Prefatory Note

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Content last modified 02/09/2012.

Class II FOMC - Restricted (FR)

Part 1

March 22, 2006

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 growth of real GDP has rebounded smartly this quarter following a sluggish performance in the fourth quarter of last year that reflected last autumn's hurricanes as well as other transitory factors. In broad terms, this pattern is similar to the one outlined in the January Greenbook. That said, both household consumption spending and business investment in equipment and software have increased at a notably faster pace than we had anticipated. Moreover, private payrolls expanded at a brisk pace in January and February and were revised up noticeably over the preceding several months, and the unemployment rate moved down further. Factory output has also been rising solidly, on net, in recent months, and capacity utilization has edged still higher. More-timely indicators, including initial claims for unemployment insurance and surveys of factory orders, point to appreciable further gains in employment and production in the near term.

In light of the higher rates of resource utilization and what we take to be a stronger thrust of household and business spending, we have conditioned this forecast on a slightly higher path for the federal funds rate relative to the January Greenbook. The past and prospective tightening in monetary policy, together with a waning stimulus from both fiscal policy and household wealth, is projected to cause real GDP to decelerate over the forecast period. We now project that real GDP will increase 3¾ percent in 2006—with hurricane-related rebuilding contributing about ½ percentage point to that gain—and that it will rise about 3 percent in 2007. These figures are a bit above those in the January Greenbook. Thus, we project an economy with labor and product markets a little tighter than we envisioned in January.

The recent data on core consumer price inflation have, on balance, come in slightly below our expectations, and the temporary uptick in core inflation that we have been predicting to occur this year is not yet evident in the data. In addition, oil prices have moved lower since January, though futures prices have moved down by less. Nonetheless, cost pressures have shown through to intermediate goods prices by somewhat more than we had anticipated and, as discussed, labor markets are a bit tighter in this projection. We have reacted to these developments by trimming a tenth from our projection for core PCE price inflation this year, leaving it at 2.1 percent, and adding a tenth in 2007, putting it at 1.9 percent.

Key Background Factors

The forecast is now conditioned on a federal funds rate that reaches 5 percent at the May FOMC meeting and remains at that level until mid-2007, when it moves back to 4¾ percent in response to a decline in core inflation; this path for the funds rate is 25 basis points higher than our assumption in the January Greenbook. Market expectations for the funds rate have revised up as well and are about in line with the staff's assumed policy path. Given the upward shift in market expectations for policy, rates on longer-term securities have moved up about ¼ percentage point since the time of the January Greenbook. We assume that long-term rates will remain near their current levels over the forecast period.

Broad equity market indexes currently stand about 1 percent above the level we had assumed in the January Greenbook, and we have raised our path for stock prices this amount throughout the projection period. We continue to assume that, beyond the current quarter, share prices will increase at an annual rate of 6½ percent, a pace that would roughly maintain risk-adjusted parity with the yield on long-term Treasury securities. Regarding house prices, the OFHEO repeat-transactions index came in higher in the fourth quarter than we expected, though it still indicates a slight slowing from earlier rates of increase. We project house prices to decelerate from last year's 13 percent increase to a 5½ percent rise in 2006 and a 2½ percent rise in 2007.

Our fiscal assumptions are little changed. We now assume that federal outlays and tax cuts related to the hurricanes will total $124 billion, of which $94 billion will occur during the forecast period; the latter figure is $24 billion more than we assumed in January. We continue to expect real defense spending to rise moderately in 2006 and then to flatten out in 2007 as outlays for operations in Iraq decline and other defense spending continues to expand slowly. Apart from defense, we expect outlays for hurricane relief to slow and for other real purchases to edge up this year and to remain flat in 2007. Regarding the new Medicare drug benefit, we expect spending to continue to ramp up quickly this year. Finally, on the tax side, we still assume the extension of most provisions that expired at the beginning of this year, including AMT relief and the research and experimentation credit.

In all, we project federal fiscal policy to provide an impetus of about ½ percentage point to real GDP growth in 2006 and to be about a neutral influence in 2007, essentially the same as the forecast in the January Greenbook. However, revenues have come in somewhat higher than we had anticipated, and we expect some of that strength to persist;

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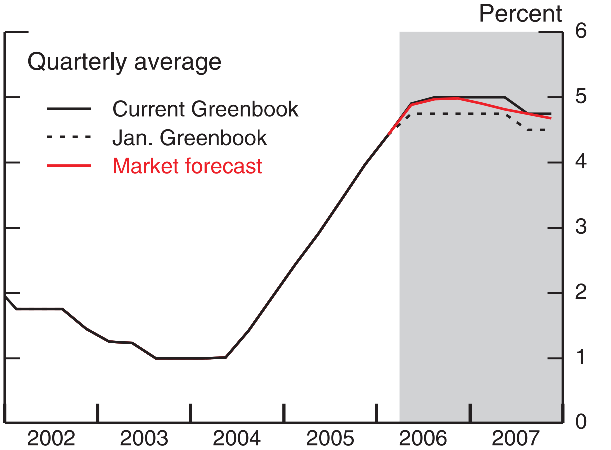
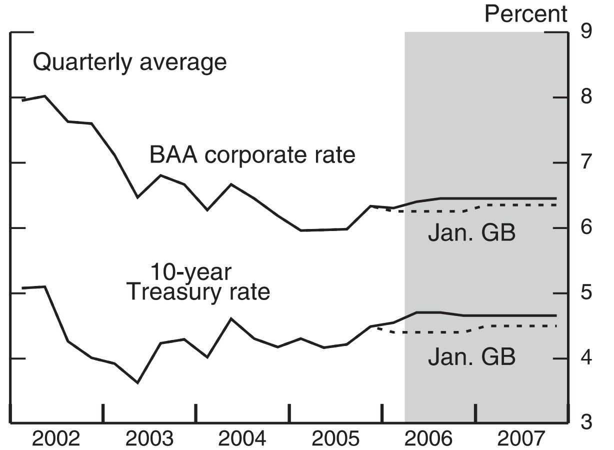
Key Background Factors Underlying the Baseline Staff Projection

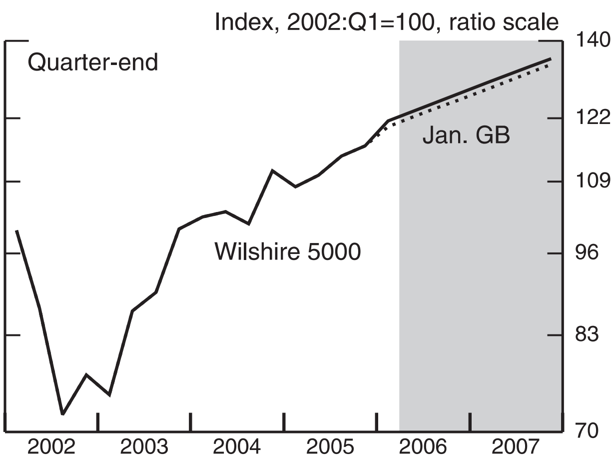
Federal Funds Rate



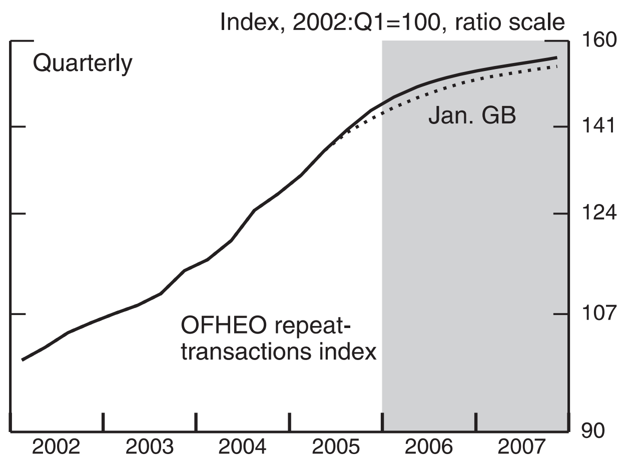
Long-term Interest Rates



Equity Prices

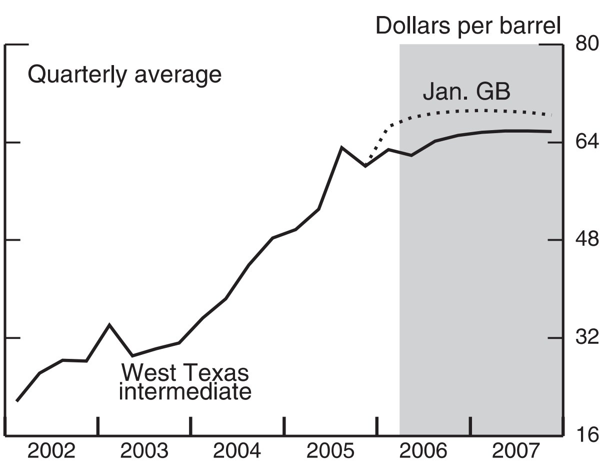


House Prices

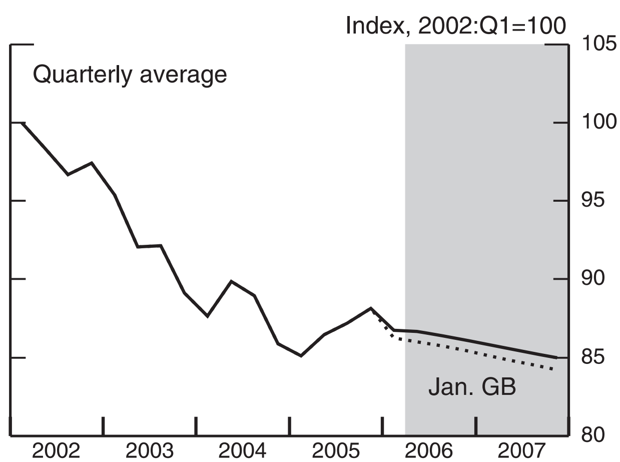


Note. Historical data end in 2005:Q4.

Crude Oil Prices



Broad Real Dollar



Note. Shading represents the projection period.

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in addition, projected receipts in 2007 are supported by a higher level of corporate profits in this projection. Thus, we now expect the unified budget deficit to increase less than we projected in January—from $318 billion in fiscal year 2005 to $333 billion in fiscal 2006 and $343 billion in fiscal 2007.

The foreign exchange value of the dollar has edged up about 1 percent, on net, since the time of the January Greenbook, and we have nudged up our projection for the level of the broad real dollar throughout the projection period. Meanwhile, incoming data on economic growth abroad have been a shade stronger than we had expected; but we view that strength as largely transitory, and we continue to project that foreign economic activity will expand 3½ percent on average in 2006 and 2007.

The spot price of West Texas intermediate (WTI) crude oil has declined since the time of the January Greenbook, largely because of a buildup of crude oil inventories to ample levels during the mild winter in North America. However, the longer-run forces affecting oil prices have not materially changed: As before, a combination of rising world demand and concerns about the implications of geopolitical instability for the reliability of supply should hold up oil prices in the coming years. Consistent with futures quotes, we expect the price of WTI to move up from its current level of a little over $60 per barrel—about $6 per barrel below its level at the time of the January Greenbook—to about $66 per barrel by the end of 2007; it thus ends the projection period about $2.50 per barrel lower than we previously assumed.

Recent Developments and the Near-Term Outlook

We now estimate that real GDP rose at an annual rate of 1¾ percent in the fourth quarter. Growth was held down late last year by disruptions from the hurricanes, which affected several components of final demand, and by temporarily low defense spending. However, the hurricane-related disruptions have been abating, and defense spending appears to be bouncing back this quarter. Furthermore, according to incoming data, household consumption and business spending on equipment and software have been particularly strong in the current quarter, although state and local government expenditures have been sluggish and imports have jumped. On net, our estimate of real GDP growth in the current quarter, 4¾ percent, leaves the level of GDP about where we projected it in the January Greenbook. We now project that, in the second quarter, real GDP will increase at an annual rate of 3½ percent—equal to the average pace over the preceding four quarters.

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

Measure	2006:Q1		2006:Q2	
	Jan. GB	Mar. GB	Jan. GB	Mar. GB
Real GDP	**4.1**	**4.7**	**3.8**	**3.5**
Private domestic final purchases	4.5	5.7	3.9	3.5
Personal consumption expenditures	4.5	5.2	3.4	3.6
Residential investment	-.4	-.2	2.8	-.9
Business fixed investment	7.3	12.8	8.3	4.9
Government outlays for consumption and investment	4.1	2.9	1.5	1.6
	Contribution to growth (percentage points)			
Inventory investment	-.6	-.3	-.2	.0
Net exports	.0	-.5	.3	.2

Labor demand has strengthened further. Private payroll employment rose 205,000 in February following a similar gain in January, and the unemployment rate moved down to 4¾ percent in January and February from 5 percent in the fourth quarter. Initial claims for unemployment insurance have gone back up a bit in recent weeks, but they remain around 300,000 per week—consistent with additional substantial near-term job gains. We project that private payrolls will rise another 200,000 in March and that the monthly gains will taper off to 150,000 in June. Because we expect the strong labor market to cause the labor force participation rate to edge higher in the near term, this pace of net hiring should be consistent with an unemployment rate that holds steady at 4.8 percent.

Although manufacturing output seems to have paused in February, sizable gains in the preceding few months put factory output on track for a gain of 6 percent at an annual rate in the current quarter. Moreover, the available indicators point to moderate increases in output in the coming months. The recent production increases have brought the capacity utilization rate in manufacturing to 80.4 percent—a touch above its long-run average.

Real PCE is expected to rise at an annual rate of 5¼ percent in the first quarter following a tepid rate of increase of 1¼ percent in the fourth quarter. Fluctuations in motor vehicle purchases fully account for that swing: Excluding motor vehicles, real PCE looks to have increased at a very strong 4¼ percent pace in both the fourth and the first quarters. We expect motor vehicle sales to support PCE growth in the second quarter as well, but we anticipate real PCE excluding motor vehicles to rise at a more modest annual rate of around 3 percent, a pace better aligned with the fundamentals in this sector.

Activity in housing markets has softened somewhat. Most clearly, sales have come off their highs of last summer; price increases seem to have moderated a bit as well. A slowing in construction is less clear-cut, in part because housing starts were supported in January and February by especially favorable weather. However, housing permits, which are less affected by weather and usually provide a better signal of the underlying pace of activity, have come down more noticeably in recent months, displaying a contour similar to that of home sales. Consequently, we see single-family starts moving lower in the coming months as a payback for the strong first-quarter pace, and we project that real residential investment will be little changed, on net, in the first and second quarters of this year.

Growth of business investment in equipment and software appears to have increased sharply in the current quarter following a comparatively small gain in the fourth quarter. As with consumer spending, fluctuations in business purchases of motor vehicles can account for much of this uneven quarterly pattern; a portion also reflects swings in aircraft purchases. Nevertheless, the underlying pace of investment seems quite strong. Excluding spending on both motor vehicles and aircraft, real outlays for E&S are projected to rise at an average rate of about 10 percent in the first and second quarters, close to their average pace in the second half of last year. Regarding business spending on nonresidential structures, we expect outlays in the drilling and mining sector to continue to expand rapidly in the near term, whereas we are anticipating outlays on other structures to emerge from the doldrums only gradually.

We project that real nonfarm inventory investment outside the motor vehicle sector will pick up in the first quarter after having remained subdued in the latter part of 2005. We suspect that some of that low stockbuilding last quarter may have reflected the effects of hurricane-related disruptions to production, though it may also have reflected some lingering deliberate moderation after the rapid accumulations of late 2004 and early 2005. In either case, inventory-sales ratios do not appear worrisome. As for motor vehicles, the recent rebound in sales coupled with the pace of assemblies should leave the level of inventories little changed this quarter after a sizable accumulation in the fourth quarter. In all, total nonfarm inventory investment is projected to subtract ¼ percentage point from first-quarter real GDP growth.

In the federal government sector, real defense spending declined sharply in the fourth quarter but appears to be rebounding in the current quarter. Meanwhile, nondefense spending is expected to level off in the first quarter after a jump in hurricane-related spending in the fourth quarter. Altogether, federal purchases are expected to add nearly ½ percentage point to real GDP growth this quarter. Real purchases by state and local governments rose only a little in the second half of 2005, and the incoming monthly data for employment and construction suggest that real spending remained sluggish in the first quarter. Given the continued improvement in the sector's fiscal condition, we expect growth in real spending to quicken a bit in the second quarter.

After growing slowly for most of the second half of last year, exports jumped in December and January and should post a strong increase for the first quarter as a whole. Some of that pattern could reflect the hurricanes' disruption of domestic production of energy and chemical products last year and the resumption of such production in late 2005 and early this year. That disruption likely contributed to a surge in imports late last year as well; however, imports also jumped in January, and we expect them to increase about as much in the first quarter as they did in the fourth quarter. All told, net exports are projected to subtract ½ percentage point from real GDP growth in the first quarter after having subtracted nearly 1½ percentage points in the fourth quarter. We look for import growth to pause in the second quarter while exports rise moderately, so that net exports are projected to contribute about ¼ percentage point to the growth of real GDP.

