

## **Part 1**

October 26, 2005

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## **CURRENT ECONOMIC AND FINANCIAL CONDITIONS**

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### **Summary and Outlook**

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## **Summary and Outlook**

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

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

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

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

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

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

### Decomposition of Structural Labor Productivity

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

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

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

1. Percentage points.

### The Outlook for the Labor Market

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

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

1. Percent, average for the fourth quarter

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

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

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

1. December to December.

less than 2 percent. Overall PCE prices, held down by falling energy prices, are projected to post increases of 2 percent and 1½ percent, respectively, in 2006 and 2007. With regard to labor compensation, we expect a pickup in rates of increase in both the P&C measure of hourly compensation and the ECI next year, reflecting in part the pass-through of higher overall price inflation to compensation. In 2007, both measures decelerate slightly, reflecting the slower pace of price inflation.

### Financial Flows and Conditions

Our forecast for the growth of domestic nonfinancial debt has been revised down a bit, on balance, but its basic contour has not changed. We still expect the growth of this debt

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

Measure and scenario	2005		2006		2007
	H1	H2	H1	H2	
<i>Real GDP</i>					
<b>Baseline</b>			<b>3.6</b>	<b>3.4</b>	<b>3.8</b>
Unanchored inflation expectations			3.6	3.4	3.6
With monetary policy response			3.6	3.4	3.6
Stagflation			3.6	3.4	3.1
With monetary policy response			3.6	3.4	3.1
Low inflation			3.6	3.4	3.9
With monetary policy response			3.6	3.4	3.9
Spending boom			3.6	3.5	4.2
With monetary policy response			3.6	3.5	4.2
Higher funds rate path			3.6	3.4	3.8
<i>Civilian unemployment rate<sup>1</sup></i>					
<b>Baseline</b>			<b>5.1</b>	<b>5.0</b>	<b>5.0</b>
Unanchored inflation expectations			5.1	5.0	5.0
With monetary policy response			5.1	5.0	5.0
Stagflation			5.1	5.0	5.1
With monetary policy response			5.1	5.0	5.3
Low inflation			5.1	5.0	5.0
With monetary policy response			5.1	5.0	5.0
Spending boom			5.1	5.0	4.9
With monetary policy response			5.1	5.0	4.9
Higher funds rate path			5.1	5.0	5.0
<i>PCE prices</i>					
<i>excluding food and energy</i>					
<b>Baseline</b>			<b>2.1</b>	<b>1.8</b>	<b>2.4</b>
Unanchored inflation expectations			2.1	1.8	2.7
With monetary policy response			2.1	1.8	2.7
Stagflation			2.1	1.8	2.6
With monetary policy response			2.1	1.8	2.6
Low inflation			2.1	1.8	2.2
With monetary policy response			2.1	1.8	2.2
Spending boom			2.1	1.8	2.4
With monetary policy response			2.1	1.8	2.4
Higher funds rate path			2.1	1.8	2.4

1. Average for the final quarter of the period.

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

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

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

1. 1978–2004.

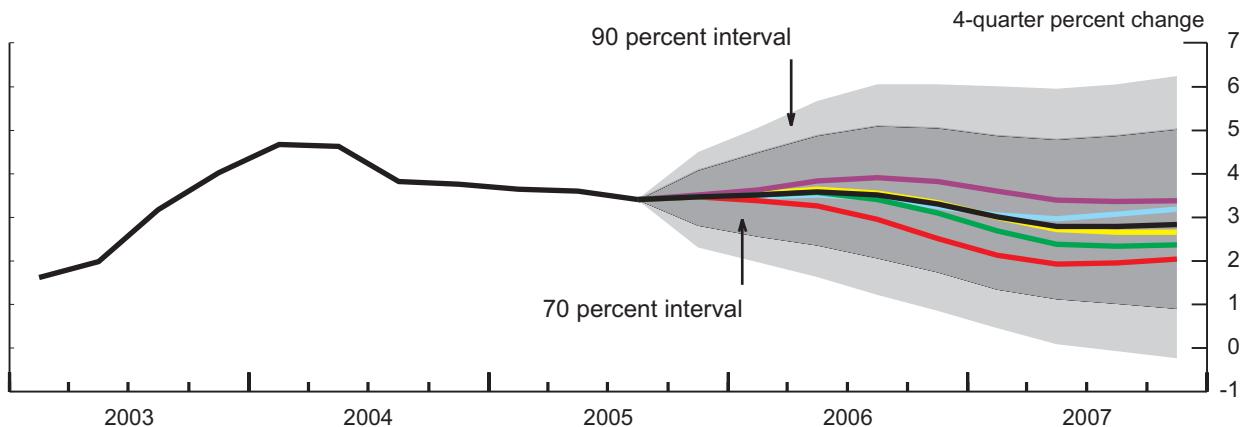
2. 1981–2004.

## Forecast Confidence Intervals and Alternative Scenarios

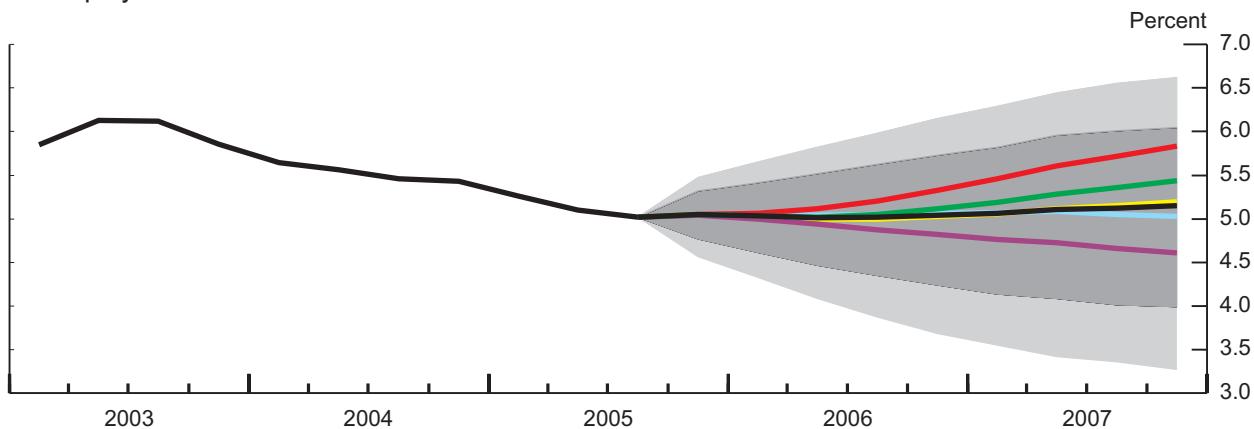
Confidence Intervals Based on FRB/US Stochastic Simulations  
Scenarios Assume Baseline Federal Funds Rate

