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Confidential (FR) Class II FOMC

Part 1

September 27, 2000

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

Confidential (FR) Class II FOMC

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Summary and Outlook

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Domestic Developments

Overview

The incoming information on economic activity that has become available since mid-August has, on balance, been in line with our forecast that real GDP would increase more moderately this quarter than during the first half of the year. Our current estimate that real GDP has been rising at an annual rate of around 3 percent in the third quarter differs only slightly overall from our projection in the August Greenbook. At the same time, headline inflation is expected to receive another boost in the second half of the year from the recent run-up in the price of crude oil.

Financial market participants seem to be reading the recent economic data as further confirmation that a soft landing is in train. This interpretation has strengthened their view that monetary policy is likely to remain on hold in the near term, and futures markets appear to be pricing in some chance of easing next year. Our forecast also assumes no adjustment in the FOMC's target for the federal funds rate through the middle of next year. Then, because we are projecting an upward drift in core inflation over the forecast period, we assume that some further tightening will be necessary in late 2001 and in 2002.

The widening acceptance in financial markets that economic activity is settling onto a more moderate growth path appears to be fostering the realization that gains in corporate earnings are likely to fall short of earlier expectations. In addition to the news related to real activity and earnings, developments in energy markets may have heightened the uncertainty about prospects for the outlook and weighed on equity markets. Broad measures of stock prices have dropped back modestly from their levels in mid-August.

In this Greenbook, we have extended our forecast through 2002. The projection continues to show the rate of increase in real GDP at 4 percent next year, and in 2002 it tilts up slightly, to 4-1/4 percent. Real GDP increases a bit more slowly than potential output throughout the forecast, and thus the unemployment rate is projected to drift up over the two-year period to 4-1/2 percent by the end of 2002. As before, we anticipate that core inflation will continue to pick up gradually over the forecast period.

The extension of the forecast through 2002 has brought into even sharper focus the importance of some key parameters and assumptions underlying the staff outlook. Among these, the most notable areas of uncertainty are the extent of the actual and projected improvements in the pace of structural productivity growth, the level of resource utilization consistent with stable inflation over the medium term, and the likely thrust of fiscal policy during the next several years. To probe the significance of these assumptions, we have expanded the range of alternative scenarios included in this Greenbook. These additional scenarios are included at the end of this section of Part 1.

The Backdrop for the Forecast

Private long-term interest rates have not changed materially from their levels at the time of the August Greenbook. We are assuming that private credit markets will remain fairly quiet through the middle of next year, with longer-term interest rates little changed from recent levels. However, our outlook for inflation leads us to believe that market participants will start to recognize by next summer that underlying core inflation is drifting higher and, as a result, that long-term rates will begin to back up. The upward movement in long-term rates roughly tracks the rise in the federal funds rate that we are assuming in the forecast.

Our baseline forecast continues to be predicated on no change in the broader measures of stock prices. With share values having moved down since mid-August, average equity values are slightly lower in this forecast than in our previous one. Although we believe that some market participants are beginning to focus on the likelihood of a slower rise in earnings, price-earnings ratios are still quite high, posing the risk of a market correction. By contrast, we cannot rule out another upswing in the market against a backdrop of still solid economic growth, stable monetary policy, and some easing of oil prices by early next year. To frame those downside and upside risks, we have also included our usual alternatives for the stock market — along with those showing the implications of a flat funds rate and tighter policy — at the end of this section.

We are now assuming that discretionary fiscal policy moves a bit more toward stimulus in 2001 than we were thinking in August; this shift becomes more pronounced in our projection for 2002. Our forecast for the federal budget includes tax cuts of $11 billion in fiscal 2001 and $50 billion in fiscal 2002 as well as rising real discretionary spending — at an annual rate of just over 2-1/2 percent, on average, in fiscal 2001 and fiscal 2002.[1] Nevertheless, we continue to expect an expanding on-budget surplus. Our projection for the on-budget surplus in the fiscal year now ending is $77 billion; we see that rising to $109 billion in fiscal 2001 and $147 billion in fiscal 2002. The economic implications of a more aggressive easing of fiscal policy are explored in one of the simulations included at the end of this section.

The real exchange value of the U.S. dollar in terms of the currencies of a broad group of our trading partners is now assumed to average slightly higher in the near term than we assumed in our August forecast. Thereafter, we continue to assume that the dollar will depreciate gradually. Although a rebound in the euro

1. In generating our baseline forecast, we assumed that the tax cuts represent decreases in personal income tax liabilities. However, we recognize that some part of those cuts could, instead, come in the form of higher transfer payments. The implications for the macroeconomic outlook would be minimal.

and some appreciation of the yen are features of our projection, the assumed path for the dollar more fundamentally is shaped by our forecast that the already large U.S. current account deficit will widen further in 2001 and 2002, testing foreign investors' appetites for further expanding their holdings of dollar-denominated assets.

Prices of crude oil continued to increase into late September despite OPEC's step-up in production. Prices have dropped back this week in the wake of the announcement that the United States would release oil from the Strategic Petroleum Reserve. But we think that world demand will remain sufficiently robust to keep the price of West Texas intermediate just under $32 per barrel through year-end, almost $2 per barrel higher than we had anticipated in the August Greenbook. Thereafter, we continue to assume a gradual decline in the price of crude oil over the remainder of the forecast period. The price of WTI is projected to fall to just under $28 per barrel by the end of next year but to be around $2.50 per barrel higher than in the August Greenbook. In this forecast, we have extended the decline in the cost of crude oil to $25 per barrel by the end of 2002.

The expansion of economic activity abroad appears to be running broadly in line with our expectations at the time of the August Greenbook. Although the rate of increase in foreign output appears to have cooled from the sizzling pace of the first half of this year, the recovery seems to be spreading in Latin America and firming in Europe, where we assume that some policy tightening will damp growth. On balance, we project that real GDP abroad will increase at an annual rate of close to 4 percent over the forecast period.

Recent Developments and the Current-Quarter Forecast

We are estimating that real GDP is increasing at an annual rate of 3 percent in the current quarter with final sales rising at about a 3-1/2 percent rate. Although the bulk of the hard information on inventory investment this quarter is still outstanding, we are expecting somewhat less accumulation than occurred in the second quarter. In particular, after having rebuilt dealer stocks last quarter, motor vehicle makers have slowed production enough to moderate their stockbuilding this quarter. Elsewhere, we expect inventory investment to edge down from the second-quarter pace. All told, the step-down in inventory investment that we are projecting represents a modest negative for the change in real GDP.

The projected moderation in domestic production this quarter seems broadly in line with the incoming information on industrial production and labor market activity. The August level of industrial output was only 3-1/2 percent (annual rate) above the second-quarter average, well below the 7-1/4 percent pace of the first half of the year. Besides slower motor vehicle assemblies, production of

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

Measure	2000:Q2			2000:Q3	
	Aug. GB	BEA[1]	Sept. GB	Aug. GB	Sept. GB
Real GDP	**4.9**	**5.3**	**5.2**	**3.2**	**3.0**
Private domestic final purchases	4.7	4.5	4.6	4.6	4.9
Personal consumption expenditures	2.9	2.9	2.9	4.2	4.7
Residential investment	1.1	-.0	1.1	-16.1	-12.4
Business fixed investment	15.1	14.6	14.5	14.3	11.9
Government outlays for consumption and investment	5.4	4.9	4.7	.3	-1.6
MEMO					
Real GDP adjusted for defense spending anomaly	4.4	4.8	4.7	3.2	3.0
	Contribution to growth, percentage points				
Inventory investment	1.5	1.8	1.5	-.3	-.5
Net exports	-1.5	-1.2	-1.0	-.6	-.5

1 Preliminary release, published August 25.

construction supplies and non-high-tech materials has dropped back. Private sector hiring moderated noticeably over the July-August period, and the average workweek moved down in a number of industries; we are expecting aggregate hours in the nonfarm business sector to be flat this quarter.

On the spending side, private domestic final sales appear to be rising less rapidly this quarter than over the first half of the year. The most pronounced slowdown has been in expenditures for residential construction, which are expected to have declined sharply this quarter after having posted modest gains during the first half. Single-family starts dropped from an annual rate of 1.34 million units in the first quarter to an average of about 1.24 million units during July and August. However, the recent data on starts in August and on sales of new and existing homes suggest that demand may be getting enough support from the drop in mortgage interest rates in recent months to offset the less favorable trends in income and wealth that households have been experiencing. Thus, we now expect that single-family starts will average 1.24 million units through year-end, a bit higher pace than in our previous projection but well below that seen earlier in the year.

The moderation in consumer spending has been more gradual. After having increased at an annual rate of 5-1/4 percent, on average, during the first half of the year, real PCE is expected to rise at a 4-3/4 percent pace in the current quarter. Certainly, the fundamental determinants of household spending have turned less favorable this year. The ratio of net worth to disposable income turned down in the second quarter and appears to have edged lower this quarter. Higher energy prices and slower employment gains have taken a bite out of real disposable income, which increased at an annual rate of 2-1/2 percent over the first half of this year compared with 3 percent during 1999. Nonetheless, consumer attitudes remain relatively upbeat.

We are expecting business outlays for equipment and structures to post another sizable increase this quarter, supported by the ongoing strength in demand for computing and communications equipment; deliveries of aircraft to domestic firms should also be up again this quarter. However, the incoming information on shipments and orders for other types of business equipment suggests that demand for non-high-tech investment items has moderated a bit from the brisk pace of the first half of the year. In addition, business purchases of medium and heavy trucks were sharply lower in July and August. For nonresidential structures, we are expecting to see a small rise in real expenditures.

Government spending should be a temporary drag on real GDP in the current quarter. Based on monthly outlays through August, federal expenditures on consumption and investment, which spiked last quarter, should drop back sharply, to a level more consistent with the level of appropriations. The swing is large enough to more than offset a gain in real spending by state and local governments.

In contrast to these components of domestic demand, net exports are expected to be less negative in the current quarter than they were during the first half of 2000. Demand for exports of goods and services has remained brisk while imports of goods and services appear to be rising more slowly than earlier in the year when domestic spending was booming.

The August data on consumer prices showed the drop for energy and the modest rise for core goods and services that we had been expecting. However, the steep run-up in oil prices since early August now is projected to push domestic energy costs up again over the next several months. As a result, we expect that the energy component of the PCE chain-weighted price index will increase at an annual rate of 6-3/4 percent this quarter and 4-1/2 percent in the fourth quarter. Those increases have boosted our projection for the annual rate of increase in the overall PCE index to 2.0 percent in the current quarter and 2.2 percent in the fourth quarter — 1/2 percentage point, on average, more than we forecast in August.

The Longer-Term Outlook for Aggregate Demand

Our projection for real economic activity between the current quarter and the end of 2001 is much the same as in the August Greenbook and shows real GDP rising at an annual rate of nearly 4 percent. As before, we anticipate that the waning wealth effect on household demand and, more generally, the cumulative effects of previous increases in interest rates should keep aggregate demand on this more moderate growth path despite a diminished drag from the external sector and the additional fiscal stimulus that we have incorporated.

Projections of Real GDP

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

Measure	2000		2001	2002
	H1	H2		
Real GDP	**5.0**	**3.3**	**4.0**	**4.3**
Previous	4.8	3.5	4.1	--
Final sales	5.2	3.8	4.1	4.3
Previous	5.0	3.9	4.2	--
PCE	5.2	4.2	3.5	3.4
Previous	5.2	4.0	3.5	--
Residential investment	2.1	-8.5	-3.6	-2.1
Previous	2.1	-12.8	-5.4	--
BFI	17.7	10.5	11.3	11.3
Previous	18.0	12.9	11.7	--
Government purchases	1.8	1.1	3.7	3.6
Previous	2.1	1.8	3.3	--
Exports	10.2	8.7	7.9	10.5
Previous	6.9	7.6	8.3	--
Imports	15.2	8.6	8.3	9.3
Previous	14.6	7.9	8.0	--
	Contribution to growth, percentage points			
Inventory change	-.1	-.5	-.1	1
Previous	-.1	-.4	-.1	--
Net exports	-1.0	-.3	-.4	-.2
Previous	-1.2	-.3	-.3	--

For 2002, we expect real GDP to increase 4-1/4 percent. That modest acceleration is the net result of a number of factors: For consumption, the pickup in real income as energy prices drop back and taxes are cut further is a positive influence, but it is offset by the additional drag from a declining wealth-to-income ratio. However, with the dollar trending lower, export demand strengthens a bit further. And with the lagged effects of the earlier rise in real interest rates fading, the decline in residential construction is a shade smaller in 2002 than in 2001. Nonetheless, some additional tightening of monetary policy in late 2001 and in 2002 should be a restraining factor as the year progresses.

Household spending. Developments affecting demand in the household sector importantly shape our forecast for real GDP during 2001 and 2002. The swing in the influence of household wealth relative to income from highly stimulative at the beginning of this year to restraint during 2001 is expected to result in a deceleration in household spending. The effect is projected to be most pronounced on the demand for consumer durables, including motor vehicles and other big-ticket household items. The restraint on consumer spending from the continued downtrend in the ratio of wealth to income is somewhat greater in 2002. Those wealth effects are cushioned a bit over the next two years by some firming in real income gains resulting from the projected retreat in energy prices from this year's highs, the assumed enactment of cuts in personal income taxes in both 2001 and 2002, and the small further step-up in the growth rate of structural productivity. We are projecting real PCE to rise at a rate of about 3-1/2 percent in both years while the personal saving rate swings back up about 1-1/4 percentage points.

Besides trends in income and wealth, demand in the market for new single-family houses should be affected by developments in mortgage markets. In the near term, with mortgage interest rates stable, we now expect that demand for new homes will be maintained at recent levels through the end of this year. But by the second half of 2001 a backup in mortgage rates should begin to crimp demand and initiate a mild downtrend in residential construction, which we are projecting to continue through the end of 2002. Starts of new single-family homes, which are expected to average 1.24 million units in the second half of this year, are projected to decline to 1.23 million units in 2001 and 1.20 million units in 2002.

Business investment. We believe that the thrust to business spending from ongoing technological advances will remain powerful over the forecast period. The economic incentives to take advantage of more efficient computing and communications equipment and software are expected to largely offset the effects that slower economic activity and less favorable financing conditions will have on business fixed investment. Thus, although we do not expect to see business outlays for equipment and software increase at the 15-1/2 percent pace that prevailed in the 1998-2000 period, the projected gains remain sizable — about 13-1/2 percent in 2001 and 2002. Outlays for nonresidential construction are projected to rise at a rate just over 4 percent.

