Appendix 1: Materials used by Ms. Johnson and Mr. Gagnon

STRICTLY CONFIDENTIAL (FR) CLASS II FOMC

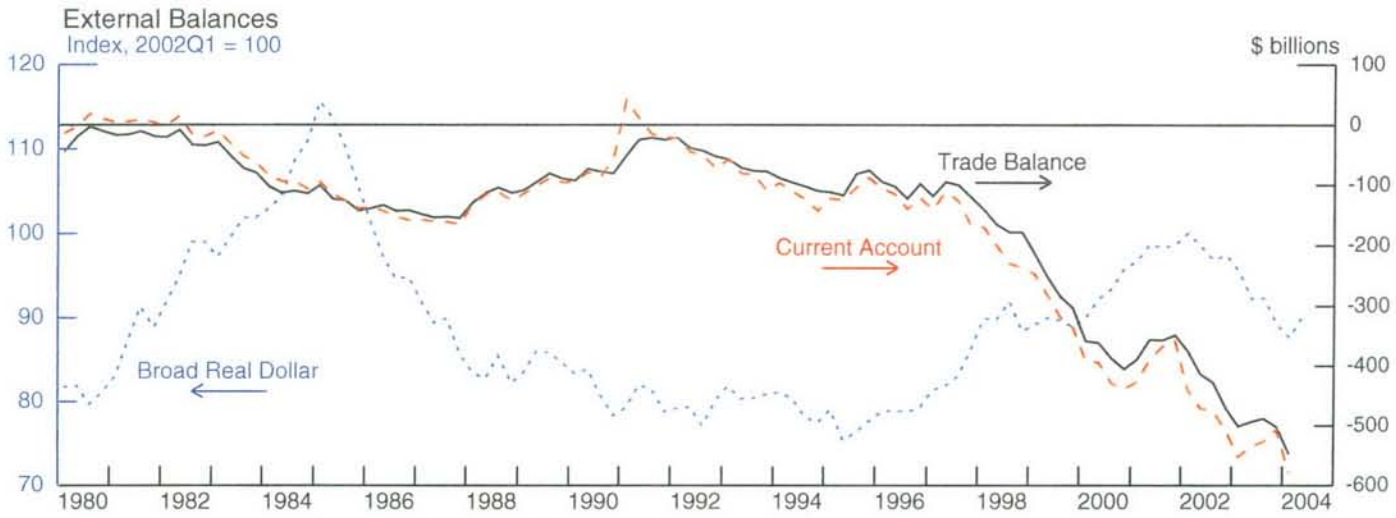
Material for the FOMC presentation on

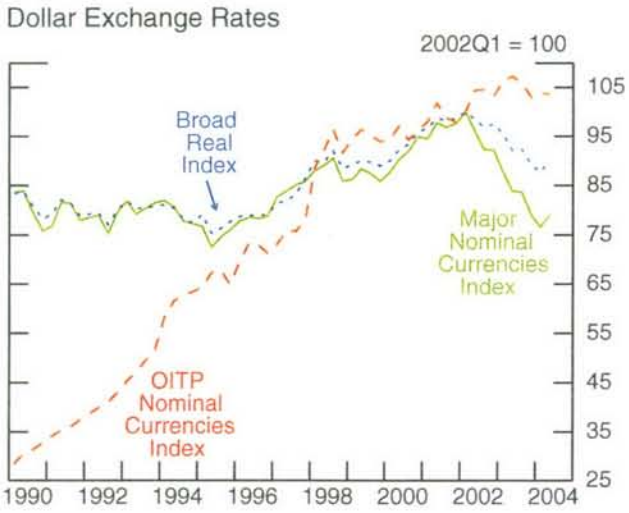
U.S. External Adjustment

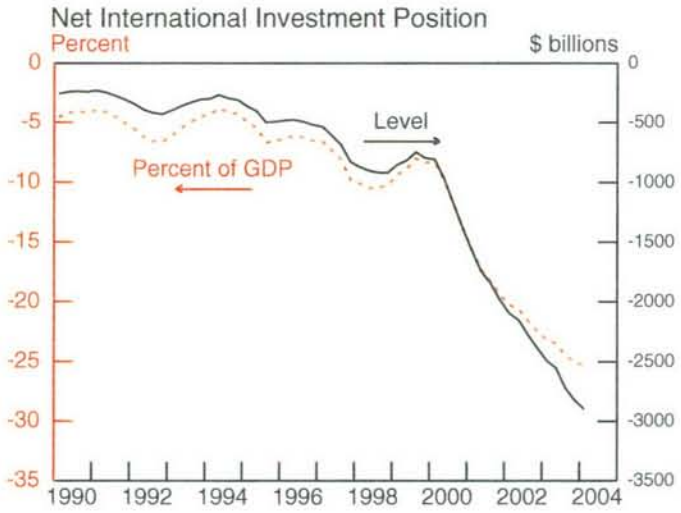
Karen Johnson and Joseph Gagnon
Exhibits by James Chavez
June 29, 2004

Exhibit 1 06-28-04

External Adjustment: Alternative Perspectives







Financial Flows
$ billions, s.a.a.r.

	2003	2004Q1
1. Current account	**-531**	**-580**
2. Foreign official	249	501
3. Pvt. foreign purchases of U.S. securities	364	515
4. Pvt. U.S. purchases of foreign securities (-)	-72	-61
5. Net direct investment	-134	-157
6. Other*	124	-218

*Primarily net flows reported by banking and non-banking concerns, acquisition of U.S. currency, and the statistical discrepancy.

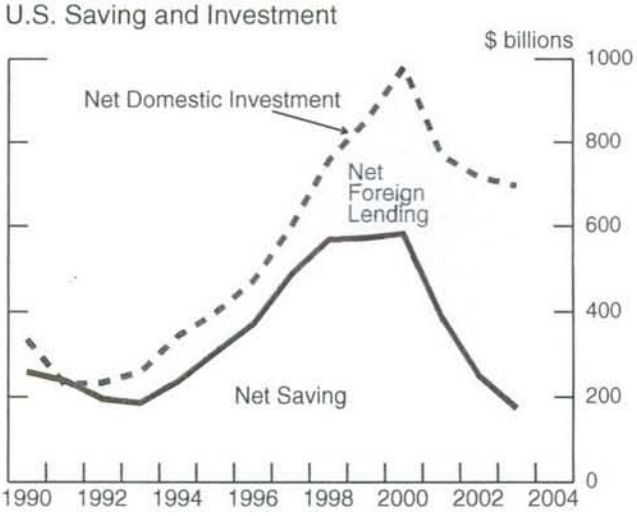
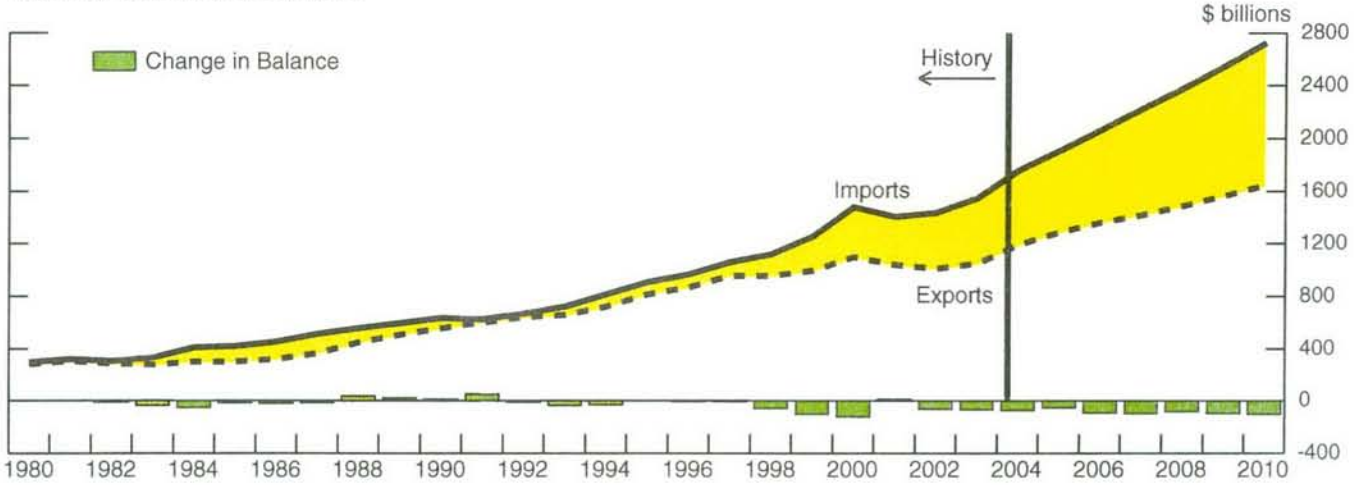


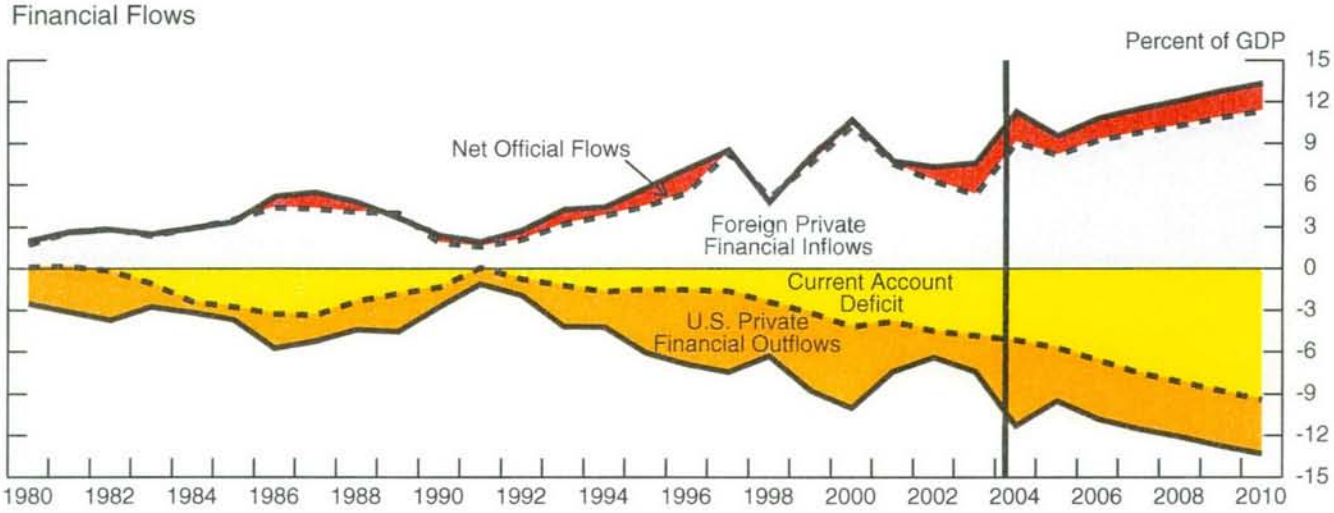
Exhibit 2 06-28-04

Financing

Nominal Goods and Services



Financial Flows



Foreign Official Holdings in the United States
$ billions, end of period

	2001	April 2004e	Change
1. Total	1074	1630	556
2. Treasury	*728*	*1092*	*364*
3. Selected Asia*	476	972	496
4. Treasury	*381*	*784*	*403*
5. Other	598	658	60
6. Treasury	*347*	*308*	*-39*

*Selected Asia includes Japan, China, Taiwan, Korea, and Hong Kong.

Foreign Private Holdings in the United States
$ billions, end of period

	1995	2004Q1e
1. Treasury Securities	330	715
2. Agency Securities	129	485
3. U.S. Corporate Debt	361	1553
4. U.S. Equities	550	1655
5. FDI in U.S.	799	1621

Exhibit 3 06-28-04

Orderly Adjustment

Characteristics

- Financial markets function normally.
- More likely if returns improve abroad.
- Net financial inflows into U.S. economy continue.
- Dollar depreciation almost certainly required.

Share of U.S. Assets Held by Foreigners
Percent, 2004Q1 end of period

	Share of Total Outstanding
Treasury Securities	47.6
Official	*30.9*
Agency Securities	11.1
Official	*3.2*
U.S. Corporate Debt	24.8
U.S. Equities	12.0

Foreign Portfolios of Bonds and Equities
Percent, December 2002

Share of Portfolio in:	Domestic Securities	U.S. Securities
	(1)	(2)
1. Euro Area	85.4	5.4
2. Switzerland	43.5	9.7
3. United Kingdom	61.4	9.2
4. Canada	84.2	8.6
5. Japan	81.6	6.8
6. Hong Kong	58.3	9.2
7. Korea	82.0	7.1
8. Singapore	45.0	13.9
9. Australia	80.5	9.6

U.S. Merchandise Exports
Percent

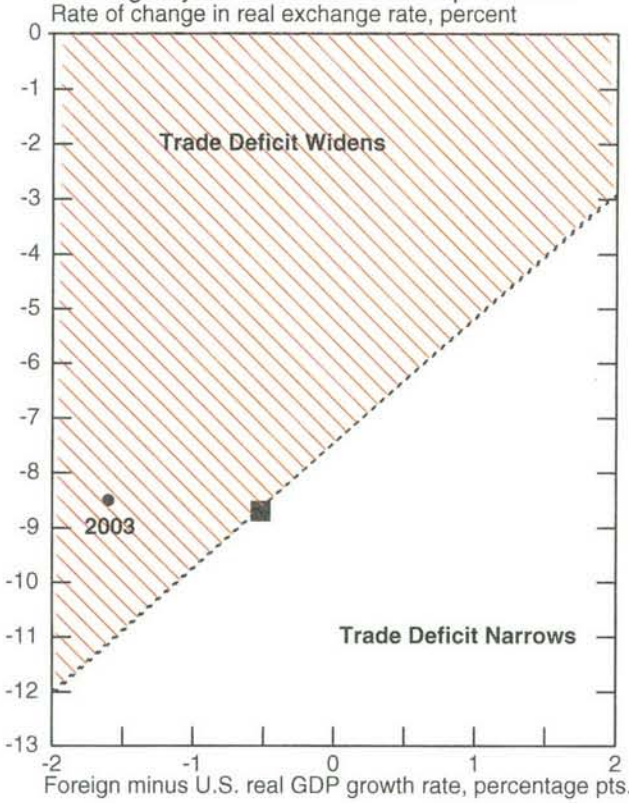
	Share of Exports 2003	Share of Change 2002Q1 to 2004Q1
1. Canada	23	22
2. Western Europe	23	17
3. Mexico	13	11
4. Other Asia*	8	8
5. Japan	7	2
6. Other Latin America	7	8
7. China and Hong Kong	6	16
8. Korea	3	4
9. Middle East**	2	3
10. Australia	2	1

*Includes Singapore, Taiwan, Indonesia, Philippines, Thailand, and Malaysia.
**Includes Israel, Iran, Iraq, Kuwait, Qatar, Saudi Arabia, and UAE.

Exhibit 4 06-28-04

Starting Adjustment: Growth & Depreciation

Rate of change in real exchange rate, percent



Implications for U.S. Economy

- Demand here and abroad shifts to U.S.-made goods.
- U.S. domestic demand is reduced relative to U.S. production.
- Fiscal contraction could contribute to domestic demand constraint.
- Monetary policy maintains full utilization of resources.
- Sectoral shifts in production may entail adjustment costs.

Disorderly Adjustment

-- Abrupt adjustment entails asset price changes.

-- Other U.S. asset prices could be affected.

-- Exchange rate depreciation at center. Magnitude and pace.

-- Implications for global asset prices.

U.S. Corporate Debt Outstanding

$ billions, end 2003

Total	12,202
Foreign currency	517
Euro	351
Pound	71
Yen	60
Other	36
Foreign currency share	*4%*

Foreign Holdings of U.S. Assets*

End 2003

	Dollar billions	Percent of own GDP
1. Total Foreign	8053	32
2. Europe	4434	37
3. United Kingdom	*1102*	*61*
4. Canada	487	56
5. Japan	1305	30
6. China	351	25
7. Other Asia	830	35

*Bank positions netted; Caribbean and unknown holdings distributed to other countries pro rata.

Exhibit 5 06-28-04

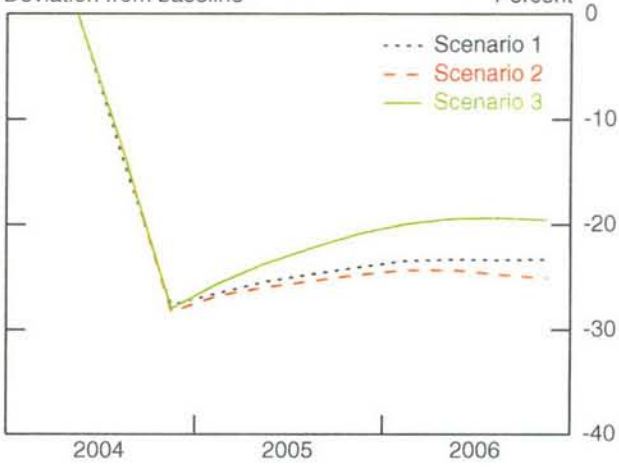
Disorderly Adjustment Scenarios

Scenario 1: 30 percent dollar depreciation absent responses in interest rates. U.S. and foreign policy interest rates follow Taylor rule.

Scenario 2: Scenario 1 plus 250 b.p. increase in U.S. equity and bond premiums. Smaller financial shock in foreign economies.

Scenario 3: Scenario 2 with no zero bound on policy interest rates (quantitative easing).

Real Exchange Value of Dollar
Deviation from baseline

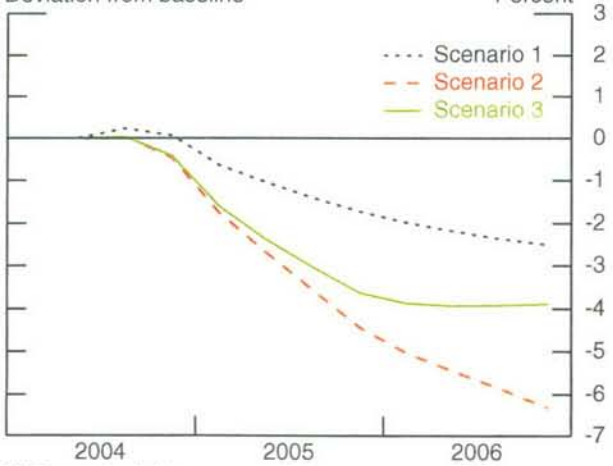


U.S. Output and Price Responses
Deviation from baseline, percent

	Scenario 1		Scenario 2		Scenario 3	
	2005Q4 (1)	2006Q4 (2)	2005Q4 (3)	2006Q4 (4)	2005Q4 (5)	2006Q4 (6)
1. GDP	1.9	1.8	-0.8	-1.9	-0.7	-1.9
2. Domestic Demand*	-0.5	-1.2	-3.3	-5.2	-3.2	-5.0
3. Net Exports*	2.4	3.0	2.5	3.3	2.5	3.1
4. Core PCE Prices	0.9	1.4	0.8	1.0	0.7	0.8
5. Non-oil Import Prices	8.9	9.2	9.2	9.8	7.6	7.0

*Percent of GDP.

Foreign GDP*
Deviation from baseline



*U.S. export weights.

Trade Balance
Deviation from baseline

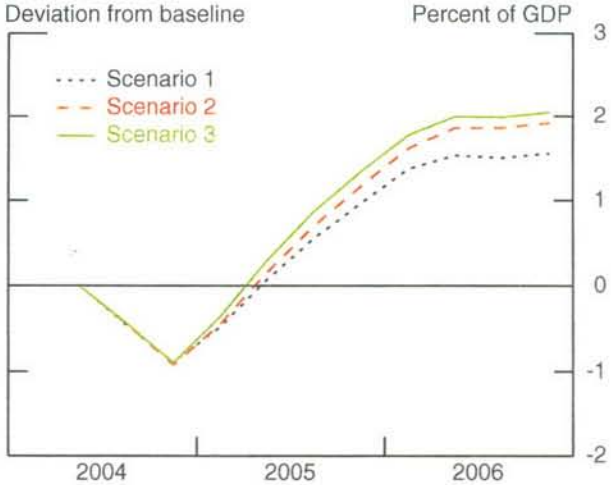
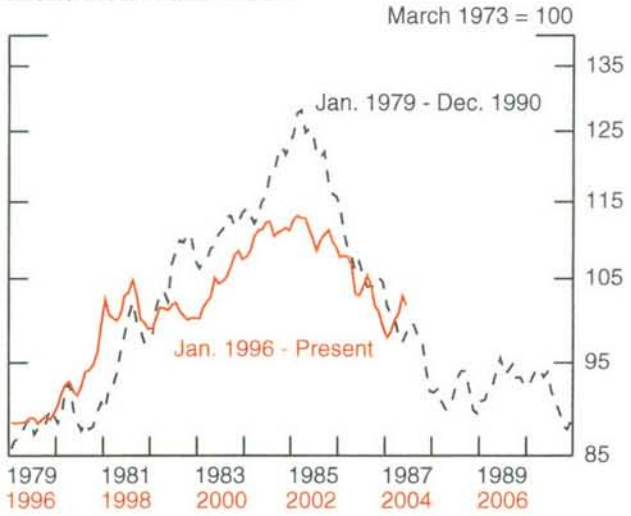


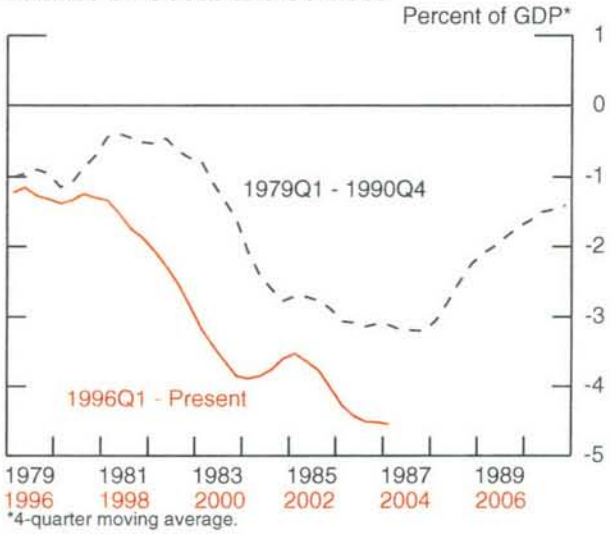
Exhibit 6 06-28-04

Is Adjustment Under Way?

