Prefatory Note

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Class III FOMC - Internal (FR)

Part 2

October 26, 2005

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

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

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Domestic Nonfinancial Developments

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Overview

Hurricane Rita hit the Gulf Coast on September 24, barely four weeks after Hurricane Katrina. These storms caused considerable damage and disruption, and although the overall magnitudes of their immediate effect and aftermath are still uncertain, they undoubtedly depressed economic activity in September and October. The energy sector was most clearly affected, as the hurricanes severely curtailed oil and natural gas extraction and petroleum refining in the Gulf region. Despite progress in bringing the Gulf's energy production capacity back on line, a significant portion of that capacity remains shut in, and recovery is expected to continue for some time. Energy prices jumped sharply in the wake of each hurricane, and while the ongoing restoration of energy production capacity has brought energy prices down from their post-hurricane peaks, they generally remain at lofty levels.

The limited information currently available suggests that economic activity outside of the Gulf region, at least so far, appears to have been well maintained. Hiring in September in the areas unaffected by the hurricanes was reported to be in line with its moderate pace of expansion over the preceding year, and, excluding the estimated effects of the hurricanes and the Boeing strike on production, industrial output increased briskly last month. In addition, residential construction remained buoyant. Consumer spending, however, showed some signs of weakness. Although spending appears to have been strong for the third quarter as a whole, it was particularly soft in September, and consumer confidence has slumped noticeably since August. Despite the huge increase in consumer energy costs, core price inflation was still restrained through September.

Energy Sector

Hurricane Rita caused further disruption to energy production in the Gulf area, which had not yet fully recovered from Hurricane Katrina. Immediately after the second hurricane, essentially all crude oil extraction, more than three-quarters of natural gas extraction, and about two-thirds of petroleum refining in the Gulf region was shut in.[1] The energy production lost in the Gulf area limited total domestic crude oil production and petroleum refining to about 70 percent of their pre-Katrina levels, while total domestic natural gas production stood at about 85 percent of its pre-hurricane level.

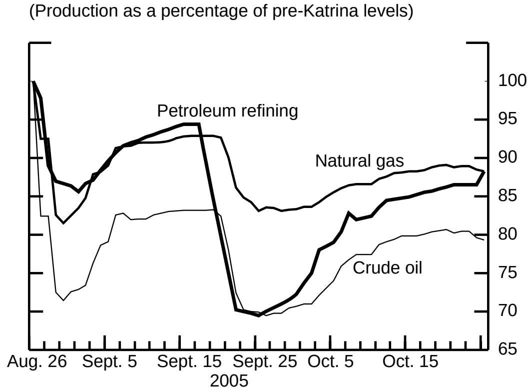
Activity in October is still below pre-hurricane levels, although progress has been made in bringing shutdown energy facilities back on line. As of October 24, total domestic crude oil production was running at about 80 percent of its pre-Katrina level, and natural gas production remained below 90 percent of its pre-hurricane rate.[2] Full recovery is not expected until the spring of next year. Meanwhile, four Gulf area refineries remain idle,

[1] The Gulf region accounts for nearly 30 percent of U.S. crude oil extraction, about 20 percent of natural gas extraction, and 47 percent of domestic refining capacity.

[2] A few platforms were evacuated as a precautionary measure prior to Hurricane Wilma's entry into the Gulf. However, these shutdowns, which account for little additional shut-in production, should be temporary.

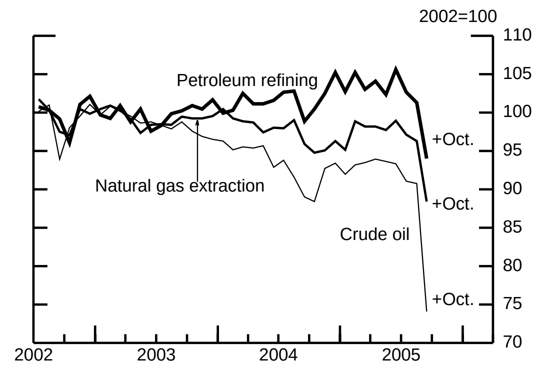
Energy Production and Inventories

Energy Production



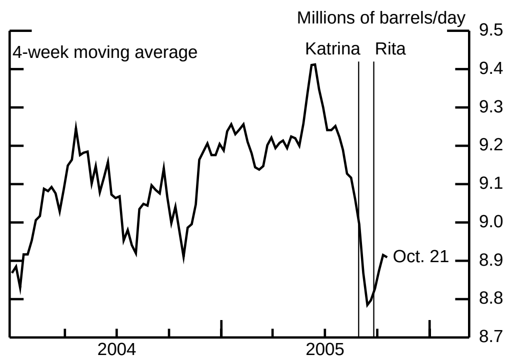
Source. Department of the Interior, Department of Energy, and staff calculations.

Energy IP



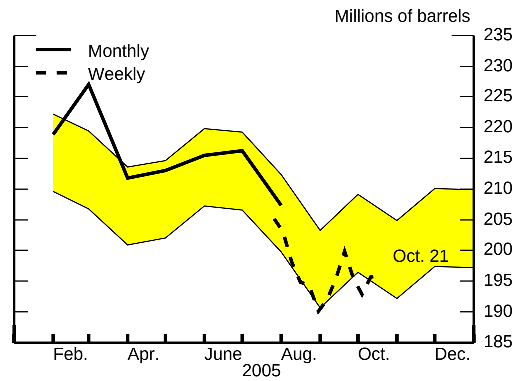
Note. October values are based on available weekly data and estimates of facilities that remain off line.

Gasoline Consumption



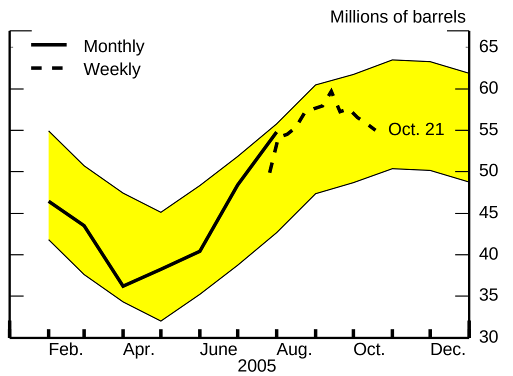
Note. U.S. gasoline product supplied (or apparent consumption), seasonally adjusted by FRB staff.
Source. Department of Energy.

Gasoline Inventories



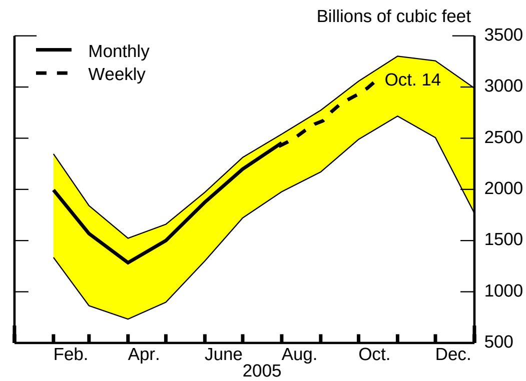
Note. Shaded region is average historical range for 2000-04 as calculated by Energy Information Administration.

Heating Oil Inventories



Note. Shaded region is average historical range for 2000-04 as calculated by FRB staff.

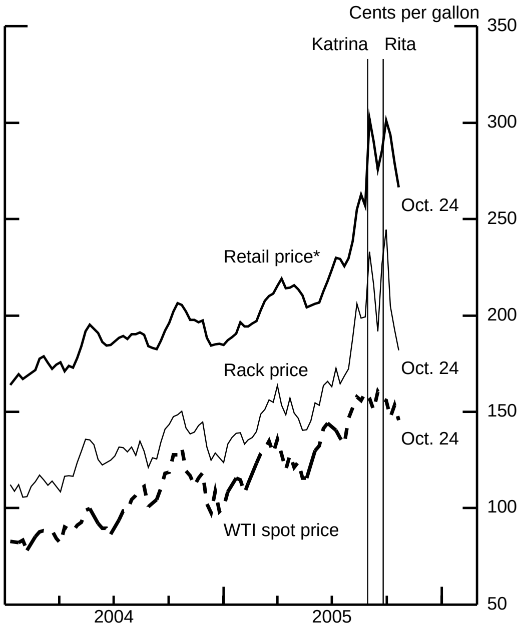
Natural Gas Inventories



Note. Shaded region is average historical range for 2000-04 as calculated by FRB staff.

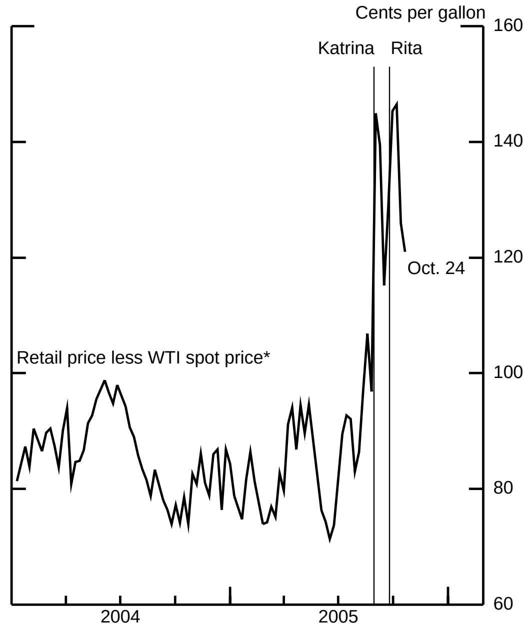
Energy Prices

Gasoline Price Decomposition



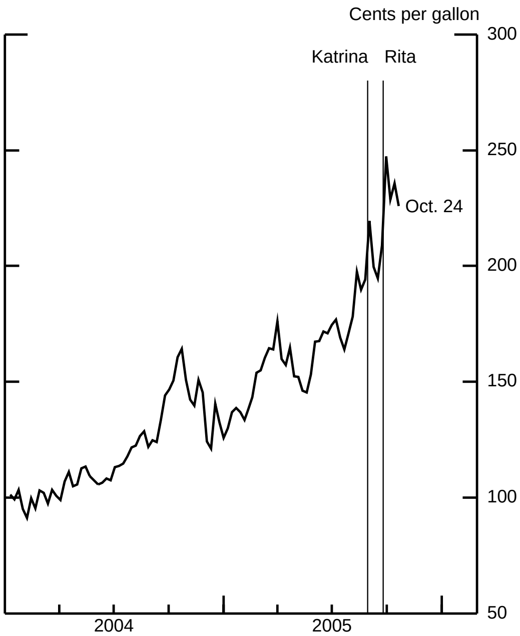
* Regular grade seasonally adjusted by FRB staff.
Source. Oil Price Information Service.

Total Gasoline Margin



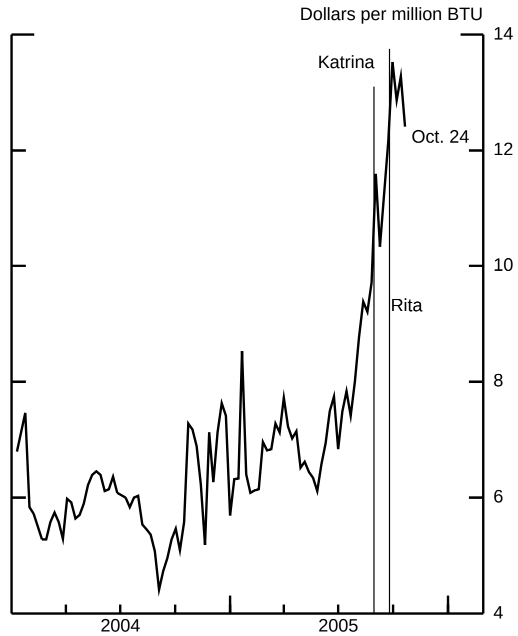
* Regular grade seasonally adjusted by FRB staff, less West Texas intermediate spot price.
Source. Oil Price Information Service.

Heating Oil Prices



Note. Price on racks at bulk terminals.
Source. Oil Price Information Service.

Natural Gas Prices



Note. National average spot price.
Source. Bloomberg.

and another six are in the process of restarting or are operating at reduced rates, keeping domestic refining output below 90 percent of its pre-Katrina level. Some refinery outages are expected to last until the end of the year.

While Hurricane Katrina had trimmed a bit off industrial production at the end of August, the hurricanes caused the IP index for oil and natural gas extraction and refining to plummet 11 percent in September. Although the level of production in the energy industries remains below pre-hurricane levels, the industries' recoveries are expected to provide a small boost to the rate of change in energy IP in October.

Following the hurricanes, rising imports, along with more-subdued consumption of gasoline and other petroleum products, helped to offset some of the output losses in refined products. In addition, to address the low level of gasoline inventories and more-immediate retail demands, domestic refiners sharply increased the share of gasoline in their output of total refined product.[3] These developments helped to boost gasoline inventories a bit, although they still hover near their low pre-hurricane levels. At the same time, inventories of heating oil and other refined products (such as diesel fuel and jet fuel) have declined from their high pre-hurricane levels as a result of shutdown production and the shift in the refining mix. In contrast, as the Gulf's natural gas production capacity has recovered, inventories of natural gas have continued to accumulate, and their current level is a little above average for this time of year.

Wholesale gasoline prices spiked soon after Rita's landfall but have since declined to pre-hurricane levels. Retail prices for regular gasoline have declined more than 30 cents per gallon from their post-Rita peak. Although retail gasoline prices and margins are down from their recent highs, they remain above levels seen before the hurricanes. Prices for heating oil are significantly above their pre-Katrina peak. The shift in the refining mix, and concerns about supply for the winter, have resulted in heating oil prices falling back only modestly as refining capacity has come back on line. Rising spot prices for natural gas soared further with the hurricanes and remain at elevated levels, even though the inventory situation for natural gas appears comfortable at the moment. Indeed, because of limited capability to import natural gas, concerns about the adequacy of inventories for the peak winter heating season have intensified as some capacity in the Gulf is expected to remain shut in through the end of the winter.

Labor Market Developments

The rise in employment in September was held down by job losses associated with Hurricane Katrina. Private nonfarm payrolls fell 66,000 in September, whereas the level

[3] By mid-October, gasoline's share of total refining output was about 55 percent, significantly above its usual 49 percent share for October.

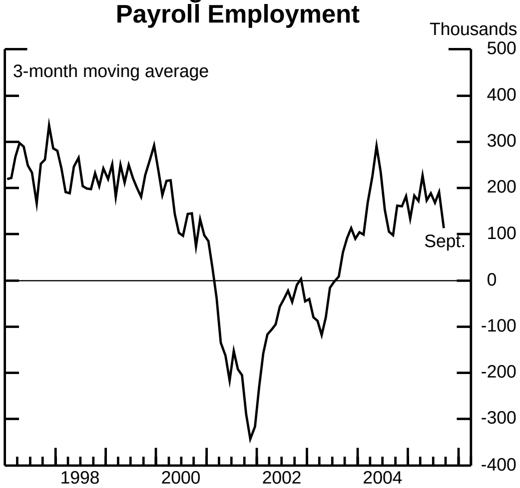
Changes in Employment

(Thousands of employees; seasonally adjusted)

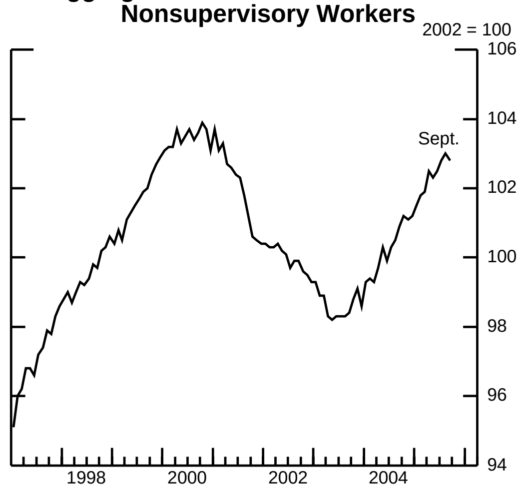
Measure and sector	2004	2005 Q1	2005 Q2	2005 Q3	2005 July	2005 Aug.	2005 Sept.
	Average monthly change				Monthly change		
Nonfarm payroll employment (establishment survey)	183	182	198	151	277	211	-35
Private	171	172	188	113	220	185	-66
Previous	171	172	188	...	200	154	...
Manufacturing	3	-6	-13	-14	-6	-9	-27
Construction	23	24	24	18	5	27	23
Wholesale trade	7	6	7	5	8	6	3
Retail trade	13	17	23	-7	52	16	-88
Transportation and utilities	9	18	8	0	8	1	-9
Information	-2	2	4	2	0	5	2
Financial activities	12	13	14	16	19	17	11
Professional and business services	45	41	37	49	58	38	52
Temporary help services	15	9	8	23	19	18	32
Nonbusiness services[1]	59	51	83	40	75	83	-38
Total government	12	10	10	38	57	26	31
Total employment (household survey)	146	115	379	265	438	373	-17
Memo:							
Aggregate hours of private production workers (percent change)[2]	2.4	2.3	2.8	1.7	.3	.2	-.2
Average workweek (hours)[3]	33.7	33.7	33.7	33.7	33.7	33.7	33.7
Manufacturing (hours)	40.8	40.6	40.4	40.5	40.5	40.5	40.5

1. Nonbusiness services comprises education and health, leisure and hospitality, and "other."
2. Establishment survey. Annual data are percent changes from Q4 to Q4. Quarterly data are percent changes from preceding quarter at an annual rate. Monthly data are percent changes from preceding month.
3. Establishment survey.
... Not applicable.

Changes in Private Payroll Employment



Aggregate Hours of Production or Nonsupervisory Workers



of private employment in August was revised up 51,000.[4,5] Although the BLS did not publish a precise figure on hurricane-related job losses, it stated that employment in the areas unaffected by the hurricane appeared to increase in line with the average pace over the twelve months ending in August. On the basis of this information, we estimate that Hurricane Katrina held down employment by approximately 220,000 in September.[6] However, measuring the change in employment stemming from such a major disruption is difficult and is associated with a wide band of uncertainty.

The largest employment loss in September occurred in the leisure and hospitality category, an industry particularly hard hit by Hurricane Katrina. Employment in retail trade also registered a sharp decline, much of which was likely the consequence of hurricane disruptions and higher energy prices. In manufacturing, only the ship and boat building category experienced job losses that appeared to be related directly to the hurricane. Elsewhere in manufacturing, and in industries such as natural resources and health services, establishments in the storm-affected region, particularly large ones, had apparently either reopened, continued to pay their idle employees, or relocated such employees. Also, the marked increase in the demand for workers in temporary help services may have reflected in part the hiring of relief workers.

The workweek remained at 33.7 hours in September, and aggregate hours of production or nonsupervisory workers declined 0.2 percent, an indication of only a small hurricane-related effect. For the third quarter as a whole, aggregate hours increased at an annual rate of 1.7 percent after a rise of 2.8 percent in the second quarter.

In the household survey, the unemployment rate moved up 0.2 percentage point in September to 5.1 percent, largely because of an increase in the number of newly unemployed. Although the BLS did not estimate the effect of Hurricane Katrina on the unemployment rate, part of the increase may be attributable to the hurricane. In contrast, the participation rate held steady at 66.2 percent in September. While some individuals displaced by Hurricane Katrina may have reported themselves as being out of the labor

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[4] Hurricane Katrina hit the Gulf two weeks before the reference period for the September survey. In response, the BLS made unprecedented changes in how it processed the establishment survey data. In areas that FEMA deemed flooded or hit by catastrophic or extensive damage, the BLS imputed zero employment for nonresponding establishments rather than following its usual procedure of imputing the change according to the reports of similar establishments. Furthermore, the BLS included data from firms in the New Orleans, Gulfport-Biloxi, and Pascagula metropolitan areas that reported zero employment rather than following its usual procedure of assuming that these were firm terminations that were offset by startups. Finally, the BLS reweighted the data in the hardest-hit counties, where underreporting was a problem. Hurricane Rita made landfall after the reference period for the September survey.

[5] The BLS announced that its preliminary benchmark revision estimate would reduce total nonfarm payroll employment in the March 2005 reference month by 191,000, or 0.1 percent, a fairly small revision.

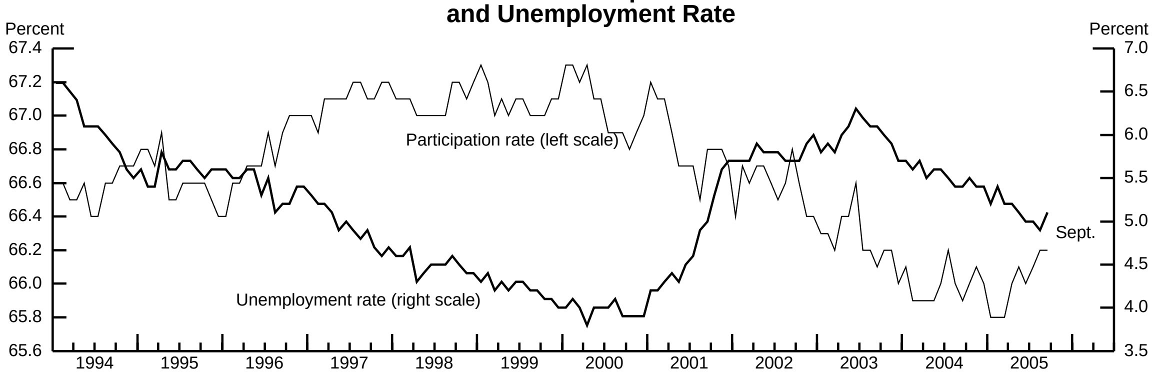
[6] In addition, employment counts in September were depressed by 22,500 because of the strikes at Boeing and Northwest Airlines. The Boeing strike ended on September 29, and the 18,300 employees who were on strike will reappear on payrolls in October. However, the 4,200 mechanics at Northwest Airlines who went on strike on August 20 have not yet returned to work.

Selected Unemployment and Labor Force Participation Rates

(Percent; seasonally adjusted)

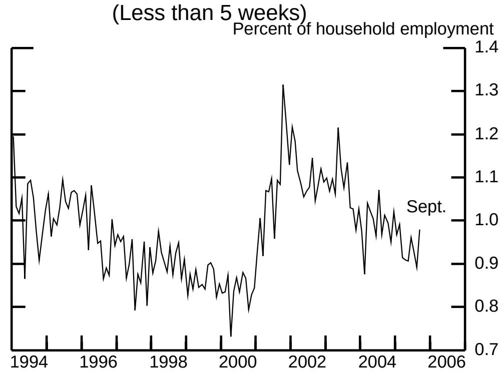
Rate and group	2004	2005 Q1	2005 Q2	2005 Q3	2005 July	2005 Aug.	2005 Sept.
Civilian unemployment rate							
Total	5.5	5.3	5.1	5.0	5.0	4.9	5.1
Teenagers	17.0	16.9	17.3	16.1	16.1	16.5	15.8
20-24 years old	9.4	9.5	8.8	8.6	8.3	8.9	8.7
Men, 25 years and older	4.4	4.1	3.8	3.8	3.8	3.6	3.9
Women, 25 years and older	4.4	4.1	4.2	4.2	4.3	4.0	4.3
Labor force participation rate							
Total	66.0	65.8	66.0	66.2	66.1	66.2	66.2
Teenagers	43.8	43.5	43.9	43.9	43.8	44.1	43.6
20-24 years old	75.0	74.4	74.3	74.7	74.7	74.5	74.7
Men, 25 years and older	75.3	75.2	75.5	75.6	75.5	75.7	75.5
Women, 25 years and older	59.3	59.1	59.2	59.5	59.5	59.4	59.6

Labor Force Participation Rate and Unemployment Rate



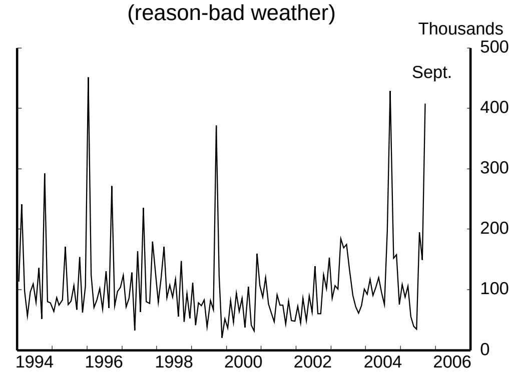
Job Losers

(Less than 5 weeks)



With a Job Not at Work

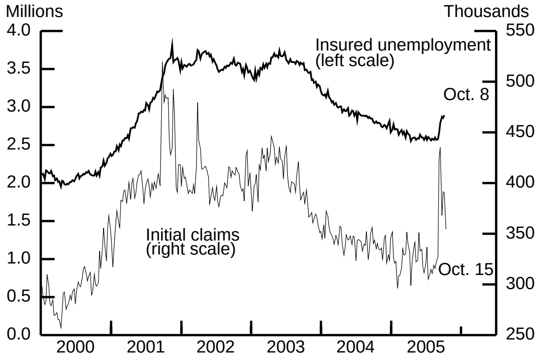
(reason-bad weather)



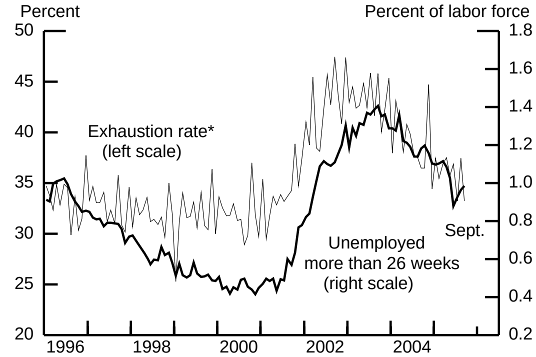
Note. Seasonally adjusted by FRB staff.

Labor Market Indicators

Unemployment Insurance

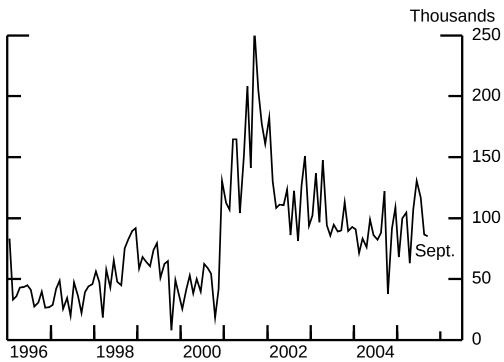


Exhaustion Rate and Long-Term Unemployed



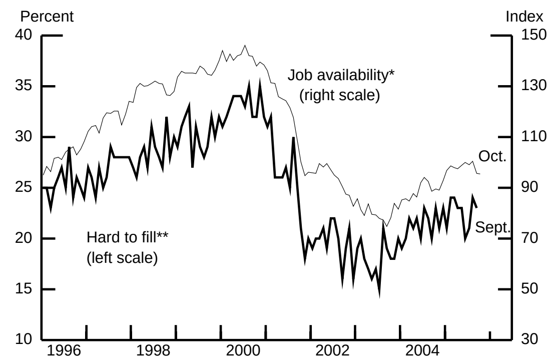
*The exhaustion rate is calculated as the number of individuals who were receiving unemployment insurance benefits but reached the end of their potential eligibility expressed as a percent of individuals who began receiving such benefits six months earlier.

Layoff Announcements



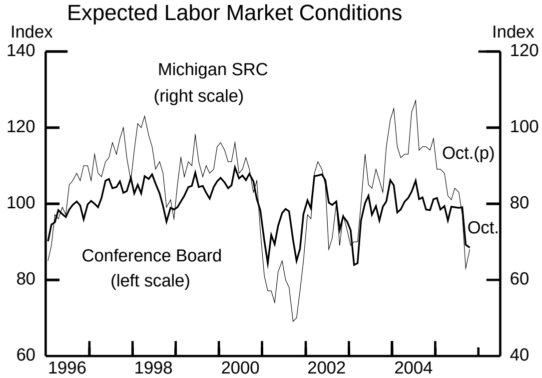
Note. Seasonally adjusted by FRB staff.
Source. Challenger, Gray, and Christmas, Inc.

Labor Market Tightness



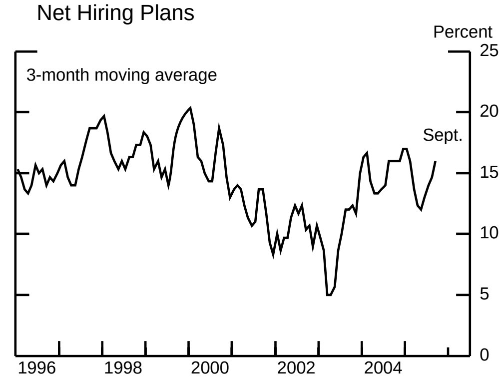
*Proportion of households believing jobs are plentiful, minus the proportion believing jobs are hard to get, plus 100.
**Percent of small businesses surveyed with at least one "hard to fill" job opening.
Source. For job availability, Conference Board; for hard to fill, National Federation of Independent Business.

Expected Labor Market Conditions



Note. The proportion of households expecting labor market conditions to improve, minus the proportion expecting conditions to worsen, plus 100.
p Preliminary.

Net Hiring Plans



Note. Percent planning an increase in employment minus percent planning a reduction.
Source. National Federation of Independent Business.

force, the number of individuals reporting that they had a job but were not at work because of bad weather increased tremendously last month to a seasonally adjusted level of 408,000, the highest level since the hurricane-affected September reading of last year. Initial claims for unemployment insurance are indicative of substantial job losses associated with hurricanes Katrina and Rita. As of the week ending October 15, the Employment and Training Administration (ETA) estimates that nearly 480,000 of the claims filed since early September have been related to the hurricanes.[7] Alternatively, the cumulative effects of the hurricanes can be measured by the increase in insured unemployment, which, as of the week ending October 8, stood about 300,000 above its pre-Katrina level. However, job losses associated with the hurricanes appear to be subsiding. In the most recent reporting week, 355,000 new claims were filed—well below the peak of the surge after the hurricanes and almost back to its pre-hurricane range.

Most other indicators of current labor market activity appear to have been unaffected by the hurricanes—at least so far—and remain generally consistent with moderately improving labor market conditions. The exhaustion rate moved down in September, retracing its August rise. After falling sharply in June, the percentage of the labor force unemployed more than twenty-six weeks has moved up gradually over the past several months, but still remains below the May level. Layoff announcements fell back in August from early summer highs and persisted at this lower level in September. The share of firms reporting to the National Federation of Independent Businesses (NFIB) that they had a hard-to-fill position was little changed in September and remained close to its highest level this year. However, household perceptions of labor market conditions were a little less upbeat. According to the Conference Board, household assessments of job availability were nearly unchanged in October after having fallen sharply in September to their lowest level since the end of last year.

Forward-looking indicators of labor market conditions paint a mixed picture, as households' expectations are apparently less optimistic than those of businesses. The net hiring plans of small businesses reporting to the NFIB were unchanged last month after having popped up in August, and the three-month moving average climbed to its highest level since February. In contrast, households' expected labor market conditions, as reported in both the Michigan and Conference Board surveys in September, fell back to their lowest levels in several years. In October, the preliminary reading from the Michigan survey suggests only a slight recovery in expectations, while expectations in the Conference Board survey worsened a bit further.

Industrial Production

The hurricanes and the strike at Boeing took their toll on industrial output in September. As a result, total IP fell 1.3 percent. But, excluding the effects of the hurricane-related

[7] This estimate is also subject to some uncertainty. In particular, the ETA simply tallies the reports filed by the state agencies, and different states may have used different criteria to categorize claims as hurricane-related.

