Prefatory Note

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Strictly Confidential (FR) Class II FOMC

Part 1 December 8, 2004

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

Economic activity seems to have been more robust recently than it appeared as of the November Greenbook. We have raised our estimate for the increase in real GDP in the third quarter to an annual rate of 3¾ percent—¼ percentage point higher than in the November Greenbook—and expect growth in the fourth quarter to proceed at that same pace—also ¼ percentage point higher than our previous projection. The upward revisions were motivated by encouraging data on household and business spending through October and a pair of employment reports that, taken together, paint a better picture of the labor market than was available at the time of the November Greenbook.

Several of the key background factors that condition our projection beyond the very near term have changed substantially in this forecast round. The foreign exchange value of the dollar has dropped, and an improving supply position has caused oil prices to reverse their run-up since midyear. In addition, a rally in equity markets and continued large gains in the value of residential real estate have boosted household net worth. By contrast, we have again weakened the outlook for business spending on high-technology capital goods. The net effect of these various forces would be to raise the growth rate of economic activity over the projection period: With our previous assumptions for monetary policy, we would have projected real GDP to overshoot potential in 2006. To forestall that outcome, we have raised our assumptions about the target federal funds rate, bringing it close to current market expectations. With this additional restraint, real GDP growth is now projected to slow from almost 4 percent in 2005 to 3¾ percent in 2006. This pace of expansion is expected to exhaust the slack in labor and product markets by the end of the projection period.

The outlook for inflation is little changed in this Greenbook. Incoming readings on the major price indexes have been in line with our expectations, and the lower projected path for oil prices is expected to be a damping factor going forward. Increases in hourly labor compensation have been modest this year, and recent productivity developments have given us little cause to alter our estimates of structural productivity or trend unit labor costs. Moreover, the depreciation of the dollar is forecast to give only a small boost to inflation as foreign producers limit their price increases in order to maintain their competitiveness. Importantly, inflation expectations remain well anchored at this juncture. In such an environment, core PCE price inflation is expected to remain stable at an annual rate of about 1½ percent over the next two years.

Key Background Factors

As noted above, the stronger outlook for aggregate demand has led us to assume that the Committee will adopt a somewhat tighter stance of policy than the one embedded in the November forecast. Specifically, we assume that the federal funds rate will rise gradually to 2¾ percent in the fourth quarter of 2005 and to 3¼ percent in the fourth quarter of 2006. These figures are ½ percentage point above the respective levels in the previous Greenbook and are only a little lower than current market expectations. Yields on long-term Treasury securities have edged up a bit, on net, since the date of the November Greenbook. We anticipate that bond yields will hold roughly steady over the forecast period at a level about 25 basis points above our previous projection.

Broad equity price indexes have risen roughly 4 percent since the November Greenbook. We have shifted up our starting level for stock prices by this amount and continue to assume that over the next two years share prices will increase 6½ percent per year, which would roughly maintain risk-adjusted parity with the yield on long-term bonds. In response to further sharp increases in house prices, and a surprisingly large third-quarter reading on the OFHEO repeat-transactions index in particular, we have raised our assumption for the increase in house prices. After a projected 11 percent increase in 2004, house prices as measured by this index are expected to increase 5½ percent over the four quarters of 2005 and 3½ percent in 2006—a cumulative upward revision of 6¼ percent in the level of prices by the end of 2006.

We have revised our fiscal assumptions somewhat on the basis of the recently passed omnibus appropriations bill. That bill allowed for less discretionary spending than we had assumed, and we lowered the projected increase in real federal nondefense purchases to 1 percent both in 2005 and in 2006; we also lowered our assumption for the increase in real defense spending in 2005 to 3½ percent while leaving our assumption for 2006 at 2½ percent. We have revised up our projection for revenues in line with higher projected income. These two changes have led us to lower our projections for the federal deficit about $25 billion, to $390 billion, in fiscal 2005 and $35 billion, to $360 billion, in fiscal 2006. We continue to expect that the federal budget will be a neutral influence on GDP growth in 2005 and a small positive influence in 2006 (mainly because of the Medicare prescription drug benefit), after having provided a substantial boost in each of the past four years.

The spot price of West Texas intermediate crude oil (WTI) is currently about $41 per barrel, down about $9 per barrel since the November Greenbook. Nevertheless, the price of oil remains well above its year-ago level because of strong world demand and concerns about the adequacy and reliability of future supply. Consistent with recent readings from futures markets, we expect the price of WTI to edge down to $40 per barrel in the fourth quarter of 2006. The price of imported crude oil, which is closer to the actual mix of crude oil grades used by U.S. refiners, is expected to drift down to less than $37 per barrel over the next two years—averaging about $3 per barrel less in 2005 and $2 per barrel less in 2006 than the projection in the November Greenbook.

The foreign exchange value of the dollar has declined on balance since the November Greenbook, apparently reflecting the market's continued focus on the current-account deficit. The starting point for our projected path of the real trade-weighted dollar is down about 3 percent from the previous forecast, and we assume further depreciation of about 3 percent between now and the end of 2006. Overall, recent data suggest that economic activity abroad has been a touch weaker than we had expected, and we have shaded our estimates for foreign GDP growth down a bit, to 3 percent this quarter and about 3¼ in 2005 and 2006.

Recent Developments and the Near-Term Outlook

Real GDP is estimated to have increased ¼ percentage point faster in the third quarter than we had anticipated at the time of the November Greenbook. Stronger-than-expected gains in consumer spending, business fixed investment, and net exports were only partly offset by a greater-than-expected decline in inventory investment. This strength appears to have carried over into the current quarter. In particular, consumer spending rose more in October than we had previously anticipated, in accord with the better news from the labor market. All told, we currently expect real GDP to rise at an annual rate of about 3¾ percent in the fourth quarter, about ¼ percentage point faster than in the November Greenbook.

Real PCE increased at an annual rate of 5 percent in the third quarter, as spending on motor vehicles surged and purchases of other goods and services continued to rise solidly. We expect that the pace of consumer spending will slow to a rate of 3¼ percent in the fourth quarter because reduced incentives have lowered spending on motor vehicles. Real disposable income is expected to increase at an annual rate of 7¾ percent in the fourth quarter, but the jump is attributable mainly to the one-time Microsoft dividend, which is expected to have little effect on consumption.

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

Measure	2004:Q3		2004:Q4	
	Nov. GB	Dec. GB	Nov. GB	Dec. GB
Real GDP	**3.4**	**3.7**	**3.4**	**3.7**
Private domestic final purchases	5.2	5.7	3.7	3.8
Personal consumption expenditures	4.6	5.1	2.9	3.3
Residential investment	2.1	1.5	.8	1.0
Business fixed investment	11.2	12.8	10.6	9.1
Government outlays for consumption and investment	1.0	0.7	1.1	1.6
	Contribution to growth (percentage points)			
Inventory investment	-.5	-1.0	.2	.3
Net exports	-.7	-.3	-.1	-.2

In October, sales of new homes remained high, and housing starts rebounded. Adjusted permits point to some slowdown in construction in November; nonetheless we expect single-family starts to average 1.61 million units at an annual rate in the fourth quarter, only slightly less than in the third quarter. Although the level of construction activity remains robust, the growth of spending has slowed sharply of late. Real residential investment soared in the first half of the year, reflecting the lagged effects of a large rise in starts in the second half of 2003, an increase in commissions from sales of existing homes, and a substantial increase in costs per start. However, because both starts and existing home sales have since flattened out, real residential investment rose at an annual rate of only 1½ percent in the third quarter and is on track for another small increase in the current quarter.

Real investment in equipment and software rose at an annual rate of 17¼ percent in the third quarter. Real high-tech spending grew at less than half its second-quarter pace, but outlays for other capital goods posted large increases, partly attributable, by our reckoning, to the partial-expensing tax incentive. But this quarter, spending on transportation equipment is expected to reverse some of its steep third-quarter rise, and outlays for capital goods outside the high-tech and transportation areas are likely to slow despite another anticipated boost from partial expensing. Although hard data remain sparse, we anticipate an increase of 11¼ percent in total E&S investment in the fourth quarter.

Real investment in nonresidential structures fell slightly in the third quarter, but we expect a modest rise in the current quarter, with increases in spending on drilling and mining structures—especially for natural gas—and post-hurricane repair of power lines and underwater pipelines accounting for much of the gain.

In the government sector, real federal expenditures on consumption and gross investment rose at an annual rate of 4¾ percent in the third quarter as a jump in defense spending was partly offset by a drop in nondefense expenditures. Early indications are that defense spending will hold about steady in the fourth quarter and that overall federal purchases will move up only 1½ percent. In the state and local sector, purchases were down in the third quarter as construction spending reversed its second-quarter spurt. But with the fiscal conditions of governments continuing to improve and hiring apparently firming, we are projecting a small advance in state and local purchases in the fourth quarter.

Nonfarm inventory investment excluding motor vehicles picked up from an annual rate of $42 billion in the second quarter to an estimated $52 billion in the third quarter. For the most part, the current level of non-auto inventories does not seem out of line with sales; our flow-of-goods system spots only a few areas of potential imbalance, and even those appear to be of limited dimension. That said, we believe that businesses will continue to maintain tight control over their inventory accumulation, and our projection assumes that non-auto inventory investment in the fourth quarter will drop back to an annual rate of $39 billion.

In the motor vehicles sector, automakers used heightened incentives to reduce their uncomfortably plentiful inventories in the third quarter. But with incentives pulled back so far in the fourth quarter, we anticipate little further progress before the end of the year.

In the external sector, real exports rose at an annual rate of 6¼ percent in the third quarter, held back some by weakness in services and semiconductors. Although real imports slowed noticeably from large increases in the first half of the year, we estimate that net exports still subtracted ¼ percentage point from the increase in real GDP in the third quarter. We expect the drag from the external sector to lessen a touch further in the current quarter, as a pickup in export growth exceeds an increase in import growth.

Core PCE prices rose at an estimated annual rate of just ¾ percent in the third quarter, in line with our projection from the November Greenbook. Last quarter's increase was held down by broad declines in prices for goods—new motor vehicles in particular. We expect core PCE prices to rise at a 1½ percent rate in the fourth quarter—about our estimate of their underlying pace; however, with energy prices having posted another large increase early this quarter, total PCE prices should increase at a rate of 2½ percent.

The Longer-Term Outlook for the Economy

We expect real GDP to grow about 4 percent in 2005, as the effects of receding energy prices, rising household wealth, and fairly flat long-term interest rates offset a negative swing in fiscal impetus. But the assumed steady withdrawal of monetary accommodation is expected to slow the pace of real GDP growth to 3¾ percent in 2006.

Household spending. We project real PCE to rise about 4 percent both in 2005 and in 2006. Increases in employment, declines in energy prices, and the implementation of the Medicare drug benefit should support solid growth in real income. Moreover, as noted above, households' wealth has benefited from a steep run-up in house prices and recent increases in equity prices. The upward revisions to wealth have also led us to revise down our forecast for the saving rate, but we continue to expect this rate to drift up over the projection period.

Housing activity has shown few signs of slippage. Mortgage rates are expected to remain low, albeit a little higher than in the previous projection, and we continue to forecast single-family starts in 2005 and 2006 at about the same high level of 1.6 million units that we have seen so far in 2004. Multifamily starts are also projected to proceed at their 2004 pace of 350,000 units for the next two years.

Business investment. We have lowered our projection for the growth of real investment in equipment and software to 6¾ percent in 2005 and 9¾ percent in 2006, about 1¾ percentage points less in each year than in the November Greenbook. This revision reflects mostly a reassessment that growth in high-tech spending is likely to match but not to exceed its long-run average. However, the broad contours of the forecast remain the same: After a lull in the first quarter of 2005 related to partial expensing, investment is projected to rise at rates in the vicinity of 10 percent through the rest of 2005 and a bit less in 2006, propelled by solid economic fundamentals, including favorable prospects for sales, a supportive financing environment, ample liquid assets, and the ongoing need to replace or upgrade aging or outmoded equipment and software.

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

Measure	2004: H2	2005: H1	2005	2006
Real GDP	**3.7**	**3.7**	**3.9**	**3.7**
Previous	3.4	3.5	3.7	4.0
Final sales	4.1	4.0	4.0	3.7
Previous	3.6	3.9	4.0	3.9
PCE	4.2	3.9	4.0	3.9
Previous	3.8	3.5	3.7	4.0
Residential investment	1.2	2.6	2.5	1.4
Previous	1.5	2.4	2.3	3.9
BFI	10.9	3.6	6.4	8.3
Previous	10.9	5.5	8.1	9.0
Government purchases	1.2	2.9	2.6	2.5
Previous	1.1	3.4	2.9	2.5
Exports	8.2	7.5	8.3	7.6
Previous	7.4	6.7	7.6	7.0
Imports	6.8	3.8	5.9	8.1
Previous	7.7	3.6	5.8	8.3
	Contribution to growth (percentage points)			
Inventory change	-.4	-.3	-.1	.0
Previous	-.2	-.5	-.3	.1
Net exports	-.2	.2	-.1	-.5
Previous	-.4	.1	-.1	-.6

Investment in nonresidential construction has shown some signs of improvement. Commercial construction has risen sharply since last winter, and more recently spending on factories and communications structures has begun to move up. So long as business activity and hiring expand about as we are anticipating, building in these sectors should continue to increase. Office construction remains depressed. But we expect that as the economy continues to expand and hiring picks up, even this category of construction should begin to grow. Spending on drilling and mining structures—primarily for natural gas—is expected to have another strong year in 2005 but to turn down in 2006 as energy prices recede.

Non-auto inventory investment is expected to move up in early 2005 as businesses replenish stocks depleted by the temporary run-up in equipment spending late this year. But given the ongoing improvements in supply-chain and logistics management, we anticipate that businesses will slow their stockbuilding in subsequent quarters to a rate that keeps inventory-to-sales ratios on a downward trend. On net, we project that inventory investment will be a neutral factor for GDP growth over the next two years.

