Prefatory Note

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Content last modified 02/07/2013.

Class II FOMC - Restricted (FR)

Part 1

May 2, 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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Summary and Outlook

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Domestic Developments

The economic data we have received in recent weeks have generally met our expectations for spending and production in the near term, and we continue to project that real GDP will increase at an annual rate of about 2 percent in the first half of this year. The one notable exception is the housing market, for which recent readings on sales and inventories of new homes suggest that the ongoing contraction will continue longer than we had projected. In response, we have deepened the projected decline in residential investment in 2007 and removed the modest recovery in 2008 that we had been forecasting in the March Greenbook. In addition, crude oil prices have jumped again, and longer-term interest rates have moved up a bit. However, on the other side of the scales, equity prices are significantly higher in this forecast, and the foreign exchange value of the dollar is lower. The net effect of these revisions is small, and we continue to project that real GDP will increase 2 percent in 2007 and 2½ percent in 2008, about the same as forecasted in the March Greenbook.

Higher prices for energy have pushed up our projection for headline inflation. In addition, our current projection has higher prices for core nonfuel imports, a somewhat lower level of structural productivity, and a slightly tighter labor market. Altogether, these factors have contributed to a small upward revision in our forecast for core PCE inflation that amounts to 0.1 percentage point in both 2007 and 2008. Nonetheless, we continue to expect core inflation to moderate as energy prices flatten out, core import prices decelerate, and resource utilization eases; core PCE price inflation drops from 2.3 percent this year to 2.1 percent in 2008.

Key Background Factors

In light of the upward revision to our inflation forecast and slightly higher resource utilization, we now assume that the Committee will hold the federal funds rate at 5¼ percent through the end of 2008 rather than lower it to 5 percent late next year as in our previous projection. Market participants have revised up their expected path for policy a bit, but they still anticipate a considerable easing over the forecast period, with the federal funds rate expected to fall to about 4½ percent by the end of 2008. Interest rates on longer-term securities have risen about 15 basis points since the March Greenbook, reflecting the market's upward revision to policy expectations and increases in term premiums. We expect yields to drift up further over the projection period as market expectations for the federal funds rate move closer to ours and as term premiums rise further from what are still exceptionally low levels. Rates on conventional mortgages are projected to follow a similar path.

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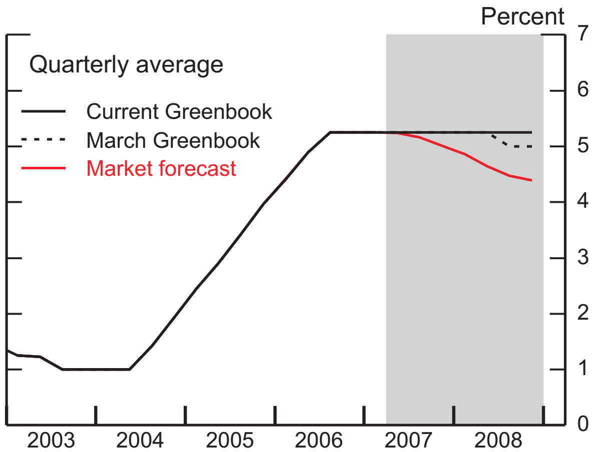
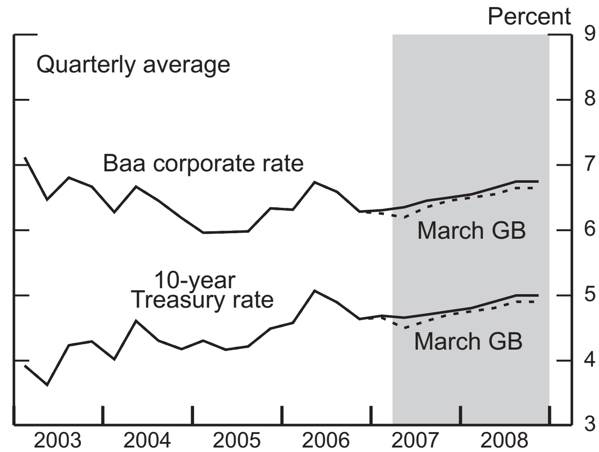
Key Background Factors Underlying the Baseline Staff Projection

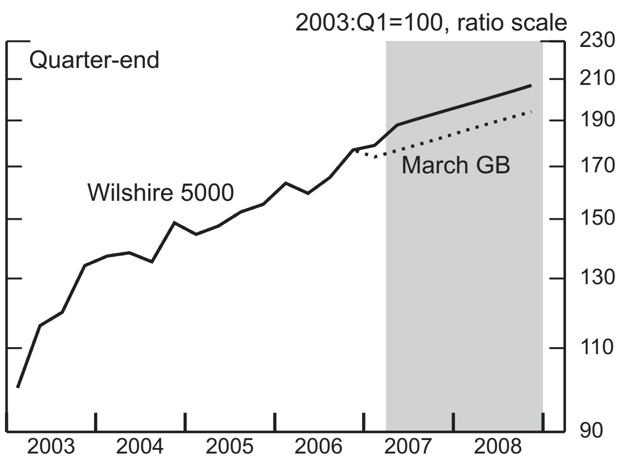
Federal Funds Rate



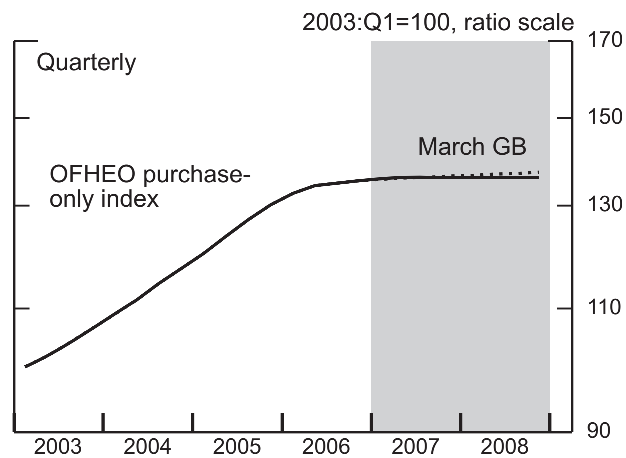
Long-Term Interest Rates



Equity Prices

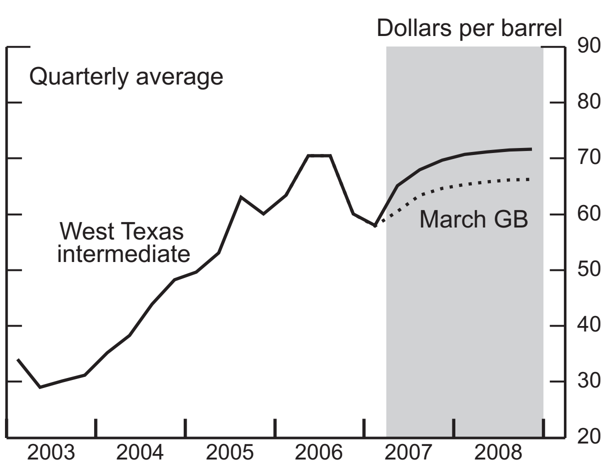


House Prices

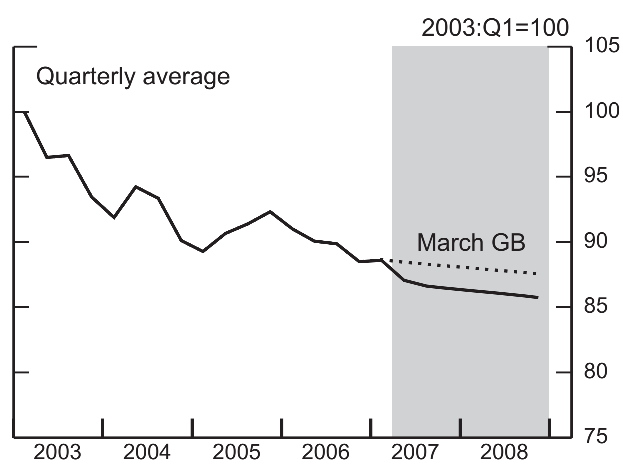


Note. The projection period begins in 2007:Q1.

Crude Oil Prices



Broad Real Dollar



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

The stock market has rallied since the March Greenbook, and we have revised up our starting point for equity prices about 6½ percent. As in previous Greenbooks, we assume that share prices will henceforth increase 6½ percent per year, which would roughly maintain risk-adjusted parity with the yield on long-term bonds. Although house prices have thus far decelerated about in line with our expectations, we have become more concerned that a worsening inventory overhang among homebuilders and a high level of delinquencies and foreclosures among homeowners could add some downward pressure. As a result, we now assume that the purchase-only version of the OFHEO house-price index will be essentially unchanged through the end of 2008 after increasing 11 percent in 2005 and 4 percent in 2006; we had previously projected this measure of house prices to increase about ¾ percent per year.

Our assumptions about fiscal policy are unchanged from the March Greenbook. In particular, we continue to assume that the supplemental spending bill for fiscal year 2007 will pass shortly, that nondefense spending will hold steady in real terms, and that relief from the alternative minimum tax will be extended through calendar 2008. In addition, we expect nominal spending for the global war on terrorism to rise from $100 billion in fiscal 2006 to $125 billion in fiscal 2007 and to $145 billion in fiscal 2008; other defense outlays are anticipated to rise moderately in real terms. We do not expect that the delay in passing the supplemental spending bill will affect defense outlays for fiscal 2007 as a whole. In all, federal fiscal policy is projected to provide an impetus to real GDP growth of ¼ percentage point in both calendar 2007 and 2008. In the state and local sector, we anticipate that policy will provide an impetus to growth of about 0.3 percentage point this year and next.

Since the last Greenbook, we have revised down our forecast for the unified federal budget deficit to $171 billion in the current fiscal year and to $238 billion in fiscal 2008, both just a little smaller than our previous projections. Corporate tax revenues have come in higher than expected while individual income tax receipts have been a bit lower than expected. The growth in corporate revenues has slowed substantially from recent years, and the rise in individual receipts has been a little less buoyant.

The foreign exchange value of the dollar has fallen since the March Greenbook. As a result, we have lowered the projected level of the real trade-weighted dollar in the current quarter 1½ percent. We continue to assume that the dollar will move down gradually through the end of 2008, and we have maintained our view that foreign real GDP will increase 3½ percent in both 2007 and 2008 after rising 4 percent in 2006.

Oil prices have risen noticeably in recent weeks amid heightened concerns about supply disruptions in the Middle East and Nigeria, firming indications that OPEC will maintain restraint on production, and possibly expectations of greater global demand for oil. The spot price of West Texas intermediate (WTI) crude oil closed at $64.41 on May 1, about $6 per barrel above its level at the time of the March Greenbook. Consistent with the readings from futures markets, we assume that the price for WTI crude oil will move up to almost $72 per barrel by the end of 2008, a path that averages about $5 per barrel higher than in our previous projection. The price of imported oil has been revised up about $6 per barrel over the forecast period, as prices of other grades of oil have risen more than the price of WTI since the time of the March Greenbook.

Recent Developments and the Near-Term Outlook

We estimate that real GDP increased at an annual rate of about 1¼ percent in the first quarter. That figure is in line with the advance estimate from the Bureau of Economic Analysis (BEA), but it reflects stronger data for construction put in place, a lower level of manufacturing inventory investment, and the staff projection that net exports will be weaker in March than the BEA had assumed. For the current quarter, we project that real GDP will move up at an annual rate of 2½ percent.

The demand for labor appears to have decelerated a bit so far this year. Private payrolls increased at an average monthly rate of 125,000 in the first quarter, about 40,000 per month less than in the fourth quarter. We anticipate that employment gains will continue to move down over the next few months, to below 100,000 per month by midyear. The unemployment rate edged down to 4.4 percent in March, but we expect it to drift up to 4.6 percent by midyear as the pace of hiring slows further.

After falling late last year, manufacturing output excluding motor vehicles increased at an annual rate of 2 percent in the first quarter; production continued to be restrained by inventory-related adjustments in industries such as construction supplies and semiconductors. With the effects of the inventory adjustments apparently lessening, we project manufacturing production excluding motor vehicles to increase at an annual rate of 3½ percent in the current quarter. In the motor vehicle sector, the sharp decline in the pace of assemblies over the past few quarters has brought inventories back into line with sales, and automakers' schedules call for a noticeable step-up in motor vehicle production in the second quarter.

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

Measure	2007:Q1		2007:Q2	
	Mar. GB	May GB	Mar. GB	May GB
Real GDP	**1.5**	**1.3**	**2.3**	**2.6**
Private domestic final purchases	1.9	2.5	.8	.7
Personal consumption expenditures	3.7	3.8	2.2	1.9
Residential investment	-22.2	-14.1	-19.9	-18.5
Business fixed investment	2.8	2.8	2.7	2.9
Government outlays for consumption and investment	1.4	1.4	4.8	4.9
	Contribution to growth (percentage points)			
Inventory investment	.1	-.4	.2	.2
Net exports	-.4	-.8	.4	.8

According to the advance estimate from the BEA, real consumer spending increased at an annual rate of about 3¾ percent in the first quarter after having risen at a 4¼ percent pace in the fourth quarter. However, the recent pattern of monthly readings suggests that the growth rate of consumer spending slowed appreciably in the late winter, and we project that real PCE will increase at an annual rate of just 2 percent in the second quarter, a pace more in line with fundamentals than was the robust showing of the past few quarters.

Recent readings on housing suggest that this sector is continuing to weaken: New home sales in March were well below the plateau seen late last year, the cancellation rate for such sales appears to have moved back up, and builders' inventories of unsold homes remain very high. Existing home sales and mortgage applications paint a more benign picture, but even these indicators remain soft. The recent weakening in the housing market likely reflects developments in nonprime mortgage lending—including a high level of delinquencies among borrowers and stricter standards among lenders—and a pullback in housing demand more generally. We now assume that new homes will be sold at an annual rate of 830,000 units in the current quarter, about 15 percent below our projection in the March Greenbook. On the production side, single-family starts picked up to an annual rate of 1.22 million units in March, but we think that homebuilding in that month was boosted by unusually favorable weather. We expect that single-family starts will move down to an annual rate of just 1.08 million units in the second quarter as weather returns to normal and as builders cut production in response to the weaker pace of sales. Starts of multifamily housing in the first quarter dropped to an annual rate of 300,000 units, a touch below the bottom of the fairly tight range they have occupied for the past decade; we expect that multifamily starts will be about unchanged in the current quarter.

