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## **Part 2**

June 18, 2003

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## **CURRENT ECONOMIC AND FINANCIAL CONDITIONS**

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### **Recent Developments**

Confidential (FR) Class III FOMC

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March 13, 2003

## **Recent Developments**

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

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## **Domestic Nonfinancial Developments**

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## **Domestic Nonfinancial Developments**

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### **Overview**

The economy appears to have expanded at a subpar pace in the current quarter, and the incoming data have provided mixed signals about the trajectory of economic activity as we move toward the second half of the year. Businesses still have been reluctant to hire, and we have seen no sign yet of any substantial pickup in their capital spending. However, consumer confidence rebounded substantially after the war with Iraq, and, adjusted for inflation, retail sales in May more than reversed their drop in April. Homebuilding has flattened out, albeit at a high level. In the public sector, federal defense outlays are up sharply, outweighing by a significant margin the spending restraint of state and local governments. Meanwhile the year-over-year change in core consumer prices edged up in May after having moved lower during the early spring.

### **Labor Market Developments**

The labor market showed some signs of stabilizing in April and May. After having fallen 35,000 per month in the first quarter of the year, employment on private nonfarm payrolls edged up 8,000 in May, after an upward-revised increase of 2,000 in April. Employment in manufacturing continued to fall last month, although employment in temporary help services—which supplies many of its workers to manufacturing—picked up noticeably. Employment in construction rose substantially for the third consecutive month, and financial activities continued to add jobs. However, employment in services industries—excluding temporary help supply—was essentially unchanged. Aggregate hours of production or nonsupervisory workers were unchanged in May after having fallen 0.3 percent in April.

In the survey of households, the unemployment rate, which is considered to be a lagging indicator, edged up further to 6.1 percent in May. The recent rise in joblessness has reflected an increase in both incidence and duration: The numbers of short-term job losers and longer-term unemployed have both increased. The labor force participation rate, which continues to be depressed by the paucity of jobs, was essentially unchanged, at 66.4 percent.

In keeping with its usual practice, the May labor market report included the BLS's benchmark of payroll employment estimates to unemployment insurance tax records for March 2002 as well as other annual updates to the payroll employment estimates.<sup>1</sup> In addition, the establishment survey program was converted from the Standard Industrial Classification (SIC) system to the North

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1. These changes include recalculation of seasonal factors, reweighting of sampled firms, and reestimation of birth-death models.

## II-2

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

	2002	2003				
	Q4	Q1	Mar.	Apr.	May	
<b>-Average monthly change-</b>						
Nonfarm payroll employment <sup>1</sup>	-39	-30	-38	-151	0	-17
Previous	-18	-53	-91	-124	-48	n.a.
Private	-55	-40	-35	-110	2	8
Manufacturing	-57	-59	-49	-48	-90	-53
Construction	-4	1	-4	20	37	26
Wholesale trade	-7	-7	-3	-2	-3	-6
Retail trade	-6	-3	-4	8	13	-14
Transportation and utilities	-4	-7	-6	-14	-17	-5
Information	-14	-10	-16	-3	2	-6
Financial activities	5	13	14	14	23	12
Professional and Business services	-10	-12	3	-63	1	48
Temporary Help Services	1	-14	-8	-16	-13	58
Non-business services <sup>2</sup>	45	44	33	-18	37	8
Total government	16	10	-3	-41	-2	-25
Total employment (household survey)	31	-291	303	-60	339	-200
<b>Memo:</b>						
Aggregate hours of private production workers (percent change) <sup>1,3</sup>	-1.0	-1.1	-1.7	0.0	-0.3	0.0
Average workweek (hours) <sup>1</sup>	33.9	33.8	33.8	33.8	33.7	33.7
Manufacturing (hours)	40.5	40.4	40.4	40.4	40.1	40.2

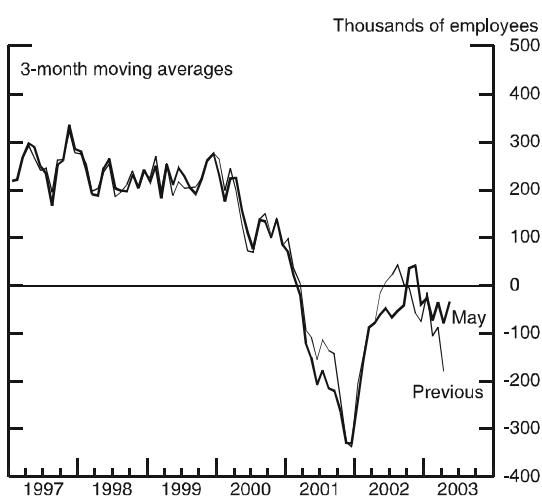
Note. Average change from final month of preceding period to final month of period indicated.

1. Survey of establishments.

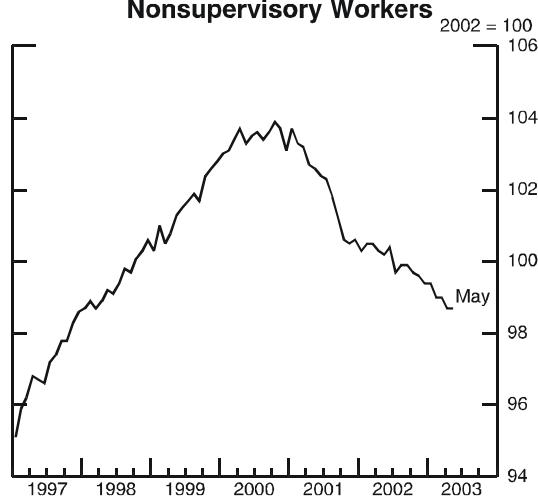
2. Non-business services comprises education and health, leisure and hospitality, and 'other'.

3. 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**



**Aggregate Hours of Production or Nonsupervisory Workers**

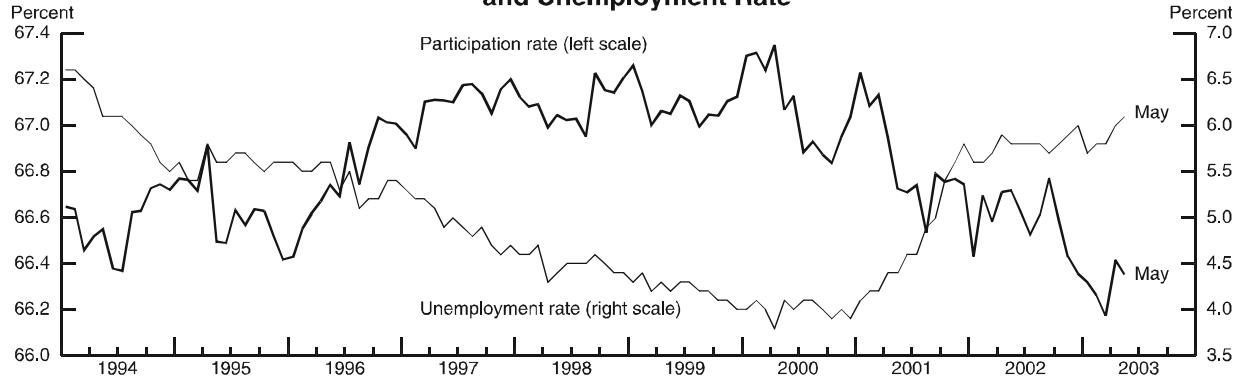


## II-3

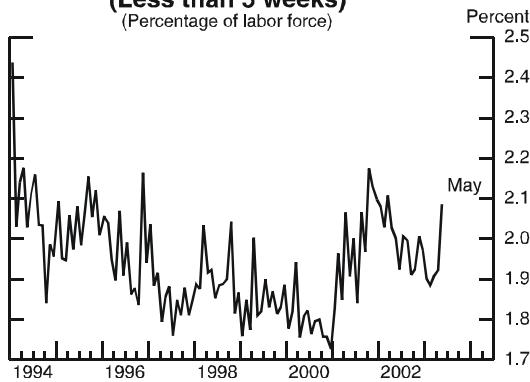
**SELECTED UNEMPLOYMENT AND LABOR FORCE PARTICIPATION RATES**  
 (Percent; based on seasonally adjusted data)

	2002	<u>2002</u>		<u>2003</u>		<u>2003</u>		
	2002	Q3	Q4	Q1	Mar.	Apr.	May	
Civilian unemployment rate (16 years and older)	5.8	5.8	5.9	5.8	5.8	6.0	6.1	
Teenagers	16.5	16.7	16.1	17.2	17.7	18.0	18.5	
20-24 years old	9.7	9.6	9.9	9.2	8.9	10.1	10.5	
Men, 25 years and older	4.7	4.7	4.9	4.9	4.9	5.1	5.2	
Women, 25 years and older	4.6	4.6	4.6	4.4	4.6	4.7	4.6	
Labor force participation rate	66.6	66.6	66.5	66.3	66.2	66.4	66.4	
Teenagers	47.4	47.6	46.8	45.2	44.1	45.0	45.1	
20-24 years old	76.4	76.6	75.8	75.5	74.8	75.5	76.0	
Men, 25 years and older	75.9	76.0	75.6	75.3	75.3	75.6	75.5	
Women, 25 years and older	59.4	59.3	59.4	59.6	59.6	59.8	59.7	

### Labor Force Participation Rate and Unemployment Rate



**Short-term Unemployed  
(Less than 5 weeks)**  
(Percentage of labor force)

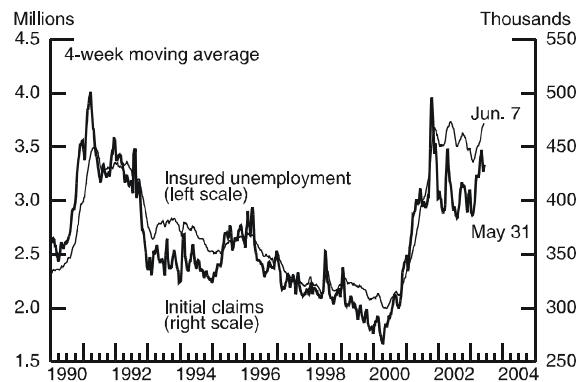


**Long-term Unemployed  
(Over 26 weeks)**  
(Percentage of labor force)

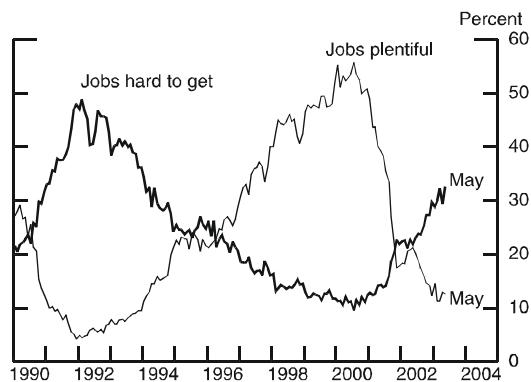


## Labor Market Indicators

### Unemployment Insurance

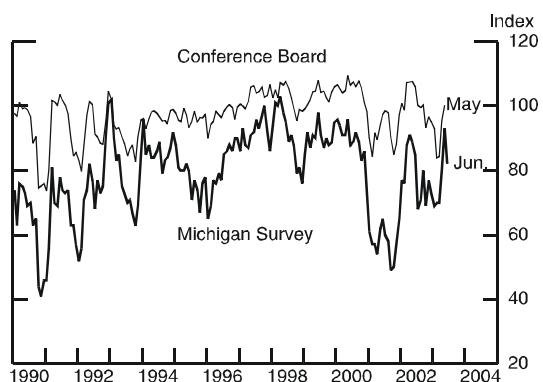


### Current Employment Conditions



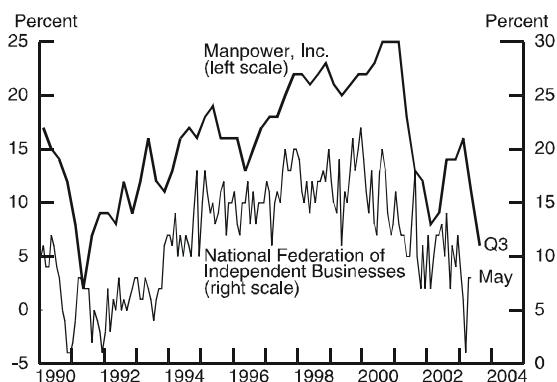
Source. Conference Board.

### Expected Labor Market Conditions



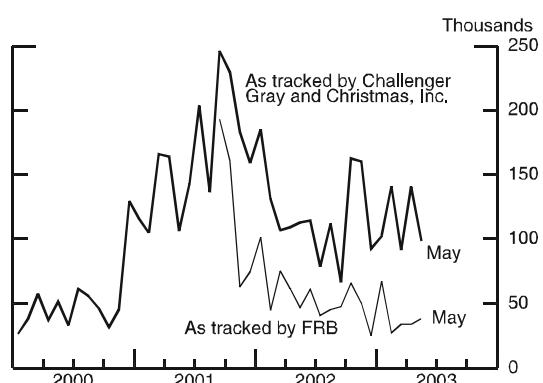
Note. The proportion of households expecting labor market conditions to improve, minus the proportion expecting conditions to worsen, plus 100.

### Net Hiring Strength



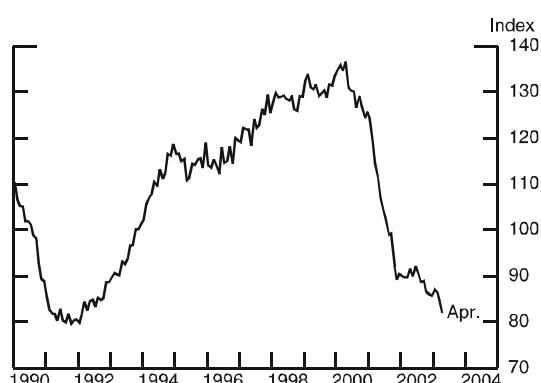
Note. Percent planning an increase in employment minus percent planning a reduction.

### Layoff Announcements



Note. Seasonally adjusted by FRB staff.

### Help Wanted Index



Source. Conference Board.

American Industrial Classification System (NAICS).<sup>2</sup> As a result of these changes, payroll employment is now estimated to have fallen more in 2002 than previously reported but to have contracted less thus far this year. On net, in the twelve months following the benchmark date of March 2002, the cumulative decline in private payroll employment is now only 40,000 steeper than estimated earlier. However, the revised figures now show a 0.1 hour decline in the workweek over the period rather than a 0.1 hour increase.<sup>3</sup>

The revised data now show that the decline in aggregate hours of production or nonsupervisory workers was more than 3/4 percentage point per year steeper in 2001 and 2002 than reported earlier. The change in aggregate hours (at an annual rate) was also revised down 1-1/4 percentage points in the first quarter of this year. The BLS will use these revised figures in estimating its broader measure of hours of all persons for its productivity and costs measures. However, because of the extent of the recent changes to both the household and payroll estimates, considerable uncertainty exists as to how the hours data will be revised. Currently, the BLS expects to update the hours series, and associated productivity series, for release with its preliminary estimates of second-quarter productivity and costs in August. Even if the BLS adheres to that schedule, the productivity estimates will likely change further after the benchmark revision to the output estimates in the national income and product accounts in December.

Despite the better readings on payroll employment in April and May, initial claims for unemployment insurance have shown little improvement over the past couple of months. The four-week moving average of initial claims stood at 434,000 for the week ended June 7, nearly the same as the average level in early April. Insured unemployment rose to 3.8 million for the week ended May 31 and now stands more than 400,000 above its recent lows in January.

Other labor market indicators have yielded mixed signals. After having deteriorated in February and March, households' perceptions of current labor market conditions were little changed in April and May, according to the Conference Board survey. Expectations of future labor market conditions improved noticeably in May in both the Conference Board and Michigan surveys but then deteriorated a bit in early June, according to the preliminary release of the Michigan survey. Among firm-level indicators, the hiring plans of small businesses, as reported by the National Federation of Independent

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2. Other one-time changes included introduction of concurrent seasonal adjustment procedures, changes to the method for measuring federal employment, and conversion of the service sector to a probability-based survey design—the last sector to be converted.

3. In addition, after the incorporation of the new, probability-based sample estimates, the level of the average workweek throughout most of published history was revised down.

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

Component	Proportion 2002 (percent)	2002 <sup>1</sup>	2002 <sup>2</sup>	2003 <sup>2</sup>	2003 <sup>3</sup>		
			Q4	Q1	Mar.	Apr.	May
<b>Total</b>	<b>100.0</b>	<b>1.4</b>	<b>-3.4</b>	<b>.3</b>	<b>-.6</b>	<b>-.6</b>	<b>.1</b>
Previous	100.0	1.4	-3.4	.4	-.5	-.5	...
Manufacturing	84.7	1.0	-3.7	-.6	-.2	-.7	.2
Ex. motor veh. and parts	78.3	.1	-3.5	-.8	-.1	-.7	.3
Ex. high-tech industries	71.6	-.5	-4.3	-1.4	-.2	-.8	.3
Mining	6.3	-1.9	1.0	-2.7	-.1	.4	.8
Utilities	9.0	7.7	-3.3	10.3	-4.0	.1	-.8
<i>Selected industries</i>							
High technology	6.6	7.1	6.7	8.0	1.0	1.1	.8
Computers	1.3	19.9	25.5	24.5	2.4	1.9	1.9
Communications equipment	2.3	-16.6	-16.1	2.8	1.0	-.1	-1.3
Semiconductors <sup>4</sup>	3.0	19.8	14.5	3.5	.2	1.4	1.7
Motor vehicles and parts	6.5	10.9	-5.6	1.5	-1.4	-1.4	-1.1
<i>Market groups excluding energy and selected industries</i>							
Consumer goods	21.9	-1.3	-3.9	-.1	.2	-.7	.1
Durables	3.5	.5	.1	-2.2	.1	-.7	.5
Nondurables	18.5	-1.6	-4.6	.4	.2	-.7	.1
Business equipment	7.8	-6.0	-7.7	-1.9	-.8	-1.0	.0
Defense and space equipment	1.8	5.1	4.3	11.1	.3	-.3	2.0
Construction supplies	6.6	.9	-4.2	-6.2	-.5	-.9	.4
Business supplies	7.4	.3	-2.5	-.7	-.2	-1.3	.2
Materials	25.3	.9	-4.7	-2.9	-.4	-.7	.1
Durables	13.6	.6	-3.8	-3.6	-.9	-.5	.4
Nondurables	11.7	1.3	-5.6	-1.8	.2	-.8	-.1

1. Fourth-quarter to fourth-quarter change.

2. Annual rate.

3. Monthly rate.

4. Includes related electronic components.

... Not applicable.

**Capacity Utilization**  
(Percent of capacity)

Sector	1972- 2002 average	1982 low	1990- 91 low	2002		2003		
				Q3	Q4	Q1	Apr.	May
<b>Total industry</b>	<b>81.3</b>	<b>70.8</b>	<b>78.6</b>	<b>76.2</b>	<b>75.3</b>	<b>75.2</b>	<b>74.3</b>	<b>74.3</b>
Manufacturing	80.2	68.6	77.2	74.3	73.5	73.2	72.5	72.6
High-tech industries	79.3	75.6	74.6	62.2	62.2	62.1	62.5	62.5
Excluding high-tech industries	80.2	68.1	77.3	75.8	75.0	74.7	73.9	74.0
Mining	86.9	78.6	83.3	84.9	85.1	84.4	84.3	85.0
Utilities	86.7	77.2	84.2	88.2	86.0	86.9	84.3	83.4

LABOR PRODUCTIVITY (Percent change from preceding period at compound annual rate; based on seasonally adjusted data)						
	2001 <sup>1</sup>	2002 <sup>1</sup>	Q2	2002 Q3	Q4	2003 Q1
<u>Output per hour</u>						
Total business	1.9	4.0	1.8	5.8	0.3	2.5
Nonfarm business	1.9	4.1	1.7	5.5	0.7	1.9
Previous	1.9	4.1	1.7	5.5	0.7	1.6
Manufacturing	1.2	4.2	4.2	5.5	-0.5	1.9
Nonfinancial corporations <sup>2</sup>	3.3	4.7	5.8	3.4	5.0	2.9

1. Changes are from fourth quarter of preceding year to fourth quarter of year shown.

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

Businesses, were unchanged in May from their low level.<sup>4</sup> In contrast, layoff announcements tumbled in May, according to the outplacement firm Challenger, Gray, and Christmas, Inc., although the Board staff's tally so far for June suggests that they have moved back up.

Productivity in the nonfarm business sector increased at an annual rate of 1.9 percent in the first quarter, bringing the change over the four quarters ending in 2003:Q1 to 2.4 percent—down from its heady 4.4 percent pace over the preceding four quarters. In the nonfinancial corporate sector, productivity rose 2.9 percent (annual rate) in the first quarter and 4.3 percent over the four quarters ending in 2003:Q1—down from 5.2 percent over the preceding four quarters.

## Industrial Production

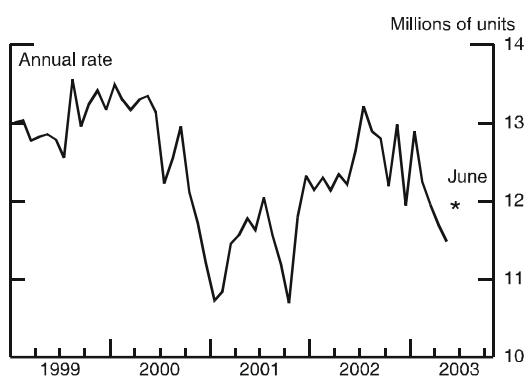
Activity in the industrial sector stabilized in May after sizable drops in the preceding two months. Total industrial production edged up 0.1 percent in May, and manufacturing output was up 0.2 percent. Nonetheless, the factory operating rate was at 72.6 percent in May, the lowest level since 1983. As of May, manufacturing production had eked out a cumulative gain of just 0.6 percent since the December 2001 trough in IP, by far the weakest recovery since World War II.

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4. Manpower, Inc.'s survey of hiring plans for the third quarter dropped to its lowest level in twelve years; however, the survey was taken in early April, before the conclusion of the war with Iraq. In general, this survey has provided more information about current labor market conditions than prospective conditions.

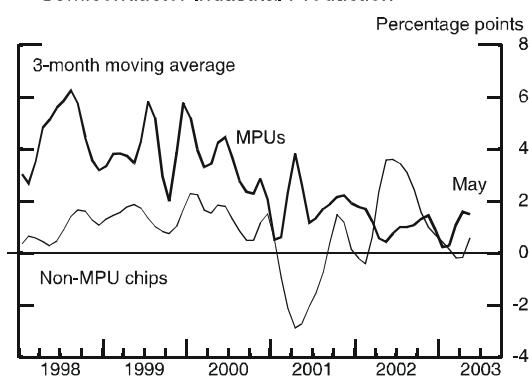
## Indicators of Manufacturing Activity

Motor Vehicle Assemblies

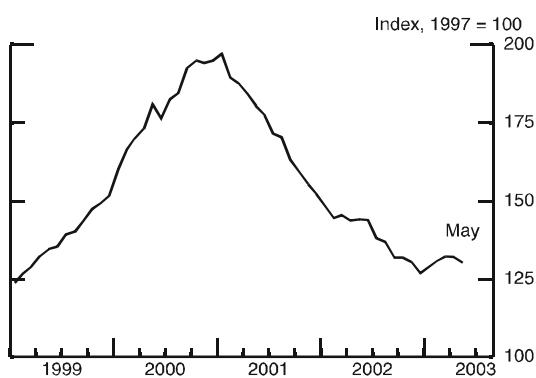


\* June value is based on weekly data.

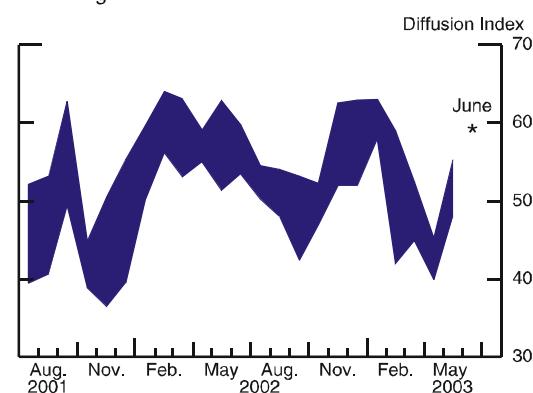
Contribution to the Rate of Change in Semiconductor Industrial Production



Communication Equipment Industrial Production



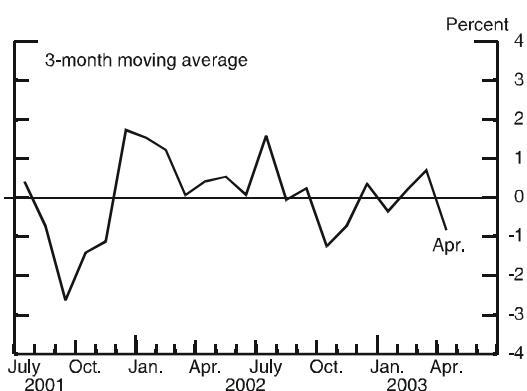
New Orders: Purchasing Managers Indexes



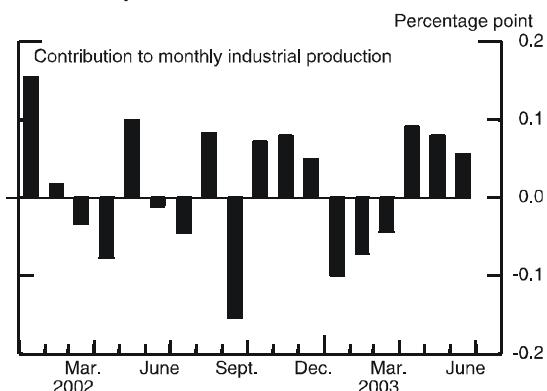
Note. Range of reports from Chicago, New York, Philadelphia, Richmond, and ISM.

\* June value of the Empire State new orders diffusion index.

Change in Real Adjusted Durable Goods Orders



Weekly Physical Product Data Except Electricity Generation and Motor Vehicles



The improvement in manufacturing activity in May was broadly based. In the transportation sector, motor vehicle assemblies dropped again but by less than in the previous three months. An increase in the production of aircraft and parts in May partially recouped a strike-induced decline in the output of military aircraft in April. Industry contacts suggest that the remaining lost production will be made up in June.

Manufacturing activity within the high-tech sector continued to expand, on balance, although developments have been mixed. Steady gains in computer output since the beginning of the year have boosted the production of high-value-added semiconductor chips, such as microprocessor units, in recent months, while the production of other semiconductors, particularly those used in cell phones, softened significantly in April and May.<sup>5</sup> Output of communications equipment—cell phones, equipment used by telecommunications service providers, and the routers, switches, and hubs used in computer networks—dropped in May after having moved sideways, on balance, since the beginning of the year.<sup>6</sup>

Apart from transportation and high-tech, factory production was up 0.3 percent in May after having declined 0.8 percent in April. Among upstream market groups, the output of construction supplies turned up in May after having contracted in each month since September, and the output of materials also moved up. However, the production of business supplies continued to be lackluster. Among market groups that align with final demand categories, production results were generally positive. The output of defense and space equipment jumped another 2 percent in May, bringing the average gain so far this year to 0.9 percent per month. In addition, the production of consumer goods (excluding motor vehicles) rose in May. In contrast, restrained capital spending continued to depress the production of business equipment, which was unchanged in May and remained well below its level in May 2002.

Indicators of near-term manufacturing activity are generally consistent with a further small rise in industrial production in June. The May readings on new orders from the diffusion indexes from the Institute for Supply Management and various regional surveys all improved in May and suggest modest gains in

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5. Our contacts at both Motorola and the Semiconductor Industry Association reported that cell phone sales in China—20 percent of the worldwide market—collapsed in April because of the outbreak of SARS. The United States produces a large share of the processors and memory chips used in cell phones, especially higher-value chips.

6. In February 2003, the Federal Communications Commission issued a ruling that changes the terms under which the regional Bell operating companies must provide competitors access to their networks. General regulatory uncertainty arising from the implementation of this ruling and the prospect of court challenges may damp demand for communications equipment in the coming months.

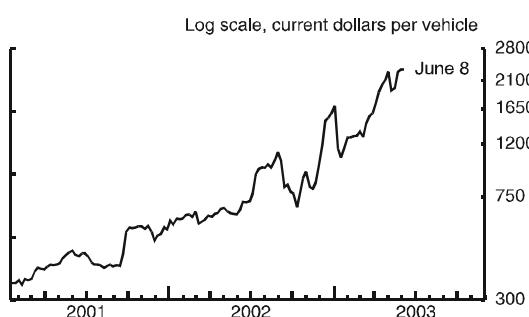
**Sales of Automobiles and Light Trucks**  
(Millions of units at an annual rate, FRB seasonals)

	2002	2002		2003	2003		
		Q3	Q4	Q1	Mar.	Apr.	May
Total	16.7	17.6	16.5	15.8	16.0	16.4	16.0
Autos	8.1	8.5	7.9	7.7	7.7	7.5	7.3
Light trucks	8.6	9.1	8.6	8.1	8.3	8.8	8.7
North American <sup>1</sup>	13.5	14.3	13.3	12.5	12.5	13.0	12.8
Autos	5.9	6.2	5.7	5.5	5.5	5.4	5.3
Light trucks	7.6	8.1	7.6	6.9	7.0	7.6	7.5
Foreign-produced	3.3	3.4	3.2	3.4	3.5	3.4	3.2
Autos	2.2	2.3	2.2	2.2	2.2	2.1	2.0
Light trucks	1.1	1.1	1.1	1.2	1.3	1.3	1.2
Memo:							
Medium and heavy trucks	.40	.43	.41	.37	.36	.38	.39

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

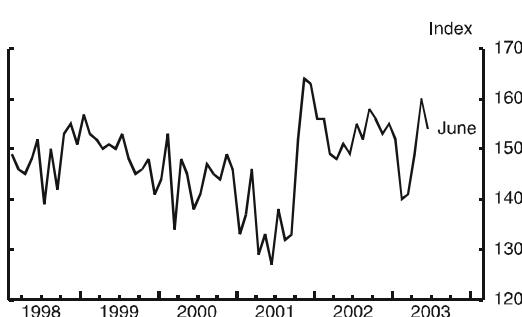
1. Excludes some vehicles produced in Canada that are classified as imports by the industry.

**Average Value of Incentives on Light Vehicles**



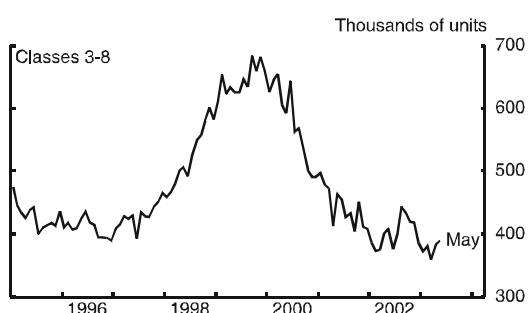
Note. Weighted average of customer cash rebate and interest rate reduction. Data are seasonally adjusted.  
Source. J.D. Power and Associates.

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



Note. Data are preliminary.

**Sales of Medium and Heavy Trucks**



Note. Annual rate, FRB seasonals.

**Net New Orders of Trucks**



Note. Monthly rate, FRB seasonals.

### New Orders for Durable Goods

(Percent change from preceding period except as noted; seasonally adjusted)

Component	Share, 2002: H2 (percent)	2003				
		Q4	Q1	Feb.	March	April
<b>Total orders</b>	<b>100.0</b>	<b>-2.8</b>	<b>1.1</b>	<b>-1.1</b>	<b>1.3</b>	<b>-2.3</b>
Adjusted orders <sup>1</sup>	75.0	-1.8	0.2	-1.6	1.2	-2.3
Computers	4.0	1.3	-4.3	-13.1	-0.8	15.6
Communication equipment	3.0	6.0	30.9	0.0	1.1	-2.3
Other capital goods	24.0	-1.3	2.1	-0.8	6.3	-5.5
Other <sup>2</sup>	44.0	-2.8	-2.2	-1.1	-1.4	-2.0
MEMO						
Real adjusted orders	...	-1.6	0.5	-1.4	0.9	-2.0
Excluding high tech	...	-2.9	-0.2	-.9	1.3	-2.8

1. Orders excluding defense capital goods, nondefense aircraft, and motor vehicle parts.

2. Primary metals, most fabricated metals, most stone, clay, and glass products, household appliances, scientific instruments, and miscellaneous durable goods.

... Not applicable.

manufacturing activity apart from motor vehicles and parts.<sup>7</sup> The first glimpse at June from the Empire State survey also showed a pickup. The three-month moving average of real adjusted durable goods orders dipped in April and is consistent with little change in IP. Based on the limited data in hand, motor vehicle assemblies are on track to move up toward an annual rate of 12 million units in June—which would add 0.1 percentage point to the rate of change in IP. Apart from motor vehicle assemblies and electricity generation, scant available data suggest that the weekly physical product aggregate will contribute a little to IP in June.

### Motor Vehicles

Sales of light motor vehicles declined slightly in May, to an annual rate of 16 million units. Taken together, April and May's sales averaged 16.2 million units, a bit above the sales pace of 15.8 million units in the first quarter. In an attempt to bolster sales, automakers raised incentives during April and May, offering a record high average of \$2,200 per vehicle in May. However, the surge in sales that has accompanied previous sweetenings of incentives has not

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7. The diffusion index from FRB Kansas City is excluded, as it does not have a sufficient history for seasonal adjustment.

