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Confidential (FR) Class II FOMC

Part 1

January 25, 2001

CURRENT ECONOMIC
AND FINANCIAL CONDITIONS

Summary and Outlook

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

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Domestic Developments

Recent economic news has been decidedly downbeat, especially for the industrial sector. Automakers have cut assemblies sharply further in January, and manufacturers in many other industries have also been moving to curtail production to avoid further accumulations of unwanted inventories. Growth of business investment spending appears to have come nearly to a standstill late last year, and consumer confidence has been falling dramatically despite the monetary easing in early January. Taken together, these factors have led us to project that real GDP will decline slightly in the current quarter.

We anticipate that the inventory correction now under way will be largely behind us by the second quarter. Nevertheless, with employment growth and sales expectations flagging, growth of household and business spending should remain subdued through the spring. Consequently, we are projecting only a meager gain in real GDP of about 1-1/4 percent at an annual rate in the second quarter.

But later this year, several influences should help stimulate overall activity. For one, the very speed with which businesses appear to be curtailing production to limit inventory overhangs should help set the stage for a relatively prompt reacceleration of activity. The growth of final demand is also expected to receive support from the dissipating effects of prior monetary restraint, the recent monetary policy action, and our assumption of a further small cut in the federal funds rate at the January FOMC meeting. The projected depreciation of the dollar, declining energy prices, and, later, an assumed swing to fiscal stimulus also contribute importantly to the firming of demand. Moreover, the intermediate-run outlook remains supported by our view that structural productivity will continue to advance near the rapid rates of the past few years. As a consequence, perceptions of permanent income ought to be comparatively well maintained even as employment growth slows dramatically, and this should help support consumption and investment by households. A continued rapid pace of technical advance also provides considerable incentives for business investment, suggesting that the lull in business spending on high-tech and other equipment will be brief. In light of these positive influences, we are projecting growth of real GDP to pick up to a 3 percent pace in the second half of this year and to 3-3/4 percent in 2002.

The near-term weakness in our outlook stops just short of what would conventionally be considered a recession, but the slowdown in activity is pronounced enough to lead to an appreciable slackening of resource utilization. We project the unemployment rate to rise 1-1/4 percentage points to 5-1/4 percent by the end of this year and to move up further to 5-1/2 percent over 2002. With the tightness of labor and product markets dissipating rapidly, core PCE inflation edges down from just below 2 percent this year to 1-3/4 percent in 2002.

Our projection is built upon a number of critical assumptions that ultimately could prove to be wide of the mark. We explore the consequences of alternative assumptions, as well as their implications for monetary policy, in simulations developed at the end of this section.

Key Background Factors

The financial markets took some comfort from the intermeeting rate cut, which reassured investors that the Committee would move aggressively to counter a sharp slowdown in economic activity. This sigh of relief has produced substantial rallies in the junk bond and equity markets. However, the commercial paper market has become much less hospitable for lower-tier issuers in recent weeks, and bank lenders report that they have turned more cautious. We expect this caution to persist over the forecast period as corporate balance sheets deteriorate further and the household sector's ability to repay debt slips a bit. With investors almost certain to be disappointed by the path of corporate earnings that we foresee, we have assumed that equity prices will turn down in coming months and stabilize at that lower level thereafter.

We are assuming that fiscal policy will move in an expansionary direction over the coming two years. As in the last Greenbook, we expect tax cuts amounting to about $50 billion in fiscal year 2002. We view this assumption as a middle path between the more gradually phased-in plan President Bush announced during the campaign and the more ambitious retroactive tax cuts that have been discussed in some quarters more recently.[1] Of course, the weaker output forecast implies lower receipts, and we now project the on-budget surplus to be about $90 billion in both fiscal 2001 and fiscal 2002; relative to the December projection, these figures are lower by about $20 billion and $50 billion, respectively.

We have revised down our projection for foreign economic activity in the near term, in part owing to the weaker outlook for the United States. But we expect foreign growth to rebound to a 3-1/2 percent pace in the second half of this year and to be 3-3/4 percent in 2002. The dollar has risen slightly, on balance, against the currencies of a broad group of our trading partners over the intermeeting period; it is projected to decline moderately in real terms over 2001 and 2002.

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1. We note that even if tax cuts are enacted retroactively to January 1 of this year, they nevertheless may have little effect on consumer spending until the latter part of this year; legislative action is not likely until the summer, and there probably will be considerable uncertainty about specifics prior to completion of the process.

The spot price of West Texas intermediate crude oil moved below $30 per barrel in early December and declined further later in the month, reflecting expectations of weaker world demand and news suggesting that inventories were not as low as had been feared. However, much of this decline was subsequently reversed, partly as a result of OPEC's recent decision to reduce production targets. Consistent with the current quotes in futures markets, we expect oil prices to recede over the next two years, with the price of WTI falling from near $31 per barrel now to about $25 per barrel by the end of this year and to $23 per barrel by the end of 2002.

Recent Developments and the Near-Term Outlook
Incoming data suggest that real GDP increased at an annual rate of 2 percent in the fourth quarter, consistent with the weak worker hours reported in the labor market surveys and a pace of productivity growth that is close to trend. In the current quarter, real GDP is projected to decline 1/2 percent at an annual rate, reflecting a sizable reduction in the pace of inventory accumulation.

A contraction in the production of new motor vehicles in response to excess inventories accounts for a good bit of the economy's recent weakness, taking off about 1 percentage point from GDP growth in the fourth quarter and, we believe, almost 1-1/2 percentage points in the current quarter. These cutbacks probably are sharp enough to put excess stocks on a downward trajectory, and we anticipate no further reduction in the pace of assemblies after this quarter.

We also expect sizable production adjustments outside of motor vehicles, and the resulting downshift in the pace of nonfarm inventory investment cuts a further 1-1/2 percentage points from real GDP growth this quarter. Inventory overhangs already have emerged in a number of industries--including metals, construction supplies, paper, and textiles--bucking the downtrend in these ratios that had been in train through most of the 1990s. Businesses seem to be acting promptly to limit any further deterioration of undesired stocks. Indeed, industrial production in manufacturing excluding motor vehicles was down sharply in December, and anecdotal information points to a substantial further decline in January.

Consumer spending on goods decelerated notably last quarter, reflecting an outright decline in expenditures on motor vehicles and only small rates of increase on a wide range of durable and nondurable goods. By contrast, spending on services continued to post solid increases through November, only a portion of which stemmed from increased energy expenditures due to cold weather. In all, we think PCE rose at a 2-3/4 percent pace in the fourth quarter. For the current quarter, we have little hard data to go on, although continuing sharp declines in consumer confidence through early January clearly do not bode well for spending. Nevertheless, anecdotal reports from retail chains

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

Measure	2000:Q4		2001:Q1	
	Dec. GB	Jan. GB	Dec. GB	Jan. GB
Real GDP	**2.4**	**2.0**	**2.2**	**-.5**
Private domestic final purchases	3.2	2.1	3.0	1.5
Personal consumption expenditures	2.9	2.8	2.9	1.4
Residential investment	-4.8	-3.4	-5.1	-2.1
Business fixed investment	7.5	.5	5.7	3.0
Government outlays for consumption and investment	2.5	2.8	3.7	2.3
	Contribution to growth, percentage points			
Inventory investment	-.7	.1	-.5	-2.6
Net exports	-.1	-.4	-.5	.4

suggest that consumer spending stabilized in early January, and motor vehicle sales appear to be rebounding some this month. Our projection calls for real PCE to rise at an annual rate of about 1-1/2 percent this quarter.

Investment spending looks to have decelerated especially sharply late last year. We now believe that equipment and software expenditures declined at an annual rate of 1-1/2 percent in the fourth quarter--versus the nearly 15 percent rate of increase seen over the several preceding years. Shipments of computer and communications equipment slowed markedly in October and November from the rapid increases seen earlier, consistent with anecdotal evidence that demand for high-tech equipment has slackened considerably. There were outright declines in expenditures on motor vehicles last quarter, and orders and shipments for a wide variety of other capital goods turned down as well. We expect this weakness to persist in the current quarter and look for real investment in equipment and software to rise at an annual rate of just 1-1/4 percent.

In contrast, construction activity appears to have remained reasonably strong. Demand in the residential sector has been supported by lower mortgage interest rates, and single-family starts were solid in the fourth quarter despite adverse weather that may have held down activity in November and December. Indeed, we expect starts in the current quarter to recoup some of their weather-related losses and to exceed their fourth-quarter average. Meanwhile, outlays for nonresidential construction remained firm at least through November, and we anticipate further increases this quarter.

Government spending is expected to rise moderately this quarter. Federal expenditures on consumption and gross investment are expected to just edge up, but state and local expenditures are projected to advance at a rate of 3-1/4 percent, as spending on highways and other construction projects should rebound somewhat following weak spending in the latter part of last year.

Part of the slowdown in domestic spending this quarter is likely to be absorbed by reduced imports rather than reduced domestic production. At the same time, exports are projected to be little changed this quarter after contracting last quarter. In all, the foreign sector contributes 1/2 percentage point to real GDP growth this quarter, after having been a sizable negative last year.

The easing in the price of crude oil should continue to push down gasoline prices, but we expect these declines to be outweighed over the next couple of months by sizable increases in natural gas prices, which affect energy prices both directly and through their effect on the costs of electricity generation. Nevertheless, futures markets suggest that by spring, natural gas prices, too, should start to decline. Outside of the energy area, we anticipate inflation to remain moderate in the near term, with the chain price index for personal consumption expenditures excluding food and energy increasing just below 2 percent at an annual rate in both the fourth quarter of 2000 and the current quarter. On the wage front, average hourly earnings turned up markedly in the fourth quarter, and nonfarm compensation per hour is likely to post another substantial increase as well. However, the ECI rose at only a modest annual rate of 3 percent over the fourth quarter; we expect the ECI to increase at a 4-1/4 percent rate this quarter, boosted in part by higher health insurance premiums in the new year.

The Longer-Term Outlook for the Economy

We think that by the end of the current quarter firms will have started to run down the existing inventory overhangs. Thus, we project small increases in production--GDP growth of 1-1/4 percent at an annual rate--in 2001:Q2, while inventory-sales ratios continue to edge lower. By the third quarter, the inventory adjustment should be largely complete, and we expect to see GDP increasing about 2-1/2 percent at an annual rate. We expect both demand and production to pick up gradually from there, aided, as discussed above, by the turnaround in monetary policy, declining energy prices, expansionary fiscal policy, and a depreciating dollar.

Household spending. The forces affecting consumer spending are mixed at present. On the negative side, the decline in the stock market since last summer

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

Measure	2000 H1	2000 H2	2001 H1	2001 H2	2002
Real GDP	**5.2**	**2.1**	**.4**	**3.1**	**3.8**
Previous	5.2	2.3	2.7	3.5	3.9
Final sales	5.3	2.2	1.7	2.8	3.7
Previous	5.3	2.8	2.8	3.7	3.9
PCE	5.3	3.6	1.2	2.0	2.8
Previous	5.3	3.7	2.9	3.0	3.0
Residential investment	2.2	-7.1	-1.1	0.0	.7
Previous	2.2	-7.7	-1.8	1.0	-.4
BFI	17.7	4.0	2.8	6.1	9.1
Previous	17.7	7.4	6.5	7.7	9.6
Government purchases	1.8	.7	2.7	3.1	3.3
Previous	1.8	.6	3.6	3.5	3.4
Exports	10.2	4.1	2.8	9.3	9.9
Previous	10.2	11.9	4.4	9.3	10.3
Imports	15.2	7.8	1.8	6.5	8.2
Previous	15.2	12.0	7.5	7.6	8.3
	Contribution to growth, percentage points				
Inventory change	.0	-.1	-1.3	.3	.2
Previous	.0	-.4	-.1	-.2	.0
Net exports	-1.0	-.7	.1	.1	-.1
Previous	-1.0	-.4	-.6	-.1	-.1

and the resultant reduction in the net worth of households should by now be depressing consumer spending. The household wealth-to-income ratio is projected to move lower and be a fairly constant drag on spending throughout the projection period. In the case of durable goods, spending may be held down as well by some retrenchment following the rapid pace of spending over the past few years. Partly for this reason, light vehicle sales are now expected to be 15-1/4 million units this year and next--far below last year's record sales of 17-1/4 million units.

On the positive side, our estimates of structural productivity growth imply that households' longer-run income prospects remain favorable. We expect real disposable income to rise more rapidly over the projection period than it did in 1999 and 2000, bolstered by an easing of energy prices, by some catch-up of real wages following the recent years' productivity acceleration, and by our assumed tax cut. Reduced interest rate burdens associated with a pickup in mortgage refinancing also should help to support consumption spending in the coming months. In all, we expect real PCE, after rising at an annual rate of only about 1-1/4 percent in the first half of this year, to increase at a 2 percent rate in the second half and to rise about 2-3/4 percent in 2002. This pace of consumption growth is subdued relative to income, and, consistent with a negative wealth effect, we project the saving rate to move up about 2-1/4 percentage points on an annual-average basis between 2000 and 2002.

Although the adverse wealth effects should also serve to damp housing demand, we think that low mortgage rates and solid income growth will continue to support this sector. On balance, homebuilding should be well maintained over the forecast period. We look for single-family starts to edge up from 1.26 million units this year to 1.29 million units in 2002, while multifamily starts are projected to be flat at near a pace of 300,000 units.

Business investment. The recent sharp slowdown in investment spending likely reflects a number of factors, including reductions in sales and earnings expectations associated with the anticipated weakness in overall activity as well as the downturn in the stock market. That said, the magnitude of the slowdown has been a surprise to us, and simply chalking up such a surprise to a reduction in "animal spirits" begs the question as to what has made businesses so much less optimistic and how long such low spirits will persist. The huge increases in investment over the past several years may have left some businesses feeling, especially in the wake of the recent slowdown in sales, as though they overinvested. We are expecting some period of retrenchment--especially in the tech sector--as firms adjust their capital stocks to more desirable levels. The size of such an adjustment depends critically on our assumptions about the longer-run rate of technological advance. If, contrary to our assumptions, the U.S. economy is now reaching the end of several years of unusually profitable investment opportunities, then investment spending could fall well short of our expectations, with serious consequences for the economic outlook. We address this possibility in one of our alternative simulations below.

