Class II FOMC - Restricted (FR)

Part 1

December 7, 2005

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Summary and Outlook

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

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Domestic Developments

The economy appears to have retained considerable momentum in recent months despite the disruptions caused by Hurricanes Katrina, Rita, and Wilma. We currently expect real GDP to rise at an annual rate of nearly 4 percent in the second half of this year, ½ percentage point more than we were forecasting in the October Greenbook. Part of this upward revision reflects our view that the drag from the hurricanes on GDP growth is likely a little smaller than we had previously assumed, especially outside of the energy-producing sector. But more importantly, the incoming data have also led us to revise up our assessment of the underlying pace of economic activity in the third and fourth quarters.

In light of our reassessment, we have incorporated into this projection a slightly more restrictive stance for monetary policy. The past and prospective tightening in policy, coupled with a waning of the stimulus from fiscal policy and household wealth, help to gradually slow economic growth over the next two years to a little below its potential. That said, we have nudged up our estimates of the growth of structural productivity and of potential output in this projection; this increment to aggregate supply feeds through to income and aggregate demand and boosts our GDP projection a bit relative to the previous Greenbook. In particular, we now project that, stimulated by hurricane-related rebuilding, real GDP growth will rise to 3½ percent in 2006 before stepping down to about 3 percent in 2007. This pace of expansion is expected to keep the unemployment rate close to its current level of 5 percent over the projection period.

The outlook for inflation is also a little more favorable than in the October Greenbook. In part, this change reflects our more optimistic assumptions about structural productivity growth, which help to restrain the rise in unit labor costs. In addition, core prices have come in a little to the low side of our forecast in recent months, and most measures of inflation expectations have receded somewhat as well. Although we still expect the indirect effects of this year's run-up in energy prices to push up core inflation next year, the projected rise in the core PCE price index in 2006—at about 2 percent—is 0.2 percentage point less than in our previous forecast. Core inflation is then anticipated to move back to 1¾ percent in 2007 as the indirect energy effects taper off.

Key Background Factors

As noted above, our judgment that the underlying pace of economic activity is a little stronger than we had thought has led us to assume a slightly tighter stance of monetary policy than we had built into the October Greenbook. In particular, we now assume that the federal funds rate will rise to 4½ percent in the first quarter of next year and then remain at that level through the end of 2007. With this adjustment, the path of the federal funds rate is now broadly in line with current market expectations, and thus we anticipate that yields on longer-term Treasury securities, which have changed little, on net, since the last Greenbook, will hold steady over the forecast period. In contrast, mortgage rates have moved up about ¼ percentage point since late October, and we have carried this higher level forward.

Broad equity price indexes are currently about 5 percent above the level we had assumed in the October Greenbook, and we have shifted up our starting point for stock prices by this amount. We assume that stock prices will increase at an annual rate of 6½ percent from this higher level, a pace that would roughly maintain risk-adjusted parity with the returns on long-term Treasury securities. In addition, we have raised our assumption about house prices in response to a larger-than-expected increase in the third-quarter OFHEO index; the level of house prices averages about 2 percent higher than that incorporated in our previous projection. Nevertheless, we continue to assume a significant deceleration in the repeat-transactions index, from a projected rise of nearly 11½ percent during the four quarters of this year to increases of about 5½ percent in 2006 and 2½ percent in 2007.

Assessing the likely effects of the hurricanes on economic activity over the forecast period remains difficult. However, the available information for the energy sector suggests that the rebuilding of damaged infrastructure will take somewhat longer than we had assumed in the October Greenbook. As a result, we have pushed back to the middle of next year our assumed date for a full recovery in the production of crude oil and natural gas and to the middle of the first quarter for refining activity.[1] In contrast, we now think that the negative effects of the hurricanes on activity outside of the energy sector were somewhat less in the aggregate than we were anticipating. In particular, surprisingly large production gains were made in October in some industries (for example, chemicals, and parts of the food, rubber and plastics, and paper industries) that were severely disrupted by the hurricanes. And there is more strength than might have been expected in some categories of consumer spending (such as housing services and real gasoline sales) for which the adverse effects of the hurricanes and of the associated spike in energy prices seemed likely to be the largest. As a result, we now estimate that the hurricanes held down real GDP growth about ¾ percentage point at an annual rate in

[1] We had previously assumed that production of crude oil and natural gas would be restored to pre-Katrina levels by next spring and that refining activity would be fully recovered by the end of this year.

the third quarter and will hold down growth ¼ percentage point in the fourth quarter; these estimates are about ¼ percentage point smaller than in the October Greenbook. Correspondingly, we have trimmed a bit off the anticipated boost to growth from the hurricane-related recovery next year.

We have made only minor adjustments to our assumptions about fiscal policy in this projection. In particular, we have maintained our assessment of spending for the Medicare drug benefit and our assumption about the ongoing scale of operations in Iraq and Afghanistan. In addition, we continue to assume that federal outlays and tax cuts related to the hurricanes will total $85 billion, about $70 billion of which will occur within the forecast period. Although recent hurricane-related outlays have been somewhat larger than we were expecting, there seems to be little impetus in the Congress to increase spending beyond what has already been authorized. On the revenue side, tax receipts are boosted by the higher GDP path in this projection.[2] All told, we expect the federal unified budget deficit to increase from $318 billion in fiscal year 2005 to $346 billion in fiscal 2006 and $352 billion in fiscal 2007, a path that is a bit lower than what we had projected in the October Greenbook. Under our assumptions, fiscal policy imparts an impetus to real GDP growth of about ½ percentage point in 2006 and is neutral in 2007 after supplying an impetus averaging roughly ¾ percentage point per year between 2001 and 2005.

The foreign exchange value of the dollar has appreciated a bit since the October Greenbook, and in response we have edged up the starting point for our projected path of the real trade-weighted dollar. However, we continue to assume that the dollar will depreciate over the forecast period, with its decline averaging about 1¾ percent annually. Meanwhile, incoming data on economic growth abroad have been stronger than we were expecting, especially in the emerging-market economies. As a result, we now expect foreign real GDP to rise at an annual rate of nearly 4 percent over the second half of this year, ¾ percentage point more than we projected in October. We project that foreign GDP will rise a bit more than 3¼ percent in 2006 and 2007.

The spot price of West Texas intermediate (WTI) crude oil moved lower during much of the period since the October Greenbook, but recently it has nearly reversed that decline and currently stands at about $60 per barrel. Futures quotes indicate that participants expect crude prices to remain elevated over the next two years, an expectation that likely

[2] As in past Greenbooks, we assume that most expiring provisions of the tax code are extended, including individual AMT relief and the research and experimentation tax credit.

reflects ongoing concerns about oil supplies around the world and continued strength in world demand. Consistent with these recent readings, we expect the price of WTI to rise to almost $63 per barrel by late 2006 before edging down to about $62 per barrel by the end of the forecast period; this path averages about $1.20 per barrel lower than our previous projection in 2006 and is about $0.50 per barrel higher in 2007.

Recent Developments and the Near-Term Outlook

Real GDP is estimated to have risen at an annual rate of about 4¼ percent in the third quarter, 1 percentage point more than we had anticipated at the time of the last Greenbook. The surprises were widespread, with both household and business spending considerably stronger than we had expected. We currently project real GDP growth to slow to an annual rate of 3½ percent in the fourth quarter, a pace similar to that in our previous forecast. The sharp deceleration between the third and fourth quarters is largely due to motor vehicle production, which moved up during the summer and edged off a bit in October and November; excluding motor vehicle output, real GDP is projected to rise at an annual rate of a little less than 4 percent in both quarters.

According to last week's labor market report, the pace of hiring picked up substantially in November after two months in which employment gains were held down by hurricane-related disruptions. The November increase was undoubtedly boosted by recovery efforts in the Gulf region, and we expect these efforts to add further to payrolls for several more months. Moreover, both this latest reading and the recent low levels of initial claims for unemployment insurance suggest that the underlying pace of labor demand has been well maintained.

Industrial production is projected to rise at an annual rate of about 3 percent in the current quarter. Hurricane-related disruptions pushed down energy production further in October, and even with some rebound anticipated for November and December, this component of IP is expected to decline at an annual rate of about 9¼ percent for the fourth quarter as a whole. Outside of energy, IP is projected to rise at roughly a 6¼ percent pace this quarter, a rate supported by the rebound in aircraft production that followed the end of the Boeing strike and by strong gains in the output of high-tech equipment and construction supplies.

After rising at an annual rate of 4¼ percent in the third quarter, real PCE is projected to increase less than 1 percent in the fourth quarter. This pattern mainly reflects the sharp swing in sales of light motor vehicles induced by this summer's "employee pricing"

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

Measure	2005:Q3 Oct. GB	2005:Q3 Dec. GB	2005:Q4 Oct. GB	2005:Q4 Dec. GB
Real GDP	**3.2**	**4.3**	**3.5**	**3.4**
Private domestic final purchases	3.6	5.0	1.6	1.8
Personal consumption expenditures	3.4	4.2	.6	.7
Residential investment	5.9	7.7	6.9	9.3
Business fixed investment	3.5	8.9	5.9	4.8
Government outlays for consumption and investment	3.3	3.2	3.5	1.6
	Contribution to growth (percentage points)			
Inventory investment	-.8	-.4	1.7	2.2
Net exports	.3	-.2	-.3	-.7

programs. In particular, the average pace of sales in October and November lagged the third-quarter pace by more than 2½ million units (annual rate), although we anticipate that the recent introduction of new incentives by automakers will boost demand somewhat in December. Excluding motor vehicles, PCE rebounded in October from its hurricane-depressed level in September, and spending in this category appears to be on track for a gain of roughly 3¼ percent, about ½ percentage point less than in the third quarter.

Although we see hints of a softening in the housing market in some of the indicators we follow, there is little hard evidence that a substantial retrenchment is under way. Single-family housing starts dropped back somewhat in October from September's very strong pace, but the level of permit issuance and the backlog of unused permits point to a pickup in starts over the remainder of the quarter. Similarly, existing home sales have eased off only a little from the high levels recorded this past summer, and new home sales reached a new high in October. With rebuilding from the hurricanes now adding to expenditures, we project that real residential investment will rise at an annual rate of about 9¼ percent this quarter, a somewhat faster pace than we had projected in the October Greenbook.

Real investment in equipment and software (E&S) rose at an annual rate of 11 percent in the third quarter, a larger gain than we had been expecting. In the fourth quarter, the growth rate of real E&S outlays is projected to slow to about 2¼ percent because of a sharp decline in business purchases of motor vehicles. In contrast, the monthly orders and shipments data suggest that the pace of investment in nontransportation equipment has been well maintained this quarter. Real investment in nonresidential structures, which rose at an annual rate of 3 percent in the third quarter, is projected to climb at a 12¾ percent pace this quarter; spending in this sector will likely be supported by another large gain in drilling and mining expenditures and by substantial construction outlays in the areas affected by the hurricanes.

Real nonfarm inventory investment excluding motor vehicles slowed from an annual rate of $23 billion in the second quarter to $14 billion in the third quarter. In most sectors, the current level of stocks does not seem out of line with sales, and based on the limited information we have for October, we have penciled in an $18 billion accumulation in the fourth quarter. In the motor vehicle sector, the elevated pace of sales last quarter resulted in a further drawdown in stocks. However, with the sharp drop-off in sales in recent months, inventories appear on track for a sizable rebound this quarter.

In the government sector, growth in real federal expenditures on consumption and gross investment was at an annual rate of 8 percent in the third quarter, an increase led by a jump in defense purchases. However, defense spending appears to have dropped back in the fourth quarter by enough to hold the projected level of overall federal purchases flat in real terms despite an increase in spending by the Federal Emergency Management Agency. In the state and local sector, purchases were little changed in the third quarter, as construction spending turned down after a strong first-half performance. However, construction activity has picked up again in recent months, and we project that real spending by state and local governments will rise at a 2½ percent pace this quarter.

In the external sector, real exports rose at an annual rate of only ¾ percent in the third quarter, while real imports increased at roughly a 2 percent pace; exports were held back by the Boeing strike, while both imports and exports were likely depressed to some extent by the disruptions to shipping associated with the hurricanes. With these disruptions diminishing, both imports and exports are expected to rebound in the fourth quarter. In addition, imports are projected to be buoyed this quarter by substantial incoming shipments of refined petroleum products, while exports should be boosted by aircraft shipments that were delayed by the Boeing strike. All told, we estimate that net exports subtracted ¼ percentage point from GDP growth in the third quarter and project that they will deduct ¾ percentage point from fourth-quarter growth; these estimates are about ½ percentage point more negative in each quarter than in the October Greenbook.

The incoming information on labor costs has been mixed. Hourly compensation as measured by both the employment cost index (ECI) and by the productivity and costs (P&C) data increased less in the third quarter than we had forecast in October, and the latest estimate of wages and salaries from the Bureau of Economic Analysis resulted in a sharp downward revision to the P&C measure in the second quarter. In contrast, increases in average hourly earnings of production or nonsupervisory workers have picked up in recent months; for the fourth quarter as a whole, this wage measure is on track to rise at an annual rate of 4 percent. We have assumed that some of this acceleration will show through to overall labor costs, and thus we have penciled in a pickup this quarter in the ECI and P&C measures of compensation growth as well.

Core PCE prices are anticipated to rise at an annual rate of about 2 percent in the fourth quarter after an increase of only 1¼ percent in the third quarter. The acceleration in core prices reflects a gradual pass-through of higher energy costs as well as the reversal of some special factors that held down price changes last quarter—including the employee pricing of motor vehicles and a sharp decline in the volatile “lodging away from home” price index. Nonetheless, the monthly data on core prices have been coming in a little lower than we had anticipated, and so the rise we now expect for this quarter is 0.1 percentage point less than in the October Greenbook. In addition, consumer energy prices are projected to increase less rapidly in the fourth quarter than we had assumed in our previous forecast; as a result, we have revised down our projection of overall PCE price inflation in the fourth quarter to about 2 percent, 1½ percentage points less than in the last Greenbook.

The Longer-Term Outlook for the Economy

We expect real GDP to rise 3½ percent in 2006 and 3 percent in 2007. As in previous Greenbooks, the slower pace of economic activity in the projection period occurs as tighter monetary policy, waning wealth effects, and reduced stimulus from fiscal policy more than offset a diminishing drag from the earlier run-up in oil prices. In 2006, however, these forces are obscured by a boost to activity associated with the recovery from the hurricanes. Without this stimulus, we judge that real GDP would rise a little more than 3 percent in each of the next two years. Our real GDP forecast is a little higher in both years than in the October Greenbook because of the upward adjustments we made

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

Measure	2005: H2	2006: H1	2006	2007
Real GDP	**3.9**	**3.6**	**3.5**	**3.0**
Previous	3.4	3.8	3.3	2.8
Final sales	2.9	4.3	3.5	2.8
Previous	2.9	4.0	3.4	2.5
PCE	2.4	4.0	3.6	3.4
Previous	2.0	3.5	3.3	3.1
Residential investment	8.5	2.1	.7	.1
Previous	6.4	1.7	.3	-.7
BFI	6.9	9.6	8.3	5.5
Previous	4.7	11.4	9.2	4.5
Government purchases	2.4	2.7	2.1	1.5
Previous	3.4	2.6	2.1	1.5
Exports	6.1	4.3	4.9	4.8
Previous	7.0	4.5	5.1	5.3
Imports	6.8	3.7	5.0	6.0
Previous	4.4	4.6	5.3	5.8
	Contribution to growth (percentage points)			
Inventory change	.9	-.7	-.1	.2
Previous	.5	-.2	-.1	.3
Net exports	-.5	-.1	-.3	-.5
Previous	.0	-.3	-.3	-.4

to our assumptions about the stock market, housing prices, and growth in potential output.

