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Part 1

October 22, 2003

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Summary and Outlook

October 22, 2003

Summary and Outlook

Domestic Developments

The economy appears to be growing with considerable vigor. We estimate that real GDP rose at an annual rate of 6-1/4 percent in the third quarter—nearly 2 percentage points faster than we had projected in the September Greenbook—and conditions seem to be in place for a sizable advance in the fourth quarter. Although the acceleration in economic activity in the third quarter exceeded our previous expectations, the key features of our forecast remain intact: Consumer spending is rising briskly, fueled in part by the midyear tax cuts; housing has remained very robust in response to low mortgage interest rates; and business investment is moving up at a solid pace. Moreover, the employment report for September and the recent readings on initial claims may be hinting at some signs of life in the labor market, although it is still too soon to conclude that a sustained pickup in hiring is under way.

We have not altered the longer-run projection substantially from the September Greenbook. Apart from the exchange value of the dollar, conditions in financial markets have changed little, on net, over the past month, and no big surprises have occurred on the fiscal front. Nonetheless, we continue to grapple with the questions of whether—and when—the extraordinary caution that firms have exhibited in recent quarters will dissipate and to what extent such a process will be reflected in a greater willingness to hire additional workers, undertake investment projects, and build inventories. We still anticipate that business caution will diminish as we move into next year; with the preponderance of evidence received over the intermeeting period suggesting that the economic expansion has gained some traction, we believe that the risks surrounding that anticipation have narrowed somewhat.

All in all, we now expect real GDP growth to total 3-3/4 percent in 2003 and then to pick up to 5 percent in 2004 and 4 percent in 2005. These projections are just a shade stronger than those in the September Greenbook. We have not changed our estimates of structural productivity and potential output; thus, the output gap narrows a bit more quickly than in our previous forecast, and it is nearly erased by the end of 2005. The unemployment rate is lower as well. Given the higher resource utilization in our current forecast, we have edged up the projection for core PCE prices, which now rise 1.1 percent in 2004 and 1.0 percent in 2005.

Key Background Factors

As in the September Greenbook, we assume that the federal funds rate will remain at 1 percent through mid-2005. We also assume that by late 2005, when slack in resource utilization has been mostly taken up, policy will turn a bit less accommodative. Financial markets still appear to be pricing into bond yields a much larger increase in the funds rate over the next two years. We continue to believe that, as incoming data show that the economy can grow at an above-potential pace for a considerable time without stoking inflationary pressures,

market participants will gradually move their expectations for the path of the funds rate closer to ours. As private expectations are revised, bond yields should decline from current levels.

Equity prices have risen about 2 percent, on balance, since the September Greenbook, largely on the positive news about corporate earnings, and we have raised our projected path for the stock market by roughly this amount. We assume that share prices will increase from their current level at an annual rate of 6-1/2 percent and thus maintain risk-adjusted parity with the yield on long-term bonds. The upbeat earnings reports and economic data releases have also contributed to some additional narrowing of spreads on corporate bonds.

We continue to expect the federal budget to provide an appreciable amount of stimulus to the economy in 2004: Indeed, as gauged by the staff's measure of fiscal impetus, the stimulus is expected to be about 1-1/4 percent of GDP, roughly the same as it was in 2002 and 2003. Some of the stimulus is projected to come from the ongoing effects of the tax cuts. In addition, defense spending is expected to increase substantially in real terms, consistent with the supplemental appropriation requested by the President for activities in Iraq and Afghanistan and now being considered by the Congress. We have also built in a modest increase in real nondefense discretionary spending, in line with the regular appropriations bills now working their way through the Congress.

With our current assumptions, fiscal policy will turn slightly restrictive in 2005. We have assumed that the tax incentive that permits the partial expensing of equipment investment will expire, as currently scheduled, at the end of 2004, and we expect the extended unemployment insurance benefits program to lapse as well.¹ Moreover, although we have assumed that real nondefense discretionary spending will remain on the uptrend that has been evident in recent years, we expect defense spending to be about flat in real terms—albeit at a very high level.

On balance, the incoming budget data have been more favorable than we had anticipated, and the unified deficit in fiscal 2003 came in at \$374 billion—\$14 billion less than estimated in the September Greenbook. We think that the deficit will reach \$498 billion in fiscal 2004 before narrowing to \$359 billion in fiscal 2005; these projections are little changed from the September Greenbook.

1. Several of the provisions affecting personal taxes in the Jobs and Growth Tax Relief Reconciliation Act of 2003—the larger child tax credit, the reduced marriage penalty, the expanded 10 percent income bracket, and the increased alternative minimum tax exemption—also are slated to expire at the end of 2004. However, we have assumed that those provisions will be extended.

The recent news on economic activity abroad has been a little better than we anticipated, especially for the emerging Asian economies and the United Kingdom, and we have edged up our forecast of foreign real GDP growth in 2003 to 2 percent; we continue to expect foreign GDP to rise about 3-1/2 percent per year in 2004 and 2005. The real trade-weighted foreign exchange value of the dollar has fallen nearly 3 percent, on net, since the September Greenbook; as in our previous projection, we assume some modest further real depreciation between now and the end of 2005.

The spot price of West Texas intermediate crude oil (WTI) is currently about \$30 per barrel, nearly \$1 per barrel higher than at the time of the September Greenbook. Consistent with recent readings in futures markets, we project WTI to decline over the next two years as additional supplies from Iraq and non-OPEC producers are forthcoming. We forecast WTI to average less than \$27 per barrel in the fourth quarter of 2004 and \$25.50 per barrel in the fourth quarter of 2005; both figures are about \$1 per barrel above our previous projections.

Recent Developments and the Near-Term Outlook

We now estimate that real GDP increased at an annual rate of 6-1/4 percent in the third quarter, up sharply from the projected increase of 4-1/2 percent in the September Greenbook. The incoming data for domestic final demand—consumer spending and housing, in particular—have outstripped our expectations, and the August report on merchandise trade and the incoming data on inventories suggest that the additional demand was satisfied with higher domestic production. The recent labor market results also were a little better than we had expected: Private payrolls increased 72,000 in September, and the declines in the previous two months were not as great as had been estimated previously. Taken together, the spending and hours data imply yet another substantial rise in labor productivity this quarter.

We expect real GDP growth to remain robust in the fourth quarter—our point-estimate is 4-1/2 percent. Final sales are projected to increase much less rapidly than they did in the third quarter as purchases of motor vehicles return to a more sustainable level after an incentive-induced splurge, spending on residential investment decelerates, and some of the weakness in real imports is reversed. However, defense spending is expected to rebound after a third-quarter lull. We are also looking for a sizable positive contribution from inventory investment as the liquidation in the third quarter gives way to a small accumulation.

The midyear tax cuts appear to have provided a boost to real consumer spending, which is now estimated to have risen at an annual rate of 6 percent in the third quarter. Although spending on services remained subdued, outlays on goods posted large and widespread gains. Spending on motor vehicles soared as

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

| Measure | 2003:Q3 | | 2003:Q4 | |
|--|---|------------|-------------|------------|
| | Sept. GB | Oct. GB | Sept. GB | Oct. GB |
| Real GDP | 4.4 | 6.3 | 4.6 | 4.4 |
| Private domestic final purchases | 6.2 | 7.0 | 2.8 | 2.7 |
| Personal consumption expenditures | 4.8 | 6.1 | 2.8 | 1.8 |
| Residential investment | 14.8 | 19.0 | -3.6 | 5.6 |
| Business fixed investment | 11.5 | 8.1 | 6.3 | 7.9 |
| Government outlays for consumption and investment | -1.0 | .8 | 6.6 | 4.7 |
| | Contribution to growth (percentage points) | | | |
| Inventory investment | -.3 | -.3 | .8 | 1.4 |
| Net exports | -.3 | .5 | .1 | -.3 |

consumers responded to a significant sweetening of incentives, and the retail sales data point to an enormous increase in real outlays on other goods—perhaps on the order of 10 percent at an annual rate. Our forecast has real PCE growth slowing to less than 2 percent in the fourth quarter, mainly because of a cooling in the demand for motor vehicles in the absence of a further step-up in incentives. We expect real PCE excluding motor vehicles to rise at an annual rate of 3-1/2 percent in the fourth quarter after having risen 5 percent in the third quarter.

Housing activity has been much stronger than we had anticipated. Despite the higher mortgage rates starting in July, single-family housing starts have continued to increase, and in the third quarter, they reached 1.51 million units at an annual rate, 100,000 units above the average pace in the first half of the year. Given the corroborating strength in permits and the dizzying pace of home sales, we expect starts to remain near this level in the fourth quarter. Real residential investment, as estimated by the BEA, is likely to post a whopping increase in the third quarter and to rise moderately further in the fourth quarter.

Turning to the business sector, we estimate that real spending on equipment and software rose at a 12 percent annual rate in the third quarter. Some of this increase was in spending on transportation equipment, especially trucks. In addition, real outlays on high-tech equipment and software appear to have risen briskly, and the data on shipments and orders point to moderate increases in spending outside high-tech and transportation. On balance, we expect E&S to

post a similar gain in the fourth quarter, which would accord with the favorable fundamentals for this sector—namely, the continued gains in business output and corporate cash flow and the low user cost of capital—and the slightly better tone of the latest anecdotal reports.

Outlays for nonresidential construction were little changed, on net, over the first half of the year after having plummeted in 2001 and 2002, and the monthly construction data point to a modest decline in the third quarter. We expect no significant improvement in the near term.

Regarding the government sector, we estimate that real federal expenditures on consumption and gross investment were about flat in the third quarter as defense spending hit a lull after having increased sharply in the second quarter. We expect growth in real defense spending to resume in the fourth quarter and to total about 13 percent over the four quarters of the year. Meanwhile, the incoming data on employment and construction imply that real spending at the state and local level barely grew in the third quarter; in light of the fiscal pressures on these governments, we expect only a minimal increase in the fourth quarter as well.

In light of the data for foreign trade through August, we estimate that net exports arithmetically added 1/2 percentage point to the increase in GDP in the third quarter. Real exports appear to have risen rapidly after having been essentially flat over the first half of the year, while real imports were surprisingly weak in August and probably rose only moderately over the quarter as whole. In the current quarter, we expect to see another large gain in exports and a rebound in imports.

Firms apparently continued to liquidate inventories in the third quarter, with drawdowns in the motor vehicles sector and elsewhere. With inventory-sales ratios having fallen to very low levels and with prospects for demand looking increasingly favorable, we expect some small accumulation to begin by the end of the year. The resulting upswing in inventory investment is expected to contribute nearly 1-1/2 percentage points to GDP growth in the fourth quarter.

Our translation of the data for the consumer price index implies that core PCE inflation picked up to nearly 2 percent at an annual rate in the third quarter, consistent with our earlier expectation that some of the special factors that had held price increases down during the first half of the year would unwind during the second half. Still, with resource utilization low, we expect core PCE prices to rise just 1-1/4 percent in the fourth quarter. Reflecting the movements in energy prices, overall PCE inflation is expected to slow from 2-1/2 percent in the third quarter to 1 percent in the fourth quarter.

The Longer-Term Outlook for the Economy

We continue to expect that real GDP will rise about 5 percent in 2004. The key factors underlying this forecast are familiar: the expansionary thrust of fiscal policy; the favorable financial conditions—especially given the lower dollar in this Greenbook; and rapid gains in structural productivity. In addition, as firms become more confident that the economic expansion will be sustained, they should become increasingly willing to take on additional workers, build inventories, and step up their capital spending. In 2005, after the partial-expensing tax provision has expired, the increase in real GDP is projected to slow to 4 percent; a waning of the boost to consumption growth from the personal tax cuts also contributes to the deceleration.

Household spending. Consumer spending is expected to rise 4-1/2 percent in 2004 and 4 percent in 2005. Spending growth should still receive some impetus from this year's tax cuts, especially in 2004, and the projected improvement in the jobs picture should bolster real personal income growth and buoy sentiment. Wealth effects are expected to have little net influence on spending growth over the next two years as the drag from the earlier declines in stock prices runs its course and the stimulus from the rise in stock prices to date and in prospect comes into play.

We have raised the longer-term projection for homebuilding. In light of the positive incoming data, the favorable outlook for employment and income, and the expectation that mortgage rates will remain at or below recent levels, we now expect single-family starts to total about 1.50 million units in both 2004 and 2005, after having edged above 1.45 million units in 2003. Multifamily starts are projected at 340,000 units in both 2004 and 2005, the same as in 2003.

Business investment. We expect investment in equipment and software to gather considerable steam in 2004, with substantial upturns anticipated for both high-tech and other spending. The heightened uncertainty that has restrained capital spending over the past year or so should lessen as the economic expansion proceeds, and investment should respond briskly to the acceleration in overall business output and the improving prospects for profits. Moreover, we expect the cost of capital to stay low—especially after one factors in the partial expensing tax provision, which is scheduled to remain in force through the end of 2004. The impetus from the tax incentive is likely to be amplified by its temporary nature, which should induce firms to shift some capital expenditures from 2005 into 2004. Largely because of this shift, we expect real E&S growth to slow to 8 percent in 2005 after having reached 17-1/2 percent in 2004.

Nonresidential construction is expected to remain sluggish in 2004 and to pick up only moderately in 2005. Outlays on non-office commercial buildings

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

| Measure | 2004 | | 2005 |
|------------------------|---|------------|------------|
| | H1 | H2 | |
| Real GDP | 5.2 | 5.0 | 4.0 |
| Previous | 5.2 | 4.9 | 3.9 |
| Final sales | 4.5 | 4.9 | 3.8 |
| Previous | 4.3 | 4.9 | 3.7 |
| PCE | 4.6 | 4.5 | 4.1 |
| Previous | 4.6 | 4.4 | 4.0 |
| Residential investment | 1.4 | 2.3 | 1.1 |
| Previous | .7 | 3.9 | .6 |
| BFI | 12.8 | 15.7 | 7.6 |
| Previous | 11.9 | 15.6 | 7.2 |
| Government purchases | 2.9 | 1.5 | 2.1 |
| Previous | 2.9 | 1.5 | 2.1 |
| Exports | 8.9 | 11.5 | 9.9 |
| Previous | 8.4 | 11.1 | 9.6 |
| Imports | 10.3 | 9.9 | 9.1 |
| Previous | 11.1 | 10.0 | 9.2 |
| | Contribution to growth (percentage points) | | |
| Inventory change | .6 | .1 | .2 |
| Previous | .9 | .0 | .3 |
| Net exports | -6 | -3 | -4 |
| Previous | -8 | -4 | -4 |

(which are largely stores and warehouses) should continue to increase, as they did in 2003; and spending by public utilities is likely to turn around after a large drop in 2003. However, outlays in other major sectors are projected to remain weak in light of the high vacancy rates and softness in rents.

With firms expected to bring their inventory liquidations to a close shortly and then to shift to accumulation, the swing in inventory investment is projected to add about 1/4 percentage point to real GDP growth in both 2004 and 2005. Even so, businesses surely will continue to focus on tight inventory control.

Government spending. We expect the growth in real federal expenditures for consumption and investment to slow from 9-1/2 percent over the four quarters of 2003 to 3-3/4 percent in 2004 and 2-1/4 percent in 2005. The deceleration is concentrated in defense spending. Nondefense purchases are expected to rise about 3 percent per year in real terms in 2004 and 2005, increases similar to those in recent years on average.

The pickup in economic activity should show through to higher state and local tax receipts in the period ahead. Even so, the budgetary strains are likely to remain considerable, forcing these governments to restrain the growth of spending awhile longer. In our forecast, real state and local purchases rise only 1-1/4 percent in 2004 and 2 percent in 2005, well below the average increase of about 3 percent over the past decade.

Net exports. Given the anticipated firming of foreign economic activity and the past and projected dollar depreciation, we expect real exports to increase about 10 percent per year in 2004 and 2005. But imports are projected to rise rapidly as well, and on balance, the external sector is expected to arithmetically deduct nearly 1/2 percentage point from real U.S. GDP growth in 2004 and 2005, after having been an essentially neutral influence in 2003. (*The International Developments section provides more detail on the outlook for the external sector.*)

Decomposition of Structural Labor Productivity

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

| Measure | 1973-95 | 1996-2001 | 2002 | 2003 | 2004 | 2005 |
|--------------------------------------|---------|-----------|------|------|------|------|
| Structural labor productivity | 1.4 | 2.7 | 2.6 | 2.8 | 2.6 | 2.8 |
| Previous | 1.4 | 2.7 | 2.6 | 2.8 | 2.6 | 2.8 |
| <i>Contributions¹</i> | | | | | | |
| Capital deepening | .6 | 1.2 | .4 | .4 | .7 | 1.0 |
| Previous | .6 | 1.2 | .4 | .4 | .7 | 1.0 |
| Multifactor productivity | .6 | 1.2 | 2.0 | 2.1 | 1.6 | 1.6 |
| Previous | .6 | 1.2 | 2.0 | 2.1 | 1.6 | 1.6 |
| Labor composition | .3 | .3 | .3 | .3 | .3 | .3 |
| MEMO | | | | | | |
| Potential GDP | 2.9 | 3.4 | 3.5 | 3.6 | 3.4 | 3.6 |
| Previous | 2.9 | 3.4 | 3.5 | 3.6 | 3.4 | 3.6 |

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

1. Percentage points.

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

| Measure | 2002 | 2003 | 2004 | 2005 |
|---|------|------|------|------|
| Output per hour, nonfarm business | 4.4 | 4.6 | 1.4 | .9 |
| Previous | 4.4 | 4.3 | 1.4 | 1.4 |
| Nonfarm private payroll employment | -.7 | -.2 | 3.7 | 3.2 |
| Previous | -.7 | -.4 | 3.7 | 2.8 |
| Household survey employment | .3 | 1.0 | 2.8 | 2.1 |
| Previous | .3 | 1.1 | 2.6 | 1.9 |
| Labor force participation rate ¹ | 66.5 | 66.3 | 66.7 | 67.0 |
| Previous | 66.5 | 66.3 | 66.9 | 67.1 |
| Civilian unemployment rate ¹ | 5.9 | 6.2 | 5.4 | 5.1 |
| Previous | 5.9 | 6.2 | 5.7 | 5.3 |
| MEMO | | | | |
| GDP gap ² | 2.3 | 2.0 | .4 | .1 |
| Previous | 2.3 | 2.4 | .9 | .6 |

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.

