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Confidential (FR) Class II FOMC

Part 1

June 20, 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

The data we have received since the May Greenbook have caused us to revise down our estimate of the pace of activity in the first half of the year. It now appears that business investment weakened even more precipitously than we had thought: The news from the high-technology sector has been decidedly more bearish, and the cutbacks in spending for more traditional types of equipment seem to have intensified. In large part as a consequence of these developments, the manufacturing sector has continued to contract sharply. Furthermore, global retrenchment in the high-tech sector, spillovers from the weakness in the United States, and related softening in domestic spending abroad have caused us to mark down our near-term outlook for foreign economic growth. However, on the positive side, household spending has held up better than we had projected, and consumer sentiment has stabilized in recent months after its sharp decline around the turn of the year.

We expect activity to remain very sluggish in the near term. Nonetheless, the weakness does not yet seem to be cumulating in the way that historically has characterized recessions. Real GDP appears to have edged up about 1/2 percent at an annual rate in the second quarter. Growth should pick up somewhat during the second half of the year but still will likely average only about 2 percent--well below our estimate of potential. Several factors continue to weigh on the economy: The shake-out in the high-technology sector clearly is not yet complete, businesses still have a way to go in clearing out unwanted inventories, and the weakness abroad and strong dollar suggest that the United States will receive little impetus to growth from foreign demand. However, the aggressive monetary policy actions since the beginning of the year ought to be providing increased support to aggregate demand as we move through the year, and we expect the recently legislated tax cuts to give a noticeable boost to consumer spending beginning next quarter. Furthermore, we still believe that the underlying pace of technological advance remains strong. This buttresses the long-run profitability of new investment and supports real wage growth and household spending.

In our projection, the maintenance of a 4 percent federal funds rate, coupled with the pending tax cuts, is sufficient stimulus to cause real GDP growth to move back up to 3-1/2 percent in 2002--in line with our current estimate of the rate of growth of potential GDP. Still, by the middle of 2002, real GDP growth will have fallen short of potential for about two years. This protracted period of subpar growth causes the unemployment rate to rise to 5-1/4 percent by the end of this year and 5-1/2 percent in 2002. On the inflation front, after having increased 2-1/4 percent in 2000, PCE prices are projected to rise 2 percent in 2001 and 1-3/4 percent in 2002. In large part, the reduced pace of inflation reflects a backing off in energy prices after their sharp increase over the past two years. Furthermore, the slack we see opening up in labor and product markets should also begin to put downward pressure on wage and price increases in the latter part of the forecast period.

Key Background Factors

Yields on longer-term Treasuries have come down since the May meeting. Futures markets have built in some more near-term easing followed by a considerable increase in the federal funds rate in 2002--as they apparently see a more robust economy than the staff does. We have assumed an unchanged federal funds rate for the purposes of the baseline forecast. Accordingly, we are assuming that long-term Treasury rates will move down a bit further by the end of the projection period as markets adjust to the absence of monetary tightening next year. Yields on corporate bonds also are expected to move lower, with little change in the spread between yields on Treasuries and investment-grade offerings.

On balance, equity prices are down a little since the May Greenbook, and we assume that broader stock indexes will hold near the lower end of their recent trading range throughout the forecast period. However, we see a downside risk to this forecast: Even adjusted for their usual bias, market analysts' forecasts of corporate earnings appear quite optimistic, and equity markets could weaken appreciably if disappointing news on profits were to prompt a more bearish assessment of longer-run earnings prospects. We address this possibility later in one of our alternative simulations.

The available indicators of credit quality have deteriorated somewhat further. Even so, most businesses have not had difficulty obtaining financing. Notably, bond markets have been receptive to both investment-grade and selected below-investment-grade issuers, although lower-rated borrowers face elevated risk spreads. Favorable conditions in the bond market also have encouraged a number of firms to strengthen their balance sheets by paying down commercial paper or bank loans. Looking ahead, some further erosion of credit quality can be anticipated in the economic environment that we are forecasting. However, we do not see any large-scale constrictions of credit supply, and with monetary policy assumed to be accommodative, borrowing rates should remain relatively low.

We have refined our fiscal policy assumptions in light of the Economic Growth and Tax Relief Reconciliation Act of 2001, which was signed by the President on June 7. The temporary tax rebate to be paid out this summer, at $38 billion, is $12 billion smaller than we had assumed in the May Greenbook. Permanent changes in the tax code are expected to reduce revenues about $3 billion in fiscal 2001 and $71 billion in fiscal 2002; we previously had assumed these

Staff Tax-Policy Assumptions in the May and June Greenbooks
(Billions of dollars)

Tax cut	Fiscal 2001		Fiscal 2002	
	May GB	June GB	May GB	June GB
Temporary	-50	-38	0	0
Permanent	-10	-3	-60	-71
Corporate tax timing	0	-28	0	28

figures would be $10 billion and $60 billion respectively.[1] The legislation also included a shift in the timing of corporate tax payments, which the staff now estimates will move roughly $28 billion of revenues from fiscal 2001 to fiscal 2002. Recent readings on spending have been in line with our expectations, and we have not made any material changes to our outlook for federal outlays this round. The incoming data on corporate tax receipts have been very weak, but we have not received any important surprises on other revenues. All told, our projection for the unified budget surplus is $185 billion in fiscal 2001 and $214 billion in fiscal 2002. Our current on-budget surplus projections (that is, excluding social security and the Postal Service) are $21 billion in fiscal 2001 and $40 billion in fiscal 2002.[2]

Measured against a broad group of our trading partners, the real trade-weighted exchange value of the dollar has strengthened slightly over the intermeeting period. We forecast that, in real terms, the dollar will depreciate about 1 percent over the projection period; nominal exchange rates change little, but foreign inflation is expected to run a bit above that in the United States. This decline leaves the real exchange value of the dollar at the end of 2002 about 1 percent higher than the level we had in the May Greenbook.

The slower pace of foreign activity that emerged in late 2000 appears to have continued into early 2001. Foreign real GDP is forecast to rise at just a

1. We estimate that in the NIPA, the tax cuts taken together will boost the level of disposable personal income at annual rates of $162 billion in the third quarter of 2001, $10 billion in the fourth quarter, and $80 billion per quarter in 2002.

2. According to our projections, the on-budget surplus excluding the Medicare Hospital Insurance trust fund would be close to balance in fiscal 2002. This measure of the surplus has gained some traction in the Congress as a benchmark when considering the budgetary consequences of policy actions. If this benchmark constrains policy, then under our economic assumptions, we do not see room for much more fiscal stimulus than we have already incorporated.

1-1/4 percent annual rate in the first half of 2001 before recovering to a 2-1/4 percent pace in the second half of 2001 and 3-1/2 percent in 2002. Our projection for growth abroad this year is 1/2 percentage point below the May Greenbook, while our outlook for 2002 has been revised down 1/4 percentage point. The revision to 2001 reflects, in part, weaker-than-expected incoming data across a number of foreign economies, some of which likely is attributable to spillovers from the sluggishness in the United States.

Despite the suspension of oil exports by Iraq early this month, the spot price of West Texas intermediate crude has remained between $27 and $30 per barrel. This muted response likely reflects OPEC's pledge to offset any persistent supply disruptions from Iraq as well as increased stocks of crude, particularly in the United States. The spot price of WTI is assumed to remain near its current level through the summer. But with more supply coming on line from non-OPEC nations, prices are assumed to gradually trend down to about $25 per barrel by the end of the forecast period. This path is consistent with current quotes in futures markets and differs very little from that in the May Greenbook.

We have again lowered our assumptions for structural labor productivity in this forecast, reflecting the effects of the weaker outlook for investment on capital deepening as well as a slight downward adjustment to multifactor productivity growth. We now are assuming that structural productivity growth will average 2-1/2 percent over the forecast period, 1/4 percentage point lower than the figures we had built into the May Greenbook. Although this rate of structural productivity growth is down slightly from the average increase of about 2-3/4 percent over the 1995-2000 period, it still comfortably exceeds the 1-1/2 percent pace that prevailed before the acceleration in productivity in the second half of the 1990s.

Recent Developments and the Second-Quarter Outlook

We are projecting that real GDP will increase at an annual rate of just 1/2 percent in the second quarter. Final sales, which rose at a 4-1/2 percent pace in the first quarter, are projected to fall at a 1/2 percent annual rate this quarter. This deceleration reflects a marked slowing of growth in consumer expenditures, a sharp drop in capital spending by businesses, and a noticeable drag from net exports. GDP growth is held in positive territory by a substantially reduced pace of inventory liquidation.

Overall, the labor market continues to soften. Private payrolls edged down in May after dropping sharply in April, and the updrift in initial claims for unemployment insurance over the past few weeks points to a further decline in employment in June. With employment down and the workweek running a bit lower than during the winter, we are looking for hours worked to fall 2 percent at an annual rate. The downtick in the unemployment rate in May probably was

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

Measure	2001:Q2		2001:Q3	
	May GB	June GB	May GB	June GB
Real GDP	**.7**	**.6**	**1.5**	**1.3**
Private domestic final purchases	.1	-.1	1.4	1.5
Personal consumption expenditures	.4	1.6	1.6	2.3
Residential investment	-.3	.7	.3	-.8
Business fixed investment	-1.5	-8.4	.9	-2.1
Government outlays for consumption and investment	1.5	2.2	3.0	2.9
	Contribution to growth, percentage points			
Inventory investment	.7	1.0	.4	.1
Net exports	-.4	-.7	-.7	-.6

just statistical noise, and we are expecting the rate to move up again in June; for the quarter as a whole, we expect the unemployment rate to average 4-1/2 percent, up from 4-1/4 percent in the first quarter.

The manufacturing sector has continued to contract sharply. In May, manufacturing employment posted another large drop, and the workweek moved down further. Factory output fell 3/4 percent last month, and with inventory-shipments ratios still high and the orders picture bleak, output probably will move down further in the months ahead. All told, we are projecting that manufacturing IP will fall at an annual rate of 6-1/2 percent this quarter, a substantially larger decline than we had projected in the previous Greenbook.

We expect nonfarm inventory investment to be negative in the current quarter. However, the liquidation is not nearly as large as in the first quarter, and the resultant swing in inventory investment adds 1 percentage point to real GDP growth in the second quarter. Most of this swing reflects developments in the motor vehicle sector, where inventories are projected to change little after the substantial correction brought about by last winter's production cuts and sales incentives. The most recent inventory data outside of motor vehicles are for April, when book-value stocks rose somewhat and the aggregate inventory-sales ratio moved up further. The weak industrial production figures and reports from purchasing managers suggest that some businesses succeeded in trimming stocks in late spring. However, these efforts likely were not adequate to resolve the overhangs that have been plaguing the high-tech sector as well as manufacturers of metals, construction supplies, chemicals, and textiles.

Household spending continued to move up in the current quarter, supported by increased discounting. In April and May, sales of cars and light trucks averaged about 1/2 million units below their first-quarter rate, and preliminary reports suggest that sales may have edged down a bit further in June. Still, at a 16-1/2 million unit annual rate, the pace of light vehicle sales that we are projecting for the quarter is quite high by historical standards. In real terms, the April-May average for spending on goods other than motor vehicles was up just 0.3 percent from the first quarter, though the latest data indicate that outlays for services held up fairly well through April. All told, we are projecting that real personal consumption expenditures will rise at about a 1-1/2 percent annual rate this quarter, down from a 3 percent pace in the first quarter.

Supported by low mortgage rates, home building has been well maintained. Single-family housing starts--which had risen smartly during the winter--changed little from the first-quarter average during April and May and are projected to continue moving sideways through the summer. Multifamily starts also are expected to change little from their recent levels.

Business outlays for equipment seem to have contracted at a double-digit pace in the second quarter. The incoming data on orders and shipments of capital goods--including the much smaller order backlog shown by the annual revisions to these data--have led us to greater pessimism. We are projecting that real spending on high-technology equipment and software will fall at an annual rate of 7 percent in the second quarter and that outlays for non-high-tech equipment (excluding transportation equipment) will drop at more than a 20 percent rate, a much larger contraction than projected in the May Greenbook. After posting large increases over the past several quarters, nonresidential construction activity appears to be advancing at a more moderate pace this quarter. Construction has been supported by developments in the energy sector, where higher prices are spurring drilling and mining activity and the construction of electrical generation facilities. However, office vacancy rates are rising, and developers reportedly are becoming more cautious about initiating new projects.