Government spending. As noted above, we have incorporated the recent appropriations bill into this projection. Real federal expenditures for consumption and investment are forecast to rise 2¾ percent in 2005 and 2 percent in 2006, less than in the November Greenbook. As in the previous projection, we expect improved budgetary conditions to lead to a moderate pickup in spending by state and local governments, where real purchases are projected to rise 2½ percent in 2005 and 2¾ percent in 2006 after two years of increases below 1 percent.

Net exports. Ongoing depreciation of the dollar is projected to support real export growth of about 8 percent per year, on average, in 2005 and 2006—similar to our current estimate for 2004. Import growth is expected to average 7 percent over the next two years, a step down from the rapid 2004 pace. All in all, real net exports are expected to be a nearly neutral influence on real GDP growth in 2005 but to deduct about ½ percentage point from growth in 2006. *(The International Developments section provides more detail on the outlook for the external sector.)*

Aggregate Supply, the Labor Market, and Inflation

Potential real GDP is expected to rise 3 percent in 2005 and 3¼ percent in 2006. Given the assumed stance of monetary policy, we project that actual GDP growth will be sufficient to close the current output gap over that time frame. Accordingly, the unemployment rate is projected to fall gradually to about 5 percent—our estimate of the natural rate—by the end of 2006. Although headline consumer price inflation is being elevated by higher energy prices in the current quarter, we expect both total and core inflation to be subdued in 2005 and 2006.

Productivity and the labor market. We anticipate that private nonfarm payroll employment will continue to accelerate in the first quarter, increasing an average of

Decomposition of Structural Labor Productivity

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

Measure	1974-95	1996-2001	2002	2003	2004	2005	2006
Structural labor productivity	**1.5**	**2.7**	**3.2**	**3.7**	**3.0**	**2.7**	**2.7**
Previous	1.5	2.7	3.2	3.7	3.0	2.7	2.8
Contributions[1]							
Capital deepening	.7	1.3	.6	.6	.8	.8	.9
Previous	.7	1.4	.6	.6	.8	.9	1.0
Multifactor productivity	.5	1.1	2.4	2.8	2.0	1.6	1.5
Previous	.5	1.1	2.4	2.8	2.0	1.6	1.5
Labor composition	.3	.3	.3	.3	.3	.3	.3
MEMO							
Potential GDP	3.0	3.4	3.4	3.8	3.4	3.1	3.2
Previous	3.0	3.4	3.4	3.8	3.4	3.2	3.3

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

1. Percentage points.

The Outlook for the Labor Market

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

Measure	2003	2004	2005	2006
Output per hour, nonfarm business	5.6	2.8	1.7	2.2
Previous	5.6	2.5	1.9	2.5
Nonfarm private payroll employment	-.2	1.8	2.2	2.0
Previous	-.2	1.5	2.1	2.1
Household survey employment	1.2	1.3	1.7	1.5
Previous	1.2	1.2	1.8	1.5
Labor force participation rate[1]	66.1	66.0	66.3	66.4
Previous	66.1	66.1	66.4	66.5
Civilian unemployment rate[1]	5.9	5.4	5.3	5.1
Previous	5.9	5.5	5.4	5.1
MEMO				
GDP gap[2]	1.7	1.3	.6	.1
Previous	1.7	1.4	.9	.2

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

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

Measure	2003	2004	2005	2006
PCE chain-weighted price index	1.7	2.5	1.2	1.3
Previous	1.7	2.5	1.2	1.3
Food and beverages	2.7	3.0	2.0	1.8
Previous	2.7	2.8	1.9	1.8
Energy	7.2	17.8	-6.4	-0.3
Previous	7.2	18.8	-5.5	-1.0
Excluding food and energy	1.2	1.5	1.6	1.4
Previous	1.2	1.5	1.5	1.4
Consumer price index	1.9	3.4	1.4	1.7
Previous	1.9	3.3	1.4	1.6
Excluding food and energy	1.2	2.2	2.0	1.8
Previous	1.2	2.1	1.9	1.8
GDP chain-weighted price index	1.7	2.3	1.5	1.6
Previous	1.7	2.2	1.4	1.6
ECI for compensation of private industry workers[1]	4.0	4.0	4.2	4.1
Previous	4.0	4.0	4.2	4.1
NFB compensation per hour	5.4	3.8	4.2	4.2
Previous	5.4	3.6	4.2	4.2
Prices of core nonfuel imports	1.6	3.7	1.0	.1
Previous	1.6	4.0	.5	.2

1. December to December.

200,000 per month. With continuing growth in sales fueling business confidence and with lingering concerns about the energy situation dissipating, job gains in the private sector should pick up further in the spring and summer of 2005—to about 225,000 per month—before easing back a bit in 2006.

Productivity in the nonfarm business sector appears to have risen at an annual rate of only 1½ percent in the third quarter—less than one-half the rate of increase in the first half of the year—and to be on track to grow at a rate of 2¼ percent in the current quarter. Despite this moderation, we estimate that by the end of this year actual productivity will be about 1½ percent above its structural level. We expect that gap to close as hours rise solidly throughout the next two years. In particular, we project productivity to grow 1¾ percent next year and 2¼ percent in 2006.

Prices and labor costs. We continue to expect total PCE price inflation to fall from 2½ percent in 2004 to about 1¼ percent both in 2005 and in 2006 reflecting the direct effect of the downturn in energy prices. We expect core PCE prices to rise about 1½ percent per year in 2005 and 2006—as they did in 2004. The relative stability of projected core inflation represents a balance of several factors. On the one hand, a slight step-down in structural productivity growth and a narrowing in the margin of slack will act to raise core inflation. On the other hand, the upward pressure from the pass-through of higher energy prices and a lower dollar will diminish as we move through the projection period. We project that the employment cost index of hourly compensation will increase a little more than 4 percent per year in 2005 and 2006—just a touch faster than over the past two years.

Financial Flows and Conditions

Total domestic nonfinancial debt is expected to expand 8 percent this year. Next year and in 2006, we expect it to rise about 7 percent, much as in our previous forecast.

Household debt growth has been marked up a bit this year, to nearly 10 percent. Given the upward revision to our projection for home prices, we revised up our forecast for mortgage borrowing despite the slightly higher level of interest rates now anticipated over the forecast period. Nonetheless, we continue to project a marked deceleration in home prices, which should temper the growth of mortgage debt in 2005 and 2006. In line with this moderation, total household debt is projected to expand 8 percent 2005 and 6¾ percent in 2006, a significant slowing from the rapid pace registered over the past several years.

The pace of nonfinancial business borrowing has strengthened somewhat this quarter as a result of a pickup in C&I lending and greater volumes of net bond issuance and commercial mortgage borrowing. Looking ahead, we expect business debt to rise a little more than 6 percent in 2005 and 2006, up from this year's increase of 5 percent, to finance the rising investment outlays in our projection.

Federal debt is projected to expand 9¾ percent this year, a bit below the pace in the previous Greenbook, consistent with the small downward revision to our estimate of the budget deficit for the current calendar year. Looking ahead, federal debt is expected to increase an average of 8 percent per year over the forecast period. We expect borrowing in the state and local government sector to decline from its 8¼ percent pace over 2004 to about 4 percent in 2006. This deceleration stems from an expected drop in advance-refunding issues and from this sector's improving budget outlook.

M2 is expected to increase 5¼ percent in the current year, the same as our projection in November. Rising opportunity costs over the forecast period should cause household demand for money balances to lag the growth in nominal income, leaving M2 up 2 percent in 2005 and 3½ percent in 2006.

Alternative Simulations
In this section, we evaluate several risks to the staff forecast using simulations of the FRB/US model. The primary subject of the first four scenarios is how the outlook for inflation would change in response to alternative assumptions about structural productivity and the influence of unit labor costs on prices. We then shift our focus to demand-side risks, first with a scenario in which the current low level of interest rates produces an unexpectedly vigorous economic expansion and then with a pair of simulations, assessing the consequences of a slump in house prices. In all these simulations, the federal funds rate is held at baseline. The final scenario assumes that the funds rate follows a path consistent with current readings from futures markets.

Greater cost pass-through. Our reading of the historical evidence suggests that firms tend not to pass on to customers temporary changes in costs associated with transitory movements in productivity. In the baseline we assumed that the projected acceleration in unit labor costs reflects a cyclical, rather than a structural, slowing of productivity and so will have little effect on inflation. However, we cannot rule out the possibility that this time businesses could be more successful in passing on these cost increases and thus maintaining profit margins. In this scenario, we assume that firms are able to raise prices enough to recover about half the increase in costs attributable to the shortfall of actual productivity growth below its structural pace. As a result, core PCE inflation picks up to 1¾ percent in each of the next two years. The consequent reduction in the real funds rate provides a slight boost to real activity.

Greater cost pass-through with lower structural productivity. In addition to the chance that prices might respond more strongly than expected to the projected rise in unit labor costs, another risk is that future structural productivity may grow less than we anticipate: History suggests that productivity booms eventually die out, and the current episode is nearly a decade old. This scenario not only incorporates the greater cost pass-

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

Measure and scenario	2004 Q4	2005 H1	2005 H2	2006
Real GDP				
Baseline	**3.7**	**3.7**	**4.1**	**3.7**
Greater cost pass-through	3.7	3.7	4.1	3.8
With lower structural productivity	3.7	3.7	3.8	2.8
Declining markup	3.8	3.8	4.1	3.4
With higher structural productivity	3.9	4.3	4.8	4.2
Stronger demand	4.4	4.4	4.9	4.6
Real estate slump	3.7	3.6	3.9	3.3
With confidence loss	3.6	3.5	3.6	2.9
Market-based funds rate	3.7	3.7	3.9	3.5
Civilian unemployment rate[1]				
Baseline	**5.4**	**5.3**	**5.3**	**5.1**
Greater cost pass-through	5.4	5.3	5.3	5.1
With lower structural productivity	5.4	5.3	5.3	5.1
Declining markup	5.4	5.3	5.2	5.1
With higher structural productivity	5.4	5.2	5.1	4.9
Stronger demand	5.3	5.1	4.9	4.3
Real estate slump	5.4	5.3	5.4	5.4
With confidence loss	5.4	5.3	5.5	5.7
Market-based funds rate	5.4	5.3	5.3	5.3
PCE prices excluding food and energy				
Baseline	**1.5**	**1.6**	**1.5**	**1.4**
Greater cost pass-through	1.7	1.8	1.8	1.8
With lower structural productivity	1.7	1.8	1.9	2.2
Declining markup	1.1	1.1	.9	1.0
With higher structural productivity	1.0	1.0	.7	.8
Stronger demand	1.5	1.6	1.6	1.6
Real estate slump	1.5	1.6	1.5	1.4
With confidence loss	1.5	1.6	1.5	1.3
Market-based funds rate	1.5	1.6	1.5	1.3

1. Average for the final quarter of the period.

through of the previous simulation, but assumes in addition that structural labor productivity growth moderates gradually to an annual rate of only 2 percent in 2006, ¾ percentage point slower than in the baseline and similar to long historical averages. Over the next two years, actual productivity falls relative to baseline by a similar amount, which passes through into prices to the same degree as it did in the previous scenario.

As a result, core PCE prices rise 2¼ percent in 2006. At the same time, the less-favorable prospects for future income and earnings restrain both consumption and investment, causing the increase in real GDP to slow to 2¾ percent by 2006. Relative to baseline, the slower advance in output about offsets the slower advance of potential, leaving the unemployment rate unaffected.

Declining markup. The "greater cost pass-through" scenario views the projected acceleration in unit labor costs over the forecast period as a source of upside risk to the inflation outlook. On the other hand, robust gains in labor productivity over the past few years have helped push the markup of prices over unit labor costs to a level that is high by historical standards. Although the baseline shows the markup falling about half way back to its 1968-2004 average, a risk is that the decline will be more substantial. In this scenario we assume that the markup returns to its average level by the end of 2006 through a combination of smaller price increases and larger nominal wage gains. As a result, core PCE inflation averages only 1 percent over the next two years. The swing toward labor income and away from capital income provides a small initial boost to aggregate spending in 2005, but this increase is more than offset later by a higher level of real interest rates. All told, the level of real GDP is about ¼ percent below baseline at the end of 2006.

Declining markup with higher structural productivity. We believe that some of the impressive productivity performance of recent years reflects temporary efficiencies arising from pronounced caution about hiring. As a consequence, in the baseline we estimate that the level of actual productivity is well above structural labor productivity. But we may have underestimated the structural component of the recent gains in output per hour. In this simulation, we build on the features of the previous "declining markup" scenario by additionally assuming that, since the start of 2003, structural productivity has been growing ½ percentage point per year faster than the staff estimates. We further assume that this stronger growth will continue for the foreseeable future and that it has already been fully priced into financial assets. These more favorable supply-side conditions augment the disinflationary impulse associated with the declining markup; as a result, core inflation falls to ¾ percent by 2006. Real GDP advances ½ percentage point faster than in the baseline in each of the next two years, as does potential output.

Stronger demand. The Greenbook baseline projection is consistent with a short-run value for the equilibrium real interest rate that is in the vicinity of 1½ percent. As reported in the Bluebook, this estimate is ¾ percentage point below the average estimate produced by three econometric models. In this scenario, we assume that aggregate demand increases more rapidly than in the baseline, by an amount consistent with a short-run equilibrium real rate equal to the average model prediction. Under this calibration, real GDP rises a little more than 4½ percent in each of the next two years, and the unemployment rate falls to 4¼ percent by the end of 2006. Inflation is only 0.2 percentage point above the baseline in 2006, but this difference would increase in 2007 and beyond in the absence of a monetary policy offset.