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

With actual growth in output expected to exceed our estimate of potential growth over the next two years, the output and unemployment gaps should narrow considerably. We project that, by the end of 2004, the unemployment rate will fall to 5-1/2 percent; by the end of 2005, it should be down nearly to 5 percent—1/4 percentage point below the September projection and close to our estimate of the natural rate. Although the inflation projection has been raised a tad to reflect the higher resource utilization in our current forecast, we still expect core PCE inflation to edge down to 1 percent by 2005.

Productivity and the labor market. Private payroll employment rose in September after a long string of declines, and our forecast anticipates further increases in the months ahead. But on the assumption that businesses will continue to focus on productivity improvements—and that caution in hiring will abate slowly—we expect employment to pick up only gradually, with increases in private payrolls averaging just about 80,000 per month over the rest of 2003. Given our output forecast, this projection implies that productivity growth will remain elevated in the fourth quarter—albeit well below the 6 percent annual rate we now estimate for the third quarter. By next year, however, businesses

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

| Measure | 2002 | 2003 | 2004 | 2005 |
|--|------|------|------|------|
| PCE chain-weighted price index | 1.8 | 1.7 | .8 | .9 |
| Previous | 1.8 | 1.6 | .7 | .8 |
| Food and beverages | 1.4 | 2.2 | 1.4 | 1.4 |
| Previous | 1.4 | 1.9 | 1.4 | 1.3 |
| Energy | 7.0 | 8.7 | -6.4 | -1.1 |
| Previous | 7.0 | 8.8 | -6.7 | -1.1 |
| Excluding food and energy | 1.6 | 1.2 | 1.1 | 1.0 |
| Previous | 1.6 | 1.1 | 1.0 | .9 |
| Consumer price index | 2.2 | 2.0 | .9 | 1.2 |
| Previous | 2.2 | 2.0 | .9 | 1.1 |
| Excluding food and energy | 2.1 | 1.4 | 1.5 | 1.4 |
| Previous | 2.1 | 1.4 | 1.4 | 1.3 |
| GDP chain-weighted price index | 1.3 | 1.5 | 1.0 | 1.1 |
| Previous | 1.3 | 1.4 | .9 | 1.0 |
| ECI for compensation of private industry workers ¹ | 3.2 | 3.8 | 3.4 | 3.4 |
| Previous | 3.2 | 3.8 | 3.3 | 3.2 |
| NFB compensation per hour | 2.8 | 3.3 | 3.0 | 3.2 |
| Previous | 2.8 | 3.5 | 2.9 | 3.1 |
| Prices of core non-oil merchandise imports | .7 | 2.2 | 1.8 | 1.1 |
| Previous | .7 | 2.2 | 1.4 | 1.3 |

1. December to December.

should have the confidence—and the need—to begin hiring in earnest. Indeed, we expect job gains in the private sector to average nearly 340,000 per month in 2004 and 300,000 per month in 2005. As hiring picks up, productivity growth is forecast to fall below its underlying structural pace.

Wages and prices. Although resource utilization is expected to be somewhat higher than projected in the September Greenbook, we still foresee enough slack to generate a small further decline in core inflation. All in all, we now expect the four-quarter change in core PCE prices to edge down from 1.2 percent in 2003 to 1.1 percent in 2004 and 1.0 percent in 2005. Total PCE inflation, which was boosted in 2003 by a large increase in energy prices, is expected to inch

below 1 percent in 2004 as energy prices turn back down and to remain at about that rate in 2005.

As for hourly compensation, we now project that the employment cost index will rise 3.4 percent in each of the next two years, after having risen 3.8 percent in 2003. The projections for 2004 and 2005 are a shade higher than those in the September Greenbook because of the tighter labor market that we are now forecasting.

Financial Flows and Conditions

The projection for the growth of total debt of the domestic nonfinancial sector in 2003 is unchanged from the September Greenbook at 8-1/4 percent, as a somewhat lower forecast for federal government borrowing in the second half is counterbalanced by an upward revision to borrowing by state and local governments. As in the previous forecast, we expect nonfinancial debt growth to moderate in the next two years, reaching 6-1/4 percent in 2005.

Nonfinancial business debt expanded at an annual rate of only 2-3/4 percent in the third quarter as the proceeds of heavy second-quarter bond issuance and strong gains in operating profits limited the need for new borrowing. Business debt growth is expected to step up in the fourth quarter to a pace more in line with nominal output growth; it is projected to pick up a bit more in 2004 and 2005 as the increase in investment spending outpaces the advance in profits.

We have edged up our projection for household sector borrowing in 2003 to 10 percent, on a par with last year's pace. Borrowing is expected to moderate over the forecast period, to a rate of about 6-1/2 percent per year. This moderation reflects a significant slowing in the growth of mortgage debt that more than offsets an acceleration in consumer credit.

Federal debt is expected to increase 11-1/2 percent this year, 1-1/2 percentage points less than in the previous forecast. This revision reflects both a somewhat smaller budget deficit and a shift away from debt issuance toward greater use of other means of financing to fund the deficit. We project federal debt to expand rapidly again in 2004, but it should rise at a noticeably slower pace—7-1/2 percent—in 2005 as the partial-expensing provision for investment expenditures expires and stronger economic activity pushes up tax revenues.

State and local government borrowing in 2003 has been revised up somewhat because of incoming data that have shown continued robust growth in capital expenditures financed by debt. This sector's debt is now expected to expand 8-1/2 percent this year but to slow to an average pace of 4-1/2 percent in 2004 and 2005 partly because of a much slower pace of advance refunding in those years.

M2 is projected to expand 6 percent in 2003, substantially less than in the previous forecast. The revision is due mainly to the effects of mortgage refinancings, which are now judged to have dropped off more steeply than previously assumed. Over the remainder of the forecast period, M2 is expected to expand somewhat less than nominal income, damped by the paucity of mortgage refinancings in 2004 and by the onset of policy tightening in 2005.

Alternative Simulations

In this section we explore alternatives to the staff forecast using simulations of the FRB/US model. The first two scenarios examine the possibility that the recent pickup in aggregate demand will fizzle out, with the situation either exacerbated or not by a substantial increase in risk premiums. The next two simulations examine the implications of stronger household spending, with potentially favorable consequences for financial markets. We then consider two risks to the inflation outlook: (1) the chance that competitive pressures will cause a sharp drop in profit margins and (2) the possibility that long-run inflation expectations will rise in an environment of low interest rates and rapid GDP growth. In all these simulations, the funds rate is assumed to remain unchanged at its baseline path. The final scenario shows the implications of allowing the funds rate to follow a path consistent with current market expectations.

Faltering economic recovery. In this scenario, we consider the possibility that the recent spurt in household spending proves temporary (perhaps because it was more heavily dependent on the tax cut than we had assumed). Specifically, we assume that consumer spending moderates more rapidly than in the baseline, adding another 1/4 percentage point to the saving rate next year. We also assume that weaker household spending causes firms to remain especially cautious about rebuilding inventories and investing in capital; in particular, the rise in real E&S spending in 2004 is little changed from the pace in the second half of this year. Under these conditions, real GDP increases only a touch faster than potential output, and the unemployment rate declines to only 6 percent by late 2005. In the face of the more persistent economic slack, core PCE prices rise only 3/4 percent in 2005.

Adverse market response. Financial markets might respond adversely to a faltering of the current pickup in real activity. This scenario builds on the previous one by incorporating a more-pronounced increase in risk premiums: By early next year, the yield spread of Baa corporate bonds over Treasuries is assumed to return to its elevated level of early 2003, roughly 1 percentage point above baseline; the equity premium rises a similar amount. The effect of these developments on asset prices is partially offset by a decline in Treasury yields, which limits the drop in equity prices to a little more than 10 percent (relative to baseline) through mid-2004. The net deterioration in financial conditions adds

Alternative Simulations

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

| Measure | 2003 | 2004 | | 2005 |
|---|------------|------------|------------|------------|
| | Q4 | H1 | H2 | |
| <i>Real GDP</i> | | | | |
| Greenbook baseline | 4.4 | 5.2 | 5.0 | 4.0 |
| Faltering economic recovery | 3.4 | 3.9 | 4.2 | 3.4 |
| Adverse market response | 3.4 | 3.4 | 3.6 | 3.1 |
| Stronger household spending | 5.0 | 6.2 | 5.6 | 4.6 |
| Financial market boom | 5.0 | 6.6 | 6.3 | 5.2 |
| Increased competitive pressures | 4.4 | 5.2 | 5.1 | 4.0 |
| Rising inflation expectations | 4.4 | 5.2 | 5.0 | 4.3 |
| Market-based funds rate | 4.4 | 5.2 | 4.8 | 2.9 |
| <i>Unemployment rate¹</i> | | | | |
| Greenbook baseline | 6.2 | 5.8 | 5.4 | 5.1 |
| Faltering economic recovery | 6.3 | 6.2 | 6.0 | 6.0 |
| Adverse market response | 6.3 | 6.2 | 6.2 | 6.4 |
| Stronger household spending | 6.2 | 5.6 | 5.0 | 4.3 |
| Financial market boom | 6.2 | 5.5 | 4.7 | 3.8 |
| Increased competitive pressures | 6.2 | 5.8 | 5.4 | 5.1 |
| Rising inflation expectations | 6.2 | 5.8 | 5.4 | 4.9 |
| Market-based funds rate | 6.2 | 5.8 | 5.4 | 5.6 |
| <i>PCE prices excluding food and energy</i> | | | | |
| Greenbook baseline | 1.3 | 1.2 | 1.1 | 1.0 |
| Faltering economic recovery | 1.3 | 1.2 | 1.0 | .7 |
| Adverse market response | 1.3 | 1.2 | 1.0 | .6 |
| Stronger household spending | 1.3 | 1.2 | 1.2 | 1.3 |
| Financial market boom | 1.3 | 1.1 | 1.2 | 1.5 |
| Increased competitive pressures | 1.3 | 1.0 | .6 | .2 |
| Rising inflation expectations | 1.3 | 1.2 | 1.2 | 1.8 |
| Market-based funds rate | 1.3 | 1.2 | 1.1 | .7 |

1. Average for the final quarter of the period.

to the downward pressure on consumption and investment in the previous scenario, causing real GDP growth to barely keep pace with potential in 2004 and to slip below in 2005. As a result, the unemployment rate remains roughly flat at 6-1/4 percent next year and edges up to nearly 6-1/2 percent by the end of 2005. Core inflation declines to just over 1/2 percent in 2005.

Stronger household spending. Another risk is that we have understated the extent to which the recent strength in consumption and housing will carry forward. Indeed, some of our models predict a considerably stronger and

more-persistent response of spending to the Greenbook projections for disposable income, interest rates, and other factors, and this scenario takes on board this alternative assessment. Doing so causes the personal saving rate to remain roughly flat through 2005, at a level about 1/2 percentage point below baseline, and residential investment grows an additional 3 percentage points per year on average. Under these conditions, real GDP increases almost 6 percent next year and 4-1/2 percent in 2005, enough to reduce the unemployment rate to 4-1/4 percent by late 2005. The shift from slack to tightness in the labor market is sufficient to keep core inflation around 1-1/4 percent through 2005 and to put it on an upward trajectory into 2006.

Financial market boom. A pickup in the pace of real activity of the magnitude just discussed could spark a substantial decline in risk premiums, even if yields on government securities were to rise in response to stronger aggregate demand. This scenario builds on the previous one by assuming that, in addition, the spread of Baa corporate yields over Treasuries falls about 1 percentage point relative to baseline, bringing it down to its mid-1990s level; the equity premium falls a similar amount. Because of an assumed backup in Treasury yields, the net decline in corporate yields by early next year is about 50 basis points; equity prices increase more than 10 percent relative to baseline. The additional stimulus implied by these changes is enough to push real GDP growth above 6 percent in 2004 and to keep it above 5 percent in 2005. As a result, the unemployment rate falls below 4 percent by the end of 2005, boosting core inflation to 1-1/2 percent that year.

Increased competitive pressures. In the staff projection, the markup of prices over unit labor costs in the nonfarm business sector edges down only gradually. In this scenario, competitive pressures turn out to be more intense than we anticipate, squeezing profit margins more substantially and returning the markup to a level roughly in line with its average during the mid-1990s. As a result, core PCE inflation declines to 1/4 percent by 2005. Real output and employment are little affected by the change in the inflation outlook: Although higher real interest rates weaken consumption and investment, this effect is roughly offset by a change in the distribution of national income away from profits and toward wages that acts to boost private spending.

Rising inflation expectations. The baseline combination of a low federal funds rate and fast output growth could trigger an upward revision to inflation expectations, particularly because market participants appear to expect both slower growth than in the baseline and an earlier and more pronounced tightening of monetary policy. In this scenario, the public begins to revise up its expectations for long-run inflation starting next spring, around the time that current futures quotes imply that monetary policy will begin to tighten. By 2005, long-run inflation expectations have increased a full percentage point

relative to baseline, accompanied by an upward movement in nominal bond yields. Actual inflation responds gradually to the change in expectations; by 2005, core inflation is on an upward trajectory and stands at 1-3/4 percent. The change in inflation expectations has only a modest effect on output and employment because the stimulative effects of lower real interest rates are mostly offset by the contractionary influence of rising nominal mortgage rates on housing.

Market-based funds rate. Futures markets are consistent with a rise in the federal funds rate to 3-1/2 percent by late 2005. Incorporating market expectations for monetary policy into the projection has only minor consequences for output and inflation in 2004 because market expectations do not diverge significantly from the staff's assumptions until the second half of next year. However, by 2005, the implications of a market-based funds rate are more considerable: The unemployment rate falls only to 5-1/2 percent, and core inflation slips to 3/4 percent.

