

Prefatory Note

The attached document represents the most complete and accurate version available based on original files from the FOMC Secretariat at the Board of Governors of the Federal Reserve System.

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September 17, 2004

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Supplemental Notes

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

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Supplemental Notes

The Domestic Nonfinancial Economy

Consumer Prices

The consumer price index rose 0.1 percent in August, reversing the decline in July. On a twelve-month change basis, overall CPI inflation was 2.7 percent last month, up 0.5 percentage point from a year earlier. Excluding food and energy, the CPI ticked up 0.1 percent in August for the third month in a row; the August increase in the core was in line with our expectations and left the twelve-month change in this index at 1.7 percent, up 0.4 percentage point relative to a year earlier.

Consumer food prices edged up 0.1 percent last month as a decline of 1-3/4 percent in dairy prices partly offset increases in a number of other components. Over the past twelve months, the CPI for food has risen 3.5 percent after having posted an increase of 2.5 percent over the preceding twelve-month period.

Energy prices declined 0.3 percent in August. Motor fuel prices fell 1.5 percent last month following a 4-percent drop in July; moreover, available survey data point to a further decline in these prices in September. Among other energy categories, prices of heating oil surged 5-1/4 percent, while natural gas prices rose 1 percent. In all, consumer energy prices have jumped 10-1/2 percent over the twelve months ending in August, compared with an 11-3/4 percent increase over the preceding twelve months.

Core goods prices ticked down 0.1 percent last month. These prices have fallen more than 1 percent over the past year, about a percentage point less rapidly than their decline over the preceding year.

Prices of non-energy services edged up 0.1 percent in August. Shelter prices were flat, as a 1.7 percent decline in the index for lodging away from home offset a 0.3 percent increase in rents for owner- and tenant-occupied housing. Outside of shelter, prices of core services rose 0.2 percent, pushed lower by a drop of 3.7 percent in airfares. Over the twelve months ending in August, prices of non-energy services rose 2.9 percent, 0.2 percentage point faster than their year-earlier rate of increase.

The chained CPI, or C-CPI-U, rose 2.1 percent over the twelve months ending in August, 0.6 percentage point less than the change in the official index.¹ The corresponding change in the core C-CPI-U was 1.2 percent, 0.5 percentage point lower than the official core CPI.

1. The chained CPI uses an index number formula that is intended to capture shifts in consumers' expenditure patterns following relative price changes.

Measures of Inflation
(Percent)

Measures	12-month change		3-month change		1-month change	
	Aug. 2003	Aug. 2004	Annual rate		Monthly rate	
			May 2004	Aug. 2004	July 2004	Aug. 2004
<i>CPI</i>						
Total	2.2	2.7	5.5	1.3	-1	.1
Food	2.5	3.5	5.1	1.9	.3	.1
Energy	11.8	10.5	29.7	1.6	-1.9	-.3
Ex. food and energy	1.3	1.7	3.3	1.0	.1	.1
Ex. tobacco	1.3	1.7	3.4	1.0	.1	.0
Core commodities	-2.2	-1.1	.9	-1.7	-.3	-.1
Core services	2.7	2.9	4.3	2.3	.3	.1
Chained CPI (n.s.a.) ¹	1.9	2.1
Ex. food and energy ¹	1.0	1.2
<i>PCE Prices</i> ²						
Total	1.7	2.2	3.5	.9	.0	.0
Food	2.2	3.1	4.7	1.6	.2	.1
Energy	12.0	11.1	30.3	1.2	-2.0	-.3
Ex. food and energy	1.1	1.5	1.8	.7	.0	.0
Ex. tobacco	1.1	1.4	1.8	.6	.0	.0
Core commodities	-2.4	-1.0	1.2	-2.4	-.4	-.2
Core services	2.6	2.5	2.0	2.1	.2	.1
Core market-based	1.1	n.a.	2.1	n.a.	.1	n.a.
Core non-market-based	1.1	n.a.	.3	n.a.	-.1	n.a.
<i>PPI</i>						
Total finished goods	3.5	3.4	8.5	-1.1	.1	-.1
Food	5.0	4.0	17.7	-9.2	-1.6	-.2
Energy	14.7	9.9	16.0	3.2	2.3	.2
Ex. food and energy	.4	1.5	3.2	.5	.1	-.1
Ex. tobacco	.9	1.6	3.5	.5	.1	-.1
Core consumer goods	.3	1.6	3.1	.0	.1	-.2
Capital equipment	.7	1.4	4.1	.9	.1	-.1
Intermediate materials	4.4	8.1	13.1	9.3	.8	1.0
Ex. food and energy	1.6	7.3	11.2	8.5	.5	1.0
Crude materials	20.8	22.4	23.0	2.8	-.2	-.7
Ex. food and energy	8.2	32.3	-23.4	63.0	8.6	4.5