We are expecting that the level of business inventory investment will move lower next quarter as businesses adjust to more moderate increases in shipments and sales than seen earlier this year. Thereafter, with real GDP projected to rise at a fairly steady pace, we anticipate that inventory investment will be a nearly neutral factor in the forecast.

Government. Under our revised assumptions for fiscal policy, we have boosted our projection for real federal expenditures for consumption and investment 1 percentage point, to 2-3/4 percent, in 2001, and we are forecasting a 2-1/2 percent rise in 2002. Much of the added spending is assumed to represent nondefense purchases, which are expected to increase at a pace of more than 3-1/4 percent, in real terms, over the two-year period. Although those increases represent a pickup from the pace of spending this year, they are still short of the rate of spending over 1998-99. We have also added a little to real defense outlays, which are now projected to rise about 2 percent per year over the forecast period. A final portion of our added fiscal stimulus represents increases in grants to state and local governments. And with economic and budgetary circumstances for those jurisdictions likely to remain favorable, they are expected to step up spending to a 4-1/4 percent pace in the next two years.

Net exports. We are forecasting that the stronger demand for U.S. exports that has emerged this year will continue, on average, over the forecast period as economic expansion abroad remains brisk and the dollar depreciates. At the same time, the slowing in domestic demand and the rise in the prices of non-oil imports that is projected to accompany the lower dollar should show through in more moderate increases in imports. (The *International Developments* section provides a more detailed discussion of the outlook for the external sector.)

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

Last week the BLS updated its estimates of multifactor productivity and extended them through 1998; those new estimates incorporated last fall's benchmark revision to the National Income and Product Accounts, which expanded capital spending to include estimates of software investment as well as the BEA's recent annual revision. The BLS figures indicate that, compared with our earlier estimates, a bit less of the acceleration in structural productivity in the late 1990s was the result of capital deepening and that a bit more was attributable to a faster rate of increase in multifactor productivity. In our forecast, the contribution of capital deepening, while still rising, increases a bit

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

Measure	1998	1999	2000	2001	2002
Structural labor productivity	**2.9**	**3.2**	**3.5**	**3.6**	**3.7**
Previous	--	3.2	3.5	3.7	--
Contributions[1]					
Capital deepening	1.4	1.6	1.8	1.9	2.0
Previous	1.6	1.8	2.0	2.2	--
Multifactor productivity	1.2	1.3	1.4	1.4	1.4
Previous	1.0	1.1	1.2	1.2	--
Labor quality	.3	.3	.3	.3	.3

1. Percentage points.

more slowly than has been the case in recent years as a result of the somewhat more moderate gains in business investment that we are projecting. We have also allowed for higher relative energy prices to have some effect on productive efficiency over the forecast period; those effects are small, shaving just 0.1 percentage point from our assumed contribution of multifactor productivity in 2001 and 2002.[2]

On balance, our assumed path for structural productivity is little changed and continues to show a gradual step-up in the rate of increase through the forecast period. Structural productivity is estimated to have risen 3.2 percent in 1999 and 3.5 percent this year and then to accelerate to 3.6 percent in 2001 and 3.7 percent in 2002. Accordingly, with the contribution of labor input assumed to be advancing at a steady rate, our projections for the rate of expansion in potential output move up from 4.3 percent last year and 4.6 percent this year to 4.7 percent next year and 4.8 percent in 2002.

2. An increase in the relative price of energy encourages firms to adopt production techniques that economize on the use of energy and employ relatively more capital and labor resources per unit of output. At the margin, the increased labor requirements reduce the level of labor productivity on the newest vintages of capital equipment, and over time the entire capital stock adjusts to the new factor intensities as pre-energy-shock equipment is replaced. In addition, the higher price of energy boosts operating costs and causes more energy-intensive factories and machines to be scrapped earlier than originally anticipated. The increased obsolescence also reduces the level of labor productivity because it reduces the quantity of capital inputs. The resulting lower levels of labor productivity are reflected in lower rates of structural productivity growth during the period of adjustment to the energy price shock, which, given the service lives of capital assets, could last as long as a decade.

Productivity, the labor market, and wages. As real GDP slows, labor productivity is expected to increase below our assumed trend for a while. After having slowed to 3 percent over the four quarters of 2001, output per hour in the nonfarm business sector is projected to increase 3-3/4 percent during 2002. With real GDP rising at a rate below our estimate of potential over the forecast period, the civilian unemployment rate edges up to 4-1/4 percent at the end of next year and to 4-1/2 percent by late 2002. On balance, the cumulative rise in joblessness over the forecast period is modest and gradual, and labor market conditions are assumed to remain tight throughout.

The persistence of tight labor markets and the faster growth in structural labor productivity underlie our forecast that wages should tend to accelerate somewhat over the forecast period. However, the pattern of wage inflation is also influenced importantly by the projected fluctuations in consumer price inflation: This year's bulge in consumer price inflation is likely to add to wage inflation next year, and the slowdown in consumer prices next year should ease pressures on wages in 2002. All told, we expect that wages, as measured by the ECI, will pick up from 4-1/4 percent over the four quarters of this year to 4-3/4 percent in 2001 and will remain at that rate in 2002.[3] Given the incoming information on health insurance costs, we have also included sizable increases in employer costs for these benefits in both 2001 and 2002. However, we do not

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

Measure	1999	2000	2001	2002
Output per hour, nonfarm business	4.1	3.3	3.1	3.7
Previous	4.1	3.1	3.2	--
Nonfarm payroll employment	2.2	1.7	1.4	1.3
Previous	2.2	1.7	1.4	--
Household employment survey	1.5	.9	1.0	.9
Previous	1.5	1.0	.9	--
Labor force participation rate[1]	67.0	67.1	67.1	67.1
Previous	67.0	67.1	67.1	--
Civilian unemployment rate[1]	4.1	4.1	4.3	4.5
Previous	4.1	4.0	4.3	--

1. Percent, average for the fourth quarter.

3. In this Greenbook, we have shifted our assumed two-stage increase in the federal minimum wage from the fourth quarters of this year and next to the first quarters of 2001 and 2002. Those adjustments are assumed to raise the federal minimum from $5.15 per hour to $6.15 per hour in two equal steps.

expect to see another spike in nonproduction bonuses in the next two years similar to the one that sharply boosted ECI benefits earlier this year. On balance, benefit costs should still be rising faster than wage rates over the forecast period, although that gap is not projected to be as large as we anticipate it will be this year. The ECI for compensation is projected to accelerate from 4-3/4 percent over the four quarters of this year to just under 5 percent in 2001 and 2002; these figures for ECI compensation represent a considerable step-up from the rate of 3-1/2 percent per year that prevailed between 1997 and 1999.

The hourly compensation measure derived from NIPA data on labor compensation has not shown the same acceleration so far this year that we have seen in the ECI. Such differences between the two series are common from year to year. Looking ahead, we are projecting a steady pickup in the rate of increase in compensation per hour in the nonfarm business sector that broadly reflects our expectations for upward pressure on employers' wage and benefit costs.

Prices. Although the tightness in resource utilization remains a key factor in our inflation forecast, recent developments in energy markets have again influenced the contour of that projection. Because of the additional boost from higher energy prices, we now are projecting that the increase in the PCE chain-weighted price index will be 2-1/2 percent this year. With energy prices expected to turn down early next year and to continue to fall though 2002, overall PCE prices are projected to slow to around 2 percent.

At the outset, the decline in energy prices that we are projecting for 2001 and 2002 is entirely the result of lower prices for gasoline and fuel oil. We still believe that, because stocks of natural gas are quite lean, those prices are likely to continue to rise rapidly over the winter. However, by 2002 we expect to see some easing in those prices as well.

Underlying the swings in top-line inflation induced by the large changes in energy prices is a gradual further pickup in core inflation over the forecast period. The PCE chain-weighted price index excluding food and energy is projected to rise 2.1 percent during 2001 and 2.2 percent during 2002 — up from an expected increase of 1.9 percent this year and 1.5 percent in 1999. The acceleration in the core CPI is similar, to 2.7 percent and 2.8 percent in 2001 and 2002, respectively, from a rise of 2.6 percent in 2000 and 2.1 percent in 1999.

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

Measure	1999	2000	2001	2002
PCE chain-weighted price index	2.0	2.5	2.0	2.1
Previous	2.0	2.3	1.9	--
Excluding food and energy	1.5	1.9	2.1	2.2
Previous	1.5	1.8	2.1	--
Consumer price index	2.6	3.3	2.4	2.4
Previous	2.6	3.1	2.3	--
Food	1.9	2.5	2.6	2.7
Previous	1.9	2.5	2.5	--
Energy	11.2	13.9	-1.5	-2.5
Previous	11.2	9.9	-2.1	--
Excluding food and energy	2.1	2.6	2.7	2.8
Previous	2.1	2.5	2.6	--
GDP chain-weighted price index	1.6	2.4	1.9	1.9
Previous	1.6	2.2	1.9	--
ECI for compensation of private industry workers[1]	3.4	4.7	4.9	4.9
Previous	3.4	4.7	4.8	--
NFB compensation per hour	4.8	4.8	5.6	5.8
Previous	4.8	4.9	5.5	--
Prices of core non-oil merchandise imports	.4	2.0	3.0	2.5
Previous	.4	2.2	3.1	--

1. December to December.

Financial Flows and Conditions

Domestic nonfinancial debt appears to have increased at an annual rate of about 5 percent in the third quarter. Debt growth has continued to be restrained by the paydown of federal debt and the minimal net borrowing by state and local governments. Elsewhere, however, borrowing has remained hefty. We estimate that household debt expanded at a rate of nearly 9 percent in the third quarter, similar to the first-half pace. Although business borrowing appears to have ebbed somewhat, we estimate that debt in this sector still increased at a pace of more than 8 percent in the third quarter.

Looking ahead, nonfinancial debt is expected to expand at close to the current rate through year-end and then to taper down to a shade under 5 percent next year and 4-1/2 percent in 2002. The slowing partly reflects the huge contraction in federal debt that we anticipate will occur over the next few years. In addition, the rise in nonfederal debt is expected to moderate through 2002, though this aggregate is likely to continue to expand somewhat faster than nominal GDP.

Household borrowing is expected to recede from its recent pace as the demand for consumer durables slows and housing activity moves lower. However, the projected slowdown in debt growth is gradual, from 9 percent this year to about 7 percent in 2002. These still sizable increases in debt, combined with the higher interest rates in our projection, should keep the household debt service burden on an upward path. The heavier debt load will likely be associated with some worsening of loan performance, and we expect that lenders will take steps to limit their losses. Nonetheless, under our baseline forecast for the macroeconomy, any credit restraint probably would affect only marginal borrowers.

In the nonfinancial business sector, we expect debt growth to remain close to a double-digit rate through 2002. Given our outlook for slower growth in profits over the next couple years, firms will need to take on substantial debt to finance the continued boom in capital spending. In addition, we have built in considerable borrowing to fund the lengthy list of cash-financed mergers that will be completed over the forecast period. Although the corporate sector generally remains in good financial shape, pockets of distress have emerged, and corporate balance sheets likely will weaken somewhat further with the rapid accumulation of debt and more sluggish increases in cash flow. In this situation, we anticipate that both banks and other creditors will continue to tighten lending standards for weaker borrowers. But, as with households, we do not expect that widespread credit constraints will emerge.

Debt in the state and local government sector is expected to only inch up over the forecast period, continuing the pattern of recent quarters. The slow growth largely reflects the time pattern of bond refundings. Issuance of new refunding bonds likely will remain subdued, given our path for interest rates, while a large volume of previously refunded debt is scheduled to be retired over the forecast period. Debt growth should also continue to be restrained by the sector's strong fiscal position, as these governments need not borrow heavily to fund their substantial volume of capital projects.

M2 growth in August and September rebounded from its early summer weakness. Over the remaining months of the year, we expect M2 growth to slow a bit, bringing its rate of expansion for the year as a whole to 6 percent. During 2001, interest rates exert a less depressing effect on the expansion of

M2, but with nominal GDP growth slowing, M2 growth weakens slightly. In 2002, M2 growth moves up with the pickup in nominal income growth.

Alternative Simulations

The extension of the forecast period through 2002 provides the opportunity to use the alternative simulations in this Greenbook to assess the importance of several aspects of our analysis that are key to the staff outlook for the next few years. The first two simulations use the FRB/US model to examine both the implications of the staff assumptions about the rate of structural productivity growth and the degree to which our more optimistic assumptions about trend growth already are embodied in equity prices and spending plans. The third simulation takes the staff's forecast of potential output as given but evaluates the importance of our assumption about the NAIRU; specifically, we consider the implications of a 4 percent NAIRU, about 3/4 percentage point below our estimate of its current level. The final simulation assesses the implications of significantly more fiscal stimulus over the medium term.

Structural productivity growth. The baseline outlook incorporates an acceleration in structural productivity over the forecast period. In addition, we have taken the view that this rising trend, because it represents a continuation of the ongoing effects of technological advance and capital deepening, has been fully anticipated by the public. Our view implies that current financial market valuations as well as household and business planning decisions already embody the higher structural productivity growth. The first alternative simulation drops the latter assumption and allows our projected acceleration in trend productivity over the forecast period to come as a surprise to financial market participants, households, and businesses.

In this "productivity surprise" scenario, the public raises its estimate of trend productivity growth a total of 0.3 percentage point between the second half of 2000 and the end of 2002. Under the assumption that the nominal federal funds rate follows the Greenbook baseline path, equity prices are about 7 percent higher by the end of 2001 and are up 10 percent by the end of 2002. The resultant rise in household wealth, coupled with an increase in expected future income and sales, boosts consumer and business spending. Relative to the Greenbook baseline, those demand-side "shocks" increase output growth and keep the unemployment rate at 4-1/4 percent. With the labor market a shade tighter under these conditions, additional upward pressure is put on inflation, but that effect is nearly imperceptible within the forecast period owing to the gradual response of inflation to changes in resource utilization. Beyond 2002, however, the implied pickup in inflation would become more substantial, absent additional monetary tightening.

