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Confidential (FR) Class II FOMC

Part 1

June 20, 2002

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Summary and Outlook

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

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Domestic Developments

On balance, the data we have received since the May Greenbook seem broadly consistent with our expectation that economic activity is expanding at a sluggish pace in the second quarter. On the plus side, most inventory overhangs seem to have been eliminated, and industrial production has risen steadily since the beginning of the year. However, household spending has decelerated considerably from its strong pace in the first quarter, and with businesses evidently still concerned about the economic outlook, recent employment gains have been quite meager, and spending on fixed investment has yet to show any vigor. Concerns about prospective earnings growth and further revelations of corporate accounting irregularities have weighed on both stock prices and the foreign exchange value of the dollar; the dollar apparently has also been pressed by a renewed focus on the current account deficit.

We expect real GDP to increase at an annual rate of 1-3/4 percent in the second quarter, a downward revision of about 1/4 percentage point from our previous forecast. Nevertheless, given the substantial degree of fiscal and monetary stimulus still in place, we continue to anticipate that the pace of economic activity will pick up again over the second half of this year. As businesses eventually become more convinced about the durability of the recovery, they should be more inclined to expand their work forces and to undertake new capital spending projects. Similarly, household spending should continue to be buoyed by low interest rates and solid real income gains, notwithstanding the greater drag associated with a weaker projected path for household wealth. With an assumed lower foreign exchange value of the dollar adding a bit more impetus to net exports in this projection, our current forecast that real GDP will increase at an annual rate of about 3-1/2 percent in the second half is similar to the projection in the May Greenbook. In 2003, GDP growth is projected to edge up to a bit more than 4 percent, also about the same as in our previous forecast.

We have not made any material changes to our assumptions about aggregate supply in this projection. We continue to expect that real GDP will expand more rapidly than potential both this year and next and that the unemployment rate will drift down to around 5-1/2 percent by the end of next year. The slack in resource utilization keeps core inflation on a generally downward path over the forecast period despite rising import prices associated with the assumed depreciation in the dollar. We still expect core PCE prices to rise slightly less than 1-1/2 percent in both 2002 and 2003, about 1/4 percentage point less than their increase in 2001.

Key Background Factors

We have altered our assumed trajectory for the federal funds rate a bit from that in the May Greenbook. In particular, we have put off until early 2003 the start of the monetary tightening we think will be necessary to prevent the emergence of inflationary pressures in subsequent years. Futures markets have marked down their path for the funds rate by substantially more than the staff has, and market participants now expect only a shade more tightening by the end of the projection period than we have built in. Treasury coupon yields and mortgage rates have fallen over the intermeeting period, but we expect these declines to be retraced over the forecast period as these instruments begin to encompass a higher average level of short-term rates.

Corporate borrowing conditions appear to have deteriorated somewhat in recent weeks, primarily for lower-rated companies, with spreads on below-investment-grade issues having widened more than 3/4 percentage point since early May. Nonetheless, given the willingness of lenders and investors to provide financing to better risks and the flush cash position for the corporate sector as a whole, we do not see credit supply as likely to exert significant restraint on business spending over the projection period. Similarly, most households appear to have ready access to credit, and with borrowing rates expected to remain low, credit markets should remain supportive of household spending.

Equity prices have fallen about 5 percent since the date of the May Greenbook, likely reflecting, at least in part, greater concerns about the strength of the economic recovery and the uncertainty created by ongoing disclosures of accounting irregularities and lapses in corporate governance. With projected profits in our forecast weaker than market expectations, we are assuming that disappointments about corporate earnings will hold share prices near current levels through the end of this year. Stock prices then rise at a pace that maintains risk-adjusted parity with the return on corporate bonds in 2003.

The more-pessimistic market perceptions of the prospects for earnings growth in the United States, combined with concerns about the widening current account deficit, have pushed down the dollar in recent weeks. We are forecasting that, in real terms, the dollar will depreciate at an annual rate of about 2 percent through the end of the projection period, leaving the real exchange value of the dollar at the end of 2003 about 3-1/2 percent lower than we assumed in the May Greenbook.

Incoming data indicate that foreign economic activity picked up in the first half of 2002, after no change in 2001. Indeed, the latest data have led us to revise up our estimate of foreign GDP growth in the first half of this year to an annual rate of around 3 percent, about 1/4 percentage point more than in the May Greenbook. Going forward, we are projecting foreign growth to pick up further, to an annual rate of roughly 3-1/2 percent in the second half of this year and to hold at that pace in 2003.

Crude oil prices have fallen in recent weeks, reflecting comfortable levels of crude inventories and evidence that Venezuela is producing above its OPEC quota. In response, we have lowered the near-term trajectory of the spot price for West Texas intermediate (WTI) crude, about 30 cents per barrel. We are now assuming that the spot WTI price will hold near current levels through the end of this year and then will move down to a bit below $24 per barrel by the fourth quarter of 2003. This path for oil prices—which is consistent with current quotes in futures markets—is flatter than the one in the May Greenbook but leaves the level of WTI in 2003 about the same as in our previous projection.

On the fiscal side, prospects for the federal budget have deteriorated further since the time of the May Greenbook. Incoming data on tax receipts have continued to run lower than expected. This time, the surprise has been primarily on the corporate side, where refund issuance continued at a brisk pace in May and estimated quarterly tax payments in June were weak. Other tax collections have been weak as well. Although recent readings on spending have been roughly in line with our expectations, we have nudged up our forecast of 2003 spending initiatives, including $5 billion of additional supplemental appropriations and $7 billion to continue the temporary extended unemployment compensation (TEUC) program through the middle of 2003. Mainly because of the lower level of receipts in this projection, we have raised our forecast for the unified budget deficit to $153 billion in fiscal year 2002 and $126 billion in fiscal 2003, compared with our May Greenbook projection of $119 billion and $77 billion, respectively.

Recent Developments and the Near-Term Outlook

As noted above, we are now projecting that real GDP will rise at an annual rate of 1-3/4 percent in the second quarter, after an increase of around 5-1/2 percent in the first quarter. Much of the slowdown relative to the strong first-quarter pace reflects a smaller—albeit still considerable—contribution from inventory investment. Firms in some sectors are continuing to liquidate inventories, and even in sectors in which inventory positions seem in good shape, we think that businesses will be cautious about rebuilding stocks until a recovery in final demand becomes more assured. For final sales, the incoming data have been close to our expectations, and we are forecasting an increase of only 1/2 percent at an annual rate in the current quarter, following a rise of 2 percent (annual rate) in the first quarter.

Our projection of a small increase in economic activity this quarter also appears consistent with recent signals from the labor market. Private payrolls only edged up in April and May, and the unemployment rate has moved up further, on balance, in recent months. Initial claims for unemployment insurance have come down in the past few weeks, the decline partly reflecting the waning

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

Measure	2002:Q2		2002:Q3	
	May GB	June GB	May GB	June GB
Real GDP	**2.0**	**1.8**	**3.2**	**3.3**
Private domestic final purchases	2.5	1.7	2.7	2.6
Personal consumption expenditures	2.8	1.7	2.8	2.6
Residential investment	-.4	2.7	1.5	.3
Business fixed investment	1.8	1.4	2.4	3.4
Government outlays for consumption and investment	1.1	1.9	3.6	3.9
	Contribution to growth, percentage points			
Inventory investment	1.1	1.2	1.1	1.0
Net exports	-1.5	-1.2	-.8	-.6

influence of the TEUC program, but the latest readings are still at levels typically associated with only modest employment gains. Similarly, hours of production or nonsupervisory workers have changed little since the beginning of the year, and for the second quarter, we are projecting aggregate hours to show a small decline. As a result, even the relatively lackluster rise in real GDP that we have penciled in this quarter implies an increase in productivity at an annual rate of about 2-1/4 percent.

Manufacturing output has continued to expand in recent months, though at a somewhat tepid pace by the standard of previous postwar recoveries. Factory output rose 0.2 percent in May, and for the quarter as a whole, we expect manufacturing IP to increase at an annual rate of around 3-1/2 percent, about the same as in the first quarter. Production of high-tech equipment and semiconductors, which rose smartly earlier this year, has decelerated in recent months, and weak demand continues to inhibit the production of communications equipment. Nevertheless, output in other industries now appears to be on an uptrend, and with inventory-shipment ratios down sharply and orders picking up, we anticipate that the pace of production in the industrial sector will strengthen a bit in coming months.

Consumer spending is projected to rise at an annual rate of about 1-3/4 percent this quarter, a little more than half the pace of the first quarter. Sales of cars and light trucks dropped to a rate of 15-1/2 million units in May, leaving the average sales pace so far this quarter roughly the same as that in the first quarter.

However, automakers still seem willing to bolster incentive packages at the first indication of any weakening in demand, and the low level of interest rates seems conducive to sustaining a fairly robust sales pace in coming months; indeed, preliminary reports point to some bounceback in sales in June. Nominal retail sales excluding the sales of light motor vehicles fell 0.4 percent in May, after a 1 percent increase in April; taking price changes into account, the level of real outlays in May looks to be only a little above the first-quarter average. Real spending on services was unchanged in April, and although available indicators point to an increase in May, we are projecting a deceleration in second-quarter outlays from their first-quarter pace.

In the housing sector, activity has moved down from the blistering first-quarter pace, but both starts and sales nevertheless remain at high levels. With mortgage rates down to their lowest levels since last November, financial conditions continue to provide substantial support to housing demand, and thus we anticipate that single-family homebuilding will proceed apace in coming months. In contrast, conditions in the rental apartment market have turned decidedly more negative in recent quarters, which we expect will damp builders' enthusiasm for erecting new multifamily units.

Business fixed investment is anticipated to edge up at an annual rate of just 1-1/2 percent this quarter. On the equipment side, the data on orders and shipments were more positive in April than in earlier months, and pending receipt of the data for May, we are projecting the first increase in spending in more than a year.[1] In contrast, the near-term outlook for nonresidential construction is still bleak. Despite a small upturn in construction spending in April, the fundamentals in this sector are quite soft, with vacancy rates now well above their levels of a year ago and rents and property values significantly lower. As a result, we are projecting real spending in this sector to decline for the quarter as a whole.

Inventory holdings are projected to edge up in the second quarter, after more than a year of liquidation. Outside the motor vehicle sector, firms continued to draw down their stocks in April. However, the pace of liquidation was slower than in the first quarter, and we anticipate that inventories will begin to turn up in coming months. Motor vehicle stocks rose somewhat in April and May from the very low levels of the previous two quarters, boosting days' supply for light vehicles back to more typical levels. All told, the change in inventory investment is projected to contribute 1-1/4 percentage points to GDP growth this

1. Our tentative reading of the annual revision to the orders and shipments data that was released yesterday did not necessitate any changes in the near-term outlook for equipment and software.

quarter, a little more than one-third of its contribution to growth in the first quarter.

In the government sector, real federal expenditures on consumption and gross investment are projected to rise at an annual rate of 5-3/4 percent in the second quarter, down from double-digit increases in each of the two preceding quarters. Incoming data point to a sharp deceleration in defense spending; in contrast, nondefense spending is projected to increase sharply this quarter, after a small decline in the first quarter. Meanwhile, state and local spending is projected to be about flat this quarter, as construction spending steps down from its high level in the first quarter and revenue shortfalls induce governments to keep a tight rein on hiring.

Net exports are forecast to make a negative arithmetic contribution of about 1-1/4 percentage points to the change in real GDP this quarter, a slightly larger drag than that in the first quarter. Despite the sharp slowing in domestic demand, real imports are anticipated to post another substantial rise this quarter. Real exports are projected to move higher as well, although by a smaller amount than imports.

We are projecting that PCE prices will rise at an annual rate of 2-1/2 percent in the second quarter, considerably faster than in the first quarter. Much of this acceleration reflects the steep rise in energy prices earlier this spring; gasoline prices jumped nearly 10 percent in April, and prices for both natural gas and heating fuel posted sizable increases in April and May. With crude oil prices having now fallen considerably from their recent peaks and retail margins starting to narrow, gasoline prices turned down in May, and we are expecting declines in both gasoline and fuel oil prices in the next couple of months. The incoming data on core inflation have been running a bit higher than we were anticipating, and we have nudged up our projected increase in core PCE prices this quarter by 1/2 percentage point, to an annual rate of 1-3/4 percent. In contrast, increases in average hourly earnings have been small in recent months, and this wage measure is now expected to rise at an annual rate of only 2-1/4 percent this quarter, about 1 percentage point less than we forecast in May.

The Longer-Term Outlook for the Economy

Our longer-term projection is not fundamentally different from that in the May Greenbook. With monetary and fiscal policy providing considerable stimulus to the economy, we anticipate that the pace of household and business spending will pick up over the next six quarters, boosting the rate of increase in real GDP to more than 4 percent in 2003. We continue to expect that spending growth in a number of sectors will be subpar compared with the typical postwar recovery period, but this is not surprising given that the decline was not as steep as the average. Changes in the assumed paths of the stock market and the dollar add a

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

Measure	2002 H1	2002 H2	2003
Real GDP	**3.6**	**3.4**	**4.1**
Previous	3.9	3.5	4.2
Final sales	1.3	3.0	3.6
Previous	1.7	2.8	3.7
PCE	2.5	2.8	3.1
Previous	3.2	3.0	3.4
Residential investment	8.9	.7	-.1
Previous	7.7	1.6	-1.2
BFI	-3.3	5.1	11.1
Previous	-1.8	5.6	12.0
Government purchases	4.2	4.1	3.8
Previous	4.0	3.9	3.8
Exports	5.3	7.9	8.4
Previous	6.2	6.7	7.6
Imports	13.4	8.3	9.2
Previous	15.6	9.8	10.3
	Contribution to growth, percentage points		
Inventory change	2.3	.5	.5
Previous	2.2	.7	.5
Net exports	-1.2	-.4	-.5
Previous	-1.3	-.7	-.7

few wrinkles to this projection but, taken together, do not materially alter our basic outlook. In particular, the lower path for equity prices places a bit more restraint on domestic demand over the forecast period, while the depreciating dollar trims the projected drag from the external sector.

Household spending. We have pared our projection for consumer spending in this Greenbook to reflect the lower levels of wealth in this forecast and the effects of the anticipated increases in import prices on real income growth. All told, personal consumption expenditures are projected to rise at an annual rate of around 2-3/4 percent over the second half of this year and then to increase slightly more than 3 percent in 2003.

