2.6	3.1	3.2	3.0	3.6	3.9	3.5	2.8	3.4
Manufacturing industr. prod.[5]	5.5	5.5	4.4	-1.7	.7	3.3	3.6	2.1	2.5	2.7	3.1	3.9	3.4	2.4	3.1
Previous[5]	5.5	5.5	4.4	-1.7	1.2	4.8	2.5	2.9	3.3	3.4	3.6	3.9	3.4	2.8	3.5
Capacity utilization rate - mfg.[3]	80.1	80.6	80.9	80.1	79.8	80.1	80.4	80.4	80.3	80.3	80.4	80.6	80.1	80.4	80.6
Previous[3]	80.1	80.6	80.9	80.1	79.9	80.3	80.4	80.4	80.5	80.6	80.7	80.9	80.1	80.4	80.9
Housing starts[6]	2.1	1.9	1.7	1.6	1.5	1.5	1.4	1.3	1.4	1.4	1.4	1.4	1.8	1.4	1.4
Light motor vehicle sales[6]	16.9	16.3	16.6	16.3	16.5	16.1	16.3	16.3	16.3	16.4	16.5	16.5	16.5	16.3	16.4
Income and saving															
Nominal GDP[5]	9.0	5.9	3.8	4.1	5.1	6.0	3.8	4.1	4.8	4.9	4.7	4.6	5.7	4.8	4.8
Real disposable pers. income[5]	4.6	-1.5	3.2	6.4	4.6	-1.1	3.3	3.3	4.6	2.8	3.5	3.3	3.2	2.5	3.5
Previous[5]	4.6	-1.5	3.2	5.3	4.5	-1.5	3.8	3.2	4.2	3.1	3.6	3.4	2.9	2.4	3.6
Personal saving rate[3]	-.3	-1.4	-1.4	-.9	-.8	-1.6	-1.4	-1.1	-.6	-.6	-.3	-.1	-.9	-1.1	-.1
Previous[3]	-.3	-1.4	-1.4	-1.2	-1.1	-1.9	-1.5	-1.2	-.8	-.6	-.4	-.2	-1.2	-1.2	-.2
Corporate profits[7]	60.8	5.9	16.4	-1.2	8.9	6.0	.4	1.5	.5	1.5	.3	.1	18.3	4.2	.6
Profit share of GNP[3]	12.0	12.0	12.4	12.2	12.3	12.3	12.2	12.2	12.1	12.0	11.9	11.7	12.2	12.2	11.7
Net federal saving[8]	-147	-163	-173	-121	-134	-179	-184	-184	-225	-216	-214	-224	-154	-170	-220
Net state & local saving[8]	13	26	-10	-18	-38	-8	-17	-21	-33	-20	-29	-30	3	-21	-28
Gross national saving rate[3]	14.4	13.5	13.3	14.2	13.3	12.9	12.9	13.0	12.8	12.9	12.9	12.9	14.2	13.0	12.9
Net national saving rate[3]	2.9	1.9	1.7	2.3	2.3	1.6	1.5	1.6	1.5	1.6	1.6	1.6	2.3	1.6	1.6

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.

Class II FOMC
Restricted (FR)

June 20, 2007

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

Item	Fiscal year				2006				2007				2008			
	2005[a]	2006[a]	2007	2008	Q1[a]	Q2[a]	Q3[a]	Q4[a]	Q1[a]	Q2	Q3	Q4	Q1	Q2	Q3	Q4
					Not seasonally adjusted											
Unified budget																
Receipts[1]	2154	2407	2567	2677	507	772	597	574	547	823	623	611	557	852	657	644
Outlays[1]	2472	2655	2737	2906	691	676	639	654	725	692	666	714	765	717	709	747
Surplus/deficit[1]	-318	-248	-170	-229	-184	96	-42	-80	-178	130	-42	-103	-208	135	-52	-103
Previous	*-318*	*-248*	*-171*	*-238*	*-184*	*96*	*-42*	*-80*	*-178*	*136*	*-49*	*-114*	*-184*	*121*	*-61*	*-127*
On-budget	-494	-435	-360	-427	-216	11	-60	-135	-212	44	-56	-171	-233	43	-66	-177
Off-budget	175	186	190	198	32	85	19	55	34	87	14	68	24	92	14	73
Means of financing																
Borrowing	297	237	191	235	156	-75	43	59	152	-91	72	90	194	-105	56	98
Cash decrease	1	-16	7	10	28	-38	-6	21	25	-24	-16	16	19	-25	0	10
Other[2]	21	28	-28	-17	-1	16	5	0	1	-15	-14	-3	-5	-5	-5	-5
Cash operating balance, end of period	36	52	45	35	8	46	52	31	6	30	45	29	10	35	35	25
NIPA federal sector					Seasonally adjusted annual rates											
Receipts	2174	2480	2655	2770	2491	2523	2557	2592	2662	2673	2695	2723	2754	2786	2817	2847
Expenditures	2509	2667	2810	2980	2638	2686	2730	2713	2796	2851	2879	2907	2979	3002	3031	3070
Consumption expenditures	758	797	836	890	804	802	809	817	825	845	859	870	889	897	904	912
Defense	509	533	565	608	538	538	539	553	553	572	584	593	607	613	619	625
Nondefense	249	264	271	282	266	265	270	264	273	273	275	277	282	284	286	287
Other spending	1751	1870	1973	2090	1834	1884	1921	1896	1971	2006	2020	2037	2090	2105	2126	2158
Current account surplus	-335	-187	-154	-210	-147	-163	-173	-121	-134	-179	-184	-184	-225	-216	-214	-224
Gross investment	107	117	122	131	118	117	118	121	118	124	127	129	130	131	133	134
Gross saving less gross investment[3]	-344	-201	-169	-228	-163	-177	-186	-135	-145	-194	-201	-202	-243	-234	-232	-241
Fiscal indicators[4]																
High-employment (HEB) surplus/deficit	-341	-230	-197	-245	-197	-215	-219	-171	-169	-221	-226	-222	-260	-251	-247	-255
Change in HEB, percent of potential GDP	-0.3	-1.0	-0.3	0.3	-0.7	0.1	0.0	-0.4	-0.0	0.4	0.0	-0.0	0.3	-0.1	-0.0	0.0
Fiscal impetus (FI), percent of GDP	0.2	0.3	0.2	0.2	0.2	-0.0	0.0	0.1	0.0	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Previous	*0.2*	*0.3*	*0.2*	*0.2*	*0.2*	*-0.0*	*0.0*	*0.1*	*0.0*	*0.1*	*0.1*	*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

Change in Debt of the Domestic Nonfinancial Sectors
(Percent)

