

Structural Labor Productivity

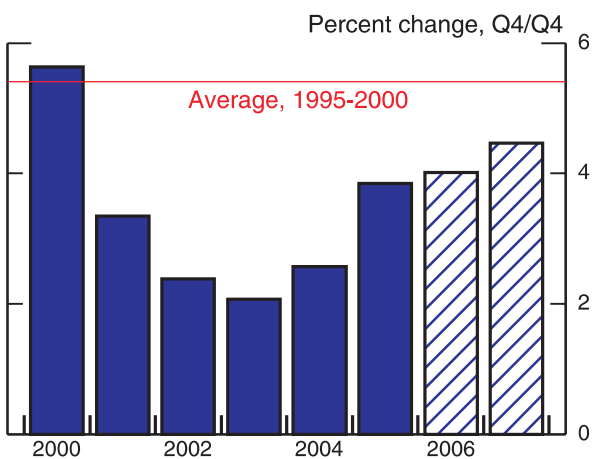
Structural labor productivity growth is defined as the increment to labor productivity that can be sustained over time.

Structural Labor Productivity Growth

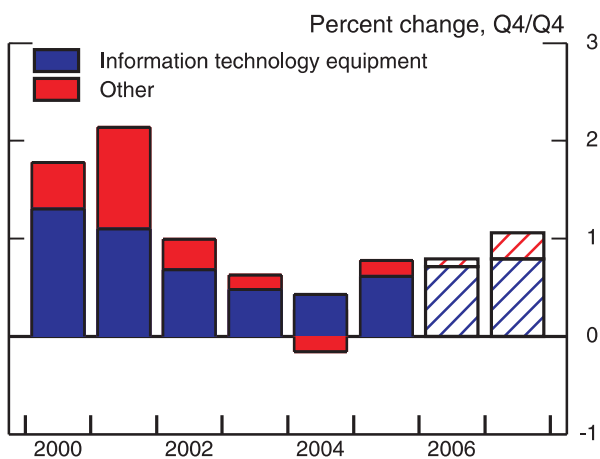
Percent change, Q4/Q4

| | 2005 | 2006 | 2007 |
|----------------------------|------|------|------|
| 1. Structural Productivity | 3.2 | 3.1 | 3.0 |
| <i>Contributions of:</i> | | | |
| 2. Capital deepening | 1.0 | 0.9 | 1.0 |
| 3. Labor quality | 0.3 | 0.2 | 0.2 |
| 4. MFP | 2.0 | 1.9 | 1.8 |

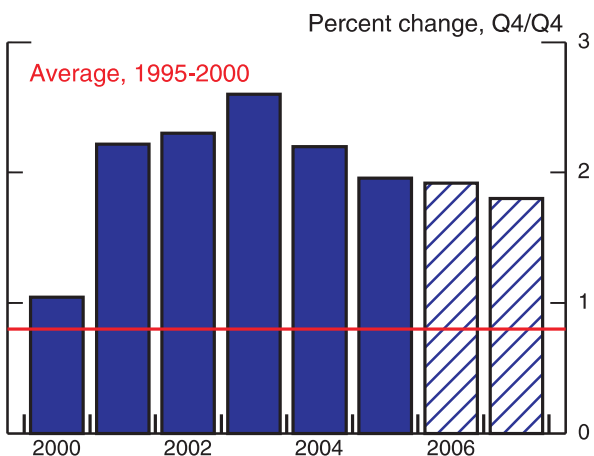
Growth in Capital Services



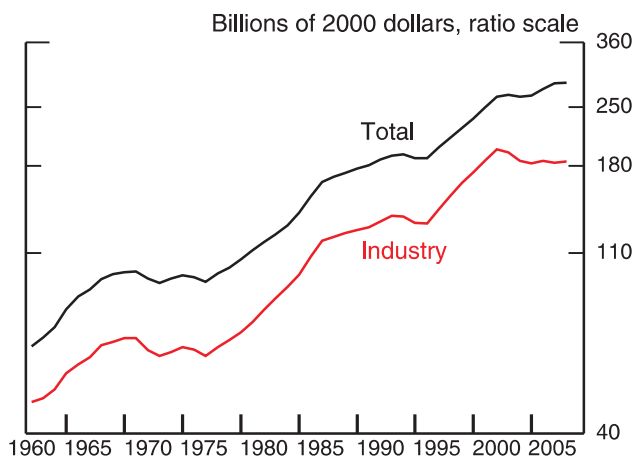
Contribution of Capital Deepening



Structural MFP



Research and Development Expenditures

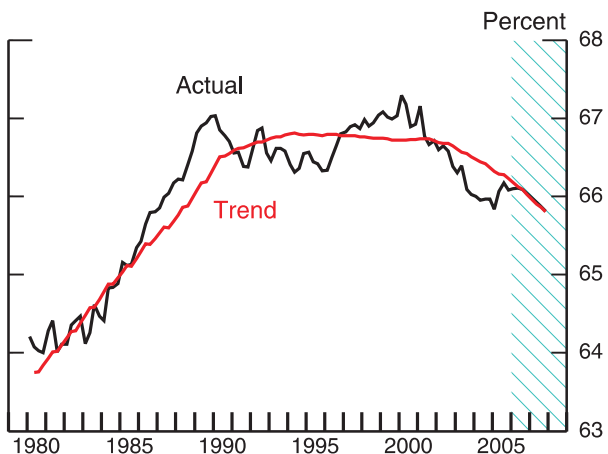


Potential Output and Labor Market

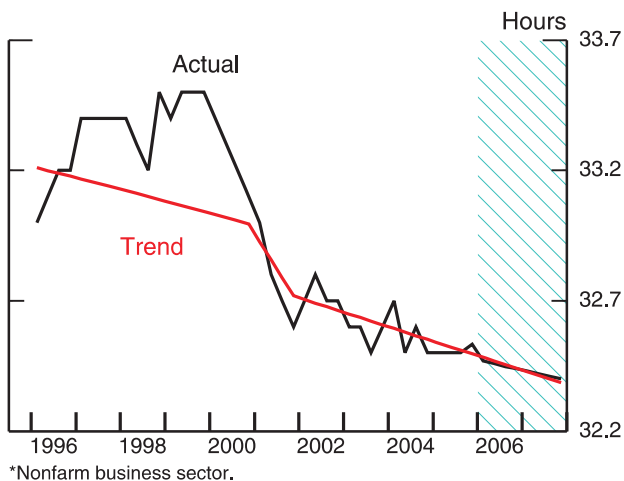
Potential Output

| | Percent change, Q4/Q4 | | |
|------------------------------|-----------------------|------|------|
| | 2005 | 2006 | 2007 |
| 1. Potential | 3.1 | 3.2 | 3.3 |
| 2. Total Hours | 0.9 | 0.7 | 0.7 |
| 3. Working-age population | 1.2 | 1.2 | 1.2 |
| 4. Labor-force participation | -0.2 | -0.3 | -0.3 |
| 5. Average workweek | -0.2 | -0.2 | -0.2 |
| 6. Structural Productivity | 3.2 | 3.1 | 3.0 |
| 7. Technical Factors | -1.0 | -0.6 | -0.4 |