Recent increases in compensation costs have generally been modest. To be sure, average hourly earnings (which are limited to wages and salaries and cover production or nonsupervisory workers only) have been rising more rapidly in recent quarters, and data through February point to a further acceleration this quarter. However, compensation per hour in the nonfarm business sector (the broader compensation measure, of which average hourly earnings are a component) seems to have been rising at an annual rate of about 4¼ percent since the middle of last year—a modest pace given 3 percent growth of structural productivity. Furthermore, the employment cost index (ECI) has come in surprisingly low, rising at an annual rate of only 3¼ percent over the second half of last year. We expect to see ECI increases picking up to an annual rate of more than 4 percent in the first half of 2006.

We expect the core PCE price index to increase at annual rates of 1.9 percent in the current quarter and 2.2 percent in the second quarter; both figures are a shade less than those projected in the January Greenbook. Although the core PCE price index was revised up in the fourth quarter, that upward revision stemmed from the components of prices that are not derived from market transactions; these nonmarket prices appear likely to add to core PCE inflation in the current quarter as well. However, the core CPI rose a little less than we had expected in January and February, and the market-based core PCE price index likely did the same. With consumer energy prices holding about flat, on average, in the first half of this year, we project overall PCE prices to rise at close to the core rate this quarter and next.

The Longer-Run Outlook for the Economy

As noted, we expect real GDP to increase 3¾ percent in 2006 and 3 percent in 2007, a bit more than projected in the January Greenbook. Abstracting from the effects of last fall's hurricanes (which depressed economic activity last year but should boost GDP growth this year through recovery and rebuilding), we estimate that real GDP growth would have been 3½ percent in 2005 and would have been projected to slow to about 3¼ percent in both 2006 and 2007. Tighter monetary policy, a waning impetus from increases in household wealth, and reduced stimulus from fiscal policy all contribute to slower growth in the period ahead relative to the past few years.

Household spending. We project real PCE to increase nearly 4 percent this year and 3¼ percent in 2007. Real disposable income is expected to rise more rapidly than it did in the past few years because of a projected acceleration in hourly labor compensation and a sharp deceleration of energy prices; income is also boosted this year by the introduction of the Medicare drug benefit. Partially offsetting the influence of income growth on consumption, however, are rising interest rates and a diminished contribution from gains in equity and housing wealth. We therefore expect the personal saving rate to move up over the next two years from a bit below zero at present to 1½ percent by the end of 2007.

We expect residential investment spending to decelerate markedly over the forecast period. The repair and replacement of houses damaged or destroyed by the hurricanes—whether the replacement occurs in the affected areas or elsewhere—should boost activity this year and next. However, we expect the increase in mortgage interest rates from the low levels of recent years to fully offset this hurricane-related impetus to construction and the pickup in real household income growth. In all, we forecast single-family starts to average near 1.7 million units this year and next—a bit below the 2005 pace. Real outlays in the residential sector, which rose 7½ percent last year, are projected to rise at an annual rate of less than 1 percent over the forecast period.

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

Measure	2006 H1	2006 H2	2007
Real GDP	**4.1**	**3.5**	**3.1**
Previous	3.9	3.4	3.0
Final sales	4.3	3.4	2.9
Previous	4.4	3.2	2.8
PCE	4.4	3.4	3.3
Previous	4.0	3.1	3.3
Residential investment	-.5	2.5	.4
Previous	1.2	2.7	-1.1
BFI	8.8	8.5	6.0
Previous	7.8	7.3	5.5
Government purchases	2.2	1.7	1.4
Previous	2.8	1.5	1.5
Exports	10.3	5.1	4.9
Previous	6.5	6.3	5.3
Imports	7.4	5.9	5.5
Previous	3.1	5.6	5.4
	Contribution to growth (percentage points)		
Inventory change	-.2	.2	.2
Previous	-.4	.3	.2
Net exports	-.2	-.4	-.4
Previous	.2	-.3	-.3

Business spending. We anticipate that real E&S spending will increase 9¼ percent this year and 7 percent in 2007, compared with a gain of 9 percent in 2005. As in previous projections, investment growth should be supported by rising sales and continued declines in the relative price of capital equipment. We look for E&S growth this year to be led by capital spending for equipment outside the high-tech and transportation categories, where spending has lately been exceptionally strong. We project spending for this category of equipment to decelerate in 2007 as the current unusual strength unwinds and as the growth of business output moderates (and with it, firms' expectations for longer-run capital needs). Outlays for transportation equipment are expected to decelerate as well,

. In the high-tech sector, demand for communications equipment has been especially strong lately, but growth of business purchases of computers has slowed. We expect outlays for high-tech equipment to decelerate slightly from last year's 17 percent gain to a 14 percent increase by 2007, a bit below their long-run average growth rate.

Our projection for spending on nonresidential structures is little changed. We expect a further jump in outlays for drilling and mining structures this year in response to high prices for oil and natural gas. However, with the steepest price increases behind us, we look for spending to decelerate noticeably in 2007. Other nonresidential construction spending has been sluggish for some time, but we continue to view the decline in vacancy rates and the firming of rents as indications that outlays for nonresidential buildings may finally turn up this year.

Beyond the near term, inventories are expected to play only a small role in the dynamics of aggregate output. We view inventories, overall, as being reasonably in line with sales at present, and we project that businesses will add to stocks at a rate consistent with a gradual decline in the ratio of inventories to sales that reflects businesses' ongoing improvements in inventory management.

Government spending. The path for real federal purchases is little changed in this projection. After their first-quarter rebound, defense expenditures are expected to post small increases over the remainder of 2006 and no change in 2007; a downturn in Iraq-related spending offsets slow growth elsewhere. Nondefense spending is projected to edge lower following its hurricane-related jump at the end of 2005. At the state and local level, real purchases are expected to increase about 2 percent both this year and next, a projection a bit lower than the one in the January Greenbook. Post-hurricane repair and rebuilding of state and local infrastructure appears to be proceeding less rapidly than we had anticipated, and we see little indication that a significant speed-up is in the offing. In addition, we now think that sharp increases in prices of energy and construction materials may cause governments to trim real spending a bit more than we had expected.

Net exports. After surging in the current quarter, both imports and exports are expected to expand more moderately in coming quarters. We project real exports to rise at an annual rate near 5 percent in the second half of 2006 and in 2007 and imports to increase at a rate of around 5¾ percent over this period. In all, real net exports are projected to deduct a little less than ½ percentage point from real GDP growth in both 2006 and 2007—a somewhat greater drag compared with both 2005 and our projection in the January Greenbook. The revision from January stems mainly from the incoming trade data, as our projections for the dollar, U.S. growth, and foreign growth are not much changed, on net. *(These topics are discussed in more detail in the International Developments section of Part 1.)*

Aggregate Supply, the Labor Market, and Inflation

We have made some small adjustments to our estimates of structural productivity growth in this Greenbook. Labor productivity appears to be coming in weaker than we had anticipated, suggesting that we may have been a bit too generous in the extent to which we marked up our estimates of structural productivity in the December forecast. Furthermore, a lower growth rate of structural productivity (and therefore of potential GDP) in the recent past would help to explain the magnitude of the past year's decline in the unemployment rate because it would imply that the output gap has been closing more

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

Measure	1974-95	1996-2000	2001-03	2004	2005	2006	2007
Structural labor productivity	1.5	2.5	3.3	3.1	3.1	3.1	3.1
Previous	1.5	2.5	3.3	3.1	3.2	3.1	3.0
Contributions[1]							
Capital deepening	.7	1.4	.7	.7	1.0	1.1	1.1
Previous	.7	1.4	.7	.7	1.0	.9	1.0
Multifactor productivity	.5	.8	2.4	2.1	1.9	1.8	1.8
Previous	.5	.8	2.4	2.2	2.0	1.9	1.8
Labor composition	.3	.3	.2	.3	.3	.2	.2
MEMO							
Potential GDP	3.0	3.4	3.2	2.9	2.9	3.3	3.3
Previous	3.0	3.4	3.2	3.0	3.1	3.2	3.3

NOTE. Components may not sum to totals because of rounding. For multiyear periods, the percent change is the annual average from Q4 of the year preceding the first year shown to Q4 of the last year shown.

1. Percentage points.

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

Measure	2004	2005	2006	2007
Output per hour, nonfarm business	2.6	2.5	2.8	3.1
Previous	2.6	2.7	3.1	2.8
Nonfarm private payroll employment	1.7	1.6	1.6	.5
Previous	1.8	1.6	1.4	.6
Household survey employment	1.3	1.9	1.3	.7
Previous	1.3	1.9	1.1	.7
Labor force participation rate[1]	66.0	66.1	66.0	65.8
Previous	66.0	66.1	66.0	65.8
Civilian unemployment rate[1]	5.4	5.0	4.8	4.9
Previous	5.4	5.0	5.0	5.1
MEMO				
GDP gap[2]	-.8	-.4	.1	-.1
Previous	-.9	-.6	-.1	-.4

1. Percent, average for the fourth quarter.
2. Percent difference between actual and potential GDP in the fourth quarter of the year indicated. A negative number indicates that the economy is operating below potential.

rapidly. Thus, whereas we had already assumed that the growth of structural multifactor productivity would slow from the unusually high pace of recent years to a lower, but still impressive, 1.8 percent rate by 2007, we now believe that the downshift occurred a bit sooner.

At the same time, however, we continue to expect the pickup in investment spending that has occurred over the past few years to support structural productivity growth in the period ahead; indeed, having marked up our forecast for E&S spending, we now project greater capital deepening in 2006 and 2007 relative to the last Greenbook. In all, these factors have resulted in a slightly lower estimate of structural productivity growth in the recent past and a slightly higher estimate during the projection period. We project that potential GDP will accelerate over the forecast period from just under 3 percent in 2005 to 3¼ percent in 2006 and 2007.

Productivity and the labor market. Output per hour in the nonfarm business sector increased 2½ percent last year, and we project a similar rate of increase in the first quarter—a rate roughly ½ percentage point less than our estimate of structural productivity growth. We expect productivity growth to pick up closer to its structural

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

Measure	2004	2005	2006	2007
PCE chain-weighted price index	3.1	3.0	2.0	1.9
Previous	3.1	2.9	2.3	1.8
Food and beverages	2.9	2.1	2.5	2.2
Previous	2.9	2.1	2.4	2.2
Energy	17.9	21.8	0.3	1.6
Previous	17.9	21.5	3.6	.6
Excluding food and energy	2.2	1.9	2.1	1.9
Previous	2.2	1.8	2.2	1.8
Consumer price index	3.4	3.7	2.2	2.2
Previous	3.4	3.7	2.6	2.0
Excluding food and energy	2.1	2.1	2.4	2.2
Previous	2.1	2.1	2.5	2.2
GDP chain-weighted price index	2.9	3.1	2.5	2.1
Previous	2.9	2.9	2.2	2.0
ECI for compensation of private industry workers[1]	3.8	3.0	4.2	4.2
Previous	3.8	3.0	4.2	4.1
Compensation per hour, nonfarm business sector	5.9	3.8	5.2	5.3
Previous	5.8	3.3	5.3	5.2
Prices of core nonfuel imports	3.7	2.2	3.1	1.2
Previous	3.7	2.3	2.9	1.1

1. December to December.

rate over the forecast period, averaging 2¾ percent this year and 3 percent in 2007. At the same time, we look for the recent robust pace of hiring to abate gradually. We project that monthly increases in private payrolls will slow substantially—to around 100,000 per month in the third quarter, to around 75,000 per month by year-end, and to only about 50,000 per month in 2007 as growth slows below potential. (In light of a declining trend in labor force participation, we estimate that payroll growth of only about 85,000 per month this year and next, on average, would be required to hold the unemployment rate steady.)

Even with our reduced assumption for the growth of potential output in 2005, we cannot fully account for the past year's reduction in the unemployment rate. Thus, even though GDP growth is expected to be slightly above potential, on average, over the forecast period, we have the unemployment rate edging up slightly to help bring the Okun's Law relationship back into better alignment. We project that the unemployment rate will end the projection period at 4.9 percent—just below our 5 percent estimate of the NAIRU. Meanwhile, the labor force participation rate now stands close to our estimate of its trend, and we expect participation to drift a few tenths lower during the projection period as the trend declines from current levels.

Prices and labor costs. As discussed above, incoming data on core consumer price inflation has generally been slightly below our expectations. At the same time, however, core intermediate PPIs have posted large increases, suggesting that higher energy prices are showing through to costs of materials; in addition, nonfuel import prices are now expected to increase a bit more than we had anticipated, and the labor market is a little tighter than it was in our previous projection. On net, in light of the incoming data, we have reduced our projection for core PCE inflation a tad in 2006 (to 2.1 percent); however, because of the pressures outlined above, we have nudged it higher in 2007 (to 1.9 percent). But the overall contour of our projection is little changed: We continue to look for core inflation to edge a bit higher this year because of the cost pressures of high energy prices and, to a lesser extent, of import prices and to step back down in 2007 as these cost pressures abate. With energy prices expected to register just a small increase this year and next, our projection for overall consumer price inflation is the same as our projection for core inflation during the forecast period.

As for hourly compensation, the ECI has risen considerably less over the past year than we had expected in light of tightening labor markets, ongoing productivity gains, and sizable energy-driven inflation increases. We project the ECI to increase more in line with these fundamentals in 2006 and 2007, rising 4¼ percent in both years after increasing only 3 percent in 2005. We expect the productivity and costs measure of compensation per hour to accelerate as well and to rise 5¼ percent both this year and next.

Financial Flows and Conditions

The growth of domestic nonfinancial debt is expected to move down over the next two years, from 9½ percent last year to about 6½ percent in 2007. This projected deceleration, which is similar to that in the January Greenbook, largely reflects a slower pace of borrowing by households and by state and local governments.

The growth of household debt is expected to moderate from nearly 12 percent in 2005 to a bit less than 7 percent in 2007, as home mortgage borrowing is tempered by the slower appreciation of home values. Consumer credit growth is expected to pick up a bit from the sluggish pace of recent months but to remain moderate by historical standards. Financial obligations as a ratio to disposable income should be about unchanged at 18½ percent.

The debt of state and local governments expanded 10½ percent last year, but growth is expected to slow appreciably to about 3 percent in 2007, reflecting paydowns of previously refunded debt and fewer opportunities for advance refunding amid higher interest rates. In contrast, a widening of the federal government deficit will likely nudge up the growth of federal debt, from 7 percent in 2005 to an average annual pace of 7½ percent in 2006 and 2007.

The debt of nonfinancial corporations is anticipated to increase at an average annual rate of about 6¼ percent this year and next, up slightly from the 5¾ percent rise in 2005. The pickup in debt growth is damped by the assumed reliance on liquid assets to help finance the anticipated rise in capital spending. For businesses outside the corporate sector, the outlook for debt growth is driven largely by a projected moderation in commercial mortgage borrowing. Taking the nonfinancial business sector as a whole, the shift to less-robust mortgage borrowing leaves debt growth over the forecast period about 1 percentage point below the 8 percent increase in 2005.

In 2006, we expect M2 to expand 5 percent, modestly below the projected growth of nominal GDP because of the lagged effects of increases in its opportunity cost. These effects are expected to taper off, and despite a slight easing of monetary policy assumed for mid-2007, growth of M2 in that year is about in line with the 5¼ percent increase in nominal GDP.

Alternative Simulations

In this section we evaluate several risks to the staff forecast using simulations of the FRB/US model. We begin with alternative assumptions about aggregate supply and consider the implications of, first, greater slack in the labor market and, second, smaller gains in structural labor productivity. The next two simulations focus on inflation. In

Alternative Scenarios and Forecast Confidence Intervals

In this round, we have made three changes to the way we generate the alternative scenarios and forecast confidence intervals.

First, we no longer report simulation results derived using the baseline federal funds rate path, but instead only show results that incorporate a monetary policy response. We believe that this change provides a more realistic depiction of the way the Committee would respond to the developments portrayed in the different scenarios.

Second, we run the FRB/US simulations with an estimated version of the Taylor rule instead of the calibrated Taylor rule used previously. The new rule is the same as the Bluebook "outcome-based rule" and is estimated using real-time data since 1988. The estimated rule responds more gradually than the calibrated rule to changes in output and inflation but yields similar long-run effects—specifically, the federal funds rate still rises about 1 percentage point in response to a sustained 1 percentage point increase in the output gap and about 1½ percentage points in response to a sustained 1 percentage point increase in core PCE inflation. We also employ the estimated rule to run the FRB/US stochastic simulations that are used to generate forecast confidence intervals.