Period[1]	Total	Households			Business	State and local governments	Federal government	Memo: Nominal GDP
		Total	Home mortgages	Consumer credit				
Year								
2001	6.3	9.3	10.1	8.6	5.9	8.8	-.2	2.7
2002	7.2	10.6	12.9	5.9	2.5	11.0	7.6	3.6
2003	8.2	11.6	14.4	5.2	2.6	8.3	10.9	5.9
2004	9.0	11.6	14.2	5.5	5.8	7.4	9.0	6.7
2005	9.4	11.5	13.4	4.2	7.6	10.2	7.0	6.4
2006	8.1	8.7	9.3	4.5	9.6	8.2	3.9	5.7
2007	6.7	5.8	6.0	4.1	8.9	7.7	4.6	4.8
2008	5.7	4.9	5.2	2.9	7.0	6.6	4.8	4.8
Quarter								
2006:1	8.9	9.3	10.6	2.2	10.0	3.3	8.0	9.0
2	7.5	9.2	9.5	6.0	8.8	6.7	1.0	5.9
3	6.9	7.9	8.6	5.4	7.0	8.2	3.6	3.8
4	8.2	7.2	7.3	4.1	11.4	13.6	2.8	4.1
2007:1	7.3	6.0	6.2	4.7	9.0	8.6	6.7	5.1
2	6.5	5.9	6.0	4.2	10.3	8.3	.1	6.0
3	6.5	5.6	5.8	3.7	8.0	6.4	6.0	3.8
4	5.9	5.2	5.4	3.4	6.9	6.9	5.1	4.1
2008:1	6.0	5.0	5.2	3.1	6.8	6.6	7.3	4.8
2	5.1	4.8	5.1	3.0	7.1	6.4	1.3	4.9
3	5.5	4.8	5.1	2.8	6.8	6.3	4.5	4.7
4	5.6	4.8	5.1	2.8	6.7	6.2	5.6	4.6

Note. Quarterly data are at seasonally adjusted annual rates.
1. Data after 2007:Q1 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

Class II FOMC
Restricted (FR)

June 20, 2007

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

Category	2005	2006	2007	2008	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2008 Q1	2008 Q2	2008 Q3	2008 Q4
Domestic nonfinancial sectors														
Net funds raised														
Total	1911.7	1542.5	1387.1	1410.0	1374.5	1584.5	1500.9	1336.9	1413.7	1296.9	1521.7	1246.0	1402.1	1470.0
Net equity issuance	-363.4	-606.1	-534.2	-332.0	-534.0	-719.2	-584.8	-560.0	-520.0	-472.0	-332.0	-332.0	-332.0	-332.0
Net debt issuance	2275.1	2148.6	1921.3	1742.0	1908.5	2303.7	2085.7	1896.9	1933.7	1768.9	1853.7	1578.0	1734.1	1802.0
Borrowing indicators														
Debt (percent of GDP) [1]	204.3	208.8	213.9	217.1	209.5	211.3	212.7	213.3	214.7	215.8	216.5	216.9	217.2	217.8
Borrowing (percent of GDP)	18.3	16.2	13.8	12.0	14.3	17.1	15.3	13.7	13.9	12.5	13.0	10.9	11.9	12.2
Households														
Net borrowing [2]	1215.2	1021.6	744.4	669.6	973.9	906.8	770.7	768.6	738.3	700.0	673.8	662.6	669.6	672.6
Home mortgages	1051.8	828.4	578.6	536.4	806.5	695.2	598.0	594.2	575.3	547.0	537.6	528.2	537.6	542.3
Consumer credit	94.4	104.8	98.6	74.3	127.3	99.6	113.3	103.3	92.9	85.0	77.7	75.4	73.0	71.3
Debt/DPI (percent) [3]	123.8	129.1	131.2	131.0	130.2	130.9	130.5	131.4	131.6	131.6	131.2	131.2	131.0	130.8
Business														
Financing gap [4]	-138.6	68.4	4.6	85.6	48.3	155.6	-11.7	-23.5	9.3	44.4	80.8	69.3	82.8	109.6
Net equity issuance	-363.4	-606.1	-534.2	-332.0	-534.0	-719.2	-584.8	-560.0	-520.0	-472.0	-332.0	-332.0	-332.0	-332.0
Credit market borrowing	581.7	791.3	799.0	687.4	606.5	995.9	815.9	954.4	761.8	663.7	665.3	704.8	690.0	689.7
State and local governments														
Net borrowing	171.4	152.3	155.4	141.7	156.6	264.5	172.3	169.7	133.7	145.7	141.7	141.7	141.7	141.7
Current surplus [5]	203.8	220.5	165.0	166.1	210.2	205.5	144.3	177.3	170.0	168.4	158.1	173.2	165.8	167.3
Federal government														
Net borrowing	306.9	183.4	222.6	243.2	171.4	136.5	326.7	4.2	299.8	259.5	373.0	69.0	232.8	298.0
Net borrowing (n.s.a.)	306.9	183.4	222.6	243.2	43.4	58.7	152.2	-91.4	71.9	89.8	193.9	-105.1	56.4	98.0
Unified deficit (n.s.a.)	321.8	209.2	193.1	229.1	41.7	80.4	178.0	-130.4	42.4	103.0	208.4	-134.6	51.9	103.5
Depository institutions														
Funds supplied	814.1	748.7	400.2	332.7	386.9	600.9	473.6	594.3	489.8	43.1	63.7	504.9	351.0	411.3

Note. Data after 2007:Q1 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 foreign economy remains on a firm upward trajectory, with growth averaging around 3¾ percent in the first half of this year and inflation under control in most economies. We expect these favorable trends to continue over the forecast period, aided by a projected moderation in the rate of increase of prices of oil and other commodities. Monetary policy abroad is also expected to play an important role in this outlook, as further tightening will likely be necessary to avoid overheating in some countries where spare capacity is narrowing, including most of the advanced foreign economies. Although to date increases in industrial country interest rates have not had major spillovers to other financial markets, the possibility remains that further monetary policy restraint in these economies could have repercussions for emerging markets. However, the extensive improvement in fundamentals in emerging markets in recent years suggests that such risks are not widespread.

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

Indicator	2006		2007	Projection		
				2007		2008
	H1	H2	Q1	Q2	H2	
Foreign output	4.3	3.4	3.7	3.8	3.6	3.5
May GB	4.4	3.5	3.7	3.6	3.5	3.5
Foreign CPI	2.3	1.8	2.8	2.7	2.5	2.3
May GB	2.4	1.8	2.8	2.7	2.4	2.3
U.S. net exports, contributions to growth, (percentage points)	.2	.7	-.7	1.0	.1	.0
May GB	.2	.7	-.8	.8	.1	.0

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

The current forecast for growth and inflation abroad is similar to that shown in the May Greenbook. Although oil prices have increased somewhat faster than previously expected, futures markets still expect prices to drift up only a little further over the forecast period. The trade-weighted value of the broad nominal dollar has shown little net change since the last FOMC meeting; we continue to expect a gradual real depreciation going forward in response to the pressure of financing the persistent current account deficit.

