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Confidential (FR) Class II FOMC

Part 1

March 13, 2002

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 economy appears to be growing with considerably more vigor than we had anticipated earlier. We now estimate that real GDP has been increasing at an above-potential pace in the first quarter after having turned up modestly in the fourth quarter. Household spending has been remarkably resilient, despite the increase in unemployment last fall. Although still cautious, businesses seem increasingly convinced that the economic outlook has improved. The pace of inventory liquidation seems to be slowing, and equipment spending has bottomed out and is again increasing in some sectors.

The preponderance of evidence now suggests that the economic recovery has gained traction and that the risks of renewed weakness have diminished. In addition, the recently enacted economic stimulus bill, with its temporary tax incentive for investment in new equipment, gives an added boost to demand over the projection period. Because of the greater ebullience in aggregate demand and the narrowing margins of slack, we have also incorporated more monetary tightening in this forecast, primarily in 2003, which tempers growth somewhat next year. On balance, we now project that real GDP will increase 3-3/4 percent this year—an upward revision from the January Greenbook of 1 percentage point—and 4 percent in 2003—an upward revision of nearly 1/2 percentage point.

A key influence on our thinking about current macroeconomic conditions is the recent performance of productivity. Growth in output per hour held up remarkably well last year while activity was decelerating sharply, and the rebound in the fourth quarter was eye-popping. The very rapid cutbacks in employment that were put into place when economic prospects appeared to sour after September 11 surely contributed to the extraordinary advance in measured labor productivity in the fourth quarter. We anticipate that some "payback" of these gains may occur in coming quarters, but we have also edged up our estimate of the pace of structural multifactor productivity (MFP) over the forecast period.

We now expect the unemployment rate to drift down from a peak of 5-3/4 percent to 5-1/4 percent by the end of 2003, a considerably lower path than we had previously anticipated. Accordingly, we have lessened the downward tilt in core inflation that characterized our previous forecast; we now expect core PCE inflation, which was 1.6 percent in 2001, to inch down to 1.4 percent in 2002 and to remain there in 2003.

Key Background Factors
We have made some notable changes to our financial assumptions since the last Greenbook. We have built in a more aggressive tightening of policy in late 2002 and 2003 in light of the smaller margin of slack and the less favorable inflation outlook in our current forecast. With this change, our path for the

funds rate has moved closer to the market's expectation, but investors still anticipate a steeper rise through 2003 than we have assumed. Most longer-term interest rates have increased 1/4 to 1/2 percentage point since the January Greenbook, and we assume that rates on the ten-year Treasury bond and high-grade private securities will remain near recent levels through the end of next year.[1]

Lenders and the markets have remained cautious lately about providing credit to riskier firms. Although the accounting problems at Enron seem to have had only minor spillover effects on credit availability, ongoing concerns about potential defaults are helping to keep most risk spreads at relatively high levels. We expect this caution regarding business financing to diminish gradually as the expansion proceeds. On the household side, the erosion of credit quality has been much less pronounced and confined mainly to more marginal credits, and we believe that a large majority of households should continue to have access to credit at attractive terms.

Equity markets have rallied since the last FOMC meeting, and we assume a moderate further increase in stock prices through the end of 2003. Reflecting the recent gains, our assumed path for stock prices is about 5 percent above that in the January Greenbook. Valuations remain elevated by historical standards, but the recent pickup in economic activity and the better productivity prospects have reduced the risk of earnings disappointments in coming quarters.

We now expect that fiscal policy will be even more expansionary over the next two years than had been anticipated in the January Greenbook. The largest change in our assumptions is the incorporation of the economic stimulus bill that was signed into law on March 9—in particular, the temporary business tax relief, which is expected to reduce revenues by $43 billion in fiscal 2002 and $39 billion in fiscal 2003. (Our previous forecast had already included the extension of unemployment insurance benefits.) In addition, after having reviewed the details of the President's budget proposals, we have added $10 billion to the assumed level of defense spending in fiscal 2003. This latter change brings our assumption for the level of total discretionary spending about into line with the President's request. We have also made some technical adjustments that reflect new information from the Administration and the Congressional Budget Office, and they worsen the fiscal outlook further. Thus, despite the higher incomes in this forecast, we now expect the unified budget to

1. All else being equal, we would expect bond yields to move up as short rates rise later this year and in 2003. However, there will be some countervailing downward pressure on yields if the market were to move toward our view of the path for the funds rate. Our projection of essentially flat bond rates assumes that these two forces are roughly offsetting.

run deficits of $65 billion in 2002 and $31 billion in 2003; in the January Greenbook, we had projected roughly balanced budgets in both years.

The incoming data on economic activity abroad have been mixed, with greater near-term strength in Canada, Mexico, and some of our other key trading partners but more weakness in Japan. On average, however, we have revised up our forecast of foreign real GDP growth to 2-1/2 percent this year and 3-1/2 percent in 2003. The real trade-weighted foreign exchange value of the dollar has eased slightly, on net, since the time of the January Greenbook; we have assumed that it will be essentially flat over the forecast period.

The spot and futures prices for oil are running a good bit higher than we anticipated in January because of lower OPEC production, the prospect of stronger global demand, and heightened tensions in the Middle East. The spot price of West Texas intermediate crude oil (WTI) is currently around $24 per barrel, $4 per barrel above the path in the January Greenbook. Consistent with readings in futures markets, we expect WTI to remain at this higher level through the end of the year and to edge down in 2003 as OPEC raises production to regain some market share in an expanding world economy. We expect WTI to average about $23 per barrel in the fourth quarter of next year, $2 per barrel higher than in the last Greenbook.

Recent Developments and the Near-term Outlook

We now project that real GDP is increasing at an annual rate of about 3-3/4 percent this quarter, up appreciably from the projected increase of 1-1/2 percent in the January Greenbook. The incoming data for the major components of household and business spending in the current quarter, though still fragmentary, have outstripped our expectations, and we have offset only a portion of this additional strength by allowing for a greater drawdown of inventories. We have not seen a comparable upward surprise in the information for the labor market; payroll employment has come in close to expectations, and aggregate hours are running below our January projection. Taken together, the spending and hours data imply another substantial gain in labor productivity this quarter.

Some of the recent good news on spending has been in the motor vehicle sector, where light-vehicle sales are now expected to average 16 million units (annual rate) this quarter, 3/4 million units more than we had anticipated in January.[2] Some of the additional sales should show up in consumer spending, and some in business investment.

2. Even at 16 million units, sales are down sharply from the spectacular fourth-quarter pace. However, this drop in sales is largely mirrored by movements in inventories.

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

Measure	2002:Q1		2002:Q2	
	Jan. GB	Mar. GB	Jan. GB	Mar. GB
Real GDP	**1.5**	**3.8**	**2.5**	**3.5**
Private domestic final purchases	-2.5	1.9	2.0	2.3
Personal consumption expenditures	-1.2	2.1	3.5	2.4
Residential investment	-6.4	7.7	-.3	.4
Business fixed investment	-8.7	-1.4	-6.2	2.3
Government outlays for consumption and investment	4.7	7.4	4.6	2.9
	Contribution to growth, percentage points			
Inventory investment	3.6	1.7	1.2	2.3
Net exports	-.8	-1.0	-1.2	-1.2

The recent strength of consumer demand has not been limited to motor vehicles. The February retail sales report shows that outlays for other goods have been rising rapidly, and the level of real expenditures on services in January was well above the fourth-quarter average. As a result, we now expect real PCE excluding motor vehicles to increase at an annual rate of about 5-1/2 percent this quarter and real total PCE to rise about 2 percent.

In addition, homebuilding has picked up after having lost a bit of steam last fall, and the level of single-family starts in January—an annual rate of 1.35 million units—was the highest in more than two years. Starts may ease in February and March, given the likelihood that reported activity was boosted in late 2001 and early 2002 by unusually favorable weather. But with permits at elevated levels and mortgage rates staying low, the level of starts should be well maintained. Reflecting the recent pattern of starts, real residential investment should show a hefty gain this quarter.

The near-term outlook for investment in equipment and software has brightened significantly. We now expect real E&S spending to be up slightly this quarter after having fallen 8-1/2 percent last year. Real spending for computer equipment rose at an annual rate of more than 30 percent in the fourth quarter, and an increase of about 40 percent appears to be in train in the current quarter. Moreover, based on the orders and shipments data through January, outlays for communications equipment are now expected to be about flat this quarter after a series of huge declines, while spending on industrial and other types of equipment is projected to turn up. The near-term prospects for nonresidential construction also look a little better than they did in January. Even so, these outlays still are expected to fall 11-1/2 percent at an annual rate this quarter, about the same as the decline over 2001 as a whole.

In the government sector, real federal expenditures on consumption and gross investment are projected to rise markedly in the current quarter as defense spending continues to surge and nondefense purchases rise moderately after a big increase in the fourth quarter. Recent developments at the state and local level have been more mixed, with hiring having slowed while construction has remained very strong. On balance, we expect state and local purchases to post a fairly sizable increase before flattening out in the second quarter.

Outside motor vehicles, real inventories are now estimated to have been reduced at an annual rate of about $80 billion in the fourth quarter, and we expect liquidations to be about this size in the current quarter as well. Inventories in many industries are getting into more reasonable shape, but businesses in other sectors—for example, machinery, primary metals, and communications equipment—still are adjusting production to work off remaining overhangs. In addition, stocks more broadly probably are being drawn down by the unanticipated burst in sales. These developments should set the stage for a substantial slowing in the rate of liquidation in the second quarter.

The upturn in domestic demand is also likely to induce a surge in imports. Accordingly, even though we are anticipating a moderate rise in real exports this quarter consistent with the firming in foreign activity, the external sector is expected to make a negative arithmetic contribution to the change in real GDP of about 1 percentage point.

Inflation has remained subdued in the current quarter. The incoming data for core PCE prices have been a little lower than we anticipated, and we have edged down the projected increase this quarter to only 1 percent at an annual rate. With energy prices likely to be down for the quarter as a whole, overall PCE prices are expected to rise at an annual rate of about 3/4 percent. However, higher gasoline prices point to somewhat larger increases in headline consumer price figures in the next couple of months. Increases in average hourly earnings have been very small in recent months, and this wage measure is now expected to rise at an annual rate of only 3 percent this quarter, 1 percentage point below the rise over 2001 as a whole.

The Longer-term Outlook for the Economy

As discussed in the overview, we have made a substantial upward revision to our longer-term projection, and we now expect real GDP to rise about

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

Measure	2002 H1	2002 H2	2003
Real GDP	**3.7**	**3.6**	**4.0**
Previous	2.0	3.4	3.6
Final sales	1.6	2.5	3.4
Previous	-.4	2.6	3.2
PCE	2.2	2.9	3.3
Previous	1.1	3.3	3.2
Residential investment	4.0	3.3	-2.1
Previous	-3.4	3.8	1.0
BFI	.4	5.5	11.9
Previous	-7.5	2.9	9.5
Government purchases	5.2	4.0	3.1
Previous	4.7	3.2	2.9
Exports	5.6	4.9	7.1
Previous	2.5	4.4	7.5
Imports	13.3	11.4	10.3
Previous	10.0	9.5	10.0
	Contribution to growth, percentage points		
Inventory change	2.0	1.1	.6
Previous	2.4	.8	.3
Net exports	-1.1	-1.0	-.7
Previous	-1.0	-.8	-.6

3-1/2 percent at an annual rate over the remaining three quarters of 2002 and 4 percent in 2003. Domestic demand appears to have a more positive thrust than we had anticipated, in part reflecting the stronger income gains associated with faster structural productivity growth. In addition, as we move into late 2002 and 2003, the newly enacted investment tax incentive should help to sustain the rebound in capital spending. The lessening of inventory liquidation and the subsequent switch to accumulation also should provide a good deal of impetus to production in coming quarters. However, the external sector doubtless will remain a drag in light of the strong dollar and the relatively moderate outlook, on average, for economic activity abroad. Despite somewhat more favorable supply conditions, resource utilization is likely to be higher than that projected in the January Greenbook, and thus the prospects for further disinflation are not quite so good.

Household spending. Smoothing through the movements in motor vehicle purchases, consumer spending has been rising rapidly since late last year, and we expect further appreciable gains in the period ahead. All told, we now expect real PCE to rise 2-1/2 percent this year and 3-1/4 percent in 2003.

On the whole, the fundamentals underlying the consumption projection are reasonably positive. To be sure, we continue to think that negative wealth effects will put a damper on spending growth through much of the projection period, even after factoring in the upward revision to our stock market assumption. But sentiment has recovered to a respectable level, and real disposable income seems to be on a solid uptrend, buttressed by the tax reduction enacted in 2001 and the improving employment picture. Moreover, households should be relatively sanguine about their longer-run income prospects, given the strong underlying trend in labor productivity. Consistent with our current estimates of wealth and permanent income, we expect the saving rate to move up about 1 percentage point on an annual-average basis between 2001 and 2003.

Homebuilding also has been robust of late, and the upward revisions to both current and permanent income bode well for activity in coming quarters. Thus, with mortgage rates expected to remain near recent levels, we have raised the projection for single-family starts, which are now expected to exceed 1.3 million units in both 2002 and 2003, after having totaled 1.27 million units in 2001. Multifamily starts are projected at 340,000 units in both 2002 and 2003, roughly the same as in 2001.

Business investment. We have altered the projection for investment in equipment and software, mainly in response to the incoming data and to the new investment incentive. Our forecast now has real E&S outlays increasing 5-1/2 percent in 2002 and 14 percent in 2003; in the January Greenbook, we had projected essentially no growth in 2002 and a 12 percent rise in 2003.

The new “partial expensing” investment incentive is virtually the same as the one that was passed by the House of Representatives last fall and was included in the staff projections for the November and December FOMC meetings. Specifically, it allows businesses to write off 30 percent of a qualified capital expenditure in the year the item is acquired and to depreciate the remaining 70 percent according to current rules. To be covered by the provision, the capital (including software) must be ordered between September 11, 2001, and

September 11, 2004, and, for the most part, be put in place by January 1, 2005. It must also have a tax service life of twenty years or less, which effectively excludes structures. For equipment with a tax life between five and seven years—the predominant category—this provision reduces the cost of capital about 1-3/4 percent.

