Prefatory Note

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Class III FOMC - Internal (FR)

Part 2

January 25, 2006

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

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

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Domestic Nonfinancial Developments

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Although top-line GDP growth seems to have slowed in the fourth quarter, incoming data indicate that the underlying pace of demand growth has remained solid. Household spending for items other than motor vehicles rose smartly last quarter, and while light vehicle sales slumped in October and November, a payback for the earlier surge was expected. Housing markets appear to have cooled somewhat, although starts and sales both remain at relatively high levels. In the business sector, orders and shipments of nondefense capital goods were generally strong in the fourth quarter, and orders backlogs were up. Even excluding the effects of a post-hurricane rebound in energy-producing and other affected industries, industrial production posted moderate gains during the fourth quarter. Moreover, private payrolls expanded at a solid rate, on average, in November and December. Headline consumer price inflation was held down in the fourth quarter by falling consumer energy prices, but crude oil prices have again risen back up above $65 per barrel in recent weeks. Meanwhile, core inflation has moved up a bit from this summer's low level.

Labor Market Developments

Labor demand expanded further in the fourth quarter. Although private nonfarm payroll employment increased only 94,000 in December, this increase followed an upward-revised gain of 281,000 in November. The average job gain over those two months was likely boosted by a catch-up in employment following the hurricanes; still, even abstracting from this influence, the recent pace of job gains appears to have been solid. The erratic monthly pattern of payroll gains may reflect, in part, seasonal adjustment difficulties, as employment was reported to have declined in December in industries with large and somewhat unpredictable seasonal variation, such as retail trade, construction, and courier and messenger services, each of which was estimated to have added jobs in November. Elsewhere, December saw robust job gains in manufacturing, professional and technical services, health-care services, and food and drink services.

Aggregate hours of production or nonsupervisory workers on private nonfarm payrolls fell 0.2 percent in December, as a 0.1 hour drop in the workweek outweighed the increase in employment. But this decrease followed a larger increase in November, and aggregate hours in the fourth quarter as a whole increased at an annual rate of 1.8 percent from their third-quarter level.

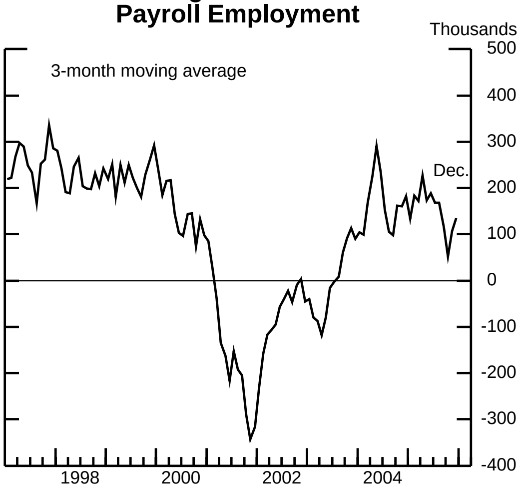
Changes in Employment

(Thousands of employees; seasonally adjusted)

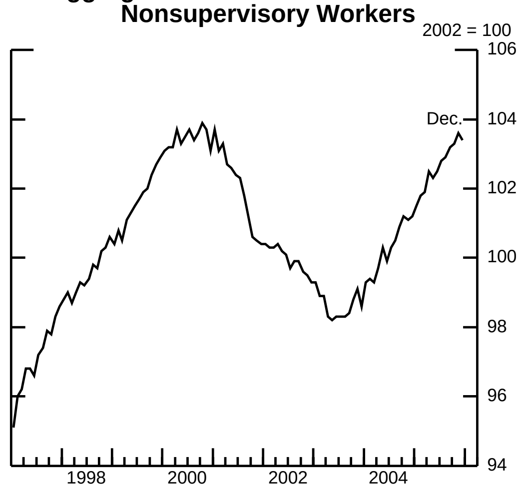
Measure and sector	2005	2005 Q2	Q3	Q4	Oct.	Nov.	Dec.
	Average monthly change				Monthly change		
Nonfarm payroll employment (establishment survey)	168	198	147	146	25	305	108
Private	153	188	115	135	31	281	94
Previous	...	188	115	...	49	194	...
Manufacturing	-4	-13	-11	13	13	8	18
Construction	21	24	18	16	15	42	-9
Wholesale trade	6	7	5	5	4	11	2
Retail trade	8	23	-5	-3	-6	13	-16
Transportation and utilities	8	8	5	1	2	12	-11
Information	2	4	2	-1	-11	4	3
Financial activities	16	14	19	17	24	15	12
Professional and business services	41	37	44	41	14	76	33
Temporary help services	13	8	21	14	13	21	9
Nonbusiness services[1]	53	83	35	43	-29	98	59
Total government	16	10	32	11	-6	24	14
Total employment (household survey)	221	383	228	115	190	-14	168
Memo:							
Aggregate hours of private production workers (percent change)[2]	2.2	2.8	2.1	1.8	.1	.3	-.2
Average workweek (hours)[3]	33.7	33.7	33.7	33.8	33.8	33.8	33.7
Manufacturing (hours)	40.6	40.4	40.6	40.8	41.0	40.8	40.7

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.

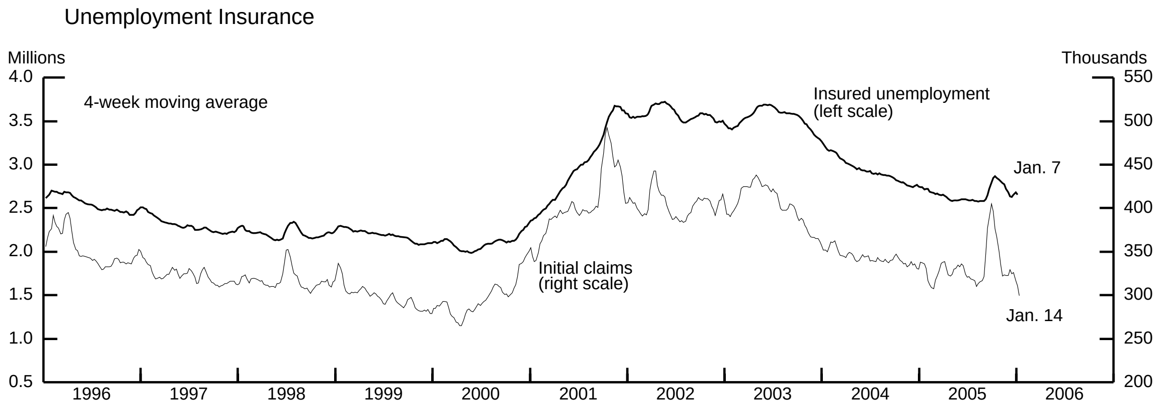
Changes in Private Payroll Employment

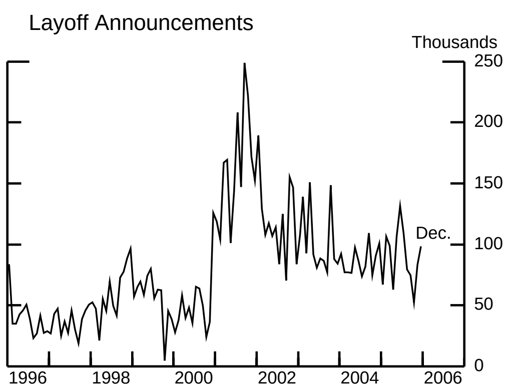


Aggregate Hours of Production or Nonsupervisory Workers

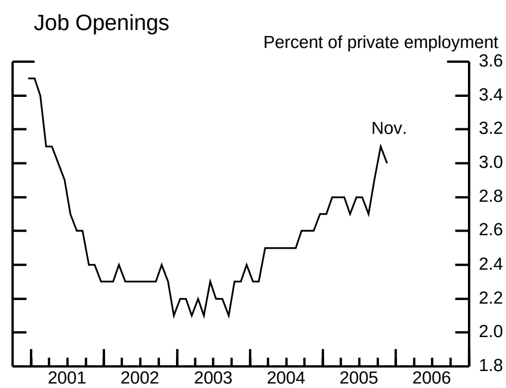


Labor Market Indicators

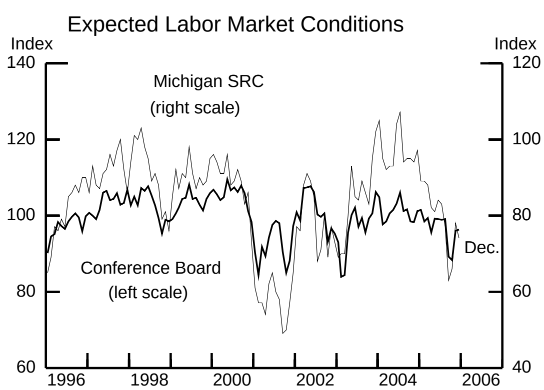




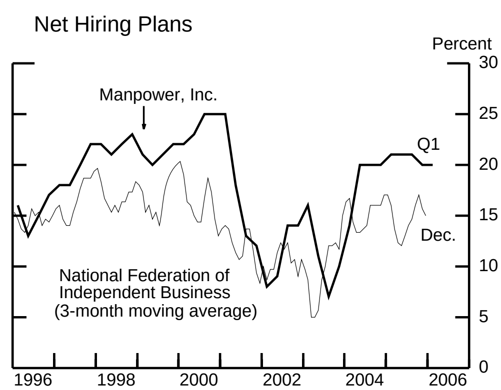
Note. Seasonally adjusted by FRB staff.
Source. Challenger, Gray, and Christmas, Inc.



Source. Job Openings and Labor Turnover Survey.



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



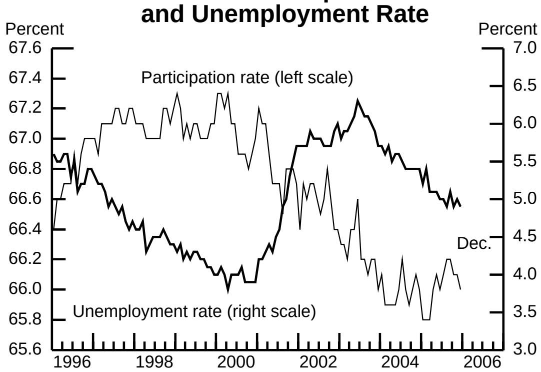
Note. Percent planning an increase in employment minus percent planning a reduction.

Selected Unemployment and Labor Force Participation Rates

(Percent; seasonally adjusted)

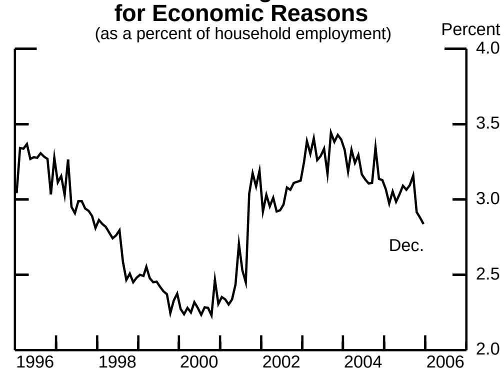
Rate and group	2005	2005 Q2	Q3	Q4	Oct.	Nov.	Dec.
Civilian unemployment rate							
Total	5.1	5.1	5.0	5.0	4.9	5.0	4.9
Teenagers	16.6	17.2	16.1	16.1	15.9	17.1	15.2
20-24 years old	8.8	8.8	8.6	8.5	8.5	8.4	8.5
Men, 25 years and older	3.8	3.8	3.8	3.7	3.7	3.7	3.8
Women, 25 years and older	4.2	4.2	4.2	4.2	4.2	4.3	4.1
Labor force participation rate							
Total	66.0	66.1	66.2	66.1	66.1	66.1	66.0
Teenagers	43.7	44.0	43.8	43.4	43.0	43.9	43.3
20-24 years old	74.6	74.4	74.6	74.8	75.1	74.9	74.5
Men, 25 years and older	75.4	75.5	75.6	75.3	75.4	75.3	75.3
Women, 25 years and older	59.4	59.3	59.5	59.6	59.5	59.6	59.6

Labor Force Participation Rate and Unemployment Rate

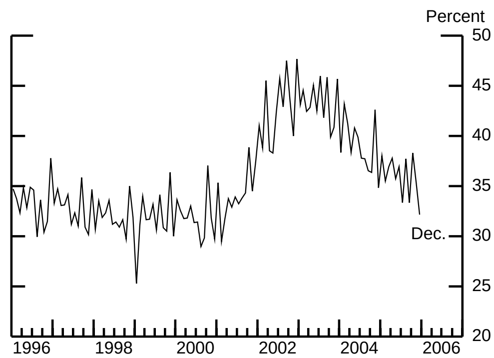


Persons Working Part-Time for Economic Reasons

(as a percent of household employment)

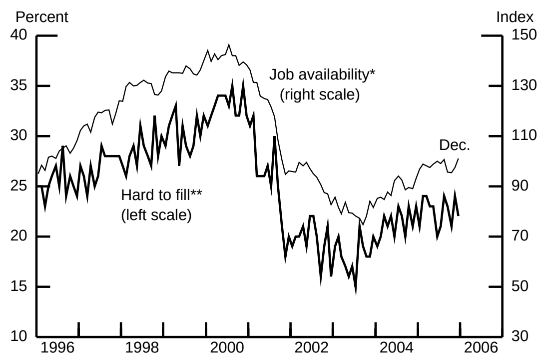


Exhaustion Rate



Note. Seasonally adjusted by FRB staff. Exhaustion rate is number of individuals who exhausted benefits without finding a job, expressed as a share of individuals who began receiving benefits six months earlier.

Labor Market Tightness



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

The four-week moving average of initial claims for unemployment insurance stood at 299,000 for the week ending January 14, a level that points to another solid gain in payrolls this month. On net, the most recent readings of some other indicators of labor demand are similar to pre-Katrina levels: The Conference Board and Michigan Survey measures of individuals' expectations of future labor market conditions were a bit below pre-hurricane levels, but job openings moved up in November to levels well above those seen earlier this year. Meanwhile, layoff announcements and the hiring-plan measures of the National Federation of Independent Business (NFIB) and Manpower Inc. all stand near the middle of their range over the past year.

In the household survey, the unemployment rate edged down to 4.9 percent in December, the low end of the narrow range it has traversed since March. The participation rate ticked down as well, to 66.0 percent. On balance, these and other labor market indicators suggest little net change in labor market slack over the second half of last year. The number of individuals in nonagricultural industries working part-time for economic reasons moved down some at the end of last year as a percentage of employment. The percentage of individuals who have used up their full benefit entitlement before leaving insured unemployment (the exhaustion rate) fell sharply in December from a high level in November, but this series has not clearly trended lower in recent months. The Conference Board’s index of whether jobs are plentiful or hard to get, and the NFIB’s measure of hard-to-fill vacancies, both have changed little in recent months.

Industrial Production

The recovery from the effects of Hurricanes Katrina and Rita boosted output in the industrial sector late last year. Industrial production (IP) rose 0.8 percent in November and 0.6 percent in December; more than half of the gains in those months originated in industries where production had been curtailed by the hurricanes. In particular, output in the mining industry, which includes oil and gas extraction, increased sharply in both November and December. The manufacturing sector was also supported late in the year by a hurricane-related recovery in production, though overall factory output was held down by a drop in motor vehicle assemblies. In addition, utilities output popped up in December as temperatures turned unseasonably cold in the first half of the month. Abstracting from the effects of these special factors, we estimate that underlying activity in the industrial sector advanced moderately near year-end. The capacity utilization rate

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

Component	Proportion 2005 (percent)	2005[1]	2005 H2	2005 Q4	2005 Oct.	2005 Nov.	2005 Dec.
			Annual rate		Monthly rate		
Total	**100.0**	**2.7**	**2.6**	**3.8**	**1.0**	**.8**	**.6**
Previous	100.0	...	...	...	1.3	.7	...
Manufacturing	82.0	3.9	4.9	7.9	1.8	.4	.2
Ex. motor veh. and parts	74.7	4.1	5.1	9.3	2.0	.9	.4
Ex. high-tech industries	69.7	2.7	3.7	8.3	2.1	.8	.3
Mining	8.5	-7.6	-16.3	-17.6	-2.2	4.7	2.5
Utilities	9.5	2.4	2.6	-7.5	-3.0	.4	2.7
Selected industries							
High technology	4.9	24.9	25.5	24.0	.9	2.3	2.7
Computers	.9	11.3	10.2	11.7	.8	1.0	1.1
Communications equipment	1.1	25.6	33.6	33.9	3.4	1.7	1.8
Semiconductors[2]	2.9	28.7	26.7	23.5	-.1	2.9	3.5
Motor vehicles and parts	7.3	1.5	3.6	-5.4	-.2	-4.9	-2.8
Market groups excluding energy and selected industries							
Consumer goods	21.7	1.9	1.7	3.4	.5	-.2	.4
Durables	4.3	2.6	5.5	8.0	1.2	-.3	-.4
Nondurables	17.4	1.8	.8	2.3	.3	-.1	.6
Business equipment	7.8	9.3	11.3	26.0	9.0	1.9	.5
Defense and space equipment	1.9	9.4	7.0	8.2	2.8	.1	1.7
Construction supplies	4.4	5.7	9.2	14.0	2.1	.5	-.9
Business supplies	7.9	2.8	3.5	6.7	1.5	.3	-.2
Materials	25.0	.7	2.7	7.1	1.5	1.3	.6
Durables	13.8	3.6	7.7	12.7	1.3	.6	.5
Nondurables	11.2	-3.0	-3.5	.1	1.8	2.1	.7

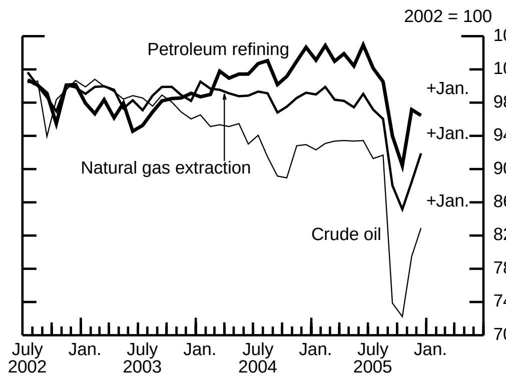
1. From fourth quarter of preceding year to fourth quarter of year shown.
2. Includes related electronic components.
... Not applicable.

Capacity Utilization
(Percent of capacity)

Sector	1972-2004 average	1994-95 high	2001-02 low	2005 Q2	2005 Q3	2005 Q4	2005 Nov.	2005 Dec.
Total industry	**81.0**	**85.0**	**73.9**	**79.9**	**79.8**	**80.2**	**80.3**	**80.7**
Manufacturing	79.8	84.5	72.0	78.5	78.5	79.6	79.6	79.6
High-tech industries	78.2	86.1	57.4	74.7	75.3	75.3	75.2	75.8
Excluding high-tech industries	79.9	84.4	73.1	78.9	78.9	80.1	80.2	80.1
Mining	87.3	89.0	85.6	89.6	86.1	82.1	82.6	84.7
Utilities	86.8	93.7	83.7	85.2	88.1	86.4	85.8	88.1

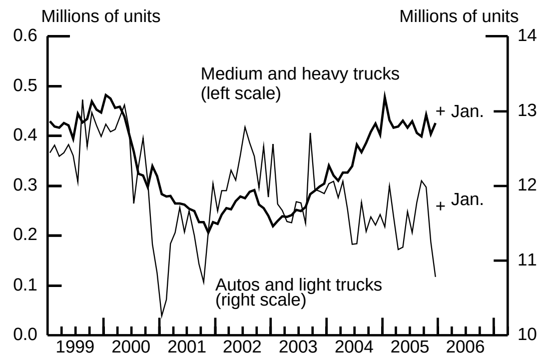
Indicators of Manufacturing Activity

Energy IP



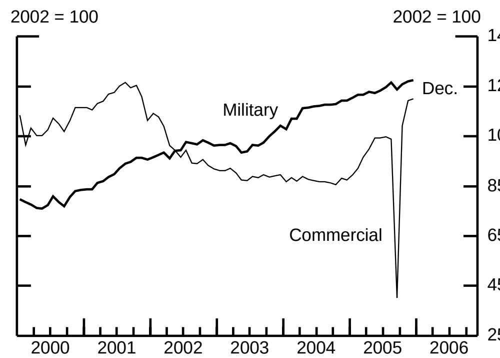
Note. January values are based on available weekly data and estimates of facilities that remain offline.

Motor Vehicle Assemblies

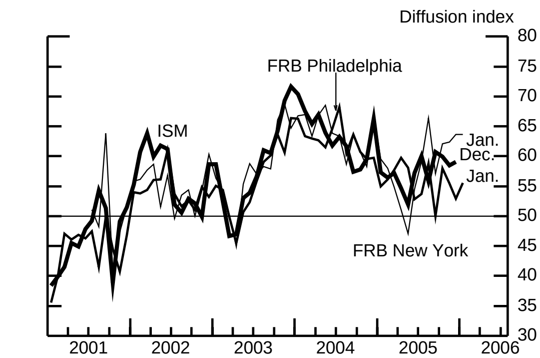


Note. January values are based on latest industry schedules.

IP for Aircraft

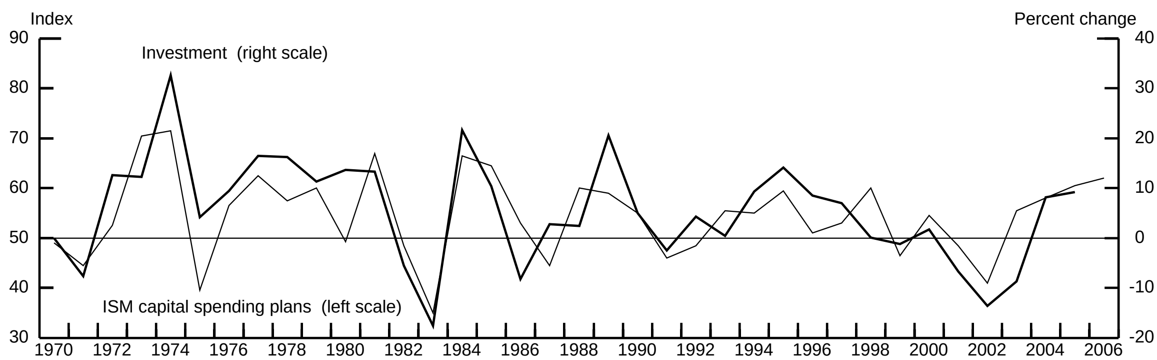


New Orders: ISM, FRB New York, and FRB Philadelphia Surveys



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

Manufacturing Investment



Note. Manufacturing investment data are from the Annual Survey of Manufacturers; the figures for 2004 and 2005 are staff estimates. The ISM series is a diffusion index that equals the percentage of respondents reporting plans to increase investment plus one-half the percentage reporting no plans to change investment.

Production of Domestic Light Vehicles

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

Item	2005	2005 Q3	2005 Q4	2006 Q1	2005 Dec.	2006 Jan.	2006 Feb.
U.S. production[1]	11.5	11.7	11.3	11.2	10.8	11.7	11.1
Autos	4.3	4.3	4.4	4.6	4.3	4.8	4.6
Light trucks	7.2	7.4	7.0	6.7	6.5	6.9	6.6
Days' supply[2]	69	58	75	n.a.	69	n.a.	n.a.
Autos	52	44	54	n.a.	54	n.a.	n.a.
Light trucks	81	68	91	n.a.	79	n.a.	n.a.
Inventories[3]	3.04	2.75	3.04	n.a.	3.04	n.a.	n.a.
Autos	.93	.82	.93	n.a.	.93	n.a.	n.a.
Light trucks	2.10	1.94	2.10	n.a.	2.10	n.a.	n.a.
Memo: U.S. production, total motor vehicles[4]	11.9	12.2	11.8	11.7	11.2	12.1	11.5

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

Inventories of Light Vehicles

Note. FRB seasonals. Monthly totals.

Days' Supply of Light Vehicles

* Constructed using 6-month moving average of sales.

in manufacturing stood at 79.6 percent in December—1.3 percentage points above its year-ago level and close to its 1972-2004 average.

The oil and gas platforms in the Gulf region that were idled or damaged by Hurricanes Katrina and Rita have continued to return to production. As of January 25, domestic crude production stood at about 92 percent of its pre-Katrina level, and natural gas extraction was at roughly 95 percent.[1] For both oil and gas, complete recoveries are not anticipated until the second half of the year. In contrast, nearly all the idled oil refineries have returned to full production; only one refinery, representing about 0.7 percent of domestic capacity, remains out of service (and that refinery is expected to return to production in the first quarter), and just four refineries are operating at reduced rates. The available information on production and shut-in capacity suggests that both oil and gas extraction will contribute modestly to IP growth in January. Outside of the energy-producing industries, the restarting of facilities idled by the hurricanes lifted output again in December, though to a lesser degree than in the previous two months; in particular, basic chemicals production in the region added nearly 0.1 percentage point to IP after boosting output ¼ percentage point in November.[2]

Total motor vehicle production fell to an annual rate of 11.2 million units in December. For the fourth quarter as a whole, assemblies averaged an 11.8 million unit pace, down about 400,000 units from the elevated rate in the previous quarter. With the supply of light vehicles at 69 days in December, inventories appear slightly elevated relative to sales. Accordingly, the automakers' latest assembly plans call for production to remain a bit soft in the first quarter.[3]

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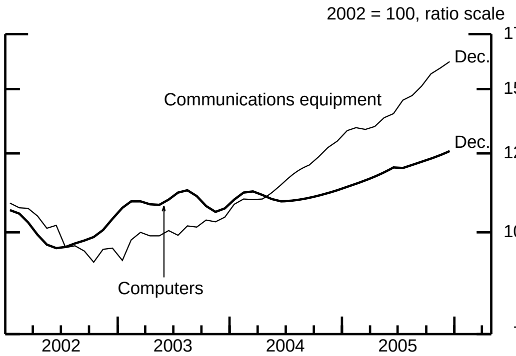
[1] About one-third of U.S. crude oil extraction, about one-fifth of natural gas extraction, and just under one-half of refining capacity are located in the Gulf of Mexico region. After Hurricane Rita, in the Gulf Coast, essentially all crude oil extraction and about 80 percent of natural gas extraction were shut in.

[2] At the beginning of October, nearly half of domestic petrochemicals capacity was idled by the hurricanes.

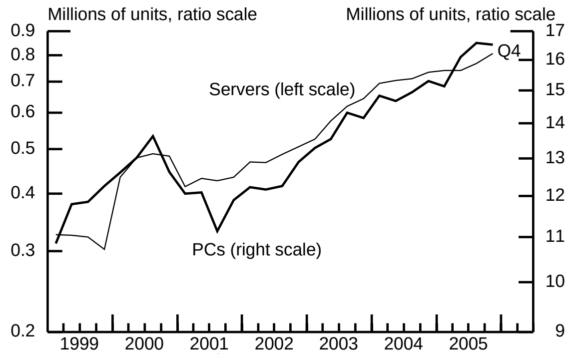
[3] Delphi, a major parts supplier to General Motors (GM), filed for bankruptcy protection in October and since then has been in ongoing negotiations with the United Auto Workers (UAW) over wages and benefits. Delphi was originally scheduled to file a motion with the bankruptcy court on December 16 to cancel its collective-bargaining agreements and to impose a drastically lower hourly labor rate and reduced benefits for workers. However, Delphi postponed filing the motion after GM intervened and agreed to provide interim financial support by forgoing 2006 price cuts for Delphi parts. Delphi now says the UAW has until February 16 to accept concessions or risk having their labor contracts terminated.

Indicators of High-Tech Manufacturing Activity

Communication Equipment and Computer IP

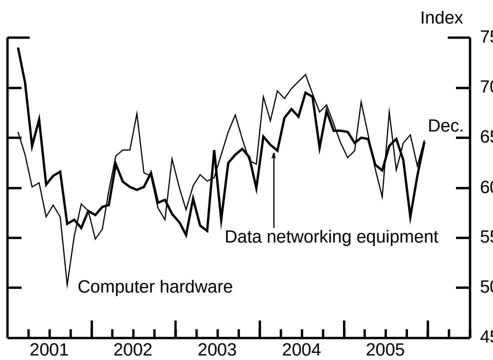


U.S. Personal Computer and Server Sales



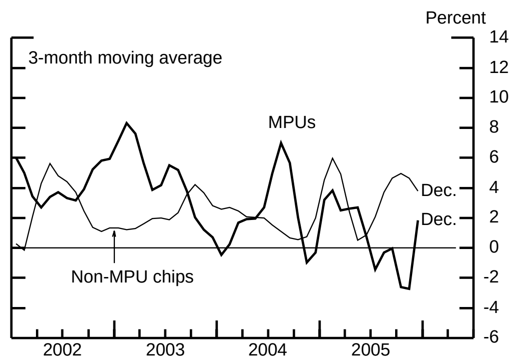
Note. FRB seasonals.
Source. Gartner.

CIO Magazine Future Spending
Diffusion Indexes

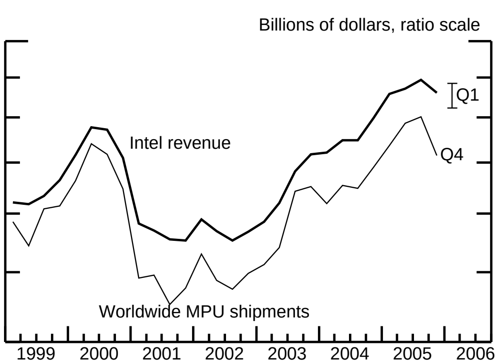


Note. The diffusion index equals the percentage of respondents planning to increase future spending plus one-half the percentage of respondents planning to leave future spending unchanged.
Source. CIO Magazine.

Rate of Change in Semiconductor
Industrial Production

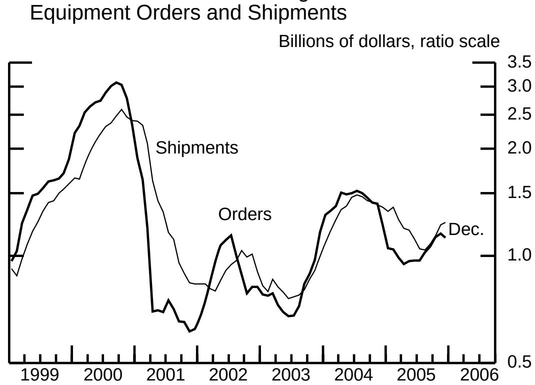


Microprocessor Unit (MPU) Shipments
and Intel Revenue



Note. Q1 is the range of Intel's revenue guidance as of January 17, 2006. FRB seasonals.
Source. Intel and Semiconductor Industry Association.

Semiconductor Manufacturing
Equipment Orders and Shipments



Note. FRB seasonals.
Source. Semiconductor Equipment and Materials International.

Elsewhere in transportation, the output of both commercial and military aircraft rose further in December. New orders at Boeing ended the year on a strong note, and with backlogs at year-end about 65 percent higher than a year earlier, production rates are scheduled to increase in the first quarter of 2006. The output of military aircraft will likely edge down in the near-term after having increased at a rapid pace from the middle of 2000 to the present.

High-tech output rose 2.7 percent in December, about the same rate as earlier in the year. The production of computers and peripherals increased in December at about the same modest pace seen throughout most of 2005. The output of communications equipment rose solidly for a ninth consecutive month, and other indicators for this industry, such as the *CIO Magazine* diffusion index, show no signs of weakening. The output of semiconductors grew briskly in December as the production of chips used in communications equipment and consumer electronics continued to rise at a rapid clip. However, the output of microprocessor units (MPUs) has been weak in recent months, in part due to a shortage of the semiconductor chipsets used in conjunction with MPUs inside lower-end personal computers. This shortage is likely to persist for a few months and may restrain near-term demand for MPUs.[4] Indeed, Intel's revenue expectation for the first quarter is consistent with only a moderate increase in MPU production. Another forward-looking indicator—orders and shipments of semiconductor manufacturing equipment—softened a touch in December after having increased notably in the preceding several months.