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

| Interval | Nominal GDP | | Real GDP | | GDP chain-weighted price index | | Consumer price index ¹ | | Unemployment rate ² | | |
|---------------------------------|-------------|----------|----------|----------|--------------------------------|----------|-----------------------------------|----------|--------------------------------|----------|------|
| | 09/10/03 | 10/22/03 | 09/10/03 | 10/22/03 | 09/10/03 | 10/22/03 | 09/10/03 | 10/22/03 | 09/10/03 | 10/22/03 | |
| ANNUAL | | | | | | | | | | | |
| 2001 | 2.6 | 2.6 | 0.3 | 0.3 | 2.4 | 2.4 | 2.8 | 2.8 | 4.8 | 4.8 | |
| 2002 | 3.6 | 3.6 | 2.4 | 2.4 | 1.1 | 1.1 | 1.6 | 1.6 | 5.8 | 5.8 | |
| 2003 | 4.2 | 4.5 | 2.6 | 2.9 | 1.5 | 1.6 | 2.3 | 2.3 | 6.1 | 6.1 | |
| 2004 | 5.9 | 6.1 | 4.8 | 5.0 | 1.0 | 1.1 | 1.0 | 1.1 | 5.9 | 5.8 | |
| 2005 | 5.3 | 5.5 | 4.3 | 4.4 | 1.0 | 1.1 | 1.1 | 1.1 | 5.4 | 5.1 | |
| QUARTERLY | | | | | | | | | | | |
| 2002 | Q1 | 6.5 | 6.5 | 5.0 | 5.0 | 1.3 | 1.3 | 1.4 | 1.4 | 5.6 | 5.6 |
| | Q2 | 2.5 | 2.5 | 1.3 | 1.3 | 1.2 | 1.2 | 3.4 | 3.4 | 5.9 | 5.9 |
| | Q3 | 5.1 | 5.1 | 4.0 | 4.0 | 1.0 | 1.0 | 2.2 | 2.2 | 5.8 | 5.8 |
| | Q4 | 3.2 | 3.2 | 1.4 | 1.4 | 1.8 | 1.8 | 2.0 | 2.0 | 5.9 | 5.9 |
| 2003 | Q1 | 3.8 | 3.8 | 1.4 | 1.4 | 2.4 | 2.4 | 3.8 | 3.8 | 5.8 | 5.8 |
| | Q2 | 4.2 | 4.3 | 3.3 | 3.3 | 0.8 | 1.0 | 0.7 | 0.7 | 6.2 | 6.2 |
| | Q3 | 5.9 | 8.2 | 4.4 | 6.3 | 1.5 | 1.8 | 2.2 | 2.4 | 6.2 | 6.1 |
| | Q4 | 5.7 | 5.2 | 4.6 | 4.4 | 1.1 | 0.8 | 1.3 | 1.2 | 6.2 | 6.2 |
| 2004 | Q1 | 6.3 | 6.3 | 5.2 | 5.2 | 1.1 | 1.1 | 0.6 | 0.7 | 6.1 | 6.0 |
| | Q2 | 6.0 | 6.1 | 5.1 | 5.2 | 0.9 | 0.9 | 0.8 | 0.9 | 6.0 | 5.8 |
| | Q3 | 6.0 | 6.1 | 5.0 | 5.1 | 0.9 | 1.0 | 1.0 | 1.0 | 5.9 | 5.7 |
| | Q4 | 5.6 | 5.8 | 4.7 | 4.8 | 0.9 | 1.0 | 1.1 | 1.1 | 5.7 | 5.4 |
| 2005 | Q1 | 5.1 | 5.3 | 3.8 | 3.9 | 1.3 | 1.4 | 1.1 | 1.2 | 5.5 | 5.2 |
| | Q2 | 5.0 | 5.2 | 4.1 | 4.2 | 0.9 | 1.0 | 1.1 | 1.2 | 5.4 | 5.1 |
| | Q3 | 4.9 | 5.0 | 4.0 | 4.1 | 0.9 | 1.0 | 1.1 | 1.2 | 5.3 | 5.1 |
| | Q4 | 4.7 | 5.0 | 3.9 | 4.0 | 0.8 | 0.9 | 1.1 | 1.3 | 5.3 | 5.1 |
| TWO-QUARTER³ | | | | | | | | | | | |
| 2002 | Q2 | 4.5 | 4.5 | 3.1 | 3.1 | 1.3 | 1.3 | 2.4 | 2.4 | 0.3 | 0.3 |
| | Q4 | 4.1 | 4.1 | 2.7 | 2.7 | 1.4 | 1.4 | 2.1 | 2.1 | 0.0 | 0.0 |
| 2003 | Q2 | 4.0 | 4.1 | 2.4 | 2.3 | 1.6 | 1.7 | 2.2 | 2.2 | 0.3 | 0.3 |
| | Q4 | 5.8 | 6.7 | 4.5 | 5.3 | 1.3 | 1.3 | 1.7 | 1.7 | 0.0 | 0.0 |
| 2004 | Q2 | 6.2 | 6.2 | 5.2 | 5.2 | 1.0 | 1.0 | 0.7 | 0.8 | -0.2 | -0.4 |
| | Q4 | 5.8 | 6.0 | 4.9 | 5.0 | 0.9 | 1.0 | 1.0 | 1.1 | -0.3 | -0.4 |
| 2005 | Q2 | 5.1 | 5.3 | 3.9 | 4.0 | 1.1 | 1.2 | 1.1 | 1.2 | -0.3 | -0.3 |
| | Q4 | 4.8 | 5.0 | 3.9 | 4.0 | 0.8 | 0.9 | 1.1 | 1.2 | -0.1 | 0.0 |
| FOUR-QUARTER⁴ | | | | | | | | | | | |
| 2001 | Q4 | 2.0 | 2.0 | 0.1 | 0.1 | 2.0 | 2.0 | 1.8 | 1.8 | 1.7 | 1.7 |
| 2002 | Q4 | 4.3 | 4.3 | 2.9 | 2.9 | 1.3 | 1.3 | 2.2 | 2.2 | 0.3 | 0.3 |
| 2003 | Q4 | 4.9 | 5.4 | 3.4 | 3.8 | 1.4 | 1.5 | 2.0 | 2.0 | 0.3 | 0.3 |
| 2004 | Q4 | 6.0 | 6.1 | 5.0 | 5.1 | 0.9 | 1.0 | 0.9 | 0.9 | -0.5 | -0.8 |
| 2005 | Q4 | 4.9 | 5.1 | 3.9 | 4.0 | 1.0 | 1.1 | 1.1 | 1.2 | -0.4 | -0.4 |

1. For all urban consumers.

2. Level, except as noted.

3. Percent change from two quarters earlier; for unemployment rate, change in percentage points.

4. Percent change from four quarters earlier; for unemployment rate, change in percentage points.

Strictly Confidential <FR>
Class II FOMCREAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS, ANNUAL VALUES
(Seasonally adjusted annual rate)

October 22, 2003

| Item | Units ¹ | - - - - - Projected - - - - - | | | | | | | | |
|---------------------------------------|--------------------|-------------------------------|--------|--------|--------|---------|---------|---------|---------|---------|
| | | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
| Expenditures | | | | | | | | | | |
| Nominal GDP | Bill. \$ | 8318.4 | 8781.5 | 9274.3 | 9824.6 | 10082.2 | 10446.2 | 10916.9 | 11587.2 | 12223.2 |
| Real GDP | Bill. Ch. \$ | 8159.5 | 8508.9 | 8859.0 | 9191.4 | 9214.5 | 9439.9 | 9710.7 | 10198.2 | 10643.7 |
| Real GDP | % change | 4.3 | 4.8 | 4.3 | 2.3 | 0.1 | 2.9 | 3.8 | 5.1 | 4.0 |
| Gross domestic purchases | | 5.0 | 5.8 | 5.2 | 2.9 | 0.1 | 3.7 | 3.7 | 5.3 | 4.2 |
| Final sales | | 3.9 | 4.7 | 4.2 | 2.6 | 1.6 | 1.7 | 4.0 | 4.7 | 3.8 |
| Priv. dom. final purchases | | 5.1 | 6.3 | 5.2 | 3.7 | 0.9 | 2.3 | 3.9 | 5.6 | 4.4 |
| Personal cons. expenditures | | 4.1 | 5.0 | 5.0 | 3.5 | 2.8 | 2.7 | 3.4 | 4.6 | 4.1 |
| Durables | | 8.8 | 12.7 | 10.0 | 3.8 | 13.2 | 1.9 | 9.3 | 8.0 | 7.6 |
| Nondurables | | 2.5 | 5.0 | 4.9 | 3.0 | 1.7 | 3.4 | 5.1 | 5.5 | 4.9 |
| Services | | 3.9 | 3.6 | 4.0 | 3.8 | 1.3 | 2.5 | 1.5 | 3.4 | 3.1 |
| Business fixed investment | | 11.8 | 12.3 | 6.6 | 6.2 | -9.3 | -1.7 | 4.6 | 14.2 | 7.6 |
| Equipment & Software | | 13.7 | 14.9 | 9.7 | 5.2 | -8.8 | 3.3 | 6.1 | 17.5 | 7.8 |
| Nonres. structures | | 6.5 | 4.9 | -2.5 | 9.3 | -10.6 | -15.9 | -0.6 | 3.1 | 6.9 |
| Residential structures | | 3.5 | 10.0 | 4.0 | -1.2 | 1.0 | 6.7 | 10.2 | 1.8 | 1.1 |
| Exports | | 8.5 | 2.3 | 4.9 | 7.3 | -11.4 | 3.9 | 5.0 | 10.2 | 9.9 |
| Imports | | 14.3 | 10.8 | 11.9 | 11.1 | -8.0 | 10.1 | 4.0 | 10.1 | 9.1 |
| Gov't. cons. & investment | | 2.4 | 2.7 | 4.5 | 1.3 | 5.1 | 3.6 | 3.5 | 2.2 | 2.1 |
| Federal | | 0.1 | 0.6 | 4.0 | -1.2 | 7.5 | 7.5 | 9.5 | 3.7 | 2.2 |
| Defense | | -1.4 | -0.8 | 4.4 | -2.5 | 7.4 | 9.3 | 12.8 | 3.7 | 1.8 |
| State & local | | 3.7 | 3.8 | 4.8 | 2.6 | 3.9 | 1.6 | 0.2 | 1.3 | 2.1 |
| Change in bus. inventories | Bill. Ch. \$ | 63.8 | 76.7 | 62.8 | 65.0 | -61.4 | 5.2 | -7.1 | 46.4 | 81.0 |
| Nonfarm | | 60.6 | 75.0 | 64.1 | 67.2 | -63.2 | 4.1 | -8.2 | 45.0 | 79.4 |
| Net exports | | -113.3 | -221.1 | -320.5 | -398.8 | -415.9 | -488.5 | -532.8 | -579.9 | -628.8 |
| Nominal GDP | % change | 6.2 | 6.0 | 5.9 | 4.6 | 2.0 | 4.3 | 5.4 | 6.1 | 5.1 |
| GDP Gap ² | % | -0.8 | -1.6 | -2.1 | -2.2 | 0.9 | 1.9 | 2.5 | 1.0 | 0.2 |
| Employment and Production | | | | | | | | | | |
| Nonfarm payroll employment | Millions | 122.8 | 125.9 | 129.0 | 131.8 | 131.8 | 130.4 | 130.0 | 132.4 | 136.5 |
| Unemployment rate | % | 4.9 | 4.5 | 4.2 | 4.0 | 4.8 | 5.8 | 6.1 | 5.8 | 5.1 |
| Industrial prod. index | % change | 8.0 | 4.0 | 4.9 | 2.7 | -5.7 | 1.4 | 0.7 | 6.5 | 5.2 |
| Capacity util. rate - mfg. | % | 82.7 | 81.9 | 81.4 | 81.4 | 75.6 | 73.7 | 73.0 | 76.1 | 79.4 |
| Housing starts | Millions | 1.47 | 1.62 | 1.64 | 1.57 | 1.60 | 1.70 | 1.80 | 1.84 | 1.86 |
| Light motor vehicle sales | | 15.07 | 15.41 | 16.78 | 17.24 | 17.02 | 16.70 | 16.55 | 17.21 | 17.57 |
| North Amer. produced | | 13.14 | 13.39 | 14.30 | 14.38 | 13.94 | 13.42 | 13.22 | 13.79 | 14.08 |
| Other | | 1.93 | 2.02 | 2.48 | 2.86 | 3.08 | 3.29 | 3.34 | 3.42 | 3.50 |
| Income and Saving | | | | | | | | | | |
| Nominal GNP | Bill. \$ | 8325.4 | 8778.1 | 9297.1 | 9848.0 | 10104.1 | 10436.7 | 10916.2 | 11599.3 | 12233.0 |
| Nominal GNP | % change | 5.7 | 5.6 | 6.9 | 4.6 | 2.1 | 3.8 | 5.5 | 6.2 | 5.1 |
| Nominal personal income | | 6.3 | 6.7 | 5.1 | 7.7 | 1.4 | 3.6 | 3.7 | 5.9 | 5.6 |
| Real disposable income | | 3.8 | 5.0 | 2.4 | 4.8 | 0.3 | 5.2 | 2.8 | 5.2 | 4.3 |
| Personal saving rate | % | 4.2 | 4.7 | 2.6 | 2.8 | 2.3 | 3.7 | 3.3 | 3.7 | 3.9 |
| Corp. profits, IVA & CCAdj. | % change | 9.9 | -9.6 | 7.0 | -9.1 | 8.2 | -1.9 | 27.2 | 7.4 | -1.4 |
| Profit share of GNP | % | 10.0 | 8.9 | 8.7 | 8.0 | 7.2 | 7.5 | 8.5 | 9.3 | 8.8 |
| Excluding FR Banks | | 9.7 | 8.6 | 8.4 | 7.7 | 7.0 | 7.3 | 8.3 | 9.1 | 8.6 |
| Federal surpl./deficit | Bill. \$ | -53.3 | 43.8 | 111.9 | 206.9 | 72.0 | -199.9 | -371.5 | -414.5 | -225.7 |
| State & local surpl./def. | | 31.0 | 40.7 | 38.3 | 18.0 | -31.3 | -51.5 | -27.1 | -5.0 | 3.1 |
| Ex. social ins. funds | | 29.9 | 40.0 | 37.4 | 17.8 | -31.2 | -51.4 | -27.0 | -4.9 | 3.2 |
| Gross natl. saving rate | % | 18.0 | 18.8 | 18.3 | 18.4 | 16.5 | 15.0 | 13.8 | 14.6 | 14.9 |
| Net natl. saving rate | | 6.7 | 7.5 | 6.8 | 6.7 | 3.8 | 1.9 | 0.8 | 2.1 | 2.5 |
| Prices and Costs | | | | | | | | | | |
| GDP chn.-wt. price index | % change | 1.8 | 1.1 | 1.6 | 2.3 | 2.0 | 1.3 | 1.5 | 1.0 | 1.1 |
| Gross Domestic Purchases | | | | | | | | | | |
| chn.-wt. price index | | 1.4 | 0.8 | 1.9 | 2.5 | 1.3 | 1.6 | 1.7 | 0.9 | 1.0 |
| PCE chn.-wt. price index | | 1.5 | 1.1 | 2.0 | 2.5 | 1.5 | 1.8 | 1.7 | 0.8 | 0.9 |
| Ex. food and energy | | 1.7 | 1.6 | 1.5 | 1.8 | 1.9 | 1.6 | 1.2 | 1.1 | 1.0 |
| CPI | | 1.9 | 1.5 | 2.6 | 3.4 | 1.8 | 2.2 | 2.0 | 0.9 | 1.2 |
| Ex. food and energy | | 2.2 | 2.3 | 2.0 | 2.6 | 2.7 | 2.1 | 1.4 | 1.5 | 1.4 |
| ECI, hourly compensation ³ | | 3.4 | 3.5 | 3.4 | 4.4 | 4.2 | 3.2 | 3.8 | 3.4 | 3.4 |
| Nonfarm business sector | | | | | | | | | | |
| Output per hour | | 2.2 | 2.9 | 2.8 | 2.2 | 3.2 | 4.4 | 4.6 | 1.4 | 0.9 |
| Compensation per Hour | | 3.4 | 5.3 | 4.2 | 7.2 | 2.7 | 2.8 | 3.3 | 3.0 | 3.2 |
| Unit labor cost | | 1.2 | 2.3 | 1.4 | 4.9 | -0.5 | -1.6 | -1.2 | 1.6 | 2.3 |

1. Changes are from fourth quarter to fourth quarter.

2. Percent difference between potential and actual. A positive number indicates that the economy is operating below potential.