After rising at a robust 5 percent annual rate last quarter, real government purchases are projected to increase at a 2-1/4 percent pace this quarter. The choppy pattern for growth reflects typical volatility in spending on national defense and on state and local highway construction.

Net exports are expected to make a negative arithmetic contribution of 3/4 percentage point to real GDP growth this quarter, as compared with the positive 1 percentage point contribution in the first quarter. Last quarter's boost to GDP reflected in large part a surprisingly sharp drop in imports in February. Imports have since returned closer to expected levels; we are anticipating some rise in real imports for the second quarter as a whole, although the gain likely will be moderate. Meanwhile, weak growth abroad and the lagged effects of earlier increases in the dollar are expected to keep exports relatively flat through the summer.

We are projecting that PCE prices will rise at an annual rate of 2.1 percent this quarter, down from a 3.2 percent rate of increase this winter. In terms of the core PCE measure, inflation is expected to run at a 1.6 percent annual rate in the current quarter, following an increase of 2.6 percent in the first quarter. After a few disappointing reports earlier in the year, the monthly information on core prices has improved--notably, the CPI for goods other than food and energy has fallen nearly 2 percent at an annual rate over the past three months--and the recent slower trend is expected to continue through the summer. Energy prices are forecast to rise at close to a 10 percent annual rate for the quarter as a whole, largely reflecting the steep increases that occurred in gasoline prices this spring. There are signs, however, that retail energy prices are beginning to ease: Natural gas prices have been falling in recent months, and the latest surveys of pump prices indicate that gasoline prices are moving down.

The Longer-Term Outlook for the Economy

Growth in economic activity in the second half of the year likely will continue to be held back by further weakness in business fixed investment and additional inventory adjustments. But the completion of the inventory correction will remove that negative influence on growth, and the profit opportunities associated with a still strong underlying pace of technological advance should eventually help turn capital spending around. Furthermore, the monetary stimulus already in place and the prospective impulse from fiscal policy should provide important boosts to aggregate demand. Consequently, after increasing at an annual rate of about 1 percent in the first half of this year, real GDP is projected to advance at a 1-1/4 percent pace in the third quarter and nearly a 3 percent pace in the fourth quarter. In 2002, our forecast is for real GDP to increase 3-1/2 percent.

Our projection for real GDP growth this year is nearly 1/2 percentage point below our forecast in the May Greenbook. Most of this revision reflects a more pessimistic assessment of business investment, which, going forward, feeds into smaller gains in capital deepening and structural productivity. All else equal, these revisions would have shown through to a smaller rise in actual GDP next year. However, changes in our assumptions concerning the effects of the tax cuts on spending have resulted in a greater degree of fiscal stimulus in 2002 than

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

Measure	2000 H1	2000 H2	2001 H1	2001 H2	2002
Real GDP	**5.2**	**1.6**	**.9**	**2.1**	**3.5**
Previous	5.2	1.6	1.3	2.4	3.5
Final sales	5.3	2.1	2.1	2.0	3.0
Previous	5.3	2.1	2.5	2.6	2.7
PCE	5.3	3.6	2.3	2.8	2.7
Previous	5.3	3.6	1.8	3.2	2.3
Residential investment	2.2	-7.2	2.2	.3	3.0
Previous	2.2	-7.2	1.6	1.3	2.5
BFI	17.7	3.7	-2.8	-.9	6.8
Previous	17.7	3.7	.6	2.1	7.2
Government purchases	1.8	.7	3.6	2.9	3.5
Previous	1.8	.7	3.3	3.0	3.5
Exports	10.2	3.2	-1.8	2.9	5.3
Previous	10.2	3.2	-.7	4.9	6.5
Imports	15.2	7.5	-2.6	4.5	7.4
Previous	15.2	7.5	-4.1	6.5	7.9
	Contribution to growth, percentage points				
Inventory change	-.0	-.4	-1.2	.0	.5
Previous	-.0	-.4	-1.1	-.2	.8
Net exports	-1.0	-.7	.2	-.3	-.5
Previous	-1.0	-.7	.5	-.4	-.4

we had assumed in the May Greenbook.[3] These changes have been offsetting, and our outlook for 2002 is unchanged from the previous forecast.

Household spending. We have altered the path for household spending in response to the provisions of the new tax act. Although the temporary tax

3. Currently, we are assuming that the tax bill will raise real GDP growth 0.4 percentage point in both 2001 and 2002. In the May Greenbook, these figures were 0.5 percentage point in 2001 and 0.1 percentage point in 2002.

rebate is somewhat smaller than we had thought, it now appears that the checks will be mailed out between July and September rather than at the end of the quarter as we had assumed last round. Consequently, they should begin to provide a noticeable boost to real PCE growth in the third quarter. We also have taken a closer look at our assumptions concerning the size and speed of household adjustments to spending in response to the rebate and to the permanent components of the tax bill.[4] Together, the tax cuts are expected to account for a bit more than half of the 2.8 percent annual rate increase that we are projecting for real PCE in the second half of this year. Although the playing out of rebate-related spending is a negative for real consumption growth in early 2002, the impetus to spending from the permanent tax cuts builds through the year. On net, about 0.3 percentage point of the 2.7 percent increase projected for real PCE in 2002 can be attributed to the tax plan.

If not for the boost from the tax cuts, we would be forecasting only lackluster gains in consumer spending in the second half of this year and early 2002. Most of the fundamentals for consumption over this period are not strong: Income growth is restrained by sluggish hiring; equity prices are assumed to remain near their current levels; and with the unemployment rate rising above 5 percent for the first time since 1997, consumer sentiment likely will remain subdued. However, the underlying trend in labor productivity should support solid growth in real wages, and declining energy prices also ought to provide a boost to real incomes.

We are anticipating little net change in housing construction over the remainder of this year, as low mortgage rates offset the negative influences of weak labor markets and the lower stock market. Single-family starts are projected to average 1.29 million units (annual rate) in the second half of the year, about the same as the first-half average. Starts are projected to edge up through the course of 2002, reflecting somewhat lower mortgage rates and the gradual recovery of income and job growth. Multifamily starts are projected to run at about a 330,000 unit annual rate over the forecast period.

Business spending on equipment and software. Demand for capital equipment is expected to remain weak in the second half of 2001, with total real equipment and software spending falling 1-1/2 percent at an annual rate. For

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4. Specifically, we have assumed that a portion of the cuts (two-thirds of the rebates and nearly one-half of the permanent changes) are received by households that have very short planning horizons, make no distinction between temporary and permanent tax provisions, and simply spend all of their extra cash flow over the course of three quarters. The remainder is received by households who distinguish between the two types of tax cuts (and amortize the temporary cuts over a long planning period); these households save part of the increase in their permanent income and take a few years to fully adjust their spending to its new long-run level.

2001 as a whole, total real outlays for equipment and software spending are projected to fall 4-1/4 percent, a rate of decline similar to that recorded during the 1990-91 recession. In the May Greenbook, we had projected that real E&S spending would fall 1-1/4 percent this year.

Prospects for the high-technology sector remain bleak. We are projecting that total real spending on high-technology equipment and software will post a sluggish rise of about 3 percent at an annual rate in the second half of the year after falling at a 9-1/2 percent pace during the first half. However, the rapid declines in the relative prices of investment goods and the need to replace outmoded equipment should eventually show through to firms' capital spending plans. In addition, under our financial assumptions, capital outlays should be supported throughout the forecast period by attractive borrowing rates. As output growth picks back up, accelerator effects also should provide a boost to spending after being a substantially negative factor for investment in 2001.

We are projecting that total real equipment and software spending will rise nearly 9 percent next year. Real outlays for high-technology equipment and software are projected to be up 17-1/2 percent in 2002, a significant improvement from this year's 3-1/2 percent decline but still well below the large increases recorded in the second half of the 1990s. Spending on other types of equipment is expected to rise 1-3/4 percent next year after falling nearly 5 percent in 2001.[5]

Nonresidential structures. We are projecting that real outlays for nonresidential structures will rise at an annual rate of about 1 percent in the second half of 2001 and 1-1/2 percent in 2002. These gains are down substantially from the double-digit increases posted in 2000 and early this year. High energy prices should continue to provide an important boost to drilling for gas and oil and the construction of electrical generation facilities. Other markets, however, have begun to soften. Vacancy rates for office buildings--though still low by longer-run standards--moved up in the first quarter, as did vacancies for industrial space. Increases in rents and property values for office buildings and retail space seem to have topped out.

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5. Previous Greenbooks have included alternative simulations to calibrate the risks to the economy of a much weaker outcome in the high-tech sector. These indicated that if real high-tech investment were to fall by 5 percentage points more than baseline in 2001 and grow 10 percentage points below baseline in 2002, then, in the absence of a monetary policy response, real GDP growth would be reduced by 1/4 percentage point this year and a full percentage point next year. The unemployment rate would end the projection period about 0.4 percentage point higher. Core PCE inflation would be little changed, as the tendency for weaker output to lower inflation would be offset by the lower productivity path that results from the reduced pace of capital accumulation.

Nonetheless, commercial real estate markets do not appear to be afflicted by the overbuilding that has characterized previous cycles. This impression is supported by the behavior of financial markets, where borrowing rates and risk spreads for commercial real estate remain low and where lending activity, particularly in the CMBS market, has been quite brisk. Accordingly, although we are projecting moderate declines in outlays for office buildings and commercial and industrial structures over the projection period, the decreases fall well short of past declines in spending.

Inventory investment. We are anticipating that nonfarm inventories will continue to be drawn down slowly in the second half of the year, leaving inventory investment as a relatively neutral influence on GDP growth. As in our previous projection, this forecast assumes that retailers and their suppliers will use inventories to help smooth through the swings in demand associated with the tax plan. Indeed, many of the consumer goods sold by these businesses are produced overseas, so that stocks cannot be easily replenished in short order once they have been drawn down.

Nonfarm inventory investment is projected to become positive around the turn of the year. Even now, stocks at retailers generally appear to be in fairly good shape, and a substantial pickup in their inventory investment could be expected following the liquidations accompanying this year's tax-related spending. Furthermore, the adjustments at manufacturers of capital equipment and other industries where inventories currently are bloated should have run their course by later this year, and as final demand for these products recovers, stockbuilding can resume in these industries as well. The swing in nonfarm inventories from liquidation to accumulation is projected to boost output growth by a full percentage point in the first half of 2002. Still, the pace of stockbuilding remains restrained, putting inventory-sales ratios back on the underlying downtrends that were evident before the recent slowing in activity.

Government spending. Although revenues will be reduced substantially by the recent tax bill, the on-budget surplus likely will remain large enough, at least over the forecast period, to accommodate the trend toward higher growth in federal government spending that has emerged over the past couple of years. Real federal purchases are projected to rise 3 percent in 2001 and 3-1/2 percent in 2002; these rates compare with an average annual gain over the past five years of about 1-1/4 percent. State and local purchases are projected to rise 3-1/2 percent both this year and next, in line with the average rate of increase posted in recent years. Although the weaker economy has reduced their revenues, most states have adequate resources, including funds set aside from past surpluses, to maintain spending at this pace.

Net exports. We expect that the sluggish pace of foreign economic activity will result in little change in U.S. exports over the near term, but as growth abroad recovers, real exports are projected to rise a moderate 5-1/4 percent in 2002. After moving up just 3/4 percent in 2001, real imports are projected to increase 7-1/2 percent in 2002, reflecting the recovery of domestic demand and the lagged effects of the earlier appreciation of the dollar. On balance, we expect that net exports will make little arithmetic contribution to U.S. GDP growth in 2001 but will subtract 1/2 percentage point in 2002. (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
As noted earlier, we have revised down our forecast of structural labor productivity growth. The changes in our investment forecast have lowered the contribution of capital deepening to overall labor productivity growth. In addition, further analysis of the BLS data on multifactor productivity that we received this spring prompted us to eliminate the slight pickup in MFP growth that had been a feature of earlier forecasts. We now estimate potential GDP growth at 3.4 percent in both 2001 and 2002; in the May Greenbook, these rates were 3.8 percent this year and 3.7 percent in 2002.[6]

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**	**3.1**	**3.2**	**2.5**	**2.5**
Previous	1.4	2.5	3.2	3.2	2.8	2.7
Contributions[1]						
Capital deepening	.7	1.2	1.6	1.7	1.0	1.0
Previous	.7	1.2	1.6	1.6	1.2	1.1
Multifactor productivity	.4	1.0	1.2	1.2	1.2	1.2
Previous	.4	1.0	1.3	1.3	1.3	1.3
Labor quality	.3	.3	.3	.3	.3	.3

1. Percentage points.

6. The weaker path for productivity also has led us to reassess our assumptions concerning the near-term effective NAIRU, which we have raised to 5.0 percent in 2001 and to 5.2 percent in 2002. In the May Greenbook, these figures were 4.9 percent and 5.0 percent respectively.