Selected Components of Industrial Production
(Percent change from preceding comparable period)

Component	Proportion 2004 (percent)	2004[1]	2005 H1	2005 Q3	2005 July	2005 Aug.	2005 Sept.
			Annual rate		Monthly rate		
Total	**100.0**	**4.3**	**2.5**	**1.3**	**.0**	**.2**	**-1.3**
Previous	100.0	4.3	2.5	...	.1	.1	...
Ex. hurricanes and Boeing strike	100.0	4.3	2.5	5.2	.0	.5	.8
Manufacturing	81.9	5.1	2.5	2.3	.1	.3	-.5
Ex. motor veh. and parts	74.7	5.3	2.8	1.4	.3	.1	-.8
Ex. high-tech industries	70.2	4.4	1.7	-.5	.1	-.1	-1.1
Mining	8.3	-2.0	5.7	-16.5	-.9	-.8	-9.1
Utilities	9.8	2.7	.4	10.7	.0	-.5	-.9
Selected industries							
High technology	4.5	18.7	21.0	31.0	2.9	2.1	3.7
Computers	1.0	6.9	13.8	9.8	.7	.7	.8
Communications equipment	1.2	9.6	15.0	29.3	3.6	.7	3.9
Semiconductors[2]	2.3	29.9	27.2	40.5	3.5	3.3	4.6
Motor vehicles and parts	7.2	2.9	-1.2	12.5	-1.6	3.1	2.2
Market groups excluding energy and selected industries							
Consumer goods	22.0	3.7	1.8	-.1	-.4	.0	.2
Durables	4.3	1.3	-1.9	2.4	-.6	1.2	1.1
Nondurables	17.7	4.3	2.7	-.6	-.3	-.3	.0
Business equipment	7.7	9.3	8.7	2.6	2.3	-.6	-5.4
Defense and space equipment	1.9	6.1	13.3	6.3	1.3	.8	-3.5
Construction supplies	4.3	3.8	3.2	3.3	.7	.9	.2
Business supplies	8.1	3.2	3.0	-2.5	-.3	.0	-.3
Materials	25.2	3.9	-1.8	-1.8	.0	-.2	-.9
Durables	13.9	4.6	-2.0	2.3	.0	.4	1.0
Nondurables	11.3	2.9	-1.5	-6.7	.1	-.9	-3.3

1. From fourth quarter of preceding year to fourth quarter of year shown.
2. Includes related electronic components.
... Not applicable.

Capacity Utilization
(Percent of capacity)

Sector	1972-2004 average	1982 low	1990-91 low	2005 Q1	2005 Q2	2005 Q3	2005 Aug.	2005 Sept.
Total industry	**81.0**	**70.8**	**78.6**	**79.3**	**79.4**	**79.4**	**79.8**	**78.6**
Manufacturing	79.8	68.5	77.2	78.1	78.1	78.2	78.5	77.9
High-tech industries	78.3	74.1	74.3	71.8	71.7	74.2	73.8	75.6
Excluding high-tech industries	79.9	68.2	77.3	79.0	79.0	79.0	79.3	78.6
Mining	87.1	78.6	83.5	87.5	88.3	84.6	87.0	79.1
Utilities	86.8	77.7	84.2	84.4	85.1	87.0	87.2	86.3

disturbances and the Boeing strike, industrial production is estimated to have risen a brisk 0.8 percent in September. Our best estimate of the effects of the hurricanes in September is that the change in IP was reduced by about 1.7 percentage points, and the Boeing strike subtracted nearly another 0.5 percentage point. For the third quarter as a whole, IP increased at an annual rate of just 1.3 percent, about the same pace as in the second quarter, when output was restrained by a marked slowing in inventory accumulation. Excluding the hurricane and strike effects, the third-quarter rise in IP is estimated to have been at an annual rate of about 5.2 percent.

Besides the energy-producing industries, the hurricanes also significantly affected chemicals producers. In particular, petrochemical production, which is concentrated along the Gulf Coast near feedstocks, plunged 20 percent in September. As of October 17, facilities that account for roughly 12.5 percent of domestic petrochemical capacity remained closed. Elsewhere, manufacturing output fell noticeably in the shipbuilding, food manufacturing (including sugar, coffee, seafood, and poultry), paper, and plywood industries.

The machinists' strike at Boeing, which lasted from September 2 to September 29, caused the company to cease nearly all commercial aircraft production during the month.[8] Boeing expects to return production rapidly to pre-strike levels—thereby contributing about ½ percentage point to the change in IP in October—and will likely boost output further in the coming months to make up for the production losses. Elsewhere in transportation equipment, motor vehicle production climbed 300,000 units in September to an annual rate of 12.5 million units. In the third quarter, automakers assembled vehicles at an annual rate of 12.2 million units, a pace about ½ million units higher than assemblies in the second quarter. Despite current inventories of light motor vehicles near a record low after the summer sell-off, the industry plans to begin the official 2006 model year with a production rate of 11.9 million units in the fourth quarter, about 300,000 units below the third-quarter pace.

High-tech output—led by strong gains in the production of semiconductors and communications equipment—surged 3¾ percent in September. In the third quarter, high-tech output rose at an annual rate of 31 percent, a significant acceleration from the tepid second-quarter pace and the largest quarterly increase since the middle of 2000. Semiconductor production jumped 4.6 percent in September, and monthly output gains averaged almost 4 percent during the third quarter. Production gains in the industry were broad-based and were led by especially large increases for chips used in communications equipment and consumer electronics. Intel's revenue guidance for the fourth quarter

[8] Machinists at Boeing's facilities in Long Beach, Calif., are covered by a different union contract and continued to produce new 717s, although they are regularly scheduled to deliver only one plane per month. The company reported that six 737s were delivered in September, but final delivery represents a fairly small share of the production of an aircraft.

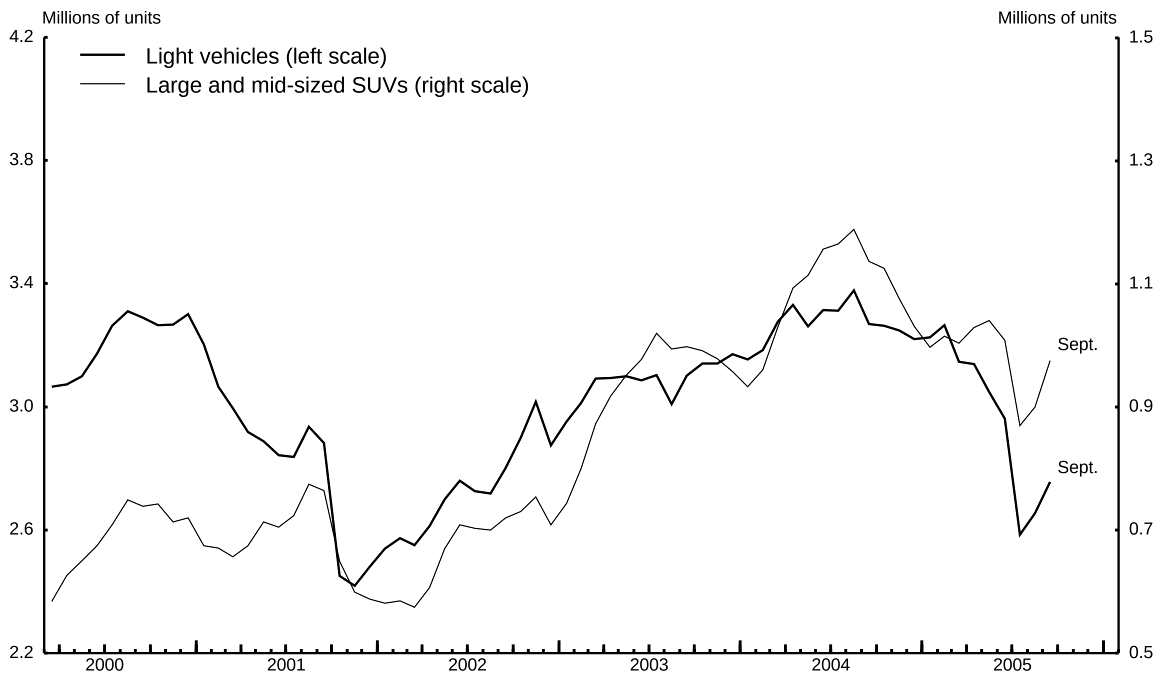
Production of Domestic Light Vehicles

(Millions of units at an annual rate except as noted; FRB seasonals)

Item	2004	2005					
		H1	Q3	Q4	July	Aug.	Sept.
U.S. production[1]	11.7	11.5	11.8	11.5	11.4	11.8	12.1
Autos	4.3	4.3	4.3	4.2	4.4	4.3	4.3
Light trucks	7.4	7.2	7.4	7.3	7.0	7.5	7.7
Days' supply[2]	74	68	59	n.a.	47	61	65
Autos	59	53	44	n.a.	45	47	44
Light trucks	83	77	68	n.a.	47	71	82
Inventories[3]	3.22	2.96	2.76	n.a.	2.58	2.65	2.76
Autos	1.02	.93	.82	n.a.	.85	.85	.82
Light trucks	2.20	2.03	1.93	n.a.	1.73	1.80	1.93
Memo: U.S. production, total motor vehicles[4]	12.0	11.9	12.2	11.9	11.9	12.2	12.5

Note. Components may not sum to totals because of rounding.
1. Production rate for the fourth quarter reflects the latest schedules from Ward's Communications.
2. Quarterly values are calculated with end-of-period stocks and average reported sales.
3. End-of-period stocks.
4. Includes medium and heavy trucks.
n.a. Not available.

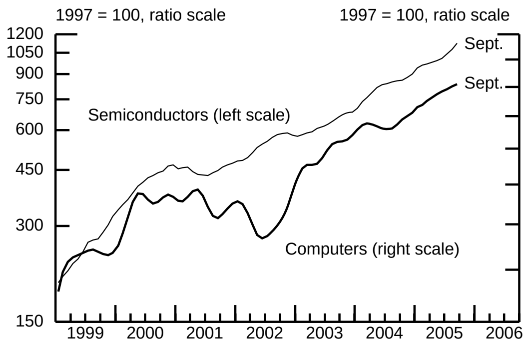
Inventories of Light Vehicles



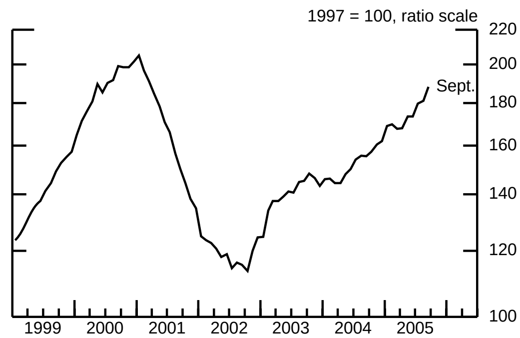
Note. FRB seasonals. Monthly totals.

Indicators of High-Tech Manufacturing Activity

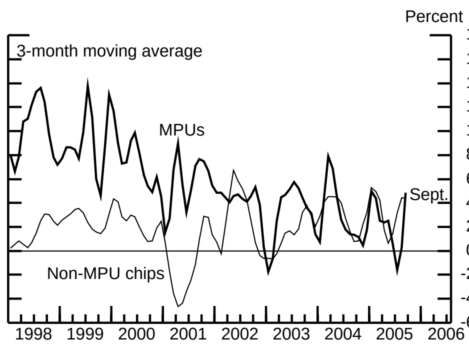
IP: Computers and Semiconductors



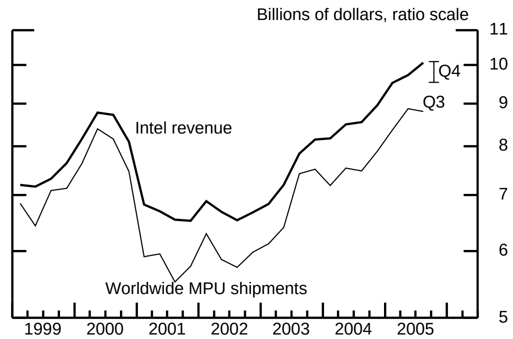
IP: Communications Equipment



Rate of Change in Semiconductor Industrial Production

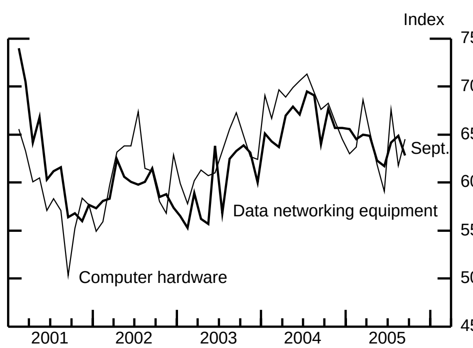


Microprocessor Unit (MPU) Shipments and Intel Revenue



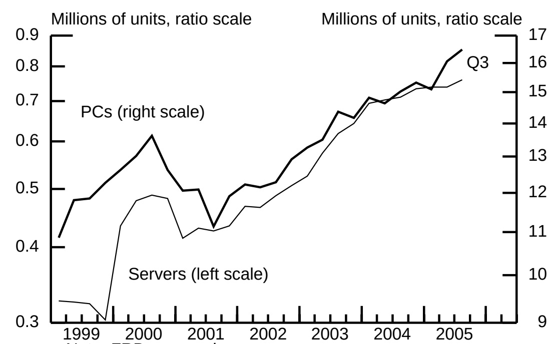
Note. Q4 is the range of Intel's revenue guidance as of October 18, 2005. FRB seasonals.
Source. Intel and Semiconductor Industry Association.

CIO Magazine Future Spending Diffusion Indexes



Note. The diffusion index equals the percentage of respondents planning to increase future spending plus one-half the percentage of respondents planning to leave future spending unchanged.
Source. CIO Magazine.

U.S. Personal Computer and Server Sales

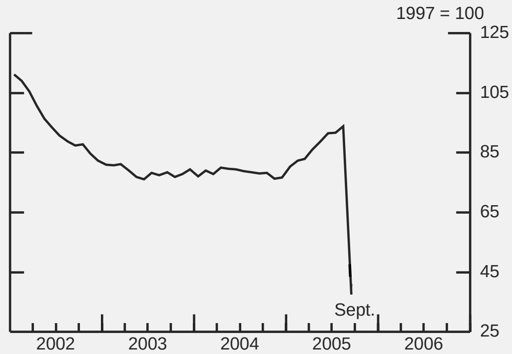


Note. FRB seasonals.
Source. Gartner.

Indicators of Manufacturing Activity

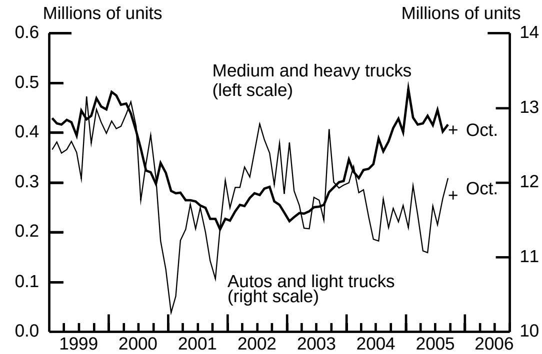
Content partially redacted.

IP: Commercial Aircraft



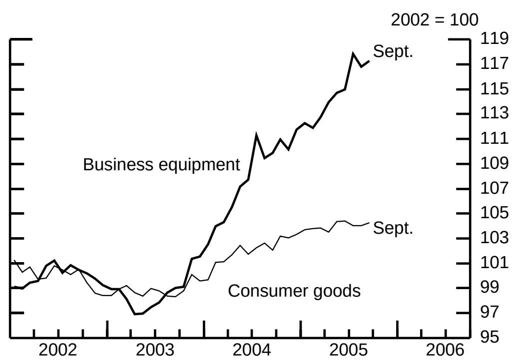
Note. The forecasts are based on confidential scheduled assembly rates from Boeing.

Motor Vehicle Assemblies



Note. October values are based on latest industry schedules.

IP: Business Equipment and Consumer Goods

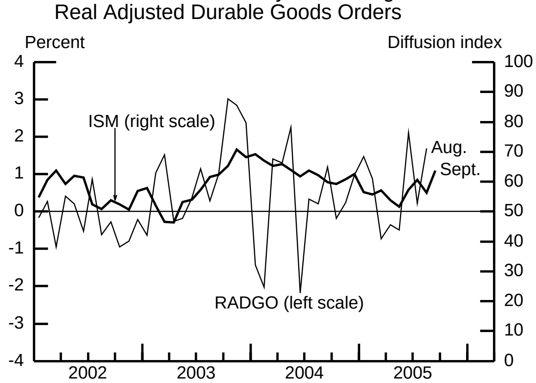


Note. Data exclude energy, motor vehicles and parts, commercial aircraft, and high-tech industries.

IP: Construction Supplies and Business Supplies

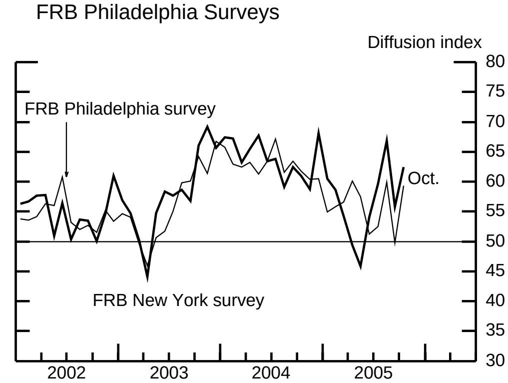
Note. Data exclude energy, motor vehicles and parts, and high-tech industries.

New Orders: ISM Survey and Change in Real Adjusted Durable Goods Orders



Note. The diffusion index equals the percentage of respondents reporting greater levels of new orders plus one-half the percentage of respondents reporting that new orders were unchanged. RADGO is a 3-month moving average.

New Orders: FRB New York and FRB Philadelphia Surveys



Note. The diffusion index equals the percentage of respondents reporting greater levels of new orders plus one-half the percentage of respondents reporting that new orders were unchanged.

suggests continued strength in real output of microprocessors, though the pace of production gains will likely slow a bit. Although the monthly index for communications equipment has been volatile of late, production has expanded substantially—output jumped at an annual rate of nearly 30 percent in the third quarter—and industry reports support a bright outlook for this sector. Computer producers remain the laggards among domestic high-tech manufacturers, as production gains are running below the pace of the late 1990s. However, recent data from Gartner indicates that sales of PCs and servers were strong in the third quarter, and that strength is perhaps a forerunner of a larger step-up in production in this category.

In other market groups, output gains continue to be mixed. Excluding the strike-related drop in aircraft production, the output of business equipment rose in September and was up at an annual rate of nearly 10 percent during the third quarter. In addition, the output of defense and space equipment jumped at an annual rate of more than 6 percent in the third quarter despite the hurricanes' disruption to shipbuilding. In contrast, the production of consumer goods, which had been weak over most of the year, only edged up in September. The production of construction supplies rose slightly in September, but output increased at an annual rate of 3.3 percent for the third quarter overall, and production should be supported in the future by the rebuilding in the Gulf region. The output of business supplies edged down for a fourth consecutive month in September.

Forward-looking indicators of manufacturing activity generally point to solid production gains in the coming months. The three-month moving average of the Board staff's series on real adjusted durable goods orders rose about 1¾ percent in August, and the Institute for Supply Management's new orders diffusion index jumped in September to its highest level in more than a year. The first readings for October from the regional surveys were also favorable; the new orders diffusion indexes from both the FRB New York and the FRB Philadelphia surveys rose smartly to levels consistent with solid output gains in the months ahead.

Motor Vehicles

Sales of light vehicles declined more than 400,000 units in September to an annual rate of 16.3 million units. General Motors, Ford, and Chrysler extended their employee discount programs through the end of September. By most accounts, however, the pricing schemes, which had boosted sales to near-record levels earlier in the summer, offered only modest support to sales in September, as they had been set to expire earlier and their potential effect had likely already run much of its course.[9] In addition, inventories of the most popular GM and Ford 2005 models were nearly depleted at the beginning of September. For the third quarter as a whole, however, sales of light vehicles averaged 17.9 million units, the highest pace recorded in almost four years.

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[9] September marked the fourth month of employee discount pricing at General Motors, and the third at Ford and Chrysler.

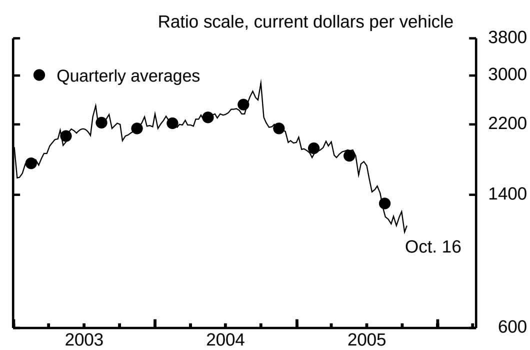
Sales of Light Vehicles
(Millions of units at an annual rate; FRB seasonals)

		2005					
Category	2004	Q1	Q2	Q3	July	Aug.	Sept.
Total	16.9	16.5	17.2	17.9	20.7	16.8	16.3
Autos	7.5	7.5	7.6	8.0	8.1	7.8	8.0
Light trucks	9.4	9.0	9.6	10.0	12.6	9.0	8.3
North American[1]	13.5	13.2	13.7	14.5	17.0	13.4	13.0
Autos	5.4	5.4	5.4	5.7	5.8	5.6	5.7
Light trucks	8.1	7.8	8.3	8.8	11.3	7.8	7.3
Foreign-produced	3.4	3.3	3.5	3.5	3.6	3.4	3.3
Autos	2.1	2.1	2.2	2.3	2.3	2.2	2.3
Light trucks	1.2	1.2	1.3	1.2	1.3	1.2	1.1
Memo: Big Three domestic market share (percent)[2]	58.7	57.7	58.4	57.3	61.6	54.7	54.6

Note. Components may not sum to totals because of rounding. Data on sales of trucks and imported autos for the most recent month are preliminary and subject to revision.

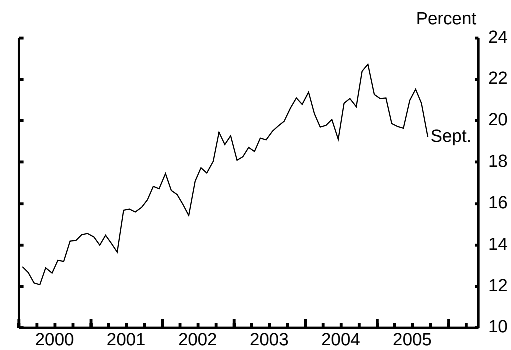
1. Excludes some vehicles produced in Canada that are classified as imports by the industry.
2. Domestic market share excludes sales of foreign brands affiliated with the Big Three.

Average Value of Incentives on Light Vehicles



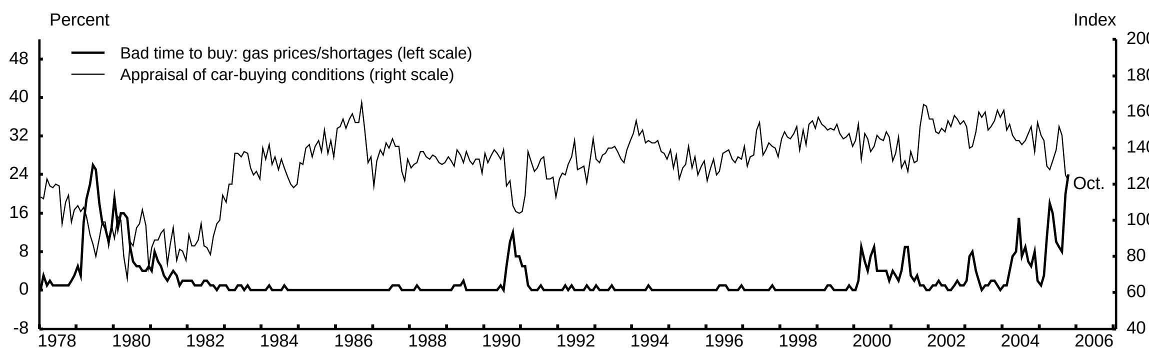
Note. Weighted average of customer cash rebate and interest rate reduction. Data are seasonally adjusted.
Source. J.D. Power and Associates.

Market Share of Large and Mid-Sized SUVs



Note. FRB seasonals.

Michigan Survey Index of Car-Buying Attitudes



Note. October data are preliminary.

Because employee discounts substituted for traditional consumer incentives in September, the average incentive per light vehicle sold declined $66 last month.[10] In October, incentives have fallen an additional $60 despite the expiration of the employee discount programs. Part of the recent decline reflects a sharp drop in September in the market share of large and mid-sized SUVs, which carry larger cash-back rebates than do other market segments. Going forward, statements by General Motors—the market leader in incentives—indicate that the automaker intends to curtail incentives for the 2006 model year. GM's commitment to pricing with lower average incentives over the next several months is a topic of industry speculation, and the transition could be challenged if sales are weak this fall.

Although price discounts boosted consumers' car buying attitudes this summer, high gasoline prices took a toll on consumer sentiment in September and October. Motor vehicle buying conditions, as measured in the Michigan SRC index, fell sharply in September, and preliminary data for October indicate that the index has edged down a bit further this month. The percentage of respondents who blamed high gasoline prices or gasoline shortages for the deterioration in vehicle buying conditions jumped to 20 percent in September and increased further to 24 percent in October, a level not seen since July 1979.

Looking ahead, automakers anticipate that the pace of sales will cool considerably in the fourth quarter, partly as payback for the sales this summer that were brought forward by the discount programs. Press reports in October indicate that showroom traffic at auto dealerships has slumped, and our industry contacts anticipate that sales of light vehicles in October will move down into the range of 14½ million to 15½ million units.

Consumer Spending

Real consumer spending appears to have increased at an annual rate of about 3½ percent in the third quarter as a whole, although it slowed markedly in August and September after having risen substantially earlier in the summer. The recent slump in spending reflects in part the diminishing boost to light vehicle sales from manufacturers' employee discount programs. However, spending on other goods and services has also been sluggish, likely as a consequence of the direct effects of the dislocation of households by the hurricanes, stratospheric energy prices, and falling consumer confidence. The personal saving rate has been below zero since June and stood at negative ¾ percent in August, held down 0.3 percentage point, according to the BEA, by the estimated effects on personal income of Hurricane Katrina.

In the retail control category of goods, which excludes sales by auto dealers and building material and supply stores, nominal spending increased 1 percent in September—about the same as in August—and was led by an increase of 4 percent in spending at gasoline stations. Retail sales at gasoline stations include items other than gasoline, such as

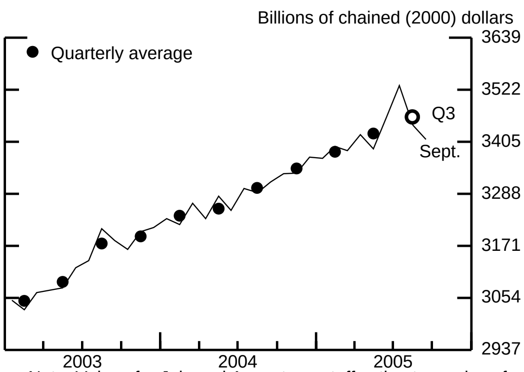
[10] The employee discounts were measured as reductions in price and not as incentives by J.D. Power and Associates.

Retail and Food Services Sales
(Percent change from preceding period; seasonally adjusted current dollars)

Category	2005 Q1	Q2	Q3	July	Aug.	Sept.
	Annual rate			Monthly rate		
Total sales	6.0	10.8	6.7	1.7	-1.9	.2
Retail control[1]	7.3	9.0	9.7	.6	1.1	1.0
Previous estimate	7.3	9.0	...	.5	1.0	...
Memo: Real PCE goods ex. autos and trucks[2]	6.5	4.5	2.8	.0	.0	-.8

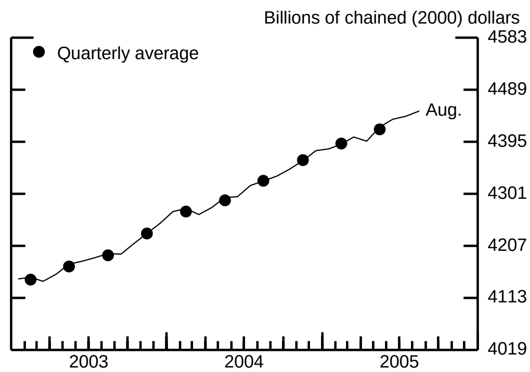
1. Total sales less outlays at building material and supply stores and automobile and other motor vehicle dealers.
2. Values for July and August are staff estimates; values for Q3 and September are staff forecasts.
... Not applicable.

Real PCE Goods



Note. Values for July and August are staff estimates; values for September and 2005:Q3 are staff forecasts.

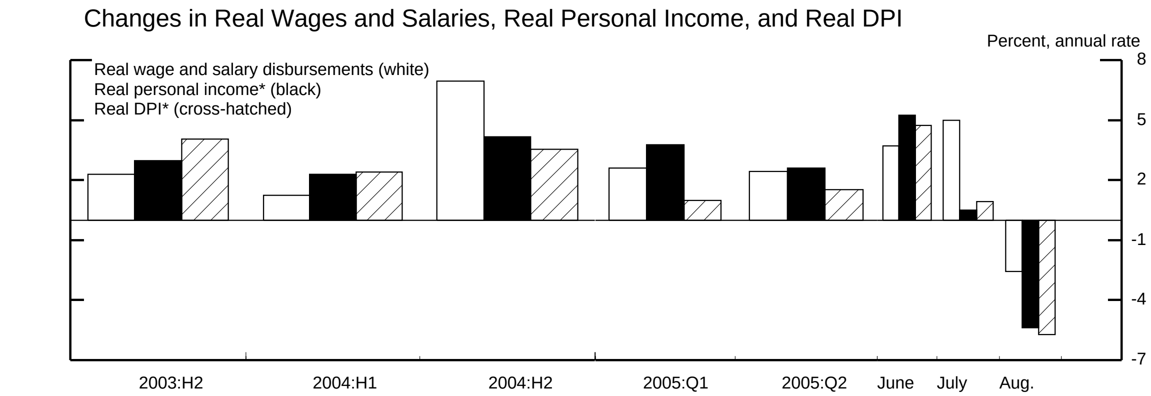
Real PCE Services



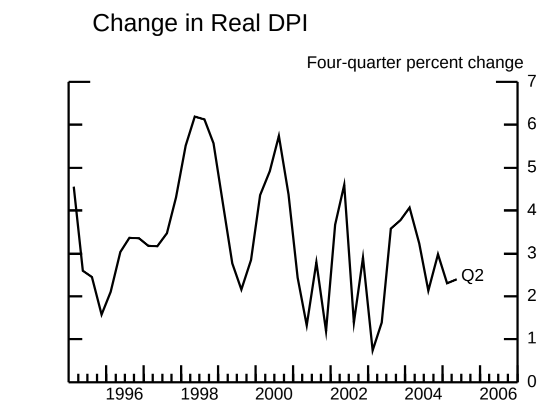
Personal Saving Rate

Note. Value for December 2004 excludes the effect on income of the one-time Microsoft dividend in that month.
* Values for July and August 2005 are staff estimates.

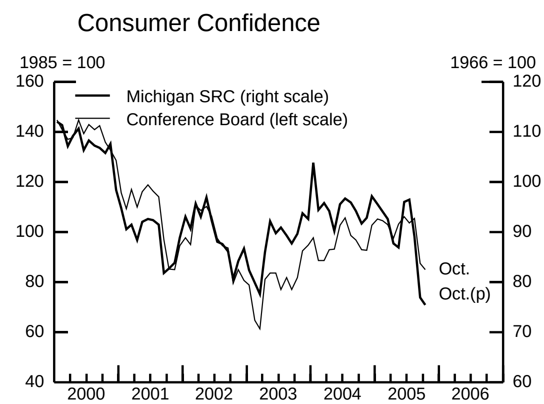
Fundamentals of Household Spending



* Values for 2004:H2 and 2005:Q1 exclude the effect on income of the one-time Microsoft dividend in December. Value for August 2005 is a staff estimate.



Note. Value for 2004:Q4 excludes the effect on income of the one-time Microsoft dividend in December.