3. Private-industry workers.

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

October 22, 2003

| Item | Units | 2001 Q1 | 2001 Q2 | 2001 Q3 | 2001 Q4 | 2002 Q1 | 2002 Q2 | 2002 Q3 | 2002 Q4 | 2003 Q1 | 2003 Q2 |
|---------------------------------------|--------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
| Expenditures | | | | | | | | | | | |
| Nominal GDP | Bill. \$ | 10028.1 | 10049.9 | 10097.7 | 10152.9 | 10313.1 | 10376.9 | 10506.2 | 10588.8 | 10688.4 | 10802.7 |
| Real GDP | Bill. Ch. \$ | 9229.9 | 9193.1 | 9186.4 | 9248.8 | 9363.2 | 9392.4 | 9485.6 | 9518.2 | 9552.0 | 9629.4 |
| Real GDP | % change | -0.6 | -1.6 | -0.3 | 2.7 | 5.0 | 1.3 | 4.0 | 1.4 | 1.4 | 3.3 |
| Gross domestic purchases | | -1.1 | -1.1 | -0.1 | 2.9 | 5.6 | 2.6 | 3.9 | 2.9 | 0.6 | 4.4 |
| Final sales | | 2.8 | -0.4 | -0.2 | 4.2 | 2.4 | -0.1 | 3.4 | 1.1 | 2.3 | 4.0 |
| Priv. dom. final purchases | | 1.5 | -1.2 | 0.3 | 3.0 | 2.5 | 1.3 | 3.4 | 2.2 | 1.6 | 4.4 |
| Personal cons. expenditures | | 2.4 | 1.4 | 1.5 | 6.0 | 3.1 | 1.8 | 4.2 | 1.7 | 2.0 | 3.8 |
| Durables | | 11.5 | 5.3 | 4.6 | 33.6 | -6.3 | 2.0 | 22.8 | -8.2 | -2.0 | 24.3 |
| Nondurables | | 2.3 | -0.3 | 1.3 | 3.6 | 7.9 | -0.1 | 1.0 | 5.1 | 6.1 | 1.4 |
| Services | | 0.6 | 1.5 | 0.9 | 2.1 | 2.9 | 2.7 | 2.3 | 2.2 | 0.9 | 1.4 |
| Business fixed investment | | -5.4 | -14.5 | -6.0 | -10.9 | -5.8 | -2.4 | -0.8 | 2.3 | -4.4 | 7.3 |
| Equipment & Software | | -6.3 | -16.7 | -9.2 | -2.5 | -2.7 | 3.3 | 6.7 | 6.2 | -4.8 | 8.3 |
| Nonres. structures | | -3.1 | -8.4 | 2.9 | -30.1 | -14.2 | -17.6 | -21.4 | -9.9 | -2.9 | 4.2 |
| Residential structures | | 8.2 | -0.5 | 0.4 | -3.5 | 14.2 | 2.7 | 1.1 | 9.4 | 10.1 | 6.6 |
| Exports | | -6.0 | -12.4 | -17.3 | -9.6 | 3.5 | 14.3 | 4.6 | -5.8 | -1.3 | -1.0 |
| Imports | | -7.9 | -6.8 | -11.8 | -5.3 | 8.5 | 22.2 | 3.3 | 7.4 | -6.2 | 8.8 |
| Gov't. cons. & investment | | 5.7 | 5.6 | -1.1 | 10.5 | 5.6 | 1.4 | 2.9 | 4.6 | 0.4 | 8.5 |
| Federal | | 9.5 | 6.0 | 1.2 | 13.5 | 7.4 | 7.5 | 4.3 | 11.0 | 0.7 | 25.5 |
| Defense | | 8.3 | 2.7 | 4.6 | 14.3 | 11.6 | 7.8 | 6.9 | 11.0 | -3.3 | 45.8 |
| State & local | | 3.8 | 5.4 | -2.3 | 8.9 | 4.6 | -1.7 | 2.2 | 1.2 | 0.2 | -0.2 |
| Change in bus. inventories | Bill. Ch. \$ | -26.9 | -58.3 | -61.8 | -98.4 | -28.9 | 4.9 | 18.8 | 25.8 | 4.8 | -17.6 |
| Nonfarm | | -32.6 | -54.9 | -63.6 | -101.5 | -35.1 | 4.2 | 20.8 | 26.5 | 3.8 | -17.1 |
| Net exports | | -404.5 | -414.8 | -419.0 | -425.3 | -446.6 | -487.4 | -488.0 | -532.2 | -510.3 | -546.1 |
| Nominal GDP | % change | 3.0 | 0.9 | 1.9 | 2.2 | 6.5 | 2.5 | 5.1 | 3.2 | 3.8 | 4.3 |
| GDP Gap ¹ | % | -0.4 | 0.8 | 1.7 | 1.8 | 1.4 | 2.0 | 1.8 | 2.3 | 2.8 | 2.9 |
| Employment and Production | | | | | | | | | | | |
| Nonfarm payroll employment | Millions | 132.5 | 132.2 | 131.7 | 130.9 | 130.5 | 130.4 | 130.2 | 130.3 | 130.2 | 130.0 |
| Unemployment rate | % | 4.2 | 4.4 | 4.8 | 5.6 | 5.6 | 5.9 | 5.8 | 5.9 | 5.8 | 6.2 |
| Industrial prod. index | % change | -6.1 | -6.1 | -4.6 | -5.8 | 1.4 | 4.4 | 3.4 | -3.4 | 0.3 | -3.7 |
| Capacity util. rate - mfg. | | 77.9 | 76.1 | 74.8 | 73.4 | 73.4 | 73.9 | 74.3 | 73.5 | 73.2 | 72.5 |
| Housing starts | Millions | 1.61 | 1.63 | 1.60 | 1.57 | 1.72 | 1.68 | 1.70 | 1.74 | 1.74 | 1.74 |
| Light motor vehicle sales | | 16.95 | 16.54 | 16.23 | 18.37 | 16.34 | 16.35 | 17.63 | 16.50 | 15.84 | 16.22 |
| North Amer. produced | | 14.04 | 13.51 | 13.23 | 15.00 | 13.04 | 13.10 | 14.27 | 13.25 | 12.45 | 12.93 |
| Other | | 2.90 | 3.04 | 3.00 | 3.37 | 3.31 | 3.25 | 3.35 | 3.24 | 3.38 | 3.29 |
| Income and Saving | | | | | | | | | | | |
| Nominal GNP | Bill. \$ | 10038.0 | 10081.0 | 10109.3 | 10188.1 | 10314.9 | 10356.8 | 10495.3 | 10579.7 | 10678.2 | 10799.1 |
| Nominal GNP | % change | 2.2 | 1.7 | 1.1 | 3.2 | 5.1 | 1.6 | 5.5 | 3.3 | 3.8 | 4.6 |
| Nominal personal income | | 3.9 | 0.8 | 1.4 | -0.2 | 4.8 | 5.1 | 2.0 | 2.4 | 3.0 | 3.4 |
| Real disposable income | | -0.1 | -0.6 | 10.5 | -7.6 | 14.5 | 3.9 | 1.8 | 1.4 | 1.6 | 2.6 |
| Personal saving rate | % | 2.4 | 1.9 | 4.0 | 0.8 | 3.5 | 4.0 | 3.5 | 3.6 | 3.5 | 3.2 |
| Corp. profits, IVA & CCAdj. | % change | -21.1 | 8.7 | -17.7 | 94.4 | -6.6 | -6.2 | -6.9 | 13.7 | 10.7 | 45.7 |
| Profit share of GNP | % | 7.0 | 7.2 | 6.8 | 8.0 | 7.7 | 7.6 | 7.3 | 7.5 | 7.6 | 8.3 |
| Excluding FR Banks | | 6.7 | 6.9 | 6.5 | 7.7 | 7.5 | 7.3 | 7.1 | 7.3 | 7.5 | 8.1 |
| Federal surpl./deficit | Bill. \$ | 173.8 | 144.4 | -51.7 | 21.3 | -145.8 | -195.6 | -210.5 | -256.6 | -280.1 | -390.2 |
| State & local surpl./def. | | -16.5 | -32.3 | -46.2 | -30.2 | -55.8 | -45.1 | -54.7 | -52.4 | -67.9 | -14.9 |
| Ex. social ins. funds | | -16.4 | -32.2 | -46.1 | -30.0 | -55.6 | -44.9 | -54.6 | -52.3 | -67.7 | -14.8 |
| Gross natl. saving rate | % | 16.9 | 16.6 | 16.5 | 15.8 | 15.5 | 15.5 | 14.6 | 14.3 | 13.9 | 13.7 |
| Net natl. saving rate | | 4.8 | 4.1 | 3.3 | 3.1 | 2.7 | 2.4 | 1.4 | 1.1 | 0.6 | 0.6 |
| Prices and Costs | | | | | | | | | | | |
| GDP chn.-wt. price index | % change | 3.7 | 2.5 | 2.2 | -0.5 | 1.3 | 1.2 | 1.0 | 1.8 | 2.4 | 1.0 |
| Gross Domestic Purchases | | | | | | | | | | | |
| chn.-wt. price index | | 3.3 | 1.7 | -0.2 | 0.4 | 1.2 | 2.3 | 1.2 | 1.8 | 3.4 | 0.4 |
| PCE chn.-wt. price index | | 3.3 | 1.8 | -0.1 | 0.8 | 1.1 | 2.7 | 1.7 | 1.8 | 2.7 | 0.8 |
| Ex. food and energy | | 2.8 | 1.2 | 0.7 | 2.7 | 1.4 | 1.9 | 1.8 | 1.5 | 0.8 | 1.1 |
| CPI | | 4.0 | 3.2 | 0.9 | -0.7 | 1.4 | 3.4 | 2.2 | 2.0 | 3.8 | 0.7 |
| Ex. food and energy | | 2.9 | 2.6 | 2.6 | 2.8 | 2.1 | 2.1 | 2.1 | 1.7 | 1.3 | 0.8 |
| ECI, hourly compensation ² | | 4.6 | 3.7 | 3.9 | 4.4 | 3.6 | 4.4 | 2.5 | 3.0 | 5.5 | 3.4 |
| Nonfarm business sector | | | | | | | | | | | |
| Output per hour | | -0.4 | 1.6 | 3.4 | 8.3 | 9.3 | 1.0 | 5.9 | 1.7 | 2.1 | 7.0 |
| Compensation per hour | | 4.3 | 2.0 | 2.4 | 2.1 | 3.7 | 3.9 | 2.0 | 1.6 | 4.1 | 3.7 |
| Unit labor cost | | 4.7 | 0.3 | -0.9 | -5.7 | -5.2 | 2.9 | -3.7 | -0.1 | 2.0 | -3.1 |

1. Percent difference between potential and actual. A positive number indicates that the economy is operating below potential.
2. Private-industry workers.

Strictly Confidential <FR>
Class II FOMCREAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS, QUARTERLY VALUES
(Seasonally adjusted, annual rate except as noted)

October 22, 2003

| Item | Units | Projected | | | | | | | | | |
|---------------------------------------|--------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
| | | 2003 Q3 | 2003 Q4 | 2004 Q1 | 2004 Q2 | 2004 Q3 | 2004 Q4 | 2005 Q1 | 2005 Q2 | 2005 Q3 | 2005 Q4 |
| EXPENDITURES | | | | | | | | | | | |
| Nominal GDP | Bill. \$ | 11017.8 | 11158.9 | 11331.9 | 11501.6 | 11674.1 | 11841.1 | 11995.6 | 12148.6 | 12299.1 | 12449.6 |
| Real GDP | Bill. Ch. \$ | 9778.1 | 9883.4 | 10009.0 | 10136.0 | 10263.3 | 10384.5 | 10483.7 | 10591.2 | 10697.0 | 10802.8 |
| Real GDP | % change | 6.3 | 4.4 | 5.2 | 5.2 | 5.1 | 4.8 | 3.9 | 4.2 | 4.1 | 4.0 |
| Gross domestic purchases | | 5.6 | 4.5 | 5.5 | 5.6 | 5.3 | 4.7 | 4.2 | 4.5 | 4.2 | 3.9 |
| Final sales | | 6.6 | 2.9 | 4.6 | 4.5 | 4.5 | 5.3 | 2.9 | 3.9 | 4.1 | 4.3 |
| Priv. dom. final purchases | | 7.0 | 2.7 | 5.1 | 5.7 | 5.5 | 6.0 | 3.4 | 4.9 | 4.8 | 4.6 |
| Personal cons. expenditures | | 6.1 | 1.8 | 4.5 | 4.6 | 4.5 | 4.5 | 4.4 | 4.3 | 4.1 | 3.8 |
| Durables | | 22.4 | -4.4 | 4.9 | 10.4 | 8.0 | 8.7 | 8.2 | 7.6 | 7.5 | 6.9 |
| Nondurables | | 8.0 | 5.0 | 6.0 | 5.3 | 5.3 | 5.2 | 5.1 | 5.0 | 4.9 | 4.6 |
| Services | | 2.2 | 1.6 | 3.7 | 3.2 | 3.4 | 3.4 | 3.3 | 3.3 | 3.1 | 2.8 |
| Business fixed investment | | 8.1 | 7.9 | 11.6 | 14.0 | 14.5 | 16.9 | -2.6 | 10.5 | 11.3 | 11.7 |
| Equipment & Software | | 11.8 | 10.2 | 14.2 | 17.3 | 17.8 | 20.7 | -4.4 | 11.8 | 12.2 | 12.4 |
| Nonres. structures | | -3.6 | 0.2 | 2.8 | 3.0 | 3.1 | 3.3 | 4.3 | 6.0 | 7.9 | 9.4 |
| Residential structures | | 19.0 | 5.6 | -0.2 | 3.0 | 0.9 | 3.7 | 3.6 | 1.3 | 0.2 | -0.5 |
| Exports | | 11.6 | 11.6 | 7.6 | 10.2 | 10.4 | 12.6 | 7.5 | 10.2 | 10.0 | 11.9 |
| Imports | | 4.1 | 10.0 | 8.8 | 11.8 | 10.2 | 9.5 | 8.4 | 10.5 | 9.2 | 8.4 |
| Gov't. cons. & investment | | 0.8 | 4.7 | 3.8 | 2.0 | 1.6 | 1.5 | 2.4 | 1.5 | 2.0 | 2.5 |
| Federal | | 1.3 | 12.3 | 8.6 | 3.5 | 1.6 | 1.1 | 3.1 | 0.8 | 1.8 | 3.0 |
| Defense | | -0.4 | 15.4 | 10.2 | 3.7 | 1.1 | 0.2 | 3.1 | -0.3 | 1.2 | 3.1 |
| State & local | | 0.5 | 0.3 | 0.9 | 1.1 | 1.5 | 1.8 | 2.0 | 1.9 | 2.2 | 2.2 |
| Change in bus. inventories | Bill. Ch. \$ | -26.7 | 11.2 | 27.7 | 45.5 | 62.1 | 50.1 | 78.3 | 85.5 | 84.3 | 75.6 |
| Nonfarm | | -28.9 | 9.5 | 26.5 | 44.3 | 60.7 | 48.5 | 76.8 | 84.0 | 82.8 | 74.1 |
| Net exports | | -533.0 | -541.8 | -556.6 | -576.8 | -590.6 | -595.6 | -610.3 | -626.5 | -637.9 | -640.3 |
| Nominal GDP | % change | 8.2 | 5.2 | 6.3 | 6.1 | 6.1 | 5.8 | 5.3 | 5.2 | 5.0 | 5.0 |
| GDP Gap ¹ | % | 2.2 | 2.0 | 1.6 | 1.2 | 0.8 | 0.4 | 0.4 | 0.3 | 0.1 | 0.1 |
| EMPLOYMENT AND PRODUCTION | | | | | | | | | | | |
| Nonfarm payroll employment | Millions | 129.8 | 130.0 | 130.6 | 131.8 | 132.9 | 134.1 | 135.1 | 136.1 | 137.0 | 137.9 |
| Unemployment rate | % | 6.1 | 6.2 | 6.0 | 5.8 | 5.7 | 5.4 | 5.2 | 5.1 | 5.1 | 5.1 |
| Industrial prod. index | % change | 3.3 | 3.1 | 7.1 | 6.5 | 6.3 | 5.9 | 5.3 | 5.1 | 5.1 | 5.3 |
| Capacity util. rate - mfg. | % | 72.9 | 73.4 | 74.6 | 75.6 | 76.7 | 77.6 | 78.3 | 79.0 | 79.7 | 80.5 |
| Housing starts | Millions | 1.87 | 1.84 | 1.84 | 1.84 | 1.84 | 1.86 | 1.87 | 1.86 | 1.85 | 1.84 |
| Light motor vehicle sales | | 17.55 | 16.60 | 16.79 | 17.19 | 17.36 | 17.48 | 17.48 | 17.53 | 17.60 | 17.68 |
| North Amer. produced | | 14.18 | 13.30 | 13.45 | 13.80 | 13.90 | 14.00 | 14.00 | 14.05 | 14.10 | 14.15 |
| Other | | 3.37 | 3.30 | 3.34 | 3.39 | 3.46 | 3.48 | 3.48 | 3.48 | 3.50 | 3.53 |
| INCOME AND SAVING | | | | | | | | | | | |
| Nominal GNP | Bill. \$ | 11022.1 | 11165.3 | 11344.6 | 11514.3 | 11686.1 | 11852.4 | 12008.3 | 12161.8 | 12308.7 | 12453.1 |
| Nominal GNP | % change | 8.5 | 5.3 | 6.6 | 6.1 | 6.1 | 5.8 | 5.4 | 5.2 | 4.9 | 4.8 |
| Nominal personal income | | 3.7 | 4.5 | 5.8 | 5.6 | 6.0 | 6.2 | 6.2 | 5.4 | 5.4 | 5.3 |
| Real disposable income | | 6.0 | 1.3 | 7.0 | 4.2 | 4.6 | 4.9 | 4.7 | 4.2 | 4.2 | 4.1 |
| Personal saving rate | % | 3.2 | 3.1 | 3.7 | 3.6 | 3.7 | 3.8 | 3.8 | 3.8 | 3.9 | 4.0 |
| Corp. profits, IVA & CCAdj. | % change | 39.8 | 16.2 | 18.0 | 8.4 | 4.7 | -0.8 | -5.0 | 1.2 | -0.5 | -1.1 |
| Profiting share of GNP | % | 8.8 | 9.1 | 9.3 | 9.4 | 9.3 | 9.2 | 8.9 | 8.9 | 8.7 | 8.6 |
| Excluding FR Banks | | 8.7 | 8.9 | 9.1 | 9.2 | 9.1 | 9.0 | 8.8 | 8.7 | 8.6 | 8.4 |
| Federal surpl./deficit | Bill. \$ | -412.7 | -402.9 | -463.5 | -445.0 | -398.8 | -350.7 | -281.6 | -223.6 | -199.0 | -198.8 |
| State & local surpl./def. | | -31.6 | 6.1 | -9.8 | -2.7 | -6.6 | -0.8 | 0.5 | 2.3 | 3.9 | 5.5 |
| Ex. social ins. funds | | -31.5 | 6.2 | -9.7 | -2.6 | -6.5 | -0.7 | 0.6 | 2.4 | 4.0 | 5.6 |
| Gross natl. saving rate | % | 13.6 | 14.0 | 14.1 | 14.5 | 14.7 | 14.9 | 14.8 | 15.0 | 15.0 | 15.0 |
| Net natl. saving rate | | 0.8 | 1.4 | 1.6 | 1.9 | 2.2 | 2.4 | 2.3 | 2.5 | 2.5 | 2.6 |
| PRICES AND COSTS | | | | | | | | | | | |
| GDP chn.-wt. price index | % change | 1.8 | 0.8 | 1.1 | 0.9 | 1.0 | 1.0 | 1.4 | 1.0 | 1.0 | 0.9 |
| Gross Domestic Purchases | | | | | | | | | | | |
| chn.-wt. price index | | 2.0 | 1.0 | 1.2 | 0.8 | 0.8 | 0.9 | 1.3 | 0.9 | 0.9 | 0.9 |
| PCE chn.-wt. price index | | 2.4 | 1.0 | 0.7 | 0.8 | 0.8 | 0.9 | 0.9 | 0.9 | 0.9 | 1.0 |
| Ex. food and energy | | 1.8 | 1.3 | 1.2 | 1.1 | 1.1 | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 |
| CPI | | 2.4 | 1.2 | 0.7 | 0.9 | 1.0 | 1.1 | 1.2 | 1.2 | 1.2 | 1.3 |
| Ex. food and energy | | 1.7 | 1.8 | 1.5 | 1.5 | 1.5 | 1.4 | 1.4 | 1.4 | 1.3 | 1.3 |
| ECI, hourly compensation ² | | 3.2 | 3.2 | 3.4 | 3.4 | 3.4 | 3.4 | 3.4 | 3.4 | 3.4 | 3.4 |
| Nonfarm business sector | | | | | | | | | | | |
| Output per hour | | 6.0 | 3.1 | 2.6 | 1.4 | 1.1 | 0.6 | 0.4 | 1.0 | 1.0 | 1.1 |
| Compensation per hour | | 3.2 | 2.1 | 3.0 | 2.9 | 3.0 | 3.1 | 3.3 | 3.2 | 3.2 | 3.3 |
| Unit labor cost | | -2.6 | -0.9 | 0.4 | 1.5 | 1.9 | 2.5 | 2.9 | 2.2 | 2.2 | 2.2 |

1. Percent difference between potential and actual. A positive number indicates that the economy is operating below potential.

