Prefatory Note

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Please note that this document may contain occasional gaps in the text. These gaps are the result of a redaction process that removed information obtained on a confidential basis. All redacted passages are exempt from disclosure under applicable provisions of the Freedom of Information Act.

[1] In some cases, original copies needed to be photocopied before being scanned into electronic format. All scanned images were deskewed (to remove the effects of printer- and scanner-introduced tilting) and lightly cleaned (to remove dark spots caused by staple holes, hole punches, and other blemishes caused after initial printing).

[2] A two-step process was used. An advanced optimal character recognition computer program (OCR) first created electronic text from the document image. Where the OCR results were inconclusive, staff checked and corrected the text as necessary. Please note that the numbers and text in charts and tables were not reliably recognized by the OCR process and were not checked or corrected by staff.

Confidential (FR) Class III FOMC

Part 2

September 27, 2001

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

Confidential (FR) Class III FOMC

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Domestic Nonfinancial Developments

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Overview
Economic activity remained on a very sluggish track up to the eve of the September 11 terrorist attacks. Household expenditures continued to expand moderately, while business investment remained on a steep downward slide. Only a few nonfinancial indicators are available for the period since the attacks. Consequently, our assessment of recent developments focuses much more heavily than usual on anecdotes and the results of various private surveys. As best we can tell, activity seems to have weakened further after the attacks.

Labor Market Developments
The labor market continued to deteriorate in August. Private payroll employment fell 110,000, with job losses in manufacturing more than accounting for the decline. Outside of manufacturing, employment continued to increase, though hiring was sluggish and uneven. Aggregate weekly hours of production or nonsupervisory workers on nonfarm private payrolls fell another 0.4 percent, leaving the level of aggregate hours in August about 3-1/2 percent (at an annual rate) below its second-quarter average.

In the household survey, the unemployment rate in August increased 0.4 percentage point, to 4.9 percent, after having held roughly steady at 4.5 percent since April. Although the jump was surprisingly large for one month, the absence of a rise in unemployment in previous months had seemed at odds with the ongoing payroll declines; the August level of the jobless rate appears quite consistent with other indicators of the labor market.

Recent weekly data on initial claims for unemployment insurance suggest that the contraction of payrolls has continued since August. After having dipped to 392,000 in the week ended September 15, claims jumped to 450,000 in the week ended September 22, and the four-week moving average of weekly claims moved up to 422,000. The insured unemployment rate was 2.6 percent in the week ended September 15; it has changed little in recent weeks but is up almost a full percentage point over the past year.

The employment figures for September should not be greatly affected by the terrorist attacks, even though they occurred in the middle of the survey week. An individual is included in the employment figures as long as he or she is paid for a single hour during the survey period. Individuals most likely were able to work regularly in the days before the attacks, and most businesses that shut down on September 11 appear to have resumed operations soon thereafter; so the effect on the payroll employment numbers should be small. However, layoffs that have since been announced, including more than 100,000 by airlines and related industries, will likely be showing through into the employment estimates for coming months. Temporary shutdowns may well have led to a

CHANGES IN EMPLOYMENT
(Thousands of employees; based on seasonally adjusted data)

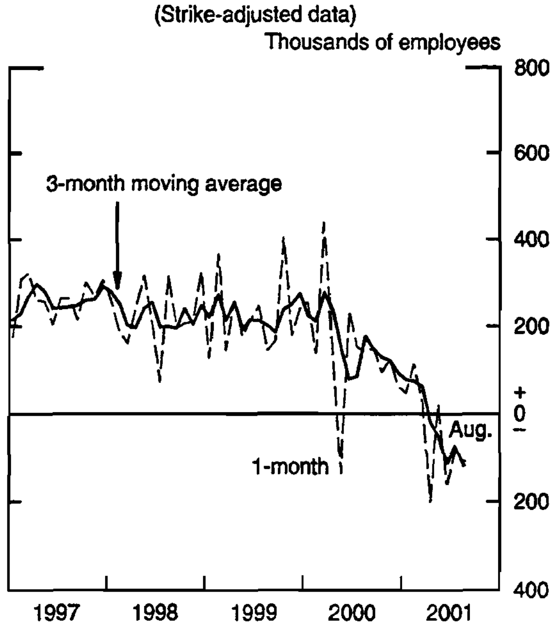
	2000 H1	2000 H2	2001 Q1	2001 Q2	2001 June	2001 July	2001 Aug.
	--Average monthly change--						
Nonfarm payroll employment[1]	267	66	96	-74	-99	13	-113
Previous	*267*	*66*	*96*	*-72*	*-93*	*-42*	
Private	178	121	63	-113	-157	-82	-110
Mining	1	1	3	3	1	1	0
Manufacturing	5	-29	-78	-120	-122	-71	-141
Construction	16	21	46	-22	-17	9	5
Transportation and utilities	13	16	6	-3	-12	-5	-24
Retail trade	31	21	17	35	15	35	-26
Wholesale trade	9	8	-1	-15	-16	-3	-2
Finance, insurance, real estate	-7	7	12	4	-13	-14	6
Services	110	76	57	4	7	-34	72
Help supply services	15	-19	-37	-44	-37	-31	-2
Total government	90	-54	32	39	58	95	-3
Total employment (household survey)	114	109	-19	-283	-171	447	-986
Nonagricultural	116	115	19	-227	27	397	-1058
Memo:							
Aggregate hours of private production workers (percent change)[1,2]	2.1	0.2	1.0	-1.5	-0.2	-0.3	-0.4
Average workweek (hours)[1]	34.5	34.3	34.3	34.2	34.2	34.1	34.1
Manufacturing (hours)	41.8	41.3	41.0	40.8	40.7	40.9	40.7

Note. Average change from final month of preceding period to final month of period indicated.

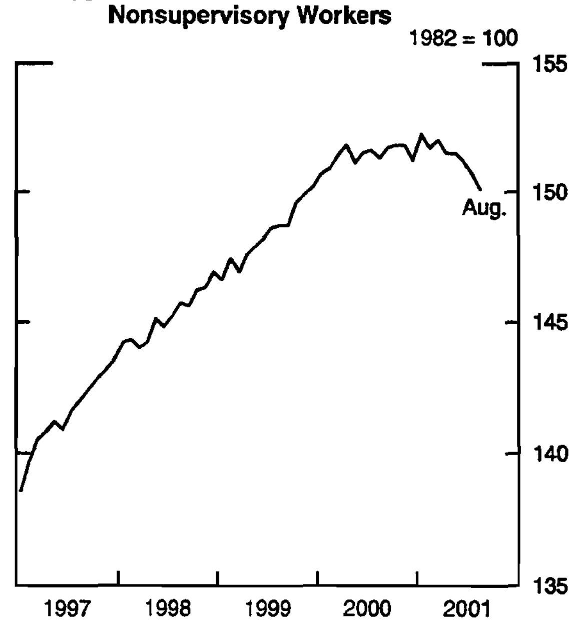
1. Survey of establishments.

2. 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.

Private Payroll Employment Growth
(Strike-adjusted data)



Aggregate Hours of Production or Nonsupervisory Workers

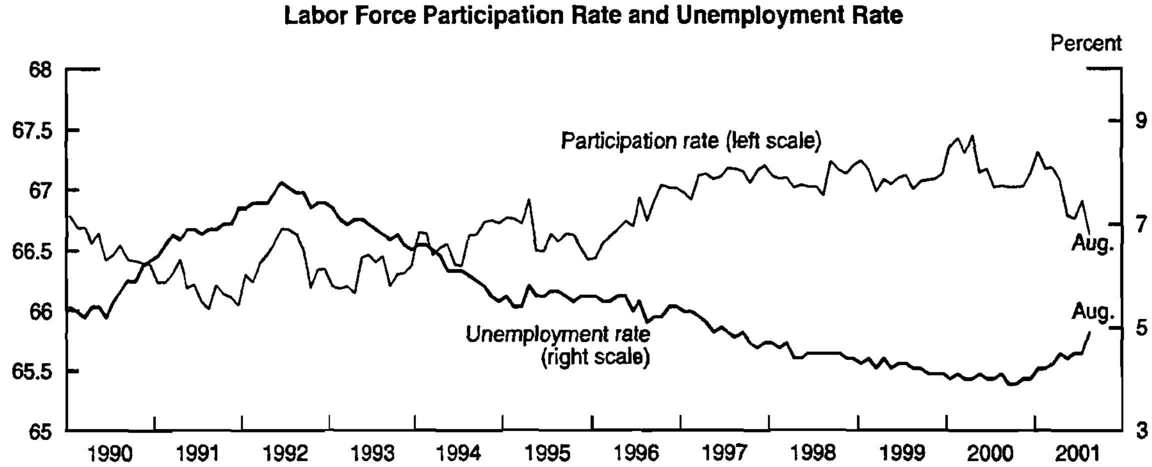


SELECTED UNEMPLOYMENT AND LABOR FORCE PARTICIPATION RATES
(Percent; based on seasonally adjusted data, as published)

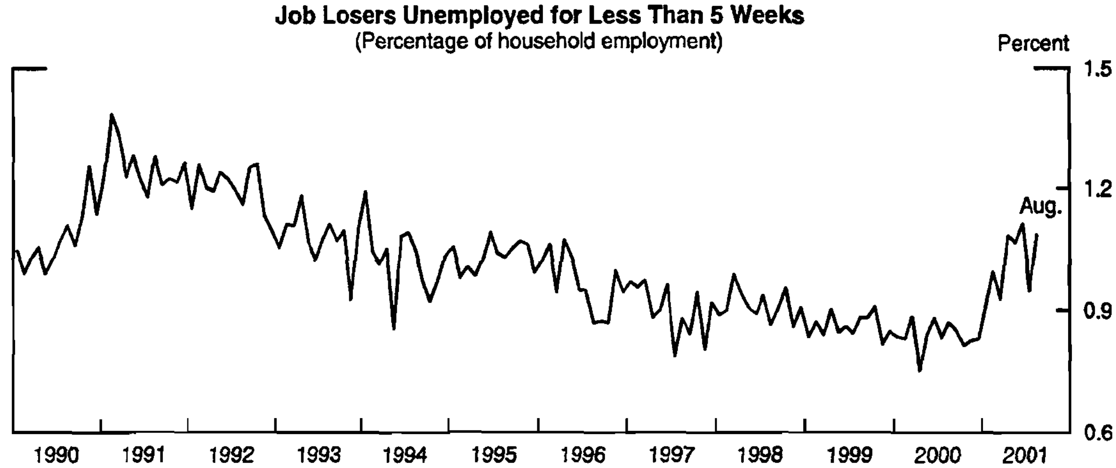
	1999	2000	2001 Q1	2001 Q2	2001 June	2001 July	2001 Aug.
Civilian unemployment rate (16 years and older)	4.2	4.0	4.2	4.5	4.5	4.5	4.9
Teenagers	13.9	13.1	13.7	14.0	14.3	14.8	16.1
20-24 years old	7.5	7.1	7.4	8.1	8.2	7.5	9.0
Men, 25 years and older	3.0	2.8	3.1	3.4	3.4	3.5	3.7
Women, 25 years and older	3.3	3.2	3.3	3.4	3.5	3.4	3.7
Labor force participation rate	67.1	67.2	67.2	66.9	66.8	66.9	66.6
Teenagers	52.0	52.2	51.3	49.7	50.5	50.0	47.4
20-24 years old	77.6	77.9	78.2	76.6	76.2	76.7	76.8
Men, 25 years and older	76.1	76.0	75.9	75.9	75.8	75.8	75.8
Women, 25 years and older	59.5	59.7	59.9	59.6	59.5	59.7	59.6
Memo: Potential worker rate[1]	7.2	6.9	7.1	7.4	7.5	7.5	8.0

1. The potential worker rate equals the number of civilian unemployed plus those who are not in the labor force and want a job as a percentage of the civilian labor force plus those who are not in the labor force and want a job.

Labor Force Participation Rate and Unemployment Rate

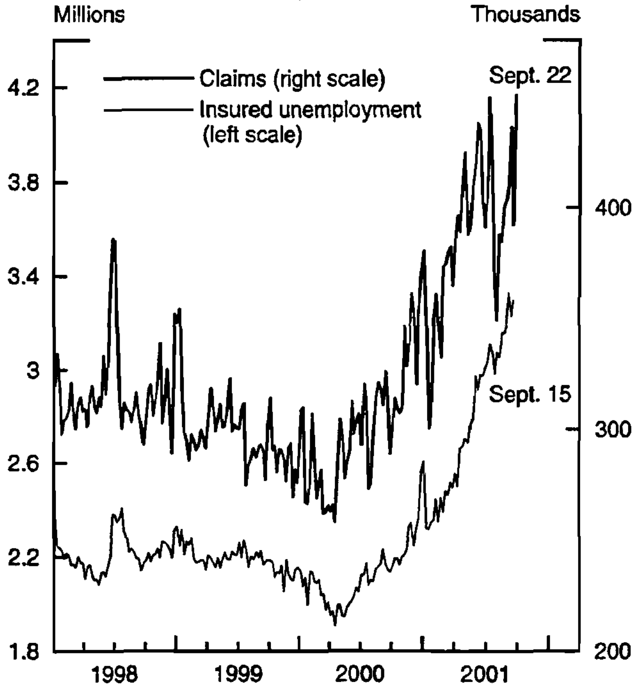


Job Losers Unemployed for Less Than 5 Weeks
(Percentage of household employment)

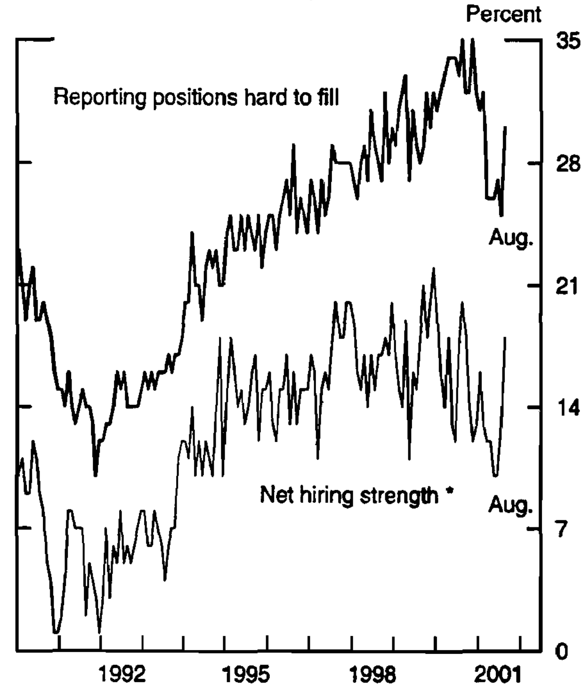


Labor Market Indicators

Initial Claims for Unemployment Insurance

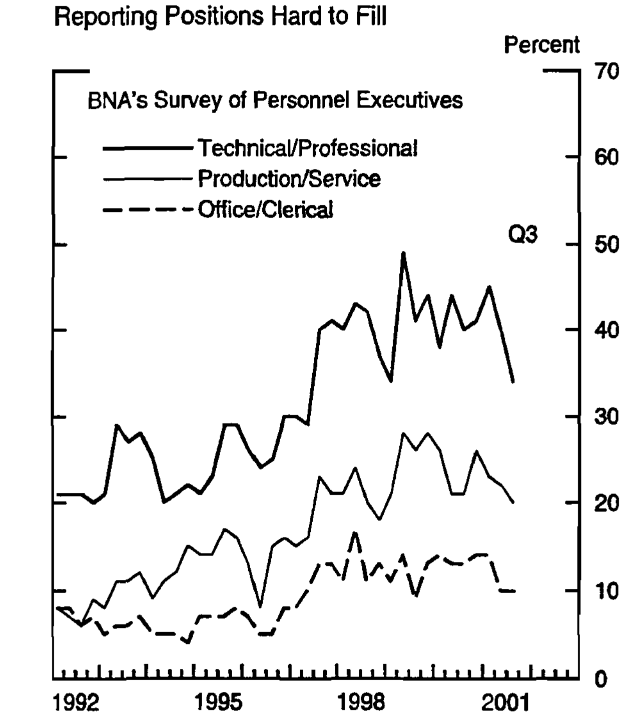


National Federation of Independent Business

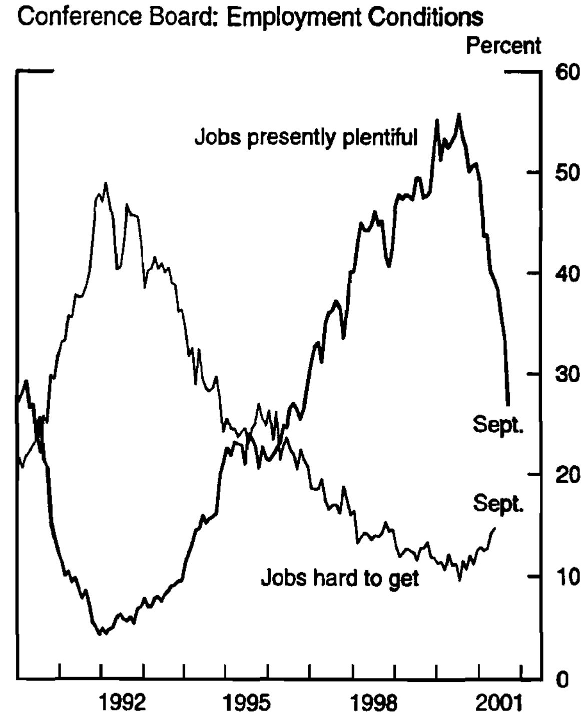


* Percentage planning an increase in employment minus percentage planning a reduction.

Reporting Positions Hard to Fill



Conference Board: Employment Conditions



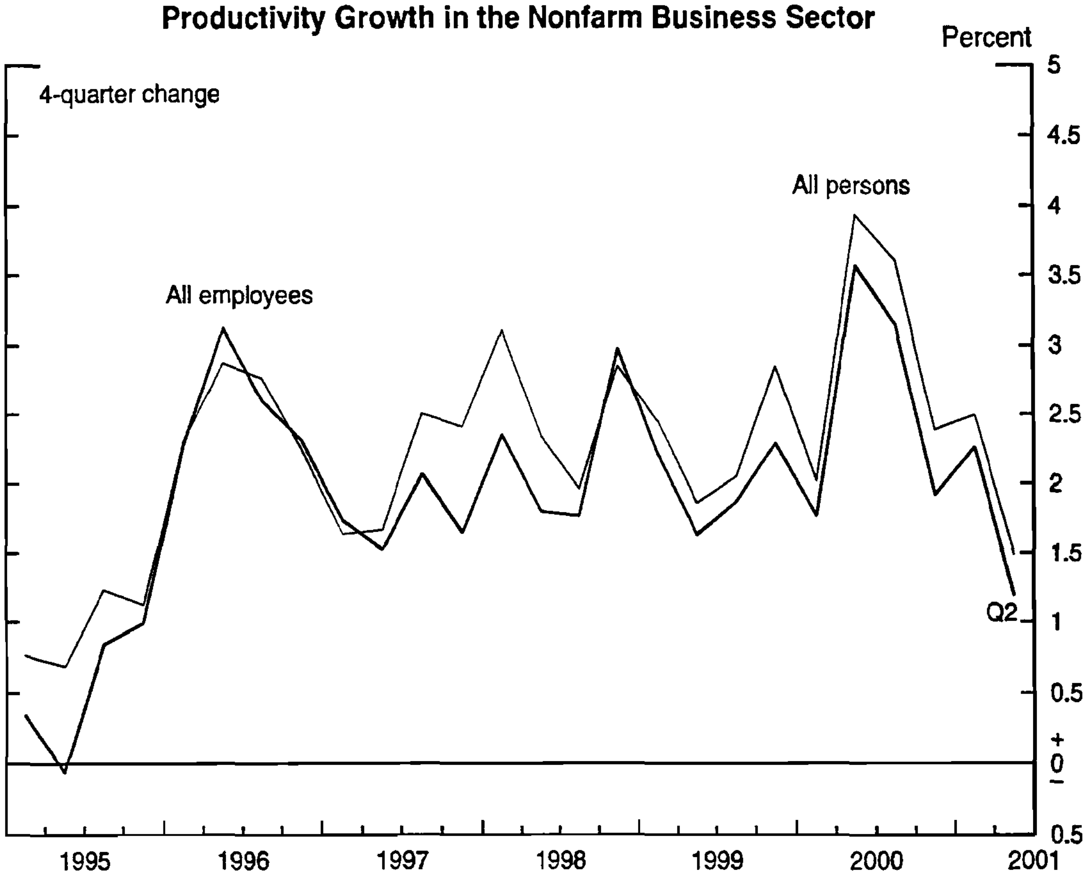
Labor Output per Hour

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

Sector	1999[1]	2000[1]	2000		2001	
			Q3	Q4	Q1	Q2
Nonfarm business (all persons)[2]	2.8	2.3	1.4	2.3	.1	2.1
Nonfarm business (all employees)[3]	2.3	1.9	1.0	1.6	.9	1.3
Nonfinancial corporations[4]	2.9	4.2	4.0	1.6	.6	2.8

1. Changes are from fourth quarter of preceding year to fourth quarter of year shown.
2. Growth in output per hour of all persons in the nonfarm business sector (published definition).
3. Growth in output per hour assuming that the growth rate of hours of all persons equals the growth rate of hours of all employees.
4. The nonfinancial corporate sector includes all corporations doing business in the United States with the exception of banks, stock and commodity brokers, and finance and insurance companies; the sector accounts for about two-thirds of business employment.

Productivity Growth in the Nonfarm Business Sector



Note. Staff estimate for 2001:Q2.

SELECTED COMPONENTS OF INDUSTRIAL PRODUCTION
(Percent change from preceding comparable period)

	Proportion 2000	2000 Q4	2001 Q1	2001 Q2	2001 June	2001 July	2001 Aug.
		----Annual rate-----			--Monthly rate---		
Total	100.0	-.9	-6.8	-4.4	-1.0	-.1	-.8
Previous		-.9	-6.8	-4.2	-.9	-.1	
Manufacturing	87.8	-1.6	-7.9	-5.1	-1.2	.0	-1.0
Ex. motor veh. and parts	82.1	.1	-6.6	-7.3	-1.2	-.3	-.8
Ex. high-tech industries	72.7	-2.8	-6.7	-5.7	-1.1	-.1	-.8
Mining	6.3	-1.5	6.0	7.5	-.4	-1.1	-.4
Utilities	5.9	9.3	-3.4	-8.2	.1	-.7	1.6
Selected industries							
High technology	9.4	25.2	-6.1	-20.4	-2.1	-2.2	-1.4
Computers	2.7	24.8	-3.5	-12.8	-1.7	-.8	-.5
Communication equipment	2.0	30.2	-1.7	-17.0	-1.9	-3.5	-1.5
Semiconductors[1]	4.7	23.3	-9.6	-26.1	-2.5	-2.4	-1.8
Motor vehicles and parts	5.7	-23.6	-27.2	37.4	-1.4	4.9	-2.7
Aircraft and parts	2.2	5.1	-5.6	-3.1	-.5	-.1	.0
Market groups, excluding energy and selected industries							
Consumer goods	22.5	-1.7	-.1	-1.9	-.6	-.2	-.6
Durables	3.5	-5.0	-5.0	-1.9	-.2	-1.3	.0
Nondurables	19.0	-1.0	.8	-1.9	-.7	.0	-.7
Business equipment	8.4	4.0	-7.6	-12.7	-2.8	-.2	-1.7
Construction supplies	6.1	-4.7	-3.1	-2.8	-.1	-.3	-.5
Business supplies	7.1	.1	-12.1	-11.0	-1.0	-.5	-.7
Materials	24.2	-7.3	-11.4	-6.4	-1.3	.1	-.7
Durables	15.9	-7.1	-9.4	-3.5	-1.0	.1	-.8
Nondurables	8.3	-7.7	-15.1	-11.8	-1.9	.2	-.5

1. Includes related electronic components.

CAPACITY UTILIZATION
(Percent of capacity)

	1967-2000 Avg.	1988-89 High	1990-91 Low	2000 Q4	2001 Q1	2001 Q2	2001 July	2001 Aug.
Manufacturing	81.1	85.7	76.6	80.3	77.9	76.4	75.5	74.6
High-tech industries	80.4	81.9	72.4	85.1	77.3	69.4	64.9	63.4
Excluding high-tech	81.2	86.1	76.8	79.5	77.6	76.9	76.5	75.7

further reduction in the average workweek and an exaggeration of the drop in aggregate hours worked compared with what otherwise would have occurred.[1] We believe that the decline in hours occurred primarily in Manhattan and in the airline and hospitality industries.

Industrial Production

Industrial production fell in August for the eleventh consecutive month. Assemblies of motor vehicles dropped back about one-half million units, reversing a similar-sized gain in July. Production of high-tech goods declined 1.4 percent in August—somewhat less than earlier in the summer and late spring. Outside the motor vehicles and high-tech industries, manufacturing output was down 0.8 percent, reflecting declines in the production of business equipment, consumer goods, and materials. The overall factory operating rate fell to 74.6 percent in August, the lowest rate since the middle of 1983.

New Orders for Durable Goods
(Percent change from preceding period; seasonally adjusted)

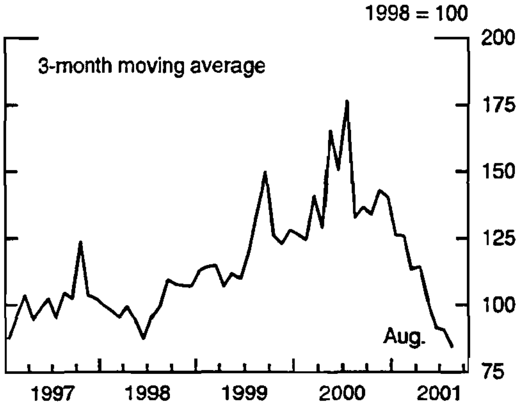
Component	Share, 2001:H1	2001				
		Q1	Q2	June	July	Aug.
Total orders	**100.0**	**-7.0**	**-2.3**	**-2.5**	**-1.1**	**-.3**
Adjusted orders[1]	73.0	-5.6	-4.2	-2.0	-2.1	.1
Computers	5.0	-8.9	-14.0	-4.9	-7.2	-8.4
Communications equipment	4.0	-10.1	-26.3	-14.9	14.7	8.7
Semiconductors and related devices	4.0	-19.2	-19.4	-5.2	-24.3	14.4
Other capital goods	20.0	3.0	.4	-.5	-.4	-1.0
Other[2]	40.0	-6.9	-1.4	-1.2	-1.6	0.0
Memo:						
Real adjusted orders	...	-4.1	-3.4	-2.0	-1.8	.8
Excluding high tech	...	-13.5	-8.2	-1.9	.1	.2

1. Orders excluding defense capital goods, nondefense aircraft, and motor vehicle parts.
2. Includes primary metals, most fabricated metals, most stone, clay, and glass products, household appliances, scientific instruments, and miscellaneous durable goods.
... Not applicable.

1. To the extent that workers are paid even if they are not at work, the series on production-worker hours, which measures hours paid, may overstate labor input in September. Contacts at several of the temporary help supply firms said that they planned to pay their employees for missed work on September 11 and 12; for the most part, workers in lower Manhattan and at the Pentagon will reportedly be paid for the entire week.

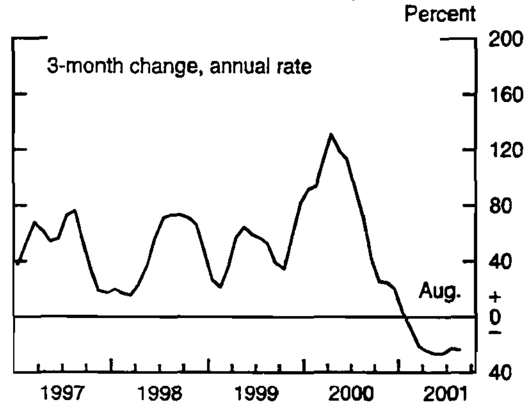
Measures of Activity in High-Tech Industry

M3 New Orders of Semiconductors

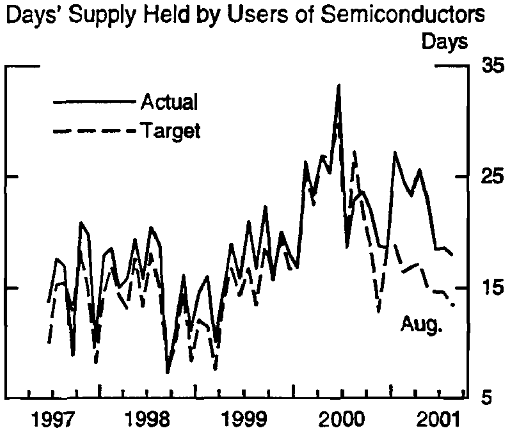


Note. Includes related components.

Semiconductor and Related Components IP

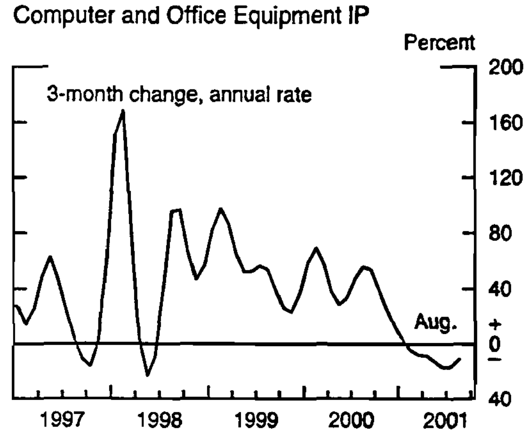


Days' Supply Held by Users of Semiconductors

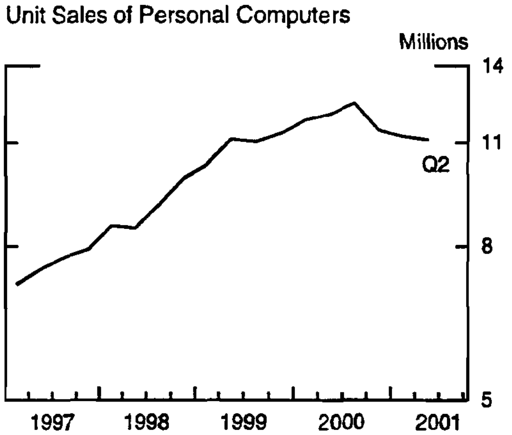


Source. Dataquest survey of large semiconductor buyers.

Computer and Office Equipment IP

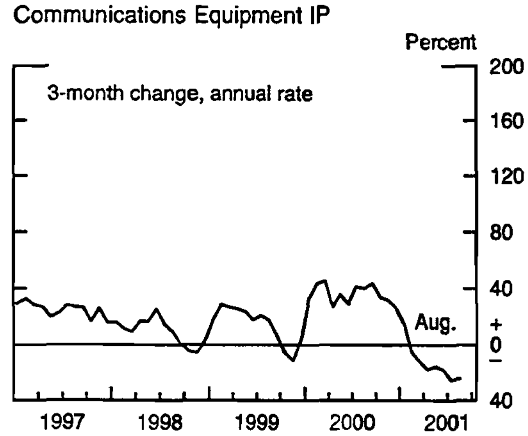


Unit Sales of Personal Computers



Note. Includes sales to government, consumers, and businesses.

Communications Equipment IP



Before the terrorist attacks, the industrial sector appeared to be headed toward further contraction, but perhaps at a less rapid rate than over the previous few months. Real adjusted durable goods orders rose 0.8 percent in August after having fallen 1.8 percent in July. The National Association of Purchasing Management's new orders diffusion index jumped above 50 in August, the first time this year that respondents reporting an increase in orders outnumbered those reporting decreases. The Philadelphia Federal Reserve Bank's Business Outlook Survey showed general activity continuing to decline in September, though at a slower rate than in August.

The high-tech sector remained weak on the eve of the attacks. Semiconductor orders had continued to fall, and inventories held by large buyers of chips remained well above target levels through August. Producers of computer networking equipment, fiber optic gear, and cell phones continued to face declining demand and excess stocks.

Motor vehicle production was significantly affected by the terrorist attacks. On September 11, Ford and Chrysler suspended their second and third shifts at all their plants; GM and Toyota stopped their lines at some plants. During the rest of the week, distribution glitches developed, especially at border crossings. Ford experienced by far the worst problems from parts shortages, reporting that output for the rest of the week was 50 percent below the scheduled rate. However, other companies saw only isolated stoppages, and there were no reports of disruptions the following week. All told, we estimate that September motor vehicle assemblies were reduced by 670,000 units (annual rate) as a direct result of the attacks. Weekly data suggest production will fall to 10.8 million units at an annual rate for the month. The decline in output of motor vehicles and parts due to the attacks will shave about 1/4 percent off September industrial production.

In other industries, disruptions of production were much less pronounced. Disturbances to supply chains temporarily lengthened delivery times for some products, and there were a few reports of temporary shutdowns at plants producing printers, musical instruments, and wood products. In the semiconductor industry, wafers produced in the United States, as well as finished chips assembled in foreign countries, were not shipped for five days after the attacks. However, downstream domestic producers had ample inventories, and production was little affected. A major computer maker, for example, reported that it could not receive components for several days, but, because demand subsided at the same time, most orders were filled. In many other industries, including industrial equipment, construction supplies, construction machinery, paper, glass, chemicals, industrial equipment and fiberglass, reports that we received indicated no disruption.

Production of Domestic Autos and Trucks
(Millions of units at an annual rate except as noted; FRB seasonal basis)

Item	2001			2001				
	Q1	Q2	Q3[1]	June	July	Aug.	Sept.[1]	Oct.[2]
U.S. production	10.9	11.7	11.5	11.7	12.1	11.6	10.8	11.0
Autos	5.0	5.1	4.6	5.1	4.9	4.6	4.4	4.7
Trucks	6.0	6.6	6.9	6.6	7.2	7.0	6.4	6.4
Days' supply[3]	62.4	62.0	n.a.	60.0	63.9	64.4	n.a.	n.a.
Autos	50.9	49.3	n.a.	49.0	49.7	52.6	n.a.	n.a.
Light trucks[4]	72.8	73.0	n.a.	69.2	75.8	73.9	n.a.	n.a.
Inventories[5]	2.84	2.75	n.a.	2.75	2.78	2.77	n.a.	n.a.

Note. Components may not sum to totals because of rounding.
1. Staff estimates.
2. Production rates reflect manufacturers' schedules.
3. Quarterly average calculated using end-of-period stocks and average reported sales.
4. Excludes medium and heavy (classes 3-8) trucks.
5. End-of-period stocks; excludes medium and heavy (class 3-8) trucks.
n.a. Not available.

The attacks severely damaged prospects for commercial aircraft production. Before these events, Boeing expected aircraft deliveries to be down about 5 percent next year from the projected level for 2001. Since September 11, several customers have asked not to take aircraft slated for delivery later this year, and new orders are expected to decline. As a result, Boeing has announced that it plans to eliminate 30,000 jobs (a third of its commercial aircraft assembly workforce) in anticipation of a drop in deliveries in 2002 of another 20 percent. Production of commercial aircraft, which had already eased slightly this year, will likely fall further in coming months and plunge more noticeably next year.[5]

Consumer Spending

Consumer spending seemed to be gaining a bit more vigor over the summer, likely buoyed to some extent by recent tax rebates.[6] In real terms, sales of goods excluding motor vehicles rose briskly in both July and August. Although sales of new light vehicles fell in both months, total real outlays for goods in the two months were an estimated 3-1/2 percent at an annual rate above their second-quarter average.

