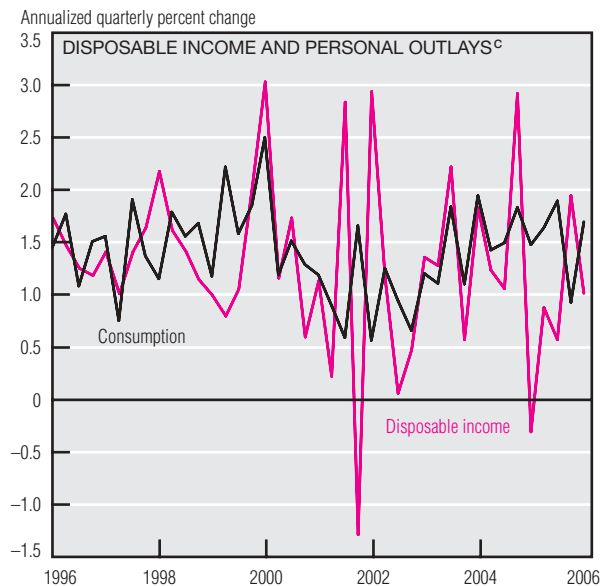
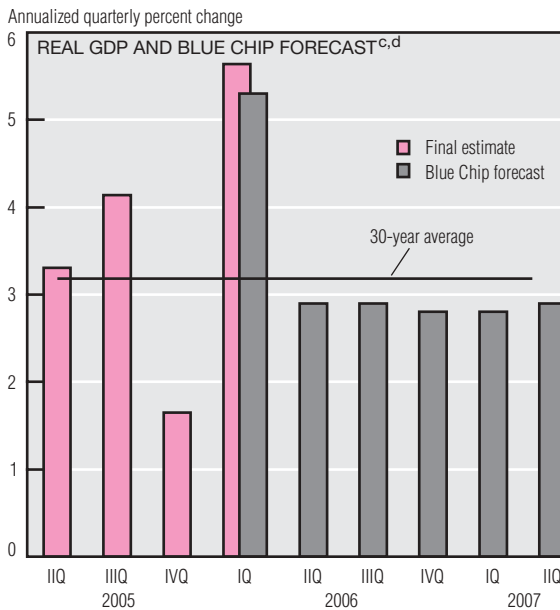
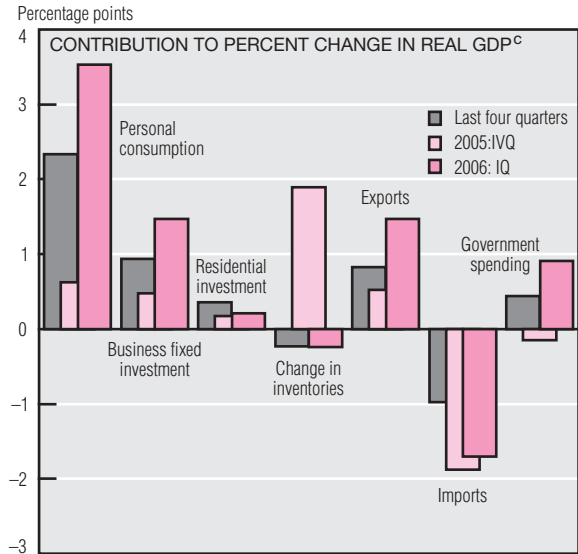


Economic Activity

| Real GDP and Components, 2006:IQ ^{a,b} (Final estimate) | Change, billions of 2000 \$ | Annualized percent change | |
|---|-----------------------------------|------------------------------|------------------|
| | | Current quarter | Four quarters |
| | | Real GDP | 155.3 |
| Personal consumption | 98.2 | 5.0 | 3.3 |
| Durables | 52.9 | 20.3 | 4.3 |
| Nondurables | 33.6 | 5.9 | 4.5 |
| Services | 21.6 | 1.9 | 2.6 |
| Business fixed investment | 44.5 | 14.2 | 8.9 |
| Equipment | 37.9 | 14.8 | 10.3 |
| Structures | 7.7 | 12.6 | 5.1 |
| Residential investment | 5.0 | 3.3 | 6.0 |
| Government spending | 23.4 | 4.8 | 2.3 |
| National defense | 11.3 | 9.5 | 3.3 |
| Net exports | -5.7 | — | — |
| Exports | 42.6 | 14.7 | 8.1 |
| Imports | 48.2 | 10.7 | 6.1 |
| Change in business inventories | -8.4 | — | — |



a. Chain-weighted data in billions of 2000 dollars.

b. Components of real GDP need not add to the total because the total and all components are deflated using independent chain-weighted price indexes.

c. Data are seasonally adjusted and annualized.

d. Blue Chip panel of economists.