Despite the negative influences mentioned above, the general outlook for consumer spending remains relatively upbeat. With a projected pickup in hiring, income gains are anticipated to be well maintained over the projection period, and the strong underlying trend in productivity should help sustain households' optimism about prospective income growth; in addition, credit markets are anticipated to be receptive to consumers' financing needs. By category, spending on durables is projected to increase at an annual rate of 5-1/4 percent over the next six quarters, as sizable incentive packages allow automakers to maintain a robust pace of motor vehicle sales, and ongoing price declines and favorable financing terms spur purchases of other durable goods. Outlays for nondurables and services are anticipated to rise at annual rates of less than 3 percent over the forecast period, leaving these increases a touch below the projected growth rate in real disposable personal income.

Homebuilding is anticipated to remain at a high level over the forecast period, as low mortgage rates and an improving employment situation offset the negative influences of a weak stock market. Single-family starts are projected to average about 1.36 million units at an annual rate over the next six quarters, up from 1.27 million units in 2001. Given the somewhat less optimistic outlook for the rental segment of the market, multifamily starts are projected to run at an annual rate of about 320,000 units over the forecast period, a bit less than in 2001.

Business fixed investment. Demand for capital equipment is projected to pick up over the next six quarters, with spending on equipment and software anticipated to rise at an annual rate of 7-1/2 percent over the second half of this year and 13-1/2 percent in 2003. As in previous Greenbooks, equipment investment generally is expected to be supported by the improving outlook for sales and profits, by low financing costs, and increasingly by the partial expensing tax incentive that the Congress passed earlier this year.

Nevertheless, the prospects for investment spending differ somewhat across the various categories of equipment. Real expenditures for computers and software have already turned up noticeably, and we expect a further acceleration in 2003, as the economic recovery induces more firms to replace outdated machines held over during the recession and encourages additional outlays for new applications. Though some of this strength is also likely to spill over to related components of communications equipment, the demand for telecom-related equipment remains very weak, and overall we expect business spending on communications equipment to edge down a bit further over the second half of this year, before rising at a moderate pace in 2003.

Outside the high-tech sector, business spending on motor vehicles is projected to rise briskly in the near-term owing to a surge in demand for heavy trucks in advance of new environmental regulations scheduled to be implemented this fall; thereafter, the pace of motor vehicle outlays is supported by a pickup in fleet sales and leasing activity and by the anticipated recovery in manufacturing activity and associated transportation needs. In contrast, demand for aircraft is projected to remain weak throughout the projection period. Excluding the high-tech and transportation sectors, investment spending is anticipated to pick up from an increase of 4-1/4 percent this year to a rise of nearly 11 percent next year, reflecting the projected acceleration in business output and the effect of the tax incentive.

Investment in nonresidential structures is projected to remain on a downtrend through the end of this year and then to rise only 4 percent in 2003. Outlays for industrial buildings are likely to remain especially weak given the current high vacancy rates and the relatively low levels of capacity utilization expected to persist through next year. Excess space and falling rents and property values also seem likely to discourage development of new office buildings, and we are not anticipating any upturn in that sector until the middle of 2003. In contrast, construction of commercial space is projected to pick up over the next six quarters, supported by increases in retail spending, new residential construction on the perimeters of major metropolitan areas, and rising demand by wholesalers and large retailers for “smart” warehouse space.

Inventory investment. We expect that firms will have largely completed their inventory liquidations by the end of the second quarter and then, as they become more persuaded of the sustainability of the recovery in final sales, will gradually rebuild stocks. As a result, inventory investment is projected to make positive contributions to real GDP growth averaging around 1/2 percentage point per quarter over the forecast period. Even so, we expect that aggregate inventory-sales ratios will remain on a downward trajectory through the middle of next year before leveling off in the second half.

Government spending. We have not made any material changes to our longer-term projection of government spending in this Greenbook. Federal consumption and investment expenditures are projected to increase at an annual rate of about 5-3/4 percent in real terms over the second half of this year and to rise 3-1/2 percent in 2003. At the state and local level, spending is expected to rise at an annual rate of just over 3 percent in the second half of this year, reflecting the relatively stringent budget positions faced by many states and localities. With the stronger economy expected to improve the fiscal positions of many state and local jurisdictions over time, the pace of spending is projected to pick up to 4 percent in 2003.

Net exports. Supported by the assumed depreciation of the dollar and rising activity abroad, real exports are projected to increase at an average annual rate of about 8-1/4 percent over the next six quarters, roughly 1 percentage point faster than forecast in the May Greenbook. The change to our dollar assumptions also reduces the anticipated increase in real imports to an annual rate of 9 percent over the projection period—about 1 percentage point slower than we previously forecast. Nevertheless, the arithmetic contribution to real GDP from the external sector still is expected to be negative over the remainder of this year and in 2003, albeit less so than we previously projected by about 1/4 percentage point. *(The International Developments section provides more detail on the outlook for the external sector.)*

Aggregate Supply, the Labor Market, and the Prospects for Inflation

As noted in the introduction, our projection of structural productivity growth and potential output is roughly the same as it was in the May Greenbook. After being held down a bit this year by the diversion of resources to address security concerns, structural multifactor productivity growth is projected to pick up to around 1-1/2 percent in 2003. Moreover, increases in the pace of business investment are expected to boost the rate of capital deepening next year. Taken together, these factors produce a sizable pickup in structural labor productivity growth, from 2 percent in 2002 to 2-1/2 percent in 2003. Commensurately, we forecast gains in potential output of 3 percent this year and 3-1/2 percent next year.

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

Measure	1973-95	1996-98	1999	2000	2001	2002	2003
Structural labor productivity	**1.4**	**2.4**	**2.9**	**3.0**	**2.3**	**2.0**	**2.5**
Previous	1.4	2.4	2.9	3.0	2.3	2.0	2.6
Contributions[1]							
Capital deepening	.6	1.2	1.4	1.4	.6	.4	.8
Previous	.6	1.2	1.4	1.4	.6	.4	.9
Multifactor productivity	.6	.9	1.3	1.4	1.4	1.3	1.5
Previous	.6	.9	1.3	1.4	1.4	1.3	1.5
Labor composition	.3	.3	.3	.3	.3	.3	.3
MEMO							
Potential GDP	2.9	3.7	4.1	4.0	3.1	2.9	3.4
Previous	2.9	3.7	4.1	4.0	3.1	2.9	3.5

NOTE. Components may not sum to totals because of rounding.
1. Percentage points.

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

Measure	2000	2001	2002	2003
Output per hour, nonfarm business	2.6	2.1	3.1	1.8
Previous	2.6	2.0	2.4	2.4
Nonfarm private payroll employment	1.6	-1.4	.4	2.3
Previous	1.8	-1.1	1.1	2.1
Household employment survey	1.0	-1.0	.6	1.6
Previous	1.0	-1.0	.9	1.5
Labor force participation rate[1]	67.1	66.9	66.9	66.9
Previous	67.1	66.9	66.9	66.9
Civilian unemployment rate[1]	4.0	5.6	5.9	5.5
Previous	4.0	5.6	5.7	5.4

1. Percent, average for the fourth quarter.

Productivity and the labor market. We continue to regard the extraordinary productivity gains reported in the first half of this year, in part, as an indication that firms have been reluctant to speed up their hiring until they become more convinced that the economic recovery will not falter. However, we expect that, as the sales and profits outlook continues to improve, firms will move more aggressively to bring their labor resources into line with their anticipated longer-run needs. And as they do so, productivity growth should drop back from its recent torrid pace to average 1 percent in the second half of this year. With the level of productivity still well above our estimated trend, output per hour is anticipated to increase about 1-3/4 percent in 2003, roughly 3/4 percentage point less than its structural growth rate.

In the labor market, we are expecting a pickup in the pace of hiring over the remainder of this year. Specifically, after an increase of 75,000 in June, private payroll employment gains are now anticipated to average around 150,000 per month in the third quarter and 200,000 per month in the fourth quarter. Next year, private employment gains are projected to average around 210,000 per month.

The unemployment rate is projected to rise a bit further in the near term and then to trend down gradually to around 5-1/2 percent by the end of 2003. This path for the unemployment rate is a touch higher than that in the May Greenbook, reflecting the slower pace of employment growth in this projection and the effects of our assumed extension of the TEUC program on job search efforts in the first half of 2003.

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

Measure	2000	2001	2002	2003
PCE chain-weighted price index	2.6	1.3	1.5	1.4
Previous	2.6	1.3	1.5	1.3
Food and beverages	2.5	3.2	1.7	2.1
Previous	2.5	3.2	1.9	2.0
Energy	15.4	-9.9	3.0	-.9
Previous	15.4	-9.9	4.6	-1.7
Excluding food and energy	1.9	1.6	1.4	1.4
Previous	1.9	1.6	1.2	1.3
Consumer price index	3.4	1.9	2.1	1.9
Previous	3.4	1.9	2.3	1.8
Excluding food and energy	2.5	2.7	2.3	2.1
Previous	2.5	2.7	2.2	2.0
GDP chain-weighted price index	2.4	1.9	1.2	1.5
Previous	2.4	1.9	1.4	1.4
ECI for compensation of private industry workers[1]	4.4	4.2	3.5	3.5
Previous	4.4	4.2	3.5	3.5
NFB compensation per hour	7.8	3.9	3.0	3.4
Previous	7.8	3.9	3.0	3.4
Prices of core non-oil merchandise imports	1.6	-3.1	1.9	2.7
Previous	1.6	-3.1	.3	2.7

1. December to December.

Wages and prices. Given the slack in labor and product markets that has opened up over the past year, we anticipate that wage and core price increases will be somewhat smaller in 2002 and 2003 than in 2001. However, we have raised our inflation forecast a bit to reflect the lower dollar's effect on import prices.

After having risen sharply this spring, energy prices are projected to fall at an annual rate of roughly 1 percent over the next six quarters. The assumed decline in crude oil prices is anticipated to put downward pressure on wholesale gasoline prices; in addition, retail margins, which widened considerably in recent months, are expected to return gradually to more normal levels. In contrast, natural gas prices are projected to increase over the forecast period, reflecting the stronger economy and the generally subdued pace of gas production.

Core PCE inflation is anticipated to slow to 1.4 percent in both 2002 and 2003, compared with 1.6 percent in 2001; the market-based core PCE measure shows a slightly greater disinflation over this period, from 1.7 percent in 2001 to 1.3 percent in 2003. As in recent Greenbooks, the expected deceleration is due primarily to the projected slack in resource utilization. Aggregate measures of consumer price inflation are boosted a little this year by the recent jump in energy prices. Next year, however, the overall PCE price index is projected to rise at the same rate as the core index.

Reflecting labor market slack and modest price increases, the employment cost index is projected to rise 3-1/2 percent both this year and next, down from a 4-1/4 percent increase in 2001. Increases in wages and salaries in recent quarters have been relatively modest, and we expect a further deceleration over the projection period. Moreover, the benefits component of the index is likely to be held down this year by a sharp decline in cash bonuses. In contrast, employer costs for health insurance are anticipated to rise at double-digit rates both this year and next, despite actions by employers to shift some of these added health care expenses onto their workers.

Financial Flows and Conditions

Domestic nonfinancial debt is projected to expand about 6 percent in 2002 and 5-3/4 percent in 2003, modestly outpacing the growth rate of nominal GDP.

Federal debt is projected to increase about 6-1/2 percent in 2002—a sizable shift from the decreases observed in recent years—as a result of surprising weakness in incoming tax receipts, significant increases in outlays, and the effects of tax cuts. We expect federal debt to continue to expand in 2003, although less rapidly, as tax receipts increase with the expansion in economic activity. In addition, we project that state and local government debt will grow at a moderate pace over the forecast period, driven largely by the need to finance construction of new schools and highways.

Nonfinancial business debt is projected to rise 3-1/2 percent over 2002—more than 1 percentage point below the forecast in the May Greenbook and the slowest pace observed since 1993. Given their large holdings of liquid assets and the rebound in profits, firms reduced their borrowing considerably over the first half of this year. The decline in borrowing may also reflect efforts by firms to reduce their reliance on short-term debt and to scale back their overall leverage amid heightened concerns about corporate balance sheets. Nevertheless, the staff anticipates that business borrowing will recover fairly quickly, as investors' concerns wane and a step-up in inventory investment and capital spending causes the financing gap to widen.

Household borrowing is projected to slow modestly from its pace in recent years. Consumer credit is expected to expand at an annual rate of 5-3/4 percent through 2003, reflecting the rise in spending on durables in our forecast. We anticipate that households will continue to take on mortgage debt at a rapid clip because of the relatively low level of mortgage rates and the buoyancy of housing activity in our forecast; mortgage debt is projected to expand at an average annual rate of 8 percent through 2003. The robust pace of borrowing causes the household debt service burden to move up further over the forecast period, although we do not expect this increase to show through to a deterioration in household credit quality.

M2 bounced back sharply in May from the run-off in April, as temporary tax-related effects unwound. M2 is projected to rise slightly faster on average over 2002 than nominal spending, consistent with last year's drop in opportunity costs. By next year, with policy tightening under way and opportunity costs widening, M2 should expand somewhat less than nominal GDP.

Alternative Simulations

In this section we use model simulations to examine several important risks to the Greenbook forecast. In the first simulation, we consider the effects of a sizable decline in equity prices prompted by investor disappointment with corporate earnings. Our second scenario builds on the first by assuming that the earnings disappointment is coupled with downward revisions to firms' expectations about the profitability of investment, leading them to revise down their capital spending plans. The next two simulations involve policy risks—specifically, the chance that federal government spending will turn out to be higher than we project and the risk that the current low level of the funds rate will impart more economic stimulus than we have estimated. The final two scenarios examine the effects of more favorable supply-side conditions, as illustrated by faster structural productivity growth and a lower NAIRU. In all the simulations, the nominal federal funds rate is assumed to remain unchanged at its baseline path.