5. Even with near-term adjustments to production, Boeing may need to inventory some completed planes.

6. Real disposable personal income jumped 1.8 percent in July—boosted 1.3 percentage points by a combination of tax rebates and a reduction in tax rates. Tax rebates should further boost disposable personal income in August and September.

RETAIL SALES
(Percent change; seasonally adjusted)

	2001		2001		
	Q1	Q2	June	July	Aug.
Total retail trade and food services	1.3	1.3	.0	.2	.3
Previous estimate		1.3	.0	.0	
Retail control[1]	1.0	.6	-.2	.1	.4
Memo:					
Real PCE control[2]	.8	.5	-.1	.5	.6

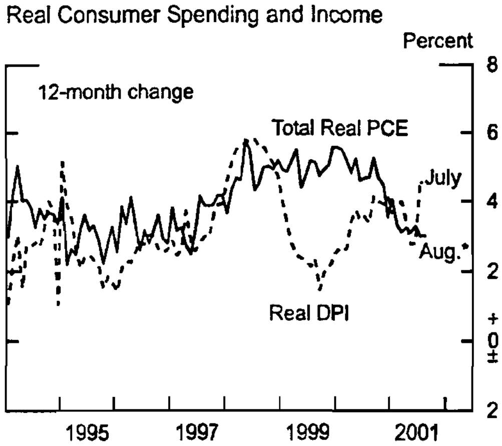
1. Total retail trade and food services less sales at building material and supply stores and automobile and other motor vehicle dealers.
2. PCE data from June through August are staff estimates.

REAL PERSONAL CONSUMPTION EXPENDITURES FOR SERVICES
(Percent change from the preceding period unless otherwise noted)

	2000	2001		2001	
		Q1	Q2	June	July
	Q4/Q4	Annual rate		Monthly rate	
Services	4.3	1.8	2.6	.1	.2
Electricity and natural gas	12.2	-11.2	-14.1	1.5	.5
Transportation	2.6	1.0	-.4	.3	.1
Personal business	6.7	.9	4.9	-.1	-.0
Brokerage services	20.4	-9.6	9.9	-3.1	-2.5
Recreation	2.6	6.5	1.0	-1.2	.4
Other	3.7	2.6	3.6	.2	.2
Memo:					
Real disposable personal income	4.0	2.7	2.4	.1	1.8
NIPA personal saving rate[1]	1.0	1.1	1.1	1.0	2.5

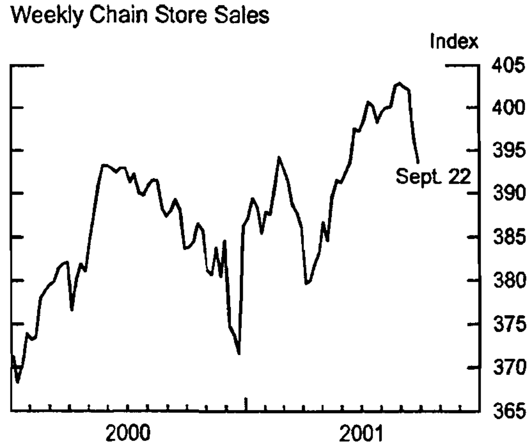
1. Data are in levels. Annual and quarterly values are averages over the period indicated.

Real Consumer Spending and Income



*PCE data from June through August are staff estimates.

Weekly Chain Store Sales



Source: Bank of Tokyo-Mitsubishi

SALES OF AUTOMOBILES AND LIGHT TRUCKS
(Millions of units at an annual rate, FRB seasonals)

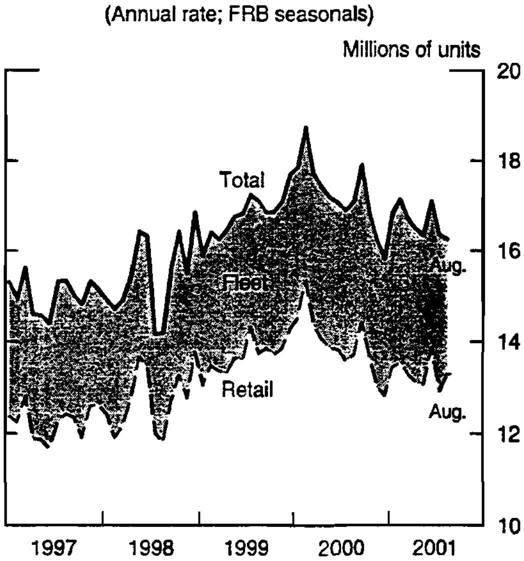
	1999	2000	2001 Q1	2001 Q2	2001 June	2001 July	2001 Aug.
Total[1]	16.8	17.2	16.9	16.6	17.1	16.4	16.3
Autos	8.7	8.8	8.6	8.4	8.4	8.1	8.0
Light trucks	8.1	8.4	8.3	8.2	8.7	8.2	8.3
North American[2]	14.3	14.4	14.0	13.6	14.1	13.4	13.2
Autos	7.0	6.8	6.6	6.3	6.4	6.1	5.9
Big Three	4.9	4.7	4.5	4.1	4.2	3.8	3.7
Transplants	2.1	2.2	2.1	2.2	2.2	2.3	2.2
Light trucks	7.3	7.5	7.4	7.3	7.7	7.3	7.4
Big Three	6.6	6.6	6.3	6.2	6.6	6.2	6.3
Transplants	.8	1.0	1.0	1.0	1.1	1.1	1.1
Foreign-produced	2.5	2.9	2.9	3.0	3.0	3.0	3.0
Autos	1.7	2.0	2.0	2.1	2.1	2.0	2.1
Light trucks	.8	.8	.9	1.0	1.0	1.0	.9
Memo:							
Total, as reported	16.8	17.2	16.9	16.6	17.1	16.4	16.3

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 the estimated effect of automakers' changes in reporting periods.

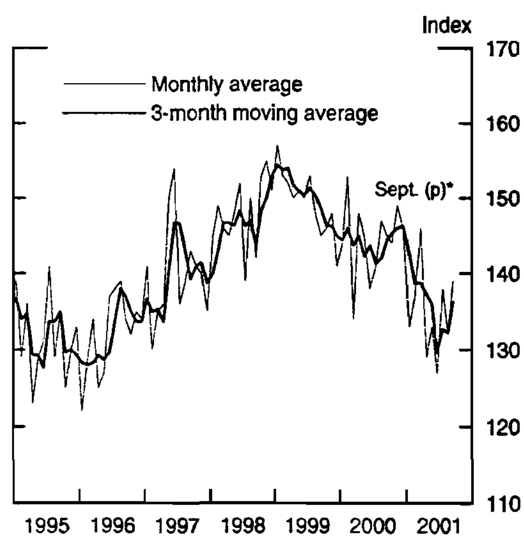
2. Excludes some vehicles produced in Canada that are classified as imports by the industry.

Fleet and Retail Sales of Light Vehicles
(Annual rate; FRB seasonals)



Note. Staff estimates based on confidential data.

Michigan Survey Index of Car-Buying Attitudes



*Preliminary estimate using responses through Sept. 10

The scattered indicators for September suggest that spending has probably declined this month. Before September 11, our contacts in the auto industry expected light vehicle sales to remain at about a 16 million unit annual pace in the short term. However, auto industry contacts report confidentially that showroom traffic dried up immediately after the terrorist attacks. One firm reported that sales in that period were down 28 percent from the same period a year ago; before September 11 they had been running a bit ahead of last year's pace. More recently, our industry contacts and a survey of auto dealerships by J.D. Power suggest that sales have improved somewhat, though they are still below the pace seen earlier in the month.

Weekly data on chain store sales from the Bank of Tokyo-Mitsubishi (BTM) indicate that sales at the stores in its panel were generally "at or above plan" through September 8. Sales and traffic in stores were down precipitously on September 11, but began to recover the following day. For the week as a whole, sales were down 1.4 percent. The following week, extending through September 22, the BTM measure of chain store sales fell another 0.8 percent.

The terrorist attacks also adversely affected services expenditures in September. With air traffic halted for almost four days and subsequent reports of a large fall in demand, personal consumption expenditures (PCE) for air travel (0.4 percent of total PCE) will likely be down substantially this month.[7] Spending at hotels and motels (0.4 percent of total PCE) has likely declined appreciably. Many spectator sports (0.2 percent of total PCE) were canceled or postponed.[8] Surprisingly, perhaps, real PCE for brokerage services (0.5 percent of total PCE) probably will not fall much, if at all. Although stock trading was halted for four days, volume soared after the resumption of activity on September 17, leaving trading volumes for the month as a whole close to normal.

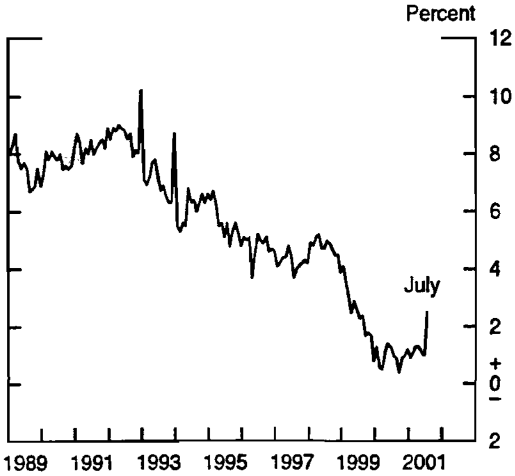
Consumer sentiment was weakening before the terrorist attacks. Preliminary September data from the Michigan Survey Research Center (SRC), which included responses through September 10, showed the overall index down almost 8 percentage points from August, reflecting in part greater concern among consumers about their current personal finances and future business

7. Airlines have announced that they plan to reduce capacity to about 80 percent of its pre-attack level. However, this is unlikely to be a significant constraint on demand in the near term given the downshift in air travel.

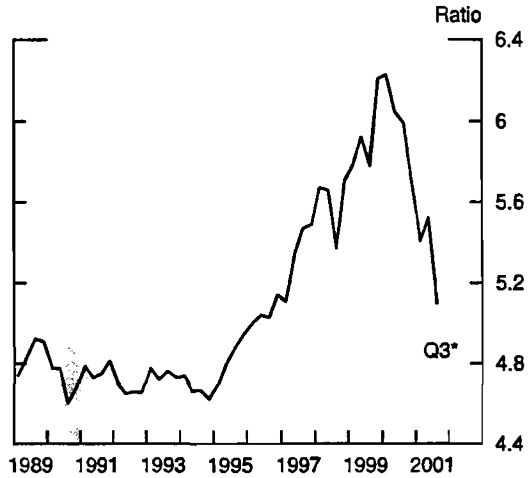
8. Other relatively small components of services that are likely to be affected by the terrorist attacks include real PCE for rail and bus travel, movies, and theaters. Real expenditures for motor vehicle insurance and life insurance are unlikely to be affected, at least initially. The BEA has announced that any surge in motor vehicle claims will involve offsetting increases in nominal outlays and the corresponding price index. Initial estimates of life insurance are extrapolated from one month to the next using changes in wages and salaries of insurance industry employees. Subsequent estimates will likely be revised down reflecting lower profits arising from life insurance claims.

Household Indicators

Personal Saving Rate

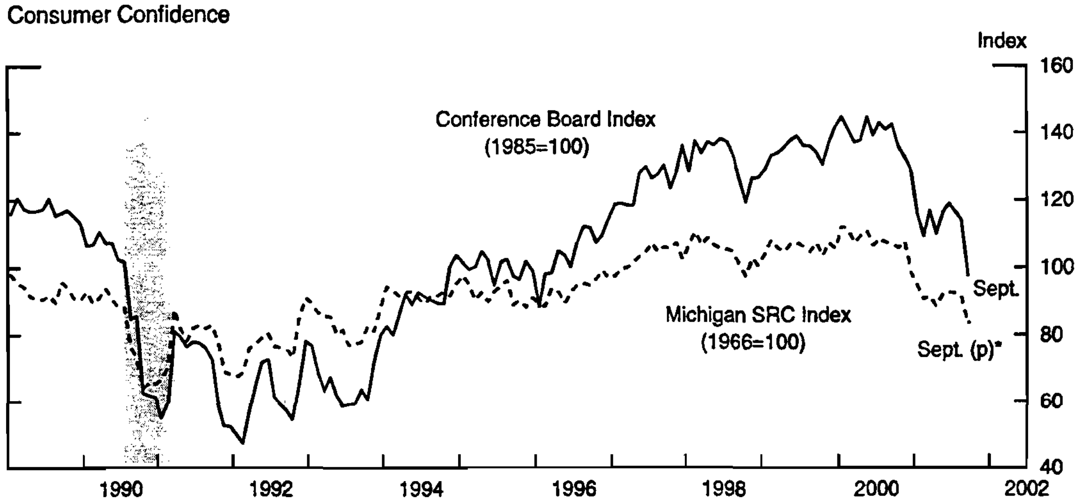


Ratio of Household Net Worth to DPI



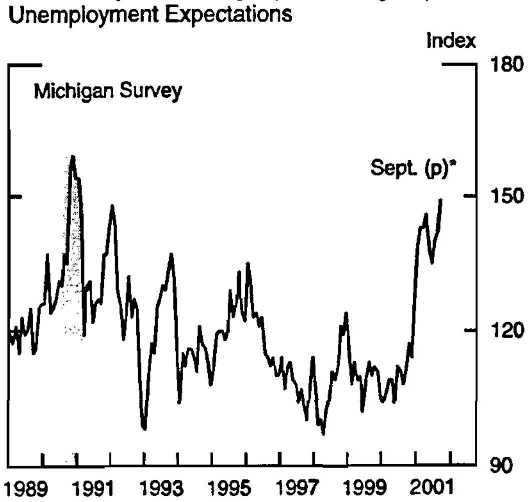
*The ratio for 2001:Q3 is a staff estimate.

Consumer Confidence



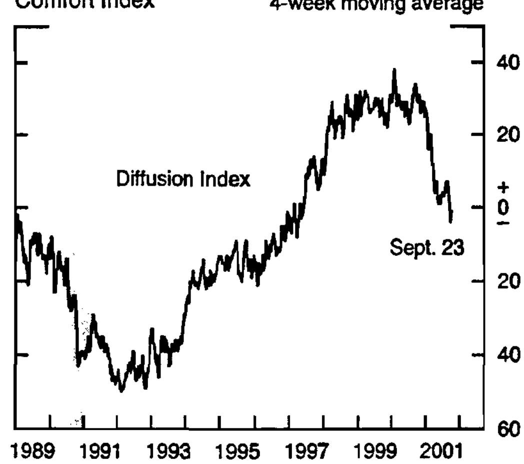
*Preliminary estimate using responses through Sept. 10.

Unemployment Expectations



*Preliminary estimate using responses through Sept. 10

ABC/Money Magazine Consumer
Comfort Index
4-week moving average



conditions. The Conference Board index of consumer confidence tumbled more than 16 points in September to its lowest level since January 1996. All of the major components of the index fell. The Conference Board noted that 88 percent of responses were received before September 11 and that, although responses received after this date "differed slightly, there was no reversal in the downward trend of the index."[9] The "consumer comfort index," a four-week moving average of responses obtained in a weekly survey of about 1,000 adults by ABC News and *Money* magazine, has, like the other indexes, fallen dramatically over the past year. Surprisingly perhaps, the index ticked up in the week ended September 16 and was unchanged during the week ended September 23.

Housing Markets

Housing activity appeared to be softening a bit prior to the terrorist attacks. Single-family housing starts fell 2-1/2 percent in August, to 1.25 million units at an annual rate, and the July reading was revised down slightly. In addition, multifamily housing starts dropped 23 percent to 280,000 units (annual rate) in August, after jumping to 363,000 units in July. New home sales edged up to 898,000 units at an annual rate in August, but the estimates for June and July were revised down; the new data show sales having changed little since April. Sales of existing homes rose to a record high 5.5 million units in August, but the August results represent sales at the time of closing and reflect commitments made a few weeks earlier.

Some of our more timely indicators of housing demand have downshifted a little in recent weeks. Builders' rating of new home sales declined in September to a level a bit below the lower end of its range in recent months.[10] The Mortgage Bankers Association weekly index of applications for mortgages to finance the purchase of a home declined noticeably in the week ended September 14 and then was little changed the following week. The four-week moving average of purchase applications has declined to the lower end of its elevated range of the past year and a half, despite low mortgage rates. By contrast, the Michigan Survey's measure of households' attitudes toward homebuying maintained, in the preliminary September reading, the strong uptrend it has shown since the middle of last year.

A few attempts have been made in the real estate industry to gauge how housing demand might be affected by the events of September 11. The National Association of Home Builders polled thirty builders on September 19 and 20. Most of them reported that sales held up during the week ending September 16, although buyer traffic declined. Because builders have a large enough backlog

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9. In a separate release on September 19, the Conference Board stated that an analysis of pre- and post-September 11 responses would be released at a later time.

10. Data collection was completed before September 11.

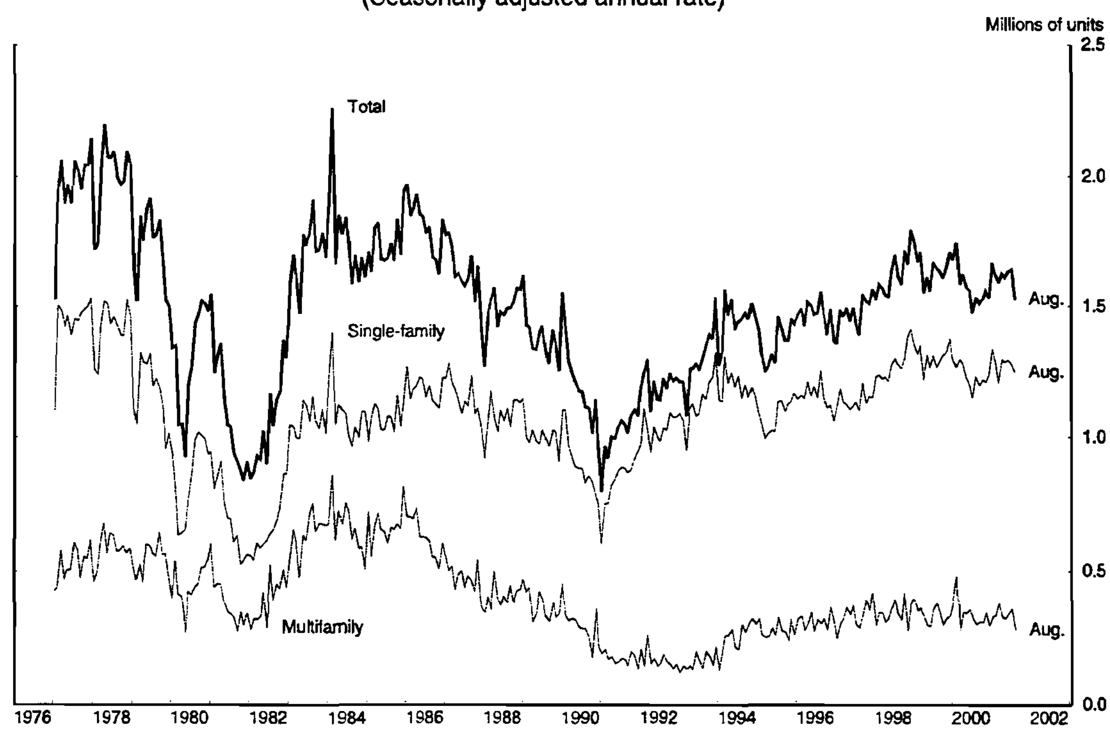
Private Housing Activity
(Millions of units; seasonally adjusted annual rate)

		2000	2001				
	2000	Q4	Q1	Q2[r]	June[r]	July[r]	Aug.[p]
All units							
Starts	1.57	1.54	1.63	1.62	1.63	1.64	1.53
Permits	1.59	1.58	1.67	1.60	1.59	1.57	1.56
Single-family units							
Starts	1.23	1.22	1.28	1.29	1.29	1.28	1.25
Permits	1.20	1.20	1.24	1.22	1.23	1.21	1.20
Adjusted permits[1]	1.25	1.23	1.28	1.27	1.29	1.25	1.24
New home sales	0.88	0.94	0.95	0.89	0.89	0.89	0.90
Existing home sales	5.11	5.10	5.27	5.30	5.33	5.20	5.50
Multifamily units							
Starts	0.34	0.32	0.35	0.33	0.34	0.36	0.28
Permits	0.39	0.38	0.43	0.38	0.36	0.36	0.36
Mobile homes							
Shipments	0.25	0.20	0.18	0.19	0.20	0.19	n.a.

1. Adjusted permits equals permit issuance plus total starts outside of permit-issuing areas.

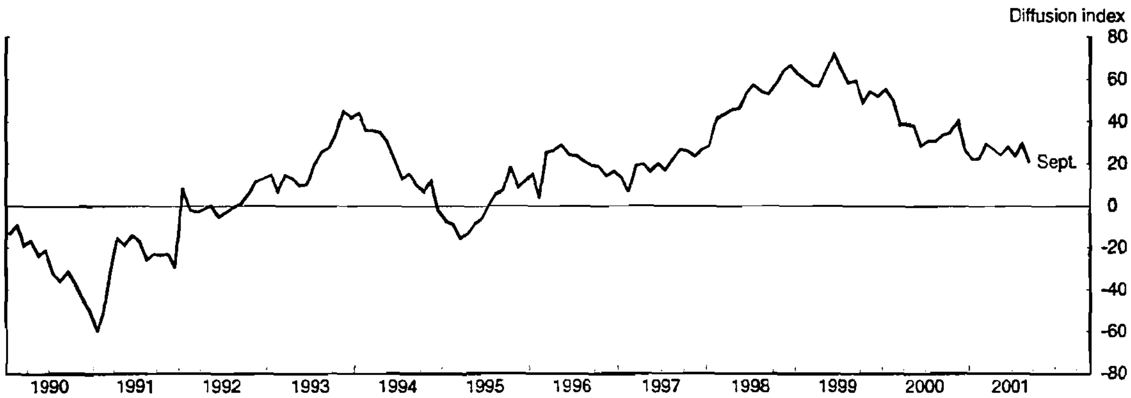
p Preliminary. r Revised. n.a. Not available.

Private Housing Starts
(Seasonally adjusted annual rate)



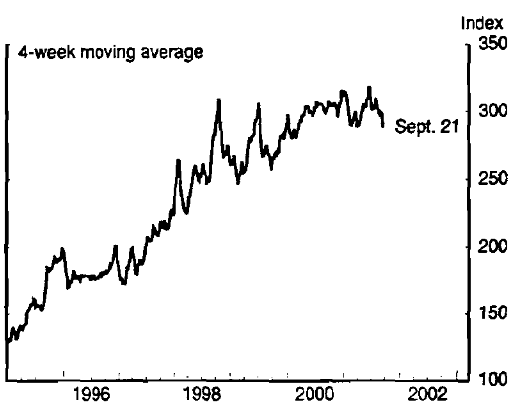
Indicators of Housing Demand and Prices

Builders' Rating of New Home Sales

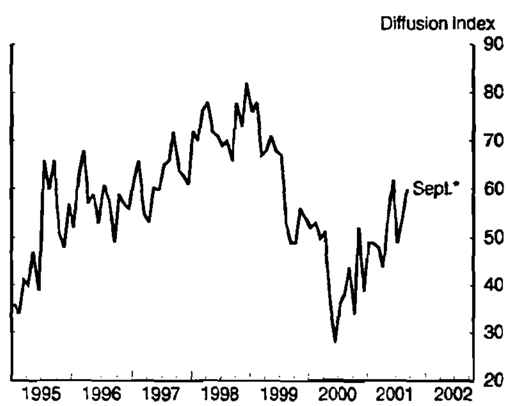


Note. Calculated from National Association of Homebuilders' data as the proportion of respondents rating current sales as good minus the proportion rating them as poor. Seasonally adjusted by Board staff.

MBA Index of Purchase Applications

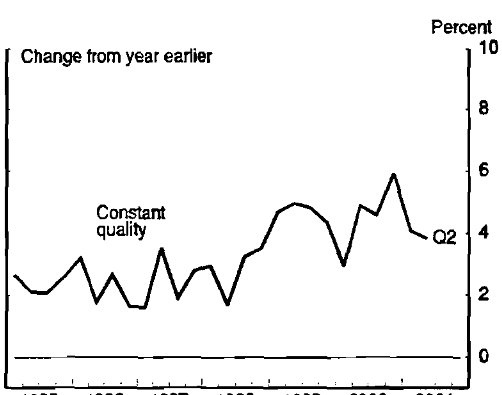


Perceived Homebuying Conditions

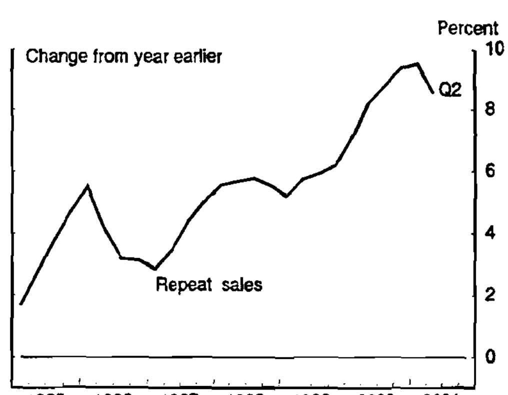


* preliminary estimate using responses through Sept. 10.
Source. Michigan Survey, not seasonally adjusted.

Prices of New Homes

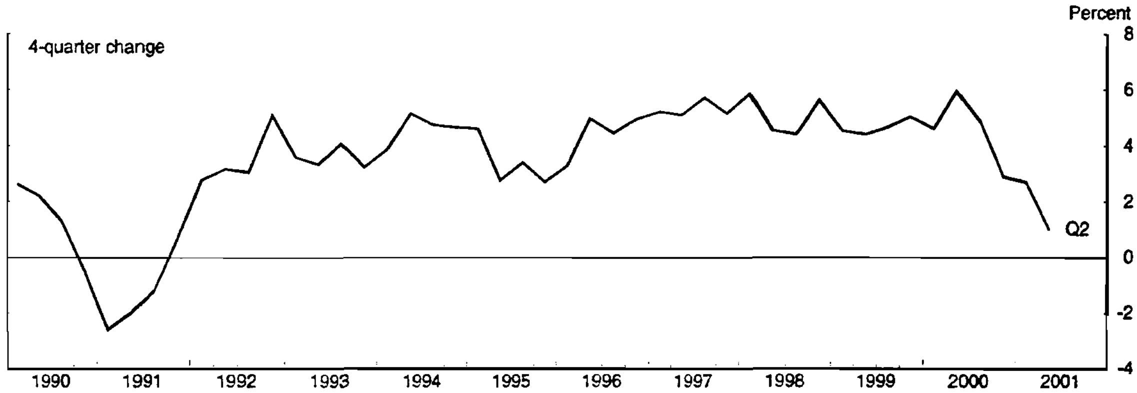


Prices of Existing Homes

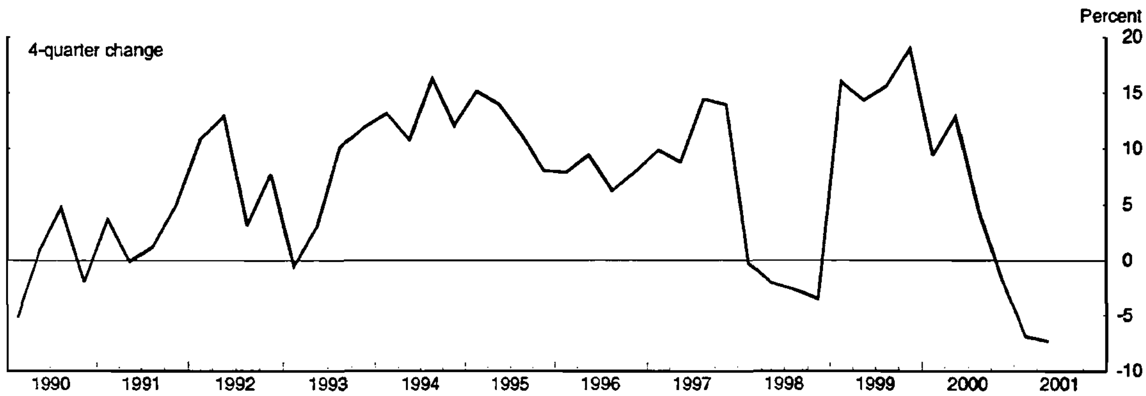


Equipment Investment Fundamentals

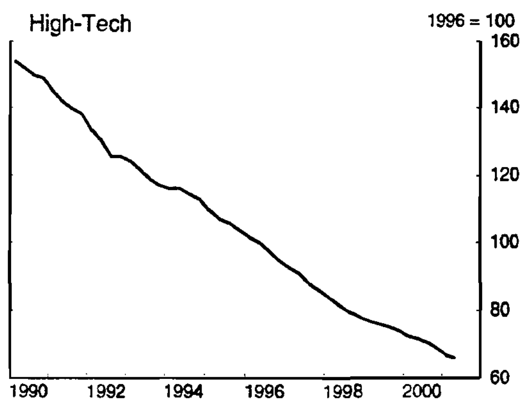
Business Output

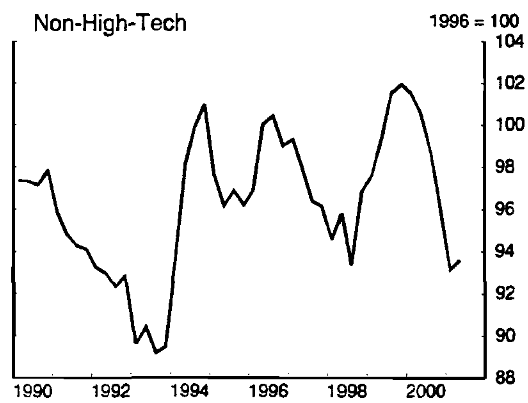


Real Cash Flow



User Cost of Capital





of orders to keep them busy for the next one or two quarters, they are reportedly not making major changes to their plans over that period. A member survey by the National Association of Realtors found an initial falloff in buyer traffic during the week of the attacks that was followed by some pickup over the following weekend.

Business Fixed Investment

Business fixed investment continued to contract over the summer. Since the attacks, there have been many reports of businesses hunkering down further, with concerns about future profits and cash flow being reinforced by the sharp decline in equity prices after the stock markets opened on September 17.

Equipment and software. Real outlays for equipment and software appear to have declined further in the third quarter following a precipitous drop in the second quarter. Indeed, apart from the sizable increase in outlays on airplanes by domestic carriers in July and August, the main indicators for each major component of real spending on equipment and software were on sharp downward trajectories into late summer. Shipments of nondefense capital goods excluding aircraft declined about 2 percent in both July and August. New orders for nondefense capital goods excluding aircraft ticked up 0.2 percent in August but were about 5 percent below the average for the second quarter.

Although it is too early to have precise estimates of the impact of the events of September 11 on the replacement demand for capital goods and software, initial estimates of property damage indicate that the increment to aggregate nominal spending on high-tech equipment and software is likely to be small—on the order of $3 billion to $4 billion.

Spending on aircraft is almost certain to drop sharply in coming months. In the wake of the terrorist attacks, air travel has fallen off dramatically, and domestic airlines—which were already struggling—are rapidly scaling back purchases of new aircraft. As mentioned earlier, Boeing has slashed its production plans in expectation of reduced demand over the next year or so.

Elsewhere in the transportation sector, motor vehicle investment has remained weak. Sales of medium and heavy trucks in August—432,000 at an annual rate—were little changed from July and were 18,000 units below the second-quarter average. Orders and backlogs of medium and heavy trucks appear to have flattened out at low levels. The decline in air travel has been accompanied by a substantial decline in car rentals. Daily rental companies are reported to have cancelled a large number of orders for light vehicles.

Nonresidential construction. Real expenditures for nonresidential structures dropped at an annual rate of 11-1/4 percent in the second quarter, not quite as much as previously indicated but nevertheless the largest percentage decline

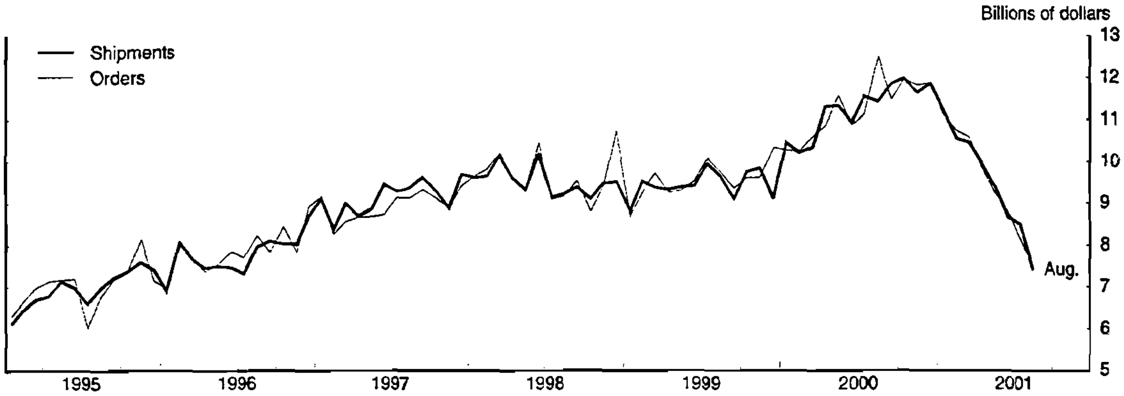
BUSINESS CAPITAL SPENDING INDICATORS
(Percent change from preceding comparable period;
based on seasonally adjusted data, in current dollars)

	2001		2001		
	Q1	Q2	June	July	Aug.
Equipment and software					
Shipments of nondefense capital goods	-2.6	-5.6	-2.8	-2.6	-2.4
Excluding aircraft	-3.0	-5.8	-3.3	-1.9	-2.1
Computers and related equipment	-9.0	-13.1	-7.8	-1.9	-12.9
Communications equipment	-13.6	-12.8	-.5	-6.9	-.4
All other categories	.7	-2.8	-2.8	-1.1	-.2
Shipments of complete aircraft	17.4	2.5	-.9	21.5	n.a.
Medium & heavy truck sales (units)	-4.7	-5.1	-3.5	-5.6	.5
Orders for nondefense capital goods	-8.6	-7.1	-3.8	-3.3	.8
Excluding aircraft	-3.9	-7.7	-3.1	-2.7	.2
Computers and related equipment	-8.9	-14.0	-4.9	-7.2	-8.4
Communications equipment	-10.1	-26.3	-14.9	14.7	8.7
All other categories	-1.3	-2.8	-1.2	-3.7	.7
Nonresidential structures					
Construction put in place, buildings	3.2	-4.5	-2.4	.7	n.a.
Office	-.6	-7.1	-1.2	-2.3	n.a.
Other commercial	6.6	-3.8	-6.3	2.0	n.a.
Institutional	2.0	-.3	-2.0	-.2	n.a.
Industrial	7.5	-4.3	2.7	5.3	n.a.
Lodging and miscellaneous	.3	-6.2	-1.9	-.6	n.a.
Rotary drilling rigs in use[1]	13.9	9.3	-1.3	.0	-4.6

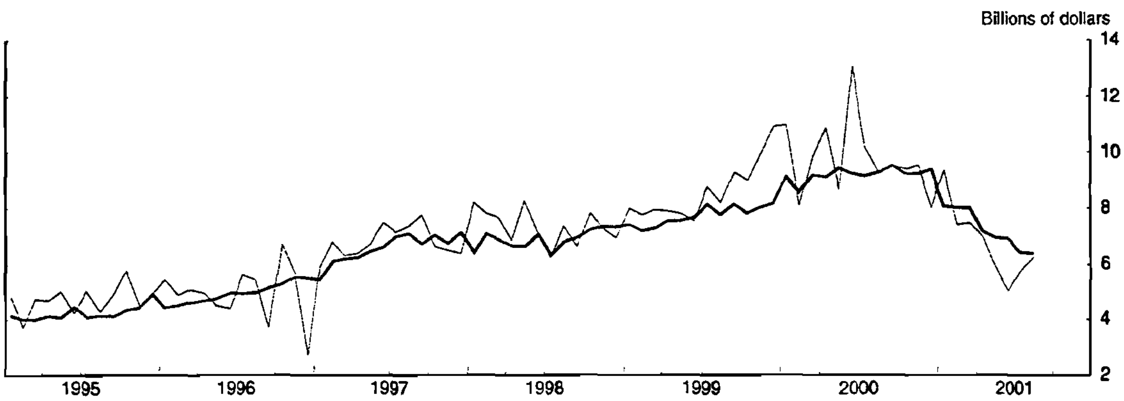
1. Percent change of number of rigs in use, seasonally adjusted.

