Prefatory Note

The attached document represents the most complete and accurate version available based on original files from the FOMC Secretariat at the Board of Governors of the Federal Reserve System.

Please note that some material may have been redacted from this document if that material was received on a confidential basis. Redacted material is indicated by occasional gaps in the text or by gray boxes around non-text content. All redacted passages are exempt from disclosure under applicable provisions of the Freedom of Information Act.

Content last modified 03/31/2011.

Class II FOMC - Restricted (FR)

Part 1

October 26, 2005

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

Class II FOMC - Restricted (FR)

October 26, 2005

Summary and Outlook

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

Domestic Developments

Our projection for real GDP growth in the second half of this year—about 3½ percent at an annual rate—is little different from the one we presented in the September Greenbook, as the news we have received during the intermeeting period has had largely offsetting implications. Hurricane Rita wreaked yet more havoc in the Gulf Coast area than we had factored into the previous projection, when only Katrina had made landfall, but the strike at Boeing proved shorter-lived than we had anticipated.[1] On balance, the incoming data have been a roughly neutral influence on the forecast. Recognizing the difficulties of abstracting from hurricane effects, we have read the data as suggesting that the economy outside the hurricane-affected areas has retained considerable momentum in the second half of this year, and excluding the effects of the hurricanes and the strike, we estimate that real GDP is on track to rise at an annual rate of about 4 percent in the second half of the year.

Over the longer term, the tightening of monetary policy and the waning impetus from equity and housing wealth are anticipated to slow that momentum. We now expect real GDP to increase 3¼ percent in 2006 and 2¾ percent in 2007—a touch less in each year than projected in the September Greenbook because of a tightening of financial conditions over the intermeeting period: Bond rates and the dollar have moved higher since we published the September Greenbook, and equity prices have fallen. Starting in the second half of next year, the projected growth of actual GDP edges below our estimate of potential growth; equivalently, the output gap is projected to widen a bit in the second half of 2006 and in 2007.

The latest data on core inflation have been favorable, and we have shaved our projection of core PCE inflation in the third and fourth quarters of this year. Over the longer term, however, our inflation outlook is little changed. As we did in the September Greenbook, we see higher energy costs putting upward pressure on core inflation next year and higher headline inflation feeding through into wages and inflation expectations. As a result, core PCE inflation is expected to increase from a pace of 2 percent in 2005 to a pace of 2¼ percent in 2006. In 2007, however, the indirect effects of changes in energy prices swing in a favorable direction and help to push core inflation back below 2 percent. Meanwhile, overall PCE prices are projected to decelerate sharply from 3¼ percent in 2005 to 2 percent in 2006 and 1¾ percent in 2007.

---

[1] According to preliminary reports, the macroeconomic consequences of Hurricane Wilma appear likely to have been considerably more limited than those related to Hurricane Katrina or Hurricane Rita.

Key Background Factors

In this projection, we have pulled forward the last tightening in our assumed path for the federal funds rate: We now assume that the funds rate will rise to 4¼ percent by the end of this year and will then remain at that level through the end of 2007. The policy path implied by futures quotes—which was below our assumed path at the time of the last Greenbook—has moved a little above our assumed path in 2006 and 2007. The upward adjustment in the market's outlook appears to have reflected economic data that were a little stronger than the market expected, indications that the disruptions from Katrina were less severe than initially feared, and commentary from Federal Reserve officials that was read as emphasizing inflation concerns. Accordingly, the yield on the ten-year Treasury bond has increased about 40 basis points since the time of the September Greenbook. Looking ahead, we assume that market participants will gradually adjust down their expectations for the path of the federal funds rate toward the path implicit in the staff projection; consequently, bond rates are expected to reverse some of their recent rise over the forecast period.

Broad equity indexes are currently about 3½ percent below the level we had assumed in the September Greenbook. In part, that softness appears to have occurred in reaction to the rise in long-term interest rates. Moreover, although earnings reports for the third quarter have generally been favorable, the forward-looking guidance in these reports has tended to be cautious, leaving investors a bit uneasy about the outlook. Following our usual approach, we assume that equity prices will increase from their current level at an annual rate of 6½ percent over the forecast period, a pace that roughly maintains risk-adjusted parity with the return on Treasury securities. For house prices, we continue to assume deceleration in the OFHEO repeat-transactions index, from nearly 10 percent this year to 4½ percent next year and to 2½ percent in 2007.

Since the last Greenbook, Hurricanes Rita and Wilma have added to the economic damage and disruption caused by Hurricane Katrina. Rita made landfall in areas that are sparsely populated, which helped limit the loss of life and property. However, it significantly damaged energy-related infrastructure beyond the destruction that we had factored into the September projection after Hurricane Katrina. We now expect that production of crude oil and natural gas will not be restored to pre-Katrina levels until the spring, though we anticipate that refining activity will almost fully recover by the end of the year.

Outside the energy sector, our estimates of the disruption effects associated with the hurricanes are just a little larger than those in our last forecast. Factoring in Hurricanes Rita and Wilma, as well as a small reduction in our estimates for Hurricane Katrina, we now estimate that these storms held down real GDP growth 1 percentage point at an annual rate in the third quarter of this year and will hold down growth ½ percentage point in the fourth quarter. In 2006, recovery from the hurricanes boosts growth ½ percentage point. These estimates of the hurricane effects in 2006 and 2007 are just a little larger both on the upside and downside than those in the last Greenbook.[2]

Our fiscal policy assumptions are unrevised from the September Greenbook. We assume that federal outlays and tax cuts related to the hurricanes will total $85 billion, about $70 billion of which we expect to occur within the forecast period. Although Rita and Wilma are generating new demands for government resources, some pressure has emerged within the Congress to offset additional spending, and we believe that our assumption balances these risks.

The final tally for fiscal year 2005 showed a federal deficit of $319 billion, $20 billion less than we had anticipated in the last Greenbook. Looking forward, we project a federal budget deficit of $354 billion for fiscal 2006 and $359 billion for fiscal 2007, down from the last Greenbook $26 billion in each year. The downward revision to the deficit path largely reflects our reaction to the recent favorable news about corporate tax receipts.

The foreign exchange value of the dollar has moved a little higher since the September Greenbook, and we have boosted our projection for the real trade-weighted dollar in the current quarter 1 percent. Over the next two years, the dollar is assumed to depreciate at an annual rate of about 2 percent. Our outlook for the growth of foreign real GDP is little changed from that in the last Greenbook; we expect foreign real GDP, after increasing 3 percent this year, to rise 3¼ percent in 2006 and 2007.

Although oil prices moved up further in the immediate aftermath of Hurricane Rita, the spot price of West Texas intermediate (WTI) crude oil has subsequently fallen, on net, to

---

[2] We now estimate that $84 billion of real private and public capital will be rebuilt, up from $76 billion in the September Greenbook. For business and public capital, we have boosted our damage estimates to reflect additional destruction from Hurricanes Rita and Wilma. For residential capital, our estimate of the amount of rebuilding that will occur is essentially the same as that in the last Greenbook. Hurricanes Rita and Wilma caused additional damage to the residential capital stock, but we reassessed our estimate of the value per unit destroyed by Hurricane Katrina and lowered it somewhat.

about $63 per barrel, down about $3 over the intermeeting period. Futures prices have also fallen, and we have lowered our projected path for the spot price to about $61 per barrel by the end of 2007, a decrease of almost $2 since the last Greenbook. In contrast, we have revised up our projection of natural gas prices. Hurricane Rita caused significant further damage to natural gas infrastructure in the Gulf, and the price of natural gas on spot and futures markets has moved up sharply. Although our projection calls for consumer prices of natural gas to begin declining in the middle of next year, the level of these prices is almost 8 percent higher at the end of 2007 than projected in the last Greenbook.

Recent Developments and the Near-Term Outlook

We now estimate that real GDP increased at an annual rate of 3.2 percent in the third quarter and will rise 3.5 percent in the fourth quarter.[3] Relative to our previous projection, the third-quarter estimate is a touch stronger, whereas the figure for the fourth quarter is a little weaker. These revisions reflect a balancing of slightly larger effects from hurricanes; an earlier-than-expected end to the Boeing strike; and the incoming data on employment, production, and spending. More broadly, the news since the last Greenbook appears, on the whole, to confirm our view that activity outside the area directly affected by the hurricanes has been well maintained. Although the data on retail sales were weaker than we had expected, several other indicators were a little to the high side of our expectations. We estimate that real GDP excluding the effects of the hurricanes and the Boeing strike would have increased at an annual rate of about 4 percent in the second half of the year, close to our estimate in the September Greenbook.

The September labor report, which provided an early indicator of hurricane effects, suggested a smaller employment effect from Hurricane Katrina than we had anticipated. However, information on hurricane-related claims for unemployment insurance points to an effect more in line with our expectation, and we anticipate more hurricane-related layoffs in revisions to the September figure or in the numbers for October. Nevertheless, employment was revised up in July and August, and—although any inferences abstracting from hurricane effects in September must be tentative—the underlying pace of labor demand appears to be slightly stronger than we had assumed in the last Greenbook.

[3] The Bureau of Economic Analysis will release its advance estimate of third-quarter GDP on Friday. However, as is usually the case, this estimate will be based on incomplete source data and will thus be influenced by the BEA's assumptions, most notably for inventories and net exports.

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

Measure	2005:Q3		2005:Q4	
	Sept. GB	Oct. GB	Sept GB	Oct. GB
Real GDP	**3.1**	**3.2**	**3.7**	**3.5**
Private domestic final purchases	3.9	3.6	1.5	1.6
Personal consumption expenditures	4.1	3.4	1.1	.6
Residential investment	3.6	5.9	2.4	6.9
Business fixed investment	2.6	3.5	3.9	5.9
Government outlays for consumption and investment	2.1	3.3	4.6	3.5
	Contribution to growth (percentage points)			
Inventory investment	-.9	-.8	2.1	1.7
Net exports	.3	.3	-.7	-.3

We estimate that industrial production increased at an annual rate of 1¼ percent in the third quarter, held down 3¾ percentage points by the effects of the hurricanes and the Boeing strike. These events have masked an improvement in the underlying pace of industrial activity now that firms appear to have worked through inventory adjustments undertaken earlier in the year. After replenishing stocks early this year, firms slowed the pace of production to bring output back in line with sales, and with that process largely complete, short-run inventory dynamics appear to no longer be a drag on production. In the fourth quarter, IP is expected to increase at an annual rate of 4 percent, the same pace as forecast in the September Greenbook.

We had anticipated some softness in consumer spending and in consumer sentiment in September, but the incoming data on retail sales were noticeably weaker than we had expected. We have attributed some of that weakness to noise in the data, but we have also taken some signal from this soft reading. We now estimate that real consumer expenditures increased at an annual rate of 3½ percent last quarter, down more than ¾ percentage point from the previous Greenbook. In the fourth quarter, real consumer spending is projected to increase at an annual rate of just ½ percent, as motor vehicle purchases drop back sharply with the end of “employee pricing” programs and real spending elsewhere decelerates a bit.

New home sales dropped back in August, and anecdotes continue to circulate about cooling in the housing sector. However, near-term indicators of housing construction remain robust: In September, housing starts rose, and permits jumped by even more, with the latter pointing to strength in October starts. Moreover, rebuilding from the hurricanes should begin in earnest this quarter in most hurricane-ravaged areas other than New Orleans. All told, we now expect real residential investment to increase at an annual rate of 6 percent in the third quarter and 7 percent in the fourth quarter, a rise greater than that projected in the September Greenbook.

Real purchases of equipment and software are expected to remain relatively subdued in the near term. Aircraft spending was held down in the third quarter by the Boeing strike, and outlays for motor vehicles are projected to decline in the fourth quarter. We also estimate that increases in capital spending outside high-tech and transportation, which have been sluggish for much of this year, are likely to remain subdued somewhat longer. We now project that real purchases of equipment and software increased at an annual rate of 3¾ percent in the third and fourth quarters. Spending on real nonresidential structures receives a boost from hurricane-related rebuilding in the fourth quarter as well as on-going support from drilling and mining expenditures, and we expect the annual rate of increase in real construction outlays to step up to 12 percent this quarter.

In the federal sector, hurricane-related spending appears to have been a little higher in the third quarter than we had anticipated, but we have assumed that this development was essentially a timing shift. We now estimate that real federal purchases increased at an annual rate of 6½ percent in the third quarter and will rise 3¼ percent in the fourth quarter, leaving the average for the second half little different from before. In the state and local sector, real spending is supported by hurricane-related grants and continued good news on tax receipts. All together, real spending by state and local governments is projected to increase at an average annual rate of 2½ percent in the second half of this year.

We have revised down the projected growth rates of both real imports and real exports in the third quarter, leaving the contribution of net exports to the growth of real GDP at ¼ percentage point, a number unrevised from the last Greenbook. The growth rate of real exports has been revised up for the fourth quarter to reflect the earlier-than-expected end to the Boeing strike. With that revision, net exports are expected to subtract ¼ percentage point from real GDP growth, compared with ¾ percentage point in the September Greenbook.

Incoming data on core prices have been a tad more favorable than anticipated at the time of the last Greenbook, and we have marked down our projection of core PCE prices to an annual rate of increase of 1.3 percent in the third quarter and 2.2 percent in the fourth quarter. Last quarter's pace was held down by the "employee pricing" of motor vehicles and by a string of unusually low readings on some typically volatile categories of prices, such as lodging away from home. The step-up in the fourth-quarter pace reflects the absence of these factors and the continued pass-through of higher energy prices. Overall PCE prices, pushed higher by surging energy prices, are projected to increase at an annual rate of 3½ percent in the second half of this year.

The Longer-Term Outlook for the Economy

We expect real GDP to decelerate to a pace of 3.3 percent in 2006 and 2.8 percent in 2007, as a diminishing drag from oil prices is more than offset by tighter monetary policy, waning wealth effects, and fiscal impetus that, on balance, declines over the forecast period. In this projection, the growth rate of real output slips below its potential pace in the middle of next year, and the output gap increases somewhat. This profile of growth in real GDP is a bit lower than we had forecast in the previous Greenbook. The downward revisions reflect less favorable financial conditions that are partly offset by the effects of lower crude oil prices and a bigger bounceback next year from hurricane disruptions.

Household spending. Real consumer spending accelerates to an annual rate of 3¼ percent in 2006 as hurricane-related disruptions come to an end. This pace is a little slower than that projected in the last Greenbook because of a lower trajectory of household net worth, higher interest rates, and slower growth of disposable income. For 2007, we project that the growth rate of real consumer spending will slow to about 3¼ percent, as the wealth-to-income ratio falls further, labor income decelerates, and the pace of federal transfers slows. The NIPA personal saving rate is expected to increase from an average of about zero in 2005 to almost 2 percent in 2007.

Rebuilding from the hurricanes is expected to boost the growth rate of real residential investment next year but to be a slight negative for growth in 2007 as the level of rebuilding activity eases a little. Accounting for those effects, along with the increase in mortgage rates that we have seen and the anticipated deceleration in overall economic activity, we expect real residential investment to flatten out next year and to decline a little in 2007.