Stock market decline. Our forecast for corporate profits later this year and next is weaker than the consensus view, even after accounting for the usual upward bias of private analysts. If investors share analysts' views, they will be disappointed to see the earnings growth we expect, which, in turn, would create the risk of a sharp markdown in long-run profit expectations and share prices. In this scenario, we assume that such disappointment does in fact emerge over the next few months, leading to a 20 percent decline in the value of the stock market by year-end. Because investors see this weakness as signaling an easier

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

Measure	2002 Q1	2002 Q2	2002 H2	2003
Real GDP				
Baseline	**5.5**	**1.8**	**3.4**	**4.1**
Stock market decline	5.5	1.8	3.3	3.4
Business disappointment	5.5	1.8	2.9	2.6
Higher government spending	5.5	1.8	3.6	4.6
Permanently higher government spending	5.5	1.8	3.5	4.4
Higher equilibrium real interest rate	5.5	1.8	3.8	4.7
Stronger productivity	5.5	1.8	3.9	5.5
Low NAIRU	5.5	1.9	3.7	4.3
Civilian unemployment rate[1]				
Baseline	**5.6**	**5.9**	**5.9**	**5.5**
Stock market decline	5.6	5.9	5.9	5.8
Business disappointment	5.6	5.9	6.0	6.2
Higher government spending	5.6	5.9	5.9	5.2
Permanently higher government spending	5.6	5.9	5.9	5.3
Higher equilibrium real interest rate	5.6	5.9	5.8	5.1
Stronger productivity	5.6	5.9	6.0	5.5
Low NAIRU	5.6	5.9	5.8	5.2
PCE prices excluding food and energy				
Baseline	**1.0**	**1.7**	**1.4**	**1.4**
Stock market decline	1.0	1.7	1.4	1.4
Business disappointment	1.0	1.7	1.4	1.4
Higher government spending	1.0	1.7	1.4	1.4
Permanently higher government spending	1.0	1.7	1.4	1.4
Higher equilibrium real interest rate	1.0	1.7	1.4	1.6
Stronger productivity	1.0	1.7	1.4	1.0
Low NAIRU	1.0	1.6	1.2	1.0

1. Average for the final quarter of the period.

future stance of monetary policy, bond rates fall over the same period about 35 basis points. These financial market developments would cut real GDP growth 3/4 percentage point in 2003 and cause the unemployment rate to remain close to 6 percent through the end of next year. The resulting increase in slack is too slight and occurs too late to have a noticeable effect on inflation over the forecast period, but it would have a more appreciable impact in subsequent years.

Business disappointment. Another risk is that firms as well as investors will find the baseline earnings projection more disappointing than we anticipate. This broader disappointment would exacerbate the worsening of economic conditions by causing a greater downward revision in business capital spending plans than any that falling share prices alone might prompt. In this simulation, we combine the financial developments of the first scenario with a delay until mid-2003 year in the recovery of high-tech investment, which is anticipated to lead the upturn in capital spending in our baseline forecast; spending on other equipment is also assumed to be scaled back. In all, next year's growth in E&S outlays is cut in half. Under these conditions, real GDP grows only 2-1/2 percent in 2003, and the unemployment rate rises to 6-1/4 percent by year-end. Inflation is about the same as in the baseline because the additional labor market slack is offset by less capital deepening and slower structural productivity growth.

Higher government spending. We expect that fiscal policy will continue to be expansionary through next year. However, another risk to the baseline forecast is that domestic security concerns and other pressures may spur even more government spending than we have projected. In this scenario, we assume that, relative to the baseline, federal purchases are almost $30 billion higher in FY2003 and more than $70 billion higher in FY2004. Assuming that investors do not see the increased spending as signaling a change in the long-run budget position, bond yields are little affected by the fiscal policy. As a result, real GDP grows 1/4 percentage point faster in the second half of 2002 and 1/2 percentage point faster in 2003, causing the unemployment rate to fall to 5-1/4 percent. However, were investors to see the fiscal package as the first installment of an erosion in long-term fiscal discipline, they would also come to expect tighter monetary policy in future years. Bond yields, jumping upon this realization, would temper the increase in GDP. For example, the "Permanently higher government spending" simulation assumes that bond rates increase 1/4 percentage point, which would shave 0.2 percentage point off the added output growth in 2003.

Higher equilibrium real interest rate. In the baseline forecast, we have assumed that the current and projected low level of the real funds rate will be consistent with only a modest pickup in activity, because various factors (such as the slump in the high-tech sector) are restraining the economy. Were these factors to dissipate more rapidly than we have assumed, economic growth would be more robust than in the baseline. These circumstances would suggest that the economy's equilibrium real interest rate is higher than the value implied in the Greenbook (2.2 percent). In this scenario we assume that the equilibrium rate is at its historical average of 2-3/4 percent. Under this assumption, and with no change in the actual funds rate, real GDP would increase 4-3/4 percent in 2003. As a result, the unemployment rate would fall to 5 percent by late next year, and inflation would begin to drift up (in part because of a deterioration in inflation expectations associated with the effectively easier stance of monetary policy).

Stronger productivity. We have been cautious in translating recent gains in output per hour into higher structural productivity growth. This scenario considers the implications of assuming that trend growth in multifactor productivity moves up over the first four quarters of the forecast period to a pace that is a full percentage point faster than assumed in the baseline forecast. The acceleration in productivity implies stronger long-run growth in both corporate earnings and household income, and thus business investment and consumer spending increase faster than in the baseline forecast. Because we have assumed that current valuations already incorporate the stronger pace of productivity growth, the stock market is little changed and thus does not provide an additional boost to aggregate demand. Under these conditions, real GDP growth reaches 5-1/2 percent in 2003, about in line with the increase in potential output, leaving the unemployment rate little affected. Core inflation falls to 1 percent next year because of the deceleration in unit labor costs.

Low NAIRU. Our final scenario considers the possibility that the staff's estimate of the NAIRU may be too high and, as an alternative, assumes that the NAIRU is currently—and has been for some time—4-1/4 percent. Owing to its implications for the level of potential output, this lower NAIRU puts significant downward pressure on inflation and provides a slight boost to GDP.

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

Interval		Nominal GDP		Real GDP		GDP chain-weighted price index		Consumer price index[1]		Unemployment rate[2]	
		05/01/02	06/19/02	05/01/02	06/19/02	05/01/02	06/19/02	05/01/02	06/19/02	05/01/02	06/19/02
ANNUAL											
1999		5.5	5.5	4.1	4.1	1.4	1.4	2.2	2.2	4.2	4.2
2000		6.5	6.5	4.1	4.1	2.3	2.3	3.4	3.4	4.0	4.0
2001		3.4	3.4	1.2	1.2	2.2	2.2	2.8	2.8	4.8	4.8
2002		3.9	3.6	2.6	2.5	1.2	1.1	1.7	1.5	5.8	5.9
2003		5.4	5.2	3.8	3.7	1.5	1.4	1.9	2.0	5.5	5.7
QUARTERLY											
2000	Q1	6.3	6.3	2.3	2.3	3.8	3.8	3.9	3.9	4.0	4.0
	Q2	8.0	8.0	5.7	5.7	2.1	2.1	3.3	3.3	4.0	4.0
	Q3	3.3	3.3	1.3	1.3	1.9	1.9	3.5	3.5	4.1	4.1
	Q4	3.7	3.7	1.9	1.9	1.8	1.8	2.8	2.8	4.0	4.0
2001	Q1	4.6	4.6	1.3	1.3	3.3	3.3	4.0	4.0	4.2	4.2
	Q2	2.4	2.4	0.3	0.3	2.1	2.1	3.2	3.2	4.5	4.5
	Q3	0.9	0.9	-1.3	-1.3	2.3	2.3	0.7	0.7	4.8	4.8
	Q4	1.5	1.5	1.7	1.7	-0.1	-0.1	-0.2	-0.2	5.6	5.6
2002	Q1	6.7	6.6	5.8	5.5	0.8	1.1	1.4	1.4	5.6	5.6
	Q2	4.1	3.2	2.0	1.8	2.1	1.3	4.0	3.4	5.9	5.9
	Q3	4.6	4.3	3.2	3.3	1.3	0.9	2.0	1.7	5.9	6.0
	Q4	5.4	4.9	3.9	3.5	1.4	1.4	1.7	2.1	5.7	5.9
2003	Q1	6.0	5.8	4.1	4.0	1.8	1.8	1.7	1.9	5.6	5.9
	Q2	5.5	5.5	4.1	4.1	1.3	1.4	1.8	1.9	5.5	5.7
	Q3	5.6	5.6	4.2	4.2	1.3	1.4	1.8	1.9	5.5	5.6
	Q4	5.6	5.6	4.2	4.2	1.4	1.4	1.9	1.9	5.4	5.5
TWO-QUARTER[3]											
2000	Q2	7.2	7.2	4.0	4.0	2.9	2.9	3.6	3.6	-0.1	-0.1
	Q4	3.5	3.5	1.6	1.6	1.8	1.8	3.3	3.3	0.0	0.0
2001	Q2	3.5	3.5	0.8	0.8	2.7	2.7	3.5	3.5	0.5	0.5
	Q4	1.2	1.2	0.1	0.1	1.1	1.1	0.2	0.2	1.1	1.1
2002	Q2	5.4	4.9	3.9	3.6	1.4	1.2	2.7	2.4	0.3	0.3
	Q4	5.0	4.6	3.5	3.4	1.4	1.2	1.9	1.9	-0.2	0.0
2003	Q2	5.7	5.7	4.1	4.0	1.5	1.6	1.8	1.9	-0.2	-0.2
	Q4	5.6	5.6	4.2	4.2	1.4	1.4	1.8	1.9	-0.1	-0.2
FOUR-QUARTER[4]											
1999	Q4	6.0	6.0	4.4	4.4	1.6	1.6	2.6	2.6	-0.3	-0.3
2000	Q4	5.3	5.3	2.8	2.8	2.4	2.4	3.4	3.4	-0.1	-0.1
2001	Q4	2.3	2.3	0.5	0.5	1.9	1.9	1.9	1.9	1.6	1.6
2002	Q4	5.2	4.7	3.7	3.5	1.4	1.2	2.3	2.1	0.1	0.3
2003	Q4	5.7	5.6	4.2	4.1	1.4	1.5	1.8	1.9	-0.3	-0.4

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

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

June 20, 2002

Item	Units[1]	1995	1996	1997	1998	1999	2000	2001	- - Projected - - 2002	2003
EXPENDITURES										
Nominal GDP	Bill. $	7400.5	7813.2	8318.4	8781.5	9268.6	9872.9	10208.1	10577.3	11127.5
Real GDP	Bill. Ch. $	7543.8	7813.2	8159.5	8508.9	8856.5	9224.0	9333.8	9566.7	9924.1
Real GDP	% change	2.2	4.1	4.3	4.8	4.4	2.8	0.5	3.5	4.1
Gross domestic purchases		1.7	4.3	5.0	5.8	5.3	3.5	0.4	4.2	4.4
Final sales		2.9	3.9	3.9	4.7	4.3	3.4	2.0	2.1	3.6
Priv. dom. final purchases		3.2	4.4	5.1	6.3	5.4	4.7	1.2	2.5	3.9
Personal cons. expenditures		2.8	3.1	4.1	5.0	5.2	4.2	3.1	2.6	3.1
Durables		3.7	5.0	8.8	12.7	11.3	5.3	13.6	1.2	5.4
Nondurables		2.5	3.2	2.5	5.0	5.0	3.6	1.4	2.8	2.7
Services		2.7	2.7	3.9	3.6	4.0	4.3	1.9	2.9	2.8
Business fixed investment		7.5	12.1	11.8	12.3	7.4	8.9	-9.4	0.8	11.1
Equipment & Software		8.9	11.8	13.7	14.9	11.2	8.3	-8.5	4.2	13.4
Nonres. structures		3.3	12.8	6.5	4.9	-3.6	10.8	-11.8	-8.9	3.9
Residential structures		-1.5	5.6	3.5	10.0	3.4	-1.2	2.9	4.8	-0.1
Exports		9.7	9.8	8.5	2.3	4.5	7.0	-10.9	6.6	8.4
Imports		5.0	11.2	14.3	10.8	11.5	11.3	-8.5	10.8	9.2
Gov't. cons. & investment		-0.8	2.7	2.4	2.7	4.0	1.2	5.1	4.1	3.8
Federal		-5.3	2.0	0.1	0.6	4.5	-1.4	4.9	7.2	3.5
Defense		-4.7	0.8	-1.4	-0.8	4.7	-2.2	5.5	7.8	3.4
State & local		2.1	3.0	3.7	3.8	3.7	2.5	5.2	2.6	4.0
Change in bus. inventories	Bill. Ch. $	--	--	63.8	76.7	62.1	50.6	-61.7	8.8	70.8
Nonfarm		41.9	21.2	60.6	75.0	63.5	52.3	-59.0	9.9	69.6
Net exports		-78.4	-89.0	-113.3	-221.1	-316.9	-399.1	-408.7	-480.3	-542.0
Nominal GDP	% change	4.3	6.0	6.2	6.0	6.0	5.3	2.3	4.7	5.6
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employment	Millions	117.2	119.6	122.7	125.9	128.9	131.7	131.9	131.1	133.7
Unemployment rate	%	5.6	5.4	4.9	4.5	4.2	4.0	4.8	5.9	5.7
Industrial prod. index	% change	3.5	5.8	7.4	3.5	4.3	2.6	-5.9	4.0	5.2
Capacity util. rate - mfg.	%	82.6	81.6	82.7	81.4	80.6	80.7	75.1	74.4	77.3
Housing starts	Millions	1.35	1.48	1.47	1.62	1.64	1.57	1.60	1.68	1.68
Light motor vehicle sales		14.77	15.05	15.06	15.43	16.78	17.25	17.03	16.58	17.19
North Amer. produced		12.87	13.34	13.12	13.41	14.30	14.39	13.95	13.24	13.77
Other		1.90	1.70	1.93	2.02	2.48	2.86	3.08	3.33	3.42
INCOME AND SAVING										
Nominal GNP	Bill. $	7420.9	7831.2	8325.4	8778.1	9261.8	9860.8	10202.8	10580.1	11136.1
Nominal GNP	% change	4.4	5.9	6.0	5.8	6.0	5.4	2.4	4.7	5.5
Nominal personal income		4.3	5.9	6.3	6.7	4.8	7.3	2.9	4.5	5.4
Real disposable income		1.7	2.6	3.8	5.0	2.1	4.0	2.1	5.5	2.9
Personal saving rate	%	5.6	4.8	4.2	4.7	2.4	1.0	1.6	3.2	3.2
Corp. profits, IVA & CCAdj.	% change	11.3	11.4	9.9	-9.6	11.3	-1.2	-3.0	8.6	4.4
Profit share of GNP	%	9.0	9.6	10.0	8.9	8.9	8.9	7.5	8.2	8.2
Excluding FR Banks		8.7	9.4	9.7	8.6	8.6	8.6	7.2	8.0	8.0
Federal surpl./deficit	Bill. $	-192.0	-136.8	-53.3	43.8	119.2	218.6	119.0	-81.2	7.5
State & local surpl./def.		15.3	21.4	31.0	40.7	42.1	32.8	17.6	23.6	36.7
Ex. social ins. funds		11.4	18.7	29.9	40.0	41.7	33.1	17.7	23.9	37.0
Gross natl. saving rate	%	16.9	17.2	18.0	18.8	18.4	18.1	17.1	16.9	17.7
Net natl. saving rate		5.1	5.7	6.7	7.5	6.8	6.3	4.4	4.2	5.0
PRICES AND COSTS										
GDP chn.-wt. price index	% change	2.1	1.9	1.8	1.1	1.6	2.4	1.9	1.2	1.5
Gross Domestic Purchases chn.-wt. price index		2.1	1.9	1.4	0.8	1.9	2.5	1.1	1.5	1.5
PCE chn.-wt. price index		2.1	2.3	1.5	1.1	2.0	2.6	1.3	1.5	1.4
Ex. food and energy		2.3	1.8	1.7	1.6	1.5	1.9	1.6	1.4	1.4
CPI		2.6	3.2	1.9	1.5	2.6	3.4	1.9	2.1	1.9
Ex. food and energy		3.1	2.6	2.2	2.3	2.1	2.5	2.7	2.3	2.1
ECI, hourly compensation[2]		2.6	3.1	3.4	3.5	3.4	4.4	4.2	3.5	3.5
Nonfarm business sector										
Output per hour		1.1	2.3	2.3	2.9	2.9	2.6	2.1	3.1	1.8
Compensation per Hour		2.6	3.2	3.5	5.3	4.5	7.8	3.9	3.0	3.4
Unit labor cost		1.5	0.9	1.1	2.3	1.5	5.0	1.7	-0.3	1.6

