

## **Prefatory Note**

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## **Part 2**

December 7, 2005

# **CURRENT ECONOMIC AND FINANCIAL CONDITIONS**

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## **Recent Developments**

December 7, 2005

## **Recent Developments**

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## **Domestic Nonfinancial Developments**

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## Domestic Nonfinancial Developments

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### Overview

Incoming data suggest that economic activity is expanding at a solid pace this quarter. Industrial production bounced back in October and appears to be headed for a sizable gain in November. Likewise, the increase in private payroll employment of nearly 200,000 in November indicates that the labor market is recovering smartly from the depressing effects of the recent hurricanes. Sales of light motor vehicles have dropped back from the extremely high levels of the summer, but other spending by consumers and businesses has been reasonably strong. Although the housing sector has shown some signs of cooling, the level of construction and sales remains high. The prices of refined petroleum products have retreated significantly, on balance, from their post-hurricane peaks. However, spot prices of natural gas moved up further in early December and remain well above their year-ago level, setting the stage for sizable increases in home heating bills this winter. Recent data on core price inflation have been favorable despite some evidence of energy price pass-through.

### Energy Sector

Energy producers in the Gulf of Mexico have made progress in repairing damage from Hurricanes Katrina and Rita. At this point, total domestic crude oil production has recovered to 88 percent of its pre-Katrina level and natural gas production to 93 percent.<sup>1</sup> However, the recovery is taking longer than had been expected; indeed, it has been significantly slower than the recovery after Hurricane Ivan in 2004, when a similar amount of oil and somewhat less gas were shut in. The biggest remaining problem is the damage to the huge Mars platform in the Gulf of Mexico; it alone generates about 4 percent of domestic crude oil extraction and is not expected to come back on line until the middle of next year.

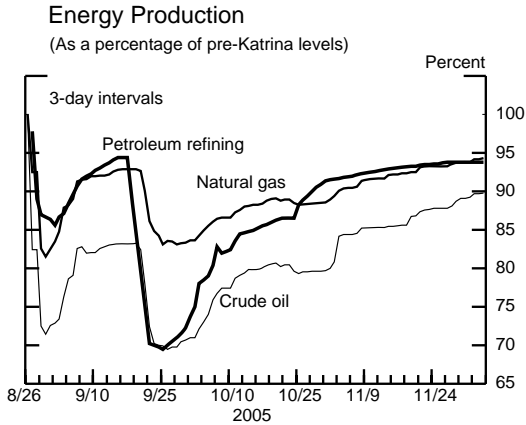
Much of the hurricane damage to oil refineries has been repaired, though these repairs are taking longer than expected. Of the twenty Gulf Coast oil refineries shut down by the hurricanes, three are still out of service.<sup>2</sup> Although a few other refineries around the country are shut down for normal maintenance, the Department of Energy reported that,

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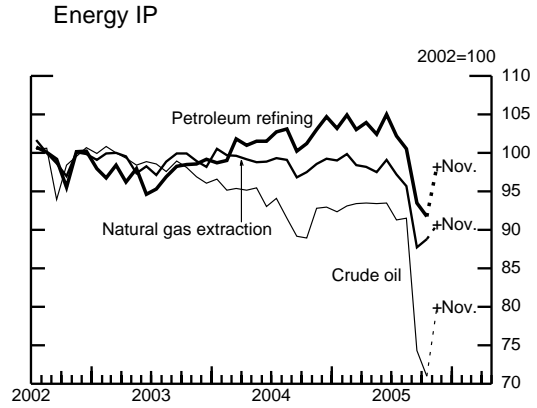
<sup>1</sup> In the Gulf, about 34 percent of crude oil production and about 27 percent of natural gas production currently remain shut in. By comparison, at the time of Hurricane Rita's landfall, all crude oil production and 80 percent of natural gas production were shut in. Damaged onshore and near-offshore (that is, within 3 miles of shore) production facilities also have recovered. After Hurricane Rita, almost all this oil and gas capacity in Louisiana was shut in. Currently, however, less than half of Louisiana's crude oil production capacity and about one-third of its natural gas capacity remain shut in.

<sup>2</sup> These three amount to roughly 5 percent of U.S. refinery capacity.

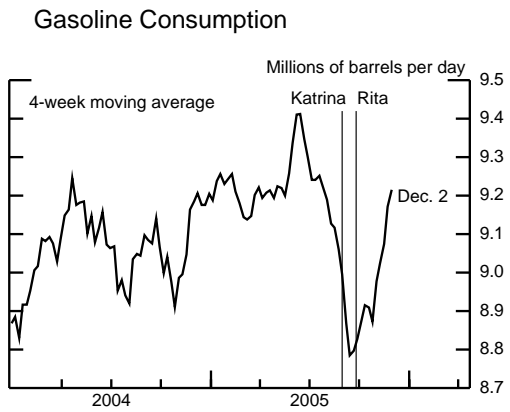
## Energy Production and Inventories



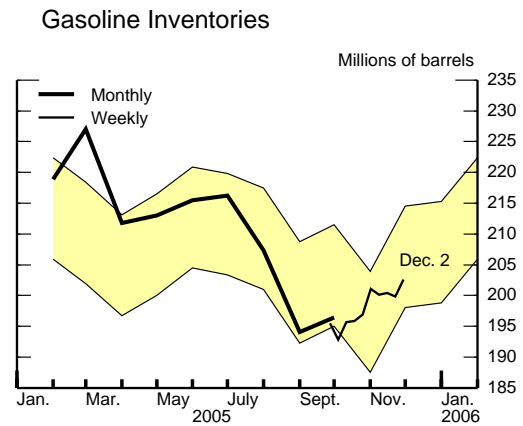
Source: Department of the Interior, Department of Energy, and staff calculations. Figures exclude onshore and near-offshore facilities in Louisiana.



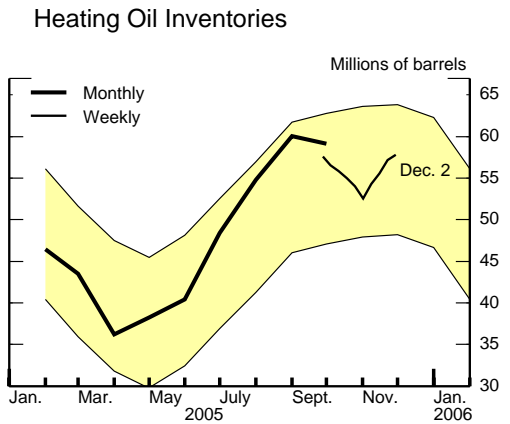
Note: November values are based on available weekly data and estimates of facilities that remain off line.



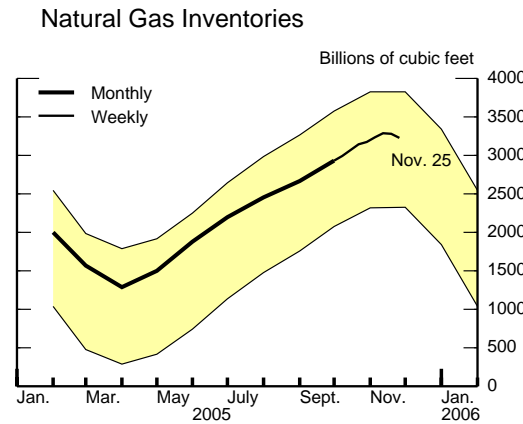
Note: U.S. gasoline product supplied (or apparent consumption), seasonally adjusted by FRB staff. Source: Department of Energy.



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



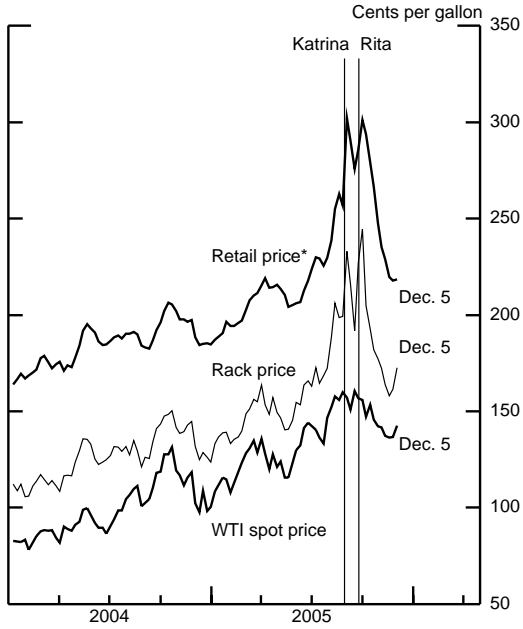
Note: Shaded region is average historical range for 2000-04 as calculated by FRB staff.



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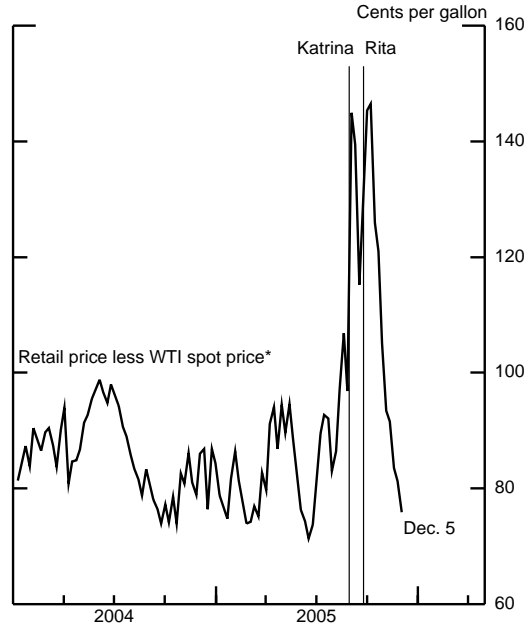
## Energy Prices

Gasoline Price Decomposition



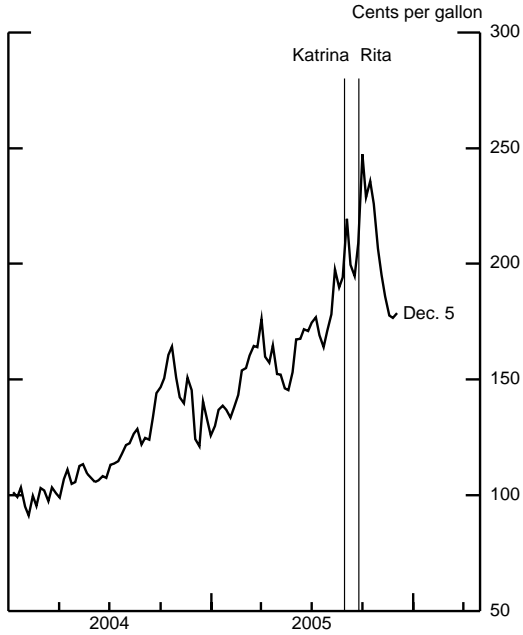
\* Regular grade seasonally adjusted by FRB staff.  
Source. Oil Price Information Service.

Total Gasoline Margin



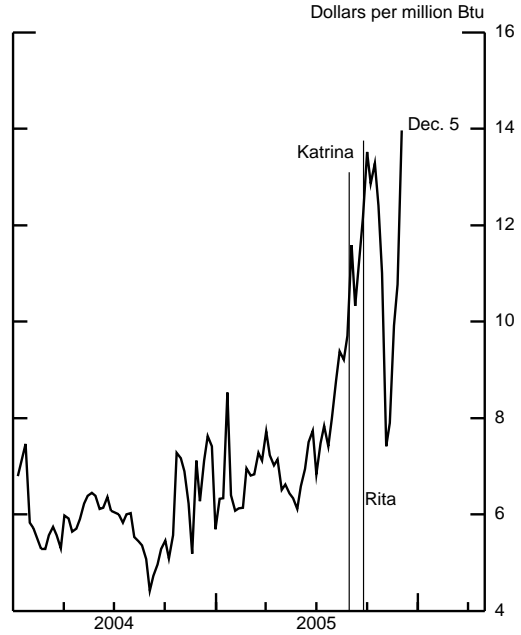
\* Regular grade seasonally adjusted by FRB staff, less West Texas intermediate spot price.  
Source. Oil Price Information Service.

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.

as of the week ending December 2, U.S. total refinery capacity utilization was running near 91 percent, about 1 percentage point below pre-Katrina levels.

Because U.S. energy production has been returning to normal and extra imports of crude oil and refined products have been readily available, the supply of energy products has been ample. On the demand side, the seasonally adjusted apparent consumption of gasoline and other refined products—which dropped roughly 2½ percent in September—has returned to pre-Katrina levels as gasoline prices have declined. In addition, unusually temperate weather through mid-November held down space-heating demand for natural gas and heating oil.

As a result of these developments, petroleum inventories have rebounded from their post-hurricane lows. Crude oil stocks are now well above normal, and inventories of gasoline, heating oil, and some other refined products are comfortably within the normal ranges for the season; by contrast, inventories of diesel fuel are at the low end of their normal range.<sup>3</sup> Natural gas inventories remained comfortably above seasonal norms in November. However, unusually cold weather in early December likely caused natural gas inventories to fall back, and spot prices spiked in the week ending December 5. If the winter were to be unusually cold, then temporary local shortages of natural gas could arise. If temperatures run at seasonal averages, however, inventories likely would be sufficient to meet space-heating demand.

The bulge in crude oil inventories has contributed to a net decline in spot crude oil prices of about \$0.75 per barrel since the October Greenbook. At the same time, wholesale markups for gasoline and heating oil fell back to the normal range as inventories of these products also recovered. As both crude oil costs and wholesale markups have moved lower, rack prices of gasoline have fallen 16 percent since late October, and rack prices of heating oil have fallen 17 percent.<sup>4</sup> Because declines in wholesale prices of gasoline are usually passed through to the retail level over a period of one to six weeks, the sharp decreases in rack prices of gasoline caused only a 6 percent decline in retail gasoline prices in October; survey data point to a substantially larger retail decline in November.

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<sup>3</sup> Domestic refiners boosted the share of gasoline in the output mix of refined products immediately after the hurricanes to address the low level of gasoline inventories at the time; since then, this share has declined only slightly.

<sup>4</sup> Rack prices are wholesale prices for oil products at bulk terminals.



For natural gas, plentiful inventories and declining prices of competing fuel oil resulted in a large decline, on balance, in the U.S. average spot price from its peak in early October to mid-November. However, consumer prices of natural gas increased in October because in many states the regulated residential prices of natural gas are based on costs at the end of the previous month. The huge net decline in spot prices from early October to mid-November is thus likely to hold down consumer prices of natural gas for the month of November. However, with the surge in spot prices since mid-November, current consumer prices of natural gas are estimated to be about 35 percent above the level of December 2004, and, as a result, households are facing a significant jump in home heating costs this winter.

### **Labor Market Developments**

The labor market appears to be recovering from the losses that occurred as the result of the recent hurricanes. After a subpar gain in October, private nonfarm payroll employment rose by nearly 200,000 in November, somewhat above the pace in the three months before September.

By industry, construction employment rose 37,000 last month, likely because of hurricane-recovery activity. Employment at food service and drinking establishments also rose nearly 40,000 last month and reversed about half of the decline experienced over the previous two months. Broad-based gains in durable goods industries pushed up manufacturing employment in November, and the related industries of temporary help services and wholesale trade experienced job growth as well. Elsewhere, significant increases occurred in professional and technical services and in education and health services.

Average weekly hours of production or nonsupervisory workers on private nonfarm payrolls ticked down 0.1 hour, to 33.7 hours, in November but remained in the narrow range that they have occupied over the past year. The decline in the workweek pushed aggregate hours down 0.1 percent. Still, aggregate hours last month stood 0.2 percentage point above their third-quarter average.

In the household survey, the unemployment rate held steady at 5.0 percent in November and has changed little, on net, since the spring.<sup>5</sup> The labor force participation rate, at

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<sup>5</sup> According to responses to special questions in the household survey that were asked of individuals who evacuated their homes as a result of Hurricane Katrina, the direct effect of Katrina on the measured unemployment rate appears to have been less than 0.1 percentage point in November.

**Changes in Employment**

(Thousands of employees; seasonally adjusted)

Measure and sector	2004	2005					
		Q1	Q2	Q3	Sept.	Oct.	Nov.
	Average monthly change			Monthly change			
Nonfarm payroll employment (establishment survey)	183	182	198	147	17	44	215
Private	171	172	188	115	10	49	194
Previous	171	172	188	107	-16	46	...
Manufacturing	3	-6	-13	-11	-16	15	11
Construction	23	24	24	18	17	35	37
Wholesale trade	7	6	7	5	4	2	12
Retail trade	13	17	23	-5	-48	3	9
Transportation and utilities	9	18	8	5	3	6	9
Information	-2	2	4	2	6	-13	3
Financial activities	12	13	14	19	17	27	13
Professional and business services	45	41	37	44	54	6	29
Temporary help services	15	9	8	21	31	6	5
Nonbusiness services <sup>1</sup>	59	51	83	35	-32	-35	70
Total government	12	10	10	32	7	-5	21
Total employment (household survey)	146	115	379	265	-17	214	-52
Memo:							
Aggregate hours of private production workers (percent change) <sup>2</sup>	2.4	2.3	2.8	2.1	.3	.1	-.1
Average workweek (hours) <sup>3</sup>	33.7	33.7	33.7	33.7	33.8	33.8	33.7
Manufacturing (hours)	40.8	40.6	40.4	40.6	40.7	41.0	40.8

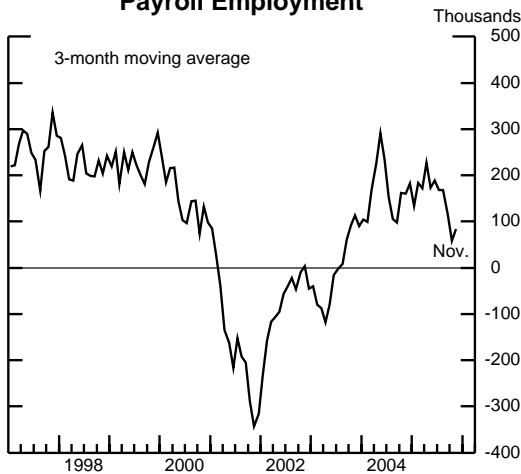
1. Nonbusiness services comprises education and health, leisure and hospitality, and "other."

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.

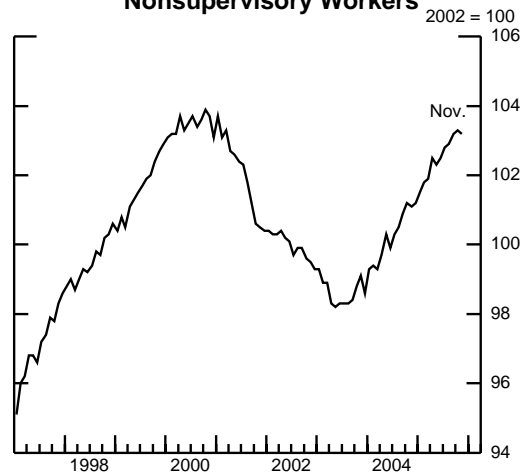
3. Establishment survey.

... Not applicable.

**Changes in Private Payroll Employment**



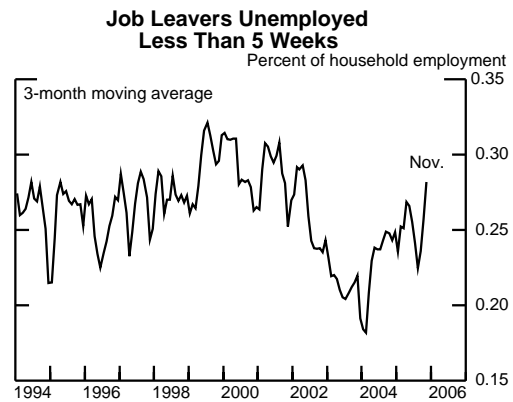
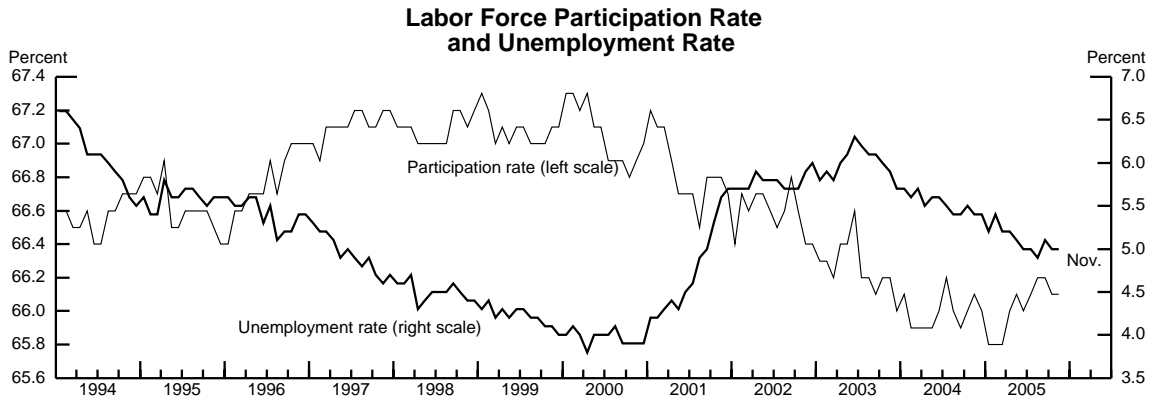
**Aggregate Hours of Production or Nonsupervisory Workers**



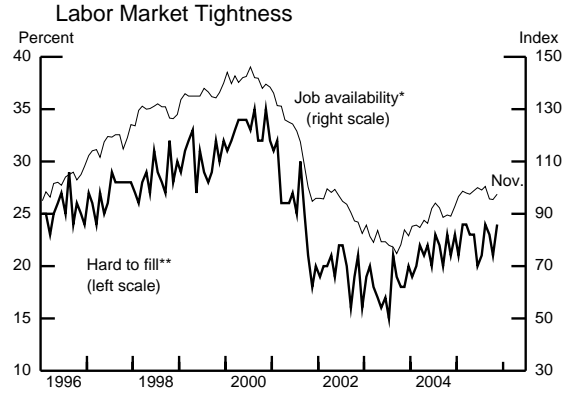
**Selected Unemployment and Labor Force Participation Rates**

(Percent; seasonally adjusted)

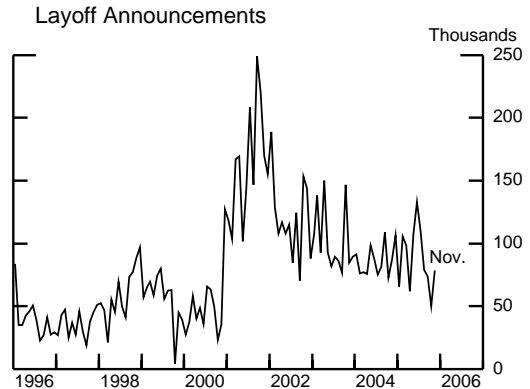
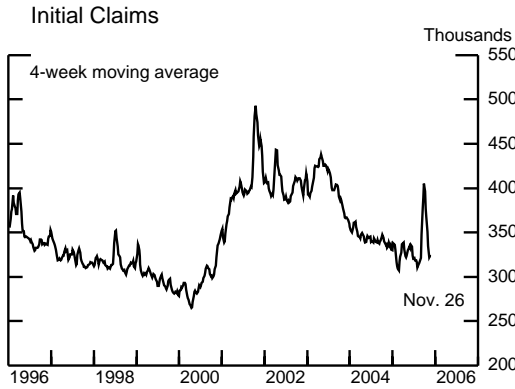
Rate and group	2004	2005					
		Q1	Q2	Q3	Sept.	Oct.	Nov.
<i>Civilian unemployment rate</i>							
Total	5.5	5.3	5.1	5.0	5.1	5.0	5.0
Teenagers	17.0	16.9	17.3	16.1	15.8	15.9	17.2
20-24 years old	9.4	9.5	8.8	8.6	8.7	8.5	8.4
Men, 25 years and older	4.4	4.1	3.8	3.8	3.9	3.7	3.7
Women, 25 years and older	4.4	4.1	4.2	4.2	4.3	4.2	4.3
<i>Labor force participation rate</i>							
Total	66.0	65.8	66.0	66.2	66.2	66.1	66.1
Teenagers	43.8	43.5	43.9	43.9	43.6	43.0	43.8
20-24 years old	75.0	74.4	74.3	74.7	74.7	75.1	75.0
Men, 25 years and older	75.3	75.2	75.5	75.6	75.5	75.5	75.3
Women, 25 years and older	59.3	59.1	59.2	59.5	59.6	59.5	59.6



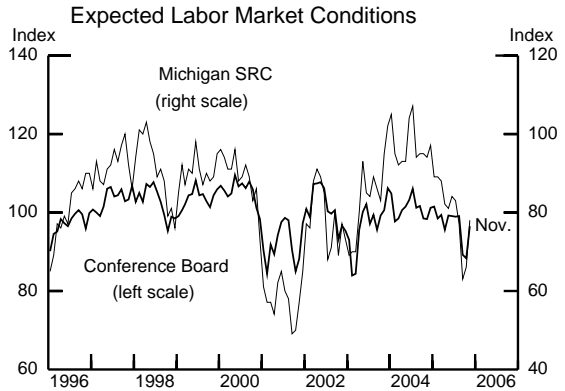
### Labor Market Indicators



\*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.



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



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

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

66.1 percent, was unchanged. Other household survey measures suggest some reduction of late in labor market slack. The number of employees working part time for economic reasons as a percent of employment has moved down, on net, over the past two months, while the number of workers leaving their jobs to enter unemployment as a percent of employment—an indicator of individuals' perceptions of job availability—has increased, on net, over this period.

Among other indicators of slack in the labor market, the four-week moving average of insured unemployment moved down to 2.78 million for the week ending November 19, about 200,000 above the levels immediately preceding Katrina but 85,000 less than the post-Katrina peak. Both the Conference Board's job availability index and the share of firms reporting hard-to-fill job openings to the National Federation of Independent Business' (NFIB) moved up in November.

The latest indicators of labor demand are consistent with a robust labor market. The four-week average of initial claims for unemployment insurance fell to 322,000 for the week ending November 26, a level similar to that prevailing before Katrina. Layoff announcements compiled by Challenger, Gray, and Christmas, Inc., bounced back from a low October reading, but the average for the past two months was still below the average for the year before September. Meanwhile, the three-month moving average of business hiring plans reported to the NFIB remained close to recent highs in November, and individuals' expectations of future labor market conditions—as measured by the Conference Board and the Michigan Survey Research Center (SRC)—moved up last month, largely reversing post-Katrina declines.

The BLS reported that output per hour in the nonfarm business sector rose at an annual rate of 4.7 percent in the third quarter. Over the four quarters ending last quarter, productivity advanced 3.1 percent, up from the 2.2 percent pace registered over the preceding four quarters. In the nonfinancial corporate sector, output per hour rose 4.7 percent over the most recent four quarters, considerably above the 3.2 percent increase over the previous four quarters.

**Labor Output per Hour**(Percent change from preceding period at an annual rate;  
seasonally adjusted)

Sector	2003:Q3 to 2004:Q3	2004:Q3 to 2005:Q3	2004	2005		
			Q4	Q1	Q2	Q3
Nonfarm business						
All persons	2.2	3.1	2.5	3.2	2.1	4.7
All employees <sup>1</sup>	2.2	2.8	2.1	3.7	1.9	3.6
Nonfinancial corporations <sup>2</sup>	3.2	4.7	8.5	2.7	4.3	3.2

1. Assumes that the growth rate of hours of non-employees equals the growth rate of hours of employees.

2. All corporations doing business in the United States except banks, stock and commodity brokers, and finance and insurance companies. The sector accounts for about two-thirds of business employment.

**Industrial Production**

Industrial production (IP) bounced back in October and appears to have increased briskly in November after having been held down in September by hurricanes and by a strike at Boeing. Total IP rose 0.9 percent in October; about one-half of the increase was due to the resumption of commercial aircraft production, and roughly one-fourth of the gain reflected recoveries in hurricane-related industries primarily outside of energy.

Manufacturing production surged nearly 1½ percent, but output at mines, which includes oil and gas extraction, slipped further in October after plunging more than 8½ percent in September. Utilities output fell for a fourth consecutive month in October, and weekly data suggest that utilities output contributed little to the increase in November IP.

The available product data for November suggest that a sharp increase in oil and gas extraction and in refining likely contributed about ½ percentage point to the change in IP last month. Outside of energy, the restarting of hurricane-idled facilities boosted output in October and appears to have further lifted output in November; most prominently, the production of chemicals rose about 2½ percent in October after falling more than 5 percent in the previous month.<sup>6</sup> Output gains in other hurricane-affected industries—such as parts of the food, rubber and plastics, and paper industries—also contributed to the increase in IP in October.

Industry estimates suggest that the pace of motor vehicle assemblies dropped to an annual rate of 11.8 million units in November; the associated decline in the production index for motor vehicles will reduce total IP in November about ¼ percentage point. The latest

<sup>6</sup> Hurricane Rita idled nearly half of petrochemicals capacity at the beginning of October.

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

Component	Proportion 2004 (percent)	2004 <sup>1</sup>	2005		2005		
			H1	Q3	Aug.	Sept.	Oct.
			Annual rate		Monthly rate		
<b>Total</b>	<b>100.0</b>	<b>4.3</b>	<b>2.7</b>	<b>.9</b>	<b>.2</b>	<b>-1.5</b>	<b>.9</b>
Previous	100.0	4.3	2.5	1.3	.2	-1.3	...
Manufacturing	82.0	5.1	2.9	1.9	.4	-.7	1.4
Ex. motor veh. and parts	74.7	5.4	3.2	.9	.1	-1.0	1.7
Ex. high-tech industries	69.7	4.4	1.7	-.9	-.1	-1.3	1.6
Mining	8.5	-.4	2.0	-14.8	-.7	-8.6	-.5
Utilities	9.5	1.2	2.2	9.3	-.9	-.9	-1.9
<i>Selected industries</i>							
High technology	4.9	18.4	24.4	27.6	2.9	2.2	1.7
Computers	.9	4.6	12.4	6.3	.2	.4	.4
Communications equipment	1.1	22.3	18.1	29.7	1.2	.9	2.7
Semiconductors <sup>2</sup>	2.9	21.4	30.8	33.5	4.4	3.2	1.7
Motor vehicles and parts	7.3	2.6	-.5	12.5	3.6	2.3	-.6
<i>Market groups excluding energy and selected industries</i>							
Consumer goods	21.7	2.3	2.2	.0	-.3	.6	.0
Durables	4.3	1.8	-.2	3.2	.5	1.5	-.6
Nondurables	17.4	2.5	2.8	-.7	-.5	.3	.2
Business equipment	7.8	9.0	7.4	-1.6	-.2	-6.3	8.2
Defense and space equipment	1.9	9.7	11.9	5.4	.3	-2.2	2.3
Construction supplies	4.4	4.6	2.3	4.5	.7	1.2	1.3
Business supplies	7.9	3.3	2.0	.3	.3	-.2	1.0
Materials	25.0	4.7	-1.3	-1.6	-.1	-1.3	1.3
Durables	13.8	6.0	-.4	2.9	.5	1.2	1.0
Nondurables	11.2	3.2	-2.4	-7.1	-.8	-4.5	1.8

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	1994- 95 high	2001- 02 low	2005				
				Q1	Q2	Q3	Sept.	Oct.
<b>Total industry</b>	<b>81.0</b>	<b>85.0</b>	<b>73.9</b>	<b>79.9</b>	<b>79.9</b>	<b>79.7</b>	<b>78.9</b>	<b>79.5</b>
Manufacturing	79.8	84.5	72.0	78.7	78.5	78.5	78.1	79.0
High-tech industries	78.2	86.1	57.4	75.3	74.7	75.4	75.8	75.8
Excluding high-tech industries	79.9	84.4	73.1	79.0	78.9	78.9	78.4	79.5
Mining	87.3	89.0	85.6	89.4	89.6	86.1	80.9	80.4
Utilities	86.8	93.7	83.7	83.9	85.2	87.2	86.4	84.8

production schedules for December suggest that assemblies will average 11.9 million units for the fourth quarter as a whole, a decline of more than 200,000 units from the rate in the third quarter. Despite the slower pace of production, dealer stocks of new vehicles are headed for a large increase in the fourth quarter. That increase should move inventories back into the range generally targeted by the automakers: Days' supply at the end of October was about sixty-six days as measured by a six-month moving average of sales. The automakers' initial plans for the first quarter of next year call for assemblies to step down further to 11.6 million units.