But given our belief that future structural productivity increases will look more like those of the past several years than of the preceding twenty--and that businesses agree with this view--we project that any such capital stock adjustment ought to be modest, leaving us in a good position to resume more rapid investment spending before too long. Thus, after posting only small gains in the first half of this year, real outlays for equipment and software are projected to increase at a rate of 6-1/4 percent in the second half--less than half the pace of the past five years--and to rise near 11 percent in 2002. We think that spending on high-tech equipment will recover and increase at a rapid clip in 2002, with ongoing technological advance and the accompanying decline in computer prices helping to shore up spending in that area. Outlays for a range of other types of equipment are expected to improve modestly as well.

The nonresidential construction sector appears to have avoided the substantial overbuilding that often has accompanied past economic booms; spending has been holding up well and is expected to rise further over the projection period. Office vacancy rates remain quite low, and although lenders are becoming more cautious, funding for projects generally remains available, and spreads on commercial-mortgage-backed securities have not deteriorated. We do expect to see a marked deceleration in construction of new industrial buildings, given the cutbacks in production and emerging excess capacity in that sector, but growth in spending on office and institutional buildings should be well maintained this year and next.

As discussed above, we expect businesses to curtail inventory investment reasonably promptly in response to the slower pace of sales growth. Thus, although inventory-sales ratios moved higher through the end of last year, we project that they will have begun moving back down by the end of the second quarter. We expect businesses to gradually increase the pace of stockbuilding thereafter, making only a small contribution to GDP growth over the remainder of the projection period.

Government spending. Given that our overall fiscal policy assumptions have not changed since the December forecast, our projection of federal expenditures for consumption and investment has changed little. Increases in real federal purchases are expected to average 2-1/2 percent over the next two years, with moderate gains in both the defense and the nondefense components.

Although the fiscal situation among states and localities has remained fairly strong overall, warning signs have emerged in a number of states. As a result, we have scaled back somewhat our projections of both spending increases and further tax reductions. We now project real purchases to rise roughly 3-1/2 percent per year over 2001 and 2002.

Net exports. We expect the demand for U.S. exports, after having declined late last year, to increase gradually over this year and next, reflecting an improved pace of economic activity abroad and a projected depreciation of the dollar. Similarly, after declining this quarter, real import spending should turn up as well with the pickup in U.S. activity. In all, the contribution to real GDP growth from the external sector should be near zero this year and next after subtracting about 3/4 percentage point from growth in 2000. (The International Developments section provides a more detailed discussion of the outlook for the external sector.)

Aggregate Supply, the Labor Market, and the Prospects for Inflation
Our reduced forecast for business investment spending implies a slower pace of capital accumulation than we had projected in the December Greenbook, and as a result, we have further reduced our assumption about structural productivity growth to an increase of 3.1 percent this year and 3 percent in 2002. The associated growth of potential GDP now is 4.2 percent in 2001 and 4.1 percent in 2002.

Productivity and the labor market. Productivity growth remained relatively robust in the second half of last year despite the substantial deceleration of output, as firms moved to reduce hours worked. We anticipate that firms will continue to adjust their workweeks and hiring promptly in response to production cutbacks this quarter, and we look for private payrolls to edge down over the first quarter. Nevertheless, we do expect a pronounced cyclical slowing in productivity growth; indeed, we project productivity to be flat this quarter and to rise at an annual rate of 1-1/2 percent in the second quarter. Productivity is expected to accelerate thereafter and to rise near its trend rate in 2002. Hiring is also likely to pick up as activity strengthens, although we still expect to see payroll gains of less than 100,000 per month through most of 2002. With this very weak employment picture, the unemployment rate is projected to move up notably, to 5-1/4 percent by the end of this year and to 5-1/2 percent by the end of 2002.

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

Measure	1973-95	1996-98	1999	2000	2001	2002
Structural labor productivity	**1.4**	**2.5**	**3.2**	**3.3**	**3.1**	**3.0**
Previous	1.4	2.5	3.2	3.4	3.3	3.2
Contributions[1]						
Capital deepening	.7	1.1	1.5	1.5	1.3	1.2
Previous	.7	1.1	1.5	1.6	1.5	1.4
Multifactor productivity	.4	1.1	1.4	1.5	1.5	1.5
Previous	.4	1.1	1.4	1.5	1.5	1.5
Labor quality	.3	.3	.3	.3	.3	.3

1. Percentage points.

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

Measure	1999	2000	2001	2002
Output per hour, nonfarm business	4.1	3.6	1.9	3.1
Previous	4.1	3.4	2.5	3.2
Nonfarm payroll employment	2.2	1.6	.2	.8
Previous	2.2	1.6	.9	1.2
Household employment survey	1.5	1.1	-.2	.6
Previous	1.5	1.0	.5	.8
Labor force participation rate[1]	67.0	67.1	67.0	66.9
Previous	67.0	67.0	67.1	67.0
Civilian unemployment rate[1]	4.1	4.0	5.2	5.5
Previous	4.1	4.0	4.7	5.0

1. Percent, average for the fourth quarter.

Wages and prices. We now project lower wage and price inflation than in the December Greenbook. This reflects both the lower levels of resource utilization in this projection and the fact that we have dropped our assumption of an increase in the minimum wage during the forecast period.[2]

We now expect the ECI for hourly compensation to increase 4.3 percent this year and 4.1 percent in 2002. Although employers' health insurance costs likely will continue to rise rapidly, the reduction in labor market tightness should ease pressure on wages; the energy-related decline in consumer price inflation also should be an important factor in holding down nominal wage increases by next year.

Regarding energy prices, we continue to expect reductions in prices of gasoline and heating oil throughout the forecast period, in line with the projected downtrend in crude oil prices. And although we look for further increases in prices of natural gas for the next couple of months, futures markets for natural gas suggest that these prices, too, will decline notably thereafter.

2. In the December Greenbook, we assumed that the minimum wage would be increased from $5.15 per hour to $5.65 per hour in January 2002. Although such an outcome certainly remains possible as part of budget negotiations, it looks increasingly unlikely in the face of a weakening economy. This change in assumptions lowers the projected increase in ECI hourly compensation in 2002 by 0.2 percentage point and lowers the increase in the core PCE price index by 0.1 percentage point.

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

Measure	1999	2000	2001	2002
PCE chain-weighted price index	2.0	2.3	1.8	1.7
Previous	2.0	2.5	1.7	1.9
Excluding food and energy	1.5	1.6	1.9	1.8
Previous	1.5	1.8	2.0	2.0
Consumer price index	2.6	3.4	2.3	2.0
Previous	2.6	3.4	2.1	2.2
Food	1.9	2.5	2.9	2.5
Previous	1.9	2.6	2.6	2.6
Energy	11.2	15.2	-2.1	-3.7
Previous	11.2	14.9	-4.2	-2.9
Excluding food and energy	2.1	2.6	2.5	2.4
Previous	2.1	2.6	2.6	2.6
GDP chain-weighted price index	1.6	2.3	2.0	1.7
Previous	1.6	2.5	1.9	1.8
ECI for compensation of private industry workers[1]	3.4	4.4	4.3	4.1
Previous	3.4	4.7	4.6	4.6
NFB compensation per hour	4.8	5.6	5.3	5.0
Previous	4.8	5.4	5.5	5.5
Prices of core non-oil merchandise imports	.4	1.5	1.6	2.7
Previous	.4	1.2	2.4	2.8

1. December to December.

We project that increases in the PCE chain price index excluding food and energy will be 1.9 percent this year and will edge slightly lower to 1.8 percent in 2002. These rates are down 0.1 and 0.2 percentage point, respectively, from our previous projection. We continue to expect that a firming of prices of core non-oil imports will exert a bit of upward pressure on domestic prices going forward. But this pressure is likely to be offset by the indirect effects of the turnaround in energy costs between last year and this year and by the elimination of excess tightness in the labor market. In all, we expect total PCE prices to rise about 1-3/4 percent both this year and next. The CPI is expected to show a similar pattern to that for PCE prices but to run roughly 1/2 percentage point higher: We expect the core CPI to rise around 2-1/2 percent both this year and in 2002 and the total CPI to rise about 2-1/4 percent this year and 2 percent next year.

Financial Flows and Conditions

Debt of the domestic nonfinancial sector is projected to grow at a rate of about 4 percent this year and next--a pace similar to that in the second half of 2000 but down substantially from the increases in the preceding couple of years. Total domestic debt growth will be held down, in part, by the continued contraction of federal government debt. In addition, we anticipate that business debt growth--which slowed sharply in the second half of 2000--will stay well below the double-digit advances of recent years, as lenders will be more restrained given the slippage in credit quality. Growth of household debt is projected to moderate over the next two years, primarily reflecting the slower growth in the stock of consumer durables.

With corporate profits projected to decelerate more rapidly than investment outlays, firms will need a growing volume of external funding to finance their investment spending. Equity markets will be a source of funds for some firms. In addition, the pace of share buybacks is likely to drop as companies attempt to conserve cash to support capital spending. Even so, business debt growth will need to pick up somewhat from the relatively low fourth-quarter pace in order to finance these expenditures. We expect that higher-grade firms will continue to have fairly ready access to funds on affordable terms. However, wide spreads on speculative-grade debt and tighter terms and standards on loans at commercial banks will continue to exert some restraint on spending by lower-rated firms.

In the household sector, debt growth is expected to slow from 8-3/4 percent in 2000 to 7-1/4 percent in 2001 and to 6-1/4 percent in 2002. This deceleration is concentrated in consumer credit. Mortgage debt growth, in contrast, moderates only slightly, as the recent declines in mortgage rates support the pace of housing activity and the refinancing of existing mortgages results in some substitution of mortgage for consumer credit. With the slower growth of total household debt and some reduction in the average interest rate on the stock of mortgages, we project that the debt service burden will edge down on net over the forecast period--a development that should help limit any decline in household credit quality.

Borrowing by the state and local government sector is expected to remain sluggish over the next couple years. Although these governments likely will continue to borrow substantial amounts to fund new capital projects, ongoing retirements of debt that had been previously refunded will hold down the growth of outstanding debt.

M2 growth has been brisk in recent months, in part reflecting a decline in its opportunity cost as well as some heightened preference for liquidity in response to the increase in equity price volatility. The expansion of M2 is expected to slow this year, but to a lesser extent than nominal GDP growth. Lower short-term market interest rates and the anticipated flatness of the yield curve provide households with little incentive to shift into capital market instruments. Moreover, mortgage refinancing activity gives M2 a lift as prepayments are temporarily parked in transaction accounts. In 2002, M2 growth is unchanged, as the effects of interest rates and refinancing activity abate and nominal GDP growth picks up.

Alternative Simulations
The staff outlook shows the economy near recession in the near term but buoyed over the longer run by, among other things, a continuation of rapid growth of structural productivity. Many factors could significantly alter this outcome, and we use several model simulations to illustrate major risks to the forecast. In the first two scenarios ("recession"), a greater near-term loss of confidence by firms and households is sufficient to push the economy into outright recession, with a severity that depends on whether or not monetary policy seeks to moderate its effects. The third scenario ("growth pause") considers the risk that final sales are stronger than we and businesses expect; as a result, the inventory correction occurs more rapidly than in the baseline, and growth rebounds sharply in the second half of this year. The fourth simulation ("easier monetary policy") shows how the baseline projection would be altered if monetary policy were to ease along the lines currently expected by financial markets. The remaining two scenarios address the risk that we have mis-gauged the fundamental supply-side conditions underlying longer-term growth. The first ("productivity slowdown") explores the implications of structural labor productivity growth returning to the average pace recorded prior to the recent acceleration, while the second ("low NAIRU") considers instead the possibility that stable long-run inflation is consistent with an unemployment rate of 4 percent.

Recession. These scenarios assume that spending is weaker this year than in the Greenbook baseline but that the loss of confidence driving this additional spending restraint fades in 2002. Under a policy of holding the real federal funds rate at the baseline path ("no policy response"), real GDP falls in 2001, pushing the unemployment rate to 6 percent by year's end. Although output growth recovers in 2002 as confidence returns, the unemployment rate drifts up further, to 6-1/2 percent--a cyclical swing in line with that typically experienced during post-war recessions. Significant slack in labor and product markets causes core inflation to fall to 1-1/4 percent by late next year.

In the second "recession" scenario ("with policy response"), a substantial reduction in the federal funds rate in 2001--on the order of an additional 1 percentage point relative to baseline by the end of the year--attenuates the loss

Alternative Simulations:
Aggregate Demand, Monetary Policy, Productivity, and the NAIRU
(Percent change, annual rate, from end of preceding period, except as noted)

Measure	2000	2001		2002	
	H2	H1	H2	H1	H2
Real GDP					
Baseline	**2.1**	**.4**	**3.1**	**3.7**	**3.9**
Recession, no policy response	2.1	-1.2	.1	3.9	4.4
Recession, with policy response	2.1	-1.1	.6	4.8	5.5
Growth pause	2.1	1.2	3.8	4.1	4.3
Easier monetary policy	2.1	.5	3.8	4.8	5.1
Productivity slowdown	2.1	.0	2.0	2.3	1.9
Low NAIRU	2.1	.5	3.3	4.0	4.2
Civilian unemployment rate[1]					
Baseline	**4.0**	**4.7**	**5.2**	**5.4**	**5.5**
Recession, no policy response	4.0	4.9	6.0	6.4	6.6
Recession, with policy response	4.0	4.9	5.9	6.1	6.1
Growth pause	4.0	4.6	4.9	5.0	4.9
Easier monetary policy	4.0	4.7	5.1	5.0	4.9
Productivity slowdown	4.0	4.7	5.3	5.7	6.0
Low NAIRU	4.0	4.7	5.1	5.3	5.2
PCE prices excluding food and energy					
Baseline	**1.4**	**1.9**	**1.9**	**1.8**	**1.8**
Recession, no policy response	1.4	1.9	1.9	1.6	1.3
Recession, with policy response	1.4	1.9	2.0	1.9	1.8
Growth pause	1.4	1.9	1.9	1.9	2.0
Easier monetary policy	1.4	1.9	2.1	2.2	2.3
Productivity slowdown	1.4	1.9	1.9	1.8	1.9
Low NAIRU	1.4	1.6	1.5	1.2	1.0

1. Average for the final quarter of the period.

of output and limits the rise in unemployment.[3] In contrast to the first scenario, output rebounds more strongly and the unemployment rate rises to only about 6 percent next year.

