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Part 1

August 7, 2002

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Summary and Outlook

Prepared for the Federal Open Market Committee
by the staff of the Board of Governors of the Federal Reserve System

Confidential (FR) Class II FOMC

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Summary and Outlook

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Domestic Developments

Since the June meeting of the FOMC, much of the news about the outlook for real activity has come in on the soft side of our expectations. Equity prices have dropped sharply, and we have received weaker-than-expected reports on the labor market, consumer confidence, manufacturing activity, and business investment. In addition, GDP growth for recent years was revised down; in response, we recalibrated downward our estimate of potential growth both this year and next about 1/3 percentage point per year. All that said, there were a few bright spots; most notably, auto sales soared in July, and housing activity remains robust. Even so, the negatives outweighed the few positives, leaving a considerably weaker underlying thrust of real activity. Accordingly, we have flattened out our assumption for the federal funds rate, and the resulting lower long-term interest rates buffer real activity from some of the effects of the recent bad news. All told, we now expect GDP to grow at an annual rate of 2-1/2 percent in the second half of this year and 3-1/2 percent next year—down nearly 1 percentage point and about 1/2 percentage point, respectively, from the previous projections.

Given the less robust pace of economic growth in this forecast, we now expect the unemployment rate to remain near 6 percent through early next year and project the jobless rate thereafter to move down to 5.7 percent by the end of 2003—0.2 percentage point higher than in the last Greenbook. With the slack created during the recession only gradually lessening, inflation is projected to remain stable despite some modest inflationary pressures stemming from a faster rise in import prices.

Key Background Factors
The stock market has been extremely volatile over the intermeeting period. As this Greenbook was being put to bed, broad indexes of equity prices were down more than 10 percent since the June Greenbook, and swings of 2 or 3 percent within a day were not uncommon. Credit spreads on debt securities have widened markedly: Whereas rates on long-term Treasuries and mortgages have fallen considerably, those on high-yield corporate debt are up sharply, and those on investment-grade corporate debt are flat to down slightly.

For businesses generally, financial markets have been less hospitable lately. Equity issuance has been extremely light, and in July, bond offerings fell to a trickle and were below the level of retirements. Some of the slowdown likely reflects a move to the sidelines during the run-up to August 14, but investors also appear to have more fundamental concerns about the continued deterioration in credit quality. Some top-tier firms have been tapping the commercial paper market, with net issuance in July posting the first positive reading this year, but bank lending has remained anemic. The recent Senior Loan Officer Opinion Survey indicated some further net tightening of terms and standards for business lending, although, as in the past, such tightening was probably directed at weaker credits. Overall, our sense is that firms with favorable prospects can obtain financing on reasonable terms and that the current weakness in net borrowing is due importantly to soft demand.

We have assumed that, after the current quarter, equity prices will rise at a pace sufficient to generate a risk-adjusted return equivalent to that on long-term debt securities. As the expansion takes hold and gathers momentum, we anticipate that credit risk spreads will narrow, with Treasury yields and mortgage rates moving up somewhat and rates on riskier corporate securities coming down.

Although our projection does not formally extend to 2004, implicit in our outlook for rising long-term Treasury yields over the course of next year is an expectation that the funds rate will rise over 2004. By then, the economic expansion should have gained sufficient momentum that the increase in rates can occur while the economy continues to move toward full utilization of resources.

Our projection for the exchange value of the dollar in the current quarter is about 1 percent lower than it was in the June Greenbook. As in that forecast, we expect the dollar to depreciate a further 2 percent by the end of next year.

The recent data on economic activity in foreign countries have been somewhat stronger than we had anticipated. Nonetheless, we have revised down our outlook for growth abroad over the next year and a half, in large part because the less-favorable conditions that have marked U.S. financial markets are also evident abroad.

Crude oil prices are about $1 per barrel higher in the current quarter than we were previously anticipating. Among the factors contributing to higher crude oil prices are OPEC production restraint, low exports from Iraq, and a somewhat tighter U.S. inventory situation. Oil prices are expected to fall $3 per barrel from current levels over the next year and a half owing to increased production.

The outlook for the federal budget deficit has deteriorated since the June Greenbook. For the current fiscal year, we are expecting a federal deficit of $161 billion, $8 billion more than last time. For fiscal year 2003, we now project a deficit of $186 billion, $60 billion more than in the previous forecast. The changes reflect the weaker economic picture in this projection and the prospect of lower tax revenues from capital gains next year due to the drop in the stock market. We have made no changes to our underlying fiscal policy assumptions.

Recent Developments and the Near-Term Forecast
Our current estimate that real GDP rose at an annual rate of 1-1/4 percent last quarter is little different from the figure published by the BEA. All of last quarter's increase in GDP resulted from a tapering-off of inventory liquidation by firms; final sales, overall, were about unchanged. We anticipate that, this quarter and next, final sales will begin to move up again, although at a slower pace than forecast in June.

Sales of light motor vehicles jumped to an annual rate of more than 18 million units in July. The zero-percent financing incentives are not scheduled to expire until September and thus should continue to support sales this quarter. Apart from motor vehicles, we have little solid evidence on consumer outlays for the current quarter. According to the major surveys, consumer sentiment fell in July, at least partly in reaction to the drop in equity prices. Chain store sales appear to have been about flat in July, but in light of strong motor vehicle sales, overall consumer spending appears to have posted a solid increase last month.

On balance, we have revised up our outlook for current-quarter PCE growth, to 3-3/4 percent, but lowered next quarter's rise to a rate of just 1-1/4 percent. Motor vehicle sales, which are projected to drop back down in the fourth quarter, more than account for the quarterly pattern. Elsewhere, we have cut our projections for spending partly because of the stock market drop.
After having fallen from the end of 2000 to the first quarter of this year, business spending on equipment and software eked out a small gain in the second quarter. However, new orders for capital equipment fell sharply in June, especially for communications equipment, and anecdotal evidence has become more negative in recent months. As a consequence, we have revised down our outlook for equipment and software spending from the June Greenbook. We have also marked down the projected pickup in spending for equipment and software in the fourth quarter, in effect pushing the projected recovery a little further into the future.

The news about nonresidential construction continues to be bleak, as high vacancy rates still plague key segments of the market. We now project another double-digit decline in spending in the current quarter, followed by some further contraction in the fourth quarter. In the residential sector, starts of new single-family units are expected to be little changed over the second half of the year from the second-quarter average. Low mortgage rates should continue to support residential construction despite the adverse influence of falling share prices.

Exports performed strongly in the second quarter, but imports rose even more, and as a consequence, the arithmetic contribution of the external sector to the growth in real GDP last quarter was a negative 1-3/4 percentage points. The

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

Measure	2002:Q2		2002:Q3	
	June GB	Aug. GB	June GB	Aug. GB
Real GDP	**1.8**	**1.2**	**3.3**	**2.7**
Private domestic final purchases	1.7	1.3	2.6	2.7
Personal consumption expenditures	1.7	1.9	2.6	3.7
Residential investment	2.7	4.1	.3	-2.8
Business fixed investment	1.4	-3.3	3.4	-.9
Government outlays for consumption and investment	1.9	1.4	3.9	3.4
	Contribution to growth (percentage points)			
Inventory investment	1.2	1.4	1.0	.0
Net exports	-1.2	-1.7	-.6	-.3

causes of last quarter's strength in exports and imports are unclear. This quarter and next, both imports and exports are projected to post more-modest increases, and the arithmetic contribution of net exports is projected to be only slightly negative in the second half.

Outside motor vehicles, inventories were drawn down much less rapidly in the second quarter than in the preceding several quarters, suggesting that most businesses are becoming more comfortable with the greatly reduced levels of their stocks. Nonetheless, businesses likely remain uncertain about the outlook for final demand, and we anticipate some further liquidation of nonfarm, non-motor-vehicle inventories in the current quarter.

The most recent labor-market news has been weak. Private employment gains were meager in June and July, the workweek dropped abruptly last month, and the unemployment rate has stayed near 6 percent. However, initial claims for unemployment insurance have continued to trend down in recent weeks, and we are inclined to think that the steep drop in production-worker hours in early July may overstate the deterioration in conditions for the month as a whole. Thus, our forecast anticipates a rebound in hours for August. For the quarter as a whole, aggregate hours are projected to increase at an annual rate of 1 percent, which, with current productivity, should be sufficient to support our GDP forecast.

Price inflation remains subdued. Both the overall and the core PCE price indexes rose just 0.1 percent in June, and we expect similar increases in the next few months. The ECI rose at a 4-1/2 percent annual rate in the second quarter, on the high side of recent experience. However, we estimate that the productivity and cost measure of hourly compensation rose at an annual rate of only 3-1/4 percent in the second quarter. All in all, the available wage data do not appear to indicate a step-up in wage gains, and we anticipate that hourly compensation will post smaller increases in the second half of the year than in the first half.

The Longer-Term Outlook for the Economy

Although we have revised down our GDP projection to reflect our re-assessment of aggregate supply, we still expect a pickup in GDP growth next year. Though the drop in equity prices this year constitutes an important "headwind" to the expansion, a number of "tailwinds" should be sufficient to permit a moderate acceleration of economic activity next year. These include the accommodative stance of monetary policy; the temporary partial-expensing tax incentive, which will stimulate business equipment spending; and the lower exchange value of the dollar, which should help boost U.S. exports and temper the increase in imports. Nonetheless, relative to a typical cyclical rebound, this one is still expected to be on the sluggish side, partly because of the drag from lower equity prices. In addition, spending on residential construction and consumer durables, which tends to fall sharply in a recession, barely paused last year. Hence, the gap between current and "desired" levels of spending is likely smaller than has been typical of previous cyclical rebounds.

Household spending. PCE growth next year will be supported by low interest rates, a pickup in employment growth, and income gains that are undergirded by ongoing structural productivity growth, while this year's declines in household wealth will continue to restrain spending. On balance, we expect personal consumption expenditures to increase 2-1/2 percent in 2003, about the same as this year, but 1/2 percentage point less than we previously projected.

Other things being equal, the slower pace of economic growth and the adverse wealth effect would hold down spending on residential investment over the forecast period. However, the lower mortgage rates we have incorporated in our financial assumptions should largely offset these effects.

Business fixed investment. We expect equipment and software spending to rise 13 percent next year, boosted by lower financing costs, increased needs for capital as the economy expands, and the partial-expensing tax incentive. Within information technology, spending on computers and software has already begun to recover, and we expect it to accelerate as the economy's expansion continues. However, because the capacity overhang in telecommunications seems far from

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

Measure	2002 H1	2002 H2	2003
Real GDP	**3.1**	**2.4**	**3.5**
Previous	3.6	3.4	4.1
Final sales	1.0	2.3	3.1
Previous	1.3	3.0	3.6
PCE	2.5	2.5	2.5
Previous	2.5	2.8	3.1
Residential investment	9.0	-3.5	-.5
Previous	8.9	.7	-.1
BFI	-4.6	1.2	9.6
Previous	-3.3	5.1	11.1
Government purchases	3.5	3.4	2.9
Previous	4.2	4.1	3.8
Exports	7.2	6.5	8.2
Previous	5.3	7.9	8.4
Imports	15.2	5.0	7.3
Previous	13.4	8.3	9.2
	Contribution to growth, percentage points		
Inventory change	2.0	.2	.4
Previous	2.3	.5	.5
Net exports	-1.3	-.1	-.2
Previous	-1.2	-.4	-.5

being worked off, we expect no noticeable upturn in outlays in this area until the second half of next year. Relative to the June Greenbook, we have pared back the longer-term pace of the recovery in equipment and software spending somewhat, mostly because of the weaker outlook for sales and production.

With high vacancy rates for office buildings and industrial space, and construction of new hotels damped by the troubles plaguing the travel industry, prospects for nonresidential construction look grim. We are not expecting any firming in nonresidential construction until late next year, and even then, the gain in spending is expected to be small.

Inventory investment. As firms become more convinced of the durability of the expansion, the pace of inventory investment should rise through the end of next year. As a result, inventory investment will make a positive contribution to the change in real GDP of about 1/2 percentage point next year. This pace of inventory investment helps bring stocks into better alignment with sales.

Government spending. We expect federal government expenditures in the second half of this year to increase at a 5-3/4 percent annual rate, reflecting the step-up in spending on security, both at home and abroad. With the ramping up of security spending largely complete, the pace of increase next year should subside to about 3 percent. At the state and local level, spending is expected to rise at a 2-1/4 percent annual rate for the remainder of this year, restrained by the tight budget situations that many of these governments face. With the pickup in the economy easing the pressures on government coffers, we expect state and local spending to move up to a 2-3/4 percent pace over the course of next year.