**Production of Domestic Autos and Trucks**

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

Item	2002		2003			2003		
	Q4	Q1	Q2	Q3	Mar.	Apr.	May	June <sup>1</sup>
U.S. production	12.4	12.4	11.7	12.6	12.0	11.7	11.5	11.8
Autos	4.9	4.7	4.4	4.9	4.4	4.4	4.4	4.6
Trucks	7.5	7.7	7.2	7.7	7.5	7.3	7.1	7.2
Total days' supply <sup>2</sup>	63.12	74.0	71.9	66.6	73.65	70.99	71.83	71.98
Inventories <sup>3</sup>	2.73	3.01	3.02	2.92	3.01	3.01	3.00	3.02

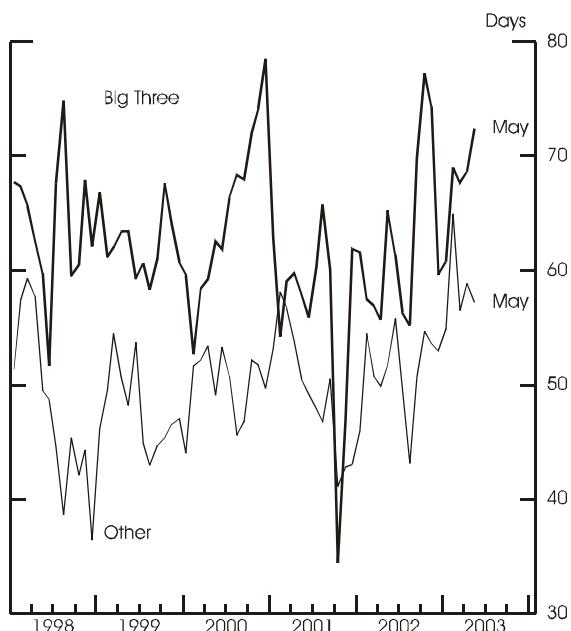
NOTE. Components may not sum to totals because of rounding.

1. Production rates reflect Ward's Communications' latest schedules for Q3 and June.

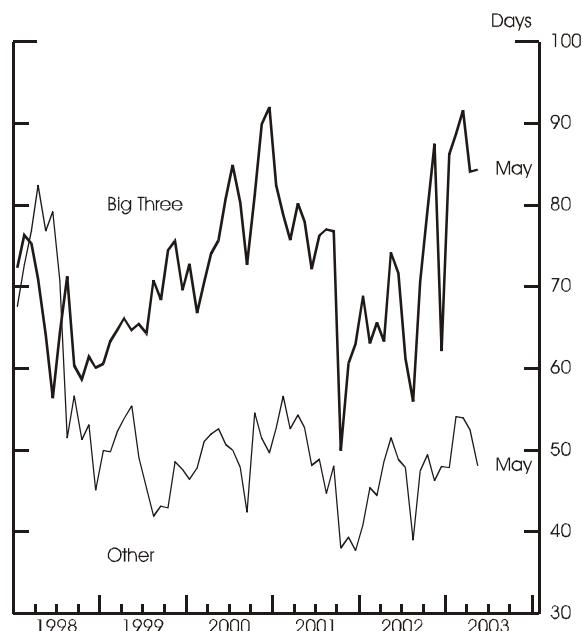
2. Semiannual and quarterly values calculated with end-of-period stocks and average reported sales.

3. End-of-period stocks; excludes medium and heavy trucks (classes 3-8).

Days' Supply of Autos



Days' Supply of Light Trucks



yet materialized. Perhaps because the window on these current deals is open longer (through July), the sales response will be spread over several months. Indeed, some industry contacts have reported a noticeable step-up in sales so far in June.

The general softness in business demand for new capital has been reflected in tepid gains in the sales of motor vehicles to businesses. Fleet sales of light vehicles were little changed in April and May from their first quarter pace of about 3 million units. However, sales of medium and heavy trucks turned up a bit in April and May, and new orders for medium and heavy trucks rose in May.

Although production of light motor vehicles fell from an annual rate of 12.7 million units in January to an 11.3 million unit rate in May, inventories remain high. With stocks of 3 million units at the end of May, dealers held more than seventy days' supply of light vehicles, well above the target range of sixty to sixty-five days. Despite elevated inventories, manufacturers' third-quarter schedules call for a jump in assemblies to 12.6 million units, nearly 1 million units more than in the second quarter. As noted earlier, the partial data for June suggest that assemblies are ramping up. However, an underbuild relative to current plans would not be surprising, given that inventories are high and that, over the last ten years, third-quarter assemblies have averaged 3 percent below the scheduled rate. That said, the higher schedules may instead represent a hedge against possible production disruptions related to the upcoming contract negotiations with the United Automobile Workers (UAW) union.<sup>8</sup>

### **Consumer Spending**

Real personal consumption expenditures are likely to post another modest gain in the second quarter after a 2.0 percent (annual rate) increase in the first quarter. Spending on motor vehicles has risen a bit, on net, relative to the first quarter, while real consumer outlays excluding cars and trucks, which were flat in April, rebounded in May. At the same time, the fundamentals underlying household spending have become more favorable: Real disposable income has posted solid gains (driven largely by the retreat in energy prices), and both the stock market and consumer confidence have recovered smartly from earlier in the year.

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8. One factor arguing against a strike, according to an industry contact, is that both sides can ill afford a labor stoppage: The Big Three automakers are in weak financial condition, and the union, which has seen sharp declines in membership in recent years, has an incentive to help them maintain their competitive position against non-union rivals. In addition, the UAW reportedly is interested in enlisting the help of the Big Three in organizing the supplier sector. They may therefore want negotiations to remain on friendly terms.

### Retail and Food Services Sales

(Percent change; seasonally adjusted)

Expenditure	2002			2003			
	H1	Q3	Q4	Q1	Mar.	Apr.	May
Total sales	.0	1.9	.1	1.4	2.3	-.3	.1
Previous estimate	...	...	...	1.4	2.3	-.1	...
Retail control <sup>1</sup>	2.7	.6	1.0	1.9	.9	-1.0	.1
Previous estimate	...	...	...	1.9	.9	-1.0	...
GAF <sup>2</sup>	2.4	.1	.9	.2	1.0	-.4	.9
Gasoline stations	5.9	1.9	3.3	7.6	1.0	-5.4	-4.3
Food services	3.5	.4	1.0	2.3	1.8	-.4	1.4
Other retailers <sup>3</sup>	2.0	.7	.4	1.9	.4	-.4	.1

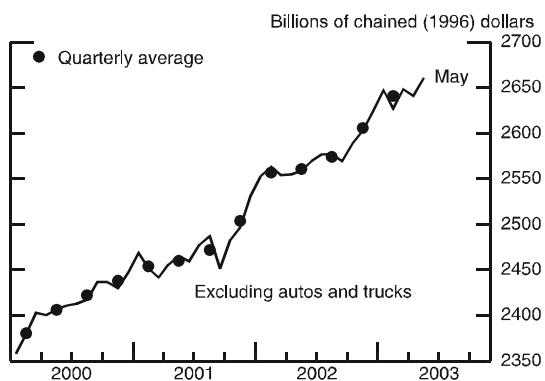
1. Total retail trade and food services less sales at building material and supply stores and automobile and other motor vehicle dealers.

2. Furniture and home furnishing stores; electronics and home appliance stores; clothing and accessories stores; sporting goods, hobby, book and music stores; and general merchandise stores.

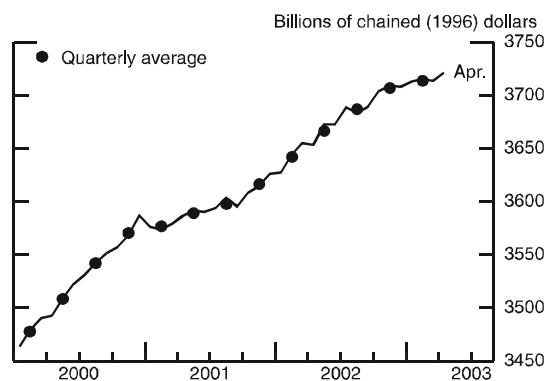
3. Health and personal care stores, food and beverage stores, electronic shopping and mail order houses, miscellaneous other retailers.

... Not applicable.

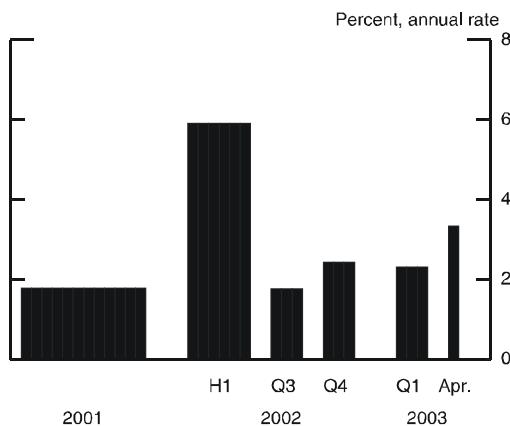
Real PCE Goods



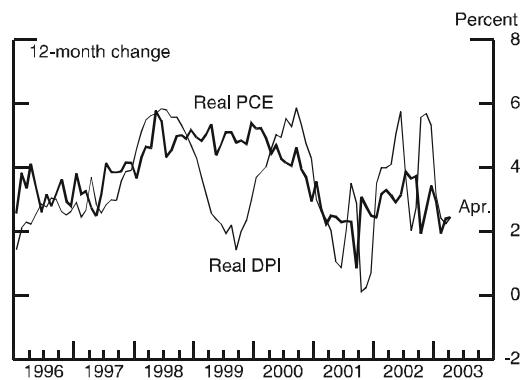
Real PCE Services



Change in Real DPI



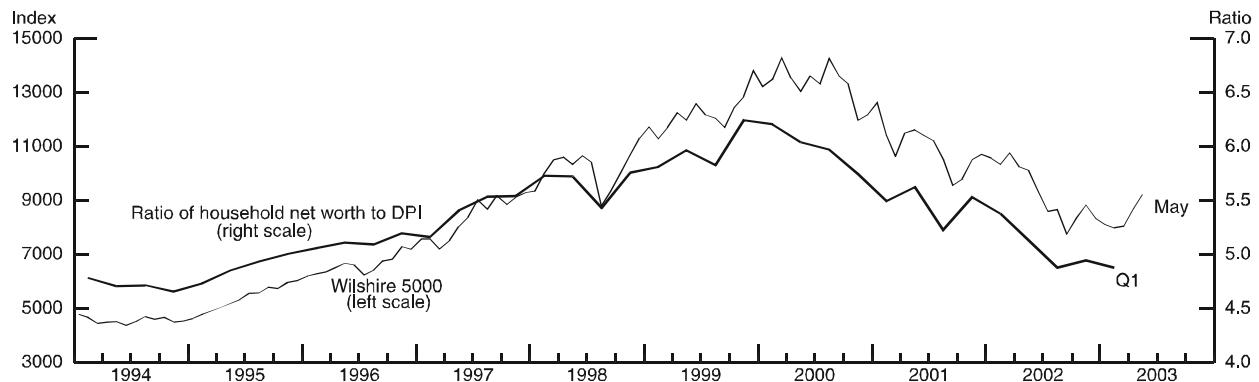
Real Consumer Spending and Income



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## Household Indicators

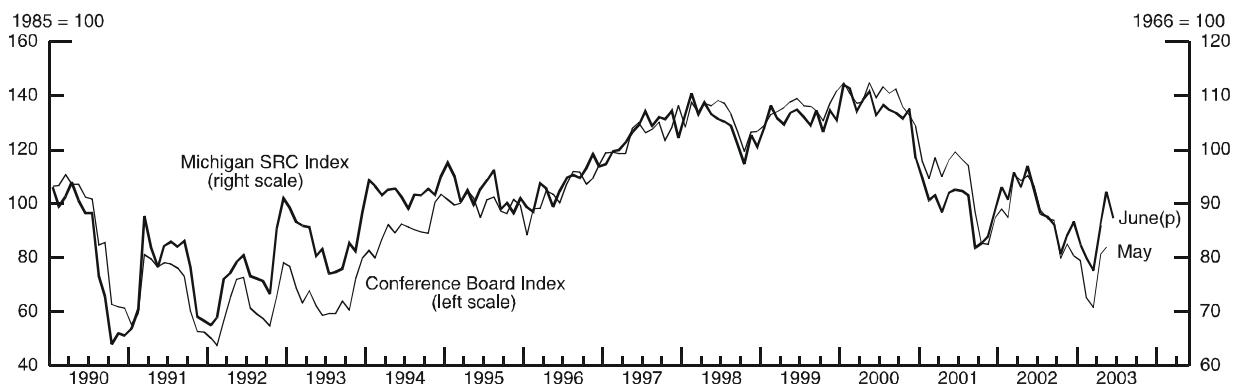
**Household Net Worth and Wilshire 5000**



**Personal Saving Rate**



**Consumer Confidence**



### Private Housing Activity

(Millions of units; seasonally adjusted annual rate)

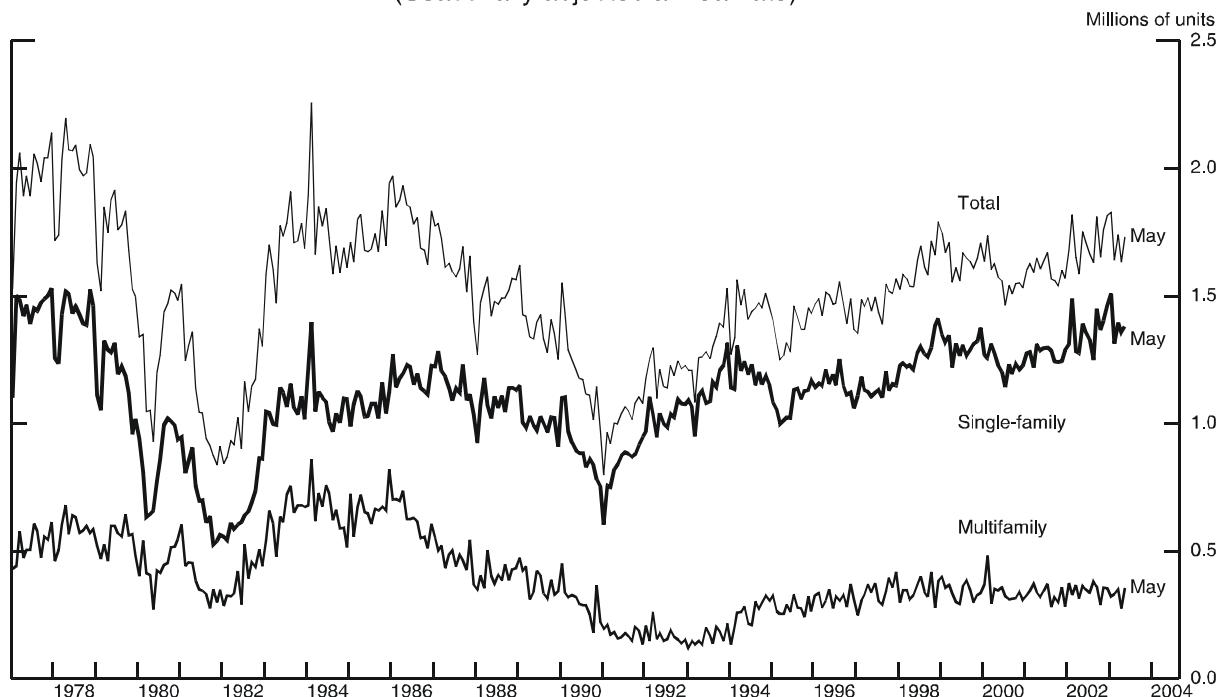
	2002			2003			
	2002	Q3	Q4	Q1 <sup>r</sup>	Mar. <sup>r</sup>	Apr. <sup>r</sup>	May <sup>p</sup>
<i>All units</i>							
Starts	1.71	1.70	1.74	1.74	1.74	1.63	1.73
Permits	1.73	1.75	1.83	1.75	1.69	1.72	1.79
<i>Single-family units</i>							
Starts	1.36	1.34	1.41	1.41	1.39	1.36	1.38
Permits	1.32	1.33	1.40	1.35	1.31	1.33	1.34
Adjusted permits <sup>1</sup>	1.37	1.38	1.44	1.39	1.37	1.36	1.37
New home sales	0.97	1.01	1.03	0.99	1.01	1.03	n.a.
<i>Existing home sales</i>							
Published	5.57	5.40	5.77	5.83	5.53	5.84	n.a.
Staff adjusted	5.57	5.43	5.75	5.76	5.74	5.76	n.a.
<i>Multifamily units</i>							
Starts	0.35	0.36	0.33	0.33	0.35	0.27	0.35
Permits	0.41	0.42	0.43	0.41	0.38	0.39	0.45
<i>Mobile homes</i>							
Shipments	0.17	0.17	0.15	0.14	0.13	0.13	n.a.

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

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

### Private Housing Starts

(Seasonally adjusted annual rate)



In May, nominal sales in the retail control group of stores, which excludes automotive dealers and building materials and supply stores, edged up 0.1 percent following a decrease in April of 1.0 percent. Falling prices pushed down nominal sales at gasoline stations last month, but spending rose substantially at most other categories of retail outlets. Factoring in the effect of declining prices, we estimate that real retail control increased a robust 0.7 percent in May, more than reversing April's decrease of 0.3 percent.

Real outlays on services rose moderately in April, the most recent month for which data are available. Much of this increase was due to higher expenditures on energy services. Spending on non-energy services has been tepid so far this year—held down, in part, by weak outlays for airline travel and recreation.

After having posted a substantial rebound in April and May, consumer sentiment retreated somewhat in early June, according to the Michigan SRC index. The recent fallback occurred as households' expectations for business conditions—both twelve months and five years hence—reversed part of the improvement registered in the preceding two months. Assessments of current conditions were little changed in early June. Despite the latest decline in the Michigan index, both the Michigan and Conference Board indexes remain well above their low levels reached earlier in the year.

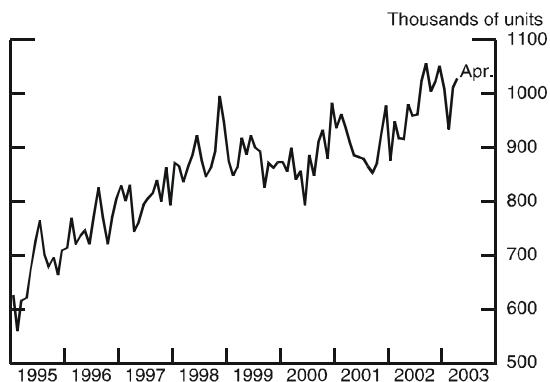
## **Housing Markets**

Activity in the housing market has been reasonably well maintained in recent months, as further declines in mortgage rates have offset much of the downward pressure from the soft labor market. Homebuilding was likely held down a bit last month by the unusually wet weather. Yet starts of single-family homes rose to an annual rate of 1.38 million units, leaving the April-May average only a little below the first-quarter pace. New permit issuance—adjusted for activity in areas where permits are not required—was at an annual rate of 1.37 million units in May, close to the first-quarter average; in addition, the backlog of unused permits remained near its record high. Along with sharply lower mortgage rates, these indicators suggest that single-family starts are likely to remain strong in coming months. In the multifamily sector, starts rebounded sharply from their April low and rose to an annual rate of 354,000 units in May, a bit above the average over the preceding six months. With vacancy rates high and rents declining, multifamily starts are unlikely to strengthen significantly anytime soon.

New home sales, which have been exceptionally vigorous during the past year, reached an annual rate of 1.03 million units in April, the third-highest level on record. Existing home sales—adjusted by the staff to eliminate trading-day

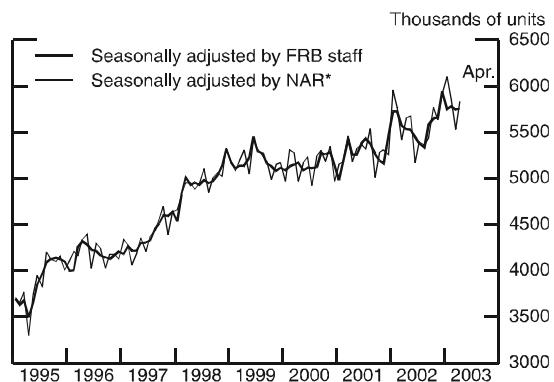
## Housing Indicators

New Home Sales



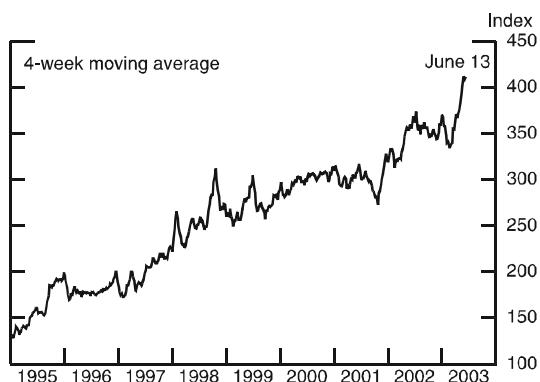
Source. Census Bureau.

Existing Home Sales

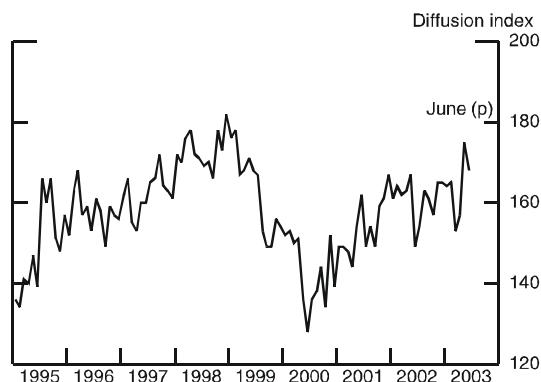


\*National Association of Realtors.

MBA Index of Purchase Applications

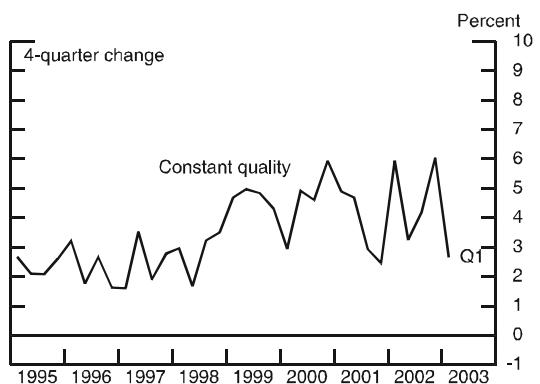


Perceived Homebuying Conditions



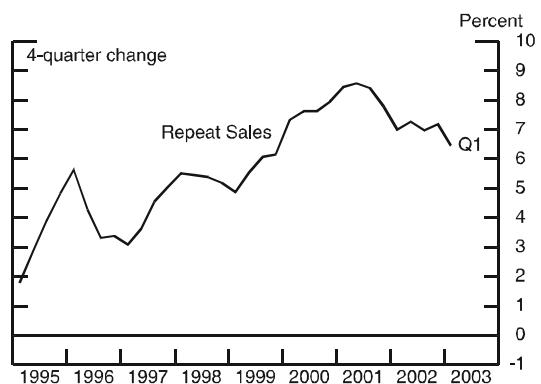
Source. Michigan Survey, not seasonally adjusted.

Prices of New Homes



Source. Census Bureau.

Prices of Existing Homes



Source. Freddie Mac.

variation—were about unchanged in April at an annual rate of 5.76 million units, also one of the highest levels on record.<sup>9</sup>

Other indicators of housing demand are also quite robust. The four-week moving average of the Mortgage Bankers Association index of purchase applications has moved up sharply since mid-May to a new record high. The Michigan Survey's early-June measure of household attitudes noted a slight drop in homebuying attitudes that was mainly due to apprehension about employment prospects. Nonetheless, the level of the index remains high, with fully three-quarters of respondents mentioning low mortgage rates as a factor contributing to favorable homebuying conditions.

House prices decelerated modestly in the first quarter but continued to post solid gains. The quality-adjusted price of new homes sold last quarter was 2.6 percent higher than a year earlier after having posted a 5.9 percent gain during the preceding year. The repeat-sales price of existing homes, which provides a better reading of the value of the overall stock of housing, was 6.4 percent higher in the first quarter of 2003 than in the first quarter of 2002. Although this increase was a bit smaller than the 7 percent increase seen during the previous year and well below the outsized gains seen in 2000 and 2001, prices of existing homes have continued to increase at a faster pace than they did in the mid- and late-1990s.

### **Business Fixed Investment**

**Equipment and Software.** Business demand for new capital has remained soft. Real outlays on equipment and software (E&S) fell at an annual rate of 6.7 percent in the first quarter of 2003, more than reversing the increase posted in the fourth quarter of last year. Excluding outlays for transportation equipment, E&S spending rose on average 1-1/2 percent in both quarters, and the data on new orders and shipments in April (the latest available) point to only a moderate pickup in the current quarter. The fundamental drivers of business investment are generally lackluster, with the four-quarter changes in business output and real corporate cash flow early this year both smaller than in the second half of last year. Nonetheless, the user cost of capital continues to fall.

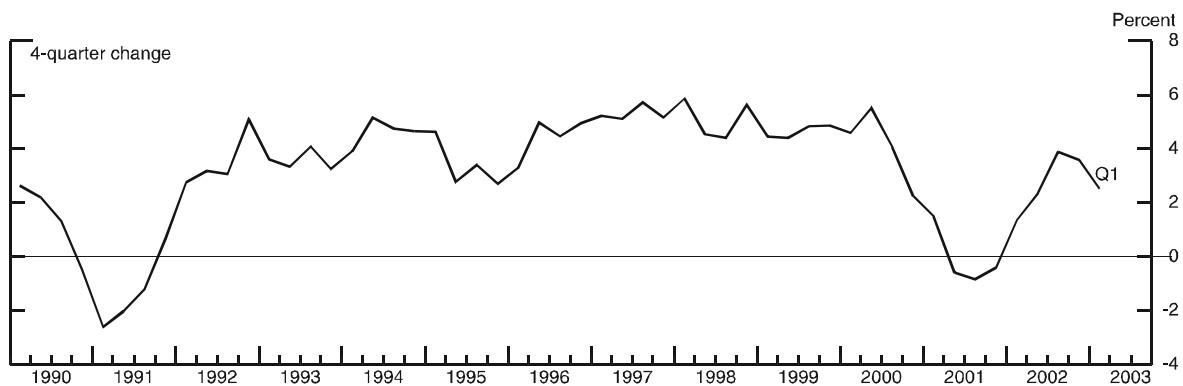
In the high-tech sector, nominal shipments of computers soared 20.2 percent (not at an annual rate) in April after two months of declines. Since the middle of 2001, computer shipments have tended to spike in the first month of each quarter and to fall back in the second and third months. Nevertheless,

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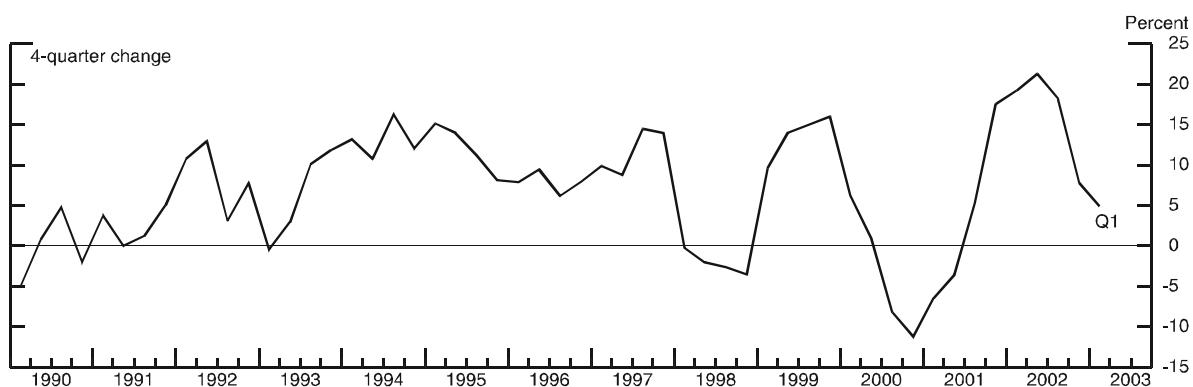
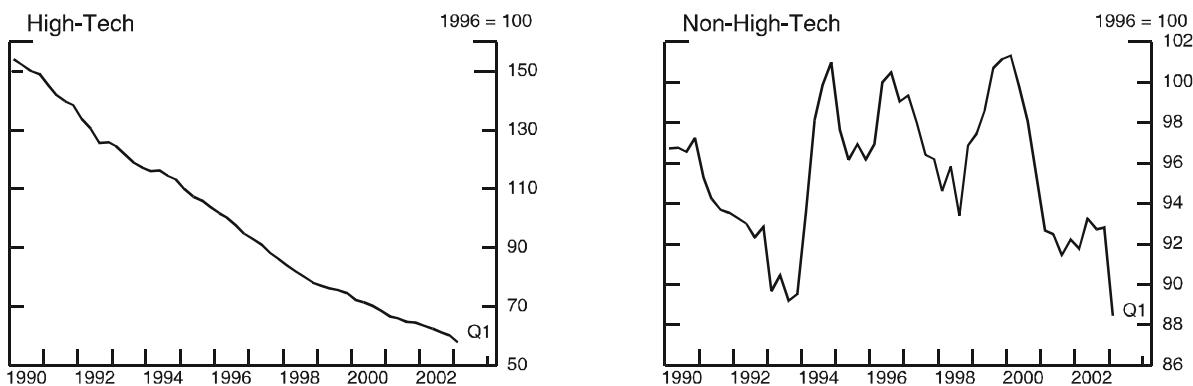
9. The existing home sales series published by the National Association of Realtors (NAR) increased 5.6 percent in April after having declined by about the same amount in March. The NAR series is not adjusted adequately for trading-day variation.

## Equipment and Software Investment Fundamentals

Business Output



Real Corporate Cash Flow

**User Cost of Capital\***

\*Excludes the effects of the partial expensing tax incentive.

**EQUIPMENT AND SOFTWARE SPENDING INDICATORS**  
 (Percent change from preceding comparable period;  
 based on seasonally adjusted data, in current dollars)

	<u>2002</u> <u>Q4</u>	<u>2003</u> <u>Q1</u>	Feb.	Mar.	Apr.
-Annual rate-					
Shipments of nondefense capital goods	-7.2	-4.1	-1.4	1.3	0.3
Excluding aircraft	-6.4	-0.4	-3.5	1.7	1.4
Computers and peripherals	-8.6	6.5	-14.0	-5.8	20.2
Communications equipment	-12.6	24.0	-1.7	1.2	-3.3
All other categories	-5.3	-4.1	-1.8	2.9	-0.9
Shipments of complete aircraft	-33.7	-4.1	37.1	-7.6	-31.1
Medium & heavy truck sales (units)	-15.7	-32.0	2.2	-5.6	6.4
Orders for nondefense capital goods	-7.9	3.0	-4.9	3.2	-0.1
Excluding aircraft	-1.4	15.7	-2.4	4.8	-2.7
Computers and peripherals	5.4	-16.3	-13.1	-0.8	15.6
Communications equipment	26.3	193.4	-0.0	1.1	-2.3
All other categories	-5.0	8.5	-0.8	6.3	-5.5

smoothing through the recent swings, computer shipments continue to trend upward; and paired with double-digit decreases in prices, we expect a solid gain in real computer outlays this quarter. Shipments of communications equipment decreased 3.3 percent in April and have been essentially flat since the beginning of the year. Orders for communications equipment also edged down in April, although they remained above the level of shipments for the fourth consecutive month. Orders and shipments of non-high-tech equipment both fell back in April after strong showings in March. These two series have moved essentially sideways over the past few months.

Business outlays for transportation equipment appear poised to make a modest contribution to the overall increase in equipment spending this quarter. In particular, business spending on autos and trucks seems to have edged up in April and May, and the rise in new orders for medium and heavy trucks in May suggests some impetus to transportation investment for the coming months. In contrast, despite a slight increase in Boeing's production schedules in May, the most recent data on shipments and net exports of aircraft indicate that outlays for aircraft by domestic carriers continue to languish at half the level of a year ago.

**Nonresidential construction.** Real investment in nonresidential structures continued to fall in the first quarter, although we estimate that the decline slowed to an annual rate of 2-1/4 percent.<sup>10</sup> Outlays for office buildings were down roughly 13 percent (annual rate) in the first quarter, and the data for April

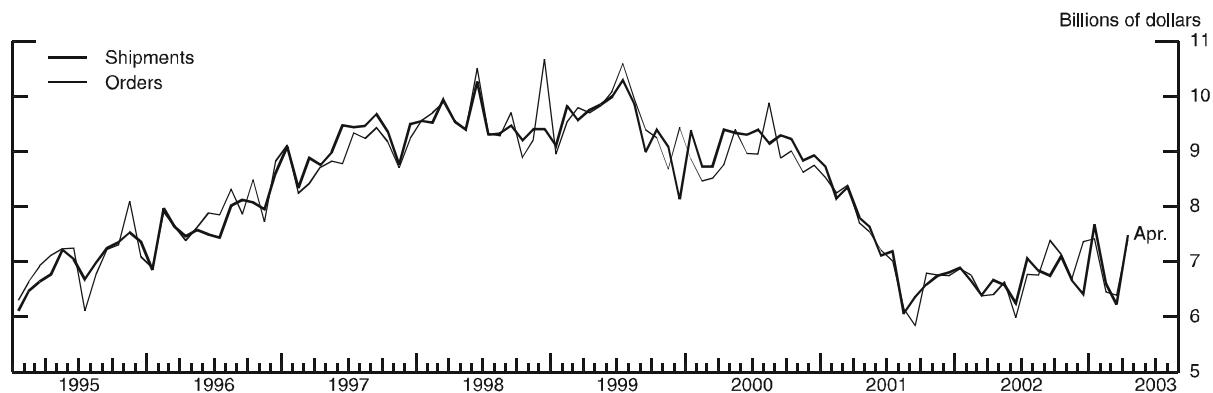
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10. The BEA's preliminary estimate of the first-quarter change in nonresidential construction showed a slight increase, but recent data on construction put-in-place have led us to estimate a small decline.