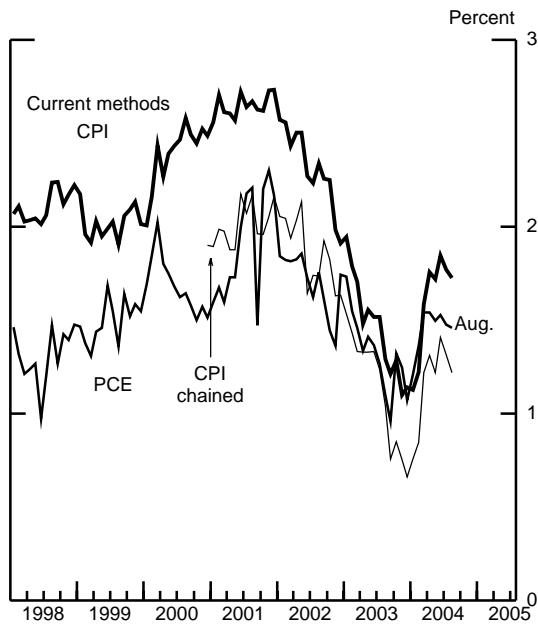
1. Higher-frequency figures are not applicable for data that are not seasonally adjusted.

2. PCE prices in August are staff estimates.

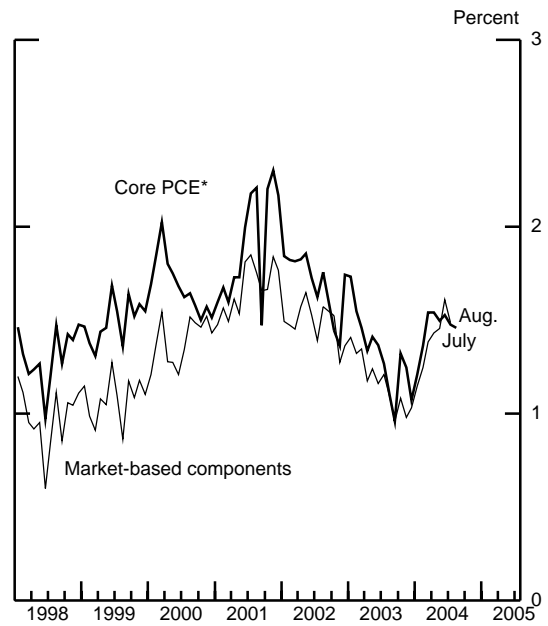
... Not applicable.

Core Consumer Price Inflation (12-month change except where noted)

