

Prefatory Note

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April 30, 2004

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Supplemental Notes

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

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Supplemental Notes

The Domestic Nonfinancial Economy

Real Gross Domestic Product

According to the BEA's advance estimate, real GDP increased at an annual rate of 4.2 percent in the first quarter, a percentage point below the staff's April Greenbook estimate. Inventory investment was significantly weaker than we assumed, accounting for about 3/4 percentage point of the difference. In addition, government spending, personal consumption expenditures, and residential investment were all slightly weaker than we anticipated; in contrast, business fixed investment was in line with our expectation, and net exports were a bit stronger than we projected.

Private inventory investment contributed just 1/4 percentage point to the change in real GDP last quarter, compared with a boost of 3/4 percentage point in the fourth quarter. The BEA's procedures for deriving constant-dollar stocks of trucks and for seasonally adjusting them yielded a smaller accumulation than we estimated—albeit still a sizable one. In addition, the BEA's translation of book-value inventories outside of the motor vehicle sector into constant-dollar terms resulted in a smaller real accumulation of stocks than occurred in the fourth quarter; we had expected the estimate of real nonfarm inventory investment excluding motor vehicles to show the same rate of accumulation as in the fourth quarter.

Final sales rose at an annual rate of 3.9 percent in the first quarter after having increased 3.4 percent in the fourth quarter. Among the components of final demand, real PCE moved up at an annual rate of 3.8 percent, as a decline in spending on motor vehicles was more than offset by a pickup in spending on other goods and services. Real business investment in equipment and software posted another double-digit advance in the first quarter, but nonresidential structures investment fell again. Residential investment rose in the first quarter, albeit at a slower pace than in the fourth quarter. Federal government consumption and investment increased at an annual rate of 10.1 percent in the first quarter because of a surge in spending on national defense, while state and local government outlays declined at an annual rate of 2.6 percent.

Exports and imports both increased modestly on the heels of outsized jumps in the fourth quarter. On balance, the arithmetic contribution of net exports to the change in real GDP growth was 0.02 percentage point compared with the -0.16 percentage point we had expected. The difference is largely explained by the BEA's lower estimate of imports, with about half of the miss being associated with weaker service imports. The increase in real exports was reported to have been slightly higher than we projected, at 3.2 percent versus our forecasted 2.7 percent, with stronger-than-expected exports of goods more

Real GDP

(Percent change at annual rate from end of preceding period except as noted)

Measure	2004:Q1	
	Staff Estimate ¹	BEA
Real GDP	5.2	4.2
Final sales	4.2	3.9
PCE	4.0	3.8
Residential investment	3.8	2.1
BFI		
Equipment and software	11.6	11.5
Nonresidential investment	-7.9	-6.5
Government purchases		
Federal	12.4	10.1
State and local	-1.4	-2.6
Exports	2.7	3.2
Imports	3.1	2.0
	Contribution to change (Percentage points)	
Nonfarm inventory change	.9	.3
Motor vehicles	.8	.5
Other	.1	-.2
Net exports	-.2	.0

1. April Greenbook

than offsetting weaker-than-expected exports of services. Core import price inflation was less than expected, at 6.6 percent versus our projected 7.2 percent.

Personal Income and Consumer Spending

Total nominal personal income rose at an annual rate of \$38 billion in March following upward-revised increases of \$46 billion in February and \$49 billion in January. For the first quarter, both wages and salaries and supplements to earned income posted larger gains than in the fourth quarter, but the gains in rental and interest income were noticeably smaller. Personal taxes were down \$26.5 billion (annual rate) from the fourth-quarter level because of January's downward adjustment to federal income taxes. As a result, current-dollar disposable personal income increased \$155.4 billion in the first quarter. Real disposable personal income, which increased 3.6 percent in 2003, rose at an annual rate of 4.3 percent in the first quarter.