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

Measure	2005: H2	2006: H1	2006	2007
Real GDP	**3.4**	**3.8**	**3.3**	**2.8**
Previous	3.4	3.9	3.4	2.9
Final sales	2.9	4.0	3.4	2.5
Previous	2.8	4.3	3.6	2.6
PCE	2.0	3.5	3.3	3.1
Previous	2.6	3.9	3.6	3.1
Residential investment	6.4	1.7	.3	-.7
Previous	3.0	3.8	1.3	-1.0
BFI	4.7	11.4	9.2	4.5
Previous	3.3	11.0	9.0	5.3
Government purchases	3.4	2.6	2.1	1.5
Previous	3.4	2.6	2.0	1.5
Exports	7.0	4.5	5.1	5.3
Previous	5.8	6.5	6.3	5.7
Imports	4.4	4.6	5.3	5.8
Previous	5.0	5.9	6.2	6.1
	Contribution to growth (percentage points)			
Inventory change	.5	-.2	-.1	.3
Previous	.6	-.4	-.1	.3
Net exports	.0	-.3	-.3	-.4
Previous	-.2	-.3	-.4	-.4

Business spending. We expect real outlays for equipment and software to pick up to a pace of 9¼ percent next year, as the current softness in spending, which we see as transitory, passes and as hurricane-related replacement demand boosts spending. In 2007, the rate of increase in real outlays for equipment and software slows to 6 percent as the growth of business sales slackens. Real spending for nonresidential structures jumps 9¼ percent next year, pushed higher by a surge in drilling and mining expenditures that reflects the very high level of natural gas prices. In 2007, real outlays for nonresidential structures increase just ¾ percent; as natural gas prices recede, drilling activity is expected to drop back somewhat.

Government spending. We project that the growth rate of real federal purchases will slow considerably in 2006, with flat real outlays for Iraq and Afghanistan, a modest increase in other real defense spending, and a small rise in the nondefense category. We continue to assume that in 2007 real federal spending will be about flat. Although hurricane-related spending is expected to provide a noticeable dose of fiscal stimulus next year, most of those outlays are not direct federal purchases but rather take the form of transfers, grants, and subsidies. In the state and local sector, with continued favorable news on the tax front and the injection of hurricane-related aid from the federal government, real spending is forecast to increase at annual rates of about 2½ percent per year over the next two years.

Net exports. Net exports are expected to be a moderate drag on real GDP growth in 2006 and 2007. These effects are about unchanged from the last Greenbook, with growth rates of both real imports and exports in 2006 and 2007 that are projected to be somewhat slower than we had previously anticipated. (*These developments are discussed in more detail in the international section of the Greenbook.*)

Productivity and the labor market. We project that total private employment will increase at an average monthly pace close to 185,000 in the fourth quarter of this year. But with real GDP decelerating and the labor force participation rate trending down, we expect private payrolls to grow only about 110,000 per month by the fourth quarter of next year and to average gains of about 70,000 per month in 2007. With this pace of hiring, we expect the unemployment rate to be about 5 percent through the end of next year and then to edge up to 5.1 percent by the end of 2007. Actual productivity is projected to rise more slowly than structural productivity in 2006, and the gap between actual and structural productivity that has persisted for some time is expected to close by the end of next year. In 2007, we project actual productivity to increase 2.5 percent, near our estimate of its structural rate.

Prices and wages. Core PCE inflation is expected to step up to 2¼ percent next year, a bit above this year's pace, as increases in energy costs are passed through to prices of items in the core and as higher overall inflation numbers feed into inflation expectations. In 2007, the effects of falling energy prices on core inflation and the small degree of slack in the economy that is expected to persist damp the increase in core PCE prices to

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

Measure	1974-95	1996-2001	2002	2003	2004	2005	2006	2007
Structural labor productivity	1.5	2.7	3.1	3.4	3.1	2.8	2.8	2.8
Previous	1.5	2.7	3.1	3.4	3.2	2.7	2.9	2.8
Contributions[1]								
Capital deepening	.7	1.4	.6	.5	.7	.9	.9	.9
Previous	.7	1.4	.6	.5	.7	.8	.9	1.0
Multifactor productivity	.5	1.1	2.3	2.6	2.2	1.7	1.7	1.6
Previous	.5	1.1	2.3	2.6	2.2	1.7	1.7	1.6
Labor composition	.3	.3	.3	.3	.3	.3	.2	.2
MEMO								
Potential GDP	3.0	3.3	3.2	3.3	3.0	3.1	3.1	3.0
Previous	3.0	3.3	3.2	3.3	3.0	2.9	3.1	3.0

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

1. Percentage points.

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

Measure	2004	2005	2006	2007
Output per hour, nonfarm business	2.6	2.8	2.2	2.5
Previous	2.6	2.8	2.2	2.5
Nonfarm private payroll employment	1.8	1.7	1.5	.7
Previous	1.8	1.6	1.5	.7
Household survey employment	1.3	1.9	1.0	.6
Previous	1.3	1.7	1.1	.8
Labor force participation rate[1]	66.0	66.2	66.0	65.8
Previous	66.0	66.1	66.0	65.9
Civilian unemployment rate[1]	5.4	5.0	5.0	5.1
Previous	5.4	5.0	5.0	5.0
MEMO				
GDP gap[2]	.9	.5	.3	.4
Previous	.9	.4	.1	.2

1. Percent, average for the fourth quarter

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

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

Measure	2004	2005	2006	2007
PCE chain-weighted price index	3.1	3.2	1.9	1.7
Previous	3.1	3.2	1.9	1.8
Food and beverages	2.9	2.0	2.5	2.1
Previous	2.9	2.0	2.5	2.2
Energy	17.9	25.7	-4.2	-1.5
Previous	17.9	26.6	-5.1	-1.3
Excluding food and energy	2.2	1.9	2.3	1.9
Previous	2.2	1.9	2.3	2.0
Consumer price index	3.4	4.0	1.9	1.8
Previous	3.4	4.2	1.9	1.9
Excluding food and energy	2.1	2.1	2.6	2.2
Previous	2.1	2.3	2.6	2.2
GDP chain-weighted price index	2.9	2.8	2.1	1.9
Previous	2.9	2.7	2.0	2.1
ECI for compensation of private industry workers[1]	3.8	3.1	4.2	3.9
Previous	3.8	3.1	4.2	4.0
NFB compensation per hour	5.8	4.4	5.3	5.0
Previous	5.8	4.7	5.4	5.1
Prices of core nonfuel imports	3.7	2.4	1.5	.8
Previous	3.7	1.9	.8	.6

1. December to December.

less than 2 percent. Overall PCE prices, held down by falling energy prices, are projected to post increases of 2 percent and 1¾ percent, respectively, in 2006 and 2007. With regard to labor compensation, we expect a pickup in rates of increase in both the P&C measure of hourly compensation and the ECI next year, reflecting in part the pass-through of higher overall price inflation to compensation. In 2007, both measures decelerate slightly, reflecting the slower pace of price inflation.

Financial Flows and Conditions

Our forecast for the growth of domestic nonfinancial debt has been revised down a bit, on balance, but its basic contour has not changed. We still expect the growth of this debt aggregate to slow over the forecast period—from 8¼ percent in 2005 to 6½ percent in 2007.

The largest contributor to this slowdown is a moderation in home mortgage borrowing, which results from our projected deceleration in house prices. The reduction in mortgage borrowing pulls down growth of total household debt from 9¼ percent in 2005 to 6½ percent in 2007. This path for household debt, combined with some further shift away from consumer credit toward longer-maturity (and lower cost) mortgage debt, keeps the debt service ratio roughly unchanged over the forecast period.

We project that the debt of nonfinancial corporations will expand at an average annual rate of about 6½ percent in 2006 and 2007, a pace similar to the one this year. This forecast of stable debt growth balances the effects of two opposing factors. On the one hand, we anticipate that profits will lag behind the projected rise in capital spending, which will boost firms' borrowing needs, all else being equal. However, we also project a slowing of equity retirements from the currently elevated level, which should restrain the demand for external funds.

Our forecast for the growth of federal government debt, reflecting the narrower projected budget deficit, is slightly lower than that in the September Greenbook. Federal debt is now anticipated to increase at an average annual pace of 7¾ percent over the forecast period. We expect the growth of debt in the state and local sector to slow from 9 percent in 2005 to 3 percent in 2007 as advance refunding diminishes.

M2 growth is expected to pick up over the forecast period, from 3¾ percent this year to 4½ percent next year and to 5 percent in 2007. The lagged effects of increases in opportunity costs should continue to hold growth in money below that of nominal income until the end of 2006.

Alternative Simulations

In this section, we consider several risks to the staff outlook using simulations of the FRB/US model. We begin with a scenario in which inflation expectations increase sharply next year; our second simulation builds on the first by assuming that the deteriorating price situation triggers an adverse financial market response. In contrast, in the third scenario, inflation expectations remain firmly anchored rather than rising somewhat as in the baseline. Our fourth scenario focuses on aggregate spending, and the risk that we have underestimated the strength in spending now in train. We evaluate each

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

Measure and scenario	2005 H1	2005 H2	2006 H1	2006 H2	2007
Real GDP					
Baseline	**3.6**	**3.4**	**3.8**	**2.8**	**2.8**
Unanchored inflation expectations	3.6	3.4	3.6	2.9	3.2
With monetary policy response	3.6	3.4	3.6	2.7	2.7
Stagflation	3.6	3.4	3.1	1.9	2.0
With monetary policy response	3.6	3.4	3.1	2.0	2.2
Low inflation	3.6	3.4	3.9	2.8	2.6
With monetary policy response	3.6	3.4	3.9	2.9	2.8
Spending boom	3.6	3.5	4.2	3.4	3.3
With monetary policy response	3.6	3.5	4.2	3.3	2.9
Higher funds rate path	3.6	3.4	3.8	2.4	2.3
Civilian unemployment rate[1]					
Baseline	**5.1**	**5.0**	**5.0**	**5.0**	**5.1**
Unanchored inflation expectations	5.1	5.0	5.0	5.0	5.0
With monetary policy response	5.1	5.0	5.0	5.0	5.2
Stagflation	5.1	5.0	5.1	5.3	5.8
With monetary policy response	5.1	5.0	5.1	5.3	5.7
Low inflation	5.1	5.0	5.0	5.0	5.1
With monetary policy response	5.1	5.0	5.0	5.0	5.0
Spending boom	5.1	5.0	4.9	4.8	4.6
With monetary policy response	5.1	5.0	4.9	4.8	4.8
Higher funds rate path	5.1	5.0	5.0	5.1	5.4
PCE prices excluding food and energy					
Baseline	**2.1**	**1.8**	**2.4**	**2.2**	**1.9**
Unanchored inflation expectations	2.1	1.8	2.7	2.7	2.8
With monetary policy response	2.1	1.8	2.7	2.7	2.7
Stagflation	2.1	1.8	2.6	2.6	2.6
With monetary policy response	2.1	1.8	2.6	2.6	2.7
Low inflation	2.1	1.8	2.2	1.9	1.4
With monetary policy response	2.1	1.8	2.2	1.9	1.5
Spending boom	2.1	1.8	2.4	2.2	2.1
With monetary policy response	2.1	1.8	2.4	2.2	1.9
Higher funds rate path	2.1	1.8	2.4	2.1	1.8

1. Average for the final quarter of the period.

of these four risks under the assumption that the federal funds rate is held at its baseline path, and then under the alternative assumption that monetary policy responds to the change in the outlook along the lines suggested by the Taylor rule.[4] The final scenario traces out the consequences of a tighter monetary policy.

Unanchored inflation expectations. In the baseline, the underlying rate of inflation increases about ½ percentage point from the end of 2003 to 2007, primarily reflecting the surge in energy prices. In this scenario, long-run inflation expectations rise a percentage point relative to baseline over the course of next year, making the cumulative increase three times as large as in the baseline. As a result, core PCE inflation rises to 2¾ percent in 2006 and 2007 under the assumption that the nominal funds rate follows its baseline path. The resulting decline in real interest rates stimulates real activity, causing real GDP to increase 3¼ percent in 2006 and 2007; the unemployment rate is marginally lower as a result. Under the Taylor-rule policy, the sharp rise in inflation causes the nominal funds rate to climb above 5 percent in early 2007. This tighter policy in turn weakens real activity and pushes the unemployment rate up to 5¼ percent by late 2007 and thereby checks the rise in inflation a bit.

Stagflation. A marked and persistent rise in inflation might cause a significant deterioration in financial market sentiment. This scenario builds on the previous one by assuming that the rise in inflation causes term premiums on long-term Treasury securities to widen ½ percentage point relative to baseline over the next few quarters. In addition, risk spreads on investment-grade corporate bonds over government yields increase ½ percentage point, boosted in part by weaker real activity. Taken together, these changes depress consumption, investment, and exports by raising the cost of borrowing, lowering household wealth (share values fall 13 percent), and boosting the exchange value of the dollar. All told, real GDP rises at an average annual rate of only 2 percent over the second half of next year and in 2007, and the unemployment rate climbs to 5¾ percent, under the assumption that the funds rate follows its baseline path. Given the deterioration in long-run inflation expectations, however, core inflation still rises above 2½ percent in 2007 despite the emergence of significant economic slack. These stagflationary conditions pull monetary policy in opposing directions, and the Taylor rule responds to the higher inflation and weaker real activity by holding the nominal funds rate at 4 percent over the next two years. Relative to the baseline policy, this slightly

[4] In the Taylor-rule scenarios, the federal funds rate is assumed to move 1 percentage point relative to baseline for each percentage point deviation of the output gap from baseline and 1½ percentage points for each percentage point deviation of the four-quarter average of core PCE inflation from baseline.

more accommodative response limits the rise in the unemployment rate at a cost of a marginally higher rate of inflation.

Low inflation. As noted above, in the baseline the underlying rate of inflation drifts up. In this scenario, we instead assume that long-run inflation expectations have not risen and, further, will remain firmly anchored, implying that core inflation should decline appreciably once the direct pass-through of higher energy costs into prices is completed. Under the baseline monetary policy, core PCE inflation falls below 1½ percent by 2007. With the nominal funds rate unchanged from baseline, real interest rates are higher, causing real GDP to expand a bit more slowly in 2007. Under the Taylor rule, by contrast, the lower inflation results in a funds rate that drifts down to 3¾ percent by the second half of 2007. As a result, real activity is marginally stronger than in the baseline.

Spending boom. Excluding hurricane-related effects, we anticipate that economic growth will slow considerably in 2006, but with interest rates low relative to historical norms, this moderation may not materialize. In this scenario, the personal saving rate climbs only half as much as in the baseline, boosting aggregate demand by enough to raise the implicit short-run equilibrium real funds rate to 2¾ percent—close to its historical average and ¾ percentage point above the baseline value. Under the baseline monetary policy, real GDP climbs at an annual rate of about 3½ percent on average over the next two years, pushing the unemployment rate down almost to 4½ percent by the end of 2007. With labor and product market conditions tighter than in the baseline, core inflation moderates by less after the pass-through of higher energy costs is completed, and it falls only to 2.1 percent in 2007. Under the Taylor rule, the nominal funds rate climbs to 5 percent by late 2007 and yields a noticeably higher level of bond rates relative to baseline, as well as a 10 percent decline in share prices and a modest appreciation of the dollar. With these tighter financial conditions, real GDP growth in 2007 is about the same as in the baseline, and the unemployment rate declines to 4¾ percent. This more modest expansion in real activity, coupled with the restraint on import prices from dollar appreciation, is sufficient to keep inflation at baseline.

Higher funds rate path. In this scenario, the target funds rate is raised in quarter-point steps at every FOMC meeting until May 2006, when it reaches 5 percent; the funds rate remains at this level thereafter. As a result, in 2007 real GDP growth slows to 2¼ percent, and the unemployment rate rises to almost 5½ percent. With more slack in labor and product markets, core inflation slows to 1¾ percent in 2007.