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

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

June 20, 2002

Item	Units	1999 Q1	1999 Q2	1999 Q3	1999 Q4	2000 Q1	2000 Q2	2000 Q3	2000 Q4	2001 Q1	2001 Q2
EXPENDITURES											
Nominal GDP	Bill. $	9093.1	9161.4	9297.4	9522.5	9668.7	9857.6	9937.5	10027.9	10141.7	10202.6
Real GDP	Bill. Ch. $	8733.5	8771.2	8871.5	9049.9	9102.5	9229.4	9260.1	9303.9	9334.5	9341.7
Real GDP	% change	3.1	1.7	4.7	8.3	2.3	5.7	1.3	1.9	1.3	0.3
Gross domestic purchases		4.8	2.9	5.3	8.2	3.5	6.3	2.0	2.2	0.7	0.4
Final sales		3.0	3.9	4.2	6.1	4.8	3.9	2.3	2.4	4.0	0.7
Priv. dom. final purchases		5.3	5.9	4.9	5.5	7.5	4.6	3.9	2.6	2.8	-0.0
Personal cons. expenditures		4.9	5.7	4.4	5.7	5.9	3.6	4.3	3.1	3.0	2.5
Durables		7.1	15.7	9.0	13.7	19.0	-2.5	8.2	-2.1	10.6	7.0
Nondurables		5.6	4.3	2.6	7.6	5.1	4.7	4.2	0.6	2.4	0.3
Services		4.1	4.5	4.3	3.2	3.7	4.4	3.5	5.6	1.8	2.8
Business fixed investment		6.0	7.7	10.2	5.8	15.8	12.2	7.1	1.0	-0.2	-14.6
Equipment & Software		10.5	11.9	16.2	6.4	18.1	12.4	4.7	-1.1	-4.1	-15.4
Nonres. structures		-6.5	-4.3	-7.0	4.0	8.8	11.8	15.2	7.6	12.3	-12.2
Residential structures		10.3	3.0	-0.8	1.6	8.5	-0.8	-10.4	-1.1	8.5	5.9
Exports		-6.8	4.2	9.7	12.1	9.0	13.5	10.6	-4.0	-1.2	-11.9
Imports		8.4	13.3	13.8	10.5	17.1	16.4	13.0	-0.5	-5.0	-8.4
Gov't. cons. & investment		2.0	1.2	4.4	8.5	-1.1	4.4	-1.8	3.3	5.3	5.0
Federal		-3.7	0.8	7.2	14.5	-12.8	15.9	-10.4	4.6	3.2	1.8
Defense		-3.5	-3.5	12.8	14.3	-20.0	15.4	-10.4	10.5	7.5	2.3
State & local		5.2	1.4	2.9	5.4	5.6	-1.1	3.0	2.7	6.4	6.6
Change in bus. inventories	Bill. Ch. $	83.4	32.7	39.6	92.7	28.9	78.9	51.7	42.8	-27.1	-38.3
Nonfarm		78.7	34.2	52.2	88.7	37.8	75.1	56.6	39.7	-27.3	-35.8
Net exports		-283.0	-313.4	-333.3	-337.8	-371.1	-392.8	-411.2	-421.1	-404.5	-406.7
Nominal GDP	% change	4.9	3.0	6.1	10.0	6.3	8.0	3.3	3.7	4.6	2.4
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	127.8	128.5	129.2	130.1	131.0	131.8	131.9	132.2	132.4	132.2
Unemployment rate	%	4.3	4.3	4.2	4.1	4.0	4.0	4.1	4.0	4.2	4.5
Industrial prod. index	% change	3.6	3.3	4.7	5.8	5.8	7.0	0.6	-2.6	-6.1	-5.9
Capacity util. rate - mfg.	%	80.5	80.4	80.5	81.0	81.2	81.6	80.7	79.1	77.2	75.6
Housing starts	Millions	1.71	1.57	1.65	1.66	1.66	1.59	1.50	1.54	1.61	1.62
Light motor vehicle sales		16.17	16.76	17.06	17.11	18.13	17.27	17.30	16.32	16.89	16.65
North Amer. produced		13.87	14.32	14.58	14.41	15.25	14.40	14.47	13.45	13.96	13.62
Other		2.30	2.44	2.47	2.70	2.87	2.87	2.83	2.87	2.93	3.03
INCOME AND SAVING											
Nominal GNP	Bill. $	9089.5	9157.0	9283.8	9517.0	9650.7	9841.0	9919.4	10032.1	10131.3	10190.9
Nominal GNP	% change	5.2	3.0	5.7	10.4	5.7	8.1	3.2	4.6	4.0	2.4
Nominal personal income		3.0	4.7	5.2	6.3	8.6	8.5	5.5	6.8	5.8	3.5
Real disposable income		1.4	2.0	2.1	3.0	3.3	5.8	2.6	4.2	2.7	2.4
Personal saving rate	%	3.5	2.7	2.1	1.4	0.8	1.3	0.8	1.0	1.1	1.1
Corp. profits, IVA & CCAdj.	% change	36.1	-10.2	-4.9	31.9	6.1	10.7	1.0	-19.6	-24.6	-14.3
Profit share of GNP	%	9.2	8.8	8.6	9.0	9.0	9.1	9.0	8.4	7.8	7.5
Excluding FR Banks		8.9	8.6	8.3	8.7	8.7	8.8	8.7	8.1	7.5	7.2
Federal surpl./deficit	Bill. $	85.2	116.5	132.0	143.1	212.8	209.1	229.9	222.5	205.3	186.7
State & local surpl./def.		48.9	36.2	38.3	44.9	33.2	34.7	34.8	28.6	22.3	21.3
Ex. social ins. funds		48.4	35.8	38.0	44.7	33.3	34.9	35.1	29.1	22.6	21.4
Gross natl. saving rate	%	19.0	18.5	18.3	18.0	18.0	18.3	18.2	17.9	17.3	17.2
Net natl. saving rate		7.6	6.9	6.4	6.3	6.3	6.6	6.4	6.0	5.1	4.6
PRICES AND COSTS											
GDP chn.-wt. price index	% change	1.7	1.4	1.4	1.8	3.8	2.1	1.9	1.8	3.3	2.1
Gross Domestic Purchases chn.-wt. price index		1.5	2.0	2.0	2.2	4.2	1.9	2.3	1.7	2.7	1.3
PCE chn.-wt. price index		1.3	2.0	2.2	2.4	4.0	2.1	2.4	2.0	3.2	1.3
Ex. food and energy		1.4	1.2	1.5	1.8	2.9	1.7	1.6	1.5	2.6	0.7
CPI		1.5	2.9	2.7	3.4	3.9	3.3	3.5	2.8	4.0	3.2
Ex. food and energy		1.8	1.8	1.8	2.7	2.3	2.7	2.7	2.4	3.1	2.4
ECI, hourly compensation[1]		1.1	4.6	3.7	4.3	5.6	4.7	4.1	3.5	4.6	4.0
Nonfarm business sector											
Output per hour		2.3	-1.3	3.2	7.8	0.0	6.7	1.6	2.3	-0.1	2.1
Compensation per hour		3.6	4.2	5.5	4.7	6.9	8.1	7.4	8.9	4.9	4.7
Unit labor cost		1.3	5.6	2.2	-2.9	6.9	1.3	5.7	6.4	5.0	2.6

1. Private-industry workers.

Strictly Confidential <FR>
Class II FOMC

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

June 20, 2002

					- - - - - - Projected - - - - - -						
Item	Units	2001 Q3	2001 Q4	2002 Q1	2002 Q2	2002 Q3	2002 Q4	2003 Q1	2003 Q2	2003 Q3	2003 Q4
EXPENDITURES											
Nominal GDP	Bill. $	10224.9	10263.3	10428.4	10509.6	10621.3	10750.0	10902.5	11049.9	11201.5	11355.9
Real GDP	Bill. Ch. $	9310.4	9348.6	9474.5	9517.2	9595.8	9679.5	9774.2	9872.4	9973.7	10076.1
Real GDP	% change	-1.3	1.7	5.5	1.8	3.3	3.5	4.0	4.1	4.2	4.2
Gross domestic purchases		-1.0	1.7	6.4	2.9	3.8	3.5	4.4	4.5	4.5	4.0
Final sales		-0.5	3.8	2.0	0.6	2.3	3.6	3.3	3.4	3.7	4.2
Priv. dom. final purchases		-0.4	2.6	2.3	1.7	2.6	3.4	3.8	3.9	4.0	4.1
Personal cons. expenditures		1.0	6.1	3.2	1.7	2.6	3.0	3.0	3.0	3.1	3.2
Durables		0.9	39.4	-9.5	4.7	4.4	5.9	5.0	5.2	5.1	6.2
Nondurables		0.6	2.5	8.3	-1.2	1.8	2.4	2.7	2.7	2.7	2.7
Services		1.2	2.0	3.7	2.6	2.7	2.7	2.8	2.8	2.8	2.8
Business fixed investment		-8.5	-13.8	-7.7	1.4	3.4	6.9	9.7	10.4	12.1	12.3
Equipment & Software		-8.8	-5.3	-2.2	4.2	5.9	9.2	12.2	12.6	14.4	14.2
Nonres. structures		-7.5	-33.6	-22.5	-6.9	-4.2	-0.3	1.7	3.3	4.7	6.1
Residential structures		2.4	-4.6	15.5	2.7	0.3	1.2	1.3	1.1	-0.6	-2.3
Exports		-18.8	-10.9	5.3	5.3	6.4	9.4	5.7	8.2	8.8	11.2
Imports		-13.0	-7.5	12.9	13.9	9.3	7.4	8.7	10.6	9.6	8.1
Gov't. cons. & investment		0.3	10.2	6.5	1.9	3.9	4.2	3.9	3.8	3.8	3.7
Federal		3.6	11.4	11.4	5.8	6.1	5.6	4.3	3.6	3.3	2.8
Defense		3.2	9.0	18.3	4.3	5.1	4.3	4.2	3.7	3.3	2.6
State & local		-1.3	9.6	4.1	-0.0	2.8	3.4	3.7	3.9	4.1	4.2
Change in bus. inventories	Bill. Ch. $	-61.9	-119.3	-28.7	3.8	30.5	29.9	48.4	68.5	82.4	83.8
Nonfarm		-59.0	-113.8	-23.9	3.6	30.2	29.7	47.7	67.4	81.2	82.3
Net exports		-411.0	-412.7	-443.9	-479.3	-497.2	-500.9	-519.4	-539.0	-553.7	-556.1
Nominal GDP	% change	0.9	1.5	6.6	3.2	4.3	4.9	5.8	5.5	5.6	5.6
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	131.9	131.1	130.8	130.8	131.2	131.9	132.6	133.3	134.0	134.7
Unemployment rate	%	4.8	5.6	5.6	5.9	6.0	5.9	5.9	5.7	5.6	5.5
Industrial prod. index	% change	-4.7	-6.7	2.8	4.0	4.7	4.5	5.1	5.3	5.3	5.3
Capacity util. rate - mfg.	%	74.5	73.1	73.5	74.0	74.7	75.3	76.1	76.9	77.7	78.5
Housing starts	Millions	1.60	1.57	1.73	1.65	1.67	1.69	1.69	1.68	1.68	1.68
Light motor vehicle sales		16.12	18.45	16.36	16.45	16.50	17.00	17.05	17.15	17.21	17.35
North Amer. produced		13.15	15.06	13.03	13.19	13.15	13.61	13.63	13.73	13.79	13.93
Other		2.97	3.39	3.33	3.26	3.35	3.39	3.42	3.42	3.42	3.42
INCOME AND SAVING											
Nominal GNP	Bill. $	10213.8	10275.3	10417.7	10511.7	10629.9	10760.9	10917.1	11062.5	11208.8	11356.1
Nominal GNP	% change	0.9	2.4	5.7	3.7	4.6	5.0	5.9	5.4	5.4	5.4
Nominal personal income		2.7	-0.2	5.1	4.3	4.0	4.7	5.6	5.5	5.0	5.6
Real disposable income		12.3	-8.1	13.8	2.4	3.1	3.0	1.6	3.4	2.8	3.5
Personal saving rate	%	3.8	0.4	2.9	3.1	3.3	3.4	3.1	3.2	3.2	3.2
Corp. profits, IVA & CCAdj.	% change	-29.2	93.4	4.9	20.1	8.4	1.7	5.3	4.6	3.7	3.9
Profit share of GNP	%	6.8	8.0	8.0	8.3	8.4	8.3	8.3	8.3	8.2	8.2
Excluding FR Banks		6.6	7.8	7.8	8.1	8.1	8.1	8.1	8.0	8.0	8.0
Federal surpl./deficit	Bill. $	-13.6	97.4	-63.5	-84.3	-81.0	-96.0	-20.5	-3.5	25.1	29.0
State & local surpl./def.		1.9	24.8	10.5	27.5	22.5	33.7	38.0	36.8	36.0	36.2
Ex. social ins. funds		2.0	24.9	10.7	27.8	22.8	34.0	38.3	37.1	36.3	36.5
Gross natl. saving rate	%	17.2	16.6	16.6	16.8	17.0	17.1	17.4	17.7	17.9	18.0
Net natl. saving rate		3.9	3.9	3.9	4.1	4.4	4.3	4.7	5.0	5.2	5.2
PRICES AND COSTS											
GDP chn.-wt. price index	% change	2.3	-0.1	1.1	1.3	0.9	1.4	1.8	1.4	1.4	1.4
Gross Domestic Purchases chn.-wt. price index		-0.1	0.5	0.8	2.3	1.2	1.5	1.8	1.4	1.4	1.4
PCE chn.-wt. price index		-0.2	0.8	0.7	2.5	1.2	1.4	1.4	1.4	1.4	1.3
Ex. food and energy		0.5	2.7	1.0	1.7	1.4	1.4	1.4	1.4	1.3	1.3
CPI		0.7	-0.2	1.4	3.4	1.7	2.1	1.9	1.9	1.9	1.9
Ex. food and energy		2.6	2.6	2.3	2.4	2.2	2.2	2.1	2.1	2.1	2.1
ECI, hourly compensation[1]		3.7	4.2	3.6	3.5	3.5	3.4	3.5	3.5	3.5	3.5
Nonfarm business sector											
Output per hour		1.1	5.5	8.6	2.2	1.2	0.8	1.5	1.9	2.0	2.0
Compensation per hour		3.7	2.2	2.8	2.7	3.0	3.2	3.4	3.4	3.4	3.4
Unit labor cost		2.6	-3.1	-5.8	0.5	1.8	2.5	2.0	1.5	1.4	1.4