Real personal consumption expenditures were up 0.1 percent in March after having increased 0.2 percent per month in January and February. Although spending on motor vehicles turned up in March, it was down sharply, on average, in the first quarter. However, real outlays for other durables increased at an annual rate of 7-1/2 percent last quarter, real spending on non-energy nondurable goods picked up at a 7-1/4 percent rate, and real expenditures for non-energy services expenditures rose at a 4 percent pace. Real outlays for energy goods and services fluctuated widely during the first quarter; for the quarter as a whole, real outlays for nondurable energy products were, on balance, little changed from the fourth-quarter level, but real spending on energy services was sharply higher. The personal saving rate, which had dipped to 1.7 percent in the fourth quarter, inched up to 1.9 percent in the first quarter.

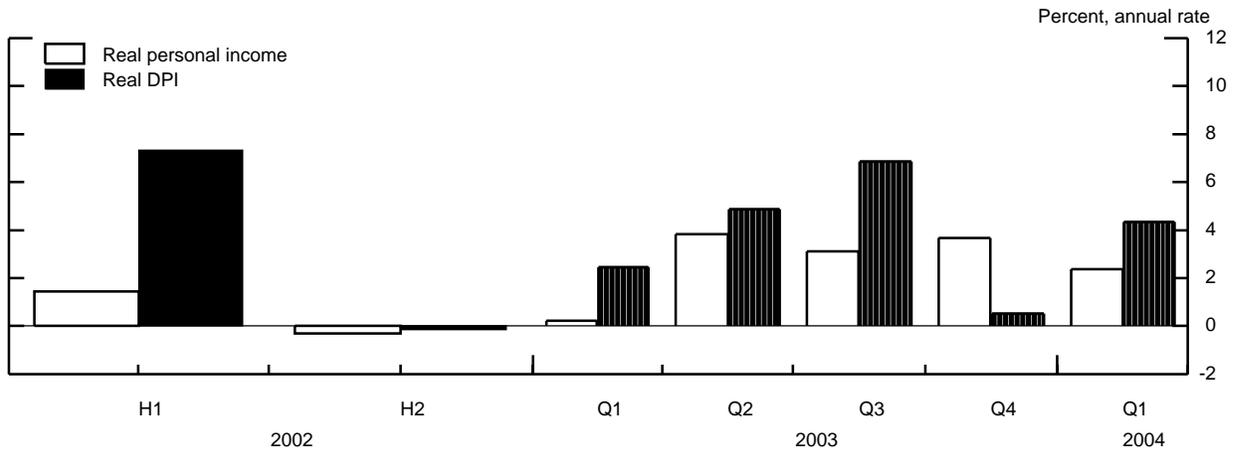
According to the final report, the Michigan Survey Research Center's (SRC) index of consumer sentiment edged down about 1-1/2 points in April, but remained above its level at the end of last year. Both components of the index were down slightly: The "current conditions" component slid about 2 points as consumers' assessments of their current personal financial situation and of buying conditions for large household appliances both decreased. The "expected conditions" component slipped 1-1/2 points as consumers' appraisals of their expected personal financial situation and of expected business conditions over the next five years both weakened. Assessments of business conditions over the next twelve months were unchanged.

Among those items not included in the overall index, consumers' assessments of buying conditions for houses strengthened somewhat in April. Consumers' expectations about the change in unemployment over the next twelve months also improved a touch. In contrast, consumers' appraisals of buying conditions for cars fell.

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

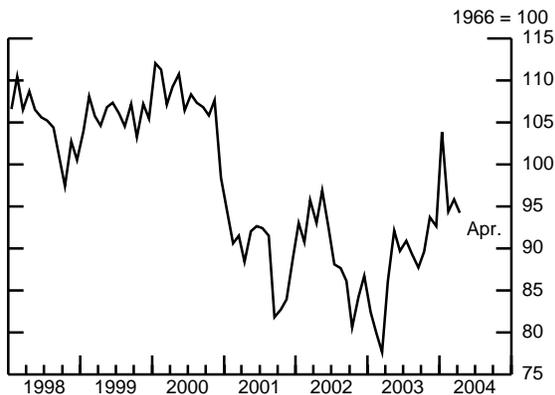
Expenditure	2003				2004
	Q1	Q2	Q3	Q4	Q1
	Annual rate				
Total real PCE	2.5	3.3	6.9	3.2	3.8
Excluding motor vehicles	2.9	2.7	5.2	4.0	5.1
Durable goods	.5	17.7	28.0	.7	-4.7
Motor vehicles	-4.2	15.3	39.7	-8.4	-18.3
Excluding motor vehicles	4.5	19.7	19.1	8.8	7.5
Nondurable goods	5.7	1.2	7.3	5.4	6.4
Energy	4.2	-18.6	3.7	22.5	-.8
Other	5.8	3.6	7.7	3.7	7.2
Services	1.5	1.7	2.8	2.8	4.3
Energy	.4	-12.7	4.1	1.1	10.8
Other	1.5	2.3	2.7	2.8	4.0
Memo: Real disposable personal income	2.4	4.9	6.8	.5	4.3