Real estate slump. The multiyear surge in residential real estate values continued into the third quarter of this year. The further rise in house prices that we are forecasting increases the tension between market values and apparent fundamentals and heightens the risk of a substantial correction at some point. In this scenario, we assume that house prices decline roughly 10 percent by the end of 2006 from their current level, leaving them 20 percent below the baseline forecast. Such a decline, when expressed relative to the change in core PCE prices, would be larger and more rapid than that seen in past housing market slumps; however, the recent gains have also been atypically large. The consequent loss in wealth restrains household spending and raises the personal saving rate ½ percentage point relative to baseline by the end of 2006. This restraint on real GDP growth boosts the unemployment rate 0.3 percentage point relative to baseline by the end of 2006. Nevertheless, this higher level of slack is not sufficient to have much effect on inflation within the forecast period. Without an offsetting policy response, the effects of the real estate slump on real activity would continue to worsen in 2007, in light of the gradual manner in which consumption typically responds to changes in wealth.

Real estate slump with confidence loss. The measured responses of household spending and economic activity more broadly to the decline in real estate values portrayed in the previous scenario are themselves subject to many risks. One is that such a sea change in real estate markets would come as a considerable surprise to households, causing consumer confidence to drop significantly. In this scenario, we assume that this decline in sentiment further boosts the saving rate so that it is a full percentage point higher than in the baseline forecast—twice the effect in the previous scenario. The effects on real GDP and the unemployment rate are also doubled. Inflation is a touch below baseline in 2006.

Market-based funds rate. Quotes from futures markets imply a cumulative increase in the federal funds rate through 2006 that is only ¼ percentage point more than we have assumed in the staff outlook. This marginally higher level of the funds rate has only a small effect on real activity and inflation throughout the projection period—real GDP increases 3½ percent in 2006, the unemployment rate is only two-tenths above baseline by the end of 2006, and inflation is down a touch.

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

Measure	2004	2005	2006
Real GDP			
(percent change, Q4 to Q4)			
Projection	3.8	3.9	3.7
Confidence interval			
Greenbook forecast errors[1]	3.3–4.4	2.1–5.7	1.8–5.6
FRB/US stochastic simulations	3.5–4.1	2.5–5.5	2.0–5.5
Civilian unemployment rate			
(percent, Q4)			
Projection	5.4	5.3	5.1
Confidence interval			
Greenbook forecast errors[1]	5.3–5.5	4.6–6.0	4.0–6.2
FRB/US stochastic simulations	5.3–5.5	4.6–5.9	3.9–6.0
PCE prices			
excluding food and energy			
(percent change, Q4 to Q4)			
Projection	1.5	1.6	1.4
Confidence interval			
Greenbook forecast errors[2]	1.3–1.7	.9–2.3	.4–2.4
FRB/US stochastic simulations	1.4–1.6	1.0–2.2	.6–2.2

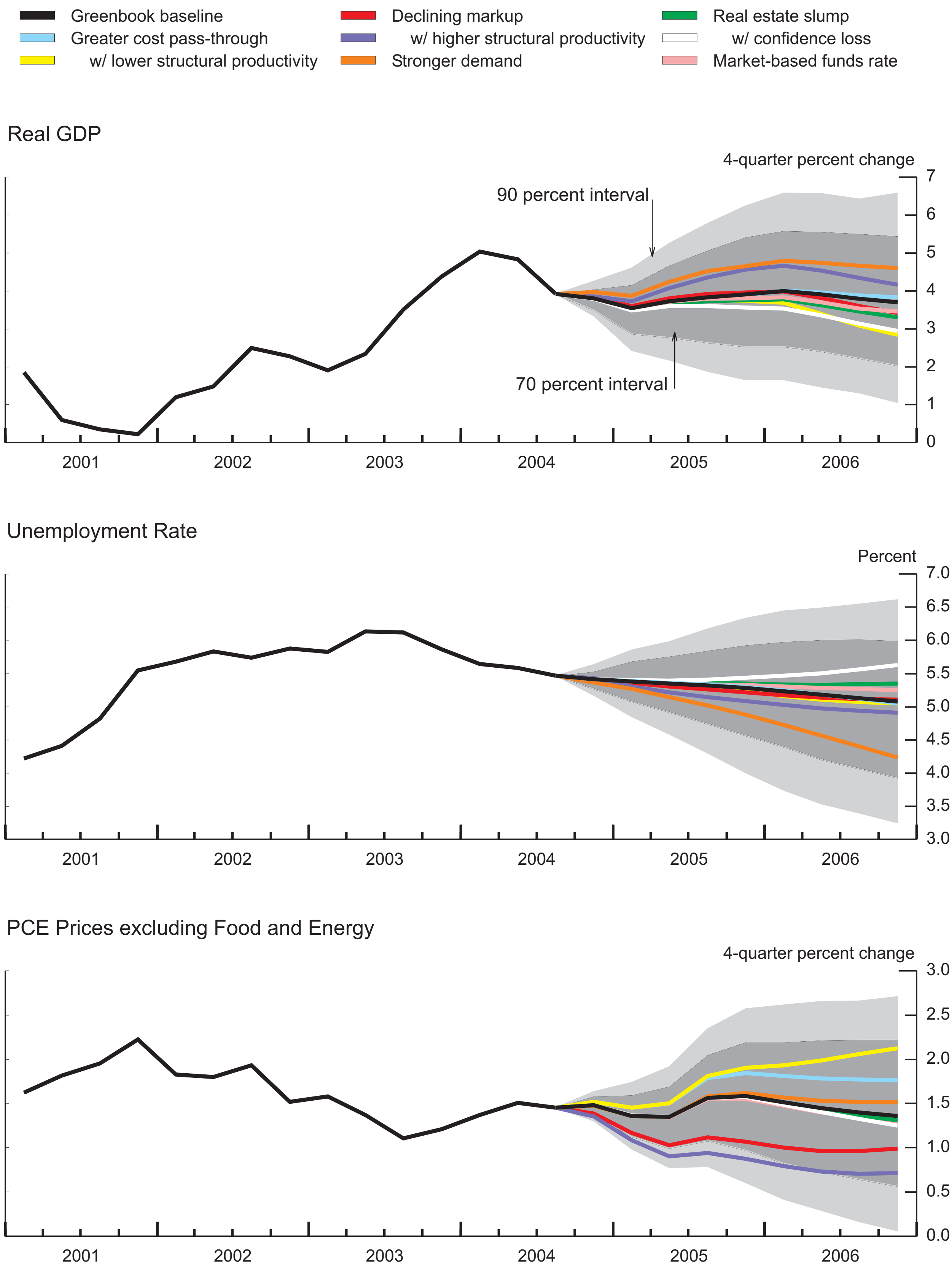
NOTE. Shocks underlying stochastic simulations are randomly drawn from the 1978–2003 set of model equation residuals.

1. 1978–2003.

2. 1981–2003.

Forecast Confidence Intervals and Alternative Scenarios

Confidence Intervals Based on FRB/US Stochastic Simulations



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

		Nominal GDP		Real GDP		GDP chain-weighted price index		Consumer price index[1]		Unemployment rate[2]	
Interval		11/03/04	12/08/04	11/03/04	12/08/04	11/03/04	12/08/04	11/03/04	12/08/04	11/03/04	12/08/04
ANNUAL											
2002		3.5	3.5	1.9	1.9	1.7	1.7	1.6	1.6	5.8	5.8
2003		4.9	4.9	3.0	3.0	1.8	1.8	2.3	2.3	6.0	6.0
2004		6.5	6.6	4.3	4.4	2.1	2.1	2.7	2.7	5.5	5.5
2005		5.2	5.5	3.5	3.8	1.6	1.6	2.0	1.9	5.4	5.3
2006		5.6	5.5	3.9	3.9	1.6	1.6	1.5	1.7	5.3	5.2
QUARTERLY											
2003	Q1	4.9	4.9	1.9	1.9	2.7	2.7	3.8	3.8	5.8	5.8
	Q2	5.3	5.3	4.1	4.1	1.1	1.1	0.7	0.7	6.1	6.1
	Q3	8.8	8.8	7.4	7.4	1.4	1.4	2.4	2.4	6.1	6.1
	Q4	5.7	5.7	4.2	4.2	1.6	1.6	0.7	0.7	5.9	5.9
2004	Q1	7.4	7.4	4.5	4.5	2.8	2.8	3.5	3.5	5.6	5.6
	Q2	6.6	6.6	3.3	3.3	3.2	3.2	4.8	4.8	5.6	5.6
	Q3	4.8	5.1	3.4	3.7	1.3	1.3	1.9	1.9	5.5	5.5
	Q4	5.2	5.6	3.4	3.7	1.7	1.9	3.2	3.6	5.5	5.4
2005	Q1	4.8	5.1	3.1	3.4	1.6	1.6	1.6	0.6	5.5	5.4
	Q2	5.2	5.4	3.8	4.0	1.3	1.3	1.1	1.4	5.4	5.3
	Q3	5.4	5.7	3.9	4.1	1.4	1.5	1.3	1.7	5.4	5.3
	Q4	5.5	5.7	3.9	4.0	1.5	1.6	1.5	1.7	5.4	5.3
2006	Q1	5.8	5.8	3.9	3.8	1.8	1.9	1.5	1.7	5.4	5.2
	Q2	5.6	5.3	4.0	3.7	1.5	1.5	1.6	1.6	5.3	5.2
	Q3	5.5	5.2	4.0	3.7	1.5	1.5	1.5	1.7	5.2	5.1
	Q4	5.4	5.2	4.0	3.7	1.4	1.5	1.6	1.7	5.1	5.1
TWO-QUARTER[3]											
2003	Q2	5.1	5.1	3.0	3.0	1.9	1.9	2.2	2.2	0.2	0.2
	Q4	7.2	7.2	5.8	5.8	1.5	1.5	1.5	1.5	-0.2	-0.2
2004	Q2	7.0	7.0	3.9	3.9	3.0	3.0	4.2	4.2	-0.3	-0.3
	Q4	5.0	5.4	3.4	3.7	1.5	1.6	2.5	2.7	-0.1	-0.2
2005	Q2	5.0	5.3	3.5	3.7	1.4	1.5	1.3	1.0	-0.1	-0.1
	Q4	5.4	5.7	3.9	4.1	1.4	1.6	1.4	1.7	0.0	0.0
2006	Q2	5.7	5.5	4.0	3.7	1.7	1.7	1.5	1.7	-0.1	-0.1
	Q4	5.5	5.2	4.0	3.7	1.5	1.5	1.6	1.7	-0.2	-0.1
FOUR-QUARTER[4]											
2002	Q4	3.8	3.8	2.3	2.3	1.6	1.6	2.2	2.2	0.3	0.3
2003	Q4	6.2	6.2	4.4	4.4	1.7	1.7	1.9	1.9	0.0	0.0
2004	Q4	6.0	6.2	3.7	3.8	2.2	2.3	3.3	3.4	-0.4	-0.5
2005	Q4	5.2	5.5	3.7	3.9	1.4	1.5	1.4	1.4	-0.1	-0.1
2006	Q4	5.6	5.4	4.0	3.7	1.6	1.6	1.6	1.7	-0.2	-0.2

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.