Growth pause. In this scenario, final demand is fundamentally stronger than assumed in the staff outlook. Consequently, compared to baseline, a more severe inventory drawdown takes place in the near term, but greater final sales

3. In this scenario, the Taylor rule is used to adjust the nominal funds rate relative to its baseline path in response to the greater weakness in output.

actually boost GDP growth slightly over the first half of this year. In the second half of the year--after the inventory correction is complete--GDP growth rebounds to close to its trend rate (assuming that the real funds rate follows the baseline path). Inflation is slightly higher than in the staff forecast under these conditions.

Easier monetary policy. Here, in contrast to the staff assumption, the federal funds rate declines over the next two years in line with the expectation implicit in current futures contracts (about 100 basis points below the baseline). With this more aggressive policy easing, the unemployment rate peaks at 5.1 percent later this year and falls to 4.9 percent in 2002. Inflation trends upward under these circumstances.

Productivity slowdown. In this scenario, we allow for the possibility that a deceleration in U.S. labor productivity initiates a considerable slowdown in GDP growth (under the assumption that the real federal funds rate is held constant). We assume that structural productivity growth gradually falls back to 1-1/2 percent per year--its average over 1973-95--as compared to about 3 percent in the staff forecast. Stock market investors quickly revise their expectations of long-run earnings growth, and equity prices average about 30 percent lower than in the baseline simulation. Households and firms revise their spending plans in response both to the fall in equity prices and to the surprising weakness that materializes in productivity and real income growth. Although the unemployment rate rises relative to baseline, there is no favorable feedback to inflation because the boost to unit labor costs implied by the reduction in productivity growth offsets the effects of greater economic slack. Monetary policy could limit the rise in the unemployment rate to that shown in the baseline simulation by cutting the nominal funds rate by about 3/4 percentage point relative to the baseline assumption, at the cost of higher inflation.

Lower NAIRU. In contrast to the staff view that the (transitory) influence of faster productivity growth has helped to offset the inflationary effects of a tight labor market, this scenario assumes that the NAIRU has been and will remain at 4 percent. Holding the real federal funds rate at baseline results in lower price inflation, lower but still rising unemployment, and faster real GDP growth compared with baseline. The faster output growth owes to the fact that a lower NAIRU is consistent with a higher level of potential output, and therefore with higher permanent income and spending. Monetary policy could limit the rise in the unemployment rate, and thereby stabilize core PCE inflation, by cutting the nominal funds rate by about 1 percentage point below the baseline level.

Strictly Confidential <FR> Class II FOMC

January 25, 2001

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

Interval		Nominal GDP		Real GDP		GDP chain-weighted price index		Consumer price index[1]		Unemployment rate[2]	
		12/13/00	01/25/01	12/13/00	01/25/01	12/13/00	01/25/01	12/13/00	01/25/01	12/13/00	01/25/01
ANNUAL											
1998		5.7	5.7	4.4	4.4	1.3	1.3	1.6	1.6	4.5	4.5
1999		5.8	5.8	4.2	4.2	1.5	1.5	2.2	2.2	4.2	4.2
2000		7.3	7.2	5.1	5.1	2.2	2.1	3.4	3.4	4.0	4.0
2001		5.0	3.8	2.9	1.7	2.1	2.1	2.5	2.7	4.5	4.8
2002		5.5	5.2	3.7	3.5	1.8	1.7	2.1	1.9	4.9	5.4
QUARTERLY											
1999	Q1	5.9	5.9	3.5	3.5	2.2	2.2	1.7	1.7	4.3	4.3
	Q2	3.9	3.9	2.5	2.5	1.4	1.4	3.2	3.2	4.3	4.3
	Q3	6.7	6.7	5.7	5.7	1.1	1.1	2.4	2.4	4.2	4.2
	Q4	9.7	9.7	8.3	8.3	1.6	1.6	2.9	2.9	4.1	4.1
2000	Q1	8.3	8.3	4.8	4.8	3.3	3.3	4.3	4.3	4.1	4.1
	Q2	8.2	8.2	5.6	5.6	2.4	2.4	3.6	3.6	4.0	4.0
	Q3	4.3	3.8	2.3	2.2	1.9	1.6	3.1	3.1	4.0	4.0
	Q4	4.7	4.1	2.4	2.0	2.3	2.0	2.8	2.8	4.0	4.0
2001	Q1	4.9	2.4	2.2	-0.5	2.7	3.0	2.5	3.9	4.3	4.4
	Q2	5.0	3.0	3.1	1.3	1.8	1.8	1.9	1.8	4.4	4.7
	Q3	5.0	4.3	3.3	2.6	1.6	1.6	1.9	1.5	4.6	5.0
	Q4	5.3	5.3	3.6	3.6	1.7	1.6	2.0	1.8	4.7	5.2
2002	Q1	5.9	5.8	3.7	3.7	2.1	1.9	2.1	1.9	4.8	5.3
	Q2	5.6	5.4	3.8	3.7	1.7	1.6	2.2	2.0	4.9	5.4
	Q3	5.7	5.5	3.9	3.8	1.7	1.6	2.3	2.0	4.9	5.5
	Q4	5.8	5.7	4.0	4.0	1.7	1.6	2.3	2.0	5.0	5.5
TWO-QUARTER[3]											
1999	Q2	4.9	4.9	3.0	3.0	1.8	1.8	2.5	2.5	-0.1	-0.1
	Q4	8.2	8.2	7.0	7.0	1.3	1.3	2.7	2.7	-0.2	-0.2
2000	Q2	8.2	8.2	5.2	5.2	2.8	2.8	4.0	4.0	-0.1	-0.1
	Q4	4.5	4.0	2.3	2.1	2.1	1.8	2.9	2.9	0.0	0.0
2001	Q2	5.0	2.7	2.7	0.4	2.2	2.4	2.2	2.9	0.4	0.7
	Q4	5.2	4.8	3.5	3.1	1.6	1.6	1.9	1.7	0.3	0.5
2002	Q2	5.7	5.6	3.8	3.7	1.9	1.8	2.1	1.9	0.2	0.2
	Q4	5.8	5.6	4.0	3.9	1.7	1.6	2.3	2.0	0.1	0.1
FOUR-QUARTER[4]											
1998	Q4	5.9	5.9	4.6	4.6	1.2	1.2	1.5	1.5	-0.3	-0.3
1999	Q4	6.5	6.5	5.0	5.0	1.6	1.6	2.6	2.6	-0.3	-0.3
2000	Q4	6.3	6.1	3.8	3.7	2.5	2.3	3.4	3.4	-0.1	-0.1
2001	Q4	5.1	3.8	3.1	1.8	1.9	2.0	2.1	2.3	0.7	1.2
2002	Q4	5.7	5.6	3.9	3.8	1.8	1.7	2.2	2.0	0.3	0.3

1. For all urban consumers.
2. Level, except as noted.
3. Percent change from two quarters earlier; for unemployment rate, change in percentage points.
4. Percent change from four quarters earlier; for unemployment rate, change in percentage points.

Strictly Confidential <FR>
Class II FOMC

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

January 25, 2001

Item	Units[1]	1994	1995	1996	1997	1998	1999	2000	2001	2002
								---------Projected---------		
EXPENDITURES										
Nominal GDP	Bill. $	7054.3	7400.5	7813.2	8318.4	8790.2	9299.2	9969.7	10347.1	10886.8
Real GDP	Bill. Ch. $	7347.7	7543.8	7813.2	8159.5	8515.7	8875.8	9324.0	9479.7	9807.7
Real GDP	% change	4.1	2.2	4.1	4.3	4.6	5.0	3.7	1.8	3.8
Gross domestic purchases		4.3	1.7	4.3	5.0	5.7	5.9	4.3	1.6	3.8
Final sales		3.2	2.9	3.9	3.9	4.6	4.8	3.7	2.3	3.7
Priv. dom. final purchases		4.3	3.2	4.4	5.1	6.4	6.1	5.1	2.0	3.7
Personal cons. expenditures		3.6	2.8	3.1	4.1	5.0	5.6	4.5	1.6	2.8
Durables		6.4	3.7	5.0	8.8	12.6	11.1	4.6	-1.6	3.9
Nondurables		4.1	2.5	3.2	2.5	5.0	5.9	3.7	1.2	2.4
Services		2.7	2.7	2.7	3.9	3.4	4.2	4.8	2.5	2.9
Business fixed investment		9.2	7.5	12.1	11.8	12.9	10.1	10.7	4.5	9.1
Equipment & Software		12.0	8.9	11.8	13.7	15.8	14.1	10.3	3.7	10.9
Nonres. structures		1.1	3.3	12.8	6.5	4.9	-1.7	11.9	6.8	4.1
Residential structures		4.0	-1.5	5.6	3.5	10.3	2.8	-2.5	-0.5	0.7
Exports		10.5	9.7	9.8	8.5	2.2	4.3	7.2	6.0	9.9
Imports		12.2	5.0	11.2	14.3	11.2	12.0	11.4	4.1	8.2
Gov't. cons. & investment		0.2	-0.8	2.7	2.4	2.6	4.4	1.2	2.9	3.3
Federal		-3.7	-5.3	2.0	0.1	0.8	4.8	-1.3	2.1	2.7
Defense		-5.9	-4.7	0.8	-1.4	-1.0	4.6	-3.0	1.2	2.1
State & local		2.8	2.1	3.0	3.7	3.6	4.2	2.6	3.3	3.5
Change in bus. inventories	Bill. Ch. $	66.8	30.4	30.0	63.8	80.2	45.3	66.0	13.4	40.8
Nonfarm		53.6	42.6	22.1	60.6	78.7	44.9	61.0	10.6	39.4
Net exports		-86.5	-78.4	-89.0	-113.3	-221.0	-322.4	-411.6	-434.7	-453.8
Nominal GDP	% change	6.2	4.3	6.0	6.2	5.9	6.5	6.1	3.8	5.6
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employment	Millions	114.1	117.2	119.6	122.7	125.8	128.8	131.4	132.0	132.8
Unemployment rate	%	6.1	5.6	5.4	4.9	4.5	4.2	4.0	4.8	5.4
Industrial prod. index	% change	6.3	3.6	5.6	7.2	3.2	5.1	4.2	0.2	3.9
Capacity util. rate - mfg.	%	82.5	82.5	81.6	82.7	81.3	80.5	81.3	77.4	77.9
Housing starts	Millions	1.46	1.35	1.48	1.47	1.62	1.67	1.61	1.57	1.60
Light motor vehicle sales		15.01	14.77	15.05	15.06	15.45	16.76	17.24	15.32	15.24
North Amer. produced		12.88	12.87	13.34	13.12	13.43	14.28	14.38	12.52	12.52
Other		2.13	1.90	1.70	1.93	2.02	2.48	2.86	2.81	2.73
INCOME AND SAVING										
Nominal GNP	Bill. $	7071.1	7420.9	7831.2	8325.4	8786.7	9288.2	9960.3	10333.2	10861.8
Nominal GNP	% change	6.2	4.4	5.9	6.0	5.7	6.5	6.1	3.7	5.5
Nominal personal income		5.1	4.3	5.9	6.3	6.3	5.6	5.8	4.7	5.3
Real disposable income		2.9	1.7	2.6	3.8	4.6	3.1	2.4	3.1	4.4
Personal saving rate	%	6.1	5.6	4.8	4.2	4.2	2.2	-0.1	0.4	2.1
Corp. profits, IVA & CCAdj.	% change	12.3	11.3	11.4	9.9	-5.8	11.2	3.0	-2.8	6.0
Profit share of GNP	%	8.1	9.0	9.6	10.0	9.3	9.2	9.5	8.5	8.5
Excluding FR Banks		7.9	8.7	9.4	9.7	9.0	8.9	9.2	8.2	8.2
Federal surpl./deficit	Bill. $	-212.3	-192.0	-136.8	-53.3	49.0	124.4	249.2	238.0	219.4
State & local surpl./def.		8.6	15.3	21.4	31.0	41.7	50.0	59.9	48.0	39.9
Ex. social ins. funds		4.0	11.4	18.7	29.9	41.3	50.4	60.3	48.0	39.6
Gross natl. saving rate	%	16.3	16.9	17.2	18.0	18.8	18.5	18.3	18.2	19.1
Net natl. saving rate		4.3	5.1	5.7	6.7	7.5	6.8	6.5	5.9	6.8
PRICES AND COSTS										
GDP chn.-wt. price index	% change	2.1	2.1	1.9	1.8	1.2	1.6	2.3	2.0	1.7
Gross Domestic Purchases chn.-wt. price index		2.1	2.1	1.9	1.4	0.8	1.9	2.5	1.7	1.7
PCE chn.-wt. price index		2.1	2.1	2.3	1.5	1.1	2.0	2.3	1.8	1.7
Ex. food and energy		2.3	2.3	1.8	1.7	1.6	1.5	1.6	1.9	1.8
CPI		2.6	2.7	3.1	1.9	1.5	2.6	3.4	2.3	2.0
Ex. food and energy		2.8	3.0	2.6	2.2	2.4	2.1	2.6	2.5	2.4
ECI, hourly compensation[2]		3.1	2.6	3.1	3.4	3.5	3.4	4.4	4.3	4.1
Nonfarm business sector										
Output per hour		1.1	1.1	2.3	2.1	2.9	4.1	3.6	1.9	3.1
Compensation per Hour		2.2	2.7	3.1	3.2	5.3	4.8	5.6	5.3	5.0
Unit labor cost		1.0	1.5	0.8	1.1	2.3	0.7	2.0	3.4	1.9