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

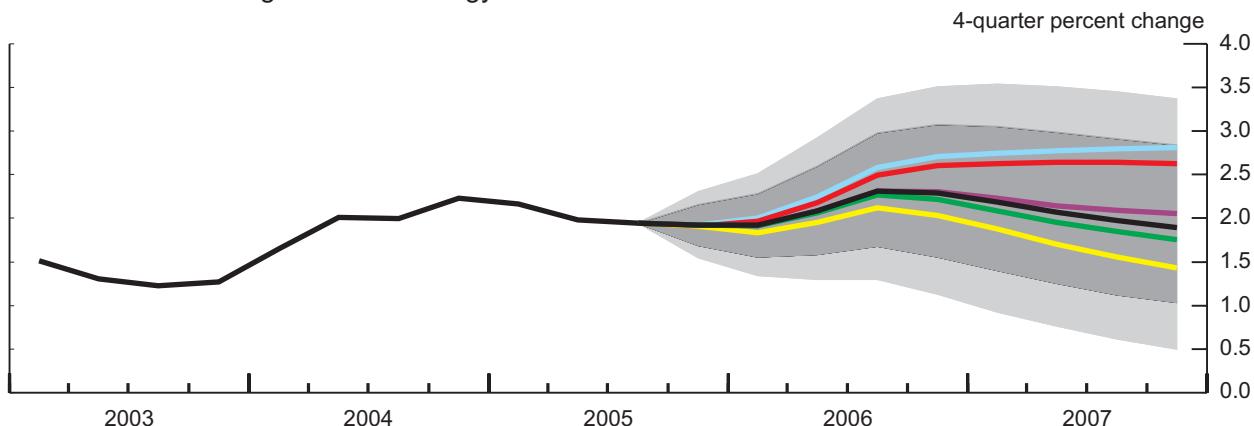
Real GDP



Unemployment Rate



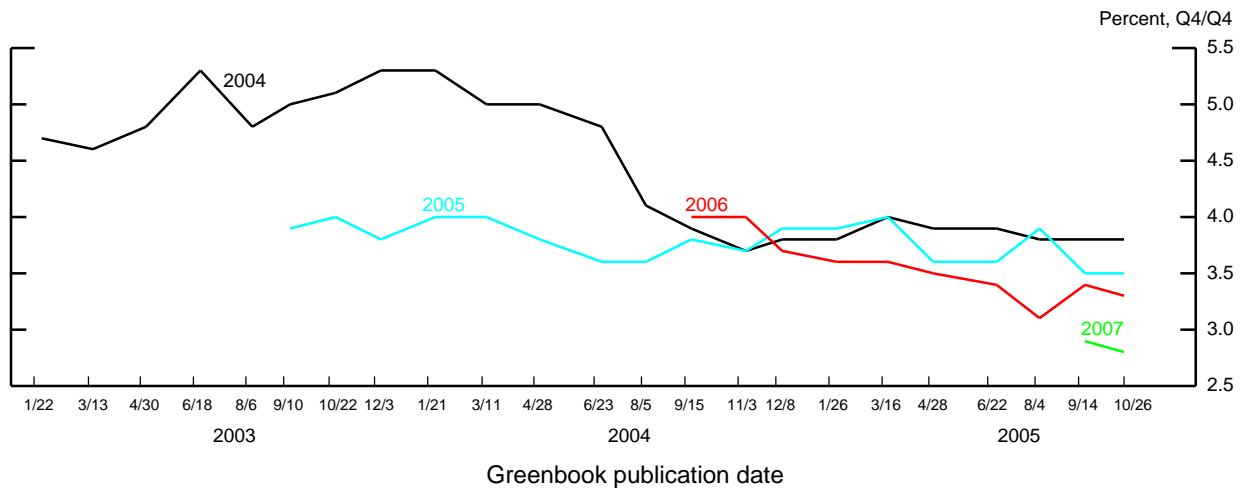
PCE Prices excluding Food and Energy



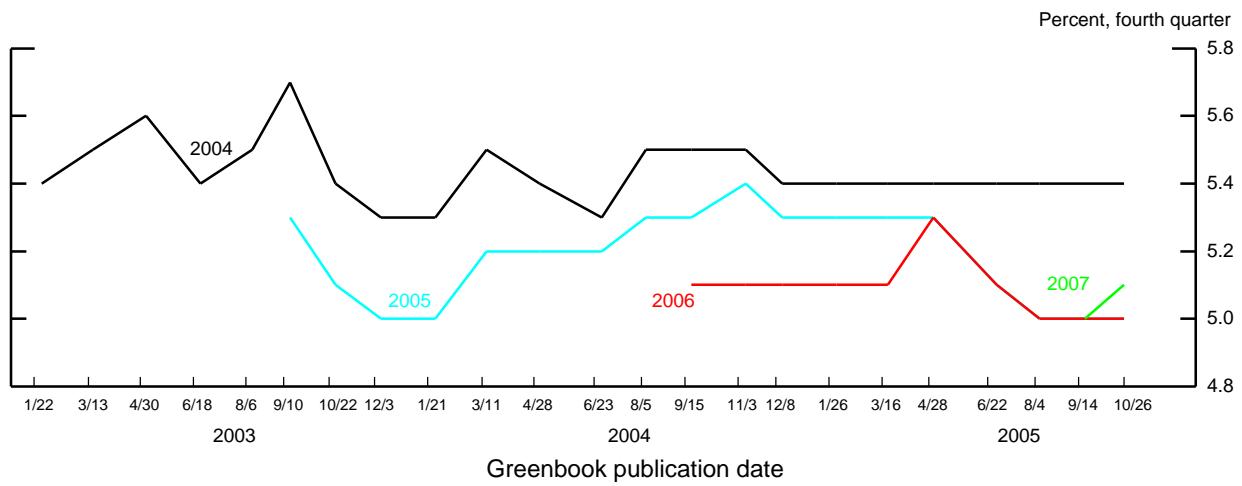
Class II FOMC - Restricted (FR)