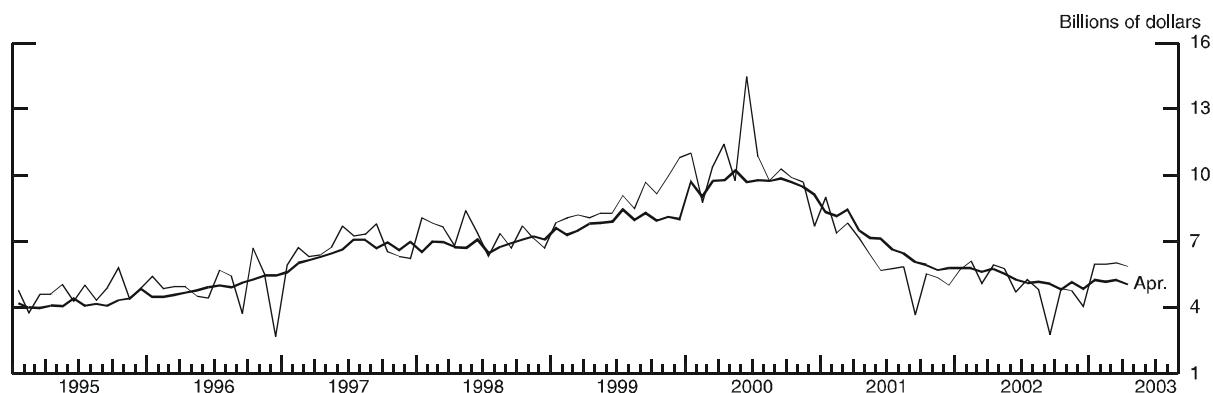
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## Recent Data on Orders and Shipments

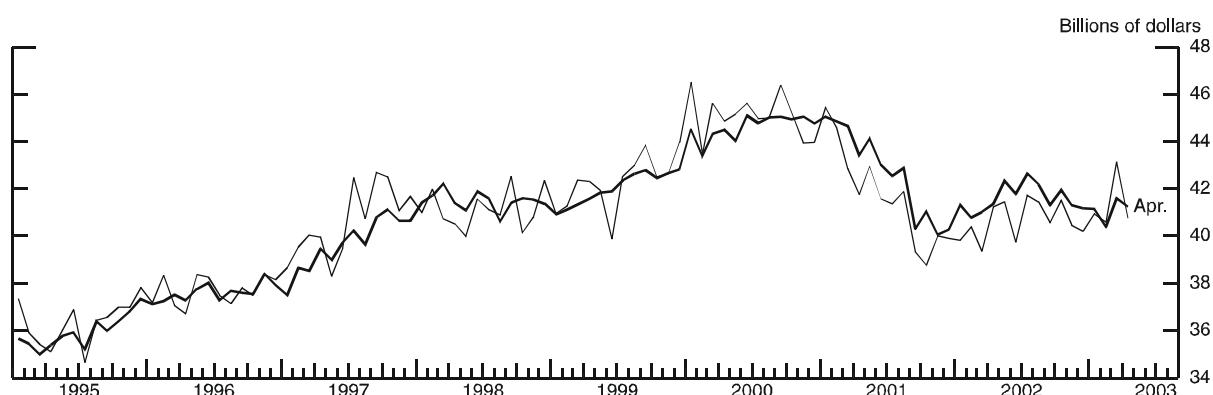
**Computers and Peripherals**



**Communications Equipment**

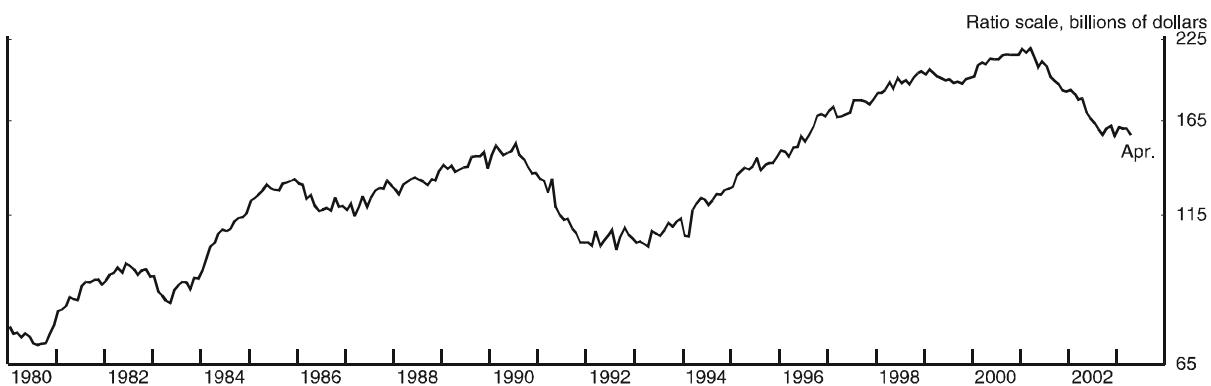


**Other Equipment (Total Ex. Transportation, Computers, Communications)**

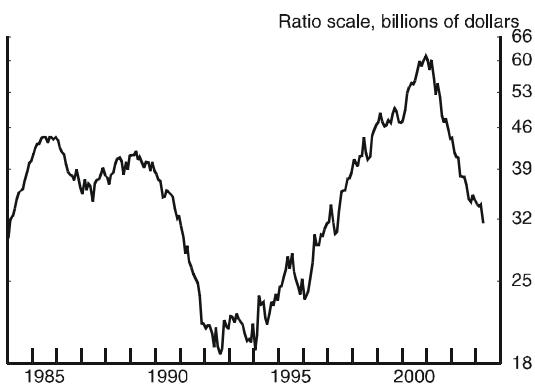


**Nonresidential Construction**  
(Seasonally adjusted, annual rate)

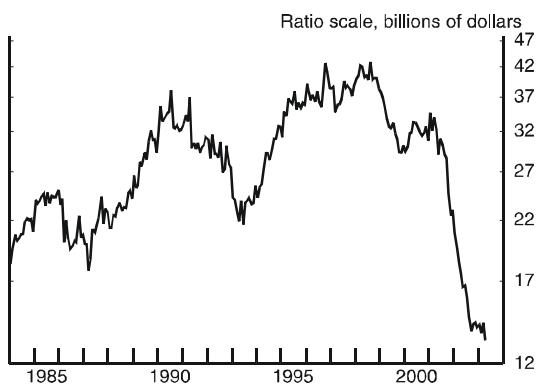
Total Building



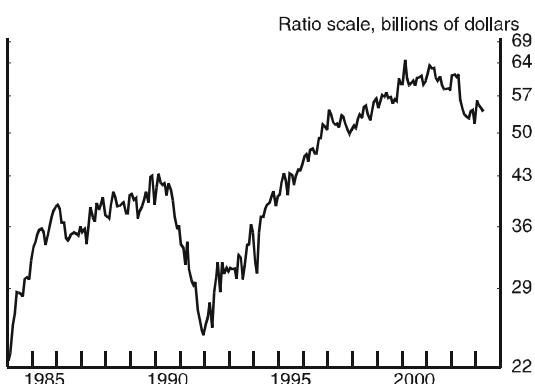
Office



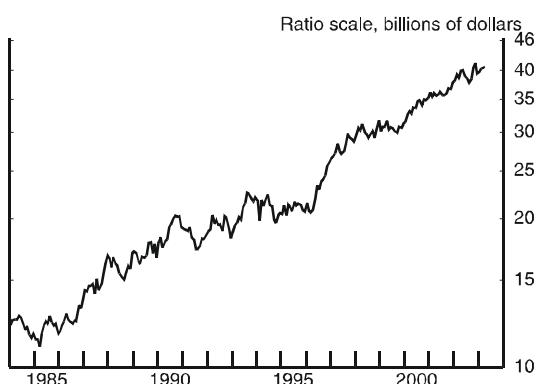
Industrial



Other Commercial



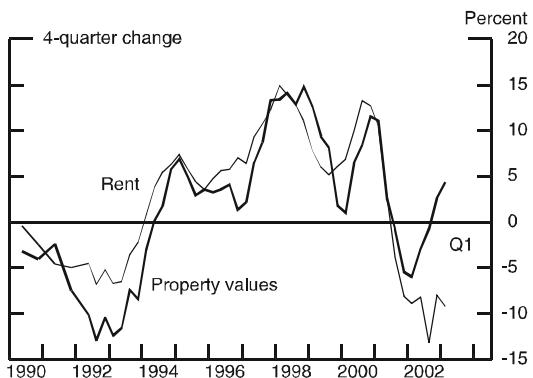
Institutional



## Indicators of Nonresidential Construction

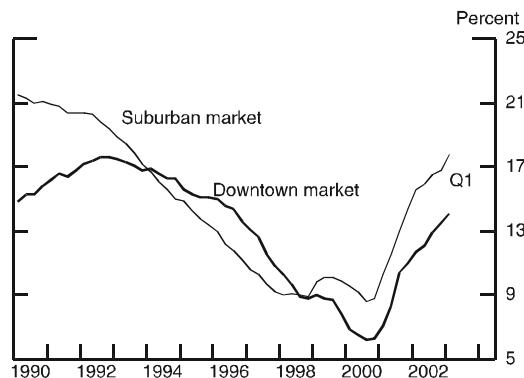
### Office Buildings

#### Property Values and Rent



Source. National Real Estate Index.

#### Vacancy Rate



Source. CB Richard Ellis.

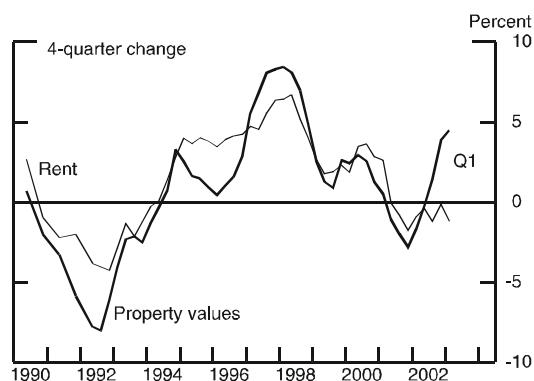
### Industrial

#### Manufacturing Capacity Utilization



### Retail Space

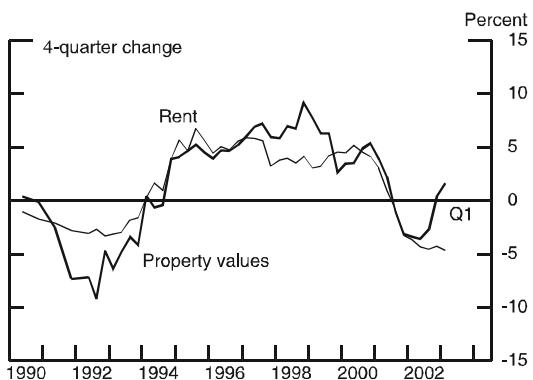
#### Property Values and Rent



Source. National Real Estate Index.

### Warehouses

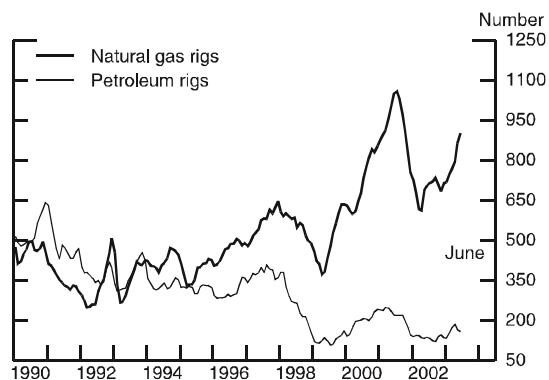
#### Property Values and Rent



Source. National Real Estate Index.

### Drilling Activity

#### Rigs in Operation



Note. June values are averages through June 13.  
Source. DOE/Baker Hughes.

suggest that a further drop is likely in the current quarter. With falling rents and rising vacancy rates, the oversupply of office space has shown few signs of abating. Spending on industrial buildings contracted at an annual rate of about 8 percent in the first quarter, and again the data for April point to another decline in the current quarter. Outlays for institutional buildings fell at an annual rate of nearly 7 percent in the first quarter, offsetting part of the fourth-quarter rise, and investment in structures by public utilities contracted at an annual rate of roughly 6 percent.

Real investment in two categories of nonresidential structures moved up in the first quarter, but these gains seem unlikely to be repeated in the second quarter. Spending in the other commercial sector rose at an annual rate of nearly 10 percent in the first quarter, but fell on a monthly basis in both March and April. Moreover, rents for both retail space and warehouses fell again in the first quarter, suggesting demand for such space remains very weak. Similarly, spending for lodging and miscellaneous structures rose 3-1/2 percent in the first quarter but edged down in April.

In the drilling and mining sector, outlays increased in the first quarter at an annual rate of 18 percent. The sharp increase in the number of natural gas drilling rigs in operation from April through mid-June indicates that drilling activity has responded to higher natural gas prices, and suggests that spending on drilling and mining structures will likely increase again in the second quarter.

### **Business Inventories**

The book value of manufacturing and trade inventories excluding motor vehicles rose at an annual rate of \$25.6 billion in the first quarter. However, in real terms, these stocks were little changed. Book-value stocks excluding motor vehicles declined at an annual rate of \$5.4 billion in April, and our guess is that they again were little changed in real terms.

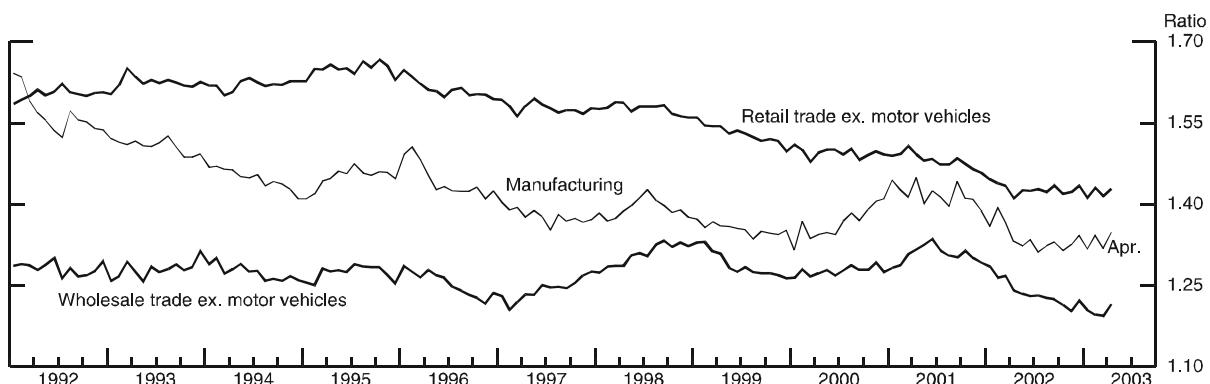
By industry, book-value manufacturing inventories were nearly unchanged in April, as stock-building by manufacturers of nondurable goods was about offset by a runoff at producers of durable goods. Non-auto wholesalers liquidated inventories at an annual rate of \$5.4 billion in April, in large part the result of a runoff at wholesalers of professional and commercial equipment. Non-auto retailers' stocks edged down in April after large run-ups in the preceding five months. Book-value inventories in all three categories stand at historically very low levels relative to shipments and sales.

In May, days' supply in the staff's flow-of-goods system pulled back a bit but remained at an elevated level, primarily because of the high level of motor

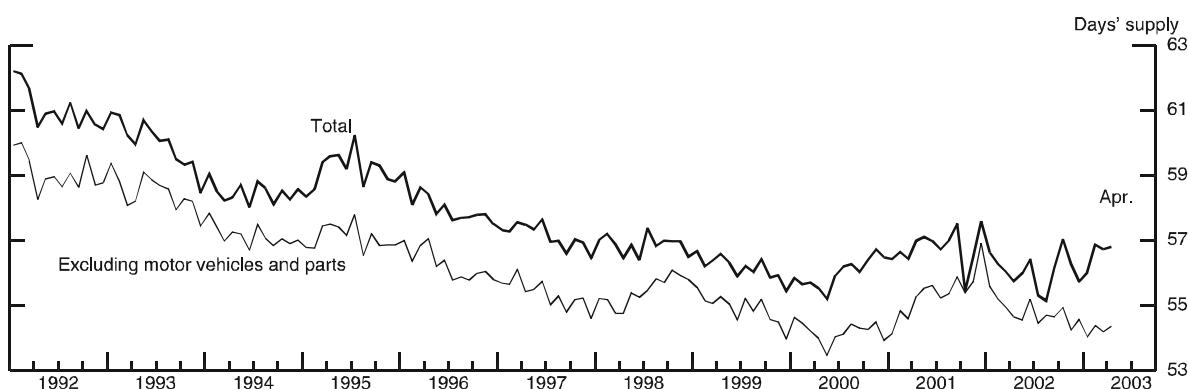
**Changes in Manufacturing and Trade Inventories**  
 (Billions of dollars, seasonally adjusted book value, annual rate)

Category	2002		2003 Q1	2003		
	Q3	Q4		Feb.	Mar.	Apr.
Manufacturing and trade	55.4	47.6	57.9	91.8	45.8	18.7
Less wholesale and retail motor vehicles	30.5	19.0	25.6	51.2	17.6	-5.4
Manufacturing	4.6	6.3	6.2	23.0	-8.7	1.4
Less aircraft	10.2	4.4	7.4	29.5	-8.9	1.4
Merchant wholesalers	12.9	7.6	8.4	11.7	15.1	-4.0
Less motor vehicles	10.7	4.2	6.8	8.6	11.3	-5.4
Retail trade	37.9	33.8	43.4	57.1	39.4	21.3
Automotive dealers	22.8	25.3	30.8	37.5	24.4	22.8
Less automotive dealers	15.1	8.5	12.6	19.7	15.0	-1.5

**Book Value Inventories Relative to Shipments and Sales: Manufacturing and Trade**



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



vehicle stocks.<sup>11</sup> Excluding motor vehicles and parts, the inventory-consumption ratio has, on balance, moved sideways at a low level since late 2002. Outside of motor vehicles, imbalances are few and include textile mill products, paper, communications equipment, and electrical equipment.

### Government Sector

**Federal.** According to the Monthly Treasury Statement, defense spending in April jumped 30 percent above the year-earlier level. Although the more recent daily data indicate much smaller year-over-year increases in these outlays, the cumulative data indicate a large increase in defense spending this quarter. Monthly data for April show that outlays excluding defense were essentially flat, a reflection of persistent slowing in spending across many categories and of one-time declines recorded for several loan programs due to revaluations of the subsidy value of the loans.

At the same time, the monthly Treasury data for April and daily data through June 17 continue to point to weakness in federal receipts. April collections were 2-1/2 percent below last year's level, as a sharp drop in nonwithheld individual income and self-employment taxes was only partially offset by a rebound in corporate income tax receipts. While daily data through June 16 indicate that corporate receipts continued to post strong gains relative to year-earlier figures, the increased bonus depreciation provision of the Jobs And Growth Tax Relief Reconciliation Act should begin to significantly damp increases in corporate collections in coming quarters as a greater share of investment spending falls under the new provision..

Principally because of the enactment of the new tax law, the Congressional Budget Office now expects the fiscal year 2003 budget deficit to exceed \$400 billion. In addition, pending legislation, if enacted, would raise spending on Medicare and several other nondefense programs.

The new tax legislation accelerates the phase-in of many of the key provisions of the 2001 Tax Act, although on a temporary basis for some of the provisions. The main changes affecting individuals include a boost to the child tax credit effective for 2003, which will be delivered primarily through a round of advance

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11. The FRB staff's flow-of-goods system measures changes in inventories by tracking the flow of goods in the economy. The system divides the output from the staff's industrial production indexes into more than sixty different product categories. For each product category, the system estimates the supply of goods flowing into the economy—that is, domestic production plus imports. The system then estimates how much of the supply flows out, whether as final demand, including exports, or as inputs for other goods. The difference between the amount flowing in and the amount flowing out represents that change in inventories.

**Federal Government Outlays and Receipts**  
 (Unified basis; billions of dollars)

Function or source	April			12 months ending in April		
	2002	2003	Percent change	2002	2003	Percent change
Outlays	170.3	180.1	5.8	1,956.3	2,087.8	6.7
Financial transactions <sup>1</sup>	-0.0	-0.0	...	-0.0	-1.8	...
Payment timing <sup>2</sup>	0.0	0.0	...	-0.6	-0.5	...
Adjusted outlays	170.3	180.1	5.8	1,957.0	2,090.1	6.8
Receipts	237.4	231.2	-2.6	1,853.9	1,793.6	-3.3
Payment timing	0.0	0.0	...	0.0	0.0	...
Adjusted receipts	237.4	231.2	-2.6	1,853.9	1,793.6	-3.3
Surplus/deficit(-)	67.2	51.0	...	-102.5	-294.3	...
Selected components of adjusted outlays and receipts						
Adjusted outlays	170.3	180.1	5.8	1,957.0	2,090.1	6.8
Net interest	14.9	14.5	-2.9	182.8	164.1	-10.2
Non-interest	155.4	165.7	6.6	1,774.2	1,926.1	8.6
National defense	28.3	37.1	30.7	328.2	377.8	15.1
Social security	38.0	39.3	3.6	447.3	466.8	4.4
Medicare	20.8	21.7	4.3	227.8	243.5	6.9
Medicaid	12.7	14.0	9.8	139.9	153.7	9.9
Income security	27.5	29.8	8.5	290.0	332.4	14.6
Agriculture	0.6	0.9	67.1	29.0	22.6	-22.2
Other	27.6	22.9	-16.8	312.0	329.2	5.5
Adjusted receipts	237.4	231.2	-2.6	1,853.9	1,793.6	-3.3
Individual income and payroll taxes	208.1	192.8	-7.3	1,533.7	1,485.6	-3.1
Withheld + FICA	110.3	112.2	1.7	1,387.0	1,371.7	-1.1
Nonwithheld + SECA	135.9	119.9	-11.8	349.6	297.3	-15.0
Refunds (-)	38.1	39.3	2.9	202.9	183.5	-9.6
Corporate <sup>3</sup>	9.8	18.3	85.9	135.9	122.7	-9.7
Gross	20.8	24.8	19.1	188.5	188.4	-0.1
Refunds (-)	11.0	6.5	-40.8	52.6	65.7	24.7
Other	19.5	20.1	2.9	184.3	185.3	0.5
Adjusted surplus/deficit(-)	67.2	51.0	...	-103.1	-296.6	...

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

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

2. A shift in payment timing occurs when the first of the month falls on a weekend or holiday, or when the first 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.

**Budget Effects of Jobs and Growth Reconciliation Act**

(Billions of dollars, fiscal years)

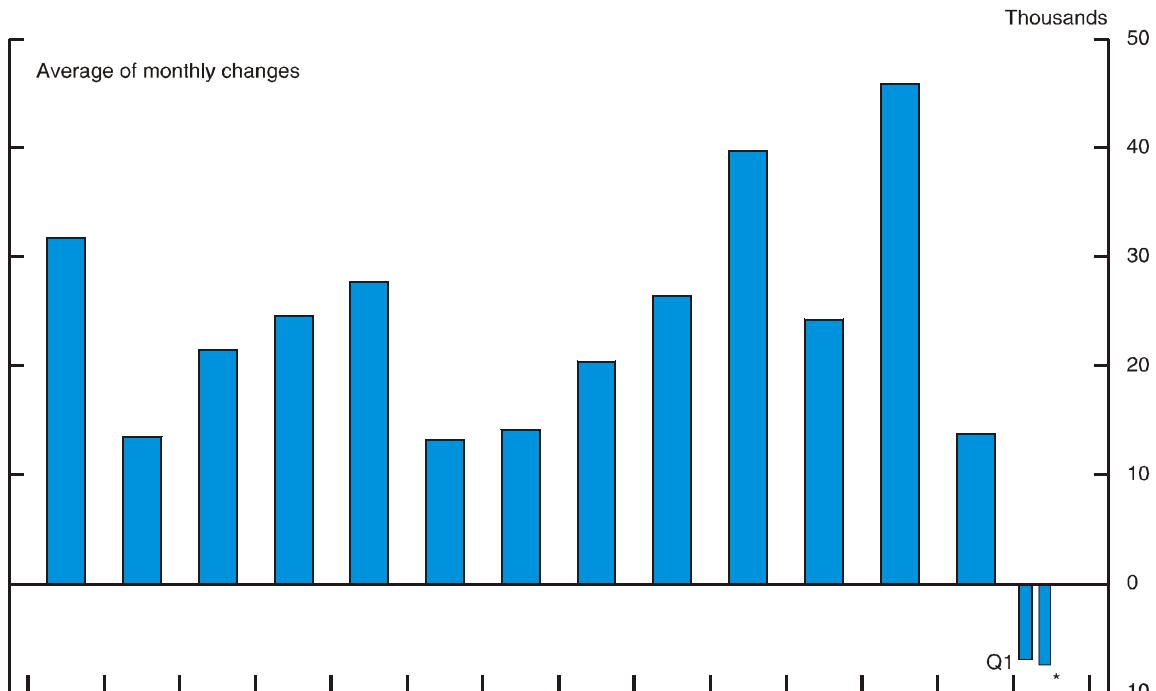
Item	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
<b>Revenues<sup>1</sup></b>	<b>-53</b>	<b>-136</b>	<b>-82</b>	<b>-21</b>	<b>-14</b>	<b>-17</b>	<b>-11</b>	<b>-4</b>	<b>4</b>	<b>3</b>	<b>2</b>
Individual income taxes <sup>1</sup>	-35	-107	-67	-29	-26	-27	-19	-10	0	0	0
Marginal rates	-10	-39	-20	-6	0	0	0	0	0	0	0
Child credit <sup>1</sup>	-14	-6	-13	0	0	0	0	0	0	0	0
Marriage penalty	-5	-25	-5	0	0	0	0	0	0	0	0
10% bracket	-2	-8	-2	0	0	0	0	0	0	0	0
AMT	-1	-10	-6	0	0	0	0	0	0	0	0
Dividends	-4	-18	-21	-23	-26	-27	-19	-10	0	0	0
Corporate income taxes	-18	-30	-15	8	12	10	8	6	4	3	2
Depreciation bonus	-10	-33	-12	9	9	8	7	5	4	2	1
Sec.179 expensing	-2	-3	-4	-1	3	2	1	1	1	0	0
Timing	-6	6	0	0	0	0	0	0	0	0	0
<b>Outlays</b>	<b>8</b>	<b>12</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Medicaid grants	3	7	0	0	0	0	0	0	0	0	0
Per capita grants	5	5	0	0	0	0	0	0	0	0	0
Primary deficit	61	149	82	21	14	17	11	4	-4	-3	-2
Interest	0	4	10	16	19	21	23	25	26	27	29
Deficit	61	153	92	36	33	38	34	29	22	25	27
Debt	61	153	306	343	375	413	448	477	498	523	550

1. Includes outlay effect of refundable child tax credit.

SOURCE. Joint Committee on Taxation and Federal Reserve Board staff.

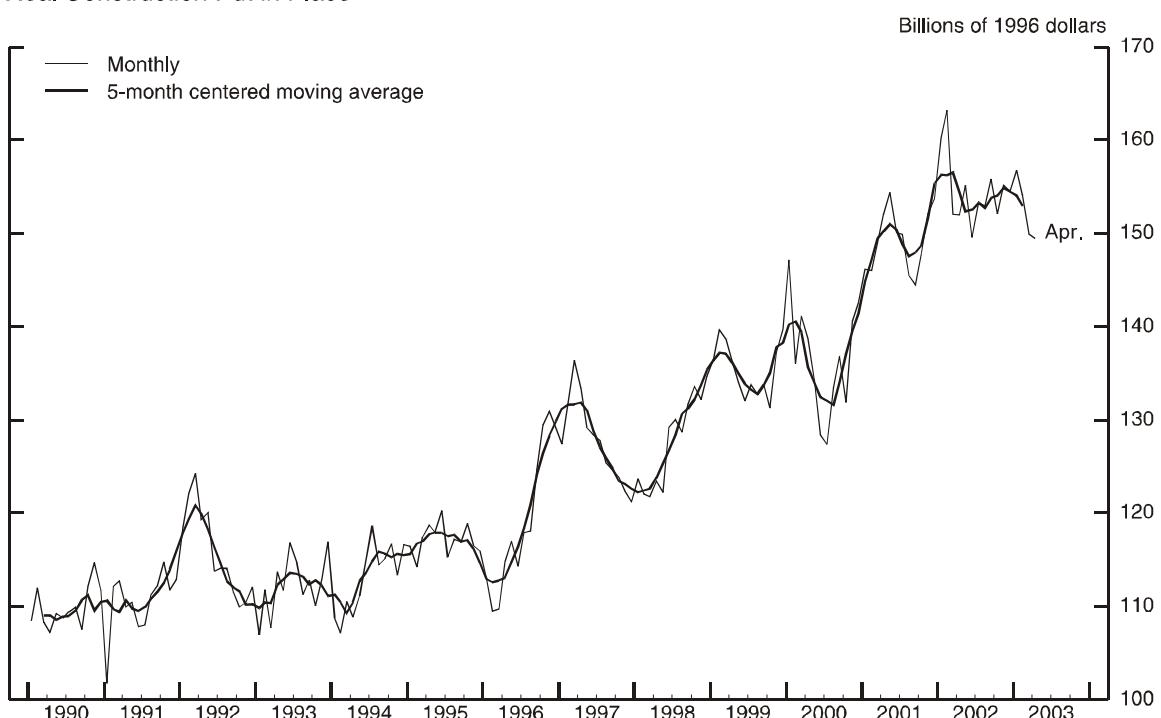
### State and Local Employment and Real Construction

#### Employment



\* April and May.

#### Real Construction Put in Place



refund checks that will be sent out between July 25 and August 8. In addition, the new act speeds up the scheduled reductions in marginal rates, cuts the maximum tax rate on long-term capital gains realizations from 20 percent to 15 percent through 2008, and sets the tax rate on most dividend income equal to the capital gains rate through 2008. Employers are slated to adjust withholding by the beginning of July of this year. On the business side, the act bumps the temporary 30 percent depreciation bonus enacted last year up to 50 percent and extends its expiration date from September 11, 2004, until the end of 2004.

In addition to the tax bill, the Congress recently extended through December the temporary unemployment benefits program that was slated to expire at the end of May. The Senate and House have passed versions of a small expansion of the child tax credit, while the Senate Finance and House Ways and Means Committees have approved versions of a Medicare bill that adds a prescription drug benefit beginning January 2006.

**State and local governments.** Indicators of state and local spending continued to deteriorate in the second quarter. Employment fell 21,000 in May after a small rise in April. The revised figures for employment now show a net decline so far this year, with a sizable drop in employment at the state level dwarfing a slight increase at local governments. Real construction spending edged down in April after larger declines in the two preceding months, and it is now at its lowest level since October 2001. Declines were concentrated in spending for buildings and for highways.

Despite the recently enacted addition of \$20 billion in federal aid, many state governments are still scrambling to pass a balanced general fund budget for fiscal year 2004, which begins in less than two weeks. Along with spending cuts, many states are enacting tax increases. As they did in fiscal year 2003, many jurisdictions will also likely plug budget gaps by borrowing both from rainy day and other funds and by issuing bonds. And more states than in recent years have employed other, one-time measures, such as moving payments into the next fiscal year and selling assets.

A recent survey from the National League of Cities indicates that declining income and sales tax receipts and reductions in state aid have led to sharply deteriorating fiscal conditions in many cities. In the aggregate, about 20 percent of city revenue comes from state aid, with another 17 percent from sales taxes and income taxes. So far, property taxes, which account for around 20 percent of city revenue, have held up fairly well, bolstered by continued strength in housing markets. The weakness in revenues comes at a time of intensifying pressure to spend for homeland security and public safety needs.