Outside of the energy, motor vehicles and parts, and high-tech products sectors, production increased last month in most market groups. The production of consumer and business equipment rose moderately in December, with the gains in business equipment concentrated in oil and gas field machinery and in farm equipment. The index for construction supplies fell in December; however, during the preceding three months, output had surged nearly 1.5 percent per month, possibly boosted by stockbuilding associated with rebuilding efforts in the Gulf region. The index for materials rose in December; continued recovery in chemicals accounted for most of the production gains.

[4] The shortage of chipsets seems to have arisen because Intel underestimated demand for low-end PCs. Unlike MPUs, most of Intel's chipsets are manufactured abroad.

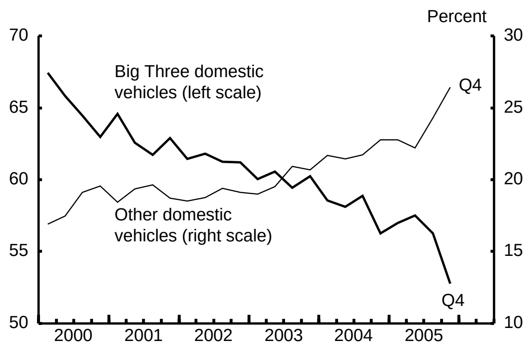
Sales of Light Vehicles
(Millions of units at an annual rate; FRB seasonals)

Category	2005	2005 H1	2005 Q3	2005 Q4	2005 Oct.	2005 Nov.	2005 Dec.
Total	16.9	16.9	17.9	15.8	14.7	15.7	17.1
Autos	7.7	7.6	8.0	7.5	7.3	7.6	7.7
Light trucks	9.3	9.3	10.0	8.3	7.4	8.1	9.5
North American[1]	13.5	13.4	14.5	12.6	11.4	12.5	13.7
Autos	5.5	5.4	5.7	5.4	5.2	5.5	5.5
Light trucks	8.1	8.0	8.8	7.1	6.2	7.0	8.2
Foreign-produced	3.4	3.4	3.5	3.3	3.3	3.2	3.4
Autos	2.2	2.2	2.3	2.1	2.1	2.0	2.1
Light trucks	1.2	1.2	1.2	1.2	1.1	1.1	1.3
Memo: Average incentive per vehicle (current dollars)	1616	1841	1309	1481	1245	1638	1566

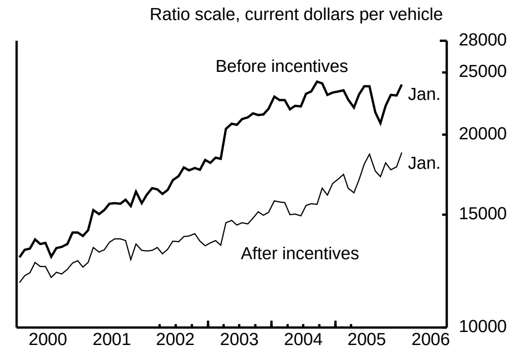
Note. Components may not sum to totals because of rounding. Data on sales of trucks and imported autos for the most recent month are preliminary and subject to revision.

1. Excludes some vehicles produced in Canada that are classified as imports by the industry.

Market Share

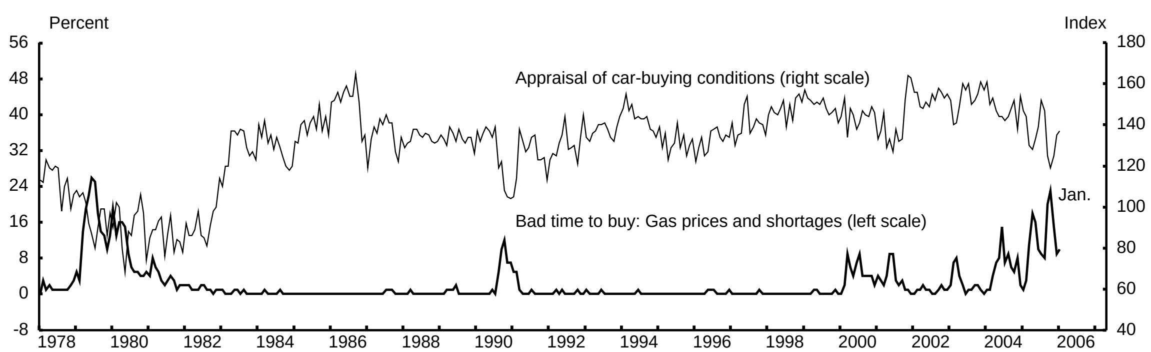


Average Price Before and After Incentives



Note. Seasonally adjusted data. Based on data through January 15.
Source. J.D. Power and Associates.

Michigan Survey Index of Car-Buying Attitudes



On balance, indicators of near-term manufacturing activity point to moderate production gains in the coming months. In particular, the Institute for Supply Management (ISM) diffusion index of new orders edged up in December and remains in the region associated with solid production increases. And the early readings on new orders in January from the regional Federal Reserve surveys were a bit firmer than their December values. However, the three-month moving average of the Board staff's series on real adjusted durable goods orders decreased 0.8 percent in November and suggests a softer outlook than that portrayed by the survey measures.

The diffusion index of capital spending plans in the ISM Semiannual Economic Forecast, released in early December, rose to its highest level in more than fifteen years. This reading suggests that manufacturers will increase capital spending more than 10 percent in 2006, a bit faster than the Board staff's estimate for manufacturing investment for 2005. As a result, manufacturing capacity will likely increase around 2½ percent in 2006, a touch more than the increase in 2005, though still below the average pace of about 3 percent from 1972 to 2004.

Motor Vehicles

The pull-ahead/payback cycle associated with last summer's employee pricing programs appears to have run its course. In December, sales moved up to an annual rate of 17.1 million units, close to the average for the year as a whole.

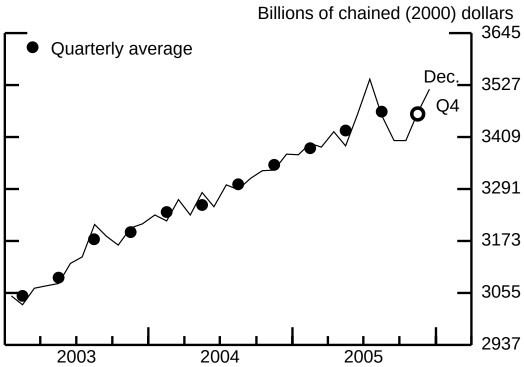
The forward-looking indicators of vehicle demand point to a moderate pace of sales in the near term. The recent gains in income and employment bode well for vehicle sales, and consumers' car-buying attitudes have recovered recently. The Michigan SRC index of car-buying attitudes increased for a third month in January and was at its highest level since August. Although gasoline prices still appear to be of concern to consumers, the fraction of Michigan Survey respondents who cited high gasoline prices as the reason for their pessimistic views of buying conditions has dropped sharply from the recent peak in October. Incentives do not appear to be influencing sales much of late. After having

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

Category	2005					
	Q2	Q3	Q4	Oct.	Nov.	Dec.
	Annual rate			Monthly rate		
Total sales	10.8	6.9	2.3	.2	.8	.7
Retail control[1]	9.0	10.5	6.5	.7	-.6	.3
Previous estimate	9.0	10.5	...	.6	-.6	...
Memo:						
Real PCE control[2]	4.5	4.0	5.7	.9	1.0	.6
Real PCE ex. motor vehicles	3.2	3.6	...	.4	.5	...

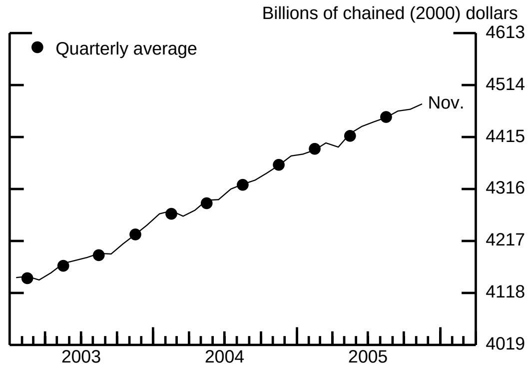
1. Total sales less outlays at building material and supply stores and automobile and other motor vehicle dealers.
2. Total goods spending excluding autos and trucks. Values for October and November are staff estimates; values for Q4 and December are staff forecasts.
... Not applicable.

Real PCE Goods



Note. Values for October and November 2005 are staff estimates; values for December 2005 and 2005:Q4 are staff forecasts.

Real PCE Services



Personal Saving Rate

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

increased in November, the average incentive per vehicle edged down in December and in the first half of January. [5]

The Big Three automakers' combined share of sales continued to decline in 2005 as an increase in Chrysler's share was more than offset by declines at General Motors and Ford. In light of these trends, both GM and Ford have announced plans for significant reductions in capacity over the next several years.[6] Nevertheless, the overall share of vehicles sold that were produced in North America was little changed for a second year because of a rise in the domestic production of foreign brands.

Consumer Spending

Overall real personal consumption expenditures (PCE) growth was held down on net in the fourth quarter by the aforementioned payback for the summertime surge in motor vehicle sales. Excluding motor vehicles, real PCE is estimated to have increased at a solid pace in both October and November. The general underlying strength in PCE appears to be consistent with the mostly positive movements in the fundamental determinants of consumer spending.

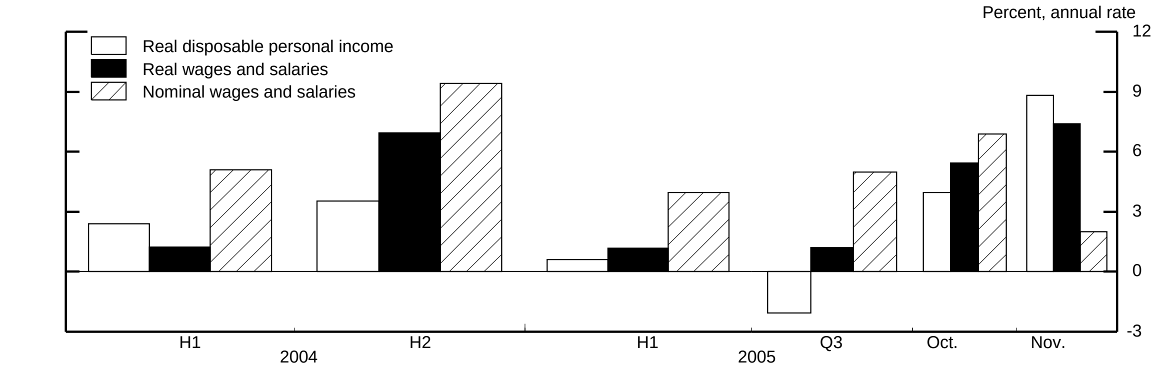
In the retail control category of goods, which excludes sales by auto dealers and building material and supply stores, nominal spending rose 0.3 percent in December, a little stronger than the average posted for October and November. Factoring in our projection of PCE prices, we estimate that real spending on consumer goods excluding motor vehicles rose 0.6 percent last month after sizable increases in the previous two months. Real outlays for consumer services rose 0.2 percent in November, the latest month of available data, and we expect that a weather-induced increase in energy services gave a temporary boost to services consumption in December. The personal saving rate stood at -0.2 percent in October and November, in line with its pre-hurricane level. (In August,

[5] GM recently announced plans to reduce both sticker prices and incentives for most of its models. We expect these changes to have little effect on bottom-line prices.

[6] GM idled three plants in 2005 and plans to idle four more plants by the end of 2008. We estimate that these plants account for about 1.3 million units per year of domestic light vehicle capacity. Similarly, Ford has announced plans to close three U.S. assembly plants by the end of 2007, reducing capacity by an estimated 650,000 units per year; Ford expects to announce two additional plant closures this year, though these plants may be in Mexico or Canada. However, capacity at transplants is likely to be increased over this period. Total light vehicle capacity at the end of 2005 was about 14.7 million units per year.

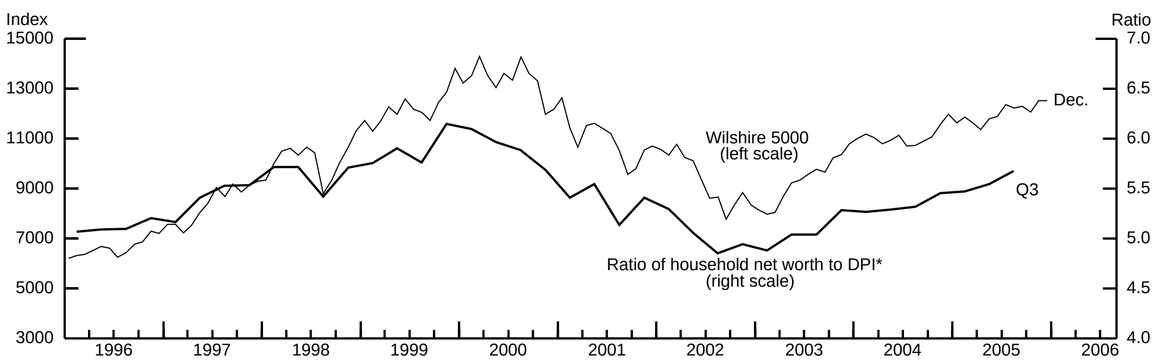
Household Indicators

Changes in DPI and Wages and Salaries



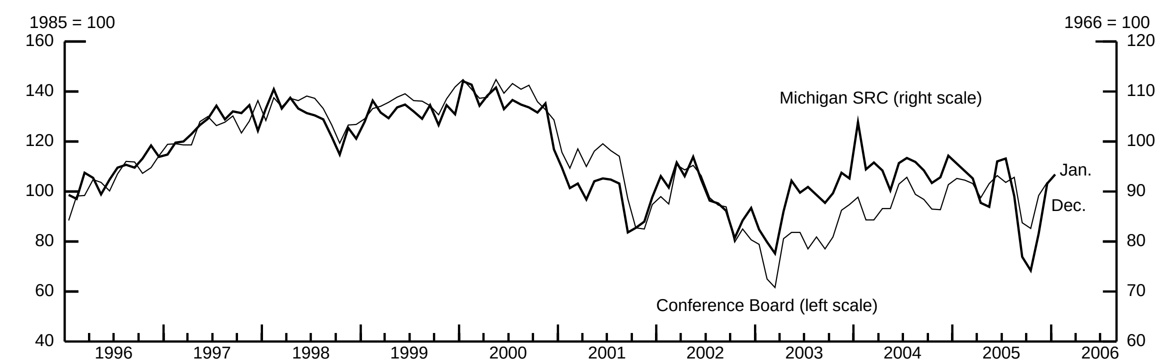
Note. Microsoft dividend is excluded.

Household Net Worth and Wilshire 5000



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

Consumer Confidence



the saving rate was reported to have dropped temporarily to -3.4 percent, a decrease reflecting a hit to income from uninsured hurricane-related losses.)

Many of the fundamental determinants of consumer spending have strengthened in recent months. After having fallen in the third quarter, real disposable personal income firmed in October and increased 0.7 percent in November, a strengthening bolstered by solid gains in the labor market and the drop in energy prices. Ongoing gains in home prices and equity prices have continued to push up the ratio of household wealth to disposable income relative to earlier in 2005. Consumer confidence, as measured by both the Michigan Survey and the Conference Board, moved up in November and December, reversing the declines that followed the hurricanes of late summer. The preliminary reading of the Michigan Survey for January edged up further, and the current level of consumer sentiment is consistent with solid consumer spending in the near term.

Housing Markets

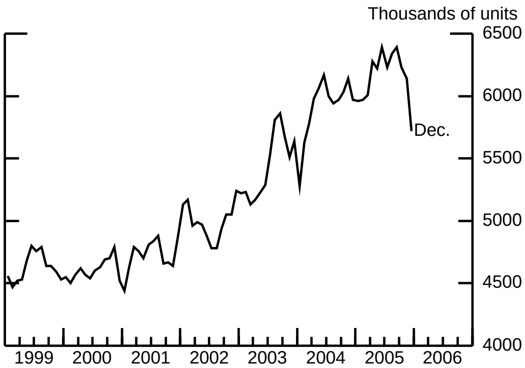
The tenor of recent anecdotal reports and near-term indicators point to some cooling in the housing market. The Mortgage Bankers Association's index of mortgage applications for home purchases declined in November and has remained at this lower level since then. The Michigan Survey index of homebuying attitudes has also remained low following a significant drop in September 2005. Furthermore, the stock of homes for sale has increased in recent months, and months' supply of new and existing homes are now both in the upper end of the ranges they have occupied since 1997.

Similarly, the pace of home sales has come off its peak from earlier in the year, although it remains at a relatively high level. Sales of existing single-family homes fell to an annual rate of 5.7 million units in December, a level not seen since early 2004. However, the average pace of sales for the fourth quarter as a whole was as high as it was last winter. New home sales in November fell from October's record-setting pace but again were not below the pace of sales earlier in the year.

Residential construction activity also has shown signs, albeit limited, of cooling. Single-family housing starts decreased markedly in December to an annual rate of 1.58 million units. However, this decline came off an especially high level in November, and we suspect that unusually cold and wet weather limited residential building activity

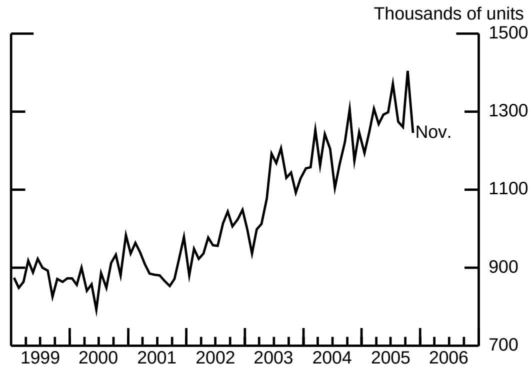
Indicators of Single-Family Housing

Existing Home Sales



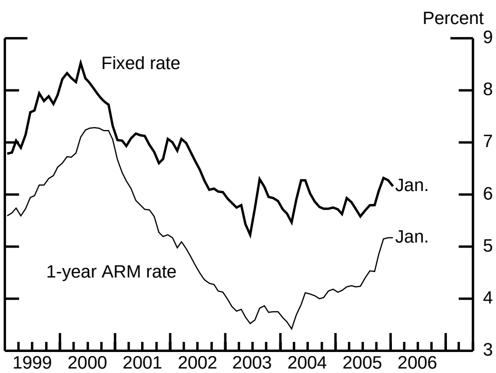
Source. National Association of Realtors.

New Home Sales



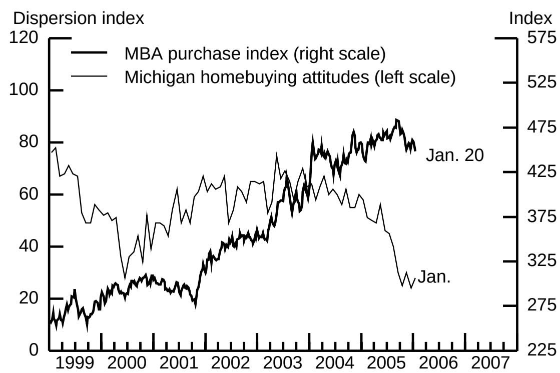
Source. Census Bureau.

Mortgage Rates



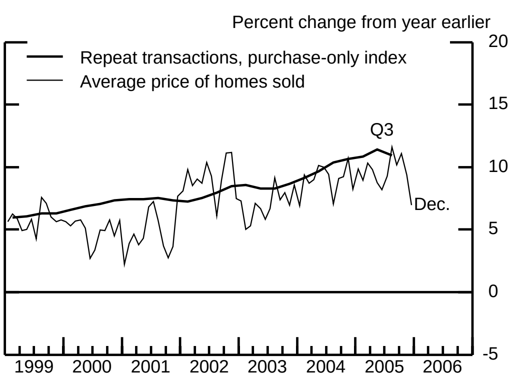
Note. The January readings are based on data through January 18, 2006.
Source. Freddie Mac.

Homebuying Indicators



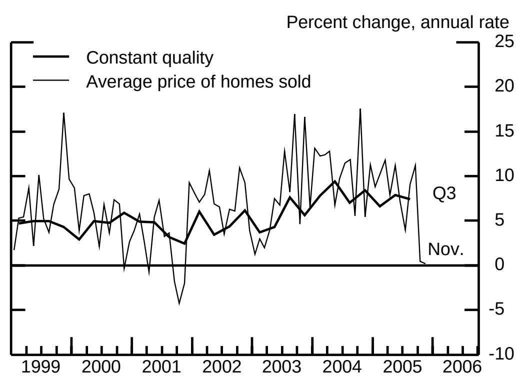
Note. MBA index is a 4-week moving average.
Source. Mortgage Bankers Association and Michigan Survey.

Prices of Existing Homes



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

Prices of New Homes



Note. Average price is a 12-month moving average with a missing value in January 2005. Constant quality price index is a 4-quarter moving average. Both series are seasonally adjusted by Board staff.
Source. Census Bureau.

in parts of the country last month. In the multifamily sector, starts increased in December to a level in the middle of the fairly tight range we have seen during the past seven years. New permit issuance and the backlog of unused permits for both single- and multifamily homes suggest that the level of residential construction in the coming months will maintain the pace averaged in the second half of last year.

House prices have not yet shown convincing signs of deceleration, although the most informative types of data are somewhat out of date. 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 it was a year earlier. 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—also showed large gains through the third quarter of 2005. More-recent indicators are limited to price measures that do not control for the mix of homes sold and that can be quite erratic. The average price of existing homes sold in December was 7 percent higher than it was a year earlier, slightly less than the increase that occurred during the previous twelve-month period. The average price of new homes sold has decelerated in recent months to the low end of the wide range experienced during the past seven years.[7]

Mortgage rates have edged lower in the past month after displaying significant increases in the second half of last year. On net, the rate on a thirty-year fixed-rate mortgage has risen about 60 basis points since June, and the rate on the one-year adjustable-rate mortgage has increased nearly 100 basis points.

Equipment and Software

Business outlays for equipment and software (E&S) appear to have increased at a significantly slower rate in the fourth quarter than they did in the third quarter as expenditures for transportation and communications equipment reversed some of their earlier sharp increases. Averaging through those two quarters, we estimate that E&S spending rose solidly in the second half of 2005. In addition, underlying fundamentals should support ongoing gains in capital spending: Business output continues to expand,

[7] Because of a change in the sampling frame, the average price of new homes sold in 2005 is not comparable to the average price in 2004. Therefore, the change in average prices shown in the chart is missing in January 2005.

Private Housing Activity

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

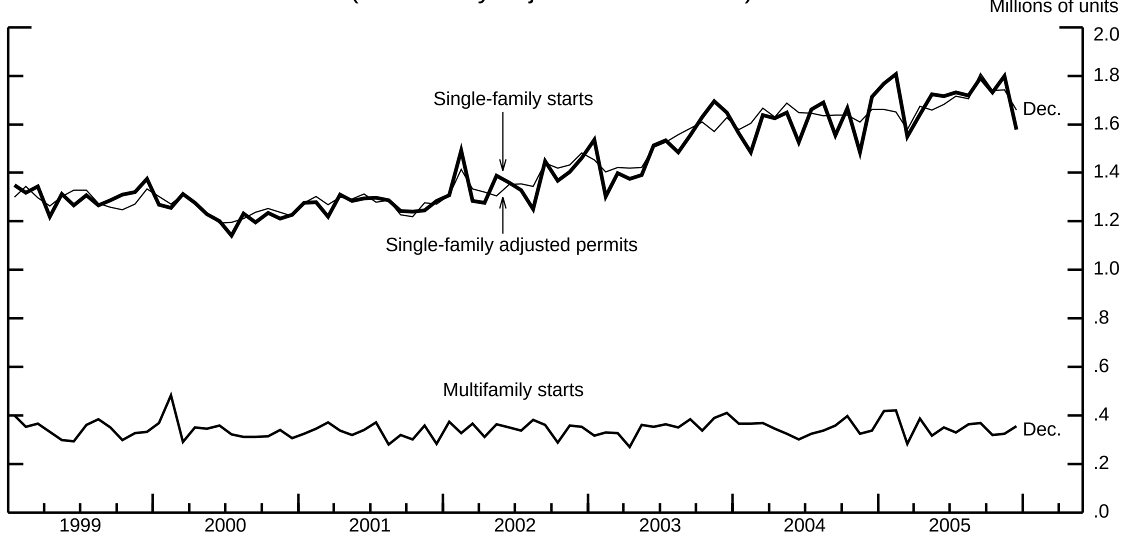
Sector	2005	2005 Q2	Q3	Q4	Oct.	Nov.	Dec.
All units							
Starts	2.06	2.04	2.10	2.04	2.05	2.12	1.93
Permits	2.14	2.11	2.18	2.11	2.10	2.16	2.07
Single-family units							
Starts	1.71	1.69	1.75	1.70	1.73	1.80	1.58
Permits	1.68	1.64	1.71	1.69	1.71	1.72	1.64
Adjusted permits[1]	1.69	1.67	1.74	1.71	1.74	1.74	1.66
Permit backlog[2]	.18	.16	.17	.18	.17	.17	.18
New homes							
Sales	n.a.	1.29	1.30	n.a.	1.40	1.25	n.a.
Months' supply[3]	n.a.	4.30	4.40	n.a.	4.20	4.90	n.a.
Existing homes							
Sales	6.18	6.30	6.32	6.03	6.23	6.14	5.72
Months' supply[3]	4.40	4.30	4.60	4.90	4.80	4.90	4.90
Multifamily units							
Starts	.35	.35	.35	.33	.32	.32	.36
Permits	.46	.47	.47	.42	.40	.44	.43
Permit backlog[2]	.06	.06	.06	.06	.06	.06	.06
Mobile homes							
Shipments	n.a.	.13	.13	n.a.	.20	.21	n.a.
Condos and co-ops							
Existing home sales	.90	.93	.92	.87	.86	.86	.88

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

n.a. Not available.

Private Housing Starts and Permits

(Seasonally adjusted annual rate)



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

firms remain flush with cash, and relative price declines continue to drive down the user cost of capital equipment. Furthermore, anecdotal reports, business surveys, and our business contacts offer optimistic readings on near-term capital spending plans.

Business outlays for motor vehicles appear to have declined in the fourth quarter after having increased at a rapid pace in the second and third quarters of 2005. Individual purchases by firms, like consumers, swung back down when employee pricing programs ended. However, fleet sales of light vehicles and sales of medium and heavy trucks (classes 4 to 8) all stood at high levels in the fourth quarter; part of the recent increase in demand for heavy trucks probably reflects a pulling forward of purchases in advance of new EPA regulations on engines slated to take effect in January 2007. The indicators of truck demand suggest further strengthening in the near term: In December, the three-month moving average of new truck orders increased to its highest level since 1998, and order backlogs moved up markedly. Meanwhile, business purchases of aircraft likely fell again in the fourth quarter. Smoothing through the lumpiness in the monthly data, shipments of aircraft by domestic producers in October and November were about unchanged from the previous quarter, but more of the jets were sent abroad to foreign carriers. Nevertheless, with the orders backlog having risen so much over the past year, purchases are likely to step back up in the near term.

In the high-tech sector, nominal shipments of computing equipment remained high in November after having posted a large gain in October, and orders moved up sharply in November. Coupling the strength in shipments with continued declines in computer prices, real expenditures look set for an appreciable gain in the fourth quarter after a somewhat lackluster increase in the third quarter. By contrast, shipments data suggest that real expenditures on communications equipment turned down modestly last quarter after having posted an increase of 28 percent (annual rate) in the third quarter. Orders of communications equipment continued their erratic pattern, posting an 8.5 percent decline in November after an even larger October increase. Looking into this year, respondents to the December *CIO Magazine* Tech Poll predicted a solid increase in nominal high-tech spending through December 2006.

Apart from high-tech and transportation equipment, nominal shipments of nondefense capital goods moved up for a fourth consecutive month in November, and the average

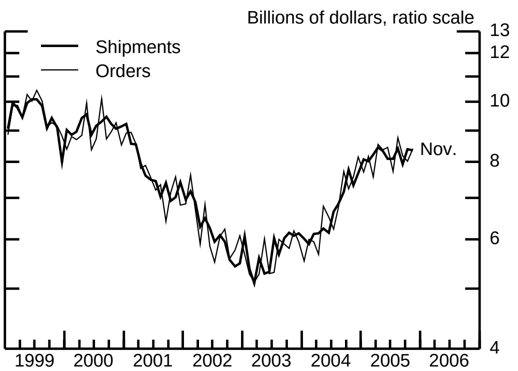
Orders and Shipments of Nondefense Capital Goods

(Percent change; seasonally adjusted current dollars)

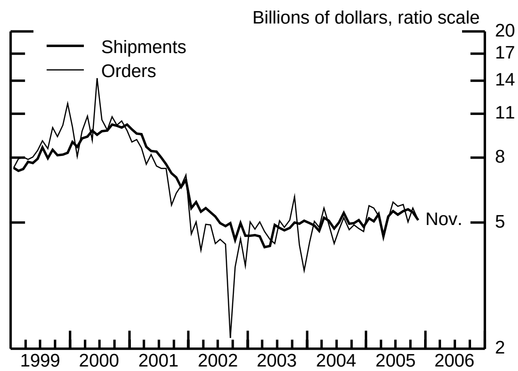
Indicators	2005 Q2	Q3	Sept.	Oct.	Nov.
	Annual rate		Monthly rate		
Shipments	8.2	1.8	-2.9	4.5	2.2
Excluding aircraft	1.3	3.2	-.6	1.7	.1
Computers and peripherals	9.3	-6.6	-5.7	5.7	-.4
Communications equipment	-8.5	30.8	1.3	-2.2	-5.3
All other categories	1.0	2.3	.1	1.5	.7
Orders	66.1	-15.6	-8.7	6.7	19.6
Excluding aircraft	2.2	4.0	-1.8	1.1	-2.1
Computers and peripherals	36.8	-10.7	-6.6	-2.0	4.8
Communications equipment	-20.5	23.2	-12.0	10.8	-8.5
All other categories	.0	4.8	.2	.7	-2.5
Memo:					
Shipments of complete aircraft[1]	30.2	26.2	14.2	28.8	26.6

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

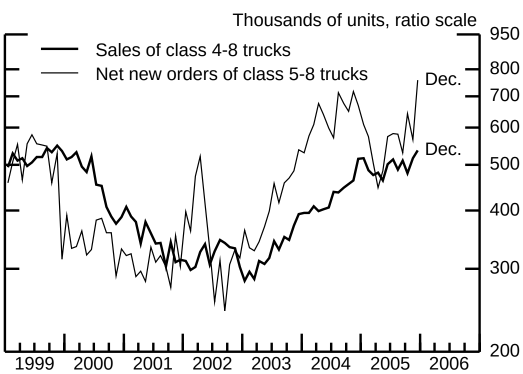
Computers and Peripherals



Communications Equipment

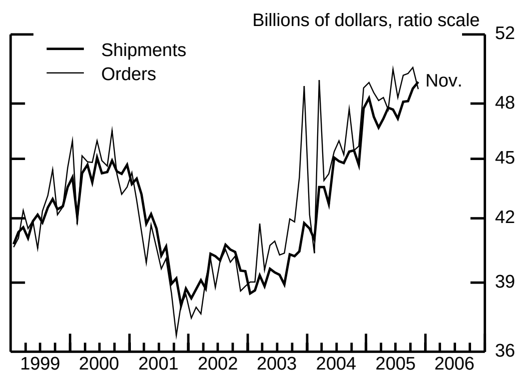


Medium and Heavy Trucks



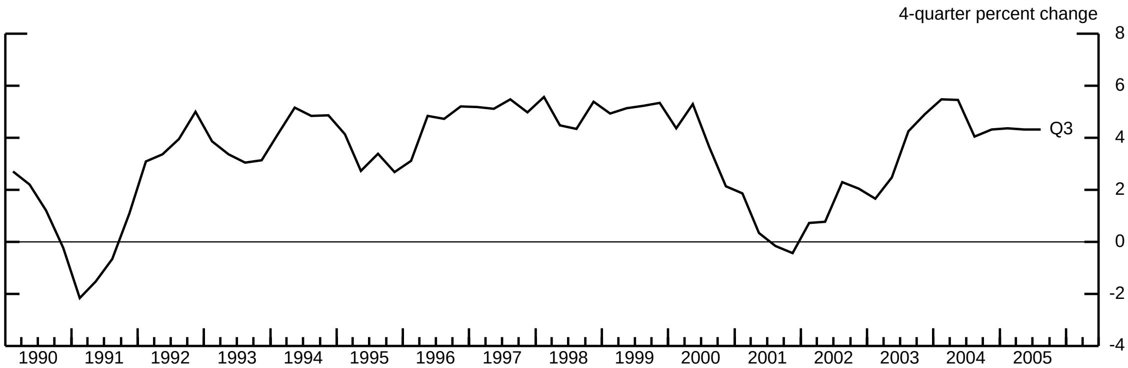
Note. Annual rate, FRB seasonals.
Source. For class 4-8 trucks, Ward's Communications; for class 5-8 trucks, ACT Research.