**Evolution of the Staff Forecast**

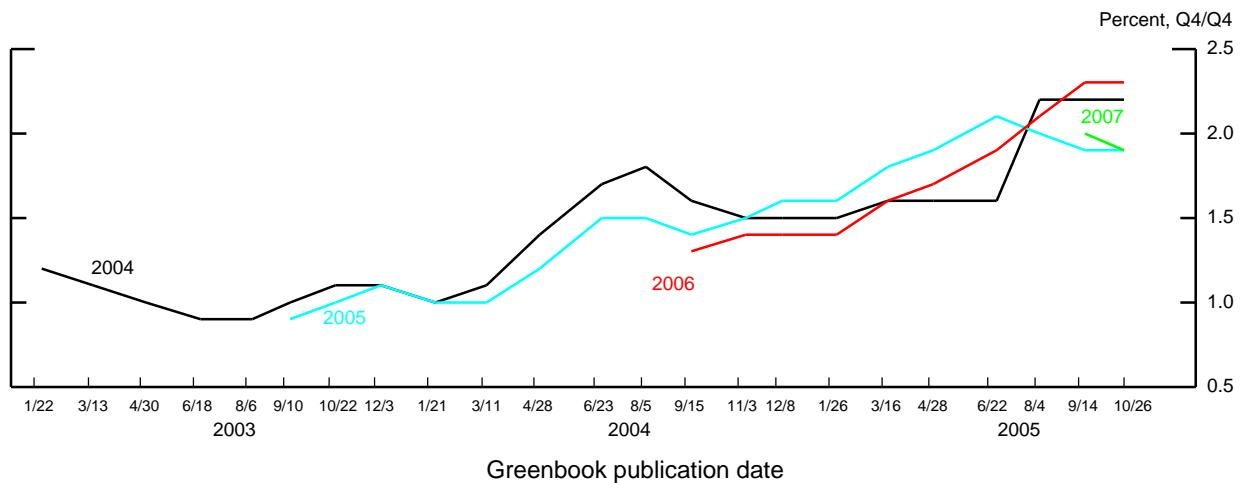
Change in Real GDP



Unemployment Rate



Change in PCE Prices excluding Food and Energy



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

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

1. Level, except for two-quarter and four-quarter intervals.

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

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

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

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

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

2. Billions of chained (2000) dollars.

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

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

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

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

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

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

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

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

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

2. Private-industry workers.

## Other Macroeconomic Indicators

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

1. Change from fourth quarter of previous year to fourth quarter of year indicated, unless otherwise indicated.

2. Change, millions.

3. Percent, annual values are for the fourth quarter of the year indicated.

4. Percent difference between potential and actual GDP; a positive number indicates that the economy is operating below potential; annual values are for the fourth quarter of the year indicated.

5. Percent change, annual rate.

6. Level, millions, annual values are annual averages.

7. Percent change, annual rate, with inventory valuation and capital consumption adjustments.

8. Billions of dollars, annual values are annual averages.

Item	Fiscal year			2005				2006				2007				
	2004 <sup>a</sup>	2005 <sup>a</sup>	2006	2007	Q1 <sup>a</sup>	Q2 <sup>a</sup>	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<b>Unified budget</b>																
Receipts <sup>1</sup>	1880	2154	2294	2404	452	665	550	525	485	718	565	554	514	746	590	585
Outlays <sup>1</sup>	2293	2473	2648	2763	628	620	619	651	681	664	652	685	716	693	669	729
Surplus/deficit <sup>1</sup>	-413	-319	-354	-359	-177	45	-69	-125	-196	54	-87	-131	-202	53	-79	-144
Previous	-413	-339	-380	-385	-177	45	-90	-131	-200	44	-93	-139	-206	45	-85	-153
On-budget	-568	-494	-532	-552	-202	-37	-84	-185	-217	-30	-100	-193	-228	-36	-95	-208
Off-budget	155	175	178	193	25	83	15	59	21	84	13	62	26	89	16	64
Means of financing																
Borrowing	378	296	361	371	165	-43	73	112	179	-25	95	121	186	-24	87	134
Cash decrease	-1	1	0	-12	2	-11	-2	10	16	-25	0	10	15	-25	0	10
Other <sup>2</sup>	36	21	-8	10	8	-1	4	1	-4	-8	-8	0	0	-4	-8	-0
Cash operating balance, end of period	36	36	35	35	22	33	36	26	10	35	35	25	10	35	35	25
<b>NIPA federal sector</b>																
Receipts	1933	2173	2370	2481	2197	2240	2201	2315	2359	2390	2416	2442	2467	2491	2525	2540
Expenditures	2348	2503	2731	2872	2495	2525	2566	2628	2734	2768	2793	2811	2876	2888	2912	2930
Consumption expenditures	711	759	808	838	760	763	779	789	807	814	820	825	839	843	847	850
Defense	474	508	544	565	509	512	522	531	543	548	552	556	568	570	573	573
Nondefense	237	251	264	274	251	251	257	258	264	266	268	269	274	275	276	278
Other spending	1637	1744	1923	2033	1735	1762	1787	1839	1927	1954	1973	1986	2037	2046	2065	2080
Current account surplus	-415	-330	-361	-390	-298	-286	-365	-313	-375	-378	-377	-369	-408	-397	-386	-390
Gross investment	99	106	115	117	101	107	110	113	116	116	116	117	117	117	117	117
Gross saving less gross investment <sup>3</sup>	-421	-339	-376	-403	-302	-295	-378	-328	-391	-393	-391	-382	-421	-409	-397	-400
<b>Fiscal indicators<sup>4</sup></b>																
High-employment (HEB) surplus/deficit	-377	-317	-369	-394	-279	-276	-361	-314	-384	-390	-389	-377	-414	-399	-386	-387
Change in HEB, percent of potential GDP	0.7	-0.7	0.3	0.0	-0.6	-0.1	0.6	-0.4	0.5	0.0	-0.1	0.2	-0.1	-0.1	-0.1	-0.0
Fiscal impetus (FI) percent of GDP	0.8	0.3	0.5	0.0	0.0	0.1	0.1	0.1	0.2	0.1	0.0	-0.0	0.0	0.0	0.0	-0.0
Previous	0.8	0.3	0.5	0.0	0.0	0.1	0.1	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	-0.0

1. Budget receipts, outlays, and surplus/deficit include corresponding social security (OASDI) categories. The OASDI surplus and the Postal Service surplus are excluded from the on-budget surplus and shown separately as off-budget, as classified under current law.

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

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

4. HEB is gross saving less gross investment (NIPA) of the federal government in current dollars, with cyclically sensitive receipts and outlays adjusted to the staff's measure of potential output and the NAIRU. Quarterly figures for change in HEB and FI are not at annual rates. The sign on Change in HEB, as a percent of nominal potential GDP, is reversed. FI is the weighted difference of discretionary changes in federal spending and taxes in chained (2000) dollars, scaled by real GDP. The annual FI estimates are on a calendar year basis. Also, for FI and the change in HEB, positive values indicate aggregate demand stimulus.

a-Actual

**Class II FOMC  
Restricted (FR)**

Change in Debt of the Domestic Nonfinancial Sectors  
(Percent)

October 26, 2005

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

Note. Quarterly data are at seasonally adjusted annual rates.

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

2.6.3 FOF

**Class II FOMC  
Restricted (FR)**

October 26, 2005

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

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

Note. Data after 2005: Q2 are staff projections.

1. For corporations: Excess of capital expenditures over U.S. internal funds.

2. Includes change in liabilities not shown in lines 8 and 9.

3. Average debt levels in the period (computed as the average of period-end debt positions) divided by disposable personal income.

2.6.4 FOF

4. NIPA state and local government saving plus consumption of fixed capital and net capital transfers.

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

6. Excludes government-insured mortgage pool securities.

n.s.a. Not seasonally adjusted.

## International Developments

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

### Summary of Staff Projections

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

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

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

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

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

we continue to assume that the expiration of the Multi-fiber Arrangement will exert downward pressure on core import prices over the forecast period.

### Staff Projections of Selected Trade Prices

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

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

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

The price of imported oil for multi-quarter periods is the price for the final quarter of the period. Imported oil includes both crude oil and refined products.

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

### Trade in Goods and Services

Taking into account August trade data, Hurricanes Katrina and Rita, and the Boeing strike, we estimate that both imports and exports turned in weak performances in the third quarter. With exports expanding modestly and imports edging down, net exports of goods and services are estimated to have boosted U.S. GDP growth about  $\frac{1}{4}$  percentage point. The contribution of net exports is projected to return to negative territory in the fourth quarter, subtracting about  $\frac{1}{4}$  percentage point, as a rebound in imports is not fully offset by rapid growth of exports. The external sector is projected to boost growth by about  $\frac{1}{4}$  percentage point for 2005 as a whole but is projected to subtract about  $\frac{1}{3}$  percentage point from growth in 2006 and 2007. Since the September Greenbook, our projection of the contribution of net exports has been revised up (made less negative) for the fourth quarter, but our forecast is little changed thereafter.

