Appendix 1: Materials used by Mr. Kos
Emerging Market and High Yield Debt Spreads
October 1, 2002 – January 27, 2006

Source: JP Morgan and Merrill Lynch

Ratings in Emerging Markets and High Yield Corporate Debt

Merrill HY Index

Source: Merrill Lynch

EMBI+ Index

Source: JP Morgan

Note: EMBI+ ratings estimated from higher of S&P and Moody’s ratings.
Merrill Lynch High Yield Index ratings estimated from average of S&P,
Moody’s, and Fitch ratings.
Fed Funds Effective Rates and Trading Ranges
Since the November 1, 2005 FOMC Meeting Period
November 2, 2005 – January 27, 2006

Fed Funds Effective Rates Minus Target Rate at Start of Maintenance Period
(maintenance periods with FOMC rate hike on first Tuesday
and no high payment flow days in the period before the meeting)

Average-to-Date Excess Reserves
(maintenance periods with FOMC rate hike on first Tuesday
and no high payment flow days in the period before the meeting)
Appendix 2: Materials used by Messrs. Stockton, Struckmeyer, and Sheets
Material for

Staff Presentation on the Economic Outlook

January 31, 2006

*Downgraded to Class II upon release of the February 2006 Monetary Policy Report.
Recent Indicators

Real GDP
Percent change, annual rate

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q3</td>
<td>4.1</td>
<td>1.1</td>
</tr>
<tr>
<td>Q4</td>
<td>1.1</td>
<td>4.7</td>
</tr>
<tr>
<td>Q1\textsuperscript{e}</td>
<td>(4.1)</td>
<td>(2.4)</td>
</tr>
</tbody>
</table>

\textit{Jan GB} (4.1) (2.4) (4.1)

e - Staff estimate.

Initial Claims
Four-week moving average
Thousands

Industrial Production
Percent change, annual rate

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q3</td>
<td>1.4</td>
<td>3.8</td>
</tr>
<tr>
<td>Q4</td>
<td>3.8</td>
<td>6.3</td>
</tr>
<tr>
<td>Q1\textsuperscript{e}</td>
<td>6.3</td>
<td>6.3</td>
</tr>
</tbody>
</table>

1. Total IP
2. Manufacturing
3. Manufacturing ex. mv

e - Staff estimate.

New Orders Indexes
Diffusion index

Real Personal Consumption Expenditures Excluding Motor Vehicles
Trillions of 2000 dollars, annual rate

Orders and Shipments of Nondefense Capital Goods\textsuperscript{*}
Billions of dollars

*Excluding aircraft.
Forecast Summary and Key Background Factors

Real GDP Projection

- Percent change, Q4/Q4
- Real GDP including hurricane effects
- Real GDP excluding hurricane effects

Note. Hurricane effects are staff estimates.

PCE Prices

- Four-quarter percent change
- PCE
- Core PCE

Crude Oil Prices

- Quarterly average
- Dollars per barrel
- West Texas Intermediate

Core Non-fuel Import Prices

- Percent change, Q4/Q4
- Current
- Dec. GB

Interest Rates

- Quarterly average
- Percent
- 10-year Treasury rate
- Federal funds rate

Fiscal Impetus

- Percent of GDP
Business Investment

Real E&S Spending and the Acceleration of Business Output

Note. The accelerator is the 8-quarter percent change in business output excluding E&S less the year-earlier 8-quarter percent change. Rate of Return on Capital for Nonfinancial Corporate Business*

Real Nonresidential Structures
Percent change, Q4/Q4

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. NRS</td>
<td>2.1</td>
<td>7.8</td>
<td>3.6</td>
</tr>
<tr>
<td>2. Drilling and mining</td>
<td>18.4</td>
<td>15.9</td>
<td>4.1</td>
</tr>
<tr>
<td>3. Ex. drilling and mining</td>
<td>-2.5</td>
<td>4.5</td>
<td>3.4</td>
</tr>
</tbody>
</table>

Investment and MFP

- Some of the acceleration in MFP this decade can be traced to the investment boom of the late 1990s.
- Embodied technological progress.
- Improvement of business processes.
- Waning adjustment costs.

Investment and MFP by Industry

MFP acceleration from 1995-2000 to 2000-2004*

*The acceleration in MFP is the percent change in MFP between 2000 and 2004 (annual rate) minus the percent change between 1995 and 2000 (annual rate).
Structural labor productivity growth is defined as the increment to labor productivity that can be sustained over time.