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

Measure	1999	2000	2001	2002
Output per hour, nonfarm business	3.8	3.3	1.5	2.9
Previous	3.8	3.3	2.0	2.8
Nonfarm payroll employment	2.5	1.7	-.1	.8
Previous	2.2	1.6	-.0	.7
Household employment survey	1.5	1.0	-.4	.5
Previous	1.5	1.1	-.3	.5
Labor force participation rate[1]	67.1	67.1	67.0	66.9
Previous	67.1	67.1	67.0	66.9
Civilian unemployment rate[1]	4.1	4.0	5.2	5.6
Previous	4.1	4.0	5.1	5.5

1. Percent, average for the fourth quarter.

Productivity and the labor market. The recent quarterly pattern of labor productivity growth has been distorted by volatility in the data on hours worked by the self-employed. Excluding the influence of these hours, we think that actual productivity growth averaged about 3/4 percent (annual rate) in the first half of the year, down substantially from the 2-3/4 percent rise recorded in 2000. When measured relative to the rate of gain in structural productivity, this path for output per hour represents a fairly typical cyclical response to the slower pace of output growth. Productivity growth is expected to pick up as activity recovers; for 2002, we are projecting that output per hour will rise nearly 3 percent, a pace that would leave the levels of actual and structural productivity in fairly close alignment by the end of the forecast period.

Private nonfarm payrolls are expected to fall about 85,000 per month, on average, through the third quarter and then edge off a bit further in the fourth. Job growth should resume as we move into 2002, but we expect the pace of hiring to remain subdued, as firms will be hesitant to add staffing until they are convinced that a recovery is firmly in place. With the sustained weakness in labor demand, the unemployment rate is projected to rise more than a full percentage point over the next year.

Wages and prices. The wage and price projections are essentially the same as in the May Greenbook. We are looking for the increases in aggregate measures of wages and prices in the second half of 2001 and in 2002 to be more moderate than during the first half of this year. The smaller increases reflect, in part, energy prices, which appear to be turning down after rising sharply for more

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

Measure	1999	2000	2001	2002
PCE chain-weighted price index	2.0	2.3	2.0	1.7
Previous	2.0	2.3	2.1	1.7
Food	2.0	2.5	3.1	2.5
Previous	2.0	2.5	3.1	2.6
Energy	12.0	15.9	-.5	-4.4
Previous	12.0	15.9	-.2	-5.2
Excluding food and energy	1.5	1.6	2.0	1.9
Previous	1.5	1.6	2.1	1.9
Consumer price index	2.6	3.4	2.6	2.0
Previous	2.6	3.4	2.6	2.0
Excluding food and energy	2.0	2.5	2.6	2.5
Previous	2.0	2.5	2.7	2.5
GDP chain-weighted price index	1.6	2.3	2.2	1.8
Previous	1.6	2.3	2.2	1.8
ECI for compensation of private industry workers[1]	3.4	4.4	4.4	3.9
Previous	3.4	4.4	4.4	4.1
NFB compensation per hour	4.4	5.7	5.4	4.8
Previous	4.4	5.7	5.4	5.0
Prices of core non-oil merchandise imports	.4	1.4	-.2	2.1
Previous	.4	1.4	.3	2.2

1. December to December.

than two years. In addition to their direct effects on inflation, the lower energy prices reduce input costs and restrain inflation expectations--though these effects occur with some lag. The projected updrift in the unemployment rate leads to the opening of some slack in labor markets as we move through next year, and provides some additional restraint on wages and prices.

We have not changed our projection of energy prices much this round. We think the PCE price index for energy will change little in 2001 and fall 4-1/2 percent in 2002. Nonetheless, we feel that the up-side risks to that forecast have been reduced substantially. In response to higher prices, natural gas production has risen sharply and demand has dropped markedly, domestic refiners have boosted gasoline production, and gasoline imports have surged. Inventories of both products--as well as stocks of crude petroleum--have risen considerably and are now at or above seasonal norms, providing markets with a much better cushion to absorb shocks from hot weather or short-term disruptions to supply.

After rising 1.6 percent in 2000, core PCE prices are expected to increase 2 percent in 2001 and 1.9 percent in 2002. In light of the more favorable incoming data, our projection for inflation in 2001 is a bit lower than in the May Greenbook. Our forecast for 2002 is unchanged from our previous projection. Although a slightly higher unemployment rate and a lower rate of capacity utilization should, ceteris paribus, reduce inflation, this effect is offset in our projection by the downward revision to our estimate of the growth rate of structural productivity.

The ECI is projected to increase 4.4 percent this year and 3.9 percent in 2002; we expect the series on nonfarm compensation per hour to increase 5.4 percent this year and 4.8 percent next year. These forecasts for 2001 are identical to our previous projections. The increases for 2002 have been reduced to reflect the effects of the higher unemployment rate and the slower pace of structural productivity growth on compensation. But given the stickiness in the wage adjustment process, over the forecast period most of the weaker productivity performance is reflected in a reduction in the share of income going to profits.

Financial Flows and Conditions

We project that the growth of domestic nonfinancial debt will average around a 4-1/2 percent pace over the next year and a half, a rate broadly in line with the average growth in nominal GDP. The contraction in federal debt slows to 4-3/4 percent in 2001, largely because of the tax rebate, and picks up only a bit in 2002. Borrowing by state and local governments is expected to slow next year, despite a continued heavy pace of capital spending, as the elevated pace of advance refunding trails off. The issuance of debt by California to fund energy expenditures provides a temporary boost to borrowing in the third quarter of this year.

The debt of nonfinancial businesses is forecast to expand at a fairly brisk pace over the next year and a half--in excess of a 7 percent rate--a bit above the gains in the first half of this year. Borrowing will be boosted by the need to finance a large and widening gap between capital expenditures and internally generated funds, although a slower pace of equity retirement will temper debt growth to some degree. Borrowing is expected to be less concentrated in bond issuance than it has been recently as firms resume issuing commercial paper and tapping their banks. The weak outlook for corporate earnings over the next few quarters is likely to be associated with rising C&I loan delinquencies and persistently high junk bond defaults. However, we do not expect a serious cutback in credit supply: Investors in junk bonds have already priced in large credit losses, and banks appear to have anticipated these developments and are fairly well positioned to absorb more credit losses.

Household debt growth is expected to continue to moderate over the projection period. With mortgage rates remaining low, housing market activity and mortgage growth are expected to stay firm throughout the forecast period. But growth in consumer credit should slow considerably in light of our projection of slower growth in expenditures on durables and a continued high debt-servicing burden. The high debt-servicing burden likely also will result in some further increases in delinquencies and some small pullback in credit supply.

The rise in the monetary aggregates, which has been very rapid in recent months, has been boosted by falling opportunity costs associated with the monetary easings as well as a high level of mortgage refinancing and volatility in the stock market. We do not expect such large gains to persist; still, given the increases already in place, M2 is projected to expand more than twice as fast as the rate of growth of nominal income this year. M2 is projected to grow in line with nominal income in 2002.

Alternative Simulations

Many developments could alter the staff outlook, and we have used model simulations to illustrate the consequences of several major uncertainties surrounding the projection. First, we consider the risk that our projection of weak corporate earnings will prove to be a considerable disappointment to the stock market. Next, we run a pair of scenarios designed to illustrate the sensitivity of the outlook to the assumed response of consumers to the upcoming tax cuts. We then consider two scenarios involving alternative paths for the federal funds rate. We conclude with a discussion of two supply-side scenarios--a multifactor productivity slowdown and a low NAIRU.

Earnings disappointment. Equity analysts are expecting a considerably higher trajectory of corporate profits than we have projected in the Greenbook--the gap is on the order of 10 percent during the fall of 2001 and widens further in 2002, even after allowance for the average bias in analysts' expectations. There is a risk that investors could be quite disappointed if events turn out as we, rather than the market analysts, expect. Under these circumstances, share prices could fall sharply, perhaps on the order of 30 percent, if the surprise in the level of earnings has a modest depressing effect on expectations of the longer-run growth of earnings. Accordingly, in this scenario we have assumed that equity prices fall 10 percent in each of the next three quarters. Assuming no change in the federal funds rate, the attendant wealth effects lead to a weaker economy,

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

Measure	2001 H1	2001 H2	2002 H1	2002 H2
Real GDP				
Baseline	**.9**	**2.1**	**3.2**	**3.7**
Earnings disappointment	.9	2.0	2.4	2.6
Smaller tax response	.9	1.7	3.1	3.8
Faster tax response	.9	2.6	3.1	3.6
Continued monetary easing	.9	2.3	4.0	4.7
Market-based funds rate	.9	2.2	3.6	3.9
Multifactor productivity slowdown	.9	.7	1.6	2.3
Low NAIRU	.9	2.3	3.4	3.9
Civilian unemployment rate[1]				
Baseline	**4.5**	**5.2**	**5.5**	**5.6**
Earnings disappointment	4.5	5.2	5.6	5.9
Smaller tax response	4.5	5.3	5.6	5.7
Faster tax response	4.5	5.1	5.4	5.5
Continued monetary easing	4.5	5.2	5.3	5.2
Market-based funds rate	4.5	5.2	5.4	5.4
Multifactor productivity slowdown	4.5	5.2	5.7	6.0
Low NAIRU	4.5	5.1	5.3	5.3
PCE prices excluding food and energy				
Baseline	**2.1**	**1.8**	**1.9**	**1.9**
Earnings disappointment	2.1	1.8	1.9	1.9
Smaller tax response	2.1	1.8	1.9	1.9
Faster tax response	2.1	1.8	1.9	2.0
Continued monetary easing	2.1	1.8	2.1	2.3
Market-based funds rate	2.1	1.8	2.0	2.1
Multifactor productivity slowdown	2.1	1.9	2.1	2.3
Low NAIRU	2.1	1.7	1.6	1.4

1. Average for the final quarter of the period.

with GDP growth off about 1 percentage point in 2002. As a result, the unemployment rate climbs to almost 6 percent by the end of next year.

Tax cuts and household spending. In the baseline, the new tax act provides considerable impetus to consumer spending. But there is a good deal of uncertainty about both the magnitude and timing of these tax effects. In the "smaller tax response" scenario, we assume that spending out of the rebates will be only half as great as in the baseline and that households will take a more gradual approach to consuming their gains in permanent income. In this scenario, GDP growth would be about 1/2 percentage point weaker in the second half of this year but would be little affected in 2002. In the "faster tax response" scenario, a proportion of households are assumed to begin spending now in anticipation of the cuts in taxes that they will receive next year. If such forward-looking behavior were to occur, GDP growth in the second half of 2001 would be 1/2 percentage point stronger than we anticipate, although the additional near-term activity would be partially offset next year.

Continued monetary easing. In this scenario, the federal funds rate is reduced by 50 basis points at the upcoming meeting and another 50 basis points in August. GDP growth rises above potential by early next year, and the unemployment rate peaks at 5-1/4 percent. However, the additional growth would come at the cost of a somewhat faster rate of inflation.

Market-based funds rate. Current federal funds rate futures suggest that investors expect short-term interest rates later this year to be about 1/2 percentage point lower than we have assumed and 1/2 percentage point higher by the end of next year. Replacing our policy assumption with this "market-based funds rate" path would have only a modest effect on the outlook: Real GDP growth would be 1/4 percentage point faster in 2002, and inflation would be a touch higher.

Multifactor productivity slowdown. In this scenario, we assume that structural multifactor productivity reverts to its rate of growth in the first half of the 1990s, about 3/4 percentage point below the staff assumption. Actual output growth over the next year and a half falls by appreciably more than the drop in structural MFP growth, in large part because prospects dim for the expected future profitability of firms, leading to a weaker stock market. Despite increased unemployment, inflation is higher than in the baseline forecast because of added cost pressures.