SOURCES: U.S. Department of Commerce, Bureau of Economic Analysis; and *Blue Chip Economic Indicators*, June 10, 2005.

Real GDP increased at an annual rate of 5.6% in 2006:IQ, according to the Commerce Department's final estimate, which was 0.3 percentage point (pp) above the preliminary estimate of 5.3%. The upward revision resulted primarily from a downward revision to imports. This was the strongest quarter of economic growth since 2003:IIIQ.

Most components made significantly higher contributions to real GDP change in 2006:IQ than in the previous quarter. PCE contributed 3.53 pp, compared to only 0.62 pp in

2005:IVQ. Exports added 1.0 pp more, bringing its total contribution to 1.5 pp. The exception was changes in private inventories, which subtracted 0.2 pp in 2006:IQ after adding 1.9 pp the previous quarter. Profits from current production were \$1.656 trillion in the quarter at a seasonally adjusted annualized rate. This new record represented an upward revision of \$60 billion from the preliminary estimates.

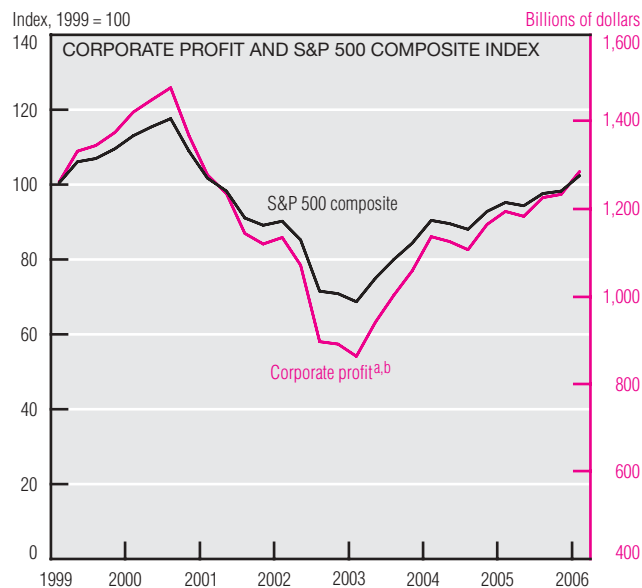
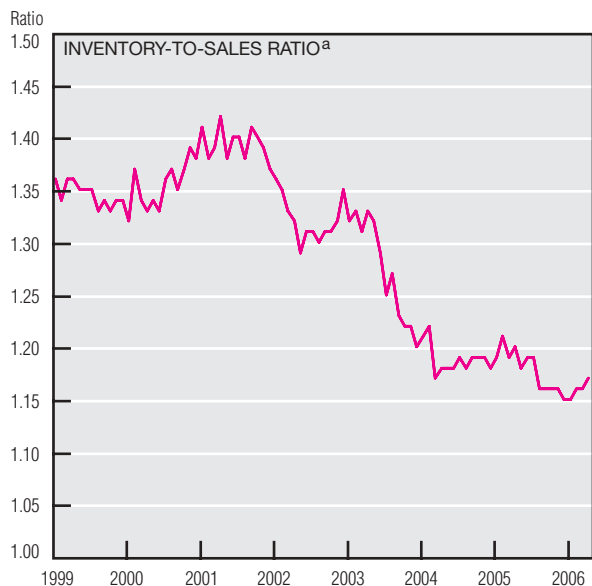
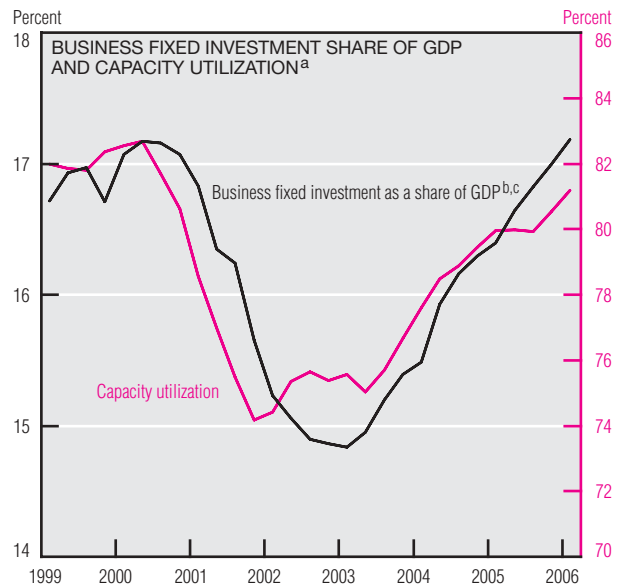
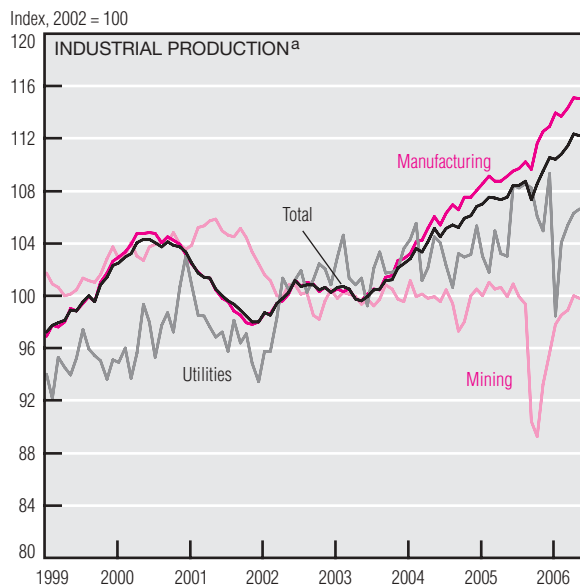
The first quarter of 2006 was only the third time that GDP growth has topped 5.0% since the beginning of 2000; it was also 2.4 pp above the