Household spending. Real consumer spending is projected to rise about 3½ percent in both 2006 and 2007. By itself, our projection of strong real disposable income growth (4¼ percent per year, on average) would be consistent with even larger increases in spending. However, with the saving rate so low this year, we anticipate that households will make some effort to increase their financial reserves. In addition, we expect that the impetus to spending from household wealth will dissipate over the forecast period and

that rising interest rates will impart some restraint on consumer demand. Taking all of these factors into account, we project that the saving rate will rise from less than zero this year to about 1½ percent in 2007.

With mortgage rates projected to exceed the low levels of the past two years, we anticipate that the housing market will cool off a bit over the next two years. In particular, we expect single-family housing starts to edge down from their record 1.72 million unit pace this year to 1.67 million units in 2007. For the sector as a whole, growth in real outlays is expected to slow from 9¼ percent this year to ¾ percent in 2006 and to near zero in 2007. The levels of starts and spending in each year are boosted a little by the replacement and repair of structures damaged by the hurricanes.

Business spending. We expect business spending on equipment and software to increase 8¼ percent in 2006 and then to decelerate to 6¾ percent in 2007. Spending should be boosted in the first half of next year by hurricane-related replacement demand. After that impetus wanes, however, investment slows in response to the projected moderation in the growth of business output and to higher interest rates. The growth in real outlays for nonresidential structures is anticipated to increase to 8¾ percent in 2006, supported by continued large increases in expenditures on drilling and mining equipment, some hurricane-related rebuilding, and improving conditions in the office, other commercial, and industrial sectors. Increases in nonresidential construction spending are projected to slow to about 2½ percent in 2007, as drilling activity flattens out in response to the assumed decline in the price of natural gas and to the leveling off of crude oil prices.

Inventory investment is projected to be a relatively neutral factor for real GDP growth over the forecast period. Businesses in most sectors appear fairly comfortable with their current inventory positions, and thus we expect stocks to rise at a pace roughly in line with sales over the next two years.

Government spending. Real federal purchases are projected to rise 1¾ percent in 2006. Defense spending is anticipated to increase 3¼ percent, with a constant level of real outlays on operations in Iraq and Afghanistan and a pickup in other real defense purchases. Real nondefense spending is projected to edge down next year as purchases related to hurricane relief subside. For 2007, we are projecting no growth in real defense spending, as a moderation in spending for Iraq offsets a small rise in other defense spending; nondefense spending is expected to hold steady in 2007 as well. As in the previous projection, we anticipate that favorable budgetary conditions in the state and local sector, aided by solid revenue growth and hurricane-related grants from the federal government, will lead to a step-up in the rate of increase in real state and local spending, from about 1¾ percent this year to a little less than 2½ percent in each of the next two years.

Net exports. Our longer-term forecast for net exports is similar to that in the last Greenbook. In particular, the dwindling effects of the depreciation of the dollar in earlier years cause the growth of real exports to slow from about 7½ percent this year to a little less than 5 percent in both 2006 and 2007. In part for the same reason, growth in real imports is projected to edge up from 5¼ percent this year to 5½ percent on average in 2006 and 2007. The resultant path of net exports subtracts a little less than ½ percentage point from real GDP growth in 2006 and 2007. *(These topics are discussed in more detail in the International Developments section of the Greenbook.)*

Aggregate Supply, the Labor Market, and Inflation

We have made an upward adjustment of a few tenths of a percentage point per year to our estimate of structural productivity growth. This change largely reflects persistent upside surprises in the pace of actual labor productivity growth this year, which we have interpreted as suggesting that our earlier assumptions about the growth of structural multifactor productivity were a little too pessimistic. In terms of potential output, the higher pace of structural productivity growth in 2005 is offset by a downward revision to a technical factor that reflects a continuation of the recent tendency for changes in payroll employment to fall short of changes in household employment; this adjustment to the technical factor also helps to better align the unemployment gap with the output gap.[3] However, we do not expect the discrepancy in employment growth between the household and payroll surveys to persist in 2006 and 2007, and so, in those years, more of the upward revision to structural productivity growth shows through to potential output. As a result, potential GDP growth is projected to step up from 3 percent this year to 3¼ percent in 2006 and 2007.

[3] In our growth accounting framework, this technical factor reconciles the fact that labor input is measured primarily from the household survey, while productivity is measured primarily using hours information derived from the payroll survey.

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

Measure	1974-95	1996-2000	2001-04	2005	2006	2007
Structural labor productivity	1.5	2.5	3.3	3.2	3.1	3.0
Previous	1.5	2.5	3.3	2.8	2.8	2.8
Contributions[1]						
Capital deepening	.7	1.4	.7	1.0	1.0	1.0
Previous	.7	1.4	.7	.9	.9	.9
Multifactor productivity	.5	.8	2.3	2.0	1.9	1.8
Previous	.5	.8	2.3	1.7	1.7	1.6
Labor composition	.3	.3	.2	.3	.2	.2
MEMO						
Potential GDP	3.0	3.4	3.2	3.1	3.2	3.2
Previous	3.0	3.4	3.2	3.1	3.1	3.0

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

1. Percentage points.

Productivity and the labor market. Our upward revision to structural productivity growth this year has reduced, but not eliminated, the extent to which the level of actual productivity currently exceeds estimated structural productivity. As a result, we continue to expect actual productivity to rise a little less rapidly than structural productivity next year. However, the smaller initial gap, coupled with the higher rates of structural productivity growth over the projection period, has led to a considerable upward revision to our forecast of actual productivity. In particular, we now project that productivity will rise 2¾ percent in both 2006 and 2007, a pace that is nearly ½ percentage point faster than in our previous forecast.

One implication of the faster productivity growth is that employment decelerates more sharply in this forecast than we had previously assumed. Indeed, we now expect the gains in private payrolls to slow from an average 180,000 per month in early 2006 to about 85,000 per month in the second half of the year and to roughly 50,000 per month in 2007. Nonetheless, with the labor force participation rate continuing to trend down, this pace of hiring is sufficient to keep the unemployment rate close to 5 percent throughout the forecast period.

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

Measure	2004	2005	2006	2007
Output per hour, nonfarm business	2.6	3.2	2.7	2.8
Previous	2.6	2.8	2.2	2.5
Nonfarm private payroll employment	1.8	1.6	1.4	.6
Previous	1.8	1.7	1.5	.7
Household survey employment	1.3	1.8	1.1	.7
Previous	1.3	1.9	1.0	.6
Labor force participation rate[1]	66.0	66.1	66.0	65.8
Previous	66.0	66.2	66.0	65.8
Civilian unemployment rate[1]	5.4	5.0	5.0	5.0
Previous	5.4	5.0	5.0	5.1
MEMO				
GDP gap[2]	.9	.3	.0	.3
Previous	.9	.5	.3	.4

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.

Prices and wages. Core PCE price inflation is projected to move a touch above 2 percent in 2006, as the indirect effects of the sharp rise in energy prices this year continue to show through to labor compensation and to prices for a variety of goods and services. Over time, however, these indirect effects are expected to diminish, which results in a deceleration in core prices in 2007. Moreover, because structural productivity is anticipated to restrain the underlying trend in unit labor costs to a greater degree than in our previous projection, and with inflation expectations having receded a bit, our forecast for core inflation in this Greenbook is 0.2 percentage point lower in 2006 and 0.1 percentage point lower in 2007. Overall PCE prices are projected to rise at about the same rate as the core index, as energy prices flatten out and food prices rise a bit faster than core prices.

Labor compensation is projected to accelerate next year because of the lagged effects of this year’s rise in overall consumer prices and ongoing robust gains in structural productivity. In particular, we expect the rate of increase in the employment cost index to rise to 4¼ percent in 2006 and growth in the P&C measure of hourly compensation to rise to 5¼ percent. Increases in both measures are projected to ease off a bit in 2007 after price inflation turns down.

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

Measure	2004	2005	2006	2007
PCE chain-weighted price index	3.1	2.8	2.1	1.7
Previous	3.1	3.2	1.9	1.7
Food and beverages	2.9	2.1	2.4	2.1
Previous	2.9	2.0	2.5	2.1
Energy	17.9	19.4	1.4	-.6
Previous	17.9	25.7	-4.2	-1.5
Excluding food and energy	2.2	1.8	2.1	1.8
Previous	2.2	1.9	2.3	1.9
Consumer price index	3.4	3.5	2.3	1.9
Previous	3.4	4.0	1.9	1.8
Excluding food and energy	2.1	2.1	2.4	2.1
Previous	2.1	2.1	2.6	2.2
GDP chain-weighted price index	2.9	2.7	2.3	1.9
Previous	2.9	2.8	2.1	1.9
ECI for compensation of private industry workers[1]	3.8	3.0	4.2	4.0
Previous	3.8	3.1	4.2	3.9
Compensation per hour, nonfinancial business sector	5.8	3.6	5.3	5.1
Previous	5.8	4.4	5.3	5.0
Prices of core nonfuel imports	3.7	2.3	1.7	.8
Previous	3.7	2.4	1.5	.8

1. December to December.

Financial Flows and Conditions

The growth of domestic nonfinancial debt is projected to step down from 9 percent this year to 7¼ percent in 2006 and then to slow a bit further in 2007. Since the October Greenbook, we have revised up our outlook for debt growth, primarily in response to stronger-than-expected incoming data for house prices and for residential and commercial mortgages.

Despite the upward revisions, we continue to expect that the growth of mortgage debt will ease over the course of the forecast period as house price appreciation slows. This deceleration shows through to overall household debt, which is projected to expand at a 10¾ percent pace this year and then to post gains of 8 percent and 6½ percent in 2006 and 2007 respectively. Household debt growth is expected to outpace that of disposable income over the forecast period; nonetheless, the debt service ratio should be fairly flat because of a further tilt in the composition of household debt toward mortgages, which tend to have lower monthly payments than other household debt because of their longer amortization periods.

The moderate growth of nonfinancial corporate debt is projected to continue over the forecast period at an average annual rate of about 6¾ percent. Although our forecast calls for capital expenditures to rise considerably over the next two years, we expect that the large stock of liquid assets that firms have accumulated will hold down debt growth.

The projected rise in the federal budget deficit in 2006 and 2007 relative to this year implies that the pace of federal government borrowing will pick up a bit. After increasing 7 percent this year, federal debt is projected to expand 7¾ percent next year and 7½ percent in 2007. In contrast, growth in state and local government debt is expected to slow fairly sharply over the forecast period, as opportunities for advance refunding decline.

We continue to expect M2 growth to pick up over the forecast period, from about 4 percent in 2005 to 4¾ percent in 2006 and 5¼ percent in 2007. Although the opportunity cost of holding M2 is projected to level off by mid-2006, the effects of previous increases in interest rates are expected to depress M2 growth below that of nominal income until 2007.

Alternative Simulations

In this section, we use simulations of the FRB/US model to consider several risks to the staff outlook. We start with a pair of scenarios involving a pronounced housing market slump that depresses household spending as well as the broader economy. We then consider two scenarios that focus on upside risks to real activity; although these two simulations have increases in real GDP that are similar, they differ in whether the additional strength is demand driven or supply driven. Finally, we turn to risks to the price outlook—specifically, the implications of having misjudged either the inflationary impetus from past energy price increases or the stability provided by anchored inflation expectations and moderate wage growth. We evaluate each of these six risks first under the assumption that the federal funds rate is held at its baseline path and then under the assumption that monetary policy responds to the change in the outlook along the lines suggested by the Taylor rule.[4]

Housing slump. We expect the housing market to cool over the next two years, with the baseline rate of home price appreciation slowing to about 2 percent by 2007. However, we cannot rule out a more pronounced slump, and in this scenario home prices fall 10 percent in 2006 and an additional 5 percent in 2007—a deviation from baseline that cumulates to more than 20 percent by the end of 2007. Given the magnitude of the wealth effect built into our models, the resultant loss in household net worth—which cumulates to more than $4½ trillion relative to baseline by late 2007—would be expected to boost the personal saving rate about 1½ percentage points in the long run, all else equal. But because the decline in home prices occurs over the course of the next two years, and because consumers take time to fully adjust their spending to shifts in wealth, income, and other factors, the predicted increment to the saving rate by late 2007 is only half as large. As a result, the initial slowdown in real activity is fairly limited under the baseline monetary policy; but by 2007, real GDP growth slows to 2½ percent, and the unemployment rate increases to 5¼ percent. Inflation is unchanged from baseline but would be expected to decline more noticeably in 2008 and beyond in the absence of a policy response. Under the Taylor rule, a widening output gap prompts a gradual reduction in the federal funds rate to 4 percent over 2007, and this more accommodative stance diminishes the adverse effects of the housing slump a bit.

Housing slump with greater fallout. The actual sensitivity of household spending to home prices could be larger than that built into FRB/US for several reasons. First, the effects of changes in real estate wealth on consumption are estimated with considerable imprecision. Second, these effects may have grown in recent years because of innovations in mortgage finance. And third, a pronounced decline in real estate values could lead to an outsized decline in consumer confidence. In this scenario, we allow for these possibilities by assuming that the response of the saving rate to the previous scenario's fall in home prices is twice as great as that built into the standard model. Thus, the fallout from the market correction becomes more substantial: Under the baseline monetary policy, real GDP expands at roughly a 2¼ percent pace over the second half of next year and in 2007, causing the unemployment rate to climb to 5¾ percent by late 2007 and core inflation to slow to almost 1½ percent. If monetary

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

Alternative Scenarios

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

Measure and scenario	2005		2006		2007
	H1	H2	H1	H2	
Real GDP					
Baseline	**3.6**	**3.9**	**3.6**	**3.3**	**3.0**
Housing slump	3.6	3.9	3.5	3.0	2.5
With monetary policy response	3.6	3.9	3.5	3.1	2.7
Housing slump with greater fallout	3.6	3.9	3.2	2.2	2.2
With monetary policy response	3.6	3.9	3.2	2.4	2.9
Stronger aggregate demand	3.6	3.9	3.9	3.9	3.6
With monetary policy response	3.6	3.9	3.9	3.8	3.2
Faster productivity growth	3.6	3.9	3.8	3.8	3.7
With monetary policy response	3.6	3.9	3.9	3.8	3.7
Deteriorating inflation expectations	3.6	3.9	3.5	3.2	3.3
With monetary policy response	3.6	3.9	3.5	3.0	2.9
Less inflationary pressure	3.6	3.9	3.5	3.3	2.9
With monetary policy response	3.6	3.9	3.5	3.3	3.2
Civilian unemployment rate[1]					
Baseline	**5.1**	**5.0**	**5.0**	**5.0**	**5.0**
Housing slump	5.1	5.0	5.0	5.1	5.3
With monetary policy response	5.1	5.0	5.0	5.0	5.2
Housing slump with greater fallout	5.1	5.0	5.1	5.3	5.7
With monetary policy response	5.1	5.0	5.1	5.2	5.4
Stronger aggregate demand	5.1	5.0	4.9	4.8	4.5
With monetary policy response	5.1	5.0	4.9	4.9	4.7
Faster productivity growth	5.1	5.0	5.0	5.0	4.9
With monetary policy response	5.1	5.0	5.0	5.0	4.9
Deteriorating inflation expectations	5.1	5.0	5.0	5.0	5.0
With monetary policy response	5.1	5.0	5.0	5.1	5.1
Less inflationary pressure	5.1	5.0	5.0	5.0	5.1
With monetary policy response	5.1	5.0	5.0	5.0	5.0
PCE prices excluding food and energy					
Baseline	**2.1**	**1.6**	**2.2**	**2.1**	**1.8**
Housing slump	2.1	1.6	2.2	2.1	1.8
With monetary policy response	2.1	1.6	2.2	2.1	1.8
Housing slump with greater fallout	2.1	1.6	2.2	2.1	1.6
With monetary policy response	2.1	1.6	2.2	2.1	1.8
Stronger aggregate demand	2.1	1.6	2.2	2.1	1.9
With monetary policy response	2.1	1.6	2.2	2.1	1.8
Faster productivity growth	2.1	1.6	2.1	2.0	1.6
With monetary policy response	2.1	1.6	2.2	2.0	1.6
Deteriorating inflation expectations	2.1	1.7	2.5	2.7	2.7
With monetary policy response	2.1	1.7	2.5	2.6	2.5
Less inflationary pressure	2.1	1.6	2.2	1.8	1.2
With monetary policy response	2.1	1.6	2.2	1.8	1.3

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

policy were to respond to these changes in economic conditions along the lines indicated by the Taylor rule, the federal funds rate would decline to 3½ percent by the middle of 2007. As a result, real GDP would increase almost 3 percent in 2007, the rise in the unemployment rate would be held to 5½ percent, and core inflation would be unchanged from baseline.