Change in Real Personal Income and Real DPI

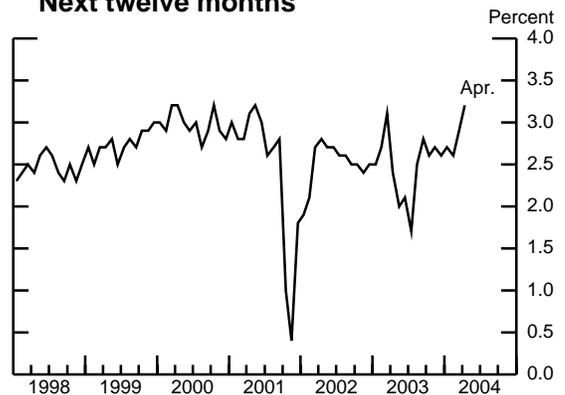


Michigan Survey

Index of Consumer Sentiment



Median Expected Inflation Next twelve months



In April, the median of expected inflation over the next twelve months rose to 3.2 percent, while the mean jumped to 4 percent. Both measures stand at their highest levels since the middle of 2001. In contrast, the median and mean of expected inflation over the next five to ten years slid to 2.7 percent and 3.2 percent, respectively.

Prices and Labor Costs

The chain-weighted GDP price index is estimated to have increased at an annual rate of 2.5 percent in the first quarter, and the index for PCE prices was up at a 3-1/4 percent rate. Core PCE prices rose at a rate of 2 percent last quarter following an increase of 1.2 percent in the fourth quarter. The BEA's estimate of core PCE price inflation was somewhat higher than the staff's estimate because it included an upward-revised increase in the price index for medical services in January. With the revision, the four-quarter change in core PCE prices was 1.3 percent in the first quarter compared with 1.6 percent over the four quarters ending in 2003:Q1.

The employment cost index of hourly compensation for private industry workers increased at an annual rate of 4.3 percent over the three months ending in March. The wages and salaries component of the ECI rose at an annual rate of 2.5 percent while the benefits component increased at a pace of nearly 11 percent. Over the twelve months ending in March, the ECI for total compensation rose 3.9 percent, about matching the increase in the preceding two twelve-month periods. Wages and salaries in March were up 2.6 percent from a year earlier, about 1/2 percentage point less than the increase in the preceding year. Workers in the construction industry, where activity has been remarkably strong, as well as those in retail trade and services saw wages accelerate over the year ending in March. However, wages in the financial industry, which had been increasing rapidly, slowed markedly; workers in manufacturing, transportation, and wholesale trade also saw their wages decelerate.

In contrast, benefit costs increased 7 percent over the twelve months ending in March, a pickup of nearly a percentage point over the previous twelve months.¹ The acceleration in benefit costs mainly reflected a step-up in contributions to defined-benefit pension funds. The rise in costs for health insurance, which previously had been contributing to a pickup in benefit costs, slowed a bit in this report, although the rate of increase remained high. With the rapid rise in benefit costs, the twelve-month changes in hourly compensation for workers in most industries in March were at or above the rates of increase recorded in the preceding year; the exceptions were finance and wholesale trade.

1. With the exception of health insurance, detail on benefits costs are unpublished and are provided by the BLS on a confidential basis.