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

Item	Units[1]	1998	1999	2000	2001	2002	2003	2004	2005	2006
								- - - - - Projected	- - - - -	
Expenditures										
Nominal GDP	Bill. $	8747.0	9268.4	9817.0	10128.0	10487.0	11004.0	11725.1	12366.1	13049.1
Real GDP	Bill. Ch. $	9066.9	9470.3	9817.0	9890.7	10074.8	10381.3	10837.4	11244.1	11677.1
Real GDP	% change	4.5	4.7	2.2	0.2	2.3	4.4	3.8	3.9	3.7
Gross domestic purchases		5.5	5.5	3.0	0.4	3.1	4.3	4.2	3.8	4.0
Final sales		4.8	4.2	2.9	1.5	1.2	4.5	3.5	4.0	3.7
Priv. dom. final purchases		6.4	5.3	4.3	1.0	1.7	4.9	4.4	4.2	4.2
Personal cons. expenditures		5.4	4.9	4.1	2.8	2.5	3.8	3.5	4.0	3.9
Durables		14.4	7.3	4.7	10.8	1.5	9.9	4.4	6.6	6.6
Nondurables		4.7	4.9	3.0	1.9	2.3	4.6	4.0	4.4	4.4
Services		3.8	4.4	4.5	1.6	2.9	2.2	3.1	3.2	3.1
Business fixed investment		10.9	7.7	7.8	-9.6	-6.0	9.4	9.6	6.4	8.3
Equipment & Software		13.5	10.8	7.5	-9.0	-2.2	12.1	12.6	6.8	9.8
Nonres. structures		4.0	-0.9	8.8	-11.1	-16.1	1.5	-0.1	5.0	3.4
Residential structures		10.3	3.6	-1.9	1.4	6.9	12.0	5.8	2.5	1.4
Exports		2.6	5.6	6.5	-11.9	3.5	6.1	7.8	8.3	7.6
Imports		11.0	12.1	11.2	-7.6	9.7	4.9	9.2	5.9	8.1
Gov't. cons. & investment		3.3	4.2	0.4	5.0	3.8	2.2	1.8	2.6	2.5
Federal		0.1	4.2	-2.2	6.4	8.2	5.5	3.9	2.7	1.9
Defense		-1.2	4.3	-3.5	6.5	8.5	8.5	5.6	3.5	2.4
State & local		5.1	4.2	1.7	4.2	1.6	0.4	0.5	2.5	2.8
Change in bus. inventories	Bill. Ch. $	72.6	68.9	56.5	-31.7	11.7	-0.8	43.6	30.6	32.2
Nonfarm		71.2	71.5	57.8	-31.8	13.5	-1.1	39.9	28.1	30.0
Net exports		-203.8	-296.2	-379.5	-399.1	-472.1	-518.5	-577.7	-590.5	-633.2
Nominal GDP	% change	5.7	6.3	4.6	2.7	3.8	6.2	6.2	5.5	5.4
GDP Gap[2]	%	-1.6	-2.4	-2.5	0.1	1.6	2.2	1.4	0.9	0.2
Employment and Production										
Nonfarm payroll employment	Millions	125.9	129.0	131.8	131.8	130.3	129.9	131.3	133.7	136.4
Unemployment rate	%	4.5	4.2	4.0	4.7	5.8	6.0	5.5	5.3	5.2
Industrial prod. index	% change	4.4	4.9	2.3	-5.2	1.3	1.5	4.8	4.8	4.3
Capacity util. rate - mfg.	%	82.0	81.4	81.1	75.4	73.9	73.4	76.2	78.3	80.3
Housing starts	Millions	1.62	1.64	1.57	1.60	1.70	1.85	1.95	1.95	1.94
Light motor vehicle sales		15.52	16.90	17.35	17.12	16.79	16.62	16.72	17.31	17.86
North Amer. produced		13.48	14.41	14.48	14.04	13.49	13.32	13.34	13.79	14.28
Other		2.03	2.49	2.87	3.08	3.30	3.31	3.37	3.52	3.58
Income and Saving										
Nominal GNP	Bill. $	8768.3	9302.2	9855.9	10171.6	10514.1	11059.2	11767.7	12372.9	13014.4
Nominal GNP	% change	5.5	6.5	4.7	2.9	3.5	6.5	5.5	5.3	5.0
Nominal personal income		7.0	5.5	7.1	2.2	1.9	4.6	6.2	5.3	6.4
Real disposable income		5.6	2.8	4.4	1.2	2.9	3.9	3.7	3.4	4.8
Personal saving rate	%	4.3	2.4	2.3	1.8	2.0	1.4	1.1	0.8	1.8
Corp. profits, IVA & CCAdj.	% change	-10.0	9.6	-8.6	-0.2	15.4	23.3	8.1	1.5	-3.0
Profit share of GNP	%	9.1	9.2	8.3	7.5	8.3	9.2	10.0	10.0	9.4
Excluding FR Banks		8.9	8.9	8.0	7.3	8.1	9.1	9.8	9.8	9.2
Federal surpl./deficit	Bill. $	38.8	103.6	189.5	46.7	-254.5	-364.5	-369.9	-247.6	-300.7
State & local surpl./def.		52.0	50.4	50.0	4.8	-25.0	-3.2	11.3	9.8	14.1
Ex. social ins. funds		50.3	48.7	47.9	2.2	-26.6	-4.3	9.9	8.2	12.5
Gross natl. saving rate	%	18.2	18.0	18.0	16.3	14.1	13.5	13.6	13.7	13.8
Net natl. saving rate		7.4	6.9	6.7	4.2	2.0	1.4	1.9	2.3	2.4
Prices and Costs										
GDP chn.-wt. price index	% change	1.1	1.6	2.2	2.4	1.6	1.7	2.3	1.5	1.6
Gross Domestic Purchases chn.-wt. price index		0.7	2.0	2.4	1.6	1.8	1.8	2.8	1.3	1.4
PCE chn.-wt. price index		0.9	2.1	2.3	1.7	1.8	1.7	2.5	1.2	1.3
Ex. food and energy		1.4	1.6	1.5	2.2	1.5	1.2	1.5	1.6	1.4
CPI		1.5	2.6	3.4	1.8	2.2	1.9	3.4	1.4	1.7
Ex. food and energy		2.3	2.0	2.6	2.7	2.0	1.2	2.2	2.0	1.8
ECI, hourly compensation[3]		3.5	3.4	4.4	4.2	3.2	4.0	4.0	4.2	4.1
Nonfarm business sector										
Output per hour		2.7	3.4	2.1	3.3	3.5	5.6	2.8	1.7	2.2
Compensation per Hour		5.5	5.2	6.4	3.5	2.9	5.4	3.8	4.2	4.2
Unit labor cost		2.7	1.7	4.3	0.3	-0.6	-0.2	0.9	2.4	2.0

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

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

Item	Units	2002 Q1	2002 Q2	2002 Q3	2002 Q4	2003 Q1	2003 Q2	2003 Q3	2003 Q4	2004 Q1	2004 Q2
Expenditures											
Nominal GDP	Bill. $	10338.2	10445.7	10546.5	10617.5	10744.6	10884.0	11116.7	11270.9	11472.6	11657.5
Real GDP	Bill. Ch. $	9993.5	10052.6	10117.3	10135.9	10184.4	10287.4	10472.8	10580.7	10697.5	10784.7
Real GDP	% change	3.4	2.4	2.6	0.7	1.9	4.1	7.4	4.2	4.5	3.3
Gross domestic purchases		4.4	2.8	2.9	2.4	1.7	4.4	6.4	4.7	5.0	4.2
Final sales		0.3	1.8	2.0	0.7	2.4	5.2	6.8	3.7	3.3	2.5
Priv. dom. final purchases		0.7	1.7	2.4	1.9	2.6	5.1	7.2	4.8	4.2	3.7
Personal cons. expenditures		1.8	2.8	2.9	2.5	2.7	3.9	5.0	3.6	4.1	1.6
Durables		-8.5	4.4	14.0	-2.4	-0.1	20.6	16.5	3.9	2.2	-0.3
Nondurables		3.8	0.8	-0.6	5.3	5.0	1.6	6.9	5.1	6.7	0.1
Services		3.3	3.5	2.4	2.2	2.1	1.8	1.9	2.8	3.3	2.7
Business fixed investment		-9.7	-9.6	-1.1	-3.2	-0.1	11.8	15.7	11.0	4.2	12.5
Equipment & Software		-6.3	-4.5	4.6	-2.0	4.5	11.0	21.7	12.0	8.0	14.2
Nonres. structures		-18.5	-22.6	-16.0	-6.6	-13.0	14.5	-1.3	7.9	-7.6	6.9
Residential structures		9.3	11.3	2.8	4.2	7.5	9.1	22.4	9.6	5.0	16.5
Exports		4.7	11.0	3.1	-4.2	-1.5	-1.6	11.3	17.5	7.3	7.3
Imports		12.5	11.4	5.4	9.6	-1.9	2.5	2.9	17.1	10.6	12.6
Gov't. cons. & investment		4.7	4.4	2.1	4.0	0.2	7.2	0.1	1.6	2.5	2.2
Federal		8.2	12.8	2.9	9.2	0.3	22.1	-3.3	4.8	7.1	2.7
Defense		5.9	11.4	3.4	13.5	-2.8	38.4	-7.7	11.6	10.6	1.9
State & local		2.9	0.3	1.7	1.4	0.1	-0.5	2.2	-0.1	-0.0	1.9
Change in bus. inventories	Bill. Ch. $	-7.4	7.9	22.7	23.8	9.6	-17.6	-3.5	8.6	40.0	61.1
Nonfarm		-11.9	16.1	24.6	25.3	9.6	-15.7	-2.7	4.6	34.5	58.8
Net exports		-444.9	-458.1	-469.8	-515.4	-511.7	-525.2	-508.7	-528.3	-550.1	-580.3
Nominal GDP	% change	4.4	4.2	3.9	2.7	4.9	5.3	8.8	5.7	7.4	6.6
GDP Gap[1]	%	1.2	1.4	1.6	2.3	2.7	2.6	1.8	1.7	1.4	1.5
Employment and Production											
Nonfarm payroll employment	Millions	130.4	130.4	130.3	130.2	130.0	129.9	129.8	130.0	130.4	131.1
Unemployment rate	%	5.7	5.8	5.7	5.9	5.8	6.1	6.1	5.9	5.6	5.6
Industrial prod. index	% change	1.9	4.2	1.2	-1.9	0.9	-4.0	3.8	5.6	6.6	4.9
Capacity util. rate - mfg.	%	73.7	74.1	74.2	73.5	73.5	72.7	73.2	74.1	75.1	76.1
Housing starts	Millions	1.72	1.68	1.70	1.74	1.74	1.75	1.88	2.04	1.94	1.92
Light motor vehicle sales		16.60	16.54	17.41	16.60	16.09	16.38	17.23	16.80	16.51	16.54
North Amer. produced		13.29	13.29	14.08	13.31	12.71	13.10	13.89	13.57	13.25	13.14
Other		3.32	3.25	3.32	3.29	3.38	3.28	3.34	3.23	3.26	3.40
Income and Saving											
Nominal GNP	Bill. $	10361.7	10461.6	10571.7	10661.2	10781.3	10929.0	11168.3	11358.1	11546.1	11693.6
Nominal GNP	% change	2.4	3.9	4.3	3.4	4.6	5.6	9.1	7.0	6.8	5.2
Nominal personal income		2.2	4.3	-0.1	1.1	3.8	4.7	4.6	5.3	5.0	6.4
Real disposable income		10.8	2.7	-1.7	0.2	1.8	4.3	8.2	1.4	2.4	2.8
Personal saving rate	%	2.7	2.7	1.6	1.2	1.0	1.1	1.9	1.3	1.0	1.3
Corp. profits, IVA & CCAdj.	% change	24.8	15.2	3.6	19.1	-1.5	36.7	32.0	30.2	13.6	2.9
Profit share of GNP	%	8.1	8.3	8.3	8.6	8.5	9.0	9.5	9.9	10.1	10.0
Excluding FR Banks		7.9	8.1	8.1	8.4	8.3	8.8	9.3	9.8	9.9	9.9
Federal surpl./deficit	Bill. $	-208.5	-251.6	-255.1	-302.7	-281.6	-364.4	-433.0	-379.2	-391.0	-380.0
State & local surpl./def.		-28.8	-23.6	-21.3	-26.3	-49.0	-5.7	6.5	35.3	11.8	18.3
Ex. social ins. funds		-30.8	-25.3	-22.8	-27.6	-50.1	-6.7	5.4	34.1	10.6	16.9
Gross natl. saving rate	%	15.0	14.6	13.7	13.2	12.8	13.1	13.6	14.3	13.6	13.8
Net natl. saving rate		2.9	2.5	1.5	0.9	0.4	0.9	1.6	2.5	2.1	2.3
Prices and Costs											
GDP chn.-wt. price index	% change	1.4	1.5	1.7	2.0	2.7	1.1	1.4	1.6	2.8	3.2
Gross Domestic Purchases chn.-wt. price index		1.2	2.5	1.8	1.9	3.7	0.4	1.7	1.4	3.4	3.5
PCE chn.-wt. price index		0.9	2.9	2.0	1.4	3.2	0.7	1.6	1.2	3.3	3.1
Ex. food and energy		1.2	2.0	2.0	0.9	1.5	1.1	0.9	1.3	2.1	1.7
CPI		1.4	3.4	2.2	2.0	3.8	0.7	2.4	0.7	3.5	4.8
Ex. food and energy		2.1	2.3	2.1	1.7	1.3	1.0	1.5	0.8	1.9	2.9
ECI, hourly compensation[2]		3.6	4.4	2.5	3.3	5.5	3.4	4.4	3.1	4.3	4.0
Nonfarm business sector											
Output per hour		6.9	1.1	4.5	1.6	3.7	6.7	9.0	3.1	3.7	3.9
Compensation per hour		5.5	3.4	1.5	1.2	5.3	5.7	6.1	4.4	2.0	5.9
Unit labor cost		-1.4	2.3	-2.9	-0.3	1.6	-1.0	-2.7	1.2	-1.6	1.9