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

Measure	2000		2001		2002	
	H1	H2	H1	H2	H1	H2
Real GDP						
Baseline	**5.0**	**3.3**	**3.8**	**4.2**	**4.3**	**4.3**
Productivity surprise	5.0	3.4	4.1	4.5	4.7	4.7
Lower structural productivity	5.0	2.5	3.0	3.2	3.5	3.5
Lower NAIRU	5.0	3.5	4.0	4.2	4.3	4.2
Greater fiscal stimulus	5.0	3.3	3.8	4.4	4.5	4.2
Civilian unemployment rate[1]						
Baseline	**4.0**	**4.1**	**4.1**	**4.3**	**4.4**	**4.5**
Productivity surprise	4.0	4.1	4.1	4.2	4.2	4.2
Lower structural productivity	4.0	4.1	4.2	4.4	4.5	4.7
Lower NAIRU	4.0	4.1	4.1	4.2	4.2	4.3
Greater fiscal stimulus	4.0	4.1	4.1	4.2	4.3	4.4
PCE prices excluding food and energy						
Baseline	**1.9**	**1.8**	**2.1**	**2.2**	**2.2**	**2.3**
Productivity surprise	1.9	1.8	2.1	2.2	2.2	2.3
Lower structural productivity	1.9	1.9	2.4	2.6	2.7	2.8
Lower NAIRU	1.9	1.6	1.7	1.5	1.4	1.3
Greater fiscal stimulus	1.9	1.8	2.1	2.1	2.2	2.3

1. Average for the final quarter of the half-year period.

The second productivity simulation assesses the implications for the economic outlook of a significantly lower rate of structural productivity growth. In the "lower structural productivity" scenario, trend productivity is assumed to have increased at a constant 3 percent pace since 1998 — a pace similar to that embodied in many outside forecasts. The simulation extends that lower trend rate for productivity through 2002. By contrast, the public is initially assumed to expect that output per hour is accelerating along the lines incorporated in the baseline — that annual increases in structural productivity step up to 3-3/4 percent by 2002. However, over time the public is disappointed by actual productivity developments and gradually revises down its estimate of trend productivity growth.

Under these assumptions and using the same path for the nominal federal funds rate as in the Greenbook forecast, both the stock market's and households' assessments of future income prospects are noticeably weaker, tempering the expansion of consumer spending and business investment. Real GDP increases only 3-1/4 percent per year, on average, over the next 2-1/2 years — well below the growth of potential — and the unemployment rate reaches 4.7 percent by late 2002. Despite the greater degree of slack in labor markets, prices accelerate more noticeably in this scenario than in the baseline. The faster rate of inflation arises because the mitigating effect of accelerating productivity on unit labor costs is greatly diminished in this alternative scenario.

The NAIRU. The absence of a decisive acceleration in core prices over the past few years while the unemployment rate has held close to 4 percent raises the possibility that current levels of resource utilization may be sustainable over the medium term. In the staff projection, increases in core inflation are relatively subdued because the acceleration in structural productivity restrains the rise in unit labor costs. That pickup in structural productivity also temporarily holds down the NAIRU but, by our current estimates, only to 4-3/4 percent.

Conditional on the Greenbook assumptions for the nominal federal funds rate, a more optimistic assumption for the NAIRU — that it has been 4 percent for several years and will remain at that level for the forecast period — implies a future path for inflation well below that in the baseline forecast. Indeed, the projected increase in core PCE prices declines to about 1-1/4 percent by the end of 2002. In addition, the lower estimate of the NAIRU has implications for aggregate spending. In the model, a lower NAIRU raises the public's assessment of the sustainable levels of employment, output, and income about 3/4 percentage point; hence permanent income and household spending are higher than in the Greenbook baseline. The outlook for business investment is also stronger because of improved sales prospects. These demand-side consequences of a revision to aggregate supply manifest themselves in a tad faster rise in GDP than in the baseline forecast and in an unemployment rate of about 4-1/4 percent by the end of 2002. This simulation clearly indicates that, if the NAIRU is 4 percent, the monetary tightening anticipated in the staff's baseline forecast will not be needed to prevent prices from accelerating.

Greater fiscal stimulus. With official forecasts showing federal budget surpluses continuing to mount in the years ahead, the future path of fiscal policy is an area of considerable uncertainty in the staff forecast. Our baseline projection takes a middle-of-the-road view that shows the on-budget surplus continuing to accumulate over the next few years despite our assumed package of increased spending and tax cuts. In the "fiscal stimulus" alternative, we add another $50 billion of increases in spending and tax cuts starting in fiscal 2002; we assume that the changes are seen as permanent. This policy reduces the projected on-budget surplus to about $100 billion in fiscal 2002. To highlight the issues that the additional stimulus would raise for the conduct of monetary policy, the nominal federal funds rate is set in this simulation using a Taylor rule that is adjusted to take into account changes in the equilibrium real rate.

Because the tax cuts are assumed to be permanent, lifetime after-tax incomes rise immediately, and the response of consumer spending is much larger than it would be to a transitory increase in income. However, investors, too, view the shift in the stance of fiscal policy as a long-term change. Thus, the fiscal expansion also results in higher bond rates, which partially offset the stimulus to spending by consumers and government. The reduction in government saving in this scenario implies a rise in the equilibrium real interest rate of about 20 basis points, and we assume that long-term rates immediately rise when the program is enacted in anticipation of higher future short-term rates. Because the drag from the increase in borrowing costs partially offsets the direct stimulus from the tax cuts and increased government spending, the net short-run effect of more stimulative fiscal policy on the economy is relatively small.[4]

Financial assumptions. In addition to the special simulations, we have also updated the "standard" alternative scenarios for monetary policy and stock prices. The "flat funds rate" simulation eliminates the tightening included in the baseline forecast. In the "tighter policy" simulation, the nominal federal funds rate reaches 7-1/4 percent by the second quarter of 2001 and remains at that level in 2002.

The "stock market correction" scenario embodies a 20 percent decline in stock prices by the end of this year with no change thereafter. In the "continued stock market gains" simulation, the Wilshire 5000 index is assumed to rise in line with nominal GDP in both 2001 and 2002.

4. Because the composition of demand shifts toward consumption and away from investment, over the long-run smaller increases in business fixed investment imply smaller additions to the capital stock.

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

Measure	2000		2001		2002	
	H1	H2	H1	H2	H1	H2
Real GDP						
Baseline	**5.0**	**3.3**	**3.8**	**4.2**	**4.3**	**4.3**
Flat funds rate	5.0	3.3	3.8	4.3	4.7	5.1
Tighter policy	5.0	3.3	3.6	3.7	3.8	4.1
Stock market correction	5.0	3.3	3.3	3.5	3.7	3.9
Continued stock market gains	5.0	3.3	3.9	4.3	4.5	4.7
Civilian unemployment rate[1]						
Baseline	**4.0**	**4.1**	**4.1**	**4.3**	**4.4**	**4.5**
Flat funds rate	4.0	4.1	4.1	4.2	4.3	4.2
Tighter policy	4.0	4.1	4.2	4.4	4.6	4.7
Stock market correction	4.0	4.1	4.2	4.4	4.6	4.8
Continued stock market gains	4.0	4.1	4.1	4.2	4.3	4.3
PCE prices excluding food and energy						
Baseline	**1.9**	**1.8**	**2.1**	**2.2**	**2.2**	**2.3**
Flat funds rate	1.9	1.8	2.1	2.2	2.3	2.5
Tighter policy	1.9	1.8	2.1	2.0	2.0	2.0
Stock market correction	1.9	1.8	2.1	2.1	2.1	2.1
Continued stock market gains	1.9	1.8	2.1	2.2	2.2	2.3

1. Average for the final quarter of the half-year period.

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

Interval		Nominal GDP		Real GDP		GDP chain-weighted price index		Consumer price index[1]		Unemployment rate[2]	
		08/16/00	09/27/00	08/16/00	09/27/00	08/16/00	09/27/00	08/16/00	09/27/00	08/16/00	09/27/00
ANNUAL											
1998		5.7	5.7	4.4	4.4	1.3	1.3	1.6	1.6	4.5	4.5
1999		5.8	5.8	4.2	4.2	1.5	1.5	2.2	2.2	4.2	4.2
2000		7.3	7.5	5.1	5.2	2.1	2.2	3.2	3.3	4.0	4.1
2001		5.8	5.9	3.9	3.8	1.8	2.0	2.3	2.6	4.2	4.2
2002			6.2		4.2		1.9		2.4		4.4
QUARTERLY											
1999	Q1	5.9	5.9	3.5	3.5	2.2	2.2	1.7	1.7	4.3	4.3
	Q2	3.9	3.9	2.5	2.5	1.4	1.4	3.2	3.2	4.3	4.3
	Q3	6.7	6.7	5.7	5.7	1.1	1.1	2.4	2.4	4.2	4.2
	Q4	9.7	9.7	8.3	8.3	1.6	1.6	2.9	2.9	4.1	4.1
2000	Q1	8.3	8.3	4.8	4.8	3.3	3.3	4.1	4.1	4.1	4.1
	Q2	7.7	8.2	4.9	5.2	2.5	2.6	3.6	3.6	4.0	4.0
	Q3	4.8	4.8	3.2	3.0	1.5	1.8	2.6	3.0	4.0	4.1
	Q4	5.4	5.7	3.8	3.7	1.6	2.0	2.0	2.7	4.0	4.1
2001	Q1	6.1	6.2	3.9	3.8	2.2	2.3	2.2	2.4	4.1	4.1
	Q2	5.8	5.7	4.0	3.9	1.7	1.8	2.2	2.5	4.1	4.1
	Q3	6.0	5.8	4.1	4.0	1.8	1.8	2.3	2.4	4.2	4.2
	Q4	6.1	6.1	4.2	4.2	1.8	1.8	2.4	2.4	4.3	4.3
2002	Q1		6.6		4.3		2.2		2.4		4.3
	Q2		6.2		4.3		1.8		2.4		4.4
	Q3		6.2		4.3		1.8		2.5		4.4
	Q4		6.2		4.4		1.8		2.5		4.5
TWO-QUARTER[3]											
1999	Q2	4.9	4.9	3.0	3.0	1.8	1.8	2.5	2.5	-0.1	-0.1
	Q4	8.2	8.2	7.0	7.0	1.3	1.3	2.7	2.7	-0.2	-0.2
2000	Q2	8.0	8.3	4.8	5.0	2.9	3.0	3.8	3.8	-0.1	-0.1
	Q4	5.1	5.3	3.5	3.3	1.5	1.9	2.3	2.8	0.0	0.1
2001	Q2	6.0	6.0	3.9	3.8	1.9	2.0	2.2	2.4	0.1	0.0
	Q4	6.0	6.0	4.2	4.1	1.8	1.8	2.3	2.4	0.2	0.2
2002	Q2		6.4		4.3		2.0		2.4		0.1
	Q4		6.2		4.3		1.8		2.5		0.1
FOUR-QUARTER[4]											
1998	Q4	5.9	5.9	4.6	4.6	1.2	1.2	1.5	1.5	-0.3	-0.3
1999	Q4	6.5	6.5	5.0	5.0	1.6	1.6	2.6	2.6	-0.3	-0.3
2000	Q4	6.6	6.8	4.2	4.2	2.2	2.4	3.1	3.3	-0.1	-0.0
2001	Q4	6.0	6.0	4.1	4.0	1.9	1.9	2.3	2.4	0.2	0.2
2002	Q4		6.3		4.3		1.9		2.4		0.2

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

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

September 27, 2000

Item	Units[1]	1994	1995	1996	1997	1998	1999	--------Projected-------- 2000	2001	2002
EXPENDITURES										
Nominal GDP	Bill. $	7054.3	7400.5	7813.2	8318.4	8790.2	9299.2	9992.5	10583.2	11239.6
Real GDP	Bill. Ch. $	7347.7	7543.8	7813.2	8159.5	8515.7	8875.8	9335.8	9692.5	10102.3
Real GDP	% change	4.1	2.2	4.1	4.3	4.6	5.0	4.2	4.0	4.3
Gross domestic purchases		4.3	1.7	4.3	5.0	5.7	5.9	4.7	4.2	4.4
Final sales		3.2	2.9	3.9	3.9	4.6	4.8	4.5	4.1	4.3
Priv. dom. final purchases		4.3	3.2	4.4	5.1	6.4	6.1	5.7	4.4	4.5
Personal cons. expenditures		3.6	2.8	3.1	4.1	5.0	5.6	4.7	3.5	3.4
Durables		6.4	3.7	5.0	8.8	12.6	11.1	7.1	4.2	4.3
Nondurables		4.1	2.5	3.2	2.5	5.0	5.9	4.5	3.3	3.2
Services		2.7	2.7	2.7	3.9	3.4	4.2	4.4	3.4	3.3
Business fixed investment		9.2	7.5	12.1	11.8	12.9	10.1	14.1	11.3	11.3
Equipment & Software		12.0	8.9	11.8	13.7	15.8	14.1	16.1	13.4	13.3
Nonres. structures		1.1	3.3	12.8	6.5	4.9	-1.7	7.6	4.2	4.1
Residential structures		4.0	-1.5	5.6	3.5	10.3	2.8	-3.3	-3.6	-2.1
Exports		10.5	9.7	9.8	8.5	2.2	4.3	9.4	7.9	10.5
Imports		12.2	5.0	11.2	14.3	11.2	12.0	11.9	8.3	9.3
Gov't. cons. & investment		0.2	-0.8	2.7	2.4	2.6	4.4	1.4	3.7	3.6
Federal		-3.7	-5.3	2.0	0.1	0.8	4.8	-1.6	2.7	2.4
Defense		-5.9	-4.7	0.8	-1.4	-1.0	4.6	-3.9	2.2	1.8
State & local		2.8	2.1	3.0	3.7	3.6	4.2	3.1	4.2	4.2
Change in bus. inventories	Bill. Ch. $	66.8	30.4	30.0	63.8	80.2	45.3	59.4	54.6	58.4
Nonfarm		53.6	42.6	22.1	60.6	78.7	44.9	53.8	51.8	57.3
Net exports		-86.5	-78.4	-89.0	-113.3	-221.0	-322.4	-404.5	-454.9	-487.3
Nominal GDP	% change	6.2	4.3	6.0	6.2	5.9	6.5	6.8	6.0	6.3
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employment	Millions	114.1	117.2	119.6	122.7	125.8	128.8	131.5	133.2	135.0
Unemployment rate	%	6.1	5.6	5.4	4.9	4.5	4.2	4.1	4.2	4.4
Industrial prod. index	% change	6.4	3.5	5.3	6.8	2.9	4.2	5.5	4.5	4.9
Capacity util. rate - mfg.	%	82.5	82.6	81.5	82.4	80.9	79.8	81.3	81.5	81.6
Housing starts	Millions	1.46	1.35	1.48	1.47	1.62	1.67	1.61	1.55	1.51
Light motor vehicle sales		15.01	14.77	15.05	15.06	15.45	16.76	17.37	16.55	16.34
North Amer. produced		12.88	12.87	13.34	13.12	13.43	14.28	14.59	14.04	13.89
Other		2.13	1.90	1.70	1.93	2.02	2.48	2.78	2.52	2.45
INCOME AND SAVING										
Nominal GNP	Bill. $	7071.1	7420.9	7831.2	8325.4	8786.7	9288.2	9980.4	10556.4	11191.0
Nominal GNP	% change	6.2	4.4	5.9	6.0	5.7	6.5	6.7	5.8	6.1
Nominal personal income		5.1	4.3	5.9	6.3	6.3	5.6	6.0	6.3	6.1
Real disposable income		2.9	1.7	2.6	3.8	4.6	3.1	2.9	4.3	4.3
Personal saving rate	%	6.1	5.6	4.8	4.2	4.2	2.2	-0.0	0.4	1.3
Corp. profits, IVA & CCAdj.	% change	12.3	11.3	11.4	9.9	-5.8	11.2	9.1	2.2	2.2
Profit share of GNP	%	8.1	9.0	9.6	10.0	9.3	9.2	9.7	9.3	9.0
Excluding FR Banks		7.9	8.7	9.4	9.7	9.0	8.9	9.4	9.1	8.8
Federal surpl./deficit	Bill. $	-212.3	-192.0	-136.8	-53.3	49.0	124.4	247.8	274.9	306.4
State & local surpl./def.		8.6	15.3	21.4	31.0	41.7	50.0	51.6	51.0	45.9
Ex. social ins. funds		4.0	11.4	18.7	29.9	41.3	50.4	51.9	51.0	45.5
Gross natl. saving rate	%	16.3	16.9	17.2	18.0	18.8	18.5	18.3	18.6	19.2
Net natl. saving rate		4.3	5.1	5.7	6.7	7.5	6.8	6.6	6.7	7.3
PRICES AND COSTS										
GDP chn.-wt. price index	% change	2.1	2.1	1.9	1.8	1.2	1.6	2.4	1.9	1.9
Gross Domestic Purchases chn.-wt. price index		2.1	2.1	1.9	1.4	0.8	1.9	2.6	1.8	1.9
PCE chn.-wt. price index		2.1	2.1	2.3	1.5	1.1	2.0	2.5	2.0	2.1
Ex. food and energy		2.3	2.3	1.8	1.7	1.6	1.5	1.9	2.1	2.2
CPI		2.6	2.7	3.1	1.9	1.5	2.6	3.3	2.4	2.4
Ex. food and energy		2.8	3.0	2.6	2.2	2.4	2.1	2.6	2.7	2.8
ECI, hourly compensation[2]		3.1	2.6	3.1	3.4	3.5	3.4	4.7	4.9	4.9
Nonfarm business sector										
Output per hour		1.1	1.1	2.3	2.1	2.9	4.1	3.3	3.1	3.7
Compensation per Hour		2.2	2.7	3.1	3.2	5.3	4.8	4.8	5.6	5.8
Unit labor cost		1.0	1.5	0.8	1.1	2.3	0.7	1.5	2.5	2.1