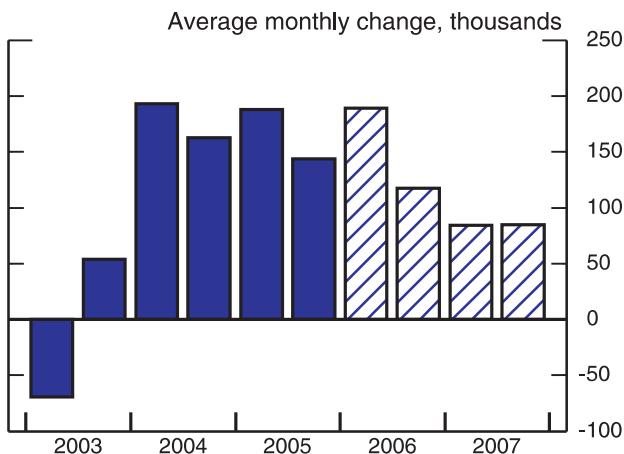
Labor Force Participation Rate



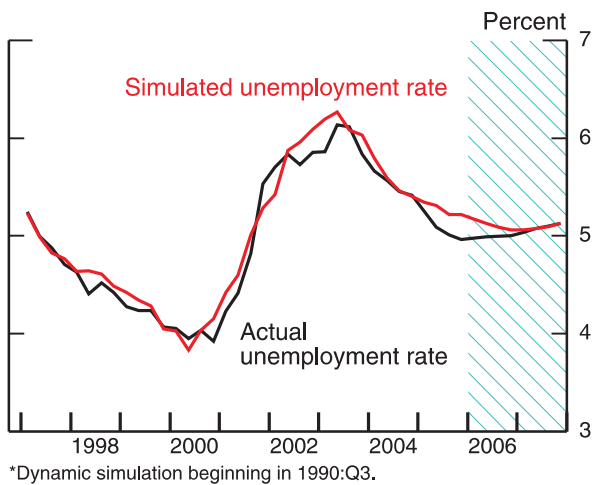
Average Workweek*



Nonfarm Payroll Employment



Okun's Law*

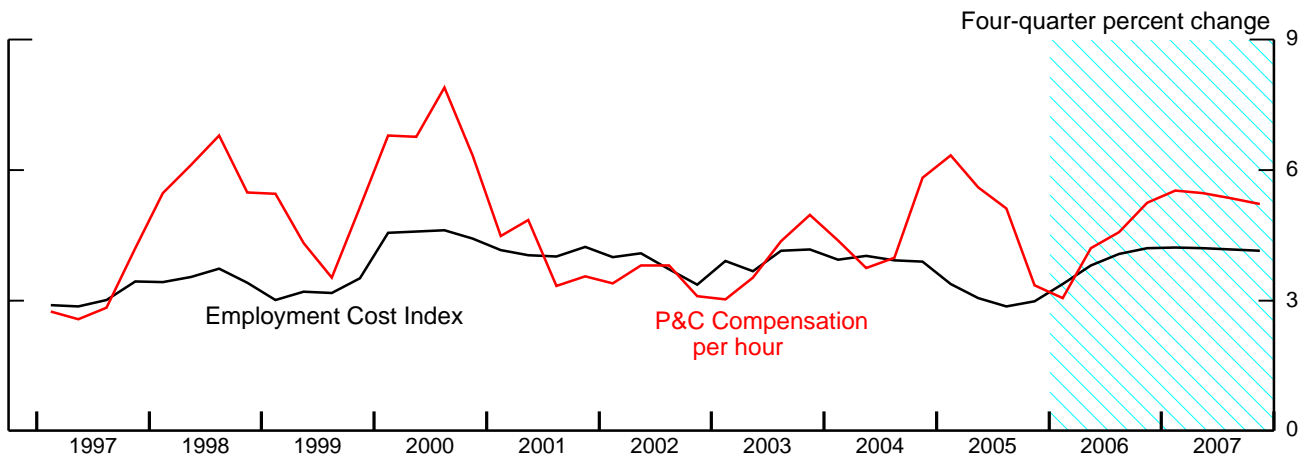


Class II FOMC - Restricted (FR)

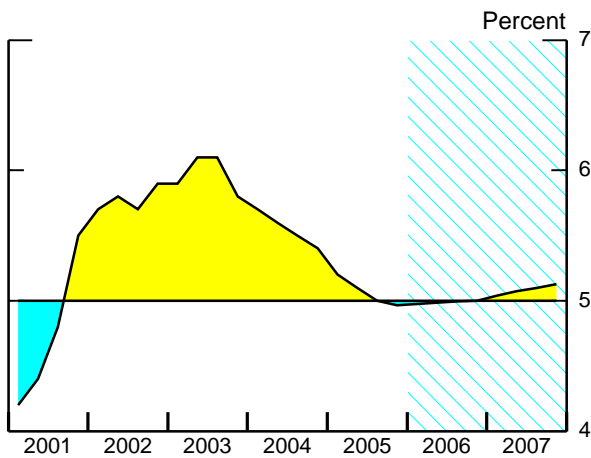
Exhibit 7

Compensation

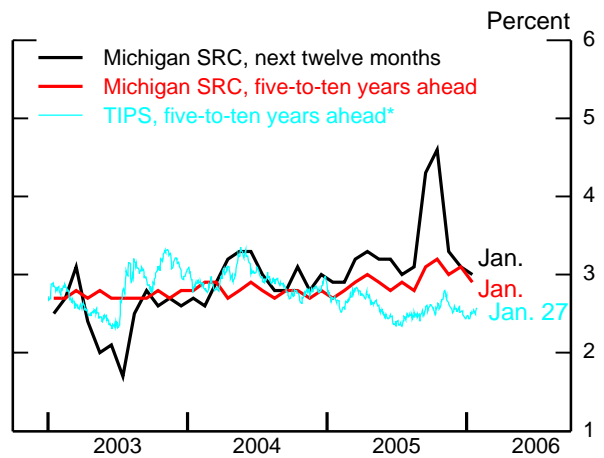
Hourly Labor Compensation



Unemployment Gap

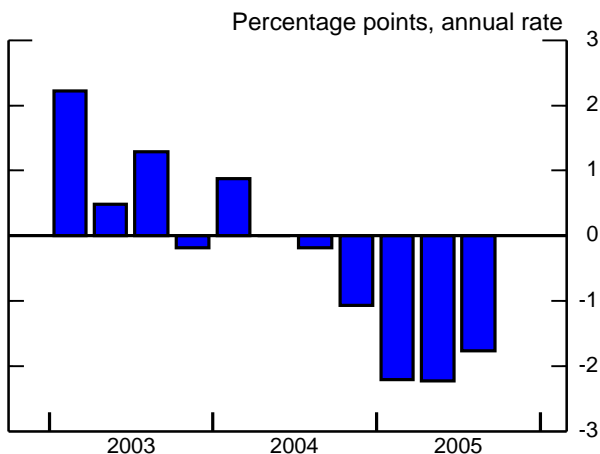


Expected Inflation



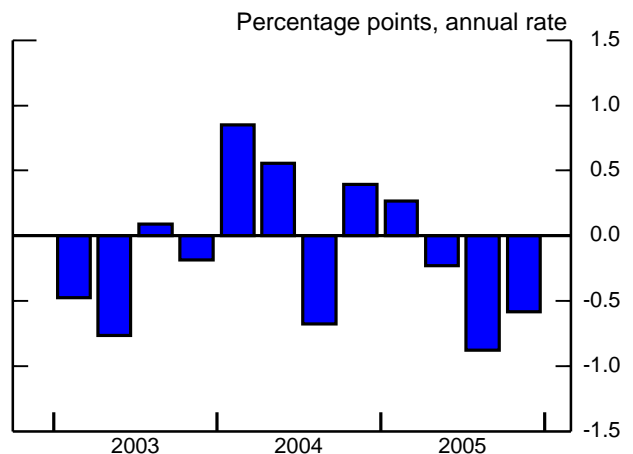
*Estimates of inflation compensation based on smoothed nominal and inflation-indexed Treasury yield curves.

ECI Equation Errors*



*Estimated through 2002:Q4. Dynamic simulation from 2003:Q1 to 2005:Q3.