RECENT PRICE INDICATORS  
(Percent)

	From 12 months earlier		From 3 months earlier		2003	
	May 2002	May 2003 <sup>1</sup>	Feb. 2003	May 2003 <sup>1</sup>	Apr.	May <sup>1</sup>
	-Annual rate-					
<b>CPI</b>						
Total	1.2	2.1	4.3	0.0	-0.3	0.0
Food	1.9	1.7	2.7	1.6	-0.1	0.3
Energy	-12.3	9.0	44.9	-12.4	-4.6	-3.1
Ex. food and energy	2.5	1.6	1.5	1.0	0.0	0.3
Ex. tobacco	2.4	1.6	1.5	1.1	-0.0	0.3
Core commodities	-0.9	-1.9	-1.9	-2.8	-0.3	-0.4
Core services	3.9	3.0	2.8	2.7	0.1	0.5
Current-methods total	1.2	2.1	4.2	-0.0	-0.3	0.0
Ex. food and energy	2.5	1.6	1.4	1.0	-0.0	0.3
Ex. tobacco	2.4	1.5	1.4	1.1	-0.0	0.3
Chained CPI (NSA) <sup>2</sup>	1.1	1.6	--	--	--	--
Ex. food and energy <sup>2</sup>	2.1	1.0	--	--	--	--
<b>PCE Prices</b>						
Total	1.0	1.7	2.9	0.2	-0.2	-0.1
Food	2.1	1.8	2.0	2.0	-0.0	0.3
Energy	-12.6	9.4	48.7	-14.6	-5.1	-3.5
Ex. food and energy	1.7	1.3	0.8	0.9	0.1	0.1
Ex. tobacco	1.6	1.2	0.8	0.9	0.1	0.1
Core commodities	-1.1	-2.2	-3.2	-2.8	-0.1	-0.4
Core services	2.9	2.7	2.6	2.4	0.1	0.3
Core market-based	1.5	0.7	-0.1	0.5	0.1	0.0
Core nonmarket-based	2.6	3.4	4.3	1.9	0.0	0.2
<b>PPI</b>						
Total finished goods	-2.9	2.5	9.8	-3.0	-1.9	-0.3
Food	-2.0	3.7	10.7	4.3	0.9	0.1
Energy	-15.5	11.9	59.8	-21.5	-8.6	-2.6
Ex. food and energy	0.1	-0.1	-0.5	-0.3	-0.9	0.1
Ex. tobacco	-0.1	0.4	-0.5	1.7	-0.5	0.1
Core consumer goods	0.4	-0.3	-0.3	-1.8	-1.3	0.1
Capital equipment	-0.3	0.2	-0.6	1.4	-0.5	0.1
Intermediate materials	-3.2	4.2	13.6	-4.1	-2.2	-0.8
Ex. food and energy	-1.5	2.2	4.2	0.6	0.0	-0.1
Crude materials	-16.3	19.1	78.5	-13.5	-16.3	1.7
Ex. food and energy	2.5	7.3	16.2	-8.7	-1.3	-1.9

1. PCE prices in May are staff estimates.

2. Higher frequency figures are not shown for data that are not seasonally adjusted.

## Prices and Labor Costs

Overall consumer prices have been moved around in recent months by large swings in energy prices. After having risen rapidly earlier this year, consumer energy prices fell sharply in April and May in the wake of the drop in crude oil prices in late March. The plunge in energy prices pushed the twelve-month change in the overall consumer price index down to 2.1 percent in May from its recent peak of 3.0 percent in March. Nonetheless, overall inflation remains considerably higher than the 1.2 percent rate recorded a year earlier.

The CPI excluding food and energy rose 0.3 percent in May after no change in March and April; the May increase reflected a 0.5 percent jump in the prices of non-energy services. By contrast, the index for core commodities fell 0.4 percent last month, with price declines posted for most categories of goods. The core CPI has increased only 1.6 percent over the last twelve months, well below the 2.5 percent run-up during the comparable period a year earlier. The most recent twelve-month change is about 3/4 percentage point above our point estimate of 0.9 percentage point for the measurement bias in this series.

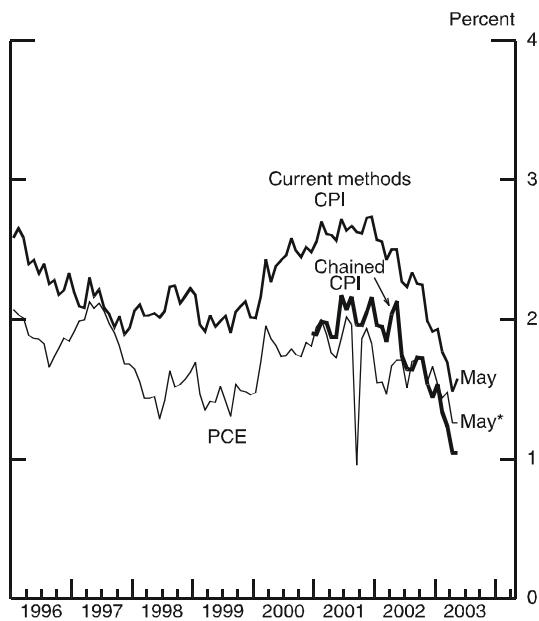
Core PCE prices edged up 0.1 percent in April (the latest available data) and likely increased 0.1 percent again in May. We estimate that core PCE prices rose 1.3 percent over the twelve months ending in May, compared with a 1.7 percent increase over the preceding year. The 1/2 percentage point deceleration in the PCE measure of core inflation is noticeably less than the 1 percentage point deceleration in the core CPI over the same period, a difference that largely reflects the wider scope of PCE prices. Over the past year, the deceleration in the CPI-based portion of PCE has been in part offset by a pickup in the prices of PCE items that are not included in the CPI and for which no market-based prices are available. Most noticeable have been an upswing in imputed service charges at financial institutions and a sizable increase in prices for travel abroad. By contrast, the market-based component of the core PCE price index is estimated to have risen only 3/4 percent over the twelve months ending in May, down 3/4 percentage point from a year ago.<sup>12</sup> The most recent twelve-month change is a touch above our point estimate of 0.5 percentage point for the measurement bias in this index. The core portion of the chained CPI, which like the PCE price index uses a superlative aggregation formula intended to take into account substitution by consumers in response to changes in relative prices, rose 1.0 percent over the twelve months ending in May, a deceleration of about 1 percentage point from the previous year.

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12. The deceleration of market-based core PCE prices over the past year is slightly less than the deceleration of the CPI; much of the reason is that the marked deceleration in the price of housing services gets considerably more weight in the CPI.

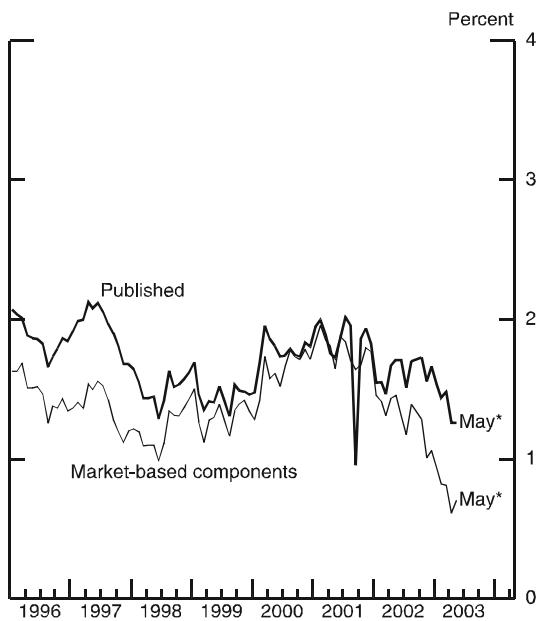
## Measures of Core Consumer Price Inflation (12-month change)

CPI and PCE excluding Food and Energy

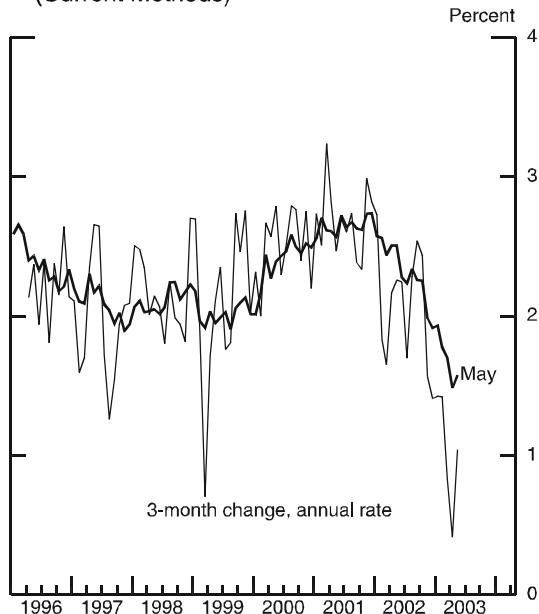


\* Staff estimate.

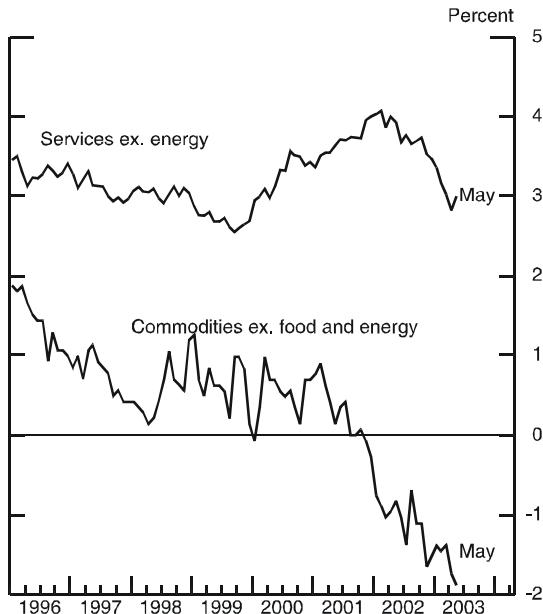
PCE excluding Food and Energy



\* Staff estimate.

CPI excluding Food and Energy  
(Current Methods)

CPI Services and Commodities



Consumer energy prices fell 3.1 percent in May, as retail prices of gasoline and fuel oil dropped sharply for the second consecutive month. Survey data for the first half of June point to a small increase this month in the CPI for gasoline on a seasonally adjusted basis. The May decline in consumer natural gas prices reflected a dropoff in demand due to mild temperatures. Because the level of natural gas inventories remains very low, natural gas prices are likely to remain quite volatile in the months ahead. In contrast to the declines posted for other energy prices, the CPI for electricity increased 1.5 percent in May, likely reflecting the lagged effects of higher fuel input costs.

Consumer food prices increased 0.3 percent in May and have risen 1.7 percent over the past twelve months. Fruit and vegetable prices turned up last month, more than reversing their April decline, and food away from home (about 40 percent of the overall food category) posted a modest increase that is broadly consistent with its long-run trend, tracking movement in the core CPI.

According to the PPI, capital equipment prices edged up in May after a large decline in April. These prices have been quite volatile of late, owing primarily to erratic movements in the PPI for light motor vehicles. Over the past twelve months, the PPI for capital equipment edged up, on balance, compared with a slight decline over the previous twelve months.

Prices at earlier stages of processing have decelerated recently, reflecting the direct and indirect effects of the decline in energy prices. The PPI for intermediate materials fell in both April and May, while prices for core intermediate materials were about unchanged. The most noticeable of the energy-related swings in core intermediate materials prices in recent months occurred in the prices of plastics, fertilizers, and industrial chemicals.

Spot commodity prices have moved up somewhat since the previous Greenbook. Both the Journal of Commerce and Commodity Research Bureau industrial price indexes have risen about 1-1/2 to 2 percent over that period. In the agricultural sector, corn and soybean crops are off to a good start; however, spot prices for these commodities have fluctuated around levels that remain about 1/4 percent higher than a year earlier. In contrast, a bumper crop of wheat has depressed spot prices of that crop. The Commodity Research Bureau's index of futures prices, which includes both food and other commodities, is up about 2-1/4 percent since the April Greenbook.

Median expected one-year inflation as measured by the Michigan Survey dropped further, to 2.0 percent in May and early June, lower than any full month since January 2002. Median expectations of inflation over the next five to ten years edged down 0.2 percentage point in early June, to 2.6 percent.

**BROAD MEASURES OF INFLATION  
(4-quarter percent change)**

	2000 Q1	2001 Q1	2002 Q1	2003 Q1
<b>Product prices</b>				
GDP chain price index	1.9	2.4	1.4	1.6
Less food and energy	1.9	2.1	1.5	1.6
Nonfarm business chain price index <sup>1</sup>	1.7	2.0	0.6	1.1
<b>Expenditure prices</b>				
Gross domestic purchases chain price index	2.5	2.4	0.8	2.2
Less food and energy	1.8	2.0	1.3	1.5
PCE chain price index	2.6	2.5	0.9	2.2
Less food and energy	1.7	1.9	1.5	1.5
PCE chain price index, market-based components	2.6	2.5	0.7	1.9
Less food and energy	1.5	1.9	1.4	0.9
CPI	3.3	3.4	1.2	2.9
Less food and energy	2.2	2.7	2.5	1.8
Chained CPI	n.a.	2.7	0.9	2.5
Less food and energy	n.a.	2.0	1.9	1.4
Median CPI	2.4	3.3	3.8	2.7
Trimmed mean CPI	2.2	2.8	2.3	2.2

1. Excluding housing.

**SURVEYS OF (CPI) INFLATION EXPECTATIONS  
(Percent)**

Actual inflation <sup>1</sup>	University of Michigan					Professional forecasters (10-year) <sup>4</sup>	
	1 year		5 to 10 years				
	Mean <sup>2</sup>	Median <sup>2</sup>	Mean <sup>3</sup>	Median <sup>3</sup>			
2001-Q3	2.7	3.1	2.7	3.5	2.9	2.5	
Q4	1.9	1.5	1.1	3.1	2.8	2.6	
2002-Q1	1.3	2.6	2.2	3.1	2.8	2.5	
Q2	1.3	3.1	2.7	3.4	2.9	2.5	
Q3	1.6	2.8	2.6	3.2	2.7	2.5	
Q4	2.2	2.7	2.5	3.3	2.8	2.5	
2003-Q1	2.9	3.2	2.8	3.0	2.7	2.5	
Q2	2.5	2.1	3.0	2.7	2.7	2.5	
2003-Jan.	2.6	2.7	2.5	3.1	2.7		
Feb.	3.0	3.2	2.7	3.1	2.7		
Mar.	3.0	3.8	3.1	2.9	2.8	2.5	
Apr.	2.2	2.7	2.4	3.1	2.7		
May	2.1	2.5	2.0	3.1	2.8		
June	2.3	2.0	2.8	2.6	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.

Average hourly earnings increased 3.2 percent in the twelve months ended in May—up from the 2.6 percent increase recorded a year earlier but still about 1 percentage point below the pre-recession peak.

## SPOT PRICES OF SELECTED COMMODITIES

		Percent change <sup>1</sup>			Memo:
	Current price (dollars)	2001	2002	Dec. 31 to Apr. 29 <sup>2</sup>	Year earlier to date
<b>Metals</b>					
Copper (lb.)	0.790	-22.0	2.8	2.7	5.3 -1.3
Steel scrap (ton)	106.000	-17.7	49.2	23.4	-11.4 4.3
Aluminum, London (lb.)	0.632	-14.3	0.7	-0.6	4.3 3.7
<b>Precious metals</b>					
Gold (oz.)	362.750	1.2	24.7	-3.9	9.5 13.9
Silver (oz.)	4.655	-3.5	3.0	-4.2	1.4 -4.3
<b>Forest products<sup>3</sup></b>					
Lumber (m. bdft.)	264.000	25.0	-13.0	17.0	12.8 10.0
Plywood (m. sqft.)	320.000	3.2	-0.3	1.7	8.8 0.6
<b>Petroleum</b>					
Crude oil (barrel)	26.930	-16.3	65.8	-28.3	17.4 9.4
Gasoline (gal.)	0.788	-28.0	54.6	-13.9	8.0 8.2
Fuel oil (gal.)	0.748	-42.6	57.4	-8.7	-5.3 14.9
<b>Livestock</b>					
Steers (cwt.)	75.960	-19.7	12.9	6.8	-1.4 18.7
Hogs (cwt.)	48.000	-9.9	-18.9	40.0	14.3 31.5
Broilers (lb.)	0.608	3.7	7.4	-8.1	10.6 1.3
<b>U.S. farm crops</b>					
Corn (bu.)	2.395	-4.1	19.2	0.0	4.4 19.8
Wheat (bu.)	3.458	-8.9	30.4	-10.5	-6.9 -3.5
Soybeans (bu.)	6.145	-13.4	35.6	10.1	-0.4 26.1
Cotton (lb.)	0.534	-45.7	53.8	6.4	4.8 49.6
<b>Other foodstuffs</b>					
Coffee (lb.)	0.488	-35.3	1.1	10.7	-1.0 18.9
<b>Memo:</b>					
JOC Industrials	86.000	-17.1	16.2	1.0	1.5 4.0
JOC Metals	79.600	-17.0	9.5	5.1	-0.1 3.1
CRB Futures	235.500	-16.3	23.0	-1.7	2.2 16.6
CRB Spot Industrials	261.600	-14.6	14.4	3.2	1.9 7.0

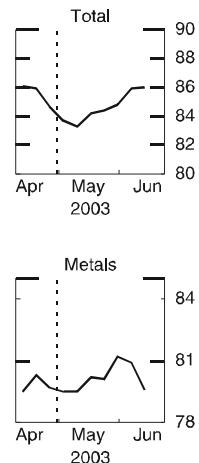
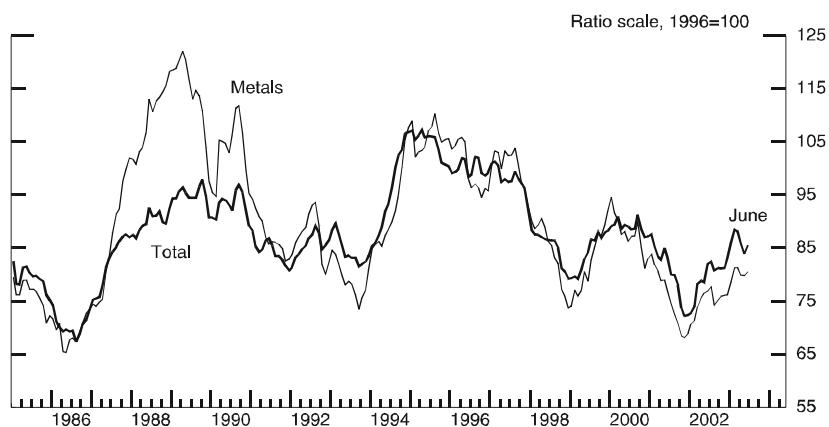
1. Changes, if not specified, are from the last week of the preceding year to the last week of the period indicated.

2. Week of the April Greenbook.

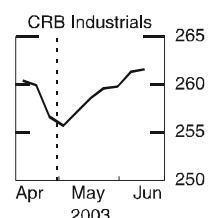
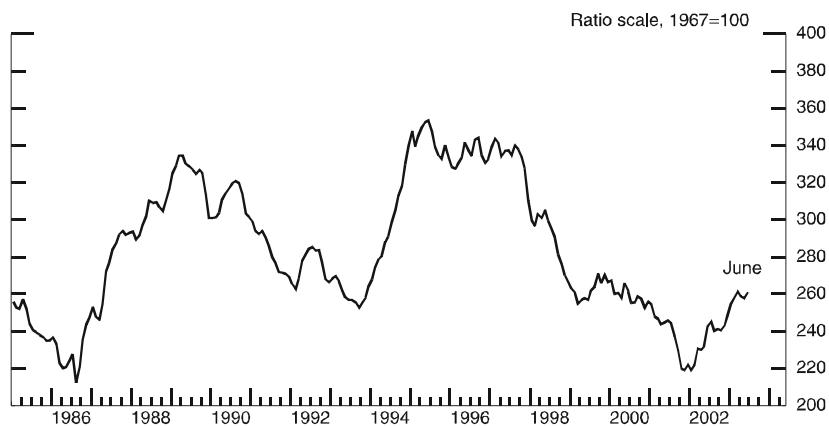
3. Reflects prices on the Friday before the date indicated.

## Commodity Price Measures

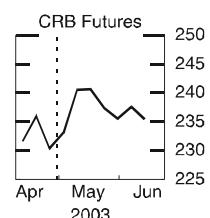
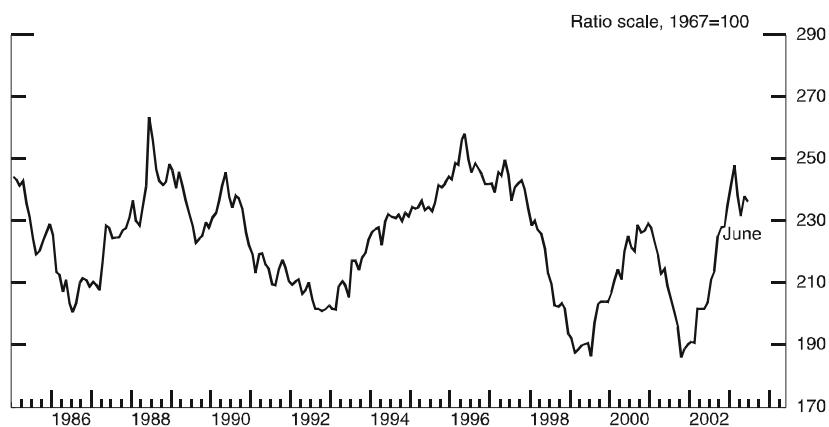
**Journal of Commerce Index**



**CRB Spot Industrials**



**CRB Futures**

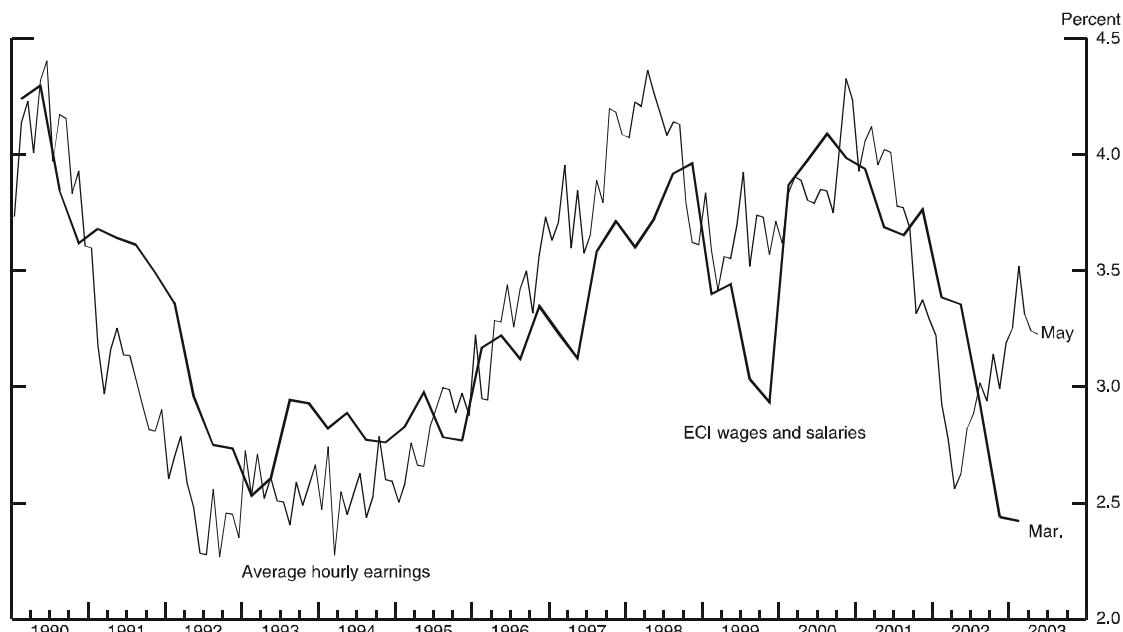


Note. Larger panels show monthly average of weekly data through last available week. Smaller panels show weekly data, Tuesdays. Vertical lines on small panels indicate week of last Greenbook. The Journal of Commerce index is based almost entirely on industrial commodities, with a small weight given to energy commodities, and the Commodity Research Board (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.

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

	12-month percent change			Percent change to May 2003 from month indicated		Percent change	
	May 2001	May 2002	May 2003	Nov. 2002	Feb. 2003	Apr. 2003	May 2003
- - - - - Annual rate - - - - -							
Total private nonfarm	4.0	2.6	3.2	2.7	1.3	0.0	0.3
Manufacturing	3.2	3.7	3.0	1.9	1.0	0.1	0.2
Construction	3.2	2.7	2.8	2.7	2.1	0.3	0.3
Wholesale trade	3.7	1.2	1.9	1.4	0.2	0.1	0.2
Retail trade	4.2	3.3	2.4	1.7	0.3	-0.3	0.6
Transportation and warehousing	2.1	2.6	3.5	2.8	0.5	-0.2	0.4
Information	3.8	1.9	4.4	4.3	3.9	0.3	0.1
Financial activities	4.2	3.0	5.9	5.3	4.1	0.8	0.2
Professional and business services	5.6	2.5	3.6	2.7	2.4	0.3	0.1
Education and health services	5.0	3.6	3.6	2.3	0.5	-0.4	0.4
Leisure and hospitality	3.2	2.5	2.2	1.6	-1.8	-0.1	0.2
Other services	4.3	2.9	2.6	1.2	-1.7	-0.1	-0.3

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



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## **Domestic Financial Developments**

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

<b>Instrument</b>	2000	2001	2003	2003	Change to June 16 from selected dates (percentage points)		
	June 26	Sept. 10	May 5	June 16	2000 June 26	2001 Sept. 10	2003 May 5
<i>Short-term</i>							
FOMC intended federal funds rate	6.50	3.50	1.25	1.25	-5.25	-2.25	.00
Treasury bills <sup>1</sup>							
3-month	5.66	3.19	1.11	0.85	-4.81	-2.34	-.26
6-month	5.94	3.13	1.14	0.86	-5.08	-2.27	-.28
Commercial paper (A1/P1 rates)							
1-month	6.56	3.42	1.21	1.00	-5.56	-2.42	-.21
3-month	6.56	3.24	1.20	0.95	-5.61	-2.29	-.25
Large negotiable CDs <sup>1</sup>							
1-month	6.64	3.46	1.26	1.05	-5.59	-2.41	-.21
3-month	6.73	3.26	1.24	0.96	-5.77	-2.30	-.28
6-month	6.89	3.24	1.22	0.93	-5.96	-2.31	-.29
Eurodollar deposits <sup>2</sup>							
1-month	6.63	3.41	1.25	1.02	-5.61	-2.39	-.23
3-month	6.69	3.26	1.21	0.95	-5.74	-2.31	-.26
Bank prime rate	9.50	6.50	4.25	4.25	-5.25	-2.25	.00
<i>Intermediate- and long-term</i>							
U.S. Treasury <sup>3</sup>							
2-year	6.54	3.59	1.56	1.17	-5.37	-2.42	-.39
10-year	6.35	5.14	4.09	3.36	-2.99	-1.78	-.73
30-year	6.22	5.55	4.97	4.41	-1.81	-1.14	-.56
U.S. Treasury 10-year indexed note	4.09	3.26	2.08	1.49	-2.60	-1.77	-.59
Municipal revenue (Bond Buyer) <sup>4</sup>	5.99	5.25	5.09	4.78	-1.21	-.47	-.31
Private instruments							
10-year swap	7.38	5.62	4.29	3.45	-3.93	-2.17	-.84
10-year FNMA <sup>5</sup>	7.19	5.68	4.39	3.77	-3.42	-1.91	-.62
10-year AA <sup>6</sup>	7.64	6.30	4.83	4.04	-3.60	-2.26	-.79
10-year BBB <sup>6</sup>	8.40	7.11	5.84	5.08	-3.32	-2.03	-.76
High-yield <sup>7</sup>	12.30	12.72	9.54	9.02	-3.28	-3.70	-.52
Home mortgages (FHLMC survey rate) <sup>8</sup>							
30-year fixed	8.14	6.89	5.70	5.21	-2.93	-1.68	-.49
1-year adjustable	7.22	5.64	3.74	3.54	-3.68	-2.10	-.20
<b>Stock exchange index</b>	Record high		2001	2003		Change to June 16 from selected dates (percent)	
	Level	Date	Sept. 10	May 5	June 16	Record high	2001 Sept. 10      2003 May 5
Dow-Jones Industrial	11,723	1-14-00	9,606	8,532	9,319	-20.51	-2.98      9.23
S&P 500 Composite	1,527	3-24-00	1,093	927	1,011	-33.83	-7.49      9.09
Nasdaq (OTC)	5,049	3-10-00	1,695	1,504	1,667	-66.99	-1.70      10.81
Russell 2000	606	3-9-00	441	410	457	-24.52	3.80      11.63
Wilshire 5000	14,752	3-24-00	10,104	8,817	9,654	-34.56	-4.46      9.49

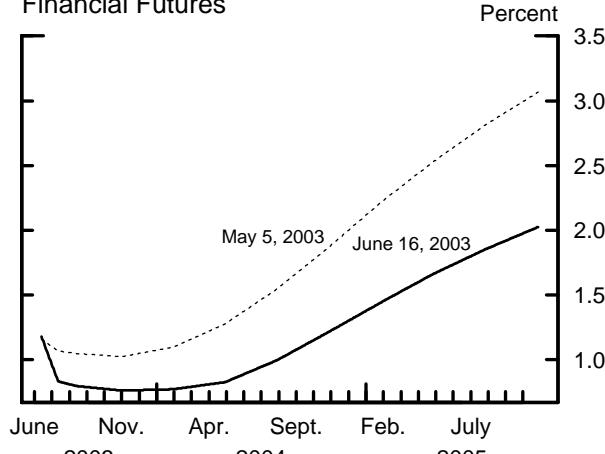
1. Secondary market.
2. Bid rates for eurodollar deposits collected around 9:30 a.m. Eastern time.
3. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
4. Most recent Thursday quote.
5. Constant maturity yields estimated from Fannie Mae domestic non-callable coupon securities.
6. Derived from smoothed corporate yield curves estimated using Merrill Lynch bond data.
7. Merrill Lynch Master II high-yield bond.
8. 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.  
September 10, 2001 is the day before the terrorist attacks.  
May 5, 2003, is the day before the most recent FOMC meetings.

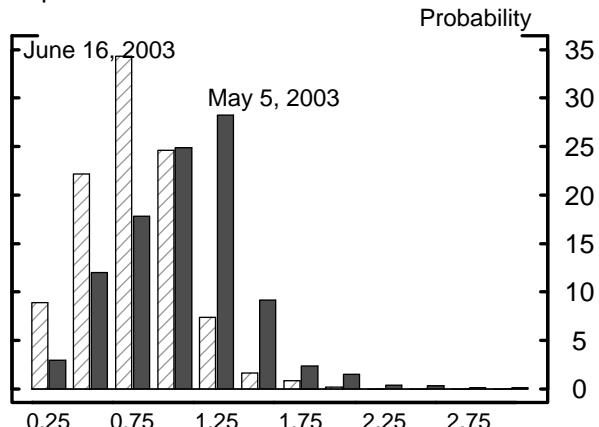
## Selected Interest Rates

Expected Federal Funds Rates Estimated from Financial Futures



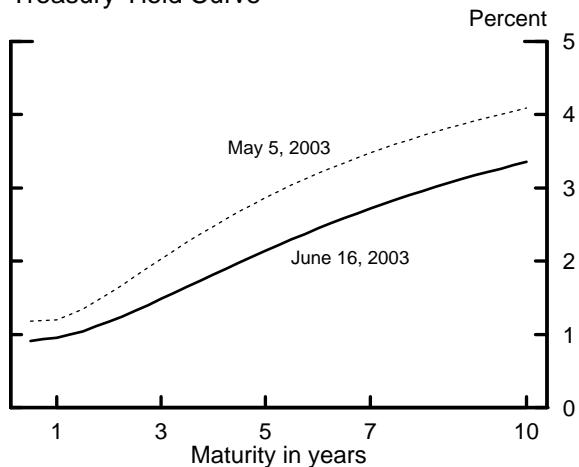
Note. Estimates from federal funds and eurodollar futures rates with an allowance for term premia and other adjustments.

Implied Distribution of Federal Funds Rate\* Probability



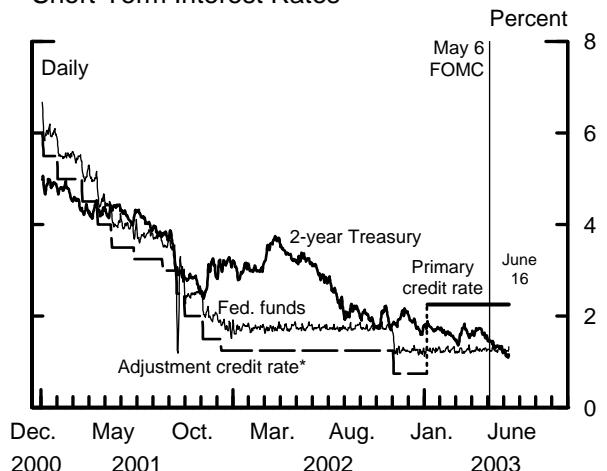
\* Derived from options on eurodollar futures contracts, adjusted to estimate expectations for the federal funds rate.

Treasury Yield Curve



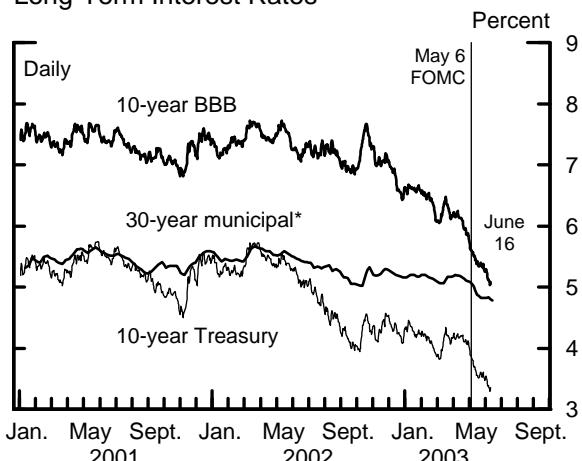
Note. Smoothed yield curve estimated using off-the-run Treasury coupon securities. Yields shown are those on notional par Treasury securities with semiannual payments.