With foreign economic growth outpacing the U.S. economic expansion, the arithmetic contribution of net exports to U.S. GDP growth turned positive last year. Although a surge in imports along with little change in exports resulted in a negative contribution of ¾ percentage point in the first quarter, recent data suggest a positive contribution of 1 percentage point in the current quarter. For the rest of the forecast period (smoothing through some volatility resulting from seasonal adjustment of real oil imports), the contribution should be roughly neutral.

The U.S. current account deficit widened by $19 billion, to $770 billion, at an annual rate (5.7 percent of GDP) in the first quarter as net transfers abroad increased while the nominal trade deficit and net investment income were little changed. The first quarter deficit was narrower than previously estimated largely as a result of an upward revision to net investment income. However, we continue to expect that net investment income will decline over the forecast period; this is the main factor underlying our projected increase in the current account deficit to about $920 billion, 6¼ percent of GDP, by the end of next year.

Oil Prices

Oil prices have moved up more than expected at the time of the May Greenbook in response to heightened concerns about supply from Nigeria as well as the possibility of stronger global oil demand. The spot price of West Texas Intermediate (WTI) crude oil rose about $5 per barrel over this period to close at $69.11 on June 19, and the price of Brent crude rose about $7 per barrel. The WTI price remains unusually low relative to other grades owing to high crude oil inventories in the Midwest. WTI futures prices also have risen recently, although not as much as spot prices. In line with futures prices and assuming some narrowing of the WTI discount, we project that the price of imported oil will climb from about $63 per barrel in the second quarter of this year to around $68 at the start of 2008 and will then edge up to $69 by the end of the forecast period. Relative to the May Greenbook, this projection is about $3 per barrel higher in the second half of this year and $1.70 per barrel higher in 2008.

The primary factors influencing the oil market continue to be OPEC production restraint and expectations that oil demand will remain strong, both of which have contributed to maintaining oil prices at historically elevated levels. Concerns about supply disruptions from Iraq, Iran, and Nigeria also continue to put upward pressure on oil prices. Long-running production problems in Nigeria, due to a lack of security, have worsened since early May, and more than a quarter of the country's production is currently off line.

International Financial Markets

Long-term bond yields rose considerably over the intermeeting period in most advanced foreign economies along with the rise in U.S. yields. Positive economic news also increased expectations of policy tightening in many countries. Since the May FOMC meeting, yields on long-term benchmark government bonds have risen about 40 basis points in Canada and in the major European countries and 20 basis points in Japan. Yields on inflation-protected government securities increased nearly as much over the period, and implied inflation compensation rose little except in the United Kingdom and Japan. Long-term yields denominated in local currencies also rose in most Asian emerging market economies.

Major stock indexes abroad have risen 2 to 3 percent since the May FOMC meeting as growth prospects have improved. Equity prices in many emerging market economies have risen more. Although the Chinese stock market fell sharply at the end of May after government authorities tripled the stamp tax on stock trades to 0.3 percent, spillovers to other markets were minimal. The Chinese stock market has since recouped most of its late-May losses, posting a net gain over the intermeeting period.

The nominal trade-weighted exchange value of the dollar against the major foreign currencies has changed little on balance over the intermeeting period. The dollar appreciated against several of the major currencies, broadly in line with movements in interest rate differentials, but this gain was offset by a 3½ percent depreciation against the Canadian dollar. Against the currencies of our other important trading partners, the trade-weighted value of the dollar was down slightly, mainly as a result of an unusually large 1 percent decline against the Chinese renminbi. Overall, the broad nominal dollar was little changed over this period, and our starting point for the broad real dollar is similar to that in the May Greenbook. However, we currently expect a somewhat faster rate of depreciation of about 2 percent in the broad real dollar over the forecast period. The reason for the revision is that market expectations for U.S. monetary policy have been revised up and are now more in line with the staff forecast, so we no longer expect future increases in market interest rates to provide support for the dollar.

On June 11, the Reserve Bank of New Zealand sold N.Z. dollars for U.S. dollars, its first intervention since 1985. The precise amount of the operation was not made public, but market participants estimated it to be in the range of about NZ$300 million to NZ$500 million, equivalent to about US$225 million to US$375 million.

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

Advanced Foreign Economies

Real GDP growth in the advanced foreign economies averaged 3.3 percent in the first quarter, about ½ percentage point higher than we had expected. Growth was particularly robust in Canada, where the economy rebounded from subpar growth over the previous three quarters, while growth in the euro area also surprised on the upside. In contrast, first-quarter growth in Japan was lower than previously projected, although still quite strong. Recent indicators suggest that the pace of expansion in these economies has moderated to about 3 percent in the current quarter, and we expect a further step-down to about 2½ percent by the beginning of next year, closer to trend growth.

The pattern of gradually slowing growth is common to all the major advanced economies and partly reflects continued tightening of monetary policy aimed at containing inflationary pressures as resource utilization rises. (In Canada, recent currency appreciation also has contributed to a tightening of financial conditions.) We now expect official interest rates to be raised 75 basis points by the end of this year in Canada, 50 basis points in the euro area, and 25 basis points in the United Kingdom. Although Japanese inflation remains quite low, we assume that the Bank of Japan will gradually raise its policy rate by 75 basis points to 1.25 percent by the end of the forecast period.

We expect that inflation will remain contained in all of these economies, partly as a result of the policy moves, with average four-quarter inflation edging up from 1½ percent in the first half of this year to 2 percent by the end of the year before falling back to 1¾ percent in 2008. In Canada and Europe, inflation recedes in 2008 in response to the projected deceleration in energy prices as well as the monetary policy restraint. We expect Japanese consumer price inflation to remain slightly negative in the near term and then to rise to ½ percent next year in response to continued moderate output growth.

On average, projected growth for the advanced economies is a little higher than in the May Greenbook for the remainder of this year. In 2008, expected growth for Canada is slightly lower, mainly because recent statements by the Bank of Canada suggest that increasing concern about a rise in core inflation will prompt more monetary policy tightening than previously expected. The overall inflation forecast for these economies has been revised up a little through mid-2008 in response to the higher path for oil prices.

Emerging Market Economies

Average output growth in the emerging market economies is estimated to have rebounded from just over 4 percent in the first quarter to 5 percent in the current quarter, largely owing to an improvement in the Mexican economy. The pace of expansion is expected to remain around this rate over the forecast period, similar to the May Greenbook projection.

In emerging Asia, real GDP growth appears to have slowed from about 7 percent in the first quarter to a still-strong rate of 6 percent in the current quarter. The moderation largely reflects our assessment that Chinese growth has cooled somewhat from its 13¾ percent pace in the first quarter, as April and May industrial production data showed some deceleration. However, the trade surplus has continued to expand, and investment and retail sales growth have remained strong, suggesting some upside risk to this projection. Growth is expected to be around 9½ percent in the current quarter and to remain near that rate over the forecast period, as Chinese authorities continue to employ both monetary restraint and administrative measures to slow investment demand. In addition, we have assumed that activity will slow somewhat in the current quarter in India, which also posted growth of 13 percent in the first quarter. Elsewhere in emerging Asia, first-quarter performance was mixed, with strong activity in most of the ASEAN countries but some deceleration in Taiwan and Hong Kong. We expect an improvement in global high-tech demand in the second half of this year to contribute to a firming in growth in the region over the forecast period.