30-year average of 3.2%. However, recent data releases suggest that the economy is losing momentum. Blue Chip forecasters revised their growth estimates downward for the rest of this year. Most notably, they lowered their estimate for 2006:IIQ by 0.5 percentage points from 3.4% to 2.9%.

Once again, disposable income, up only 1% in 2006:IQ, lagged personal outlays. The change in personal outlays increased 1.7% for 2006:IQ, up from 0.9% in 2005:IVQ.

With many analysts anticipating that the FOMC is nearing the end of
(continued on next page)

Economic Activity (cont.)



a. Seasonally adjusted.
b. Annualized.
c. Fiscal year GDP.

SOURCES: U.S. Department of Commerce, Bureau of the Census and Bureau of Economic Analysis; Board of Governors of the Federal Reserve System; and the *Wall Street Journal*.

its current sequence of rate increases, economic observers are scouring incoming economic data for signs that the economy is either heating up too much or cooling down too fast. Driven by manufacturing output, which increased 5.4% over the last year, total industrial production rose 4.3% but was essentially flat from April to May 2006. Utilities were up only 3.4% from May 2005 to May 2006, but this series is highly volatile because unseasonable weather can cause sharp swings in demand. Except for the hurricanes'

disruptions of Gulf Coast oil and natural gas production last fall, mining output has been essentially flat since April 2003.

As output has expanded, so has capacity utilization, a widely followed measure of how close the economy is to its potential; however, at 81.1% it has just reached the level it averaged in the late 1990s. Consequently, there is little upward pressure on prices from this source. Investment, which expands capacity, was up 3.9% from March 2005 to March 2006 and could keep capacity utilization at a moderate

level. The inventory-to-sales ratio is another measure that is often considered an indicator of the health of the economy. This series also seems to be sending a favorable signal: It has been relatively unchanged over the last 12 months.

Despite the stock market's recent downturn of about 2% since the end of the first quarter, investors have been pleased with corporate profits, which increased 28.5% from 2005:1Q to 2006:1Q. Over the same period, the S&P 500 Composite Index rose 7.6%.