CPI and PCE excluding Food and Energy

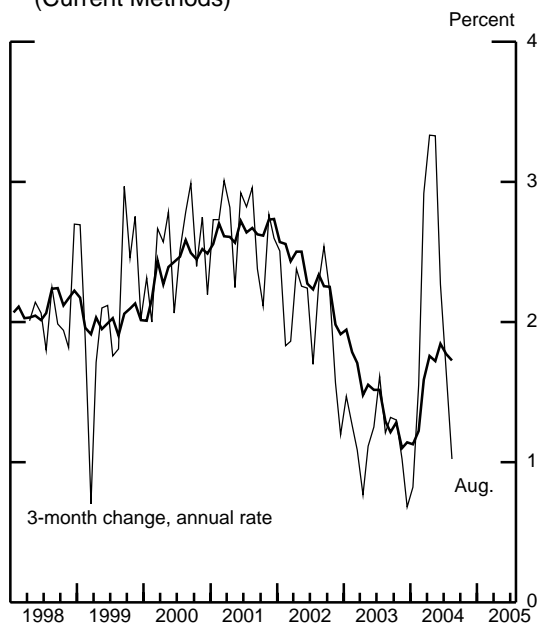


PCE excluding Food and Energy

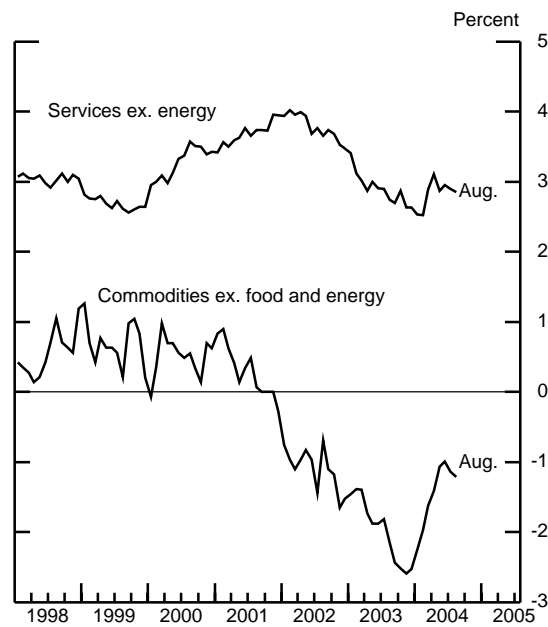


* Overall core PCE in August is staff estimate.

CPI excluding Food and Energy
(Current Methods)



CPI Services and Commodities



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

Measure	2001	2002	2003	2004
<i>Product prices</i>				
GDP price index	2.5	1.5	1.9	2.3
Less food and energy	2.0	2.0	1.6	1.9
Nonfarm business chain price index	2.0	.9	1.2	1.5
<i>Expenditure prices</i>				
Gross domestic purchases price index	2.3	1.3	1.9	2.5
Less food and energy	1.8	1.8	1.6	1.9
PCE price index	2.4	1.2	1.8	2.3
Less food and energy	1.8	1.8	1.4	1.5
PCE price index, market-based components	2.3	.9	1.8	2.4
Less food and energy	1.7	1.6	1.2	1.5
CPI	3.4	1.3	2.2	2.8
Less food and energy	2.7	2.4	1.5	1.8
Chained CPI	2.7	1.0	1.9	2.3
Less food and energy	2.0	1.9	1.3	1.3
Median CPI	3.5	3.6	2.2	2.5
Trimmed mean CPI	2.9	2.2	1.9	2.1

Surveys of Inflation Expectations
(Percent)

Period	Actual CPI inflation ¹	University of Michigan				Professional forecasters (10-year) ⁴
		1 year ²		5 to 10 years ³		
		Mean	Median	Mean	Median	
2002:Q4	2.2	2.7	2.5	3.3	2.8	2.5
2003:Q1	2.9	3.2	2.8	3.0	2.7	2.5
Q2	2.1	2.6	2.2	3.1	2.7	2.5
Q3	2.2	2.8	2.3	3.1	2.7	2.5
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	n.a.	3.4	2.9	3.1	2.8	2.5
2004:Apr.	2.3	4.0	3.2	3.2	2.7	...
May	3.1	3.9	3.3	3.3	2.8	...
June	3.3	4.0	3.3	3.4	2.9	2.5
July	3.0	3.5	3.0	3.1	2.8	...
Aug.	2.7	3.1	2.8	3.1	2.7	...
Sept.	n.a.	3.5	2.9	3.2	2.8	2.5

1. CPI; 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.
n.a. Not available.
... Not applicable.

Consumer Sentiment

According to the preliminary report, the Michigan Survey Research Center's (SRC) index of consumer sentiment was unchanged in early September at 95.8, about equal to its average level since the beginning of the year. An improvement in the "expected conditions" component of the overall index was offset by a decline in the "current conditions" component. Within the "expected conditions" component, households' assessments of business conditions rose, while their view of expected personal financial conditions worsened. Within the "current conditions" component, consumers' assessments both of their current personal financial situations and of buying conditions for large household appliances slipped. Among the items not included in the overall index, households' expectations about the change in unemployment over the next twelve months improved. Consumers' appraisals of buying conditions for cars and houses strengthened.

Inflation expectations edged up in early September. The mean and median of expected inflation over the next twelve months rose to 3.5 percent and 2.9 percent, respectively. In addition, the mean and median of expected inflation over the next five to ten years edged up to 3.2 percent and 2.8 percent, respectively.