In Latin America, recent industrial production data suggest that Mexican real GDP growth has rebounded to about 3¾ percent this quarter, after stagnating in the first quarter. We expect growth in Mexico to average about 3½ percent over the rest of the forecast period, supported by a pickup in construction activity and a firming in demand from the U.S. manufacturing sector. The pace of expansion in Brazil also appears to have improved to 4 percent in the second quarter and is expected to remain around that rate as the authorities continue to ease monetary policy.

Four-quarter inflation in emerging market economies is expected to increase from a little less than 3 percent at the end of 2006 to about 3½ percent in the third quarter in response to higher food and energy prices and then to taper off to 3 percent by the end of 2008. This pattern is most pronounced in China, where food price inflation has recently risen to over 8 percent and four-quarter headline inflation is expected to reach 3¾ percent in the third quarter. We expect Chinese inflation to recede over the forecast period as some temporary factors that have affected meat supply abate. We also assume that the Chinese authorities will take action to restrain food price inflation if necessary, possibly including restricting the production of ethanol, which has contributed directly to higher prices of corn and indirectly to higher meat prices. Chinese inflation is thus expected to drop back to 2¼ percent by the end of 2008.

Prices of Internationally Traded Goods

Core import prices rose at an annual rate of 2¾ percent in the first quarter of this year, with much of the increase in prices for material-intensive goods. In the current quarter, higher nonfuel commodity prices and the depreciation of the dollar are expected to push core import price inflation up to 4½ percent. Prices of imported metals rose briskly in April and early May, and despite some subsequent weakness in the spot markets, these prices are projected to remain elevated. The dollar, which declined sharply earlier this year, should provide further upward impetus to import prices in the third quarter. For the remainder of the forecast period, core import prices decelerate as commodity prices level off and the pace of dollar depreciation slows.

Core export prices surged at an annual rate of almost 6 percent in the first quarter, mainly owing to a rebound in the prices of exported industrial supplies, particularly fuels, which had fallen sharply in the fourth quarter. Prices of exported industrial supplies are also up significantly so far in the second quarter despite some flattening in May. In addition, rising costs for intermediate inputs are putting upward pressure on prices of exported finished goods. As a result, we expect core export price inflation to remain around 6 percent in the second quarter, ½ percentage point higher than projected in the May Greenbook. However, as commodity prices level off, core export price inflation is projected to move down quickly over the next few quarters, falling to 2¾ percent in the fourth quarter of this year and to about 1¼ percent next year.

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

Indicator	2006 H1	2006 H2	2007 Q1	Projection 2007 Q2	Projection 2007 H2	Projection 2008
Imports						
Core goods	2.7	2.7	2.8	4.5	3.3	1.6
May GB	2.7	2.7	2.8	4.5	2.8	1.3
Oil (dollars per barrel)	63.81	55.33	54.39	63.24	68.32	68.79
May GB	63.75	55.34	54.39	61.90	65.58	67.14
Exports						
Core goods	5.3	3.0	5.9	6.0	3.2	1.2
May GB	5.3	3.0	5.9	5.5	2.6	1.3

Note. Prices for core exports exclude computers and semiconductors. Prices for core imports exclude computers, semiconductors, oil, and natural gas. Both price series 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

Since the May Greenbook, we have received monthly trade data for March and April, as well as annual revisions to trade data for previous months. These data indicated that both imports and exports were above our previous estimates for the first quarter, although the projected contribution of real net exports to U.S. growth is little changed at negative ¾ percentage point. We estimate that the contribution of net exports swung to a positive 1 percentage point in the current quarter, owing to a contraction of imports, particularly of oil, while exports accelerated. The contribution of net exports is a little higher than in the May Greenbook, as April imports of core goods were down more than we had expected. We continue to project the contribution of real net exports to be roughly neutral on average over the remainder of the forecast period.

Although real imports of core goods and services decelerated along with the slower pace of U.S. growth in the first quarter, a surge in imported oil and computers boosted growth of total real imports to an estimated annual rate of 5½ percent. We estimate that real imports have fallen 2½ percent in the current quarter, down from a projection of little change in the May Greenbook, largely owing to weak April data and a downward revision to oil imports. Imports of consumer goods declined significantly in April, notably in the volatile category of pharmaceuticals, and auto imports also fell sharply.

These data suggest that imports of core goods will decline slightly for the second consecutive quarter. In addition, we expect real imports of oil and computers to retrace some of their first-quarter rise. Real imports of services, which were weak in April, are expected to increase at a sluggish rate of 2¼ percent in the quarter.

Staff Projections for Trade in Goods and Services

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

Indicator	2006		2007	Projection		
				2007		2008
	H1	H2	Q1	Q2	H2	
Real imports	5.2	1.4	5.4	-2.4	3.8	3.8
May GB	5.2	1.4	4.1	0.1	3.6	4.2
Real exports	10.0	8.7	1.2	5.4	6.0	5.7
May GB	10.0	8.7	-1.1	7.6	6.2	5.7

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

We expect growth of real imports of goods and services to pick up to about 3¾ percent at an annual rate over the remainder of the forecast period, as slower import price inflation and higher U.S. GDP growth boost imports of core goods and services. In contrast, real imports of oil should decelerate as U.S. production increases through the end of the forecast period. Our projection for next year is down ½ percentage point from the May Greenbook, as the lower path for the dollar and weaker real imports of oil offset a boost from higher projected growth of U.S. GDP.

We estimate that the growth of real exports of goods and services slowed sharply in the first quarter to 1¼ percent at an annual rate following a very strong performance in 2006, particularly in the fourth quarter. Although much of the first-quarter slowdown was due to a leveling-out of exports of aircraft, which accounted for a large portion of the fourth-quarter surge, growth of exports of other capital goods also slowed significantly. April data suggest some rebound in the current quarter, as agricultural exports rose strongly, and exports of industrial supplies and consumer goods registered modest gains. Accordingly, we expect growth of real exports of goods and services to improve to a 5½ percent rate in the second quarter. Exports of core goods are projected to increase at a pace of 6 percent, in line with movements in foreign income growth and relative prices. Real exports of services are also projected to pick up again after a weak first quarter.

Partly because of April declines, we expect exports of computers to remain sluggish and exports of semiconductors to fall in the current quarter.