Broad Real Dollar Index

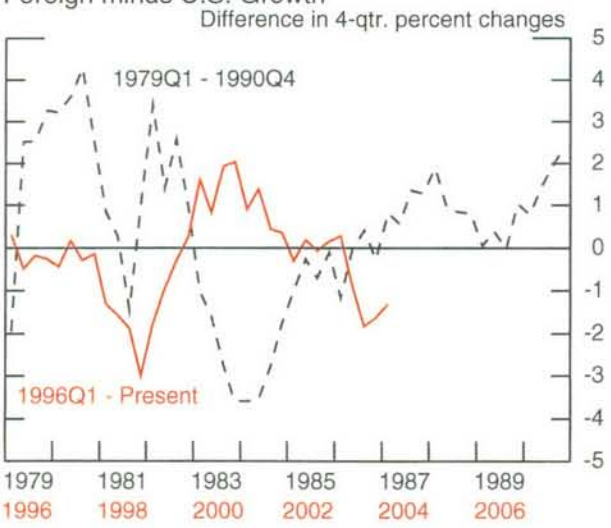


Balance on Goods and Services



Real Import and Export Growth Rates

Foreign minus U.S. Growth



Net Securities Flows

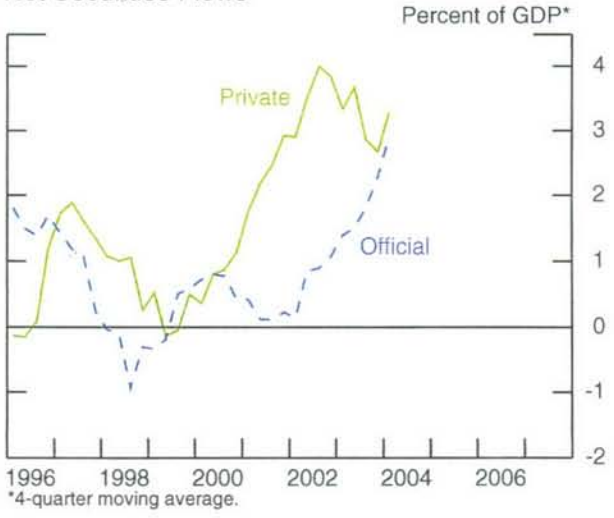
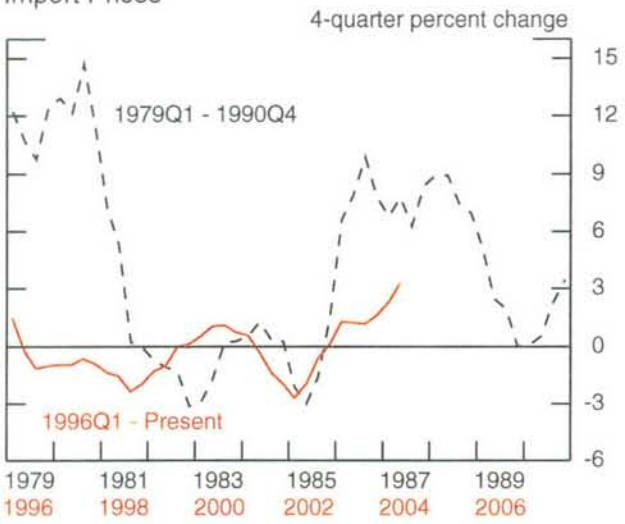


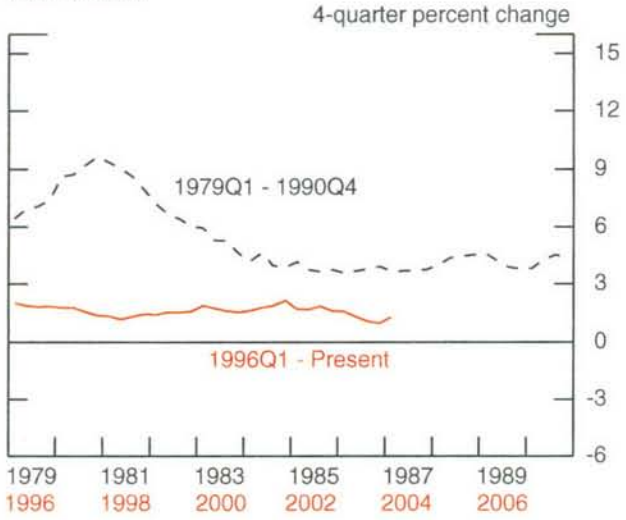
Exhibit 7 06-28-04

Import Prices*



*Excluding natural gas, oil, computers, and semiconductors.

PCE Prices*



*Excluding food and energy.

Conclusions

- U.S. external deficits are not sustainable.
- Depreciation in 2002 and 2003 helped slow the widening trade deficit, but no evidence that adjustment has begun.
- Substantial further dollar depreciation is required.
- Orderly adjustment of 1980s associated with acceleration of foreign activity and brighter investment prospects abroad.
- Disorderly adjustment more likely with loss of confidence in U.S. policies and prospects.
  - -- Contractionary effects could be greater for foreign economies.
  - -- Asset price declines depress output at home and abroad.
  - -- Dollar depreciation boosts U.S. production and damps foreign production.
- Effect on U.S. inflation is modest.

Appendix 2: Materials used by Ms. Goldberg

EXHIBIT 1

International Trade Exposure of High-Trade-Oriented U.S. Industries

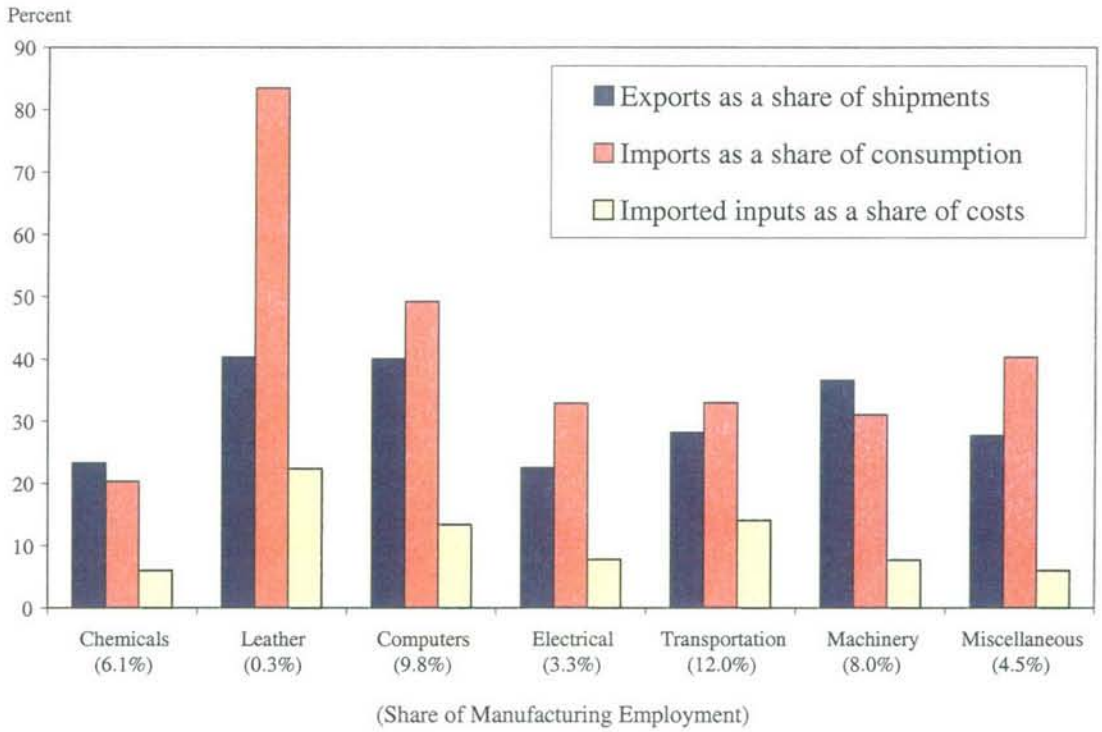
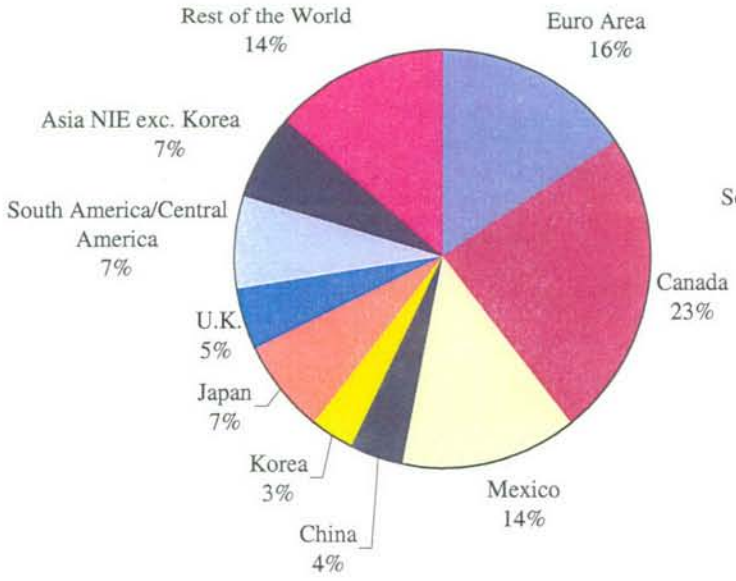


EXHIBIT 2

Trade Partner Shares of Total U.S. Exports and Imports, 2003

Destinations of U.S. Exports



Sources of U.S. Imports

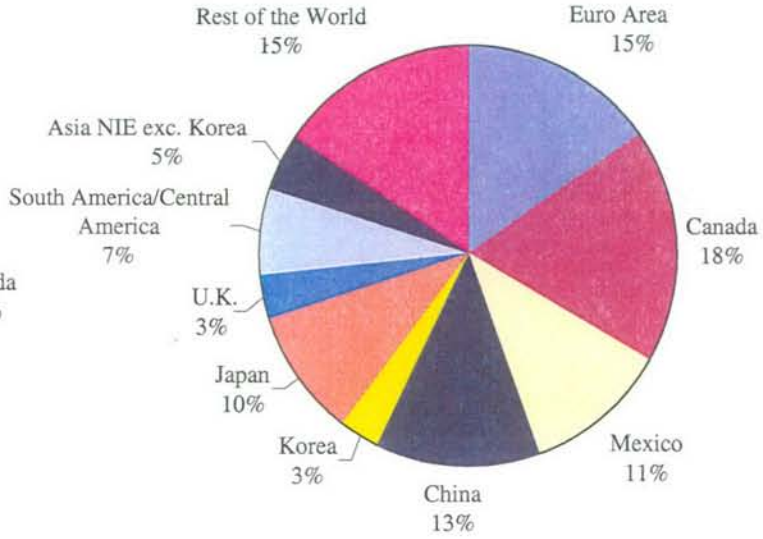


EXHIBIT 3

Export Destinations and Import Sources of High-Trade-Oriented U.S. Industries

Industries (NAICs)	Destinations of U.S. Exports (Percentage of Industry Exports)			Sources of U.S. Imports (Percentage of Industry Imports)		
	Euro Area	Japan	China	Euro Area	Japan	China
Chemicals	25	7	4	42	8	3
Leather and allied products	11	14	6	12	0	61
Machinery, except electrical	15	6	4	26	23	11
Computer and electronics	17	7	5	8	12	21
Transportation equipment	16	6	3	17	22	1
Electrical equipment, appliances	12	4	2	11	7	28
Miscellaneous manufacturing	27	12	1	15	4	35
Total U.S. exports or imports	16	7	4	15	10	13

EXHIBIT 4

U.S. Manufacturing Employment in Industries with Different Degrees of Penetration by Chinese Products

Made in China, As a share of U.S. Consumption by Industry	Industry Share in Total U.S. Manufacturing Employment (Percent, 2003)
Less than 5 percent	69.3
Between 5 and 10 percent	22.6
Between 10 and 20 percent	6.2
More than 20 percent	1.9

EXHIBIT 5

Real Dollar Exchange Rates
Index: January 2000=100

EXHIBIT 6

Dollar Depreciation Experienced by High-Trade-Oriented U.S. Industries

	2/1/02 to 6/25/04 (In Percent)	
Industries (NAICs)	Export-Partner Weighted*	Import-Partner Weighted*
Chemicals	15.8	26.6
Leather and allied products	7.0	3.8
Machinery, except electrical	13.5	18.0
Computer and electronics	9.8	5.2
Transportation equipment	16.6	15.3
Electrical equipment, appliances	10.4	5.5
Miscellaneous manufacturing	18.4	7.4

*Constructed using real bilateral exchange rates and respective trade weights.

EXHIBIT 7

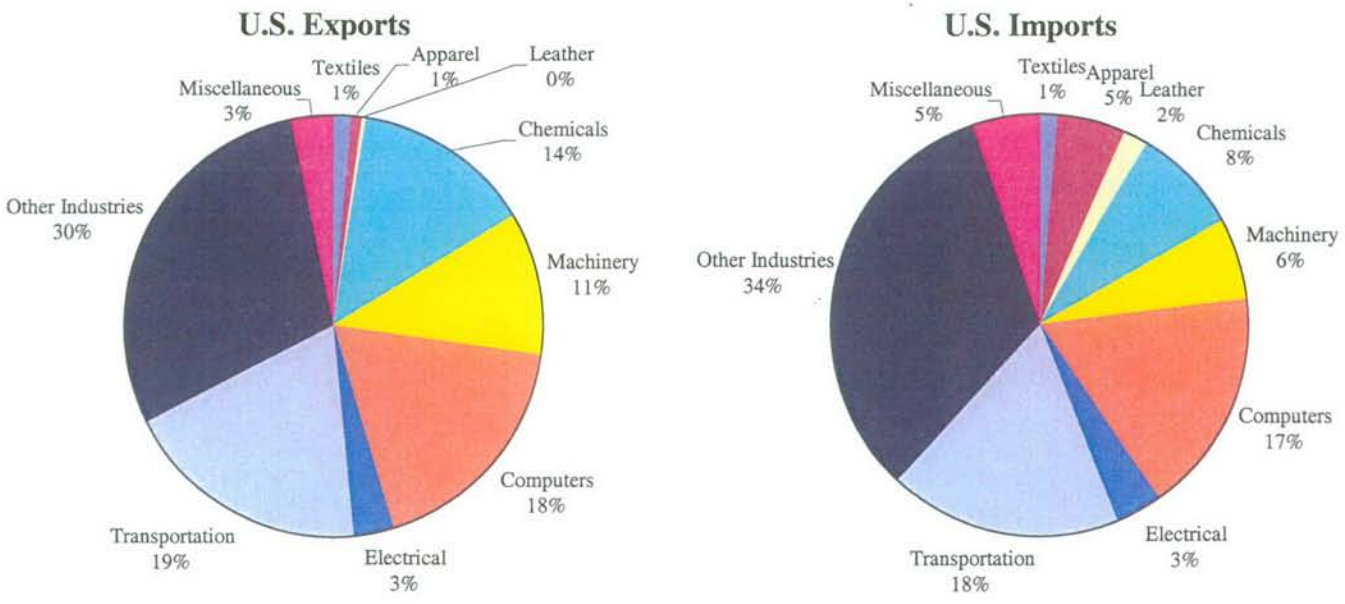
Import Price Elasticity to Exchange Rate Movements

Industry Weight (%)	Industry (SITC)	Data included in Analysis	
		Late 1970s/Early 1980s -2004:Q2#	1990:Q1 -2004:Q2#
	All commodities	**0.54**	**0.75**
	All commodities except fuels	**0.46**	**0.27**
(0.9)	Beverages and tobacco	**0.19**	0.01
(2.1)	Crude materials, inedible, except fuels	**0.74**	**0.82**
(13.9)	Mineral fuels, lubricants, and related	0.29	1.73
(7.7)	Chemicals and related products	**0.39**	**0.37**
(12.2)	Manufactured goods (classified)	**0.72**	**0.69**
(41.8)	Machinery and transport equipment	**0.41**	**0.17**
(17.1)	Miscellaneous manufactured articles	**0.40**	0.16

Indicated in bold are data significantly different from zero.
2004:Q2 data use April and May 2004 import prices and consensus forecast for GDP.

EXHIBIT 8

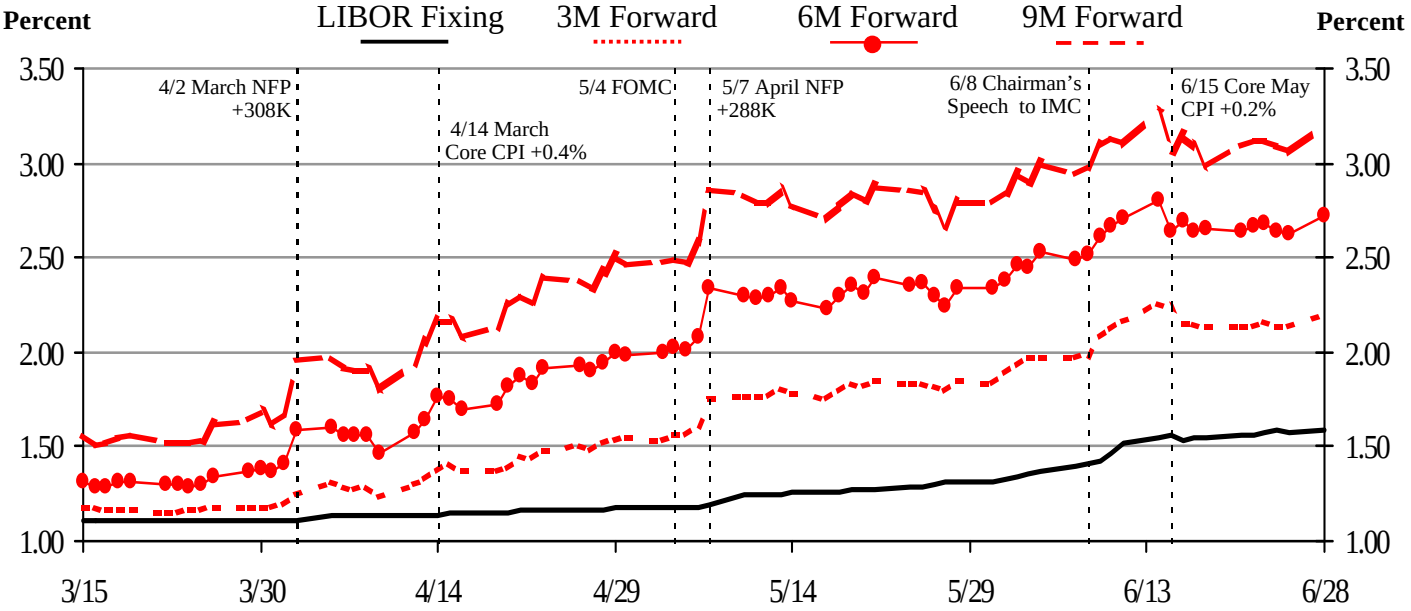
Industry Contribution to Total U.S. Exports and Imports, 2003



Appendix 3: Materials used by Mr. Kos

Current U.S. 3-Month Deposit Rates and Rates Implied by Traded Forward Rate Agreements

March 15, 2004 - June 28, 2004

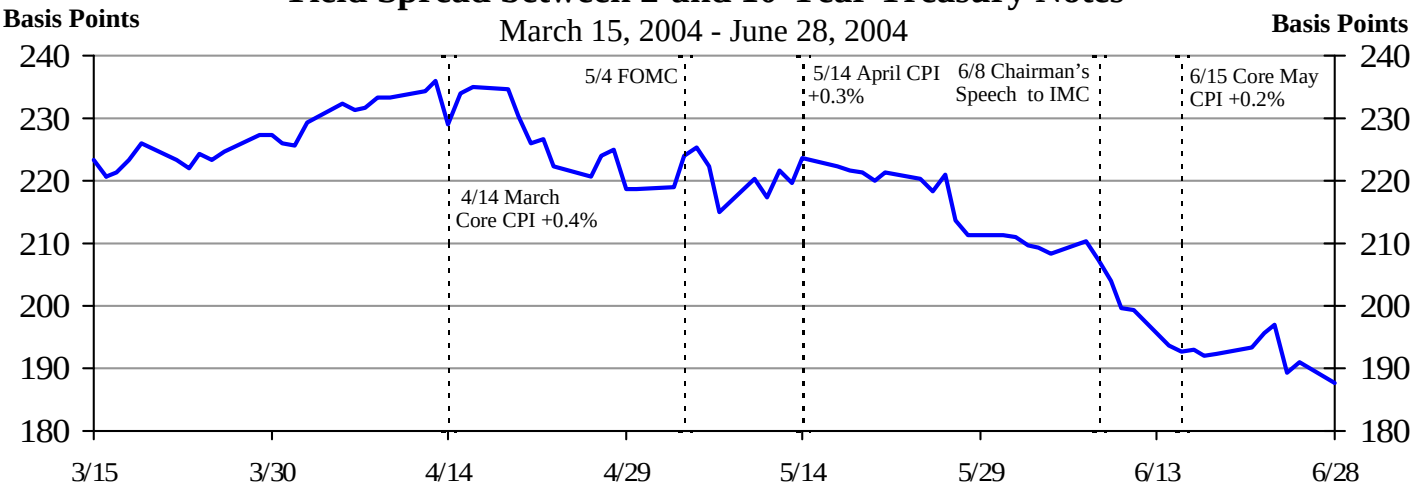


Target Federal Funds Rate and 2-Year Treasury Note

January 1, 2002 - June 28, 2004

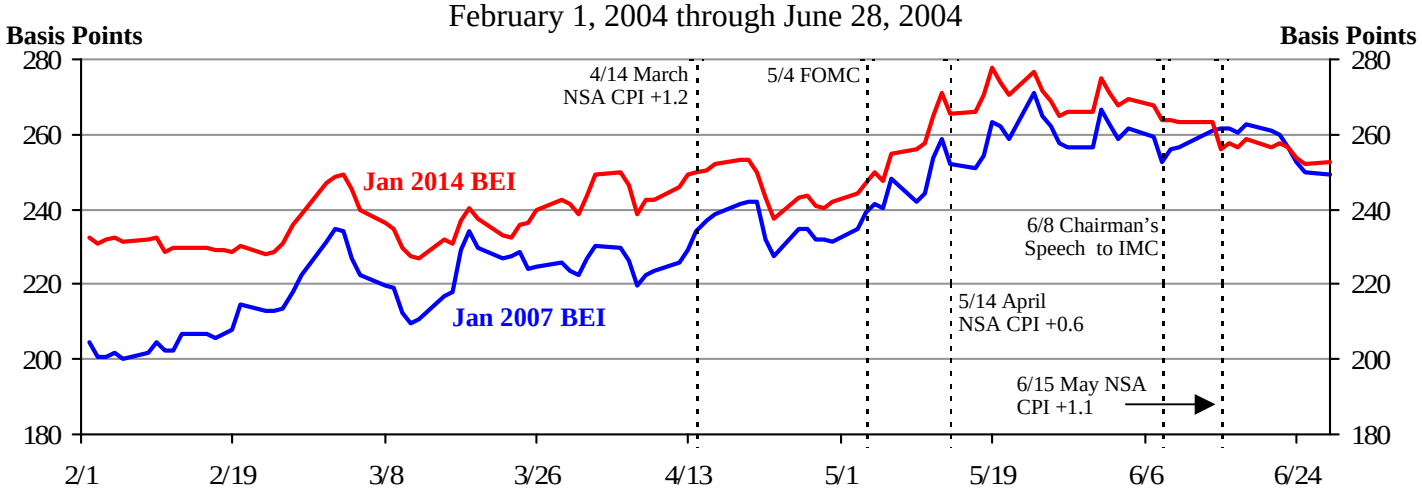
Yield Spread between 2-and 10-Year Treasury Notes