Low NAIRU. The acceleration in productivity is one explanation for the simultaneous declines in both inflation and unemployment in the late 1990s. An alternative possibility, however, is that the economy's sustainable unemployment rate has fallen. We therefore consider the possibility that the NAIRU fell permanently to 4 percent in the early 1990s. With the federal funds rate held at the baseline level, the main consequence of a lower NAIRU is lower inflation--1/2 percentage point lower at the end of next year. However, a low and stable NAIRU also would imply a modestly higher level of output and employment relative to the Greenbook baseline.

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Class II FOMC

June 20, 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]	
		05/09/01	06/20/01	05/09/01	06/20/01	05/09/01	06/20/01	05/09/01	06/20/01	05/09/01	06/20/01
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		7.1	7.1	5.0	5.0	2.1	2.1	3.4	3.4	4.0	4.0
2001		4.2	3.9	1.8	1.6	2.3	2.3	3.1	3.0	4.7	4.7
2002		4.8	4.6	3.0	2.8	1.7	1.7	1.8	1.9	5.4	5.5
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	2.7	2.7	4.3	4.3
	Q3	6.7	6.7	5.7	5.7	1.1	1.1	2.9	2.9	4.2	4.2
	Q4	9.7	9.7	8.3	8.3	1.6	1.6	3.1	3.1	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	2.8	2.8	4.0	4.0
	Q3	3.8	3.8	2.2	2.2	1.6	1.6	3.5	3.5	4.0	4.0
	Q4	3.0	3.0	1.0	1.0	2.0	2.0	3.0	3.0	4.0	4.0
2001	Q1	5.4	4.6	2.0	1.2	3.2	3.2	4.2	4.2	4.2	4.2
	Q2	3.8	3.5	0.7	0.6	3.1	2.9	3.4	2.9	4.6	4.5
	Q3	2.8	2.5	1.5	1.3	1.3	1.3	1.6	1.5	4.9	4.9
	Q4	4.7	4.2	3.4	2.9	1.3	1.3	1.2	1.6	5.1	5.2
2002	Q1	5.4	5.2	3.3	3.2	2.0	1.9	1.6	1.8	5.3	5.4
	Q2	5.1	4.9	3.3	3.2	1.7	1.7	1.9	1.9	5.4	5.5
	Q3	5.4	5.6	3.5	3.7	1.8	1.8	2.1	2.1	5.4	5.6
	Q4	5.6	5.7	3.7	3.8	1.8	1.8	2.2	2.1	5.5	5.6
TWO-QUARTER[3]											
1999	Q2	4.9	4.9	3.0	3.0	1.8	1.8	2.2	2.2	-0.1	-0.1
	Q4	8.2	8.2	7.0	7.0	1.3	1.3	3.0	3.0	-0.2	-0.2
2000	Q2	8.2	8.2	5.2	5.2	2.8	2.8	3.6	3.6	-0.1	-0.1
	Q4	3.4	3.4	1.6	1.6	1.8	1.8	3.2	3.2	0.0	0.0
2001	Q2	4.6	4.1	1.3	0.9	3.2	3.1	3.8	3.6	0.6	0.5
	Q4	3.8	3.4	2.4	2.1	1.3	1.3	1.4	1.6	0.5	0.7
2002	Q2	5.2	5.1	3.3	3.2	1.8	1.8	1.8	1.9	0.3	0.3
	Q4	5.5	5.6	3.6	3.7	1.8	1.8	2.1	2.1	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	5.8	5.8	3.4	3.4	2.3	2.3	3.4	3.4	-0.1	-0.1
2001	Q4	4.2	3.7	1.9	1.5	2.2	2.2	2.6	2.6	1.1	1.2
2002	Q4	5.3	5.3	3.5	3.5	1.8	1.8	2.0	2.0	0.3	0.4

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

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Class II FOMC

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

June 20, 2001

Item	Units[1]	1994	1995	1996	1997	1998	1999	2000 (Projected)	2001 (Projected)	2002 (Projected)
EXPENDITURES										
Nominal GDP	Bill. $	7054.3	7400.5	7813.2	8318.4	8790.2	9299.2	9963.1	10355.3	10831.9
Real GDP	Bill. Ch. $	7347.7	7543.8	7813.2	8159.5	8515.7	8875.8	9318.5	9465.1	9733.3
Real GDP	% change	4.1	2.2	4.1	4.3	4.6	5.0	3.4	1.5	3.5
Gross domestic purchases		4.3	1.7	4.3	5.0	5.7	5.9	4.1	1.5	3.8
Final sales		3.2	2.9	3.9	3.9	4.6	4.8	3.7	2.1	3.0
Priv. dom. final purchases		4.3	3.2	4.4	5.1	6.4	6.1	5.0	1.8	3.3
Personal cons. expenditures		3.6	2.8	3.1	4.1	5.0	5.6	4.5	2.6	2.7
Durables		6.4	3.7	5.0	8.8	12.6	11.1	5.2	2.7	3.5
Nondurables		4.1	2.5	3.2	2.5	5.0	5.9	3.8	2.0	2.7
Services		2.7	2.7	2.7	3.9	3.4	4.2	4.6	2.8	2.5
Business fixed investment		9.2	7.5	12.1	11.8	12.9	10.1	10.5	-1.8	6.8
Equipment & Software		12.0	8.9	11.8	13.7	15.8	14.1	9.8	-4.3	8.9
Nonres. structures		1.1	3.3	12.8	6.5	4.9	-1.7	12.7	5.5	1.4
Residential structures		4.0	-1.5	5.6	3.5	10.3	2.8	-2.6	1.3	3.0
Exports		10.5	9.7	9.8	8.5	2.2	4.3	6.7	0.5	5.3
Imports		12.2	5.0	11.2	14.3	11.2	12.0	11.3	0.8	7.4
Gov't. cons. & investment		0.2	-0.8	2.7	2.4	2.6	4.4	1.3	3.2	3.5
Federal		-3.7	-5.3	2.0	0.1	0.8	4.8	-1.3	3.0	3.6
Defense		-5.9	-4.7	0.8	-1.4	-1.0	4.6	-2.0	2.4	2.6
State & local		2.8	2.1	3.0	3.7	3.6	4.2	2.7	3.4	3.5
Change in bus. inventories	Bill. Ch. $	66.8	30.4	30.0	63.8	80.2	45.3	60.9	-8.9	41.2
Nonfarm		53.6	42.6	22.1	60.6	78.7	44.9	55.8	-13.9	39.7
Net exports		-86.5	-78.4	-89.0	-113.3	-221.0	-322.4	-412.4	-435.1	-493.0
Nominal GDP	% change	6.2	4.3	6.0	6.2	5.9	6.5	5.8	3.7	5.3
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employment	Millions	114.1	117.2	119.6	122.7	125.8	128.9	131.8	132.4	132.7
Unemployment rate	%	6.1	5.6	5.4	4.9	4.5	4.2	4.0	4.7	5.5
Industrial prod. index	% change	6.3	3.6	5.6	7.2	3.2	5.1	4.2	-4.2	3.3
Capacity util. rate - mfg.	%	82.5	82.5	81.6	82.7	81.3	80.5	81.3	75.8	75.0
Housing starts	Millions	1.46	1.35	1.48	1.47	1.62	1.64	1.57	1.62	1.65
Light motor vehicle sales		15.01	14.77	15.05	15.06	15.45	16.76	17.25	16.29	15.66
North Amer. produced		12.88	12.87	13.34	13.12	13.43	14.28	14.38	13.35	12.76
Other		2.13	1.90	1.70	1.93	2.02	2.48	2.87	2.94	2.90
INCOME AND SAVING										
Nominal GNP	Bill. $	7071.1	7420.9	7831.2	8325.4	8786.7	9288.2	9958.7	10340.9	10791.8
Nominal GNP	% change	6.2	4.4	5.9	6.0	5.7	6.5	6.0	3.4	5.2
Nominal personal income		5.1	4.3	5.9	6.3	6.3	5.6	5.7	4.4	5.0
Real disposable income		2.9	1.7	2.6	3.8	4.6	3.1	2.2	2.1	4.7
Personal saving rate	%	6.1	5.6	4.8	4.2	4.2	2.2	-0.1	-0.5	0.8
Corp. profits, IVA & CCAdj.	% change	12.3	11.3	11.4	9.9	-5.8	11.2	2.4	-7.4	1.2
Profit share of GNP	%	8.1	9.0	9.6	10.0	9.3	9.2	9.5	8.3	7.9
Excluding FR Banks		7.9	8.7	9.4	9.7	9.0	8.9	9.2	8.0	7.6
Federal surpl./deficit	Bill. $	-212.3	-192.0	-136.8	-53.3	49.0	124.4	251.8	228.5	174.9
State & local surpl./def.		8.6	15.3	21.4	31.0	41.7	50.0	59.6	40.4	42.4
Ex. social ins. funds		4.0	11.4	18.7	29.9	41.3	50.4	60.1	40.7	42.6
Gross natl. saving rate	%	16.3	16.9	17.2	18.0	18.8	18.5	18.3	17.1	17.4
Net natl. saving rate		4.3	5.1	5.7	6.7	7.5	6.8	6.5	4.8	4.8
PRICES AND COSTS										
GDP chn.-wt. price index	% change	2.1	2.1	1.9	1.8	1.2	1.6	2.3	2.2	1.8
Gross Domestic Purchases chn.-wt. price index		2.1	2.1	1.9	1.4	0.8	1.9	2.4	1.9	1.7
PCE chn.-wt. price index		2.1	2.1	2.3	1.5	1.1	2.0	2.3	2.0	1.7
Ex. food and energy		2.3	2.3	1.8	1.7	1.6	1.5	1.6	2.0	1.9
CPI		2.6	2.7	3.2	1.9	1.5	2.6	3.4	2.6	2.0
Ex. food and energy		2.8	3.0	2.6	2.2	2.4	2.0	2.5	2.6	2.5
ECI, hourly compensation[2]		3.1	2.6	3.1	3.4	3.5	3.4	4.4	4.4	3.9
Nonfarm business sector										
Output per hour		1.1	1.1	2.3	2.3	2.8	3.8	3.3	1.5	2.9
Compensation per Hour		2.2	2.6	3.2	3.5	5.1	4.4	5.7	5.4	4.8
Unit labor cost		1.0	1.5	0.9	1.1	2.3	0.6	2.3	3.9	1.9

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

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Class II FOMC

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

June 20, 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	128.5	129.2	130.1	131.0	131.9
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	1.71	1.57	1.65	1.66	1.67	1.59
Light motor vehicle sales		14.99	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	1.2	1.7	2.0	1.7	2.7	2.9	3.1	4.3	2.8
Ex. food and energy		2.6	2.1	2.3	2.3	1.8	2.1	1.8	2.5	2.5	2.7
ECI, hourly compensation[1]		3.0	3.3	4.4	2.6	1.4	4.6	3.4	4.6	5.6	4.7
Nonfarm business sector											
Output per hour		4.7	1.6	1.6	3.2	2.0	0.2	5.0	8.0	2.1	6.3
Compensation per hour		6.3	5.3	4.9	4.0	3.8	4.5	5.2	4.2	4.1	6.0
Unit labor cost		1.6	3.6	3.3	0.7	1.8	4.3	0.2	-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)