Elsewhere in transportation, commercial aircraft production at Boeing snapped back in October. However, the company has decided not to make up for the production lost during the September strike; as a result, previously scheduled deliveries of commercial aircraft are essentially delayed by one month.<sup>7</sup>

Output in high-technology industries rose 1.7 percent in October, a step down from the average monthly rate of 2½ percent during the third quarter but about the average monthly pace during the first half of 2005. Production of communications equipment continued to surge after increasing at an annual rate of about 30 percent in the third quarter. The output gains for communications equipment, while broadly based, have been particularly strong for data networking equipment. For the most part, industry reports continue to be positive. However, the *CIO Magazine* diffusion index for future spending on data networking equipment fell sharply in October, and in November the index remained near the low end of its range over the past two years. In contrast to communications equipment, growth in the output of computers and peripherals has slowed recently, even relative to the tepid pace of the past year. Although unit sales and production of personal computers have held up reasonably well, the product mix has shifted toward lower-end desktops and laptops. In addition, the production of large servers dropped off markedly, although the output of small and midsize servers was solid in the third quarter. The composition of semiconductor production has reflected the contrast between the output growth of computers and that of communications equipment; rates of increase in the IP index for the microprocessor chips used in computers have been running well below the rapid pace of the index for other chips.

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<sup>7</sup> Nevertheless, Boeing intends to increase production substantially over the next couple of years, partly because of the introduction of the 787 Dreamliner. By not boosting scheduled production to make up for the output lost during the strike, Boeing is attempting to avoid the problems that occurred during its last major expansion: Sales and production soared in 1997, but overtime charges, parts shortages, and late-delivery fees imposed large financial losses.



**Production of Domestic Light Vehicles**  
(Millions of units at an annual rate except as noted; FRB seasonals)

Item	2004	2005					
		H1	Q3	Q4	Aug.	Sept.	Oct.
U.S. production <sup>1</sup>	11.7	11.5	11.7	11.5	11.8	12.1	11.9
Autos	4.3	4.3	4.3	4.5	4.3	4.4	4.4
Light trucks	7.4	7.2	7.4	7.0	7.5	7.7	7.5
Days' supply <sup>2</sup>	74	68	59	n.a.	61	65	80
Autos	59	53	44	n.a.	47	44	51
Light trucks	83	77	68	n.a.	71	82	103
Inventories <sup>3</sup>	3.22	2.96	2.76	n.a.	2.65	2.76	2.97
Autos	1.02	.93	.82	n.a.	.85	.82	.86
Light trucks	2.20	2.03	1.94	n.a.	1.80	1.94	2.10
Memo: U.S. production, total motor vehicles <sup>4</sup>	12.0	11.9	12.1	11.9	12.2	12.5	12.4

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

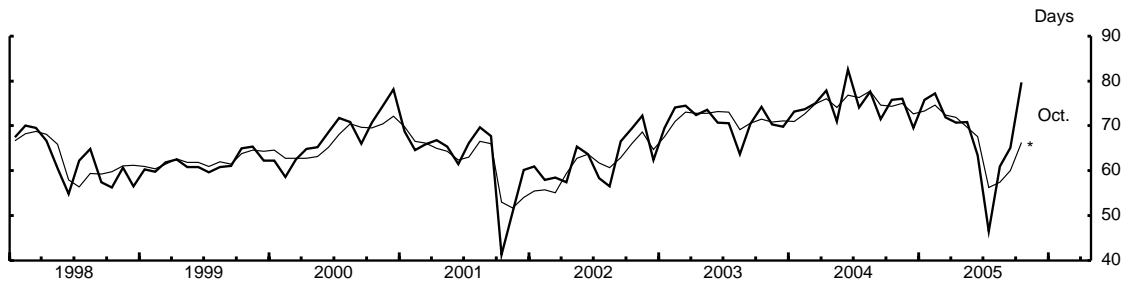
1. Production rate for the fourth quarter reflects the latest schedules from Ward's Communications.
  2. Half-year and quarterly values are calculated with end-of-period stocks and average reported sales.
  3. End-of-period stocks.
  4. Includes medium and heavy trucks.
- n.a. Not available.

**Inventories of Light Vehicles**



Note. FRB seasonals. Monthly totals.

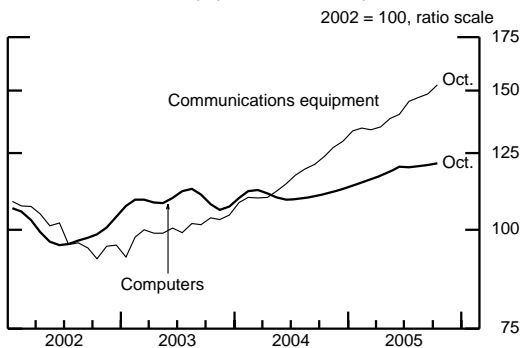
**Days' Supply of Light Vehicles**



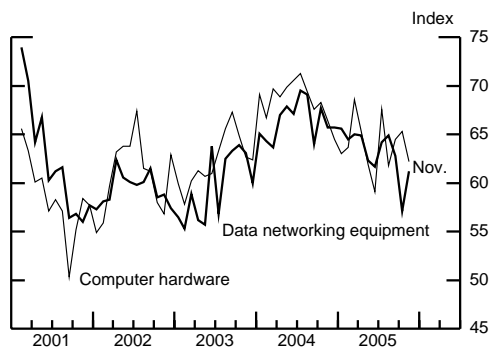
\* Constructed using 6-month moving average of sales.

## Indicators of High-Tech Manufacturing Activity

Communication Equipment and Computer IP

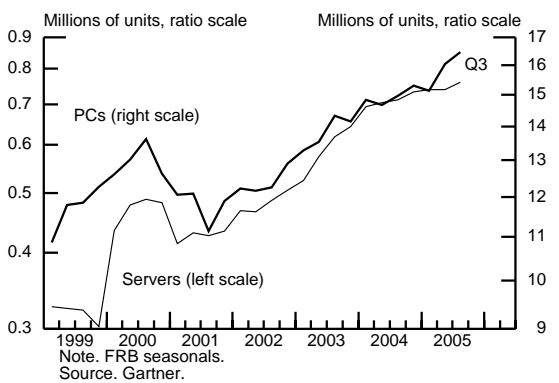


CIO Magazine Future Spending Diffusion Indexes



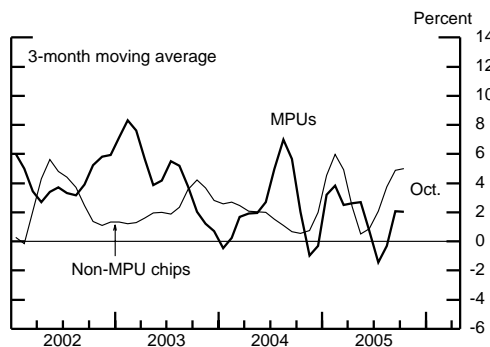
Note. The diffusion index equals the percentage of respondents planning to increase future spending plus one-half the percentage of respondents planning to leave future spending unchanged.  
Source. CIO Magazine.

U.S. Personal Computer and Server Sales

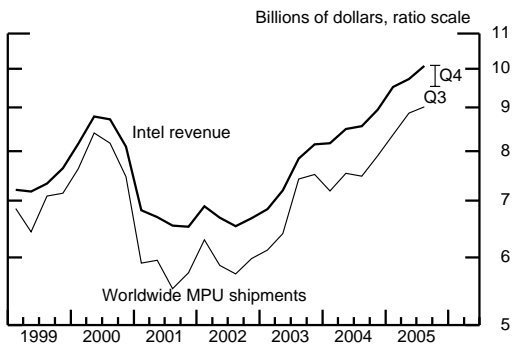


Note. FRB seasonals.  
Source. Gartner.

Rate of Change in Semiconductor Industrial Production

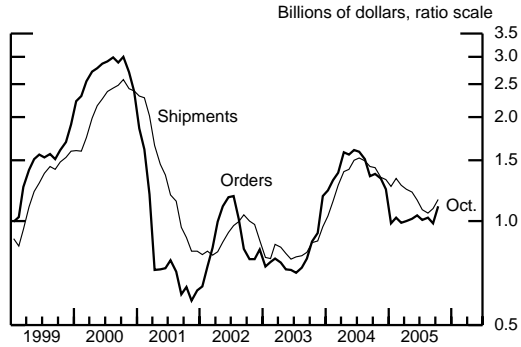


Microprocessor Unit (MPU) Shipments and Intel Revenue



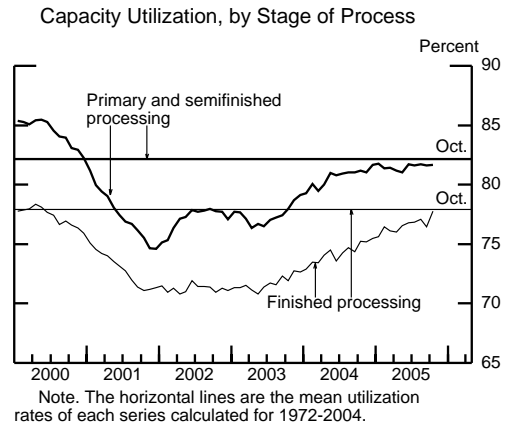
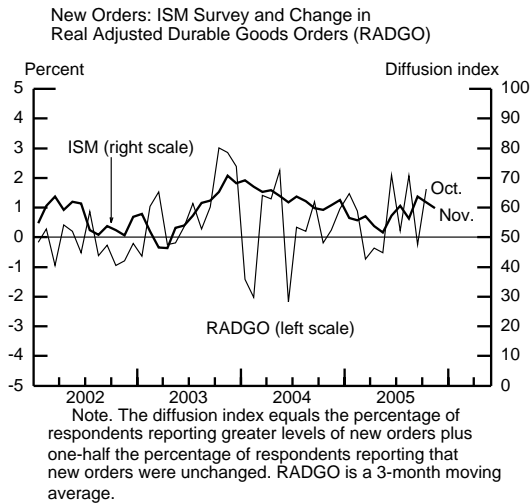
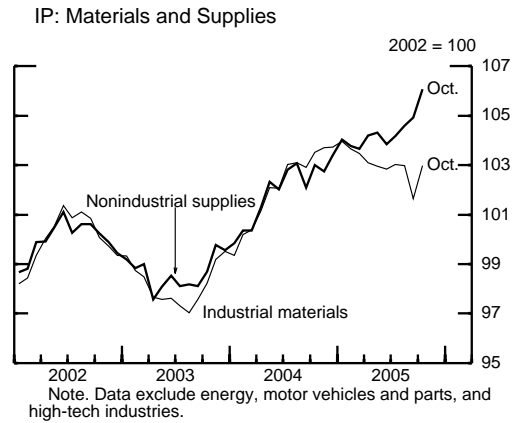
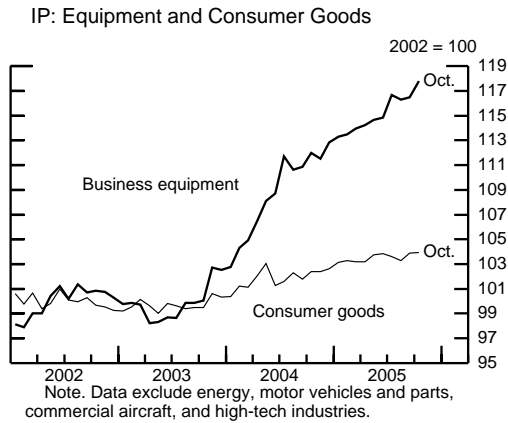
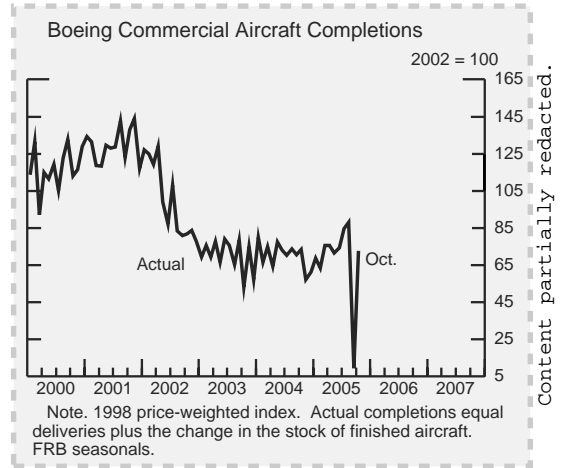
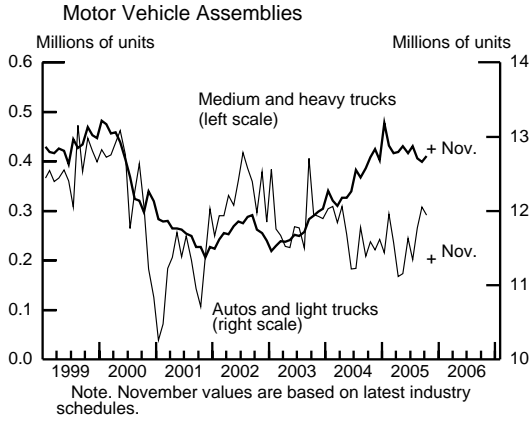
Note. Q4 is the range of Intel's revenue guidance as of October 18, 2005. FRB seasonals.  
Source. Intel and Semiconductor Industry Association.

Semiconductor Manufacturing Equipment Orders and Shipments



Source. Semiconductor Equipment and Materials International.

## Indicators of Manufacturing Activity



In market groups excluding energy, motor vehicles and parts, and high-tech products, business equipment output jumped more than 8 percent in October. Much of the increase reflected the resumption of commercial aircraft production. But excluding aircraft, production still rose substantially; oil and gas field machinery recorded a particularly large gain. By contrast, the output of consumer goods remained weak in October, continuing the pattern evident in recent quarters. The output of construction supplies surged in both September and October, and some of the increase was likely related to rebuilding efforts in the Gulf Coast region. Materials output also rose in October, partly because of the hurricane-related recovery in chemicals output. By stage of process, capacity utilization rates in October for both the primary and semifinished stages and the finished stage were only a touch below their long-run averages.<sup>8</sup> Because additions to capacity continue to be meager, a sustained pickup in production could move the industrial operating rate to its long-term average fairly quickly.<sup>9</sup>

The forward-looking indicators of production remain indicative of solid, if unspectacular, increases in manufacturing output. The three-month moving average of the staff's series on real adjusted durable goods orders rose moderately in October. The new orders diffusion index from the Institute for Supply Management (ISM) slipped a bit in November, but like the new orders indexes from most of the regional surveys, the ISM index remained at a level consistent with further output gains in coming months.

### **Motor Vehicles**

Smoothing through the large swings caused by the automakers' temporary summer pricing programs shows that sales of light vehicles averaged an annual rate of 16.8 million units over the past five months, a pace little changed from that recorded in the first half of the year. Sales plunged in October after the expiration of the employee discount programs, but the decline was widely forecasted after the summer spike, and sales in November rebounded to an annual rate of 15.7 million units. The pace of sales will likely advance further this month after the introduction of another round of

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<sup>8</sup> The annual revision of industrial production and capacity utilization was published in November, and revisions were generally small. Capacity utilization for total industry in the third quarter of 2005, at 79.7 percent, was 0.3 percentage point higher than previously reported. Between the fourth quarter of 2000 and the third quarter of 2005, industrial output increased about 1 percentage point more than previously estimated, and because capacity was revised up less than was production, operating rates are above those previously reported.

<sup>9</sup> Capacity growth may be restrained slightly by the plant closures recently announced by GM. If GM carries through with these plans, capacity in the light motor vehicle sector, currently 14.7 million units, would fall about 450,000 units by the end of calendar year 2006 and would decline another 275,000 units by the end of 2008. In addition, in January Ford will announce details of a restructuring plan that the company has said will include several plant closures and deep cuts in its workforce.

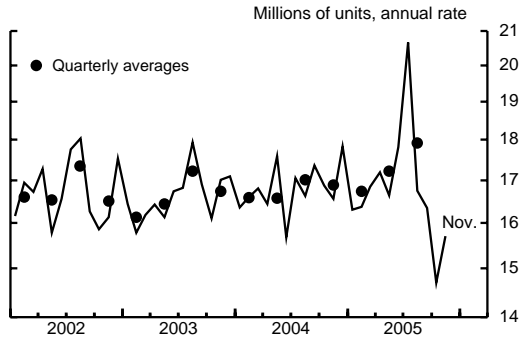
**Sales of Light Vehicles**  
(Millions of units at an annual rate; FRB seasonals)

Category	2004	2005					
		Q1	Q2	Q3	Sept.	Oct.	Nov.
Total	16.8	16.7	17.2	17.9	16.3	14.7	15.7
Autos	7.5	7.6	7.6	8.0	8.0	7.3	7.6
Light trucks	9.3	9.1	9.6	10.0	8.4	7.4	8.1
North American <sup>1</sup>	13.4	13.3	13.7	14.5	13.0	11.4	12.5
Autos	5.3	5.5	5.4	5.7	5.7	5.2	5.5
Light trucks	8.1	7.9	8.3	8.8	7.3	6.2	7.0
Foreign-produced	3.4	3.4	3.5	3.5	3.3	3.3	3.2
Autos	2.1	2.2	2.2	2.3	2.3	2.1	2.1
Light trucks	1.2	1.2	1.3	1.2	1.1	1.1	1.1
Memo: Big Three domestic market share (percent) <sup>2</sup>	58.7	57.7	58.4	57.3	54.6	52.0	53.4

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.

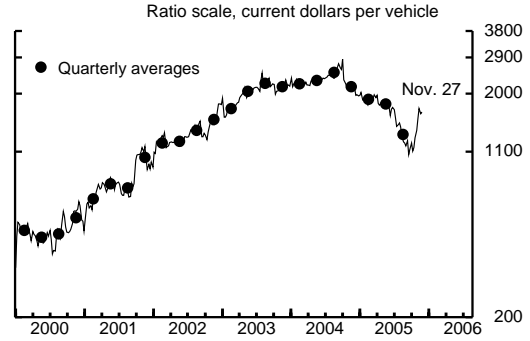
1. Excludes some vehicles produced in Canada that are classified as imports by the industry.
2. Domestic market share excludes sales of foreign brands affiliated with the Big Three.

**Sales of Light Vehicles**



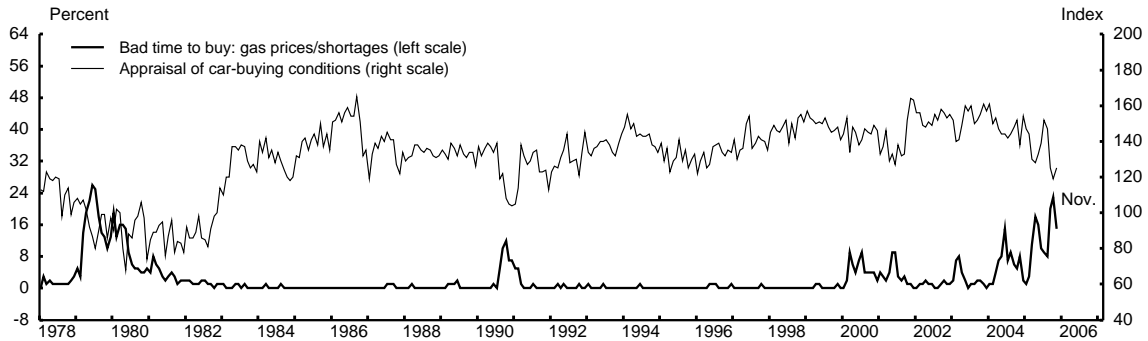
Note. FRB seasonals.

**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.

**Michigan Survey Index of Car-Buying Attitudes**



aggressive incentives by the Big Three firms in an attempt to bolster their year-end totals. Weekly data indicate that the average incentive per light vehicle sold moved up to \$1,650 in the week ending November 27, well above the recent low of about \$1,100 recorded in September.

Forward-looking indicators suggest that vehicle demand will be fairly well maintained in the near term. The Michigan SRC index of car-buying attitudes ticked up in November, indicating that consumers' buying perceptions have improved a bit from their recent lows. Also, the fraction of Michigan survey respondents who cited high gasoline prices as the reason behind their pessimistic views of buying conditions declined noticeably in November.

### **Consumer Spending**

Although the dropback in motor vehicle sales in recent months will likely hold down growth in total real consumer spending this quarter, spending outside motor vehicles is on pace for a solid gain. Non-auto spending moved up notably in October after having edged down in September in response to the hurricanes. Consumer spending has been supported by an improving labor market, a strengthening of equity and housing prices, and a rebuilding of household purchasing power due to the recent fall in retail energy prices.

Excluding motor vehicles, spending gains in October were broad based. Real expenditures on durable goods expanded, reversing some of the decline posted in September. Outlays for nondurable goods, which rose briskly, were aided by a recovery in real outlays on gasoline. At the same time, spending on services moved up despite a sizable fall in outlays for electricity services. Further, early indications from retailers point to robust spending in late November and early December and suggest that the holiday shopping season is off to a decent start.

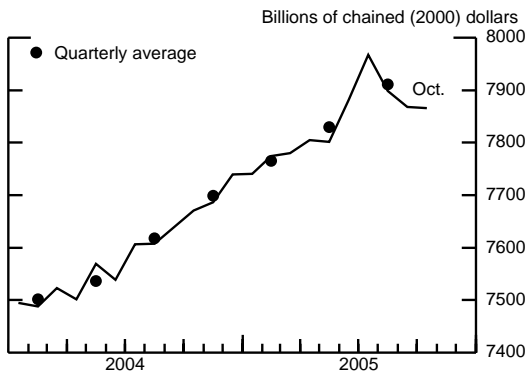
The fundamental determinants of consumer spending, which were lackluster in the third quarter, appear to have improved of late. Real disposable personal income firmed in October and looks to have increased further in November, bolstered by improvements in the labor market and falling energy prices. Continued brisk gains in home prices and a recent pickup in the stock market have strengthened household balance sheets and pushed up the ratio of household wealth to disposable income. The personal saving rate, which plummeted in August to -2.2 percent (partly because of the uninsured hurricane-related losses to income), moved up to -0.7 percent in October.

**Real Personal Consumption Expenditures**  
(Percent change from the preceding period)

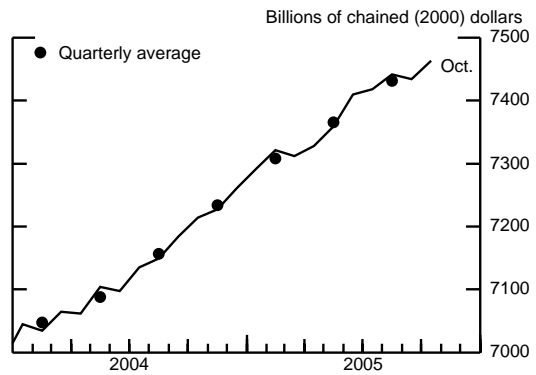
	2004:	2005				
	H2	H1	Q3	Aug.	Sept.	Oct.
	Annual rate			Monthly rate		
Total real PCE	4.4	3.4	4.2	-.9	-.4	.0
Durable goods	8.1	5.2	10.5	-8.5	-3.0	-3.3
Motor vehicles	7.5	-.6	15.1	-18.7	-6.0	-8.3
Excluding motor vehicles	8.6	10.1	6.9	1.1	-.7	.3
Nondurable goods	4.7	4.5	3.6	.4	-.7	1.0
Energy <sup>1</sup>	2.0	2.2	-5.1	-.7	-4.0	3.6
Other	5.0	4.8	4.9	.5	-.2	.6
Services	3.5	2.6	3.3	.2	.3	.1
Energy <sup>2</sup>	10.8	-1.9	2.9	.3	1.1	-1.8
Other	3.2	2.7	3.4	.2	.3	.2
Real PCE excl. motor vehicles	4.2	3.7	3.7	.3	-.1	.4
Memo: Real disposable personal income <sup>3</sup>	3.5	.6	-.7	-1.5	1.0	.2

1. Includes gasoline, motor oil, fuel oil, and coal.
2. Includes natural gas and electricity usage for household operations.
3. Microsoft dividend is excluded.

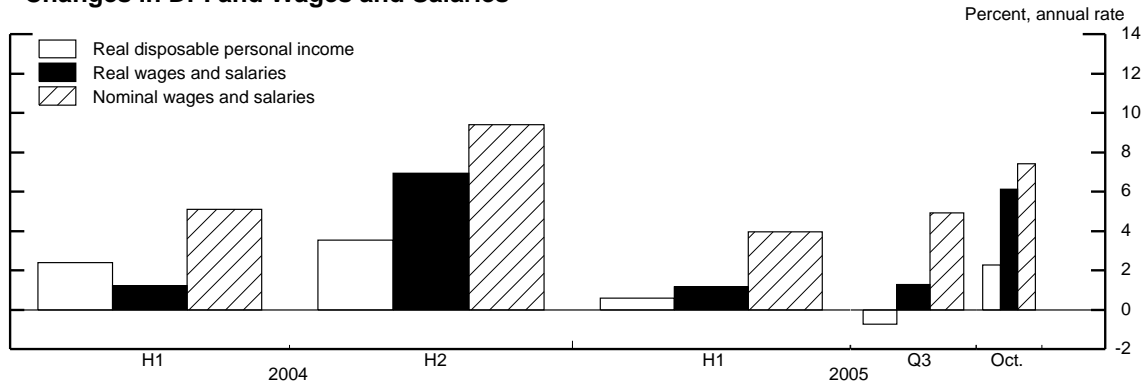
**Real PCE**



**Real PCE Excluding Motor Vehicles**



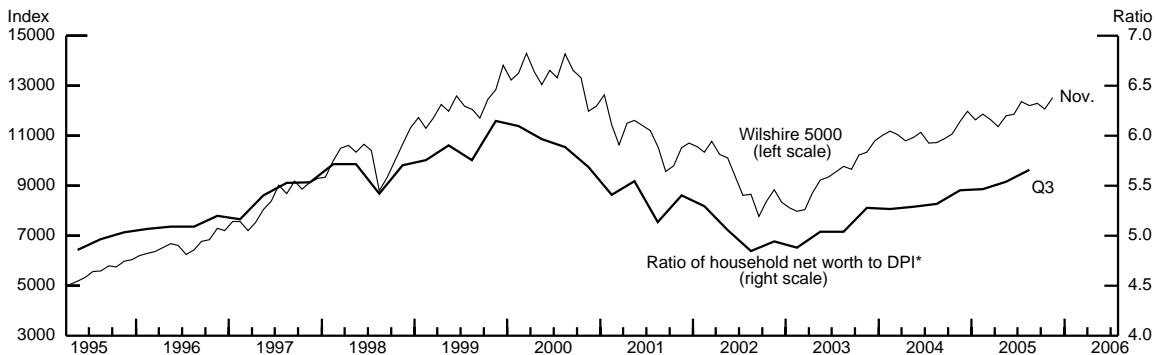
**Changes in DPI and Wages and Salaries**



Note. Microsoft dividend is excluded.

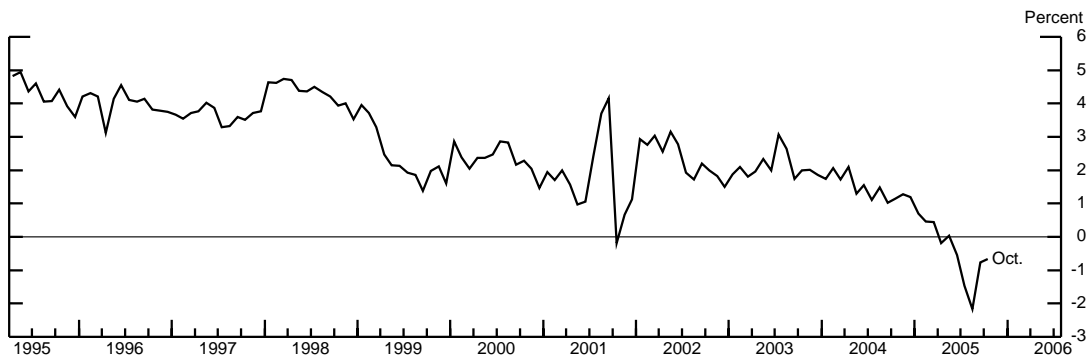
## Household Indicators

Household Net Worth and Wilshire 5000



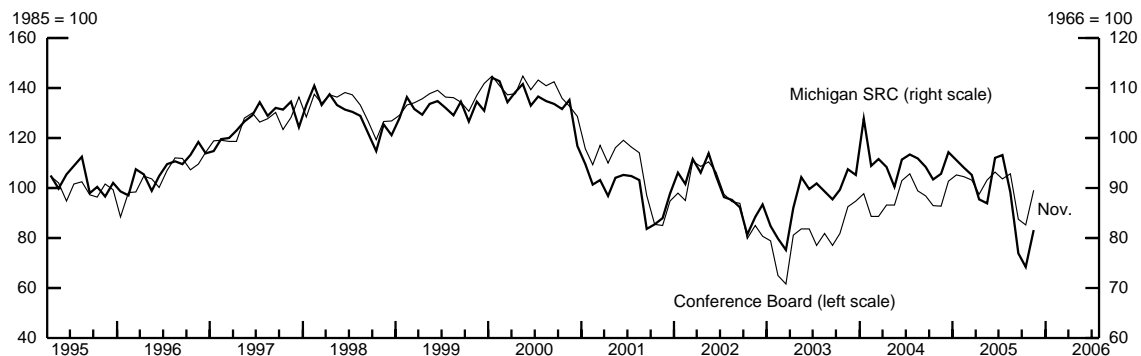
\* Value for 2004:Q4 excludes the effect on income of the one-time Microsoft dividend in December. Value for 2005:Q3 is a staff estimate.

Personal Saving Rate



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

Consumer Confidence





Consumer confidence picked up some in November after having been weighed down by high energy prices and the hurricanes during the late summer and early fall. However, as indicated by surveys from the Michigan Survey Research Center and the Conference Board, confidence remains below levels seen during the first half of the year and is likely damping spending a touch.

### **Housing Markets**

Despite the downbeat tone of many anecdotes and press reports, the available data show only limited signs of cooling in the housing market. Although starts of single-family homes declined in October to an annual rate of 1.70 million units, this pace was equal to the average level seen in the first half of the year. In the multifamily sector, starts dipped to an annual rate of 310,000 units in October, only a bit below the average pace of the last few months. New permit issuance for both single-family and multifamily homes also moved down in October, but the level of permits and the backlog of unused permits both remained elevated, suggesting that housing starts will remain strong through the end of the year.

New home sales jumped in October to an annual rate of 1.42 million units, the highest pace on record. Nevertheless, the stock of new homes for sale moved up in October and represents 4.3 months' supply at October's elevated sales pace, a level near the upper end of the range it has occupied since 1997. In October, sales of existing single-family homes declined but remained quite elevated, while inventories of existing homes for sale edged up.

Mortgage rates have moved up significantly since midyear. The rate on a thirty-year fixed-rate mortgage has increased about 75 basis points since June, and the rate on the one-year adjustable-rate mortgage has increased about 90 basis points. Nevertheless, mortgage rates remain well below their levels of a few years ago.

Other indicators of housing activity have turned down recently. The Mortgage Bankers Association's index of mortgage applications for home purchases declined in November, and builders' ratings of new home sales have also fallen off in recent months. Moreover, the Michigan SRC index of homebuying attitudes fell significantly in September and October and bounced back only a little in November; recent homebuying attitudes are at levels last observed in the early 1990s.