### Structural Labor Productivity Growth

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Structural Productivity</td>
<td>3.2</td>
<td>3.1</td>
<td>3.0</td>
</tr>
</tbody>
</table>

**Contributions of:**

1. Capital deepening: 1.0, 0.9, 1.0
2. Labor quality: 0.3, 0.2, 0.2
3. MFP: 2.0, 1.9, 1.8

### Growth in Capital Services

Percent change, Q4/Q4

### Contribution of Capital Deepening

Percent change, Q4/Q4

### Structural MFP

Percent change, Q4/Q4

### Research and Development Expenditures

Billions of 2000 dollars, ratio scale
Potential Output and Labor Market

### Potential Output

<table>
<thead>
<tr>
<th></th>
<th>Percent change, Q4/Q4</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2005</td>
</tr>
<tr>
<td>1. Potential</td>
<td>3.1</td>
</tr>
<tr>
<td>2. Total Hours</td>
<td>0.9</td>
</tr>
<tr>
<td>3. Working-age population</td>
<td>1.2</td>
</tr>
<tr>
<td>4. Labor-force participation</td>
<td>-0.2</td>
</tr>
<tr>
<td>5. Average workweek</td>
<td>-0.2</td>
</tr>
<tr>
<td>6. Structural Productivity</td>
<td>3.2</td>
</tr>
<tr>
<td>7. Technical Factors</td>
<td>-1.0</td>
</tr>
</tbody>
</table>

### Labor Force Participation Rate

- Actual and trend lines for labor force participation rate from 1980 to 2005.

### Average Workweek*

- Actual and trend lines for average workweek from 1996 to 2006 for the nonfarm business sector.

### Nonfarm Payroll Employment

- Average monthly change, thousands from 2003 to 2007.

### Okun’s Law*

- Simulated and actual unemployment rate from 1998 to 2006.

Compensation

Hourly Labor Compensation

Unemployment Gap

Expected Inflation

ECI Equation Errors*

Core PCE Equation Errors*


Exhibit 8

Inflation Outlook

Total Consumer Prices

12-month percent change

Core Consumer Prices

12-month percent change

PCE Energy Prices

Percent change, Q4/Q4

PPI-Intermediate Materials less Food and Energy

Percent change, Q4/Q4

PCE Price Projection

Percent change, Q4/Q4

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Total PCE</td>
<td>3.0</td>
<td>2.3</td>
<td>1.8</td>
</tr>
<tr>
<td>2. Food</td>
<td>2.1</td>
<td>2.4</td>
<td>2.2</td>
</tr>
<tr>
<td>3. Energy</td>
<td>21.5</td>
<td>3.6</td>
<td>0.6</td>
</tr>
<tr>
<td>4. Core</td>
<td>1.9</td>
<td>2.2</td>
<td>1.8</td>
</tr>
<tr>
<td>5. Market based</td>
<td>1.7</td>
<td>2.1</td>
<td>1.7</td>
</tr>
</tbody>
</table>

Core PCE Prices

Four-quarter percent change

- 70% confidence interval
- 90% confidence interval
- Low NAIRU
- Adverse Shocks
The Dollar

Nominal Dollar Indexes

Index, Dec. 31, 2004=100

Weekly

Major

Broad

Other important trading partners

Industrial Country Exchange Rates

Foreign currency/$

Index, Dec. 31, 2004=100

Weekly

Yen

Euro

Canadian dollar

Emerging Market Exchange Rates

Foreign currency/$

Index, Dec. 31, 2004=100

Weekly

Chinese RMB

Korean won

Mexican peso

Brazilian real

*Calculated as U.S. rate minus trade-weighted average of Canada, euro area, Japan, and the United Kingdom.
Foreign Net Financial Inflows

**Foreign Official Inflows**

<table>
<thead>
<tr>
<th>Region</th>
<th>2003</th>
<th>2004</th>
<th>2005*</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td>267</td>
<td>395</td>
<td>221</td>
</tr>
<tr>
<td><strong>Selected Regions:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. G-10 Countries</td>
<td>111</td>
<td>162</td>
<td>-11</td>
</tr>
<tr>
<td>3. Emerging Asia</td>
<td>108</td>
<td>135</td>
<td>190</td>
</tr>
<tr>
<td>4. OPEC</td>
<td>6</td>
<td>12</td>
<td>11</td>
</tr>
<tr>
<td>5. Other</td>
<td>42</td>
<td>86</td>
<td>32</td>
</tr>
</tbody>
</table>

*2005 data are cumulative flows through Nov. 2005, annualized.