Real investment in equipment and software (E&S) increased at an annual rate of only 1¾ percent last quarter after falling 4¾ percent in the previous quarter. Although an outsized gain in spending for aircraft and robust business outlays on high-tech equipment boosted capital spending last quarter, the tightening of emissions standards that took effect in January crimped spending on medium and heavy trucks, and spending on capital goods outside of high-tech and transportation contracted sharply. We expect that a drop in spending on transportation equipment and a moderation in high tech will restrain investment growth in the current quarter. Orders and shipments of other types of capital goods showed some improvement in March and seem consistent with our projection that outlays in this sector will turn up modestly this quarter. All told, we project that real E&S investment will increase at an annual rate of just 1½ percent in the second quarter.

We estimate that business spending on nonresidential structures (NRS) increased at an annual rate of 5¼ percent in the first quarter after a ¾ percent rise in the fourth quarter, and we are projecting investment growth in this sector to step up to a 6¼ percent rate in the second quarter. Although outlays for drilling and mining structures fell sharply last quarter, the high prices for natural gas and crude oil suggest that the decline will be temporary. We estimate that private spending on other NRS construction increased at a 12 percent pace last quarter, and the recent readings on architectural billings—which tend to lead NRS spending by about six months—suggest that construction in this sector will post another sizable advance in the second quarter.

We estimate that real nonfarm inventory investment edged down from an annual rate of $20 billion in the fourth quarter to $8 billion in the first quarter. As noted previously, inventories of motor vehicles were drawn down sharply in the first quarter to more comfortable levels, and we expect to see little further change in these stocks in the current quarter. Excluding motor vehicles, we estimate that nonfarm inventory investment slowed in the first quarter as firms adjusted production in response to inventory overhangs in some sectors. However, our sense is that some imbalances remain, and thus we expect that non-auto firms will further reduce the pace of inventory investment in the current quarter.

In the government sector, real federal expenditures on consumption and gross investment decreased at an annual rate of 3 percent in the first quarter, mainly on a 6½ percent decline in real defense spending. We project that real federal purchases will increase at an annual rate of about 8 percent in the second quarter as defense spending bounces back. In the state and local sector, we estimate that real purchases increased at an annual rate of 4 percent in the first quarter, led by a surge in construction activity. Although we anticipate that capital outlays will decelerate appreciably this quarter, we still expect that the sound fiscal condition of most state and local jurisdictions will allow overall spending in this sector to increase at a solid pace.

We estimate that net exports trimmed ¾ percentage point from the change in real GDP in the first quarter, as real imports rose at an annual rate of 4 percent and real exports fell 1 percent. Imports were boosted by sizable increases in imports of oil and computers, while the weakness in exports was broadly based. We expect net exports to add ¾ percentage point to real growth in the current quarter, as we project exports to rebound and imports to be flat.

The core PCE price index rose at an annual rate of 2¼ percent in the first quarter, a step up from the pace seen late last year but about equal to the increase for 2006 as a whole. Core PCE prices posted sizable increases in January and February but moderated significantly in March. In all, the near-term data on core inflation were in line with our projection in the March Greenbook, and we continue to expect that this measure of prices will increase at an annual rate of 2¼ percent in the second quarter. A sharp increase in gasoline prices pushed overall PCE price inflation to 3¼ percent in the first quarter, ½ percentage point above our projection in the March Greenbook. We expect an even sharper increase in gasoline prices in the current quarter to push overall PCE inflation to 4¼ percent, 1½ percentage points above our previous projection.

The recent data on compensation remain difficult to interpret. We estimate that, in the first quarter, compensation per hour in the nonfarm business sector rose at an annual rate of just 1¾ percent after an outsized gain in the fourth quarter (when the BEA incorporated an estimate of one-time bonus payments and stock option exercises). The employment cost index (ECI) increased only 2¼ percent in the first quarter, held down by a sharp drop in employer contributions to defined-benefit pension plans. The combination of large contributions in recent years and strong returns on assets apparently left the plans in better shape and allowed firms to cut back on contributions early this year. The wages and salaries component of the ECI posted a sizable 4¼ percent rise last quarter. In light of what we presume are temporary factors restraining compensation growth, we are projecting both measures of compensation to accelerate noticeably in the second quarter.

The Longer-Run Outlook for the Economy

After a projected rise of 2 percent at an annual rate over the first half of this year, real GDP is expected to increase at a similar rate in the second half and then nearly 2½ percent in 2008. As in previous Greenbooks, this gradual acceleration largely reflects a waning of the drag from residential investment. With real GDP growth expected to remain below potential growth on average over the projection period, the output gap closes by the end of next year.

Household spending. The projected contour for personal consumption spending is similar to that in the March Greenbook, with real PCE expected to increase at an annual rate of about 2 percent in the second half of this year and 2½ percent in 2008. The higher path of equity prices in this projection provides an added boost to spending, though this effect is nearly offset by the greater drag on real income from the recent run-up in energy prices. More broadly, we anticipate that the combination of diminishing wealth effects and a lagged response to higher interest rates and energy prices will keep growth in household spending below that of income over most of the projection period, so that the personal saving rate eventually rises about 1 percentage point, to nearly zero, by the end of next year.

As noted above, the incoming data on home sales suggest that housing demand has been weaker than expected and that inventory problems among homebuilders have intensified. Accordingly, we now expect that single-family homes will be started at an annual rate of 1.05 million units in the second half of this year and at a 1.10 million unit pace in 2008; this forecast represents a downward revision of almost 4 percent in 2007 and 10 percent in 2008 relative to our previous projection. In the multifamily sector, starts are expected to hold steady at about 310,000 units per year. Consistent with our starts forecast, real residential investment is projected to fall 15 percent in 2007 and 1 percent in 2008.

Business investment. After a sluggish first half, the growth of real E&S spending is projected to pick up to an annual rate of about 4 percent in the second half of this year and to 4¾ percent in 2008. In part, the acceleration reflects an upturn in business outlays for motor vehicles following a temporary pullback early this year. More broadly, we

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

Measure	2007 H1	2007 H2	2008
Real GDP	**1.9**	**2.0**	**2.4**
Previous	1.9	2.3	2.3
Final sales	2.0	1.8	2.4
Previous	1.7	2.1	2.4
PCE	2.9	2.1	2.5
Previous	3.0	2.1	2.4
Residential investment	-16.3	-13.6	-1.1
Previous	-21.1	-3.9	1.9
BFI	2.8	3.5	3.8
Previous	2.7	3.9	3.9
Government purchases	3.1	2.9	1.9
Previous	3.0	2.5	2.1
Exports	3.2	6.2	5.7
Previous	5.6	5.7	5.2
Imports	2.1	3.6	4.2
Previous	4.0	4.4	4.7
	Contribution to growth (percentage points)		
Inventory change	-.1	.2	-.1
Previous	.2	.2	-.1
Net exports	.0	.1	-.0
Previous	-.0	-.1	-.2

anticipate that the demand for high-tech equipment will continue to rise smartly, and we expect that several factors—favorable financial conditions, an expected gradual pickup in the growth of business output, and what appears to be reasonably positive business attitudes—will boost outlays for other types of equipment.

We project that real outlays for NRS construction will decelerate markedly in the second half of this year and will increase 2 percent in 2008. Although we expect investment in drilling and mining structures to rebound in the second half of this year in response to higher prices for natural gas and crude oil, growth of spending in this area should slow late next year after energy prices flatten out. Spending on other types of structures is projected to move up further this year, but the growth in outlays will likely be restrained by a deceleration in the demand for workspace associated with our projected slowdown in overall employment growth.

We anticipate that any lingering inventory imbalances will be eliminated by midyear. As a result, inventory investment is projected to be a roughly neutral influence on real GDP growth over the remainder of the projection period.

Government spending. We project that real federal expenditures for consumption and investment will rise at an annual rate of 3¾ percent in the second half of 2007 and 1½ percent in 2008; virtually all of the increase over this period is expected to be in defense purchases. Meanwhile, with state and local balance sheets in good shape, we expect real purchases in that sector to rise at a 2½ percent pace over the remainder of this year and 2 percent in 2008.

Net exports. We project that real exports will increase at an annual rate of about 6¼ percent in the second half of this year before slowing to a 5¾ percent pace in 2008 as the effects of dollar depreciation lessen. The reduced pace of depreciation, along with the flattening out of commodity prices and a pickup in GDP growth, leads real imports to accelerate from a 3½ percent rate of growth in the second half of 2007 to 4¼ percent in 2008. In light of the downward revision in our forecast for the broad real dollar, we now project that the effect of real net exports on the growth of real GDP this year and next will be roughly neutral instead of the slight drag we had assumed in the March Greenbook. *(The International Developments section provides more detail on the outlook for the external sector.)*

Aggregate Supply, the Labor Market, and Inflation

In this forecast, we have altered our estimates for the growth of both trend hours and structural productivity. In particular, labor force participation and average weekly hours have been higher for a while than we had been projecting, and we have boosted our assumption for trend hours growth in response. In contrast, the recent pace of productivity growth has been a little slower than we had been projecting; we have thus edged down our assumption for the growth rate of structural productivity about ¼ percentage point, to 2¼ percent this year and to about 2 percent in 2008. The implications of these revisions for potential output are small: On net, we have reduced our estimate of potential output growth a touch in 2005 and 2006, but we are still

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**	**2.3**	**2.3**	**2.2**	**2.1**
Previous	1.5	2.5	3.0	2.5	2.6	2.5	2.4
Contributions[1]							
Capital deepening	.7	1.4	.7	.6	.7	.6	.6
Previous	.7	1.4	.6	.5	.7	.6	.6
Multifactor productivity	.5	.7	2.1	1.5	1.4	1.4	1.4
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	2.5	2.6	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	2.1	1.5	1.9	2.6
Previous	2.1	1.5	2.1	2.6
Nonfarm private payroll employment	2.0	1.8	.8	.3
Previous	2.0	1.8	.7	.3
Household survey employment	1.9	2.1	.6	.5
Previous	1.9	2.1	.4	.4
Labor force participation rate[1]	66.1	66.3	66.1	65.8
Previous	66.1	66.3	66.0	65.7
Civilian unemployment rate[1]	5.0	4.5	4.8	5.0
Previous	5.0	4.5	4.9	5.1
MEMO				
GDP gap[2]	.2	.7	.1	.0
Previous	.1	.5	-.0	-.2

1. Percent, average for the fourth quarter.
2. Actual less potential GDP in the fourth quarter of the year indicated as a percent of potential GDP. A negative number thus indicates that the economy is operating below potential.

assuming that it will increase about 2½ percent per year in 2007 and 2008. With the growth of actual GDP projected to run below that pace in both years, we expect the output gap to close by the end of the 2008.

Productivity and the labor market. Productivity in the nonfarm business sector increased at an annual rate of only ¾ percent in the second half of 2006, as hiring remained robust despite the reduced pace of output growth. We project that productivity will increase at an annual rate of about 1½ percent in the first half of the year. However, we expect that, in the second half of this year, firms will bring their workforces into better alignment with production and that private hiring will slow markedly to a pace of less than 50,000 per month. As a consequence of this adjustment, we project that productivity growth will pick up to a 2½ percent rate in the second half of 2007 and in 2008, a pace slightly above our updated estimate of its structural rate. Our forecast has the unemployment rate moving up to 4¾ percent in the second half of 2007 and 5 percent by the end of 2008; the path of the unemployment rate is 0.1 percentage point below that in the March Greenbook.

Prices and labor costs. We have marked up our projection for the increase in total PCE prices this year 0.4 percentage point, to 2.9 percent, in response to the recent high readings on energy prices. These added pressures—along with higher projected prices for core nonfuel imports, the small downward revision we made to our estimate of structural productivity growth, and slightly tighter labor and product markets—led us to revise up our projection for core PCE prices as well. That said, with long-term inflation expectations apparently still contained, we continue to project a modest lessening of core inflation as energy prices flatten out, core nonfuel import prices decelerate, and pressures on resource utilization gradually ease. All told, we expect core PCE prices to rise 2.3 percent this year and 2.1 percent in 2008.

As noted above, increases in both the ECI and productivity and costs (P&C) measures of compensation per hour in the nonfarm business sector came in to the low side of our expectations in the first quarter. In both cases, however, we think that the latest readings likely reflected temporary factors that have little bearing on marginal costs of production and the setting of prices. Given higher headline price inflation and the slightly lower unemployment rate in this projection, we have edged up our forecast for the change in the

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

Measure	2005	2006	2007	2008
PCE chain-weighted price index	3.1	1.9	2.9	2.1
Previous	3.1	1.9	2.5	2.1
Food and beverages	2.1	2.3	3.4	2.2
Previous	2.1	2.3	3.1	2.2
Energy	21.2	-3.7	11.0	.8
Previous	21.2	-3.6	6.1	1.7
Excluding food and energy	2.1	2.2	2.3	2.1
Previous	2.1	2.2	2.2	2.0
Consumer price index	3.7	1.9	3.3	2.2
Previous	3.7	1.9	2.8	2.2
Excluding food and energy	2.1	2.7	2.4	2.3
Previous	2.1	2.7	2.4	2.2
GDP chain-weighted price index	3.1	2.5	2.6	2.3
Previous	3.1	2.5	2.7	2.3
ECI for compensation of private industry workers[1]	2.9	3.2	3.4	4.0
Previous	2.9	3.2	3.9	3.9
Compensation per hour, nonfarm business sector	3.7	4.9	3.9	4.9
Previous	3.7	4.9	4.1	4.8
Prices of core nonfuel imports	2.2	2.7	3.2	1.3
Previous	2.2	2.7	2.0	1.1

1. December to December.

ECI to 4 percent in 2008 and for the growth rate in the P&C measure of hourly compensation for that year to almost 5 percent.[1]

Financial Flows and Conditions

After having increased nearly 8 percent in 2006, domestic nonfinancial debt is projected to expand 6¾ percent in the first quarter before slowing to 6 percent, on average, over the

[1] We continue to assume that the Congress will pass legislation that raises the federal minimum wage 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. We expect the initial increase to take place in the third quarter of 2007. However, the effect on hourly compensation growth likely will be less than 0.1 percentage point in each year because the wages of most workers will not be affected.

remainder of this year and to 5¾ percent in 2008. The projected slowdown holds for all sectors except the federal government.

Household debt is expected to increase 5½ percent this year and 5 percent next year, well below last year's pace of 8½ percent. The moderation reflects, in part, an expectation of restrained mortgage borrowing as home prices flatten out. In addition, the growth of consumer credit is projected to moderate in line with the small expected increases in spending on consumer durable goods. The problems faced by borrowers with variable-rate mortgages are expected to rise, and our forecast of flat home prices and higher mortgage rates is expected to weigh further on household credit quality this year and next. However, we do not expect the deterioration to be broad enough to affect aggregate consumer spending significantly.

Nonfinancial business debt rose 9 percent last year, and we expect its pace to slow to 8¼ percent this year and to 6¾ percent next year. The deceleration mainly reflects reduced merger and acquisition activity and fewer share repurchases. Over the projection period, we view corporate defaults as likely to move up from their extraordinarily low levels of late as profits level out and leverage rises toward a more typical level.