1. Private-industry workers.

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

Item	1999 Q3	1999 Q4	2000 Q1	2000 Q2	2000 Q3	2000 Q4	2001 Q1	2001 Q2	2001 Q3	99Q4/ 98Q4	00Q4/ 99Q4	01Q4/ 00Q4
Real GDP	4.7	8.3	2.3	5.7	1.3	1.9	1.3	0.3	-1.3	4.4	2.8	0.5
Gross dom. purchases	5.4	8.4	3.6	6.5	2.0	2.3	0.7	0.4	-1.1	5.4	3.6	0.5
Final sales	4.2	6.2	4.7	3.9	2.3	2.4	3.9	0.7	-0.5	4.2	3.3	2.0
Priv. dom. final purchases	4.2	4.8	6.2	4.0	3.3	2.2	2.4	-0.0	-0.3	4.5	3.9	1.1
Personal cons. expenditures	3.0	4.0	3.9	2.5	2.9	2.1	2.1	1.7	0.7	3.5	2.9	2.1
Durables	0.7	1.1	1.5	-0.2	0.7	-0.2	0.8	0.6	0.1	0.9	0.4	1.1
Nondurables	0.5	1.5	1.0	1.0	0.8	0.1	0.5	0.1	0.1	1.0	0.7	0.3
Services	1.7	1.4	1.5	1.8	1.4	2.2	0.7	1.1	0.5	1.6	1.7	0.8
Business fixed investment	1.3	0.8	1.9	1.5	0.9	0.1	-0.0	-2.0	-1.1	0.9	1.1	-1.2
Equipment & Software	1.5	0.6	1.6	1.2	0.5	-0.1	-0.4	-1.6	-0.8	1.0	0.8	-0.8
Nonres. structures	-0.2	0.1	0.3	0.4	0.5	0.2	0.4	-0.4	-0.3	-0.1	0.3	-0.4
Residential structures	-0.0	0.1	0.4	-0.0	-0.5	-0.1	0.4	0.3	0.1	0.1	-0.1	0.1
Net exports	-0.8	-0.2	-1.3	-0.8	-0.7	-0.4	0.6	-0.1	-0.3	-1.0	-0.8	0.0
Exports	1.0	1.3	1.0	1.4	1.1	-0.5	-0.1	-1.4	-2.1	0.5	0.8	-1.2
Imports	-1.8	-1.4	-2.3	-2.3	-1.8	0.1	0.8	1.3	1.9	-1.5	-1.6	1.2
Government cons. & invest.	0.8	1.5	-0.2	0.8	-0.3	0.6	0.9	0.9	0.1	0.7	0.2	0.9
Federal	0.4	0.9	-0.8	0.9	-0.7	0.3	0.2	0.1	0.2	0.3	-0.1	0.3
Defense	0.5	0.6	-0.9	0.6	-0.4	0.4	0.3	0.1	0.1	0.2	-0.1	0.2
Nondefense	-0.1	0.3	0.0	0.3	-0.2	-0.1	-0.1	0.0	0.1	0.1	0.0	0.1
State and local	0.3	0.7	0.6	-0.1	0.3	0.3	0.7	0.8	-0.2	0.4	0.3	0.6
Change in bus. inventories	0.4	2.2	-2.3	1.8	-1.0	-0.5	-2.6	-0.4	-0.8	0.2	-0.5	-1.5
Nonfarm	0.9	1.5	-2.0	1.5	-0.8	-0.7	-2.6	-0.3	-0.8	0.1	-0.5	-1.5
Farm	-0.4	0.6	-0.3	0.3	-0.2	0.2	0.0	-0.1	-0.0	0.0	-0.0	-0.0

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

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

Item	2001 Q4	2002 Q1	2002 Q2	2002 Q3	2002 Q4	2003 Q1	2003 Q2	2003 Q3	2003 Q4	01Q4/ 00Q4	02Q4/ 01Q4	03Q4/ 02Q4
Real GDP	1.7	5.5	1.8	3.3	3.5	4.0	4.1	4.2	4.2	0.5	3.5	4.1
Gross dom. purchases	1.8	6.6	3.0	3.9	3.6	4.6	4.7	4.6	4.2	0.5	4.3	4.5
Final sales	3.8	2.1	0.6	2.4	3.6	3.3	3.4	3.7	4.1	2.0	2.2	3.6
Priv. dom. final purchases	2.2	2.1	1.5	2.2	2.9	3.2	3.3	3.4	3.5	1.1	2.2	3.3
Personal cons. expenditures	4.1	2.3	1.2	1.9	2.1	2.1	2.1	2.1	2.2	2.1	1.8	2.1
Durables	2.8	-0.9	0.4	0.4	0.5	0.4	0.4	0.4	0.5	1.1	0.1	0.4
Nondurables	0.5	1.6	-0.2	0.4	0.5	0.5	0.5	0.5	0.5	0.3	0.6	0.5
Services	0.8	1.5	1.1	1.1	1.1	1.2	1.2	1.2	1.2	0.8	1.2	1.2
Business fixed investment	-1.8	-0.9	0.2	0.4	0.7	1.0	1.1	1.3	1.3	-1.2	0.1	1.2
Equipment & Software	-0.5	-0.2	0.3	0.5	0.7	1.0	1.0	1.2	1.2	-0.8	0.4	1.1
Nonres. structures	-1.3	-0.7	-0.2	-0.1	-0.0	0.0	0.1	0.1	0.2	-0.4	-0.3	0.1
Residential structures	-0.2	0.6	0.1	0.0	0.1	0.1	0.1	-0.0	-0.1	0.1	0.2	-0.0
Net exports	-0.1	-1.1	-1.2	-0.6	-0.1	-0.6	-0.6	-0.5	-0.0	0.0	-0.8	-0.4
Exports	-1.1	0.5	0.5	0.6	0.9	0.5	0.8	0.9	1.1	-1.2	0.6	0.8
Imports	1.0	-1.6	-1.7	-1.2	-1.0	-1.2	-1.4	-1.3	-1.1	1.2	-1.4	-1.3
Government cons. & invest.	1.8	1.2	0.4	0.7	0.8	0.7	0.7	0.7	0.7	0.9	0.8	0.7
Federal	0.7	0.7	0.4	0.4	0.4	0.3	0.2	0.2	0.2	0.3	0.4	0.2
Defense	0.3	0.7	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.2	0.3	0.1
Nondefense	0.3	-0.0	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
State and local	1.1	0.5	-0.0	0.3	0.4	0.4	0.5	0.5	0.5	0.6	0.3	0.5
Change in bus. inventories	-2.2	3.4	1.2	1.0	-0.0	0.7	0.7	0.5	0.0	-1.5	1.4	0.5
Nonfarm	-2.1	3.4	1.0	1.0	-0.0	0.6	0.7	0.5	0.0	-1.5	1.3	0.5
Farm	-0.1	-0.0	0.1	-0.0	0.0	0.0	0.0	-0.0	0.0	-0.0	0.0	0.0

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

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

Item	Fiscal year[1]				2001				2002				2003			
	2000[a]	2001[a]	2002	2003	Q1[a]	Q2[a]	Q3[a]	Q4[a]	Q1[a]	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Unified budget					Not seasonally adjusted											
Receipts[2]	2025	1991	1862	1993	460	660	409	466	413	524	459	437	442	624	490	477
Outlays[2]	1789	1864	2016	2119	482	467	451	503	509	510	493	538	533	531	517	558
Surplus/deficit[2]	236	127	-153	-126	-22	194	-42	-37	-97	14	-33	-101	-92	93	-28	-81
On-budget	87	-33	-309	-295	-88	119	-51	-81	-127	-55	-46	-140	-130	18	-43	-126
Off-budget	150	161	155	169	65	75	10	44	30	69	13	39	39	75	16	45
Surplus excluding deposit insurance	233	126	-153	-127	-23	193	-42	-37	-96	14	-34	-101	-92	93	-28	-81
Means of financing																
Borrowing	-223	-90	178	156	24	-157	69	60	51	18	50	101	91	-54	19	66
Cash decrease	4	8	-6	5	-7	-15	-1	-8	38	-28	-8	21	-1	-30	15	15
Other[3]	-18	-45	-18	-35	6	-21	-26	-14	8	-3	-8	-21	2	-9	-6	-0
Cash operating balance, end of period	53	44	50	45	28	44	44	52	14	42	50	29	30	60	45	30
NIPA federal sector					Seasonally adjusted annual rates											
Receipts	2012	2041	1962	2077	2087	2092	1907	2027	1925	1943	1955	1978	2075	2109	2146	2184
Expenditures	1813	1891	1995	2101	1882	1905	1921	1929	1989	2027	2036	2074	2095	2112	2121	2155
Consumption expenditures	492	506	551	593	508	510	514	525	551	559	568	577	593	599	604	609
Defense	322	337	368	394	338	340	343	348	371	374	379	383	393	397	401	404
Nondefense	170	170	183	199	169	171	171	177	181	185	189	193	200	202	203	205
Other spending	1321	1384	1445	1507	1375	1395	1407	1404	1438	1468	1468	1497	1502	1514	1517	1546
Current account surplus	199	150	-33	-24	205	187	-14	97	-64	-84	-81	-96	-21	-3	25	29
Gross investment	96	100	111	121	98	100	102	107	109	113	115	118	120	122	123	125
Current and capital account surplus	102	50	-144	-144	108	87	-116	-9	-173	-198	-197	-214	-140	-125	-98	-96
Fiscal indicators[4]																
High-employment (HEB) surplus/deficit	-5	-5	-143	-163	34	38	-127	-3	-178	-194	-196	-220	-155	-147	-128	-133
Change in HEB, percent of potential GDP	-.9	-0	1	.1	0	-0	2	-1	2	.1	-0	.2	-.6	-.1	-.2	0
Fiscal impetus (FI) percent, calendar year	2	8	23	11	3	3	9	-4	14	6	2	4	4	2	-.4	2

1. Fiscal year data for the unified budget come from OMB; quarterly data come from the Monthly Treasury Statement and may not sum to OMB fiscal year totals.
2. OMB's February 2002 baseline surplus estimates are -$9 billion in FY 2002 and $51 billion in FY 2003. CBO's April 2002 baseline surplus estimates, which includes the March 2002 stimulus bill, are -$46 billion in FY 2002 and -$40 billion in FY 2003. 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.
3. Other means of financing are checks issued less checks paid, accrued items, and changes in other financial assets and liabilities.
4. HEB is the NIPA current and capital account surplus in current dollars, with cyclically sensitive receipts and outlays adjusted to the level of potential output associated with an unemployment rate of 6 percent. 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 (1996) dollars, scaled by real federal consumption plus investment. For FI and the change in HEB, negative values indicate aggregate demand restraint.
a--Actual

Change in Debt of the Domestic Nonfinancial Sectors
(Percent)

			Nonfederal						
				Households					
Period[1]	Total	Federal government	Total	Total	Home mortgages	Consumer credit	Business	State and local governments	Memo: Nominal GDP
Year									
1996	5.4	4.0	5.8	7.0	6.8	8.1	6.2	-0.6	6.0
1997	5.6	0.6	7.3	6.4	6.7	4.7	9.0	5.3	6.2
1998	6.8	-1.4	9.6	8.2	8.9	5.9	11.8	7.2	6.0
1999	6.6	-1.9	9.1	8.3	9.0	7.4	11.0	4.4	6.0
2000	5.0	-8.0	8.4	8.4	8.2	9.6	9.8	2.2	5.3
2001	6.0	-0.2	7.5	8.7	9.8	6.9	6.0	8.1	2.3
2002	5.9	6.5	5.8	8.0	9.0	5.5	3.5	4.8	4.7
2003	5.8	3.4	6.3	7.2	8.0	5.8	5.7	4.3	5.6
Quarter									
2001:1	5.3	-0.1	6.6	7.4	7.6	9.1	5.4	8.1	4.6
2	5.3	-7.6	8.2	9.3	11.4	4.7	7.0	8.3	2.4
3	7.1	7.7	6.9	8.8	9.5	4.3	5.7	3.2	0.9
4	5.9	-0.5	7.3	8.3	9.4	9.0	5.3	11.7	1.5
2002:1	5.2	3.3	5.5	9.0	10.1	4.7	1.8	4.6	6.6
2	6.3	13.5	4.8	7.4	8.4	5.7	2.1	3.1	3.1
3	5.6	4.9	5.8	7.2	8.1	5.3	4.5	4.5	4.3
4	5.9	3.7	6.4	7.4	8.2	5.7	5.3	6.4	4.9
2003:1	6.4	7.5	6.1	7.1	8.1	5.6	5.3	4.2	5.8
2	6.0	4.7	6.2	7.0	7.8	5.7	5.8	4.2	5.5
3	5.3	1.3	6.2	7.0	7.7	5.7	5.6	4.4	5.6
4	5.1	-0.2	6.2	7.0	7.6	5.7	5.7	4.3	5.6