Stronger aggregate demand. In the staff projection, economic growth slows substantially over the next two years to a pace roughly in line with potential. However, the "neutral" level of the federal funds rate may be higher than we estimate, and in this scenario such a possibility manifests itself through stronger consumer spending and business investment. In particular, the personal saving rate rises to only ½ percent by late 2007 under the baseline monetary policy (it is 1½ percent in the staff projection), while the pace of real E&S spending runs 1½ percentage points faster on average. Under these conditions, real GDP grows almost 4 percent next year and 3½ percent in 2007, pushing the unemployment rate down to 4½ percent by the end of the forecast period; tighter labor and product markets cause inflation to end up a touch above baseline. The Taylor rule calls for the federal funds rate to climb to 5 percent by 2007 in response to this stronger real activity; as a result, under this policy the decline in the unemployment rate is damped a bit and inflation is contained at baseline.

Faster productivity growth. An alternative source of greater strength in aggregate spending could be growth in potential output that is faster than we are assuming. In this simulation, structural multifactor productivity continues to increase at its estimated 2004 pace of almost 2¼ percent rather than gradually slowing to about 1¾ percent as in the baseline. This revision implies a more favorable long-run outlook for personal income and corporate earnings and therefore larger increases in household spending and business investment. In addition, stock prices are 6 percent above baseline in 2006 and 2007 because we assume that current valuations have not fully priced in the faster productivity growth. Under these conditions, real GDP grows about as rapidly as in the previous scenario, but because stronger demand is largely matched by stronger supply in this case, the unemployment rate is only a little below baseline by late 2007. More-rapid productivity growth also damps the rise in unit labor costs, causing core PCE inflation to fall to just over 1½ percent in 2007. With somewhat tighter resource utilization balancing less inflation, the Taylor rule calls for essentially no change in policy. This policy response differs markedly from that in the preceding scenario, in which the faster pace of activity was generated from the demand side.

Deteriorating inflation expectations. We may be underestimating the inflationary impetus from higher energy prices and other cost factors, and in this scenario we assume that long-run inflation expectations move up about 1 percentage point relative to baseline over the course of next year. Under the baseline monetary policy, such a drift in expectations causes core inflation to reach 2¾ percent by the end of 2007, 1 percentage point above baseline. Output is a little higher in 2007 because of somewhat lower real long-term interest rates. Under the Taylor rule, monetary policy steadily tightens as inflation picks up, pushing the federal funds rate to almost 5½ percent by late 2007. Both nominal and real bond yields rise more sharply as a result, damping real activity and capping the rise in core inflation at 2½ percent.

Less inflationary pressure. The baseline projection incorporates a noticeable pickup in the growth rate of hourly compensation next year; it also assumes that higher energy prices and other factors have caused long-run inflation expectations to drift up almost ½ percentage point since 2004. In this scenario, compensation per hour in the nonfarm business sector instead continues to rise a bit less than 4 percent per year, about 1½ percentage points less rapidly than in the baseline; long-run inflation expectations are also assumed to have been, and to continue to be, completely anchored. As a result, core inflation remains at 1¾ percent next year and then slows to 1¼ percent in 2007. Under the baseline monetary policy, the more pronounced slowing in inflation leads to higher real bond rates; partly for this reason, real activity is a touch weaker than in the baseline. Under the Taylor rule, by contrast, the nominal federal funds rate rises less in 2006 and averages about 4 percent in 2007, thereby allowing real GDP to grow a bit faster in that year.

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

Measure	2005	2006	2007
Real GDP			
(percent change, Q4 to Q4)			
Projection	3.7	3.5	3.0
Confidence interval			
Greenbook forecast errors[1]	3.2–4.2	1.7–5.2	1.1–4.9
FRB/US stochastic simulations	3.4–4.1	2.0–5.2	1.2–5.1
Civilian unemployment rate			
(percent, Q4)			
Projection	5.0	5.0	5.0
Confidence interval			
Greenbook forecast errors[1]	4.9–5.1	4.3–5.7	3.9–6.1
FRB/US stochastic simulations	4.9–5.2	4.3–5.6	4.0–5.9
PCE prices			
excluding food and energy			
(percent change, Q4 to Q4)			
Projection	1.8	2.1	1.8
Confidence interval			
Greenbook forecast errors[2]	1.6–2.1	1.4–2.8	0.9–2.7
FRB/US stochastic simulations	1.7–2.0	1.5–2.8	0.9–2.7

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

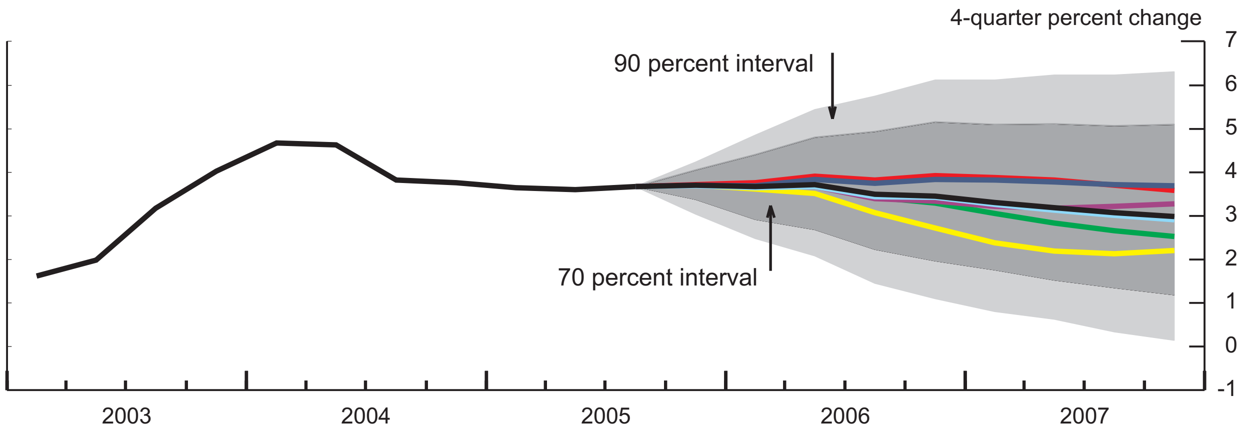
1. 1978–2004.
2. 1981–2004.

Forecast Confidence Intervals and Alternative Scenarios

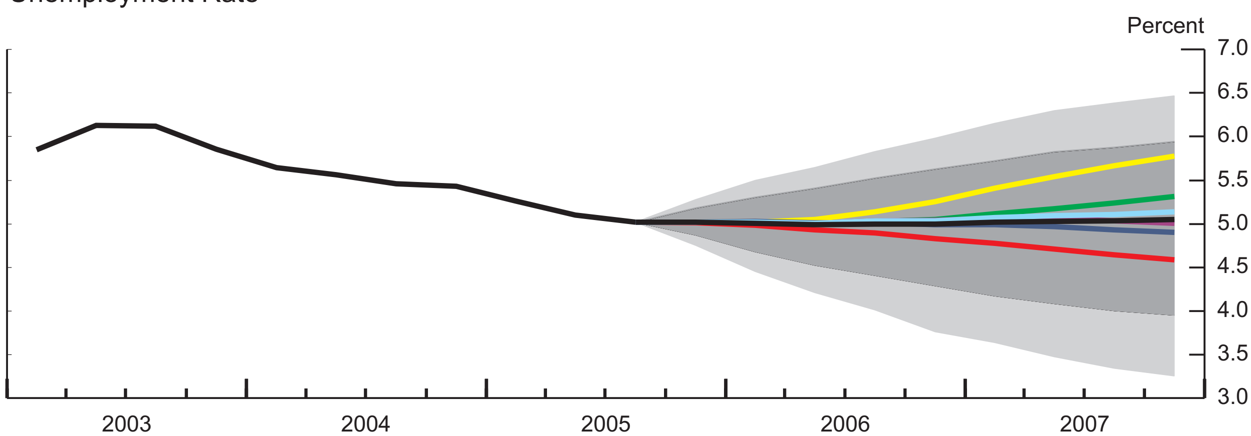
Confidence Intervals Based on FRB/US Stochastic Simulations
Scenarios Assume Baseline Federal Funds Rate

- Greenbook baseline
- Housing slump
- Housing slump with greater fallout
- Stronger aggregate demand
- Faster productivity growth
- Deteriorating inflation expectations
- Less inflationary pressure

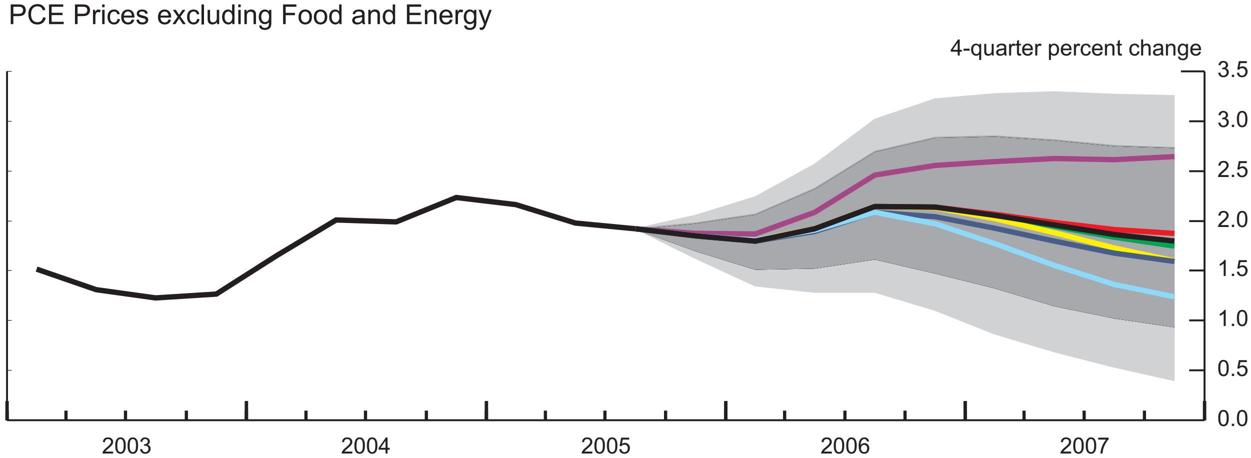
Real GDP



Unemployment Rate



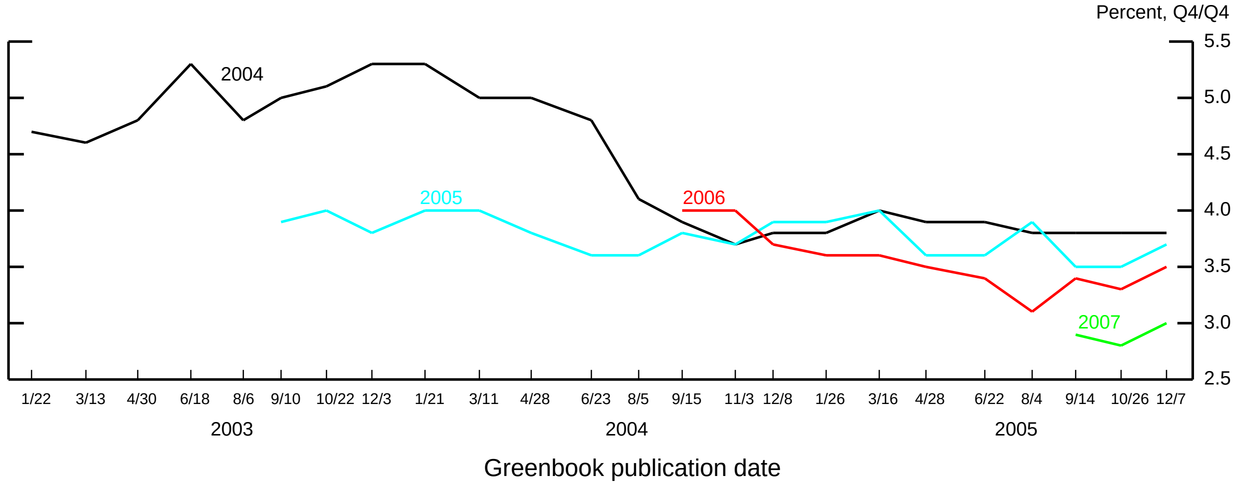
PCE Prices excluding Food and Energy



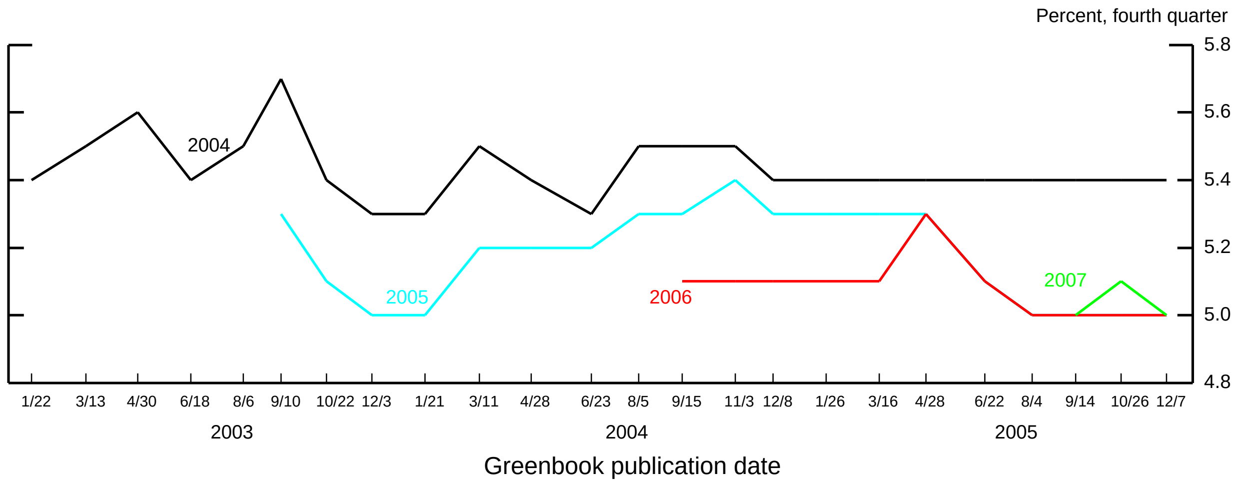
Class II FOMC - Restricted (FR)