2. Private-industry workers.

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

| Item | 2001 | | | | | | | | 2002 | | | | | | | | 2003 | | | | | | | | Projected | |
|-----------------------------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|-----------|-----------|-----------|--|--|--|-----------|--|
| | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | 01Q4/00Q4 | 02Q4/01Q4 | 03Q4/02Q4 | | | | | |
| Real GDP | -0.3 | 2.7 | 5.0 | 1.3 | 4.0 | 1.4 | 1.4 | 3.3 | 6.3 | 0.1 | 2.9 | 3.8 | 0.1 | 2.9 | 3.8 | 0.1 | 2.9 | 3.8 | 0.1 | 2.9 | 3.8 | | | | | |
| Gross dom. purchases | -0.1 | 3.0 | 5.8 | 2.7 | 4.0 | 3.0 | 0.6 | 4.6 | 5.8 | 0.2 | 3.9 | 3.9 | 0.2 | 3.9 | 3.9 | 0.2 | 3.9 | 3.9 | 0.2 | 3.9 | 3.9 | | | | | |
| Final sales | -0.2 | 4.1 | 2.5 | -0.1 | 3.5 | 1.1 | 2.2 | 4.0 | 6.6 | 1.6 | 1.7 | 3.9 | 1.6 | 1.7 | 3.9 | 1.6 | 1.7 | 3.9 | 1.6 | 1.7 | 3.9 | | | | | |
| Priv. dom. final purchases | 0.3 | 2.6 | 2.2 | 1.1 | 2.9 | 1.8 | 1.4 | 3.7 | 6.0 | 0.8 | 2.0 | 3.4 | 0.8 | 2.0 | 3.4 | 0.8 | 2.0 | 3.4 | 0.8 | 2.0 | 3.4 | | | | | |
| Personal cons. expenditures | 1.0 | 4.1 | 2.2 | 1.2 | 2.9 | 1.2 | 1.4 | 2.7 | 4.3 | 1.9 | 1.9 | 2.4 | 1.9 | 1.9 | 2.4 | 1.9 | 1.9 | 2.4 | 1.9 | 1.9 | 2.4 | | | | | |
| Durables | 0.4 | 2.5 | -0.6 | 0.2 | 1.7 | -0.7 | -0.2 | 1.8 | 1.7 | 1.0 | 0.2 | 0.7 | 1.0 | 0.2 | 0.7 | 1.0 | 0.2 | 0.7 | 1.0 | 0.2 | 0.7 | | | | | |
| Nondurables | 0.3 | 0.7 | 1.6 | -0.0 | 0.2 | 1.0 | 1.2 | 0.3 | 1.6 | 0.3 | 0.3 | 1.0 | 0.3 | 0.3 | 1.0 | 0.3 | 0.3 | 1.0 | 0.3 | 0.3 | 1.0 | | | | | |
| Services | 0.4 | 0.9 | 1.2 | 1.1 | 1.0 | 0.9 | 0.4 | 0.6 | 1.0 | 0.5 | 0.4 | 0.6 | 1.0 | 0.5 | 0.4 | 0.6 | 1.0 | 0.5 | 0.4 | 0.6 | 1.0 | | | | | |
| Business fixed investment | -0.7 | -1.3 | -0.7 | -0.3 | -0.1 | 0.2 | -0.5 | 0.7 | 0.8 | -1.2 | -0.2 | 0.5 | -1.2 | -0.2 | 0.5 | -1.2 | -0.2 | 0.5 | -1.2 | -0.2 | 0.5 | | | | | |
| Equipment & Software | -0.8 | -0.2 | -0.2 | 0.3 | 0.5 | 0.5 | -0.4 | 0.6 | 0.9 | -0.8 | 0.3 | 0.5 | -0.8 | 0.3 | 0.5 | -0.8 | 0.3 | 0.5 | -0.8 | 0.3 | 0.5 | | | | | |
| Nonres. structures | 0.1 | -1.1 | -0.4 | -0.5 | -0.6 | -0.3 | -0.1 | 0.1 | -0.1 | -0.4 | -0.5 | -0.0 | -0.4 | -0.5 | -0.0 | -0.4 | -0.5 | -0.0 | -0.4 | -0.5 | -0.0 | | | | | |
| Residential structures | 0.0 | -0.2 | 0.6 | 0.1 | 0.1 | 0.4 | 0.5 | 0.3 | 0.9 | 0.0 | 0.3 | 0.5 | 0.0 | 0.3 | 0.5 | 0.0 | 0.3 | 0.5 | 0.0 | 0.3 | 0.5 | | | | | |
| Net exports | -0.2 | -0.3 | -0.8 | -1.4 | -0.0 | -1.6 | 0.8 | -1.3 | 0.5 | -0.1 | 0.8 | -1.3 | -0.1 | 0.8 | -1.3 | -0.1 | 0.8 | -1.3 | -0.1 | 0.8 | -1.3 | | | | | |
| Exports | -1.9 | -1.0 | 0.3 | 1.3 | 0.5 | -0.6 | -0.1 | -0.1 | 1.1 | -1.3 | -0.1 | 1.1 | -1.3 | -0.1 | 1.1 | -1.3 | -0.1 | 1.1 | -1.3 | -0.1 | 1.1 | | | | | |
| Imports | 1.7 | 0.7 | -1.1 | -2.7 | -0.5 | -1.0 | 0.9 | -1.2 | -0.6 | 1.2 | 0.9 | -0.6 | 1.2 | 0.9 | -0.6 | 1.2 | 0.9 | -0.6 | 1.2 | 0.9 | -0.6 | | | | | |
| Government cons. & invest. | -0.2 | 1.9 | 1.0 | 0.3 | 0.6 | 0.9 | 0.1 | 1.6 | 0.2 | -0.2 | 0.1 | 1.6 | 0.2 | -0.2 | 0.1 | 1.6 | 0.2 | -0.2 | 0.1 | 1.6 | 0.2 | | | | | |
| Federal | 0.1 | 0.8 | 0.5 | 0.5 | 0.3 | 0.7 | 0.1 | 1.6 | 0.1 | 0.1 | 0.1 | 1.6 | 0.1 | 0.1 | 0.1 | 1.6 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | | | | | |
| Defense | 0.2 | 0.5 | 0.5 | 0.3 | 0.3 | 0.5 | -0.2 | 1.7 | -0.0 | 0.3 | -0.2 | 1.7 | -0.0 | 0.3 | -0.2 | 1.7 | -0.0 | 0.3 | -0.2 | 1.7 | -0.0 | | | | | |
| Nondefense | -0.1 | 0.3 | 0.0 | 0.2 | -0.0 | 0.3 | 0.2 | -0.1 | 0.1 | 0.2 | 0.2 | -0.1 | 0.1 | 0.2 | 0.2 | -0.1 | 0.1 | 0.2 | 0.2 | 0.2 | 0.1 | | | | | |
| State and local | -0.3 | 1.1 | 0.6 | -0.2 | 0.3 | 0.2 | 0.0 | -0.0 | 0.1 | -0.3 | 0.0 | -0.0 | 0.1 | -0.3 | 0.0 | -0.0 | 0.1 | -0.3 | 0.0 | -0.0 | 0.1 | | | | | |
| Change in bus. inventories | -0.1 | -1.4 | 2.6 | 1.3 | 0.6 | 0.3 | -0.8 | -0.7 | -0.3 | -0.1 | -0.8 | -0.7 | -0.3 | -0.1 | -0.8 | -0.7 | -0.3 | -0.1 | -0.8 | -0.7 | -0.3 | | | | | |
| Nonfarm | -0.3 | -1.4 | 2.5 | 1.5 | 0.7 | 0.2 | -0.9 | -0.7 | -0.4 | -1.5 | -0.9 | -0.7 | -0.4 | -1.5 | -0.9 | -0.7 | -0.4 | -1.5 | -0.9 | -0.7 | -0.4 | | | | | |
| Farm | 0.2 | 0.1 | 0.1 | -0.2 | -0.1 | 0.1 | 0.1 | -0.1 | 0.1 | 0.2 | 0.1 | 0.1 | -0.1 | 0.1 | 0.2 | 0.1 | 0.1 | -0.1 | 0.1 | 0.2 | 0.1 | | | | | |

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

CONTRIBUTIONS TO GROWTH IN REAL GROSS DOMESTIC PRODUCT AND RELATED ITEMS

| Item | Projected | | | | | | | | | | | |
|-----------------------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|---------------|---------------|---------------|
| | 2003 Q4 | 2004 Q1 | 2004 Q2 | 2004 Q3 | 2004 Q4 | 2005 Q1 | 2005 Q2 | 2005 Q3 | 2005 Q4 | 03Q4/ 02Q4 | 04Q4/ 03Q4 | 05Q4/ 04Q4 |
| Real GDP | 4.4 | 5.2 | 5.2 | 5.1 | 4.8 | 3.9 | 4.2 | 4.1 | 4.0 | 3.8 | 5.1 | 4.0 |
| Gross dom. purchases | 4.7 | 5.7 | 5.9 | 5.6 | 5.0 | 4.3 | 4.7 | 4.4 | 4.1 | 3.9 | 5.5 | 4.4 |
| Final sales | 3.0 | 4.6 | 4.5 | 4.5 | 5.2 | 2.9 | 3.9 | 4.1 | 4.3 | 3.9 | 4.7 | 3.8 |
| Priv. dom. final purchases | 2.4 | 4.4 | 4.8 | 4.7 | 5.1 | 2.9 | 4.1 | 4.1 | 3.9 | 3.4 | 4.7 | 3.8 |
| Personal cons. expenditures | 1.3 | 3.2 | 3.3 | 3.2 | 3.2 | 3.0 | 3.0 | 2.8 | 2.7 | 2.4 | 3.2 | 2.9 |
| Durables | -0.4 | 0.4 | 0.8 | 0.6 | 0.7 | 0.7 | 0.6 | 0.6 | 0.6 | 0.7 | 0.6 | 0.6 |
| Nondurables | 1.0 | 1.2 | 1.1 | 1.1 | 1.1 | 1.0 | 1.0 | 1.0 | 0.9 | 1.0 | 1.1 | 1.0 |
| Services | 0.7 | 1.5 | 1.3 | 1.4 | 1.4 | 1.4 | 1.4 | 1.3 | 1.2 | 0.6 | 1.4 | 1.3 |
| Business fixed investment | 0.8 | 1.2 | 1.4 | 1.5 | 1.7 | -0.3 | 1.1 | 1.2 | 1.3 | 0.5 | 1.5 | 0.8 |
| Equipment & Software | 0.8 | 1.1 | 1.3 | 1.4 | 1.7 | -0.4 | 1.0 | 1.0 | 1.0 | 0.5 | 1.4 | 0.7 |
| Nonres. structures | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.2 | 0.2 | -0.0 | 0.1 | 0.2 |
| Residential structures | 0.3 | -0.0 | 0.2 | 0.0 | 0.2 | 0.2 | 0.1 | 0.0 | -0.0 | 0.5 | 0.1 | 0.1 |
| Net exports | -0.3 | -0.5 | -0.7 | -0.5 | -0.2 | -0.5 | -0.5 | -0.3 | -0.1 | -0.1 | -0.5 | -0.4 |
| Exports | 1.1 | 0.7 | 1.0 | 1.0 | 1.2 | 0.7 | 1.0 | 1.0 | 1.2 | 0.5 | 1.0 | 1.0 |
| Imports | -1.4 | -1.2 | -1.7 | -1.5 | -1.4 | -1.2 | -1.5 | -1.4 | -1.3 | -0.6 | -1.4 | -1.4 |
| Government cons. & invest. | 0.9 | 0.7 | 0.4 | 0.3 | 0.3 | 0.5 | 0.3 | 0.4 | 0.5 | 0.7 | 0.4 | 0.4 |
| Federal | 0.8 | 0.6 | 0.3 | 0.1 | 0.1 | 0.2 | 0.1 | 0.1 | 0.2 | 0.6 | 0.3 | 0.2 |
| Defense | 0.7 | 0.5 | 0.2 | 0.1 | 0.0 | 0.2 | -0.0 | 0.1 | 0.1 | 0.6 | 0.2 | 0.1 |
| Nondefense | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| State and local | 0.0 | 0.1 | 0.1 | 0.2 | 0.2 | 0.2 | 0.2 | 0.3 | 0.3 | 0.0 | 0.2 | 0.2 |
| Change in bus. inventories | 1.4 | 0.6 | 0.6 | 0.6 | -0.4 | 1.0 | 0.2 | -0.0 | -0.3 | -0.1 | 0.4 | 0.2 |
| Nonfarm | 1.4 | 0.6 | 0.6 | 0.6 | -0.4 | 1.0 | 0.2 | -0.0 | -0.3 | -0.2 | 0.4 | 0.2 |
| Farm | -0.0 | -0.0 | -0.0 | -0.0 | 0.0 | -0.0 | -0.0 | -0.0 | -0.0 | 0.0 | -0.0 | -0.0 |

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

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

October 22, 2003

| Item | Fiscal year | | | | 2003 | | | | 2004 | | | | 2005 | | | |
|---|-------------------------|------|------|------|-----------------|-----------------|------|------|------|------|------|------|------|------|------|------|
| | 2002 ^a | 2003 | 2004 | 2005 | Q1 ^a | Q2 ^a | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| | Not seasonally adjusted | | | | | | | | | | | | | | | |
| Unified budget¹ | | | | | | | | | | | | | | | | |
| Receipts ² | 1853 | 1782 | 1815 | 2023 | 398 | 528 | 429 | 429 | 405 | 518 | 463 | 466 | 435 | 603 | 519 | 509 |
| Outlays ² | 2011 | 2157 | 2312 | 2382 | 543 | 544 | 534 | 586 | 584 | 579 | 563 | 597 | 597 | 593 | 595 | 607 |
| Surplus/deficit ² | -158 | -374 | -498 | -359 | -145 | -17 | -104 | -157 | -179 | -61 | -101 | -132 | -162 | 10 | -75 | -98 |
| On-budget | -317 | -535 | -668 | -547 | -169 | -91 | -113 | -198 | -217 | -138 | -114 | -176 | -203 | -72 | -95 | -145 |
| Off-budget | 160 | 161 | 170 | 188 | 24 | 75 | 9 | 41 | 38 | 77 | 14 | 44 | 41 | 82 | 20 | 46 |
| Means of financing | | | | | | | | | | | | | | | | |
| Borrowing | 221 | 374 | 531 | 376 | 64 | 106 | 108 | 146 | 165 | 105 | 115 | 115 | 154 | 29 | 78 | 75 |
| Cash decrease | -17 | 26 | -10 | 0 | 20 | -17 | -5 | 2 | 8 | -35 | 15 | 15 | 0 | -30 | 15 | 15 |
| Other ³ | -46 | -25 | -23 | -17 | 62 | -73 | 2 | 10 | 6 | -9 | -29 | 2 | 7 | -9 | -17 | 9 |
| Cash operating balance, end of period | 61 | 35 | 45 | 45 | 13 | 30 | 35 | 33 | 25 | 60 | 45 | 30 | 30 | 60 | 45 | 30 |
| NIPA federal sector | | | | | | | | | | | | | | | | |
| Receipts | 1906 | 1854 | 1900 | 2146 | 1865 | 1871 | 1817 | 1887 | 1865 | 1896 | 1952 | 2018 | 2130 | 2195 | 2239 | 2263 |
| Expenditures | 2039 | 2189 | 2327 | 2409 | 2145 | 2262 | 2230 | 2289 | 2328 | 2341 | 2351 | 2369 | 2411 | 2419 | 2438 | 2461 |
| Consumption expenditures | 570 | 642 | 708 | 740 | 627 | 664 | 666 | 685 | 710 | 717 | 721 | 724 | 742 | 745 | 749 | 756 |
| Defense | 375 | 429 | 482 | 502 | 409 | 452 | 451 | 466 | 484 | 488 | 491 | 492 | 504 | 505 | 507 | 512 |
| Nondefense | 195 | 213 | 226 | 238 | 218 | 213 | 216 | 219 | 226 | 228 | 230 | 232 | 238 | 240 | 242 | 244 |
| Other spending | 1469 | 1547 | 1619 | 1669 | 1519 | 1597 | 1564 | 1605 | 1618 | 1624 | 1630 | 1645 | 1669 | 1674 | 1689 | 1705 |
| Current account surplus | -133 | -335 | -428 | -264 | -280 | -390 | -413 | -403 | -464 | -445 | -399 | -351 | -282 | -224 | -199 | -199 |
| Gross investment | 106 | 113 | 129 | 133 | 109 | 116 | 120 | 125 | 129 | 131 | 131 | 132 | 133 | 134 | 135 | 136 |
| Gross saving less gross investment ⁴ | -138 | -343 | -448 | -283 | -284 | -400 | -426 | -421 | -484 | -466 | -419 | -371 | -302 | -243 | -218 | -218 |
| Fiscal indicators⁵ | | | | | | | | | | | | | | | | |
| High-employment (HEB) surplus/deficit | -73 | -254 | -394 | -275 | -191 | -301 | -343 | -341 | -424 | -422 | -389 | -353 | -291 | -238 | -217 | -220 |
| Change in HEB, percent of potential GDP | 1.8 | 1.6 | 1.1 | -1.1 | 0.1 | 1.0 | 0.3 | -0.1 | 0.7 | -0.1 | -0.3 | -0.3 | -0.6 | -0.5 | -0.2 | 0.0 |
| Fiscal impetus (FI) percent of GDP | 1.1 | 1.2 | 1.2 | -0.3 | 0.0 | 0.7 | 0.1 | 0.7 | 0.2 | 0.2 | 0.1 | 0.2 | -0.5 | -0.0 | 0.0 | 0.1 |

1. Fiscal year data for the unified budget come from OMB; quarterly data come from the Monthly Treasury Statement and may not sum to OMB fiscal year totals.