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

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

September 27, 2000

Item	Units	1998 Q1	1998 Q2	1998 Q3	1998 Q4	1999 Q1	1999 Q2	1999 Q3	1999 Q4	2000 Q1	2000 Q2
EXPENDITURES											
Nominal GDP	Bill. $	8634.7	8722.0	8829.1	8974.9	9104.5	9191.5	9340.9	9559.7	9752.7	9947.3
Real GDP	Bill. Ch.	8404.9	8465.6	8537.6	8654.5	8730.0	8783.2	8905.8	9084.1	9191.8	9310.0
Real GDP	% change	6.5	2.9	3.4	5.6	3.5	2.5	5.7	8.3	4.8	5.2
Gross domestic purchases		8.1	4.8	4.4	5.4	4.9	3.8	6.6	8.4	5.6	6.1
Final sales		4.1	5.6	2.9	5.9	4.5	4.0	4.5	6.4	6.7	3.7
Priv. dom. final purchases		7.2	7.5	4.4	6.3	6.4	6.2	5.6	6.2	9.3	4.6
Personal cons. expenditures		4.8	5.8	4.3	4.9	5.7	5.6	5.0	5.9	7.6	2.9
Durables		9.4	13.9	4.1	23.9	8.6	15.0	8.0	13.0	23.6	-5.0
Nondurables		4.7	5.8	4.3	5.2	7.8	3.8	4.9	7.4	6.0	3.5
Services		4.0	4.3	4.3	1.3	4.1	4.6	4.5	3.8	5.2	4.4
Business fixed investment		20.1	15.6	3.5	13.2	9.5	9.6	11.8	9.5	21.0	14.5
Equipment & Software		24.6	16.1	6.5	16.7	14.1	15.2	18.0	9.5	20.6	17.7
Nonres. structures		7.9	14.1	-4.7	3.3	-3.4	-6.2	-6.2	9.7	22.3	4.7
Residential structures		9.6	12.6	10.3	8.9	8.2	5.9	-3.1	0.5	3.2	1.1
Exports		1.0	-3.0	-3.2	15.1	-7.9	5.8	10.2	10.3	6.3	14.2
Imports		14.2	13.1	5.5	12.2	4.5	16.2	16.9	10.7	12.0	18.6
Gov't. cons. & investment		-1.0	7.3	1.4	2.8	3.7	0.8	4.8	8.5	-1.1	4.7
Federal		-9.1	12.9	-3.2	3.7	-2.2	2.0	6.9	13.2	-14.2	16.7
Defense		-17.7	13.1	5.8	-2.4	-3.1	-2.3	12.3	12.6	-19.8	16.3
State & local		3.8	4.4	4.0	2.3	7.0	0.1	3.7	6.1	6.6	-1.1
Change in bus. inventories	Bill. Ch.	117.3	60.9	73.1	69.4	48.1	13.1	39.1	80.9	36.6	78.9
Nonfarm		109.7	62.5	79.2	63.5	49.2	14.1	43.5	73.0	33.0	72.6
Net exports		-175.3	-219.8	-244.1	-244.9	-279.8	-314.6	-342.6	-352.5	-376.8	-403.9
Nominal GDP	% change	7.6	4.1	5.0	6.8	5.9	3.9	6.7	9.7	8.3	8.2
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	124.7	125.5	126.2	127.0	127.8	128.4	129.1	129.8	130.6	131.6
Unemployment rate	%	4.7	4.4	4.5	4.4	4.3	4.3	4.2	4.1	4.1	4.0
Industrial prod. index	% change	2.4	3.0	2.9	3.3	2.0	4.7	4.8	5.3	6.5	8.0
Capacity util. rate - mfg.	%	82.0	81.0	80.3	80.2	79.6	79.6	79.7	80.3	80.8	81.5
Housing starts	Millions	1.56	1.57	1.63	1.72	1.76	1.59	1.66	1.69	1.73	1.60
Light motor vehicle sales		15.00	16.01	14.55	16.24	16.18	16.79	17.08	17.00	18.20	17.24
North Amer. produced		13.07	14.04	12.53	14.07	13.87	14.34	14.61	14.31	15.32	14.36
Other		1.93	1.97	2.02	2.17	2.31	2.45	2.47	2.69	2.88	2.88
INCOME AND SAVING											
Nominal GNP	Bill. $	8640.3	8725.0	8814.9	8966.6	9097.2	9181.8	9327.3	9546.3	9745.0	9939.3
Nominal GNP	% change	7.8	4.0	4.2	7.1	6.0	3.8	6.5	9.7	8.6	8.2
Nominal personal income		7.7	6.2	5.9	5.7	4.3	5.4	5.2	7.6	6.9	6.3
Real disposable income		6.6	4.5	3.6	3.6	2.9	2.8	2.2	4.5	1.9	3.1
Personal saving rate	%	4.6	4.3	4.1	3.8	3.1	2.5	1.8	1.5	0.2	0.2
Corp. profits, IVA & CCAdj.	% change	-12.6	-5.0	2.0	-7.0	26.5	-6.9	2.5	26.6	20.7	17.1
Profit share of GNP	%	9.5	9.3	9.3	9.0	9.4	9.1	9.0	9.4	9.6	9.8
Excluding FR Banks		9.3	9.0	9.0	8.7	9.1	8.8	8.8	9.1	9.3	9.5
Federal surpl./deficit	Bill. $	25.9	41.9	71.9	56.4	89.7	117.5	147.3	143.3	235.8	238.9
State & local surpl./def.		38.1	33.4	37.5	57.7	47.9	38.0	47.4	66.6	52.0	54.2
Ex. social ins. funds		37.5	32.9	37.2	57.6	48.1	38.3	47.9	67.2	52.5	54.6
Gross natl. saving rate	%	18.9	18.7	19.0	18.7	18.9	18.4	18.4	18.3	18.2	18.5
Net natl. saving rate		7.7	7.4	7.6	7.2	7.3	6.7	6.5	6.6	6.6	6.8
PRICES AND COSTS											
GDP chn.-wt. price index	% change	1.0	1.1	1.5	1.1	2.2	1.4	1.1	1.6	3.3	2.6
Gross Domestic Purchases chn.-wt. price index		0.1	0.8	1.1	1.2	1.9	2.0	1.7	1.9	3.8	2.3
PCE chn.-wt. price index		0.4	1.2	1.4	1.5	1.7	2.3	1.9	2.2	3.5	2.3
Ex. food and energy		1.2	1.8	1.8	1.7	1.8	1.3	1.3	1.7	2.2	1.7
CPI		1.0	1.7	1.7	1.7	1.7	3.2	2.4	2.9	4.1	3.6
Ex. food and energy		2.8	2.3	2.3	2.1	1.8	2.1	2.1	2.3	2.3	2.8
ECI, hourly compensation[1]		3.0	3.3	4.4	2.6	1.7	4.3	3.7	4.0	5.9	4.4
Nonfarm business sector											
Output per hour		4.5	1.6	1.8	3.6	2.6	0.6	5.2	8.0	1.9	5.7
Compensation per hour		6.1	5.3	5.2	4.5	4.5	5.0	5.5	4.2	3.9	5.3
Unit labor cost		1.5	3.6	3.3	0.8	1.8	4.3	0.3	-3.5	1.9	-0.4

1. Private-industry workers.

Strictly Confidential <FR>
Class II FOMC

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

September 27, 2000

Item	Units	Projected 2000 Q3	2000 Q4	2001 Q1	2001 Q2	2001 Q3	2001 Q4	2002 Q1	2002 Q2	2002 Q3	2002 Q4
EXPENDITURES											
Nominal GDP	Bill. $	10064.5	10205.3	10359.5	10504.9	10655.1	10813.4	10987.8	11154.1	11322.3	11494.3
Real GDP	Bill. Ch. $	9378.1	9463.2	9551.4	9642.4	9737.8	9838.5	9942.8	10048.2	10154.5	10263.6
Real GDP	% change	3.0	3.7	3.8	3.9	4.0	4.2	4.3	4.3	4.3	4.4
Gross domestic purchases		3.3	3.7	4.3	4.4	4.2	3.8	4.7	4.6	4.4	3.9
Final sales		3.4	4.2	3.8	3.8	4.0	4.8	3.9	4.1	4.3	4.9
Priv. dom. final purchases		4.9	4.2	4.5	4.4	4.3	4.4	4.5	4.5	4.5	4.5
Personal cons. expenditures		4.7	3.8	3.6	3.5	3.4	3.4	3.4	3.4	3.4	3.4
Durables		7.9	3.6	4.5	3.7	4.0	4.5	4.1	4.3	4.3	4.4
Nondurables		5.1	3.3	3.4	3.3	3.3	3.2	3.2	3.2	3.3	3.3
Services		3.8	4.0	3.5	3.5	3.3	3.3	3.3	3.3	3.3	3.3
Business fixed investment		11.9	9.1	11.7	11.1	11.2	11.1	11.4	11.3	11.2	11.2
Equipment & Software		15.1	11.1	14.2	13.2	13.1	13.0	13.4	13.3	13.2	13.3
Nonres. structures		1.9	2.6	3.5	4.0	4.5	4.6	4.4	4.3	4.0	3.8
Residential structures		-12.4	-4.3	-5.1	-1.9	-4.1	-3.2	-2.3	-1.7	-2.3	-2.0
Exports		9.1	8.1	4.3	7.5	8.2	11.9	6.7	10.3	10.8	14.3
Imports		10.2	7.0	7.7	10.0	8.5	7.1	8.6	10.6	9.5	8.5
Gov't. cons. & investment		-1.6	3.9	3.5	3.5	3.5	4.3	3.5	3.6	3.6	3.5
Federal		-9.6	3.3	2.0	2.1	2.1	4.4	2.1	2.4	2.7	2.3
Defense		-11.1	3.0	1.9	2.1	2.0	2.7	1.3	1.9	2.1	2.1
State & local		2.8	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.1	4.1
Change in bus. inventories	Bill. Ch. $	66.8	55.1	55.3	57.8	59.9	45.4	55.8	62.4	63.7	51.5
Nonfarm		60.7	49.0	51.3	54.9	57.5	43.5	54.5	61.1	62.9	50.7
Net exports		-416.6	-420.7	-437.9	-455.5	-466.0	-460.3	-475.9	-488.9	-496.2	-488.1
Nominal GDP	% change	4.8	5.7	6.2	5.7	5.8	6.1	6.6	6.2	6.2	6.2
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	131.6	132.0	132.5	133.0	133.5	133.9	134.4	134.8	135.3	135.7
Unemployment rate	%	4.1	4.1	4.1	4.1	4.2	4.3	4.3	4.4	4.4	4.5
Industrial prod. index	% change	3.5	4.2	4.5	4.5	4.3	4.6	4.8	5.1	4.8	4.9
Capacity util. rate - mfg.	%	81.3	81.4	81.5	81.5	81.6	81.6	81.6	81.7	81.6	81.6
Housing starts	Millions	1.55	1.57	1.57	1.55	1.54	1.53	1.52	1.51	1.50	1.49
Light motor vehicle sales		17.20	16.83	16.68	16.56	16.49	16.48	16.42	16.37	16.31	16.26
North Amer. produced		14.45	14.23	14.11	14.04	14.00	14.00	13.95	13.91	13.87	13.83
Other		2.75	2.60	2.57	2.52	2.49	2.48	2.47	2.46	2.44	2.43
INCOME AND SAVING											
Nominal GNP	Bill. $	10051.2	10186.3	10337.8	10480.5	10627.0	10780.2	10947.8	11108.6	11270.7	11436.9
Nominal GNP	% change	4.6	5.5	6.1	5.6	5.7	5.9	6.4	6.0	6.0	6.0
Nominal personal income		5.6	5.1	7.3	6.1	5.9	5.9	6.7	6.0	5.9	6.0
Real disposable income		3.5	2.9	6.3	3.7	3.5	3.6	7.3	3.5	3.3	3.4
Personal saving rate	%	-0.1	-0.3	0.3	0.3	0.4	0.4	1.3	1.3	1.3	1.3
Corp. profits, IVA & CCAdj.	% change	1.7	-1.5	1.6	0.6	2.1	4.5	1.4	2.5	2.1	2.6
Profit share of GNP	%	9.7	9.6	9.5	9.3	9.3	9.2	9.1	9.1	9.0	8.9
Excluding FR Banks		9.5	9.3	9.2	9.1	9.0	9.0	8.9	8.8	8.7	8.7
Federal surpl./deficit	Bill. $	254.6	262.0	245.3	266.1	290.9	297.3	265.1	293.6	323.5	343.4
State & local surpl./def.		46.2	53.9	54.0	52.1	48.5	49.4	50.5	47.4	44.4	41.2
Ex. social ins. funds		46.5	54.1	54.1	52.1	48.4	49.2	50.1	47.0	44.1	40.9
Gross natl. saving rate	%	18.3	18.2	18.4	18.5	18.7	18.7	19.0	19.1	19.3	19.4
Net natl. saving rate		6.5	6.4	6.6	6.7	6.8	6.8	7.1	7.2	7.4	7.4
PRICES AND COSTS											
GDP chn.-wt. price index	% change	1.8	2.0	2.3	1.8	1.8	1.8	2.2	1.8	1.8	1.8
Gross Domestic Purchases chn.-wt. price index		2.1	2.1	2.1	1.7	1.7	1.7	2.1	1.8	1.8	1.8
PCE chn.-wt. price index		2.0	2.2	2.0	2.0	2.0	2.0	2.0	2.1	2.1	2.1
Ex. food and energy		1.4	2.1	2.1	2.1	2.1	2.2	2.2	2.2	2.3	2.3
CPI		3.0	2.7	2.4	2.5	2.4	2.4	2.4	2.4	2.5	2.5
Ex. food and energy		2.5	2.7	2.7	2.7	2.7	2.8	2.8	2.8	2.9	2.9
ECI, hourly compensation[1]		4.1	4.2	4.8	4.9	4.9	4.8	5.0	5.0	4.9	4.9
Nonfarm business sector											
Output per hour		3.5	1.9	2.7	2.8	3.2	3.5	3.7	3.7	3.7	3.7
Compensation per hour		4.8	5.0	5.7	5.5	5.5	5.5	6.0	5.8	5.7	5.7
Unit labor cost		1.4	3.1	3.0	2.7	2.3	2.0	2.3	2.1	2.1	2.0