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

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

Item	Units	Projected									
		2004 Q3	2004 Q4	2005 Q1	2005 Q2	2005 Q3	2005 Q4	2006 Q1	2006 Q2	2006 Q3	2006 Q4
EXPENDITURES											
Nominal GDP	Bill. $	11803.5	11966.8	12115.8	12277.0	12449.5	12622.1	12799.8	12966.1	13132.0	13298.5
Real GDP	Bill. Ch. $	10883.9	10983.6	11076.7	11186.6	11300.4	11412.7	11519.5	11624.4	11729.3	11835.0
Real GDP	% change	3.7	3.7	3.4	4.0	4.1	4.0	3.8	3.7	3.7	3.7
Gross domestic purchases		3.9	3.8	3.3	3.5	4.1	4.3	4.3	3.6	3.8	4.1
Final sales		4.8	3.5	3.3	4.8	4.2	3.8	3.5	4.1	3.7	3.4
Priv. dom. final purchases		5.7	3.8	3.0	4.6	4.6	4.4	4.4	4.2	4.2	4.2
Personal cons. expenditures		5.1	3.3	3.7	4.1	4.1	3.9	4.0	3.8	3.8	3.8
Durables		17.2	-0.5	6.9	6.6	6.5	6.5	6.6	6.6	6.5	6.6
Nondurables		4.8	4.6	4.2	4.4	4.5	4.4	4.5	4.4	4.4	4.4
Services		2.9	3.5	2.8	3.5	3.4	3.2	3.2	3.0	3.0	3.0
Business fixed investment		12.8	9.1	-1.3	8.8	9.4	9.0	8.5	8.4	8.4	8.1
Equipment & Software		17.3	11.3	-2.9	10.2	10.7	9.9	9.7	9.8	10.0	9.8
Nonres. structures		-1.3	2.1	4.4	4.2	5.3	6.0	4.3	3.7	3.1	2.6
Residential structures		1.5	1.0	2.6	2.6	2.5	2.2	2.0	1.4	1.2	1.0
Exports		6.3	10.2	6.5	8.5	8.6	9.8	6.5	7.7	7.4	8.6
Imports		6.0	7.6	4.4	3.1	6.7	9.6	9.3	5.4	7.6	10.0
Gov't. cons. & investment		0.7	1.6	3.7	2.1	2.3	2.3	2.4	2.5	2.4	2.6
Federal		4.7	1.4	6.2	1.7	1.7	1.4	1.8	1.9	1.9	2.2
Defense		9.9	0.5	8.3	1.9	2.1	1.9	2.0	2.3	2.3	2.8
State & local		-1.5	1.8	2.2	2.4	2.6	2.8	2.8	2.8	2.8	2.8
Change in bus. inventories	Bill. Ch. $	33.3	40.1	44.8	25.5	22.3	29.9	39.0	28.4	27.3	33.9
Nonfarm		29.1	37.1	41.8	22.5	20.3	27.8	36.8	26.3	25.2	31.8
Net exports		-588.1	-592.3	-593.1	-582.5	-586.7	-599.7	-621.4	-622.8	-634.6	-654.1
Nominal GDP	% change	5.1	5.6	5.1	5.4	5.7	5.7	5.8	5.3	5.2	5.2
GDP Gap[1]	%	1.4	1.3	1.2	1.0	0.8	0.6	0.4	0.3	0.2	0.1
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	131.5	132.1	132.7	133.4	134.1	134.8	135.4	136.1	136.7	137.3
Unemployment rate	%	5.5	5.4	5.4	5.3	5.3	5.3	5.2	5.2	5.1	5.1
Industrial prod. index	% change	3.2	4.3	4.6	4.7	5.0	5.0	4.6	4.3	4.1	4.2
Capacity util. rate - mfg.	%	76.6	76.9	77.4	77.9	78.5	79.2	79.7	80.2	80.5	81.0
Housing starts	Millions	1.97	1.98	1.95	1.95	1.95	1.95	1.95	1.94	1.94	1.94
Light motor vehicle sales		17.07	16.75	17.10	17.24	17.38	17.51	17.65	17.79	17.93	18.08
North Amer. produced		13.81	13.18	13.60	13.73	13.86	13.97	14.11	14.23	14.33	14.46
Other		3.27	3.57	3.50	3.51	3.52	3.54	3.54	3.56	3.60	3.62
INCOME AND SAVING											
Nominal GNP	Bill. $	11847.0	11984.0	12138.4	12285.5	12451.6	12616.1	12779.7	12938.7	13094.0	13245.0
Nominal GNP	% change	5.4	4.7	5.3	4.9	5.5	5.4	5.3	5.1	4.9	4.7
Nominal personal income		3.4	10.1	2.2	6.2	6.4	6.3	7.6	6.2	5.9	5.9
Real disposable income		2.0	7.7	-0.4	4.6	4.6	4.7	6.0	4.6	4.3	4.3
Personal saving rate	%	0.5	1.5	0.5	0.7	0.8	1.1	1.5	1.7	1.9	2.0
Corp. profits, IVA & CCAdj.	% change	-10.5	30.8	3.7	-0.2	2.9	-0.4	-1.5	-1.6	-3.4	-5.4
Profit share of GNP	%	9.6	10.2	10.2	10.0	10.0	9.8	9.7	9.5	9.3	9.1
Excluding FR Banks		9.5	10.0	10.0	9.9	9.8	9.7	9.5	9.4	9.2	8.9
Federal surpl./deficit	Bill. $	-376.1	-332.6	-276.0	-251.6	-230.4	-232.5	-294.5	-298.9	-303.0	-306.6
State & local surpl./def.		8.8	6.4	9.3	8.7	10.0	11.0	14.5	13.4	13.6	14.9
Ex. social ins. funds		7.3	4.8	7.7	7.1	8.4	9.4	12.9	11.8	12.0	13.3
Gross natl. saving rate	%	13.8	13.3	13.5	13.6	13.8	13.8	13.7	13.8	13.8	13.7
Net natl. saving rate		1.4	1.9	2.0	2.2	2.4	2.4	2.3	2.4	2.4	2.3
PRICES AND COSTS											
GDP chn.-wt. price index	% change	1.3	1.9	1.6	1.3	1.5	1.6	1.9	1.5	1.5	1.5
Gross Domestic Purchases chn.-wt. price index		1.8	2.4	1.3	1.3	1.4	1.4	1.6	1.3	1.3	1.3
PCE chn.-wt. price index		1.1	2.4	0.7	1.3	1.4	1.4	1.3	1.3	1.4	1.4
Ex. food and energy		0.7	1.5	1.6	1.6	1.5	1.5	1.4	1.4	1.4	1.4
CPI		1.9	3.6	0.6	1.4	1.7	1.7	1.7	1.6	1.7	1.7
Ex. food and energy		1.6	2.4	2.1	2.0	2.0	1.9	1.9	1.8	1.8	1.8
ECI, hourly compensation[2]		3.5	4.1	4.2	4.2	4.2	4.1	4.1	4.1	4.1	4.1
Nonfarm business sector											
Output per hour		1.4	2.3	0.8	1.9	2.1	2.1	2.1	2.1	2.2	2.2
Compensation per hour		3.6	3.6	3.8	4.2	4.3	4.3	4.2	4.2	4.2	4.2
Unit labor cost		2.2	1.3	3.0	2.3	2.2	2.1	2.1	2.0	2.0	2.0

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

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CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

Item	2002 Q3	2002 Q4	2003 Q1	2003 Q2	2003 Q3	2003 Q4	2004 Q1	2004 Q2	2004 Q3 (Projected)	02Q4/ 01Q4	03Q4/ 02Q4	04Q4/ 03Q4 (Projected)
Real GDP	2.6	0.7	1.9	4.1	7.4	4.2	4.5	3.3	3.7	2.3	4.4	3.8
Gross dom. purchases	3.0	2.4	1.8	4.6	6.8	4.9	5.3	4.4	4.0	3.2	4.5	4.4
Final sales	2.0	0.7	2.4	5.1	6.8	3.7	3.3	2.5	4.7	1.2	4.5	3.5
Priv. dom. final purchases	2.1	1.6	2.2	4.3	6.2	4.1	3.6	3.2	4.9	1.4	4.2	3.8
Personal cons. expenditures	2.0	1.7	1.8	2.7	3.6	2.5	2.9	1.1	3.5	1.8	2.7	2.5
Durables	1.2	-0.2	-0.0	1.6	1.4	0.3	0.2	-0.0	1.4	0.1	0.8	0.4
Nondurables	-0.1	1.0	1.0	0.3	1.4	1.0	1.3	0.0	1.0	0.5	0.9	0.8
Services	1.0	0.9	0.9	0.8	0.8	1.2	1.4	1.1	1.2	1.2	0.9	1.3
Business fixed investment	-0.1	-0.3	-0.0	1.1	1.5	1.1	0.4	1.2	1.3	-0.6	0.9	1.0
Equipment & Software	0.3	-0.2	0.3	0.8	1.5	0.9	0.6	1.1	1.3	-0.2	0.9	1.0
Nonres. structures	-0.5	-0.2	-0.3	0.3	-0.0	0.2	-0.2	0.2	-0.0	-0.5	0.0	-0.0
Residential structures	0.1	0.2	0.4	0.4	1.1	0.5	0.3	0.9	0.1	0.3	0.6	0.3
Net exports	-0.4	-1.7	0.1	-0.5	0.6	-0.7	-0.8	-1.1	-0.3	-0.9	-0.1	-0.6
Exports	0.3	-0.4	-0.2	-0.2	1.0	1.6	0.7	0.7	0.6	0.3	0.6	0.8
Imports	-0.7	-1.3	0.3	-0.3	-0.4	-2.2	-1.5	-1.8	-0.9	-1.3	-0.7	-1.3
Government cons. & invest.	0.4	0.8	0.1	1.4	0.0	0.3	0.5	0.4	0.1	0.7	0.4	0.3
Federal	0.2	0.6	0.0	1.4	-0.2	0.3	0.5	0.2	0.3	0.5	0.4	0.3
Defense	0.1	0.5	-0.1	1.5	-0.4	0.5	0.5	0.1	0.4	0.3	0.4	0.3
Nondefense	0.1	0.0	0.2	-0.1	0.1	-0.2	0.0	0.1	-0.1	0.2	-0.0	0.0
State and local	0.2	0.2	0.0	-0.1	0.3	-0.0	0.0	0.2	-0.2	0.2	0.1	0.1
Change in bus. inventories	0.6	0.1	-0.5	-1.0	0.6	0.5	1.2	0.8	-1.0	1.1	-0.1	0.3
Nonfarm	0.4	0.1	-0.5	-0.9	0.5	0.3	1.1	0.9	-1.1	1.0	-0.2	0.3
Farm	0.2	0.0	0.1	-0.1	0.1	0.2	0.1	-0.1	0.1	0.0	0.1	-0.0

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

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

	Projected									Projected		
Item	2004 Q4	2005 Q1	2005 Q2	2005 Q3	2005 Q4	2006 Q1	2006 Q2	2006 Q3	2006 Q4	04Q4/ 03Q4	05Q4/ 04Q4	06Q4/ 05Q4
Real GDP	3.7	3.4	4.0	4.1	4.0	3.8	3.7	3.7	3.7	3.8	3.9	3.7
Gross dom. purchases	4.0	3.5	3.7	4.3	4.5	4.5	3.7	4.0	4.3	4.4	4.0	4.1
Final sales	3.5	3.3	4.7	4.2	3.8	3.5	4.0	3.7	3.4	3.5	4.0	3.7
Priv. dom. final purchases	3.3	2.6	3.9	4.0	3.8	3.8	3.6	3.6	3.6	3.8	3.6	3.7
Personal cons. expenditures	2.3	2.6	2.9	2.9	2.7	2.8	2.7	2.7	2.7	2.5	2.8	2.7
Durables	-0.0	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.5	0.5
Nondurables	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.8	0.9	0.9
Services	1.4	1.2	1.5	1.4	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Business fixed investment	0.9	-0.1	0.9	1.0	0.9	0.9	0.9	0.9	0.8	1.0	0.7	0.9
Equipment & Software	0.9	-0.2	0.8	0.8	0.8	0.8	0.8	0.8	0.8	1.0	0.5	0.8
Nonres. structures	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	-0.0	0.1	0.1
Residential structures	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.1	0.1
Net exports	-0.2	-0.0	0.4	-0.1	-0.4	-0.7	-0.0	-0.4	-0.6	-0.6	-0.1	-0.5
Exports	1.0	0.7	0.9	0.9	1.0	0.7	0.8	0.8	0.9	0.8	0.9	0.8
Imports	-1.1	-0.7	-0.5	-1.0	-1.4	-1.4	-0.8	-1.2	-1.5	-1.3	-0.9	-1.2
Government cons. & invest.	0.3	0.7	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.3	0.5	0.5
Federal	0.1	0.4	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.2	0.1
Defense	0.0	0.4	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.2	0.1
Nondefense	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
State and local	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.1	0.3	0.3
Change in bus. inventories	0.3	0.2	-0.7	-0.1	0.3	0.3	-0.4	-0.0	0.2	0.3	-0.1	0.0
Nonfarm	0.3	0.2	-0.7	-0.1	0.3	0.3	-0.4	-0.0	0.2	0.3	-0.1	0.0
Farm	-0.0	0.0	0.0	-0.0	0.0	0.0	0.0	0.0	0.0	-0.0	-0.0	0.0

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

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

Item	Fiscal year				2004				2005				2006			
	2003[a]	2004[a]	2005	2006	Q1[a]	Q2[a]	Q3[a]	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
					Not seasonally adjusted											
Unified budget																
Receipts[1]	1782	1880	2042	2215	410	550	479	454	444	632	513	518	479	674	543	531
Outlays[1]	2159	2292	2430	2572	580	576	565	602	617	604	607	629	664	645	635	667
Surplus/deficit[1]	-377	-413	-388	-358	-171	-26	-86	-149	-173	27	-94	-110	-185	30	-92	-135
On-budget	-538	-568	-558	-545	-193	-99	-96	-192	-208	-50	-108	-155	-226	-56	-109	-184
Off-budget	161	155	170	187	23	73	10	43	35	78	14	44	40	86	16	48
Means of financing																
Borrowing	374	379	384	365	136	41	83	132	134	11	107	95	170	-1	101	126
Cash decrease	26	-1	1	0	12	-23	8	11	15	-29	5	10	15	-25	0	10
Other[2]	-22	35	3	-7	23	8	-6	6	23	-9	-17	5	0	-4	-8	-0
Cash operating balance, end of period	35	36	35	35	21	45	36	26	11	40	35	25	10	35	35	25
NIPA federal sector					Seasonally adjusted annual rates											
Receipts	1863	1932	2161	2313	1915	1949	1964	2034	2161	2200	2249	2275	2309	2323	2344	2367
Expenditures	2209	2314	2434	2595	2306	2329	2340	2367	2437	2452	2479	2507	2604	2622	2647	2673
Consumption expenditures	646	694	738	771	691	700	713	717	739	744	749	754	771	777	782	789
Defense	425	469	504	530	465	474	487	489	505	509	513	518	529	534	539	544
Nondefense	221	225	233	241	226	227	226	229	234	235	236	236	242	243	244	244
Other spending	1563	1620	1696	1824	1615	1629	1627	1649	1698	1708	1730	1753	1833	1846	1864	1885
Current account surplus	-345	-382	-273	-282	-391	-380	-376	-333	-276	-252	-230	-232	-294	-299	-303	-307
Gross investment	92	102	110	114	102	104	104	107	110	111	112	113	114	115	116	117
Gross saving less gross investment[3]	-347	-391	-286	-296	-402	-391	-387	-345	-290	-266	-245	-247	-309	-313	-317	-321
Fiscal indicators[4]																
High-employment (HEB) surplus/deficit	-271	-341	-250	-285	-354	-346	-342	-303	-250	-232	-218	-227	-295	-304	-313	-321
Change in HEB, percent of potential GDP	1.2	0.5	-0.9	0.2	0.2	-0.1	-0.1	-0.4	-0.5	-0.2	-0.1	0.1	0.5	0.0	0.0	0.0
Fiscal impetus (FI) percent of GDP	1.0	0.9	0.0	0.2	0.2	0.1	0.1	0.1	-0.2	0.0	0.0	0.0	0.1	0.1	0.1	0.0

1. OMB's July 2004 baseline surplus estimates are -$444 billion in FY 2004, -$292 billion in FY 2005, and -$234 billion in FY 2006, and surplus estimates under enactment of its proposed policies are -$445 billion, -$331 billion, and -$261 billion respectively. CBO's September 2004 baseline surplus estimates are -$422 billion in FY 2004, -$348 billion in FY 2005 and -$298 billion in FY 2006. Budget receipts, outlays, and surplus/deficit include corresponding social security (OASDI) categories. The OASDI surplus and the Postal Service surplus are excluded from the on-budget surplus and shown separately as off-budget, as classified under current law.

2. Other means of financing are checks issued less checks paid, accrued items, and changes in other financial assets and liabilities.

3. Gross saving is the current account surplus plus consumption of fixed capital of the general government as well as government enterprises.