Recent Data on Orders and Shipments

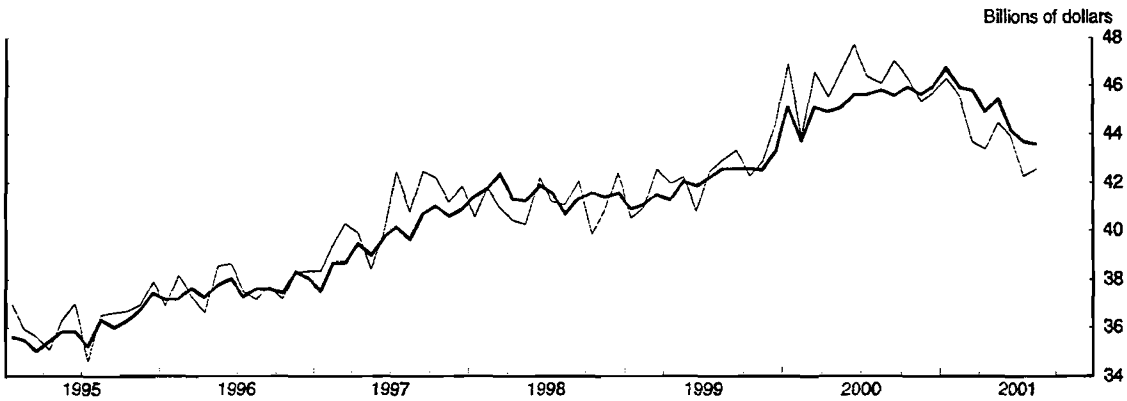
Computers and Related Equipment



Communications Equipment



Other Equipment (Total Ex. Transportation, Computers, Communications)

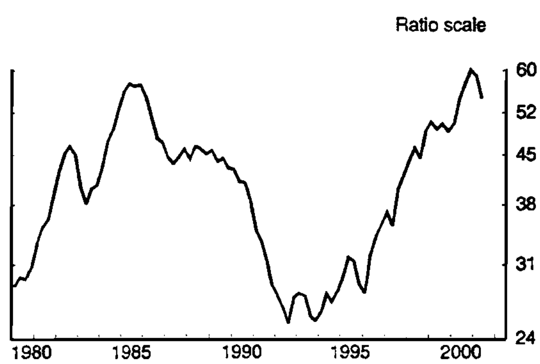


Real Investment in Nonresidential Structures
(Billions of 1996 dollars, chain weighted)

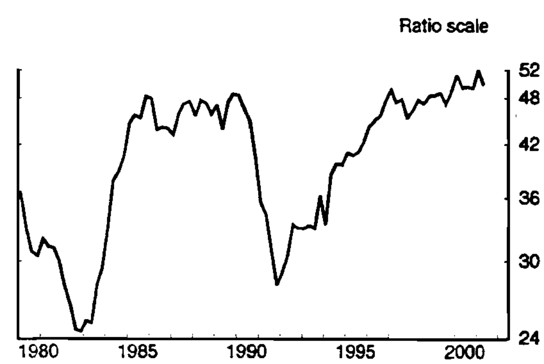
Buildings

Note. In addition to buildings, the nonresidential structures category includes outlays for drilling and mining, expenditures by utilities, and investment in miscellaneous private facilities such as streets, sewers, and parks.

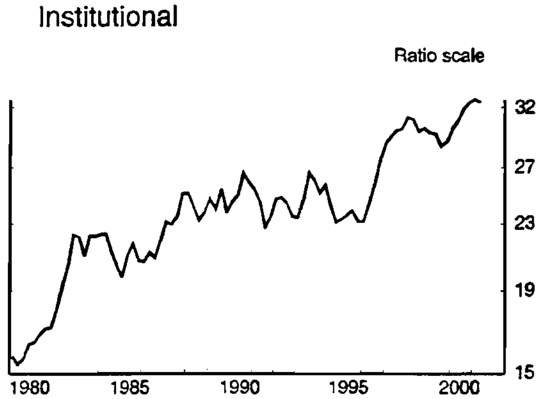
Office



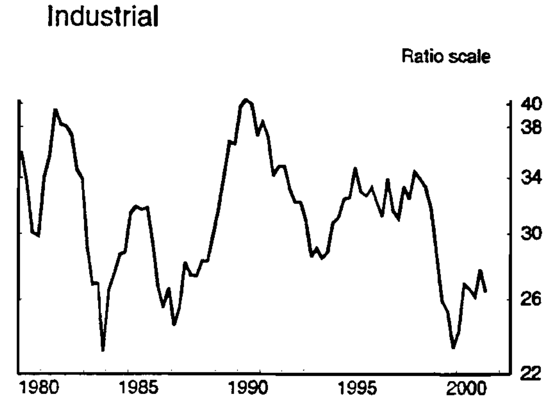
Other Commercial



Institutional



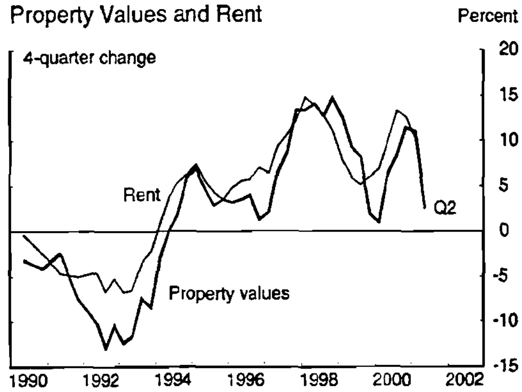
Industrial



Indicators of Nonresidential Construction

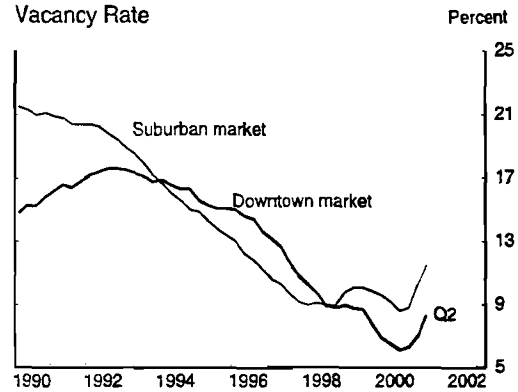
Office Buildings

Property Values and Rent



Source. National Real Estate Index.

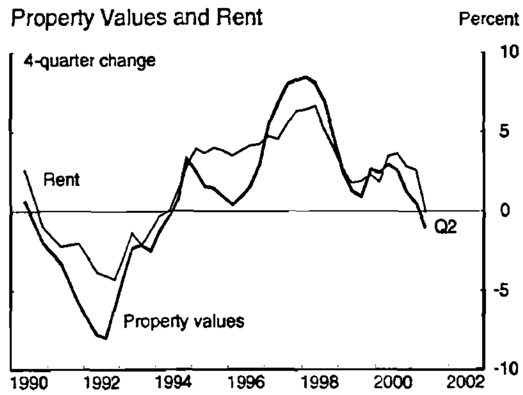
Vacancy Rate



Source. CB Richard Ellis.

Retail Space

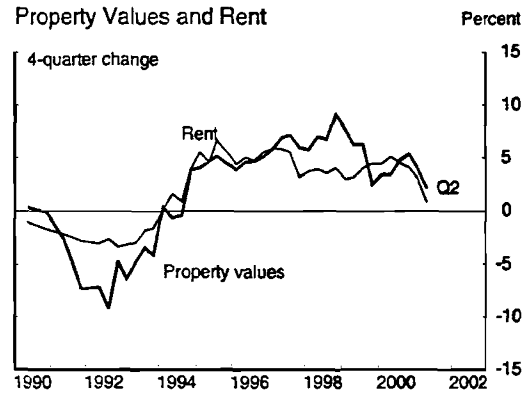
Property Values and Rent



Source. National Real Estate Index.

Warehouses

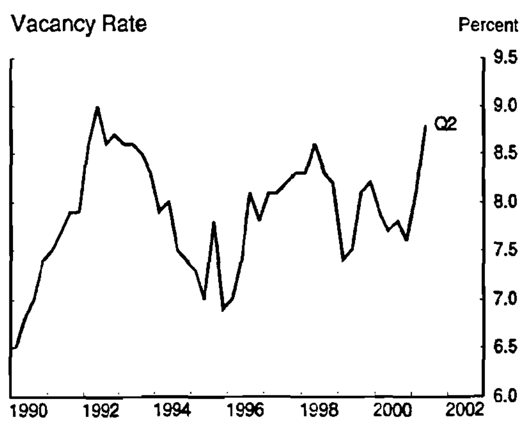
Property Values and Rent



Source. National Real Estate Index.

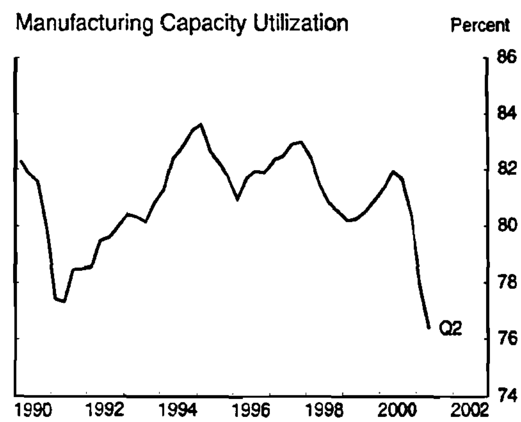
Industrial

Vacancy Rate



Source. CB Richard Ellis.

Manufacturing Capacity Utilization



CHANGES IN MANUFACTURING AND TRADE INVENTORIES
(Billions of dollars; annual rate except as noted;
based on seasonally adjusted Census book value)

Category	2000	2001		2001		
	Q4	Q1	Q2	May	June	July
Manufacturing and trade	45.7	-24.0	-43.3	-22.2	-85.5	-57.8
Less wholesale and retail motor vehicles	36.5	-10.0	-40.4	-21.0	-83.3	-74.9
Manufacturing	17.2	-11.9	-34.4	-35.4	-56.9	-33.6
Less aircraft and parts	16.0	-9.3	-35.3	-36.2	-56.0	-34.3
Merchant wholesalers	9.4	-5.0	.2	10.8	-13.6	-27.0
Less motor vehicles	7.0	-2.4	3.3	16.8	-13.3	-27.9
Retail trade	19.1	-7.2	-9.0	2.3	-14.9	2.9
Automotive dealers	6.8	-11.5	.3	4.8	-2.0	16.3
Less automotive dealers	12.3	4.3	-9.3	-2.5	-13.0	-13.4

SELECTED INVENTORY-SALES RATIOS IN MANUFACTURING AND TRADE
(Months' supply, based on seasonally adjusted Census book value)

Category	2000	2001		2001		
	Q4	Q1	Q2	May	June	July
Manufacturing and trade	1.42	1.42	1.42	1.42	1.43	1.42
Less wholesale and retail motor vehicles	1.38	1.38	1.38	1.38	1.40	1.38
Manufacturing	1.36	1.38	1.38	1.37	1.40	1.38
Primary metals	1.77	1.80	1.76	1.74	1.78	1.72
Steel	2.28	2.30	2.20	2.16	2.23	2.17
Machinery	2.05	2.01	2.06	2.02	2.11	2.06
Computers and electronics	1.27	1.38	1.52	1.55	1.56	1.58
Electrical equipment	1.39	1.41	1.39	1.40	1.41	1.45
Transportation equipment	1.48	1.49	1.42	1.39	1.39	1.38
Motor vehicles	.61	.62	.59	.57	.59	.56
Aircraft	4.35	4.02	3.84	3.79	3.49	3.77
Fabricated metals	1.67	1.71	1.69	1.68	1.71	1.68
Textiles	1.85	1.75	1.68	1.71	1.66	1.62
Paper	1.17	1.17	1.18	1.18	1.20	1.18
Chemicals	1.40	1.41	1.43	1.42	1.47	1.44
Petroleum	.66	.68	.68	.66	.72	.71
Rubber and plastics	1.24	1.25	1.22	1.23	1.22	1.16
Merchant wholesalers	1.30	1.30	1.32	1.32	1.33	1.32
Less motor vehicles	1.28	1.28	1.31	1.31	1.32	1.30
Durable goods	1.62	1.62	1.61	1.62	1.62	1.60
Nondurable goods	.97	.97	1.03	1.02	1.04	1.02
Retail trade	1.62	1.59	1.56	1.57	1.56	1.56
Less automotive dealers	1.51	1.50	1.47	1.48	1.48	1.47
Automotive dealers	1.91	1.85	1.80	1.81	1.80	1.80
General merchandise	1.92	1.94	1.92	1.93	1.92	1.90
Apparel	2.47	2.41	2.41	2.42	2.42	2.37
Food	.85	.85	.86	.85	.86	.85

since early 1994. For the buildings component of nonresidential structures, expenditures increased some in July, but they were still below the second-quarter average.[11]

Only rough guesses can be made at this time about the extent, timing, and location of reconstruction efforts arising from the destruction at the World Trade Center. Commercial real estate firms estimate that roughly 30 million square feet of office space was destroyed or damaged—about 7 percent of the New York City supply. We estimate that the cost of replacing this office space might be around \$6 billion to \$8 billion.

Business Inventories

Stocks continued to run off at a rapid clip in July, the last month for which we have complete data. Large liquidations were reported in manufacturing and, excluding vehicles, in both wholesale trade and retail trade. However, despite the July reductions in stocks, overhangs were still apparent for several industries, notably computers and electrical goods, machinery, chemicals, primary and fabricated metals, textiles, and paper products.

The limited data we have for August show further liquidation. In the motor vehicles industry, dealers' stocks of both automobiles and light trucks edged down. Days' supply of automobiles remained low, but days' supply of light trucks was still above its desired level. Inventories held by manufacturers of durable goods fell at an annual rate of nearly \$25 billion in August; the average rate of liquidation in July and August in this part of the manufacturing sector was a little faster than the average for the second quarter. Nonetheless, the inventory-sales ratio for producers of durable goods edged up last month, led by a further noticeable rise in the ratio for producers of computers.[12]

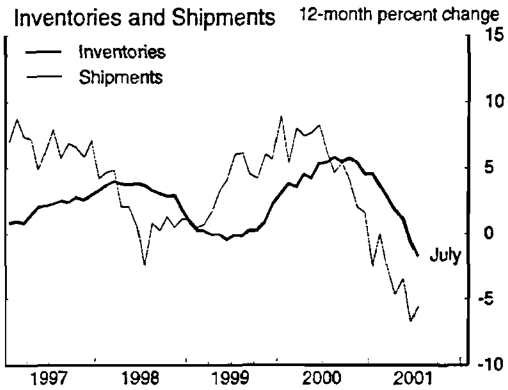
In the days immediately following the attacks, many of the normal means of transporting goods were disrupted to some degree, leaving a few firms scrambling to obtain the inputs needed to maintain operations at desired levels and other firms, both here and abroad, with unintended backups. Serious problems were not widespread, however, and most of the disruptions that did emerge seem to have eased within a few days. The disruption to the inventory

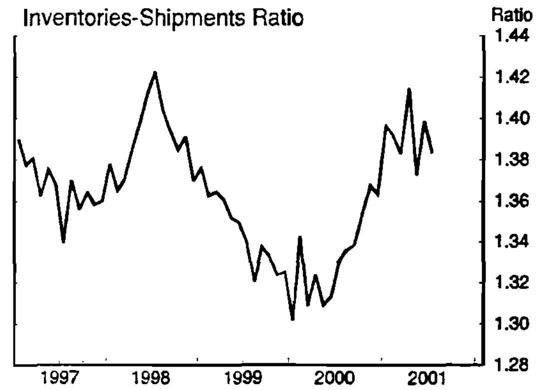
11. The buildings component includes construction of office, industrial, retail, warehouse, lodging, and institutional facilities, and excludes mining, drilling activity, and utility construction.

12. The August release for the durable goods industries also showed a steeper rate of liquidation in July than was previously reported. In the absence of an offsetting change in the stocks of nondurables, the July liquidation for manufacturing as a whole will also be larger than the published data currently show, by about 7-1/2 billion at an annual rate.

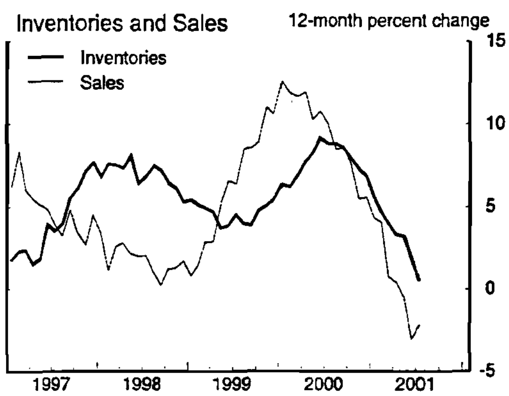
Inventories and Sales
(Seasonally adjusted, book value)

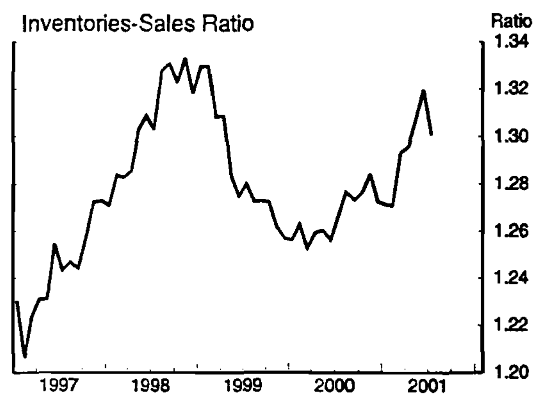
Manufacturing



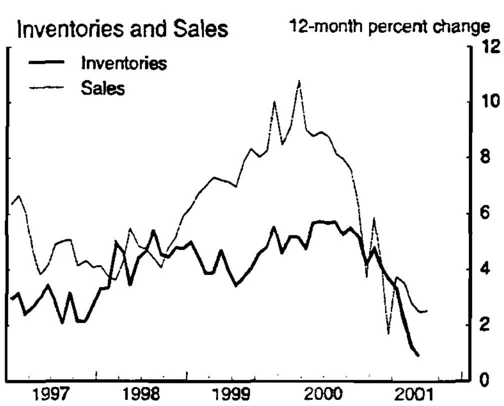


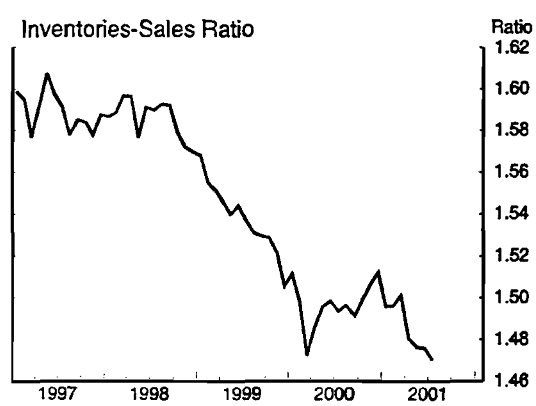
Wholesale Trade Excluding Motor Vehicles





Retail Trade Excluding Motor Vehicles





distribution system stemming from the temporary suspension of air cargo service turned out to be quite limited.[13]

Government Sector

Federal. Fiscal policy appears to be on a substantially more expansionary track in the wake of the terrorist attacks. On September 18, the President signed a $40 billion supplemental appropriations bill. The bill allows the President to transfer up to $20 billion to any department or agency in order to (1) improve government preparedness for mitigating and responding to the attacks; (2) counter, investigate, or prosecute terrorists; (3) increase transportation security; (4) repair public facilities; and (5) enhance national security. The remaining $20 billion will have to go through the usual appropriations process. In addition, the Congress passed a $15 billion package of financial assistance for the airline industry on September 21. This included $5 billion to compensate carriers for losses incurred as a result of the terrorist attacks and up to $10 billion in loan guarantees.

Meanwhile, work on the regular fiscal 2002 spending bills has slowed, and the spending outlook remains uncertain, in part because the Congress and the Administration are still developing plans for the emergency funds.[14] Countercyclical tax proposals have been put forth by some members of the Congress, and the Administration is reported to be considering an economic stimulus plan.

In the federal budget data for July and August, outlays were buffeted by special factors, including a re-estimate of spectrum auction credit subsidies, the acceleration of some payments usually made in September, and an August surge in payments to farmers. Abstracting from these factors, overall outlays have been increasing at a moderate rate, albeit slightly faster than earlier this year. The pickup in spending reflects rapid increases in Medicare, Medicaid, and income-support programs, the latter due in part to rising unemployment benefit payments.

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13. Major cargo carriers, such as FedEx, United Parcel Service, and Emery Worldwide, resumed flying full schedules beginning on the Saturday following the attacks. Moreover, the Federal Aviation Administration announced on that Saturday that passenger carriers could resume transporting cargo, though subject to tighter rules. Apart from lengthy waits at border crossings, disruptions to the trucking industry also were reported to be limited. Freight and mail carriers that switched to trucks while air traffic was grounded for the most part used their own excess trucks, which they had on hand for peak holiday periods.

14. At this time, the spending bills appear to be in line with the Administration's proposals, including this summer's amended defense proposal, which boosts budget authority by $18-1/2 billion and is estimated to raise outlays in fiscal 2002 about $10 billion.

FEDERAL GOVERNMENT OUTLAYS AND RECEIPTS
(Unified basis; billions of dollars)

	July-August			12 months ending in Aug.		
	2000	2001	Percent change	2000	2001	Percent change
Outlays	277.6	327.6	18.0	1776.8	1893.7	6.6
Deposit insurance	-0.2	0.1	...	-3.4	-1.5	...
Spectrum auctions	-0.2	-12.4	...	-0.9	-13.4	...
Sale of major assets	0.0	0.0	...	0.0	0.0	...
Other	278.0	339.9	22.3	1781.1	1908.6	7.2
Receipts	272.2	250.4	-8.0	2006.0	2051.2	2.3
Surplus	-5.4	-77.2	...	229.2	157.5	-31.3
	Outlays excluding deposit insurance, spectrum auction, and sale of major assets are adjusted for payment timing shifts[1]					
Outlays	288.9	313.0	8.4	1780.6	1870.2	5.0
National defense	46.5	52.5	13.1	289.9	306.4	5.7
Net interest	37.7	34.7	-7.8	226.1	209.6	-7.3
Social security	68.7	73.2	6.6	407.2	431.4	5.9
Medicare	35.6	38.7	9.0	197.7	211.8	7.1
Medicaid	20.5	22.4	9.2	117.5	129.4	10.1
Other health	6.5	7.2	10.4	36.1	42.0	16.2
Income security	36.2	41.3	14.0	244.2	265.2	8.6
Agriculture	1.9	6.5	232.4	32.8	36.3	10.8
Other	35.4	36.5	3.2	229.1	238.2	4.0
Receipts	272.2	250.4	-8.0	2006.0	2051.2	2.3
Individual income and payroll taxes	228.7	211.3	-7.6	1604.1	1674.4	4.4
Withheld + FICA	219.7	229.6	4.5	1350.3	1424.5	5.5
Nonwithheld + SECA	13.2	12.7	-3.9	387.3	421.7	8.9
Refunds (-)	4.1	31.0	653.2	133.5	171.8	28.6
Corporate	9.7	5.9	-39.6	204.1	187.0	-8.4
Gross	13.2	9.7	-26.8	232.0	223.4	-3.7
Refunds (-)	3.5	3.8	8.8	28.0	36.3	30.0
Other	33.8	33.3	-1.5	197.8	189.7	-4.1
Surplus	-16.7	-62.6	...	225.4	181.0	-19.7

Note. Components may not sum to totals because of rounding.
1. A shift in payment timing occurs when the first of the month falls on a weekend or holiday, or when the first three days of a month are nonworking days. Outlays for defense, social security, Medicare, income security, and "other" have been adjusted to account for these shifts.
... Not applicable.

Receipts in July and August fell 8 percent from year-earlier levels, partly reflecting the payout of $25 billion in rebates and the notching down of withholding schedules for higher income earners. Excluding the effects of the tax cuts, receipts in July and August rose a sluggish 2 percent relative to a year earlier. The IRS reports that it sent $11 billion of rebates in September. According to daily data, nonwithheld income tax receipts in September are coming in well below last year's level, in part because of changes in filing deadlines resulting from the terrorist attacks. The CBO has revised down its estimate of the fiscal 2001 budget surplus to $121 billion, from an August estimate of $153 billion, mainly because of the weakness in receipts over the past couple of months.

State and local. Spending by state and local governments apparently remained strong in the third quarter. The increase in employment averaged 47,000 in July and August, well above the 34,000 average monthly gain during the first half of the year. Many of the new jobs were in education. Further large increases in state and local consumption expenditures have arisen in connection with the cleanup and recovery from the terrorist attacks. Press reports suggested that roughly one-half billion dollars was spent on New York's recovery effort in the two weeks following the collapse of the World Trade Center. The total cost seems likely to be at least a few billion dollars. Most expenditures will take the form of contracts for services and compensation for overtime and supplemental workers; some of the workers and funding will likely be diverted from other programs.

Construction data for the sector have been strong as well. Real construction spending rose 1.3 percent in July, to a level 2.2 percent above the second-quarter level (not at an annual rate). The increase in July was concentrated in educational facilities.

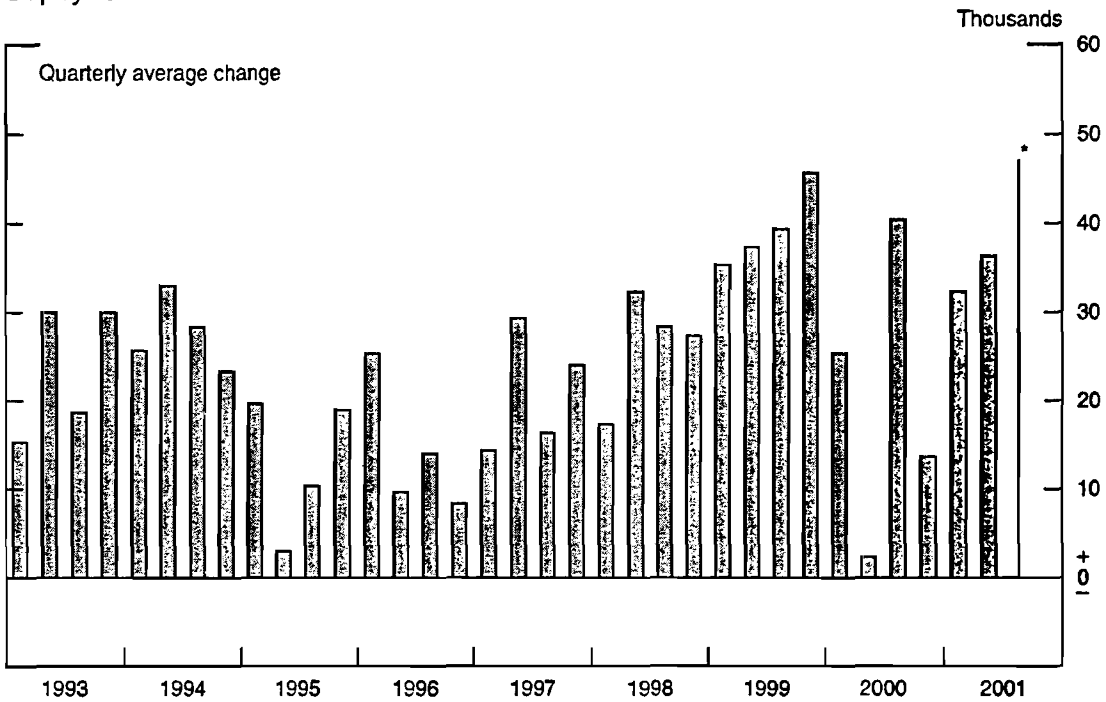
We continue to get reports that some states are struggling with budget shortfalls. In addressing their difficulties, many of these states seem to be focusing on a combination of strategies, especially spending cuts along with debt issuance to fund projects that would otherwise have been financed with tax revenues. The direction of tax changes has been mixed. The National Conference of State Legislatures estimates that net tax cuts during this spring's legislative session were the smallest in seven years.

Prices and Labor Costs

Core consumer price inflation remained modest in July and August. Excluding food and energy, the CPI rose 0.2 percent in each of those two months, about the same rate of increase as in the second quarter. PCE prices continued to rise less rapidly than the CPI.

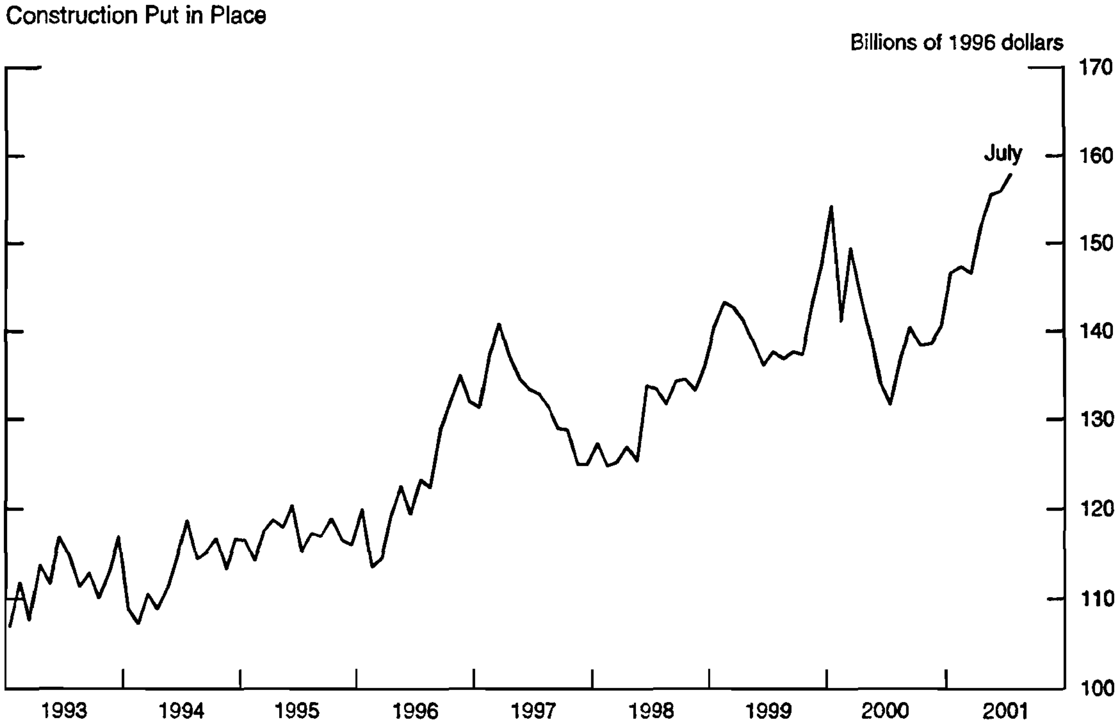
State and Local Employment and Construction

Employment



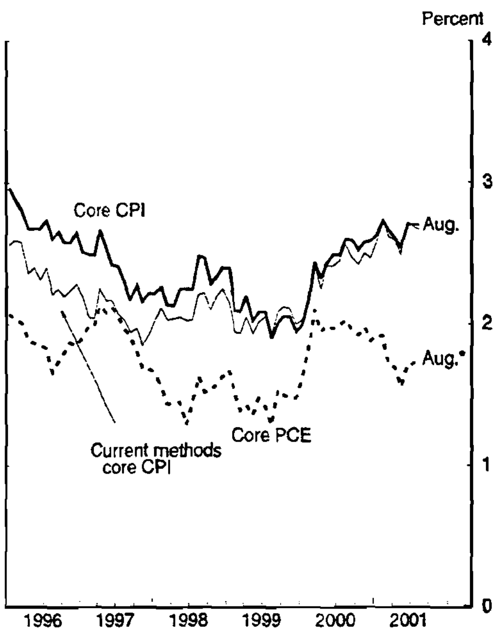
* Average of employment data for July and August 2001.