#### Staff Projections for Trade in Goods and Services

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

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

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

After contracting slightly in the second quarter, real imports of goods and services are estimated to have fallen about  $\frac{1}{2}$  percent at an annual rate in the third quarter, rather than rising a bit as projected in the September Greenbook. This revision owes importantly to widespread weakness in the August nominal trade data. In August, nominal imports rebounded from a weak July, but not by as much as we had anticipated, especially for core goods. Core imports are now projected to have contracted about 1 percent in the third quarter, substantially weaker growth than would be predicted by U.S. GDP and relative prices alone. Core imports are assumed to have been held back by the effects of recent weather in the Gulf region, which we think restrained non-oil merchandise imports in September. These effects are expected to dissipate by November. Shipping has gradually been returning to the affected area; the first container ship called at the Port of

period. The shock exerts a small stimulative effect on U.S. output, with real GDP growth rising about 0.2 percentage point above baseline by the latter half of 2006. Real U.S. exports rise as the effects of the contraction in foreign activity are more than offset by the decline in the real dollar.

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

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

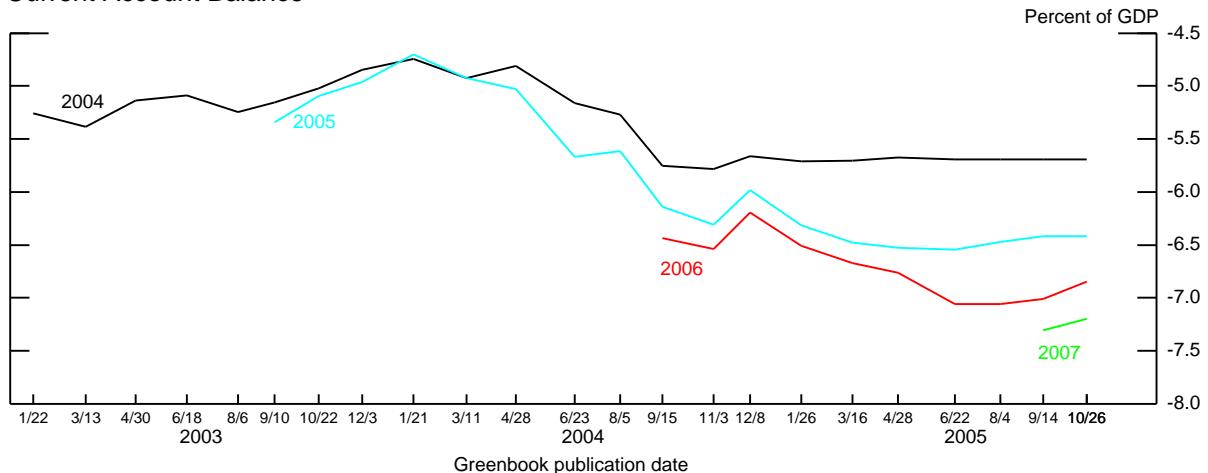
Indicator and simulation	2005		2006		2007	
	H1	H2	H1	H2	H1	H2
<i>U.S. real GDP</i>						
Baseline	3.6	3.4	3.8	2.8	2.8	2.9
Higher inflation abroad	3.6	3.3	3.8	3.0	3.1	3.1
Weaker dollar	3.6	3.4	4.5	3.5	3.4	3.1
<i>U.S. PCE prices excluding food and energy</i>						
Baseline	2.1	1.8	2.4	2.2	1.9	1.9
Higher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

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

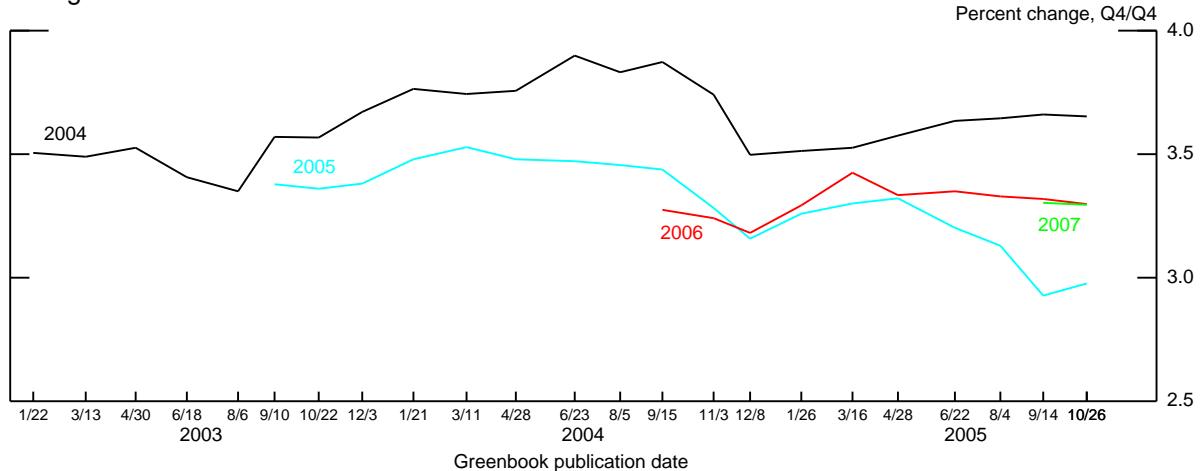
Class II FOMC -- Restricted (FR)

**Evolution of the Staff Forecast**

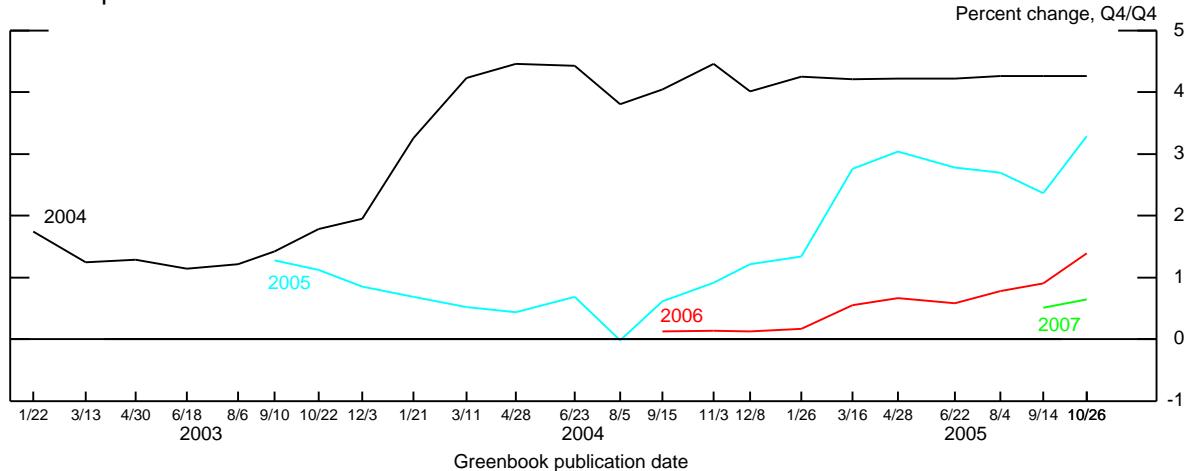
Current Account Balance



Foreign Real GDP



Core Import Prices



Class II FOMC  
Restricted (FR) OUTLOOK FOR FOREIGN REAL GDP AND CONSUMER PRICES: SELECTED COUNTRIES  
(Percent, Q4 to Q4)