Against the backdrop of sustained solid economic growth abroad, we expect growth of real exports of goods and services to improve further in the second half of the year to a 6 percent rate and then to move down slightly from that pace by the end of next year. This includes steady growth of 5 percent in real exports of core goods. Although slowing core export price inflation and past and prospective dollar depreciation provide some lift to exports, this effect is offset by the waning influence of some special factors that have recently boosted growth, such as the surging global demand for U.S. aircraft and other investment goods. Growth of real exports of services peaks in the second half of this year and slows over the forecast period, as the effect of recent rapid dollar depreciation dissipates fairly quickly. Exports of computers and semiconductors are expected to grow at a pace near their historical averages. The projection is little changed from the May Greenbook, as the effect of the lower path for the dollar is offset by the effect of higher core export prices, mainly for agricultural goods. We have also reduced our projection of exports of computers and semiconductors somewhat.

Alternative Simulations

Our benchmark forecast for oil prices follows futures markets in projecting modest increases, but of course a wide range of outcomes for oil prices is plausible over the forecast period. In our alternative scenario, we used SIGMA, the staff's forward-looking multicountry model, to consider the effects of a much larger increase in the price of oil.[1] Specifically, we assume that an adverse supply shock causes oil prices to rise permanently by 50 percent in real terms relative to our baseline path, starting in the third quarter of 2007. Both households and firms are assumed to understand the shock to be permanent. The simulation exercise also assumes that monetary policy in both the United States and foreign countries follows a Taylor rule and is highly credible, so long-run inflation expectations remain well anchored.

In reaction to the higher oil prices, U.S. real GDP growth falls about 0.3 percentage point below baseline in the second half of 2007 before recovering to just a bit below baseline at the end of 2008. Following our specification of the Taylor rule, the U.S. federal funds rate rises 20 basis points relative to baseline throughout the forecast period. Both

[1] The effects of an oil shock that are reported below for SIGMA are within the range of estimates derived from other macroeconomic models used at the Board. These models include the FRB/Global model and variants of the FRB/US model with model-consistent expectations.

consumption and investment fall; consumer spending drops in response to the reduction in permanent income, while elevated energy prices lead firms to reduce investment. Although long-run inflation expectations are unchanged, core PCE price inflation increases ¼ percentage point relative to baseline over the forecast period, reflecting an increase in unit labor costs as the lower investment reduces labor productivity while real wages fall only gradually. Rising energy costs also contribute to a widening of the U.S. trade deficit of about 0.6 percent of GDP.

Alternative Simulation:
Higher Oil Price Path
(Percent change from previous period, annual rate)

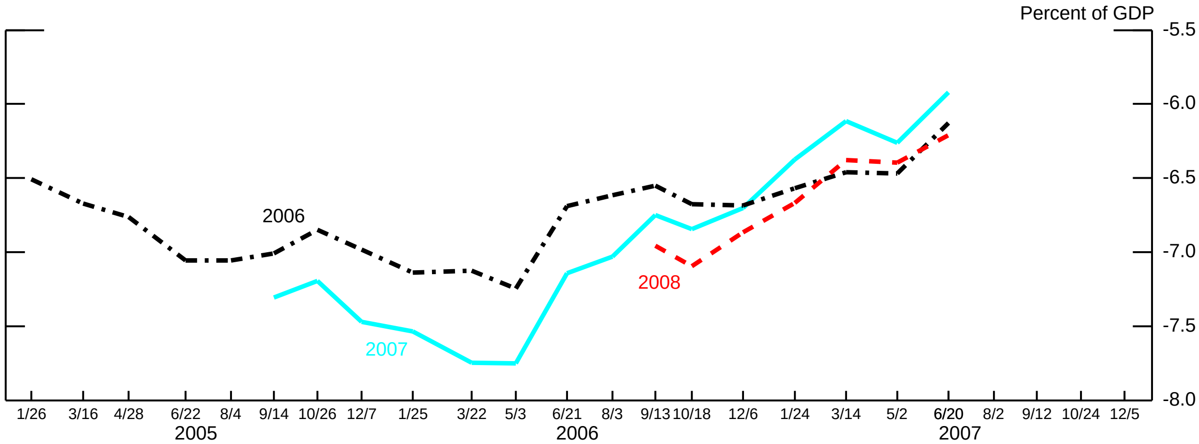
Indicator and simulation	2007		2008	
	H1	H2	H1	H2
U.S. real GDP				
Baseline	2.0	2.3	2.5	2.5
Permanently higher oil price	2.0	2.0	2.3	2.4
U.S. PCE prices excluding food and energy				
Baseline	1.9	2.2	2.1	2.0
Permanently higher oil price	1.9	2.4	2.4	2.3
U.S. federal funds rate (percent)				
Baseline	5.3	5.3	5.3	5.3
Permanently higher oil price	5.3	5.5	5.5	5.5
U.S. trade balance (percent of GDP)				
Baseline	-5.2	-5.3	-5.3	-5.1
Permanently higher oil price	-5.2	-5.9	-5.9	-5.7

Note. H1 is Q2/Q4; H2 is Q4/Q2. The federal funds rate is the average rate for the final quarter of the period. The monetary authorities in the United States and the major foreign economies adjust their policy rates according to Taylor rules.

Class II FOMC -- Restricted (FR)