1. Private-industry workers.

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

Item	1998 Q3	1998 Q4	1999 Q1	1999 Q2	1999 Q3	1999 Q4	2000 Q1	2000 Q2	2000 Q3	98Q4/ 97Q4	99Q4/ 98Q4	0Q4/ 99Q4
Real GDP	3.4	5.6	3.5	2.5	5.7	8.3	4.8	5.2	3.0	4.6	5.0	4.2
Gross dom. purchases	4.5	5.5	5.0	3.8	6.8	8.6	5.8	6.3	3.4	5.8	6.0	4.8
Final sales	2.9	5.8	4.4	3.9	4.5	6.5	6.6	3.7	3.4	4.6	4.8	4.5
Priv. dom. final purchases	3.7	5.3	5.3	5.2	4.7	5.2	7.9	3.9	4.2	5.3	5.1	4.9
Personal cons. expenditures	2.8	3.3	3.7	3.7	3.4	4.1	5.0	2.0	3.2	3.3	3.7	3.2
Durables	0.3	1.7	0.7	1.1	0.6	1.0	1.8	-0.4	0.6	1.0	0.9	0.6
Nondurables	0.8	1.0	1.5	0.8	1.0	1.5	1.2	0.7	1.0	1.0	1.2	0.9
Services	1.7	0.5	1.6	1.8	1.8	1.6	2.0	1.7	1.5	1.4	1.7	1.7
Business fixed investment	0.4	1.6	1.2	1.2	1.5	1.2	2.5	1.9	1.6	1.5	1.3	1.8
Equipment & Software	0.6	1.5	1.3	1.4	1.7	0.9	1.9	1.7	1.5	1.4	1.3	1.6
Nonres. structures	-0.2	0.1	-0.1	-0.2	-0.2	0.3	0.6	0.1	0.1	0.2	-0.1	0.2
Residential structures	0.4	0.4	0.3	0.3	-0.1	0.0	0.1	0.0	-0.6	0.4	0.1	-0.1
Net exports	-1.0	0.1	-1.4	-1.4	-1.1	-0.4	-0.9	-1.0	-0.5	-1.1	-1.1	-0.6
Exports	-0.4	1.5	-0.9	0.6	1.1	1.1	0.7	1.5	1.0	0.3	0.5	1.0
Imports	-0.7	-1.5	-0.6	-2.0	-2.1	-1.5	-1.6	-2.5	-1.4	-1.4	-1.5	-1.7
Government cons. & invest.	0.3	0.5	0.6	0.1	0.8	1.5	-0.2	0.8	-0.3	0.5	0.8	0.3
Federal	-0.2	0.2	-0.1	0.1	0.4	0.8	-0.9	0.9	-0.6	0.0	0.3	-0.1
Defense	0.2	-0.1	-0.1	-0.1	0.5	0.5	-0.9	0.6	-0.4	-0.0	0.2	-0.2
Nondefense	-0.4	0.3	-0.0	0.2	-0.1	0.3	-0.1	0.4	-0.2	0.1	0.1	0.1
State and local	0.5	0.3	0.8	0.0	0.4	0.7	0.8	-0.1	0.3	0.4	0.5	0.4
Change in bus. inventories	0.6	-0.2	-0.9	-1.4	1.2	1.8	-1.8	1.5	-0.5	0.0	0.2	-0.3
Nonfarm	0.8	-0.7	-0.6	-1.4	1.3	1.3	-1.6	1.6	-0.5	0.0	0.1	-0.2
Farm	-0.2	0.5	-0.3	0.0	-0.1	0.5	-0.2	-0.1	0.0	0.0	0.1	-0.0

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

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

Item	2000 Q4	2001 Q1	2001 Q2	2001 Q3	2001 Q4	2002 Q1	2002 Q2	2002 Q3	2002 Q4	00Q4/ 99Q4	01Q4/ 00Q4	02Q4/ 01Q4
Real GDP	3.7	3.8	3.9	4.0	4.2	4.3	4.3	4.3	4.4	4.2	4.0	4.3
Gross dom. purchases	3.8	4.4	4.5	4.4	4.0	4.9	4.8	4.5	4.1	4.8	4.3	4.5
Final sales	4.1	3.8	3.8	3.9	4.8	3.9	4.1	4.3	4.8	4.5	4.1	4.3
Priv. dom. final purchases	3.6	3.8	3.8	3.7	3.8	3.8	3.9	3.8	3.9	4.9	3.8	3.9
Personal cons. expenditures	2.5	2.4	2.3	2.3	2.3	2.3	2.3	2.3	2.3	3.2	2.4	2.3
Durables	0.3	0.4	0.3	0.3	0.4	0.3	0.3	0.3	0.3	0.6	0.3	0.3
Nondurables	0.7	0.7	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.9	0.7	0.6
Services	1.6	1.4	1.4	1.3	1.3	1.3	1.3	1.3	1.3	1.7	1.4	1.3
Business fixed investment	1.2	1.6	1.5	1.5	1.6	1.6	1.6	1.6	1.6	1.8	1.6	1.6
Equipment & Software	1.1	1.5	1.4	1.4	1.4	1.5	1.5	1.5	1.5	1.6	1.4	1.5
Nonres. structures	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.1	0.1
Residential structures	-0.2	-0.2	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Net exports	-0.1	-0.6	-0.6	-0.4	0.2	-0.5	-0.4	-0.2	0.3	-0.6	-0.4	-0.2
Exports	0.9	0.5	0.8	0.9	1.3	0.7	1.1	1.2	1.6	1.0	0.9	1.2
Imports	-1.0	-1.1	-1.5	-1.3	-1.1	-1.3	-1.6	-1.4	-1.3	-1.7	-1.2	-1.4
Government cons. & invest.	0.7	0.6	0.6	0.6	0.7	0.6	0.6	0.6	0.6	0.3	0.6	0.6
Federal	0.2	0.1	0.1	0.1	0.3	0.1	0.1	0.2	0.1	-0.1	0.2	0.1
Defense	0.1	0.1	0.1	0.1	0.1	0.0	0.1	0.1	0.1	-0.2	0.1	0.1
Nondefense	0.1	0.0	0.0	0.0	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
State and local	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.5	0.5
Change in bus. inventories	-0.5	0.0	0.1	0.1	-0.6	0.4	0.3	0.0	-0.5	-0.3	-0.1	0.1
Nonfarm	-0.5	0.1	0.1	0.1	-0.5	0.4	0.2	0.1	-0.4	-0.2	-0.1	0.1
Farm	-0.0	-0.1	-0.0	-0.0	-0.0	-0.0	0.0	-0.0	-0.0	-0.0	-0.0	-0.0

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

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

Item	1999[a]	2000	2001	2002	2000 Q1[a]	2000 Q2[p]	2000 Q3	2000 Q4	2001 Q1	2001 Q2	2001 Q3	2001 Q4	2002 Q1	2002 Q2	2002 Q3	2002 Q4
Unified budget					Not seasonally adjusted											
Receipts[2]	1827	2023	2123	2239	434	656	489	479	473	658	513	517	487	685	550	537
Outlays[2]	1703	1788	1849	1905	449	444	431	463	474	464	447	484	476	476	469	494
Surplus/deficit[2]	125	234	274	333	-15	212	58	16	-1	193	65	33	11	208	81	43
On-budget	1	77	109	147	-45	147	38	-31	-29	122	46	-18	-21	130	55	-12
Off-budget	124	157	166	186	30	65	20	47	28	71	19	50	32	78	26	55
Surplus excluding deposit insurance	119	231	273	332	-18	211	58	16	-1	193	65	32	10	208	81	42
Means of financing																
Borrowing	-89	-224	-251	-342	-27	-190	-55	9	-25	-164	-70	-58	-24	-161	-99	-66
Cash decrease	-18	6	5	0	39	-13	7	-17	40	-22	5	20	5	-40	15	20
Other[3]	-18	-16	-29	9	4	-10	-10	-8	-14	-7	-0	5	9	-7	2	3
Cash operating balance, end of period	56	50	45	45	45	57	50	68	28	50	45	25	20	60	45	25
NIPA federal sector					Seasonally adjusted annual rates											
Receipts	1837	2023	2138	2238	2012	2055	2086	2105	2118	2149	2183	2218	2210	2245	2281	
Expenditures	1735	1805	1875	1946	1776	1816	1832	1844	1875	1886	1894	1923	1947	1953	1960	
Consumption expenditures	464	489	507	536	479	499	491	494	507	511	515	522	536	541	545	
Defense	306	320	331	346	311	326	320	323	331	333	336	339	347	349	351	
Nondefense	158	169	176	190	168	174	172	171	176	178	179	183	190	192	194	
Other spending	1270	1316	1368	1410	1297	1317	1341	1350	1368	1375	1379	1401	1410	1413	1415	1427
Current account surplus	103	218	264	293	236	239	254	260	243	264	288	295	263	292	321	341
Gross investment	94	103	108	113	101	105	102	106	108	109	110	111	112	113	115	116
Current and capital account surplus	9	115	156	180	134	134	152	154	135	155	179	184	151	178	206	225
Fiscal indicators[4]																
High-employment (HEB) surplus/deficit	-68	8	61	102	31	20	42	51	39	64	91	99	72	102	133	154
Change in HEB, percent of potential GDP	-.8	-.9	-.5	-.3	-.1	.1	-.2	-.1	.1	-.2	-.3	-.1	.3	-.3	-.3	-.2
Fiscal impetus (FI) percent, calendar year	5	2	5	7	-4	5	-2	2	2	.6	.4	2	5	.5	.6	.5

1. Fiscal year data for the unifie lget come from OMB; quarterly data com om the Monthly Treasury Statement and may not sum to OMB fiscal year totals.
2. OMB's Mid-Session Review line surplus estimates are $224 billion in I 000, $239 billion in FY2001, and $279 billion in FY 2002. CBO's July 2000 baseline surplus estimates, assuming discretionary spending grows wit lation beginning in FY 2001 are $232 bill in FY2000, $268 billion in FY2001, and $312 billion in FY 2002. Budget receipts, outlays, and surplus/deficit include corresponding social secu (OASDI) categories. The OASDI surplus xcluded from the on-budget surplus and shown separately as off-budget, as classified under current law.
3. Other means of financing are ks issued less checks paid, accrued items, l changes in other financial assets and liabilities.
4. *HEB is the NIPA current and tal account surplus in current dollars, with :ically sensitive receipts and outlays adjusted to the level of potential output associated with an unemployment rate of* 6 percent. Quarterly figures for c :e in HEB and FI are not at annual rates. 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 t in chained (1996) dollars, scaled by real f ral consumption plus investment. For FI and the change in HEB, negative values indicate aggregate demand restraint.

a--Actual p--Preliminary

Strictly Confidential (FR)
Class II FOMC

Change in Debt of the Domestic Nonfinancial Sectors
(Percent)

September 27, 2000

Period [1]	Total [2]	Federal government [3]	Nonfederal						Memo: Nominal GDP
				Households					
			Total [4]	Total	Home mortgages	Consumer credit	Business	State and local governments	
Year									
1992	4.6	10.9	2.6	4.5	5.3	0.8	0.8	2.2	6.4
1993	4.9	8.3	3.7	5.3	4.4	7.3	1.4	6.0	5.0
1994	4.5	4.7	4.4	7.6	5.9	14.5	3.6	-4.0	6.2
1995	5.5	4.1	6.0	7.9	5.7	14.1	6.8	-4.6	4.3
1996	5.3	4.0	5.8	7.3	7.2	7.9	5.8	-0.6	6.0
1997	5.6	0.6	7.3	6.5	6.9	4.3	8.7	5.3	6.2
1998	6.8	-1.4	9.6	8.8	10.0	5.4	11.0	7.2	5.9
1999	6.9	-1.9	9.5	9.2	10.1	7.1	11.0	4.4	6.5
2000	5.5	-7.1	8.8	9.0	9.2	8.8	10.3	1.2	6.8
2001	4.7	-9.3	7.9	7.6	8.6	5.3	9.6	1.1	6.0
2002	4.5	-11.3	7.5	6.8	7.8	3.8	9.4	1.0	6.3
Quarter									
1999:3	6.9	-1.9	9.5	9.5	10.7	5.5	10.5	4.3	6.7
4	6.4	-0.9	8.4	8.0	8.6	7.8	9.9	2.7	9.7
2000:1	5.4	-5.9	8.4	8.2	7.2	10.0	10.4	0.3	8.3
2	5.6	-11.4	10.0	9.6	10.5	9.0	12.1	2.0	8.2
3	5.0	-6.4	7.8	8.7	9.1	8.1	8.4	0.4	4.8
4	5.3	-5.7	7.9	8.2	8.9	6.9	8.8	2.2	5.7
2001:1	5.1	-6.0	7.7	7.9	8.7	6.3	8.6	1.1	6.2
2	4.8	-9.3	7.9	7.6	8.4	5.5	9.5	1.1	5.7
3	4.9	-8.7	7.7	7.2	8.2	4.8	9.5	1.1	5.8
4	3.9	-14.5	7.6	7.0	8.0	4.4	9.4	1.0	6.1

Note. Quarterly data are at seasonally adjusted annual rates.

