

Prefatory Note

The attached document represents the most complete and accurate version available based on original files from the FOMC Secretariat at the Board of Governors of the Federal Reserve System.

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Part 2

June 23, 2004

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

June 23, 2004

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Domestic Nonfinancial Developments

Domestic Nonfinancial Developments

Overview

Economic activity likely registered another solid increase this quarter. Although consumer spending looks to have slowed a bit in recent months, higher levels of housing starts and home sales indicate a substantial step-up in residential construction expenditures. Bolstered by strong fundamentals, equipment and software spending began the quarter on an upward trajectory. Meanwhile, the labor market has continued to bounce back, and factory output has accelerated in the current quarter. Driven in part by large increases in energy prices, top-line consumer price inflation has increased in recent months. Core price inflation has risen as well since the turn of the year, though the twelve-month change in core CPI prices is only a touch higher than over the comparable year-earlier period.

Labor Market Developments

The labor market is rebounding strongly. Private nonfarm payrolls rose 275,000 in May, after an increase of 325,000 in April. Employment gains have been widespread; in May the six-month diffusion index of employment changes moved up to 70.7, its highest level since April 2000.¹ Notably, after three and one-half years of decline, manufacturers have added jobs in each of the past four months. Aggregate hours of production or nonsupervisory workers rose 0.3 percent in May and now stands 2.0 percent above its trough of last summer.

In the last Greenbook, we noted that the improvement in the labor market to that point was mainly due to a reduction in layoffs. The more recent improvement, however, also reflects an expansion in hiring. The hiring rate from the Job Openings and Labor Turnover Survey (JOLTS) shot up to 3.5 percent in March, and, despite reversing some of that rise in April, the hiring rate stands well above the lows of last year. Similarly, the decline in the exhaustion rate for unemployment insurance since the turn of the year is consistent with stronger hiring pulling individuals back into jobs before their benefits run out. The JOLTS job openings rate has also edged up since the end of last year.

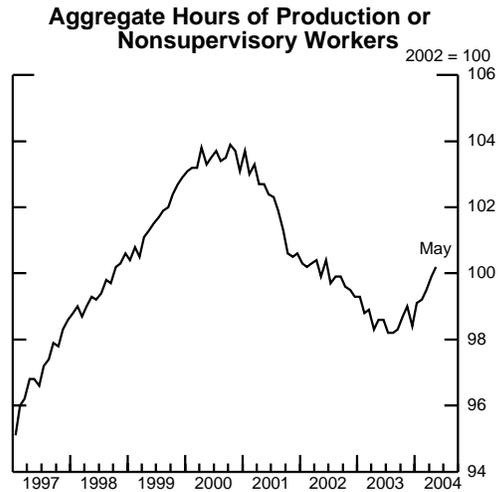
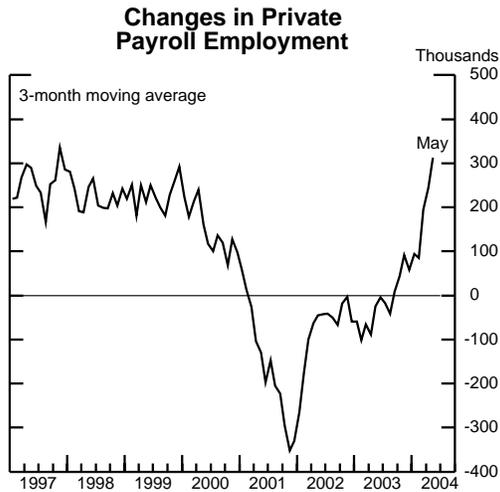
Despite the large increases in employment over the past several months, significant slack appears to remain in the labor market. In the household survey, the unemployment rate, at 5.6 percent in May, and the labor force participation rate, at 65.9 percent in May, have exhibited little movement since the start of the year. Indeed, the employment-to-population ratio, the movement of which reflects changes in both the unemployment rate and the labor force participation rate, is still close to the low it reached last year. Moreover, the proportion of individuals working part-time for economic reasons has been roughly flat at a

1. The diffusion index equals the percent of industries in which employment rose over the six months ending last month plus one-half of the percent of industries with unchanged employment.