1. Changes are from fourth quarter to fourth quarter.
2. Private-industry workers.

Strictly Confidential <FR>
Class II FOMC

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

January 25, 2001

Item	Units	1998 Q1	1998 Q2	1998 Q3	1998 Q4	1999 Q1	1999 Q2	1999 Q3	1999 Q4	2000 Q1	2000 Q2
EXPENDITURES											
Nominal GDP	Bill. $	8634.7	8722.0	8829.1	8974.9	9104.5	9191.5	9340.9	9559.7	9752.7	9945.7
Real GDP	Bill. Ch. $	8404.9	8465.6	8537.6	8654.5	8730.0	8783.2	8905.8	9084.1	9191.8	9318.9
Real GDP	% change	6.5	2.9	3.4	5.6	3.5	2.5	5.7	8.3	4.8	5.6
Gross domestic purchases		8.1	4.8	4.4	5.4	4.9	3.8	6.6	8.4	5.6	6.5
Final sales		4.1	5.6	2.9	5.9	4.5	4.0	4.5	6.4	6.7	3.9
Priv. dom. final purchases		7.2	7.5	4.4	6.3	6.4	6.2	5.6	6.2	9.3	4.7
Personal cons. expenditures		4.8	5.8	4.3	4.9	5.7	5.6	5.0	5.9	7.6	3.1
Durables		9.4	13.9	4.1	23.9	8.6	15.0	8.0	13.0	23.6	-5.0
Nondurables		4.7	5.8	4.3	5.2	7.8	3.8	4.9	7.4	6.0	3.6
Services		4.0	4.3	4.3	1.3	4.1	4.6	4.5	3.8	5.2	4.6
Business fixed investment		20.1	15.6	3.5	13.2	9.5	9.6	11.8	9.5	21.0	14.6
Equipment & Software		24.6	16.1	6.5	16.7	14.1	15.2	18.0	9.5	20.6	17.9
Nonres. structures		7.9	14.1	-4.7	3.3	-3.4	-6.2	-6.2	9.7	22.3	4.4
Residential structures		9.6	12.6	10.3	8.9	8.2	5.9	-3.1	0.5	3.2	1.3
Exports		1.0	-3.0	-3.2	15.1	-7.9	5.8	10.2	10.3	6.3	14.3
Imports		14.2	13.1	5.5	12.2	4.5	16.2	16.9	10.7	12.0	18.6
Gov't. cons. & investment		-1.0	7.3	1.4	2.8	3.7	0.8	4.8	8.5	-1.1	4.8
Federal		-9.1	12.9	-3.2	3.7	-2.2	2.0	6.9	13.2	-14.2	17.2
Defense		-17.7	13.1	5.8	-2.4	-3.1	-2.3	12.3	12.6	-19.8	16.9
State & local		3.8	4.4	4.0	2.3	7.0	0.1	3.7	6.1	6.6	-1.1
Change in bus. inventories	Bill. Ch. $	117.3	60.9	73.1	69.4	48.1	13.1	39.1	80.9	36.6	78.6
Nonfarm		109.7	62.5	79.2	63.5	49.2	14.1	43.5	73.0	33.0	72.3
Net exports		-175.3	-219.8	-244.1	-244.9	-279.8	-314.6	-342.6	-352.5	-376.8	-403.4
Nominal GDP	% change	7.6	4.1	5.0	6.8	5.9	3.9	6.7	9.7	8.3	8.2
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	124.7	125.5	126.2	127.0	127.8	128.4	129.1	129.8	130.6	131.6
Unemployment rate	%	4.7	4.4	4.5	4.4	4.3	4.3	4.2	4.1	4.1	4.0
Industrial prod. index	% change	3.6	3.0	3.4	2.9	3.9	4.9	5.8	5.7	6.7	7.9
Capacity util. rate - mfg.	%	82.4	81.5	80.8	80.5	80.2	80.3	80.5	80.9	81.3	81.9
Housing starts	Millions	1.56	1.57	1.63	1.72	1.76	1.59	1.66	1.69	1.73	1.61
Light motor vehicle sales		15.00	16.01	14.55	16.24	16.18	16.79	17.08	17.00	18.20	17.24
North Amer. produced		13.07	14.04	12.53	14.07	13.87	14.34	14.61	14.31	15.32	14.36
Other		1.93	1.97	2.02	2.17	2.31	2.45	2.47	2.69	2.88	2.88
INCOME AND SAVING											
Nominal GNP	Bill. $	8640.3	8725.0	8814.9	8966.6	9097.2	9181.8	9327.3	9546.3	9745.0	9937.4
Nominal GNP	% change	7.8	4.0	4.2	7.1	6.0	3.8	6.5	9.7	8.6	8.1
Nominal personal income		7.7	6.2	5.9	5.7	4.3	5.4	5.2	7.6	6.9	6.9
Real disposable income		6.6	4.5	3.6	3.6	2.9	2.8	2.2	4.5	1.9	3.7
Personal saving rate	%	4.6	4.3	4.1	3.8	3.1	2.5	1.8	1.5	0.2	0.3
Corp. profits, IVA & CCAdj.	% change	-12.6	-5.0	2.0	-7.0	26.5	-6.9	2.5	26.6	20.7	12.2
Profit share of GNP	%	9.5	9.3	9.3	9.0	9.4	9.1	9.0	9.4	9.6	9.7
Excluding FR Banks		9.3	9.0	9.0	8.7	9.1	8.8	8.8	9.1	9.3	9.4
Federal surpl./deficit	Bill. $	25.9	41.9	71.9	56.4	89.7	117.5	147.3	143.3	235.8	240.9
State & local surpl./def.		38.1	33.4	37.5	57.7	47.9	38.0	47.4	66.6	52.0	60.1
Ex. social ins. funds		37.5	32.9	37.2	57.6	48.1	38.3	47.9	67.2	52.5	60.6
Gross natl. saving rate	%	18.9	18.7	19.0	18.7	18.9	18.4	18.4	18.3	18.2	18.6
Net natl. saving rate		7.7	7.4	7.6	7.2	7.3	6.7	6.5	6.6	6.6	6.9
PRICES AND COSTS											
GDP chn.-wt. price index	% change	1.0	1.1	1.5	1.1	2.2	1.4	1.1	1.6	3.3	2.4
Gross Domestic Purchases chn.-wt. price index		0.1	0.8	1.1	1.2	1.9	2.0	1.7	1.9	3.8	2.1
PCE chn.-wt. price index		0.4	1.2	1.4	1.5	1.7	2.3	1.9	2.2	3.5	2.1
Ex. food and energy		1.2	1.8	1.8	1.7	1.8	1.3	1.3	1.7	2.2	1.4
CPI		1.0	1.7	1.7	1.7	1.7	3.2	2.4	2.9	4.3	3.6
Ex. food and energy		2.8	2.3	2.3	2.1	1.8	2.1	2.1	2.3	2.5	2.9
ECI, hourly compensation[1]		3.0	3.3	4.4	2.6	1.7	4.3	3.7	4.0	5.9	4.4
Nonfarm business sector											
Output per hour		4.5	1.6	1.8	3.6	2.6	0.6	5.2	8.0	1.9	6.1
Compensation per hour		6.1	5.3	5.2	4.5	4.5	5.0	5.5	4.2	3.9	5.9
Unit labor cost		1.5	3.6	3.3	0.8	1.8	4.3	0.3	-3.5	1.9	-0.2

1. Private-industry workers.

Strictly Confidential <FR>
Class II FOMC

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

January 25, 2001

Item	Units	2000 Q3	2000 Q4	2001 Q1	2001 Q2	2001 Q3	2001 Q4	2002 Q1	2002 Q2	2002 Q3	2002 Q4
			- - - Projected - - -								
EXPENDITURES											
Nominal GDP	Bill. $	10039.4	10141.2	10201.7	10278.3	10386.7	10521.8	10670.0	10810.8	10956.5	11109.9
Real GDP	Bill. Ch. $	9369.5	9415.8	9404.6	9435.1	9496.8	9582.1	9670.5	9759.2	9851.4	9949.6
Real GDP	% change	2.2	2.0	-0.5	1.3	2.6	3.6	3.7	3.7	3.8	4.0
Gross domestic purchases		3.0	2.3	-0.9	1.6	2.7	3.2	4.1	3.9	3.8	3.5
Final sales		2.4	1.9	2.1	1.3	2.3	3.3	3.3	3.5	3.7	4.2
Priv. dom. final purchases		4.2	2.1	1.5	1.3	2.3	2.8	3.7	3.7	3.8	3.7
Personal cons. expenditures		4.5	2.8	1.4	1.1	1.8	2.2	2.8	2.8	2.9	2.9
Durables		7.6	-5.2	-5.3	-3.6	0.3	2.4	3.5	3.6	4.5	4.1
Nondurables		4.7	0.8	1.5	0.6	1.0	1.8	2.4	2.4	2.4	2.4
Services		3.7	5.6	2.7	2.3	2.4	2.4	2.9	2.9	2.9	2.9
Business fixed investment		7.7	0.5	3.0	2.6	5.6	6.6	8.9	9.0	9.3	9.2
Equipment & Software		5.6	-1.5	1.3	1.0	5.4	7.1	10.4	10.7	11.2	11.2
Nonres. structures		14.6	7.1	8.6	7.3	6.2	5.2	4.6	4.2	3.8	3.6
Residential structures		-10.6	-3.4	-2.1	-0.0	-0.2	0.2	1.3	1.6	0.6	-0.5
Exports		13.9	-4.7	0.8	4.9	7.2	11.5	6.3	9.7	10.2	13.6
Imports		17.0	-0.8	-2.3	6.0	6.6	6.4	7.9	9.4	8.6	7.1
Gov't. cons. & investment		-1.4	2.8	2.3	3.1	3.0	3.1	3.2	3.2	3.3	3.3
Federal		-9.0	3.6	0.4	2.8	2.5	2.8	2.7	2.6	2.7	2.7
Defense		-9.7	4.4	-1.5	2.2	2.0	2.1	2.1	2.0	2.1	2.1
State & local		2.9	2.3	3.3	3.2	3.2	3.3	3.5	3.5	3.6	3.6
Change in bus. inventories	Bill. Ch. $	72.5	76.2	8.6	6.5	15.0	23.4	35.1	42.2	45.2	40.6
Nonfarm		67.4	71.1	4.8	3.7	12.6	21.4	33.5	40.5	44.0	39.5
Net exports		-427.7	-438.4	-426.7	-436.1	-441.5	-434.3	-447.2	-456.7	-461.4	-449.9
Nominal GDP	% change	3.8	4.1	2.4	3.0	4.3	5.3	5.8	5.4	5.5	5.7
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	131.6	131.9	132.0	132.0	132.0	132.1	132.3	132.6	132.9	133.2
Unemployment rate	%	4.0	4.0	4.4	4.7	5.0	5.2	5.3	5.4	5.5	5.5
Industrial prod. index	% change	3.5	-1.1	-6.5	0.9	3.1	3.8	4.0	4.2	3.6	3.6
Capacity util. rate - mfg.	%	81.7	80.2	77.7	77.2	77.3	77.5	77.8	77.9	78.0	78.0
Housing starts	Millions	1.53	1.56	1.59	1.56	1.57	1.58	1.59	1.60	1.60	1.60
Light motor vehicle sales		17.37	16.17	15.72	15.26	15.16	15.15	15.16	15.21	15.27	15.33
North Amer. produced		14.54	13.30	12.80	12.44	12.41	12.42	12.44	12.49	12.54	12.60
Other		2.83	2.87	2.92	2.82	2.75	2.73	2.72	2.72	2.73	2.73
INCOME AND SAVING											
Nominal GNP	Bill. $	10030.5	10128.5	10186.7	10267.1	10374.1	10504.8	10649.2	10787.4	10930.5	11080.2
Nominal GNP	% change	3.8	4.0	2.3	3.2	4.2	5.1	5.6	5.3	5.4	5.6
Nominal personal income		5.3	4.2	5.5	4.0	4.4	4.7	5.8	5.1	5.0	5.2
Real disposable income		2.6	1.2	4.2	2.3	2.8	2.9	8.4	3.0	3.0	3.1
Personal saving rate	%	-0.2	-0.6	0.1	0.3	0.6	0.7	2.1	2.1	2.1	2.2
Corp. profits, IVA & CCAdj.	% change	2.8	-19.3	-16.5	-3.7	1.6	9.4	3.5	6.1	6.4	8.1
Profit share of GNP	%	9.7	9.1	8.6	8.5	8.4	8.5	8.5	8.5	8.5	8.6
Excluding FR Banks		9.4	8.8	8.3	8.2	8.1	8.2	8.2	8.2	8.2	8.3
Federal surpl./deficit	Bill. $	253.3	266.7	226.0	229.1	245.3	251.4	187.2	209.4	233.3	247.6
State & local surpl./def.		63.2	64.2	55.0	49.3	43.4	44.3	44.9	41.3	38.5	34.9
Ex. social ins. funds		63.6	64.5	55.2	49.4	43.4	44.2	44.7	41.0	38.2	34.6
Gross natl. saving rate	%	18.5	18.0	17.9	18.0	18.3	18.5	18.8	19.0	19.2	19.4
Net natl. saving rate		6.6	6.0	5.6	5.7	5.9	6.2	6.5	6.7	6.9	7.0
PRICES AND COSTS											
GDP chn.-wt. price index	% change	1.6	2.0	3.0	1.8	1.6	1.6	1.9	1.6	1.6	1.6
Gross Domestic Purchases chn.-wt. price index		2.0	1.9	2.5	1.4	1.4	1.5	1.9	1.6	1.6	1.7
PCE chn.-wt. price index		1.8	2.0	2.6	1.5	1.4	1.5	1.6	1.7	1.7	1.7
Ex. food and energy		1.1	1.8	1.9	1.9	1.9	1.9	1.8	1.8	1.8	1.8
CPI		3.1	2.8	3.9	1.8	1.5	1.8	1.9	2.0	2.0	2.0
Ex. food and energy		2.5	2.4	2.6	2.6	2.5	2.5	2.4	2.4	2.4	2.4
ECI, hourly compensation[1]		4.1	3.0	4.3	4.3	4.3	4.2	4.2	4.1	4.1	4.1
Nonfarm business sector											
Output per hour		2.9	3.2	-0.1	1.5	2.6	3.7	3.2	3.1	3.1	3.2
Compensation per hour		6.3	6.5	5.8	5.3	5.2	5.1	5.3	5.0	5.0	4.9
Unit labor cost		2.9	3.3	5.9	3.7	2.6	1.5	2.1	1.9	1.9	1.7