Federal government debt, which increased 4 percent last year, is expected to increase at an average pace of 5 percent through the end of 2008. Because we expect state and local government borrowing to be held down by reduced opportunities for advance refunding, we project the rise in debt in this sector to slow from last year's pace of 8¼ percent to 8 percent this year and 6½ percent in 2008.

After having expanded 5 percent in 2006, M2 is projected to increase 5½ percent in 2007 and 5 percent in 2008. This pace is a bit faster than the rate of growth projected for nominal GDP, given a gradual decline in opportunity costs over the forecast period.

Alternative Simulations

We consider several risks to the staff outlook using simulations of the FRB/US model. In the initial two scenarios, aggregate spending is weaker than expected—in the first case because of a more pronounced correction in the housing market and in the second case because of greater business caution that spills over into financial markets. In contrast, the third scenario considers the risk that consumers and firms will be more willing to spend than assumed in the baseline. The fourth and fifth scenarios focus on supply-side risks by exploring the implications of a lower NAIRU and of a systematic understatement of

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

Measure and scenario	2006	2007 H1	2007 H2	2008 H1	2008 H2
Real GDP					
Greenbook baseline	2.2	1.9	2.0	2.4	2.4
Greater housing correction	. . .	1.7	1.4	1.9	2.2
Business caution with financial spillovers	. . .	1.7	1.1	1.3	1.4
Stronger aggregate demand	. . .	2.0	3.0	3.0	3.6
Lower NAIRU	. . .	1.9	2.2	2.6	2.7
Mismeasured productivity	2.5	2.5	2.2	2.5	2.5
Unanchored inflation expectations	. . .	1.9	2.0	2.4	2.5
Market-based federal funds rate	. . .	1.9	2.0	2.6	2.8
Unemployment rate[1]					
Greenbook baseline	4.5	4.6	4.8	4.9	5.0
Greater housing correction	. . .	4.6	4.9	5.1	5.3
Business caution with financial spillovers	. . .	4.6	4.9	5.2	5.5
Stronger aggregate demand	. . .	4.6	4.7	4.6	4.5
Lower NAIRU	. . .	4.6	4.8	4.8	4.9
Mismeasured productivity	. . .	4.6	4.7	4.7	4.8
Unanchored inflation expectations	. . .	4.6	4.8	4.9	5.0
Market-based federal funds rate	. . .	4.6	4.8	4.9	4.9
Core PCE inflation					
Greenbook baseline	2.0	2.2	2.3	2.2	2.1
Greater housing correction	. . .	2.2	2.3	2.2	2.1
Business caution with financial spillovers	. . .	2.2	2.3	2.3	2.2
Stronger aggregate demand	. . .	2.2	2.3	2.2	2.1
Lower NAIRU	. . .	2.2	2.2	2.0	1.8
Mismeasured productivity	. . .	2.2	2.2	2.1	1.9
Unanchored inflation expectations	. . .	2.2	2.3	2.4	2.4
Market-based federal funds rate	. . .	2.2	2.3	2.3	2.2
Federal funds rate[1]					
Greenbook baseline	5.2	5.3	5.3	5.3	5.3
Greater housing correction	. . .	5.2	5.0	4.7	4.6
Business caution with financial spillovers	. . .	5.2	4.9	4.4	4.1
Stronger aggregate demand	. . .	5.3	5.8	6.1	6.5
Lower NAIRU	. . .	5.3	5.3	5.1	4.9
Mismeasured productivity	. . .	5.3	5.5	5.5	5.4
Unanchored inflation expectations	. . .	5.3	5.3	5.3	5.5
Market-based federal funds rate	. . .	5.3	5.1	4.7	4.4

1. Percent, average for the final quarter of the period.
. . . Not applicable.

recent productivity growth. The sixth scenario considers the possibility that long-run inflation expectations—which have been quite stable for some time in the face of elevated price gains—will begin to drift up appreciably. We evaluate the risks in each of

these scenarios under the assumption that monetary policy responds to the change in the outlook as suggested by an estimated version of the Taylor rule. In the final scenario, we assume that monetary policy follows a path implied by quotes from the futures market.

Greater housing correction. The baseline forecast for the housing market could be too optimistic in several ways: Builders may cut back on new construction by more than we expect in an attempt to more quickly reduce the backlog of unsold homes; the pace of home sales may stabilize rather than firm later this year; and home prices may decline appreciably rather than merely level out as in the baseline. In this scenario, all these possibilities occur. The level of real residential investment falls 10 percent below baseline by the middle of 2008. In addition, home prices fall 10 percent both this year and next, lowering household net worth $4½ trillion relative to baseline and eliminating most of the current overvaluation in the housing market that is suggested by some models. The reductions in employment and income implied by the falloff in construction activity, combined with the loss in wealth, directly damp consumer spending and indirectly depress business investment. As a result, real GDP rises only 1½ percent this year and 2 percent next year, causing the unemployment rate to rise to 5¼ percent by late 2008. In response to weaker real activity, the federal funds rate falls to 4½ percent by late next year. Inflation is unchanged from baseline because the additional amount of slack is small and because the easing in monetary policy leads to a lower dollar and somewhat higher import prices.

Business caution with financial spillovers. The recent weakness in business investment may be a sign that firms are more cautious than we have assumed, perhaps because of uncertainty about the economywide implications of the current housing slump. In this scenario, such caution keeps real outlays on both equipment and structures unchanged through the end of 2008; in the baseline, they expand on average about 4 percent per year. Firms also scale back hiring more aggressively than in the baseline, so private payrolls stay flat. The resultant weakening in real activity leads investors to reassess market risks; as a result, yield spreads on corporate bonds over Treasuries rise about 100 basis points, and equity prices fall about 15 percent. All told, real GDP increases only 1½ percent per year on average this year and next, and the unemployment rate rises to 5½ percent by late 2008. Despite the additional slack in labor and product markets, inflation is a touch above baseline in part because the reduced pace of capital deepening slows the rise in trend labor productivity and therefore boosts unit labor costs; in addition, the lower path for the dollar boosts import prices. With the monetary policy implications of weaker real activity outweighing those of faster inflation, the federal funds rate falls to 4 percent by the end of next year.

Stronger aggregate demand. The baseline forecast for only modest economic growth through the end of the projection period rests importantly on the view that consumer spending will slow noticeably, thereby pushing up the personal saving rate almost to zero, and that business investment will expand at a pace that is subdued by historical standards. In this scenario we instead assume that households and firms are more willing to spend. As a result, the saving rate remains near negative 1 percent, and real E&S outlays rise 7 percent this year and next, a rate close to the historical norm and nearly 3 percentage points faster than in the baseline. Accordingly, real GDP rises 2½ percent this year and 3¼ percent in 2008, and the unemployment rate remains close to its current level. In response to stronger real activity, the federal funds rate gradually moves up to 6½ percent, causing both a rise in long-term interest rates and a modest appreciation of the dollar. The latter effect helps to offset the inflationary pressures associated with tighter labor and product markets, and so inflation is unchanged from baseline.

Lower NAIRU. Recent increases in real wages have been modest despite the relatively low level of the unemployment rate; given that our estimates of aggregate resource utilization are imprecise, we may have misjudged how much slack remains in labor and product markets. In this scenario we assume that, over the past few years, the NAIRU gradually declined to 4¼ percent rather than having held steady at 5 percent as in the baseline. The additional slack causes core inflation to fall to 1¾ percent by the end of next year, prompting a monetary easing that gradually lowers the federal funds rate to just under 5 percent. Lower interest rates, in turn, stimulate real activity.

Mismeasured productivity. The deceleration in output per hour in recent quarters has led us to mark down our estimates for structural productivity growth. But because these data are still subject to considerable revision, the apparent slowdown may simply reflect measurement error. In fact, income-side measures of real activity suggest much larger productivity gains over the past year. In this scenario, we assume that published estimates of inflation and employment are accurate but that actual output and productivity since early last year have, in reality, been rising about 1 percentage point faster per year than indicated by the BEA’s current estimates. We assume that this stronger performance is partly structural, reflecting growth in both trend labor productivity and potential output that is ¼ percentage point faster than in the baseline since early 2005. However, because the rest of the additional output growth is cyclical, the current output gap is about ½ percentage point higher in this scenario—a revision that largely eliminates the tension that has been created by a labor market that has continued to tighten in the face of only modest measured GDP growth. By itself, the revision to structural productivity implies smaller future gains in unit labor costs and thus less upward pressure on prices; the revisions also imply that the markup of prices over trend unit labor costs is in reality now higher than we estimate, implying more scope for price restraint as profit margins erode. Taken together, these two factors outweigh the inflationary effect of greater resource utilization, and so core inflation edges down below 2 percent in the second half of 2008. The upward revision to potential output growth also implies a more favorable outlook for permanent household income and corporate earnings. However, this stimulus to aggregate demand is partly offset by tighter monetary policy: With the effect of a higher output gap outweighing the effect of lower inflation, the federal funds rate rises to 5½ percent by late this year, boosting the real federal funds rate about 35 basis points on average relative to baseline. As a result, real GDP expands more slowly than its now-higher potential, and the unemployment rate edges up to 4¾ percent by late next year.

Unanchored inflation expectations. Long-run inflation expectations appear to have remained reasonably contained since 2003 despite elevated readings for both top-line and core inflation, but this stability may not persist. In this scenario, we assume that the recent string of large increases in headline prices causes long-run inflation expectations to move up a cumulative 50 basis points over the course of this year and next. These higher expectations manifest themselves gradually in actual inflation, and as a result core inflation edges up to almost 2½ percent over the second half of this year and in 2008. In response, monetary policy (which under the estimated rule responds only gradually to changes in economic conditions) starts to tighten late next year. Real activity is little changed from baseline, despite lower real short-term rates, in part because nominal long-term interest rates rise almost ½ percentage point relative to baseline in anticipation of additional policy tightening beyond 2008.

Market-based federal funds rate. Quotes from futures markets imply a path for the federal funds rate that is about 25 basis points below the staff's assumed path at the end of 2007 and nearly 90 basis points below that path at the end of 2008. The increased stimulus from such a lower path would boost real GDP growth to about 2¾ percent in 2008 and cause inflation to be a shade higher than in the baseline.

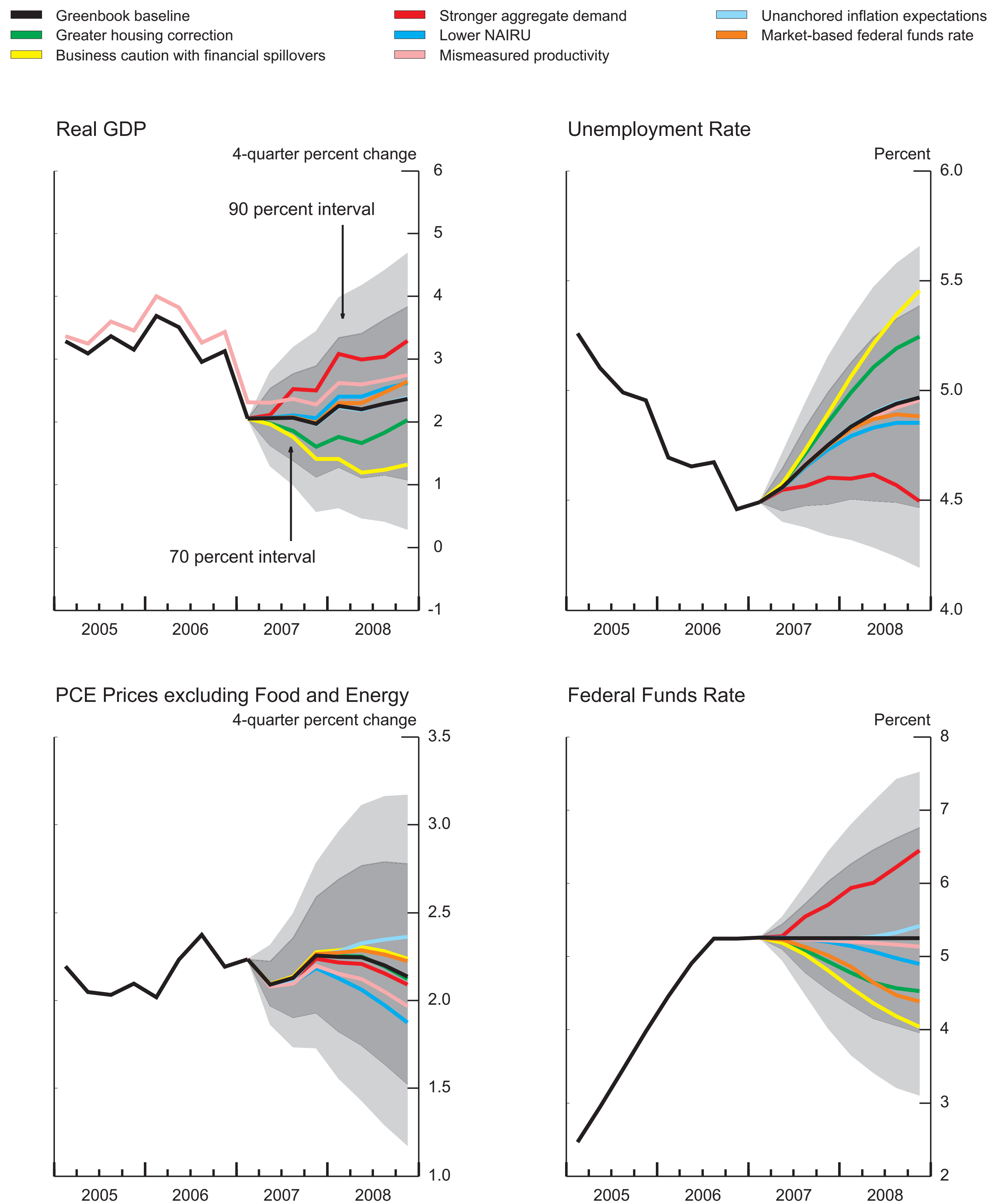
Selected Greenbook Projections and 70 Percent Confidence Intervals Derived from Historical Forecast Errors and FRB/US Simulations

Measure	2007	2008
Real GDP		
(percent change, Q4 to Q4)		
Projection	2.0	2.4
Confidence interval		
Greenbook forecast errors	.8–3.1	.8–3.9
FRB/US stochastic simulations	1.1–2.9	1.1–3.8
Civilian unemployment rate		
(percent, Q4)		
Projection	4.8	5.0
Confidence interval		
Greenbook forecast errors	4.5–5.1	4.2–5.7
FRB/US stochastic simulations	4.5–5.0	4.5–5.4
PCE prices		
excluding food and energy		
(percent change, Q4 to Q4)		
Projection	2.3	2.1
Confidence interval		
Greenbook forecast errors	1.8–2.7	1.3–2.9
FRB/US stochastic simulations	1.9–2.6	1.5–2.8
Federal funds rate		
(percent, Q4)		
Projection	5.3	5.3
Confidence interval		
FRB/US stochastic simulations	4.5–6.0	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