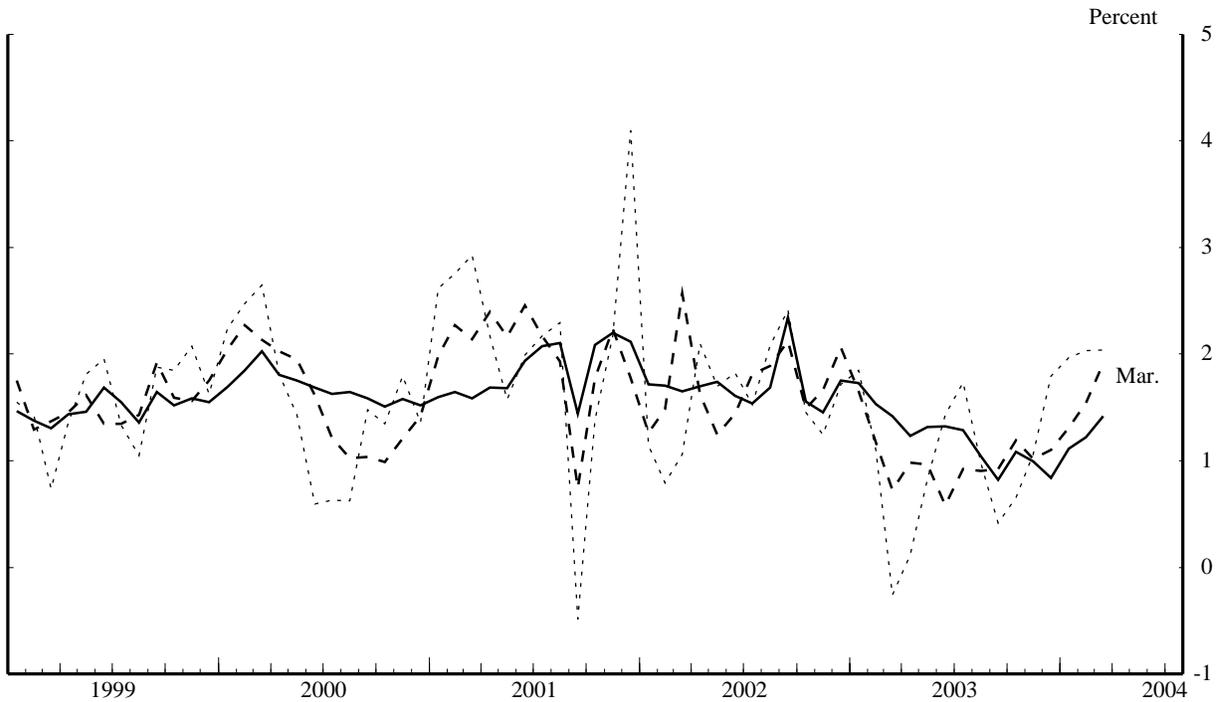
PCE Price Indexes
(Percent changes)

Item	From twelve months earlier		2003	2004	2004	
	Mar. 2003	Mar. 2004	Q4	Q1	Feb.	Mar.
			-Annual rate-		Monthly rate	
All items	2.4	1.6	1.0	3.2	.2	.3
Food and Beverages	1.5	2.8	4.0	2.6	.2	.3
Energy	24.0	1.2	-9.5	26.9	1.7	2.2
PCE less food and energy	1.4	1.4	1.2	2.0	.1	.2
Commodities	-1.9	-1.1	-2.2	.3	.1	.3
Services	2.8	2.5	2.6	2.7	.1	.1
Memo:						
CPI ¹	3.0	1.8	.8	3.6	.3	.5
CPI less food and energy ¹	1.7	1.6	1.0	1.8	.2	.4
Core PCE, market-based components	1.4	1.5	.8	1.8	.2	.2

1. Current-methods.

Monthly Core PCE Prices

- 12 month changes
- - - 6 month changes
- 3 month changes



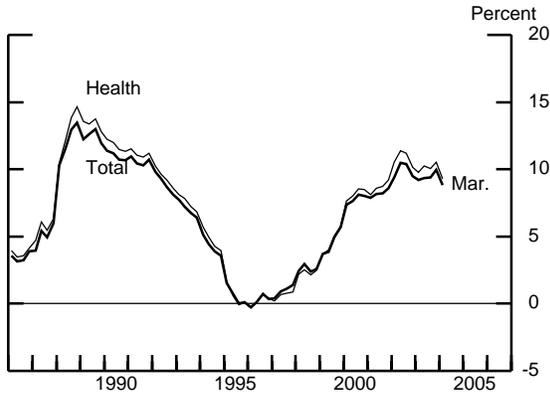
**Change in Employment Cost Index of Hourly Compensation
for Private-Industry Workers**