Note. Quarterly data are at seasonally adjusted annual rates.
1. Data after 2002: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

Strictly Confidential (FR)
Class II FOMC

Flow of Funds Projections: Highlights
(Billions of dollars except as noted)

June 20, 2002

					Seasonally adjusted annual rates									
	Calendar year				2001		2002				2003			
Category	2000	2001	2002	2003	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Net funds raised by domestic nonfinancial sectors														
1 Total	702.1	1046.3	1169.7	1183.9	1202.1	1119.7	1019.6	1286.6	1150.3	1222.6	1311.4	1241.3	1109.2	1073.7
2 Net equity issuance	-159.7	-57.5	29.7	-6.7	-126.4	-7.3	20.2	52.4	24.0	22.0	7.0	0.2	-12.0	-22.0
3 Net debt issuance	861.8	1103.7	1140.1	1190.6	1328.5	1127.0	999.4	1234.2	1126.3	1200.6	1304.4	1241.1	1121.2	1095.7
Borrowing sectors														
Nonfinancial business														
4 Financing gap [1]	264.2	164.2	112.3	176.6	160.5	31.8	97.1	107.9	121.4	122.8	142.0	166.4	188.0	210.1
5 Net equity issuance	-159.7	-57.5	29.7	-6.7	-126.4	-7.3	20.2	52.4	24.0	22.0	7.0	0.2	-12.0	-22.0
6 Credit market borrowing	584.6	391.4	240.6	409.0	381.2	365.2	127.4	146.2	314.2	374.5	381.3	417.6	409.9	427.0
Households														
7 Net borrowing [2]	545.9	614.6	614.6	597.9	648.6	622.0	695.8	583.8	577.0	602.0	591.4	589.3	599.7	611.4
8 Home mortgages	373.6	480.9	483.7	471.0	486.0	493.7	546.3	462.5	453.9	471.9	473.1	467.4	468.6	475.0
9 Consumer credit	139.0	110.2	93.0	103.6	70.6	149.9	79.9	98.5	93.0	100.5	100.0	103.7	104.5	106.1
10 Debt/DPI (percent) [3]	96.7	99.6	102.2	105.5	98.4	102.4	101.1	102.0	102.7	103.5	104.5	105.1	105.9	106.4
State and local governments														
11 Net borrowing	27.2	103.2	65.7	62.8	43.0	157.5	64.2	44.0	63.8	90.8	60.8	60.8	64.8	64.8
12 Current surplus [4]	191.9	190.9	206.6	228.3	181.1	199.8	193.4	208.2	205.6	219.3	225.9	227.1	228.8	231.6
Federal government														
13 Net borrowing	-295.9	-5.6	219.2	120.9	255.7	-17.6	112.0	460.2	171.3	133.3	271.0	173.4	46.8	-7.5
14 Net borrowing (quarterly, n.s.a.)	-295.9	-5.6	219.2	120.9	68.6	59.5	50.8	17.5	49.9	101.0	90.5	-54.2	18.8	65.8
15 Unified deficit (quarterly, n.s.a.)	-254.8	-92.3	217.1	106.6	41.9	37.1	96.6	-13.6	33.5	100.7	91.6	-93.3	27.5	80.8
Depository institutions														
16 Funds supplied	445.3	286.3	344.5	368.3	306.6	410.9	255.2	332.8	358.6	431.4	367.8	348.7	373.1	383.8
Memo (percentage of GDP)														
17 Domestic nonfinancial debt [5]	180.6	184.4	188.6	189.7	185.1	187.4	187.0	188.2	189.0	189.5	189.7	190.0	190.1	189.9
18 Domestic nonfinancial borrowing	8.7	10.8	10.8	10.7	13.0	11.0	9.6	11.7	10.6	11.2	12.0	11.2	10.0	9.6
19 Federal government [6]	-3.0	-0.1	2.1	1.1	2.5	-0.2	1.1	4.4	1.6	1.2	2.5	1.6	0.4	-0.1
20 Nonfederal	11.7	10.9	8.7	9.6	10.5	11.2	8.5	7.4	9.0	9.9	9.5	9.7	9.6	9.7

Note. Data after 2002:Q1 are staff projections.
1. For corporations: Excess of capital expenditures over U.S. internal funds.
2. Includes change in liabilities not shown in lines 8 and 9.
3. Average debt levels in the period (computed as the average of period-end debt positions) divided by disposable personal income.
4. NIPA surplus less changes in retirement fund assets plus consumption of fixed capital.
5. Average debt levels in the period (computed as the average of period-end debt positions) divided by nominal GDP.
6. Excludes government-insured mortgage pool securities.

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International Developments

Recovery abroad appears to be proceeding, and recent data on foreign economic activity in the first half of this year have been coming in a bit stronger on an export-weighted average basis than we had expected in the May Greenbook. The pace of the recovery remains uneven across countries and regions, however. Growth in Canada, Australia, and emerging Asia has been strong, and monetary authorities in some of those economies have already started tightening policy. Growth in the euro area has been somewhat less impressive but on an uptrend nonetheless since the fourth quarter. Underlying growth in Japan appears to have moved into positive territory in the first half of this year but remains weak. In South America, GDP growth is still negative on average, with severe contractions under way in Argentina and Venezuela. In Brazil, growth in the first half looks to have been reasonably strong, but political concerns have driven up financing spreads and are threatening to derail the country's recovery.

Despite the upward tilt to news on real activity abroad, foreign financial markets have taken a negative tone, in line with U.S. markets, with equity markets generally weaker and government bond yields lower than they were earlier this year. The dollar has also declined further during the intermeeting period, and market commentary appears to be giving more attention to the view that the dollar may be at the beginning of a sustained adjustment from its sixteen-year high.

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

Indicator	2001	2002 Q1	Projection		
			2002		2003
			Q2	H2	
Foreign output	.1	3.2	2.8	3.4	3.5
Previous GB	*.0*	*2.7*	*2.8*	*3.1*	*3.4*
Foreign CPI	1.7	1.9	2.9	2.1	2.1
Previous GB	*1.7*	*1.6*	*2.8*	*2.7*	*2.5*

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

Largely because of the strength of recent data, we have revised up our outlook for growth in several economies, including Canada, the United Kingdom, Japan, and emerging Asia. Political concerns in Brazil and Venezuela prompted downward revisions to the growth projections for those countries. On balance, our projection for export-weighted foreign growth has been raised about 1/4 percentage point to a rate of about 3-1/4 percent for this year; it remains at around 3-1/2 percent for 2003. Foreign inflation is projected to be higher this year than last, largely reflecting the turnaround in oil prices earlier this year, but remaining excess capacity and our projection that the foreign exchange value of the dollar will decline a bit further over the forecast period should help keep average foreign inflation moderate through next year. Compared with the May Greenbook, we have marked down somewhat our outlook for foreign inflation, as deflation in China, Hong Kong, and Taiwan now appears to be more persistent than we had expected.

All told, net exports are expected to make a negative arithmetic contribution to U.S. GDP growth of about 3/4 percentage point this year and 1/2 percentage point next year. These are each about 1/4 percentage point less negative than projected in the May Greenbook, the difference largely reflecting the lower path for the dollar.

Oil prices. The spot price of West Texas intermediate (WTI) crude oil rose to a high above $29 per barrel in mid-May, driven largely by cuts in targeted production agreed to earlier this year by OPEC and non-OPEC producers. The price subsequently declined, on data indicating comfortable world inventory levels of crude oil and petroleum products, reports that Venezuela was producing more than its OPEC quota, and public statements that Russia and Norway will not extend their production and export restraint agreements with OPEC beyond the first half of the year. These factors more than offset upward pressures associated with tensions in the Middle East and expectations of world economic recovery. We project that, in line with recent quotes from futures markets, the spot price of WTI will decrease slightly from its current level of about $25.50 per barrel to $23.80 by the end of the forecast period, as OPEC production restraints are eased. Compared with the previous Greenbook, this projection is little changed.

International financial markets. The foreign exchange value of the dollar, as measured by the staff's major currencies index, declined 2-3/4 percent during the intermeeting period. The dollar depreciated against all the major foreign currencies, with drops of 4 percent against the euro, 2-3/4 percent against the yen, and 1-3/4 percent against the Canadian dollar. The dollar also moved lower against several of the currencies of emerging Asia, including the Korean won. A softening of investors' outlook for the strength of the U.S. recovery and corporate earnings and a reduction in the expected pace of tightening by the Federal Reserve exerted some downward pressure on the dollar. Increases in policy interest rates by the central banks of Canada, Australia, New Zealand, and Korea, where recovery appears to be gaining momentum, added to the pressure.

A number of background factors also likely weighed on the dollar. Market commentary on the implications for the dollar of the growing U.S. current account deficit and the consequent need for increasing capital inflows has become more common, suggesting that a correction in the value of the dollar might be occurring. Speculation that the Bush Administration might welcome further declines in the dollar to improve the competitive position of U.S. businesses and concerns that the United States likely remains the primary target for terrorist attacks may also have damped interest in U.S. dollar assets.

Only Latin American currencies underperformed the dollar during the intermeeting period. The dollar appreciated 3 percent against the Mexican peso, unwinding some of the substantial appreciation of the peso seen in 2001 and early 2002. The dollar appreciated 11 percent against the Brazilian *real* amid concerns about the October presidential election and fears that the incoming government will be less committed to sound macroeconomic and financial policies. Political instability in Venezuela and rising fiscal financing needs left the Venezuelan bolivar down more than 25 percent against the dollar over the intermeeting period, and the Argentine peso declined another 11 percent, as Argentine authorities continued to struggle to stabilize the economy. The poor performance of the Latin American currencies more than offset the appreciation of currencies in emerging Asia, and the dollar rose about 3/4 percent on average against the currencies of our other important trading partners.

The starting point for our forecast for the dollar incorporates the exchange rate movements we have seen since the May Greenbook. Those adjustments put the value of the staff's broad real index in the third quarter about 1-1/2 percent below its level in the previous projection. Going forward, we project that the dollar will move down another 2 percent on average over the remainder of the forecast period, with the projected decline concentrated against the major currencies. Compared with our Greenbook projections earlier this year, this outlook strikes a slightly different balance among risks, giving a bit more weight to the view that the dollar has finally begun to yield to concerns about the attractiveness of holding a large and growing volume of U.S. external liabilities and may be in for further correction. The downward pressure appears moderate at this point, but if it were to intensify, the dollar could decline more sharply. We explore this risk in the alternative simulations presented later.

Foreign equity markets moved substantially lower during the intermeeting period, and government bond yields in the major industrial countries were flat or declined. European yields were down about 15 to 20 basis points, somewhat less than the decline in the yield on the comparable U.S. Treasury security. Emerging market bond yield spreads over Treasuries were up significantly in South America, with spreads in Brazil and Venezuela rising 425 basis points and 160 basis points, respectively. The increase in the spread in Argentina continued to be outsized at more than 1,100 basis points. In contrast, spreads in Mexico and emerging Asia changed little on net.

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

Foreign industrial countries. Data for the second quarter suggest that economic activity in the foreign industrial countries continues to strengthen. Compared with the May Greenbook, second-quarter data for the euro area and Canada have been relatively consistent with our previous forecast, whereas Japanese and U.K. data have surprised us on the upside. Consequently, our growth forecast, though having the same contours as before, is a bit stronger than that in the May Greenbook. On balance, we project growth in foreign industrial countries to average about 3 percent in both 2002 and 2003. Headline inflation rates in Europe and Canada, which had moved up noticeably in the first quarter, declined in May, although core inflation rates increased. Headline inflation rates in these countries are projected to move up a bit in the near term and then to moderate over the remainder of the forecast period, as the effect of the recent oil price increase recedes, expected foreign currency appreciation against the dollar helps to moderate import price inflation, and output remains below our estimates of potential in most countries.

Canadian data for the second quarter indicate that total domestic demand remains strong, boosted in particular by interest-sensitive spending. Auto sales and housing starts have remained near record highs. Buoyed by strong demand in both the external and domestic sectors, the Canadian economy is projected to grow faster than its rate of potential over the forecast period, pushing the level of output a bit above potential and raising inflation in the near term. On June 4, the Bank of Canada increased its overnight rate 25 basis points, bringing its cumulative tightening since April to 50 basis points. We expect further rate increases over the forecast period, as the Bank of Canada reverses about 250 of the 375 basis points of easing begun in 2001.

The euro-area economy is expected to continue its gradual recovery in the second quarter, led by a positive inventory swing. While euro-area industrial production came in a bit below expectations in April, the May purchasing managers' index (PMI) for manufacturing rose to its highest level in more than a year. Although service-sector PMI edged down in May, it still points to expansion. Final domestic demand is not projected to pick up until the second half of this year, when recent improvements in business and consumer sentiment begin to show through to spending. Growth should pick up to a rate near potential by year-end and stay at that rate through 2003, with some excess capacity remaining at the end of the forecast period. Euro-area inflation is projected to hover just above the European Central Bank's 2 percent target ceiling for the remainder of this year. We expect the ECB to keep monetary policy on hold until later this year, when it is likely to begin tightening moderately to return interest rates to a more neutral level, as signs of stronger growth become evident.

We expect activity in the United Kingdom to rebound in the second quarter and to grow at a rate above potential for the remainder of the year. Consumption has remained strong, and indicators suggest that the manufacturing sector is beginning to recover. With labor markets relatively tight, the Bank of England is expected to begin raising official rates in the third quarter, reversing much of the 200 basis points of policy easing that occurred last year.

We have discounted heavily the recently released data showing extraordinary first-quarter growth of GDP in Japan, which appears to have been influenced significantly by an unreliable survey of household consumption spending and is inconsistent with other information. Better indicators suggest that the economy is in a weak recovery, sustained to a large extent by growth in exports. Industrial production posted its third consecutive increase in April, core machinery orders were up 6 percent from their average first-quarter level, and car registrations rose in April and May. Looking through the first-quarter spike, we expect real GDP growth to be positive in both halves of this year and to continue at a modest pace in 2003, as a boost from exports eventually translates into stronger final domestic demand. Consumer price deflation is likely to persist through the forecast period. The Bank of Japan is expected to maintain nominal short-term interest rates near zero.