Construction Put in Place



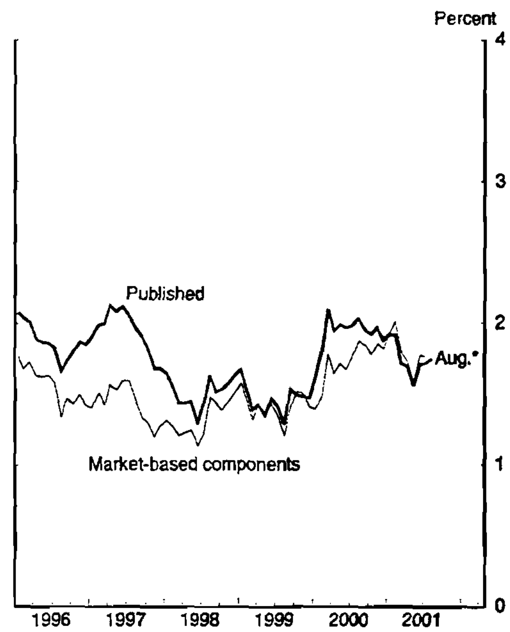
Measures of Core Consumer Price Inflation
(12-month change except as noted)

CPI and PCE Excluding Food and Energy



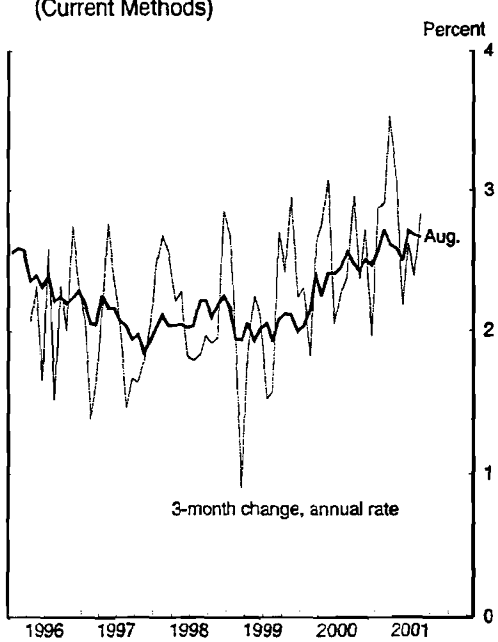
* Staff estimate

PCE Excluding Food and Energy

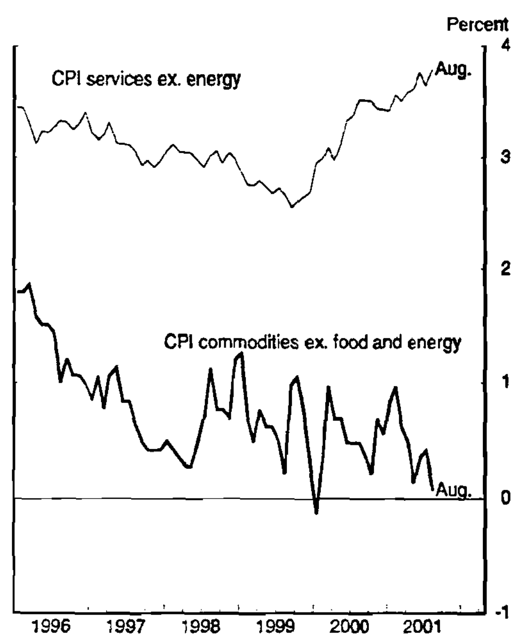


* Staff estimate

CPI Excluding Food and Energy
(Current Methods)



CPI Services and Commodities



RECENT PRICE INDICATORS
(Percent)

	From 12 months earlier		2001		2001	
	Aug. 2000	Aug. 2001[1]	Q1	Q2	July	Aug.[1]
			-Annual rate-		-Monthly rate-	
CPI						
Total	3.4	2.7	4.2	3.1	-0.3	0.1
Core	2.6	2.7	3.2	2.6	0.2	0.2
ex tobacco	2.4	2.6	3.1	2.4	0.1	0.3
Core commodities	0.5	0.1	1.1	-0.9	0.1	-0.4
ex tobacco	-0.2	-0.4	0.8	-1.8	-0.2	-0.2
Core services	3.6	3.8	4.0	4.0	0.2	0.5
Current-methods	3.3	2.7	4.2	3.1	-0.3	0.1
Core	2.6	2.7	3.1	2.6	0.2	0.2
ex tobacco	2.4	2.6	3.1	2.4	0.1	0.3
PCE Prices						
Total	2.6	2.0	3.2	1.6	-0.1	0.0
Core	2.0	1.8	2.6	0.9	0.2	0.1
ex tobacco	1.9	1.7	2.5	0.7	0.2	0.2
Core commodities	-0.4	-0.7	0.3	-1.9	0.1	-0.5
ex tobacco	-0.9	-1.1	0.0	-2.7	-0.1	-0.3
Core services	3.1	2.8	3.5	2.2	0.3	0.4
Core market prices	1.9	1.8	2.4	1.0	0.2	0.1
Core nonmarket prices	2.8	1.6	3.3	0.7	0.2	0.1
PPI						
Total finished goods	3.4	2.1	5.3	1.2	-0.9	0.4
Core	1.7	1.4	1.6	1.5	0.2	-0.1
ex tobacco	1.3	0.8	0.4	0.8	0.2	-0.1
Core consumer goods	2.1	1.8	2.5	2.2	0.1	-0.1
ex tobacco	1.3	0.9	0.6	1.1	0.2	-0.1
Capital equipment	1.2	0.7	0.4	0.8	0.2	-0.1
Core intermediate materials	2.5	-0.7	1.0	0.1	-0.4	-0.4
Core crude materials	3.7	-9.5	-7.5	-16.5	-0.9	-0.8

1. PCE Prices for August are staff estimates.

BROAD MEASURES OF INFLATION
(4-quarter percent change)

	1998 Q2	1999 Q2	2000 Q2	2001 Q2
Product prices				
GDP chain price index	1.2	1.4	2.3	2.3
Less food and energy	1.3	1.4	2.2	1.7
Nonfarm business chain price index[1]	0.8	1.1	1.9	1.9
Expenditure prices				
Gross domestic purchases chain price index	0.8	1.4	2.6	2.0
Less food and energy	1.0	1.3	2.0	1.6
PCE chain price index	1.0	1.5	2.7	2.3
Less food and energy	1.4	1.4	2.0	1.7
PCE chain price index, market-based components	0.8	1.5	2.6	2.4
Less food and energy	1.2	1.4	1.7	1.7
CPI	1.6	2.1	3.3	3.4
Less food and energy	2.2	2.1	2.4	2.7
Current-methods CPI	1.3	2.0	3.3	3.4
Less food and energy	2.1	2.0	2.3	2.7
Median CPI	2.9	2.7	2.6	3.5
Trimmed mean CPI	2.0	1.7	2.5	3.0

1. Excluding housing.

SURVEYS OF (CPI) INFLATION EXPECTATIONS
(Percent)

	Actual inflation[1]	University of Michigan: 1 year		University of Michigan: 5 to 10 years		Professional forecasters (10-year)[4]
		Mean[2]	Median[2]	Mean[3]	Median[3]	
1999-Q4	2.6	3.5	2.9	3.3	2.9	2.5
2000-Q1	3.2	3.6	3.0	3.5	3.0	2.5
Q2	3.3	3.5	3.0	3.3	2.8	2.5
Q3	3.5	3.6	2.9	3.4	2.9	2.5
Q4	3.4	3.8	3.0	3.7	3.0	2.5
2001-Q1	3.4	3.4	2.9	3.6	3.0	2.5
Q2	3.4	3.9	3.1	3.6	3.0	2.5
Q3		3.0	2.6	3.4	2.9	2.5
Apr.	3.3	3.7	3.1	3.6	3.1	
May	3.6	3.9	3.2	3.6	3.0	
June	3.2	4.0	3.0	3.6	3.0	2.5
July	2.7	3.0	2.6	3.4	2.9	
Aug.	2.7	3.1	2.7	3.6	3.0	
Sept.		2.8	2.6	3.2	2.9	2.5

1. CPI; percent change from the same period in the preceding year.
2. Responses to the question: By about what percent do you expect prices to go up, on the 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 the average, during the next 5 to 10 years?
4. Compiled by the Federal Reserve Bank of Philadelphia.

Energy prices. The CPI for energy fell sharply in July and August. However, the September report likely will bring a sizable rebound, as prices of petroleum products pushed higher after mid-summer in response to another round of refinery disruptions and tightening supplies. The September 11 attacks caused prices to increase further, but only briefly. At retail, there were scattered reports of panic buying and price spikes for gasoline for a day or so, mostly in the Midwest. However, by September 17, the Department of Energy reported that retail gasoline prices were virtually unchanged from their level on September 10. Crude prices moved higher immediately after the attacks, but they have since turned down sharply in response to pledges by various members of OPEC to maintain supplies and to rising expectations in the market that sluggish economies here and abroad will substantially curb oil demand. Wholesale gasoline prices are also down sharply.

Last year's spectacular run-up of natural gas prices has continued to unwind. Gas futures quotes for the coming winter are about one-third the level of spot prices last winter. In sharp contrast to the situation for petroleum products, inventories of natural gas have continued to rise with unusual speed, as production has remained strong and demand sluggish. These inventories are now near their highest level in the past five years.

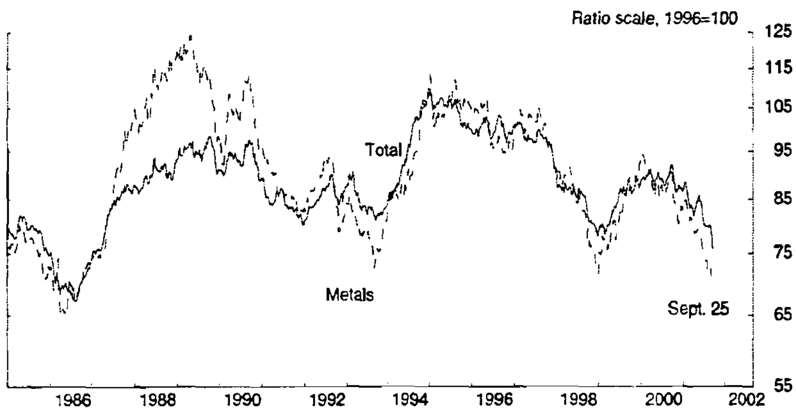
In electricity markets, upward price pressures dissipated over the summer. The CPI for electricity edged down in August after having increased almost 9 percent (not at an annual rate) over the first seven months of the year. The difficulties anticipated in California failed to materialize.

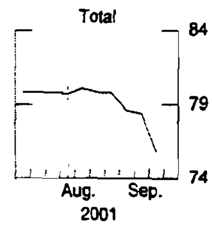
Food prices. Consumer food prices rose 0.2 percent in August, keeping the twelve-month change for this series slightly above 3 percent. Through August, consumer food prices had accelerated 0.4 percentage point on a year-over-year basis, boosted by a rebound in farm prices over the past twelve months. This week's futures quotes suggest that farm prices will register a moderate decline over the coming four quarters.

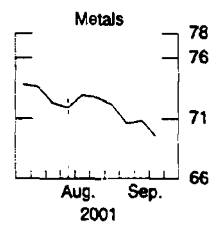
Core consumer prices. For the twelve months ending in August, the CPI excluding food and energy rose 2.7 percent, only slightly more than in the year-earlier period. Prices for core commodities fell 0.4 percent in August, partly reflecting weak demand for autos and for computers and electronics. In contrast, prices for core services increased 0.5 percent in August; both owners' equivalent rent and tenants' rent continued to rise at elevated rates. In addition, the index for medical services jumped 0.6 percent in August; it has risen 4.7 percent over the past twelve months, a touch more than in the year-earlier period. Tuition increased 0.9 percent in August, bringing the twelve-month change for that category to 5.7 percent.

Commodity Price Measures

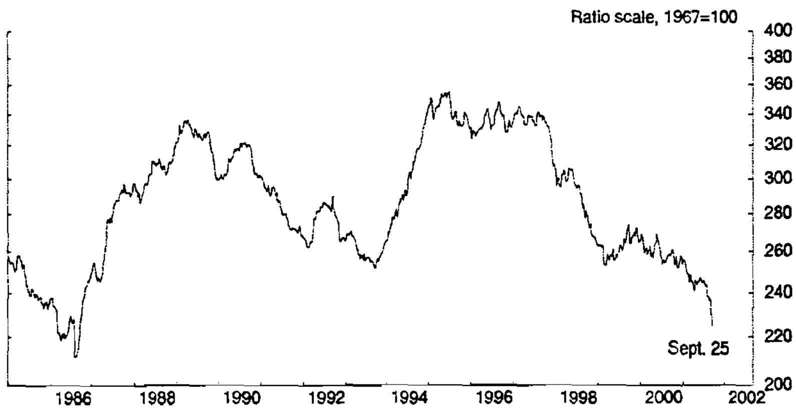
Journal of Commerce Index

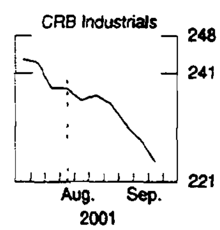




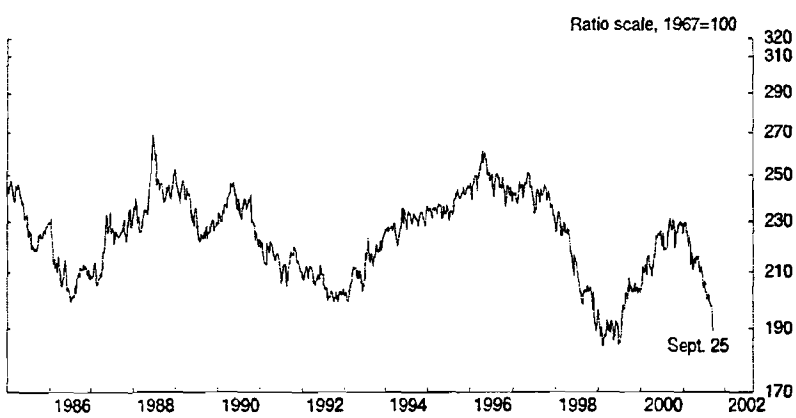


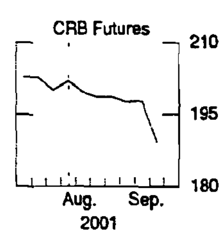
CRB Spot Industrials





CRB Futures





Note. Weekly data, Tuesdays. Vertical lines on small panels indicate week of last Greenbook. The Journal of Commerce index is based almost entirely on industrial commodities, with a small weight given to energy commodities, and the CRB spot price index consists entirely of industrial commodities, excluding energy. The CRB futures index gives about a 60 percent weight to food commodities and splits the remaining weight roughly equally among energy commodities, industrial commodities, and precious metals. Copyright for Journal of Commerce data is held by CIBCR, 1994.

SPOT PRICES OF SELECTED COMMODITIES

	Current price (dollars)	Percent change[1]: 1999	2000	Dec. 26 to Aug. 14[2]	Aug. 14[2] to Sept. 25	Memo: Year earlier to date
Metals						
Copper (lb.)	0.690	26.1	3.4	-24.2	0.0	-28.9
Steel scrap (ton)	79.333	61.5	-32.7	1.3	-0.8	-13.8
Aluminum, London (lb.)	0.598	27.7	-0.8	-13.5	-2.1	-18.0
Precious metals						
Gold (oz.)	288.000	-1.6	-5.7	0.1	4.9	4.8
Silver (oz.)	4.565	5.5	-10.9	-9.6	8.2	-8.1
Forest products[3]						
Lumber (m. bdft.)	282.000	8.3	-44.6	71.1	-8.4	22.6
Plywood (m. sqft.)	318.000	-3.2	-8.2	25.0	-9.1	-3.6
Petroleum						
Crude oil (barrel)	19.990	163.3	-13.0	16.0	-22.5	-31.9
Gasoline (gal.)	0.618	132.9	5.2	10.4	-23.7	-33.3
Fuel oil (gal.)	0.613	140.7	34.4	-21.6	-17.7	-34.0
Livestock						
Steers (cwt.)	67.220	15.7	13.2	-11.5	-1.4	1.8
Hogs (cwt.)	45.000	194.0	7.1	38.4	-13.9	3.4
Broilers (lb.)	0.614	-4.0	-13.7	19.3	3.5	14.5
U.S. farm crops						
Corn (bu.)	1.880	-10.2	10.1	-1.0	-8.5	18.2
Wheat (bu.)	3.155	-17.4	31.9	-11.9	2.8	1.9
Soybeans (bu.)	4.420	-17.6	10.8	2.7	-12.5	-5.0
Cotton (lb.)	0.329	-20.9	27.0	-39.6	-7.2	-45.9
Other foodstuffs						
Coffee (lb.)	0.410	5.1	-43.1	-33.5	-9.4	-51.8
Memo:						
JOC Industrials	75.800	11.0	-1.5	-8.2	-4.9	-17.7
JOC Metals	69.500	26.3	-10.3	-13.8	-3.3	-23.0
CRB Futures	189.100	7.8	12.1	-11.7	-6.4	-16.4
CRB Spot	224.750	-0.1	-3.5	-7.2	-5.7	-13.7

1. Changes, if not specified, are from the last week of the preceding year to the last week of the period indicated.
2. Week of the August Greenbook.
3. Reflects prices on the Friday before the date indicated.

Core PCE price inflation continued to run lower than core CPI price inflation this summer; the August reading on the CPI suggests that core PCE prices rose only 0.1 percent that month. Core PCE prices rose an estimated 1.8 percent in the twelve months to August, compared with 2 percent in the twelve months to August 2000.

Producer prices. Prices for capital goods as measured by the producer price index edged down 0.1 percent in August, leaving the twelve-month change for this series at 0.7 percent, 1/2 percentage point below the year-earlier increase. Prices for computers plunged 9 percent in August and were almost 25 percent below their year-earlier level, one of the largest reductions in recent years. Prices for communications equipment have also slipped substantially over the past several months, led downward by decreases for networking equipment. Core inflation measures at earlier stages of processing continued to fall in both July and August; the index for intermediate materials was 0.7 percent below the level of a year earlier, and the index for crude materials was down almost 10 percent.

Commodity prices. As of September 10, indexes of materials prices, such as those of the *Journal of Commerce* and the Commodity Research Bureau, were down 1-1/2 percent to 3 percent from their levels at the time of the August Greenbook. Since then, the prices of gold and silver have moved up, on net, but the prices of other metals, agricultural raw materials, and forest products generally have fallen steeply. As of September 25, the *Journal of Commerce* industrial index was down 3-1/2 percent from its pre-attack level and off about 5 percent since the week of the last Greenbook. The Commodity Research Bureau indexes, both spot and futures, also have declined sharply.

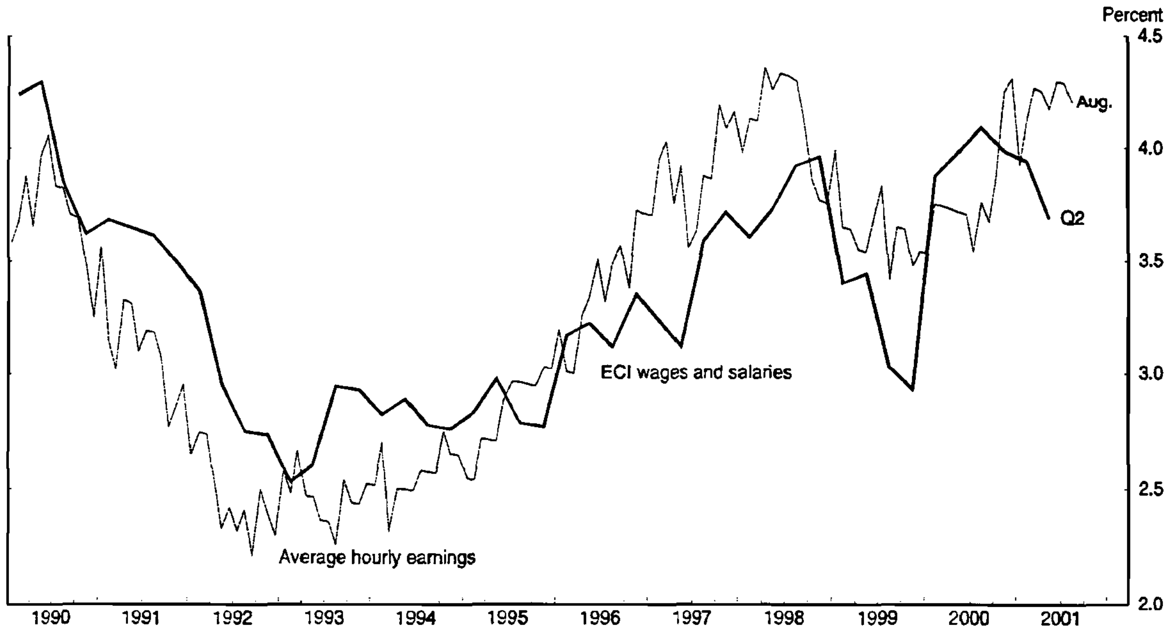
Expected inflation. Survey measures of inflation expectations have turned down in recent months. The median response to the University of Michigan survey of one-year-ahead inflation expectations stood at 2.6 percent in September, almost 1/2 percentage point lower than the average for the fourth quarter of 2000. The median expectation over five to ten years was 2.9 percent in the early-September reading, down 0.1 percentage point from the August level and at the low end of the narrow range reported for the year to date.

Labor costs. In August, average hourly earnings of production or nonsupervisory workers rose 0.3 percent, following a 0.2 percent rise in July. Over the past twelve months, average hourly earnings increased 4.2 percent, a pickup of 0.4 percentage point from the preceding twelve months and a reading that is toward the upper end of the range seen since the mid-1990s. However, most of the past year's step-up was already in place by the end of 2000. The twelve-month change has since held fairly steady at around 4-1/4 percent.

AVERAGE HOURLY EARNINGS
(Percent change; based on seasonally adjusted data)

	12-month percent change			Percent change to Aug 2001 from month indicated		Percent change	
	Aug. 1999	Aug. 2000	Aug. 2001	Feb. 2001	May 2001	July 2001	Aug. 2001
	- - - - - - - - Annual rate- - - -				- - - - -	-Monthly rate-	
Total private nonfarm	3.4	3.8	4.2	3.9	4.0	0.2	0.3
Manufacturing	3.5	3.1	3.5	4.3	4.4	0.4	0.5
Construction	3.2	4.2	2.4	0.7	3.1	-0.2	0.6
Transportation and public utilities	2.5	3.4	3.7	2.9	2.9	-0.2	0.1
Finance, insurance, and real estate	3.5	3.2	5.5	5.3	5.7	0.3	0.3
Retail trade	3.8	4.1	3.7	3.3	2.5	0.1	0.1
Wholesale trade	3.3	4.1	3.3	1.9	1.3	-0.3	-0.4
Services	3.8	4.0	5.1	4.8	5.3	0.4	0.5

Average Hourly Earnings for Production or Nonsupervisory Workers
(12-month change)



Some large increases in health insurance costs have been announced for 2002. Premiums for the Federal Employees Health Benefits (FEHB) Program—the largest employer-sponsored program in the nation—will go up an estimated 13.3 percent, on average, next year, following an increase of 10.5 percent in 2001. The California Public Employees' Retirement System (CalPERS) has announced increases in premiums for 2002 that are expected to average about 9-1/2 percent, as well as substantially higher copayments on drugs and office visits for HMO members.

Domestic Financial Developments

Selected Financial Market Quotations

(One-day quotes in percent except as noted)

Instrument	2000 June 26	2001 Aug. 20	2001 Sept. 10	2001 Sept. 26	Change to Sept. 26 from selected dates (percentage points) 2000 June 26	2001 Aug. 20	2001 Sept. 10
Short-term							
FOMC intended federal funds rate	6.50	3.50	3.50	3.00	-3.50	-.50	-.50
Treasury bills [1]							
3-month	5.66	3.34	3.19	2.33	-3.33	-1.01	-.86
6-month	5.94	3.30	3.13	2.28	-3.66	-1.02	-.85
Commercial paper							
1-month	6.56	3.50	3.42	2.66	-3.90	-.84	-.76
3-month	6.56	3.37	3.24	2.49	-4.07	-.88	-.75
Large negotiable CDs [1]							
1-month	6.64	3.55	3.46	2.64	-4.00	-.91	-.82
3-month	6.73	3.45	3.26	2.52	-4.21	-.93	-.74
6-month	6.89	3.46	3.24	2.48	-4.41	-.98	-.76
Eurodollar deposits [2]							
1-month	6.63	3.49	3.41	2.60	-4.03	-.89	-.81
3-month	6.69	3.42	3.26	2.51	-4.18	-.91	-.75
Bank prime rate	9.50	6.75	6.50	6.00	-3.50	-.75	-.50
Intermediate- and long-term							
U.S. Treasury [3]							
2-year	6.54	3.81	3.59	2.89	-3.65	-.92	-.70
10-year	6.35	5.21	5.14	4.98	-1.37	-.23	-.16
30-year	6.22	5.59	5.55	5.58	-.64	-.01	.03
U.S. Treasury 10-year indexed note	4.08	3.33	3.26	3.17	-.91	-.16	-.09
Municipal revenue (Bond Buyer) [4]	5.99	5.31	5.25	5.37	-.62	.06	.12
Private instruments							
10-year swap	7.38	5.77	5.62	5.37	-2.01	-.40	-.25
10-year FNMA	7.15	5.72	5.64	5.38	-1.77	-.34	-.26
10-year AA [5]	7.60	6.35	6.30	6.36	-1.24	.01	.06
10-year BBB [5]	8.49	7.14	7.08	7.19	-1.30	.05	.11
High yield [6]	11.97	12.51	12.86	14.13	2.16	1.62	1.27
Home mortgages (FHLMC survey rate) [7]							
30-year fixed	8.14	6.92	6.89	6.80	-1.34	-.12	-.09
1-year adjustable	7.22	5.71	5.64	5.58	-1.64	-.13	-.06

Stock exchange index	Record high Level	Record high Date	2001 Aug. 20	2001 Sept. 10	2001 Sept. 26	Change to Sept. 26 from selected dates (percent) Record high	2001 Aug. 20	2001 Sept. 10
Dow-Jones Industrial	11,723	1-14-00	10,320	9,606	8,567	-26.92	-16.98	-10.81
S&P 500 Composite	1,527	3-24-00	1,171	1,093	1,007	-34.07	-14.03	-7.83
Nasdaq (OTC)	5,049	3-10-00	1,881	1,695	1,464	-71.00	-22.18	-13.65
Russell 2000	606	3-9-00	479	441	390	-35.69	-18.60	-11.56
Wilshire 5000	14,752	3-24-00	10,838	10,104	9,247	-37.32	-14.68	-8.49

1. Secondary market.
2. Bid rates for Eurodollar deposits collected around 9:30 a.m. Eastern time.
3. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
4. Most recent Thursday quote.
5. Derived from smoothed corporate yield curves estimated using Merrill Lynch bond data.
6. Merrill Lynch 175 high-yield bond index composite.
7. For week ending Friday previous to date shown.

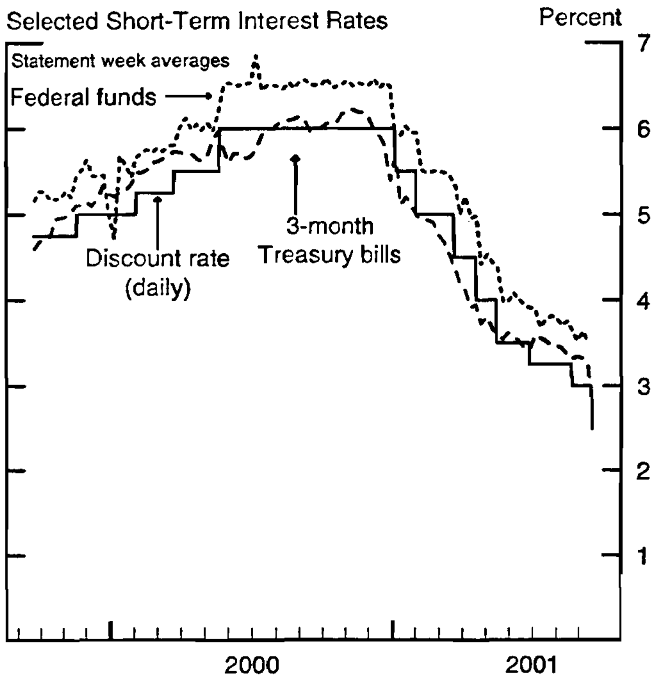
NOTES:

June 26, 2000 is the day before the FOMC meeting that ended the most recent period of policy tightening.
August 20, 2001 is the day before the most recent FOMC meeting.
September 10, 2001 is the day before the terrorist attacks.

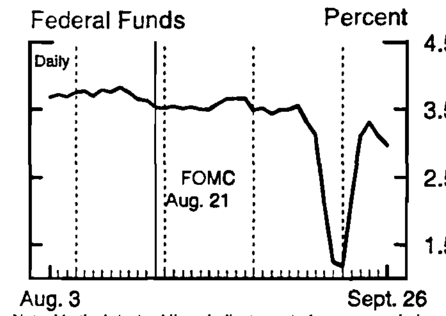
BA:DAM

Selected Interest Rates

Selected Short-Term Interest Rates

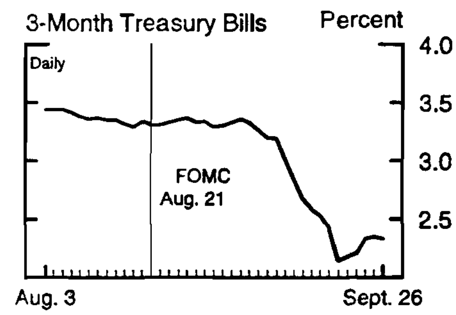


Federal Funds

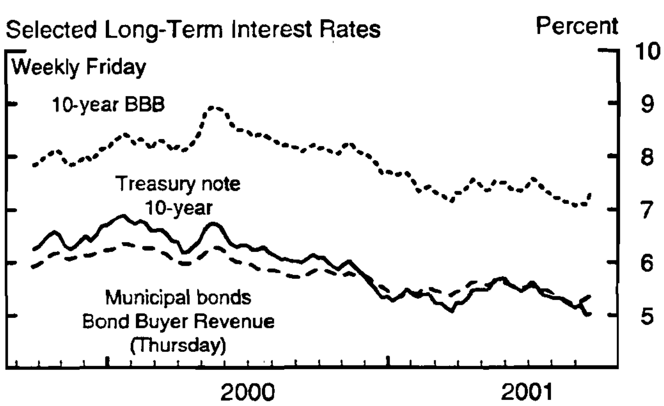


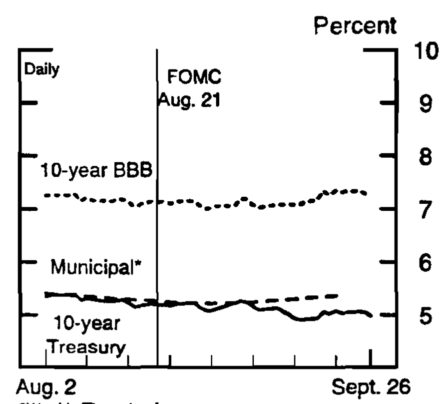
Note. Vertical dashed lines indicate end of reserve period.

3-Month Treasury Bills



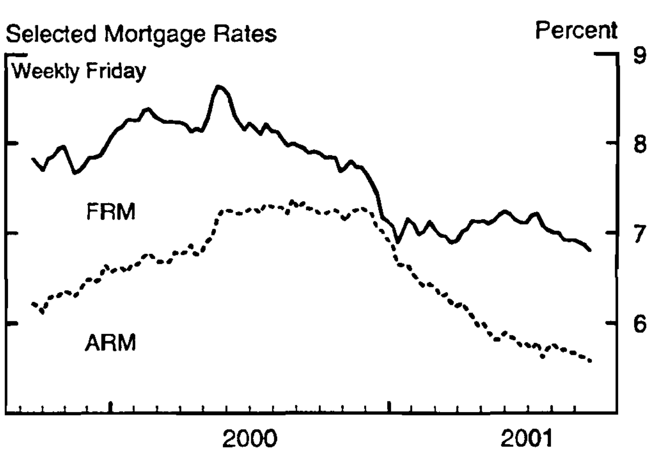
Selected Long-Term Interest Rates

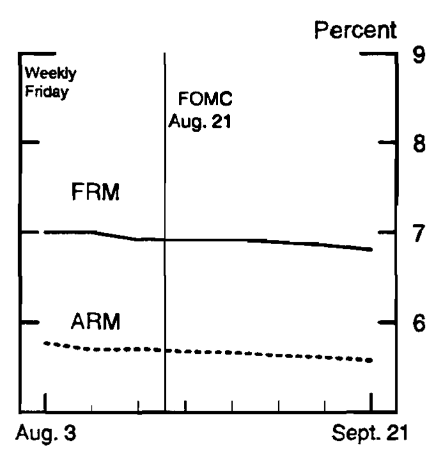




*Weekly Thursday frequency.

Selected Mortgage Rates





Domestic Financial Developments

Overview

The damage to New York's financial district on September 11 significantly disrupted the operation of financial markets, causing most to close temporarily. The Federal Reserve responded by providing massive liquidity to the banking sector immediately after the attacks and by cutting the federal funds rate target by 50 basis points on September 17. While activity and liquidity in most markets recovered in subsequent days, the attacks have fueled fears of recession, reducing investors' willingness to hold risky securities and bolstering expectations that the Federal Reserve would ease policy further.

In the days following the attacks, investors shifted down their expectation of the federal funds rate path and began a widespread repricing of risk. Short-term Treasury yields fell dramatically on the anticipation of additional rate cuts and flight-to-safety demands, stock prices tumbled, credit spreads soared, and implied volatilities spiked. This negative reevaluation of the economic outlook followed on the heels of the already weaker economic news that had been weighing on markets before the attacks.

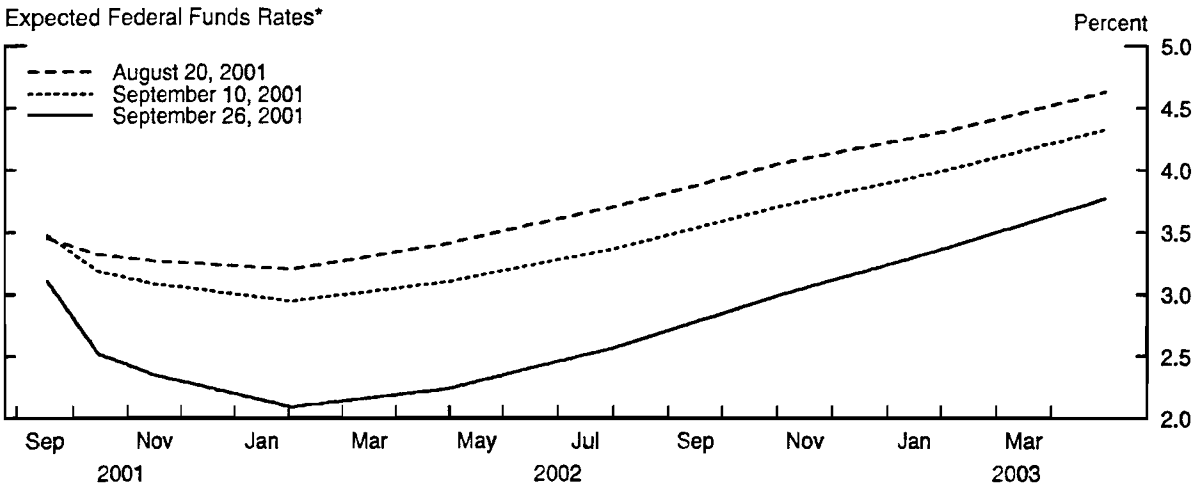
Available data for the third quarter suggests that debt growth by both businesses and consumers had slowed noticeably from the first-half pace, even prior to September 11. The market interruption appears to have accelerated a reduction in borrowing by firms and to have induced some temporary substitution to bank credit from the commercial paper and bond markets. The federal government, on the other hand, has returned to the credit markets as a net issuer of debt in recent months and is now expected to pay down debt more slowly in the months ahead.