Industry and occupational group	2003				2004
	Mar.	June	Sept.	Dec.	Mar.
	Quarterly change (compound annual rate) ¹				
Total hourly compensation	5.5	3.4	4.4	3.1	4.3
Wages and salaries	4.1	2.5	3.5	2.0	2.5
Benefits	8.5	5.7	6.1	5.6	10.9
<i>By industry</i>					
Construction	3.3	4.1	3.3	3.0	3.5
Manufacturing	6.6	3.2	3.9	2.7	9.4
Transportation and public utilities	3.2	4.7	2.4	2.9	6.1
Wholesale trade	5.4	2.1	3.6	1.9	2.6
Retail trade	.8	2.1	6.2	4.1	1.7
FIRE	20.9	3.7	4.3	1.6	3.6
Services	3.4	3.1	4.1	3.8	4.3
<i>By occupation</i>					
White collar	5.7	2.6	4.8	3.3	3.8
Blue collar	4.9	4.1	3.8	3.5	6.7
Service occupations	4.6	2.8	3.2	2.7	4.7
Memo: State and local governments	4.0	4.0	2.2	3.2	3.9
	12-month change				
Total hourly compensation	3.8	3.5	4.0	4.0	3.9
Excluding sales workers	3.8	3.8	4.0	4.1	3.9
Wages and salaries Excluding sales workers	3.0	2.6	3.0	3.0	2.6
Benefits	6.1	6.1	6.5	6.4	7.0
<i>By industry</i>					
Construction	3.2	3.8	3.8	3.4	3.5
Manufacturing	4.7	4.6	4.7	4.1	4.7
Transportation and public utilities	3.8	4.1	3.5	3.3	4.0
Wholesale trade	4.7	3.0	3.7	3.2	2.5
Retail trade	2.0	1.2	2.5	3.3	3.5
FIRE	7.0	6.6	7.3	7.4	3.3
Services	2.8	2.9	3.3	3.6	3.8
<i>By occupation</i>					
White collar	3.8	3.4	4.0	4.1	3.6
Sales	3.7	2.2	3.5	3.2	3.5
Nonsales	3.9	3.7	4.1	4.3	3.7
Blue collar	4.0	4.1	4.2	4.0	4.5
Service occupations	3.4	3.3	3.0	3.2	3.2
Memo: State and local governments	4.2	4.1	3.6	3.3	3.3

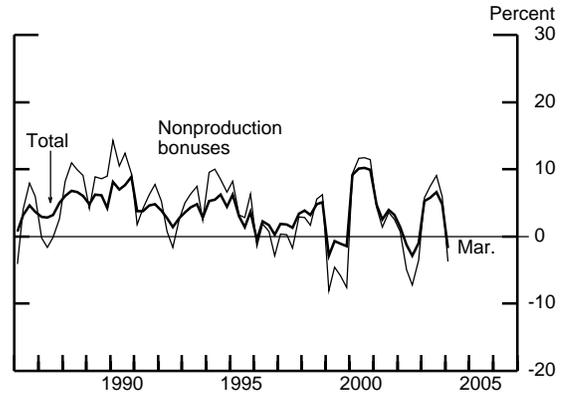
1. Seasonally adjusted by the BLS.

ECI Benefits Costs (confidential) (Private-industry workers; 12-month change)