Core PCE Equation Errors*



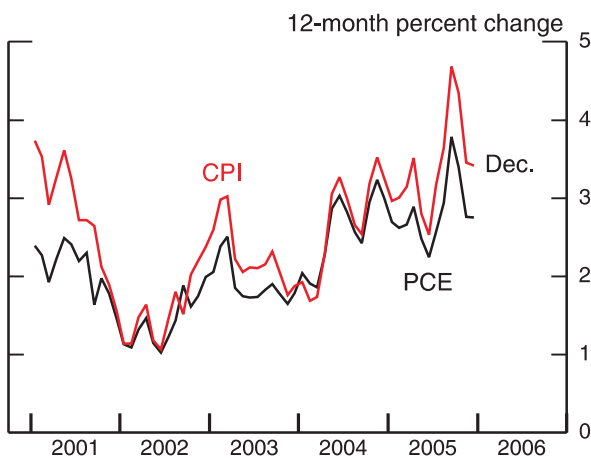
*Estimated through 2002:Q4. Dynamic simulation from 2003:Q1 to 2005:Q4.

Class II FOMC - Restricted (FR)

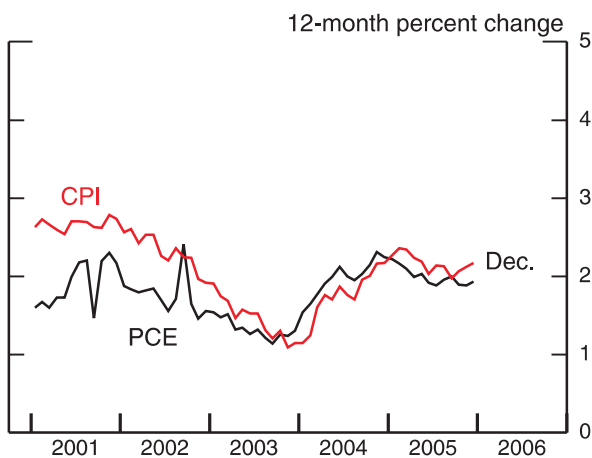
Exhibit 8

Inflation Outlook

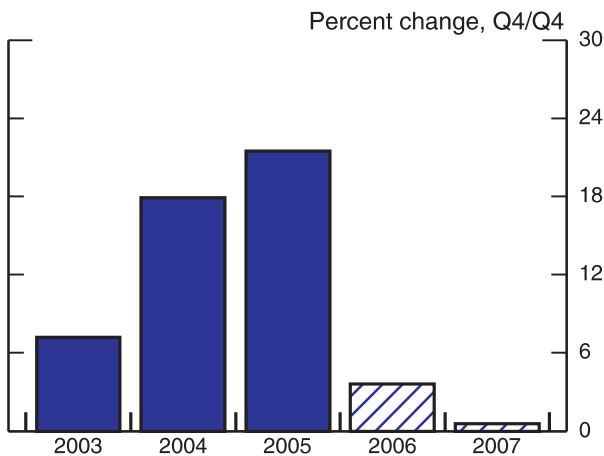
Total Consumer Prices



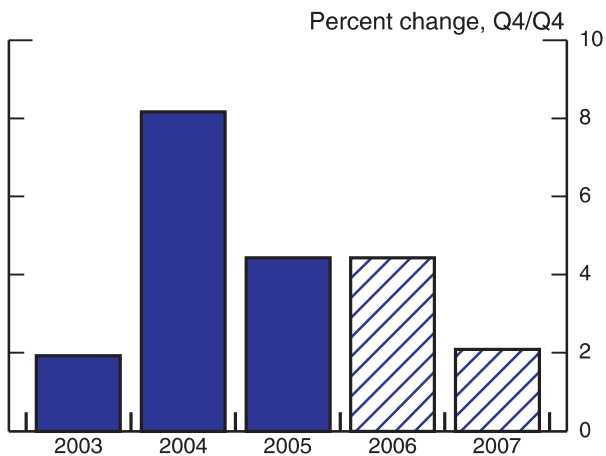
Core Consumer Prices



PCE Energy Prices



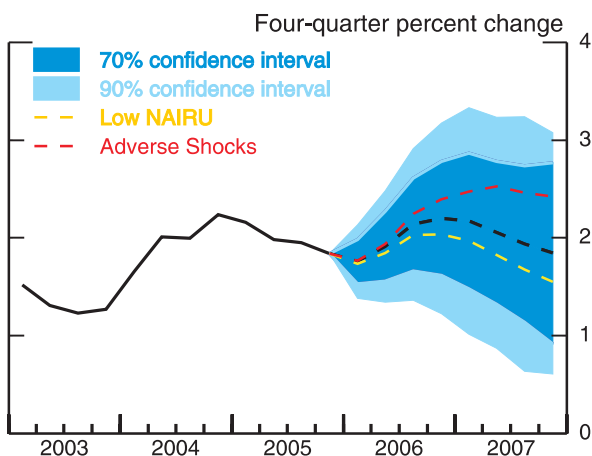
PPI-Intermediate Materials less Food and Energy



PCE Price Projection

| | Percent change, Q4/Q4 | | |
|-----------------|-----------------------|------|------|
| | 2005 | 2006 | 2007 |
| 1. Total PCE | 3.0 | 2.3 | 1.8 |
| 2. Food | 2.1 | 2.4 | 2.2 |
| 3. Energy | 21.5 | 3.6 | 0.6 |
| 4. Core | 1.9 | 2.2 | 1.8 |
| 5. Market based | 1.7 | 2.1 | 1.7 |

Core PCE Prices

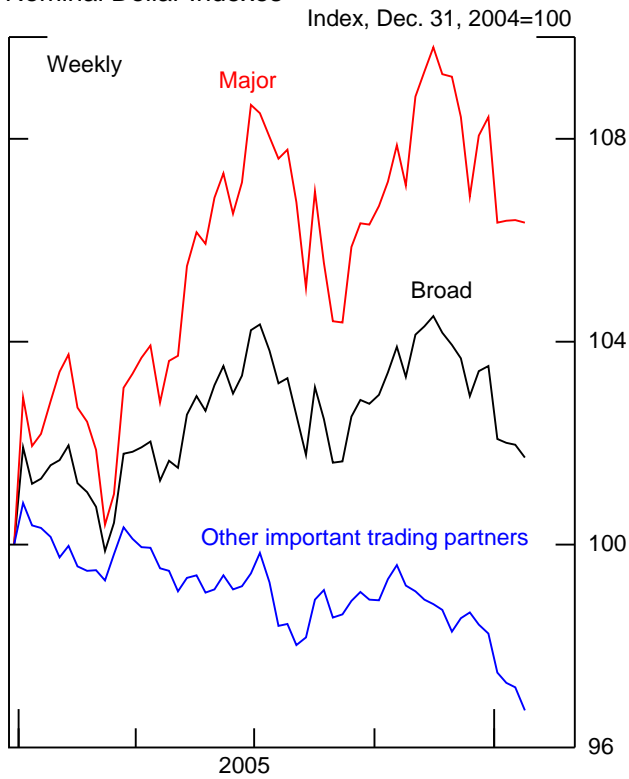


Class II FOMC - Restricted (FR)