Policy Expectations, Interest Rates, and Stock Prices

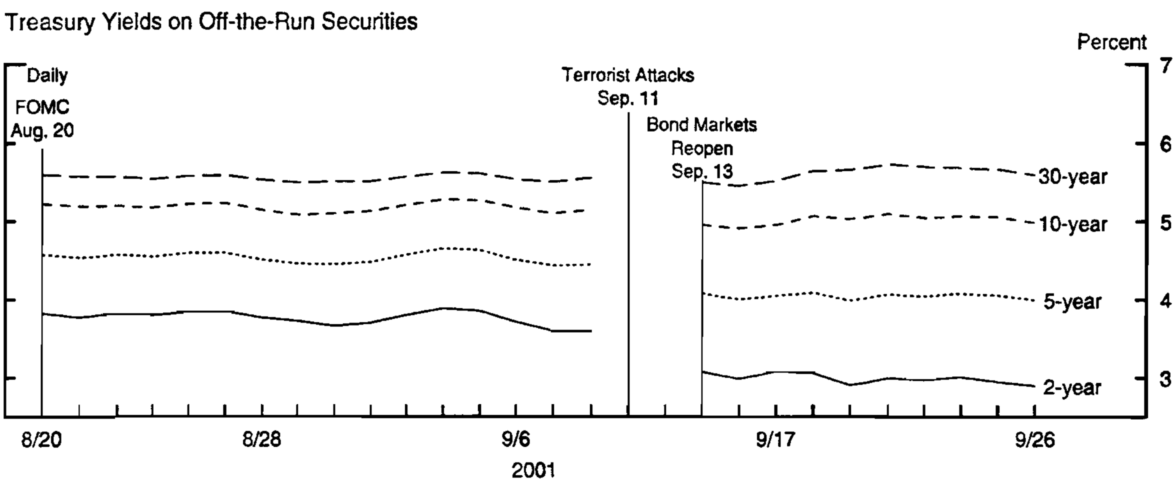
Investors had largely anticipated the FOMC's decision on August 21 to lower the federal funds rate 25 basis points, and the announcement had relatively little effect on financial markets. Before September 11, expectations of additional monetary easing had on balance increased, especially after the weaker-than-expected August employment report released on September 7. The terrorist attacks led to additional declines in federal funds and Eurodollar futures rates, and money market participants were only modestly surprised by the 50 basis point easing prior to the reopening of equity markets on September 17. Judging from current futures prices and market surveys, market participants see high odds of an additional 50 basis points of easing at the October FOMC meeting.

The Treasury market suffered from settlement delays, loss of critical infrastructure, and thin trading upon reopening after the attacks. Activity has since improved, though trading in off-the-run securities has continued to lag. Over the intermeeting period, the slope of the Treasury yield curve steepened dramatically. Yields on two-year Treasury notes declined about 90 basis points,

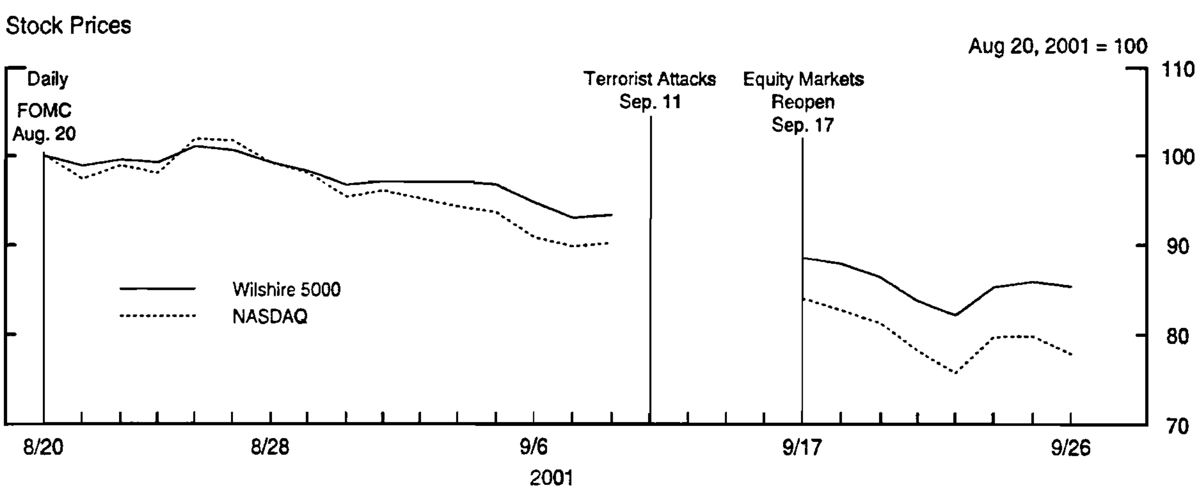
Interest Rates and Stock Prices



*Estimates from federal funds and eurodollar futures with an allowance for term premia and other adjustments.

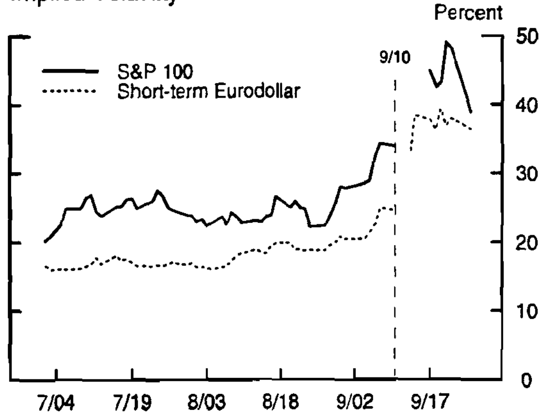


Note: Secondary Market. Two-year through thirty-year rates based on yield curves estimated using off-the-run securities.

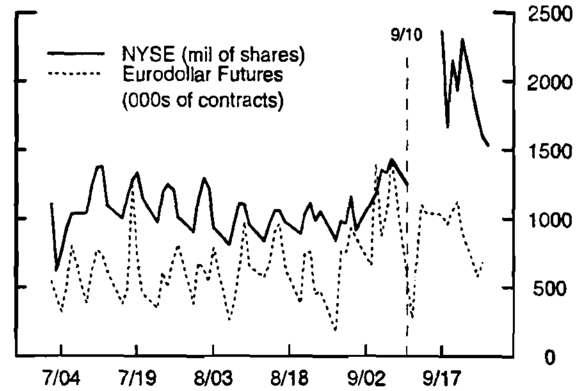


Recent Financial Market Activity

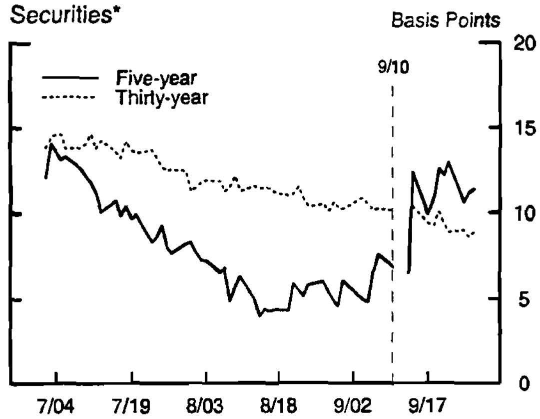
Implied Volatility



Trading Volume

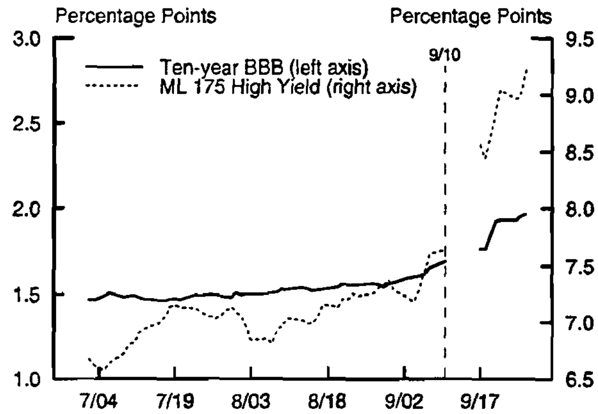


On-the-Run Premia for Benchmark Treasury Securities*

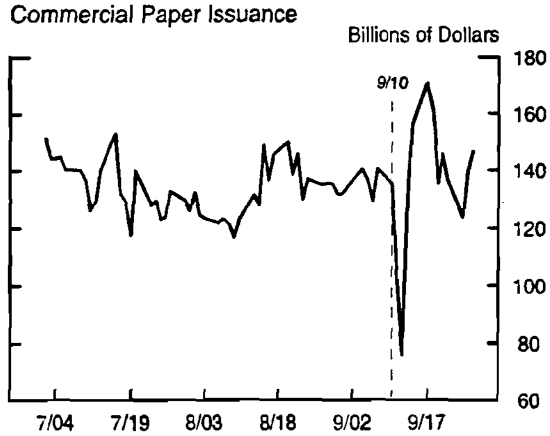


*On-the-run vs. non-benchmark synthetic

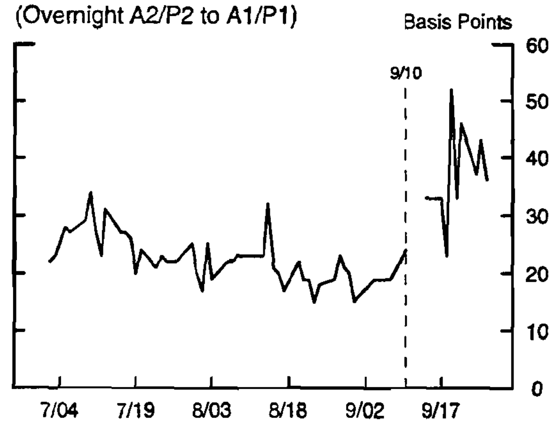
Corporate Risk Spreads to Ten-year AAA



Commercial Paper Issuance

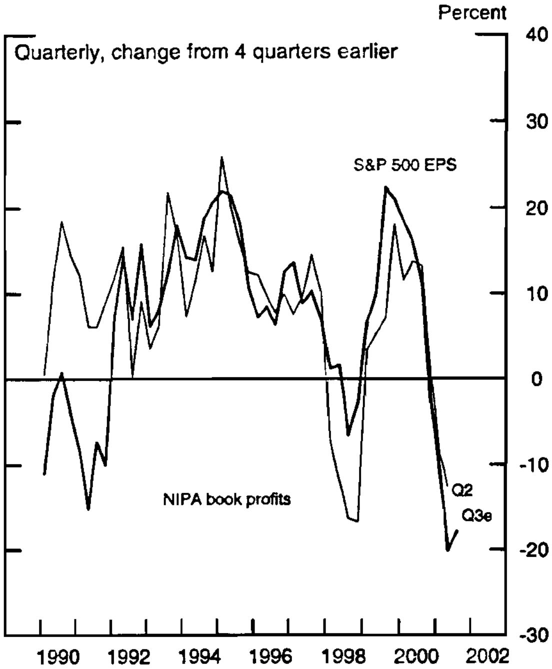


Commercial Paper Rate Spreads
(Overnight A2/P2 to A1/P1)



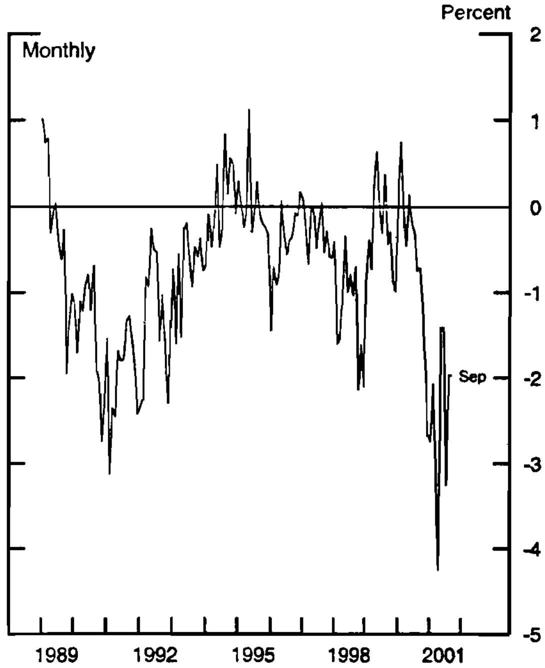
Earnings and Stock Valuations

After-Tax Corporate Earnings

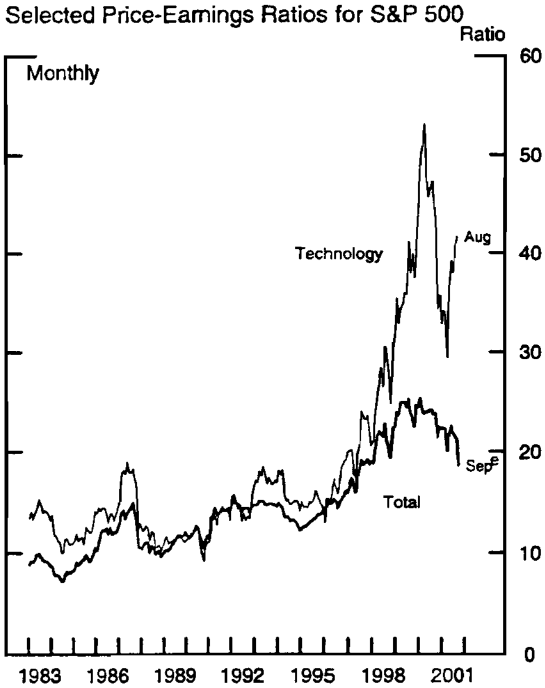


e Staff estimate.

Revisions to S&P 500 Year-ahead Earnings

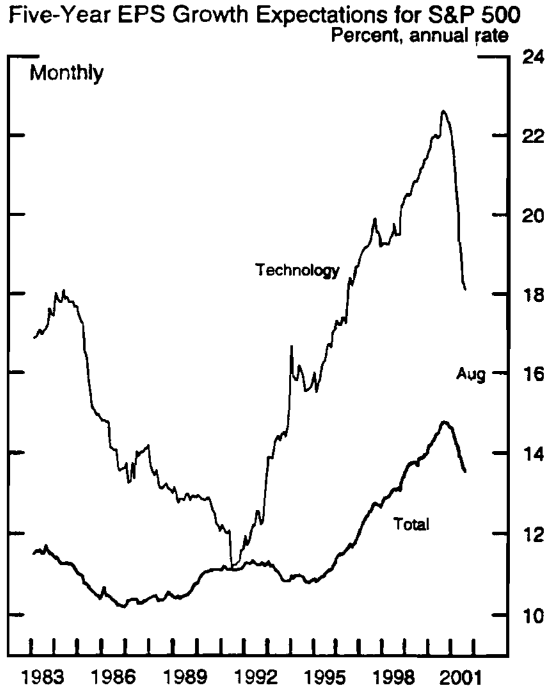


Selected Price-Earnings Ratios for S&P 500



Note. Using expected earnings for 12 months ahead.
Source. I/B/E/S.

Five-Year EPS Growth Expectations for S&P 500



Note. Earnings-weighted average of I/B/E/S consensus firm-level 5-year growth forecasts.

reflecting the revision in near-term policy expectations and safe-haven demands. At the same time, the yield on the ten-year note was down only about 23 basis points and the long-bond yield was little changed reflecting concerns that dwindling tax revenues and increased spending would boost the Treasury's borrowing requirements.

After being closed for the rest of the week following the terrorist attacks, equity markets reopened with a sell-off of 5 percent that day for the market as a whole. Declines were widespread, but airline and hotel stocks were hit hardest, losing almost 30 percent each. Market operations were reportedly normal, though trading volume on the NYSE hit a record high. Since the reopening, stock prices have sagged a bit further on net, leaving broad equity price indexes—which had already fallen between 7 percent and 10 percent on the weak economic news before the attacks—down 14 percent to 22 percent since the August FOMC meeting. Households, in the aftermath of the attacks, accelerated their ongoing shift out of equity mutual funds and into money market and bond funds.

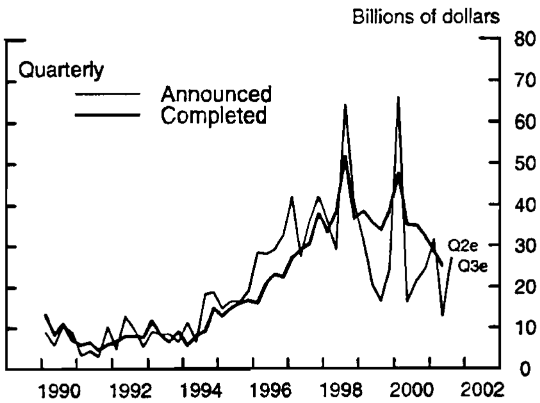
Equity analysts are in the process of reassessing the implications for corporate profits of the worsening outlook for near-term economic growth. Published estimates, which still imply a rebound in third-quarter earnings from the second-quarter level, have yet to be updated, even for airlines and hotels. Substantial downward revisions are likely after companies provide further guidance regarding the third quarter.

Trading in corporate bonds virtually ceased while the stock exchanges were closed but has since recovered slowly, with greatly reduced liquidity in the high-yield segment. When trading resumed, credit spreads opened up as investors shied away from holding risky securities. Spreads on ten-year BBB- and AA-rated bonds over AAA-rated bonds widened about 20 basis points over the intermeeting period. High-yield spreads, which had widened considerably before the attacks as equity values dropped, ballooned after September 11; these spreads now exceed 800 basis points, an increase of nearly 150 basis points from the August FOMC meeting. In contrast, spreads of agency debt and interest-rate swaps over Treasuries have narrowed a bit since the August FOMC meeting, reflecting the prospects for more supply of Treasury debt.

Credit spreads on commercial paper, even for top-tier issuers, also jumped immediately following the attacks, as risks of payment delays increased significantly. Both the repayment of maturing paper and the issuance of new paper were hindered in the two days following the attacks, and bank lines reportedly were drawn in volume by those seeking new funds. However, by the end of the week of the attacks, issuance volumes had returned to normal levels, suggesting no lingering liquidity squeeze, although credit spreads remain elevated.

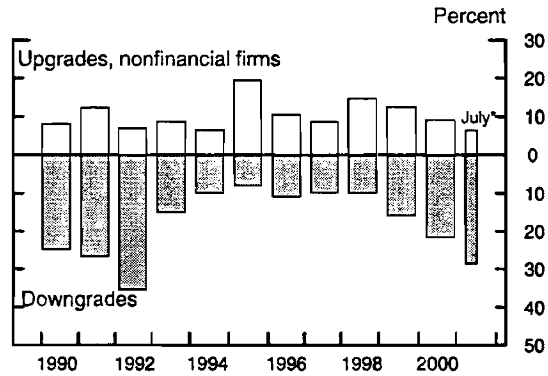
Corporate Finance Conditions

Share Repurchases



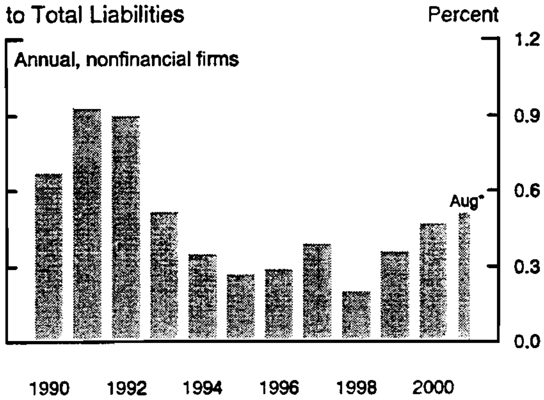
Source. Compustat & Securities Data Company.

Rating Changes



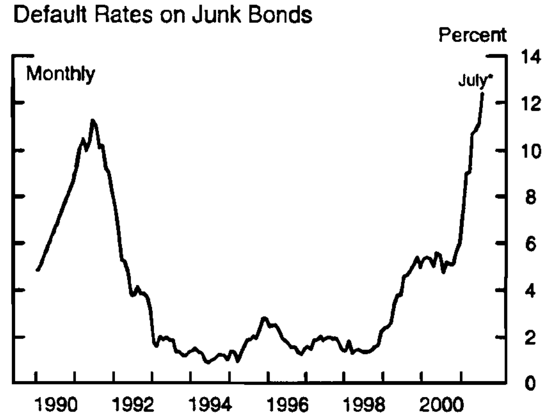
Note. Total debt upgrades (downgrades) as a percentage of par value of bonds outstanding.
*Year-to-date at an annual rate.
Source. Moody's.

Liabilities of Failed Businesses
to Total Liabilities



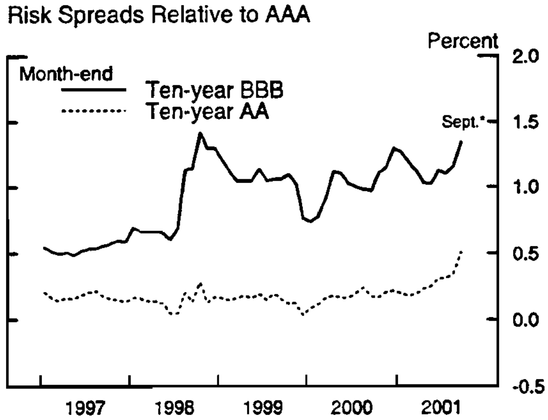
* 12-month trailing rate
Source. Dun & Bradstreet.

Default Rates on Junk Bonds



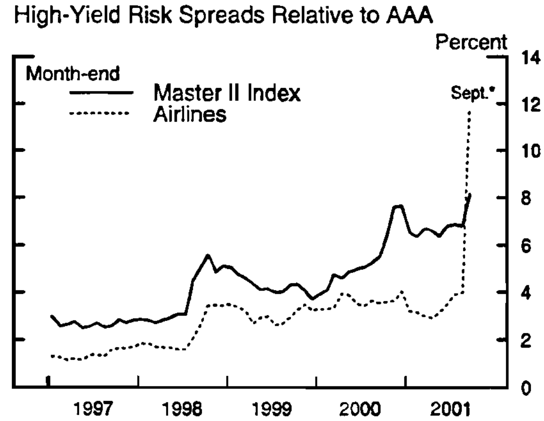
*12-month trailing rate.
Source. Moody's.

Risk Spreads Relative to AAA



Source. Merrill Lynch.
*As of September 26.

High-Yield Risk Spreads Relative to AAA



Source. Merrill Lynch.
*As of September 26.

Business Finance

The market disruption and associated pullback from risk-taking has reduced the volume of corporate financing. Both bond and equity issues were postponed, and new issuance volumes remain below pre-attack levels. Nonfinancial corporations have not completed any IPOs since late August, and raised less than $400 million through seasoned offerings. Bond issuance in September, which was on pace to match the robust August level before the attacks, will now fall short of that level, although issuance of investment-grade bonds has resumed. High-yield issuance, which had already tailed off in mid-August, has yet to start up again as heightened credit-quality concerns take their toll. Business loans made by banks jumped after the attacks, but, in part, appear to reflect a temporary substitution from other debt, in particular commercial paper. On net, growth in commercial paper and C&I loans in September is expected to be slightly negative, similar to the pace in August, leaving net corporate borrowing very low relative to the first half of the year.

Announcements of share repurchases had stalled in July and August as firms' profits fell, but the SEC's temporary easing of share repurchase restrictions, in an effort to buoy equity prices after the market shutdown, appears to have spurred a spate of opportunistic buying. Since the SEC's announcement, about 100 firms have announced new repurchase programs totaling about $20 billion; still, total announcements for the third quarter are well below recent peaks. While timely reporting of actual share repurchases does not exist, anecdotal reports from dealers indicate elevated buyback activity in the first few days after the market reopened. Domestic cash mergers in the third quarter have not evaporated with the profits malaise, especially those involving energy firms or the restructuring of distressed firms, but activity has been curtailed since the attacks. On balance, equity retirements in the third quarter are likely to match the moderate first-half pace.

Corporate credit quality continued to deteriorate over the intermeeting period. Prior to the attacks, both GM and Ford had all of their debt—a total of $290 billion—put on watch for a downgrade to A3 by Moody's and to A- by S&P's. The economic fallout from the attacks makes these downgrades nearly certain, and Daimler/Chrysler (already A3/A- rated) has since also been put on watch for a downgrade. Pre-attack readings on business failures, junk-bond defaults, and net downgrades all indicate a continued elevated level of distress, and these measures can be expected to weaken further in the wake of the disaster. Nearly all of the major domestic airlines have been downgraded following the terrorist attacks, and firms in other sectors directly affected—including airline manufacturers, hotel and lodging operators, and some insurance companies—have been put on watch for downgrades.

More broadly, the widespread decline in equity values suggests significantly higher expected default probabilities as more persistent cash flow weakness puts

Gross Issuance of Securities by U.S. Corporations

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

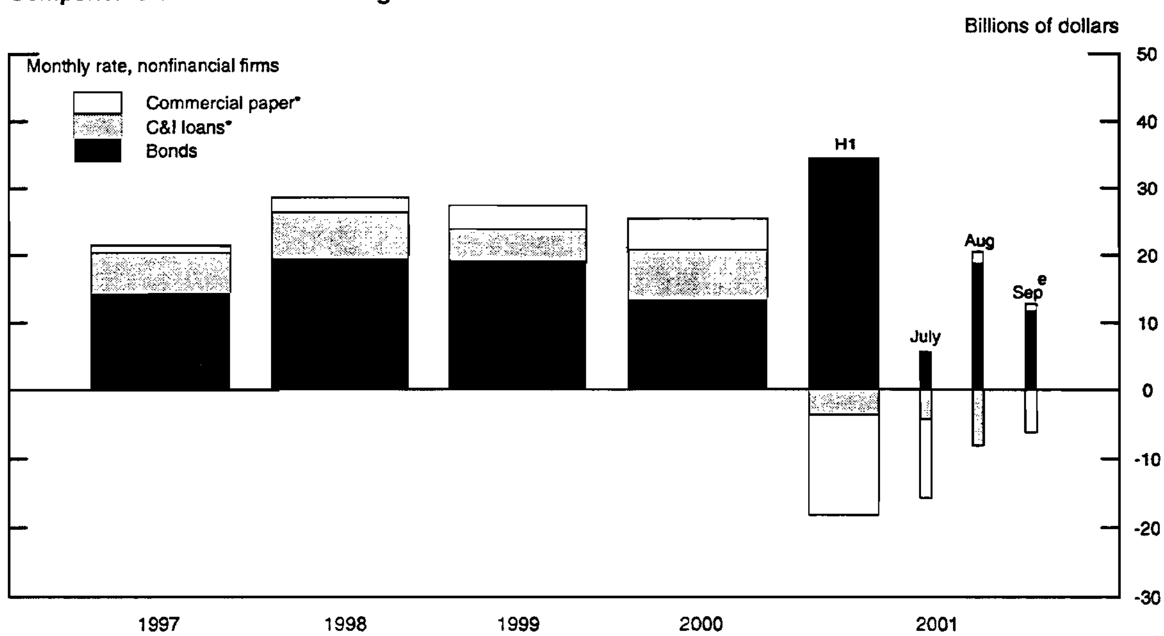
Type of security	1998	1999	2000 H1	2000 H2	2001 H1	2001 July	Aug.	Sept. e
All U.S. corporations	94.0	89.4	80.0	77.0	123.6	91.5	92.5	n.a.
Stocks [1]	10.6	11.0	14.1	8.4	10.5	8.1	7.8	n.a.
Bonds	83.5	78.4	65.9	68.6	113.1	83.4	84.7	n.a.
Nonfinancial corporations								
Stocks [1]	6.2	9.2	12.4	7.3	7.5	4.2	5.4	.3
Initial public offerings	2.2	4.2	5.7	3.1	3.2	2.5	.4	.0
Seasoned offerings	4.0	5.0	6.7	4.2	4.2	1.7	5.0	.3
Bonds [2]	25.6	24.5	21.3	19.1	43.2	18.9	28.8	18.4
Investment grade [3]	14.1	13.9	11.5	12.4	28.9	14.2	21.7	17.2
Speculative grade [3]	10.2	7.5	5.4	3.7	11.9	4.0	6.1	.7
Other (sold abroad/unrated)	1.3	3.1	4.4	3.1	2.4	.7	1.0	.5
Financial corporations								
Stocks [1]	4.4	1.8	1.6	1.1	3.0	3.9	2.4	.1
Bonds	57.8	53.9	44.7	49.5	69.9	64.5	55.9	n.a.
Memo								
Net issuance of commercial paper, nonfinancial corporations [4]	2.3	3.6	6.4	2.7	-14.5	-11.4	1.7	-6.2
Change in C&I loans at commercial banks [4]	7.0	4.7	10.4	4.7	-3.7	-4.3	-8.1	1.0

Note. Components may not sum to totals because of rounding. These data include speculative-grade bonds issued privately under Rule 144A. All other private placements are excluded. Total reflects gross proceeds rather than par value of original discount bonds.

1. Excludes equity issues associated with equity-for-equity swaps that have occurred in restructurings.
2. Excludes mortgage-backed and asset-backed bonds.
3. Bonds sold in U.S. categorized according to Moody's bond ratings, or to Standard Poor's if unrated by Moody's.
4. End-of-period basis, seasonally adjusted.

e Staff estimate.

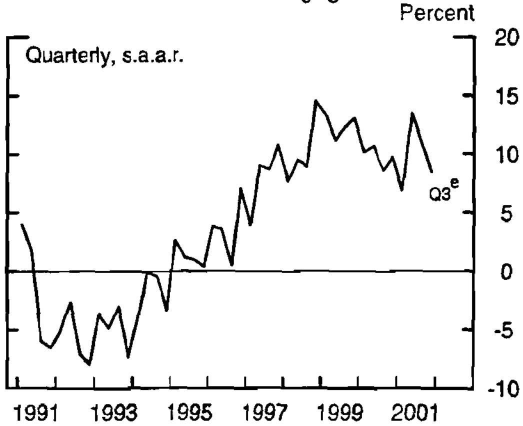
Components of Net Debt Financing



* Seasonally adjusted.
e Staff estimate

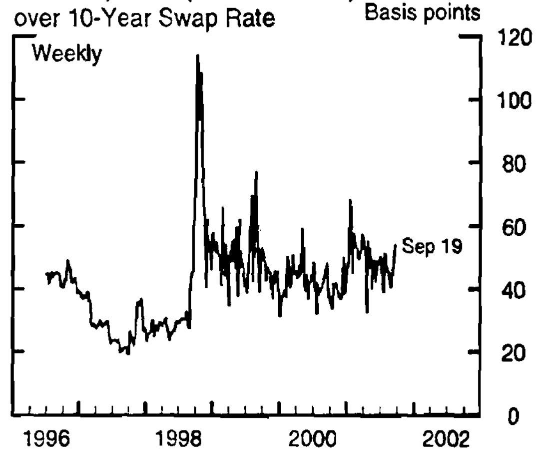
Commercial Real Estate

Growth of Commercial Mortgage Debt



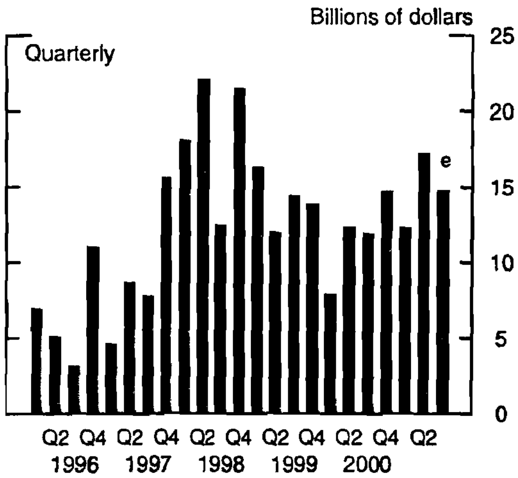
e. Staff estimate.

CMBS Spreads (AAA Tranches) over 10-Year Swap Rate



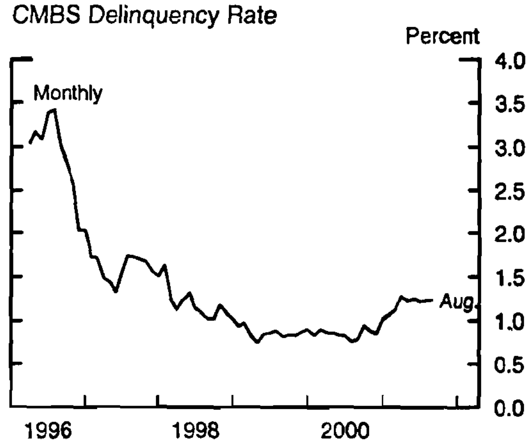
Source. Morgan Stanley.

Total CMBS Gross Issuance



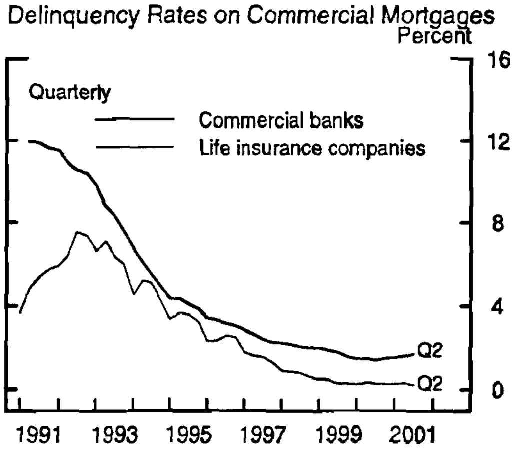
e. Staff estimate.
Source. Commercial Mortgage Alert.

CMBS Delinquency Rate



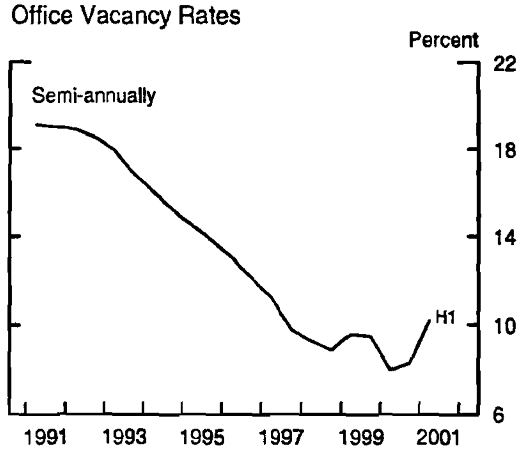
Source. Morgan Stanley.

Delinquency Rates on Commercial Mortgages



Source. ACLI, Call Report.

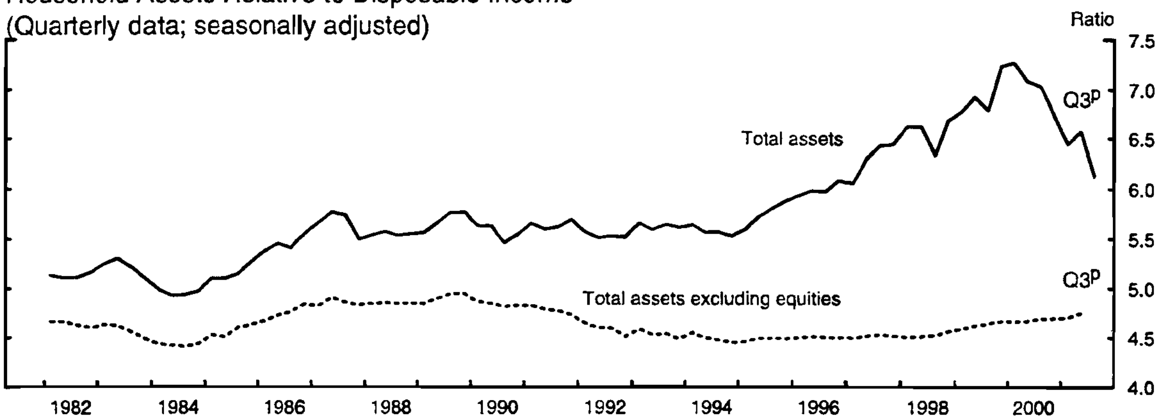
Office Vacancy Rates



Source. Torto Wheaton Research.