Third, we have shortened the sample period used to compute forecast confidence intervals as derived both from FRB/US stochastic simulations and from historical Greenbook projection errors. The previous sample period extended from 1978 to 2004 and thus included the turbulent conditions of the late 1970s and early 1980s. In contrast, the new sample period includes only the past twenty years; by making this change, we are implicitly assuming that the relatively calm conditions seen since the mid-1980s will continue. Consistent with this assumption, the estimated confidence intervals for the forecast have narrowed from those published in previous Greenbooks.

one, adverse movements in labor costs, materials prices, and inflation expectations lead to a surge of inflation; in the other, inflation expectations are more firmly anchored than we have assumed in the baseline. We then consider upside risks to the outlook for aggregate demand, coming either from a more robust expansion in business outlays for equipment and software or through a broader-based acceleration in private spending. We next consider a scenario in which aggregate spending is restrained by a substantial rise in long-term interest rates. In all these simulations, monetary policy responds to changes in the outlook as suggested by an estimated version of the Taylor rule. A final simulation traces out the consequences of a path for the federal funds rate that is consistent with current readings from futures markets.

Low NAIRU. On balance, increases in hourly labor compensation have remained moderate in recent quarters even as the labor market has tightened. This suggests a risk that the NAIRU could be lower than the staff assumption of 5 percent. In this scenario, the NAIRU is instead assumed to have declined over the past several years, reaching 4¼ percent in 2005—a decline that would be consistent with additional structural changes in labor markets of the kind that the staff believes contributed to a fall in the natural rate during the 1980s and 1990s. Reflecting the larger margin of slack implied by this assumption, core PCE inflation moderates more than in the baseline and falls to 1½ percent in 2007. Policymakers gradually reduce the nominal funds rate to 4¼ percent as they observe these favorable inflation developments and, in addition, come to recognize that the level of output remains well below potential. The associated decline in the real federal funds rate, coupled with a gradual realization on the part of households and firms that the lower NAIRU implies a higher long-run level of income and earnings, provides a modest stimulus to real activity. In 2007, real GDP rises 3½ percent, and the unemployment rate is a touch below baseline at 4¾ percent.

Slower productivity growth. Although incoming data on hourly labor compensation hint that supply-side conditions may be looser than we have assumed, the relatively modest gains in output per hour seen recently could be interpreted as signaling a contrasting risk—specifically, that gains in structural productivity have been and will be more modest than we estimate. In this scenario, we assume that the pace of structural multifactor productivity growth fell back to 1½ percent last year and that it will slow a bit more over the projection period. By 2007, structural multifactor productivity rises 1¼ percent, or ½ percentage point less than in the baseline. Under these assumptions, core inflation averages about 2¼ percent this year and next, and the federal funds rate rises to 5¼ percent later this year before falling back to 5 percent next year. The weakened long-run outlook for personal income and corporate earnings implies smaller increases in household spending and business investment. As a result, a slower pace of aggregate demand emerges, one that roughly matches the slowdown in aggregate supply. The unemployment rate is a bit lower than in the baseline, on average.

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

Measure and scenario	2005		2006		2007
	H1	H2	H1	H2	
Real GDP					
Baseline	**3.6**	**3.0**	**4.1**	**3.5**	**3.1**
Low NAIRU	3.6	3.0	4.2	3.7	3.5
Slower productivity growth	3.6	3.0	3.6	2.8	2.3
Greater cost pressures	3.6	3.0	4.2	3.4	3.0
Anchored inflation expectations	3.6	3.0	4.2	3.6	3.1
Robust E&S investment	3.6	3.0	4.2	3.9	3.6
Strong demand	3.6	3.0	4.6	4.6	3.9
Higher term premium	3.6	3.0	4.1	2.6	2.4
Market-based federal funds rate	3.6	3.0	4.1	3.5	3.2
Civilian unemployment rate[1]					
Baseline	**5.1**	**5.0**	**4.8**	**4.8**	**4.9**
Low NAIRU	5.1	5.0	4.8	4.8	4.7
Slower productivity growth	5.1	5.0	4.7	4.7	4.9
Greater cost pressures	5.1	5.0	4.8	4.8	4.9
Anchored inflation expectations	5.1	5.0	4.8	4.8	4.9
Robust E&S investment	5.1	5.0	4.8	4.7	4.7
Strong demand	5.1	5.0	4.7	4.5	4.2
Higher term premium	5.1	5.0	4.8	4.9	5.4
Market-based federal funds rate	5.1	5.0	4.8	4.8	4.9
PCE prices excluding food and energy					
Baseline	**2.1**	**1.7**	**2.0**	**2.2**	**1.9**
Low NAIRU	2.1	1.7	1.9	2.0	1.6
Slower productivity growth	2.1	1.7	2.2	2.4	2.2
Greater cost pressures	2.1	1.7	2.0	2.6	2.4
Anchored inflation expectations	2.1	1.7	1.8	1.7	1.5
Robust E&S investment	2.1	1.7	2.0	2.2	1.8
Strong demand	2.1	1.7	2.0	2.2	1.9
Higher term premium	2.1	1.7	1.9	2.0	1.9
Market-based federal funds rate	2.1	1.7	2.0	2.2	1.9
Federal funds rate[1]					
Baseline	**2.9**	**4.0**	**4.9**	**5.0**	**4.8**
Low NAIRU	2.9	4.0	4.7	4.6	4.2
Slower productivity growth	2.9	4.0	5.0	5.2	5.0
Greater cost pressures	2.9	4.0	4.9	5.1	5.2
Anchored inflation expectations	2.9	4.0	4.9	4.8	4.3
Robust E&S investment	2.9	4.0	4.9	5.1	5.2
Strong demand	2.9	4.0	5.0	5.6	6.1
Higher term premium	2.9	4.0	4.9	4.6	3.7
Market-based federal funds rate	2.9	4.0	4.8	5.0	4.7

1. Percent, average for the final quarter of the period.

Greater cost pressures. Factors other than structural productivity also pose upside risks to our inflation forecast. In this scenario, larger increases in labor and material costs put additional upward pressure on prices this year; we assume further that the consequent rise in inflation is sufficiently large to disturb the relative stability of long-run inflation expectations. Specifically, compensation per hour advances 1 percentage point more rapidly than in the baseline this year (a possibility given recent reports of increasing shortages of some types of skilled workers), and the price of core intermediate materials rises an additional 2 percent. Under these conditions, core inflation moves above 2½ percent in the second half of this year, and the pass-through of this rise into expected inflation sustains core inflation at nearly the same rate next year. In response to the step-up in inflation, the federal funds rate rises to 5¼ percent by the end of 2007. The policy response, however, does not boost the level of real interest rates relative to baseline within the forecast period, so real activity is little changed.

Anchored inflation expectations. In the baseline, underlying inflation is assumed to have moved up some in recent years, on the order of ½ percentage point. In this scenario, we instead assume that the underlying trend has not changed and that expectations have remained firmly anchored. We further assume that the relatively high level of firms' profit margins will limit the pass-through of higher energy and materials costs. As a result, core inflation slows appreciably more than it does in the baseline, reaching 1½ percent in 2007. Under the estimated Taylor rule, the federal funds rate moves down during 2007 to 4¼ percent by year-end. Real interest rates are a bit below baseline at that time, but their effect on real activity is not significant within the projection period.

Robust E&S investment. We have raised our forecast of the average growth rate of real investment in equipment and software more than 1 percentage point since the previous Greenbook. By some measures, however, the level of investment has been low in recent years, especially in light of low long-term interest rates and the relatively strong financial position of firms. In this scenario, we assume that real E&S outlays grow 3½ percentage points more rapidly than in the baseline on average over the forecast period. As a result, the ratio of nominal E&S outlays to GDP increases about as much over the next two years as it did over the past two years. The investment-driven stimulus to aggregate demand causes real GDP to rise more than 3½ percent in 2007. The added investment also augments potential GDP, but not by as much as its effect on aggregate demand, and so the unemployment rate ends 2007 close to 4¾ percent—¼ percentage point below baseline. Inflation is also down a bit relative to baseline: Although a tighter labor market puts upward pressure on prices, this effect is more than offset by faster productivity growth as a result of additional capital deepening. With the output gap up ½ percentage point relative to baseline by late 2007 and with inflation only a touch weaker, the federal funds rate rises to 5¼ percent next year.

Strong demand. This scenario builds on the previous simulation and assumes that the household sector will also provide more impetus to aggregate spending than we anticipate. In particular, the saving rate rises only half as much as in the baseline (fueled in part by faster increases in house prices), and housing investment is somewhat firmer. Given these assumptions and the ones from the previous scenario, real GDP increases 4½ percent this year and 4 percent next year, well above the growth of potential. Consequently, the unemployment rate falls to 4¼ percent by the end of the projection period. The upward pressure on inflation from less economic slack is offset by the downward pressure on inflation from the faster pace of structural productivity growth. The federal funds rate—responding to the marked increase in output relative to potential—climbs to 6 percent by early 2007.

Higher term premium. We expect bond yields to be roughly unchanged over the projection period but recognize the risk of a substantial jump in yields given the unusually low level of term premiums. In this scenario, term premiums on government securities increase sharply over the next several months, reversing the decline seen since mid-2004; premiums on private securities rise in a similar fashion. Accordingly, Treasury yields initially rise ¾ percentage point relative to the baseline, but yields reverse about one-half of their initial rise by late next year as economic conditions weaken and monetary policy responds by gradually lowering the federal funds rate to 3½ percent. The higher path of long-term interest rates causes real GDP growth to slow to 3¼ percent in 2006 and 2½ percent in 2007, pushing the unemployment rate up to 5½ percent by late next year. The effects of this degree of slack on inflation are minimal during the forecast period, but the higher bond rates prompt an appreciation of the dollar that reduces inflation somewhat, especially this year.

Market-based federal funds rate. Quotes from futures markets imply a path for the federal funds rate that is below the baseline path by less than 5 basis points on average over the rest of 2006 and 10 basis points on average in 2007. Taking on board the market's path for the funds rate marginally increases real GDP in 2007. Inflation is unaffected.

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

Measure	2006	2007
Real GDP		
(percent change, Q4 to Q4)		
Projection	3.8	3.1
Confidence interval		
Greenbook forecast errors	2.3–5.3	1.4–4.8
FRB/US stochastic simulations	2.7–5.0	1.6–4.7
Civilian unemployment rate		
(percent, Q4)		
Projection	4.8	4.9
Confidence interval		
Greenbook forecast errors	4.3–5.3	4.0–5.8
FRB/US stochastic simulations	4.3–5.2	4.2–5.5
PCE prices		
excluding food and energy		
(percent change, Q4 to Q4)		
Projection	2.1	1.9
Confidence interval		
Greenbook forecast errors	1.5–2.7	1.0–2.8
FRB/US stochastic simulations	1.6–2.6	1.1–2.8
Federal funds rate		
(percent, Q4)		
Projection	5.0	4.8
Confidence interval		
FRB/US stochastic simulations	4.2–5.9	3.5–6.3

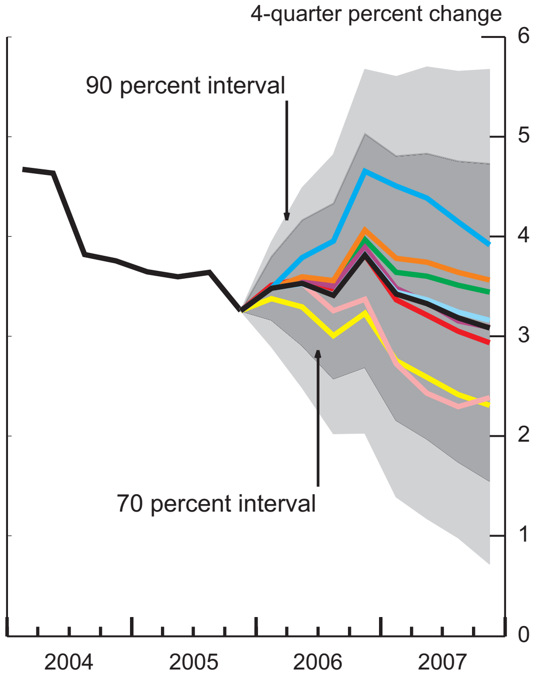
NOTE. Shocks underlying FRB/US stochastic simulations are randomly drawn from the 1986–2004 set of model equation residuals. Intervals derived from Greenbook forecast errors are based on the 1986–2004 set of Greenbook historical errors.

Forecast Confidence Intervals and Alternative Scenarios under the Assumption that Monetary Policy Follows an Estimated Taylor Rule

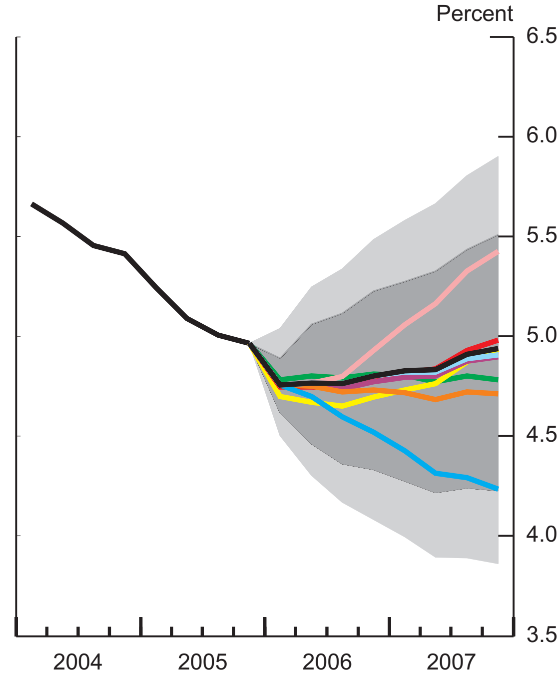
Confidence Intervals based on FRB/US Stochastic Simulations

Greenbook baseline
Low NAIRU
Slower productivity growth
Greater cost pressures
Anchored inflation expectations
Robust E&S investment
Strong demand
Higher term premium
Market-based federal funds rate