September 17, 2004

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

Category	2004							
	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept. ^P
Composite of current and expected conditions ¹	94.4	95.8	94.2	90.2	95.6	96.7	95.9	95.8
Current conditions ¹	103.6	106.8	105.0	103.6	106.7	105.2	107.9	105.8
Expected conditions ¹	88.5	88.8	87.3	81.6	88.5	91.1	88.2	89.4
Personal financial situation								
Now compared with 12 months ago ²	111	114	113	113	112	115	121	118
Expected in 12 months ²	128	134	132	125	130	134	133	127
Expected business conditions								
Next 12 months ²	118	116	116	105	117	124	114	117
Next 5 years ²	110	107	103	98	108	108	108	116
Appraisal of buying conditions								
Cars	150	153	147	144	144	142	144	147
Large household appliances ²	157	163	159	156	164	158	158	156
Houses	158	163	167	160	162	160	156	165
Expected unemployment change - next 12 months	105	108	107	107	96	93	106	104
Prob. household will lose a job - next 5 years	25	24	26	27	25	25	22	22
Expected inflation - next 12 months								
Mean	2.9	3.4	4.0	3.9	4.0	3.5	3.1	3.5
Median	2.6	2.9	3.2	3.3	3.3	3.0	2.8	2.9
Expected inflation - next 5 to 10 years								
Mean	3.3	3.4	3.2	3.3	3.4	3.1	3.1	3.2
Median	2.9	2.9	2.7	2.8	2.9	2.8	2.7	2.8

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.

P Preliminary.

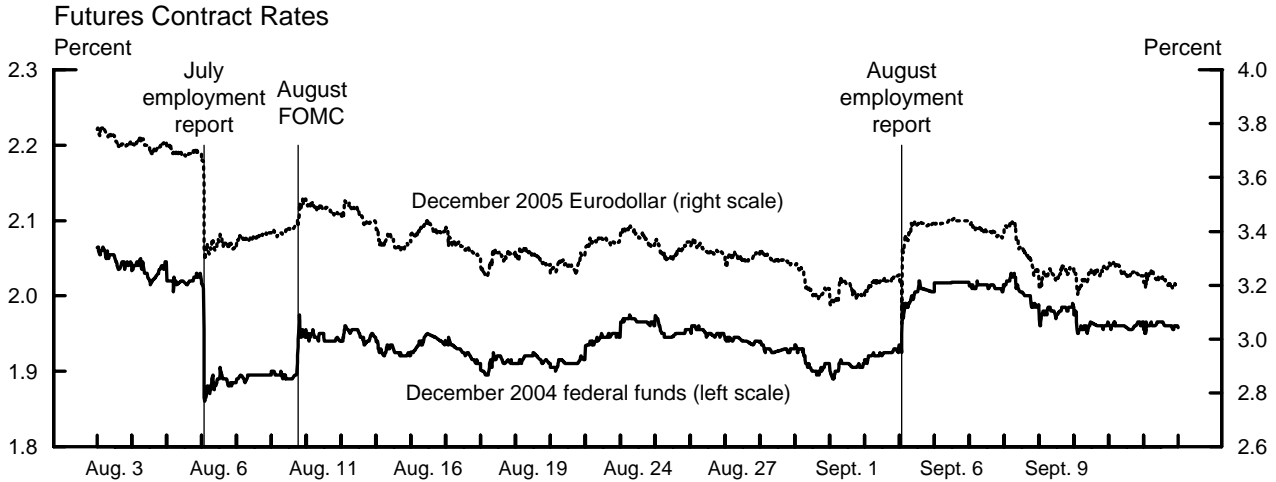
1. Feb. 1966 = 100.

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

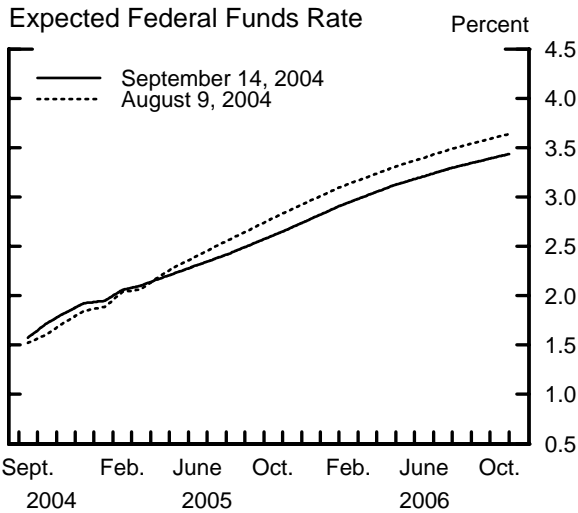
The Domestic Financial Economy

Corrected copies of the charts that appeared on pages III-C-1 and III-2 of Part 2 of the Greenbook are attached.