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

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

Measure and country	2005				2006				Projected 2007			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<b>REAL GDP (1)</b>												
Total foreign	2.5	3.2	3.1	3.1	3.2	3.3	3.3	3.3	3.3	3.3	3.3	3.3
Industrial Countries of which:	2.0	2.8	2.3	2.3	2.6	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Canada	2.1	3.2	3.1	3.0	3.5	3.4	3.3	3.2	3.1	3.1	3.1	3.1
Japan	5.8	3.3	1.0	1.4	1.5	1.5	1.6	1.7	1.6	1.6	1.6	1.5
United Kingdom	1.0	2.0	1.5	2.2	2.1	2.2	2.2	2.2	2.3	2.3	2.3	2.4
Euro Area (2)	1.5	1.2	1.6	1.4	1.5	1.5	1.6	1.6	1.7	1.7	1.8	1.8
Germany	3.0	0.0	1.4	1.1	1.1	1.2	1.2	1.3	1.4	1.5	1.5	1.6
Developing Countries	3.1	3.7	4.4	4.3	4.2	4.5	4.5	4.5	4.5	4.5	4.5	4.5
Asia	4.5	6.9	6.0	5.1	4.7	5.1	5.2	5.2	5.3	5.3	5.3	5.3
Korea	1.2	5.0	7.5	3.5	3.7	3.9	3.9	3.9	4.1	4.1	4.1	4.1
China	1.4	0.2	2.8	8.2	5.6	7.4	7.4	7.4	7.4	7.4	7.4	7.4
Latin America	0.7	-1.7	2.6	3.2	3.7	3.8	3.8	3.8	3.7	3.7	3.7	3.7
Mexico	1.5	5.8	2.8	3.1	3.1	3.6	3.8	3.8	3.7	3.7	3.7	3.7
Brazil												
<b>CONSUMER PRICES (3)</b>												
Industrial Countries of which:	1.4	1.4	1.8	1.7	1.9	1.8	1.5	1.3	1.4	1.5	1.5	1.6
Canada	2.1	1.9	2.6	2.7	2.8	2.5	2.0	1.7	1.9	2.0	1.9	2.0
Japan	-0.4	-0.4	-0.5	-0.8	-0.8	-0.2	-0.2	-0.2	0.3	0.3	0.4	0.4
United Kingdom (4)	1.7	1.9	2.4	2.5	2.5	2.4	2.0	1.9	1.9	1.9	2.0	2.0
Euro Area (2)	2.0	2.0	2.3	2.3	2.3	2.4	2.0	1.5	1.7	1.8	1.8	1.9
Germany	1.7	1.6	2.1	2.1	2.1	2.4	2.1	1.4	1.4	1.4	1.5	1.5
Developing Countries	3.5	3.3	3.1	3.3	3.6	3.8	3.7	3.7	3.6	3.6	3.5	3.4
Asia	2.9	2.4	2.4	3.0	3.4	3.8	3.6	3.5	3.3	3.2	3.1	3.3
Korea	3.1	3.0	2.4	3.2	3.6	4.0	4.2	4.1	3.9	3.6	3.3	3.0
China	2.8	1.7	1.3	1.9	2.2	3.0	3.2	3.3	3.2	3.1	3.0	2.8
Latin America	4.9	5.0	4.4	3.7	3.9	3.7	3.8	4.0	4.0	4.0	4.0	4.0
Mexico	4.4	4.5	4.0	3.1	3.5	3.3	3.4	3.6	3.6	3.7	3.7	3.7
Brazil	7.4	7.7	6.2	5.6	4.8	4.1	4.5	4.5	4.3	4.3	4.2	4.1

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

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

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

	2002								2003				2004				
	Q1		Q2		Q3		Q4		Q1		Q2		Q3		Q4		
	NIPA REAL EXPORTS and IMPORTS								Percentage point contribution to GDP growth								
Net Goods & Services	-1.0	-0.6	-0.5	-1.5	0.1	-0.7	0.5	-0.5	-1.2	-1.4	-0.2	-0.5	-1.0	-0.2	-0.5	-1.0	
Exports of G&S	0.5	1.0	0.3	-0.3	-0.2	-0.4	-0.4	-0.5	0.5	0.7	0.7	0.7	0.7	0.7	0.7	0.7	
Imports of G&S	-1.4	-1.6	-0.8	-1.2	0.0	-1.2	0.0	-0.6	-2.2	-1.6	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	
Percentage change from previous period, s.a.a.r.																	
Exports of G&S Services	5.2	10.6	2.9	-3.1	-2.9	-2.1	11.5	19.1	5.0	6.9	5.5	7.1	5.5	7.1	5.5	7.1	
Computers	22.9	2.7	4.6	11.7	-11.9	-6.6	17.2	23.7	-0.4	4.8	-0.6	15.5	-0.6	15.5	-0.6	15.5	
Semiconductors	-21.1	14.7	-6.0	12.6	-5.7	0.2	35.9	18.7	-7.4	1.6	21.7	11.5	21.7	11.5	21.7	11.5	
Other Goods 1/	-22.3	42.1	12.6	-25.0	34.8	33.9	43.7	43.2	7.0	-4.8	-19.4	-5.5	-19.4	-5.5	-19.4	-5.5	
Imports of G&S Services	-1.6	12.5	2.0	-9.1	0.0	-2.0	5.5	15.4	8.6	9.2	9.5	3.8	9.2	9.5	9.2	9.5	
Oil	11.7	12.5	5.7	9.0	-2.5	3.3	4.1	16.5	12.0	14.5	4.7	11.3	4.7	11.3	4.7	11.3	
Computers	24.7	-3.0	1.7	14.0	-2.2	-10.2	21.4	10.7	10.0	13.7	4.6	3.1	4.6	3.1	4.6	3.1	
Semiconductors	-9.8	-10.3	-12.7	64.3	-9.0	7.8	-1.3	9.5	35.7	-26.0	-0.5	45.0	-0.5	45.0	-0.5	45.0	
Other Goods 2/	52.2	5.3	2.8	-0.2	11.5	12.4	8.7	36.4	21.2	34.3	25.3	9.5	25.3	9.5	25.3	9.5	
Net Goods & Services	39.8	34.8	-6.2	-14.0	-6.7	1.5	-3.7	8.9	42.6	20.2	4.7	-20.3	4.7	-20.3	4.7	-20.3	
Exports of G&S	7.6	19.4	9.5	4.3	-2.6	5.8	0.7	17.7	8.4	20.4	9.7	9.7	9.7	9.7	9.7	9.7	
Billions of Chained 2000 Dollars, s.a.a.r.																	
Net Goods & Services	-441.3	-458.9	-472.2	-513.0	-510.7	-528.4	-516.2	-530.2	-530.2	-563.0	-601.7	-606.5	-634.1	-606.5	-634.1	-606.5	
Exports of G&S	992.8	1018.0	1025.2	1017.2	1009.7	1004.5	1032.2	1078.4	1078.4	1091.8	1110.2	1125.0	1144.5	1110.2	1125.0	1144.5	
Imports of G&S	1434.0	1476.9	1497.4	1530.2	1520.4	1532.9	1548.4	1608.6	1608.6	1654.8	1711.9	1731.5	178.6	1711.9	1731.5	178.6	
Billions of dollars, s.a.a.r.																	
US CURRENT ACCOUNT BALANCE	-440.4	-477.1	-480.3	-503.0	-546.6	-515.9	-501.0	-584.4	-584.4	-666.5	-667.9	-753.4	-753.4	-667.9	-753.4	-753.4	
Current Account as % of GDP	-4.3	-4.6	-4.6	-4.7	-5.1	-4.8	-4.7	-4.5	-4.5	-5.1	-5.7	-6.3	-6.3	-5.7	-6.3	-6.3	
Net Goods & Services (BOP)	-372.7	-413.8	-430.3	-467.9	-499.3	-491.4	-490.8	-497.7	-497.7	-555.4	-608.2	-629.9	-676.9	-608.2	-629.9	-676.9	
Investment Income, Net	11.4	1.8	14.1	34.5	29.3	50.6	50.9	76.5	76.5	29.6	30.8	18.8	18.8	29.6	30.8	18.8	
Direct, Net	100.5	91.4	95.0	112.2	102.3	117.4	119.9	147.8	147.8	140.3	116.3	121.4	133.7	140.3	116.3	121.4	133.7
Portfolio, Net	-89.2	-89.6	-80.9	-77.7	-72.9	-66.8	-69.0	-71.3	-71.3	-74.6	-86.7	-90.6	-114.9	-86.7	-90.6	-114.9	
Other Inc. & Transfers, Net	-79.0	-65.1	-64.2	-69.6	-76.6	-74.4	-76.0	-79.7	-79.7	-88.0	-88.0	-68.8	-95.3	-88.0	-68.8	-95.3	