June 20, 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	10114.4	10228.8	10318.1	10383.0	10491.2	10624.3	10753.1	10899.5	11051.0
Real GDP	Bill. Ch. $	9369.5	9393.7	9422.7	9437.0	9466.7	9534.2	9609.1	9685.5	9773.9	9864.8
Real GDP	% change	2.2	1.0	1.2	0.6	1.3	2.9	3.2	3.2	3.7	3.8
Gross domestic purchases		3.0	1.5	0.1	1.3	1.8	2.8	3.8	3.8	4.1	3.6
Final sales		2.4	1.7	4.6	-0.4	1.2	2.9	1.9	2.4	3.6	4.0
Priv. dom. final purchases		4.2	2.0	3.1	-0.1	1.5	2.8	2.3	2.9	4.1	3.9
Personal cons. expenditures		4.5	2.8	3.0	1.6	2.3	3.3	1.9	2.2	3.5	3.1
Durables		7.6	-3.1	12.3	-1.8	-1.4	2.2	1.8	1.7	5.8	4.9
Nondurables		4.7	1.0	1.9	0.4	2.1	3.5	1.9	2.8	3.1	3.1
Services		3.7	4.9	1.8	2.9	3.2	3.5	1.9	2.0	3.3	2.8
Business fixed investment		7.7	-0.1	3.1	-8.4	-2.1	0.4	4.9	6.2	7.8	8.2
Equipment & Software		5.6	-3.3	-0.6	-13.0	-3.3	0.3	6.8	8.3	10.1	10.4
Nonres. structures		14.6	10.4	15.2	5.6	1.2	0.5	0.1	1.0	2.1	2.6
Residential structures		-10.6	-3.6	3.8	0.7	-0.8	1.4	2.2	3.8	3.2	2.8
Exports		13.9	-6.4	-2.6	-0.9	0.4	5.4	1.7	4.8	5.6	9.1
Imports		17.0	-1.2	-9.0	4.2	4.7	4.2	6.5	8.5	8.1	6.4
Gov't. cons. & investment		-1.4	2.9	4.9	2.2	2.9	3.0	3.4	3.5	3.5	3.6
Federal		-9.0	3.8	4.9	1.1	3.1	3.0	3.6	3.5	3.5	3.6
Defense		-9.7	8.9	5.4	-1.0	2.6	2.5	2.7	2.7	2.5	2.7
State & local		2.9	2.5	5.0	2.7	2.8	3.0	3.3	3.4	3.5	3.6
Change in bus. inventories	Bill. Ch. $	72.5	55.7	-26.8	-2.4	-1.4	-4.9	26.7	46.6	48.6	43.1
Nonfarm		67.4	50.5	-33.1	-8.1	-6.2	-8.0	24.1	45.0	47.5	42.0
Net exports		-427.7	-441.7	-412.3	-431.0	-448.0	-449.3	-469.9	-489.7	-506.1	-506.5
Nominal GDP	% change	3.8	3.0	4.6	3.5	2.5	4.2	5.2	4.9	5.6	5.7
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	131.9	132.3	132.6	132.4	132.2	132.2	132.3	132.6	132.9	133.2
Unemployment rate	%	4.0	4.0	4.2	4.5	4.9	5.2	5.4	5.5	5.6	5.6
Industrial prod. index	% change	3.5	-0.9	-6.7	-6.1	-4.2	0.5	3.1	3.4	3.7	3.2
Capacity util. rate - mfg.	%	81.7	80.3	77.9	76.1	74.8	74.5	74.6	74.9	75.2	75.4
Housing starts	Millions	1.51	1.54	1.63	1.62	1.61	1.62	1.64	1.65	1.65	1.66
Light motor vehicle sales		17.38	16.17	17.12	16.45	15.90	15.70	15.59	15.59	15.69	15.77
North Amer. produced		14.54	13.30	14.19	13.46	13.02	12.74	12.72	12.70	12.78	12.83
Other		2.84	2.87	2.93	3.00	2.88	2.96	2.87	2.89	2.91	2.94
INCOME AND SAVING											
Nominal GNP	Bill. $	10030.5	10121.8	10228.2	10309.9	10363.1	10462.5	10589.1	10714.8	10857.8	11005.6
Nominal GNP	% change	3.8	3.7	4.3	3.2	2.1	3.9	4.9	4.8	5.4	5.6
Nominal personal income		5.3	3.9	6.0	4.3	4.2	3.1	5.5	4.8	4.9	5.0
Real disposable income		2.6	0.7	2.2	1.8	11.9	-6.6	10.4	2.8	2.8	2.8
Personal saving rate	%	-0.2	-0.7	-1.0	-0.9	1.3	-1.2	0.8	0.9	0.7	0.7
Corp. profits, IVA & CCAdj.	% change	2.8	-21.0	-9.6	-12.1	-10.3	3.3	3.0	-0.3	0.5	1.8
Profit share of GNP	%	9.7	9.0	8.7	8.4	8.1	8.1	8.1	8.0	7.9	7.8
Excluding FR Banks		9.4	8.7	8.4	8.1	7.8	7.8	7.8	7.7	7.6	7.5
Federal surpl./deficit	Bill. $	253.3	277.0	276.1	269.5	101.2	267.2	158.4	168.7	185.4	186.9
State & local surpl./def.		63.2	63.1	40.3	44.5	35.6	41.0	40.5	39.6	42.9	46.6
Ex. social ins. funds		63.6	63.5	40.7	44.8	35.9	41.3	40.7	39.8	43.1	46.8
Gross natl. saving rate	%	18.5	18.0	17.4	17.2	17.0	16.8	17.2	17.4	17.5	17.5
Net natl. saving rate		6.6	6.0	5.3	4.9	4.5	4.3	4.7	4.9	4.9	4.8
PRICES AND COSTS											
GDP chn.-wt. price index	% change	1.6	2.0	3.2	2.9	1.3	1.3	1.9	1.7	1.8	1.8
Gross Domestic Purchases chn.-wt. price index		2.0	1.9	2.8	2.0	1.3	1.4	2.0	1.6	1.7	1.7
PCE chn.-wt. price index		1.8	1.9	3.2	2.1	1.3	1.4	1.6	1.6	1.7	1.8
Ex. food and energy		1.1	1.6	2.6	1.6	1.7	1.9	1.9	1.9	1.9	1.9
CPI		3.5	3.0	4.2	2.9	1.5	1.6	1.8	1.9	2.1	2.1
Ex. food and energy		2.5	2.4	3.1	2.5	2.3	2.5	2.5	2.5	2.5	2.5
ECI, hourly compensation[1]		3.8	3.5	4.6	4.3	4.3	4.2	4.0	4.0	3.9	3.9
Nonfarm business sector											
Output per hour		3.0	2.0	-0.9	2.3	1.5	3.0	3.1	2.8	2.9	2.9
Compensation per hour		6.2	6.6	5.1	6.0	5.3	5.1	5.0	4.8	4.7	4.6
Unit labor cost		3.2	4.5	6.0	3.7	3.8	2.1	2.0	2.0	1.8	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	3.4
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	4.3
Final sales	2.9	5.8	4.4	3.9	4.5	6.5	6.6	3.9	2.4	4.6	4.8	3.6
Priv. dom. final purchases	3.7	5.3	5.2	5.1	4.8	5.3	7.7	4.1	3.5	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	1.8
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	-0.9
Exports	-0.4	1.5	-0.9	0.6	1.1	1.1	0.7	1.5	1.5	0.3	0.5	0.7
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	-0.2
Nonfarm	0.8	-0.7	-0.6	-1.4	1.3	1.3	-1.6	1.6	-0.2	0.0	0.1	-0.2
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	1.0	1.2	0.6	1.3	2.9	3.2	3.2	3.7	3.8	3.4	1.5	3.5
Gross dom. purchases	1.6	0.1	1.3	1.9	2.9	3.9	3.9	4.3	3.8	4.3	1.6	4.0
Final sales	1.7	4.6	-0.4	1.2	2.9	1.9	2.4	3.6	4.0	3.6	2.1	3.0
Priv. dom. final purchases	1.7	2.6	-0.1	1.3	2.4	2.0	2.5	3.5	3.3	4.3	1.6	2.8
Personal cons. expenditures	1.9	2.0	1.1	1.6	2.3	1.3	1.5	2.4	2.1	3.0	1.7	1.8
Durables	-0.3	0.9	-0.2	-0.1	0.2	0.1	0.1	0.4	0.4	0.4	0.2	0.3
Nondurables	0.2	0.4	0.1	0.4	0.7	0.4	0.6	0.6	0.6	0.8	0.4	0.5
Services	1.9	0.7	1.2	1.3	1.4	0.8	0.8	1.3	1.2	1.8	1.1	1.0
Business fixed investment	-0.0	0.4	-1.2	-0.3	0.1	0.6	0.8	1.0	1.0	1.4	-0.2	0.9
Equipment & Software	-0.4	-0.1	-1.4	-0.3	0.0	0.6	0.8	0.9	1.0	1.0	-0.4	0.8
Nonres. structures	0.3	0.5	0.2	0.0	0.0	0.0	0.0	0.1	0.1	0.4	0.2	0.1
Residential structures	-0.2	0.2	0.0	-0.0	0.1	0.1	0.2	0.1	0.1	-0.1	0.1	0.1
Net exports	-0.6	1.1	-0.7	-0.6	-0.0	-0.7	-0.7	-0.6	0.0	-0.9	-0.1	-0.5
Exports	-0.7	-0.3	-0.1	0.0	0.6	0.2	0.5	0.6	0.9	0.7	0.1	0.6
Imports	0.2	1.4	-0.6	-0.7	-0.6	-0.9	-1.2	-1.1	-0.9	-1.6	-0.1	-1.0
Government cons. & invest.	0.5	0.8	0.4	0.5	0.5	0.6	0.6	0.6	0.7	0.2	0.6	0.6
Federal	0.2	0.3	0.1	0.2	0.2	0.2	0.2	0.2	0.2	-0.1	0.2	0.2
Defense	0.3	0.2	-0.0	0.1	0.1	0.1	0.1	0.1	0.1	-0.1	0.1	0.1
Nondefense	-0.1	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	0.6	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.3	0.4	0.4
Change in bus. inventories	-0.6	-3.3	1.0	0.1	-0.0	1.3	0.8	0.1	-0.2	-0.2	-0.6	0.5
Nonfarm	-0.6	-3.3	1.0	0.1	-0.1	1.3	0.8	0.1	-0.2	-0.2	-0.6	0.5
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

June 20, 2001

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

Item	Fiscal year[1]				2000				2001				2002			
	1999[a]	2000[a]	2001	2002	Q1[a]	Q2[a]	Q3[a]	Q4[a]	Q1[a]	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Unified budget					Not seasonally adjusted											
Receipts[2]	1827	2025	2070	2154	434	656	492	461	460	670	478	515	452	666	521	497
Outlays[2]	1703	1789	1884	1940	449	444	431	464	482	463	476	494	486	483	477	511
Surplus/deficit[2]	125	236	185	214	-15	212	60	-2	-22	207	3	21	-34	183	45	-14
On-budget	1	87	21	40	-45	147	50	-14	-88	138	-15	-29	-62	107	23	-70
Off-budget	124	150	164	174	30	65	10	12	65	69	18	50	27	75	21	56
Surplus excluding deposit insurance	119	233	183	212	-18	211	60	-3	-23	207	2	21	-35	182	44	-14
Means of financing																
Borrowing	-89	-223	-154	-195	-27	-190	-54	-25	24	-161	9	-30	20	-133	-52	-6
Cash decrease	-18	4	9	-1	39	-13	5	32	-7	-20	5	14	10	-40	15	20
Other[3]	-18	-18	-40	-18	4	-10	-12	-4	6	-26	-16	-5	4	-10	-7	0
Cash operating balance, end of period	56	53	44	45	45	57	53	21	28	48	44	30	20	60	45	25
NIPA federal sector					Seasonally adjusted annual rates											
Receipts	1837	2024	2105	2152	2012	2055	2089	2107	2141	2157	2014	2190	2113	2138	2168	2198
Expenditures	1735	1806	1873	1957	1776	1814	1836	1830	1862	1887	1912	1923	1954	1969	1982	2012
Consumption expenditures	464	489	506	538	479	499	490	489	508	511	516	521	538	543	549	555
Defense	306	320	332	348	311	326	320	322	334	335	337	340	349	351	354	357
Nondefense	158	168	174	189	168	173	170	167	173	177	179	181	189	192	195	198
Other spending	1270	1317	1367	1419	1297	1315	1346	1341	1354	1376	1396	1402	1416	1426	1433	1457
Current account surplus	103	218	232	195	236	241	253	277	279	269	101	267	159	169	185	187
Gross investment	94	104	112	117	101	106	104	113	110	112	113	115	117	118	119	121
Current and capital account surplus	9	114	120	78	134	135	149	164	170	158	-12	152	42	51	66	66
Fiscal indicators[4]																
High-employment (HEB) surplus/deficit	-67	5	54	57	29	17	35	69	90	101	-45	125	23	34	48	45
Change in HEB, percent of potential GDP	-.8	-.8	-.5	-0	-1	.1	-.2	-.3	-.2	-.1	1	-2	1	-.1	-.1	0
Fiscal impetus (FI) percent, calendar year	5	2	9	12	-6	6	-2	.3	2	2	12	-8	10	1	.8	1