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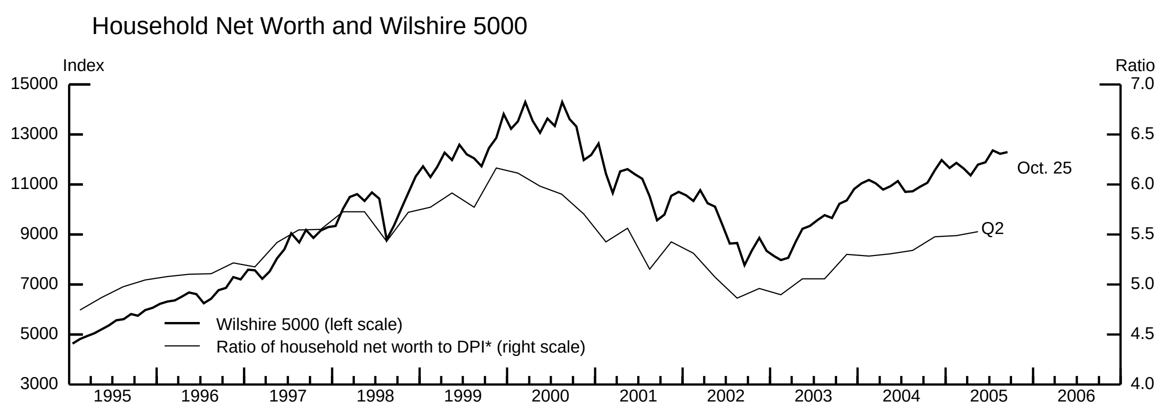


* Value for 2004:Q4 excludes the effect on income of the one-time Microsoft dividend in December.

purchases at convenience stores, but a 4 percent increase is remarkably small in light of the 18 percent rise in gasoline prices last month. Taking the retail sales data at face value, we estimate that real spending in PCE goods excluding motor vehicles fell 0.8 percent in September after having been unchanged in August.[11]

Rising home prices have continued to boost household wealth, but equity prices have declined recently, and other fundamentals for consumer spending have also been a little less favorable because of factors related to the hurricanes. Although nominal wages and salaries rose in August, real disposable income fell ½ percent, mostly because of steep increases in energy prices and Hurricane Katrina's hit to rental and proprietor's income.[12] Increases in average hourly earnings suggest a further gain in nominal wages and salaries in September, but sharply higher energy prices presumably held down real income last month. Rising interest rates are also damping the rise in consumer spending. Consumer sentiment in October, as measured by both the preliminary reading of the Michigan Survey and the Conference Board, dropped a little further after having plunged in September. Consumer sentiment appears to have weakened even more than underlying fundamentals would suggest and is likely putting some downward pressure on spending.

Housing Markets

Residential construction has continued at a robust pace. New single-family homes were started at an annual rate of 1.75 million units in September, a bit above their average level in the first half of the year. New adjusted permit issuance jumped in September to a new high of 1.75 million units, while the backlog of unused permits was still near record levels. In the multifamily sector, starts in August and September remained at the average pace seen since 2001. Permits for these units in the past two months were a bit lower than in the first half of the year but remained strong in comparison with previous years.

New home sales in August fell 9.9 percent from July's elevated level to an annual rate of 1.24 million units. The stock of new homes for sale moved up in August and represented 4.7 months of supply at August's sales pace. Although months' supply is now at the upper end of the range it has occupied since 1996, it remains low by historical norms. Sales of existing single-family homes rose 0.6 percent in September after having risen 1¾ percent in August. Inventories of existing homes for sale moved up in September and

[11] Because Department of Energy data indicate that nominal gasoline sales increased 15 percent in September, this estimate was constructed by using the BEA's standard methodology, which allocates most of the apparent relative weakness in retail sales at gasoline stations to other expenditure categories.

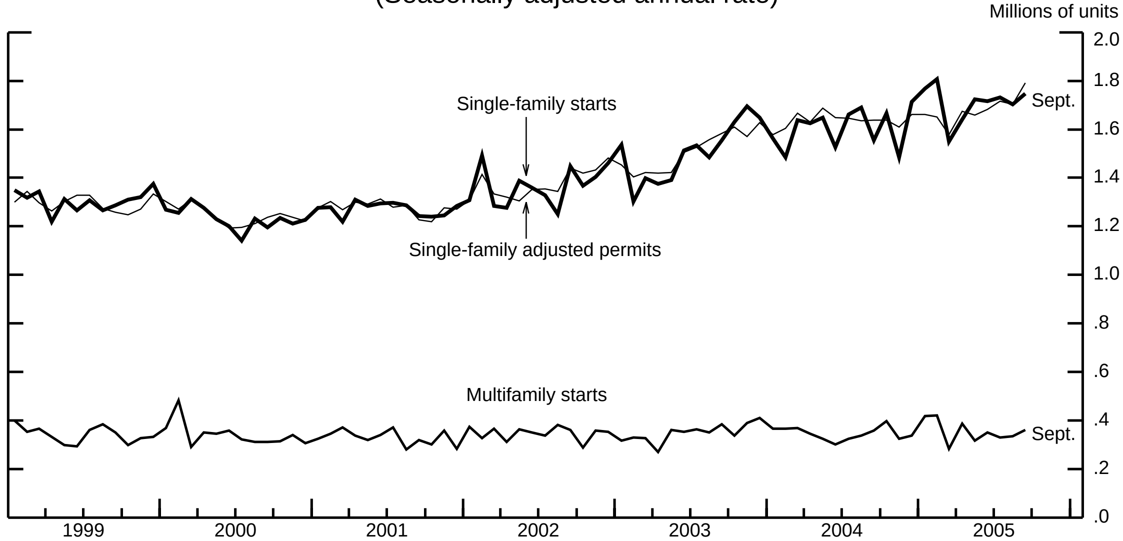
[12] The BEA's hurricane-related adjustments to personal income in August, which include a $92 billion decrease in rental income and a $6 billion reduction in proprietors' income, were partly offset by a $72 billion increase in transfer payments. The decreases in rental and proprietors' income stem from estimated uninsured losses in housing and proprietorships, and the increase in transfer payments reflects estimated business payments for insured losses outside these two categories. The BEA's estimates of the effects of Hurricane Katrina on personal income are preliminary because insurance data are still not available.

Private Housing Activity
(Millions of units, seasonally adjusted; annual rate except as noted)

Sector	2004	2005 Q1	2005 Q2	2005 Q3	2005 July	2005 Aug.	2005 Sept.
All units							
Starts	1.96	2.08	2.04	2.07	2.06	2.04	2.11
Permits	2.05	2.08	2.11	2.17	2.17	2.14	2.19
Single-family units							
Starts	1.61	1.71	1.69	1.73	1.73	1.70	1.75
Permits	1.60	1.60	1.64	1.71	1.69	1.68	1.75
Adjusted permits[1]	1.64	1.63	1.67	1.74	1.72	1.70	1.79
Permit backlog[2]	.15	.15	.16	.17	.16	.16	.17
New Homes							
Sales	1.20	1.25	1.29	n.a.	1.37	1.24	n.a.
Months' supply[3]	4.03	4.30	4.30	n.a.	4.10	4.70	n.a.
Existing Homes							
Sales	5.96	5.98	6.30	6.32	6.23	6.34	6.38
Months' supply[3]	4.30	4.00	4.30	4.60	4.50	4.70	4.60
Multifamily units							
Starts	.35	.37	.35	.34	.33	.34	.36
Permits	.46	.48	.47	.46	.48	.46	.44
Permit backlog[2]	.07	.07	.06	.06	.06	.07	.06
Mobile homes							
Shipments	.13	.14	.13	n.a.	.13	.12	n.a.
Condos and co-ops							
Existing home sales	.82	.85	.93	.92	.92	.94	.90

1. Adjusted permits equal permit issuance plus total starts outside of permit-issuing areas.
2. Number outstanding at end of period. Excludes permits that have expired or have been canceled, abandoned, or revoked. Not at an annual rate.
3. At current sales rate. The ratio of n.s.a. inventories to n.s.a. sales is seasonally adjusted by the Census Bureau; as a result, the s.a. ratio may not be the same as the ratio of s.a. inventories to s.a. sales. Quarterly and annual figures are averages of monthly figures.
n.a. Not available.

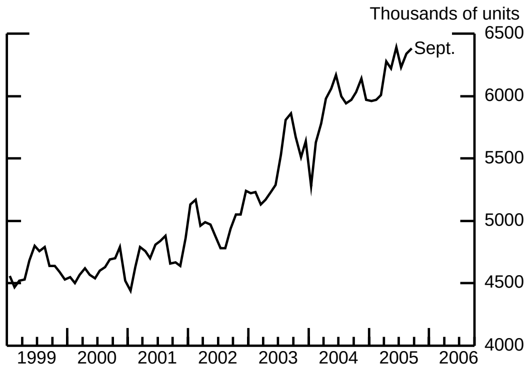
Private Housing Starts and Permits
(Seasonally adjusted annual rate)



Note. Adjusted permits equal permit issuance plus total starts outside of permit-issuing areas.

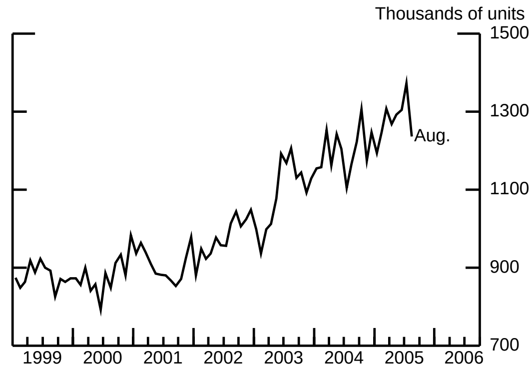
Indicators of Single-Family Housing

Existing Home Sales



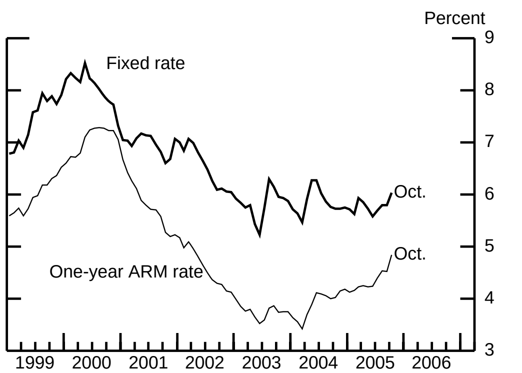
Source. National Association of Realtors.

New Home Sales



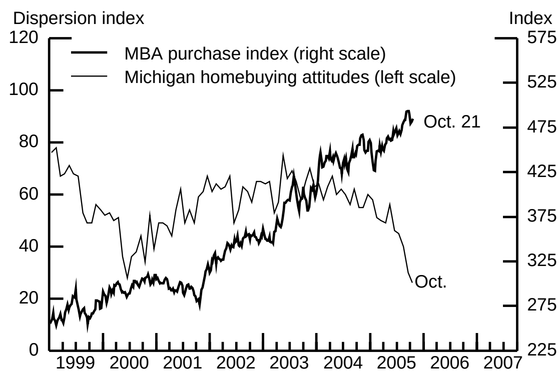
Source. Census Bureau.

Mortgage Rates



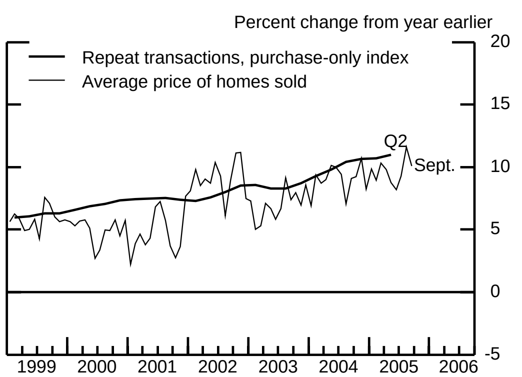
Note. The October readings are based on data through October 19, 2005.
Source. Freddie Mac.

Homebuying Indicators



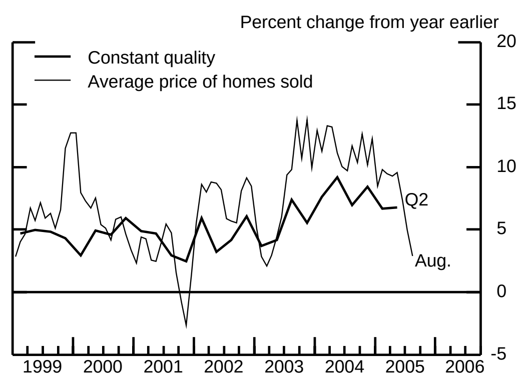
Note. MBA index is a 4-week moving average. Builders' ratings are seasonally adjusted by Board staff.
Source. Mortgage Bankers Association and Michigan Survey.

Prices of Existing Homes



Source. For repeat transactions, OFHEO; for average price, National Association of Realtors.

Prices of New Homes



Note. Average price of homes sold is a 3-month moving average.
Source. Census Bureau.

equaled 4.7 months' supply at September's pace—also at the high end of recent readings but a good bit below the historical average.

Other recent indicators of homebuying activity have been mixed. Although they remain low historically, both the thirty-year fixed mortgage rate and the one-year adjustable rate have moved up a bit in recent months and are now about 40 and 75 basis points, respectively, above the levels seen at the beginning of the year. The Michigan SRC index of homebuying attitudes fell sharply in September and October to its lowest level since October 2000. In contrast, the Mortgage Bankers Association's index of mortgage applications for home purchases remained elevated through early October. The average price of existing homes sold in September was 10 percent higher than it was a year earlier, about the same increase as in the previous twelve-month period. However, the average price of new homes has decelerated markedly over the past couple of months.

Equipment and Software

Real outlays for equipment and software appear to have been sluggish last summer. Nevertheless, a broad-based pickup in orders and shipments of nondefense capital goods excluding aircraft in August may be pointing to a firming that would bring capital spending into better alignment with relatively solid investment fundamentals—namely, continued expansion in business sales, a declining cost of capital, and corporate balance sheets that are flush with cash. Surveys of executive sentiment currently square well with these fundamentals: Although business leaders have expressed some misgivings about the overall macroeconomic environment, their stated capital spending intentions point to increasing investment.

In the high-tech sector, recent orders and shipments data for computers, on net, point to moderate real spending gains. Similarly, earnings reports from major software vendors have shown solid, though unspectacular, growth. Real outlays for communications equipment likely expanded at a robust pace in the third quarter, a development consistent with industry reports that telecom service providers had planned solid increases in capital spending for the second half of this year.

Outside of a sharp strike-related drop in aircraft investment, business spending on transportation has been well maintained. Domestic automakers, which account for the bulk of fleet sales, appear to have taken advantage of the pause in retail sales in August and September to speed up deliveries of light vehicles to businesses. Sales of medium and heavy trucks were also strong in September; in particular, the recent strength in sales of class 8 trucks, according to industry sources, may reflect some pull-forward in demand before new EPA regulations on engines take effect in 2007.

Real business outlays for non-high-tech, non-transportation equipment appear to have remained soft over the summer after having declined modestly in the second quarter. The most recent data, however, suggest that spending growth may be regaining traction; August shipments of non-high-tech, non-transportation equipment advanced 1.4 percent,

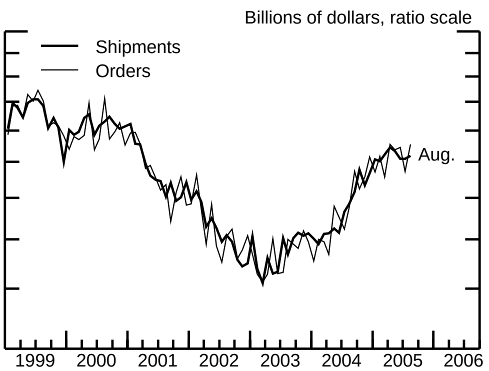
Orders and Shipments of Nondefense Capital Goods

(Percent change; seasonally adjusted current dollars)

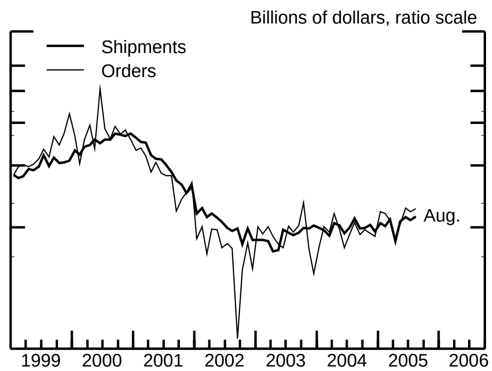
Indicators	2005 Q1	2005 Q2	2005 June	2005 July	2005 Aug.
	Annual rate		Monthly rate		
Shipments	13.0	8.2	.0	-1.2	3.0
Excluding aircraft	15.6	1.3	-.2	-1.0	1.5
Computers and peripherals	30.2	9.3	-2.8	.0	1.0
Communications equipment	16.7	-8.5	3.6	-2.3	2.6
All other categories	13.2	1.0	-.2	-1.0	1.4
Orders	5.9	66.1	-2.2	-7.6	3.8
Excluding aircraft	20.5	2.2	4.9	-3.9	3.1
Computers and peripherals	8.8	36.8	.9	-8.7	10.7
Communications equipment	71.1	-20.5	12.9	-2.7	2.6
All other categories	18.0	.0	4.7	-3.2	1.9
Memo:					
Shipments of complete aircraft[1]	23.9	30.2	27.9	26.8	37.5

1. From Census Bureau, Current Industrial Reports; billions of dollars, annual rate.

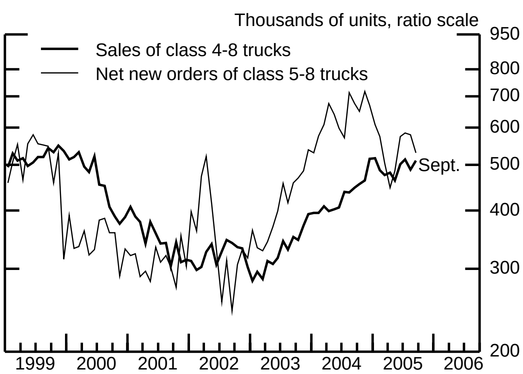
Computers and Peripherals



Communications Equipment

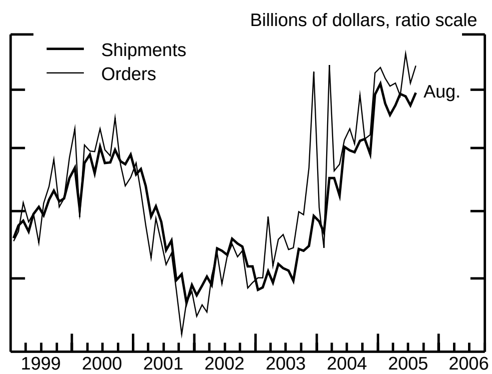


Medium and Heavy Trucks



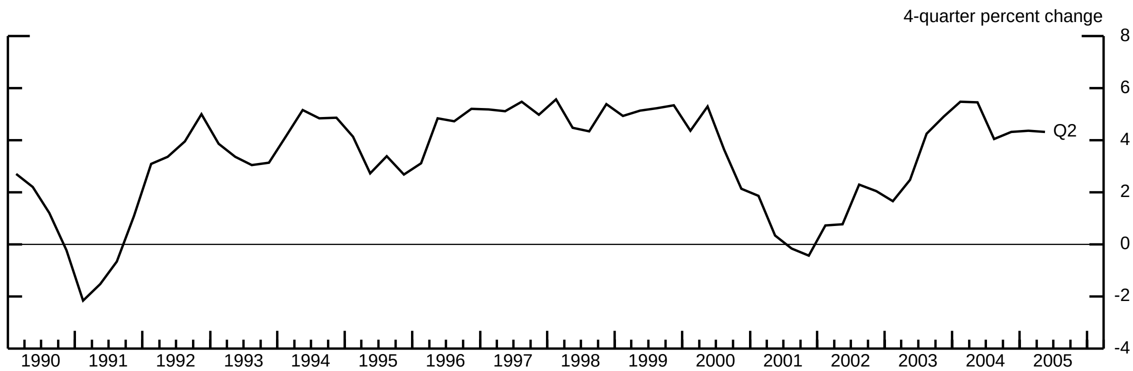
Note. Annual rate, FRB seasonals.
Source. For class 4-8 trucks, Ward's Communications; for class 5-8 trucks, ACT Research.

Other Equipment



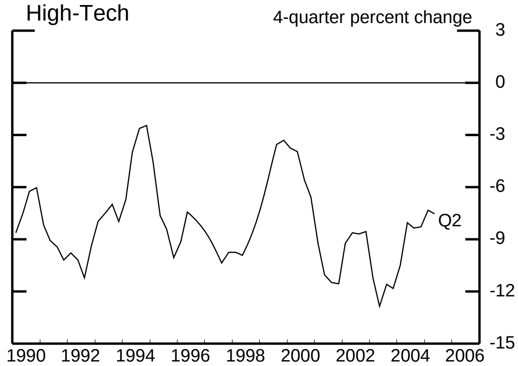
Fundamentals of Equipment and Software Investment

Real Business Output

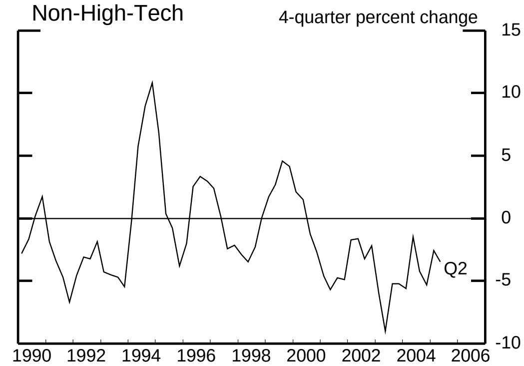


User Cost of Capital

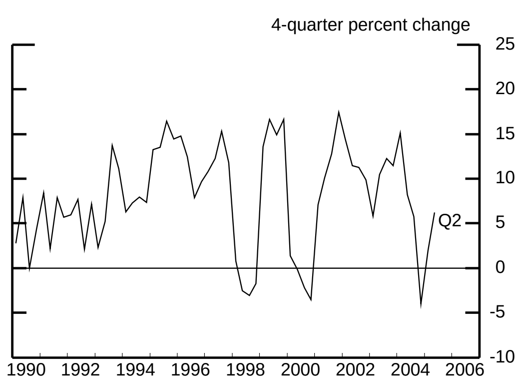
High-Tech



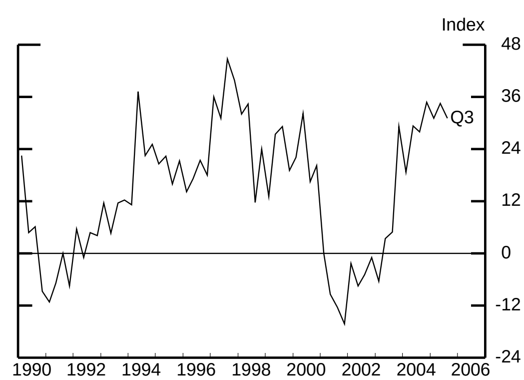
Non-High-Tech



Real Corporate Cash Flow



NABE Capital Spending Diffusion Index



Note. The diffusion index equals the percentage of respondents planning to increase spending minus the percentage of respondents planning to reduce spending.
Source. NABE Industry Survey.

and orders moved up 1.9 percent. Moreover, after having floundered earlier in the year, imports of this type of equipment rose 3.4 percent in August.

Nonresidential Construction
Although vacancy rates for nonresidential properties have continued to edge down, they remain elevated for office and industrial properties, and real spending on new construction has yet to markedly improve. The vacancy rate for office buildings stood at 12½ percent in the third quarter, about 2 percentage points below its peak in the first quarter of 2004. Construction in this sector, however, remains at a low level. Spending on commercial buildings has also held steady at a low level since the middle of 2002, despite persistently high occupancy rates for these types of structures. Furthermore, real construction outlays in the manufacturing sector dipped during the summer after having increased late last year.

In contrast, in the drilling and mining sector, the number of gas rigs in operation continued to rise in September and, according to initial estimates from Baker Hughes, remained high in early October. The number of rigs drilling for crude oil rose over the summer after some weakness last spring and is estimated to have held fairly steady after the recent hurricanes. The Baker Hughes data, however, consider rigs to be operating unless officially confirmed lost or significantly damaged; thus, the data may not yet fully reflect hurricane-related disruptions.[13]

Business Inventories
Business investment in real nonfarm inventories was relatively subdued over the summer. The book value of stocks held by the manufacturing and trade sectors, excluding motor vehicles, increased in July and August at annual rates of $36 billion and $42 billion respectively. However, a portion of the accumulation was in the petroleum sector and probably related to the run-up in oil prices.

Although inventory-to-sales ratios moved down some in July and August, businesses did not appear dissatisfied with their level of stocks. For example, September survey results from the ISM indicate that respondents viewed their customers' current inventory situation as reasonably well aligned with demand. Information from the staff's flow-of-goods inventory system suggests that inventory-consumption ratios rose in September. Excluding motor vehicles, however, much of the increase was concentrated in the chemicals and aerospace industries, in which hurricane- and strike-related shutdowns markedly decreased consumption. Elsewhere—with the exception of paper—inventories remained well aligned with consumption.

Federal Sector
As a result of an exceptionally strong increase in tax receipts in September, the fiscal 2005 budget closed with a deficit of $319 billion. As recently as August, the

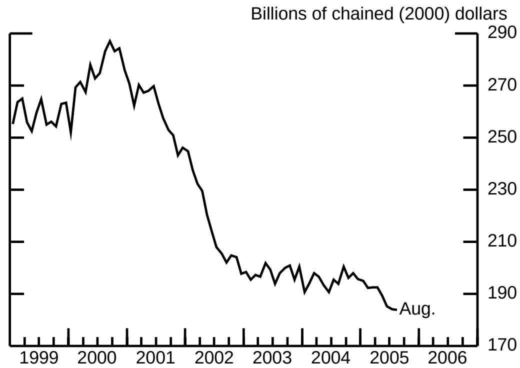
[13] Less than 15 percent of active drilling rigs are located in areas affected by the hurricanes. Reports suggest that only a fraction of rigs in these areas were damaged.

Nonresidential Construction and Indicators

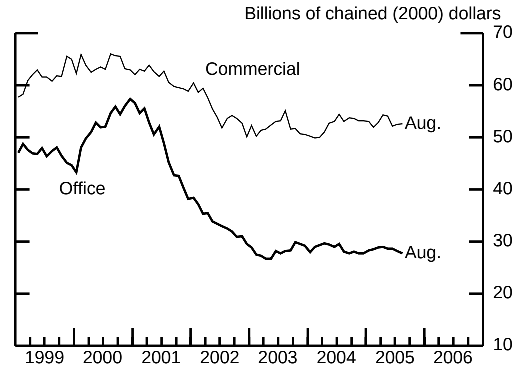
Real Construction

(Seasonally adjusted, annual rate; nominal CPIP deflated by BEA prices through Q2 and by staff projection thereafter)

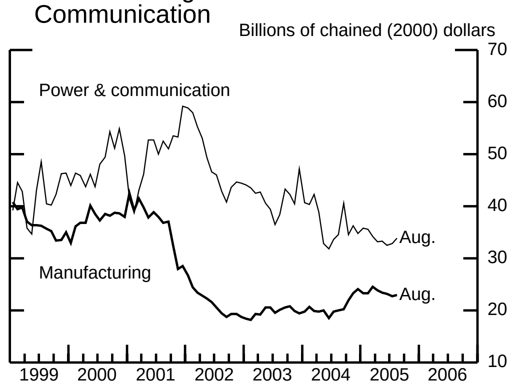
Total Structures



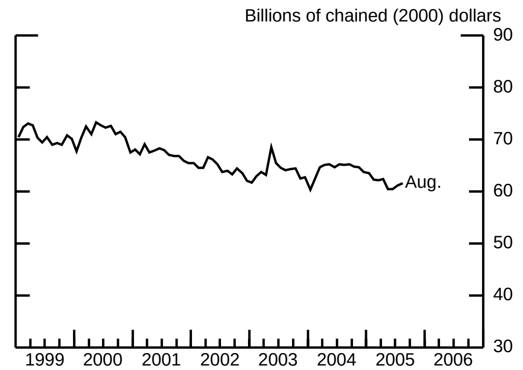
Office and Commercial



Manufacturing and Power & Communication



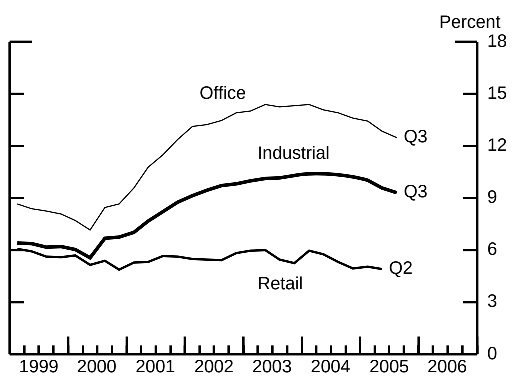
Other



Note. Includes religious, educational, lodging, amusement and recreation, transportation, and health-care facilities.

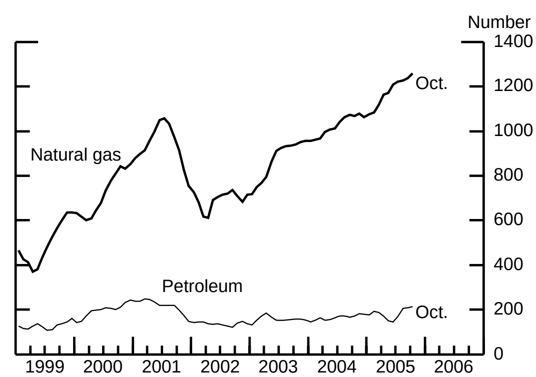
Indicators

Vacancy Rates



Source. For office and industrial, CoStar Property Professional; for retail, National Council of Real Estate Investment Fiduciaries.

Drilling Rigs in Operation

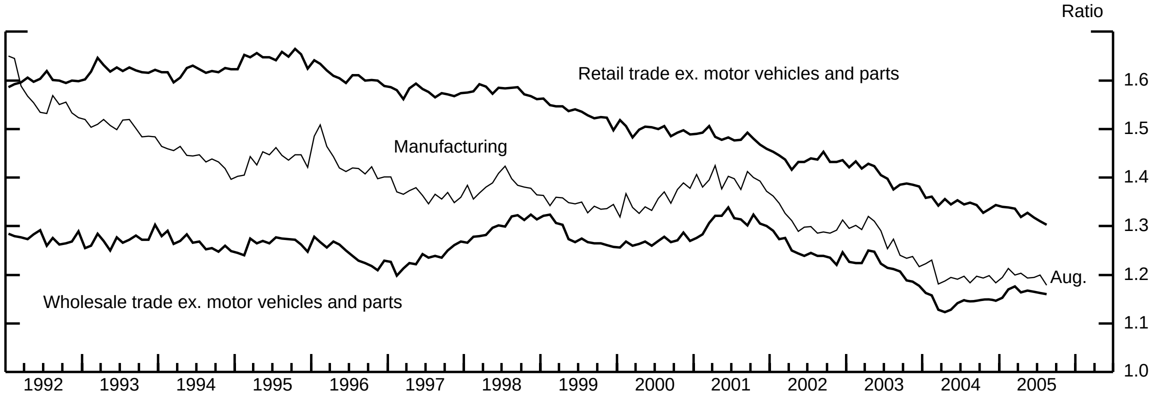


Note. October values are averages through October 21, 2005.
Source. DOE/Baker Hughes.