Net exports. We expect that, with a depreciation of the dollar and a pickup in economic activity abroad, export gains will pick up from an annual rate of 6-1/2 percent in the second half of this year to 8-1/4 percent in 2003. Imports are projected to decelerate noticeably in the second half of this year, after the surprising surge in the second quarter, and then to rise 7-1/4 percent in 2003 as domestic demand accelerates. On balance, the negative arithmetic contribution of the external sector to the change in real GDP is anticipated to be 0.1 percentage point at an annual rate in the second half of this year and 1/4 percentage point in 2003. These contributions are slightly less negative than those in the June Greenbook, reflecting the weaker path for the dollar and the slower growth in U.S. GDP in the current forecast. *(The International Developments section provides more detail on the outlook for net exports.)*

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

In the annual revision of the national accounts, output and investment were revised down for recent years. As a consequence, we have lowered our estimates of the contributions of both capital deepening and multifactor productivity to structural labor productivity growth. We now estimate that structural labor productivity growth peaked at 2-3/4 percent in 1998 and 1999 and subsequently slowed, reaching 1-3/4 percent this year. That trajectory was shaped by the drop in the contribution of capital deepening. In our revised view, multifactor productivity has continued to accelerate through 2002, although heightened security efforts obscure the acceleration this year. Next year, the waning of the security-measure buildup and the recovery in capital

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

Measure	1973-95	1996-98	1999	2000	2001	2002	2003
Structural labor productivity	**1.4**	**2.4**	**2.7**	**2.6**	**1.9**	**1.7**	**2.1**
Previous	1.4	2.4	2.9	3.0	2.3	2.0	2.5
Contributions[1]							
Capital deepening	.6	1.2	1.4	1.2	.4	.3	.5
Previous	.6	1.2	1.4	1.4	.6	.4	.8
Multifactor productivity	.6	.9	1.1	1.2	1.3	1.2	1.4
Previous	.6	.9	1.3	1.4	1.4	1.3	1.5
Labor composition	.3	.3	.3	.3	.3	.3	.3
MEMO							
Potential GDP	2.9	3.4	3.7	3.6	2.9	2.7	3.1
Previous	2.9	3.7	4.1	4.0	3.1	2.9	3.4

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

spending in our projection contribute to a rebound in structural productivity growth.

We have long interpreted the low-inflation, low-unemployment economy of 1996-2000 as reflecting the effects of both a permanent reduction in the NAIRU and the acceleration in productivity. With the inflation and unemployment picture essentially unchanged, the lower productivity growth in the national accounts revision suggests that the permanent reduction in the NAIRU was more important than we previously thought. Hence, we have revised down our estimate of the level of the NAIRU in the forecast period, to 5 percent from the 5-1/4 percent assumption we had been using earlier.

Productivity and the labor market. So far, the economic expansion has produced few job gains. In part, the slow pace of hiring is a result of the sluggish pace of the expansion to date, but it also seems to reflect an unusual degree of caution in firms' hiring decisions. As the expansion becomes more firmly established later this year and early next year, the recent caution should wane. Over the second half of this year, we anticipate only a slow pickup in private employment increases, from around 50,000 per month in the next few months to just over 100,000 per month by year-end. By late 2003, monthly job gains are expected to strengthen to around 170,000. Initially, these employment gains will about match increases in the labor force, keeping the unemployment rate roughly steady at around 6 percent through early 2003. We are expecting

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

Measure	2000	2001	2002	2003
Output per hour, nonfarm business	2.0	2.0	2.8	1.3
Previous	2.6	2.1	3.1	1.8
Nonfarm private payroll employment	1.6	-1.4	-.1	1.9
Previous	1.6	-1.4	.4	2.3
Household employment survey	1.0	-1.0	.0	1.6
Previous	1.0	-1.0	.6	1.6
Labor force participation rate[1]	67.1	66.9	66.6	66.7
Previous	67.1	66.9	66.9	66.9
Civilian unemployment rate[1]	4.0	5.6	6.0	5.7
Previous	4.0	5.6	5.9	5.5

1. Percent, average for the fourth quarter.

that hiring will be sufficiently strong later next year to bring down the unemployment rate to 5.7 percent. During this period of a "catch-up" in hiring, the rise in actual productivity, at 1-1/4 percent, will lag behind its structural rate.

Prices and wages. After running at an annual rate of just under 2 percent in 2000 and 2001, core PCE inflation is projected to move down to a 1.4 percent pace in 2002 and 2003. The reduction in inflation this year reflects downward pressure from economic slack as well as further benefits from last year's big drop in energy prices. The persistence of economic slack also works to push down inflation next year, but that effect is offset by other factors, such as the faster rise in import prices. On balance, the current inflation forecast is little changed from the June Greenbook.

We expect the rise in the ECI for hourly compensation to move down to 3-3/4 percent this year and to 3-1/2 percent next year. High unemployment is a key factor pushing down wage gains in both years. Working to push up labor costs are rapid increases in health insurance premiums. Private-sector surveys and public-sector announcements suggest that employer costs for health insurance will likely accelerate further next year from their recent double-digit increases. Thus, although the ECI for wages slows from a rise of 3-1/2 percent this year to a bit more than 2-1/2 percent in 2003, the benefits component is anticipated to accelerate from 4-3/4 percent to 5-1/2 percent.

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

Measure	2000	2001	2002	2003
PCE chain-weighted price index	2.5	1.5	1.6	1.4
Previous	2.6	1.3	1.5	1.4
Food and beverages	2.5	3.1	1.6	2.0
Previous	2.5	3.2	1.7	2.1
Energy	15.4	-10.3	4.2	-1.6
Previous	15.4	-9.9	3.0	-.9
Excluding food and energy	1.8	1.9	1.4	1.4
Previous	1.9	1.6	1.4	1.4
Consumer price index	3.4	1.9	2.1	1.8
Previous	3.4	1.9	2.1	1.9
Excluding food and energy	2.5	2.7	2.1	2.1
Previous	2.5	2.7	2.3	2.1
GDP chain-weighted price index	2.3	2.0	1.2	1.5
Previous	2.4	1.9	1.2	1.5
ECI for compensation of private industry workers[1]	4.4	4.2	3.8	3.4
Previous	4.4	4.2	3.5	3.5
NFB compensation per hour	7.2	1.4	3.3	3.2
Previous	7.8	3.9	3.0	3.4
Prices of core non-oil merchandise imports	1.6	-2.9	2.3	2.9
Previous	1.6	-3.1	1.9	2.7

1. December to December.

Financial Flows and Conditions

With a slowing in the expansion of federal debt, the growth rate of total domestic nonfinancial debt is projected to edge down to the 5-1/2 to 5-3/4 percent range over the forecast period.

The slowdown in federal borrowing next year largely reflects the usual budgetary benefits of a stronger economy. In the state and local sector, the combination of weak tax inflows, the continuing needs to finance school and highway construction, and some further advance refunding should contribute to considerable debt growth over the forecast period.

Borrowing by nonfinancial business, which has been anemic in recent months, is expected to pick up gradually in coming quarters. The recent deterioration of business credit quality, reflected in substantial net downgrades by rating agencies, is unlikely to be reversed quickly. Though lenders and investors are expected to remain highly selective, a protracted broad retrenchment of credit supplies seems unlikely. Indeed, as suggested by the latest Senior Loan Officer Opinion Survey, some of the recent weakness in business borrowing is attributable to a meager demand for funds, owing to weak capital investment and moribund merger activity. Business borrowing should gather some momentum as capital spending and inventory investment pick up and as lenders and investors see diminishing risks in supplying funds to firms. After rising at a rate of 3-3/4 percent in the second half of this year, business debt is projected to increase at a 5-1/2 percent pace in 2003.

Household borrowing will be elevated in the near term by auto financing and the extraction of home equity but is expected to slow somewhat over the remainder of the forecast period. Spurred by another round of auto incentives, the growth in consumer credit should pick up to a 6-1/4 percent rate in the second half of this year before dropping back to a 5-1/2 percent rate next year. With mortgage interest rates likely to remain low for a while, the expansion of home mortgage debt should slow only a bit, to a 7-3/4 percent clip in the second half of this year, still buoyed by cash-out refinancings and strong home equity lending. Next year, home mortgage debt is expected to increase at a 7-1/4 percent pace. Household borrowing is not expected to be damped by any marked upswing in financial stress.

M2 has been increasing robustly of late, reflecting disenchantment of households with investments in stocks relative to the safety and liquidity of deposits and money funds. Although M2 is expected to decelerate in coming months, it should nonetheless rise substantially faster than nominal GDP over the second half of this year. In 2003, the growth of M2 is projected to slip below that of nominal spending, reflecting some unwinding of the portfolio shifts seen this year as financial markets become less volatile.

Alternative Simulations

In this section, we report the results of simulations using the FRB/US model to illustrate several important risks to the Greenbook forecast. In the first simulation, we consider the likely prospect that equity prices will evolve quite differently than we have assumed. For illustrative purposes, we have assumed that they reverse their 20 percent decline since early May; the implications of a further drop would be symmetric. The next scenario involves a stalling of business investment as firms turn out to be still more cautious in undertaking new capital spending projects. Our third scenario considers the implications of another possible source of a shortfall in aggregate demand—an abrupt

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

Measure	2002 H1	2002 H2	2003 H1	2003 H2
Real GDP				
Greenbook baseline	**3.0**	**2.5**	**3.4**	**3.7**
Stock market rebound	3.0	2.6	3.9	4.3
Weaker investment	3.0	2.0	2.7	2.7
Weaker consumption	3.0	0.9	2.2	3.2
Faster productivity	3.0	2.9	4.4	4.7
Low NAIRU	3.0	2.6	3.4	3.8
Market-based funds rate	3.0	2.5	3.6	3.8
Civilian unemployment rate[1]				
Greenbook baseline	**5.9**	**6.0**	**5.9**	**5.7**
Stock market rebound	5.9	6.0	5.8	5.4
Weaker investment	5.9	6.1	6.1	6.1
Weaker consumption	5.9	6.3	6.6	6.6
Faster productivity	5.9	6.0	5.9	5.5
Low NAIRU	5.9	6.0	5.9	5.6
Market-based funds rate	5.9	6.0	5.8	5.6
PCE prices excluding food and energy				
Greenbook baseline	**1.5**	**1.3**	**1.4**	**1.4**
Stock market rebound	1.5	1.3	1.4	1.5
Weaker investment	1.5	1.3	1.4	1.4
Weaker consumption	1.5	1.3	1.3	1.1
Faster productivity	1.5	1.3	1.3	1.2
Low NAIRU	1.5	1.2	1.1	1.0
Market-based funds rate	1.5	1.3	1.4	1.5

1. Average for the final quarter of the period.

deterioration in consumer confidence. The next two scenarios examine the effects of more favorable supply-side conditions, which are illustrated by faster structural productivity growth and a lower NAIRU than assumed in the baseline. Our final simulation shows the effects of a path for the funds rate that is in line with the one anticipated by the futures market.

Stock market rebound. The decline in stock market valuations over the past two years appears to have been associated with a sharp rise in the equity premium, and some measures of the premium now look high by historical standards. In this scenario, we consider the possibility that investor concerns about both the quality of reported corporate earnings and the riskiness of future earnings will rapidly dissipate. As a result, the equity premium falls appreciably, and equity prices rise 20 percent above the baseline forecast by the end of this quarter. Because investors see this stock market rebound as a signal that the stance of monetary policy will eventually be tighter than in the baseline, bond rates simultaneously increase about 35 basis points. On balance, these financial market developments—assuming no change in the nominal funds rate within the forecast period—both boost next year's rise in real GDP 1/2 percentage point and cause the unemployment rate by the end of 2003 to fall 1/4 percentage point, relative to baseline. However, the additional decrease in labor market slack occurs too late to have much of an effect on inflation over the forecast period. As noted above, the effects of a 20 percent decline would be roughly symmetric.

Weaker investment. In the staff projection, the overall economic recovery depends importantly on a resurgence in business investment. In light of the current high level of excess capacity in many sectors, however, businesses may be more reluctant than we have anticipated to undertake new capital projects. To illustrate this risk, we simulate the consequences of no change in the level of real outlays on business equipment and software through the end of this year and half the rate of increase we have projected in the baseline for next year. Assuming no adjustment in the funds rate, the stagnation in business spending keeps growth in real GDP well below its potential rate through next year, thereby pushing the unemployment rate up to 6.1 percent, where it remains through the end of 2003. Inflation is little changed from baseline because, despite the increase in labor market slack, the reduction in capital deepening weakens labor productivity.

Weaker consumption. Another possible source of a shortfall in aggregate demand would be a greater retrenchment in consumer spending. In this scenario, we assume that a substantial erosion in consumer confidence raises the personal saving rate 1 percentage point above our baseline projection by early next year. Assuming no change in the funds rate, GDP growth drops to less than 1 percent at an annual rate in the second half of this year before moving up to a 2-3/4 percent increase next year. The unemployment rate rises to 6-1/2 percent throughout 2003, and core inflation drops to a 1 percent annual rate by the end of next year.

Faster productivity. Even in the revised data, productivity growth has been extraordinarily robust, on average, since the fourth quarter of last year. Although we have taken some positive signal for structural productivity growth from this recent strength, we may not have taken on board enough. Accordingly, in this scenario, structural productivity rises 1/2 percentage point more quickly than in the baseline over the projection period. The implied increases in permanent income and expected earnings boost consumption, investment, and the stock market. Assuming no change in the funds rate, stronger aggregate spending translates into a 1 percentage point faster increase in real GDP in 2003. Because the rise in actual output outstrips the increase in potential, the unemployment rate falls 1/4 percentage point relative to baseline by the end of 2003. The reduction in unit labor costs resulting from faster productivity growth more than offsets the effects of lower unemployment on inflation, and core inflation slows to about 1 percent by the end of next year.

Low NAIRU. Reflecting the possibility that the staff's estimate of the NAIRU may still be too high, the next scenario assumes that the NAIRU is 4-1/4 percent. The lower NAIRU puts significant downward pressure on inflation. At the same time, because expected incomes are higher, aggregate spending is also boosted.

Market-based funds rate. Futures quotes are consistent with a modest easing in the funds rate over the rest of this year and then a noticeable tightening over 2003. The implications of this path for the outlook are not much different on balance from the flat profile assumed by the staff.