**Private Housing Activity**

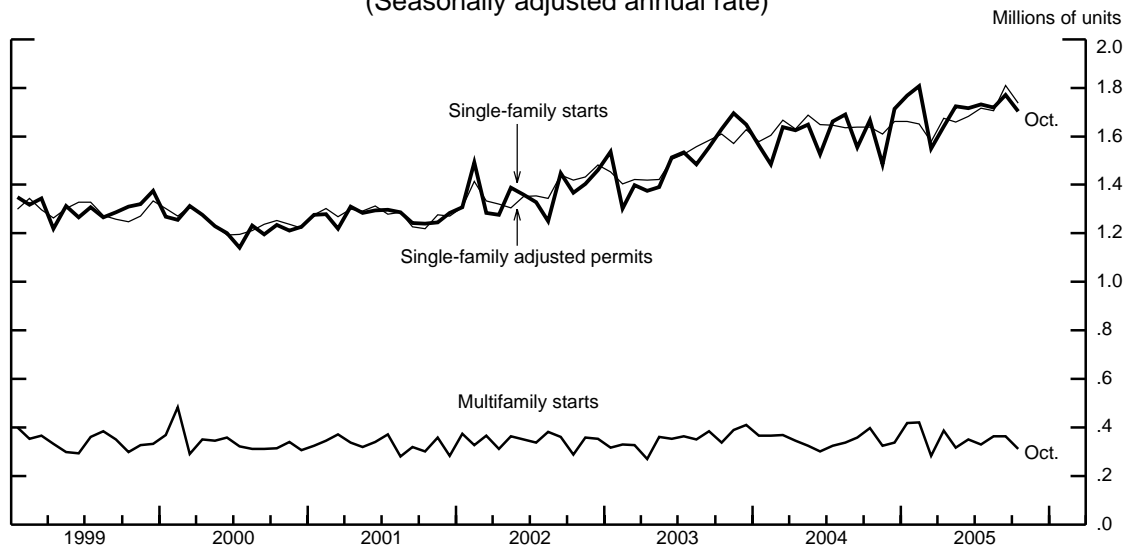
(Millions of units, seasonally adjusted; annual rate except as noted)

Sector	2004	2005					
		Q1	Q2	Q3	Aug.	Sept.	Oct.
<i>All units</i>							
Starts	1.96	2.08	2.04	2.09	2.08	2.13	2.01
Permits	2.05	2.08	2.11	2.18	2.14	2.22	2.10
<i>Single-family units</i>							
Starts	1.61	1.71	1.69	1.74	1.72	1.77	1.70
Permits	1.60	1.60	1.64	1.71	1.68	1.77	1.71
Adjusted permits <sup>1</sup>	1.64	1.63	1.67	1.74	1.71	1.81	1.74
Permit backlog <sup>2</sup>	.15	.15	.16	.17	.16	.17	.17
<i>New homes</i>							
Sales	1.20	1.25	1.29	1.29	1.25	1.26	1.42
Months' supply <sup>3</sup>	4.03	4.30	4.30	4.50	4.70	4.70	4.30
<i>Existing homes</i>							
Sales	5.96	5.98	6.30	6.32	6.34	6.39	6.23
Months' supply <sup>3</sup>	4.30	4.00	4.30	4.60	4.70	4.50	4.80
<i>Multifamily units</i>							
Starts	.35	.37	.35	.35	.36	.36	.31
Permits	.46	.48	.47	.47	.46	.45	.40
Permit backlog <sup>2</sup>	.07	.07	.06	.06	.07	.06	.06
<i>Mobile homes</i>							
Shipments	.13	.14	.13	.13	.13	.14	.19
<i>Condos and co-ops</i>							
Existing home sales	.82	.85	.93	.92	.94	.90	.86

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.

**Private Housing Starts and Permits**

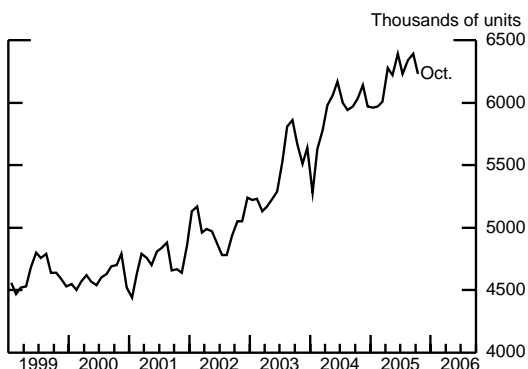
(Seasonally adjusted annual rate)



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

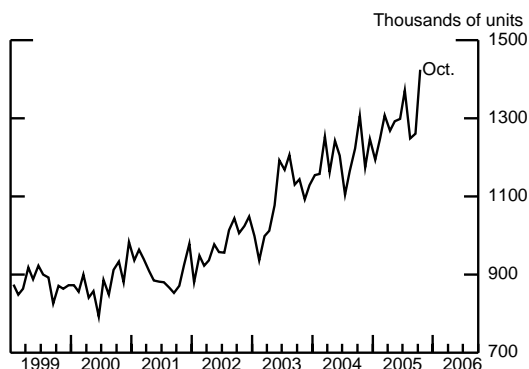
## Indicators of Single-Family Housing

Existing Home Sales



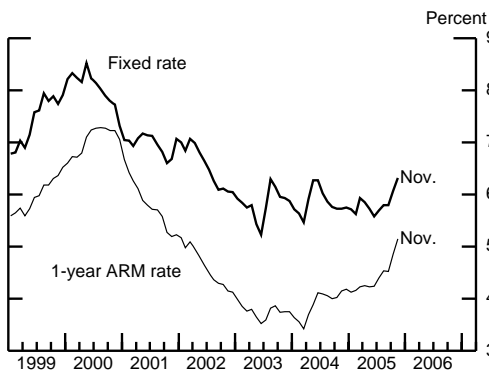
Source. National Association of Realtors.

New Home Sales



Source. Census Bureau.

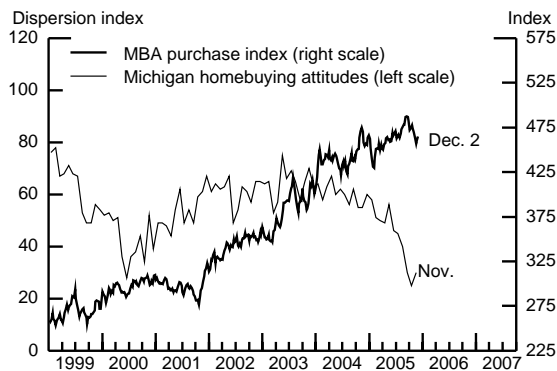
Mortgage Rates



Note. The November readings are based on data through November 30, 2005.

Source. Freddie Mac.

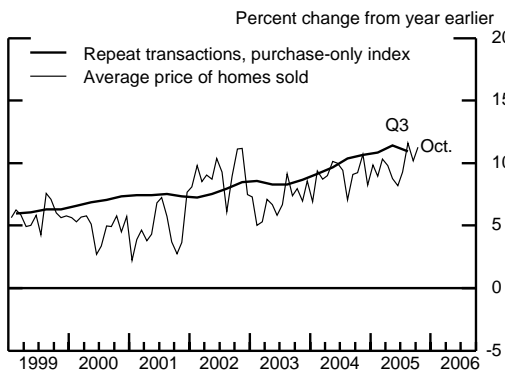
Homebuying Indicators



Note. MBA index is a 4-week moving average. Builders' ratings are seasonally adjusted by Board staff.

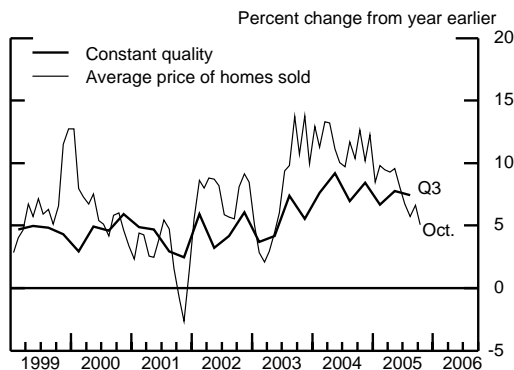
Source. Mortgage Bankers Association and Michigan Survey.

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.

At the same time, prices of existing homes continue to increase rapidly. The purchase-only version of the OFHEO price index, which controls for differences in quality by tracking repeat sales of the same houses over time, was 11 percent higher in the third quarter than its year-ago level. The constant-quality price index for new homes—which controls for changes in the geographic composition of sales, home size, and other readily measurable attributes—was up 7½ percent in the third quarter from its year-ago level. The average price of existing homes sold in October was 11¼ percent higher than its year-earlier level, a slightly larger increase than the previous twelve-month rise. The only house price measure that has shown any moderation is the average price of new homes sold, which has decelerated markedly since the beginning of the year.

### **Equipment and Software**

Real outlays for equipment and software posted a solid gain in the third quarter, growing at an annual rate of about 11 percent. Although business purchases of motor vehicles were weak in October and November, spending excluding motor vehicles appears strong this quarter: Shipments of nondefense capital goods excluding aircraft moved up 1.8 percent in October. Business investment has been supported by robust growth in business sales and by ample financial resources in the corporate sector. Additionally, the cost of capital continues to decline as the relative prices of high-tech equipment and, more recently, of motor vehicles have moved down. The favorable investment climate is reflected in executive surveys, which generally point to widespread, planned increases in capital outlays.

Real spending on high-tech equipment and software increased at an annual rate of 16 percent in the third quarter, and demand indicators for the fourth quarter are positive on balance. October shipments of computers jumped 6.3 percent; deliveries of communications equipment edged down 0.4 percent, but bookings surged 14.4 percent.

After having increased at a rapid pace in the previous two quarters, business purchases of motor vehicles appear to have moderated. Fleet sales of light vehicles moved up to a record high level in the third quarter and have come off a bit since then. In the commercial truck sector, sales of medium and heavy trucks (classes 5 to 8) edged down to 490,000 units in October, but the level was well within the range of values recorded over the past year. The indicators of near-term truck demand suggest that sales will continue at a solid pace. The three-month moving average of new orders for medium and

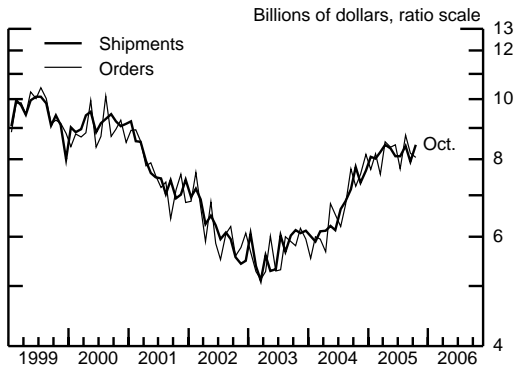
**Orders and Shipments of Nondefense Capital Goods**

(Percent change; seasonally adjusted current dollars)

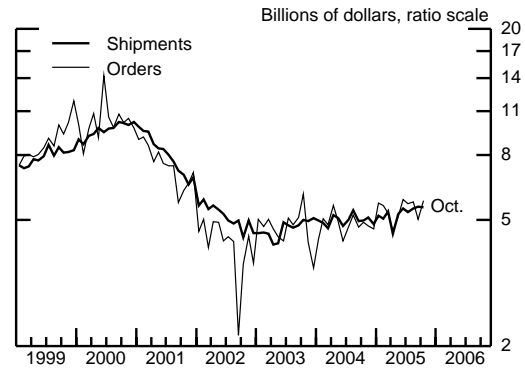
Indicators	2005				
	Q2	Q3	Aug.	Sept.	Oct.
	Annual rate		Monthly rate		
Shipments	8.2	1.8	3.7	-2.9	4.4
Excluding aircraft	1.3	3.2	2.3	-6	1.8
Computers and peripherals	9.3	-6.6	4.0	-5.7	6.3
Communications equipment	-8.5	30.8	2.5	1.3	-4
All other categories	1.0	2.3	2.0	.1	1.4
Shipments of complete aircraft <sup>1</sup>	30.2	26.2	37.5	14.4	n.a.
Orders	66.1	-15.6	4.0	-8.7	6.7
Excluding aircraft	2.2	4.0	3.9	-1.8	1.4
Computers and peripherals	36.8	-10.7	13.5	-6.6	-1.4
Communications equipment	-20.5	23.2	1.3	-12.0	14.4
All other categories	.0	4.8	2.6	.2	.5

1. From Census Bureau, Current Industrial Reports; billions of dollars, annual rate.  
n.a. Not available.

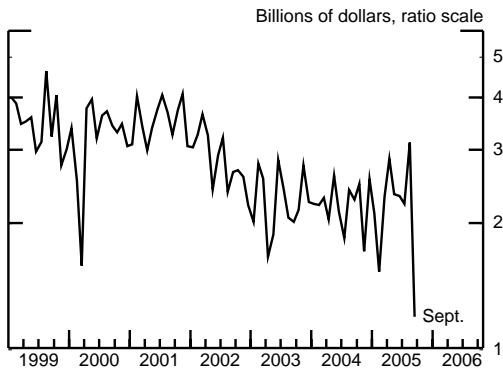
**Computers and Peripherals**



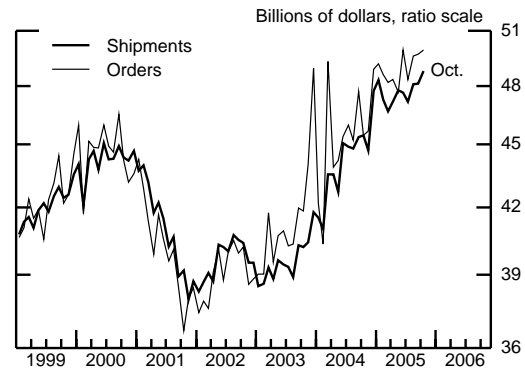
**Communications Equipment**



**Aircraft Shipments**



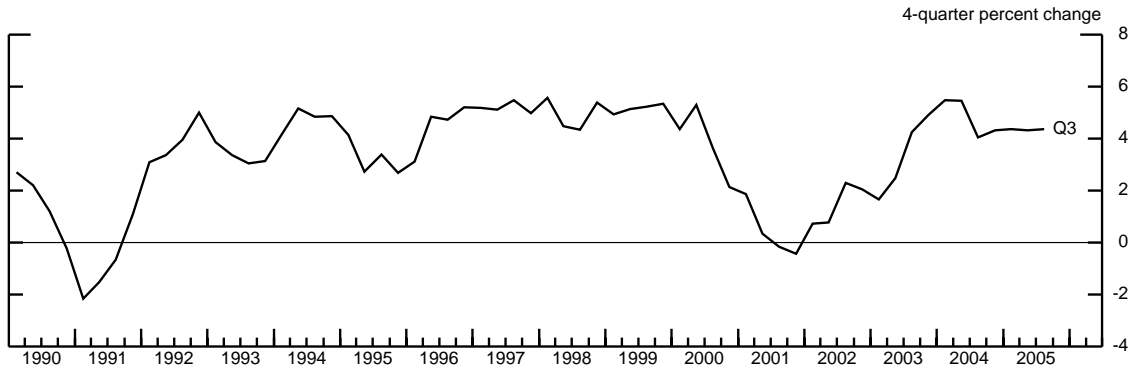
**Other Equipment**



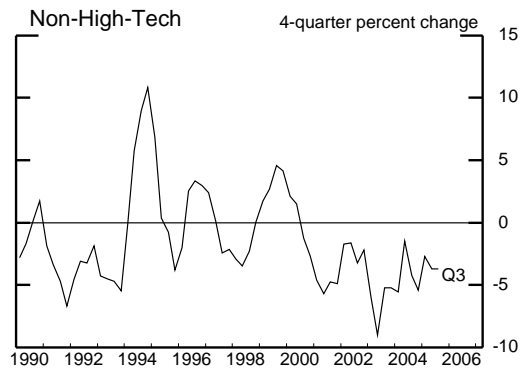
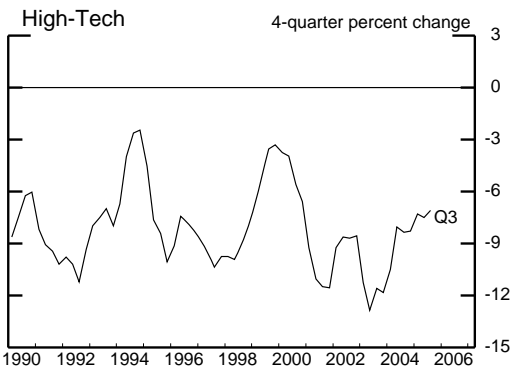
Source. Census Bureau, Current Industrial Reports.

## Fundamentals of Equipment and Software Investment

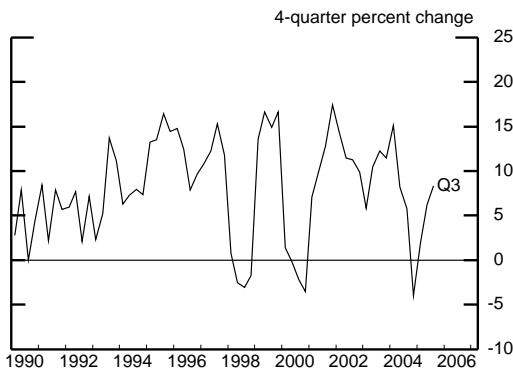
Real Business Output



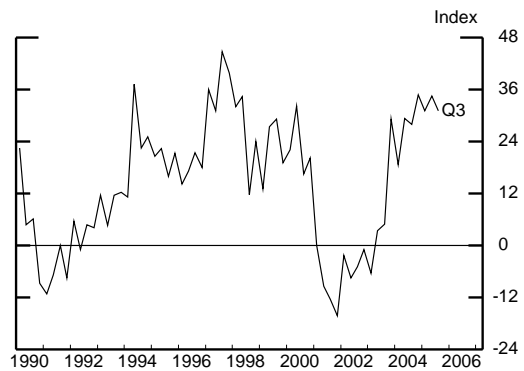
User Cost of Capital



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.

heavy trucks increased in October. Order backlogs, although down from their peak, remained elevated through October.

Real investment in non-high-tech, non-transportation equipment increased at an annual rate of nearly 5 percent in the third quarter—a noticeable pickup from the sluggish ½ percent pace registered in the first half of the year. Shipments of this equipment type increased 1.4 percent in October, and bookings moved up ½ percent. An important contributor to growth in this category over the past two years has been construction machinery: After pausing earlier in the year, real investment in construction machinery reached a new high in the third quarter, and nominal orders and shipments both posted increases in October.

### **Nonresidential Construction**

Real expenditures on nonresidential structures rose at an average annual rate of about 3 percent over the second and third quarters, primarily reflecting an increase in outlays on drilling and mining structures. Outside this category, spending on new construction has yet to gain traction, even though vacancy rates in nonresidential properties have moved down a bit during the past two years. The vacancy rate for office buildings stood at 12¼ percent in November, about 2 percentage points below its peak in the first quarter of 2004. However, construction in this sector remains near the depressed levels of the past two years. Similarly, spending on commercial buildings has held steady at a low level since the middle of 2002 despite persistently low vacancy rates in this sector. In addition, real construction outlays in the manufacturing sector have flattened out after increasing a bit late last year.

Outlays on drilling and mining structures, which rose at an annual rate of 18 percent in the third quarter, continue the strong growth from earlier in the year. Although the number of gas rigs in operation has edged down since October, large increases in natural gas prices over the past year suggest that expenditures on drilling and mining structures will continue to grow in the near term.<sup>10</sup>

### **Business Inventories**

The book value of inventories held by the manufacturing and trade sectors increased \$25 billion in the third quarter. When measured in real terms, however, nonfarm inventories actually declined \$6 billion. The runoff in the third quarter largely reflected a

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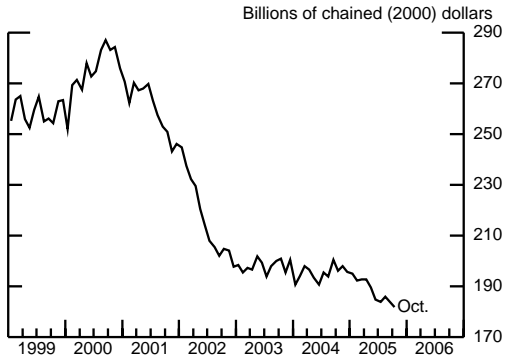
<sup>10</sup> Less than 15 percent of active drilling rigs are located in areas affected by the hurricanes. Reports suggest that only a fraction of these rigs were damaged.

## Nonresidential Construction and Indicators

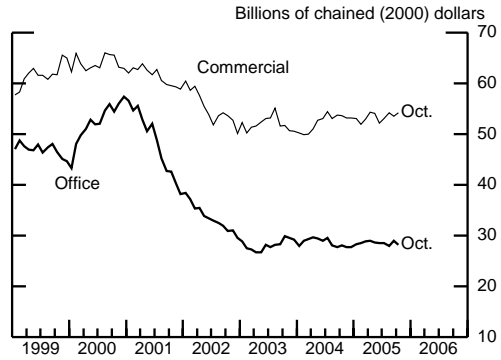
### Real Construction

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

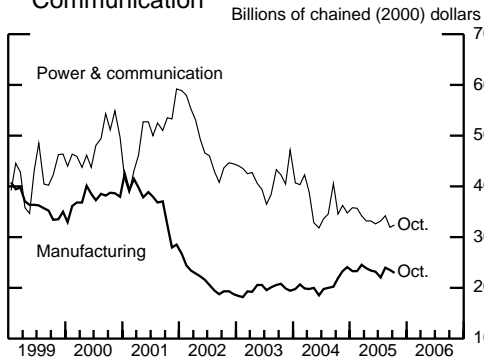
Total Structures



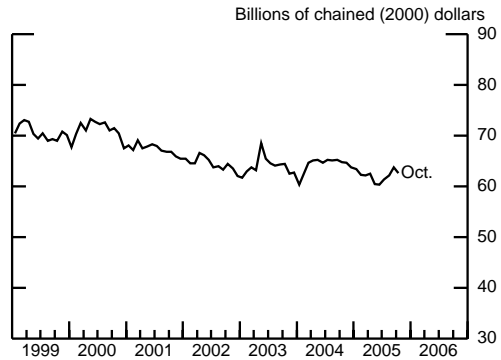
Office and Commercial



Manufacturing and Power & Communication



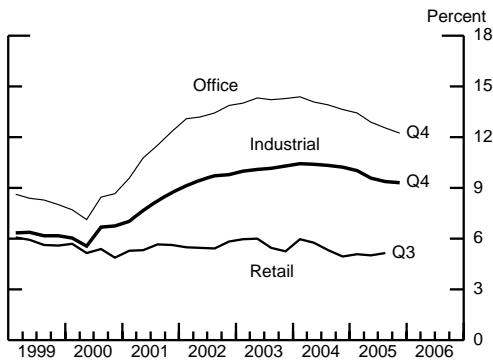
Other



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

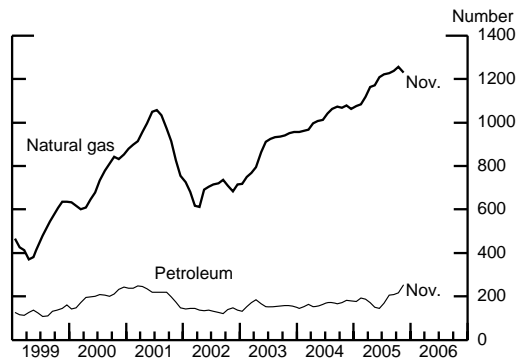
### Indicators

Vacancy Rates



Note. The Q4 readings are based on data through November. Source. For office and industrial, CoStar Property Professional; for retail, National Council of Real Estate Investment Fiduciaries.

Drilling Rigs in Operation



Note. November values are averages through November 25, 2005. Source. DOE/Baker Hughes.

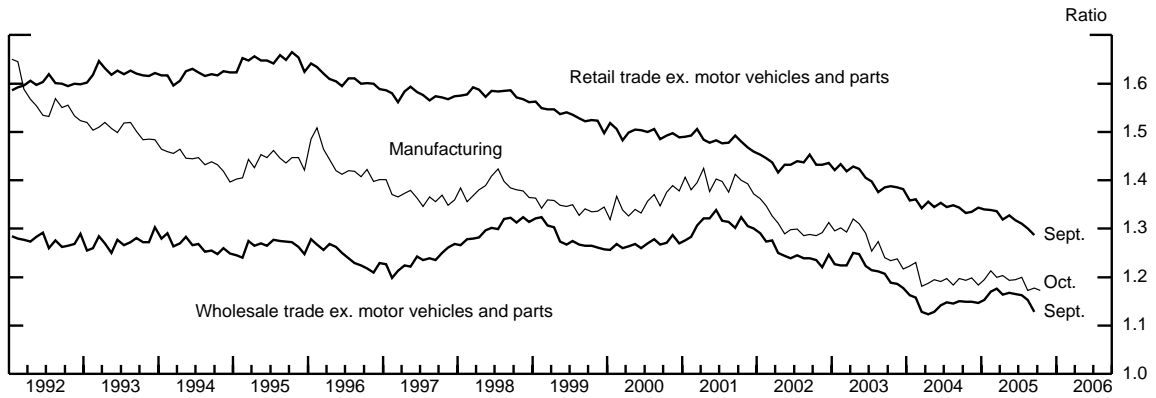


**Changes in Manufacturing and Trade Inventories**  
(Billions of dollars; seasonally adjusted book value; annual rate)

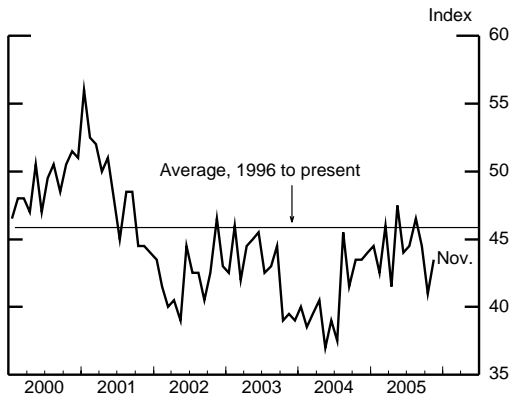
Sector	2005					
	Q1	Q2	Q3	Aug.	Sept.	Oct.
Manufacturing and trade	88.6	18.7	24.6	57.9	81.8	n.a.
Ex. wholesale and retail motor vehicles and parts	92.0	29.1	38.5	33.8	46.1	n.a.
Manufacturing	42.6	.9	8.3	-13.3	5.7	31.9
Ex. aircraft	38.1	4.0	5.2	-4.2	-1.8	25.8
Wholesale trade	30.5	20.2	16.8	20.6	25.7	n.a.
Motor vehicles and parts	-1.1	7.9	-2.0	-5.2	-.4	n.a.
Ex. motor vehicles and parts	31.6	12.4	18.7	25.8	26.1	n.a.
Retail trade	15.5	-2.4	-.5	50.6	50.4	n.a.
Motor vehicles and parts	-2.3	-18.3	-11.9	29.3	36.1	n.a.
Ex. motor vehicles and parts	17.7	15.8	11.4	21.3	14.3	n.a.

n.a. Not available.

**Book-Value Inventories Relative to Shipments and Sales**

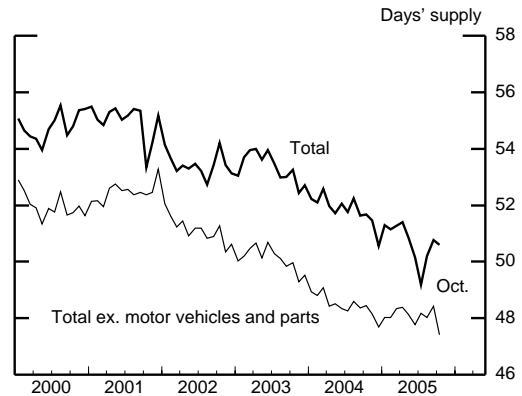


**ISM Customer Inventories: Manufacturing**



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

**Inventory-Consumption Ratios, Flow-of-Goods System**



paring of motor vehicle stocks. Even excluding motor vehicles, inventory investment was relatively subdued. While the lull in non-auto stockbuilding may have been merely an intentional pause after the large restocking that businesses undertook earlier in the year, it may also have reflected stronger-than-expected sales in the third quarter. Indeed, survey data from the ISM indicate that an increasing number of firms believed their customers' inventories were running too low in October and November relative to the readings earlier in the year. Moreover, the book value of inventories relative to sales for the combined manufacturing and trade sectors excluding motor vehicles dropped in August and September. In October, manufacturers' book-value inventories (the only inventory data received for the fourth quarter) rose \$32 billion at an annual rate.

Information from the staff's flow-of-goods inventory system suggests that, excluding motor vehicles, inventory-consumption ratios fell in October after increasing in September. The rise in September was concentrated among chemicals and aerospace products, whose hurricane- and strike-related jumps were reversed in October. Elsewhere, inventories, with the exception of paper, remained well aligned with consumption.

### **Federal Government Sector**

Recent data show the federal deficit continuing to narrow as robust growth of receipts has more than offset large increases in outlays. For the twelve months ending in October, the deficit was \$308 billion, down nearly \$100 billion from a year earlier. After adjusting for shifts in the timing of payments, receipts in October were 14 percent above year-earlier levels while outlays were up 8 percent; both are similar to the increases recorded in earlier months of this year. Spending for national defense rose 5 percent, a slower pace than earlier in the year. Outlays for emergency preparedness and response (mostly disaster relief and expenditures less premiums for national flood insurance) remained elevated in October.<sup>11</sup>

Just before the Thanksgiving recess, the Congress passed a second continuing resolution; set to expire December 17, it funds spending for the three appropriations bills that have yet to clear the Congress (Labor-HHS-Education, Defense, and the District of Columbia). In addition, the House and the Senate each passed spending and tax reconciliation bills, but they face uncertain outcomes because provisions in the separate versions of the bills

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<sup>11</sup> Outlays were \$4 billion in both September and October, and daily data indicate that they will be even higher in November. In 2004, these outlays were about \$1 billion per month in September, October, and November.

## Federal Government Outlays and Receipts

(Unified basis; billions of dollars except as noted)

Function or source	October			12 months ending in October		
	2004	2005	Percent change	2004	2005	Percent change
Outlays	194.2	196.7	1.3	2281.5	2474.3	8.5
Financial transactions <sup>1</sup>	-.1	.0	...	-1.9	-1.2	...
Payment timing <sup>2</sup>	.0	-12.3	...	-13.3	-.5	...
Adjusted outlays	194.3	209.1	7.6	2296.6	2476.0	7.8
Receipts	136.9	149.5	9.2	1880.9	2165.9	15.2
Payment timing	6.0	.0	...	.0	.0	...
Adjusted receipts	130.9	149.5	14.2	1880.9	2165.9	15.2
Surplus or deficit (-)	-57.3	-47.2	...	-400.6	-308.4	...
<i>Selected components of adjusted outlays and receipts</i>						
Adjusted outlays	194.3	209.1	7.6	2296.6	2476.0	7.8
Net interest	15.6	17.7	13.0	162.2	185.5	14.4
Non-interest	178.7	191.4	7.1	2134.4	2290.5	7.3
National defense	37.8	39.6	4.8	458.2	492.4	7.5
Social Security	41.7	44.1	5.7	497.5	525.7	5.7
Medicare	22.5	23.3	3.6	270.9	296.4	9.4
Medicaid	15.1	15.4	2.1	175.9	182.0	3.5
Income security	23.9	25.4	6.3	333.1	346.1	3.9
Agriculture	7.6	9.7	26.9	17.8	30.3	70.3
Other	30.0	33.9	12.9	381.0	417.5	9.6
Adjusted receipts	130.9	149.5	14.2	1880.9	2165.9	15.2
Individual income and payroll taxes	116.0	128.9	11.2	1493.1	1686.3	12.9
Withheld + FICA	109.2	120.8	10.7	1395.0	1498.3	7.4
Nonwithheld + SECA	9.4	10.8	15.4	285.6	366.3	28.3
Less: Refunds	2.6	2.7	5.3	187.5	180.4	-3.8
Corporate	1.7	6.1	260.6	193.4	276.7	43.1
Gross	7.9	10.5	33.2	231.9	303.7	31.0
Less: Refunds	6.2	4.4	-28.7	38.5	27.0	-29.8
Other	13.2	14.4	9.0	194.4	202.9	4.4
Adjusted surplus or deficit (-)	-63.4	-59.6	...	-415.7	-310.1	...