Evolution of the Staff Forecast

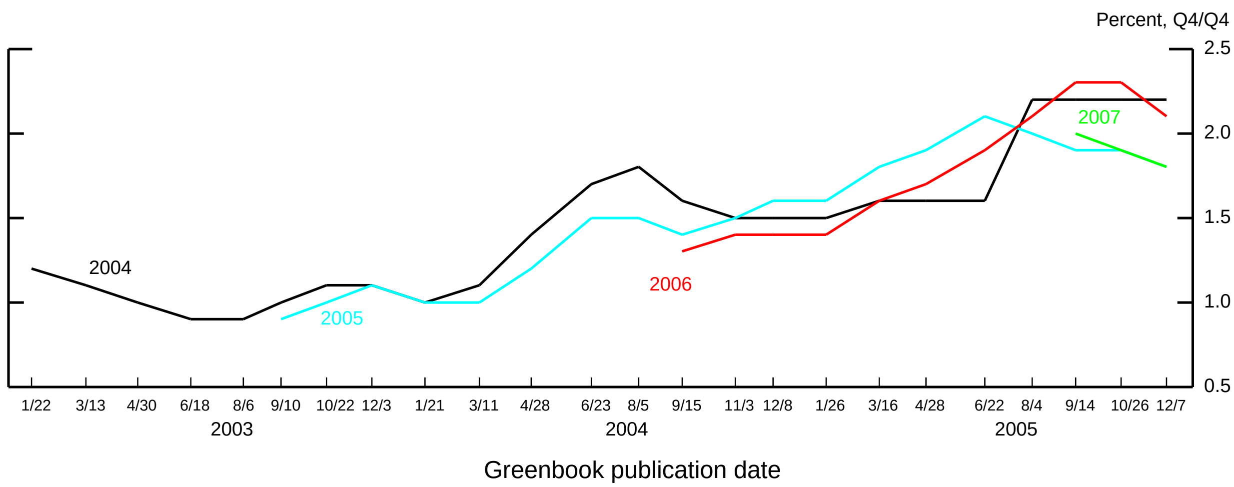
Change in Real GDP



Unemployment Rate



Change in PCE Prices excluding Food and Energy



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

	Nominal GDP		Real GDP		PCE price index		Core PCE price index		Unemployment rate[1]	
Interval	10/26/05	12/7/05	10/26/05	12/7/05	10/26/05	12/7/05	10/26/05	12/7/05	10/26/05	12/7/05
Quarterly										
2005:Q1	7.0	7.0	3.8	3.8	2.3	2.3	2.4	2.4	5.3	5.3
Q2	6.0	6.0	3.3	3.3	3.3	3.3	1.7	1.7	5.1	5.1
Q3	5.9	7.6	3.2	4.3	3.7	3.6	1.3	1.2	5.0	5.0
Q4	6.6	5.6	3.5	3.4	3.5	2.1	2.2	2.1	5.0	5.0
2006:Q1	5.9	6.5	4.0	3.7	1.3	1.9	2.4	2.2	5.0	5.0
Q2	5.9	6.0	3.6	3.5	2.2	2.5	2.4	2.2	5.0	5.0
Q3	5.1	5.7	2.9	3.4	2.1	2.1	2.2	2.1	5.0	5.0
Q4	4.8	5.3	2.7	3.2	2.0	2.0	2.2	2.0	5.0	5.0
2007:Q1	5.0	5.3	2.8	3.1	1.8	1.8	2.0	1.9	5.1	5.0
Q2	4.7	4.9	2.8	3.0	1.7	1.7	1.9	1.8	5.1	5.0
Q3	4.8	4.8	2.9	2.9	1.7	1.7	1.9	1.8	5.1	5.0
Q4	4.8	4.8	2.9	2.9	1.7	1.6	1.8	1.8	5.1	5.0
Two-quarter[2]										
2005:Q2	6.5	6.5	3.6	3.6	2.8	2.8	2.1	2.1	-.3	-.3
Q4	6.3	6.6	3.4	3.9	3.6	2.9	1.8	1.6	-.1	-.1
2006:Q2	5.9	6.3	3.8	3.6	1.8	2.2	2.4	2.2	.0	.0
Q4	4.9	5.5	2.8	3.3	2.0	2.1	2.2	2.1	.0	.0
2007:Q2	4.9	5.1	2.8	3.0	1.8	1.8	1.9	1.8	.1	.0
Q4	4.8	4.8	2.9	2.9	1.7	1.6	1.9	1.8	.0	.0
Four-quarter[3]										
2004:Q4	6.8	6.8	3.8	3.8	3.1	3.1	2.2	2.2	-.5	-.5
2005:Q4	6.4	6.5	3.5	3.7	3.2	2.8	1.9	1.8	-.4	-.4
2006:Q4	5.4	5.9	3.3	3.5	1.9	2.1	2.3	2.1	.0	.0
2007:Q4	4.8	5.0	2.8	3.0	1.7	1.7	1.9	1.8	.1	.0
Annual										
2004	7.0	7.0	4.2	4.2	2.6	2.6	2.0	2.0	5.5	5.5
2005	6.3	6.4	3.5	3.7	2.9	2.8	2.0	2.0	5.1	5.1
2006	5.9	6.2	3.5	3.6	2.4	2.4	2.2	2.0	5.0	5.0
2007	4.9	5.2	2.9	3.1	1.9	1.9	2.0	1.9	5.1	5.0

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

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

Item	2005				2006				2007						
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2005[1]	2006[1]	2007[1]
Real GDP	3.8	3.3	4.3	3.4	3.7	3.5	3.4	3.2	3.1	3.0	2.9	2.9	3.7	3.5	3.0
Previous	3.8	3.3	3.2	3.5	4.0	3.6	2.9	2.7	2.8	2.8	2.9	2.9	3.5	3.3	2.8
Final sales	3.5	5.6	4.7	1.1	4.8	3.9	3.1	2.5	2.5	3.3	3.0	2.6	3.7	3.5	2.8
Previous	3.5	5.6	4.0	1.8	4.4	3.6	3.0	2.5	2.1	3.0	2.7	2.3	3.7	3.4	2.5
Priv. dom. final purch.	4.1	4.5	5.0	1.8	5.2	3.9	3.5	3.3	3.5	3.5	3.4	3.4	3.9	4.0	3.5
Previous	4.1	4.5	3.6	1.6	5.0	3.7	3.3	3.2	3.0	3.0	3.1	3.1	3.5	3.8	3.0
Personal cons. expend.	3.5	3.4	4.2	.7	4.8	3.2	3.2	3.2	3.5	3.4	3.4	3.4	2.9	3.6	3.4
Previous	3.5	3.4	3.4	.6	3.9	3.1	3.1	3.1	3.1	3.1	3.1	3.1	2.7	3.3	3.1
Durables	2.6	7.9	10.5	-16.4	19.1	5.0	5.8	5.1	5.7	5.9	5.6	5.7	.6	8.6	5.8
Nondurables	5.3	3.6	3.6	4.3	3.7	3.7	3.7	3.7	4.0	4.0	3.9	3.9	4.2	3.7	3.9
Services	2.8	2.3	3.3	2.6	2.8	2.6	2.5	2.5	2.8	2.7	2.8	2.8	2.8	2.6	2.8
Residential investment	9.5	10.8	7.7	9.3	2.7	1.4	-1.1	-.3	-.4	.6	.3	-.2	9.3	.7	.1
Previous	9.5	10.8	5.9	6.9	2.0	1.5	-1.3	-1.0	-1.3	-1.0	-.7	.1	8.3	.3	-.7
Business fixed invest.	5.7	8.8	8.9	4.8	9.1	10.1	7.8	6.3	6.2	5.5	5.3	5.0	7.0	8.3	5.5
Previous	5.7	8.8	3.5	5.9	14.0	8.9	7.6	6.4	4.4	4.5	4.6	4.6	6.0	9.2	4.5
Equipment & software	8.3	10.9	10.9	2.2	7.7	10.4	7.7	6.8	7.4	6.8	6.4	6.0	8.0	8.2	6.7
Previous	8.3	10.9	3.7	3.8	14.5	8.7	7.6	6.3	5.5	6.1	6.1	6.0	6.6	9.2	5.9
Nonres. structures	-2.0	2.7	3.1	12.8	12.8	9.1	7.9	5.0	3.0	2.2	2.5	2.5	4.0	8.7	2.5
Previous	-2.0	2.7	2.9	12.1	12.7	9.7	7.5	6.9	1.3	.5	.8	.7	3.8	9.2	.8
Net exports[2]	-645	-614	-621	-639	-651	-647	-653	-673	-698	-699	-708	-728	-630	-656	-708
Previous[2]	-645	-614	-607	-612	-627	-626	-631	-647	-668	-665	-672	-690	-620	-633	-674
Exports	7.5	10.7	.8	11.5	3.6	5.0	4.6	6.4	2.7	4.9	5.0	6.8	7.6	4.9	4.8
Imports	7.4	-.3	2.1	11.8	4.9	2.4	4.4	8.5	7.1	3.3	5.1	8.5	5.2	5.0	6.0
Govt. cons. & invest.	1.9	2.5	3.2	1.6	3.7	1.7	1.4	1.7	1.5	1.5	1.5	1.5	2.3	2.1	1.5
Previous	1.9	2.5	3.3	3.5	3.2	2.0	1.7	1.6	1.5	1.5	1.5	1.4	2.8	2.1	1.5
Federal	2.4	2.4	8.1	.0	5.0	.8	.3	.6	.0	.0	.0	.0	3.2	1.7	.0
Defense	3.0	3.7	10.3	-5.8	9.3	2.1	1.1	.7	.0	.0	.0	.0	2.7	3.2	.0
Nondefense	1.1	-.2	3.6	12.9	-3.0	-1.8	-1.3	.4	.0	.0	.0	.0	4.2	-1.4	.0
State & local	1.6	2.6	.4	2.5	2.9	2.3	2.1	2.3	2.4	2.4	2.4	2.4	1.7	2.4	2.4
Change in bus. inventories[2]	58	-2	-13	50	21	10	21	43	62	52	52	63	23	24	57
Previous[2]	58	-2	-21	27	18	19	15	22	42	36	41	57	16	18	44
Nonfarm[2]	62	3	-8	51	21	9	20	42	61	52	51	63	27	23	57
Farm[2]	-2	-4	-4	-1	0	1	1	1	1	1	1	1	-3	1	1

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

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

Item	1999[1]	2000[1]	2001[1]	2002[1]	2003[1]	2004[1]	2005[1]	2006[1]	2007[1]
Real GDP	4.7	2.2	.2	1.9	4.0	3.8	3.7	3.5	3.0
Previous	4.7	2.2	.2	1.9	4.0	3.8	3.5	3.3	2.8
Final sales	4.2	2.9	1.5	.8	4.0	3.6	3.7	3.5	2.8
Previous	4.2	2.9	1.5	.8	4.0	3.6	3.7	3.4	2.5
Priv. dom. final purch.	5.3	4.3	1.0	1.1	4.4	4.8	3.9	4.0	3.5
Previous	5.3	4.3	1.0	1.1	4.4	4.8	3.5	3.8	3.0
Personal cons. expend.	4.9	4.1	2.8	1.9	3.8	3.8	2.9	3.6	3.4
Previous	4.9	4.1	2.8	1.9	3.8	3.8	2.7	3.3	3.1
Durables	7.3	4.7	10.8	1.2	9.2	5.2	.6	8.6	5.8
Nondurables	4.9	3.0	1.9	2.1	4.1	4.6	4.2	3.7	3.9
Services	4.4	4.5	1.6	1.9	2.5	3.1	2.8	2.6	2.8
Residential investment	3.6	-1.9	1.4	7.0	11.8	6.6	9.3	.7	.1
Previous	3.6	-1.9	1.4	7.0	11.8	6.6	8.3	.3	-.7
Business fixed invest.	7.7	7.8	-9.6	-6.5	5.6	10.9	7.0	8.3	5.5
Previous	7.7	7.8	-9.6	-6.5	5.6	10.9	6.0	9.2	4.5
Equipment & software	10.8	7.5	-9.0	-3.4	7.2	13.8	8.0	8.2	6.7
Previous	10.8	7.5	-9.0	-3.4	7.2	13.8	6.6	9.2	5.9
Nonres. structures	-.9	8.8	-11.1	-14.9	1.2	2.7	4.0	8.7	2.5
Previous	-.9	8.8	-11.1	-14.9	1.2	2.7	3.8	9.2	.8
Net exports[2]	-296	-379	-399	-471	-521	-601	-630	-656	-708
Previous[2]	-296	-379	-399	-471	-521	-601	-620	-633	-674
Exports	5.6	6.5	-11.9	3.8	6.0	6.1	7.6	4.9	4.8
Imports	12.1	11.2	-7.6	9.7	5.1	10.6	5.2	5.0	6.0
Govt. cons. & invest.	4.2	.4	5.0	4.0	1.9	2.1	2.3	2.1	1.5
Previous	4.2	.4	5.0	4.0	1.9	2.1	2.8	2.1	1.5
Federal	4.2	-2.2	6.4	7.8	5.5	4.2	3.2	1.7	.0
Defense	4.3	-3.5	6.5	8.4	7.5	4.9	2.7	3.2	.0
Nondefense	4.1	.3	6.3	6.8	1.6	2.8	4.2	-1.4	.0
State & local	4.2	1.7	4.2	2.1	.0	.9	1.7	2.4	2.4
Change in bus. inventories[2]	69	56	-32	12	15	52	23	24	57
Previous[2]	69	56	-32	12	15	52	16	18	44
Nonfarm[2]	72	58	-32	15	15	50	27	23	57
Farm[2]	-3	-1	0	-2	0	2	-3	1	1