Short-Term Interest Rates



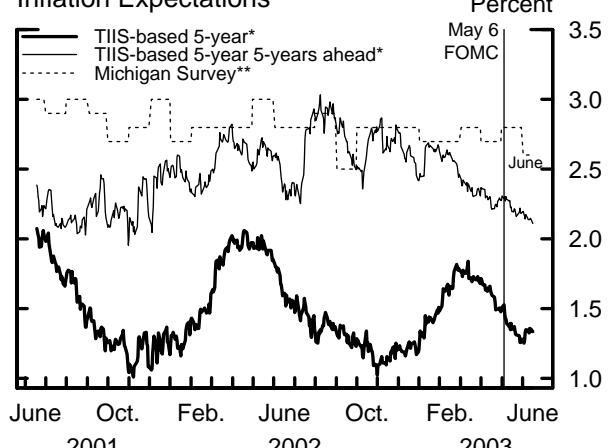
\*On Jan. 9, 2003, the primary credit discount window program replaced the adjustment credit discount window program.

Long-Term Interest Rates



\*Bond Buyer Revenue, weekly Thursday frequency.

Inflation Expectations



\*Daily- the inflation rate at which the price of the indexed security equals the value of a portfolio of zero-coupon securities that replicates its payments. \*\*Monthly- median 5 to 10-year inflation expectations.

## **Domestic Financial Developments**

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### **Overview**

The May FOMC announcement pointing to the risks of “an unwelcome substantial fall in inflation,” along with subsequent comments by the Chairman and other Federal Reserve officials later in the intermeeting period, seemed to convince investors that the FOMC would move policy aggressively and hold rates lower for longer than previously expected to ward off any incipient deflationary pressures. This sizable downward revision in the market’s expected path for policy pulled down Treasury and private yields and boosted equity prices.

The drop in longer-term interest rates spurred another wave of debt restructuring in both the business and household sectors. Firms issued a large volume of bonds, with the proceeds slated primarily to pay down commercial paper and bank loans, and record numbers of households flocked to refinance home mortgages. State and local government borrowing also picked up. Federal borrowing was robust over recent weeks, reflecting somewhat weaker-than-expected tax receipts and an increase in defense spending stemming from the war in Iraq.

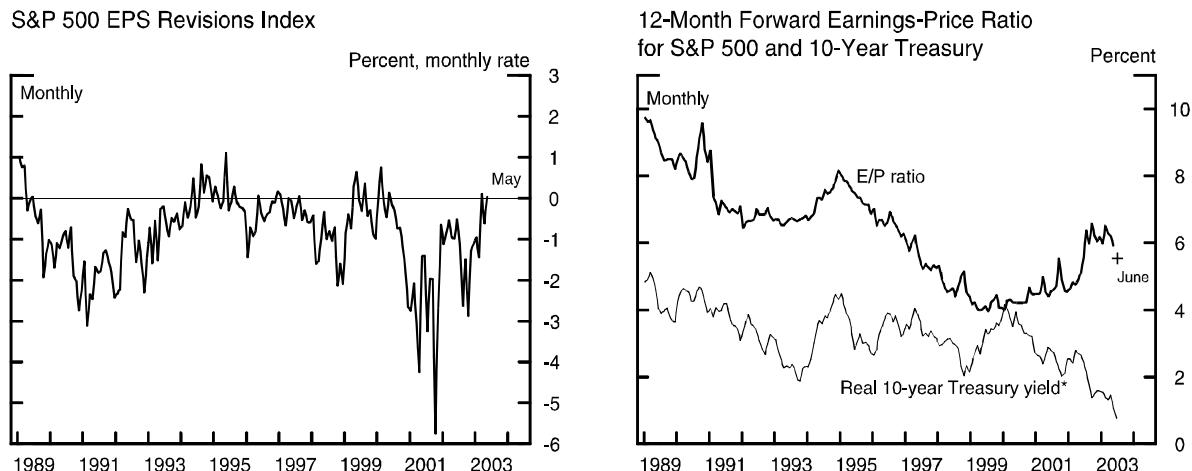
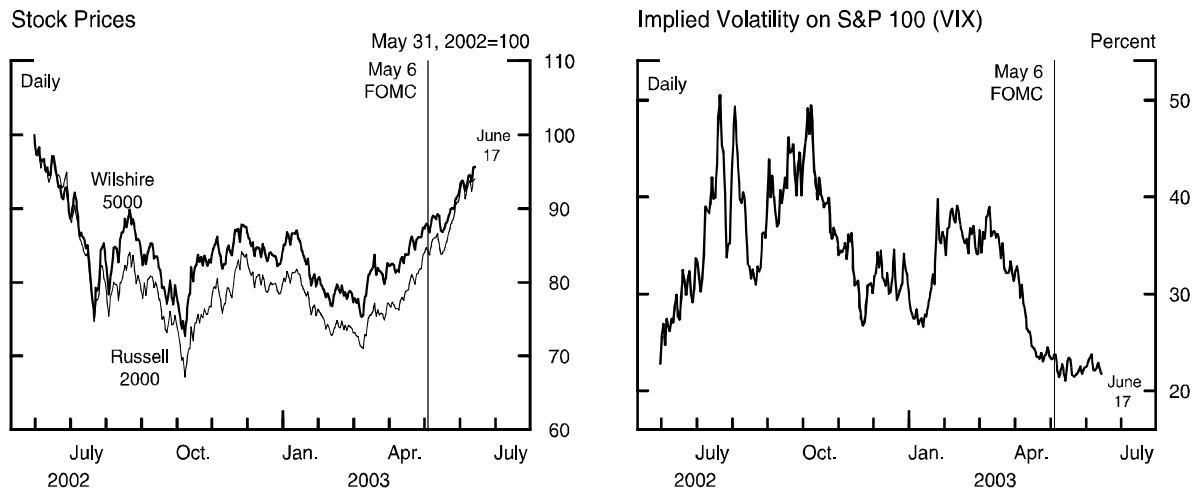
### **Policy Expectations and Interest Rates**

Market participants largely anticipated the FOMC’s decision at the May 6 meeting to leave the target federal funds rate unchanged. But the accompanying statement apparently surprised investors by signaling that the FOMC was prepared to ease policy to guard against further substantial disinflation. Subsequent comments from Federal Reserve officials were viewed as reinforcing this message.

Investors marked down their expected path for policy substantially, and options data suggest that uncertainty about the future path of policy has fallen considerably as well. Options on federal funds futures now imply that investors are virtually certain that the FOMC will ease at the June meeting; they are placing about equal odds on a quarter-point versus a half-point easing. Further ahead, eurodollar futures options suggest that investors revised up the probability that they attach to target rates of less than 75 basis points by late this year.

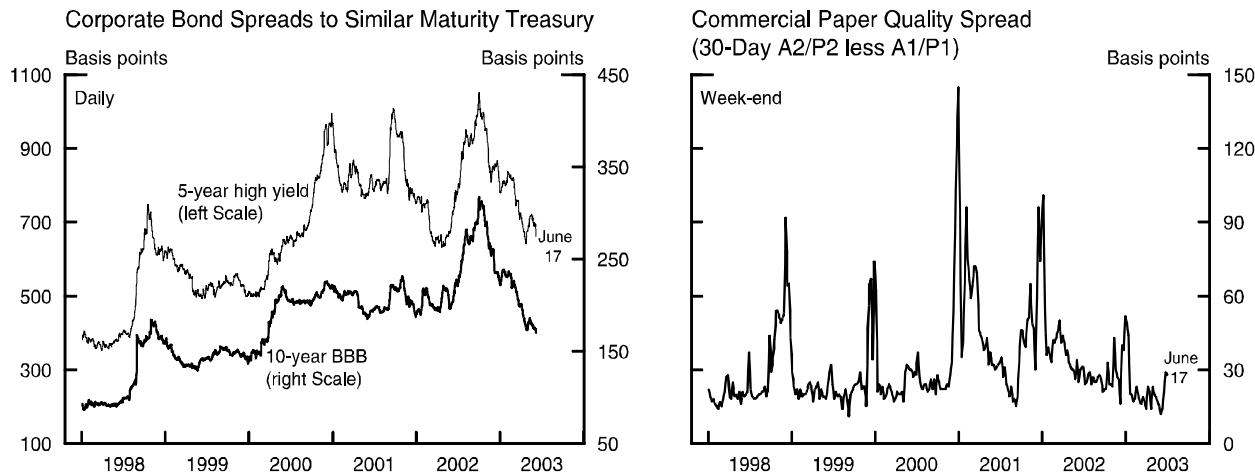
Despite incoming economic news that was close to market expectations, on balance, and the deteriorating outlook for the federal budget, nominal Treasury yields declined 32 to 65 basis points over the intermeeting period. Both market- and survey-based measures of longer-term inflation expectations edged a little lower, but these indicators are well within the range observed over the last few years. In fact, judging from the inflation-indexed yields, much of the drop in

## Stock Prices and Corporate Risk Spreads



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

\* 10-year Treasury yield minus Philadelphia Fed 10-year expected inflation.  
+ Denotes the latest observation using daily prices and latest earnings data from I/B/E/S.



longer-term nominal Treasury yields appears to reflect a decline in expected real interest rates that, in turn, may be attributable to the change in policy outlook.

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

Major equity price indexes have risen between 9 and 11 percent since the last FOMC meeting, with small cap, biotech, and Internet stocks outperforming the broader indexes. Implied-volatility has remained low since the end of military action in Iraq. In addition to the substantial fall in real interest rates, stock prices have been bolstered by the most stable earnings outlook since early 2000; over the past three months, almost no downward revisions have been made to year-ahead forecasts of S&P 500 earnings per share. Also, the passage of the fiscal stimulus package may have provided some additional lift for equity prices, but there is scant evidence that investors have shifted their preferences toward stocks with higher dividends. Despite the increase in share values, the equity risk premium apparently has not narrowed, as the forward earnings-price ratio—a proxy for the required return on equities—has fallen by about as much as real long-term Treasury yields.

Yields on investment-grade corporate bonds fell along with those on comparable Treasury securities over the intermeeting period, leaving their spreads roughly unchanged. Yields on speculative-grade bonds fell by slightly less than those on comparable Treasuries, and spreads widened modestly. Issuance of high-yield bonds has been robust, and the onslaught of new bonds coming to market may have put some upward pressure on speculative-grade spreads.

### **Business Finance**

Low long-term yields proved quite alluring to many businesses, and gross corporate bond issuance jumped last month to its highest monthly level in two years, with gross junk bond issuance reaching a historical peak. Issuance so far this month has not matched the pace in May but nonetheless has remained strong. Many firms report that they have continued to use the bulk of the proceeds from bond issuance to pay down existing debt, consistent with declines in commercial paper outstanding and bank credit. The amount of net borrowing this quarter is about roughly equal to its first quarter pace.

Gross public equity issuance by nonfinancial firms picked up some in May from the extremely slow pace in March and April. Energy and utility firms continued to account for most of the seasoned equity offerings, in many cases to pay down debt. Also, although the nonfinancial IPO market finally ended its four-month drought in May, the longest since 1975, the streak was broken by just a single \$10 million offering. However, an \$80 million tech offering was well received last week, and a number of IPOs are on the calendar for the near future, developments that perhaps reflect the recent rise in stock prices. With the

## Business Finance

### Gross Issuance of Securities by U.S. Corporations (Billions of dollars; monthly rates, not seasonally adjusted)

Type of security	2000	2001	2002		Q1	2003	
			H1	H2		Apr.	May
<i>Nonfinancial corporations</i>							
Stocks <sup>1</sup>	9.9	6.5	7.4	2.9	2.5	1.2	2.9
Initial public offerings	4.4	2.1	1.2	0.3	0.0	0.0	0.0
Seasoned offerings	5.5	4.4	6.3	2.6	2.5	1.2	2.9
Bonds	22.6	39.1	31.4	18.0	29.2	22.1	49.6
Investment grade <sup>2</sup>	13.2	27.5	19.8	11.6	18.8	12.1	25.2
Speculative grade <sup>2</sup>	4.7	8.9	6.4	3.3	6.8	9.9	21.8
Other (sold abroad/unrated)	4.8	2.7	5.3	3.1	3.6	0.2	2.6
<i>Memo</i>							
Net issuance of commercial paper <sup>3</sup>	4.5	-8.0	-10.4	-2.2	-1.3	-4.7	-7.7
Change in C&I loans at commercial banks <sup>3</sup>	7.8	-5.7	-6.2	-4.2	-5.2	-3.2	-12.6
<i>Financial corporations</i>							
Stocks <sup>1</sup>	1.4	4.2	4.2	3.8	4.2	6.7	5.6
Bonds <sup>4</sup>	57.9	80.2	89.8	83.9	105.4	96.9	104.4

Note. Components may not sum to totals because of rounding. These data include 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.

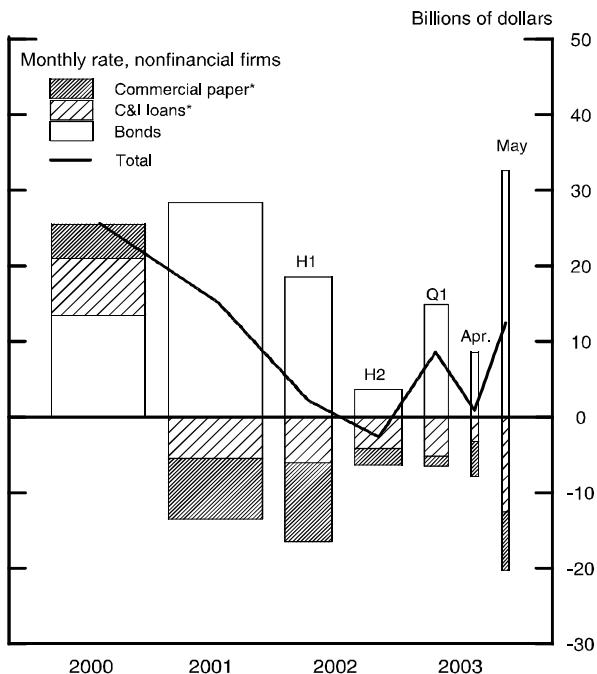
2. Bonds sold in U.S. categorized according to Moody's bond ratings, or to Standard & Poor's if unrated by Moody's.

3. End-of-period basis, seasonally adjusted.

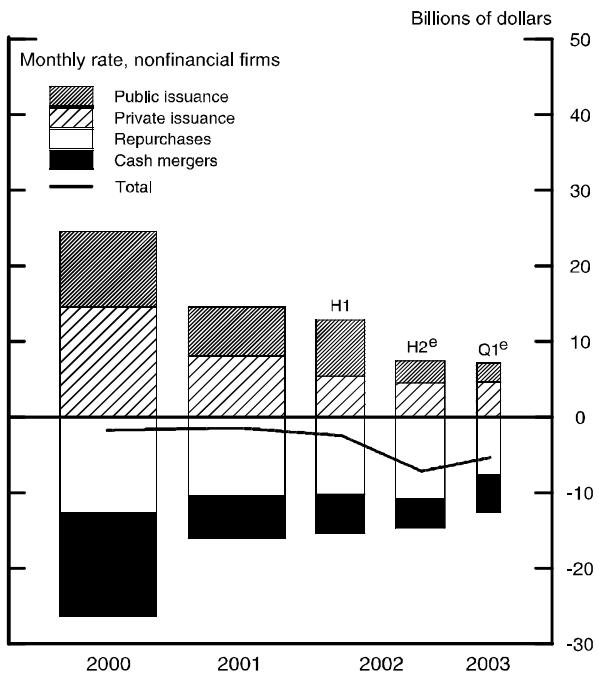
4. Excludes mortgage-backed and asset-backed bonds.

e Staff estimate.

#### Components of Net Debt Financing



#### Components of Net Equity Issuance

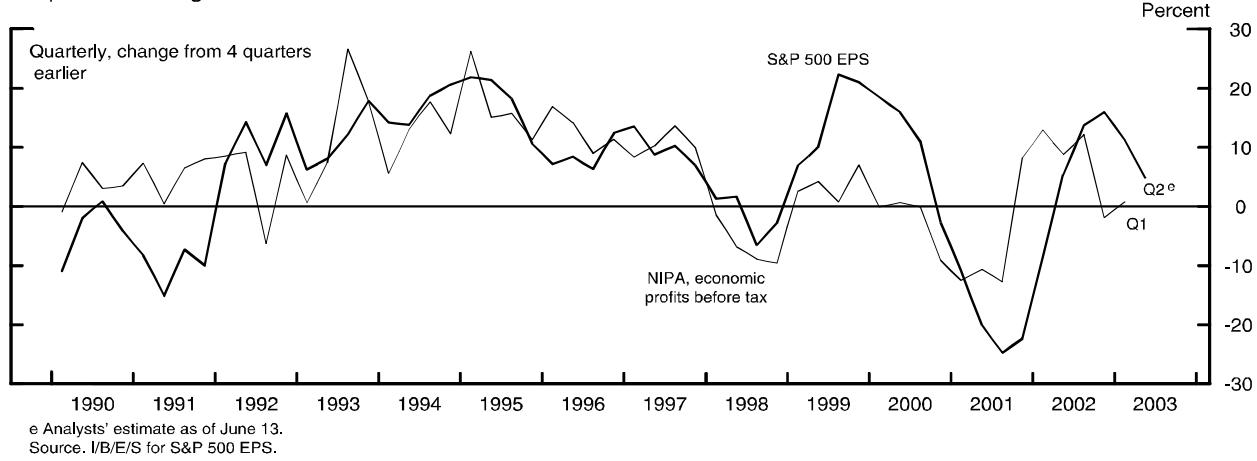


\* Seasonally adjusted.

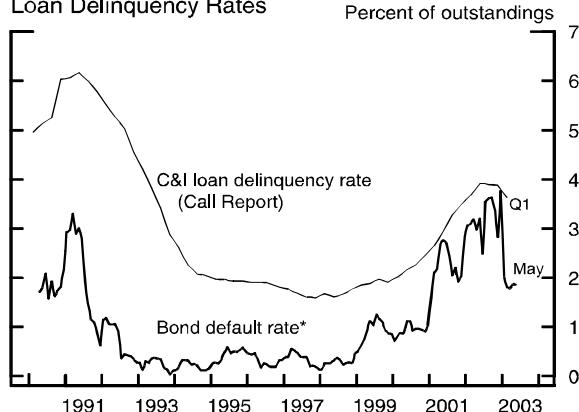
e Staff estimate.

## Corporate Credit Quality and Earnings

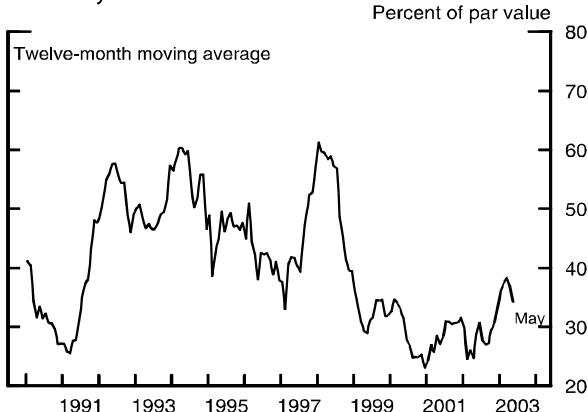
### Corporate Earnings



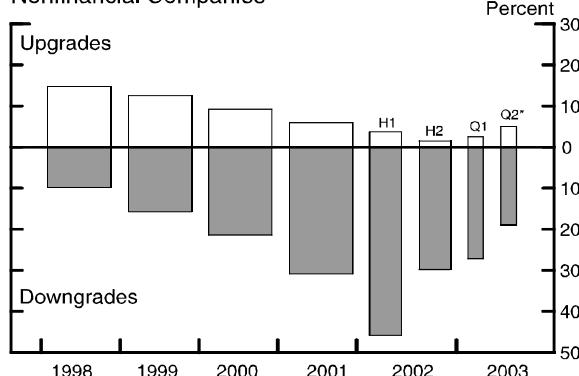
### Bond Default and Loan Delinquency Rates



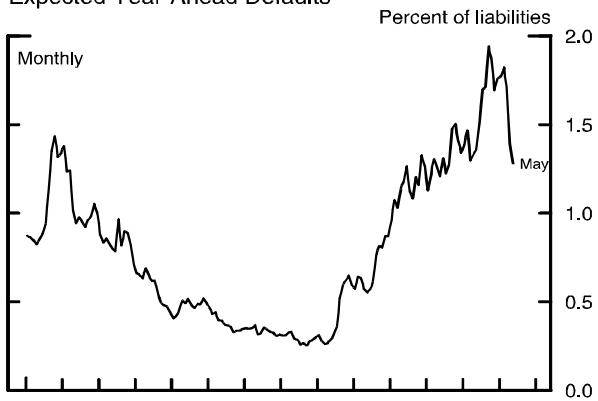
### Recovery Rate on All Defaulted Bonds



### Ratings Changes of Nonfinancial Companies

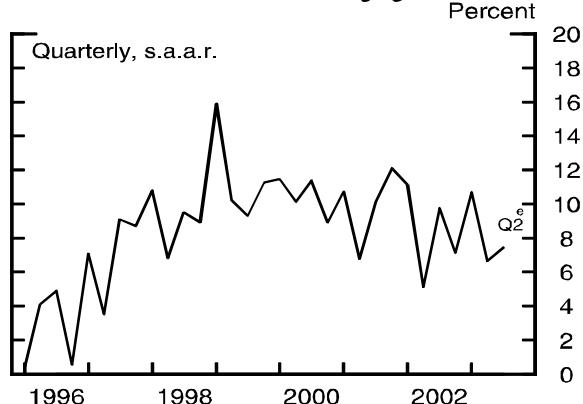


### Expected Year-Ahead Defaults

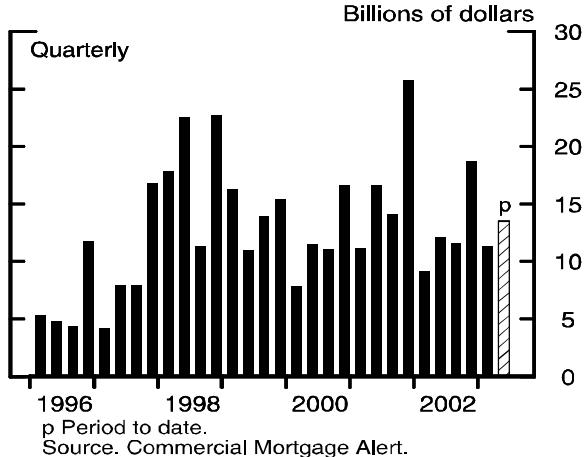


## Commercial Real Estate

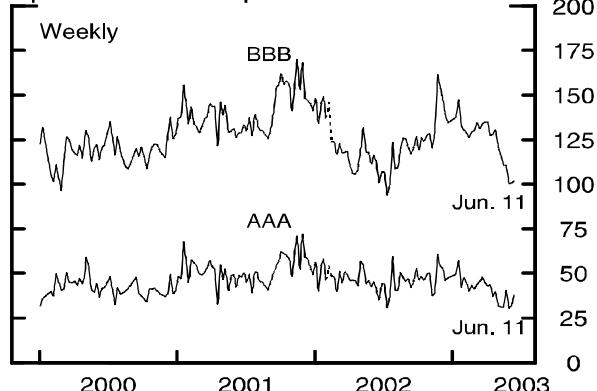
Growth of Commercial Mortgage Debt



Total CMBS Gross Issuance

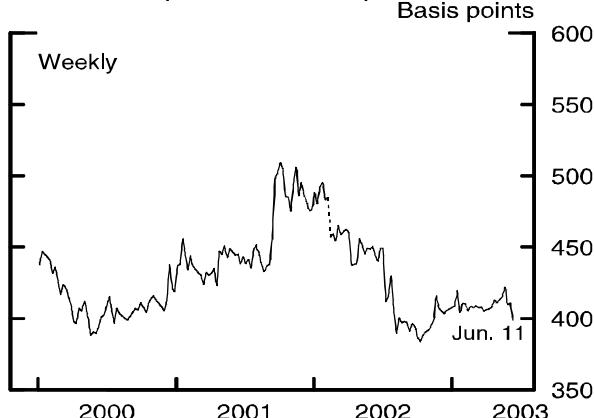


Investment-Grade CMBS Spreads over Swaps



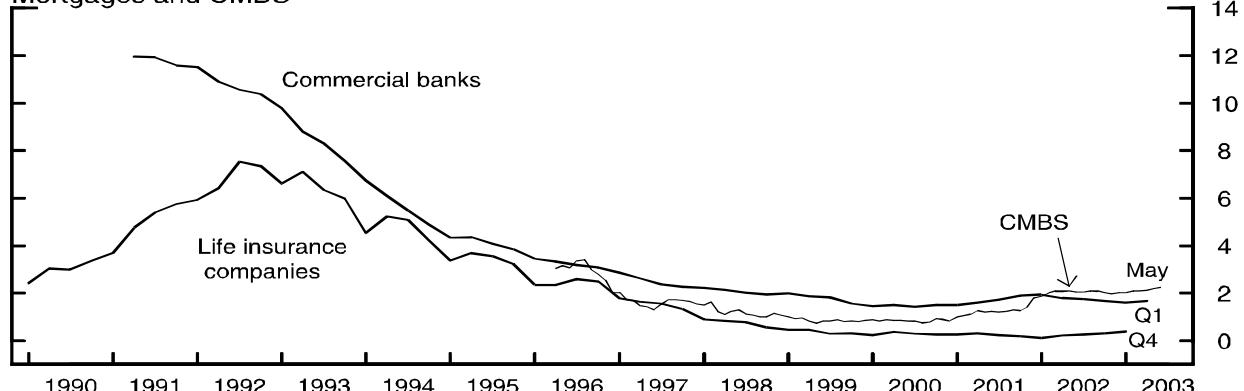
Note. Yield indexes were rebalanced on Feb. 1, 2002.  
Source. Morgan Stanley.

BB CMBS Spread over Swap



Note. Yield indexes were rebalanced on Feb. 1, 2002.  
Source. Morgan Stanley.

Delinquency Rates on Commercial Mortgages and CMBS



Source. Call Report, ACLI, Morgan Stanley.

exception of Oracle's recent hostile, and quickly snubbed, bid for PeopleSoft, talk of mergers remained sporadic even as financial market conditions have improved. Announcements of share repurchases are likely to repeat last quarter's modest flow. Still, with gross new offerings remaining low, net equity issuance should remain in solidly negative territory this quarter.

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

With the first-quarter earnings season essentially complete, S&P 500 operating earnings per share are estimated to have risen 11 percent from last year's levels. However, the spike in oil prices resulted in the three largest oil companies accounting for about two-thirds of that gain. Moreover, the rise in fuel costs was not yet fully accounted for in the income statements of oil-consuming industries last quarter. In the second quarter, the reversal in oil prices has removed this boost to earnings, which accounts for a good part of the slowdown in aggregate earnings growth expected by analysts for this quarter.

Measures of credit quality for nonfinancial firms either held steady or improved somewhat of late. The six-month trailing default rate on corporate bonds has changed little in recent months after dropping back around the turn of the year, while the net pace of ratings downgrades continued to moderate in the second quarter. In addition, delinquency rates on C&I bank loans fell somewhat in the first quarter from elevated levels. The forecast of aggregate year-ahead default rates based on the KMV model plunged in April and dropped again in May, a reflection of higher stock prices and lower asset price volatility.

### **Commercial Real Estate**

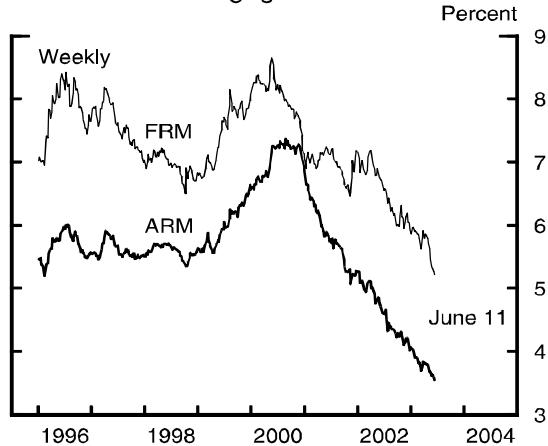
Despite continuing declines in construction activity, commercial mortgage debt increased about 7 percent at an annual rate in the first quarter, a pace that is likely to be exceeded in the second quarter. Gross CMBS issuance in April and May was strong on average, and issues set to price in June suggest that issuance this quarter will be comparable to the rapid pace of the fourth quarter of last year. The CMBS delinquency rate has ticked up in recent months from low historical levels. Nonetheless, investors continue to show little concern about credit quality; spreads on CMBS over swaps contracted further over the intermeeting period and are now at the low end of their ranges in recent years.

### **Household Finance**

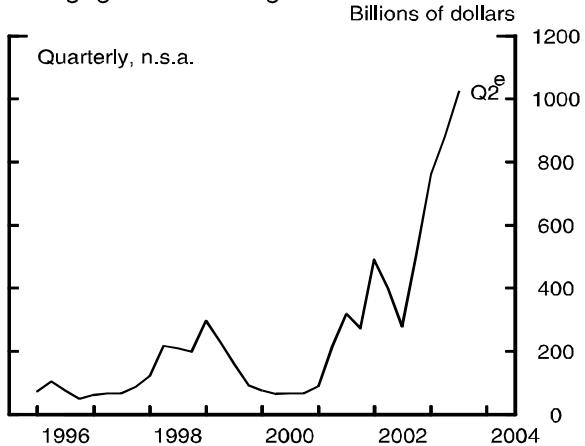
Household debt, which rose to a 10 percent pace in the first quarter, appears on track to post another substantial gain in the current quarter; the increase stems from a record amount of refinancing activity. Many households have refinanced for the second or third time in as many years, and the average amount of home equity extracted per dollar of mortgage refinanced has ebbed somewhat. Nonetheless, the estimated volume of home equity extracted has risen to a very

### Household Liabilities

Freddie Mac Mortgage Rates

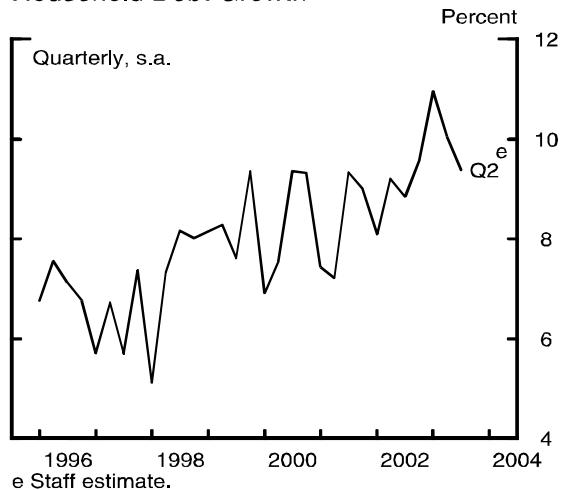


Mortgage Refinancing



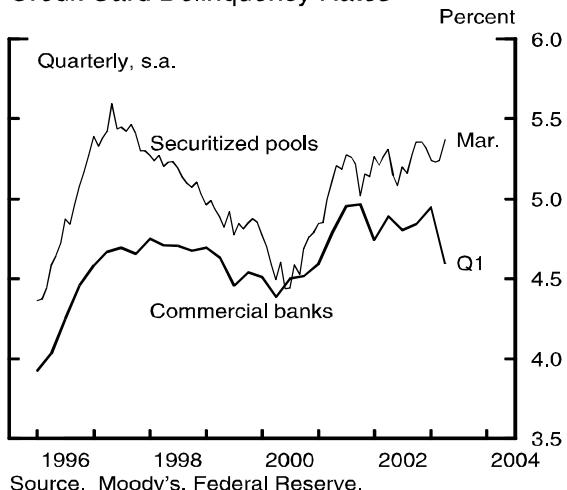
Source. Staff estimates based on Home Mortgage Disclosure Act records (1996-2002) and on the MBA applications index (since 2002).

Household Debt Growth



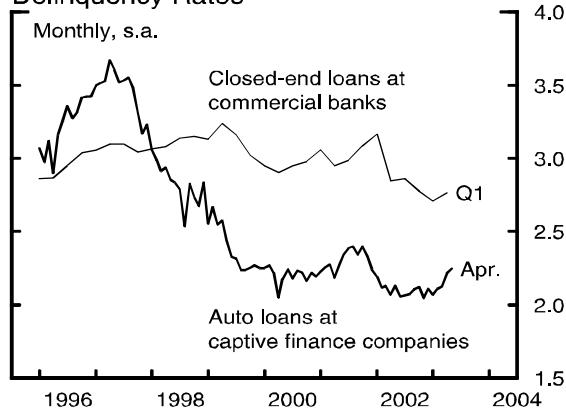
e Staff estimate.

Credit Card Delinquency Rates



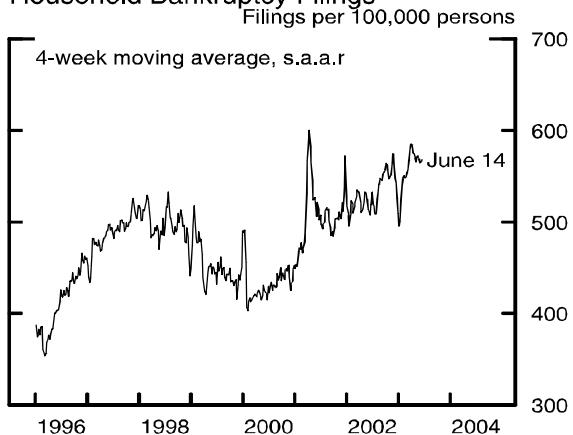
Source. Moody's, Federal Reserve.