**Foreign Private Net Purchases of U.S. Securities**

<table>
<thead>
<tr>
<th>Region</th>
<th>2003</th>
<th>2004</th>
<th>2005*</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td>336</td>
<td>506</td>
<td>704</td>
</tr>
<tr>
<td><strong>By Instrument:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Treasuries</td>
<td>113</td>
<td>123</td>
<td>214</td>
</tr>
<tr>
<td>3. Agency Bonds</td>
<td>-38</td>
<td>66</td>
<td>80</td>
</tr>
<tr>
<td>4. Corporate Bonds</td>
<td>224</td>
<td>255</td>
<td>326</td>
</tr>
<tr>
<td>5. Equities</td>
<td>37</td>
<td>62</td>
<td>84</td>
</tr>
</tbody>
</table>

*2005 data are cumulative flows through Nov. 2005, annualized.

**Emerging Market Debt**

**Net Issuance of Debt Securities**

<table>
<thead>
<tr>
<th>Region</th>
<th>2003</th>
<th>2004</th>
<th>2005*</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td>336</td>
<td>506</td>
<td>704</td>
</tr>
<tr>
<td><strong>By Instrument:</strong></td>
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<tr>
<td>2. Treasuries</td>
<td>113</td>
<td>123</td>
<td>214</td>
</tr>
<tr>
<td>3. Agency Bonds</td>
<td>-38</td>
<td>66</td>
<td>80</td>
</tr>
<tr>
<td>4. Corporate Bonds</td>
<td>224</td>
<td>255</td>
<td>326</td>
</tr>
<tr>
<td>5. Equities</td>
<td>37</td>
<td>62</td>
<td>84</td>
</tr>
</tbody>
</table>

*Spread over 10-year U.S. Treasury bond.
Source: Merrill Lynch and JPMorgan.
Outlook for Foreign Growth and Inflation

Real GDP Projections*

<table>
<thead>
<tr>
<th></th>
<th>H1</th>
<th>H2</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Total Foreign</td>
<td>3.2</td>
<td>4.1</td>
</tr>
<tr>
<td>2. Industrial Countries</td>
<td>2.6</td>
<td>2.6</td>
</tr>
<tr>
<td>3. Euro Area</td>
<td>1.4</td>
<td>2.0</td>
</tr>
<tr>
<td>4. Japan</td>
<td>5.3</td>
<td>1.5</td>
</tr>
<tr>
<td>5. Canada</td>
<td>2.7</td>
<td>3.3</td>
</tr>
<tr>
<td>6. Emerging Markets</td>
<td>4.0</td>
<td>6.3</td>
</tr>
<tr>
<td>7. Mexico</td>
<td>-0.3</td>
<td>6.1</td>
</tr>
<tr>
<td>8. China</td>
<td>9.5</td>
<td>10.2</td>
</tr>
</tbody>
</table>

*Weighted by non-oil U.S. imports.

Consumer Prices*

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Emerging markets</td>
<td>40</td>
<td>55</td>
<td>70</td>
</tr>
<tr>
<td>Average foreign</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industrial countries</td>
<td>85</td>
<td>100</td>
<td>115</td>
</tr>
</tbody>
</table>

Japan

Corporate Debt, Investment, and Labor Market

Bank Credit and Land Prices

China

Nominal GDP

External Trade

*Aggregates weighted by U.S. exports.

**Years are Q4/Q4; half years are Q2/Q4 or Q4/Q2.
Trade Prices

Commodity Prices
Index, Jan. 2005=100
$/barrel

Monthly

WTI spot

Non-fuel commodities

Broad Real Dollar
Index, 2005:Q1=100
Quarterly

Core Import Prices
Percent change
Quarterly

Core import price*

Core non-fuel

Trade Developments
Trade in Goods and Services
Billions of dollars, a.r.

<table>
<thead>
<tr>
<th>Q3</th>
<th>O-N*</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>-731</td>
<td>-794</td>
<td>-63</td>
</tr>
</tbody>
</table>

Exports:
2. G & S 1283 1300 17
4. Ind. Sup. 236 231 -5
5. Other 684 692 8

Imports:
6. G & S 2014 2094 80
7. Cons. Goods 404 408 4
9. Ind. Sup.** 263 293 30
10. Oil 270 300 30
11. Other 693 708 15

*Average of October and November data.
**Excludes oil.