2. OMB's July 2003 baseline surplus estimates are -\$455 billion in FY 2003 and -\$458 billion in FY 2004. CBO's August 2003 baseline surplus estimates are -\$401 billion in FY 2003, -\$480 billion in FY 2004, and -\$341 billion in FY 2005. Budget receipts, outlays, and surplus/deficit include corresponding social security (OASDI) categories. The OASDI surplus and the Postal Service surplus are excluded from the on-budget surplus and shown separately as off-budget, as classified under current law.

3. Other means of financing are checks issued less checks paid, accrued items, and changes in other financial assets and liabilities.

4. Gross saving is the current account surplus plus consumption of fixed capital of the general government as well as government enterprises.

5. HEB is gross saving less gross investment (NIPA) 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 (1996) 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.

at-Actual

Strictly Confidential (FR) **Change in Debt of the Domestic Nonfinancial Sectors** **October 22, 2003**
Class II FOMC **(Percent)**

| Period ¹ | Total | Federal government | Nonfederal | | | | | Memo: Nominal GDP | |
|---------------------|-------|--------------------|------------|------------|----------------|-----------------|----------|-------------------|-----------------------------|
| | | | Total | Households | | Consumer credit | Business | | State and local governments |
| | | | | Total | Home mortgages | | | | |
| <i>Year</i> | | | | | | | | | |
| 1998 | 6.9 | -1.4 | 9.6 | 8.1 | 8.8 | 6.5 | 12.1 | 6.3 | 6.0 |
| 1999 | 6.4 | -1.9 | 8.9 | 8.3 | 9.0 | 8.4 | 10.7 | 3.4 | 5.9 |
| 2000 | 4.9 | -8.0 | 8.4 | 8.6 | 8.3 | 10.7 | 9.7 | 1.3 | 4.6 |
| 2001 | 6.2 | -0.2 | 7.6 | 8.7 | 9.8 | 7.3 | 6.3 | 8.9 | 2.0 |
| 2002 | 7.1 | 7.6 | 7.0 | 10.0 | 12.4 | 4.3 | 2.9 | 11.2 | 4.3 |
| 2003 | 8.2 | 11.6 | 7.4 | 10.0 | 11.9 | 4.8 | 4.2 | 8.4 | 5.4 |
| 2004 | 6.9 | 12.3 | 5.7 | 6.5 | 7.1 | 5.3 | 5.0 | 4.7 | 6.1 |
| 2005 | 6.2 | 7.4 | 5.9 | 6.3 | 6.4 | 6.3 | 5.7 | 4.6 | 5.1 |
| <i>Quarter</i> | | | | | | | | | |
| 2003:1 | 6.1 | 2.2 | 7.0 | 10.0 | 11.8 | 4.9 | 3.7 | 5.2 | 3.8 |
| 2 | 12.1 | 24.3 | 9.6 | 11.8 | 14.3 | 4.6 | 6.2 | 12.8 | 4.3 |
| 3 | 6.9 | 8.2 | 6.6 | 9.4 | 11.0 | 4.9 | 2.7 | 8.5 | 8.2 |
| 4 | 6.7 | 10.3 | 5.9 | 7.5 | 8.7 | 4.4 | 3.8 | 6.1 | 5.2 |
| 2004:1 | 6.6 | 12.0 | 5.5 | 6.5 | 7.4 | 4.4 | 4.4 | 4.3 | 6.3 |
| 2 | 8.4 | 21.1 | 5.5 | 6.3 | 6.9 | 5.2 | 4.7 | 4.5 | 6.1 |
| 3 | 6.1 | 7.9 | 5.6 | 6.2 | 6.6 | 5.5 | 5.1 | 4.6 | 6.1 |
| 4 | 5.9 | 6.3 | 5.8 | 6.3 | 6.6 | 5.8 | 5.4 | 5.2 | 5.8 |
| 2005:1 | 6.6 | 9.7 | 5.8 | 6.3 | 6.6 | 6.0 | 5.5 | 4.6 | 5.3 |
| 2 | 7.1 | 12.4 | 5.8 | 6.2 | 6.3 | 6.2 | 5.6 | 4.5 | 5.2 |
| 3 | 5.5 | 4.6 | 5.8 | 6.1 | 6.2 | 6.3 | 5.7 | 4.5 | 5.0 |
| 4 | 5.1 | 2.3 | 5.8 | 6.0 | 6.1 | 6.2 | 5.7 | 4.5 | 5.0 |

Note. Quarterly data are at seasonally adjusted annual rates.

1. Data after 2003: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

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

Strictly Confidential (FR)
Class II FOMIC

October 22, 2003

| Category | Seasonally adjusted annual rates | | | | | | | | | | | | | |
|--|----------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| | Calendar year | | | 2003 | | | 2004 | | | 2005 | | | | |
| | 2002 | 2003 | 2004 | 2005 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| <i>Net funds raised by domestic nonfinancial sectors</i> | | | | | | | | | | | | | | |
| 1 Total | 1333.5 | 1640.7 | 1510.8 | 1463.3 | 1471.5 | 1414.3 | 1439.6 | 1867.1 | 1367.0 | 1369.3 | 1543.0 | 1695.3 | 1353.4 | 1261.6 |
| 2 Net equity issuance | -41.9 | -50.4 | -38.8 | -19.5 | -13.0 | -51.0 | -46.0 | -41.0 | -39.0 | -29.0 | -27.0 | -22.0 | -17.0 | -12.0 |
| 3 Net debt issuance | 1375.4 | 1691.1 | 1549.5 | 1482.8 | 1484.5 | 1465.3 | 1485.6 | 1908.1 | 1406.0 | 1398.3 | 1570.0 | 1717.3 | 1370.4 | 1273.6 |
| <i>Borrowing sectors</i> | | | | | | | | | | | | | | |
| Nonfinancial business | | | | | | | | | | | | | | |
| 4 Financing gap ¹ | 80.7 | 8.6 | 30.1 | 232.1 | -25.7 | -5.1 | -19.1 | -0.9 | 43.0 | 97.5 | 177.1 | 225.4 | 255.5 | 270.6 |
| 5 Net equity issuance | -41.9 | -50.4 | -38.8 | -19.5 | -13.0 | -51.0 | -46.0 | -41.0 | -39.0 | -29.0 | -27.0 | -22.0 | -17.0 | -12.0 |
| 6 Credit market borrowing | 200.7 | 296.1 | 371.2 | 447.4 | 196.9 | 280.8 | 323.7 | 356.1 | 386.6 | 418.1 | 427.3 | 441.6 | 456.0 | 464.5 |
| Households | | | | | | | | | | | | | | |
| 7 Net borrowing ² | 771.8 | 850.8 | 604.8 | 621.8 | 842.0 | 683.8 | 609.6 | 597.7 | 599.7 | 612.3 | 624.6 | 621.9 | 620.1 | 620.6 |
| 8 Home mortgages | 666.4 | 721.3 | 477.6 | 465.7 | 707.4 | 574.0 | 502.0 | 474.3 | 466.4 | 467.6 | 475.4 | 465.4 | 460.9 | 461.1 |
| 9 Consumer credit | 79.2 | 92.7 | 108.2 | 134.6 | 97.7 | 87.8 | 89.3 | 107.0 | 113.7 | 122.9 | 127.7 | 135.0 | 137.7 | 138.1 |
| 10 Debt/DPI (percent) ³ | 103.5 | 109.1 | 111.8 | 112.8 | 109.7 | 111.4 | 111.3 | 111.7 | 111.9 | 112.1 | 112.3 | 112.6 | 112.9 | 113.2 |
| State and local governments | | | | | | | | | | | | | | |
| 11 Net borrowing | 145.4 | 121.2 | 73.8 | 75.3 | 127.9 | 94.5 | 66.8 | 70.8 | 72.8 | 84.8 | 74.8 | 74.8 | 74.8 | 76.8 |
| 12 Current surplus ⁴ | 127.7 | 155.7 | 185.3 | 200.8 | 152.5 | 191.8 | 177.7 | 186.7 | 184.6 | 192.2 | 195.4 | 199.1 | 202.6 | 206.1 |
| Federal government | | | | | | | | | | | | | | |
| 13 Net borrowing | 257.5 | 423.0 | 499.7 | 335.8 | 317.7 | 406.2 | 485.5 | 883.5 | 346.9 | 283.0 | 443.2 | 579.0 | 219.4 | 111.7 |
| 14 Net borrowing (quarterly, n.s.a.) | 257.5 | 423.0 | 499.7 | 335.8 | 107.6 | 145.6 | 164.9 | 105.1 | 114.9 | 114.7 | 154.4 | 29.0 | 77.9 | 74.5 |
| 15 Unified deficit (quarterly, n.s.a.) | 230.6 | 422.8 | 472.6 | 325.7 | 104.5 | 156.8 | 179.3 | 61.1 | 100.5 | 131.8 | 161.8 | -9.9 | 75.4 | 98.4 |
| <i>Depository institutions</i> | | | | | | | | | | | | | | |
| 16 Funds supplied | 482.5 | 382.8 | 442.0 | 502.2 | -108.9 | 282.8 | 401.9 | 503.6 | 444.4 | 418.3 | 479.9 | 550.4 | 525.5 | 453.1 |
| Memo (percentage of GDP) | | | | | | | | | | | | | | |
| 17 Domestic nonfinancial debt ⁵ | 191.3 | 197.1 | 199.7 | 201.7 | 197.9 | 198.7 | 199.0 | 199.7 | 200.3 | 200.4 | 201.0 | 201.8 | 202.5 | 202.7 |
| 18 Domestic nonfinancial borrowing | 13.2 | 15.5 | 13.4 | 12.1 | 13.5 | 13.1 | 13.1 | 16.6 | 12.0 | 11.8 | 13.1 | 14.1 | 11.1 | 10.2 |
| 19 Federal government ⁶ | 2.5 | 3.9 | 4.3 | 2.8 | 2.9 | 3.6 | 4.3 | 7.7 | 3.0 | 2.4 | 3.7 | 4.8 | 1.8 | 0.9 |
| 20 Nonfederal | 10.7 | 11.6 | 9.1 | 9.4 | 10.6 | 9.5 | 8.8 | 8.9 | 9.1 | 9.4 | 9.4 | 9.4 | 9.4 | 9.3 |

Note. Data after 2003: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.

2.6.4 FOF

4. NIPA surplus less changes in retirement fund assets plus consumption of fixed capital.

5. Average debt levels in the period (computed as the average of period-end debt positions) divided by nominal GDP.

6. Excludes government-insured mortgage pool securities.

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International Developments

Notwithstanding growing optimism about the pace of U.S. economic expansion, the foreign exchange value of the dollar declined substantially on balance during the intermeeting period. The dollar depreciated against all major foreign currencies following the call for increased exchange rate flexibility contained in the G-7 communiqué issued in Dubai on September 20, which many market participants interpreted as a call for a weaker dollar. Since the September FOMC meeting, the trade-weighted value of the dollar against other major currencies has fallen 4¾ percent. Consequently, we have marked down our projection of the broad real index of the dollar in the current quarter, and we continue to forecast some additional depreciation over the rest of the forecast period.

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

| Indicator | 2002 | Projection | | | | |
|--------------------|------|------------|-----|------|------|-----|
| | | 2003: | | 2004 | 2005 | |
| | | H1 | Q3 | | | Q4 |
| Foreign output | 2.7 | .7 | 3.5 | 3.4 | 3.6 | 3.4 |
| <i>Previous GB</i> | 2.8 | .5 | 2.9 | 3.4 | 3.6 | 3.4 |
| Foreign CPI | 2.6 | 2.0 | 1.3 | 2.2 | 2.0 | 1.9 |
| <i>Previous GB</i> | 2.6 | 1.9 | 1.6 | 2.1 | 1.9 | 1.9 |

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

Recent indicators have supported our forecast of a moderate rebound in GDP growth abroad that started in the third quarter of this year. We expect growth to continue at an annual rate of around 3½ percent over the projection period. Compared with the September Greenbook, we have raised our estimate of growth in the third quarter ½ percentage point, mainly owing to stronger-than-expected data releases, especially for emerging Asian economies and the United Kingdom. Beyond this near-term revision, our growth forecast is little changed from our projection in September: Slight downward revisions for the euro area and Japan were offset by stronger outlooks for other Asian countries and the United Kingdom.

The average rate of foreign inflation fell to 2 percent in the first half of the year, and we project inflation to remain at or below this level through 2005, as spare capacity is reduced but not eliminated.

Net exports are estimated to have arithmetically contributed ½ percentage point to U.S. real GDP growth in the third quarter as import growth moderated and

exports grew rapidly. With imports projected to rebound in the fourth quarter, net exports should subtract about $\frac{1}{4}$ percentage point from growth. In 2004 and 2005, the amount subtracted from U.S. GDP growth by imports should outweigh the positive contribution from exports. The erosion in net exports occurs because U.S. economic activity is projected to grow faster than foreign activity, and this outweighs the effect of the weaker dollar in restraining imports and stimulating exports. Our forecast is that net exports will deduct nearly $\frac{1}{2}$ percentage point from U.S. growth in each of the next two years. The U.S. current account deficit is projected to expand from about \$550 billion in the second half of 2003 to \$640 billion (a bit over 5 percent of GDP) by the end of 2005.

Oil Prices

The spot price of West Texas Intermediate (WTI) crude oil closed at \$30.18 per barrel on October 21, \$0.80 higher than at the time of the September Greenbook and \$2.60 higher than at the time of the FOMC meeting. After falling to \$27 per barrel in mid-September, the spot price rose in response to delays in the recovery of Iraqi oil exports and OPEC's decision to decrease its production target 900,000 barrels per day as of November 1. Tanker bookings suggest that Saudi Arabia intends to cut production to comply with the target. In line with quotes from futures markets, the spot price of WTI is projected to fall to \$26.70 by the fourth quarter of 2004 and \$25.50 by the fourth quarter of 2005 as Iraqi and non-OPEC production rises. Relative to the September Greenbook, this projection is about \$1.25 higher in the first quarter of 2004 and averages about \$1 higher in 2004 and 2005.

International Financial Markets

On balance during the intermeeting period, the dollar depreciated significantly against all major foreign currencies. Releases of U.S. economic data that were more favorable than expected at times temporarily boosted the dollar. However, the more sustained downward movement in the dollar came on the heels of the G-7 communiqué stating that “more flexibility in exchange rates is desirable . . . to promote smooth and widespread adjustments.” Market participants generally interpreted this statement as a signal that G-7 members had acquiesced to further depreciation of the dollar. On a nominal trade-weighted basis, the dollar fell $4\frac{3}{4}$ percent against other major foreign currencies during the intermeeting period, led by a 7 percent drop vis-à-vis the Japanese yen. Much of the downward move against the yen coincided with a temporary halt in Japanese intervention purchases of dollars around the time of the G-7 meeting. However, Japanese authorities resumed their intervention activities later in the period after the yen had strengthened significantly. Over the intermeeting period, the dollar depreciated $3\frac{3}{4}$ percent against the euro, and 4 to 5 percent against the Canadian dollar and the pound.

The dollar changed little against the currencies of our other important trading partners during the intermeeting period. The dollar appreciated 2 percent against the Mexican peso but depreciated against many other emerging market currencies. After the call from G-7 officials for more flexible exchange rates, the nondeliverable forward exchange rate of the Chinese renminbi against the dollar strengthened; it currently prices in a renminbi appreciation of 4 percent over the next year.¹ The Hong Kong Monetary Authority allowed the Hong Kong dollar (usually tightly linked to the U.S. dollar in a currency board arrangement) to appreciate about ½ percent, and the dollar also moved down against the currencies of Taiwan, Singapore, and Thailand.