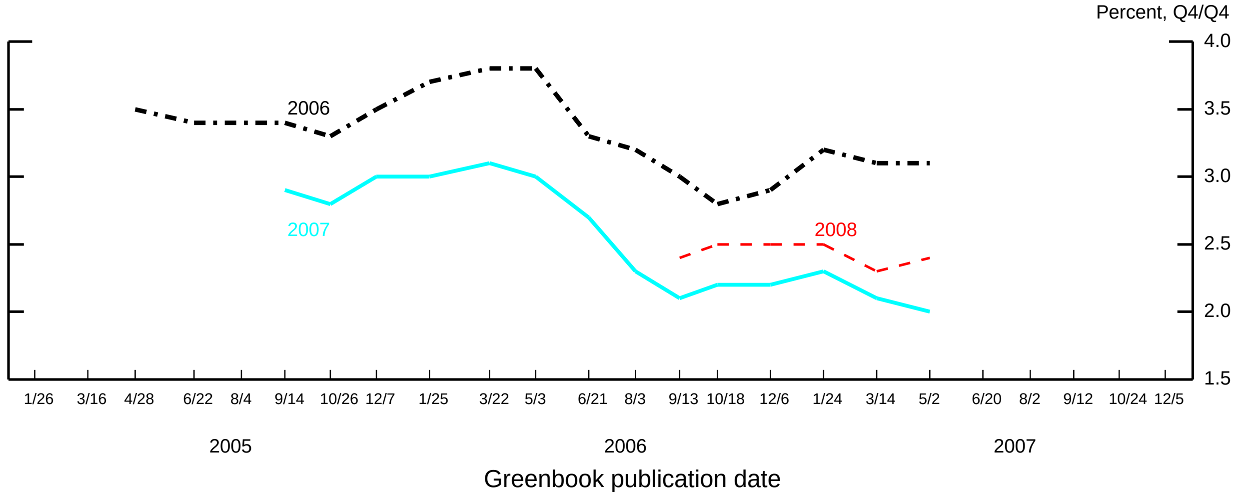
Confidence Intervals based on FRB/US Stochastic Simulations



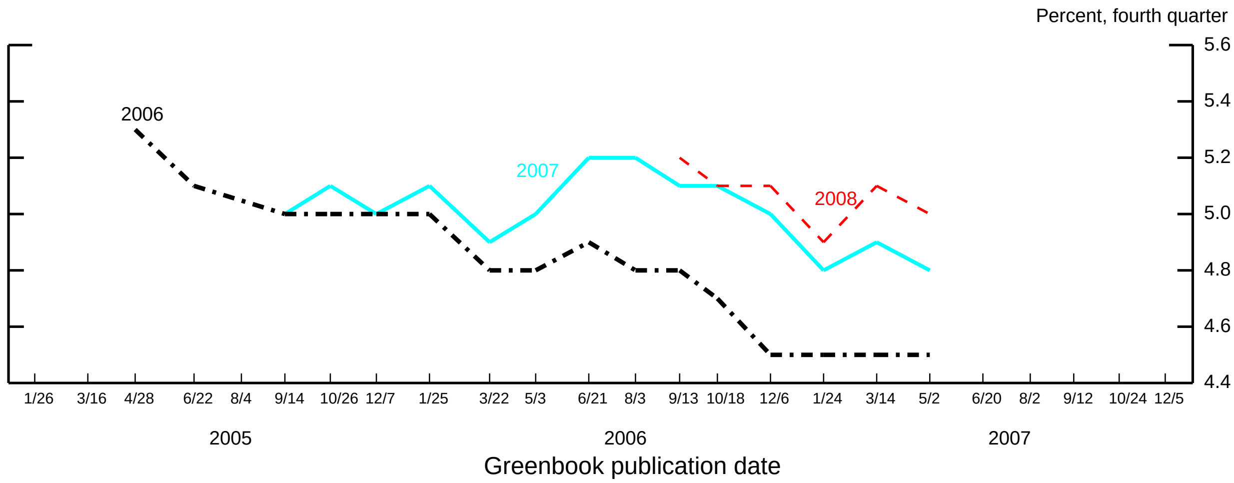
Class II FOMC - Restricted (FR)

Evolution of the Staff Forecast

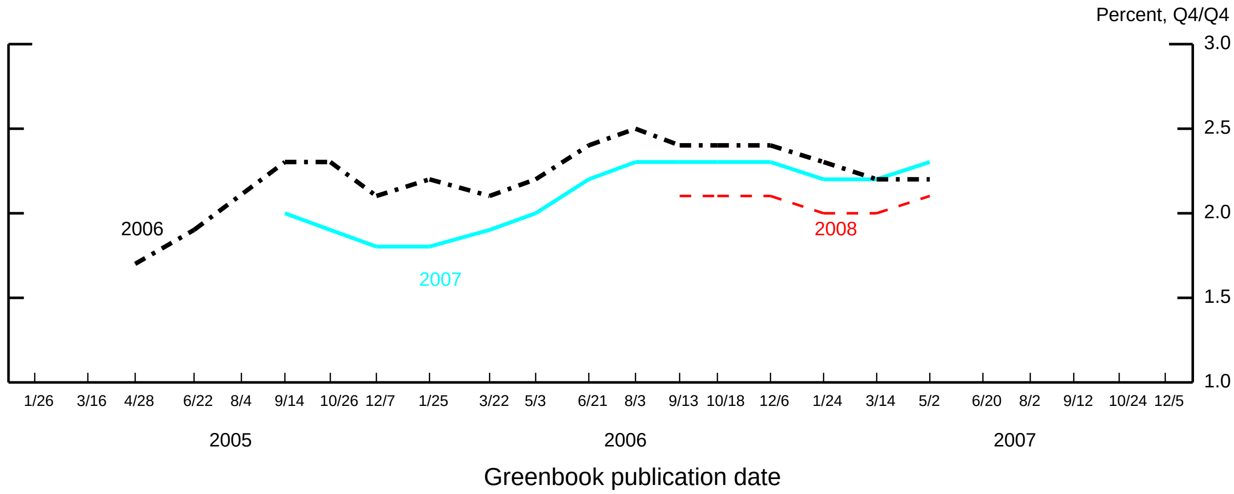
Change in Real GDP



Unemployment Rate



Change in PCE Prices excluding Food and Energy



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

	Nominal GDP		Real GDP		PCE price index		Core PCE price index		Unemployment rate[1]	
Interval	03/14/07	05/02/07	03/14/07	05/02/07	03/14/07	05/02/07	03/14/07	05/02/07	03/14/07	05/02/07
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	3.9	4.1	2.2	2.5	-.9	-1.0	1.9	1.8	4.5	4.5
2007:Q1	5.5	5.2	1.5	1.3	2.9	3.3	2.2	2.2	4.6	4.5
Q2	5.1	5.5	2.3	2.6	2.8	4.2	2.2	2.2	4.7	4.6
Q3	4.3	3.7	2.3	2.0	2.2	2.0	2.2	2.3	4.8	4.7
Q4	4.5	4.2	2.3	2.1	2.2	2.2	2.2	2.3	4.9	4.8
2008:Q1	4.7	4.7	2.3	2.4	2.1	2.1	2.1	2.2	4.9	4.8
Q2	4.7	4.8	2.3	2.4	2.1	2.1	2.1	2.2	5.0	4.9
Q3	4.6	4.7	2.3	2.4	2.0	2.0	2.0	2.1	5.0	4.9
Q4	4.5	4.5	2.3	2.4	2.0	2.0	2.0	2.1	5.1	5.0
Two-quarter[2]										
2006:Q2	7.5	7.5	4.1	4.1	3.0	3.0	2.4	2.4	-.3	-.3
Q4	3.9	4.0	2.1	2.2	.7	.7	2.0	2.0	-.2	-.2
2007:Q2	5.3	5.3	1.9	1.9	2.9	3.7	2.2	2.2	.2	.1
Q4	4.4	4.0	2.3	2.0	2.2	2.1	2.2	2.3	.2	.2
2008:Q2	4.7	4.8	2.3	2.4	2.1	2.1	2.1	2.2	.1	.1
Q4	4.5	4.6	2.3	2.4	2.0	2.0	2.0	2.1	.1	.1
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	5.7	5.7	3.1	3.1	1.9	1.9	2.2	2.2	-.5	-.5
2007:Q4	4.8	4.6	2.1	2.0	2.5	2.9	2.2	2.3	.4	.3
2008:Q4	4.6	4.7	2.3	2.4	2.1	2.1	2.0	2.1	.2	.2
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	6.3	3.3	3.3	2.8	2.7	2.2	2.2	4.6	4.6
2007	4.7	4.7	2.1	2.0	2.1	2.4	2.2	2.2	4.7	4.6
2008	4.6	4.5	2.3	2.3	2.2	2.2	2.1	2.2	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	2.5	1.3	2.6	2.0	2.1	2.4	2.4	2.4	2.4	3.1	2.0	2.4
Previous	5.6	2.6	2.0	2.2	1.5	2.3	2.3	2.3	2.3	2.3	2.3	2.3	3.1	2.1	2.3
Final sales	5.6	2.1	1.9	3.7	1.6	2.4	1.8	1.9	2.0	2.9	2.6	2.3	3.3	1.9	2.4
Previous	5.6	2.1	1.9	3.6	1.4	2.0	2.3	1.9	2.1	2.7	2.6	2.4	3.3	1.9	2.4
Priv. dom. final purch.	5.5	1.8	2.1	1.6	2.5	.7	.9	1.8	2.2	2.4	2.6	2.6	2.7	1.5	2.5
Previous	5.5	1.8	2.1	1.6	1.9	.8	1.8	2.1	2.4	2.5	2.6	2.7	2.7	1.7	2.6
Personal cons. expend.	4.8	2.6	2.8	4.2	3.8	1.9	2.1	2.2	2.4	2.4	2.6	2.5	3.6	2.5	2.5
Previous	4.8	2.6	2.8	4.1	3.7	2.2	2.1	2.1	2.3	2.4	2.5	2.5	3.6	2.5	2.4
Durables	19.8	-.1	6.4	4.4	7.3	-.3	2.4	2.7	2.7	3.4	3.9	4.0	7.4	3.0	3.5
Nondurables	5.9	1.4	1.5	5.9	2.9	1.1	2.2	2.4	2.4	2.6	2.8	2.5	3.7	2.1	2.6
Services	1.6	3.7	2.8	3.4	3.7	2.7	1.9	2.0	2.3	2.1	2.2	2.3	2.9	2.6	2.2
Residential investment	-.3	-11.1	-18.7	-19.8	-14.1	-18.5	-19.2	-7.7	-6.0	-1.2	1.1	2.1	-12.8	-15.0	-1.1
Previous	-.3	-11.1	-18.7	-19.7	-22.2	-19.9	-6.2	-1.6	-.5	2.1	2.4	3.6	-12.8	-12.9	1.9
Business fixed invest.	13.7	4.4	10.0	-3.1	2.8	2.9	3.5	3.5	4.4	4.0	3.5	3.4	6.1	3.2	3.8
Previous	13.7	4.4	10.0	-2.5	2.8	2.7	3.9	3.9	4.6	3.8	3.7	3.4	6.2	3.3	3.9
Equipment & software	15.6	-1.4	7.7	-4.8	1.7	1.4	4.1	4.1	4.9	4.4	4.6	4.8	4.0	2.8	4.7
Previous	15.6	-1.4	7.7	-3.4	2.4	.8	3.4	4.1	5.8	4.9	5.0	4.7	4.4	2.7	5.1
Nonres. structures	8.7	20.3	15.7	.8	5.3	6.3	2.1	2.3	3.2	2.9	1.3	.4	11.2	4.0	2.0
Previous	8.7	20.3	15.7	-.5	3.8	7.0	4.8	3.5	2.2	1.6	1.0	.6	10.8	4.8	1.3
Net exports[2]	-637	-624	-629	-583	-606	-582	-574	-575	-584	-572	-570	-576	-618	-584	-576
Previous[2]	-637	-624	-629	-584	-596	-584	-579	-589	-602	-599	-601	-609	-618	-587	-603
Exports	14.0	6.2	6.8	10.6	-1.1	7.6	6.3	6.1	5.9	5.8	5.7	5.6	9.4	4.7	5.7
Imports	9.1	1.4	5.6	-2.6	4.1	.1	2.7	4.5	6.1	1.8	3.6	5.2	3.3	2.8	4.2
Govt. cons. & invest.	4.9	.8	1.7	3.4	1.4	4.9	3.6	2.2	2.2	2.1	1.7	1.6	2.7	3.0	1.9
Previous	4.9	.8	1.7	3.3	1.4	4.8	2.8	2.2	2.2	2.1	2.0	2.0	2.7	2.8	2.1
Federal	8.8	-4.5	1.3	4.6	-3.0	8.3	5.7	1.9	1.8	1.6	1.5	1.4	2.4	3.1	1.6
Defense	8.9	-2.0	-1.2	12.3	-6.6	12.7	8.5	2.8	2.6	2.3	2.2	2.0	4.3	4.1	2.3
Nondefense	8.5	-9.3	6.5	-9.6	4.7	-.3	.0	.0	.0	.0	.0	.0	-1.4	1.1	.0
State & local	2.7	4.0	1.9	2.7	4.0	3.0	2.4	2.4	2.4	2.4	1.8	1.8	2.8	3.0	2.1
Change in bus. inventories[2]	41	54	55	22	12	16	24	28	40	26	19	19	43	20	26
Previous[2]	41	54	55	18	21	27	27	38	45	34	27	23	42	28	32
Nonfarm[2]	37	52	53	20	8	15	23	27	40	25	18	19	41	19	25
Farm[2]	4	2	2	2	3	1	1	1	1	1	1	1	3	1	1