Household Assets

Household Assets Relative to Disposable Income
(Quarterly data; seasonally adjusted)



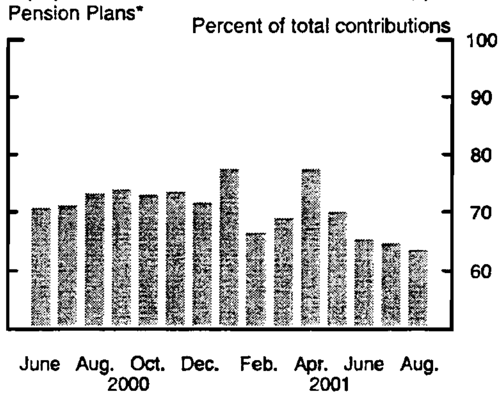
p. Staff projection.

Net Flows into Long-Term Mutual Funds
(Excluding reinvested dividends; billions of dollars, monthly rates.)

	1999	2000	2001 H1	2001 July	2001 Aug. e	2001 Sep. p	Assets Jul.
Total long-term funds	**14.2**	**18.4**	**15.2**	**9.4**	**11.2**	**-8.1**	**4,825**
Equity funds	**15.7**	**25.1**	**8.3**	**-1.2**	**-6.6**	**-35.9**	**3,590**
Domestic	14.8	21.2	9.2	2.4	-1.7	-25.5	3,128
Capital appreciation	13.5	25.5	5.3	-0.6	-3.8	n.a.	1,891
Total return	1.4	-4.3	3.9	3.0	2.1	n.a.	1,237
International	0.9	3.9	-0.8	-3.6	-4.9	-10.4	461
Hybrid funds	**-1.0**	**-2.6**	**1.0**	**1.3**	**0.9**	**2.0**	**352**
Bond funds	**-0.5**	**-4.0**	**5.9**	**9.3**	**16.9**	**25.8**	**883**
International	-0.2	-0.2	0.0	-0.1	-0.0	n.a.	20
High-yield	-0.2	-1.0	0.9	0.6	0.6	n.a.	96
Other taxable	1.0	-1.6	4.2	6.5	13.0	n.a.	474
Municipals	-1.0	-1.2	0.8	2.3	3.2	n.a.	292

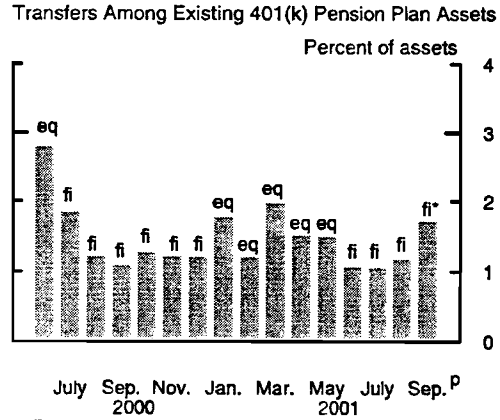
e. Staff estimates based on confidential ICI weekly data.
p. Preliminary estimate, through Sep. 25.
Source. Investment Company Institute (ICI).

Equity Allocation of New Contributions to 401(k) Pension Plans*



* Includes equity mutual funds and company stock.
Source. Hewitt Associates.

Transfers Among Existing 401(k) Pension Plan Assets



p. Preliminary, through Sep.25
* Indicates predominant direction of transfers,
eq = toward equity, fi = toward fixed income investments.
Source. Hewitt Associates.

debt payments at risk. Credit spreads on junk-rated bonds in nearly every industry group have jumped, with those on airline bonds exploding almost 800 basis points. Credit spreads for domestic insurance companies increased by less than might have been feared, as these companies appear to have ample capital and diversification to absorb the expected losses. European re-insurance companies are likely to be the focus of credit-quality concerns, and two major firms have already been downgraded.

Growth of commercial mortgage debt appears to have remained solid in the third quarter, though down somewhat from the surprisingly strong 13 percent rate of increase in the second quarter. Trading in commercial-mortgage-backed securities (CMBS) was sparse after the terrorist attacks, with spreads to swaps reportedly widening 8 basis points on AAA tranches and 20 basis points on BBB tranches.[1] Many CMBS deals that were in the pipeline and expected to be issued by the end of September now have been postponed.

Household Finance

Household assets relative to disposable income are estimated to have fallen sharply in the third quarter as the plunge in equity prices overwhelmed the estimated increase in the value of homes. With the latest decline, the ratio of household assets to disposable income has now retraced about 60 percent of its run-up over the second half of the 1990s but still remains above its long-run historical average.

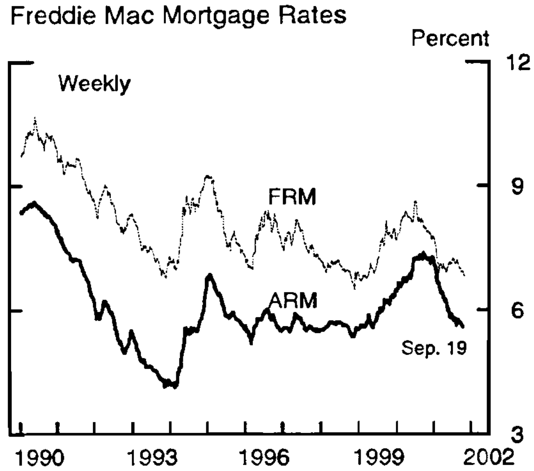
Even before the terrorist attacks, households had been shifting investments from equity to fixed income. This trend accelerated when equity markets reopened, with an estimated $4 billion pulled out of domestic equity funds on Monday September 17, followed by an additional $15 billion over the rest of the week as stock prices tumbled. Outflows for the week amounted to about one-half of 1 percent of total fund assets, and for the month are on pace to match the outflows seen in August 1990, but only about one-third the level of outflows in October 1987. Daily data on transfer activity in 401(k) pension plans show the same pattern, with ten times the normal transfer activity on Monday followed by additional spikes later in the week. This weekly transfer activity is the largest since the data began in 1997, and twice as large as the most active week during the market crisis in the fall of 1998. Daily data for the most recent week show that the pace of reallocation slowed dramatically as equity prices stabilized.

Mortgage rates edged down since the most recent FOMC meeting, with the thirty-year fixed-rate mortgage now at 6.8 percent, the lowest level since early 1999. Refinancing activity remains elevated, and growth in residential

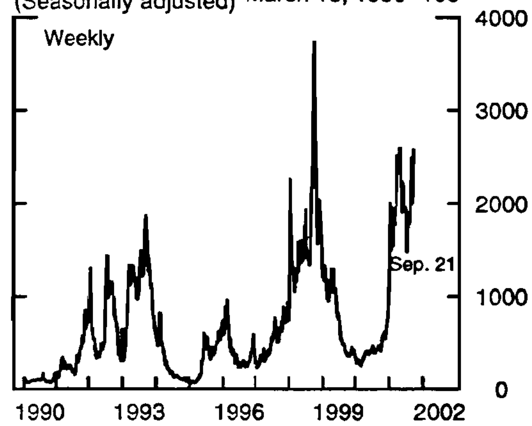
1. The destruction of the World Trade Center is not expected to cause any defaults for the CMBS backed by the WTC's rental income, because issuers are well insured.

Household Liabilities

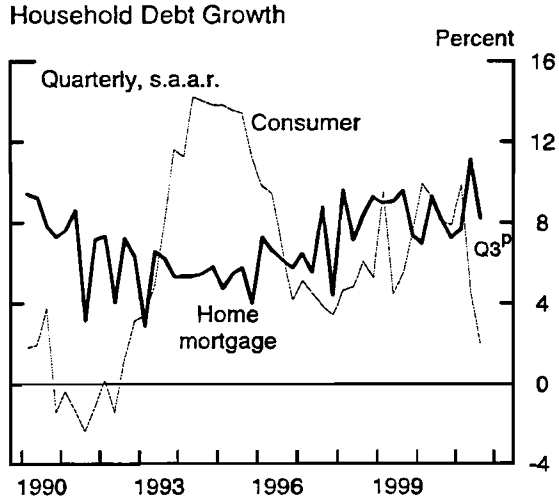
Freddie Mac Mortgage Rates



MBA Refinancing Index
(Seasonally adjusted)

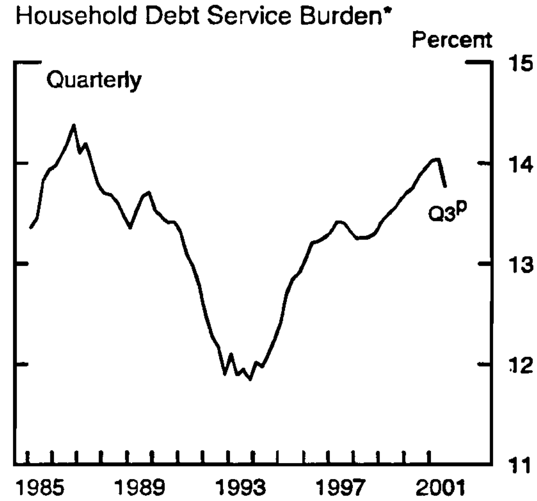


Household Debt Growth



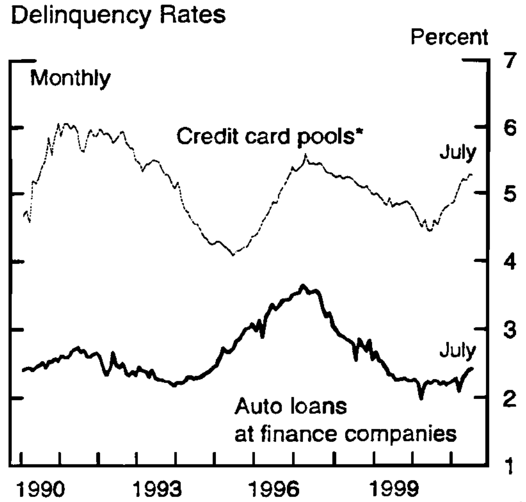
p. Staff projection.

Household Debt Service Burden*



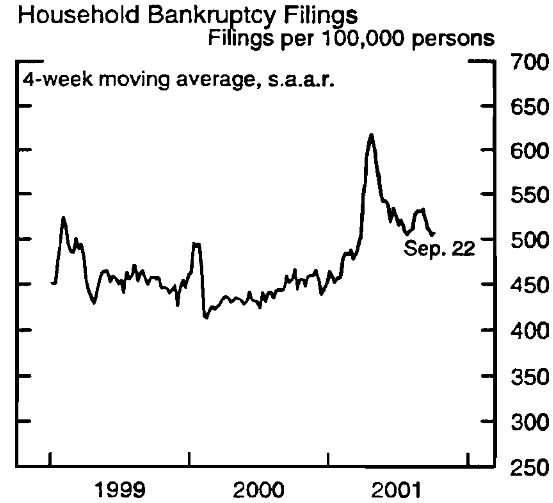
*Required debt payments relative to disposable personal income.

Delinquency Rates



* Securitized receivables (Moody's, seasonally adjusted).

Household Bankruptcy Filings



mortgage debt in the third quarter is estimated to have been strong—around 8 percent at an annual rate—after an extremely rapid 12 percent pace in the second quarter. Interest rates on consumer debt have moved little since the last FOMC meeting, except for home-equity credit lines, which have fallen 26 basis points. Consumer credit growth is estimated to have fallen to 2.0 percent in the third quarter, apparently on a slowdown in consumer spending.

The latest data point to little change in household credit quality. Personal bankruptcy filings in September have remained at a relatively high level. The July delinquency rate on auto loans edged up, while the delinquency rate on credit card pools edged down. Owing to less growth in residential mortgage debt and the temporary effect of the tax rebates on disposable income, the household debt service burden is estimated to have dropped below 14 percent in the third quarter.

Treasury Finance

The disruptions to financial markets had some spillover to Treasury financing. Most notably, in the week of the attacks, the Treasury canceled its $10 billion four-week bill auction scheduled for September 11 and raised funds by drawing down nearly all of its compensating balances with commercial banks, about $12.6 billion in total. On Thursday of that same week, the $26 billion in three- and six-month bills auctioned on September 10 settled, providing the Treasury with adequate funds.

During the following week, by which time most infrastructure problems had been resolved, the Treasury's regular issuance of bills met with strong demand, driving stop-out rates to their lowest levels since 1961. The Treasury's cash needs eased with the arrival of estimated quarterly personal income tax payments, although individuals and firms affected by the disruption may defer tax payments until January. The Treasury canceled debt buybacks scheduled for September 20 and 27, but announced that buyback operations will resume next month. Looking forward, the $40 billion of emergency funds approved by the Congress, as well as the potential for other forthcoming "emergency" spending, has boosted expectations for the Treasury's borrowing needs.

Agency Finance

Debt issuance by Fannie Mae and Freddie Mac was derailed only briefly by the attacks. Reportedly, both were able to issue overnight discount notes as early as the day after the attacks to cope with their immediate financing needs. Later that week, Freddie Mac was able to issue longer-term Reference notes, which elicited strong demand, and soon after, both agencies resumed their regularly scheduled debt-issuance programs without problems.

Treasury and Agency Finance

Treasury Financing
(Billions of dollars)

Item	2000	2001				
	Q4	Q1	Q2	Jul.	Aug.	Sep. (e)
Total surplus, deficit (−)	**-2.3**	**-22.5**	**193.7**	**2.8**	**-80.0**	**n.a.**
Means of financing deficit						
Net borrowing	-25.1	23.7	-157.4	-7.5	74.1	.1
Nonmarketable	1.5	6.0	6.2	-3.6	-1.5	-2.2
Marketable	-26.6	17.6	-163.6	-3.5	75.6	2.3
Bills	30.4	65.0	-92.1	33.0	79.5	2.3
Coupons[1]	-48.2	-39.4	62.3	-32.3	-.3	0
Debt buybacks	-8.7	-8.0	-9.2	-4.2	-3.5	0
Decrease in cash balance	31.6	-7.2	-15.4	20.6	16.8	-39.6
Other[2]	-4.2	6.0	-20.9	-15.9	-10.9	n.a.
MEMO						
Cash balance, end of period	21.1	28.3	43.7	23.1	6.3	46.0

NOTE. Components may not sum to totals because of rounding.
1. Does not include Treasury debt buybacks.
2. Direct loan financing, accrued items, checks issued less checks paid, and other transactions.
e. Estimated.
n.a. Not available.

Net Borrowing of Government-Sponsored Enterprises
(Billions of dollars)

Agency	2000	2001				
	Q4	Q1	Q2	Jul.	Aug.	Sep. (e)
FHLBs	13.8	8.4	-7.7	6.3	-2.4	n.a.
Freddie Mac	20.0	34.4	35.4	12.2	n.a.	n.a.
Fannie Mae	35.7	23.9	35.7	4.5	11.2	n.a.
Farm Credit Banks	3.1	0	2.2	0	0	n.a.
Sallie Mae	3.0	1.9	.4	n.a.	n.a.	n.a.
MEMO						
Outstanding noncallable Reference and Benchmark Securities						
Notes and Bonds	313.1	351.2	384.1	393.3	404.2	411.5
Bills	235.0	270.0	278.0	292.0	298.5	288.5
Total	548.1	621.2	662.1	685.3	702.7	700.0

NOTE. Excludes mortgage pass-through securities issued by Fannie Mae and Freddie Mac.
n.a. Not available

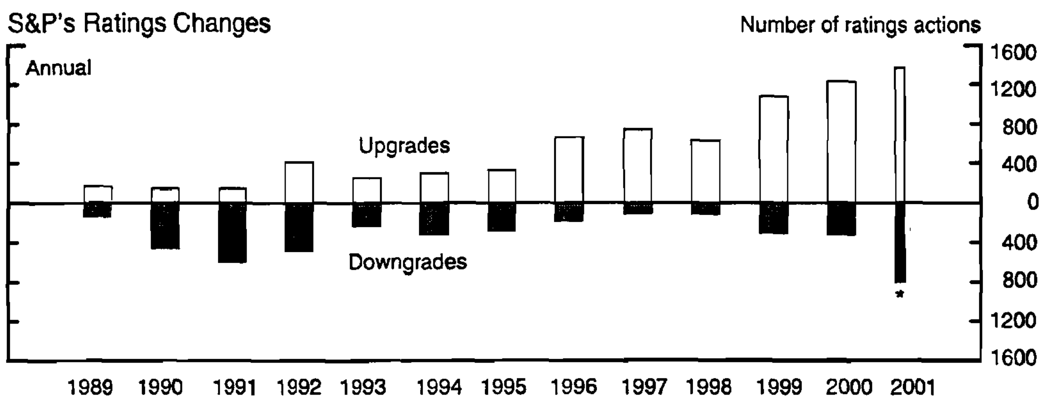
State and Local Government Finance

Gross Offerings of Municipal Securities
(Billions of dollars; monthly rates, not seasonally adjusted)

	1999	2000	2001 Q1	2001 Q2	2001 July	2001 Aug.	2001 Sept.[e]
Long-term[1]	18.0	15.0	18.5	24.2	19.2	21.2	14.5
Refundings[2]	4.5	2.2	6.0	6.7	4.2	7.6	4.0
New capital	13.5	12.9	12.5	17.4	15.0	13.5	10.5
Short-term	2.7	2.8	2.6	4.7	2.4	7.0	8.0
Total tax-exempt	20.6	17.9	21.2	28.9	21.6	28.1	22.5
Total taxable	1.1	0.7	1.0	1.4	1.0	0.3	0.1

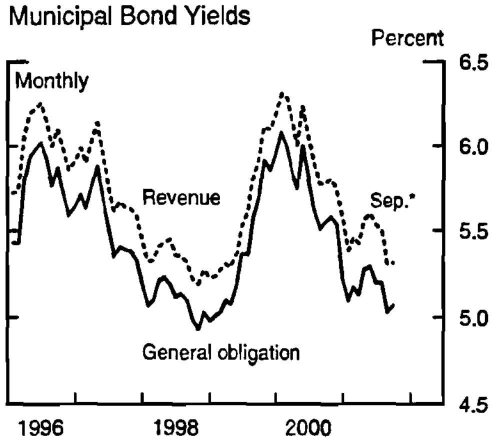
1. Includes issues for public and private purposes.
2. All issues that include any refunding bonds.
e. Staff estimate based on data through Sep. 24.

S&P's Ratings Changes



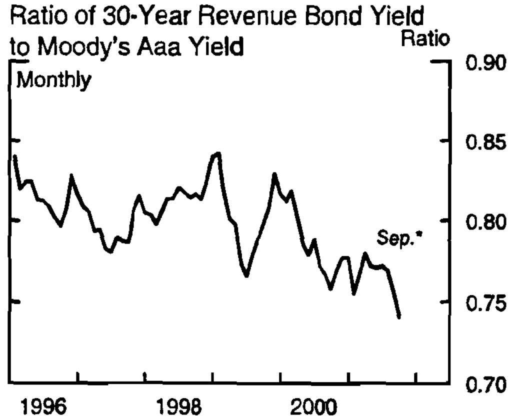
Source. S&P's Credit Week Municipal.
* Data through Sep. 19 at an annual rate.

Municipal Bond Yields



Note. Average of weekly data.
* Data through Sep. 21.

Ratio of 30-Year Revenue Bond Yield to Moody's Aaa Yield



Note. Average of weekly data.
* Data through Sep. 21

Monetary Aggregates

(Based on seasonally adjusted data)

Aggregate or component	2000	2001 Q2	2001 Q3 (p)	2001 Jul.	2001 Aug.	2001 Sep. (p)	Level (bil. $) Sep. 01 (p)
	Percent change (annual rate)[1]						
Aggregate							
1. M2[2]	6.2	10.4	9.7	8.8	7.4	19.6	5371.1
2. M3	9.3	15.0	8.5	6.4	-1.0	19.6	7796.7
Selected components							
3. Currency	4.2	6.0	11.7	12.3	18.9	11.3	567.7
4. Liquid deposits[3]	3.2	17.2	18.7	14.7	18.6	34.3	2780.3
5. Small time deposits	9.5	-4.1	-9.7	-13.5	-10.7	-10.0	1004.6
6. Retail money market funds	12.2	11.2	5.3	14.1	-10.5	14.8	1009.9
7. M3 minus M2[4]	17.1	25.2	6.0	1.1	-19.1	19.7	2425.6
8. Large time deposits, net[5]	13.6	0.7	-4.5	-7.6	-21.5	-3.0	800.1
9. Institution-only money market mutual funds	24.0	54.9	21.6	8.1	-20.9	58.1	1045.9
10. RPs	11.7	21.0	-9.1	-12.4	-12.2	-35.0	359.5
11. Eurodollars	17.9	7.7	2.0	25.2	-14.8	20.5	220.2
Memo							
12. M1	-1.7	5.4	12.2	13.6	7.9	40.2	1181.3
13. Sweep-adjusted M1[6]	1.6	6.5	11.0	12.0	8.8	30.6	1617.7
14. Demand deposits	-10.9	-4.2	17.1	10.5	6.5	124.4	347.0
15. Other checkable deposits	-0.8	16.5	6.8	18.2	-13.4	2.3	258.0
16. Savings deposits	6.7	20.9	20.5	14.9	24.5	24.8	2175.3
17. Monetary base	1.4	5.4	14.8	11.6	15.2	48.4	640.2
	Average monthly change (billions of dollars)[7]						
Selected managed liabilities at commercial banks							
18. Large time deposits, gross	8.7	1.3	-3.9	-6.5	-14.8	1.6	944.8
19. Net due to related foreign institutions	1.3	-10.2	-5.3	6.4	2.9	-43.8	149.9
20. U.S. government deposits at commercial banks	-1.4	-2.4	3.8	2.3	44.1	-53.0	6.1

1. For the years shown, Q4 to Q4 precent change. For the quarters shown, based on quarterly averages.
2. Sum of M1, retail money market funds, saving deposits, and small time deposits.
3. Sum of demand deposits, other checkable deposits, and saving deposits.
4. Sum of large time deposits, institutional money funds, RP liabilities of depository institutions, and Eurodollars held by U.S. addressees.
5. Net of holdings of depository institutions, money market mutual funds, U.S. government and foreign banks and official institutions.
6. Sweep figures used to adjust these series are the estimated national total of transaction account balances initially swept into MMDAs owing to the introduction of new sweep programs on the basis of monthly averages of daily data.
7. 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.

p--Preliminary

State and Local Government Finance

Credit quality of the state and local sector appears not to have been significantly impaired by the terrorist attacks. Bonds of the Port Authority of New York and New Jersey have been put on watch for a downgrade, as concerns have surfaced about the effect of the attack on the authority's airport revenues. Other airport authority bonds around the country have already begun to be downgraded, but these bonds tend to be small. For the rest of the municipal sector, upgrades continue to outnumber downgrades, although the pace of downgrades has picked up.

Issuance of long-term tax-exempt securities slowed in September, following a strong August, as refunding activity waned and the terrorist attacks disrupted the market. The $12 billion issue expected from California to finance expenditures related to its power crisis has been tied up in the approval process, and California instead issued nearly $6 billion in short-term debt to bridge the gap.

Money and Bank Credit

M2 grew at a 7-1/2 percent annual rate in August, continuing its deceleration from the blistering pace of the first half of the year. But even before the terrorist attacks, partial data for September suggested a return to double-digit growth. Liquid deposits, which grew briskly in August, were on track for rapid growth in September, owing to the decline in opportunity cost as rates fell. Payment system disruptions after the attacks have further inflated M2 growth in September by temporarily boosting both the demand and savings deposits components of liquid deposits. This bulge accounts for nearly half of the estimated M2 growth for September and is expected to run off in coming weeks. Retail money market funds, whose weakness helped damp M2 growth in August, snapped back in September, partly owing to the decline in equity values.

Institutional money market fund flows, which had been slowing since June, accelerated notably in early September and then surged following the intermeeting easing as investors jumped into money funds to take advantage of their slower adjustment to lower market rates.

Bank credit in August was about flat, as another month of strong growth in adjusted securities offset continued declines in loans. Business loans contracted in August, but at a slower pace than in previous months. While loan weakness likely owes mostly to continued soft demand, it may also reflect tightened supply conditions; in this regard, the August Survey of Terms of Business Lending indicated that spreads on loans not made under commitment remain elevated. The most recent data show that delinquencies on loans, especially business loans, jumped higher in the second quarter, and the staff estimates that C&I delinquencies continued to rise in the current quarter.

Commercial Bank Credit

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

Type of credit	2000	Q2 2001	Q3p 2001	July 2001	Aug. 2001	Sept.p 2001	Level, Sept. 2001p ($ billions)
Total							
1. Adjusted[1]	**9.3**	**3.1**	**2.3**	**3.1**	**-.7**	**16.9**	**5,252**
2. Reported	9.8	3.6	2.4	-.5	2.5	19.3	5,410
Securities							
3. Adjusted[1]	1.9	3.8	13.2	20.9	17.5	7.4	1,281
4. Reported	4.2	6.0	12.5	5.1	28.3	17.4	1,439
5. Treasury & Agency	-2.4	-4.4	9.2	11.6	17.7	14.1	792
6. Other[2]	15.9	20.0	16.7	-2.9	41.6	21.5	647
Loans[3]							
7. Total	11.9	2.8	-1.1	-2.4	-6.5	19.9	3,971
8. Business	9.0	-5.3	-10.5	-12.2	-8.2	3.1	1,061
9. Real estate	14.0	6.7	3.1	4.2	-3.3	9.4	1,718
10. Home equity	26.2	13.4	13.6	13.7	11.9	23.5	146
11. Other	13.0	6.1	2.2	3.4	-4.7	8.1	1,572
12. Consumer	9.8	7.4	-2.0	-1.5	-7.4	2.4	548
13. Adjusted[4]	6.9	8.2	.6	1.1	-3.2	-.1	873
14. Other[5]	13.3	2.8	4.5	-4.8	-11.9	95.8	645

Note. All data are adjusted 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. These data have been benchmarked to the December 1999 Call Report.

1. Adjusted to remove effects of mark-to-market accounting rules (FIN 39 and FIN 115).
2. Includes securities of corporations, state and local governments, and foreign governments and any trading account assets that are not Treasury or Agency securities.
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.

p Preliminary.

Growth of bank credit in September is estimated to have surged to a double-digit rate, as transactions disruptions caused bank balance sheets to balloon for a period following the attacks. With payment flows temporarily halted, a substantial volume of overdrafts was created, lending to a spike in "other" loans. Business loans were also boosted, apparently reflecting demands from businesses that were unable to issue commercial paper and bonds. Although most of the jump in C&I loans was reversed in the following week, on a month average basis, business loan growth likely will be positive for September.

Contacts with several large banks by staff suggest that changes in the overall business climate since the terrorist attacks have not yet affected standards for C&I loans, but could if economic conditions continue to worsen. The banks reported that borrowers in the most affected sectors were receiving heightened scrutiny, and some of the banks reported that they had tightened terms. There was also concern that loan demand continues to dissipate, although some banks reported that weaker credits may be utilizing their existing credit lines.

International Developments

International Developments

U.S. International Transactions

Trade in Goods and Services

The U.S. trade deficit in goods and services was $28.8 billion in July, little changed from the $29.1 billion deficit (revised) recorded in June. However, the level of both exports and imports dropped sharply. From December of last year to July, exports of goods and services fell 6 percent and imports fell 8 percent, reflecting the weak state of world-wide economic activity this year.

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

	2000	Annual rate 2000 Q4	Annual rate 2001 Q1	Annual rate 2001 Q2	Monthly rate 2001 May	Monthly rate 2001 June	Monthly rate 2001 July
Real NIPA[1]							
Net exports of G&S	-399.1	-421.1	-404.5	-410.5	...	...	...
Nominal BOP							
Net exports of G&S	-375.7	-401.2	-380.1	-355.2	-28.2	-29.1	-28.8
Goods, net	-452.2	-474.1	-450.1	-430.6	-34.4	-35.6	-35.4
Services, net	76.5	72.9	70.0	75.4	6.2	6.5	6.6

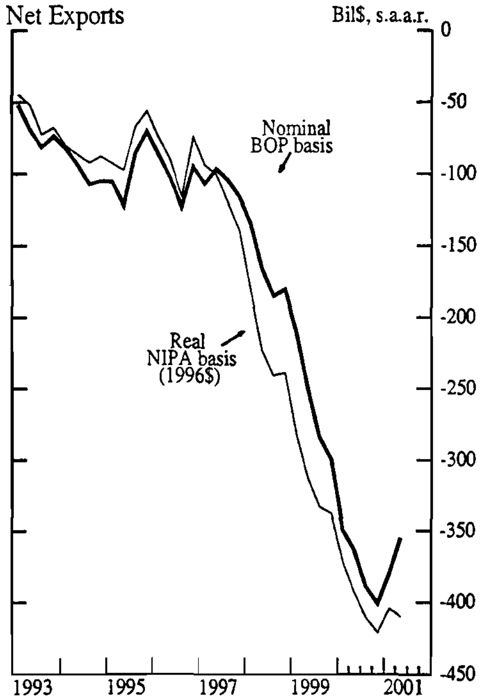
1. Billions of chained (1996) dollars.
Source: U.S. Department of Commerce, Bureaus of Economic Analysis and Census.
n.a. Not available. ... Not applicable.

The value of exports was 2.5 percent lower in July than in June with the decline spread among most trade categories, particularly machinery (high tech and other), industrial supplies, and automotive products. A 12 percent annual rate drop in exports in the second quarter marked the third consecutive quarter of decline. Exports of semiconductors and other machinery accounted for most of the decline. The value of exported industrial supplies also fell sharply. The increase in exported automotive products in the second quarter was partly reversed by the decline recorded in July.

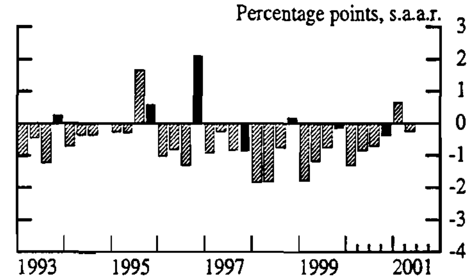
The value of imports fell 2.1 percent in July with large declines in the value of oil (both price and quantity), semiconductors, other machinery, automotive products, and consumer goods. The 15 percent annual rate fall in imports in the second quarter was the second consecutive quarter of decline. As in the case of exports, the bulk of the import decline occurred in computers, semiconductors, and other machinery. Imported industrial supplies and consumer goods both fell sharply in the second quarter as well. The rise in imported automotive products in the second quarter was largely reversed in July.