Drawing on our earlier analysis, we expect the new incentive to have only limited effects on E&S outlays in the next couple of quarters; this expectation reflects the low levels of capacity utilization and the lags in building and installing new equipment. However, the effects of the incentive should show through more forcefully later this year and in 2003. Because it reduces the after-tax price of new capital, the incentive induces firms to acquire more capital; and because it is temporary, it induces them to bring investment forward into the period that the tax break is in effect. All else being equal, we expect this provision to add 2-3/4 percentage points (annual rate) to the rate of increase in real E&S in the second half of this year and in 2003. The effect on E&S growth likely will remain positive through much of 2004, but it should turn sharply negative if the incentive expires late that year, as the provision calls for.

We would be forecasting a rebound in E&S even without the tax break. In the high-tech sector, demand for computer-related equipment and software appears to be picking up; communications equipment also has shown a few signs of life, although these signs have been spotty and confined to certain segments of the industry. More broadly, the improving outlook for sales and profits should lift capital spending. Some lower-rated firms may continue to find obtaining financing difficult. But with capital markets generally accommodative, most businesses should be able to finance a step-up in investment when profitable opportunities arise.

The projection for nonresidential construction remains weak, although the outlook is not quite so bleak as it seemed in January—we now expect real outlays to decline less than 5 percent this year and to increase 5-1/2 percent in 2003. In particular, prospects for the non-office commercial sector (which consists largely of stores and warehouses) have improved in light of the strong incoming data and the upward revisions to the forecasts for consumer spending and inventory investment. But outlays in virtually all other major categories of construction are likely to decline sharply this year, given the marked increases in vacancy rates and the slowing in rents and property values in recent quarters. In 2003, we expect industrial construction to decline further while construction in the office sector bottoms out and non-office commercial building continues to move up.

Inventory investment. With firms expected to bring their inventory liquidations to a close around midyear and subsequently to shift to accumulation, the swing in inventory investment is projected to make a sizable positive contribution to real GDP growth both this year and next. Even so, businesses surely will continue to focus on tight inventory control, which we think will keep the inventory-sales ratio on a downward trend.

Government spending. Consistent with the changes to our fiscal assumptions noted earlier, we have raised the projected increase in real federal expenditures for consumption and investment over the four quarters of 2002 to 8-1/2 percent, mainly because of stronger defense expenditures. Spending is expected to continue to grow in 2003, although much less rapidly than in 2002, with real increases of less than 2 percent in both the defense and the nondefense categories.

At the state and local level, we project spending to rise relatively slowly, on average, over the remainder of this year as the budget cuts instituted in late 2001 and early 2002 show through to actual expenditures. In addition, we expect construction to move back toward trend after the outsized gains of recent quarters, which probably reflected, at least in part, favorable weather. However, in 2003, the pace of spending rebounds to 4 percent—a rate similar to that of the late 1990s. With this year's budgetary adjustments in place, and with the economy continuing to improve, most states and localities should be in reasonably good fiscal shape next year and thus should be able both to sustain robust increases in general-funds spending and to satisfy the strong underlying demand for school construction and for expansion and repair of highways and other infrastructure.

Net exports. After having declined significantly in 2001, real exports are expected to pick up this year and to expand further in 2003. But with real GDP expected to increase more quickly at home than abroad and with the dollar remaining high, real imports are likely to rise even faster. As a result, the arithmetic contribution to real GDP growth from the external sector is expected to be a substantial negative over the forecast period, after having been a roughly neutral factor, on average, in 2001. *(The International Developments section provides more detail on the outlook for the external sector.)*

Aggregate Supply, the Labor Market, and the Prospects for Inflation

As noted above, we have edged up our estimate of the pace of structural multifactor productivity (MFP) in this Greenbook. Together with the improved outlook for business investment, which boosts capital deepening, this upgrading of MFP growth lifts our forecast for overall structural labor productivity growth to 1.8 percent this year and 2.5 percent in 2003, compared with rates of 1.7 percent and 2.2 percent, respectively, in the January Greenbook. We now expect that potential real GDP will increase 2.7 percent this year and 3.5 percent

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

Measure	1973-95	1996-98	1999	2000	2001	2002	2003
Structural labor productivity	**1.4**	**2.4**	**2.9**	**2.8**	**2.1**	**1.8**	**2.5**
Previous	1.4	2.4	2.9	2.8	2.0	1.7	2.2
Contributions[1]							
Capital deepening	.6	1.1	1.5	1.4	.7	.5	1.0
Previous	.6	1.1	1.5	1.4	.7	.4	.8
Multifactor productivity	.6	1.0	1.1	1.1	1.1	1.0	1.2
Previous	.6	1.0	1.1	1.1	1.0	.9	1.1
Labor composition	.3	.3	.3	.3	.3	.3	.3
Memo:							
Potential GDP	2.9	3.6	3.9	3.8	2.8	2.7	3.5
Previous	2.9	3.6	3.9	3.7	2.7	2.5	3.1

NOTE. Components may not sum to totals because of rounding.
1. Percentage points.

in 2003—upward revisions from the January Greenbook of 0.2 percentage point and 0.4 percentage point, respectively.[3]

Productivity and the labor market. We are guessing that businesses were surprised—as we were—by the firmness in final demand late last year and so may have taken more drastic steps to pare back their work forces than turned out to have been necessary. Thus, although measured productivity in the nonfarm business sector appears to be on track for another 5 percent gain in the current quarter, we expect it to decelerate thereafter and to be up only about 2-1/4 percent over 2002 as a whole. We expect productivity growth to remain at about this pace in 2003.

We believe that work forces probably have been stretched pretty thin, and thus, with the economic expansion looking increasingly solid, firms should soon be adjusting up their workweeks and hiring. We now expect private payroll employment to be rising about 200,000 per month by midyear and to continue to expand at that pace, on average, in the second half of this year and in 2003. We anticipate that the unemployment rate will drift down to 5-1/4 percent by the end of 2003. In the January Greenbook, we had expected the unemployment rate to be 5-3/4 percent at the end of next year.

3. With the upward revision to structural productivity growth, we edged down our estimate of the NAIRU, which gives an added boost to the level of potential output in 2002 and 2003.

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

Measure	2000	2001	2002	2003
Output per hour, nonfarm business	2.6	2.0	2.2	2.2
Previous	2.6	1.5	1.7	2.3
Nonfarm private payroll employment	1.8	-1.1	1.1	2.0
Previous	1.8	-1.1	.6	1.5
Household employment survey	1.0	-1.0	1.1	1.5
Previous	1.0	-1.0	.5	1.1
Labor force participation rate[1]	67.1	66.9	66.8	66.9
Previous	67.1	66.9	66.8	66.7
Civilian unemployment rate[1]	4.0	5.6	5.5	5.3
Previous	4.0	5.6	6.0	5.8

1. Percent, average for the fourth quarter.

Wages and prices. We have revised up our wage and price projections and now anticipate only minimal slowing in underlying inflation over the next two years. The revision reflects the higher levels of resource utilization in our current forecast, partially offset by the improved prospects for structural productivity growth.

We expect the employment cost index for hourly compensation to rise 3.2 percent this year, after having risen 4.2 percent in 2001. Despite the lower unemployment rate in our current forecast, labor market slack should still be sufficient to exert some downward pressure on wage increases, and the relatively small rise in consumer prices last year should continue to limit nominal wage demands. But by 2003, with labor market slack having essentially disappeared, we expect ECI growth to be about flat at 3.3 percent.

We project core PCE inflation to edge down from 1.6 percent in 2001 to 1.4 percent in 2002, reflecting mainly the slack in resource utilization. With this downward pressure expected to wane as we move into 2003 and with import prices turning up, core inflation remains at 1.4 percent. Total PCE inflation is expected to move up from 1.2 percent in 2001 to 1.5 percent this year and 1.4 percent in 2003 as energy prices flatten out after having fallen about 10 percent in 2001.

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

Measure	2000	2001	2002	2003
PCE chain-weighted price index	2.6	1.2	1.5	1.4
Previous	2.6	1.3	1.3	1.2
Food and beverages	2.5	3.2	2.1	2.1
Previous	2.5	3.2	1.9	1.8
Energy	15.4	-9.9	1.4	-.3
Previous	15.4	-10.0	-1.7	2.0
Excluding food and energy	1.9	1.6	1.4	1.4
Previous	1.9	1.6	1.3	1.1
Consumer price index	3.4	1.9	2.0	1.9
Previous	3.4	1.9	1.8	1.8
Excluding food and energy	2.5	2.7	2.2	2.1
Previous	2.5	2.7	2.1	1.8
GDP chain-weighted price index	2.4	1.8	1.7	1.6
Previous	2.4	1.9	1.5	1.4
ECI for compensation of private industry workers[1]	4.4	4.2	3.2	3.3
Previous	4.4	4.0	3.0	3.0
NFB compensation per hour	7.8	3.9	3.1	3.3
Previous	7.8	4.0	3.4	3.2
Prices of core non-oil merchandise imports	1.6	-3.1	-.6	2.3
Previous	1.6	-3.2	.4	1.5

1. December to December.

Financial Flows and Conditions

We project that total domestic nonfinancial debt will increase at an average annual rate of about 5-1/2 percent in 2002 and 2003, similar to the average pace in recent years. A substantial reversal of the recent paydown of federal debt is offset by a modest slowing of nonfederal debt growth, mostly in the household sector.

Federal government debt is expected to rise about 4 percent in 2002, the first increase in four years, as receipts decline appreciably. By next year, with the economic expansion helping to reduce the deficit, federal debt should increase only fractionally.

Borrowing in the household sector is expected to slow in the first quarter of 2002 and, for the remainder of the forecast period, is projected to remain somewhat below last year's 8-1/2 percent pace. We see little easing in the growth of home mortgage debt, as mortgage interest rates should remain low enough to keep housing activity at a high level. But the surge in consumer credit from auto sales incentives should subside, which would pull consumer credit growth back down to the modest pace recorded during much of last year. Although household credit quality has deteriorated a bit over the past several quarters, the problems have been confined largely to subprime borrowers. We do not expect any broad-based tightening of credit supply conditions to households over the projection period.

We see debt growth in the business sector rebounding somewhat from its slower pace in recent months and continuing to strengthen with the expected acceleration in capital spending. Demand for credit is tempered by a pickup in equity issuance, a still-reduced pace of share repurchases, and an emphasis on stock-financed mergers. Although net issuance of commercial paper should turn positive after the sharp runoff over the past couple of months, we expect the lion's share of new corporate borrowing to be financed through bond issuance and a revival in bank business lending. Weaker firms, particularly in the telecom sector, are likely to continue to face cautious lenders and investors in coming quarters, but credit supply conditions even for these businesses should ease over time as profitability improves.

Borrowing by state and local governments will likely be boosted by offerings to finance infrastructure investment. In the second half of 2002, California should offer a large issue, which, among other uses, is intended to repay the state general fund for past expenditures for electricity. New York City has scheduled a large advance-refunding bond over the remainder of 2002, but retirements from earlier refundings should temper the net effect of advance-refundings on debt growth.

With the cessation of policy easing at the end of last year, the opportunity cost of holding M2 assets has begun to rise again, and M2 has decelerated. Going forward, the impetus to M2 coming from the lagged response of deposit rates to market rates should play out, begin to reverse in the second half of the year as short-term rates increase, and become a significant drag on M2 in 2003 as policy tightens. Special factors such as foreign demand for currency and mortgage-refinancing effects are expected to contribute modestly to M2 growth this year and hardly at all in 2003. On balance, M2 grows slightly faster than nominal GDP in 2002 and considerably less than nominal GDP in 2003.

Alternative Simulations
Our baseline forecast assumes that equity prices will continue to trend up over the next two years despite growth in corporate profits that falls short of the current expectations of analysts, particularly in 2003. We expect that market participants will remain reasonably patient, as they appear to have been over the past year, in the face of some earnings disappointments. Alternatively, we consider two developments—one an expansion of aggregate supply and the other an expansion of aggregate demand—that would boost the growth of profits to be more in line with analysts' expectations; we also consider the joint probability that a combination of supply, demand, and price shocks could boost profitability. Another scenario considers a downward adjustment of equity prices. Besides these scenarios, we address three other risks to the forecast—the chance that the recovery apparently now under way will turn out to be surprisingly anemic; the possibility that the stock market will boom this year and next; and the risk that the NAIRU is much lower than the staff estimates. Finally, we present a scenario in which the federal funds rate rises in line with market expectations.

Higher productivity. We have been cautious in translating recent gains in output per hour into faster structural productivity growth, and hence we may have understated the trend. One implication of a more rapid expansion in output per hour would be a higher profit share, which would bring earnings into more comfortable alignment with our projection of share prices. In the baseline, equity prices rise steadily at a "neutral" rate of about 7 percent per year, despite earnings growth below that anticipated by market analysts (particularly in 2003).[4] However, if structural multifactor productivity increases 3/4 percentage point per year faster than we assumed in the baseline, then the growth of earnings about matches analysts' expectations, and the corporate profit share rises to 8-1/2 percent by late next year, compared with 7-1/2 percent in the staff forecast. Under these conditions, growth of real GDP runs around 5 percent after the first half of the year, and the unemployment rate slips to about 5 percent in 2003, assuming that the funds rate follows the baseline path. Nonetheless, with nominal wages responding only gradually to the increase in productivity, unit labor costs decelerate, pushing core inflation down to

4. All else being equal, shares prices should rise by enough to equate the return on equity to that on bonds, after adjusting for differences in risk. The current yield on AAA corporate securities is about 6-1/2 percent. Assuming an equity premium of about 2 percent, the total return on stocks—the dividend yield plus price appreciation—should therefore be about 8-1/2 percent per year. With the S&P 500 dividend-price ratio now standing at about 1-1/2 percent, this implies that share prices should rise about 7 percent per year on average to ensure arbitrage between the bond and stock markets.