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

Measure	2005	2006	2007
Real GDP			
(percent change, Q4 to Q4)			
Projection	3.5	3.3	2.8
Confidence interval			
Greenbook forecast errors[1]	2.9–4.0	1.5–5.1	1.0–4.7
FRB/US stochastic simulations	2.8–4.1	1.7–5.1	0.9–5.0
Civilian unemployment rate			
(percent, Q4)			
Projection	5.0	5.0	5.1
Confidence interval			
Greenbook forecast errors[1]	4.9–5.1	4.3–5.7	4.0–6.2
FRB/US stochastic simulations	4.8–5.3	4.2–5.7	4.0–6.0
PCE prices			
excluding food and energy			
(percent change, Q4 to Q4)			
Projection	1.9	2.3	1.9
Confidence interval			
Greenbook forecast errors[2]	1.7–2.1	1.6–3.0	1.0–2.8
FRB/US stochastic simulations	1.7–2.2	1.6–3.1	1.0–2.8

NOTE. Shocks underlying stochastic simulations are randomly drawn from the 1978–2004 set of model equation residuals.

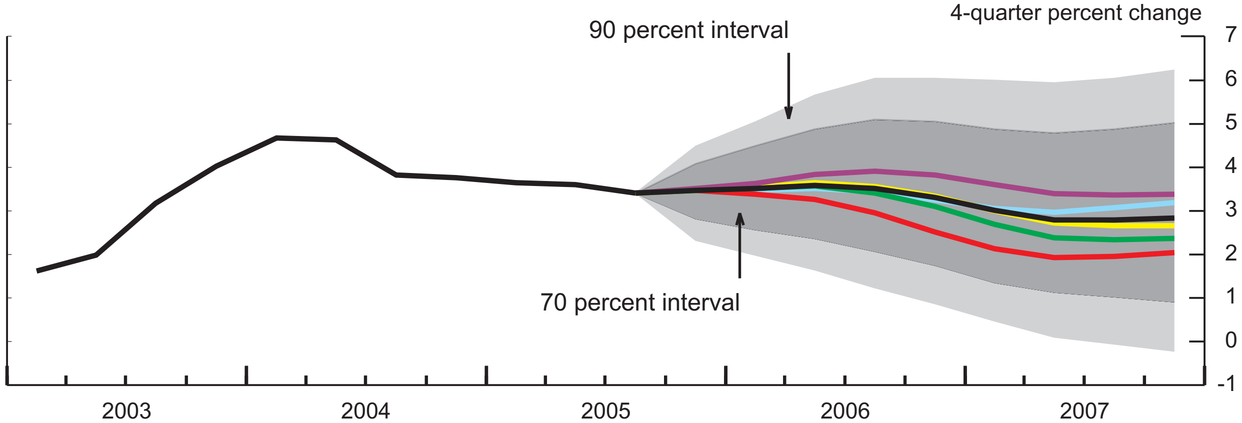
1. 1978–2004.
2. 1981–2004.

Forecast Confidence Intervals and Alternative Scenarios

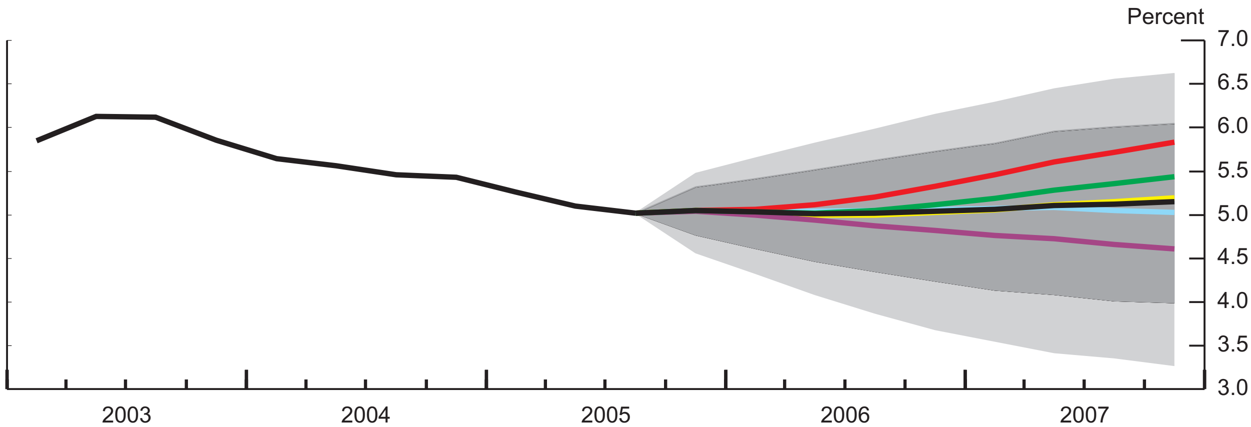
Confidence Intervals Based on FRB/US Stochastic Simulations
Scenarios Assume Baseline Federal Funds Rate

Greenbook baseline
Unanchored inflation expectations
Stagflation
Low inflation
Spending boom
Higher funds rate path

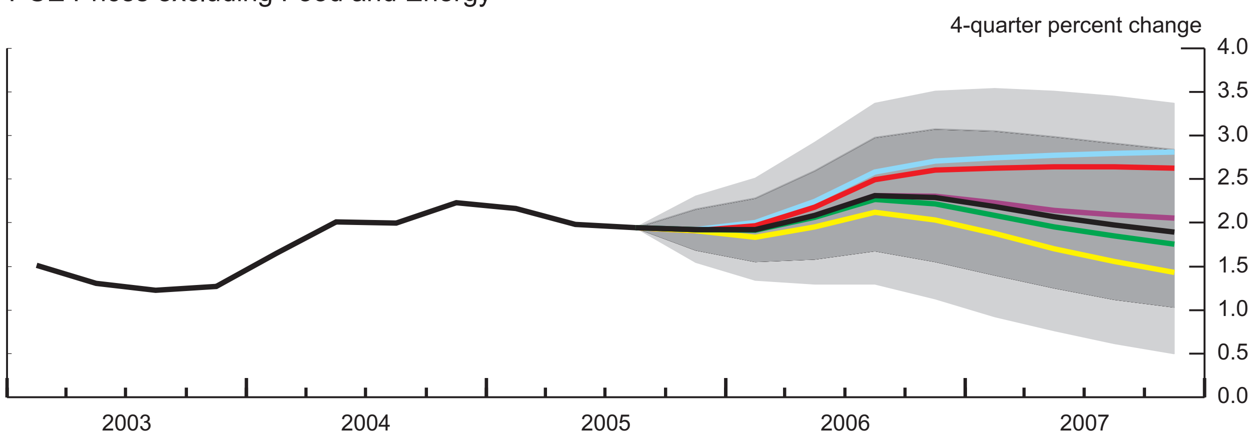
Real GDP



Unemployment Rate



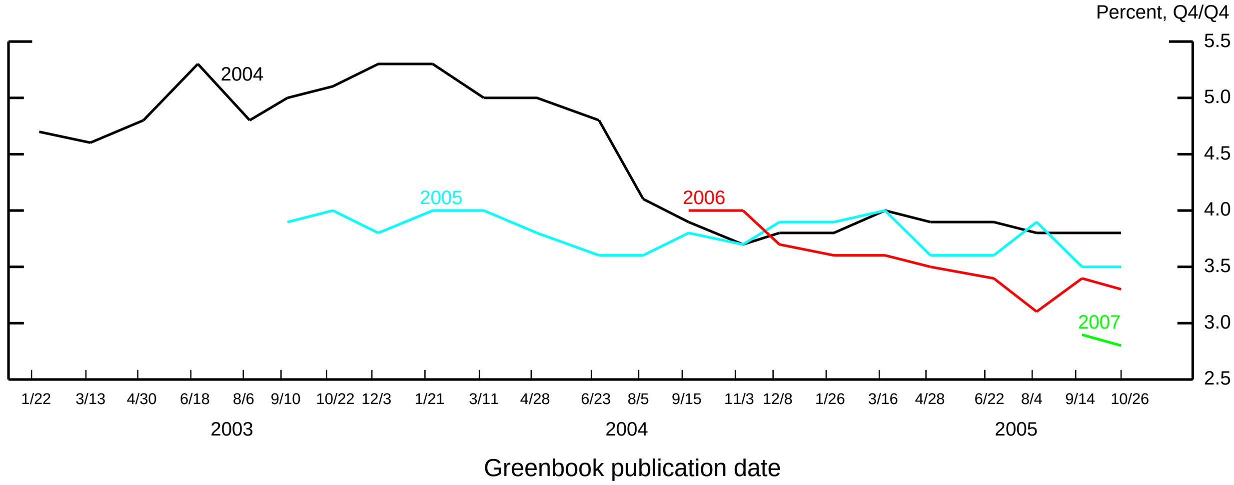
PCE Prices excluding Food and Energy



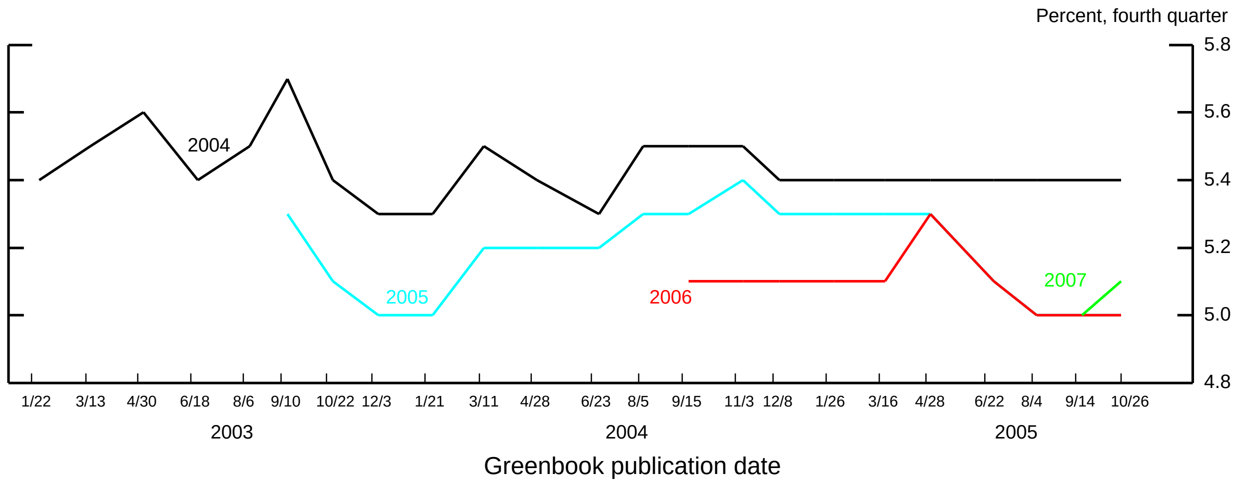
Class II FOMC - Restricted (FR)

Evolution of the Staff Forecast

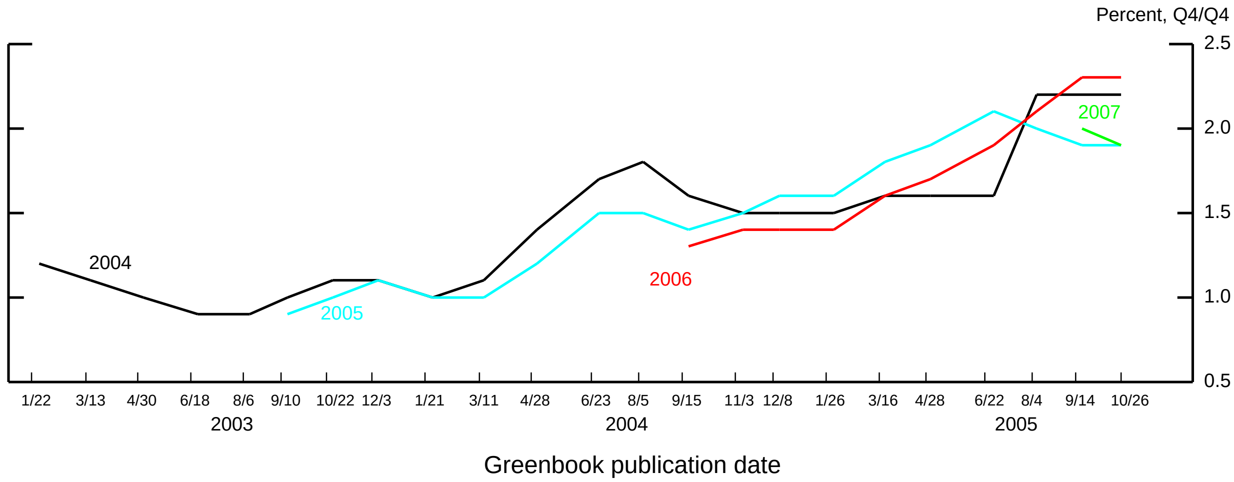
Change in Real GDP



Unemployment Rate



Change in PCE Prices excluding Food and Energy



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

	Nominal GDP		Real GDP		PCE price index		Core PCE price index		Unemployment rate[1]	
Interval	9/14/05	10/26/05	9/14/05	10/26/05	9/14/05	10/26/05	9/14/05	10/26/05	9/14/05	10/26/05
Quarterly										
2005:Q1	7.0	7.0	3.8	3.8	2.3	2.3	2.4	2.4	5.3	5.3
Q2	5.8	6.0	3.2	3.3	3.2	3.3	1.6	1.7	5.1	5.1
Q3	5.8	5.9	3.1	3.2	3.7	3.7	1.4	1.3	5.0	5.0
Q4	6.6	6.6	3.7	3.5	3.8	3.5	2.4	2.2	5.0	5.0
2006:Q1	6.1	5.9	4.2	4.0	1.4	1.3	2.4	2.4	5.0	5.0
Q2	5.7	5.9	3.5	3.6	2.1	2.2	2.4	2.4	5.0	5.0
Q3	5.3	5.1	3.1	2.9	2.0	2.1	2.2	2.2	5.0	5.0
Q4	5.0	4.8	2.9	2.7	2.0	2.0	2.2	2.2	5.0	5.0
2007:Q1	5.3	5.0	2.9	2.8	1.9	1.8	2.0	2.0	5.0	5.1
Q2	4.9	4.7	2.9	2.8	1.8	1.7	2.0	1.9	5.0	5.1
Q3	4.9	4.8	2.9	2.9	1.8	1.7	2.0	1.9	5.0	5.1
Q4	4.9	4.8	2.9	2.9	1.8	1.7	2.0	1.8	5.0	5.1
Two-quarter[2]										
2005:Q2	6.4	6.5	3.5	3.6	2.7	2.8	2.0	2.1	-.3	-.3
Q4	6.2	6.3	3.4	3.4	3.7	3.6	1.9	1.8	-.1	-.1
2006:Q2	5.9	5.9	3.9	3.8	1.7	1.8	2.4	2.4	.0	.0
Q4	5.2	4.9	3.0	2.8	2.0	2.0	2.2	2.2	.0	.0
2007:Q2	5.1	4.9	2.9	2.8	1.8	1.8	2.0	1.9	.0	.1
Q4	4.9	4.8	2.9	2.9	1.8	1.7	2.0	1.9	.0	.0
Four-quarter[3]										
2004:Q4	6.8	6.8	3.8	3.8	3.1	3.1	2.2	2.2	-.5	-.5
2005:Q4	6.3	6.4	3.5	3.5	3.2	3.2	1.9	1.9	-.4	-.4
2006:Q4	5.5	5.4	3.4	3.3	1.9	1.9	2.3	2.3	.0	.0
2007:Q4	5.0	4.8	2.9	2.8	1.8	1.7	2.0	1.9	.0	.1
Annual										
2004	7.0	7.0	4.2	4.2	2.6	2.6	2.0	2.0	5.5	5.5
2005	6.2	6.3	3.5	3.5	2.9	2.9	2.0	2.0	5.1	5.1
2006	5.9	5.9	3.6	3.5	2.5	2.4	2.2	2.2	5.0	5.0
2007	5.1	4.9	2.9	2.9	1.9	1.9	2.1	2.0	5.0	5.1