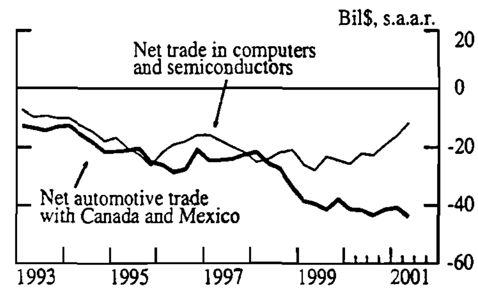
U.S. International Trade in Goods and Services

Net Exports

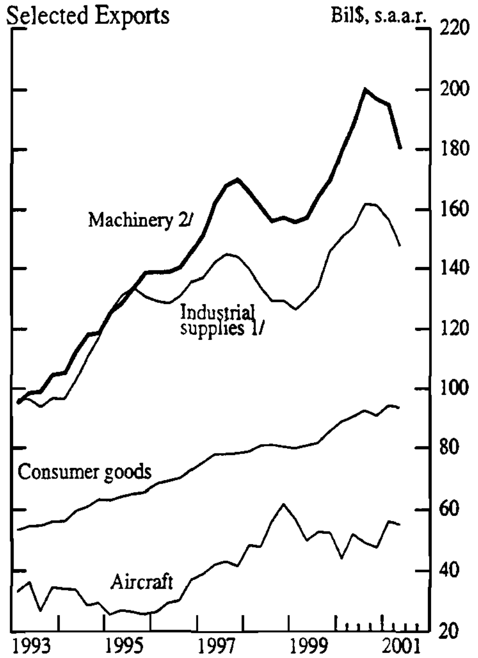


Contribution of Net Exports to Real GDP Growth



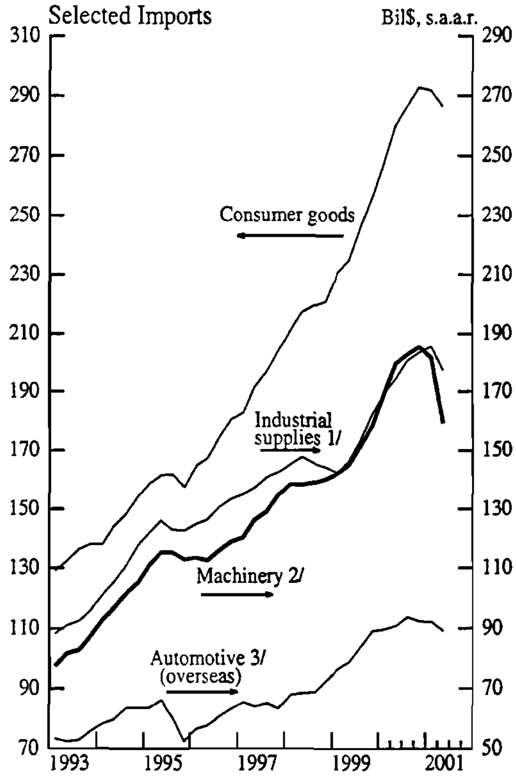


Selected Exports



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

Selected Imports



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

U.S. Exports and Imports of Goods and Services
(Billions of dollars, s.a.a.r., BOP basis)

	Levels				Amount Change[1]			
	2001		2001		2001		2001	
	Q1	Q2	June	July	Q1	Q2	June	July
Exports of G&S	**1076.4**	**1042.1**	**1030.8**	**1004.7**	**-4.2**	**-34.2**	**-20.1**	**-26.1**
Goods exports	779.8	743.5	730.2	705.6	-5.2	-36.3	-24.0	-24.5
Gold	6.7	7.6	7.1	3.0	0.2	0.9	-0.9	-4.1
Other goods	773.1	735.9	723.1	702.6	-5.4	-37.2	-23.1	-20.5
Aircraft & parts	56.1	55.1	54.6	54.1	8.6	-0.9	-3.5	-0.5
Computers	56.0	48.6	48.0	46.3	-1.2	-7.4	0.3	-1.7
Semiconductors	58.0	46.5	41.6	41.6	-4.2	-11.5	-7.5	-0.1
Other capital gds	197.3	182.7	180.1	174.8	-1.7	-14.6	-4.2	-5.3
Automotive	71.8	76.3	79.6	74.7	-5.5	4.5	3.5	-4.9
to Canada	37.5	42.2	44.1	40.1	-4.5	4.7	2.7	-4.0
to Mexico	16.2	15.9	16.7	12.8	-0.9	-0.3	0.3	-3.8
to ROW	18.0	18.2	18.8	21.8	-0.0	0.2	0.4	3.0
Agricultural	54.4	53.9	53.6	53.9	1.2	-0.6	0.4	0.3
Ind supplies (ex. ag)	156.7	147.6	144.0	140.1	-4.6	-9.1	-4.9	-3.9
Consumer goods	94.0	93.6	88.3	89.2	3.3	-0.5	-9.2	0.9
All other goods	28.9	31.7	33.3	27.9	-1.3	2.8	-2.2	-5.3
Services exports	296.6	298.7	300.6	299.1	1.0	2.1	3.9	-1.5
Imports of G&S	**1456.5**	**1397.3**	**1379.6**	**1350.7**	**-25.2**	**-59.1**	**-9.8**	**-28.9**
Goods imports	1229.9	1174.1	1156.8	1130.7	-29.2	-55.8	-10.7	-26.1
Petroleum	117.2	114.3	111.9	103.0	-9.9	-3.0	-4.0	-8.9
Gold	6.1	6.5	6.1	1.9	-0.6	0.4	-1.7	-4.2
Other goods	1106.5	1053.3	1038.9	1025.7	-18.7	-53.2	-5.0	-13.1
Aircraft & parts	31.0	31.1	31.9	34.1	0.4	0.0	1.1	2.3
Computers	85.7	75.9	72.7	72.1	-3.9	-9.8	-2.7	-0.6
Semiconductors	44.3	30.8	30.2	24.7	-4.7	-13.5	1.3	-5.5
Other capital gds	184.6	162.1	157.9	152.7	-3.5	-22.6	-2.5	-5.2
Automotive	186.9	191.3	192.7	187.9	-6.1	4.3	4.8	-4.8
from Canada	56.1	61.0	62.6	59.6	-4.3	5.0	2.7	-3.0
from Mexico	38.7	41.1	42.8	38.1	-1.7	2.5	0.9	-4.6
from ROW	92.2	89.1	87.3	90.1	-0.1	-3.1	1.2	2.8
Ind supplies	185.4	177.3	171.7	172.8	2.2	-8.2	-6.3	1.1
Consumer goods	291.7	286.3	283.9	281.1	-0.9	-5.4	0.3	-2.8
Foods, feeds, bev.	45.9	45.7	47.3	48.8	-0.5	-0.1	2.3	1.5
All other goods	50.9	52.9	50.6	51.6	-1.8	2.0	-3.2	0.9
Services imports	226.6	223.2	222.8	220.0	3.9	-3.4	0.9	-2.8
Memo:								
Oil quantity (mb/d)	12.80	12.92	12.56	12.15	0.75	0.12	-0.34	-0.41
Oil import price ($/bbl)	25.08	24.22	24.39	23.22	-3.81	-0.86	-0.22	-1.17

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

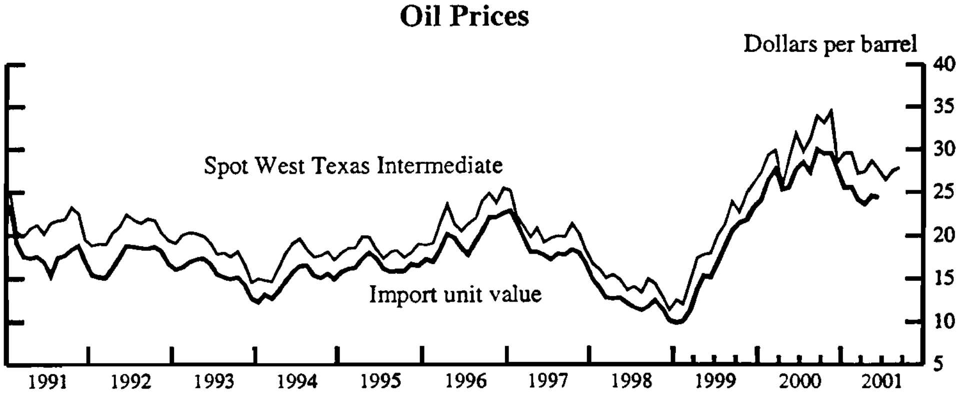
Prices of U.S. Imports and Exports

(Percentage change from previous period)

	Annual rates 2001			Monthly rates 2001		
	Q1	Q2	Q3^{e}	June	July	Aug.
	------------- BLS prices (1995 weights)-------------					
Merchandise imports	-5.3	-6.9	-6.9	-0.4	-1.5	-0.1
Oil	-44.8	-10.9	-13.9	-1.0	-5.3	1.7
Non-oil	2.4	-6.4	-5.9	-0.3	-1.0	-0.4
Core goods*	3.1	-6.1	-5.9	-0.3	-1.0	-0.4
Computers	-4.3	-12.6	-10.6	-0.4	-2.2	-0.4
Semiconductors	-3.7	-6.2	-0.4	-0.6	0.5	0.0
Cap. goods ex comp & semi	-0.3	-0.6	-0.8	0.0	-0.2	0.0
Automotive products	-0.1	-1.0	-0.8	0.0	-0.2	0.1
Consumer goods	0.6	-1.2	-1.0	-0.2	-0.1	0.0
Foods, feeds, beverages	0.1	-8.8	-8.3	-1.2	-1.3	0.1
Industrial supplies ex oil	12.4	-18.1	-19.8	-0.9	-3.7	-1.7
Merchandise exports	-0.3	-2.1	-2.8	-0.3	-0.3	-0.2
Core goods*	-0.1	-1.7	-2.1	-0.3	-0.2	-0.2
Computers	-2.4	-4.7	-7.3	-0.6	-0.5	-1.3
Semiconductors	-2.9	-7.1	-7.2	-0.9	-1.3	0.3
Cap. goods ex comp & semi	2.4	1.3	0.1	0.0	0.0	0.0
Automotive products	0.5	0.5	0.0	0.0	0.0	0.0
Consumer goods	-0.7	-1.0	0.3	0.0	0.1	0.0
Agricultural products	2.9	-2.9	6.1	0.1	0.8	1.2
Industrial supples ex ag	-4.1	-6.3	-11.4	-0.7	-1.8	-0.9
Chain price index	---Prices in the NIPA accounts (1996 weights)---					
Imports of goods & services	-3.0	-5.9	n.a.	...	...	...
Non-oil merchandise	1.4	-5.7	n.a.	...	...	...
Core goods*	2.2	-5.0	n.a.	...	...	...
Exports of goods & services	-0.1	-0.8	n.a.	...	...	...
Total merchandise	-0.4	-1.5	n.a.	...	...	...
Core goods*	-0.0	-0.9	n.a.	...	...	...

*/ Excludes computers and semiconductors.
e/ Average of two months.
n.a. Not available. ... Not applicable.

Oil Prices



Prices of Internationally Traded Goods

Oil. The BLS price of imported oil rose a bit in August following a sharp drop in July. For July-August combined, the price of imported oil fell 14 percent at an annual rate, about the same rate of decline as in the second quarter and much less than in the first quarter. Factors that placed downward pressures on oil prices included the resumption of Iraqi oil exports, increased levels of oil inventories, and signs of weak global demand. In response to these pressures, OPEC agreed in late July to cut production targets 1 million barrels per day beginning in September. Immediately following the terrorist attacks in the United States on September 11, oil prices surged higher, but have since fallen well below pre-attack levels as apprehensions about possible supply disruptions gave way to concerns about weaker world oil demand and the increasing difficulty OPEC will face in defending its price target. The spot price of West Texas Intermediate has recently traded around $22 per barrel, more than $5 per barrel below the August average.

Non-oil imports. Prices of imported non-oil goods (and core goods) declined 0.4 percent (not an annual rate) in August, following a much sharper decrease in July. The decline in August was largely in prices of imported industrial supplies (primarily unfinished metals but also paper) building materials, and chemicals. For July-August combined, prices of imported core goods fell 5.9 percent at an annual rate, about the same rate of decline as in the second quarter. As in the second quarter, the drop in prices in July-August was led by decreases in prices of imported industrial supplies with smaller price declines recorded in all other major trade categories.

Exports. Prices of U.S. goods exports (total and core) decreased 0.2 percent in August, the seventh consecutive monthly decline. The fall in the price of core goods in August was largely from industrial supplies (chemicals and metals). For the third consecutive month, the price of exported capital goods (excluding computers and semiconductors) was unchanged. For July-August combined, the price of exported core goods declined 2 percent at an annual rate, a slightly higher rate than recorded in the second quarter. A larger drop in prices of exported industrial supplies in July-August than in the second quarter was only partly offset by a swing from negative to positive in the price of agricultural exports.

U.S. Current Account through 2001:Q2

In 2001:Q2, the U.S. current account deficit narrowed, for the second consecutive quarter, to $426 billion at a seasonally adjusted annual rate. The $21 billion decline resulted from a large drop in the deficit for trade in goods and services that was only partly offset by small increases in the deficits in investment income and other income and transfers.

The trade deficit fell as the U.S. economic slowdown reduced imports more than the foreign economic slowdown reduced exports. Income on investments also reflected sagging global conditions, with the declines in income receipts on U.S.-owned assets abroad (both portfolio and direct) slightly exceeding decreases in income payments on foreign-owned assets in the United States. Unilateral transfer payments rose slightly, primarily an increase in private remittances and other private transfers.

U.S. Current Account
(Billions of dollars, seasonally adjusted annual rate)

Period	Goods and services, net	Investment income, net	Other income and transfers, net	Current account balance
Annual				
1999	-261.8	-8.5	-54.0	-324.4
2000	-375.7	-9.6	-59.3	-444.7
Quarterly				
2000:Q3	-389.4	-14.5	-57.4	-461.2
Q4	-401.2	7.9	-72.0	-465.3
2001:Q1	-380.1	-14.6	-52.4	-447.1
Q2	-355.8	-16.6	-53.6	-426.0
Change				
Q3-Q2	-26.2	-0.1	-2.3	-28.7
Q4-Q3	-11.8	22.4	-14.6	-4.1
Q1-Q4	21.1	-22.5	19.6	18.2
Q2-Q1	24.3	-2.0	-1.2	21.1

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

U.S. International Financial Transactions

Foreign private net purchases of U.S. securities (line 4 of the Summary of U.S. International Transactions table) slowed somewhat in July, but for the year remain on pace to surpass last year's record level. The slowdown in July was primarily due to a pickup in net sales of Treasury securities. Net purchases of agency bonds and corporate bonds remained strong, but somewhat below recent record amounts; in July, issuance of both types of bonds was low compared with recent levels. Net purchases of equities have slowed in the past two months, but remain at levels that are high by historical standards.

U.S. net acquisitions of foreign securities (line 5) were near zero in July, as net sales of foreign bonds increased and there were no stock swaps. U.S. net purchases of foreign equities held at near the first half's pace in July, although transactions in Japanese equities switched from significant net purchases to small net sales.

Following a $20 billion decrease in the second quarter, foreign official assets held in the United States (line 1) increased $10 billion in July. Increases were widespread in the month and were only partly offset by decreases recorded by Japan ($4 billion) and Argentina ($3 billion). For the year through July, foreign official assets in the United States have declined $6 billion, with the largest decline recorded for Japan ($14 billion). Partial data from the FRBNY show that between end-July and mid-September, total foreign official holdings increased $7 billion.[1]

The U.S. banking sector (line 3) recorded extremely modest net inflows in the second quarter and in July, following a net outflow of $51 billion in the first quarter.

Foreign direct investment in the United States (line 7) was strong in the second quarter. Almost half of the $67 billion inflow was due to the takeover of Voicestream Wireless by Deutsche Telekom. Going forward, however, announced takeover deals are few, suggesting that merger-related inflows might be at reduced levels in the second half of the year. U.S. direct investment abroad (line 6) continued at about the same pace as past quarters, even though merger activity was subdued.

The statistical discrepancy for the second quarter was negative $18 billion, following a positive $8 billion discrepancy in the first quarter.

1. The split between foreign official and private capital flows has been clouded lately by unusual transactions by China. In the second quarter, $10 billion in reported private Chinese purchases of agency and Treasury bonds were reclassified as official purchases, because it is suspected that securities purchased by Chinese government entities not classified as official are being transferred to the official sector (Ministry of Finance and Central Bank) in a manner that is not captured in the TIC reporting system.

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

	1999	2000	2000		2001			
			Q3	Q4	Q1	Q2	June	July
Official financial flows	**55.0**	**39.3**	**12.9**	**-5.4**	**4.7**	**-21.7**	**-3.1**	**10.0**
1. Change in foreign official assets in the U.S. (increase, +)	46.4	39.6	13.2	-4.0	4.5	-20.3	-2.6	10.0
a. G-10 countries	49.7	12.3	-4.2	-.8	-5.5	-6.1	-.2	-3.1
b. OPEC countries	2.0	10.7	3.4	.6	.8	-2.1	.0	.8
c. All other countries	-5.3	16.7	14.0	-3.7	9.2	-12.1	-2.4	12.3
2. Change in U.S. official reserve assets (decrease, +)	8.6	-.3	-.3	-1.4	.2	-1.3	-.5	n.a.
Private financial flows	**321.7**	**404.0**	**101.5**	**119.1**	**98.8**	**146.3**	**...**	**...**
Banks								
3. Change in net foreign positions of banking offices in the U.S.[1]	-12.4	-6.7	-8.4	9.9	-51.4	2.4	-8.6	2.2
Securities[2]								
4. Foreign net purchases of U.S. securities (+)	333.2	435.7	115.8	117.7	149.2	127.0	43.3	27.9
a. Treasury securities	-19.9	-52.4	-12.9	-10.1	.0	-8.5	-.9	-10.5
b. Agency bonds	71.9	111.9	28.6	38.3	38.7	29.4	17.6	13.5
c. Corporate and municipal bonds	158.8	182.1	45.7	50.8	68.8	71.3	16.3	13.7
d. Corporate stocks[3]	122.4	194.0	54.4	38.8	41.7	34.8	10.3	11.2
5. U.S. net acquisitions (-) of foreign securities	-112.9	-101.1	-22.1	-17.8	-25.2	-42.9	-34.9	.6
a. Bonds	-5.7	-4.1	-9.0	3.3	-.9	8.8	1.0	5.6
b. Stock purchases	15.6	-13.1	-5.4	3.6	-21.7	-17.5	-5.3	-5.0
c. Stock swaps[3]	-122.9	-84.0	-7.7	-24.7	-2.6	-34.2	-30.6	.0
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-155.4	-152.4	-41.6	-39.1	-40.9	-35.6	...	...
7. Foreign direct investment in U.S.	301.0	287.7	76.0	84.7	52.5	67.2	...	...
8. Foreign holdings of U.S. currency	22.4	1.1	.8	6.2	2.3	2.8	...	...
9. Other (inflow, +)[4]	-54.2	-60.2	-19.0	-42.6	12.3	25.5	...	...
U.S. current account balance (s.a.)	**-324.4**	**-444.7**	**-115.3**	**-116.3**	**-111.8**	**-106.5**	**...**	**...**
Capital account balance (s.a.)[5]	**-3.5**	**.7**	**.2**	**.2**	**.2**	**.2**	**...**	**...**
Statistical discrepancy (s.a.)	**-48.8**	**.7**	**.7**	**2.4**	**8.1**	**-18.4**	**...**	**...**

NOTE. The sum of official and private financial flows, the current account balance, the capital account balance, and the statistical discrepancy is zero. 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 excludes adjustments BEA makes to account for incomplete coverage; 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 mergers.

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

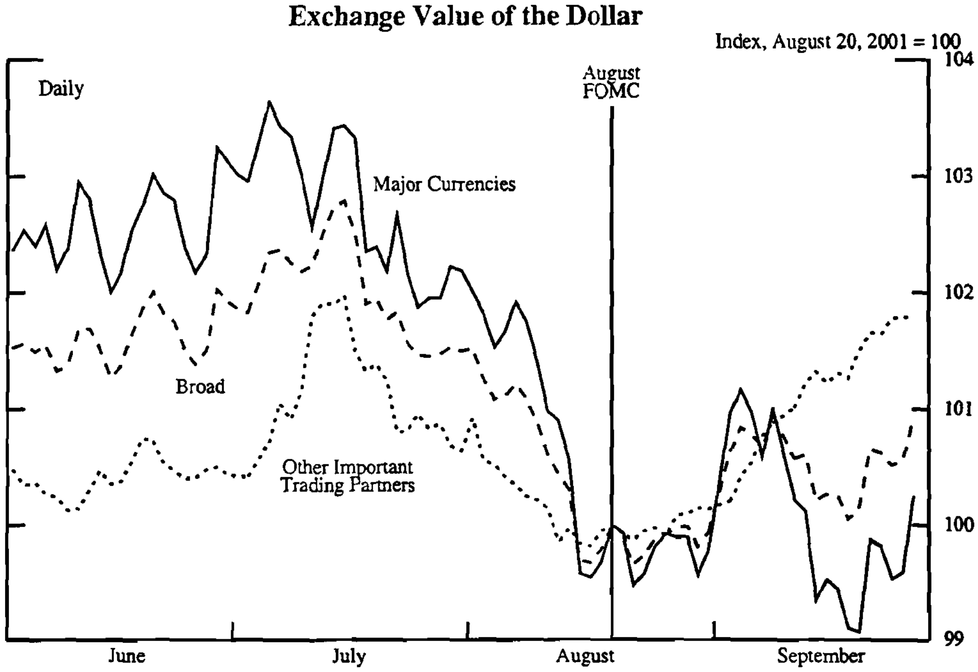
5. Consists of transactions in nonproduced nonfinancial assets and capital transfers.

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

Foreign Exchange Markets

On balance, the trade-weighted exchange value of the dollar against other major currencies was little changed over the intermeeting period. Dollar appreciation against several major currencies early in the period was reversed by market reactions to the weak August U.S. employment data reported on September 7 and to the terrorist attacks of September 11. The dollar's exchange value against the currencies of our other important trading partners rose almost 2 percent, on balance, over the period; the dollar appreciated 4½ percent on net against the Mexican peso, 7½ percent relative to the Brazilian *real*, and 3½ percent vis-à-vis the Chilean peso, as the economies of Latin America appeared particularly vulnerable to the current slowdown in U.S. economic activity and to repercussions from the attacks.

Exchange Value of the Dollar



Early in the period, the dollar appreciated against the European currencies after the September 4 release of a stronger-than-expected reading of the U.S. NAPM manufacturing index for August led market participants to surmise that U.S. manufacturing output could be poised for a recovery. The dollar also appreciated against the yen on indications that Japan's economy is contracting and after Japan's sovereign debt rating was placed on credit watch by Moody's on September 6. The following day, however, the release of the weaker-than-expected U.S. employment report for August initiated a shift down of the exchange value of the dollar. While trading in global foreign exchange markets did not come to a standstill in the days following the terrorist attacks, transaction volume did decline substantially as a major component of the foreign exchange trading infrastructure in New York was destroyed and as market participants reported a wide-spread reluctance to trade. In recent days, the dollar has retraced some of these post-attack losses, as prospects for a near-term immediate engagement of U.S. military forces appear to have receded and as the Japanese monetary authorities repeatedly purchased very large amounts of dollars for yen. On balance, the dollar depreciated ½ and ¾ percent, respectively, against the euro and the yen over the intermeeting period. In contrast, the dollar appreciated 2 percent on net vis-à-vis the Canadian dollar, as investors appeared to react to weakening growth prospects for Canada.

Financial Indicators in Major Industrial Countries

	Three-month rate		Ten-year yield		Equities
Country	Sep. 27 (Percent)	Percentage Point Change	Sep. 27 (Percent)	Percentage Point Change	Percent Change
Canada	3.22	-.86	5.31	-.19	-11.86
Japan	.01	-.01	1.41	.06	-13.87
Euro area	3.66	-.68	4.77	.00	-17.35
United Kingdom	4.44	-.43	4.86	.04	-12.18
Switzerland	2.19	-.82	3.31	.03	-14.00
Australia	4.50	-.53	5.57	-.14	-9.13
United States	2.52	-.93	4.61	-.30	-12.86
Memo: Weighted-average foreign	2.56	-.55	4.51	-.03	n.a.

NOTE. Change is from August 20 to September 27 (10 a.m. EDT).
n.a. Not available.

Following the FOMC's intermeeting cut in the federal funds rate on September 17, the central banks of most foreign industrial countries acted to ease rates and to provide liquidity at favorable terms. The Bank of Canada, the European Central Bank, the Swiss National Bank, the central banks of Sweden and Denmark, and the Reserve Bank of New Zealand all lowered their respective policy rates by 50 basis points, and the Bank of England eased policy by 25 basis points. The Bank of Japan announced an indefinite increase in current account balances above its current target of ¥6 trillion and lowered the discount rate from 25 to 10 basis points. Justifying these changes, the central banks mentioned the current weak outlook for global growth as well as the uncertainties for financial market stability and consumer confidence created by the terrorist attacks. The Federal Reserve set up temporary swap facilities with the European Central Bank and the Bank of England and augmented its existing swap arrangement with the Bank of Canada. The European Central Bank drew on its facility to provide temporary dollar liquidity to financial institutions operating in Europe. On September 24, the Swiss National Bank lowered the target band for its policy rate an additional 50 basis points to counter upward pressures on the exchange value of the Swiss franc.

Financial Indicators in Latin America, Asia, and Russia

	Currency/ US dollar		Short-term Interest rates[1]		Dollar-denominated bond spread[2]		Equity prices
Economy	Sep. 27	Percent Change	Sep.26/27 (Percent)	Percentage Point Change	Sep.26/27 (Percent)	Percentage Point Change	Percent Change
Mexico	9.57	4.74	9.51	2.43	4.94	.84	-14.74
Brazil	2.72	7.20	20.60	.40	14.34	2.73	-24.39
Argentina	1.00	.16	22.00	-13.00	15.69	-2.23	-22.19
Chile	695.30	3.53	6.42	.38	2.68	.13	-10.03
China	8.28	.00	n.a.	n.a.	1.34	.22	-8.76
Korea	1307.00	1.63	4.20	-.50	3.00	.90	-16.70
Taiwan	34.55	-.29	3.11	-.58	...	...	-21.60
Singapore	1.77	.50	1.75	-.63	...	...	-16.96
Hong Kong	7.80	.00	2.57	-.82	...	...	-16.21
Malaysia	3.80	.01	2.90	.00	1.94	.47	-6.38
Thailand	44.55	-.74	3.50	.25	2.81	-.61	-14.06
Indonesia	9645.00	13.47	17.74	.11	5.19	-2.55	-9.78
Philippines	51.25	.10	13.94	3.81	6.91	.85	-12.93
Russia	29.43	.20	n.a.	n.a.	8.14	.29	-8.45

NOTE. Change is from August 20 to September 26/27.

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

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

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

In response to these developments, short-term market rates fell substantially in most foreign industrial countries. However, yields on bellwether government bonds declined only 19 basis points in Canada and 14 basis points in Australia, were unchanged in Germany, and rose 4 to 6 basis points in the United Kingdom and Japan, leading to marked steepenings of yield curves in all major industrial countries.

Share prices fell sharply around the world, in industrial countries as well as in emerging market economies, for broad indexes as well for indexes of the technology, transportation, and insurance sectors, both in the days immediately following the attacks when U.S. exchanges were closed, and after September 17 when U.S. bourses re-opened. On balance, broad equity indexes declined 12 to 18 percent in Europe and Japan over the intermeeting period, generally outpacing equity price drops in the United States. Share prices fell more than 20 percent in Brazil and Argentina and are down in the 15-to-20-percent range on several stock exchanges in East Asia.

Trading in emerging market debt came to a near standstill for several days following the terrorist attacks, as important financial infrastructure installations located in the World Trade Center were destroyed. After active trading in Brady debt and global bonds resumed, their risk spreads jumped substantially. On balance, the EMBI+ spreads of Argentina, Brazil, and Mexico are up between 100 and 230 basis points over the intermeeting period.

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

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Developments in Foreign Industrial Countries

GDP data for the foreign industrial economies confirm that growth ground to a halt in the second quarter and more recent indicators, albeit for the period preceding the September 11 terrorist attack, suggest that growth remained very weak in the third quarter. In Japan, GDP fell sharply in the second quarter and recent data are consistent with a sharp contraction in the third quarter as well, with a slump in domestic activity being exacerbated by slowing global demand. The deteriorating external environment has also contributed to a slowdown in the euro area and in the United Kingdom, with manufacturing in both areas being particularly weak. Canadian GDP was about flat in the second quarter, as consumer spending slowed sharply; the worsening of employment conditions in the third quarter point to further weakening.

With oil prices continuing to ease and economic slack increasing, consumer price inflation has declined in recent months. The twelve-month rate of consumer price inflation dropped below 3 percent in the euro area and Canada in July and remained there in August. Retail price inflation in the United Kingdom remained near the Bank of England's 2½ percent target, while deflation continued in Japan.

Against the background of deterioration in economic prospects even before September 11, foreign central banks have accelerated the pace of monetary easing in response to disruptions to financial markets and concerns about plunging confidence in the aftermath of the attacks. The Bank of Canada and the ECB each cut rates 25 basis points at their regular August policy meetings and 50 basis points on September 17. The Bank of England joined in the easing with a 25 basis-point rate cut the following day, while the Bank of Japan cut its official discount rate and took other measures to increase liquidity.

Recent indicators for **Japan** suggest that the economy is in another recession. Real GDP fell at an annual rate of 3.2 percent in the second quarter, and indicators for the third quarter suggest a further decline. The second-quarter decline was led by a steep drop in private investment, which subtracted about 3 percentage points from growth; business fixed investment fell roughly 11 percent, and residential investment dropped at a rate of about 30 percent. Government investment also fell sharply as the impact of last year's supplemental budget package began to fade, subtracting about 1¼ percentage points from growth. Consumption spending showed surprising strength, however, boosted in part by a rise in automobile sales. Both exports and imports continued to fall, with net exports subtracting about ½ percentage point from growth.

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

Component	1999[1]	2000[1]	2000 Q3	2000 Q4	2001 Q1	2001 Q2
GDP	.4	2.5	-2.7	2.6	.5	-3.2
Total domestic demand	.5	2.5	-2.5	4.2	1.4	-2.8
Consumption	-.4	1.5	.1	-2.5	2.5	2.0
Private investment	3.5	6.9	5.4	27.6	-6.9	-14.8
Public investment	-6.4	-7.5	-39.7	-2.3	22.3	-15.5
Government consumption	4.1	3.7	2.2	3.6	.0	3.4
Inventories[2]	.0	.2	-.1	.1	.0	-.1
Exports	7.0	9.8	.9	3.4	-13.7	-11.1
Imports	10.3	11.1	5.3	22.1	-8.3	-9.4
Net exports[2]	-.1	.1	-.3	-1.4	-.9	-.4

1. Q4/Q4.
2. Percentage point contribution to GDP growth, s.a.a.r.

Recent data indicate a further contraction, with the all-industry index, a supply-side proxy for GDP, falling 1.2 percent in July, led by a drop in industrial production. On the demand side, shipments of machinery also registered a steep decline in July, led by weaker demand in the electrical category that includes high-tech equipment. Machinery orders, a leading indicator of business investment, fell 1.6 percent in July, the third consecutive monthly drop. Household spending also appears to be weakening, with July household expenditures about unchanged from their second-quarter level, and new passenger car registrations down about 2 percent over the same period. Residential and nonresidential building starts both rebounded somewhat in July, but the level of activity in the construction sector remains weak.

Labor market conditions have continued to deteriorate. The unemployment rate hit a record 5 percent in July, with employment down about 1½ percent from its recent peak in November of last year. The job-offers-to-applicants ratio slipped to 0.60, below its peak of 0.66 last December, although still well above its mid-1999 trough of 0.46.

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

Indicator	2000	2001					
	Q4	Q1	Q2	May	June	July	Aug.
Industrial production[1]	.57	-3.6	-4.1	-1.2	-.8	-3.0	n.a.
All-industry index	.4	.9	-2.0	-1.0	.3	-1.2	n.a.
Housing starts	1.7	-4.0	-2.9	5.6	-7.9	11.0	n.a.
Machinery orders[2]	1.3	-7.0	1.1	-2.1	-6.6	-1.6	n.a.
Machinery shipments	1.4	-4.6	-7.2	-1.4	-.2	-3.6	n.a.
New car registrations	-.6	2.6	1.7	5.5	.4	-3.6	n.a.
Unemployment rate[3]	4.8	4.8	4.9	4.9	4.9	5.0	n.a.
Job offers ratio[4]	.65	.63	.61	.61	.61	.60	n.a.
Business sentiment[5]	-14	-22	-27	...	...	...	...
CPI (Core, Tokyo area)[6]	-1.3	-1.3	-1.3	-1.4	-1.1	-1.1	-1.2
Wholesale prices[6]	-.1	-.4	-.7	-.6	-.7	-.8	-.9

1. Mining and manufacturing.
2. Private sector, excluding ships and electric power.
3. Percent.
4. Level of indicator.
5. Tankan survey, diffusion index.
6. Percent change from year earlier, n.s.a.

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

Prices have continued to decline. Core consumer goods prices in the Tokyo area (which exclude fresh food but include energy) were down 1.2 percent in August from a year earlier. Deflation in wholesale prices for domestic goods has intensified as the impact of the earlier run-up in energy prices has faded, with prices in August down 0.9 percent from a year earlier. Recent data from the National Land Agency showed a decline of 4.1 percent in average land prices in the twelve months to July, a little more than the 3.6 percent decline recorded in the preceding year. The GDP deflator in the second quarter was a little more than 1 percent (n.s.a.) below its year-earlier level.

The merchandise trade surplus (customs clearance basis) shrank about 7 percent on average in July and August from its second-quarter level, as the fall in exports continued to outpace the decline in imports.

On September 18, the Bank of Japan (BOJ) announced a number of measures to ease monetary policy. The BOJ said that it would maintain the level of the outstanding balance of banks' deposits held at the central bank above the current target of ¥6 trillion for the time being. Since September 11, the BOJ has kept the balance between ¥8 trillion and ¥11 trillion to provide ample liquidity to the banking system. The BOJ also cut the official discount rate from 25 to 10 basis points, and increased the maximum time period for this Lombard-type facility from 5 to 10 business days during the current reserve period (through October 15). There was no change in the amount of outright purchases of government securities.

Shortly after second-quarter GDP figures were released on September 7, Prime Minister Koizumi directed his Cabinet to put together a supplemental budget for this fiscal year, with the focus on labor market programs, not on public works. Koizumi's pledge to hold new annual debt issuance to ¥30 trillion beginning this fiscal year would allow room for a supplemental budget of at most ¥2 trillion, but political pressures for a larger package are mounting.

Data confirm that economic growth in the **euro area** slowed significantly in the second quarter, with real GDP rising only 0.2 percent (s.a.a.r.). Consumption expenditures remained fairly strong, increasing 2.4 percent in the second quarter and 2.8 percent for the first half of 2001. Fixed investment spending weakened notably, declining 3.2 percent after registering essentially no change in the first quarter. Net exports subtracted more than1 percentage point from second-quarter growth as a decline in imports was more than offset by a sharp fall in exports. Real GDP in Germany declined 0.1 percent (s.a.a.r.) in the second quarter, with investment being especially weak, while Italian GDP was also about flat. French GDP increased 1 percent, as consumer spending slowed from a rapid pace in the first quarter and investment declined slightly.

Recent data suggest that activity remained weak in the third quarter. Euro-area industrial production declined 1.4 percent in July. The euro-area purchasing managers' surveys for the manufacturing sector edged up in August but remained below the threshold that indicates a contraction in manufacturing. Service sector purchasing managers' surveys have been little changed on balance over the past several months, indicating expansion of activity, but at a considerably slower pace than earlier this year. Euro-area industrial confidence declined further in July, largely reflecting more negative opinions on orders. German manufacturing orders fell 1.5 percent in July, as a decline in foreign orders offset a modest improvement in domestic orders.

Euro-Area Real GDP[1]
(Percent change from previous period, except as noted, s.a.a.r.)

Component	1999[2]	2000[2]	2000		2001	
			Q3	Q4	Q1	Q2
GDP	3.6	2.9	2.0	2.4	2.1	.2
Total domestic demand	3.4	2.3	.8	1.9	-.0	1.3
Consumption	3.1	1.8	.8	.5	3.1	2.4
Investment	5.9	3.2	4.0	-.5	.2	-3.2
Government consumption	2.4	1.7	.6	2.6	2.5	.5
Inventories[3]	-.1	.2	-.6	1.2	-2.3	.5
Exports	10.4	11.5	12.8	10.7	1.3	-4.8
Imports	10.1	10.3	9.9	9.7	-4.2	-2.2
Net exports[3]	.3	.6	1.2	.6	2.1	-1.1
Memo:						
France	3.7	3.1	3.2	3.3	1.7	1.0
Germany	3.0	2.5	.5	.6	1.6	-.1
Italy	2.8	2.6	1.6	3.3	3.4	.1

1. Includes Greece as of 2001 Q1.
2. Q4/Q4.
3. Percentage point contribution to GDP growth, s.a.a.r.

Prior to the terrorist attacks, some euro area confidence indicators had edged up somewhat, providing some hope that business conditions had stabilized. In July, the German Ifo index edged up for the first time since January, reflecting a modest improvement in the expectations component for the first time since last October. In August, the Ifo index edged down again reflecting further erosion in the current conditions component. About one-fourth of Ifo responses were received after September 11, but these responses were not notably more pessimistic than those received prior to that date. However, the German ZEW indicator, which is derived from a financial market survey, showed a noticeable difference in responses, with an improvement in sentiment in responses received before the attacks, and a deterioration among responses received after September 11. The French INSEE monthly business survey fell in September to its lowest level in five years, primarily on a more pessimistic view for foreign orders. The decline was larger than expected, as only 1/5 of the responses were received after September 11. The ISAE Italian consumer confidence index rose slightly

Euro-Area Economic Indicators[1]
(Percent change from previous period except as noted, s.a.)

Indicator	2000	2001					
	Q4	Q1	Q2	May	June	July	Aug.
Industrial production[2]	1.2	-.4	-.8	-.2	.8	-1.4	n.a.
Retail sales volume	.4	.6	.2	-.3	.6	n.a.	n.a.
Unemployment rate[3]	8.5	8.4	8.4	8.4	8.3	8.3	n.a.
Consumer confidence[4]	-2.7	-1.7	-3.7	-4.0	-5.0	-7.0	n.a.
Industrial confidence[5]	5.3	1.0	-5.3	-5.0	-7.0	-9.0	n.a.
Mfg. orders, Germany	1.8	-2.7	-1.7	4.2	-2.4	-1.5	n.a.
CPI[6]	2.7	2.5	3.1	3.4	3.0	2.8	2.7
Producer prices[6]	6.1	4.7	3.9	3.9	3.5	2.5	n.a.
M3[6]	4.8	4.5	6.1	5.2	6.1	6.4	6.7

1. Euro-area indicators do not include Greece prior to 2001 but do include Greece as of January.
2. Excludes construction.
3. Euro-area standardized to ILO definition. Includes Eurostat estimates in some cases.
4. Diffusion index based on European Commission surveys in individual countries; Averages of responses to questions on financial situation, general economic situation, and purchasing attitudes.
5. Diffusion index based on European Commission surveys in individual countries; Averages of responses to questions on production expectations, orders, and stocks.
6. Eurostat harmonized definition, 12-month percent change.
n.a. Not available.

in September, but ISAE noted that responses taken after the attacks showed a significant, though limited, decline.

Labor market data for the euro area as a whole have yet to show much deterioration, as the harmonized unemployment rate edged down to 8.3 percent in June and remained at that rate in July. National statistics, however, show a small rise in the French unemployment rate in July, and an increase in the number of unemployed in Germany since year end.

The twelve-month rate of euro-area consumer price inflation edged down to 2.7 percent in August, but remained above the ECB's 2 percent target ceiling. Core consumer price inflation (which excludes food, energy, alcohol and tobacco) remained 2.1 percent on a twelve-month basis, but the twelve-month rate of change in producer prices, which peaked at 6.7 percent last October, has moved down steadily this year to 2.5 percent in July.

