Prefatory Note

The attached document represents the most complete and accurate version available based on original files from the FOMC Secretariat at the Board of Governors of the Federal Reserve System.

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Class II FOMC - Restricted (FR)

Part 1

January 24, 2007

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Summary and Outlook

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

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Domestic Developments

On balance, the incoming spending data have been stronger than we anticipated at the time of the last Greenbook; in response, we have boosted our projection for the trajectory of aggregate activity in the near term. Most notably, the data suggest considerably more vigor in consumer spending late last year than we had expected, and we have carried forward some of that strength into the first quarter. Real GDP also appears to have received a boost in the fourth quarter from a pickup in defense spending and a surge in net exports, but we believe that these factors will prove transitory. The contraction in housing construction is unfolding very much as we had expected, but business fixed investment has come in to the soft side of our earlier expectation. All told, we have marked up our estimate for the growth of real GDP in the fourth and first quarters by an average of about ¾ percentage point at an annual rate, leaving it at about 2½ percent for last quarter and 2 percent for this quarter.

Beyond the near term, however, our forecast for the growth of real activity is little changed from the one in the last Greenbook. Although interest rates are projected to be a little higher than in our previous forecast and the dollar is assumed to be somewhat stronger, the additional restraint implied by these factors is offset by a significantly lower projected path for oil prices. As a result, we continue to forecast that real GDP will rise about 2¼ percent in 2007 and 2½ percent in 2008 and that the unemployment rate will gradually rise over the projection period. Because the level of activity is higher throughout the forecast period, the unemployment rate is now projected to remain below 5 percent through the end of next year.

Although the higher level of resource utilization in this projection would, by itself, have implied a slight upward adjustment to our inflation forecast, that effect is more than offset by the recent favorable readings on consumer prices, the lower projected path of energy prices, and the restraint on import prices from the higher assumed path of the dollar. Consequently, we have marked down our projection for core PCE inflation to 2.2 percent this year and 2.0 percent next year, 0.1 percentage point lower in each year than we forecast in the December Greenbook.

Key Background Factors

We now assume that the FOMC will keep the federal funds rate at 5¼ percent through the end of 2008 rather than nudging it down to 5 percent around the middle of next year as we had assumed in the previous Greenbook forecast. Financial market participants responded to the recent economic data by marking up the expected path of the federal funds rate beyond the near term by roughly 50 basis points, leaving the expected funds rate somewhat below 4¾ percent by the end of 2008. Interest rates on longer-term securities also have risen since the December Greenbook. We assume that long-term rates will drift up a bit further over the projection period as market participants come to recognize that the federal funds rate will remain higher than they currently anticipate.

Broad equity prices have increased about 1 percent since the December Greenbook. As in previous Greenbooks, we assume that share prices will increase at an annual rate of 6½ percent over the next two years, a pace that would roughly maintain risk-adjusted parity with the returns on long-term Treasury securities. Regarding house prices, we expect the OFHEO purchase-only price index to decelerate from a pace of about 4 percent in 2006 to a pace of 1 percent this year and next, leaving the path of house prices a shade below that in our last projection.

Our fiscal policy assumptions are unchanged. We continue to expect increases in defense spending to fund ongoing activities in Iraq and Afghanistan. Although the shift in control of the Congress may alter the composition of nondefense spending, we are assuming that it will not affect total spending. On the revenue side, we continue to assume that alternative minimum tax relief will be extended through 2008 without any offsetting tax increases or spending cuts. All told, we expect the unified budget to show a deficit of $232 billion in fiscal 2007, a touch less than in the previous fiscal year. For fiscal 2008, we project that the deficit will step up to $269 billion, as receipts decelerate to a pace more in line with that of nominal income and as spending increases only a little more slowly than its average in recent years.

On net, federal fiscal policy is expected to provide an impetus to real GDP growth of about 0.3 percentage point this year and 0.1 percentage point next year. In the state and local sector, where finances have improved, policy is expected to provide an impetus to real GDP growth of about ¼ percentage point this year and next.

The foreign exchange value of the dollar (as measured by the real trade-weighted index) is about 1¼ percent above where we thought it would be as of the December Greenbook. Going forward, with the dollar depreciating modestly as in past Greenbooks, its path is commensurately higher over the forecast period. We forecast that foreign real GDP will increase about 3½ percent this year and next, a touch faster than in the previous Greenbook.

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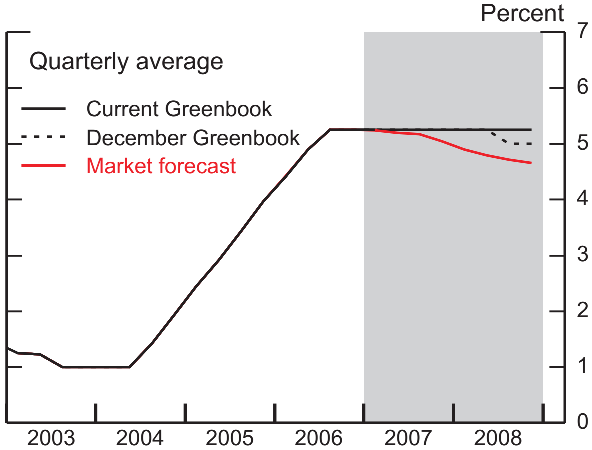
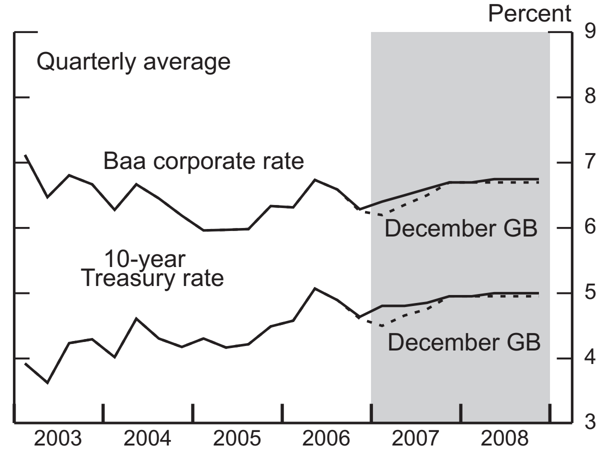
Key Background Factors Underlying the Baseline Staff Projection

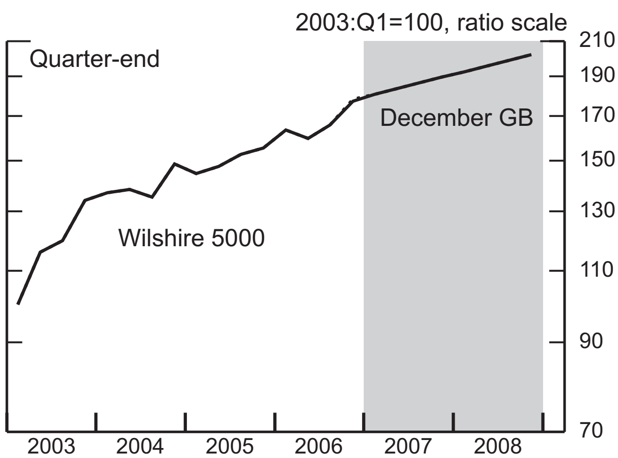
Federal Funds Rate



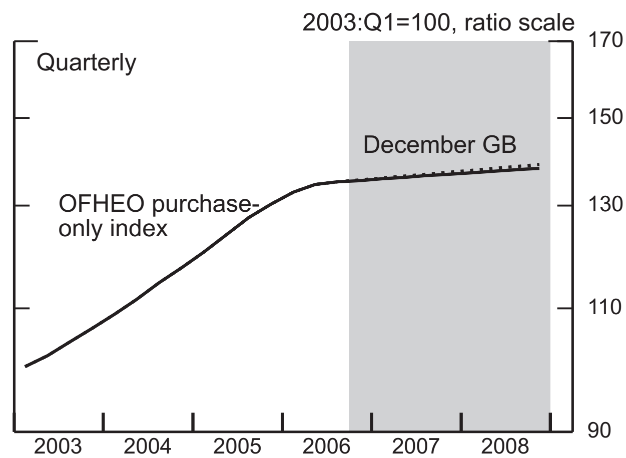
Long-Term Interest Rates



Equity Prices

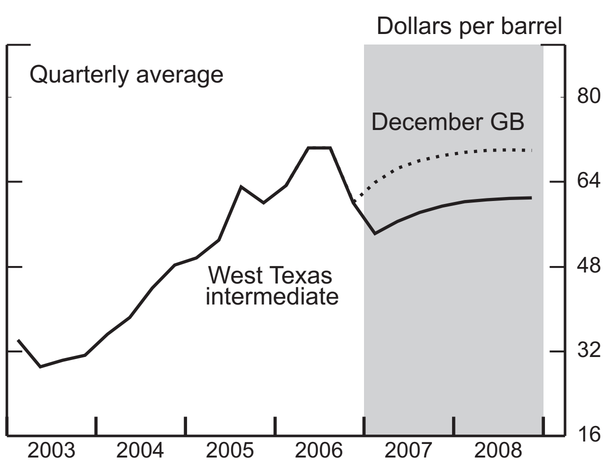


House Prices

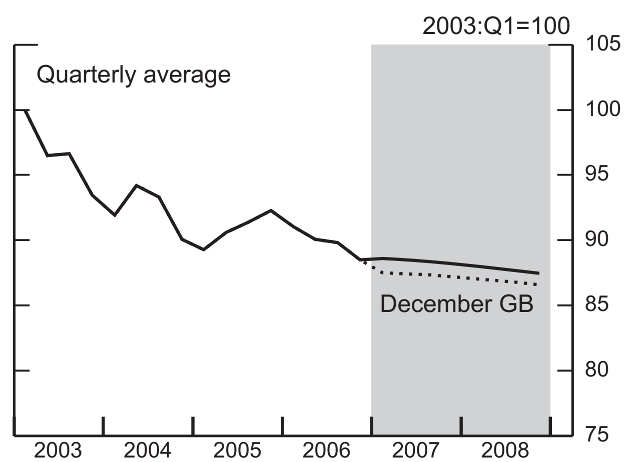


Note. The projection period begins in 2006:Q4.

Crude Oil Prices



Broad Real Dollar



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

Since the last Greenbook, the spot price of West Texas intermediate (WTI) crude oil has fallen more than $8 per barrel, to around $54 per barrel. This decline in spot prices appears to have resulted largely from warmer-than-usual weather this winter in North America and Europe. Further-dated oil futures prices also moved down noticeably in recent weeks, possibly reflecting a market reevaluation of Saudi Arabia's willingness to defend elevated oil prices. Nevertheless, with global demand likely to remain firm, we expect the price of WTI to rise gradually on a path consistent with futures quotes to about $61 per barrel by the end of next year. This projection leaves the price of WTI at the end of 2008 more than $9 per barrel below that in the last Greenbook.

Recent Developments and the Near-Term Outlook

As noted above, we have revised up sharply our estimate of real GDP growth in the fourth quarter, as data for consumer expenditures, federal defense spending, and the contribution of net exports all came in above our expectations. We now project that the Bureau of Economic Analysis (BEA) will report that real GDP increased at an annual rate of about 2½ percent in the fourth quarter, compared with our estimate of 1¼ percent in the December Greenbook. We have revised up projected growth of real GDP in the first quarter by considerably less—just ¼ percentage point—to 2 percent at an annual rate.

Extracting a meaningful signal from the quarterly pattern of real GDP growth is more challenging than usual because we believe that anomalies in the way that the BEA measures the output of the motor vehicle sector caused important distortions in the quarterly pattern of real GDP.[1] Perhaps the clearest picture of underlying aggregate demand can be gleaned from the recent behavior of private domestic final purchases (PDFP)—that is, the sum of consumption, residential investment, and business fixed investment. This aggregate is largely unaffected by the measurement anomalies in the motor vehicle sector and wholly unaffected by the swings in defense spending and net exports. We estimate that real PDFP increased in the fourth quarter at a pace of about 2 percent—nearly the same rate as in the second and third quarters of last year—and we expect this pace to continue into the current quarter. For the fourth and first quarters, this

[1] As reported in the national accounts, the real value of new motor vehicle output is currently estimated to have risen at an annual rate of nearly 29 percent in the third quarter even though motor vehicle assemblies declined at an annual rate of almost 600,000 units. As discussed in the December Greenbook, we believe that the BEA's measurement procedures are not correctly capturing motor vehicle production. According to our best estimates, these anomalies boosted reported GDP growth nearly 1 percentage point in the third quarter, will pull down reported growth in the fourth quarter by about the same amount, and will add a little in the first quarter.

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

Measure	2006:Q4		2007:Q1	
	Dec. GB	Jan. GB	Dec. GB	Jan. GB
Real GDP	**1.3**	**2.6**	**1.7**	**2.0**
Private domestic final purchases	1.2	2.1	1.3	2.0
Personal consumption expenditures	3.1	4.6	2.7	3.6
Residential investment	-23.8	-20.6	-20.3	-21.2
Business fixed investment	4.1	-1.4	3.9	3.9
Government outlays for consumption and investment	3.4	4.9	2.9	2.3
	Contribution to growth (percentage points)			
Inventory investment	-.9	-1.2	.3	.3
Net exports	.5	1.1	-.3	-.5

pace is about ¾ percentage point faster than we had projected in the December Greenbook.

That unexpected strength in private spending has been mirrored in the recent labor market data, which continue to provide little indication of the slowdown in the pace of hiring that we had expected. Increases in private payroll employment averaged 119,000 in the fourth quarter, close to the average pace in the previous two quarters, and the unemployment rate held steady at 4.5 percent in December. In response, we have revised up our forecast for private payroll gains in the first quarter by 25,000 per month, to an average of about 100,000 per month. We continue to expect the unemployment rate to average 4.6 percent in the first quarter.

Manufacturing production jumped 0.7 percent in December after some very soft readings in the fall. Forward-looking indicators point to more-modest monthly increases in manufacturing output—on the order of 0.2 percent—in coming months. Production of semiconductors, computers, and aircraft appears poised for continued solid gains, but output in sectors related to construction and motor vehicles appears likely to remain soft. As for motor vehicles, automakers' schedules call for only a slight increase in the production of light vehicles from the low pace of the fourth quarter. Production of medium and heavy trucks is expected to drop sharply this quarter after last year's surge to fill orders before the new EPA emission standards took effect at the beginning of this year.

On the spending side, the robust readings on retail sales in November and December boosted our estimate of the growth in real consumer outlays in the fourth quarter to an annual rate of about 4½ percent, well above the rate projected in the December Greenbook. The fundamentals have remained quite solid, with steady gains in employment, increases in stock market wealth in the second half of last year, and declines in energy prices that have raised real incomes and boosted consumer sentiment. Fourth-quarter spending seems to have been even stronger than what would have been consistent with these underlying fundamentals; we have reacted by carrying into the current quarter some of the unexplained strength in the growth of real consumption spending. Overall, we expect real consumption outlays to increase about 3½ percent this quarter, nearly 1 percentage point more than we had projected in the last Greenbook.

The latest data on new and existing home sales, as well as recent readings on homebuying attitudes and mortgage applications, appear consistent with our view that home sales are stabilizing, albeit at a level more than 13 percent below their peak in 2005. With the inventory of unsold new homes still high, the level of new home construction should remain quite weak. Single-family starts fell to an annual rate of 1.23 million units in the fourth quarter, and we anticipate a further drop, to 1.18 million units, in the first quarter. Accordingly, we project that real residential investment declined at an annual rate of more than 20 percent in the fourth quarter and will fall at a similar pace in the first quarter. These declines subtract about 1¼ percentage points from real GDP growth each quarter.

We estimate that real outlays for equipment and software fell at an annual rate of about 4 percent in the fourth quarter. This decline in E&S spending is accentuated by a drop in the volatile transportation sector, but the most recent indicators now suggest that real spending outside transportation and high-tech softened last quarter. However, the fourth-quarter decline in this so-called other category appears to have particularly reflected weakness in equipment related to construction and motor vehicle manufacturing. With orders remaining above shipments in the other category and imports of capital goods expected to move up, we forecast that real spending will rise modestly in the first quarter. Purchases of high-tech equipment and software are anticipated to accelerate in the first quarter after a fourth-quarter lull. Overall, we project that spending for equipment and software will increase at an annual rate of about 3½ percent this quarter, somewhat more than we anticipated in the December Greenbook.