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

Measure	2001 Q4	2002 Q1	2002 Q2	2002 H2	2003
Real GDP					
Baseline	**1.4**	**3.8**	**3.5**	**3.6**	**4.0**
Higher productivity	1.4	3.8	3.5	4.7	5.4
Stronger cyclical rebound	1.4	3.9	3.9	4.6	6.0
Stock market adjustment	1.4	3.8	3.5	3.6	3.7
Slower recovery	1.4	3.8	2.1	2.1	2.8
Stronger stock market	1.4	3.8	3.6	3.9	4.9
Lower NAIRU	1.4	3.8	3.6	3.8	4.2
Market-based funds rate	1.4	3.8	3.5	3.4	3.2
Civilian unemployment rate[1]					
Baseline	**5.6**	**5.6**	**5.7**	**5.5**	**5.3**
Higher productivity	5.6	5.6	5.8	5.5	5.1
Stronger cyclical rebound	5.6	5.6	5.7	5.3	4.2
Stock market adjustment	5.6	5.6	5.7	5.5	5.4
Slower recovery	5.6	5.6	5.8	5.9	6.4
Stronger stock market	5.6	5.6	5.7	5.4	4.8
Lower NAIRU	5.6	5.6	5.7	5.5	5.1
Market-based funds rate	5.6	5.6	5.7	5.5	5.7
PCE prices excluding food and energy					
Baseline	**2.6**	**1.0**	**1.7**	**1.4**	**1.4**
Higher productivity	2.6	1.0	1.7	1.3	1.0
Stronger cyclical rebound	2.6	1.0	1.7	1.4	1.5
Stock market adjustment	2.6	1.0	1.7	1.4	1.4
Slower recovery	2.6	1.0	1.7	1.4	1.2
Stronger stock market	2.6	1.0	1.7	1.4	1.5
Lower NAIRU	2.6	1.0	1.6	1.1	.9
Market-based funds rate	2.6	1.0	1.7	1.4	1.2

1. Average for the final quarter of the period.

1 percent by next year. All in all, we would be facing a pattern of surprises similar to those experienced through much of the late 1990s.

Stronger cyclical rebound. We may also have understated the degree to which the surprising strength of incoming data is signaling a more robust sustained pace of consumption and investment. Such stronger demand provides an alternative way of justifying analysts' expectations for earnings because it would also yield a higher profit share even under the baseline assumption for structural productivity. In the "stronger cyclical rebound" scenario, growth in real GDP picks up to 6 percent by next year, holding the nominal funds rate at its baseline path, and the profit share again rises to 8-1/2 percent. The unemployment rate drops to 4-1/4 percent by late next year, thereby putting inflation on an upward trend.

The preceding two simulations present specific examples of how the profit share could rise to 8-1/2 percent by the end of next year. However, such an increase in the profit share could occur through many different combinations of shocks to productivity (both transitory and permanent), demand, and wages and prices. To calculate the probability, more generally, that we could see such a rise in the profit share, we performed stochastic simulations of the model. Based on these simulations, we estimate that the probability that the higher profit share could be realized through shocks to productivity or to demand alone are small. However, when we allow the shocks to occur in combination, the probability of reaching a profit share of 8-1/2 percent (or higher) increases to 25 percent. Of course, these results are highly dependent on the structure of the FRB/US model, its historical equation errors, and the use of the Greenbook forecast as a baseline.

Stock market adjustment. Investors may prove less tolerant about potential earnings disappointments than we have assumed in the baseline, and this could be reflected in lower equity prices than we have projected. In this alternative scenario, the stock market remains roughly flat through next year, leaving the level of share prices 12 percent below baseline by the end of 2003. The lower level of equity valuations has little effect on consumer spending in 2002, but in 2003, it depresses consumption modestly and shaves 1/4 percentage point from real GDP growth. Nonetheless, the unemployment rate and inflation are virtually unaffected.

Slower recovery. An alternative risk to the outlook is that we have been too quick to respond to signs of a turnaround in the economy. Consumers—still pressed by past declines in wealth and coming off a strong spurt in durable goods spending—may decide to boost saving more than we anticipate. In addition, problems in telecommunications and some other segments of the high-tech sector persist, and nominal spending on high-tech equipment may stall out at current levels for the remainder of this year. In this scenario, an additional 1/2 percentage point increase in the personal saving rate, coupled with a delay in the recovery of high-tech spending until next year, lowers real GDP growth to close to 2 percent over the remainder of the year. Under the baseline monetary policy, output growth remains anemic in 2003, the unemployment rate drifts up to 6-1/2 percent by late that year, and inflation edges down.

Stronger stock market. In the staff forecast, equity valuations increase in line with our projections for earnings growth, as both bonds rates and the equity premium are projected to remain near current levels. Relative to past cyclical episodes, such growth in share prices would be quite modest, befitting the shallow nature of the recession. Nonetheless, there is a risk that sustained low inflation and rapid productivity growth may generate more bullish market sentiment. If the equity premium returns gradually to the low levels of late 1999, then growth in share prices this year and next returns to the 25 percent rate seen during the late 1990s. If the nominal funds rate follows its baseline path, real GDP growth climbs to almost 5percent in 2003, bringing the unemployment rate to 4-3/4 percent by late next year.

Low NAIRU. This scenario considers the possibility that the NAIRU is 4-1/4 percent—1 percentage point lower than assumed by the staff and at the low end of the range of values consistent with recent statistical evidence. The lower NAIRU puts significant downward pressure on inflation and provides a slight boost to real GDP, owing to its implications for the level of potential output.

Market-based funds rate. Futures quotes are consistent with a more aggressive tightening in monetary policy than assumed by the staff, with investors expecting the funds rate to reach 5 percent by late next year. Modifying the baseline outlook to incorporate this steeper trajectory for short-term interest rates shaves 3/4 percentage point from output growth in 2003. As a result, the unemployment rate edges back up to 5-3/4 percent by late next year, and inflation falls to 1-1/4 percent.

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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]	
		01/23/02	03/13/02	01/23/02	03/13/02	01/23/02	03/13/02	01/23/02	03/13/02	01/23/02	03/13/02
ANNUAL											
1999		5.5	5.5	4.1	4.1	1.4	1.4	2.2	2.2	4.2	4.2
2000		6.5	6.5	4.1	4.1	2.3	2.3	3.4	3.4	4.0	4.0
2001		3.3	3.4	1.1	1.2	2.2	2.2	2.8	2.8	4.8	4.8
2002		2.7	3.8	1.3	2.4	1.4	1.4	1.3	1.5	6.0	5.6
2003		4.9	5.5	3.4	3.8	1.5	1.6	1.9	2.0	5.9	5.4
QUARTERLY											
2000	Q1	6.3	6.3	2.3	2.3	3.8	3.8	4.3	3.9	4.0	4.0
	Q2	8.0	8.0	5.7	5.7	2.1	2.1	2.8	3.3	4.0	4.0
	Q3	3.3	3.3	1.3	1.3	1.9	1.9	3.5	3.5	4.1	4.1
	Q4	3.7	3.7	1.9	1.9	1.8	1.8	3.0	2.8	4.0	4.0
2001	Q1	4.6	4.6	1.3	1.3	3.3	3.3	4.2	4.0	4.2	4.2
	Q2	2.4	2.4	0.3	0.3	2.1	2.1	3.0	3.2	4.5	4.5
	Q3	0.9	0.9	-1.3	-1.3	2.3	2.3	0.7	0.7	4.8	4.8
	Q4	-0.1	1.0	-0.3	1.4	0.2	-0.3	-0.4	-0.2	5.6	5.6
2002	Q1	3.3	5.4	1.5	3.8	1.7	1.5	1.1	1.2	5.9	5.6
	Q2	4.1	5.7	2.5	3.5	1.6	2.1	2.2	3.4	6.0	5.7
	Q3	5.0	5.3	3.5	3.6	1.5	1.6	2.1	1.9	6.0	5.6
	Q4	4.7	5.1	3.3	3.6	1.4	1.4	2.0	1.7	6.0	5.5
2003	Q1	5.2	5.9	3.4	3.9	1.7	1.9	1.9	1.9	5.9	5.5
	Q2	4.8	5.4	3.5	3.9	1.3	1.4	1.8	1.9	5.9	5.4
	Q3	4.9	5.5	3.6	3.9	1.3	1.5	1.8	1.9	5.9	5.3
	Q4	5.0	5.6	3.7	4.1	1.3	1.5	1.8	1.9	5.8	5.3
TWO-QUARTER[3]											
2000	Q2	7.2	7.2	4.0	4.0	2.9	2.9	3.6	3.6	-0.1	-0.1
	Q4	3.5	3.5	1.6	1.6	1.8	1.8	3.2	3.3	0.0	0.0
2001	Q2	3.5	3.5	0.8	0.8	2.7	2.7	3.6	3.5	0.5	0.5
	Q4	0.4	0.9	-0.8	0.0	1.2	1.0	0.1	0.2	1.1	1.1
2002	Q2	3.7	5.5	2.0	3.7	1.6	1.8	1.6	2.3	0.4	0.1
	Q4	4.9	5.2	3.4	3.6	1.4	1.5	2.0	1.8	0.0	-0.2
2003	Q2	5.0	5.6	3.5	3.9	1.5	1.7	1.8	1.9	-0.1	-0.1
	Q4	5.0	5.6	3.7	4.0	1.3	1.5	1.8	1.9	-0.1	-0.1
FOUR-QUARTER[4]											
1999	Q4	6.0	6.0	4.4	4.4	1.6	1.6	2.6	2.6	-0.3	-0.3
2000	Q4	5.3	5.3	2.8	2.8	2.4	2.4	3.4	3.4	-0.1	-0.1
2001	Q4	1.9	2.2	0.0	0.4	1.9	1.8	1.9	1.9	1.6	1.6
2002	Q4	4.3	5.4	2.7	3.7	1.5	1.7	1.8	2.0	0.4	-0.1
2003	Q4	5.0	5.6	3.6	4.0	1.4	1.6	1.8	1.9	-0.2	-0.3

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

REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS, ANNUAL VALUES (Seasonally adjusted annual rate) — March 13, 2002

Item	Units[1]	1995	1996	1997	1998	1999	2000	2001 (Projected)	2002 (Projected)	2003 (Projected)
EXPENDITURES										
Nominal GDP	Bill. $	7400.5	7813.2	8318.4	8781.5	9268.6	9872.9	10204.6	10594.6	11176.4
Real GDP	Bill. Ch. $	7543.8	7813.2	8159.5	8508.9	8856.5	9224.0	9332.1	9554.9	9919.8
Real GDP	% change	2.2	4.1	4.3	4.8	4.4	2.8	0.4	3.7	4.0
Gross domestic purchases		1.7	4.3	5.0	5.8	5.3	3.5	0.4	4.6	4.5
Final sales		2.9	3.9	3.9	4.7	4.3	3.4	2.0	2.1	3.4
Priv. dom. final purchases		3.2	4.4	5.1	6.3	5.4	4.7	1.2	2.7	4.1
Personal cons. expenditures		2.8	3.1	4.1	5.0	5.2	4.2	3.1	2.6	3.3
Durables		3.7	5.0	8.8	12.7	11.3	5.3	13.6	-3.0	5.8
Nondurables		2.5	3.2	2.5	5.0	5.0	3.6	1.4	3.9	2.9
Services		2.7	2.7	3.9	3.6	4.0	4.3	1.9	3.1	3.0
Business fixed investment		7.5	12.1	11.8	12.3	7.4	8.9	-9.4	2.9	11.9
Equipment & Software		8.9	11.8	13.7	14.9	11.2	8.3	-8.4	5.6	14.0
Nonres. structures		3.3	12.8	6.5	4.9	-3.6	10.8	-12.0	-4.7	5.4
Residential structures		-1.5	5.6	3.5	10.0	3.4	-1.2	3.0	3.7	-2.1
Exports		9.7	9.8	8.5	2.3	4.5	7.0	-11.2	5.2	7.1
Imports		5.0	11.2	14.3	10.8	11.5	11.3	-8.4	12.4	10.3
Gov’t. cons. & investment		-0.8	2.7	2.4	2.7	4.0	1.2	5.2	4.6	3.1
Federal		-5.3	2.0	0.1	0.6	4.5	-1.4	5.0	8.4	1.5
Defense		-4.7	0.8	-1.4	-0.8	4.7	-2.2	5.6	7.3	1.3
State & local		2.1	3.0	3.7	3.8	3.7	2.5	5.3	2.6	4.0
Change in bus. inventories	Bill. Ch. $	--	--	63.8	76.7	62.1	50.6	-62.2	-6.4	91.6
Nonfarm		41.9	21.2	60.6	75.0	63.5	52.3	-59.5	-6.6	89.4
Net exports		-78.4	-89.0	-113.3	-221.1	-316.9	-399.1	-410.2	-498.4	-607.7
Nominal GDP	% change	4.3	6.0	6.2	6.0	6.0	5.3	2.2	5.4	5.6
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employment	Millions	117.2	119.6	122.7	125.8	128.9	131.8	132.2	132.2	134.6
Unemployment rate	%	5.6	5.4	4.9	4.5	4.2	4.0	4.8	5.6	5.4
Industrial prod. index	% change	3.5	5.8	7.4	3.5	4.3	2.6	-5.9	3.9	4.2
Capacity util. rate - mfg.	%	82.6	81.6	82.7	81.4	80.6	80.7	75.1	74.1	76.7
Housing starts	Millions	1.35	1.48	1.47	1.62	1.64	1.57	1.61	1.67	1.66
Light motor vehicle sales		14.77	15.05	15.06	15.43	16.78	17.25	17.02	16.26	16.81
North Amer. produced		12.87	13.34	13.12	13.41	14.30	14.39	13.94	13.17	13.63
Other		1.90	1.70	1.93	2.02	2.48	2.86	3.08	3.09	3.17
INCOME AND SAVING										
Nominal GNP	Bill. $	7420.9	7831.2	8325.4	8778.1	9261.8	9860.8	10194.8	10589.8	11161.1
Nominal GNP	% change	4.4	5.9	6.0	5.8	6.0	5.4	2.1	5.4	5.4
Nominal personal income		4.3	5.9	6.3	6.7	4.8	7.3	2.9	5.0	5.0
Real disposable income		1.7	2.6	3.8	5.0	2.1	4.0	2.1	4.8	3.0
Personal saving rate	%	5.6	4.8	4.2	4.7	2.4	1.0	1.6	2.4	2.4
Corp. profits, IVA & CCAdj.	% change	11.3	11.4	9.9	-9.6	11.3	-1.2	-10.9	8.9	6.7
Profit share of GNP	%	9.0	9.6	10.0	8.9	8.9	8.9	7.4	7.7	7.7
Excluding FR Banks		8.7	9.4	9.7	8.6	8.6	8.6	7.1	7.5	7.4
Federal surpl./deficit	Bill. $	-192.0	-136.8	-53.3	43.8	119.2	218.6	110.2	-12.8	57.3
State & local surpl./def.		15.3	21.4	31.0	40.7	42.1	32.8	17.0	26.4	24.4
Ex. social ins. funds		11.4	18.7	29.9	40.0	41.7	33.1	17.2	26.7	24.7
Gross natl. saving rate	%	16.9	17.2	18.0	18.8	18.4	18.1	16.9	16.5	17.2
Net natl. saving rate		5.1	5.7	6.7	7.5	6.8	6.3	4.2	4.0	4.6
PRICES AND COSTS										
GDP chn.-wt. price index	% change	2.1	1.9	1.8	1.1	1.6	2.4	1.8	1.7	1.6
Gross Domestic Purchases chn.-wt. price index		2.1	1.9	1.4	0.8	1.9	2.5	1.1	1.6	1.6
PCE chn.-wt. price index		2.1	2.3	1.5	1.1	2.0	2.6	1.2	1.5	1.4
Ex. food and energy		2.3	1.8	1.7	1.6	1.5	1.9	1.6	1.4	1.4
CPI		2.6	3.2	1.9	1.5	2.6	3.4	1.9	2.0	1.9
Ex. food and energy		3.1	2.6	2.2	2.3	2.1	2.5	2.7	2.2	2.1
ECI, hourly compensation[2]		2.6	3.1	3.4	3.5	3.4	4.4	4.2	3.2	3.3
Nonfarm business sector										
Output per hour		1.1	2.3	2.3	2.9	2.9	2.6	2.0	2.2	2.2
Compensation per Hour		2.6	3.2	3.5	5.3	4.5	7.8	3.9	3.1	3.3
Unit labor cost		1.5	0.9	1.1	2.3	1.5	5.0	1.8	0.8	1.1