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Class II FOMC

August 7, 2002

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

Interval		Nominal GDP 06/19/02	Nominal GDP 08/07/02	Real GDP 06/19/02	Real GDP 08/07/02	GDP chain-weighted price index 06/19/02	GDP chain-weighted price index 08/07/02	Consumer price index[1] 06/19/02	Consumer price index[1] 08/07/02	Unemployment rate[2] 06/19/02	Unemployment rate[2] 08/07/02
ANNUAL											
1999		5.5	5.6	4.1	4.1	1.4	1.4	2.2	2.2	4.2	4.2
2000		6.5	5.9	4.1	3.8	2.3	2.1	3.4	3.4	4.0	4.0
2001		3.4	2.6	1.2	0.3	2.2	2.4	2.8	2.8	4.8	4.8
2002		3.6	3.4	2.5	2.3	1.1	1.1	1.5	1.5	5.9	5.9
2003		5.2	4.4	3.7	2.9	1.4	1.4	2.0	1.9	5.7	5.8
QUARTERLY											
2000	Q1	6.3	5.7	2.3	2.6	3.8	3.1	3.9	3.9	4.0	4.0
	Q2	8.0	7.3	5.7	4.8	2.1	2.3	3.3	3.3	4.0	4.0
	Q3	3.3	2.2	1.3	0.6	1.9	1.6	3.5	3.5	4.1	4.1
	Q4	3.7	3.2	1.9	1.1	1.8	2.1	2.8	2.8	4.0	4.0
2001	Q1	4.6	3.0	1.3	-0.6	3.3	3.7	4.0	4.0	4.2	4.2
	Q2	2.4	0.9	0.3	-1.6	2.1	2.5	3.2	3.2	4.5	4.5
	Q3	0.9	1.9	-1.3	-0.3	2.3	2.2	0.7	0.7	4.8	4.8
	Q4	1.5	2.2	1.7	2.7	-0.1	-0.5	-0.2	-0.2	5.6	5.6
2002	Q1	6.6	6.5	5.5	5.0	1.1	1.3	1.4	1.4	5.6	5.6
	Q2	3.2	2.3	1.8	1.2	1.3	1.2	3.4	3.4	5.9	5.9
	Q3	4.3	3.5	3.3	2.7	0.9	0.8	1.7	1.7	6.0	6.0
	Q4	4.9	3.4	3.5	2.2	1.4	1.3	2.1	1.9	5.9	6.0
2003	Q1	5.8	5.0	4.0	3.3	1.8	1.7	1.9	1.8	5.9	6.0
	Q2	5.5	4.8	4.1	3.4	1.4	1.4	1.9	1.8	5.7	5.9
	Q3	5.6	5.0	4.2	3.6	1.4	1.4	1.9	1.9	5.6	5.7
	Q4	5.6	5.3	4.2	3.8	1.4	1.4	1.9	1.9	5.5	5.7
TWO-QUARTER[3]											
2000	Q2	7.2	6.5	4.0	3.7	2.9	2.7	3.6	3.6	-0.1	-0.1
	Q4	3.5	2.7	1.6	0.8	1.8	1.9	3.3	3.3	0.0	0.0
2001	Q2	3.5	1.9	0.8	-1.1	2.7	3.1	3.5	3.5	0.5	0.5
	Q4	1.2	2.1	0.1	1.2	1.1	0.8	0.2	0.2	1.1	1.1
2002	Q2	4.9	4.4	3.6	3.1	1.2	1.3	2.4	2.4	0.3	0.3
	Q4	4.6	3.5	3.4	2.4	1.2	1.1	1.9	1.8	0.0	0.1
2003	Q2	5.7	4.9	4.0	3.3	1.6	1.6	1.9	1.8	-0.2	-0.1
	Q4	5.6	5.1	4.2	3.7	1.4	1.4	1.9	1.9	-0.2	-0.2
FOUR-QUARTER[4]											
1999	Q4	6.0	5.9	4.4	4.3	1.6	1.6	2.6	2.6	-0.3	-0.3
2000	Q4	5.3	4.6	2.8	2.3	2.4	2.3	3.4	3.4	-0.1	-0.1
2001	Q4	2.3	2.0	0.5	0.1	1.9	2.0	1.9	1.9	1.6	1.6
2002	Q4	4.7	3.9	3.5	2.7	1.2	1.2	2.1	2.1	0.3	0.4
2003	Q4	5.6	5.0	4.1	3.5	1.5	1.5	1.9	1.8	-0.4	-0.3

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

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

August 7, 2002

Item	Units[1]	1995	1996	1997	1998	1999	2000	2001	- - Projected - - 2002	2003
EXPENDITURES										
Nominal GDP	Bill. $	7400.5	7813.2	8318.4	8781.5	9274.3	9824.6	10082.2	10425.3	10879.4
Real GDP	Bill. Ch. $	7543.8	7813.2	8159.5	8508.9	8859.0	9191.4	9214.5	9427.2	9704.7
Real GDP	% change	2.2	4.1	4.3	4.8	4.3	2.3	0.1	2.7	3.5
Gross domestic purchases		1.7	4.3	5.0	5.8	5.2	2.9	0.1	3.3	3.6
Final sales		2.9	3.9	3.9	4.7	4.2	2.6	1.6	1.6	3.1
Priv. dom. final purchases		3.2	4.4	5.1	6.3	5.2	3.7	0.9	1.9	3.2
Personal cons. expenditures		2.8	3.1	4.1	5.0	5.0	3.5	2.8	2.5	2.5
Durables		3.7	5.0	8.8	12.7	10.0	3.8	13.2	1.0	4.4
Nondurables		2.5	3.2	2.5	5.0	4.9	3.0	1.7	2.8	2.6
Services		2.7	2.7	3.9	3.6	4.0	3.8	1.3	2.6	2.1
Business fixed investment		7.5	12.1	11.8	12.3	6.6	6.2	-9.3	-1.7	9.6
Equipment & Software		8.9	11.8	13.7	14.9	9.7	5.2	-8.8	2.8	12.9
Nonres. structures		3.3	12.8	6.5	4.9	-2.5	9.3	-10.6	-14.4	-1.0
Residential structures		-1.5	5.6	3.5	10.0	4.0	-1.2	1.0	2.6	-0.5
Exports		9.7	9.8	8.5	2.3	4.9	7.3	-11.4	6.8	8.2
Imports		5.0	11.2	14.3	10.8	11.9	11.1	-8.0	10.0	7.3
Gov't. cons. & investment		-0.8	2.7	2.4	2.7	4.5	1.3	5.1	3.5	2.9
Federal		-5.3	2.0	0.1	0.6	4.0	-1.2	7.5	6.6	3.1
Defense		-4.7	0.8	-1.4	-0.8	4.4	-2.5	7.4	7.1	2.9
State & local		2.1	3.0	3.7	3.8	4.8	2.6	3.9	1.8	2.8
Change in bus. inventories	Bill. Ch. $	30.4	30.0	63.8	76.7	62.8	65.0	-61.4	0.5	48.7
Nonfarm		41.9	21.2	60.6	75.0	64.1	67.2	-63.2	-1.6	47.2
Net exports		-78.4	-89.0	-113.3	-221.1	-320.5	-398.8	-415.9	-486.8	-522.5
Nominal GDP	% change	4.3	6.0	6.2	6.0	5.9	4.6	2.0	3.9	5.0
EMPLOYMENT AND PRODUCTION										
Nonfarm payroll employment	Millions	117.2	119.6	122.7	125.9	128.9	131.7	131.9	130.9	132.7
Unemployment rate	%	5.6	5.4	4.9	4.5	4.2	4.0	4.8	5.9	5.8
Industrial prod. index	% change	3.5	5.8	7.4	3.5	4.3	2.6	-5.9	3.1	4.7
Capacity util. rate - mfg.	%	82.6	81.6	82.7	81.4	80.6	80.7	75.1	74.2	76.3
Housing starts	Millions	1.35	1.48	1.47	1.62	1.64	1.57	1.60	1.67	1.66
Light motor vehicle sales		14.77	15.05	15.06	15.43	16.78	17.24	17.02	16.69	16.88
North Amer. produced		12.87	13.34	13.12	13.42	14.30	14.38	13.94	13.37	13.55
Other		1.90	1.70	1.93	2.01	2.48	2.86	3.08	3.33	3.33
INCOME AND SAVING										
Nominal GNP	Bill. $	7420.9	7831.2	8325.4	8778.1	9297.1	9848.0	10104.1	10429.7	10885.0
Nominal GNP	% change	4.4	5.9	6.0	5.8	6.4	4.6	2.1	3.6	5.0
Nominal personal income		4.3	5.9	6.3	6.7	5.1	7.7	1.4	4.4	4.5
Real disposable income		1.7	2.6	3.8	5.0	2.4	4.8	0.3	5.8	2.0
Personal saving rate	%	5.6	4.8	4.2	4.7	2.6	2.8	2.3	3.8	3.9
Corp. profits, IVA & CCAdj.	% change	11.3	11.4	9.9	-9.6	7.0	-9.1	8.2	-2.5	3.3
Profit share of GNP	%	9.0	9.6	10.0	8.9	8.7	8.0	7.2	7.6	7.4
Excluding FR Banks		8.7	9.4	9.7	8.6	8.4	7.7	7.0	7.4	7.1
Federal surpl./deficit	Bill. $	-192.0	-136.8	-53.3	43.8	111.9	206.9	72.0	-182.8	-153.1
State & local surpl./def.		15.3	21.4	31.0	40.7	38.3	18.0	-31.3	-44.0	-12.0
Ex. social ins. funds		11.4	18.7	29.9	40.0	37.4	17.8	-31.2	-43.9	-11.9
Gross natl. saving rate	%	16.9	17.2	18.0	18.8	18.3	18.4	16.5	15.6	16.3
Net natl. saving rate		5.1	5.7	6.7	7.5	6.8	6.7	3.8	2.5	3.1
PRICES AND COSTS										
GDP chn.-wt. price index	% change	2.1	1.9	1.8	1.1	1.6	2.3	2.0	1.2	1.5
Gross Domestic Purchases chn.-wt. price index		2.1	1.9	1.4	0.8	1.9	2.5	1.3	1.5	1.5
PCE chn.-wt. price index		2.1	2.3	1.5	1.1	2.0	2.5	1.5	1.6	1.4
Ex. food and energy		2.3	1.8	1.7	1.6	1.5	1.8	1.9	1.4	1.4
CPI		2.6	3.2	1.9	1.5	2.6	3.4	1.9	2.1	1.8
Ex. food and energy		3.1	2.6	2.2	2.3	2.1	2.5	2.7	2.1	2.1
ECI, hourly compensation[2]		2.6	3.1	3.4	3.5	3.4	4.4	4.2	3.8	3.4
Nonfarm business sector										
Output per hour		1.1	2.2	2.4	2.9	2.8	2.1	2.0	2.8	1.3
Compensation per Hour		2.6	3.2	3.5	5.3	4.3	7.2	1.4	3.3	3.2
Unit labor cost		1.5	0.9	1.1	2.3	1.4	4.9	-0.7	0.4	1.8

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)