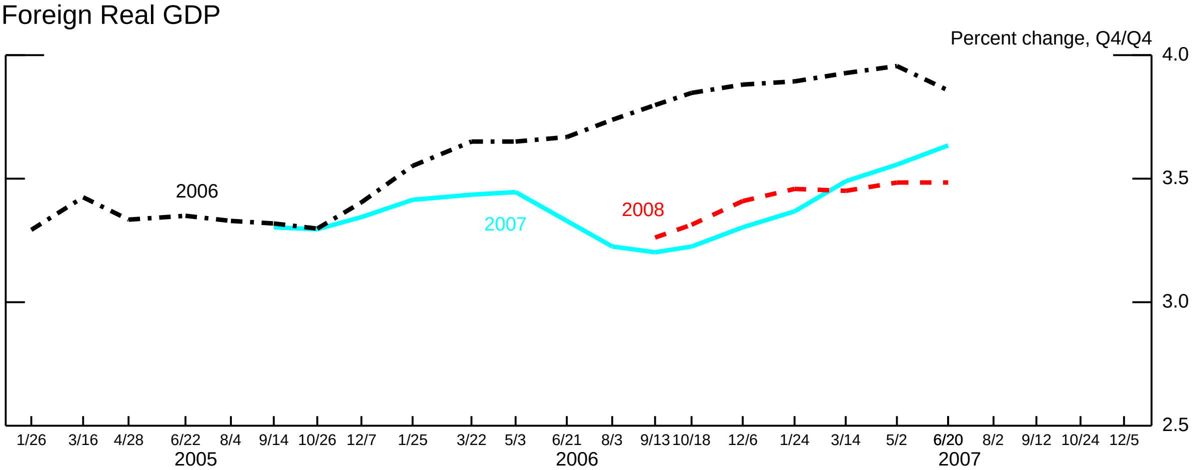
Evolution of the Staff Forecast

Current Account Balance



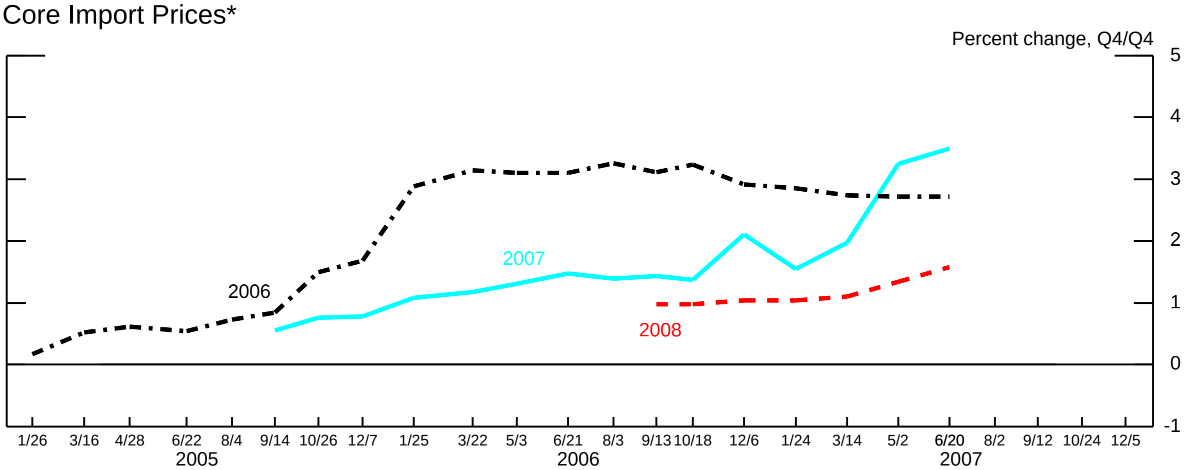
Greenbook publication date

Foreign Real GDP



Greenbook publication date

Core Import Prices*



Greenbook publication date

*Prices for merchandise imports excluding computers, semiconductors, oil, and natural gas.

Class II FOMC
Restricted (FR)

June 20, 2007

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

Measure and country	2000	2001	2002	2003	2004	2005	2006	Projected 2007	Projected 2008
REAL GDP (1)									
Total foreign	4.2	0.4	3.1	3.0	3.8	3.8	3.9	3.6	3.5
Advanced Foreign Economies	3.5	0.9	2.5	1.8	2.5	2.7	2.5	2.9	2.4
of which:									
Canada	4.1	1.3	3.5	1.5	3.5	3.2	1.9	3.0	2.6
Japan	3.1	-1.7	2.0	2.4	1.1	2.8	2.4	2.6	1.9
United Kingdom	3.1	2.0	2.3	3.3	2.6	1.9	3.0	3.0	2.6
Euro Area (2)	3.3	1.1	1.0	1.1	1.6	1.9	3.3	2.6	2.1
Germany	2.3	1.1	0.0	0.2	0.2	1.7	3.9	2.8	2.1
Emerging Market Economies	5.2	-0.4	3.9	4.8	5.7	5.4	5.7	4.7	4.9
Asia	5.8	1.0	6.3	6.9	6.0	7.5	6.7	6.3	6.2
Korea	4.4	4.7	7.7	4.2	2.9	5.7	4.0	4.1	4.4
China	7.8	7.1	8.5	10.1	9.6	10.0	10.4	10.3	9.2
Latin America	4.5	-1.3	1.6	2.4	5.3	3.1	4.8	3.1	3.6
Mexico	4.8	-1.3	2.0	2.1	4.8	2.5	4.3	2.8	3.4
Brazil	4.4	-0.7	5.0	0.8	5.0	3.1	4.7	3.8	4.0
CONSUMER PRICES (3)									
Advanced Foreign Economies	1.9	0.9	2.1	1.3	1.8	1.5	1.3	2.1	1.7
of which:									
Canada	3.1	1.1	3.8	1.7	2.3	2.3	1.3	2.9	2.0
Japan	-0.5	-1.1	-0.5	-0.3	0.5	-1.0	0.3	0.3	0.5
United Kingdom (4)	0.9	1.1	1.5	1.3	1.4	2.1	2.7	2.2	2.0
Euro Area (2)	2.5	2.1	2.3	2.0	2.3	2.3	1.8	2.3	1.9
Germany	1.7	1.5	1.2	1.1	2.1	2.2	1.3	2.4	1.8
Emerging Market Economies	4.1	2.8	2.9	3.1	3.9	3.0	2.9	3.3	3.0
Asia	1.8	1.2	0.8	2.2	3.2	2.6	2.3	3.1	2.6
Korea	2.5	3.3	3.3	3.5	3.4	2.5	2.1	3.2	2.8
China	1.0	-0.1	-0.6	2.7	3.3	1.4	2.1	3.4	2.3
Latin America	8.4	5.3	6.4	4.9	5.7	3.8	4.2	3.7	3.8
Mexico	8.7	5.1	5.2	3.9	5.3	3.1	4.1	3.4	3.5
Brazil	6.4	7.5	10.7	11.5	7.2	6.1	3.2	4.0	3.7

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.

Class II FOMC
Restricted (FR)