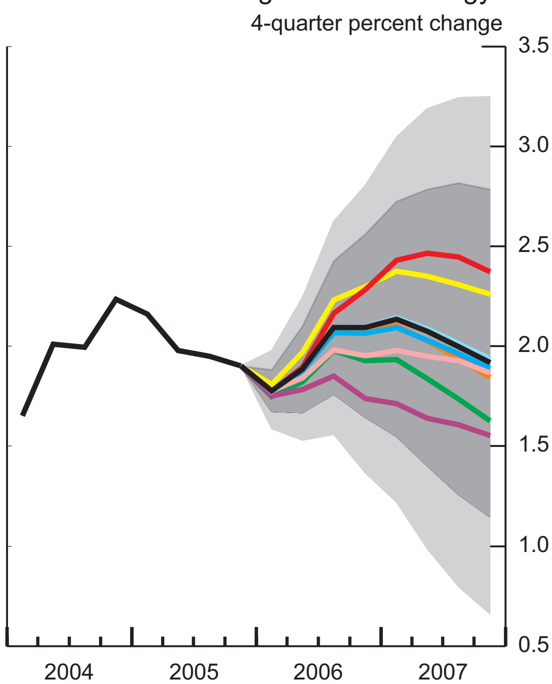
Real GDP



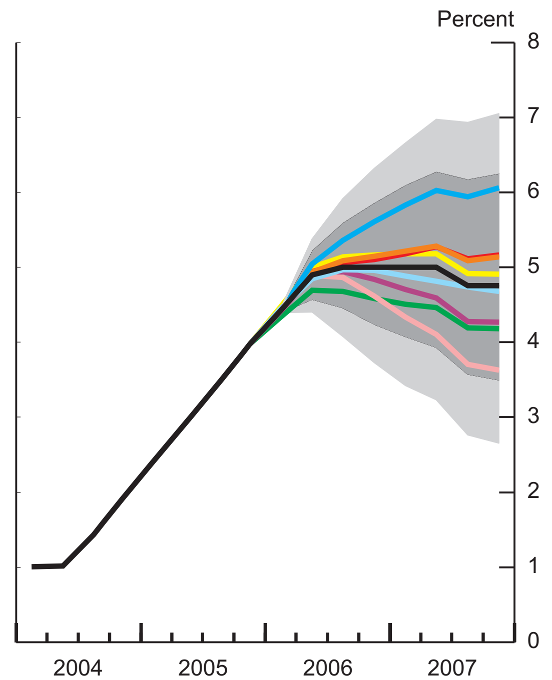
Unemployment Rate



PCE Prices excluding Food and Energy



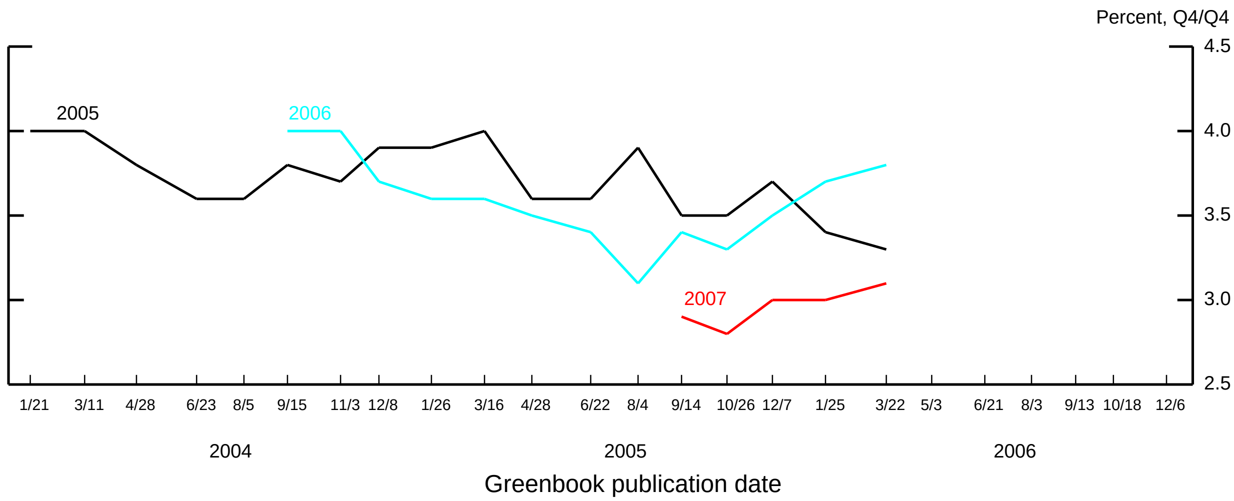
Federal Funds Rate



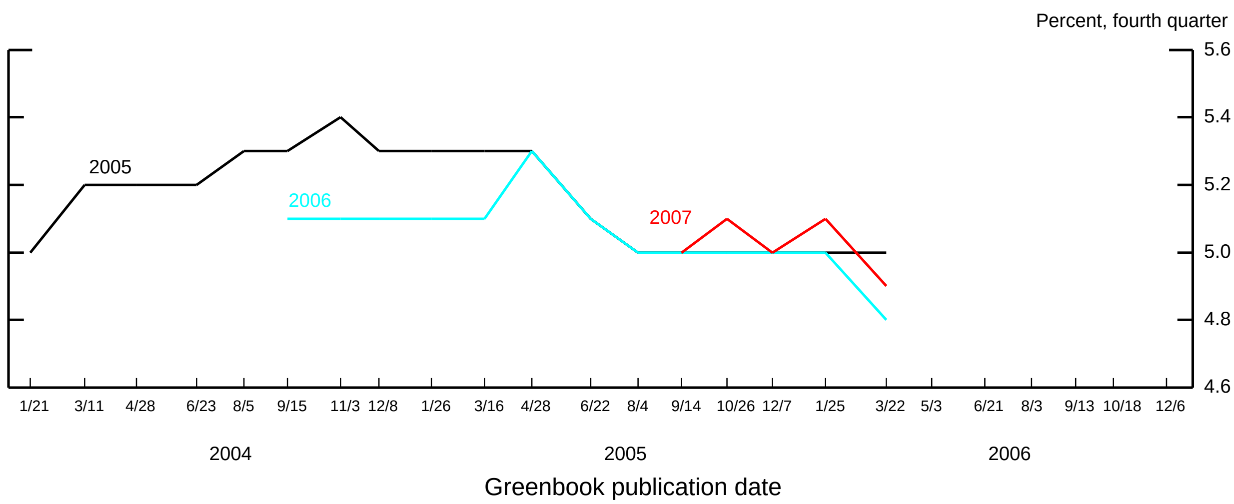
Class II FOMC - Restricted (FR)

Evolution of the Staff Forecast

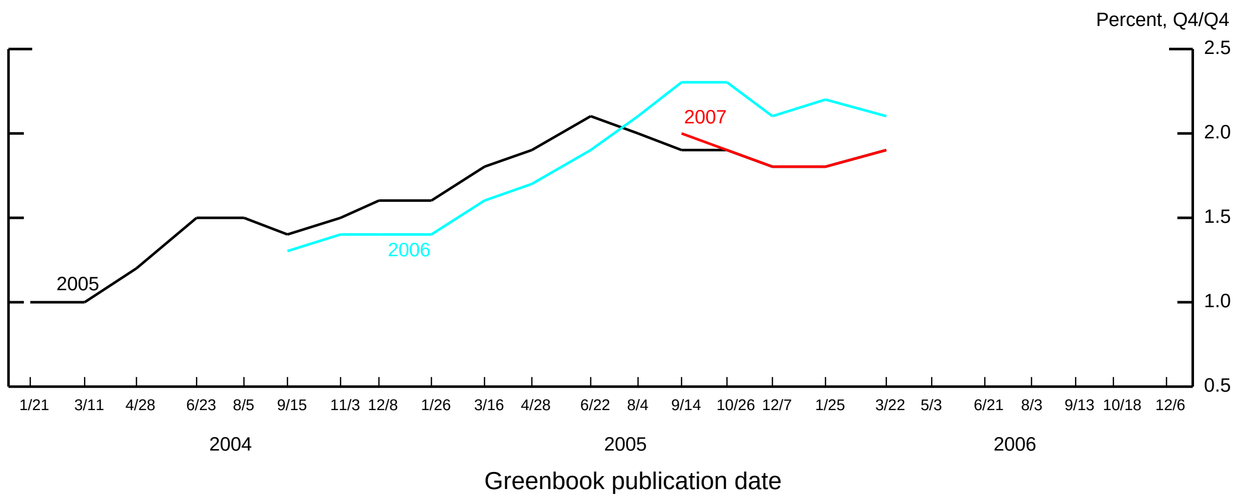
Change in Real GDP



Unemployment Rate



Change in PCE Prices excluding Food and Energy



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

	Nominal GDP		Real GDP		PCE price index		Core PCE price index		Unemployment rate[1]	
Interval	1/25/06	3/22/06	1/25/06	3/22/06	1/25/06	3/22/06	1/25/06	3/22/06	1/25/06	3/22/06
Quarterly										
2005:Q1	7.0	7.0	3.8	3.8	2.3	2.3	2.4	2.4	5.2	5.2
Q2	6.0	6.0	3.3	3.3	3.3	3.3	1.7	1.7	5.1	5.1
Q3	7.6	7.6	4.1	4.1	3.7	3.7	1.4	1.4	5.0	5.0
Q4	5.1	5.2	2.4	1.8	2.4	2.7	1.9	2.1	5.0	5.0
2006:Q1	6.3	8.2	4.1	4.7	2.1	1.9	2.0	1.9	5.0	4.8
Q2	6.3	6.2	3.8	3.5	2.7	2.0	2.3	2.2	5.0	4.8
Q3	5.8	5.7	3.6	3.7	2.3	2.1	2.3	2.2	5.0	4.8
Q4	5.4	5.5	3.3	3.4	2.1	2.2	2.1	2.2	5.0	4.8
2007:Q1	5.2	5.3	3.0	3.1	1.9	2.1	1.9	2.0	5.0	4.8
Q2	5.0	5.4	3.0	3.1	1.8	2.0	1.9	1.9	5.1	4.8
Q3	4.9	5.2	3.0	3.1	1.8	1.9	1.8	1.9	5.1	4.9
Q4	4.8	5.0	2.9	3.0	1.7	1.8	1.8	1.8	5.1	4.9
Two-quarter[2]										
2005:Q2	6.5	6.5	3.6	3.6	2.8	2.8	2.1	2.1	-.3	-.3
Q4	6.3	6.4	3.3	3.0	3.1	3.2	1.6	1.7	-.1	-.1
2006:Q2	6.3	7.2	3.9	4.1	2.4	1.9	2.2	2.0	.0	-.2
Q4	5.6	5.6	3.4	3.5	2.2	2.1	2.2	2.2	.0	.0
2007:Q2	5.1	5.4	3.0	3.1	1.9	2.0	1.9	2.0	.1	.0
Q4	4.9	5.1	2.9	3.1	1.7	1.8	1.8	1.9	.0	.1
Four-quarter[3]										
2004:Q4	6.8	6.8	3.8	3.8	3.1	3.1	2.2	2.2	-.4	-.4
2005:Q4	6.4	6.4	3.4	3.3	2.9	3.0	1.8	1.9	-.4	-.4
2006:Q4	6.0	6.4	3.7	3.8	2.3	2.0	2.2	2.1	.0	-.2
2007:Q4	5.0	5.2	3.0	3.1	1.8	1.9	1.8	1.9	.1	.1
Annual										
2004	7.0	7.0	4.2	4.2	2.6	2.6	2.0	2.0	5.5	5.5
2005	6.4	6.4	3.6	3.5	2.8	2.8	2.0	2.0	5.1	5.1
2006	6.1	6.6	3.6	3.6	2.6	2.4	2.0	2.0	5.0	4.8
2007	5.3	5.4	3.2	3.3	2.0	2.0	2.0	2.0	5.1	4.9

1. Level, except for two-quarter and four-quarter intervals.
2. Percent change from two quarters earlier; for unemployment rate, change is in percentage points.
3. Percent change from four quarters earlier; for unemployment rate, change is in percentage points.

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

	2005				2006				2007						
Item	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	2005[1]	2006[1]	2007[1]
Real GDP	3.8	3.3	4.1	1.8	4.7	3.5	3.7	3.4	3.1	3.1	3.1	3.0	3.3	3.8	3.1
Previous	3.8	3.3	4.1	2.4	4.1	3.8	3.6	3.3	3.0	3.0	3.0	2.9	3.4	3.7	3.0
Final sales	3.5	5.6	4.6	.0	5.0	3.5	3.7	3.0	3.0	3.4	2.8	2.3	3.4	3.8	2.9
Previous	3.5	5.6	4.6	.3	4.7	4.0	3.4	2.9	2.4	3.4	2.9	2.4	3.5	3.8	2.8
Priv. dom. final purch.	4.1	4.5	4.8	1.8	5.7	3.5	4.1	3.9	3.8	3.5	3.3	3.3	3.8	4.3	3.5
Previous	4.1	4.5	4.8	1.9	4.5	3.9	3.7	3.6	3.4	3.3	3.2	3.1	3.8	3.9	3.2
Personal cons. expend.	3.5	3.4	4.1	1.2	5.2	3.6	3.5	3.4	3.5	3.3	3.3	3.3	3.0	3.9	3.3
Previous	3.5	3.4	4.1	1.1	4.5	3.4	3.1	3.1	3.3	3.3	3.3	3.3	3.0	3.5	3.3
Durables	2.6	7.9	9.3	-16.5	20.6	6.8	6.3	5.8	6.0	5.3	5.2	5.0	.3	9.7	5.4
Nondurables	5.3	3.6	3.5	5.1	5.5	2.1	5.1	4.5	4.3	4.0	4.0	4.0	4.4	4.3	4.1
Services	2.8	2.3	3.3	3.0	2.4	3.8	2.3	2.3	2.5	2.5	2.5	2.6	2.9	2.7	2.6
Residential investment	9.5	10.8	7.3	3.0	-.2	-.9	.3	4.6	3.9	.6	-2.1	-.8	7.6	.9	.4
Previous	9.5	10.8	7.3	7.6	-.4	2.8	2.6	2.9	.8	-.5	-2.2	-2.6	8.8	2.0	-1.1
Business fixed invest.	5.7	8.8	8.5	5.4	12.8	4.9	10.0	6.9	5.7	6.5	6.2	5.7	7.1	8.6	6.0
Previous	5.7	8.8	8.5	4.0	7.3	8.3	7.8	6.9	5.4	5.9	5.7	5.0	6.7	7.6	5.5
Equipment & software	8.3	10.9	10.6	6.0	15.2	3.9	11.2	7.5	6.3	7.6	7.1	6.6	9.0	9.3	6.9
Previous	8.3	10.9	10.6	3.5	6.7	8.1	8.0	7.2	5.9	6.9	6.5	5.8	8.3	7.5	6.3
Nonres. structures	-2.0	2.7	2.2	3.5	6.5	7.9	6.9	5.5	4.1	3.6	3.8	3.5	1.6	6.7	3.7
Previous	-2.0	2.7	2.2	5.5	9.0	8.9	7.1	6.1	4.2	3.5	3.6	3.0	2.1	7.8	3.6
Net exports[2]	-645	-614	-617	-656	-668	-663	-668	-688	-704	-702	-710	-734	-633	-672	-712
Previous[2]	-645	-614	-617	-655	-654	-645	-645	-659	-681	-675	-680	-696	-633	-651	-683
Exports	7.5	10.7	2.5	5.1	15.0	5.7	5.2	4.9	4.7	5.0	4.9	4.9	6.4	7.6	4.9
Imports	7.4	-.3	2.4	12.2	12.5	2.5	4.6	7.3	6.4	2.8	4.8	8.0	5.3	6.7	5.5
Govt. cons. & invest.	1.9	2.5	2.9	-.8	2.9	1.6	1.7	1.8	1.4	1.4	1.4	1.4	1.6	2.0	1.4
Previous	1.9	2.5	2.9	.2	4.1	1.5	1.3	1.7	1.5	1.5	1.5	1.5	1.8	2.1	1.5
Federal	2.4	2.4	7.4	-2.6	5.9	1.0	1.0	1.1	.0	.0	.0	.0	2.3	2.2	.0
Defense	3.0	3.7	10.0	-9.0	9.5	1.5	1.6	1.6	.0	.0	.0	.0	1.7	3.5	.0
Nondefense	1.1	-.2	2.4	11.9	-.9	.0	-.1	.1	.0	.0	.0	.0	3.7	-.2	.0
State & local	1.6	2.6	.2	.3	1.1	2.0	2.0	2.1	2.2	2.2	2.2	2.2	1.2	1.8	2.2
Change in bus. inventories[2]	58	-2	-13	34	29	29	29	39	44	37	46	66	19	32	48
Previous[2]	58	-2	-13	43	28	21	25	37	51	41	45	61	22	28	50
Nonfarm[2]	62	3	-8	39	29	28	28	38	43	36	45	65	24	31	47
Farm[2]	-2	-4	-5	-4	0	1	1	1	1	1	1	1	-4	1	1

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

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

Item	1999[1]	2000[1]	2001[1]	2002[1]	2003[1]	2004[1]	2005[1]	2006[1]	2007[1]
Real GDP	4.7	2.2	.2	1.9	4.0	3.8	3.3	3.8	3.1
Previous	4.7	2.2	.2	1.9	4.0	3.8	3.4	3.7	3.0
Final sales	4.2	2.9	1.5	.8	4.0	3.6	3.4	3.8	2.9
Previous	4.2	2.9	1.5	.8	4.0	3.6	3.5	3.8	2.8
Priv. dom. final purch.	5.3	4.3	1.0	1.1	4.4	4.8	3.8	4.3	3.5
Previous	5.3	4.3	1.0	1.1	4.4	4.8	3.8	3.9	3.2
Personal cons. expend.	4.9	4.1	2.8	1.9	3.8	3.8	3.0	3.9	3.3
Previous	4.9	4.1	2.8	1.9	3.8	3.8	3.0	3.5	3.3
Durables	7.3	4.7	10.8	1.2	9.2	5.2	.3	9.7	5.4
Nondurables	4.9	3.0	1.9	2.1	4.1	4.6	4.4	4.3	4.1
Services	4.4	4.5	1.6	1.9	2.5	3.1	2.9	2.7	2.6
Residential investment	3.6	-1.9	1.4	7.0	11.8	6.6	7.6	.9	.4
Previous	3.6	-1.9	1.4	7.0	11.8	6.6	8.8	2.0	-1.1
Business fixed invest.	7.7	7.8	-9.6	-6.5	5.6	10.9	7.1	8.6	6.0
Previous	7.7	7.8	-9.6	-6.5	5.6	10.9	6.7	7.6	5.5
Equipment & software	10.8	7.5	-9.0	-3.4	7.2	13.8	9.0	9.3	6.9
Previous	10.8	7.5	-9.0	-3.4	7.2	13.8	8.3	7.5	6.3
Nonres. structures	-.9	8.8	-11.1	-14.9	1.2	2.7	1.6	6.7	3.7
Previous	-.9	8.8	-11.1	-14.9	1.2	2.7	2.1	7.8	3.6
Net exports[2]	-296	-379	-399	-471	-521	-601	-633	-672	-712
Previous[2]	-296	-379	-399	-471	-521	-601	-633	-651	-683
Exports	5.6	6.5	-11.9	3.8	6.0	6.1	6.4	7.6	4.9
Imports	12.1	11.2	-7.6	9.7	5.1	10.6	5.3	6.7	5.5
Govt. cons. & invest.	4.2	.4	5.0	4.0	1.9	2.1	1.6	2.0	1.4
Previous	4.2	.4	5.0	4.0	1.9	2.1	1.8	2.1	1.5
Federal	4.2	-2.2	6.4	7.8	5.5	4.2	2.3	2.2	.0
Defense	4.3	-3.5	6.5	8.4	7.5	4.9	1.7	3.5	.0
Nondefense	4.1	.3	6.3	6.8	1.6	2.8	3.7	-.2	.0
State & local	4.2	1.7	4.2	2.1	.0	.9	1.2	1.8	2.2
Change in bus. inventories[2]	69	56	-32	12	15	52	19	32	48
Previous[2]	69	56	-32	12	15	52	22	28	50
Nonfarm[2]	72	58	-32	15	15	50	24	31	47
Farm[2]	-3	-1	0	-2	0	2	-4	1	1