We estimate that real outlays for nonresidential structures rose at an annual rate of 5 percent in the fourth quarter and will rise at a similar pace in the first quarter. This pace is a bit below that projected in the December Greenbook because of smaller increases in activity in the drilling and mining sector. Spending on drilling and mining remains at a high level; however, incoming data on drilling rigs in operation and footage drilled have been weaker than we were expecting.

Our near-term forecast of real nonfarm inventory investment continues to be distorted by the anomaly in the BEA's measurement of motor vehicle output that was noted above. When we abstract from this measurement issue, the automakers appear to have made some progress in paring stocks last quarter. Nevertheless, inventories of light vehicles at year-end appear still to have been above desired levels. We expect the pace of production currently scheduled for the first quarter to be restrained enough to allow the manufacturers to trim their inventories somewhat further. Outside motor vehicles, businesses appear to be making relatively prompt production adjustments in response to emerging buildups of inventories; we believe that, as a result of these adjustments, the level of inventory investment stepped down in the fourth quarter and will be little changed in the first quarter.

Real federal expenditures on consumption and investment are estimated to have increased at an annual rate of 8¾ percent in the fourth quarter, a noticeably faster pace than we had projected in the December Greenbook. This upward revision reflects indications from recent monthly Treasury statements that defense spending posted a larger increase than we had anticipated. We believe that much of this additional spending is a pull-forward of outlays that would have occurred later in the fiscal year. Accordingly, we have marked down our near-term forecast of the growth rate of real defense purchases, leading us to lower our forecast of growth in real total federal spending to about 2 percent in the current quarter. For the state and local sector, we estimate that real expenditures rose 2¾ percent in the fourth quarter, supported by continued gains in employment and a return to positive growth in construction outlays following a third-quarter dip. We expect real expenditures in the current quarter to increase about 2½ percent, with continued increases in both employment and construction.

Regarding the external sector, we estimate that real net exports added more than 1 percentage point to real GDP growth in the fourth quarter, more than double the contribution that we had forecast in the December Greenbook. Monthly data on exports have come in somewhat stronger than we had expected, and imports—notably of oil, other industrial supplies, and capital goods—were lower than we had anticipated. With the growth of exports expected to slow and imports expected to rebound, real net exports are projected to subtract about ½ percentage point from real GDP growth in the first quarter.

The incoming data on consumer price inflation have been favorable. The core PCE price index was unchanged in November, and our translation of the December CPI suggests an increase of 0.2 percent in core PCE prices last month. As a result, we have marked down our forecast of core PCE inflation in the fourth quarter 0.5 percentage point, to 2.1 percent, and in the first quarter we have revised down the forecast 0.2 percentage point, to 2.2 percent. Although consumer energy prices rose in December, they were down substantially for the fourth quarter as a whole, and the recent decline in oil prices points to some further retreat in consumer energy prices this quarter. As a result, we project that overall PCE prices will rise at an annual rate of about 2 percent in the current quarter after declining at a ¾ percent pace in the fourth quarter.

The Longer-Term Outlook for the Economy

As the restraint from housing diminishes this year, economic growth is expected to move back up toward our estimate of the growth in potential output. Relative to the December Greenbook, our forecast for the growth of real GDP this year and next is little changed, as the effect of lower oil prices is about offset by slightly higher interest rates and a higher path for the dollar.

Household spending. After increasing 3¾ percent last year, consumption growth is expected to slow to an annual rate of about 2¾ percent this year and next. That slowdown reflects a diminishing impetus to PCE growth from household wealth and a greater drag on spending from past increases in interest rates. In addition, we expect that households will gradually bring their spending back into line with fundamentals after a period of unexplained strength. With the growth of real disposable income running ahead of spending, we project that the saving rate will rise from negative ¾ percent in the fourth quarter of last year to 1 percent by the end of 2008. Our forecast of real PCE growth in the second half of this year and in 2008 is a little stronger than it was in the December

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

Measure	2006: H2	2007: H1	2007	2008
Real GDP	**2.3**	**2.2**	**2.3**	**2.5**
Previous	1.7	2.0	2.2	2.5
Final sales	2.9	2.0	2.2	2.5
Previous	2.1	1.9	2.1	2.5
PCE	3.7	3.0	2.8	2.7
Previous	3.0	2.5	2.5	2.6
Residential investment	-19.6	-15.2	-8.8	2.0
Previous	-21.3	-14.0	-7.6	1.4
BFI	4.1	5.8	5.1	4.2
Previous	6.7	4.1	3.9	4.1
Government purchases	3.3	2.2	2.1	1.9
Previous	2.7	2.7	2.4	1.9
Exports	7.2	5.2	5.1	5.1
Previous	5.9	5.5	5.4	5.6
Imports	1.8	5.1	5.0	5.1
Previous	3.0	3.9	4.2	5.1
	Contribution to growth (percentage points)			
Inventory change	-.6	.1	.1	-.0
Previous	-.4	.0	.1	.0
Net exports	.5	-.2	-.2	-.3
Previous	.1	-.0	-.1	-.2

Greenbook, the strength largely reflecting the lagged effects of the faster pace of real income growth that we now project over the first half of this year.

As noted earlier, the inventory of unsold new homes remains high. Accordingly, we forecast that single-family housing starts will remain weak in 2007, averaging 1.2 million units. That level of starts should go a long way toward eliminating the excess stock of unsold new homes, given our forecast that sales will stabilize and begin to edge up in the middle of this year. As the inventory adjustment proceeds, we expect single-family starts to turn up and to reach a pace of 1.3 million units by the end of 2008. In the multifamily sector—where construction activity has been relatively stable in recent years—we expect starts to average about 330,000 units this year and 350,000 units next year. Putting together the pieces, we project that real residential investment will fall another 8¾ percent this year, before rising 2 percent next year.

Business spending. Real spending on equipment and software (E&S) is projected to accelerate from a growth rate of 4¼ percent in 2006 to 5¼ percent in 2007 and 5¾ percent in 2008. Among other factors, the step-up in E&S growth reflects a partial recovery of spending on transportation equipment following last year's decline: Although outlays for medium and heavy trucks are expected to be held down this year by a payback for last year's bulge, purchases of aircraft by domestic airlines should turn up sharply this year. In addition, we expect continued solid increases in spending on high-tech equipment, as telecommunications service providers further expand their fiber optic networks and as businesses continue to invest in information technology equipment to improve the efficiency of their business processes. Outside the transportation and high-tech categories, we expect growth in real equipment spending to slow from about 3¾ percent in 2006 to 2 percent this year and then to edge up to about 2¼ percent in 2008; this contour largely reflects the pattern of changes in the growth of business output.

After rising 12¼ percent in 2006, real outlays for nonresidential structures are expected to decelerate to a pace of 4¾ percent this year and 1 percent next year. Incoming information on construction outlays for nonresidential buildings suggests that spending growth has downshifted, and our projection for next year brings growth in this component of nonresidential structures closer to its long-run average. Drilling and mining activity is projected to flatten out at a high level by the end of the forecast period; our projection for this component is down slightly from the December Greenbook, reflecting the lower path of energy prices.

Although there are some signs that inventories were elevated in a number of sectors toward the end of last year, most businesses appear to be responding quickly to keep inventories well aligned with sales, so we expect any imbalances to be short-lived. Consequently, we project that inventories will be a roughly neutral influence on real GDP growth this year and next.

Government spending. Real federal expenditures on consumption and investment are expected to increase 1½ percent this year and 1¼ percent next year. Across both years, increases in real defense spending average about 2 percent, and real nondefense outlays are projected to remain flat. Our projection for defense spending is predicated on the assumption that the Administration will ask for, and the Congress will approve, a further increase in the level of funding.

In the state and local sector, real spending is expected to increase about 2½ percent this year and 2¼ percent next year. Although these projected increases are down slightly from last year's rate, they are noticeably above the very subdued pace that prevailed during the previous several years. State and local governments appear to have stepped up the rate of increase in their spending in response to the improvements in their finances that occurred in recent years.

Net exports. Both real exports and real imports are projected to increase at annual rates of about 5 percent over the forecast period. Relative to the last Greenbook, the projected growth rate of exports has been revised down a little owing to the higher path for the dollar; at the same time, our projection of real import growth has been revised up a bit, reflecting the higher dollar and stronger U.S. demand. Because the volume of imports is larger than that of exports, these projected growth rates imply that real net exports will subtract about ¼ percentage point from real GDP growth both this year and next, a little more than in the December Greenbook. *(The International Developments section provides more detail on the outlook for the external sector.)*

Aggregate Supply, the Labor Market, and Inflation

We continue to assume that structural productivity will increase 2½ percent per year over the forecast period and that the growth rate of potential output will edge down from 2.7 percent in 2006 to 2.5 percent in 2008. This slowdown reflects our assumptions of a steepening downward trend in labor force participation and a slowdown in the rate of growth of the working-age population.

With a higher projected level of actual real GDP over the forecast period and unchanged estimates of potential output, we have revised up our projection of the GDP gap (meaning more-intensive utilization of resources). Indeed, the below-trend output growth that we anticipate this year will not suffice to push the level of GDP below the level of potential. In addition, the unemployment rate at the end of the projection period remains a touch below our estimate of the NAIRU.

Productivity and the labor market. Productivity growth stepped down last year, as firms made only small adjustments to the rate of increase in their labor input in the latter part of the year despite the slower pace of output growth. We expect employers to reduce

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

Measure	1974-95	1996-2000	2001-04	2005	2006	2007	2008
Structural labor productivity	**1.5**	**2.5**	**3.0**	**2.5**	**2.6**	**2.5**	**2.5**
Previous	1.5	2.5	3.0	2.5	2.6	2.5	2.5
Contributions[1]							
Capital deepening	.7	1.4	.6	.5	.7	.6	.6
Previous	.7	1.4	.6	.5	.7	.6	.6
Multifactor productivity	.5	.8	2.1	1.8	1.7	1.7	1.7
Previous	.5	.8	2.1	1.8	1.7	1.7	1.7
Labor composition	.3	.3	.3	.3	.2	.2	.2
MEMO							
Potential GDP	3.0	3.3	2.9	2.6	2.7	2.6	2.5
Previous	3.0	3.3	2.9	2.6	2.7	2.6	2.5

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

1. Percentage points.

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

Measure	2005	2006	2007	2008
Output per hour, nonfarm business	2.5	1.5	2.4	2.6
Previous	2.5	1.2	2.6	2.7
Nonfarm private payroll employment	1.6	1.5	.7	.4
Previous	1.6	1.4	.5	.4
Household survey employment	1.9	2.1	.4	.5
Previous	1.9	1.8	.2	.5
Labor force participation rate[1]	66.1	66.3	66.0	65.7
Previous	66.1	66.2	65.8	65.6
Civilian unemployment rate[1]	5.0	4.5	4.8	4.9
Previous	5.0	4.5	5.0	5.1
MEMO				
GDP gap[2]	-.0	.4	.1	.1
Previous	-.0	.1	-.3	-.3

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

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

Measure	2005	2006	2007	2008
PCE chain-weighted price index	3.1	1.9	2.2	2.1
Previous	3.1	2.0	2.8	2.1
Food and beverages	2.1	2.3	2.9	2.2
Previous	2.1	2.6	2.5	2.3
Energy	21.2	-3.9	1.8	2.2
Previous	21.2	-4.7	9.5	1.1
Excluding food and energy	2.1	2.3	2.2	2.0
Previous	2.1	2.4	2.3	2.1
Consumer price index	3.7	2.0	2.4	2.2
Previous	3.7	2.0	3.1	2.2
Excluding food and energy	2.1	2.7	2.4	2.2
Previous	2.1	2.8	2.5	2.3
GDP chain-weighted price index	3.1	2.6	2.6	2.3
Previous	3.1	2.5	2.6	2.4
ECI for compensation of private industry workers[1]	2.9	3.2	4.0	4.0
Previous	2.9	3.2	4.1	4.1
Compensation per hour, nonfarm business sector	4.1	4.9	4.9	4.9
Previous	4.1	4.9	5.1	5.0
Prices of core nonfuel imports	2.2	2.9	1.5	1.0
Previous	2.2	2.9	2.1	1.0

1. December to December.

the pace of hiring in coming quarters. Consequently, productivity is forecast to rise about in line with its trend this year and next, whereas payroll employment gains are expected to slow to about 60,000 per month in the second half of 2007 and in 2008.[2] These projected employment gains are below our estimate of the pace needed to absorb the projected increases in the labor force; accordingly, we expect the unemployment rate to rise to 4.9 percent by the end of 2008.

Prices and wages. Core PCE inflation is expected to edge down to 2.2 percent this year and 2 percent next year, 0.1 percentage point less each year than anticipated in the

[2] We estimate that the monthly pace of payroll employment growth consistent with no change in the unemployment rate will slow from about 110,000 in 2006 to roughly 80,000 in 2008.

December Greenbook. Although resource utilization is higher than it was in the last forecast, incoming consumer price data have been favorable, and the projected paths of both energy and import prices are lower than they were in the last Greenbook. The deceleration in core prices reflects the same factors as in previous Greenbooks: the waning indirect effects of earlier increases in energy prices, declining relative import prices, and a slowdown in the rate of increase of shelter prices. Overall PCE prices are expected to increase 2.2 percent in 2007 and 2.1 percent in 2008, close to the rates of increase in core prices in those years.

Hourly compensation in the nonfarm business sector is expected to increase about 5 percent this year and next.[3] These projections are a touch below those in the December Greenbook, as the downward revision to overall consumer price inflation more than offsets the effects of a slightly tighter labor market. The employment cost index is forecast to increase 4 percent in 2007 and 2008, bringing it into better alignment with hourly compensation in the nonfarm business sector.

Financial Flows and Conditions

Domestic nonfinancial debt is estimated to have risen at an annual rate of 7½ percent in the fourth quarter of 2006, about the same as for the year as a whole. We expect debt growth to continue apace in the current quarter before slowing to an average annual rate of around 6 percent over the rest of projection period. That reduction in debt growth reflects a broad-based slowdown in borrowing by households, businesses, and state and local governments.

Household debt is projected to expand at an annual rate of 6 percent in the first quarter of this year, which would be the slowest quarterly rise in nearly a decade. We expect household debt to decelerate a touch more over the forecast period, as mortgage borrowing in 2007 and 2008 is restrained by sluggish home price appreciation. Although the extraordinary growth in household debt in recent years has pushed the financial obligations ratio well above its historical range, household balance sheets appear to remain healthy overall, and delinquency rates on most types of consumer and mortgage loans have moved up only slightly from their recent lows. Nevertheless, higher mortgage

[3] The House has passed an increase in the federal minimum wage. This bill boosts the hourly minimum from its current level of $5.15 an hour to $5.85 an hour sixty days after the bill is signed into law, to $6.55 a year later, and to $7.25 a year after that. As in the last Greenbook, we assume that the first increase will go into effect in the second quarter. However, we anticipate that these increases will have only a small effect on hourly compensation growth—less than 0.1 percentage point in each year—because the wages of only a few workers will be affected by the higher federal wage floor.

rates and lackluster house price appreciation are expected to put some downward pressure on household credit quality over the forecast period.

Growth of nonfinancial business debt is estimated to have stepped up to a robust annual rate of 10¼ percent in the fourth quarter of 2006, boosted by the additional debt associated with elevated levels of cash-financed mergers and acquisitions and share repurchases. We expect that the growth of business debt will drop back to an average of 7 percent in 2007 and 2008, as M&A and share repurchase activity returns to more-typical levels. Debt defaults will likely tick up from their extraordinarily low levels as profit growth is projected to slow and corporate leverage is expected to increase somewhat.

Federal debt rose moderately in the fourth quarter, bringing its growth for the year as a whole to 4 percent. The growth of federal debt is projected to pick up to about 5½ percent in 2008 as the unified deficit widens. In the state and local government sector, issuance for advance refunding as well as new capital projects was quite strong in the fourth quarter of 2006. We expect new capital issuance to remain robust over the forecast period, although a drop in issuance for advance refunding as interest rates rise causes debt growth to ease somewhat this year and next.