March 15, 2004 - June 28, 2004



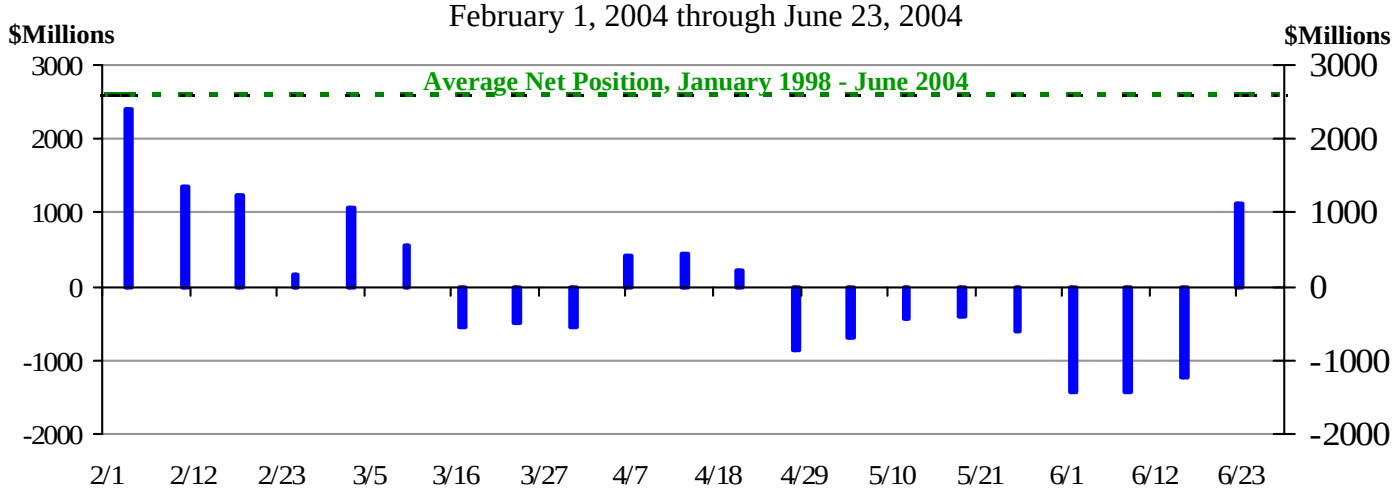
TIPS Breakeven Inflation Rates

February 1, 2004 through June 28, 2004

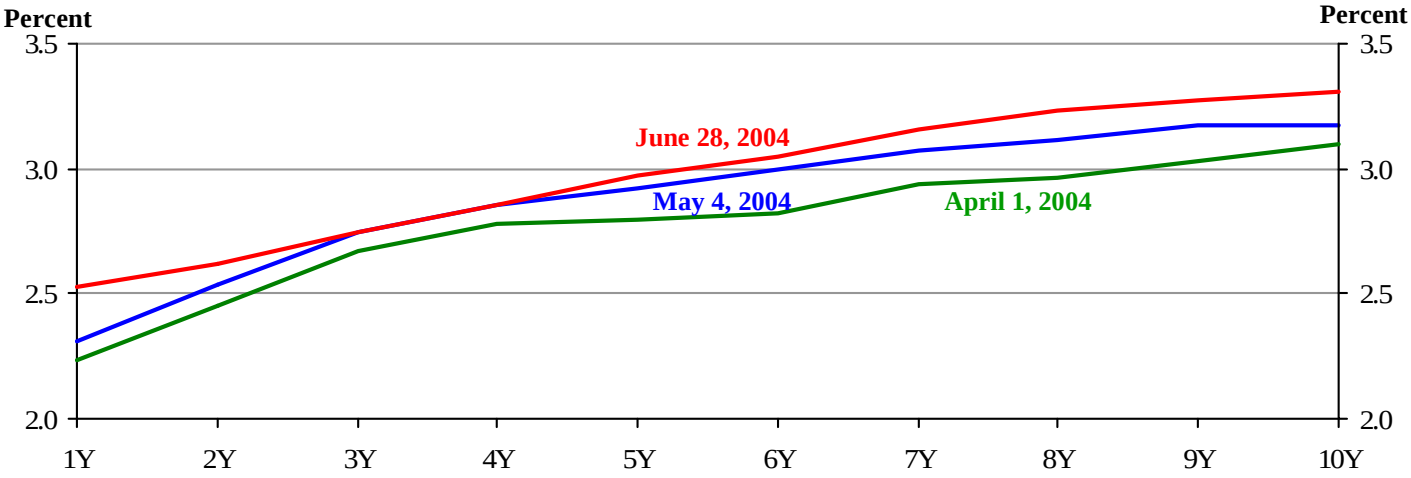


Primary Dealers Net Outright Positions in TIPS

February 1, 2004 through June 23, 2004

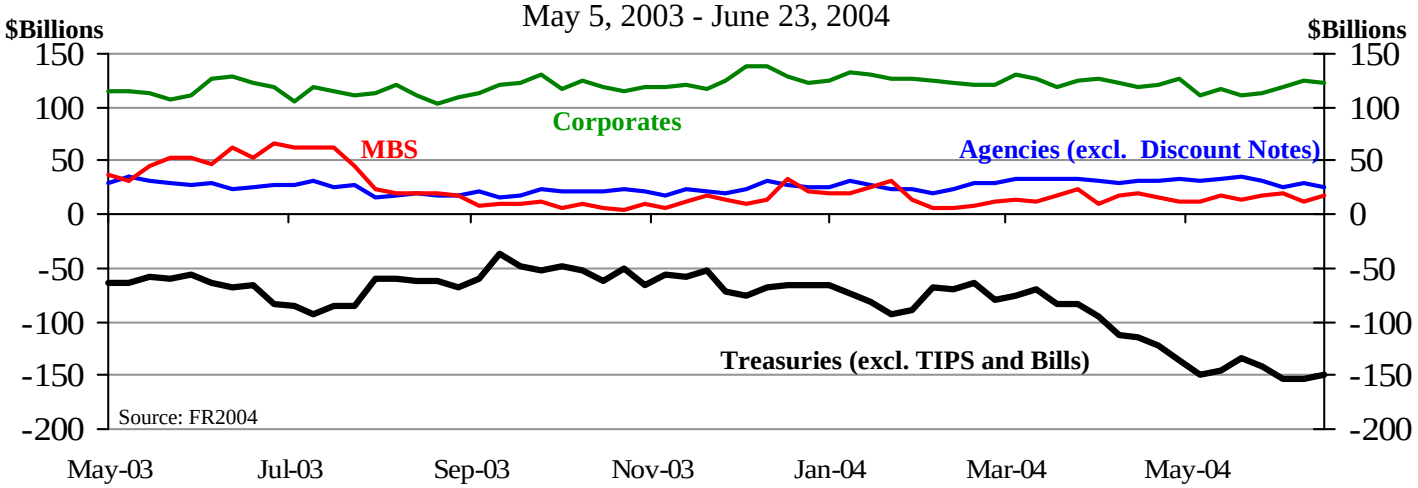


1-Year Inflation Forward Rates Derived from CPI Swaps



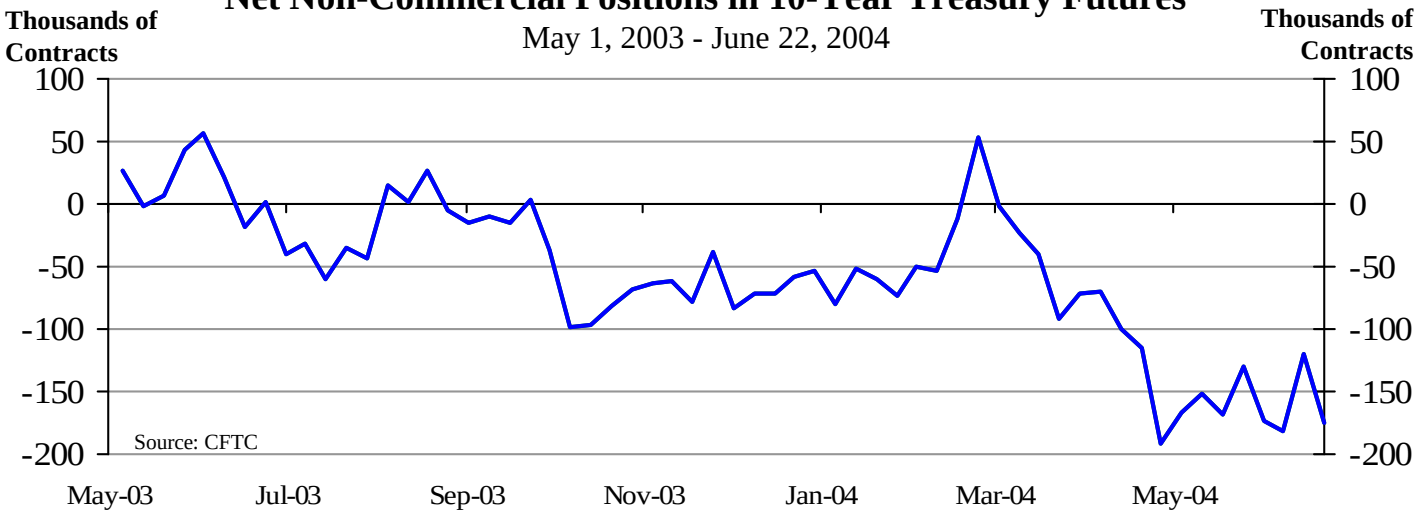
Primary Dealer Net Outright Positions

May 5, 2003 - June 23, 2004



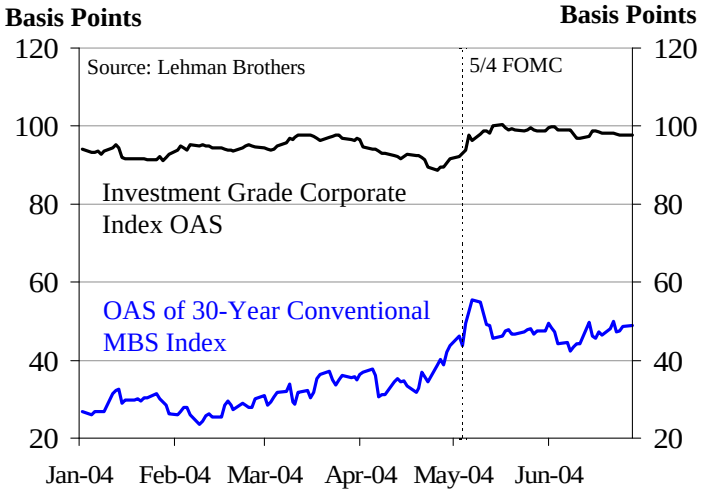
Net Non-Commercial Positions in 10-Year Treasury Futures

May 1, 2003 - June 22, 2004



MBS and Corporate Debt Spreads

January 1, 2004 - June 28, 2004

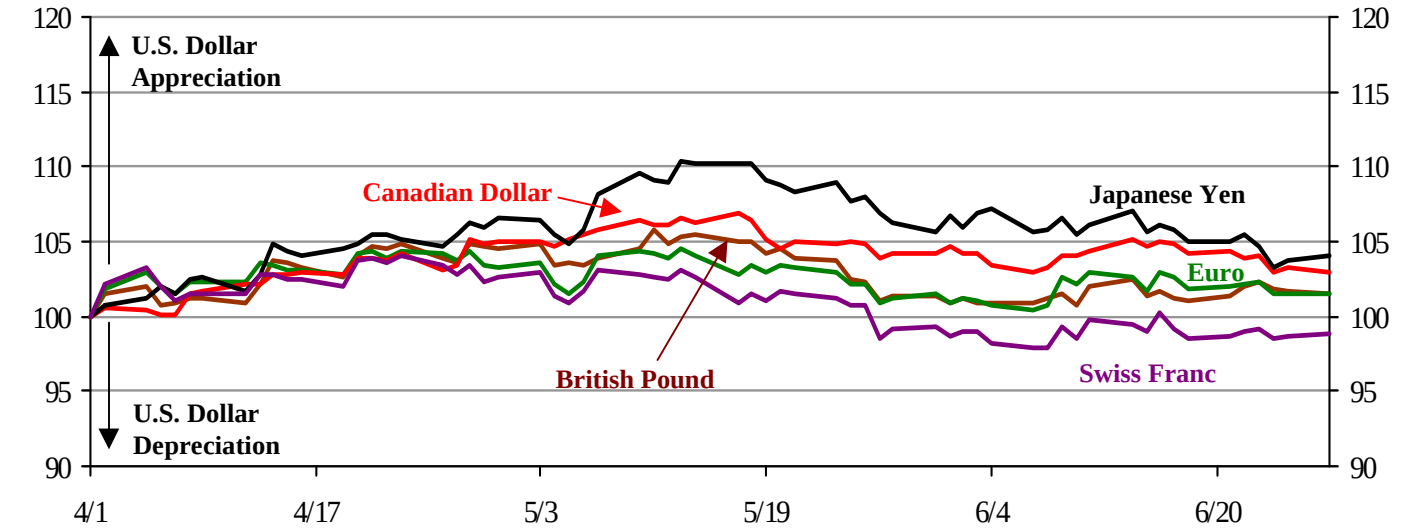


High Yield and EMBI+ Spreads

January 1, 2004 - June 28, 2004

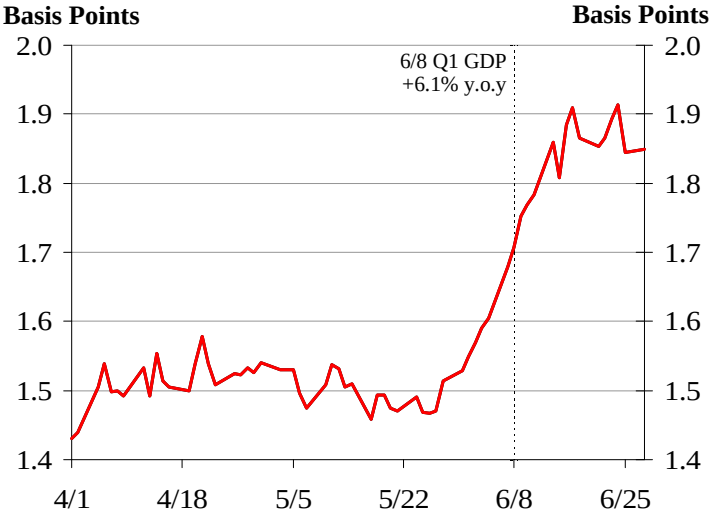
Select Foreign Currencies Versus U.S. Dollar

April 1, 2004 - June 28, 2004

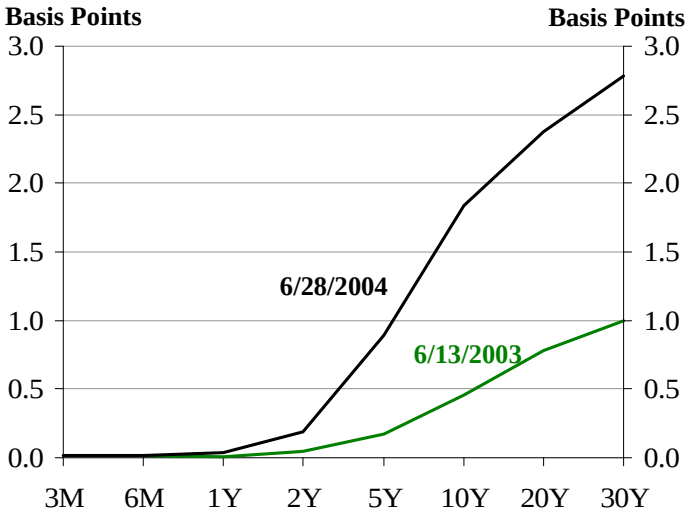


Yield on the 10-Year Japanese Government Bond

April 1, 2004 through June 28, 2004

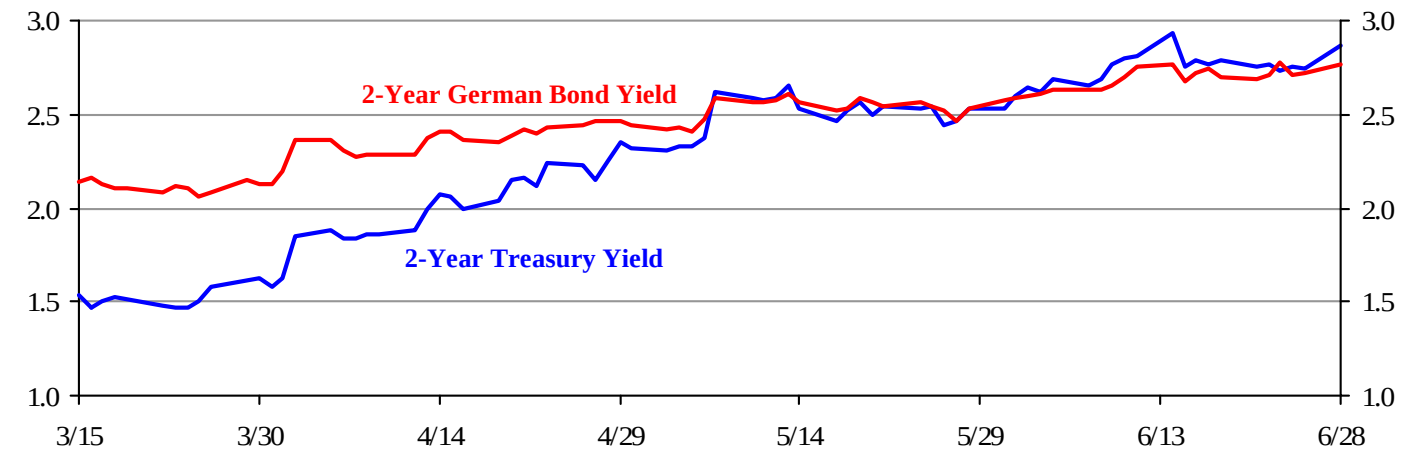


Japanese 3-Month to 30-Year Government Bond Yield Curve

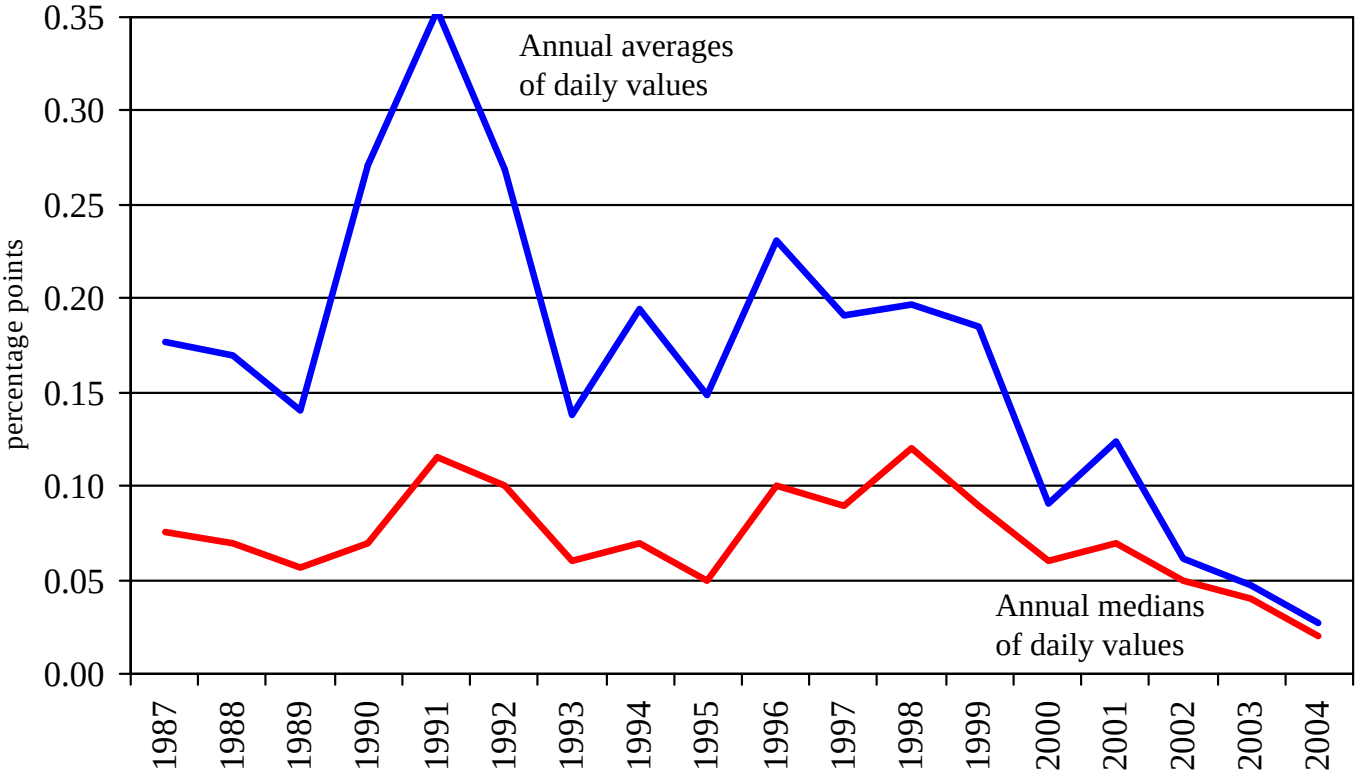


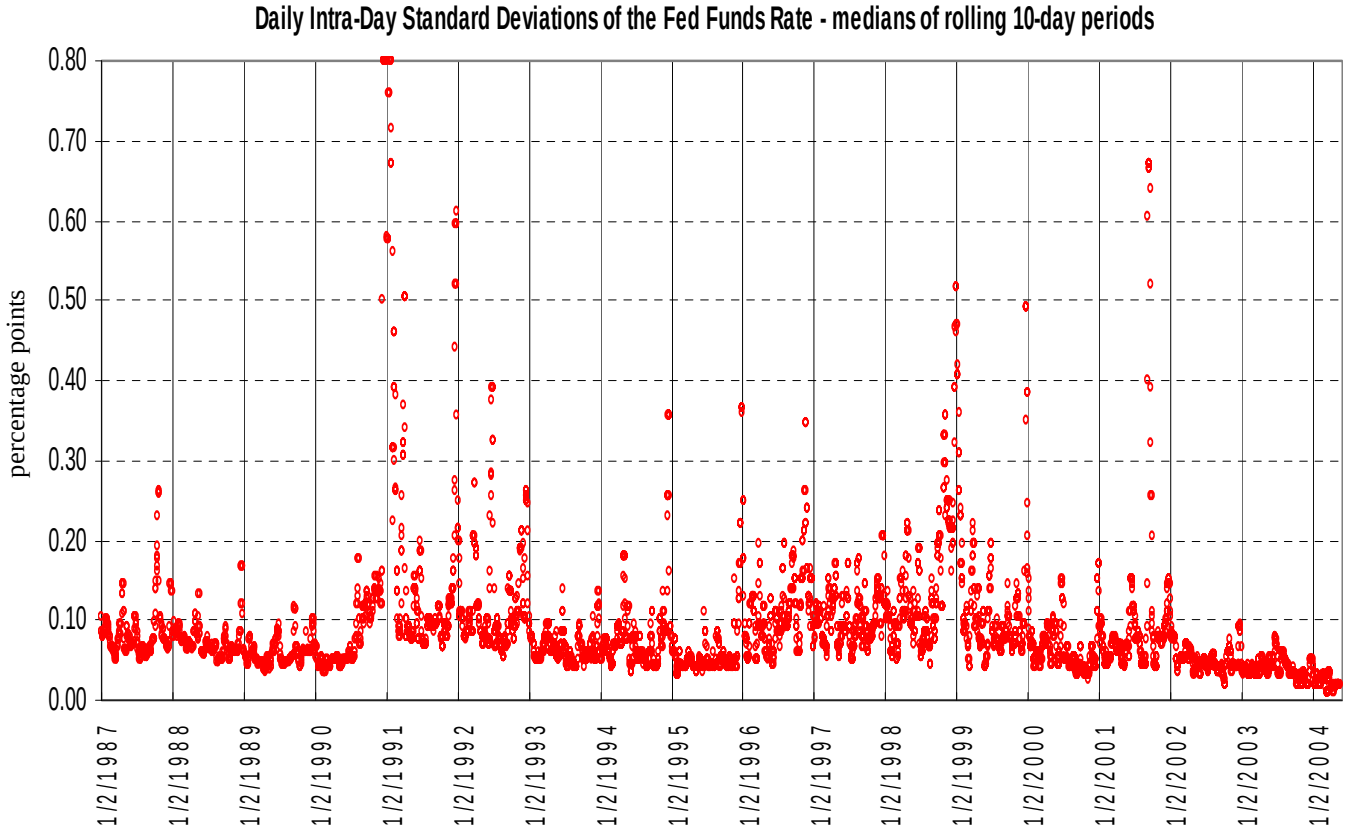
2-Year U.S. and German Government Debt Yields