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

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

Item	2005 Q1	2005 Q2	2005 Q3	2005 Q4	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2005[1]	2006[1]	2007[1]
Real GDP	3.8	3.3	3.2	3.5	4.0	3.6	2.9	2.7	2.8	2.8	2.9	2.9	3.5	3.3	2.8
Previous	3.8	3.2	3.1	3.7	4.2	3.5	3.1	2.9	2.9	2.9	2.9	2.9	3.5	3.4	2.9
Final sales	3.5	5.6	4.0	1.8	4.4	3.6	3.0	2.5	2.1	3.0	2.7	2.3	3.7	3.4	2.5
Previous	3.5	5.4	4.1	1.5	4.7	3.9	3.1	2.6	2.2	3.0	2.8	2.4	3.6	3.6	2.6
Priv. dom. final purch.	4.1	4.5	3.6	1.6	5.0	3.7	3.3	3.2	3.0	3.0	3.1	3.1	3.5	3.8	3.0
Previous	4.1	4.4	3.9	1.5	5.2	4.2	3.6	3.3	3.1	3.1	3.1	3.1	3.5	4.1	3.1
Personal cons. expend.	3.5	3.4	3.4	.6	3.9	3.1	3.1	3.1	3.1	3.1	3.1	3.1	2.7	3.3	3.1
Previous	3.5	3.1	4.1	1.1	4.3	3.5	3.4	3.3	3.1	3.1	3.1	3.1	3.0	3.6	3.1
Durables	2.6	7.9	9.4	-11.4	13.6	6.5	6.9	6.6	6.8	6.7	6.5	6.5	1.8	8.4	6.6
Nondurables	5.3	3.6	2.5	2.3	3.5	3.5	3.5	3.5	3.7	3.7	3.7	3.7	3.4	3.5	3.7
Services	2.8	2.3	2.6	2.3	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.5	2.2	2.2
Residential investment	9.5	10.8	5.9	6.9	2.0	1.5	-1.3	-1.0	-1.3	-1.0	-.7	.1	8.3	.3	-.7
Previous	9.5	12.1	3.6	2.4	2.1	5.7	-1.3	-1.2	-1.3	-1.0	-1.4	-.3	6.8	1.3	-1.0
Business fixed invest.	5.7	8.8	3.5	5.9	14.0	8.9	7.6	6.4	4.4	4.5	4.6	4.6	6.0	9.2	4.5
Previous	5.7	8.7	2.6	3.9	13.7	8.5	7.7	6.5	5.5	5.3	5.3	5.2	5.2	9.0	5.3
Equipment & software	8.3	10.9	3.7	3.8	14.5	8.7	7.6	6.3	5.5	6.1	6.1	6.0	6.6	9.2	5.9
Previous	8.3	10.5	2.4	2.4	15.2	8.6	8.0	7.2	6.3	6.5	6.5	6.4	5.9	9.7	6.4
Nonres. structures	-2.0	2.7	2.9	12.1	12.7	9.7	7.5	6.9	1.3	.5	.8	.7	3.8	9.2	.8
Previous	-2.0	3.3	3.2	8.4	9.3	8.1	6.7	4.7	3.2	2.0	2.0	1.9	3.2	7.2	2.3
Net exports[2]	-645	-614	-607	-612	-627	-626	-631	-647	-668	-665	-672	-690	-620	-633	-674
Previous[2]	-645	-614	-607	-625	-637	-640	-646	-663	-687	-686	-692	-709	-623	-646	-694
Exports	7.5	10.7	1.8	12.5	4.2	4.9	4.7	6.6	3.2	5.4	5.5	7.3	8.0	5.1	5.3
Imports	7.4	-.3	-.5	9.5	6.1	3.0	4.2	7.8	6.6	3.0	4.9	8.5	3.9	5.3	5.8
Govt. cons. & invest.	1.9	2.5	3.3	3.5	3.2	2.0	1.7	1.6	1.5	1.5	1.5	1.4	2.8	2.1	1.5
Previous	1.9	2.3	2.1	4.6	3.4	1.9	1.3	1.5	1.6	1.5	1.5	1.4	2.7	2.0	1.5
Federal	2.4	2.4	6.5	3.3	3.7	1.3	.9	.6	.0	.0	.0	.0	3.6	1.6	.0
Defense	3.0	3.7	5.4	4.2	3.2	2.0	1.2	.7	.0	.0	.0	.0	4.1	1.8	.0
Nondefense	1.1	-.2	8.8	1.6	4.8	-.2	.2	.4	.0	.0	.0	.0	2.8	1.3	.0
State & local	1.6	2.6	1.5	3.5	2.9	2.4	2.2	2.2	2.4	2.4	2.4	2.2	2.3	2.4	2.4
Change in bus. inventories[2]	58	-2	-21	27	18	19	15	22	42	36	41	57	16	18	44
Previous[2]	58	1	-23	38	26	15	15	23	44	40	44	58	19	20	46
Nonfarm[2]	62	3	-18	29	16	17	13	20	40	34	39	55	19	17	42
Farm[2]	-2	-4	-3	-2	1	2	2	2	2	2	2	2	-3	2	2

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

Class II FOMC
Restricted (FR)

October 26, 2005

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

Item	1999[1]	2000[1]	2001[1]	2002[1]	2003[1]	2004[1]	2005[1]	2006[1]	2007[1]
Real GDP	4.7	2.2	.2	1.9	4.0	3.8	3.5	3.3	2.8
Previous	4.7	2.2	.2	1.9	4.0	3.8	3.5	3.4	2.9
Final sales	4.2	2.9	1.5	.8	4.0	3.6	3.7	3.4	2.5
Previous	4.2	2.9	1.5	.8	4.0	3.6	3.6	3.6	2.6
Priv. dom. final purch.	5.3	4.3	1.0	1.1	4.4	4.8	3.5	3.8	3.0
Previous	5.3	4.3	1.0	1.1	4.4	4.8	3.5	4.1	3.1
Personal cons. expend.	4.9	4.1	2.8	1.9	3.8	3.8	2.7	3.3	3.1
Previous	4.9	4.1	2.8	1.9	3.8	3.8	3.0	3.6	3.1
Durables	7.3	4.7	10.8	1.2	9.2	5.2	1.8	8.4	6.6
Nondurables	4.9	3.0	1.9	2.1	4.1	4.6	3.4	3.5	3.7
Services	4.4	4.5	1.6	1.9	2.5	3.1	2.5	2.2	2.2
Residential investment	3.6	-1.9	1.4	7.0	11.8	6.6	8.3	.3	-.7
Previous	3.6	-1.9	1.4	7.0	11.8	6.6	6.8	1.3	-1.0
Business fixed invest.	7.7	7.8	-9.6	-6.5	5.6	10.9	6.0	9.2	4.5
Previous	7.7	7.8	-9.6	-6.5	5.6	10.9	5.2	9.0	5.3
Equipment & software	10.8	7.5	-9.0	-3.4	7.2	13.8	6.6	9.2	5.9
Previous	10.8	7.5	-9.0	-3.4	7.2	13.8	5.9	9.7	6.4
Nonres. structures	-.9	8.8	-11.1	-14.9	1.2	2.7	3.8	9.2	.8
Previous	-.9	8.8	-11.1	-14.9	1.2	2.7	3.2	7.2	2.3
Net exports[2]	-296	-379	-399	-471	-521	-601	-620	-633	-674
Previous[2]	-296	-379	-399	-471	-521	-601	-623	-646	-694
Exports	5.6	6.5	-11.9	3.8	6.0	6.1	8.0	5.1	5.3
Imports	12.1	11.2	-7.6	9.7	5.1	10.6	3.9	5.3	5.8
Govt. cons. & invest.	4.2	.4	5.0	4.0	1.9	2.1	2.8	2.1	1.5
Previous	4.2	.4	5.0	4.0	1.9	2.1	2.7	2.0	1.5
Federal	4.2	-2.2	6.4	7.8	5.5	4.2	3.6	1.6	.0
Defense	4.3	-3.5	6.5	8.4	7.5	4.9	4.1	1.8	.0
Nondefense	4.1	.3	6.3	6.8	1.6	2.8	2.8	1.3	.0
State & local	4.2	1.7	4.2	2.1	.0	.9	2.3	2.4	2.4
Change in bus. inventories[2]	69	56	-32	12	15	52	16	18	44
Previous[2]	69	56	-32	12	15	52	19	20	46
Nonfarm[2]	72	58	-32	15	15	50	19	17	42
Farm[2]	-3	-1	0	-2	0	2	-3	2	2

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

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

Item	2005 Q1	2005 Q2	2005 Q3	2005 Q4	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2005[1]	2006[1]	2007[1]
Real GDP	3.8	3.3	3.2	3.5	4.0	3.6	2.9	2.7	2.8	2.8	2.9	2.9	3.5	3.3	2.8
Previous	3.8	3.2	3.1	3.7	4.2	3.5	3.1	2.9	2.9	2.9	2.9	2.9	3.5	3.4	2.9
Final sales	3.5	5.5	4.0	1.9	4.3	3.6	3.0	2.5	2.1	3.0	2.7	2.3	3.7	3.4	2.5
Previous	3.5	5.3	4.0	1.6	4.7	3.9	3.1	2.6	2.2	3.0	2.7	2.4	3.6	3.6	2.6
Priv. dom. final purch.	3.6	3.9	3.1	1.5	4.3	3.2	2.9	2.8	2.6	2.6	2.6	2.7	3.0	3.3	2.6
Previous	3.6	3.7	3.4	1.4	4.5	3.6	3.1	2.9	2.7	2.7	2.7	2.7	3.0	3.5	2.7
Personal cons. expend.	2.4	2.4	2.4	.4	2.7	2.1	2.1	2.1	2.2	2.2	2.2	2.2	1.9	2.3	2.2
Previous	2.4	2.2	2.9	.8	3.0	2.4	2.4	2.3	2.2	2.2	2.2	2.2	2.1	2.5	2.2
Durables	.2	.6	.8	-1.0	1.0	.5	.5	.5	.5	.5	.5	.5	.1	.7	.5
Nondurables	1.1	.7	.5	.5	.7	.7	.7	.7	.7	.7	.7	.7	.7	.7	.7
Services	1.2	1.0	1.1	1.0	1.0	.9	.9	.9	.9	.9	.9	.9	1.0	.9	.9
Residential investment	.5	.6	.3	.4	.1	.1	-.1	-.1	-.1	-.1	.0	.0	.5	.0	.0
Previous	.5	.7	.2	.1	.1	.3	-.1	-.1	-.1	-.1	-.1	.0	.4	.1	-.1
Business fixed invest.	.6	.9	.4	.6	1.4	.9	.8	.7	.5	.5	.5	.5	.6	1.0	.5
Previous	.6	.9	.3	.4	1.4	.9	.8	.7	.6	.6	.6	.6	.5	.9	.6
Equipment & software	.6	.8	.3	.3	1.1	.7	.6	.5	.4	.5	.5	.5	.5	.7	.5
Previous	.6	.8	.2	.2	1.1	.7	.6	.6	.5	.5	.5	.5	.5	.7	.5
Nonres. structures	-.1	.1	.1	.3	.3	.3	.2	.2	.0	.0	.0	.0	.1	.3	.0
Previous	-.1	.1	.1	.2	.2	.2	.2	.1	.1	.1	.1	.1	.1	.2	.1
Net exports	-.4	1.1	.3	-.3	-.5	.0	-.2	-.6	-.7	.1	-.2	-.6	.2	-.3	-.4
Previous	-.4	1.1	.3	-.7	-.5	-.1	-.3	-.6	-.8	.0	-.2	-.6	.1	-.4	-.4
Exports	.7	1.1	.2	1.2	.4	.5	.5	.7	.3	.6	.6	.8	.8	.5	.6
Imports	-1.1	.0	.1	-1.5	-1.0	-.5	-.7	-1.2	-1.1	-.5	-.8	-1.4	-.6	-.9	-.9
Govt. cons. & invest.	.4	.5	.6	.7	.6	.4	.3	.3	.3	.3	.3	.3	.5	.4	.3
Previous	.4	.4	.4	.9	.6	.4	.3	.3	.3	.3	.3	.3	.5	.4	.3
Federal	.2	.2	.4	.2	.3	.1	.1	.0	.0	.0	.0	.0	.3	.1	.0
Defense	.1	.2	.3	.2	.2	.1	.1	.0	.0	.0	.0	.0	.2	.1	.0
Nondefense	.0	.0	.2	.0	.1	.0	.0	.0	.0	.0	.0	.0	.1	.0	.0
State & local	.2	.3	.2	.4	.4	.3	.3	.3	.3	.3	.3	.3	.3	.3	.3
Change in bus. inventories	.3	-2.1	-.8	1.7	-.4	.0	-.1	.2	.7	-.2	.2	.5	-.2	-.1	.3
Previous	.3	-2.1	-.9	2.1	-.4	-.4	.0	.3	.7	-.1	.1	.5	-.1	-.1	.3
Nonfarm	.4	-2.1	-.7	1.7	-.4	.0	-.1	.2	.7	-.2	.2	.5	-.2	-.1	.3
Farm	-.1	-.1	.0	.0	.1	.0	.0	.0	.0	.0	.0	.0	.0	.0	.0

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

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

Item	2005 Q1	2005 Q2	2005 Q3	2005 Q4	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2005[1]	2006[1]	2007[1]
GDP chain-wt. price index	3.1	2.6	2.6	3.0	1.8	2.2	2.1	2.1	2.2	1.9	1.9	1.8	2.8	2.1	1.9
Previous	3.1	2.5	2.6	2.8	1.7	2.1	2.1	2.1	2.3	2.0	2.0	2.0	2.7	2.0	2.1
PCE chain.-wt. price index	2.3	3.3	3.7	3.5	1.3	2.2	2.1	2.0	1.8	1.7	1.7	1.7	3.2	1.9	1.7
Previous	2.3	3.2	3.7	3.8	1.4	2.1	2.0	2.0	1.9	1.8	1.8	1.8	3.2	1.9	1.8
Energy	3.6	28.6	50.2	24.7	-13.3	-1.2	-.6	-.9	-1.4	-1.4	-1.4	-1.5	25.7	-4.2	-1.5
Previous	3.6	28.6	49.0	29.2	-13.3	-3.1	-1.8	-1.5	-1.4	-1.2	-1.2	-1.2	26.6	-5.1	-1.3
Food	1.0	3.5	1.3	2.3	2.5	2.5	2.4	2.3	2.2	2.1	2.0	2.0	2.0	2.5	2.1
Previous	1.0	3.5	1.3	2.1	2.6	2.6	2.5	2.4	2.3	2.2	2.2	2.2	2.0	2.5	2.2
Ex. food & energy	2.4	1.7	1.3	2.2	2.4	2.4	2.2	2.2	2.0	1.9	1.9	1.8	1.9	2.3	1.9
Previous	2.4	1.6	1.4	2.4	2.4	2.4	2.2	2.2	2.0	2.0	2.0	2.0	1.9	2.3	2.0
CPI	2.5	4.0	5.3	4.4	1.2	2.3	2.2	2.1	1.9	1.9	1.8	1.8	4.0	1.9	1.8
Previous	2.5	4.0	5.3	4.9	1.1	2.1	2.1	2.0	1.9	1.9	1.9	1.9	4.2	1.9	1.9
Ex. food & energy	2.6	2.0	1.4	2.2	2.7	2.6	2.5	2.4	2.3	2.2	2.1	2.1	2.1	2.6	2.2
Previous	2.6	2.0	1.9	2.7	2.6	2.6	2.5	2.4	2.3	2.2	2.2	2.2	2.3	2.6	2.2
ECI, hourly compensation[2]	2.5	2.5	3.4	3.9	4.2	4.3	4.2	4.1	4.0	3.9	3.9	3.9	3.1	4.2	3.9
Previous[2]	2.5	2.5	3.6	4.0	4.2	4.3	4.2	4.1	4.0	4.0	4.0	4.0	3.1	4.2	4.0
Nonfarm business sector															
Output per hour	3.2	2.1	3.3	2.7	3.1	2.3	1.9	1.7	2.5	2.4	2.6	2.6	2.8	2.2	2.5
Previous	3.2	1.7	3.6	2.8	2.6	2.0	2.0	2.1	2.5	2.5	2.5	2.5	2.8	2.2	2.5
Compensation per hour	5.5	3.9	4.1	3.9	5.0	5.3	5.4	5.3	5.2	5.1	4.9	4.9	4.4	5.3	5.0
Previous	5.5	4.4	4.4	4.3	5.3	5.4	5.4	5.3	5.2	5.1	5.0	5.0	4.7	5.4	5.1
Unit labor costs	2.2	1.8	.8	1.2	1.8	3.0	3.5	3.5	2.6	2.6	2.3	2.3	1.5	2.9	2.4
Previous	2.2	2.6	.8	1.5	2.7	3.3	3.3	3.2	2.6	2.6	2.4	2.4	1.8	3.1	2.5