Insurance Costs



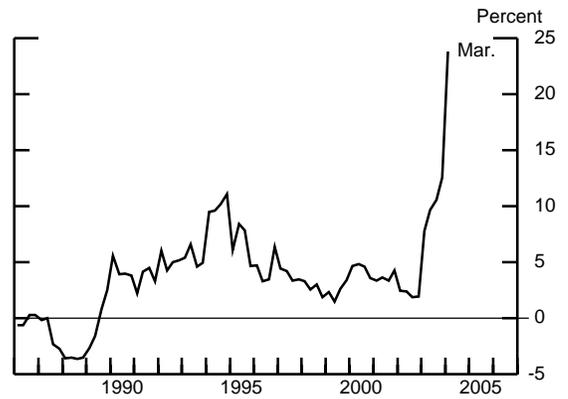
Supplemental Pay



Paid Leave



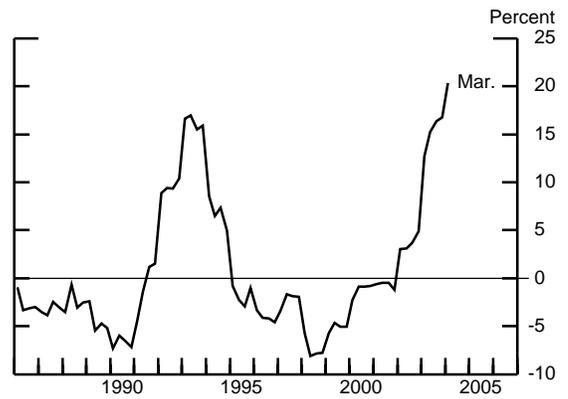
Retirement and Savings



Workers' Compensation Insurance



State Unemployment Insurance



**Labor Productivity and Costs
Nonfarm Business Sector**

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

	2002	2003 ¹	2003		2004
			Q3 ¹	Q4 ¹	Q1 ¹
Output per hour					
All persons ²	4.3	5.4	9.5	2.5	3.6
All employees ³	4.5	5.9	10.8	2.9	2.5
Compensation per hour	1.8	3.6	4.8	2.4	4.1
Unit labor costs	-2.4	-1.7	-4.3	-1	0.5

Note. Annual changes are from fourth quarter of preceding year to fourth quarter of year shown.

1. Staff estimate.

2. Includes non-employees (published definition).

3. Assumes that the rate of increase in hours of all persons equals the rate of increase in hours of all employees.

Four-quarter changes in compensation per hour in the nonfarm business sector, have been running roughly in line with changes in the ECI over the past year. Official figures for the first quarter will be released on May 6, and we currently estimate that compensation per hour increased at an annual rate of 4.1 percent last quarter. The release also will incorporate revisions to compensation in the third and fourth quarters of last year, based on unemployment insurance tax records that are more comprehensive (but much less timely) than the average hourly earnings figures used by the BEA in forming its initial compensation estimates.² We currently estimate that the four-quarter change in compensation per hour through the first quarter of this year was about 4 percent.

On May 6, the Bureau of Labor Statistics will also release its advance estimate of productivity for the first quarter. Based on the NIPA output data and the available data on hours, we estimate that output per hour in the nonfarm business sector increased at an annual rate of 3.6 percent in the first quarter, above the fourth-quarter pace but below the average increase of the last two years. Productivity measured with only employee hours is expected to have increased more slowly, at an annual rate of 2.5 percent in the first quarter. The rates of

2. The unemployment insurance data are more comprehensive than the average hourly earnings data because they cover a broader range of workers, they cover almost all nonfarm establishments, and they include alternative forms of compensation such as bonuses and stock options.

increase differ because of a sharp decline in the hours worked by self- employed workers in March.

Commercial Bank Credit

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

Type of credit	2003	Q4 2003	Q1 2004	Feb. 2004	Mar. 2004	Apr. ^e 2004	Level, Apr. 2004 ^e (\$ billions)
Total							
1. Adjusted¹	5.9	-.5	10.4	22.6	12.2	8.9	6,239
2. Reported	5.6	.1	11.4	23.1	14.2	.8	6,416
<i>Securities</i>							
3. Adjusted ¹	8.7	6.9	17.2	51.1	23.9	4.1	1,745
4. Reported	7.4	8.1	19.8	49.6	29.1	-22.0	1,922
5. Treasury and agency	8.7	2.5	25.6	72.6	32.4	-8.4	1,198
6. Other ²	5.5	16.8	11.1	14.4	23.9	-43.9	724
<i>Loans³</i>							
7. Total	4.9	-3.2	7.9	12.1	7.7	10.9	4,494
8. Business	-9.3	-11.8	-4.8	3.3	-5.0	-6.9	859
9. Real estate	11.1	-2.3	9.3	10.3	20.1	24.9	2,344
10. Home equity	30.7	31.4	38.2	26.8	42.7	32.3	317
11. Other	8.8	-6.6	5.2	7.9	16.6	23.8	2,027
12. Consumer	5.6	10.8	11.6	4.4	10.2	3.2	641
13. Adjusted ⁴	5.9	9.4	10.5	1.8	10.5	-6.7	1,012
14. Other ⁵	6.6	-7.4	16.8	37.2	-20.2	-7.5	650

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

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

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

3. Excludes interbank loans.

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

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

e Estimated.