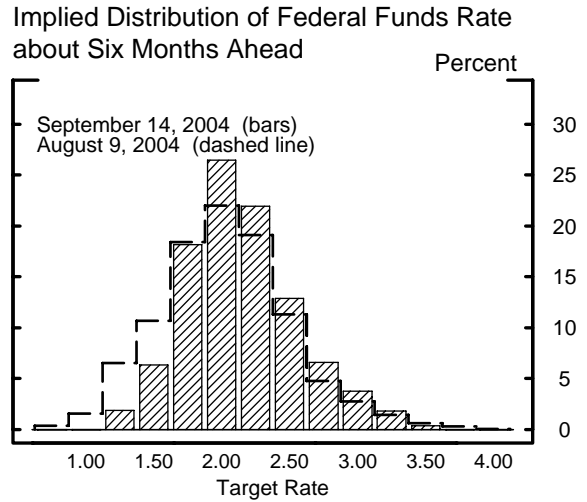
Policy Expectations and Treasury Yields



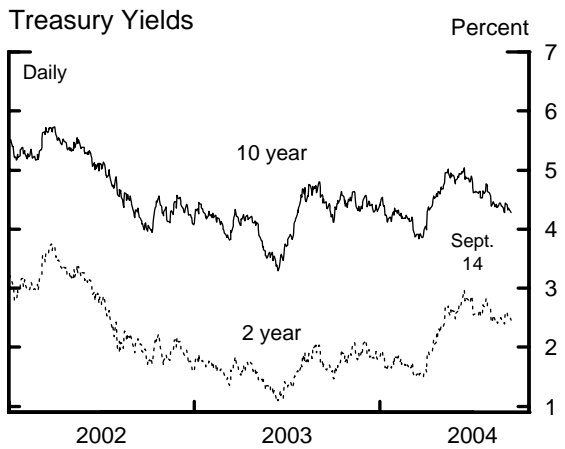
Note. 5-minute intervals.



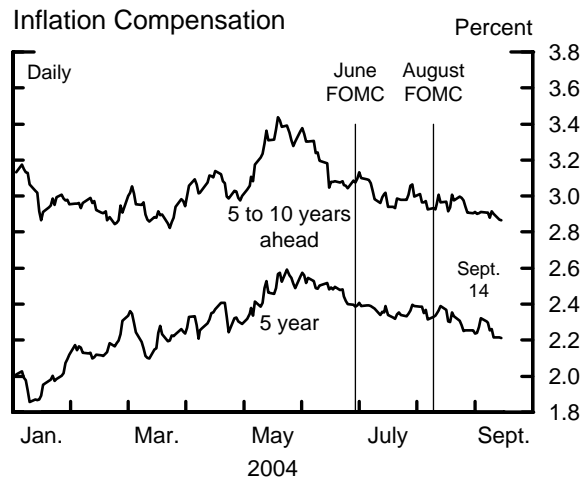
Note. Estimates from federal funds and Eurodollar futures, with an allowance for term premia and other adjustments.



Note. Based on the distribution of the three-month Eurodollar rate five months ahead (adjusted for a risk premium), implied by options on Eurodollar futures contracts.



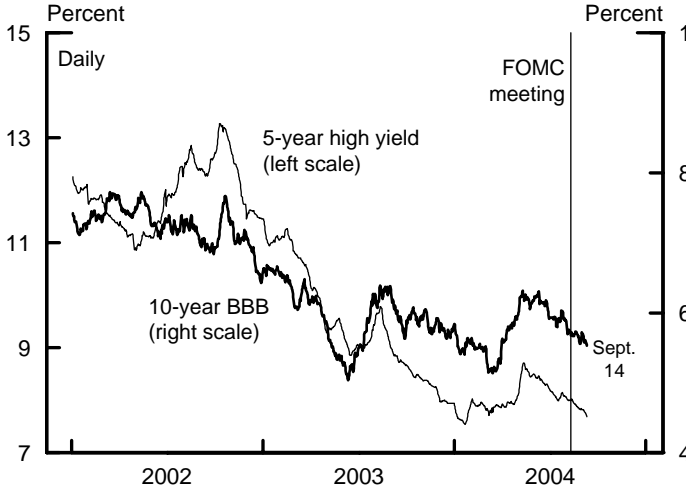
Note. Estimates from smoothed Treasury yield curve based on off-the-run securities.