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 April 2001 baseline surplus estimates are $284 billion in FY2001 and $283 billion in FY 2002. CBO's May 2001 baseline surplus estimates, assuming discretionary spending grows with inflation beginning in FY 2002, are $275 billion in FY2001 and $304 billion in FY 2002. These baseline estimates exclude the recently enacted tax bill which, according to estimates from the Joint Commitee on Taxation, will reduce the surplus by $74 billion in FY 2001 and by $38 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						Memo: Nominal GDP
			Total [4]	Households			Business	State and local governments	
				Total	Home mortgages	Consumer credit			
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	6.5	7.0	4.3	8.9	5.3	6.2
1998	6.6	-1.4	9.3	8.5	9.6	5.4	10.7	7.2	5.9
1999	6.7	-1.9	9.3	8.8	9.8	7.1	10.9	4.4	6.5
2000	5.0	-8.0	8.5	8.6	8.6	9.3	9.6	2.2	5.8
2001	4.7	-4.7	6.8	7.2	7.5	6.6	6.5	6.1	3.7
2002	4.5	-5.3	6.5	6.4	7.3	4.2	7.5	2.5	5.3
Quarter									
1999:3	6.9	-1.9	9.3	9.1	10.3	5.5	10.7	4.3	6.7
4	6.1	-0.9	8.1	7.6	8.3	7.8	9.8	2.7	9.7
2000:1	5.3	-5.9	8.3	7.9	6.9	10.2	10.4	0.3	8.3
2	5.4	-11.4	9.8	9.5	9.9	9.4	11.8	1.7	8.2
3	4.2	-6.2	6.8	8.0	8.5	8.2	6.4	1.9	3.8
4	4.6	-9.6	8.0	8.1	8.1	8.1	8.5	4.8	3.0
2001:1	5.3	-0.3	6.6	7.8	7.8	9.9	5.1	7.0	4.6
2	4.1	-8.9	7.0	7.3	7.2	7.4	7.1	4.8	3.5
3	5.6	0.9	6.6	6.6	7.0	4.9	6.4	8.0	2.5
4	3.4	-10.6	6.4	6.4	7.1	3.4	6.9	4.0	4.2
2002:1	5.1	-0.8	6.3	6.2	7.0	4.4	7.2	2.5	5.2
2	4.3	-5.8	6.3	6.1	7.0	3.8	7.3	2.4	4.9
3	4.3	-6.7	6.4	6.3	7.1	4.2	7.4	2.4	5.6
4	4.1	-8.3	6.4	6.3	7.1	4.3	7.3	2.4	5.7

Note. Quarterly data are at seasonally adjusted annual rates.
1. Data after 2001:Q1 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 4.9 percent in 2001 and 4.4 percent in 2002.
3. On a monthly average basis, federal debt is projected to grow -4.5 percent in 2001 and -5.7 percent in 2002.
4. On a monthly average basis, nonfederal debt is projected to grow 7.0 percent in 2001 and 6.5 percent in 2002.

2.6.3 FOF

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

	Calendar year				Seasonally adjusted annual rates									
					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	945.3	696.0	810.1	821.1	664.5	434.3	931.6	672.0	1025.8	611.0	922.3	785.4	801.2	775.6
2 Net equity issuance	-143.5	-166.6	-46.7	-45.1	-87.7	-394.8	-33.9	-90.4	-25.7	-36.7	-53.9	-47.6	-42.0	-36.8
3 Net debt issuance	1088.8	862.7	856.8	866.2	752.2	829.1	965.5	762.4	1051.5	647.7	976.2	833.0	843.2	812.4
Borrowing sectors														
Nonfinancial business														
4 Financing gap [1]	205.3	265.5	241.0	297.5	281.2	299.8	217.2	247.3	254.2	245.2	277.1	291.8	308.9	312.2
5 Net equity issuance	-143.5	-166.6	-46.7	-45.1	-87.7	-394.8	-33.9	-90.4	-25.7	-36.7	-53.9	-47.6	-42.0	-36.8
6 Credit market borrowing	575.3	565.2	420.6	516.2	397.6	537.9	326.5	466.5	423.7	465.7	492.7	510.7	529.6	531.7
Households														
7 Net borrowing [2]	532.4	566.2	516.3	488.1	550.5	565.2	559.9	532.8	492.2	480.6	475.6	476.5	494.1	506.5
8 Home mortgages	409.8	397.8	374.0	390.5	407.3	399.5	390.3	365.2	365.2	375.2	376.2	385.2	395.2	405.2
9 Consumer credit	94.4	132.3	102.7	70.7	122.5	123.7	155.6	118.7	79.7	57.0	73.4	64.0	71.6	74.0
10 Debt/DPI (percent) [3]	94.9	98.1	101.1	102.4	98.4	99.8	100.5	101.4	100.0	103.1	101.7	102.2	102.6	103.0
State and local governments														
11 Net borrowing	52.3	27.2	78.2	33.4	23.6	60.4	89.9	62.8	105.8	54.4	33.4	33.4	33.4	33.4
12 Current surplus [4]	196.8	220.9	216.9	229.2	225.6	229.1	211.5	220.7	214.0	221.7	223.5	225.0	230.8	237.3
Federal government														
13 Net borrowing	-71.2	-295.9	-158.4	-171.5	-219.5	-334.5	-10.8	-299.7	29.8	-353.0	-25.4	-187.6	-213.9	-259.2
14 Net borrowing (quarterly, n.s.a.)	-71.2	-295.9	-158.4	-171.5	-53.8	-25.0	23.7	-161.0	8.6	-29.7	20.0	-132.9	-52.4	-6.2
15 Unified deficit (quarterly, n.s.a.)	-158.3	-254.8	-208.8	-178.8	-60.4	2.3	22.5	-207.3	-2.7	-21.2	34.3	-182.5	-44.6	14.1
Depository institutions														
16 Funds supplied	404.3	446.6	242.5	279.2	456.0	268.8	197.9	228.0	265.8	278.5	258.7	273.7	291.7	292.7
Memo (percentage of GDP)														
17 Domestic nonfinancial debt [5]	180.9	178.9	180.5	180.5	178.8	179.5	179.7	180.3	181.3	181.5	181.1	181.0	180.5	179.9
18 Domestic nonfinancial borrowing	11.7	8.7	8.3	8.0	7.5	8.2	9.4	7.4	10.1	6.2	9.2	7.7	7.7	7.4
19 Federal government [6]	-0.8	-3.0	-1.5	-1.6	-2.2	-3.3	-0.1	-2.9	0.3	-3.4	-0.2	-1.7	-2.0	-2.3
20 Nonfederal	12.5	11.6	9.8	9.6	9.7	11.5	9.5	10.3	9.8	9.5	9.4	9.5	9.7	9.7

Note. Data after 2001:Q1 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

Once again, we have marked down our estimate of foreign economic growth in the first half of this year, as recent data from Latin America, Japan, and many Asian developing countries have been weaker than anticipated. Canada is the only major trading partner for which data have surprised us on the upside, but Canadian growth is still weaker than in the previous few years.

We have adjusted down our projections for growth in the second half of 2001 nearly everywhere, reflecting our revised assessment of the implications of the high-tech slowdown for the United States and the rest of the world. With reduced high-tech investment and with inflation data coming in a little higher than expected in many countries, we have also lowered our estimates of the levels and growth rates of foreign potential output.

With the projected return of U.S. output growth to its potential rate and some stimulus from macroeconomic policy abroad, we expect foreign economic growth to pick up in 2002 to roughly the rate of potential growth. Because foreign activity should remain a little below potential over the rest of the forecast period, we do not expect a generalized acceleration of foreign price pressures in 2002.

Summary of Staff Projections

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

Indicator	2000		Projection			
			2001			2002
	H1	H2	Q1	Q2	H2	
Foreign output	5.5	2.7	1.1	1.4	2.3	3.4
May GB	*5.6*	*2.9*	*1.7*	*1.7*	*2.9*	*3.7*
Foreign CPI	2.1	3.5	1.5	3.0	3.1	2.7
May GB	*2.1*	*3.5*	*1.4*	*2.5*	*3.0*	*2.7*

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

Oil prices have held fairly steady in the past few weeks. In line with futures prices, we continue to project a gradual decline over the forecast period toward roughly the same level we projected in the May Greenbook. The foreign exchange value of the dollar has strengthened slightly since our last projection. We are forecasting a 1 percent depreciation of the broad real dollar index over the next six quarters, to a level in 2002:Q4 that is a bit higher than its projected value in the May Greenbook.

Real net exports of goods and services are expected to make essentially a zero arithmetic contribution to U.S. GDP growth this year as the sharp slowdown in U.S. activity has reduced imports by enough to offset the effects of slowing foreign growth and a strong dollar on U.S. exports. In 2002, we project that net exports will resume making a negative arithmetic contribution to growth. However, the projected ½ percentage point negative contribution is about half of the average magnitude of the net export contribution in the last three years.

Recent Developments

International financial markets. The index of the exchange value of the dollar in terms of the major currencies has risen ¾ percent since the May FOMC meeting, as the dollar's appreciation against European currencies was only partially offset by its depreciation against the Canadian dollar. Market participants' disappointment with weak data releases in the United States seems to have been more than matched by their disappointment with weak data in Europe. In contrast, Canadian data releases were more positive.

Early in the intermeeting period, the Bank of Canada lowered its policy interest rate by 25 basis points, citing reduced demand for exports to the United States. There were no other changes in the policy interest rates of the major foreign industrial countries during this period. Long-term rates generally declined in these countries, but by less than the drop in U.S. long rates. Broad equity indexes in most major industrial countries moved lower over the period, especially in Japan, where share prices fell 8½ percent as the market optimism that followed Prime Minister Koizumi's election began to fade.

The dollar's exchange value against the currencies of our other important trading partners was also up slightly, on balance, over the intermeeting period. Significant appreciation of the dollar against the Brazilian *real* and the Taiwan dollar outweighed modest depreciation against the Mexican peso. The larger-than-expected bond exchange by the Argentine government led to sharp declines in Argentine short- and long-term interest rates. Subsequently, rates reversed part of this decline on market concerns about the exchange-rate-linked system of import taxes and export subsidies that was announced on June 15. Movements of emerging-market equity indexes were mixed over the intermeeting period.

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

Economic activity abroad. Although the timing and magnitude of the slowdown differ across countries, data through the first quarter of 2001 reveal a sharp reduction in GDP growth rates in nearly all industrial countries since early last year. In Japan, output declined in 2001:Q1, with exports and private investment both down sharply. Indicators point to a further decline in the current quarter. The euro area experienced 2¼ percent growth in the first quarter, but this rate is down from 3 percent growth last year, and current-quarter indicators for the manufacturing sector suggest further slowing. U.K. growth began to fade in 2000:Q4, and it remained near 1¾ percent in the first quarter. After slowing sharply late last year, Canadian growth picked up modestly to 2½ percent in the first quarter. But Canadian manufacturers have been hit hard by the U.S. slowdown, and growth is likely to fall back in the current quarter.

Higher food and energy prices have boosted rates of headline consumer price inflation significantly in Europe and Canada. In the euro area, headline inflation in May was almost 1½ percentage points above the ECB's target ceiling of 2 percent, and core inflation edged above 2 percent as well. Core inflation also moved up in Canada. In Japan, consumer prices continued to fall by about 1 percent per year.

The economic slowdown has intensified in most of the major developing countries this year, with the notable exception of China, where strong growth was supported by robust domestic demand. Other developing Asian economies have seen much weaker growth, with first-quarter output declines in the Philippines, Singapore, Taiwan, and Thailand. Growth rates were positive, but low, in Hong Kong and Korea. The drop in electronics exports and imports has been particularly pronounced for many of these countries. In Mexico, output declined for a second consecutive quarter in 2001:Q1 as exports dropped. Brazilian economic activity decelerated further in the first quarter as the spillover from Argentina's difficulties and pessimism on political fronts sapped the economy's momentum. After two years of contraction, Argentina's economy showed some signs of growth late last year, but recent indicators are mixed.

Prices of internationally traded goods. The spot price of West Texas intermediate crude has been in the relatively narrow range of $27 to $30 per barrel over the intermeeting period and is now at the bottom end of this range. On June 4, Iraq suspended oil exports through the U.N. oil-for-food program to protest the revisions to the sanctions framework that are currently being debated by the U.N. Security Council. However, OPEC officials pledged to counteract any significant supply disruption from Iraq, and market participants appear to believe that the effect on oil supplies will be small. Crude oil price movements may also have been damped by the increased levels of crude oil inventories, particularly in the United States. After rising nearly 3 percent (a.r.) in the first quarter, prices of imported non-oil core goods are estimated to have fallen 5 percent in the second quarter based on April and May data. The increase and decrease largely reflect the spike of imported natural gas prices last winter. For April and May combined, the prices of exported core goods declined at an annual rate of about 1 percent.