M2 is estimated to have expanded 5 percent in 2006, a bit less than the growth of nominal GDP because of a modest drag from the rise in opportunity costs. With opportunity costs expected to decline over the forecast period, M2 is projected to rise at an average pace of 5¼ percent in 2007 and 2008, a shade faster than the rate of growth projected for nominal GDP.

Alternative Simulations

In this section, we evaluate several alternatives to the staff forecast using simulations of the FRB/US model. In the first scenario, the recent strength in consumer spending is assumed to be more persistent than we anticipate in the baseline forecast. We then focus on downside risks to aggregate demand—that the pace of business equipment spending will not pick up as we expect and that the ongoing slump in the housing market will prove deeper than we project. The next set of simulations considers the implications of alternative assumptions about aggregate supply, including a lower NAIRU, slower productivity growth, and faster trend labor force growth. We evaluate each of these risks under the assumption that monetary policy responds to changes in the outlook according

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

Measure and scenario	2006	2007		2008	
	H2	H1	H2	H1	H2
Real GDP					
Greenbook baseline	2.3	2.2	2.4	2.5	2.5
Buoyant consumer spending		2.8	3.2	3.5	3.2
Weak investment		1.8	1.9	1.9	1.9
More extensive housing correction		2.1	1.8	2.0	2.3
Lower NAIRU		2.4	2.6	2.8	2.8
Slower productivity growth		1.9	1.5	1.3	1.3
with stable participation		2.2	2.2	2.3	2.3
Market-based federal funds rate		2.2	2.4	2.7	2.8
Unemployment rate[1]					
Greenbook baseline	4.5	4.7	4.8	4.9	4.9
Buoyant consumer spending		4.6	4.6	4.5	4.3
Weak investment		4.7	4.9	5.1	5.2
More extensive housing correction		4.7	4.9	5.1	5.2
Lower NAIRU		4.7	4.7	4.8	4.7
Slower productivity growth		4.7	4.8	5.1	5.2
with stable participation		4.7	4.8	4.9	5.0
Market-based federal funds rate		4.7	4.8	4.9	4.8
Core PCE inflation					
Greenbook baseline	2.1	2.2	2.1	2.0	2.0
Buoyant consumer spending		2.2	2.1	2.0	2.1
Weak investment		2.2	2.1	2.1	2.1
More extensive housing correction		2.2	2.1	2.0	2.0
Lower NAIRU		2.1	1.9	1.7	1.7
Slower productivity growth		2.3	2.3	2.2	2.3
with stable participation		2.3	2.4	2.4	2.4
Market-based federal funds rate		2.2	2.1	2.1	2.1
Federal funds rate[1]					
Greenbook baseline	5.3	5.3	5.3	5.3	5.3
Buoyant consumer spending		5.5	5.9	6.4	6.7
Weak investment		5.2	5.0	4.8	4.7
More extensive housing correction		5.3	5.0	4.7	4.6
Lower NAIRU		5.2	5.1	4.9	4.8
Slower productivity growth		5.6	5.7	5.7	5.4
with stable participation		5.4	5.5	5.6	5.6
Market-based federal funds rate		5.2	5.1	4.8	4.7

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

to an estimated version of the Taylor rule. In the final scenario, we assume that monetary policy follows the path implied by quotes from the futures market.

Buoyant consumer spending. At least by the lights of some of our models, consumer expenditures advanced more rapidly last year than would have been expected given income, wealth, and interest rates. In contrast to our baseline view that household spending will gradually come back into better alignment with fundamentals, in this scenario the recent surprising strength is assumed to persist, and outlays expand in line with income. As a result, the personal saving rate remains below zero rather than rising to 1 percent as in the baseline. Under these conditions, real GDP increases about 3 percent this year and 3¼ percent in 2008, and the unemployment rate continues to move down rather than rising as in the baseline. In response to the further tightening of labor and product markets, the federal funds rate moves up to 6¾ percent next year. Inflation is up only slightly relative to baseline, largely because expectations remain well anchored but also because the rise in the funds rate causes a modest appreciation of the dollar and thus lowers import prices. If demand continued to outstrip supply past 2008, however, inflation would move up more noticeably.

Weak investment. Recent readings on orders and shipments have come in weaker than we expected, but we view this slowdown as likely to prove temporary, in part because we believe firms have ample investment opportunities and are not financially constrained given the high level of profits. However, the sizable cash positions of firms could be a signal that the return on new capital is not in fact viewed as that favorable; moreover, businesses may have recently become more cautious about their capital expenditures pending a resolution of the slowdown in the housing market. In this scenario, real E&S outlays are projected to continue to advance at their estimated average pace since the spring of less than 1 percent per year, compared with 5½ percent in the baseline. In addition, real investment in nonresidential construction levels out more quickly than in the staff forecast. The slower pace of business spending causes real GDP to expand by a little less than 2 percent both this year and next, and the unemployment rate rises a bit more than in the baseline, to 5¼ percent. As a result, the federal funds rate falls to 4¾ percent next year. Inflation is slightly above baseline next year despite the additional slack and stable inflation expectations because of the combined effects of dollar depreciation and smaller productivity gains arising from less capital deepening.

More-extensive housing correction. In the baseline forecast, we expect construction activity to begin to recover later this year and house prices to be roughly unchanged from here on out. In this scenario, we adopt a considerably less sanguine view of the housing market by considering the implications of a 20 percent decline in nominal house prices over the next two years. Such a decline would eliminate most of the current overvaluation in house prices that is suggested by one model monitored by the staff, and by itself would shave about $4½ trillion from household net worth by the end of 2008. In addition, residential investment continues to decline through mid-2008 and is off about 9 percent relative to baseline by late 2008. The reduction in overall demand stemming from weaker construction activity and the restraint on consumer spending from lower wealth and other multiplier effects are sufficient to raise the unemployment rate to 5¼ percent by the end of next year. As households continue to adjust to the loss in wealth, a further rise in the unemployment rate in 2009 would be likely. Monetary policy eases in response to weaker real activity, pushing the funds rate to 4½ percent by late next year. Inflation is virtually unchanged over the forecast period but would be expected to moderate more noticeably in 2009.

Lower NAIRU. On balance, hourly compensation gains over the past year remained moderate despite elevated readings on consumer price inflation and a labor market that, by the staff's estimate, was persistently tight. In this scenario, we take on board the view that these conditions indicate greater slack in labor and product markets; specifically, we assume that the NAIRU gradually declined to 4¼ percent over the past few years rather than holding steady at 5 percent as in the baseline. This additional margin of slack causes the projected deceleration in prices to be more pronounced, and core inflation falls to 1¾ percent next year. Monetary policy responds by gradually lowering the federal funds rate to 4¾ percent by late 2008, enough to provide a mild stimulus to real activity through lower real interest rates. As a result, real GDP growth is somewhat stronger than in the baseline, and the unemployment rate stays close to 4¾ percent rather than rising as in the baseline.

Slower productivity growth. Measured labor productivity appears to have increased modestly in recent quarters, in contrast to the robust gains seen in previous years. Although we estimate that structural labor productivity is now expanding more slowly than it did earlier in the decade, we have not written down figures as low as some of our statistical models might suggest. In this scenario, we adopt these alternative estimates and assume that structural labor productivity is increasing about 2 percent per year, ½ percentage point below baseline. This assumption implies less-favorable prospects for future household income and corporate earnings; as a result, consumer spending, residential investment, and business outlays grow more slowly than in the baseline. Real

GDP increases only 1½ percent on average this year and next. This shortfall relative to baseline is somewhat larger than the downward revision to potential output, partly because the less-favorable prospects for growth are assumed to come as a surprise to financial-market participants and therefore to depress equity values. Slower structural productivity growth also implies larger increases in trend unit labor costs, and so core inflation remains roughly stable at 2¼ percent rather than moderating as in the baseline. Reflecting the offsetting influences of greater slack and higher inflation, monetary policy is little changed.

Slower productivity growth and stable participation. Although we may be overestimating the contribution to potential output from labor productivity, we may also be underestimating the contribution from an expanding labor force. This scenario builds on the previous one by combining slower productivity growth with a flat labor force participation rate, in contrast to the baseline assumption that the participation rate will fall steadily owing to demographic factors. The combination of these two adjustments leaves the growth of potential output little changed from baseline even though the sources of trend growth are changed considerably. For this reason, real activity is only slightly weaker than baseline in this scenario. Nevertheless, inflation is still elevated relative to baseline because the slower structural productivity growth translates into more-rapid increases in trend unit labor costs. As a result, monetary policy is somewhat more restrictive.

Market-based federal funds rate. Quotes from futures markets suggest that investors expect a policy stance that is easier than the baseline assumption in the second half of 2007 and 2008. Were the funds rate to decline to a bit below 4¾ percent, as the market expects, real GDP growth would rise to 2¾ percent in 2008, and inflation would be slightly above baseline.

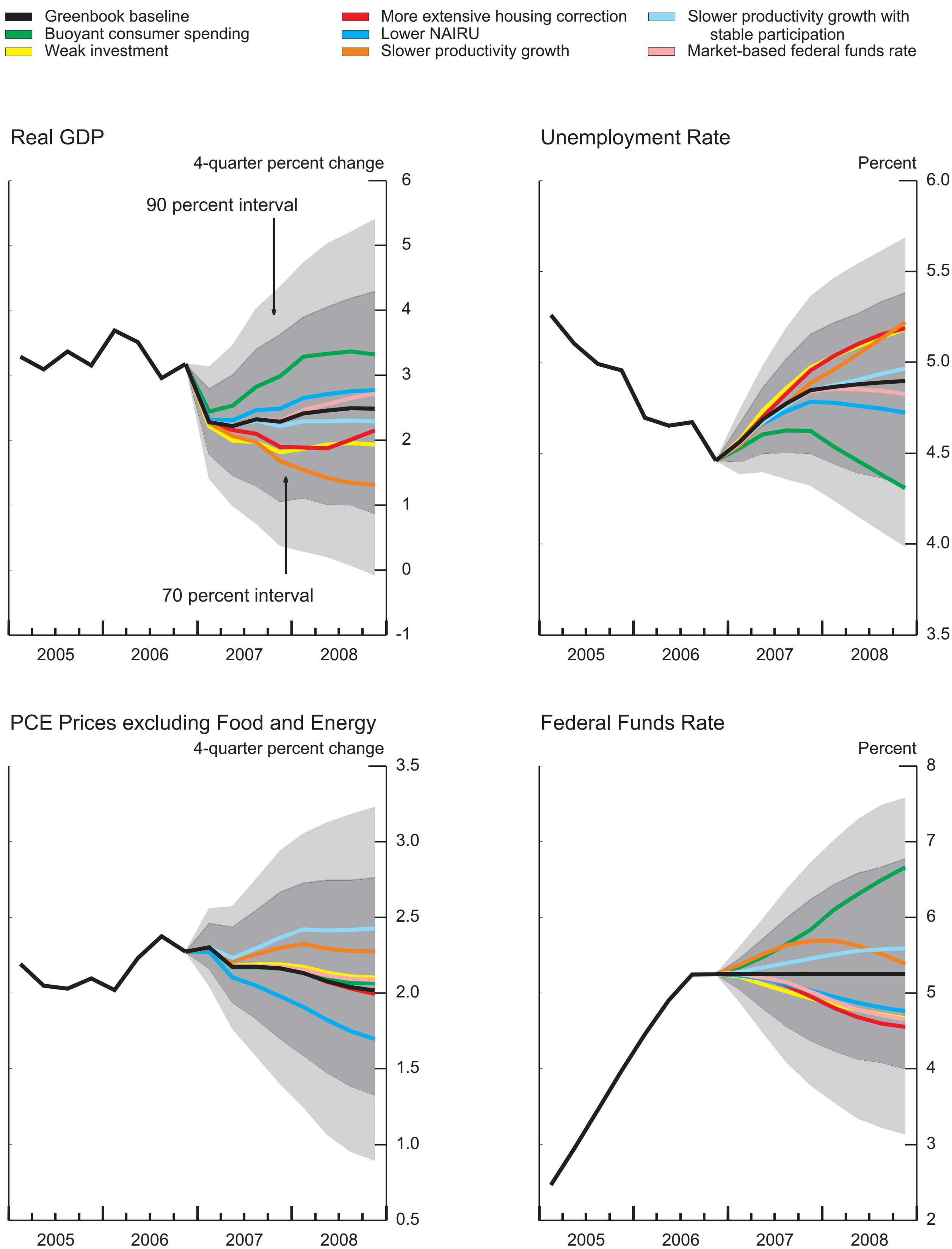
Selected Greenbook Projections and 70 Percent Confidence Intervals Derived from Historical Forecast Errors and FRB/US Simulations

Measure	2007	2008
Real GDP		
(percent change, Q4 to Q4)		
Projection	2.3	2.5
Confidence interval		
Greenbook forecast errors	.8–3.8	.8–4.2
FRB/US stochastic simulations	1.1–3.6	.9–4.3
Civilian unemployment rate		
(percent, Q4)		
Projection	4.8	4.9
Confidence interval		
Greenbook forecast errors	4.4–5.3	4.0–5.8
FRB/US stochastic simulations	4.5–5.2	4.3–5.4
PCE prices		
excluding food and energy		
(percent change, Q4 to Q4)		
Projection	2.2	2.0
Confidence interval		
Greenbook forecast errors	1.6–2.7	1.1–2.9
FRB/US stochastic simulations	1.7–2.7	1.3–2.8
Federal funds rate		
(percent, Q4)		
Projection	5.2	5.2
Confidence interval		
FRB/US stochastic simulations	4.4–6.2	4.0–6.8

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

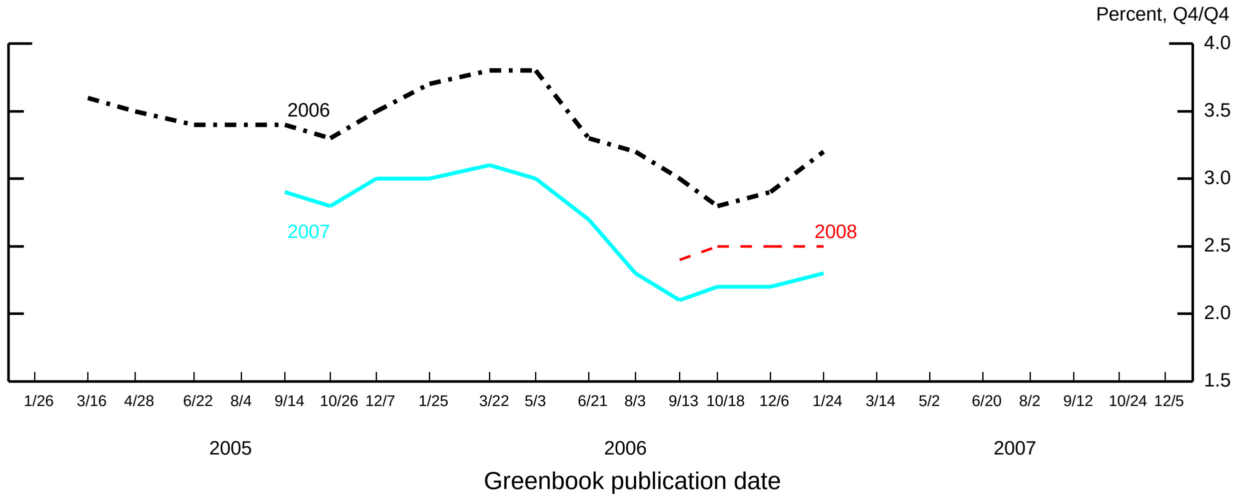
Forecast Confidence Intervals and Alternative Scenarios under the Assumption that Monetary Policy Follows an Estimated Taylor Rule