March 15, 2004 through June 28, 2004

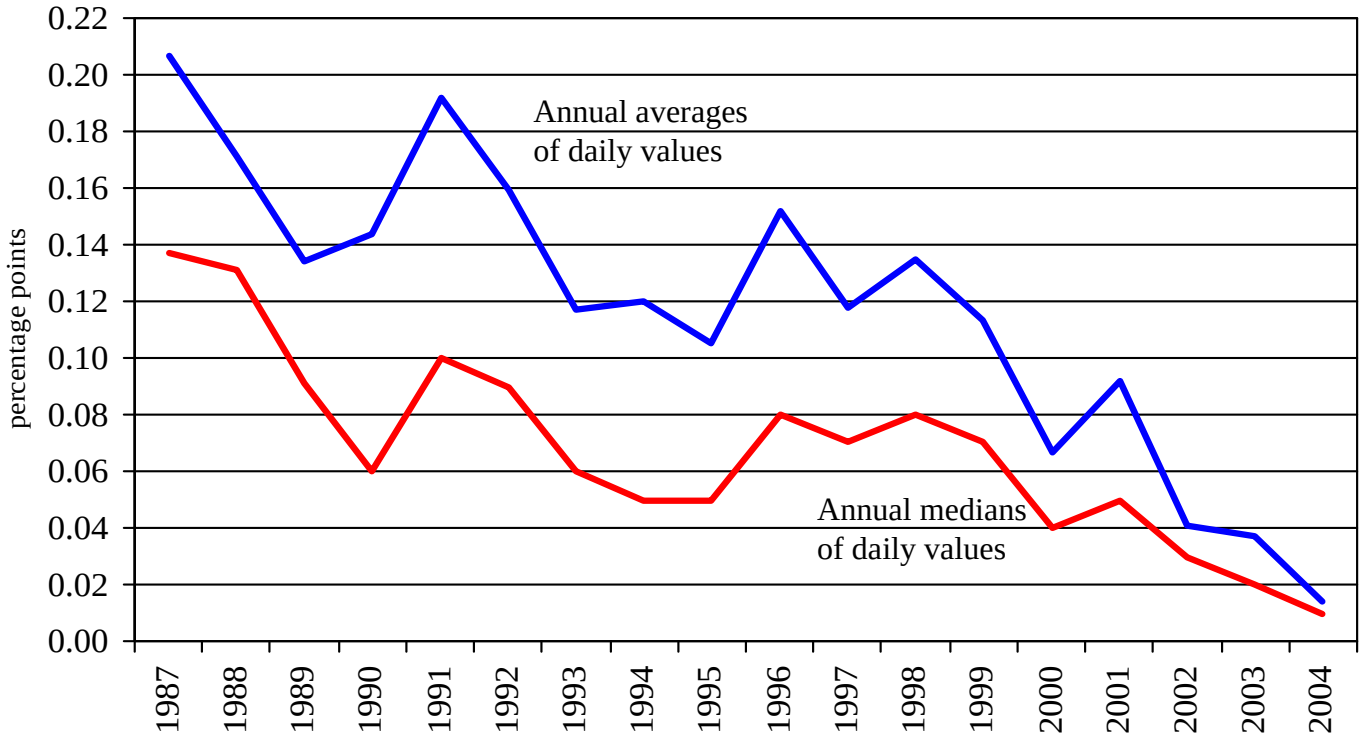


Daily Intra-Day Standard Deviations of the Federal Funds Rate

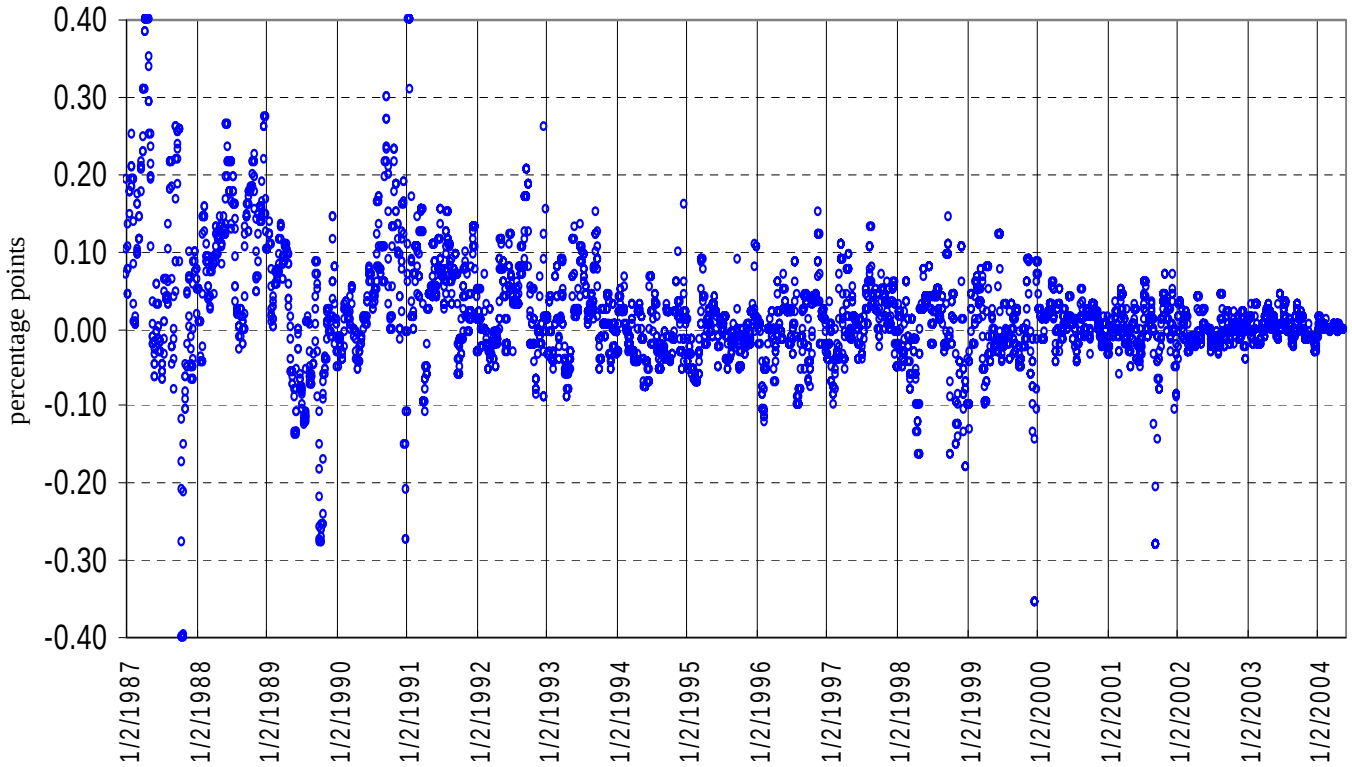




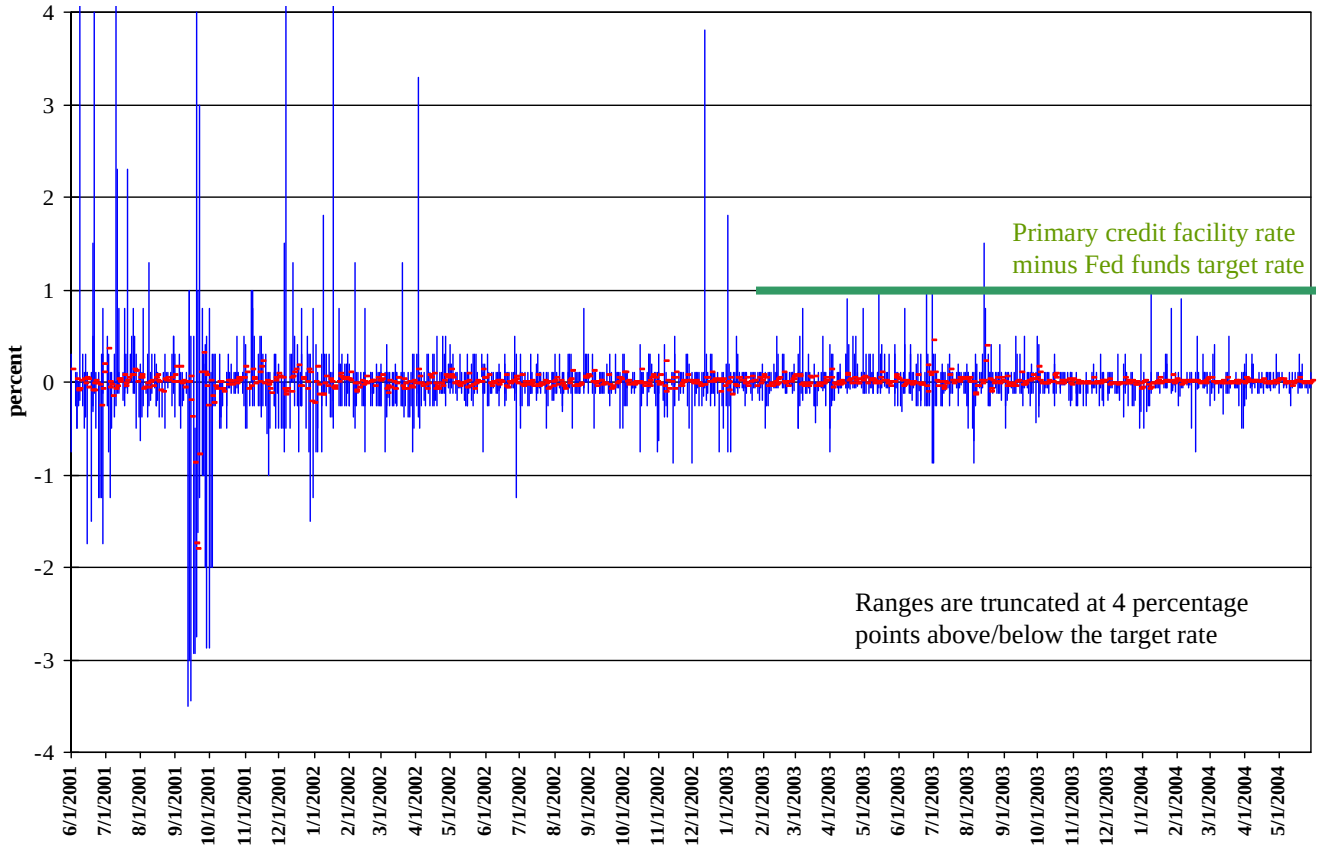
Absolute Deviations of Daily Effective Federal Funds Rate from Target



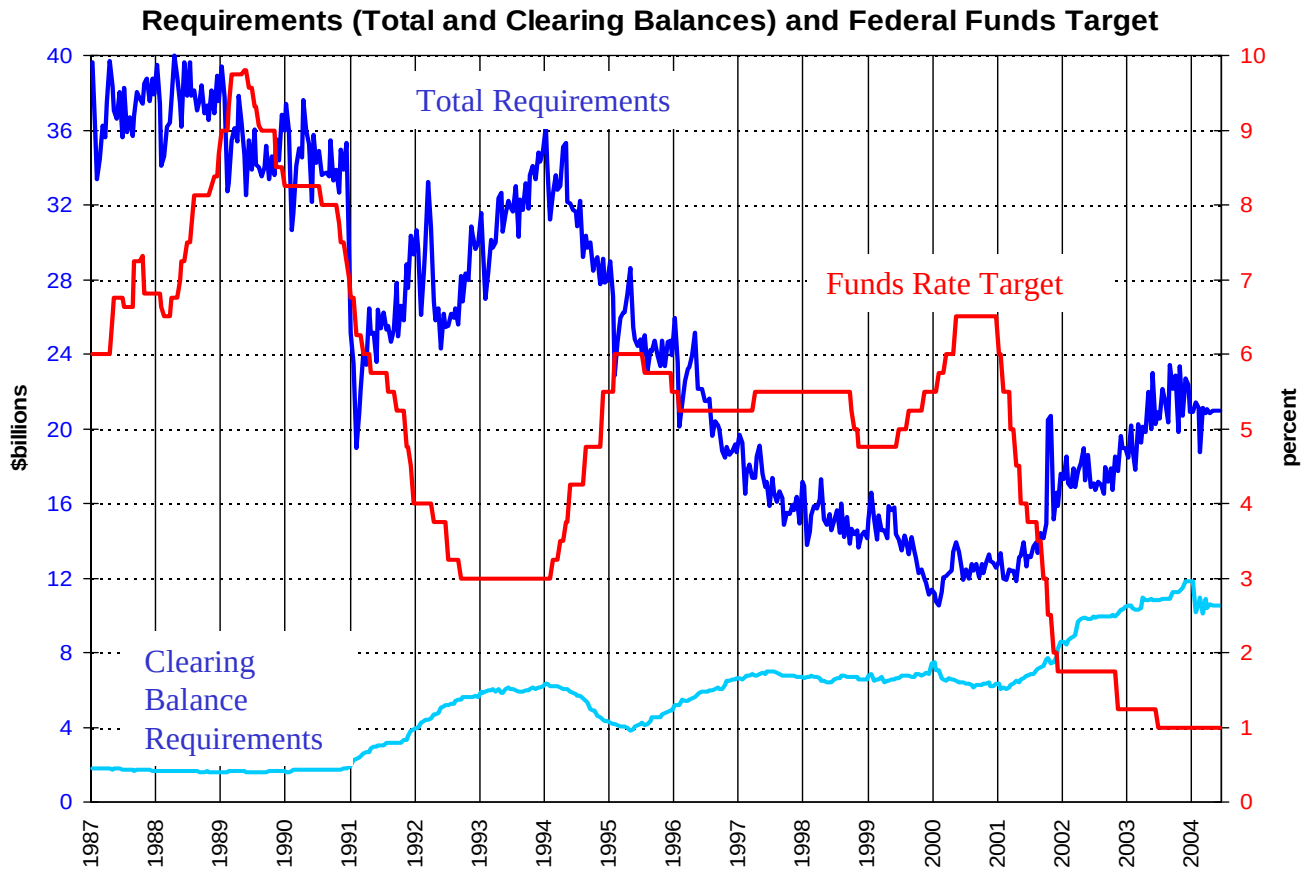
Daily Effective Fed Funds Rate less Target Rate - medians of rolling 10-day periods



High-Low Range, Effective Rate, & Primary Credit Rate, minus the Target Rate
June 2001 - May 2004



Reference Chart



Chronology of Select Events Influencing Funds Rate Volatility

late 1990 - deteriorating financial position of banking sector amid recession

Dec 1990 - reserve requirements eliminated on non-transaction and eurodollar deposits

Apr 1992 - reserve requirement ratio on transaction deposits reduced from 12 to 10 percent

Feb 1994 - FOMC begins to publicly indicate policy changes

1996 to 1998 - period of most rapid growth in bank sweep account programs

Aug 1998 - shift to lagged reserve accounting

Q4 1998 - fallout from financial turmoil in emerging markets

1999 - preparations ahead of Y2K

Sep 2001 - extra liquidity provided in the wake of 9/11 attacks

Jan 2003 - introduction of the primary credit facility

Jun 2003 - Federal funds rate target reaches historic low

Appendix 4: Materials used by Messrs. Oliner, Wilcox, and Sheets

STRICTLY CONFIDENTIAL (FR) CLASS I-FOMC*

Material for

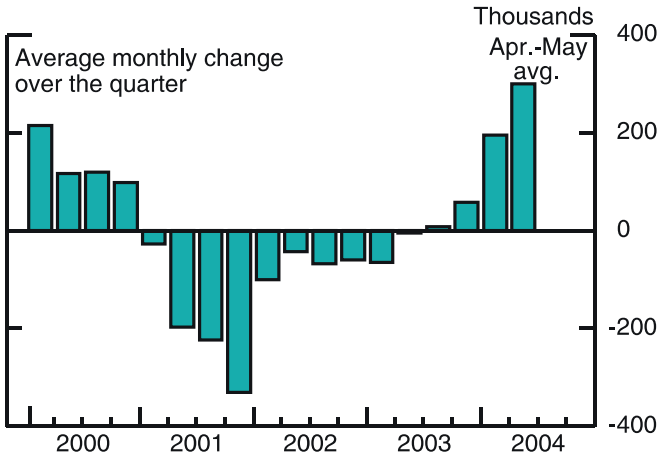
Staff Presentation on the Economic Outlook

June 30, 2004

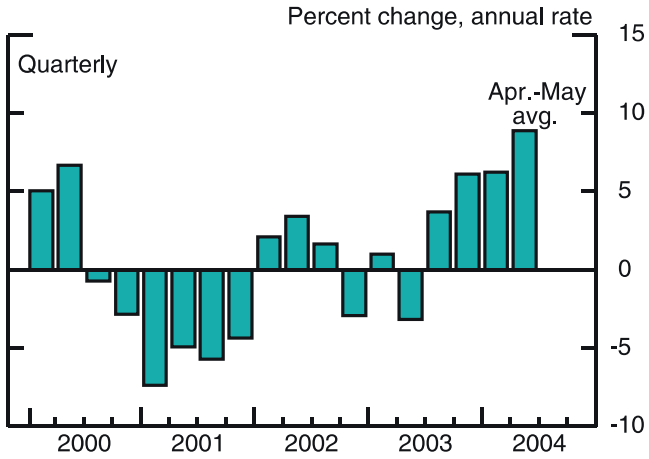
*Downgraded to Class II upon release of the July 2004 Monetary Policy Report.

Chart 1
Recent Data

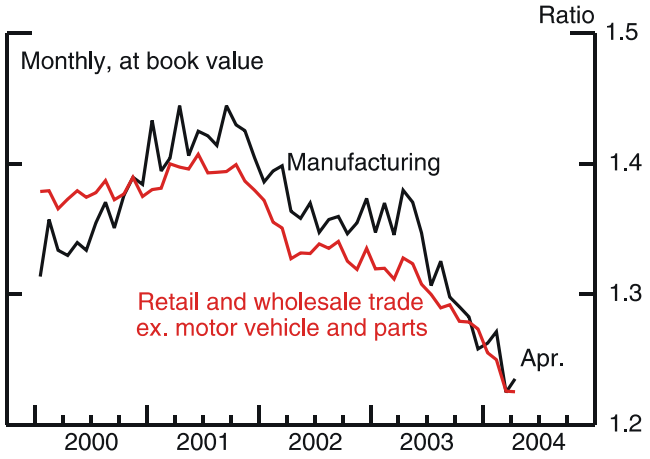
Private Payroll Employment



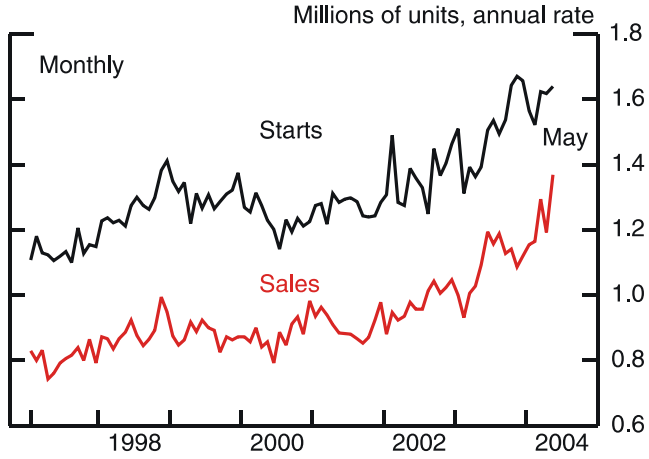
Manufacturing Industrial Production



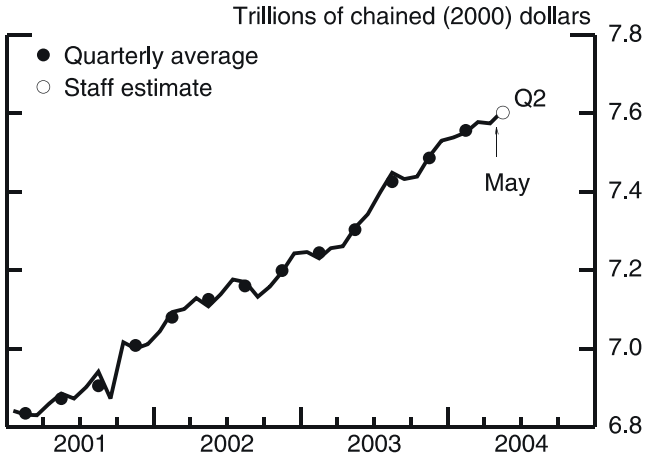
Inventories Relative to Shipments and Sales



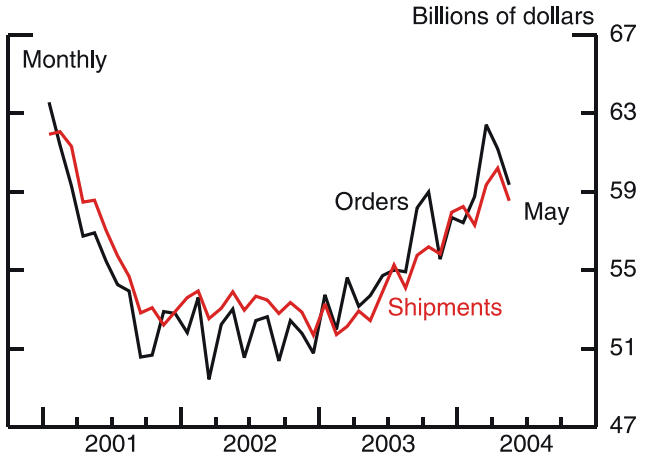
Single-family Home Sales and Starts



Real Personal Consumption Expenditures



Orders and Shipments of Nondefense Capital Goods*



*Excluding aircraft.

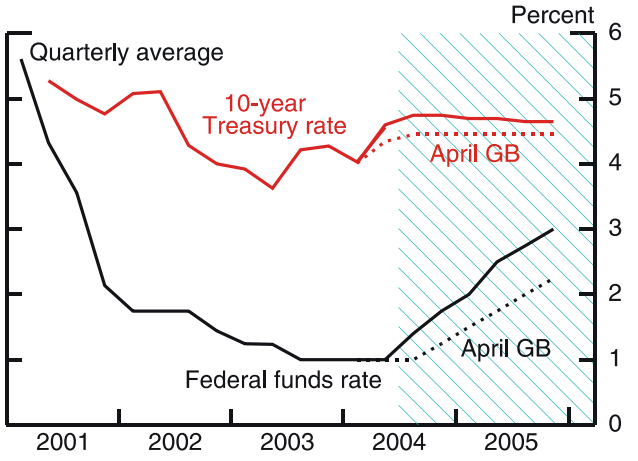
Chart 2

Forecast Summary and Key Background Factors

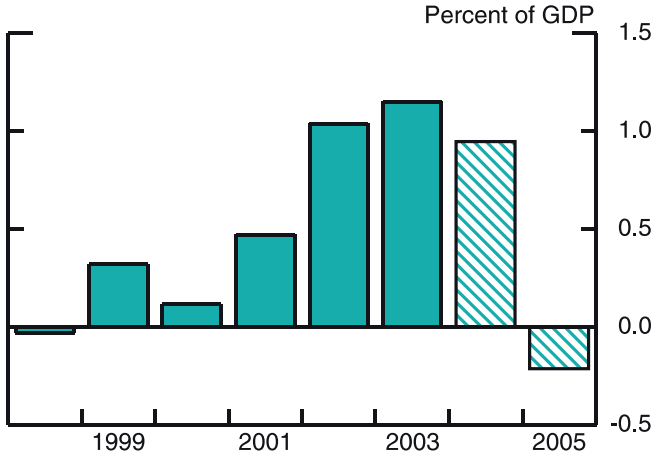
	2004 Q1	2004 Q2	2004 H2	2004 Q4/Q4	2005 Q4/Q4
		projection			
1. Real GDP*	3.9	4.2	4.8	4.4	3.6
2. *(June GB)*	*(4.4)*	*(4.7)*	*(5.0)*	*(4.8)*	*(3.6)*
3. Unemployment rate**	5.6	5.6	5.4	5.4	5.3
4. *(June GB)*		*(5.6)*	*(5.3)*	*(5.3)*	*(5.2)*
5. Core PCE price index*	2.0	2.3	1.8	2.0	1.6
6. *(June GB)*	*(1.7)*	*(1.6)*	*(1.7)*	*(1.7)*	*(1.5)*

*Percent change, annual rate. H2 calculated as Q4/Q2.
**Percent, average for final quarter of half-yearly and annual periods.