1. Merchandise exports excluding computers and semiconductors.

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

OUTLOOK FOR U.S. INTERNATIONAL TRANSACTIONS

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

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

## **Part 2**

October 26, 2005

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## **CURRENT ECONOMIC AND FINANCIAL CONDITIONS**

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### **Recent Developments**

October 26, 2005

## **Recent Developments**

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**Broad Measures of Inflation**  
(Percent change, Q2 to Q2)

Measure	2002	2003	2004	2005
<i>Product prices</i>				
GDP price index	1.6	2.0	2.8	2.5
Less food and energy	2.1	1.8	2.5	2.5
Nonfarm business chain price index	1.0	1.2	2.2	2.4
<i>Expenditure prices</i>				
Gross domestic purchases price index	1.4	2.1	3.0	2.9
Less food and energy	1.9	1.7	2.5	2.4
PCE price index	1.2	1.8	2.7	2.5
Less food and energy	1.8	1.3	2.0	2.0
PCE price index, market-based components	.9	1.7	2.5	2.4
Less food and energy	1.5	1.2	1.5	1.6
CPI	1.3	2.2	2.8	2.9
Less food and energy	2.4	1.5	1.8	2.2
Chained CPI	1.0	1.9	2.5	2.5
Less food and energy	1.9	1.2	1.6	1.8
Median CPI	3.6	2.2	2.5	2.3
Trimmed mean CPI	2.2	1.9	2.1	2.2

**Surveys of Inflation Expectations**  
(Percent)

Period	Actual CPI inflation <sup>1</sup>	University of Michigan				Professional forecasters (10-year) <sup>4</sup>	
		1 year <sup>2</sup>		5 to 10 years <sup>3</sup>			
		Mean	Median	Mean	Median		
2003:Q4	1.9	3.0	2.6	3.1	2.8	2.5	
2004:Q1	1.8	3.1	2.7	3.4	2.9	2.5	
Q2	2.9	4.0	3.3	3.3	2.8	2.5	
Q3	2.7	3.3	2.9	3.1	2.8	2.5	
Q4	3.3	3.4	3.0	3.1	2.8	2.5	
2005:Q1	3.0	3.6	3.0	3.2	2.8	2.5	
Q2	2.9	3.9	3.2	3.3	2.9	2.5	
Q3	3.8	4.3	3.5	3.5	2.9	2.5	
2005:July	3.2	3.6	3.0	3.3	2.9	...	
Aug.	3.6	3.7	3.1	3.3	2.8	...	
Sept.	4.7	5.5	4.3	3.8	3.1	2.5	
Oct.	n.a.	5.4	4.6	3.8	3.1	...	

1. Percent change from the same period in the preceding year.

2. Responses to the question: By about what percent do you expect prices to go up, on average, during the next 12 months?

3. Responses to the question: By about what percent per year do you expect prices to go up, on average, during the next 5 to 10 years?

4. Quarterly CPI projections compiled by the Federal Reserve Bank of Philadelphia.

... Not applicable.

n.a. Not available.

## Business Finance

### Gross Issuance of Securities by U.S. Corporations

(Billions of dollars; monthly rates, not seasonally adjusted)

Type of security	2001	2002	2003	2004	2005		
					H1	Q3	Oct. <sup>e</sup>
<i>Nonfinancial corporations</i>							
Stocks <sup>1</sup>	6.5	5.2	3.7	5.3	3.8	5.9	2.0
Initial public offerings	2.1	.7	.4	1.6	1.6	2.2	1.0
Seasoned offerings	4.4	4.4	3.2	3.8	2.1	3.7	1.0
Bonds <sup>2</sup>	39.8	24.8	31.6	22.7	18.1	19.7	9.0
Investment grade	27.5	15.7	16.0	8.3	7.9	9.8	6.0
Speculative grade	8.9	4.8	11.3	9.5	6.2	7.4	2.5
Other (sold abroad/unrated)	3.4	4.2	4.3	4.9	3.9	2.6	.5
<i>Memo</i>							
Net issuance of commercial paper <sup>3</sup>	-8.0	-6.3	-3.8	1.4	2.6	.4	8.0
Change in C&I loans at commercial banks <sup>3,4</sup>	-5.8	-5.1	-7.9	3.5	10.4	11.6	12.5
<i>Financial corporations</i>							
Stocks <sup>1</sup>	4.2	4.0	6.9	6.7	5.3	4.8	3.0
Bonds <sup>2</sup>	80.2	87.0	111.1	139.3	167.3	175.6	60.0

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

1. Excludes private placements and equity-for-equity swaps that occur in restructurings.

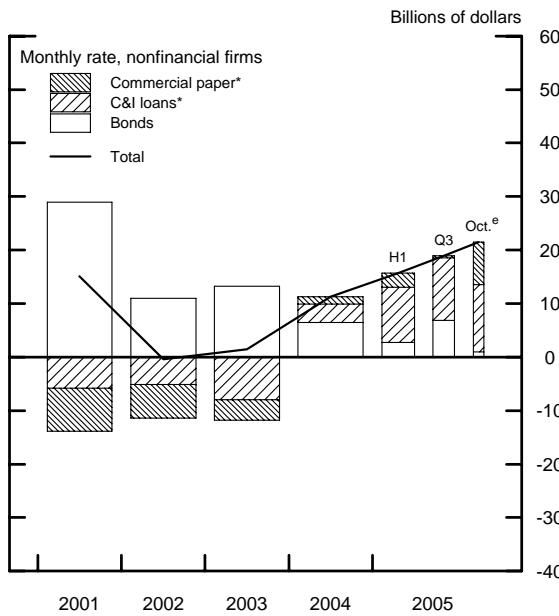
2. Data include regular and 144a private placements. Bond totals reflect gross proceeds rather than par value of original discount bonds. Bonds are categorized according to Moody's bond ratings, or to Standard & Poor's if unrated by Moody's.