Real imports

Real exports*

*Includes petroleum products.
U.S. External Sector

Real Exports and Imports

Contributions to U.S. GDP Growth

Current Account

Current Account Forecasts

Change in Current Account Balance

*Half years are Q2/Q4 or Q4/Q2.

*Difference in levels of annualized series.

Source 2005 2006 2007
1. Jan. GB -818 -945 -1053
2. OECD -806 -890 -980
3. Consensus -793 -828 -831
4. Macro Advisors** -807 -871 -887
5. Global Insight -816 -909 -928

*OECD forecast from November; other forecasts from January.
**Adjusted to BOP basis by staff.
### ECONOMIC PROJECTIONS FOR 2006

<table>
<thead>
<tr>
<th></th>
<th>FOMC</th>
<th></th>
<th>Staff</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Range</td>
<td>Central Tendency</td>
<td></td>
</tr>
<tr>
<td>Nominal GDP</td>
<td>5¼ to 6½</td>
<td>(5 to 6)</td>
<td>6.4</td>
</tr>
<tr>
<td>July 2005</td>
<td>5½ to 6</td>
<td>(5¼ to 5½)</td>
<td>(5.4)</td>
</tr>
<tr>
<td>Real GDP</td>
<td>3¼ to 4</td>
<td>(3¼ to 3¾)</td>
<td>3.9</td>
</tr>
<tr>
<td>July 2005</td>
<td>About 3½</td>
<td>(3¼ to 3½)</td>
<td>(3.4)</td>
</tr>
<tr>
<td>Core PCE Prices</td>
<td>1¾ to 2½</td>
<td>(1¾ to 2%)</td>
<td>2.2</td>
</tr>
<tr>
<td>July 2005</td>
<td>About 2</td>
<td>(1¾ to 2)</td>
<td>(1.9)</td>
</tr>
</tbody>
</table>

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<p>| | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Nominal GDP</td>
<td>Percentage change, Q4 to Q4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>July 2005</td>
<td>5 to 6</td>
<td>5 to 5¼</td>
<td>5.0</td>
</tr>
<tr>
<td>Real GDP</td>
<td>3 to 4</td>
<td>3 to 3½</td>
<td>3.0</td>
</tr>
<tr>
<td>Core PCE Prices</td>
<td>1¾ to 2</td>
<td>1¾ to 2</td>
<td>1.8</td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
<th></th>
<th>Average level, Q4, percent</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Unemployment rate</td>
<td>4½ to 5</td>
<td>4¾ to 5</td>
<td>5.1</td>
</tr>
<tr>
<td>July 2005</td>
<td>(5)</td>
<td>(5)</td>
<td>(5.1)</td>
</tr>
</tbody>
</table>

Central tendencies calculated by dropping high and low three from ranges.

### ECONOMIC PROJECTIONS FOR 2007

<table>
<thead>
<tr>
<th></th>
<th>FOMC</th>
<th></th>
<th>Staff</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Range</td>
<td>Central Tendency</td>
<td></td>
</tr>
<tr>
<td>Nominal GDP</td>
<td>5 to 6</td>
<td>5 to 5¼</td>
<td>5.0</td>
</tr>
<tr>
<td>Real GDP</td>
<td>3 to 4</td>
<td>3 to 3½</td>
<td>3.0</td>
</tr>
<tr>
<td>Core PCE Prices</td>
<td>1¾ to 2</td>
<td>1¾ to 2</td>
<td>1.8</td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
<th></th>
<th>Average level, Q4, percent</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Unemployment rate</td>
<td>4½ to 5</td>
<td>4¾ to 5</td>
<td>5.1</td>
</tr>
</tbody>
</table>
Appendix 3: Materials used by Mr. Reinhart
Exhibit 1
Policy Considerations

Probability of a 25 Basis Point Tightening at Upcoming FOMC Meetings*

<table>
<thead>
<tr>
<th>Month</th>
<th>Probability (Percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan.</td>
<td>80</td>
</tr>
<tr>
<td>Mar.</td>
<td>60</td>
</tr>
<tr>
<td>May</td>
<td>40</td>
</tr>
</tbody>
</table>

*Estimated from federal funds futures.

Expected Federal Funds Rates*

Jan. 30, 2006
December 12, 2005

*Estimates from federal funds and Eurodollar futures, with an allowance for term premia and other adjustments.