On August 30, the European Central Bank reduced its official interest rates 25 basis points, noting lower inflationary pressures and an expectation that euro-area real GDP growth would most likely be lower than expected a few months ago. On September 17, the ECB cut official rates an additional 50 basis points, bringing the minimum bid rate for the main refinancing tender to 3.75 percent.

Real GDP growth in the **United Kingdom** slowed from near trend in the first quarter of 2001 to 1.8 percent (s.a.a.r.) in the second quarter. Total domestic demand grew 2.8 percent (s.a.a.r.) in the second quarter as strong growth in fixed investment, consumption expenditures, and government consumption more than offset a decline in inventories that subtracted nearly 4 percentage points from growth. Net exports had a negligible effect on growth, as both imports and exports contracted sharply.

U.K. Real GDP

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

Component	1999[1]	2000[1]	2000		2001	
			Q3	Q4	Q1	Q2
GDP	2.7	2.4	2.8	2.0	2.6	1.8
Total domestic demand	3.6	2.9	4.5	2.1	3.6	1.7
Consumption	4.8	3.5	3.7	3.3	4.0	5.2
Investment	.6	7.7	6.7	15.2	-12.2	8.5
Government consumption	2.3	.8	3.3	-2.9	4.0	3.0
Inventories[2]	.0	-.9	.3	-2.2	2.9	-3.9
Exports	8.6	10.3	2.1	10.7	5.2	-9.4
Imports	10.4	10.4	6.5	9.6	6.2	-8.2
Net exports[2]	-1.0	-.6	-1.8	-.2	-.7	-.0

1. Q4/Q4.
2. Percentage point contribution to GDP growth, s.a.a.r.

Indicators for the third quarter paint a mixed picture. Consumer confidence moved up in July to its highest level in over a year, and retail sales continued to show strong gains. On the other hand, industrial production fell 0.5 percent in July, business confidence dropped sharply in August, and surveys of expected future production in the manufacturing sector remain pessimistic. Recent surveys of the service sector are consistent with growth slowing in the third quarter.

Notwithstanding the recent slowing in activity, labor market conditions remain tight. The official claims-based unemployment rate remained at 3.1 percent in August, the lowest rate in 26 years, while the labor force survey measure of the unemployment rate remained at a record low of 5 percent for the three months centered in June.

The twelve-month rate of retail price inflation (excluding mortgage interest payments) rose to 2.6 percent in August -- slightly above the Bank of England's official target of 2.5 percent, as gasoline and oil prices fell more slowly and the increase in food prices picked up. In July, growth in average earnings fell below the 4½ percent rate (from year earlier) that the Bank of England believes to be compatible with its inflation target.

U.K. Economic Indicators

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

Indicator	2000	2001					
	Q4	Q1	Q2	May	June	July	Aug.
Industrial production	-.6	-.6	-1.1	-1.0	.2	-.6	n.a.
Retail sales	1.3	1.6	1.7	.8	.0	.6	.5
Unemployment rate[1]							
Claims-based	3.4	3.3	3.2	3.2	3.2	3.2	3.1
Labor force survey[2]	5.3	5.1	5.0	5.0	5.0	n.a	n.a
Business confidence[3]	5.3	8.7	-.7	-2.0	2.0	3.0	-13.0
Retail prices[4]	2.1	1.9	2.3	2.4	2.4	2.2	2.6
Producer input prices[5]	9.9	4.9	4.4	4.2	2.4	-1.0	-2.3
Average earnings[5]	4.4	5.0	4.8	4.5	4.9	4.4	n.a.

1. Percent.
2. Three-month average centered on month shown.
3. Percentage of firms expecting output to increase in the next four months less percentage expecting output to decrease.
4. Excluding mortgage interest payments. Percent change from year earlier.
5. Percent change from year earlier.
n.a. Not available. ... Not applicable.

On September 18, the Monetary Policy Committee (MPC) of the Bank of England voted to lower the official repo rate 25 basis points to 4.75 percent. The repo rate has been cut five times, totaling 125 basis points, since the beginning of this year. In its statement of September 18, the MPC cited the recent cuts by other central banks, the sharp declines in stock prices, and concerns about consumer confidence.

In **Canada**, real GDP grew only 0.4 percent (s.a.a.r.) in the second quarter, following a downwardly revised 2.0 percent gain in the first quarter. Consumer spending growth slowed sharply, suggesting that worsening employment conditions are beginning to restrain the household sector, previously the main support for Canadian growth. In contrast, business fixed investment rebounded in the second quarter, and inventory accumulation contributed about ¾ percentage point to GDP growth, after two quarters of negative inventory adjustment. The rise in business investment spurred machinery imports, pushing import growth back into positive territory, while exports continued to fall, mainly as a result of weak external demand for telecommunications equipment and energy products. A decline in telecommunication equipment manufacturing led to a fall in industrial capacity utilization to 83.2 percent in the second quarter, marking the fourth consecutive quarterly decrease.

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

Component	1999[1]	2000[1]	2000		2001	
			Q3	Q4	Q1	Q2
GDP	5.1	3.5	4.5	1.6	2.0	.4
Total domestic demand	5.4	2.7	3.6	-1.4	.6	2.6
Consumption	4.2	3.3	5.2	1.2	3.4	1.1
Investment	8.8	3.7	2.2	-1.7	-.3	2.9
Government consumption	2.7	2.3	1.2	3.5	3.0	3.2
Inventories[2]	.6	-.4	-.1	-2.3	-1.8	.7
Exports	8.7	4.3	1.2	-.1	-4.7	-3.1
Imports	10.4	2.1	-.3	-9.1	-9.6	2.1
Net exports[2]	-.2	1.1	.6	3.8	1.8	-2.1

1. Q4/Q4.
2. Percentage point contribution to GDP growth, s.a.a.r.

Indicators for the third quarter have tended to be weak. Both retail and wholesale sales fell in July. Among retailers, gasoline stations registered the most severe drop in sales. Exports declined in July, reflected primarily in the automotive and energy sectors, while imports were flat, as an increase in the importation of oil-drilling machinery offset decreases in automotive imports. Manufacturing shipments edged down in July. Canada's unemployment rate increased in August to 7.2 percent, the highest level since September 1999, owing to small job losses along with a rise in labor force participation. However, part-time employment more than accounted for the decline in overall employment, with full-time employment rising somewhat. Housing starts provided a positive note, posting a stronger-than-expected increase in August. Low vacancy rates, low inventories of unoccupied housing, and falling mortgage rates have contributed to the relative strength of the housing sector.

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

Indicator	2000	2001					
	Q4	Q1	Q2	May	June	July	Aug.
GDP at factor cost	.4	.1	.3	.3	-.2.	n.a.	n.a.
Industrial production	-.2	-1.4	.1	.1	-1.0	n.a.	n.a.
New mfg. orders	.2	-5.4	1.6	1.2	-3.7	1.7	n.a.
Retail sales	.1	1.3	2.1	0.5	-.1	-.5	n.a.
Employment	.7	.2	.3	.1	-.1	-.1	-.1
Unemployment rate[1]	6.9	6.9	7.0	7.0	7.0	7.0	7.2
Consumer prices[2]	3.1	2.8	3.6	3.9	3.3	2.6	2.8
Consumer attitudes[3]	114.2	109.8	113.5	...	...	...	...
Business confidence[4]	140.4	117.5	131.6	...	...	...	...

1. Percent.
2. Percent change from year earlier, n.s.a.
3. Level of index, 1991 = 100.
4. Level of index, 1977 = 100.
n.a. Not available. ... Not applicable.

The twelve-month rate of consumer price inflation increased slightly to 2.8 percent in August from 2.6 percent in July. The increase reflected a rise in energy prices over the year. The twelve-month rate excluding food and energy prices was 2.2 percent.

The Bank of Canada has lowered its policy rate, the Bank Rate, a total of 225 basis points this year, most recently by 50 basis points on September 17. The Bank Rate now stands at 3.75 percent. The September 17 announcement underscored the Bank's concern that the terrorist attacks on the United States may pose significant challenges to consumer and business confidence in the United States, Canada, and elsewhere.

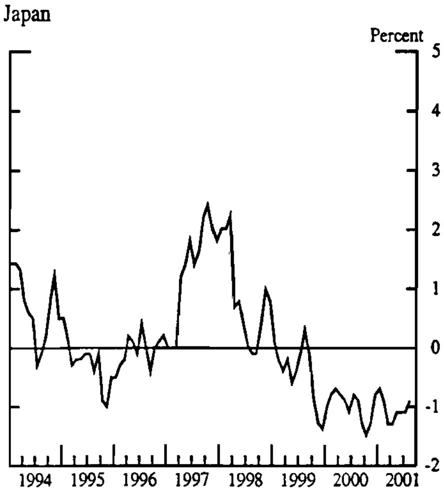
External Balances
(Billions of U.S. dollars, s.a.a.r.)

Country and balance	2000	2001				
	Q4	Q1	Q2	June	July	Aug.
Japan						
Trade	67.9	67.6	50.3	63.6	32.1	61.3
Current account	99.4	101.9	66.9	36.2	84.7	n.a.
Euro area						
Trade[1]	3.4	-11.0	17.0	51.6	n.a.	n.a.
Current account[1]	-56.6	-25.0	-19.6	-9.6	n.a.	n.a.
Germany						
Trade	44.2	73.5	66.3	62.3	74.0	n.a.
Current account	-32.4	-3.6	-8.0	-47.1	-32.1	n.a.
France						
Trade	-.8	.6	.7	1.6	.2	n.a.
Current account	2.1	4.0	1.5.	4.8	n.a.	n.a.
Italy						
Trade	.7	8.9	6.5	2.7	n.a.	n.a.
Current account[1]	-9.5	-7.7	-2.3	6.2	37.2	n.a.
United Kingdom						
Trade	-45.1	-45.7	-52.3	-57.5	-43.2	n.a.
Current Account	-28.7	-9.2	-22.1	...	...	...
Canada						
Trade	44.8	56.6	46.8	43.2	42.0	n.a.
Current Account	22.4	35.3	25.6.	...	...	...

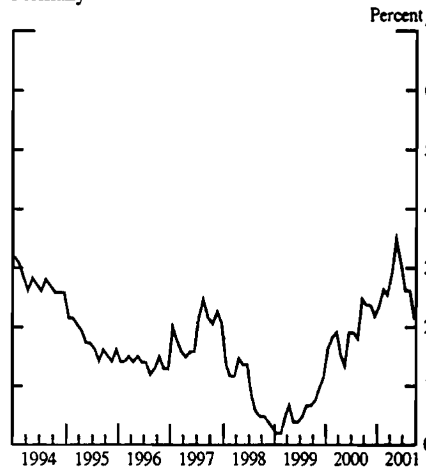
1. Not seasonally adjusted.
n.a. Not available. ... Not applicable.

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

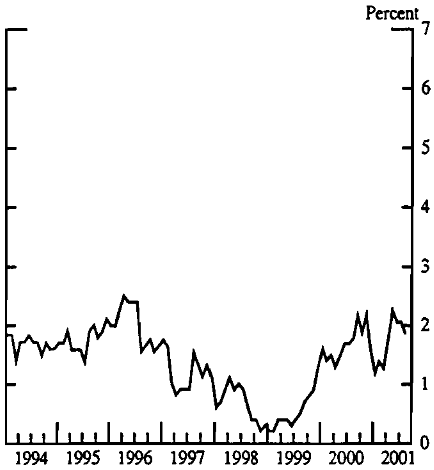
Japan



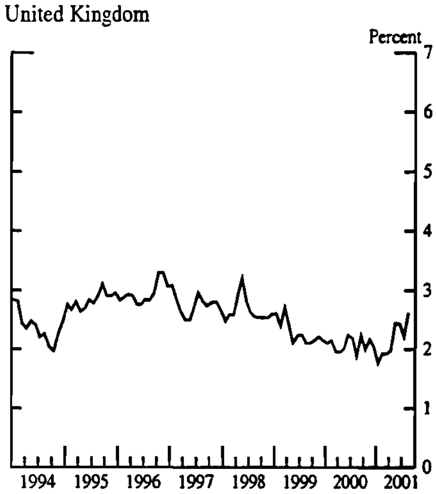
Germany



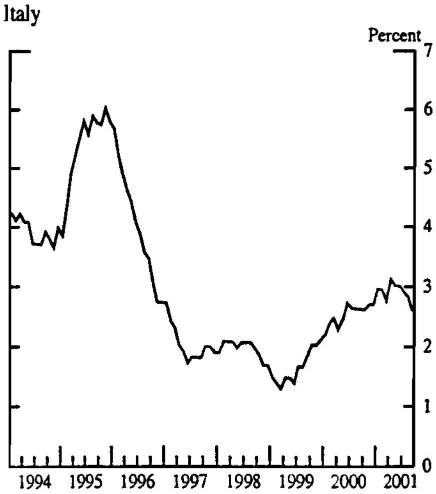
France



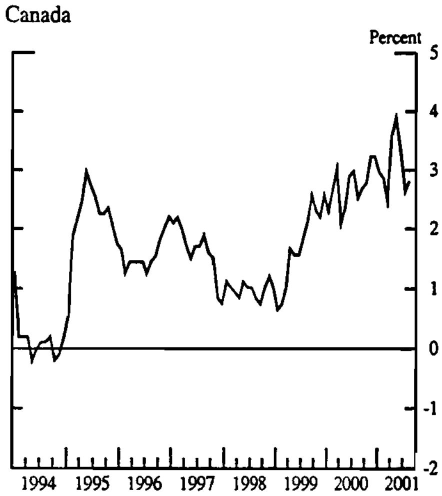
United Kingdom



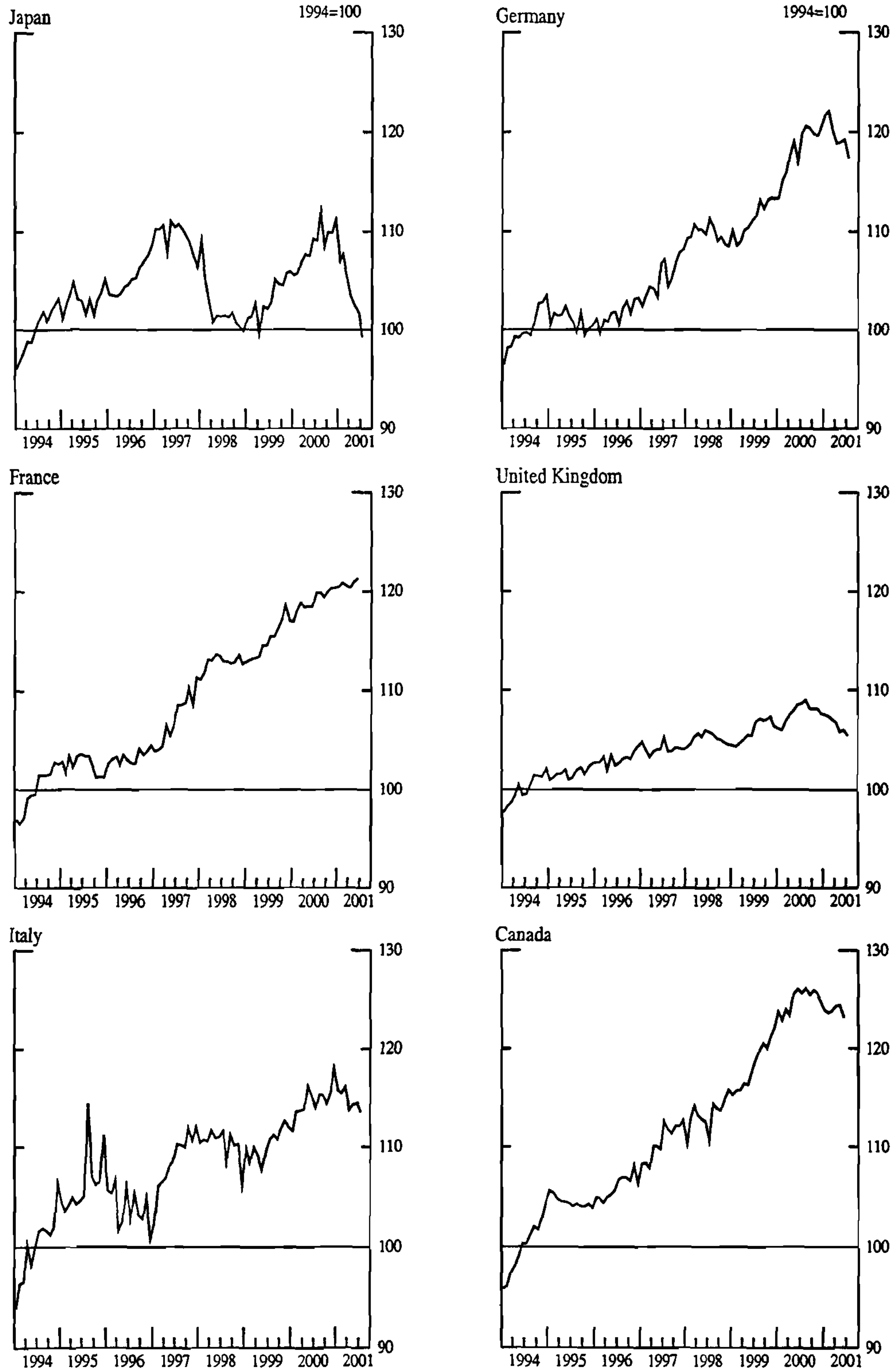
Italy



Canada



Industrial Production in Selected Industrial Countries



Economic Situation in Other Countries

Reports on economic conditions throughout the major developing countries were generally unfavorable over the past month. In Latin America, internal economic problems continued to plague Argentina and spilled over onto Brazil. More generally, weakness in the United States weighed on the economies of the region, particularly Mexico. In Asia, poor performance in the global high-tech industry depressed exports further, and most countries have recently experienced negative or slowing growth.

There is little macroeconomic data, as of yet, from the period after the terrorist attacks on the United States. Financial indicators, however, suggest that developing country economies will be adversely affected. In particular, following the attacks on September 11, developing country stock markets plunged and have just started to recover on the back of gains in the U.S. market. The prospects of weaker U.S. growth and the desire for "safe haven" investments has put downward pressure on some developing country exchange rates. Brazil seems to have suffered the most, with the *real* declining 4½ percent since the terrorist attacks.

Economic indicators for **Argentina** have continued to weaken, on balance, since the last Greenbook. GDP for the second quarter showed a surprising rise of 1.1 percent at an annual rate, but indicators for the third quarter are down. Industrial production fell considerably in August, and data for previous months were revised lower. Other indicators such as supermarket sales, shopping center sales, and construction also plunged in August. Consumer prices declined 1.3 percent during the year ended August, and consumer confidence, measured prior to September 11, diminished sharply in early September. A continuing pattern of flat or rising exports and falling imports generated an $8.7 billion trade surplus in July and contributed to a substantial improvement in the current account deficit in the second quarter. The federal government reported a slight budget surplus in August but it still appears that reaching the IMF fiscal targets for the year will be difficult.

Turmoil in the financial sector and sizable deposit and reserve outflows during July and August boosted market fears of default. The IMF announced an $8 billion augmentation to the country's current program on August 21. Total IMF funding available under the program now stands at almost $22 billion. The augmentation included $5 billion that was approved for disbursement on September 7–$4 billion to the central bank to shore up reserves and $1 billion to the Argentine treasury–and a further $3 billion to be disbursed in conjunction with a yet-to-be announced voluntary exchange of Argentine sovereign debt. An additional $1.3 billion from the original Fund program was also disbursed in early September.

Financial conditions improved slightly after the announcement of additional IMF funds in mid-August. Spreads on sovereign debt, as measured by JP Morgan's EMBI+ index, dropped 200 basis points and then fluctuated between 1400 and 1500 basis points until the September 11 attacks. Rates then moved back up to around 1600 basis points. Since August 21, deposit outflows have stabilized, and total deposits are up about $1½ billion. However, the level of deposits remains 11 percent below that of end June. Domestic interest rates have come down since mid-August but are still elevated, with the 30-day interest rate on peso deposits at 22 percent as of late-September. Rates are unlikely to decline much further, if at all, until after October 14, when Argentina holds elections for all of the seats in the senate and half those in the lower house. Finally, the Argentine stock market has fallen 15 percent since the terrorist attacks, and is now at its lowest level in a decade.

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

Indicator	1999	2000	2001				
			Q1	Q2	June	July	Aug.
Real GDP[1]	-.6	-2.4	-.8	1.1	...	...	...
Industrial production	-5.8	-1.9	-.5	-.9	-.7	-.1	-3.1
Unemployment rate[2]	13.8	15.1	...	16.4	...	...	...
Consumer prices[3]	-1.8	-.7	-1.4	-.1	-.3	-1.1	-1.3
Trade balance[4]	-.8	2.6	3.4	4.6	7.8	8.7	n.a.
Current account[5]	-12.0	-9.0	-12.2	-4.0	...	...	...

1. Annual rate. Annual figures are Q4/Q4.
2. Percent, n.s.a. Data are released for May and October only. Figures for Q2 reflect data for May.
3. Percent change from year-earlier period, except annual figures, 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 **Mexico**, recent data releases suggest that the economy continues to be hard hit by the slowdown in the United States. Second-quarter real GDP growth marked the third consecutive quarter of decline. Moreover, private consumption–the only component of expenditure that had held up relatively well–decelerated significantly in the second quarter. Data so far in the third quarter point to continued weakness. Industrial production fell in July and exports in July and

August were below the second-quarter level. Twelve-month consumer price inflation remained around 6 percent in August, under the government's year-end inflation target of 6½ percent.

The economic recession has put a dent in government revenues, and the fiscal deficit widened in July, notwithstanding efforts to reduce expenditures. Although new cuts have been announced, concern has mounted that, if the trend of weak revenues continues, the government may overshoot this year's fiscal deficit target of 0.65 percent of GDP. The deterioration of the fiscal situation has further focused attention on the importance of tax reform in Mexico, including the need to reduce Mexico's excessive dependence on oil income as a source of government revenue.

Mexican financial markets have reacted adversely following the terrorist attacks in the United States on September 11. The Mexican equity market was most affected–dropping over 9 percent since the incident. The effect on the peso and short-term interest rates was more muted, with a slight increase in interest rates and a depreciation of roughly 2¼ percent of the peso since the attack.

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

Indicator	1999	2000	2001				
			Q1	Q2	June	July	Aug.
Real GDP[1]	5.4	5.2	-1.3	-1.0	...	...	...
Industrial production	4.5	6.3	-1.5	-1.2	.0	-.3	n.a.
Unemployment rate[2]	2.5	2.2	2.3	2.3	2.3	2.5	2.3
Consumer prices[3]	12.3	9.0	7.5	6.9	6.6	5.9	5.9
Trade balance[4]	-5.6	-8.0	-10.0	-7.8	-7.6	-9.5	-5.4
Imports[4]	142.0	174.5	175.8	170.3	168.6	168.0	166.6
Exports[4]	136.4	166.5	165.8	162.6	161.0	158.4	161.2
Current account[5]	-14.4	-18.7	-18.9	-13.5	...	...	...

1. Annual rate. Annual figures 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 figures, 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 released since the last Greenbook point to further weakening. Industrial production fell in July for the fifth straight month. The urban unemployment rate in July was unchanged, reflecting mostly an exit of workers from the labor force. Inflation declined in August, bringing the twelve-month increase in the CPI to 6.3 percent. The weakening economy seems to have contributed to an improvement in the trade balance in August, as imports were up only slightly while exports jumped. The stronger trade figures contributed to a significant narrowing of the current account deficit in August. Fiscal data for July indicate that Brazil remains on track to meet its IMF program targets–the primary surplus was larger than expected, although high interest costs weighed heavily on the overall deficit.

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

Indicator	1999	2000	2001				
			Q1	Q2	June	July	Aug.
Real GDP[1]	3.5	4.8	1.6	-3.9	...	...	...
Industrial production	-.7	6.5	1.6	-3.5	-.9	-1.1	n.a.
Unemployment rate[2]	7.6	7.1	5.7	6.2	6.2	n.a.	n.a.
Consumer prices[3]	8.9	6.0	6.2	7.0	7.5	7.1	6.3
Trade balance[4]	-1.3	-.7	-2.5	-3.8	-1.9	.6	11.1
Current account[5]	-25.4	-24.6	-26.2	-27.4	-25.3	-24.4	-13.6

1. Annual rate. Annual figures are Q4/Q4.
2. Percent. "Open" unemployment rate.
3. Percent change from year-earlier period, except annual figures, which are Dec./Dec. Price index is IPC-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.

Brazilian asset prices had already come under downward pressure in response to deteriorating conditions in Argentina, but were struck especially hard by the terrorist attacks on September 11. Since September 10, the Bovespa has plummeted almost 18 percent and the *real* reached an all-time low of 2.83 *reais* per dollar on September 21. The central bank responded with concerted intervention sales and large sales of dollar-linked bonds and has held its benchmark overnight interest rate at 19 percent rather than lower it in tandem with other countries. These actions have reversed some of the currency's depreciation but it is still down 7 percent since the last Greenbook.

On September 14, the IMF Executive Board approved the previously-announced $15.6 billion program for Brazil, paving the way for the release of $4.6 billion. While the Brazilian government had earlier indicated that it would not necessarily withdraw the money, in light of recent events, market analysts now see it as more likely that Brazil will draw on the IMF funds.

The **Venezuelan** recovery appears to have slowed in the past several months, as the price of oil declined. GDP growth has moderated since last year, although the unemployment rate continued to fall, dropping to 13.3 percent in June, and consumer price inflation has been edging up in recent months, after four years of declines. The past month has seen an outflow of more than $1 billion in foreign reserves, amid mounting fears of capital controls or devaluation. In response, the central bank has undertaken a variety of measures including selling short-term certificates of deposits, raising the discount rate, and selling dollars. Since September 10, the spread on Venezuelan foreign currency sovereign debt has risen about 100 basis points, and the domestic stock market has fallen 7 percent, mostly reflecting uncertainty regarding world demand for oil.

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

Indicator	1999	2000	2001				
			Q1	Q2	June	July	Aug.
Real GDP[1]	-4.1	6.1	2.2	1.5	...	...	...
Unemployment rate[2]	15.2	13.4	14.2	13.6	13.3	n.a.	n.a.
Consumer prices[3]	20.0	13.4	12.6	12.4	12.5	13.0	12.9
Non-oil trade balance[4]	-9.1	-10.8	-10.2	n.a.	n.a.	n.a.	n.a.
Trade balance[4]	7.6	18.0	16.8	n.a.	n.a.	n.a.	n.a.
Current account[5]	3.7	13.4	9.7	6.7	...	...	...

1. Annual rate. Annual figures are Q4/Q4.
2. Percent, n.s.a.
3. Percent change from year-earlier period, except annual figures, 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 **Korea**, real GDP growth remained slightly positive in the second quarter, but recent indicators suggest that growth may be slipping into negative territory in the third quarter. Industrial production declined for the fourth consecutive month in July. July's decline was broadbased. Previously, weakness had been concentrated in the high-tech sectors. The rate of capacity utilization dropped to its lowest level in nearly three years in July, and the inventory-to-sales ratio continued to move up sharply. Investment in manufacturing facilities, which tends to be strongly influenced by trends in exports, fell sharply in July, while construction investment remained fairly robust. Indicators of business confidence have turned down in recent months after moving up, on balance, in the first half of the year.

In response to evidence of further weakening in economic activity, the government stated in late August that it planned to supplement previously announced spending measures with a reduction in tax rates. The government indicated that its goal was to reduce income taxes by an average of 15 percent for wage earners and 10 percent for private business owners. The central bank decided at its regular monthly meeting in early September to keep interest rates unchanged but, following the terrorist attacks on the United States, announced a 50 basis point reduction in its target for the overnight rate, to 4 percent. The Korean won has depreciated 1¼ percent since September 10.

Korean Economic Indicators

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

Indicator	1999	2000	2001				
			Q1	Q2	June	July	Aug.
Real GDP[1]	13.8	5.2	1.3	1.8	...	...	...
Industrial production	24.1	17.0	.6	-1.5	-2.0	-1.4	n.a.
Unemployment rate[2]	6.3	4.1	4.2	3.7	3.6	3.7	3.6
Consumer prices[3]	1.3	3.1	4.2	5.3	5.3	5.1	4.7
Trade balance[4]	28.4	16.6	19.9	17.1	17.6	9.2	16.0
Current account[5]	24.5	11.0	12.3	15.2	12.5	5.3	-1.3

1. Annual rate. Annual figures are Q4/Q4.
2. Percent.
3. Percent change from year earlier, except annual changes, 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.

Second-quarter data for the **ASEAN** region suggest that the countries with the greatest concentration of high-tech production, Singapore and Malaysia, have been hardest hit by the global downturn in electronics, while economies with more diverse exports have held up somewhat better. Malaysian real GDP fell precipitously, in line with Singapore's previously reported decline. Both countries saw industrial production rise in July, after several consecutive months of weakness, but the August production figure for Singapore turned down again, falling over 3 percent. In contrast, Thailand and, especially, the Philippines reported positive real GDP growth for the second quarter. In both countries, the growth was due to a pickup in consumption after the resolution of some of the political uncertainties that had plagued the first quarter. For the most part, the ASEAN countries have been able to maintain their trade surpluses, despite the slowdown in the global economy. Inflation edged down slightly in the region.

Following the September 11 attacks, stock markets in the ASEAN countries have fallen between 10 and 17 percent while exchange rates have been fairly stable, with the exception of the Indonesian rupiah which is down 6½ percent since the attack.

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

Indicator and country	1999	2000	2001				
			Q1	Q2	June	July	Aug.
Real GDP[1]							
Indonesia	6.4	5.7	2.0	6.5	...	...	...
Malaysia	11.5	6.4	-3.1	-8.5	...	...	...
Philippines	5.1	3.9	.3	6.0	...	...	...
Singapore	8.0	11.0	-10.8	-10.7	...	...	...
Thailand	6.4	3.1	-.2	.6	...	...	...
Industrial production[2]							
Indonesia[3]	-1.0	11.6	-.6	3.1	.5	n.a.	n.a.
Malaysia	9.0	19.2	-3.4	-5.3	-3.7	3.5	n.a.
Philippines	3.5	14.3	-6.4	1.7	10.4	n.a.	n.a.
Singapore	13.7	15.4	-9.1	-6.2	-8.8	1.9	-3.2
Thailand	12.6	3.1	-1.8	-.1	-1.7	-.6	n.a.

1. Annual rate. Annual figures are Q4/Q4.
2. Annual figures 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.)

Country	1999	2000	2001				
			Q1	Q2	June	July	Aug.
Indonesia	24.7	28.6	24.2	21.8	20.9	26.5	n.a.
Malaysia	19.1	16.0	16.3	13.9	10.8	15.7	n.a.
Philippines	4.3	6.7	6.2	-1.3	-1.5	.5	n.a.
Singapore	3.6	3.3	6.1	6.0	7.1	4.6	8.0
Thailand	9.3	5.5	.3	3.2	9.2	-1.3	n.a.

n.a. Not available.

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

Country	1999[1]	2000[1]	2001				
			Q1	Q2	June	July	Aug.
Indonesia	2.0	9.3	9.3	11.1	12.1	13.0	12.7
Malaysia	2.5	1.3	1.5	1.6	1.5	1.4	1.3
Philippines	4.3	6.6	6.8	6.7	6.7	6.8	6.3
Singapore	.9	2.1	1.7	1.7	1.2	1.3	.7
Thailand	.7	1.3	1.4	2.5	2.3	2.2	1.4

1. December/December.

In **China**, recent indicators point to a continued moderation in growth. Industrial production rose 8.1 percent in August from its year-earlier level, well below the pace reported in the first half of the year. In August, retail sales grew 9.6 percent from a year earlier, down from the first two quarters of this year. The global economic slowdown has led to some tapering off of foreign direct investment, with indicators implying further declines in the near term. In response to weaker consumer demand and FDI, the government increased spending on infrastructure. Fixed asset investment by state-owned enterprises surged over 21 percent in August compared with the same month last year. Consistent with slowing consumer demand, consumer prices rose only 1 percent in August from twelve months earlier, a bit lower than in previous months. Following the sharp declines registered earlier in the year, imports jumped sharply in August, while exports posted their third month of slow growth, resulting in China's first trade deficit in more than five years.

Data received since the last FOMC meeting suggest that **Hong Kong** has slipped into recession. GDP fell 6.6 percent in the second quarter; first quarter GDP growth was revised down to zero from over 1 percent. The volume of retail sales in July was about 6 percent below the June level, and the unemployment rate increased to 4.9 percent in the June-August period. Exports were up slightly in July and August from their second-quarter average, but still remain well below their average level in the first quarter, reflecting a falloff in electronics exports. Consumer prices fell 1.2 percent over the twelve months ended August, a steeper drop than in the previous two months.

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

Indicator	1999	2000	2001				
			Q1	Q2	June	July	Aug.
Real GDP[1]	4.1	8.0	8.1	7.5	...	...	...
Industrial production[2]	8.0	11.4	11.2	10.6	10.1	8.1	8.1
Consumer prices[2]	-1.0	1.5	.7	1.6	1.4	1.5	1.0
Trade balance[3]	29.2	24.1	18.6	21.1	19.5	18.6	-8.4

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

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

Indicator	1999	2000	2001				
			Q1	Q2	June	July	Aug.
Real GDP[1]	9.3	6.6	.0	-6.6	...	...	...
Unemployment rate[2]	6.1	5.0	4.5	4.5	4.5	4.7	4.9
Consumer prices[3]	-4.0	-2.1	-2.0	-1.3	-1.0	-.9	-1.1
Trade balance[4]	-5.6	-11.0	-10.9	-11.5	-12.3	-15.8	-12.8

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

Indicators released over the past month confirm that **Taiwan** is in recession. In the second quarter, GDP plummeted over 10 percent (s.a.a.r.), and recent data suggest that economic activity has continued to decline in the third quarter. While the volatile industrial production series jumped in August following a decline in July, other reports were more negative. Exports declined almost 4½ percent in August on the heels of an 8.7 percent drop in July, owing to sagging global demand for electronics and information technology products. Imports fell a dramatic 14.3 percent for August, implying very weak demand, especially for imported inputs. In addition, the unemployment rate for August now stands almost half a percentage point below the second quarter average. Consumer prices increased slightly in August from year earlier levels. Taiwan's central bank cut key interest rates–which were already at record lows–½ percentage point on September 18. The bank cited Taiwan's weakening economy and record high unemployment for the cut, and also made reference to the terrorist attacks on the United States.

Across Greater China, stock markets plunged in the wake of the terrorist attacks, while exchange rates were little affected.

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

Indicator	1999	2000	2001				
			Q1	Q2	June	July	Aug.
Real GDP[1]	6.5	3.8	-2.3	-10.1	...	...	...
Unemployment rate[2]	2.9	3.0	3.8	4.4	4.6	4.7	4.8
Industrial production	7.7	7.4	-3.8	-2.9	-2.5	-1.2	5.2
Consumer prices[3]	.1	1.7	.6	.0	-.2	.1	.4
Trade balance[4]	10.9	8.3	17.1	13.7	21.4	7.8	18.2
Current account[5]	8.4	8.9	16.3	14.7	...	...	...

1. Annual rate. Annual figures are Q4/Q4.
2. Percent.
3. Percent change from year-earlier period, except annual figures, 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.