Other Equipment



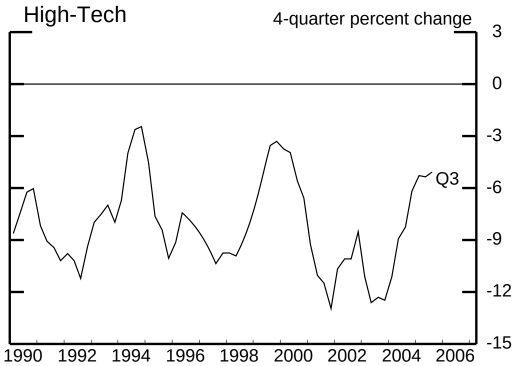
Fundamentals of Equipment and Software Investment

Real Business Output

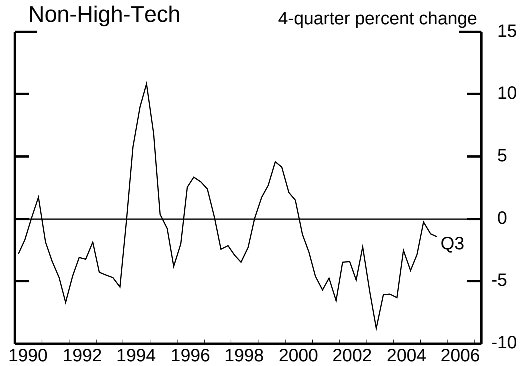


User Cost of Capital

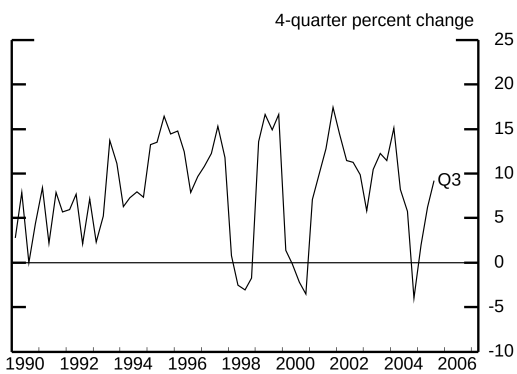
High-Tech



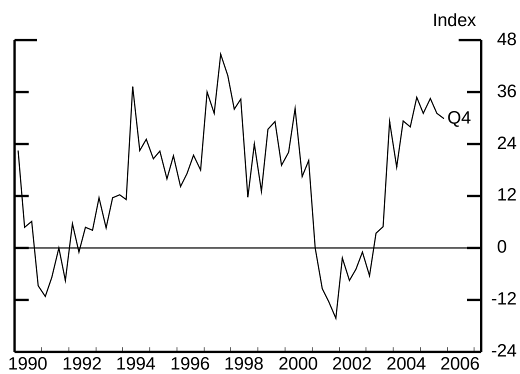
Non-High-Tech



Real Corporate Cash Flow



NABE Capital Spending Diffusion Index



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

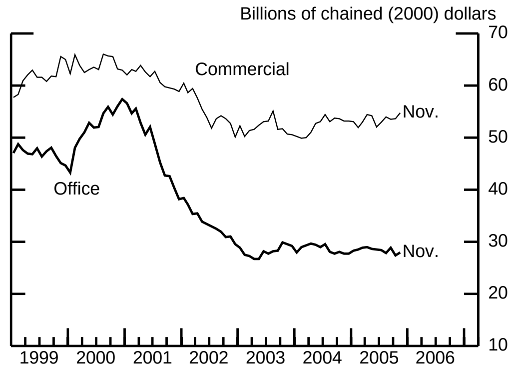
Nonresidential Construction and Indicators

Real Construction

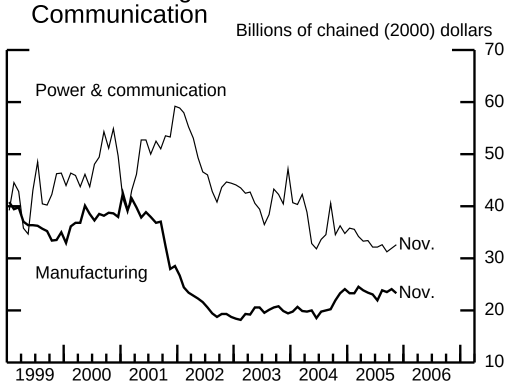
(Seasonally adjusted, annual rate; nominal CPIP deflated by BEA prices through Q3 and by staff projection thereafter)

Total Structures

Office and Commercial



Manufacturing and Power & Communication

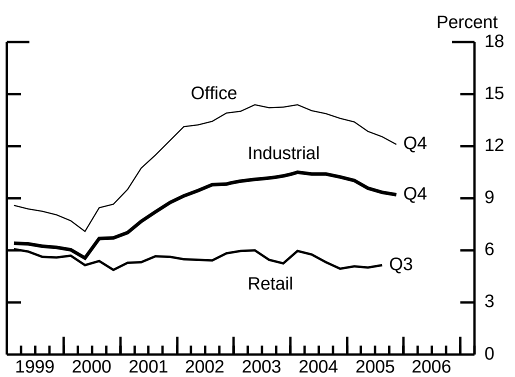


Other

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

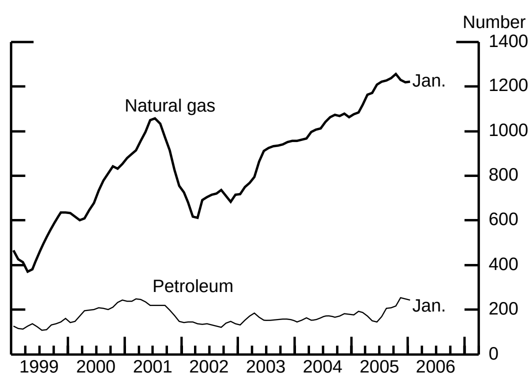
Indicators

Vacancy Rates



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

Drilling Rigs in Operation



Note. January values are averages through January 20, 2006.
Source. DOE/Baker Hughes.

level of shipments in October and November stood 2½ percent (not at an annual rate) above the third-quarter average. Increases in foreign demand for capital equipment apparently drew a larger share of shipments abroad, and we estimate that spending by domestic businesses rose a bit more slowly last quarter than the robust third-quarter pace. New orders for this category of equipment—which rose in August, September, and October—retreated sharply in November; nevertheless, the backlog of unfilled orders narrowed only slightly, and the long pipeline of projects already in train should provide momentum for shipments in coming months.

Nonresidential Construction

Although vacancy rates for nonresidential properties have drifted down a bit during the past two years, real spending on new construction has yet to gain traction. The vacancy rate for office buildings stood near 12 percent in December, about 2¼ percentage points below its peak in the first quarter of 2004, but expenditures in this sector have continued to run at only about 60 percent of their 1999 levels. Spending on commercial buildings has also held steady at a low level since the middle of 2002 despite persistently low vacancy rates in the retail sector (which accounts for a major portion of spending on commercial buildings). In addition, real outlays for structures in the manufacturing sector have changed little in recent quarters after increasing a bit at the end of 2004.

In contrast to the other categories of nonresidential spending, outlays on drilling and mining structures have continued to increase strongly, rising at an annual rate of 18 percent in the third quarter. Although the number of gas rigs in operation has edged down since October, the 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.

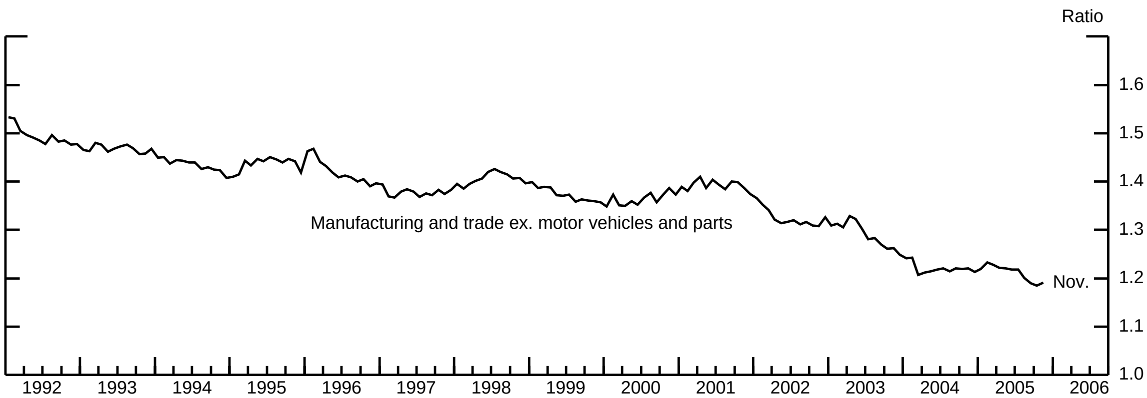
Business Inventories

Motor vehicle inventories were accumulated rapidly in the fourth quarter, reflecting the decline in light vehicle sales. Outside of the motor vehicle sector, however, inventory investment seems to have remained low. The book value of manufacturing and trade inventories excluding motor vehicles increased at an average annual rate of $34 billion in October and November, little different from the pace of accumulation seen in the second and third quarters. Prices of goods held in inventories—most notably petroleum-based products and many non-energy materials—have fluctuated widely since Hurricane

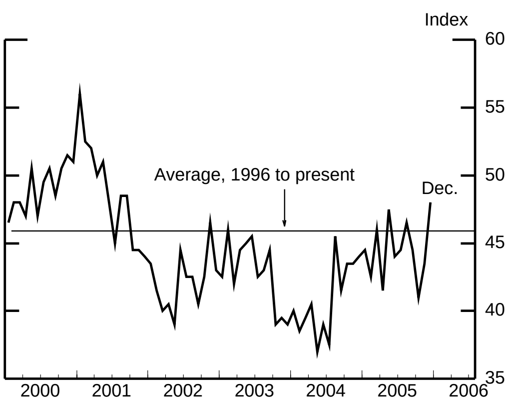
Changes in Manufacturing and Trade Inventories
(Billions of dollars; seasonally adjusted book value; annual rate)

Sector	2005 Q1	Q2	Q3	Sept.	Oct.	Nov.
Manufacturing and trade	88.6	18.7	21.7	73.0	60.3	75.3
Ex. wholesale and retail motor vehicles and parts	92.0	29.1	33.5	31.2	31.9	36.0
Manufacturing	42.6	.9	8.3	5.7	33.9	8.8
Ex. aircraft	38.1	4.0	5.2	-1.8	27.4	9.9
Wholesale trade	30.5	20.2	16.1	23.6	10.3	17.2
Motor vehicles and parts	-1.1	7.9	-1.4	1.3	7.7	1.6
Ex. motor vehicles and parts	31.6	12.4	17.5	22.3	2.6	15.6
Retail trade	15.5	-2.4	-2.7	43.7	16.1	49.3
Motor vehicles and parts	-2.3	-18.3	-10.5	40.6	20.6	37.6
Ex. motor vehicles and parts	17.7	15.8	7.7	3.1	-4.5	11.6

Book-Value Inventories Relative to Shipments and Sales

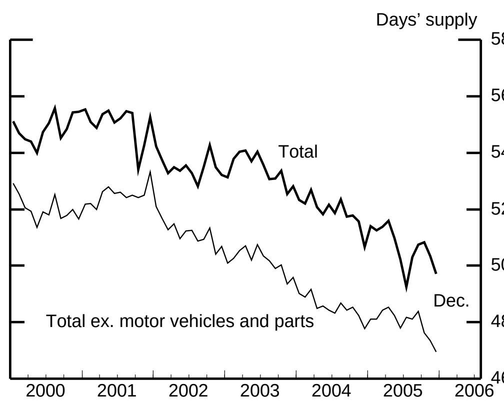


ISM Customer Inventories: Manufacturing



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

Inventory-Consumption Ratios, Flow-of-Goods System



Katrina hit the Gulf Coast last August. With many prices rising sharply in October, the Bureau of Economic Analysis has estimated that real manufacturing and trade inventories declined sharply that month after having posted meager accumulations in August and September; this decrease put real non-auto inventory accumulation on a weaker trajectory into the fourth quarter than it had followed earlier in the year.[8]

The inventory readings of the past few months may still reflect a continuation of intentionally lower stockbuilding after the strong accumulations seen in late 2004 and early 2005, but some of the recent weakness may also reflect supply interruptions after last year's hurricanes. In particular, the fraction of purchasing managers in the ISM survey who saw their customers' inventories as too low rose in September and October, but that increase was reversed over the subsequent two months. Overall inventory-sales ratios through November appeared generally in line with their downtrend over the past fifteen years. The inventory-sales ratio for manufacturing and trade excluding motor vehicles moved down through October before inching up in November to a level a few notches below its third-quarter average.

Information from the staff's flow-of-goods inventory system suggests that inventory-consumption ratios outside of vehicles and parts fell in December for a third consecutive month. Inventories appear to remain well aligned with consumption in most industries other than paper products, in which stocks remain excessive.

Federal Government Sector

Data from the *Monthly Treasury Statement* (MTS) for the fourth quarter indicate that defense spending was quite subdued after a large increase in the third quarter; indeed, on a NIPA basis, we estimate that real defense purchases plunged at a double-digit annual rate last quarter. However, given the level of defense appropriations, the fourth quarter decline appears mostly to reflect volatility in a typically choppy category of spending.

In terms of the unified budget, the improvement in the federal budget stalled in the fourth quarter following several quarters of progress. Outlays accelerated last quarter and were 9½ percent higher than a year earlier, a result of both a sharp rise in interest outlays

[8] We do not yet have November real inventory data. Prices of goods held in inventories likely increased more modestly in November than in October.

Federal Government Outlays and Receipts

(Unified basis; billions of dollars except as noted)

Function or source	October-December 2004	October-December 2005	October-December Percent change	12 months ending in December 2004	12 months ending in December 2005	12 months ending in December Percent change
Outlays	605.2	649.5	7.3	2327.0	2516.1	8.1
Financial transactions[1]	-.4	-.1	...	-1.7	-1.0	...
Payment timing[2]	11.6	.1	...	-.9	.2	...
Adjusted outlays	594.0	649.6	9.4	2329.6	2516.8	8.0
Receipts	487.2	530.2	8.8	1926.2	2196.4	14.0
Payment timing	6.0	.0	...	.0	.0	...
Adjusted receipts	481.2	530.2	10.2	1926.2	2196.4	14.0
Surplus or deficit (-)	-118.1	-119.3	...	-400.7	-319.7	...
Selected components of adjusted outlays and receipts						
Adjusted outlays	594.0	649.6	9.4	2329.6	2516.8	8.0
Net interest	44.3	57.0	28.9	163.1	196.3	20.3
Non-interest	549.8	592.5	7.8	2166.5	2320.6	7.1
National defense	119.3	125.1	4.9	466.0	496.4	6.5
Social Security	126.0	132.4	5.1	501.7	529.7	5.6
Medicare	70.6	71.4	1.1	276.7	296.4	7.1
Medicaid	45.1	46.7	3.6	178.0	183.4	3.0
Income security	75.9	77.5	2.1	334.1	346.2	3.6
Agriculture	16.6	19.4	16.6	20.4	31.0	52.4
Other	96.2	120.0	24.7	389.7	437.4	12.3
Adjusted receipts	481.2	530.2	10.2	1926.2	2196.4	14.0
Individual income and payroll taxes	381.6	403.2	5.7	1521.9	1695.0	11.4
Withheld + FICA	368.0	391.9	6.5	1417.6	1510.5	6.6
Nonwithheld + SECA	21.9	21.9	.0	289.1	364.9	26.2
Less: Refunds	10.4	10.6	1.4	186.9	180.4	-3.5
Corporate	58.3	80.7	38.3	210.5	294.6	39.9
Gross	68.5	89.7	30.9	245.4	322.2	31.3
Less: Refunds	10.2	9.0	-11.6	34.9	27.6	-20.8
Other	41.2	46.3	12.3	193.8	206.8	6.7
Adjusted surplus or deficit (-)	-112.8	-119.4	...	-403.4	-320.5	...

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.

(driven by the outsized increases in inflation adjustments on Treasury inflation-protected securities, or TIPS) and spending related to the hurricanes (including $18 billion in expenditures by the Federal Emergency Management Agency for disaster aid and national flood insurance).[9] In contrast to the pickup in outlays, receipts decelerated last quarter, although the rate of increase in receipts was still sizable.

In December, the Congress passed the fiscal 2006 defense bill, the last of the regular appropriations bills. Besides providing funding for defense, including a $50 billion down payment for this year's spending on Iraq, the bill authorized $6 billion of new spending for hurricane relief, $4 billion to address the avian flu, and a 1 percent across-the-board cut in discretionary spending. In addition, the Congress passed the Gulf Opportunity Zone Act, which cuts taxes by $4 billion in 2006 and $8 billion over five years. The Senate and the House have passed virtually identical spending reconciliation bills that cut mandatory spending an estimated $5 billion in 2006 and $40 billion over five years.

State and Local Government Sector

Data on the state and local sector indicate that real purchases rose modestly in the latter part of last year. Employment rose 13,000 per month, on average, during the fourth quarter, a rate a bit lower than the average over the past two years. Nominal outlays for state and local construction in October and November stood at an annual rate of 8 percent above the third-quarter average; although much of this nominal increase likely reflected higher prices for construction-related materials, it may also have reflected some reconstruction and repair activity in the South.

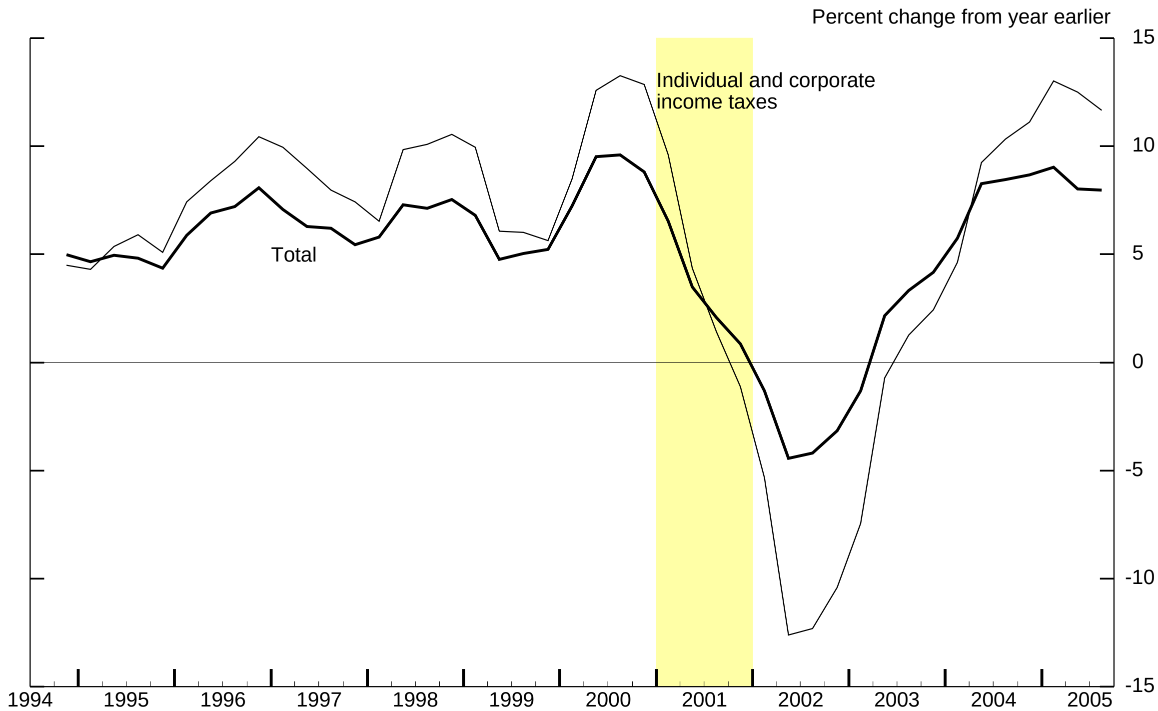
Moderate spending growth and robust tax collections have contributed to a further improvement in state and local budget balances.[10] Fueled by strong gains in personal and corporate income tax payments, state tax receipts were 8 percent higher in the four quarters ending in 2005:Q3 than in the four quarters ending in 2004:Q3. Over the same

[9] Price increases boost the principal on TIPS as well as the coupon payments (the principal times the coupon rate). Both factors are recorded as interest outlays in the MTS.

[10] In the NIPA accounts, state and local net saving declined in 2005:Q3 because of one-time charges on government-sponsored enterprises related to the hurricanes and a drop in personal income tax receipts from the exceptionally high second-quarter reading. But smoothing through the quarterly swings in personal taxes, we find that the budget situation has improved over the past year.

State and Local Revenues
(4-quarter moving average)

State



Local

Note. Shaded bars indicate a period of recession.

period, an acceleration in property tax collections led to an 8 percent rise in revenues of local governments.

Prices and Labor Costs

The overall CPI edged down in December, a result of small increases for food and core items and substantial declines, on balance, in the volatile energy components of the price index. Translating these CPI data into an estimate of PCE prices for December, we estimate that overall PCE prices rose 2.7 percent over the twelve months of 2005, about 0.3 percentage point less than the increase during the preceding year. Excluding food and energy, PCE prices appear to have risen 1.8 percent last year, 0.4 percentage point less than the increase during the preceding year; a deceleration in the erratic nonmarket components of this index accounts for all of that slowing.[11]

Large swings in energy prices have dominated recent changes in headline consumer prices. We estimate that the energy component of PCE prices fell 2.3 percent in December after a drop of 8.6 percent in November. However, survey data for gasoline point to an increase in January large enough to more than reverse the December decline in overall consumer energy prices. The projected January increase in gasoline prices is due to the recent backup in crude oil prices; gasoline inventories have run near the middle of the historical range for this time of year, and markups for gasoline are near normal levels. In other energy markets, unseasonably warm weather of late has left stocks of natural gas near the high end of their historical range for this time of the winter, helping to drive down spot prices more than 40 percent since their peak in mid-December. As production capacity continues to be below normal, however, prices may rise if the weather turns unseasonably cold for a few weeks. Finally, residential electricity prices rose late in the year as electric utilities passed through higher fossil fuel input costs.

We estimate that the PCE price index for food rose 0.1 percent in December after a 0.3 percent increase in the preceding month. An ample harvest and increasing supplies of meats and poultry have moderated food prices over the past year. Although the general trend in 2005 was a gradual alignment of increases in food prices with core inflation, some disruptions in food markets occurred near the end of the year. Hurricane Wilma,

[11] Our estimates of December changes in the nonmarket prices are far less precise than are our estimates for the market-based components of PCE prices.

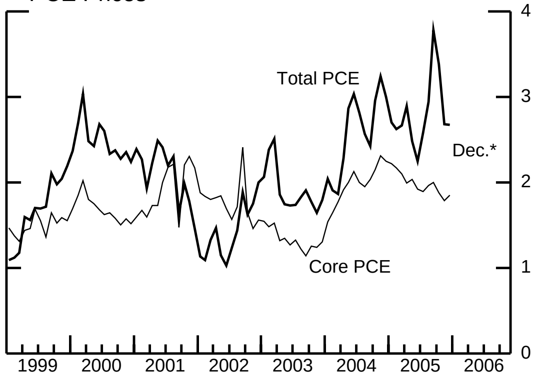
Measures of Inflation
(Percent)

Measures	12-month change Dec. 2004	12-month change Dec. 2005	3-month change, Annual rate Sept. 2005	3-month change, Annual rate Dec. 2005	1-month change, Monthly rate Nov. 2005	1-month change, Monthly rate Dec. 2005
CPI						
Total	**3.3**	**3.4**	**9.4**	**-1.6**	**-.6**	**-.1**
Food	2.7	2.3	1.9	3.0	.3	.2
Energy	16.6	17.1	122.1	-35.2	-8.0	-2.2
Ex. food and energy	**2.2**	**2.2**	**1.4**	**2.8**	**.2**	**.2**
Core goods	.6	.2	.0	-.3	-.1	.0
Core services	2.8	2.9	2.2	3.9	.4	.3
Chained CPI (n.s.a.)[1]	2.9	2.8	...	...	...	...
Ex. food and energy[1]	2.0	1.7	...	...	...	...
PCE prices[2]						
Total	**3.0**	**2.7**	**6.9**	**-1.3**	**-.4**	**.0**
Food	2.5	2.1	2.2	2.3	.3	.1
Energy	17.5	16.5	126.8	-37.7	-8.6	-2.3
Ex. food and energy	**2.2**	**1.8**	**1.7**	**1.7**	**.1**	**.1**
Core goods	.3	-.1	-.8	-.2	.0	-.1
Core services	3.1	2.7	2.7	2.4	.2	.2
Core market-based	1.7	1.7	1.2	1.6	.2	.1
Core non-market-based	4.8	n.a.	3.8	n.a.	.0	n.a.
PPI						
Total finished goods	**4.2**	**5.4**	**14.2**	**3.6**	**-.7**	**.9**
Food	3.1	1.4	2.3	5.2	.5	.9
Energy	13.4	23.9	80.1	12.7	-4.0	3.1
Ex. food and energy	**2.3**	**1.7**	**2.3**	**.0**	**.1**	**.1**
Core consumer goods	2.2	1.9	2.0	.5	.2	.1
Capital equipment	2.4	1.3	2.5	-.8	-.1	.1
Intermediate materials	9.2	8.4	17.5	8.1	-1.2	.2
Ex. food and energy	8.3	4.5	4.2	8.5	.5	.3
Crude materials	17.4	22.1	103.2	12.2	-1.2	-2.3
Ex. food and energy	20.5	4.8	54.9	17.2	5.4	.0

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

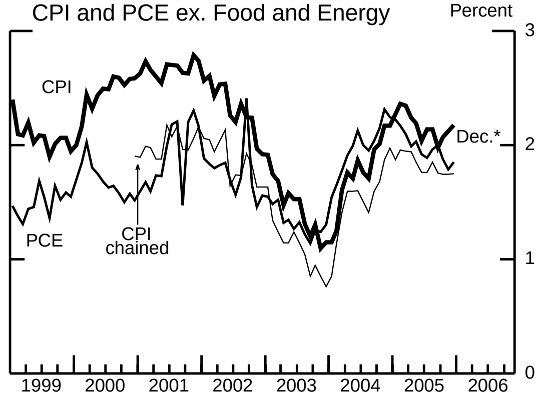
Consumer Price Inflation
(12-month change except as noted)

PCE Prices



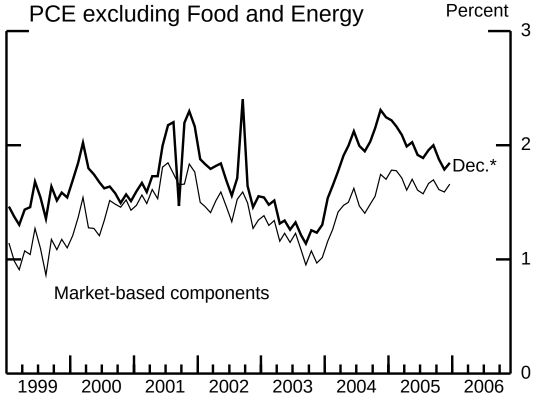
* Staff estimate.

CPI and PCE ex. Food and Energy



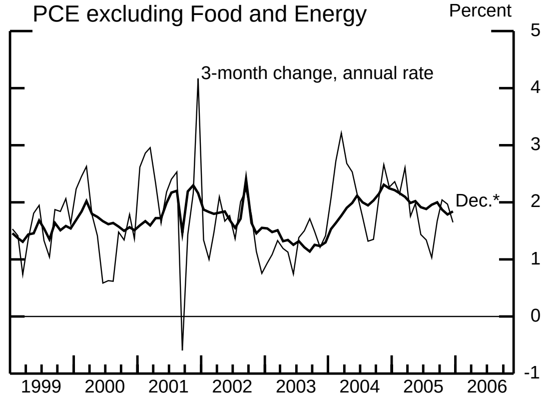
* PCE for December is a staff estimate.

PCE excluding Food and Energy



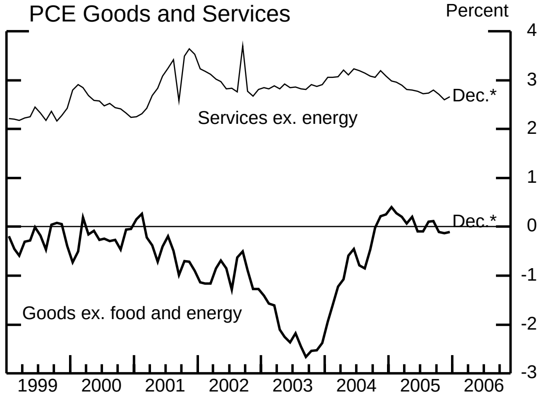
* Staff estimate.

PCE excluding Food and Energy



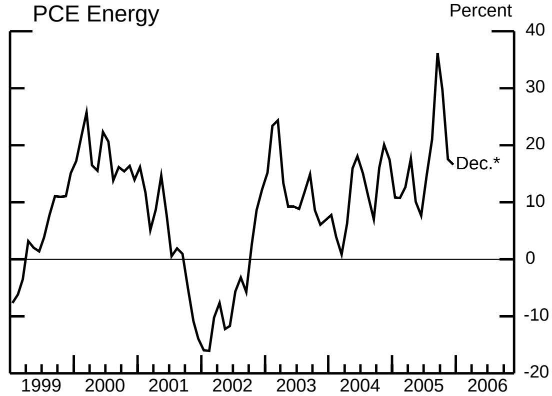
* Staff estimate.

PCE Goods and Services



* Staff estimate.

PCE Energy

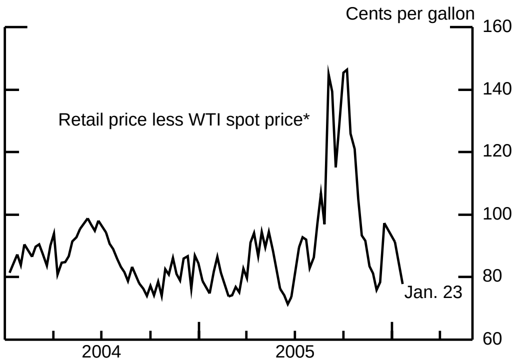


* Staff estimate.