4. HEB is gross saving less gross investment (NIPA) of the federal government in current dollars, with cyclically sensitive receipts and outlays adjusted to the staff's measure of potential output and the NAIRU. Quarterly figures for change in HEB and FI are not at annual rates. The sign on Change in HEB, as a percent of nominal potential GDP, is reversed. FI is the weighted difference of discretionary changes in federal spending and taxes in chained (2000) dollars, scaled by real GDP. The annual FI estimates are on a calendar year basis. Also, for FI and the change in HEB, positive values indicate aggregate demand stimulus.

a--Actual

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Change in Debt of the Domestic Nonfinancial Sectors
(Percent)

December 8, 2004

Period [1]	Total	Federal government	Nonfederal						Memo: Nominal GDP
				Households					
			Total	Total	Home mortgages	Consumer credit	Business	State and local governments	
Year									
1999	6.4	-1.9	8.9	8.3	9.2	7.8	10.6	3.4	6.3
2000	4.8	-8.0	8.3	8.7	8.3	10.7	9.4	1.3	4.6
2001	6.2	-0.2	7.6	8.9	9.7	8.0	6.1	8.9	2.7
2002	6.8	7.6	6.7	9.6	11.9	4.4	2.6	11.1	3.8
2003	8.1	10.9	7.5	10.0	12.4	4.5	4.3	8.2	6.2
2004	8.1	9.7	7.7	9.8	11.5	5.1	5.0	8.2	6.2
2005	7.1	7.9	6.9	7.9	8.7	5.8	6.2	4.6	5.5
2006	6.7	8.3	6.3	6.7	7.3	5.4	6.2	4.0	5.4
Quarter									
2004:1	9.1	12.0	8.5	11.4	13.2	6.2	4.6	9.5	7.4
2	7.0	10.7	6.2	8.5	9.8	2.3	3.6	4.0	6.6
3	7.4	4.9	8.0	9.1	11.3	5.9	5.1	14.2	5.1
4	7.9	10.0	7.4	8.8	9.9	5.8	6.3	4.4	5.6
2005:1	7.8	10.8	7.1	8.6	9.6	5.9	5.8	4.7	5.1
2	6.9	7.2	6.9	7.7	8.6	5.6	6.2	4.6	5.4
3	6.6	6.5	6.6	7.3	8.0	5.7	6.1	4.6	5.7
4	6.3	6.1	6.4	7.0	7.7	5.6	6.0	4.3	5.7
2006:1	7.5	13.0	6.3	6.8	7.4	5.6	6.1	4.0	5.8
2	6.1	5.7	6.2	6.6	7.1	5.4	6.0	4.0	5.3
3	6.0	5.5	6.1	6.5	7.0	5.2	6.0	3.9	5.2
4	6.4	8.0	6.0	6.3	6.8	5.1	6.1	3.7	5.2

Note. Quarterly data are at seasonally adjusted annual rates.
1. Data after 2004:Q3 are staff projections. Changes are measured from end of the preceding period to end of period indicated except for annual nominal GDP growth, which is calculated from Q4 to Q4.

2.6.3 FOF

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

Category	2003	2004	2005	2006	2004		2005				2006			
					Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Net funds raised by domestic nonfinancial sectors														
1 Total	1602.1	1599.3	1524.8	1639.5	1501.1	1521.7	1648.7	1508.4	1476.3	1466.1	1855.3	1524.7	1521.9	1656.4
2 Net equity issuance	-57.8	-197.2	-183.0	-75.0	-208.8	-338.0	-228.0	-190.0	-169.0	-145.0	-87.0	-71.0	-71.0	-71.0
3 Net debt issuance	1659.9	1796.6	1707.8	1714.5	1709.9	1859.7	1876.7	1698.4	1645.3	1611.1	1942.3	1595.7	1592.9	1727.4
Borrowing sectors														
Nonfinancial business														
4 Financing gap [1]	-21.1	23.9	-21.0	154.5	-52.5	156.4	-39.7	-35.5	-15.9	7.2	140.3	136.8	155.6	185.3
5 Net equity issuance	-57.8	-197.2	-183.0	-75.0	-208.8	-338.0	-228.0	-190.0	-169.0	-145.0	-87.0	-71.0	-71.0	-71.0
6 Credit market borrowing	305.6	370.3	480.2	511.0	386.5	482.8	449.1	489.6	490.0	491.9	500.9	506.0	513.6	523.6
Households														
7 Net borrowing [2]	840.6	905.9	802.2	738.8	887.9	872.2	871.0	804.0	774.7	759.0	750.9	740.2	732.9	730.9
8 Home mortgages	734.9	767.9	649.5	588.7	796.9	719.6	714.9	654.2	621.5	607.4	598.1	588.7	584.1	584.1
9 Consumer credit	88.4	105.3	125.9	123.9	123.4	123.5	128.1	122.9	127.0	125.6	126.9	125.4	122.7	120.5
10 Debt/DPI (percent) [3]	108.0	112.6	116.8	117.8	113.9	113.8	116.1	116.8	117.2	117.6	117.5	117.7	118.0	118.2
State and local governments														
11 Net borrowing	117.8	128.6	77.8	69.8	228.5	73.7	78.8	78.8	78.8	74.8	70.8	70.8	70.8	66.8
12 Current surplus [4]	176.2	182.0	171.6	181.5	171.0	164.9	169.1	169.7	172.5	174.9	179.8	180.1	181.7	184.4
Federal government														
13 Net borrowing	396.0	391.7	347.7	395.0	207.0	431.1	477.8	325.9	301.8	285.5	619.6	278.7	275.5	406.1
14 Net borrowing (n.s.a.)	396.0	391.7	347.7	395.0	83.4	131.8	134.3	10.9	107.1	95.4	169.8	-0.9	100.5	125.6
15 Unified deficit (n.s.a.)	399.1	430.7	349.7	383.0	85.7	148.6	172.7	-27.4	94.1	110.3	185.2	-29.8	92.1	135.5
Depository institutions														
16 Funds supplied	476.4	711.5	565.7	588.3	424.2	553.0	637.6	507.5	596.1	521.5	670.7	536.9	624.9	520.7
Memo (percentage of GDP)														
17 Domestic nonfinancial debt [5]	194.5	197.6	201.6	204.1	198.1	199.2	200.6	201.6	202.2	202.7	203.3	204.1	204.6	205.1
18 Domestic nonfinancial borrowing	15.1	15.3	13.8	13.1	14.5	15.5	15.5	13.8	13.2	12.8	15.2	12.3	12.1	13.0
19 Federal government [6]	3.6	3.3	2.8	3.0	1.8	3.6	3.9	2.7	2.4	2.3	4.8	2.1	2.1	3.1
20 Nonfederal	11.5	12.0	11.0	10.1	12.7	11.9	11.5	11.2	10.8	10.5	10.3	10.2	10.0	9.9

Note. Data after 2004:Q3 are staff projections.
1. For corporations: Excess of capital expenditures over U.S. internal funds.
2. Includes change in liabilities not shown in lines 8 and 9.
3. Average debt levels in the period (computed as the average of period-end debt positions) divided by disposable personal income.
4. NIPA state and local government saving plus consumption of fixed capital and net capital transfers.
5. Average debt levels in the period (computed as the average of period-end debt positions) divided by nominal GDP.
6. Excludes government-insured mortgage pool securities.
n.s.a. Not seasonally adjusted.

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International Developments

The dollar has depreciated further on balance since the November FOMC meeting. The dollar declined during most of the period, even when the news for the U.S. outlook was generally more positive than that from abroad, as well as following the weaker-than-expected November employment report. Market commentary suggested that these declines were related to an increased focus on the burgeoning U.S. current account deficit. However, late in the period, the dollar rallied, reversing much of the prior drop. We have maintained our assumption that the broad real value of the dollar will depreciate about 3 percent between the fourth quarter of 2004 and the fourth quarter of 2006.

Since the November FOMC meeting, the spot price of West Texas intermediate (WTI) oil has dropped about $7.50 per barrel, closing around $41.50 on December 7. Futures prices have also dropped significantly. The average price of imported oil is estimated to have declined as well, although by a smaller amount as the unusually wide October spread between the WTI price and that of other, more sulphurous, types of crude has narrowed. Our current forecast for the price of imported oil for the next two years has been revised down $2 to $3 per barrel compared with the November path.

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

Indicator	2004		Projection				
			2004:	2005			2006
	H1	Q3	Q4	Q1	Q2	H2	
Foreign output	4.1	2.7	3.1	3.0	3.2	3.2	3.2
November GB	*4.2*	*3.2*	*3.4*	*3.2*	*3.3*	*3.3*	*3.2*
Foreign CPI	2.8	2.8	2.6	2.0	2.2	2.2	2.2
November GB	*2.8*	*2.9*	*3.1*	*2.5*	*2.3*	*2.2*	*2.2*

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

Export-weighted foreign real GDP growth is estimated to have dipped to an annual rate of about 2¾ percent in the third quarter, somewhat below our expectations. The deceleration in activity was widespread across regions. Softness in exports was a factor in a number of industrial countries where exchange rates have appreciated. Among emerging markets, output in Mexico decelerated sharply relative to the first half of the year along with slower growth in U.S. manufacturing industrial production; high oil prices restrained activity in a number of emerging Asian economies. Foreign GDP growth is projected to rise to an annual rate of about 3 percent in the current quarter and to average about 3¼ percent over the next two years, as oil prices edge down and exchange rate changes are less pronounced. This projection is a bit lower than that in the previous Greenbook, primarily for the industrial countries whose currencies have borne the brunt of recent dollar depreciation.

Average foreign inflation is expected to edge down in the current quarter to around 2½ percent at an annual rate. An increase in inflation in the industrial countries, driven largely by higher prices of oil and other commodities, is offset by moderation in prices in the emerging Asian economies, notably China, where food prices have begun to reverse the sharp increases that occurred earlier this year. We continue to expect foreign inflation to ease next year in part in response to lower oil prices.

Largely as a result of the lower value of the dollar, our projection for net exports has been revised up a bit, with some adjustment in both exports and imports. The projected arithmetic contribution of net exports is about neutral next year and is a negative ½ percentage point in 2006. The current account deficit is expected to increase from 5.7 percent of GDP in 2004 to 6.2 percent in 2006, about ¼ percentage point less than in the November Greenbook. The trade deficit is expected to be little changed over the forecast period at around 5¼ percent of GDP, whereas the balance on investment income deteriorates as net U.S. portfolio payments rise in response to increasing interest rates.

Oil Prices

After averaging more than $53 per barrel in October, the spot price of WTI crude oil has fallen sharply. The fall in oil prices has been attributed mainly to increasing oil inventories and a revival of production in the Gulf of Mexico. The WTI price has recently fallen more than prices for more sour (higher sulphur content) grades of oil, which had increased less in October. The price spread between WTI and Dubai, a benchmark sour crude, currently stands around $8 per barrel. This spread is down about $10 per barrel from its October peak, although it is still significantly higher than its average of a bit more than $3 per barrel over the past fifteen years. Futures prices for WTI also have fallen significantly, and our oil price projection has been reduced in response. The current projection calls for the spot price of WTI to edge down to $40 per barrel by the fourth quarter of 2006. Relative to the November Greenbook, our projection for the spot price is about $5 per barrel lower on average in 2005 and $3 per barrel lower in 2006. Our projection of the average price of imported oil has also been reduced, but by a smaller amount, because we have factored in the narrower spread between WTI and other types of oil and are projecting that the spread will narrow further over the forecast period. Oil import prices have been revised down an average of $3 per barrel in 2005 and $2 per barrel in 2006.

International Financial Markets

The traded-weighted exchange value of the dollar, as measured by the staff's major currencies index, has declined 1¼ percent on net since the November FOMC meeting. This index reached a nine-year low during the intermeeting period before reversing much of its decline very late in the period. The depreciation occurred despite economic news that on average raised near-term market expectations for U.S. growth and lowered expectations for European and Japanese growth. Market participants attributed the dollar's decline to concern over the financing of the U.S. current account deficit. News reports also suggested that some foreign central banks have been considering reducing the share of their foreign exchange reserves held in dollar assets. On balance, the dollar depreciated about 4 percent against sterling and 2½ percent against both the yen and the euro. The dollar appreciated 2¼ percent against the Canadian dollar.

The dollar declined 1½ percent on a trade-weighted basis against the currencies of our other important trading partners, led by a 4¾ percent depreciation against the Korean won. The dollar moved down 1¼ percent against the Mexican peso.

The starting point of our projected path for the broad real dollar is down about 3 percent from that in the November Greenbook, and we have maintained our projection of a 1½ percent annual rate of real depreciation over the forecast period. We believe that further depreciation will be required at some point to achieve a sustainable path for the U.S. net international investment position, although considerable uncertainty surrounds the speed and timing of such a move, as other factors also affect the exchange rate. Indeed, the higher projection for U.S. versus foreign growth embodied in our current forecast raises the risk of a halt or a temporary reversal of the dollar's slide. In our view, this risk is countered to some extent by the growing market focus on the U.S. current account deficit and the fact that our projection of the deficit is larger than that of most private forecasters.

Short-term interest rates were unchanged or down slightly in most foreign industrial countries over the intermeeting period. Benchmark government bond yields were down 5 basis points in Japan and 15 to 30 basis points in the other major foreign industrial countries. Share price indexes in most major industrial economies were little changed, as lower oil prices offset the effects of disappointing economic news and currency appreciations.

Among emerging market economies, the central banks of Brazil and Mexico again tightened monetary policy in reaction to concerns about inflationary pressures. In contrast, the Bank of Korea lowered its main policy interest rate 25 basis points in response to sluggish economic growth. Korea also reported an increase of $14 billion in foreign exchange reserves during November as the authorities intervened to blunt the appreciation of the won. Emerging market equity prices rose broadly, led by Indonesia and Brazil. Two major exceptions were Argentina and Russia, where equity prices fell 7 percent and 8 percent, respectively.