Note. Estimates based on smoothed nominal and inflation-indexed Treasury yield curves.

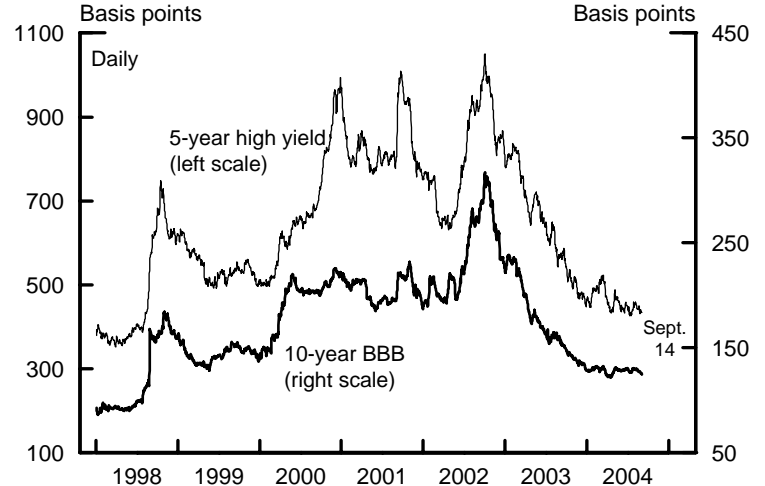
Corporate Yields, Risk Spreads, and Stock Prices

Yields for BBB and High-Yield Corporate Bonds

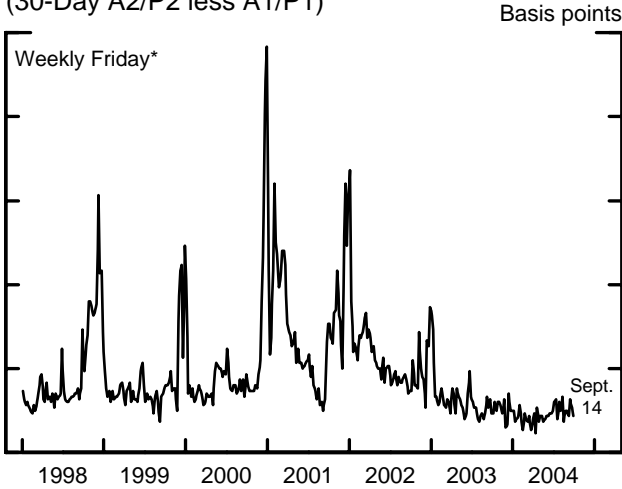


Note. Yields from smoothed yield curves based on Merrill Lynch bond data.

Corporate Bond Spreads to Similar Maturity Treasury

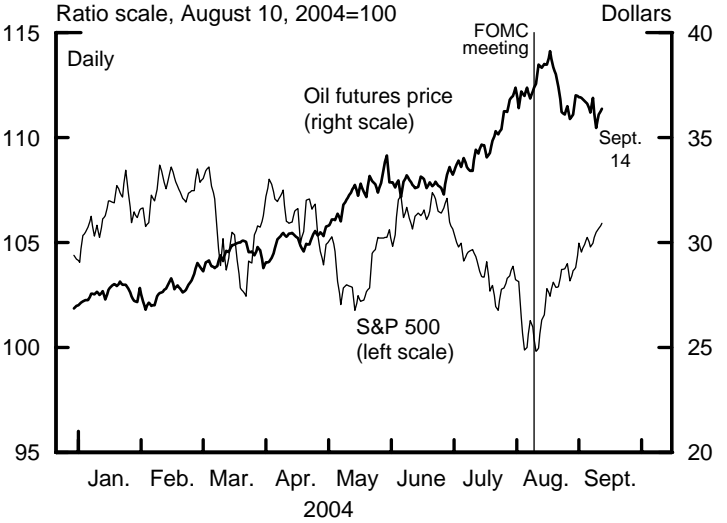


Commercial Paper Quality Spread (30-Day A2/P2 less A1/P1)