U.S. international transactions. The U.S. trade deficit in goods and services was $31 billion in March, somewhat larger than the surprisingly small deficit in February. For the first quarter, the deficit at an annual rate was $365 billion, significantly smaller than in the fourth quarter of last year.

In the first quarter, the value of exports declined 3 percent at an annual rate, the second consecutive quarter of negative growth. The largest declines were in automotive products (primarily cross-border trade with Canada), machinery (both high tech and other), and industrial supplies. Goods exports to most regions declined, with the notable exception of exports to Europe.

The value of imports of goods and services rebounded in March after dropping sharply in February, to a level that was nonetheless lower than that recorded in any of the preceding eight months. In the first quarter, the value of imports fell 10 percent at an annual rate. The largest declines in the first quarter were in high-tech machinery, automotive products (primarily from Canada), and oil (entirely from a drop in price). In contrast, there were moderately strong increases in imports of consumer goods and non-oil industrial supplies.

Outlook

The dollar. As in the May Greenbook, we project that the exchange value of the dollar will remain constant in nominal terms against the yen and the euro over the forecast period while depreciating slightly against the Canadian dollar. Factoring in some real dollar depreciation owing to inflation rate differentials with many of our other important trading partners, we project that the broad real dollar index will decline about 1 percent over the six-quarter forecast period, a bit less than in our previous forecast. This more modest depreciation from a slightly higher starting point results in a projected dollar path that is above that in the May Greenbook throughout the forecast period. As before, we continue to believe that a sharp depreciation of the dollar remains a risk as long as the United States maintains a large trade deficit.

Foreign industrial countries. Relative to the May Greenbook, we have extended the projected period of weak growth in the foreign industrial countries through the third quarter of this year, but we still expect a modest revival of growth by the end of the year. This path is closely aligned with the revised pattern of projected U.S. growth and it also reflects our assessment of the effects of macroeconomic policies abroad. For 2002, we anticipate industrial-country growth of 2¾ percent, down a touch from the May Greenbook.

In the euro area, growth is projected to slow to 1½ percent in the second quarter, down from 2¼ percent in the first quarter, as domestic demand remains weak. Growth should rise slightly later this year and reach 2½ percent in 2002 as inventory overhangs are reduced. Although we expect little additional stimulus from ECB policy, this year's tax reductions in several euro-area countries and moderating oil prices should support activity. Second-quarter growth in the United Kingdom is expected to be 1½ percent, about the same as in the first quarter. We expect growth to be supported by continued strength in the service sector and to pick up in the second half of this year as the monetary stimulus of the past few months kicks in. In Canada, growth in the current quarter is projected to be just 1¼ percent and should rebound as the U.S. economy recovers and as the monetary and fiscal stimulus already in place bolsters domestic demand.

Headline inflation rates in Canada and Europe are projected to peak in the current quarter and to decline gradually thereafter as prices for food and energy moderate and as weak growth reduces pressures on resources. Despite the weaker growth outlook, we are less optimistic about the prospects for core inflation than previously because we have also revised down our estimate of potential output.

Japanese economic output, which declined in the first quarter, is projected to contract further over the remainder of this year and then to expand at just a 1 percent pace in 2002. This forecast largely reflects a further retrenchment in private investment over the rest of this year followed by a modest rebound next year. However, the outcome of the July Upper House elections and the subsequent policy actions of the Japanese government, as well as their impact on the economy, are very difficult to predict at this point. We continue to project modest deflation throughout the forecast period.

Foreign central banks are assumed to continue easing monetary policy, but at a slower rate than so far this year. The Bank of Canada is expected to trim rates another 25 basis points this summer, in addition to the 125 basis points of easing undertaken so far this year. The ECB is expected to reduce official rates another 25 basis points in the second half of this year. The Bank of Japan is not expected to change the stance of monetary policy.

Other countries. Since the May Greenbook, we have significantly lowered our outlook for growth in the major developing-country trading partners of the United States. This downward revision is our reaction to weaker-than-expected incoming data on economic activity as well as a worsened outlook for exports by emerging market economies of high-tech products. We now estimate that average real GDP in the major developing countries increased at only a 1 percent rate in the first half of this year, a percentage point slower than forecast in the May Greenbook. Growth is then expected to strengthen gradually, moving up to 4½ percent by the end of next year, led by exports. For these countries, recovery depends importantly on the projected strengthening in global growth, particularly growth in the United States. For several of the developing Asian economies, recovery in the global high-tech sector is critical. Our outlook for Latin America assumes that developments in Argentina do not have significant additional spillover effects.

Prices of internationally traded goods. In line with recent futures quotes, we project that the spot price of WTI will hold near $28 per barrel into the fourth quarter of this year, but will then decline to around $25 per barrel by the end of next year. Prices of non-oil core imports are projected to decline in the current quarter, moving in response to swings in natural gas prices, before rising a bit during the second half of the year. In 2002, core prices accelerate to a 2 percent rate, reflecting the slight depreciation of the dollar and a modest acceleration of non-oil commodity prices. Prices of exported core goods are projected to decline a bit through most of this year and increase at an average rate of about 1 percent next year, as declines in energy-related products are eventually more than offset by modest increases in the prices of other exported goods.

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

Trade category	2000		Projection			
			2001			2002
	Q3	Q4	Q1	Q2	H2	
Exports						
Core goods	.1	1.1	.0	-1.3	-.2	.9
Imports						
Non-oil core goods	1.4	1.0	1.9	-5.2	1.4	2.1
Oil (dollars per barrel)	28.73	29.11	25.28	24.38	24.65	21.95

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

U.S. international transactions. Real imports of goods and services are estimated to have declined 9 percent at an annual rate in the first quarter, a somewhat smaller decline than we had written down in the May Greenbook. This decline was broadly based, with the steepest declines recorded in high-tech products and other machinery, automotive products, and consumer goods, consistent with the marked slowdown of U.S. activity. The modest pickup in real imports estimated to have begun in the current quarter is attributable primarily to the effects of the strong dollar. Imports should accelerate further next year as U.S. growth gathers momentum.

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

Measure	2000		Projection			
			2001			2002
	Q3	Q4	Q1	Q2	H2	
Real exports	13.9	-6.4	-2.6	-0.9	2.9	5.3
May GB	*13.9*	*-6.4*	*-2.0*	*0.6*	*4.9*	*6.5*
Real imports	17.0	-1.2	-9.0	4.2	4.5	7.4
May GB	*17.0*	*-1.2*	*-10.8*	*3.2*	*6.5*	*7.9*

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

We estimate that real exports of goods and services declined 2½ percent (a.r.) in the first quarter after a 6½ percent decline in the previous quarter. The downward shift in real exports during those quarters was shared by many categories, with the largest declines in high-tech goods and automotive products. This decline owes to weak foreign growth and the dollar's strength. These factors are also expected to hold down exports in the current quarter. Going forward, despite the lingering contractionary effects of past dollar appreciation, exports are projected to accelerate by the end of this year, as foreign economic growth rebounds.

We project that the contribution of exports to U.S. GDP growth will be negligible in 2001 and rise to ½ percentage point in 2002. Imports are also expected to make a negligible contribution in 2001 and a negative arithmetic contribution of 1 percentage point in 2002. Overall, the arithmetic contribution of the foreign sector to GDP growth is near zero in 2001 and moves to a negative ½ percentage point next year. The U.S. current account deficit as a share of GDP is projected to drop in the first two quarters of this year to just over 4 percent (compared with 4½ percent in the second half of last year), reflecting a larger drop in imports than exports. We expect the deficit will increase to over 4½ percent of GDP in the second half of 2001 and rise to nearly 5 percent in 2002. Much of the projected movement in the current account is in the goods and services account, but the net outflow of investment income also increases substantially as the U.S. net liability position expands.

Alternative simulations. One risk to our outlook is that the economic slump in Asia will be more prolonged and serious. Accordingly, we use the FRB/Global model to quantify the risk to the U.S. outlook of a shock to major U.S. trading partners in Asia. This scenario assumes an autonomous fall in domestic demand both in Japan and in major developing economies in Asia that would depress output in those regions 2 percent of baseline GDP by year-end 2001 in the absence of any endogenous adjustment. This shock is coupled with an exogenous rise in the risk premium on the currencies of the Asian economies. The risk premium shock induces an immediate real depreciation of the yen against the dollar of about 30 percent in 2000:Q3, while other major Asian currencies experience a real depreciation of roughly half that magnitude.

Two cases of this alternative are considered: The first case assumes no U.S. monetary policy response and holds the real federal funds rate unchanged from its baseline path, while the second assumes that policy is adjusted according to a Taylor rule. (In both cases, the major foreign central banks adjust interest rates according to a Taylor rule, subject to a zero-bound constraint on nominal interest rates.)

In the case in which U.S. monetary policy does not respond, annual U.S. real GDP growth is 0.3 percentage point lower in 2001:H2, and also 0.3 percentage point lower in 2002. U.S. net exports deteriorate due both to a fall in domestic absorption in the Asian economies and to a sizable real appreciation of the U.S. dollar. The appreciation of the dollar puts immediate downward pressure on U.S. import prices and eventually depresses core consumer prices. The PCE inflation rate falls 0.1 percentage point below baseline in 2001:H2 and 0.4 percentage point in 2002.

In the case with a U.S. monetary policy response, the initial effects on output and inflation are similar to those with the real funds rate unchanged. However, the Taylor rule response implies a progressive fall in the nominal funds rate to around 75 basis points below baseline by year-end 2002. This induces a rise in U.S. domestic demand that partially offsets the effects of the external shock, and succeeds in stabilizing output growth at baseline by the second half of next year. Because of longer lags in the inflation adjustment process, the two alternative U.S. monetary policy assumptions have similar consequences for inflation during the six-quarter simulation horizon.

Alternative Simulations:
Asian Gloom
(Percent change from previous period, annual rate)

Indicator and simulation	2001		2002	
	H1	H2	H1	H2
U.S. real GDP				
Baseline	0.9	2.1	3.2	3.7
Currency and domestic demand shocks in Japan and developing Asia				
Unchanged real funds rate	0.9	1.8	2.9	3.4
Taylor rule	0.9	1.8	2.9	3.7
U.S. PCE prices excl. food and energy				
Baseline	2.1	1.8	1.9	1.9
Currency and domestic demand shocks in Japan and developing Asia				
Unchanged real funds rate	2.1	1.7	1.5	1.5
Taylor rule	2.1	1.7	1.5	1.5

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

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

Measure and country	1994	1995	1996	1997	1998	1999	2000	--Projected- 2001	2002
REAL GDP (1)									
Total foreign	5.1	2.4	4.1	4.2	1.4	4.8	4.1	1.8	3.4
Industrial Countries	4.0	1.9	2.6	3.5	2.6	3.8	3.1	1.6	2.7
of which:									
Canada	5.3	1.5	2.6	4.5	4.2	5.1	3.5	2.2	3.1
Japan	1.7	2.6	2.9	0.7	-1.4	0.4	2.5	-1.1	1.0
United Kingdom	4.6	1.9	2.9	3.5	2.0	3.2	2.6	2.0	2.6
Euro Area (2)	3.0	1.4	1.6	3.1	2.1	3.4	2.9	1.8	2.6
Germany	2.9	1.1	1.3	1.6	1.0	2.5	2.6	1.2	2.2
Developing Countries	6.8	3.1	6.2	5.1	-0.2	6.2	5.4	1.9	4.4
Asia	8.8	7.2	7.0	4.7	-2.0	8.8	6.1	1.9	4.7
Korea	9.1	7.5	6.4	3.4	-5.2	13.8	5.2	2.0	4.2
China	16.3	12.6	9.2	8.2	9.5	6.2	7.4	7.3	7.6
Latin America	5.3	-3.7	6.0	6.1	1.3	4.3	4.8	1.7	4.1
Mexico	5.2	-7.1	7.1	6.7	2.8	5.5	5.2	1.6	4.4
Brazil	10.2	-0.7	3.4	2.3	-0.8	3.5	4.2	1.6	2.9
CONSUMER PRICES (3)									
Industrial Countries	1.1	1.3	1.4	1.5	1.0	1.1	1.9	1.5	1.2
of which:									
Canada	-0.0	2.0	2.0	1.0	1.1	2.4	3.1	2.2	1.9
Japan	0.8	-0.8	0.1	2.0	0.8	-1.3	-1.1	-0.6	-0.7
United Kingdom (4)	2.2	2.9	3.2	2.7	2.5	2.2	2.1	2.2	2.4
Euro Area (2)	NA	NA	1.9	1.5	0.8	1.5	2.7	2.3	1.9
Germany	2.8	1.4	1.3	1.5	0.3	1.1	2.5	2.3	1.3
Developing Countries	22.9	16.9	10.7	6.8	9.0	4.6	4.2	4.2	4.8
Asia	10.8	6.4	4.2	2.8	4.4	0.2	1.9	2.5	3.7
Korea	5.8	4.3	5.0	4.9	5.9	1.2	2.8	4.1	3.0
China	26.9	11.1	6.8	0.9	-1.2	-0.9	0.9	1.6	3.8
Latin America	54.0	42.0	25.8	15.5	15.4	12.5	8.4	6.4	6.5
Mexico	7.0	48.7	28.0	17.0	17.4	13.6	8.8	6.5	6.7
Brazil	1196.9	21.5	9.6	4.6	1.5	8.2	6.1	5.9	5.0