Confidence Intervals based on FRB/US Stochastic Simulations

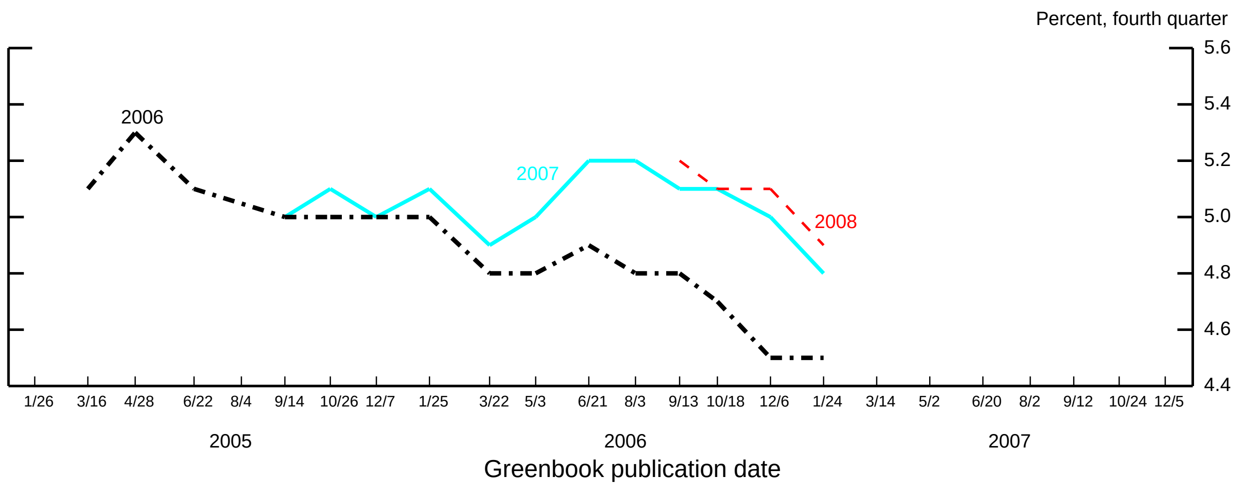


Evolution of the Staff Forecast

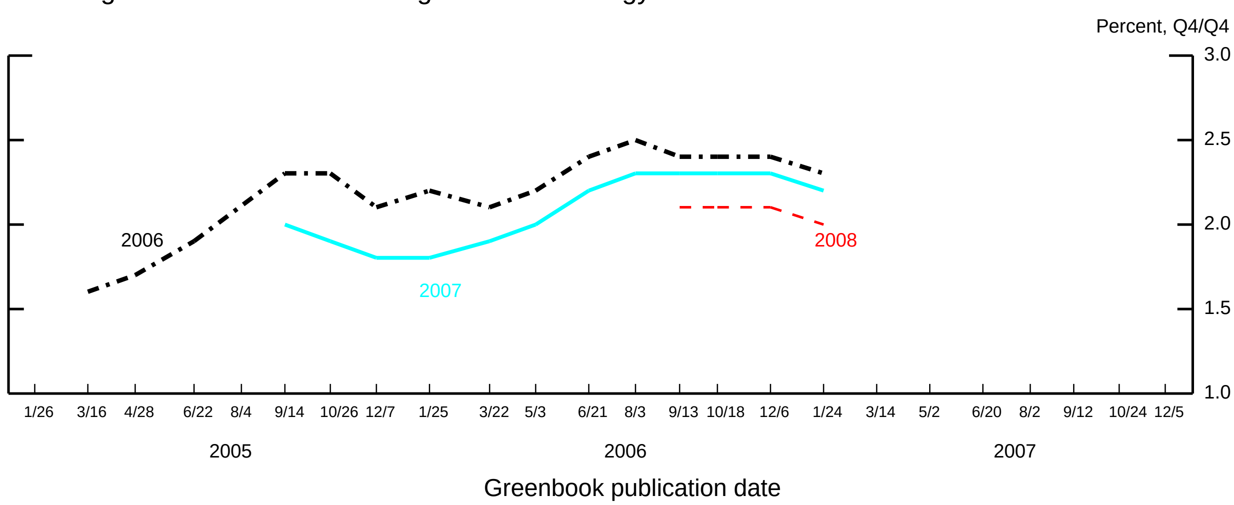
Change in Real GDP



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	12/06/06	01/24/07	12/06/06	01/24/07	12/06/06	01/24/07	12/06/06	01/24/07	12/06/06	01/24/07
Quarterly										
2006:Q1	9.0	9.0	5.6	5.6	2.0	2.0	2.1	2.1	4.7	4.7
Q2	5.9	5.9	2.6	2.6	4.0	4.0	2.7	2.7	4.7	4.7
Q3	3.8	3.8	2.0	2.0	2.4	2.4	2.2	2.2	4.7	4.7
Q4	2.9	4.6	1.3	2.6	-.5	-.8	2.6	2.1	4.5	4.5
2007:Q1	5.2	5.7	1.7	2.0	3.7	1.9	2.4	2.2	4.6	4.6
Q2	4.7	4.7	2.2	2.3	2.6	2.4	2.3	2.2	4.8	4.7
Q3	4.9	4.7	2.4	2.4	2.5	2.4	2.3	2.2	4.9	4.8
Q4	4.7	4.7	2.4	2.5	2.3	2.2	2.3	2.1	5.0	4.8
2008:Q1	5.1	5.0	2.5	2.5	2.2	2.2	2.2	2.1	5.0	4.9
Q2	5.0	4.9	2.5	2.5	2.1	2.1	2.1	2.0	5.0	4.9
Q3	4.9	4.8	2.5	2.5	2.1	2.0	2.1	2.0	5.1	4.9
Q4	4.8	4.7	2.5	2.5	2.0	2.0	2.1	2.0	5.1	4.9
Two-quarter[2]										
2006:Q2	7.5	7.5	4.1	4.1	3.0	3.0	2.4	2.4	-.3	-.3
Q4	3.3	4.2	1.7	2.3	1.0	.8	2.4	2.1	-.2	-.2
2007:Q2	5.0	5.2	2.0	2.2	3.1	2.2	2.4	2.2	.3	.2
Q4	4.8	4.7	2.4	2.4	2.4	2.3	2.3	2.1	.2	.1
2008:Q2	5.1	4.9	2.5	2.5	2.2	2.1	2.2	2.0	.0	.1
Q4	4.8	4.7	2.5	2.5	2.0	2.0	2.1	2.0	.1	.0
Four-quarter[3]										
2005:Q4	6.4	6.4	3.1	3.1	3.1	3.1	2.1	2.1	-.4	-.4
2006:Q4	5.4	5.8	2.9	3.2	2.0	1.9	2.4	2.3	-.5	-.5
2007:Q4	4.9	5.0	2.2	2.3	2.8	2.2	2.3	2.2	.5	.4
2008:Q4	4.9	4.8	2.5	2.5	2.1	2.1	2.1	2.0	.1	.1
Annual										
2005	6.3	6.3	3.2	3.2	2.9	2.9	2.1	2.1	5.1	5.1
2006	6.3	6.4	3.3	3.3	2.8	2.8	2.3	2.2	4.6	4.6
2007	4.5	4.9	1.9	2.3	2.3	1.8	2.4	2.2	4.8	4.7
2008	4.9	4.8	2.5	2.5	2.2	2.2	2.2	2.1	5.0	4.9

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

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

Item	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2008 Q1	2008 Q2	2008 Q3	2008 Q4	2006[1]	2007[1]	2008[1]
Real GDP	5.6	2.6	2.0	2.6	2.0	2.3	2.4	2.5	2.5	2.5	2.5	2.5	3.2	2.3	2.5
Previous	5.6	2.6	2.0	1.3	1.7	2.2	2.4	2.4	2.5	2.5	2.5	2.5	2.9	2.2	2.5
Final sales	5.6	2.1	1.9	3.9	1.6	2.4	2.5	2.0	2.2	2.8	2.7	2.5	3.4	2.2	2.5
Previous	5.6	2.1	1.9	2.2	1.4	2.5	2.7	2.0	2.2	2.8	2.8	2.1	3.0	2.1	2.5
Priv. dom. final purch.	5.5	1.8	2.1	2.1	2.0	2.3	2.5	2.5	2.8	2.8	2.8	2.9	2.8	2.3	2.8
Previous	5.5	1.8	2.0	1.2	1.3	2.0	2.4	2.5	2.7	2.7	2.7	2.8	2.6	2.0	2.7
Personal cons. expend.	4.8	2.6	2.8	4.6	3.6	2.4	2.5	2.6	2.7	2.7	2.7	2.7	3.7	2.8	2.7
Previous	4.8	2.6	2.9	3.1	2.7	2.3	2.4	2.4	2.6	2.6	2.6	2.6	3.3	2.5	2.6
Durables	19.8	-.1	6.4	10.2	6.1	1.4	3.9	3.9	4.8	4.2	4.0	4.1	8.8	3.8	4.3
Nondurables	5.9	1.4	1.5	6.8	5.3	3.1	2.6	2.6	2.8	2.8	2.9	2.9	3.9	3.4	2.8
Services	1.6	3.7	2.8	2.6	2.4	2.2	2.2	2.3	2.3	2.3	2.3	2.3	2.7	2.2	2.3
Residential investment	-.3	-11.1	-18.7	-20.6	-21.2	-8.7	-2.2	-1.6	-.7	2.2	2.7	4.1	-13.0	-8.8	2.0
Previous	-.3	-11.1	-18.7	-23.8	-20.3	-7.2	-1.5	.0	-1.3	.8	1.8	4.5	-13.9	-7.6	1.4
Business fixed invest.	13.7	4.4	10.0	-1.4	3.9	7.7	4.4	4.2	4.9	4.0	4.0	4.0	6.5	5.1	4.2
Previous	13.7	4.4	9.4	4.1	3.9	4.3	3.7	3.9	4.8	4.2	3.9	3.6	7.8	3.9	4.1
Equipment & software	15.6	-1.4	7.7	-4.1	3.4	8.5	4.5	4.7	6.3	5.2	5.6	5.9	4.2	5.2	5.7
Previous	15.6	-1.4	7.2	3.0	2.8	4.0	3.7	4.3	6.0	5.4	5.5	5.3	5.9	3.7	5.6
Nonres. structures	8.7	20.3	15.7	5.0	5.3	6.0	4.3	3.1	1.9	1.5	.7	.1	12.3	4.7	1.1
Previous	8.7	20.3	14.8	6.6	6.2	4.8	3.7	3.0	2.1	1.8	.6	.0	12.5	4.4	1.1
Net exports[2]	-637	-624	-629	-596	-610	-610	-609	-625	-642	-643	-646	-657	-621	-613	-647
Previous[2]	-637	-624	-629	-615	-624	-617	-609	-624	-637	-633	-631	-650	-626	-619	-638
Exports	14.0	6.2	6.8	7.5	5.3	5.2	5.0	4.8	4.9	5.1	5.2	5.3	8.6	5.1	5.1
Imports	9.1	1.4	5.6	-1.8	6.7	3.5	3.2	6.5	6.9	3.7	4.2	5.8	3.5	5.0	5.1
Govt. cons. & invest.	4.9	.8	1.7	4.9	2.3	2.2	2.0	2.0	2.0	2.0	1.8	1.8	3.0	2.1	1.9
Previous	4.9	.8	2.0	3.4	2.9	2.6	2.0	2.0	2.0	2.0	1.8	1.8	2.8	2.4	1.9
Federal	8.8	-4.5	1.3	8.8	1.9	1.5	1.3	1.3	1.4	1.4	1.3	1.3	3.4	1.5	1.3
Defense	8.9	-2.0	-1.2	14.9	2.8	2.2	2.0	2.0	2.0	2.0	2.0	2.0	4.9	2.2	2.0
Nondefense	8.5	-9.3	6.5	-2.7	.0	.0	.0	.0	.0	.0	.0	.0	.5	.0	.0
State & local	2.7	4.0	1.9	2.7	2.6	2.6	2.4	2.4	2.4	2.4	2.1	2.1	2.8	2.5	2.2
Change in bus. inventories[2]	41	54	55	20	30	27	22	35	44	36	31	30	43	29	35
Previous[2]	41	54	57	31	40	34	27	40	49	40	34	45	46	35	42
Nonfarm[2]	37	52	53	21	31	27	22	35	44	36	30	30	41	29	35
Farm[2]	4	2	2	-1	-0	1	1	1	1	1	1	1	2	1	1

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

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

Item	2000[1]	2001[1]	2002[1]	2003[1]	2004[1]	2005[1]	2006[1]	2007[1]	2008[1]
Real GDP	2.2	.2	1.9	3.7	3.4	3.1	3.2	2.3	2.5
Previous	2.2	.2	1.9	3.7	3.4	3.1	2.9	2.2	2.5
Final sales	2.9	1.5	.8	3.7	3.1	3.2	3.4	2.2	2.5
Previous	2.9	1.5	.8	3.7	3.1	3.2	3.0	2.1	2.5
Priv. dom. final purch.	4.3	1.0	1.1	4.1	4.4	3.6	2.8	2.3	2.8
Previous	4.3	1.0	1.1	4.1	4.4	3.6	2.6	2.0	2.7
Personal cons. expend.	4.1	2.8	1.9	3.4	4.0	2.9	3.7	2.8	2.7
Previous	4.1	2.8	1.9	3.4	4.0	2.9	3.3	2.5	2.6
Durables	4.7	10.8	1.2	8.3	5.6	2.5	8.8	3.8	4.3
Nondurables	3.0	1.9	2.1	3.9	3.8	4.4	3.9	3.4	2.8
Services	4.5	1.6	1.9	2.2	3.7	2.3	2.7	2.2	2.3
Residential investment	-1.9	1.4	7.0	11.7	6.1	9.0	-13.0	-8.8	2.0
Previous	-1.9	1.4	7.0	11.7	6.1	9.0	-13.9	-7.6	1.4
Business fixed invest.	7.8	-9.6	-6.5	4.9	6.9	5.6	6.5	5.1	4.2
Previous	7.8	-9.6	-6.5	4.9	6.9	5.6	7.8	3.9	4.1
Equipment & software	7.5	-9.0	-3.4	6.6	8.3	7.0	4.2	5.2	5.7
Previous	7.5	-9.0	-3.4	6.6	8.3	7.0	5.9	3.7	5.6
Nonres. structures	8.8	-11.1	-14.9	.2	2.7	1.8	12.3	4.7	1.1
Previous	8.8	-11.1	-14.9	.2	2.7	1.8	12.5	4.4	1.1
Net exports[2]	-379	-399	-471	-519	-591	-619	-621	-613	-647
Previous[2]	-379	-399	-471	-519	-591	-619	-626	-619	-638
Exports	6.5	-11.9	3.8	5.8	7.0	6.7	8.6	5.1	5.1
Imports	11.2	-7.6	9.7	4.8	10.6	5.2	3.5	5.0	5.1
Govt. cons. & invest.	.4	5.0	4.0	1.7	1.1	1.2	3.0	2.1	1.9
Previous	.4	5.0	4.0	1.7	1.1	1.2	2.8	2.4	1.9
Federal	-2.2	6.4	7.8	5.5	2.3	2.1	3.4	1.5	1.3
Defense	-3.5	6.5	8.4	7.5	2.5	1.9	4.9	2.2	2.0
Nondefense	.3	6.3	6.8	1.9	1.8	2.4	.5	.0	.0
State & local	1.7	4.2	2.1	-.4	.4	.8	2.8	2.5	2.2
Change in bus. inventories[2]	56	-32	12	14	53	20	43	29	35
Previous[2]	56	-32	12	14	53	20	46	35	42
Nonfarm[2]	58	-32	15	14	47	20	41	29	35
Farm[2]	-1	0	-2	0	6	0	2	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	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2008 Q1	2008 Q2	2008 Q3	2008 Q4	2006[1]	2007[1]	2008[1]
Real GDP	5.6	2.6	2.0	2.6	2.0	2.3	2.4	2.5	2.5	2.5	2.5	2.5	3.2	2.3	2.5
Previous	5.6	2.6	2.0	1.3	1.7	2.2	2.4	2.4	2.5	2.5	2.5	2.5	2.9	2.2	2.5
Final sales	5.6	2.1	1.9	3.8	1.7	2.4	2.5	2.0	2.2	2.8	2.7	2.5	3.4	2.2	2.5
Previous	5.6	2.1	1.9	2.2	1.4	2.5	2.6	2.0	2.2	2.8	2.7	2.1	3.0	2.1	2.5
Priv. dom. final purch.	4.7	1.5	1.8	1.8	1.7	2.0	2.1	2.2	2.4	2.4	2.4	2.5	2.4	2.0	2.4
Previous	4.7	1.5	1.7	1.1	1.1	1.7	2.0	2.1	2.3	2.3	2.3	2.4	2.3	1.7	2.3
Personal cons. expend.	3.4	1.8	2.0	3.2	2.5	1.6	1.7	1.8	1.9	1.9	1.9	1.9	2.6	1.9	1.9
Previous	3.4	1.8	2.0	2.1	1.9	1.6	1.7	1.7	1.8	1.8	1.8	1.8	2.3	1.7	1.8
Durables	1.5	.0	.5	.8	.5	.1	.3	.3	.4	.3	.3	.3	.7	.3	.3
Nondurables	1.2	.3	.3	1.4	1.1	.6	.5	.5	.6	.6	.6	.6	.8	.7	.6
Services	.7	1.5	1.1	1.1	1.0	.9	.9	.9	1.0	1.0	1.0	1.0	1.1	.9	1.0
Residential investment	.0	-.7	-1.2	-1.3	-1.2	-.4	-.1	-.1	.0	.1	.1	.2	-.8	-.5	.1
Previous	.0	-.7	-1.2	-1.5	-1.2	-.4	-.1	.0	-.1	.0	.1	.2	-.9	-.4	.1
Business fixed invest.	1.4	.5	1.0	-.2	.4	.8	.5	.4	.5	.4	.4	.4	.7	.5	.5
Previous	1.4	.5	1.0	.4	.4	.5	.4	.4	.5	.5	.4	.4	.8	.4	.4
Equipment & software	1.1	-.1	.6	-.3	.2	.6	.3	.3	.5	.4	.4	.4	.3	.4	.4
Previous	1.1	-.1	.5	.2	.2	.3	.3	.3	.4	.4	.4	.4	.4	.3	.4
Nonres. structures	.3	.6	.5	.2	.2	.2	.1	.1	.1	.1	.0	.0	.4	.2	.0
Previous	.3	.6	.4	.2	.2	.2	.1	.1	.1	.1	.0	.0	.4	.1	.0
Net exports	.0	.4	-.2	1.1	-.5	.0	.0	-.5	-.6	.0	-.1	-.4	.3	-.2	-.3
Previous	.0	.4	-.2	.5	-.3	.3	.2	-.5	-.5	.1	.1	-.6	.2	-.1	-.2
Exports	1.4	.7	.7	.8	.6	.6	.6	.5	.6	.6	.6	.6	.9	.6	.6
Imports	-1.5	-.2	-.9	.3	-1.1	-.6	-.5	-1.1	-1.1	-.6	-.7	-1.0	-.6	-.8	-.8
Govt. cons. & invest.	.9	.2	.3	.9	.4	.4	.4	.4	.4	.4	.3	.4	.6	.4	.4
Previous	.9	.2	.4	.6	.6	.5	.4	.4	.4	.4	.3	.3	.5	.5	.4
Federal	.6	-.3	.1	.6	.1	.1	.1	.1	.1	.1	.1	.1	.2	.1	.1
Defense	.4	-.1	-.1	.7	.1	.1	.1	.1	.1	.1	.1	.1	.2	.1	.1
Nondefense	.2	-.2	.2	-.1	.0	.0	.0	.0	.0	.0	.0	.0	.0	.0	.0
State & local	.3	.5	.2	.3	.3	.3	.3	.3	.3	.3	.3	.3	.3	.3	.3
Change in bus. inventories	.0	.4	.1	-1.2	.3	-.1	-.2	.4	.3	-.3	-.2	.0	-.2	.1	.0
Previous	.0	.4	.1	-.9	.3	-.2	-.2	.5	.3	-.3	-.2	.4	-.1	.1	.0
Nonfarm	.0	.5	.1	-1.1	.3	-.1	-.2	.4	.3	-.3	-.2	.0	-.2	.1	.0
Farm	.0	-.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)