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. In addition, defense outlays have been adjusted to treat the timing of accruals for retiree health consistently.

... Not applicable.

Source. Monthly Treasury Statement.

are quite different.<sup>12</sup> Also, the Congress cleared a bill to increase the borrowing authority of the national flood insurance fund. This increase will allow hurricane-related claims to be paid but will force future increases in flood insurance premiums to repay the resulting increase in debt.

### **State and Local Government Sector**

Real state and local purchases are off to a slow start in the current quarter despite further signs of improvement in the sector's fiscal position. Employment rose an anemic 8,000 per month, on average, in October and November, a pace only about half that recorded over the first nine months of the year. As for construction, expenditures fell sharply in real terms in the third quarter after a strong performance in the first half of the year. In October, construction spending rose 0.6 percent in nominal terms; this gain follows similar increases in August and September and suggests that real construction spending entered the fourth quarter on a gradual uptrend.

The results of the November election point to some cooling of voters' enthusiasm for tight controls on state spending and taxes. In California, voters soundly defeated an initiative that would have limited increases in state spending to the average rate of increase in revenues over the preceding three years; the initiative would also have permitted the governor to reduce spending unilaterally under certain circumstances. In Colorado, voters approved a five-year suspension of the state's stringent structure of fiscal constraints, which had been in place since the early 1990s and required the state to return to the taxpayers any revenue gains in excess of the sum of the rates of population growth and inflation. As of now, Colorado will be able to spend these "excess revenues" on health care, education, transportation projects, and some pensions. In the state of Washington, voters sustained a gasoline tax increase approved by the legislature earlier this year.

### **Prices**

Overall consumer prices rose 0.1 percent in October; this move reflects small increases in food and core prices and a decline in energy prices. Nonetheless, over the twelve months ending in October, PCE prices increased 3.3 percent, nearly ½ percentage point more than in the preceding year; this step-up reflected soaring energy prices over the past twelve months. In contrast, core consumer price inflation has remained fairly subdued:

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<sup>12</sup> The House version of the tax reconciliation bill has only cleared the Ways and Means Committee; the bill is slated for a vote by the full House on December 8.

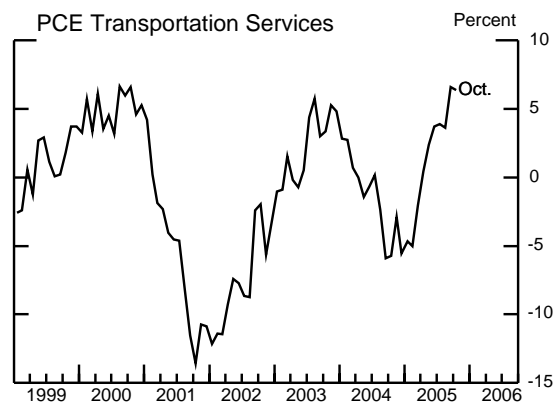
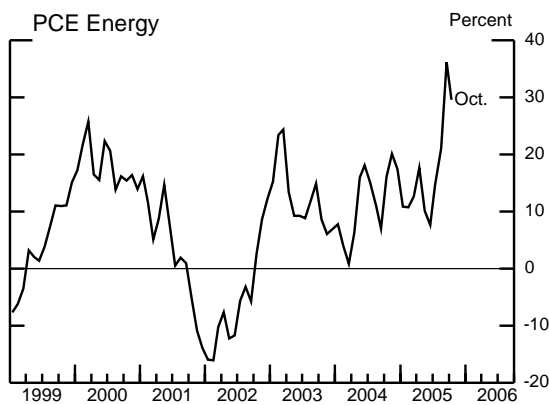
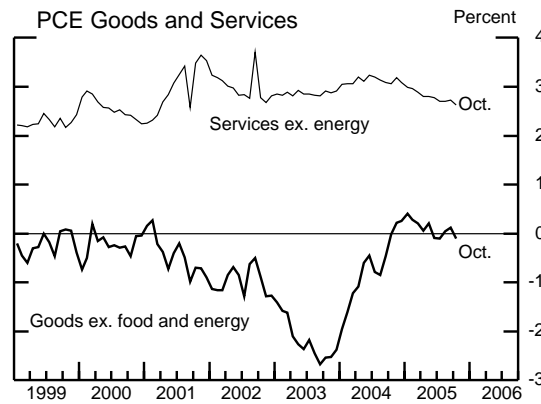
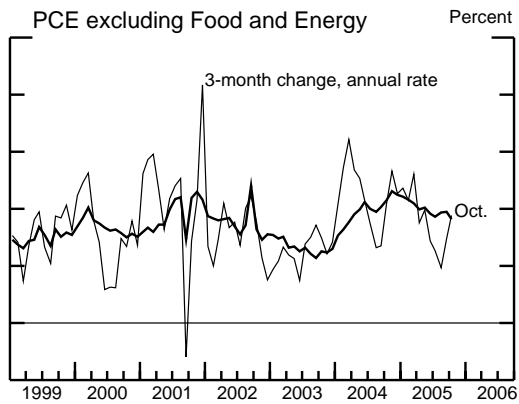
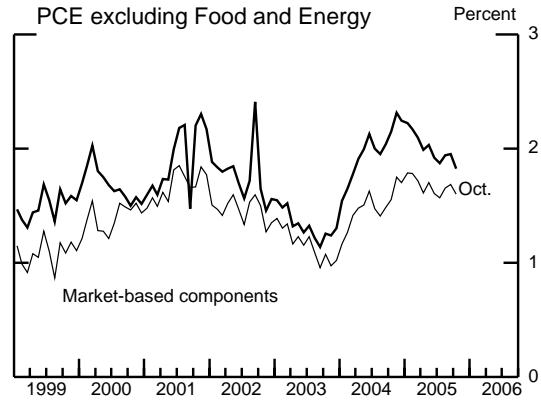
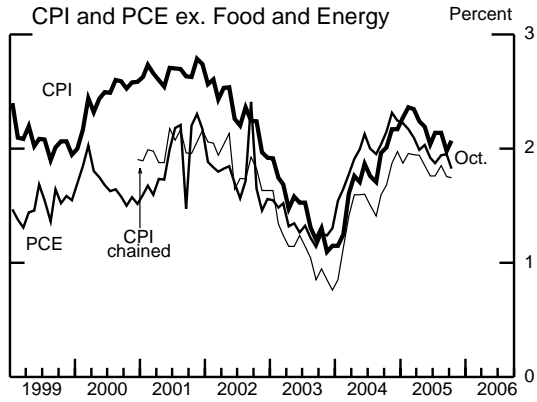
**Measures of Inflation**  
(Percent)

Measures	12-month change		3-month change		1-month change	
	Oct. 2004	Oct. 2005	Annual rate		Monthly rate	
			July 2005	Oct. 2005	Sept. 2005	Oct. 2005
<i>CPI</i>						
<b>Total</b>	<b>3.2</b>	<b>4.3</b>	<b>1.9</b>	<b>8.0</b>	<b>1.2</b>	<b>.2</b>
Food	3.4	2.2	1.5	2.3	.3	.3
Energy	15.2	29.5	4.7	89.3	12.0	-.2
<b>Ex. food and energy</b>	<b>2.0</b>	<b>2.1</b>	<b>1.6</b>	<b>1.8</b>	<b>.1</b>	<b>.2</b>
Core goods	.1	.4	-1.1	1.1	.1	.0
Core services	2.8	2.7	2.4	2.2	.1	.3
Chained CPI (n.s.a.) <sup>1</sup>	2.7	3.3	...	...	...	...
Ex. food and energy <sup>1</sup>	1.7	1.7	...	...	...	...
<i>PCE prices</i>						
<b>Total</b>	<b>2.9</b>	<b>3.3</b>	<b>1.4</b>	<b>5.9</b>	<b>.9</b>	<b>.1</b>
Food	3.1	2.0	.9	2.3	.3	.2
Energy	16.1	29.6	3.5	90.0	12.3	-.6
<b>Ex. food and energy</b>	<b>2.1</b>	<b>1.8</b>	<b>1.3</b>	<b>1.9</b>	<b>.2</b>	<b>.1</b>
Core goods	.0	-.1	-1.8	.5	.1	.0
Core services	3.1	2.6	2.5	2.5	.2	.2
Core market-based	1.6	1.6	1.2	1.6	.1	.1
Core non-market-based	5.0	2.9	1.7	3.4	.4	.2
<i>PPI</i>						
<b>Total finished goods</b>	<b>4.5</b>	<b>5.9</b>	<b>1.8</b>	<b>13.2</b>	<b>1.9</b>	<b>.7</b>
Food	2.7	.3	-5.8	4.0	1.4	-.1
Energy	17.3	26.1	11.2	78.9	7.1	4.1
<b>Ex. food and energy</b>	<b>1.8</b>	<b>1.9</b>	<b>1.5</b>	<b>.0</b>	<b>.3</b>	<b>-.3</b>
Core consumer goods	1.7	2.0	1.7	-.2	.2	-.2
Capital equipment	1.8	1.7	1.4	.3	.3	-.2
Intermediate materials	9.2	10.5	2.1	27.7	2.5	3.0
Ex. food and energy	8.0	4.3	-1.8	9.7	1.2	1.2
Crude materials	16.3	31.5	2.5	109.1	10.2	6.7
Ex. food and energy	27.6	1.1	-19.8	40.1	5.3	-1.2

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

... Not applicable.

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



**Broad Measures of Inflation**  
(Percent change, Q3 to Q3)

Measure	2002	2003	2004	2005
<i>Product prices</i>				
GDP price index	1.6	2.1	2.7	2.8
Less food and energy	2.0	1.8	2.6	2.6
Nonfarm business chain price index	1.1	1.2	2.3	2.8
<i>Expenditure prices</i>				
Gross domestic purchases price index	1.6	2.1	3.0	3.3
Less food and energy	1.9	1.7	2.6	2.4
PCE price index	1.5	1.8	2.6	3.1
Less food and energy	1.9	1.2	2.0	1.9
PCE price index, market-based components	1.1	1.8	2.3	3.0
Less food and energy	1.5	1.1	1.5	1.6
CPI	1.6	2.2	2.7	3.8
Less food and energy	2.3	1.3	1.8	2.1
Chained CPI	1.3	2.0	2.3	3.0
Less food and energy	1.8	1.0	1.5	1.8
Median CPI	3.3	2.0	2.5	2.4
Trimmed mean CPI	2.1	1.8	2.1	2.3

**Surveys of Inflation Expectations**  
(Percent)

Period	Actual CPI inflation <sup>1</sup>	University of Michigan				Professional forecasters (10-year) <sup>4</sup>
		1 year <sup>2</sup>		5 to 10 years <sup>3</sup>		
		Mean	Median	Mean	Median	
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
Q4	n.a.	n.a.	n.a.	n.a.	n.a.	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.	4.3	5.5	4.6	3.8	3.2	...
Nov.	n.a.	4.1	3.3	3.3	3.0	...

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.

PCE prices excluding food and energy rose 1.8 percent over the twelve months ending in October, slightly less than in the preceding year.

Consumer energy prices have started to recede. The PCE price index for energy fell 0.6 percent in October and reflects a sizable 4¼ percent decline in gasoline prices. The PCE price indexes for both fuel oil and natural gas increased in October.

Core consumer price inflation remains moderate, though some signs of a pass-through of higher energy costs are becoming evident, especially in transportation services. The PCE price index for purchased intercity transportation (mainly airfares) turned up 0.6 percent in October and rose 6.4 percent over the past twelve months after having declined 5.7 percent during the previous twelve months. Some pass-through of energy costs was also evident in PCE prices for delivery services and for moving and storage, though the weights of these two categories in the overall PCE price index are quite small.

On a twelve-month change basis, the slight step-down in the rate of core PCE inflation reflected a deceleration in the non-market component of PCE prices, particularly in the index for imputed financial service charges. The market-based component of core PCE prices increased 1.6 percent over the twelve months ending in October, the same as in the preceding year. Changes in core goods prices were near zero over the twelve months ending in October. Prices of core market-based services increased about 2.6 percent over this period, about the same as in the preceding twelve months.

Near-term inflation expectations declined sharply in November, presumably in response to receding energy prices. As measured by the Michigan SRC survey, median inflation expectations for the coming year dropped more than 1 percentage point in November; still, year-ahead inflation expectations remained slightly higher than those in August. Median expectations for the next five to ten years remained about 3 percent for the third consecutive month—a touch above the narrow range observed in recent years. By contrast, rate spreads on CPI-indexed Treasury bonds (as of December 6) implied inflation compensation just below 2½ percent over both the next five and ten years—the low end of the range observed over the past year.

Most of the broader measures of inflation have picked up a bit over the past four quarters, a reflection of higher energy prices. Excluding food and energy, however, GDP price inflation this year has remained near last year's 2½ percent rate, as slower increases in



prices for residential investment have offset faster increases in prices for state and local government purchases.

Increases in energy costs have pushed up producer prices in some sectors. The soaring cost of diesel and jet fuel contributed to large increases in producer prices for air, rail, truck, and water transport services in October. In addition, core intermediate materials prices rose 1.2 percent for the second consecutive month in October; the increase reflects the further pass-through of energy costs into the prices of energy-intensive products, such as chemicals, plastics, metals, and nitrogenate fertilizer. The prices of several types of building materials, such as concrete, cement, asphalt, and gypsum, increased sharply in October, a move possibly related to rebuilding efforts after the hurricanes and to high energy costs. Still, notwithstanding the recent increases in core materials prices, the PPI for intermediate materials has decelerated nearly 4 percentage points in the past twelve months relative to the preceding twelve-month period.

Changes in non-energy commodity prices since the October Greenbook have been mixed: Prices of steel scrap and copper have surged, while prices of plywood and oriented strand board fell sharply after posting very large increases in August and September. Over the past six weeks, the Journal of Commerce metals index has risen 11.2 percent, and the CRB spot industrials index (which excludes energy) increased 0.2 percent.

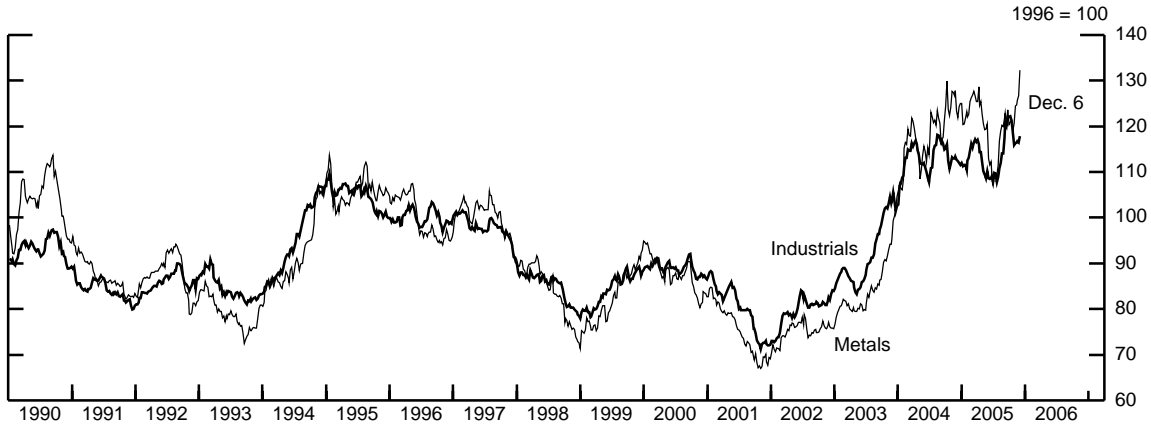
### **Labor Costs**

Over the three months ending in September, the employment cost index (ECI) for hourly compensation in private industry rose at an annual rate of 3.2 percent—a bit faster than in the first half of the year. Nonetheless, September's twelve-month increase was only 3 percent, well below the 3.7 percent increase of a year earlier. Another measure of labor costs—compensation per hour in the nonfarm business sector—has been buffeted by transitory factors since late last year but, on balance, has shown some moderation in growth since then.

The wages and salaries component of the ECI rose at an annual rate of 2.4 percent in the third quarter, a reading unchanged from the two previous ones for this year. Monthly increases in average hourly earnings of production workers were similarly restrained for most of this year and averaged about 3 percent at an annual rate from March through September. However, this indicator has increased more rapidly so far in the fourth quarter, rising at an average monthly rate of 0.4 percent in October and November.

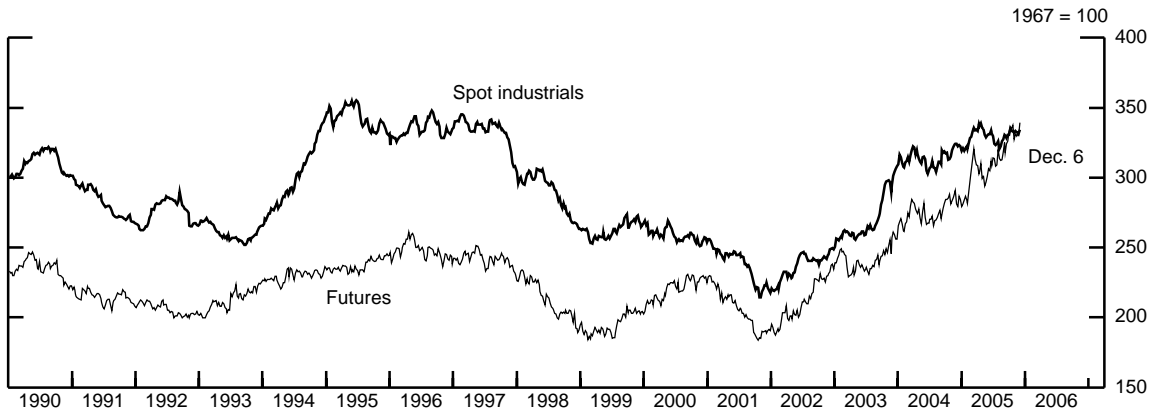
## Commodity Price Indexes

Journal of Commerce



Note. The Journal of Commerce (JOC) industrial price index is based almost entirely on industrial commodities, with a small weight given to energy commodities. Copyright for Journal of Commerce data is held by CIBC, 1994.

Commodity Research Bureau



Note. 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.

### Selected Commodity Price Indexes (Percent change)

Index	2004 <sup>1</sup>	12/28/04 to 10/25/05 <sup>2</sup>	10/25/05 <sup>2</sup> to 12/6/05	52-week change to 12/6/05
JOC industrials	8.7	6.3	-.6	4.6
JOC metals	19.4	-4.9	11.2	7.3
CRB spot industrials	4.6	3.4	.2	3.1
CRB spot foodstuffs	2.7	-3.2	1.0	-8.6
CRB futures	11.1	18.7	.6	20.7

1. From the last week of the preceding year to the last week of the year indicated.
2. October 25, 2005, is the Tuesday preceding publication of the October Greenbook.

The benefits component of the ECI increased at an annual rate of 5.2 percent in the third quarter, a faster rise than experienced in the first half of the year. Nonetheless, over the past twelve months, the increase in benefits costs (4.8 percent) was 2 percentage points slower than over the preceding twelve months, when benefit costs were swollen by a surge in outlays for retirement and savings plans.

In the ECI release, employer contributions for health insurance are estimated to have risen  $6\frac{3}{4}$  percent over the twelve months ending in September—about the same as the previous year but well below the 10 percent yearly increases in 2002 and 2003.

Available indicators provide no evidence that a sharp change in the rate of increase is in the offing. Private surveys suggest that premiums will rise about 7 percent to 10 percent in 2006, increases similar to the survey results for 2005. Among the major plans for public employees, OPM expects premiums in the Federal Employees Health Benefits Program to rise  $6\frac{1}{2}$  percent, on average, in 2006 after a rise of  $7\frac{1}{2}$  percent in 2005.

Premiums for the California Public Retirement System are slated to increase 9 percent, on average, in 2006 after a climb of 10 percent in 2005.

Compensation per hour in the nonfarm business sector increased at an annual rate of  $3\frac{3}{4}$  percent in the third quarter. In addition, the incorporation of new state UI data caused the second-quarter increase in compensation per hour to be revised down sharply to an annual rate of 0.9 percent. This low figure appears to indicate that the unwinding of the transitory factors—bonuses and exercises of stock options—that led to a sizable gain in compensation in the fourth quarter of last year is largely completed. Averaging through these transitory factors, compensation growth seems to have slowed a bit recently.

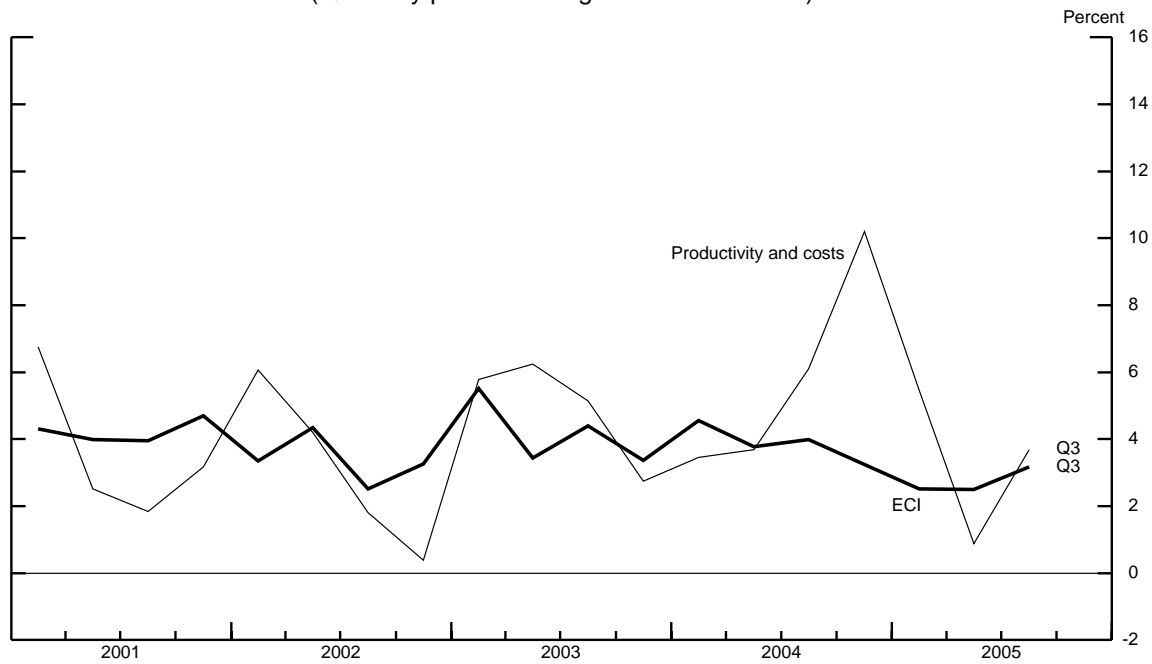
**Hourly Compensation**

(Percent change from preceding period at compound annual rate; based on seasonally adjusted data)

Category	2003:Q3 to 2004:Q3	2004:Q3 to 2005:Q3	2005			2005 <sup>1</sup>		
			Q1	Q2	Q3	Sept.	Oct.	Nov.
Nonfarm business compensation per hour	4.0	5.0	5.5	.9	3.7	...	...	...
Employment cost index	3.7	3.0	2.5	2.5	3.2	...	...	...
Benefit costs	6.8	4.8	4.3	3.2	5.2	...	...	...
Wages and salaries	2.6	2.2	2.4	2.4	2.4	...	...	...
Average hourly earnings <sup>2</sup>	2.2	2.7	2.4	2.9	3.4	.1	.6	.2

- 1. Percent change at a monthly rate.
- 2. Production or nonsupervisory workers.
- ... Not applicable.

**Compensation per Hour**  
(Quarterly percent change at an annual rate)



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## **Domestic Financial Developments**

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

Instrument	2004		2005		Change to Dec. 6 from selected dates (percentage points)		
	June 28	Dec. 31	Oct. 31	Dec. 6	2004 June 28	2004 Dec. 31	2005 Oct. 31
<i>Short-term</i>							
FOMC intended federal funds rate	1.00	2.25	3.75	4.00	3.00	1.75	.25
Treasury bills <sup>1</sup>							
3-month	1.36	2.18	3.89	3.95	2.59	1.77	.06
6-month	1.74	2.52	4.12	4.18	2.44	1.66	.06
Commercial paper (A1/P1 rates) <sup>2</sup>							
1-month	1.28	2.29	4.01	4.22	2.94	1.93	.21
3-month	1.45	2.28	4.13	4.35	2.90	2.07	.22
Large negotiable CDs <sup>1</sup>							
3-month	1.53	2.50	4.22	4.42	2.89	1.92	.20
6-month	1.82	2.72	4.43	4.61	2.79	1.89	.18
Eurodollar deposits <sup>3</sup>							
1-month	1.29	2.32	4.08	4.31	3.02	1.99	.23
3-month	1.51	2.49	4.25	4.43	2.92	1.94	.18
Bank prime rate	4.00	5.25	6.75	7.00	3.00	1.75	.25
<i>Intermediate- and long-term</i>							
U.S. Treasury <sup>4</sup>							
2-year	2.88	3.08	4.45	4.44	1.56	1.36	-.01
5-year	3.97	3.63	4.46	4.42	.45	.79	-.04
10-year	4.90	4.34	4.67	4.61	-.29	.27	-.06
U.S. Treasury indexed notes							
5-year	1.56	1.03	1.81	2.05	.49	1.02	.24
10-year	2.25	1.65	2.00	2.17	-.08	.52	.17
Municipal general obligations (Bond Buyer) <sup>5</sup>	5.01	4.49	4.56	4.53	-.48	.04	-.03
Private instruments							
10-year swap	5.21	4.65	5.05	5.08	-.13	.43	.03
10-year FNMA <sup>6</sup>	5.30	4.61	4.97	4.92	-.38	.31	-.05
10-year AA <sup>7</sup>	5.59	4.98	5.37	5.34	-.25	.36	-.03
10-year BBB <sup>7</sup>	6.18	5.38	5.97	5.95	-.23	.57	-.02
5-year high yield <sup>7</sup>	8.30	7.34	8.34	8.36	.06	1.02	.02
Home mortgages (FHLMC survey rate) <sup>8</sup>							
30-year fixed	6.21	5.77	6.31	6.26	.05	.49	-.05
1-year adjustable	4.19	4.10	5.09	5.16	.97	1.06	.07

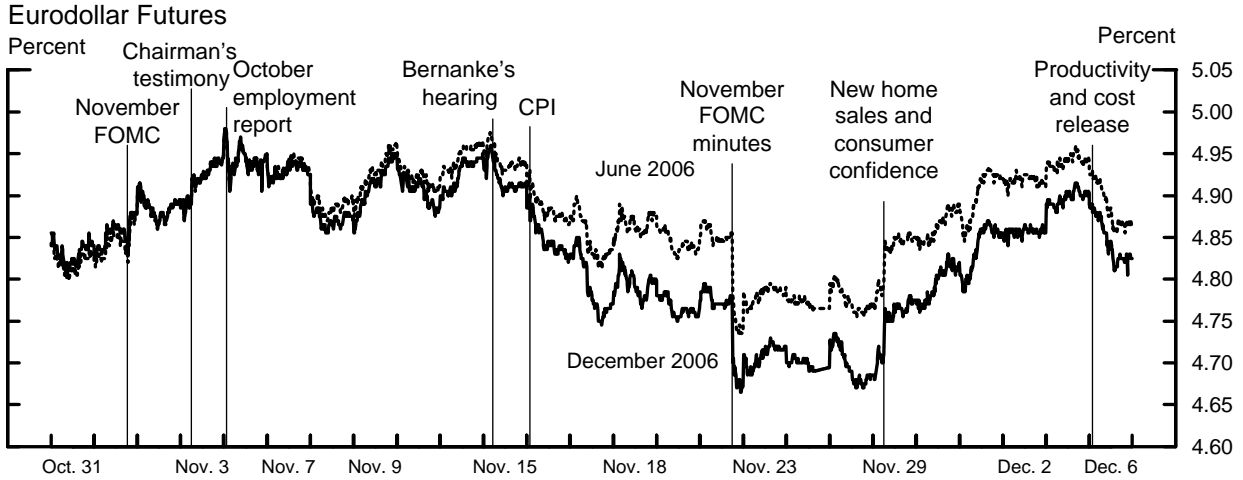
Stock exchange index	Record high		2004	2005		Change to Dec. 6 from selected dates (percent)		
	Level	Date	Dec. 31	Oct. 31	Dec. 6	Record high	2004 Dec. 31	2005 Oct. 31
Dow Jones Industrial	11,723	1-14-00	10,783	10,440	10,857	-7.39	.68	3.99
S&P 500 Composite	1,527	3-24-00	1,212	1,207	1,264	-17.27	4.27	4.70
Nasdaq	5,049	3-10-00	2,175	2,120	2,261	-55.22	3.92	6.62
Russell 2000	691	12-2-05	652	647	688	-.43	5.53	6.34
Wilshire 5000	14,752	3-24-00	11,971	12,063	12,668	-14.13	5.82	5.01

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 December 6, 2005, is from December 1, 2005.

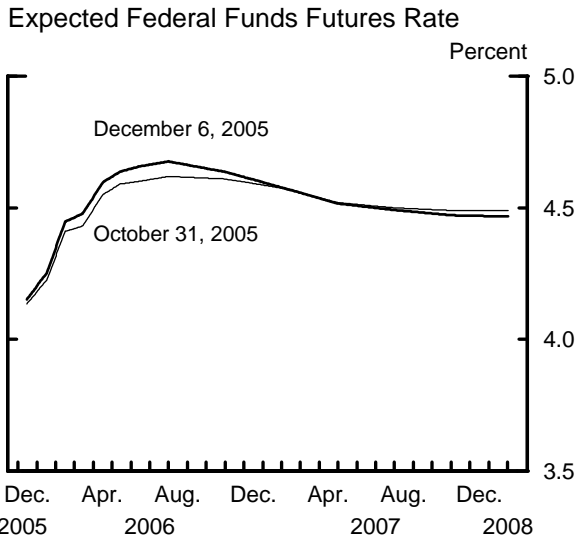
NOTES:

June 28, 2004, is the day before the most recent policy tightening began.  
October 31, 2005, is the day before the most recent FOMC meeting.

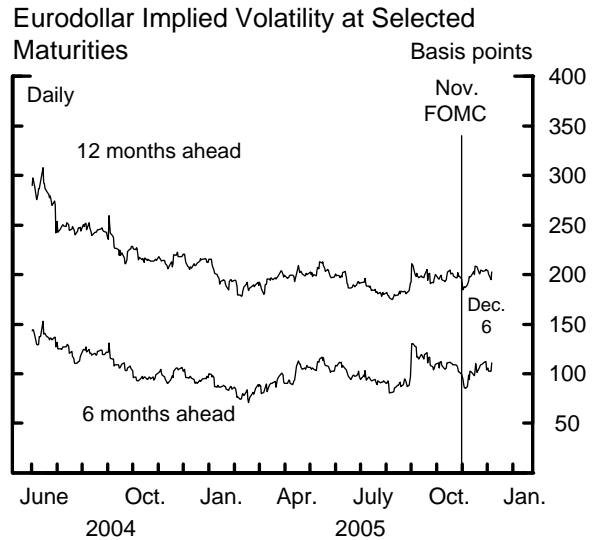
**Policy Expectations and Treasury Yields**



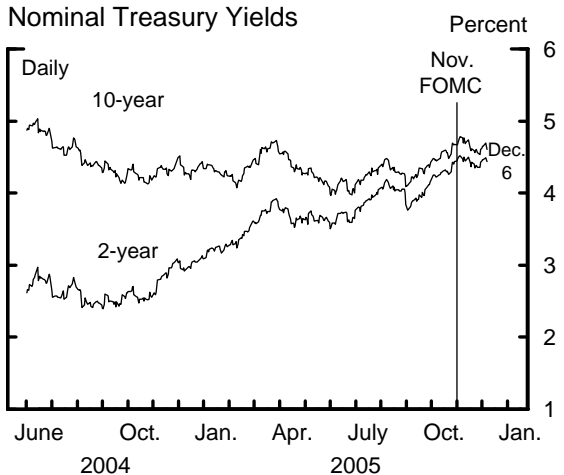
Note. 5-minute intervals.