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

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

March 13, 2002

Item	Units	1999 Q1	1999 Q2	1999 Q3	1999 Q4	2000 Q1	2000 Q2	2000 Q3	2000 Q4	2001 Q1	2001 Q2
EXPENDITURES											
Nominal GDP	Bill. $	9093.1	9161.4	9297.4	9522.5	9668.7	9857.6	9937.5	10027.9	10141.7	10202.6
Real GDP	Bill. Ch. $	8733.5	8771.2	8871.5	9049.9	9102.5	9229.4	9260.1	9303.9	9334.5	9341.7
Real GDP	% change	3.1	1.7	4.7	8.3	2.3	5.7	1.3	1.9	1.3	0.3
Gross domestic purchases		4.8	2.9	5.3	8.2	3.5	6.3	2.0	2.2	0.7	0.4
Final sales		3.0	3.9	4.2	6.1	4.8	3.9	2.3	2.4	4.0	0.7
Priv. dom. final purchases		5.3	5.9	4.9	5.5	7.5	4.6	3.9	2.6	2.8	-0.0
Personal cons. expenditures		4.9	5.7	4.4	5.7	5.9	3.6	4.3	3.1	3.0	2.5
Durables		7.1	15.7	9.0	13.7	19.0	-2.5	8.2	-2.1	10.6	7.0
Nondurables		5.6	4.3	2.6	7.6	5.1	4.7	4.2	0.6	2.4	0.3
Services		4.1	4.5	4.3	3.2	3.7	4.4	3.5	5.6	1.8	2.8
Business fixed investment		6.0	7.7	10.2	5.8	15.8	12.2	7.1	1.0	-0.2	-14.6
Equipment & Software		10.5	11.9	16.2	6.4	18.1	12.4	4.7	-1.1	-4.1	-15.4
Nonres. structures		-6.5	-4.3	-7.0	4.0	8.8	11.8	15.2	7.6	12.3	-12.2
Residential structures		10.3	3.0	-0.8	1.6	8.5	-0.8	-10.4	-1.1	8.5	5.9
Exports		-6.8	4.2	9.7	12.1	9.0	13.5	10.6	-4.0	-1.2	-11.9
Imports		8.4	13.3	13.8	10.5	17.1	16.4	13.0	-0.5	-5.0	-8.4
Gov’t. cons. & investment		2.0	1.2	4.4	8.5	-1.1	4.4	-1.8	3.3	5.3	5.0
Federal		-3.7	0.8	7.2	14.5	-12.8	15.9	-10.4	4.6	3.2	1.8
Defense		-3.5	-3.5	12.8	14.3	-20.0	15.4	-10.4	10.5	7.5	2.3
State & local		5.2	1.4	2.9	5.4	5.6	-1.1	3.0	2.7	6.4	6.6
Change in bus. inventories	Bill. Ch. $	83.4	32.7	39.6	92.7	28.9	78.9	51.7	42.8	-27.1	-38.3
Nonfarm		78.7	34.2	52.2	88.7	37.8	75.1	56.6	39.7	-27.3	-35.8
Net exports		-283.0	-313.4	-333.3	-337.8	-371.1	-392.8	-411.2	-421.1	-404.5	-406.7
Nominal GDP	% change	4.9	3.0	6.1	10.0	6.3	8.0	3.3	3.7	4.6	2.4
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	127.8	128.5	129.2	130.1	131.0	131.9	131.9	132.3	132.6	132.5
Unemployment rate	%	4.3	4.3	4.2	4.1	4.0	4.0	4.1	4.0	4.2	4.5
Industrial prod. index	% change	3.6	3.3	4.7	5.8	5.8	7.0	0.6	-2.6	-6.1	-5.9
Capacity util. rate - mfg.	%	80.5	80.4	80.5	81.0	81.2	81.6	80.7	79.1	77.2	75.6
Housing starts	Millions	1.71	1.57	1.65	1.66	1.67	1.59	1.51	1.54	1.63	1.62
Light motor vehicle sales		16.17	16.76	17.06	17.11	18.13	17.27	17.30	16.32	16.89	16.65
North Amer. produced		13.87	14.32	14.58	14.41	15.25	14.40	14.47	13.45	13.96	13.62
Other		2.30	2.44	2.47	2.70	2.87	2.87	2.83	2.87	2.93	3.03
INCOME AND SAVING											
Nominal GNP	Bill. $	9089.5	9157.0	9283.8	9517.0	9650.7	9841.0	9919.4	10032.1	10131.3	10190.9
Nominal GNP	% change	5.2	3.0	5.7	10.4	5.7	8.1	3.2	4.6	4.0	2.4
Nominal personal income		3.0	4.7	5.2	6.3	8.6	8.5	5.5	6.8	5.8	3.5
Real disposable income		1.4	2.0	2.1	3.0	3.3	5.8	2.6	4.2	2.7	2.4
Personal saving rate	%	3.5	2.7	2.1	1.4	0.8	1.3	0.8	1.0	1.1	1.1
Corp. profits, IVA & CCAdj.	% change	36.1	-10.2	-4.9	31.9	6.1	10.7	1.0	-19.6	-24.6	-14.3
Profit share of GNP	%	9.2	8.8	8.6	9.0	9.0	9.1	9.0	8.4	7.8	7.5
Excluding FR Banks		8.9	8.6	8.3	8.7	8.7	8.8	8.7	8.1	7.5	7.2
Federal surpl./deficit	Bill. $	85.2	116.5	132.0	143.1	212.8	209.1	229.9	222.5	205.3	186.7
State & local surpl./def.		48.9	36.2	38.3	44.9	33.2	34.7	34.8	28.6	22.3	21.3
Ex. social ins. funds		48.4	35.8	38.0	44.7	33.3	34.9	35.1	29.1	22.6	21.4
Gross natl. saving rate	%	19.0	18.5	18.3	18.0	18.0	18.3	18.2	17.9	17.3	17.2
Net natl. saving rate		7.6	6.9	6.4	6.3	6.3	6.6	6.4	6.0	5.1	4.6
PRICES AND COSTS											
GDP chn.-wt. price index	% change	1.7	1.4	1.4	1.8	3.8	2.1	1.9	1.8	3.3	2.1
Gross Domestic Purchases chn.-wt. price index		1.5	2.0	2.0	2.2	4.2	1.9	2.3	1.7	2.7	1.3
PCE chn.-wt. price index		1.3	2.0	2.2	2.4	4.0	2.1	2.4	2.0	3.2	1.3
Ex. food and energy		1.4	1.2	1.5	1.8	2.9	1.7	1.6	1.5	2.6	0.7
CPI		1.5	2.9	2.7	3.4	3.9	3.3	3.5	2.8	4.0	3.2
Ex. food and energy		1.8	1.8	1.8	2.7	2.3	2.7	2.7	2.4	3.1	2.4
ECI, hourly compensation[1]		1.4	4.6	3.4	4.6	5.6	4.7	3.8	3.5	4.6	4.0
Nonfarm business sector											
Output per hour		2.3	-1.3	3.2	7.8	0.0	6.7	1.6	2.3	-0.1	2.1
Compensation per hour		3.6	4.2	5.5	4.7	6.9	8.1	7.4	8.9	4.9	4.7
Unit labor cost		1.3	5.6	2.2	-2.9	6.9	1.3	5.7	6.4	5.0	2.6

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)

March 13, 2002

Item	Units	2001 Q3	2001 Q4	2002 Q1 (Projected)	2002 Q2 (Projected)	2002 Q3 (Projected)	2002 Q4 (Projected)	2003 Q1 (Projected)	2003 Q2 (Projected)	2003 Q3 (Projected)	2003 Q4 (Projected)
EXPENDITURES											
Nominal GDP	Bill. $	10224.9	10249.3	10383.9	10529.8	10665.5	10799.4	10954.3	11099.0	11248.5	11404.0
Real GDP	Bill. Ch. $	9310.4	9341.8	9428.7	9511.2	9596.7	9683.0	9776.2	9870.3	9966.3	10066.5
Real GDP	% change	-1.3	1.4	3.8	3.5	3.6	3.6	3.9	3.9	3.9	4.1
Gross domestic purchases		-1.0	1.7	4.6	4.6	4.8	4.2	4.7	4.6	4.5	4.2
Final sales		-0.5	3.7	2.0	1.2	2.2	2.8	3.1	3.1	3.4	3.9
Priv. dom. final purchases		-0.4	2.5	1.9	2.3	3.1	3.4	4.1	4.1	4.1	4.2
Personal cons. expenditures		1.0	6.0	2.1	2.4	2.8	2.9	3.3	3.4	3.3	3.3
Durables		0.9	39.4	-17.8	-1.8	6.2	3.5	6.3	6.1	5.2	5.5
Nondurables		0.6	2.5	8.7	2.3	2.2	2.7	2.8	3.0	3.0	3.0
Services		1.2	1.8	3.7	3.3	2.5	2.9	2.9	3.1	3.1	3.1
Business fixed investment		-8.5	-13.7	-1.4	2.3	5.1	6.0	11.3	11.8	11.8	12.5
Equipment & Software		-8.8	-4.9	2.2	5.1	7.5	7.7	14.2	14.1	13.6	14.1
Nonres. structures		-7.5	-34.1	-11.4	-5.7	-1.9	0.7	2.7	4.8	6.4	7.9
Residential structures		2.4	-4.5	7.7	0.4	2.4	4.3	0.2	-3.3	-2.8	-2.5
Exports		-18.8	-12.2	6.3	4.8	3.6	6.2	4.0	6.9	7.6	10.0
Imports		-13.0	-7.0	12.9	13.8	12.6	10.3	10.2	11.8	10.5	8.8
Gov't. cons. & investment		0.3	10.4	7.4	2.9	4.4	3.6	3.0	2.9	3.4	3.1
Federal		3.6	11.6	13.8	8.7	7.2	3.9	2.0	1.0	2.1	0.9
Defense		3.2	9.4	18.9	4.7	3.1	3.3	1.7	0.6	2.2	0.5
State & local		-1.3	9.8	4.3	-0.0	2.9	3.5	3.6	4.0	4.1	4.3
Change in bus. inventories	Bill. Ch. $	-61.9	-121.5	-76.6	-16.3	22.2	45.0	66.3	87.8	103.6	108.7
Nonfarm		-59.0	-116.0	-74.6	-16.8	21.1	43.6	64.7	85.6	101.2	106.0
Net exports		-411.0	-418.6	-447.0	-483.2	-520.1	-543.2	-572.3	-600.8	-623.7	-633.9
Nominal GDP	% change	0.9	1.0	5.4	5.7	5.3	5.1	5.9	5.4	5.5	5.6
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	132.4	131.5	131.3	131.7	132.6	133.1	133.7	134.3	135.0	135.6
Unemployment rate	%	4.8	5.6	5.6	5.7	5.6	5.5	5.5	5.4	5.3	5.3
Industrial prod. index	% change	-4.7	-6.9	1.0	4.9	5.4	4.2	3.9	4.4	4.2	4.5
Capacity util. rate - mfg.	%	74.5	73.1	73.1	73.7	74.6	75.2	75.8	76.4	77.0	77.6
Housing starts	Millions	1.60	1.57	1.65	1.65	1.68	1.71	1.68	1.66	1.65	1.64
Light motor vehicle sales		16.12	18.41	16.04	16.00	16.50	16.50	16.69	16.84	16.83	16.86
North Amer. produced		13.15	15.02	12.84	13.04	13.40	13.40	13.55	13.68	13.65	13.65
Other		2.97	3.39	3.20	2.96	3.10	3.10	3.14	3.16	3.18	3.21
INCOME AND SAVING											
Nominal GNP	Bill. $	10213.8	10243.4	10378.1	10525.0	10660.1	10795.9	10948.0	11088.5	11230.2	11377.8
Nominal GNP	% change	0.9	1.2	5.4	5.8	5.2	5.2	5.8	5.2	5.2	5.4
Nominal personal income		2.7	-0.1	4.7	5.4	5.6	4.5	5.0	5.0	5.0	4.8
Real disposable income		12.3	-7.9	8.9	3.8	3.7	2.8	3.0	3.2	3.1	2.8
Personal saving rate	%	3.8	0.4	2.0	2.3	2.6	2.5	2.5	2.5	2.5	2.4
Corp. profits, IVA & CCAdj.	% change	-29.2	38.1	29.6	8.8	-5.1	5.0	7.1	7.4	4.8	7.6
Profit share of GNP	%	6.8	7.4	7.8	7.8	7.6	7.6	7.6	7.7	7.7	7.7
Excluding FR Banks		6.6	7.1	7.5	7.6	7.4	7.4	7.4	7.4	7.4	7.5
Federal surpl./deficit	Bill. $	-13.6	62.4	-14.5	-22.4	-10.3	-3.9	26.1	45.5	66.0	91.8
State & local surpl./def.		1.9	22.6	32.5	23.9	21.8	27.3	28.3	26.3	23.5	19.5
Ex. social ins. funds		2.0	22.7	32.8	24.2	22.1	27.6	28.6	26.6	23.8	19.8
Gross natl. saving rate	%	17.2	15.9	16.3	16.4	16.6	16.7	16.9	17.1	17.3	17.4
Net natl. saving rate		3.9	3.1	3.8	3.9	4.1	4.1	4.4	4.6	4.7	4.8
PRICES AND COSTS											
GDP chn.-wt. price index	% change	2.3	-0.3	1.5	2.1	1.6	1.4	1.9	1.4	1.5	1.5
Gross Domestic Purchases chn.-wt. price index		-0.1	0.4	1.3	2.3	1.4	1.4	1.9	1.5	1.5	1.5
PCE chn.-wt. price index		-0.2	0.7	0.8	2.5	1.4	1.3	1.4	1.4	1.5	1.5
Ex. food and energy		0.5	2.6	1.0	1.7	1.5	1.4	1.4	1.4	1.4	1.4
CPI		0.7	-0.2	1.2	3.4	1.9	1.7	1.9	1.9	1.9	1.9
Ex. food and energy		2.6	2.6	2.2	2.4	2.2	2.0	2.1	2.1	2.1	2.1
ECI, hourly compensation[1]		3.7	4.2	3.3	3.2	3.2	3.2	3.2	3.2	3.3	3.3
Nonfarm business sector											
Output per hour		1.1	5.1	5.5	0.9	0.6	1.9	2.2	2.2	2.1	2.3
Compensation per hour		3.7	2.3	3.1	2.7	3.1	3.2	3.4	3.2	3.3	3.3
Unit labor cost		2.6	-2.8	-2.4	1.9	2.6	1.3	1.2	1.0	1.2	1.1

