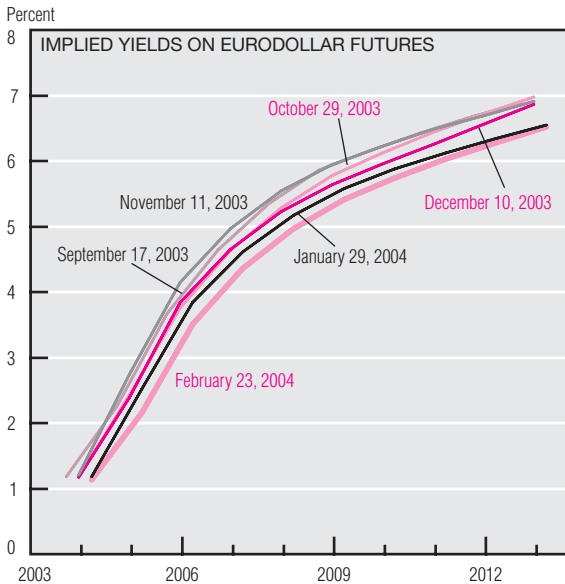
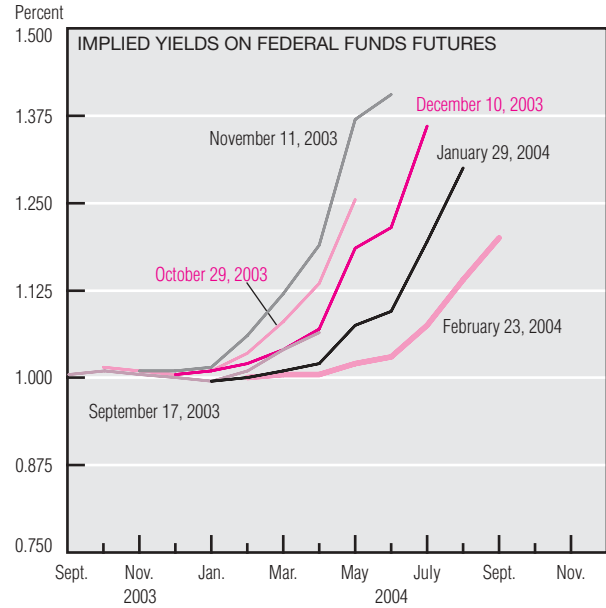
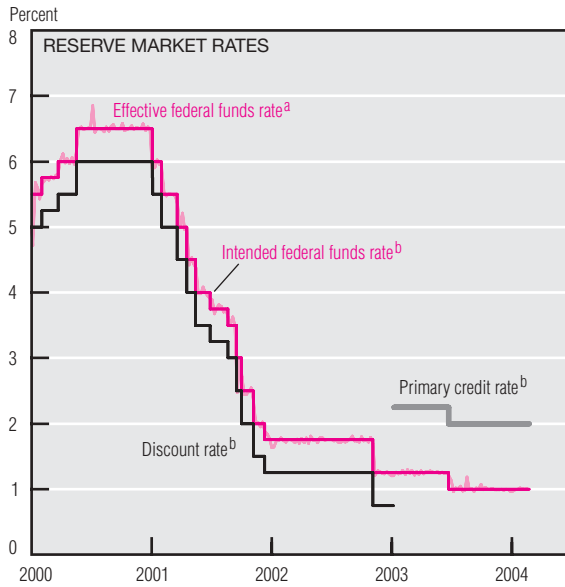


Monetary Policy



Economic Projections for 2004

	Federal Reserve governors and Reserve Bank presidents		
	Actual 2003	Range	Central tendency
Nominal GDP ^c	5.90	5.50–6.50	5.50–6.25
Real GDP ^d	4.30	4.00–5.50	4.50–5.00
PCE Chain-type Price Index ^c	1.40	1.00–1.50	1.00–1.25
Civilian unemployment rate ^e	5.90	5.25–5.50	5.25–5.50

- a. Weekly average of daily figures.
 b. Daily observations.
 c. Change, fourth quarter to fourth quarter.
 d. Change, fourth quarter to fourth quarter. Chain weighted.
 e. Average level, fourth quarter.