Energy Prices and Inventories

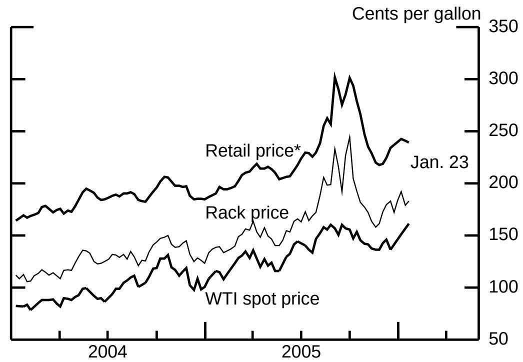
(Data from Energy Information Administration except as noted)

Total Gasoline Margin



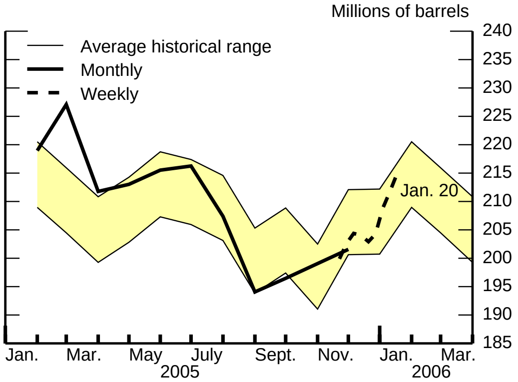
* Regular grade seasonally adjusted by FRB staff, less West Texas intermediate spot price.

Gasoline Price Decomposition



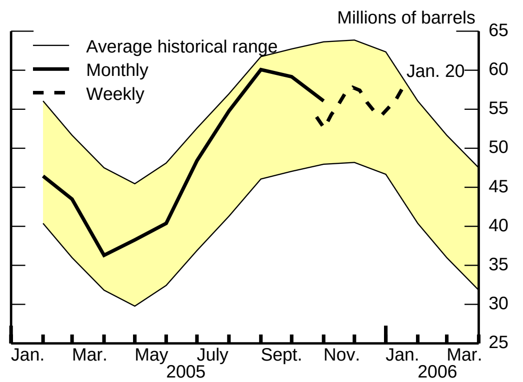
* Regular grade seasonally adjusted by FRB staff.

Gasoline Inventories



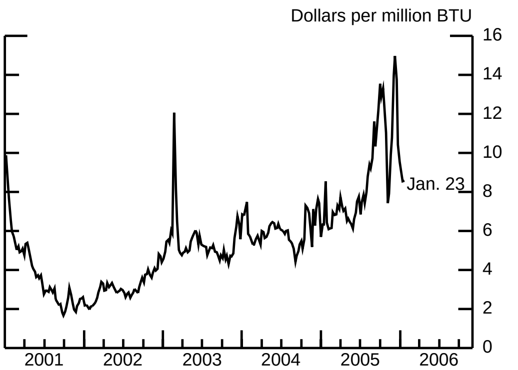
Note. Average historical range calculated by Energy Information Administration.

Heating Oil Inventories



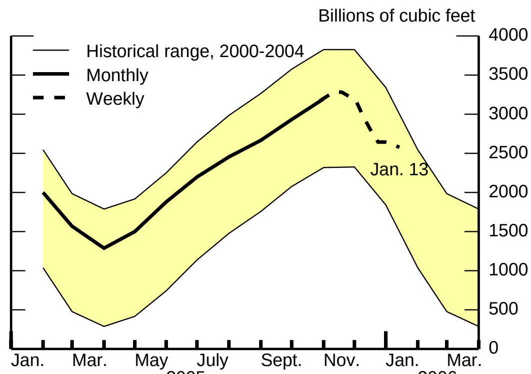
Note. Historical range calculated by FRB staff.

Natural Gas Prices



Note. National average spot price.
Source. Bloomberg.

Natural Gas Inventories



Note. Historical range calculated by FRB staff.

which struck Florida in late October, damaged the winter crop of some vegetables more than was initially reported, and the decline in supply has led to temporary spikes in prices for those goods.

Core consumer price inflation has been modest. Last summer, core PCE prices posted a string of very low increases, held down in part by falling motor vehicle prices. More recently, core price increases have come up from those very low readings to moderate levels. In December, we estimate that core PCE prices rose 0.1 percent; this increase would bring the three-month change to an annual rate of 1.7 percent—about the same as the twelve-month change. As noted above, core PCE inflation is estimated to have moved down 0.4 percentage point over the past year. The slowdown reflects a deceleration of about 2 percentage points in the erratic nonmarket components of core PCE prices, which now seem to be increasing at a more moderate pace after bulging noticeably in the latter half of 2004 and in early 2005. In contrast, core market-based PCE prices are estimated to have risen at the same 1.7 percent pace as in the preceding year.

Near-term inflation expectations edged lower in January, further reversing the sharp increases seen after the hurricanes in the fall. The preliminary January reading on the Michigan SRC measure of median inflation expectations for the coming year ticked down to 3 percent. Median five- to ten-year inflation expectations moved down as well, to just under 3 percent. By way of comparison, rate spreads on CPI-indexed Treasury bonds implied inflation compensation of about 2½ percent for both five- and ten-year maturities. Although this level is up a bit from that in the December Greenbook, it remains toward the low end of the range seen over the past year.

Last autumn’s sharp increases in energy prices still seem to be showing through to a number of inputs to production, though apparently with somewhat less strength in December than in previous months. In particular, prices for many energy-intensive intermediate products such as chemicals, plastics, and nitrogenous fertilizers, which had risen sharply in October and November, generally posted smaller increases or declined in December. For core intermediate materials as a whole, prices rose 0.3 percent in December after increases of 0.5 percent in November and 1 percent or higher in the preceding two months. Notwithstanding the post-hurricane increases in prices, the

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

Measure	2002	2003	2004	2005
Product prices				
GDP price index	1.6	2.1	2.7	2.9
Less food and energy	2.0	1.8	2.6	2.7
Nonfarm business chain price index	1.1	1.2	2.3	2.9
Expenditure prices				
Gross domestic purchases price index	1.6	2.1	3.0	3.4
Less food and energy	1.9	1.7	2.6	2.5
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	3.1
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 [1]	University of Michigan: 1 year [2] Mean	University of Michigan: 1 year [2] Median	University of Michigan: 5 to 10 years [3] Mean	University of Michigan: 5 to 10 years [3] Median	Professional forecasters (10-year) [4]
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	3.7	4.6	3.7	3.5	3.1	2.5
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.	3.5	4.1	3.3	3.3	3.0	...
Dec.	3.4	4.1	3.1	3.5	3.1	2.5
2006:Jan.	n.a.	3.5	3.0	3.3	2.9	...

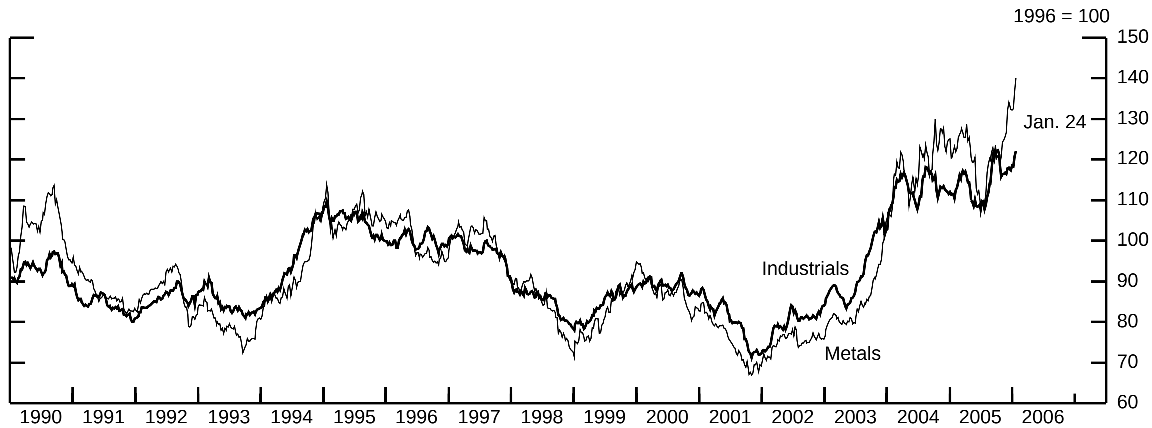
1. Percent change from the same period in the preceding year.
2. Responses to the question: By about what percent do you expect prices to go up, on average, during the next 12 months?
3. Responses to the question: By about what percent per year do you expect prices to go up, on average, during the next 5 to 10 years?
4. Quarterly CPI projections compiled by the Federal Reserve Bank of Philadelphia.
... Not applicable.
n.a. Not available.

twelve-month change in the PPI for core intermediate materials in December—4½ percent—was almost 4 percentage points below the rate of increase in the preceding year.

Commodity prices have moved higher since the time of the December Greenbook. The *Journal of Commerce* (JOC) metals index has risen 6 percent, as declines for steel scrap have been more than offset by increases for other industrial metals. The broader JOC industrial price index has moved up 3½ percent since the last Greenbook, while the Commodity Research Bureau spot industrial index, which excludes energy items, has risen 7¾ percent. Anecdotes are mixed as to whether hurricane-related reconstruction activity is having a notable effect on prices of construction materials. Commodity prices for lumber and for plywood are both up, on net, though we should note that these prices are measured in the West, and regional disparities are sometimes important for these products.

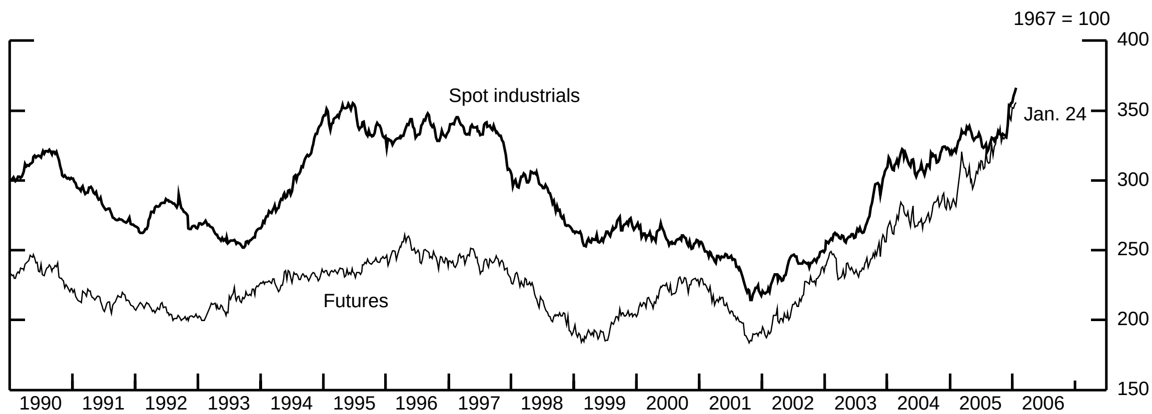
Commodity Price Indexes

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 CIBCR, 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[1]	12/28/04 to 12/6/05[2]	12/6/05[2] to 1/24/06	52-week change to 1/24/06
JOC industrials	8.7	5.7	3.6	9.5
JOC metals	19.4	5.8	5.9	15.0
CRB spot industrials	4.6	5.4	7.8	14.1
CRB spot foodstuffs	2.7	-2.2	-3.4	-3.3
CRB futures	11.1	19.4	4.8	24.2

1. From the last week of the preceding year to the last week of the year indicated.
2. December 6, 2005, is the Tuesday preceding publication of the December Greenbook.

Domestic Financial Developments

III-T-1

Selected Financial Market Quotations

(One-day quotes in percent except as noted)

Instrument	2004 June 28	2004 Dec. 31	2005 Dec. 12	2006 Jan. 24	Change to Jan. 24 from selected dates (percentage points): 2004 June 28	2004 Dec. 31	2005 Dec. 12
Short-term							
FOMC intended federal funds rate	1.00	2.25	4.00	4.25	3.25	2.00	.25
Treasury bills[1]							
3-month	1.36	2.18	3.83	4.30	2.94	2.12	.47
6-month	1.74	2.52	4.19	4.35	2.61	1.83	.16
Commercial paper (A1/P1 rates)[2]							
1-month	1.28	2.29	4.26	4.43	3.15	2.14	.17
3-month	1.45	2.28	4.37	4.52	3.07	2.24	.15
Large negotiable CDs[1]							
3-month	1.53	2.50	4.46	4.59	3.06	2.09	.13
6-month	1.82	2.72	4.61	4.70	2.88	1.98	.09
Eurodollar deposits[3]							
1-month	1.29	2.32	4.35	4.53	3.24	2.21	.18
3-month	1.51	2.49	4.47	4.62	3.11	2.13	.15
Bank prime rate	4.00	5.25	7.00	7.25	3.25	2.00	.25
Intermediate- and long-term							
U.S. Treasury[4]							
2-year	2.88	3.08	4.48	4.40	1.52	1.32	-.08
5-year	3.97	3.63	4.47	4.34	.37	.71	-.13
10-year	4.90	4.34	4.67	4.48	-.42	.14	-.19
U.S. Treasury indexed notes							
5-year	1.56	1.03	2.11	1.88	.32	.85	-.23
10-year	2.25	1.65	2.20	2.00	-.25	.35	-.20
Municipal general obligations (Bond Buyer)[5]	5.01	4.49	4.49	4.33	-.68	-.16	-.16
Private instruments							
10-year swap	5.21	4.65	5.09	4.88	-.33	.23	-.21
10-year FNMA[6]	5.30	4.61	4.97	4.77	-.53	.16	-.20
10-year AA[7]	5.59	4.98	5.39	5.24	-.35	.26	-.15
10-year BBB[7]	6.18	5.38	6.00	5.83	-.35	.45	-.17
5-year high yield[7]	8.30	7.34	8.33	8.21	-.09	.87	-.12
Home mortgages (FHLMC survey rate)[8]							
30-year fixed	6.21	5.77	6.30	6.10	-.11	.33	-.20
1-year adjustable	4.19	4.10	5.15	5.18	.99	1.08	.03

Stock exchange index	Record high: Level	Record high: Date	2004 Dec. 31	2005 Dec. 12	2006 Jan. 24	Change to Jan. 24 from selected dates (percent): Record high	2004 Dec. 31	2005 Dec. 12
Dow Jones Industrial	11,723	1-14-00	10,783	10,768	10,712	-8.62	-.66	-.52
S&P 500 Composite	1,527	3-24-00	1,212	1,260	1,267	-17.06	4.53	.51
Nasdaq	5,049	3-10-00	2,175	2,261	2,265	-55.13	4.13	.19
Russell 2000	718	1-24-06	652	690	718	.00	1.20	4.13
Wilshire 5000	14,752	3-24-00	11,971	12,655	12,802	-13.22	6.94	1.16

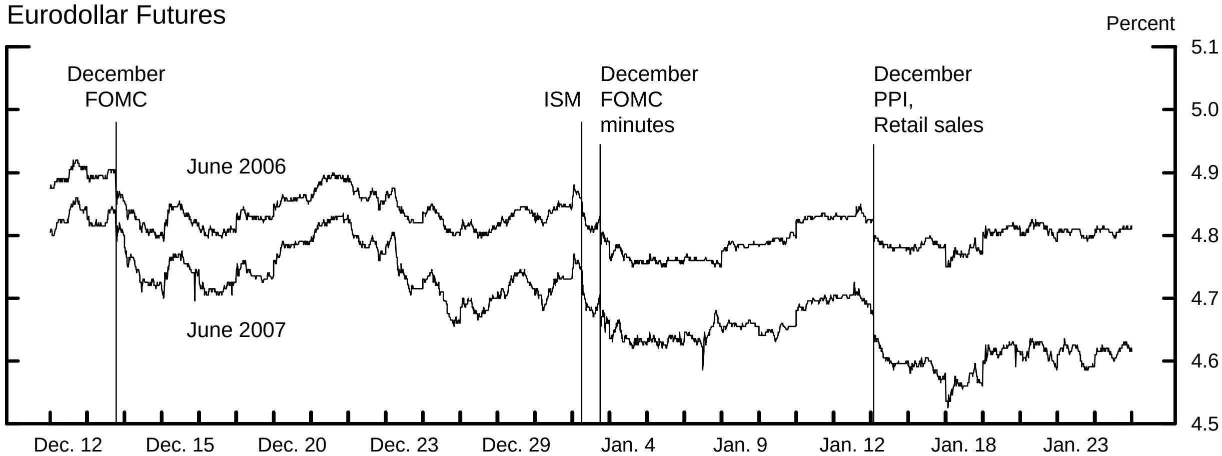
1. Secondary market.
2. Financial commercial paper.
3. Bid rates for Eurodollar deposits collected around 9:30 a.m. eastern time.
4. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
5. Most recent Thursday quote.
6. Constant-maturity yields estimated from Fannie Mae domestic noncallable coupon securities.
7. Derived from smoothed corporate yield curves estimated using Merrill Lynch bond data.
8. Home-mortgage data for January 24, 2006, is from January 19, 2006.

NOTES:

June 28, 2004, is the day before the most recent policy tightening began.
December 12, 2005, is the day before the most recent FOMC meeting.

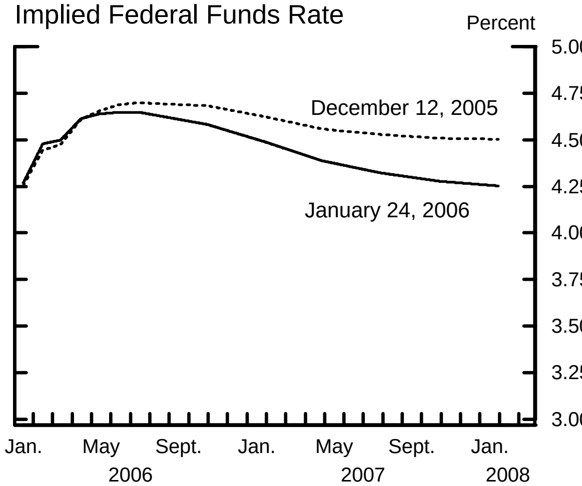
Policy Expectations and Treasury Yields

Eurodollar Futures



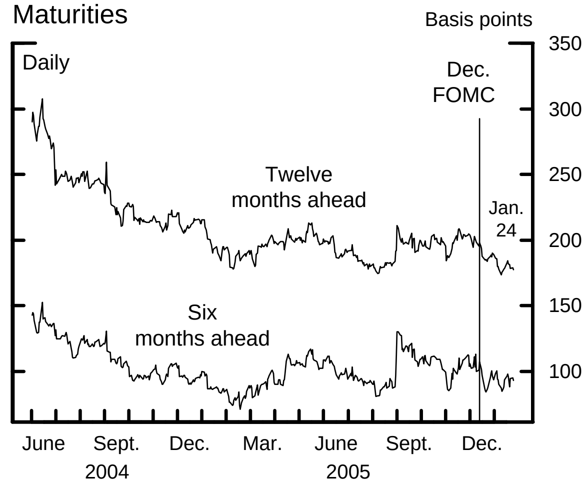
Note. 5-minute intervals.

Implied Federal Funds Rate



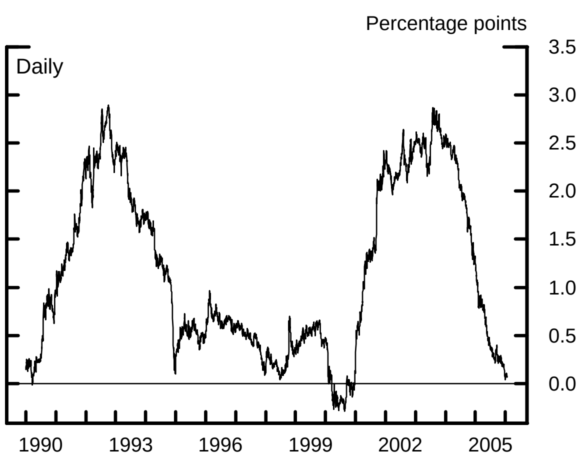
Note. Estimates from federal funds and Eurodollar futures, with an allowance for term premia and other adjustments.

Eurodollar Implied Volatility at Selected Maturities



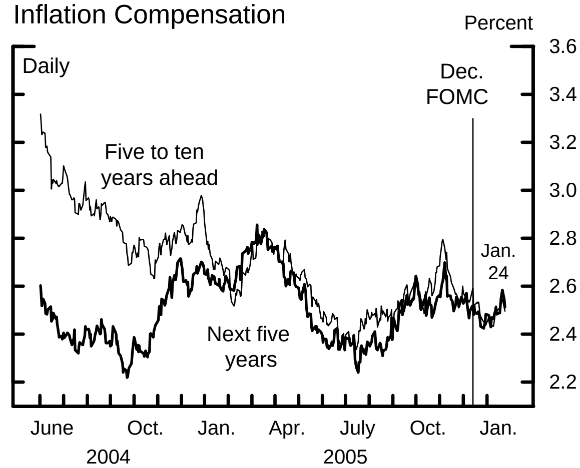
Note. Width of a 90 percent confidence interval for the federal funds rate computed from the term structures for both the expected federal funds rate and implied volatility.

Ten-year less Two-year Treasury Yield



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

Inflation Compensation



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

Domestic Financial Developments

Overview

Near-term expectations about monetary policy held steady over the intermeeting period, but the anticipated path for the funds rate beyond the first half of this year moved down in response to statements by the FOMC that were reportedly interpreted as indicating that the tightening cycle would end sooner than previously envisioned and to data that was viewed as consistent with benign inflation and moderate output growth. Yields on longer-dated Treasury securities declined a bit more than those at the shorter end of the term structure, resulting in a somewhat flatter yield curve. Credit spreads on corporate bonds barely budged. Equity prices were about unchanged on net, as a run-up at the beginning of January was subsequently reversed amid lackluster fourth-quarter earnings reports and a jump in oil prices. Business and household credit quality appear to have remained solid.

Policy Expectations and Treasury Yields

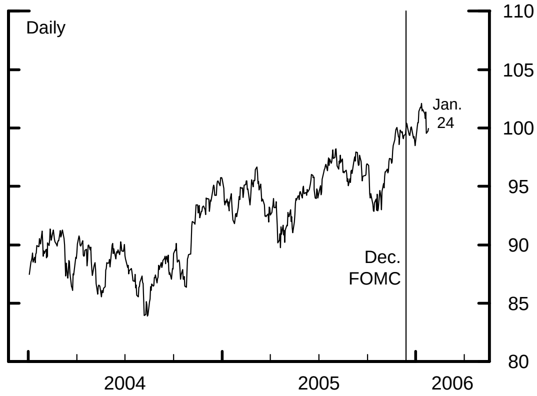
Market participants widely anticipated the FOMC's decision at the December meeting to raise the target federal funds rate 25 basis points. However, the removal of the reference to "policy accommodation" from the statement reportedly suggested to some investors that the tightening cycle might draw to a close sooner than they had previously anticipated. The minutes of the December meeting seemed to reinforce that view, as investors pointed to the Committee's assessment that "the number of additional firming steps required probably would not be large." Data indicating that core inflation remains low and that economic growth perhaps has been a bit softer than expected also appear to have contributed to a downward revision in policy expectations beyond the near term, as implied rates on longer-dated Eurodollar futures contracts declined 10 to 25 basis points, on net. Even so, market participants continue to attach a very high probability to a 25 basis point increase in the federal funds target at the January meeting, and they place about even odds on a similar increase in March. After the middle of this year, the expected policy path begins to tilt down. Uncertainty about future policy, as indicated by options on Eurodollar futures contracts, edged lower.

Over the intermeeting period, two- and ten-year nominal Treasury yields declined about 10 and 20 basis points, respectively, further narrowing the slope of the yield curve. Nevertheless, the current flat term structure is similar to that near the end of recent tightening episodes and, after adjustment for the level of short-term interest rates and the estimated low level of the term premium, the shape of the yield curve remains consistent with expectations of moderate economic growth. Inflation compensation rates implied by

Corporate Yields, Risk Spreads, and Stock Prices

S&P 500

Ratio scale, Dec. 13, 2005=100



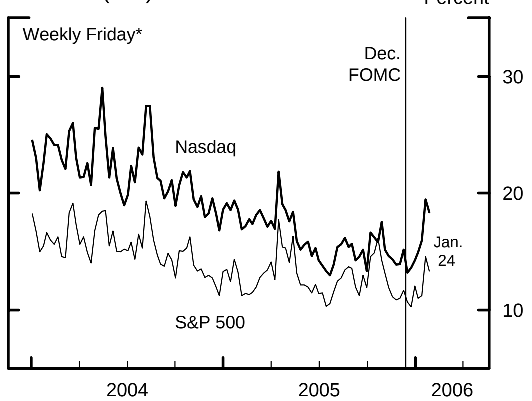
Trend Earnings-Price Ratio for S&P 500 and Long-Run Treasury Yield

Percent

* 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)

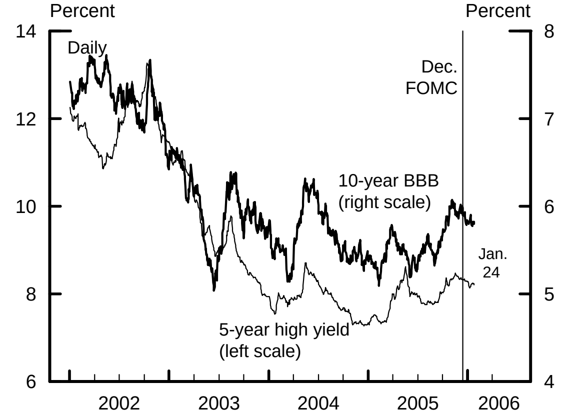
Percent



* Latest observation is for most recent business day.

Yields for BBB and High-Yield Corporate Bonds

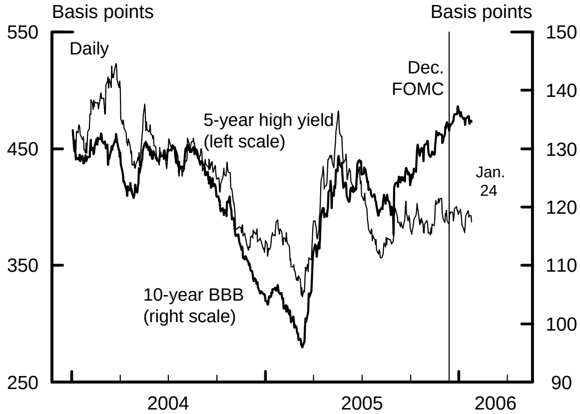
Percent | Percent



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

Corporate Bond Spreads

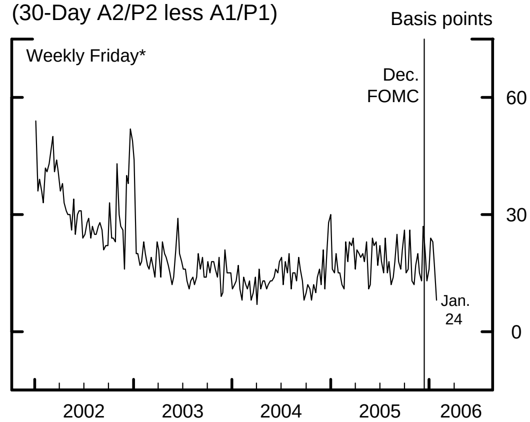
Basis points | Basis points



Note. Measured relative to comparable-maturity Treasuries.

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

Basis points



* Latest observation is for most recent business day.

Treasury inflation-protected securities (TIPS) have recently ticked up somewhat with the rise in oil prices but are little changed, on net, over the period.

Stock Prices and Corporate Interest Rates

Major stock price indexes were about unchanged, on balance, over the intermeeting period. The recent spike in oil prices and the somewhat disappointing fourth-quarter earnings reports appear to have offset the favorable effects of the revision in monetary policy expectations and the benign inflation data. The equity risk premium—measured by the spread between the twelve-month forward trend earnings-price ratio for S&P 500 firms and a real long-run Treasury yield—remained close to the level that has prevailed for the past year. Implied volatilities on both the Nasdaq 100 and the S&P 500 indexes moved higher but remain at the low end of their historical ranges.

Yields on investment-grade and high-yield corporate bonds declined roughly in line with rates on comparable Treasury securities over the intermeeting period, and so their risk spreads were little changed. In the commercial paper market, the difference between yields on thirty-day A2/P2- and A1/P1-rated paper remained low. Year-end pressures on quality spreads were again subdued.

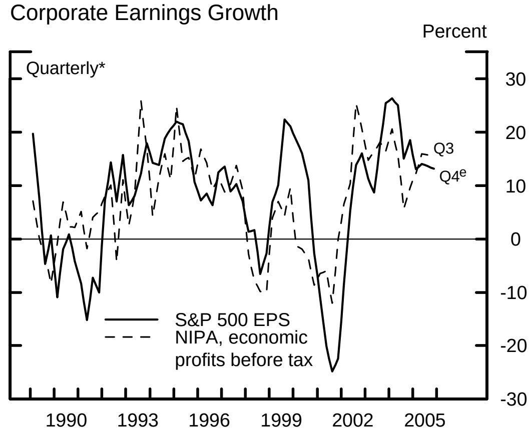
Corporate Earnings and Credit Quality

With nearly 150 of the S&P 500 firms reporting, operating earnings per share for the S&P 500 in the fourth quarter are expected to have been about 14 percent above the year-earlier level. However, analysts' forecasts of year-ahead earnings for the S&P 500 have been revised down over recent weeks given the notably cautious tone of forward-looking guidance, particularly in the technology sector.

On net, the credit quality of nonfinancial firms has remained strong, sustained by continued hefty profits, relatively low leverage, and high liquidity on corporate balance sheets. Credit rating changes in the fourth quarter of last year were roughly balanced between upgrades and downgrades, and delinquency rates on commercial and industrial (C&I) loans remained low through the third quarter. The six-month trailing bond default rate moved higher again in December owing to the bankruptcy filing of Calpine, a large energy company. However, the step-up in the default rate over the past few months has not reflected a widespread deterioration in credit quality, as most of the recent defaults had been long anticipated by financial markets and the troubles have been confined to a few large firms. In that regard, the expected aggregate year-ahead default rate based on the KMV model remained low in December.