1. Private-industry workers.

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

Item	1999 Q3	1999 Q4	2000 Q1	2000 Q2	2000 Q3	2000 Q4	2001 Q1	2001 Q2	2001 Q3	99Q4/ 98Q4	00Q4/ 99Q4	01Q4/ 00Q4
Real GDP	4.7	8.3	2.3	5.7	1.3	1.9	1.3	0.3	-1.3	4.4	2.8	0.4
Gross dom. purchases	5.4	8.4	3.6	6.5	2.0	2.3	0.7	0.4	-1.1	5.4	3.6	0.4
Final sales	4.2	6.2	4.7	3.9	2.3	2.4	3.9	0.7	-0.5	4.2	3.3	2.0
Priv. dom. final purchases	4.2	4.8	6.2	4.0	3.3	2.2	2.4	-0.0	-0.3	4.5	3.9	1.1
Personal cons. expenditures	3.0	4.0	3.9	2.5	2.9	2.1	2.1	1.7	0.7	3.5	2.9	2.1
Durables	0.7	1.1	1.5	-0.2	0.7	-0.2	0.8	0.6	0.1	0.9	0.4	1.1
Nondurables	0.5	1.5	1.0	1.0	0.8	0.1	0.5	0.1	0.1	1.0	0.7	0.3
Services	1.7	1.4	1.5	1.8	1.4	2.2	0.7	1.1	0.5	1.6	1.7	0.8
Business fixed investment	1.3	0.8	1.9	1.5	0.9	0.1	-0.0	-2.0	-1.1	0.9	1.1	-1.2
Equipment & Software	1.5	0.6	1.6	1.2	0.5	-0.1	-0.4	-1.6	-0.8	1.0	0.8	-0.8
Nonres. structures	-0.2	0.1	0.3	0.4	0.5	0.2	0.4	-0.4	-0.3	-0.1	0.3	-0.4
Residential structures	-0.0	0.1	0.4	-0.0	-0.5	-0.1	0.4	0.3	0.1	0.1	-0.1	0.1
Net exports	-0.8	-0.2	-1.3	-0.8	-0.7	-0.4	0.6	-0.1	-0.3	-1.0	-0.8	-0.0
Exports	1.0	1.3	1.0	1.4	1.1	-0.5	-0.1	-1.4	-2.1	0.5	0.8	-1.2
Imports	-1.8	-1.4	-2.3	-2.3	-1.8	0.1	0.8	1.3	1.9	-1.5	-1.6	1.2
Government cons. & invest.	0.8	1.5	-0.2	0.8	-0.3	0.6	0.9	0.9	0.1	0.7	0.2	0.9
Federal	0.4	0.9	-0.8	0.9	-0.7	0.3	0.2	0.1	0.2	0.3	-0.1	0.3
Defense	0.5	0.6	-0.9	0.6	-0.4	0.4	0.3	0.1	0.1	0.2	-0.1	0.2
Nondefense	-0.1	0.3	0.0	0.3	-0.2	-0.1	-0.1	0.0	0.1	0.1	0.0	0.1
State and local	0.3	0.7	0.6	-0.1	0.3	0.3	0.7	0.8	-0.2	0.4	0.3	0.6
Change in bus. inventories	0.4	2.2	-2.3	1.8	-1.0	-0.5	-2.6	-0.4	-0.8	0.2	-0.5	-1.5
Nonfarm	0.9	1.5	-2.0	1.5	-0.8	-0.7	-2.6	-0.3	-0.8	0.1	-0.5	-1.5
Farm	-0.4	0.6	-0.3	0.3	-0.2	0.2	0.0	-0.1	-0.0	0.0	-0.0	-0.0

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

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

Item	2001 Q4	2002 Q1	2002 Q2	2002 Q3	2002 Q4	2003 Q1	2003 Q2	2003 Q3	2003 Q4	01Q4/ 00Q4	02Q4/ 01Q4	03Q4/ 02Q4
Real GDP	1.4	3.8	3.5	3.6	3.6	3.9	3.9	3.9	4.1	0.4	3.7	4.0
Gross dom. purchases	1.7	4.7	4.8	4.9	4.4	4.9	4.8	4.7	4.4	0.4	4.7	4.7
Final sales	3.7	2.1	1.3	2.2	2.8	3.1	3.1	3.4	3.9	2.0	2.1	3.4
Priv. dom. final purchases	2.2	1.7	2.0	2.7	2.9	3.5	3.5	3.5	3.6	1.1	2.3	3.5
Personal cons. expenditures	4.1	1.5	1.7	2.0	2.0	2.3	2.3	2.3	2.3	2.1	1.8	2.3
Durables	2.8	-1.7	-0.1	0.5	0.3	0.5	0.5	0.4	0.4	1.1	-0.3	0.5
Nondurables	0.5	1.7	0.5	0.4	0.5	0.6	0.6	0.6	0.6	0.3	0.8	0.6
Services	0.7	1.5	1.4	1.0	1.2	1.2	1.3	1.3	1.3	0.8	1.3	1.2
Business fixed investment	-1.7	-0.2	0.3	0.6	0.7	1.2	1.3	1.3	1.4	-1.2	0.3	1.3
Equipment & Software	-0.4	0.2	0.4	0.6	0.6	1.2	1.2	1.1	1.2	-0.8	0.5	1.2
Nonres. structures	-1.3	-0.4	-0.2	-0.1	0.0	0.1	0.1	0.2	0.2	-0.4	-0.1	0.2
Residential structures	-0.2	0.3	0.0	0.1	0.2	0.0	-0.1	-0.1	-0.1	0.1	0.2	-0.1
Net exports	-0.4	-1.0	-1.2	-1.2	-0.7	-1.0	-0.9	-0.7	-0.3	-0.0	-1.1	-0.7
Exports	-1.3	0.6	0.5	0.3	0.6	0.4	0.6	0.7	0.9	-1.2	0.5	0.7
Imports	0.9	-1.6	-1.7	-1.6	-1.3	-1.3	-1.6	-1.4	-1.2	1.2	-1.6	-1.4
Government cons. & invest.	1.8	1.3	0.5	0.8	0.7	0.6	0.6	0.6	0.6	0.9	0.8	0.6
Federal	0.7	0.8	0.5	0.5	0.3	0.1	0.1	0.1	0.1	0.3	0.5	0.1
Defense	0.4	0.7	0.2	0.1	0.1	0.1	0.0	0.1	0.0	0.2	0.3	0.1
Nondefense	0.3	0.1	0.4	0.3	0.1	0.1	0.0	0.0	0.0	0.1	0.2	0.0
State and local	1.1	0.5	0.0	0.4	0.4	0.4	0.5	0.5	0.5	0.6	0.3	0.5
Change in bus. inventories	-2.3	1.7	2.3	1.4	0.8	0.8	0.8	0.6	0.2	-1.5	1.6	0.6
Nonfarm	-2.2	1.6	2.2	1.4	0.8	0.8	0.8	0.6	0.2	-1.5	1.5	0.6
Farm	-0.2	0.1	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.

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

Item	Fiscal year[1]				2001				2002				2003			
	2000[a]	2001[a]	2002	2003	Q1[a]	Q2[a]	Q3[a]	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Unified budget					Not seasonally adjusted											
Receipts[2]	2025	1991	1948	2065	460	660	409	466	411	602	468	443	456	662	505	483
Outlays[2]	1789	1864	2013	2096	482	467	451	503	511	504	495	536	526	521	512	549
Surplus/deficit[2]	236	127	-65	-31	-22	194	-42	-37	-99	98	-27	-93	-71	141	-8	-66
On-budget	87	-33	-219	-209	-88	119	-51	-81	-124	28	-42	-147	-99	62	-26	-128
Off-budget	150	161	154	178	65	75	10	44	25	70	15	54	28	78	18	61
Surplus excluding deposit insurance	233	126	-65	-33	-23	193	-42	-37	-99	98	-27	-93	-71	140	-8	-67
Means of financing																
Borrowing	-223	-90	94	77	24	-157	69	60	57	-66	43	106	74	-101	-1	51
Cash decrease	4	8	26	-26	-7	-15	-1	-8	25	-19	27	-6	-5	-30	15	15
Other[3]	-18	-45	-55	-20	6	-21	-26	-14	17	-14	-43	-6	2	-9	-6	-0
Cash operating balance, end of period	53	44	19	45	28	44	44	52	27	46	19	25	30	60	45	30
NIPA federal sector					Seasonally adjusted annual rates											
Receipts	2012	2041	1994	2106	2087	2091	1907	2001	1972	1988	2016	2050	2092	2124	2157	2203
Expenditures	1813	1891	1988	2072	1882	1905	1921	1930	1987	2010	2026	2054	2066	2078	2091	2111
Consumption expenditures	492	506	557	602	508	510	514	525	555	569	581	588	604	607	611	614
Defense	322	337	366	388	338	340	343	348	368	372	376	379	389	390	393	395
Nondefense	170	170	191	214	169	171	171	177	187	196	205	208	215	216	218	219
Other spending	1321	1384	1431	1470	1375	1395	1407	1405	1432	1441	1446	1466	1462	1472	1480	1497
Current account surplus	199	150	6	34	205	187	-14	71	-14	-22	-10	-4	26	46	66	92
Gross investment	96	100	111	116	98	100	102	107	110	112	113	115	115	116	117	117
Current and capital account surplus	102	50	-104	-82	107	87	-116	-36	-125	-134	-123	-118	-89	-70	-51	-25
Fiscal indicators[4]																
High-employment (HEB) surplus/deficit	-4	-15	-118	-119	26	25	-142	-47	-135	-146	-143	-145	-125	-110	-96	-77
Change in HEB, percent of potential GDP	-.8	.1	1	-0	0	0	2	-.9	.8	.1	-0	0	-.2	-.1	-.1	-.2
Fiscal impetus (FI) percent, calendar year	2	9	23	7	3	3	9	-4	16	4	2	3	1	.9	1	.3

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 February 2002 baseline surplus estimates are $-9 billion in FY 2002 and $51 billion in FY 2003. CBO's March 2002 deficit estimates, assuming discretionary spending grows with inflation beginning in FY 2003, are $5 billion in FY 2002 and $6 billion in FY 2003. Budget receipts, outlays, and surplus/deficit include corresponding social security (OASDI) categories. The OASDI surplus and the Postal Service surplus are excluded from the on-budget surplus and shown separately as off-budget, as classified under current law.
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)

			Nonfederal						
				Households					
Period [1]	Total [2]	Federal government [3]	Total [4]	Total	Home mortgages	Consumer credit	Business	State and local governments	Memo: Nominal GDP
Year									
1996	5.4	4.0	5.8	7.0	6.8	8.1	6.2	-0.6	6.0
1997	5.6	0.6	7.3	6.4	6.7	4.7	9.0	5.3	6.2
1998	6.9	-1.4	9.6	8.4	9.2	5.9	11.6	7.2	6.0
1999	6.8	-1.9	9.3	8.6	9.3	7.4	11.3	4.4	6.0
2000	5.0	-8.0	8.5	8.5	8.4	9.6	9.8	2.2	5.3
2001	6.0	-0.2	7.4	8.6	9.9	6.0	6.0	8.3	2.2
2002	5.8	4.1	6.1	6.7	8.0	3.3	5.8	4.9	5.4
2003	5.4	0.6	6.4	6.7	7.8	3.9	6.5	3.4	5.6
Quarter									
2001:1	5.4	-0.1	6.7	7.6	7.8	9.0	5.4	8.1	4.6
2	5.3	-7.6	8.2	9.2	11.3	4.6	7.0	8.3	2.4
3	6.9	7.7	6.7	8.5	9.9	1.5	5.5	3.2	0.9
4	6.0	-0.5	7.4	8.1	9.2	8.3	5.5	12.8	1.0
2002:1	5.5	3.9	5.8	6.8	8.2	3.0	5.0	4.3	5.4
2	5.5	3.2	6.0	6.5	7.8	3.1	5.9	3.4	5.7
3	5.8	4.4	6.1	6.3	7.5	3.3	6.0	5.7	5.3
4	5.9	4.8	6.1	6.5	7.6	3.6	5.9	5.6	5.1
2003:1	6.1	5.6	6.2	6.5	7.7	3.6	6.4	3.4	5.9
2	5.0	-0.9	6.2	6.5	7.6	3.8	6.4	3.3	5.4
3	5.1	-0.7	6.2	6.6	7.5	3.9	6.4	3.3	5.5
4	4.9	-1.4	6.2	6.6	7.4	4.0	6.4	3.3	5.6

Note. Quarterly data are at seasonally adjusted annual rates.
1. Data after 2001:Q4 are staff projections. Changes are measured from end of the preceding period to end of period indicated except for annual nominal GDP growth, which is calculated from Q4 to Q4.
2. On a monthly average basis, total debt is projected to grow 5.7 percent in 2002 and 5.5 percent in 2003.
3. On a monthly average basis, federal debt is projected to grow 3.4 percent in 2002 and 1.4 percent in 2003.
4. On a monthly average basis, nonfederal debt is projected to grow 6.2 percent in 2002 and 6.3 percent in 2003.