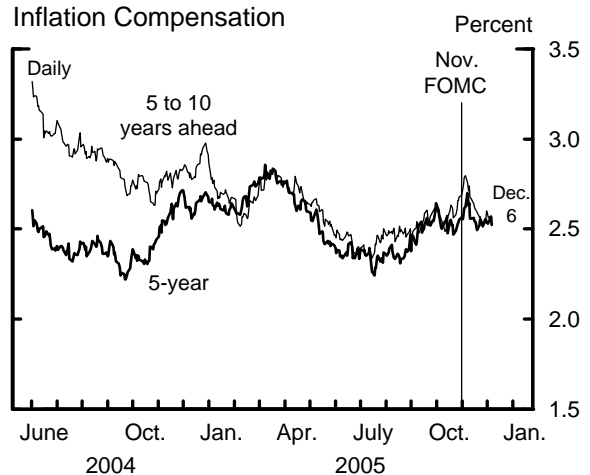
Note. Estimates from federal funds and Eurodollar futures, with an allowance for term premia and other adjustments.



Note. Width of a 90 percent confidence interval for the federal funds rate computed from the term structures for both the expected federal funds rate and implied volatility.



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



Note. Estimates based on smoothed nominal and inflation-indexed Treasury yield curves, and are adjusted for the indexation-lag effect.

## Domestic Financial Developments

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### Overview

Most market interest rates changed little, on balance, over the intermeeting period, as the effects of better-than-expected data on spending and output were offset by benign incoming data on core inflation and communications from the FOMC that were perceived as optimistic about inflation prospects. On net, market participants revised up only slightly the expected path of monetary policy through 2006, though some notable swings occurred over the intermeeting period. Equity markets rallied on the perception that the economy has substantial momentum with limited inflation pressure.

Household and business credit quality appears to have remained favorable. Net borrowing by nonfinancial businesses stayed moderate in October and November, and cash-rich firms are estimated to have been retiring equity at a near-record pace. Home prices advanced again at a double-digit annual rate in the third quarter, supporting robust growth in household mortgage debt.

### Policy Expectations and Treasury Interest Rates

The decision at the November FOMC meeting to increase the target for the federal funds rate 25 basis points and the accompanying statement were in line with expectations and evoked little reaction in financial markets. Favorable inflation data in mid-November led investors to mark down their expectations for the path of monetary policy. Market participants also revised down the policy path in response to the November FOMC minutes and speeches by Federal Reserve officials that investors reportedly read as suggesting that only moderate additional policy firming would likely be necessary to contain inflation pressures. A steady stream of strong economic data over the past couple of weeks, however, more than offset those declines in the expected policy path.

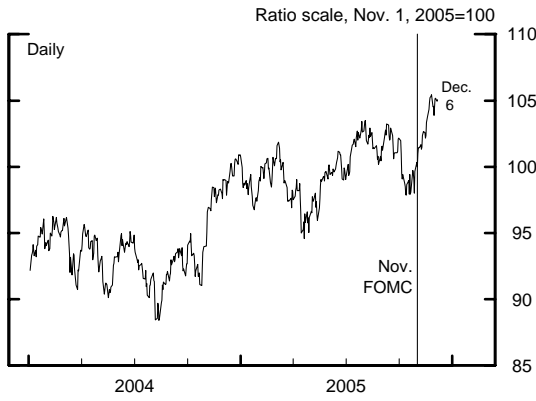
Judging from federal funds futures quotes, market participants have fully priced in a 25-basis-point tightening at the upcoming FOMC meeting and place high odds on another move at the January meeting. The policy path over the next year was marked up slightly, on net, over the intermeeting period. With longer-term expectations about unchanged, the policy path now has a slightly more pronounced downtilt between late-2006 and mid-2007. Uncertainty about the path of monetary policy, implied by options on Eurodollar futures, edged up at the six- and twelve-month horizons.

Yields on two-year Treasury securities were about unchanged, on net, over the intermeeting period, but longer-term Treasury yields decreased slightly. Five-year inflation compensation implied by TIPS adjusted for the indexation lag was little changed



### Corporate Yields, Risk Spreads, and Stock Prices

S&P 500

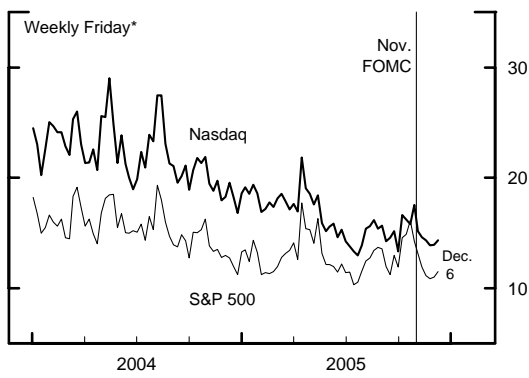


12-Month Forward Trend Earnings-Price Ratio for S&P 500 and Long-Run Treasury Yield



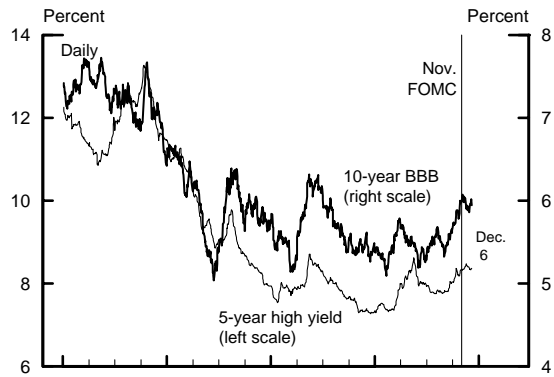
\* Yield on synthetic Treasury perpetuity minus Philadelphia Fed 10-year expected inflation.  
 + Denotes the latest observation using daily interest rates and stock prices and latest earnings data from I/B/E/S.

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



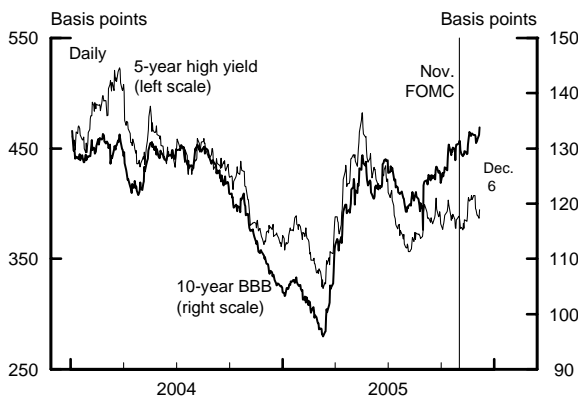
\* Latest observation is for most recent business day.

Yields for BBB and High-Yield Corporate Bonds



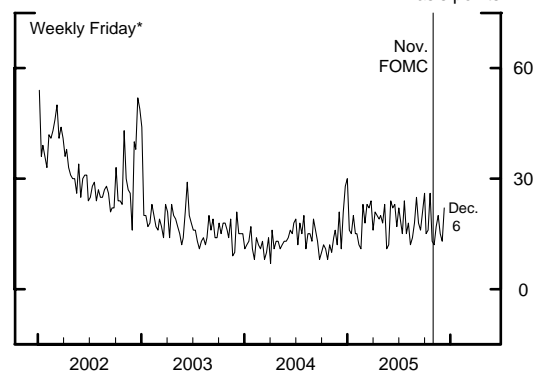
Note. Yields from smoothed yield curves based on Merrill Lynch bond data.

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.

amid mixed energy price movements, but inflation compensation for the interval five to ten years ahead declined somewhat.<sup>1</sup>

### **Stock Prices and Corporate Interest Rates**

On net, most major stock price indexes rose 5 percent to 7 percent since the last FOMC meeting, an increase spurred by reduced inflation concerns and favorable real-side economic data. The equity price gains were broad based, though technology stocks posted the biggest increases. The equity risk premium—measured by the spread between the twelve-month forward trend earnings-price ratio for S&P 500 firms and an estimate of the real long-run Treasury yield—narrowed slightly but remained above the average of the past two decades. Implied volatilities on both the Nasdaq 100 and S&P 500 indexes declined over the intermeeting period.

Yields on investment-grade corporate bonds moved about in line with those on comparable Treasuries since the November FOMC meeting, so credit spreads were roughly unchanged. Indexes of high-yield bond spreads were also little changed, as GM and Ford bonds spreads widened after further troubles were reported at GM and these increases were largely offset by narrower spreads for other issuers. Risk spreads on commercial paper—measured by the spread of yields on thirty-day A2/P2 paper over A1/P1 paper—remained low. No evidence of year-end pressures has emerged.

### **Corporate Earnings and Credit Quality**

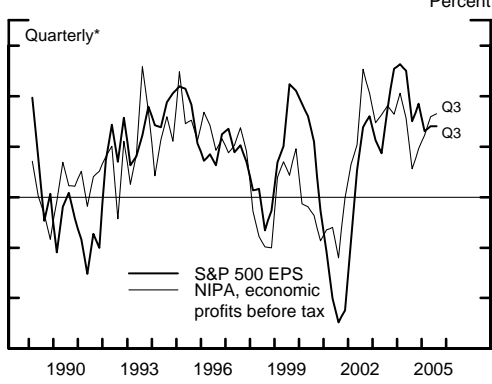
With the third-quarter reporting period now almost concluded, four-quarter growth in operating earnings per share for S&P 500 firms is estimated to have remained close to 15 percent. Third-quarter NIPA profits were robust as well, coming in about 18 percent higher than the level of four quarters earlier. Excluding the hurricane-related hit to insurance industry profits, both series also imply strong growth on a quarter-over-quarter basis. Analysts' revisions to year-ahead earnings for S&P 500 firms turned slightly negative in November. The decrease from October, however, was driven almost entirely by downward revisions to energy sector forecasts that reflected the movement of oil prices away from their recent peaks.

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<sup>1</sup> The larger decline in inflation compensation implied by the unadjusted five-year TIPS rate reflects a substantial indexation lag effect from the large swings in energy prices, which have led investors to expect that total CPI will fall back in November from its spike in September. The high volatility of energy prices, however, may have made the adjustment somewhat imprecise.

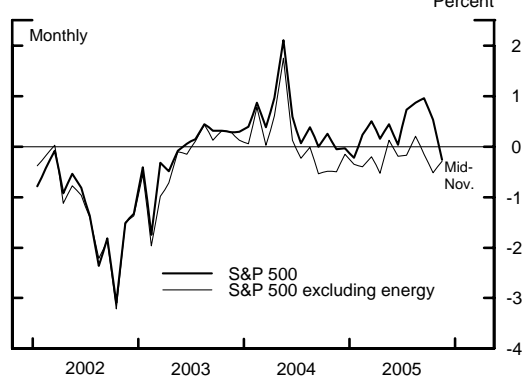
### Corporate Earnings and Credit Quality

Corporate Earnings Growth



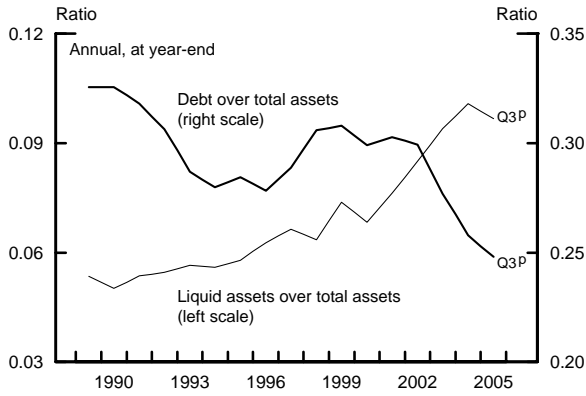
\* Change from four quarters earlier.  
Source: I/B/E/S for S&P 500 EPS.

S&P 500 Earnings Expectations Revisions Index



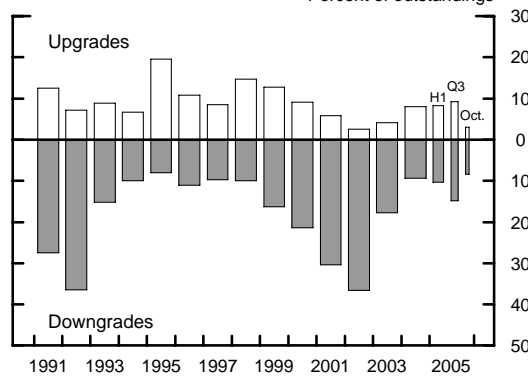
Note. Index is a weighted average of the percent change in the consensus forecasts of current-year and following-year EPS for constant sample.

Financial Ratios for Nonfinancial Corporations



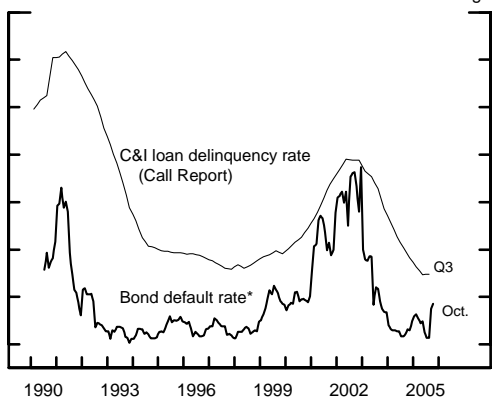
Note. Compustat data.  
p Preliminary.

Bond Ratings Changes of Nonfinancial Companies



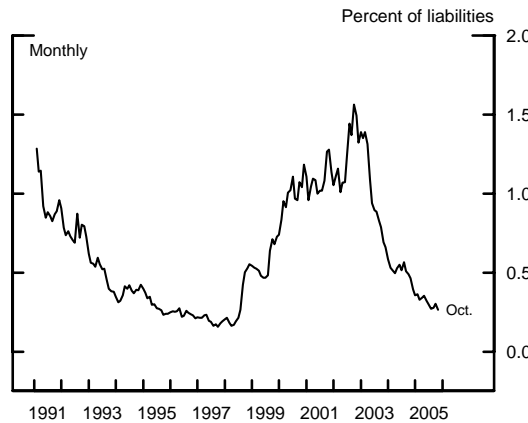
Note. Data are at an annual rate.  
Source: Moody's Investors Service.

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.

On balance, the credit quality of nonfinancial firms has remained strong, supported by continued high profitability. Data through the third quarter indicate that leverage on corporate balance sheets has stayed fairly low and liquidity has stayed high despite a rapid pace of equity retirements. The modest volume of bond rating downgrades in October owed mainly to the announcement of major share repurchase programs by a few highly-rated firms. The six-month trailing bond default rate ticked up in October on bankruptcy filings by Delphi and Refco after a sharper rise in September.<sup>2</sup> About one-half of the jump in the default rate in September and October reflects troubles in the airline and auto industries which are saddled with high legacy cost structures, and these factors have not affected broader credit trends. The rise may also reflect filings that were pulled ahead to avoid changes in the bankruptcy code that took effect on October 17. The delinquency rate on C&I loans at commercial banks remained very low in the third quarter, and the aggregate expected year-ahead default rate based on KMV was little changed in October at a low level.

### **Business Finance**

Gross bond issuance by nonfinancial firms rebounded strongly in November after a lull in October when interest rates were climbing. C&I loan growth in October and November about matched its rapid third-quarter pace. By contrast, commercial paper outstandings fell sharply in November, reportedly in part because some multinational firms used repatriated foreign profits to pay down their paper. On balance, the amount of net debt raised by nonfinancial firms through bank loans, commercial paper, and bonds in October and November remained near the solid pace of recent quarters.

Net equity outstanding contracted even more sharply in the third quarter than earlier this year, as equity retirements approached a record high. The pace of retirements reflected a surge in cash-financed mergers and acquisitions and continued large share repurchase programs, bolstered by strong profits and still plentiful cash on corporate balance sheets. Gross equity issuance picked up with a rebound in IPOs in November, about matching

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<sup>2</sup> The bankruptcy of Delphi temporarily created settlement problems in the credit derivatives market stemming from the mismatch between the notional amount of these derivatives written on Delphi (estimated to be \$25 to \$30 billion) and its outstanding debt (\$2.5 billion). Because credit derivatives typically require delivery of a defaulted security to the protection provider in exchange for its par value, market participants were concerned that investors would substantially bid up the price of Delphi's defaulted bonds to obtain them for delivery. This concern was eased, however, when market participants agreed to settle index trades in cash at a price determined by an auction. Furthermore, most of the single-name credit default swap contracts on Delphi were terminated through a netting process, which facilitated a smooth physical settlement for the remaining contracts.

**Business Finance**

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

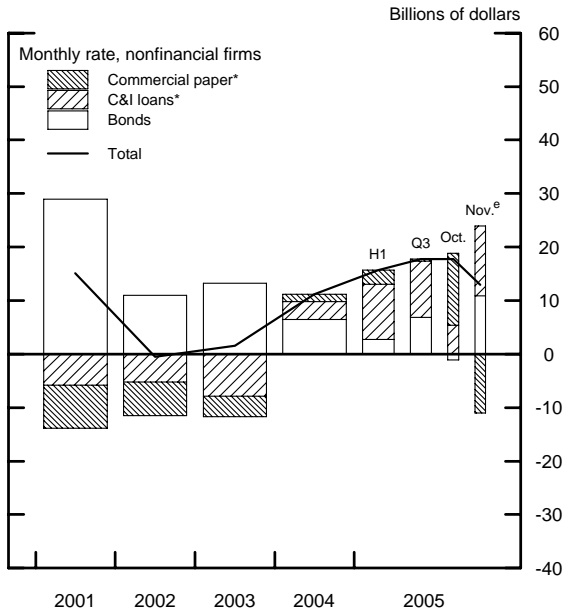
(Billions of dollars; monthly rates, not seasonally adjusted)

Type of security	2001	2002	2003	2004	2005			
					H1	Q3	Oct.	Nov. <sup>e</sup>
<i>Nonfinancial corporations</i>								
Stocks <sup>1</sup>	6.5	5.2	3.7	5.4	3.8	5.2	2.4	4.3
Initial public offerings	2.1	.7	.4	1.6	1.6	2.2	.7	2.1
Seasoned offerings	4.4	4.4	3.3	3.8	2.1	3.8	1.7	2.1
Bonds <sup>2</sup>	39.8	24.8	31.6	22.7	18.1	19.7	8.8	24.8
Investment grade	27.5	15.7	16.0	8.3	7.9	9.8	6.3	12.7
Speculative grade	8.9	4.8	11.3	9.5	6.2	7.4	1.8	7.5
Other (sold abroad/unrated)	3.4	4.2	4.3	4.9	3.9	2.6	.8	4.6
<i>Memo</i>								
Net issuance of commercial paper <sup>3</sup>	-8.0	-6.3	-3.8	1.4	2.6	.4	13.5	-11.0
Change in C&I loans at commercial banks <sup>3,4</sup>	-5.8	-5.2	-7.8	3.4	10.4	10.5	5.3	13.0
<i>Financial corporations</i>								
Stocks <sup>1</sup>	4.2	4.0	6.6	6.9	5.3	5.6	4.5	3.6
Bonds <sup>2</sup>	80.2	87.0	111.1	139.3	167.3	180.9	156.5	131.4

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

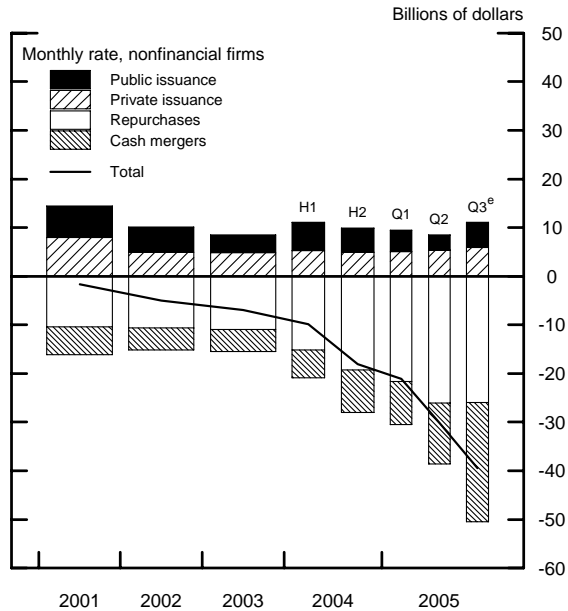
1. Excludes private placements and equity-for-equity swaps that occur in restructurings.
2. Data include regular and 144a private placements. Bond totals reflect gross proceeds rather than par value of original discount bonds. Bonds are categorized according to Moody's bond ratings, or to Standard & 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.

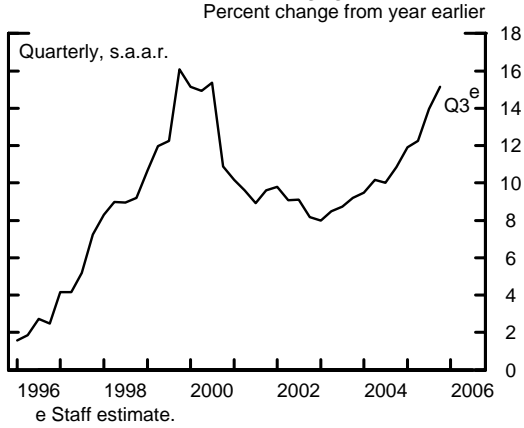
**Components of Net Equity Issuance**



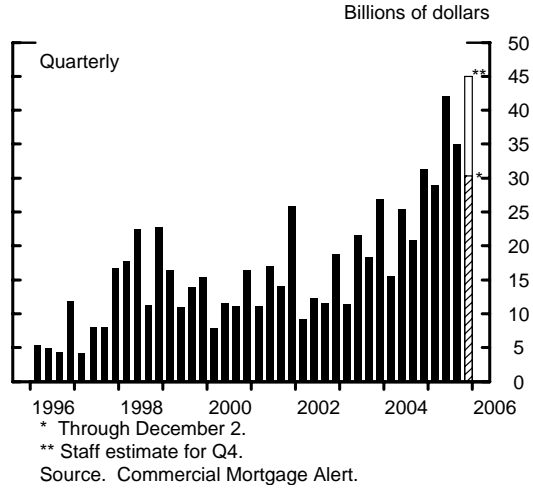
e Staff estimate.

## Commercial Real Estate

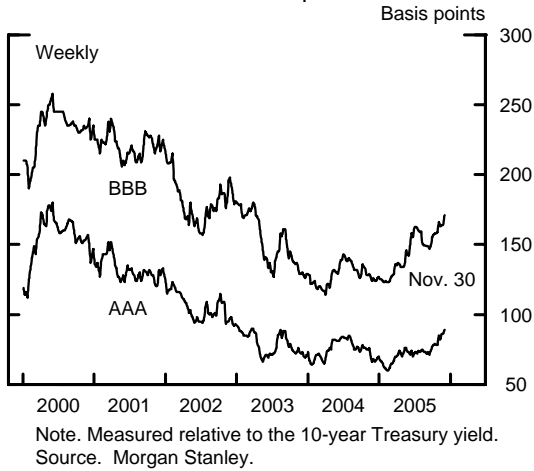
**Growth of Commercial Mortgage Debt**



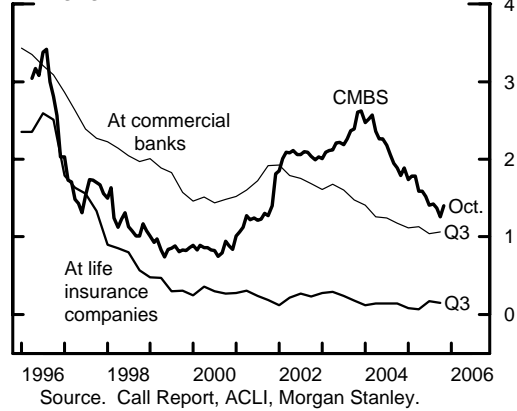
**Gross Issuance of CMBS**



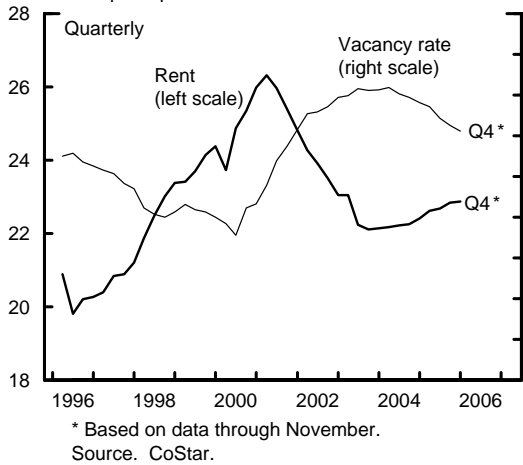
**Investment-Grade CMBS Spreads**



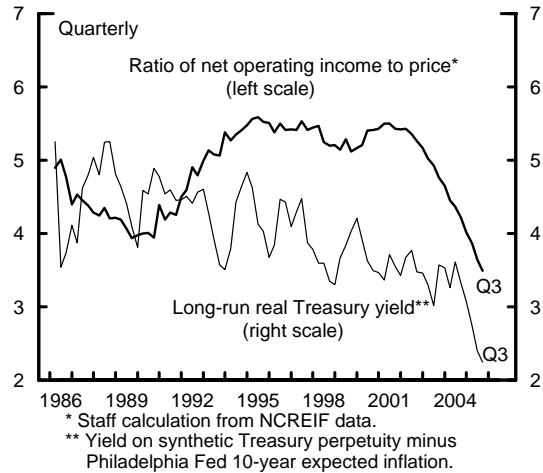
**Delinquency Rates on Commercial Mortgages and CMBS**



**Average Office Rent and Vacancy Rate**

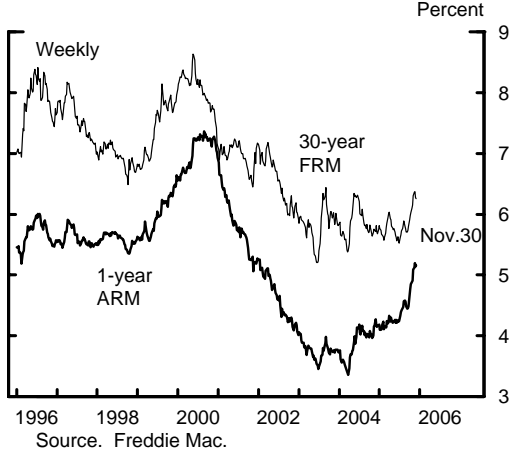


**Commercial Real Estate Valuation**

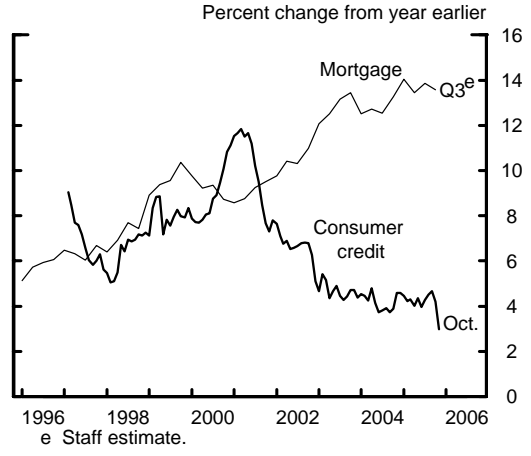


### Household Liabilities

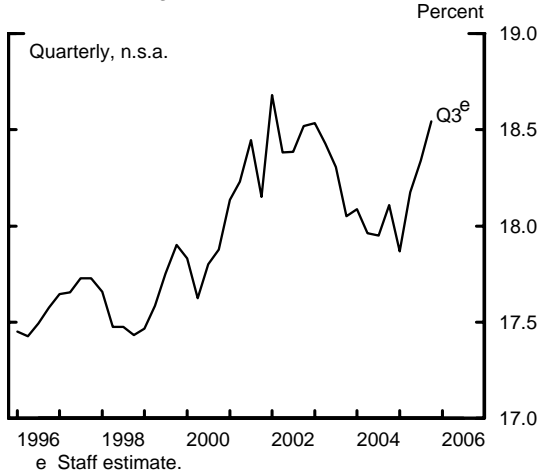
Mortgage Rates



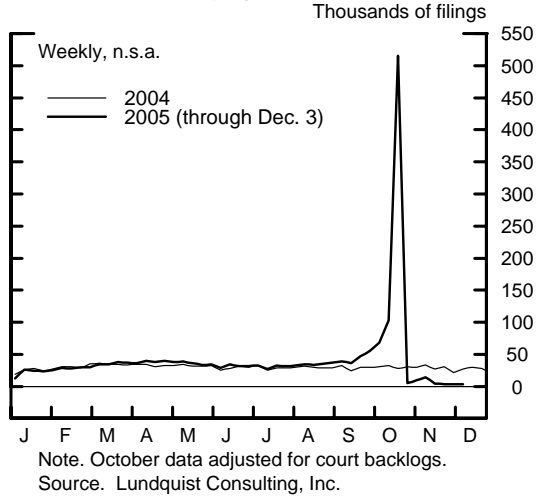
Household Debt Growth



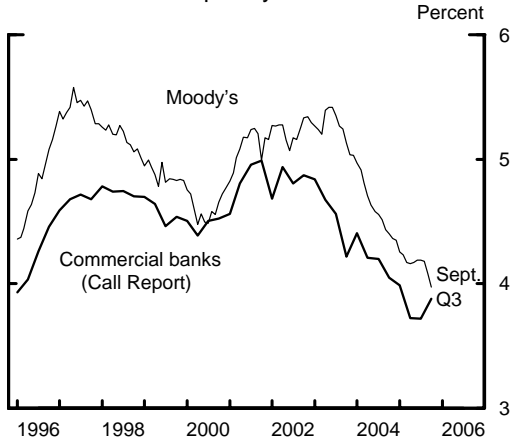
Financial Obligations Ratio



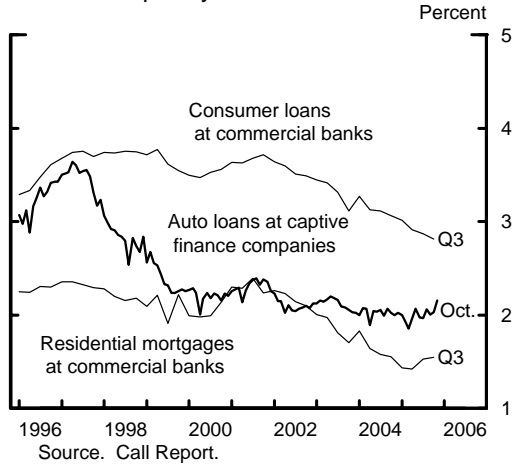
Household Bankruptcy



Credit Card Delinquency Rates



Other Delinquency Rates



their average monthly pace this year. Nonetheless, sizable announcements of both share repurchases and cash mergers suggest that net equity retirements will remain deeply negative in the fourth quarter.

### **Commercial Real Estate**

Commercial mortgage borrowing has been strong over the past year, with the level of debt in the third quarter estimated to have been about 15 percent above that of a year earlier. Continued robust debt growth in the sector appears to be in prospect: The issuance calendar for commercial-mortgage-backed securities (CMBS) currently shows that a record volume of deals are scheduled to close during the fourth quarter.

Spreads of CMBS to comparable Treasuries edged up in November, reportedly owing in part to the plentiful supply, even as credit quality in the sector remains favorable. Delinquency rates on CMBS and commercial mortgages at commercial banks and life insurance companies remain low by historical standards, and data on office vacancy rates and rents point to further improvement in market fundamentals. Prices of commercial properties have risen rapidly this year, keeping the ratio of net operating income to property prices on a steep downtrend. Nonetheless, the spread of this ratio over the real perpetuity Treasury yield—a measure of the risk premium on commercial real estate assets—has widened somewhat in recent quarters.