Item	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2008 Q1	2008 Q2	2008 Q3	2008 Q4	2006[1]	2007[1]	2008[1]
GDP chain-wt. price index	3.3	3.3	1.9	1.9	3.7	2.4	2.3	2.2	2.4	2.3	2.2	2.1	2.6	2.6	2.3
Previous	3.3	3.3	1.8	1.5	3.5	2.4	2.4	2.3	2.5	2.4	2.3	2.2	2.5	2.6	2.4
PCE chain-wt. price index	2.0	4.0	2.4	-.8	1.9	2.4	2.4	2.2	2.2	2.1	2.0	2.0	1.9	2.2	2.1
Previous	2.0	4.0	2.4	-.5	3.7	2.6	2.5	2.3	2.2	2.1	2.1	2.0	2.0	2.8	2.1
Energy	.1	29.7	3.7	-36.6	-5.7	3.2	6.1	4.0	3.2	2.3	1.9	1.4	-3.9	1.8	2.2
Previous	.1	29.7	3.7	-38.9	26.2	5.9	4.7	2.8	1.9	1.3	.8	.4	-4.7	9.5	1.1
Food	2.7	1.7	2.9	1.8	3.6	3.1	2.6	2.4	2.3	2.2	2.2	2.2	2.3	2.9	2.2
Previous	2.7	1.7	2.9	2.9	2.7	2.4	2.4	2.4	2.4	2.4	2.3	2.3	2.6	2.5	2.3
Ex. food & energy	2.1	2.7	2.2	2.1	2.2	2.2	2.2	2.1	2.1	2.0	2.0	2.0	2.3	2.2	2.0
Previous	2.1	2.7	2.2	2.6	2.4	2.3	2.3	2.3	2.2	2.1	2.1	2.1	2.4	2.3	2.1
CPI	2.2	4.9	3.0	-2.1	2.0	2.6	2.6	2.4	2.3	2.2	2.1	2.1	2.0	2.4	2.2
Previous	2.2	4.9	3.0	-1.9	4.3	2.9	2.7	2.5	2.3	2.3	2.2	2.1	2.0	3.1	2.2
Ex. food & energy	2.4	3.6	3.0	1.8	2.4	2.5	2.3	2.3	2.2	2.2	2.2	2.2	2.7	2.4	2.2
Previous	2.4	3.6	3.0	2.3	2.7	2.6	2.5	2.5	2.4	2.4	2.3	2.3	2.8	2.5	2.3
ECI, hourly compensation[2]	2.4	3.2	3.6	3.8	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	3.2	4.0	4.0
Previous[2]	2.4	3.2	3.6	3.8	4.0	4.1	4.1	4.1	4.1	4.1	4.1	4.1	3.2	4.1	4.1
Nonfarm business sector															
Output per hour	4.3	1.2	-.2	.9	1.5	2.5	2.7	2.8	2.7	2.6	2.6	2.5	1.5	2.4	2.6
Previous	4.3	1.2	.0	-.5	1.9	2.8	2.9	2.9	2.7	2.7	2.6	2.6	1.2	2.6	2.7
Compensation per hour	13.7	-1.2	3.1	4.6	4.9	4.9	4.9	4.9	4.9	5.0	4.8	4.8	4.9	4.9	4.9
Previous	13.7	-1.2	2.6	4.9	5.0	5.2	5.1	5.0	5.0	5.2	5.0	4.9	4.9	5.1	5.0
Unit labor costs	9.0	-2.4	3.2	3.7	3.3	2.3	2.2	2.0	2.1	2.3	2.1	2.2	3.3	2.4	2.2
Previous	9.0	-2.4	2.6	5.5	3.0	2.3	2.1	2.0	2.2	2.4	2.3	2.2	3.6	2.4	2.3

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

Other Macroeconomic Indicators

Item	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2008 Q1	2008 Q2	2008 Q3	2008 Q4	2006[1]	2007[1]	2008[1]
Employment and production															
Nonfarm payroll employment[2]	.6	.4	.5	.5	.4	.2	.2	.2	.2	.2	.2	.2	1.9	1.0	.7
Unemployment rate[3]	4.7	4.7	4.7	4.5	4.6	4.7	4.8	4.8	4.9	4.9	4.9	4.9	4.5	4.8	4.9
Previous[3]	4.7	4.7	4.7	4.5	4.6	4.8	4.9	5.0	5.0	5.0	5.1	5.1	4.5	5.0	5.1
GDP gap[4]	.7	.6	.5	.4	.3	.2	.2	.1	.1	.1	.1	.1	.4	.1	.1
Previous[4]	.7	.6	.5	.1	-.1	-.2	-.2	-.3	-.3	-.3	-.3	-.3	.1	-.3	-.3
Industrial production[5]	5.0	6.5	4.0	-.5	2.8	3.4	3.2	3.4	4.0	3.4	3.5	3.6	3.7	3.2	3.6
Previous[5]	5.1	6.6	4.2	.7	2.8	3.4	3.3	3.3	4.0	3.6	3.7	3.2	4.1	3.2	3.6
Manufacturing industr. prod.[5]	5.5	5.5	4.4	-1.4	3.4	3.7	3.5	3.6	4.5	4.0	3.6	3.7	3.5	3.5	4.0
Previous[5]	5.3	5.1	4.5	.1	3.0	3.7	3.4	3.8	4.3	4.0	3.9	4.0	3.7	3.5	4.1
Capacity utilization rate - mfg.[3]	80.1	80.6	80.9	80.2	80.3	80.5	80.7	81.0	81.2	81.3	81.3	81.4	80.2	81.0	81.4
Previous[3]	80.3	80.8	81.2	80.7	80.8	80.9	80.9	80.9	81.1	81.2	81.3	81.4	80.7	80.9	81.4
Housing starts[6]	2.1	1.9	1.7	1.6	1.5	1.5	1.5	1.5	1.6	1.6	1.6	1.6	1.8	1.5	1.6
Light motor vehicle sales[6]	16.9	16.3	16.6	16.3	16.6	16.5	16.5	16.5	16.6	16.7	16.7	16.7	16.5	16.5	16.7
Income and saving															
Nominal GDP[5]	9.0	5.9	3.8	4.6	5.7	4.7	4.7	4.7	5.0	4.9	4.8	4.7	5.8	5.0	4.8
Real disposable pers. income[5]	4.6	-1.5	4.1	6.5	5.0	3.0	3.3	3.4	4.1	3.2	3.5	3.4	3.4	3.7	3.5
Previous[5]	4.6	-1.5	3.7	5.3	3.5	2.7	3.2	3.3	4.3	3.2	3.5	3.4	3.0	3.2	3.6
Personal saving rate[3]	-.3	-1.4	-1.2	-.7	-.4	-.2	.0	.2	.5	.6	.8	1.0	-.7	.2	1.0
Previous[3]	-.3	-1.4	-1.3	-.7	-.5	-.4	-.2	.0	.4	.6	.8	1.0	-.7	.0	1.0
Corporate profits[7]	60.8	5.9	16.4	.2	-.6	-4.1	1.6	-1.1	1.3	.2	.3	-.8	18.7	-1.1	.2
Profit share of GNP[3]	12.0	12.0	12.4	12.3	12.1	11.9	11.8	11.6	11.5	11.4	11.3	11.1	12.3	11.6	11.1
Net federal saving[8]	-147	-163	-166	-201	-216	-217	-221	-238	-264	-264	-263	-273	-169	-223	-266
Net state & local saving[8]	13	26	-10	-4	4	5	-5	-8	-8	-8	-17	-19	6	-1	-13
Gross national saving rate[3]	14.4	13.5	13.5	13.5	13.5	13.4	13.3	13.2	13.2	13.2	13.2	13.1	13.5	13.2	13.1
Net national saving rate[3]	2.9	1.9	1.9	2.1	2.2	2.0	2.0	1.8	1.8	1.8	1.8	1.8	2.1	1.8	1.8

1. Change from fourth quarter of previous year to fourth quarter of year indicated, unless otherwise indicated.
2. Change, millions.
3. Percent, annual values are for the fourth quarter of the year indicated.
4. Percent difference between actual and potential GDP; a negative number indicates that the economy is operating below potential. (In previous Greenbooks, we expressed the GDP gap with the opposite sign, so that a positive number indicated that actual output fell short of potential.) Annual values are for the fourth quarter of the year indicated.
5. Percent change, annual rate.
6. Level, millions, annual values are annual averages.
7. Percent change, annual rate, with inventory valuation and capital consumption adjustments.
8. Billions of dollars, annual values are annual averages.

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

Item	Fiscal year				2006				2007				2008			
	2005[a]	2006[a]	2007	2008	Q1[a]	Q2[a]	Q3[a]	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
					Not seasonally adjusted											
Unified budget																
Receipts[1]	2154	2407	2531	2661	507	772	597	574	519	832	607	602	552	873	634	619
Outlays[1]	2473	2655	2763	2930	691	676	639	654	728	706	674	735	744	732	719	768
Surplus/deficit[1]	-319	-248	-232	-269	-184	96	-42	-80	-209	125	-67	-133	-192	141	-85	-149
Previous	*-319*	*-248*	*-247*	*-285*	*-184*	*96*	*-42*	*-102*	*-200*	*118*	*-64*	*-134*	*-188*	*123*	*-86*	*-147*
On-budget	-494	-435	-417	-469	-216	11	-60	-143	-232	37	-80	-200	-216	46	-98	-222
Off-budget	175	186	185	199	32	85	19	62	22	88	13	67	24	95	13	73
Means of financing																
Borrowing	297	237	216	271	156	-75	43	59	181	-94	70	123	165	-110	94	139
Cash decrease	1	-16	17	0	28	-38	-6	21	16	-25	5	10	15	-25	0	10
Other[2]	22	28	-1	-2	-1	16	5	0	12	-6	-8	-0	12	-6	-8	-0
Cash operating balance, end of period	36	52	35	35	8	46	52	31	15	40	35	25	10	35	35	25
					Seasonally adjusted annual rates											
NIPA federal sector																
Receipts	2174	2482	2622	2733	2491	2523	2565	2571	2612	2638	2667	2692	2719	2747	2775	2802
Expenditures	2509	2667	2836	2990	2638	2686	2730	2772	2828	2855	2888	2929	2983	3012	3038	3076
Consumption expenditures	758	797	845	886	804	802	809	825	844	851	859	866	885	892	900	907
Defense	509	533	570	601	538	538	539	556	569	575	581	587	600	606	612	618
Nondefense	249	264	274	284	266	265	270	269	275	276	278	279	285	286	288	289
Other spending	1751	1870	1991	2105	1834	1884	1921	1947	1984	2004	2029	2063	2098	2120	2138	2168
Current account surplus	-335	-185	-214	-257	-147	-163	-166	-201	-216	-217	-221	-238	-264	-264	-263	-273
Gross investment	107	117	126	130	118	117	118	124	125	126	127	128	129	130	131	132
Gross saving less gross investment[3]	-344	-199	-231	-273	-163	-177	-179	-219	-234	-234	-239	-254	-280	-280	-278	-288
Fiscal indicators[4]																
High-employment (HEB) surplus/deficit	-339	-222	-252	-282	-191	-208	-205	-250	-256	-252	-252	-266	-289	-288	-285	-295
Change in HEB, percent of potential GDP	-0.3	-1.0	0.1	0.1	-0.7	0.1	-0.0	0.3	0.0	-0.0	-0.0	0.1	0.1	-0.0	-0.0	0.0
Fiscal impetus (FI), percent of GDP	0.2	0.3	0.3	0.1	0.2	-0.0	0.0	0.1	0.1	-0.0	-0.0	0.0	0.0	0.0	0.0	0.0
Previous	*0.2*	*0.3*	*0.3*	*0.1*	*0.2*	*-0.0*	*0.0*	*0.1*	*0.2*	*-0.0*	*-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

Change in Debt of the Domestic Nonfinancial Sectors
(Percent)