1. Private-industry workers.

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

Item	1998 Q3	1998 Q4	1999 Q1	1999 Q2	1999 Q3	1999 Q4	2000 Q1	2000 Q2	2000 Q3	98Q4/ 97Q4	99Q4/ 98Q4	0Q4/ 99Q4
Real GDP	3.4	5.6	3.5	2.5	5.7	8.3	4.8	5.6	2.2	4.6	5.0	3.7
Gross dom. purchases	4.5	5.5	5.0	3.8	6.8	8.6	5.8	6.7	3.1	5.8	6.0	4.5
Final sales	2.9	5.8	4.4	3.9	4.5	6.5	6.6	3.9	2.4	4.6	4.8	3.7
Priv. dom. final purchases	3.7	5.3	5.3	5.2	4.7	5.2	7.9	4.0	3.6	5.3	5.1	4.3
Personal cons. expenditures	2.8	3.3	3.7	3.7	3.4	4.1	5.0	2.1	3.0	3.3	3.7	3.0
Durables	0.3	1.7	0.7	1.1	0.6	1.0	1.8	-0.4	0.6	1.0	0.9	0.4
Nondurables	0.8	1.0	1.5	0.8	1.0	1.5	1.2	0.7	0.9	1.0	1.2	0.8
Services	1.7	0.5	1.6	1.8	1.8	1.6	2.0	1.8	1.5	1.4	1.7	1.9
Business fixed investment	0.4	1.6	1.2	1.2	1.5	1.2	2.5	1.9	1.0	1.5	1.3	1.4
Equipment & Software	0.6	1.5	1.3	1.4	1.7	0.9	1.9	1.7	0.6	1.4	1.3	1.0
Nonres. structures	-0.2	0.1	-0.1	-0.2	-0.2	0.3	0.6	0.1	0.4	0.2	-0.1	0.4
Residential structures	0.4	0.4	0.3	0.3	-0.1	0.0	0.1	0.1	-0.5	0.4	0.1	-0.1
Net exports	-1.0	0.1	-1.4	-1.4	-1.1	-0.4	-0.9	-1.0	-0.9	-1.1	-1.1	-0.8
Exports	-0.4	1.5	-0.9	0.6	1.1	1.1	0.7	1.5	1.5	0.3	0.5	0.8
Imports	-0.7	-1.5	-0.6	-2.0	-2.1	-1.5	-1.6	-2.5	-2.4	-1.4	-1.5	-1.6
Government cons. & invest.	0.3	0.5	0.6	0.1	0.8	1.5	-0.2	0.9	-0.2	0.5	0.8	0.2
Federal	-0.2	0.2	-0.1	0.1	0.4	0.8	-0.9	1.0	-0.6	0.0	0.3	-0.1
Defense	0.2	-0.1	-0.1	-0.1	0.5	0.5	-0.9	0.6	-0.4	-0.0	0.2	-0.1
Nondefense	-0.4	0.3	-0.0	0.2	-0.1	0.3	-0.1	0.4	-0.2	0.1	0.1	0.0
State and local	0.5	0.3	0.8	0.0	0.4	0.7	0.8	-0.1	0.3	0.4	0.5	0.3
Change in bus. inventories	0.6	-0.2	-0.9	-1.4	1.2	1.8	-1.8	1.7	-0.2	0.0	0.2	-0.0
Nonfarm	0.8	-0.7	-0.6	-1.4	1.3	1.3	-1.6	1.6	-0.2	0.0	0.1	-0.0
Farm	-0.2	0.5	-0.3	0.0	-0.1	0.5	-0.2	0.1	-0.1	0.0	0.1	-0.0

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

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

Item	2000 Q4	2001 Q1	2001 Q2	2001 Q3	2001 Q4	2002 Q1	2002 Q2	2002 Q3	2002 Q4	00Q4/ 99Q4	01Q4/ 00Q4	02Q4/ 01Q4
Real GDP	2.0	-0.5	1.3	2.6	3.6	3.7	3.7	3.8	4.0	3.7	1.8	3.8
Gross dom. purchases	2.4	-0.9	1.6	2.8	3.3	4.2	4.0	4.0	3.6	4.5	1.7	3.9
Final sales	1.9	2.1	1.3	2.3	3.3	3.3	3.4	3.7	4.2	3.7	2.2	3.7
Priv. dom. final purchases	1.8	1.2	1.1	1.9	2.4	3.1	3.2	3.3	3.2	4.3	1.7	3.2
Personal cons. expenditures	1.9	0.9	0.8	1.2	1.5	1.9	1.9	1.9	1.9	3.0	1.1	1.9
Durables	-0.4	-0.4	-0.3	0.0	0.2	0.3	0.3	0.3	0.3	0.4	-0.1	0.3
Nondurables	0.2	0.3	0.1	0.2	0.4	0.5	0.5	0.5	0.5	0.8	0.2	0.5
Services	2.2	1.1	0.9	1.0	1.0	1.1	1.1	1.1	1.1	1.9	1.0	1.2
Business fixed investment	0.1	0.4	0.3	0.8	0.9	1.2	1.2	1.3	1.3	1.4	0.6	1.2
Equipment & Software	-0.2	0.1	0.1	0.5	0.7	1.0	1.1	1.1	1.1	1.0	0.4	1.1
Nonres. structures	0.2	0.3	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.4	0.2	0.1
Residential structures	-0.1	-0.1	-0.0	-0.0	0.0	0.1	0.1	0.0	-0.0	-0.1	-0.0	0.0
Net exports	-0.4	0.4	-0.3	-0.2	0.3	-0.4	-0.3	-0.1	0.4	-0.8	0.1	-0.1
Exports	-0.5	0.1	0.5	0.8	1.2	0.7	1.1	1.1	1.5	0.8	0.7	1.1
Imports	0.1	0.4	-0.9	-1.0	-0.9	-1.1	-1.4	-1.3	-1.1	-1.6	-0.6	-1.2
Government cons. & invest.	0.5	0.4	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.2	0.5	0.6
Federal	0.2	0.0	0.2	0.2	0.2	0.2	0.2	0.2	0.2	-0.1	0.1	0.2
Defense	0.2	-0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	-0.1	0.0	0.1
Nondefense	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.1	0.1
State and local	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.3	0.4	0.4
Change in bus. inventories	0.1	-2.6	-0.0	0.3	0.3	0.5	0.3	0.1	-0.2	-0.0	-0.5	0.2
Nonfarm	0.1	-2.6	-0.0	0.4	0.3	0.5	0.3	0.1	-0.2	-0.0	-0.5	0.2
Farm	-0.0	0.0	0.0	-0.0	-0.0	-0.0	0.0	-0.0	-0.0	-0.0	0.0	-0.0

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

Strictly Confidential (FR)
Class II FOMC

January 25, 2001

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

Item	Fiscal year[1] 1999[a]	2000[a]	2001	2002	2000 Q1[a]	2000 Q2[a]	2000 Q3[a]	2000 Q4[a]	2001 Q1	2001 Q2	2001 Q3	2001 Q4	2002 Q1	2002 Q2	2002 Q3	2002 Q4
Unified budget					Not seasonally adjusted											
Receipts[2]	1827	2025	2104	2178	434	656	492	461	463	674	506	505	459	679	534	521
Outlays[2]	1703	1789	1855	1914	449	444	431	464	476	466	449	485	478	479	472	498
Surplus/deficit[2]	125	236	249	264	-15	212	60	-2	-13	208	57	20	-19	200	62	23
On-budget	1	86	91	89	-45	147	50	-14	-72	137	40	-28	-48	124	40	-28
Off-budget	124	150	158	175	30	65	10	12	59	70	17	48	29	75	22	51
Surplus excluding deposit insurance	119	233	248	262	-18	211	60	-3	-14	207	57	20	-19	199	62	23
Means of financing																
Borrowing	-89	-223	-215	-273	-27	-190	-54	-25	40	-190	-40	-45	5	-153	-79	-46
Cash decrease	-18	4	8	0	39	-13	5	32	-9	-1	-14	20	5	-40	15	20
Other[3]	-18	-17	-42	9	4	-10	-11	-4	-18	-17	-3	5	9	-7	2	3
Cash operating balance, end of period	56	53	45	45	45	57	53	21	30	31	45	25	20	60	45	25
NIPA federal sector					Seasonally adjusted annual rates											
Receipts	1837	2024	2122	2173	2012	2055	2089	2112	2108	2123	2148	2179	2140	2170	2204	2238
Expenditures	1735	1806	1881	1953	1776	1814	1836	1845	1882	1894	1902	1928	1952	1961	1970	1991
Consumption expenditures	464	489	508	536	479	499	490	496	507	512	517	522	536	541	545	550
Defense	306	320	331	346	311	326	320	325	331	333	336	338	346	348	351	354
Nondefense	158	168	177	190	168	173	170	171	177	179	181	184	190	192	194	197
Other spending	1270	1317	1373	1417	1297	1315	1346	1349	1374	1381	1386	1406	1417	1420	1425	1440
Current account surplus	103	218	242	220	236	241	253	267	226	229	245	251	187	209	233	248
Gross investment	94	104	110	114	101	106	104	108	109	110	111	113	114	115	116	117
Current and capital account surplus	9	114	132	106	134	135	149	158	117	119	134	139	73	94	117	130
Fiscal indicators[4]																
High-employment (HEB) surplus/deficit	-67	8	78	104	31	20	39	63	53	81	114	130	70	95	120	135
Change in HEB, percent of potential GDP	-.8	-.8	-.7	-.2	-.1	.1	-.2	-.2	.1	-.3	-.3	-.1	.6	-.2	-.2	-.1
Fiscal impetus (FI) percent, calendar year	5	2	4	11	-6	6	-2	2	.4	.7	.5	1	9	.5	.6	.5

1. Fiscal year data for the unified budget come from OMB; quarterly data come from the Monthly Treasury Statement and may not sum to OMB fiscal year totals.
2. OMB's January 2001 baseline surplus estimates are $256 billion in FY2001 and $277 billion in FY 2002. CBO's July 2000 baseline surplus estimates, assuming discretionary spending grows with inflation beginning in FY 2001 are $268 billion in FY2001 and $312 billion in FY 2002. Budget receipts, outlays, and surplus/deficit include corresponding social security (OASDI) categories. The OASDI surplus is excluded from the on-budget surplus and shown separately as off-budget, as classified under current law.
3. Other means of financing are checks issued less checks paid, accrued items, and changes in other financial assets and liabilities.
4. HEB is the NIPA current and capital account surplus in current dollars, with cyclically sensitive receipts and outlays adjusted to the level of potential output associated with an unemployment rate of 6 percent. 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 (1996) dollars, scaled by real federal consumption plus investment. For FI and the change in HEB, negative values indicate aggregate demand restraint.
a--Actual

Change in Debt of the Domestic Nonfinancial Sectors
(Percent)

Period [1]	Total [2]	Federal government [3]	Nonfederal: Total [4]	Households: Total	Households: Home mortgages	Households: Consumer credit	Business	State and local governments	Memo: Nominal GDP
Year									
1995	5.5	4.1	6.0	8.0	6.0	14.1	6.6	-4.6	4.3
1996	5.3	4.0	5.8	7.3	7.3	7.9	5.7	-0.6	6.0
1997	5.6	0.6	7.3	6.6	7.0	4.3	8.7	5.3	6.2
1998	6.8	-1.4	9.6	8.8	9.8	5.4	11.1	7.2	5.9
1999	6.9	-1.9	9.5	9.0	9.9	7.1	11.2	4.4	6.5
2000	4.7	-8.0	8.1	8.8	9.0	8.7	8.7	2.0	6.1
2001	4.1	-6.9	6.6	7.2	8.7	3.2	6.7	2.5	3.8
2002	3.9	-8.7	6.3	6.2	7.8	1.6	7.4	1.6	5.6
Quarter									
1999:3	6.9	-1.9	9.4	9.3	10.4	5.5	10.7	4.3	6.7
4	6.4	-0.9	8.4	7.9	8.4	7.8	10.1	2.7	9.7
2000:1	5.4	-5.9	8.4	8.1	7.1	10.0	10.5	0.3	8.3
2	5.4	-11.4	9.8	9.7	10.2	9.2	11.6	1.7	8.2
3	4.2	-6.2	6.8	8.2	8.8	8.1	6.2	2.0	3.8
4	3.5	-9.7	6.6	8.2	9.0	6.6	5.5	3.8	4.1
2001:1	5.8	1.6	6.7	7.7	8.9	4.5	6.2	3.2	2.4
2	3.0	-12.2	6.4	7.4	8.7	3.6	6.0	2.6	3.0
3	4.4	-4.9	6.5	6.8	8.2	2.5	6.9	2.3	4.3
4	3.0	-12.8	6.3	6.4	7.8	1.9	7.0	1.9	5.3
2002:1	4.7	-2.7	6.2	6.3	7.8	1.6	7.1	1.6	5.8
2	3.8	-8.6	6.2	6.1	7.6	1.6	7.1	1.6	5.4
3	3.6	-10.5	6.2	6.0	7.4	1.6	7.2	1.6	5.5
4	3.1	-14.1	6.2	5.9	7.3	1.7	7.3	1.6	5.7

Note. Quarterly data are at seasonally adjusted annual rates.
1. Data after 2000:Q3 are staff projections. Changes are measured from end of the preceding period to end of period indicated except for annual nominal GDP growth, which is calculated from Q4 to Q4.
2. On a monthly average basis, total debt is projected to grow 5.3 percent in 2000, 4.1 percent in 2001 and 3.8 percent in 2002.
3. On a monthly average basis, federal debt is projected to grow -6.7 percent in 2000, -6.6 percent in 2001 and -8.5 percent in 2002.
4. On a monthly average basis, nonfederal debt is projected to grow 8.5 percent in 2000, 6.6 percent in 2001 and 6.4 percent in 2002.