Other countries. Recent indicators suggest that a recovery in Mexico is under way, but many of the countries in South America are experiencing considerable economic and financial weakness. Data releases since the May Greenbook show that Mexican exports, industrial production (including auto production), and business confidence have strengthened significantly. Accordingly, we project that Mexico will grow 3-1/4 percent this year and more than 4-1/4 percent next year, roughly in line with the projected growth in U.S. activity. In Brazil, strong growth in the first quarter has been followed by a mixed performance more recently, and the financial market stress that has developed will likely damp activity going forward. Turmoil in Argentina and Venezuela has continued to disrupt economic activity, and our outlook for these two countries remains bleak. Overall, we project that average growth for Latin

America will be about 3-1/2 percent over the forecast period, largely accounted for by growth in Mexico.

Recent data suggest that in emerging Asia the recovery has gained momentum, driven to a large extent by a revival of exports, although evidence of strength in other sectors is developing as well. In Korea, indicators suggest that the strength is being fueled by both exports and domestic demand, as private investment has begun to rebound. In response, the Bank of Korea raised its target interest rate 25 basis points in early May. Recent industrial production figures suggest that growth has continued apace in the second quarter in the ASEAN economies, mainland China, and Taiwan. While China's growth is coming largely from domestic demand, the driving force in Taiwan is primarily exports, although fixed investment there has begun to show signs of revival as well. In contrast, domestic demand has remained weak in Hong Kong, as the economy continues to struggle with deflation and a strong Hong Kong dollar. On balance, we project that average growth in emerging Asia will be about 5-1/2 percent this year and next.

Inflationary pressures in the major developing countries are expected to remain generally contained, although inflation in Argentina, Brazil, and Venezuela is slated to increase somewhat relative to the previous Greenbook, owing to recent further depreciations of their currencies.

Prices of internationally traded goods. The price index for imports of non-oil core goods appears to have risen about 1-3/4 percent at an annual rate in the second quarter, the first quarterly increase since the beginning of 2001. The turnaround largely reflects the behavior of prices of non-petroleum industrial supplies, which fell sharply last year but stabilized earlier this year and rose in the past several months. With commodity prices expected to continue moving up this year, along with the strengthening of world demand, and the dollar projected to decline, import prices should continue to rise. We are projecting core import prices to increase at an average rate of 4 percent in the second half of this year and at a more moderate pace of 2-3/4 percent next year, as commodity price increases slow.

The price index for exports of U.S. core goods also appears to have turned up in the second quarter following a year of decline, rising at an annual rate of about 2-1/2 percent. We expect this index to increase at an average rate of about 1-3/4 percent over the remainder of the forecast period, in line with projected U.S. producer price inflation.

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

Trade category	2001	2002 Q1	Projection 2002 Q2	Projection 2002 H2	Projection 2003
Exports					
Core goods	-1.5	-1.2	2.5	1.7	1.6
Imports					
Non-oil core goods	-3.1	-2.3	1.7	4.1	2.7
Oil (dollars per barrel)	18.40	18.35	23.90	23.36	21.42

NOTE. Prices for core exports and non-oil core imports, which exclude computers and semiconductors, are on a NIPA chain-weighted basis.

The price of imported oil for multi-quarter periods is the price for the final quarter of the period.

Trade in goods and services. Real exports of goods and services are estimated to have increased 5-1/4 percent at an annual rate in the first quarter, the first quarterly gain since mid-2000. The increase was primarily in services exports, as exports of core goods continued to fall. As foreign growth recovers, exports of core goods are projected to rebound, growing at an average rate of about 6 percent over the forecast period. The considerably stronger projected growth in exports than in foreign GDP largely reflects the reversal of the divergence that appeared over the past year as U.S. goods exports dropped much more sharply than did foreign GDP. This divergence may be partly related to the presence of intermediate production inputs in core exports, as the export drop more closely paralleled last year’s slump in foreign industrial production than it did the relatively shallow cycle in foreign GDP. As production abroad recovers, core exports should rise in response. Exports of computers and semiconductors are projected to make sizable positive contributions to real export growth this year and next, after falling sharply last year; and service receipts, especially travel and passenger fares, should continue to recover. In addition, the projected depreciation of the dollar boosts exports going forward. We project that real exports of all goods and services, after declining 11 percent in 2001, will increase 6-1/2 percent in 2002 and about 8-1/2 percent in 2003.

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

Measure	2001	2002 Q1	Projection		
			2002		2003
			Q2	H2	
Real exports	-10.9	5.3	5.3	7.9	8.4
Previous GB	*-10.9*	*7.0*	*5.3*	*6.7*	*7.6*
Real imports	-8.5	12.9	13.9	8.3	9.2
Previous GB	*-8.5*	*14.9*	*16.3*	*9.8*	*10.3*

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

The level of real imported goods and services also registered its first increase since mid-2000 in the first quarter, rising 13 percent at an annual rate. All major categories except oil contributed to the increase, reflecting a surge in U.S. domestic demand. We continue to project further sizable increases both this year and next in imports, which will be boosted by growth in U.S. activity. Growth in total imports of goods and services is expected to average about 10 percent over the remainder of 2002, reflecting cyclical growth in demand for core goods and a rebound in the travel portion of service imports as the effects of September 11 wane. We project growth to slow a bit, to 9-1/4 percent in 2003, owing in part to the lower projected path of the dollar.

The U.S. current account deficit as a share of GDP is estimated to have been about 4-1/2 percent in the first quarter. We project the current account deficit to increase to nearly $600 billion by the end of 2003, 5-1/4 percent of GDP.

Alternative simulations. The recent downward pressures on the dollar may intensify, generating a much sharper fall than is projected in our baseline forecast. In our first alternative simulation, we use the FRB/Global model to consider a more substantial decline in the value of the broad real dollar index than is assumed in the baseline. Our second simulation assumes that the rise in the risk premium on dollar-denominated assets is accompanied by a more general weakening of U.S. financial market confidence. This adverse shock to confidence induces a higher equity premium and an exogenous rise in risk premiums on corporate bonds.

In the first simulation, we consider a sequence of shocks to the risk premium on dollar assets that are phased in over the four quarters beginning in 2002:Q3.

The shocks are scaled so that the real foreign exchange value of the dollar would decline about 20 percent against most foreign currencies by 2003:Q2, in the absence of adjustment of domestic and foreign real interest rates. The shocks to the dollar's values against the Canadian dollar and the Mexican peso, however, are scaled to deliver declines of only 10 percent, absent interest rate adjustments.

Under the assumption that the real federal funds rate is unchanged from baseline (the "fixed real rate" case), the broad real value of the dollar falls about 16 percent by 2003:Q2. The real exchange rate depreciation has a stimulative effect on net exports, boosting real GDP growth about 0.5 percentage point above baseline in 2003. Rising import prices pass through to core consumer prices with a lag of a quarter or two. Accordingly, core PCE inflation rises about 0.7 percentage point relative to baseline in 2003:H1 and about 1 percentage point in 2003:H2.

In the case in which the Federal Reserve is assumed to follow a Taylor rule, the response of output is similar initially to the case of a fixed real funds rate. However, the rise in real interest rates eventually restrains domestic spending, reduces the stimulative effect of the shock on real activity, and moderates the extent of the real dollar depreciation. Real GDP growth in 2003:H2 is only 0.2 percentage point above baseline, roughly half the magnitude of the response under a fixed real funds rate. By contrast, the PCE inflation rate response is almost identical to the fixed real funds rate case, reflecting somewhat longer lags in the transmission of monetary policy changes to prices than to output.

Alternative Simulation 1:
Weaker Dollar[1]
(Percent change from previous period, annual rate)

Indicator and simulation	2002		2003	
	H1	H2	H1	H2
U.S. real GDP				
Baseline	3.6	3.4	4.0	4.2
Fixed real rate	3.6	3.6	4.4	4.7
Taylor rule	3.6	3.6	4.3	4.4
U.S. PCE prices excl. food and energy				
Baseline	1.3	1.4	1.4	1.3
Fixed real rate	1.3	1.4	2.1	2.3
Taylor rule	1.3	1.4	2.1	2.3

NOTE. H1 is Q2/Q4; H2 is Q4/Q2.

1. In the fixed real rate case, the Federal Reserve holds the *ex post* real federal funds rate unchanged from its baseline path. In the Taylor rule case, the real federal funds rate is adjusted according to a Taylor rule, with a coefficient of 1/2 on both the inflation and output gaps. In each case, foreign industrial countries and most developing countries adjust short-term interest rates according to a Taylor rule.

In the first simulation, while interest rates adjust to the risk premium shock, the shock is assumed to induce very little change in corporate risk spreads or in the required return on equity. In the second simulation, we add a "confidence shock" that raises spreads on corporate bond yields and equity returns. Because a confidence shock of this type leads in general to a decline in domestic demand and a contraction in GDP, it will tend to offset the expansionary effect of the decline in the dollar.

In the absence of any precise view on the appropriate relative magnitudes of the shocks, we have chosen to calibrate the confidence shock to offset roughly the effects of the dollar decline on U.S. GDP. The shock to confidence involves a gradual, exogenous rise of 50 basis points in the equity risk premium (over the risk-free return), again phased in during the forecast period. In addition, it includes increases in the risk premiums on corporate bonds: The spread on Aaa corporates would rise 25 basis points over the same period in the absence of endogenous adjustments, while the spread on Baa bonds would rise 50 basis points. These premiums increase the cost of raising capital through bond or equity finance and weaken consumer spending by inducing a substantial decline in the stock market. (The stock market declines 15 percent by 2003:H2 in response to the combined effects.)

By design, the combined shock has very little effect on the path of U.S. output relative to baseline over the simulation period, a result that does not depend significantly on which of the two types of U.S. monetary policy response is considered. A larger confidence shock would tilt the outcome of this second simulation toward a net contraction in GDP relative to baseline, and a smaller confidence shock would leave a net expansion. The rise in the PCE inflation in this simulation is virtually identical to that reported in the first simulation, primarily reflecting in both cases the direct pass-through of import prices.

Alternative Simulation 2:
Weaker Dollar and Higher Risk Premiums[1]
(Percent change from previous period, annual rate)

Indicator and simulation	2002		2003	
	H1	H2	H1	H2
U.S. real GDP				
Baseline	3.6	3.4	4.0	4.2
Fixed real rate	3.6	3.5	4.1	4.2
Taylor rule	3.6	3.5	4.0	4.0
U.S. PCE prices excl. food and energy				
Baseline	1.3	1.4	1.4	1.3
Fixed real rate	1.3	1.4	2.1	2.3
Taylor rule	1.3	1.5	2.1	2.3

NOTE. H1 is Q2/Q4; H2 is Q4/Q2.

1. In the fixed real rate case, the Federal Reserve holds the *ex post* real federal funds rate unchanged from its baseline path. In the Taylor rule case, the real federal funds rate is adjusted according to a Taylor rule, with a coefficient of 1/2 on both the inflation and output gaps. In each case, foreign industrial countries and most developing countries adjust short-term interest rates according to a Taylor rule.

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

Measure and country	1995	1996	1997	1998	1999	2000	2001	--Projected-- 2002	2003
REAL GDP (1)									
Total foreign	2.1	4.1	4.1	1.6	4.9	4.0	0.1	3.2	3.5
Industrial Countries	1.9	2.8	3.4	2.7	4.2	3.2	0.4	2.9	2.9
of which:									
Canada	1.4	2.7	4.4	4.4	5.7	3.5	0.8	4.1	3.5
Japan	2.5	3.7	0.5	-1.3	0.6	2.3	-2.0	0.6	1.2
United Kingdom	2.0	2.9	3.6	2.6	2.7	2.6	1.6	2.6	2.9
Euro Area (2)	1.5	1.6	3.1	2.0	3.8	2.9	0.3	2.0	2.7
Germany	1.1	1.4	1.7	0.6	3.0	2.5	0.0	1.7	2.5
Developing Countries	2.4	6.2	5.2	-0.2	6.2	5.2	-0.4	3.7	4.4
Asia	7.0	6.6	4.9	-2.0	8.7	6.3	0.7	5.5	5.6
Korea	7.5	6.4	3.4	-5.2	13.8	5.1	4.4	6.2	6.0
China	10.4	5.3	8.7	9.5	4.1	8.0	7.5	7.5	7.5
Latin America	-3.8	6.2	6.1	1.2	4.3	4.5	-1.5	2.3	3.6
Mexico	-7.1	7.1	6.7	2.8	5.4	4.9	-1.5	3.2	4.3
Brazil	-1.7	5.4	2.4	-1.6	3.7	3.9	-0.6	2.2	2.1
CONSUMER PRICES (3)									
Industrial Countries	1.3	1.5	1.5	0.9	1.2	1.9	0.9	1.7	1.2
of which:									
Canada	2.0	2.0	1.0	1.1	2.3	3.1	1.1	3.0	2.0
Japan	-0.8	0.2	2.1	0.7	-1.2	-1.2	-1.3	-0.9	-0.8
United Kingdom (4)	2.9	3.2	2.7	2.5	2.2	2.1	2.0	2.5	2.4
Euro Area (2)	NA	NA	1.5	0.8	1.5	2.7	2.1	2.1	1.5
Germany	1.4	1.3	1.5	0.3	1.1	2.5	1.7	1.6	0.9
Developing Countries	17.0	11.1	6.8	9.0	4.6	4.1	2.8	2.6	3.1
Asia	6.4	4.8	2.7	4.4	0.1	1.8	1.0	0.9	2.0
Korea	4.4	5.0	4.9	5.8	1.2	2.5	3.3	4.5	3.1
China	11.1	6.8	0.9	-1.2	-0.9	0.9	-0.2	-1.3	1.0
Latin America	42.0	25.8	15.5	15.4	12.5	8.4	5.4	6.0	5.3
Mexico	48.7	28.0	17.0	17.3	13.5	8.8	5.2	4.5	4.6
Brazil	21.5	9.6	4.6	1.5	8.1	6.0	7.4	6.3	4.3

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.