2.6.3 FOF

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

					Seasonally adjusted annual rates									
	Calendar year				2001		2002				2003			
Category	2000	2001	2002	2003	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Net funds raised by domestic nonfinancial sectors														
1 Total	711.9	1047.3	1183.5	1153.9	1176.6	1136.3	1110.2	1140.5	1227.4	1255.9	1300.7	1086.4	1120.0	1108.4
2 Net equity issuance	-159.7	-55.7	58.8	50.0	-120.8	-5.1	50.0	60.2	64.4	60.6	50.0	50.0	50.0	50.0
3 Net debt issuance	871.6	1103.0	1124.7	1103.9	1297.4	1141.4	1060.2	1080.3	1163.0	1195.3	1250.7	1036.4	1070.0	1058.4
Borrowing sectors														
Nonfinancial business														
4 Financing gap [1]	264.2	171.3	154.4	265.3	173.1	47.5	89.5	135.8	183.7	208.4	228.5	253.6	276.2	303.0
5 Net equity issuance	-159.7	-55.7	58.8	50.0	-120.8	-5.1	50.0	60.2	64.4	60.6	50.0	50.0	50.0	50.0
6 Credit market borrowing	585.7	391.5	403.2	479.5	369.0	377.5	345.5	414.4	428.5	424.4	467.5	473.4	486.7	490.2
Households														
7 Net borrowing [2]	554.6	610.3	514.0	553.0	629.7	609.9	524.0	507.2	501.8	523.3	537.9	546.5	558.0	569.9
8 Home mortgages	382.3	490.7	435.6	457.1	513.4	490.8	447.1	434.1	422.1	439.1	451.7	456.7	457.8	462.1
9 Consumer credit	139.0	95.2	55.4	67.6	24.4	137.0	51.2	52.3	56.6	61.6	62.9	66.6	68.6	72.5
10 Debt/DPI (percent) [3]	97.1	100.0	102.7	104.7	98.9	102.8	102.4	102.5	102.8	103.4	103.9	104.4	104.9	105.5
State and local governments														
11 Net borrowing	27.2	106.8	67.3	48.8	43.0	171.5	59.8	47.8	80.8	80.8	48.8	48.8	48.8	48.8
12 Current surplus [4]	191.9	190.3	208.9	217.6	181.1	197.6	211.2	205.1	205.6	213.8	217.5	218.2	218.1	216.9
Federal government														
13 Net borrowing	-295.9	-5.6	140.2	22.6	255.7	-17.6	130.9	110.9	152.0	166.8	196.6	-32.2	-23.5	-50.5
14 Net borrowing (quarterly, n.s.a.)	-295.9	-5.6	140.2	22.6	68.6	59.5	57.5	-65.7	42.7	105.6	73.9	-101.4	-1.2	51.3
15 Unified deficit (quarterly, n.s.a.)	-254.8	-92.3	120.8	4.2	41.9	37.1	99.5	-98.4	26.8	92.9	70.9	-140.6	7.6	66.2
Depository institutions														
16 Funds supplied	445.3	280.5	340.0	373.3	288.1	406.4	346.9	338.3	345.1	329.9	379.3	361.3	372.3	380.3
Memo (percentage of GDP)														
17 Domestic nonfinancial debt [5]	181.0	184.9	188.6	188.8	185.6	188.1	188.3	188.2	188.5	188.9	189.0	189.1	188.9	188.7
18 Domestic nonfinancial borrowing	8.8	10.8	10.6	9.9	12.7	11.1	10.2	10.3	10.9	11.1	11.4	9.3	9.5	9.3
19 Federal government [6]	-3.0	-0.1	1.3	0.2	2.5	-0.2	1.3	1.1	1.4	1.5	1.8	-0.3	-0.2	-0.4
20 Nonfederal	11.8	10.9	9.3	9.7	10.2	11.3	8.9	9.2	9.5	9.5	9.6	9.6	9.7	9.7

Note. Data after 2001:Q4 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

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International Developments

Foreign real GDP data for the fourth quarter of 2001 came in, on balance, stronger than we estimated at the time of the January Greenbook, and we now estimate that after mild contractions in the second and third quarters, growth of aggregate foreign GDP resumed late last year. With increasing evidence that turning points have been reached in most regions and with the stronger outlook for the U.S. economy, we have marked up our forecast for foreign growth this year and next. Financial markets abroad have also moved in a manner consistent with stronger growth: Bond yields in industrial countries are generally higher, bond spreads in developing countries have moved down on average, and equity prices have risen in both industrial and developing countries. Our outlook for recovery abroad is driven importantly by a rebound in exports and in global demand for high-tech goods, but we anticipate that foreign growth will be less robust than in the United States. Foreign inflation is expected to remain subdued, as growth abroad should narrow but not close most output gaps by the end of the forecast period.

The strength in recent indicators supports our view that the factors we have been expecting to boost activity abroad—economic recovery in the United States, lagged effects of the considerable macroeconomic policy easing, and a slowing of inventory liquidations—have begun to take hold. The projected pace of recovery, however, is mixed across regions. We have marked up our forecast more for the developing Asian economies and for North America, whereas we continue to project a subdued recovery in Europe and in South America.

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

Indicator	2001		Projection				
	H1	Q3	2001 Q4	2002 Q1	2002 Q2	2002 H2	2003
Foreign output	-.0	-.4	.5	1.6	2.4	2.9	3.4
January GB	*.1*	*-.2*	*-.4*	*.5*	*1.7*	*2.8*	*3.3*
Foreign CPI	2.6	1.6	.2	1.3	2.4	2.4	2.2
January GB	*2.5*	*1.8*	*.4*	*1.5*	*2.2*	*2.2*	*2.2*

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

After declining significantly in 2001, U.S. exports and, especially, imports should pick up markedly this year and expand even more in 2003. With foreign growth lagging U.S. growth and the dollar projected to remain little changed from its present high level, we expect the arithmetic contribution to U.S. real GDP growth from the external sector to be negative over the forecast period, compared with an almost neutral contribution recorded last year.

Oil prices. After falling for four consecutive months, the spot price of West Texas intermediate (WTI) crude oil rose slightly in January, to more than $19.50 per barrel. Oil prices continued to rise through February and moved sharply higher in the first half of March. The current spot price of WTI is more than $24 per barrel, a level not seen since September. Factors generating the price increase include stronger signs of world economic recovery, production restraint by OPEC, and heightened tensions in the Middle East. We project that the spot price of WTI, in line with recent quotes from futures markets, will decrease slightly to about $23 by the end of the forecast period as production restraints are eased. Compared with the previous Greenbook, this projection is about $4 per barrel higher in the near term and roughly $2 higher at the end of 2003.

International financial markets. The foreign exchange value of the dollar eased on balance since the January FOMC meeting, with the major currencies index down about 1¼ percent. The dollar declined against most major foreign currencies, depreciating 3 percent against the yen and 1¼ percent against the euro. Much of the dollar's decline has occurred since early March and may have been fueled in part by market participants' concerns that the President's imposition of tariffs on imported steel might signal a possible change in U.S. policy towards a "strong dollar." Conversely, the dollar rose significantly against the Argentine peso and the Venezuelan bolivar during the intermeeting period. Domestic policy challenges and social unrest continued to weigh on those currencies, prompting the dual exchange rate regime in Argentina to give way and forcing the heavily managed exchange rate regime in Venezuela to be abandoned. Spillovers to other markets remained negligible; the Mexican peso and the Brazilian *real* rose ½ percent and 4 percent, respectively, against the dollar during the period.

Our outlook for the dollar remains essentially flat, similar to that in the previous Greenbook. As before, this projection takes a middle ground between two opposing forces. The dollar may strengthen in the near term if investors are attracted by stronger growth in the United States than that abroad, particularly if U.S. productivity performance remains relatively strong. However, if investors at some point become less willing to absorb the large and growing volume of U.S. external liabilities, the dollar could come under downward pressure. Growing visibility of special political and industry interests concerned about the dollar's high level may reinforce such pressure.

Recent evidence of stronger economic activity in the United States and greater optimism regarding global recovery helped boost stock markets abroad. Equity markets in Europe were generally up about 1 to 3 percent, and Canadian share prices rose 4 percent, a bit less than the rise in U.S. equity prices. Although prospects for economic growth remain considerably less buoyant in Japan, stock prices there moved up nearly 10 percent, perhaps influenced by new restrictions on short selling. The yield on Japanese long-term government bonds declined slightly, as the Bank of Japan announced it would step up its purchases of government securities to help maintain liquidity. Long-term government bond yields in major foreign countries other than Japan rose during the period, with yields in the euro area up about 15 basis points. Other than some modest moves towards easing in Japan, the stance of monetary policy in foreign countries remained essentially unchanged during the intermeeting period.

The step-up in optimism about global economic prospects showed through in the financial markets of most developing economies as well. Emerging-market equity prices registered solid gains, and global dollar-denominated bond yield spreads generally moved lower, with the overall EMBI+ spread down about 100 basis points during the period.

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

Foreign industrial countries. Real GDP in the foreign industrial countries, on average, edged up in the fourth quarter of 2001, in contrast to the small decline that we had projected in January. Given recent improvements in business and consumer confidence, the rebound in the U.S. economy, and the further effects of monetary stimulus already in place, we project that growth will firm this year and next, reaching about 2 percent in 2002 and nearly 3 percent in 2003. Headline inflation rates, which had moved down noticeably in recent months because of lower oil prices and sluggish activity, ticked up slightly at the beginning of the year, in part reflecting weather-related rises in food prices. Although we have marked up our forecast for industrial country inflation a bit in response to the higher outlook for oil prices, we still expect inflation to remain subdued throughout the forecast period, as output will remain below potential in most countries.

The Canadian economy, supported by robust consumption growth and net exports, grew a faster-than-expected 2 percent (s.a.a.r.) in the fourth quarter. Data for the current quarter are limited, but housing starts have been strong through February, and employment has shown a steady increase since September. Real GDP is projected to accelerate this year, as firmer U.S.

demand lifts Canadian exports and as moderate fiscal stimulus and the effects of previous substantial monetary easing continue to boost domestic demand. Growth is projected to remain strong in 2003, closing the output gap by the end of the forecast period. We assume that, after the latest cut of 25 basis points on January 15, the Bank of Canada will begin to tighten monetary policy in the second half of this year as the Canadian expansion solidifies.

The euro-area economy contracted 0.7 percent (s.a.a.r.) in the fourth quarter, but monthly data suggest November may have been the turning point in the cycle. Orders have moved up on balance since November, and survey indicators through February point to recovery in the service sector. Although the tepid upturn in confidence to date leads us to expect sluggish growth in the near term, growth should revive to near-potential rates by midyear, as consumption and investment spending respond to the cumulative effects of last year's monetary easing and as exports are supported by stronger global activity. Euro-area inflation is projected to fall below the European Central Bank's 2 percent target ceiling in coming months as some temporary factors are reversed. We expect the ECB to keep its policy on hold until later this year, when it will begin to tighten moderately as signs of stronger growth become evident. In the United Kingdom, real GDP growth stalled in the fourth quarter, but we expect the pause to be only temporary, as incoming survey indicators suggest a stronger pace of activity so far this year.

Japan remains a bleak spot in the outlook. Real GDP plunged 4½ percent (s.a.a.r.) in the fourth quarter, and incoming data point to further contraction over the next several months. In January, industrial production fell 1 percent, and core machinery orders tumbled 15.6 percent, after a nearly 8 percent drop in the fourth quarter. Although some indicators such as building starts moved up in January, they did so from depressed levels. Fiscal policy is expected to be slightly contractionary this year, as the budget for fiscal year 2002 approved in early March calls for public works spending to decline. Accordingly, we expect negative growth in Japan to persist over most of this year. However, by year end, the global recovery should bolster exports, and the ongoing inventory correction should have been worked out. The Bank of Japan is expected to maintain short-term interest rates near zero through the forecast period. Consumer-price deflation is projected to continue at a rate of about 1 percent.

Other countries. Recent data have provided clear signs of recovery in emerging Asia. Growth rebounded with surprising strength during the fourth quarter in several economies that are intensive producers of high-tech goods: Real GDP expanded 10 percent (s.a.a.r.) in Taiwan, 7 percent in Malaysia, and 5½ percent in Singapore. Indonesia and the Philippines also posted solid growth. In January, industrial production recorded strong gains in Korea, Malaysia, Singapore, and Taiwan. In addition, recent data on exports have been strong. In line with the projected rebound in the industrial countries and further recuperation in global electronics markets, we project that average growth for the region will climb from 3¼ percent during the first half of this year to 5½ percent at the end of the forecast period. These projections are 1¼ percentage points and ½ percentage point stronger, respectively, than in the January Greenbook. Growth in China is expected to continue to exceed 7 percent both this year and next. Rising external demand and strong inflows of foreign investment are expected to allow the government to taper off the amount of fiscal stimulus. Recent inflation data have come in well below expectations, with China, Hong Kong, Singapore, and Taiwan all experiencing deflation last year. We expect inflation in emerging Asia to rise a bit over the forecast period, but price pressures should remain well contained.