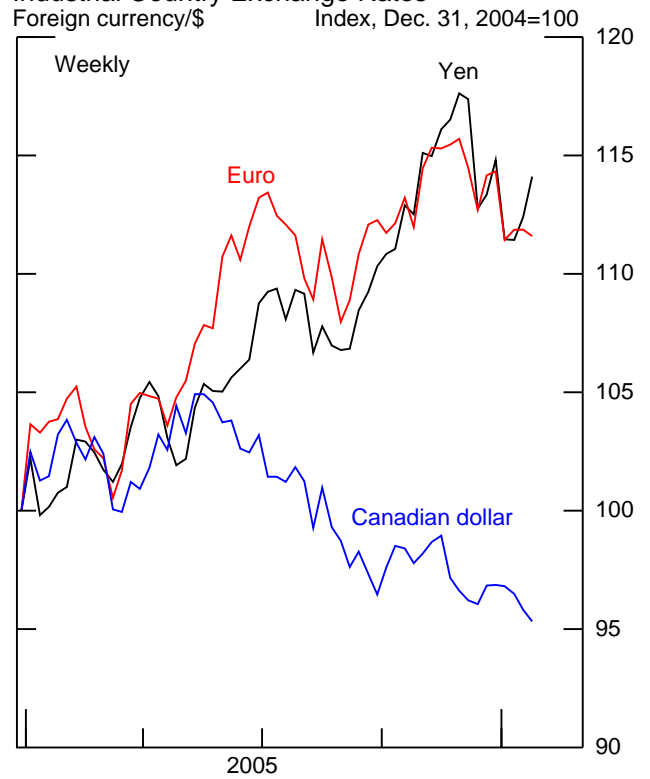
Exhibit 9

The Dollar

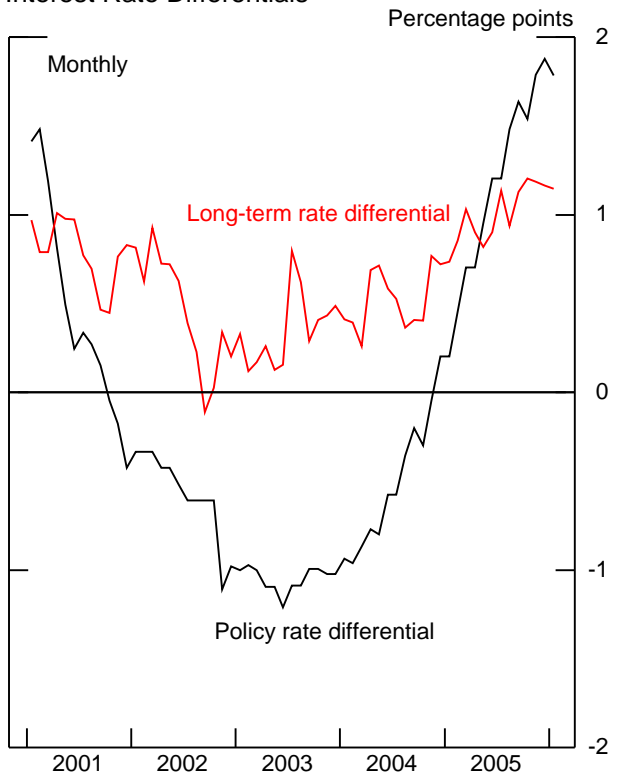
Nominal Dollar Indexes



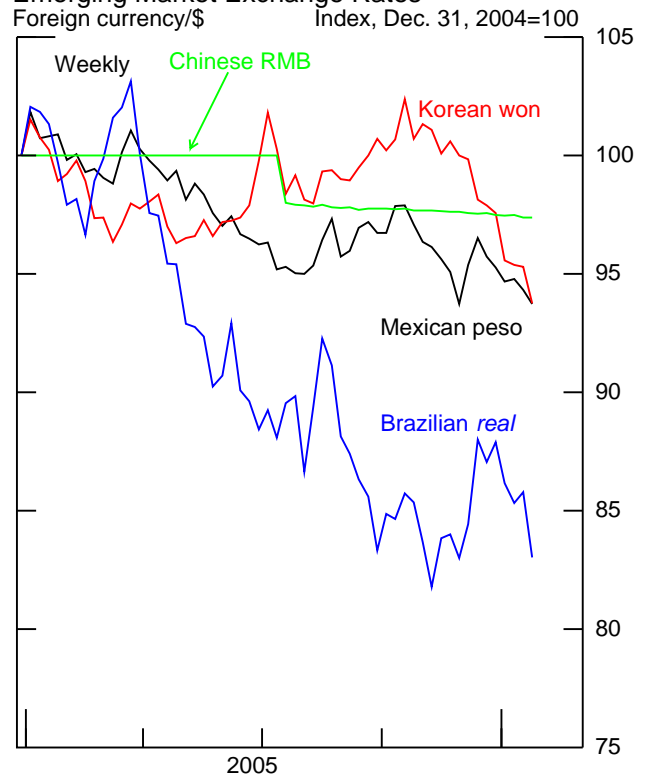
Industrial Country Exchange Rates



Interest Rate Differentials*



Emerging Market Exchange Rates



*Calculated as U.S. rate minus trade-weighted average of Canada, euro area, Japan, and the United Kingdom.

Class II FOMC - Restricted (FR)

Exhibit 10

Foreign Net Financial Inflows

Foreign Official Inflows
Billions of dollars

| | 2003 | 2004 | 2005* |
|--------------------------|------------|------------|------------|
| 1. Total | 267 | 395 | 221 |
| <i>Selected Regions:</i> | | | |
| 2. G-10 Countries | 111 | 162 | -11 |
| 3. Emerging Asia | 108 | 135 | 190 |
| 4. OPEC | 6 | 12 | 11 |
| 5. Other | 42 | 86 | 32 |

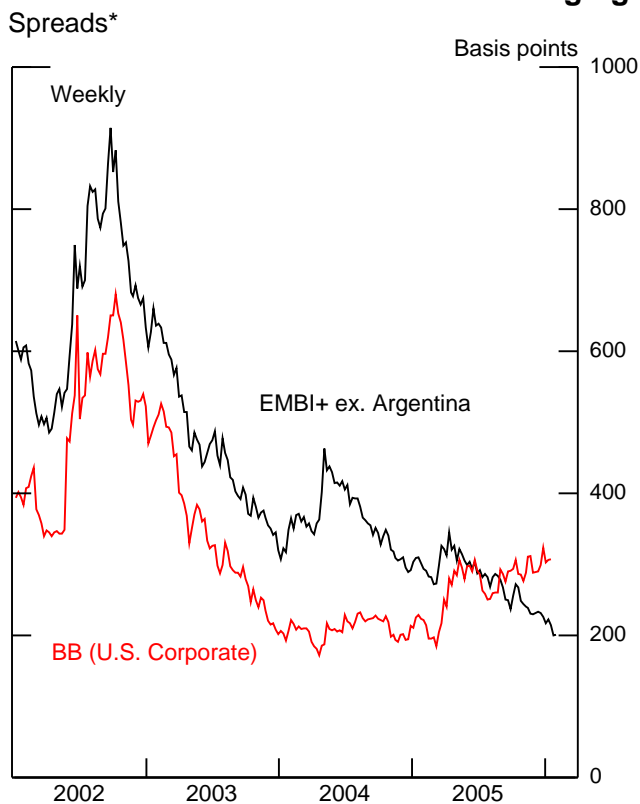
*2005 data are cumulative flows through Nov. 2005, annualized.

Foreign Private Net Purchases of U.S. Securities
Billions of dollars

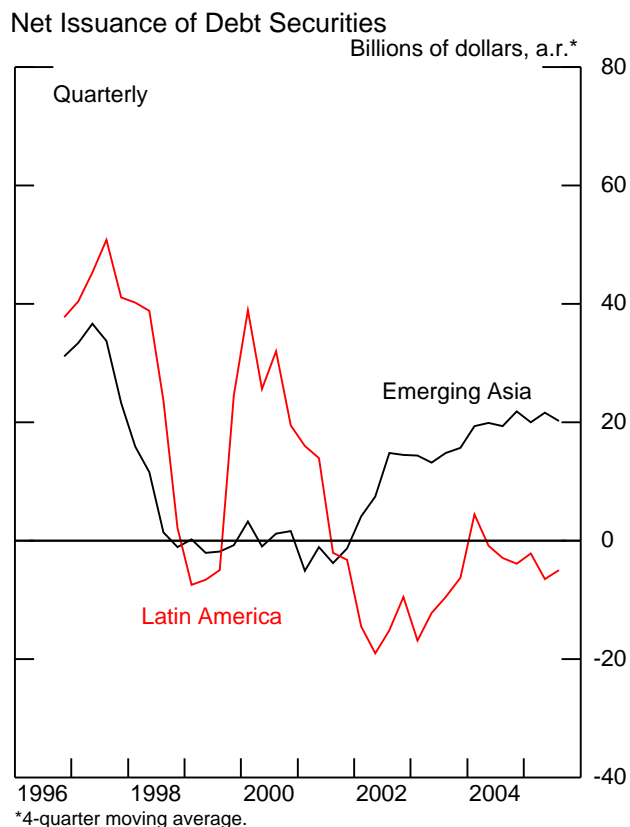
| | 2003 | 2004 | 2005* |
|-----------------------|------------|------------|------------|
| 1. Total | 336 | 506 | 704 |
| <i>By Instrument:</i> | | | |
| 2. Treasuries | 113 | 123 | 214 |
| 3. Agency Bonds | -38 | 66 | 80 |
| 4. Corporate Bonds | 224 | 255 | 326 |
| 5. Equities | 37 | 62 | 84 |

*2005 data are cumulative flows through Nov. 2005, annualized.