June 20, 2007

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

Measure and country	2006 Q1	2006 Q2	2006 Q3	2006 Q4	Projected 2007 Q1	2007 Q2	2007 Q3	2007 Q4	2008 Q1	2008 Q2	2008 Q3	2008 Q4
REAL GDP (1)	Quarterly changes at an annual rate											
Total foreign	4.8	3.9	3.2	3.5	3.7	3.8	3.6	3.5	3.5	3.5	3.5	3.4
Advanced Foreign Economies	3.3	2.4	1.8	2.6	3.3	2.9	2.7	2.6	2.5	2.5	2.4	2.4
of which:												
Canada	3.4	1.5	1.3	1.5	3.7	2.9	2.8	2.6	2.6	2.7	2.7	2.6
Japan	2.2	1.8	0.3	5.4	3.3	2.5	2.3	2.1	2.0	1.9	1.8	1.8
United Kingdom	3.3	3.1	2.7	2.7	2.9	3.5	2.9	2.8	2.7	2.6	2.5	2.5
Euro Area (2)	3.6	3.8	2.4	3.5	2.4	2.9	2.6	2.4	2.2	2.1	2.0	1.9
Germany	3.4	5.0	3.3	4.0	2.1	3.4	2.9	2.7	2.4	2.2	2.0	1.9
Emerging Market Economies	6.9	6.0	5.1	4.9	4.1	5.0	4.8	4.8	4.9	4.9	5.0	5.0
Asia	7.2	6.5	6.6	6.5	7.1	6.0	6.0	6.1	6.2	6.2	6.3	6.3
Korea	4.0	3.2	5.0	3.8	3.6	4.2	4.3	4.3	4.4	4.4	4.4	4.4
China	11.2	12.8	7.3	10.5	13.7	9.4	9.0	9.0	9.1	9.1	9.5	9.3
Latin America	7.4	5.3	4.1	2.7	1.3	4.0	3.6	3.6	3.6	3.6	3.7	3.7
Mexico	7.5	5.4	2.7	1.5	0.6	3.8	3.4	3.4	3.4	3.4	3.5	3.5
Brazil	5.2	-1.4	11.2	4.3	3.1	4.0	4.0	4.0	4.0	4.0	4.0	4.0
CONSUMER PRICES (3)	Four-quarter changes											
Advanced Foreign Economies	1.8	2.0	1.6	1.3	1.5	1.5	1.7	2.1	1.9	1.8	1.7	1.7
of which:												
Canada	2.5	2.6	1.6	1.3	1.9	1.9	2.4	2.9	2.3	2.1	2.1	2.0
Japan	-0.2	0.2	0.6	0.3	-0.1	-0.1	-0.2	0.3	0.6	0.6	0.6	0.5
United Kingdom (4)	2.0	2.2	2.4	2.7	2.8	2.6	2.3	2.2	2.1	2.0	2.0	2.0
Euro Area (2)	2.3	2.5	2.1	1.8	1.9	1.8	2.0	2.3	2.2	2.1	2.0	1.9
Germany	2.1	2.1	1.6	1.3	1.9	1.9	2.2	2.4	2.1	2.0	1.8	1.8
Emerging Market Economies	3.0	2.9	2.7	2.9	3.1	3.2	3.4	3.3	3.2	3.1	3.0	3.0
Asia	2.4	2.5	2.2	2.3	2.7	2.8	3.2	3.1	3.1	2.8	2.7	2.6
Korea	2.1	2.3	2.5	2.1	2.0	2.4	2.5	3.2	3.8	3.4	3.1	2.8
China	1.2	1.3	1.2	2.1	2.8	3.4	3.7	3.4	3.1	2.6	2.3	2.3
Latin America	4.2	3.5	3.8	4.2	4.2	4.3	4.0	3.7	3.5	3.7	3.8	3.8
Mexico	3.7	3.1	3.5	4.1	4.1	4.1	3.7	3.4	3.2	3.5	3.5	3.5
Brazil	5.6	4.3	3.8	3.2	3.1	3.4	4.1	4.0	3.6	3.7	3.7	3.7

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.

Class II FOMC
Restricted (FR)

June 20, 2007

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2000	2001	2002	2003	2004	2005	2006	Projected 2007	Projected 2008
NIPA REAL EXPORTS and IMPORTS									
Percentage point contribution to GDP growth, Q4/Q4									
Net Goods & Services	-0.9	-0.2	-0.9	-0.1	-0.8	-0.1	0.5	0.1	0.0
Exports of G&S	0.7	-1.3	0.4	0.6	0.7	0.7	1.0	0.5	0.7
Imports of G&S	-1.6	1.1	-1.3	-0.7	-1.5	-0.8	-0.5	-0.4	-0.6
Percentage change, Q4/Q4									
Exports of G&S	6.5	-11.9	3.8	5.8	7.0	6.7	9.4	4.6	5.7
Services	1.8	-8.9	10.2	3.0	7.1	3.1	7.5	6.4	6.3
Computers	22.7	-23.5	-1.1	11.3	6.4	14.1	8.2	2.7	9.5
Semiconductors	27.6	-34.6	10.1	38.3	-6.3	17.2	1.0	5.6	11.1
Core Goods 1/	5.9	-10.2	0.6	4.9	8.0	7.5	10.8	3.9	5.0
Imports of G&S	11.2	-7.6	9.7	4.8	10.6	5.2	3.3	2.6	3.8
Services	10.6	-5.9	8.8	2.2	7.6	1.9	5.1	2.5	3.2
Oil	13.3	3.7	3.8	1.2	9.6	0.9	-9.7	4.4	-1.4
Natural Gas	37.3	-6.5	19.5	1.3	6.6	11.9	-17.2	1.8	5.3
Computers	13.9	-13.6	13.2	17.0	22.5	11.8	13.7	15.3	15.6
Semiconductors	22.8	-51.1	11.0	-0.1	9.3	7.5	-0.4	6.0	5.0
Core Goods 2/	10.3	-6.5	10.0	5.2	10.7	6.2	5.6	1.4	4.2
Billions of Chained 2000 Dollars									
Net Goods & Services	-379.5	-399.1	-471.3	-518.9	-590.9	-619.2	-618.0	-578.1	-563.8
Exports of G&S	1096.3	1036.7	1013.3	1026.1	1120.4	1196.1	1302.8	1376.0	1455.6
Imports of G&S	1475.8	1435.8	1484.6	1545.0	1711.3	1815.3	1920.9	1954.1	2019.4
Billions of dollars									
US CURRENT ACCOUNT BALANCE	-417.4	-384.7	-459.6	-522.1	-640.2	-754.8	-811.5	-821.8	-901.9
Current Acct as Percent of GDP	-4.3	-3.8	-4.4	-4.8	-5.5	-6.1	-6.1	-5.9	-6.2
Net Goods & Services (BOP)	-379.8	-365.1	-423.7	-496.9	-612.1	-714.4	-758.5	-732.4	-756.0
Investment Income, Net	25.7	36.9	33.2	51.1	62.5	54.5	43.2	20.1	-34.6
Direct, Net	94.9	115.9	102.4	112.7	139.4	152.5	174.2	203.9	215.8
Portfolio, Net	-69.2	-79.0	-69.1	-61.5	-76.9	-98.1	-131.0	-183.8	-250.4
Other Income & Transfers,Net	-63.3	-56.5	-69.2	-76.3	-90.6	-94.9	-96.1	-109.6	-111.3

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

Class II FOMC
Restricted (FR)