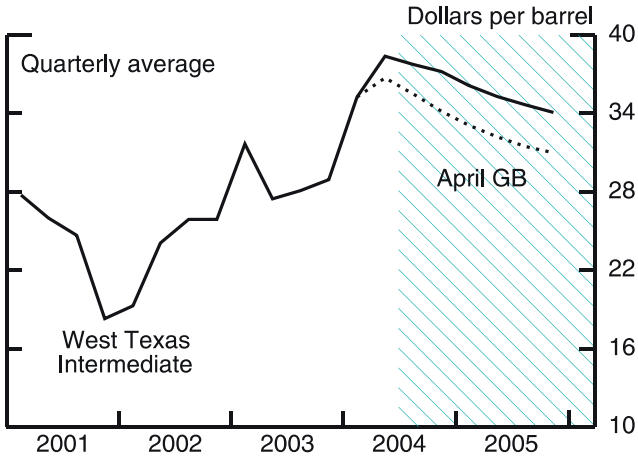
Interest Rates



Fiscal Impetus



Crude Oil Prices



Equity Prices

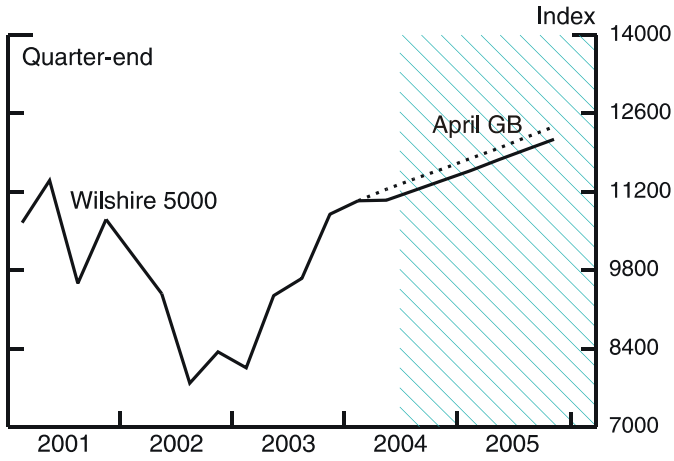
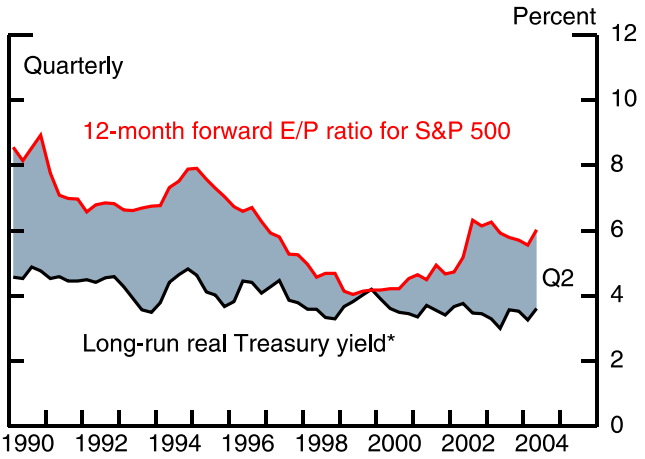


Chart 3

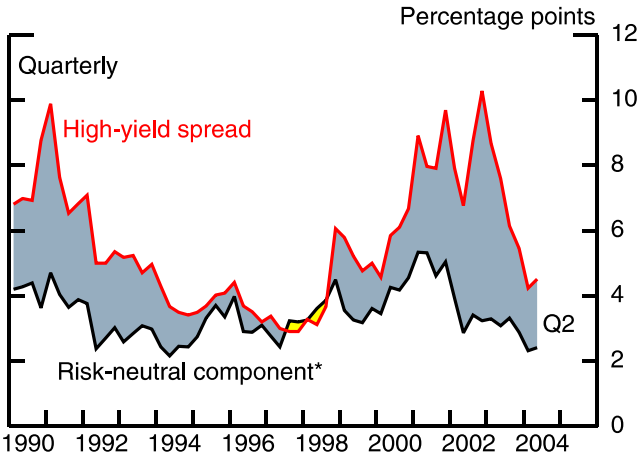
Asset Valuations

Equity Valuation



*Yield on synthetic Treasury perpetuity minus Philadelphia Fed 10-year expected inflation.

High-Yield Spread and Risk-Neutral Component



*Staff estimate of spread necessary to compensate for the expected cost of default.

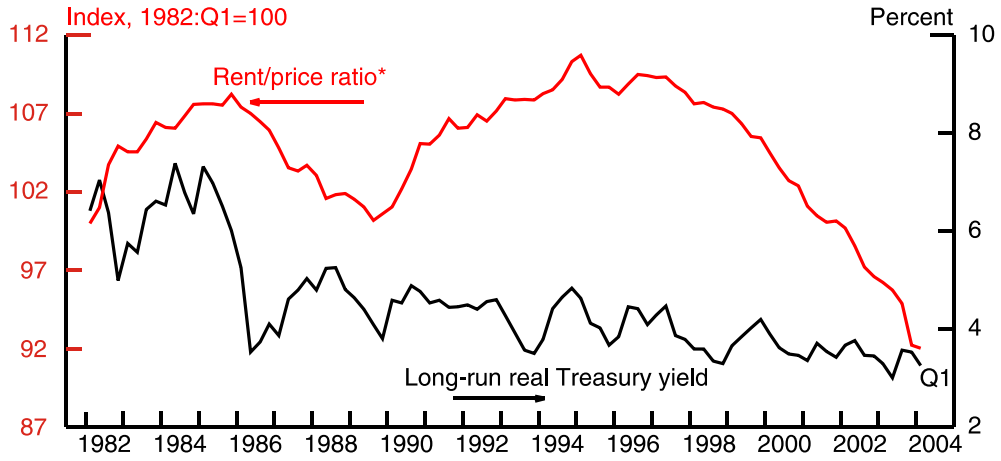
House Prices and Rents*

Q4/Q4 percent change

	Prices	Rents
2000	7.6	4.0
2001	7.5	4.7
2002	7.6	3.3
2003	8.2	2.7

*OFHEO repeat-sales price index and CPI tenants' rent.

Housing Valuation



*Adjusted for biases in the trends of both rents and prices.

Commercial Real Estate Prices and Net Operating Income*

Q4/Q4 percent change

	Prices	NOI
2000	6.2	11.7
2001	1.6	2.2
2002	1.5	-4.2
2003	3.9	-5.6

*Staff calculations from NCREIF data.

Commercial Real Estate Valuation

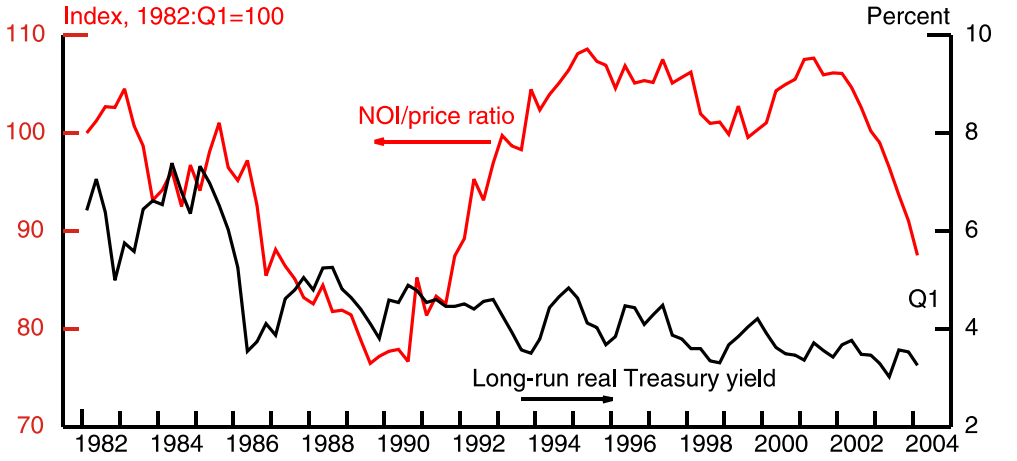
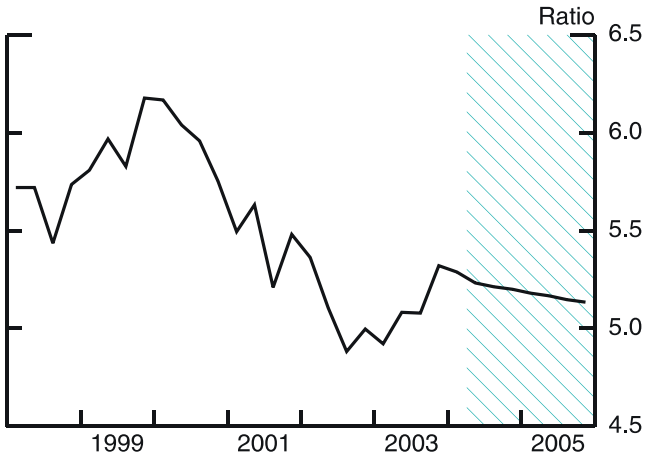
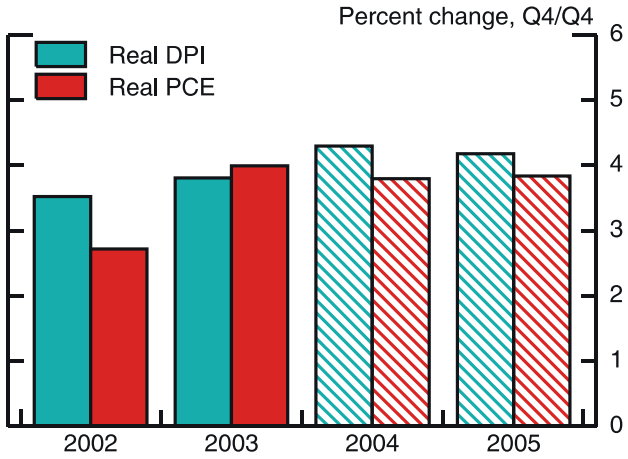


Chart 4
Household Sector

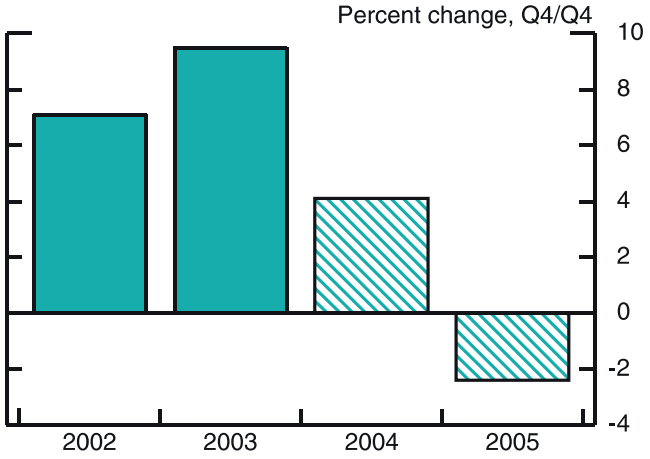
Household Net Worth to DPI



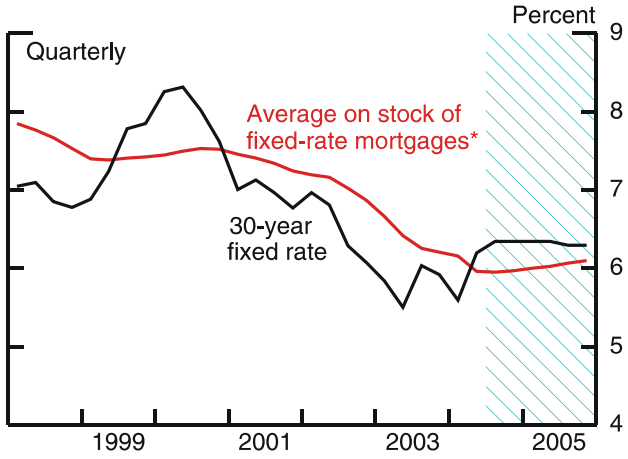
Real Consumer Spending and Income



Real Residential Investment

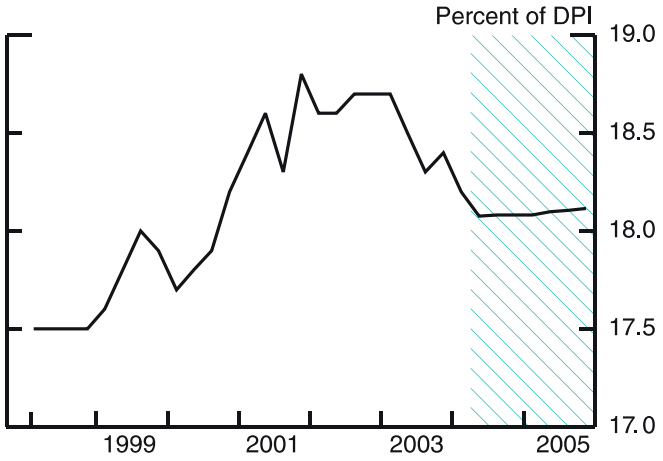


Mortgage Rates



*Weighted-average coupon on securitized home mortgages.

Financial Obligations Ratio



Credit Card ABS Spread over Swap Rate

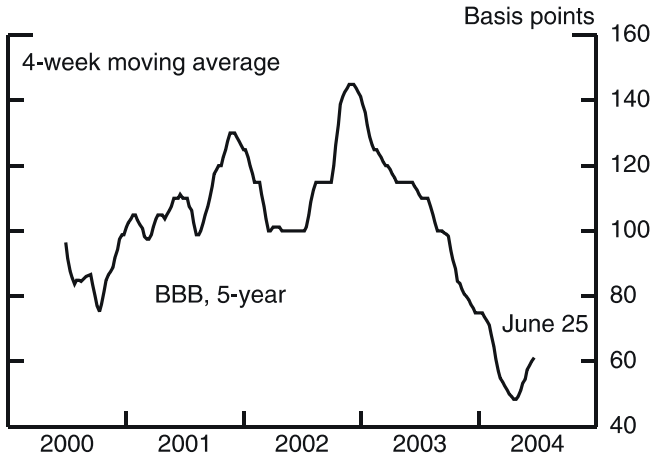
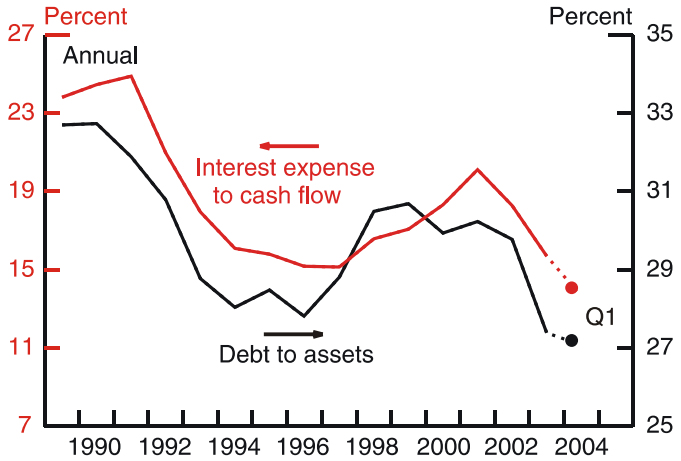


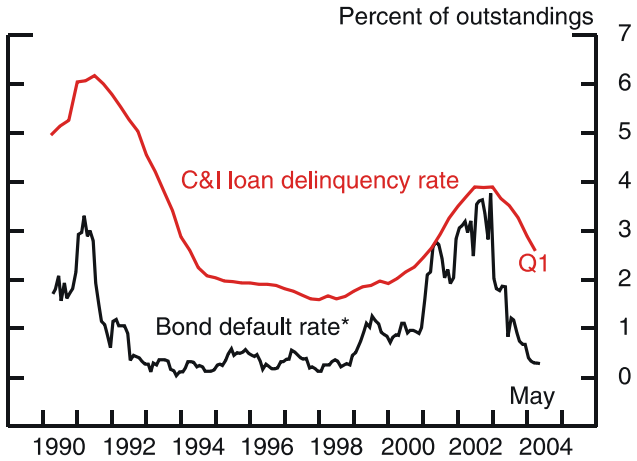
Chart 5
Business Sector

Financial Ratios



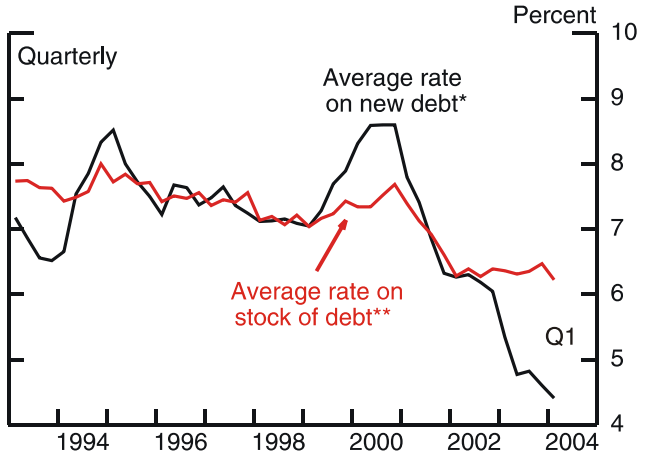
Source: Compustat, nonfinancial corporations.

Bond Default and Loan Delinquency Rates



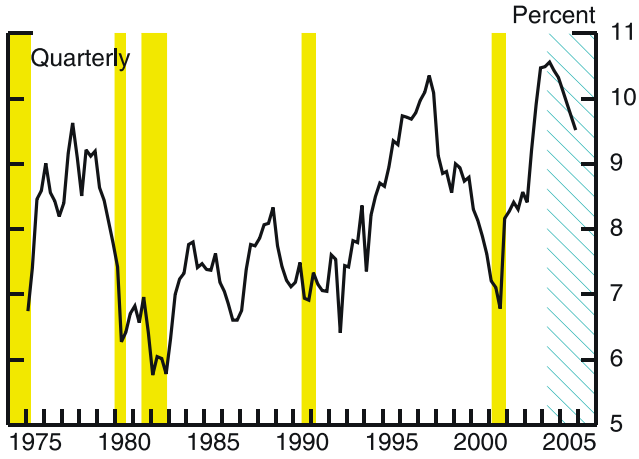
*6-month moving average, from Moody's Investors Service.

Interest Rates



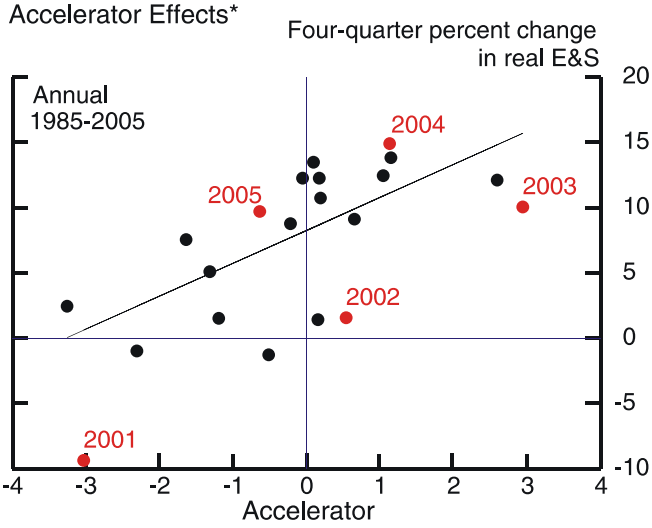
*Weighted average of corporate bond yields and bank loan rates.
**Source: Compustat, nonfinancial corporations. Weighted average for investment-grade, speculative-grade, and unrated firms.

Profit Share*



*Ratio of economic profits before tax to GNP. Excludes FR Banks.

Accelerator Effects*



*Accelerator measured as 8-quarter percent change in real business output less year-earlier 8-quarter percent change. Regression line fit to data for 1985-2000.

Real Business Fixed Investment

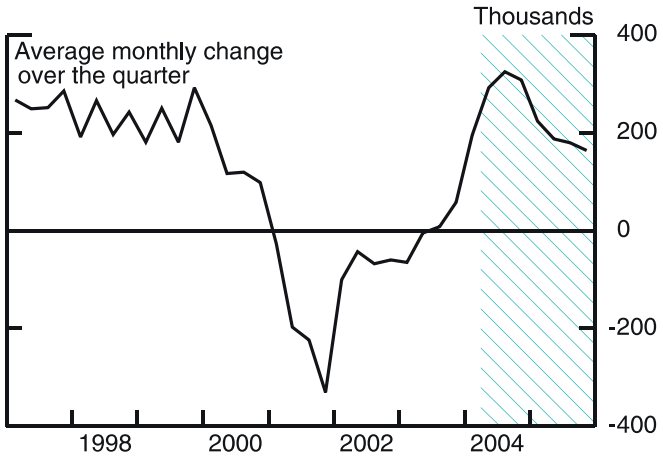
Percent change, Q4/Q4

	2003	2004	2005
		---projection---	
1. Total BFI	7	12	9
2. E&S	10	15	10
3. NRS	-1	1	7

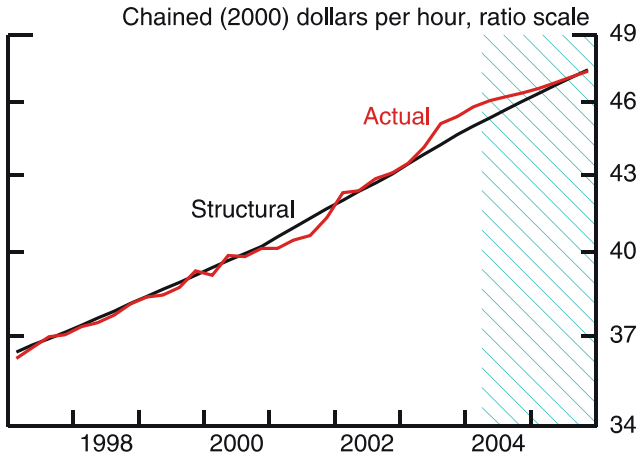
Chart 6

The Labor Market

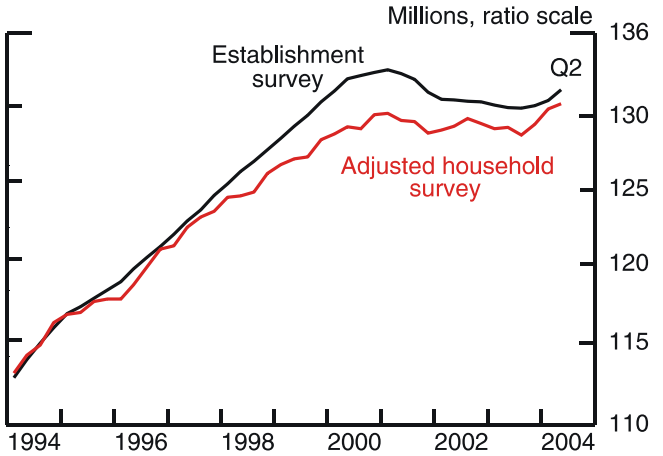
Private Payroll Employment



Output per Hour

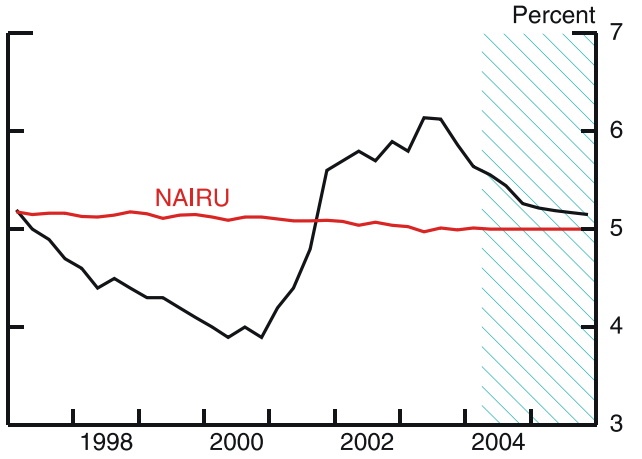


Private Employment

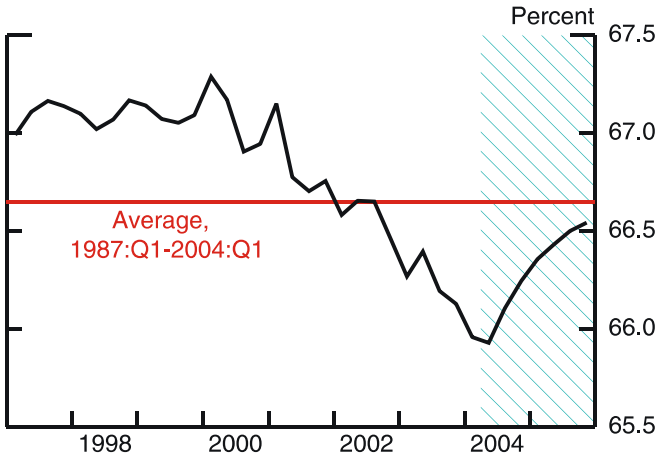


Note: Observations for 2004:Q2 are April-May averages.