Emerging Market Debt



*Spread over 10-year U.S. Treasury bond.
Source: Merrill Lynch and JPMorgan.



*4-quarter moving average.

Outlook for Foreign Growth and Inflation

Real GDP Projections*

Percent change, a.r.**

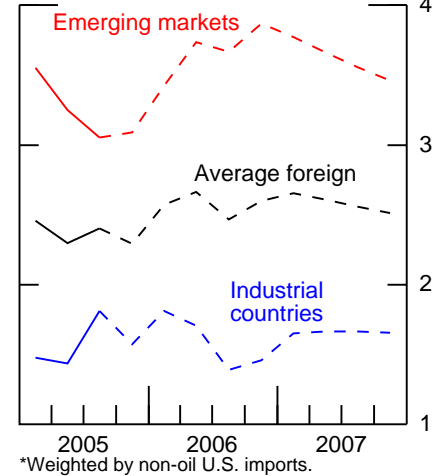
| | 2005 | | 2006 | 2007 |
|-------------------------|------|------|------|------|
| | H1 | H2 | | |
| 1. Total Foreign | 3.2 | 4.1 | 3.6 | 3.4 |
| 2. Industrial Countries | 2.6 | 2.6 | 2.7 | 2.4 |
| 3. Euro Area | 1.4 | 2.0 | 2.2 | 1.7 |
| 4. Japan | 5.3 | 1.5 | 1.6 | 1.6 |
| 5. Canada | 2.7 | 3.3 | 3.2 | 3.1 |
| 6. Emerging Markets | 4.0 | 6.3 | 4.8 | 4.8 |
| 7. Mexico | -0.3 | 6.1 | 3.7 | 3.7 |
| 8. China | 9.5 | 10.2 | 7.7 | 8.0 |

*Aggregates weighted by U.S. exports.