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

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

Measure and country	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	7.5	3.5	3.8	1.5	1.1	1.4	1.9	2.8	3.4	3.2	3.5	3.6
Industrial Countries	5.7	2.4	2.4	2.0	1.8	1.1	1.3	2.3	2.7	2.7	2.8	2.8
of which:												
Canada	6.1	1.9	4.5	1.6	2.5	1.3	1.8	3.0	3.1	3.1	3.2	3.2
Japan	10.0	0.5	-2.7	2.6	-0.8	-1.2	-2.3	-0.2	1.1	0.7	1.0	1.3
United Kingdom	1.6	3.6	3.4	1.6	1.7	1.5	2.3	2.6	2.5	2.7	2.7	2.7
Euro Area (2)	3.8	3.0	2.4	2.4	2.2	1.4	1.7	2.1	2.5	2.5	2.6	2.6
Germany	3.9	4.8	1.1	0.8	1.5	0.7	1.0	1.7	2.2	2.2	2.3	2.3
Developing Countries	10.3	5.0	5.8	0.6	0.0	1.7	2.6	3.5	4.3	4.0	4.5	4.7
Asia	10.9	4.4	6.5	2.7	0.2	1.3	2.4	3.5	4.7	4.0	4.8	5.1
Korea	6.6	6.4	9.8	-1.7	1.2	2.0	2.0	3.0	3.5	4.0	4.5	5.0
China	9.6	1.9	11.0	7.5	12.3	2.0	7.5	7.5	12.0	3.0	7.5	8.0
Latin America	10.4	5.5	4.8	-1.3	-0.9	1.7	2.5	3.4	4.0	4.0	4.1	4.1
Mexico	12.0	6.0	5.7	-2.4	-1.4	1.5	2.5	3.8	4.4	4.4	4.5	4.5
Brazil	5.4	5.9	4.5	1.0	0.4	2.0	2.0	2.0	2.5	2.7	3.0	3.2
CONSUMER PRICES (3)	Four-quarter changes											
Industrial Countries	1.6	1.5	1.7	1.9	1.8	2.0	1.7	1.5	1.5	1.3	1.3	1.2
of which:												
Canada	2.7	2.4	2.7	3.1	2.8	2.8	2.4	2.2	2.4	2.3	2.1	1.9
Japan	-0.8	-0.9	-1.1	-1.1	-0.6	-0.5	-0.7	-0.6	-1.1	-0.8	-0.8	-0.7
United Kingdom (4)	2.1	2.1	2.1	2.1	1.9	2.1	2.2	2.2	2.4	2.4	2.4	2.4
Euro Area (2)	2.0	2.1	2.5	2.7	2.5	3.0	2.6	2.3	2.3	1.7	1.8	1.9
Germany	2.0	1.7	2.2	2.5	2.4	3.2	2.6	2.3	1.8	1.2	1.2	1.3
Developing Countries	3.9	3.8	4.0	4.2	3.8	4.1	4.1	4.2	5.1	5.2	5.1	4.8
Asia	0.5	0.8	1.4	1.9	1.8	2.5	2.5	2.5	3.2	3.6	3.7	3.7
Korea	1.5	1.5	3.2	2.8	4.2	5.2	4.1	4.1	3.9	3.3	3.0	3.0
China	0.1	0.2	0.3	0.9	0.6	1.5	1.6	1.6	2.4	3.3	3.7	3.8
Latin America	10.0	9.2	8.7	8.4	7.2	6.9	6.5	6.4	7.6	7.5	7.0	6.5
Mexico	10.5	9.6	9.0	8.8	7.5	7.0	6.6	6.5	8.0	7.8	7.3	6.7
Brazil	7.8	6.7	7.6	6.1	6.2	6.9	5.8	5.9	6.0	5.9	5.4	5.0

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

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OUTLOOK FOR 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	-0.9	-0.1	-0.5
Exports of G&S	1.0	1.0	1.1	1.0	0.3	0.5	0.7	0.1	0.6
Imports of G&S	-1.3	-0.6	-1.3	-1.7	-1.4	-1.5	-1.6	-0.1	-1.0
	Percentage change, Q4/Q4								
Exports of G&S	10.5	9.7	9.8	8.5	2.2	4.3	6.7	0.5	5.3
Services	8.2	8.8	8.9	1.4	2.8	0.2	2.7	1.3	5.6
Computers	27.4	39.1	21.6	25.8	7.0	13.3	23.7	5.6	25.1
Semiconductors	66.9	79.6	44.6	21.3	9.3	34.4	26.3	-8.8	25.7
Other Goods 1/	7.9	4.6	7.3	9.8	1.2	3.7	5.8	0.6	2.1
Imports of G&S	12.2	5.0	11.2	14.3	11.2	12.0	11.3	0.8	7.4
Services	1.8	5.5	5.3	14.0	9.5	2.1	13.2	3.4	5.1
Oil	-0.2	2.4	7.8	3.9	4.6	-3.9	12.6	2.9	2.1
Computers	39.0	35.0	17.8	33.0	26.7	25.0	14.7	-1.5	25.1
Semiconductors	54.5	92.4	56.7	32.9	-7.3	34.0	23.4	-14.6	25.7
Other Goods 2/	12.3	-1.2	10.5	12.7	11.6	13.9	10.0	0.9	6.4
	Billions of chained 1996 dollars								
Net Goods & Services	-86.5	-78.4	-89.0	-113.3	-221.0	-322.4	-412.4	-435.1	-493.0
Exports of G&S	732.8	808.2	874.2	981.5	1003.6	1033.0	1126.3	1134.4	1175.1
Imports of G&S	819.4	886.6	963.1	1094.8	1224.6	1355.3	1538.7	1569.6	1668.1
	Billions of dollars								
US CURRENT ACCOUNT BALANCE	-118.6	-109.5	-123.3	-140.5	-217.1	-331.5	-435.8	-452.4	-533.0
Current Acct as Percent of GDP	-1.7	-1.5	-1.6	-1.7	-2.5	-3.6	-4.4	-4.4	-4.9
Net Goods & Services (BOP)	-97.0	-96.0	-102.1	-105.9	-166.9	-265.0	-368.9	-373.9	-427.6
Investment Income, Net	21.1	25.0	23.4	11.1	-1.0	-13.1	-8.1	-18.7	-44.5
Direct, Net	55.2	64.9	69.4	71.9	67.7	62.7	83.8	90.4	80.6
Portfolio, Net	-34.1	-39.9	-46.0	-60.9	-68.8	-75.8	-91.9	-109.1	-125.1
Other Income & Transfers,Net	-42.7	-38.6	-44.6	-45.7	-49.2	-53.4	-58.8	-59.8	-60.8

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

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OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	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	-0.8	-0.9	-1.6	-1.9	-1.0	0.1	-1.4	-1.3	-1.0	-0.3
Exports of G&S	0.8	1.9	1.2	-0.1	0.1	-0.3	-0.4	1.5	-0.9	0.6	1.1	1.1
Imports of G&S	-1.8	-2.2	-2.0	-0.8	-1.7	-1.6	-0.7	-1.5	-0.6	-1.9	-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
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/	8.4	19.2	10.9	1.5	-0.3	-7.2	-2.3	15.9	-13.2	3.7	13.9	12.8
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 computers, and semiconductors.
2. Merchandise imports excluding oil, computers, and semiconductors.

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OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2000				Projected 2001				Projected 2002			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-0.9	-1.0	-0.9	-0.5	1.1	-0.7	-0.6	-0.0	-0.7	-0.7	-0.5	0.0
Exports of G&S	0.7	1.5	1.5	-0.7	-0.3	-0.1	0.0	0.6	0.2	0.5	0.6	0.9
Imports of G&S	-1.6	-2.5	-2.3	0.2	1.4	-0.6	-0.7	-0.6	-0.9	-1.2	-1.1	-0.9
Percentage change from previous period, s.a.a.r.												
Exports of G&S	6.3	14.3	13.9	-6.4	-2.6	-0.9	0.4	5.4	1.7	4.8	5.6	9.1
Services	6.9	3.5	-2.8	3.4	2.2	-0.0	0.2	2.9	4.9	5.4	5.9	6.0
Computers	44.6	44.9	27.5	-12.4	-0.2	-0.4	9.1	14.8	21.6	26.3	26.3	26.3
Semiconductors	20.7	71.2	38.6	-11.0	-27.4	-20.3	4.1	14.8	24.0	26.3	26.3	26.3
Other Goods 1/	2.5	13.5	19.0	-9.5	-2.5	0.4	-0.5	5.2	-2.8	1.4	2.3	7.9
Imports of G&S	12.0	18.6	17.0	-1.2	-9.0	4.2	4.7	4.2	6.5	8.5	8.1	6.4
Services	16.6	10.6	22.3	4.0	-2.8	7.2	3.9	5.5	5.5	4.6	5.1	5.2
Oil	30.3	35.3	-4.9	-4.3	26.6	4.3	5.7	-19.6	-7.0	22.5	11.7	-14.7
Computers	2.8	44.5	28.7	-9.6	-21.2	-2.0	8.2	12.6	21.6	26.3	26.2	26.2
Semiconductors	20.7	33.5	88.9	-23.8	-44.3	-20.3	4.1	14.8	23.9	26.3	26.3	26.3
Other Goods 2/	9.7	15.8	15.1	0.1	-10.9	5.2	4.5	5.8	6.5	6.1	6.3	6.6
Billions of chained 1996 dollars, s.a.a.r.												
Net Goods & Services	-376.8	-403.4	-427.7	-441.7	-412.3	-431.0	-448.0	-449.3	-469.9	-489.7	-506.1	-506.5
Exports of G&S	1084.8	1121.8	1158.8	1139.8	1132.2	1129.5	1130.5	1145.5	1150.4	1163.9	1179.9	1206.0
Imports of G&S	1461.7	1525.2	1586.4	1581.5	1544.4	1560.5	1578.5	1594.8	1620.2	1653.6	1686.0	1712.5
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-407.1	-420.9	-452.4	-462.6	-426.2	-432.7	-461.7	-489.2	-504.4	-526.1	-543.1	-558.5
Current Account as % of GDP	-4.2	-4.2	-4.5	-4.6	-4.2	-4.2	-4.4	-4.7	-4.7	-4.9	-5.0	-5.1
Net Goods & Services (BOP)	-341.0	-355.0	-382.5	-397.0	-365.1	-363.5	-380.9	-385.9	-407.8	-425.8	-439.4	-437.6
Investment Income, Net	-12.2	-11.1	-12.7	3.5	-5.0	-12.6	-24.2	-33.2	-39.6	-42.7	-46.1	-49.7
Direct, Net	68.1	75.9	86.1	105.0	97.5	93.9	87.1	82.9	80.7	81.3	80.9	79.5
Portfolio, Net	-80.3	-87.0	-98.9	-101.5	-102.4	-106.5	-111.4	-116.1	-120.3	-124.0	-127.0	-129.3
Other Inc. & Transfers, Net	-53.8	-54.9	-57.2	-69.1	-56.1	-56.6	-56.6	-70.1	-57.1	-57.6	-57.6	-71.1

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