Unemployment Rate



Labor Force Participation Rate



Average Workweek

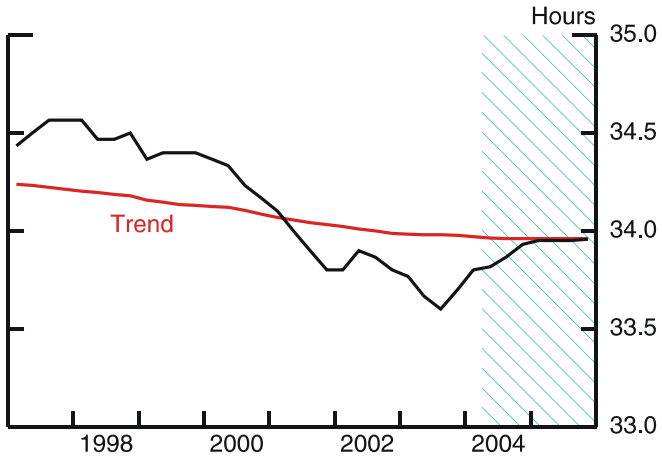
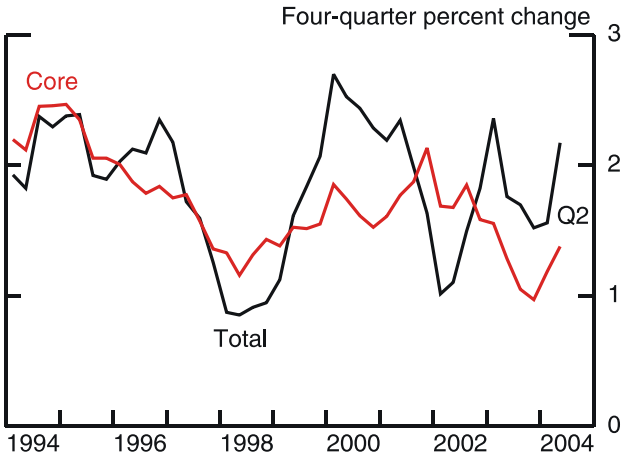


Chart 7

Recent Inflation Developments

PCE Price Inflation



Note: Observation for 2004:Q2 is staff forecast.

Recent Monthly Price Changes

Percent

	Total PCE	Core
January	.4	.2
February	.2	.1
March	.3	.2
April	.2	.2
May	.5	.2

Contributions to Core PCE Inflation: By Component

Percentage points

	2003		2004
	H1	H2	H1
1. Total	.8	1.1	2.1
2. Motor vehicles	-.2	-.3	.1
3. Non-MV goods	-.7	-.2	.1
4. Market services	1.6	1.5	1.5
5. Owner-occupied rent	.3	.3	.4
6. Nonmarket services	.2	.1	.5

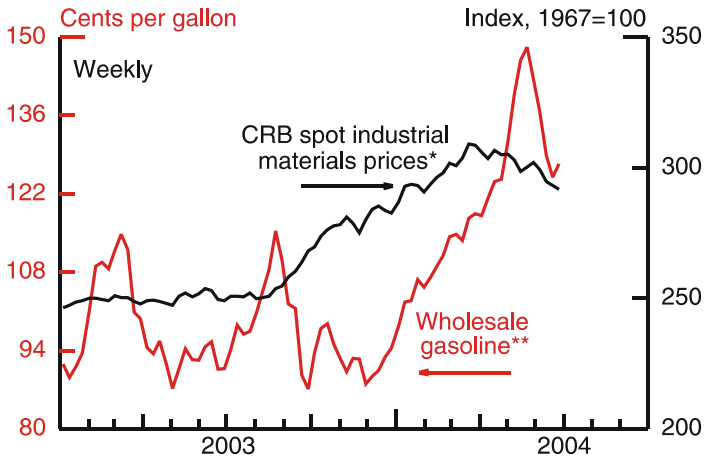
Note: Half years are Q2/Q4 or Q4/Q2. Figures for 2004:H1 are staff forecasts.

Contributions to Core PCE Inflation: By Underlying Cause

Percentage points

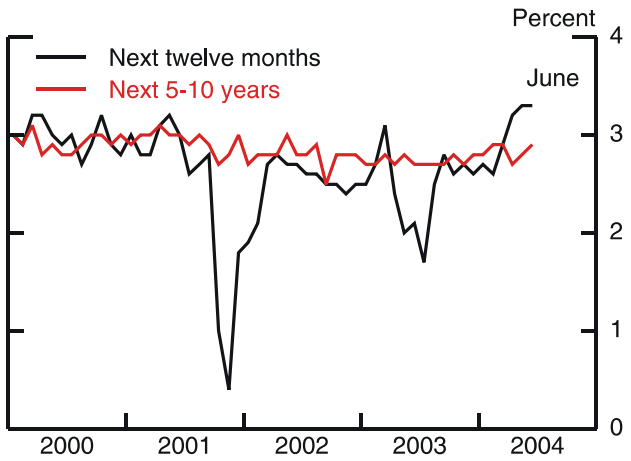
	2003		2004
	H1	H2	H1
1. Energy-price pass-through	.0	.1	.2
2. Import-price pass-through	.0	.0	.2
3. Other	.8	1.0	1.7

Commodity Prices



Sources: Commodity Research Bureau and Department of Energy.
*Last observation is for Monday, June 28.
**Last observation is average for June 23 through June 28.

Median Expected Inflation



Source: Michigan SRC.

Chart 8

Inflation Outlook

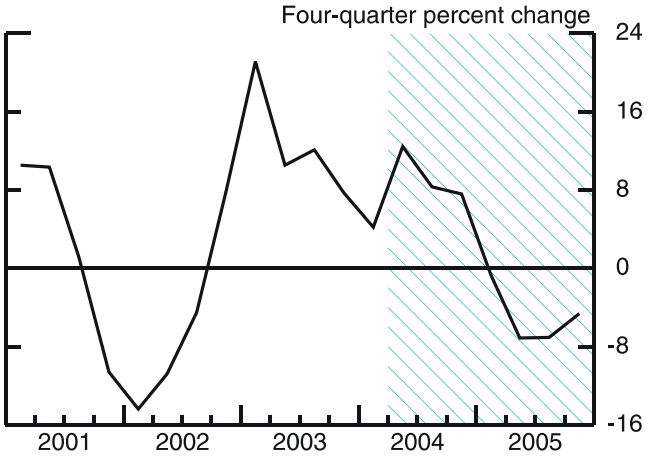
PCE Price Inflation

Percent, annual rate*

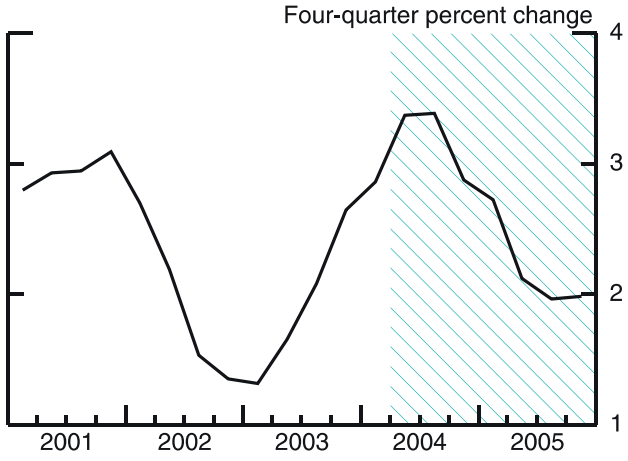
	2003	2004 H1	2004 H2	2005
		projection		
1. Total	1.5	3.4	1.3	1.3
2. (Jan. GB)	*(1.4)*	*(1.3)*	*(.7)*	*(1.0)*
3. Energy	7.8	25.7	-8.7	-4.2
4. *(Jan. GB)*	*(8.5)*	*(3.8)*	*(-6.8)*	*(-.4)*
5. Food	2.6	3.3	2.1	2.0
6. *(Jan. GB)*	*(2.7)*	*(1.8)*	*(1.4)*	*(1.4)*
7. Excluding food and energy	1.0	2.1	1.8	1.6
8. (Jan. GB)	*(.8)*	*(1.0)*	*(1.0)*	*(1.0)*

*Years are Q4/Q4; half years are Q2/Q4 or Q4/Q2.

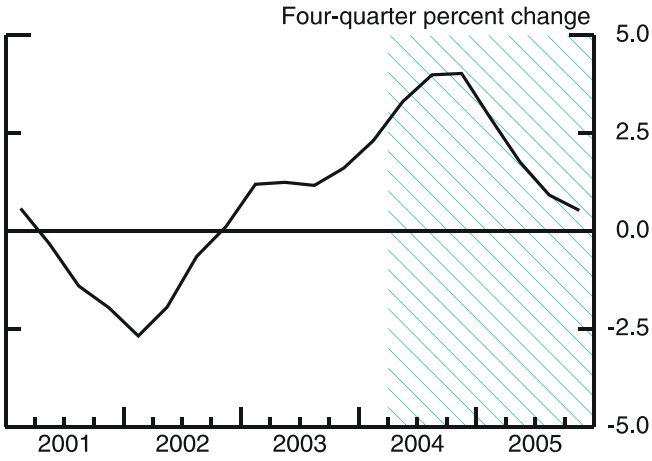
Energy Prices



Food Prices

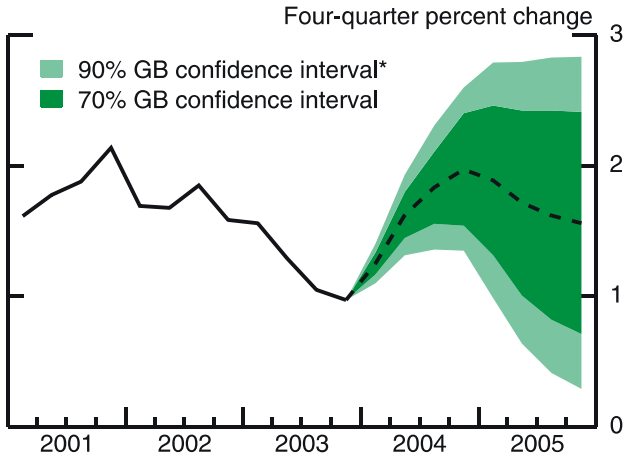


Core Non-fuel Import Prices*



*Excluding oil, natural gas, semiconductors, and computers.

Core PCE Prices

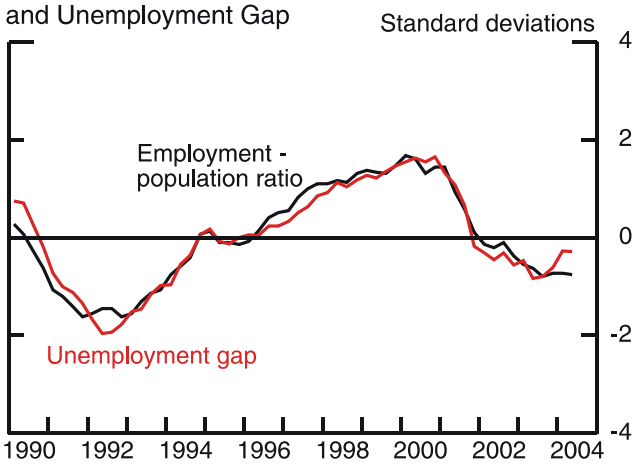


*Confidence intervals based on Greenbook forecast errors, 1978-2003.

Chart 9

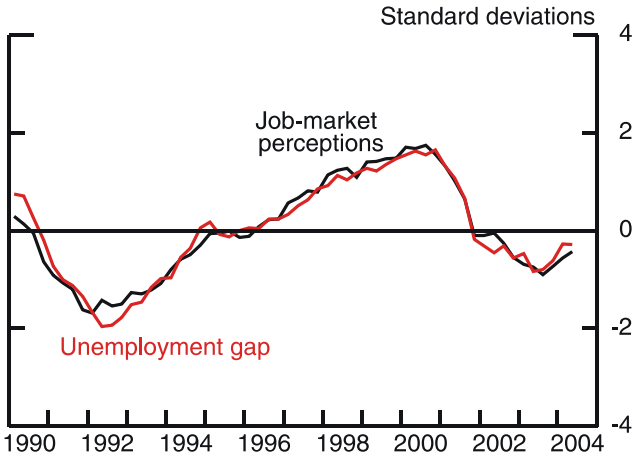
How Big is the Gap in Resource Utilization?

Employment-Population Ratio and Unemployment Gap



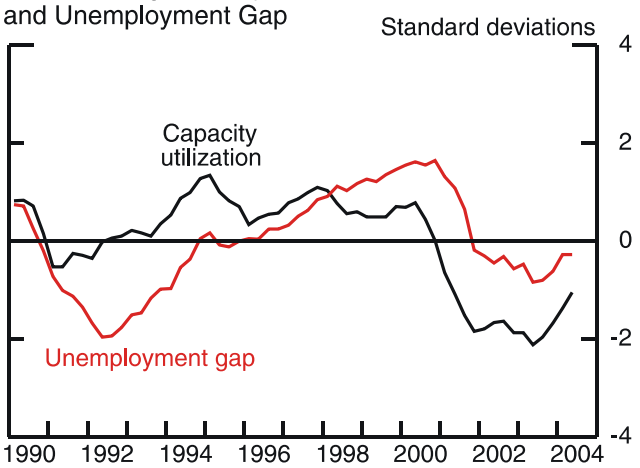
Except where noted, observations for 2004:Q2 are the averages of April and May.

Job-Market Perceptions* and Unemployment Gap

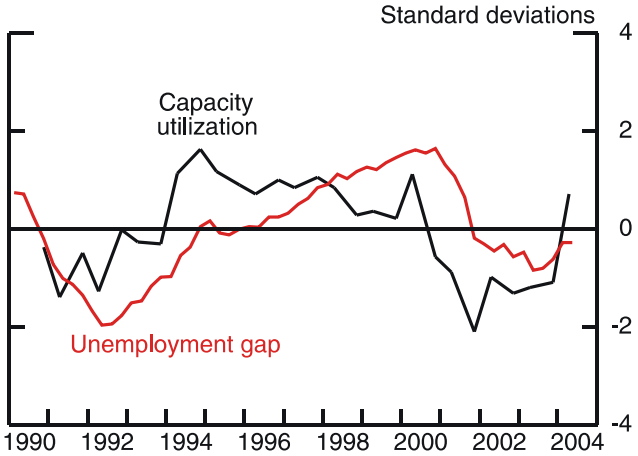


*Source: Conference Board. The proportion of households believing jobs are easy to get, minus those believing jobs are hard to get, plus 100. Observation for 2004:Q2 is average of April, May, and June.

Manufacturing Capacity Utilization and Unemployment Gap

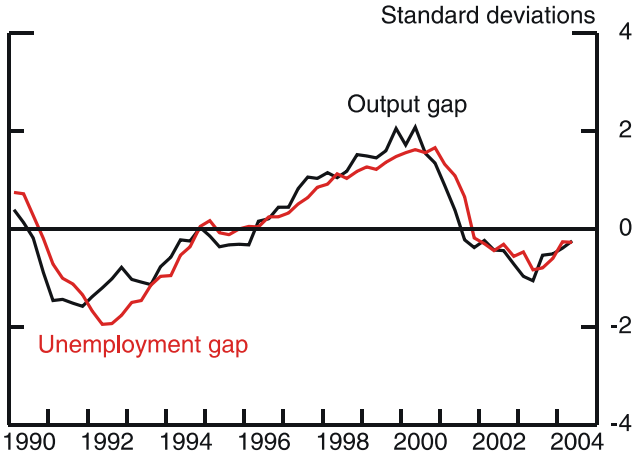


ISM Capacity Utilization and Unemployment Gap



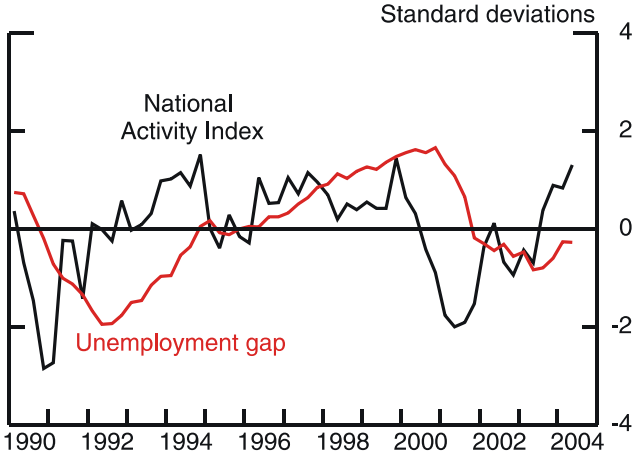
Note: ISM series is semiannual. Last observation for ISM series is 2004:H1.

Output Gap* and Unemployment Gap



*Observation for 2004:Q2 is staff forecast.

National Activity Index* and Unemployment Gap



*Source: Federal Reserve Bank of Chicago. Observation for 2004:Q2 is the April figure.

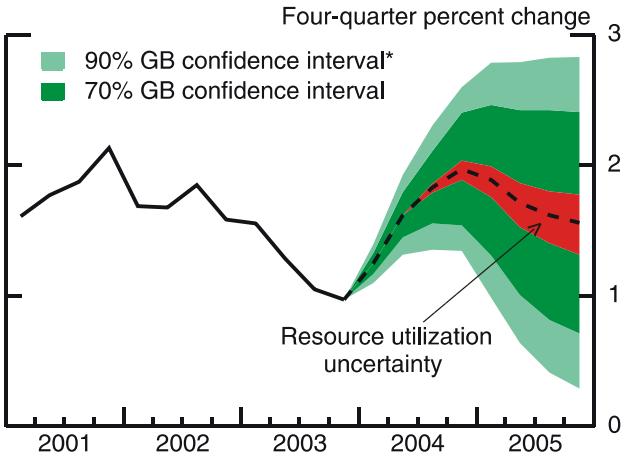
Chart 10

Selected Sources of Uncertainty in the Outlook for Inflation

Resource Utilization Simulations

- NAIRU is baseline value plus or minus ½ percentage point
- Slope coefficient is baseline value plus or minus one standard error
- "Resource utilization uncertainty" includes coefficient uncertainty

Core PCE Prices

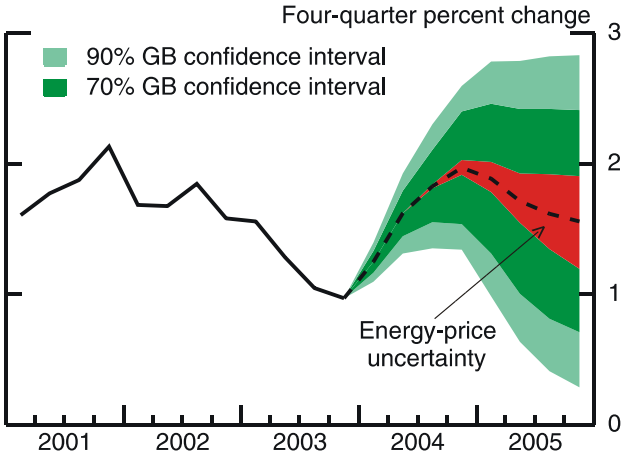


*Confidence intervals based on Greenbook forecast errors, 1978-2003.

Energy Price Simulations

- Energy prices are in range consistent with a ⅔ confidence interval around baseline oil price
- Slope coefficient is baseline value plus or minus one standard error
- "Energy-prices uncertainty" includes coefficient uncertainty

Core PCE Prices



Core Non-fuel Import Price Simulations

- Import prices are in range consistent with a ⅔ confidence interval around baseline exchange rate
- Slope coefficient is baseline value plus or minus one standard error
- "Core non-fuel import price uncertainty" includes coefficient uncertainty

Core PCE Prices

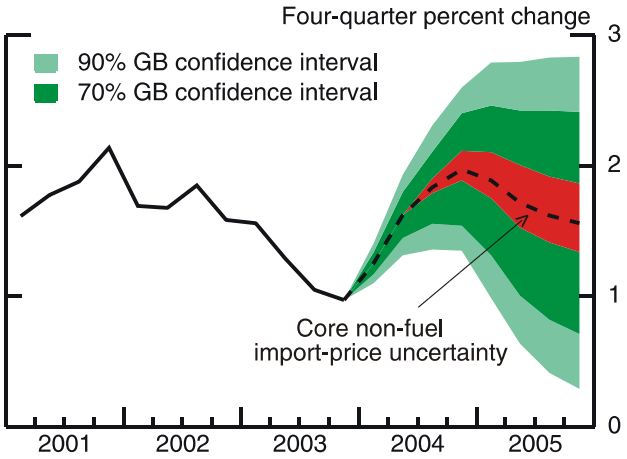


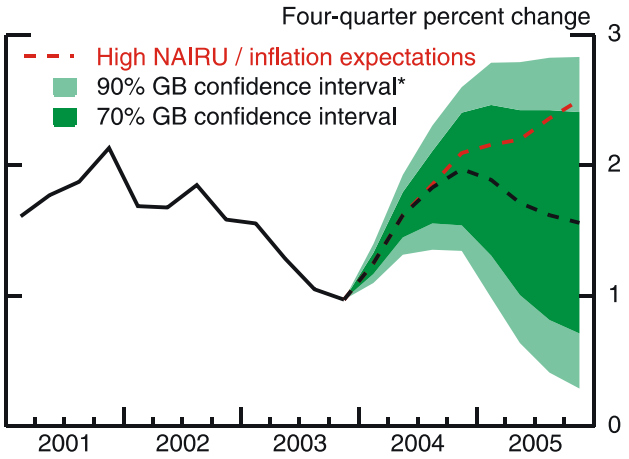
Chart 11

Risks to Inflation Outlook

An Upside Risk

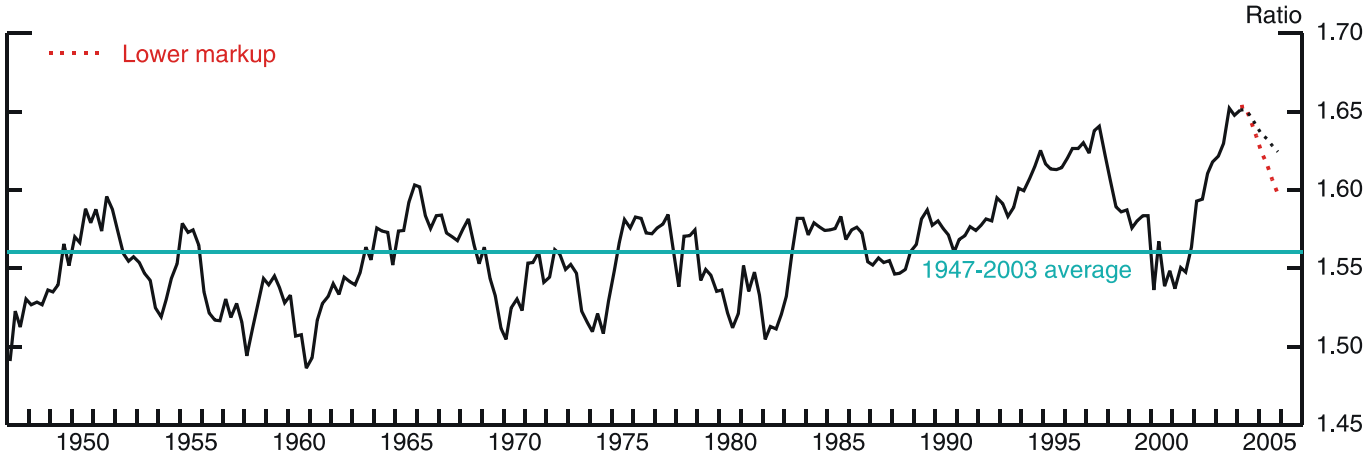
- Assume NAIRU is 5-3/4 percent rather than 5 percent
- Assume rebound in labor force participation will be only half as great
- Assume long-term inflation expectations gradually rise one percentage point

Core PCE Inflation



*Confidence intervals based on Greenbook forecast errors, 1978-2003.