**Years are Q4/Q4; half years are Q2/Q4 or Q4/Q2.

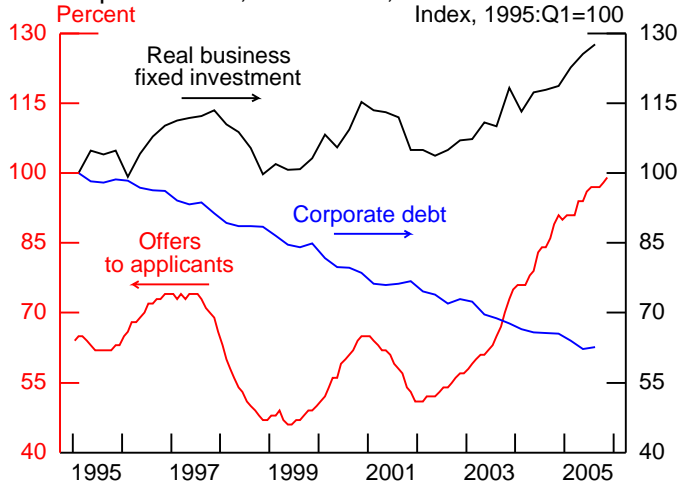
Consumer Prices*

4-quarter percent change

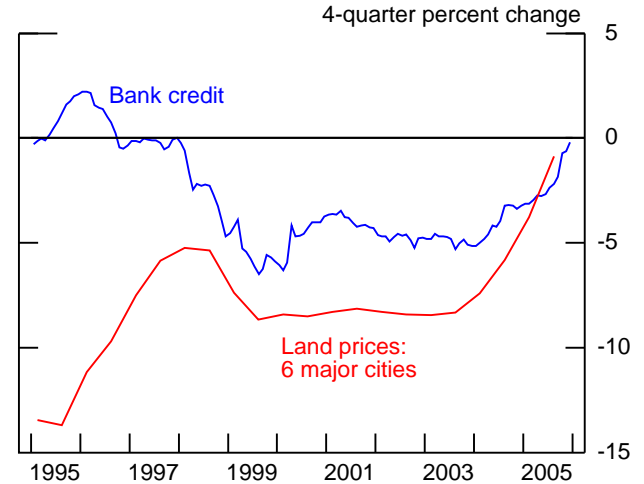


Japan

Corporate Debt, Investment, and Labor Market

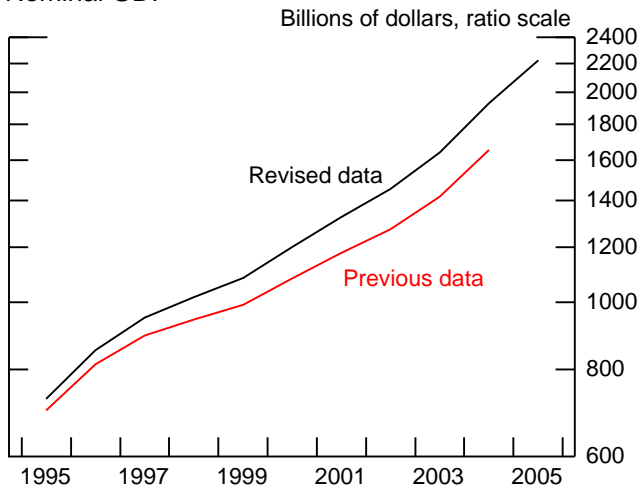


Bank Credit and Land Prices

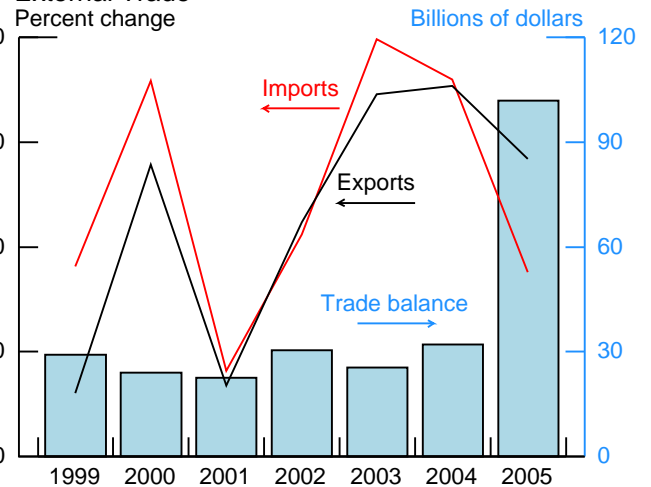


China

Nominal GDP



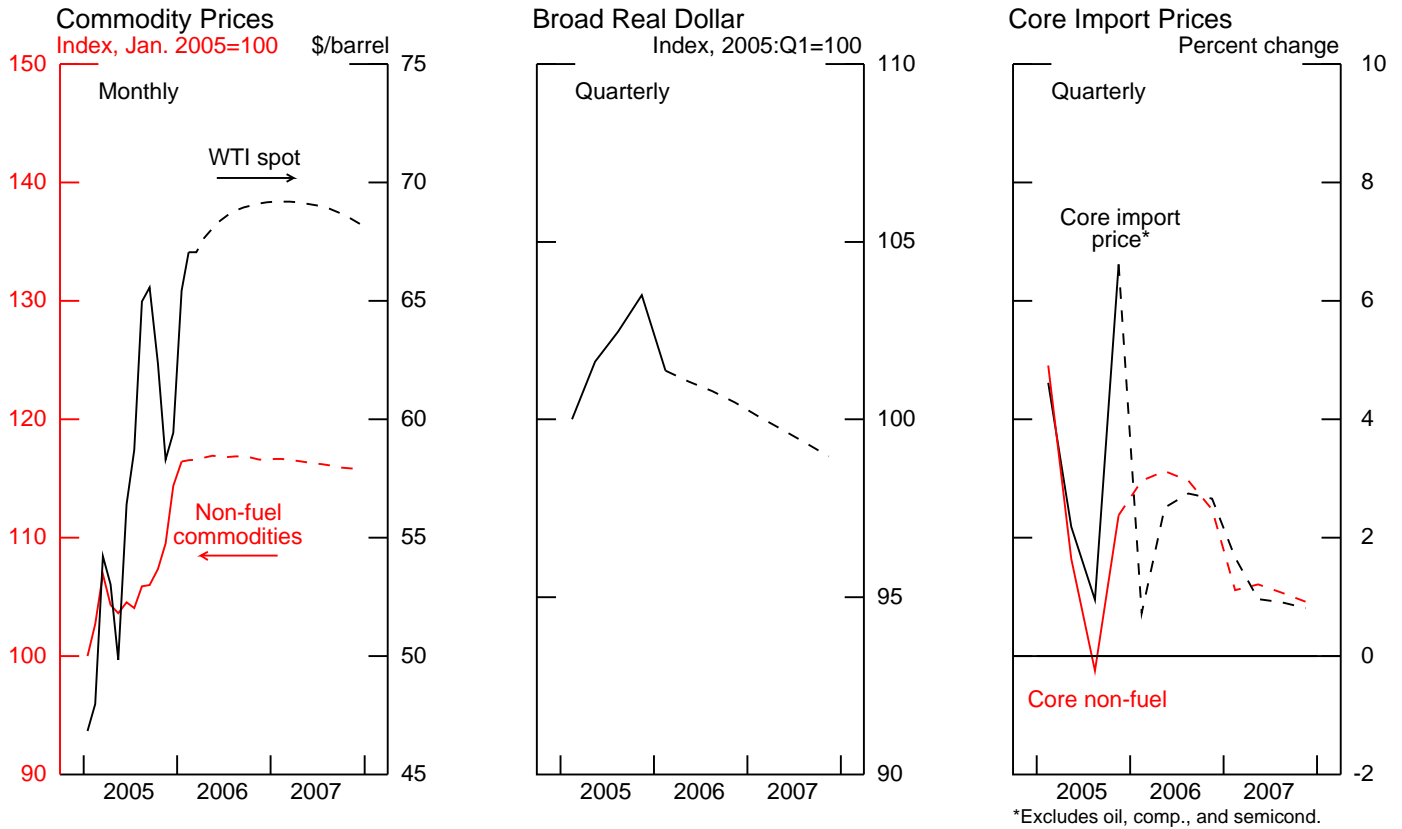
External Trade



Class II FOMC - Restricted (FR)

Exhibit 12

Trade Prices



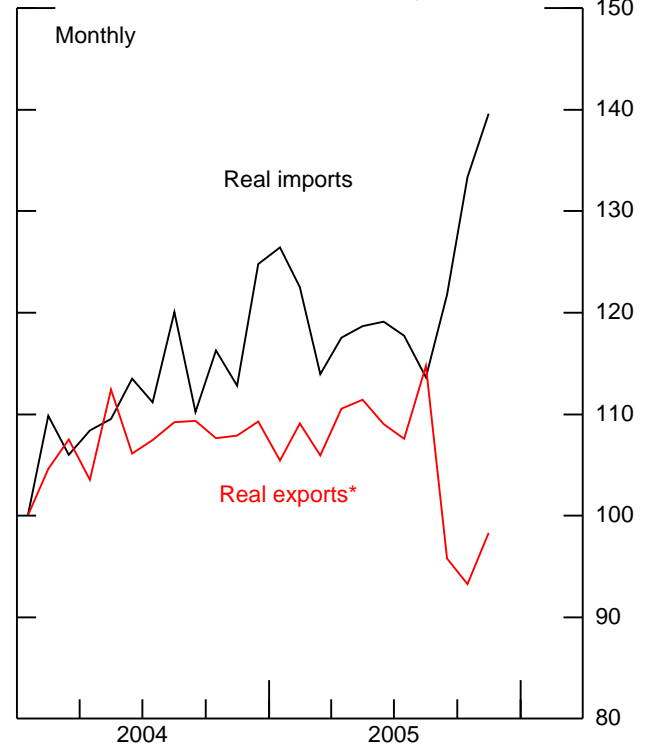
Trade Developments

Trade in Goods and Services
Billions of dollars, a.r.

| | Q3 | O-N* | Change |
|-----------------|------|------|--------|
| 1. Balance | -731 | -794 | -63 |
| Exports: | | | |
| 2. G & S | 1283 | 1300 | 17 |
| 3. Cap. Goods | 363 | 378 | 15 |
| 4. Ind. Sup. | 236 | 231 | -5 |
| 5. Other | 684 | 692 | 8 |
| Imports: | | | |
| 6. G & S | 2014 | 2094 | 80 |
| 7. Cons. Goods | 404 | 408 | 4 |
| 8. Cap. Goods | 384 | 386 | 2 |
| 9. Ind. Sup.** | 263 | 293 | 30 |
| 10. Oil | 270 | 300 | 30 |
| 11. Other | 693 | 708 | 15 |

*Average of October and November data.
**Excludes oil.

Imports and Exports of Chemicals
Index, Jan. 2004=100



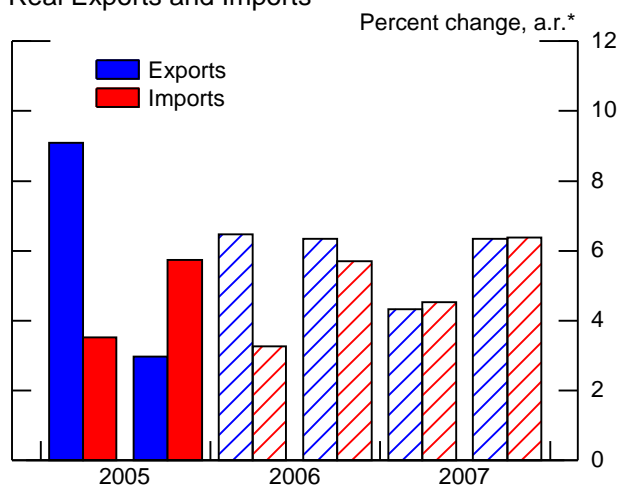
*Includes petroleum products.