		Households						
Period[1]	Total	Total	Home mortgages	Consumer credit	Business	State and local governments	Federal government	Memo: Nominal GDP
Year								
2001	6.3	9.3	10.1	8.6	6.0	8.8	-.2	2.7
2002	7.2	10.6	12.9	5.9	2.5	11.0	7.6	3.6
2003	8.2	11.6	14.3	5.2	2.7	8.3	10.9	5.9
2004	9.0	11.6	14.1	5.5	5.9	7.4	9.0	6.7
2005	9.5	11.8	13.8	4.2	7.8	10.2	7.0	6.4
2006	7.8	8.2	8.7	4.7	9.3	8.4	3.9	5.8
2007	6.5	5.9	6.1	4.4	7.6	7.4	5.7	5.0
2008	6.1	5.7	6.1	3.6	6.6	7.1	5.6	4.8
Quarter								
2006:1	9.5	9.7	10.9	2.4	9.6	3.5	11.3	9.0
2	6.7	9.1	9.1	6.3	8.4	6.6	-2.4	5.9
3	6.6	6.8	7.2	5.5	7.7	9.3	3.3	3.8
4	7.5	6.2	6.3	4.5	10.3	13.3	3.3	4.6
2007:1	7.9	5.9	6.1	4.8	8.2	6.8	12.9	5.7
2	4.8	5.8	6.0	4.5	7.5	7.5	-3.9	4.7
3	6.2	5.7	6.0	4.2	7.2	7.4	5.4	4.7
4	6.5	5.6	6.0	4.0	6.5	7.2	8.2	4.7
2008:1	6.8	5.6	6.0	3.8	6.2	7.1	11.0	5.0
2	4.2	5.6	6.0	3.6	6.6	7.0	-4.9	4.9
3	6.2	5.5	6.0	3.5	6.5	6.9	6.9	4.8
4	6.5	5.5	6.0	3.5	6.5	6.8	9.0	4.7

Note. Quarterly data are at seasonally adjusted annual rates.
1. Data after 2006: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

Class II FOMC
Restricted (FR)

January 24, 2007

Flow of Funds Projections: Highlights

(Billions of dollars at seasonally adjusted annual rates except as noted)

Category	2005	2006	2007	2008	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2008 Q1	2008 Q2	2008 Q3	2008 Q4
Domestic nonfinancial sectors														
Net funds raised														
Total	1953.7	1441.0	1551.3	1619.0	1287.0	1281.9	1852.5	1050.7	1589.3	1712.8	1848.9	1081.6	1703.7	1842.0
Net equity issuance	-363.4	-637.3	-314.0	-232.0	-554.6	-823.6	-420.0	-352.0	-252.0	-232.0	-232.0	-232.0	-232.0	-232.0
Net debt issuance	2317.1	2078.3	1865.3	1851.0	1841.6	2105.5	2272.5	1402.7	1841.3	1944.8	2080.9	1313.6	1935.7	2074.0
Borrowing indicators														
Debt (percent of GDP) [1]	204.6	209.0	213.3	216.3	209.9	211.3	212.3	213.2	213.7	214.6	215.5	215.9	216.1	217.1
Borrowing (percent of GDP)	18.6	15.7	13.4	12.7	13.8	15.6	16.6	10.2	13.2	13.8	14.5	9.1	13.2	14.0
Households														
Net borrowing [2]	1241.6	965.0	749.9	766.2	835.5	777.3	758.5	747.9	744.7	748.5	754.7	762.1	769.5	778.5
Home mortgages	1077.7	768.4	593.3	625.3	672.7	601.6	592.1	587.4	592.1	601.6	611.1	620.6	630.0	639.5
Consumer credit	94.3	109.9	108.0	92.7	129.7	107.6	116.2	111.6	104.5	99.5	96.0	93.6	91.1	90.3
Debt/DPI (percent) [3]	123.7	128.7	130.0	130.1	129.9	130.2	129.9	130.1	130.1	130.1	129.9	130.0	130.1	130.1
Business														
Financing gap [4]	-138.6	25.9	55.2	147.8	47.9	-14.0	15.3	44.7	61.7	99.1	129.0	138.0	151.6	172.5
Net equity issuance	-363.4	-637.3	-314.0	-232.0	-554.6	-823.6	-420.0	-352.0	-252.0	-232.0	-232.0	-232.0	-232.0	-232.0
Credit market borrowing	597.3	773.9	685.1	643.9	669.8	911.4	744.0	695.6	674.8	625.8	606.8	655.8	651.7	661.4
State and local governments														
Net borrowing	171.3	156.0	149.7	153.7	176.3	258.8	137.7	153.7	153.7	153.7	153.7	153.7	153.7	153.7
Current surplus [5]	203.8	203.0	181.6	177.8	171.8	173.8	183.5	186.6	178.5	177.8	179.3	181.8	175.1	174.7
Federal government														
Net borrowing	306.9	183.4	280.7	287.2	160.1	158.0	632.3	-194.5	268.0	416.8	565.7	-258.0	360.8	480.4
Net borrowing (n.s.a.)	306.9	183.4	280.7	287.2	43.4	58.6	181.3	-94.4	70.4	123.3	164.7	-110.2	93.6	139.2
Unified deficit (n.s.a.)	321.8	209.2	284.5	285.4	41.7	80.4	209.5	-125.3	67.1	133.3	192.0	-141.0	85.2	149.2
Depository institutions														
Funds supplied	814.1	810.2	492.3	333.4	404.0	829.6	585.8	590.9	664.2	128.5	93.3	507.5	370.2	362.7

Note. Data after 2006:Q3 are staff projections.
1. Average debt levels in the period (computed as the average of period-end debt positions) divided by nominal GDP.
2. Includes change in liabilities not shown in home mortgages and consumer credit.
3. Average debt levels in the period (computed as the average of period-end debt positions) divided by disposable personal income.
4. For corporations, excess of capital expenditures over U.S. internal funds.
5. NIPA state and local government saving plus consumption of fixed capital and net capital transfers.
n.s.a. Not seasonally adjusted.

2.6.4 FOF

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International Developments

Since the December FOMC meeting, prospects for foreign economic growth have been improved by a decline in spot and future oil prices of around $8 to $10 per barrel and an increase in the broad nominal value of the dollar of a little more than 1 percent. We have lowered our projected path of oil prices and raised our projected path of the broad real dollar accordingly. In addition, readings on foreign activity during the intermeeting period have been strong. All together, these developments suggest that the expansion abroad should continue at a pace that is a notch higher than the already healthy pace in the previous Greenbook. Foreign consumer price inflation, which declined as oil prices trended down, will move back up as oil prices reverse some of their decline but will remain below the rate previously forecast.

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

Indicator	2006		Projection				
			2006	2007			2008
	H1	Q3	Q4	Q1	Q2	H2	
Foreign output	4.4	3.3	3.5	3.3	3.4	3.4	3.5
December GB	4.4	3.4	3.3	3.2	3.3	3.3	3.4
Foreign CPI	2.4	1.8	1.5	2.1	2.0	2.1	2.1
December GB	2.4	1.8	1.4	2.5	2.4	2.3	2.2

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

Core import price inflation is forecast to remain subdued, moving from about 2 percent at present to 1 percent in 2008 as nonfuel commodity prices flatten out and the dollar depreciates only slightly. The forecast for core import price inflation is lower this year than in the previous Greenbook, largely reflecting the recent increase in the dollar.

Real net exports of goods and services are estimated to have made a positive arithmetic contribution to U.S. GDP growth of more than 1 percentage point in the last quarter of 2006—more than ½ percentage point higher than projected in the December Greenbook. This year and next, net exports are forecast to subtract around ¼ percentage point from U.S. GDP growth. The magnitude of the negative contribution is somewhat greater than in the previous Greenbook, largely because of the higher path for the dollar.

The U.S. current account deficit widened to a record $902 billion in the third quarter of last year. We estimate that the deficit subsequently narrowed with the decline in oil prices, but we project it to resume widening later this year, reaching about $1 trillion or 6.7 percent of GDP by the end of 2008.

Oil Prices

The spot price of West Texas intermediate (WTI) crude oil closed at $53.90 per barrel on January 23, a decline of over $8 per barrel since the time of the December Greenbook. Our projected path of oil prices over the next two years follows the path of NYMEX futures prices; it climbs gradually to about $61 per barrel by the end of 2008, supported by continued concerns about possible production disruptions and by expectations of solid global demand. Compared with the December Greenbook, our forecast calls for the spot price to average $9.75 per barrel less in 2007 and $9.20 per barrel less in 2008.

The sharp fall in the spot price appears largely to have reflected unusually warm weather throughout much of the northern hemisphere, which has reduced the demand for heating oil. Because oil is a storable commodity, the recent weather helps to explain a portion of the fall in prices of further-dated futures contracts, but the decline is larger than can be reasonably explained by near-term weather conditions alone. A possible additional factor is that market participants have reevaluated the willingness of Saudi Arabia to defend elevated oil prices, in light of official statements that the Saudis see no need for an emergency meeting of OPEC to address recent declines.

International Financial Markets

Over the intermeeting period, the nominal trade-weighted exchange value of the dollar rose 2¼ percent against the major foreign currencies and was about flat against the currencies of our other important trading partners. Accordingly, we have raised our current-quarter forecast of the broad real dollar 1¼ percent relative to the December Greenbook. Going forward, we continue to project that the dollar will depreciate at a modest pace, as the large and growing U.S. current account deficit diminishes the willingness of investors to accumulate additional dollar-denominated assets at unchanged exchange rates.

Since the December FOMC meeting, the dollar has appreciated 3¾ percent against the yen and about 2 percent against the euro and the Canadian dollar but has depreciated ¾ percent against the renminbi. The yen’s depreciation early in the period came largely in reaction to several weaker-than-expected Japanese data releases. Subsequently, growing expectations among market participants that the Bank of Japan's Policy Board would leave its target rate unchanged at its meeting on January 17 and 18, which it did, put further downward pressure on the yen. Sterling appreciated following the unexpected decision by the Bank of England's Monetary Policy Committee on January 11 to raise its policy interest rate 25 basis points, but retraced that move later in the period.

Nominal and inflation-adjusted long-term government bond yields rose 25 to 30 basis points on net in Europe and Canada, the rise roughly matching the runups in U.S. yields. In contrast, nominal and inflation-adjusted JGB yields were little changed. Share prices rose 2½ to 6 percent in Europe and Japan but were more variable in some emerging-market economies. The Shanghai Composite index soared 34 percent, reportedly in reaction to takeover speculation affecting some large firms. The Stock Exchange of Thailand index fell 11 percent on net, as investors reacted sharply to new restrictions on stock ownership announced by the government to curb short-term capital inflows. Venezuelan share prices tumbled in the first half of January on news that President Chavez would seek to nationalize companies in the telecommunications and energy sectors, but they subsequently partially recovered. Emerging market risk spreads declined: The EMBI+ measure was down about 15 basis points, to a record low of less than 170 basis points.

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

Advanced Foreign Economies

Real GDP growth in the advanced foreign economies rose to an estimated annual rate of 2¾ percent in the fourth quarter, a rise that was broadly based. In Japan, an apparent surge in consumption and production suggests that GDP advanced 3½ percent. Euro-area growth picked up as well; French GDP growth recovered to an estimated 2 percent pace, and German GDP growth climbed to an estimated 3½ percent, in part because of strong consumer spending in anticipation of the scheduled hike in the value-added tax (VAT). In Canada, indicators have been somewhat mixed, but with employment remaining strong, we estimate that GDP grew 2¼ percent in the fourth quarter. Fourth-quarter GDP in the United Kingdom rose 3.4 percent.

We forecast that growth in the advanced foreign economies will slow in the current quarter to around 2¼ percent because of more moderate Japanese growth and some reduction in growth in the euro area in response to the German VAT hike. Over the rest of the forecast period, annual growth in the advanced economies should average 2½ percent. This flat contour masks two disparate trends. Canadian GDP is projected to accelerate to a rate of 3 percent, in line with the contour of the U.S. forecast. In contrast, GDP growth in the euro area and Japan will recover in the second quarter but then trend down, in part as monetary policy tightening restrains growth of domestic demand.

The four-quarter change in consumer prices in the advanced foreign economies in aggregate should decline to around 1 percent in the second quarter of this year, primarily reflecting the recent drop in oil prices. With the path of oil prices sloping up over time, inflation should then return to an annual rate of 1½ percent for the rest of the forecast period. We project that Japanese inflation will edge down to around zero during 2007 before coming back to ½ percent in 2008. Despite the recent decline in oil prices, the increase in the German VAT is projected to push up inflation in the euro area to about 2 percent in 2007; it should then edge down in 2008. U.K. inflation climbed to 3 percent in December, partly as a result of higher gasoline taxes; we expect inflation to remain elevated through mid-2007, before the tightening of monetary policy helps bring inflation below 2 percent in 2008.

This GDP forecast is slightly stronger than the one in the December Greenbook, reflecting stronger data in most of the advanced foreign economies, lower oil prices, and the recent depreciation of the yen, euro, and Canadian dollar against the U.S. dollar. These factors will be partly offset by tighter monetary policy on the part of the Bank of England and the European Central Bank than assumed in the previous Greenbook. The inflation forecast for 2007 is about ¼ percentage point lower than it was in the previous Greenbook, mainly because of the recent decline in oil prices.

Emerging Market Economies

Economic activity in the emerging market economies appears to have slowed further in the fourth quarter of last year, to an annual rate of about 4¾ percent. The pace of economic expansion is projected to edge up slightly, reaching just under 5 percent in 2008 (Q4/Q4). A lower path for oil and other commodity prices has prompted us to increase projected growth for emerging Asia, which imports commodities on net, and reduce our projection for Latin America, which exports commodities on net.

In emerging Asia, real GDP growth is estimated to have moved down to an annual rate of 5¾ percent in the fourth quarter of last year. Although we estimate that Chinese growth picked up after a sharp slowdown in the third quarter, economic growth in several other Asian economies appears to have dropped from their very rapid third-quarter rates. Over the forecast period, output growth in China is projected to edge up gradually, reflecting the diminished effect of the recent administrative measures to restrain investment. For the rest of the region, growth is expected to benefit from a moderate increase in the growth of global high-tech demand.

Latin American growth is estimated to have declined further to an annual rate of 3 percent in the fourth quarter of last year, as weak U.S. manufacturing production weighed on the pace of economic expansion in Mexico. However, such developments are not expected to persist. In the current quarter, recovery in U.S. manufacturing production is projected to boost activity in Mexico; going forward, Mexican growth should average about 3½ percent. Over the forecast period, growth in South America trends down as commodity prices stabilize and output decelerates in Argentina and Venezuela.

Four-quarter consumer price inflation in the emerging market economies was 2¾ percent last year and is projected to remain at about this pace in 2007 and 2008. In emerging Asia, inflation is expected to rise from about 2 percent last year to 2¼ percent this year and next, in response to fuel prices. In contrast, in Latin America, consumer price inflation is projected to decline to a four-quarter rate of 3¾ percent over the next two years, after surging to 4¼ percent last year in response to a temporary increase in Mexican food prices. Our forecast for inflation in the emerging market economies is slightly lower than that in the December Greenbook, reflecting the lower level of oil prices throughout the forecast period.

Prices of Internationally Traded Goods

We estimate that core import price inflation dropped from a 4¼ percent annual rate in the third quarter to 1¾ percent in the fourth quarter, reflecting sharp decelerations in the prices of both finished and material intensive goods; in particular, the runup in metals prices slowed from their surge earlier in the year. This estimate is little changed from that in the December Greenbook, as incoming data on core import prices in November and December were very close to our expectations, with core import prices rising at an average monthly rate of ¼ percent in those months. The rise in the dollar and a fall in metals prices since the time of the previous Greenbook are expected to keep core import price inflation in the current quarter relatively low, at 2 percent. Thereafter, inflation steps down further and hovers just above 1 percent for most of the forecast period. This forecast reflects our projection that commodity prices will remain flat, consistent with futures markets, and that the effects of earlier commodity price increases will diminish quickly over the next several quarters. Compared with the December Greenbook, our projection is down 1 percentage point on average in the first half, in light of the recent strengthening of the dollar, but it is little changed thereafter.

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

Indicator	2006		Projection				
	H1	Q3	2006: Q4	2007 Q1	2007 Q2	2007 H2	2008
Exports							
Core goods	5.3	5.8	1.0	4.0	2.7	1.4	1.0
December GB	5.3	5.8	-0.2	4.0	3.7	1.5	1.2
Imports							
Core goods	2.7	4.3	1.7	2.0	1.6	1.3	1.0
December GB	2.7	4.2	2.0	3.3	2.2	1.5	1.0
Oil (dollars per barrel)	63.75	66.55	55.43	50.08	51.39	54.48	55.97
December GB	63.75	66.58	56.08	58.68	61.32	63.98	65.03

NOTE. Prices for core exports exclude computers and semiconductors. Prices for core imports exclude computers, semiconductors, oil, and natural gas. Both price series are on a NIPA chain-weighted basis.