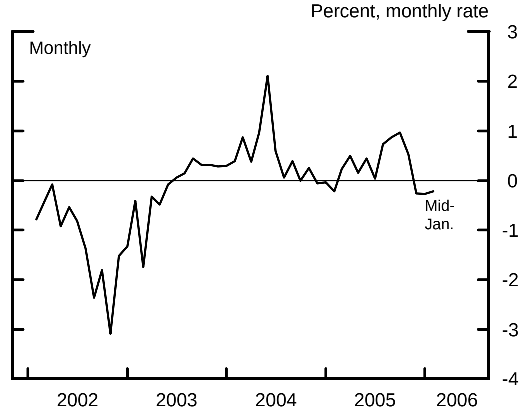
Corporate Earnings and Credit Quality

Corporate Earnings Growth



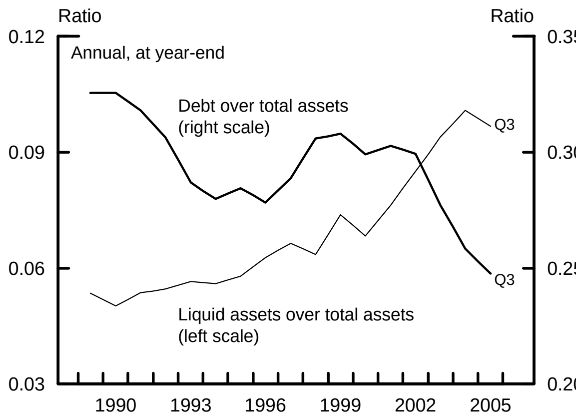
* Change from four quarters earlier.
Source. I/B/E/S for S&P 500 EPS.
e Staff estimate

S&P 500 EPS Revisions Index



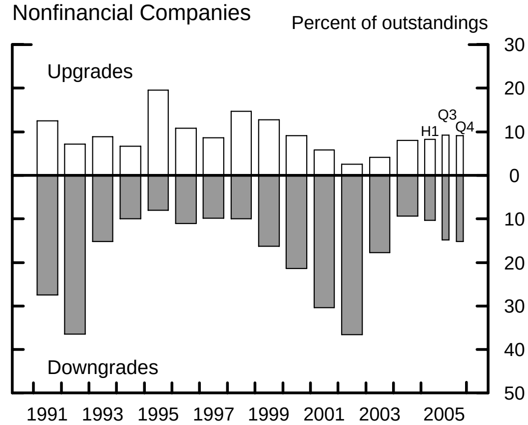
Note. Index is a weighted average of the percent change in the I/B/E/S consensus forecasts of current-year and following-year EPS.

Financial Ratios for Nonfinancial Corporations



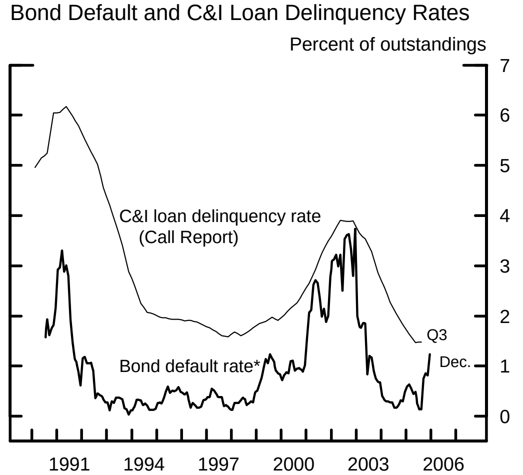
Source. Compustat.

Bond Ratings Changes of Nonfinancial Companies



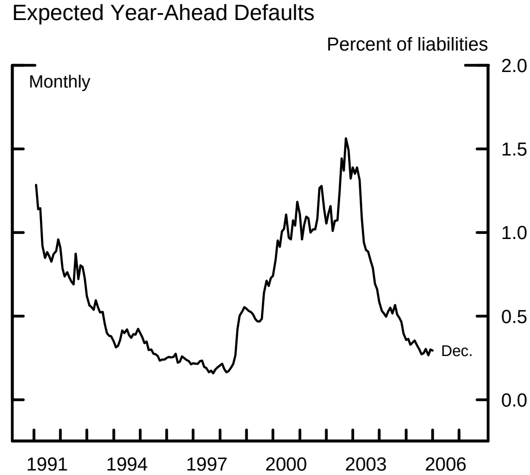
Note. Data are at an annual rate.
Source. Moody's Investors Service.

Bond Default and C&I Loan Delinquency Rates



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

Expected Year-Ahead Defaults



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

Business Finance

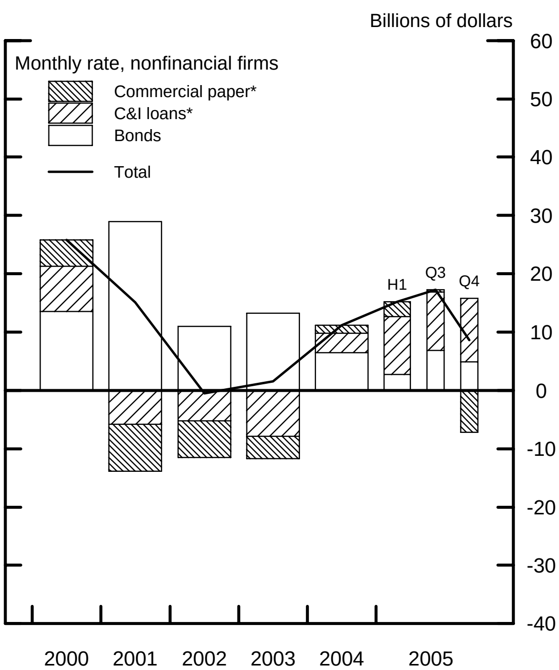
Gross Issuance of Securities by U.S. Corporations

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

Type of security	2001	2002	2003	2004	2005 H1	2005 H2	2005 Dec.	2006 Jan. e
Nonfinancial corporations								
Stocks[1]	6.5	5.2	3.7	5.4	3.8	5.3	7.3	4.0
Initial public offerings	2.1	.7	.4	1.6	1.6	1.8	1.5	1.5
Seasoned offerings	4.4	4.4	3.3	3.8	2.1	3.5	5.8	2.5
Bonds[2]	39.8	24.8	31.6	22.7	18.1	18.8	20.6	27.0
Investment grade	27.5	15.7	16.0	8.3	7.9	9.0	7.0	12.0
Speculative grade	8.9	4.8	11.3	9.5	6.2	6.6	8.0	7.0
Other (sold abroad/unrated)	3.4	4.2	4.3	4.9	3.9	3.2	5.6	8.0
Memo								
Net issuance of commercial paper[3]	-8.0	-6.3	-3.8	1.4	2.6	-3.4	-24.1	11.8
Change in C&I loans at commercial banks[3,4]	-5.8	-5.2	-7.8	3.3	9.9	10.5	17.2	10.0
Financial corporations								
Stocks[1]	4.2	4.0	6.6	6.9	5.3	4.7	2.6	4.0
Bonds[2]	80.2	87.0	111.1	139.3	167.3	181.5	198.9	80.0

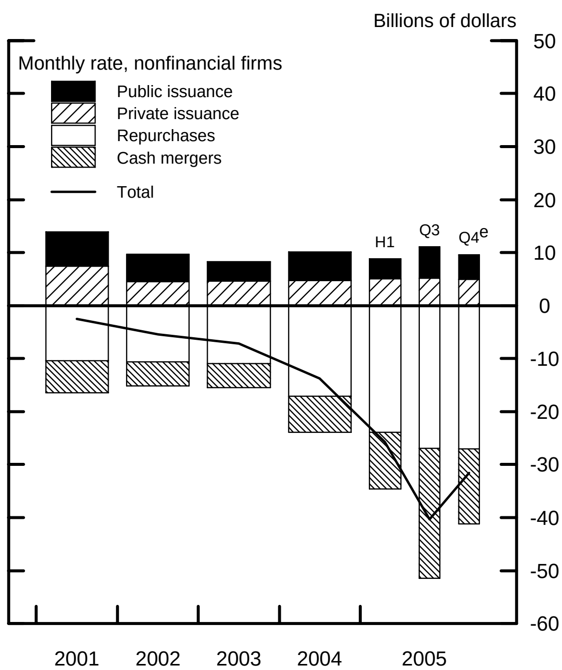
Note. Components may not sum to totals because of rounding.
1. Excludes private placements and equity-for-equity swaps that occur in restructurings.
2. Data include regular and 144a private placements. Bond totals reflect gross proceeds rather than par value of original discount bonds. Bonds are categorized according to Moody's bond ratings, or to Standard & Poor's if unrated by Moody's.
3. End-of-period basis, seasonally adjusted.
4. Adjusted for FIN 46 effects.
e Staff estimate.

Selected Components of Net Debt Financing



* Seasonally adjusted, period-end basis.

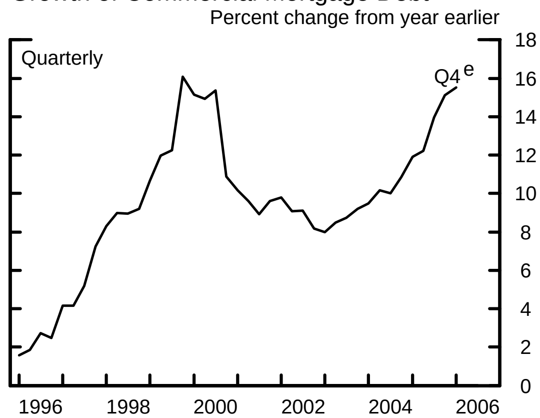
Components of Net Equity Issuance



e Staff estimate.

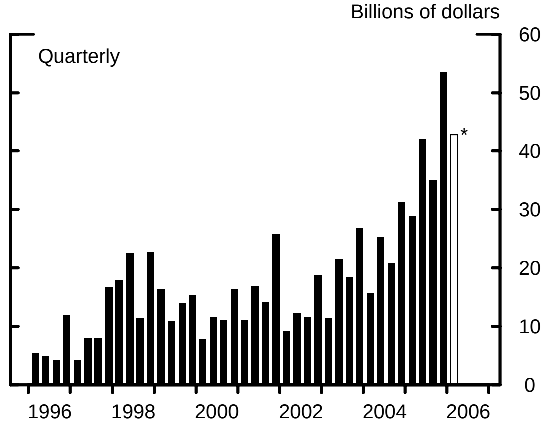
Commercial Real Estate

Growth of Commercial Mortgage Debt



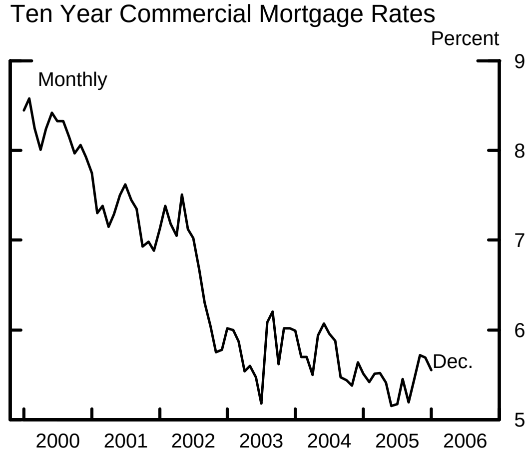
e Staff estimate.

Gross Issuance of CMBS



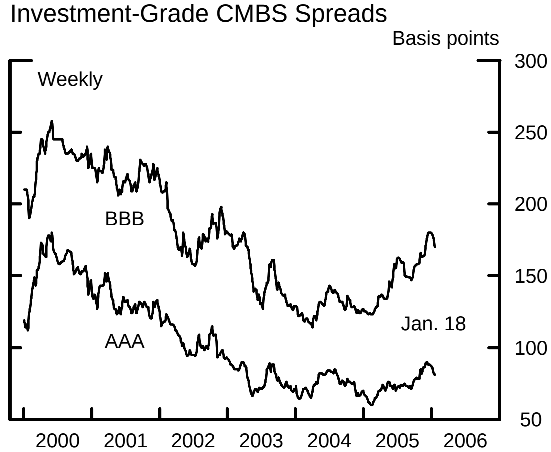
* Staff estimate for Q1.
Source. Commercial Mortgage Alert.

Ten Year Commercial Mortgage Rates



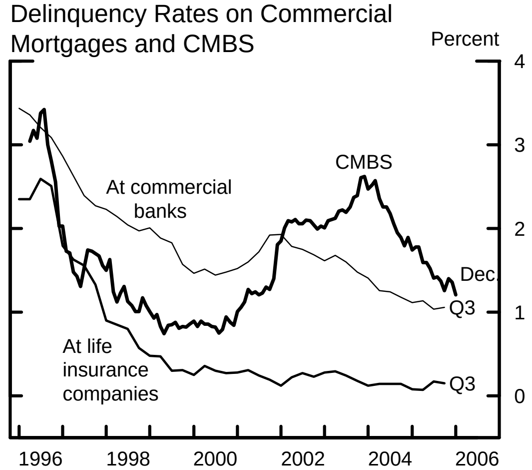
Source. Barron's/Levy.

Investment-Grade CMBS Spreads



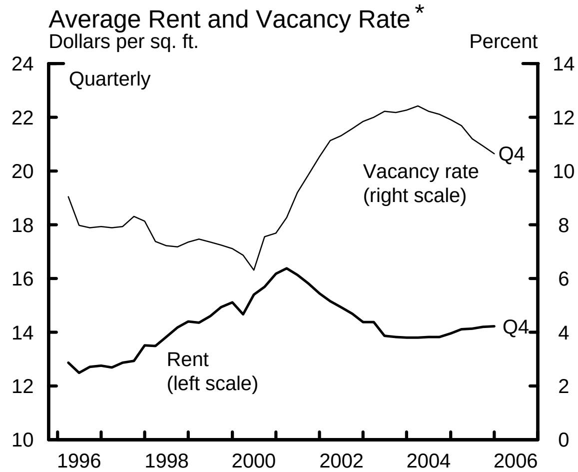
Note. Measured relative to the 10-year Treasury yield.
Source. Morgan Stanley.

Delinquency Rates on Commercial Mortgages and CMBS



Source. Call Report, ACLI, Morgan Stanley.

Average Rent and Vacancy Rate*



*Average of Office and Industrial.
Source. CoStar.

Business Finance

With a spate of offerings slated to finance acquisitions, gross bond issuance by nonfinancial firms strengthened in December and January but remained modest owing to firms' ample internal funds and liquid assets. Commercial paper outstanding contracted sharply in December, in part because a number of large multinational firms paid down their programs with repatriated profits. In contrast, C&I loan growth strengthened a bit further, on net, in December and January. All in all, net financing across bonds, commercial paper, and business loans was a bit weaker in the fourth quarter than in the rest of last year.

Gross public issuance of equity rose in December, as seasoned offerings, led by the energy sector, increased to about twice the average pace of last year, but issuance fell back to its more modest pace in January. Bolstered by strong profits, equity retirements continued at a rapid rate late last year. Retirements reached a record in the third quarter and are estimated to have fallen off only a little last quarter. Cash-financed mergers subsided somewhat in the fourth quarter, but repurchases are expected to have sustained their third-quarter pace as announcements of new repurchase programs set a record in the fourth quarter.

Commercial Real Estate

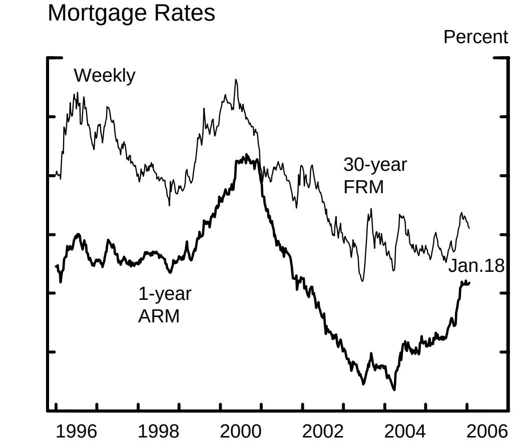
Commercial mortgage borrowing in the fourth quarter remained robust and brought the level of debt about 15 percent higher than that of a year earlier. The issuance calendar for commercial-mortgage-backed securities (CMBS) suggests continued strength this quarter. Spreads of BBB-rated CMBS over comparable Treasuries edged down, on net, over the period. Movements in CMBS spreads during the past year have been roughly in line with spreads on similarly rated corporate bonds; therefore, the general updrift in their spreads does not appear to signal particular concerns about commercial real estate markets. Delinquency rates have remained low by historical standards, and a decline in vacancy rates and some firming in rents point to further improvement in fundamentals.

Household Finance

Average interest rates on thirty-year fixed-rate mortgages have fallen slightly from their most recent peak in November, while rates on one-year adjustable-rate mortgages have hovered near recent highs. Household mortgage debt continued to grow rapidly during the third quarter, propelled in part by rapidly increasing house prices, and limited data for the fourth quarter show only a little abatement in mortgage borrowing. Meanwhile, consumer credit was held down in October and November by elevated charge-offs related

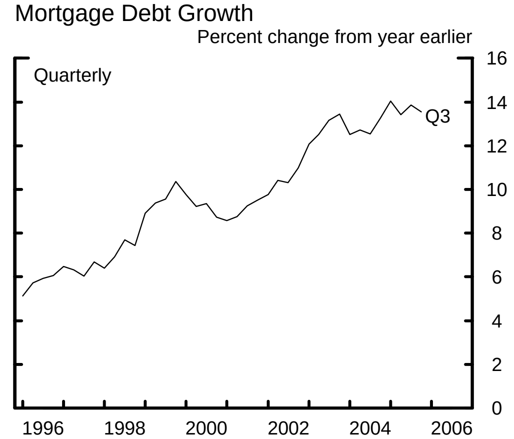
Household Liabilities

Mortgage Rates

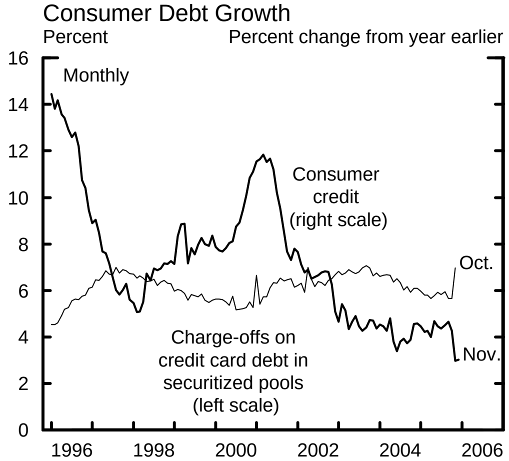


Source. Freddie Mac.

Mortgage Debt Growth

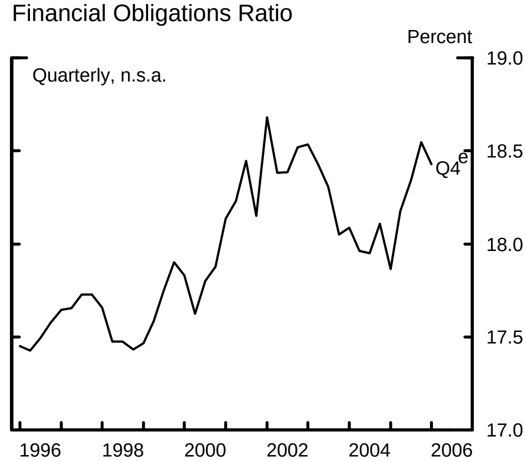


Consumer Debt Growth



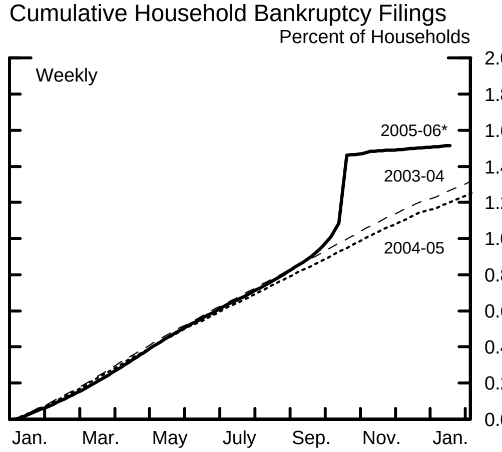
Source. FRB, Moody's.

Financial Obligations Ratio



e Staff estimate.

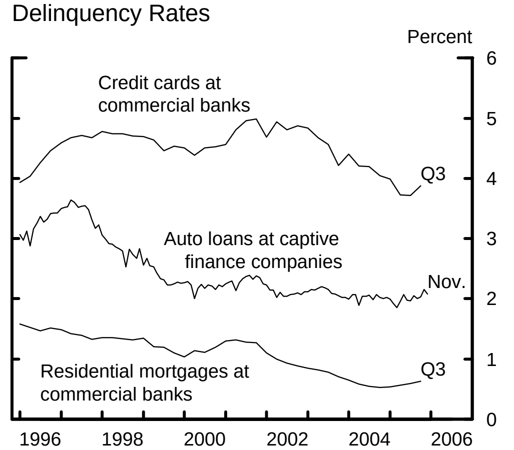
Cumulative Household Bankruptcy Filings



* Through Jan. 14.

Source. Visa Bankruptcy Notification Service Statistics.

Delinquency Rates



Source. Call Report, Federal Reserve.

to the surge in bankruptcy filings before the implementation of new rules in mid-October. Smoothing through hurricane-related swings in disposable personal income, the available evidence suggests that the financial obligations ratio in the fourth quarter rose a bit from its second-quarter level.[1]

After reaching unprecedented levels just before implementation of more-stringent bankruptcy laws in mid-October, weekly personal bankruptcy filings have remained low, as many of the pre-reform filings were apparently pulled forward from future months. Indeed, according to the January Senior Loan Officer Opinion Survey, a significant portion of the fourth-quarter increase in credit card charge-offs related to the bankruptcy wave was accounted for by individuals and households that were judged as likely to have otherwise filed sometime in the near future. The survey results and commentary related to banks' fourth-quarter earnings reports also leave open the possibility that some of the bankruptcies last quarter were unexpected, presumably reflecting a pull in of filers due to the law change rather than a deterioration of credit quality. Meanwhile, delinquency rates on residential mortgages, credit cards, and auto loans have remained low, suggesting that underlying household credit quality trends remain favorable.

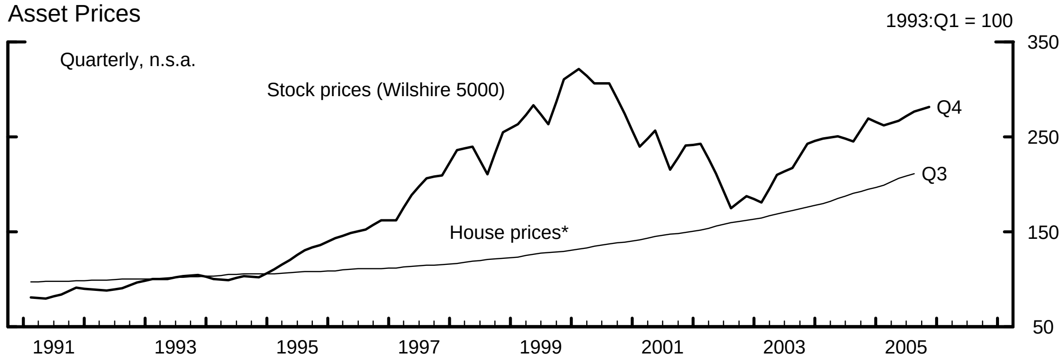
After the solid increase in the ratio of household net worth to income in the third quarter, stock price gains again supported that ratio last quarter. Net purchases of equity mutual funds were strong in November and December, as substantial inflows to international funds continued and inflows to domestic funds rebounded.

Treasury and Agency Financing

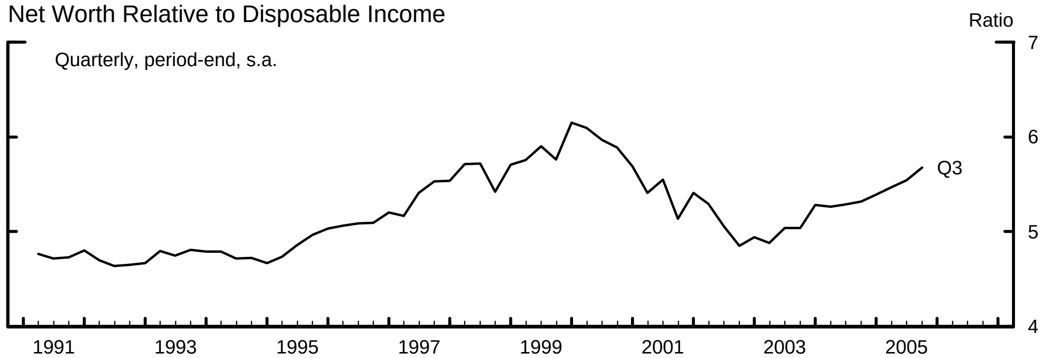
The Treasury auctioned two- and five-year nominal notes and ten- and twenty-year TIPS over the intermeeting period. The share of indirect bids awarded at the five-year auction, a proxy for demand from foreign official institutions, was below average, while indirect bidder participation was more robust at the TIPS auctions. Other news over the intermeeting period about demand for Treasury securities from foreign investors was somewhat mixed: The amount of Treasuries held in custody at the Federal Reserve Bank of New York on behalf of foreign official institutions was about unchanged, but the

[1] The Office of the Comptroller of the Currency urged the largest credit card lenders it regulates to adopt new formulas for minimum payments by the end of 2005. This change was intended to encourage households to pay off their credit card debt in a timelier manner. However, preliminary staff analysis suggests that these new formulas are unlikely to materially affect household financial obligations in the aggregate because, under the new formula, the required rate of repayment for credit card debt for the average household is similar to the 2½ percent already required by most lenders.

Household Assets



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



Net Flows into Long-Term Mutual Funds

(Billions of dollars, monthly rate)

Fund type	2003	2004		2005				Assets
		H1	H2	H1	Q3	Nov.	Dec.[e]	Nov.
Total long-term funds	**18.0**	**20.0**	**15.0**	**18.1**	**15.7**	**20.7**	**24.1**	**6,775**
Equity funds	**12.7**	**19.7**	**10.0**	**12.2**	**8.1**	**20.7**	**19.6**	**4,862**
Domestic	10.7	13.7	4.9	4.1	0.7	8.9	5.3	3,993
International	2.0	6.0	5.1	8.1	7.3	11.8	14.3	869
Hybrid funds	**2.7**	**4.1**	**3.0**	**3.4**	**1.5**	**0.5**	**0.5**	**563**
Bond funds	**2.6**	**-3.8**	**2.0**	**2.4**	**6.1**	**-0.5**	**4.0**	**1,349**
High-yield	2.2	-2.1	0.5	-1.6	-1.0	-0.3	-0.3	144
Other taxable	1.0	0.1	1.9	3.7	5.7	0.5	4.6	868
Municipals	-0.6	-1.9	-0.4	0.4	1.4	-0.7	-0.3	338

Note. Excludes reinvested dividends.

e Staff estimates based on confidential ICI weekly data.

Source. Investment Company Institute.

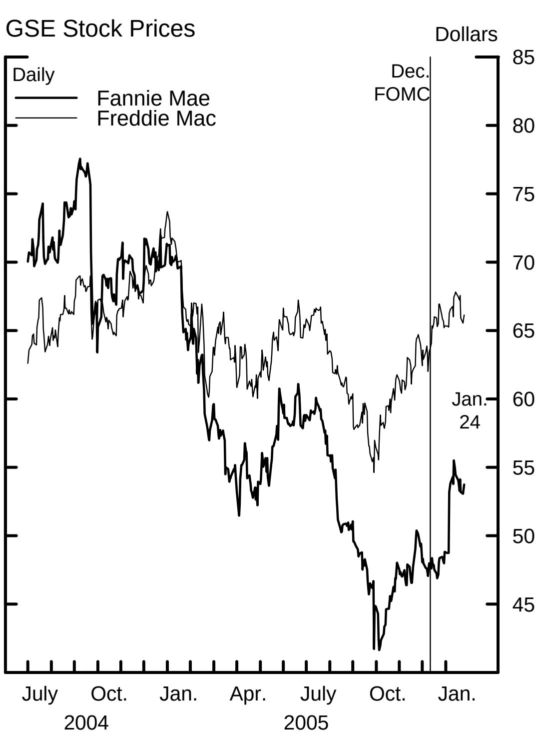
Treasury Financing

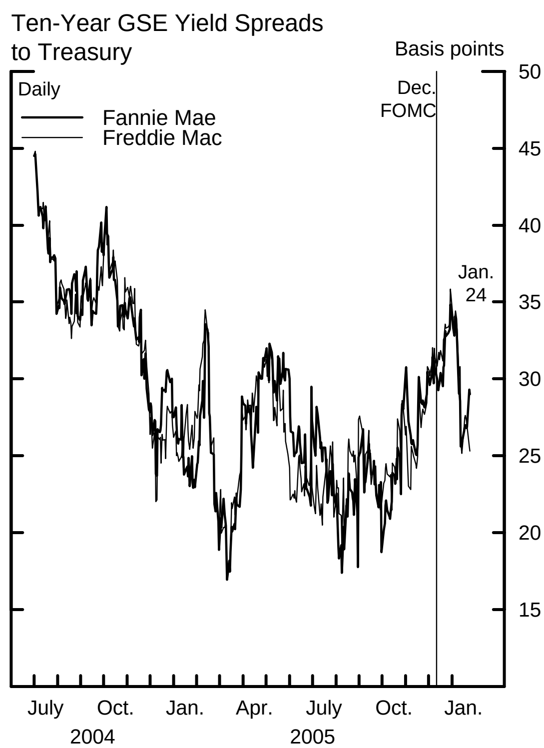
(Billions of dollars)

Item	2004	2005					
	Q4	Q1	Q2	Q3	Q4	Nov.	Dec.
Total surplus, deficit (–)	**-118.1**	**-176.6**	**45.2**	**-69.0**	**-119.3**	**-83.1**	**11.0**
Means of financing deficit							
Net borrowing	102.1	164.7	-42.8	72.6	112.2	58.7	4.7
Nonmarketable	2.4	20.8	35.9	20.4	21.2	10.0	6.8
Marketable	99.7	143.9	-78.7	52.1	91.0	48.7	-2.1
Bills	43.6	55.7	-135.8	-9.3	48.8	49.6	-23.1
Coupons	56.0	88.2	57.1	61.4	42.3	-0.9	21.0
Decrease in cash balance	11.7	2.2	-10.7	-2.5	-0.9	34.7	-30.6
Other[1]	4.3	9.7	8.3	-1.0	8.0	-10.4	14.9
Memo:							
Cash balance, end of period	24.7	22.4	33.2	35.7	36.6	6.0	36.6

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





Note. GSE yields based on senior unsecured debt.

State and Local Government Finance

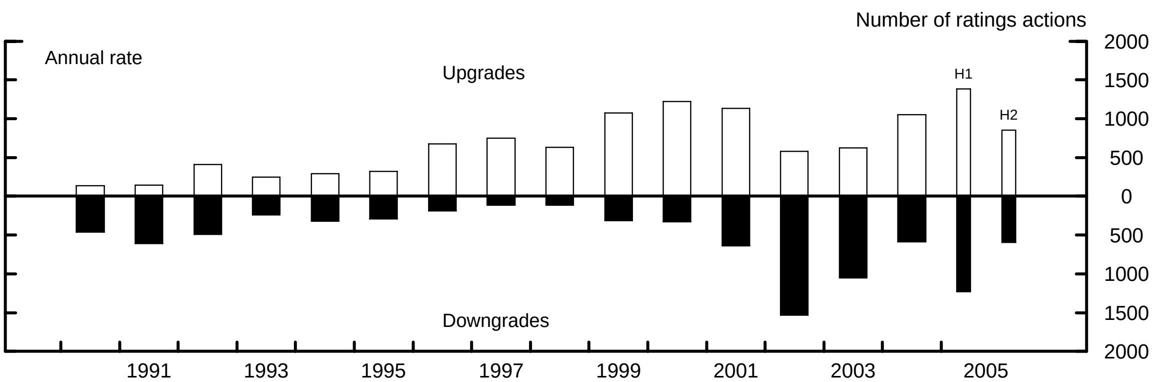
Gross Offerings of Municipal Securities

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

Type of security	2002	2003	2004	2005 H1	2005 Q3	2005 Q4	2006 Jan. [e]
Total	36.3	37.9	34.7	38.1	39.0	37.7	18.0
Long-term [1]	30.3	32.0	29.8	35.0	33.6	32.7	15.0
Refundings [2]	10.1	10.0	10.8	17.1	15.6	10.4	2.0
New capital	20.2	22.1	19.0	17.9	18.0	22.3	13.0
Short-term	6.0	5.8	4.9	3.1	5.4	5.0	2.0
Memo: Long-term taxable	1.7	3.5	2.0	2.0	2.3	2.0	1.0

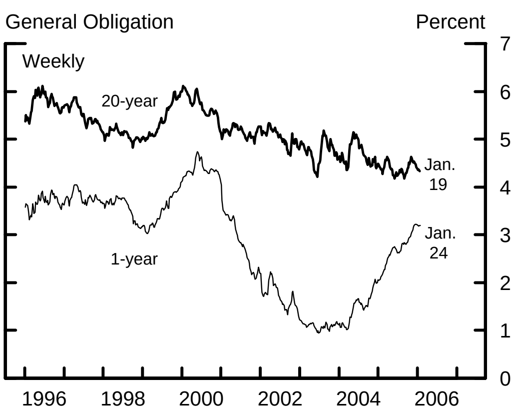
1. Includes issues for public and private purposes.
2. All issues that include any refunding bonds.
e Staff estimate based on preliminary data through January 19.