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

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

Item	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	3.1	2.0	2.4
Previous	2.2	.2	1.9	3.7	3.4	3.1	3.1	2.1	2.3
Final sales	2.9	1.5	.8	3.7	3.1	3.2	3.3	1.9	2.4
Previous	2.9	1.5	.8	3.7	3.1	3.2	3.3	1.9	2.4
Priv. dom. final purch.	4.3	1.0	1.1	4.1	4.4	3.6	2.7	1.5	2.5
Previous	4.3	1.0	1.1	4.1	4.4	3.6	2.7	1.7	2.6
Personal cons. expend.	4.1	2.8	1.9	3.4	4.0	2.9	3.6	2.5	2.5
Previous	4.1	2.8	1.9	3.4	4.0	2.9	3.6	2.5	2.4
Durables	4.7	10.8	1.2	8.3	5.6	2.5	7.4	3.0	3.5
Nondurables	3.0	1.9	2.1	3.9	3.8	4.4	3.7	2.1	2.6
Services	4.5	1.6	1.9	2.2	3.7	2.3	2.9	2.6	2.2
Residential investment	-1.9	1.4	7.0	11.7	6.1	9.0	-12.8	-15.0	-1.1
Previous	-1.9	1.4	7.0	11.7	6.1	9.0	-12.8	-12.9	1.9
Business fixed invest.	7.8	-9.6	-6.5	4.9	6.9	5.6	6.1	3.2	3.8
Previous	7.8	-9.6	-6.5	4.9	6.9	5.6	6.2	3.3	3.9
Equipment & software	7.5	-9.0	-3.4	6.6	8.3	7.0	4.0	2.8	4.7
Previous	7.5	-9.0	-3.4	6.6	8.3	7.0	4.4	2.7	5.1
Nonres. structures	8.8	-11.1	-14.9	.2	2.7	1.8	11.2	4.0	2.0
Previous	8.8	-11.1	-14.9	.2	2.7	1.8	10.8	4.8	1.3
Net exports[2]	-379	-399	-471	-519	-591	-619	-618	-584	-576
Previous[2]	-379	-399	-471	-519	-591	-619	-618	-587	-603
Exports	6.5	-11.9	3.8	5.8	7.0	6.7	9.4	4.7	5.7
Imports	11.2	-7.6	9.7	4.8	10.6	5.2	3.3	2.8	4.2
Govt. cons. & invest.	.4	5.0	4.0	1.7	1.1	1.2	2.7	3.0	1.9
Previous	.4	5.0	4.0	1.7	1.1	1.2	2.7	2.8	2.1
Federal	-2.2	6.4	7.8	5.5	2.3	2.1	2.4	3.1	1.6
Defense	-3.5	6.5	8.4	7.5	2.5	1.9	4.3	4.1	2.3
Nondefense	.3	6.3	6.8	1.9	1.8	2.4	-1.4	1.1	.0
State & local	1.7	4.2	2.1	-.4	.4	.8	2.8	3.0	2.1
Change in bus. inventories[2]	56	-32	12	14	53	20	43	20	26
Previous[2]	56	-32	12	14	53	20	42	28	32
Nonfarm[2]	58	-32	15	14	47	20	41	19	25
Farm[2]	-1	0	-2	0	6	0	3	1	1

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

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

Item	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	2.5	1.3	2.6	2.0	2.1	2.4	2.4	2.4	2.4	3.1	2.0	2.4
Previous	5.6	2.6	2.0	2.2	1.5	2.3	2.3	2.3	2.3	2.3	2.3	2.3	3.1	2.1	2.3
Final sales	5.6	2.1	1.9	3.6	1.6	2.4	1.8	1.9	2.0	2.8	2.6	2.3	3.3	1.9	2.4
Previous	5.6	2.1	1.9	3.6	1.4	2.0	2.3	1.9	2.1	2.7	2.6	2.4	3.3	1.9	2.4
Priv. dom. final purch.	4.7	1.5	1.8	1.4	2.2	.6	.8	1.5	1.9	2.1	2.2	2.2	2.3	1.3	2.1
Previous	4.7	1.5	1.8	1.4	1.6	.7	1.6	1.8	2.1	2.2	2.2	2.3	2.3	1.4	2.2
Personal cons. expend.	3.4	1.8	2.0	2.9	2.7	1.3	1.4	1.5	1.7	1.7	1.8	1.8	2.5	1.7	1.7
Previous	3.4	1.8	2.0	2.9	2.6	1.5	1.5	1.5	1.6	1.7	1.8	1.8	2.5	1.8	1.7
Durables	1.5	.0	.5	.4	.6	.0	.2	.2	.2	.3	.3	.3	.6	.2	.3
Nondurables	1.2	.3	.3	1.2	.6	.2	.4	.5	.5	.5	.6	.5	.7	.4	.5
Services	.7	1.5	1.1	1.4	1.5	1.1	.8	.8	1.0	.9	.9	1.0	1.2	1.1	.9
Residential investment	.0	-.7	-1.2	-1.2	-.8	-1.0	-1.0	-.4	-.3	-.1	.0	.1	-.8	-.8	.0
Previous	.0	-.7	-1.2	-1.2	-1.3	-1.1	-.3	-.1	.0	.1	.1	.2	-.8	-.7	.1
Business fixed invest.	1.4	.5	1.0	-.3	.3	.3	.4	.4	.5	.4	.4	.4	.6	.3	.4
Previous	1.4	.5	1.0	-.3	.3	.3	.4	.4	.5	.4	.4	.4	.6	.3	.4
Equipment & software	1.1	-.1	.6	-.4	.1	.1	.3	.3	.4	.3	.3	.3	.3	.2	.3
Previous	1.1	-.1	.6	-.3	.2	.1	.2	.3	.4	.3	.4	.3	.3	.2	.4
Nonres. structures	.3	.6	.5	.0	.2	.2	.1	.1	.1	.1	.0	.0	.3	.1	.1
Previous	.3	.6	.5	.0	.1	.2	.2	.1	.1	.1	.0	.0	.3	.2	.0
Net exports	.0	.4	-.2	1.6	-.8	.8	.3	-.1	-.3	.4	.0	-.2	.5	.1	.0
Previous	.0	.4	-.2	1.6	-.4	.4	.2	-.3	-.5	.1	-.1	-.3	.4	-.1	-.2
Exports	1.4	.7	.7	1.1	-.1	.8	.7	.7	.7	.7	.7	.6	1.0	.5	.7
Imports	-1.5	-.2	-.9	.5	-.7	.0	-.5	-.8	-1.0	-.3	-.6	-.9	-.5	-.5	-.7
Govt. cons. & invest.	.9	.2	.3	.6	.3	.9	.7	.4	.4	.4	.3	.3	.5	.6	.4
Previous	.9	.2	.3	.6	.3	.9	.5	.4	.4	.4	.4	.4	.5	.5	.4
Federal	.6	-.3	.1	.3	-.2	.6	.4	.1	.1	.1	.1	.1	.2	.2	.1
Defense	.4	-.1	-.1	.6	-.3	.6	.4	.1	.1	.1	.1	.1	.2	.2	.1
Nondefense	.2	-.2	.2	-.2	.1	.0	.0	.0	.0	.0	.0	.0	.0	.0	.0
State & local	.3	.5	.2	.3	.5	.4	.3	.3	.3	.3	.2	.2	.3	.4	.3
Change in bus. inventories	.0	.4	.1	-1.2	-.4	.2	.3	.1	.4	-.5	-.2	.0	-.2	.1	-.1
Previous	.0	.4	.1	-1.3	.1	.2	.0	.4	.2	-.4	-.3	-.1	-.2	.2	-.1
Nonfarm	.0	.5	.1	-1.2	-.4	.3	.3	.1	.4	-.5	-.2	.0	-.2	.1	-.1
Farm	.0	-.1	.0	.0	.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.

Class II FOMC
Restricted (FR)

May 2, 2007

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	1.7	3.9	2.8	1.7	2.1	2.3	2.3	2.3	2.1	2.5	2.6	2.3
Previous	3.3	3.3	1.9	1.6	3.9	2.7	2.0	2.1	2.4	2.3	2.2	2.1	2.5	2.7	2.3
PCE chain-wt. price index	2.0	4.0	2.4	-1.0	3.3	4.2	2.0	2.2	2.1	2.1	2.0	2.0	1.9	2.9	2.1
Previous	2.0	4.0	2.4	-.9	2.9	2.8	2.2	2.2	2.1	2.1	2.0	2.0	1.9	2.5	2.1
Energy	.1	29.7	3.7	-36.0	16.1	35.7	-3.7	.2	1.0	1.0	.7	.4	-3.7	11.0	.8
Previous	.1	29.7	3.7	-36.0	10.5	9.9	1.9	2.3	2.3	1.9	1.6	1.3	-3.6	6.1	1.7
Food	2.7	1.7	2.9	1.9	4.8	3.8	2.6	2.4	2.3	2.2	2.1	2.1	2.3	3.4	2.2
Previous	2.7	1.7	2.9	1.9	4.1	3.4	2.6	2.4	2.3	2.3	2.2	2.2	2.3	3.1	2.2
Ex. food & energy	2.1	2.7	2.2	1.8	2.2	2.2	2.3	2.3	2.2	2.2	2.1	2.1	2.2	2.3	2.1
Previous	2.1	2.7	2.2	1.9	2.2	2.2	2.2	2.2	2.1	2.1	2.0	2.0	2.2	2.2	2.0
CPI	1.8	5.1	3.0	-2.0	3.8	5.1	1.9	2.3	2.3	2.3	2.2	2.0	1.9	3.3	2.2
Previous	1.8	5.1	3.0	-2.0	3.3	3.2	2.3	2.3	2.3	2.2	2.2	2.1	1.9	2.8	2.2
Ex. food & energy	2.4	3.2	3.2	1.8	2.3	2.4	2.5	2.5	2.4	2.4	2.3	2.2	2.7	2.4	2.3
Previous	2.4	3.2	3.2	1.8	2.4	2.5	2.4	2.3	2.3	2.3	2.2	2.2	2.7	2.4	2.2
ECI, hourly compensation[2]	2.8	3.2	3.6	3.2	2.3	3.8	3.8	3.8	4.0	4.0	4.0	4.0	3.2	3.4	4.0
Previous[2]	2.4	3.2	3.6	3.2	3.9	3.9	4.0	3.9	3.9	3.9	4.0	3.9	3.2	3.9	3.9
Nonfarm business sector															
Output per hour	3.5	1.2	-.5	1.9	1.5	1.4	2.3	2.4	2.6	2.6	2.6	2.6	1.5	1.9	2.6
Previous	3.5	1.2	-.5	1.6	2.0	1.1	2.6	2.6	2.6	2.6	2.6	2.6	1.5	2.1	2.6
Compensation per hour	12.9	-1.4	.6	8.2	1.7	4.0	4.8	4.9	4.9	4.8	4.9	4.8	4.9	3.9	4.9
Previous	12.9	-1.4	.6	8.2	2.2	4.5	4.8	4.8	4.8	4.8	4.9	4.8	4.9	4.1	4.8
Unit labor costs	9.1	-2.5	1.1	6.2	.2	2.6	2.5	2.5	2.2	2.2	2.2	2.2	3.3	1.9	2.2
Previous	9.1	-2.5	1.1	6.5	.3	3.4	2.1	2.1	2.2	2.2	2.3	2.2	3.4	2.0	2.2

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]	.7	.5	.5	.5	.5	.4	.1	.1	.1	.2	.1	.1	2.3	1.2	.6
Unemployment rate[3]	4.7	4.7	4.7	4.5	4.5	4.6	4.7	4.8	4.8	4.9	4.9	5.0	4.5	4.8	5.0
Previous[3]	4.7	4.7	4.7	4.5	4.6	4.7	4.8	4.9	4.9	5.0	5.0	5.1	4.5	4.9	5.1
GDP gap[4]	.9	.9	.7	.7	.4	.4	.3	.1	.1	.1	.1	.0	.7	.1	.0
Previous[4]	.8	.8	.6	.5	.2	.1	.1	.0	.0	-.1	-.1	-.2	.5	.0	-.2
Industrial production[5]	5.0	6.5	4.0	-1.5	1.4	4.0	2.6	3.1	3.2	3.0	3.6	3.9	3.5	2.8	3.4
Previous[5]	5.0	6.5	4.0	-.8	1.8	2.6	3.4	3.1	3.3	3.0	3.4	3.9	3.7	2.7	3.4
Manufacturing industr. prod.[5]	5.5	5.5	4.4	-1.7	1.2	4.8	2.5	2.9	3.3	3.4	3.6	3.9	3.4	2.8	3.5
Previous[5]	5.5	5.5	4.4	-1.7	.9	3.5	3.8	3.3	3.6	3.6	3.6	3.9	3.4	2.8	3.7
Capacity utilization rate - mfg.[3]	80.1	80.6	80.9	80.1	79.9	80.3	80.4	80.4	80.5	80.6	80.7	80.9	80.1	80.4	80.9
Previous[3]	80.1	80.6	80.9	80.1	79.8	80.0	80.3	80.4	80.5	80.7	80.8	81.0	80.1	80.4	81.0
Housing starts[6]	2.1	1.9	1.7	1.6	1.5	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.8	1.4	1.4
Light motor vehicle sales[6]	16.9	16.3	16.6	16.3	16.5	16.4	16.4	16.4	16.3	16.3	16.3	16.3	16.5	16.4	16.3
Income and saving															
Nominal GDP[5]	9.0	5.9	3.8	4.1	5.2	5.5	3.7	4.2	4.7	4.8	4.7	4.5	5.7	4.6	4.7
Real disposable pers. income[5]	4.6	-1.5	3.2	5.3	4.5	-1.5	3.8	3.2	4.2	3.1	3.6	3.4	2.9	2.4	3.6
Previous[5]	4.6	-1.5	3.2	5.3	6.0	.6	3.2	3.2	4.1	2.6	3.8	3.4	2.9	3.2	3.5
Personal saving rate[3]	-.3	-1.4	-1.4	-1.2	-1.1	-1.9	-1.5	-1.2	-.8	-.6	-.4	-.2	-1.2	-1.2	-.2
Previous[3]	-.3	-1.4	-1.4	-1.2	-.6	-1.0	-.7	-.4	.0	.1	.4	.6	-1.2	-.4	.6
Corporate profits[7]	60.8	5.9	16.4	-1.2	7.3	5.7	.1	-.3	-.8	1.5	1.9	.6	18.3	3.1	.8
Profit share of GNP[3]	12.0	12.0	12.4	12.2	12.3	12.3	12.2	12.1	11.9	11.8	11.8	11.7	12.2	12.1	11.7
Net federal saving[8]	-147	-163	-173	-131	-147	-176	-195	-192	-234	-227	-225	-234	-154	-178	-230
Net state & local saving[8]	13	26	-10	-18	-32	-3	-16	-20	-23	-21	-31	-32	3	-18	-27
Gross national saving rate[3]	14.4	13.5	13.3	14.0	13.0	12.8	12.8	12.8	12.7	12.8	12.8	12.8	14.0	12.8	12.8
Net national saving rate[3]	2.9	1.9	1.7	2.0	2.0	1.4	1.4	1.4	1.3	1.4	1.4	1.4	2.0	1.4	1.4