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

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

Item	2005 Q1	2005 Q2	2005 Q3	2005 Q4	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2005[1]	2006[1]	2007[1]
Real GDP	3.8	3.3	4.3	3.4	3.7	3.5	3.4	3.2	3.1	3.0	2.9	2.9	3.7	3.5	3.0
Previous	3.8	3.3	3.2	3.5	4.0	3.6	2.9	2.7	2.8	2.8	2.9	2.9	3.5	3.3	2.8
Final sales	3.5	5.5	4.7	1.2	4.7	3.8	3.1	2.5	2.5	3.3	3.0	2.6	3.7	3.5	2.8
Previous	3.5	5.5	4.0	1.9	4.3	3.6	3.0	2.5	2.1	3.0	2.7	2.3	3.7	3.4	2.5
Priv. dom. final purch.	3.6	3.9	4.4	1.6	4.4	3.4	3.0	2.9	3.0	3.0	3.0	2.9	3.3	3.4	3.0
Previous	3.6	3.9	3.1	1.5	4.3	3.2	2.9	2.8	2.6	2.6	2.6	2.7	3.0	3.3	2.6
Personal cons. expend.	2.4	2.4	3.0	.5	3.3	2.2	2.3	2.2	2.4	2.4	2.4	2.4	2.1	2.5	2.4
Previous	2.4	2.4	2.4	.4	2.7	2.1	2.1	2.1	2.2	2.2	2.2	2.2	1.9	2.3	2.2
Durables	.2	.6	.8	-1.5	1.4	.4	.5	.4	.5	.5	.4	.5	.0	.7	.5
Nondurables	1.1	.7	.7	.9	.8	.8	.8	.8	.8	.8	.8	.8	.9	.8	.8
Services	1.2	1.0	1.4	1.1	1.2	1.1	1.0	1.0	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Residential investment	.5	.6	.5	.6	.2	.1	-.1	.0	.0	.0	.0	.0	.5	.0	.0
Previous	.5	.6	.3	.4	.1	.1	-.1	-.1	-.1	-.1	.0	.0	.5	.0	.0
Business fixed invest.	.6	.9	.9	.5	.9	1.1	.8	.7	.7	.6	.6	.6	.7	.9	.6
Previous	.6	.9	.4	.6	1.4	.9	.8	.7	.5	.5	.5	.5	.6	1.0	.5
Equipment & software	.6	.8	.8	.2	.6	.8	.6	.5	.6	.5	.5	.5	.6	.6	.5
Previous	.6	.8	.3	.3	1.1	.7	.6	.5	.4	.5	.5	.5	.5	.7	.5
Nonres. structures	-.1	.1	.1	.3	.3	.3	.2	.2	.1	.1	.1	.1	.1	.2	.1
Previous	-.1	.1	.1	.3	.3	.3	.2	.2	.0	.0	.0	.0	.1	.3	.0
Net exports	-.4	1.1	-.2	-.7	-.4	.1	-.2	-.7	-.9	.0	-.3	-.7	-.1	-.3	-.5
Previous	-.4	1.1	.3	-.3	-.5	.0	-.2	-.6	-.7	.1	-.2	-.6	.2	-.3	-.4
Exports	.7	1.1	.1	1.2	.4	.5	.5	.7	.3	.5	.5	.7	.8	.5	.5
Imports	-1.1	.0	-.3	-1.8	-.8	-.4	-.7	-1.4	-1.2	-.5	-.8	-1.4	-.8	-.8	-1.0
Govt. cons. & invest.	.4	.5	.6	.3	.7	.3	.3	.3	.3	.3	.3	.3	.4	.4	.3
Previous	.4	.5	.6	.7	.6	.4	.3	.3	.3	.3	.3	.3	.5	.4	.3
Federal	.2	.2	.6	.0	.3	.1	.0	.0	.0	.0	.0	.0	.2	.1	.0
Defense	.1	.2	.5	-.3	.4	.1	.1	.0	.0	.0	.0	.0	.1	.2	.0
Nondefense	.0	.0	.1	.3	-.1	.0	.0	.0	.0	.0	.0	.0	.1	.0	.0
State & local	.2	.3	.1	.3	.4	.3	.3	.3	.3	.3	.3	.3	.2	.3	.3
Change in bus. inventories	.3	-2.1	-.4	2.2	-1.0	-.4	.4	.7	.6	-.3	.0	.4	.0	-.1	.2
Previous	.3	-2.1	-.8	1.7	-.4	.0	-.1	.2	.7	-.2	.2	.5	-.2	-.1	.3
Nonfarm	.4	-2.1	-.4	2.1	-1.0	-.4	.4	.7	.6	-.3	.0	.4	.0	-.1	.2
Farm	-.1	-.1	.0	.1	.0	.0	.0	.0	.0	.0	.0	.0	.0	.0	.0

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

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

	2005				2006				2007						
Item	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2005[1]	2006[1]	2007[1]
GDP chain-wt. price index	3.1	2.6	3.1	2.2	2.7	2.4	2.2	2.0	2.2	1.9	1.8	1.8	2.7	2.3	1.9
Previous	3.1	2.6	2.6	3.0	1.8	2.2	2.1	2.1	2.2	1.9	1.9	1.8	2.8	2.1	1.9
PCE chain.-wt. price index	2.3	3.3	3.6	2.1	1.9	2.5	2.1	2.0	1.8	1.7	1.7	1.6	2.8	2.1	1.7
Previous	2.3	3.3	3.7	3.5	1.3	2.2	2.1	2.0	1.8	1.7	1.7	1.7	3.2	1.9	1.7
Energy	3.6	28.6	49.8	2.0	-2.8	6.1	1.7	.8	-.2	-.4	-.8	-1.3	19.4	1.4	-.6
Previous	3.6	28.6	50.2	24.7	-13.3	-1.2	-.6	-.9	-1.4	-1.4	-1.4	-1.5	25.7	-4.2	-1.5
Food	1.0	3.5	1.3	2.6	2.5	2.5	2.4	2.3	2.2	2.1	2.1	2.1	2.1	2.4	2.1
Previous	1.0	3.5	1.3	2.3	2.5	2.5	2.4	2.3	2.2	2.1	2.0	2.0	2.0	2.5	2.1
Ex. food & energy	2.4	1.7	1.2	2.1	2.2	2.2	2.1	2.0	1.9	1.8	1.8	1.8	1.8	2.1	1.8
Previous	2.4	1.7	1.3	2.2	2.4	2.4	2.2	2.2	2.0	1.9	1.9	1.8	1.9	2.3	1.9
CPI	2.5	4.0	5.3	2.5	2.0	2.8	2.3	2.1	2.0	1.9	1.8	1.8	3.5	2.3	1.9
Previous	2.5	4.0	5.3	4.4	1.2	2.3	2.2	2.1	1.9	1.9	1.8	1.8	4.0	1.9	1.8
Ex. food & energy	2.6	2.0	1.4	2.2	2.4	2.4	2.4	2.3	2.2	2.1	2.1	2.1	2.1	2.4	2.1
Previous	2.6	2.0	1.4	2.2	2.7	2.6	2.5	2.4	2.3	2.2	2.1	2.1	2.1	2.6	2.2
ECI, hourly compensation[2]	2.5	2.5	3.2	3.7	4.1	4.2	4.2	4.2	4.1	4.0	4.0	4.0	3.0	4.2	4.0
Previous[2]	2.5	2.5	3.4	3.9	4.2	4.3	4.2	4.1	4.0	3.9	3.9	3.9	3.1	4.2	3.9
Nonfarm business sector															
Output per hour	3.2	2.1	4.6	2.8	2.4	2.4	3.0	2.9	3.0	2.8	2.8	2.7	3.2	2.7	2.8
Previous	3.2	2.1	3.3	2.7	3.1	2.3	1.9	1.7	2.5	2.4	2.6	2.6	2.8	2.2	2.5
Compensation per hour	5.5	.9	3.7	4.4	4.6	5.3	5.5	5.5	5.3	5.1	5.1	5.0	3.6	5.3	5.1
Previous	5.5	3.9	4.1	3.9	5.0	5.3	5.4	5.3	5.2	5.1	4.9	4.9	4.4	5.3	5.0
Unit labor costs	2.2	-1.2	-.9	1.5	2.2	2.9	2.5	2.6	2.3	2.3	2.2	2.3	.4	2.5	2.3
Previous	2.2	1.8	.8	1.2	1.8	3.0	3.5	3.5	2.6	2.6	2.3	2.3	1.5	2.9	2.4

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

Other Macroeconomic Indicators

Item	2005 Q1	2005 Q2	2005 Q3	2005 Q4	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2005[1]	2006[1]	2007[1]
Employment and production															
Nonfarm payroll employment[2]	.5	.6	.5	.3	.7	.5	.4	.3	.2	.3	.2	.2	2.0	1.9	1.0
Unemployment rate[3]	5.3	5.1	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Previous[3]	5.3	5.1	5.0	5.0	5.0	5.0	5.0	5.0	5.1	5.1	5.1	5.1	5.0	5.0	5.1
GDP gap[4]	.7	.6	.4	.3	.2	.1	.0	.0	.0	.1	.2	.3	.3	.0	.3
Previous[4]	.7	.6	.6	.5	.3	.1	.2	.3	.3	.4	.4	.4	.5	.3	.4
Industrial production[5]	3.8	1.6	.9	3.1	8.3	6.4	5.0	3.7	2.9	2.7	2.8	2.9	2.4	5.9	2.8
Previous[5]	3.6	1.4	1.3	4.0	6.7	5.5	3.7	3.3	2.9	2.9	3.1	3.1	2.6	4.8	3.0
Manufacturing industr. prod.[5]	4.5	1.3	1.9	6.1	5.5	6.0	4.7	3.8	3.1	3.0	3.2	3.4	3.4	5.0	3.2
Previous[5]	4.0	1.0	2.3	4.8	5.2	4.8	3.7	3.5	3.3	3.2	3.4	3.4	3.0	4.3	3.3
Capacity utilization rate - mfg.[3]	78.7	78.5	78.5	79.2	79.8	80.4	80.8	81.0	81.1	81.1	81.1	81.3	79.2	81.0	81.3
Previous[3]	78.1	78.1	78.2	78.9	79.5	80.0	80.2	80.4	80.6	80.7	80.9	81.1	78.9	80.4	81.1
Housing starts[6]	2.1	2.0	2.1	2.0	2.1	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.1	2.1	2.0
Light motor vehicle sales[6]	16.5	17.2	17.9	15.8	17.0	17.0	17.1	17.0	17.0	17.1	17.1	17.1	16.9	17.0	17.1
Income and saving															
Nominal GDP[5]	7.0	6.0	7.6	5.6	6.5	6.0	5.7	5.3	5.3	4.9	4.8	4.8	6.5	5.9	5.0
Real disposable pers. income[5]	-3.4	.2	-.7	6.7	5.1	4.4	4.3	4.2	4.6	4.0	4.0	4.0	.6	4.5	4.2
Previous[5]	-3.4	1.5	1.7	1.8	6.5	4.9	3.8	3.8	4.5	3.7	3.2	4.1	.4	4.7	3.9
Personal saving rate[3]	.5	-.2	-1.5	.0	.1	.4	.6	.9	1.2	1.3	1.4	1.6	.0	.9	1.6
Previous[3]	.5	.1	-.3	.0	.6	1.0	1.2	1.4	1.7	1.9	1.9	2.1	.0	1.4	2.1
Corporate profits[7]	24.5	19.7	-18.1	58.6	15.0	3.8	1.9	-4.1	-3.1	-3.5	-3.9	-4.5	18.0	3.9	-3.7
Profit share of GNP[3]	10.5	10.9	10.1	11.2	11.5	11.4	11.3	11.1	10.9	10.6	10.4	10.2	11.2	11.1	10.2
Excluding FR Banks[3]	10.3	10.6	9.9	11.0	11.3	11.2	11.1	10.9	10.7	10.4	10.2	10.0	11.0	10.9	10.0
Net federal saving[8]	-298	-297	-408	-310	-354	-348	-345	-336	-369	-360	-364	-360	-328	-346	-363
Net state & local saving[8]	7	21	-4	16	24	28	31	34	33	32	31	32	10	29	32
Gross national saving rate[3]	13.4	13.1	13.1	13.6	13.3	13.5	13.6	13.7	13.5	13.5	13.4	13.4	13.6	13.7	13.4
Net national saving rate[3]	1.7	1.6	-1.2	1.9	2.0	2.2	2.3	2.4	2.1	2.1	2.0	2.0	1.9	2.4	2.0

1. Change from fourth quarter of previous year to fourth quarter of year indicated, unless otherwise indicated.
2. Change, millions.
3. Percent, annual values are for the fourth quarter of the year indicated.
4. Percent difference between potential and actual GDP; a positive number indicates that the economy is operating below potential; annual values are for the fourth quarter of the year indicated.
5. Percent change, annual rate.
6. Level, millions, annual values are annual averages.
7. Percent change, annual rate, with inventory valuation and capital consumption adjustments.
8. Billions of dollars, annual values are annual averages.

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

Item	Fiscal year				2005				2006				2007			
	2004[a]	2005[a]	2006	2007	Q1[a]	Q2[a]	Q3[a]	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
					Not seasonally adjusted											
Unified budget																
Receipts[1]	1880	2153	2296	2411	452	665	549	522	482	724	567	555	514	749	594	587
Outlays[1]	2293	2472	2641	2763	628	620	618	646	679	664	652	686	716	693	669	728
Surplus/deficit[1]	-413	-318	-346	-352	-177	45	-69	-123	-197	60	-85	-131	-201	56	-75	-141
Previous	*-413*	*-319*	*-354*	*-359*	*-177*	*45*	*-69*	*-125*	*-196*	*54*	*-87*	*-131*	*-202*	*53*	*-79*	*-144*
On-budget	-568	-494	-518	-537	-202	-37	-84	-182	-216	-23	-97	-191	-225	-31	-90	-203
Off-budget	155	175	172	186	25	83	15	58	19	83	12	60	24	87	15	62
Means of financing																
Borrowing	378	297	354	364	165	-43	73	112	180	-32	94	121	186	-27	84	131
Cash decrease	-1	1	1	0	2	-11	-2	10	15	-24	-0	10	15	-25	0	10
Other[2]	36	21	-9	-12	10	8	-1	1	2	-4	-8	-0	0	-4	-8	-0
Cash operating balance, end of period	36	36	35	35	22	33	36	26	10	35	35	25	10	35	35	25
					Seasonally adjusted annual rates											
NIPA federal sector																
Receipts	1933	2159	2372	2496	2197	2228	2158	2313	2357	2392	2425	2455	2486	2509	2532	2556
Expenditures	2348	2503	2711	2853	2495	2525	2566	2623	2711	2740	2770	2791	2855	2869	2896	2915
Consumption expenditures	711	760	808	839	760	763	784	788	809	815	821	826	840	844	848	852
Defense	474	510	542	566	509	512	529	524	543	549	553	557	566	569	572	575
Nondefense	237	250	266	273	251	251	255	265	266	267	268	269	274	275	276	277
Other spending	1637	1743	1903	2013	1735	1762	1782	1835	1902	1924	1949	1965	2014	2025	2048	2063
Current account surplus	-415	-344	-339	-357	-298	-297	-408	-310	-354	-348	-345	-336	-369	-360	-364	-360
Gross investment	99	106	113	115	101	107	109	109	114	114	114	114	115	115	115	115
Gross saving less gross investment[3]	-421	-352	-350	-365	-302	-307	-419	-318	-366	-359	-355	-346	-377	-367	-370	-364
Fiscal indicators[4]																
High-employment (HEB) surplus/deficit	-378	-332	-348	-365	-280	-288	-409	-312	-363	-360	-357	-349	-378	-367	-366	-358
Change in HEB, percent of potential GDP	0.7	-0.5	-0.0	-0.0	-0.6	0.0	0.9	-0.8	0.4	-0.1	-0.1	-0.1	0.2	-0.1	-0.0	-0.1
Fiscal impetus (FI) percent of GDP	0.8	0.3	0.4	0.0	0.0	0.1	0.1	0.1	0.2	0.1	0.0	0.0	-0.0	-0.0	0.0	-0.0
Previous	*0.8*	*0.3*	*0.5*	*0.0*	*0.0*	*0.1*	*0.1*	*0.1*	*0.2*	*0.1*	*0.0*	*-0.0*	*-0.0*	*0.0*	*0.0*	*-0.0*