Closed-End Consumer Loan Delinquency Rates



Source. Federal Reserve.

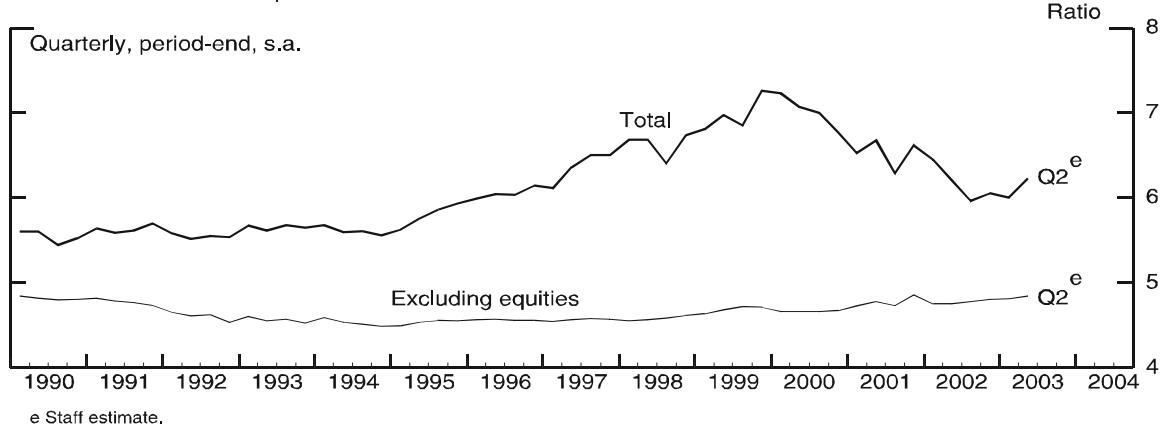
Household Bankruptcy Filings



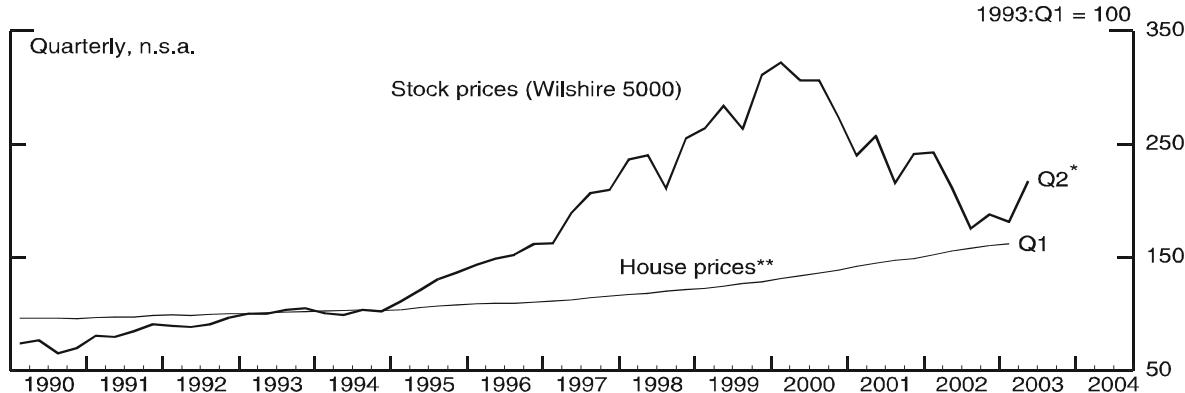
Source. Visa Bankruptcy Notification Service Statistics.

### Household Assets

#### Assets Relative to Disposable Income



#### Asset Prices



\* Based on data through June 17.

\*\* From the Office of Federal Housing Enterprise Oversight.

#### Net Flows into Long-Term Mutual Funds

(Billions of dollars, monthly rate)

	2000	2001	2002		Q1	Apr.	May <sup>e</sup>	Assets Apr.
			H1	H2				
<b>Total long-term funds</b>	<b>18.5</b>	<b>10.8</b>	<b>21.0</b>	<b>-0.5</b>	<b>11.2</b>	<b>29.4</b>	<b>27.0</b>	<b>4,327</b>
<b>Equity funds</b>	<b>25.2</b>	<b>2.8</b>	<b>9.1</b>	<b>-13.4</b>	<b>-3.9</b>	<b>16.1</b>	<b>12.3</b>	<b>2,770</b>
Domestic	21.3	4.6	7.9	-11.8	-3.6	12.5	11.7	2,406
International	3.9	-1.8	1.2	-1.6	-0.3	3.6	0.6	364
<b>Hybrid funds</b>	<b>-2.6</b>	<b>0.7</b>	<b>2.2</b>	<b>-0.7</b>	<b>0.7</b>	<b>2.7</b>	<b>3.0</b>	<b>347</b>
<b>Bond funds</b>	<b>-4.0</b>	<b>7.3</b>	<b>9.7</b>	<b>13.7</b>	<b>14.4</b>	<b>10.6</b>	<b>11.7</b>	<b>1,210</b>
High-yield	-1.0	0.6	0.9	0.9	3.5	6.5	2.4	129
Other taxable	-1.8	5.7	7.6	11.4	10.3	4.4	7.4	748
Municipals	-1.2	1.0	1.3	1.5	0.6	-0.3	1.9	333

Note. Excludes reinvested dividends.

Source. Investment Company Institute.

e Staff estimates based on confidential ICI weekly data.

## State and Local Government Finance

### Gross Offerings of Municipal Securities

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

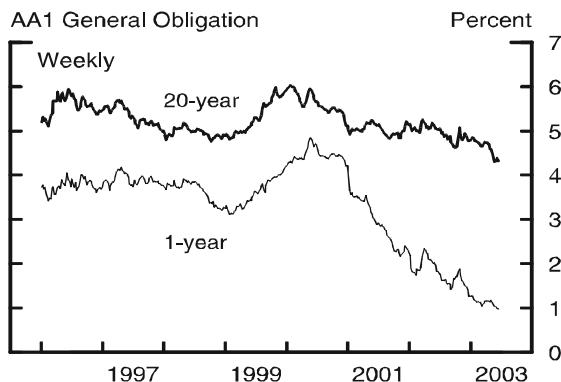
Type of security	2000	2001	2002	2003			
				Q1	Apr.	May	June <sup>e</sup>
Total	17.9	29.0	36.4	30.7	34.7	36.5	61
Long-term <sup>1</sup>	15.0	24.3	30.3	28.2	33.2	32.1	37
Refundings <sup>2</sup>	2.2	7.6	10.1	9.9	9.6	11.9	9
New capital	12.9	16.7	20.3	18.3	23.6	20.2	28
Short-term	2.8	4.7	6.0	2.5	1.5	4.4	24
Memo: Long-term taxable	0.7	1.4	1.7	1.7	2.9	1.9	11

1. Includes issues for public and private purposes.

2. All issues that include any refunding bonds.

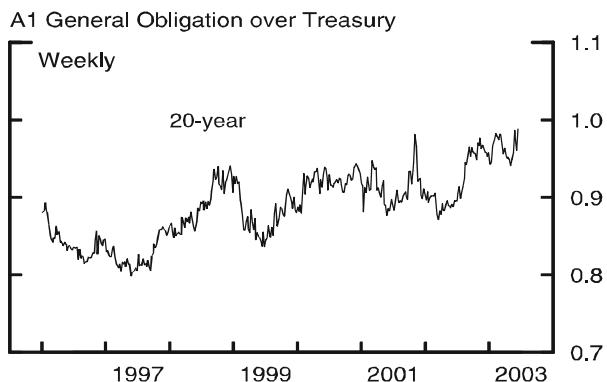
e Staff estimate based on preliminary data through June 12.

### Municipal Bond Yields



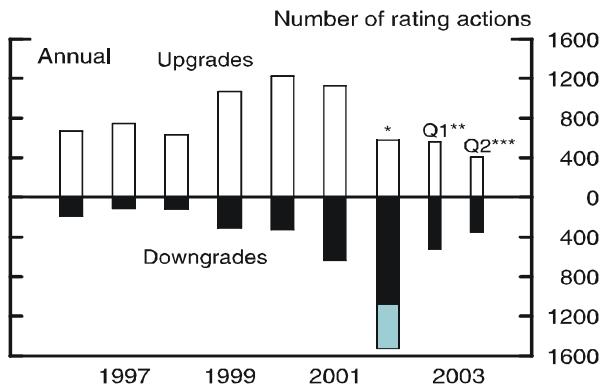
Note. Last observation is for week of June 12.  
Source. Bloomberg.

### Municipal Bond Ratios



Note. Last observation is for week of June 12.  
Source. Bond Buyer.

### Bond Rating Changes



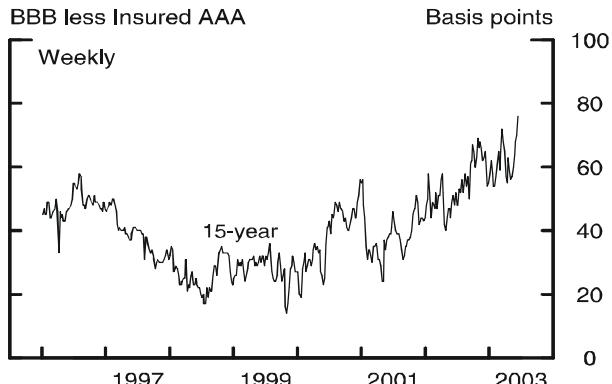
\* Lightly shaded region shows a staff estimate of the number of downgrades related to downgrades of financial institutions that provided financial support for the bonds.

\*\* At an annual rate.

\*\*\* Data through June 11 at an annual rate.

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

### Revenue Bond Spread



Note. Last observation is for week of June 12.  
Source. Bloomberg.

high level because of the large number of mortgages being refinanced. Meanwhile, consumer credit is likely to accelerate a bit from the modest growth of recent quarters; in particular, nonrevolving credit expanded briskly in April, an apparent response to the step-up in auto financing incentives during that month.

The credit quality of the household sector has been holding steady on balance, with limited pockets of distress. The delinquency rate on credit card loans at commercial banks moved down in the first quarter, and rates on other types of loans, such as credit card loans in securitized pools and nonrevolving consumer loans at commercial banks, have continued to hover in fairly narrow ranges. However, the bankruptcy rate remains quite elevated despite a small improvement in the past few weeks.

Recent gains in share values have pushed the ratio of household assets to income somewhat above its level at the end of last year. Consistently positive net inflows to equity mutual funds since mid-March suggest that households have renewed their confidence in the stock market, and inflows into high-yield bond mutual funds have also remained sizable.

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

The underlying pace of gross municipal bond issuance remained quite strong, reflecting efforts by state and local governments to cope with ongoing tax shortfalls. A \$10 billion taxable bond used to fund Illinois's pension liability augmented long-term issuance in June, and California's rollover of \$11 billion in securities that had been issued to deal with the state's fiscal crisis boosted short-term issuance. At the same time, the substantial decline in yields following the last FOMC meeting has bolstered issuance for advance refundings, which remain near recent levels.

The recent dividend and capital gains tax cuts appeared to have had little visible effect on municipal bond yields. After a sizable net downgrade in 2002, municipal bond ratings upgrades and downgrades have been roughly balanced so far this year, but the spread of BBB- over AAA-rated municipal bond yields has widened since the last FOMC meeting and remains quite high by historical levels.

### **Treasury and Agency Finance**

The Congress raised the federal debt limit last month to a level that likely will not bind Treasury borrowing until at least early next year. Faced with the prospect of large deficits for some years, the Treasury is increasingly shifting issuance patterns toward longer-term securities, a move that will appreciably

### III-12

Item	Treasury Financing (Billions of dollars)					
	2002		2003			
	Q3	Q4	Q1	Mar.	Apr.	May (e)
<b>Total surplus, deficit (-)</b>	<b>-41.5</b>	<b>-108.3</b>	<b>-143.9</b>	<b>-58.7</b>	<b>51.0</b>	n.a.
Means of financing deficit						
Net borrowing	89.4	96.9	63.5	29.2	-8.7	81.1
Nonmarketable	6.7	14.9	-51.0	-13.9	7.9	44.5
Marketable	82.8	82.0	114.5	43.1	-16.6	36.6
Bills	44.4	20.0	67.5	36.7	-25.0	-19.1
Coupons <sup>1</sup>	38.4	62.0	47.0	6.4	8.4	55.7
Debt buybacks	0.0	0.0	0.0	0.0	0.0	0.0
Decrease in cash balance	-21.3	27.9	19.8	-4.7	-15.2	20.9
Other <sup>2</sup>	-26.7	-16.4	60.6	34.2	-27.2	n.a.
MEMO						
Cash balance, end of period	60.9	33.0	13.3	13.3	28.4	7.5

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

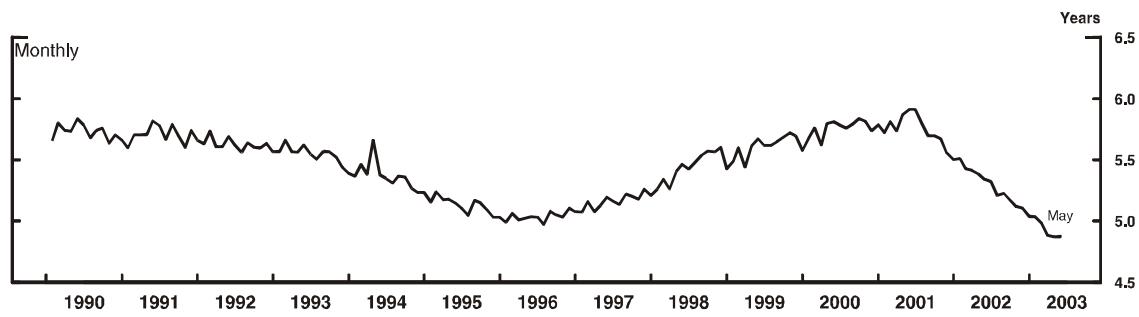
1. Does not include Treasury debt buybacks.

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

e. Estimated.

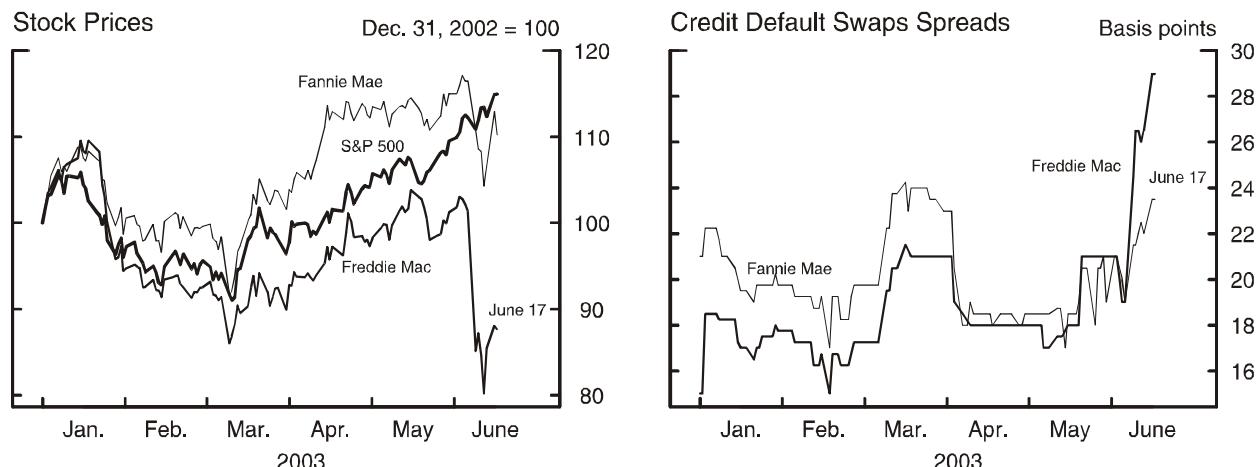
n.a. Not available.

#### Average Maturity of Marketable Treasury Debt



Source. U.S. Treasury.

#### Agency Asset Prices



lengthen the average maturity of Treasury debt, which now stands at its lowest level since 1985.

Fannie Mae and Freddie Mac have scaled back their reference and benchmark note programs, in part because of renewed Treasury issuance and sluggish growth of their on-balance-sheet mortgage portfolios. Demand for Freddie Mac securities has been curtailed somewhat lately following revelations of alleged accounting irregularities that led to the departure of its top three officers and news of impending investigations by the SEC and Justice Department. The price of Freddie Mac's stock dropped, and credit default swap spreads on its debt moved sharply higher in response. Although Fannie Mae's stock price also declined, and its credit default swap spreads rose a few basis points, there appears to be little, if any, lasting spillover into broader financial markets.

### **Money and Bank Credit**

M2 growth surged in May partly because of special factors. This year, total tax payments were somewhat weaker than expected, so the April build-up and May run-offs in balances were damped relative to the pattern embedded in seasonal factors. Also, the recent spike in mortgage refinancing and the accompanying bulge in escrow accounts that serve as temporary repositories of funds in connection with prepayments on MBS likely contributed to the pickup in M2 growth last month.

Withdrawals from retail money funds over recent months have been associated with a fall in money fund yields relative to rates paid on bank deposits. Low yields on short-term securities have pressured some money market mutual funds to reduce fees to keep investors' yields in positive territory, although the assets under management in such funds represent less than 1 percent of total money market fund assets.

Bank credit maintained its recent strong growth in May. Falling mortgage rates spurred continued robust demand for home purchases and mortgage refinancings, and banks continued to acquire MBS. But the ongoing contraction in commercial and industrial lending partially offset these factors.

The May Survey of Terms of Business Lending indicates a downward shift of the entire distribution of rate spreads, as the average spread on C&I loans over comparable-maturity market rates at domestic banks declined from the previous quarter. For loans not made under commitment, which are more representative of recent pricing conditions, spreads declined for both higher-risk and lower-risk loans, a trend that is largely consistent with the corporate bond market over the same period.

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

Aggregate or component	2002	2002	2003	2003			Level (\$ billions) May 03
		Q4	Q1	Mar.	Apr.	May	
<i>Aggregate</i>							
1. M2 <sup>2</sup>	6.8	7.0	6.5	3.0	4.7	17.5	6,000
2. M3 <sup>3</sup>	6.3	7.7	5.1	3.0	1.8	12.9	8,683
<i>Components of M2<sup>4</sup></i>							
3. Currency	8.2	5.1	7.8	9.2	5.8	4.8	647
4. Liquid deposits <sup>5</sup>	16.5	15.4	14.3	6.7	14.1	29.4	3,586
5. Small time deposits	-9.0	-6.9	-6.9	-6.7	-7.5	-10.9	864
6. Retail money market funds	-6.0	-6.3	-8.8	-5.5	-19.7	7.7	896
<i>Components of M3</i>							
7. M3 minus M2 <sup>6</sup>	5.4	9.2	2.1	3.0	-4.6	3.0	2,683
8. Large time deposits, net <sup>7</sup>	3.0	-3.2	-2.4	7.0	2.5	16.5	819
9. Institutional money market funds	2.2	2.1	-4.9	-13.1	-22.4	-20.1	1,125
10. RPs	19.8	45.6	29.8	44.6	18.5	12.7	506
11. Eurodollars	7.0	28.9	.7	-16.0	11.9	50.4	233
<i>Memo</i>							
12. Monetary base	7.2	5.1	7.7	8.0	5.7	4.9	702
<i>Selected managed liabilities at commercial banks</i>							
13. Large time deposits, gross	1.8	-7.1	1.6	-4.9	-18.5	8.1	990
14. Net due to related foreign institutions	-3.2	11.1	5.5	-6.6	5.9	11.2	157
15. U.S. government deposits at commercial banks	-1.0	-.2	-4.2	3.7	-2.2	-1.2	9

1. For the years shown, Q4 to Q4 percent change. For the quarters shown, based on quarterly averages.

2. Sum of currency, liquid deposits (demand, other checkable, savings), small time deposits, retail money market funds, and non-bank travelers checks.

3. Sum of M2, net large time deposits, institutional money market funds, RP liabilities of depository institutions, and eurodollars held by U.S. addressees.

4. Non-bank travelers checks not listed.

5. Sum of demand deposits, other checkable deposits, and savings deposits.

6. Sum of large time deposits, institutional money market funds, RP liabilities of depository institutions, and eurodollars held by U.S. addressees.

7. Net of holdings of depository institutions, money market funds, U.S. government and foreign banks and official institutions.

8. For the years shown, "average monthly change" is the Q4 to Q4 dollar change divided by 12. For the quarters shown, it is the quarter-to-quarter dollar change divided by 3.

p Preliminary.

**Commercial Bank Credit**

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

Type of credit	2002	Q4 2002	Q1 2003	Mar. 2003	Apr. 2003	May 2003	Level, May 2003 (\$ billions)
<b>Total</b>							
<b>1. Adjusted<sup>1</sup></b>	<b>7.1</b>	<b>12.4</b>	<b>7.3</b>	<b>7.1</b>	<b>9.4</b>	<b>10.9</b>	<b>5,892</b>
2. Reported	7.1	11.8	8.0	6.1	6.4	17.4	6,112
<i>Securities</i>							
3. Adjusted <sup>1</sup>	13.3	16.2	11.9	11.3	18.7	16.9	1,603
4. Reported	12.7	13.5	13.9	7.4	7.5	38.6	1,822
5. Treasury and agency	19.2	25.2	16.9	11.5	34.9	34.5	1,119
6. Other <sup>2</sup>	4.4	-2.6	9.6	1.4	-33.9	44.9	704
<i>Loans<sup>3</sup></i>							
7. Total	5.0	11.1	5.6	5.5	6.0	8.7	4,290
8. Business	-6.9	-4.0	-6.0	-8.7	-3.2	-13.6	933
9. Real estate	13.1	20.4	13.5	7.3	8.8	13.3	2,129
10. Home equity	36.7	24.7	26.2	38.3	20.9	18.5	237
11. Other	10.8	19.9	12.0	3.6	7.4	12.6	1,891
12. Consumer	5.5	8.6	4.2	-6.1	-4.9	8.2	593
13. Adjusted <sup>4</sup>	4.1	4.9	7.7	.5	-1.3	12.6	959
14. Other <sup>5</sup>	1.4	8.5	-.7	33.5	21.2	27.4	636

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. The conversion from a thrift to a commercial bank charter added approximately \$37 billion to the assets and liabilities of domestically chartered commercial banks in the week ending May 8, 2002.

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

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

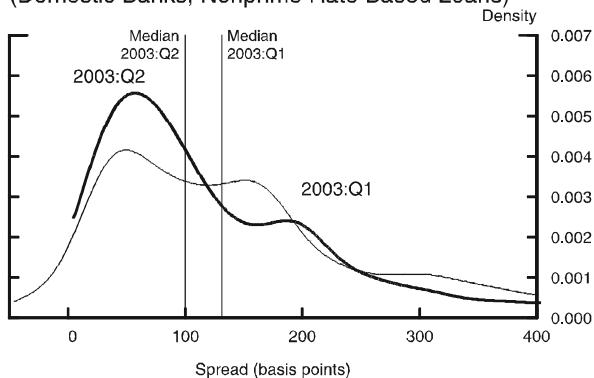
3. Excludes interbank loans.

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

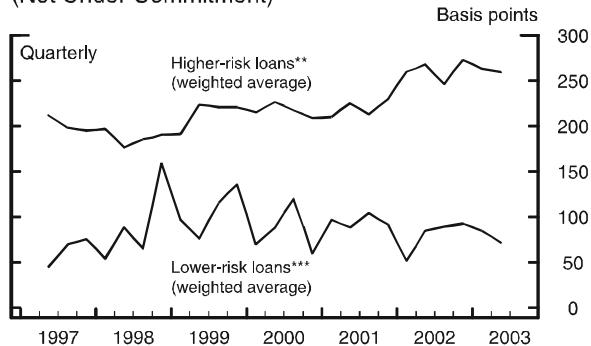
5. Includes security loans and loans to farmers, state and local governments, and all others not elsewhere classified. Also includes lease financing receivables.

**Survey of Terms of Business Lending**

Distribution of C&I Loan Rate Spreads\*  
(Domestic Banks, Nonprime Rate Based Loans)



C&I Loan Rate Spreads\* at Domestic Banks  
(Not Under Commitment)



\*The spread over market interest rate on an instrument of comparable maturity.

\*\*Loans in risk categories "moderate," "acceptable," and "classified."

\*\*\*Loans in risk categories "minimal" and "low."

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## **International Developments**

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## International Developments

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### U.S. International Transactions

#### Trade in Goods and Services

The U.S. international trade deficit in April was \$42 billion, slightly smaller than recorded in March (revised) as exports declined less than imports.

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

	2002	Annual rate			Monthly rate		
		2002	2003	2003	Feb.	Mar.	Apr.
		Q3	Q4	Q1			
<i>Real NIPA<sup>1</sup></i>							
Net exports of G&S	-488.5	-488.0	-532.2	-506.9	...	...	...
<i>Nominal BOP</i>							
Net exports of G&S	-418.0	-427.9	-464.5	-486.4	-38.6	-42.9	-42.0
Goods, net	-482.9	-493.2	-529.0	-544.1	-43.7	-47.5	-46.6
Services, net	64.8	65.3	64.5	57.7	5.1	4.6	4.6

1. Billions of chained (1996) dollars.

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

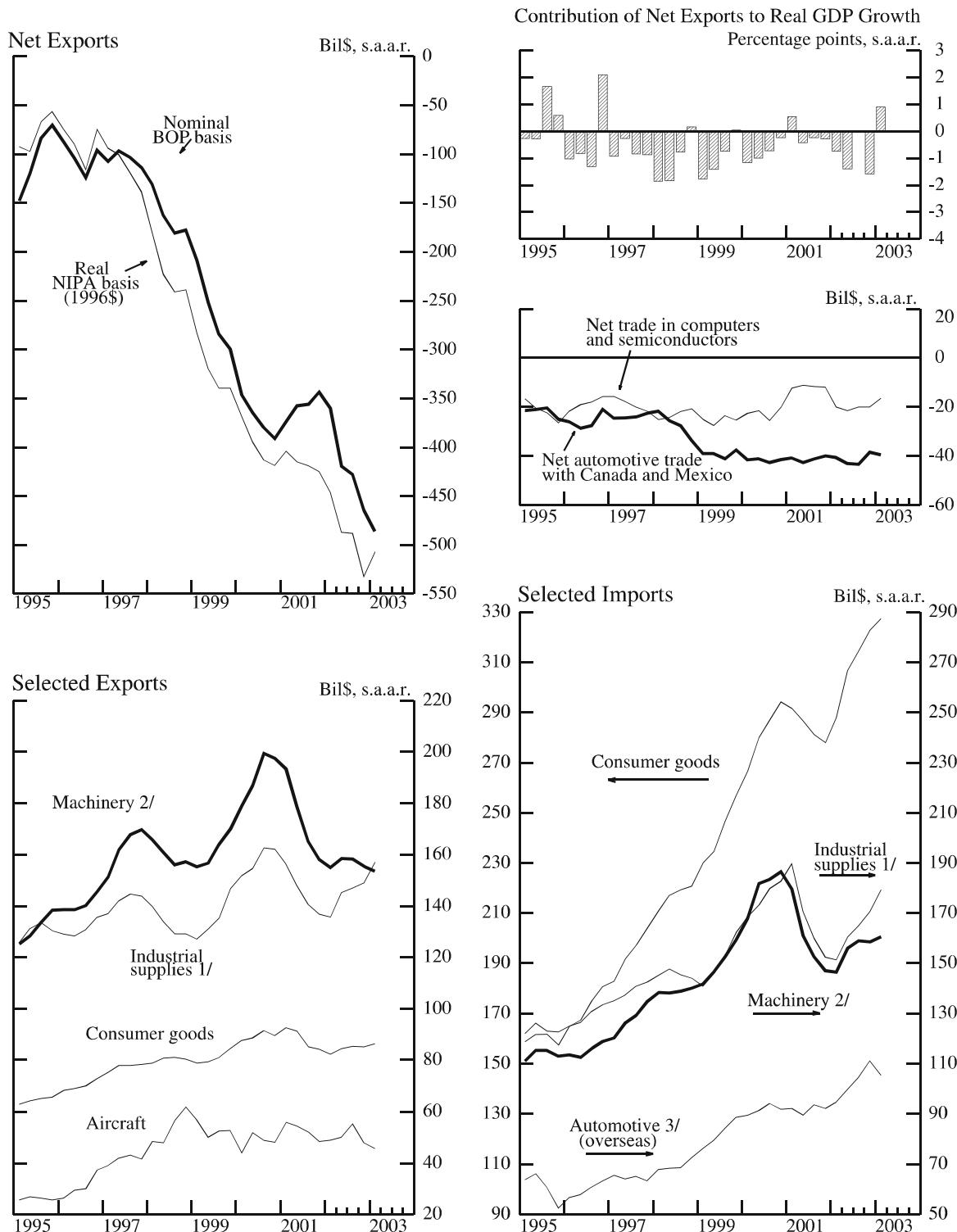
n.a. Not available. ... Not applicable.

Exports of goods and services decreased 2.2 percent in April. There were declines in most trade categories, with the largest in services (reduced foreign travel in the United States) and capital equipment, both of which fell for the second consecutive month. The value of exported industrial supplies eased slightly from the high levels recorded during the first three months of the year, largely accounted for by fuels and chemicals.

Imports of goods and services fell 2.1 percent in April, with declines concentrated in petroleum and natural gas. The value of petroleum and natural gas, which jumped up in March reflecting a run up in prices, fell in April as prices declined. Imports of automotive products turned down in April, continuing a pattern of declines begun in January. In contrast, imports of capital goods rose in April, reversing part of the declines recorded during the previous three months. Services payments fell for the third consecutive month, largely because of reduced U.S. travel abroad.