August 7, 2002

Item	Units	1999 Q1	1999 Q2	1999 Q3	1999 Q4	2000 Q1	2000 Q2	2000 Q3	2000 Q4	2001 Q1	2001 Q2
EXPENDITURES											
Nominal GDP	Bill. $	9092.7	9171.7	9316.5	9516.4	9649.5	9820.7	9874.8	9953.6	10028.1	10049.9
Real GDP	Bill. Ch. $	8733.2	8775.5	8886.9	9040.1	9097.4	9205.7	9218.7	9243.8	9229.9	9193.1
Real GDP	% change	3.0	2.0	5.2	7.1	2.6	4.8	0.6	1.1	-0.6	-1.6
Gross domestic purchases		4.8	3.3	5.8	6.8	3.6	5.7	1.2	1.3	-1.1	-1.1
Final sales		3.1	4.1	4.3	5.2	4.4	3.1	1.7	1.3	2.8	-0.4
Priv. dom. final purchases		5.3	6.0	4.9	4.6	6.8	3.8	3.1	1.1	1.5	-1.2
Personal cons. expenditures		4.7	5.7	4.6	5.0	5.3	3.0	3.8	2.1	2.4	1.4
Durables		5.5	14.4	10.3	10.1	17.8	-3.7	8.1	-5.3	11.5	5.3
Nondurables		4.9	4.8	2.5	7.5	2.2	4.9	2.0	2.7	2.3	-0.3
Services		4.4	4.4	4.5	2.8	4.4	3.6	3.9	3.3	0.6	1.5
Business fixed investment		7.7	7.9	7.7	3.0	15.0	10.2	3.5	-3.2	-5.4	-14.5
Equipment & Software		12.0	12.5	12.5	2.1	15.5	10.9	0.9	-5.4	-6.3	-16.7
Nonres. structures		-4.1	-5.1	-6.3	6.1	13.8	8.2	12.1	3.6	-3.1	-8.4
Residential structures		7.6	4.9	0.9	2.7	8.3	-3.0	-9.3	0.0	8.2	-0.5
Exports		-6.9	4.3	10.6	12.6	7.7	14.6	11.6	-4.0	-6.0	-12.4
Imports		8.4	15.4	14.5	9.4	14.7	18.6	13.8	-1.6	-7.9	-6.8
Gov't. cons. & investment		3.0	2.9	5.3	7.1	-1.2	4.6	-1.0	2.9	5.7	5.6
Federal		-3.3	2.6	7.4	9.9	-13.2	16.0	-7.2	2.0	9.5	6.0
Defense		-5.2	-0.2	14.0	10.0	-19.9	15.0	-6.1	4.7	8.3	2.7
State & local		6.5	3.0	4.2	5.6	5.6	-0.8	2.4	3.3	3.8	5.4
Change in bus. inventories	Bill. Ch. $	80.0	31.2	47.6	92.2	45.3	91.5	63.1	59.9	-26.9	-58.3
Nonfarm		71.1	30.1	58.7	96.7	58.9	88.6	64.6	56.8	-32.6	-54.9
Net exports		-283.2	-319.6	-339.6	-339.5	-368.8	-394.6	-413.1	-418.5	-404.5	-414.8
Nominal GDP	% change	4.9	3.5	6.5	8.9	5.7	7.3	2.2	3.2	3.0	0.9
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	127.8	128.5	129.2	130.1	131.0	131.8	131.9	132.2	132.4	132.2
Unemployment rate	%	4.3	4.3	4.2	4.1	4.0	4.0	4.1	4.0	4.2	4.5
Industrial prod. index	% change	3.6	3.3	4.7	5.8	5.8	7.0	0.6	-2.6	-6.1	-5.9
Capacity util. rate - mfg.	%	80.5	80.4	80.5	81.0	81.2	81.6	80.7	79.1	77.2	75.6
Housing starts	Millions	1.71	1.57	1.65	1.66	1.66	1.59	1.50	1.54	1.61	1.62
Light motor vehicle sales		16.19	16.60	17.14	17.17	18.15	17.14	17.42	16.26	16.95	16.54
North Amer. produced		13.95	14.20	14.65	14.39	15.29	14.27	14.56	13.41	14.04	13.51
Other		2.24	2.40	2.49	2.78	2.86	2.87	2.86	2.85	2.90	3.04
INCOME AND SAVING											
Nominal GNP	Bill. $	9112.7	9195.9	9333.6	9546.0	9670.5	9846.4	9892.5	9982.8	10038.0	10081.0
Nominal GNP	% change	6.3	3.7	6.1	9.4	5.3	7.5	1.9	3.7	2.2	1.7
Nominal personal income		4.3	3.5	4.5	8.0	13.2	6.9	6.8	4.2	3.9	0.8
Real disposable income		2.7	0.8	1.5	4.8	8.4	4.8	4.3	1.8	-0.1	-0.6
Personal saving rate	%	3.9	2.7	2.0	1.9	2.6	2.9	2.9	2.9	2.4	1.9
Corp. profits, IVA & CCAdj.	% change	20.9	-3.0	-6.8	20.0	-8.0	-0.1	-9.4	-17.9	-21.1	8.7
Profit share of GNP	%	8.9	8.7	8.4	8.6	8.4	8.2	8.0	7.5	7.0	7.2
Excluding FR Banks		8.6	8.5	8.2	8.3	8.0	7.9	7.7	7.2	6.7	6.9
Federal surpl./deficit	Bill. $	88.7	112.9	117.4	128.8	223.2	197.2	213.2	193.8	173.8	144.4
State & local surpl./def.		48.4	31.3	33.8	39.6	32.7	20.2	19.2	-0.2	-16.5	-32.3
Ex. social ins. funds		47.5	30.3	32.9	38.8	32.2	20.0	19.2	-0.1	-16.4	-32.2
Gross natl. saving rate	%	19.1	18.4	17.9	17.9	18.8	18.4	18.5	17.8	16.9	16.6
Net natl. saving rate		7.8	6.9	6.1	6.4	7.3	6.9	6.8	5.9	4.8	4.1
PRICES AND COSTS											
GDP chn.-wt. price index	% change	1.8	1.5	1.2	1.7	3.1	2.3	1.6	2.1	3.7	2.5
Gross Domestic Purchases chn.-wt. price index		1.4	2.1	1.9	2.2	3.7	2.2	2.2	2.1	3.3	1.7
PCE chn.-wt. price index		1.2	2.3	2.2	2.4	3.4	2.3	2.1	2.2	3.3	1.8
Ex. food and energy		1.3	1.4	1.5	1.7	2.2	1.8	1.3	1.8	2.8	1.2
CPI		1.5	2.9	2.7	3.4	3.9	3.3	3.5	2.8	4.0	3.2
Ex. food and energy		1.8	1.8	1.8	2.7	2.3	2.7	2.7	2.4	3.1	2.4
ECI, hourly compensation[1]		1.1	4.6	3.7	4.3	5.6	4.7	4.1	3.5	4.6	4.0
Nonfarm business sector											
Output per hour		2.2	-0.7	3.7	6.3	0.1	6.1	0.7	1.7	-1.5	0.1
Compensation per hour		7.3	0.5	3.7	5.8	15.1	2.3	8.7	3.3	2.9	0.1
Unit labor cost		5.1	1.2	0.0	-0.5	15.0	-3.8	8.0	1.6	4.5	0.0

1. Private-industry workers.

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

August 7, 2002

Item	Units	2001 Q3	2001 Q4	2002 Q1	2002 Q2	2002 Q3	2002 Q4	2003 Q1	2003 Q2	2003 Q3	2003 Q4
					------ Projected ------						
EXPENDITURES											
Nominal GDP	Bill. $	10097.7	10152.9	10313.1	10372.9	10463.2	10552.2	10682.3	10809.2	10942.7	11083.6
Real GDP	Bill. Ch. $	9186.4	9248.8	9363.2	9390.5	9452.3	9502.9	9579.6	9659.4	9744.5	9835.3
Real GDP	% change	-0.3	2.7	5.0	1.2	2.7	2.2	3.3	3.4	3.6	3.8
Gross domestic purchases		-0.1	2.9	5.6	2.8	2.9	1.9	3.5	3.7	3.7	3.5
Final sales		-0.2	4.2	2.4	-0.3	2.6	1.9	2.7	2.8	3.3	3.7
Priv. dom. final purchases		0.3	3.0	2.5	1.3	2.7	1.2	2.8	3.1	3.5	3.5
Personal cons. expenditures		1.5	6.0	3.1	1.9	3.7	1.2	2.4	2.4	2.6	2.6
Durables		4.6	33.6	-6.3	2.4	16.3	-6.6	5.7	3.1	4.4	4.5
Nondurables		1.3	3.6	7.9	-0.5	1.7	2.4	2.5	2.5	2.6	2.6
Services		0.9	2.1	2.9	3.0	2.3	2.3	1.7	2.2	2.2	2.3
Business fixed investment		-6.0	-10.9	-5.8	-3.3	-0.9	3.3	8.1	8.7	10.8	10.9
Equipment & Software		-9.2	-2.5	-2.7	2.8	4.3	7.1	12.1	12.0	14.0	13.4
Nonres. structures		2.9	-30.1	-14.2	-19.3	-15.6	-8.1	-4.4	-1.8	0.1	2.4
Residential structures		0.4	-3.5	14.2	4.1	-2.8	-4.2	-2.8	1.2	1.0	-1.3
Exports		-17.3	-9.6	3.5	11.0	4.4	8.5	5.7	8.2	8.5	10.6
Imports		-11.8	-5.3	8.5	22.3	5.6	4.4	6.4	8.9	7.9	6.1
Gov't. cons. & investment		-1.1	10.5	5.6	1.4	3.4	3.5	3.1	2.9	2.8	2.9
Federal		1.2	13.5	7.4	7.4	6.3	5.4	4.0	3.2	2.6	2.5
Defense		4.6	14.3	11.6	8.0	5.0	4.1	3.9	3.2	2.4	2.1
State & local		-2.3	8.9	4.6	-1.6	1.9	2.4	2.6	2.8	2.9	3.1
Change in bus. inventories	Bill. Ch. $	-61.8	-98.4	-28.9	7.2	8.1	15.4	31.1	47.5	56.4	59.7
Nonfarm		-63.6	-101.5	-35.1	4.9	8.7	15.0	30.1	46.0	54.8	57.9
Net exports		-419.0	-425.3	-446.6	-495.4	-505.1	-500.2	-509.8	-522.4	-531.1	-526.8
Nominal GDP	% change	1.9	2.2	6.5	2.3	3.5	3.4	5.0	4.8	5.0	5.3
EMPLOYMENT AND PRODUCTION											
Nonfarm payroll employment	Millions	131.9	131.1	130.8	130.7	130.9	131.3	131.8	132.4	133.0	133.6
Unemployment rate	%	4.8	5.6	5.6	5.9	6.0	6.0	6.0	5.9	5.7	5.7
Industrial prod. index	% change	-4.7	-6.7	2.6	4.6	3.7	1.5	4.8	4.8	5.1	4.2
Capacity util. rate - mfg.	%	74.5	73.1	73.5	74.1	74.5	74.7	75.3	76.0	76.8	77.3
Housing starts	Millions	1.60	1.57	1.73	1.66	1.65	1.64	1.65	1.66	1.67	1.67
Light motor vehicle sales		16.23	18.37	16.34	16.35	17.29	16.80	16.80	16.80	16.95	16.95
North Amer. produced		13.23	15.00	13.04	13.10	13.88	13.45	13.50	13.50	13.60	13.60
Other		3.00	3.37	3.31	3.25	3.41	3.35	3.30	3.30	3.35	3.35
INCOME AND SAVING											
Nominal GNP	Bill. $	10109.3	10188.1	10314.9	10377.4	10468.4	10558.1	10687.9	10814.5	10949.4	11088.4
Nominal GNP	% change	1.1	3.2	5.1	2.4	3.6	3.5	5.0	4.8	5.1	5.2
Nominal personal income		1.4	-0.2	5.1	5.1	3.8	3.5	5.7	4.2	3.7	4.2
Real disposable income		10.5	-7.6	14.6	3.9	2.9	2.2	2.7	2.1	1.4	2.1
Personal saving rate	%	4.0	0.8	3.5	3.9	3.8	4.0	4.1	4.1	3.8	3.7
Corp. profits, IVA & CCAdj.	% change	-17.7	94.4	-6.6	3.0	-5.8	-0.3	-0.5	2.1	4.6	7.3
Profit share of GNP	%	6.8	8.0	7.7	7.7	7.6	7.5	7.4	7.3	7.3	7.4
Excluding FR Banks		6.5	7.7	7.5	7.5	7.3	7.3	7.2	7.1	7.1	7.2
Federal surpl./deficit	Bill. $	-51.7	21.3	-143.5	-182.9	-191.0	-213.8	-189.8	-168.7	-132.3	-121.8
State & local surpl./def.		-46.2	-30.2	-51.7	-42.9	-45.5	-35.9	-25.6	-17.2	-7.3	2.0
Ex. social ins. funds		-46.1	-30.0	-51.6	-42.8	-45.4	-35.8	-25.5	-17.1	-7.2	2.1
Gross natl. saving rate	%	16.5	15.8	15.6	15.7	15.5	15.6	16.0	16.2	16.5	16.7
Net natl. saving rate		3.3	3.1	2.8	2.7	2.3	2.4	2.8	3.0	3.3	3.4
PRICES AND COSTS											
GDP chn.-wt. price index	% change	2.2	-0.5	1.3	1.2	0.8	1.3	1.7	1.4	1.4	1.4
Gross Domestic Purchases chn.-wt. price index		-0.2	0.4	1.2	2.2	1.3	1.5	1.8	1.4	1.4	1.4
PCE chn.-wt. price index		-0.1	0.8	1.1	2.5	1.2	1.4	1.3	1.3	1.4	1.4
Ex. food and energy		0.7	2.7	1.4	1.6	1.1	1.4	1.4	1.4	1.4	1.4
CPI		0.7	-0.2	1.4	3.4	1.7	1.9	1.8	1.8	1.9	1.9
Ex. food and energy		2.6	2.6	2.4	2.1	1.7	2.2	2.1	2.1	2.1	2.1
ECI, hourly compensation[1]		3.7	4.2	3.6	4.4	3.7	3.5	3.5	3.4	3.4	3.4
Nonfarm business sector											
Output per hour		2.2	7.3	8.3	1.3	1.9	0.1	1.0	1.1	1.4	1.9
Compensation per hour		1.1	1.5	3.6	3.3	3.2	3.2	3.2	3.1	3.1	3.1
Unit labor cost		-1.1	-5.7	-4.8	2.0	1.3	3.1	2.2	2.0	1.7	1.3