The price of imported oil for multiquarter periods is the price for the final quarter of the period. Imported oil includes both crude oil and refined products.

We estimate that core export price inflation dropped from 5¾ percent at an annual rate in the third quarter to just 1 percent in the fourth quarter. Data on export prices in the fourth quarter were quite weak on average, in part reflecting the slower pace of commodity price increases relative to the third quarter. Even so, this estimate is up noticeably from the last Greenbook, when we projected that core export prices had fallen slightly. Core export prices came in very close to our expectations in November but exceeded our expectations in December; prices for agricultural industrial supplies, fuels, and building materials all moved up strongly.

We expect core export price inflation to move up in the current quarter to 4 percent, in line with projected increases in U.S. prices, especially agricultural prices, and reflecting the high level of core export prices in December. Further out we project core export price inflation to slow gradually to 1 percent by the end of 2008, as agricultural prices flatten out. Compared with the previous Greenbook, this outlook is little changed aside from the second quarter, which is down 1 percentage point primarily because we now project smaller increases in U.S. producer prices for intermediate goods.

Trade in Goods and Services

Based on incoming trade data for October and November, we estimate that real net exports contributed 1.1 percentage points to real GDP growth in the fourth quarter, up from the ½ percentage point contribution projected in the December Greenbook. Exports were stronger than had been expected, while imports slowed to a greater extent than we had anticipated. In 2007 and 2008 we expect export growth to edge down while import growth recovers, so that exports and imports expand at about the same pace. Even so, real net exports subtract ¼ percentage point from GDP growth in 2007 and 2008, as imports grow off a much larger base. This projection is nearly ¼ percentage point more negative in 2007 than in the previous Greenbook, as a result of the higher dollar and slightly stronger near-term U.S. GDP growth.

We estimate that real imports of goods and services fell 1¾ percent at an annual rate in the fourth quarter, as declining imports of oil, natural gas, and high-tech goods more than offset both a slight gain in imports of core goods and a more robust increase in imports of services. Our estimate for import growth in the fourth quarter is 2½ percentage points lower than in the December Greenbook, primarily on account of weaker-than-expected imports of oil, non-oil industrial supplies, and capital goods in both the October and November trade data. In the current quarter, we expect imports to increase 6¾ percent, as real oil imports resume growth and core import growth recovers from its surprising weakness in the fourth quarter to a rate consistent with the projection for U.S. GDP and relative prices. In contrast, the growth of services imports is expected to moderate somewhat following surprisingly strong growth in the fourth quarter. Compared with the previous Greenbook, we have increased our projection for the growth rate of overall imports by 1 percentage point in the first quarter, as the current and lagged effects of the faster projected pace of U.S. growth and the higher path of the dollar boost imports of core goods and services.

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

Measure	2006		Projection				
	H1	Q3	2006: Q4	2007			2008
				Q1	Q2	H2	
Real exports	10.0	6.8	7.5	5.3	5.2	4.9	5.1
December GB	10.0	6.3	5.4	5.5	5.6	5.4	5.6
Real imports	5.2	5.6	-1.8	6.7	3.5	4.9	5.1
December GB	5.2	5.3	.7	5.6	2.2	4.5	5.1

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

We project that import growth will slow to 3½ percent in the second quarter, largely on account of a quirky seasonal adjustment factor that depresses real oil imports, before climbing to about 5 percent in the second half of 2007 and in 2008. Core import growth is expected to pick up throughout 2007, supported by firming U.S. GDP growth and a deceleration in core import prices, before leveling off at just over 5½ percent in 2008. Imports of services are expected to grow steadily throughout the projection period, as are imports of computers and semiconductors. Our forecast for import growth in the final three quarters of this year has been revised up about ¾ percentage point from the December Greenbook forecast, because of a smaller projected decline in real oil imports as well as the positive effect of the higher projected path of the dollar on imports of core goods and services.

Real exports of goods and services are estimated to have increased 7½ percent in the fourth quarter, a bit faster than the pace of growth in the third quarter, as an acceleration in exports of services more than offsets a decline in the growth rate of core exports. This estimate is about 2 percentage points stronger than the one in the December Greenbook, largely because of stronger-than-expected exports in both the October and the November trade data, with exports of aircraft exhibiting particular strength. We project that real export growth will decline to 5¼ percent in the current quarter, as exports of aircraft flatten out and exports of both core goods and services decelerate to rates consistent with the pace of foreign GDP growth and recent developments in relative prices. Our projection for the first quarter is about ¼ percentage point lower than that in the previous Greenbook, largely because of negative effects of the higher projected path of the dollar on exports of core goods and services.

For the remainder of 2007 and in 2008, we expect total export growth to stay in the vicinity of 5 percent. Against the backdrop of steady support from foreign growth, core export growth edges down over the rest of this year in response to current and lagged effects of the past few year's swings in the dollar and then picks up in 2008, buoyed by slowing core export price inflation. In contrast, exports of services, which respond to exchange rate movements more rapidly than do core exports, are expected to slow over 2008 as the lagged effect of real dollar depreciation in 2006 fades and in line with our projection of only modest real dollar depreciation going forward. Exports of computers and semiconductors are expected to continue to grow in line with their historical pace. Compared with the previous Greenbook, we have revised down about ½ percentage point our projection for total export growth in the remainder of 2007 and in 2008, primarily because of the effect of the higher projected path of the dollar on core exports and services.

Alternative Simulations

In our baseline forecast, relatively strong growth abroad is expected to contribute to a continued expansion in U.S activity. However, foreign growth may expand less robustly than projected. To explore this possibility, we used the FRB/Global model to consider two alternative scenarios associated with lower foreign activity.

In the first scenario, we examine a large autonomous fall in foreign investment and consumption. The shock is phased in gradually over two years beginning in the first quarter of 2007, and it lowers foreign GDP 2 percent relative to baseline by the second half of 2008. U.S. real net exports fall directly in response to weaker foreign demand for U.S. goods and indirectly in response to an appreciation of the dollar. The dollar appreciates as monetary authorities abroad cut policy interest rates in reaction to lower foreign inflation and activity. U.S. GDP growth falls 0.2 percentage point below baseline in the second half of this year and 0.4 percentage point in 2008. Core PCE inflation falls 0.1 percentage point relative to baseline in the second half of this year and about 0.2 percentage point in 2008, reflecting both falling import prices and the effects of lower aggregate demand on domestic prices. Although the nominal trade balance improves initially because of J-curve effects, it deteriorates by 0.3 percentage point of GDP relative to baseline in the second half of 2008 and 0.7 percentage point in the second half of 2009 (not shown).

In the second scenario, we examine the effects of an inflationary supply shock such as might be generated by an acceleration of wages or a widening of mark-ups over cost.

This leads monetary policy abroad to tighten, raising real interest rates and causing foreign activity to decelerate. This shock is phased in beginning in the first quarter of 2007 and is also calibrated to lower foreign GDP 2 percent below baseline in the second half of 2008. In the second scenario, there are noticeably smaller spillover effects on U.S. activity and prices than in the first scenario because the dollar depreciates in response to higher real interest rates abroad. Accordingly, the reduction of U.S. real net exports is smaller, and U.S. GDP growth declines only 0.1 percentage point below baseline in the second half of 2007 and in 2008. Core PCE inflation is unchanged in the second half of 2007 and is down about 0.1 percentage point on average in 2008, as the effect of lower resource utilization on domestic inflation is offset to some extent by a rise in import prices.

Alternative Scenarios
Lower Foreign Demand and Higher Foreign Inflation
(Percent change from previous period, annual rate, except as noted)

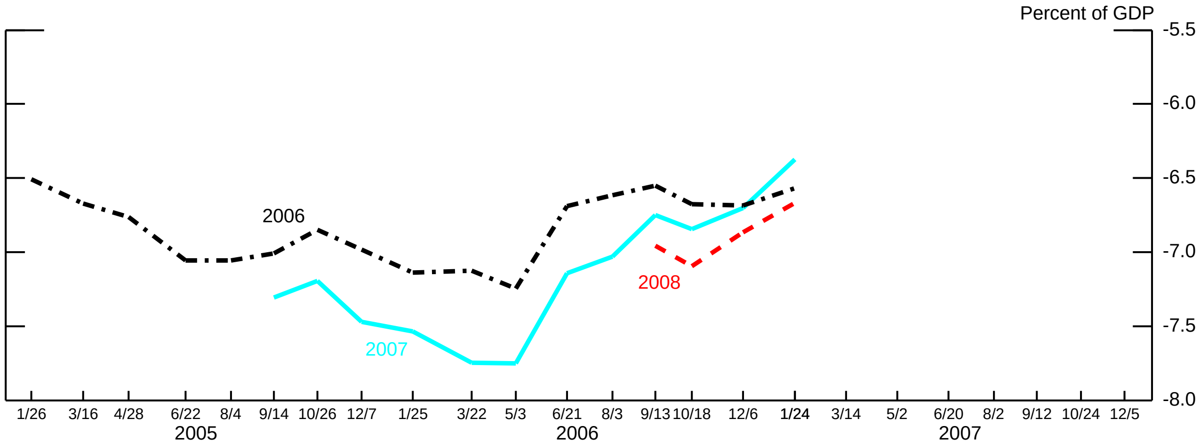
Indicator and simulation	2007		2008	
	H1	H2	H1	H2
U.S. real GDP				
Baseline	2.2	2.4	2.5	2.5
Lower foreign demand	2.1	2.2	2.2	2.1
Higher foreign inflation	2.1	2.3	2.4	2.4
U.S. core PCE inflation				
Baseline	2.2	2.1	2.0	2.0
Lower foreign demand	2.2	2.0	1.8	1.8
Higher foreign inflation	2.2	2.1	1.9	1.8
U.S. federal funds rate (percent)				
Baseline	5.3	5.3	5.3	5.3
Lower foreign demand	5.2	5.0	4.7	4.4
Higher foreign inflation	5.3	5.2	5.1	4.9
U.S. trade balance (percent of GDP)				
Baseline	-5.1	-5.2	-5.3	-5.2
Lower foreign demand	-5.0	-5.2	-5.4	-5.5
Higher foreign inflation	-5.1	-5.2	-5.3	-5.2

NOTE. Half year changes are measured as Q2/Q4 or Q4/Q2. The federal funds rate is the average rate for the final quarter of the period. The monetary authorities in the United States and the major foreign adjust their policy rates according to Taylor rules.

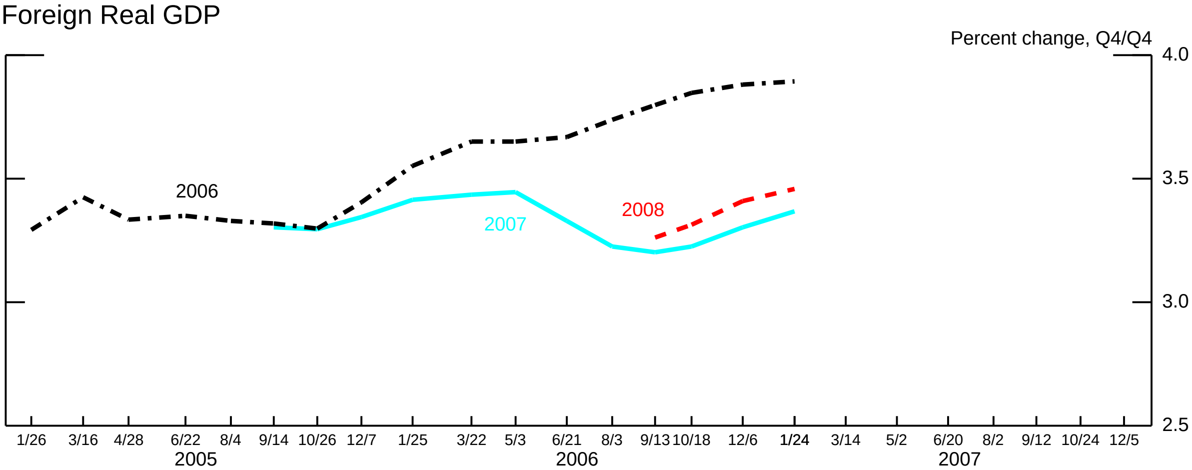
Class II FOMC -- Restricted (FR)

Evolution of the Staff Forecast

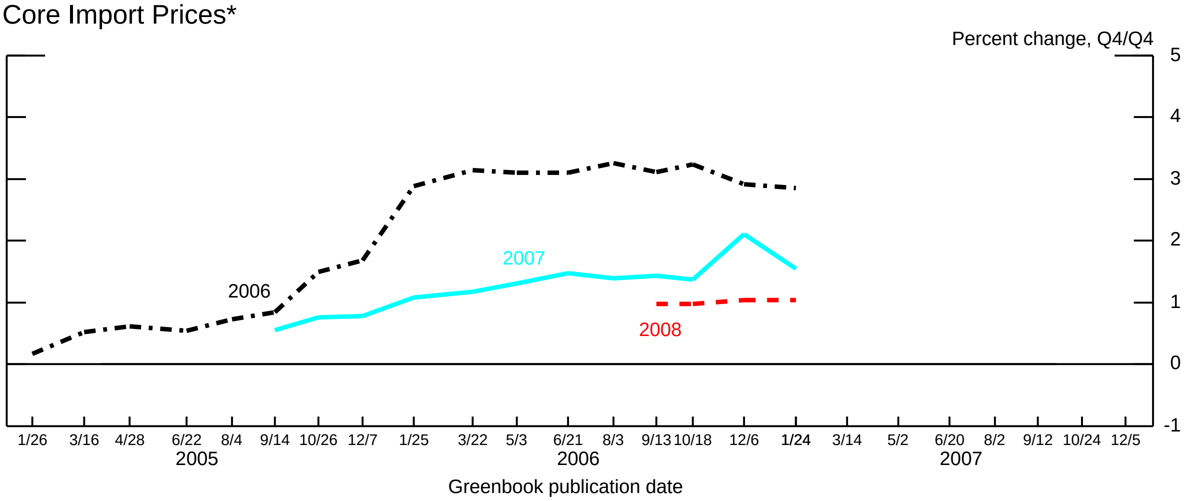
Current Account Balance



Foreign Real GDP



Core Import Prices*



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

Class II FOMC
Restricted (FR)

January 24, 2007

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

Measure and country	2000	2001	2002	2003	2004	2005	2006	2007	2008
							-----Projected----		
REAL GDP (1)									
Total foreign	4.2	0.3	3.1	3.0	3.8	3.7	3.9	3.4	3.5
Advanced Foreign Economies	3.6	0.9	2.5	1.8	2.6	2.6	2.7	2.4	2.5
of which:									
Canada	4.1	1.3	3.5	1.5	3.7	2.8	2.5	2.6	2.9
Japan	3.1	-1.7	2.0	2.4	1.1	2.9	2.0	1.9	1.7
United Kingdom	3.1	2.0	2.3	3.3	2.6	2.0	3.0	2.9	2.5
Euro Area (2)	3.3	1.0	1.1	1.0	1.5	1.8	3.0	1.8	1.8
Germany	2.3	1.1	0.0	0.2	0.2	1.7	3.4	1.5	1.6
Emerging Market Economies	5.2	-0.4	3.8	4.7	5.6	5.4	5.6	4.8	4.9
Asia	5.8	1.0	6.2	6.8	6.0	7.3	6.5	6.0	6.2
Korea	4.3	4.7	7.8	4.2	2.9	5.3	4.2	4.6	4.8
China	7.8	7.1	8.4	10.1	9.6	9.9	9.9	8.8	9.1
Latin America	4.4	-1.3	1.5	2.4	5.2	3.2	4.9	3.5	3.5
Mexico	4.8	-1.3	2.0	2.0	4.8	2.7	4.7	3.4	3.4
Brazil	3.8	-1.0	4.1	0.9	4.8	1.6	3.0	3.5	3.5
CONSUMER PRICES (3)									
Advanced Foreign Economies	1.9	0.9	2.1	1.3	1.8	1.5	1.4	1.5	1.5
of which:									
Canada	3.1	1.1	3.8	1.7	2.3	2.3	1.3	1.7	2.0
Japan	-0.5	-1.1	-0.5	-0.4	0.5	-1.0	0.4	0.2	0.5
United Kingdom (4)	0.9	1.1	1.5	1.3	1.4	2.1	2.7	2.0	1.8
Euro Area (2)	2.5	2.1	2.3	2.0	2.3	2.3	1.8	1.9	1.7
Germany	1.7	1.5	1.2	1.1	2.1	2.2	1.3	2.4	1.4
Emerging Market Economies	4.1	2.8	2.9	3.0	3.9	3.0	2.7	2.8	2.7
Asia	1.8	1.2	0.8	2.2	3.2	2.6	2.1	2.3	2.2
Korea	2.5	3.3	3.4	3.5	3.4	2.5	2.1	2.0	2.3
China	1.0	-0.1	-0.5	2.7	3.3	1.4	1.8	2.1	1.9
Latin America	8.4	5.3	6.4	4.9	5.7	3.8	4.2	3.8	3.7
Mexico	8.7	5.1	5.2	3.9	5.3	3.1	4.1	3.6	3.5
Brazil	6.4	7.5	10.7	11.5	7.2	6.1	3.1	3.5	3.5