June 20, 2007

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2003				2004				2005			
	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	0.2	-0.7	0.5	-0.5	-0.7	-1.6	-0.2	-0.8	-0.2	0.7	-0.1	-1.1
Exports of G&S	-0.5	-0.2	1.0	1.8	0.7	0.6	0.5	1.0	0.5	0.9	0.3	1.0
Imports of G&S	0.7	-0.6	-0.5	-2.3	-1.4	-2.2	-0.7	-1.8	-0.6	-0.2	-0.4	-2.0
Percentage change from previous period, s.a.a.r.												
Exports of G&S	-5.3	-1.7	11.4	20.8	7.2	6.2	4.8	9.9	4.7	9.4	3.2	9.6
Services	-20.0	-2.8	17.5	23.1	7.5	5.6	-2.8	19.2	2.9	2.0	2.1	5.5
Computers	-2.3	-5.2	34.7	23.2	-5.8	-3.1	20.7	16.5	13.6	21.9	17.8	3.9
Semiconductors	37.4	30.9	44.6	40.7	11.5	-7.8	-19.1	-7.2	-7.7	21.3	26.3	33.6
Core Goods 1/	0.2	-2.9	5.2	18.3	7.7	8.2	9.7	6.4	5.8	11.9	1.8	10.7
Imports of G&S	-5.0	4.1	3.8	17.6	10.2	16.0	4.4	12.0	4.1	1.4	2.5	13.2
Services	-10.6	-15.7	21.2	19.6	10.9	7.6	3.1	9.0	-0.2	-1.5	1.2	8.3
Oil	-9.7	12.4	-6.0	9.9	37.2	-22.9	-6.4	45.5	7.0	-21.2	-12.5	40.5
Natural Gas	-45.9	72.5	66.4	-32.1	16.2	72.0	43.7	-55.1	23.0	12.3	109.8	-45.9
Computers	11.4	10.7	11.1	36.9	21.1	30.2	27.5	11.9	9.2	9.4	19.6	9.3
Semiconductors	-6.3	1.1	-4.2	9.7	43.3	19.6	3.8	-19.9	-7.4	8.4	15.6	14.9
Core Goods 2/	-3.1	7.2	-0.1	18.1	5.3	23.2	4.2	11.0	4.4	5.8	2.7	12.3
Billions of Chained 2000 Dollars, s.a.a.r.												
Net Goods & Services	-507.2	-526.9	-513.8	-527.8	-548.5	-593.9	-599.4	-621.9	-626.4	-606.1	-607.6	-636.6
Exports of G&S	1003.3	999.0	1026.3	1075.8	1094.8	1111.3	1124.3	1151.3	1164.5	1191.0	1200.5	1228.4
Imports of G&S	1510.5	1525.9	1540.0	1603.6	1643.2	1705.2	1723.7	1773.1	1790.9	1797.1	1808.1	1865.0
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-540.4	-520.4	-522.1	-505.5	-559.8	-634.7	-632.3	-733.8	-729.6	-732.9	-693.6	-863.2
Current Account as % of GDP	-5.0	-4.8	-4.7	-4.5	-4.9	-5.4	-5.4	-6.1	-6.0	-5.9	-5.5	-6.8
Net Goods & Services (BOP)	-498.6	-494.8	-493.4	-500.9	-544.1	-602.4	-626.4	-675.4	-666.6	-682.7	-723.8	-784.4
Investment Income, Net	34.6	47.8	47.8	74.3	82.2	59.4	69.2	39.2	56.2	53.5	72.8	35.3
Direct, Net	97.1	108.2	109.2	136.2	146.2	129.6	143.4	138.4	140.4	147.3	176.1	146.2
Portfolio, Net	-62.4	-60.4	-61.4	-62.0	-63.9	-70.3	-74.2	-99.2	-84.3	-93.8	-103.3	-110.9
Other Inc. & Transfers, Net	-76.5	-73.4	-76.5	-78.8	-97.8	-91.7	-75.1	-97.6	-119.2	-103.8	-42.6	-114.1

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

Class II FOMC
Restricted (FR)

June 20, 2007

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2006				Projected 2007				Projected 2008			
	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	-0.0	0.4	-0.2	1.6	-0.7	1.0	0.3	-0.2	-0.3	0.7	0.1	-0.4
Exports of G&S	1.4	0.7	0.7	1.1	0.1	0.6	0.7	0.7	0.7	0.7	0.7	0.7
Imports of G&S	-1.5	-0.2	-0.9	0.5	-0.9	0.4	-0.3	-0.9	-1.0	0.0	-0.6	-1.0
Percentage change from previous period, s.a.a.r.												
Exports of G&S	14.0	6.2	6.8	10.6	1.2	5.4	6.2	5.9	5.8	5.7	5.6	5.6
Services	6.7	6.7	0.8	16.3	3.4	6.7	8.0	7.6	6.9	6.4	6.1	5.8
Computers	9.8	12.0	-0.1	11.5	-8.0	0.9	9.5	9.5	9.5	9.5	9.5	9.5
Semiconductors	15.7	29.9	-12.4	-20.8	14.7	-12.3	11.1	11.1	11.1	11.1	11.1	11.1
Core Goods 1/	17.8	4.4	11.4	10.1	0.0	5.9	5.0	4.8	4.9	4.9	5.0	5.1
Imports of G&S	9.1	1.4	5.6	-2.6	5.4	-2.4	2.1	5.5	5.9	-0.2	3.4	6.0
Services	7.4	9.9	-2.6	6.2	2.8	2.2	2.8	2.3	2.9	3.3	7.9	-0.9
Oil	-4.8	-18.3	7.1	-20.2	30.6	-20.3	-7.7	23.7	16.9	-26.2	-11.3	23.6
Natural Gas	-22.7	38.7	-26.4	-40.3	11.9	104.2	-25.2	-37.2	23.3	19.8	18.1	-29.4
Computers	34.3	17.0	18.4	-10.1	41.2	-6.3	15.6	15.6	15.6	15.6	15.6	15.6
Semiconductors	3.6	-1.3	21.6	-21.0	4.4	9.5	5.0	5.0	5.0	5.0	5.0	5.0
Core Goods 2/	12.3	2.5	6.9	1.2	-0.3	-0.9	3.8	3.1	3.3	4.0	4.5	4.8
Billions of Chained 2000 Dollars, s.a.a.r.												
Net Goods & Services	-636.6	-624.2	-628.8	-582.6	-604.0	-574.5	-563.9	-570.0	-578.5	-557.5	-554.6	-564.4
Exports of G&S	1269.3	1288.5	1310.0	1343.5	1347.4	1365.2	1385.7	1405.8	1425.8	1445.6	1465.5	1485.5
Imports of G&S	1905.9	1912.7	1938.8	1926.1	1951.4	1939.6	1949.6	1975.8	2004.3	2003.1	2020.1	2050.0
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-802.4	-822.4	-869.3	-751.8	-770.3	-815.4	-838.4	-863.2	-908.5	-884.0	-891.5	-923.6
Current Account as % of GDP	-6.2	-6.2	-6.5	-5.6	-5.7	-5.9	-6.0	-6.1	-6.4	-6.1	-6.1	-6.3
Net Goods & Services (BOP)	-758.8	-770.3	-797.2	-707.7	-707.2	-727.2	-740.4	-754.7	-774.8	-746.8	-743.7	-758.8
Investment Income, Net	48.3	49.2	30.0	45.3	48.1	22.3	12.3	-2.1	-18.3	-29.7	-40.2	-50.2
Direct, Net	168.0	178.6	161.9	188.3	205.3	195.4	205.6	209.4	209.4	213.6	218.0	222.3
Portfolio, Net	-119.8	-129.4	-132.0	-143.0	-157.2	-173.0	-193.3	-211.5	-227.7	-243.3	-258.2	-272.5
Other Inc. & Transfers, Net	-91.8	-101.2	-102.1	-89.4	-111.3	-110.5	-110.3	-106.4	-115.3	-107.6	-107.6	-114.6

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