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

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

Item	2005 Q1	2005 Q2	2005 Q3	2005 Q4	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2005[1]	2006[1]	2007[1]
Real GDP	3.8	3.3	4.1	1.8	4.7	3.5	3.7	3.4	3.1	3.1	3.1	3.0	3.3	3.8	3.1
Previous	3.8	3.3	4.1	2.4	4.1	3.8	3.6	3.3	3.0	3.0	3.0	2.9	3.4	3.7	3.0
Final sales	3.5	5.5	4.6	.0	5.0	3.5	3.7	3.0	3.0	3.4	2.8	2.3	3.4	3.8	2.9
Previous	3.5	5.5	4.6	.3	4.7	4.0	3.4	2.9	2.4	3.4	2.8	2.4	3.5	3.8	2.8
Priv. dom. final purch.	3.6	3.9	4.2	1.6	5.0	3.0	3.6	3.4	3.3	3.0	2.8	2.9	3.3	3.7	3.0
Previous	3.6	3.9	4.2	1.7	3.9	3.4	3.2	3.1	2.9	2.9	2.8	2.7	3.3	3.4	2.8
Personal cons. expend.	2.4	2.4	2.9	.8	3.6	2.5	2.5	2.3	2.4	2.3	2.3	2.3	2.1	2.7	2.3
Previous	2.4	2.4	2.9	.8	3.2	2.4	2.2	2.2	2.3	2.3	2.3	2.3	2.1	2.5	2.3
Durables	.2	.6	.8	-1.5	1.5	.5	.5	.5	.5	.4	.4	.4	.0	.8	.4
Nondurables	1.1	.7	.7	1.0	1.1	.4	1.0	.9	.9	.8	.8	.8	.9	.9	.8
Services	1.2	1.0	1.4	1.2	1.0	1.6	.9	1.0	1.0	1.0	1.0	1.1	1.2	1.1	1.0
Residential investment	.5	.6	.4	.2	.0	-.1	.0	.3	.2	.0	-.1	-.1	.4	.1	.0
Previous	.5	.6	.4	.5	.0	.2	.2	.2	.0	.0	-.1	-.2	.5	.1	-.1
Business fixed invest.	.6	.9	.9	.6	1.3	.5	1.1	.8	.6	.7	.7	.6	.7	.9	.7
Previous	.6	.9	.9	.4	.8	.9	.8	.7	.6	.6	.6	.5	.7	.8	.6
Equipment & software	.6	.8	.8	.5	1.2	.3	.9	.6	.5	.6	.6	.5	.7	.7	.6
Previous	.6	.8	.8	.3	.5	.6	.6	.6	.5	.5	.5	.5	.6	.6	.5
Nonres. structures	-.1	.1	.1	.1	.2	.2	.2	.2	.1	.1	.1	.1	.0	.2	.1
Previous	-.1	.1	.1	.1	.2	.3	.2	.2	.1	.1	.1	.1	.1	.2	.1
Net exports	-.4	1.1	-.1	-1.4	-.5	.2	-.2	-.7	-.6	.1	-.3	-.8	-.2	-.3	-.4
Previous	-.4	1.1	-.1	-1.4	.0	.3	.0	-.5	-.8	.2	-.2	-.6	-.2	-.1	-.3
Exports	.7	1.1	.3	.5	1.5	.6	.6	.5	.5	.5	.5	.5	.6	.8	.5
Imports	-1.1	.0	-.4	-1.9	-2.0	-.4	-.8	-1.2	-1.1	-.5	-.8	-1.3	-.9	-1.1	-.9
Govt. cons. & invest.	.4	.5	.5	-.1	.6	.3	.3	.3	.3	.3	.3	.3	.3	.4	.3
Previous	.4	.5	.5	.0	.8	.3	.2	.3	.3	.3	.3	.3	.4	.4	.3
Federal	.2	.2	.5	-.2	.4	.1	.1	.1	.0	.0	.0	.0	.2	.2	.0
Defense	.1	.2	.5	-.4	.4	.1	.1	.1	.0	.0	.0	.0	.1	.2	.0
Nondefense	.0	.0	.1	.3	.0	.0	.0	.0	.0	.0	.0	.0	.1	.0	.0
State & local	.2	.3	.0	.0	.1	.2	.2	.3	.3	.3	.3	.3	.1	.2	.3
Change in bus. inventories	.3	-2.1	-.4	1.7	-.3	.0	.0	.4	.2	-.2	.3	.7	-.1	.0	.2
Previous	.3	-2.1	-.4	2.1	-.6	-.2	.1	.4	.5	-.4	.2	.5	.0	-.1	.2
Nonfarm	.4	-2.1	-.4	1.7	-.4	.0	.0	.4	.2	-.2	.3	.7	-.1	.0	.2
Farm	-.1	-.1	.0	.1	.0	.0	.0	.0	.0	.0	.0	.0	.0	.0	.0

1. Change from fourth quarter of previous year to fourth quarter of year indicated.

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

Item	2005 Q1	2005 Q2	2005 Q3	2005 Q4	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2005[1]	2006[1]	2007[1]
GDP chain-wt. price index	3.1	2.6	3.3	3.3	3.4	2.6	2.0	2.0	2.1	2.2	2.1	1.9	3.1	2.5	2.1
Previous	3.1	2.6	3.3	2.6	2.1	2.5	2.2	2.0	2.2	1.9	1.9	1.9	2.9	2.2	2.0
PCE chain.-wt. price index	2.3	3.3	3.7	2.7	1.9	2.0	2.1	2.2	2.1	2.0	1.9	1.8	3.0	2.0	1.9
Previous	2.3	3.3	3.7	2.4	2.1	2.7	2.3	2.1	1.9	1.8	1.8	1.7	2.9	2.3	1.8
Energy	3.6	28.6	50.0	10.2	-.1	-1.2	.6	1.8	2.9	1.9	1.0	.5	21.8	.3	1.6
Previous	3.6	28.6	50.0	8.9	3.0	7.5	2.7	1.3	1.1	.7	.4	.0	21.5	3.6	.6
Food	1.0	3.5	1.3	2.4	2.9	2.2	2.4	2.4	2.3	2.2	2.2	2.1	2.1	2.5	2.2
Previous	1.0	3.5	1.3	2.6	2.1	2.5	2.5	2.4	2.3	2.2	2.1	2.1	2.1	2.4	2.2
Ex. food & energy	2.4	1.7	1.4	2.1	1.9	2.2	2.2	2.2	2.0	1.9	1.9	1.8	1.9	2.1	1.9
Previous	2.4	1.7	1.4	1.9	2.0	2.3	2.3	2.1	1.9	1.9	1.8	1.8	1.8	2.2	1.8
CPI	2.3	3.8	5.5	3.3	2.1	2.0	2.3	2.3	2.4	2.2	2.1	2.0	3.7	2.2	2.2
Previous	2.5	4.0	5.3	3.1	2.5	3.0	2.6	2.3	2.2	2.1	2.0	1.9	3.7	2.6	2.0
Ex. food & energy	2.6	1.8	1.6	2.4	2.2	2.4	2.4	2.4	2.3	2.2	2.2	2.1	2.1	2.4	2.2
Previous	2.6	2.0	1.4	2.4	2.6	2.5	2.5	2.4	2.3	2.2	2.1	2.1	2.1	2.5	2.2
ECI, hourly compensation[2]	2.5	2.5	3.2	3.2	4.1	4.2	4.2	4.3	4.2	4.2	4.2	4.2	3.0	4.2	4.2
Previous[2]	2.5	2.5	3.2	3.7	4.1	4.2	4.2	4.3	4.2	4.1	4.1	4.1	3.0	4.2	4.1
Nonfarm business sector															
Output per hour	3.8	2.4	4.2	-.2	2.3	2.4	3.1	3.3	3.2	3.1	3.1	3.0	2.5	2.8	3.1
Previous	3.2	2.1	4.4	1.0	3.5	2.7	3.1	2.9	2.8	2.8	2.8	2.7	2.7	3.1	2.8
Compensation per hour	5.6	1.3	5.5	2.8	4.3	5.1	5.6	5.6	5.4	5.3	5.2	5.2	3.8	5.2	5.3
Previous	5.5	.9	4.1	3.0	4.3	5.4	5.6	5.6	5.4	5.2	5.2	5.1	3.3	5.3	5.2
Unit labor costs	1.8	-1.0	1.2	3.1	2.0	2.7	2.4	2.3	2.2	2.2	2.1	2.1	1.3	2.3	2.1
Previous	2.2	-1.2	-.3	2.0	.8	2.6	2.5	2.6	2.6	2.3	2.3	2.3	.6	2.1	2.4

1. Change from fourth quarter of previous year to fourth quarter of year indicated.
2. Private-industry workers.

Other Macroeconomic Indicators

Item	2005 Q1	2005 Q2	2005 Q3	2005 Q4	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2005[1]	2006[1]	2007[1]
Employment and production															
Nonfarm payroll employment[2]	.5	.5	.5	.4	.6	.6	.4	.3	.2	.2	.2	.2	1.9	2.0	1.0
Unemployment rate[3]	5.2	5.1	5.0	5.0	4.8	4.8	4.8	4.8	4.8	4.8	4.9	4.9	5.0	4.8	4.9
Previous[3]	5.2	5.1	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.1	5.1	5.1	5.0	5.0	5.1
GDP gap[4]	-.6	-.5	-.2	-.4	-.1	.0	.1	.1	.1	.0	.0	-.1	-.4	.1	-.1
Previous[4]	-.7	-.7	-.4	-.6	-.4	-.2	-.1	-.1	-.2	-.3	-.3	-.4	-.6	-.1	-.4
Industrial production[5]	3.8	1.6	1.4	5.3	5.2	6.8	5.4	4.5	3.8	3.1	2.7	2.9	3.0	5.5	3.1
Previous[5]	3.8	1.6	1.4	3.8	6.3	7.5	5.7	4.5	3.4	2.7	2.7	2.7	2.7	6.0	2.9
Manufacturing industr. prod.[5]	4.5	1.3	2.0	9.2	6.0	4.7	4.8	4.4	3.9	3.2	2.8	3.2	4.2	5.0	3.3
Previous[5]	4.5	1.3	2.0	7.9	5.6	5.5	5.1	4.4	3.6	2.9	3.0	3.0	3.9	5.2	3.1
Capacity utilization rate - mfg.[3]	78.7	78.5	78.5	79.8	80.5	80.9	81.3	81.7	81.9	81.9	81.9	81.8	79.8	81.7	81.8
Previous[3]	78.7	78.5	78.5	79.6	80.2	80.8	81.2	81.5	81.7	81.7	81.7	81.7	79.6	81.5	81.7
Housing starts[6]	2.1	2.0	2.1	2.1	2.1	2.0	2.0	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Light motor vehicle sales[6]	16.5	17.2	17.9	15.8	16.8	16.6	16.9	17.0	17.1	17.1	17.1	17.2	16.9	16.8	17.1
Income and saving															
Nominal GDP[5]	7.0	6.0	7.6	5.2	8.2	6.2	5.7	5.5	5.3	5.4	5.2	5.0	6.4	6.4	5.2
Real disposable pers. income[5]	-3.4	.2	-1.4	7.1	4.2	5.2	5.1	4.6	4.8	4.5	4.0	4.0	.5	4.8	4.3
Previous[5]	-3.4	.2	-2.0	7.4	4.5	4.7	4.4	4.3	4.8	4.2	3.9	4.0	.4	4.5	4.2
Personal saving rate[3]	.5	-.2	-1.6	-.2	-.4	.0	.3	.6	.9	1.2	1.4	1.6	-.2	.6	1.6
Previous[3]	.5	-.2	-1.8	-.2	-.2	.1	.4	.7	1.0	1.3	1.4	1.6	-.2	.7	1.6
Corporate profits[7]	24.5	19.7	-15.2	40.5	14.3	12.0	.4	2.3	-2.8	-.5	-1.4	3.8	15.4	7.1	-.3
Profit share of GNP[3]	10.5	10.9	10.2	11.0	11.2	11.3	11.2	11.1	10.9	10.8	10.6	10.6	11.0	11.1	10.6
Excluding FR Banks[3]	10.3	10.6	10.0	10.8	11.0	11.1	11.0	10.9	10.7	10.6	10.4	10.4	10.8	10.9	10.4
Net federal saving[8]	-298	-297	-408	-297	-327	-336	-341	-329	-363	-355	-356	-346	-325	-333	-355
Net state & local saving[8]	7	21	-6	-12	19	23	22	23	25	25	25	28	3	22	26
Gross national saving rate[3]	13.4	13.1	13.6	13.0	12.8	13.1	13.2	13.4	13.2	13.3	13.4	13.4	13.0	13.4	13.4
Net national saving rate[3]	1.7	1.6	-1.3	1.3	1.4	1.8	1.8	2.1	1.8	2.0	2.0	2.2	1.3	2.1	2.2

1. Change from fourth quarter of previous year to fourth quarter of year indicated, unless otherwise indicated.
2. Change, millions.
3. Percent, annual values are for the fourth quarter of the year indicated.
4. Percent difference between actual and potential GDP; a negative number indicates that the economy is operating below potential. (In previous Greenbooks, we expressed the GDP gap with the opposite sign, so that a positive number indicated that actual output fell short of potential.) Annual values are for the fourth quarter of the year indicated.
5. Percent change, annual rate.
6. Level, millions, annual values are annual averages.
7. Percent change, annual rate, with inventory valuation and capital consumption adjustments.
8. Billions of dollars, annual values are annual averages.

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

Item	Fiscal year				2005				2006				2007			
	2004[a]	2005[a]	2006	2007	Q1[a]	Q2[a]	Q3[a]	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
					Not seasonally adjusted											
Unified budget																
Receipts[1]	1880	2154	2330	2427	452	665	549	530	506	725	568	554	509	768	595	583
Outlays[1]	2293	2472	2662	2770	628	620	618	650	691	667	655	688	718	692	671	731
Surplus/deficit[1]	-412	-318	-333	-343	-177	45	-69	-119	-185	59	-87	-134	-210	77	-76	-148
Previous	*-413*	*-318*	*-347*	*-353*	*-177*	*45*	*-69*	*-119*	*-200*	*57*	*-85*	*-136*	*-209*	*71*	*-79*	*-147*
On-budget	-568	-494	-500	-524	-202	-37	-84	-170	-209	-23	-99	-193	-232	-8	-90	-209
Off-budget	155	175	167	181	25	83	15	51	24	81	11	60	23	85	14	61
Means of financing																
Borrowing	378	297	354	353	165	-43	73	112	171	-37	107	122	194	-48	84	138
Cash decrease	-1	1	-1	2	2	-11	-2	-1	23	-12	-11	12	15	-25	0	10
Other[2]	35	21	-20	-12	10	8	-1	8	-9	-10	-9	-0	0	-4	-8	-0
Cash operating balance, end of period	36	36	37	35	22	33	36	37	14	26	37	25	10	35	35	25
NIPA federal sector					Seasonally adjusted annual rates											
Receipts	1933	2159	2389	2524	2197	2228	2156	2315	2383	2413	2445	2480	2514	2538	2563	2594
Expenditures	2348	2503	2714	2874	2495	2525	2564	2612	2710	2749	2786	2809	2877	2892	2919	2939
Consumption expenditures	711	760	801	835	760	763	783	773	803	810	817	822	836	840	844	847
Defense	474	510	536	561	509	512	529	514	538	543	548	552	561	564	566	569
Nondefense	237	250	265	275	251	251	254	259	265	267	269	270	275	276	277	278
Other spending	1637	1742	1914	2039	1735	1762	1781	1839	1907	1939	1970	1987	2041	2052	2075	2092
Current account surplus	-415	-344	-325	-351	-298	-297	-408	-297	-327	-336	-341	-329	-363	-355	-356	-346
Gross investment	99	106	114	114	101	107	109	116	113	113	113	114	114	114	114	114
Gross saving less gross investment[3]	-421	-352	-338	-360	-302	-307	-418	-313	-339	-347	-351	-339	-373	-363	-364	-352
Fiscal indicators[4]																
High-employment (HEB) surplus/deficit	-379	-337	-339	-365	-284	-294	-414	-303	-341	-353	-359	-349	-377	-368	-366	-351
Change in HEB, percent of potential GDP	0.7	-0.5	-0.1	0.1	-0.6	0.0	0.9	-0.9	0.2	0.1	0.0	-0.1	0.2	-0.1	-0.0	-0.1
Fiscal impetus (FI) percent of GDP	0.8	0.3	0.4	0.1	0.0	0.1	0.1	-0.0	0.2	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Previous	*0.8*	*0.3*	*0.4*	*0.0*	*0.0*	*0.1*	*0.1*	*-0.0*	*0.2*	*0.1*	*0.0*	*0.0*	*-0.0*	*-0.0*	*0.0*	*-0.0*