1. Private-industry workers.

Item	1999 Q3	1999 Q4	2000 Q1	2000 Q2	2000 Q3	2000 Q4	2001 Q1	2001 Q2	2001 Q3	99Q4/ 98Q4	00Q4/ 99Q4	01Q4/ 00Q4
Real GDP	5.2	7.1	2.6	4.8	0.6	1.1	-0.6	-1.6	-0.3	4.3	2.3	0.1
Gross dom. purchases	5.9	7.0	3.7	5.8	1.3	1.3	-1.1	-1.2	-0.1	5.3	3.0	0.2
Final sales	4.3	5.3	4.3	3.1	1.7	1.2	2.7	-0.5	-0.2	4.1	2.6	1.6
Priv. dom. final purchases	4.1	4.0	5.6	3.2	2.6	1.0	1.2	-1.0	0.3	4.3	3.1	0.8
Personal cons. expenditures	3.1	3.5	3.5	2.1	2.5	1.4	1.5	0.9	1.0	3.3	2.4	1.9
Durables	0.8	0.8	1.4	-0.3	0.6	-0.4	0.9	0.4	0.4	0.8	0.3	1.0
Nondurables	0.5	1.5	0.5	1.0	0.4	0.5	0.5	-0.1	0.3	1.0	0.6	0.3
Services	1.8	1.2	1.7	1.4	1.5	1.3	0.2	0.6	0.4	1.6	1.5	0.5
Business fixed investment	1.0	0.4	1.8	1.3	0.5	-0.4	-0.7	-1.9	-0.7	0.8	0.8	-1.2
Equipment & Software	1.2	0.2	1.4	1.0	0.1	-0.5	-0.6	-1.6	-0.8	0.9	0.5	-0.8
Nonres. structures	-0.2	0.2	0.4	0.3	0.4	0.1	-0.1	-0.3	0.1	-0.1	0.3	-0.4
Residential structures	0.0	0.1	0.4	-0.1	-0.4	0.0	0.3	-0.0	0.0	0.2	-0.1	0.0
Net exports	-0.8	0.0	-1.2	-1.0	-0.7	-0.2	0.5	-0.4	-0.2	-1.0	-0.8	-0.1
Exports	1.1	1.3	0.8	1.5	1.3	-0.5	-0.7	-1.4	-1.9	0.5	0.8	-1.3
Imports	-1.8	-1.3	-2.0	-2.5	-2.0	0.2	1.2	1.0	1.7	-1.5	-1.5	1.2
Government cons. & invest.	0.9	1.3	-0.2	0.8	-0.2	0.5	1.0	1.0	-0.2	0.8	0.2	0.9
Federal	0.4	0.6	-0.9	0.9	-0.5	0.1	0.5	0.4	0.1	0.2	-0.1	0.4
Defense	0.5	0.4	-0.9	0.5	-0.2	0.2	0.3	0.1	0.2	0.2	-0.1	0.3
Nondefense	-0.1	0.2	0.0	0.4	-0.2	-0.1	0.2	0.3	-0.1	0.1	0.0	0.2
State and local	0.5	0.7	0.7	-0.1	0.3	0.4	0.5	0.6	-0.3	0.6	0.3	0.5
Change in bus. inventories	0.8	1.8	-1.8	1.8	-1.1	-0.1	-3.3	-1.1	-0.1	0.2	-0.3	-1.5
Nonfarm	1.3	1.6	-1.5	1.2	-1.0	-0.3	-3.4	-0.8	-0.3	0.2	-0.4	-1.6
Farm	-0.5	0.2	-0.3	0.6	-0.2	0.2	0.2	-0.3	0.2	-0.1	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	2001 Q4	2002 Q1	2002 Q2	2002 Q3	2002 Q4	2003 Q1	2003 Q2	2003 Q3	2003 Q4	01Q4/ 00Q4	02Q4/ 01Q4	03Q4/ 02Q4
Real GDP	2.7	5.0	1.2	2.7	2.2	3.3	3.4	3.6	3.8	0.1	2.7	3.5
Gross dom. purchases	3.0	5.8	2.9	3.0	2.0	3.6	3.8	3.9	3.6	0.2	3.4	3.7
Final sales	4.1	2.5	-0.3	2.6	1.9	2.7	2.8	3.2	3.7	1.6	1.7	3.1
Priv. dom. final purchases	2.6	2.2	1.1	2.3	1.0	2.4	2.6	3.0	2.9	0.8	1.7	2.8
Personal cons. expenditures	4.1	2.2	1.3	2.6	0.9	1.7	1.7	1.8	1.8	1.9	1.7	1.8
Durables	2.5	-0.6	0.2	1.3	-0.6	0.5	0.3	0.4	0.4	1.0	0.1	0.4
Nondurables	0.7	1.6	-0.1	0.3	0.5	0.5	0.5	0.5	0.5	0.3	0.6	0.5
Services	0.9	1.2	1.2	0.9	1.0	0.7	0.9	0.9	1.0	0.5	1.1	0.9
Business fixed investment	-1.3	-0.7	-0.4	-0.1	0.3	0.8	0.9	1.1	1.2	-1.2	-0.2	1.0
Equipment & Software	-0.2	-0.2	0.2	0.3	0.6	1.0	1.0	1.1	1.1	-0.8	0.2	1.0
Nonres. structures	-1.1	-0.4	-0.6	-0.4	-0.2	-0.1	-0.0	0.0	0.1	-0.4	-0.4	-0.0
Residential structures	-0.2	0.6	0.2	-0.1	-0.2	-0.1	0.1	0.0	-0.1	0.0	0.1	-0.0
Net exports	-0.3	-0.8	-1.7	-0.3	0.2	-0.3	-0.4	-0.3	0.2	-0.1	-0.7	-0.2
Exports	-1.0	0.3	1.0	0.4	0.8	0.6	0.8	0.8	1.0	-1.3	0.7	0.8
Imports	0.7	-1.1	-2.7	-0.8	-0.6	-0.9	-1.2	-1.1	-0.9	1.2	-1.3	-1.0
Government cons. & invest.	1.9	1.0	0.3	0.6	0.7	0.6	0.6	0.5	0.6	0.9	0.6	0.6
Federal	0.8	0.5	0.5	0.4	0.4	0.3	0.2	0.2	0.2	0.4	0.4	0.2
Defense	0.5	0.5	0.3	0.2	0.2	0.2	0.1	0.1	0.1	0.3	0.3	0.1
Nondefense	0.3	0.0	0.1	0.2	0.2	0.1	0.1	0.1	0.1	0.2	0.1	0.1
State and local	1.1	0.6	-0.2	0.2	0.3	0.3	0.3	0.4	0.4	0.5	0.2	0.4
Change in bus. inventories	-1.4	2.6	1.4	0.0	0.3	0.6	0.6	0.3	0.1	-1.5	1.1	0.4
Nonfarm	-1.4	2.5	1.5	0.1	0.2	0.6	0.6	0.3	0.1	-1.6	1.1	0.4
Farm	0.1	0.1	-0.1	-0.1	0.0	0.0	0.0	-0.0	0.0	0.0	-0.0	0.0

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

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

Item	Fiscal year[1]				2001				2002				2003			
	2000[a]	2001[a]	2002	2003	Q1[a]	Q2[a]	Q3[a]	Q4[a]	Q1[a]	Q2[a]	Q3	Q4	Q1	Q2	Q3	Q4
Unified budget					Not seasonally adjusted											
Receipts[2]	2025	1991	1852	1929	460	660	409	466	413	523	450	427	429	596	477	465
Outlays[2]	1789	1864	2013	2114	482	467	451	503	509	507	493	534	537	529	514	550
Surplus/deficit[2]	236	127	-161	-186	-22	194	-42	-37	-97	16	-43	-108	-108	67	-37	-85
On-budget	87	-33	-322	-355	-88	119	-51	-81	-127	-58	-56	-147	-147	-8	-53	-130
Off-budget	150	161	160	169	65	75	10	44	30	73	13	39	39	75	16	45
Surplus excluding deposit insurance	233	126	-161	-186	-23	193	-42	-37	-96	15	-43	-108	-108	67	-37	-85
Means of financing																
Borrowing	-223	-90	206	186	24	-157	69	60	51	21	74	92	100	-34	28	80
Cash decrease	4	8	-1	-0	-7	-15	-1	-8	38	-26	-5	10	5	-30	15	15
Other[3]	-18	-45	-44	0	6	-21	-26	-14	8	-11	-26	6	3	-4	-6	-10
Cash operating balance, end of period	53	44	45	45	28	44	44	52	14	40	45	35	30	60	45	30
NIPA federal sector					Seasonally adjusted annual rates											
Receipts	2001	2024	1916	1972	2073	2072	1896	1992	1887	1890	1896	1909	1957	1993	2030	2070
Expenditures	1810	1909	2041	2148	1899	1928	1948	1971	2031	2074	2087	2123	2147	2162	2162	2192
Consumption expenditures	490	517	569	611	517	525	528	544	566	580	586	595	611	617	621	626
Defense	321	337	374	399	338	340	343	356	372	382	385	389	399	403	406	409
Nondefense	169	180	195	212	179	185	185	188	194	198	201	206	212	214	215	217
Other spending	1320	1392	1471	1537	1382	1403	1420	1428	1464	1493	1501	1528	1535	1545	1541	1566
Current account surplus	191	115	-124	-176	174	144	-52	21	-144	-183	-191	-214	-190	-169	-132	-122
Gross investment	97	98	107	117	96	100	100	103	106	107	113	115	116	118	120	121
Current and capital account surplus	94	17	-231	-293	78	45	-151	-82	-249	-290	-304	-328	-306	-287	-252	-243
Fiscal indicators[4]																
High-employment (HEB) surplus/deficit	-33	-39	-231	-293	3	6	-160	-81	-256	-288	-301	-323	-304	-287	-258	-256
Change in HEB, percent of potential GDP	-.7	0	2	.5	-.1	-0	2	-.8	2	.3	.1	.2	-.2	-.2	-.3	-0
Fiscal impetus (FI) percent, calendar year	2	11	22	11	4	3	10	-2	11	6	1	4	4	2	-.6	1

1. Fiscal year data for the unified budget come from OMB; quarterly data come from the Monthly Treasury Statement and may not sum to OMB fiscal year totals.
2. OMB's July 2002 baseline surplus estimates are -$165 billion in FY 2002 and -$62 billion in FY 2003. CBO's April 2002 baseline surplus estimates, which includes the March 2002 stimulus bill, are -$46 billion in FY 2002 and -$40 billion in FY 2003. Budget receipts, outlays, and surplus/deficit include corresponding social security (OASDI) categories. The OASDI surplus and the Postal Service surplus are excluded from the on-budget surplus and shown separately as off-budget, as classified under current law.
3. Other means of financing are checks issued less checks paid, accrued items, and changes in other financial assets and liabilities.
4. HEB is the NIPA current and capital account surplus in current dollars, with cyclically sensitive receipts and outlays adjusted to the level of potential output associated with an unemployment rate of 6 percent. Quarterly figures for change in HEB and FI are not at annual rates. The sign on Change in HEB, as a percent of nominal potential GDP, is reversed. FI is the weighted difference of discretionary changes in federal spending and taxes in chained (1996) dollars, scaled by real federal consumption plus investment. For FI and the change in HEB, negative values indicate aggregate demand restraint.
a--Actual

Change in Debt of the Domestic Nonfinancial Sectors
(Percent)

Period[1]	Total	Federal government	Nonfederal							Memo: Nominal GDP
			Total	Households			Business	State and local governments		
				Total	Home mortgages	Consumer credit				
Year										
1996	5.4	4.0	5.8	7.0	6.8	8.1	6.2	-0.6		6.0
1997	5.6	0.6	7.3	6.4	6.7	4.7	9.0	5.3		6.2
1998	6.8	-1.4	9.6	8.2	8.9	5.9	11.8	7.2		6.0
1999	6.6	-1.9	9.1	8.3	9.0	7.4	11.0	4.4		5.9
2000	5.0	-8.0	8.4	8.4	8.2	9.6	9.8	2.2		4.6
2001	6.0	-0.2	7.5	8.7	9.8	6.9	6.0	8.1		2.0
2002	5.9	7.0	5.7	8.0	8.8	6.0	2.8	7.2		3.9
2003	5.8	4.8	6.0	6.6	7.3	5.5	5.6	5.2		5.0
Quarter										
2001:1	5.3	-0.1	6.6	7.4	7.6	9.1	5.4	8.1		3.0
2	5.3	-7.6	8.2	9.3	11.4	4.7	7.0	8.3		0.9
3	7.1	7.7	6.9	8.8	9.5	4.3	5.7	3.2		1.9
4	5.9	-0.5	7.3	8.3	9.4	9.0	5.3	11.7		2.2
2002:1	5.2	3.3	5.5	9.0	10.1	4.7	1.8	4.6		6.5
2	7.0	13.9	5.5	7.4	8.2	6.2	1.9	13.1		2.3
3	5.9	7.6	5.5	7.6	8.0	6.9	3.2	5.7		3.5
4	5.1	2.7	5.6	6.9	7.6	5.7	4.3	4.7		3.4
2003:1	6.2	8.6	5.7	6.4	7.3	5.6	4.9	5.7		5.0
2	6.1	6.9	5.9	6.3	7.1	5.4	5.5	5.1		4.8
3	5.3	2.2	6.0	6.5	7.1	5.3	5.6	5.0		5.0
4	5.1	1.3	5.9	6.4	7.1	5.2	5.7	4.5		5.3

Note. Quarterly data are at seasonally adjusted annual rates.
1. Data after 2002:Q1 are staff projections. Changes are measured from end of the preceding period to end of period indicated except for annual nominal GDP growth, which is calculated from Q4 to Q4.