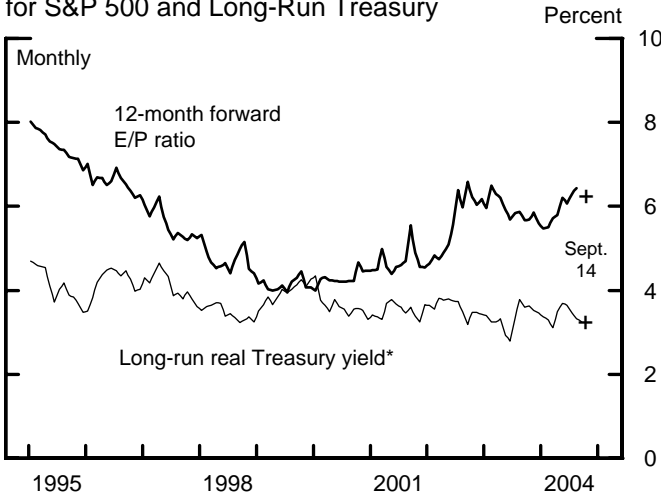


* Latest observation is for most recent business day.

S&P 500 and Oil Futures Priced 24 Months Ahead

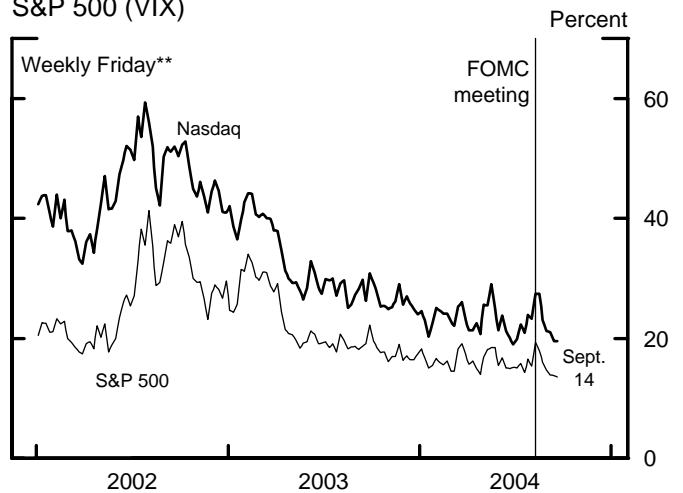


12-Month Forward Earnings-Price Ratio for S&P 500 and Long-Run Treasury



* Yield on synthetic Treasury perpetuity minus Philadelphia Fed 10-year expected inflation.
 + Denotes the latest observation using daily interest rates and stock prices and latest earnings data from I/B/E/S.

Implied Volatility on Nasdaq 100 (VXN) and S&P 500 (VIX)



Note. Latest observation is for most recent business day.

Commercial Bank Credit

(Percent change, annual rate, except as noted; seasonally adjusted)

Type of credit	2003	Q1 2004	Q2 2004	June 2004	July 2004	Aug. 2004	Level, Aug. 2004 (\$ billions)
Total							
1. Adjusted¹	5.9	11.4	10.9	7.4	-7	3.7	6,341
2. Reported	5.6	12.0	7.2	6.8	2.8	5.6	6,511
<i>Securities</i>							
3. Adjusted ¹	8.6	18.0	14.5	2.7	-30.5	-2.3	1,709
4. Reported	7.3	19.5	2.0	.9	-16.4	4.8	1,880
5. Treasury and agency	8.8	24.1	10.5	.1	-6.3	2.2	1,182
6. Other ²	5.0	12.4	-11.4	2.4	-33.0	9.0	698
<i>Loans³</i>							
7. Total	4.9	8.9	9.5	9.2	10.7	6.0	4,632
8. Business	-9.3	-6.0	-3.7	5.1	6.7	9.2	869
9. Real estate	11.1	10.2	19.5	6.0	4.1	7.7	2,421
10. Home equity	30.8	37.8	36.7	34.2	35.4	39.2	357
11. Other	8.8	6.3	16.8	1.4	-.9	2.4	2,065
12. Consumer	5.6	11.5	4.3	5.4	53.6	.9	672
13. Adjusted ⁴	6.0	10.4	-2.1	.7	40.4	-.6	1,035
14. Other ⁵	6.7	22.6	-2.6	30.3	-1.3	.7	669

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.