1. Budget receipts, outlays, and surplus/deficit include corresponding social security (OASDI) categories. The OASDI surplus and the Postal Service surplus are excluded from the on-budget surplus and shown separately as off-budget, as classified under current law.
2. Other means of financing are checks issued less checks paid, accrued items, and changes in other financial assets and liabilities.
3. Gross saving is the current account surplus plus consumption of fixed capital of the general government as well as government enterprises.
4. HEB is gross saving less gross investment (NIPA) of the federal government in current dollars, with cyclically sensitive receipts and outlays adjusted to the staff's measure of potential output and the NAIRU. Quarterly figures for change in HEB and FI are not at annual rates. The sign on Change in HEB, as a percent of nominal potential GDP, is reversed. FI is the weighted difference of discretionary changes in federal spending and taxes in chained (2000) dollars, scaled by real GDP. The annual FI estimates are on a calendar year basis. Also, for FI and the change in HEB, positive values indicate aggregate demand stimulus.
a--Actual

Change in Debt of the Domestic Nonfinancial Sectors
(Percent)

Period [1]	Total	Households			Business	State and local governments	Federal government	Memo: Nominal GDP
		Total	Home mortgages	Consumer credit				
Year								
2000	4.8	8.6	8.2	10.8	9.3	1.3	-8.0	4.6
2001	6.1	8.6	9.5	7.6	6.1	8.9	-.2	2.7
2002	6.9	9.7	11.9	4.7	2.6	11.1	7.6	3.6
2003	8.1	11.4	14.3	4.5	2.7	8.2	10.9	6.1
2004	8.7	11.1	13.5	4.4	5.9	7.6	9.0	6.8
2005	9.5	11.7	14.1	2.9	7.9	10.6	7.0	6.4
2006	7.4	8.3	9.6	3.6	6.8	3.6	7.7	6.4
2007	6.6	6.8	7.7	4.1	6.6	3.1	7.3	5.2
Quarter								
2005:1	9.7	9.7	11.5	3.4	6.6	12.0	14.4	7.0
2	8.1	11.8	13.8	3.7	8.2	6.0	.1	6.0
3	9.6	12.4	14.9	5.3	7.5	13.1	5.1	7.6
4	9.5	11.0	13.2	-.7	8.3	9.6	7.8	5.2
2006:1	8.6	8.8	10.4	3.5	6.4	3.5	14.0	8.2
2	6.1	8.2	9.5	4.0	6.7	4.4	.6	6.2
3	7.1	7.7	8.9	3.2	7.0	3.1	7.6	5.7
4	6.9	7.3	8.4	3.4	6.5	3.1	8.1	5.5
2007:1	7.9	6.9	7.9	3.7	6.4	3.3	14.8	5.3
2	5.1	6.7	7.5	3.9	6.5	3.2	-.3	5.4
3	6.0	6.6	7.3	4.1	6.4	2.8	5.3	5.2
4	6.6	6.4	7.1	4.2	6.3	2.8	8.7	5.0

Note. Quarterly data are at seasonally adjusted annual rates.
1. Data after 2005:Q4 are staff projections. Changes are measured from end of the preceding period to end of period indicated except for annual nominal GDP growth, which is calculated from Q4 to Q4.

2.6.3 FOF

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

Category	2004	2005	2006	2007	2005 Q3	2005 Q4	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4
Domestic nonfinancial sectors														
Net funds raised														
Total	1791.6	1931.8	1620.3	1663.3	1930.5	2050.7	1827.8	1326.3	1661.0	1666.4	2044.8	1287.9	1568.9	1751.7
Net equity issuance	-141.1	-366.0	-325.5	-200.0	-481.1	-394.6	-442.0	-320.0	-290.0	-250.0	-200.0	-200.0	-200.0	-200.0
Net debt issuance	1932.7	2297.8	1945.8	1863.3	2411.6	2445.3	2269.8	1646.3	1951.0	1916.4	2244.8	1487.9	1768.9	1951.7
Borrowing indicators														
Debt (percent of GDP) [1]	197.1	202.2	205.6	208.6	202.1	204.4	204.9	205.5	206.0	206.8	208.0	208.6	208.8	209.6
Borrowing (percent of GDP)	16.5	18.4	14.6	13.3	19.1	19.2	17.4	12.5	14.6	14.1	16.3	10.7	12.5	13.7
Households														
Net borrowing [2]	1023.4	1204.7	950.3	851.1	1347.2	1235.0	1017.0	969.1	923.0	892.3	864.8	850.0	847.9	841.8
Home mortgages	898.7	1067.0	834.2	726.5	1205.1	1110.5	899.2	842.4	814.0	780.9	747.8	728.8	719.4	709.9
Consumer credit	88.8	62.5	78.2	91.9	114.3	-15.8	75.9	87.5	72.4	77.1	84.3	88.9	95.8	98.7
Debt/DPI (percent) [3]	112.8	120.5	124.2	125.1	122.0	122.7	123.8	124.3	124.5	124.8	124.9	125.0	125.3	125.5
Business														
Financing gap [4]	47.0	-100.4	58.5	207.9	-237.7	-159.3	-67.3	67.0	101.1	133.1	167.8	184.0	215.4	264.4
Net equity issuance	-141.1	-366.0	-325.5	-200.0	-481.1	-394.6	-442.0	-320.0	-290.0	-250.0	-200.0	-200.0	-200.0	-200.0
Credit market borrowing	429.2	608.9	565.5	584.4	603.4	677.0	531.7	563.9	601.0	565.4	568.2	588.7	587.7	592.8
State and local governments														
Net borrowing	118.2	177.3	66.2	58.8	229.1	174.2	64.4	82.8	58.8	58.8	62.8	62.8	54.8	54.8
Current surplus [5]	181.3	197.0	194.2	206.8	208.3	158.1	187.6	193.9	196.2	199.1	203.4	205.0	207.0	211.9
Federal government														
Net borrowing	361.9	306.9	363.8	369.1	231.9	359.0	656.7	30.4	368.2	399.9	749.0	-13.5	278.5	462.3
Net borrowing (n.s.a.)	361.9	306.9	363.8	369.1	72.8	112.2	171.2	-36.7	106.8	122.5	194.2	-47.6	84.4	138.1
Unified deficit (n.s.a.)	400.7	319.7	347.3	357.1	69.0	119.3	184.8	-58.6	87.2	133.9	209.7	-76.6	76.0	148.0
Depository institutions														
Funds supplied	796.9	817.2	570.1	551.7	864.4	488.1	763.0	425.8	592.7	498.7	645.0	494.2	566.5	500.9

Note. Data after 2005:Q4 are staff projections.
1. Average debt levels in the period (computed as the average of period-end debt positions) divided by nominal GDP.
2. Includes change in liabilities not shown in home mortgages and consumer credit.
3. Average debt levels in the period (computed as the average of period-end debt positions) divided by disposable personal income.
4. For corporations, excess of capital expenditures over U.S. internal funds.
5. NIPA state and local government saving plus consumption of fixed capital and net capital transfers.
n.s.a. Not seasonally adjusted.

2.6.4 FOF

International Developments

Expansion abroad is forecast to continue at a solid pace, with incoming data pushing projected near-term growth a touch higher than it was in the previous Greenbook. Emerging economies should continue to grow apace, whereas expansion in industrial countries slows a bit after the first half of the year, consistent with recent tightening in monetary policy in a number of countries. Foreign CPI inflation is projected to edge up in the current quarter but to remain contained, as recent and projected tightening of monetary policy and the deceleration of commodity prices weigh on prices. Our forecast for foreign CPI inflation is a bit lower than it was in the January Greenbook, consistent with a lower projected path for oil prices.

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

Indicator	2005		Projection				
				2006			
	H1	Q3	2005: Q4	Q1	Q2	H2	2007
Foreign output	3.2	4.5	3.9	3.9	3.7	3.5	3.4
January GB	3.2	4.4	3.9	3.6	3.6	3.5	3.4
Foreign CPI	1.9	3.3	2.1	2.4	2.4	2.5	2.5
January GB	1.9	3.4	2.0	2.6	2.7	2.6	2.5

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

The spot price of West Texas intermediate (WTI) crude oil has moved down significantly since the time of the January Greenbook, to a little over $60 per barrel, as inventories of crude oil in the United States have risen sharply. However, the far-dated futures price is little changed.

The nominal trade-weighted exchange value of the dollar rose about 1 percent on balance over the intermeeting period. We again project that the broad real dollar will decline at a modest rate over the forecast period, reflecting the need to finance the large and growing U.S. current account deficit.

Real net exports are estimated to subtract ½ percentage point from real GDP growth in the first quarter, after subtracting 1½ percentage points in the fourth. In the second quarter, the contribution from real net exports is expected to swing temporarily into positive territory, but thereafter net exports are expected to subtract nearly ½ percentage point from real GDP growth, a bit more than in 2005.

According to data published last week, the U.S. current account deficit rose from $742 billion at an annual rate in the third quarter of last year to $900 billion in the fourth. The increase reflected a widening of the trade gap and a swing of the investment income balance into negative territory. In addition, net unilateral transfers abroad increased significantly, reflecting normalization from a third-quarter level that had been depressed by foreign payments of hurricane-related insurance claims. The deficit is expected to grow to more than $1.1 trillion, or nearly 8 percent of GDP, by the end of the forecast period.

Oil Prices

The spot price of West Texas intermediate (WTI) crude oil closed at $60.58 per barrel on March 21, a decrease of roughly $6 per barrel since the time of the January Greenbook. Above-normal temperatures in the first quarter have lessened oil demand, allowing inventories to build. Notwithstanding this recent decline, oil prices remain elevated because of recent supply disruptions in Ecuador and Nigeria, lasting hurricane damage that has left 350,000 b/d of production in the Gulf of Mexico shut in, and concerns stemming from an unsuccessful terrorist attack on Saudi oil infrastructure. Also keeping upward pressure on oil prices are uncertainties about future supplies from Iraq, where production has gradually declined and violence has escalated, and from Iran, which has been referred to the U.N. Security Council because of its nuclear program.

These supply concerns are intensified by OPEC’s low spare production capacity and expectations of relatively robust growth in demand for oil, consistent with a continued solid outlook for the world economy. Anticipation of a tight oil market shows up in the price of the far-dated futures contract (currently for delivery in December 2012), which settled at $62.76 per barrel on March 21, about unchanged from the time of the January Greenbook.

In line with NYMEX futures prices, our projection calls for the spot price of WTI to rise to about $65.80 in the second quarter of 2007 and to remain at about that level through the rest of that year. Relative to the January Greenbook, the current projection averages about $4.50 per barrel lower in 2006 and $3 per barrel lower in 2007. The projected path of the oil import price has been revised in a similar fashion.

International Financial Markets

The trade-weighted exchange value of the dollar against the major foreign currencies rose 1¼ percent on balance over the intermeeting period, as the dollar appreciated about 2 percent against the Canadian dollar and sterling but was little changed on net against the euro and the yen. Against the currencies of our other important trading partners, the dollar's trade-weighted exchange value increased about ½ percent, mainly as the dollar appreciated 3½ percent against the Mexican peso. Debate about a continued lack of flexibility of the renminbi's exchange value has intensified recently; over the intermeeting period, the renminbi appreciated almost ½ percent on balance against the dollar, much faster than in recent months.

The projected value of the broad real dollar in the second quarter of 2006 now stands ¾ percent above that in the January Greenbook. We continue to foresee downward pressures on the dollar, stemming from the need to finance the growing U.S. current account deficit. As a result, we again project that the broad real dollar will decline at an annual rate of just over 1 percent over the forecast period.

The European Central Bank raised its policy rates 25 basis points on March 2. The Bank of Japan's Policy Board decided on March 9 to end its policy of quantitative easing, which had been in place since March 2001. It announced that it would continue to keep the overnight interbank interest rate near zero for the time being, while drawing down the banking system's level of excess current account balances. Ten-year nominal sovereign yields rose 15 to 20 basis points on balance in the euro area, the United Kingdom, and Japan—about as much as in the United States—as investors raised their assessment for future economic activity and monetary-policy tightening. However, long-term benchmark yields were little changed on net in Canada, even as the Bank of Canada raised its policy rate in early March, reportedly because investors concluded that the BoC's tightening phase may be near its end. Major equity indexes rose 4 to 6 percent in the euro area and the United Kingdom but registered slight declines in Canada and Japan.

Emerging-market bond spreads declined to record lows by late February, but in March these spreads reversed some of their earlier declines amid rising interest rates in large industrial economies. The currencies of several countries where relatively high interest rates had attracted investors, such as the Australian and New Zealand dollars, the Hungarian forint, the Icelandic krona, and Brazilian *real*, experienced sharp bouts of depreciation on several days in late February and early March, but they reversed some of those moves later in the intermeeting period.

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

Foreign Industrial Countries

Having risen 2.6 percent (annual rate) in the fourth quarter, real GDP in the advanced foreign economies is projected to accelerate to around 3 percent growth in the first half of this year; growth is expected to edge back down to 2½ percent for the remainder of the forecast period. Compared with the January Greenbook, our projection is slightly higher in the first three quarters of this year, primarily on the basis of recent data pointing to much stronger-than-expected growth in Japan. The four-quarter change in consumer prices is expected to increase to just under 2 percent this quarter, again in large part a result of data from Japan. After slipping back to 1½ percent in the second half of this year, inflation moves up slightly in 2007, boosted chiefly by the slated increase in the German value-added tax.

After growing at a notable 5.4 percent (annual rate) pace in the fourth quarter, Japanese GDP is projected to expand at a still-robust rate of 3 percent in the current quarter. Supported by improving labor market conditions and by the rise in the stock market late last year, consumption growth should remain solid, while net exports continue to make a strong contribution. Thereafter, we project that real GDP growth will slow further, as the wealth effects of the stock market's rise play out and the recent strength in net exports abates. In January, consumer prices were up 0.5 percent over the year-earlier level, as a rise in energy prices pushed inflation higher. Strong output growth should push the 12-month rate of inflation up further to almost 1 percent later this year. Inflation is then projected to slip back to ½ percent in 2007, as the response to higher oil prices is completed. On March 9, the Bank of Japan ended its policy of quantitative easing, but policymakers continue to keep short-term interest rates at zero. We assume that the BoJ will start gradually raising interest rates in the fourth quarter of this year.

Euro-area real GDP rose only 1 percent (at an annual rate) in the fourth quarter, with French GDP edging up 0.9 percent and German GDP unchanged. Despite this disappointing news, recent forward-looking indicators, such as sentiment and new orders, have largely been positive. Accordingly, we project growth to strengthen to an annual rate of just below 2½ percent for the first half of this year. Later in 2006, growth is damped by monetary tightening by the ECB. Our forecast incorporates some anticipatory effects of the 3 percentage point increase in the German value-added tax scheduled for 2007, which should shift some demand and production from early 2007 into late 2006. The tax hike also pushes up euro-area inflation about ¼ percentage point in 2007, to just above the ECB's 2-percent inflation ceiling. We assume that the ECB will raise its official interest rates another 75 basis points this year on concerns about inflation and rapid money and credit growth.

Although growth of the Canadian economy slowed to 2.5 percent (annual rate) in the fourth quarter (in part because of a negative contribution from inventories), we project growth to return to a pace of 3½ percent in the first half of this year as domestic demand continues to expand robustly. The effects of past tightening and one additional assumed tightening of 25 basis points by the Bank of Canada should cause growth then to slow to around 3 percent, on average, over the remainder of the forecast period. We project that headline inflation will remain above 2 percent (12-month rate) during the first half of this year, consistent with past energy price increases, and then will edge down to a bit under 2 percent for the second half of 2006 and into 2007.

Real GDP in the United Kingdom is projected to expand 2¾ percent in the current quarter, up from a pace of 2.3 percent in the final quarter of 2005. This acceleration partly reflects recent pickups in mortgage lending and house-price inflation, which suggest a continued improvement in consumption growth. By late 2007, we expect growth to notch up to just over 3 percent, as consumption and investment strengthen further. The effects of increases in energy prices wane later this year, but we project a slight increase in core inflation as output growth strengthens, keeping headline inflation near the current rate of 2 percent through the forecast period. We assume that the Bank of England will raise its policy rates 25 basis points in early 2007.

Emerging-Market Economies

We expect average output growth in the emerging-market economies to drop back from the pace of nearly 6 percent in the fourth quarter to about 5 percent in the current quarter and thereafter. This drop reflects a deceleration of robust activity in developing Asia to a more-sustainable pace, even as Latin American growth recovers from its earlier weakness. The growth path for the emerging economies is roughly unchanged from that in the previous Greenbook.