2.6.3 FOF

Flow of Funds Projections: Highlights
(Billions of dollars except as noted)

					Seasonally adjusted annual rates									
	Calendar year				2000		2001				2002			
Category	1999	2000	2001	2002	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Net funds raised by domestic nonfinancial sectors														
1 Total	976.9	666.9	657.4	681.8	670.9	285.8	943.1	446.1	745.5	494.8	851.1	679.1	642.1	554.9
2 Net equity issuance	-143.5	-156.4	-91.0	-52.0	-87.6	-350.0	-108.0	-104.0	-84.0	-68.0	-52.0	-52.0	-52.0	-52.0
3 Net debt issuance	1120.4	823.3	748.4	733.8	758.5	635.8	1051.1	550.1	829.5	562.8	903.1	731.1	694.1	606.9
Borrowing sectors														
Nonfinancial business														
4 Financing gap [1]	172.1	219.0	223.1	291.5	227.4	242.9	206.8	209.9	227.7	248.0	273.5	288.8	300.6	303.1
5 Net equity issuance	-143.5	-156.4	-91.0	-52.0	-87.6	-350.0	-108.0	-104.0	-84.0	-68.0	-52.0	-52.0	-52.0	-52.0
6 Credit market borrowing	591.2	513.5	429.3	504.7	387.5	347.7	399.6	391.4	457.2	469.0	484.2	496.2	513.2	525.2
Households														
7 Net borrowing [2]	548.1	581.2	521.7	481.2	564.8	575.1	556.1	541.0	505.9	483.8	483.2	481.1	481.1	479.7
8 Home mortgages	415.9	417.3	436.5	424.5	422.3	441.2	450.2	446.2	429.2	420.2	428.2	423.2	423.2	423.2
9 Consumer credit	94.4	124.5	49.2	25.8	120.4	100.7	69.2	57.1	40.0	30.5	25.2	25.1	25.1	27.7
10 Debt/DPI (percent) [3]	95.4	98.7	101.8	102.6	99.1	100.4	100.7	101.6	102.4	102.9	102.0	102.4	102.8	103.1
State and local governments														
11 Net borrowing	52.3	24.5	32.2	21.4	25.2	48.0	40.8	33.4	29.4	25.4	21.4	21.4	21.4	21.4
12 Current surplus [4]	156.8	176.5	173.0	173.8	181.4	184.1	176.9	173.2	169.4	172.5	175.3	174.0	173.6	172.5
Federal government														
13 Net borrowing	-71.2	-295.9	-234.8	-273.5	-219.0	-335.0	54.6	-415.6	-163.0	-415.4	-85.6	-267.6	-321.5	-419.4
14 Net borrowing (quarterly, n.s.a.)	-71.2	-295.9	-234.8	-273.5	-53.6	-25.7	40.0	-190.0	-39.6	-45.2	5.0	-153.0	-79.3	-46.2
15 Unified deficit (quarterly, n.s.a.)	-158.3	-254.9	-272.0	-266.3	-60.5	2.3	13.2	-207.7	-57.3	-20.2	18.7	-199.9	-62.2	-22.9
Depository institutions														
16 Funds supplied	404.3	476.6	275.1	288.7	468.5	381.0	312.7	268.0	261.8	258.0	283.2	284.2	293.2	294.2
Memo (percentage of GDP)														
17 Domestic nonfinancial debt [5]	181.4	179.2	180.3	178.1	179.5	179.5	180.5	181.1	180.8	180.2	179.4	178.9	178.2	177.2
18 Domestic nonfinancial borrowing	12.0	8.3	7.2	6.7	7.6	6.3	10.3	5.4	8.0	5.3	8.5	6.8	6.3	5.5
19 Federal government [6]	-0.8	-3.0	-2.3	-2.5	-2.2	-3.3	0.5	-4.0	-1.6	-3.9	-0.8	-2.5	-2.9	-3.8
20 Nonfederal	12.8	11.2	9.5	9.3	9.7	9.6	9.8	9.4	9.6	9.3	9.3	9.2	9.3	9.2

Note. Data after 2000:Q3 are staff projections.
1. For corporations: Excess of capital expenditures over U.S. internal funds.
2. Includes change in liabilities not shown in lines 8 and 9.
3. Average debt levels in the period (computed as the average of period-end debt positions) divided by disposable personal income.
4. NIPA surplus less changes in retirement fund assets plus consumption of fixed capital.
5. Average debt levels in the period (computed as the average of period-end debt positions) divided by nominal GDP.
6. Excludes government-insured mortgage pool securities.

2.6.4 FOF

International Developments

Overview

Foreign growth appears to have slowed more than expected. The step-down in U.S. economic growth has cast a noticeable shadow abroad, especially in countries with relatively strong trade links with the United States. As a result, the staff has lowered the forecast for foreign activity once again. Compared with the December Greenbook, total foreign growth has been reduced ½ percentage point for the second half of last year and almost a full percentage point for the current quarter. The largest downward revision is to projected growth in developing Asia, where the high-tech shakeout is taking a toll on exports. In Japan, private demand stagnated in the second half of last year, and there appears to be little reason to project more than anemic growth going forward. European growth also has slowed, but the outlook remains positive. On balance, the foreign slowdown is expected to be relatively mild, and total foreign growth should return to trend as U.S. economic activity revives, oil prices decline, and domestic demand picks up again abroad.

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

Indicator	2000		Projection			
	H1	Q3	2000 Q4	2001 H1	2001 H2	2002
Foreign output	5.8	3.9	2.6	2.7	3.5	3.7
December GB	*5.8*	*4.4*	*3.2*	*3.3*	*3.7*	*3.7*
Foreign CPI	2.0	4.1	3.5	2.9	3.0	3.0
December GB	*2.0*	*4.1*	*3.6*	*3.2*	*3.2*	*3.2*

NOTE. Changes for years are measured as Q4/Q4; for half-years, Q2/Q4 or Q4/Q2; and for quarters, from previous quarter.

Rates of foreign consumer price inflation appear to have peaked during the second half of 2000 and are expected to ease during the forecast period because of lower energy prices and lessening pressures on capacity. The benign inflation picture and the slower pace of foreign growth are likely to prompt some foreign central banks to ease monetary policy this year.

Our oil price projection, in line with futures prices, continues to call for a gradual decline over the forecast period. The staff has maintained the overall contour of our projected exchange rate path. The real broad dollar index is projected to weaken about 5 percent during the forecast period, with around two-thirds of its decline coming in 2001 when U.S. growth is expected to fall short of average growth in the other major industrial countries.

The value of exports of goods and services dropped in October and November following two quarters of rapid growth. The decline in exports was widespread across product categories and was concentrated in Asia, where high-tech industries are important, and in Latin America. The weakness in exports, which in part resulted from the sharp slowdown in foreign economic growth, is projected to continue into the current quarter. Export growth should improve in the second quarter as foreign growth moves back up and the effects of the projected depreciation of the dollar begin to feed through. While the value of imports of goods and services fell in both October and November, on average imports were a bit higher than in the third quarter. We forecast that real imports will decline in the first quarter, in line with the projected path of U.S. GDP, before turning up in the second quarter and growing moderately for the rest of the forecast period.

The arithmetic contribution of real net exports of goods and services to GDP growth is expected to swing from negative 0.4 percentage point in the fourth quarter of 2000 to positive 0.4 percentage point in the first quarter of 2001, as imports slow in response to the decline in U.S. demand and exports begin to recover. However, on balance, net exports make a negligible contribution to growth going forward.

The weakness in U.S. economic growth has raised concerns about the possibility of a substantial decline in the dollar, or even a global recession. At the end of this section, we consider the implications for U.S. growth and inflation of two alternative simulations. The first assumes that the U.S. slowdown engenders 10 percent more dollar depreciation than assumed in our baseline forecast. The second involves a considerably lower path of growth abroad that could occur in the event of the U.S. recession simulation discussed in the Domestic Developments section.

Recent Developments

International financial markets. The major currencies index of the exchange value of the dollar slipped almost 2½ percent in the period between the December FOMC meeting and the Federal Reserve's surprise rate cut, as market participants focused on the deterioration of the near-term growth prospects of the United States relative to those of Europe. Since January 3, the major currencies index has reversed all of this decline. The dollar depreciated about 2½ percent against the euro during the intermeeting period. In contrast, the dollar appreciated about 4¼ percent against the yen, reflecting continued economic stagnation in Japan. Amid concerns about countries that would be vulnerable to the U.S. slowdown and problems in the high-tech sector, the dollar appreciated significantly against the Korean won and the Mexican peso.

In late December, the more negative outlook for high-tech industries contributed to equity price declines in that sector for most countries, particularly in emerging Asia. Federal Reserve action on January 3, however, sparked a rebound in both technology-heavy and emerging-market stock indexes. Broad equity price indexes of most foreign industrial countries went up in January, but were little changed over the intermeeting period, while Japanese equities fell about 5 percent. Since the December FOMC meeting, long-term rates have changed little in the euro area and have fallen 25 basis points in Japan.

On January 23, the Bank of Canada lowered its key policy rate 25 basis points, to 5.75 percent, citing an unexpectedly abrupt deterioration in the outlook for the U.S. economy as the primary justification for its action. The European Central Bank, the Bank of Japan, and the Bank of England kept policy rates unchanged during the period.

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

Economic activity abroad. In the foreign industrial countries, recent indicators suggest that growth moderated in the third and fourth quarters and point to further slowing in the first quarter of this year. The Japanese economy seems to have entered another period of stagnation, with both the all-industries index of output and indicators of household demand below their third-quarter levels on average in October and November. Even business investment spending seems to be losing steam, as both orders and shipments of machinery have slowed in recent months following a robust expansion earlier last year. In the euro area, fourth-quarter growth is estimated to have softened to an annual rate of 2 percent, as consumer spending continued to be disappointing. However, forward-looking indicators have been mixed; business confidence indicators are down from levels reached in the first half of last year, but have stabilized while consumer confidence has improved. An ongoing inventory correction and weaker exports to the United States have lowered Canadian real GDP growth, which is estimated to have fallen to 3 percent in the fourth quarter compared with growth of about 5 percent during the first three quarters of 2000.

Twelve-month consumer price inflation in the euro area was 2.6 percent in December, well above the European Central Bank's 2 percent target ceiling, while core inflation was 1.4 percent. Canadian consumer price inflation breached the ceiling of the Bank of Canada's 1 to 3 percent inflation band, and core inflation also moved up, to 1.9 percent. In the United Kingdom, retail price inflation remained below the target rate of 2.5 percent, while in Japan consumer price deflation remained near 1 percent.

The latest available data for major developing countries have confirmed a slowing of economic growth. Against the backdrop of a weakening U.S. economy and a slump in global demand for electronics, developing Asia has experienced a widespread slowdown in production, and exports also appear to be sagging. Mexican industrial production fell in October and November. In contrast, activity in the rest of Latin America has held up thus far.

Prices of internationally traded goods. In December, the spot price of WTI crude averaged around \$28.50 per barrel, down nearly \$6 per barrel from November. Lower expectations for economic growth and the apparent absence of a significant fourth-quarter drawdown of stocks contributed to the decline. Notably, the price decline occurred despite a substantial reduction in Iraqi crude exports. During the first half of January, however, oil prices generally crept higher as it became increasingly clear that OPEC would cut production. At its January 17 meeting, OPEC agreed to lower its official production targets by 1.5 million barrels per day starting on February 1. Spot WTI is currently trading near \$31 per barrel.

In the fourth quarter, prices of both non-oil and core imports rose at a slower pace than in the previous four quarters, as many categories (with the notable exception of industrial supplies, particularly natural gas) registered declines. Core export prices fell slightly in the fourth quarter, as decreases in the prices of consumer goods and industrial supplies outweighed increases in exported machinery prices.

U.S. international transactions. The U.S. trade deficit in goods and services was \$33 billion in November, down from its level in the previous two months. For October and November combined, the deficit was \$17 billion larger (at an annual rate) than in the third quarter. While the deficit is running only a bit above what we projected in the December Greenbook, both exports and imports have been substantially weaker than we anticipated. Average exports in October and November fell at an annual rate of 4½ percent from the third quarter. This decline, which was spread about equally across most categories of goods, likely reflects softening aggregate demand abroad and some payback for the surprising strength of exports earlier in 2000. The value of imports dropped in both October and November, reversing much of the sharp run-up in September but, on average, was still slightly above the third-quarter level.

Outlook

The dollar. We project that the real value of the dollar will depreciate about 5 percent against the currencies of a broad group of U.S. trading partners by the end of 2002, which is not much different from the December Greenbook forecast. This depreciation is front-loaded, as we expect market participants to remain sensitive to weak U.S. economic activity relative to the rest of the world in the near term. Over the longer run, large U.S. current account deficits are expected to weigh on the dollar.

Foreign industrial countries. Expansion of economic activity in the major foreign industrial countries is projected to slow further from an estimated average pace of about 2½ percent in the fourth quarter of 2000 to about 1¾ percent in the current quarter. We expect the slowdown to be short-lived, however, with the average pace of growth rebounding to above 2½ percent in the second half of 2001 and 3 percent in 2002.

The revival of U.S. growth as well as the decline in oil prices should bolster growth abroad over the forecast period. In addition, in the euro area, fiscal stimulus measures already in place, improved labor markets conditions, and gains in competitiveness stemming from the euro's previous depreciation are expected to provide impetus to growth. For Canada, we project that the deterioration in U.S. demand will cut growth to less than 1 percent in the first quarter. However, we expect Canadian growth to rebound to more than 3 percent in the second half of 2001 and 2002 as the United States recovers and fiscal policy impetus (of about 1½ percent of GDP) comes on line in Canada.