2.6.3 FOF

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

					Seasonally adjusted annual rates									
	Calendar year				2001		2002				2003			
Category	2000	2001	2002	2003	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Net funds raised by domestic nonfinancial sectors														
1 Total	702.1	1046.3	1151.1	1131.9	1202.1	1119.7	1019.6	1448.4	1139.4	997.2	1237.9	1212.9	1059.0	1017.7
2 Net equity issuance	-159.7	-57.5	4.0	-60.2	-126.4	-7.3	20.2	74.5	-41.6	-37.3	-42.3	-52.1	-66.5	-79.9
3 Net debt issuance	861.8	1103.7	1147.2	1192.1	1328.5	1127.0	999.4	1373.9	1181.0	1034.5	1280.2	1265.0	1125.5	1097.6
Borrowing sectors														
Nonfinancial business														
4 Financing gap [1]	328.9	135.1	84.5	142.5	105.2	-9.7	64.0	87.0	87.7	99.4	119.6	138.6	149.9	162.0
5 Net equity issuance	-159.7	-57.5	4.0	-60.2	-126.4	-7.3	20.2	74.5	-41.6	-37.3	-42.3	-52.1	-66.5	-79.9
6 Credit market borrowing	584.6	391.4	196.7	395.9	381.2	365.2	127.4	132.7	221.5	305.2	350.9	398.9	409.9	423.7
Households														
7 Net borrowing [2]	545.9	614.6	613.3	545.3	648.6	622.0	695.8	584.0	609.1	564.3	535.1	534.1	556.9	555.0
8 Home mortgages	373.6	480.9	473.1	430.0	486.0	493.7	546.3	455.5	453.2	437.2	427.2	424.2	428.2	440.2
9 Consumer credit	139.0	110.2	101.7	99.2	70.6	149.9	79.9	106.2	120.0	100.6	100.5	99.4	99.2	97.8
10 Debt/DPI (percent) [3]	95.4	99.9	102.3	105.7	99.1	103.0	101.5	101.9	102.8	103.7	104.4	105.2	106.1	106.9
State and local governments														
11 Net borrowing	27.2	103.2	99.2	76.8	43.0	157.5	64.2	182.7	81.8	68.2	84.8	76.8	76.8	68.8
12 Current surplus [4]	177.0	141.4	136.7	176.1	132.5	144.1	129.7	135.4	134.9	146.7	159.2	169.8	182.0	193.4
Federal government														
13 Net borrowing	-295.9	-5.6	238.0	174.2	255.7	-17.6	112.0	474.5	268.6	96.8	309.4	255.3	81.9	50.1
14 Net borrowing (quarterly, n.s.a.)	-295.9	-5.6	238.0	174.2	68.6	59.5	50.8	21.1	74.2	91.9	100.1	-33.7	27.5	80.2
15 Unified deficit (quarterly, n.s.a.)	-254.8	-92.3	232.1	163.0	41.9	37.1	96.6	-15.6	43.3	107.9	108.2	-67.4	37.0	85.2
Depository institutions														
16 Funds supplied	445.3	286.3	309.1	302.0	306.6	410.9	255.2	375.3	328.3	277.7	196.4	362.3	367.1	282.2
Memo (percentage of GDP)														
17 Domestic nonfinancial debt [5]	181.5	186.7	191.4	194.1	187.5	189.5	189.1	190.9	192.3	193.3	193.6	194.3	194.7	194.7
18 Domestic nonfinancial borrowing	8.8	10.9	11.0	11.0	13.2	11.1	9.7	13.2	11.3	9.8	12.0	11.7	10.3	9.9
19 Federal government [6]	-3.0	-0.1	2.3	1.6	2.5	-0.2	1.1	4.6	2.6	0.9	2.9	2.4	0.7	0.5
20 Nonfederal	11.8	11.0	8.7	9.4	10.6	11.3	8.6	8.7	8.7	8.9	9.1	9.3	9.5	9.5

Note. Data after 2002:Q1 are staff projections.
1. For corporations: Excess of capital expenditures over U.S. internal funds.
2. Includes change in liabilities not shown in lines 8 and 9.
3. Average debt levels in the period (computed as the average of period-end debt positions) divided by disposable personal income.
4. NIPA surplus less changes in retirement fund assets plus consumption of fixed capital.
5. Average debt levels in the period (computed as the average of period-end debt positions) divided by nominal GDP.
6. Excludes government-insured mortgage pool securities.

2.6.4 FOF

International Developments

The recent turmoil in global financial markets looms as a cloud over the foreign outlook. Equity markets across the world have tumbled in recent weeks, and the volatility of these markets has increased markedly. In response, investors have shifted to assets that are perceived as safe havens, most notably government securities in industrial countries. In addition, financial conditions in Brazil, Uruguay, and several other South American countries have weakened significantly; if conditions in these countries were to deteriorate further, crisis could sweep the continent, possibly spilling over to Mexico and to other emerging-market economies. The major challenge that we faced in constructing our forecast was determining how this recent worsening of global financial conditions should be factored into our baseline projections for foreign economic activity and our assessment of the attendant risks.

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

Indicator	2001	2002: Q1	Projection		
			2002		2003
			Q2	H2	
Foreign output	.0	3.2	3.4	2.9	3.4
Previous GB	*.1*	*3.2*	*2.8*	*3.4*	*3.5*
Foreign CPI	1.7	1.9	3.3	2.2	2.1
Previous GB	*1.7*	*1.9*	*2.9*	*2.1*	*2.1*

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

Economic indicators for the second quarter that have come in since the June Greenbook were generally stronger than we had expected, causing us to mark up our estimates of second-quarter growth for an array of countries, including Canada, Japan, Mexico, and several emerging Asian economies. All told, we have raised our estimate of average foreign growth in the second quarter to 3½ percent at an annual rate, up from 2¾ percent in the previous forecast. We have decided against any extension of these stronger-than-expected data into the future, however, given that they pre-date much of the recent turmoil in financial markets.

Looking ahead, we project that foreign growth in the second half of the year will step down to just below 3 percent, in line with three related factors. First, less favorable financial conditions are expected to weigh on confidence and, ultimately, on activity abroad; indeed, hints of this are already beginning to be seen in sentiment surveys. Second, the pace of growth in the economies where recovery this year has been most robust, particularly Canada and several emerging Asian economies, is expected to moderate to a more sustainable pace as boosts from inventory cycles subside. Third, the projected slowdown in the growth of U.S. domestic demand during the second half of the year will also constrain activity abroad. Our forecast for 2003 calls for foreign growth to return to nearly 3½ percent, supported by a normalizing of conditions in financial markets, a strengthening of domestic demand in key foreign economies, and the projected acceleration in U.S. growth. Our projection for 2003 is only a bit lower than in the June Greenbook, as the assumed path for monetary policy in the major foreign economies now envisions much less tightening. There are, of course, significant risks surrounding this forecast for foreign activity. Most notably, financial conditions may deteriorate more markedly or prove to be more detrimental to growth than we now expect.

Over the intermeeting period, the value of the U.S. dollar appreciated ¾ percent against the major foreign currencies and was about unchanged against the currencies of our major developing-country trading partners. Nevertheless, given that the dollar depreciated during the few days before the June FOMC meeting, after the Greenbook had gone to press, we now project that the broad real value of the dollar during the third quarter will be about 1 percent weaker than projected in the last Greenbook. We expect the dollar to depreciate a further 2 percent over the forecast period, leaving the dollar more than 5 percent below its recent peak reached in the first quarter of this year.

The arithmetic contribution from net exports to U.S. GDP growth is expected to be about zero in the second half of this year and negative ¼ percentage point next year. These projections are less negative than those in the June Greenbook. The difference, largely in reduced imports, reflects weaker U.S. economic activity and the lower path of the dollar. The U.S. current account deficit as a share of nominal GDP is projected to rise from just under 4½ percent in the first quarter of this year to 5 percent both in the second half of this year and in 2003.

Oil Prices

The spot price of West Texas intermediate (WTI) crude oil is currently trading at $27 per barrel, around its average in July and about $0.75 above its average in the second quarter. Tighter inventory conditions in the United States, reduced exports from Iraq, and a perceived increase in the probability of military action against Iraq have all served to keep oil prices at relatively elevated levels. However, looking forward, we expect that OPEC members will be increasingly unwilling to comply with their quotas and that non-OPEC production will continue to rise. Given these factors, we project that the spot price of WTI will decrease to $24 per barrel by the end of the forecast period, consistent with recent quotes from futures markets. Compared with the June Greenbook, the current projection is about $1.20 per barrel higher in the third quarter of 2002 and about $0.20 per barrel higher at the end of 2003.

International Financial Markets

The foreign exchange value of the dollar, as measured by the staff's major currencies index, has appreciated ¾ percent on balance since the June FOMC meeting. The dollar has risen 3¾ percent against the Canadian dollar and more than 6 percent against the Australian dollar, as recent concerns about the pace of global recovery have weighed on the currencies of these exporters of primary commodities. The dollar has also moved up a bit against the euro. In contrast, the dollar has weakened 1 percent on net against the yen and 2¼ percent against the pound. In the first half of the intermeeting period, the dollar declined sharply on average against the major currencies, amid continuing worries about the strength of the U.S. recovery and further revelations of accounting irregularities, but market participants subsequently appeared to conclude that such concerns are not unique to the United States.

Against the currencies of our other important trading partners, the dollar has been about unchanged on a weighted-average basis. The dollar rose more than 9 percent on balance against the Brazilian *real*, which continued to suffer because of concerns about the country's October presidential election, particularly the strong showing in the polls of candidates whose commitment to sound economic and financial policies is seen as questionable. The Colombian peso also depreciated significantly during the period, falling 10½ percent against the dollar. In contrast, the Mexican peso and the Korean won moved up against the dollar.

Our projection for the broad real value of the dollar in the third quarter is about 1 percent weaker than the previous forecast, reflecting recent market developments. Going forward, our projection is for the dollar to move down another 2 percent on average through the end of 2003, a rate of decline similar to that in the June Greenbook. This forecast reflects our continued effort to strike a balance between the various factors affecting the dollar. At present, we view these factors as pointing to further net depreciation. Most important, it seems unlikely to us that investors will--at current exchange rates--want to hold a large and growing stock of U.S. external liabilities, particularly if returns on assets in the United States are relatively weak. Indeed, there is some risk of a more substantial decline in the perceived attractiveness of U.S. assets than is embedded in our baseline forecast; such a shift would trigger a more pronounced depreciation of the dollar. We examine one such scenario in the alternative simulations below.

Global stock prices moved considerably lower during the intermeeting period, extending the substantial declines seen in recent months. Euro-area and U.K. share prices shed 14 percent and 12 percent of their values, respectively, a little more than the 11 percent decline in the S&P 500. Stock prices in Japan fared somewhat better, falling only about 5 percent, as further evidence of a modest economic recovery in that country emerged. Government bond yields moved lower during the period, as investors shifted funds into less-risky instruments and as expectations of monetary tightening were pushed back. Yields on ten-year foreign government securities declined as much as 40 basis points, less than the decline of about 50 basis points in the comparable U.S. Treasury yield. In contrast, gold seemed to benefit little from its traditional safe-haven status, with its price falling 4 percent, to $307.80.

Yields on emerging-market bonds relative to U.S. Treasuries rose more than 130 basis points on average during the intermeeting period, led by a net increase of 420 basis points in Brazilian debt spreads. The comparable spread for Mexico moved up 80 basis points. However, the level of Mexican spreads remains low at around 400 basis points, compared with spreads of over 2,000 basis points for Brazil and over 7,000 basis points for Argentina. Spreads in emerging Asia were generally little changed at low levels.

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

Foreign Industrial Countries

In response to generally favorable incoming data, we have raised our estimate of growth in the foreign industrial countries during the first half of the year to 3¼ percent, up ½ percentage point from the previous forecast. Nevertheless, softness in recent sentiment surveys and other leading indicators, along with the implications of the recent turbulence in global financial markets, has caused us to mark down our projection for the second half of this year to just under 2½ percent, ½ percentage point less than before. We project that growth in 2003 will edge back up to 2¾ percent as domestic demand in these countries strengthens. Monetary policy should remain quite stimulative, with central banks now expected to push back further tightening until the effects of the recent financial shocks abate.

After falling in recent months, headline inflation rates in the foreign industrial countries are expected to rise moderately through the end of the year, as energy price increases feed through into inflation. By early next year, however, inflation rates should again decline, with output in most countries expected to remain below potential and with the projected appreciation of major foreign currencies against the dollar helping to attenuate price pressures.

We estimate that the Canadian economy expanded at an annual rate of more than 5 percent during the first half of the year. We expect growth in the second half to step down to a more sustainable pace of 3 percent and to continue at about that pace through 2003. This slowing is consistent with a recent tapering off of increases in business and consumer confidence, as well as with negative wealth effects coming from the drop in equity prices. Favorable labor market conditions, however, are expected to continue to support domestic demand. In mid-July, the Bank of Canada raised its target for the overnight rate 25 basis points, bringing its cumulative tightening since April to 75 basis points. The Bank of Canada is now expected to keep rates unchanged through the end of next year, in response to recent financial market turmoil and concerns about the robustness of the U.S. recovery.

Economic sentiment in the euro area moved down in June and July, in line with financial market developments. In addition, recent readings on industrial production, orders, and employment weakened a bit. Accordingly, we have revised down our forecast for the euro area somewhat. Nevertheless, in the near term, a reduction in the pace of destocking should allow inventories to contribute significantly to growth. Consumption is expected to pick up gradually over the next several quarters, as conditions in labor markets begin to improve and as uncertainty due to the recent financial market turmoil abates. These positive developments will also support a modest rebound in investment. We now expect that the ECB will keep monetary policy on hold until early next year, when signs of stronger growth should become evident.

In the United Kingdom, purchasing managers' assessments of economic conditions are down from their April highs, and consumer confidence stopped rising in July. Although most indicators point to continued expansion, we expect growth to slow over the next few quarters, in part owing to negative wealth effects, before picking back up in 2003. The twelve-month rate of inflation has been--and is expected to remain--below the Bank of England's 2½ percent target, allowing the Bank to postpone tightening until early next year.

Japanese data suggest that a slow recovery took hold during the first half of the year, with net exports making a significant contribution to growth. Signals from forward-looking indicators, such as machinery orders and business sentiment, suggest that final domestic demand is now close to bottoming out. We thus project that positive, albeit anemic, growth will continue through the end of the forecast period. This growth, however, will not be sufficient to narrow Japan's sizable output gap, and deflation is expected to persist. The Bank of Japan is assumed to keep nominal short-term interest rates near zero through the end of the forecast period.