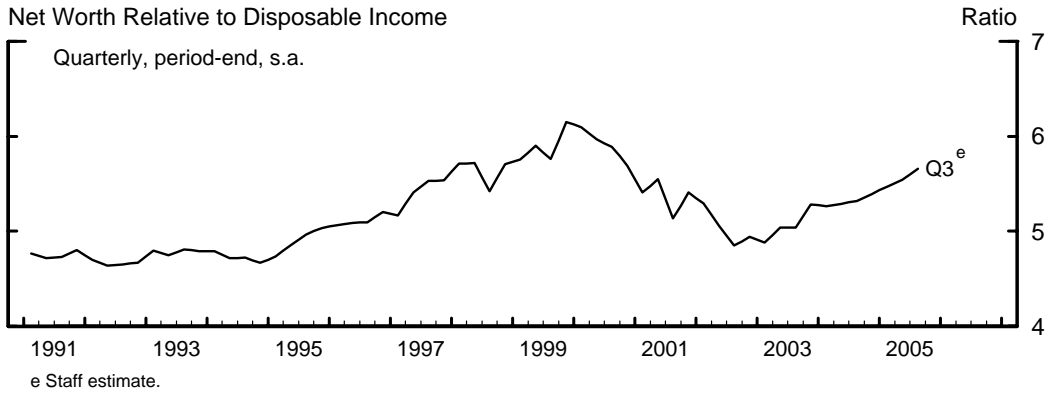
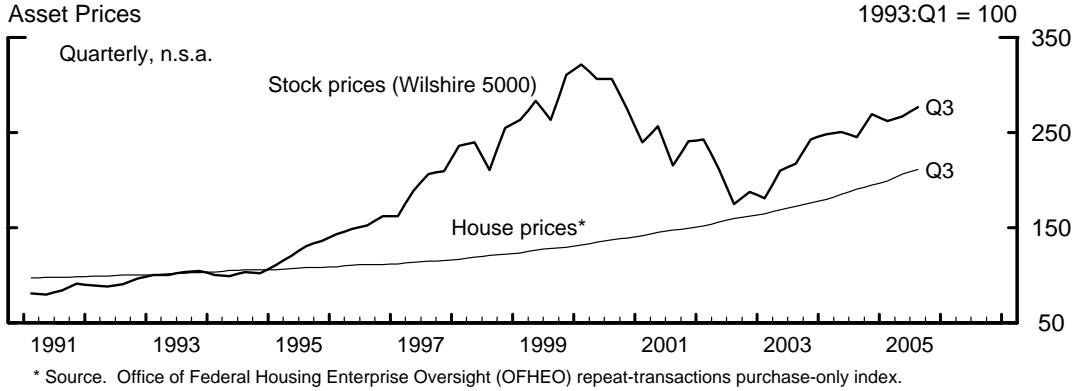
### **Household Finance**

Average interest rates on thirty-year fixed-rate and one-year adjustable-rate home mortgages were little changed over the intermeeting period after having moved higher in late October. The OFHEO all-transactions house price index increased at an annual rate of 11½ percent in the third quarter after an upwardly revised gain of 14½ percent in the second quarter. Household mortgage debt continued to expand rapidly in the third quarter, spurred by the ongoing steep increase in home prices. Meanwhile, the expansion of consumer credit in September and October slowed a bit from its already modest pace. Growth of overall household debt exceeded that of personal income in the third quarter, and the financial obligations ratio moved up further.

After reaching unprecedented levels just before the implementation of more-stringent bankruptcy rules in mid-October, personal bankruptcy filings have hovered at very low levels in recent weeks, an indication that at least some of the pre-reform filings were pulled forward from future months. Delinquency rates on residential mortgages and



### Household Assets



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

Fund type	2003	2004		2005				Assets Oct.
		H1	H2	Q1	Q2	Oct.	Nov. <sup>e</sup>	
<b>Total long-term funds</b>	<b>18.0</b>	<b>20.0</b>	<b>15.0</b>	<b>22.3</b>	<b>13.9</b>	<b>8.1</b>	<b>17.7</b>	<b>6,560</b>
<b>Equity funds</b>	<b>12.7</b>	<b>19.7</b>	<b>9.9</b>	<b>15.8</b>	<b>8.7</b>	<b>6.5</b>	<b>17.4</b>	<b>4,663</b>
Domestic	10.7	13.7	4.9	5.2	3.1	-2.9	7.0	3,834
International	2.0	6.0	5.1	10.6	5.6	9.4	10.3	829
<b>Hybrid funds</b>	<b>2.7</b>	<b>4.1</b>	<b>3.0</b>	<b>4.5</b>	<b>2.3</b>	<b>0.9</b>	<b>0.6</b>	<b>552</b>
<b>Bond funds</b>	<b>2.6</b>	<b>-3.8</b>	<b>2.0</b>	<b>2.0</b>	<b>2.9</b>	<b>0.8</b>	<b>-0.3</b>	<b>1,345</b>
High-yield	2.2	-2.1	0.5	-2.3	-1.0	-1.9	-0.9	143
Other taxable	1.0	0.1	2.0	3.8	3.5	2.4	1.3	864
Municipals	-0.6	-1.9	-0.4	0.4	0.4	0.2	-0.6	338

Note. Excludes reinvested dividends.

e Staff estimates based on confidential ICI weekly data.

Source. Investment Company Institute.

**Treasury Financing**  
(Billions of dollars)

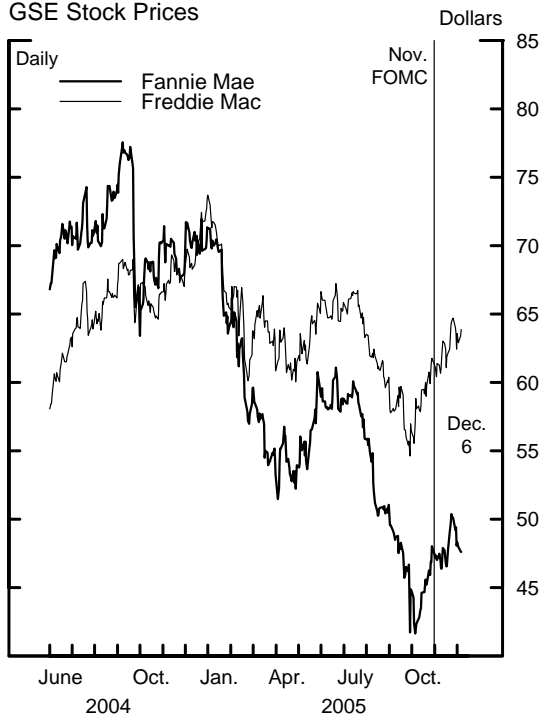
Item	2004		2005				
	Q3	Q4	Q1	Q2	Q3	Sept.	Oct.
<b>Total surplus, deficit (-)</b>	<b>-85.7</b>	<b>-118.1</b>	<b>-176.6</b>	<b>45.2</b>	<b>-69.0</b>	<b>35.7</b>	<b>-47.2</b>
Means of financing deficit							
Net borrowing	83.4	102.1	164.7	-42.8	72.6	-15.7	48.8
Nonmarketable	-5.2	2.4	20.8	35.9	20.4	7.3	4.3
Marketable	88.6	99.7	143.9	-78.7	52.1	-23.0	44.5
Bills	14.3	43.6	55.7	-135.8	-9.3	-39.1	22.3
Coupons	74.3	56.0	88.2	57.1	61.4	16.0	22.2
Decrease in cash balance	8.3	11.7	2.2	-10.7	-2.5	-27.1	-5.0
Other <sup>1</sup>	-6.0	4.3	9.7	8.3	-1.0	7.1	3.5
Memo:							
Cash balance, end of period	36.3	24.7	22.4	33.2	35.7	35.7	40.7

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

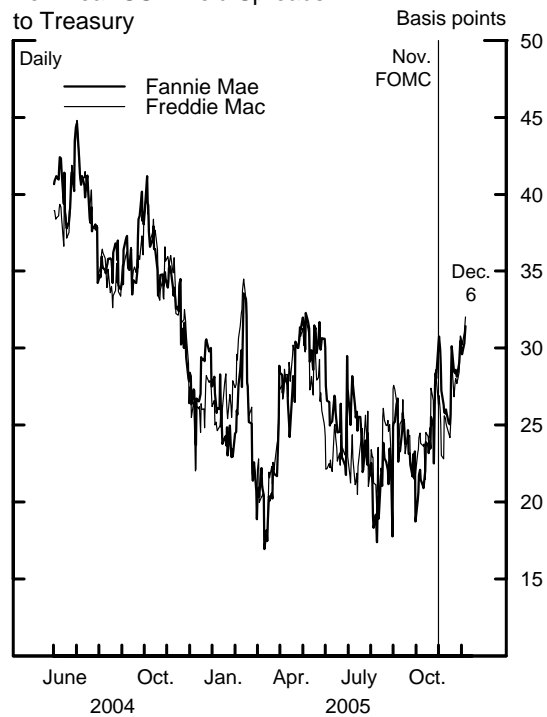
1. Direct loan financing, accrued items, checks issued less checks paid, and other transactions.

**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

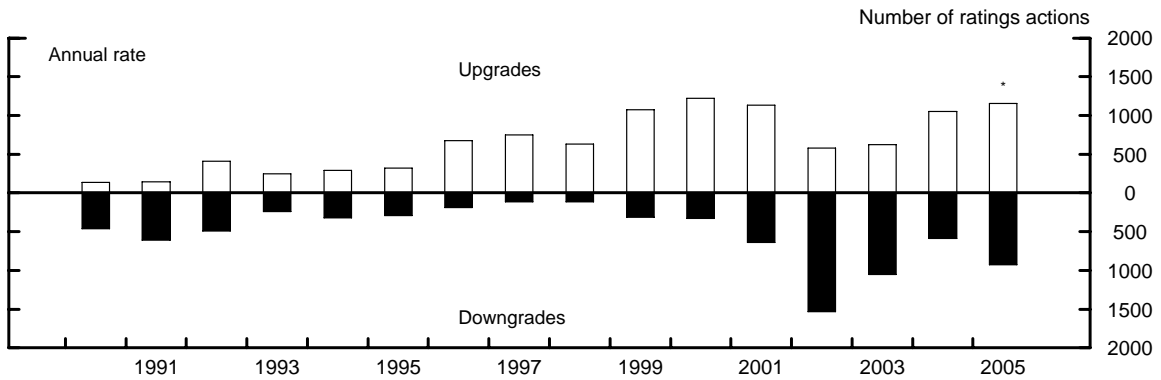
(Billions of dollars; monthly rate, not seasonally adjusted)

Type of security	2002	2003	2004	2005			
				H1	Q3	Oct.	Nov.
Total	36.3	37.9	34.7	38.2	38.4	30.1	44.8
Long-term <sup>1</sup>	30.3	32.0	29.8	35.1	33.0	27.7	37.5
Refundings <sup>2</sup>	10.1	10.0	10.8	17.0	15.3	9.7	10.4
New capital	20.2	22.1	19.0	18.0	17.7	18.0	27.1
Short-term	6.0	5.8	4.9	3.1	5.4	2.4	7.2
Memo: Long-term taxable	1.7	3.5	2.0	2.0	2.5	1.3	2.1

1. Includes issues for public and private purposes.

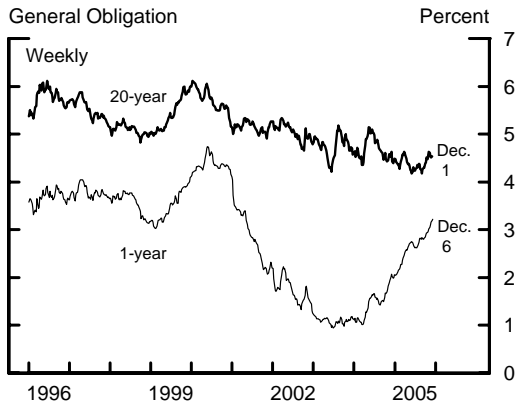
2. All issues that include any refunding bonds.

### Ratings Changes



\* Data through November 30 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.

consumer loans have remained low in recent months and do not point to deterioration in household credit quality.

The continued strength in house prices, coupled with gains in stock prices, led to an increase in household net worth relative to income in the third quarter. Net purchases of equity mutual funds were strong in November, as significant inflows to international funds continued and inflows to domestic funds rebounded amid the rally in U.S. equity markets. Net purchases of bond funds dipped in November.

### **Treasury and Agency Financing**

The Treasury's auction of ten-year notes during the intermeeting period was well received, but demand in other auctions was somewhat tepid. In the three- and five-year note auctions, indirect bidder participation—which includes purchases by foreign official institutions—was a bit below recent averages. In the ten-year auction, however, indirect bidders were awarded 56 percent of the amount sold, an unusually high proportion. The Treasury's mid-quarter refunding announcement noted that they continue to study the possibility of establishing a securities lending facility as a possible solution to resolve episodes of chronic failures to deliver in Treasury repo markets.

The share price of Freddie Mac ended the period about 4 percent higher, roughly in line with the average rise for other financial firms, but the share price of Fannie Mae was little changed, as investors remained concerned about its financial reporting practices. Agency debt spreads over comparable-maturity Treasuries were largely unchanged, on net, over the intermeeting period, tracking the behavior of other highly-rated corporate bonds.

### **State and Local Government Finance**

Gross issuance of long-term municipal bonds was strong in November, largely owing to a surge in new capital issuance that was fueled by education bond issues by entities in California and New York. The higher level of interest rates, however, continued to hold advance refunding activity well below the robust pace recorded in the first three quarters of the year. Issuance of short-term municipal bonds, boosted by a few large deals, also jumped in November.

The credit quality of municipal bonds has remained stable. Rating upgrades have slightly outpaced downgrades so far this year despite the recent downgrades of hurricane-affected issuers on the Gulf Coast and the downgrade of Detroit in response to the recent GM

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

Aggregate or component	2003	2004	2005				Level (\$ billions), Nov. (e)
			H1	Q3	Oct.	Nov. (e)	
<i>Aggregate</i>	Percent change (annual rate) <sup>1</sup>						
1. M2 <sup>2</sup>	5.5	5.2	2.8	3.9	7.2	4.2	6,650
2. M3 <sup>3</sup>	4.8	5.8	5.7	8.3	9.9	4.7	10,098
<i>Components of M2<sup>4</sup></i>							
3. Currency	5.9	5.5	3.2	3.4	1.3	4.4	719
4. Liquid deposits <sup>5</sup>	14.1	10.1	.8	1.5	5.9	1.6	4,244
5. Small time deposits	-9.3	-.4	18.6	19.6	11.0	12.0	960
6. Retail money market funds	-11.5	-11.9	-3.1	-1.4	15.6	8.4	720
<i>Components of M3</i>							
7. M3 minus M2 <sup>6</sup>	3.4	7.0	11.9	17.3	15.1	5.7	3,447
8. Large time deposits, net <sup>7</sup>	4.3	20.9	30.5	18.9	27.9	1.3	1,340
9. Institutional money market funds	-5.5	-5.6	-3.1	14.4	7.2	-6.2	1,120
10. RPs	12.5	-.1	-4.0	20.0	23.9	32.4	552
11. Eurodollars	29.3	27.3	23.9	16.7	-13.6	17.3	435
<i>Memo</i>							
12. Monetary base	5.9	5.6	3.2	2.9	3.1	5.0	783
	Average monthly change (billions of dollars) <sup>8</sup>						
<i>Selected managed liabilities at commercial banks</i>							
13. Large time deposits, gross	-1.5	14.9	22.2	13.1	23.5	-2.0	1,414
14. Net due to related foreign institutions	3.1	-10.8	3.6	10.7	22.1	-15.3	73
15. U.S. government deposits at commercial banks	-.3	.2	2.4	-4.3	-5.2	20.3	37

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	2004	Q1 2005	Q2 2005	Q3 2005	Oct. 2005	Nov. <sup>e</sup> 2005	Level (\$ billions), Nov. 2005 <sup>e</sup>
<b>Total</b>							
<b>1. Adjusted<sup>1</sup></b>	<b>8.9</b>	<b>14.6</b>	<b>10.2</b>	<b>8.8</b>	<b>2.7</b>	<b>5.8</b>	<b>7,145</b>
2. Reported	8.4	12.3	10.1	9.2	1.3	5.4	7,293
<i>Securities</i>							
3. Adjusted <sup>1</sup>	6.6	23.7	5.6	.0	.1	-2.5	1,854
4. Reported	5.2	14.9	5.4	1.9	-4.9	-3.3	2,002
5. Treasury and agency	4.8	20.2	-5.6	-6.0	-7.9	-17.5	1,140
6. Other <sup>2</sup>	5.8	6.7	22.7	13.4	-6	15.9	863
<i>Loans<sup>3</sup></i>							
7. Total	9.8	11.3	12.0	12.1	3.6	8.7	5,291
8. Business	1.3	16.8	13.8	12.2	9.2	12.9	1,009
9. Real estate	14.0	13.5	14.2	15.6	7.6	6.3	2,856
10. Home equity	43.9	18.6	14.1	11.7	-4.9	1.4	437
11. Other	9.8	12.6	14.3	16.3	10.0	7.4	2,420
12. Consumer	8.8	8.3	3.1	4.7	-18.5	5.2	694
13. Adjusted <sup>4</sup>	5.9	4.9	-2.7	4.3	-22.6	1.7	1,046
14. Other <sup>5</sup>	7.9	-1.3	9.7	5.6	2.0	15.8	732

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

1. Adjusted to remove effects of mark-to-market accounting rules (FIN 39 and FAS 115).

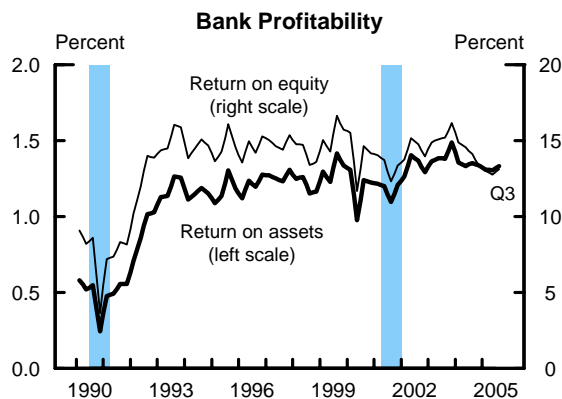
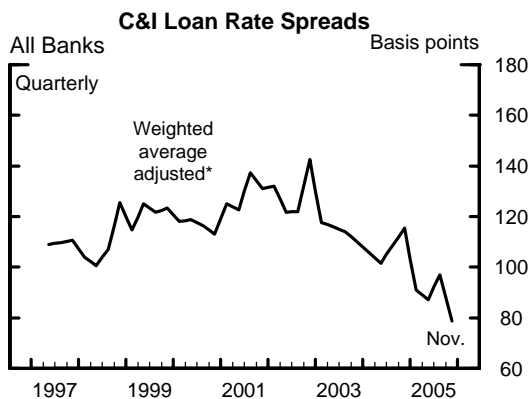
2. Includes private mortgage-backed securities, securities of corporations, state and local governments, foreign governments, and any trading account assets that are not Treasury or agency securities, including revaluation gains on derivative contracts.

3. Excludes interbank loans.

4. Includes an estimate of outstanding loans securitized by commercial banks.

5. Includes security loans and loans to farmers, state and local governments, and all others not elsewhere classified. Also includes lease financing receivables.

e Estimated.



\* Spread over estimated cost of funds adjusted for changes in nonprice loan characteristics.

Source. Survey of Terms of Business Lending.

layoff announcement. In addition, the ratio of yields on ten-year municipal bonds to comparable Treasuries narrowed a touch over the intermeeting period.

### **Money and Bank Credit**

M2 is now on track to grow at a 5¾ percent annual rate in the fourth quarter—close to the projected growth rate of nominal GDP—after apparently receiving a substantial boost from hurricane relief payments. After a robust October, M2 decelerated in November, as growth of both liquid deposits and retail money market funds slowed. The continued rise in the opportunity cost of holding M2 balances, along with waning mortgage prepayment effects and perhaps the increased relative attractiveness of equities, evidently outweighed a further boost to M2 from federal disaster relief payments.

Bank credit decelerated in October and November from its third-quarter pace, reflecting slower growth in both securities and total loans. Continued increases in the prime rate apparently began to restrain home equity lending in recent months, and other real estate lending also cooled a bit from the double-digit gains posted earlier in the year. Consumer loans decreased slightly in October even after adjusting for the acquisition of a large credit card bank by a thrift institution. As noted earlier, however, business lending continues to be strong. The spread of interest rates on newly originated business loans over comparable-maturity Eurodollar and swap rates fell in the most recent Survey of Terms of Business Lending (conducted during the week starting November 7), continuing the downward trend over the past several years.

Call Report data for the third quarter indicated that commercial bank profitability remained robust, in part because of a rise in non-interest income that outweighed the drag from higher loss provisioning. The increase in provisioning reportedly reflected in part an expected rise in consumer loan charge-offs as banks prepared for a surge in personal bankruptcies before the new rules went into effect in October.

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## **International Developments**

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## International Developments

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### U.S. International Transactions

#### Trade in Goods and Services

The U.S. international trade deficit widened to a record \$66.1 billion in September from \$59.3 billion in August (revised). The increase in the deficit reflected a surge in imports that was compounded by a fairly sizeable drop in exports.

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

	2004	Annual rate			Monthly rate		
		2005			2005		
		Q1	Q2	Q3	July	Aug.	Sept.
<i>Real NIPA<sup>1</sup></i>							
Net exports of G&S	-601.3	-645.4	-614.2	-621.3	...	...	...
<i>Nominal BOP</i>							
Net exports of G&S	-617.6	-692.2	-693.3	-733.7	-58.0	-59.3	-66.1
Goods, net	-665.4	-745.3	-747.7	-790.9	-62.5	-64.1	-71.1
Services, net	47.8	53.1	54.4	57.3	4.6	4.7	5.0

1. Billions of chained (2000) dollars.

Source. U.S. Department of Commerce, Bureaus of Economic Analysis and Census.

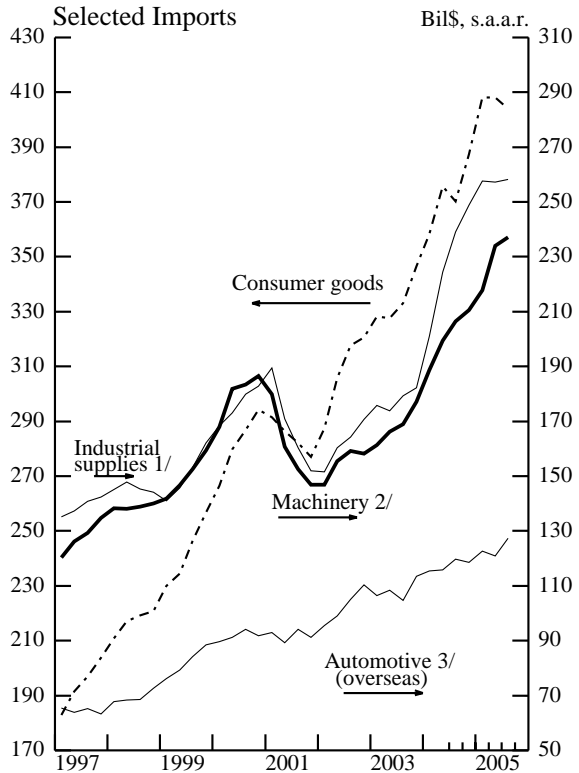
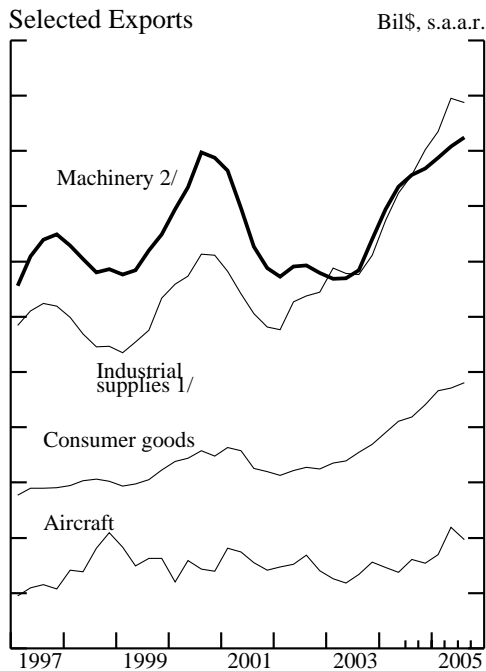
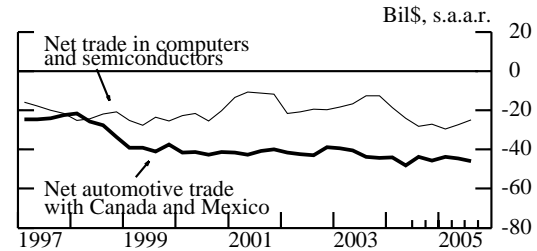
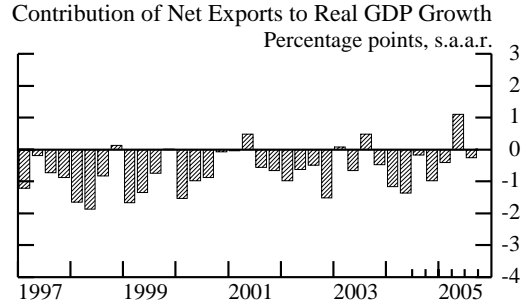
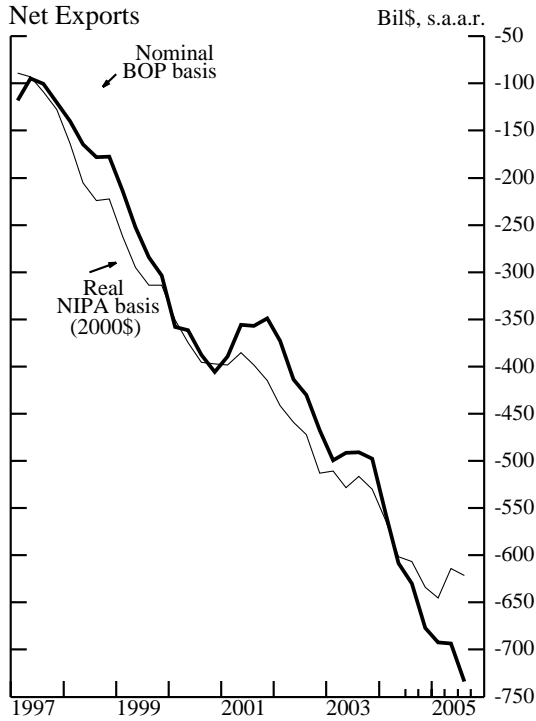
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In September, the value of exports of goods and services fell 2½ percent from a strong August level. The decline reflected a drop in merchandise exports, driven mainly by a steep falloff in aircraft exports owing to the strike at Boeing. Exports of industrial supplies and agricultural products declined as well, partly on account of hurricane-related disruptions to trade, whereas exports of consumer goods rose.

For the third quarter as a whole, nominal exports of goods and services rose a modest 2¾ percent at an annual rate, as higher exports in July and August offset September's decline. Exports of automotive products and capital goods (with the exception of aircraft) were particularly strong. In contrast, exports of aircraft, industrial supplies, and agricultural products declined. In real terms, exports of goods and services (on a NIPA basis) increased only ¾ percent in the third quarter.

The value of imported goods and services rose about 2½ percent in September, reflecting gains in most categories of merchandise imports and, to a lesser extent, services. Within goods, increases in imports of oil and of industrial supplies (especially natural gas) were particularly strong, reflecting higher prices. Imports of automotive products, on the other hand, fell from an elevated August level.

### U.S. International Trade in Goods and Services



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

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 <sup>1</sup>			
	2005		2005		2005		2005	
	Q2	Q3	Aug.	Sept.	Q2	Q3	Aug.	Sept.
<b>Exports of G&amp;S</b>	<b>1269.1</b>	<b>1278.2</b>	<b>1296.0</b>	<b>1262.5</b>	<b>43.4</b>	<b>9.1</b>	<b>19.7</b>	<b>-33.5</b>
Goods exports	894.2	900.7	920.4	881.0	38.8	6.6	19.7	-39.4
Gold	5.5	5.4	5.3	5.8	-0.0	-0.1	0.3	0.6
Other goods	888.7	895.4	915.2	875.2	38.8	6.7	19.4	-40.0
Aircraft & parts	63.7	59.4	72.6	42.1	9.9	-4.3	9.1	-30.6
Computers & accessories	45.8	46.7	46.5	47.2	1.8	0.9	0.2	0.7
Semiconductors	45.9	48.8	49.8	48.9	2.4	2.9	2.2	-1.0
Other capital goods	205.2	208.4	208.2	211.1	4.8	3.2	2.3	2.9
Automotive	93.9	98.7	100.0	100.1	-0.9	4.8	4.2	0.0
to Canada	51.4	53.5	54.5	54.9	-0.0	2.1	3.4	0.4
to Mexico	15.4	15.6	16.6	17.5	0.6	0.2	3.9	0.9
to ROW	27.1	29.5	28.9	27.6	-1.4	2.4	-3.1	-1.3
Agricultural	68.6	67.1	68.0	63.0	6.3	-1.5	-2.3	-4.9
Ind supplies (ex. ag, gold)	219.0	217.4	223.9	210.8	12.0	-1.6	6.4	-13.1
Consumer goods	114.1	116.0	114.4	119.1	0.9	1.9	-0.3	4.7
All other goods	32.5	33.0	31.8	32.9	1.6	0.5	0.0	1.1
Services exports	375.0	377.5	375.5	381.5	4.6	2.5	0.0	6.0
<b>Imports of G&amp;S</b>	<b>1962.4</b>	<b>2011.9</b>	<b>2008.1</b>	<b>2055.8</b>	<b>44.5</b>	<b>49.5</b>	<b>36.3</b>	<b>47.6</b>
Goods imports	1641.9	1691.7	1689.2	1734.5	41.2	49.8	37.9	45.3
Petroleum	229.6	269.6	273.6	285.6	17.9	40.0	23.9	12.0
Gold	4.0	4.4	4.1	5.4	0.2	0.4	0.4	1.4
Other goods	1408.3	1417.6	1411.5	1443.5	23.1	9.4	13.7	31.9
Aircraft & parts	28.2	24.4	21.5	26.2	2.6	-3.8	-4.0	4.7
Computers & accessories	93.7	94.2	94.2	92.9	1.6	0.5	-1.1	-1.3
Semiconductors	25.3	26.1	25.3	25.9	0.4	0.7	-1.7	0.6
Other capital goods	236.3	239.5	242.5	242.0	16.0	3.2	8.5	-0.5
Automotive	232.3	242.5	250.2	241.4	-0.4	10.2	14.1	-8.7
from Canada	65.7	72.2	73.0	75.8	-3.6	6.4	5.2	2.8
from Mexico	45.6	43.0	46.4	48.9	5.0	-2.6	12.8	2.5
from ROW	121.0	127.4	130.8	116.7	-1.7	6.4	-3.8	-14.1
Ind supplies (ex. oil, gold)	257.2	258.2	251.8	271.2	-0.5	1.0	0.3	19.4
Consumer goods	408.1	403.9	399.6	410.0	-0.0	-4.2	-2.6	10.5
Foods, feeds, bev.	67.3	69.2	68.8	71.6	1.0	2.0	1.6	2.8
All other goods	59.7	59.6	57.7	62.1	2.4	-0.1	-1.4	4.5
Services imports	320.6	320.2	318.9	321.2	3.3	-0.3	-1.6	2.3
<i>Memo:</i>								
Oil quantity (mb/d)	13.57	13.37	13.63	13.00	-0.98	-0.19	0.15	-0.63
Oil import price (\$/bbl)	46.28	55.22	54.95	60.14	6.39	8.93	4.23	5.19

1. Change from previous quarter or month.

Source. U.S. Department of Commerce, Bureaus of Economic Analysis and Census.

For the third quarter, nominal imports of goods and services expanded 10¼ percent at an annual rate. Most of this rise reflected higher prices, with the 90 percent increase in nominal oil imports being particularly notable. Imports of non-oil goods rose about 2¾ percent. Gains were widespread, with the exception of consumer goods. In real terms, imports of goods and services (on a NIPA basis) rose only about 2 percent at an annual rate in the third quarter.