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

Foreign Industrial Countries

Third-quarter GDP growth slowed to 2 percent in the foreign industrial countries, with the slowdown widespread among these economies. We expect the average pace of expansion to edge up to around 2½ percent by the middle of next year, as growth in the euro area picks up to near its potential rate and the Japanese economy recovers from its recent slump. Growth should continue near that pace over the remainder of the forecast period. We expect that twelve-month headline inflation rates in the foreign industrial countries will tick up in the current quarter and will moderate over the rest of the forecast period, in part reflecting the path of oil prices.

In Japan, the newly released chain-weighted GDP series showed a slight increase in the third quarter. Exports moved up in October, but industrial production and household expenditures both declined, suggesting a weak start to the fourth quarter. We expect growth to pick up a little next year as exports strengthen further and a gradual improvement in Japan's labor market helps sustain growth in consumption. Headline rates of inflation have been boosted into positive territory recently by spikes in food prices following a series of typhoons and an earthquake, but are projected to fall again early next year as the effect of these factors disappears. We expect twelve-month CPI inflation to turn positive on a sustained basis in early 2006 and have penciled in a slight rise in policy rates around that time, when we assume the BOJ will begin exiting from quantitative easing.

Euro-area growth slowed in the third quarter, especially in Germany and France, with weaker consumption and a sharp deceleration in exports. We expect euro-area growth to recover a bit in the current quarter, consistent with an improvement in French consumption data in October. Going forward, private consumption and investment are projected to revive gradually, and growth in real GDP should firm to just below 1¾ percent in 2005 and 2006. Twelve-month inflation, boosted by higher oil and administered prices, is expected to remain at or above 2 percent for most of 2005 and to move down to 1¾ percent in 2006.

On balance, manufacturing and service sector surveys, as well as consumer confidence, hint at a step-up in British GDP growth in the fourth quarter to around 2¼ percent after some slowing in the third quarter. Growth is projected to remain near that rate through 2006. We assume that the Bank of England will tighten monetary policy another 25 basis points early next year and then keep policy on hold through the end of 2006. This tightening should be sufficient to prevent inflation from moving above the target rate of 2 percent.

Canadian GDP growth moderated to about 3¼ percent in the third quarter as a small decline in exports followed an outsized gain in the second quarter. We expect growth to remain close to its estimated potential rate (just over 3 percent) over the rest of the forecast period. We assume a further 100 basis points of monetary policy tightening over the forecast period, sufficient to keep core inflation around the 2 percent midpoint of the Bank's inflation target range.

Other Economies

Real GDP growth in the emerging market economies slipped to about 3½ percent in the third quarter, down from an average annual pace of just less than 6 percent in the first half of the year. We expect growth to pick back up in the fourth quarter and to average 4¼ percent over the forecast period

Real GDP growth in emerging Asia averaged around 4½ percent in the third quarter, down from about 6½ percent in the first half of the year. The slowing occurred outside of China, where growth picked up again following a weak second quarter. Although circumstances differed across countries, both higher oil prices and some slowing of high-tech demand played a role. Going forward, we are projecting growth to improve to about 5 percent in the fourth quarter and then to moderate to 4½ percent in 2005 and 2006.

This forecast is little changed from the November Greenbook, as the benefits of lower projected oil prices offset the negative effect on exports of stronger exchange rates for some countries, especially Korea, and somewhat slower expected growth in global high-tech demand. For China, the recent deceleration in investment and lending has caused us to edge down our forecast for output growth in the fourth quarter to 7½ percent. We continue to forecast a soft landing for China, with output growing 7 percent in 2005 and 7½ percent in 2006.

We estimate that real GDP in Latin America grew 2¾ percent in the third quarter, somewhat below our prediction in the November Greenbook. The difference is primarily a result of weaker-than-expected activity in Mexico, reflecting sluggish export demand. We expect growth in Mexico to increase to 4 percent in the fourth quarter as fiscal spending responds to higher oil revenues, and then to maintain about that pace over the next two years as it tracks the forecast for U.S. manufacturing industrial production. This path is slightly weaker than the one in the previous Greenbook, partly as a result of tighter expected monetary policy in Mexico. For the region as a whole, we expect output to rise 4 percent over the forecast period, about the same as in the previous Greenbook.

Recent data suggesting a moderation in food prices in a number of countries plus the lower projected path for oil prices have led us to lower our forecast for developing country inflation slightly. We expect twelve-month inflation to decline from around 4½ percent in the third quarter to 3 percent by the end of 2006, reflecting lower oil prices and monetary policy restraint in some countries, notably Mexico and Brazil.

Prices of Internationally Traded Goods

Core import price inflation is projected to pick up to an annual rate of 3½ percent in the fourth quarter from 2 percent in the third quarter as a result of upward pressure from the recent depreciation of the dollar. Nevertheless, this projection is down 1½ percentage points from the November Greenbook forecast because of lower-than-expected prices in October. The monthly BLS data for October showed sharp declines both in industrial supplies and in foods, feeds, and beverages, the two categories that were the main contributors to the import price inflation seen earlier this year.

The recent depreciation of the dollar is expected to keep import price inflation around 2¾ percent at an annual rate in the first quarter of 2005. However, import price inflation is projected to decline to less than 1 percent over the rest of the year, in line with the slow rate of projected dollar depreciation and a deceleration of commodity prices. In addition, the expiration of the multifiber arrangement (MFA) at the end of this year is expected to lead to a substantial fall in imported apparel prices over time, with China likely to increase its market share. The assumed decline in apparel prices will reduce core import price inflation more than ½ percentage point in both 2005 and 2006.

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

Indicator	2004		Projection				
			2004:	2005			2006
	H1	Q3	Q4	Q1	Q2	H2	
Exports							
Core goods	6.9	1.8	4.7	0.7	1.8	1.8	2.2
Imports							
Non-oil core goods	5.2	2.1	3.6	2.8	0.9	0.6	0.1
Oil (dollars per barrel)	34.55	37.55	40.51	37.68	37.90	37.29	36.57

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

Largely as a result of falling prices for agricultural goods, the increase in the price of exported core goods dropped to an annual rate of just 1¾ percent in the third quarter, following an increase of almost 7 percent in the first half of 2004. In the fourth quarter, higher prices for intermediate goods and a rebound in prices for agricultural goods should push core export price inflation back up to nearly 5 percent, about 2 percentage points higher than in the November Greenbook. In 2005 and 2006, core export price inflation is projected to move in line with U.S. price inflation.

Trade in Goods and Services

Nominal imports of goods and services dropped in September, as the value of imports of both oil and services retreated from August's elevated levels. Real imports of goods and services increased 6 percent in the third quarter, almost 2 percentage points less than projected in the November Greenbook, with the weakness primarily in core goods. In the fourth quarter, growth of real imports should pick up to around 7½ percent, as a jump in imports of oil and a more modest rise in imports of core goods overshadow a projected decline in imports of services. This projection is slightly higher than the one in the

November Greenbook, as an upward revision to projected U.S. GDP growth more than offsets the negative effect of the lower dollar.

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

Indicator	2004		Projection				
	H1	Q3	2004: Q4	2005 Q1	2005 Q2	2005 H2	2006
Real exports	7.3	6.3	10.2	6.5	8.5	9.2	7.6
November GB	*7.3*	*4.5*	*10.4*	*5.6*	*7.8*	*8.5*	*7.0*
Real imports	11.6	6.0	7.6	4.4	3.1	8.1	8.1
November GB	*11.6*	*7.9*	*7.4*	*3.6*	*3.6*	*8.1*	*8.3*

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

Real import growth is expected to weaken in the first half of 2005, as capital goods imports dip in response to the expiration of partial-expensing provisions. The lagged response to the dollar's depreciation also continues to restrain imports of core goods and services. Import growth should pick up again by the second half of the year as the effect of the dollar depreciation lessens. The projection for real imports in both 2005 and 2006 is little changed from the November Greenbook.

Nominal exports of goods and services expanded briskly in September following upwardly revised growth in August. A small decline in services exports was more than offset by unexpectedly robust growth of goods exports. Real exports of goods and services climbed 6¼ percent in the third quarter, considerably faster than the 4½ percent pace projected in the November Greenbook. Growth is expected to increase to 10¼ percent in the fourth quarter, as services exports rebound.

We expect real export growth to move up from 7¾ percent in 2004 to 8¼ percent in 2005 as growth in exports of both services and high-tech goods is projected to recover following some weakness earlier this year. Growth of exports of core goods is expected to average 7½ percent next year and then to drop back to 6¾ percent in 2006 as the effect of dollar depreciation wanes while foreign GDP growth is little changed. Real export growth in 2005 and 2006 is roughly ½ percentage point higher than in the November Greenbook as a result of our assumption of a weaker exchange rate.

Alternative Simulation

The broad real dollar has depreciated about 16 percent on average from its peak in early 2002, but the decline has been much more pronounced against the currencies of the foreign G-7 countries, especially the euro. In our alternative simulation, we used the FRB/Global model to consider the effects of a further slide of the dollar that is again heavily concentrated against the euro. This risk premium shock occurs in 2005:Q1 and is scaled so that the dollar would depreciate 20 percent against the euro and around 7 percent against all other major currencies in the absence of endogenous adjustment in long-term interest rates. The shock induces an initial decline in the broad real dollar of roughly 10 percent. The depreciation causes substitution away from foreign, and especially euro-area, products into U.S. goods and services, stimulating U.S. net exports. Accordingly, U.S. GDP growth rises ½ percentage point above baseline in 2005 and a bit more in 2006. Higher import prices push core PCE inflation about ¼ percentage point above baseline in 2005, and cost pressures arising from increased resource utilization keep inflation somewhat elevated in 2006. Although U.S. export-weighted foreign GDP growth (not shown) declines only about ¼ percentage point below baseline in 2005, the shock has a sizable contractionary effect on the euro area, reducing GDP growth more than 1½ percentage points relative to baseline in both 2005 and 2006.

Alternative Simulation:
The Effect of Dollar Depreciation Concentrated Against the Euro
(Percent change from previous period, annual rate)

Indicator and simulation	2004		2005		2006	
	H1	H2	H1	H2	H1	H2
U.S. real GDP						
Baseline	3.9	3.7	3.7	4.1	3.7	3.7
Dollar Depreciation	3.9	3.7	4.2	4.9	4.6	4.3
U.S. PCE prices excluding food and energy						
Baseline	1.9	1.1	1.6	1.5	1.4	1.4
Dollar Depreciation	1.9	1.1	1.9	1.7	1.7	1.7

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

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Strictly Confidential (FR) December 8, 2004
Class II FOMC

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

							-----Projected----		
Measure and country	1998	1999	2000	2001	2002	2003	2004	2005	2006
REAL GDP (1)									
Total foreign	1.5	5.0	4.2	0.3	3.0	2.7	3.5	3.2	3.2
Industrial Countries	2.7	4.3	3.5	0.7	2.6	1.7	2.5	2.5	2.5
of which:									
Canada	4.4	5.9	4.1	1.4	3.8	1.7	3.2	3.2	3.1
Japan	-1.2	0.1	3.2	-2.0	1.4	2.0	1.7	1.5	1.8
United Kingdom	2.8	3.3	3.0	2.2	1.9	2.9	2.6	2.4	2.2
Euro Area (2)	2.0	3.9	2.7	0.8	1.1	0.8	1.8	1.6	1.7
Germany	0.7	3.3	1.9	0.5	0.5	0.0	1.2	1.0	1.3
Developing Countries	-0.3	6.1	5.3	-0.3	3.5	4.2	5.0	4.2	4.3
Asia	-2.2	8.6	5.9	0.9	5.8	6.0	5.5	4.5	4.5
Korea	-5.4	11.4	4.5	4.7	7.7	4.1	2.8	3.9	4.2
China	9.8	7.0	7.6	6.9	8.3	10.0	8.6	7.1	7.5
Latin America	1.2	4.2	4.5	-1.3	1.4	2.3	4.5	3.9	4.1
Mexico	2.9	5.4	4.8	-1.2	1.9	2.0	4.1	3.9	4.3
Brazil	-1.7	3.5	3.9	-0.9	4.2	0.8	5.3	3.0	3.0
CONSUMER PRICES (3)									
Industrial Countries	0.9	1.1	1.7	0.9	2.1	1.3	1.6	1.2	1.4
of which:									
Canada	1.1	2.4	3.1	1.1	3.9	1.7	1.9	1.7	2.0
Japan	0.7	-1.1	-1.2	-1.3	-0.5	-0.4	0.3	-0.5	0.2
United Kingdom (4)	1.4	1.2	1.0	1.0	1.6	1.3	1.2	1.5	1.9
Euro Area (2)	0.9	1.5	2.5	2.1	2.3	2.1	2.3	1.8	1.7
Germany	0.3	1.1	1.7	1.5	1.2	1.2	2.2	1.1	0.7
Developing Countries	9.0	4.6	4.1	2.8	2.9	3.0	4.2	3.4	3.1
Asia	4.4	0.1	1.8	1.1	0.7	2.1	3.4	2.7	2.4
Korea	5.8	1.2	2.6	3.4	3.4	3.5	3.5	4.1	3.3
China	-1.2	-1.0	0.9	-0.1	-0.6	2.6	4.0	2.2	1.9
Latin America	15.4	12.5	8.4	5.3	6.4	4.9	5.5	4.4	4.2
Mexico	17.3	13.5	8.7	5.1	5.3	3.9	5.3	4.0	3.8
Brazil	2.0	8.4	6.4	7.5	10.7	11.5	7.0	5.7	5.3

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)