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

Other Macroeconomic Indicators

Item	2005 Q1	2005 Q2	2005 Q3	2005 Q4	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2005[1]	2006[1]	2007[1]
Employment and production															
Nonfarm payroll employment[2]	.5	.6	.6	.4	.6	.5	.4	.4	.3	.3	.3	.3	2.1	1.9	1.1
Unemployment rate[3]	5.3	5.1	5.0	5.0	5.0	5.0	5.0	5.0	5.1	5.1	5.1	5.1	5.0	5.0	5.1
Previous[3]	5.3	5.1	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
GDP gap[4]	.7	.6	.6	.5	.3	.1	.2	.3	.3	.4	.4	.4	.5	.3	.4
Previous[4]	.7	.6	.6	.4	.1	.0	.0	.1	.1	.2	.2	.2	.4	.1	.2
Industrial production[5]	3.6	1.4	1.3	4.0	6.7	5.5	3.7	3.3	2.9	2.9	3.1	3.1	2.6	4.8	3.0
Previous[5]	3.6	1.5	1.8	4.0	6.7	4.7	3.4	3.4	3.1	2.9	3.0	3.0	2.7	4.6	3.0
Manufacturing industr. prod.[5]	4.0	1.0	2.3	4.8	5.2	4.8	3.7	3.5	3.3	3.2	3.4	3.4	3.0	4.3	3.3
Previous[5]	4.0	1.0	2.2	3.6	6.3	4.9	3.5	3.7	3.5	3.3	3.3	3.3	2.7	4.6	3.4
Capacity utilization rate - mfg.[3]	78.1	78.1	78.2	78.9	79.5	80.0	80.2	80.4	80.6	80.7	80.9	81.1	78.9	80.4	81.1
Previous[3]	78.1	78.1	78.2	78.6	79.4	79.9	80.1	80.3	80.5	80.7	80.9	81.0	78.6	80.3	81.0
Housing starts[6]	2.1	2.0	2.1	2.1	2.1	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.1	2.0	2.0
Light motor vehicle sales[6]	16.5	17.2	17.9	16.1	17.0	16.9	16.9	17.0	17.0	17.0	17.1	17.1	16.9	17.0	17.0
Income and saving															
Nominal GDP[5]	7.0	6.0	5.9	6.6	5.9	5.9	5.1	4.8	5.0	4.7	4.8	4.8	6.4	5.4	4.8
Real disposable pers. income[5]	-3.4	1.5	1.7	1.8	6.5	4.9	3.8	3.8	4.5	3.7	3.2	4.1	.4	4.7	3.9
Previous[5]	-3.4	2.1	-3.0	5.9	6.9	5.7	4.2	4.1	4.4	3.8	3.2	4.0	.3	5.2	3.8
Personal saving rate[3]	.5	.1	-.3	.0	.6	1.0	1.2	1.4	1.7	1.9	1.9	2.1	.0	1.4	2.1
Previous[3]	.5	.3	-1.5	-.3	.3	.9	1.1	1.3	1.6	1.7	1.7	1.9	-.3	1.3	1.9
Corporate profits[7]	24.5	19.7	-27.2	77.4	5.3	.6	-5.2	-6.7	-3.1	-4.0	-2.1	-2.7	17.8	-1.6	-3.0
Profit share of GNP[3]	10.5	10.9	9.9	11.2	11.2	11.1	10.8	10.5	10.3	10.1	9.9	9.8	11.2	10.5	9.8
Excluding FR Banks[3]	10.3	10.6	9.7	11.1	11.1	10.9	10.7	10.4	10.2	10.0	9.8	9.6	11.1	10.4	9.6
Federal surplus/deficit[8]	-298	-286	-365	-313	-375	-378	-377	-369	-408	-397	-386	-390	-316	-375	-396
State & local surplus/deficit[8]	7	21	15	15	21	21	26	29	29	30	30	33	15	24	31
Gross national saving rate[3]	13.4	13.4	13.6	13.7	13.4	13.6	13.6	13.5	13.4	13.4	13.4	13.4	13.7	13.5	13.4
Net national saving rate[3]	1.7	1.9	.2	2.0	2.1	2.3	2.2	2.2	1.9	2.0	1.9	1.9	2.0	2.2	1.9

1. Change from fourth quarter of previous year to fourth quarter of year indicated, unless otherwise indicated.
2. Change, millions.
3. Percent, annual values are for the fourth quarter of the year indicated.
4. Percent difference between potential and actual GDP; a positive number indicates that the economy is operating below potential; annual values are for the fourth quarter of the year indicated.
5. Percent change, annual rate.
6. Level, millions, annual values are annual averages.
7. Percent change, annual rate, with inventory valuation and capital consumption adjustments.
8. Billions of dollars, annual values are annual averages.

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

Item	Fiscal year				2005				2006				2007			
	2004[a]	2005[a]	2006	2007	Q1[a]	Q2[a]	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Unified budget					Not seasonally adjusted											
Receipts[1]	1880	2154	2294	2404	452	665	550	525	485	718	565	554	514	746	590	585
Outlays[1]	2293	2473	2648	2763	628	620	619	651	681	664	652	685	716	693	669	729
Surplus/deficit[1]	-413	-319	-354	-359	-177	45	-69	-125	-196	54	-87	-131	-202	53	-79	-144
Previous	*-413*	*-339*	*-380*	*-385*	*-177*	*45*	*-90*	*-131*	*-200*	*44*	*-93*	*-139*	*-206*	*45*	*-85*	*-153*
On-budget	-568	-494	-532	-552	-202	-37	-84	-185	-217	-30	-100	-193	-228	-36	-95	-208
Off-budget	155	175	178	193	25	83	15	59	21	84	13	62	26	89	16	64
Means of financing																
Borrowing	378	296	361	371	165	-43	73	112	179	-25	95	121	186	-24	87	134
Cash decrease	-1	1	1	0	2	-11	-2	10	16	-25	0	10	15	-25	0	10
Other[2]	36	21	-8	-12	10	8	-1	4	1	-4	-8	-0	0	-4	-8	-0
Cash operating balance, end of period	36	36	35	35	22	33	36	26	10	35	35	25	10	35	35	25
NIPA federal sector					Seasonally adjusted annual rates											
Receipts	1933	2173	2370	2481	2197	2240	2201	2315	2359	2390	2416	2442	2467	2491	2525	2540
Expenditures	2348	2503	2731	2872	2495	2525	2566	2628	2734	2768	2793	2811	2876	2888	2912	2930
Consumption expenditures	711	759	808	838	760	763	779	789	807	814	820	825	839	843	847	850
Defense	474	508	544	565	509	512	522	531	543	548	552	556	565	568	570	573
Nondefense	237	251	264	274	251	251	257	258	264	266	268	269	274	275	276	278
Other spending	1637	1744	1923	2033	1735	1762	1787	1839	1927	1954	1973	1986	2037	2046	2065	2080
Current account surplus	-415	-330	-361	-390	-298	-286	-365	-313	-375	-378	-377	-369	-408	-397	-386	-390
Gross investment	99	106	115	117	101	107	110	113	116	116	116	117	117	117	117	117
Gross saving less gross investment[3]	-421	-339	-376	-403	-302	-295	-378	-328	-391	-393	-391	-382	-421	-409	-397	-400
Fiscal indicators[4]																
High-employment (HEB) surplus/deficit	-377	-317	-369	-394	-279	-276	-361	-314	-384	-390	-389	-377	-414	-399	-386	-387
Change in HEB, percent of potential GDP	0.7	-0.7	0.3	0.0	-0.6	-0.1	0.6	-0.4	0.5	0.0	-0.1	-0.1	0.2	-0.1	-0.1	-0.0
Fiscal impetus (FI) percent of GDP	0.8	0.3	0.5	0.0	0.0	0.1	0.1	0.1	0.2	0.1	0.0	-0.0	-0.0	0.0	0.0	-0.0
Previous	*0.8*	*0.3*	*0.5*	*0.0*	*0.0*	*0.1*	*0.1*	*0.2*	*0.2*	*0.1*	*0.0*	*-0.0*	*0.0*	*0.0*	*0.0*	*-0.0*

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

Change in Debt of the Domestic Nonfinancial Sectors
(Percent)

			Nonfederal						
				Households					
Period [1]	Total	Federal government	Total	Total	Home mortgages	Consumer credit	Business	State and local governments	Memo: Nominal GDP
Year									
2000	4.8	-8.0	8.3	8.7	8.2	10.8	9.3	1.3	4.6
2001	6.1	-0.2	7.6	8.8	9.6	7.7	6.0	8.9	2.7
2002	6.9	7.6	6.8	9.8	12.0	4.7	2.7	11.1	3.6
2003	8.1	10.9	7.6	10.1	12.5	4.6	4.4	8.2	6.1
2004	8.5	9.0	8.4	10.9	13.2	4.5	5.7	7.4	6.8
2005	8.3	7.0	8.6	9.3	11.1	3.1	7.5	9.1	6.4
2006	6.8	7.9	6.6	7.2	8.4	3.4	6.4	4.1	5.4
2007	6.4	7.6	6.1	6.4	7.1	4.2	6.5	2.9	4.8
Quarter									
2005:1	9.7	14.4	8.7	9.3	11.3	2.7	7.2	12.0	7.0
2	7.3	0.1	9.0	9.9	11.5	3.8	8.4	5.6	6.0
3	8.2	5.1	8.9	8.9	10.5	3.5	7.5	15.3	5.9
4	6.9	7.7	6.8	7.9	9.6	2.2	6.2	2.5	6.6
2006:1	8.2	14.7	6.8	7.6	9.0	3.1	6.3	4.5	5.9
2	5.6	1.6	6.5	7.0	8.2	3.1	6.2	4.5	5.9
3	6.3	6.6	6.3	6.8	7.8	3.5	6.2	3.6	5.1
4	6.5	7.9	6.2	6.6	7.5	3.7	6.2	3.5	4.8
2007:1	7.6	14.2	6.1	6.5	7.3	3.9	6.3	2.9	5.0
2	5.2	1.6	6.0	6.3	7.0	4.1	6.4	2.9	4.7
3	5.9	5.5	5.9	6.1	6.7	4.3	6.3	2.8	4.8
4	6.4	8.3	5.9	6.1	6.6	4.4	6.4	2.8	4.8

Note. Quarterly data are at seasonally adjusted annual rates.
1. Data after 2005:Q2 are staff projections. Changes are measured from end of the preceding period to end of period indicated except for annual nominal GDP growth, which is calculated from Q4 to Q4.

2.6.3 FOF

Class II FOMC
Restricted (FR)

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

October 26, 2005

Category	2004	2005	2006	2007	2005 Q3	2005 Q4	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4
Net funds raised by domestic nonfinancial sectors														
1 Total	1742.0	1690.3	1567.9	1635.9	1647.1	1465.3	1879.8	1276.5	1511.3	1603.9	1962.8	1333.7	1537.1	1709.9
2 Net equity issuance	-157.0	-313.8	-221.0	-152.0	-414.6	-320.0	-276.0	-216.0	-206.0	-186.0	-152.0	-152.0	-152.0	-152.0
3 Net debt issuance	1899.0	2004.1	1788.9	1787.9	2061.7	1785.3	2155.8	1492.5	1717.3	1789.9	2114.8	1485.7	1689.1	1861.9
Borrowing sectors														
Nonfinancial business														
4 Financing gap [1]	45.4	-137.0	22.2	196.2	-327.2	-212.4	-137.2	36.6	71.5	117.9	160.4	178.3	203.6	242.6
5 Net equity issuance	-157.0	-313.8	-221.0	-152.0	-414.6	-320.0	-276.0	-216.0	-206.0	-186.0	-152.0	-152.0	-152.0	-152.0
6 Credit market borrowing	419.2	591.5	536.4	581.5	609.9	517.1	527.0	533.5	540.1	544.9	561.7	580.6	585.4	598.4
Households														
7 Net borrowing [2]	1002.8	953.3	807.2	767.6	953.0	865.6	856.0	799.6	788.5	784.6	780.5	768.0	758.8	763.2
8 Home mortgages	878.6	841.7	702.6	641.9	840.4	784.3	756.3	700.3	681.6	672.3	662.9	644.3	630.3	630.3
9 Consumer credit	92.5	65.7	73.8	96.5	75.3	47.9	67.4	68.1	77.2	82.5	88.4	94.5	99.3	103.7
10 Debt/DPI (percent) [3]	112.5	118.3	120.3	121.3	119.1	120.0	120.0	120.1	120.4	120.7	120.8	121.1	121.5	121.6
State and local governments														
11 Net borrowing	115.1	153.2	74.8	54.8	267.7	46.0	82.8	82.8	66.8	66.8	54.8	54.8	54.8	54.8
12 Current surplus [4]	181.3	194.1	191.6	204.2	176.2	178.2	186.1	187.4	194.0	199.0	200.5	202.8	204.6	209.0
Federal government														
13 Net borrowing	361.9	306.1	370.5	384.0	231.1	356.6	690.0	76.5	321.9	393.6	717.8	82.4	290.2	445.5
14 Net borrowing (n.s.a.)	361.9	306.1	370.5	384.0	72.6	111.6	179.5	-25.1	95.3	120.9	186.4	-23.7	87.3	133.9
15 Unified deficit (n.s.a.)	400.7	325.9	359.7	372.0	69.2	125.4	196.1	-54.1	86.9	130.8	201.9	-52.6	79.0	143.8
Depository institutions														
16 Funds supplied	825.6	824.8	557.3	601.7	757.7	599.0	631.1	499.2	578.6	520.2	691.9	544.9	622.0	548.2
Memo (percentage of GDP)														
17 Domestic nonfinancial debt [5]	197.7	201.7	204.9	208.2	202.8	203.3	204.2	204.8	205.3	206.1	207.2	208.1	208.5	209.3
18 Domestic nonfinancial borrowing	16.2	16.1	13.5	12.9	16.4	14.0	16.7	11.4	12.9	13.3	15.5	10.8	12.1	13.2
19 Federal government [6]	3.1	2.5	2.8	2.8	1.8	2.8	5.3	0.6	2.4	2.9	5.3	0.6	2.1	3.2
20 Nonfederal	13.1	13.6	10.7	10.1	14.6	11.2	11.3	10.8	10.5	10.4	10.3	10.2	10.0	10.0

Note. Data after 2005:Q2 are staff projections.
1. For corporations: Excess of capital expenditures over U.S. internal funds.
2. Includes change in liabilities not shown in lines 8 and 9.
3. Average debt levels in the period (computed as the average of period-end debt positions) divided by disposable personal income.
4. NIPA state and local government saving plus consumption of fixed capital and net capital transfers.
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.
n.s.a. Not seasonally adjusted.

2.6.4 FOF

(This page intentionally blank.)