1. Budget receipts, outlays, and surplus/deficit include corresponding social security (OASDI) categories. The OASDI surplus and the Postal Service surplus are excluded from the on-budget surplus and shown separately as off-budget, as classified under current law.
2. Other means of financing are checks issued less checks paid, accrued items, and changes in other financial assets and liabilities.
3. Gross saving is the current account surplus plus consumption of fixed capital of the general government as well as government enterprises.
4. HEB is gross saving less gross investment (NIPA) of the federal government in current dollars, with cyclically sensitive receipts and outlays adjusted to the staff's measure of potential output and the NAIRU. Quarterly figures for change in HEB and FI are not at annual rates. The sign on Change in HEB, as a percent of nominal potential GDP, is reversed. FI is the weighted difference of discretionary changes in federal spending and taxes in chained (2000) dollars, scaled by real GDP. The annual FI estimates are on a calendar year basis. Also, for FI and the change in HEB, positive values indicate aggregate demand stimulus.
a--Actual

Class II FOMC
Restricted (FR)

December 7, 2005

Change in Debt of the Domestic Nonfinancial Sectors
(Percent)

			Nonfederal						
				Households					
Period [1]	Total	Federal government	Total	Total	Home mortgages	Consumer credit	Business	State and local governments	Memo: Nominal GDP
Year									
2000	4.8	-8.0	8.3	8.6	8.2	10.8	9.3	1.3	4.6
2001	6.1	-0.2	7.5	8.6	9.5	7.6	6.0	8.9	2.7
2002	6.9	7.6	6.7	9.7	11.9	4.7	2.6	11.1	3.6
2003	8.1	10.9	7.5	9.9	12.3	4.5	4.4	8.2	6.1
2004	8.7	9.0	8.6	11.1	13.5	4.5	5.9	7.6	6.8
2005	9.0	7.0	9.5	10.7	13.1	3.7	7.9	9.3	6.5
2006	7.3	7.7	7.2	8.0	9.2	4.0	6.8	4.1	5.9
2007	6.5	7.4	6.3	6.5	7.2	4.2	6.9	2.5	5.0
Quarter									
2005:1	9.6	14.4	8.5	9.1	11.3	2.7	7.0	12.0	7.0
2	8.1	0.1	9.9	11.1	13.3	4.0	9.1	6.1	6.0
3	9.1	5.1	10.0	11.6	14.0	5.4	7.4	12.6	7.6
4	8.1	7.8	8.2	9.4	11.5	2.6	7.1	5.2	5.6
2006:1	8.8	14.7	7.5	8.5	9.8	4.1	6.8	4.7	6.5
2	6.1	1.0	7.2	7.9	9.2	3.8	6.7	4.7	6.0
3	6.7	6.5	6.8	7.5	8.6	4.0	6.5	3.3	5.7
4	6.7	7.9	6.5	7.0	7.9	4.0	6.4	3.3	5.3
2007:1	7.7	14.1	6.3	6.6	7.3	4.0	6.6	2.7	5.3
2	5.4	1.3	6.2	6.4	7.0	4.1	6.8	2.6	4.9
3	6.0	5.2	6.1	6.3	6.9	4.2	6.8	2.2	4.8
4	6.5	8.1	6.1	6.2	6.7	4.3	6.8	2.2	4.8

Note. Quarterly data are at seasonally adjusted annual rates.
1. Data after 2005:Q3 are staff projections. Changes are measured from end of the preceding period to end of period indicated except for annual nominal GDP growth, which is calculated from Q4 to Q4.

2.6.3 FOF

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

					2005		2006				2007			
Category	2004	2005	2006	2007	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Net funds raised by domestic nonfinancial sectors														
1 Total	1769.1	1821.7	1675.4	1672.8	1850.3	1729.2	2019.6	1397.7	1613.8	1670.5	1999.8	1372.4	1573.4	1745.8
2 Net equity issuance	-157.0	-351.2	-235.0	-164.0	-446.2	-356.0	-296.0	-228.0	-218.0	-198.0	-164.0	-164.0	-164.0	-164.0
3 Net debt issuance	1926.1	2172.9	1910.4	1836.8	2296.5	2085.2	2315.6	1625.7	1831.8	1868.5	2163.8	1536.4	1737.4	1909.8
Borrowing sectors														
Nonfinancial business														
4 Financing gap [1]	47.0	-93.5	20.1	198.8	-214.7	-154.7	-131.3	28.2	62.2	121.2	166.6	180.9	204.9	242.7
5 Net equity issuance	-157.0	-351.2	-235.0	-164.0	-446.2	-356.0	-296.0	-228.0	-218.0	-198.0	-164.0	-164.0	-164.0	-164.0
6 Credit market borrowing	434.3	619.5	575.6	626.4	608.0	592.4	579.7	575.4	573.3	573.9	599.1	628.2	634.2	644.0
Households														
7 Net borrowing [2]	1011.7	1090.6	897.0	790.0	1235.9	1038.8	957.9	913.3	879.1	837.6	798.3	787.4	785.6	788.9
8 Home mortgages	887.3	978.4	774.8	660.9	1106.6	943.2	831.7	794.5	757.3	715.5	673.7	659.8	655.1	655.1
9 Consumer credit	91.0	79.0	89.0	96.8	117.0	56.2	89.7	85.2	90.2	91.0	93.0	95.5	97.9	100.7
10 Debt/DPI (percent) [3]	111.4	118.5	121.6	122.7	119.9	120.5	121.1	121.5	121.9	122.2	122.4	122.6	122.8	123.0
State and local governments														
11 Net borrowing	118.2	155.7	74.8	46.8	220.7	94.0	86.8	86.8	62.8	62.8	50.8	50.8	42.8	42.8
12 Current surplus [4]	181.3	191.0	197.4	205.9	161.9	180.3	190.2	195.7	199.4	204.3	204.3	205.5	205.5	208.3
Federal government														
13 Net borrowing	361.9	307.1	363.1	373.6	231.9	359.9	691.2	50.2	316.7	394.2	715.6	70.1	274.9	434.1
14 Net borrowing (n.s.a.)	361.9	307.1	363.1	373.6	72.8	112.5	179.8	-31.7	94.0	121.0	185.9	-26.7	83.5	131.0
15 Unified deficit (n.s.a.)	400.7	323.8	353.3	361.6	69.1	123.4	197.0	-59.9	85.2	131.0	201.3	-55.7	75.1	140.9
Depository institutions														
16 Funds supplied	796.9	817.2	565.0	573.4	884.7	467.9	618.4	518.8	602.2	520.7	657.9	518.7	592.8	524.2
Memo (percentage of GDP)														
17 Domestic nonfinancial debt [5]	197.0	201.6	205.2	208.4	201.9	203.5	204.5	205.3	205.7	206.5	207.5	208.3	208.8	209.6
18 Domestic nonfinancial borrowing	16.4	17.4	14.4	13.2	18.2	16.3	17.8	12.3	13.7	13.8	15.8	11.1	12.4	13.4
19 Federal government [6]	3.1	2.5	2.7	2.7	1.8	2.8	5.3	0.4	2.4	2.9	5.2	0.5	2.0	3.1
20 Nonfederal	13.3	14.9	11.7	10.5	16.4	13.5	12.5	12.0	11.3	10.9	10.6	10.6	10.4	10.4

Note. Data after 2005: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.

2.6.4 FOF

International Developments

Economic growth abroad was considerably more vigorous in the third quarter than had been expected, especially in emerging market economies. Some of the strength reflected temporary factors, but some appears to be more persistent, and forward-looking indicators also suggest an improved outlook. Despite the stronger pace of activity, partial data for the fourth quarter indicate that foreign inflation will be somewhat lower than had been expected. We expect foreign inflation to remain around its current pace over the forecast period.

The spot price of West Texas intermediate crude oil is little changed on net since the November FOMC meeting and remains about $10 per barrel below its hurricane-related peak. Prices of near-term oil futures contracts are down a little since the time of the October Greenbook, resulting in a path for oil prices that rises in the near term and is approximately flat thereafter. Our projected path for the price of oil is a little lower in 2006 and a little higher in 2007 than in the October forecast.

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

Indicator	2005		Projection				
				2006			
	H1	Q3	2005: Q4	Q1	Q2	H2	2007
Foreign output	3.0	4.5	3.3	3.4	3.5	3.4	3.3
October GB	2.8	3.1	3.1	3.2	3.3	3.3	3.3
Foreign CPI	1.9	3.4	2.4	2.5	2.5	2.5	2.4
October GB	1.8	3.3	2.8	2.3	2.4	2.4	2.4

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

The average foreign exchange value of the dollar ticked up on balance over the intermeeting period, as the dollar appreciated against most of the major foreign currencies but depreciated against some of the currencies of our other important trading partners. We continue to expect the dollar to decline over the forecast period in response to the need to finance the large and growing U.S. current account deficit. The projected broad real dollar index moves down at an average annual rate of 1¾ percent over the next two years.

Net exports of real goods and services are estimated to have made a negative arithmetic contribution to the growth of U.S. GDP of about ¼ percentage point in the third quarter, as exports were flat and imports grew slightly. The contribution of net exports is expected to become more negative in the fourth quarter, subtracting about ¾ percentage point from real GDP growth, as a strong pickup in import growth is projected to outweigh a sizable gain in exports. Net exports are projected to subtract a little less than ½ percentage point from growth in both 2006 and 2007.

The U.S. current account deficit is estimated to have been nearly $790 billion at an annual rate in the third quarter and is expected to be about $875 billion, 6¾ percent of GDP, in the fourth quarter. The deficit is expected to widen to more than $1 trillion, about 7½ percent of GDP, in 2007.

Oil Prices

Over the intermeeting period, the spot price of West Texas intermediate (WTI) crude oil was volatile, partly reflecting changing assessments of winter heating demand in response to fluctuations in the weather. The spot price of WTI generally moved lower for much of the intermeeting period, but has increased of late to close at $59.95 per barrel on December 6, little changed from the time of the November FOMC meeting. The prices of oil futures contracts for delivery in the near term have edged down, possibly owing to the unwinding of risks associated with the just-ended hurricane season and to statements by OPEC representatives indicating that the cartel may maintain current production levels to allow oil inventories to build.

Nevertheless, oil prices remain elevated, as market participants continue to anticipate a tight oil market going forward. Although growth of world oil consumption has slowed this year, market analysts expect relatively robust growth next year, consistent with a buoyant outlook for the world economy. In addition, concerns regarding prospects for increases of OPEC production capacity and about potential supply disruptions continue to keep upward pressure on oil prices. The price of the far-dated futures contract (currently for delivery in December 2012) settled at $56.50 per barrel on December 6, about $1 per barrel higher than at the time of the October Greenbook. Crude oil and refined product prices are currently below their pre-Katrina levels, despite lingering disruptions—500,000 barrels per day of oil production in the Gulf of Mexico remains shut in and 800,000 barrels per day of refining capacity is still offline.

In line with NYMEX futures prices, our projection calls for the spot price of WTI to rise to nearly $63 per barrel by the end of 2006 and then to drop back about $1 per barrel over 2007. Relative to the oil price outlook in the October Greenbook, the current projection averages about $2.40 per barrel lower in the fourth quarter of 2005, $1.20 per barrel lower on average in 2006, and $0.50 per barrel higher on average in 2007. The projected path of the oil import price has been revised in a similar fashion. Our import price projection takes into account the prices of different grades of crude oil and the expectation of greater refined product imports in the near term due to domestic refinery outages.

International Financial Markets

The trade-weighted exchange value of the dollar rose only slightly over the intermeeting period, but individual exchange rate movements were mixed. The dollar appreciated about 3½ percent versus the yen, 2½ percent against the euro, and 1¾ percent versus sterling. In contrast, the dollar depreciated 1½ percent against the Canadian dollar and about 3½ percent versus the Mexican peso and the Brazilian *real*; the dollar was little changed against the currencies of the emerging Asian economies.

The current value of the broad real dollar is now slightly higher than the projection in the October Greenbook. Going forward, we continue to foresee downward pressures on the dollar stemming from the need to finance the growing U.S. current account deficit. As a result, we assume that the broad real dollar index will decline at an annual rate of about 1¾ percent over the forecast period. The projected path for the dollar is about ½ percent above that in the October Greenbook.

Ten-year sovereign yields edged down on balance over the intermeeting period in the euro area, the United Kingdom, and Japan. Equity indexes rose substantially in the major industrial countries and in many emerging markets. Euro-area stock prices rose 6 percent over the period; the Nikkei index surged 12 percent, to its highest level in five years. The price of gold rose about 11 percent, exceeding $500 per ounce for the first time since 1983. The increase did not appear to result from market expectations of future inflationary pressures, as the differences between nominal and inflation-indexed sovereign bond yields narrowed in Europe and in Japan as well as in the United States.

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

Foreign Industrial Countries

Real GDP growth in the foreign industrial countries is expected to average around 2½ percent over the forecast period, just below the stronger-than-expected 2.8 percent third-quarter growth rate. Our projection is slightly higher in the current and subsequent two quarters compared with the October Greenbook, as we judged that some of the surprise in the third-quarter growth rate will persist. The four-quarter change in consumer prices is expected to remain near 2 percent through mid-2006, reflecting previous increases in energy prices, but should decline to around 1½ percent thereafter.

The Canadian economy continues to expand at a robust pace. Real GDP rose at an annual rate of 3.6 percent in the third quarter, ½ percentage point faster than our previous forecast, and unemployment remains at a thirty-year low. A projected dip in GDP growth in the current quarter mainly reflects transitory inventory movements. The Bank of Canada tightened policy another 25 basis points, raising its target rate to 3.25 percent, on December 6. We assume that policy interest rates will be increased gradually through the third quarter of 2006. We project that growth will remain strong in the first half of next year before moderating slightly over the forecast period as the effects of the monetary policy tightening are felt. Headline twelve-month CPI inflation declined to 2.6 percent in October as gasoline prices fell sharply, and we expect inflation to drop further, to around 2 percent, later in the forecast period.

Third-quarter real GDP growth in the euro area, at 2.6 percent, was higher than expected. Although we think it is unlikely that the euro area will sustain this pace of growth, recent positive surveys and indicators have led us to raise our GDP growth forecast about ¼ percentage point for the near term. Growth is now projected to average about 1¾ percent over the entire forecast period. The European Central Bank (ECB) increased its official interest rate 25 basis points on December 1, its first policy move since June 2003. We assume that the ECB will increase its policy rates only 25 basis points more in 2006; this assumption is in line with recent statements by ECB officials and also appears to be consistent with market expectations. As a result of the tighter monetary policy, we lowered our growth forecast for 2007 slightly. Headline inflation is predicted to fall back below 2 percent in the second half of 2006 as the effect of higher energy prices wanes.

Japanese GDP growth slowed to 1.7 percent in the third quarter after a surge in the first half of the year. The outcome was a little higher than we had expected on the basis of the available monthly indicators, with the discrepancy in part due to stronger-than-expected inventory accumulation and government spending. We believe these factors are temporary, and we expect real GDP growth to slow a bit more, to about 1½ percent, a rate closer to our estimate of potential growth. We still do not expect headline inflation to turn positive on a sustained basis until the second half of 2006, and we maintain our assumption that the Bank of Japan will not raise interest rates until the third quarter of 2006.

In the United Kingdom, real GDP growth slowed to 1.6 percent in the third quarter, largely as a result of a decline in exports. As both investment and consumption growth have picked up over the past two quarters and house prices have resumed rising, we expect growth to recover in the fourth quarter to a near-trend rate of 2½ percent and to remain around this rate for the rest of the forecast period. Twelve-month inflation is projected to remain near 2½ percent in the current quarter but then to move below 2 percent by the second half of 2006 as the pass-through of the previous rise in energy prices is completed. We assume that this moderation in inflation will allow the Bank of England to keep its policy on hold throughout the forecast period.