III-T-1
Selected Financial Market Quotations
 (One-day quotes in percent except as noted)

Instrument	2003		2004		Change to Sept. 16 from selected dates (percentage points)		
	June 24	Dec. 31	Aug. 9	Sept. 16	2003 June 24	2003 Dec. 31	2004 Aug. 9
<i>Short-term</i>							
FOMC intended federal funds rate	1.25	1.00	1.25	1.50	.25	.50	.25
Treasury bills ¹							
3-month	0.81	0.93	1.49	1.64	.83	.71	.15
6-month	0.82	1.00	1.69	1.83	1.01	.83	.14
Commercial paper (A1/P1 rates) ²							
1-month	0.95	1.00	1.50	1.73	.78	.73	.23
3-month	0.91	1.05	1.58	1.81	.90	.76	.23
Large negotiable CDs ¹							
1-month	0.96	1.06	1.54	1.76	.80	.70	.22
3-month	0.93	1.09	1.61	1.86	.93	.77	.25
6-month	0.92	1.16	1.75	2.03	1.11	.87	.28
Eurodollar deposits ³							
1-month	0.94	1.04	1.50	1.76	.82	.72	.26
3-month	0.91	1.07	1.60	1.85	.94	.78	.25
Bank prime rate	4.25	4.00	4.25	4.50	.25	.50	.25
<i>Intermediate- and long-term</i>							
U.S. Treasury ⁴							
2-year	1.14	1.83	2.44	2.42	1.28	.59	-.02
10-year	3.46	4.40	4.42	4.22	.76	-.18	-.20
U.S. Treasury 10-year indexed note	1.70	2.00	1.85	1.81	.11	-.19	-.04
Municipal revenue (Bond Buyer) ⁵	4.89	5.04	5.24	5.03	.14	-.01	-.21
Private instruments							
10-year swap	3.67	4.66	4.71	4.57	.90	-.09	-.14
10-year FNMA ⁶	3.84	4.72	4.77	4.57	.73	-.15	-.20
10-year AA ⁷	4.13	5.05	5.12	4.88	.75	-.17	-.24
10-year BBB ⁷	5.16	5.74	5.71	5.46	.30	-.28	-.25
5-year high yield ⁷	8.95	7.94	8.01	7.70	-1.25	-.24	-.31
Home mortgages (FHLMC survey rate) ⁸							
30-year fixed	5.21	5.81	5.99	5.83	.62	.02	-.16
1-year adjustable	3.51	3.73	4.08	4.00	.49	.27	-.08

Stock exchange index	Record high		2003	2004		Change to Sept. 16 from selected dates (percent)		
	Level	Date	Dec. 31	Aug. 9	Sept. 16	Record high	2003 Dec. 31	2004 Aug. 9
Dow-Jones Industrial	11,723	1-14-00	10,454	9,815	10,244	-12.61	-2.00	4.38
S&P 500 Composite	1,527	3-24-00	1,112	1,065	1,124	-26.45	1.04	5.47
Nasdaq	5,049	3-10-00	2,003	1,775	1,904	-62.29	-4.96	7.29
Russell 2000	606	4-5-04	557	518	575	-5.25	3.17	10.83
Wilshire 5000	14,752	3-24-00	10,800	10,312	10,957	-25.73	1.45	6.25

1. Secondary market.
2. Financial commercial paper.
3. Bid rates for eurodollar deposits collected around 9:30 a.m. Eastern time.
4. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
5. Most recent Thursday quote.
6. Constant maturity yields estimated from Fannie Mae domestic noncallable coupon securities.
7. Derived from smoothed corporate yield curves estimated using Merrill Lynch bond data.
8. For week ending Friday previous to date shown.

NOTES:

June 28, 2004, is the day before the beginning of the current tightening period.
 August 9, 2004, is the day before the most recent FOMC meeting.

The International Economy

Erratum: The first sentence on page IV-27 of Part 2 should read: “Real GDP in **Taiwan** fell at an annual rate of 0.6 percent in the second quarter, as consumption spending contracted in the wake of the confusion surrounding the March presidential elections.”