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

Instrument	2003		2004		Change to Apr. 29 from selected dates (percentage points)		
	June 24	Dec. 31	Mar. 15	Apr. 29	2003 June 24	2003 Dec. 31	2004 Mar. 15
<i>Short-term</i>							
FOMC intended federal funds rate	1.25	1.00	1.00	1.00	-.25	.00	.00
Treasury bills ¹							
3-month	0.81	0.93	0.95	0.95	.14	.02	.00
6-month	0.82	1.00	1.00	1.13	.31	.13	.13
Commercial paper (A1/P1 rates) ²							
1-month	0.95	1.00	1.01	1.01	.06	.01	.00
3-month	0.91	1.05	1.02	1.08	.17	.03	.06
Large negotiable CDs ¹							
1-month	0.96	1.06	1.03	1.05	.09	-.01	.02
3-month	0.93	1.09	1.04	1.11	.18	.02	.07
6-month	0.92	1.16	1.08	1.31	.39	.15	.23
Eurodollar deposits ³							
1-month	0.94	1.04	1.02	1.03	.09	-.01	.01
3-month	0.91	1.07	1.04	1.10	.19	.03	.06
Bank prime rate	4.25	4.00	4.00	4.00	-.25	.00	.00
<i>Intermediate- and long-term</i>							
U.S. Treasury ⁴							
2-year	1.14	1.83	1.55	2.37	1.23	.54	.82
10-year	3.46	4.40	3.91	4.71	1.25	.31	.80
30-year	4.53	5.22	4.83	5.44	.91	.22	.61
U.S. Treasury 10-year indexed note	1.70	2.00	1.49	2.15	.45	.15	.66
Municipal revenue (Bond Buyer) ⁵	4.89	5.04	4.75	5.28	.39	.24	.53
Private instruments							
10-year swap	3.67	4.66	4.11	4.95	1.28	.29	.84
10-year FNMA ⁶	3.84	4.72	4.24	5.03	1.19	.31	.79
10-year AA ⁷	4.13	5.05	4.56	5.37	1.24	.32	.81
10-year BBB ⁷	5.16	5.74	5.21	5.95	.79	.21	.74
5-year high yield ⁷	8.95	7.94	7.76	8.00	-.95	.06	.24
Home mortgages (FHLMC survey rate) ⁸							
30-year fixed	5.21	5.81	5.41	5.94	.73	.13	.53
1-year adjustable	3.51	3.73	3.41	3.69	.18	-.04	.28

Stock exchange index	Record high		2003	2004		Change to Apr. 29 from selected dates (percent)		
	Level	Date	Dec. 31	Mar. 15	Apr. 29	Record high	2003 Dec. 31	2004 Mar. 15
Dow-Jones Industrial	11,723	1-14-00	10,454	10,103	10,272	-12.37	-1.74	1.68
S&P 500 Composite	1,527	3-24-00	1,112	1,104	1,114	-27.08	.18	.85
Nasdaq	5,049	3-10-00	2,003	1,939	1,959	-61.20	-2.23	1.01
Russell 2000	606	4-5-04	557	567	567	-6.45	1.86	.05
Wilshire 5000	14,752	3-24-00	10,800	10,799	10,867	-26.33	.62	.63

1. Secondary market.
2. Financial commercial paper.
3. Bid rates for eurodollar deposits collected around 9:30 a.m. Eastern time.
4. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
5. Most recent Thursday quote.
6. Constant maturity yields estimated from Fannie Mae domestic noncallable coupon securities.
7. Derived from smoothed corporate yield curves estimated using Merrill Lynch bond data.
8. For week ending Friday previous to date shown.

NOTES:

June 24, 2003, is the last day before the most recent policy easing.
March 15, 2004, is the day before the most recent FOMC meeting.