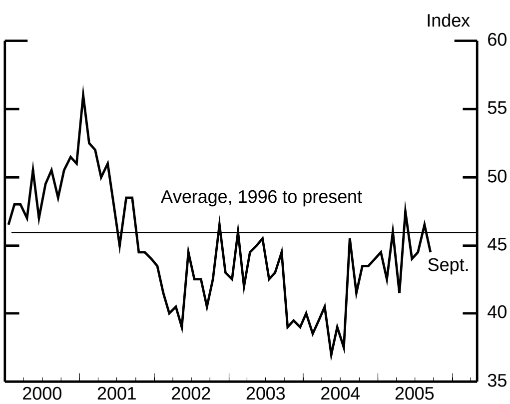
Changes in Manufacturing and Trade Inventories
(Billions of dollars; seasonally adjusted book value; annual rate)

Sector	2004 Q4	2005 Q1	2005 Q2	2005 June	2005 July	2005 Aug.
Manufacturing and trade	86.7	88.6	18.7	-5.7	-66.0	67.0
Ex. wholesale and retail motor vehicles and parts	103.9	92.0	29.1	24.9	35.5	42.1
Manufacturing	37.9	42.6	.9	3.5	32.5	-6.7
Ex. aircraft	35.7	38.1	4.0	8.8	21.5	3.6
Wholesale trade	36.7	30.5	20.2	18.9	4.0	22.1
Motor vehicles and parts	-2.4	-1.1	7.9	12.3	-.3	-4.5
Ex. motor vehicles and parts	39.1	31.6	12.4	6.6	4.3	26.6
Retail trade	12.0	15.5	-2.4	-28.0	-102.5	51.5
Motor vehicles and parts	-14.8	-2.3	-18.3	-42.8	-101.2	29.4
Ex. motor vehicles and parts	26.8	17.7	15.8	14.8	-1.3	22.1

Book-Value Inventories Relative to Shipments and Sales

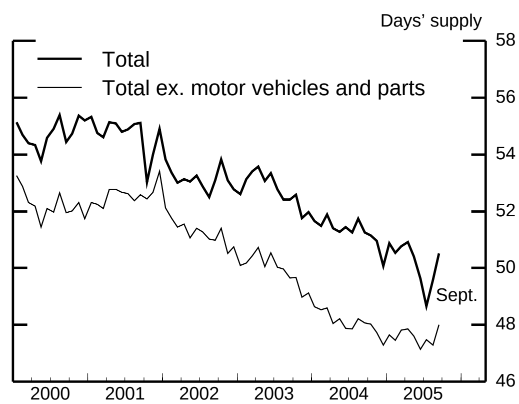


ISM Customer Inventories: Manufacturing



Note. A number above 50 indicates inventories are "too high."

Inventory-Consumption Ratios, Flow-of-Goods System



Congressional Budget Office had projected a deficit of $331 billion for the fiscal year. Legislative initiatives, particularly spending for hurricane disaster relief, continue to put some upward pressure on the deficit outlook.

Tax receipts in September stood 18½ percent above the year-earlier level (after adjusting for payment timing shifts), boosted by a jump of 46 percent in corporate income tax collections.[14] September is an important month for corporate tax collections because of the quarterly tax filing deadline of September 15, and payments last month were much larger than they were in earlier quarters. A portion of the surge in corporate receipts may reflect one-time payments on repatriated corporate foreign earnings.[15] Nonetheless, quarterly payments for nonwithheld personal income and social insurance taxes were 23 percent higher than they were a year earlier, also a larger increase than the one seen in earlier quarterly payments.

Outlays in September, adjusted for shifts in payment timing, rose 12 percent from a year earlier, a significantly larger increase than for the fiscal year as a whole. The acceleration in spending reflected an increase in outlays for disaster relief, Medicare, and defense. Disaster relief spending in September by the Department of Homeland Security totaled $4 billion, an amount about $3½ billion higher than such spending in September 2004.

For the fiscal year as a whole, receipts rose 14 percent, reaching 17½ percent of GDP, while outlays increased 7 percent, remaining around 20 percent of GDP. As a result, the deficit fell from $413 billion in fiscal 2004 to $319 billion in fiscal 2005, or 2½ percent of GDP.

The Congress continues to consider legislation related to hurricane relief. In September, the Congress passed $62.6 billion in new budget authority for disaster relief, $2 billion in borrowing authority for the federal flood insurance program, and $6 billon in tax cuts (over two years).[16] With regards to regular budget legislation, little progress has been made on the annual appropriations bills and on the two reconciliation bills to reduce taxes

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[14]Last year's receipts were held down by a temporary tax code provision that had allowed companies to delay payments of a portion of their corporate income taxes from September until October

[15] A provision in the American Jobs Creation Act of 2004, which allows a temporary, one-year deduction by corporations for earnings repatriated to U.S. parent firms from foreign subsidiaries, results in an effective tax rate of 5.25 percent on the repatriated earnings. Through September, U.S. companies had announced plans to repatriate about $200 billion in foreign profits, which would yield about $10 billion in corporate tax revenue. However, the timing of the payment of these taxes during the year is uncertain.

[16] In September, the Department of Energy sold 11 million barrels of crude oil from the Strategic Petroleum Reserve (at an average price of $63.85 per barrel). In addition, exchange agreements—which are in-kind loans of oil that are paid back with oil—were reached for 13.2 million barrels, although the amount was later reduced to 10.8 million barrels at the request of the contractors. As of October 24, about 5½ million barrels of oil had been delivered from the sale agreements, and almost 9½ million barrels had been delivered from the exchange agreements. Damage done by Hurricane Rita reduced the rate at which purchasers have been able to take delivery of the oil and process it, so delivery is planned to continue through November.

Federal Government Outlays and Receipts

(Unified basis; billions of dollars except as noted)

Function or source	September 2004	September 2005	September Percent change	12 months ending in September 2004	12 months ending in September 2005	12 months ending in September Percent change
Outlays	182.7	216.8	18.7	2292.6	2472.9	7.9
Financial transactions[1]	.3	.0	...	-1.9	-1.3	...
Payment timing[2]	.0	13.0	...	-.3	12.9	...
Adjusted outlays	182.5	203.9	11.7	2294.9	2461.3	7.3
Receipts	207.4	252.6	21.8	1879.8	2154.3	14.6
Payment timing	-6.0	.0	...	.0	6.0	...
Adjusted receipts	213.4	252.6	18.4	1879.8	2148.3	14.3
Surplus or deficit (-)	24.6	35.8	...	-412.8	-318.6	...
Selected components of adjusted outlays and receipts						
Adjusted outlays	182.5	203.9	11.7	2294.9	2461.3	7.3
Net interest	4.7	9.7	106.2	160.5	183.5	14.3
Non-interest	177.7	194.1	9.2	2134.4	2277.8	6.7
National defense	40.5	44.3	9.3	455.7	488.0	7.1
Social Security	41.4	43.8	5.9	495.6	523.3	5.6
Medicare	23.6	26.8	13.7	269.5	295.6	9.7
Medicaid	14.9	14.8	-.4	176.2	181.7	3.1
Income security	22.6	23.2	2.7	334.7	344.6	3.0
Agriculture	-.1	1.4	...	17.3	28.3	63.2
Other	34.9	39.8	14.2	385.4	416.3	8.0
Adjusted receipts	213.4	252.6	18.4	1879.8	2148.3	14.3
Individual income and payroll taxes	149.1	164.5	10.3	1493.9	1673.4	12.0
Withheld + FICA	110.3	115.7	4.9	1397.0	1486.6	6.4
Nonwithheld + SECA	42.8	52.6	22.9	284.5	364.9	28.2
Less: Refunds	3.9	3.8	-2.8	187.6	180.3	-3.9
Corporate	48.3	70.5	46.0	189.4	272.3	43.8
Gross	51.6	72.0	39.6	230.6	301.1	30.6
Less: Refunds	3.3	1.5	-55.1	41.2	28.8	-30.1
Other	15.9	17.6	10.4	196.5	202.7	3.1
Adjusted surplus or deficit (-)	30.9	48.7	...	-415.1	-313.0	...

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

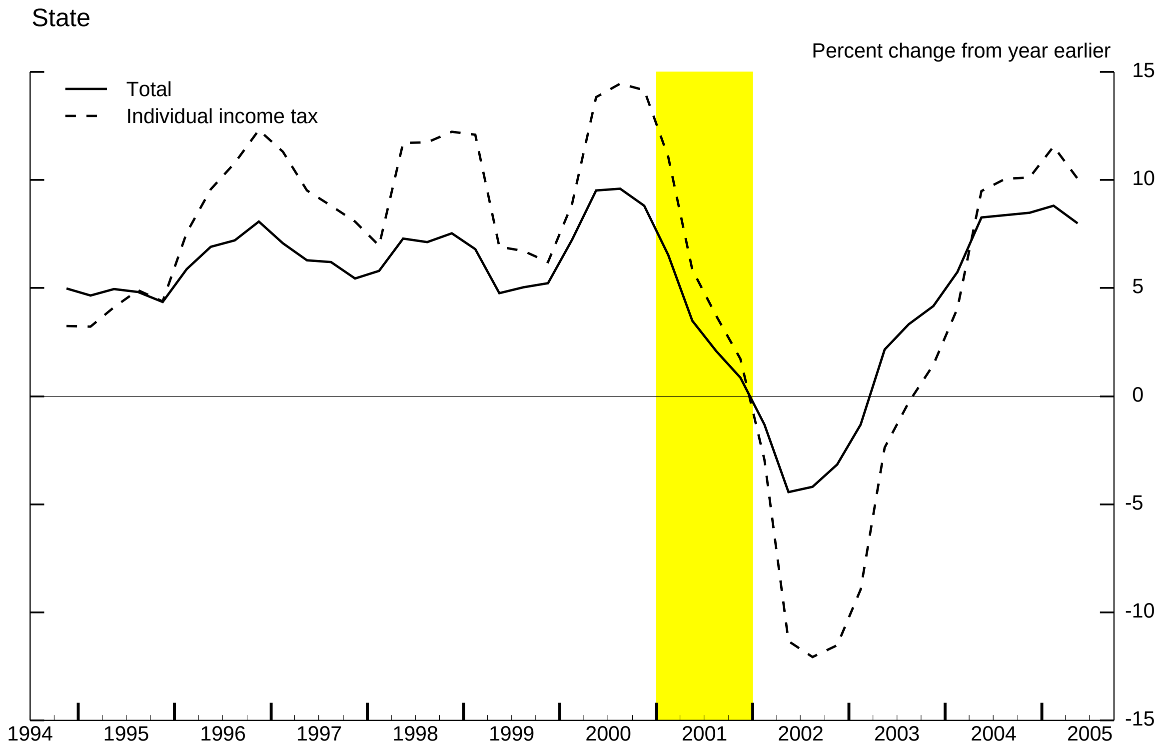
1. Financial transactions consist of deposit insurance, spectrum auctions, and sales of major assets.

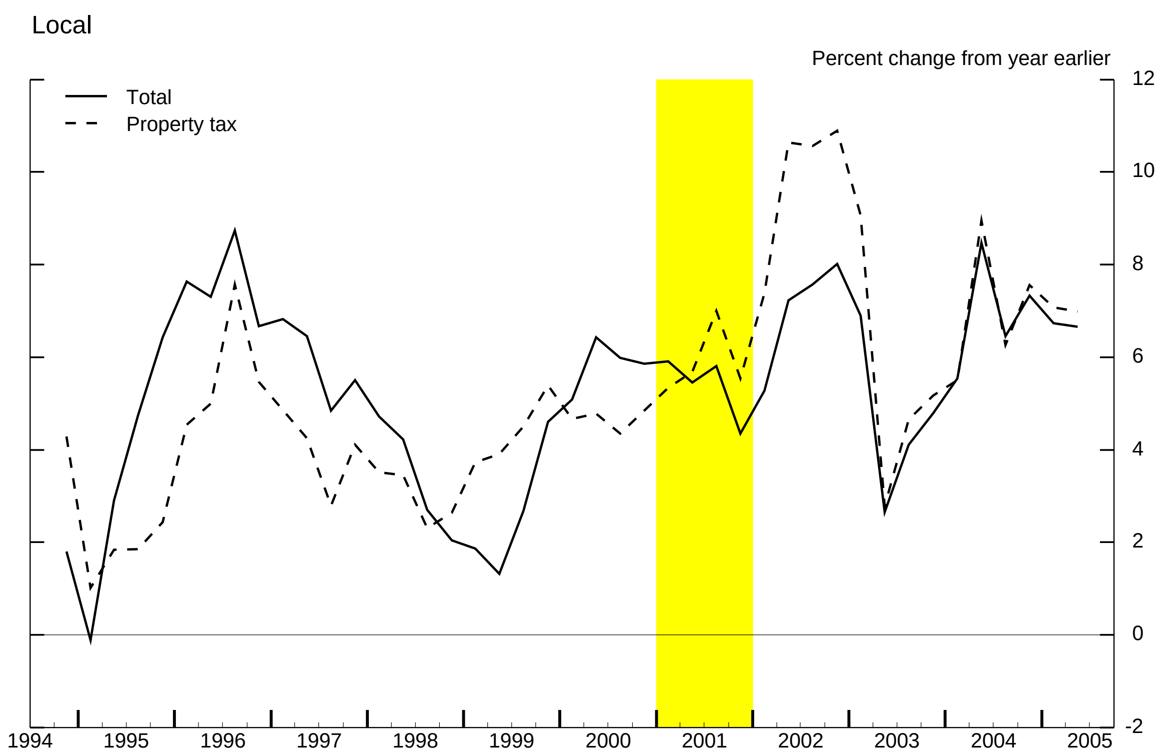
2. A shift in payment timing occurs when the first of the month falls on a weekend or holiday, or when the first 3 days of a month are nonworking days. Outlays for defense, Social Security, Medicare, income security, and "other" have been adjusted to account for these shifts.

... Not applicable.

Source. Monthly Treasury Statement.

State and Local Revenues
(4-quarter moving average)





Note. Shaded bars indicate a period of recession.

and mandatory spending. The Congress passed a continuing resolution on September 30 to fund government programs normally covered under the annual appropriations bills through November 18.

State and Local Government Sector

Indicators of state and local government spending have posted moderate increases in recent months against a backdrop of improving financial conditions. State and local employment rose 32,000 in September despite layoffs in New Orleans as a result of the closure of its schools after Hurricane Katrina. Employment gains over the three months ending in September averaged 38,000, a pace more than twice the one seen over the past year. Nominal construction spending is now estimated to have risen 0.7 percent in August and 0.5 percent in July. These data are consistent with a small gain for the third quarter in the NIPA measure of real state and local investment in structures.

Census data indicate that tax revenues at the state and local levels increased markedly in the second quarter. For the year ending in June, state taxes were 8 percent higher than they were the previous year, as individual income tax revenues surged. Local governments experienced a 6½ percent increase in tax revenues, led by a sizable increase in property tax payments (which account for about 75 percent of local revenues). With spending rising moderately and receipts robust, state and local finances continued to improve. The National Conference of State Legislatures reports that general fund balances of state governments for fiscal 2005, which in general closed in June, were higher than expected; the increase reflects the surge in tax receipts. The balances of the forty-six states included in the survey reached 7 percent of spending, somewhat above the average level seen over the past 20 years.[17] Looking toward fiscal 2006, these states have budgeted an increase of 5¾ percent in general fund spending. According to the survey, new legislation is expected to boost revenues ½ percent on net, as increases in tobacco taxes outweigh small cuts to personal income taxes.

Prices

Soaring energy prices boosted overall measures of consumer price inflation during the past three months. However, recent measures of core consumer price inflation have been much more restrained. Although the aggregate CPI rose 1.2 percent in September—the largest monthly increase in 25 years—core consumer prices rose just 0.1 percent for the fifth straight month. The latest figures left the estimated twelve-month change in core PCE prices at 1.9 percent, essentially the same as in the year-earlier period. In contrast, we estimate that overall PCE prices increased 3.7 percent over the twelve months ending in September, compared with 2.4 percent a year earlier.[18]

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[17] Year-end balances are the sum of rainy day funds and cash-on-hand.

[18] The August figures for PCE prices in the table and charts correct a mistake in BEA's published data for truck prices. Core PCE prices were reported to have increased 0.2 percent in August, while the corrected figure rounds down to 0.1 percent.

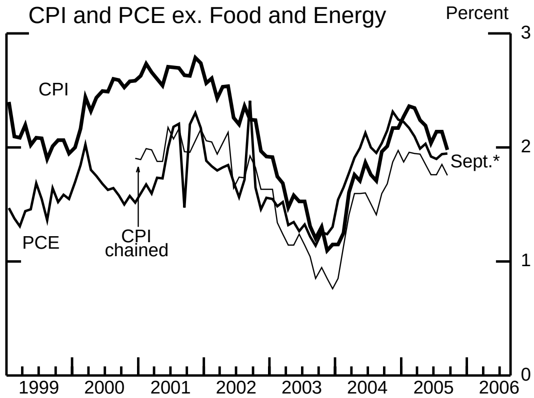
Measures of Inflation
(Percent)

Measures	12-month change		3-month change		1-month change	
			Annual rate		Monthly rate	
	Sept. 2004	Sept. 2005	June 2005	Sept. 2005	Aug. 2005	Sept. 2005
CPI						
Total	**2.5**	**4.7**	**1.9**	**9.4**	**.5**	**1.2**
Food	3.3	2.5	3.4	1.9	.0	.3
Energy	6.7	34.8	7.5	122.1	5.0	12.0
Ex. food and energy	**2.0**	**2.0**	**1.2**	**1.4**	**.1**	**.1**
Core goods	-.6	.6	-.3	.0	.1	.1
Core services	3.0	2.5	1.7	2.2	.1	.1
Chained CPI (n.s.a.) [1]	2.1	3.5	...	...	...	...
Ex. food and energy [1]	1.6	1.8	...	...	...	...
PCE prices [2]						
Total	**2.4**	**3.7**	**1.9**	**6.7**	**.4**	**.9**
Food	3.1	2.2	2.9	2.1	.0	.3
Energy	7.1	36.6	6.7	129.1	5.2	12.4
Ex. food and energy	**2.0**	**1.9**	**1.4**	**1.5**	**.1**	**.2**
Core goods	-.5	.1	-1.1	-1.0	.0	.1
Core services	3.1	2.8	2.6	2.5	.2	.2
Core market-based	1.5	1.7	1.3	1.2	.1	.2
Core non-market-based	4.7	n.a.	2.3	n.a.	.2	n.a.
PPI						
Total finished goods	**3.3**	**6.9**	**-.5**	**14.8**	**.6**	**1.9**
Food	3.2	2.1	-5.5	3.4	-.3	1.4
Energy	9.4	27.8	.3	80.7	3.7	7.1
Ex. food and energy	**1.7**	**2.6**	**1.0**	**2.6**	**.0**	**.3**
Core consumer goods	1.7	2.7	1.5	2.2	-.1	.2
Capital equipment	1.7	2.3	.6	3.1	-.1	.3
Intermediate materials	8.4	8.4	.8	18.1	.7	2.5
Ex. food and energy	7.8	3.5	-1.3	4.2	-.1	1.2
Crude materials	14.6	28.5	-12.5	109.7	2.3	10.2
Ex. food and energy	26.8	6.5	-22.8	66.3	4.6	5.3

1. Higher-frequency figures are not applicable for data that are not seasonally adjusted.
2. PCE prices in September are staff estimates.
... Not applicable.
n.a. Not available.

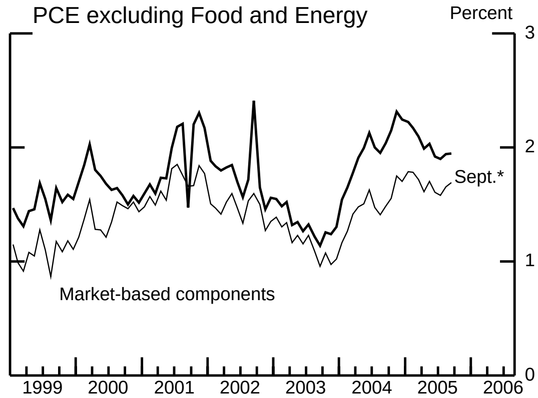
Consumer Price Inflation
(12-month change except as noted)

CPI and PCE ex. Food and Energy



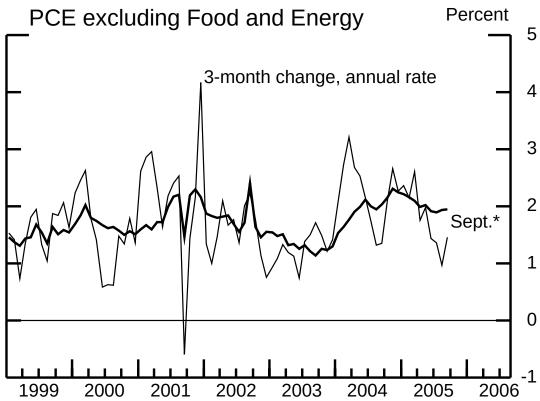
* PCE for September is a staff estimate.

PCE excluding Food and Energy



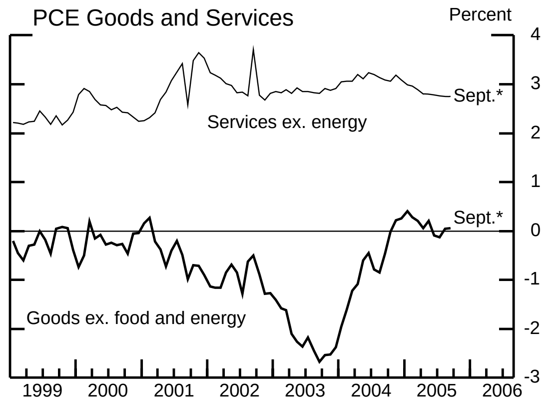
* Staff estimate.

PCE excluding Food and Energy



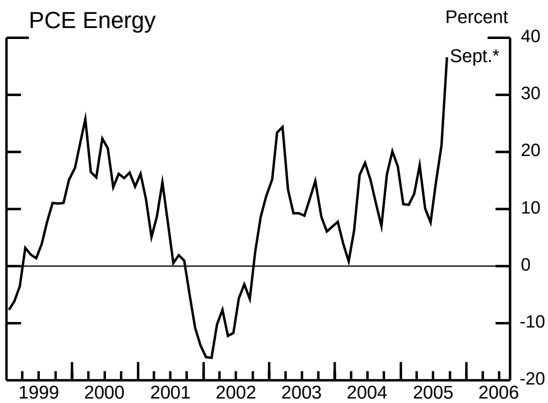
* Staff estimate.

PCE Goods and Services



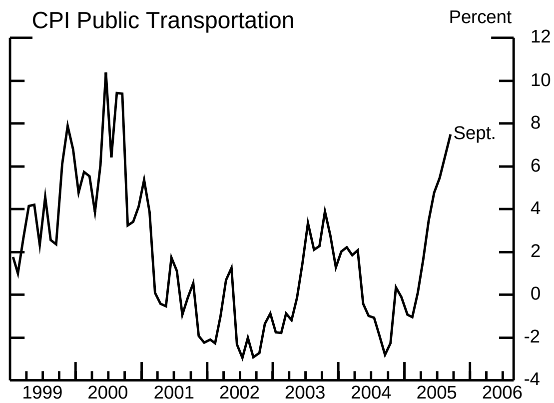
* Staff estimate.

PCE Energy



* Staff estimate.

CPI Public Transportation



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

Measure	2002	2003	2004	2005
Product prices				
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
Expenditure prices				
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 [1]	University of Michigan				Professional forecasters (10-year) [4]
		1 year [2]		5 to 10 years [3]		
		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.

The CPI for energy rose 12 percent in September, after increases of 5 percent in August and 3.8 percent in July. Motor fuel prices jumped almost 18 percent in September, by far the largest monthly increase on record in that category. The CPI for natural gas also increased considerably, although much of the sharp run-up in spot prices has not yet been passed through to consumers, probably because of lags in rate adjustments by some state public utility commissions. Over the twelve months ending in September, the CPI for energy increased 35 percent, a jump far exceeding the approximate 7 percent rise posted over the previous twelve months.

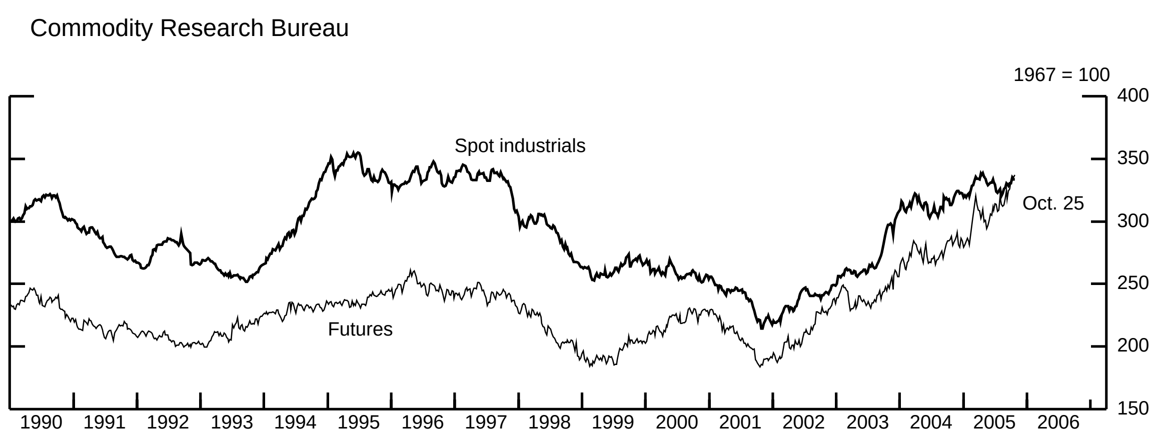
The food component of the CPI increased 0.3 percent in September after no change in the previous month. This pickup reflects price increases for meats and vegetables, which reversed the previous month's declines. Compared with twelve months earlier, consumer food prices increased 2.5 percent, down ¾ percentage point relative to the previous year. The hurricanes had little effect on food and agricultural markets. However, favorable export prospects have lifted prices for wheat over the past few weeks, while unexpectedly strong harvest estimates have eroded the prices of corn and soybeans. Transportation disruptions associated with the hurricanes were short-lived and do not appear to have had any lasting effect on crop prices, although barge rates remain elevated.

Excluding food and energy, consumer prices have been quiescent. Prices of transportation services—which are especially energy intensive—have increased noticeably over the past year after having held steady during 2004. In September, however, the only hint of a pass-through of higher fuel prices to the core CPI was an increase of 1.1 percent in the CPI category for delivery services. Prices for airfares and other intercity transportation were reported to have declined for a second month despite sharp increases in the prices of jet fuel and diesel.

PCE prices of core consumer goods are estimated to have changed little over the twelve months ending in September and to have declined at an annual rate of about 1 percent from three months earlier. Some of this recent softness reflects the automakers' discount pricing schemes, which have now expired. We estimate that PCE prices of core services rose about 2¾ percent between September 2004 and September 2005; the figure is about ½ percentage point less than the year-earlier reading and reflects a noticeable deceleration in shelter prices. On balance, core PCE prices have increased an estimated 1.9 percent over the twelve months ending in September, little changed from the 2.0 percent increase over the previous year.

Inflation expectations have moved higher, presumably in response to rising energy prices. As measured by the preliminary October release of the Michigan SRC survey, median expectations for inflation over the coming year rose to 4.6 percent—well above the 3 to 3¼ percent readings that had prevailed over the spring and summer. However, median expectations for inflation over the next five to ten years remained at 3.1 percent in early October, only a little above the average range reported in recent years. As noted in the financial section of Part II, rate spreads on CPI-indexed Treasury bonds as of October 24 implied inflation compensation near 2.6 percent over both the next five and ten years,

Commodity Price Indexes



Note. The Journal of Commerce industrial price index is based almost entirely on industrial commodities, with a small weight given to energy commodities. The Commodity Research Bureau (CRB) spot industrials index consists entirely of industrial commodities, excluding energy. The CRB futures index gives about a 60 percent weight to food commodities and splits the remaining weight roughly equally among energy commodities, industrial commodities, and precious metals. Copyright for Journal of Commerce data is held by CIBCR, 1994.

Selected Commodity Price Indexes
(Percent change)

Index	2004[1]	12/28/04 to 9/13/05[2]	9/13/05[2] to 10/25/05	52-week change to 10/25/05
JOC industrials	8.7	8.4	-1.9	7.1
JOC metals	19.4	-1.7	-3.3	-2.8
CRB spot industrials	4.6	2.3	1.1	6.5
CRB spot foodstuffs	2.7	-2.9	-.3	-4.2
CRB futures	11.1	11.8	6.2	17.1

1. From the last week of the preceding year to the last week of the year indicated.
2. September 13, 2005, is the Tuesday preceding publication of the September Greenbook.

about the same as in mid-September and near the middle of the range observed over the past year.

The PPI for capital equipment increased 0.3 percent in September after having declined 0.1 percent in August. Over the twelve months ending in September, capital equipment prices rose 2.3 percent, compared with an increase of 1.7 percent during the year-earlier period and little change over the two previous years. This year's pickup occurred mainly in the prices of heavy trucks and the catchall category of non-high-tech, non-transportation capital equipment.

Although Hurricane Katrina had little apparent effect on the core CPI or the core PPI for finished goods, it appears to have had a substantial effect on prices at earlier stages of processing. Producer prices for core intermediate materials rose 1.2 percent last month after four months of small declines, with prices of industrial chemicals, fertilizers, and plastics—all energy-intensive intermediate materials—picking up notably. Also, prices for nearly all types of building materials increased substantially; plywood prices rose 14 percent, and prices of cement, concrete, and asphalt all rose about 1 percent. Despite the September increase, prices of core intermediate materials moved up just 3½ percent from a year earlier, 4 percentage points less than the increase over the preceding year.

Movements in commodity prices have been mixed since the September Greenbook. Steel scrap prices have fallen noticeably, while spot prices of copper and building materials have risen sharply. Since the September Greenbook, the Journal of Commerce metals index has fallen 3.3 percent, while the CRB spot industrials index, which excludes energy, has picked up 1.1 percent.

Domestic Financial Developments

III-T-1

Selected Financial Market Quotations

(One-day quotes in percent except as noted)

Instrument	2004 June 28	2004 Dec. 31	2005 Sept. 19	2005 Oct. 25	Change to Oct. 25 from selected dates (percentage points): 2004 June 28	2004 Dec. 31	2005 Sept. 19
Short-term							
FOMC intended federal funds rate	1.00	2.25	3.50	3.75	2.75	1.50	.25
Treasury bills[1]							
3-month	1.36	2.18	3.51	3.84	2.48	1.66	.33
6-month	1.74	2.52	3.72	4.07	2.33	1.55	.35
Commercial paper (A1/P1 rates)[2]							
1-month	1.28	2.29	3.74	3.95	2.67	1.66	.21
3-month	1.45	2.28	3.79	4.11	2.66	1.83	.32
Large negotiable CDs[1]							
3-month	1.53	2.50	3.88	4.18	2.65	1.68	.30
6-month	1.82	2.72	4.03	4.36	2.54	1.64	.33
Eurodollar deposits[3]							
1-month	1.29	2.32	3.75	4.00	2.71	1.68	.25
3-month	1.51	2.49	3.85	4.15	2.64	1.66	.30
Bank prime rate	4.00	5.25	6.50	6.75	2.75	1.50	.25
Intermediate- and long-term							
U.S. Treasury[4]							
2-year	2.88	3.08	3.94	4.38	1.50	1.30	.44
5-year	3.97	3.63	4.03	4.42	.45	.79	.39
10-year	4.90	4.34	4.34	4.63	-.27	.29	.29
U.S. Treasury indexed notes							
5-year	1.56	1.03	1.36	1.79	.23	.76	.43
10-year	2.25	1.65	1.71	2.02	-.23	.37	.31
Municipal general obligations (Bond Buyer)[5]	5.01	4.49	4.30	4.47	-.54	-.02	.17
Private instruments							
10-year swap	5.21	4.65	4.69	4.93	-.28	.28	.24
10-year FNMA[6]	5.30	4.61	4.58	4.86	-.44	.25	.28
10-year AA[7]	5.59	4.98	5.04	5.32	-.27	.34	.28
10-year BBB[7]	6.18	5.38	5.59	5.91	-.27	.53	.32
5-year high yield[7]	8.30	7.34	7.91	8.20	-.10	.86	.29
Home mortgages (FHLMC survey rate)[8]							
30-year fixed	6.21	5.77	5.80	6.10	-.11	.33	.30
1-year adjustable	4.19	4.10	4.48	4.89	.70	.79	.41

Stock exchange index	Record high: Level	Record high: Date	2004 Dec. 31	2005 Sept. 19	2005 Oct. 25	Change to Oct. 25 from selected dates (percent): Record high	2004 Dec. 31	2005 Sept. 19
Dow Jones Industrial	11,723	1-14-00	10,783	10,558	10,378	-11.47	-3.76	-1.70
S&P 500 Composite	1,527	3-24-00	1,212	1,231	1,197	-21.66	-1.27	-2.80
Nasdaq	5,049	3-10-00	2,175	2,145	2,109	-58.22	-3.03	-1.67
Russell 2000	689	8-2-05	652	667	643	-6.65	-1.36	-3.64
Wilshire 5000	14,752	3-24-00	11,971	12,292	11,963	-18.90	-.07	-2.68

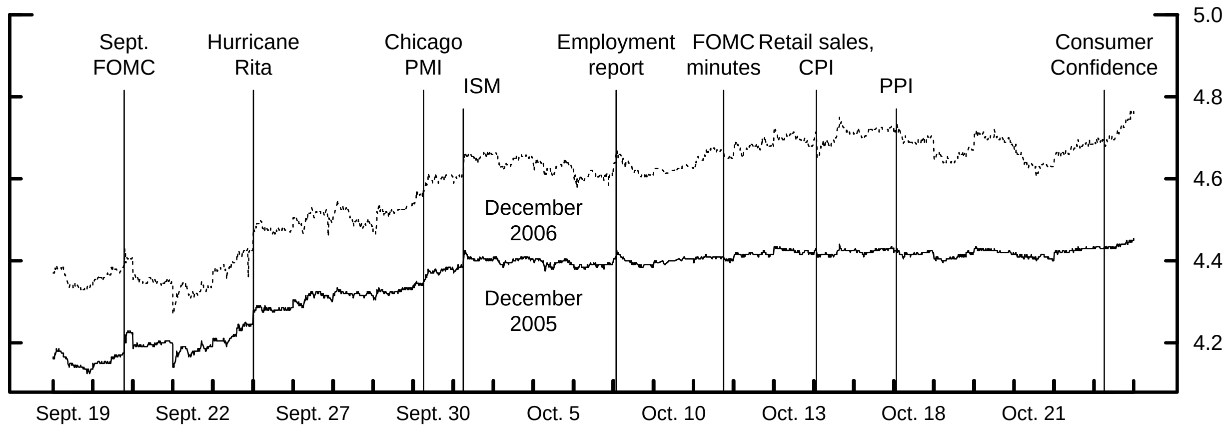
1. Secondary market.
2. Financial commercial paper.
3. Bid rates for Eurodollar deposits collected around 9:30 a.m. eastern time.
4. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
5. Most recent Thursday quote.
6. Constant-maturity yields estimated from Fannie Mae domestic noncallable coupon securities.
7. Derived from smoothed corporate yield curves estimated using Merrill Lynch bond data.
8. Home-mortgage data for October 25, 2005, is from October 20, 2005.