Other Countries

In South America, economic and financial conditions have deteriorated markedly. In recent weeks, in addition to the sharp depreciation of the Brazilian *real* and the widening of spreads, access to trade and interbank credits has been reduced and the government has had difficulty rolling over its maturing domestic debt. In response, our forecast for Brazil has been marked down. We have maintained our assumption of a "muddle-through" scenario, but a further deterioration in investor confidence toward Brazil, perhaps in response to intensified political risk in the run-up to the October election or to heightened concerns about the government's ability or willingness to service its debt, could result in a full-blown crisis in the country. As the Greenbook goes to press, Brazil is negotiating an extension and enlargement of its current IMF program.

Elsewhere in South America, Argentina has made little progress putting in place the policies necessary to support an economic recovery, and negotiations with the IMF regarding an adjustment program remain stalled. Uruguay has been battered by spillovers from Argentina and by a sustained run on its banking system; in response, the international official community recently announced another round of financial assistance for the country. Conditions in Venezuela, Colombia, and several other South American countries are almost equally grim.

Recent indicators for Mexico, in contrast, suggest that the economy is recovering. Data through May for the index of overall economic activity and export data through June both point to strength. Despite this positive news, the outlook for Mexico in the second half of the year has been marked down somewhat, in light of the revised path for U.S. growth and the turmoil elsewhere in Latin America. We expect Mexican GDP to grow 3½ percent during the second half of this year and 4 percent next year, in line with the projected path of U.S. output. However, a crisis in Brazil represents a crucial risk for Mexico, in that a further deterioration in global investor sentiment could destabilize Mexican financial conditions.

In emerging Asia, industrial production in all of the ASEAN countries continued to move up during the second quarter, and production also strengthened in Korea and Taiwan. Higher demand for high-tech goods was the driving force behind the resurgence of activity in many of these countries, although domestic demand also played an important role in Korea and Thailand. China recorded higher-than-expected GDP growth at an annual rate of 9 percent in the second quarter, which government officials attributed to strong exports and to increased foreign direct investment. Hong Kong's economy, the major soft spot in the region, has only weakly come out of last year's recession, and declines in property prices have recently resumed. For emerging Asia as a whole, we project that average growth will moderate from about 6 percent during the first half of this year to 5¼ percent in the second half. We look for growth to move back up a bit next year, supported by the pickup in global activity and demand for high-tech products. Nevertheless, these economies remain highly vulnerable to a slackening of external demand.

We project that average consumer price inflation in the developing countries will hover around 3 percent through the end of the forecast period. We expect inflation to remain low in emerging Asia. In Latin America, in contrast, recent currency depreciations should put upward pressure on prices in the near term.

Prices of Internationally Traded Goods
The price index for U.S. imports of non-oil core goods rose about 2 percent at an annual rate in the second quarter, the first quarterly increase since the beginning of 2001. This turnaround largely reflects the behavior of prices of nonpetroleum industrial supplies, which fell sharply last year but stabilized earlier this year and rose during the past several months. With commodity prices expected to keep moving up this year, in line with quotes on futures exchanges, and with the dollar projected to decline, import prices should continue to rise. We are projecting that core import prices will increase at an average rate of nearly 5 percent in the second half of this year and at a more moderate pace of around 3 percent next year, as commodity price increases and the rate of dollar depreciation both slow.

The price index for exports of U.S. core goods also turned up in the second quarter following a year of decline, rising at an annual rate of 3¼ percent. We expect this index to increase at an average rate of about 1¾ percent over the remainder of the forecast period, in line with projected U.S. producer price inflation.

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

Trade category	2001	2002: Q1	Projection		
			2002		2003
			Q2	H2	
Exports					
Core goods	-1.5	-1.1	3.3	2.2	1.6
Imports					
Non-oil core goods	-2.9	-2.2	2.1	4.8	2.9
Oil (dollars per barrel)	18.39	18.38	24.03	24.39	21.85

NOTE. Prices for core exports and non-oil core imports, which exclude computers and semiconductors, are on a NIPA chain-weighted basis.

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

Trade in Goods and Services

Real exports of goods and services are estimated to have grown 11 percent at an annual rate in the second quarter, about twice as fast as we had expected in the previous Greenbook and only the second quarterly gain in the past two years. The increase in the second quarter was primarily in core goods, particularly in exported industrial supplies, machinery, and automotive parts. By region, the largest increases were to Canada and Mexico, countries where estimated growth in the second-quarter has been marked up appreciably. Over the forecast period, foreign economic activity is projected to expand at a pace of around 3 percent or slightly higher, while exports of core goods are projected to grow at an average rate of 5½ percent. The relatively rapid growth in exports is due largely to the reversal of a pattern that emerged over the past year or so: U.S. goods exports more closely tracked the slump in foreign industrial production than the stagnation in foreign GDP. Hence, as production abroad recovers, core goods exports (60 percent of which are industrial supplies and capital equipment) are expected to rise as well. Exports will also be boosted by the projected depreciation of the dollar. Exports of computers and semiconductors are projected to make positive contributions to real export growth this year and next, after falling sharply last year; and service receipts should continue to recover. We thus project that real exports of all goods and services, after declining 11½ percent in 2001, will increase 6¾ percent in 2002 and 8¼ percent in 2003.

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

Measure	2001	2002 Q1	Projection		
			2002		2003
			Q2	H2	
Real exports	-11.4	3.5	11.0	6.5	8.2
Previous GB	*-10.9*	*5.3*	*5.3*	*7.9*	*8.4*
Real imports	-8.0	8.5	22.3	5.0	7.3
Previous GB	*-8.5*	*12.9*	*13.9*	*8.3*	*9.2*

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

Real imported goods and services registered an even larger increase in the second quarter than in the previous quarter, rising at a surprisingly strong estimated 22 percent annual rate. All major trade categories, except aircraft, posted gains. Particularly notable growth was recorded in imported automotive products (due to the strength of U.S. motor vehicle sales), consumer goods, and machinery. For the latter, not only were there increases in high-tech goods, but also in imports of basic industrial and service equipment, which rose for the first time in more than a year. Given press reports as early as last winter about a possible dock strike this summer on the West Coast, a portion of the second-quarter strength in imports may have reflected efforts to accelerate shipments into the spring. We have found no hard evidence of such behavior; however, this possibility cannot be dismissed entirely. Given the elevated level of second quarter imports, we now expect somewhat less growth in the current quarter than was projected in the June Greenbook, although we expect automotive imports to remain strong, as U.S. sales of motor vehicles have continued at a rapid clip. However, there is a risk of much slower import growth in the near term, if a dock strike occurs or if it turns out that importers did accelerate shipments into the second quarter to a significant extent.

Given the outlook for U.S. domestic demand and the weaker projected path of the dollar, the growth of core goods imports is projected to be about 6 percent over the remainder of the forecast period. This is a downward revision from average growth of 8½ percent projected in the last Greenbook. Total imports of goods and services are expected to expand 5 percent in the second half of this year and 7¼ percent next year.

Alternative Simulations

As noted above, there is some risk that investor perceptions of the attractiveness of U.S. assets may decline more than in our baseline forecast. Thus, in the first alternative simulation, we use the FRB/Global model to consider a larger-than-projected decline in the broad real value of the dollar, precipitated by a sequence of shocks to the risk premium on dollar assets. These shocks are phased in over the four quarters beginning in 2002:Q3 and scaled so that the real value of the dollar would decline about 10 percent against most foreign currencies relative to baseline, in the absence of endogenous adjustment in domestic and foreign real interest rates. This depreciation of the dollar stimulates net exports and, thus, boosts U.S. GDP growth about 0.3 percentage point above baseline in 2003. Rising import prices pass through to core consumer prices with a lag of a quarter or two; thus, core PCE inflation moves up about 0.3 percentage point relative to baseline in 2003:H1 and about 0.6 percentage point in 2003:H2.

Alternative Simulations:
Rise in External and Equity Risk Premiums[1]
(Percent change from previous period, annual rate)

Indicator and simulation	2002		2003	
	H1	H2	H1	H2
U.S. real GDP				
Baseline	3.1	2.4	3.3	3.7
Simulation 1: Rise in external risk premium	3.1	2.5	3.6	4.1
Simulation 2: Rise in external and equity risk premiums	3.1	2.4	3.3	3.6
U.S. PCE prices excl. food and energy				
Baseline	1.5	1.3	1.4	1.4
Simulation 1: Rise in external risk premium	1.5	1.3	1.7	2.0
Simulation 2: Rise in external and equity risk premiums	1.5	1.3	1.7	2.0

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

1. In these simulations, the nominal federal funds rate remains unchanged from baseline, and the monetary authorities in major foreign economies adjust their policy rates according to a Taylor rule.

A decline in the dollar might very well be associated with further weakness in U.S. equity markets. Accordingly, in our second simulation, the rise in the risk premium on dollar assets is combined with a shock to the risk premium on U.S. equities. Specifically, this shock is phased in so that it would gradually raise the equity risk premium (over the risk-free rate) by 75 basis points in 2003:Q2, in the absence of any endogenous response. This rise in the equity risk premium induces a 16 percent decline in the U.S. stock market by 2003:Q2. The drop in share prices has a contractionary effect on U.S. GDP, as it raises the cost of capital and constrains consumer spending. We calibrated the magnitude of this shock to the equity risk premium to roughly offset the stimulative effects of the other shock; as a result, the combined shock has little net effect on U.S. GDP growth. The rise in core PCE inflation is virtually identical to that reported in the first simulation; in both cases it reflects primarily the direct pass-through of import prices.

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Class II FOMC

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

Measure and country	1995	1996	1997	1998	1999	2000	2001	--Projected-- 2002	2003
REAL GDP (1)									
Total foreign	2.1	4.1	4.1	1.6	5.0	4.0	0.0	3.1	3.4
Industrial Countries	1.9	2.8	3.5	2.7	4.2	3.1	0.3	2.8	2.7
of which:									
Canada	1.4	2.7	4.4	4.4	5.7	3.5	0.8	4.0	3.2
Japan	2.5	3.7	0.5	-1.3	0.6	2.3	-2.0	1.2	1.2
United Kingdom	2.0	2.8	3.7	2.6	3.2	2.2	1.5	2.1	2.5
Euro Area (2)	1.5	1.6	3.1	2.0	3.8	2.9	0.4	1.7	2.6
Germany	1.1	1.4	1.7	0.6	3.0	2.5	0.0	1.3	2.4
Developing Countries	2.4	6.2	5.2	-0.2	6.2	5.2	-0.4	3.6	4.3
Asia	7.0	6.6	4.9	-2.0	8.7	6.3	0.7	5.6	5.6
Korea	7.5	6.4	3.4	-5.2	13.8	5.1	4.4	6.2	6.0
China	10.4	5.3	8.7	9.5	4.1	8.0	7.5	8.0	7.5
Latin America	-3.8	6.2	6.1	1.2	4.3	4.5	-1.5	2.0	3.4
Mexico	-7.1	7.1	6.7	2.8	5.4	4.9	-1.5	3.0	4.1
Brazil	-1.7	5.4	2.4	-1.6	3.7	3.9	-0.6	1.6	1.4
CONSUMER PRICES (3)									
Industrial Countries	1.3	1.5	1.5	0.9	1.2	1.9	0.9	1.7	1.2
of which:									
Canada	2.0	2.0	1.0	1.1	2.3	3.1	1.1	3.2	2.0
Japan	-0.8	0.2	2.1	0.7	-1.2	-1.2	-1.3	-1.0	-0.9
United Kingdom (4)	2.9	3.2	2.7	2.5	2.2	2.1	2.0	2.1	2.3
Euro Area (2)	2.4	1.9	1.5	0.8	1.5	2.7	2.1	2.3	1.6
Germany	1.4	1.3	1.5	0.3	1.1	2.5	1.7	1.6	1.0
Developing Countries	17.0	11.1	6.8	9.0	4.6	4.1	2.8	2.9	3.1
Asia	6.4	4.8	2.7	4.4	0.1	1.8	1.0	1.2	2.0
Korea	4.4	5.0	4.9	5.8	1.2	2.5	3.3	3.4	3.1
China	11.1	6.8	0.9	-1.2	-0.9	0.9	-0.2	-0.2	1.0
Latin America	42.0	25.8	15.5	15.4	12.5	8.4	5.4	6.0	5.3
Mexico	48.7	28.0	17.0	17.3	13.5	8.8	5.2	4.8	4.6
Brazil	21.5	9.6	4.6	2.0	8.4	6.4	7.5	5.7	4.3