Range of Estimated Equilibrium Real Rates

- Red: Range of model-based estimates
- Black: Actual real federal funds rate
- Sky blue: 70 percent confidence band
- Light blue: 90 percent confidence band
- Green: Greenbook-consistent measure

An explanatory note is provided in Chart 7 of the Bluebook.

Nominal Federal Funds Rate

Real Federal Funds Rate

Note. The real federal funds rate is the nominal funds rate less four-quarter core PCE inflation.
Two Key Wording Questions

1. How high are the odds you place on tightening at the March meeting?

2. How much do you want to emphasize dependence on the data?

Alternative B

The Committee judges that some further policy firming may well be needed to keep the risks to the attainment of both sustainable economic growth and price stability roughly in balance.

In any event, the Committee will respond to changes in economic prospects as needed to foster these objectives.

Greater Emphasis on Data Dependence

The Committee will respond to changes in economic prospects as needed to foster the attainment of both sustainable economic growth and price stability.

In these circumstances, the Committee judges that some further policy firming may well be needed to keep the risks to those objectives roughly in balance.
Exhibit 3
Ownership of the Statement

Options

1. Vote on the entire statement and the directive.

2. Vote on the directive and assessment of risks. Clarify ownership of the remaining portions of the statement by voting to authorize the Chairman to provide a rationale for that action.

3. Retain the status quo.

Vote Under Option 1

**Directive Wording**
The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with increasing the federal funds rate to an average of around 4½ percent.

**Statement Language**
The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 4½ percent.

Although recent economic data have been uneven, the expansion in economic activity appears solid. Core inflation has stayed relatively low in recent months and longer-term inflation expectations remain contained. Nevertheless, possible increases in resource utilization as well as elevated energy prices have the potential to add to inflation pressures.

The Committee judges that some further policy firming may well be needed to keep the risks to the attainment of both sustainable economic growth and price stability roughly in balance. In any event, the Committee will respond to changes in economic prospects as needed to foster these objectives.

Vote Under Option 2

**Directive Wording**
The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee in the immediate future seeks conditions in reserve markets consistent with increasing the federal funds rate to an average of around 4½ percent.

**Risk Assessment**
The Committee judges that some further policy firming may well be needed to keep the risks to the attainment of both sustainable economic growth and price stability roughly in balance. In any event, the Committee will respond to changes in economic prospects as needed to foster these objectives.

**Rationale Language**
The Committee authorizes the Chairman to provide a rationale for the policy action in the statement to be released after this meeting.
<table>
<thead>
<tr>
<th>December FOMC</th>
<th>Alternative A</th>
<th>Alternative B</th>
<th>Alternative C</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Policy Decision</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 4¼ percent.</td>
<td>The Federal Open Market Committee decided today to keep its target for the federal funds rate unchanged by 25 basis points to at 4¼ percent.</td>
<td>The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 4½ percent.</td>
<td>The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 4½ percent.</td>
</tr>
<tr>
<td><strong>Rationale</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Despite elevated energy prices and hurricane-related disruptions, the expansion in economic activity appears solid.</td>
<td>Although recent economic data have been uneven Despite elevated energy prices and hurricane-related disruptions, the expansion in economic activity appears solid.</td>
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<tr>
<td>3. Core inflation has stayed relatively low in recent months and longer-term inflation expectations remain contained. Nevertheless, possible increases in resource utilization as well as elevated energy prices have the potential to add to inflation pressures.</td>
<td>While possible increases in resource utilization as well as elevated energy prices have the potential to add to inflation pressures, core inflation has stayed relatively low in recent months. Moreover, longer-term inflation expectations remain contained.</td>
<td>[Unchanged]</td>
<td>While core inflation has stayed relatively low in recent months and longer-term inflation expectations remain contained, Nevertheless, possible increases in resource utilization as well as elevated energy and other cost pressures have the potential to add to boost underlying inflation pressures.</td>
</tr>
<tr>
<td><strong>Assessment of Risk</strong></td>
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<tr>
<td>4. The Committee judges that some further measured policy firming is likely to be needed to keep the risks to the attainment of both sustainable economic growth and price stability roughly in balance.</td>
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<td>[Unchanged]</td>
</tr>
<tr>
<td>5. In any event, the Committee will respond to changes in economic prospects as needed to foster these objectives.</td>
<td>[Unchanged]</td>
<td>[Unchanged]</td>
<td>[Unchanged]</td>
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