Ratings Changes



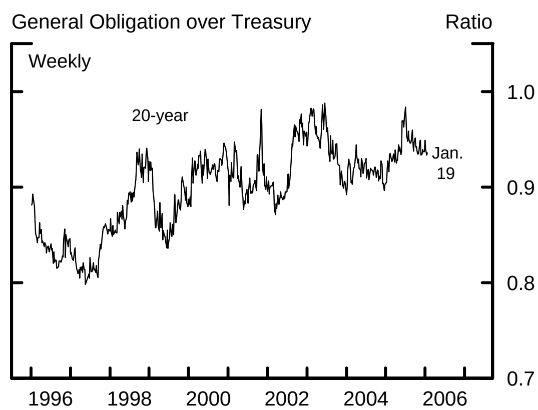
Source. S&P's Credit Week Municipal and Ratings Direct.

Municipal Bond Yields



Source. Bloomberg and Bond Buyer.

Municipal Bond Yield Ratio



Source. Bond Buyer.

Treasury International Capital System report for November indicated increased purchases of Treasury securities from both official and private foreign investors.

The Office of Federal Housing Enterprise Oversight announced in December that Fannie Mae had satisfied its previous agreement to maintain an excess of at least 30 percent over minimum capital requirements, which fueled speculation that Fannie Mae might soon resume expansion of its portfolio. Fannie Mae's share price jumped about 10 percent in early January after news that the investigator in that firm's internal probe had discovered no new accounting problems. Fannie Mae's and Freddie Mac's debt spreads over Treasuries edged down, on net, over the intermeeting period.

State and Local Government Finance

Gross issuance of long-term municipal bonds in December about matched the robust average rate posted earlier in the year, but, as in previous years, issuance in January has been muted. The credit quality of municipal bonds remained stable, as upgrades about matched downgrades in December. Yields moved in line with Treasuries, leaving yield ratios about unchanged.

Money and Bank Credit

M2 expanded moderately in December and brought M2 growth for the fourth quarter to about 5¼ percent at an annual rate, a somewhat faster pace than would be expected from the historical relationships among money growth, nominal income, and opportunity cost. Staff estimates suggest that some of the unexpected rise in the fourth quarter was due to the effects of Hurricane Katrina, including relief payments to individuals by the Federal Emergency Management Agency and funds advanced to hurricane victims against likely future settlements by insurance companies. M2 growth is expected to pick up in January.

Bank credit grew at an annual rate of about 8½ percent in December, boosted by a significant acceleration in loans. C&I loans continued to expand at a brisk pace and grew at an almost 10 percent annual rate in the fourth quarter. Respondents to the January Senior Loan Officer Opinion Survey reported some further easing of lending standards and terms for C&I loans as well as stronger demand for those loans over the previous three months. The stronger demand was attributed to borrowers' increased needs to finance mergers and acquisitions, accounts receivable, and investments in plant and equipment. The growth of residential and commercial mortgage loans picked up noticeably in December, but the pace for last quarter as a whole nonetheless edged down from the third quarter. Credit card charge-offs jumped at several large banks, reflecting

Monetary Aggregates

(Based on seasonally adjusted data*)

Aggregate or component	2004	2005	2005 Q3	2005 Q4	2005 Dec.	2006 Jan. (e)	Level ($ billions), Jan. (e)
Aggregate	Percent change (annual rate)[1]						
1. M2[2]	5.2	4.0	4.4	5.2	5.1	7.9	6,725
2. M3[3]	5.8	7.5	7.8	9.5	9.6	8.2	10,239
Components of M2[4]							
3. Currency	5.5	3.5	4.0	4.2	5.8	8.8	729
4. Liquid deposits[5]	10.0	1.9	2.1	2.9	3.4	4.6	4,275
5. Small time deposits	-.3	18.7	19.7	14.9	12.2	14.9	986
6. Retail money market funds	-11.7	-.2	-.4	7.0	5.4	17.7	728
Components of M3							
7. M3 minus M2[6]	7.0	14.8	14.8	18.2	18.3	8.7	3,514
8. Large time deposits, net[7]	20.8	27.0	15.4	25.0	21.4	31.7	1,395
9. Institutional money market funds	-5.7	5.0	11.6	12.1	16.7	16.4	1,152
10. RPs	.1	10.5	22.5	21.7	18.8	-36.7	546
11. Eurodollars	27.2	14.3	11.3	9.4	12.1	-24.5	421
Memo							
12. Monetary base	5.6	3.4	3.3	4.3	4.2	8.8	792
	Average monthly change (billions of dollars)[8]						
Selected managed liabilities at commercial banks							
13. Large time deposits, gross	14.9	19.5	11.9	22.1	23.3	32.3	1,471
14. Net due to related foreign institutions	-11.3	4.9	12.8	1.6	-2.4	-3.0	70
15. U.S. government deposits at commercial banks	.3	.0	-2.1	-0.3	8.6	3.5	26

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.
* These data also reflect the effects of the annual seasonal factor review.

Commercial Bank Credit

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

Type of credit	2004	2005	2005: Q3	2005: Q4	Nov. 2005	Dec. 2005	Level ($ billions), Dec. 2005
Total							
1. Adjusted[1]	**8.9**	**10.4**	**9.6**	**5.8**	**4.4**	**8.6**	**7,208**
2. Reported	8.4	9.7	9.7	5.3	4.0	7.7	7,345
Securities							
3. Adjusted[1]	6.6	7.4	.5	-.7	-2.6	-5.4	1,849
4. Reported	5.2	5.1	1.7	-2.0	-3.8	-7.8	1,987
5. Treasury and agency	4.9	-.3	-5.4	-9.7	-18.0	-9.3	1,133
6. Other[2]	5.6	13.4	12.0	8.9	15.6	-6.0	854
Loans[3]							
7. Total	9.8	11.5	12.9	8.1	6.9	13.5	5,359
8. Business	1.2	13.5	11.8	9.5	10.9	14.8	1,015
9. Real estate	14.0	14.0	17.0	8.3	5.1	10.6	2,897
10. Home equity	43.8	11.1	10.9	-1.8	.0	-1.9	436
11. Other	9.8	14.5	18.2	10.2	6.0	12.8	2,461
12. Consumer	8.8	3.0	4.9	-4.5	1.2	-8.2	687
13. Adjusted[4]	5.9	.4	3.4	-4.9	1.3	7.8	1,052
14. Other[5]	7.9	8.3	6.4	17.6	14.1	43.6	759

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.

the surge in personal bankruptcy filings last October and weighing on fourth-quarter profits at some banking institutions. However, an index of bank equity prices only underperformed the market by a few percentage points over the intermeeting period, suggesting that any negative effects on profits are seen as limited.

Appendix

Senior Loan Officer Opinion Survey on Bank Lending Practices

The January 2006 Senior Loan Officer Opinion Survey on Bank Lending Practices addressed changes in the supply of, and demand for, bank loans to businesses and households over the past three months. In addition, the survey contained a special question on changes in selected terms on commercial real estate loans over the past year. The survey also asked banks about the extent to which the spike in bankruptcy filings in September and early October affected fourth-quarter charge-offs on credit card loans. Finally, banks were queried about their expectations for changes in asset quality in 2006. This appendix is based on responses from fifty-four domestic banks and nineteen foreign banking institutions.

Domestic commercial banks reported a further net easing of lending standards and terms for commercial and industrial (C&I) loans and no change in lending standards on commercial real estate loans over the past three months. For the same period, a notable net percentage of domestic institutions reported stronger demand for C&I loans from large and middle-market firms, but only a small net fraction of domestic respondents experienced increased demand for commercial real estate loans. Significant net fractions of domestic banks reported that, since the last survey, demand for mortgages to purchase homes was weaker, as was demand for consumer loans.

Significant net fractions of respondents reported that they had eased selected terms on commercial real estate loans in 2005. Banks cited more-aggressive competition from other banks or nonbank lenders as the most important reason for having done so. Among banks that experienced an increase in credit card charge-offs in the fourth quarter of 2005 as the result of the introduction of the new bankruptcy law, about three-quarters of respondents indicated that less than 40 percent of fourth-quarter charge-offs were attributable to this increase. In addition, banks accounting for more than one-half of credit card loans on respondents' books at the end of the third quarter reported that between 60 percent and 100 percent of the increase in the fourth-quarter charge-offs that reflected the introduction of the new law was attributable to households or individuals who would have filed for bankruptcy anyway later in 2005 or during 2006.

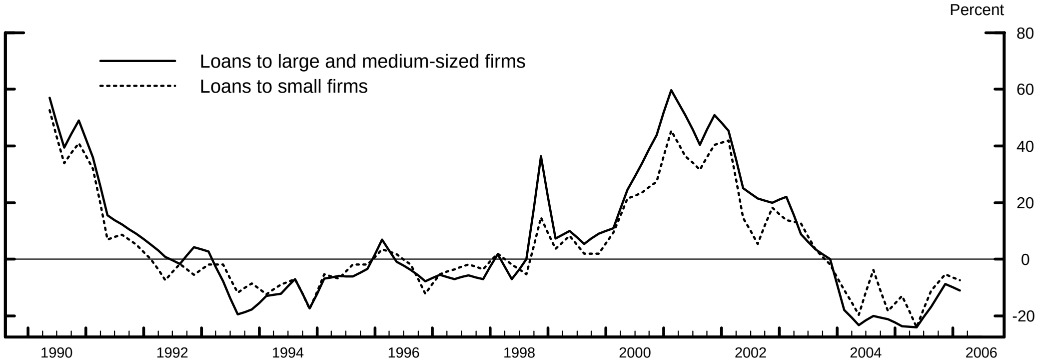
Looking ahead, banks indicated that, on balance, they expect loan quality on loans to businesses and households to deteriorate somewhat in 2006.

Business Lending

Domestic banks indicated that they had further eased standards and terms on C&I loans over the past three months. On net, about 10 percent of domestic institutions indicated that they had eased credit standards on C&I loans to large and middle-market firms,

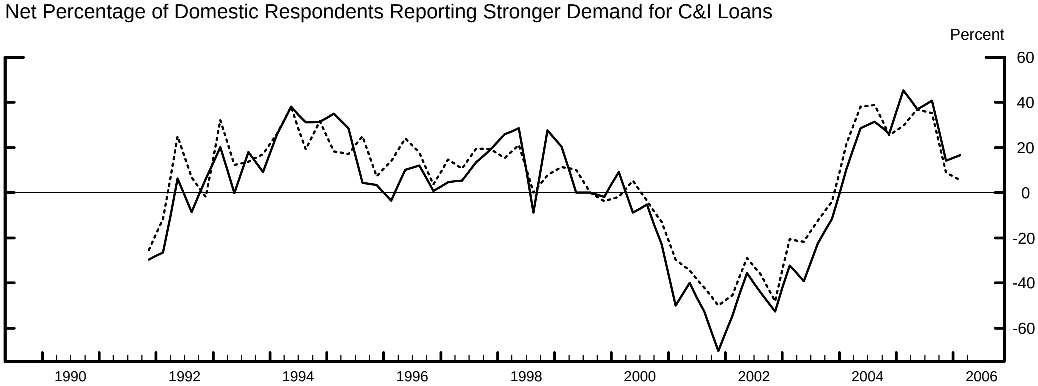
Measures of Supply and Demand for C&I Loans, by Size of Firm Seeking Loan

Net Percentage of Domestic Respondents Tightening Standards for C&I Loans



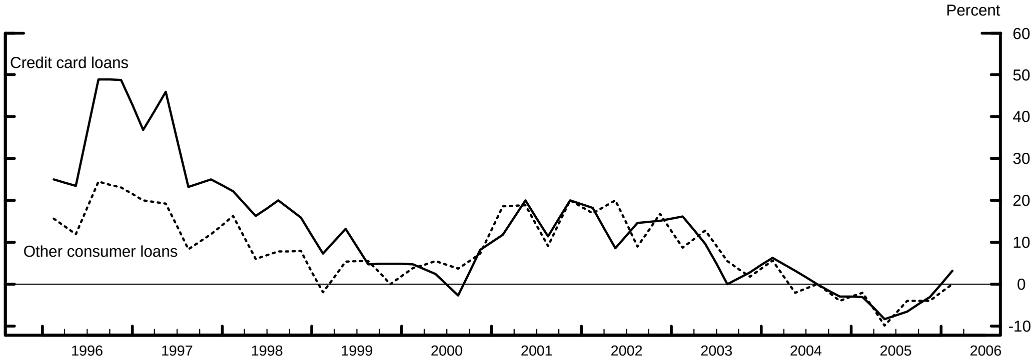
Net Percentage of Domestic Respondents Increasing Spreads of Loan Rates over Banks' Costs of Funds

Net Percentage of Domestic Respondents Reporting Stronger Demand for C&I Loans

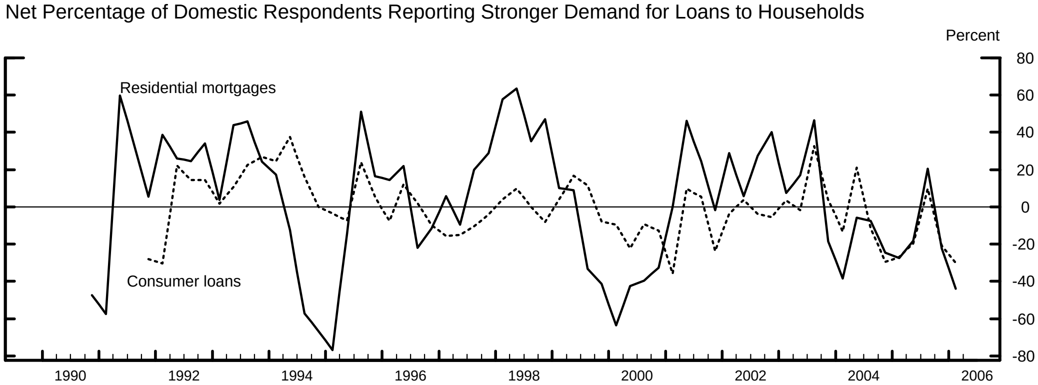


Measures of Supply and Demand for Loans to Households

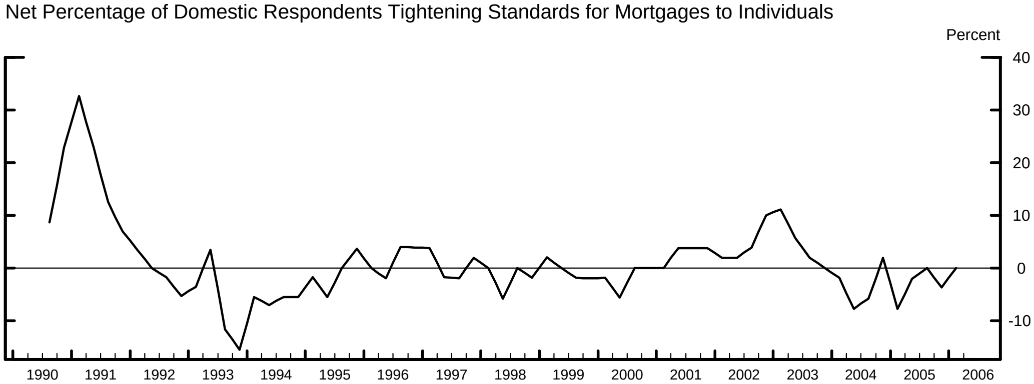
Net Percentage of Domestic Respondents Tightening Standards for Consumer Loans



Net Percentage of Domestic Respondents Reporting Stronger Demand for Loans to Households



Net Percentage of Domestic Respondents Tightening Standards for Mortgages to Individuals



roughly the same net fraction as in the October 2005 survey. Almost one-half of domestic respondents reported that they had trimmed spreads of loan rates over their cost of funds for such firms, and about 30 percent of domestic institutions indicated that they had reduced the costs of credit lines. Domestic institutions also reported that they had eased other lending terms to large and middle-market firms over the past three months: On net, about one-fourth of banks reported that they had increased the maximum maturity of loans or credit lines, and almost one-fifth of respondents indicated that they had eased loan covenants. The net percentages of banks that reported easing these loan terms were about the same as in the October 2005 survey.

For C&I loans to small firms, 8 percent of domestic respondents, on net, noted that they had eased their lending standards over the past three months. On net, one-third of banks indicated that they had narrowed spreads of loan rates over their cost of funds. About one-fifth of them, on balance, reported having reduced the cost of credit lines, and a similar fraction reported having increased the maximum maturity of loans or credit lines over the same period.

As they did in the previous survey, U.S. branches and agencies of foreign banks reported that their standards on C&I loans had changed little. However, significant net fractions of these institutions indicated that they had reduced the cost of credit lines, narrowed spreads of loan rates over their cost of funds, and increased the maximum maturity of loans or credit lines.

Nearly all domestic institutions that indicated having eased their lending standards and terms in the January survey pointed to more-aggressive competition from other banks or nonbank lenders as an important reason for having done so. Notable net percentages of such respondents also cited an increased tolerance for risk and increased liquidity in the secondary market for these loans as reasons for having eased credit standards or terms on C&I loans.

On net, almost one-fifth of domestic banks reported stronger demand for C&I loans from large and middle-market firms, roughly the same net fraction as in the previous survey. By contrast, only 6 percent of domestic respondents, on net, reported an increase in demand for C&I loans from small firms. At U.S. branches and agencies of foreign banks, about one-fifth of respondents, on net, indicated that demand for C&I loans had increased over the past three months.

Among the domestic respondents that experienced stronger demand for C&I loans, most cited borrowers' increased needs to finance accounts receivable and mergers and acquisitions. Substantial fractions of these respondents also pointed to customers' increased needs to finance investment in plant and equipment and in inventories as contributing to the strengthening of business loan demand over the past three months. All foreign institutions that experienced stronger demand for C&I loans cited increased needs to finance mergers and acquisitions; significant fractions of the foreign respondents also pointed to increased investment in inventories and in plant and equipment as important reasons for stronger C&I loan demand. Regarding future business, about one-fifth of domestic respondents, on net, indicated that the number of inquiries from potential business borrowers had increased over the previous three months, a somewhat larger net fraction than in the October survey. At foreign institutions, the number of inquiries from potential business borrowers was little changed in January.

On net, domestic institutions reported that lending standards on commercial real estate loans were essentially unchanged over the past three months. However, a small net fraction of foreign respondents indicated that they had tightened standards on such loans. On net, 4 percent of domestic banks saw an increase in demand for commercial real estate loans, a somewhat smaller net fraction than in the October survey. At foreign institutions, demand for this type of loan was reportedly unchanged in the January survey.

For several years, the January survey has asked banks to report their changes in various terms on commercial real estate loans over the past twelve months. This year's responses suggest a considerable easing in the terms on such loans, a pattern consistent with improving conditions in commercial real estate markets and the rapid expansion of commercial real estate loans in 2005. Almost 30 percent of domestic institutions, on net, indicated that they had reduced spreads of loan rates over the cost of funds in 2005. In addition, one-fourth of domestic respondents reported that they had raised the maximum size of the loans they were willing to extend, and almost one-fourth of them indicated that they had increased loan-to-value ratios and the maximum loan maturity over the past year. At foreign institutions, 60 percent of respondents, on net, reported that they had narrowed spreads of loan rates over their cost of funds over the past twelve months. In addition, 30 percent of foreign institutions, on net, indicated that they had increased loan-to-value ratios over the same period.

Domestic and foreign institutions that had eased terms on commercial real estate loans in 2005 cited more-aggressive competition from other banks or nonbank lenders as the most important reason for having done so. Those respondents also pointed to improvements in the condition of, or the outlook for, the commercial real estate sector in the markets in which they operate as another important reason for having eased terms.

Household Lending

Credit standards on residential mortgage loans were reportedly unchanged over the past three months. About 45 percent of domestic banks, on net, reported weaker demand for mortgages to purchase homes, a notably larger net fraction than in the October survey.

More than 10 percent of domestic respondents—a somewhat larger fraction than in the October survey—indicated that their willingness to make consumer installment loans had increased over the past three months. Standards and most terms on credit card and non-credit-card consumer loans were reportedly little changed, on balance. However, about one-fourth of respondents indicated that they had increased the minimum percent of outstanding credit card balances required to be repaid each month. This change in lending practices likely reflected adjustments banks made in response to efforts by the Office of the Comptroller of the Currency to encourage the largest credit card lenders to boost minimum payments by the end of 2005.

Demand for consumer loans reportedly had weakened further over the past three months: Almost one-third of domestic banks, on net, saw weaker demand for such loans, up from about one-fifth in the October survey.

Bankruptcy filings spiked in September and early October in advance of the implementation of more-stringent bankruptcy rules on October 17. Special questions queried domestic banks about the effects of that spike on charge-offs on credit card loans in the fourth quarter.[1] Among banks that experienced an increase in credit card charge-offs as the result of the new bankruptcy law, one-half indicated that the portion of fourth-quarter charge-offs attributable to this increase was less than 20 percent, and about one-fourth indicated that the portion was between 20 percent and 40 percent. These two groups of banks accounted for about 20 percent to 50 percent, respectively, of all credit card loans on the books of respondent banks at the end of the third quarter of 2005. Three institutions indicated that the portion of fourth-quarter credit card charge-offs attributable to the deadline-related increase was between 80 percent and 100 percent. However, these institutions accounted for 2 percent of all credit card loans on the respondents’ books at the end of the third quarter.

[1] According to third-quarter Call Reports, the respondent banks accounted for 35 percent of all credit card loans on the books of domestic commercial banks as of September 30, 2005.

About one-third of banks reported that between 60 percent and 100 percent of the increase in credit card charge-offs related to the new bankruptcy law was attributable to borrowers who filed ahead of the October 17 deadline but who would have filed anyway at some point in 2005 or during 2006. These banks held more than 50 percent of all credit card loans on the respondents' books at the end of the third quarter of 2005. Institutions that accounted for more than 25 percent of credit card loans on the respondents' books reported shares of 40 percent to 60 percent, and the remainder generally reported shares of 20 percent to 40 percent.

A final set of special questions asked banks about their expectations for the behavior of delinquencies and charge-offs on loans to businesses and households in 2006 under the assumption that economic activity progresses in line with consensus forecasts. On balance, the responses suggest that banks expect some modest deterioration in loan quality this year from recent very high levels. On net, about 30 percent of domestic respondents indicated that they anticipate that the quality of their loans to businesses—including both C&I and commercial real estate loans—will deteriorate somewhat in 2006. Notable net fractions of domestic institutions reported that they expect the quality of both credit card and non-credit-card consumer loans to deteriorate somewhat. About 40 percent of domestic respondents indicated that they expect the quality of their nontraditional residential mortgages to decline. By contrast, only a few respondents reported that they anticipate a worsening of the quality of their traditional residential mortgages in 2006. Foreign institutions indicated that, on net, they anticipate that the quality of their C&I loans will stabilize around current levels. Only two foreign institutions expected the quality of their commercial real estate loans to deteriorate somewhat this year.

Last Page of Financial Developments

International Developments

International Developments

U.S. International Transactions

Trade in Goods and Services

After reaching a record $68.1 billion in October, the U.S. international trade deficit narrowed to $64.2 billion in November. The narrowing in the deficit reflected a $2 billion increase in exports and a decrease in imports of about the same magnitude.

Trade in Goods and Services
(Seasonally adjusted)

	2004	Annual rate 2005			Monthly rate 2005		
		Q2	Q3	Q4e	Sept.	Oct.	Nov.
	Percent change						
Nominal BOP							
Exports	10.8	14.9	4.5	5.4	-2.4	1.5	1.8
Imports	18.7	9.8	10.8	16.8	2.7	2.2	-1.1
Real NIPA							
Exports	6.1	10.7	2.5	n.a.	...	...	...
Imports	10.6	-0.3	2.4	n.a.	...	...	...
	Billions of dollars						
Nominal BOP							
Net exports	-617.6	-694.4	-731.2	-794.0	-66.0	-68.1	-64.2
Goods, net	-665.4	-747.7	-791.7	-852.2	-71.3	-73.2	-68.9
Services, net	47.8	53.3	60.5	58.2	5.3	5.0	4.7

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

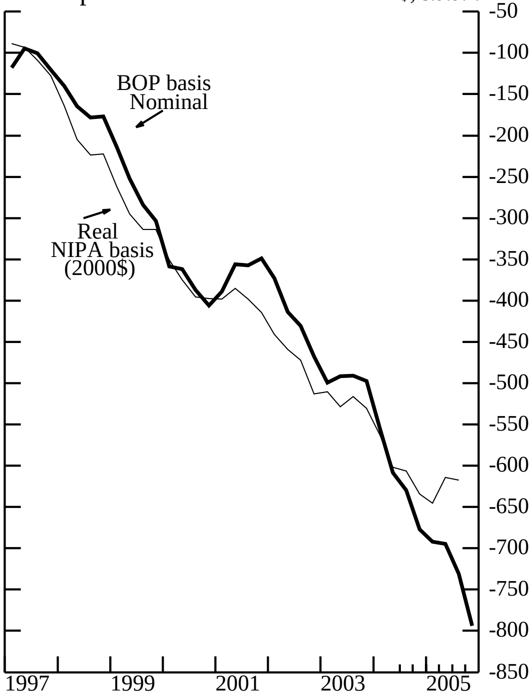
The average value of exports of goods and services in October and November increased 5½ percent (a.r.) from the third quarter, with the pace of increase roughly equal in both months. In October, the increase in exports was more than accounted for by a sharp rebound in aircraft exports following a strike at Boeing in September. In November, exports were boosted by a further increase in aircraft exports as well as sharp increases in exports of other capital goods and consumer goods. Following a steep plunge in September on account of hurricane-related production disruptions, exports of industrial supplies, particularly chemicals and petroleum products, remained weak in October and recovered only slightly in November. Services exports were little changed in both October and November.

The average value of imports in October and November increased nearly 17 percent (a.r.) from the third quarter, as imports in October surged from an elevated September level

U.S. International Trade in Goods and Services

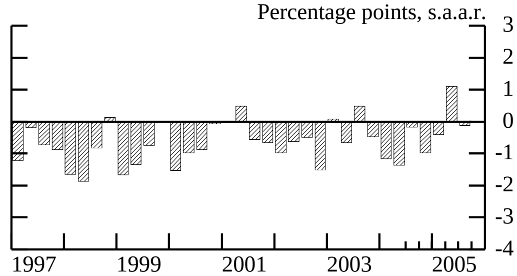
Net Exports

Bil$, s.a.a.r.

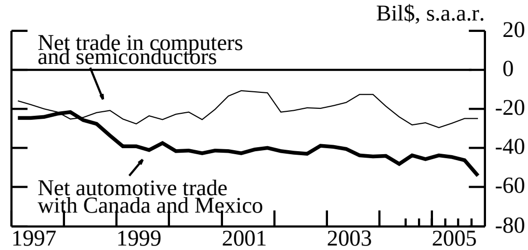


Contribution of Net Exports to Real GDP Growth

Percentage points, s.a.a.r.

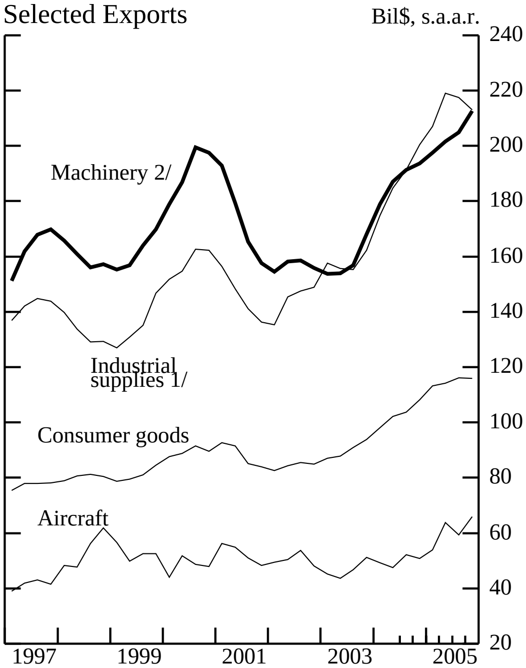


Bil$, s.a.a.r.



Selected Exports

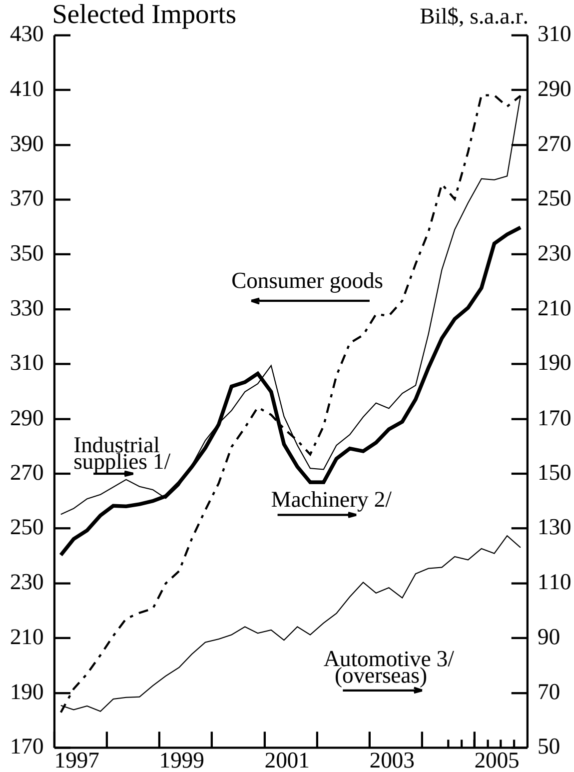
Bil$, s.a.a.r.



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

Selected Imports

Bil$, s.a.a.r.