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)

January 24, 2007

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

					Projected							
	2006				2007				2008			
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	4.7	4.1	3.3	3.5	3.3	3.4	3.4	3.4	3.5	3.5	3.5	3.5
Advanced Foreign Economies	3.3	2.7	2.0	2.7	2.2	2.4	2.5	2.4	2.5	2.5	2.5	2.4
of which:												
Canada	3.8	2.0	1.7	2.3	2.5	2.4	2.7	2.7	2.9	2.9	3.0	2.9
Japan	2.7	1.1	0.8	3.5	1.8	2.0	1.9	1.9	1.7	1.7	1.7	1.6
United Kingdom	2.9	3.0	2.8	3.4	3.2	3.0	2.8	2.6	2.5	2.5	2.5	2.5
Euro Area (2)	3.3	4.0	2.1	2.6	1.4	2.1	2.0	1.9	1.8	1.8	1.8	1.8
Germany	3.2	4.4	2.6	3.6	-0.2	2.2	2.1	1.8	1.7	1.7	1.6	1.6
Emerging Market Economies	6.6	6.1	5.2	4.7	4.7	4.8	4.8	4.8	4.8	4.8	4.9	4.9
Asia	7.5	5.9	7.0	5.8	5.8	6.0	6.0	6.1	6.2	6.2	6.3	6.3
Korea	4.9	3.4	4.4	4.2	4.5	4.5	4.6	4.7	4.7	4.8	4.8	4.8
China	12.2	12.0	7.0	8.6	8.8	8.8	8.8	8.8	9.0	9.0	9.1	9.3
Latin America	6.2	5.9	4.3	3.1	3.6	3.6	3.5	3.5	3.5	3.5	3.5	3.5
Mexico	6.6	5.6	4.1	2.6	3.3	3.4	3.4	3.4	3.4	3.4	3.4	3.4
Brazil	4.8	1.7	2.0	3.8	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5
CONSUMER PRICES (3)	Four-quarter changes											
Advanced Foreign Economies	1.8	2.0	1.6	1.4	1.3	1.0	1.2	1.5	1.6	1.6	1.5	1.5
of which:												
Canada	2.5	2.6	1.6	1.3	1.0	0.8	1.3	1.7	2.0	2.0	2.0	2.0
Japan	-0.1	0.2	0.6	0.4	-0.0	0.0	-0.2	0.2	0.4	0.5	0.5	0.5
United Kingdom (4)	2.0	2.2	2.4	2.7	2.8	2.5	2.1	2.0	1.9	1.9	1.8	1.8
Euro Area (2)	2.3	2.5	2.1	1.8	2.0	1.6	1.7	1.9	1.8	1.8	1.7	1.7
Germany	2.1	2.1	1.6	1.3	2.5	2.2	2.3	2.4	1.5	1.5	1.4	1.4
Emerging Market Economies	3.0	2.9	2.7	2.7	2.9	2.7	2.8	2.8	2.7	2.7	2.7	2.7
Asia	2.4	2.6	2.1	2.1	2.4	2.1	2.3	2.3	2.2	2.2	2.2	2.2
Korea	2.1	2.3	2.5	2.1	2.0	1.6	1.4	2.0	2.3	2.6	2.5	2.3
China	1.2	1.4	1.2	1.8	2.2	2.1	2.3	2.1	2.0	2.0	1.9	1.9
Latin America	4.2	3.5	3.8	4.2	4.0	4.3	4.1	3.8	3.7	3.7	3.7	3.7
Mexico	3.7	3.1	3.5	4.1	4.0	4.3	3.9	3.6	3.5	3.5	3.5	3.5
Brazil	5.6	4.3	3.8	3.1	2.6	2.9	3.5	3.5	3.5	3.5	3.5	3.5

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)

January 24, 2007

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2000	2001	2002	2003	2004	2005	------ 2006	Projected 2007	------ 2008
NIPA REAL EXPORTS and IMPORTS									
	Percentage point contribution to GDP growth, Q4/Q4								
Net Goods & Services	-0.9	-0.2	-0.9	-0.1	-0.8	-0.1	0.3	-0.2	-0.3
Exports of G&S	0.7	-1.3	0.4	0.6	0.7	0.7	0.9	0.6	0.6
Imports of G&S	-1.6	1.1	-1.3	-0.7	-1.5	-0.8	-0.6	-0.8	-0.8
	Percentage change, Q4/Q4								
Exports of G&S	6.5	-11.9	3.8	5.8	7.0	6.7	8.6	5.1	5.1
Services	1.8	-8.9	10.2	3.0	7.1	3.1	5.4	5.8	5.0
Computers	22.7	-23.5	-1.1	11.3	6.4	14.1	10.0	14.2	14.4
Semiconductors	27.6	-34.6	10.1	38.3	-6.3	17.2	5.5	19.2	17.0
Core Goods 1/	5.9	-10.2	0.6	4.9	8.0	7.5	10.2	3.6	4.1
Imports of G&S	11.2	-7.6	9.7	4.8	10.6	5.2	3.5	5.0	5.1
Services	10.6	-5.9	8.8	2.2	7.6	1.9	5.4	3.2	3.5
Oil	13.3	3.7	3.8	1.2	9.6	0.9	-9.1	4.0	-0.2
Natural Gas	37.3	-6.5	19.5	1.3	6.6	11.9	-13.7	4.7	1.5
Computers	13.9	-13.6	13.2	17.0	22.5	11.8	15.9	17.3	17.5
Semiconductors	22.8	-51.1	11.0	-0.1	9.3	7.5	1.7	17.0	17.0
Core Goods 2/	10.3	-6.5	10.0	5.2	10.7	6.2	5.5	4.5	5.5
	Billions of Chained 2000 Dollars								
Net Goods & Services	-379.5	-399.1	-471.3	-518.9	-590.9	-619.2	-621.5	-613.5	-646.6
Exports of G&S	1096.3	1036.7	1013.3	1026.1	1120.4	1196.1	1300.4	1376.6	1445.7
Imports of G&S	1475.8	1435.8	1484.6	1545.0	1711.3	1815.3	1921.9	1990.1	2092.2
	Billions of dollars								
US CURRENT ACCOUNT BALANCE	-415.2	-389.0	-472.4	-527.5	-665.3	-791.5	-870.4	-886.0	-971.7
Current Acct as Percent of GDP	-4.2	-3.8	-4.5	-4.8	-5.7	-6.4	-6.6	-6.4	-6.7
Net Goods & Services (BOP)	-377.6	-362.8	-421.1	-494.9	-611.3	-716.7	-763.1	-714.7	-767.4
Investment Income, Net	25.7	30.3	17.8	42.3	33.6	17.6	-12.3	-71.9	-103.7
Direct, Net	94.9	115.9	102.4	112.8	123.9	134.4	140.7	130.3	157.5
Portfolio, Net	-69.2	-85.5	-84.6	-70.5	-90.2	-116.8	-153.1	-202.1	-261.1
Other Income & Transfers,Net	-63.3	-56.5	-69.2	-74.9	-87.6	-92.4	-95.0	-99.4	-100.6

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2003				2004				2005			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	0.2	-0.7	0.5	-0.5	-0.7	-1.6	-0.2	-0.8	-0.2	0.7	-0.1	-1.1
Exports of G&S	-0.5	-0.2	1.0	1.8	0.7	0.6	0.5	1.0	0.5	0.9	0.3	1.0
Imports of G&S	0.7	-0.6	-0.5	-2.3	-1.4	-2.2	-0.7	-1.8	-0.6	-0.2	-0.4	-2.0
Percentage change from previous period, s.a.a.r.												
Exports of G&S	-5.3	-1.7	11.4	20.8	7.2	6.2	4.8	9.9	4.7	9.4	3.2	9.6
Services	-20.0	-2.8	17.5	23.1	7.5	5.6	-2.8	19.2	2.9	2.0	2.1	5.5
Computers	-2.3	-5.2	34.7	23.2	-5.8	-3.1	20.7	16.5	13.6	21.9	17.8	3.9
Semiconductors	37.4	30.9	44.6	40.7	11.5	-7.8	-19.1	-7.2	-7.7	21.3	26.3	33.6
Core Goods 1/	0.2	-2.9	5.2	18.3	7.7	8.2	9.7	6.4	5.8	11.9	1.8	10.7
Imports of G&S	-5.0	4.1	3.8	17.6	10.2	16.0	4.4	12.0	4.1	1.4	2.5	13.2
Services	-10.6	-15.7	21.2	19.6	10.9	7.6	3.1	9.0	-0.2	-1.5	1.2	8.3
Oil	-9.7	12.4	-6.0	9.9	37.2	-22.9	-6.4	45.5	7.0	-21.2	-12.5	40.5
Natural Gas	-45.9	72.5	66.4	-32.1	16.2	72.0	43.7	-55.1	23.0	12.3	109.8	-45.9
Computers	11.4	10.7	11.1	36.9	21.1	30.2	27.5	11.9	9.2	9.4	19.6	9.3
Semiconductors	-6.3	1.1	-4.2	9.7	43.3	19.6	3.8	-19.9	-7.4	8.4	15.6	14.9
Core Goods 2/	-3.1	7.2	-0.1	18.1	5.3	23.2	4.2	11.0	4.4	5.8	2.7	12.3
Billions of Chained 2000 Dollars, s.a.a.r.												
Net Goods & Services	-507.2	-526.9	-513.8	-527.8	-548.5	-593.9	-599.4	-621.9	-626.4	-606.1	-607.6	-636.6
Exports of G&S	1003.3	999.0	1026.3	1075.8	1094.8	1111.3	1124.3	1151.3	1164.5	1191.0	1200.5	1228.4
Imports of G&S	1510.5	1525.9	1540.0	1603.6	1643.2	1705.2	1723.7	1773.1	1790.9	1797.1	1808.1	1865.0
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-548.7	-524.4	-526.2	-510.8	-583.3	-667.1	-665.3	-745.4	-766.9	-773.0	-733.7	-892.4
Current Account as % of GDP	-5.1	-4.8	-4.7	-4.6	-5.1	-5.7	-5.6	-6.2	-6.3	-6.3	-5.8	-7.0
Net Goods & Services (BOP)	-496.9	-492.9	-491.9	-497.9	-544.6	-605.6	-626.7	-668.3	-672.4	-688.2	-727.2	-779.1
Investment Income, Net	24.4	41.7	39.2	63.8	57.3	28.2	33.4	15.6	20.7	14.2	37.9	-2.3
Direct, Net	97.2	108.4	109.3	136.3	130.4	113.4	122.8	128.8	121.4	124.2	161.5	130.6
Portfolio, Net	-72.7	-66.6	-70.1	-72.5	-73.1	-85.2	-89.4	-113.2	-100.7	-110.0	-123.6	-132.9
Other Inc. & Transfers, Net	-76.2	-73.2	-73.5	-76.7	-96.1	-89.7	-72.0	-92.7	-115.1	-99.0	-44.3	-111.0

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

Class II FOMC
Restricted (FR)

January 24, 2007

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2006				2007 (Projected)				2008 (Projected)			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-0.0	0.4	-0.2	1.1	-0.5	0.0	0.0	-0.5	-0.6	-0.0	-0.1	-0.4
Exports of G&S	1.4	0.7	0.7	0.8	0.6	0.6	0.6	0.5	0.6	0.6	0.6	0.6
Imports of G&S	-1.5	-0.2	-0.9	0.3	-1.1	-0.6	-0.5	-1.1	-1.1	-0.6	-0.7	-1.0
Percentage change from previous period, s.a.a.r.												
Exports of G&S	14.0	6.2	6.8	7.5	5.3	5.2	5.0	4.8	4.9	5.1	5.2	5.3
Services	6.7	6.7	0.8	7.4	5.7	6.1	5.9	5.6	5.3	5.1	4.9	4.9
Computers	9.8	12.0	-0.1	19.3	13.7	14.4	14.4	14.4	14.4	14.4	14.4	14.4
Semiconductors	15.7	29.9	-12.4	-5.9	26.2	17.0	17.0	17.0	17.0	17.0	17.0	17.0
Core Goods 1/	17.8	4.4	11.4	7.8	3.7	3.7	3.5	3.3	3.7	4.1	4.3	4.5
Imports of G&S	9.1	1.4	5.6	-1.8	6.7	3.5	3.2	6.5	6.9	3.7	4.2	5.8
Services	7.4	9.9	-2.6	7.2	2.3	3.5	3.5	3.5	3.5	3.5	8.0	-0.8
Oil	-4.8	-18.3	7.1	-18.1	25.5	-8.8	-12.6	16.9	18.6	-14.2	-15.7	15.5
Natural Gas	-24.6	42.1	-26.4	-29.5	-21.8	40.8	19.0	-8.3	-14.4	34.3	20.5	-23.5
Computers	34.3	17.0	18.4	-3.0	16.9	17.5	17.5	17.5	17.5	17.5	17.5	17.5
Semiconductors	3.6	-1.3	21.6	-13.9	17.0	17.0	17.0	17.0	17.0	17.0	17.0	17.0
Core Goods 2/	12.4	2.4	6.9	0.8	4.4	4.0	4.6	5.0	5.3	5.6	5.7	5.7
Billions of Chained 2000 Dollars, s.a.a.r.												
Net Goods & Services	-636.6	-624.2	-628.8	-596.3	-610.3	-610.0	-609.0	-624.6	-641.7	-642.5	-645.5	-656.5
Exports of G&S	1269.3	1288.5	1310.0	1333.9	1351.3	1368.5	1385.3	1401.5	1418.4	1436.2	1454.6	1473.5
Imports of G&S	1905.9	1912.7	1938.8	1930.2	1961.6	1978.4	1994.3	2026.1	2060.1	2078.7	2100.1	2130.0
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-852.8	-868.5	-902.2	-858.1	-850.1	-876.5	-888.0	-929.3	-953.8	-960.8	-971.6	-1000.4
Current Account as % of GDP	-6.6	-6.6	-6.8	-6.4	-6.2	-6.3	-6.4	-6.6	-6.7	-6.6	-6.6	-6.7
Net Goods & Services (BOP)	-764.6	-772.5	-801.3	-714.3	-702.0	-706.1	-713.0	-737.7	-764.7	-762.4	-764.6	-777.8
Investment Income, Net	-3.6	-2.1	-8.7	-34.8	-52.3	-73.2	-76.2	-85.7	-90.2	-99.5	-108.1	-116.7
Direct, Net	137.2	152.2	143.2	130.4	126.9	121.0	133.7	139.5	149.5	154.7	160.4	165.4
Portfolio, Net	-140.8	-154.4	-151.9	-165.2	-179.2	-194.3	-209.8	-225.2	-239.8	-254.2	-268.5	-282.1
Other Inc. & Transfers, Net	-84.7	-93.9	-92.3	-109.0	-95.8	-97.2	-98.9	-105.9	-98.9	-98.9	-98.9	-105.9

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