In Latin America, the Mexican and Brazilian economies contracted during the fourth quarter, but recent monthly data point to a firming of activity. In Mexico, exports have stabilized, declines in auto production have become less severe, and business confidence has rebounded. In Brazil, retail sales and consumer confidence have recently risen. In Argentina, in contrast, economic activity appears to be in free fall. Industrial production in January was down 18 percent from a year earlier, and auto sales in February were down nearly 50 percent. Looking ahead, we expect Mexico to achieve the most vigorous recovery in the region, as the rebounding U.S. economy helps lift growth to 3 percent this year and 4 percent next year, while Brazilian growth recovers a bit more slowly. For Argentina, we have penciled in a contraction of more than 6 percent in 2002. We are guessing that policies allowing activity to stabilize sometime next year will eventually be put in place, but enormous uncertainty surrounds the outlook. Inflation rates in Mexico and Brazil are expected to decline relative to 2001, as the central banks in these countries attempt to hit ambitious inflation targets. In Argentina and Venezuela, inflation rates will likely spike up this year, driven by pass-through from the recent devaluations.

Prices of internationally traded goods. The price index for imports of non-oil core goods declined about 3½ percent at an annual rate in the fourth quarter—the third consecutive quarterly decline. In the current quarter, it is projected to fall at an annual rate of about 2¼ percent. Although monthly BLS data showed a slight increase in the price of imported core goods in January, following eleven consecutive monthly declines, the level was still below the fourth-quarter average. The January increase was due primarily to a rise in prices of food imports. Prices in other major categories generally showed little change in January. In particular, prices for industrial supplies and materials excluding petroleum were unchanged after falling for most of the previous year. Import price inflation is projected to remain negative in the second quarter, reflecting the lagged effects of dollar appreciation last year as well as recent declines in natural gas prices. Prices are projected to rise by the end of the year and to pick up more next year, largely as a result of a turnaround in primary commodity prices. We expect core import prices to decline about ½ percent on balance in 2002 and to rise 2¼ percent in 2003.

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

Trade category	2001			Projection			
				2002			2003
	H1	Q3	Q4	Q1	Q2	H2	
Exports							
Core goods	-.5	-1.5	-3.4	-1.4	1.3	1.0	1.3
Imports							
Non-oil core goods	-1.5	-6.2	-3.4	-2.3	-1.7	.8	2.3
Oil (dollars per barrel)	24.21	23.51	18.41	18.22	21.29	21.17	20.36

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 multiquarter periods is the price for the final quarter of the period.

The price index for exports of U.S. core goods also dropped about 3½ percent at an annual rate in the fourth quarter and is expected to show a further, but smaller, decline in the current quarter. This forecast incorporates data from January, when the level of the core goods index was a little below the fourth-quarter average, as well as a decline in U.S. producer prices in the current quarter. Export prices for core goods are projected to begin to move back up in the second quarter but to show only moderate increases over the rest of the forecast period, in line with the inflation projected for U.S. goods prices.

Trade in goods and services. In December, the U.S. trade deficit in goods and services was $25.3 billion, much smaller than in the previous two months. For the fourth quarter, the nominal deficit was $333 billion at an annual rate, about $20 billion smaller than would have been recorded in the third quarter in the absence of a large one-time estimated payment by foreign insurers related to the events of September 11. BEA estimates that NIPA real net exports of goods and services weakened a bit in the fourth quarter as real exports fell more than did real imports.

The value of exported goods and services rose marginally in December; goods exports, primarily aircraft and automotive products, declined, whereas exports of services rose strongly for the second consecutive month. Even though goods and services together rose for the third month, the level in December was still 6 percent below the average for July-August. In the fourth quarter, NIPA real exports of goods and services fell an estimated 12 percent at an annual rate; service exports declined at a slightly faster rate than goods. We expect export growth to turn positive in the first quarter of 2002. As foreign growth recovers, exports of core goods are projected to rebound, growing over 2 percent in 2002 and just under 5 percent in 2003; the positive effects from stronger foreign demand are expected to be partially offset by lagged effects of past dollar appreciation. Exports of computers and semiconductors should make sizable positive contributions to real export growth this year and next after falling sharply last year, and service receipts, especially travel and passenger fares, should continue to recover. We project that real exports of all goods and services, after declining 11 percent in 2001, will increase 5 percent in 2002 and 7 percent in 2003.

The value of imported goods and services declined sharply in December to a level that was 8 percent below the average for July-August. Goods imports fell more than 4 percent in the month, with decreases recorded in all major trade categories, especially consumer goods. In contrast, service imports rose strongly for the second month, largely reflecting increases in travel and passenger fares. BEA estimates that NIPA real imports of goods and services fell 7 percent at an annual rate in the fourth quarter as real services payments plunged at a pace of 26 percent and goods imports declined moderately. For the year, real imports of goods and services fell 8 percent. As the recovery in U.S. activity strengthens in 2002, imports of goods and services should rise beginning in the current quarter, reflecting a pickup in both investment and consumption goods. Specifically, we project that imports will grow 12 percent in 2002 and 10 percent in 2003. The lagged effects of the dollar's past appreciation should stimulate core imports in the near term, but the primary boost derives from revived U.S. growth and the high elasticity of U.S. import demand.

We estimate that in the fourth quarter of 2001 the U.S. current account deficit as a share of GDP returned to 4 percent from a temporarily reduced share recorded in the third quarter. We expect that the current account deficit will exceed $600 billion by the end of 2003, or 5½ percent of GDP.

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

Measure	2001		Projection				
	H1	Q3	2001 Q4	2002 Q1	2002 Q2	2002 H2	2003
Real exports	-6.7	-18.8	-12.2	6.3	4.8	4.9	7.1
January GB	*-6.7*	*-18.8*	*-11.6*	*4.3*	*.8*	*4.4*	*7.5*
Real imports	-6.7	-13.0	-7.0	12.9	13.8	11.4	10.3
January GB	*-6.7*	*-13.0*	*-3.7*	*9.5*	*10.6*	*9.5*	*10.0*

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

Alternative simulations. Our baseline forecast projects that oil prices will decline slightly from current levels. Over the past few weeks, however, oil prices have risen about $4 per barrel, and increased political tensions in the Middle East and possible supply disruptions could result in a higher path for oil prices. The tensions and uncertainties that are posited to contribute to the rise in oil prices may also bring about a decline in confidence in foreign countries that reduces foreign domestic demand. To assess these possibilities, we used the FRB/Global model to consider two alternative simulations: first, one that keeps oil prices $10 per barrel higher than in our baseline forecast owing to supply disruptions beginning in 2002:Q2 and, second, one that combines this oil-price shock with an autonomous shock to foreign demand.

Two alternative U.S. monetary policy responses were considered in the higher oil price simulation. In one case, the Federal Reserve holds the real federal funds rate unchanged from its baseline; in the other, it adjusts the real federal funds rate according to a Taylor rule with a coefficient of ½ on core PCE inflation and ½ on the output gap. In both cases, monetary authorities in the major foreign industrial countries and in most developing countries adjust interest rates according to a Taylor rule.

Under either U.S. policy response, higher oil prices have a moderate adverse effect. U.S. GDP growth falls 0.3 percentage point below baseline in the second half of 2002 and in 2003 under the fixed rate rule. This response reflects a reduction in domestic spending induced by the higher oil prices that is offset to some extent by greater exports to oil-producing nations. Core consumer price inflation rises 0.5 percentage point relative to baseline in the second half of

2002 and 0.2 percentage point in 2003, as the slower pace of growth partially offsets the inflationary effect of the shock.

The responses of both GDP and core price inflation under the Taylor rule are nearly identical to the fixed real rate case. In our model, the oil price shock raises core inflation about the same extent that it decreases output. As a result, the Taylor rule, which places equal weights on output and inflation, keeps real interest rates largely unchanged.

Alternative Simulation 1:
$10 Rise in the Price of Oil
(Percent change from previous period, annual rate)

Indicator and simulation	2002		2003	
	H1	H2	H1	H2
U.S. real GDP				
Baseline	3.7	3.6	3.9	4.0
Fixed real rate	3.7	3.3	3.6	3.7
Taylor rule	3.7	3.3	3.6	3.7
U.S. PCE prices excl. food and energy				
Baseline	1.3	1.4	1.4	1.4
Fixed real rate	1.1	1.9	1.6	1.5
Taylor rule	1.1	1.9	1.6	1.5

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

In our second alternative simulation, we combined the oil-price shock discussed above with an autonomous decline in spending. The spending shock would reduce demand by 1 percent of baseline GDP in the major foreign industrial countries and 2 percent of GDP in the major developing countries in the absence of endogenous adjustments. The shock is phased in over three quarters beginning in 2002:Q2. We considered the same two alternative responses for U.S. monetary policy as above and maintained the same assumptions about monetary policy in foreign countries.

In the case of the fixed real federal funds rate, the fall in foreign demand combined with the rise in oil prices depresses U.S. real output growth in the second half of 2002 about 0.8 percentage point and around 0.5 percentage point in 2003, relative to baseline. The autonomous shock to foreign demand, by itself, has a relatively large impact on U.S. GDP, as average foreign GDP declines by significantly more than the size of the initial shock because of multiplier effects and spillovers across countries. Core price inflation rises 0.4 percentage point relative to baseline in 2002:H2, mainly because of the inflationary impact of the rise in oil prices, but is largely unchanged in 2003, as the effect of the oil price shock is offset by the contractionary shock to external demand.

The Taylor rule reduces the effect of the shock on activity, especially in 2003. However, the effects of the shock on core price inflation are almost identical to those in the fixed real rate case, since monetary policy changes affect core price inflation with a considerable lag.

Alternative Simulation 2:
$10 Rise in the Price of Oil and Foreign Demand Contraction
(Percent change from previous period, annual rate)

Indicator and simulation	2002		2003	
	H1	H2	H1	H2
U.S. real GDP				
Baseline	3.7	3.6	3.9	4.0
Fixed real rate	3.6	2.8	3.3	3.6
Taylor rule	3.6	2.9	3.5	3.8
U.S. PCE prices excl. food and energy				
Baseline	1.3	1.4	1.4	1.4
Fixed real rate	1.1	1.8	1.5	1.3
Taylor rule	1.1	1.8	1.5	1.4

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

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

Measure and country	1995	1996	1997	1998	1999	2000	2001	-----Projected---- 2002	2003
REAL GDP (1)									
Total foreign	2.2	4.0	4.1	1.6	4.8	4.0	-0.0	2.5	3.4
Industrial Countries	2.0	2.7	3.5	2.6	3.9	3.2	0.5	2.1	2.9
of which:									
Canada	1.5	2.6	4.5	4.2	5.1	3.5	0.9	3.1	3.4
Japan	2.5	3.7	0.5	-1.3	0.6	2.3	-1.9	-0.9	1.1
United Kingdom	2.0	2.9	3.6	2.6	2.7	2.7	1.7	1.9	2.7
Euro Area (2)	1.5	1.6	3.1	1.9	3.6	2.8	0.6	1.8	2.8
Germany	1.1	1.4	1.7	0.6	3.0	2.5	0.0	1.6	2.7
Developing Countries	2.5	6.1	5.2	-0.1	6.2	5.3	-0.7	3.0	4.2
Asia	7.0	6.6	4.8	-2.0	8.7	6.3	0.1	3.8	5.1
Korea	7.5	6.4	3.4	-5.2	13.8	5.2	1.7	3.9	5.5
China	10.4	5.3	8.7	9.5	4.1	8.0	7.5	7.3	7.5
Latin America	-3.8	6.2	5.9	1.2	4.4	4.6	-1.6	2.4	3.5
Mexico	-7.1	7.1	6.7	2.9	5.4	4.9	-1.5	2.9	4.0
Brazil	-0.9	4.2	1.3	-1.1	4.2	4.1	-2.3	2.4	2.6
CONSUMER PRICES (3)									
Industrial Countries	1.3	1.5	1.5	0.9	1.2	1.9	0.9	1.2	0.9
of which:									
Canada	2.0	2.0	1.0	1.1	2.3	3.1	1.1	2.2	1.6
Japan	-0.8	0.2	2.1	0.7	-1.2	-1.2	-1.3	-1.3	-1.1
United Kingdom (4)	2.9	3.2	2.7	2.5	2.2	2.1	2.0	2.2	2.4
Euro Area (2)	NA	NA	1.5	0.8	1.5	2.7	2.2	1.8	1.6
Germany	1.4	1.3	1.5	0.3	1.1	2.5	1.7	1.5	1.0
Developing Countries	17.0	11.1	6.8	9.0	4.6	4.1	2.8	3.1	3.9
Asia	6.4	4.8	2.7	4.4	0.1	1.8	1.0	1.9	3.3
Korea	4.4	5.0	4.9	5.8	1.2	2.5	3.3	2.7	3.1
China	11.1	6.8	0.9	-1.2	-0.9	0.9	-0.2	1.6	3.8
Latin America	42.0	25.8	15.5	15.4	12.5	8.4	5.4	5.6	4.8
Mexico	48.7	28.0	17.0	17.4	13.6	8.8	5.2	4.4	4.4
Brazil	21.5	9.6	4.6	1.5	8.2	6.1	7.5	5.3	4.3

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)