Measure and country	2004 Q1	2004 Q2	2004 Q3	2004 Q4	Projected 2005 Q1	2005 Q2	2005 Q3	2005 Q4	2006 Q1	2006 Q2	2006 Q3	2006 Q4
REAL GDP (1)	Quarterly changes at an annual rate											
Total foreign	4.7	3.6	2.7	3.1	3.0	3.2	3.2	3.3	3.2	3.2	3.2	3.2
Industrial Countries	3.3	2.6	2.0	2.1	2.3	2.5	2.5	2.5	2.5	2.5	2.4	2.4
of which:												
Canada	2.7	3.9	3.2	2.9	3.0	3.2	3.3	3.3	3.2	3.1	3.0	3.0
Japan	6.8	-0.6	0.2	0.7	1.3	1.5	1.5	1.6	1.7	1.8	1.8	1.8
United Kingdom	2.7	3.6	1.8	2.2	2.3	2.5	2.4	2.4	2.2	2.2	2.2	2.2
Euro Area (2)	2.6	1.9	1.2	1.5	1.5	1.6	1.7	1.7	1.7	1.7	1.7	1.7
Germany	1.7	1.7	0.4	0.8	0.8	1.0	1.1	1.2	1.2	1.2	1.3	1.3
Developing Countries	6.8	5.0	3.6	4.5	4.1	4.1	4.2	4.3	4.3	4.3	4.3	4.2
Asia	7.7	5.1	4.4	4.9	4.4	4.5	4.4	4.4	4.5	4.5	4.5	4.5
Korea	3.0	2.6	2.6	3.0	3.5	4.0	4.0	4.2	4.2	4.2	4.2	4.2
China	14.4	2.8	10.1	7.5	7.1	7.1	7.1	7.1	7.5	7.5	7.5	7.5
Latin America	6.4	4.9	2.8	4.0	3.7	3.7	4.0	4.2	4.2	4.2	4.2	4.1
Mexico	5.5	4.5	2.6	4.0	3.7	3.7	4.1	4.3	4.3	4.3	4.3	4.2
Brazil	7.5	5.5	4.2	4.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
CONSUMER PRICES (3)	Four-quarter changes											
Industrial Countries	0.8	1.5	1.5	1.6	1.5	1.2	1.3	1.2	1.4	1.4	1.4	1.4
of which:												
Canada	0.8	2.2	2.0	1.9	1.9	1.4	1.6	1.7	1.8	1.9	2.0	2.0
Japan	-0.3	-0.2	-0.2	0.3	-0.3	-0.3	-0.1	-0.5	-0.0	0.1	0.2	0.2
United Kingdom (4)	1.2	1.4	1.2	1.2	1.1	1.4	1.5	1.5	1.7	1.8	1.8	1.9
Euro Area (2)	1.7	2.3	2.3	2.3	2.4	2.1	2.0	1.8	1.8	1.8	1.7	1.7
Germany	1.0	1.9	2.0	2.2	2.2	1.8	1.5	1.1	1.1	0.9	0.8	0.7
Developing Countries	3.0	3.6	4.4	4.2	4.1	3.8	3.4	3.4	3.3	3.2	3.2	3.1
Asia	2.2	3.3	4.2	3.4	3.5	2.9	2.4	2.7	2.5	2.4	2.4	2.4
Korea	3.3	3.4	4.3	3.5	3.7	4.3	3.7	4.1	3.9	3.7	3.6	3.3
China	2.8	4.4	5.3	4.0	4.0	2.7	1.9	2.2	2.0	1.9	1.9	1.9
Latin America	4.7	4.5	5.1	5.5	5.2	5.4	4.9	4.4	4.4	4.4	4.3	4.2
Mexico	4.3	4.3	4.8	5.3	4.9	5.0	4.6	4.0	4.0	4.0	4.0	3.8
Brazil	6.8	5.5	6.8	7.0	6.8	6.6	5.9	5.7	5.4	5.3	5.3	5.3

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

	1998	1999	2000	2001	2002	2003	2004 (Projected)	2005 (Projected)	2006 (Projected)
NIPA REAL EXPORTS and IMPORTS									
Percentage point contribution to GDP growth, Q4/Q4									
Net Goods & Services	-1.1	-1.0	-0.9	-0.2	-0.9	-0.1	-0.6	-0.1	-0.5
Exports of G&S	0.3	0.6	0.7	-1.3	0.3	0.6	0.8	0.9	0.8
Imports of G&S	-1.4	-1.6	-1.6	1.1	-1.3	-0.7	-1.3	-0.9	-1.2
Percentage change, Q4/Q4									
Exports of G&S	2.6	5.6	6.5	-11.9	3.5	6.1	7.8	8.3	7.6
Services	4.4	5.3	1.8	-8.9	9.8	3.8	5.4	7.2	6.1
Computers	7.3	13.4	22.7	-23.5	-1.0	11.2	7.4	13.5	14.4
Semiconductors	9.5	34.6	27.6	-34.6	9.9	38.8	-1.0	27.3	29.1
Other Goods 1/	1.2	3.3	5.9	-10.2	0.4	5.0	9.6	7.5	6.8
Imports of G&S	11.0	12.1	11.2	-7.6	9.7	4.9	9.2	5.9	8.1
Services	10.4	6.5	10.7	-5.9	8.9	3.7	3.8	3.1	4.6
Oil	4.2	-3.4	13.3	3.7	4.2	1.8	4.1	-3.4	3.1
Computers	26.4	26.0	13.9	-13.6	13.4	16.9	24.5	14.8	17.5
Semiconductors	-7.7	34.2	22.8	-51.1	10.0	0.3	21.8	26.1	29.1
Other Goods 2/	11.2	12.9	10.5	-6.5	9.9	4.9	10.0	7.0	8.5
Billions of Chained 2000 Dollars									
Net Goods & Services	-203.8	-296.2	-379.5	-399.1	-472.1	-518.5	-577.7	-590.5	-633.2
Exports of G&S	966.5	1008.2	1096.3	1036.7	1012.4	1031.8	1125.5	1216.1	1313.0
Imports of G&S	1170.3	1304.5	1475.8	1435.8	1484.4	1550.2	1703.2	1806.6	1946.2
Billions of dollars									
US CURRENT ACCOUNT BALANCE	-209.6	-296.8	-413.5	-385.7	-473.9	-530.7	-664.0	-739.5	-808.4
Current Acct as Percent of GDP	-2.4	-3.2	-4.2	-3.8	-4.5	-4.8	-5.7	-6.0	-6.2
Net Goods & Services (BOP)	-164.9	-263.3	-378.4	-362.7	-421.7	-496.5	-607.5	-640.0	-667.3
Investment Income, Net	8.3	18.4	25.3	28.7	12.6	38.8	22.4	-14.3	-55.8
Direct, Net	65.5	78.2	94.9	115.9	100.8	118.9	125.5	138.8	141.9
Portfolio, Net	-57.2	-59.8	-69.7	-87.2	-88.2	-80.1	-103.2	-153.1	-197.8
Other Income & Transfers,Net	-53.0	-52.0	-60.4	-51.7	-64.8	-72.9	-78.9	-85.3	-85.3

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				2003			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-0.0	0.5	-0.6	-0.7	-1.1	-0.5	-0.4	-1.7	0.1	-0.5	0.6	-0.7
Exports of G&S	-0.6	-1.4	-2.0	-1.1	0.4	1.0	0.3	-0.4	-0.2	-0.2	1.0	1.6
Imports of G&S	0.6	1.9	1.5	0.5	-1.5	-1.4	-0.7	-1.3	0.3	-0.3	-0.4	-2.2
Percentage change from previous period, s.a.a.r.												
Exports of G&S	-5.3	-12.7	-18.2	-10.8	4.7	11.0	3.1	-4.2	-1.5	-1.6	11.3	17.5
Services	-5.0	-0.6	-13.7	-15.3	21.7	4.5	3.5	10.5	-12.7	-3.5	14.1	20.6
Computers	-9.8	-35.7	-24.9	-21.3	-20.4	11.9	-3.8	12.3	-4.5	-3.4	38.2	19.8
Semiconductors	-30.0	-54.0	-45.3	3.7	24.9	38.8	11.4	-24.4	40.9	28.0	40.8	45.9
Other Goods 1/	-2.5	-11.5	-17.6	-8.6	-2.1	12.6	2.7	-10.3	2.4	-2.4	6.6	13.9
Imports of G&S	-3.7	-12.6	-10.3	-3.4	12.5	11.4	5.4	9.6	-1.9	2.5	2.9	17.1
Services	-5.1	12.9	-18.3	-10.4	24.6	-5.7	2.8	16.5	-2.4	-9.4	17.9	11.0
Oil	63.5	-33.8	-28.2	49.1	-5.6	-17.5	-10.8	69.9	-6.0	-2.8	0.6	16.6
Computers	-22.6	-23.3	-13.4	8.4	50.2	7.2	2.6	0.2	7.0	15.9	12.0	34.2
Semiconductors	-43.9	-70.1	-55.4	-23.7	42.3	33.9	-6.7	-17.6	-4.0	2.4	-1.5	4.4
Other Goods 2/	-5.5	-10.6	-3.7	-5.9	8.3	19.4	8.5	4.1	-1.8	5.5	-0.9	17.9
Billions of Chained 2000 Dollars, s.a.a.r.												
Net Goods & Services	-398.2	-385.2	-398.4	-414.6	-444.9	-458.1	-469.8	-515.4	-511.7	-525.2	-508.7	-528.3
Exports of G&S	1097.2	1060.6	1008.7	980.3	991.6	1017.8	1025.5	1014.5	1010.6	1006.5	1033.8	1076.2
Imports of G&S	1495.4	1445.8	1407.1	1394.9	1436.5	1475.9	1495.3	1529.8	1522.3	1531.7	1542.5	1604.5
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-426.8	-390.2	-367.6	-358.3	-440.8	-471.6	-476.0	-507.4	-552.8	-535.5	-526.5	-507.8
Current Account as % of GDP	-4.3	-3.9	-3.6	-3.5	-4.3	-4.5	-4.5	-4.8	-5.1	-4.9	-4.7	-4.5
Net Goods & Services (BOP)	-389.3	-356.1	-357.1	-348.3	-375.0	-413.5	-427.7	-470.7	-501.6	-493.5	-489.0	-502.0
Investment Income, Net	23.9	29.8	1.5	59.7	9.2	1.8	10.6	28.8	21.5	29.1	34.5	70.1
Direct, Net	106.2	116.1	95.0	146.2	100.6	95.1	94.9	112.8	101.3	105.4	114.6	154.2
Portfolio, Net	-82.3	-86.3	-93.5	-86.6	-91.4	-93.2	-84.3	-84.0	-79.8	-76.3	-80.1	-84.1
Other Inc. & Transfers, Net	-61.3	-63.9	-12.0	-69.7	-75.0	-59.9	-59.0	-65.4	-72.8	-71.0	-72.0	-76.0

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2004				Projected 2005				Projected 2006			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-0.8	-1.1	-0.3	-0.2	-0.0	0.4	-0.1	-0.4	-0.7	-0.0	-0.4	-0.6
Exports of G&S	0.7	0.7	0.6	1.0	0.7	0.9	0.9	1.0	0.7	0.8	0.8	0.9
Imports of G&S	-1.5	-1.8	-0.9	-1.1	-0.7	-0.5	-1.0	-1.4	-1.4	-0.8	-1.2	-1.5
Percentage change from previous period, s.a.a.r.												
Exports of G&S	7.3	7.3	6.3	10.2	6.5	8.5	8.6	9.8	6.5	7.7	7.4	8.6
Services	3.4	10.2	0.1	8.2	7.7	7.4	7.2	6.7	6.4	6.3	6.0	5.7
Computers	-8.3	-1.8	22.9	20.2	11.2	14.1	14.3	14.3	14.4	14.4	14.4	14.4
Semiconductors	12.5	-10.1	-20.4	19.1	22.2	28.5	29.2	29.2	29.1	29.1	29.1	29.1
Other Goods 1/	10.1	7.7	10.6	10.0	4.7	7.6	7.8	10.0	5.0	6.8	6.6	8.7
Imports of G&S	10.6	12.6	6.0	7.6	4.4	3.1	6.7	9.6	9.3	5.4	7.6	10.0
Services	1.1	10.7	8.3	-4.2	0.9	2.6	4.0	5.1	4.8	4.6	4.5	4.5
Oil	39.0	-33.1	5.4	19.9	10.2	-28.3	-7.3	18.7	16.4	-22.1	-2.3	27.2
Computers	12.8	38.6	29.5	18.6	8.1	16.7	17.3	17.3	17.5	17.5	17.5	17.5
Semiconductors	42.2	21.2	7.7	18.4	18.5	28.2	28.8	29.2	29.1	29.1	29.1	29.1
Other Goods 2/	8.9	19.6	4.0	7.9	3.9	7.4	8.3	8.6	8.5	8.5	8.5	8.5
Billions of Chained 2000 Dollars, s.a.a.r.												
Net Goods & Services	-550.1	-580.3	-588.1	-592.3	-593.1	-582.5	-586.7	-599.7	-621.4	-622.8	-634.6	-654.1
Exports of G&S	1095.4	1114.8	1132.1	1159.8	1178.1	1202.3	1227.4	1256.4	1276.5	1300.3	1323.8	1351.5
Imports of G&S	1645.5	1695.1	1720.1	1752.0	1771.2	1784.9	1814.1	1856.1	1897.9	1923.0	1958.4	2005.6
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-588.7	-664.7	-664.2	-738.3	-735.8	-728.9	-737.2	-756.2	-797.2	-789.1	-807.3	-840.1
Current Account as % of GDP	-5.1	-5.7	-5.6	-6.2	-6.1	-5.9	-5.9	-6.0	-6.2	-6.1	-6.1	-6.3
Net Goods & Services (BOP)	-554.4	-601.1	-622.6	-651.7	-644.9	-633.8	-635.4	-645.8	-663.6	-658.2	-665.3	-682.1
Investment Income, Net	54.3	16.7	22.4	-3.9	1.5	-12.6	-18.9	-27.1	-41.2	-48.4	-59.1	-74.7
Direct, Net	139.1	116.2	122.5	124.3	137.7	138.7	139.2	139.5	136.5	140.7	145.3	145.1
Portfolio, Net	-84.8	-99.5	-100.1	-128.2	-136.3	-151.3	-158.2	-166.6	-177.7	-189.2	-204.4	-219.8
Other Inc. & Transfers, Net	-88.5	-80.3	-64.0	-82.7	-92.4	-82.5	-82.9	-83.3	-92.4	-82.5	-82.9	-83.3

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