Class II FOMC - Restricted (FR)

Exhibit 13

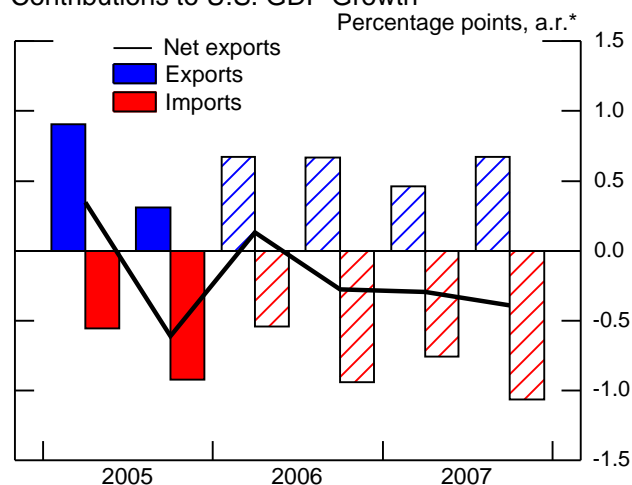
U.S. External Sector

Real Exports and Imports



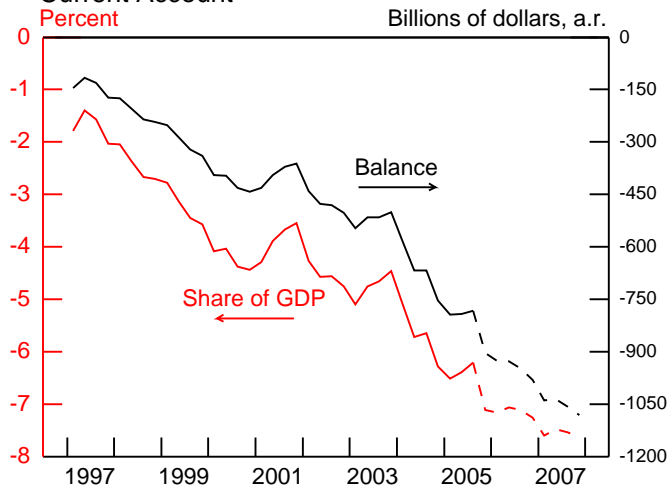
*Half years are Q2/Q4 or Q4/Q2.

Contributions to U.S. GDP Growth



*Half years are Q2/Q4 or Q4/Q2.

Current Account



Current Account Forecasts

| Source | 2005 | 2006 | 2007 |
|--------------------------|------|------|-------|
| 1. Jan. GB | -818 | -945 | -1053 |
| <i>Other forecasts:*</i> | | | |
| 2. OECD | -806 | -890 | -980 |
| 3. Consensus | -793 | -828 | -831 |
| 4. Macro Advisors** | -807 | -871 | -887 |
| 5. Global Insight | -816 | -909 | -928 |

*OECD forecast from November; other forecasts from January.
**Adjusted to BOP basis by staff.

Change in Current Account Balance

| | 1997:Q1 to 2001:Q4 (1) | 2001:Q4 to 2005:Q3 (2) | 2005:Q3 to 2007:Q4 (3) |
|------------------------------------|---------------------------|---------------------------|---------------------------|
| 1. Current Account Balance | -217 | -421 | -298 |
| 2. Non-oil Trade Balance | -231 | -195 | -110 |
| 3. Oil Imports | 0 | -187 | -53 |
| 4. Investment Income, Net | 45 | -54 | -93 |
| 5. Transfers and Other Income, Net | -31 | 15 | -42 |

*Difference in levels of annualized series.

Class II FOMC - Restricted (FR)

Exhibit 14 -- Last Exhibit

ECONOMIC PROJECTIONS FOR 2006

| | FOMC | | |
|--------------------------------|---------------------------------------|------------------------|--------------|
| | Range | Central Tendency | Staff |
| | -----Percentage change, Q4 to Q4----- | | |
| Nominal GDP July 2005 | 5¼ to 6½ (5 to 6) | 5½ to 6 (5¼ to 5½) | 6.4 (5.4) |
| Real GDP July 2005 | 3¼ to 4 (3¼ to 3¾) | About 3½ (3¼ to 3½) | 3.9 (3.4) |
| Core PCE Prices July 2005 | 1¾ to 2½ (1½ to 2½) | About 2 (1¾ to 2) | 2.2 (1.9) |
| | -----Average level, Q4, percent----- | | |
| Unemployment rate July 2005 | 4½ to 5 (5) | 4¾ to 5 (5) | 5.0 (5.1) |

Central tendencies calculated by dropping high and low three from ranges.

ECONOMIC PROJECTIONS FOR 2007

| | FOMC | | |
|-------------------|---------------------------------------|---------------------|-------|
| | Range | Central Tendency | Staff |
| | -----Percentage change, Q4 to Q4----- | | |
| Nominal GDP | 5 to 6 | 5 to 5¾ | 5.0 |
| Real GDP | 3 to 4 | 3 to 3½ | 3.0 |
| Core PCE Prices | 1¾ to 2 | 1¾ to 2 | 1.8 |
| | -----Average level, Q4, percent----- | | |
| Unemployment rate | 4½ to 5 | 4¾ to 5 | 5.1 |