1. Data after 2000:Q2 are staff projections. Changes are measured from end of the preceding period to end of period indicated except for annual nominal GDP growth, which is calculated from Q4 to Q4.

2. On a monthly average basis, total debt is projected to grow 5.7 percent in 2000, 4.9 percent in 2001 and 4.5 percent in 2002.

3. On a monthly average basis, federal debt is projected to grow -6.1 percent in 2000, -8.4 percent in 2001 and -11.0 percent in 2002.

4. On a monthly average basis, nonfederal debt is projected to grow 8.8 percent in 2000, 8.0 percent in 2001 and 7.6 percent in 2002.

2.6.3 FOF

Strictly Confidential (FR)
Class II FOMC

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

September 27, 2000

					Seasonally adjusted annual rates									
	Calendar year				1999		2000				2001			
Category	1999	2000	2001	2002	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Net funds raised by domestic nonfinancial sectors														
1 Total	977.5	870.3	792.3	813.9	1042.3	1040.5	1010.1	746.4	841.2	883.5	856.5	807.8	844.0	660.9
2 Net equity issuance	-143.5	-83.3	-80.0	-48.0	-128.4	-55.0	62.8	-248.0	-64.0	-84.0	-84.0	-84.0	-76.0	-76.0
3 Net debt issuance	1121.0	953.6	872.3	861.9	1170.7	1095.5	947.3	994.4	905.2	967.5	940.5	891.8	920.0	736.9
Borrowing sectors														
Nonfinancial business														
4 Financing gap [1]	171.3	216.3	289.6	377.3	177.9	206.3	190.4	211.0	230.5	233.3	258.2	282.6	305.0	312.4
5 Net equity issuance	-143.5	-83.3	-80.0	-48.0	-128.4	-55.0	62.8	-248.0	-64.0	-84.0	-84.0	-84.0	-76.0	-76.0
6 Credit market borrowing	596.5	620.5	637.8	682.7	601.3	583.7	627.7	747.9	534.0	572.4	573.6	646.6	661.6	669.2
Households														
7 Net borrowing [2]	543.4	580.8	538.8	516.4	588.5	509.6	531.4	635.4	591.3	565.2	560.3	545.0	530.3	519.9
8 Home mortgages	411.2	413.0	420.2	416.2	458.5	377.3	322.6	477.1	426.2	426.2	424.2	422.2	418.2	416.2
9 Consumer credit	94.4	125.3	82.8	62.3	76.2	109.5	143.1	131.8	121.2	105.1	97.2	85.9	77.2	70.8
10 Debt/DPI (percent) [3]	93.4	96.5	98.3	98.9	94.1	94.5	95.2	96.0	96.9	97.7	97.7	98.2	98.6	99.0
State and local governments														
11 Net borrowing	52.3	15.3	13.4	13.4	52.5	33.6	3.8	25.0	4.5	27.9	13.4	13.4	13.4	13.4
12 Current surplus [4]	156.8	168.1	176.5	180.9	155.1	176.5	164.7	169.9	164.0	173.8	176.1	176.5	175.2	178.4
Federal government														
13 Net borrowing	-71.2	-263.0	-317.7	-350.6	-71.4	-31.5	-215.5	-414.0	-224.6	-198.0	-206.7	-313.2	-285.3	-465.6
14 Net borrowing (quarterly, n.s.a.)	-71.2	-263.0	-317.7	-350.6	-19.0	48.3	-27.5	-189.6	-55.0	9.1	-25.3	-164.4	-70.2	-57.8
15 Unified deficit (quarterly, n.s.a.)	-158.3	-270.9	-290.7	-343.3	-30.1	20.6	15.0	-211.8	-58.0	-16.1	1.0	-193.5	-65.5	-32.8
Depository institutions														
16 Funds supplied	404.3	554.2	363.3	324.9	535.0	587.6	467.2	598.3	569.5	581.9	374.3	365.8	356.8	356.4
Memo (percentage of GDP)														
17 Domestic nonfinancial debt [5]	181.4	179.4	178.0	175.3	182.1	181.1	180.1	179.0	179.3	179.1	178.7	178.4	178.1	177.4
18 Domestic nonfinancial borrowing	12.1	9.5	8.2	7.7	12.5	11.5	9.7	10.0	9.0	9.5	9.1	8.5	8.6	6.8
19 Federal government [6]	-0.8	-2.6	-3.0	-3.1	-0.8	-0.3	-2.2	-4.2	-2.2	-1.9	-2.0	-3.0	-2.7	-4.3
20 Nonfederal	12.8	12.2	11.2	10.8	13.3	11.8	11.9	14.2	11.2	11.4	11.1	11.5	11.3	11.1

Note. Data after 2000:Q2 are staff projections.
1. For corporations: Excess of capital expenditures over U.S. internal funds.
2. Includes change in liabilities not shown in lines 8 and 9.
3. Average debt levels in the period (computed as the average of period-end debt positions) divided by disposable personal income.
4. NIPA surplus less changes in retirement fund assets plus consumption of fixed capital.
5. Average debt levels in the period (computed as the average of period-end debt positions) divided by nominal GDP.
6. Excludes government-insured mortgage pool securities.

2.6.4 FOF

International Developments

Overview

Foreign economic activity continues to flourish, although the pace of expansion appears to have cooled somewhat from the torrid rates observed earlier this year. The emerging Asian economies are still posting the most rapid rates of growth, but economic expansion appears to be spreading in Latin America and consolidating in Europe and Canada. Japan remains an exception: Although first-half growth was the fastest in several years, indicators point to a sharp slowing in the second half of 2000. Over the next two years we expect overall foreign economic growth to remain near its current rate of 4 percent.

The run-up in oil prices since the August Greenbook has cast a shadow on the generally upbeat economic outlook for the world economy. However, the direct effects of an increase in oil prices–at least an increase of the size recorded to date–are likely to be fairly small in light of the reduced dependence on oil compared with the 1970s. Moreover, important, but not easily quantified, confidence effects on consumption and investment are less likely to have much of an impact in the current environment of strong global growth and contained inflation expectations. A serious supply disruption is not part of this forecast, but of course it cannot be ruled out in this politically charged market. Later in this Greenbook, we report the results of an alternative simulation in which a supply shock causes the price of oil to jump up sharply and stay at the elevated level through the end of 2002.

Summary of Staff Projections
(Percent change from end of previous period)

Measure	1999	Projection			
		2000		2001	2002
		H1	H2		
Foreign output	4.5	5.7	4.1	4.0	3.9
August GB	*4.5*	*5.7*	*4.1*	*4.0*	*n.a.*
Foreign CPI	2.6	1.9	4.0	3.4	3.3
August GB	*2.6*	*2.0*	*3.8*	*3.3*	*n.a.*

Higher energy prices have had a noticeable effect on headline inflation around the world. Although OPEC began to step up production last spring and agreed at its September 10 meeting to increase output by a further 800,000 barrels per day, robust growth in global demand continues to put upward pressure on prices. In an environment in which inventories appear to be lean, the possibility of exaggerated price movements remains high. We have steered a middle course between the price outcomes that could emerge should supply become disrupted or should demand for inventories abate. On net, our projection for oil prices is \$2-3 per barrel higher than last time. We expect a decline from the current level of $32 per barrel for WTI to about $28 by the end of next year and to about $25 by the end of 2002 as inventories settle at more comfortable levels and additional capacity comes on line.

The projected drop in oil prices is expected to allow headline foreign inflation to ease over the forecast period, although it likely will remain higher than during the past couple of years as core inflation rates move up in response to reduced economic slack. Because the oil price increase is partially reversed in our outlook, it is unlikely either to feed significantly into inflation expectations or to sap household and business confidence. We expect monetary authorities in the major foreign industrial countries to respond primarily to cyclical pressure on core inflation, implying that official interest rates will move up by a moderate amount on average.

Once again, we project that the broad real value of the dollar, weighed down by investor concerns about the large and growing U.S. current account imbalance, will soften over the forecast period. The cumulative drop of about 5 percent in the dollar index in our outlook over the next two years, primarily against the euro, would bring the dollar back down to about its level at year-end 1999.

The projected growth of activity abroad, along with the decline in the dollar and persistent demand for U.S. high-tech products, should keep U.S. export growth near its current high rate. However, the rise in the value of exports will continue to be outpaced by the absorption of imports by the U.S. economy. Partly as a result, the current account deficit is forecast to continue to widen, to 5 percent of GDP in 2002.

At the end of this section, we present several alternative scenarios that quantify the likely influence on the U.S. economy of different outcomes for areas where there are important risks. The first alternative assumes that oil prices rise to $40 per barrel in the fourth quarter and remain there throughout the forecast period. The second holds constant the broad real value of the dollar. The third alternative assumes that the pickup in productivity growth evident in the United States will emerge to a similar extent in Canada and Europe over the next two years.

Recent Developments

International financial markets. Joint intervention last week by the European Central Bank and the monetary authorities of the United States, Japan, the United Kingdom, and Canada to stem the slide of the euro has reversed about two-thirds of the 5½ percent decline relative to the dollar that had occurred since the August FOMC. The intervention, initiated by the ECB, took place on September 22, the day before the meeting of the G-7 finance ministers and central bank governors, and was accompanied by a statement expressing concern about the potential implications of the recent movements in the euro for the world economy. U.S. monetary authorities purchased $1.3 billion of euros, the first U.S. intervention in foreign exchange markets since June 1998. The Desk's purchases were split evenly between the accounts of the System and the Treasury.

On balance, the dollar is up about 1 percent since the August FOMC meeting in terms of both our major foreign currencies index and the index of currencies of our other important trading partners. Both short-term and long-term interest rates abroad were generally little changed over the same period. The only significant policy move was a 25-basis-point increase in official rates by the ECB on August 31 that essentially had already been priced into market interest rates. Equity prices shed 2 to 5 percent in the industrial countries and were down more significantly in many of the emerging market economies.

Economic activity abroad. In the foreign industrial countries, recent data indicate some moderation in the current quarter from the robust pace of growth in the first half of the year. This pattern mostly owes to variations in Japanese growth, which had rebounded sharply in the first half from a very weak level in 1999:Q4 and received a further impetus from a surge in public investment spending in 2000:Q2. With the all-industry index of activity flat in July relative to the second quarter and shipments of both machinery and consumer goods down, the current quarter likely has seen a sharp deceleration in activity. In Canada as well, sluggish employment growth in July and August points to some slowing following first-half growth averaging nearly 5 percent, although demand indicators suggest that the pace of expansion remains above potential. Protests over higher oil prices in some European countries may have had a measurable, albeit temporary, effect on third-quarter output.

Headline inflation in the foreign industrial countries is clearly showing the impact of the recent oil price increases. However, spillover effects have been limited so far, as core prices have shown only a mild acceleration. Twelve-month headline inflation in the euro area, which has also been boosted by the weakness of the euro, was about 2¼ percent in August, up from less than 1 percent a year and a half ago and above the ECB's 2 percent ceiling. In Japan, where only a small portion of the increase in oil prices has shown up in the consumer price index, the rate of consumer price deflation has intensified in recent months.

Growth in the developing countries is somewhat uneven, but on balance activity in both the Asian and the Latin American regions remains firm. The strength in Asia is fairly widespread across countries, with third-quarter indicators pointing to growth averaging somewhat above 5 percent. Growth in Mexico appears to have slowed from the very rapid pace registered earlier in the year but still is robust, and activity has picked up in Brazil. There is only scattered evidence of a pickup in developing-country inflation.

Prices of Internationally Traded Goods. The spot price of WTI breached $37 per barrel during the intermeeting period, its highest level since the Gulf War, although it dropped below $32 per barrel after the United States decided to release oil from the Strategic Petroleum Reserve. Strong world demand for oil, which has been driven by robust economic growth and the desire to rebuild stocks, has kept upward pressure on oil prices even as world supply has been increasing. Spot and near-term futures prices for oil have likely received an additional boost from the heightened possibility that Iraq may disrupt exports for political purposes. Crude oil futures prices for delivery in 2001 and 2002 have moved up significantly as well.

Prices of imported core goods (which exclude oil, computers, and semiconductors) increased slightly in August and, for July-August combined, were up 2.1 percent at an annual rate from the second quarter. The increase was attributable largely to industrial supplies (primarily natural gas and unfinished metals). In contrast, the price indexes of imported machinery, consumer goods, and foods all declined in July-August from the second quarter.

Prices of total goods exports declined moderately in August and were down 1 percent at an annual rate from the second quarter for July-August combined. The decline was concentrated in agricultural exports, which fell 15 percent at an annual rate. Prices of nonagricultural exports were up slightly over the same period.

U.S. International Transactions. TU.S. trade deficit in goods and services was $383 billion at an annual rate in July, up from an average of $357 billion in the second quarter. The July level of exports was about 1½ percent higher than the second-quarter average, largely from gains in machinery. However, the level of imports was nearly 3 percent higher over the same period, because of sharp increases in the value of oil imports and automotive products. There were smaller gains in industrial supplies, capital goods, and services.