The projected value of the broad real index of the dollar in 2003:Q4 is 2¾ percent lower than in the September Greenbook. We continue to project that this index will decline at an annual rate of about 1¼ percent over the rest of the forecast period. Going forward, the dollar may be boosted by continued strength of the U.S. economic expansion relative to that of our trading partners. This supportive factor, however, will be countered by the ongoing need to finance the persistent and widening current account deficit. The downward trend in our forecast reflects our expectation that the latter will ultimately predominate.

Short-term market interest rates moved little during the intermeeting period as central banks in the major industrial countries kept policy interest rates steady. However, the Bank of Japan (BOJ) raised the upper bound of its target range for banks' current account balances ¥2 trillion, to ¥32 trillion. The BOJ also clarified its commitment to maintain its accommodative stance by stating that the policy would be continued some months after prices stop falling and would not be lifted if deflation was expected to reemerge. Ten-year sovereign yields fell slightly in Japan but edged up in the euro area and Canada. Gilt yields of the same maturities increased 35 basis points over the period, as market participants came to believe that the Bank of England would likely be the first major central bank to tighten monetary policy. Headline equity indexes fell slightly in the euro area and increased a bit in the United Kingdom and Canada. Japan's Topix index rose 3 percent, and the price of Japanese banking sector shares shot up more than 15 percent.

1. With foreign exchange convertibility restrictions making the renminbi "nondeliverable," forward contracts settled in another currency (usually the dollar) and traded outside of China are used to hedge the currency risk.

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

Foreign industrial countries

Indicators for third-quarter growth have come in as expected or slightly better for most foreign industrial countries, except Japan. We estimate that real GDP in the foreign industrial countries grew 1 $\frac{3}{4}$ percent in the third quarter following growth of just $\frac{1}{2}$ percent in the second quarter. Rising consumer and business confidence, accommodative monetary conditions, and robust U.S. growth are projected to boost foreign growth to 2 $\frac{1}{2}$ percent in the current quarter and a bit higher in 2004 and 2005. The recent appreciation of industrial country currencies against the dollar is likely to damp, but not overwhelm, these positive factors.

Twelve-month headline inflation rates in most major foreign industrial countries are expected to decline or hold steady over the forecast period. In Japan, deflation is expected to diminish only slightly over the forecast period.

Real GDP growth in Japan is estimated to have moderated in the third quarter, after a robust investment-led expansion in the second quarter. Declines in core machinery orders in July and August suggest that the brisk pace of investment may be easing. Beyond the third quarter, growth is expected to remain around 1 $\frac{1}{2}$ percent through 2005, with contributions both from domestic demand and, to a lesser extent, from the external sector.

In the euro area, recent indicators point to a mild pickup in economic activity. In September, both services and manufacturing purchasing managers' indexes (PMIs) indicated expansion. An uptrend in business and consumer confidence measures in recent months suggests that the malaise afflicting the region since last year may be lifting. Real GDP growth is estimated to have been slightly positive in the third quarter and the pace of growth is projected to rise gradually to 2 $\frac{1}{2}$ percent by the end of 2004. Consumer spending, driven by firming confidence, should support growth, whereas the net appreciation of the euro likely will exert some restraint. Fiscal policy is projected to be about neutral over the forecast interval. Next year, German tax cuts will provide stimulus, but France will attempt to cut its budget deficit (though likely not enough to satisfy the Stability and Growth Pact). We expect the ECB to leave policy unchanged through the beginning of 2005.

A substantial upward revision to British real GDP data in the first half of the year has led us to raise our estimate of third-quarter growth and our forecast. A

large part of the revision stemmed from stronger data on the construction sector, which continues to be spurred by rapidly rising house prices. Real GDP is now projected to grow 3 percent in the fourth quarter, and it should continue to expand at that pace through the first half of next year before moderating over the rest of the forecast period. Recent comments by Governor Mervyn King, along with the improved outlook for growth and above-target inflation, have led us to assume that the Bank of England will begin raising its policy rate soon.

In Canada, strong domestic demand related to employment gains and the housing boom are estimated to have boosted real GDP growth to around 2¼ percent in the third quarter after a small, SARS-related contraction in the second quarter. The waning of an inventory cycle should propel growth to roughly 3½ percent in the current quarter and sustain it early next year. Growth is then expected to moderate slightly through the end of 2005, but it should remain a bit above potential. The Bank of Canada is assumed to keep its policy rate constant through the end of 2004.

Other economies

The emerging Asian economies appear to be recovering from the negative economic effects of SARS even more rapidly than we had anticipated, with retail sales and tourism at or near their pre-SARS levels. In addition, we have seen mounting evidence that the region's high-tech sector is expanding rapidly. In consequence, we have raised our estimate of third-quarter growth in emerging Asian economies to an annual rate of nearly 10 percent and have revised up our forecast for fourth-quarter growth in the region, bringing second-half growth to about 8 percent. Real GDP is expected to expand at a more sustainable rate of 5½ percent over the next two years.

Real GDP in China is estimated to have grown at a remarkable annual rate of 17½ percent in the third quarter, driven by public investment and exports. China also appears to have made a complete recovery from the economic impact of SARS. Growth should fall back to 9 percent in the fourth quarter and subside to a more sustainable pace of 8 percent over the next two years. Hong Kong's economy is also showing signs of improvement as it bounces back from the effects of SARS and benefits from the boom in China; real GDP is projected to grow at a double-digit annual rate in the second half before settling down to a pace of 4 to 5 percent over the rest of the forecast period. After contracting in the first half of the year, the Korean economy appears to be recovering, although some adverse shocks, mainly labor strikes in July and a typhoon in September, restrained output in the third quarter.

In Mexico, third-quarter indicators point to a slowing in growth from its rapid second-quarter pace, with the manufacturing sector remaining weak and survey

evidence suggesting that consumer spending is decelerating. However, activity outside of manufacturing appears to have held up, and forward-looking indicators for manufacturing are somewhat encouraging. In particular, business confidence has stayed high and auto sales seem to be reviving. We expect GDP to grow about 3½ percent during the second half of 2003. Based on the forecast trajectory of U.S. activity, we project that Mexican GDP will grow about 5 percent next year and about 4 percent in 2005. In Brazil, rising industrial production suggests that the economy has started to recover from its first-half slump. The recent loosening of monetary policy and continued strength of the external sector should help support a moderate pickup in activity. The Argentine economy continues to improve, but, with no concrete signs of policies that would begin to address the country's structural problems, we foresee only a moderate pace of growth.

We expect average inflation in the developing economies to remain subdued at around 2¾ percent over the forecast period, a rate little changed from that in the September Greenbook. Projected inflation rates are positive in China, Singapore, and Taiwan, but Hong Kong is still projected to record deflation next year.

Prices of internationally traded goods

Prices of imported non-oil core goods are projected to increase 2 percent in the second half of 2003 and then to rise 2¼ percent in the first half of next year, owing to the dollar's depreciation, higher commodity prices, and a steady rise in prices abroad. Core import price inflation is projected to decline to just over 1 percent for the rest of the forecast period. The projected price increases in the near term are larger than those in the previous Greenbook, owing mainly to the recent decline in the dollar. In light of recent data and ongoing staff research on exchange rate pass-through, we have tempered the upward revision to projected import prices so that prices respond somewhat less to exchange rate movements than our model predicts.

Higher prices for agricultural and energy-related products are responsible for the acceleration of prices of exported core goods that began last year. After increasing 3.4 percent in the first half of 2003, core export prices are expected to rise at a more subdued pace of around 1 percent for the rest of the projection period.

Selected Trade Prices

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

| Trade category | 2002 | 2003: H1 | Projection | | | |
|--------------------------|-------|-------------|------------|-------|-------|-------|
| | | | 2003: | | 2004 | 2005 |
| | | | Q3 | Q4 | | |
| <i>Exports</i> | | | | | | |
| Core goods | 2.1 | 3.4 | .9 | 1.2 | .9 | 1.0 |
| <i>Imports</i> | | | | | | |
| Non-oil core goods | .7 | 2.6 | 1.3 | 2.5 | 1.8 | 1.1 |
| Oil (dollars per barrel) | 24.05 | 26.46 | 27.98 | 27.74 | 24.41 | 22.99 |

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

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

Trade in Goods and Services

August trade data surprised us with unexpected weakness in imports and, to a lesser extent, exports. This led us to revise our quarterly estimates for real imports and exports, causing the estimated arithmetic contribution of net exports to U.S. real GDP growth in the third quarter to swing from a negative $\frac{1}{4}$ percentage point in the September Greenbook to a positive $\frac{1}{2}$ percentage point in our current forecast. With imports projected to rebound in the fourth quarter from their recent weakness, the projected contribution of net exports to growth is negative $\frac{1}{4}$ percentage point, down from a slightly positive figure in the September Greenbook.

The decline in the value of exports in August only partly reversed the large increase in July; moreover, indicators suggest that exports picked up speed in September. In consequence, even after taking into account the August data, we still estimate real exports of goods and services to have grown $11\frac{1}{2}$ percent at an annual rate in the third quarter, $2\frac{1}{2}$ percentage points more than we estimated in the September Greenbook. Much of the upward revision was in services exports, especially receipts from international travel, as the effects of SARS and the war in Iraq receded. Real exports are projected to grow rapidly again in the fourth quarter.

The decline in the value of imports in August came mainly from a drop in automotive imports, but also decreases in imported consumer goods, aircraft, high-tech products, and oil. Our assessment is that much of the decline was

transitory, caused in part by factors such as the power blackout, reported delays in introducing winter styles by various department stores, and domestic automakers' concerns about inventory stocks of some models. Accordingly, our view is that imports bounced back in September. Even so, real goods and services imports are estimated to have slowed sharply in the third quarter, growing 4 percent at an annual rate, only half the pace projected in the September Greenbook. We anticipate that import growth will continue to strengthen in the fourth quarter and have penciled in a growth rate of about 10 percent, 3 percentage points higher than in the September Greenbook.

Summary of Staff Projections for Trade in Goods and Services

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

| Measure | 2002 | Projection | | | | |
|--------------------|------|------------|-------|------|------|------|
| | | 2003: | 2003: | | 2004 | 2005 |
| | | H1 | Q3 | Q4 | | |
| Real exports | 3.9 | -1.1 | 11.6 | 11.6 | 10.2 | 9.9 |
| <i>Previous GB</i> | 3.9 | -1.3 | 9.0 | 11.6 | 9.7 | 9.6 |
| Real imports | 10.1 | 1.0 | 4.1 | 10.0 | 10.1 | 9.1 |
| <i>Previous GB</i> | 10.1 | .6 | 8.5 | 7.1 | 10.5 | 9.2 |

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

In 2004 and 2005, exports of core goods, computers, semiconductors, and services are all expected to show continued solid growth. The projected strength in core exports stems from the acceleration of foreign activity and a lagged response to the dollar's depreciation. In addition, because exports have shown greater cyclicity than suggested by their historical relationship with exchange rates and foreign GDP, we have built in some further growth of exports over the forecast period to return them gradually to a more normal level. We project that services exports will moderate to a rate of about 6 percent in 2004 and 2005. Total export growth in 2004 is $\frac{1}{2}$ percentage point stronger than projected in the September Greenbook, and $\frac{1}{4}$ percentage point higher in 2005, primarily because of the lower projected path of the dollar.

We are projecting import growth to remain high in 2004 as a result of continued strength of U.S. demand. In 2005, import growth should move down slightly as U.S. growth moderates. In addition, the lower projected path of the dollar restrains import growth over the forecast period. As we have noted in past

Greenbooks, imports of core goods have fallen below their traditional relationship with U.S. GDP and exchange rates, but we expect some of this to be made up over the forecast period. Imports of computers and semiconductors are expected to grow at double-digit rates as the high-tech sector recovers strongly. We project that the growth of services imports, after being boosted in the near term by the recovery of international travel, will settle down to about 5 percent in 2004 and 2005.

Alternative simulation

The index of the broad real dollar has declined about 10 percent since its peak in early 2002. We are projecting only a small additional decline over the forecast period. However, concerns about the financing burden posed by the growing U.S. current account deficit may induce a much sharper depreciation.

Accordingly, in our alternative simulation, we used the FRB/Global model to assess the effects of a rise in the risk premium on the dollar that would generate an additional real dollar decline of about 20 percent by the end of next year. Under this alternative, the decline in the broad real dollar over 2002 to 2004 would be similar to that experienced in the mid-1980s. The simulation assumes that the risk premium shocks begin in 2003:Q4 and are phased in so that the dollar declines about 5 percent per quarter through 2004:Q3. The simulation assumes that the federal funds rate is held constant.

Alternative Simulation: 20 Percent Depreciation of the Broad Real Dollar

(Percent change from previous period, annual rate)

| Indicator and simulation | 2003 | | 2004 | | 2005 | |
|--|------|-----|------|-----|------|-----|
| | H1 | H2 | H1 | H2 | H1 | H2 |
| <i>U.S. real GDP</i> | | | | | | |
| Baseline | 2.3 | 5.3 | 5.2 | 5.0 | 4.0 | 4.0 |
| Dollar Depreciation | 2.3 | 5.4 | 5.7 | 6.0 | 5.4 | 5.8 |
| <i>U.S. PCE prices excl. food and energy</i> | | | | | | |
| Baseline | .9 | 1.5 | 1.2 | 1.1 | 1.0 | 1.0 |
| Dollar Depreciation | .9 | 1.5 | 1.6 | 2.2 | 2.2 | 1.7 |

NOTE. H1 is Q2/Q4; H2 is Q4/Q2. In these simulations, the nominal federal funds rate remains unchanged from baseline, and the monetary authorities in major foreign economies adjust their policy rates according to a Taylor rule.

The depreciation of the dollar provides a strong stimulus to net exports. This stimulus contributes to a substantial increase in real output: Real GDP growth rises about $\frac{3}{4}$ percentage point above baseline in 2004 and $1\frac{1}{2}$ percentage points

above baseline in 2005. The larger boost to real GDP in the latter part of the forecast period reflects lags in the adjustment process and the assumption that the shocks are gradually phased in. Core PCE inflation rises about $\frac{3}{4}$ percentage point above baseline in 2004 and nearly 1 percentage point above it in 2005. Most of the upward pressure on the core PCE deflator reflects the pass-through of higher prices for imported goods and services. Given that import prices appear to have responded less to recent changes in exchange rates than implied by the historical relationship in the model, the estimated effects on both U.S. prices and GDP may be at the high end of what one might expect.