SOURCES: Board of Governors of the Federal Reserve System, *Monetary Policy Report to the Congress*; Board of Governors of the Federal Reserve System, "Selected Interest Rates," *Federal Reserve Statistical Releases*, H.15; and Bloomberg Financial Information Services.

On February 11 and 12, Federal Reserve Chairman Alan Greenspan delivered his semiannual *Monetary Policy Report* to Congress. He began his comments by noting the strong expansion of GDP and productivity in the second half of 2003 but also the limited progress in creating jobs. He stated that "prospects are good for sustained expansion" and that "employment will begin to grow more quickly before long as output continues to expand." He remarked on the low level of inflation, which he said

was in a range "consistent with price stability."

The Chairman also noted that the real federal funds rate "will eventually need to rise toward a more neutral level," but reiterated the Federal Open Market Committee's January 28 statement that the Fed "can be patient" in doing so. Despite his statement that the funds rate will need to rise eventually, participants in the federal funds futures markets continue to push back the date at which they expect the nominal funds rate to increase. Participants currently place

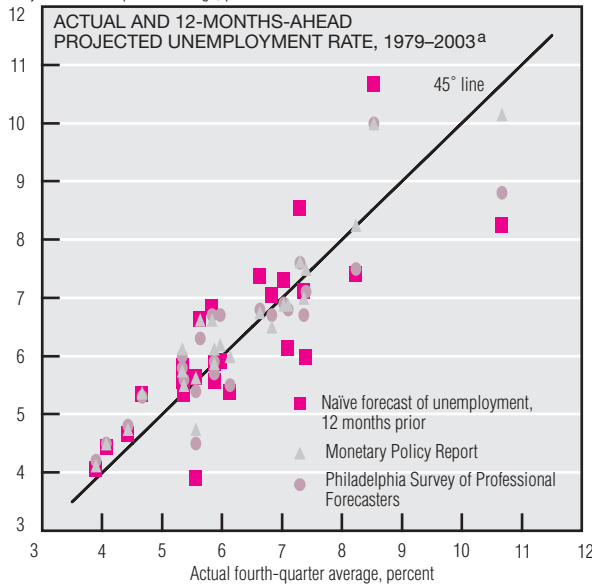
an extremely low probability of a rate change occurring at the March meeting. Traders in eurodollar futures have lowered their trajectory for the future funds rate path as well.

The *Monetary Policy Report* contains a set of economic projections by the Federal Reserve Board of Governors and Reserve Bank presidents. The central tendency of projections for 2004 real GDP growth is 4.50%–5.00%. The PCE Chain-type Price Index is expected to grow at an annual rate of 1.00%–1.25%, and the

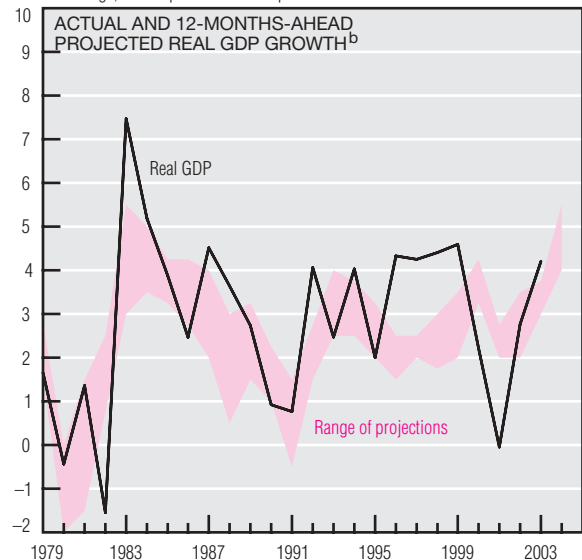
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Monetary Policy (cont.)