International Developments

Incoming data suggest that the pace of foreign economic growth generally held steady in the third quarter. Several recent developments should support continued expansion abroad. The spot price of West Texas intermediate (WTI) crude oil and oil futures prices have fallen since mid-September; the projected path of WTI prices is now almost $2 lower than in the September Greenbook. Additionally, the foreign exchange value of the dollar rose over the intermeeting period, making foreign economies more competitive. We continue to anticipate that the underlying strength of demand abroad will keep foreign growth at a solid pace over the forecast period, although risks remain.

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

Indicator	2004	2005: H1	Projection			
			2005		2006	2007
			Q3	Q4		
Foreign output	3.7	2.8	3.1	3.1	3.3	3.3
September GB	3.7	2.8	3.1	3.1	3.3	3.3
Foreign CPI	2.8	1.8	3.3	2.8	2.4	2.4
September GB	2.8	1.8	3.4	2.9	2.4	2.4

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

Rising energy prices have boosted foreign headline inflation in recent months about in line with what we projected in the September Greenbook. To date, core consumer prices have been little affected by the run-up in energy prices, and we expect that headline inflation will ease in coming quarters as energy prices decline somewhat and as economic slack persists in many countries.

The rise in the dollar over the intermeeting period has caused us to raise our projection for the broad real dollar about 1 percent in the fourth quarter relative to the September Greenbook. We assume that, going forward, the dollar will depreciate at an annual rate of roughly 2 percent. This pace is a touch faster than the one assumed in the previous forecast because we now expect that market participants will over time revise down their expectations of future dollar interest rates, and hence the differential return to dollar assets, to match the interest rate path assumed in this forecast.

We estimate that net exports of goods and services boosted U.S. GDP growth about ¼ percentage point in the third quarter. Incorporating the August trade data, as well as the effects of Hurricanes Katrina and Rita and the Boeing strike, we estimate that exports grew only modestly in the third quarter and imports actually contracted a bit. In the fourth quarter, net exports are projected to subtract about ¼ percentage point from GDP growth, as a rebound in imports is not fully offset by rapid growth of exports. The external sector is projected to subtract about ⅓ percentage point from growth in 2006 and 2007.

We estimate that the U.S. current account deficit exceeded $770 billion in the third quarter and project that it will increase to nearly $850 billion, about 6¾ percent of GDP, by year-end. This projected deficit is about $15 billion narrower than the one in the September Greenbook, largely because of an upward revision to the non-oil trade balance. The current account deficit is projected to widen further over the next two years and to exceed $1 trillion, about 7¼ percent of GDP, at the end of 2007.

Oil Prices

The spot price of West Texas intermediate (WTI) crude oil closed at $63 per barrel on October 25, down about $3 per barrel over the intermeeting period. The decline in oil prices appears to have been driven largely by weaker oil demand, particularly in the United States. Recent data from the Department of Energy show that U.S. demand for petroleum products has softened significantly since late August. Although part of this weakness stems from hurricane-related disruptions to oil distribution and use in the Gulf Coast region, it also is possible that final demand is adjusting to the prior run-ups in petroleum product prices. Consequently, market participants appear to have marked down their expectations for oil demand going forward, leading to a noticeable decline in crude oil futures prices over the intermeeting period. The price of the far-dated futures contract (currently for delivery in December 2011) fell from around $60 per barrel at the time of the September FOMC meeting to $56.60 per barrel on October 25.

After Hurricane Katrina, the spot price of WTI approached $70 per barrel, but it subsequently fell because of the release of strategic reserves in the United States and abroad and diminished demand by refineries in the United States. Hurricane Rita caused oil prices to rebound a bit in late September, but with 25 percent of domestic refining capacity offline in the immediate aftermath of the storm, demand for crude oil was greatly reduced and crude oil prices soon retraced these gains. U.S. oil production in the

Gulf of Mexico is currently down about 1 million barrels per day as a result of the hurricanes. Moreover, four refineries remain shut, with a combined capacity of nearly 1 million barrels per day, roughly 6 percent of total U.S. refining capacity. Our projections assume that all the refineries will be operational by the beginning of 2006 and that crude oil production will be back to normal by the end of April.

Notwithstanding their recent declines, oil prices remain elevated as market participants continue to perceive a tight market going forward. The Department of Energy and the International Energy Agency have both marked down their estimate of world oil demand in 2005 but project that demand growth will rebound in 2006. In addition, market participants do not expect world oil production to increase at a pace sufficient to reverse the recent upward shift in oil prices. These demand and supply concerns are amplified by the historically low spare production capacity of OPEC.

In line with NYMEX futures prices, our projection calls for the spot price of WTI to remain close to $63 per barrel through 2006 and to drift down to $61 per barrel by the end of 2007. Relative to the oil price outlook in the September Greenbook, the current projection averages about $1.50 per barrel lower in the fourth quarter of 2005, $2 per barrel lower in 2006, and $1.65 per barrel lower in 2007. The projected path of the import price has been revised down by similar amounts. Our import price projection takes into account the effect of an expected increase in imports of refined products relative to crude oil over the near-term. This expectation has been borne out in recent data from the Department of Energy.

International Financial Markets

The trade-weighted exchange value of the dollar against the major foreign currencies rose 1⅓ percent on net over the intermeeting period, as the dollar appreciated against all currencies in that index. On balance, the dollar appreciated 3¾ percent against the yen, about 1½ percent against sterling, but less than 1 percent against the euro and the Canadian dollar. Interest rate differentials against yen and sterling assets widened in favor of the dollar. The Bank of Canada tightened policy another 25 basis points on October 18, and market participants reportedly expect further increases in policy rates in coming months.

The exchange value of the dollar rose slightly on balance over the intermeeting period against the currencies of our other important trading partners, largely on a ½ percent appreciation of the dollar against the Mexican peso. The renminbi's spot exchange rate against the dollar again fluctuated only in a very narrow range.

On the basis of these developments, we have raised the fourth-quarter value of the broad real dollar 1 percent relative to the projection in the September Greenbook. We continue to foresee downward pressures on the dollar stemming from the need to finance the increasing U.S. current account deficit. Because the staff assumes that long-term U.S. interest rates will edge down over the forecast period whereas market quotes currently suggest that long-term dollar rates will rise moderately, we are now projecting a slightly more rapid rate of dollar depreciation against the major foreign currencies than was built into the previous forecast. As a result, the broad real dollar index is projected to decline at an annual rate of about 2 percent over the forecast period, versus 1½ percent in the September Greenbook, leaving the endpoint of the dollar's forecast path only slightly higher than it was in the September projection.

The European Central Bank, the Bank of Japan, and the Bank of England kept their respective policy stances unchanged over the intermeeting period, as had been widely expected. However, comments by officials of the ECB and the BOJ were interpreted as indicating that these two institutions may begin to tighten policy sooner than previously anticipated, and market participants took comments by Bank of England officials as signaling a reduced likelihood of policy easing in the near future. Whereas three-month euro interest rates changed little over the intermeeting period, long-term interest rates in euro-area countries rose almost 30 basis points. Ten-year JGB yields rose almost 20 basis points as Bank of Japan Governor Fukui noted that Japanese CPI inflation may exceed zero in the coming months, a pre-condition for the end of the BOJ's quantitative easing policy.

Rising long-term interest rates during the intermeeting period weighed on share prices, which declined 2½ percent to 6 percent on balance in the major industrial countries. The exception was Japan, where the headline share price index rose 4 percent, mainly on a strong rally in the shares of Japanese banks, which was fueled by the successful passage of the previously stalled postal reform legislation. Emerging market debt spreads over Treasuries were little changed over the period, and share prices declined 3 to 7 percent in emerging Asia and in Latin America.

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

Foreign Industrial Countries

We estimate that real GDP in the foreign industrial countries grew 2¼ percent in the third quarter, about what we forecasted in the September Greenbook. We project that growth will remain at this rate in the current quarter before moving up to about 2½ percent in 2006 and 2007. Inflation picked up in the third quarter everywhere but in Japan, mainly because of increases in energy prices. However, with crude oil prices expected to level off, we project that inflation in the foreign industrial countries will peak in early 2006 and decline thereafter.

Euro-area indicators suggest that growth picked up somewhat in the third quarter to an estimated pace of about 1½ percent, and recent indicators are consistent with some momentum in activity heading into the fourth quarter. However, the previous rise in energy prices is expected to weigh on consumer spending and keep euro-area growth from increasing further in the near term. Growth is projected to remain near 1½ percent in 2006 before rising to 1¾ percent in 2007. Higher energy prices pushed euro-area headline inflation to 2½ percent in the twelve months to September. However, core inflation remains below 1½ percent and is expected to rise only modestly over the forecast period. Thus, we project that four-quarter headline inflation will fall back below 2 percent in the second half of 2006. Although the ECB recently has adopted a more hawkish tone, we assume that it will look through the effects on headline inflation of the change in the relative price of energy and keep policy rates unchanged this year and next.

In the United Kingdom, preliminary data show that real GDP growth slowed to 1.5 percent in the third quarter. Growth is projected to recover in the fourth quarter to 2¼ percent and then to remain near this rate for the rest of the forecast period. Four-quarter inflation is projected to remain near 2½ percent through mid-2006 but then to move below 2 percent as the adjustment to the recent rise in energy prices is completed. The moderation in inflation likely will allow the Bank of England to remain on hold throughout the forecast period.

We estimate that third-quarter growth in Japan was 1 percent, a bit lower than our previous forecast and consistent with weaker-than-expected incoming indicators, especially those for household demand. This dip in growth follows the surge of activity in the first half of the year. We expect GDP growth to step up to about 1½ percent in the fourth quarter and to remain around that pace in 2006 and 2007. The Tokyo core CPI fell more than expected in September. We now see no return to positive inflation until the third quarter of 2006, one quarter later than we had previously been projecting. Recently, Bank of Japan officials have hinted that they may end quantitative easing in the first half of next year. On the basis of our inflation forecast, however, we assume that the BOJ will not raise interest rates until the third quarter of 2006.

Recent data for Canada continue to support our view that third-quarter real GDP grew slightly more than 3 percent and that growth will continue around that pace for the rest of the forecast period. Headline 12-month CPI inflation rose to 3.4 percent in September, up from 2.6 percent in August, with the rise due entirely to a jump in gasoline prices. Headline CPI inflation is now projected to average 2¾ percent in the fourth quarter of this year, a touch higher than in our previous forecast, before declining to around 2 percent later in the forecast period. The Bank of Canada is assumed to continue gradually raising interest rates through the third quarter of 2006, a continuation of a tightening campaign begun in September.

Other Countries

We estimate that output growth in the developing economies will pick up to about 4½ percent in the second half of 2005 and continue at that pace for the rest of the forecast period. This forecast is in line with that in the previous Greenbook. The lower oil price projection leads to offsetting changes in expected performance for oil-importing and oil-exporting countries.

We estimate that third-quarter real GDP growth in emerging Asia was around 6 percent. We are projecting growth to slow to around 5 percent thereafter, in part as China's economy decelerates. This forecast is little changed from the one in the September Greenbook, with the benefits for this region of lower projected oil prices balancing the slightly slower demand from the United States. For China, incoming data show a slight pickup in growth in the third quarter. With policy measures to slow investment having not yet materialized, we now expect a slowdown in investment to occur in the first quarter of next year rather than at the end of this year. As a result, Chinese economic growth is expected to be around 8 percent in the fourth quarter and to come down to around 7¼ percent later in the forecast period. Elsewhere in the region, growth is projected to average around 6½ percent in India and to range around 4 to 5 percent for the other economies, spurred by strengthening global high-tech demand.

We now estimate that real GDP in Latin America grew 2¾ percent in the third quarter after stagnating in the second quarter. Mexican GDP appears to have about reversed its second-quarter decline, while growth in the rest of the region moderated following a strong second quarter. Output growth is expected to rise to 3¾ percent by early 2006 and to remain at that pace in 2007. The rise largely reflects the path for Mexico, where strengthening U.S. manufacturing production should boost exports.

Inflation in the emerging economies likely decelerated to about 3 percent in the third quarter. However, a positive outlook for growth and the pass-through of high oil prices, in part due to reduced fuel subsidies in Asia, are expected to put upward pressure on prices. Over the forecast period, inflation for the emerging economies is expected to pick up to almost 4 percent in mid-2006 before decelerating slowly to a touch below 3½ percent by the end of 2007. This projection, reflecting the lower path for oil prices, is slightly below that of the previous Greenbook.

Prices of Internationally Traded Goods

In the third quarter, we estimate that core import price inflation slowed to 1 percent at an annual rate from slightly more than 2 percent in the second quarter. The decline reflects both the strengthening of the dollar earlier this year and a previous leveling off of non-energy commodity prices. We revised up the increase in core import prices in the third quarter from about zero in the last forecast in response to stronger-than-expected monthly BLS price data for September. After remaining about unchanged in July and August, core import prices jumped more than 1 percent in September, mainly because of a sharp increase in the price of imported natural gas. Excluding natural gas, core import prices increased just over ½ percent in September, primarily as a result of higher prices for material-intensive industrial supplies. Despite the September increase, core prices excluding those for natural gas were little changed in the third quarter.

We project that core import price inflation will increase to 5½ percent at an annual rate in the fourth quarter. The increase, which is about 2½ percentage points higher than that in the previous Greenbook, in part reflects the high stepping-off point following September's unexpected jump in prices, which levers up the average price level in the current quarter. Recent run-ups in natural gas and commodity prices also contribute to higher inflation rates. In 2006, we project that core import price inflation will fall to about 1½ percent before declining further to ½ percent in 2007, in line with decelerating commodity prices and only a modest projected depreciation of the dollar. Additionally, we continue to assume that the expiration of the Multi-fiber Arrangement will exert downward pressure on core import prices over the forecast period.

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

Trade category	2004	2005: H1	Projection			
			2005		2006	2007
			Q3	Q4		
Exports						
Core goods	5.1	4.9	2.4	4.4	1.8	.9
September GB	5.1	5.0	1.4	1.4	1.7	1.3
Imports						
Non-oil core goods	4.3	3.4	1.0	5.4	1.4	.6
September GB	4.3	3.3	.0	2.8	.9	.5
Excluding natural gas	3.7	3.3	-.1	3.1	1.5	.8
September GB	3.7	3.2	-.8	1.9	.8	.6
Oil (dollars per barrel)	40.91	46.30	55.32	56.94	57.59	56.19
September GB	40.91	46.30	55.40	58.37	59.36	57.88

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. Imported oil includes both crude oil and refined products.

We estimate that core export price inflation slowed to 2½ percent at an annual rate in the third quarter from 3¾ percent in the second quarter, largely on account of weaker prices for agricultural exports. The third-quarter increase is 1 percentage point faster than we projected in the previous Greenbook, primarily reflecting stronger-than-expected price increases in the BLS monthly data for September. Core export prices jumped 1.1 percent last month, led by higher prices for exported petroleum products and chemicals. We expect core export prices to climb just under 4½ percent in the fourth quarter. This projection is about 3 percentage points higher than in the previous Greenbook, with the upward adjustment reflecting a higher projected path for prices of intermediate materials and commodities. The pace of core export price inflation is expected to moderate to 1¾ percent in 2006 before falling further to about 1 percent in 2007, a trajectory in line with the projected slowing of growth in prices of intermediate materials and commodities.

Trade in Goods and Services

Taking into account August trade data, Hurricanes Katrina and Rita, and the Boeing strike, we estimate that both imports and exports turned in weak performances in the third quarter. With exports expanding modestly and imports edging down, net exports of goods and services are estimated to have boosted U.S. GDP growth about ¼ percentage point. The contribution of net exports is projected to return to negative territory in the fourth quarter, subtracting about ¼ percentage point, as a rebound in imports is not fully offset by rapid growth of exports. The external sector is projected to boost growth by about ¼ percentage point for 2005 as a whole but is projected to subtract about ⅓ percentage point from growth in 2006 and 2007. Since the September Greenbook, our projection of the contribution of net exports has been revised up (made less negative) for the fourth quarter, but our forecast is little changed thereafter.