NOTES:

June 28, 2004, is the day before the most recent policy tightening began.
September 19, 2005, is the day before the most recent FOMC meeting.

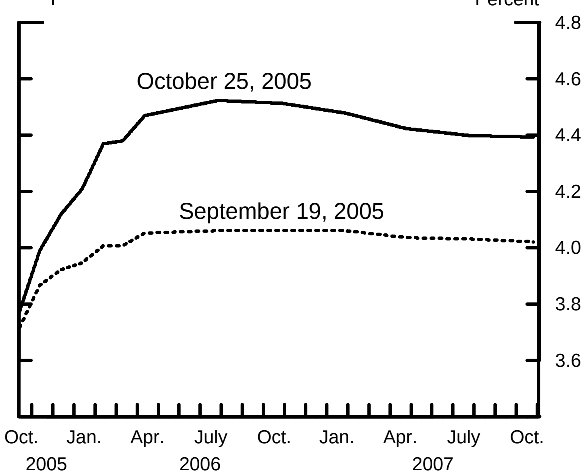
Policy Expectations and Treasury Yields

Eurodollar Futures



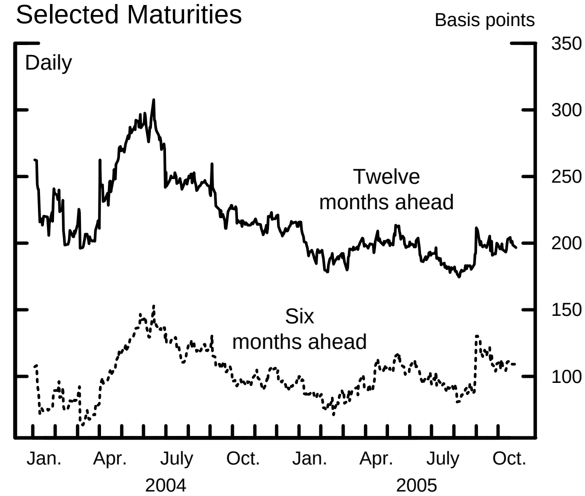
Note. 5-minute intervals.

Expected Federal Funds Rates

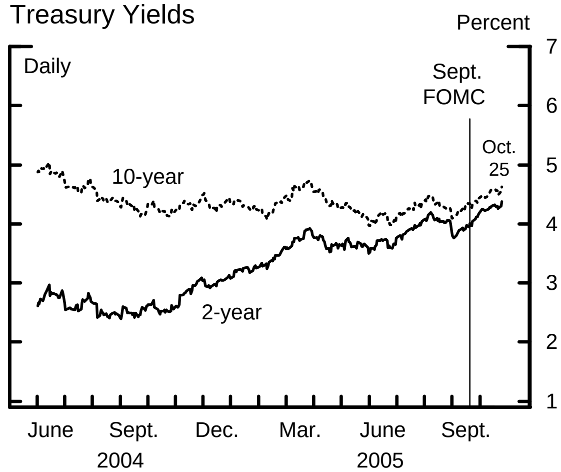


Note. Estimates from federal funds and Eurodollar futures, with an allowance for term premia and other adjustments.

Eurodollar Implied Volatility at Selected Maturities

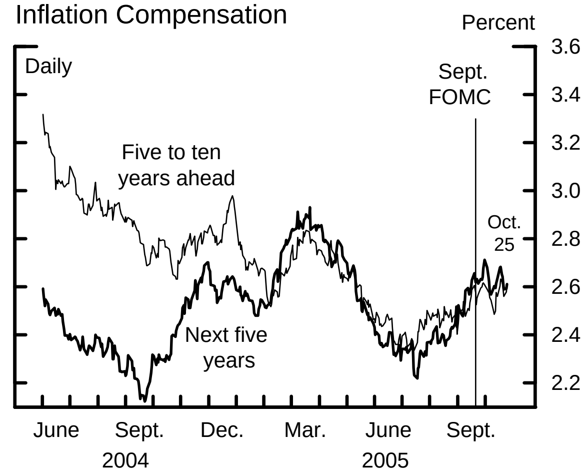


Treasury Yields



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

Inflation Compensation



Note. Estimates based on nominal and inflation-indexed Treasury yields.

Domestic Financial Developments

Overview

Interest rates rose appreciably over the intermeeting period, reflecting an easing of investors' concerns about the impact of Hurricane Katrina on economic activity, data releases that were on net a bit stronger than the market had expected, and comments by Federal Reserve officials that were interpreted to suggest that more substantial tightening would be necessary to contain inflation risks. The increase in nominal interest rates seemed to represent primarily a rise in the market's outlook for real rates, as measures of inflation compensation based on TIPS yields did not change materially, on net. A few high-profile credit events—including bankruptcy filings in the airline and auto sectors and the revelation of fraud at a major derivatives dealer—garnered considerable attention in the press but apparently left little imprint on market functioning or asset prices more broadly. Amid higher interest rates and cautious guidance from companies about expected earnings, stock prices fell about 3 percent over the period.

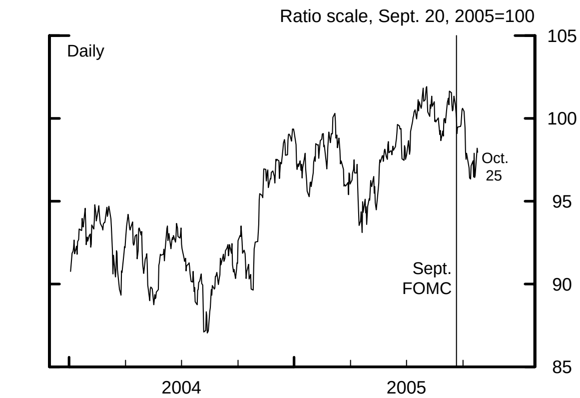
Policy Expectations and Treasury Yields

Short-term interest rates rose slightly following the announcement that the FOMC had raised the intended federal funds rate 25 basis points at the September meeting; market participants had placed some odds on a pause in the tightening cycle. Policy expectations rose further over the intermeeting period in response to data releases that confirmed that the economy had been on a solid growth track before the hurricanes and to signs that disruptions from Katrina were less severe than had been feared. The market reaction to the incoming data likely was colored by comments from Federal Reserve officials that were seen as hawkish on inflation, although the fall in oil prices over the period may have tempered inflation fears somewhat. Judging from federal funds futures, investors currently place a 95 percent probability on a quarter-point tightening at the November FOMC meeting and now expect a federal funds rate of about 4½ percent by next summer—up from a bit over 4 percent just before the September meeting. Uncertainty about the future path of policy implied by options on Eurodollar futures diminished over the period, but remains above the level of late August.

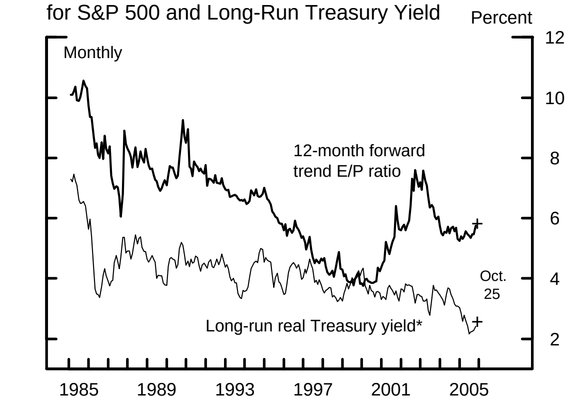
In line with the increase in near-term policy expectations, nominal Treasury yields rose 30 to 45 basis points over the intermeeting period, with the largest increases at shorter maturities. A good part of the rise in Treasury yields occurred in the first half of the intermeeting period, with noticeable responses to better-than-expected data on initial claims and from surveys of manufacturing activity. TIPS yields rose about in line with their nominal counterparts. As a result, inflation compensation over the next five years and five to ten years ahead was little changed, on net, as investors evidently viewed the

Corporate Yields, Risk Spreads, and Stock Prices

S&P 500

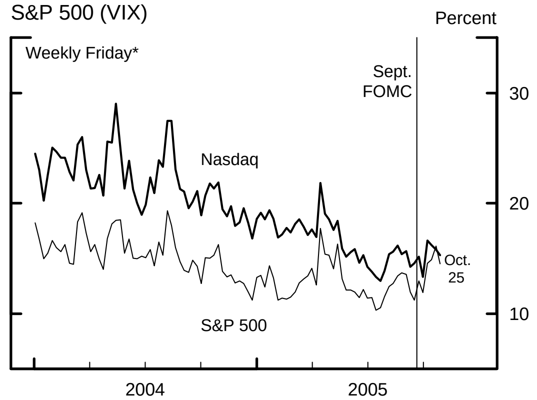


12-Month Forward Trend Earnings-Price Ratio
for S&P 500 and Long-Run Treasury Yield



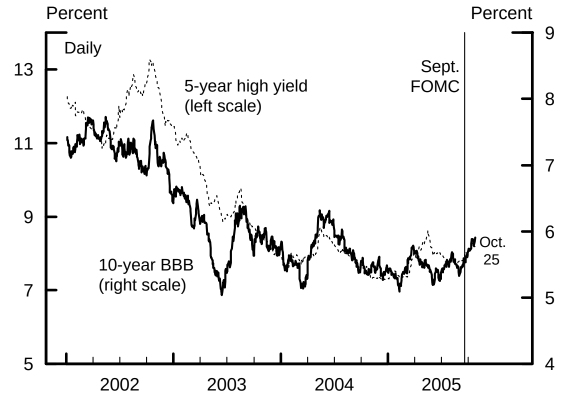
* Yield on synthetic Treasury perpetuity minus Philadelphia Fed 10-year expected inflation.
\+ Denotes the latest observation using daily interest rates and stock prices and latest earnings data from I/B/E/S.

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



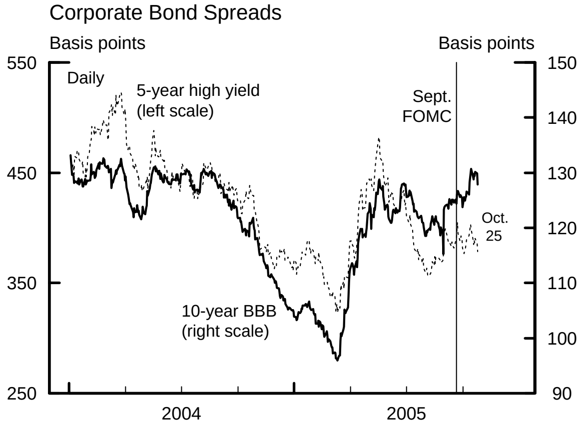
* Latest observation is for most recent business day.

Yields for BBB and High-Yield Corporate Bonds



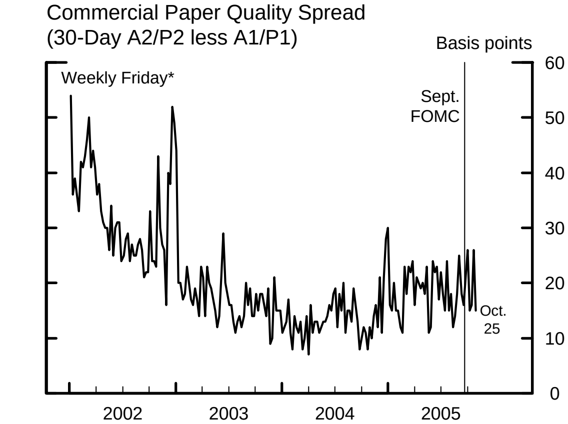
Note. Yields from smoothed yield curves based on Merrill Lynch bond data.

Corporate Bond Spreads



Note. Measured relative to comparable-maturity Treasuries.

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



* Latest observation is for most recent business day.

comments of Federal Reserve officials as highlighting the FOMC's resolve to keep inflation in check.

Stock Prices and Corporate Interest Rates

Broad stock market indexes declined 2 to 4 percent over the intermeeting period in response to the rise in long-term interest rates and to some concerns about profits going forward. Energy stocks posted some of the largest drops because of the fall in oil prices over the period. Declines were also relatively large for segments of the market that tend to be more sensitive to interest rates, such as small companies, utilities, and REITs. The ratio of trend earnings to share prices for S&P 500 firms—a measure of expected long-run real equity returns—has remained near 5½ percent, where it has hovered since early 2004. As a result, the rise in the long-run real Treasury yield indicated a slight narrowing of the long-run real equity premium.

Implied volatilities for the Nasdaq and the S&P 500 rose a bit over the intermeeting period, although these measures of equity market risk remained relatively low. As broad indexes of corporate yields increased about in line with Treasuries, risk spreads on bonds were little changed. Bankruptcies in the airline sector and the revelation of accounting fraud at Refco, a large derivatives broker, did not appear to have any lasting effect on bond spreads; however, the bankruptcy filing of a major auto parts firm did lead to some increase in spreads in the auto sector. Risk spreads on thirty-day commercial paper remained in a fairly low range.

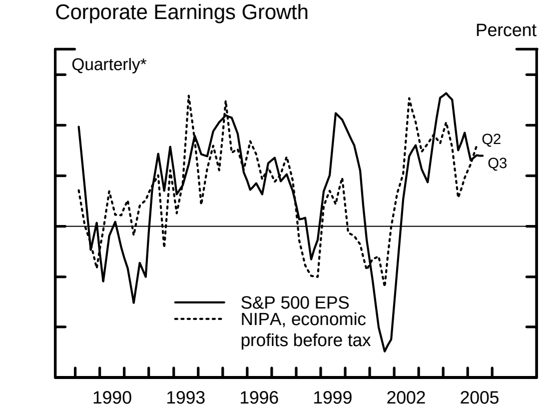
Corporate Earnings and Credit Quality

The third-quarter earnings season has been relatively uneventful to date, with the news about the third quarter, including insurance companies' reported losses from Katrina and Rita, coming in close to expectations. With about 250 of the S&P 500 firms having reported, earnings per share for the S&P 500 are estimated to have come in nearly 15 percent above the year-ago level, an increase boosted almost 7 percentage points by growth at energy firms. At the same time, forward-looking guidance has been cautious, and expectations for earnings in the year ahead, outside of the energy sector, were revised down a bit through mid-October.

Outside the airline and auto sectors, firms' credit quality—boosted by continued profitability, relatively low leverage, and high liquidity—remained strong. Ratings changes in the auto and airline sectors pushed up the overall rate of bond downgrades in the third quarter; apart from these troubled sectors, bond downgrades have been modest.

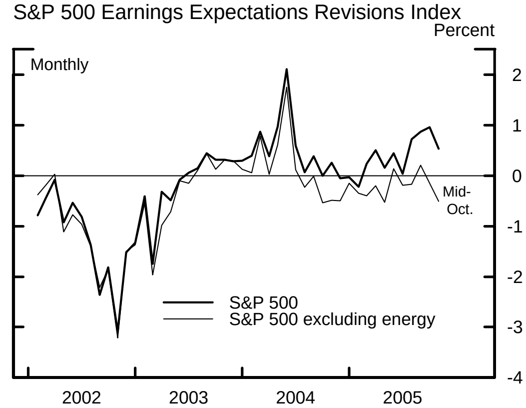
Corporate Earnings and Credit Quality

Corporate Earnings Growth



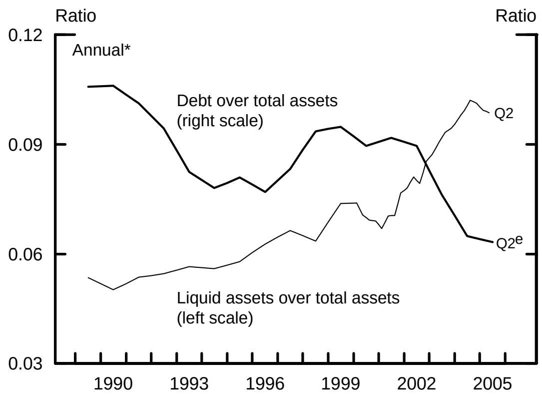
* Change from four quarters earlier.
Source. I/B/E/S for S&P 500 EPS.

S&P 500 Earnings Expectations Revisions Index



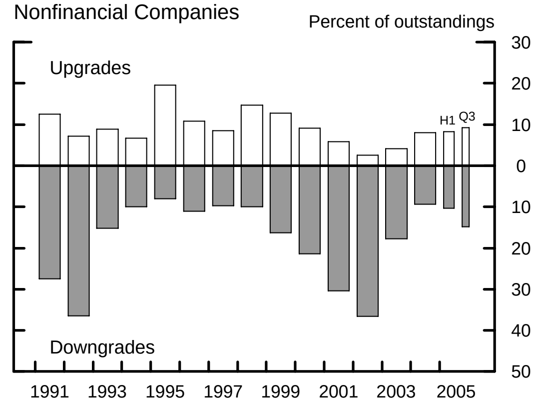
Note. Index is a weighted average of the percent change in the consensus forecasts of current-year and following-year EPS for constant sample.

Financial Ratios for Nonfinancial Corporations



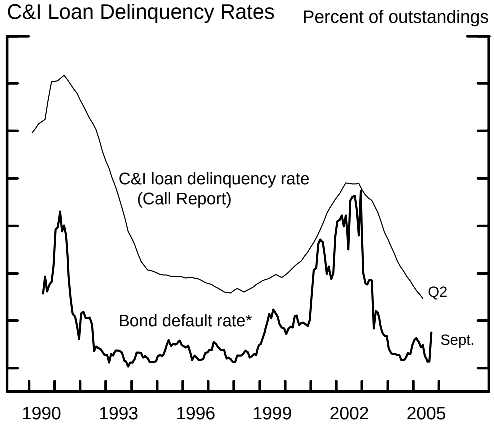
Note. Computstat data.
* Liquid assets over assets are quarterly starting in 2000:Q1.
e Staff estimate.

Bond Ratings Changes of Nonfinancial Companies



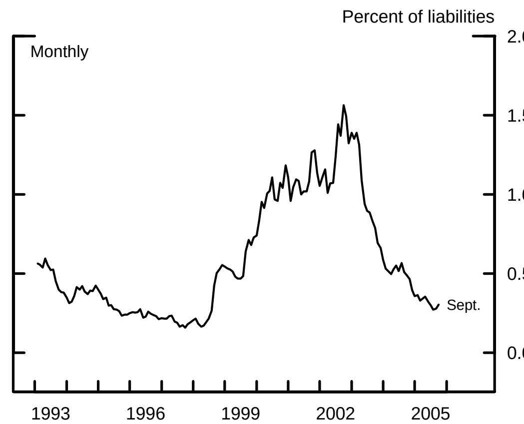
Note. Data are at an annual rate.
Source. Moody's Investors Service.

Bond Defaults and C&I Loan Delinquency Rates



* 6-month moving average, from Moody's Investors Service.

Expected Year-Ahead Defaults



Note. Firm-level estimates of default weighted by firm liabilities as a percent of total liabilities, excluding defaulted firms.
Source. Moody's KMV.

Business Finance

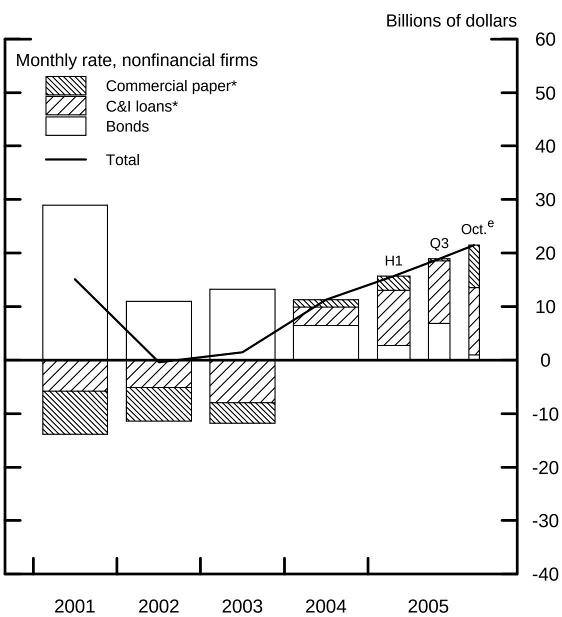
Gross Issuance of Securities by U.S. Corporations

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

Type of security	2001	2002	2003	2004	2005 H1	2005 Q3	2005 Oct. e
Nonfinancial corporations							
Stocks[1]	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[2]	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
Memo							
Net issuance of commercial paper[3]	-8.0	-6.3	-3.8	1.4	2.6	.4	8.0
Change in C&I loans at commercial banks[3,4]	-5.8	-5.1	-7.9	3.5	10.4	11.6	12.5
Financial corporations							
Stocks[1]	4.2	4.0	6.9	6.7	5.3	4.8	3.0
Bonds[2]	80.2	87.0	111.1	139.3	167.3	175.6	60.0

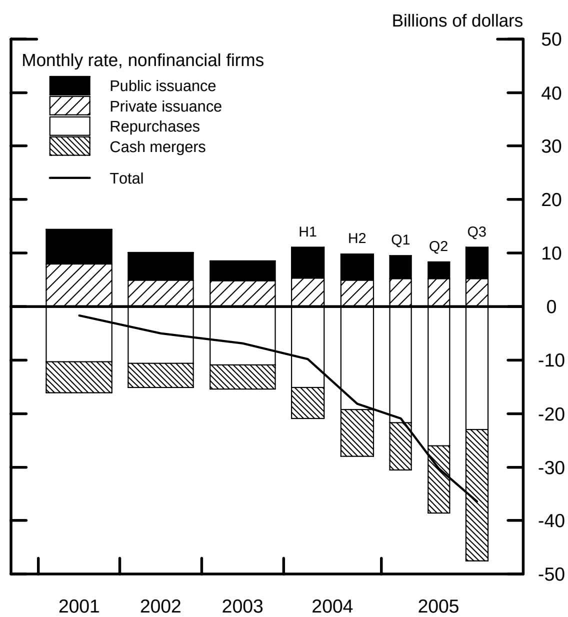
Note. Components may not sum to totals because of rounding.
1. Excludes private placements and equity-for-equity swaps that occur in restructurings.
2. Data include regular and 144a private placements. Bond totals reflect gross proceeds rather than par value of original discount bonds. Bonds are categorized 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



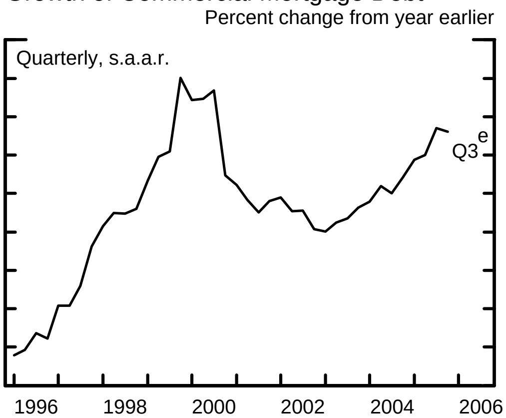
* Seasonally adjusted, period-end basis.
e Staff estimate.

Components of Net Equity Issuance



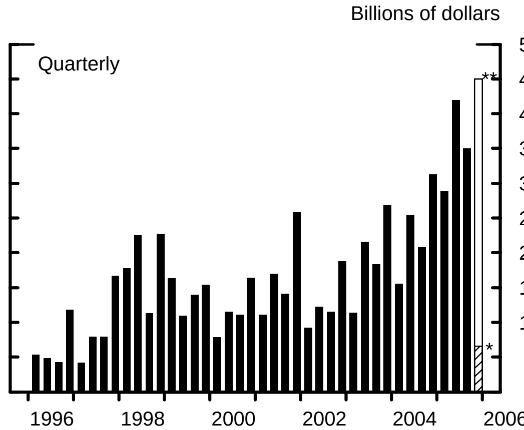
Commercial Real Estate

Growth of Commercial Mortgage Debt



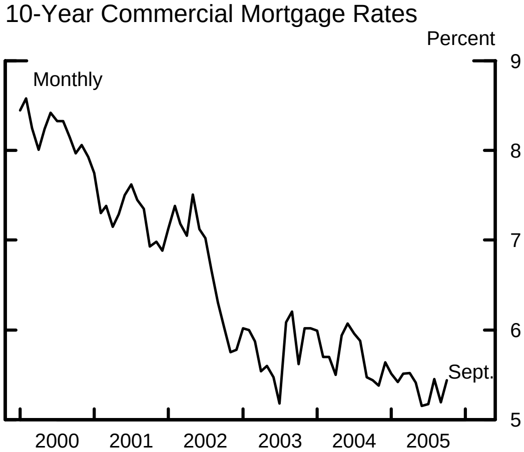
e Staff estimate.

Gross Issuance of CMBS



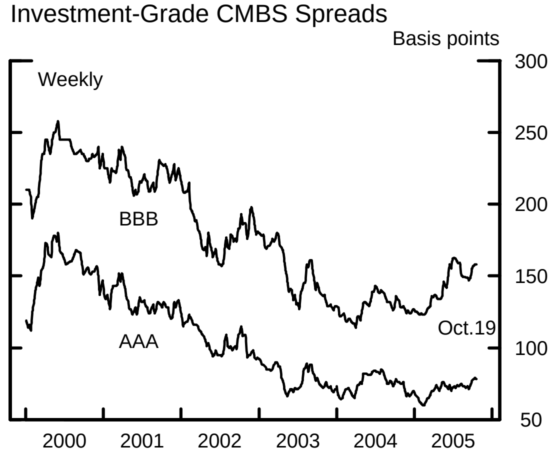
* Through October 21.
** Staff estimate for Q4.
Source. Commercial Mortgage Alert.

10-Year Commercial Mortgage Rates



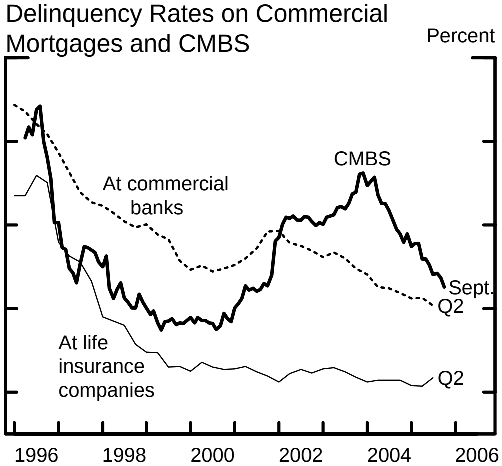
Source. Barron's/Levy.

Investment-Grade CMBS Spreads



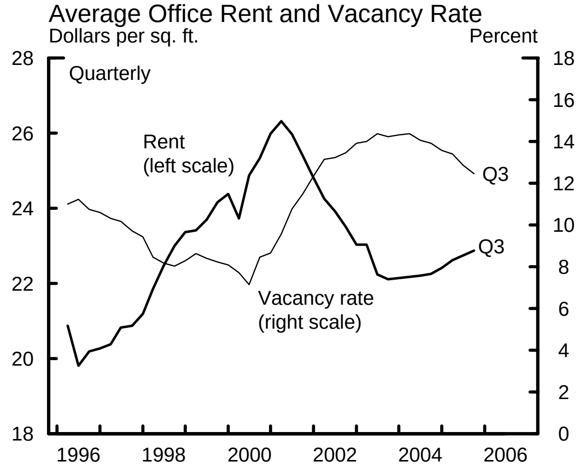
Note. Measured relative to the 10-year Treasury yield.
Source. Morgan Stanley.

Delinquency Rates on Commercial Mortgages and CMBS



Source. Call Report, ACLI, Morgan Stanley.

Average Office Rent and Vacancy Rate



Source. CoStar.

The bond default rate moved up in September and is expected to tick up again in October on the filings of Delta and Northwest Airlines and major auto parts supplier Delphi. The timing of these filings likely was pulled ahead in order to avoid changes in the bankruptcy code that took effect on October 17. The expected one-year-ahead default rate based on estimates from KMV Corporation remains low.

Business Finance

Overall, the pace of net debt financing appears to have been moderate over the past couple of months. C&I lending has continued to be particularly strong, consistent with reports from the Senior Loan Officers Opinion Survey that standards and terms on these loans were eased somewhat further over the past three months.[1] In contrast, commercial paper outstanding only edged up over the period, and bond issuance has been modest of late, as higher yields apparently have discouraged new longer-term issues.

Boosted by a substantial seasoned offering from Google, gross public equity issuance ended the third quarter rather strongly but has waned a bit in October with the softening in the equity market. Registrations of new offers with the SEC have slowed after having surged in the middle of the year, an indication that gross equity issuance will likely remain moderate into the winter. Equity retirements related to mergers ballooned in the third quarter because of strong merger activity, including several large leveraged buyouts. Moreover, announcements suggest that share repurchases continued to be very robust in the third quarter. Taken together, gross equity issuance and retirements suggest that outstanding net equity decreased by more than $35 billion per month during the third quarter—a pace that exceeds the rapid contraction of the late 1990s. However, compared with firms in the late 1990s, firms currently are less leveraged and have larger cash positions, mitigating concerns about a deterioration in credit quality.