### **Prices of Internationally Traded Goods**

**Non-oil imports.** In October, BLS prices of U.S. imports of non-oil goods increased 0.8 percent, and prices of imports of core goods increased 0.9 percent. A large increase in the price of imported natural gas contributed to both increases. Core goods prices excluding natural gas rose 0.3 percent, as higher prices for material-intensive goods were partially offset by slightly lower prices for finished goods. Prices of imported non-oil industrial supplies, including natural gas, increased 4.4 percent in October, following an identical increase in September. Natural gas prices led the increase, with chemicals and metals also contributing to the gain. Imported food prices increased 1.1 percent in October, while the remaining categories of core imports recorded flat or declining prices. Imported computer and semiconductor prices both fell sharply, declining 0.7 and 0.8 percent respectively.

**Oil.** The BLS price index of imported oil fell 4.4 percent in October, reflecting declines in the prices of imported crude oil and refined petroleum products from their hurricane-induced highs the previous month. The average spot price of West Texas Intermediate (WTI) crude oil fell nearly 5 percent in October to about \$62.40 per barrel. The spot price continued its decline in November, averaging \$58.30 per barrel. The decline in the spot price over the past few months reflects in part the release of strategic stocks in response to the hurricanes and, until recently, warmer-than-normal temperatures, which reduced oil demand and allowed inventories to build. Recently, the spot price has edged up, closing on December 6 at \$59.95 per barrel, little changed from the time of the November FOMC meeting.

**Exports.** In October, the prices of U.S. exports of total goods increased 0.6 percent, and the price of core exports increased 0.7 percent. The increase in export prices was led by a 1.7 percent increase in prices of exported non-agricultural industrial supplies, with the largest contribution coming from chemicals. However, all other major categories of core exports also posted increases. Prices of both exported capital goods and consumer goods increased 0.3 percent, while prices of automotive products and agricultural products both

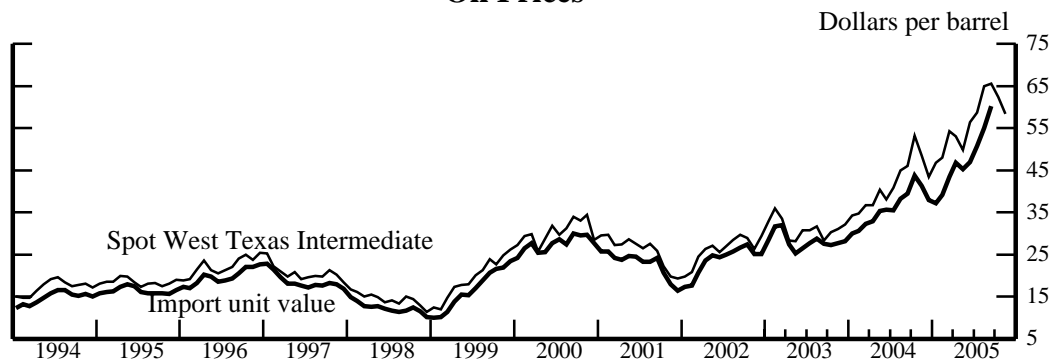
**Prices of U.S. Imports and Exports**  
(Percentage change from previous period)

	Annual rate			Monthly rate		
	2005			2005		
	Q1	Q2	Q3	Aug.	Sept.	Oct.
	----- BLS prices -----					
<b>Merchandise imports</b>	3.3	10.5	14.7	1.4	2.3	-0.3
Oil	-1.6	69.7	115.0	7.5	8.0	-4.4
Non-oil	4.2	1.7	0.0	0.1	1.0	0.8
Core goods*	5.1	2.1	0.8	0.1	1.1	0.9
Cap. goods ex comp & semi	5.3	2.0	-0.7	-0.1	0.2	-0.1
Automotive products	0.4	0.5	0.6	0.1	0.1	0.0
Consumer goods	4.7	0.0	-0.8	-0.2	0.3	-0.1
Foods, feeds, beverages	9.2	7.3	-3.2	0.5	0.1	1.1
Industrial supplies ex oil	8.5	6.8	5.4	0.3	4.4	4.4
Computers	-6.6	-4.9	-10.2	-0.1	-0.4	-0.7
Semiconductors	-1.1	-2.0	-4.9	0.2	-0.8	-0.8
<b>Merchandise exports</b>	4.9	3.3	1.0	-0.1	0.8	0.6
Core goods*	6.0	4.3	2.5	0.1	1.0	0.7
Cap. goods ex comp & semi	3.9	1.5	0.6	0.0	0.3	0.3
Automotive products	1.4	0.8	0.8	0.1	0.0	0.2
Consumer goods	2.4	0.3	-0.4	0.0	0.3	0.3
Agricultural products	3.6	18.7	2.0	-0.6	-1.3	0.2
Industrial supplies ex ag	12.9	6.5	6.3	0.2	3.4	1.7
Computers	-7.8	-7.4	-8.4	0.1	-0.5	-1.1
Semiconductors	-1.4	-3.3	-12.7	-3.2	-0.4	0.1
	----- NIPA prices -----					
<b>Chain price index</b>	2.9	8.2	9.3	...	...	...
Imports of goods & services	3.7	1.6	0.0	...	...	...
Non-oil merchandise	4.6	2.2	0.9	...	...	...
Core goods*	4.6	3.7	3.0	...	...	...
Exports of goods & services	4.5	2.9	1.5	...	...	...
Total merchandise	6.1	3.8	2.0	...	...	...
Core goods*						

\*/ Excludes computers and semiconductors.

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

**Oil Prices**



increased 0.2 percent. In October, prices of exported computers fell 1.1 percent, and prices of exported semiconductors increased 0.1 percent.

### **U.S. International Financial Transactions**

In October, foreign official flows into the United States (line 1 of the Summary of U.S. International Transactions table) totaled \$31 billion, compared with outflows of \$5 billion in September. September's outflows were unusual and reflected both a significant slowing of inflows from China and net official sales of U.S. assets by the G-10 countries and the ECB (line 1a). In October, however, flows from the G-10 countries and the ECB turned positive, and those from OPEC (line 1b) moved up significantly.

. For the third quarter, total foreign official inflows were \$37 billion, below the unusually large inflows recorded for the second quarter. However, the pace of inflows from July to October was similar to that during the first half of the year.

It should be noted that these monthly transactions data may attribute some foreign official flows to the foreign private sector if the official investments are made via foreign private intermediaries. Thus, the official inflows reported above are likely to be understated, and the foreign private inflows reported below in line 4 are likely to be overstated.

As recorded, net foreign private purchases of U.S. securities (line 4) slowed in October to \$78 billion as foreign purchases of corporate-debt securities (line 4c) dropped from their rapid pace in September. Foreign purchases of other debt securities picked up, whereas purchases of equities cooled. For the first ten months of the year, total net foreign private acquisitions of U.S. securities amounted to \$574 billion, surpassing the value recorded for 2004 as a whole.

U.S. residents purchased \$5 billion of foreign securities (line 5) in October, a significant slowing from the pace in September. Net sales of foreign bonds (line 5a) partly offset net purchases of foreign equities (line 5b). U.S. residents continued to show a marked preference for Japanese equities in October, increasing their holdings of those securities by \$4 billion. For the third quarter, total purchases of foreign securities amounted to \$34 billion, somewhat lower than in the second quarter.

The volatile banking sector (line 3) registered a substantial inflow in October of \$34 billion, exceeding the inflows recorded for September. For the third quarter, total net inflows were \$20 billion, compared to net outflows of \$45 billion for the second quarter.

**Summary of U.S. International Transactions**  
(Billions of dollars, not seasonally adjusted except as noted)

	2003	2004	2004	2005				
			Q4	Q1	Q2	Q3	Sep	Oct
<b>Official financial flows</b>	<b>269.0</b>	<b>398.1</b>	<b>94.9</b>	<b>31.3</b>	<b>81.0</b>	<b>42.0</b>	<b>-5.4</b>	<b>31.6</b>
1. Change in foreign official assets in the U.S. (increase, +)	267.5	395.3	94.2	25.9	81.8	37.3	-5.4	31.2
a. G-10 countries + ECB	111.4	161.7	-3.1	5.5	-18.2	-5.5	-10.1	3.6
b. OPEC	5.9	12.1	6.8	-3.9	4.4	-4.1	-6	8.8
c. All other countries	150.2	221.5	90.4	24.3	95.6	46.8	5.4	18.9
2. Change in U.S. official reserve assets (decrease, +)	1.5	2.8	.7	5.3	-8	4.8	-0	.4
<b>Private financial flows</b>	<b>291.7</b>	<b>186.5</b>	<b>74.1</b>	<b>130.7</b>	<b>61.3</b>	<b>n.a.</b>	<b>...</b>	<b>...</b>
<b>Banks</b>								
3. Change in net foreign positions of banking offices in the U.S. <sup>1</sup>	64.7	-20.4	-2.6	-2.9	-44.9	19.5	26.7	33.8
<b>Securities <sup>2</sup></b>								
4. Foreign net purchases of U.S. securities (+)	336.0	505.9	170.9	152.2	125.9	218.3	98.6	77.7
a. Treasury securities	113.3	122.5	10.9	76.0	10.6	41.3	15.1	18.4
b. Agency bonds	-38.3	66.0	43.2	.8	20.6	39.3	14.4	19.4
c. Corporate and municipal bonds	223.8	255.0	71.1	54.9	80.2	98.8	45.4	27.9
d. Corporate stocks <sup>3</sup>	37.2	62.4	45.8	20.5	14.5	38.9	23.7	12.0
5. U.S. net acquisitions (-) of foreign securities	-146.6	-146.2	-29.6	-46.9	-42.0	-34.3	-18.2	-5.2
a. Bonds	-28.0	-60.9	-19.9	-6.5	-17.8	.6	-10.1	1.7
b. Stock purchases	-101.2	-97.6	-35.2	-38.3	-22.3	-34.9	-8.1	-6.9
c. Stock swaps <sup>3</sup>	-17.4	12.2	25.5	-2.1	-1.9	.0	.0	.0
<b>Other flows (quarterly data, s.a.)</b>								
6. U.S. direct investment (-) abroad	-140.6	-252.0	-100.0	-27.0	-33.6	n.a.	...	...
7. Foreign direct investment in the U.S.	67.1	106.8	31.6	35.1	17.6	n.a.	...	...
8. Foreign holdings of U.S. currency	16.6	14.8	5.3	1.1	4.5	n.a.	...	...
9. Other (inflow, +) <sup>4</sup>	94.3	-22.5	-1.6	19.2	33.8	n.a.	...	...
<b>U.S. current account balance (s.a.)</b>	<b>-519.7</b>	<b>-668.1</b>	<b>-188.4</b>	<b>-198.7</b>	<b>-195.7</b>	<b>n.a.</b>	<b>...</b>	<b>...</b>
<b>Capital account balance (s.a.) <sup>5</sup></b>	<b>-3.2</b>	<b>-1.6</b>	<b>-.5</b>	<b>-4.5</b>	<b>-.3</b>	<b>n.a.</b>	<b>...</b>	<b>...</b>
<b>Statistical discrepancy (s.a.)</b>	<b>-37.8</b>	<b>85.1</b>	<b>19.9</b>	<b>41.2</b>	<b>53.6</b>	<b>n.a.</b>	<b>...</b>	<b>...</b>

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.

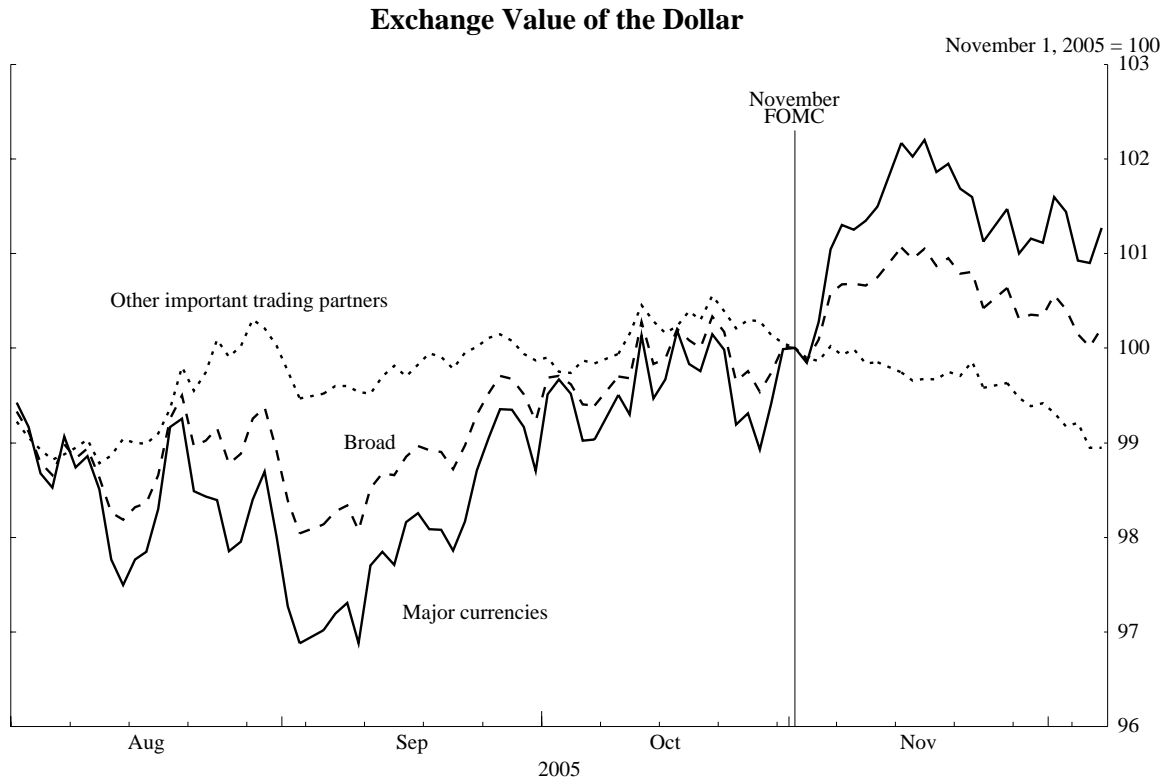
4. Transactions by nonbanking concerns and other banking and official transactions not shown elsewhere plus amounts resulting from adjustments made by the Department of Commerce and revisions in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.

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 1¼ percent on net over the intermeeting period, as the dollar appreciated against most major currencies. On a bilateral basis, the dollar appreciated 2¼ percent versus the euro, 1¾ percent against sterling, and 3½ percent vis-à-vis the yen. In contrast, the dollar depreciated 1½ percent vis-à-vis the Canadian dollar.



The dollar appreciated against the euro over the intermeeting period despite a tightening move by the European Central Bank which had not been widely expected as of early November. European Central Bank President Trichet strongly signaled in mid-November that an increase in the ECB's minimum refinancing rate would come sooner than had been expected and, on December 1, the ECB raised its minimum refinancing rate 25 basis points, to 2.25 percent, its first move since June 2003. Social unrest in France appeared to weigh on the euro early in the period; some market analysts also speculated that the euro's weakness versus the dollar may be due in part to the repatriation of funds from Europe to the United States spurred by the Homeland Investment Act. The dollar appreciated versus the yen to its highest level since early 2003, as investors scaled back expectations that the Bank of Japan would end its policy of quantitative easing in the next



few months. Japanese government officials publicly pressured the Bank of Japan to delay a change in its monetary policy stance, going as far as threatening to change the law governing the Bank of Japan's independence. The Canadian dollar was supported by growing expectations over the period that the Bank of Canada may extend its current tightening cycle for a longer period than had previously been expected. This was spurred by strong Canadian output, export, and inflation data. The Bank of Canada increased its main policy interest rate 25 basis points, to 3.25 percent, on December 6, and signaled that further tightening moves were likely.

### Financial Indicators in Major Industrial Countries

Country	Three-month rate		Ten-year yield		Equities
	Dec.6/7 (Percent)	Percentage point change	Dec.6/7 (Percent)	Percentage point change	percent change
Canada	3.42	.27	4.08	-.09	7.15
Japan	.08	.00	1.54	-.03	8.52
Euro area	2.45	.19	3.39	-.03	6.25
United Kingdom	4.56	.03	4.28	-.06	4.60
Switzerland	1.02	.16	2.11	-.01	6.81
Australia	5.63	-.03	5.43	-.03	3.42
United States	4.42	.20	4.49	-.08	5.13
Memo: Weighted-average foreign	2.28	.15	n.a.	-.06	n.a.

NOTE. Change is from October 31/November 1 to December 6/7.  
n.a. Not available.

Three-month interest rates rose about 25 basis points on balance over the period in Canada and about 20 basis points in the euro area and the United States; they were little changed in the United Kingdom and Japan. Ten-year sovereign yields were little changed on balance in the euro area and Japan; they declined about 5 basis points in the United Kingdom and about 10 basis points in Canada and the United States. The inflation compensation implied by the difference between long-term nominal yields and yields on inflation-indexed notes declined about 5 basis points in the euro area, Japan and the United Kingdom. Equity indexes rose substantially throughout the industrial world over the period, with net increases of 6 percent or more in the euro area and Canada. In

Japan, the Topix index rose 8½ percent and the Nikkei index rose nearly 12 percent, to its highest level in five years, amid continuing reports of large purchases of Japanese equities by foreign investors, better-than-expected economic data, and improving earnings expectations.

### Financial Indicators in Latin America, Asia, and Russia

Economy	Currency/ US dollar		Short-term interest rates <sup>1</sup>		Dollar-denominated bond spread <sup>2</sup>		Equity prices
	Dec. 7	Percent change	Dec.6/7 (Percent)	Percentage point change	Dec.6/7 (Percent)	Percentage point change	Percent change
Mexico	10.42	-3.28	8.40	-.42	1.24	-.08	10.56
Brazil	2.17	-3.71	18.79	-.84	3.16	-.41	9.29
Argentina	2.99	-.15	7.88	1.44	4.73	1.02	-2.93
Chile	509.55	-6.38	4.91	.25	.75	.01	-3.78
China	8.08	-.12	n.a.	n.a.	.68	.09	.89
Korea	1035.60	-.65	3.60	.02	...	...	11.42
Taiwan	33.48	-.29	1.57	-.02	...	...	9.16
Singapore	1.69	-.52	3.09	.59	...	...	3.44
Hong Kong	7.75	.03	4.15	-.06	...	...	3.86
Malaysia	3.78	.07	3.12	.23	.82	.02	-2.10
Thailand	41.29	1.18	4.05	.05	.46	-.02	.23
Indonesia	9830.00	-1.80	13.25	-1.03	2.63	-.42	8.11
Philippines	53.84	-1.93	7.44	-.13	3.21	-.39	7.31
Russia	28.98	1.35	n.a.	n.a.	1.11	-.01	16.02

NOTE. Change is from October 31/November 1 to December 6/7.

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. Spreads over similar maturity U.S. Treasuries. Mexico, Brazil, Argentina, Chile, Korea, China, Malaysia, Thailand, Indonesia, the Philippines and Russia: EMBI+/EMBI Global.

Taiwan, Singapore, and Hong Kong do not have outstanding sovereign bonds denominated in dollars.

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

Equity prices also rose substantially in a number of emerging market economies over the period. Headline indexes registered increases of about 10 percent in Mexico, Brazil, Taiwan, and Korea. There were only small movements in the exchange rates of the currencies of emerging Asian countries versus the dollar, implying an appreciation of these currencies against the Japanese yen. In contrast, the Mexican peso and the Brazilian *real* appreciated about 3-1/2 percent versus the dollar. The Mexican peso appeared to have been boosted by growing optimism about the country's economic

performance. The Argentine peso was little changed against the dollar, and the Merval stock index declined 3 percent. Argentine Finance Minister Lavagna, widely credited with the recent recovery in Argentina's economy, resigned his post in late November, reportedly following a dispute with Argentina's president over the conduct of economic policy.

The dollar price of gold rose 11 percent over the period, exceeding \$500 per ounce for the first time since 1983. Although the factors driving this price increase were unclear, market analysts generally did not interpret this move as a harbinger of future inflationary pressure.

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

## Developments in Foreign Industrial Countries

Growth in the foreign industrial countries was surprisingly strong in the third quarter, and indicators for the fourth quarter are promising, on balance. The growth rate in the euro area picked up as investment and exports strengthened, and some surveys of business activity improved further in the fourth quarter. Although growth moderated in Japan and the United Kingdom, investment expanded briskly, and consumption growth in both countries stayed firm. Canadian GDP accelerated in the third quarter, boosted by net exports and still solid growth in domestic demand. Employment growth in Canada remained robust in the first two months of this quarter.

Headline rates of consumer price inflation fell back a touch in October in most of the major foreign economies in line with the declines in energy prices. Central banks in Canada and the euro area tightened monetary policy.

Real GDP in **Japan** rose 1.7 percent (s.a.a.r.) during the third quarter, marking the fourth consecutive quarter of positive growth. Although domestic demand decelerated from its pace in the first half of the year, it continued to be the country's primary source of growth. Both private consumption and gross fixed private investment expanded at a moderate pace. Inventories also rose for the quarter, leading to a further rise in inventory/sales ratios. Imports posted a surprisingly strong increase, which resulted in a slight decline in net exports.

October data have been generally positive. Industrial production rose 0.6 percent on the month, lower than had been expected, but shipments rose 1.7 percent. Real worker household spending rose 1.2 percent, rebounding from a decline in the third quarter. Real exports rose slightly while real imports fell, leaving the real trade surplus up 9.5 percent from the previous month. The unemployment rate jumped back up to 4.5 percent after falling to 4.2 percent in September; however, the decline in employment was almost entirely amongst those reporting themselves as self-employed or as family workers, while regular employment was fairly stable. Despite the rise in the unemployment rate, the job offers-to-applicants ratio rose to a new twelve-year high. Nominal wages rose 0.5 percent over the twelve months ending in October, and summer bonuses rose 1.3 percent from the previous year following an already strong round of bonuses at the start of the year.

**Japanese Real GDP**

(Percent change from previous period, except as noted, s.a.a.r.)

Component	2003 <sup>1</sup>	2004 <sup>1</sup>	2004: Q4	2005		
				Q1	Q2	Q3
<b>GDP</b>	<b>2.2</b>	<b>.9</b>	<b>.4</b>	<b>6.3</b>	<b>3.3</b>	<b>1.7</b>
Total domestic demand	1.3	.6	.7	6.6	2.8	2.1
Consumption	1.0	.3	-1.1	5.0	2.7	1.4
Private investment	8.9	1.1	1.1	9.3	10.1	3.5
Public investment	-12.5	-12.0	-1.3	-1.2	-7.4	4.1
Government consumption	.9	3.1	2.6	2.8	1.3	1.2
Inventories <sup>2</sup>	-.3	.4	.7	1.3	-.6	.2
Exports	10.6	10.8	6.6	-.0	13.0	11.4
Imports	2.8	10.4	10.3	.3	9.4	16.7
Net exports <sup>2</sup>	.9	.3	-.2	-.0	.7	-.2

1. Q4/Q4.

2. Percentage point contribution to GDP growth, s.a.a.r.

**Japanese Economic Indicators**

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

Indicator	2005						
	Q1	Q2	Q3	Aug.	Sept.	Oct.	Nov.
Industrial production <sup>1</sup>	1.8	-.4	-.2	1.1	.4	.6	n.a.
All-industries index	1.3	.3	.2	1.2	-.4	n.a.	n.a.
Housing starts	3.3	-2.1	8.0	-4.8	-2.1	3.8	n.a.
Machinery orders <sup>2</sup>	.8	.8	2.1	8.2	-10.0	n.a.	n.a.
Machinery shipments <sup>3</sup>	-.4	2.4	1.2	3.6	-1.6	2.9	n.a.
New car registrations	-2.7	1.6	-2.9	1.3	2.1	-6.1	1.2
Unemployment rate <sup>4</sup>	4.6	4.3	4.3	4.3	4.2	4.5	n.a.
Job offers ratio <sup>5</sup>	.91	.95	.97	.97	.97	.98	n.a.
Business sentiment <sup>6</sup>	-2.0	1.0	2.0	...	...	...	...
CPI (core, Tokyo area) <sup>7</sup>	-.5	-.4	-.4	-.3	-.4	-.3	-.3
Wholesale prices <sup>7</sup>	1.3	1.7	1.6	1.7	1.7	1.9	n.a.

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.

Consumer prices declined 0.7 percent in the twelve months ending in October, though core consumer prices, which exclude fresh food but include energy, were unchanged over the same period and their twelve-month rate is expected to turn positive by the end of the year. Tokyo core consumer prices, which are reported one month in advance of the figures for the country as a whole, fell 0.3 percent in the year to November. In the third quarter, the GDP deflator fell 1.1 percent below its level a year earlier. Monetary policy was unchanged. Long-term interest rates fell following statements by the Prime Minister and other government officials that strongly questioned the Bank of Japan's apparent intention to end its policy of quantitative easing in the first half of 2006. However, we do not see any sign that Bank officials have given ground on this issue, although they have emphasized that they may hold the policy rate at zero for some time after ending quantitative easing.

### Euro-Area Real GDP

(Percent change from previous period, except as noted, s.a.a.r.)

Component	2003 <sup>1</sup>	2004 <sup>1</sup>	2004: Q4	2005		
				Q1	Q2	Q3
<b>GDP</b>	<b>1.0</b>	<b>1.6</b>	<b>.8</b>	<b>1.3</b>	<b>1.6</b>	<b>2.6</b>
Total domestic demand	1.5	2.0	2.4	.3	2.1	1.4
Consumption	.9	1.8	3.4	.6	.9	1.2
Investment	1.0	1.6	2.4	.5	3.2	6.6
Government consumption	1.6	.7	-4	1.1	2.2	2.6
Inventories <sup>2</sup>	.5	.5	.0	-4	.5	-1.2
Exports	1.5	5.9	1.3	-3.3	9.1	14.5
Imports	2.9	7.1	5.5	-5.9	10.7	11.7
Net exports <sup>2</sup>	-5	-4	-1.6	1.0	-5	1.2
Memo:						
<i>GDP of selected countries</i>						
France	1.4	2.0	2.7	1.3	.4	2.7
Germany	.2	.5	-3	2.4	.9	2.5
Italy	.1	.8	-1.6	-2.1	2.6	1.2

1. Q4/Q4.

2. Percentage point contribution to GDP growth, s.a.a.r.

In the **euro area**, GDP growth rebounded to a 2.6 percent annual rate in the third quarter, supported by strength in investment and exports. GDP grew at about the euro-area average rate in Germany and France following weak second-quarter performance, but growth slowed in the third quarter in Italy and the Netherlands.

Recent survey data generally indicate that business activity in the euro area entered the fourth quarter on an upswing. The manufacturing PMI rose from 51.7 in September to 52.7 in October, the highest level in a year, and edged slightly higher in November. The services PMI made smaller gains edging up to 55.2 in November from 54.6 in September. The European Commission survey of business sentiment also improved (for the fifth month in a row) in October and held that gain in November. Hard data on business activity have been mixed, with euro-area industrial production declining 0.4 percent (not annualized) in September but rising a solid 0.8 percent for the third quarter as a whole.

### Euro-Area Economic Indicators

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

Indicator	2005						
	Q1	Q2	Q3	Aug.	Sep.	Oct.	Nov.
Industrial production <sup>1</sup>	-.1	.7	.8	.8	-.4	n.a.	n.a.
Retail sales volume <sup>2</sup>	.7	-.3	.1	1.0	-.9	.5	n.a.
Unemployment rate <sup>3</sup>	8.8	8.6	8.4	8.4	8.3	8.3	n.a.
Consumer confidence <sup>4</sup>	-13.3	-14.3	-14.7	-15.0	-14.0	-13.0	-13.0
Industrial confidence <sup>4</sup>	-6.7	-10.3	-7.7	-8.0	-7.0	-6.0	-6.0
Manufacturing orders, Germany	-.2	.9	4.6	-3.4	2.9	2.0	n.a.
CPI <sup>5</sup>	2.0	2.0	2.3	2.2	2.6	2.5	2.4
Producer prices <sup>5</sup>	4.1	3.9	4.1	4.0	4.4	4.1	n.a.
M3 <sup>5</sup>	6.5	7.6	8.4	8.2	8.4	8.0	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.

Consumer spending continued to be a relative weak component of demand in the euro area in the third quarter, especially in Germany, where private consumption declined again. However, a recent upturn in euro-area consumer sentiment may be a sign that improved prospects for employment and income could lead to a rebound in consumer spending. The European Commission's measure of consumer sentiment picked up in September and October from weak readings over the summer (and held those gains in November), with the improvement coming mainly in consumers' perceptions of employment prospects. In contrast, French consumer confidence declined in November. The euro-area unemployment rate ticked down to 8.3 percent in September and remained there in October. The rate is down from the cyclical peak of 8.9 percent late last year, but is still above the 7.8 percent low reached in mid-2001.

Twelve-month consumer price inflation edged down to 2.4 percent in November from a high of 2.6 percent in September. Core inflation, excluding energy and unprocessed food, picked up to 1.6 percent in October but remained near recent lows.

On December 1, the ECB's Governing Council raised its official interest rates 25 basis points, moving its key policy rate up to 2.25 percent after keeping it unchanged for nearly 2½ years. The rate hike had been widely expected after President Trichet had indicated in a speech on November 18 that the Governing Council was ready to move rates higher. At the press conference following the December 1 meeting, Trichet said that "we [the Governing Council] are not engaging ex ante in a series of interest rate increases and ... we will continue to monitor closely all developments with respect to risks to price stability." Also following the December meeting, the ECB unveiled its new staff forecasts, which showed a somewhat higher path than the previous forecast for GDP growth and inflation this year and next. The mid-point of the ECB's forecast for inflation is just above 2 percent in 2006 and just below in 2007.

### U.K. Real GDP

(Percent change from previous period, except as noted, s.a.a.r.)

Component	2003 <sup>1</sup>	2004 <sup>1</sup>	2004: Q4	2005		
				Q1	Q2	Q3
<b>GDP</b>	<b>3.1</b>	<b>2.5</b>	<b>1.9</b>	<b>1.0</b>	<b>2.0</b>	<b>1.6</b>
Total domestic demand	3.2	2.9	2.8	.8	-.3	3.3
Consumption	2.4	3.9	2.5	.6	1.4	1.9
Investment	-.8	4.1	3.0	-.2	3.9	4.3
Government consumption	6.1	.5	1.0	2.2	2.0	1.2
Inventories <sup>2</sup>	.6	-.4	.3	.4	-2.6	1.6
Exports	3.7	5.6	4.6	-2.7	18.6	3.0
Imports	4.0	6.8	7.4	-3.0	7.8	8.7
Net exports <sup>2</sup>	-.2	-.5	-1.0	.2	2.3	-1.8

1. Q4/Q4.

2. Percentage point contribution to GDP growth, s.a.a.r.

GDP for the **United Kingdom** rose 1.6 percent in the third quarter, up slightly from the preliminary estimate. Private consumption grew more than had been expected. Fixed investment growth was also robust. Net exports subtracted 1.8 percentage points from growth.



After rising steadily since June, the PMI for manufacturing crossed the 50 threshold in the third quarter and remains at 51 in November, though industrial production declined in October. The PMI for services has remained just above 55 through all of 2005 and continued to do so in November. Retail sales grew 1.5 percent in the twelve months ending in October. After rising sharply over the second and third quarters, the PMI for construction activity fell from its year-to-date high in September of 57 to 54 in October and November.

### U.K. Economic Indicators

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

Indicator	2005						
	Q1	Q2	Q3	Aug.	Sept.	Oct.	Nov.
Industrial production	-1.0	.0	-.6	-.9	.5	-1.0	n.a.
Retail sales volume <sup>1</sup>	-.1	.6	.5	.2	.6	.2	n.a.
Unemployment rate <sup>2</sup>							
Claims-based	2.6	2.7	2.8	2.8	2.8	2.8	n.a.
Labor force survey <sup>3</sup>	4.7	4.7	n.a.	4.7	n.a.	n.a.	n.a.
Business confidence <sup>4</sup>	12.7	-.3	5.0	3.0	6.0	2.0	-4.0
Consumer confidence <sup>5</sup>	1.0	-2.0	-2.0	-2.0	-3.0	-4.0	-4.0
Consumer prices <sup>6</sup>	1.7	1.9	2.4	2.4	2.5	2.3	n.a.
Producer input prices <sup>7</sup>	10.5	9.8	12.5	13.0	10.2	7.7	n.a.
Average earnings <sup>7</sup>	4.5	4.1	4.0	4.0	3.7	n.a.	n.a.