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

U.S. Exports and Imports of Goods and Services

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

	Levels				Change[1]			
	2005		2005		2005		2005	
	Q3	Q4[e]	Oct.	Nov.	Q3	Q4[e]	Oct.	Nov.
Exports of G&S	**1283.1**	**1300.1**	**1288.6**	**1311.7**	**14.0**	**17.1**	**19.3**	**23.1**
Goods exports	900.9	915.4	902.4	928.3	6.7	14.5	21.0	25.9
Gold	5.4	5.9	6.1	5.8	-0.1	0.6	0.2	-0.3
Other goods	895.5	909.4	896.4	922.5	6.9	13.9	20.7	26.2
Aircraft & parts	59.4	66.0	62.0	70.1	-4.3	6.6	19.8	8.2
Computers & accessories	46.7	45.0	45.3	44.8	0.9	-1.7	-2.0	-0.5
Semiconductors	48.8	49.7	49.7	49.8	2.9	1.0	0.8	0.2
Other capital goods	208.4	216.8	213.8	219.7	3.1	8.4	2.8	5.9
Automotive	98.6	102.8	101.8	103.8	4.7	4.2	2.0	2.1
to Canada	53.5	54.5	56.1	52.9	2.1	1.0	1.2	-3.2
to Mexico	15.5	19.1	18.9	19.3	0.1	3.6	1.6	0.4
to ROW	29.5	29.2	26.8	31.6	2.4	-0.3	-0.8	4.9
Agricultural	67.3	65.6	66.6	64.6	-1.3	-1.7	3.0	-2.0
Ind supplies (ex. ag, gold)	217.5	213.1	210.6	215.6	-1.6	-4.4	-0.4	5.0
Consumer goods	116.0	116.0	112.5	119.5	1.9	-0.1	-6.6	7.0
All other goods	33.0	34.4	34.3	34.6	0.5	1.4	1.6	0.2
Services exports	382.2	384.7	386.1	383.3	7.2	2.6	-1.7	-2.8
Imports of G&S	**2014.2**	**2094.1**	**2106.1**	**2082.1**	**50.8**	**79.9**	**44.9**	**-24.0**
Goods imports	1692.6	1767.6	1780.3	1754.9	50.7	75.0	43.0	-25.5
Petroleum	270.1	299.7	304.4	295.1	40.5	29.7	17.5	-9.3
Gold	4.4	5.3	5.1	5.4	0.4	0.8	-0.3	0.2
Other goods	1418.1	1462.6	1470.8	1454.4	9.9	44.5	25.8	-16.4
Aircraft & parts	24.4	23.8	25.6	22.0	-3.8	-0.6	-0.6	-3.7
Computers & accessories	94.2	93.0	92.1	94.0	0.5	-1.1	-0.9	1.9
Semiconductors	26.1	26.5	26.7	26.4	0.7	0.5	0.7	-0.2
Other capital goods	239.7	242.1	241.4	242.9	3.4	2.4	-1.3	1.6
Automotive	242.4	250.8	250.1	251.5	10.1	8.4	9.1	1.4
from Canada	72.2	77.4	78.0	76.8	6.4	5.2	2.2	-1.2
from Mexico	43.0	50.5	51.7	49.2	-2.6	7.5	2.8	-2.6
from ROW	127.3	123.0	120.4	125.5	6.3	-4.3	4.0	5.1
Ind supplies (ex. oil, gold)	258.6	287.8	290.7	284.9	1.4	29.3	18.4	-5.8
Consumer goods	404.0	407.9	414.3	401.5	-4.1	3.9	3.9	-12.8
Foods, feeds, bev.	69.1	69.6	69.1	70.1	1.9	0.5	-2.2	1.0
All other goods	59.6	61.0	60.8	61.1	-0.1	1.4	-1.3	0.3
Services imports	321.6	326.5	325.8	327.3	0.0	4.9	1.9	1.5
Memo:								
Oil quantity (mb/d)	13.37	14.40	13.96	14.84	-0.19	1.03	0.96	0.88
Oil import price ($/bbl)	55.31	57.08	59.70	54.45	9.02	1.71	-0.72	-5.25

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

before falling back a bit in November. Imports of oil and industrial supplies rose particularly strongly in October, following large increases in September due in part to hurricane-related disruptions to domestic supplies. In November, imports of both oil and industrial supplies retreated a bit, but remained above pre-hurricane levels. Among other categories of goods, automotive imports were strong in both October and November, whereas imports of consumer goods fell back steeply in November following only a modest gain in October, largely on account of a drop in the volatile pharmaceutical products category. Imports of services increased in both months.

Prices of Internationally Traded Goods

Non-oil imports. Since the last Greenbook, we received BLS trade price data for November and December. After increasing 0.1 percent in November, BLS import prices of non-oil goods and of core goods were unchanged in December. In part, these price movements reflect large price fluctuations for natural gas. Prices of imported non-oil industrial supplies increased 0.5 percent in November, as prices for imported natural gas rose, and then fell 0.2 percent in December as natural gas prices turned back down. Compared to the core price index, prices for imported core goods excluding natural gas followed a somewhat different pattern–little changed in November and then increasing 0.2 percent in December. Prices for foods, feeds, and beverages rose 0.3 percent in November and 1.5 percent in December. Over these two months, the price indexes for the remaining categories of core imports were flat or declining. Between October and December, prices for imported computers fell 0.6 percent, whereas prices for semiconductors increased 1.0 percent.

In the fourth quarter, the average level of BLS prices for imported core goods was 7 percent at an annual rate above the third-quarter average. With the November and December data being quite weak (see above), the pick-up from the third quarter's ¾ percent inflation rate mainly reflected price hikes in September and October. The main contributor to the fourth-quarter price increase was non-oil industrial supplies, which increased 32 percent (a.r.), primarily reflecting a surge in natural gas prices in September and October. Prices of imported core goods excluding natural gas rose 2¾ percent (a.r.), in the fourth quarter, following a decline of ¼ percent in the third quarter.

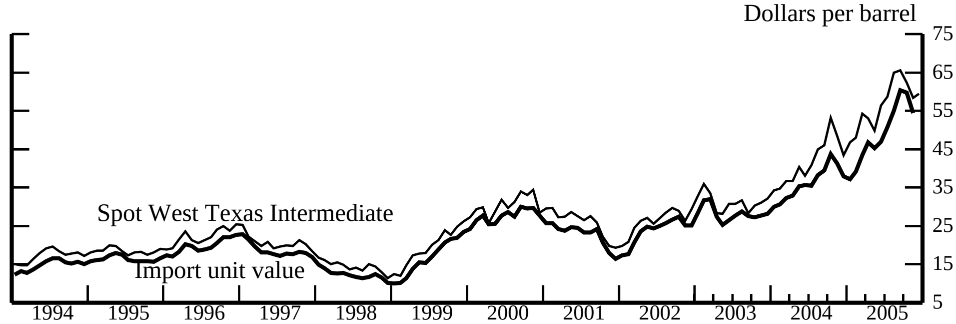
Oil. The BLS price index of imported oil fell 0.9 percent in December, following a 9.2 percent decline in November. The average spot price of West Texas Intermediate (WTI) crude oil rose 1.9 percent in December to about $59.40 per barrel. The spot price

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

	Annual rate 2005			Monthly rate 2005		
	Q2	Q3	Q4	Oct.	Nov.	Dec.
	----------------------- BLS prices ---------------------					
Merchandise imports	10.5	14.3	2.5	0.1	-1.8	-0.2
Oil	69.7	110.9	-9.6	-2.5	-9.2	-0.9
Non-oil	1.7	-0.1	6.0	0.8	0.1	0.0
Core goods*	2.1	0.7	7.0	0.9	0.1	0.0
Cap. goods ex comp & semi	2.0	-0.4	0.3	0.0	0.0	-0.2
Automotive products	0.5	0.6	0.4	0.0	0.0	0.0
Consumer goods	0.0	-0.9	-0.3	0.0	-0.2	0.0
Foods, feeds, beverages	7.3	-3.7	7.1	0.9	0.3	1.5
Industrial supplies ex oil	6.8	6.1	32.4	3.7	0.5	-0.2
Computers	-4.9	-11.1	-6.6	-0.6	-0.2	-0.5
Semiconductors	-2.0	-4.9	-3.6	-0.7	-0.1	1.1
Merchandise exports	3.3	0.8	3.2	0.7	-0.7	0.1
Core goods*	4.3	2.2	4.6	0.9	-0.7	0.2
Cap. goods ex comp & semi	1.5	0.5	2.2	0.3	0.1	0.2
Automotive products	0.8	0.9	1.6	0.3	0.0	0.0
Consumer goods	0.3	-0.1	0.8	0.0	0.0	-0.1
Agricultural products	18.7	1.9	-4.7	0.2	-0.2	-0.5
Industrial supples ex ag	6.5	6.1	13.0	2.3	-2.2	0.2
Computers	-7.4	-8.4	-11.2	-1.1	-1.9	-0.8
Semiconductors	-3.3	-12.4	-6.4	0.1	-0.6	-0.3
Chain price index	--------------------- NIPA prices ---------------------					
Imports of goods & services	8.2	9.4	n.a.	...	...	...
Non-oil merchandise	1.6	-0.0	n.a.	...	...	...
Core goods*	2.2	1.0	n.a.	...	...	...
Exports of goods & services	3.7	2.9	n.a.	...	...	...
Total merchandise	2.9	1.3	n.a.	...	...	...
Core goods*	3.8	1.9	n.a.	...	...	...

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

Oil Prices



of WTI edged up late in the month and then rose sharply in January, as the diplomatic fight over Iran's nuclear program escalated, rebels threatened oil production infrastructure in Nigeria, and violence and production problems in Iraq worsened. In addition, a dispute between Russia and Ukraine over natural gas supplies raised concerns about the reliability of Russia as an energy supplier. The spot price of WTI closed on January 24 at \$66.75 per barrel.

Exports. Having fallen 0.7 percent in November, the prices of U.S. exports of total goods and of core goods rose 0.1 and 0.2 percent, respectively, in December. The decrease in export prices in November was led by a 2.2 percent decline in prices of exported non-agricultural industrial supplies, which mainly reflected a steep decline in petroleum and petroleum product prices. In December, prices of exported non-agricultural industrial supplies and capital goods (excluding computers and semiconductors) increased 0.2 percent, more than offsetting a decline in prices of agricultural products and consumer goods. Between October and December, prices of exported computers and semiconductors fell 2.7 and 0.8 percent, respectively.

The average level of core export prices in the fourth quarter was 4½ percent at an annual rate above the third quarter average, as prices increased in all sub-categories with the exception of agricultural products. Non-agricultural industrial supplies were the main contributor to the overall price increase, rising 13 percent.

U.S. International Financial Transactions

Foreign official flows into the United States (line 1 of the Summary of U.S. International Transactions table) slowed slightly in November but remained at historically high levels. Net inflows from the G-10 countries and the ECB (line 1a) increased a bit, while inflows from OPEC countries (line 1b) decreased by a similar amount. Inflows from other countries (line 1c) were only slightly lower on net

.

Given the data in hand, foreign official inflows in the second half of 2005 are on track to be slightly higher than those in the first six months, though official inflows for all of 2005 are significantly lower than those recorded for 2004. Most of the decrease this year can be attributed to the cessation of two years of Japanese intervention and the associated inflows.

It has been widely reported in the press that these monthly transactions data may understate inflows from official sources because they erroneously attribute some foreign official flows to the foreign private sector. It is true that there is some misattribution in these data if official agencies use a foreign intermediary to acquire U.S. assets. To the extent possible, BEA corrects for this misattribution in quarterly balance of payments statistics using data from FRBNY and elsewhere, and these corrections are carried through to the monthly data shown in the table. Nonetheless, there may be some remaining misattribution.

Much of what press reports consider misattribution is in fact a misunderstanding of what the financial accounts are designed to report. The financial accounts reflect changes in claims on the United States, which are distinct from changes in dollar exposure. For example, dollar deposits in London banks represent dollar claims on the U.K. private sector. To the extent that a U.K. bank then uses these deposits to acquire claims on the United States, they represent claims of the U.K. private sector on the United States. Thus, when a foreign official agent increases its dollar deposits in a London bank, it is taking on additional dollar exposure without acquiring an additional claim on the United States. In general, transactions among foreigners (such as those among foreign exporters, foreign official agents, and foreign banks) are not U.S. balance of payments transactions even if they are in dollar denominated assets, and therefore should not be included in the U.S. financial accounts.

Foreign private purchases of U.S. securities (line 4) picked up further in November on record private purchases of Treasury securities (line 4a) and continued strong flows into corporate bonds (line 4c). Most of the net inflows are attributed to the United Kingdom, providing little information about the residence of the ultimate purchaser. There was a slight net outflow in the typically volatile agency bond category (line 4b) and a modest slowing in net purchases of equities (line 4d). On net, average monthly foreign purchases of long-term securities in the second half of 2005 exceeded the already strong purchases recorded in the beginning of the year. For the first eleven months of 2005, total net foreign private acquisitions of U.S. securities totaled $645 billion, surpassing the net purchases recorded for all of 2004. With these large purchases, foreign investors continued the trend of increasing their share of the amount outstanding of each of the four types of U.S. securities shown in lines 4a through 4d.

Purchases of foreign securities by U.S. residents (line 5) rebounded in November from an unusually low level in October, as the appetite of U.S. investors for foreign equities (line 5b), primarily Asian equities, reached a record level. There were continued small net sales of foreign bonds (line 5a). Year-to-date purchases of foreign securities totaled $144 billion and are near the level of purchases in 2004.

Banking sector flows (line 3) continued to be volatile in November, with an outflow of $11 billion following inflows in several previous months. Year-to-date outflows have totaled $24 billion, which is well within the range of recent historical experience.

Since the last FOMC meeting, BEA released balance of payments data for the third quarter, including direct investment flows and other data not captured in the monthly reports on securities and banking flows. The typical outflow of U.S. direct investment abroad (line 6) reversed sign to an inflow in response to the partial tax holiday established in the 2004 American Jobs Creation Act (also known as the Homeland Investment Act). Under this one-fiscal-year tax holiday, companies that repatriate previously retained earnings from foreign subsidiaries and reinvest them in the United States are subject to a reduced effective tax rate on those earnings. Sizeable repatriation of earnings began in the third quarter of 2005, after the Treasury Department issued a series of guidelines through May. By our estimate, foreign affiliates remitted $60 billion of previously retained earnings in the third quarter, which more than offset the usual $40 billion in outflows associated with newly reinvested earnings. Flows of foreign direct investment into the United States (line 7) rebounded in the third quarter, returning to trend levels. This third-quarter rebound reflects the reversal of second-quarter inter-company debt flows and some new equity investment. As in previous quarters, three-fourths of inflows originated in EU countries and one-eighth originated in Japan. Merger-related inflows continued at the relatively subdued pace of the last several years.

Overall, the third-quarter data show an unusual increase in net private financial inflows to $230 billion, due mostly to sizeable net direct investment inflows in addition to the high level of foreign purchases of U.S. securities. These higher private inflows more than offset the decline in official flows. With total financial inflows, both private and official, rising to \$273 billion in the third quarter while the current account deficit was nearly unchanged at \$196 billion, the statistical discrepancy swung from a positive \$48 billion in the second quarter to negative \$77 billion in the third.

Summary of U.S. International Transactions

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

	2003	2004	2004	2005				
			Q4	Q1	Q2	Q3	Oct.	Nov.
Official financial flows	**269.0**	**398.1**	**94.9**	**31.2**	**81.0**	**42.5**	**30.8**	**27.1**
1. Change in foreign official assets in the U.S. (increase, +)	267.5	395.3	94.2	25.9	81.8	37.7	30.4	26.8
a. G-10 countries + ECB	111.4	161.7	-3.1	5.5	-18.2	-5.1	2.5	4.7
b. OPEC	5.9	12.1	6.8	-3.9	4.4	-4.1	8.8	5.0
c. All other countries	150.2	221.5	90.4	24.3	95.6	46.8	19.1	17.0
2. Change in U.S. official reserve assets (decrease, +)	1.5	2.8	0.7	5.3	-0.8	4.8	0.4	0.3
Private financial flows	**291.7**	**186.5**	**74.1**	**130.7**	**69.6**	**230.4**	**...**	**...**
Banks								
3. Change in net foreign positions of banking offices in the U.S. [1]	64.7	-3.8	14.0	9.8	-61.6	5.4	33.5	-10.9
Securities [2]								
4. Foreign net purchases of U.S. securities (+)	336.0	506.0	171.0	153.9	127.0	205.4	74.8	84.2
a. Treasury securities	113.3	122.6	10.9	76.0	11.5	41.2	18.0	49.7
b. Agency bonds	-38.3	66.0	43.2	0.7	20.1	34.7	19.1	-1.7
c. Corporate and municipal bonds	223.8	255.0	71.1	56.8	81.3	102.2	28.3	30.5
d. Corporate stocks [3]	37.2	62.4	45.8	20.4	14.0	27.2	9.3	5.7
5. U.S. net acquisitions (-) of foreign securities	-146.6	-146.2	-29.6	-45.2	-42.7	-35.0	-4.9	-15.8
a. Bonds	-28.0	-60.9	-19.9	-4.6	-18.6	-0.3	2.1	1.6
b. Stock purchases	-101.2	-97.6	-35.2	-38.5	-22.2	-34.7	-7.0	-17.4
c. Stock swaps [3]	-17.4	12.2	25.5	-2.1	-1.9	0.0	0.0	0.0
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-140.6	-252.0	-100.0	-27.0	-21.4	27.1	...	...
7. Foreign direct investment in the U.S.	67.1	106.8	31.6	35.1	14.5	38.8	...	...
8. Foreign acquisitions of U.S. currency	16.6	14.8	5.3	1.1	4.5	4.7	...	...
9. Other (inflow, +) [4]	94.3	-39.2	-18.2	3.0	49.3	-15.8	...	...
U.S. current account balance (s.a.)	**-519.7**	**-668.1**	**-188.4**	**-198.7**	**-197.8**	**-195.8**	**...**	**...**
Capital account balance (s.a.) [5]	**-3.2**	**-1.6**	**-0.5**	**-4.5**	**-0.3**	**-0.3**	**...**	**...**
Statistical discrepancy (s.a.)	**-37.8**	**85.1**	**19.9**	**41.2**	**47.5**	**-76.8**	**...**	**...**

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.

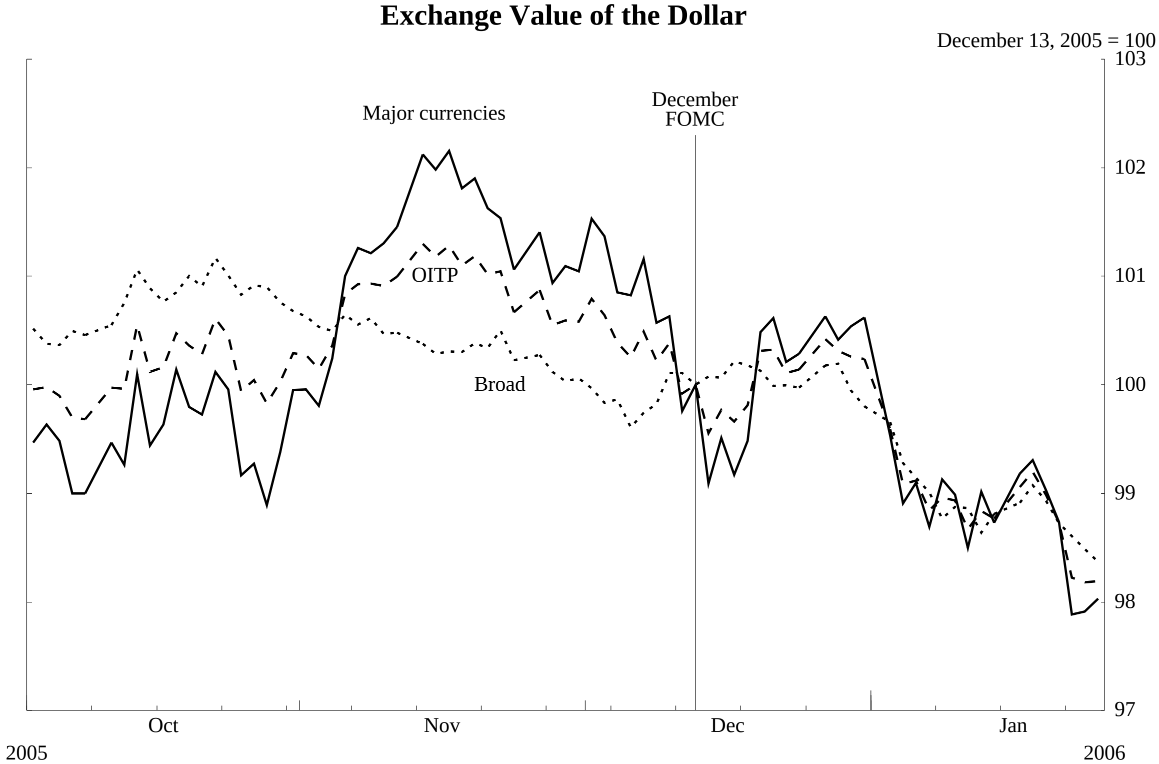
1. Changes in dollar-denominated positions of all depository institutions and bank holding companies plus certain transactions between broker-dealers and unaffiliated foreigners (particularly borrowing and lending under repurchase agreements). Includes changes in custody liabilities other than U.S. Treasury 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 dollar's foreign exchange value against other major currencies moved down about 2 percent on net over the intermeeting period. Downward pressure on the dollar in the last week of December and the first week of January was prompted in part by lower-than-expected U.S. ISM and payroll data for December and a reduction in market expectations for the future path of U.S. interest rates. On a bilateral basis, the dollar depreciated about 3½ percent against the yen, as economic data from Japan continued to confirm steady, solid growth. The decline of the dollar against the yen essentially unwound a rise that had occurred in the weeks preceding the December FOMC meeting. That strength had been attributed by market participants to a combination of carry-trades and diversification of Japanese investment portfolios. The dollar also depreciated 3 percent on net against the euro, which was supported late in the period by increasing expectations of monetary tightening by the ECB. The dollar was little changed on balance against the Canadian dollar and sterling.

Exchange Value of the Dollar



Financial Indicators in Major Industrial Countries

Country	Three-month rate Jan.24/25 (Percent)	Three-month rate Percentage point change	Ten-year yield Jan.24/25 (Percent)	Ten-year yield Percentage point change	Equities percent change
Canada	3.67	.22	4.07	-.07	5.34
Japan	.10	.03	1.46	-.12	-.47
Euro area	2.53	.08	3.41	.01	2.75
United Kingdom	4.55	-.05	4.08	-.22	3.69
Switzerland	.98	-.07	2.12	.02	1.88
Australia	5.61	-.04	5.25	-.21	6.02
United States	4.59	.13	4.40	-.16	.17
Memo: Weighted-average foreign	2.38	.08	3.53	-.10	n.a.

NOTE. Change is from December 12/13 to January 24/25.
n.a. Not available.

The European Central Bank, the Bank of England and the Bank of Japan did not change their monetary policy stances over the intermeeting period. The Bank of Canada raised its target for the overnight rate 25 basis points, to 3.5 percent, on January 24. Ten-year government bond yields decreased in most industrial economies. In the euro area, ten-year German government bond yields declined in the first two weeks of January, but they moved back up late in the intermeeting period after ECB Chief Economist Issing commented that “Almost all data show that the upswing is continuing and strengthening.” Mr. Issing also stated that oil prices, which rose to a four-month high, may spur an increase in inflation. Market participants attribute the 22 basis point drop in the U.K. 10-year yield in part to comments from the Bank of England’s chief economist Bean that were viewed as signaling that policy makers may lower interest rates in the coming months.

Over the intermeeting period, headline equity indexes rose 2 to 5 percent in the euro area, United Kingdom and Canada, and were little changed on net in the United States and Japan. Japanese equity prices experienced a large swing over the period. They rose to a

5-year peak in the first half of January but later dropped on news of the investigation of Livedoor, a large internet services company, for accounting irregularities. Lower-than-expected earnings released by several large U.S. corporations also appeared to weigh on Japanese and U.S. equity prices, as did an increase in crude oil prices over the period.

Financial Indicators in Latin America, Asia, and Russia

Economy	Currency/ US dollar		Short-term interest rates[1]		Dollar-denominated bond spread[2]		Equity prices
	Jan. 25	Percent change	Jan.24/25 (Percent)	Percentage point change	Jan.24/25 (Percent)	Percentage point change	Percent change
Mexico	10.49	-1.30	7.80	-.60	1.17	-.09	7.71
Brazil	2.25	-.38	17.15	-1.52	2.73	-.43	13.43
Argentina	3.04	1.31	8.69	1.06	4.44	-.49	10.79
Chile	526.80	3.04	5.16	.38	.74	-.03	.54
China	8.06	-.16	n.a.	n.a.	.67	.00	12.54
Korea	968.30	-5.53	n.a.	n.a.	...	...	.46
Taiwan	31.97	-4.44	1.66	.06	...	...	4.33
Singapore	1.62	-3.16	3.31	.25	...	...	3.21
Hong Kong	7.76	.05	3.73	-.37	...	...	3.87
Malaysia	3.75	-.70	3.15	.02	.82	.00	1.28
Thailand	39.06	-5.03	4.40	.25	.54	.08	9.98
Indonesia	9335.00	-4.55	13.21	-.32	2.59	.06	4.07
Philippines	52.43	-2.09	6.75	-.56	2.95	-.19	.64
Russia	27.95	-2.76	n.a.	n.a.	1.08	-.07	20.42

NOTE. Change is from December 12/13 to January 24/25.

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.

On net over the intermeeting period, the dollar depreciated about 4½ percent against the Taiwan dollar, about 5 percent against the Thailand baht, about 3 percent against the Singapore dollar, and 5½ percent against the Korean won.

Most emerging Asian equity

indexes increased on balance, but some were affected by the events in the Japanese stock market; in particular, Korean equity prices were little changed on balance.

Equity prices recorded strong increases in Latin America, where financial conditions for major U.S. trading partners continued to be favorable. The Brazilian central bank cut its policy rate 75 basis points in mid-January. Both Brazil and Argentina surprised financial markets by announcing repayment of all their remaining obligations to the IMF. EMBI+ spreads went down about 50 basis points in Brazil and Argentina.

Over the intermeeting period the spot price of gold soared $30 per ounce, to $557 per once. Gold prices have increased along with other precious metal prices, in part due to a shortfall in annual mining production and rising jewelry and investment demand. The investment demand for gold rose on rumors that some central banks, including those in Russia and South Africa, may seek to diversify their portfolios by increasing their holdings of gold.

Developments in Foreign Industrial Countries

The firm pace of third-quarter activity in the foreign industrial countries appears to have continued in the fourth quarter. Indicators of consumer spending and sentiment have been positive on balance in each of the major foreign industrial countries. Survey measures of business sentiment suggest optimism in Japan and the euro area, and purchasing managers' indexes (PMI) improved in Japan, the euro area, and the United Kingdom. Employment growth in Canada was very strong in the fourth quarter, with the unemployment rate touching a 30-year low.

Twelve-month rates of consumer price inflation continued to recede in November and December. The Bank of Canada continued its tightening campaign with a fourth consecutive increase in its overnight rate.

Third-quarter GDP growth in **Japan** was revised down to 1 percent (s.a.a.r.), as the contribution from inventory investment was revised to -1.4 percent following a preliminary estimate of a slight positive contribution. However, monthly indicators of activity in the fourth quarter have been positive. Industrial production rose 1.5 percent in November, the fourth consecutive month of positive growth, and the manufacturing PMI rose further in December. Housing starts, machinery orders, and machinery shipments all posted increases in the fourth quarter. Real spending by households fell in November but remained 0.5 percent above its average level in the third quarter, and in December, consumer confidence rose to its highest level since 1991. Average real exports in October and November were 2.2 percent above their average level in the third quarter, and real imports were 1.1 percent lower.

Japanese Economic Indicators

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

Indicator	2005						
	Q2	Q3	Q4	Sept.	Oct.	Nov.	Dec.
Industrial production[1]	-.4	-.2	n.a.	.4	.6	1.5	n.a.
All-industries index	.3	.2	n.a.	-.5	.9	0.3	n.a.
Housing starts	-2.1	8.0	n.a.	-2.1	3.8	.7	n.a.
Machinery orders[2]	.8	2.1	n.a.	-10.0	4.8	2.3	n.a.
Machinery shipments[3]	2.4	1.2	n.a.	-1.6	2.8	1.5	n.a.
New car registrations	1.4	-2.8	-5.0	2.1	-6.2	.9	-3.5
Unemployment rate[4]	4.3	4.3	n.a.	4.2	4.5	4.6	n.a.
Job offers ratio[5]	.95	.97	n.a.	.97	.98	.99	n.a.
Business sentiment[6]	1.0	2.0	5.0	…	…	…	…
CPI (core, Tokyo area)[7]	-.4	-.4	-.3	-.4	-.3	-.3	-.2
Wholesale prices[7]	1.7	1.6	2.0	1.7	2.0	1.9	2.2

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.

The Bank of Japan's Tankan diffusion index of business conditions for firms of all sizes and industries rose three points in December to 5, consistent with a moderate but steady rate of growth over the next year. Firms revised their projections of investment spending growth for the current fiscal year to 9.1 percent, up 3.1 percentage points from the September survey. Reported annual employment growth rose and the diffusion index of excess employment conditions indicated a tighter labor market. Projections of sales growth were revised up by all firms.

Overall consumer prices fell 0.8 percent in November from a year earlier. Core consumer goods prices, which exclude volatile food prices but include oil, were up 0.1 percent from a year earlier; however this positive rate of core inflation was due in large part to base-year effects – core consumer prices fell 0.1 percent from the previous month’s level. The Tokyo consumer price index, which is reported one month earlier than the national price index, rose 0.1 percent in December from the previous month but fell 0.6 percent from a year earlier. Nominal wages rose 0.5 percent in November compared with the same month a year earlier. Although the unemployment rate edged up to 4.6 percent in November, there is anecdotal evidence linking the rise to a greater willingness of some employees to quit and seek better employment options. Despite the rise in the unemployment rate, the offers-to-applicants ratio (the number of officially posted job openings relative to the number of officially registered job seekers) rose to a thirteen-year high.

In the **euro area**, industrial production rebounded to a new high in November, and forward-looking indicators of activity continued to strengthen. Survey measures of business sentiment improved further in December and January to the best levels since 2000. The euro-area manufacturing PMI rose to 53.6 in December from 52.8 the previous month. The pickup in the euro-area economy appears to be spreading beyond just manufacturing, with the services PMI also jumping in December, to 56.8 from just over 55 the previous month. In Germany, new manufacturing orders posted a strong increase in November, and German industrial production in November gave back only a small part of the very large gains of the previous two months. German business sentiment suggests a continuation of these positive trends, with the IFO business climate index surging in December and January to a level just shy of the previous cycle's peak reached in May 2000. In contrast, with French businesses experiencing less of an export boom than in Germany, the French INSEE business climate index was flat in December and January and is a bit below the year-ago level.

Euro-Area Economic Indicators

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

Indicator	2005						
	Q2	Q3	Q4	Sep.	Oct.	Nov.	Dec.
Industrial production[1]	.7	.8	n.a.	-.2	-.7	1.3	n.a.
Retail sales volume[2]	-.4	.2	n.a.	-.7	.2	-.0	n.a.
Unemployment rate[3]	8.6	8.4	n.a.	8.3	8.3	8.3	n.a.
Consumer confidence[4]	-14.3	-14.7	-12.3	-14.0	-13.0	-13.0	-11.0
Industrial confidence[4]	-10.3	-7.7	-6.0	-7.0	-6.0	-7.0	-5.0
Manufacturing orders, Germany	.9	4.6	n.a.	2.9	2.0	1.3	n.a.
CPI[5]	2.0	2.3	2.3	2.6	2.5	2.3	2.2
Producer prices[5]	3.9	4.2	n.a.	4.4	4.2	4.2	n.a.
M3[5]	7.6	8.5	n.a.	8.5	8.0	7.6	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.

It now appears that euro-area firms, especially those in Germany, are gaining enough confidence in the durability of the recovery and in the soundness of their balance sheet positions to begin to spend on capital investment and business services. Hiring of new workers tends to lag behind capital spending, but there are some early indications that the labor market is improving. The European Commission’s measure of consumer sentiment picked up further in December, largely because of a strong improvement in consumers’ perceptions of employment prospects. However, the euro-area unemployment rate remained at 8.3 percent in November for the third straight month.

The twelve-month rate of consumer price inflation continued to edge down, to 2.2 percent, in December from a recent high of 2.6 percent in September. Core inflation, excluding energy and unprocessed food remained around 1.5 percent. The European Central Bank kept policy unchanged at its January 12 meeting, and market expectations of further near-term rate hikes were reduced a bit by ECB President Trichet’s post-meeting comments that emphasized the downside risks to euro-area growth.