3. End-of-period basis, seasonally adjusted.

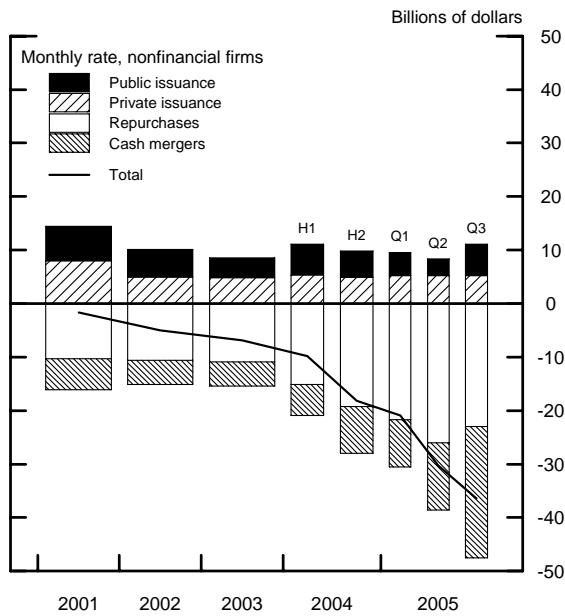
4. Adjusted for FIN 46 effects.

e Staff estimate.

### Selected Components of Net Debt Financing



### Components of Net Equity Issuance



\* Seasonally adjusted, period-end basis.

e Staff estimate.

## State and Local Government Finance

### Gross Offerings of Municipal Securities

(Billions of dollars; monthly rate, not seasonally adjusted)

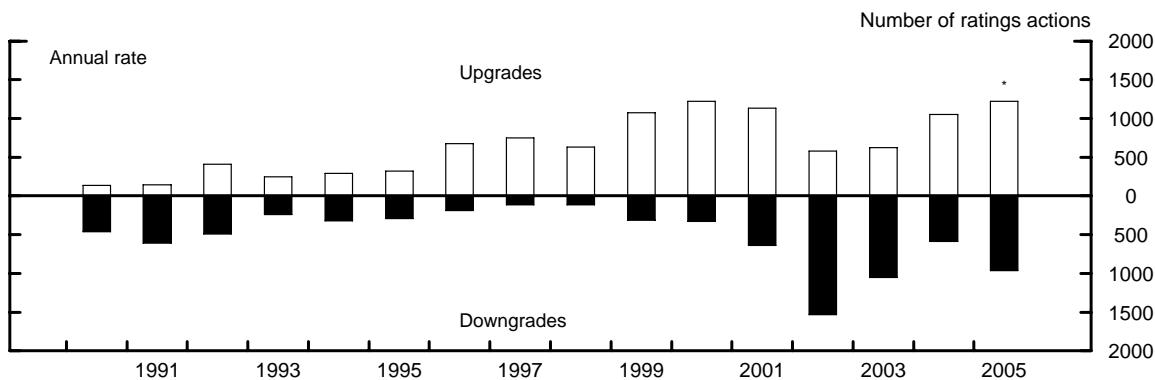
Type of security	2002	2003	2004	2005		
				H1	Q3	Oct. <sup>e</sup>
Total	36.3	37.9	34.7	38.1	38.6	27.0
Long-term <sup>1</sup>	30.3	32.0	29.8	35.0	33.2	24.0
Refundings <sup>2</sup>	10.1	10.0	10.8	16.9	14.8	8.0
New capital	20.2	22.1	19.0	18.1	18.4	17.0
Short-term	6.0	5.8	4.9	3.1	5.4	2.0
Memo: Long-term taxable	1.7	3.5	2.0	2.0	2.5	1.0

1. Includes issues for public and private purposes.

2. All issues that include any refunding bonds.

e Staff estimate based on preliminary data through October 20.

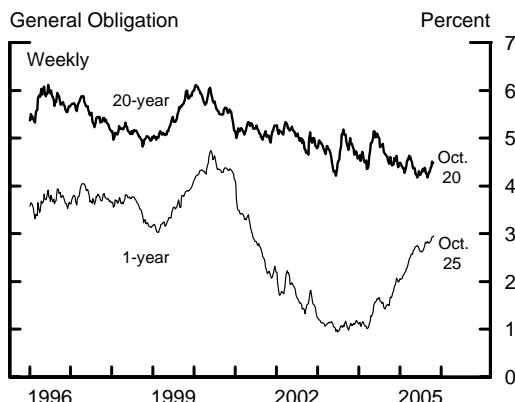
### Ratings Changes



\* Data through October 19 at an annual rate.

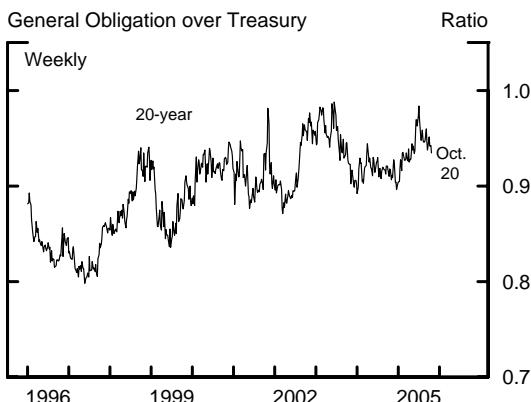
Source. S&P's Credit Week Municipal and Ratings Direct.

### Municipal Bond Yields



Source. Bloomberg and Bond Buyer.

### Municipal Bond Yield Ratio



Source. Bond Buyer.