Fourth-quarter output in emerging Asia is estimated to have continued to grow at an annual rate of about 8 percent, with strength widespread across the region. We project that growth will moderate to around 6 percent in the current quarter and then will maintain that pace over the forecast period — an outlook slightly stronger than the one in the January Greenbook. Chinese growth is projected to average about 8¼ percent over the forecast period, as efforts by the Chinese government to slow investment and an expected continuation of the recent deceleration of exports keep growth noticeably below the pace of roughly 10 percent of the previous three years. Korean growth is projected to remain close to 4½ percent throughout the forecast period, down from its more rapid pace in the second half of last year. Elsewhere in the region, growth is projected to average a bit less than 5½ percent over the forecast period, a projection supported by a robust outlook for high-tech goods and expected solid expansion in the United States and China.

Growth in Latin American output is estimated to have been just above 3 percent in the fourth quarter, held down by low Mexican growth, but we project expansion in Latin America to move up to around 3¾ percent in 2006 and 2007. Mexican real GDP was depressed by weakness in agriculture in the fourth quarter but is forecast to accelerate to a bit more than 3½ percent growth over the forecast period, as service-sector output stays solid and manufacturing output continues to recover from last year's weakness. We also expect Brazilian output to expand about 3½ percent this year and next as monetary policy eases further. This projection is up from the previous Greenbook, as Brazilian financial conditions have improved noticeably.

We estimate that four-quarter inflation in the emerging-market economies hovered just above 3 percent at the end of last year. However, the pass-through of past oil price increases and the generally reduced slack in emerging market economies are expected to put upward pressure on prices. Accordingly, inflation for the emerging-market economies is expected to pick up a bit, to about 3½ percent by late 2006, before dropping back slightly by the end of 2007.

Prices of Internationally Traded Goods

Since the January Greenbook, we have revised our definition of core imports to exclude natural gas. On this basis, core import prices, after increasing in the fourth quarter at an annual rate of 2½ percent, are projected to increase 3 percent in the first quarter. This pickup largely reflects a jump in core import prices that occurred in January, as prices increased only slightly in February. As in the fourth quarter, much of the recent rise in core import prices reflects increases in nonfuel industrial supplies. Prices for imported consumer goods and capital goods (excluding computers and semiconductors) also turned up in the first two months of the year, following declines in the previous two quarters.

For the second quarter of 2006, we project that core import price inflation will rise a bit further to 3½ percent, reflecting the lagged effects of higher nonfuel commodity prices. These increases are projected to keep core import price inflation just above 3 percent for the second half of 2006. Furthermore, the dollar, which had restrained core import prices as it strengthened in 2005, will boost those prices somewhat as it returns to a depreciating path. In 2007, core import prices decelerate as commodity prices flatten and the dollar depreciates only gradually. Our projection for core import price inflation is somewhat higher than it was in the January Greenbook because of an upward shift in the projected path of commodity prices. The upward revision to core import price inflation is ½ percentage point in the second of half of 2006 and somewhat less in 2007.

Having increased sharply in the fourth quarter of 2005, price inflation of core exports remains elevated in the first quarter of 2006. According to BLS price data, core export prices rose steeply in January, reflecting a surge in prices for exported nonagricultural industrial supplies, but were little changed in February. In addition, prices of exported finished goods, having risen sharply in the fourth quarter of 2005, look to have increased again in the current quarter. Incoming data on core export prices and the recent strength in both the PPI for intermediate materials excluding food and energy and the prices of primary commodities, especially metals, led us to mark up our projection for core export price inflation to 4 percent in the current quarter. We have also revised up our projection for the remainder of the year. All told, core export price inflation, which was 4 percent in 2005, is expected to remain at that pace in 2006 before declining to 1½ percent in 2007, as price inflation for intermediate materials and primary commodities is projected to step down.

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

Indicator	2005		Projection				
	H1	Q3	2005: Q4	2006 Q1	2006 Q2	2006 H2	2007
Exports							
Core goods	4.9	1.9	4.1	4.0	4.9	3.4	1.3
January GB	4.9	1.9	4.6	3.0	4.4	2.6	1.1
Imports							
Nonfuel core goods	3.3	-.2	2.6	3.1	3.4	3.1	1.2
January GB	3.3	-.2	2.8	3.0	3.1	2.7	1.1
Oil (dollars per barrel)	46.30	55.24	55.40	55.13	55.64	59.41	60.76
January GB	46.30	55.24	55.50	59.72	61.60	63.19	63.41

Note. Prices for core exports exclude computers and semiconductors. Prices for nonfuel core imports exclude computers, semiconductors, oil, and natural gas. Both price series are on a NIPA chain-weighted basis.

The price of imported oil for multiquarter periods is the price for the final quarter of the period. Imported oil includes both crude oil and refined products.

Trade in Goods and Services

Having made a negative arithmetic contribution of 1½ percentage points to real GDP growth in the fourth quarter, real net exports are projected to make a negative contribution of ½ percentage point in the first. Export growth is expected to outpace import growth in the current quarter; however, the higher initial level of imports implies a decline in net exports, which accordingly subtracts from real GDP growth. The contribution of net exports becomes positive in the second quarter, reflecting a seasonal factor that depresses oil imports, but then net exports subtract an average of ½ percentage point for the remainder of the forecast period. Compared with the January Greenbook, our projection of the contribution of real net exports in the first quarter has been revised down about ½ percentage point, primarily in response to the December and January trade data. Our projection of the contribution for the remainder of the forecast is a touch more negative as well, reflecting both the stronger dollar and a slight upward revision to the projection for U.S. GDP growth.

Real imports of goods and services increased 12¼ percent at an annual rate in the fourth quarter, as imports of oil and other industrial supplies surged in the wake of hurricane-related disruptions to domestic production. In the current quarter, the unexpected strength of the January nominal import data has led us to expect import growth to continue at the same pace, about 8 percentage points higher than in the January Greenbook, despite a slight decline in oil imports as domestic production recovers. With the notable exception of chemicals, which declined from their earlier, hurricane-elevated level, January imports across a broad set of categories jumped. Some of this surge reflects transitory factors that we anticipate will be reversed in the months ahead. Even so, for the second quarter running, overall core imports are estimated to be growing considerably faster in the current quarter than would be suggested by incomes and relative prices. Additionally, services imports are expected to be boosted by licensing payments related to the Winter Olympics.

Real import growth is expected to fall to 2½ percent in the second quarter, when oil imports are held back by a quirky seasonal factor and the growth rate of core goods steps down to a pace more in line with the projected pace of U.S. growth and core import price inflation. Thereafter, we expect real import growth to average 5¾ percent over the remainder of the forecast period. Our projection for core import growth reflects the effect of slowing U.S. growth that is balanced by a deceleration of core import prices. Imports of computers and semiconductors should maintain firm growth, whereas imports of services decelerate slightly along with U.S. activity.

Real exports of goods and services grew slightly more than 5 percent at an annual rate in the fourth quarter, despite hurricane-induced weakness early in the quarter in exports of certain industrial supplies, including chemicals and petroleum products. For the current quarter, we are projecting real export growth to rise to 15 percent, as exports of core goods increase following the relative weakness of the second half of 2005. Consistent with this projection, in the December and January nominal trade data, exports of industrial supplies exhibited particularly robust growth, as they bounced back from their earlier hurricane-depressed levels. Exports of other capital goods, automobiles, and consumption goods were also very strong in December and January. We expect a pickup in growth of exports of services and computers, which had been weak previously. Since the January Greenbook, we have revised up our projection for overall export growth in the first quarter about 7¾ percentage points, primarily in response to the strength of incoming data.

We expect real export growth to moderate after the first quarter, to 5¾ percent in the second quarter and to 5 percent in the second half of 2006 and in 2007. The growth of core goods exports is projected to decline in the second quarter to a pace more in line with foreign GDP growth and relative prices. Thereafter, growth slows further over the forecast period, as the positive impetus of dollar depreciation in 2003-04 wanes. The slowing of core exports is partially balanced by an acceleration of services exports, which respond to exchange rate changes with a shorter lag than core exports and are boosted by the projected decline in the dollar. Since the January Greenbook, our projection for overall export growth beyond the current quarter has been revised down, in part in response to the stronger dollar.

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

Indicator	2005		Projection				
	H1	Q3	2005: Q4	2006 Q1	2006 Q2	2006 H2	2007
Real exports	9.1	2.5	5.1	15.0	5.7	5.1	4.9
January GB	9.1	2.5	4.8	7.2	5.9	6.3	5.3
Real imports	3.5	2.4	12.2	12.5	2.5	5.9	5.5
January GB	3.5	2.4	11.9	4.4	1.9	5.6	5.4

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

Alternative Simulations

Our baseline forecast has GDP growing above trend in the euro area and Japan this year, accompanied by some tightening of policy rates in these economies. However, it is possible that this growth will stall and that the Bank of Japan and the European Central Bank then will respond only slowly to the weaker activity. Accordingly, we use the FRB/Global model to examine the effects of an autonomous fall in demand in the euro area and Japan of 2 percent of GDP. This simulation also incorporates 50 basis points less monetary easing than would be called for by a Taylor rule subject to a zero-bound constraint. These shocks are phased in over a year beginning in 2006:Q2. After four quarters, the shocks induce a fall in euro-area and Japanese GDP of 2.4 percent and 3.3 percent, respectively, relative to baseline, and return Japan to deflation. In the euro area, the short-term interest rate falls about 150 basis points relative to baseline after four quarters. However, the Taylor rule for Japan implies that the short-term interest rate should fall to the zero lower bound, and then the monetary shock pushes it up to 50 basis points.

U.S. GDP growth falls 0.2 percentage point relative to baseline in the second half of this year and about 0.1 percentage point in 2007. Nearly all the reduction in U.S. GDP reflects the effects of the autonomous negative demand shock, which depresses U.S. real net exports directly through lower European and Japanese demand and indirectly through a modest appreciation of the dollar. As a result, the trade deficit widens about 0.1 percent of GDP in 2007. Core PCE inflation falls 0.1 percentage point below baseline in 2007:H2 reflecting the effects of weaker demand.

Alternative Simulation:
Weaker Demand and Monetary Tightening in the Euro Area and Japan
(Percent change from previous period, annual rate, except as noted)

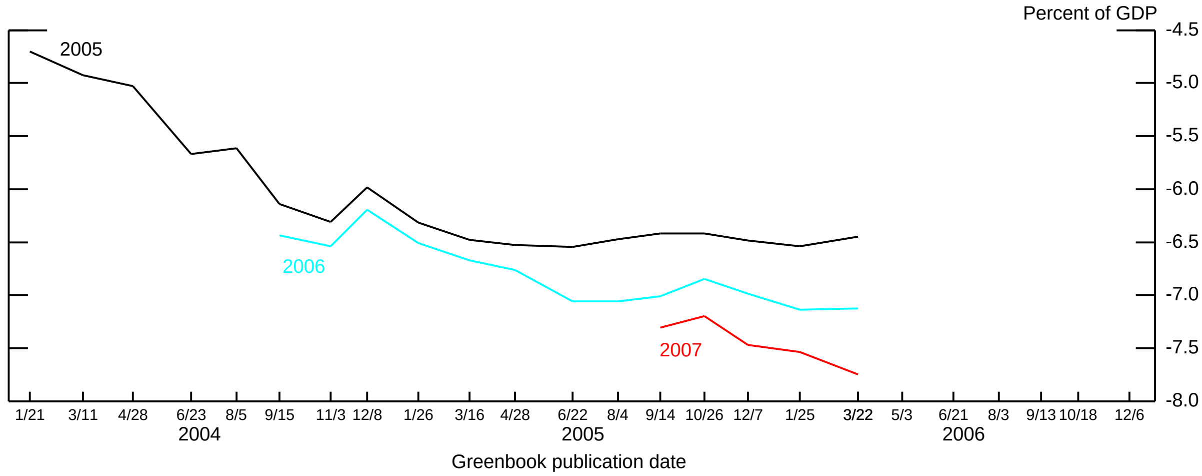
Indicator and simulation	2006		2007	
	H1	H2	H1	H2
U.S. real GDP				
Baseline	4.1	3.5	3.1	3.1
Alternative Simulation	4.0	3.3	2.9	3.1
U.S. PCE prices excluding food and energy				
Baseline	2.0	2.2	2.0	1.9
Alternative Simulation	2.0	2.2	2.0	1.8
U.S. trade balance (percent share of GDP)				
Baseline	-6.0	-6.1	-6.3	-6.3
Alternative Simulation	-6.0	-6.1	-6.4	-6.4

Note. H1 is Q2/Q4; H2 is Q4/Q2. The monetary authorities in the United States and the major foreign economies adjust their policy rates according to a Taylor rule.

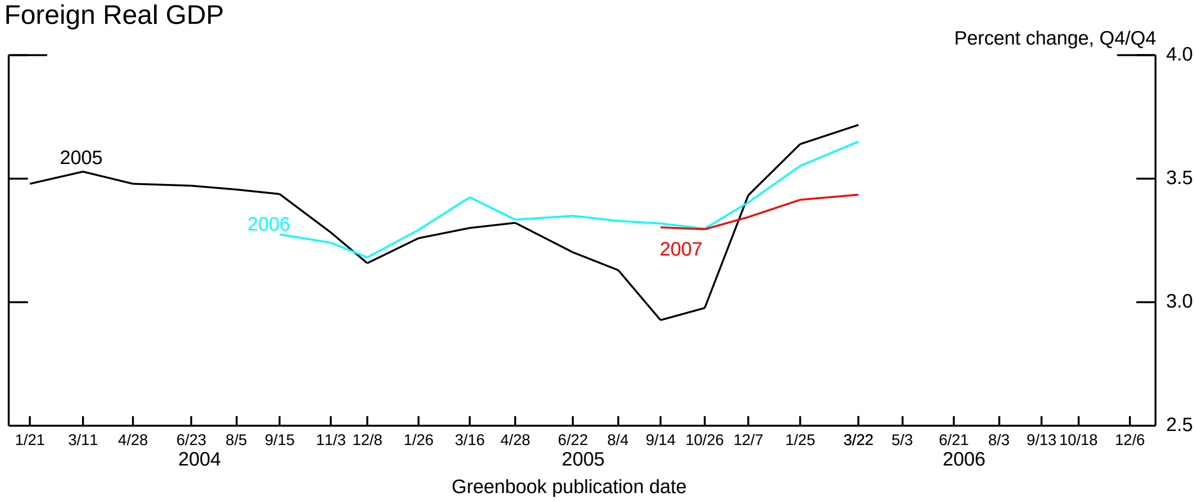
Class II FOMC -- Restricted (FR)

Evolution of the Staff Forecast

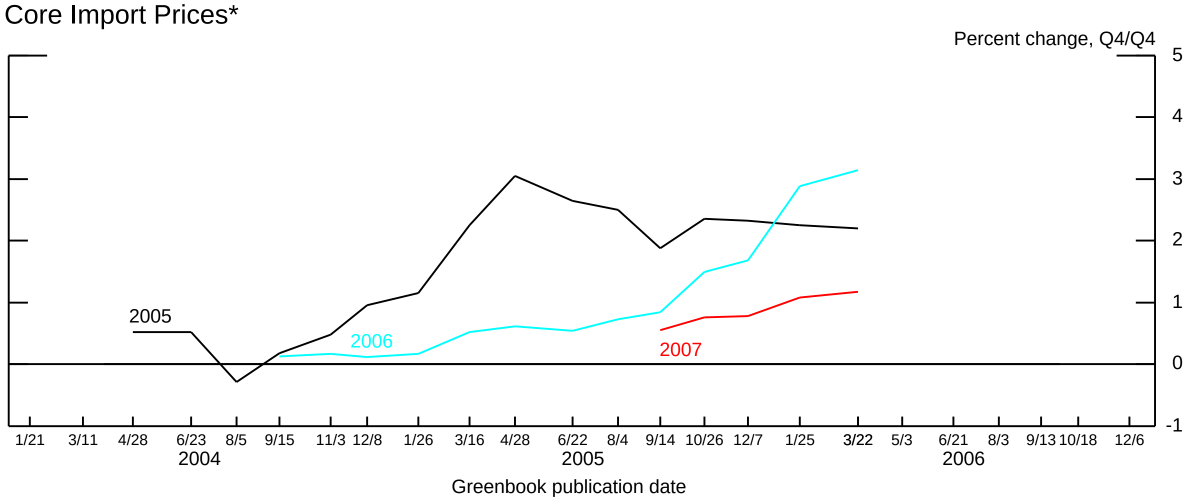
Current Account Balance



Foreign Real GDP



Core Import Prices*



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

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Restricted (FR)