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[a]	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
					Not seasonally adjusted											
Unified budget																
Receipts[1]	2154	2407	2568	2670	507	772	597	574	547	827	620	614	556	848	653	639
Outlays[1]	2472	2655	2739	2908	691	676	639	654	725	691	669	727	739	727	714	766
Surplus/deficit[1]	-318	-248	-171	-238	-184	96	-42	-80	-178	136	-49	-114	-184	121	-61	-127
Previous	*-318*	*-248*	*-180*	*-243*	*-184*	*96*	*-42*	*-80*	*-183*	*143*	*-60*	*-129*	*-192*	*153*	*-75*	*-143*
On-budget	-494	-435	-361	-435	-216	11	-60	-135	-212	48	-62	-181	-207	28	-74	-200
Off-budget	175	186	190	197	32	85	19	55	34	88	13	68	24	92	13	73
Means of financing																
Borrowing	297	237	174	251	156	-75	43	59	152	-110	73	103	173	-91	66	122
Cash decrease	1	-16	12	5	28	-38	-6	21	25	-24	-10	15	15	-25	0	10
Other[2]	21	28	-15	-18	-1	16	5	0	1	-2	-14	-5	-5	-5	-5	-5
Cash operating balance, end of period	36	52	40	35	8	46	52	31	6	30	40	25	10	35	35	25
NIPA federal sector					Seasonally adjusted annual rates											
Receipts	2174	2480	2645	2755	2491	2523	2557	2581	2651	2660	2686	2712	2740	2769	2800	2830
Expenditures	2509	2667	2807	2975	2638	2686	2730	2713	2798	2836	2881	2904	2974	2996	3025	3064
Consumption expenditures	758	797	838	890	804	802	809	817	827	847	862	870	889	897	905	913
Defense	509	533	566	608	538	538	539	553	554	573	586	593	606	612	619	625
Nondefense	249	264	272	283	266	265	270	264	273	274	275	277	283	285	286	288
Other spending	1751	1870	1969	2084	1834	1884	1921	1896	1971	1990	2020	2034	2085	2099	2120	2152
Current account surplus	-335	-187	-162	-220	-147	-163	-173	-131	-147	-176	-195	-192	-234	-228	-225	-235
Gross investment	107	117	123	131	118	117	118	121	119	124	128	129	131	132	133	134
Gross saving less gross investment[3]	-344	-201	-178	-238	-163	-177	-186	-146	-159	-192	-213	-211	-252	-246	-243	-252
Fiscal indicators[4]																
High-employment (HEB) surplus/deficit	-340	-229	-204	-245	-196	-214	-219	-181	-186	-216	-232	-222	-259	-251	-246	-253
Change in HEB, percent of potential GDP	-0.3	-1.0	-0.3	0.2	-0.7	0.1	0.0	-0.3	0.0	0.2	0.1	-0.1	0.2	-0.1	-0.1	0.0
Fiscal impetus (FI), percent of GDP	0.2	0.3	0.2	0.2	0.2	-0.0	0.0	0.1	0.0	0.1	0.1	0.1	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*	*0.1*	*0.1*	*0.0*	*0.1*	*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	14.4	5.2	2.7	8.3	10.9	5.9
2004	9.0	11.6	14.2	5.5	5.8	7.4	9.0	6.7
2005	9.4	11.7	13.8	4.2	7.3	10.2	7.0	6.4
2006	7.9	8.5	8.9	4.6	9.1	8.2	3.9	5.7
2007	6.4	5.6	5.5	3.7	8.3	7.9	4.5	4.6
2008	5.7	4.9	5.0	3.1	6.7	6.5	5.3	4.7
Quarter								
2006:1	8.9	9.7	10.9	2.2	9.6	3.3	8.0	9.0
2	7.4	9.3	9.4	6.0	8.3	6.7	1.0	5.9
3	6.5	7.5	7.8	5.4	6.5	8.2	3.6	3.8
4	7.8	6.7	6.4	4.5	10.9	13.5	2.8	4.1
2007:1	6.8	5.8	5.7	4.0	9.0	9.7	4.2	5.2
2	5.8	5.6	5.6	3.9	8.3	7.1	1.0	5.5
3	6.4	5.3	5.3	3.6	7.9	7.0	6.1	3.7
4	6.0	5.2	5.2	3.4	6.9	6.8	6.3	4.2
2008:1	5.6	4.9	5.0	3.2	6.4	6.5	5.7	4.7
2	5.1	4.8	4.9	3.1	6.7	6.4	2.4	4.8
3	5.5	4.8	4.9	3.0	6.6	6.3	5.2	4.7
4	5.9	4.8	4.9	3.0	6.5	6.2	7.5	4.5

Note. Quarterly data are at seasonally adjusted annual rates.

1. Data after 2006:Q4 are staff projections. Changes are measured from end of the preceding period to end of period indicated except for annual nominal GDP growth, which is calculated from Q4 to Q4.

2.6.3 FOF

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

					2006		2007				2008			
Category	2005	2006	2007	2008	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Domestic nonfinancial sectors														
Net funds raised														
Total	1915.5	1494.0	1414.3	1493.7	1277.8	1493.5	1436.3	1198.8	1499.6	1522.6	1480.6	1353.3	1500.6	1640.1
Net equity issuance	-363.4	-602.1	-421.6	-232.0	-535.2	-701.2	-510.4	-492.0	-392.0	-292.0	-232.0	-232.0	-232.0	-232.0
Net debt issuance	2278.9	2096.1	1835.9	1725.7	1813.0	2194.7	1946.7	1690.8	1891.6	1814.6	1712.6	1585.3	1732.6	1872.1
Borrowing indicators														
Debt (percent of GDP) [1]	204.4	208.7	213.6	216.6	209.6	211.2	212.3	212.8	214.1	215.2	215.8	216.1	216.5	217.2
Borrowing (percent of GDP)	18.3	15.8	13.2	11.9	13.6	16.3	14.3	12.2	13.6	12.9	12.0	11.0	11.9	12.7
Households														
Net borrowing [2]	1238.8	1007.7	715.6	660.7	924.9	838.2	739.3	730.2	701.8	691.2	661.5	654.8	658.2	668.3
Home mortgages	1074.9	792.5	536.5	509.2	728.1	611.7	550.7	546.0	527.0	522.2	508.0	503.2	508.0	517.5
Consumer credit	94.4	106.9	91.1	77.8	127.8	107.6	96.5	95.0	88.5	84.3	80.0	78.2	76.2	76.8
Debt/DPI (percent) [3]	123.8	129.2	131.5	131.0	130.4	131.3	130.8	131.8	131.7	131.7	131.3	131.2	130.9	130.7
Business														
Financing gap [4]	-138.6	68.5	-0.4	82.7	48.3	156.2	-17.1	-24.6	6.5	33.6	73.1	74.5	81.6	101.8
Net equity issuance	-363.4	-602.1	-421.6	-232.0	-535.2	-701.2	-510.4	-492.0	-392.0	-292.0	-232.0	-232.0	-232.0	-232.0
Credit market borrowing	561.8	753.4	743.9	653.5	560.1	958.0	806.6	764.6	743.7	660.9	619.7	663.8	661.9	668.5
State and local governments														
Net borrowing	171.4	151.6	157.9	141.7	156.6	262.1	194.7	145.7	145.7	145.7	141.7	141.7	141.7	141.7
Current surplus [5]	203.8	220.5	168.2	167.8	210.2	205.5	150.8	181.9	171.4	168.7	168.4	172.5	164.5	165.8
Federal government														
Net borrowing	306.9	183.4	218.4	269.8	171.4	136.4	206.2	50.4	300.3	316.9	289.7	125.0	270.8	393.6
Net borrowing (n.s.a.)	306.9	183.4	218.4	269.8	43.4	58.7	152.2	-109.7	73.3	102.7	173.1	-91.1	65.9	121.9
Unified deficit (n.s.a.)	321.8	209.2	204.5	251.8	41.7	80.4	178.0	-136.2	49.1	113.5	183.6	-120.6	61.4	127.4
Depository institutions														
Funds supplied	814.1	758.1	353.2	292.5	409.1	616.1	333.1	376.5	629.6	73.8	43.7	468.3	328.2	329.6

Note. Data after 2006:Q4 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

International Developments

A number of key background factors have changed since the time of the March Greenbook. Spot oil prices have risen about $6 per barrel. Nonfuel commodity prices, mostly those of metals, have also moved up, though futures markets anticipate that these prices will level out or even decline over the rest of the forecast period. In addition, the foreign exchange value of the dollar has fallen about 2 percent since the time of the last Greenbook, declining against a wide range of currencies. We continue to project that the value of the dollar will decline over the forecast period in light of continuing concerns over the financing of the current account deficit.

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

Indicator	2006		Projection			
			2007			2008
	H1	H2	Q1	Q2	H2	
Foreign output	4.4	3.5	3.7	3.6	3.5	3.5
March GB	4.5	3.4	3.4	3.5	3.5	3.5
Foreign CPI	2.4	1.8	2.8	2.7	2.4	2.3
March GB	2.4	1.8	2.3	2.3	2.3	2.2
U.S. net exports, contributions to growth, (percentage points)	.2	.7	-.8	.8	.1	.0
March GB	.2	.7	-.5	.4	-.1	-.2

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

Over the forecast period, the foreign economy will likely enjoy continued solid growth with moderate rates of inflation. Recent readings on activity in several major economies, including China, Japan, and the euro area, have surprised us on the upside. The recent cooling of output growth in the United States does not seem to have had an appreciable effect on most economies, other than Canada and Mexico, though a wider spillover remains a risk. We expect that growth in the advanced foreign economies will edge down over the rest of the forecast period, while growth in the emerging-market economies will remain robust, near 5 percent.

The recent increases in energy prices, along with higher readings on core inflation, led us to raise our forecast for foreign consumer price inflation. With solid growth in many foreign economies, a risk to our forecast is that inflationary pressures will be higher than we expect, thereby prompting central banks, which have already been tightening monetary policy, to react more than we currently have assumed.

Data for the first quarter led us to estimate that real net exports subtracted about 0.8 percentage point from the growth of real GDP, somewhat more drag than we had anticipated in the March Greenbook. Nevertheless, we forecast that the contributions in 2007 as a whole and in 2008 will be roughly neutral. Compared with the previous forecast, we have revised real net exports up slightly over the forecast period, mostly as a result of the recent depreciation of the dollar. Our projection for the current account deficit is little changed from the last Greenbook, widening to $943 billion by the final quarter of 2008.

Oil Prices

The spot price of West Texas intermediate (WTI) crude oil closed at $64.41 on May 1, an increase of about $6 per barrel since the time of the last Greenbook. This increase likely understates the run-up in world oil prices more generally as spot WTI has commanded a smaller premium relative to other grades of crude oil since early March. For example, WTI has typically traded at a premium to Brent crude of $1 to $2 per barrel, but in April it traded at an average discount of about $3. This development is due in part to high oil inventories at Cushing, Oklahoma, the delivery point for spot WTI and NYMEX oil futures, and elsewhere in the Midwest, as local demand for crude oil has been damped by several refinery outages. We expect that these effects will be transitory as futures prices call for WTI to trade again at a premium to Brent by mid-2008.

In line with NYMEX futures prices, our projected path of the spot price of WTI climbs gradually to almost $72 per barrel by the end of 2008, as expanding global demand keeps spare production capacity limited. Relative to our forecast in the March Greenbook, our projection for the spot price averages about $4.60 per barrel higher in the current quarter and $5.40 per barrel higher in 2008. Because of the anomalous weakness in WTI relative to other grades, we have revised upward our projection of the price of imported oil by more than our projection of WTI. Compared with the last Greenbook, the import price is now projected to be $6.60 per barrel higher in the current quarter and $6 per barrel higher in 2008.

The increase in oil prices since the March Greenbook appears to primarily reflect concerns about oil supply. Tensions with Iran over its nuclear program have increased, including the imposition of additional U.N. sanctions in late March. OPEC also appears to be maintaining its production restraint, which has not always been the case in the past when oil prices have climbed. In Nigeria, significant oil production remains offline due to a lack of security, and political disruptions in the wake of late April's flawed elections pose a risk. Escalating violence in Iraq also puts production there at greater risk. In addition, the market's expectations for global oil demand may have increased, particularly in light of China's rapid first-quarter GDP growth.

International Financial Markets

Since the last FOMC meeting, prices of risky financial assets in emerging-market and advanced economies have recovered further from the losses they incurred in late February and early March. As in the United States, headline share price indexes rose to either record highs or multiyear highs in many foreign economies late in the intermeeting period. Yields on sovereign debt denominated in local and foreign currencies declined for most emerging-market economies, in some cases to new record lows, and measures of both option-implied and realized volatility fell for many financial assets. These movements in asset prices occurred against a backdrop of generally positive releases of economic data abroad.

In most major advanced foreign economies, benchmark government bond yields rose between 10 and 25 basis points on net, but they were about unchanged in Japan. Although none of the central banks in these countries changed their policy stances during the intermeeting period, market participants widely expect that the Bank of England, the European Central Bank, and the Bank of Canada will raise their respective policy rates in the near term.

Driven in part by perceptions of likely forthcoming increases in foreign interest rates, the nominal major currencies index of the dollar has declined 2 percent on balance since the last FOMC meeting. The dollar's rate against the yen was a notable exception; it rose nearly 2 percent, as international investors reportedly established new yen-funded carry trade positions after April 1, the beginning of the Japanese fiscal year. The dollar depreciated ¾ percent on a trade-weighted basis against the currencies of the other important trading partners of the United States.

Accordingly, we have adjusted down the current-quarter starting value of the broad real dollar 1½ percent. We project that the dollar will depreciate at an annual rate of about ¾ percent. This relatively modest depreciation balances downward pressures on the dollar created by the need to finance the U.S. current account deficit with upward pressures that emerge as market expectations of U.S. interest rates rise toward the staff's financial assumptions.

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

Advanced Foreign Economies

On average, real GDP in the advanced foreign economies is estimated to have grown at an annual rate of 2¾ percent in the first quarter, and we expect growth to continue at this pace in the current quarter. For the rest of the forecast period, we project that average growth will edge down to a 2½ percent pace. After recovering from its slowdown in the first quarter, euro-area growth should move down from 2½ percent in the current quarter to 2 percent in 2008. We expect that Japanese GDP will moderate further from its estimated high pace in the first quarter to something closer to its trend rate in 2008. Canadian GDP is expected to increase at an annual rate of 2¾ percent during most of the forecast period, and we project that U.K. growth will edge down from 3 percent in the current quarter to 2½ percent in 2008.

On balance, the growth outlook is little changed from our March Greenbook projection; downward revisions for near-term growth in Canada and the United Kingdom were largely offset by upward revisions to projected growth in Japan and the euro area.

Average inflation is projected to rise from 1½ percent in the first half of this year to 1¾ percent in 2008. We forecast that Canadian and U.K. inflation will decline from elevated rates in 2007 to around 2 percent in 2008 because the effects of recent energy price increases will abate and because of additional assumed monetary tightening. We now assume 50 basis points of tightening by the Bank of Canada by the end of this year and an increase of 25 basis points by the Bank of England this quarter. Inflation in the euro area will remain close to 2 percent over the forecast period, as the ECB raises its minimum bid rate a cumulative 50 basis points over the next several months. In contrast, Japanese consumer prices recently registered slight deflation, but we expect that moderate output growth will raise the inflation rate to ½ percent next year. We assume the Bank of Japan will raise its policy rate to 1¼ percent by the end of the forecast period.