Appendix 3: Materials used by Mr. Reinhart

Class I FOMC - Restricted Controlled FR

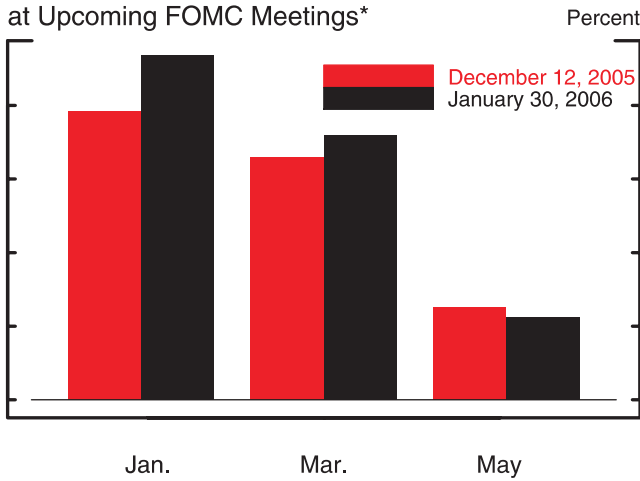
Material for

FOMC Briefing on Monetary Policy Alternatives

Vincent R. Reinhart
January 31, 2006

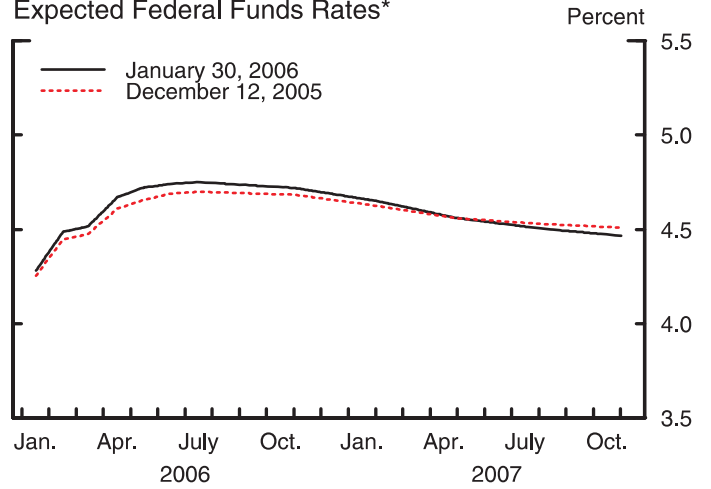
Exhibit 1 Policy Considerations

Probability of a 25 Basis Point Tightening at Upcoming FOMC Meetings*



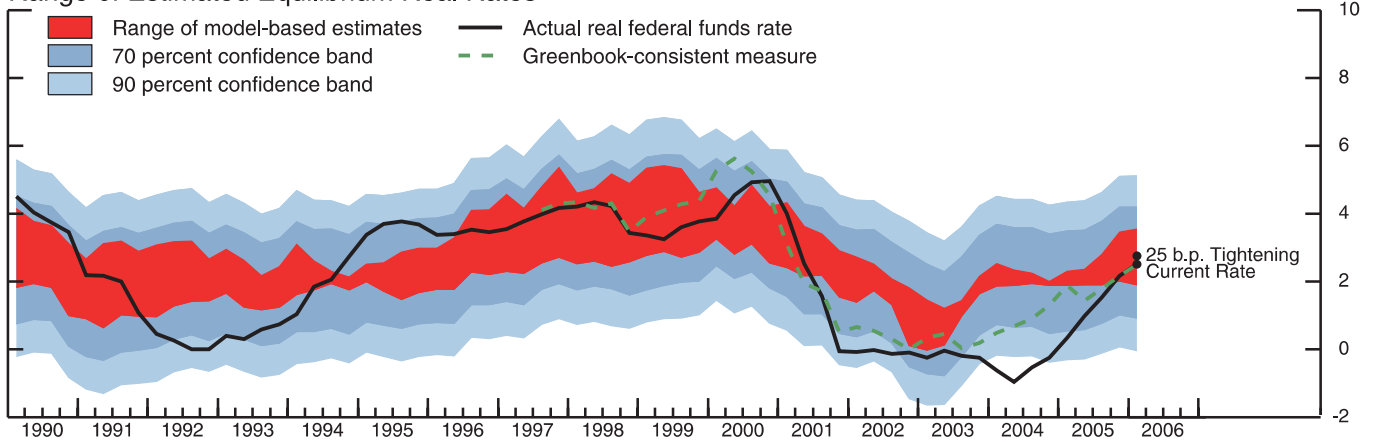
*Estimated from federal funds futures.

Expected Federal Funds Rates*



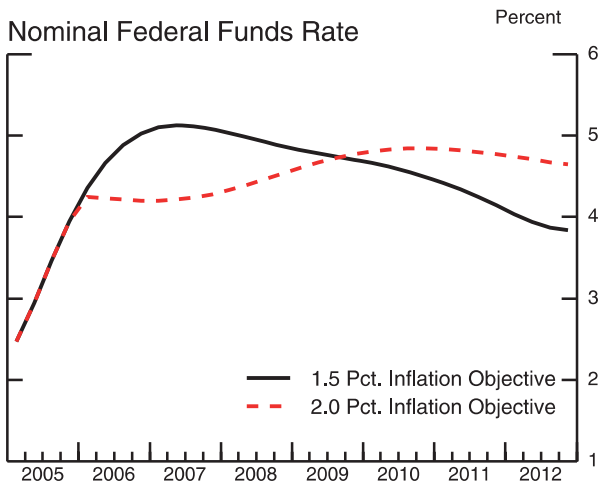
*Estimates from federal funds and Eurodollar futures, with an allowance for term premia and other adjustments.

Range of Estimated Equilibrium Real Rates

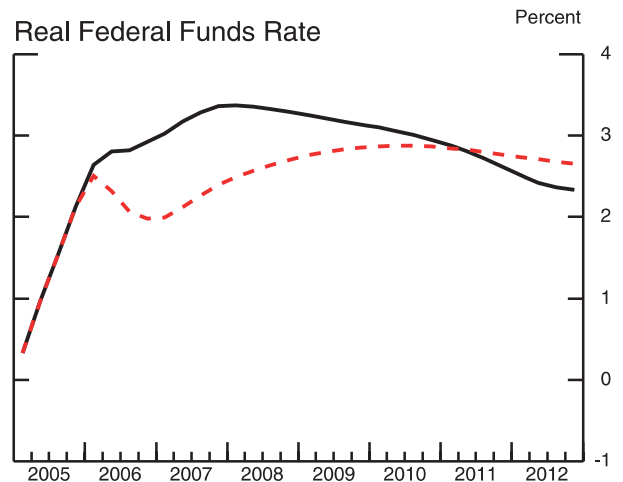


An explanatory note is provided in Chart 7 of the Bluebook.

Nominal Federal Funds Rate



Real Federal Funds Rate



Note. The real federal funds rate is the nominal federal funds rate less four-quarter core PCE inflation.

Exhibit 2
Statement Considerations

Two Key Wording Questions

1. How high are the odds you place on tightening at the March meeting?
2. How much do you want to emphasize dependence on the data?

Alternative B

The Committee judges that some further policy firming may well be needed to keep the risks to the attainment of both sustainable economic growth and price stability roughly in balance.

In any event, the Committee will respond to changes in economic prospects as needed to foster these objectives.

Greater Emphasis on Data Dependence

The Committee will respond to changes in economic prospects as needed to foster the attainment of both sustainable economic growth and price stability.

In these circumstances, the Committee judges that some further policy firming may well be needed to keep the risks to those objectives roughly in balance.

Exhibit 3

Ownership of the Statement

Options

1. Vote on the entire statement and the directive.
2. Vote on the directive and assessment of risks. Clarify ownership of the remaining portions of the statement by voting to authorize the Chairman to provide a rationale for that action.
3. Retain the status quo.

Vote Under Option 1

Directive Wording

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with increasing the federal funds rate to an average of around 4½ percent.

Statement Language

The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 4½ percent.

Although recent economic data have been uneven, the expansion in economic activity appears solid. Core inflation has stayed relatively low in recent months and longer-term inflation expectations remain contained. Nevertheless, possible increases in resource utilization as well as elevated energy prices have the potential to add to inflation pressures.

The Committee judges that some further policy firming may well be needed to keep the risks to the attainment of both sustainable economic growth and price stability roughly in balance. In any event, the Committee will respond to changes in economic prospects as needed to foster these objectives.

Vote Under Option 2

Directive Wording

The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with increasing the federal funds rate to an average of around 4½ percent.

Risk Assessment

The Committee judges that some further policy firming may well be needed to keep the risks to the attainment of both sustainable economic growth and price stability roughly in balance. In any event, the Committee will respond to changes in economic prospects as needed to foster these objectives.

Rationale Language

The Committee authorizes the Chairman to provide a rationale for the policy action in the statement to be released after this meeting.

Table 1: Alternative Language for the January FOMC Announcement (January 31, 2006)

| | December FOMC | Alternative A | Alternative B | Alternative C |
|---------------------------|--|---|--|--|
| Policy Decision | 1. The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 4¼ percent. | The Federal Open Market Committee decided today to keep raise its target for the federal funds rate unchanged by 25 basis points to at 4¼ percent. | The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 4½ ¼ percent. | The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 4½ ¼ percent. |
| Rationale | 2. Despite elevated energy prices and hurricane-related disruptions, the expansion in economic activity appears solid. | Although recent economic data have been uneven Despite elevated energy prices and hurricane-related disruptions, the expansion in economic activity appears solid. | Although recent economic data have been uneven Despite elevated energy prices and hurricane-related disruptions, the expansion in economic activity appears solid. | Although recent economic data have been uneven Despite elevated energy prices and hurricane-related disruptions, the expansion in economic activity appears solid. |
| | 3. Core inflation has stayed relatively low in recent months and longer-term inflation expectations remain contained. Nevertheless, possible increases in resource utilization as well as elevated energy prices have the potential to add to inflation pressures. | While possible increases in resource utilization as well as elevated energy prices have the potential to add to inflation pressures, core inflation has stayed relatively low in recent months. Moreover, longer-term inflation expectations remain contained. | [Unchanged] | While c Core inflation has stayed relatively low in recent months and longer-term inflation expectations remain contained, Nevertheless, possible increases in resource utilization as well as elevated energy and other cost pressures prices have the potential to add to boost underlying inflation pressures . |
| Assessment of Risk | 4. The Committee judges that some further measured policy firming is likely to be needed to keep the risks to the attainment of both sustainable economic growth and price stability roughly in balance. | The Committee judges that some further measured policy firming may well-is-likely-to be needed to keep the risks to the attainment of both sustainable economic growth and price stability roughly in balance. | The Committee judges that some further measured policy firming may well-is-likely-to be needed to keep the risks to the attainment of both sustainable economic growth and price stability roughly in balance. | [Unchanged] |
| | 5. In any event, the Committee will respond to changes in economic prospects as needed to foster these objectives. | [Unchanged] | [Unchanged] | [Unchanged] |