The preliminary estimate of fourth-quarter GDP growth in the **United Kingdom** was 2.6 percent. Manufacturing output in the fourth quarter fell by 0.6 percent, which was partly offset by a 1.3 percent rise in mining and quarrying (which includes oil and gas extraction). Services output grew by 0.9 percent, slightly faster than in the third quarter.

Other indicators for the fourth quarter were generally positive for the United Kingdom**.** The PMI for manufacturing squeaked above the 50 mark in third quarter and hovered just above 51 throughout the fourth quarter. The services PMI, after remaining essentially unchanged near 55 through most of 2005, jumped to 58 in December.

Retail sales accelerated in the fourth quarter. On the downside, after dipping in October, consumer confidence failed to rebound in November and December. Consumer credit (credit not secured on dwellings) fell slightly in November, with the decline driven by reduced credit card lending.

House prices have been rising in recent months, after having been roughly unchanged for much of the previous year. In December, the Nationwide and Halifax indexes of house prices rose on a twelve-month basis 3.2 and 5.6 percent, respectively. Lending secured on dwellings rose 0.9 percent in November.

U.K. Economic Indicators

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

Indicator	2005						
	Q2	Q3	Q4	Oct.	Nov.	Dec.	Jan.
Real GDP*	1.9	1.5	2.6	…	…	…	…
Industrial production	-.0	-.6	n.a.	-1.2	.7	n.a.	n.a.
Retail sales volume[1]	.5	.4	1.6	.4	.9	.5	n.a.
Unemployment rate[2]							
Claims-based	2.7	2.8	2.9	2.9	2.9	2.9	n.a.
Labor force survey[3]	4.7	4.8	n.a.	5.0	n.a.	n.a.	n.a.
Business confidence[4]	-.3	5.0	-2.0	2.0	-4.0	-4.0	1.0
Consumer confidence[5]	-2.0	-2.0	-4.0	-4.0	-4.0	-4.0	n.a.
Consumer prices[6]	1.9	2.4	2.1	2.3	2.1	2.0	n.a.
Producer input prices[7]	9.8	12.5	13.2	9.0	13.6	17.2	n.a.
Average earnings[7]	4.1	4.1	n.a.	3.1	3.4	n.a.	n.a.

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

The twelve-month rate of consumer price inflation fell in December to 2 percent, the Bank of England's target. The twelve-month rate of inflation excluding energy also fell, from 1.6 percent in November to 1.4 percent in December.

Data for **Canada** suggest economic activity remained firm in the fourth quarter. The composite index of leading indicators accelerated throughout the quarter. Housing starts ended the year on a strong note, and 2005 housing starts were the second-highest in the past 18 years, topped only in 2004. Retail sales in November posted a second straight advance. Average real exports and imports in October and November were both about 10 percent (a.r.) above their average third-quarter average. The manufacturing sector, however, continued to struggle, as manufacturing shipments fell in November in real terms for the third time in four months, and, following a strong October, manufacturers received fewer new orders in November. The PMI retreated in December, following a strong cumulative gain over the previous three months.

Although employment dipped slightly in December, fourth-quarter job gains were the strongest in six quarters, continuing the solid labor market performance of the past few years. After unemployment touched a 30-year low of 6.4 percent in November, it crept back up to 6.5 percent in December. The manufacturing sector remains the biggest source of weakness in the labor market, continuing to experience large job losses.

In December, the twelve-month rate of consumer price inflation was 2.2 percent. Gasoline prices, which fell sharply in October and November, were flat in December, which pushed the twelve-month inflation rate up slightly from 2 percent in November. The twelve-month rate of core inflation, which excludes the eight most volatile components, edged down to 1.4 percent.

In January, the Bank of Canada increased the targeted overnight rate 25 basis points to 3.5 percent, following 25-basis-point increases at each of its previous three meetings. This move was widely expected. In its accompanying statement, the Bank said that "…some modest further increase in the policy interest rate…" would be required to keep inflation on target.

Canadian Economic Indicators

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

Indicator	2005						
	Q2	Q3	Q4	Sept.	Oct.	Nov.	Dec.
GDP by industry	.8	1.1	n.a.	-.0	.2	n.a.	n.a.
Industrial production	-.1	1.3	n.a.	-.6	.4	n.a.	n.a.
New manufacturing orders	-1.3	1.4	n.a.	-1.9	2.2	-1.8	n.a.
Retail sales	1.1	.3	n.a.	-1.9	1.5	1.3	n.a.
Employment	.4	.3	.6	-.0	.4	.2	-.0
Unemployment rate[1]	6.8	6.8	6.5	6.7	6.6	6.4	6.5
Consumer prices[2]	1.9	2.6	2.3	3.4	2.6	2.0	2.2
Core consumer prices[2,3]	1.6	1.7	1.6	1.8	1.8	1.5	1.4
Consumer attitudes (1991 = 100)	122.0	107.6	118.4	…	…	…	…
Business confidence (1991 = 100)	139.2	127.1	n.a.	…	…	…	…

1. Percent.
2. Percent change from year earlier, n.s.a.
3. Excluding the 8 most volatile components (fruits, vegetables, gasoline, fuel oil, natural gas, mortgage interest, intercity transportation, and tobacco).

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

In federal elections held January 23, the Conservative party won 124 out of 308 Parliamentary seats, and Conservative Leader Stephen Harper will become the country's twenty-second prime minister. The Conservative win ends the 12-year reign of the Liberal party, which took 103 seats. The Conservatives now face the task of forming the country's second consecutive minority government. The previous minority government, led by the Liberal party, had been in place since June 2004.

External Balances

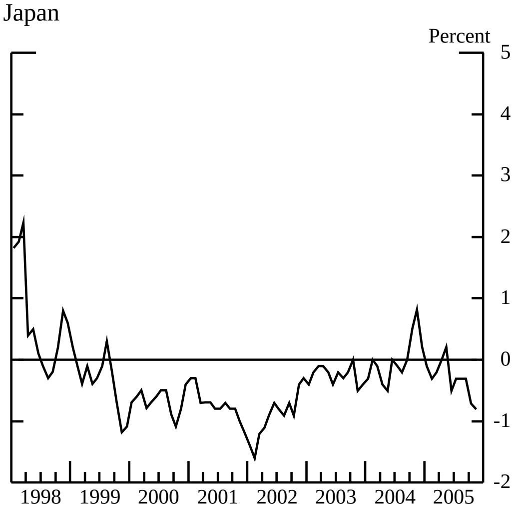
(Billions of U.S. dollars, s.a.a.r.)

Country and balance	2005					
	Q1	Q2	Q3	Sept.	Oct.	Nov.
Japan						
Trade	102.4	78.6	65.8	63.1	73.0	71.7
Current account	171.3	160.0	154.6	173.9	174.8	159.0
Euro area						
Trade	71.1	53.3	11.4	35.4	-14.3	1.3
Current account	23.5	11.9	-62.5	-38.2	-106.8	-142.9
Germany						
Trade	212.8	202.2	200.0	217.6	183.4	197.9
Current account	144.2	108.9	115.3	104.9	71.3	102.1
France						
Trade	-28.5	-24.3	-34.4	-25.6	-35.1	-44.4
Current account	-31.7	-37.4	-29.0	-24.8	-60.4	-75.7
Italy						
Trade	-9.5	-8.4	-17.0	-16.2	-19.9	-14.4
Current account	-33.8	-27.2	-23.4	-18.0	-15.2	-19.6
United Kingdom						
Trade	-119.0	-109.7	-121.2	-121.4	-107.0	-124.2
Current account	-50.5	-10.1	-72.9	…	…	…
Canada						
Trade	41.8	44.1	61.0	70.6	77.8	69.9
Current account	14.8	15.7	30.8	…	…	…

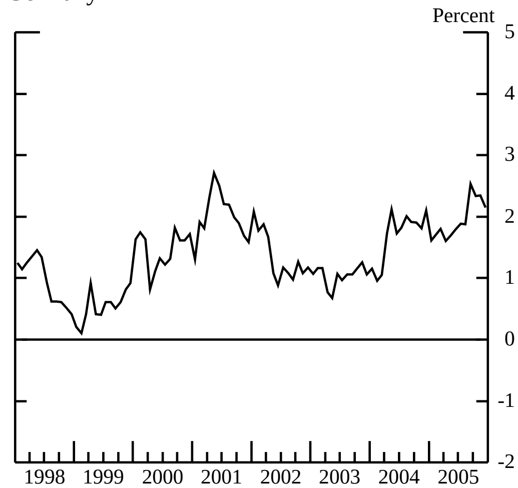
. . . Not applicable.

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

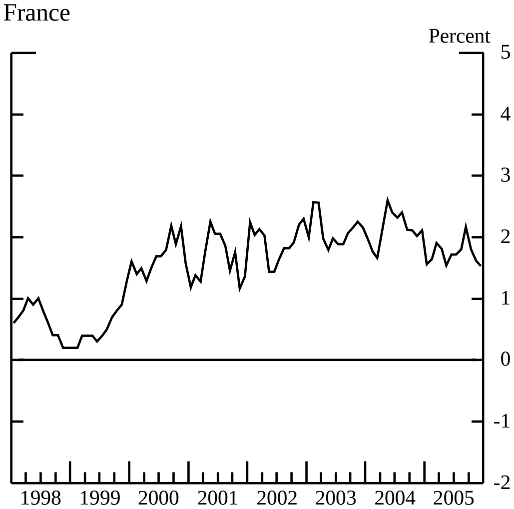
Japan



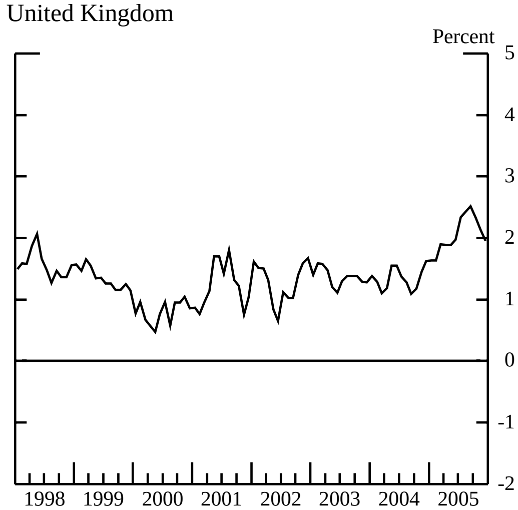
Germany



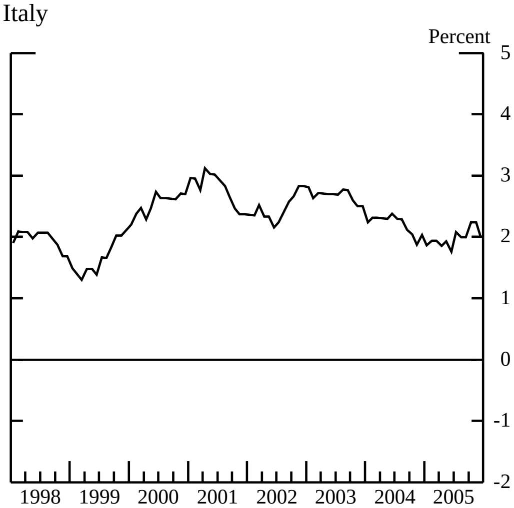
France



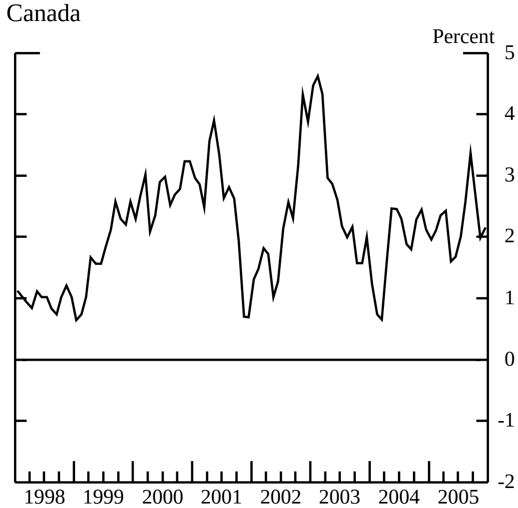
United Kingdom



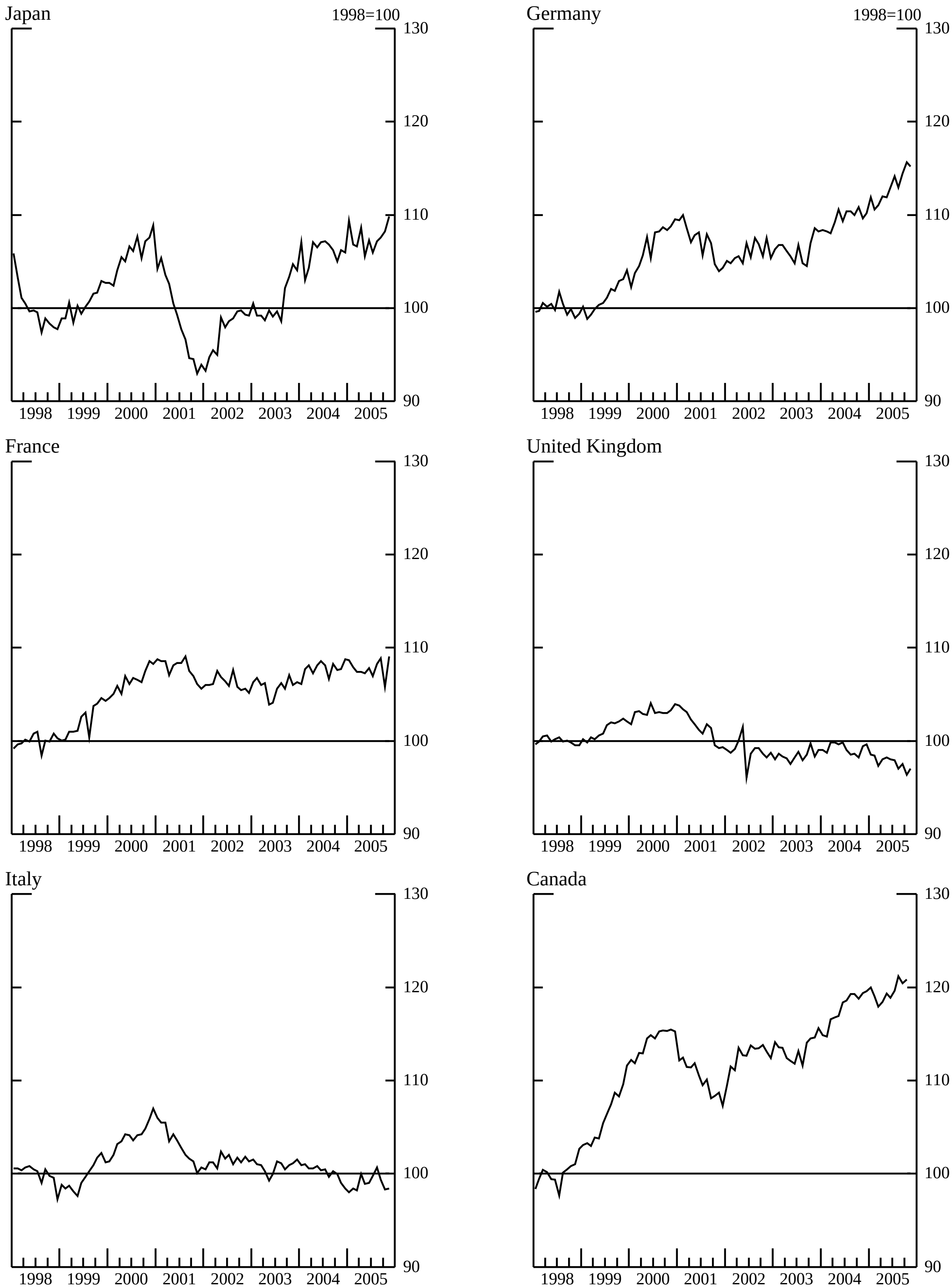
Italy



Canada



Industrial Production in Selected Industrial Countries



Economic Situation in Other Countries

Activity in Asia in the fourth quarter continued to be generally robust, supported by strong Chinese performance and by global demand for electronics. Indicators in Latin America, in contrast, were mixed. In Mexico, the industrial sector has shown signs of recovery, although recent data releases have been a bit disappointing. Economic activity in Brazil showed continued weakness, while Argentina saw strong growth but high inflation. The emergence of the bird flu in a remote area of Turkey has resurrected fears of a flu pandemic, but the economic effect remains limited.

Chinese real GDP rose more than 11 percent (staff estimate) in the fourth quarter. Coupled with revision to recent quarters, this brought 2005 real GDP growth to 9.9 percent, just a step below last year's pace. While industrial production surged in December, investment and retails sales decelerated in recent months, although growth remained elevated. Export growth also slowed somewhat in recent months. Nevertheless, the Chinese trade surplus for 2005 exceeded $100 billion, more than three times the surplus of the previous year. For the year as a whole, both export and import growth slowed from the pace of recent years, but import growth fell by half, whereas export growth slowed only modestly. Consumer price inflation moved up a tad in recent months, with twelve-month rate of inflation ending the year at 1½ percent.

The Chinese government released the results of the economic census undertaken in 2004, revising upward 2004 nominal GDP about 17 percent, owing in large part to a sizeable upward revision in service sector output. Real GDP growth was also revised up about ½ percentage point per year on average over the last twelve years.

Chinese Economic Indicators

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

Indicator	2004	2005	2005				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP[1]	10.1	9.9	8.9	11.5	…	…	…
Industrial production	14.4	17.1	3.2	4.0	1.1	.7	2.3
Consumer prices[2]	2.6	1.6	1.3	1.4	1.2	1.3	1.6
Trade balance[3]	32.1	101.9	113.7	89.1	100.0	76.7	90.4

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** suggest that activity in the fourth quarter slowed from the very rapid growth seen earlier last year, as the boost to investment and consumption from the completion of Hong Kong Disneyland appears to have waned somewhat. The trade deficit widened a little in November, reflecting a small decline in exports and a slight rise in imports. December unemployment remained at its lowest level in four years. Twelve-month consumer price inflation edged up in recent months but ended the year below 2 percent.

Hong Kong Economic Indicators

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

Indicator	2004	2005	2005				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP[1]	6.9	n.a.	9.9	n.a.	…	…	…
Unemployment rate[2]	6.9	5.7	5.5	5.3	5.3	5.3	5.3
Consumer prices[3]	.2	1.8	1.4	1.8	1.8	1.7	1.8
Trade balance[4]	-12.0	n.a.	-12.0	n.a.	-5.1	-8.7	n.a.

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

In **Taiwan**, incoming data suggest that fourth quarter growth remained at a heady pace following a strong third quarter, when real GDP expanded almost 7 percent (s.a.a.r.) mainly as a result of export growth and inventory accumulation. Fourth-quarter industrial production was up 4.5 percent from the third quarter, and new orders for electronics remained elevated in December. Exports surged to a new high in December, boosted by soaring high-tech exports, and imports edged down, contributing to a sharp expansion of the monthly trade surplus. The unemployment rate has inched down in recent months. Consumer price inflation ended the year at 2.2 percent on a twelve-month basis.

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

Indicator	2004	2005	2005				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP[1]	2.6	n.a.	6.9	n.a.	…	…	…
Unemployment rate[2]	4.5	4.1	4.1	4.0	4.0	4.0	4.0
Industrial production	9.8	3.4	3.2	4.5	.6	1.1	-.4
Consumer prices[3]	1.6	2.2	3.0	2.5	2.7	2.5	2.2
Trade balance[4]	6.1	7.8	4.4	21.6	13.0	10.5	41.3
Current account[5]	18.6	n.a.	3.5	n.a.	…	…	…

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

Korean growth continued to be strong, with real GDP jumping 7.2 percent in the fourth quarter, bringing output 5.4 percent above its level a year ago. Consumer demand remained robust in the fourth quarter, and business fixed investment and net exports posted strong gains. In December, the Bank of Korea unexpectedly raised its policy rate, indicating that core inflation likely would exceed its target in the latter half of 2006, but the Bank left rates unchanged in January. Twelve-month consumer price inflation increased a touch in December to 2.6 percent but core inflation ended the year at about 2 percent, below the central bank's target of 2½ to 3½ percent.

Following the sharp appreciation of the won, in early January, officials from several government bodies issued a warning that the Bank of Korea and Financial Supervisory

Service would take action against speculative activity. Officials also announced they had decided to ease restrictions on Korean nationals' purchases of foreign real estate and raise caps on individual overseas investments. Moreover, the government indicated that it would liberalize further by eliminating these caps altogether by the end of this year.

Korean Economic Indicators

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

Indicator	2004	2005	2005				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP[1]	3.0	5.4	8.0	7.2	…	…	…
Industrial production	10.2	n.a.	3.3	n.a.	1.1	5.0	n.a.
Unemployment rate[2]	3.5	3.7	3.8	3.7	3.9	3.6	3.5
Consumer prices[3]	3.0	2.6	2.4	2.5	2.5	2.4	2.6
Trade balance[4]	37.6	n.a.	32.3	n.a.	32.7	30.8	n.a.
Current account[5]	28.2	n.a.	10.1	n.a.	34.2	24.6	n.a.

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

Incoming data from the **ASEAN** countries suggest that economic activity continued to expand at a solid pace in the fourth quarter of last year. In Singapore, the advance estimate of fourth-quarter real GDP (unofficial) indicates that the economy expanded nearly 10 percent, fueled by a robust performance in the biomedical sector and healthy global demand for electronic products. A strong electronics PMI reading for the fourth quarter suggests expansion in activity going forward. Elsewhere in the region, industrial production for recent months was up on balance in Indonesia, Malaysia, and the Philippines. In Thailand, industrial production was down, mostly because of temporary closures of chemical and petroleum production plants for maintenance.

Even though consumer price inflation eased a bit, it remained elevated in several parts of the region, mostly reflecting higher imported energy prices and a reduction in fuel subsidies (particularly in Indonesia). Citing the moderation in inflation and the recent strong appreciation of the rupiah, Bank Indonesia left its policy rate unchanged at its latest meeting, having raising it 400 basis points, to 12.75 percent, in five consecutive moves between August and December. In contrast, the Thai central bank raised its key interest rate 25 basis points at each of its December and January meetings. The policy rate stands at 4.25 percent, up 300 basis points since the tightening began in August 2004, but the central bank suggested that the tightening episode is reaching its end.

ASEAN Economic Indicators: Growth

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

Indicator	2003	2004	2005				
			Q2	Q3	Sept.	Oct.	Nov.
Real GDP[1]							
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	…	…	…
Industrial production[2]							
Indonesia[3]	5.5	3.3	-3.1	-1.5	-.3	10.2	n.a.
Malaysia	9.3	11.3	-.2	1.1	1.3	-1.2	4.1
Philippines	.0	1.0	1.7	-.4	-4.0	7.6	-.1
Singapore	3.0	13.9	7.9	7.9	10.7	.2	1.5
Thailand	13.9	11.0	3.2	2.6	.3	-1.4	-.1

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	2004	2005	2005				
			Q3	Q4	Oct.	Nov.	Dec.
Indonesia	25.1	n.a.	25.2	n.a.	30.4	36.6	n.a.
Malaysia	21.2	n.a.	25.7	n.a.	32.7	23.1	n.a.
Philippines	-4.4	n.a.	-4.8	n.a.	-6.6	-2.1	n.a.
Singapore	16.1	21.1	16.6	33.0	24.1	32.7	42.1
Thailand	1.5	n.a.	.3	n.a.	-7.9	-1.9	n.a.

n.a. Not available.

ASEAN Economic Indicators: CPI Inflation

(Percent change from year earlier, except as noted)

Indicator	2004[1]	2005[1]	2005				
			Q3	Q4	Oct.	Nov.	Dec.
Indonesia	6.6	17.0	8.4	17.8	17.4	18.9	17.0
Malaysia	2.1	3.5	3.4	3.4	3.3	3.5	3.5
Philippines	8.6	6.6	7.1	6.9	7.0	7.1	6.6
Singapore	1.3	1.3	.5	1.1	1.1	1.0	1.3
Thailand	2.9	5.8	5.6	6.0	6.2	5.9	5.8

1. Dec./Dec.

Data for **India** indicate that economic activity continued to be robust. Average industrial production over October and November was up 3½ percent from the third quarter, boosted by strong growth in consumer goods output. The fourth-quarter merchandise trade deficit narrowed, as exports remained healthy and imports moderated a touch. Both consumer price inflation and wholesale price inflation moved up from the third quarter. At its January meeting, the central bank raised its policy rate 25 basis points to 5.5 percent, citing inflationary pressures posed by expected strong growth and higher oil prices.

Indian Economic Indicators

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

Indicator	2004	2005	2005				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP[1]	6.4	n.a.	7.6	n.a.	…	…	…
Industrial production	8.5	n.a.	.0	n.a.	3.3	-4.1	n.a.
Consumer prices[2]	3.8	n.a.	3.7	n.a.	4.2	5.3	n.a.
Wholesale prices[2]	6.7	4.4	4.0	4.5	4.7	4.3	4.4
Trade balance[3]	-21.7	-39.5	-45.3	-35.5	-33.7	-40.7	-32.1
Current account[4]	1.4	n.a.	-30.6	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**, performance in the industrial sector was a bit disappointing in the fourth quarter, given strong growth in U.S. manufacturing activity. Industrial production rose just 0.3 percent in November, bringing average production for October and November up 1.6 percent from the third quarter, an increase that was smaller than had been anticipated. On the other hand, vehicle production surged in December, a good sign, given that this sector had been particularly weak earlier in 2005.

Consumer price inflation remained well within the Bank of Mexico’s 2-to-4 percent target range. Twelve-month consumer price inflation was 2.9 percent in November, the lowest on record, and edged up to 3.3 percent in December on the back of a jump in some food prices. Twelve-month core inflation (not shown) stayed at 3.1 percent in November and December. The softness in manufacturing and the benign inflation prospects led the Bank of Mexico (BOM) to continue easing policy in December; the BOM has eased policy five times since August. 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 August to 7.7 percent in late January.

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

Indicator	2004	2005	2005 Q3	2005 Q4	2005 Oct.	2005 Nov.	2005 Dec.
Real GDP[1]	4.9	n.a.	8.9	n.a.	…	…	…
Overall economic activity	4.1	n.a.	1.9	n.a.	.0	n.a.	n.a.
Industrial production	3.5	n.a.	.5	n.a.	.5	.3	n.a.
Unemployment rate[2]	3.9	3.6	3.5	3.3	3.4	3.2	3.3
Consumer prices[3]	5.2	3.3	4.0	3.1	3.0	2.9	3.3
Trade balance[4]	-8.8	-7.6	-7.1	-6.0	-7.1	-7.1	-1.9
Imports[4]	196.8	221.3	223.1	237.4	230.2	240.3	241.7
Exports[4]	188.0	213.7	216.0	231.4	221.1	233.2	239.7
Current account[5]	-7.2	n.a.	-2.6	n.a.	…	…	…

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

In **Brazil**, data releases since the last Greenbook point to continued weakness in economic activity following a sharp decline in GDP in the third quarter. November industrial production was up about ½ percent, less than expected, and the October-November average was down 0.7 percent from its third-quarter level. Retail sales in November were soft. Monthly headline inflation in December declined to 0.4 percent, as the effects of the September hike in domestic prices of vehicle fuels waned, bringing twelve-month inflation down to 5.7 percent. However, increases in prices of food and prices of some types of energy (fuel ethanol and electricity) have put upward pressures on inflation in recent weeks, raising concerns.

The Brazilian central bank has continued the monetary easing begun last September, reducing the target for the policy rate, the Selic rate, 50 and 75 basis points at the December and January meetings. The Selic rate now stands at 17.25 percent, down from 19.75 percent last September. In December, the Brazilian government prepaid $15.5 billion in loans from the IMF, a move aimed at improving prospects for a credit rating upgrade. However, the government succumbed to pressures to raise the minimum wage nearly 17 percent, which will increase the deficits of the pension systems.

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

Indicator	2004	2005	2005				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP[1]	4.8	n.a.	-4.7	n.a.	…	…	…
Industrial production	8.3	n.a.	-.7	n.a.	.2	.6	n.a.
Unemployment rate[2]	11.5	n.a.	9.3	n.a.	9.7	9.9	n.a.
Consumer prices[3]	7.6	5.7	6.2	6.1	6.4	6.2	5.7
Trade balance[4]	33.7	44.8	44.8	50.3	40.9	59.3	50.8
Current account[5]	11.7	14.2	23.1	12.7	10.9	20.8	6.8

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**, data releases point to continued recovery. The monthly index of economic activity, which has closely tracked real GDP growth in recent years, suggests that output in the fourth quarter likely continued to expand at close to the third quarter's robust 10 percent pace. Industrial production over October-November averaged 2.2 percent above its third-quarter level. Consumer price inflation remained high, ending 2005 at over 12 percent on a twelve-month basis, well above the central bank's informal target range of 5 to 8 percent. (The central bank's 2006 inflation projection is 8 to 11 percent.)

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In early January, the government prepaid $10 billion in IMF debt out of international reserves. The payment lowered the government's gross debt-to-GDP ratio from roughly 72 to 66 percent, excluding the $20 billion in defaulted debt held by creditors who did not accept the government's debt exchange last year. Although the prepayment followed a similar move by Brazil, the Argentine government's decision comes against a background of a contentious relationship with the IMF and raised concerns that the Kirchner government will pursue more unorthodox economic policies.

Argentine Economic Indicators

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

Indicator	2004	2005	2005				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP[1]	9.1	n.a.	9.6	n.a.	…	…	…
Industrial production	10.7	n.a.	2.1	n.a.	.6	.4	n.a.
Unemployment rate[2]	13.6	n.a.	11.1	n.a.	…	…	…
Consumer prices[3]	6.1	12.3	9.8	11.7	10.7	12.0	12.3
Trade balance[4]	12.1	n.a.	13.6	n.a.	15.0	9.3	n.a.
Current account[5]	3.3	n.a.	8.4	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**, reliable data on activity are scarce, but anecdotal evidence suggests that economic activity was strong in the fourth quarter, supported by the high price of petroleum and by expansionary fiscal and monetary policies. Inflation ended the year at over 14 percent on a twelve-month basis, down from a year earlier, but still very high. President Chavez, who faces re-election next December, proposed in January to raise the wages of public sector workers 80 percent, heightening concerns about the poor policy environment.

Venezuelan Economic Indicators

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

Indicator	2004	2005	2005				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP[1]	12.1	n.a.	-10.4	n.a.	…	…	…
Unemployment rate[2]	15.1	12.2	11.9	11.8	11.7	12.6	10.9
Consumer prices[3]	19.2	14.4	15.4	15.2	16.1	15.3	14.3
Non-oil trade balance[4]	-10.5	n.a.	-19.4	n.a.	n.a.	n.a.	n.a.
Trade balance[4]	21.4	n.a.	28.1	n.a.	n.a.	n.a.	n.a.
Current account[5]	13.8	n.a.	30.4	n.a.	…	…	…

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

Turkish real GDP rose 7 percent in the third quarter from a year earlier and indications are that this pace of growth continued in the fourth quarter, while inflation ended the year at 7.7 percent. Turkey has recently experienced an outbreak of the bird flu that has infected 20 people and killed four. Although 900,000 birds have been slaughtered in affected areas since late December, when the virus was detected in a remote region near the border with Iran, human-to-human transmission has not been identified and the economic effects so far appear to be minimal. A concern is the potential effect on tourism, but it is still too early to tell. In mid-January, donor countries pledged to provide $2 billion to help currently infected countries and countries at risk contain the virus.