Changes in Employment
(Thousands of employees; seasonally adjusted)

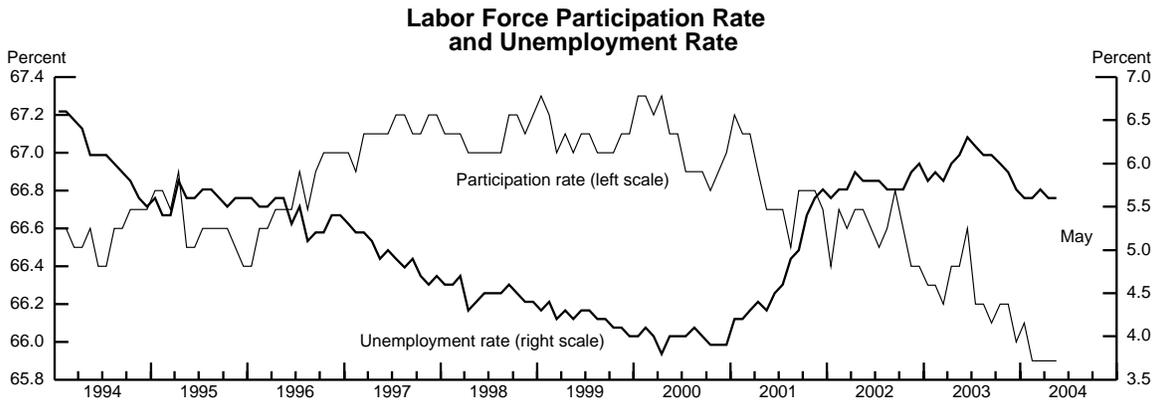
| Measure and sector | 2003 | | 2004 | | | |
|---|------------------------|------|------|----------------|------|------|
| | H1 | Q4 | Q1 | Mar. | Apr. | May |
| | Average monthly change | | | Monthly change | | |
| Nonfarm payroll employment (establishment survey) | -40 | 60 | 198 | 353 | 346 | 248 |
| Private | -35 | 58 | 195 | 339 | 325 | 275 |
| Previous | -35 | 58 | 186 | 310 | 280 | ... |
| Manufacturing | -64 | -17 | 7 | 23 | 29 | 32 |
| Construction | 4 | 7 | 26 | 62 | 19 | 37 |
| Wholesale trade | -4 | 4 | 8 | 11 | 10 | 3 |
| Retail trade | -4 | -17 | 46 | 50 | 28 | 19 |
| Transportation and utilities | -8 | -1 | 14 | 22 | 0 | 16 |
| Information | -16 | 0 | -2 | 0 | 4 | 3 |
| Financial activities | 14 | -8 | 7 | 14 | 13 | 15 |
| Professional and business services | 14 | 36 | 26 | 41 | 130 | 64 |
| Temporary help services | 10 | 23 | 8 | 10 | 47 | 31 |
| Nonbusiness services ¹ | 31 | 53 | 59 | 106 | 88 | 83 |
| Total government | -5 | 2 | 3 | 14 | 21 | -27 |
| Total employment (household survey) | 202 | 278 | -60 | -3 | 278 | 196 |
| Memo: | | | | | | |
| Aggregate hours of private production workers (percent change) ² | -1.9 | 1.9 | 2.3 | 0.3 | 0.4 | 0.3 |
| Average workweek (hours) ³ | 33.7 | 33.7 | 33.8 | 33.8 | 33.8 | 33.8 |
| Manufacturing (hours) | 40.3 | 40.6 | 41.0 | 40.9 | 40.7 | 41.1 |

1. Nonbusiness services comprises education and health, leisure and hospitality, and "other."
 2. Establishment survey. Semiannual data are percent changes from Q4 to Q2. Quarterly data are percent changes from preceding quarter at an annual rate. Monthly data are percent changes from preceding month.
 3. Establishment survey.
- ... Not applicable.

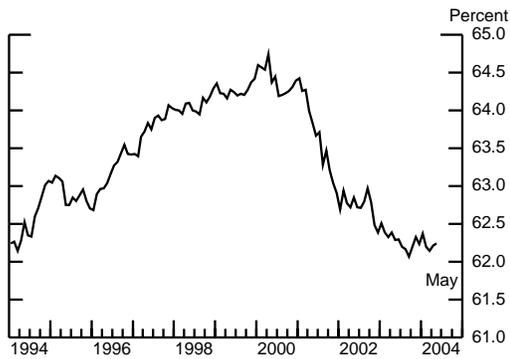


Selected Unemployment and Labor Force Participation Rates
(Percent; seasonally adjusted)