Outlook

The dollar. We continue to project that the dollar will depreciate against the major foreign currencies over the next two years as appetites for U.S. assets diminish. With so much depending on hard-to-pin-down investor sentiment, the exact timing remains elusive. As a point forecast, we have assumed that the real trade-weighted value of the dollar in terms of the major foreign currencies will peak in the fourth quarter and depreciate at a steady rate to a level about 5½ percent lower by the final quarter of 2002. The broad real index depreciates slightly less, by about 5 percent, as the dollar appreciates a bit in real terms relative to the currencies of the emerging market economies.

Activity in foreign industrial countries. Export-weighted real GDP growth in the foreign industrial countries is expected to average about 3¼ percent during the second half of this year and to remain near that pace over the following two years.

Growth in Japan is expected to slow sharply to just under 1 percent at an annual rate in the second half of this year. The projected deceleration in activity is partly a result of the volatility in the official GDP statistics over the past year, which show a rebound in the first half of 2000 that offsets a steep decline in the second half of last year. Only a slight improvement is expected over the following two years, as a projected fiscal contraction offsets continued growth in private investment, particularly in high-tech equipment. Consumption spending is expected to improve only gradually over the forecast period, reflecting weak income growth, high unemployment rates, and concerns about the aging of the population.

Second-half growth in the euro area is projected to remain near the first-half pace of almost 4 percent, consistent with record high levels of economic sentiment. Recent and prospective monetary tightening should result in a gradual deceleration in activity over the next two years to just over 3 percent, still above the estimated growth rate of potential GDP in the euro area. U.K. growth is expected to remain about 2¾ percent over the forecast period, as an expected weakening in the trade-weighted pound eases the recent dichotomy between the strong service sector and the weak manufacturing sector. Although the Canadian economy continued to expand at a pace close to 5 percent in the second quarter, monetary tightening is expected to result in a slowing to just over 3½ percent for the remainder of the forecast period.

Inflation. The recent run-up in oil prices is expected to continue to push headline inflation higher in the foreign industrial countries in the near term, but the expected easing in oil prices subsequently should have a moderating effect on inflation. This should offset a pickup in core inflation rates resulting from diminishing economic slack in most countries. In Japan, the exception once again, consumer prices are expected to continue to decline over the forecast period, but at a somewhat slower rate than over the past year as the expansion lengthens. On average, inflation in the foreign industrial countries is expected to remain just above 1½ percent over the forecast period.

Interest rates. We expect the Bank of Japan to refrain from further rate increases in 2001 in light of anemic economic growth and to push rates up only modestly in 2002 as deflation wanes. Elsewhere, more substantial monetary tightening is expected. The ECB is projected to raise interest rates a further 50 basis points in the remainder of this year and another 25 basis points in the first half of next year, taking its policy rate to 5¼ percent. We assume that the Bank of England will tighten policy an additional 25 basis points. The Bank of Canada is expected to raise interest rates 75 basis points in 2001 and another 50 basis points in 2002.

Other countries. Real GDP growth in the major developing-country trading partners of the United States is expected to moderate to about 5 percent over the forecast period from the strong 7½ percent pace recorded during the first half of this year. Robust cyclical expansions in the Asian developing countries are expected to slow as recoveries mature and macroeconomic policy counters the expected emergence of inflationary pressures. Activity in Mexico is also projected to decelerate to a more sustainable pace following a rapid first-half expansion. Inflation in the developing countries is expected to pick up modestly in response to some tightening of capacity constraints.

Prices of internationally traded goods. Along with futures markets, we continue to project that oil prices will gradually decline as increases in production outpace the growth in demand over the forecast period. However, in an environment where inventories are relatively low, the volatile situation in Iraq and the possibility that the winter may be unexpectedly cold pose risks that oil prices could spike over the next few months. Alternatively, if much of the current strength in demand is being driven by stockbuilding, demand pressures could ease as inventories are restored, perhaps leading to lower oil prices than we project.

Core import price inflation is projected to move up about 1 percentage point from current rates, to 3¼ percent by the middle of next year, but then moderate to 2½ percent in 2002 largely because the upward pressure from commodity prices eases. Prices of exported core goods are expected to decelerate in the second half of this year and into the first half of next year as the run-up in prices of industrial supplies (which include petroleum products and petrochemicals) slows.

Selected Trade Prices
(Percent change from end of previous period
except as noted; seasonally adjusted)

Trade category	1999	Projection			
		2000		2001	2002
		H1	H2		
Exports					
Nonagricultural (core)	1.7	2.8	1.4	0.8	0.8
Agricultural	-5.0	0.5	0.5	7.4	1.7
Imports					
Non-oil (core)	0.4	1.6	2.4	3.0	2.5
Oil (level, dollars per barrel)	22.08	26.15	30.11	25.70	22.85

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

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

U.S. international transactions. Real exports of goods and services, which grew at an average annual rate of 10 percent in the first half of this year, are projected to expand at an 8½ percent pace in the second half of the year. Looking ahead, growth of core goods exports should pick up later in the forecast period as the dollar's projected depreciation causes relative prices to shift from being a slight restraining factor during this year and the first half of next year to a source of stimulus thereafter. A projected acceleration of service exports also should contribute to the strengthening of total export growth.

Growth of real imports of goods and services is projected to slow sharply this year, from an estimated 15 percent annual rate increase in the first half to 8½ percent through the end of 2001, and then to pick up somewhat in 2002. The contour of the forecast largely reflects the pattern of projected U.S. real GDP growth. Relative prices, which have been boosting growth of core imports in recent quarters, will change to a slightly restraining factor as a result of the dollar's projected depreciation. The quantity of imported oil should expand moderately over the forecast period.

Summary of Staff Projections for Goods and Services
(Percent change from end of previous period except as noted; seasonally adjusted)

Measure	1999	Projection			
		2000		2001	2002
		H1	H2		
Real Exports	4.3	10.2	8.6	7.9	10.5
August GB	*4.3*	*6.9*	*7.6*	*8.3*	*n.a.*
Real Imports	12.0	15.2	8.6	8.3	9.3
August GB	*12.0*	*14.6*	*7.9*	*8.0*	*n.a*

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

Given the outlook for trade, export growth is anticipated to make a rising contribution to U.S. growth. With imports expanding at a relatively steady pace, the arithmetic contribution of the foreign sector to GDP growth diminishes over the forecast period, reaching minus 0.2 percentage point in 2002.

The U.S. current account deficit is projected to be a steadily rising share of GDP, moving from 4.4 percent this year to 4.8 percent next year and 5.0 percent (or about $565 billion) in 2002. Much of the projected change is in goods and services, but the net outflow of investment income also increases notably as these large current account deficits translate into increases in the U.S. net liability position.

Alternative Simulations
We have used the FRB Global model to assess the effect of different outcomes in several key areas of risk to our forecast. The first alternative simulation assumes that the price of oil rises to $40 per barrel in the fourth quarter and remains there over the forecast period to give a sense of the vulnerability of the global economy to a prolonged disruption of supply. While it is difficult to envisage such a disruption lasting so long, this scenario illustrates the key international mechanisms through which the effects of an oil shock are transmitted to the U.S. economy.

Because the response of monetary policy has an important influence on the outcome, for the oil price scenario we have simulated the model under two different policy assumptions. In the first, the federal funds rate remains at the baseline path assumed in the September Greenbook. In the second, U.S. monetary policy follows a Taylor rule. In both of these cases, the monetary authorities in foreign industrial countries are each assumed to follow a Taylor rule.

The effects on U.S. prices and output are summarized in the following table. With the federal funds rate fixed relative to the baseline, the inflation rate is about ¼ percentage point higher by the end of 2002. Real GDP growth remains close to the baseline, because lower domestic spending is largely offset by higher exports to oil-producing countries. If U.S. monetary policy instead follows a Taylor rule, the federal funds rate is higher relative to the baseline by 20 basis points early in 2001 and by an additional 20 basis points later in the year. As a result, in this simulation real GDP growth is lower relative to the baseline by about ½ percentage point in 2001 and is about ¼ percentage point lower in 2002. The slower pace of growth is sufficient to offset the inflationary impact of the shock, so that core consumer price inflation remains very close to baseline throughout the simulation.

It is inherently difficult to forecast exchange rates, which introduces additional uncertainty to any macroeconomic forecast. The second scenario assesses the effect on the outlook of replacing the staff projection for the dollar with a "random walk" forecast. Specifically, we assume that the broad real value of the dollar is unchanged over the forecast period rather than declining about 5 percent as assumed in the baseline. In this scenario, we assume that the U.S. federal funds rate remains at the baseline path throughout the simulation, but that other countries adjust interest rates in line with a Taylor rule. The effect on real GDP growth is minimal for this year and next but increases to about ¼ percent by the end of 2002, reflecting a decline in real net exports. The stronger dollar also exerts a restraining effect on inflation.

Effect of Alternative Assumptions
(Percent change from previous period, annual rate)

Measure	2000		2001		2002	
	H1	H2	H1	H2	H1	H2
U.S. real GDP						
Baseline	5.0	3.3	3.8	4.2	4.3	4.3
Higher Oil Prices						
Baseline federal funds rate	5.0	3.3	3.6	4.3	4.2	4.3
Taylor rule monetary policy in U.S.	5.0	3.3	3.3	3.8	3.9	4.1
Stronger Dollar	5.0	3.3	3.8	4.2	4.2	4.0
"New Economy" abroad	5.0	3.3	3.9	4.4	4.6	4.7
U.S. PCE prices excl.food and energy						
Baseline	1.9	1.8	2.1	2.2	2.2	2.3
Higher Oil Prices						
Baseline federal funds rate	1.9	1.8	2.2	2.3	2.4	2.6
Taylor rule monetary policy in U.S.	1.9	1.8	2.1	2.2	2.2	2.3
Stronger Dollar	1.9	1.8	2.1	2.1	2.1	2.1
"New Economy" abroad	1.9	1.8	2.1	2.2	2.3	2.4

NOTE. H1 is Q2/Q4; H2 is Q4/Q2. Except as noted, all simulations assume federal funds rate unchanged from baseline path.

The final simulation attempts to put an upper limit on the possibility that the seeds of the new economy have already been planted abroad and will bear fruit in the form of dramatically higher potential growth in Canada and Europe over the next two years. We have made the extreme assumption that by the beginning of next year productivity growth in these countries will have risen to a rate close to that in the United States. Under these assumptions, annual potential growth in these areas is roughly 1¼ percentage points higher over the forecast period than in the baseline simulation. We have again assumed that the U.S. federal funds rate follows the baseline path and that monetary authorities in foreign industrial countries each follow a Taylor rule.

As foreign demand is boosted by higher expected income growth, foreign real GDP growth, weighted by shares in U.S. exports, picks up nearly 1 percentage point by the end of 2002. In the United States, real GDP growth rises about ½ percentage point by the end of 2002, while inflation is up a tad by the end of the forecast period.

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

Measure and country	1994	1995	1996	1997	1998	1999	------Projected---- 2000	2001	2002
REAL GDP (1)									
Total foreign	5.1	2.3	4.2	4.2	1.0	4.5	4.9	4.0	3.9
Industrial Countries	4.0	1.9	2.9	3.5	1.9	3.6	3.9	3.1	3.1
of which:									
Canada	5.5	1.4	2.4	4.8	3.2	4.9	4.3	3.6	3.6
Japan	0.9	2.5	5.2	-0.5	-3.1	-0.2	3.9	1.1	1.5
United Kingdom	4.6	1.9	2.9	3.5	2.0	2.8	2.8	2.7	2.7
Euro-11	3.0	1.7	1.6	3.1	1.9	3.1	3.7	3.4	3.1
Germany	2.9	1.1	1.3	1.6	0.9	2.4	3.7	3.2	3.2
Developing Countries	6.8	3.0	6.3	5.1	-0.3	5.9	6.3	5.3	5.1
Asia	8.8	7.2	6.8	4.8	-1.9	8.3	7.1	6.3	5.9
Korea	9.2	7.4	6.1	3.1	-4.6	14.0	6.2	6.0	6.0
China	16.3	12.6	9.2	8.2	9.5	6.2	7.6	8.0	8.0
Latin America	5.3	-3.8	6.3	6.1	1.0	3.9	5.8	4.7	4.6
Mexico	5.2	-7.1	7.2	6.8	2.7	5.3	7.1	5.3	5.0
Brazil	9.7	-1.5	5.1	2.0	-2.0	3.8	3.0	3.2	4.1
CONSUMER PRICES (2)									
Industrial Countries	1.1	1.3	1.4	1.5	1.0	1.1	1.7	1.4	1.6
of which:									
Canada	-0.0	2.1	2.0	1.0	1.1	2.4	2.7	2.1	2.5
Japan	0.8	-0.8	0.1	2.0	0.8	-1.3	-0.6	-0.4	0.0
United Kingdom (3)	2.2	2.9	3.2	2.7	2.5	2.2	2.2	2.4	2.5
Euro-11 (4)	NA	NA	NA	1.5	0.8	1.5	2.4	1.8	1.7
Germany	2.7	1.4	1.3	1.5	0.3	1.1	1.9	1.3	1.3
Developing Countries	22.9	16.9	11.1	6.8	9.1	4.7	4.7	6.2	5.8
Asia	10.7	6.3	4.8	2.8	4.5	0.2	2.3	4.4	4.5
Korea	5.8	4.4	5.0	5.0	5.9	1.3	2.8	3.8	4.2
China	26.9	11.0	6.8	0.9	-1.2	-0.9	1.7	4.8	5.4
Latin America	54.0	42.1	25.9	15.6	15.5	12.6	8.5	9.3	7.9
Mexico	7.0	48.9	28.2	17.2	17.5	13.6	8.9	9.9	8.2
Brazil	1196.9	21.5	9.6	4.7	1.6	8.3	6.4	5.6	4.9