Price Markup Over Unit Labor Costs, Nonfarm Business Sector

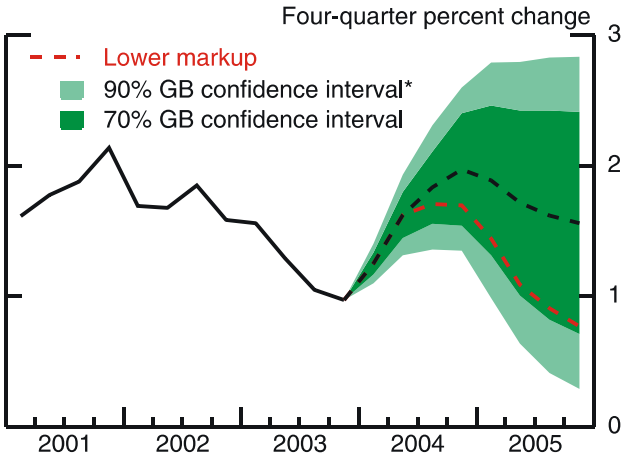


Note: Nonfarm business sector using compensation per hour and actual productivity.

A Downside Risk

- Firms may bid up wages faster than in the baseline
- Competitive pressures may be so strong that they more than offset the price effects of higher unit labor costs
- For a combination of these reasons, assume markup moves halfway back to its long-term average

Core PCE Prices



*Confidence intervals based on Greenbook forecast errors, 1978-2003.

Chart 12

International Financial Markets

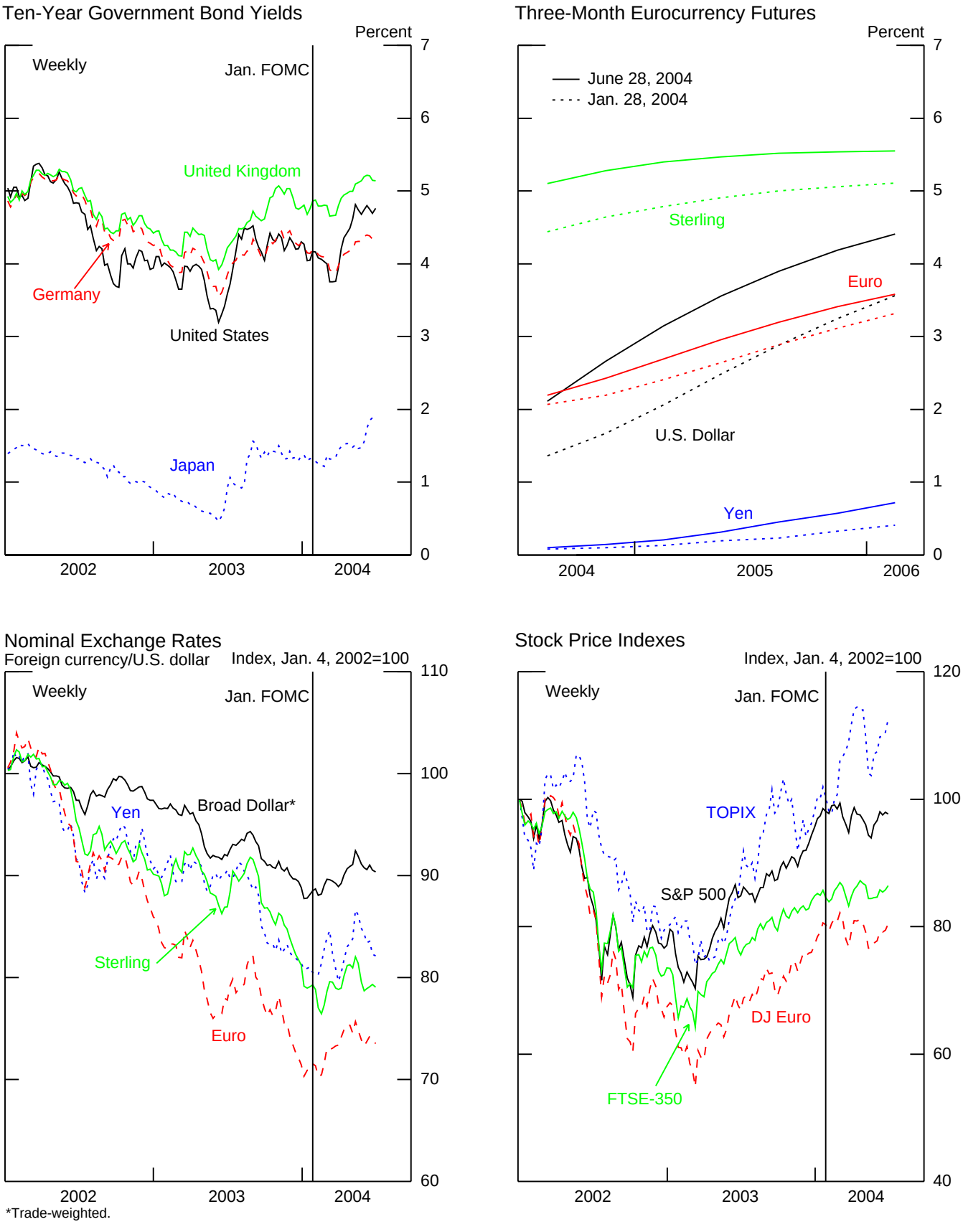


Chart 13

Outlook for the Foreign Economies

Real GDP Projections*

Percent change, a.r.**

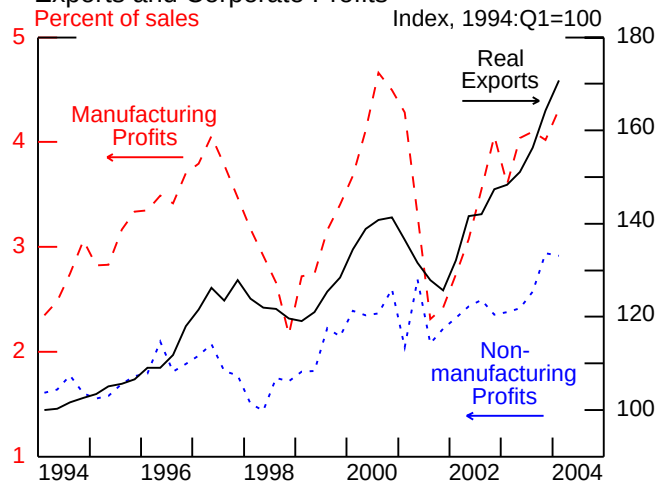
	2004 H1	2004 H2	2005
1. Japan	5.0	2.8	2.4
2. China	11.3	6.3	7.3
3. Other Emerging Asia	5.9	5.1	4.7
4. Germany	1.2	1.2	1.5
5. Other Euro Area	2.3	2.0	2.0
6. Canada	3.2	3.6	3.5
7. Latin America	5.2	4.2	3.8
8. Total Foreign	4.2	3.6	3.5

*Aggregates weighted by U.S. exports.
**Year is Q4/Q4; half years are Q2/Q4 or Q4/Q2.

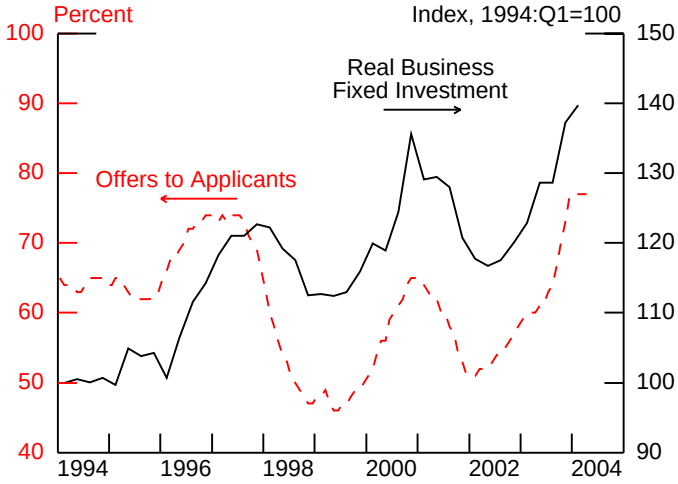
- Global recovery now under way.
- Inflation likely to remain contained.
- New risks have emerged:
  - -- High and volatile oil prices.
  - -- Rising interest rates.
  - -- Hard landing in China.

Rebound in Japan

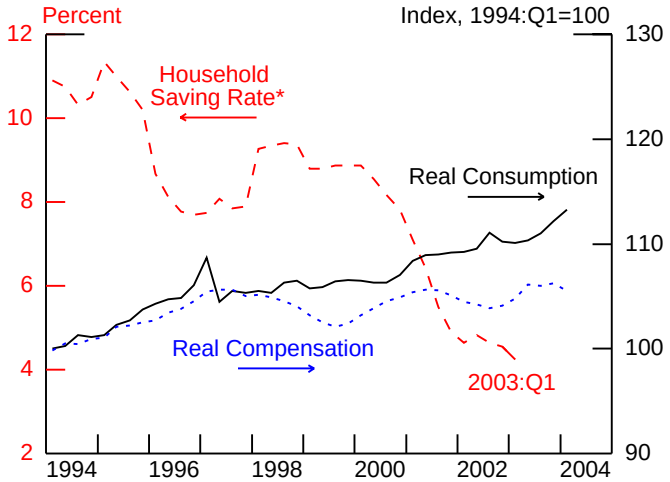
Exports and Corporate Profits



Investment and Labor Market



Household Sector



*Source: National Income Accounts; 4-quarter moving average.

Bank Credit and Land Prices

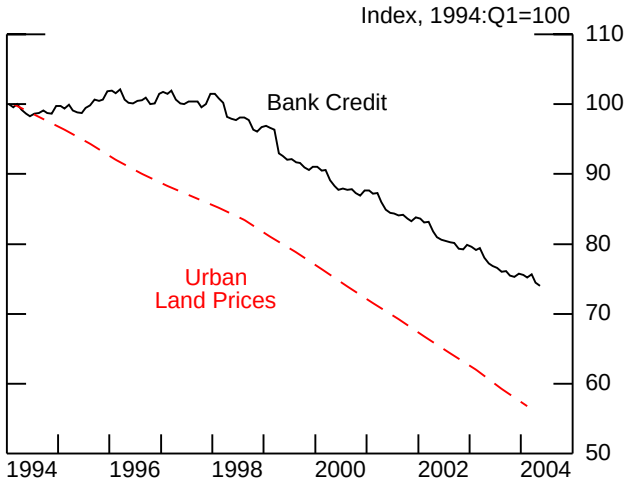
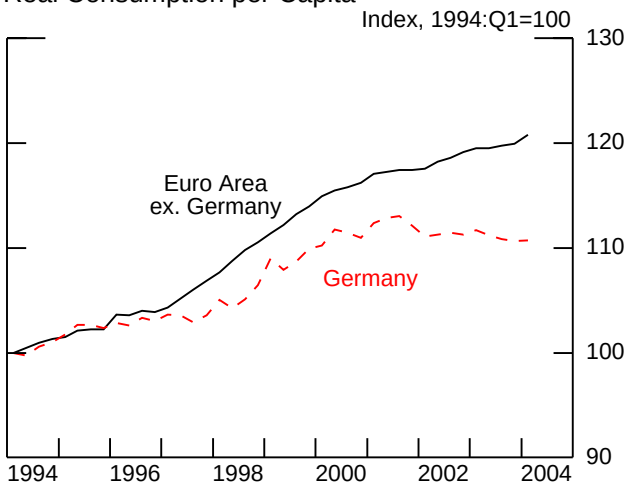


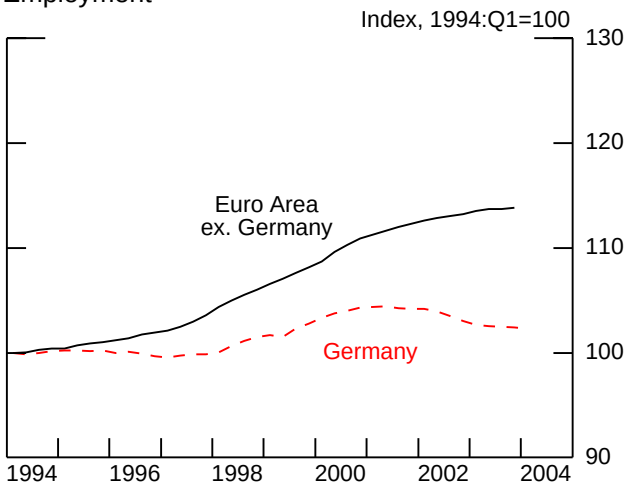
Chart 14

Divergence in the Euro Area

Real Consumption per Capita



Employment



Inflation Abroad

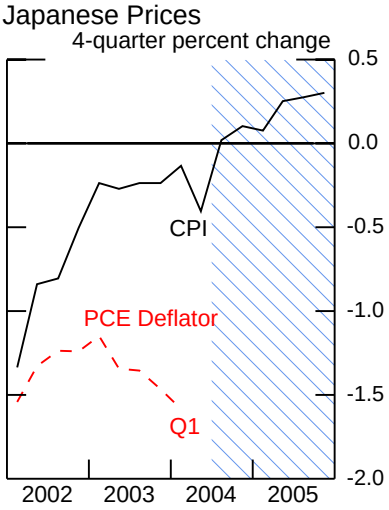
Outlook for Consumer Prices

4-quarter percent change

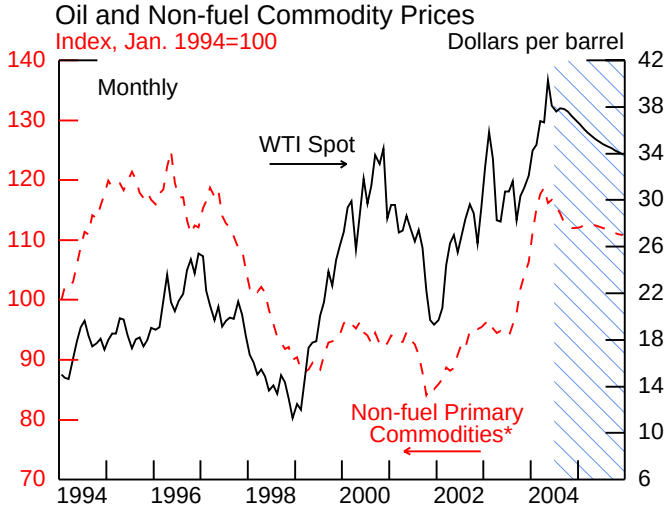
	2003	2004 Q1	2004 Q2	2004 H2	2005
				-----projection-----	
1. Average Foreign*	2.1	1.8	2.4	2.5	2.1
of which:					
2. Euro Area	2.0	1.6	2.3	2.1	1.9
3. Japan	-0.4	-0.3	-0.3	0.1	0.3
4. United Kingdom	1.3	1.2	1.6	1.3	1.8
5. Canada	1.7	0.9	1.9	1.8	1.7
6. China	2.6	2.8	4.3	3.7	1.6
7. Mexico	4.0	4.3	4.3	3.9	3.8

*Weighted by U.S. non-oil imports.

Japanese Prices



Oil and Non-fuel Commodity Prices



*IMF component indexes weighted by U.S. imports.

Selected Commodity Prices

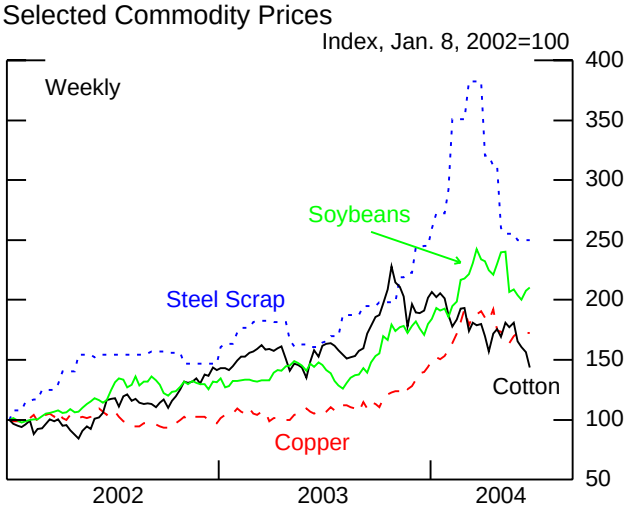
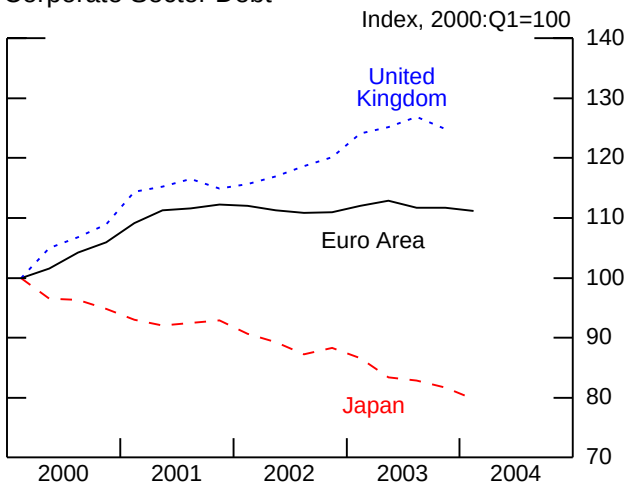


Chart 15

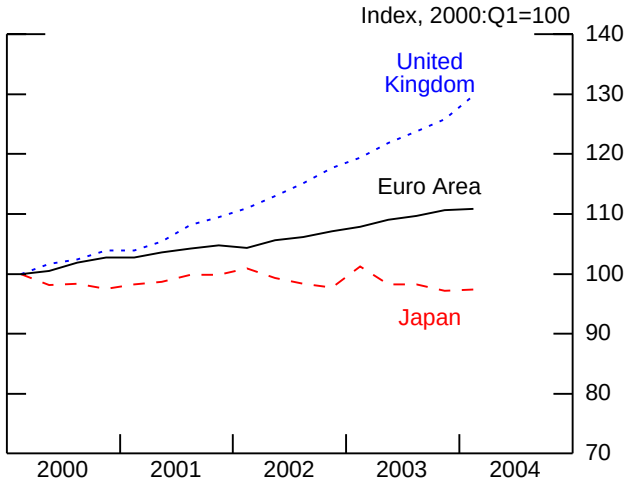
Debt Burdens

Corporate Sector Debt*



*Bank loans and securities; percent of GDP.

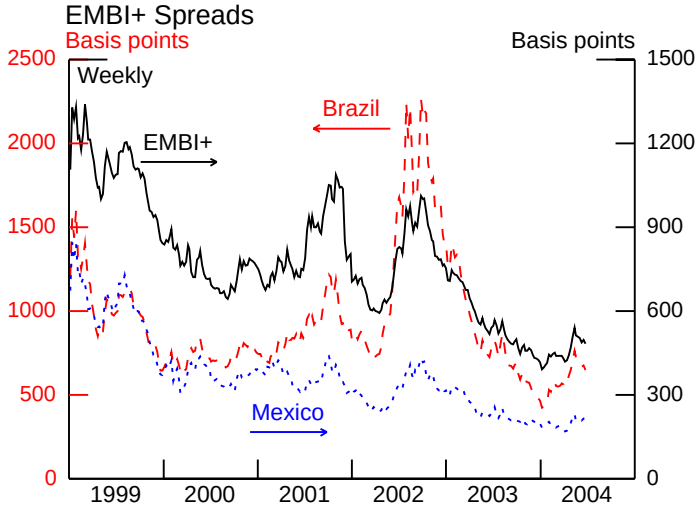
Household Debt*



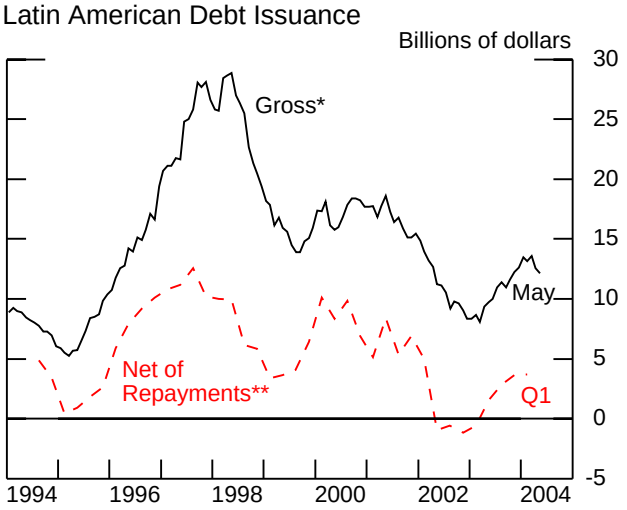
*Percent of GDP.

Vulnerabilities in Latin America

EMBI+ Spreads



Latin American Debt Issuance



*12-month moving average. **4-quarter moving average.

Vulnerability Indicators

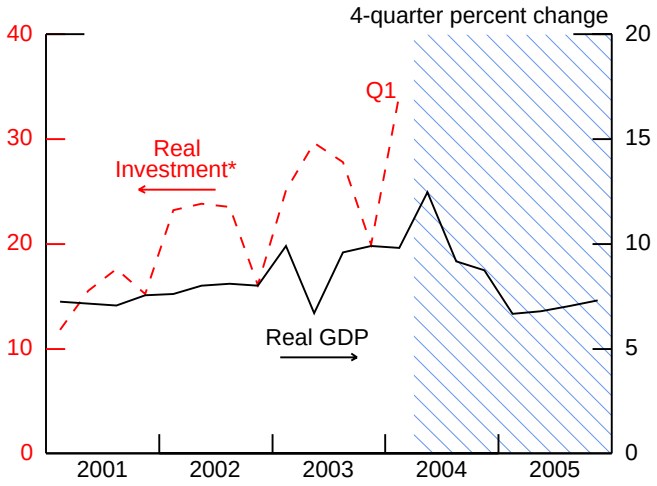
	Current Account (% of GDP)		Gross External Debt* (% of GDP)		Reserves* ($ billions)		Short-term External Debt* (% of reserves)	
	1993	2003	1993	2003	1993	2003	1993	2003
1. Mexico	-5.8	-1.5	33.9	20.8	22.6	59.0	116.8	64.7
2. Chile	-5.7	-0.8	34.0	48.1	9.6	16.0	50.9	64.7
3. Brazil	-0.0	0.8	32.3	48.8	32.2	50.5	106.6	81.8
4. Argentina	-3.2	6.1	31.0	114.1	13.8	14.6	101.2	177.9

*End of period.

Chart 16

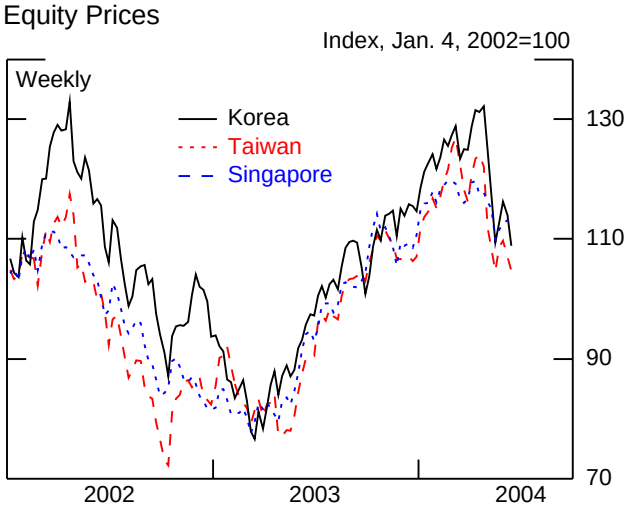
A Hard Landing in China?

Real GDP and Investment



*Deflated by corporate goods price index.

Equity Prices



Spillovers

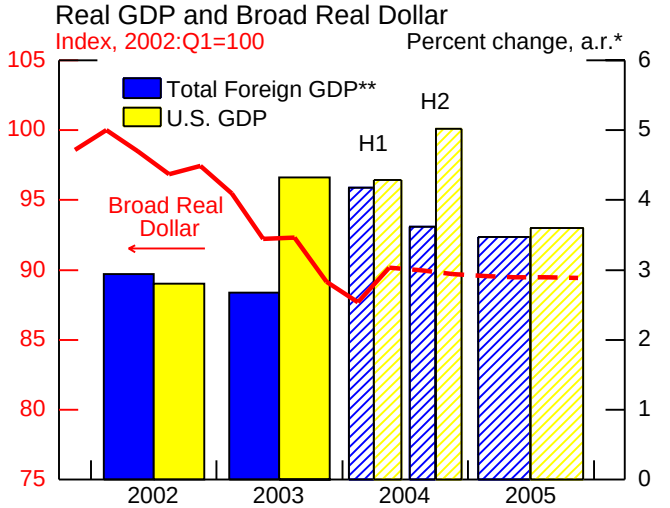
Percent of GDP

	Exports to China* (1)	Net Exports of Commodities** (2)
1. Taiwan	17.4	-5.3
2. ASEAN-5	11.4	0.6
3. Korea	8.2	-7.2
4. Chile	2.7	7.6
5. Japan	2.1	-3.1
6. Argentina	2.0	13.1
7. Russia	1.9	14.7
8. Brazil	1.2	2.8
9. Euro Area	0.8	-1.7
10. Canada	0.5	5.2
11. United Kingdom	0.4	-0.6
12. United States	**0.4**	**-1.1**
13. Mexico	0.3	1.0

*Includes to Hong Kong; 2003 data.
**Food and beverages, crude materials, and fuels; 2002 data.