**Monetary Aggregates**  
(Based on seasonally adjusted data)

Aggregate or component	2003	2004	2005				Level (\$ billions), Oct. (e)
			H1	Q3	Sept.	Oct. (e)	
<i>Aggregate</i>							
1. M2 <sup>2</sup>	5.5	5.2	2.8	3.9	6.1	6.9	6,626
2. M3 <sup>3</sup>	4.8	5.8	5.7	8.3	11.9	9.4	10,055
<i>Components of M2<sup>4</sup></i>							
3. Currency	5.9	5.5	3.2	3.4	5.1	2.2	717
4. Liquid deposits <sup>5</sup>	14.1	10.1	.8	1.5	3.1	5.8	4,238
5. Small time deposits	-9.3	-.4	18.6	19.6	15.5	10.4	950
6. Retail money market funds	-11.5	-11.9	-3.1	-1.4	12.9	13.9	714
<i>Components of M3</i>							
7. M3 minus M2 <sup>6</sup>	3.4	7.0	11.9	17.3	23.2	14.2	3,429
8. Large time deposits, net <sup>7</sup>	4.3	20.9	30.5	18.9	30.7	28.3	1,339
9. Institutional money market funds	-5.5	-5.6	-3.1	14.4	29.0	7.1	1,126
10. RPs	12.5	-.1	-4.0	20.1	23.0	18.4	536
11. Eurodollars	29.3	27.3	23.9	16.7	-11.8	-15.5	428
<i>Memo</i>							
12. Monetary base	5.9	5.6	3.2	2.9	4.2	3.1	779
<i>Average monthly change (billions of dollars)<sup>8</sup></i>							
<i>Selected managed liabilities at commercial banks</i>							
13. Large time deposits, gross	-1.5	14.9	22.2	13.1	28.2	25.3	1,418
14. Net due to related foreign institutions	3.1	-10.8	3.6	8.0	2.6	14.9	81
15. U.S. government deposits at commercial banks	-.3	.2	2.4	-4.3	6.6	5.4	28

1. For the years shown, Q4-to-Q4 percent change. For the quarters shown, based on quarterly averages.

2. Sum of currency, liquid deposits (demand, other checkable, savings), small time deposits, retail money market funds, and nonbank traveler's checks.

3. Sum of M2, net large time deposits, institutional money market funds, RP liabilities of depository institutions, and Eurodollars held by U.S. addressees.

4. Nonbank traveler's checks not listed.

5. Sum of demand deposits, other checkable deposits, and savings deposits.

6. Sum of large time deposits, institutional money market funds, RP liabilities of depository institutions, and Eurodollars held by U.S. addressees.

7. Net of holdings of depository institutions, money market funds, U.S. government, and foreign banks and official institutions.

8. For the years shown, "average monthly change" is the Q4-to-Q4 dollar change divided by 12. For the quarters shown, it is the quarter-to-quarter dollar change divided by 3.

e Estimated.

October 28, 2005

## CURRENT ECONOMIC AND FINANCIAL CONDITIONS

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### **Supplemental Notes**

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

October 28, 2005

**University of Michigan Survey Research Center: Survey of Consumer Attitudes**  
**Indexes of consumer sentiment**  
**(Not seasonally adjusted)**

Category	2005							
	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct. <sup>F</sup>
Composite of current and expected conditions <sup>1</sup>	92.6	87.7	86.9	96.0	96.5	89.1	76.9	74.2
Current conditions <sup>1</sup>	108.0	104.4	104.9	113.2	113.5	108.2	98.1	91.2
Expected conditions <sup>1</sup>	82.8	77.0	75.3	85.0	85.5	76.9	63.3	63.2
Personal financial situation								
Now compared with 12 months ago <sup>2</sup>	117	113	109	122	122	117	103	96
Expected in 12 months <sup>2</sup>	130	121	121	129	133	121	115	112
Expected business conditions								
Next 12 months <sup>2</sup>	104	96	95	109	112	102	62	68
Next 5 years <sup>2</sup>	98	91	85	103	99	85	76	72
Appraisal of buying conditions								
Cars	130	128	133	139	152	147	125	119
Large household appliances <sup>2</sup>	163	158	163	172	172	164	151	139
Houses	150	149	156	146	145	140	130	125
Expected unemployment change - next 12 months	112	118	119	116	117	123	137	134
Prob. household will lose a job - next 5 years	23	27	24	23	22	23	23	22
Expected inflation - next 12 months								
Mean	4.0	4.0	3.8	4.0	3.6	3.7	5.5	5.5
Median	3.2	3.3	3.2	3.2	3.0	3.1	4.3	4.6
Expected inflation - next 5 to 10 years								
Mean	3.3	3.4	3.5	3.1	3.3	3.3	3.8	3.8
Median	2.9	3.0	2.9	2.8	2.9	2.8	3.1	3.2

Note. Figures on financial, business, and buying conditions are the percent reporting 'good times' (or 'better') minus the percent reporting 'bad times' (or 'worse'), plus 100. Expected change in unemployment is the fraction expecting unemployment to rise minus the fraction expecting unemployment to fall, plus 100.

F Final.

1. Feb. 1966 = 100.

2. Indicates the question is one of the five equally-weighted components of the index of sentiment.

**Commercial Bank Credit**  
(Percent change, annual rate, except as noted; seasonally adjusted)

Type of credit	2003	2004	H1 2005	Q3 2005	Sept. 2005	Oct. <sup>e</sup> 2005	Level (\$ billions), Oct. 2005 <sup>e</sup>
<b>Total</b>							
<b>1. Adjusted<sup>1</sup></b>	<b>5.9</b>	<b>8.9</b>	<b>12.5</b>	<b>9.3</b>	<b>5.0</b>	<b>4.6</b>	<b>7,125</b>
2. Reported	5.6	8.4	11.3	9.2	7.1	3.4	7,273
<i>Securities</i>							
3. Adjusted <sup>1</sup>	8.6	6.6	14.5	1.5	-1.0	3.8	1,866
4. Reported	7.2	5.2	10.2	1.8	6.7	-.6	2,015
5. Treasury and agency	8.9	4.8	7.2	-6.0	-8.3	-2.8	1,162
6. Other <sup>2</sup>	4.8	5.8	14.8	13.3	27.9	2.3	853
<i>Loans<sup>3</sup></i>							
7. Total	5.0	9.8	11.8	12.1	7.2	5.0	5,259
8. Business	-9.3	1.3	15.5	12.4	8.9	16.1	1,006
9. Real estate	11.1	14.0	14.1	15.5	3.5	6.8	2,837
10. Home equity	30.8	43.9	16.7	11.7	-2.7	-4.4	437
11. Other	8.8	9.8	13.6	16.2	4.6	8.9	2,401
12. Consumer	5.4	8.8	5.7	4.7	4.3	-21.7	689
13. Adjusted <sup>4</sup>	5.8	5.9	1.1	4.4	3.3	-24.9	1,042
14. Other <sup>5</sup>	7.2	7.9	4.2	5.7	22.4	8.1	727

Note. Data are adjusted to remove estimated effects of consolidation related to FIN 46 and for breaks caused by reclassifications. Monthly levels are pro rata averages of weekly (Wednesday) levels. Quarterly levels (not shown) are simple averages of monthly levels. Annual levels (not shown) are levels for the fourth quarter. Growth rates are percentage changes in consecutive levels, annualized but not compounded.

- 1. Adjusted to remove effects of mark-to-market accounting rules (FIN 39 and FAS 115).
- 2. Includes private mortgage-backed securities, securities of corporations, state and local governments, foreign governments, and any trading account assets that are not Treasury or agency securities, including revaluation gains on derivative contracts.
- 3. Excludes interbank loans.
- 4. Includes an estimate of outstanding loans securitized by commercial banks.
- 5. Includes security loans and loans to farmers, state and local governments, and all others not elsewhere classified. Also includes lease financing receivables.

e Estimated.