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

Measure	2004	2005: H1	Projection			
			2005		2006	2007
			Q3	Q4		
Real exports	6.1	9.1	1.8	12.5	5.1	5.3
September GB	6.1	9.1	4.1	7.5	6.3	5.7
Real imports	10.6	3.5	-0.5	9.5	5.3	5.8
September GB	10.6	3.5	1.0	9.1	6.2	6.1

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

After contracting slightly in the second quarter, real imports of goods and services are estimated to have fallen about ½ percent at an annual rate in the third quarter, rather than rising a bit as projected in the September Greenbook. This revision owes importantly to widespread weakness in the August nominal trade data. In August, nominal imports rebounded from a weak July, but not by as much as we had anticipated, especially for core goods. Core imports are now projected to have contracted about 1 percent in the third quarter, substantially weaker growth than would be predicted by U.S. GDP and relative prices alone. Core imports are assumed to have been held back by the effects of recent weather in the Gulf region, which we think restrained non-oil merchandise imports in September. These effects are expected to dissipate by November. Shipping has gradually been returning to the affected area; the first container ship called at the Port of

New Orleans on September 13. Fourteen ships, including four container ships, about 35 percent of normal traffic, were scheduled to call in the week of October 10.

In the fourth quarter, growth of real imports of goods and services is projected to rebound to 9½ percent, owing partly to recovery from hurricane-related disruptions to merchandise trade. We project that crude-oil imports will be diminished by refinery outages but expect this to be more than offset by an increase in imports of refined petroleum products. We expect imports of services also to rebound as U.S. GDP strengthens. Growth in imports of computers and semiconductors should pick up a touch.

In 2006 and 2007, real import growth is expected to remain firm at around 5½ percent, as the effect on core imports of slowing U.S. growth over this period is offset by a lessening drag from core import prices. The growth of imported services eases. Imports of computers and semiconductors are projected to rise steadily. Compared with the September Greenbook, our current projection for growth of real imports of goods and services in 2006 is about 1 percentage point lower, reflecting the reduced forecast for U.S. growth and the upward revision to core import prices. In addition, oil imports contract more sharply than previously projected from the run-up in late 2005. Our forecast for 2007 has also been revised down a bit.

In the third quarter, real exports of goods and services are expected to have grown a modest 1¾ percent at an annual rate, a significant step down from the second quarter's double-digit pace, and about 2¼ percentage points below our projection in the September Greenbook. In the fourth quarter, however, they are projected to surge ahead 12½ percent, about 5 percentage points higher than in the September Greenbook. This quarterly see-saw pattern in real exports owes importantly to the effects on aircraft exports of the recent strike at Boeing. Aircraft exports (which are part of core exports) are assumed to have been held down substantially in September, but to bounce back in the fourth quarter, as, in addition to normal shipments, planes not sent out earlier are also exported. Our assumptions about the effects of the strike have been updated from the September Greenbook; we now estimate that the strike held back September aircraft exports by more than assumed in the previous forecast, but because it ended earlier than expected, we have revised up our projection for exports in the fourth quarter. Accordingly, our projections for real core exports were revised down for the third quarter, but up for the fourth. As with real imports, the quarterly pattern in real exports for the second half also reflects the effects of recent storms in the Gulf, which depress growth a bit in the third quarter and boost it in the fourth. Nominal export data for

August were generally in line with our expectations and had little impact on our projections for total real exports in the third and fourth quarters.

Beyond the current quarter, the growth of exports of goods and services slows to about 5 percent from 8 percent for 2005 as a whole. This stepdown reflects a deceleration of core goods exports, which slow early on as aircraft exports return to normal and more generally as the boost from dollar depreciation in 2003-04 wanes. Conversely, the growth of services exports, which slumped this year, picks up a bit going forward; services, which react much more quickly to exchange rate changes than do core goods, had already been held back by the run-up in the dollar earlier this year, and are projected to accelerate as the dollar returns to its projected path of mild depreciation. Exports of computers and semiconductors continue to grow briskly. Our projection for the growth of total exports is about 1 percentage point lower than in the September Greenbook, reflecting in part the damping effects of the upwardly revised path of the dollar on exports of core goods and services.

Alternative Simulations

Our outlook for U.S. price inflation depends in part on our projection for foreign price inflation and for the exchange value of the dollar. Although our forecast projects that inflation in the industrialized economies will remain fairly stable on balance over the forecast period, a sustained pickup remains a possibility, particularly if inflation expectations become unanchored in the wake of substantial increases in energy prices. Accordingly, in our first alternative scenario, we used the FRB/Global model to examine the effects of a rise in foreign inflation in major industrialized countries. The dollar depreciates in this scenario because of the foreign monetary policy response. We also analyzed a second scenario in which the dollar comes under direct pressure due to a preference shift away from dollar-denominated assets.

In our first scenario, we simulated the effects of a rise in inflation in Canada, the euro area, the United Kingdom, and Japan of about 1 percentage point relative to baseline in 2006 and 2007. The inflation pickup abroad is generated by a gradual rise in producer markups beginning in 2005:Q4. Foreign central banks respond by raising real interest rates sharply, causing economic activity in the foreign industrialized countries to contract and their currencies to appreciate. As seen in the table, the foreign inflation shock boosts U.S. core PCE prices as import prices rise in response to higher foreign prices and a 5 percent real depreciation of the dollar; nevertheless, given low pass-through to import prices, U.S. core PCE inflation rises less than 0.1 percentage point over the forecast period. The shock exerts a small stimulative effect on U.S. output, with real GDP growth rising about 0.2 percentage point above baseline by the latter half of 2006. Real U.S. exports rise as the effects of the contraction in foreign activity are more than offset by the decline in the real dollar.

In a separate scenario, we simulated the effects of a decline in the dollar against all major foreign currencies that is induced by a risk premium shock. The shock begins in 2005:Q4 and is scaled to induce an initial 10 percent decline in the broad real dollar in the absence of endogenous interest rate adjustment. While the effects of this shock on U.S. core PCE prices are nearly twice as large as in the first scenario—reflecting mainly the greater magnitude of real dollar depreciation in this case—the core inflation rate still rises by less than 0.2 percentage point over the forecast period. On the other hand, the shock imparts a sizable stimulus to U.S. GDP through its effect on real exports, with real GDP growth rising about 0.7 percentage point above baseline in 2006. The improvement in real net exports accounts for a rise in the nominal trade balance of about 0.4 percentage point of GDP in 2007.

Alternative Simulations:
Higher Inflation Abroad and Weaker Dollar
(Percent change from previous period, annual rate)

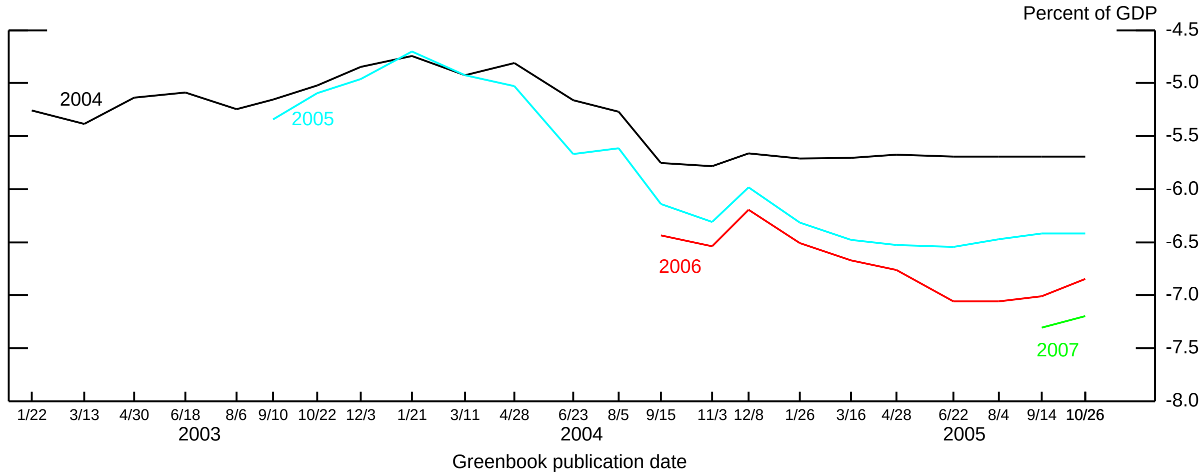
Indicator and simulation	2005		2006		2007	
	H1	H2	H1	H2	H1	H2
U.S. real GDP						
Baseline	3.6	3.4	3.8	2.8	2.8	2.9
Higher inflation abroad	3.6	3.3	3.8	3.0	3.1	3.1
Weaker dollar	3.6	3.4	4.5	3.5	3.4	3.1
U.S. PCE prices excluding food and energy						
Baseline	2.1	1.8	2.4	2.2	1.9	1.9
Higher inflation abroad	2.1	1.9	2.5	2.3	1.9	2.0
Weaker dollar	2.1	2.0	2.5	2.3	2.0	2.1
U.S. Trade Balance (percent of GDP)						
Baseline	-5.6	-5.8	-5.9	-5.9	-6.0	-5.9
Higher inflation abroad	-5.6	-5.9	-6.0	-5.9	-5.9	-5.8
Weaker dollar	-5.6	-6.1	-5.9	-5.7	-5.6	-5.5

Note. H1 is Q2/Q4; H2 is Q4/Q2. The federal funds rate is adjusted according to a Taylor rule.

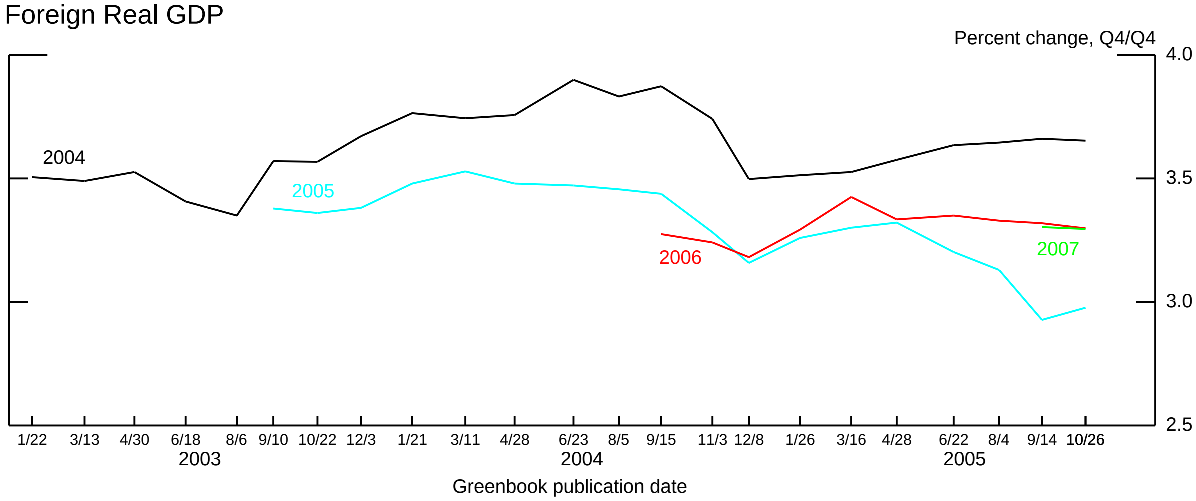
Class II FOMC -- Restricted (FR)

Evolution of the Staff Forecast

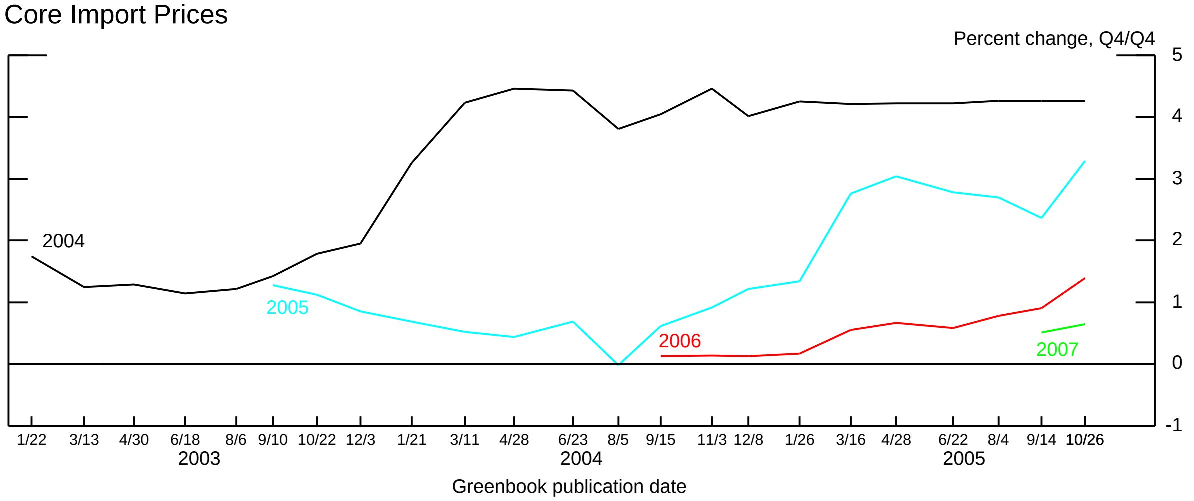
Current Account Balance



Foreign Real GDP



Core Import Prices



Class II FOMC
Restricted (FR)

October 26, 2005

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

Measure and country	1999	2000	2001	2002	2003	2004	2005 (Projected)	2006 (Projected)	2007 (Projected)
REAL GDP (1)									
Total foreign	5.0	4.2	0.3	3.0	2.9	3.7	3.0	3.3	3.3
Industrial Countries	4.4	3.5	0.8	2.5	1.8	2.4	2.4	2.5	2.5
of which:									
Canada	5.9	4.1	1.3	3.6	1.7	3.3	2.9	3.3	3.1
Japan	0.2	3.2	-1.9	1.5	2.2	0.9	2.8	1.6	1.6
United Kingdom	3.4	3.2	2.0	2.1	3.1	2.5	1.7	2.2	2.3
Euro Area (2)	4.0	3.0	1.0	1.1	0.9	1.6	1.4	1.6	1.8
Germany	3.5	2.3	1.1	0.2	0.2	0.5	1.4	1.2	1.5
Developing Countries	6.0	5.2	-0.4	3.6	4.6	5.5	3.9	4.4	4.5
Asia	8.6	5.7	1.1	6.0	6.5	5.9	5.6	5.0	5.3
Korea	11.5	4.5	4.6	7.8	4.2	3.0	4.4	3.9	4.1
China	7.1	7.7	7.0	8.4	10.0	9.5	8.5	6.9	7.4
Latin America	4.3	4.5	-1.3	1.5	2.4	5.1	1.9	3.8	3.7
Mexico	5.5	4.8	-1.3	2.0	2.1	4.8	1.2	3.7	3.7
Brazil	3.4	3.9	-0.9	4.2	0.9	4.7	3.3	3.2	3.2
CONSUMER PRICES (3)									
Industrial Countries	1.1	1.7	0.9	2.1	1.3	1.8	1.7	1.3	1.6
of which:									
Canada	2.4	3.1	1.1	3.8	1.7	2.3	2.7	1.7	2.0
Japan	-1.1	-1.2	-1.3	-0.5	-0.5	0.4	-0.8	0.2	0.4
United Kingdom (4)	1.2	1.0	1.0	1.5	1.3	1.4	2.5	1.9	2.0
Euro Area (2)	1.5	2.5	2.1	2.3	2.0	2.3	2.3	1.5	1.9
Germany	1.1	1.7	1.5	1.2	1.2	2.1	2.1	1.3	1.5
Developing Countries	4.6	4.1	2.8	2.8	3.1	3.9	3.3	3.7	3.3
Asia	0.1	1.9	1.2	0.7	2.2	3.2	3.0	3.5	2.9
Korea	1.2	2.5	3.3	3.4	3.5	3.4	3.2	4.1	3.0
China	-1.0	1.0	-0.1	-0.5	2.7	3.3	1.9	3.3	2.8
Latin America	12.5	8.4	5.3	6.4	4.9	5.6	3.7	4.0	4.0
Mexico	13.4	8.7	5.1	5.2	3.9	5.3	3.1	3.6	3.7
Brazil	8.4	6.4	7.5	10.7	11.5	7.2	5.6	4.5	4.1