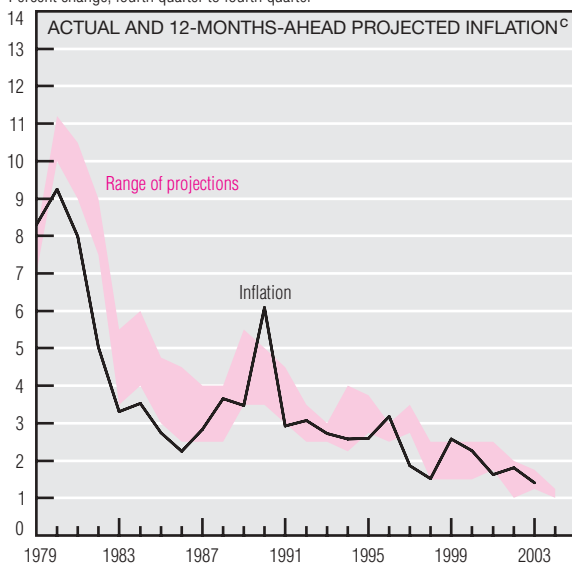
Projected fourth-quarter average, percent



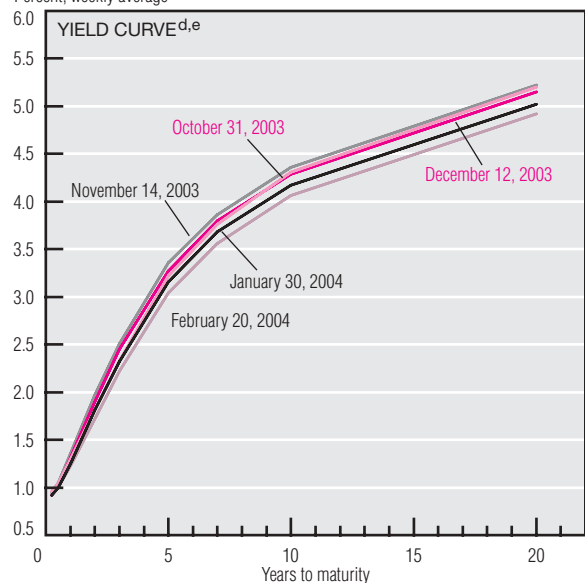
Percent change, fourth quarter to fourth quarter



Percent change, fourth quarter to fourth quarter



Percent, weekly average



a. The *Monetary Policy Report* projection is the midpoint of the range. The *Survey of Professional Forecasters* projection is the median response.

b. Projected and real GDP are both GNP prior to 1992.

c. From 1979 to 1989, inflation and projected inflation are plotted as the implicit GDP deflator; from 1990 to 1999 they are plotted in terms of the CPI; and from 1999 to 2002 as the PCE Chain-type Price Index.

d. All yields are from constant-maturity series.

e. Average for the week ending on the date shown.

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; U.S. Department of Labor, Bureau of Labor Statistics; Board of Governors of the Federal Reserve System, *Monetary Policy Report to the Congress*; Board of Governors of the Federal Reserve System, "Selected Interest Rates," *Federal Reserve Statistical Releases*, H.15; and Federal Reserve Bank of Philadelphia, *Survey of Professional Forecasters*.

fourth-quarter unemployment rate is projected to be 5.25%–5.50%.

How accurate are these projections and those of private forecasters? If the projections were perfect, a scatter plot of the projections versus the actual values would show all its points lying along a 45-degree line. The scatter plot above compares the Report's accuracy to that of private forecasters and to a naïve forecast predicting that a variable's future value will equal its current value. Certainly, none of these forecasts is perfect. A summary

statistic that measures the overall accuracy is the mean absolute error of the forecasts. At a 12-month horizon, the average absolute error of professional forecasters' unemployment projection is 0.54% versus the Fed's 0.40%. Both are superior to the naïve forecast, whose average absolute error is 0.70%.

Fed projections of real GDP growth generally follow the pattern of actual values but at times stray far afield. These projections understated real GDP growth during the late 1990s and overstated it during the

recent recession. Overall, real GDP projections have an average absolute error of 1.32%. Inflation rate projections track the actual inflation rate fairly closely, with an average absolute error of 0.88%.

Since the FOMC's January meeting, the yield curve has continued to shift downward across the intermediate and long-term maturities. The yield on 10-year maturities fell 11 basis points and the yield on 20-year maturities declined 10 basis points.