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.

House prices have been rising in recent months, after staying roughly unchanged for much of the previous year. In November, the Nationwide and Halifax indexes of house prices rose 2.3 and 5.9 percent on a twelve-month basis, respectively. Lending secured on dwellings rose 0.8 percent in October, a tad higher than in September. Mortgage refinancing fell, suggesting that much of the October lending was associated with new lending.

The twelve-month rate of consumer price inflation fell from 2.5 percent in September to 2.3 percent in October, both above the Bank of England's 2 percent target. The twelve-month rate of inflation excluding energy remained stable at 1.7 percent in October.

Chancellor of the Exchequer Gordon Brown presented the government's Pre-Budget Report on December 5. Brown raised his projection for Public Sector Net Borrowing to about 3 percent of GDP for fiscal year 2005-06 and to about 2.7 percent of GDP for fiscal year 2006-07.

In the third quarter, real GDP in **Canada** expanded 3.6 percent in the third quarter, with strong domestic demand helped by a rebound in exports. After a small decline in exports in the second quarter, third-quarter export growth topped 10 percent, led by exports of automobiles, energy products, and agricultural products. Output of the mining, oil, and gas extraction sector was up strongly as well, and overall industrial production posted a solid advance. Business investment growth continued its recent steady climb, reaching its fastest pace in nearly two years, but output in the residential construction sector declined. Consumer spending, which propped up growth over the past year, continued to decelerate, led by a second straight quarter of declining spending in the household furnishings sector.

### Canadian Real GDP

(Percent change from previous period, except as noted, s.a.a.r.)

Component	2003 <sup>1</sup>	2004 <sup>1</sup>	2004: Q4	2005		
				Q1	Q2	Q3
<b>GDP</b>	<b>1.7</b>	<b>3.3</b>	<b>2.1</b>	<b>2.0</b>	<b>3.4</b>	<b>3.6</b>
Total domestic demand	3.9	5.1	6.2	3.2	2.7	3.6
Consumption	2.7	3.9	3.8	6.4	3.2	2.4
Investment	8.5	5.4	7.5	7.3	4.9	7.7
Government consumption	2.7	2.5	2.1	1.8	5.1	4.4
Inventories <sup>2</sup>	.0	1.2	1.9	-2.3	-1.1	-.4
Exports	.1	3.0	-3.1	5.4	-1.0	10.4
Imports	5.7	8.3	8.3	9.2	-1.9	9.2
Net exports <sup>2</sup>	-2.1	-1.9	-4.5	-1.4	.4	.5

1. Q4/Q4.

2. Percentage point contribution to GDP growth, s.a.a.r.

On balance, early indicators for the fourth quarter suggest that activity continues to be firm. The composite index of leading indicators advanced in October, with indicators of retail trade activity among the sources of strength. Housing starts declined in October,

but still remain elevated. The Ivey Purchasing Managers Index picked up a bit in November.

The solid job gains of the past year have continued in the fourth quarter. Total employment increased in both October and November, with the November jump driven entirely by an increase in full-time jobs, which have been where job gains have been concentrated throughout the year. The unemployment rate dipped in November to 6.4 percent, its lowest level in over 30 years. Even the beleaguered manufacturing sector, which has shed about 5 percent of its workforce over the past year, saw solid job gains in November.

In October, the twelve-month rate of consumer price inflation fell to 2.6 percent from 3.4 percent in September, almost entirely a result of a sharp fall in gasoline prices. The twelve-month rate of core inflation, excluding the eight most volatile components, held steady at 1.7 percent for the third consecutive month.

### Canadian Economic Indicators

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

Indicator	2005						
	Q1	Q2	Q3	Aug.	Sept.	Oct.	Nov.
GDP by industry	.6	.7	1.0	.5	-.0	n.a.	n.a.
Industrial production	-.2	-.1	1.3	1.2	-.5	n.a.	n.a.
New manufacturing orders	3.2	-1.3	1.3	3.0	-1.7	n.a.	n.a.
Retail sales	2.3	1.1	.1	-1.2	-1.5	n.a.	n.a.
Employment	.1	.4	.3	.2	-.0	.4	.2
Unemployment rate <sup>1</sup>	7.0	6.8	6.8	6.8	6.7	6.6	6.4
Consumer prices <sup>2</sup>	2.1	1.9	2.6	2.6	3.4	2.6	n.a.
Core consumer prices <sup>2,3</sup>	1.7	1.6	1.7	1.8	1.8	1.7	n.a.
Consumer attitudes (1991 = 100)	123.6	121.1	108.1	...	...	...	...
Business confidence (1991 = 100)	135.9	139.2	127.1	...	...	...	...

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 December, the Bank of Canada increased the targeted overnight rate 25 basis points to 3.25 percent, following 25-basis-point increases at each of its previous two meetings. This move was widely expected. In its accompanying statement, the Bank said the economy has been evolving broadly in line with its expectations and that “some further

reduction in monetary stimulus will be required...over the next four to six quarters” to keep inflation on target.

On November 29, after the minority Liberal government lost a vote of confidence, Prime Minister Martin announced that national elections will be held on January 23. The current minority government has been in place since June 2004.

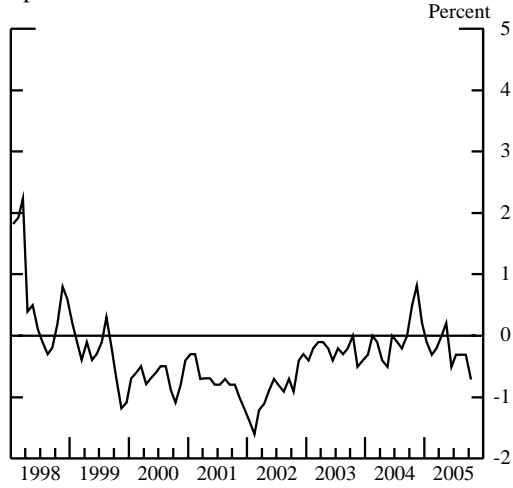
**External Balances**  
(Billions of U.S. dollars, s.a.a.r.)

Country and balance	2005					
	Q1	Q2	Q3	Aug.	Sept.	Oct.
<i>Japan</i>						
Trade	102.0	78.1	65.4	67.7	62.7	75.2
Current account	171.3	160.0	154.0	140.2	175.2	n.a.
<i>Euro area</i>						
Trade	66.8	49.5	13.1	2.8	18.2	n.a.
Current account	23.5	2.5	-62.0	-73.8	-66.1	n.a.
<i>Germany</i>						
Trade	212.8	202.1	200.0	182.9	217.6	n.a.
Current account	144.2	108.9	113.1	84.0	98.5	n.a.
<i>France</i>						
Trade	-27.8	-26.2	-31.9	-32.9	-25.3	n.a.
Current account	-31.7	-37.4	-32.7	-42.5	-25.3	n.a.
<i>Italy</i>						
Trade	-8.8	-8.4	-16.6	-20.8	-14.8	n.a.
Current account	-33.8	-27.2	-23.4	-39.4	-13.6	n.a.
<i>United Kingdom</i>						
Trade	-119.0	-108.5	-119.2	-127.0	-117.9	n.a.
Current account	-55.5	-22.7	n.a.	...	...	...
<i>Canada</i>						
Trade	42.2	43.6	62.2	63.5	71.5	n.a.
Current account	14.8	15.7	30.8	...	...	...

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

**Consumer Price Inflation in Selected Industrial Countries**  
(12-month change)

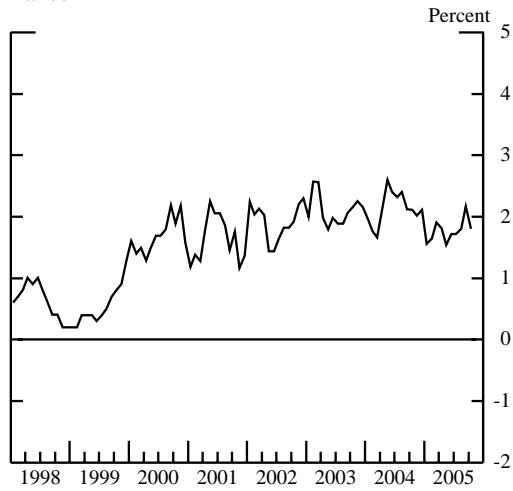
Japan



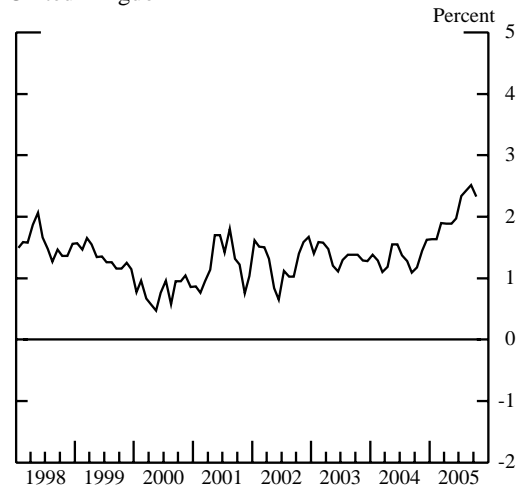
Germany



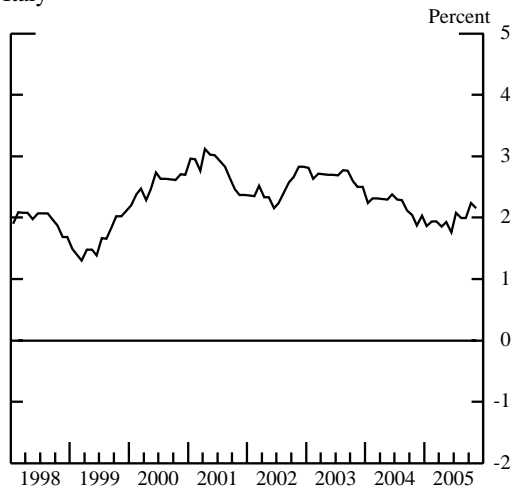
France



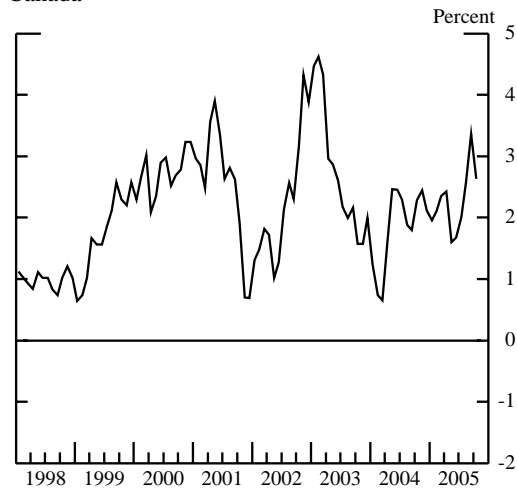
United Kingdom



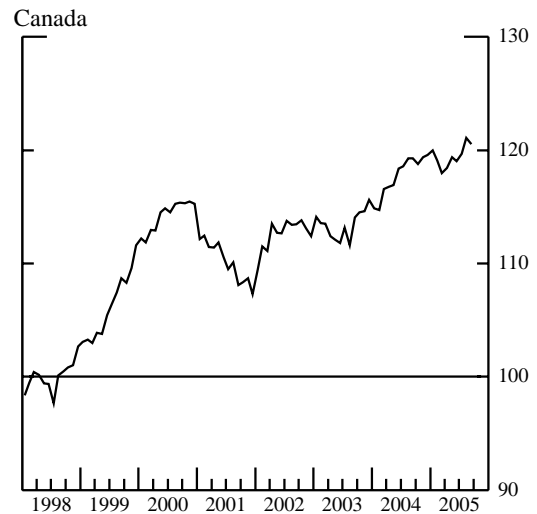
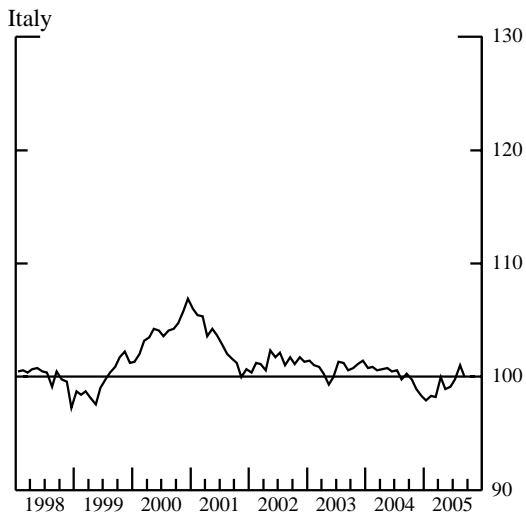
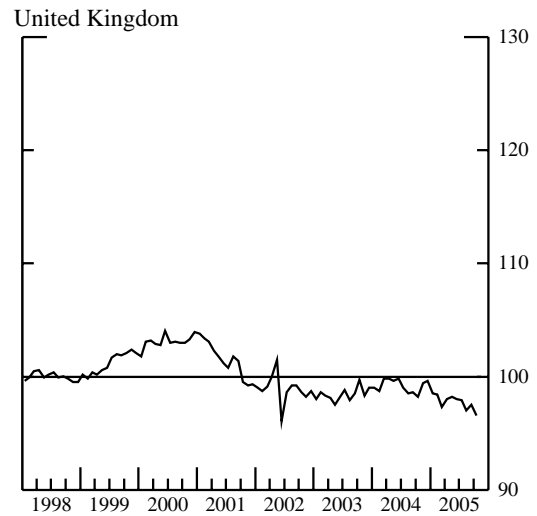
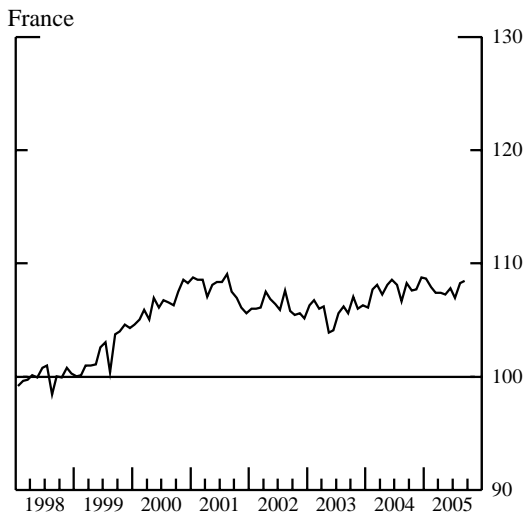
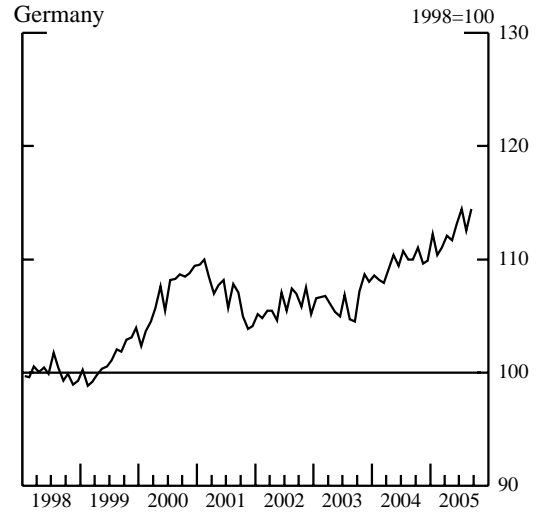
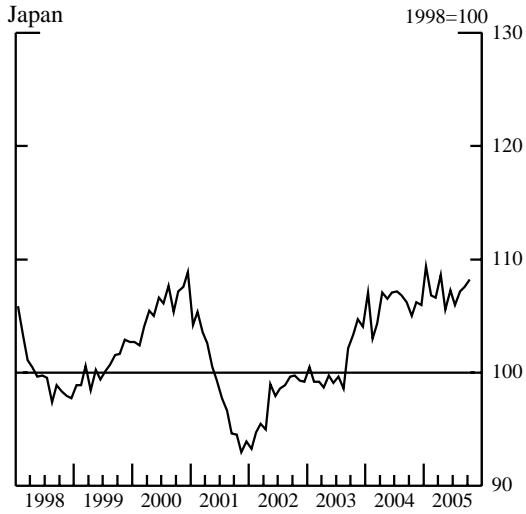
Italy



Canada



**Industrial Production in Selected Industrial Countries**



## Economic Situation in Other Countries

Recent indicators of economic activity across the developing economies have been generally positive. In Asia, economic performance has been robust, most notably in greater China, Korea, and India. In Latin America, performance in Mexico and Argentina was solid in the third quarter; however, Brazilian activity has been weak. Inflation in the developing world has edged up but generally remains contained.

**Chinese** industrial production continued to grow at a solid pace in October, as did investment, which was up more than 25 percent from a year earlier. Chinese government officials, including Premier Wen, have made several statements about the need to slow investment growth further. However, to date no new steps have been taken. At the same time, retail sales growth has remained in double-digit territory. The trade surplus has hovered around \$100 billion (annualized) in recent months, triple the 2004 level, and both exports and imports surged in October to new record highs. Twelve-month consumer price inflation remains low.

### Chinese Economic Indicators

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

Indicator	2003	2004	2005				
			Q2	Q3	Aug.	Sept.	Oct.
Real GDP <sup>1</sup>	10.0	9.5	5.0	8.2	...	...	...
Industrial production	18.9	14.4	4.3	3.2	1.2	1.9	1.1
Consumer prices <sup>2</sup>	3.2	2.6	1.7	1.3	1.2	1.0	1.2
Trade balance <sup>3</sup>	25.5	32.1	109.0	113.8	115.7	87.2	100.4

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 the third quarter, real GDP expanded almost 10 percent (s.a.a.r.), on the back of strong performance in exports and private consumption. Reports indicate that Hong Kong Disneyland opened to large crowds, which may have boosted growth in the third quarter. In October, the unemployment rate fell to its lowest rate in four years. Trade volume, a good indicator of activity in Hong Kong's entrepôt economy, moved up in September. Twelve-month consumer price inflation has continued to edge up in recent months but remains below 2 percent.



**Hong Kong Economic Indicators**

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

Indicator	2003	2004	2005				
			Q2	Q3	Aug.	Sep.	Oct.
Real GDP <sup>1</sup>	4.5	6.9	12.6	9.9	...	...	...
Unemployment rate <sup>2</sup>	7.9	6.9	5.7	5.5	5.7	5.5	5.3
Consumer prices <sup>3</sup>	-1.8	.2	.8	1.4	1.3	1.6	1.8
Trade balance <sup>4</sup>	-8.5	-12.0	-9.1	-12.0	-16.7	-12.7	-5.1

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.

... Not applicable.

In **Taiwan**, recently revised GDP figures indicate growth in the first half of the year was about two times higher than previously reported. In the third quarter, output expanded almost 7 percent (s.a.a.r.), the highest rate in nearly two years, reflecting strong export growth and inventory accumulation. Industrial production in the third quarter was 3.2 percent higher than in the second quarter and continued to expand in October, while new orders for electronics and other goods were also up. The unemployment rate has inched down in recent months. Exports surged to a new high in October, contributing to a sizeable monthly trade surplus, before moderating a bit in November. Twelve-month consumer price inflation fell back for the third straight month in November to 2½ percent.

**Taiwan Economic Indicators**

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

Indicator	2003	2004	2005				
			Q2	Q3	Sept.	Oct.	Nov.
Real GDP <sup>1</sup>	5.9	2.6	5.9	6.9	...	...	...
Unemployment rate <sup>2</sup>	5.0	4.5	4.2	4.1	4.0	4.0	n.a.
Industrial production	7.1	9.8	1.3	3.2	2.4	1.3	n.a.
Consumer prices <sup>3</sup>	-.1	1.6	2.1	3.0	3.2	2.7	2.5
Trade balance <sup>4</sup>	16.9	6.1	3.1	4.4	7.7	13.1	10.5
Current account <sup>5</sup>	29.3	18.6	7.0	3.5	...	...	...

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.

Economic indicators for **Korea** remain upbeat. Third-quarter real GDP was revised up half a percentage point, to 8 percent. More recently, industrial production rose 1 percent in October after surging the previous month. A post-strike recovery in the auto sector was behind much of the October gain but increases in other export-linked sectors also boosted production. Consumer and business confidence jumped in October, and the level of retail sales remained elevated. Exports fell slightly in October after previous rapid increases, but a larger decline in imports led to an improvement in the trade balance. Twelve-month consumer price inflation was 2.4 percent in November, unchanged from the third-quarter pace.

### Korean Economic Indicators

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

Indicator	2003	2004	2005				
			Q2	Q3	Sept.	Oct.	Nov.
Real GDP <sup>1</sup>	4.2	3.0	5.0	8.0	...	...	...
Industrial production	4.9	10.2	.5	3.3	2.4	1.0	n.a.
Unemployment rate <sup>2</sup>	3.4	3.5	3.6	3.8	4.0	3.9	n.a.
Consumer prices <sup>3</sup>	3.4	3.0	3.0	2.4	2.7	2.5	2.4
Trade balance <sup>4</sup>	22.0	38.2	27.7	32.3	29.1	34.3	n.a.
Current account <sup>5</sup>	11.9	27.6	11.0	10.1	19.7	35.8	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.

Data from the **ASEAN** countries indicate that economic activity continued to expand at a solid pace, but performance varied across the region. Third-quarter real GDP rose 9 percent in Thailand, 7 percent in Singapore, and around 6 percent in Malaysia and Indonesia. In the Philippines, however, growth moderated from the strong second-quarter pace, mostly due to a contraction of government expenditures aimed at reining in the high public debt level. More recently, October industrial activity was up a bit in Singapore, but down in Thailand and Malaysia. Data and anecdotes from the region point to a recovery in global demand for high-tech products and to an expansion of the external sector going forward.

Consumer price inflation remains elevated in much of the region, reflecting higher food prices in some countries as well as the effect of higher energy prices. The increases in energy costs were partly a result of cuts in fuel subsidies, most notably in Indonesia, where twelve-month inflation exceeded 17 percent in October and November after fuel subsidies were sharply reduced. Citing concerns over higher inflation, the central bank of Indonesia raised interest rates 125 basis points in November and another 50 basis points in December. Similarly, Malaysia raised interest rates 30 basis points in November.

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

Indicator	2003	2004	2005				
			Q2	Q3	Aug.	Sept.	Oct.
<i>Real GDP<sup>1</sup></i>							
Indonesia	5.3	6.5	3.2	5.7	...	...	...
Malaysia	6.7	5.8	.9	6.3	...	...	...
Philippines	4.6	5.4	7.1	2.3	...	...	...
Singapore	5.5	6.5	19.0	7.1	...	...	...
Thailand	7.9	5.5	9.3	9.0	...	...	...
<i>Industrial production<sup>2</sup></i>							
Indonesia <sup>3</sup>	5.5	3.3	-2.5	-2.1	-1.8	-.3	n.a.
Malaysia	9.3	11.3	-.2	1.1	4.6	1.3	-1.3
Philippines	.0	1.0	1.7	-.6	.9	-4.4	n.a.
Singapore	3.0	13.9	8.0	7.8	2.5	10.7	.1
Thailand	13.9	11.0	3.1	2.7	2.5	-.7	-1.4

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	Q3	Aug.	Sep.	Oct.
Indonesia	28.5	25.1	20.9	n.a.	20.5	n.a.	n.a.
Malaysia	21.4	21.2	26.1	25.7	28.5	25.2	32.6
Philippines	-4.2	-4.4	-4.4	n.a.	-5.4	n.a.	n.a.
Singapore	16.2	16.1	16.3	16.5	21.4	10.1	11.9
Thailand	3.8	1.2	-20.6	n.a.	-2.9	n.a.	n.a.

n.a. Not available.

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

Indicator	2003 <sup>1</sup>	2004 <sup>1</sup>	2005				
			Q2	Q3	Sept.	Oct.	Nov.
Indonesia	5.3	6.6	7.6	8.4	9.0	17.4	18.9
Malaysia	1.2	2.1	3.0	3.4	3.4	3.3	n.a.
Philippines	3.9	8.6	8.2	7.1	7.0	7.0	7.1
Singapore	.7	1.3	.1	.5	.6	1.1	n.a.
Thailand	1.8	2.9	3.7	5.6	6.0	6.2	5.9

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

The **Indian** economy remains strong. Output rose 7.6 percent in the third quarter with large gains in the trade and service sectors and continued healthy growth in manufacturing. More recent data point to a slight improvement in India's trade deficit in October, reflecting an uptick in export growth. The closely watched wholesale price index rose 4.6 percent in October, in part reflecting the effect of earlier reductions in fuel subsidies.

**Indian Economic Indicators**

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

Indicator	2003	2004	2005				
			Q2	Q3	Aug.	Sept.	Oct.
Real GDP <sup>1</sup>	11.0	6.4	11.6	7.6	...	...	...
Industrial production	6.6	8.5	3.5	.8	2.3	1.5	n.a.
Consumer prices <sup>2</sup>	3.7	3.8	4.0	3.7	3.4	3.6	4.2
Wholesale prices <sup>2</sup>	5.8	6.7	5.3	4.0	3.7	4.1	4.6
Trade balance <sup>3</sup>	-13.7	-21.7	-38.7	-39.2	-38.2	-39.5	-33.7
Current account <sup>4</sup>	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 point to a strong but uneven recovery from the weak second quarter. Real GDP jumped almost 9 percent (s.a.a.r.) in the third quarter, supported by a sharp recovery in agriculture from its contraction in the second quarter. Services sector output also grew solidly. Despite high real interest rates, domestic

demand has continued to perform well. However, industrial activity (especially manufacturing) remained weak, mainly due to anemic auto exports to the United States.

Consumer price inflation has stayed well contained. Twelve-month consumer price inflation was 3 percent in October, at the middle of the 2-to-4 percent target range. Furthermore, twelve-month core inflation stood at 3.1 percent in October. The soft economy and improved inflation prospects led the Bank of Mexico (BOM) to begin easing policy in late August; the BOM has eased policy four times in as many months since then. As a result, the rate on 28-day peso-denominated bills, a widely used measure of the monetary policy stance, has fallen from 9.6 percent in early August to 8.4 percent in early December.

### Mexican Economic Indicators

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

Indicator	2003	2004	2005				
			Q2	Q3	Aug.	Sept.	Oct.
Real GDP <sup>1</sup>	2.1	4.9	-1.3	8.9	...	...	...
Overall economic activity	1.4	4.1	-2	2.0	.8	.4	n.a.
Industrial production	-.1	3.5	-.1	.4	.4	1.0	n.a.
Unemployment rate <sup>2</sup>	3.4	3.9	3.8	3.5	3.3	3.4	3.4
Consumer prices <sup>3</sup>	4.0	5.2	4.5	4.0	3.9	3.5	3.0
Trade balance <sup>4</sup>	-5.8	-8.8	-5.2	-7.7	-9.2	-4.0	-9.1
Imports <sup>4</sup>	170.5	196.8	213.6	222.1	224.9	223.4	228.4
Exports <sup>4</sup>	164.8	188.0	208.4	214.4	215.7	219.4	219.3
Current account <sup>5</sup>	-8.6	-7.2	.3	-2.6	...	...	...

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.

In **Brazil**, real GDP declined 4.7 percent (s.a.a.r.) in the third quarter, led by a 13 percent fall in agricultural output. Industrial output also contracted. Indicators for the fourth quarter point to continued weakness, as October auto sales and production were down, unemployment edged up, and industrial output stagnated. Headline inflation rose to 6.4 percent in October on a twelve-month basis, reflecting in part a September hike in prices of gasoline and diesel fuel. Food and energy price increases appear to have kept

inflation elevated through mid-November as well. The trade surplus rose in November, on the back of strong export growth.

In late November, the central bank reduced its policy rate 50 basis points to 18.5 percent, following rate reductions of 25 and 50 basis points at the September and October meetings. The weakening economy and the political scandals have exacerbated political pressures to loosen macroeconomic policies, and Finance Minister Palocci has been rumored in recent weeks to be on the verge of resigning.

### Brazilian Economic Indicators

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

Indicator	2003	2004	2005				
			Q2	Q3	Sept.	Oct.	Nov.
Real GDP <sup>1</sup>	.9	4.8	4.6	-4.7	...	...	...
Industrial production	.1	8.3	1.9	-.8	-2.3	.0	n.a.
Unemployment rate <sup>2</sup>	12.3	11.5	9.8	9.3	9.5	9.7	n.a.
Consumer prices <sup>3</sup>	9.3	7.6	7.8	6.2	6.0	6.4	n.a.
Trade balance <sup>4</sup>	24.8	33.7	44.8	46.2	40.9	37.6	58.3
Current account <sup>5</sup>	4.2	11.7	10.3	23.1	28.6	10.9	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.

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**, the monthly index of economic activity, which has closely tracked real GDP growth in recent years, suggests that output in the third quarter likely continued to expand at close to the second quarter's robust 10 percent pace. In addition, industrial production in the third quarter was 2 percent above its second-quarter level. Twelve-month consumer price inflation was 12 percent in November, well above the central bank's informal target range of 5 to 8 percent for the end of 2005. The central bank has continued to intervene to stem upward pressures on the peso, although recently in smaller amounts.

In late November, the government announced the appointment of Felisa Miceli as Finance Minister, after the resignation of Roberto Lavagna. Rumors of a rift between President Kirchner and Mr. Lavagna had long existed, and a cabinet reshuffle was expected after recent legislative elections. Mrs. Miceli, currently president of the state-

owned Banco de la Nacion, will have to steer Argentina through difficult negotiations with the IMF. Markets reacted unfavorably to the appointment of Mrs. Miceli, a little-known economist who has close political connections to the administration, because of concerns that she will be less independent than Mr. Lavagna.

### Argentine Economic Indicators

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

Indicator	2003	2004	2005				
			Q2	Q3	Sept.	Oct.	Nov.
Real GDP <sup>1</sup>	11.8	9.1	10.1	n.a.	...	...	...
Industrial production	16.2	10.7	1.6	2.0	1.1	.7	n.a.
Unemployment rate <sup>2</sup>	17.3	13.6	12.1	n.a.	...	...	...
Consumer prices <sup>3</sup>	3.7	6.1	8.8	9.8	10.3	10.7	12.0
Trade balance <sup>4</sup>	15.7	12.1	12.1	13.6	12.1	15.3	n.a.
Current account <sup>5</sup>	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**, real GDP is estimated to have fallen 10.4 percent (s.a.a.r.) in the third quarter. The contraction followed a very strong first half of the year and reflected declines in both petroleum and non-petroleum output. The policy environment continues to be weak, as monetary and fiscal policies remain lax. Despite a fixed exchange rate and price controls on many products, inflation has been persistently high and was 15.3 percent in November on a twelve-month basis. President Chavez's ruling party won a landslide victory in the December 4 parliamentary elections, but opposition parties had boycotted the vote over concerns about electoral procedures.



**Venezuelan Economic Indicators**

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

Indicator	2003	2004	2005				
			Q2	Q3	Sept.	Oct.	Nov.
Real GDP <sup>1</sup>	6.6	12.1	25.5	-10.4	...	...	...
Unemployment rate <sup>2</sup>	18.0	15.1	11.9	11.9	11.3	n.a.	n.a.
Consumer prices <sup>3</sup>	27.1	19.2	16.3	15.4	16.0	16.0	15.3
Non-oil trade balance <sup>4</sup>	-5.5	-10.5	-16.2	-19.4	n.a.	n.a.	n.a.
Trade balance <sup>4</sup>	16.5	21.4	30.4	28.1	n.a.	n.a.	n.a.
Current account <sup>5</sup>	11.4	13.8	24.7	30.4	...	...	...

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.