Emerging Market Economies

We project that output growth in the emerging market economies will moderate from the heady 7 percent pace in the third quarter to 4½ percent in the fourth quarter and remain near that rate for the rest of the forecast period. This growth path is stronger than that in the previous Greenbook and reflects recent data, an improved outlook for global high-tech demand, and our expectation for more robust growth in the industrial economies.

Output growth in emerging Asia in the third quarter was 7½ percent, down only slightly from the second-quarter pace. The third-quarter strength was widespread and included a surge in exports across the region. We project that economic growth will average a healthy 5½ percent over the forecast period, noticeably higher than in the October Greenbook. Recent indicators suggest additional strength in demand for exports going forward, particularly for high-tech products, as well as greater-than-expected strength in consumption in some economies. For China, we still expect policy measures aimed at slowing investment in the first quarter of next year. Accordingly, Chinese GDP growth is expected to dip to 5½ percent in the first quarter, then pick back up to around 7½ percent over the rest of the forecast period, still considerably below the average 9 percent pace seen over the past few years.

The growth of output in Latin America was boosted to almost 7 percent at an annual rate in the third quarter by a sharp rebound in Mexican GDP arising from a reversal of the preceding quarter's decline in agricultural output. In contrast, Mexico's industrial sector remained weak. We expect Mexican real GDP growth to drop back to about 3 percent in the fourth quarter and then to increase to 3¾ percent in 2006 and 2007 as monetary conditions continue to be eased. Third-quarter GDP declined 4¾ percent in Brazil, where adverse weather contributed to a fall in agricultural output. We continue to expect Brazilian output to expand about 3¼ percent in each of the next two years as monetary policy eases further.

Recent data for the emerging market economies point to a continuation of twelve-month inflation at around 3¼ percent in the near term. However, a healthy growth outlook and the pass-through of high oil prices, partly reflecting reduced fuel subsidies in Asia, are expected to put upward pressure on prices. Over the forecast period, inflation for the emerging economies is expected to pick up to 3¾ percent in early 2006 before dropping back to 3½ percent by the end of 2007.

Prices of Internationally Traded Goods

Core import price inflation appears to have picked up significantly in the fourth quarter, as sizable increases in the prices of natural gas and other commodities more than offset the restraining effect of a stronger dollar. This projection incorporates a rise in the BLS monthly price index for core imports of just under 1 percent in October, which was led by a higher price for natural gas. Excluding natural gas, core import prices rose ¼ percent in October, an increase primarily reflecting higher prices for chemicals and other material-intensive goods.

For 2006, we project that core import price inflation will drop back to around 1½ percent, reflecting a decline in the price of natural gas and smaller increases in non-energy commodity prices. Core import prices decelerate further in 2007 as commodity prices are flat and the dollar depreciates only gradually. Our projection for core import price inflation is a bit higher than in the October Greenbook, as the restraining effect of the higher dollar is more than offset by a modest upward shift in the expected path of imported commodity prices.

Core export price inflation also is expected to increase sharply in the fourth quarter, largely as a result of higher prices for exports of intermediate materials and nonagricultural commodities. The BLS monthly price data for October show a jump in core export prices of ¾ percent, led by higher prices for exported chemicals and other industrial supplies. Our projection for the fourth quarter is more than 1 percentage point higher than in the previous Greenbook because of an increase in the projected path of prices for exports of materials and commodities. Core export price inflation is expected to moderate to 2½ percent in 2006 before declining even further to 1 percent in 2007, a pattern consistent with a projected deceleration of prices of intermediate goods and nonagricultural commodities.

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

Indicator	2005		Projection				
	H1	Q3	2005: Q4	2006			2007
				Q1	Q2	H2	
Exports							
Core goods	4.9	2.0	5.6	3.2	3.0	2.0	1.0
October GB	4.9	2.4	4.4	1.8	2.1	1.6	.9
Imports							
Non-oil core goods	3.4	.9	5.7	2.1	1.2	1.5	.7
October GB	3.4	1.0	5.4	2.1	1.1	1.2	.6
Excluding natural gas	3.3	-.3	3.1	1.5	1.9	1.7	.8
October GB	3.3	-.1	3.1	1.4	1.7	1.4	.8
Oil (dollars per barrel)	46.30	55.15	56.17	54.74	56.22	57.22	56.88
October GB	46.30	55.32	56.94	56.89	57.21	57.59	56.19

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

Trade in Goods and Services

Real net exports are projected to make a negative arithmetic contribution to real GDP growth of ¾ percentage point in the fourth quarter following a negative contribution of ¼ percentage point in the third quarter, as a sharp rebound in imports outweighs rapid growth of exports. After making a neutral contribution to growth for 2005 as a whole, net exports are projected to subtract about ⅓ percentage point from growth in 2006 and about ½ percentage point in 2007. Our projection of the contribution of real net exports has been significantly revised down from the October Greenbook for the second half of this year, mainly because of higher import growth, but it is little changed thereafter.

After contracting slightly in the second quarter, real imports of goods and services are estimated to have grown about 2 percent at an annual rate in the third quarter rather than declining slightly as projected in the October Greenbook. September nominal imports, particularly of industrial supplies, came in much stronger than expected, consistent with the upward revision to projected U.S. GDP growth. We had assumed only a modest depressing effect of the hurricanes on imports in the third quarter; the September import data suggest that the impact may have been even smaller than we had expected. Core imports are now projected to have expanded about 3½ percent in the third quarter, whereas imports of services contracted sharply.

In the fourth quarter, growth of real imports of goods and services is projected to jump to 11¾ percent, owing largely to a boost in oil imports from hurricane-related disruptions. Although crude-oil imports have been and will be diminished by ongoing refinery outages, the reduction is more than offset by an increase in imports of refined petroleum products. Imports of core goods are also expected to accelerate, supported by solid GDP growth. We project that imports of services will recover from their third-quarter dip and grow at a pace more in line with U.S. GDP and relative prices. In comparison with the October Greenbook, growth in real imports of goods and services in the fourth quarter is about 2¼ percentage points higher. The difference is almost entirely in oil imports and is a result of an increase in our estimate of the extent of the disruptions to oil production and refining in the Gulf region, suggesting that more oil is being imported to compensate.

In 2006, real import growth is expected to average around 5 percent, just below the 2005 pace, as a recovery in domestic oil production reduces oil imports. However, growth of core imports is projected to increase in response to a deceleration in import prices. In addition, imports of services are expected to rebound from their earlier slump. In 2007, the growth of real imports of goods and services rises as oil imports start to grow again. Core goods and services imports decelerate somewhat in response to slowing U.S. GDP growth in 2007, although core imports are supported by further declines in core import price inflation. Throughout this period, imports of computers and semiconductors are projected to rise steadily.

We estimate that growth in real exports of goods and services slowed significantly in the third quarter, to an annual rate of ¾ percent, down from the second quarter's double-digit pace. This stepdown in part reflects the effects of the Boeing strike on aircraft exports, which fell $2½ billion in September in nominal terms. Real core exports expanded only 1 percent in the third quarter, as the effects of the Boeing strike were compounded by the restraining effect on trade of Hurricanes Katrina and Rita. Real exports of services contracted in the third quarter.

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

Indicator	2005		Projection				
	H1	Q3	2005: Q4	2006 Q1	2006 Q2	2006 H2	2007
Real exports	9.1	0.8	11.5	3.6	5.0	5.5	4.8
October GB	9.1	1.8	12.5	4.2	4.9	5.6	5.3
Real imports	3.5	2.1	11.8	4.9	2.4	6.4	6.0
October GB	3.5	-.5	9.5	6.1	3.0	6.0	5.8

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

In the fourth quarter, we expect growth in real exports to pick up smartly, to 11½ percent. Real exports of core goods should rebound given the end of the Boeing strike and the dwindling effects from the hurricanes. Expansion of real exports of services is projected to recover to a pace more in line with growth of foreign GDP and relative prices. Growth in exports of computers and semiconductors is expected to remain firm. Our current-quarter forecast for real export growth, which is a little lower than in the October Greenbook, partly reflects the damping effect of a slightly stronger dollar on real exports of services. In addition, it now appears that Boeing is not currently expanding production to make up for deliveries missed during the strike.

Real exports of goods and services are projected to rise a little less than 5 percent in 2006 and 2007, significantly more slowly than the average 7½ percent rate expected for 2005. The slower pace of growth reflects a marked deceleration of core goods exports as the boost from dollar depreciation in 2003-04 wanes. The growth of services exports, which slumped this year, picks up a bit going forward to a pace more in line with growth of foreign GDP and relative prices. Exports of computers and semiconductors are expected to continue to grow briskly. For both years, small downward revisions to the forecast for total real exports reflect the negative effect of the upwardly revised path of the dollar.

Alternative Simulations

Although our baseline forecast has the broad real dollar depreciating slightly over the forecast period, the dollar's recent strength suggests that investor appetite for dollar-denominated assets may be greater than is implicit in the baseline forecast. Accordingly, in our alternative scenario, we use the FRB/Global model to examine the effects of an appreciation of the dollar that is induced by a favorable risk premium shock. The shock begins in 2006:Q1 and is scaled so that it generates a 10 percent rise in the broad real dollar in the absence of adjustment of domestic or foreign interest rates. We consider the effects of this shock under two alternative monetary policy assumptions: First, the federal funds rate is held unchanged from its baseline path, and second, U.S. monetary policy follows a Taylor rule.

When the federal funds rate is unchanged, the risk premium shock reduces U.S. real GDP growth by roughly 0.4 percentage point in 2006 and 2007 relative to the baseline. Output falls because U.S. exports become less competitive and because U.S. consumers substitute away from domestically-produced products toward imports. Core PCE price inflation drops roughly 0.2 percentage point in 2006:H1 in response to lower import prices and remains slightly below baseline over the remainder of the forecast period due to the restraining effect of weaker U.S. activity. While the trade balance initially improves because of J-curve effects, it deteriorates by roughly 0.3 percentage point of GDP by the latter part of the forecast period.

Under a Taylor rule, nominal interest rates decline roughly 50 basis points below baseline by the second half of 2006. Lower interest rates reduce the extent to which the dollar rises in response to the risk premium shock and also stimulate domestic demand, thus allowing the effect on real GDP growth to turn positive by the end of the forecast period. On average over the forecast period, core PCE price inflation falls a bit less below baseline in this simulation than in the case in which the federal funds rate is unchanged.

Alternative Scenarios:
10 Percent Real Dollar Appreciation
(Percent change from previous period, annual rate, except as noted)

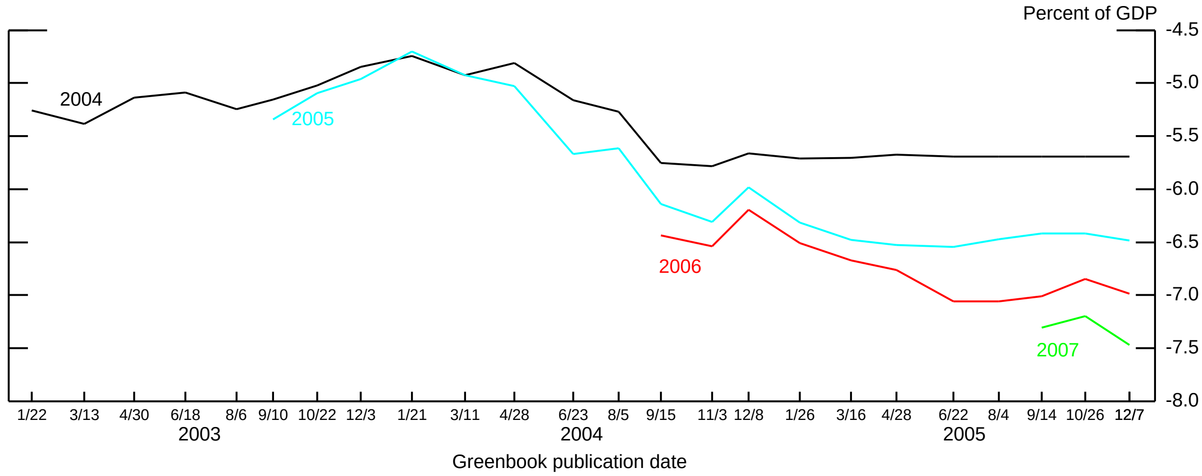
Indicator and simulation	2006		2007	
	H1	H2	H1	H2
U.S. real GDP				
Baseline	3.6	3.3	3.0	2.9
Unchanged federal funds rate	3.3	2.7	2.5	2.6
Taylor rule	3.3	2.9	2.9	3.1
U.S. PCE prices excluding food and energy				
Baseline	2.2	2.1	1.8	1.8
Unchanged federal funds rate	2.0	2.0	1.7	1.7
Taylor rule	2.0	2.1	1.7	1.8
U.S. trade balance (percent share of GDP)				
Baseline	-5.9	-5.9	-6.1	-6.1
Unchanged federal funds rate	-5.8	-6.0	-6.4	-6.4
Taylor rule	-5.8	-6.1	-6.5	-6.5

Note. H1 is Q2/Q4; H2 is Q4/Q2. In these simulations, the monetary authorities in major foreign economies adjust their policy rates according to a Taylor rule.

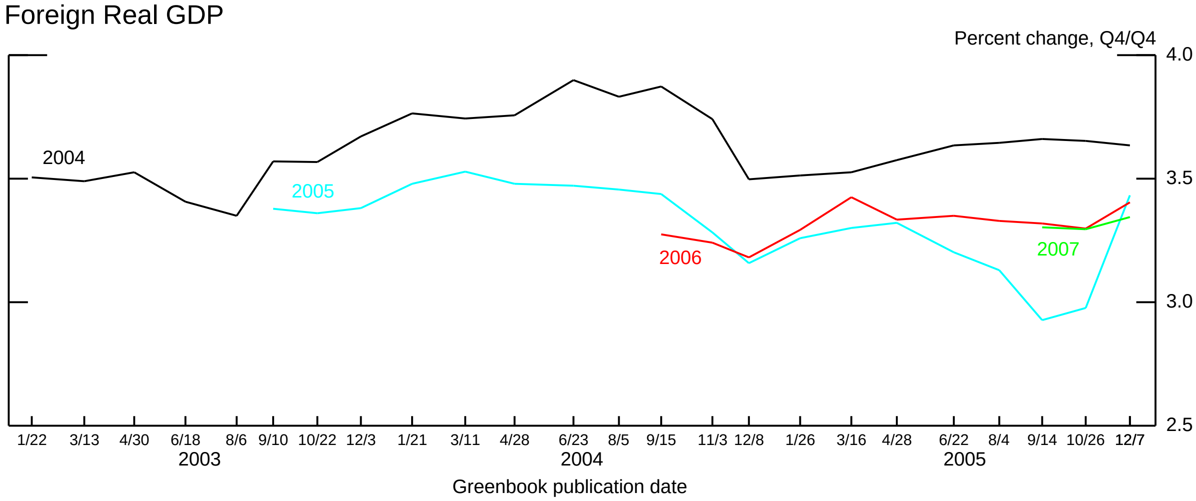
Class II FOMC -- Restricted (FR)