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

Measure and country	1999	2000	2001	2002	2003	2004	2005	-----Projected---- 2006	2007
REAL GDP (1)									
Total foreign	5.1	4.2	0.4	3.1	3.0	3.7	3.7	3.7	3.4
Industrial Countries	4.4	3.5	0.9	2.6	1.8	2.4	2.6	2.8	2.5
of which:									
Canada	5.9	4.1	1.3	3.6	1.7	3.3	2.9	3.1	3.1
Japan	0.2	3.3	-1.5	2.0	2.6	0.5	4.3	2.3	1.8
United Kingdom	3.4	3.2	2.0	2.1	3.1	2.7	1.8	2.8	3.0
Euro Area (2)	4.1	3.2	1.1	1.2	0.9	1.6	1.7	2.2	1.5
Germany	3.5	2.3	1.1	0.2	0.2	0.5	1.6	2.4	0.9
Developing Countries	6.2	5.2	-0.4	3.9	4.7	5.6	5.2	4.9	4.8
Asia	8.8	5.9	1.1	6.3	6.9	6.1	7.3	5.9	5.9
Korea	11.5	4.5	4.6	7.8	4.2	2.9	5.3	4.6	4.4
China	7.7	8.2	7.8	9.2	10.5	10.1	9.9	8.2	8.3
Latin America	4.4	4.4	-1.3	1.5	2.3	5.2	3.1	3.9	3.7
Mexico	5.5	4.8	-1.3	1.9	2.0	4.8	2.7	3.7	3.5
Brazil	3.4	3.8	-1.0	4.1	0.9	4.7	1.5	3.5	3.5
CONSUMER PRICES (3)									
Industrial Countries	1.2	1.8	0.9	2.1	1.3	1.8	1.6	1.5	1.7
of which:									
Canada	2.4	3.1	1.1	3.8	1.7	2.3	2.3	1.8	1.9
Japan	-1.0	-0.9	-1.0	-0.5	-0.4	0.5	-0.5	0.9	0.6
United Kingdom (4)	1.2	0.9	1.0	1.6	1.3	1.4	2.1	1.9	2.1
Euro Area (2)	1.5	2.5	2.1	2.3	2.0	2.3	2.3	1.6	2.0
Germany	1.1	1.7	1.4	1.2	1.1	2.2	2.2	1.2	2.5
Developing Countries	4.6	4.1	2.8	2.8	3.1	3.9	3.1	3.5	3.3
Asia	0.1	1.9	1.2	0.7	2.2	3.2	2.6	3.2	3.0
Korea	1.2	2.5	3.3	3.4	3.5	3.4	2.5	3.5	3.0
China	-1.0	1.0	-0.1	-0.5	2.7	3.3	1.4	3.0	2.9
Latin America	12.5	8.4	5.3	6.4	4.9	5.7	3.8	4.1	3.9
Mexico	13.4	8.7	5.1	5.2	3.9	5.3	3.1	3.8	3.7
Brazil	8.4	6.4	7.5	10.7	11.5	7.2	6.1	4.8	4.0

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

Class II FOMC
Restricted (FR)

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

Measure and country	2005 Q1	2005 Q2	2005 Q3	2005 Q4	Projected 2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4
REAL GDP (1)	Quarterly changes at an annual rate											
Total foreign	2.5	4.0	4.5	3.9	3.9	3.7	3.5	3.5	3.4	3.5	3.5	3.5
Industrial Countries	1.9	3.4	2.6	2.6	3.1	2.9	2.6	2.5	2.3	2.5	2.5	2.5
of which:												
Canada	2.1	3.6	3.5	2.5	3.6	3.4	2.9	2.7	3.0	3.1	3.1	3.1
Japan	5.5	5.7	0.8	5.4	3.0	2.3	2.1	1.9	1.8	1.8	1.8	1.7
United Kingdom	1.0	1.8	2.1	2.3	2.7	2.8	2.9	2.9	3.0	3.0	3.1	3.1
Euro Area (2)	1.1	1.8	2.7	1.0	2.4	2.4	2.0	2.1	1.0	1.7	1.6	1.6
Germany	2.4	1.2	2.5	0.0	2.4	2.5	2.1	2.6	-0.8	1.6	1.4	1.4
Developing Countries	3.3	4.8	7.1	5.8	5.0	4.9	4.9	4.9	4.8	4.8	4.8	4.8
Asia	5.3	7.8	7.8	8.1	6.2	5.8	5.8	5.8	5.9	5.9	5.9	5.9
Korea	2.1	5.9	6.6	6.7	4.8	4.5	4.5	4.5	4.5	4.4	4.4	4.4
China	11.9	7.2	8.9	11.5	9.0	7.8	8.0	8.0	8.3	8.3	8.3	8.3
Latin America	1.2	1.3	6.7	3.1	3.9	3.9	3.9	3.9	3.7	3.7	3.7	3.7
Mexico	0.6	-0.7	8.7	2.4	3.7	3.7	3.7	3.7	3.5	3.5	3.5	3.5
Brazil	0.6	5.7	-3.4	3.4	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5
CONSUMER PRICES (3)	Four-quarter changes											
Industrial Countries	1.5	1.5	1.8	1.6	1.9	1.7	1.5	1.5	1.7	1.7	1.7	1.7
of which:												
Canada	2.1	1.9	2.7	2.3	2.4	2.1	1.6	1.8	1.9	1.9	2.0	1.9
Japan	-0.2	-0.1	-0.2	-0.5	0.5	0.6	0.9	0.9	0.4	0.5	0.5	0.6
United Kingdom (4)	1.7	2.0	2.4	2.1	2.0	1.9	1.7	1.9	2.0	2.0	2.1	2.1
Euro Area (2)	2.0	2.0	2.3	2.3	2.4	2.1	1.8	1.6	2.1	2.1	2.1	2.0
Germany	1.7	1.6	2.1	2.2	2.1	1.9	1.4	1.2	2.7	2.6	2.6	2.5
Developing Countries	3.6	3.2	3.1	3.1	3.2	3.4	3.3	3.5	3.5	3.5	3.4	3.3
Asia	2.9	2.4	2.3	2.6	2.7	3.1	2.9	3.2	3.3	3.3	3.1	3.0
Korea	3.1	3.0	2.4	2.5	2.5	2.8	3.0	3.5	3.7	3.6	3.3	3.0
China	2.8	1.7	1.3	1.4	1.5	2.3	2.4	3.0	3.1	3.1	3.0	2.9
Latin America	4.9	5.1	4.5	3.8	4.2	3.9	4.0	4.1	3.9	4.0	3.9	3.9
Mexico	4.4	4.5	4.0	3.1	3.7	3.5	3.6	3.8	3.6	3.6	3.7	3.7
Brazil	7.4	7.7	6.2	6.1	5.6	4.9	5.3	4.8	4.4	4.3	4.2	4.0

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

Class II FOMC
Restricted (FR)

March 22, 2006

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1999	2000	2001	2002	2003	2004	2005 (Projected)	2006 (Projected)	2007 (Projected)
NIPA REAL EXPORTS and IMPORTS									
Percentage point contribution to GDP growth, Q4/Q4									
Net Goods & Services	-1.0	-0.9	-0.2	-0.9	-0.1	-0.9	-0.2	-0.3	-0.4
Exports of G&S	0.6	0.7	-1.3	0.4	0.6	0.6	0.6	0.8	0.5
Imports of G&S	-1.6	-1.6	1.1	-1.3	-0.7	-1.5	-0.9	-1.1	-0.9
Percentage change, Q4/Q4									
Exports of G&S	5.6	6.5	-11.9	3.8	6.0	6.1	6.4	7.6	4.9
Services	5.3	1.8	-8.9	10.2	4.5	4.6	2.8	4.9	5.8
Computers	13.4	22.7	-23.5	-1.1	11.0	6.3	14.4	17.0	14.4
Semiconductors	34.6	27.6	-34.6	10.1	38.8	-6.1	16.9	17.7	17.0
Other Goods 1/	3.3	5.9	-10.2	0.7	4.5	7.8	7.1	7.9	3.3
Imports of G&S	12.1	11.2	-7.6	9.7	5.1	10.6	5.3	6.7	5.5
Services	6.6	10.6	-5.9	8.8	4.2	7.7	2.3	5.3	4.0
Oil	-3.4	13.3	3.7	3.8	1.5	9.7	1.9	-7.0	1.4
Computers	26.0	13.9	-13.6	13.2	16.8	22.2	12.0	18.6	17.5
Semiconductors	34.2	22.8	-51.1	11.0	-0.2	9.4	7.7	15.4	17.0
Other Goods 2/	13.0	10.3	-6.5	10.0	5.2	10.6	6.4	8.8	5.8
Billions of Chained 2000 Dollars									
Net Goods & Services	-296.2	-379.5	-399.1	-471.3	-521.4	-601.3	-633.2	-671.7	-712.1
Exports of G&S	1008.2	1096.3	1036.7	1013.3	1031.2	1117.9	1195.3	1286.3	1350.0
Imports of G&S	1304.4	1475.8	1435.8	1484.6	1552.6	1719.2	1828.5	1958.0	2062.1
Billions of dollars									
US CURRENT ACCOUNT BALANCE	-300.1	-416.0	-389.5	-475.2	-519.7	-668.1	-805.0	-948.4	-1086.6
Current Acct as Percent of GDP	-3.2	-4.2	-3.8	-4.5	-4.7	-5.7	-6.4	-7.1	-7.7
Net Goods & Services (BOP)	-263.4	-378.3	-362.7	-421.2	-494.8	-617.6	-723.6	-809.3	-888.4
Investment Income, Net	19.1	25.7	30.3	15.5	51.8	36.2	7.4	-35.5	-90.7
Direct, Net	78.2	94.9	115.9	99.8	121.8	127.9	129.9	131.5	150.2
Portfolio, Net	-59.1	-69.2	-85.5	-84.3	-70.0	-91.7	-122.5	-167.0	-240.9
Other Income & Transfers,Net	-55.8	-63.5	-57.1	-69.5	-76.7	-86.7	-88.7	-103.6	-107.5

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2002				2003				2004			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-1.0	-0.6	-0.5	-1.5	0.1	-0.7	0.5	-0.5	-1.2	-1.4	-0.2	-1.0
Exports of G&S	0.5	1.0	0.3	-0.3	-0.3	-0.2	1.0	1.7	0.5	0.7	0.5	0.7
Imports of G&S	-1.4	-1.6	-0.8	-1.2	0.4	-0.5	-0.6	-2.2	-1.6	-2.0	-0.7	-1.7
Percentage change from previous period, s.a.a.r.												
Exports of G&S	5.2	10.6	2.9	-3.1	-2.9	-2.1	11.5	19.1	5.0	6.9	5.5	7.1
Services	22.9	2.7	4.6	11.7	-11.9	-6.6	17.2	23.7	-0.4	4.8	-0.6	15.5
Computers	-21.1	14.7	-6.0	12.6	-5.7	0.2	35.9	18.2	-7.4	1.6	21.7	11.5
Semiconductors	22.3	42.1	12.6	-25.0	34.8	33.9	43.7	43.2	7.0	-4.8	-19.4	-5.5
Other Goods 1/	-1.6	12.5	2.0	-9.1	0.0	-2.0	5.5	15.4	8.6	9.2	9.5	3.8
Imports of G&S	11.7	12.5	5.7	9.0	-2.5	3.3	4.1	16.5	12.0	14.5	4.7	11.3
Services	24.7	-3.0	1.7	14.0	-2.2	-10.2	21.4	10.7	10.0	13.7	4.6	3.1
Oil	-9.8	-10.3	-12.7	64.3	-9.0	7.8	-1.3	9.5	35.7	-26.0	-0.5	45.0
Computers	52.2	5.3	2.8	-0.2	11.5	12.4	8.7	36.4	21.2	34.3	25.3	9.5
Semiconductors	39.8	34.8	-6.2	-14.0	-6.7	1.5	-3.7	8.9	42.6	20.2	4.7	-20.3
Other Goods 2/	7.7	19.6	9.2	4.0	-1.8	5.4	-0.4	18.7	8.1	20.3	3.1	11.5
Billions of Chained 2000 Dollars, s.a.a.r.												
Net Goods & Services	-441.3	-458.9	-472.2	-513.0	-510.7	-528.4	-516.2	-530.2	-563.0	-601.7	-606.5	-634.1
Exports of G&S	992.8	1018.0	1025.2	1017.2	1009.7	1004.5	1032.2	1078.4	1091.8	1110.2	1125.0	1144.5
Imports of G&S	1434.0	1476.9	1497.4	1530.2	1520.4	1532.9	1548.4	1608.6	1654.8	1711.9	1731.5	1778.6
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-440.4	-477.1	-480.3	-503.0	-546.6	-515.2	-515.9	-501.0	-584.4	-666.5	-667.9	-753.4
Current Account as % of GDP	-4.3	-4.6	-4.6	-4.7	-5.1	-4.8	-4.7	-4.5	-5.1	-5.7	-5.7	-6.3
Net Goods & Services (BOP)	-372.7	-413.8	-430.3	-467.9	-499.3	-491.4	-490.8	-497.7	-555.4	-608.2	-629.9	-676.9
Investment Income, Net	11.4	1.8	14.1	34.5	29.3	50.6	50.9	76.5	65.8	29.6	30.8	18.8
Direct, Net	100.5	91.4	95.0	112.2	102.3	117.4	119.9	147.8	140.3	116.3	121.4	133.7
Portfolio, Net	-89.2	-89.6	-80.9	-77.7	-72.9	-66.8	-69.0	-71.3	-74.6	-86.7	-90.6	-114.9
Other Inc. & Transfers, Net	-79.0	-65.1	-64.2	-69.6	-76.6	-74.4	-76.0	-79.7	-94.7	-88.0	-68.8	-95.3

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2005				Projected 2006				Projected 2007			
	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	-0.4	1.1	-0.1	-1.4	-0.5	0.2	-0.2	-0.7	-0.6	0.1	-0.3	-0.8
Exports of G&S	0.7	1.1	0.3	0.5	1.5	0.6	0.6	0.5	0.5	0.5	0.5	0.5
Imports of G&S	-1.1	0.0	-0.4	-1.9	-2.0	-0.4	-0.8	-1.2	-1.1	-0.5	-0.8	-1.3
Percentage change from previous period, s.a.a.r.												
Exports of G&S	7.5	10.7	2.5	5.1	15.0	5.7	5.2	4.9	4.7	5.0	4.9	4.9
Services	12.5	-0.4	1.0	-1.2	4.8	4.9	4.8	5.0	5.1	5.9	6.1	6.2
Computers	12.6	26.9	18.5	1.0	25.4	14.4	14.4	14.4	14.4	14.4	14.4	14.4
Semiconductors	-12.9	26.7	24.4	36.2	19.8	17.0	17.0	17.0	17.0	17.0	17.0	17.0
Other Goods 1/	6.1	14.9	1.2	6.8	19.3	5.0	4.3	3.7	3.4	3.4	3.2	3.2
Imports of G&S	7.4	-0.3	2.4	12.2	12.5	2.5	4.6	7.3	6.4	2.8	4.8	8.0
Services	3.7	4.4	-3.2	4.7	9.1	2.7	5.0	4.5	4.1	4.0	4.0	3.9
Oil	3.4	-24.5	-3.1	42.5	-1.1	-26.3	-11.4	15.9	13.3	-18.0	-7.0	22.3
Computers	11.3	13.7	15.2	8.1	21.9	17.5	17.5	17.5	17.5	17.5	17.5	17.5
Semiconductors	-7.9	8.3	18.0	14.5	10.8	17.0	17.0	17.0	17.0	17.0	17.0	17.0
Other Goods 2/	8.6	2.9	2.4	11.9	15.6	7.5	6.4	5.9	5.5	5.5	5.9	6.1
Billions of Chained 2000 Dollars, s.a.a.r.												
Net Goods & Services	-645.4	-614.2	-617.5	-655.7	-668.2	-662.7	-668.4	-687.6	-703.5	-701.6	-709.7	-733.5
Exports of G&S	1165.3	1195.4	1202.7	1217.6	1261.0	1278.6	1295.0	1310.5	1325.7	1341.9	1358.1	1374.4
Imports of G&S	1810.7	1809.6	1820.2	1873.3	1929.2	1941.4	1963.3	1998.1	2029.2	2043.5	2067.8	2108.0
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-791.0	-787.6	-741.7	-899.5	-920.6	-919.5	-955.2	-998.2	-1065.0	-1066.3	-1089.5	-1125.5
Current Account as % of GDP	-6.5	-6.4	-5.9	-7.0	-7.1	-7.0	-7.1	-7.3	-7.7	-7.6	-7.7	-7.9
Net Goods & Services (BOP)	-688.5	-690.9	-725.6	-789.5	-798.0	-786.3	-808.8	-844.4	-879.5	-875.5	-884.0	-914.5
Investment Income, Net	8.2	-0.5	25.7	-3.8	-16.9	-29.5	-40.6	-54.8	-69.9	-85.3	-97.7	-110.0
Direct, Net	113.5	113.9	155.4	136.7	127.8	127.5	133.1	137.6	142.1	146.1	153.1	159.6
Portfolio, Net	-105.3	-114.4	-129.7	-140.4	-144.7	-157.1	-173.7	-192.4	-212.0	-231.4	-250.8	-269.5
Other Inc. & Transfers, Net	-110.6	-96.2	-41.8	-106.2	-105.6	-103.7	-105.8	-99.0	-115.5	-105.5	-107.8	-101.0

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