On average in the advanced foreign economies, consumer price inflation in the first quarter came in slightly higher than we had estimated, largely owing to recent energy price increases. Signs of emerging capacity pressures are evident in some countries as well. Overall, we raised our outlook for inflation nearly ½ percentage point for the remaining three quarters of this year and very slightly for 2008. The largest revisions are for Canada and the United Kingdom (¾ and ½ percentage point, respectively, in 2007), where core inflation rates have been moving up in recent months.

Emerging-Market Economies

The emerging-market economies are estimated to have recorded an average growth rate of 5 percent in the first quarter, the same pace as in the fourth quarter. Growth is expected to edge down to about 4¾ percent this quarter before picking up to nearly 5 percent next year.

We expect growth in emerging Asia to shift down from an estimated 7¼ percent in the first quarter to 6 percent this quarter and to edge up to 6¼ percent by the end of the forecast period. This downshift mainly reflects our view that growth in China will slow from the elevated 13¾ percent pace that we estimate for the first quarter to around 9 percent in the last three quarters, reflecting in part further administrative measures to slow investment growth. In contrast, we forecast that real GDP growth in Latin America will pick up from an estimated 3 percent in the first quarter to 3½ percent over the rest of the forecast period, as we expect a rise in Mexican growth to be supported by a rebound in construction activity and a firming in U.S. manufacturing output. Compared with the last Greenbook, the emerging-market growth forecast was marked up a bit in 2007 and 2008, given the continued strength of the Chinese economy, as well as the positive effect on commodity exporters of higher prices for petroleum and metals.

Four-quarter inflation in the emerging-market economies is expected to rise to nearly 3½ percent in the third quarter, before declining to 3 percent next year, as the path of oil prices flattens out. Also, factors that have pushed up food prices and overall inflation in China are expected to wane. Inflation in emerging Asia is expected to decline a little as a result and end 2008 at about 2½ percent. In Latin America, we expect that inflation is moving up in the current quarter but will decline to 3¾ percent in 2008.

Prices of Internationally Traded Goods

Core import prices rose 2¾ percent in the first quarter of this year, largely a result of a jump in prices for material-intensive goods. Food prices surged in January, and prices for metals were up sharply in March. In the current quarter, we project that core import price inflation will rise to 4½ percent, double the pace in the previous forecast, reflecting the effects of higher nonfuel commodity prices and the depreciation of the dollar. Metals prices have continued to move up in recent weeks amid indications of strong demand from China, and they are projected to remain elevated. Furthermore, the dollar, which provided only a little price pressure early this year, has recently declined more sharply and should provide further upward pressure on import prices in the third quarter. For the remainder of the forecast period, core import prices decelerate as commodity prices level off and the pace of dollar depreciation slows.

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

Indicator	2006		Projection			
			2007			2008
	H1	H2	Q1	Q2	H2	
Imports						
Core goods	2.7	2.7	2.8	4.5	2.8	1.3
March GB	2.7	2.8	2.8	2.1	1.5	1.1
Oil (dollars per barrel)	63.75	55.34	54.39	61.90	65.58	67.14
March GB	63.75	55.34	53.72	55.35	59.60	61.31
Exports						
Core goods	5.3	3.0	5.9	5.5	2.6	1.3
March GB	5.3	3.0	6.2	3.1	1.7	1.1

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.

Our projection for commodity prices is based on quotes from commodity futures markets. However, as futures markets missed the strong increases in commodity prices over the past couple of years, considerable uncertainty surrounds the outlook.

Core export prices surged at an annual rate of almost 6 percent in the first quarter, about the rate we forecast in the March Greenbook. This rise was mainly a result of a recovery in the prices of exported industrial supplies, particularly fuels, which had fallen sharply in the fourth quarter. Prices of exported foods continued to soar, rising at an annual rate of nearly 30 percent.

The recent increases in primary commodities prices should boost the prices of industrial supplies and led us to pencil in core export price inflation for the second quarter of 5½ percent, 2½ percentage points higher than in the last Greenbook. It then will move down quickly over the next few quarters as commodity prices level off, falling to 3 percent in the third quarter and ending at close to a 1¼ percent rate next year.

Trade in Goods and Services

We estimate that real net exports subtracted 0.8 percentage point from U.S. GDP growth in the first quarter, reflecting a rebound in import growth and a slump in export growth from the fourth quarter. The February trade data, the advance NIPA release, and other information point to a sharper slowdown in export growth and a more muted rebound in import growth than we had previously expected. On net, the contribution is more negative than in the March Greenbook. Smoothing through the quarterly swings induced by oil imports, we project that net exports will have a roughly neutral effect on U.S. GDP growth in 2007 and 2008. The contributions for both years are less negative than in the previous Greenbook, primarily because of the lower value of the dollar.

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

Indicator	2006		Projection			
			2007			2008
	H1	H2	Q1	Q2	H2	
Real imports	5.2	1.4	4.1	.1	3.6	4.2
March GB	5.2	1.5	6.3	1.7	4.4	4.7
Real exports	10.0	8.7	-1.1	7.6	6.2	5.7
March GB	10.0	8.7	5.2	6.1	5.7	5.2

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

We estimate that the growth rate of real imports of goods and services rebounded to a 4 percent annual rate in the first quarter; an estimated surge in real imports of oil and computers more than accounted for the gain. In contrast, on the basis of weak February data, imports of core goods are estimated to have contracted at an annual rate of 1¾ percent in the first quarter. Recent data also suggest that the growth of real imports of services moved down from its fourth-quarter pace. In the current quarter, we expect imported goods and services to be flat; core import growth rebounds to 1¾ percent, but real oil imports are depressed by a quirky oil seasonal factor and computer imports contract after very strong first-quarter growth. We then expect total real imports to increase 3½ percent at an annual rate in the second half of 2007 and 4¼ percent in 2008. Imports of core goods and services drive this acceleration as price inflation for these categories slows and as U.S. GDP growth firms.

Our estimate of first-quarter total import growth has been revised down 2¼ percentage points compared with the March Greenbook because imports of core goods in February were significantly weaker than expected. We revised down our projection for import growth over the rest of the forecast period, in part because of the lower dollar and higher commodity prices.[1]

Real exports of goods and services are estimated to have fallen at an annual rate of 1 percent in the first quarter. The February trade data point to sharp declines in exports of core goods, concentrated in capital goods and industrial supplies, and exports of services declined for a second consecutive month. In the current quarter, we expect the growth of real exports of goods and services to snap back to 7½ percent. Exports of core goods and services rebound to a pace more in line with movements in foreign income growth and relative prices, and exports of computers and semiconductors pick up after below-average growth in the first quarter. Beyond the current quarter, the growth of real exports is projected to slow: The dollar depreciates more gradually over the forecast period, and services decelerate some as the lagged effects of dollar depreciation over the past year fade. Growth of exported core goods holds steady, as the lift from slowing core export price inflation is offset by the waning effects of some special factors—such as surging global demand for U.S. aircraft and other investment goods—that had contributed to the exceptional growth recorded in 2006.

Relative to the March Greenbook, our estimate of first-quarter export growth has been revised down 6¼ percentage points, mainly because of the weakness of the February trade data. For the rest of the forecast, our projection of export growth has been revised up: Exports bounce back from their depressed first-quarter pace and thereafter respond to the lower value of the dollar.

Alternative Simulations

Estimates of the elasticity of U.S. exports with respect to foreign activity are typically lower than estimates of the responsiveness of U.S. imports to domestic activity.

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[1] Additionally, for the second quarter, we are reversing a boost to first-quarter imports that resulted from the translation of balance of payments data to a NIPA basis.

However, estimates of these parameters vary considerably, and U.S. exports may be more responsive to foreign activity than assumed in our baseline forecast. To assess this possibility, we simulated the FRB/Global model under an alternative calibration that effectively raised the sensitivity of U.S. exports to foreign activity to equal the income elasticity of U.S. imports. Specifically, given that U.S. exports are determined by the import demand of our trading partners, we increased the long-run elasticity of imports of U.S. trading partners with respect to activity from 1.3 to 1.7.

With foreign activity projected to rise about 3½ percent per year, our alternative with a higher U.S. export elasticity implies a considerably larger increase in U.S. real exports than under our baseline. This export stimulus pushes U.S. real GDP growth 0.1 percentage point above baseline in 2007 and 2008. With U.S. interest rates reacting to the stronger activity according to a Taylor rule, the dollar appreciates somewhat, and import prices fall a bit. Core PCE inflation remains basically unchanged, as the upward pressure on prices arising from slightly stronger real activity is roughly offset by the decline in import prices. With higher U.S. exports, the nominal trade balance rises 0.2 percent of GDP above baseline in 2008.

Alternative Simulation:
Higher Elasticity of U.S. Exports to Foreign Activity
(Percent change from previous period, annual rate)

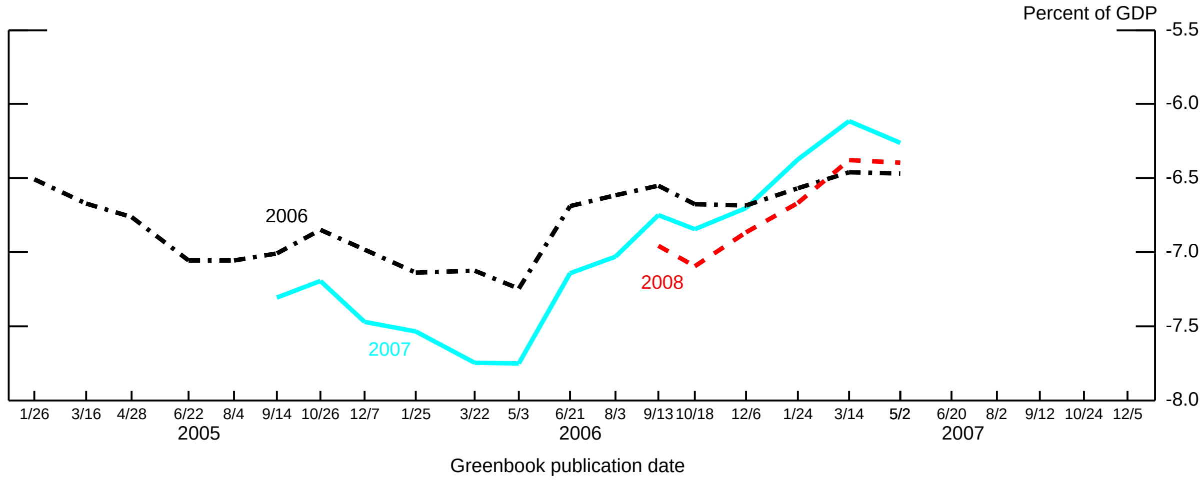
Indicator and simulation	2007		2008	
	H1	H2	H1	H2
U.S. real GDP				
Baseline	1.9	2.0	2.4	2.4
Higher U.S. export elasticity	2.0	2.1	2.5	2.5
U.S. PCE prices excluding food and energy				
Baseline	2.2	2.3	2.2	2.1
Higher U.S. export elasticity	2.2	2.3	2.2	2.1
U.S. federal funds rate (percent)				
Baseline	5.3	5.3	5.3	5.3
Higher U.S. export elasticity	5.3	5.4	5.5	5.5
U.S. trade balance (percent of GDP)				
Baseline	-5.3	-5.4	-5.4	-5.2
Higher U.S. export elasticity	-5.3	-5.3	-5.2	-5.0

Note. H1 is Q2/Q4; H2 is 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 economies adjust their policy rates according to Taylor rules.

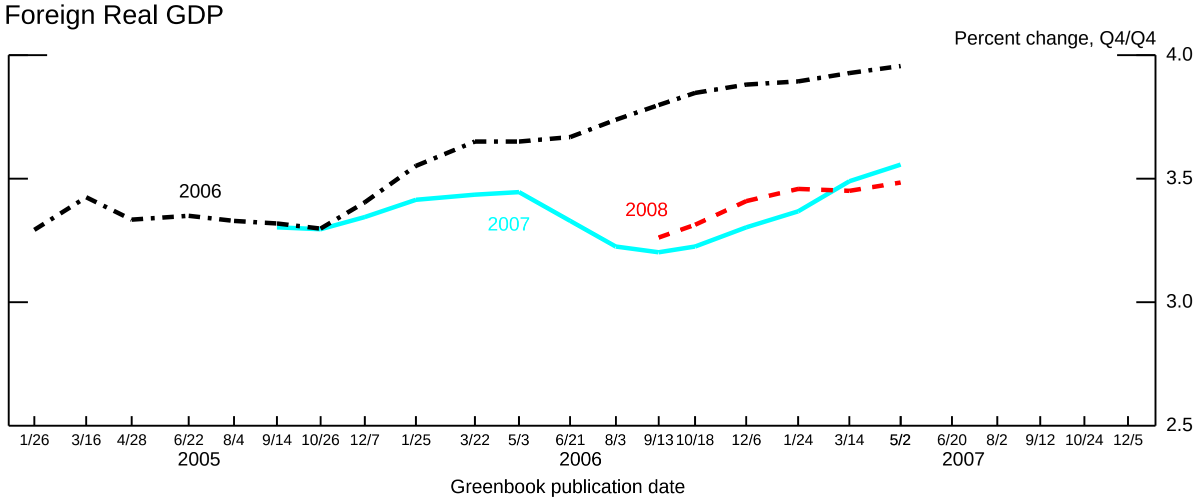
Class II FOMC -- Restricted (FR)