We estimate that Japanese real GDP changed little in the fourth quarter, with both private and public spending stalling. We are projecting growth of only about 1 percent this year and next, with expected fiscal contraction offsetting a feeble pickup in private spending. High unemployment as well as continued uncertainty about long-term economic prospects is likely to restrain consumption growth over the forecast period.

Headline consumer price inflation in the foreign industrial countries is projected to decline from the recent peak reached in the fourth quarter, as the effect of last year's rise in oil prices dissipates.

With the global economic outlook softening, our best guess is that policy interest rates in the foreign industrial countries will be unchanged or down slightly. The ECB is projected to cut official rates 25 basis points as inflation moves back below the 2 percent target ceiling. The Bank of England is expected to cut rates 50 basis points in response to slower growth and well-behaved inflation. Canadian official rates were just lowered 25 basis points, and we currently do not foresee further easing by the Bank of Canada. We expect the Bank of Japan to keep policy on hold in light of the weak economy.

Other countries. Real GDP growth in the major developing-country trading partners of the United States is estimated to have slowed sharply to an average rate of about 2¾ percent in the final quarter of last year, less than half the rate recorded earlier in the year. In the current quarter, growth is expected to remain subdued but it is then forecast to firm gradually to almost 5 percent by the end of 2002. In developing Asia, weaker demand from industrial countries, particularly the United States, should slow exports, especially high-tech products, in the near term. Growth in China is expected to remain robust. In Latin America, the forecast for Mexican growth for this year has been lowered mainly because of slower projected U.S. growth.

Prices of internationally traded goods. The announced reduction in OPEC supply has put upward pressure on oil prices, and our near-term outlook for oil prices is a bit above what we projected in the December Greenbook. However, weaker prospects for world economic growth are consistent with a slightly steeper downward trajectory, and thus the endpoint of our projection is a bit below the December Greenbook forecast.

Selected Trade Prices
(Percent change from end of previous period except as noted; s.a.)

Trade category	2000		Projection			
			2000	2001		
	H1	Q3	Q4	H1	H2	2002
Exports						
Nonagricultural (core)	2.8	1.2	-.1	.0	.4	.7
Agricultural	.6	-12.5	10.8	7.6	5.1	4.4
Imports						
Non-oil (core)	1.6	1.5	1.1	1.5	1.7	2.7
Oil (dollars per barrel)	26.15	28.73	29.20	25.88	23.17	20.86

NOTE. Prices for exports and non-oil imports of goods, excluding computers and semiconductors, are on a NIPA chain-weighted basis.

The price of imported oil for multi-quarter periods is the price for the final quarter of the period.

Core import price inflation is projected to rise from an estimated 1 percent at an annual rate in the fourth quarter of last year to 2 percent in the current quarter. This increase reflects the sharp rise in prices of industrial supplies (especially natural gas) in December. The rate of increase of core import prices should drop back to around 1 percent in the second quarter as natural gas prices retrace part of their recent rise. Core import prices are projected to accelerate to a 2¾ percent growth rate in 2002 as the effects of the projected dollar depreciation feed through. Prices of exported core goods are expected to change little through the first half of this year as the reversal of the recent run-up in prices of industrial supplies (which include petroleum products and petrochemicals) offsets increases in other components. Some acceleration of prices of core exports is expected later in the forecast period.

U.S. international transactions. Real exports of goods and services are estimated to have fallen about 4¾ percent at an annual rate in the fourth quarter compared with a projected increase of 8½ percent in the December Greenbook. This surprisingly weak export performance reflects slower growth abroad, the effects of past dollar appreciation, and some retrenchment from unusually strong export growth earlier last year. We expect that export growth will be close to zero in the current quarter, owing in large part to the decline in production in the automotive sector. The growth rate of exports is projected to pick up beginning in the second quarter of 2001, mainly because the rate of economic growth abroad is expected to move back up. Exports are forecast to grow 6 percent this year and nearly 10 percent in 2002, boosted by the projected depreciation of the dollar.

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

Measure	2000		Projection			
	H1	Q3	2000 Q4	2001 H1	2001 H2	2002
Real exports	10.2	13.9	-4.7	2.8	9.3	9.9
December GB	*10.2*	*15.4*	*8.5*	*4.4*	*9.3*	*10.3*
Real imports	15.2	17.0	-.8	1.8	6.5	8.2
December GB	*15.2*	*17.4*	*6.9*	*7.5*	*7.6*	*8.3*

NOTE. Changes for years are measured as Q4/Q4; for half-years, Q2/Q4 or Q4/Q2; and for quarters, from previous quarter.

Growth of real imports of goods and services came to a halt in the fourth quarter. This slowdown was broadly based among trade categories, although a notable exception was imported non-auto consumer goods, which continued to expand. Given the projected path of U.S. GDP, and particularly developments in the automotive sector, we forecast that imports will decline at an annual rate of 2¼ percent in the first quarter before rebounding in the second quarter. Imports are expected to grow 4 percent in 2001 and 8¼ percent in 2002. Relative prices, which have been boosting growth of core imports in recent quarters, will become a slightly restraining factor next year as a result of the dollar's expected depreciation.

We project that the contribution of exports to U.S. GDP growth will average ¾ percentage point in 2001 and rise to 1 percentage point in 2002. Imports, after dipping in the current quarter, are expected to resume expanding at a relatively steady pace, making a negative contribution of ½ percentage point in 2001 and 1¼ percentage points in 2002. Overall, the arithmetic contribution of the foreign sector to GDP growth is close to zero over the forecast period. The U.S. current account deficit is projected to remain about 4½ percent of GDP during the forecast period.

Alternative simulations. The recent softness of the U.S. economy poses a number of potential risks to the global outlook. To address these risks, two alternative scenarios were simulated using the FRB/Global model. The first scenario assumes an immediate loss in confidence in U.S. assets that amplifies the modest depreciation of the dollar assumed in the baseline outlook. The second alternative examines the case in which a U.S. downturn spills over to foreign economies by combining the results of the recession simulation reported in the Domestic Developments section with a weaker-than-baseline forecast for foreign growth.

In the first scenario, the shock consists of an exogenous rise in the risk premium on the dollar that results in an immediate real dollar depreciation of 10 percent relative to baseline in the absence of changes in real interest rates at home or abroad. Two cases of this alternative are considered. The first case assumes no U.S. monetary policy response to output and inflation developments by holding the real funds rate unchanged from its baseline path. The second case assumes that U.S. policy is adjusted according to a Taylor rule. In both cases, the major foreign central banks adjust interest rates according to a Taylor rule while Japan holds real interest rates constant.

With 10 percent depreciation of the dollar and a flat real funds rate, annual real GDP growth is nearly ¼ percentage point higher in 2001 and about ½ percentage point higher in 2002 than in the baseline. Rising import prices and an expanding output gap put upward pressure on the inflation rate: The core PCE inflation rate rises ½ percentage point in 2001 and a bit less than that in 2002 relative to baseline. In the case of a policy response, the initial effects on output and inflation are similar to the flat funds case, but eventually real interest rates rise noticeably, inducing an appreciation of the real exchange rate that undoes some of the shock and reverses its expansionary effects on output and inflation. In this case, the federal funds rate peaks about 70 basis points higher than in the baseline in the first half of 2002, but after then it starts to recede. Note that this scenario has contractionary consequences for output abroad whether or not U.S. monetary policy responds; annual foreign GDP growth falls around ½ percentage point below baseline, because of the loss of competitiveness.

Alternative Simulations: Lower Dollar
(Percent change from previous period, annual rate)

Indicator and simulation	2001 H1	2001 H2	2002 H1	2002 H2
U.S. real GDP				
Baseline	.4	3.1	3.7	3.9
Immediate 10 percent depreciation				
No U.S. policy response	.5	3.5	4.2	4.5
U.S. policy response	.5	3.4	3.9	4.1
U.S. PCE prices excl. food and energy				
Baseline	1.9	1.9	1.8	1.8
Immediate 10 percent depreciation				
No U.S. policy response	2.2	2.5	2.2	2.0
U.S. policy response	2.2	2.5	2.2	1.8

NOTE. H1 is Q2/Q4; H2 is Q4/Q2.

For the second scenario we extend the case of U.S. recession (repeated in the second table below for comparison) to include a more pronounced slowdown in foreign growth than in our baseline forecast. As in the U.S. recession scenario, we assume a temporary shock to foreign consumer and investor confidence that lowers overall foreign demand by a slightly smaller magnitude than the U.S. demand shock in the domestic recession scenario, but it is differentiated by region. The foreign demand shock is specified to fall more heavily on developing Asia than the rest of the world. The simulation assumes policy responses by both U.S. and foreign monetary authorities. U.S. GDP growth is ¼ percentage point lower in 2001 and a bit lower in 2002 than in the case where the United States alone experiences recession. Core PCE inflation is essentially unchanged from its baseline level in either case shown.

Alternative Simulations: Lower Growth
(Percent change from previous period, annual rate)

Indicator and simulation	2001		2002	
	H1	H2	H1	H2
U.S. real GDP				
U.S. recession, with policy response	-1.1	.6	4.8	5.5
U.S. recession and lower foreign growth, with policy responses	-1.3	.3	4.7	5.5
U.S. PCE prices excl. food and energy				
U.S. recession, with policy response	1.9	2.0	1.9	1.8
U.S. recession and lower foreign growth, with policy responses	1.9	1.9	1.8	1.7

NOTE. H1 is Q2/Q4; H2 is Q4/Q2.

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

							-----Projected----		
Measure and country	1994	1995	1996	1997	1998	1999	2000	2001	2002
REAL GDP (1)									
Total foreign	5.2	2.3	4.0	4.3	1.2	4.8	4.5	3.1	3.7
Industrial Countries	4.1	1.9	2.5	3.7	2.2	3.8	3.6	2.4	3.0
of which:									
Canada	5.5	1.4	2.4	4.8	3.2	4.9	4.5	2.3	3.4
Japan	1.7	2.6	2.9	0.7	-1.4	0.4	2.0	0.9	1.2
United Kingdom	4.6	1.9	2.9	3.5	2.0	3.2	2.9	2.5	2.5
Euro-12	3.0	1.5	1.6	3.0	1.9	3.2	2.8	2.8	3.0
Germany	2.9	1.1	1.3	1.6	0.9	2.5	2.9	2.6	3.2
Developing Countries	6.8	3.0	6.2	5.1	-0.2	6.2	6.0	4.1	4.8
Asia	8.8	7.2	6.8	4.8	-1.9	8.7	6.1	4.5	5.2
Korea	9.2	7.4	6.1	3.1	-4.6	14.0	5.8	3.0	4.7
China	16.3	12.6	9.2	8.2	9.5	6.2	7.4	7.4	7.7
Latin America	5.4	-3.7	6.1	6.0	1.1	4.2	6.0	3.8	4.4
Mexico	5.2	-7.1	7.1	6.7	2.7	5.3	7.2	4.0	4.7
Brazil	10.0	-0.6	4.6	2.0	-1.4	3.5	3.9	3.3	4.0
CONSUMER PRICES (2)									
Industrial Countries	1.1	1.3	1.4	1.5	1.0	1.1	1.9	1.2	1.4
of which:									
Canada	-0.0	2.1	2.0	1.0	1.1	2.4	3.1	1.7	1.9
Japan	0.8	-0.8	0.1	2.0	0.8	-1.3	-0.9	-0.7	-0.3
United Kingdom (3)	2.2	2.9	3.2	2.7	2.5	2.2	2.1	2.4	2.4
Euro-12 (4)	NA	NA	NA	1.5	0.8	1.5	2.6	1.7	1.9
Germany	2.8	1.4	1.3	1.5	0.3	1.1	2.5	1.4	1.5
Developing Countries	22.9	16.9	11.1	6.8	9.1	4.7	4.2	5.4	5.3
Asia	10.7	6.4	4.8	2.8	4.5	0.2	1.9	3.7	3.9
Korea	5.8	4.4	5.0	5.0	5.9	1.3	2.9	2.7	3.0
China	26.9	11.0	6.8	0.9	-1.2	-0.9	0.9	3.8	4.2
Latin America	54.0	42.1	25.9	15.6	15.5	12.6	8.5	8.0	7.7
Mexico	7.0	48.9	28.2	17.2	17.5	13.6	8.9	8.5	8.1
Brazil	1196.9	21.5	9.6	4.7	1.6	8.3	6.2	5.0	4.9

1. Foreign GDP aggregates calculated using shares of U.S. non-agricultural exports.
2. Foreign CPI aggregates calculated using shares of U.S. non-oil imports.
3. CPI excluding mortgage interest payments, which is the targeted inflation rate.
4. Harmonized CPI's, weighted by shares in final consumption of households converted to a common currency using estimated PPP exchange rates.