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

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Class II FOMC

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

					Projected							
	2001				2002				2003			
Measure and country	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
REAL GDP (1)	Quarterly changes at an annual rate											
Total foreign	0.6	-0.9	-0.2	0.7	3.2	3.4	2.9	3.0	3.3	3.4	3.4	3.4
Industrial Countries	1.5	-0.4	-0.1	0.4	4.1	2.3	2.4	2.4	2.7	2.7	2.8	2.7
of which:												
Canada	0.6	0.3	-0.5	2.9	6.0	4.3	3.0	2.8	3.1	3.3	3.3	3.1
Japan	4.1	-4.9	-2.2	-4.9	5.7	-3.0	1.0	1.1	1.2	1.2	1.3	1.3
United Kingdom	2.0	2.3	1.4	0.4	0.6	3.6	2.2	2.1	2.4	2.5	2.5	2.6
Euro Area (2)	1.8	0.2	0.8	-1.0	1.3	1.4	1.9	2.3	2.5	2.6	2.6	2.5
Germany	1.6	0.2	-0.7	-1.0	0.7	0.8	1.6	2.3	2.4	2.5	2.5	2.4
Developing Countries	-0.7	-1.8	-0.4	1.2	1.8	5.2	3.5	3.8	4.3	4.3	4.4	4.4
Asia	-1.0	-2.4	0.2	6.0	6.0	6.1	5.0	5.4	5.5	5.6	5.6	5.7
Korea	4.9	1.0	5.3	6.4	7.6	6.2	5.0	6.0	6.0	6.0	6.0	6.0
China	8.2	7.7	7.1	7.1	8.5	9.3	7.2	7.2	7.5	7.5	7.5	7.5
Latin America	-0.5	-1.8	-1.1	-2.6	-1.7	4.7	2.4	2.6	3.4	3.4	3.4	3.4
Mexico	-1.3	-1.7	-0.8	-2.4	-1.0	6.5	3.3	3.5	4.1	4.1	4.1	4.1
Brazil	4.8	-5.4	-1.7	0.4	5.4	1.0	0.0	0.0	1.2	1.2	1.5	1.5
CONSUMER PRICES (3)	Four-quarter changes											
Industrial Countries	1.7	2.2	1.7	0.9	1.1	1.0	1.1	1.7	1.5	1.2	1.2	1.2
of which:												
Canada	2.8	3.6	2.7	1.1	1.5	1.3	1.9	3.2	2.9	2.2	2.0	2.0
Japan	-1.0	-1.2	-1.1	-1.3	-1.5	-1.1	-1.4	-1.0	-1.0	-1.2	-1.0	-0.9
United Kingdom (4)	1.9	2.3	2.4	2.0	2.4	1.9	1.8	2.1	1.9	2.1	2.2	2.3
Euro Area (2)	2.3	3.1	2.4	2.1	2.6	2.1	2.4	2.3	2.0	1.6	1.6	1.6
Germany	2.4	3.2	2.4	1.7	2.0	1.1	1.3	1.6	0.9	1.1	1.0	1.0
Developing Countries	3.8	4.1	3.5	2.8	2.6	2.5	2.6	2.9	3.3	3.1	3.0	3.1
Asia	1.8	2.4	1.9	1.0	0.8	0.6	0.8	1.2	1.6	1.6	1.8	2.0
Korea	3.7	5.1	4.2	3.3	2.5	2.7	2.3	3.4	3.7	2.8	3.2	3.1
China	0.7	1.6	0.8	-0.2	-0.6	-1.0	-0.5	-0.2	0.1	0.5	0.6	1.0
Latin America	7.3	6.9	6.0	5.4	5.1	5.4	5.8	6.0	7.0	6.3	5.7	5.3
Mexico	7.5	6.9	6.0	5.2	4.8	4.8	4.9	4.8	5.7	5.1	4.7	4.6
Brazil	6.3	7.1	6.7	7.5	7.7	7.9	6.5	5.7	5.2	4.6	4.5	4.3

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1995	1996	1997	1998	1999	2000	2001	--Projected-- 2002	2003
NIPA REAL EXPORTS and IMPORTS									
	Percentage point contribution to GDP growth, Q4/Q4								
Net Goods & Services	0.4	-0.2	-0.8	-1.1	-1.0	-0.8	-0.1	-0.7	-0.2
Exports of G&S	1.0	1.1	1.0	0.3	0.5	0.8	-1.3	0.7	0.8
Imports of G&S	-0.6	-1.3	-1.7	-1.3	-1.5	-1.5	1.2	-1.3	-1.0
	Percentage change, Q4/Q4								
Exports of G&S	9.7	9.8	8.5	2.3	4.9	7.3	-11.4	6.8	8.2
Services	8.8	8.9	1.4	2.9	3.2	4.8	-9.2	9.1	6.2
Computers	39.1	21.6	25.8	8.1	13.4	23.0	-23.4	5.9	32.6
Semiconductors	79.6	44.6	21.3	9.1	34.6	26.9	-34.9	28.9	34.2
Other Goods 1/	4.6	7.3	9.8	1.3	3.1	5.7	-9.4	4.5	6.0
Imports of G&S	5.0	11.2	14.3	10.8	11.9	11.1	-8.0	10.0	7.3
Services	5.5	5.3	14.0	8.5	5.9	10.9	-8.6	7.0	2.6
Oil	2.4	7.8	3.9	4.1	-3.4	13.3	0.1	1.6	3.1
Computers	35.0	17.8	33.0	25.8	26.0	13.6	-13.8	27.0	32.6
Semiconductors	92.4	56.7	32.9	-8.7	34.2	22.5	-51.4	33.5	34.2
Other Goods 2/	-1.2	10.4	12.7	11.5	12.7	10.4	-6.2	9.7	6.2
	Billions of chained 1996 dollars								
Net Goods & Services	-78.4	-89.0	-113.3	-221.1	-320.5	-398.8	-415.9	-486.8	-522.5
Exports of G&S	808.2	874.2	981.5	1002.4	1036.3	1137.2	1076.1	1062.3	1142.3
Imports of G&S	886.6	963.1	1094.8	1223.5	1356.8	1536.0	1492.0	1549.2	1664.8
	Billions of dollars								
US CURRENT ACCOUNT BALANCE	-105.8	-117.8	-128.4	-203.8	-292.9	-410.3	-393.4	-500.8	-552.2
Current Acct as Percent of GDP	-1.4	-1.5	-1.5	-2.3	-3.2	-4.2	-3.9	-4.8	-5.1
Net Goods & Services (BOP)	-96.4	-101.8	-107.8	-166.9	-262.2	-378.7	-358.3	-439.4	-494.7
Investment Income, Net	29.1	28.6	25.1	12.7	23.9	27.6	20.5	1.9	3.1
Direct, Net	64.9	69.4	72.4	65.5	75.0	88.9	102.6	91.3	102.9
Portfolio, Net	-35.8	-40.8	-47.3	-52.9	-51.1	-61.2	-82.1	-89.4	-99.8
Other Income & Transfers,Net	-38.6	-44.6	-45.7	-49.6	-54.5	-59.3	-55.6	-63.3	-60.7

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	1998				1999				2000			
	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	-1.8	-1.8	-0.8	0.2	-1.8	-1.4	-0.7	0.1	-1.1	-1.0	-0.7	-0.2
Exports of G&S	0.1	-0.5	-0.2	1.7	-0.8	0.4	1.1	1.3	0.8	1.5	1.2	-0.5
Imports of G&S	-1.9	-1.4	-0.5	-1.5	-1.0	-1.9	-1.8	-1.2	-1.9	-2.5	-1.9	0.3
Percentage change from previous period, s.a.a.r.												
Exports of G&S	0.5	-4.0	-2.2	16.3	-6.9	4.3	10.6	12.6	7.7	14.6	11.6	-4.0
Services	2.4	8.0	-8.4	10.5	-1.5	3.4	4.7	6.4	10.2	11.2	-5.9	4.4
Computers	-8.3	8.2	12.0	22.8	0.8	24.7	20.6	9.2	33.5	45.9	28.8	-8.8
Semiconductors	5.9	-17.2	272.7	-56.6	34.2	45.2	41.3	19.0	14.6	90.9	43.4	-17.5
Other Goods 1/	0.0	-9.2	-9.3	27.8	-12.1	0.7	10.7	15.4	4.2	9.2	16.7	-5.9
Imports of G&S	15.9	11.3	4.2	12.2	8.4	15.4	14.5	9.4	14.7	18.6	13.8	-1.6
Services	21.3	6.7	7.0	0.1	0.2	6.8	9.7	7.1	20.7	9.6	15.1	-0.5
Oil	3.6	42.8	1.1	-21.6	3.9	29.8	-5.8	-31.5	28.6	40.4	-2.3	-6.5
Computers	38.4	18.5	6.4	43.6	35.0	43.7	14.4	13.5	2.5	40.4	27.9	-9.5
Semiconductors	8.5	-25.4	-6.3	-8.2	23.0	67.9	16.3	35.0	23.5	50.0	69.8	-28.5
Other Goods 2/	14.2	11.9	4.1	16.2	7.8	12.2	17.4	13.4	13.1	15.5	12.3	1.3
Billions of chained 1996 dollars, s.a.a.r.												
Net Goods & Services	-180.8	-223.1	-241.2	-239.2	-283.2	-319.6	-339.6	-339.5	-368.8	-394.6	-413.1	-418.5
Exports of G&S	1003.4	993.1	987.6	1025.6	1007.5	1018.1	1044.1	1075.6	1095.8	1133.9	1165.5	1153.7
Imports of G&S	1184.2	1216.2	1228.9	1264.8	1290.7	1337.7	1383.7	1415.2	1464.6	1528.5	1578.6	1572.2
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-163.3	-197.2	-229.1	-225.7	-238.7	-280.6	-320.6	-331.6	-376.4	-392.3	-428.7	-443.9
Current Account as % of GDP	-1.9	-2.3	-2.6	-2.5	-2.6	-3.1	-3.4	-3.5	-3.9	-4.0	-4.3	-4.5
Net Goods & Services (BOP)	-139.9	-170.0	-181.9	-175.9	-209.5	-253.4	-286.5	-299.6	-348.7	-367.7	-393.3	-405.0
Investment Income, Net	21.1	18.3	1.0	10.4	20.8	24.9	18.3	31.5	25.1	30.6	22.1	32.8
Direct, Net	73.2	68.8	57.1	63.0	72.3	71.4	71.3	85.0	79.0	86.9	89.2	100.3
Portfolio, Net	-52.2	-50.6	-56.1	-52.7	-51.5	-46.5	-53.0	-53.5	-53.9	-56.3	-67.1	-67.5
Other Inc. & Transfers, Net	-44.5	-45.5	-48.2	-60.1	-50.0	-52.1	-52.4	-63.5	-52.8	-55.3	-57.5	-71.7

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2001				2002		Projected					
									2003			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	0.5	-0.4	-0.2	-0.3	-0.7	-1.7	-0.3	0.2	-0.3	-0.4	-0.3	0.2
Exports of G&S	-0.7	-1.4	-2.0	-1.0	0.3	1.0	0.4	0.8	0.6	0.8	0.8	1.0
Imports of G&S	1.2	1.0	1.7	0.7	-1.1	-2.7	-0.8	-0.6	-0.9	-1.2	-1.1	-0.9
Percentage change from previous period, s.a.a.r.												
Exports of G&S	-6.0	-12.4	-17.3	-9.6	3.5	11.0	4.4	8.5	5.7	8.2	8.5	10.6
Services	-6.0	-2.5	-13.9	-13.8	21.7	4.8	4.9	6.1	6.8	6.3	5.9	5.8
Computers	-7.3	-41.7	-22.8	-17.6	-21.1	-0.2	26.3	26.3	31.1	32.3	33.6	33.6
Semiconductors	-34.6	-47.3	-40.9	-11.7	13.7	52.4	26.2	26.2	31.1	33.5	36.0	36.0
Other Goods 1/	-3.0	-10.6	-16.5	-6.9	-3.1	12.6	1.6	7.5	2.1	6.0	6.3	9.7
Imports of G&S	-7.9	-6.8	-11.8	-5.3	8.5	22.3	5.6	4.4	6.4	8.9	7.9	6.1
Services	0.3	8.5	-23.2	-16.5	35.7	-2.0	-0.6	-0.8	1.2	2.4	3.2	3.5
Oil	23.3	7.2	-26.9	3.9	-19.0	36.8	15.9	-17.1	0.0	27.8	8.5	-18.5
Computers	-21.6	-24.5	-18.7	14.6	52.4	7.3	21.6	31.1	31.1	32.3	33.6	33.6
Semiconductors	-43.9	-68.8	-55.9	-27.5	45.2	37.4	26.2	26.2	31.1	33.5	36.0	36.0
Other Goods 2/	-9.4	-6.2	-4.7	-4.5	1.9	28.7	4.3	5.9	5.9	6.3	6.3	6.4
Billions of chained 1996 dollars, s.a.a.r.												
Net Goods & Services	-404.5	-414.8	-419.0	-425.3	-446.6	-495.4	-505.1	-500.2	-509.8	-522.4	-531.1	-526.8
Exports of G&S	1135.8	1098.8	1048.0	1021.8	1030.6	1057.9	1069.4	1091.5	1106.7	1128.8	1152.0	1181.5
Imports of G&S	1540.3	1513.6	1467.0	1447.2	1477.1	1553.3	1574.6	1591.7	1616.5	1651.2	1683.1	1708.3
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-430.9	-396.9	-365.3	-380.3	-450.0	-498.3	-519.7	-535.1	-535.0	-548.2	-556.5	-568.9
Current Account as % of GDP	-4.3	-3.9	-3.6	-3.7	-4.4	-4.8	-5.0	-5.1	-5.0	-5.1	-5.1	-5.1
Net Goods & Services (BOP)	-388.6	-373.3	-319.1	-352.1	-379.4	-443.9	-466.0	-468.1	-480.7	-493.7	-503.3	-500.9
Investment Income, Net	10.3	30.1	9.4	32.4	-0.6	2.1	2.7	3.4	3.1	2.8	4.2	2.3
Direct, Net	89.0	111.3	95.6	114.4	83.6	89.4	94.1	98.0	100.9	101.5	104.5	104.7
Portfolio, Net	-78.7	-81.2	-86.3	-82.0	-84.2	-87.4	-91.3	-94.6	-97.8	-98.7	-100.3	-102.4
Other Inc. & Transfers, Net	-52.5	-53.7	-55.6	-60.6	-69.9	-56.4	-56.4	-70.4	-57.4	-57.4	-57.4	-70.4

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