All previously published trade data were revised beginning in 1992. The deficit in net exports of goods and services in 2003:Q1 is now \$486 billion at an annual rate, \$14 billion smaller than published previously. For the fourth quarter of last year the deficit is \$17 billion smaller. Small upward revisions were made to exports (by \$2-3 billion at an annual rate in both Q4 and Q1). The level of imported goods and services was revised down significantly (by \$15 billion at an

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



1. Excludes agriculture and gold.

2. Excludes computers and semiconductors.

1. Excludes oil and gold.

2. Excludes computers and semiconductors.

3. Excludes Canada and Mexico.

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

	Levels				Amount Change <sup>1</sup>			
	2002		2003		2002		2003	
	Q4	Q1	Mar.	Apr.	Q4	Q1	Mar.	Apr.
<b>Exports of G&amp;S</b>	<b>984.6</b>	<b>991.8</b>	<b>994.1</b>	<b>972.0</b>	<b>-6.7</b>	<b>7.2</b>	<b>-0.9</b>	<b>-22.0</b>
Goods exports	683.4	693.4	699.6	686.7	-13.9	10.0	4.7	-12.9
Gold	3.8	3.8	3.1	3.9	0.3	-0.1	-0.6	0.7
Other goods	679.5	689.6	696.4	682.8	-14.2	10.1	5.2	-13.6
Aircraft & parts	47.9	45.6	42.9	42.6	-7.4	-2.3	-10.8	-0.2
Computers & accessories	38.8	38.4	38.2	36.1	0.7	-0.5	1.2	-2.1
Semiconductors	40.4	42.8	45.1	44.9	-4.1	2.4	3.4	-0.2
Other capital goods	158.2	156.2	157.7	152.9	-2.7	-2.0	0.4	-4.8
Automotive	78.5	79.8	79.9	80.0	-2.8	1.3	0.1	0.1
to Canada	45.0	46.7	45.4	44.5	-1.4	1.7	-2.0	-0.9
to Mexico	14.8	13.1	14.0	14.1	0.2	-1.7	1.6	0.1
to ROW	18.7	20.1	20.6	21.4	-1.7	1.3	0.5	0.8
Agricultural	54.9	56.9	57.2	56.8	0.7	2.0	1.1	-0.3
Ind supplies (ex. ag, gold)	148.9	157.1	160.4	156.8	2.0	8.2	5.3	-3.7
Consumer goods	85.2	86.5	87.6	85.8	-0.1	1.3	3.7	-1.9
All other goods	26.6	26.3	27.3	27.0	-0.5	-0.3	6.6	-0.4
Services exports	301.2	298.4	294.5	285.4	7.2	-2.9	-5.6	-9.2
<b>Imports of G&amp;S</b>	<b>1449.1</b>	<b>1478.1</b>	<b>1508.6</b>	<b>1476.4</b>	<b>29.9</b>	<b>29.1</b>	<b>50.6</b>	<b>-32.2</b>
Goods imports	1212.3	1237.5	1269.6	1245.6	21.8	25.1	50.9	-24.0
Petroleum	117.5	135.9	150.2	134.5	5.9	18.4	17.1	-15.7
Gold	2.9	2.4	2.1	2.9	-0.1	-0.6	-0.5	0.8
Other goods	1091.8	1099.1	1117.4	1108.2	16.0	7.3	34.3	-9.2
Aircraft & parts	26.4	23.5	22.2	22.7	4.1	-2.8	0.1	0.6
Computers & accessories	74.5	73.2	69.4	75.1	-1.6	-1.3	-1.6	5.6
Semiconductors	24.8	24.5	24.7	24.8	-1.8	-0.3	0.5	0.1
Other capital goods	160.1	162.5	162.3	166.6	-0.5	2.4	0.9	4.3
Automotive	209.4	204.6	208.0	203.2	0.4	-4.8	6.1	-4.8
from Canada	57.4	59.2	60.3	56.9	-5.0	1.8	1.3	-3.3
from Mexico	40.9	40.1	43.7	41.1	-1.3	-0.7	3.3	-2.6
from ROW	111.1	105.3	104.0	105.2	6.7	-5.9	1.5	1.2
Ind supplies (ex. oil, gold)	170.4	179.3	188.8	175.7	5.5	9.0	12.6	-13.1
Consumer goods	322.6	327.3	336.1	334.0	8.3	4.7	13.4	-2.2
Foods, feeds, bev.	52.0	54.3	55.6	56.3	1.6	2.4	2.6	0.7
All other goods	51.8	49.9	50.2	49.7	-0.1	-1.9	-0.2	-0.5
Services imports	236.7	240.7	238.9	230.7	8.1	3.9	-0.3	-8.2
<i>Memo:</i>								
Oil quantity (mb/d)	12.49	12.11	12.86	13.41	0.53	-0.38	1.40	0.55
Oil import price (\$/bbl)	25.76	30.74	31.98	27.46	0.20	4.98	0.20	-4.52

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)

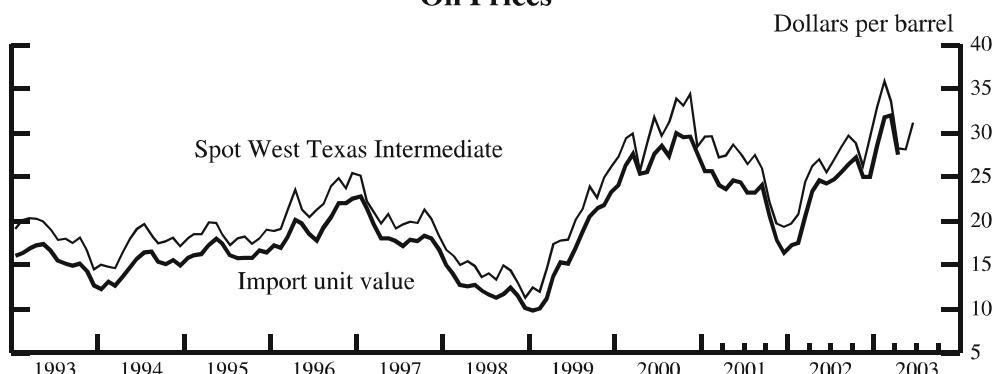
	Annual rates			Monthly rates		
	2002		2003	2003		
	Q4	Q1	Q2 <sup>e</sup>	Mar.	Apr.	May
----- BLS prices (2000 weights) -----						
<b>Merchandise imports</b>	0.7	13.5	-8.7	0.6	-3.0	-0.3
Oil	3.8	134.0	-50.7	-1.0	-18.0	-1.1
Non-oil	0.4	3.9	-1.4	1.0	-1.0	-0.2
Core goods*	1.5	5.1	-0.9	1.2	-1.1	-0.1
Cap. goods ex comp & semi	-0.8	2.1	0.8	0.2	0.0	0.0
Automotive products	1.2	-0.4	0.5	0.0	0.0	0.1
Consumer goods	-0.7	-0.3	-0.1	0.0	0.0	0.0
Foods, feeds, beverages	9.3	6.8	0.0	1.0	-0.2	-1.0
Industrial supplies ex oil	5.8	25.5	-6.7	5.2	-5.4	-0.5
Computers	-9.3	-5.7	-5.3	-0.6	-0.1	-1.0
Semiconductors	-4.6	-3.4	-0.4	-0.2	0.7	-1.5
<b>Merchandise exports</b>	0.7	2.7	1.1	0.2	-0.1	0.1
Core goods*	1.3	3.8	1.2	0.3	-0.2	0.2
Cap. goods ex comp & semi	0.5	0.9	0.1	-0.1	0.0	0.1
Automotive products	1.3	0.7	0.1	-0.1	0.1	-0.1
Consumer goods	0.4	-0.1	-0.4	0.0	-0.2	0.0
Agricultural products	8.2	0.2	4.9	-0.4	0.4	2.4
Industrial supplies ex ag	1.5	12.4	3.1	1.3	-0.5	-0.6
Computers	-5.8	3.1	0.5	-0.1	-0.2	0.2
Semiconductors	-2.8	-6.2	-0.9	-0.4	0.1	-0.2
---Prices in the NIPA accounts (1996 weights)---						
Imports of goods & services	0.9	11.8	n.a.	...	...	...
Non-oil merchandise	0.7	4.6	n.a.	...	...	...
Core goods*	1.5	5.6	n.a.	...	...	...
Exports of goods & services	0.9	3.9	n.a.	...	...	...
Total merchandise	0.9	3.4	n.a.	...	...	...
Core goods*	1.7	4.6	n.a.	...	...	...

\*/ Excludes computers and semiconductors.

e/ Average of two months.

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

**Oil Prices**



annual rate in Q4 and \$11 billion in Q1), primarily because of services transactions.

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

**Non-oil imports.** In May, the price of imported non-oil goods declined slightly (0.2 percent). Prices of imported computers and semiconductors fell moderately, and prices of core goods showed a marginal decline (mostly foods and unfinished metals). In April, non-oil import prices (and core goods prices) had fallen sharply, reflecting a reversal of the sharp run up in prices of imported natural gas in March. The price index for core goods in April-May, on average, declined nearly 1 percent at an annual rate from the first quarter and followed a jump of 5 percent in the first quarter. When natural gas and other fuels are excluded from the index, prices of the remaining imported core goods rose fractionally in April-May, on average, from the level in the first quarter, and the increase in the first quarter was 1½ percent at an annual rate.

**Oil.** The BLS price of imported oil fell 1 percent in April following a revised 18 percent drop in March. The spot price of West Texas Intermediate (WTI) crude oil fell more steeply in April than the BLS price, averaging about \$28.25 per barrel, down more than \$5 per barrel from its March average. The commencement of military action in Iraq and the relatively rapid conclusion of the war led the spot price of WTI to fall to less than \$26 per barrel by late-April. Increased OPEC oil production, particularly by Saudi Arabia, Kuwait, and Venezuela (where oil production recovered substantially from low first-quarter levels), also contributed to the price decline. In May and June, delays in the return of Iraqi exports, along with recent terrorist bombings in the Middle East, have helped push the price of WTI to more than \$30 per barrel. Spot WTI closed on June 17 at \$31.07 per barrel.

**Exports.** In May, the price of exported goods rose slightly. Most of the 0.2 percent increase in the price of exported core goods was from rising prices of agricultural products (particularly soybeans, wheat, corn, and meat). Prices of exported industrial supplies declined for the second consecutive month led by decreasing prices of petroleum and precious metals. The price index for core goods in April-May on average rose just over 1 percent at an annual rate from the first quarter and followed an increase of nearly 4 percent in the first quarter.

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

Treasury data recorded a \$3 billion decrease in foreign official assets in the United States in April, following a \$9 billion increase in March (line 1 of the Summary of U.S. International Transactions table). The first quarter as a whole saw very strong official inflows of \$37 billion, similar to the amount in the fourth quarter of last year. Notwithstanding the \$3 billion outflow in April,

second quarter inflows should also be very strong: May data from custody accounts at the Federal Reserve Bank of New York show a \$37 billion increase for the month, led by large increases for Japan (associated with its official exchange intervention), Korea, China, and Russia.

Foreign private net purchases of U.S. securities (line 4) surged in March and showed continued strength in April. The \$65 billion in inflows in March brought the total for the first quarter to \$95 billion, in line with the quarterly average from last year. In the quarter, strong inflows were recorded for all types of U.S. debt securities, but especially corporate bonds. Robust purchases of debt securities continued in April and comprised nearly all of the \$47 billion in inflows in the month, with inflows into corporate bonds again leading the way. Purchases of other debt securities—Treasuries and agencies—were sizeable in March and April, following only modest inflows in the first two months of the year. Inflows into U.S. equities, while small, have been positive in the past two months.

As is typical, about one-half of the securities inflows in the first quarter originated in the United Kingdom, but purchases from Asia, especially China, were also substantial. It should be noted, however, that given China's severe restrictions on outward portfolio investment, recorded inflows from China's private sector are likely made by public entities outside the official sector.

The first quarter marked a resumption of substantial U.S. acquisitions of foreign equities, with \$20 billion in straight purchases (line 5b) and another \$14 billion in a merger-related stock swap (line 5c). Although the equity acquisitions ceased in April and U.S. investors have on net sold foreign bonds this year, the year-to-date acquisitions of all foreign securities (line 5) totaled \$26 billion in the first four months of this year, consistent with levels of 2001 and previous years.

Net capital flows in the banking sector (line 3) amounted to an outflow of \$27 billion in the first quarter that was more than reversed by a \$43 billion inflow in April.

Full balance of payments data for the first quarter, including direct investment, will be released on June 19 and discussed in the Greenbook Supplement.

**Summary of U.S. International Transactions**

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

	2001	2002	2002			2003		
			Q2	Q3	Q4	Q1	Mar.	Apr.
<b>Official financial flows</b>	<b>2.4</b>	<b>91.0</b>	<b>45.3</b>	<b>7.1</b>	<b>31.5</b>	<b>36.6</b>	<b>8.3</b>	<b>-3.2</b>
1. Change in foreign official assets in the U.S. (increase, +)	7.3	94.7	47.2	8.5	32.3	36.6	9.4	-3.4
a. G-10 countries	-7.9	30.4	17.6	1.8	6.0	26.5	11.1	-1.4
b. OPEC countries	-1.2	-9.4	.9	-1.4	.7	-7.5	-1.7	-1.6
c. All other countries	16.4	73.7	28.7	8.1	25.7	17.6	.0	-.4
2. Change in U.S. official reserve assets (decrease, -)	-4.9	-3.7	-1.8	-1.4	-.8	.1	-1.2	.2
<b>Private financial flows</b>	<b>379.5</b>	<b>383.2</b>	<b>27.8</b>	<b>162.4</b>	<b>112.7</b>	<b>n.a.</b>	<b>...</b>	<b>...</b>
Banks								
3. Change in net foreign positions of banking offices in the U.S. <sup>1</sup>	-5.9	95.8	-27.2	65.7	51.0	-27.3	-31.5	43.4
Securities <sup>2</sup>								
4. Foreign net purchases of U.S. securities (+)	401.6	387.8	119.6	105.0	76.0	95.0	65.3	45.5
a. Treasury securities	-7.4	97.3	14.5	57.8	13.0	14.9	25.3	9.5
b. Agency bonds	85.3	72.1	33.1	22.0	10.6	21.7	11.2	11.0
c. Corporate and municipal bonds	201.8	160.3	60.0	17.2	39.9	60.4	26.0	20.6
d. Corporate stocks <sup>3</sup>	121.8	58.1	12.0	8.0	12.6	-2.1	2.8	4.4
5. U.S. net acquisitions (-) of foreign securities	-95.0	1.3	-9.0	18.4	-10.3	-25.5	-13.7	-.6
a. Bonds	12.4	19.5	10.4	5.7	2.7	8.6	6.9	-1.6
b. Stock purchases	-62.7	-14.9	-19.4	14.0	-13.0	-19.9	-6.4	1.0
c. Stock swaps <sup>3</sup>	-44.7	-3.2	.0	-1.4	.0	-14.2	-14.2	.0
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-127.8	-123.4	-34.5	-26.4	-33.0	n.a.	...	...
7. Foreign direct investment in U.S.	130.8	30.1	-2.6	2.9	13.5	n.a.	...	...
8. Foreign holdings of U.S. currency	23.8	21.5	7.2	2.6	7.2	n.a.	...	...
9. Other (inflow, +) <sup>4</sup>	52.1	-29.9	-25.7	-5.7	8.3	n.a.	...	...
<b>U.S. current account balance (s.a.)</b>	<b>-393.4</b>	<b>-503.4</b>	<b>-127.7</b>	<b>-126.3</b>	<b>-136.9</b>	<b>n.a.</b>	<b>...</b>	<b>...</b>
<b>Capital account balance (s.a.)<sup>5</sup></b>	<b>.8</b>	<b>.7</b>	<b>.2</b>	<b>.2</b>	<b>.1</b>	<b>n.a.</b>	<b>...</b>	<b>...</b>
<b>Statistical discrepancy (s.a.)</b>	<b>10.7</b>	<b>28.5</b>	<b>54.4</b>	<b>-43.4</b>	<b>-7.4</b>	<b>n.a.</b>	<b>...</b>	<b>...</b>

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.

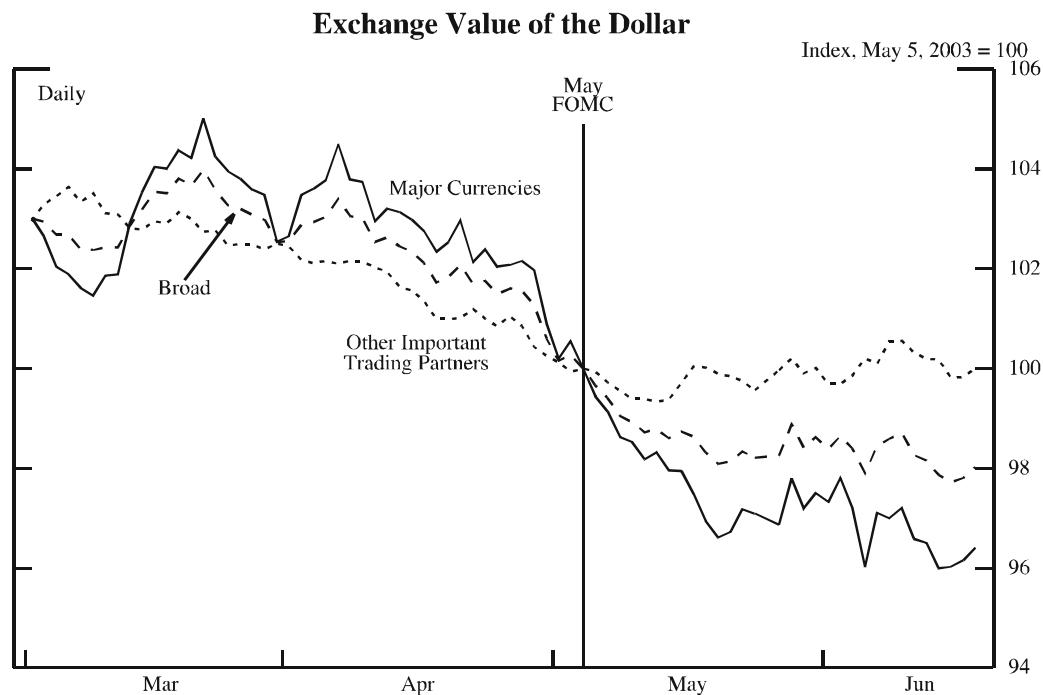
4. Transactions by nonbanking concerns and other banking and official transactions not shown elsewhere plus amounts resulting from adjustments made by the Department of Commerce and revisions in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business

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

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

## Foreign Exchange Markets

The most salient developments in global financial markets over the intermeeting period were the continued drop in the exchange value of the dollar and the sharp fall in long-term interest rates in all major industrial economies. The drop in yields began as a reaction to the concerns over disinflation expressed in the May 6 statement of the FOMC. Further declines in long-term yields came in the wake of statements by Federal Reserve officials about policy measures available to head off deflation in a low short-term interest rate environment, such as increasing purchases of long-term bonds or capping their yields. Despite the lackluster pace of global economic activity, equity prices in major financial markets rose substantially during the intermeeting period. Equity prices appeared to be boosted by moderately upbeat earnings news in several sectors and by the growing market perception that policy interest rates were likely to remain at extremely low levels in the foreseeable future.



The exchange value of the dollar, as measured by the major currencies index, dropped 3½ percent over the intermeeting period, continuing a trend that began about a year ago. The dollar's decline was particularly sharp in the first half of the period. Continued concerns about the financing burden of the large and growing U.S. current account deficit weighed on the dollar, as did statements by Treasury Secretary Snow that seemed to signal a shift away from the U.S. authorities' long-standing but indeterminate "strong dollar" policy. The

potential benefits to the United States of a weaker dollar – increased exports and decreased deflationary pressures – were widely cited as reasons for the perceived shift in policy. Later in the period, however, perhaps in part in reaction to concerns expressed by several of our major trading partners, President Bush reaffirmed on several occasions the administration’s commitment to a strong dollar. During the intermeeting period, the dollar was little changed on net against the currencies of our other important trading partners.

On balance, the dollar depreciated against all individual major foreign currencies over the intermeeting period, falling 3¾ percent against the euro. The dollar’s exchange value versus the euro retreated for the first time since early 1999 beyond its level at the time of the euro’s debut, reaching an all-time low above 1.19 \$/€ in late May before retracing slightly. The dollar depreciated 4½ percent against sterling. On June 9, the British government announced that it would not hold a referendum this year on EMU entry, but that it may do so next year; this “not yet” decision was not a surprise. During the period, the dollar also depreciated 5½ percent against the Canadian dollar and 2 percent vis-a-vis the Swiss franc.

In contrast, the dollar depreciated ¼ percent on balance versus the yen. Japan’s Ministry of Finance continued to intervene heavily in an attempt to prevent its currency’s appreciation. The MoF purchased nearly \$38 billion dollars over the intermeeting period, pushing Japan’s foreign currency reserves to more than \$500 billion.

In monetary policy actions, the European Central Bank lowered its minimum refinancing rate 50 basis points to 2.0 percent, and the National Bank of Denmark and Sweden’s Riksbank lowered rates by the same amount. Also during the intermeeting period, the Reserve Bank of New Zealand lowered its main policy rate 25 basis points and the Bank of Japan adjusted its target range for current account balances up from ¥22–27 trillion to ¥27–30 trillion. Reflecting the ECB’s action, three-month euro rates fell about 35 basis points over the period. Canadian and Australian three-month rates declined more modestly, while sterling rates rose slightly.

Long-term rates, as mentioned above, fell dramatically in all industrial countries over the period, but have retraced somewhat in recent days. On balance, ten-year sovereign yields fell about 45 basis points in the euro area and the United Kingdom, somewhat less than the 60 to 70 basis point drop in the United States and Canada. Japanese ten-year benchmark yields fell a further 6 basis points, reaching multi-decade lows.

### Financial Indicators in Major Industrial Countries

Country	Three-month rate		Ten-year yield		Equities Percent Change
	Jun. 18 (Percent)	Percentage Point Change	Jun. 18 (Percent)	Percentage Point Change	
Canada	3.22	-.14	4.26	-.70	6.36
Japan	.08	.00	.54	-.06	11.06
Euro area	2.14	-.36	3.66	-.43	6.50
United Kingdom	3.53	.06	4.02	-.44	7.11
Switzerland	.21	-.03	2.32	-.15	8.08
Australia	4.64	-.13	4.77	-.53	3.72
United States	1.00	-.24	3.31	-.61	8.51
Memo: Weighted-average foreign	1.96	-.16	3.40	-.45	n.a.

NOTE. Change is from May 5 to June 18 (10 a.m. EDT).

n.a. Not available.

Equity indexes registered gains over the intermeeting period in all major industrial countries, ranging from 6½ percent in Canada to about 11 percent in Japan. Japanese banking sector shares rose more than 15 percent; the Japanese government announced in mid-May that it would bail out Japan's fifth-largest financial institution, Resona Holdings, injecting the yen equivalent of about \$17 billion.

Equity prices also rose in a number of emerging market economies, particularly in Asia, where receding concerns over SARS and signs of recovery in the global high-tech sector interacted to generate large gains. Share prices rose 19 percent in Taiwan and Thailand, 13 percent in Korea, and 12 percent Hong Kong over the period. Equity prices also rose in Latin America, although generally more moderately than in Asia. The exception was Argentina, where equity prices rose more than 21 percent. The Argentine peso was little changed, on net, over the period. The Brazilian *real* appreciated about 3½ percent against the dollar, as President Lula appeared to move closer to an agreement with Brazil's Congress on a reform of civil service pensions. The Mexican peso, in contrast, depreciated about 3½ percent, in part on concerns about a slowdown in

economic activity. Latin American sovereign bond spreads declined moderately over the intermeeting period.

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

Economy	Jun. 18	Currency/ US dollar	Short-term Interest rates <sup>1</sup>		Dollar-denominated bond spread <sup>2</sup>		Equity prices
		Percent Change	Jun.17/18 (Percent)	Percentage Point Change	Jun.17/18 (Percent)	Percentage Point Change	
Mexico	10.56	3.58	4.89	-.81	2.19	.03	7.77
Brazil	2.89	-3.64	25.60	-.47	7.04	-.77	7.63
Argentina	2.80	.00	n.a.	n.a.	43.79	-7.71	21.17
Chile	705.00	.86	3.17	.25	4.68	.65	7.87
China	8.28	.00	n.a.	n.a.	2.14	-.05	2.13
Korea	1184.90	-2.64	4.60	.00	...	...	13.11
Taiwan	34.45	-1.01	1.37	-.08	...	...	18.97
Singapore	1.73	-1.60	.50	-.13	...	...	12.69
Hong Kong	7.80	-.01	1.13	-.31	...	...	11.82
Malaysia	3.80	.00	3.00	.00	2.25	-.01	8.29
Thailand	41.58	-2.58	1.75	.00	.86	-.41	18.91
Indonesia	8227.00	-4.11	10.27	-1.13	3.16	-.19	9.65
Philippines	53.35	2.01	7.00	-1.38	4.10	-.37	15.98
Russia	30.38	-2.34	n.a.	n.a.	2.63	-.54	14.73

NOTE. Change is from May 5 to June 17/18.

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

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

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

## Developments in Foreign Industrial Countries

On average, real GDP growth remained weak in the first quarter in major foreign industrial countries, as external demand sagged amid heightened geopolitical uncertainties and, in some countries, local currency appreciation that had taken place over the previous year. Net exports contributed negatively to growth in all major foreign industrial countries, but domestic demand remained strong in Canada. Limited data for the second quarter do not inspire much optimism for the near term, with no apparent bounceback in activity following the ebbing of conflict in Iraq.

Twelve-month rates of consumer price inflation fell in recent months, reflecting both declines in oil prices and local currency appreciations. Canadian headline inflation dipped to 3 percent in April, while euro-area inflation fell below 2 percent in May for the first time since June 2002. Inflation fell below 1 percent in Germany where recession is expected to continue. In Japan, deflation continued.

Earlier this month the European Central Bank (ECB), the Reserve Bank of New Zealand, the Swedish Riksbank, and Denmark's central bank lowered official interest rates. The Bank of Japan (BOJ) eased monetary policy in late May, increasing its target range for the outstanding balance of reserve accounts held by private financial institutions at the BOJ.

In **Japan**, real GDP growth slowed to a revised 0.6 percent (s.a.a.r.) in the first quarter. Business fixed investment advanced for the fourth straight quarter, increasing 2.8 percent, while private consumption expanded 0.8 percent. A slowing in the pace of inventory decumulation added about  $\frac{1}{2}$  percentage point to growth. However, public investment continued to contract sharply, subtracting 0.8 percentage point from growth, and residential investment declined nearly 5 percent. Net exports also contributed negatively to growth, as exports fell and imports rose only slightly.

Most available indicators for the second quarter suggest that economic activity remains sluggish. Industrial production fell 1.5 percent in April from the previous month. Real exports continued to contract, declining 1.3 percent in April from the previous month, while imports fell 0.8 percent. Household expenditures rose 1.2 percent in April from March, but were up only slightly from the first-quarter average. New car registrations rebounded in May, but the average for April and May was about 6 percent below the first-quarter average. Core machinery orders, a leading indicator of business fixed investment, fell

Component	Japanese Real GDP (Percent change from previous period, except as noted, s.a.a.r.)						
	2001 <sup>1</sup>	2002 <sup>1</sup>	2002			2003	
			Q2	Q3	Q4	Q1	
GDP	-2.4	2.4	5.4	2.6	1.5	.6	
Total domestic demand	-1.8	1.3	3.6	3.6	.0	.9	
Consumption	1.4	1.4	1.3	2.5	-.2	.8	
Private investment	-10.6	2.2	4.3	4.4	7.6	1.5	
Public investment	-1.2	-6.0	-11.0	-10.8	-9.8	-12.3	
Government consumption	2.3	1.4	.3	3.1	.4	2.5	
Inventories <sup>2</sup>	-.6	.3	2.6	1.5	-.7	.4	
Exports	-11.0	17.7	30.0	.2	18.9	-1.6	
Imports	-7.1	8.7	13.4	11.1	5.8	.5	
Net exports <sup>2</sup>	-.6	1.1	1.9	-.9	1.5	-.2	

1. Q4/Q4.

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

1.8 percent in April. On the other hand, non-residential building starts were up about 4 percent in April from the first-quarter average

The unemployment rate was unchanged at 5.4 percent in April, only a bit below the record-high 5.5 percent rate in January. The job-offers-to-applicants ratio, a leading indicator of employment, remained steady at 0.6 in April. Core consumer goods prices in the Tokyo area (which exclude fresh food but include energy) fell marginally in May and were down 0.4 percent from a year earlier. Wholesale prices for domestic goods declined 1 percent in May from a year earlier. Recently released data show that urban land prices were down 7.1 percent in March from a year earlier.

On May 20 the Bank of Japan raised its target range for the outstanding balance of reserve accounts held by private financial institutions at the BOJ from ¥22-27 trillion to ¥27-30 trillion. In its announcement, the BOJ noted its “determination to ensure financial market stability” in the wake of the government’s decision on May 17 to inject close to ¥2 trillion (\$17 billion) into Resona Holdings, Japan’s fifth largest banking institution, to shore up its capital position. Resona failed to meet Japanese minimum capital standards after

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

Indicator	2002		2003				
	Q3	Q4	Q1	Feb.	Mar.	Apr.	May
Industrial production <sup>1</sup>	2.0	.4	.4	-1.6	.1	-1.5	n.a.
All-industries index	.3	-.3	.6	-.8	.7	n.a.	n.a.
Housing starts	-4.6	1.7	.7	-3.5	-4.8	5.6	n.a.
Machinery orders <sup>2</sup>	.1	-.1	5.8	-6.8	3.8	-1.8	n.a.
Machinery shipments <sup>3</sup>	1.3	2.3	.2	-2.6	-1.4	1.2	n.a.
New car registrations	5.0	-1.0	1.5	.1	-.2	-11.1	12.2
Unemployment rate <sup>4</sup>	5.4	5.4	5.4	5.2	5.4	5.4	n.a.
Job offers ratio <sup>5</sup>	.54	.57	.60	.61	.60	.60	n.a.
Business sentiment <sup>6</sup>	-30	-28	-26	...	...	...	...
CPI (Core, Tokyo area) <sup>7</sup>	-.9	-.7	-.7	-.7	-.7	-.4	-.4
Wholesale prices <sup>7</sup>	-2.0	-1.3	-.9	-.9	-.7	-.8	-1.0

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

auditors forced the bank to exclude from capital a substantial portion of deferred tax assets. The government will hold ¥280 billion of common stock and nearly ¥2 billion of preferred shares (with voting rights) once the capital injection is complete, giving it 70 percent of the voting rights at Resona.

On June 11, the BOJ announced details of its plan to purchase asset-backed securities (ABS) issued to help finance small- and medium-sized enterprises. To be eligible for BOJ consideration, longer-term ABS must be rated BB or higher, while asset-backed commercial paper must meet a stricter A-1 rating hurdle. The BOJ will purchase ABS from late July 2003 through March 2006, and will initially limit its total purchases to ¥1 trillion (\$8.5 billion) over this period.

**Euro-area** real GDP was flat in the first quarter, as modest gains in private consumption were offset by a steep fall in investment, the largest decline since 1996. In addition, exports fell while imports grew, resulting in a substantial negative contribution from net exports. A slowing in the pace of inventory decumulation helped to keep overall GDP growth from declining. German, Italian and the Dutch growth rates were negative in the first quarter. Italian GDP was pulled down by a decline in private consumption, while Germany and the Netherlands suffered large declines in investment.

#### Euro-Area Real GDP<sup>1</sup>

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

Component	2001 <sup>2</sup>	2002 <sup>2</sup>	2002			2003
			Q2	Q3	Q4	
GDP	.6	1.2	1.6	1.3	.3	.0
Total domestic demand	.1	.9	.7	1.0	1.8	2.0
Consumption	1.6	.9	1.1	1.8	1.7	1.4
Investment	-2.4	-1.7	-5.1	.6	.3	-5.4
Government consumption	2.0	2.4	3.0	1.8	.7	.9
Inventories <sup>3</sup>	-.7	.2	.5	-.5	.5	2.1
Exports	-2.3	3.7	8.6	8.3	-.7	-2.5
Imports	-3.8	3.0	6.6	8.2	3.2	2.5
Net exports <sup>3</sup>	.5	.4	.9	.3	-1.4	-1.9
<i>Memo:</i>						
France	.7	1.5	2.0	1.3	-.2	1.0
Germany	.1	.7	.6	1.2	-.1	-.9
Italy	.7	.9	1.4	.5	1.7	-.4

1. Includes Greece as of 2001 Q1.

2. Q4/Q4.

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

Incoming data suggest continued stagnation in the second quarter. Although euro-area industrial production rose in April, it has remained essentially flat since the beginning of the year. The May euro-area purchasing managers' index (PMI) for manufacturing, a timely indicator of production, fell further below the 50 threshold for positive growth. The European Commission's measure of industrial confidence also declined in May. German industrial production ticked down in April, while the volume of German industry orders rose 1.4 percent in

April, recovering only part of the sharp decline in March, to a level of about 1 percent below the first-quarter average.

Surveys of consumer confidence in the euro area also have continued to fall, primarily owing to increases in expectations of unemployment, particularly in Germany. Consistent with the survey results, the April euro-area unemployment rate was above the first-quarter average rate. In Germany, unemployment was 10.7 percent in May.

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

Indicator	2002		2003				
	Q3	Q4	Q1	Feb.	Mar.	Apr.	May
Industrial production <sup>1</sup>	.2	.1	.2	.3	-.7	.4	n.a.
Retail sales volume <sup>2</sup>	.8	-.4	.5	-.8	-1.2	n.a.	n.a.
Unemployment rate <sup>3</sup>	8.4	8.5	8.7	8.7	8.8	8.8	n.a.
Consumer confidence <sup>4</sup>	-10	-14	-19.3	-19	-21	-19	-20
Industrial confidence <sup>4</sup>	-11.3	-10.0	-11.3	-11	-12	-12	-13
Mfg. orders, Germany	-1.2	.3	.0	-.7	-3.2	1.4	n.a.
CPI <sup>5</sup>	2.1	2.3	2.3	2.4	2.4	2.1	1.9
Producer prices <sup>5</sup>	.0	1.2	2.4	2.6	2.4	1.7	n.a.
M3 <sup>5</sup>	7.1	6.9	7.9	7.9	7.9	8.7	n.a.

1. Excludes construction.

2. Excludes motor vehicles.

3. Percent. Euro area standardized to ILO definition. Includes Eurostat estimates in some cases.

4. Diffusion index based on European Commission surveys in individual countries.

5. Eurostat harmonized definition. Percent change from year earlier.

n.a. Not available.

The European Central Bank (ECB) reduced its main policy rate, the minimum bid rate for the refinancing tender, 50 basis points to 2 percent at its June meeting. The move largely had been signaled by comments from ECB officials. ECB President Duisenberg stressed that the ECB aims to keep inflation rates “below but close to 2 percent over the medium term” and argued that “there are currently no forecasts indicating any deflationary risks” for the euro area. Implicitly addressing the concern that Germany could experience deflation, he

stated that “within a monetary union, deflation is not a meaningful concept when applied to individual regions.” Bank of France Governor Jean-Claude Trichet was acquitted of charges in the Credit Lyonnais scandal. The verdict clears the way for Mr. Trichet to take over as head of the ECB when Duisenberg steps down, most likely during the summer.

Euro-area twelve-month consumer price inflation declined to 1.9 percent in May, falling below the ECB’s target ceiling for the first time since June 2002, according to the preliminary estimate. Excluding energy and unprocessed food, inflation was 2.2 percent in April, up from the 2 percent rate it had maintained throughout the first quarter of 2003. German twelve-month consumer price inflation declined to 0.7 percent in May from 1.0 percent in April, as consumer prices fell for the second month in a row.

In the **United Kingdom**, first-quarter real GDP growth was weak after lackluster fourth-quarter growth. Substantial growth in government spending was offset by a deceleration in consumer spending and a decline in gross fixed capital formation. Net exports declined as imports rose considerably while exports were flat.