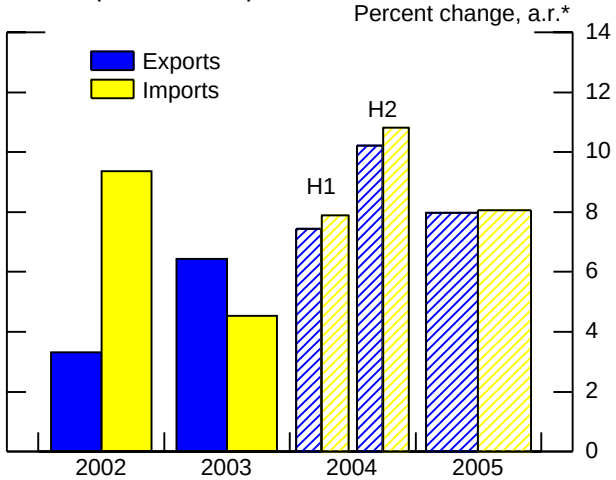
U.S. External Sector

Real GDP and Broad Real Dollar



*Years are Q4/Q4; half years are Q2/Q4 or Q4/Q2.
**Weighted by shares of U.S. exports.

Real Exports and Imports



*Years are Q4/Q4; half years are Q2/Q4 or Q4/Q2.

Chart 17

ECONOMIC PROJECTIONS FOR 2004

	FOMC		
	Range	Central Tendency	Staff
	----------Percentage change, Q4 to Q4----------		
Nominal GDP	6 to 7	6¼ to 6¾	6.4
February 2004	(5½ to 6½)	(5½ to 6¼)	(6.2)
Real GDP	4 to 4¾	4½ to 4¾	4.4
February 2004	(4 to 5½)	(4½ to 5)	(5.3)
Core PCE Prices	1½ to 2	1½ to 1¾	2.0
	----------Average level, Q4, percent----------		
Unemployment rate	5¼ to 5½	5¼ to 5½	5.4
February 2004	(5¼ to 5½)	(5¼ to 5½)	(5.3)

Central tendencies calculated by dropping high and low three from ranges.

ECONOMIC PROJECTIONS FOR 2005

	FOMC		
	Range	Central Tendency	Staff
	----------Percentage change, Q4 to Q4----------		
Nominal GDP	4¾ to 6½	5 to 6	5.0
Real GDP	3½ to 4	3½ to 4	3.6
Core PCE Prices	1½ to 2½	1½ to 2	1.6
	----------Average level, Q4, percent----------		
Unemployment rate	5 to 5½	5 to 5¼	5.3

Appendix 5: Materials used by Mr. Reinhart

Material for

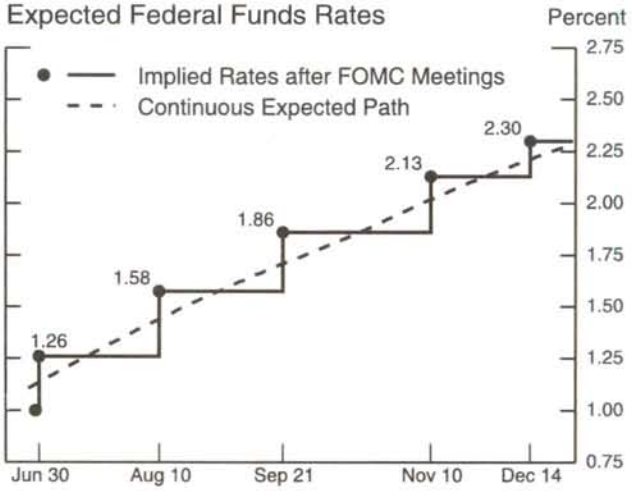
FOMC Briefing on Monetary Policy Alternatives

Vincent R. Reinhart

June 30, 2004

Exhibit 1
The Policy Situation

Expected Federal Funds Rates



Note. Estimates from federal funds futures on June 29, 2004, with an allowance for term premia and other adjustments.

Policy Expectations

	Expected Federal Funds Rate (percent)	
	June Meeting	Year-End
Futures Market	1.26	2.30
Dealer Survey (median)	1.25	2.00

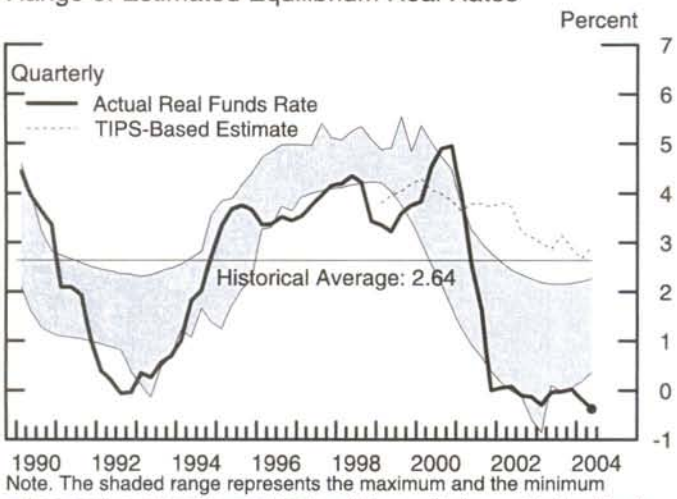
	Assessment of Risks Paragraph (percent of dealers)	
	To the Upside	Balanced
Growth Risks	17	83
Inflation Risks	22	78

	Use "Measured"	Similar Language
"Measured" Sentence	70	30

Note. Expected funds rate from futures market based on money market futures prices as of June 29, 2004. Dealer expectations based on a Trading Desk survey conducted June 17-22, 2004.

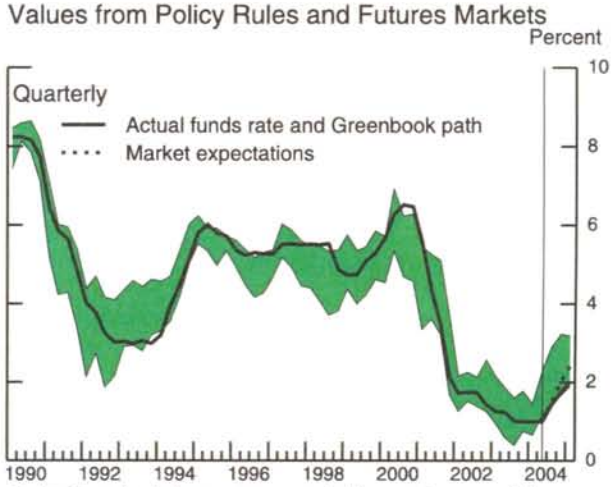
The Case for Alternative B

Range of Estimated Equilibrium Real Rates



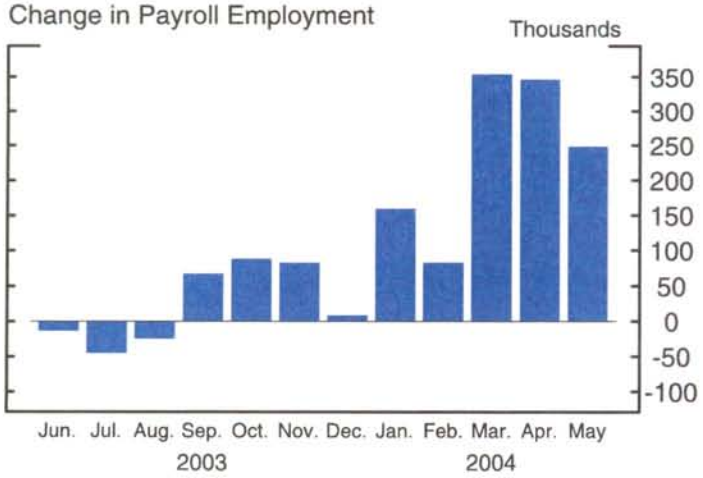
Note. The shaded range represents the maximum and the minimum values each quarter of four estimates of the equilibrium real federal funds rate. A four-quarter moving average of core PCE inflation is used as a proxy for inflation expectations. Historical average for 1964Q1-2004Q1.

Values from Policy Rules and Futures Markets

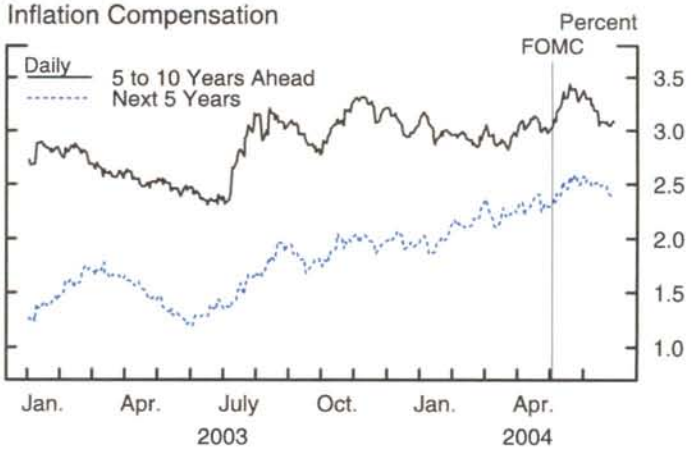


Note. The shaded range represents the maximum and the minimum values each quarter of the prescriptions from five estimated policy rules based on the output gap and core PCE inflation.

Change in Payroll Employment



Inflation Compensation



Note. Based on a comparison of an estimated TIPS yield curve to an estimated nominal off-the-run Treasury yield curve. Final observation is June 29, 2004.

Exhibit 2
Monetary Policy Alternatives

The Case For Alternative C

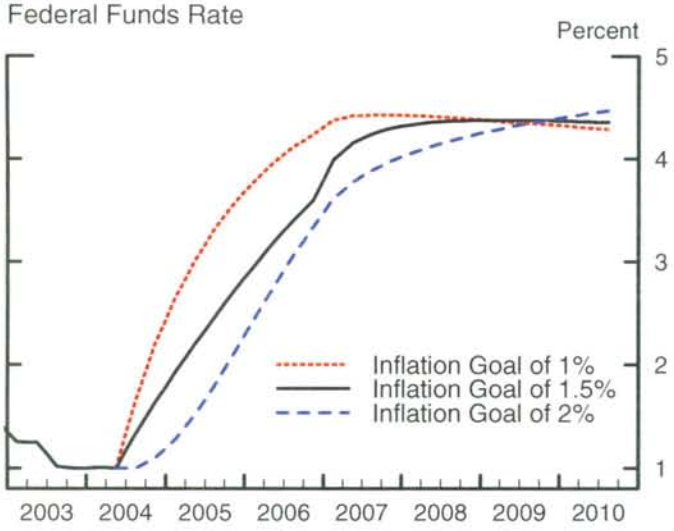
- Intermediate-term inflation goal of 1 percent
- Concerned about the rapid erosion of slack
- But: Inconsistent with May announcement and subsequent statements

The Case For Alternative A

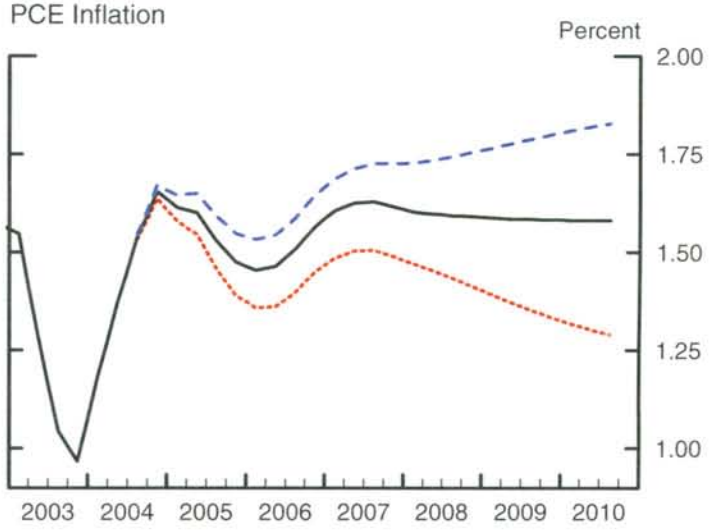
- Intermediate-term inflation goal of 2 percent
- Concerned about the remaining level of slack
- But: Inconsistent with May announcement and subsequent statements

Model Simulations of Optimal Policy with Different Inflation Goals

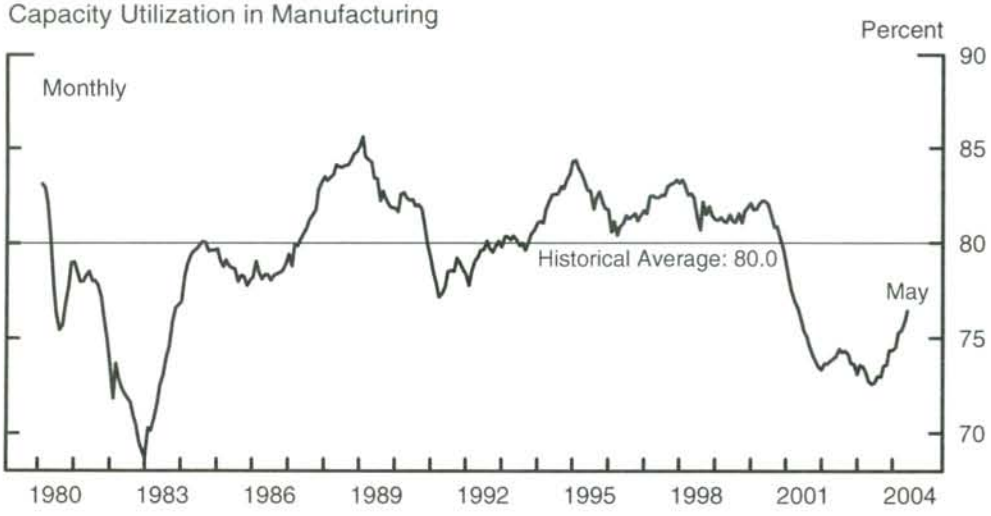
Federal Funds Rate



PCE Inflation



Capacity Utilization in Manufacturing



Note. Historical average for 1972-2003.

Fiscal Impetus

Calendar Year	Percent of GDP
2002	1.04
2003	1.15
2004	0.95
2005	-0.21

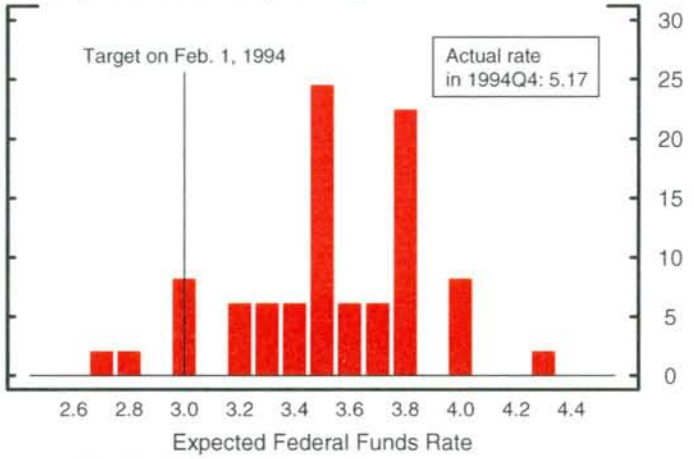
Exhibit 3
Market Preparedness

Policy Tightening During the First Year of Tightenings

	Expected*	Realized
	(Basis Points)	
1988	118	325
1994	111	300
1999	83	175
2004	221	

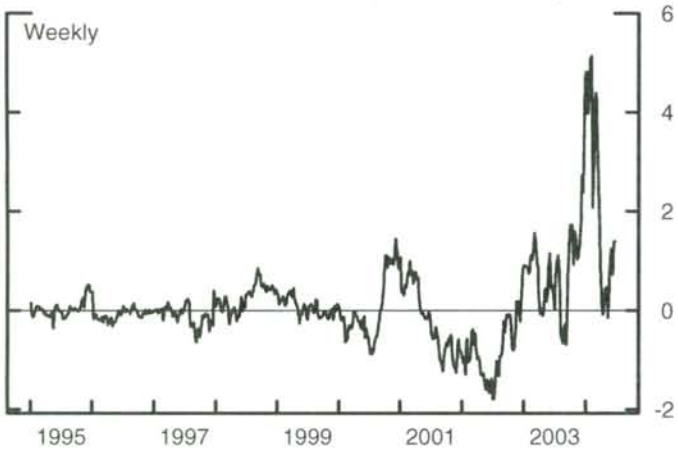
*Based on futures rates the day before the tightening began. For 2004, based on futures rates on June 29.

Fed Funds Expectations for 1994 Q4
Feb. 1, 1994 Blue Chip Survey



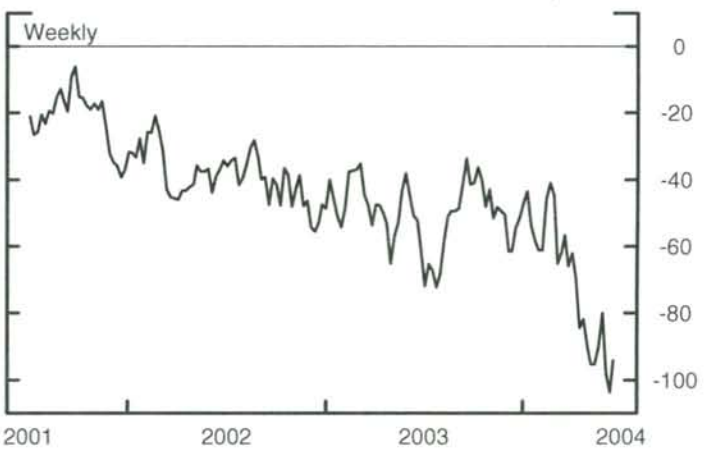
Note. Frequencies based on interest rate forecasts by panel members.

Net Long Position of Non-Hedgers



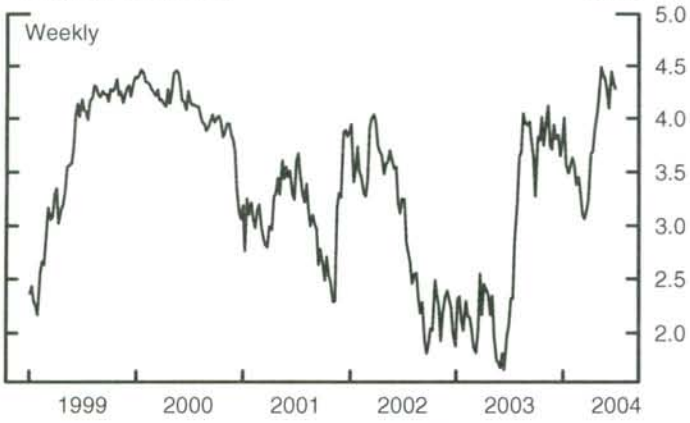
Note. Positions in two-year Treasury futures. Final observation is June 22, 2004.
Source: CFTC.

Net Long Position of Primary Dealers



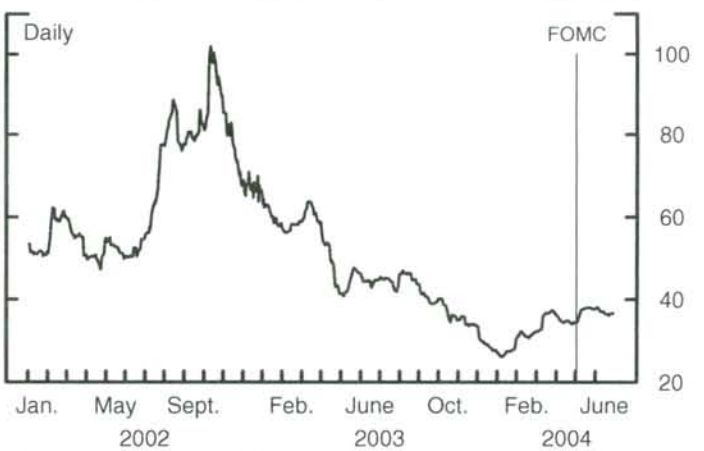
Note. Positions in Treasury securities with more than three years to maturity. Final observation is June 16, 2004.
Source: FRBNY.

Mortgage Duration



Note. Estimated duration of a representative sample of fifteen- and thirty-year fixed rate mortgages. Final observation is June 25, 2004.
Source: Merrill Lynch.

Credit Default Swap Financial Index



Note. Average of individual CDS quotes of 32 investment-grade financial firms weighted by the book value of liabilities. Final observation is June 29, 2004.

Exhibit 4: FOMC Statement Alternatives for the June Bluebook

	May FOMC	Alternative A	Alternative B	Alternative C
Policy Decision	1. The Federal Open Market Committee decided today to keep its target for the federal funds rate at 1 percent.	[Unchanged]	The Federal Open Market Committee decided today to raise its target for the federal funds rate to 1¼ percent.	The Federal Open Market Committee decided today to raise its target for the federal funds rate to 1½ percent.
Rationale	2. The Committee continues to believe that an accommodative stance of monetary policy, coupled with robust underlying growth in productivity, is providing important ongoing support to economic activity.	[Unchanged]	The Committee believes that, even after this action, the stance of monetary policy remains accommodative and, coupled with robust underlying growth in productivity, is providing ongoing support to economic activity.	The Committee believes that, even after this action, the stance of monetary policy remains accommodative and, coupled with robust underlying growth in productivity, is providing ongoing support to economic activity.
	3. The evidence accumulated over the intermeeting period indicates that output is continuing to expand at a solid rate and hiring appears to have picked up.	The evidence accumulated over the intermeeting period indicates that output is continuing to expand at a solid rate and hiring has picked up.	The evidence accumulated over the intermeeting period indicates that output is continuing to expand at a solid ~~rate~~ **pace** and hiring has picked up.	The evidence accumulated over the intermeeting period indicates that, with output expanding at a solid rate and hiring having picked up, the economic expansion is now well established.
	4. Although incoming inflation data have moved somewhat higher, long-term inflation expectations appear to have remained well contained.	Although incoming inflation data are somewhat elevated, a portion of the increase in recent months presumably has been due to transitory factors.	Although incoming inflation data are somewhat elevated, a portion of the increase in recent months ~~has~~ **appears to have** been due to transitory factors.	Incoming inflation data are somewhat elevated, and long-term inflation expectations have shown some tendency to edge higher.
Assessment of Risks	5. The Committee perceives that the upside and downside risks to the attainment of sustainable growth for the next few quarters are roughly equal.	The Committee perceives that the upside and downside risks to the attainment of both sustainable growth and price stability for the next few quarters are roughly equal.	The Committee perceives that the upside and downside risks to the attainment of both sustainable growth and price stability for the next few quarters are roughly equal.	The Committee perceives that the upside and downside risks to the attainment of sustainable growth for the next few quarters are roughly equal.
	6. Similarly, the risks to the goal of price stability have moved into balance.	[Covered above]	[Covered above]	However, the upside risks to the goal of price stability now appear to outweigh the downside risks.
	7. At this juncture, with inflation low and resource use slack, the Committee believes that policy accommodation can be removed at a pace that is likely to be measured.	With underlying inflation still relatively low and resource use slack, the Committee believes that policy accommodation can be removed at a pace that is likely to be measured.	With underlying inflation still expected to be relatively low, the Committee judges the outlook to be such that policy accommodation can be removed at a pace that is likely to be measured. Nonetheless, the Committee will respond to changes in economic prospects as needed to fulfill its obligation to maintain price stability ~~so as to foster maximum sustainable economic growth~~.	[None]