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

Measure and country	2000 Q1	2000 Q2	2000 Q3	2000 Q4	Projected 2001 Q1	2001 Q2	2001 Q3	2001 Q4	2002 Q1	2002 Q2	2002 Q3	2002 Q4
REAL GDP (1)	Quarterly changes at an annual rate											
Total foreign	7.4	4.3	3.9	2.6	2.3	3.1	3.5	3.6	3.6	3.6	3.7	3.8
Industrial Countries	5.3	3.7	2.7	2.5	1.6	2.5	2.6	2.8	3.0	3.0	3.0	3.0
of which:												
Canada	5.5	4.6	4.8	3.1	0.9	2.3	2.9	3.2	3.4	3.4	3.4	3.4
Japan	10.0	0.9	-2.6	0.2	0.9	1.8	0.5	0.6	1.2	1.2	1.3	1.3
United Kingdom	1.6	4.1	2.8	3.2	2.4	2.5	2.5	2.6	2.5	2.5	2.5	2.5
Euro-12	3.5	3.3	2.3	2.0	2.4	2.8	2.9	3.0	3.0	3.0	3.0	3.0
Germany	3.6	4.6	2.3	1.3	2.0	2.7	2.8	3.1	3.1	3.2	3.1	3.2
Developing Countries	10.6	5.2	5.6	2.8	3.2	3.9	4.7	4.7	4.6	4.6	4.9	4.9
Asia	12.3	4.7	6.2	1.4	2.9	4.3	5.4	5.4	5.0	5.0	5.4	5.5
Korea	7.1	4.8	14.0	-2.0	1.0	3.0	4.0	4.0	4.0	4.5	5.0	5.5
China	9.5	1.9	11.0	7.5	5.5	6.0	9.0	9.0	6.5	6.5	9.0	9.0
Latin America	9.9	5.5	4.8	4.0	3.3	3.4	4.2	4.2	4.4	4.4	4.4	4.4
Mexico	11.8	6.7	5.8	4.5	3.5	3.5	4.6	4.6	4.8	4.7	4.8	4.8
Brazil	5.6	2.1	4.8	3.0	3.0	3.2	3.5	3.7	4.0	4.0	4.0	4.0
CONSUMER PRICES (2)	Four-quarter changes											
Industrial Countries	1.6	1.5	1.7	1.9	1.8	1.8	1.4	1.2	1.2	1.3	1.4	1.4
of which:												
Canada	2.7	2.4	2.7	3.1	3.0	2.8	2.1	1.7	1.7	1.8	1.8	1.9
Japan	-0.8	-1.0	-1.1	-0.9	-0.9	-0.6	-0.7	-0.7	-0.5	-0.4	-0.3	-0.3
United Kingdom (3)	2.1	2.1	2.1	2.1	2.2	2.3	2.3	2.4	2.4	2.4	2.4	2.4
Euro-12 (4)	2.1	2.1	2.5	2.6	2.4	2.3	1.9	1.7	1.7	1.8	1.9	1.9
Germany	2.0	1.7	2.2	2.5	2.0	2.1	1.6	1.4	1.3	1.4	1.5	1.5
Developing Countries	3.9	3.8	4.0	4.2	4.9	5.4	5.3	5.4	5.5	5.5	5.5	5.3
Asia	0.5	0.8	1.4	1.9	2.7	3.7	3.8	3.7	3.7	3.8	3.9	3.9
Korea	1.5	1.4	3.2	2.9	4.1	4.6	3.0	2.7	3.0	3.0	3.0	3.0
China	0.1	0.1	0.3	0.9	1.6	3.4	3.6	3.8	3.8	3.9	4.1	4.2
Latin America	10.0	9.1	8.7	8.5	8.8	8.6	8.2	8.0	8.1	7.9	7.8	7.7
Mexico	10.6	9.6	9.0	8.9	9.2	8.9	8.6	8.5	8.6	8.5	8.3	8.1
Brazil	7.8	6.6	7.7	6.2	6.7	7.8	5.7	5.0	4.9	4.9	4.9	4.9

1. Foreign GDP aggregates calculated using shares of U.S. non-agricultural exports.
2. Foreign CPI aggregates calculated using shares of U.S. non-oil imports.
3. CPI excluding mortgage interest payments, which is the targeted inflation rate.
4. Harmonized CPI's, weighted by shares in final consumption of households converted to a common currency using estimated PPP exchange rates.

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1994	1995	1996	1997	1998	1999	------ 2000	Projected 2001	------ 2002
NIPA REAL EXPORTS and IMPORTS									
	Percentage point contribution to GDP growth, Q4/Q4								
Net Goods & Services	-0.3	0.4	-0.2	-0.8	-1.1	-1.1	-0.8	0.1	-0.1
Exports of G&S	1.0	1.0	1.1	1.0	0.3	0.5	0.8	0.7	1.1
Imports of G&S	-1.3	-0.6	-1.3	-1.7	-1.4	-1.5	-1.6	-0.6	-1.2
	Percentage change, Q4/Q4								
Exports of G&S	10.5	9.7	9.8	8.5	2.2	4.3	7.2	6.0	9.9
Services	8.2	8.8	8.9	1.4	2.8	0.2	1.5	4.2	7.0
Agricultural Goods	16.3	-4.0	3.8	1.0	-0.3	-0.5	8.2	-1.4	2.9
Computers	27.4	39.1	21.6	25.8	7.0	13.3	23.4	21.4	33.5
Semiconductors	66.9	79.6	44.6	21.3	9.3	34.4	27.2	21.3	37.3
Other Goods 1/	6.9	5.7	7.8	10.9	1.3	4.1	7.0	4.8	6.9
Imports of G&S	12.2	5.0	11.2	14.3	11.2	12.0	11.4	4.1	8.2
Services	1.8	5.5	5.3	14.0	9.5	2.1	12.8	1.2	4.9
Oil	-0.2	2.4	7.8	3.9	4.6	-3.9	10.4	2.9	3.7
Computers	39.0	35.0	17.8	33.0	26.7	25.0	18.2	18.9	28.6
Semiconductors	54.5	92.4	56.7	32.9	-7.3	34.0	22.9	24.3	38.6
Other Goods 2/	12.3	-1.2	10.5	12.7	11.6	13.9	10.2	2.6	6.0
	Billions of chained 1996 dollars								
Net Goods & Services	-86.5	-78.4	-89.0	-113.3	-221.0	-322.4	-411.6	-434.7	-453.8
Exports of G&S	732.8	808.2	874.2	981.5	1003.6	1033.0	1127.5	1175.8	1279.9
Imports of G&S	819.4	886.6	963.1	1094.8	1224.6	1355.3	1539.1	1610.4	1733.7
	Billions of dollars								
US CURRENT ACCOUNT BALANCE	-118.6	-109.5	-123.3	-140.5	-217.1	-331.5	-438.3	-451.0	-477.8
Current Acct as Percent of GDP	-1.7	-1.5	-1.6	-1.7	-2.5	-3.6	-4.4	-4.4	-4.4
Net Goods & Services (BOP)	-97.0	-96.0	-102.1	-105.9	-166.9	-265.0	-367.6	-374.5	-389.4
Investment Income, Net	21.1	25.0	23.4	11.1	-1.0	-13.1	-13.0	-17.7	-28.8
Direct, Net	55.2	64.9	69.4	71.9	67.7	62.7	77.7	89.4	98.0
Portfolio, Net	-34.1	-39.9	-46.0	-60.9	-68.8	-75.8	-90.7	-107.2	-126.7
Other Income & Transfers,Net	-42.7	-38.6	-44.6	-45.7	-49.2	-53.4	-57.7	-58.7	-59.7

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1997				1998				1999			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-1.0	-0.3	-0.9	-0.9	-1.6	-1.9	-1.0	0.1	-1.4	-1.4	-1.1	-0.4
Exports of G&S	0.8	1.9	1.2	-0.1	0.1	-0.3	-0.4	1.5	-0.9	0.6	1.0	1.1
Imports of G&S	-1.8	-2.2	-2.1	-0.8	-1.7	-1.6	-0.7	-1.5	-0.6	-2.0	-2.1	-1.4
Percentage change from previous period, s.a.a.r.												
Exports of G&S	7.5	17.6	10.6	-0.8	1.0	-3.0	-3.2	15.1	-7.9	5.8	10.2	10.3
Services	-5.8	9.4	6.0	-3.3	5.2	6.4	-10.0	10.8	-3.8	2.8	-2.5	4.6
Agricultural Goods	-19.4	6.7	12.0	7.9	-2.7	-13.8	-12.5	34.7	-33.4	33.1	38.0	-19.9
Computers	60.0	44.5	25.7	-14.0	-7.5	7.6	14.7	14.7	5.2	26.7	22.2	1.2
Semiconductors	50.3	22.1	19.6	-1.4	2.1	-13.6	18.9	35.9	38.7	39.1	37.8	22.5
Other Goods 1/	12.2	20.6	10.8	0.9	0.0	-6.6	-1.2	14.3	-11.1	1.4	11.9	16.3
Imports of G&S	15.3	18.8	17.3	6.4	14.2	13.1	5.5	12.2	4.5	16.2	16.9	10.7
Services	20.0	5.6	23.1	8.3	20.0	6.7	9.8	2.2	-7.7	2.5	6.3	8.2
Oil	-7.5	36.8	5.7	-12.9	6.4	41.2	2.1	-22.0	2.4	29.4	-5.8	-31.5
Computers	46.6	45.8	32.4	10.5	32.5	22.6	10.6	43.2	28.8	48.5	14.8	11.2
Semiconductors	78.1	26.0	31.6	5.6	2.0	-22.9	0.1	-6.1	17.8	53.8	24.1	43.3
Other Goods 2/	11.6	17.2	14.8	7.5	12.6	14.0	4.5	15.6	5.0	14.6	21.5	14.9
Billions of chained 1996 dollars, s.a.a.r.												
Net Goods & Services	-94.0	-100.6	-119.6	-139.2	-175.3	-219.7	-244.1	-244.9	-279.8	-314.6	-342.6	-352.5
Exports of G&S	940.3	979.2	1004.2	1002.1	1004.5	996.8	988.8	1024.1	1003.3	1017.6	1042.6	1068.4
Imports of G&S	1034.3	1079.8	1123.8	1141.2	1179.8	1216.6	1232.9	1269.0	1283.1	1332.2	1385.2	1420.9
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-137.5	-119.9	-133.6	-171.1	-169.6	-205.9	-245.2	-247.9	-266.5	-315.9	-358.6	-384.9
Current Account as % of GDP	-1.7	-1.4	-1.6	-2.0	-2.0	-2.4	-2.8	-2.8	-2.9	-3.4	-3.8	-4.0
Net Goods & Services (BOP)	-108.2	-94.3	-101.1	-120.1	-134.5	-166.4	-185.3	-181.4	-210.7	-253.2	-290.9	-305.1
Investment Income, Net	11.5	16.3	10.7	5.7	9.1	6.0	-12.1	-7.3	-7.1	-11.3	-16.8	-17.3
Direct, Net	68.9	76.6	74.1	68.1	74.9	72.4	59.0	64.7	64.1	58.8	62.8	65.1
Portfolio, Net	-57.4	-60.3	-63.4	-62.4	-65.7	-66.4	-71.1	-71.9	-71.2	-70.0	-79.6	-82.4
Other Inc. & Transfers, Net	-40.8	-41.9	-43.2	-56.7	-44.3	-45.5	-47.8	-59.2	-48.7	-51.5	-51.0	-62.5

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

Strictly Confidential (FR)
Class II FOMC

January 25,

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2000				Projected 2001				Projected 2002			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
PA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-0.9	-1.0	-0.9	-0.4	0.4	-0.3	-0.2	0.3	-0.4	-0.3	-0.1	0.4
Exports of G&S	0.7	1.5	1.5	-0.5	0.1	0.5	0.8	1.2	0.7	1.1	1.1	1.5
Imports of G&S	-1.6	-2.5	-2.4	0.1	0.4	-0.9	-1.0	-0.9	-1.1	-1.4	-1.3	-1.1
Percentage change from previous period, s.a.a.r.												
Exports of G&S	6.3	14.3	13.9	-4.7	0.8	4.9	7.2	11.5	6.3	9.7	10.2	13.6
Services	6.9	3.5	-2.8	-1.5	0.3	3.5	5.6	7.6	7.5	7.0	6.8	6.7
Agricultural Goods	25.3	-2.0	42.5	-21.7	-6.2	0.8	-1.0	1.1	3.0	2.8	2.9	3.0
Computers	44.6	44.9	27.5	-13.3	8.2	12.5	33.5	33.5	33.5	33.5	33.5	33.5
Semiconductors	20.7	71.2	38.6	-8.7	4.1	12.6	36.0	36.0	37.3	37.3	37.3	37.3
Other Goods 1/	0.7	15.0	17.1	-3.4	0.8	4.5	3.9	10.1	0.7	6.6	7.4	13.4
Imports of G&S	12.0	18.6	17.0	-0.8	-2.3	6.0	6.6	6.4	7.9	9.4	8.6	7.1
Services	16.6	10.6	22.3	2.6	-0.7	0.6	1.4	3.6	4.8	4.9	4.9	5.1
Oil	30.3	35.3	-4.9	-11.5	-11.1	32.8	9.6	-13.4	-2.9	25.3	11.0	-14.3
Computers	2.8	44.5	28.7	2.0	10.4	11.5	27.4	27.4	28.6	28.6	28.6	28.6
Semiconductors	20.7	33.5	88.9	-25.2	10.4	12.6	38.6	38.6	38.6	38.6	38.6	38.6
Other Goods 2/	9.7	15.8	15.1	1.0	-3.3	3.8	4.3	6.0	6.3	6.0	5.8	5.9
Billions of chained 1996 dollars, s.a.a.r.												
Net Goods & Services	-376.8	-403.4	-427.7	-438.4	-426.7	-436.1	-441.5	-434.3	-447.2	-456.7	-461.4	-449.9
Exports of G&S	1084.8	1121.8	1158.8	1144.8	1147.2	1161.0	1181.2	1213.7	1232.3	1261.2	1292.2	1334.1
Imports of G&S	1461.7	1525.2	1586.4	1583.2	1573.9	1597.0	1622.7	1648.1	1679.5	1717.8	1753.6	1784.0
Billions of dollars, s.a.a.r.												
CURRENT ACCOUNT BALANCE	-406.0	-419.9	-451.6	-475.8	-448.9	-448.9	-450.0	-456.1	-462.6	-475.6	-484.0	-489.3
rrent Account as % of GDP	-4.2	-4.2	-4.5	-4.7	-4.4	-4.4	-4.3	-4.3	-4.3	-4.4	-4.4	-4.4
Net Goods & Services (BOP)	-340.5	-354.4	-382.5	-393.2	-374.6	-377.8	-377.6	-368.2	-381.4	-391.3	-397.0	-387.7
Investment Income, Net	-11.9	-10.8	-12.7	-16.5	-18.7	-15.0	-16.3	-20.8	-24.6	-27.2	-29.8	-33.5
Direct, Net	68.3	76.1	86.2	80.1	80.9	89.4	93.5	94.0	95.0	97.3	99.3	100.4
Portfolio, Net	-80.2	-86.9	-98.9	-96.6	-99.7	-104.4	-109.8	-114.8	-119.6	-124.4	-129.1	-133.8
Other Inc. & Transfers, Net	-53.6	-54.7	-56.4	-66.1	-55.6	-56.1	-56.1	-67.1	-56.6	-57.1	-57.1	-68.1

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