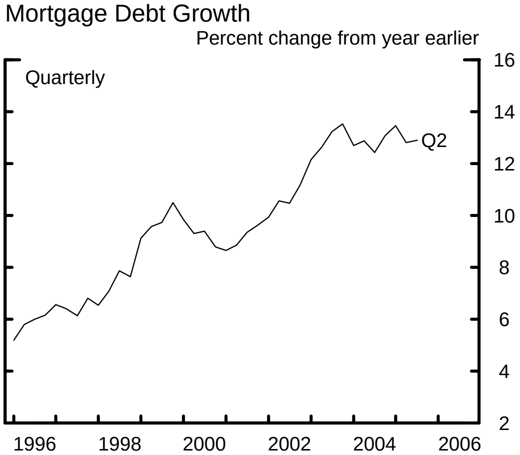
Commercial Real Estate

Commercial mortgage debt in the third quarter is estimated to be about 13 percent above its level of a year earlier. Gross issuance of commercial mortgage backed securities (CMBS) was elevated in the third quarter, and the CMBS issuance calendar currently shows that a record volume of deals may close in the fourth quarter. The surge in supply of late has been associated with a modest increase in CMBS spreads. In addition, concern about lax underwriting standards has led at least one rating agency to increase the amount of credit support required to achieve a given rating. Nonetheless, market

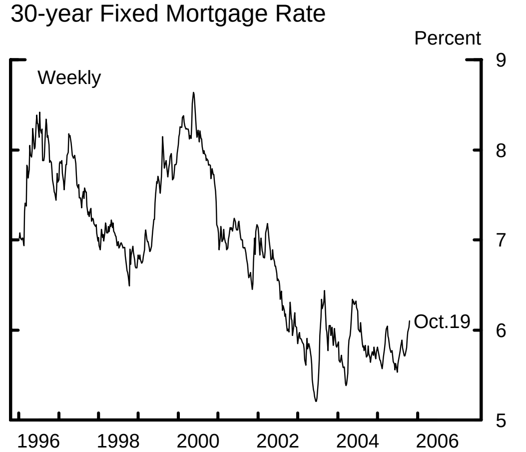
[1] A summary of the results of the Senior Loan Officers Opinion Survey will be included in the Greenbook supplement that will be distributed on Friday.

Household Liabilities

Mortgage Debt Growth

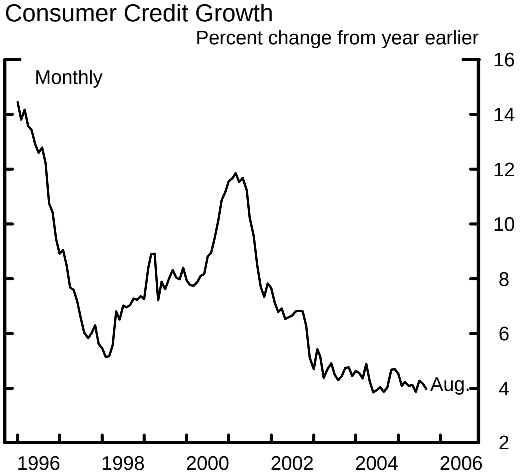


30-year Fixed Mortgage Rate

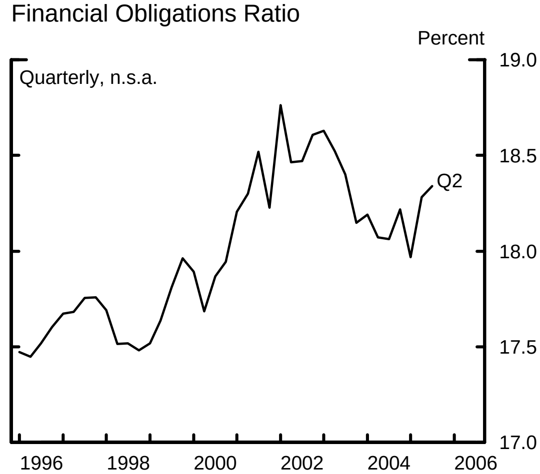


Source. Freddie Mac.

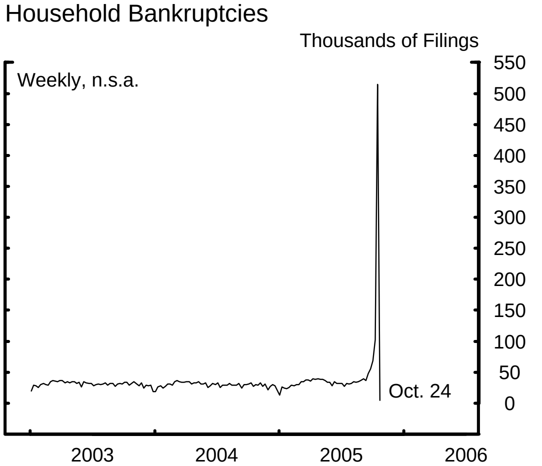
Consumer Credit Growth



Financial Obligations Ratio

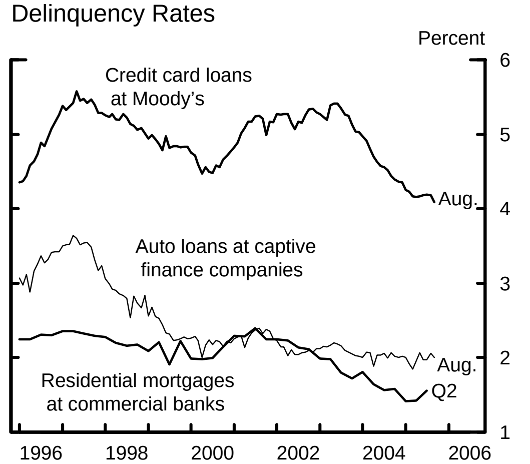


Household Bankruptcies



Source. Lundquist Consulting, Inc. Last two observations adjusted to account for court estimates of processing backlog.

Delinquency Rates



Source. Moody's, Federal Reserve, Call Report.

indicators do not point to a broad increase in credit risk. Delinquency rates on commercial mortgages at banks and on CMBS have continued to trend down, and delinquencies on commercial mortgages at insurance companies remain low. Data on vacancy rates and rents through the third quarter point to continued improvement in real estate market conditions.

Household Finance

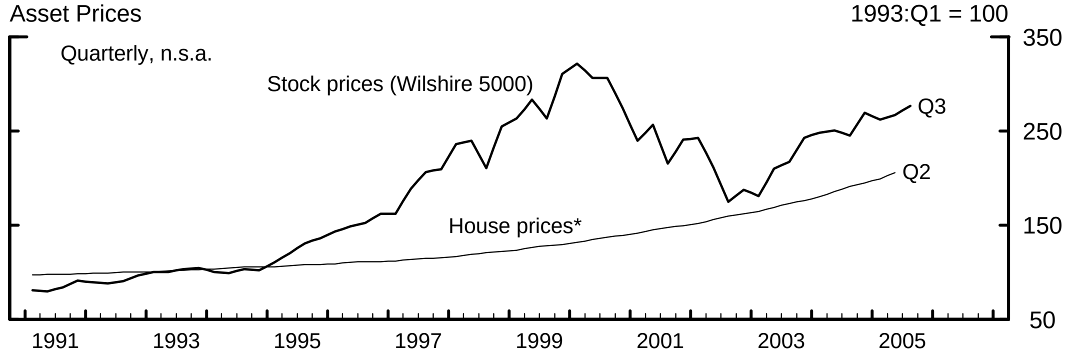
Over the intermeeting period, the thirty-year fixed mortgage rate increased about 30 basis points to 6.1 percent, its highest level since the summer of 2004. Mortgage debt in the second quarter was 13 percent above its level a year earlier. Although refinancing activity has tapered off recently in response to higher rates, low rates throughout most of the summer suggest that growth of mortgage debt likely remained strong in the third quarter. In contrast, consumer credit has continued to expand only moderately: The August figure was just 4 percent above its level of a year earlier. Growth in overall household debt outpaced that of disposable income in the second quarter, and the financial obligations ratio ticked up again but remains below its peak reached earlier this decade.

Personal bankruptcy filings have surged to unprecedented levels. Filings are estimated to have exceeded 500,000 in the week before the implementation of the much-publicized bankruptcy reforms on October 17. This figure included a large number of filings that had been made over the weekend just before the new law went into effect but may not have been processed by the courts until the following week. Estimates of the number of filings after October 17 point to a sharp drop, an indication that most of the recent surge of filings was likely pulled forward from future months.[2] Most delinquency rates for consumer loans have remained low in recent months and do not point to a deterioration in household credit quality.

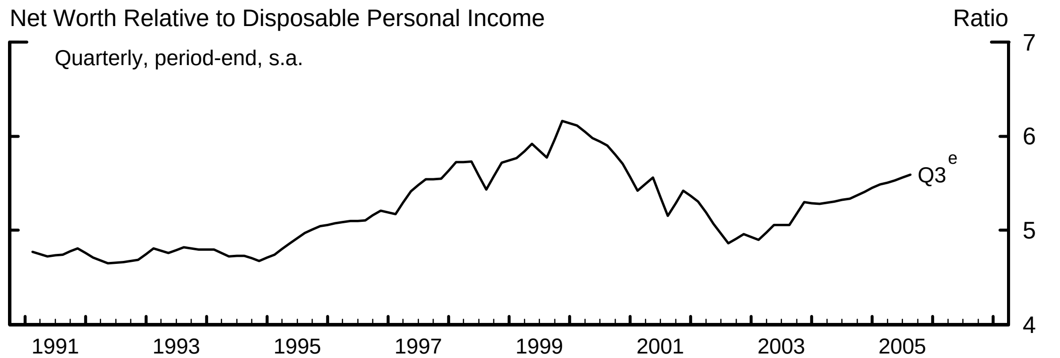
By itself, the net gain in stock prices over the third quarter would suggest a slight increase in household net worth. Despite the rise in stock prices last quarter, net purchases of equity mutual funds were moderate in August and September; domestic equity funds had net outflows while bond funds had relatively strong net inflows.

[2] Financial distress related to the hurricanes does not appear to have contributed to the rise in personal bankruptcies; data from the affected areas roughly track national patterns once adjustments have been made for disruptions stemming from courts being temporarily closed.

Household Assets



* Source. Office of Federal Housing Enterprise Oversight (OFHEO); repeat-transactions purchase-only index.



e Staff estimate.

Net Flows into Long-Term Mutual Funds
(Billions of dollars, monthly rate)

Fund type	2003	2004		2005				Assets
		H1	H2	Q1	Q2	Aug.	Sept.e	Aug.
Total long-term funds	**18.0**	**20.0**	**15.0**	**22.3**	**13.9**	**15.4**	**15.1**	**6,595**
Equity funds	**12.7**	**19.7**	**9.9**	**15.8**	**8.7**	**6.3**	**6.2**	**4,678**
Domestic	10.7	13.7	4.8	5.2	3.1	-1.9	-2.7	3,872
International	2.0	6.0	5.1	10.6	5.6	8.2	9.0	806
Hybrid funds	**2.7**	**4.1**	**3.0**	**4.5**	**2.3**	**1.8**	**1.0**	**559**
Bond funds	**2.6**	**-3.8**	**2.0**	**2.0**	**2.9**	**7.3**	**7.8**	**1,359**
High-yield	2.2	-2.1	0.5	-2.3	-1.0	-0.7	-2.2	150
Other taxable	1.0	0.1	2.0	3.8	3.5	6.5	8.5	868
Municipals	-0.6	-1.9	-0.4	0.4	0.4	1.5	1.4	341

Note. Excludes reinvested dividends.
e Staff estimates based on confidential ICI weekly data.
Source. Investment Company Institute.

Treasury Financing

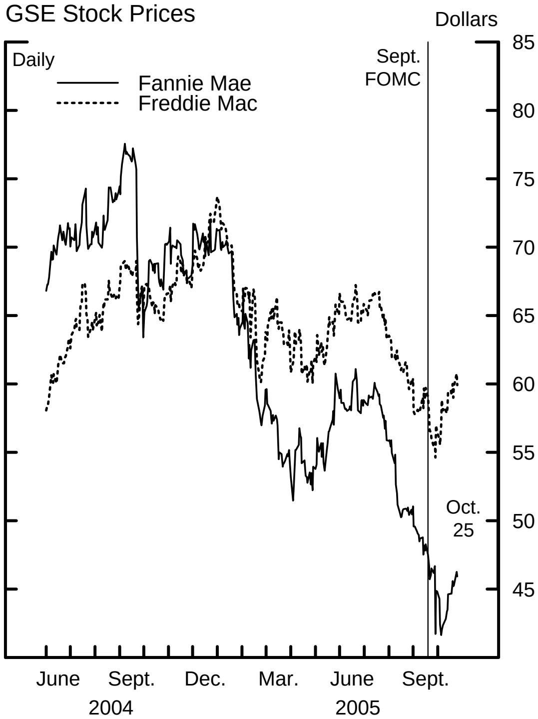
(Billions of dollars)

Item	2004 Q3	2004 Q4	2005 Q1	2005 Q2	2005 Q3	2005 Aug.	2005 Sept.
Total surplus, deficit (–)	**-85.7**	**-118.1**	**-176.6**	**44.8**	**-67.0**	**-50.0**	**35.8**
Means of financing deficit							
Net borrowing	83.4	102.1	164.7	-42.8	72.6	35.3	-15.7
Nonmarketable	-5.2	2.4	20.8	35.9	20.4	7.0	7.3
Marketable	88.6	99.7	143.9	-78.7	52.1	28.3	-23.0
Bills	14.3	43.6	55.7	-135.8	-9.3	11.0	-39.1
Coupons	74.3	56.0	88.2	57.1	61.4	17.4	16.0
Decrease in cash balance	8.3	11.7	2.2	-10.7	-2.5	32.4	-27.1
Other[1]	-6.0	4.3	9.7	8.7	-3.1	-17.7	7.0
Memo:							
Cash balance, end of period	36.3	24.7	22.4	33.2	35.7	8.6	35.7

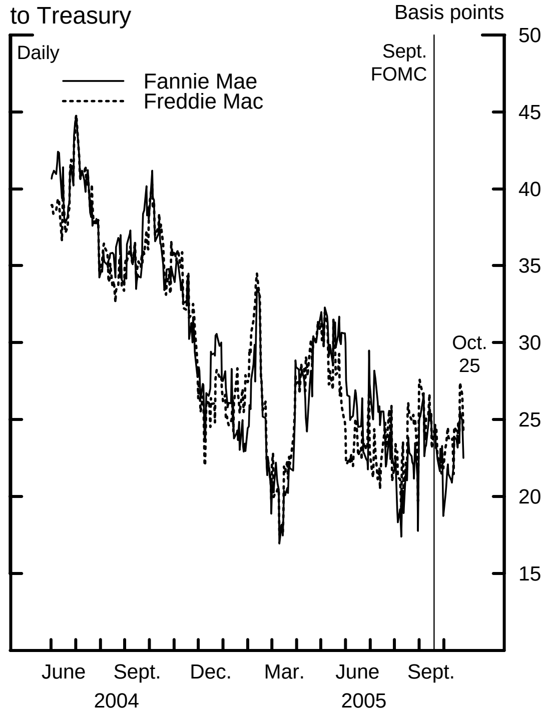
Note. Components may not sum to totals because of rounding.
1. Direct loan financing, accrued items, checks issued less checks paid, and other transactions.

GSE Market Developments

GSE Stock Prices



Ten-Year GSE Yield Spreads to Treasury



Note. GSE yields based on senior unsecured debt.

State and Local Government Finance

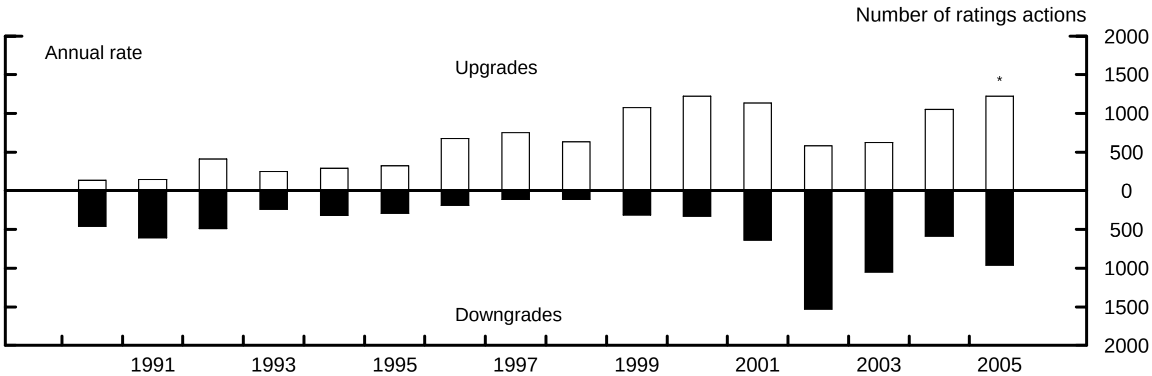
Gross Offerings of Municipal Securities

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

Type of security	2002	2003	2004	2005 H1	2005 Q3	2005 Oct. [e]
Total	36.3	37.9	34.7	38.1	38.6	27.0
Long-term [1]	30.3	32.0	29.8	35.0	33.2	24.0
Refundings [2]	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

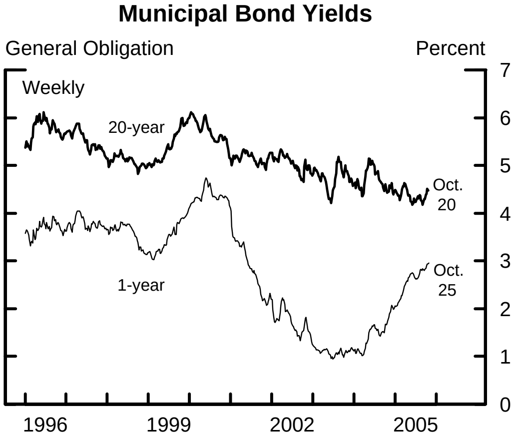
1. Includes issues for public and private purposes.
2. All issues that include any refunding bonds.
e Staff estimate based on preliminary data through October 20.

Ratings Changes



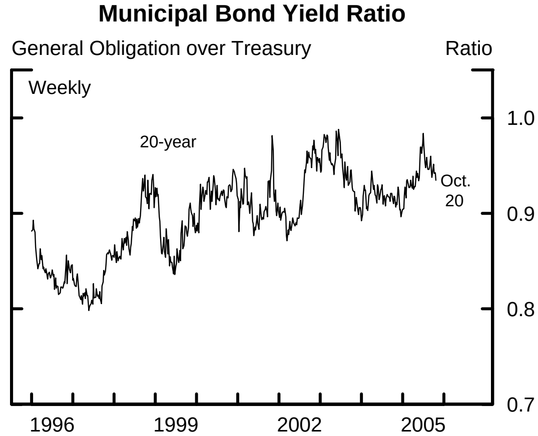
* Data through October 19 at an annual rate.
Source. S&P's Credit Week Municipal and Ratings Direct.

Municipal Bond Yields



Source. Bloomberg and Bond Buyer.

Municipal Bond Yield Ratio



Source. Bond Buyer.

Treasury and Agency Financing

The federal budget's surplus in September reflected particularly strong corporate tax receipts. During the intermeeting period, the Treasury auctioned two- and five-year nominal coupon securities and five- and ten-year TIPS, and on balance the auctions were well subscribed. Indirect bidder participation—an indicator of demand by foreign official institutions—was above its recent average.

Fannie Mae's stock price fell 3 percent during the period as more evidence of accounting inadequacies was revealed. Freddie Mac's share price, supported by news of a proposed share buyback, ended the period up 1 percent. Agency debt spreads over comparable-maturity Treasuries are roughly unchanged since the last FOMC meeting.

State and Local Government Finance

Gross issuance of municipal securities, supported by strong issuance of both new capital and refunding bonds, remained elevated in the third quarter. However, refunding issues have slowed significantly in October as interest rates have moved higher. The credit quality of municipal bonds has remained stable, as rating upgrades have just outpaced downgrades so far this year. To date, no municipal bond rating downgrades have been specifically related to the hurricanes in September, although some bonds from the affected region are still on Moody's watchlist. The ratio of yields on high-grade general obligation municipal bonds to those on comparable-maturity Treasuries, an additional measure of credit quality, was also little changed over the intermeeting period.

Money and Bank Credit

In September and October, growth of M2 averaged 6½ percent at an annual rate — somewhat above the pace registered earlier this year. The staff estimates that the effects of Hurricane Katrina contributed about 1 percentage point to the growth of M2 in September; in particular, currency expanded, the Federal Emergency Management Agency delivered relief payments to individuals, and insurance companies advanced funds to hurricane victims against likely future settlements. For September and October, overall M2 growth was boosted by a turnaround in the volatile retail money market fund component and an uptick in growth of liquid deposits.

After having surged in August, growth of bank credit dropped in September to an annual rate of 5 percent. A marked decline in banks' lending to households accounted for the bulk of last month's slowdown. Growth of residential mortgage loans on banks' books slowed sharply, in part as a large volume of mortgages was securitized. In addition,

Monetary Aggregates

(Based on seasonally adjusted data)

Aggregate or component	2003	2004	2005 H1	2005 Q3	2005 Sept.	2005 Oct. (e)	Level ($ billions), Oct. (e)
	Percent change (annual rate)[1]						
Aggregate							
1. M2[2]	5.5	5.2	2.8	3.9	6.1	6.9	6,626
2. M3[3]	4.8	5.8	5.7	8.3	11.9	9.4	10,055
Components of M2[4]							
3. Currency	5.9	5.5	3.2	3.4	5.1	2.2	717
4. Liquid deposits[5]	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
Components of M3							
7. M3 minus M2[6]	3.4	7.0	11.9	17.3	23.2	14.2	3,429
8. Large time deposits, net[7]	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
Memo							
12. Monetary base	5.9	5.6	3.2	2.9	4.2	3.1	779
	Average monthly change (billions of dollars)[8]						
Selected managed liabilities at commercial banks							
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.

Commercial Bank Credit

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

Type of credit	2003	2004	H1 2005	Q3 2005	Aug. 2005	Sept. 2005	Level ($ billions), Sept. 2005
Total							
1. Adjusted[1]	**5.9**	**8.9**	**12.5**	**9.3**	**12.2**	**5.0**	**7,098**
2. Reported	5.6	8.5	11.3	9.2	12.0	7.0	7,253
Securities							
3. Adjusted[1]	8.6	6.6	14.5	1.5	1.5	-1.0	1,860
4. Reported	7.2	5.2	10.2	1.8	1.7	6.7	2,016
5. Treasury and agency	8.9	4.8	7.2	-6.0	-3.8	-8.3	1,164
6. Other[2]	4.8	5.8	14.8	13.3	9.5	27.9	851
Loans[3]							
7. Total	4.9	9.8	11.8	12.1	16.1	7.2	5,237
8. Business	-9.4	1.4	15.5	12.5	11.0	9.0	994
9. Real estate	11.1	14.0	14.1	15.5	14.6	3.5	2,821
10. Home equity	30.8	43.9	16.7	11.7	3.8	-2.7	438
11. Other	8.8	9.8	13.6	16.2	16.6	4.6	2,383
12. Consumer	5.4	8.8	5.7	4.7	11.6	4.3	702
13. Adjusted[4]	5.8	5.9	1.1	4.4	7.8	3.3	1,065
14. Other[5]	6.8	8.0	4.2	5.7	33.9	22.4	720

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.

home equity loans contracted in September, likely reflecting the continued rise in the floating rates on such loans. Growth of banks' consumer loans fell back from the outsized pace in August to the range seen earlier this year. By comparison, commercial real estate and C&I loans expanded notably last month.

Last Page of Financial Developments

International Developments

International Developments

U.S. International Transactions

Trade in Goods and Services

The U.S. international trade deficit widened to $59 billion in August from $58 billion in July (revised). The increase in the deficit reflected a surge in imports that was partially offset by a sizeable gain in exports.

Net Trade in Goods and Services
(Billions of dollars, seasonally adjusted)

	2004	Annual rate 2005 Q1	Annual rate 2005 Q2	Annual rate 2005 Q3[e]	Monthly rate 2005 June	Monthly rate 2005 July	Monthly rate 2005 Aug.
Real NIPA[1]							
Net exports of G&S	-601.3	-645.4	-614.2	n.a.	...	...	...
Nominal BOP							
Net exports of G&S	-617.6	-692.2	-693.3	-701.9	-59.5	-58.0	-59.0
Goods, net	-665.4	-745.3	-747.7	-758.3	-63.8	-62.5	-63.8
Services, net	47.8	53.1	54.4	56.4	4.3	4.6	4.8

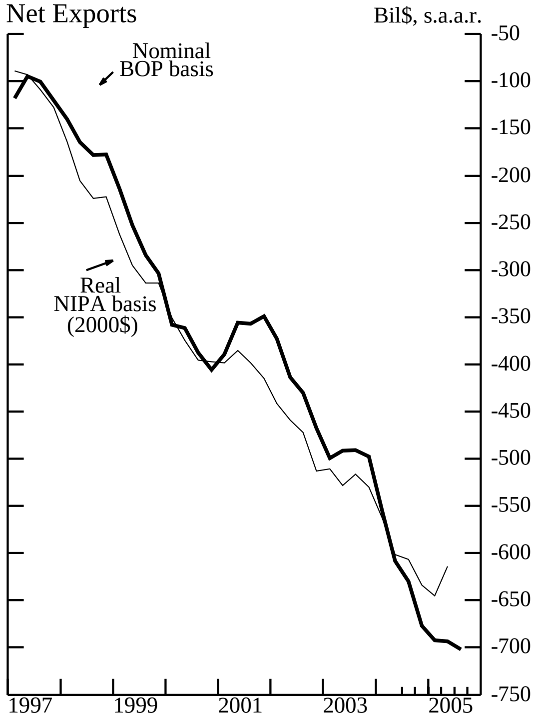
1. Billions of chained (2000) dollars.
e. BOP data are two months at an annual rate.
Source. U.S. Department of Commerce, Bureaus of Economic Analysis and Census.
n.a. Not available. ... Not applicable.

In August, the value of exports of goods and services increased 1.7 percent from a strong July level. The increase was largely driven by higher merchandise exports, although exports of services also advanced a bit. Most major categories of merchandise posted gains in August, with capital goods, automotive products, and industrial supplies showing particular strength. Within capital goods, exports of aircraft recorded the largest absolute gain, but semiconductors, computers, and telecommunication products also rose. In contrast, exports of agricultural products fell. The average value of exports in July and August increased 5¾ percent (a.r.) from the second quarter. Exports of capital goods (particularly aircraft) and automotive products exhibited particularly robust growth.

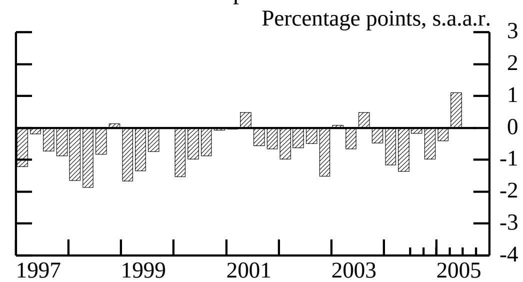
The value of imported goods and services rose 1.8 percent in August, reflecting gains in non-oil goods and, more markedly, oil; imports of services were little changed. Within non-oil goods, imports of automotive products surged. Imports of capital goods also rose, as an increase in imports of machinery offset a decline in aircraft. Imports of industrial supplies and consumer goods retreated a bit. The drop in consumer goods reflected declines in imports of apparel and textile products. The average value of imports in July and August increased 5¾ percent (a.r.) from the second quarter, more

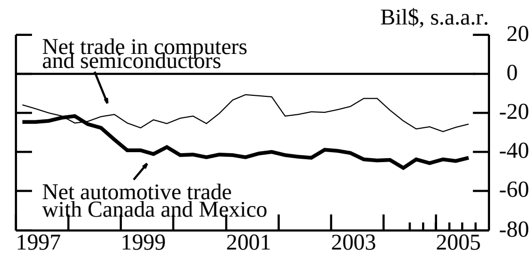
U.S. International Trade in Goods and Services

Net Exports

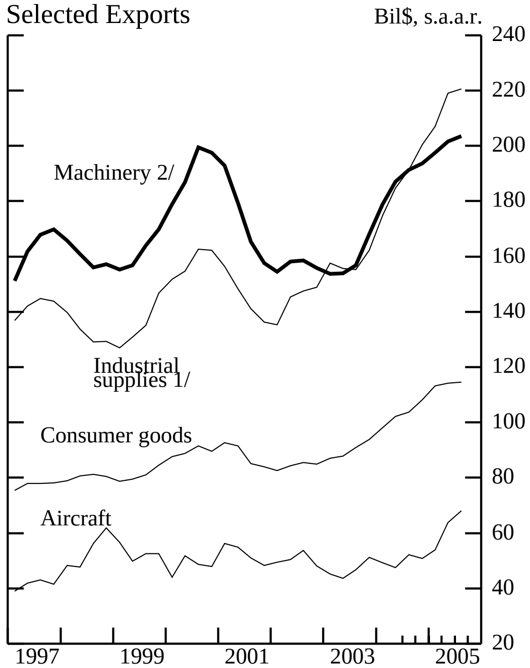


Contribution of Net Exports to Real GDP Growth



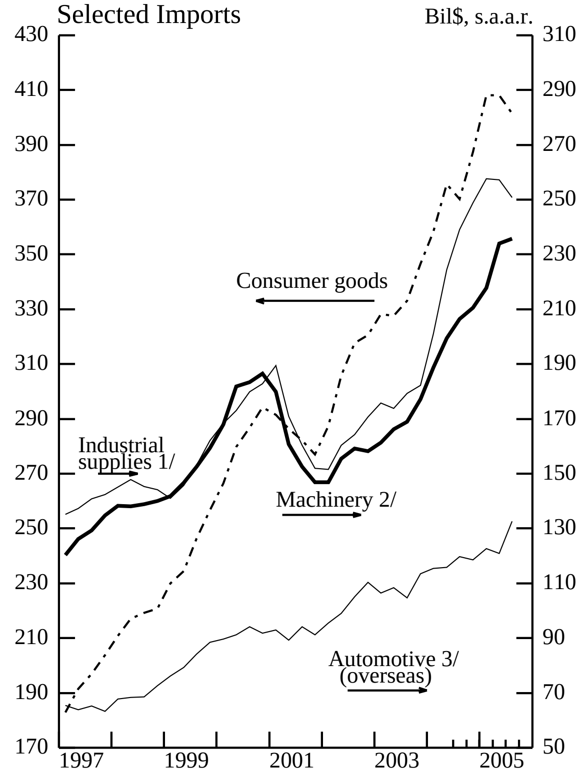


Selected Exports



1. Excludes agriculture and gold.
2. Excludes computers and semiconductors.

Selected Imports



1. Excludes oil and gold.
2. Excludes computers and semiconductors.
3. Excludes Canada and Mexico.

U.S. Exports and Imports of Goods and Services

(Billions of dollars, s.a.a.r., BOP basis)

	Levels				Change[1]			
	2005		2005		2005		2005	
	Q2	Q3[e]	July	Aug.	Q2	Q3[e]	July	Aug.
Exports of G&S	**1269.1**	**1287.2**	**1276.3**	**1298.1**	**43.4**	**18.1**	**6.6**	**21.8**
Goods exports	894.2	910.4	900.8	920.1	38.8	16.3	6.6	19.3
Gold	5.5	5.1	5.0	5.3	-0.0	-0.4	-0.6	0.3
Other goods	888.7	905.3	895.8	914.8	38.8	85.2	7.3	19.0
Aircraft & parts	63.7	68.1	63.5	72.6	9.9	4.3	1.7	9.1
Computers & accessories	45.8	46.4	46.3	46.5	1.8	0.6	1.3	0.2
Semiconductors	45.9	48.7	47.6	49.8	2.4	2.8	2.3	2.2
Other capital goods	205.2	207.0	205.9	208.1	4.8	1.8	-3.5	2.1
Automotive	93.9	97.9	95.9	100.0	-0.9	4.1	1.9	4.1
to Canada	51.4	52.8	51.1	54.5	-0.0	1.4	-1.0	3.4
to Mexico	15.4	14.6	12.7	16.5	0.6	-0.8	-2.3	3.8
to ROW	27.1	30.5	32.0	29.0	-1.4	3.4	5.2	-3.0
Agricultural	68.6	69.2	70.2	68.1	6.3	0.6	2.3	-2.1
Ind supplies (ex. ag, gold)	219.0	220.6	217.5	223.7	12.0	1.6	-0.0	6.2
Consumer goods	114.1	114.6	114.7	114.5	0.9	0.5	0.5	-0.2
All other goods	32.5	32.8	34.1	31.4	1.6	0.3	5.0	-2.7
Services exports	375.0	376.8	375.5	378.1	4.6	1.8	-0.1	2.5
Imports of G&S	**1962.4**	**1989.1**	**1971.8**	**2006.5**	**44.5**	**26.7**	**-11.8**	**34.6**
Goods imports	1641.9	1668.7	1651.3	1686.1	41.2	26.8	-8.9	34.9
Petroleum	229.6	260.5	249.7	271.3	17.9	30.9	11.9	21.6
Gold	4.0	3.9	3.7	4.1	0.2	-0.2	-0.4	0.4
Other goods	1408.3	1404.3	1397.9	1410.7	23.1	-4.0	-20.3	12.9
Aircraft & parts	28.2	23.6	25.5	21.8	2.6	-4.6	-3.7	-3.8
Computers & accessories	93.7	94.8	95.3	94.2	1.6	1.1	-2.0	-1.1
Semiconductors	25.3	26.2	27.0	25.3	0.4	0.8	1.8	-1.7
Other capital goods	236.3	238.2	234.0	242.4	16.0	1.9	-5.5	8.4
Automotive	232.3	243.0	236.0	250.0	-0.4	10.7	1.0	14.0
from Canada	65.7	70.4	67.8	73.0	-3.6	4.6	1.5	5.2
from Mexico	45.6	40.0	33.6	46.4	5.0	-5.6	-11.7	12.8
from ROW	121.0	132.7	134.6	130.7	-1.7	11.7	11.2	-3.9
Ind supplies (ex. oil, gold)	257.2	250.8	251.5	250.0	-0.5	-6.4	-4.5	-1.5
Consumer goods	408.1	401.5	402.1	400.9	-0.0	-6.6	-8.0	-1.2
Foods, feeds, bev.	67.3	67.8	67.2	68.5	1.0	0.6	-0.3	1.2
All other goods	59.7	58.3	59.1	57.6	2.4	-1.4	1.0	-1.5
Services imports	320.6	320.4	320.6	320.3	3.3	-0.1	-3.0	-0.2
Memo:								
Oil quantity (mb/d)	13.57	13.51	13.48	13.55	-0.98	-0.06	-0.40	0.07
Oil import price ($/bbl)	46.28	52.78	50.72	54.84	6.39	6.48	3.81	4.12

1. Change from previous quarter or month. e. Average of two months.
Source. U.S. Department of Commerce, Bureaus of Economic Analysis and Census.

than accounted for by a surge in oil imports as non-oil imports dropped sharply in July. Automotive products also grew robustly, but imports of consumer goods and industrial supplies fell.