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

Class II FOMC
Restricted (FR)

October 26, 2005

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

					Projected							
	2005				2006				2007			
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	2.5	3.2	3.1	3.1	3.2	3.3	3.3	3.3	3.3	3.3	3.3	3.3
Industrial Countries	2.0	2.8	2.3	2.3	2.6	2.5	2.5	2.5	2.5	2.5	2.5	2.5
of which:												
Canada	2.1	3.2	3.1	3.0	3.5	3.4	3.3	3.2	3.1	3.1	3.1	3.1
Japan	5.8	3.3	1.0	1.4	1.5	1.5	1.6	1.7	1.6	1.6	1.6	1.5
United Kingdom	1.0	2.0	1.5	2.2	2.1	2.2	2.2	2.2	2.3	2.3	2.3	2.4
Euro Area (2)	1.5	1.2	1.6	1.4	1.5	1.5	1.6	1.6	1.7	1.7	1.8	1.8
Germany	3.0	0.0	1.4	1.1	1.1	1.2	1.2	1.3	1.4	1.5	1.5	1.6
Developing Countries	3.1	3.7	4.4	4.3	4.2	4.5	4.5	4.5	4.5	4.5	4.5	4.5
Asia	4.5	6.9	6.0	5.1	4.7	5.1	5.2	5.2	5.3	5.3	5.3	5.3
Korea	1.5	5.0	7.5	3.5	3.7	3.9	3.9	3.9	4.1	4.1	4.1	4.1
China	12.7	5.0	8.2	8.2	5.6	7.4	7.4	7.4	7.4	7.4	7.4	7.4
Latin America	1.4	0.2	2.8	3.2	3.7	3.8	3.8	3.8	3.7	3.7	3.7	3.7
Mexico	0.7	-1.7	2.6	3.1	3.6	3.8	3.8	3.8	3.7	3.7	3.7	3.7
Brazil	1.5	5.8	2.8	3.1	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2
CONSUMER PRICES (3)	Four-quarter changes											
Industrial Countries	1.4	1.4	1.8	1.7	1.9	1.8	1.5	1.3	1.4	1.5	1.5	1.6
of which:												
Canada	2.1	1.9	2.6	2.7	2.8	2.5	2.0	1.7	1.9	2.0	1.9	2.0
Japan	-0.4	-0.4	-0.5	-0.8	-0.2	-0.0	0.2	0.2	0.3	0.3	0.4	0.4
United Kingdom (4)	1.7	1.9	2.4	2.5	2.5	2.4	2.0	1.9	1.8	1.9	1.9	2.0
Euro Area (2)	2.0	2.0	2.3	2.3	2.4	2.0	1.7	1.5	1.7	1.8	1.8	1.9
Germany	1.7	1.6	2.1	2.1	2.4	2.1	1.4	1.3	1.4	1.4	1.5	1.5
Developing Countries	3.5	3.3	3.1	3.3	3.6	3.8	3.7	3.7	3.6	3.5	3.4	3.3
Asia	2.9	2.4	2.4	3.0	3.4	3.8	3.6	3.5	3.3	3.2	3.1	2.9
Korea	3.1	3.0	2.4	3.2	3.6	4.0	4.2	4.1	3.9	3.6	3.3	3.0
China	2.8	1.7	1.3	1.9	2.2	3.0	3.2	3.3	3.2	3.1	3.0	2.8
Latin America	4.9	5.0	4.4	3.7	3.9	3.7	3.8	4.0	4.0	4.0	4.0	4.0
Mexico	4.4	4.5	4.0	3.1	3.5	3.3	3.4	3.6	3.6	3.6	3.7	3.7
Brazil	7.4	7.7	6.2	5.6	4.8	4.1	4.5	4.5	4.4	4.3	4.2	4.1

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

	1999	2000	2001	2002	2003	2004	------ 2005	Projected 2006	------ 2007
NIPA REAL EXPORTS and IMPORTS									
	Percentage point contribution to GDP growth, Q4/Q4								
Net Goods & Services	-1.0	-0.9	-0.2	-0.9	-0.1	-0.9	0.2	-0.3	-0.4
Exports of G&S	0.6	0.7	-1.3	0.4	0.6	0.6	0.8	0.5	0.6
Imports of G&S	-1.6	-1.6	1.1	-1.3	-0.7	-1.5	-0.6	-0.9	-0.9
	Percentage change, Q4/Q4								
Exports of G&S	5.6	6.5	-11.9	3.8	6.0	6.1	8.0	5.1	5.3
Services	5.3	1.8	-8.9	10.2	4.5	4.6	3.9	4.5	5.8
Computers	13.4	22.7	-23.5	-1.1	11.0	6.3	16.5	14.4	14.4
Semiconductors	34.6	27.6	-34.6	10.1	38.8	-6.1	15.5	17.0	17.0
Other Goods 1/	3.3	5.9	-10.2	0.7	4.5	7.8	9.2	4.2	4.0
Imports of G&S	12.1	11.2	-7.6	9.7	5.1	10.6	3.9	5.3	5.8
Services	6.6	10.6	-5.9	8.8	4.2	7.7	2.8	4.3	3.4
Oil	-3.4	13.3	3.7	3.8	1.5	9.7	-1.2	-3.7	2.2
Computers	26.0	13.9	-13.6	13.2	16.8	22.2	14.7	17.5	17.5
Semiconductors	34.2	22.8	-51.1	11.0	-0.2	9.4	8.2	17.0	17.0
Other Goods 2/	12.9	10.5	-6.5	10.1	5.1	10.5	4.2	6.4	6.1
	Billions of Chained 2000 Dollars								
Net Goods & Services	-296.2	-379.4	-399.1	-471.3	-521.4	-601.3	-619.6	-632.9	-673.8
Exports of G&S	1008.2	1096.3	1036.7	1013.3	1031.2	1117.9	1199.4	1272.7	1337.2
Imports of G&S	1304.4	1475.8	1435.8	1484.6	1552.6	1719.2	1819.0	1905.6	2011.0
	Billions of dollars								
US CURRENT ACCOUNT BALANCE	-300.1	-416.0	-389.5	-475.2	-519.7	-668.1	-800.2	-904.3	-996.9
Current Acct as Percent of GDP	-3.2	-4.2	-3.8	-4.5	-4.7	-5.7	-6.4	-6.8	-7.2
Net Goods & Services (BOP)	-263.4	-378.3	-362.7	-421.2	-494.8	-617.6	-716.1	-779.5	-826.5
Investment Income, Net	19.1	25.7	30.3	15.5	51.8	36.2	5.7	-22.1	-65.9
Direct, Net	78.2	94.9	115.9	99.8	121.8	127.9	120.1	130.8	149.6
Portfolio, Net	-59.1	-69.2	-85.5	-84.3	-70.0	-91.7	-114.4	-152.9	-215.5
Other Income & Transfers,Net	-55.8	-63.5	-57.1	-69.5	-76.7	-86.7	-89.8	-102.6	-104.5

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

Class II FOMC
Restricted (FR)

October 26, 2005

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2002 Q1	2002 Q2	2002 Q3	2002 Q4	2003 Q1	2003 Q2	2003 Q3	2003 Q4	2004 Q1	2004 Q2	2004 Q3	2004 Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-1.0	-0.6	-0.5	-1.5	0.1	-0.7	0.5	-0.5	-1.2	-1.4	-0.2	-1.0
Exports of G&S	0.5	1.0	0.3	-0.3	-0.3	-0.2	1.0	1.7	0.5	0.7	0.5	0.7
Imports of G&S	-1.4	-1.6	-0.8	-1.2	0.4	-0.5	-0.6	-2.2	-1.6	-2.0	-0.7	-1.7
Percentage change from previous period, s.a.a.r.												
Exports of G&S	5.2	10.6	2.9	-3.1	-2.9	-2.1	11.5	19.1	5.0	6.9	5.5	7.1
Services	22.9	2.7	4.6	11.7	-11.9	-6.6	17.2	23.7	-0.4	4.8	-0.6	15.5
Computers	-21.1	14.7	-6.0	12.6	-5.7	0.2	35.9	18.2	-7.4	1.6	21.7	11.5
Semiconductors	22.3	42.1	12.6	-25.0	34.8	33.9	43.7	43.2	7.0	-4.8	-19.4	-5.5
Other Goods 1/	-1.6	12.5	2.0	-9.1	0.0	-2.0	5.5	15.4	8.6	9.2	9.5	3.8
Imports of G&S	11.7	12.5	5.7	9.0	-2.5	3.3	4.1	16.5	12.0	14.5	4.7	11.3
Services	24.7	-3.0	1.7	14.0	-2.2	-10.2	21.4	10.7	10.0	13.7	4.6	3.1
Oil	-9.8	-10.3	-12.7	64.3	-9.0	7.8	-1.3	9.5	35.7	-26.0	-0.5	45.0
Computers	52.2	5.3	2.8	-0.2	11.5	12.4	8.7	36.4	21.2	34.3	25.3	9.5
Semiconductors	39.8	34.8	-6.2	-14.0	-6.7	1.5	-3.7	8.9	42.6	20.2	4.7	-20.3
Other Goods 2/	7.6	19.4	9.5	4.3	-2.6	5.8	0.7	17.7	8.4	20.4	4.0	9.7
Billions of Chained 2000 Dollars, s.a.a.r.												
Net Goods & Services	-441.3	-458.9	-472.2	-513.0	-510.7	-528.4	-516.2	-530.2	-563.0	-601.7	-606.5	-634.1
Exports of G&S	992.8	1018.0	1025.2	1017.2	1009.7	1004.5	1032.2	1078.4	1091.8	1110.2	1125.0	1144.5
Imports of G&S	1434.0	1476.9	1497.4	1530.2	1520.4	1532.9	1548.4	1608.6	1654.8	1711.9	1731.5	1778.6
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-440.4	-477.1	-480.3	-503.0	-546.6	-515.2	-515.9	-501.0	-584.4	-666.5	-667.9	-753.4
Current Account as % of GDP	-4.3	-4.6	-4.6	-4.7	-5.1	-4.8	-4.7	-4.5	-5.1	-5.7	-5.7	-6.3
Net Goods & Services (BOP)	-372.7	-413.8	-430.3	-467.9	-499.3	-491.4	-490.8	-497.7	-555.4	-608.2	-629.9	-676.9
Investment Income, Net	11.4	1.8	14.1	34.5	29.3	50.6	50.9	76.5	65.8	29.6	30.8	18.8
Direct, Net	100.5	91.4	95.0	112.2	102.3	117.4	119.9	147.8	140.3	116.3	121.4	133.7
Portfolio, Net	-89.2	-89.6	-80.9	-77.7	-72.9	-66.8	-69.0	-71.3	-74.6	-86.7	-90.6	-114.9
Other Inc. & Transfers, Net	-79.0	-65.1	-64.2	-69.6	-76.6	-74.4	-76.0	-79.7	-94.7	-88.0	-68.8	-95.3

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

Class II FOMC
Restricted (FR)

October 26, 2005

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2005				Projected 2006				Projected 2007			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
NIPA REAL EXPORTS and IMPORTS												
Percentage point contribution to GDP growth												
Net Goods & Services	-0.4	1.1	0.3	-0.3	-0.5	0.0	-0.2	-0.6	-0.7	0.1	-0.2	-0.6
Exports of G&S	0.7	1.1	0.2	1.2	0.4	0.5	0.5	0.7	0.3	0.6	0.6	0.8
Imports of G&S	-1.1	0.0	0.1	-1.5	-1.0	-0.5	-0.7	-1.2	-1.1	-0.5	-0.8	-1.4
Percentage change from previous period, s.a.a.r.												
Exports of G&S	7.5	10.7	1.8	12.5	4.2	4.9	4.7	6.6	3.2	5.4	5.5	7.3
Services	12.5	-0.4	0.5	3.6	4.0	4.5	4.7	4.9	5.4	5.8	6.0	6.1
Computers	12.6	26.9	12.6	14.3	14.4	14.4	14.4	14.4	14.4	14.4	14.4	14.4
Semiconductors	-12.9	26.7	37.1	17.7	17.0	17.0	17.0	17.0	17.0	17.0	17.0	17.0
Other Goods 1/	6.1	14.9	0.1	16.5	3.0	3.9	3.5	6.4	0.8	4.2	4.1	6.9
Imports of G&S	7.4	-0.3	-0.5	9.5	6.1	3.0	4.2	7.8	6.6	3.0	4.9	8.5
Services	3.7	4.4	-2.0	5.2	5.7	4.8	3.6	3.3	3.4	3.3	3.4	3.4
Oil	3.4	-24.5	-3.6	26.6	-2.5	-20.6	-9.1	22.3	11.3	-16.4	-5.2	23.9
Computers	11.3	13.7	16.1	17.7	17.5	17.5	17.5	17.5	17.5	17.5	17.5	17.5
Semiconductors	-7.9	8.3	16.5	17.9	17.0	17.0	17.0	17.0	17.0	17.0	17.0	17.0
Other Goods 2/	9.1	2.3	-1.0	6.5	7.2	7.0	6.0	5.4	5.7	6.0	6.2	6.4
Billions of Chained 2000 Dollars, s.a.a.r.												
Net Goods & Services	-645.4	-614.2	-606.6	-612.3	-627.2	-626.3	-631.4	-646.8	-668.2	-665.5	-671.9	-689.5
Exports of G&S	1165.3	1195.4	1200.6	1236.4	1249.1	1264.1	1278.5	1299.1	1309.3	1326.8	1344.5	1368.3
Imports of G&S	1810.7	1809.6	1807.2	1848.7	1876.3	1890.4	1909.9	1945.9	1977.5	1992.2	2016.3	2057.9
Billions of dollars, s.a.a.r.												
US CURRENT ACCOUNT BALANCE	-794.7	-782.6	-774.9	-848.7	-886.6	-887.7	-908.6	-934.2	-986.5	-981.2	-999.1	-1020.8
Current Account as % of GDP	-6.5	-6.3	-6.2	-6.7	-6.8	-6.8	-6.8	-6.9	-7.2	-7.1	-7.2	-7.2
Net Goods & Services (BOP)	-692.2	-693.3	-727.6	-751.3	-771.0	-770.8	-778.7	-797.6	-822.3	-817.7	-823.6	-842.4
Investment Income, Net	8.3	3.9	7.3	3.2	-4.9	-16.1	-27.0	-40.6	-51.6	-60.9	-70.6	-80.4
Direct, Net	113.5	116.3	123.7	126.7	127.0	127.7	132.6	135.8	141.2	147.3	152.6	157.2
Portfolio, Net	-105.2	-112.4	-116.4	-123.5	-131.9	-143.8	-159.6	-176.4	-192.8	-208.2	-223.2	-237.6
Other Inc. & Transfers, Net	-110.7	-93.2	-54.6	-100.6	-110.7	-100.8	-102.9	-96.0	-112.6	-102.6	-104.9	-98.0

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