	2001				Projected 2002				Projected 2003			
Measure and country	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
REAL GDP (1)	Quarterly changes at an annual rate											
Total foreign	0.6	-0.7	-0.4	0.5	1.6	2.4	2.8	3.1	3.3	3.4	3.4	3.5
Industrial Countries	1.8	-0.1	-0.0	0.3	1.3	2.0	2.4	2.7	2.9	2.9	2.8	2.8
of which:												
Canada	1.1	0.9	-0.6	2.0	2.7	3.1	3.2	3.4	3.5	3.5	3.3	3.3
Japan	4.1	-4.8	-2.1	-4.5	-2.2	-0.8	-0.6	0.2	0.7	1.0	1.2	1.3
United Kingdom	3.0	1.8	1.9	0.1	1.0	1.9	2.3	2.5	2.7	2.7	2.7	2.7
Euro Area (2)	2.1	0.3	0.8	-0.7	0.7	1.5	2.4	2.7	2.9	2.9	2.8	2.7
Germany	1.6	0.2	-0.7	-1.0	0.3	1.2	2.4	2.5	2.8	2.8	2.6	2.6
Developing Countries	-1.0	-1.7	-1.1	0.8	2.2	3.0	3.3	3.6	3.9	4.1	4.3	4.4
Asia	-1.6	-2.3	-0.0	4.2	3.1	3.6	4.2	4.5	4.8	5.0	5.3	5.5
Korea	1.2	1.8	5.1	-1.0	3.0	3.8	4.3	4.7	4.8	5.2	5.7	6.2
China	8.2	7.7	7.1	7.1	7.0	7.1	7.5	7.5	7.5	7.5	7.5	7.5
Latin America	-0.9	-1.3	-2.1	-1.9	1.4	2.5	2.7	2.9	3.3	3.4	3.6	3.7
Mexico	-1.8	-1.5	-1.8	-0.9	2.0	3.2	3.2	3.4	3.8	3.9	4.1	4.1
Brazil	3.8	-3.0	-3.3	-6.5	2.0	2.2	2.7	2.7	2.6	2.5	2.6	2.6
CONSUMER PRICES (3)	Four-quarter changes											
Industrial Countries	1.7	2.2	1.7	0.9	0.9	0.5	0.6	1.2	1.1	1.0	0.9	0.9
of which:												
Canada	2.8	3.6	2.7	1.1	1.2	0.5	0.9	2.2	2.1	1.9	1.7	1.6
Japan	-1.0	-1.2	-1.1	-1.3	-1.6	-1.4	-1.6	-1.3	-1.3	-1.2	-1.2	-1.1
United Kingdom (4)	1.9	2.3	2.4	2.0	2.1	1.8	1.8	2.2	2.3	2.3	2.4	2.4
Euro Area (2)	2.4	3.1	2.5	2.2	2.4	1.6	1.9	1.8	1.6	1.5	1.5	1.6
Germany	2.4	3.2	2.4	1.7	1.8	1.2	1.4	1.5	1.0	0.9	1.0	1.0
Developing Countries	3.8	4.1	3.5	2.8	2.6	2.4	2.6	3.1	3.8	3.9	3.9	3.9
Asia	1.8	2.4	1.9	1.0	0.7	0.7	1.1	1.9	2.6	2.9	3.1	3.3
Korea	3.7	5.1	4.2	3.3	2.5	1.8	1.8	2.7	3.0	3.0	3.0	3.1
China	0.7	1.6	0.8	-0.2	-0.6	-0.4	0.5	1.6	2.7	3.1	3.5	3.8
Latin America	7.2	6.8	6.0	5.4	5.4	5.5	5.5	5.6	6.4	5.8	5.3	4.8
Mexico	7.5	6.9	6.0	5.2	5.1	4.7	4.5	4.4	5.3	5.0	4.7	4.4
Brazil	6.2	7.1	6.6	7.5	7.7	7.6	6.5	5.3	5.0	4.7	4.5	4.3

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 U.S. INTERNATIONAL TRANSACTIONS

	1995	1996	1997	1998	1999	2000	------ Projected ------ 2001	2002	2003
NIPA REAL EXPORTS and IMPORTS									
Percentage point contribution to GDP growth, Q4/Q4									
Net Goods & Services	0.4	-0.2	-0.8	-1.1	-1.0	-0.8	-0.0	-1.1	-0.7
Exports of G&S	1.0	1.1	1.0	0.3	0.5	0.8	-1.2	0.5	0.7
Imports of G&S	-0.6	-1.3	-1.7	-1.3	-1.5	-1.6	1.2	-1.6	-1.4
Percentage change, Q4/Q4									
Exports of G&S	9.7	9.8	8.5	2.3	4.5	7.0	-11.2	5.2	7.1
Services	8.8	8.9	1.4	2.9	1.9	4.1	-8.0	6.6	4.9
Computers	39.1	21.6	25.8	8.1	13.8	23.1	-23.0	26.2	32.6
Semiconductors	79.6	44.6	21.3	9.1	34.6	26.9	-35.5	20.8	34.0
Other Goods 1/	4.6	7.3	9.8	1.3	3.2	5.7	-9.6	2.2	4.6
Imports of G&S	5.0	11.2	14.3	10.8	11.5	11.3	-8.4	12.4	10.3
Services	5.5	5.3	14.0	8.5	2.8	12.2	-14.4	11.9	5.5
Oil	2.4	7.8	3.9	4.1	-3.4	12.4	0.2	3.9	3.2
Computers	35.0	17.8	33.0	25.8	25.1	13.6	-13.7	26.2	32.5
Semiconductors	92.4	56.7	32.9	-8.7	33.5	22.5	-51.3	21.3	33.8
Other Goods 2/	-1.2	10.4	12.7	11.5	12.9	10.4	-5.7	12.1	9.9
Billions of chained 1996 dollars									
Net Goods & Services	-78.4	-89.0	-113.3	-221.1	-316.9	-399.1	-410.2	-498.4	-607.7
Exports of G&S	808.2	874.2	981.5	1002.4	1034.8	1133.2	1080.8	1052.1	1112.9
Imports of G&S	886.6	963.1	1094.8	1223.5	1351.7	1532.3	1491.0	1550.4	1720.6
Billions of dollars									
US CURRENT ACCOUNT BALANCE	-109.9	-120.9	-139.8	-217.5	-324.4	-444.7	-417.3	-469.9	-583.1
Current Acct as Percent of GDP	-1.5	-1.5	-1.7	-2.5	-3.5	-4.5	-4.1	-4.4	-5.2
Net Goods & Services (BOP)	-96.4	-101.8	-107.8	-166.8	-261.8	-375.7	-346.3	-401.5	-503.4
Investment Income, Net	25.0	25.5	13.6	-1.2	-8.5	-9.6	-13.5	-8.6	-19.1
Direct, Net	64.9	69.4	72.4	66.3	67.0	81.2	94.2	87.7	83.0
Portfolio, Net	-39.9	-43.9	-58.8	-67.5	-75.6	-90.9	-107.7	-96.4	-102.1
Other Income & Transfers,Net	-38.6	-44.6	-45.7	-49.4	-54.0	-59.3	-57.6	-59.8	-60.7

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1998 Q1	1998 Q2	1998 Q3	1998 Q4	1999 Q1	1999 Q2	1999 Q3	1999 Q4	2000 Q1	2000 Q2	2000 Q3	2000 Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-1.8	-1.8	-0.8	0.2	-1.8	-1.2	-0.7	-0.1	-1.3	-0.8	-0.7	-0.4
Exports of G&S	0.1	-0.5	-0.2	1.7	-0.8	0.4	1.0	1.3	0.9	1.4	1.1	-0.5
Imports of G&S	-1.9	-1.4	-0.5	-1.5	-1.0	-1.6	-1.7	-1.3	-2.2	-2.2	-1.8	0.1
Percentage change from previous period, s.a.a.r.												
Exports of G&S	0.5	-4.0	-2.2	16.3	-6.8	4.2	9.7	12.1	9.0	13.5	10.6	-4.0
Services	2.4	8.0	-8.4	10.5	-3.9	3.8	2.0	6.0	10.3	9.9	-6.7	3.7
Computers	-8.3	8.2	12.0	22.8	0.5	26.8	18.3	11.0	32.7	49.2	25.8	-7.9
Semiconductors	5.9	-17.2	272.7	-56.6	45.4	31.6	36.5	25.8	29.9	64.5	35.0	-10.2
Other Goods 1/	0.0	-9.2	-9.3	27.8	-11.5	1.1	11.0	14.2	5.3	9.1	16.3	-6.5
Imports of G&S	15.9	11.3	4.2	12.2	8.4	13.3	13.8	10.5	17.1	16.4	13.0	-0.5
Services	21.3	6.7	7.0	0.1	-8.2	1.8	7.9	11.0	20.6	12.4	17.1	0.0
Oil	3.6	42.8	1.1	-21.6	3.9	29.8	-5.8	-31.5	29.7	40.3	-4.9	-7.7
Computers	38.4	18.5	6.4	43.6	40.6	41.1	8.3	13.8	12.8	34.4	18.4	-7.2
Semiconductors	8.5	-25.4	-6.3	-8.2	37.0	47.5	12.7	39.6	45.6	24.9	64.9	-24.9
Other Goods 2/	14.2	11.9	4.1	16.2	9.0	11.3	17.6	14.0	14.6	13.1	11.9	2.4
Billions of chained 1996 dollars, s.a.a.r.												
Net Goods & Services	-180.8	-223.1	-241.2	-239.2	-283.0	-313.4	-333.3	-337.8	-371.1	-392.8	-411.2	-421.1
Exports of G&S	1003.4	993.1	987.6	1025.6	1007.6	1018.0	1041.8	1072.1	1095.5	1130.6	1159.3	1147.5
Imports of G&S	1184.2	1216.2	1228.9	1264.8	1290.6	1331.4	1375.1	1409.8	1466.6	1523.4	1570.6	1568.5
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-174.0	-209.6	-242.1	-244.1	-265.8	-309.5	-352.3	-369.9	-419.6	-432.5	-461.2	-465.3
Current Account as % of GDP	-2.0	-2.4	-2.7	-2.7	-2.9	-3.4	-3.8	-3.9	-4.3	-4.4	-4.6	-4.6
Net Goods & Services (BOP)	-139.5	-169.9	-181.9	-176.0	-211.5	-251.5	-284.5	-299.9	-349.3	-363.1	-389.4	-401.2
Investment Income, Net	9.9	5.8	-12.3	-8.3	-5.2	-6.6	-15.5	-6.7	-17.5	-14.4	-14.5	7.9
Direct, Net	74.2	69.8	57.8	63.3	66.2	63.0	63.3	75.7	65.5	72.5	84.2	102.8
Portfolio, Net	-64.2	-64.0	-70.1	-71.5	-71.4	-69.6	-78.8	-82.5	-83.0	-86.8	-98.7	-94.9
Other Inc. & Transfers, Net	-44.4	-45.5	-47.9	-59.8	-49.1	-51.5	-52.2	-63.3	-52.8	-55.0	-57.4	-72.0

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2001				Projected 2002				Projected 2003			
	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	0.6	-0.1	-0.2	-0.4	-1.0	-1.2	-1.2	-0.7	-0.9	-0.9	-0.7	-0.3
Exports of G&S	-0.1	-1.4	-2.1	-1.3	0.6	0.5	0.3	0.6	0.4	0.6	0.7	0.9
Imports of G&S	0.8	1.3	1.9	0.9	-1.6	-1.7	-1.6	-1.3	-1.3	-1.5	-1.4	-1.2
Percentage change from previous period, s.a.a.r.												
Exports of G&S	-1.2	-11.9	-18.8	-12.2	6.3	4.8	3.6	6.2	4.0	6.9	7.6	10.0
Services	1.8	2.4	-17.2	-16.9	15.1	5.2	2.8	3.8	4.7	4.9	4.9	5.0
Computers	-5.8	-41.1	-24.3	-16.0	26.2	26.2	26.2	26.2	31.0	32.2	33.5	33.5
Semiconductors	-22.4	-56.1	-46.6	-5.2	6.1	26.1	26.1	26.1	30.9	33.3	35.8	35.9
Other Goods 1/	-0.1	-10.8	-16.8	-10.0	1.0	2.0	1.2	4.7	0.2	4.3	5.1	9.0
Imports of G&S	-5.0	-8.4	-13.0	-7.0	12.9	13.8	12.6	10.3	10.2	11.8	10.5	8.8
Services	4.9	-2.0	-29.1	-26.3	33.9	5.4	5.6	5.2	5.5	5.4	5.5	5.4
Oil	27.1	4.3	-26.7	3.8	-7.8	28.1	10.5	-10.8	-6.4	25.9	9.8	-12.4
Computers	-11.0	-29.1	-24.9	16.8	21.5	26.2	26.2	31.0	31.0	32.2	33.5	33.5
Semiconductors	-31.8	-75.0	-58.4	-20.5	8.2	26.0	26.0	26.0	30.8	33.2	35.7	35.7
Other Goods 2/	-8.4	-4.8	-4.5	-4.9	10.1	13.2	13.2	11.9	11.0	10.0	9.4	9.1
Billions of chained 1996 dollars, s.a.a.r.												
Net Goods & Services	-404.5	-406.7	-411.0	-418.6	-447.0	-483.2	-520.1	-543.2	-572.3	-600.8	-623.7	-633.9
Exports of G&S	1144.1	1108.3	1052.2	1018.5	1034.2	1046.5	1055.8	1071.7	1082.4	1100.5	1120.8	1147.9
Imports of G&S	1548.6	1515.0	1463.2	1437.1	1481.2	1529.7	1575.9	1614.9	1654.7	1701.3	1744.5	1781.8
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-447.5	-430.7	-378.8	-412.4	-417.2	-455.6	-487.2	-519.4	-536.7	-568.7	-598.2	-629.0
Current Account as % of GDP	-4.4	-4.2	-3.7	-4.0	-4.0	-4.3	-4.6	-4.8	-4.9	-5.1	-5.3	-5.5
Net Goods & Services (BOP)	-380.5	-362.6	-309.2	-332.8	-351.8	-390.6	-421.8	-441.7	-469.3	-497.0	-518.8	-528.6
Investment Income, Net	-14.6	-14.6	-14.9	-9.7	-9.5	-8.6	-9.1	-7.3	-10.0	-14.3	-22.0	-30.0
Direct, Net	90.7	93.7	96.2	96.2	91.7	89.4	85.9	84.0	83.8	83.8	82.3	82.2
Portfolio, Net	-105.3	-108.3	-111.0	-105.9	-101.2	-98.0	-94.9	-91.3	-93.8	-98.1	-104.3	-112.1
Other Inc. & Transfers, Net	-52.4	-53.5	-54.7	-69.9	-55.9	-56.4	-56.4	-70.4	-57.4	-57.4	-57.4	-70.4

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