Prices of Internationally Traded Goods

Non-oil imports. In September, BLS prices of U.S. imports of non-oil goods and core goods both increased 1.2 percent, led by a strong increase in the price of imported natural gas. Core goods prices excluding natural gas rose 0.6 percent, largely reflecting higher prices for material intensive goods, with chemicals and building supplies exhibiting particularly large increases. Finished goods prices recorded much more modest gains; prices of imported capital goods (excluding computers and semiconductors) and consumer goods both increased 0.3 percent in September after declining slightly in the previous two months. Prices of imported semiconductors fell 0.8 percent in September, whereas prices of imported computers declined 0.3 percent.

In the third quarter, BLS non-oil import prices climbed 0.3 percent at an annual rate, whereas the prices of imported core goods increased 1.1 percent, a difference attributable to a 9.7 percent decrease in imported computer prices and a 5.6 percent decrease in imported semiconductor prices. The rise in core goods prices primarily reflected a 6.4 percent increase in prices of non-oil industrial supplies that was concentrated in September. Prices of most other categories of imports fell in the third quarter, with imported food prices declining 3.3 percent and the prices of consumer goods edging down 0.8 percent.

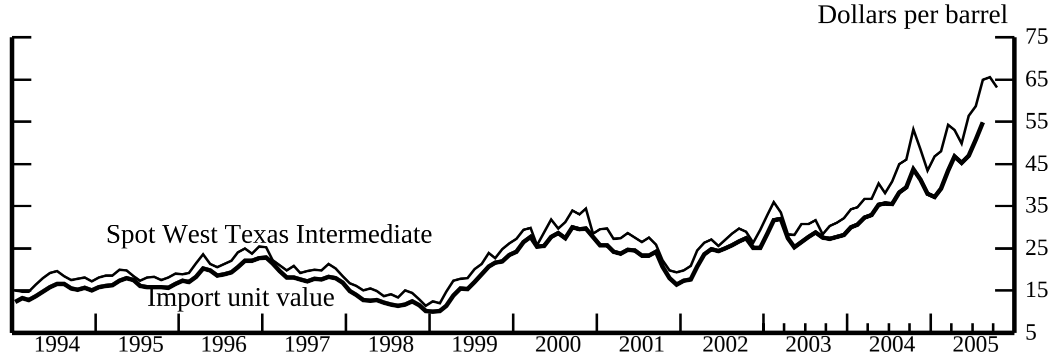
Oil. The BLS price index of imported oil rose 7.3 percent in September, reflecting a modest rise in the price of imported crude oil and much larger increases in the prices of refined petroleum products. The average spot price of West Texas Intermediate (WTI) crude oil rose 1 percent in September to average about $65.50 per barrel. The spot price of WTI reached nearly $70 per barrel at the beginning of the month in the immediate aftermath of Hurricane Katrina, but then edged down following the release of strategic stocks by the International Energy Agency and diminished demand by refiners. The spot price rebounded somewhat due to Hurricane Rita later in September, but has since eased to an average of $62.76 per barrel so far this month. Nonetheless, prices remain elevated due to diminished oil production in the Gulf of Mexico and perceptions of a tight market going forward. The spot price of WTI closed at $63.05 per barrel on October 25.

Prices of U.S. Imports and Exports
(Percentage change from previous period)

	Annual rate 2005			Monthly rate 2005		
	Q1	Q2	Q3	July	Aug.	Sept.
	BLS prices					
Merchandise imports	3.3	10.5	13.9	1.2	1.2	2.3
Oil	-1.6	69.7	103.8	7.6	6.0	7.3
Non-oil	4.2	1.7	0.3	-0.2	0.1	1.2
Core goods*	5.1	2.0	1.1	0.0	0.1	1.2
Cap. goods ex comp & semi	5.3	2.0	-0.1	-0.1	-0.1	0.3
Automotive products	0.4	0.5	0.6	0.0	0.1	0.1
Consumer goods	4.7	0.0	-0.8	-0.2	-0.2	0.3
Foods, feeds, beverages	9.2	7.3	-3.3	-0.5	0.4	0.7
Industrial supplies ex oil	8.5	6.8	6.4	0.3	0.5	5.0
Computers	-6.6	-4.9	-9.7	-2.0	0.0	-0.3
Semiconductors	-1.1	-2.0	-5.6	-1.2	0.1	-0.8
Merchandise exports	4.9	3.3	1.1	0.1	-0.1	0.9
Core goods*	6.0	4.3	2.5	0.3	0.1	1.1
Cap. goods ex comp & semi	3.9	1.5	0.3	0.0	0.1	0.1
Automotive products	1.4	0.8	0.9	0.1	0.1	0.1
Consumer goods	2.4	0.3	-0.1	0.0	0.1	0.3
Agricultural products	3.6	18.7	2.1	0.0	-0.5	-1.4
Industrial supples ex ag	12.9	6.5	6.7	1.0	0.1	3.6
Computers	-7.8	-7.4	-5.3	-1.4	0.5	0.1
Semiconductors	-1.4	-3.3	-12.9	-1.3	-3.3	-0.3
Chain price index	NIPA prices					
Imports of goods & services	2.9	8.2	n.a.	...	...	...
Non-oil merchandise	3.7	1.6	n.a.	...	...	...
Core goods*	4.6	2.2	n.a.	...	...	...
Exports of goods & services	4.6	3.7	n.a.	...	...	...
Total merchandise	4.5	2.9	n.a.	...	...	...
Core goods*	6.1	3.8	n.a.	...	...	...

*/ Excludes computers and semiconductors.
n.a. Not available. ... Not applicable.

Oil Prices



Exports. In September, the prices of U.S. exports of total goods increased 0.9 percent, and the prices of core exports increased 1.1 percent. The increase in export prices was largely due to a 3.6 percent increase in prices for exports of non-agricultural industrial supplies, particularly for petroleum products and chemicals, which more than offset a 1.4 percent drop in the price of agricultural products. Other categories of export prices changed only modestly. In September, prices of exported semiconductors fell 0.3 percent, whereas prices of computers increased 0.1 percent.

In the third quarter, total goods export prices increased 1.1 percent at an annual rate, whereas core export prices rose 2.5 percent, with the price increase concentrated in September. Within core goods, prices of non-agricultural industrial supplies showed the most pronounced increase in the third quarter, rising 6.7 percent. Agricultural prices increased 2.1 percent. Other categories in core goods saw only modest price changes. In the third quarter, semiconductor export prices fell 12.9 percent, and computer export prices fell 5.3 percent.

U.S. International Financial Transactions

Net foreign private purchases of U.S. securities continued strong in August (line 4 of the Summary of U.S. International Transactions table) at $58 billion, led by unusually high net acquisitions of corporate debt securities (line 4c). There were also substantial acquisitions of Treasuries (line 4a), while net foreign purchases of both equities (line 4d) and agency debt securities (line 4b) lagged. For the first eight months of the year, net foreign private acquisitions of U.S. securities are well above last year's pace.

Foreign official inflows (line 1) continued at a high level in August but remained well below the record pace of 2004. For both the month and the year to date, China has accounted for the bulk of official inflows. Japanese official holdings have decreased slightly during the year through August and we have seen almost no inflows attributable to the major oil exporting countries. Partial and confidential data on custody holdings at FRBNY indicate very modest foreign acquisitions during September and moderate inflows thus far in October.

It should be noted that both the monthly transactions data and the annual holdings surveys may record some foreign official inflows as private if investments are made via foreign private intermediaries. Thus, the private inflows reported above are likely overstated and the official inflows correspondingly understated. This could help to account for the very modest increase in official holdings attributed to the oil exporting countries.

U.S. residents reduced their holdings of foreign securities (line 5) slightly in August, with strong net purchase of foreign equities (line 5b) offset by even larger net sales of foreign bonds (line 5a). U.S. residents showed a particular appetite for Japanese equities in August, increasing their holdings by $7 billion during the month.

The volatile banking sector (line 3) registered a modest outflow in August that roughly offset a similar inflow in July.

Summary of U.S. International Transactions

(Billions of dollars, not seasonally adjusted except as noted)

	2003	2004	2004		2005			
			Q3	Q4	Q1	Q2	July	August
Official financial flows	**269.0**	**398.1**	**76.4**	**94.9**	**31.3**	**81.4**	**23.2**	**23.7**
1. Change in foreign official assets in the U.S. (increase, +)	267.5	395.3	76.0	94.2	25.9	82.2	21.5	20.6
a. G-10 countries + ECB	111.4	161.7	20.4	-3.1	5.5	-18.2	4.0	.5
b. OPEC	5.9	12.1	3.5	6.8	-3.9	4.6	-4.5	.7
c. All other countries	150.2	221.5	52.1	90.4	24.3	95.7	22.0	19.4
2. Change in U.S. official reserve assets (decrease, +)	1.5	2.8	.4	.7	5.3	-.8	1.7	3.1
Private financial flows	**291.7**	**186.5**	**40.3**	**74.1**	**130.7**	**60.9**	**...**	**...**
Banks								
3. Change in net foreign positions of banking offices in the U.S. [1]	64.7	-20.4	-16.0	-2.6	-2.9	-59.1	25.2	-28.1
Securities [2]								
4. Foreign net purchases of U.S. securities (+)	336.0	505.9	87.5	170.9	152.2	119.7	67.7	58.3
a. Treasury securities	113.3	122.5	.7	10.9	76.0	4.5	16.0	16.2
b. Agency bonds	-38.3	66.0	.5	43.2	.8	20.6	22.0	2.9
c. Corporate and municipal bonds	223.8	255.0	84.8	71.1	54.9	80.1	19.4	34.2
d. Corporate stocks [3]	37.2	62.4	1.6	45.8	20.5	14.5	10.4	4.9
5. U.S. net acquisitions (-) of foreign securities	-146.6	-146.2	-47.9	-29.6	-46.9	-42.0	-15.5	1.8
a. Bonds	-28.0	-60.9	-29.8	-19.9	-6.5	-17.8	-5.8	16.4
b. Stock purchases	-101.2	-97.6	-17.6	-35.2	-38.3	-22.3	-9.7	-14.6
c. Stock swaps [3]	-17.4	12.2	-.6	25.5	-2.1	-1.9	.0	.0
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-140.6	-252.0	-41.2	-100.0	-27.0	-33.6	...	...
7. Foreign direct investment in the U.S.	67.1	106.8	35.7	31.6	35.1	17.6	...	...
8. Foreign holdings of U.S. currency	16.6	14.8	2.6	5.3	1.1	4.5	...	...
9. Other (inflow, +) [4]	94.3	-22.5	19.6	-1.6	19.2	53.8	...	...
U.S. current account balance (s.a.)	**-519.7**	**-668.1**	**-167.0**	**-188.4**	**-198.7**	**-195.7**	**...**	**...**
Capital account balance (s.a.) [5]	**-3.2**	**-1.6**	**-.4**	**-.5**	**-4.5**	**-.3**	**...**	**...**
Statistical discrepancy (s.a.)	**-37.8**	**85.1**	**50.7**	**19.9**	**41.2**	**53.6**	**...**	**...**

Note. Data in lines 1 through 5 differ in timing and coverage from the balance of payments data published by the Department of Commerce. Details may not sum to totals because of rounding.

1. Changes in dollar-denominated positions of all depository institutions and bank holding companies plus certain transactions between broker-dealers and unaffiliated foreigners (particularly borrowing and lending under repurchase agreements). Includes changes in custody liabilities other than U.S. Treasury bills.

2. Includes commissions on securities transactions and therefore does not match exactly the data on U.S. international transactions published by the Department of Commerce.

3. Includes (4d) or represents (5c) stocks acquired through non-market means such as mergers and reincorporations.

4. Transactions by nonbanking concerns and other banking and official transactions not shown elsewhere plus amounts resulting from adjustments made by the Department of Commerce and revisions in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.

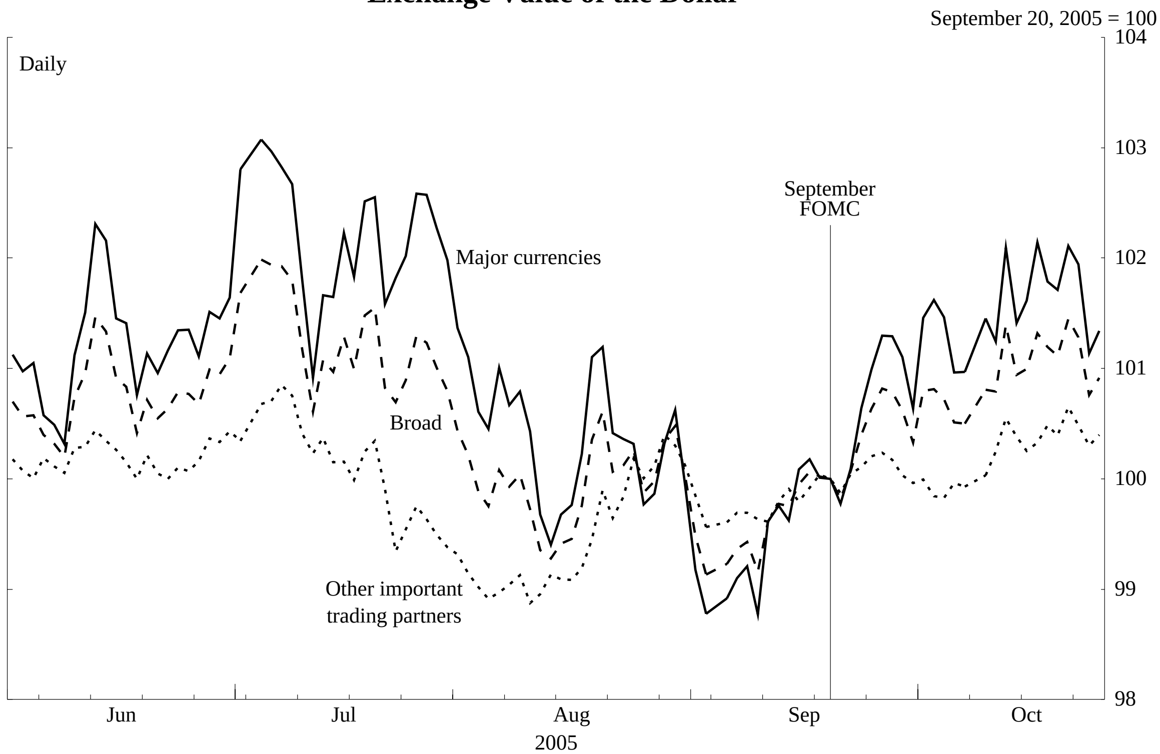
5. Consists of transactions in nonproduced nonfinancial assets and capital transfers.

n.a. Not available. ... Not applicable.

Foreign Financial Markets

The major currencies index of the dollar rose about 1⅓ percent on net over the intermeeting period. This rise occurred as dollar-denominated interest rates rose more than those of currencies of the other major industrial economies. Late in the period, the dollar retraced some of its earlier gains as Treasury yields fell while European yields rose following confidence survey data that was significantly stronger than expected in Germany but was weaker-than-expected in the United States. On net, long-term yields rose globally, as market participants focused on comments from policy makers in several major economies that were interpreted as indicating that upside risks to inflation might necessitate some firming of monetary policy. Energy prices spiked up early on in the intermeeting period on the landfall of Hurricane Rita, but declined later as concerns over the long-term damage caused by the hurricane moderated and market reports indicated that U.S. demand for petroleum products was softening. Even so, energy prices remained near historically elevated levels. Major equity indexes generally declined across the globe, driven in part by the rise in global bond yields. The exception was Japan, as market participants continued to discuss signs of progress in Japanese economic recovery and in financial sector reform.

Exchange Value of the Dollar



The dollar appreciated 3¾ percent on balance against the Japanese yen, about 1½ percent against sterling, but less than 1 percent against the euro and the Canadian dollar. The dollar appreciated in reaction to a widening of interest rate differentials against the yen- and sterling-denominated assets in favor of the dollar. Federal Reserve officials' commentary highlighting inflation concerns was generally interpreted as indicating that a greater-than-previously-anticipated degree of monetary tightening was forthcoming. The underperformance of the yen against the dollar also appeared to owe to Japanese private-sector outflows that did not appear to be driven by economic fundamentals.

Financial Indicators in Major Industrial Countries

Country	Three-month rate		Ten-year yield		Equities
	Oct. 26 (Percent)	Percentage point change	Oct. 26 (Percent)	Percentage point change	percent change
Canada	3.13	.24	4.15	.27	-2.36
Japan	.08	.02	1.52	.16	4.08
Euro area	2.21	.07	3.38	.31	-2.67
United Kingdom	4.47	-.03	4.44	.22	-3.80
Switzerland	.78	.06	2.05	.24	1.15
Australia	5.67	.06	5.48	.23	-2.80
United States	4.18	.30	4.57	.32	-2.17
Memo: Weighted-average foreign	2.10	.09	3.59	.20	n.a.

NOTE. Change is from September 19/20 to October 26 (10 a.m. EDT).
n.a. Not available.

Only short-term Canadian dollar interest rates nearly kept pace with the rise in short-term dollar denominated rates, rising over 20 basis points during the intermeeting period. The Bank of Canada further tightened its monetary policy stance, raising its policy rate another 25 basis points, to 3.0 percent, on October 18. Three-month euro interest rates rose only slightly on net, despite statements by European Central Bank President Trichet and other officials that highlighted inflation concerns. Yields implied by sterling interest rate futures currently show that market participants have reduced the odds of an additional 25-basis-point cut by the Bank of England through next year.

While short-term interest rates rose more moderately in non-dollar currencies, global benchmark long-term yields rose around 30 basis points in the euro area as well as in Canada, and close to 20 basis points in Japan, as market participants focused on global official commentary highlighting inflation risks. Yields on inflation-indexed notes rose nearly as much as nominal yields, leaving inflation compensation measures only slightly higher on the period.

Financial Indicators in Latin America, Asia, and Russia

Economy	Currency/ US dollar		Short-term interest rates[1]		Dollar-denominated bond spread[2]		Equity prices
	Oct. 26	Percent change	Oct.25/26 (Percent)	Percentage point change	Oct.25/26 (Percent)	Percentage point change	Percent change
Mexico	10.88	.52	8.82	-.18	1.35	.01	-1.85
Brazil	2.28	-.91	18.85	-.40	3.66	.02	-2.55
Argentina[3]	2.99	2.58	6.38	.19	3.99	.11	-4.42
Chile	547.00	2.30	4.41	.63	.51	-.02	-.22
China	8.09	-.03	n.a.	n.a.	.49	.04	-9.52
Korea	1045.40	1.47	3.58	.25	...	...	-1.00
Taiwan	33.66	1.87	1.56	-.02	...	...	-6.63
Singapore	1.69	.63	2.44	.25	...	...	-2.91
Hong Kong	7.75	-.10	4.13	.43	...	...	-5.14
Malaysia	3.77	.12	2.89	.01	.39	-.06	-1.82
Thailand	40.86	-.44	3.95	.25	n.a.	n.a.	-5.27
Indonesia	9987.00	-1.85	13.44	1.55	.64	1.44	.62
Philippines	54.95	-2.22	7.44	-.56	n.a.	n.a.	.05
Russia	28.50	.39	n.a.	n.a.	n.a.	n.a.	-3.78

NOTE. Change is from September 19/20 to October 25/26.

1. One month interbank interest rate, except Chile: 30-day deposit rate; Korea: 1-week call rate. No reliable short-term interest rates exist for China or Russia.

2. Spread over similar maturity U.S. Treasury security yield. Mexico, Brazil, Argentina, Korea, the Philippines and Russia: EMBI+ yield. Chile and China: Global bond yield. Malaysia: Eurobond yield. Thailand and Indonesia: Yankee bond yield. Taiwan, Singapore, and Hong Kong do not have outstanding sovereign bonds denominated in dollars.

3. J.P. Morgan re-structured Argentina's EMBI+ index in reaction to the recent debt exchange, prompting a drop in the Argentine EMBI+ spread from 66.07 to 9.10 percentage points on June 13.

n.a. Not available. ... Not applicable.

The rise in long-term yields contributed to some downward pressure in global equity markets. Headline indexes in the United Kingdom dropped more than in U.S. equity markets, falling nearly 4 percent, while the euro-area headline index declined about

2½ percent. In contrast, Japanese equities continued to breach multi-year highs, as market participants discussed the likelihood that economic recovery was firming. The Topix banking sub-index gained over 10 percent, as the passage of the postal reform bill appeared to support sentiment over the outlook for further financial sector reform.

In several emerging markets, equity market indexes declined, particularly late in the period, as the rise in U.S. interest rates reportedly reduced investor demand for riskier assets. Emerging market sovereign external debt spreads over Treasuries were little changed on balance. Although the Brazilian *real* gained nearly 2 percent against the dollar over the period, and the Mexican peso depreciated modestly against the dollar, late in the period these currencies came under some pressure as market participants noted that expectations of additional monetary easing by the Mexican and Brazilian central banks, had begun to weigh on the exchange value of these currencies.

The Desk did not intervene during the period for the accounts of the System or the Treasury.

Developments in Foreign Industrial Countries

Rising energy prices led consumer prices to run up in the twelve months to September in all major industrial economies, except Japan, where mild deflation persisted. In the euro area, headline inflation jumped to 2.6 percent, but core inflation remained moderate. Consumer price inflation in the United Kingdom rose to 2.5 percent, also pushed up by rising gasoline prices. Headline inflation in Canada surged to 3.4 percent, above the ceiling of the Bank of Canada's 1-3 percent target range.

Economic performance in the third quarter appears to have varied substantially among the foreign industrial economies. In the United Kingdom, GDP growth declined to 1.5 percent from 2 percent in the second quarter. In Japan, indicators of private investment and consumption were fairly flat, pointing to a slowdown in the pace of economic growth. In contrast, in the euro area, recent figures for industrial production and retail sales indicate that the economy has improved from its disappointing second-quarter performance. In Canada, data on external activity and housing starts point to continued robust GDP growth in the third quarter.

Monthly indicators suggest that economic activity in **Japan** rebounded in August from a weak July, but third-quarter growth nevertheless appears to have stepped down from its rapid pace in the first half of the year. In August, real household spending rose 3.2 percent and retail sales rose 1.5 percent, but averages of both over July and August are below their second-quarter levels. Industrial production rose 1.1 percent in August, bouncing back to the average level recorded in the second quarter. The external sector continued to contribute positively. In July and August, on average, real merchandise exports were 2.5 percent higher, while real imports were up 1.8 percent.

The Bank of Japan's (BOJ) Tankan business conditions index for all firms rose one point in September from its level in June. Capital spending projections for 2005 were revised upward slightly in the Tankan survey. Sales and profits forecasts were also revised upward, with large manufacturers now expecting domestic sales to exceed exports, underscoring the resurgence in domestic demand that has taken place this year.

Tokyo core consumer prices, which exclude fresh food but include energy, fell 0.4 percent in September from a year ago. In August, nominal wages were up 0.4 percent on an annual basis, as the unemployment rate edged back down to 4.3 percent after a temporary uptick in July, and the job-offers-to-applicants ratio remained at a thirteen-year high. BOJ officials continue to state that they expect twelve-month consumer price inflation to turn positive by the end of 2005. Monetary policy was unchanged, but long-term interest rates rose in the wake of comments by several BOJ officials that were interpreted as indicating that the Bank's policy of quantitative easing might end in the first half of 2006.

Japanese Economic Indicators
(Percent change from previous period except as noted, s.a.)

Indicator	2005						
	Q1	Q2	Q3	June	July	Aug.	Sept.
Industrial production[1]	1.8	-.4	n.a.	1.6	-1.2	1.1	n.a.
All-industries index	1.3	.3	n.a.	1.2	-.8	1.1	n.a.
Housing starts	3.3	-2.1	n.a.	1.4	9.2	-4.8	n.a.
Machinery orders[2]	.8	.8	n.a.	11.1	-4.3	8.2	n.a.
Machinery shipments[3]	-.4	2.4	n.a.	3.2	-1.5	3.6	n.a.
New car registrations	-2.6	1.3	-2.1	4.5	-6.6	1.6	2.5
Unemployment rate[4]	4.6	4.3	n.a.	4.2	4.4	4.3	n.a.
Job offers ratio[5]	.91	.95	n.a.	.96	.97	.97	n.a.
Business sentiment[6]	-2.0	1.0	2.0	...	...	...	...
CPI (core, Tokyo area)[7]	-.5	-.4	-.4	-.4	-.4	-.3	-.4
Wholesale prices[7]	1.3	1.7	1.6	1.4	1.5	1.7	1.7

1. Mining and manufacturing.
2. Private sector, excluding ships and electric power.
3. Excluding orders for ships and from electric power companies.
4. Percent.
5. Level of indicator.
6. Tankan survey, diffusion index.
7. Percent change from year earlier, n.s.a.
n.a. Not available. . . . Not applicable.

Parliament approved Prime Minister Koizumi's bills to privatize the postal savings system following the Liberal Democratic Party's (LDP) victory in the September elections. According to the bills, in October 2007 Japan Post will be split into four stock companies which, under a holding company, will take over mail delivery, postal savings, life insurance, and the network of post offices. The holding company must then dispose of its entire stake in the savings and life insurance companies by March 2017. The plan will create the largest private bank in the world; Japan Post currently has $1.8 trillion equivalent in deposits.

In the **euro area**, recent data suggest that the pace of economic activity accelerated in the third quarter from its second-quarter lull. In August, industrial output in the euro area rose for the third consecutive month, and the pickup appears increasingly broad-based. Industrial orders remained strong in the euro area, especially in Germany where orders in July and August on average were up more than 1 percent from the second-quarter level. Household demand appears to have firmed. Retail sales in the euro area rebounded strongly in August after dropping in July, and French consumption of manufactured goods in the third quarter was up almost 2½ percent from the second-quarter average.

Business confidence improved in the third quarter. The European Commission measure of industrial confidence in the euro area increased in September, recording the highest reading since February. In September, the euro-area PMI for manufacturing rose well above the 50 threshold indicating expansion, reaching its highest level in seven months; the PMI for services moved up as well. In October, the IFO measure of business climate in Germany jumped to 98.7, a five-year peak. Consumer confidence, in contrast, has shown no sign of improvement in the third quarter. Even in France, the overall household confidence indicator continued to slip in September.

Increasing energy prices have contributed to the ongoing deterioration of the trade balance. In August, the euro-area trade account showed a deficit of $0.9 billion in August, the first monthly deficit since 2000.

Euro-Area Economic Indicators
(Percent change from previous period except as noted, s.a.)

Indicator	2005						
	Q1	Q2	Q3	June	July	Aug.	Sept.
Industrial production[1]	.1	.6	n.a.	.5	.1	.8	n.a.
Retail sales volume[2]	.7	-.3	n.a.	.0	-.7	1.1	n.a.
Unemployment rate[3]	8.8	8.7	n.a.	8.6	8.5	8.6	n.a.
Consumer confidence[4]	-13.3	-14.3	-15.0	-15.0	-15.0	-15.0	-15.0
Industrial confidence[4]	-6.7	-10.3	-7.7	-10.0	-8.0	-8.0	-7.0
Manufacturing orders, Germany	-.3	.8	n.a.	2.3	4.1	-3.7	n.a.
CPI[5]	2.0	2.0	2.3	2.1	2.2	2.2	2.6
Producer prices[5]	4.1	3.9	n.a.	4.0	4.1	4.0	n.a.
M3[5]	6.5	7.6	n.a.	7.6	7.9	8.1	n.a.

1. Excludes construction.
2. Excludes motor vehicles.
3. Percent. Euro-area standardized to ILO definition. Includes Eurostat estimates in some cases.
4. Diffusion index based on European Commission surveys in individual countries.
5. Eurostat harmonized definition. Percent change from year earlier, s.a.
n.a. Not available.

Labor market conditions in the euro area have remained weak. The unemployment rate edged up to 8.6 percent in August and has fallen only 0.2 percentage point since the beginning of the year. In addition, unit labor costs have accelerated a bit, as labor productivity growth has fallen.

Twelve-month consumer price inflation jumped to 2.6 percent in September from to 2.2 percent in August. Higher energy prices contributed 1.2 percentage points to the headline figure. In contrast, core inflation, excluding energy and unprocessed food, remained moderate, edging up to 1.5 percent as administered prices for alcohol and tobacco were set higher. In October, according to the preliminary estimate, German consumer prices rose 0.4 percent from the previous month and the twelve-month rate of inflation remained at 2.7 percent.

GDP for the **United Kingdom** rose 1.5 percent in the third quarter, according to the preliminary estimate. Total output from production industries fell 2.4 percent as a 24.2 percent drop in the mining and quarrying sectors more than offset a 1.6 percent increase in manufacturing output. Services rose 2.4 percent, maintaining similar pace to that of the previous two quarters, and construction grew 2.0 percent.

Business confidence rebounded from negative territory in the third quarter. The PMI for manufacturing squeaked above the 50 mark in August and increased a bit further in September. The PMI for services remained essentially unchanged near its 2005 average of 55. The PMI for construction activity rose to its highest mark of the year surpassing 57 in both August and September.

Month-to-month changes in house prices continue to be just slightly positive. According to the Nationwide Building Society index, the twelve-month change of house prices was 1.8 percent in September, down from 2.4 percent in August. The Halifax index of house prices showed a twelve-month increase of 3.7 percent in September, also down from 4.1 percent in the previous month. Household net borrowing for house purchases remained stable in August.

U.K. Economic Indicators
(Percent change from previous period except as noted, s.a.)

Indicator	2005						
	Q1	Q2	Q3	June	July	Aug.	Sept.
Preliminary GDP*	1.0	2.0	1.5	. . .	. . .	. . .	. . .
Industrial production	-.9	.0	n.a.	-.2	-.4	-.9	n.a.
Retail sales volume[1]	-.1	.6	.5	1.2	-.6	.2	.7
Unemployment rate[2]							
Claims-based	2.6	2.7	2.8	2.8	2.8	2.8	2.8
Labor force survey[3]	4.7	4.7	n.a.	4.7	4.7	n.a.	n.a.
Business confidence[4]	12.7	-.3	5.0	-5.0	6.0	3.0	6.0
Consumer confidence[5]	1.0	-2.0	-2.0	-3.0	-1.0	-2.0	-3.0
Consumer prices[6]	1.7	1.9	2.4	2.0	2.3	2.4	2.5
Producer input prices[7]	10.5	9.8	12.5	11.9	14.2	12.9	10.3
Average earnings[7]	4.5	4.1	n.a.	4.0	4.6	3.9	n.a.