#### U.K. Real GDP

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

Component	2001 <sup>1</sup>	2002 <sup>1</sup>	2002			2003
			Q2	Q3	Q4	Q1
GDP	1.9	2.2	2.4	4.3	1.5	.6
Total domestic demand	2.3	3.4	-.3	5.2	6.8	2.0
Consumption	4.3	3.6	4.5	3.1	4.3	1.6
Investment	-5.0	-1.1	3.6	-1.0	1.8	-.5
Government consumption	4.6	2.2	-5.3	1.5	4.2	5.8
Inventories <sup>2</sup>	-.4	.9	-3.1	3.2	3.0	.1
Exports	-4.6	-.7	16.9	-4.3	-13.6	.2
Imports	-2.5	3.0	5.5	.7	1.0	3.0
Net exports <sup>2</sup>	-.6	-1.4	3.1	-1.8	-5.2	-1.1

1. Q4/Q4.

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

Data for the second quarter suggest that the pace of activity is recovering, but remains sluggish. Whereas industrial production slid 0.4 percent in the first quarter, it rose 0.2 percent in April, and business confidence recovered somewhat in May. May's Purchasing Managers Index (PMI) for manufacturing ticked down after rebounding somewhat in April, and still suggests further contraction in the sector.

Retail sales grew mildly in April after being unchanged in the first quarter. The leading survey of retail sales points to further improvement in May. Consumer confidence recovered for the second month in a row in May, though sentiment remains below its level in late 2002.

#### **U.K. Economic Indicators**

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

Indicator	2002		2003				
	Q3	Q4	Q1	Feb.	Mar.	Apr.	May
Industrial production	.4	-.9	-.4	.5	-.8	.2	n.a.
Retail sales volume <sup>1</sup>	.7	1.6	.0	.2	.7	.3	n.a.
Unemployment rate <sup>2</sup>							
Claims-based	3.1	3.1	3.1	3.1	3.1	3.1	3.1
Labor force survey <sup>3</sup>	5.2	5.1	5.1	5.1	5.1	n.a.	n.a.
Business confidence <sup>4</sup>	10.7	3	-1.3	-1	-5	-10	-3
Consumer confidence <sup>5</sup>	-3.0	-3	-10	-10	-11	-8	-6
Retail prices <sup>6</sup>	2.0	2.6	2.9	3.0	3.0	3.0	2.9
Producer input prices <sup>7</sup>	-2.3	1.4	4.9	6.2	4.2	.7	1.1
Average earnings <sup>7</sup>	3.8	3.7	3.4	2.5	4.4	2.6	n.a.

1. Excludes motor vehicles.

2. Percent

3. Three-month average centered on month shown.

4. Percentage of firms expecting output to increase in the next four months less percentage expecting output to decrease.

5. Average of the percentage balance from consumers' expectations of their financial situation, general economic situation, unemployment, and savings over the next 12 months.

6. Excluding mortgage interest payments. Percent change from year earlier.

7. Percent change from year earlier.

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

The rate of increase in housing prices is slowing. The April/May average of housing prices was 2 percent higher than the first-quarter average, down from an increase of 4.4 percent in the first quarter. The deceleration in prices has spread

beyond London to most other regions of the country. Net mortgage lending remained elevated through April, while the growth of other consumer credit slowed.

The labor market continues to be tight as both the official claims-based and the labor force survey measures of the unemployment remain near record lows. The twelve-month rate of retail price inflation (excluding mortgage interest payments) ticked down in May but remained above the Bank of England's 2½ percent target. The harmonized index of consumer prices (HICP) rose 1.2 percent in the twelve months ending in May. The twelve-month growth rate of average earnings slid to 2.6 percent in April.

On June 9, Chancellor of the Exchequer Gordon Brown announced that the five economic conditions for Britain joining the euro area have not been met. The government will reassess the five tests with the release of next year's budget, expected in March. The tests are now to be reviewed annually in the budget. In the meantime, legislation will be introduced this autumn to enable a referendum on euro entry, should the tests be met. Further measures to promote convergence will be enacted, including housing market reform and changing the Bank of England's target inflation rate to the HICP at the time of the Pre-Budget Report, expected in November. Public opinion remains strongly against entry.

In **Canada**, real GDP increased 2.4 percent (s.a.a.r.) in the first quarter as final domestic demand grew 3.9 percent led by robust growth in consumption and residential construction. A record increase in the level of inventories also provided a substantial boost to activity, with roughly half of the stockpiling occurring among motor vehicle retailers and wholesalers. Net exports subtracted from GDP growth, reflecting a decline in exports and strong import growth. The data on monthly real GDP indicate that much of the first quarter's growth occurred in the beginning of the quarter.

Recent indicators suggest weak growth for the second quarter. Following robust job growth throughout 2002 and early 2003 the labor market cooled in April and May, partially reflecting the impact of SARS on accommodation and food service employment in Toronto. Declining employment, in conjunction with continued strong labor force growth, increased the unemployment rate to 7.8 percent in May. Housing starts declined in both April and May, though they remain at a level above the historical average. Manufacturing shipments dropped significantly in April while inventories continued to increase, raising the inventory-to-shipment ratio to its highest level in 14 months.

In April, the twelve-month rate of headline CPI inflation declined to 3 percent from 4.3 percent in March, returning to the top of the Bank of Canada's 1 to 3

percent target band. The decline in the headline rate largely reflects lower energy prices. Twelve-month core inflation, excluding food, energy prices, and indirect taxes, decreased to 2.7 percent in April.

### Canadian Real GDP

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

Component	2001 <sup>1</sup>	2002 <sup>1</sup>	2002			2003
			Q2	Q3	Q4	
GDP	1.4	3.5	3.8	2.7	1.6	2.4
Total domestic demand	.8	5.7	10.5	1.5	4.5	6.5
Consumption	2.3	3.8	4.4	1.3	4.4	3.5
Investment	3.4	2.0	1.4	3.2	.1	5.0
Government consumption	3.5	2.8	3.7	4.2	2.4	4.0
Inventories <sup>2</sup>	-1.9	2.3	6.1	-.7	1.4	2.5
Exports	-5.4	.7	.5	8.5	-8.7	-5.7
Imports	-8.4	6.5	19.3	5.8	-1.4	2.6
Net exports <sup>2</sup>	.8	-2.0	-6.2	1.3	-3.2	-3.3

1. Q4/Q4.

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

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

Indicator	2002		2003				
	Q3	Q4	Q1	Feb.	Mar.	Apr.	May
GDP by industry	1.0	.5	.7	.3	.0	n.a.	n.a.
Industrial production	1.0	-.1	.3	-.4	.0	n.a.	n.a.
New mfg. orders	.8	-2.5	1.9	2.2	.9	-4.5	n.a.
Retail sales	.7	.8	1.8	1.8	-.7	n.a.	n.a.
Employment	.9	.8	.5	.4	.1	-.1	-.1
Unemployment rate <sup>1</sup>	7.6	7.5	7.4	7.4	7.3	7.5	7.8
Consumer prices <sup>2</sup>	2.3	3.8	4.5	4.6	4.3	3.0	n.a.
Core Consumer Prices <sup>2,3</sup>	2.2	3.0	3.2	3.3	3.1	2.7	n.a.
Consumer attitudes <sup>4</sup>	124.4	121.8	114.3	...	...	...	...
Business confidence <sup>4</sup>	129.7	136	131.4	...	...	...	...

1. Percent.

2. Percent change from year earlier, n.s.a.

3. Excluding food, energy, and indirect taxes.

4. Level of index, 1991 = 100.

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

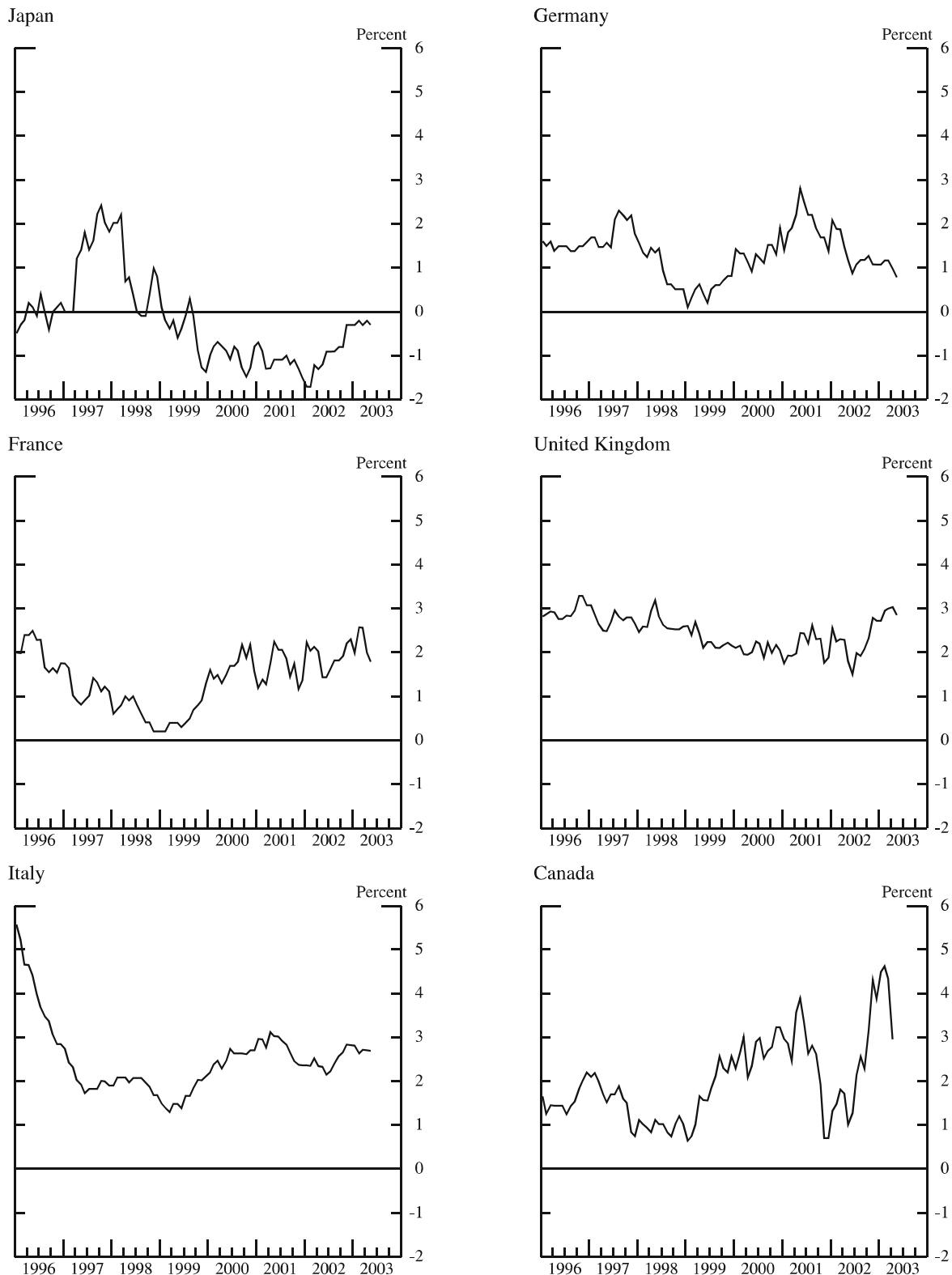
**External Balances**  
(Billions of U.S. dollars, s.a.a.r.)

Country and balance	2002		2003			
	Q3	Q4	Q1	Feb.	Mar.	Apr.
<i>Japan</i>						
Trade	82.2	83.5	73.3	82.9	65.2	80.3
Current account	111.5	102.2	115.7	124.3	122.8	120.9
<i>Euro area</i>						
Trade <sup>1</sup>	128.5	106.2	26.5	69.7	26.1	38.7
Current account <sup>1</sup>	90.4	98.1	-8.6	41.4	15.5	n.a.
<i>Germany</i>						
Trade	136.3	124.3	125.8	130.8	110.6	124.6
Current account <sup>1</sup>	42.6	77.4	41.7	56.6	85.2	40.9
<i>France</i>						
Trade	1.8	1.2	.7	1.0	.2	1.2
Current account	3.9	4.6	3.9	3.9	2.7	n.a.
<i>Italy</i>						
Trade	7.8	5.2	.9	1.6	-1.1	-1.6
Current account <sup>1</sup>	11.5	-15.8	-28.4	-16.3	-19.4	n.a.
<i>United Kingdom</i>						
Trade	-54.7	-70.7	-57.7	-50.9	-64.2	-58.3
Current Account	-6.6	-19.3	n.a.	...	...	...
<i>Canada</i>						
Trade	37.1	34.7	39.6	36.7	43.1	33.7
Current Account	13.6	12.4	21.3	...	...	...

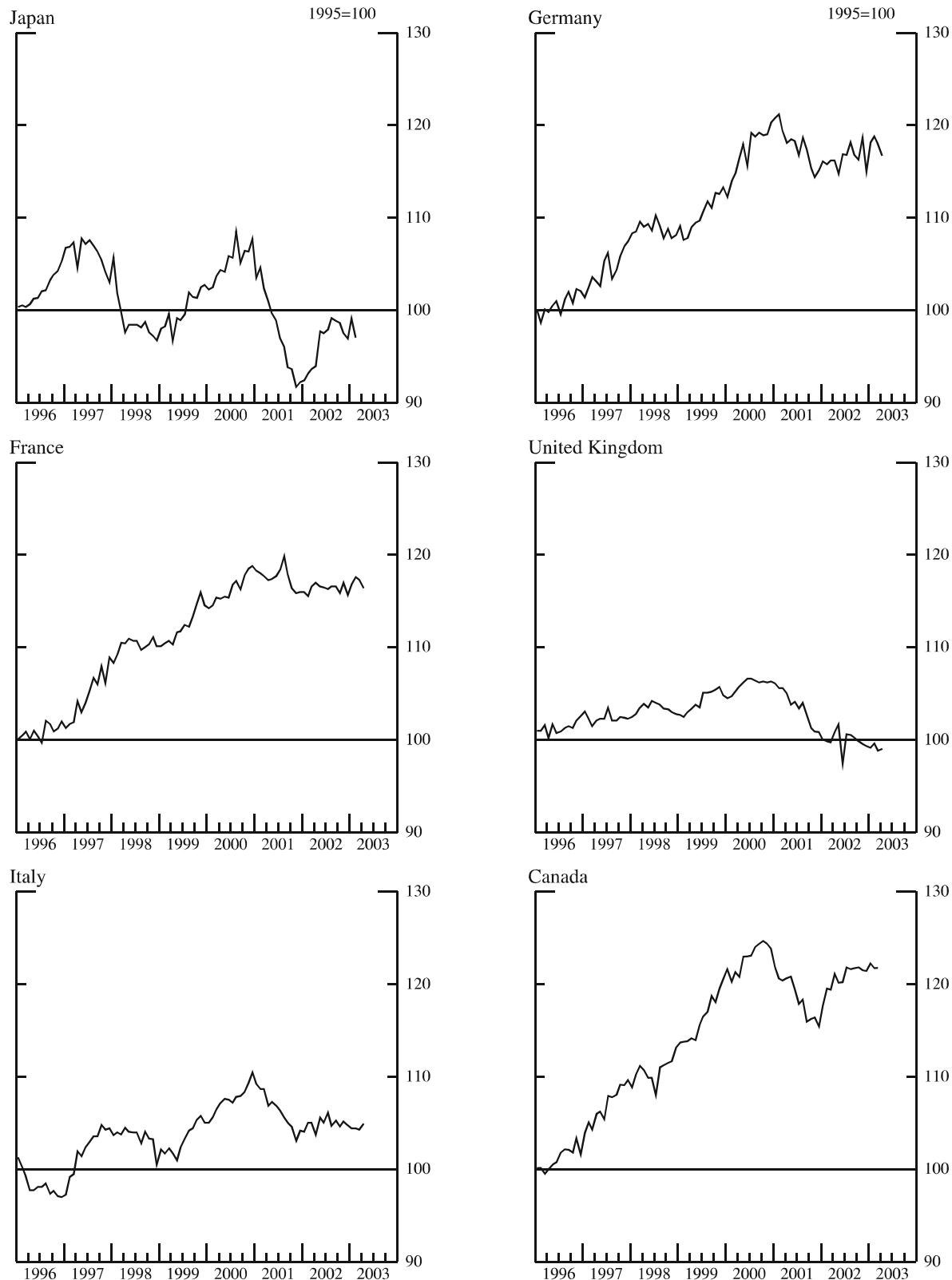
1. Not seasonally adjusted.

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

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



## **Industrial Production in Selected Industrial Countries**



## Economic Situation in Other Countries

Economic conditions in the developing world remain weak. Recent indicators suggest that growth has continued to slow in much of developing Asia, with the negative economic effects of SARS beginning to show up in data throughout the region, particularly for Hong Kong. In Latin America, Mexican economic growth turned negative in the first quarter, and Brazilian indicators suggest that economic activity remains soft. The Venezuelan economy has contracted sharply as a result of that country's ongoing political crisis, while Argentina's recovery has continued.

Although the SARS outbreak in **China** appears to have been largely contained, the economic effects are just now beginning to show through available data. Twelve-month growth rates of retail sales and tourist arrivals both slowed considerably in April. Industrial production growth also decreased to a twelve-month growth rate of just under 14 percent in May from 17 percent in the first quarter. Some deceleration was expected, however, as many producers who drastically increased output in the first quarter to fill orders before the start of the Iraq war have since cut back. Consumer prices continued to rise slowly on a twelve-month basis, but month-to-month changes have turned negative again due to lower oil prices and, possibly, weaker demand resulting from SARS. Lower oil prices helped return the Chinese trade balance to surplus in April, but rapid growth in non-oil imports narrowed the surplus in May.

Real GDP in **Hong Kong** fell just over 1 percent (s.a.a.r.) in the first quarter. The outbreak of SARS has apparently been contained. The categories that were expected to be hurt most by SARS, personal consumption and tourism, were both down in the quarter. In contrast, both exports and imports grew strongly. This, coupled with robust trade figures for April, lends support to anecdotal reports that SARS has not significantly affected merchandise trade. Other economic effects of SARS, however, were evident in April. Retail sales for that month fell, and tourist arrivals plummeted. The unemployment rate rose in April and May, as SARS-related layoffs began to show up in the data, and consumer prices fell at a twelve-month rate of about 2 percent, partly reflecting the anemic property market and weaker sales of goods due to SARS.

### Chinese Economic Indicators

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

Indicator	2001	2002	2002	2003				
			Q4	Q1	Mar.	Apr.	May	
Real GDP <sup>1</sup>	7.5	8.0	6.8	16.3	...	...	...	
Industrial production <sup>2</sup>	8.9	11.8	14.5	17.0	16.9	14.9	13.7	
Consumer prices <sup>2</sup>	-.3	-.4	-.6	.5	.9	1.0	.7	
Trade balance <sup>3</sup>	23.1	30.3	45.6	-13.1	-2.6	23.8	13.1	

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	2001	2002	2002	2003				
			Q4	Q1	Mar.	Apr.	May	
Real GDP <sup>1</sup>	-1.3	5.2	7.0	-1.2	...	...	...	
Unemployment rate <sup>2</sup>	4.9	7.3	7.2	7.5	7.5	7.8	8.3	
Consumer prices <sup>3</sup>	-3.7	-1.6	-2.9	-.9	-2.3	-1.9	n.a.	
Trade balance <sup>4</sup>	-11.4	-7.7	-10.2	-6.9	-5.3	-5.0	n.a.	

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.

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

Real GDP in **Taiwan** contracted slightly in the first quarter reflecting declines in investment spending and sluggish growth in private consumption. Exports, however, were up sharply for that period on average. Since the first quarter ended, the outbreak of SARS in Taiwan has worsened considerably, and its economic effects are now being felt. Industrial production decreased in April, and unemployment remained at a high level. Both exports and imports have fallen sharply since February. Of most concern is the reduction in imports of intermediate goods used in the production of high-tech goods, indicating a potential further decline in future exports. Twelve-month inflation turned

positive in May due to a base month effect, while the month-to-month change was slightly negative.

### Taiwan Economic Indicators

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

Indicator	2001	2002	2002	2003				
			Q4	Q1	Mar.	Apr.	May	
Real GDP <sup>1</sup>	-1.8	4.1	3.7	-.1	...	...	...	
Unemployment rate <sup>2</sup>	4.6	5.2	5.1	5.2	5.2	5.2	n.a.	
Industrial production	-7.3	6.4	1.1	.0	-2.5	-.6	n.a.	
Consumer prices <sup>3</sup>	-1.7	.8	-.5	-.2	-.2	-.1	.3	
Trade balance <sup>4</sup>	15.6	18.1	19.6	13.5	17.8	18.8	19.2	
Current account <sup>5</sup>	17.9	25.7	31.4	29.0	...	...	...	

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.

Incoming data for **Korea** since the last Greenbook have been generally weak. GDP fell 1.4 percent at an annual rate in the first quarter, weighed down by a sizeable decline in consumption and low export growth. Industrial production in April dropped almost 2 percent, with the contraction concentrated in the high-tech sectors. Consumer and business confidence indicators held steady or lost ground in May, and recent measures of retail sales and service-sector demand have also been anemic. Consumer prices were up 3.2 percent over the twelve months ended in May, and the unemployment rate rose to 3.4 percent. The trade balance jumped in April as exports climbed and imports dropped off, in part due to lower oil prices. Early figures suggest that this improvement in the trade balance is unlikely to be sustained in May. Concerns over weakening demand led the Korean central bank to lower its target interest rate in May by 25 basis points to 4 percent. The government has also announced a fiscal stimulus package of roughly ¾ percentage point of GDP for the rest of this year.

### Korean Economic Indicators

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

Indicator	2001	2002	2003				
			Q4	Q1	Mar.	Apr.	May
Real GDP <sup>1</sup>	4.2	7.0	8.3	-1.4	...	...	...
Industrial production	1.0	7.4	2.7	.5	.6	-1.9	n.a.
Unemployment rate <sup>2</sup>	3.8	3.1	3.0	3.1	3.1	3.2	3.4
Consumer prices <sup>3</sup>	3.2	3.8	3.4	4.1	4.6	3.8	3.2
Trade balance <sup>4</sup>	13.5	14.2	15.5	9.6	-3.8	18.2	n.a.
Current account <sup>5</sup>	8.2	6.1	7.9	-6.7	-14.3	-4.6	n.a.

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.

In the ASEAN region, data releases since the last Greenbook have generally pointed to weak economic activity. In the first quarter, private consumption contributed negatively to real GDP growth in Malaysia and Singapore but drove the expansions in Indonesia and Thailand. Real GDP in the Philippines contracted, owing to reduced agricultural output. With the exception of Malaysia, recent industrial production data for these countries suggest a further slowing in activity so far in the second quarter. Trade surpluses, however, widened across the region, primarily reflecting rising exports, while inflation remained benign.

**ASEAN Economic Indicators: Growth**

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

Indicator and country	2001	2002	2002	2003			
			Q4	Q1	Feb.	Mar.	Apr.
<i>Real GDP<sup>1</sup></i>							
Indonesia	1.8	3.8	-.8	5.6	...	...	...
Malaysia	-.9	5.3	1.9	.9	...	...	...
Philippines	3.6	5.7	10.0	-2.0	...	...	...
Singapore	-6.0	3.0	.4	1.1	...	...	...
Thailand	2.2	6.4	8.7	6.3	...	...	...
<i>Industrial production<sup>2</sup></i>							
Indonesia <sup>3</sup>	.7	-1.1	1.4	1.0	4.9	-2.6	n.a.
Malaysia	-4.1	4.2	-1.0	2.4	8.0	-4.1	8.3
Philippines	-5.7	-6.1	2.4	-.7	-2.4	4.4	n.a.
Singapore	-11.6	8.5	-2.2	3.3	-13.8	11.5	-3.6
Thailand	1.3	8.5	2.2	4.3	-2.0	4.6	3.3

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	2001	2002	2002	2003			
			Q4	Q1	Mar.	Apr.	May
Indonesia	25.4	25.9	23.9	27.6	25.3	27.6	n.a.
Malaysia	14.2	13.4	14.3	19.6	17.7	21.8	n.a.
Philippines	-.9	-.2	-.8	-2.1	-1.4	n.a.	n.a.
Singapore	5.8	8.7	10.7	16.7	7.8	12.0	14.9
Thailand	2.5	3.5	4.0	5.5	4.1	5.4	n.a.

n.a. Not available.

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

Country	2001 <sup>1</sup>	2002 <sup>1</sup>	2002	2003			
			Q4	Q1	Mar.	Apr.	May
Indonesia	12.5	10.0	10.3	7.7	7.1	7.5	6.9
Malaysia	1.2	1.7	1.8	1.3	.7	1.0	1.0
Philippines	4.1	2.6	2.6	2.9	2.9	2.8	2.7
Singapore	-.6	.4	.1	.7	.8	.9	n.a.
Thailand	.8	1.6	1.4	2.0	1.7	1.6	1.9

1. December/December.

n.a. Not available

In **Mexico**, data releases since the last Greenbook generally point to weakness in the economy. Real GDP fell 2 percent (s.a.a.r.) in the first quarter, exports declined in April, and business confidence was down in May. Industrial production appears to have fared somewhat better, however, rising 0.8 percent in April. The weakness in exports in April led to a sizeable widening of the trade deficit in that month.

The twelve-month rate of consumer price inflation declined in April and May, probably helped in part by the net appreciation of the Mexican peso since early March. Survey measures of inflation expectations for end-2003 edged down a bit to 4.1 percent in May, near the top of the central bank's 2-4 percent target range.

In **Brazil**, real GDP in the first quarter was roughly flat after having risen about 3½ percent over the second half of 2002 in the midst of considerable financial turmoil. Data releases since the last Greenbook suggest that activity continued to weaken into the second quarter. Monthly trade surpluses have remained sizable, reflecting some trade adjustment from the large depreciation of the currency in recent years.

The weak economy and the nominal appreciation of the *real* since March contributed to a decline in monthly headline consumer price inflation in April and May. The twelve-month inflation rate rose nevertheless. Inflation therefore remains well above the 8.5 percent "adjusted inflation target" for 2003 that was set by the central bank last January. In consequence, the central bank maintained its overnight interest rate at 26.5 percent at its May policy meeting. Brazilian asset prices have moved up significantly in recent weeks. The improvement

most likely reflects investors' approval of the fiscal performance of the Lula government, including further progress towards pension reform.

### Mexican Economic Indicators

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

Indicator	2001	2002	2002	2003			
			Q4	Q1	Mar.	Apr.	May
Real GDP <sup>1</sup>	-1.5	2.0	-.1	-2.0	...	...	...
Overall economic activity	-.1	.8	.1	.1	-.5	n.a.	n.a.
Industrial production	-3.3	-.2	-.4	.2	-1.0	.8	n.a.
Unemployment rate <sup>2</sup>	2.5	2.7	2.6	2.7	2.8	2.8	n.a.
Consumer prices <sup>3</sup>	4.4	5.7	5.3	5.4	5.6	5.2	4.7
Trade balance <sup>4</sup>	-10.0	-7.9	-6.6	-4.4	-6.1	-10.7	n.a.
Imports <sup>4</sup>	168.4	168.7	168.5	169.2	169.7	170.7	n.a.
Exports <sup>4</sup>	158.4	160.8	161.9	164.8	163.5	159.9	n.a.
Current account <sup>5</sup>	-18.0	-13.9	-18.6	-8.6	...	...	...

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 **Argentina**, industrial production in May was up 16 percent from a year ago, but it has edged down in the last two months. Inflation has continued to decelerate considerably, and the consumer price index fell 0.3 percent in May from April—the first decline since the peso's devaluation in January 2002. The peso continued to strengthen, and has appreciated nearly 20 percent against the U.S. dollar since the beginning of the year, amid accumulation of foreign reserves by the central bank. Federal tax collection in May increased 48 percent year-on-year, exceeding expectations. While Argentina has so far met the fiscal and monetary targets agreed with the IMF, the government is lagging in the implementation of structural reforms. President Néstor Kirchner, who took office in late May, has not yet fully articulated a program that addresses the country's fundamental economic problems, including the restructuring of the banking system and the renegotiation of the country's defaulted debt.

**Brazilian Economic Indicators**

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

Indicator	2001	2002	2002	2003			
			Q4	Q1	Mar.	Apr.	May
Real GDP <sup>1</sup>	-.7	3.4	2.9	-.2	...	...	...
Industrial production	1.6	2.3	1.8	-1.0	-3.3	-.1	n.a.
Unemployment rate <sup>2</sup>	12.4	11.7	12.0	11.1	11.1	11.6	n.a.
Consumer prices <sup>3</sup>	7.7	12.5	10.6	15.6	16.6	16.8	17.2
Trade balance <sup>4</sup>	2.6	13.1	23.9	17.0	18.6	20.5	25.5
Current account <sup>5</sup>	-23.2	-7.6	-1.1	0.3	1.4	-11.6	n.a.

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

2. Percent. Break in October 2001 as a result of change in methodology. Thus, 2001 is average for Q4 only.

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.

**Argentine Economic Indicators**

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

Indicator	2001	2002	2002	2003			
			Q4	Q1	Mar.	Apr.	May
Real GDP <sup>1</sup>	-10.3	-4.0	3.4	n.a.	...	...	...
Industrial production	-7.6	-10.7	5.8	7.6	1.6	-.8	-1.1
Unemployment rate <sup>2</sup>	17.4	19.7	17.8	n.a.	...	...	...
Consumer prices <sup>3</sup>	-1.4	41.0	40.4	35.8	31.7	19.3	14.3
Trade balance <sup>4</sup>	7.5	16.7	15.9	15.7	15.6	13.9	n.a.
Current account <sup>5</sup>	-4.5	9.0	8.7	n.a.	...	...	...

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

2. Percent, n.s.a. Data are released for May and October only. Figures for Q4 reflect data for October.

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 **Venezuela**, real GDP fell 29 percent on a four-quarter basis in the first quarter, reflecting a 47 percent decrease in oil output and a 21 percent decline in non-oil output. The decline implies a drop of 52 percent (s.a.a.r.) from the previous quarter, according to staff estimates. The first quarter result follows a similarly large drop in real GDP in the fourth quarter of 2002. Plummeting economic activity in recent months has been associated with political turmoil that led to a general strike from December to February. Activity has also been weakened by the imposition of capital controls last January, which have virtually halted non-oil related imports and disrupted production in sectors that rely on imported intermediate goods. Monthly consumer price inflation rose in April and May, despite the pegging of the currency to the dollar last February; the rise has been attributed to shortage-induced increases in domestic prices of imported goods. Oil production and exports remain below pre-strike levels.

#### **Venezuelan Economic Indicators**

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

Indicator	2001	2002	2003				
			Q4	Q1	Mar.	Apr.	May
Real GDP <sup>1</sup>	.9	-16.7	-41.5	-52.4	...	...	...
Unemployment rate <sup>2</sup>	13.3	15.5	n.a.	n.a.	n.a.	n.a.	n.a.
Consumer prices <sup>3</sup>	12.3	31.2	30.6	35.5	34.1	33.5	35.0
Non-oil trade balance <sup>4</sup>	-12.2	-7.4	-5.5	-2.5	n.a.	n.a.	n.a.
Trade balance <sup>4</sup>	9.3	13.9	14.8	12.8	n.a.	n.a.	n.a.
Current account <sup>5</sup>	3.9	7.7	8.6	7.8	...	...	...

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

2. Percent, n.s.a. For 2002, Q2 is latest reported.

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.

**BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM**

**DIVISION OF RESEARCH AND STATISTICS**

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**Date:** June 24, 2003

**To:** Members of the FOMC

**From:** Division of Research and Statistics

**Subject:** Corrected Greenbook Chart

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The attached chart shows a corrected version of the long-term unemployment series that was presented in the lower-right panel of page II-3 from the June Greenbook.

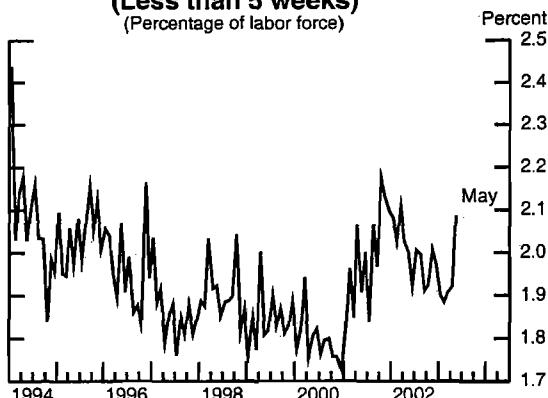
**SELECTED UNEMPLOYMENT AND LABOR FORCE PARTICIPATION RATES**  
 (Percent; based on seasonally adjusted data)

	2002	2002	2003	2003	Mar.	Apr.	May
		Q3	Q4	Q1			
Civilian unemployment rate (16 years and older)	5.8	5.8	5.9	5.8	5.8	6.0	6.1
Teenagers	16.5	16.7	16.1	17.2	17.7	18.0	18.5
20-24 years old	9.7	9.6	9.9	9.2	8.9	10.1	10.5
Men, 25 years and older	4.7	4.7	4.9	4.9	4.9	5.1	5.2
Women, 25 years and older	4.6	4.6	4.6	4.4	4.6	4.7	4.6
Labor force participation rate	66.6	66.6	66.5	66.3	66.2	66.4	66.4
Teenagers	47.4	47.6	46.8	45.2	44.1	45.0	45.1
20-24 years old	76.4	76.6	75.8	75.5	74.8	75.5	76.0
Men, 25 years and older	75.9	76.0	75.6	75.3	75.3	75.6	75.5
Women, 25 years and older	59.4	59.3	59.4	59.6	59.6	59.8	59.7

**Labor Force Participation Rate  
and Unemployment Rate**



**Short-term Unemployed  
(Less than 5 weeks)**  
 (Percentage of labor force)



**Long-term Unemployed  
(Over 26 weeks)**  
 (Percentage of labor force)