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

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

	Projected											
	2000				2001				2002			
Measure and country	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
REAL GDP (1)	Quarterly changes at an annual rate											
Total foreign	7.3	4.1	4.0	4.1	4.0	4.0	4.1	4.1	3.9	3.9	3.9	3.9
Industrial Countries	5.2	4.1	3.2	3.3	3.1	3.1	3.2	3.2	3.1	3.1	3.1	3.1
of which:												
Canada	5.1	4.7	3.7	3.6	3.5	3.5	3.7	3.7	3.6	3.6	3.6	3.6
Japan	10.3	4.2	1.3	0.3	0.8	1.0	1.3	1.3	1.4	1.5	1.6	1.6
United Kingdom	2.0	3.6	1.8	3.8	2.5	2.6	2.8	2.8	2.5	2.8	2.7	2.7
Euro-11	4.0	3.3	3.7	3.7	3.5	3.5	3.3	3.3	3.2	3.2	3.0	3.0
Germany	3.1	4.7	3.6	3.4	3.3	3.4	3.1	3.2	3.1	3.2	3.2	3.2
Developing Countries	10.4	4.3	5.1	5.4	5.3	5.3	5.4	5.4	5.1	5.0	5.1	5.2
Asia	12.5	4.2	5.6	6.4	6.2	6.2	6.4	6.4	6.0	5.8	6.0	5.9
Korea	7.2	4.6	7.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
China	9.5	1.9	9.0	10.0	7.0	7.0	9.0	9.0	7.0	7.0	9.0	9.0
Latin America	9.2	4.2	4.8	4.9	4.7	4.7	4.7	4.8	4.7	4.6	4.6	4.6
Mexico	12.0	5.4	5.5	5.5	5.3	5.3	5.3	5.3	5.0	5.0	5.0	5.0
Brazil	5.0	0.9	3.0	3.0	3.0	3.0	3.0	3.7	4.3	4.0	4.0	4.0
CONSUMER PRICES (2)	Four-quarter changes											
Industrial Countries	1.5	1.4	1.7	1.7	1.6	1.6	1.4	1.4	1.4	1.5	1.5	1.6
of which:												
Canada	2.7	2.4	2.7	2.7	2.6	2.5	2.1	2.1	2.2	2.3	2.4	2.5
Japan	-0.8	-1.0	-1.0	-0.6	-0.6	-0.5	-0.5	-0.4	-0.3	-0.2	-0.1	0.0
United Kingdom (3)	2.1	2.1	2.2	2.2	2.2	2.3	2.3	2.4	2.5	2.5	2.5	2.5
Euro-11 (4)	2.1	2.1	2.5	2.4	2.1	2.0	1.8	1.8	1.7	1.7	1.7	1.7
Germany	2.0	1.7	2.0	1.9	1.6	1.6	1.3	1.3	1.3	1.3	1.3	1.3
Developing Countries	3.9	3.8	4.1	4.7	5.6	6.4	6.4	6.2	6.1	6.0	5.9	5.8
Asia	0.5	0.8	1.4	2.3	3.3	4.7	4.8	4.4	4.3	4.3	4.4	4.5
Korea	1.5	1.4	2.8	2.8	4.6	5.2	4.2	3.8	3.8	3.9	4.1	4.2
China	0.1	0.1	0.5	1.7	2.6	5.1	5.2	4.8	4.7	4.8	5.0	5.4
Latin America	10.0	9.1	8.7	8.5	9.2	9.3	9.2	9.3	9.1	8.7	8.3	7.9
Mexico	10.6	9.6	9.0	8.9	9.6	9.6	9.6	9.9	9.6	9.1	8.6	8.2
Brazil	7.8	6.6	7.5	6.4	7.3	8.7	6.6	5.6	5.2	4.9	4.9	4.9

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1994	1995	1996	1997	1998	1999	------- Projected 2000	2001	------ 2002
NIPA REAL EXPORTS and IMPORTS									
	Percentage point contribution to GDP growth, Q4/Q4								
Net Goods & Services	-0.3	0.4	-0.2	-0.8	-1.1	-1.1	-0.6	-0.4	-0.2
Exports of G&S	1.0	1.0	1.1	1.0	0.3	0.5	1.0	0.9	1.2
Imports of G&S	-1.3	-0.6	-1.3	-1.7	-1.4	-1.5	-1.7	-1.2	-1.4
	Percentage change, Q4/Q4								
Exports of G&S	10.5	9.7	9.8	8.5	2.2	4.3	9.4	7.9	10.5
Services	8.2	8.8	8.9	1.4	2.8	0.2	4.2	5.9	7.2
Agricultural Goods	16.3	-4.0	3.8	1.0	-0.3	-0.5	4.3	-2.2	3.3
Computers	27.4	39.1	21.6	25.8	7.0	13.3	38.4	36.0	36.0
Semiconductors	66.9	79.6	44.6	21.3	9.3	34.4	40.6	41.2	41.2
Other Goods 1/	6.9	5.7	7.8	10.9	1.3	4.1	7.6	3.9	5.9
Imports of G&S	12.2	5.0	11.2	14.3	11.2	12.0	11.9	8.3	9.3
Services	1.8	5.5	5.3	14.0	9.5	2.1	11.3	4.4	5.3
Oil	-0.2	2.4	7.8	3.9	4.6	-3.9	12.4	2.3	4.1
Computers	39.0	35.0	17.8	33.0	26.7	25.0	25.9	29.9	29.9
Semiconductors	54.5	92.4	56.7	32.9	-7.3	34.0	34.8	41.2	41.2
Other Goods 2/	12.3	-1.2	10.5	12.7	11.6	13.9	9.8	6.3	6.7
	Billions of chained 1996 dollars								
Net Goods & Services	-86.5	-78.4	-89.0	-113.3	-221.0	-322.4	-404.5	-454.9	-487.3
Exports of G&S	732.8	808.2	874.2	981.5	1003.6	1033.0	1130.3	1218.0	1334.4
Imports of G&S	819.4	886.6	963.1	1094.8	1224.6	1355.3	1534.8	1672.9	1821.7
	Billions of dollars								
US CURRENT ACCOUNT BALANCE	-118.6	-109.5	-123.3	-140.5	-217.1	-331.4	-441.7	-511.0	-564.3
Current Acct as Percent of GDP	-1.7	-1.5	-1.6	-1.7	-2.5	-3.6	-4.4	-4.8	-5.0
Net Goods & Services (BOP)	-97.0	-96.0	-102.1	-105.9	-166.9	-265.0	-367.8	-420.9	-451.4
Investment Income, Net	21.1	25.0	23.4	11.1	-1.0	-13.1	-16.5	-31.4	-53.2
Direct, Net	55.2	64.9	69.4	71.9	67.7	62.7	72.8	79.9	88.1
Portfolio, Net	-34.1	-39.9	-46.0	-60.9	-68.8	-75.8	-89.3	-111.2	-141.2
Other Income & Transfers,Net	-42.7	-38.6	-44.6	-45.7	-49.2	-53.4	-57.4	-58.7	-59.7

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

Strictly Confidential (FR)
Class II FOMC

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OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1997				1998				1999			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
	Percentage point contribution to GDP growth											
Net Goods & Services	-1.0	-0.3	-0.9	-0.9	-1.6	-1.9	-1.0	0.1	-1.4	-1.4	-1.1	-0.4
Exports of G&S	0.8	1.9	1.2	-0.1	0.1	-0.3	-0.4	1.5	-0.9	0.6	1.0	1.1
Imports of G&S	-1.8	-2.2	-2.1	-0.8	-1.7	-1.6	-0.7	-1.5	-0.6	-2.0	-2.1	-1.4
	Percentage change from previous period, s.a.a.r.											
Exports of G&S	7.5	17.6	10.6	-0.8	1.0	-3.0	-3.2	15.1	-7.9	5.8	10.2	10.3
Services	-5.8	9.4	6.0	-3.3	5.2	6.4	-10.0	10.8	-3.8	2.8	-2.5	4.6
Agricultural Goods	-19.4	6.7	12.0	7.9	-2.7	-13.8	-12.5	34.7	-33.4	33.1	38.0	-19.9
Computers	60.0	44.5	25.7	-14.0	-7.5	7.6	14.7	14.7	5.2	26.7	22.2	1.2
Semiconductors	50.3	22.1	19.6	-1.4	2.1	-13.6	18.9	35.9	38.7	39.1	37.8	22.5
Other Goods 1/	12.2	20.6	10.8	0.9	0.0	-6.6	-1.2	14.3	-11.1	1.4	11.9	16.3
Imports of G&S	15.3	18.8	17.3	6.4	14.2	13.1	5.5	12.2	4.5	16.2	16.9	10.7
Services	20.0	5.6	23.1	8.3	20.0	6.7	9.8	2.2	-7.7	2.5	6.3	8.2
Oil	-7.5	36.8	5.7	-12.9	6.4	41.2	2.1	-22.0	2.4	29.4	-5.8	-31.5
Computers	46.6	45.8	32.4	10.5	32.5	22.6	10.6	43.2	28.8	48.5	14.8	11.2
Semiconductors	78.1	26.0	31.6	5.6	2.0	-22.9	0.1	-6.1	17.8	53.8	24.1	43.3
Other Goods 2/	11.6	17.2	14.8	7.5	12.6	14.0	4.5	15.6	5.0	14.6	21.5	14.9
	Billions of chained 1996 dollars, s.a.a.r.											
Net Goods & Services	-94.0	-100.6	-119.6	-139.2	-175.3	-219.7	-244.1	-244.9	-279.8	-314.6	-342.6	-352.5
Exports of G&S	940.3	979.2	1004.2	1002.1	1004.5	996.8	988.8	1024.1	1003.3	1017.6	1042.6	1068.4
Imports of G&S	1034.3	1079.8	1123.8	1141.2	1179.8	1216.6	1232.9	1269.0	1283.1	1332.2	1385.2	1420.9
	Billions of dollars, s.a.a.r.											
US CURRENT ACCOUNT BALANCE	-137.5	-119.9	-133.6	-171.1	-169.6	-205.9	-245.2	-247.7	-266.5	-315.9	-358.6	-384.9
Current Account as % of GDP	-1.7	-1.4	-1.6	-2.0	-2.0	-2.4	-2.8	-2.8	-2.9	-3.4	-3.8	-4.0
Net Goods & Services (BOP)	-108.2	-94.3	-101.1	-120.1	-134.5	-166.4	-185.3	-181.4	-210.7	-253.2	-290.9	-305.1
Investment Income, Net	11.5	16.3	10.7	5.7	9.1	6.0	-12.1	-7.3	-7.1	-11.3	-16.8	-17.3
Direct, Net	68.9	76.6	74.1	68.1	74.9	72.4	59.0	64.7	64.1	58.8	62.8	65.1
Portfolio, Net	-57.4	-60.3	-63.4	-62.4	-65.7	-66.4	-71.1	-71.9	-71.2	-70.0	-79.6	-82.4
Other Inc. & Transfers, Net	-40.8	-41.9	-43.2	-56.7	-44.3	-45.5	-47.8	-59.1	-48.7	-51.4	-50.9	-62.5

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

Strictly Confidential (FR)
Class II FOMC

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OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	Projected											
	2000				2001				2002			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
	Percentage point contribution to GDP growth											
Net Goods & Services	-0.9	-1.0	-0.5	-0.1	-0.6	-0.6	-0.4	0.2	-0.5	-0.4	-0.2	0.3
Exports of G&S	0.7	1.5	1.0	0.9	0.5	0.8	0.9	1.3	0.7	1.1	1.2	1.6
Imports of G&S	-1.6	-2.5	-1.4	-1.0	-1.1	-1.5	-1.3	-1.1	-1.3	-1.6	-1.4	-1.3
	Percentage change from previous period, s.a.a.r.											
Exports of G&S	6.3	14.2	9.1	8.1	4.3	7.5	8.2	11.9	6.7	10.3	10.8	14.3
Services	6.9	3.6	3.5	2.8	3.7	5.5	6.8	7.5	7.2	7.2	7.2	7.2
Agricultural Goods	25.3	-2.0	8.4	-11.1	1.7	1.9	-4.2	-7.9	3.5	3.3	3.1	3.0
Computers	44.6	45.0	31.1	33.5	36.0	36.0	36.0	36.0	36.0	36.0	36.0	36.0
Semiconductors	20.7	68.6	38.6	38.6	41.2	41.2	41.2	41.2	41.2	41.2	41.2	41.2
Other Goods 1/	0.7	14.9	7.7	7.7	-1.2	3.0	3.8	10.1	-0.3	5.7	6.3	12.5
Imports of G&S	12.0	18.6	10.2	7.0	7.7	10.0	8.5	7.1	8.6	10.6	9.5	8.5
Services	16.6	11.0	12.8	5.1	4.4	4.0	4.3	4.9	5.4	5.3	5.1	5.2
Oil	30.3	35.8	0.5	-10.2	-5.6	27.1	6.8	-14.4	-1.6	26.1	6.6	-11.2
Computers	2.8	43.6	31.1	29.9	29.9	29.9	29.9	29.9	29.9	29.9	29.9	29.9
Semiconductors	20.7	33.5	45.1	41.2	41.2	41.2	41.2	41.2	41.2	41.2	41.2	41.2
Other Goods 2/	9.7	15.8	7.7	6.4	6.6	6.2	6.1	6.2	6.6	6.7	6.7	6.8
	Billions of chained 1996 dollars, s.a.a.r.											
Net Goods & Services	-376.8	-403.9	-416.6	-420.7	-437.9	-455.5	-466.0	-460.3	-475.9	-488.9	-496.2	-488.1
Exports of G&S	1084.8	1121.5	1146.2	1168.8	1181.2	1202.7	1226.6	1261.6	1282.1	1313.9	1347.9	1393.8
Imports of G&S	1461.7	1525.4	1562.8	1589.5	1619.1	1658.2	1692.6	1721.9	1758.0	1802.8	1844.0	1881.9
	Billions of dollars, s.a.a.r.											
US CURRENT ACCOUNT BALANCE	-406.0	-424.6	-455.6	-480.7	-486.7	-506.8	-520.6	-529.9	-540.6	-559.1	-573.5	-584.0
Current Account as % of GDP	-4.2	-4.3	-4.5	-4.7	-4.7	-4.8	-4.9	-4.9	-4.9	-5.0	-5.1	-5.1
Net Goods & Services (BOP)	-340.5	-357.1	-382.7	-391.0	-404.8	-421.8	-431.9	-425.1	-439.6	-451.9	-460.2	-454.0
Investment Income, Net	-11.9	-12.6	-17.9	-23.6	-26.2	-28.9	-32.7	-37.6	-44.5	-50.1	-56.1	-61.9
Direct, Net	68.3	73.7	75.3	74.1	75.8	78.5	81.5	83.7	84.4	86.9	89.3	91.6
Portfolio, Net	-80.2	-86.3	-93.1	-97.7	-102.0	-107.4	-114.1	-121.3	-128.9	-137.0	-145.4	-153.5
Other Inc. & Transfers, Net	-53.6	-55.0	-55.1	-66.1	-55.6	-56.1	-56.1	-67.1	-56.6	-57.1	-57.1	-68.1

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