* Annual rate.
1. Excludes motor vehicles.
2. Percent.
3. Three-month average centered on month shown.
4. Percentage of firms expecting output to increase in the next four months less percentage expecting output to decrease.
5. Average of the percentage balance from consumers' expectations of their financial situation, general economic situation, unemployment, and savings over the next 12 months.
6. Consumer prices index (CPI), percent change from year earlier.
7. Percent change from year earlier.
n.a. Not available. . . . Not applicable.

The twelve-month rate of consumer price inflation rose to 2.5 percent in September, well above the Bank of England's 2 percent target. For the third consecutive month, the largest upward impact on the CPI came from transport prices, pushed up by rising gasoline prices. Gasoline prices increased 4.3 percent in September from the previous month.

In **Canada**, indicators for the third quarter suggest that economic activity remained strong, although retail sales slipped in August after two months of robust advances. The composite index of leading indicators posted another solid improvement in September, with household spending continuing to dominate. Housing starts moved up strongly again in September after an August lull. The nominal merchandise trade balance expanded in August for the fifth time in the past six months; much of the August increase was due to rising energy prices. The value of manufacturing shipments, new orders, and unfilled orders all advanced strongly in August. Leading the expansion in shipments were the petroleum and auto industries.

Canadian Economic Indicators
(Percent change from previous period except as noted, s.a.)

Indicator	2005						
	Q1	Q2	Q3	June	July	Aug.	Sept.
GDP by industry	.6	.7	n.a.	.3	.2	n.a.	n.a.
Industrial production	-.2	-.1	n.a.	-.2	.3	n.a.	n.a.
New manufacturing orders	3.2	-1.2	n.a.	.7	-1.0	3.4	n.a.
Retail sales	2.3	1.1	n.a.	1.2	1.1	-1.0	n.a.
Employment	.1	.4	.3	.1	.0	.2	-.0
Unemployment rate[1]	7.0	6.8	6.8	6.7	6.8	6.8	6.7
Consumer prices[2]	2.1	1.9	2.6	1.7	2.0	2.6	3.4
Core consumer prices[2,3]	1.7	1.6	1.7	1.5	1.4	1.8	1.8
Consumer attitudes (1991 = 100)	123.6	121.1	108.1	...	...	...	...
Business confidence (1991 = 100)	135.9	139.2	n.a.	...	...	...	...

1. Percent.
2. Percent change from year earlier, n.s.a.
3. Excluding the 8 most volatile components (fruits, vegetables, gasoline, fuel oil, natural gas, mortgage interest, intercity transportation, and tobacco).
n.a. Not available. . . . Not applicable.

In September, overall employment declined slightly, the first dip since January. However, gains in full-time employment continued to be impressive, and growth in full-time positions has accounted for virtually the entire expansion in employment thus far this year. The unemployment rate stood at 6.7 percent in September, matching a 30-year low.

In September, the twelve-month rate of consumer price inflation moved up to 3.4 percent, due almost entirely to upward pressure from gasoline prices. The twelve-month rate of core inflation, excluding the eight most volatile components, remained at 1.8 percent. With inflation edging higher and the economy operating at full capacity, the Bank of Canada increased its target for the overnight rate 25 basis points for the second consecutive time, bringing the rate to 3 percent at its October meeting.

External Balances
(Billions of U.S. dollars, s.a.a.r.)

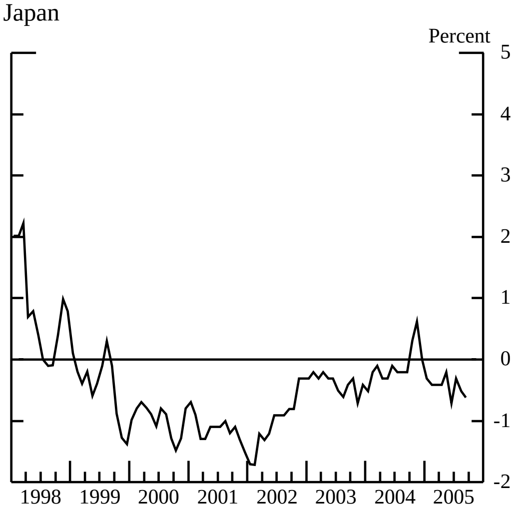
Country and balance	2004	2005				
	Q4	Q1	Q2	June	July	Aug.
Japan						
Trade	103.7	103.5	78.1	74.6	65.1	66.7
Current account	173.8	171.3	160.0	167.2	146.6	140.2
Euro area						
Trade	68.0	67.3	49.1	53.5	14.7	-10.2
Current account	43.9	30.4	9.8	-5.8	-67.9	-97.4
Germany						
Trade	192.7	214.9	200.8	213.2	194.5	186.7
Current account	86.3	144.2	108.9	159.3	156.8	81.5
France						
Trade	-26.1	-27.1	-25.4	-21.5	-36.6	-34.9
Current account	-16.9	-31.7	-37.4	-6.2	-30.4	-42.5
Italy						
Trade	-7.2	-8.5	-8.1	-6.9	-15.3	-26.2
Current account	-24.4	-33.8	-27.2	-12.0	-17.5	-39.4
United Kingdom						
Trade	-120.1	-119.0	-108.5	-90.9	-116.0	-121.0
Current account	-30.7	-55.5	-22.7	...	...	...
Canada						
Trade	47.3	42.1	42.8	42.5	48.0	55.5
Current account	17.3	11.0	15.0	...	...	...

n.a. Not available. . . . Not applicable.

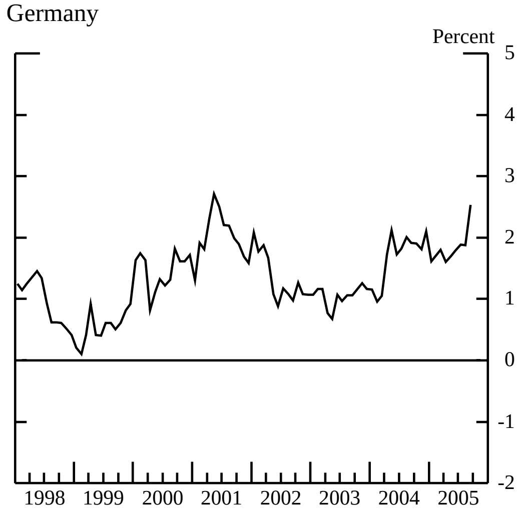
Consumer Price Inflation in Selected Industrial Countries

(12-month change)

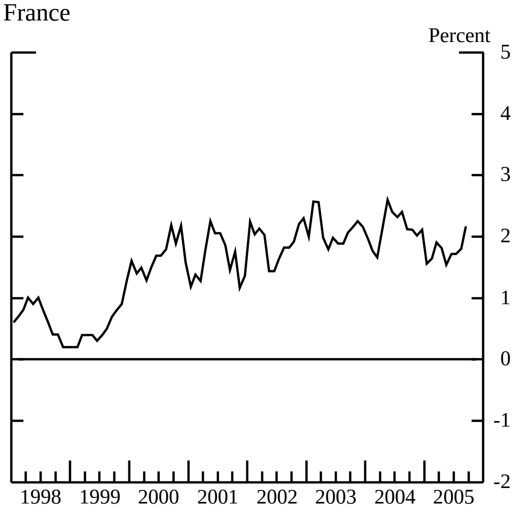
Japan



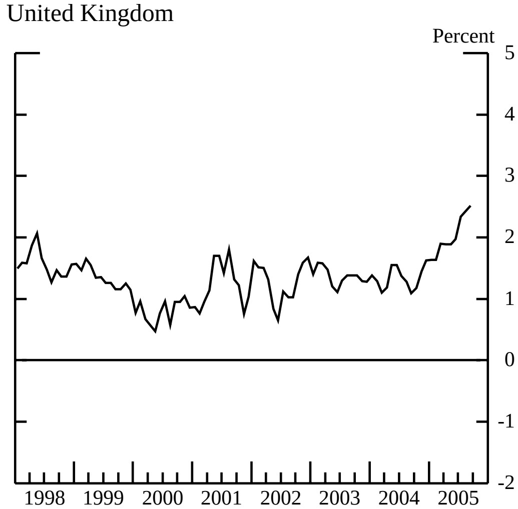
Germany



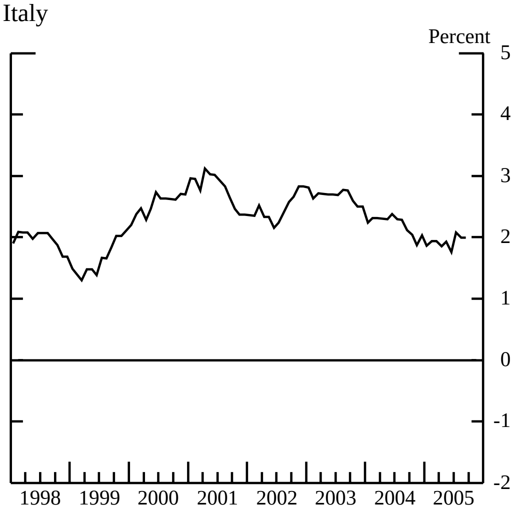
France



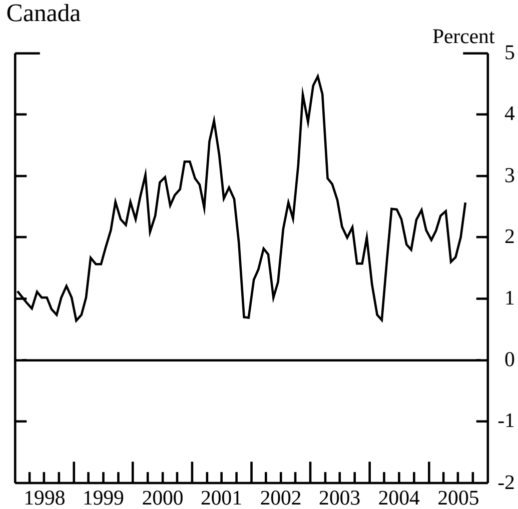
United Kingdom



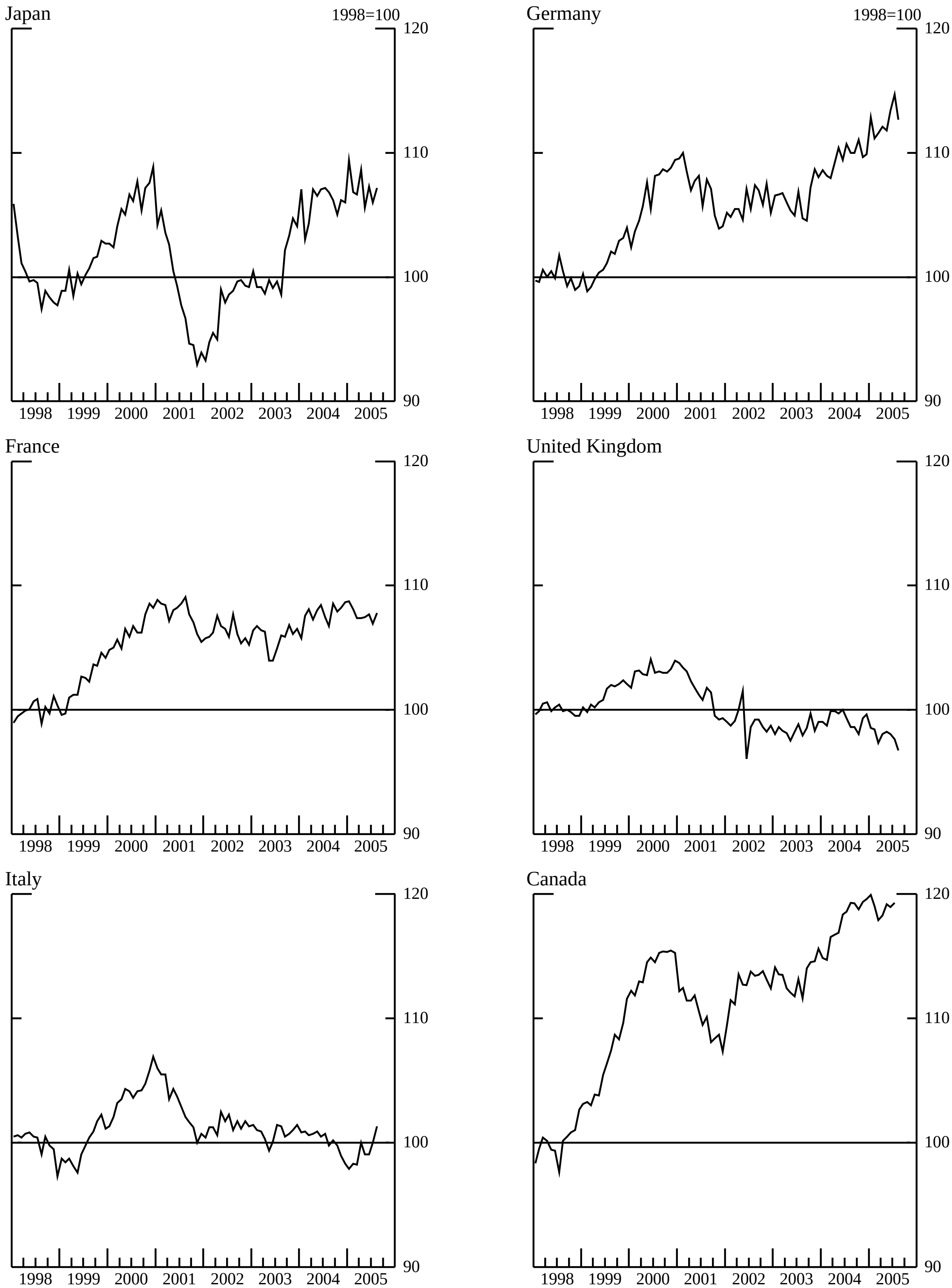
Italy



Canada



Industrial Production in Selected Industrial Countries



Economic Situation in Other Countries

Indicators have varied across the developing economies, but on balance, point to a moderate pickup in economic activity in the third quarter. In Asia, acceleration in Chinese and Korean third-quarter GDP is tempered by a slowdown in some of the other Asian economies, particularly Singapore. In Latin America, recent data suggest that the Mexican economy has not fully recovered from its weak second quarter, while performance appears to have moderated from the strong second-quarter growth rates in Argentina and Brazil. Inflation rates in most of the emerging economies, with the notable exceptions of China and Mexico, have risen recently. In many cases, these increases reflect a greater pass-through of higher crude oil prices to consumer prices following reductions in domestic fuel price controls. The higher inflation has prompted several central banks in Asia to raise interest rates.

Chinese real GDP rose 8.2 percent in the third quarter, in line with staff expectations. The growth appears to have been broad-based. Investment accelerated in the quarter, retail sales growth remained in double-digit territory, and exports continued to grow rapidly. Industrial production accelerated in the last few months and was up more than 3 percent in the third quarter. While Chinese exports grew rapidly in the third quarter, the rate of growth slowed slightly, and import growth picked up a bit. The trade surplus for the third quarter was roughly the same size as in the second quarter. Twelve-month consumer price inflation slowed in recent months, as food prices held down overall inflation and state-controlled fuel prices were raised only minimally.

Chinese Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	2003	2004	2005				
			Q2	Q3	July	Aug.	Sept.
Real GDP[1]	10.0	9.5	5.0	8.2	…	…	…
Industrial production	18.9	14.4	4.3	3.2	.6	1.2	1.9
Consumer prices[2]	3.2	2.6	1.7	1.3	1.7	1.2	1.0
Trade balance[3]	25.5	32.1	109.1	113.7	138.2	115.6	87.4

1. Annual rate. Quarterly data estimated by staff from reported four-quarter growth rates. Annual data are Q4/Q4.
2. Percent change from year-earlier period, except annual data, which are Dec./Dec.
3. Billions of U.S. dollars, annual rate. Imports are c.i.f.
. . . Not applicable.

Recent data from **Hong Kong** have been generally positive. In September, the unemployment rate fell to its lowest rate in four years. Reports indicate that Hong Kong Disneyland opened to large crowds and should be a boost to growth. Trade volume, a good indicator of activity in Hong Kong's entrepôt economy, moved up in August. Twelve-month consumer price inflation continued to edge up in recent months, but still remains low.

Hong Kong Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	2003	2004	2005				
			Q2	Q3	July	Aug.	Sep.
Real GDP[1]	4.5	6.9	12.6	n.a.	…	…	…
Unemployment rate[2]	7.9	6.9	5.7	5.5	5.7	5.7	5.5
Consumer prices[3]	-1.9	.2	.9	1.5	1.3	1.4	1.6
Trade balance[4]	-8.5	-12.0	-9.1	n.a.	-6.8	-16.7	n.a.

1. Annual rate. Annual data are Q4/Q4.
2. Percent. Monthly data are averages of the current and previous two months.
3. Percent change from year-earlier period, except annual data, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate. Imports are c.i.f.
n.a. Not available. . . . Not applicable.

In **Taiwan**, industrial production rebounded sharply in August and September, more than offsetting the July decline, and new orders for electronics and other goods were also up. The unemployment rate inched down in recent months. Exports surged to a new high in September, contributing to a sizeable monthly trade surplus. Twelve-month consumer price inflation fell back some in September owing, in part, to a small decline in core prices.

Taiwan Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	2003	2004	2005				
			Q2	Q3	July	Aug.	Sept.
Real GDP[1]	5.8	3.2	3.3	n.a.	…	…	…
Unemployment rate[2]	5.0	4.5	4.2	4.1	4.2	4.1	4.0
Industrial production	7.1	9.8	1.3	3.0	-2.4	4.9	1.8
Consumer prices[3]	-.1	1.6	2.1	3.0	2.4	3.6	3.1
Trade balance[4]	16.9	6.1	3.1	4.4	6.8	-1.3	7.7
Current account[5]	29.3	18.6	6.9	n.a.	…	…	…

1. Annual rate. Annual data are Q4/Q4.
2. Percent.
3. Percent change from year-earlier period, except annual data, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate. Imports are c.i.f.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. . . . Not applicable.

Korean real GDP accelerated 7.5 percent in the third quarter, on the back of strong domestic demand, particularly private consumption, and a robust pickup in exports. The most recent data suggest sustained high levels of consumer and business confidence in September. Exports of high-tech goods to the United States are down from recent peaks but sales to China are rising, and August high-tech industrial production posted strong gains. Consumer prices jumped in September reflecting surging food, fuel, and transportation prices. Citing concerns over higher inflation due to persistently high oil prices, Bank of Korea raised its target interest rate 25 basis points to 3.5 percent on October 11, ending an easing phase that had lasted more than three years.

Korean Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	2003	2004	2005				
			Q2	Q3	July	Aug.	Sept.
Real GDP[1]	4.2	3.0	5.0	7.5	…	…	…
Industrial production	4.9	10.2	.5	n.a.	1.2	-1.6	n.a.
Unemployment rate[2]	3.6	3.7	3.7	3.8	3.8	3.7	4.0
Consumer prices[3]	3.4	3.0	3.0	2.4	2.5	2.0	2.7
Trade balance[4]	22.0	38.2	27.7	n.a.	40.0	28.9	n.a.
Current account[5]	11.9	27.6	11.0	n.a.	16.6	-4.8	n.a.

1. Annual rate. Annual data are Q4/Q4.
2. Percent.
3. Percent change from year-earlier period, except annual data, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate. Imports are c.i.f.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. . . . Not applicable.

Incoming data from the **ASEAN** countries suggest that economic growth generally moderated in the third quarter. In Singapore, the advance estimate of third-quarter real GDP (unofficial) indicates a 3.2 percent expansion, down from 18 percent in the second quarter. A strong electronics PMI reading for the third quarter suggests expansion in activity going forward. Elsewhere in the region, the average industrial production for recent months inched down in Malaysia, but was up in the Philippines, Indonesia, and Thailand from the second-quarter level. Recent trade data show the ASEAN economies continuing, on average, to run trade surpluses. However, the August trade balance deteriorated in Thailand owing to high imports of capital goods, and in the Philippines due mainly to a high import bill for fuel products.

Consumer price inflation continued to be elevated in the region, reflecting higher imported energy prices, and in some countries, a reduction in fuel subsidies and higher food prices. The exception is Singapore, where reductions in vehicle prices and accommodation costs earlier in the year contributed to containing inflation. Citing concerns over higher inflation, central banks raised interest rates 100 basis points in Indonesia in early October, 50 basis points in Thailand on October 19, and 25 basis points on October 20 in the Philippines following a similar rate increase in late September.

ASEAN Economic Indicators: Growth
(Percent change from previous period, s.a., except as noted)

Indicator	2003	2004	2005 Q2	2005 Q3	2005 July	2005 Aug.	2005 Sept.
Real GDP[1]							
Indonesia	5.0	6.5	.6	n.a.	…	…	…
Malaysia	6.6	5.7	.0	n.a.	…	…	…
Philippines	4.6	5.4	5.5	n.a.	…	…	…
Singapore	5.5	6.5	18.0	n.a.	…	…	…
Thailand	7.6	5.5	7.9	n.a.	…	…	…
Industrial production[2]							
Indonesia[3]	3.9	4.0	-6.6	n.a.	2.4	n.a.	n.a.
Malaysia	9.3	11.3	.0	n.a.	-4.1	4.1	n.a.
Philippines	.0	1.0	3.2	n.a.	5.1	n.a.	n.a.
Singapore	3.0	13.9	8.1	7.4	-2.2	2.6	7.4
Thailand	13.9	11.0	3.1	n.a.	-.7	2.5	n.a.

1. Annual rate. Annual data are Q4/Q4.
2. Annual data are annual averages.
3. Staff estimate.
n.a. Not available. . . . Not applicable.

ASEAN Economic Indicators: Trade Balance
(Billions of U.S. dollars, s.a.a.r.)

Indicator	2003	2004	2005 Q2	2005 Q3	2005 July	2005 Aug.	2005 Sep.
Indonesia	28.5	25.1	20.9	n.a.	25.1	18.7	n.a.
Malaysia	21.4	21.2	26.3	n.a.	21.9	29.2	n.a.
Philippines	-4.2	-4.4	-4.4	n.a.	-.1	-5.4	n.a.
Singapore	16.2	16.1	16.3	16.5	17.9	21.4	10.1
Thailand	3.8	1.2	-20.6	n.a.	2.3	-2.9	n.a.

n.a. Not available.

ASEAN Economic Indicators: CPI Inflation
(Percent change from year earlier, except as noted)

Indicator	2003[1]	2004[1]	2005				
			Q2	Q3	July	Aug.	Sept.
Indonesia	5.2	6.4	7.6	8.4	7.8	8.3	9.1
Malaysia	1.2	2.1	3.0	3.4	3.0	3.7	3.4
Philippines	3.9	8.6	8.2	7.1	7.1	7.2	7.0
Singapore	.7	1.3	.1	n.a.	.1	.7	n.a.
Thailand	1.8	2.9	3.7	5.6	5.3	5.6	6.0

1. Dec./Dec.
n.a. Not available.

The **Indian** economy surged in the second quarter and more recent data also point to robust conditions. Output rose 11.6 percent in the second quarter, with gains widespread across manufacturing and services. Industrial production recovered somewhat in August from a weather-related dip in July, and recent confidence and sales indicators are positive. Oil imports continue to widen India's trade deficit. In addition, wholesale prices have accelerated recently, reflecting higher oil prices and a reduction of some fuel subsidies in early September. Citing concerns over higher inflation, the Bank of India raised its short-term benchmark interest rate 25 basis points to 5.25 percent on October 25.

Indian Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	2003	2004	2005				
			Q2	Q3	July	Aug.	Sept.
Real GDP[1]	11.0	6.4	11.6	n.a.	...	...	...
Industrial production	6.6	8.5	3.3	n.a.	-3.3	1.5	n.a.
Consumer prices[2]	3.7	3.8	4.0	n.a.	4.1	3.5	n.a.
Wholesale prices[2]	5.8	6.7	5.3	3.8	4.3	3.4	3.6
Trade balance[3]	-13.7	-21.8	-39.4	-36.5	-31.9	-38.2	-39.5
Current account[4]	6.9	-.8	-24.8	n.a.	...	...	...

1. Annual rate. Annual data are Q4/Q4.
2. Percent change from year-earlier period, except annual data, which are Dec./Dec.
3. Billions of U.S. dollars, annual rate.
4. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. . . . Not applicable.

In **Mexico**, recent data releases suggest that the economy has not fully recovered from the weak second-quarter performance. Although overall economic activity improved in July and August, industrial production and manufacturing output have been weak on average in recent months. Industrial activity was little changed in July from the previous month reflecting, in part, anemic performance in the auto industry, due to declining car and truck demand in the United States and some retooling in Mexican plants. The improvement in industrial production for August, and reports from the auto industry in Mexico point to some recovery in activity.

Mexico's twelve-month headline and core inflation continued to decline in recent months as a result of the aggressive monetary policy tightening by the Bank of Mexico (BOM) from early 2004 to March 2005. In September, twelve-month headline inflation fell to 3.5 percent, well within the 2-4 percent target range, and core inflation (not shown) fell to 3.2 percent. Price regulations have prevented high international oil prices from passing through to domestic inflation. The improved inflation prospects and a slowing economy led the BOM to begin easing policy in late August. As a result, the rate on 28-day peso-denominated bills (Cetes), a widely used measure of the monetary policy stance, has fallen from 9.6 percent in early August to 8.9 percent in mid-October.

Mexican Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	2003	2004	2005				
			Q2	Q3	July	Aug.	Sept.
Real GDP[1]	2.1	4.8	-1.7	n.a.	…	…	…
Overall economic activity	1.4	4.0	-.1	n.a.	2.0	.8	n.a.
Industrial production	-.1	3.5	-.2	n.a.	.1	.4	n.a.
Unemployment rate[2]	3.4	3.9	3.8	3.5	3.7	3.3	3.4
Consumer prices[3]	4.0	5.2	4.5	4.0	4.5	3.9	3.5
Trade balance[4]	-5.8	-8.8	-5.0	-6.8	-9.1	-8.2	-3.0
Imports[4]	170.5	196.8	213.9	221.7	218.1	224.5	222.4
Exports[4]	164.8	188.0	208.9	214.9	209.0	216.3	219.4
Current account[5]	-8.6	-7.3	-.1	n.a.	…	…	…

1. Annual rate. Annual data are Q4/Q4.
2. Percent; counts as unemployed those working one hour a week or less.
3. Percent change from year-earlier period, except annual data, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. . . . Not applicable.

Data from **Brazil** since the last Greenbook have been mixed. Although industrial production rose about 1 percent in August, the increase was concentrated in a few industries, including refining (petroleum and ethanol), and average production for July and August was down from the second-quarter level. Retail sales for August were also weak. The export sector has remained the bright spot, with Brazil on track to post a record trade surplus this year, due primarily to higher prices of exported commodities. A hike in vehicle fuel prices in mid-September led to a rise in monthly inflation, but inflation remained at 6 percent on a twelve-month basis. Survey-based measures of inflation expectations have continued to decline with twelve-month ahead expected inflation falling to 4.7 percent in mid-October.

Indications of weakening economic activity and subdued inflation prompted the central bank to reduce its policy rate 25 basis points in mid-September and again by 50 basis points in mid-October to 19 percent. The scandals that have dominated the political agenda have continued, and in mid-October led to the resignations of two more members of Congress. Although the scandals have further delayed progress on tax and other economic reforms, fiscal and monetary discipline has remained tight. Citing the commitment to fiscal responsibility, changes in the government's debt structure, and a more competitive export sector, Moody's upgraded Brazilian foreign currency-denominated debt by one notch, from B1 to Ba3 on October 12.

Brazilian Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	2003	2004	2005				
			Q2	Q3	July	Aug.	Sept.
Real GDP[1]	.9	4.7	5.8	n.a.	...	...	...
Industrial production	.1	8.3	2.0	n.a.	-1.9	1.1	n.a.
Unemployment rate[2]	12.3	11.5	9.8	n.a.	9.2	9.1	n.a.
Consumer prices[3]	9.3	7.6	7.8	6.2	6.6	6.0	6.0
Trade balance[4]	24.8	33.7	44.8	46.2	57.9	39.9	41.0
Current account[5]	4.2	11.7	10.3	n.a.	31.1	9.9	n.a.

1. Annual rate. Annual data are Q4/Q4.
2. Percent; break in October 2001 as a result of change in methodology.
3. Percent change from year-earlier period, except annual data, which are Dec./Dec. Price index is IPC-A. Data are n.s.a.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. . . . Not applicable.

In **Argentina**, real GDP jumped up at an annual rate of 10 percent in the second quarter after a weak first quarter, on the back of strong growth in consumption and investment. In the third quarter, average industrial production for July and August was up from the second-quarter level. Twelve-month consumer price inflation has moved up this year, reaching over 10 percent in September, well above the central bank's informal target range of 5-8 percent for the end of 2005. The central bank has continued to intervene to stem upward pressures on the peso.

In mid-September, the Argentine Congress passed the 2006 budget, which projects the consolidated primary fiscal surplus next year to be 4 percent of GDP, half a percentage point less than demanded in recent IMF statements. Unlike in previous auctions this year, in its latest auction, the Argentine government was unable to place bonds at an interest rate it was willing to accept. As a result, the government began to search for alternative sources of funding.

Argentine Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	2003	2004	2005				
			Q2	Q3	July	Aug.	Sept.
Real GDP[1]	11.8	9.1	10.1	n.a.	…	…	…
Industrial production	16.2	10.7	1.3	n.a.	.2	1.6	n.a.
Unemployment rate[2]	17.3	13.6	12.1	n.a.	…	…	…
Consumer prices[3]	3.7	6.1	8.8	9.8	9.6	9.7	10.3
Trade balance[4]	15.7	12.1	12.4	n.a.	14.9	15.7	n.a.
Current account[5]	8.0	3.3	7.1	n.a.	…	…	…

1. Annual rate. Annual data are Q4/Q4.
2. Percent; n.s.a.
3. Percent change from year-earlier period, except annual data, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. . . . Not applicable.

In **Venezuela**, monetary and fiscal policies have continued to be expansionary, supported by high oil prices. Despite a fixed exchange rate and price controls on many products, twelve-month inflation rose to 16 percent in September.

Around early-October, President Chavez attracted attention when he asserted that the central bank had sold up to $20 billion in U.S. Treasury securities to buy foreign currency-denominated assets and transferred the funds from the United States to the BIS. That assertion was promptly contradicted by an official from the central bank, who later modified his statement. The central bank has not issued a statement to clarify the situation. Treasury data indicate that Venezuelan public and private sector holdings in the United States amounted to about $25 billion at the beginning of this year, of which $7 billion was held in the form of U.S. Treasuries. Total holdings had not changed through August. Although $5 billion in short-term U.S. Treasuries were sold over the first half of this year, holdings of other short-term U.S. assets rose by a commensurate amount.

Venezuelan Economic Indicators
(Percent change from previous period, s.a., except as noted)

Indicator	2003	2004	2005				
			Q2	Q3	July	Aug.	Sept.
Real GDP[1]	6.6	12.1	23.0	n.a.	…	…	…
Unemployment rate[2]	18.0	15.1	11.9	11.9	12.5	12.0	11.3
Consumer prices[3]	27.1	19.2	16.3	15.4	15.3	14.9	16.0
Non-oil trade balance[4]	-5.5	-10.5	-16.1	n.a.	n.a.	n.a.	n.a.
Trade balance[4]	16.5	21.4	29.3	n.a.	n.a.	n.a.	n.a.
Current account[5]	11.4	13.8	23.3	n.a.	…	…	…

1. Annual rate. Annual data are Q4/Q4.
2. Percent.
3. Percent change from year-earlier period, except annual data, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. . . . Not applicable.