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

	2001				Projected 2002				Projected 2003			
Measure and country	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
REAL GDP (1)	Quarterly changes at an annual rate											
Total foreign	0.8	-1.0	-0.2	0.7	3.2	2.8	3.3	3.5	3.5	3.5	3.5	3.5
Industrial Countries	1.6	-0.4	-0.1	0.3	3.8	1.7	3.0	3.0	3.0	2.8	2.8	2.8
of which:												
Canada	0.6	0.3	-0.5	2.9	6.0	3.5	3.7	3.5	3.7	3.5	3.4	3.4
Japan	4.1	-4.9	-2.2	-4.9	5.7	-4.5	0.7	0.9	1.0	1.1	1.3	1.4
United Kingdom	2.6	2.0	1.7	-0.0	0.1	3.6	3.4	3.3	3.1	2.9	2.8	2.8
Euro Area (2)	2.0	0.1	0.4	-1.2	0.9	1.5	2.6	2.9	2.8	2.6	2.6	2.6
Germany	1.6	0.2	-0.7	-1.0	0.7	1.0	2.3	2.9	2.6	2.5	2.6	2.4
Developing Countries	-0.5	-1.9	-0.5	1.3	2.3	4.5	3.9	4.2	4.4	4.4	4.5	4.5
Asia	-0.8	-2.5	0.1	6.1	6.2	5.3	5.1	5.4	5.5	5.6	5.6	5.6
Korea	4.9	1.0	5.3	6.4	7.6	6.2	5.0	6.0	6.0	6.0	6.0	6.0
China	8.2	7.7	7.1	7.1	8.5	7.2	7.2	7.2	7.5	7.5	7.5	7.5
Latin America	-0.5	-1.7	-1.1	-2.5	-1.2	4.1	3.0	3.4	3.6	3.6	3.7	3.7
Mexico	-1.3	-1.7	-0.8	-2.4	-1.0	5.5	4.0	4.3	4.3	4.3	4.3	4.3
Brazil	4.8	-5.4	-1.7	0.4	5.4	2.0	0.0	1.5	1.7	2.0	2.2	2.5
CONSUMER PRICES (3)	Four-quarter changes											
Industrial Countries	1.7	2.1	1.7	0.9	1.1	0.9	1.1	1.7	1.5	1.2	1.2	1.2
of which:												
Canada	2.8	3.6	2.7	1.1	1.5	1.3	1.7	3.0	2.7	2.1	2.1	2.0
Japan	-1.0	-1.2	-1.1	-1.3	-1.5	-1.2	-1.3	-0.9	-0.8	-0.9	-0.8	-0.8
United Kingdom (4)	1.9	2.3	2.4	2.0	2.4	2.1	2.2	2.5	2.4	2.4	2.4	2.4
Euro Area (2)	2.3	3.1	2.4	2.1	2.6	2.0	2.3	2.1	1.8	1.5	1.5	1.5
Germany	2.4	3.2	2.4	1.7	2.0	1.3	1.5	1.6	0.9	0.9	0.9	0.9
Developing Countries	3.8	4.1	3.5	2.8	2.5	2.3	2.3	2.6	3.0	3.0	3.0	3.1
Asia	1.8	2.4	1.9	1.0	0.8	0.4	0.5	0.9	1.2	1.5	1.8	2.0
Korea	3.7	5.1	4.2	3.3	2.5	2.8	3.3	4.5	4.7	3.7	3.2	3.1
China	0.7	1.6	0.8	-0.2	-0.6	-1.7	-1.6	-1.3	-1.0	-0.1	0.6	1.0
Latin America	7.3	6.9	6.0	5.4	5.1	5.4	5.8	6.0	6.9	6.2	5.7	5.3
Mexico	7.5	6.9	6.0	5.2	4.8	4.7	4.7	4.5	5.4	4.9	4.7	4.6
Brazil	6.2	7.2	6.6	7.4	7.7	7.8	7.2	6.3	5.7	4.7	4.5	4.3

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1995	1996	1997	1998	1999	2000	2001	Projected 2002	Projected 2003
NIPA REAL EXPORTS and IMPORTS									
Percentage point contribution to GDP growth, Q4/Q4									
Net Goods & Services	0.4	-0.2	-0.8	-1.1	-1.0	-0.8	0.0	-0.8	-0.4
Exports of G&S	1.0	1.1	1.0	0.3	0.5	0.8	-1.2	0.6	0.8
Imports of G&S	-0.6	-1.3	-1.7	-1.3	-1.5	-1.6	1.2	-1.4	-1.3
Percentage change, Q4/Q4									
Exports of G&S	9.7	9.8	8.5	2.3	4.5	7.0	-10.9	6.6	8.4
Services	8.8	8.9	1.4	2.9	1.9	4.1	-6.9	10.6	6.1
Computers	39.1	21.6	25.8	8.1	13.8	23.1	-22.9	11.5	32.5
Semiconductors	79.6	44.6	21.3	9.1	34.6	26.9	-35.3	26.9	34.0
Other Goods 1/	4.6	7.3	9.8	1.3	3.2	5.7	-9.6	3.0	6.3
Imports of G&S	5.0	11.2	14.3	10.8	11.5	11.3	-8.5	10.8	9.2
Services	5.5	5.3	14.0	8.5	2.8	12.2	-15.0	12.6	3.7
Oil	2.4	7.8	3.9	4.1	-3.4	12.4	0.1	2.4	2.9
Computers	35.0	17.8	33.0	25.8	25.1	13.6	-13.7	38.0	32.5
Semiconductors	92.4	56.7	32.9	-8.7	33.5	22.5	-51.3	41.0	33.9
Other Goods 2/	-1.2	10.4	12.7	11.5	12.9	10.4	-5.7	8.5	8.4
Billions of chained 1996 dollars									
Net Goods & Services	-78.4	-89.0	-113.3	-221.1	-316.9	-399.1	-408.7	-480.3	-542.0
Exports of G&S	808.2	874.2	981.5	1002.4	1034.8	1133.2	1081.7	1059.8	1140.8
Imports of G&S	886.6	963.1	1094.8	1223.5	1351.7	1532.3	1490.4	1540.1	1682.8
Billions of dollars									
US CURRENT ACCOUNT BALANCE	-109.9	-120.9	-139.8	-217.5	-324.4	-444.7	-417.1	-495.0	-559.5
Current Acct as Percent of GDP	-1.5	-1.5	-1.7	-2.5	-3.5	-4.5	-4.1	-4.7	-5.0
Net Goods & Services (BOP)	-96.4	-101.8	-107.8	-166.8	-261.8	-375.7	-347.5	-420.8	-493.3
Investment Income, Net	25.0	25.5	13.6	-1.2	-8.5	-9.6	-13.7	-11.5	-5.5
Direct, Net	64.9	69.4	72.4	66.3	67.0	81.2	95.2	86.4	98.8
Portfolio, Net	-39.9	-43.9	-58.8	-67.5	-75.6	-90.9	-109.0	-97.9	-104.3
Other Income & Transfers,Net	-38.6	-44.6	-45.7	-49.4	-54.0	-59.3	-55.9	-62.8	-60.7

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

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OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1998 Q1	1998 Q2	1998 Q3	1998 Q4	1999 Q1	1999 Q2	1999 Q3	1999 Q4	2000 Q1	2000 Q2	2000 Q3	2000 Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-1.8	-1.8	-0.8	0.2	-1.8	-1.2	-0.7	-0.1	-1.3	-0.8	-0.7	-0.4
Exports of G&S	0.1	-0.5	-0.2	1.7	-0.8	0.4	1.0	1.3	0.9	1.4	1.1	-0.5
Imports of G&S	-1.9	-1.4	-0.5	-1.5	-1.0	-1.6	-1.7	-1.3	-2.2	-2.2	-1.8	0.1
Percentage change from previous period, s.a.a.r.												
Exports of G&S	0.5	-4.0	-2.2	16.3	-6.8	4.2	9.7	12.1	9.0	13.5	10.6	-4.0
Services	2.4	8.0	-8.4	10.5	-3.9	3.8	2.0	6.0	10.3	9.9	-6.7	3.7
Computers	-8.3	8.2	12.0	22.8	0.5	26.8	18.3	11.0	32.7	49.2	25.8	-7.9
Semiconductors	5.9	-17.2	272.7	-56.6	45.4	31.6	36.5	25.8	29.9	64.5	35.0	-10.2
Other Goods 1/	0.0	-9.2	-9.3	27.8	-11.5	1.1	11.0	14.2	5.3	9.1	16.3	-6.5
Imports of G&S	15.9	11.3	4.2	12.2	8.4	13.3	13.8	10.5	17.1	16.4	13.0	-0.5
Services	21.3	6.7	7.0	0.1	-8.2	1.8	7.9	11.0	20.6	12.4	17.1	0.0
Oil	3.6	42.8	1.1	-21.6	3.9	29.8	-5.8	-31.5	29.7	40.3	-4.9	-7.7
Computers	38.4	18.5	6.4	43.6	40.6	41.1	8.3	13.8	12.8	34.4	18.4	-7.2
Semiconductors	8.5	-25.4	-6.3	-8.2	37.0	47.5	12.7	39.6	45.6	24.9	64.9	-24.9
Other Goods 2/	14.2	11.9	4.1	16.2	9.0	11.3	17.6	14.0	14.6	13.1	11.9	2.4
Billions of chained 1996 dollars, s.a.a.r.												
Net Goods & Services	-180.8	-223.1	-241.2	-239.2	-283.0	-313.4	-333.3	-337.8	-371.1	-392.8	-411.2	-421.1
Exports of G&S	1003.4	993.1	987.6	1025.6	1007.6	1018.0	1041.8	1072.1	1095.5	1130.6	1159.3	1147.5
Imports of G&S	1184.2	1216.2	1228.9	1264.8	1290.6	1331.4	1375.1	1409.8	1466.6	1523.4	1570.6	1568.5
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-174.0	-209.6	-242.1	-244.1	-265.8	-309.5	-352.3	-369.9	-419.6	-432.5	-461.2	-465.3
Current Account as % of GDP	-2.0	-2.4	-2.7	-2.7	-2.9	-3.4	-3.8	-3.9	-4.3	-4.4	-4.6	-4.6
Net Goods & Services (BOP)	-139.5	-169.9	-181.9	-176.0	-211.5	-251.5	-284.5	-299.9	-349.3	-363.1	-389.4	-401.2
Investment Income, Net	9.9	5.8	-12.3	-8.3	-5.2	-6.6	-15.5	-6.7	-17.5	-14.4	-14.5	7.9
Direct, Net	74.2	69.8	57.8	63.3	66.2	63.0	63.3	75.7	65.5	72.5	84.2	102.8
Portfolio, Net	-64.2	-64.0	-70.1	-71.5	-71.4	-69.6	-78.8	-82.5	-83.0	-86.8	-98.7	-94.9
Other Inc. & Transfers, Net	-44.4	-45.5	-47.9	-59.8	-49.1	-51.5	-52.2	-63.3	-52.8	-55.0	-57.4	-72.0

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

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OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2001				2002 (Projected)				2003 (Projected)			
	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	0.6	-0.1	-0.2	-0.1	-1.0	-1.2	-0.6	-0.1	-0.6	-0.6	-0.5	-0.0
Exports of G&S	-0.1	-1.4	-2.1	-1.1	0.5	0.5	0.6	0.9	0.5	0.8	0.9	1.1
Imports of G&S	0.8	1.3	1.9	1.0	-1.5	-1.7	-1.2	-1.0	-1.2	-1.4	-1.3	-1.1
Percentage change from previous period, s.a.a.r.												
Exports of G&S	-1.2	-11.9	-18.8	-10.9	5.3	5.3	6.4	9.4	5.7	8.2	8.8	11.2
Services	1.8	2.4	-17.2	-13.1	26.0	6.1	5.4	6.2	6.6	6.1	5.9	5.8
Computers	-5.8	-41.1	-24.3	-15.7	-23.1	26.2	26.2	26.2	31.0	32.2	33.5	33.5
Semiconductors	-22.4	-56.1	-46.6	-4.0	34.4	21.4	26.1	26.1	30.9	33.4	35.9	35.9
Other Goods 1/	-0.1	-10.8	-16.8	-9.9	-3.5	2.7	4.4	9.0	1.9	6.0	6.8	10.7
Imports of G&S	-5.0	-8.4	-13.0	-7.5	12.9	13.9	9.3	7.4	8.7	10.6	9.6	8.1
Services	4.9	-2.0	-29.1	-28.5	52.0	3.5	0.9	1.3	2.7	3.7	4.2	4.3
Oil	27.1	4.3	-26.7	3.5	-18.5	31.3	19.2	-14.0	-1.6	25.1	8.2	-16.0
Computers	-11.0	-29.1	-24.9	16.9	80.5	21.5	26.2	31.0	31.0	32.2	33.5	33.5
Semiconductors	-31.8	-75.0	-58.4	-20.4	83.8	35.5	26.0	26.0	30.8	33.3	35.8	35.8
Other Goods 2/	-8.4	-4.8	-4.5	-5.1	3.3	13.6	8.3	8.9	8.7	8.4	8.2	8.4
Billions of chained 1996 dollars, s.a.a.r.												
Net Goods & Services	-404.5	-406.7	-411.0	-412.7	-443.9	-479.3	-497.2	-500.9	-519.4	-539.0	-553.7	-556.1
Exports of G&S	1144.1	1108.3	1052.2	1022.2	1035.4	1048.9	1065.2	1089.5	1104.6	1126.5	1150.5	1181.5
Imports of G&S	1548.6	1515.0	1463.2	1434.9	1479.2	1528.2	1562.4	1590.5	1624.0	1665.4	1704.2	1737.5
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-448.5	-431.7	-394.1	-393.9	-459.3	-488.5	-506.8	-525.3	-527.8	-549.3	-569.4	-591.5
Current Account as % of GDP	-4.4	-4.2	-3.9	-3.8	-4.4	-4.6	-4.8	-4.9	-4.8	-5.0	-5.1	-5.2
Net Goods & Services (BOP)	-381.3	-363.4	-313.8	-331.4	-366.5	-420.0	-444.9	-451.6	-470.8	-490.3	-505.0	-507.1
Investment Income, Net	-14.6	-14.5	-24.4	-1.5	-24.9	-12.1	-5.6	-3.3	0.4	-1.6	-6.9	-14.0
Direct, Net	90.8	93.8	87.9	108.4	77.2	84.6	90.9	93.0	97.0	98.3	99.2	100.7
Portfolio, Net	-105.3	-108.4	-112.3	-109.9	-102.1	-96.7	-96.4	-96.2	-96.7	-99.9	-106.1	-114.6
Other Inc. & Transfers, Net	-52.7	-53.8	-55.9	-61.0	-67.9	-56.4	-56.4	-70.4	-57.4	-57.4	-57.4	-70.4

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