Evolution of the Staff Forecast

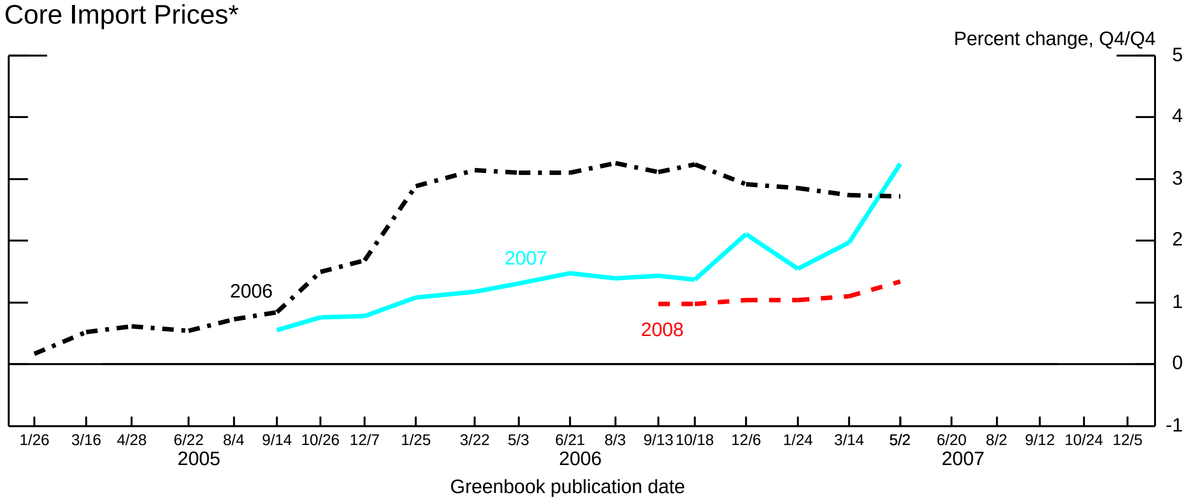
Current Account Balance



Foreign Real GDP



Core Import Prices*



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

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

Measure and country	2000	2001	2002	2003	2004	2005	2006	Projected 2007	Projected 2008
REAL GDP (1)									
Total foreign	4.2	0.3	3.1	2.9	3.9	3.7	4.0	3.6	3.5
Advanced Foreign Economies	3.6	0.9	2.5	1.8	2.6	2.6	2.7	2.6	2.5
of which:									
Canada	4.1	1.3	3.5	1.5	3.7	2.8	2.3	2.7	2.8
Japan	3.1	-1.7	2.0	2.4	1.1	2.8	2.5	2.6	1.7
United Kingdom	3.1	2.0	2.3	3.3	2.6	1.9	3.0	2.7	2.5
Euro Area (2)	3.3	1.1	1.1	1.0	1.5	1.8	3.3	2.2	2.0
Germany	2.3	1.1	0.0	0.2	0.2	1.7	3.7	2.3	2.1
Emerging Market Economies	5.2	-0.4	3.9	4.6	5.7	5.4	5.7	4.8	4.9
Asia	5.8	1.0	6.2	6.8	6.0	7.5	6.7	6.2	6.2
Korea	4.4	4.7	7.7	4.2	2.9	5.7	4.0	3.9	4.4
China	7.8	7.1	8.5	10.1	9.6	10.0	10.4	10.1	9.2
Latin America	4.5	-1.3	1.6	2.4	5.3	3.1	4.9	3.4	3.6
Mexico	4.8	-1.3	2.0	2.1	4.8	2.5	4.3	3.1	3.4
Brazil	4.4	-0.7	5.0	0.8	5.0	3.1	4.7	4.0	4.0
CONSUMER PRICES (3)									
Advanced Foreign Economies	1.9	0.9	2.1	1.3	1.8	1.5	1.3	1.9	1.7
of which:									
Canada	3.1	1.1	3.8	1.7	2.3	2.3	1.3	2.7	2.0
Japan	-0.5	-1.1	-0.5	-0.3	0.5	-1.0	0.3	0.2	0.5
United Kingdom (4)	0.9	1.1	1.5	1.3	1.4	2.1	2.7	2.3	1.9
Euro Area (2)	2.5	2.1	2.3	2.0	2.3	2.3	1.8	2.1	1.9
Germany	1.7	1.5	1.2	1.1	2.1	2.2	1.3	2.2	1.7
Emerging Market Economies	4.1	2.8	2.9	3.1	3.9	3.0	2.9	3.3	2.9
Asia	1.8	1.2	0.8	2.2	3.2	2.6	2.3	2.9	2.6
Korea	2.5	3.3	3.3	3.5	3.4	2.5	2.1	2.7	2.7
China	1.0	-0.1	-0.5	2.7	3.3	1.4	2.1	3.0	2.2
Latin America	8.4	5.3	6.4	4.9	5.7	3.8	4.2	4.0	3.7
Mexico	8.7	5.1	5.2	3.9	5.3	3.1	4.1	3.7	3.5
Brazil	6.4	7.5	10.7	11.5	7.2	6.1	3.2	4.1	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.

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

Measure and country	2006 Q1	2006 Q2	2006 Q3	2006 Q4	Projected 2007 Q1	2007 Q2	2007 Q3	2007 Q4	2008 Q1	2008 Q2	2008 Q3	2008 Q4
REAL GDP (1)	Quarterly changes at an annual rate											
Total foreign	4.8	4.1	3.4	3.6	3.7	3.6	3.5	3.5	3.5	3.5	3.5	3.5
Advanced Foreign Economies	3.4	2.7	2.2	2.6	2.7	2.8	2.6	2.5	2.4	2.5	2.5	2.4
of which:												
Canada	3.8	2.0	2.0	1.4	2.7	2.9	2.7	2.7	2.7	2.9	2.9	2.8
Japan	2.9	1.3	0.5	5.5	3.8	2.4	2.1	2.0	1.8	1.8	1.7	1.7
United Kingdom	3.3	3.1	2.7	2.7	2.6	2.9	2.7	2.7	2.5	2.5	2.5	2.5
Euro Area (2)	3.4	4.0	2.4	3.6	1.8	2.5	2.3	2.2	2.1	2.1	2.0	1.9
Germany	3.4	4.8	3.2	3.5	1.0	2.8	2.7	2.6	2.4	2.2	2.0	1.9
Emerging Market Economies	6.7	6.1	5.1	5.0	5.0	4.7	4.8	4.8	4.9	4.9	4.9	4.9
Asia	6.9	6.7	6.5	6.5	7.2	5.9	6.0	6.0	6.1	6.1	6.3	6.2
Korea	4.0	3.2	5.0	3.8	3.6	4.0	4.1	4.1	4.3	4.4	4.4	4.4
China	11.2	12.8	7.3	10.5	13.7	8.9	8.9	8.9	9.1	9.1	9.5	9.3
Latin America	7.1	5.4	4.1	2.9	2.9	3.6	3.6	3.6	3.6	3.6	3.6	3.6
Mexico	7.0	5.6	2.7	1.9	2.3	3.3	3.4	3.4	3.4	3.4	3.4	3.4
Brazil	6.6	-2.0	10.9	3.7	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
CONSUMER PRICES (3)	Four-quarter changes											
Advanced Foreign Economies	1.8	2.0	1.6	1.3	1.5	1.4	1.6	1.9	1.8	1.7	1.7	1.7
of which:												
Canada	2.5	2.6	1.6	1.3	1.9	1.7	2.2	2.7	2.1	2.1	2.1	2.0
Japan	-0.2	0.2	0.6	0.3	-0.1	-0.1	-0.2	0.2	0.6	0.6	0.5	0.5
United Kingdom (4)	2.0	2.2	2.4	2.7	2.8	2.8	2.5	2.3	2.2	1.9	1.9	1.9
Euro Area (2)	2.3	2.5	2.1	1.8	1.9	1.8	1.8	2.1	2.1	2.0	1.9	1.9
Germany	2.1	2.1	1.6	1.3	1.9	1.9	2.0	2.2	2.0	1.8	1.8	1.7
Emerging Market Economies	3.0	2.9	2.7	2.9	3.1	3.2	3.4	3.3	3.2	3.0	2.9	2.9
Asia	2.4	2.6	2.1	2.3	2.7	2.7	3.1	2.9	2.9	2.7	2.6	2.6
Korea	2.1	2.3	2.5	2.1	2.0	2.0	2.0	2.7	3.2	3.2	3.0	2.7
China	1.2	1.4	1.2	2.1	2.8	3.1	3.4	3.0	2.6	2.3	2.2	2.2
Latin America	4.2	3.5	3.8	4.2	4.2	4.5	4.3	4.0	3.7	3.7	3.7	3.7
Mexico	3.7	3.1	3.5	4.1	4.1	4.4	4.1	3.7	3.6	3.5	3.5	3.5
Brazil	5.6	4.3	3.8	3.2	3.1	3.5	4.1	4.1	3.6	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)

May 2, 2007

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2000	2001	2002	2003	2004	2005	2006	Projected 2007	Projected 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	0.5	0.1	-0.0
Exports of G&S	0.7	-1.3	0.4	0.6	0.7	0.7	1.0	0.5	0.7
Imports of G&S	-1.6	1.1	-1.3	-0.7	-1.5	-0.8	-0.5	-0.5	-0.7
Percentage change, Q4/Q4									
Exports of G&S	6.5	-11.9	3.8	5.8	7.0	6.7	9.4	4.7	5.7
Services	1.8	-8.9	10.2	3.0	7.1	3.1	7.5	5.0	5.6
Computers	22.7	-23.5	-1.1	11.3	6.4	14.1	8.2	14.5	14.4
Semiconductors	27.6	-34.6	10.1	38.3	-6.3	17.2	1.0	13.5	17.0
Core Goods 1/	5.9	-10.2	0.6	4.9	8.0	7.5	10.8	3.7	4.9
Imports of G&S	11.2	-7.6	9.7	4.8	10.6	5.2	3.3	2.8	4.2
Services	10.6	-5.9	8.8	2.2	7.6	1.9	5.1	2.9	3.4
Oil	13.3	3.7	3.8	1.2	9.6	0.9	-9.7	3.6	-0.9
Natural Gas	37.3	-6.5	19.5	1.3	6.6	11.9	-17.2	3.9	6.8
Computers	13.9	-13.6	13.2	17.0	22.5	11.8	13.7	17.8	17.5
Semiconductors	22.8	-51.1	11.0	-0.1	9.3	7.5	-0.4	16.7	17.0
Core Goods 2/	10.3	-6.5	10.0	5.2	10.7	6.2	5.6	1.5	4.3
Billions of Chained 2000 Dollars									
Net Goods & Services	-379.5	-399.1	-471.3	-518.9	-590.9	-619.2	-618.0	-583.9	-575.8
Exports of G&S	1096.3	1036.7	1013.3	1026.1	1120.4	1196.1	1302.8	1374.0	1456.8
Imports of G&S	1475.8	1435.8	1484.6	1545.0	1711.3	1815.3	1920.9	1957.9	2032.6
Billions of dollars									
US CURRENT ACCOUNT BALANCE	-415.2	-389.0	-472.4	-527.5	-665.3	-791.5	-856.7	-867.9	-927.1
Current Acct as Percent of GDP	-4.2	-3.8	-4.5	-4.8	-5.7	-6.4	-6.5	-6.3	-6.4
Net Goods & Services (BOP)	-377.6	-362.8	-421.1	-494.9	-611.3	-716.7	-765.3	-739.7	-763.7
Investment Income, Net	25.7	30.3	17.8	42.3	33.6	17.6	-0.8	-23.0	-56.4
Direct, Net	94.9	115.9	102.4	112.8	123.9	134.4	150.3	172.3	197.5
Portfolio, Net	-69.2	-85.5	-84.6	-70.5	-90.2	-116.8	-151.1	-195.3	-253.9
Other Income & Transfers,Net	-63.3	-56.5	-69.2	-74.9	-87.6	-92.4	-90.6	-105.3	-107.0

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

Class II FOMC
Restricted (FR)

May 2, 2007

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)

May 2, 2007

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2006				Projected 2007				Projected 2008			
	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	1.6	-0.8	0.8	0.3	-0.1	-0.3	0.4	0.0	-0.2
Exports of G&S	1.4	0.7	0.7	1.1	-0.1	0.8	0.7	0.7	0.7	0.7	0.7	0.6
Imports of G&S	-1.5	-0.2	-0.9	0.5	-0.7	-0.0	-0.5	-0.8	-1.0	-0.3	-0.6	-0.9
Percentage change from previous period, s.a.a.r.												
Exports of G&S	14.0	6.2	6.8	10.6	-1.1	7.6	6.3	6.1	5.9	5.8	5.7	5.6
Services	6.7	6.7	0.8	16.3	-2.3	8.0	7.6	7.0	6.3	5.7	5.3	5.0
Computers	9.8	12.0	-0.1	11.5	9.5	20.2	14.4	14.4	14.4	14.4	14.4	14.4
Semiconductors	15.7	29.9	-12.4	-20.8	6.7	13.6	17.0	17.0	17.0	17.0	17.0	17.0
Core Goods 1/	17.8	4.4	11.4	10.1	-1.5	6.6	4.9	4.8	4.9	4.9	4.9	4.9
Imports of G&S	9.1	1.4	5.6	-2.6	4.1	0.1	2.7	4.5	6.1	1.8	3.6	5.2
Services	7.4	9.9	-2.6	6.2	4.4	2.8	2.2	2.4	3.0	3.5	8.0	-0.8
Oil	-4.8	-18.3	7.1	-20.2	26.2	-14.6	-4.9	12.5	18.5	-18.2	-12.0	12.8
Natural Gas	-22.7	38.7	-26.4	-40.3	-22.1	58.0	17.4	-19.4	-1.3	39.0	20.2	-21.0
Computers	34.3	17.0	18.4	-10.1	44.7	-3.5	17.5	17.5	17.5	17.5	17.5	17.5
Semiconductors	3.6	-1.3	21.6	-21.0	14.1	18.7	17.0	17.0	17.0	17.0	17.0	17.0
Core Goods 2/	12.3	2.5	6.9	1.2	-1.8	1.8	3.0	2.9	3.5	4.2	4.6	4.8
Billions of Chained 2000 Dollars, s.a.a.r.												
Net Goods & Services	-636.6	-624.2	-628.8	-582.6	-605.7	-581.5	-573.6	-574.8	-583.8	-572.5	-570.4	-576.4
Exports of G&S	1269.3	1288.5	1310.0	1343.5	1339.6	1364.5	1385.6	1406.2	1426.6	1446.8	1466.9	1486.9
Imports of G&S	1905.9	1912.7	1938.8	1926.1	1945.3	1946.0	1959.2	1981.0	2010.4	2019.2	2037.4	2063.3
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-855.1	-870.8	-917.5	-783.2	-837.0	-865.1	-876.2	-893.5	-935.0	-913.1	-917.2	-943.1
Current Account as % of GDP	-6.6	-6.6	-6.9	-5.8	-6.1	-6.3	-6.3	-6.3	-6.6	-6.3	-6.3	-6.4
Net Goods & Services (BOP)	-766.6	-774.5	-805.6	-714.4	-717.9	-739.3	-746.0	-755.5	-776.8	-759.9	-755.1	-762.8
Investment Income, Net	-3.9	-2.4	-15.5	18.6	-12.5	-19.5	-24.2	-35.9	-47.1	-49.9	-58.7	-69.9
Direct, Net	136.9	152.0	137.0	175.4	158.9	167.6	179.5	183.2	185.8	196.7	202.4	205.1
Portfolio, Net	-140.8	-154.4	-152.5	-156.7	-171.5	-187.1	-203.7	-219.1	-233.0	-246.6	-261.1	-274.9
Other Inc. & Transfers, Net	-84.7	-93.9	-96.4	-87.4	-106.5	-106.3	-106.1	-102.2	-111.1	-103.4	-103.4	-110.4

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