Evolution of the Staff Forecast

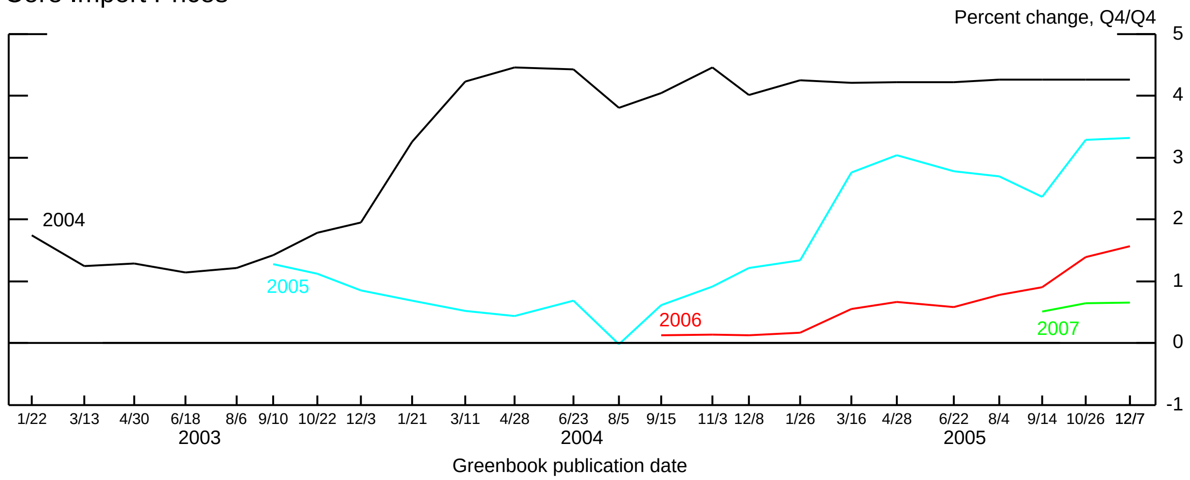
Current Account Balance



Foreign Real GDP



Core Import Prices



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

Measure and country	1999	2000	2001	2002	2003	2004	-----Projected---- 2005	2006	2007
REAL GDP (1)									
Total foreign	5.1	4.2	0.3	3.0	2.9	3.6	3.4	3.4	3.3
Industrial Countries	4.4	3.5	0.8	2.5	1.8	2.4	2.6	2.5	2.4
of which:									
Canada	5.9	4.1	1.3	3.6	1.7	3.3	3.0	3.2	3.1
Japan	0.2	3.2	-1.9	1.5	2.2	0.9	3.1	1.6	1.5
United Kingdom	3.4	3.2	2.0	2.1	3.1	2.5	1.8	2.3	2.5
Euro Area (2)	4.1	3.1	1.1	1.2	1.0	1.6	1.8	1.7	1.7
Germany	3.5	2.3	1.1	0.2	0.2	0.5	1.8	1.5	1.4
Developing Countries	6.1	5.2	-0.4	3.7	4.6	5.5	4.7	4.7	4.7
Asia	8.7	5.7	1.1	6.0	6.5	5.9	6.4	5.5	5.6
Korea	11.5	4.5	4.6	7.8	4.2	3.0	4.6	4.1	4.1
China	7.1	7.7	7.0	8.4	10.0	9.5	8.5	6.9	7.4
Latin America	4.4	4.4	-1.3	1.5	2.4	5.1	2.9	3.8	3.7
Mexico	5.5	4.8	-1.3	2.0	2.1	4.9	2.8	3.8	3.7
Brazil	3.4	3.8	-0.9	4.1	0.9	4.8	0.9	3.2	3.2
CONSUMER PRICES (3)									
Industrial Countries	1.2	1.8	0.9	2.1	1.3	1.8	1.7	1.4	1.5
of which:									
Canada	2.4	3.1	1.1	3.8	1.7	2.3	2.6	1.8	2.0
Japan	-0.9	-0.9	-1.0	-0.6	-0.3	0.6	-0.7	0.2	0.4
United Kingdom (4)	1.2	1.0	1.0	1.5	1.3	1.4	2.4	1.7	1.9
Euro Area (2)	1.5	2.5	2.1	2.3	2.0	2.3	2.3	1.7	1.7
Germany	1.1	1.7	1.5	1.2	1.2	2.1	2.2	1.4	1.5
Developing Countries	4.6	4.1	2.8	2.8	3.1	3.9	3.2	3.8	3.4
Asia	0.1	1.9	1.2	0.7	2.2	3.2	2.9	3.6	3.1
Korea	1.2	2.5	3.3	3.4	3.5	3.4	2.5	4.1	3.1
China	-1.0	1.0	-0.1	-0.5	2.7	3.3	1.6	3.4	2.9
Latin America	12.5	8.4	5.3	6.4	4.9	5.6	3.6	4.0	4.0
Mexico	13.4	8.7	5.1	5.2	3.9	5.3	3.0	3.6	3.7
Brazil	8.4	6.4	7.5	10.7	11.5	7.2	6.0	4.5	4.1

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

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

					Projected							
	2005				2006				2007			
Measure and country	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
REAL GDP (1)	Quarterly changes at an annual rate											
Total foreign	2.5	3.5	4.5	3.3	3.4	3.5	3.4	3.3	3.4	3.3	3.3	3.3
Industrial Countries	2.0	2.9	2.8	2.4	2.7	2.7	2.5	2.4	2.5	2.4	2.4	2.4
of which:												
Canada	2.0	3.4	3.6	3.0	3.6	3.5	3.0	2.9	3.1	3.1	3.1	3.1
Japan	6.3	3.3	1.7	1.4	1.5	1.6	1.6	1.6	1.5	1.5	1.5	1.4
United Kingdom	1.0	2.0	1.6	2.6	2.3	2.3	2.3	2.4	2.5	2.5	2.5	2.6
Euro Area (2)	1.3	1.6	2.6	1.6	1.7	1.8	1.8	1.7	1.7	1.7	1.7	1.7
Germany	2.4	0.9	2.5	1.3	1.4	1.4	1.6	1.4	1.4	1.4	1.4	1.4
Developing Countries	3.1	4.2	6.9	4.6	4.5	4.7	4.7	4.7	4.7	4.7	4.6	4.6
Asia	4.8	7.7	7.5	5.7	5.2	5.6	5.6	5.6	5.6	5.6	5.6	5.6
Korea	1.5	5.0	8.0	4.0	4.0	4.1	4.1	4.1	4.1	4.1	4.1	4.1
China	12.7	5.0	8.2	8.2	5.6	7.4	7.4	7.4	7.4	7.4	7.4	7.4
Latin America	1.2	0.5	6.8	3.3	3.8	3.9	3.9	3.9	3.7	3.7	3.7	3.7
Mexico	0.7	-1.3	8.9	3.1	3.7	3.8	3.8	3.8	3.7	3.7	3.7	3.7
Brazil	0.8	4.6	-4.7	3.1	3.2	3.3	3.3	3.3	3.3	3.2	3.2	3.2
CONSUMER PRICES (3)	Four-quarter changes											
Industrial Countries	1.5	1.4	1.8	1.7	1.9	1.8	1.5	1.4	1.4	1.5	1.5	1.5
of which:												
Canada	2.1	1.9	2.6	2.6	2.7	2.4	1.9	1.8	1.9	2.0	1.9	2.0
Japan	-0.2	-0.1	-0.3	-0.7	-0.2	-0.1	0.1	0.2	0.2	0.3	0.4	0.4
United Kingdom (4)	1.7	1.9	2.4	2.4	2.2	2.1	1.7	1.7	1.7	1.7	1.8	1.9
Euro Area (2)	2.0	2.0	2.3	2.3	2.5	2.2	1.9	1.7	1.7	1.7	1.7	1.7
Germany	1.7	1.6	2.1	2.2	2.5	2.2	1.6	1.4	1.4	1.4	1.4	1.5
Developing Countries	3.6	3.3	3.1	3.2	3.5	3.8	3.6	3.8	3.7	3.5	3.5	3.4
Asia	2.9	2.4	2.4	2.9	3.2	3.7	3.5	3.6	3.5	3.3	3.2	3.1
Korea	3.1	3.0	2.4	2.5	2.8	3.3	3.5	4.1	4.0	3.8	3.4	3.1
China	2.8	1.7	1.3	1.6	1.9	2.8	2.9	3.4	3.3	3.2	3.0	2.9
Latin America	4.9	5.0	4.4	3.6	3.9	3.7	3.8	4.0	4.0	4.0	4.0	4.0
Mexico	4.4	4.5	4.0	3.0	3.4	3.2	3.2	3.6	3.6	3.6	3.7	3.7
Brazil	7.4	7.7	6.2	6.0	5.2	4.5	4.9	4.5	4.4	4.3	4.2	4.1

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

Class II FOMC
Restricted (FR)

December 7, 2005

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1999	2000	2001	2002	2003	2004	------ Projected ------ 2005	2006	2007
NIPA REAL EXPORTS and IMPORTS									
Percentage point contribution to GDP growth, Q4/Q4									
Net Goods & Services	-1.0	-0.9	-0.2	-0.9	-0.1	-0.9	-0.1	-0.3	-0.5
Exports of G&S	0.6	0.7	-1.3	0.4	0.6	0.6	0.8	0.5	0.5
Imports of G&S	-1.6	-1.6	1.1	-1.3	-0.7	-1.5	-0.8	-0.8	-1.0
Percentage change, Q4/Q4									
Exports of G&S	5.6	6.5	-11.9	3.8	6.0	6.1	7.6	4.9	4.8
Services	5.3	1.8	-8.9	10.2	4.5	4.6	2.6	4.0	5.6
Computers	13.4	22.7	-23.5	-1.1	11.0	6.3	18.0	14.4	14.4
Semiconductors	34.6	27.6	-34.6	10.1	38.8	-6.1	12.6	17.0	17.0
Other Goods 1/	3.3	5.9	-10.2	0.7	4.5	7.8	9.1	4.2	3.3
Imports of G&S	12.1	11.2	-7.6	9.7	5.1	10.6	5.2	5.0	6.0
Services	6.6	10.6	-5.9	8.8	4.2	7.7	2.4	4.8	3.7
Oil	-3.4	13.3	3.7	3.8	1.5	9.7	2.2	-6.4	2.2
Computers	26.0	13.9	-13.6	13.2	16.8	22.2	14.1	17.5	17.5
Semiconductors	34.2	22.8	-51.1	11.0	-0.2	9.4	8.3	17.0	17.0
Other Goods 2/	12.9	10.5	-6.5	10.1	5.1	10.5	5.4	6.5	6.3
Billions of Chained 2000 Dollars									
Net Goods & Services	-296.2	-379.5	-399.1	-471.3	-521.4	-601.3	-630.1	-656.1	-708.2
Exports of G&S	1008.2	1096.3	1036.7	1013.3	1031.2	1117.9	1197.4	1265.4	1325.3
Imports of G&S	1304.4	1475.8	1435.8	1484.6	1552.6	1719.2	1827.4	1921.5	2033.5
Billions of dollars									
US CURRENT ACCOUNT BALANCE	-300.1	-416.0	-389.5	-475.2	-519.7	-668.1	-809.6	-926.0	-1042.8
Current Acct as Percent of GDP	-3.2	-4.2	-3.8	-4.5	-4.7	-5.7	-6.5	-7.0	-7.5
Net Goods & Services (BOP)	-263.4	-378.3	-362.7	-421.2	-494.8	-617.6	-721.4	-784.9	-850.7
Investment Income, Net	19.1	25.7	30.3	15.5	51.8	36.2	2.1	-37.2	-86.2
Direct, Net	78.2	94.9	115.9	99.8	121.8	127.9	121.9	128.5	148.1
Portfolio, Net	-59.1	-69.2	-85.5	-84.3	-70.0	-91.7	-119.9	-165.6	-234.2
Other Income & Transfers,Net	-55.8	-63.5	-57.1	-69.5	-76.7	-86.7	-90.3	-104.0	-105.9

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

Class II FOMC
Restricted (FR)

December 7, 2005

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

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

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

Class II FOMC
Restricted (FR)

December 7, 2005

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2005				Projected 2006				Projected 2007			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-0.4	1.1	-0.2	-0.7	-0.4	0.1	-0.2	-0.7	-0.9	-0.0	-0.3	-0.7
Exports of G&S	0.7	1.1	0.1	1.2	0.4	0.5	0.5	0.7	0.3	0.5	0.5	0.7
Imports of G&S	-1.1	0.0	-0.3	-1.8	-0.8	-0.4	-0.7	-1.4	-1.2	-0.5	-0.8	-1.4
Percentage change from previous period, s.a.a.r.												
Exports of G&S	7.5	10.7	0.8	11.5	3.6	5.0	4.6	6.4	2.7	4.9	5.0	6.8
Services	12.5	-0.4	-3.9	3.1	3.4	4.0	4.2	4.5	5.0	5.6	5.9	6.1
Computers	12.6	26.9	18.5	14.4	14.4	14.4	14.4	14.4	14.4	14.4	14.4	14.4
Semiconductors	-12.9	26.7	24.4	17.0	17.0	17.0	17.0	17.0	17.0	17.0	17.0	17.0
Other Goods 1/	6.1	14.9	1.0	15.3	2.4	4.3	3.6	6.3	0.3	3.5	3.4	6.2
Imports of G&S	7.4	-0.3	2.1	11.8	4.9	2.4	4.4	8.5	7.1	3.3	5.1	8.5
Services	3.7	4.4	-3.9	5.5	7.7	2.7	4.6	4.3	3.9	3.7	3.6	3.5
Oil	3.4	-24.5	-3.1	44.4	-10.1	-21.3	-11.2	22.3	11.3	-16.4	-5.2	23.9
Computers	11.3	13.7	13.5	17.9	17.5	17.5	17.5	17.5	17.5	17.5	17.5	17.5
Semiconductors	-7.9	8.3	17.8	17.0	17.0	17.0	17.0	17.0	17.0	17.0	17.0	17.0
Other Goods 2/	9.1	2.3	3.6	6.9	6.6	6.6	6.5	6.3	6.2	6.3	6.4	6.4
Billions of Chained 2000 Dollars, s.a.a.r.												
Net Goods & Services	-645.4	-614.2	-621.3	-639.4	-651.0	-647.1	-653.4	-673.0	-698.2	-698.8	-707.9	-727.7
Exports of G&S	1165.3	1195.4	1197.9	1231.0	1241.9	1257.1	1271.3	1291.3	1299.9	1315.7	1331.7	1353.8
Imports of G&S	1810.7	1809.6	1819.1	1870.4	1892.9	1904.2	1924.7	1964.3	1998.2	2014.5	2039.6	2081.6
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-794.7	-782.6	-788.0	-873.0	-905.4	-905.3	-929.3	-964.1	-1024.4	-1024.7	-1047.4	-1074.5
Current Account as % of GDP	-6.5	-6.3	-6.3	-6.8	-7.0	-6.9	-7.0	-7.1	-7.5	-7.4	-7.5	-7.6
Net Goods & Services (BOP)	-692.2	-693.3	-733.7	-766.3	-772.9	-773.5	-783.5	-809.7	-841.0	-840.4	-849.5	-871.9
Investment Income, Net	8.3	3.9	7.2	-11.0	-20.4	-29.7	-41.5	-57.0	-69.5	-80.4	-91.7	-103.1
Direct, Net	113.5	116.3	134.3	123.7	123.1	126.3	131.1	133.4	139.0	145.6	151.4	156.3
Portfolio, Net	-105.2	-112.4	-127.1	-134.7	-143.5	-156.0	-172.6	-190.4	-208.5	-226.0	-243.1	-259.4
Other Inc. & Transfers, Net	-110.7	-93.2	-61.5	-95.7	-112.1	-102.2	-104.3	-97.4	-114.0	-104.0	-106.3	-99.4

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