Strictly Confidential (FR) October 22, 2003
 Class II FOMC
 OUTLOOK FOR FOREIGN REAL GDP AND CONSUMER PRICES: SELECTED COUNTRIES
 (Percent, Q4 to Q4)

| Measure and country | -----Projected----- | | | | | | | | | |
|----------------------|---------------------|------|------|------|------|------|------|------|------|--|
| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | |
| REAL GDP (1) | | | | | | | | | | |
| ----- | | | | | | | | | | |
| Total foreign | 4.2 | 1.5 | 4.9 | 4.4 | 0.3 | 2.7 | 2.0 | 3.6 | 3.4 | |
| Industrial Countries | 3.4 | 2.7 | 4.2 | 3.9 | 0.7 | 2.5 | 1.6 | 2.7 | 2.7 | |
| of which: | | | | | | | | | | |
| Canada | 4.4 | 4.4 | 5.9 | 4.2 | 1.4 | 3.5 | 1.9 | 3.4 | 3.2 | |
| Japan | 0.3 | -1.3 | -0.5 | 5.1 | -2.4 | 2.5 | 2.4 | 1.5 | 1.4 | |
| United Kingdom | 3.4 | 2.8 | 3.3 | 2.9 | 1.9 | 2.0 | 2.2 | 2.9 | 2.5 | |
| Euro Area (2) | 3.2 | 2.0 | 3.8 | 2.7 | 0.8 | 1.1 | 0.6 | 2.1 | 2.4 | |
| Germany | 1.7 | 0.7 | 3.3 | 1.9 | 0.5 | 0.5 | 0.2 | 1.9 | 2.0 | |
| Developing Countries | 5.4 | -0.3 | 6.1 | 5.3 | -0.3 | 3.1 | 2.8 | 4.9 | 4.4 | |
| Asia | 5.0 | -2.2 | 8.6 | 6.2 | 0.9 | 5.6 | 3.4 | 5.5 | 5.4 | |
| Korea | 3.4 | -5.2 | 13.8 | 5.1 | 4.2 | 7.0 | 0.8 | 4.6 | 5.5 | |
| China | 8.7 | 9.5 | 4.1 | 8.0 | 7.5 | 8.0 | 9.7 | 8.3 | 7.7 | |
| Latin America | 6.1 | 1.2 | 4.2 | 4.5 | -1.4 | 1.1 | 2.1 | 4.6 | 3.8 | |
| Mexico | 6.8 | 2.9 | 5.4 | 4.8 | -1.4 | 2.0 | 2.5 | 5.1 | 4.1 | |
| Brazil | 2.5 | -1.6 | 3.4 | 3.9 | -0.9 | 3.2 | -0.5 | 3.5 | 3.5 | |
| CONSUMER PRICES (3) | | | | | | | | | | |
| ----- | | | | | | | | | | |
| Industrial Countries | 1.5 | 1.0 | 1.2 | 1.8 | 1.0 | 2.2 | 1.3 | 1.3 | 1.3 | |
| of which: | | | | | | | | | | |
| Canada | 1.0 | 1.1 | 2.4 | 3.1 | 1.1 | 3.8 | 1.7 | 1.9 | 1.8 | |
| Japan | 2.1 | 0.7 | -1.1 | -1.3 | -1.3 | -0.4 | -0.5 | -0.4 | -0.3 | |
| United Kingdom (4) | 2.7 | 2.5 | 2.2 | 2.1 | 2.0 | 2.6 | 2.7 | 2.6 | 2.5 | |
| Euro Area (2) | 1.5 | 0.8 | 1.5 | 2.5 | 2.1 | 2.3 | 1.7 | 1.5 | 1.6 | |
| Germany | 1.5 | 0.3 | 1.1 | 1.7 | 1.5 | 1.2 | 0.9 | 1.0 | 1.0 | |
| Developing Countries | 6.8 | 9.0 | 4.6 | 4.1 | 2.8 | 3.1 | 2.7 | 2.8 | 2.8 | |
| Asia | 2.7 | 4.4 | 0.1 | 1.8 | 1.1 | 0.8 | 1.5 | 2.0 | 2.2 | |
| Korea | 4.9 | 5.8 | 1.2 | 2.5 | 3.3 | 3.4 | 3.2 | 2.7 | 2.7 | |
| China | 0.8 | -1.2 | -1.0 | 0.9 | -0.1 | -0.5 | 1.3 | 1.6 | 1.8 | |
| Latin America | 15.5 | 15.4 | 12.5 | 8.4 | 5.3 | 6.4 | 4.8 | 4.0 | 3.5 | |
| Mexico | 17.0 | 17.3 | 13.4 | 8.7 | 5.1 | 5.3 | 3.8 | 3.6 | 3.1 | |
| Brazil | 4.6 | 2.0 | 8.4 | 6.4 | 7.5 | 10.7 | 11.9 | 5.8 | 5.2 | |

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

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

| Measure and country | 2003 | | | | Projected | | | | Quarterly changes at an annual rate | | | |
|-----------------------------------|------|------|------|------|-----------|------|------|------|-------------------------------------|------|------|------|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | | | | |
| REAL GDP (1) | | | | | | | | | | | | |
| Total foreign | 0.7 | 0.7 | 3.5 | 3.4 | 3.5 | 3.6 | 3.6 | 3.6 | 3.4 | 3.3 | 3.3 | 3.3 |
| Industrial Countries of which: | | | | | | | | | | | | |
| Canada | 2.6 | -0.3 | 2.2 | 3.3 | 3.5 | 3.4 | 3.3 | 3.3 | 3.2 | 3.2 | 3.2 | 3.2 |
| Japan | 2.4 | 3.9 | 1.4 | 2.0 | 1.6 | 1.5 | 1.5 | 1.4 | 1.3 | 1.3 | 1.3 | 1.5 |
| United Kingdom | 0.7 | 2.4 | 2.8 | 3.0 | 3.0 | 3.0 | 2.8 | 2.7 | 2.7 | 2.6 | 2.4 | 2.4 |
| Euro Area (2) | 0.1 | -0.3 | 1.1 | 1.4 | 1.7 | 2.0 | 2.4 | 2.5 | 2.5 | 2.5 | 2.3 | 2.3 |
| Germany | -1.0 | -0.2 | 1.0 | 1.1 | 1.4 | 1.7 | 2.3 | 2.2 | 2.1 | 2.1 | 2.0 | 2.0 |
| Developing Countries | | | | | | | | | | | | |
| Asia | -0.6 | 0.9 | 6.1 | 4.8 | 4.8 | 4.9 | 4.8 | 4.9 | 4.5 | 4.5 | 4.4 | 4.3 |
| Korea | 2.8 | -5.0 | 9.7 | 6.7 | 5.5 | 5.6 | 5.5 | 5.6 | 5.6 | 5.5 | 5.2 | 5.2 |
| China | -1.6 | -2.9 | 3.0 | 5.0 | 4.5 | 4.5 | 4.5 | 5.0 | 5.5 | 5.5 | 5.5 | 5.5 |
| Latin America | 16.3 | -2.9 | 17.5 | 9.0 | 8.5 | 8.5 | 8.2 | 8.2 | 8.0 | 8.0 | 7.5 | 7.5 |
| Mexico | -4.2 | 6.0 | 3.5 | 3.5 | 4.6 | 4.6 | 4.6 | 4.6 | 3.8 | 3.8 | 3.8 | 3.8 |
| Brazil | -1.7 | 4.9 | 3.4 | 3.4 | 5.1 | 5.1 | 5.1 | 5.1 | 4.1 | 4.1 | 4.1 | 4.1 |
| Brazil | -2.3 | -6.2 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 | 3.5 |
| CONSUMER PRICES (3) | | | | | | | | | | | | |
| Industrial Countries of which: | | | | | | | | | | | | |
| Canada | 2.5 | 1.8 | 1.5 | 1.3 | 0.7 | 1.3 | 1.4 | 1.3 | 1.3 | 1.3 | 1.3 | 1.3 |
| Japan | 4.5 | 2.8 | 2.1 | 1.7 | 0.6 | 1.9 | 1.9 | 1.9 | 1.8 | 1.8 | 1.8 | 1.8 |
| United Kingdom (4) | -0.3 | -0.3 | -0.6 | -0.5 | -0.5 | -0.5 | -0.3 | -0.4 | -0.4 | -0.4 | -0.3 | -0.3 |
| Euro Area (2) | 2.9 | 2.9 | 2.9 | 2.7 | 2.3 | 2.7 | 2.6 | 2.6 | 2.5 | 2.5 | 2.5 | 2.5 |
| Germany | 2.3 | 1.9 | 2.0 | 1.7 | 1.3 | 1.5 | 1.5 | 1.5 | 1.6 | 1.6 | 1.6 | 1.6 |
| Germany | 1.1 | 0.9 | 1.0 | 0.9 | 0.6 | 1.0 | 0.9 | 1.0 | 1.0 | 1.1 | 1.1 | 1.0 |
| Developing Countries | | | | | | | | | | | | |
| Asia | 3.6 | 3.1 | 2.7 | 2.7 | 2.4 | 2.6 | 2.9 | 2.8 | 2.8 | 2.8 | 2.8 | 2.8 |
| Korea | 1.4 | 1.2 | 1.2 | 1.5 | 1.3 | 1.8 | 2.1 | 2.0 | 2.0 | 2.1 | 2.2 | 2.2 |
| China | 4.1 | 3.3 | 3.2 | 3.2 | 2.6 | 2.8 | 3.0 | 2.7 | 2.7 | 2.7 | 2.7 | 2.7 |
| Latin America | 0.5 | 0.6 | 0.9 | 1.3 | 1.1 | 1.6 | 1.6 | 1.6 | 1.8 | 1.8 | 1.8 | 1.8 |
| Mexico | 7.1 | 6.3 | 5.4 | 4.8 | 4.3 | 4.2 | 4.2 | 4.0 | 3.8 | 3.7 | 3.6 | 3.5 |
| Brazil | 5.5 | 4.7 | 4.1 | 3.8 | 3.9 | 3.9 | 3.8 | 3.6 | 3.4 | 3.3 | 3.2 | 3.1 |
| Brazil | 15.6 | 17.0 | 15.3 | 11.9 | 6.9 | 5.4 | 6.1 | 5.8 | 5.6 | 5.5 | 5.3 | 5.2 |

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

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | Projected 2004 | Projected 2005 |
|--|--------|--------|--------|--------|--------|--------|--------|-------------------|-------------------|
| NIPA REAL EXPORTS and IMPORTS | | | | | | | | | |
| Percentage point contribution to GDP growth, Q4/Q4 | | | | | | | | | |
| Net Goods & Services | -0.8 | -1.1 | -1.0 | -0.8 | -0.1 | -1.0 | -0.1 | -0.5 | -0.4 |
| Exports of G&S | 1.0 | 0.3 | 0.5 | 0.8 | -1.3 | 0.4 | 0.5 | 1.0 | 1.0 |
| Imports of G&S | -1.7 | -1.3 | -1.5 | -1.5 | 1.2 | -1.3 | -0.6 | -1.4 | -1.4 |
| Percentage change, Q4/Q4 | | | | | | | | | |
| Exports of G&S | 8.5 | 2.3 | 4.9 | 7.3 | -11.4 | 3.9 | 5.0 | 10.2 | 9.9 |
| Services | 1.4 | 2.9 | 3.2 | 4.8 | -9.2 | 11.4 | 5.2 | 6.7 | 5.9 |
| Computers | 25.8 | 8.1 | 13.4 | 23.0 | -23.4 | -2.1 | 10.6 | 37.3 | 31.0 |
| Semiconductors | 21.3 | 9.1 | 34.6 | 26.9 | -34.9 | 8.5 | 33.1 | 40.1 | 33.7 |
| Other Goods 1/ | 9.8 | 1.3 | 3.2 | 5.7 | -9.4 | 0.5 | 2.9 | 8.2 | 8.4 |
| Imports of G&S | 14.3 | 10.8 | 11.9 | 11.1 | -8.0 | 10.1 | 4.0 | 10.1 | 9.1 |
| Services | 14.0 | 8.5 | 5.9 | 10.9 | -8.6 | 11.5 | 1.8 | 4.6 | 4.5 |
| Oil | 3.9 | 4.1 | -3.4 | 13.3 | 0.1 | 4.0 | -0.2 | 2.4 | 2.7 |
| Computers | 33.0 | 25.8 | 26.0 | 13.6 | -13.8 | 13.6 | 13.8 | 37.3 | 31.1 |
| Semiconductors | 32.9 | -8.7 | 34.2 | 22.5 | -51.4 | 9.3 | 5.5 | 40.2 | 33.7 |
| Other Goods 2/ | 12.7 | 11.5 | 12.7 | 10.4 | -6.2 | 10.1 | 4.3 | 9.8 | 8.5 |
| Billions of chained 1996 dollars | | | | | | | | | |
| Net Goods & Services | -113.3 | -221.1 | -320.5 | -398.8 | -415.9 | -488.5 | -532.8 | -579.9 | -628.8 |
| Exports of G&S | 981.5 | 1002.4 | 1036.3 | 1137.2 | 1076.1 | 1058.8 | 1078.4 | 1180.0 | 1298.5 |
| Imports of G&S | 1094.8 | 1223.5 | 1356.8 | 1536.0 | 1492.0 | 1547.4 | 1611.2 | 1759.9 | 1927.3 |
| Billions of dollars | | | | | | | | | |
| US CURRENT ACCOUNT BALANCE | -127.7 | -204.7 | -290.8 | -411.5 | -393.7 | -480.9 | -550.4 | -582.2 | -622.8 |
| Current Acct as Percent of GDP | -1.5 | -2.3 | -3.1 | -4.2 | -3.9 | -4.6 | -5.0 | -5.0 | -5.1 |
| Net Goods & Services (BOP) | -107.0 | -163.2 | -261.2 | -375.4 | -357.8 | -418.0 | -494.1 | -541.2 | -581.4 |
| Investment Income, Net | 25.1 | 11.5 | 22.3 | 24.2 | 15.7 | 1.3 | 15.0 | 27.7 | 25.3 |
| Direct, Net | 72.4 | 65.5 | 78.2 | 94.9 | 106.5 | 93.5 | 96.1 | 112.2 | 122.1 |
| Portfolio, Net | -47.3 | -54.1 | -55.9 | -70.7 | -90.8 | -92.2 | -81.1 | -84.5 | -96.9 |
| Other Income & Transfers, Net | -45.7 | -53.0 | -52.0 | -60.3 | -51.6 | -64.1 | -71.3 | -68.7 | -66.7 |

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

| | 2000 | | | | 2001 | | | | 2002 | | | |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| Percentage point contribution to GDP growth | | | | | | | | | | | | |
| Net Goods & Services | -1.1 | -1.0 | -0.7 | -0.2 | 0.5 | -0.4 | -0.2 | -0.3 | -0.7 | -1.4 | 0.0 | -1.6 |
| Exports of G&S | 0.8 | 1.5 | 1.2 | -0.5 | -0.7 | -1.4 | -2.0 | -1.0 | 0.3 | 1.3 | 0.5 | -0.6 |
| Imports of G&S | -1.9 | -2.5 | -1.9 | 0.3 | 1.2 | 1.0 | 1.7 | 0.7 | -1.1 | -2.7 | -0.4 | -1.0 |
| Percentage change from previous period, s.a.a.r. | | | | | | | | | | | | |
| Exports of G&S | 7.7 | 14.6 | 11.6 | -4.0 | -6.0 | -12.4 | -17.3 | -9.6 | 3.5 | 14.3 | 4.6 | -5.8 |
| Services | 10.2 | 11.2 | -5.9 | 4.4 | -6.0 | -2.5 | -13.9 | -13.8 | 21.7 | 10.7 | 5.9 | 8.0 |
| Computers | 33.5 | 45.9 | 28.8 | -8.8 | -7.3 | -41.7 | -22.8 | -17.6 | -21.1 | -0.5 | -0.8 | 17.9 |
| Semiconductors | 14.6 | 90.9 | 43.4 | -17.5 | -34.6 | -47.3 | -40.9 | -11.7 | 13.7 | 65.8 | 21.3 | -39.4 |
| Other Goods 1/ | 4.2 | 9.1 | 16.7 | -5.9 | -2.9 | -10.5 | -16.5 | -6.9 | -3.1 | 14.2 | 3.3 | -10.7 |
| Imports of G&S | 14.7 | 18.6 | 13.8 | -1.6 | -7.9 | -6.8 | -11.8 | -5.3 | 8.5 | 22.2 | 3.3 | 7.4 |
| Services | 20.7 | 9.6 | 15.1 | -0.5 | 0.3 | 8.5 | -23.2 | -16.5 | 35.7 | -2.1 | 3.1 | 13.0 |
| Oil | 28.6 | 40.4 | -2.3 | -6.5 | 23.3 | 7.2 | -26.9 | 3.9 | -19.0 | 34.5 | -13.3 | 24.1 |
| Computers | 2.5 | 40.4 | 27.9 | -9.5 | -21.6 | -24.5 | -18.7 | 14.6 | 52.4 | 5.6 | -4.4 | 8.2 |
| Semiconductors | 23.5 | 50.0 | 69.8 | -28.5 | -43.9 | -68.8 | -55.9 | -27.5 | 45.2 | 41.8 | -5.9 | -26.4 |
| Other Goods 2/ | 13.1 | 15.5 | 12.3 | 1.3 | -9.4 | -6.2 | -4.7 | -4.5 | 1.9 | 28.8 | 6.3 | 5.2 |
| Billions of chained 1996 dollars, s.a.a.r. | | | | | | | | | | | | |
| Net Goods & Services | -368.8 | -394.6 | -413.1 | -418.5 | -404.5 | -414.8 | -419.0 | -425.3 | -446.6 | -487.4 | -488.0 | -532.2 |
| Exports of G&S | 1095.8 | 1133.9 | 1165.5 | 1153.7 | 1135.8 | 1098.8 | 1048.0 | 1021.8 | 1030.6 | 1065.5 | 1077.7 | 1061.6 |
| Imports of G&S | 1464.6 | 1528.5 | 1578.6 | 1572.2 | 1540.3 | 1513.6 | 1467.0 | 1447.2 | 1477.1 | 1552.9 | 1565.7 | 1593.8 |
| Billions of dollars, s.a.a.r. | | | | | | | | | | | | |
| US CURRENT ACCOUNT BALANCE | -380.1 | -396.5 | -434.3 | -435.0 | -416.0 | -399.9 | -414.5 | -344.6 | -426.9 | -491.3 | -490.9 | -514.3 |
| Current Account as % of GDP | -3.9 | -4.0 | -4.4 | -4.4 | -4.1 | -4.0 | -4.1 | -3.4 | -4.1 | -4.7 | -4.7 | -4.9 |
| Net Goods & Services (BOP) | -346.9 | -364.5 | -391.8 | -398.4 | -373.8 | -357.8 | -356.2 | -343.5 | -360.2 | -419.5 | -427.9 | -464.5 |
| Investment Income, Net | 19.9 | 23.2 | 15.8 | 37.8 | 8.6 | 8.2 | -8.3 | 54.3 | 2.2 | -12.4 | -1.9 | 17.2 |
| Direct, Net | 84.5 | 88.9 | 91.9 | 114.5 | 94.5 | 96.7 | 91.3 | 143.5 | 95.7 | 85.6 | 87.7 | 104.9 |
| Portfolio, Net | -64.5 | -65.7 | -76.1 | -76.6 | -86.0 | -88.4 | -99.6 | -89.2 | -93.5 | -98.1 | -89.6 | -87.7 |
| Other Inc. & Transfers, Net | -53.1 | -55.2 | -58.3 | -74.5 | -50.8 | -50.3 | -50.0 | -55.4 | -68.9 | -59.3 | -61.1 | -67.1 |

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