| Rate and group | 2002 | 2003 | 2003 | 2004 | | | | |
|---------------------------------------|------|------|------|------|------|------|------|--|
| | | | Q4 | Q1 | Mar. | Apr. | May | |
| <i>Civilian unemployment rate</i> | | | | | | | | |
| 16 years and older | 5.8 | 6.0 | 5.9 | 5.6 | 5.7 | 5.6 | 5.6 | |
| Teenagers | 16.5 | 17.4 | 16.3 | 16.6 | 16.5 | 16.9 | 17.2 | |
| 20-24 years old | 9.7 | 10.0 | 10.0 | 9.6 | 9.6 | 9.2 | 9.7 | |
| Men, 25 years and older | 4.7 | 5.1 | 4.9 | 4.5 | 4.6 | 4.4 | 4.6 | |
| Women, 25 years and older | 4.6 | 4.6 | 4.6 | 4.5 | 4.6 | 4.6 | 4.2 | |
| <i>Labor force participation rate</i> | | | | | | | | |
| Total | 66.6 | 66.2 | 66.1 | 66.0 | 65.9 | 65.9 | 65.9 | |
| Teenagers | 47.4 | 44.5 | 43.6 | 43.6 | 42.9 | 43.7 | 43.9 | |
| 20-24 years old | 76.4 | 75.4 | 74.9 | 74.7 | 74.6 | 75.1 | 75.0 | |
| Men, 25 years and older | 75.9 | 75.5 | 75.6 | 75.4 | 75.3 | 75.0 | 75.2 | |
| Women, 25 years and older | 59.4 | 59.6 | 59.4 | 59.2 | 59.2 | 59.3 | 59.2 | |



Employment-Population Ratio



Persons Working Part-Time for Economic Reasons
(Percent of household employment)



high level since the start of the year. The share of small firms reporting to the National Federation of Independent Businesses that they have a hard-to-fill position open is currently only at the upper end of the low range it has occupied since late 2001, a reading that suggests that workers are not appreciably hard to find. Household perceptions of the labor market, as reported in the Conference Board survey, also support the view that the labor market has ample room for expansion. Survey respondents' assessments of current labor market conditions were about unchanged in May and remain below the level at the trough of the recent recession.

Looking ahead, the level of initial claims through the middle of June continues to point to a strong gain in employment; the four-week moving average for the week ending June 12 was 343,000. The hiring plans of small businesses, as reported by the National Federation of Independent Businesses survey, have been unchanged, on net, over the past several months, albeit at a level well above their trough. Similarly, Manpower Inc.'s index of firms' hiring plans for the third quarter was unchanged at its highest level in three years.²

We now estimate that productivity in the nonfarm business sector increased at an annual rate of 3.7 percent in 2004:Q1, after a rise of 2.5 percent in the fourth

Labor Output per Hour

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

| Sector | 2002 | 2003 | 2003 | | 2004 |
|--|------|------|------|-----|-----------------|
| | | | Q3 | Q4 | Q1 ¹ |
| Nonfarm businesses | | | | | |
| All persons | 4.3 | 5.4 | 9.5 | 2.5 | 3.7 |
| All employees ² | 4.5 | 5.8 | 10.8 | 2.8 | 2.7 |
| Nonfinancial corporations ³ | 5.1 | 6.5 | 9.5 | 4.3 | 2.2 |

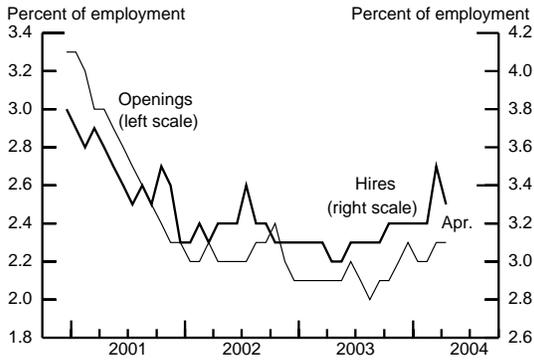
Note. Annual changes are from fourth quarter of preceding year to fourth quarter of year shown.

1. Staff estimate.
2. Assumes that the growth rate of hours of all persons equals the growth rate of hours of all employees.
3. 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.

2. Though the Manpower survey asks respondents about their hiring plans for the next quarter, we have found the series to be most strongly correlated with employment gains in the last month of the current quarter and the first month of the next quarter.

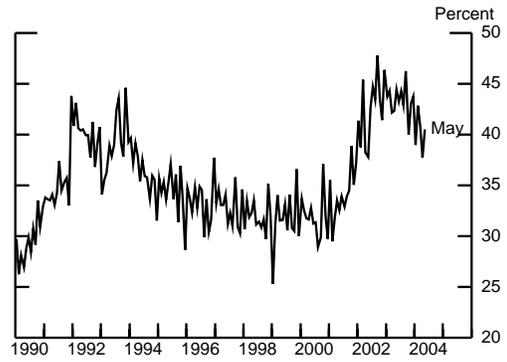
Labor Market Indicators

Job Openings and Hires



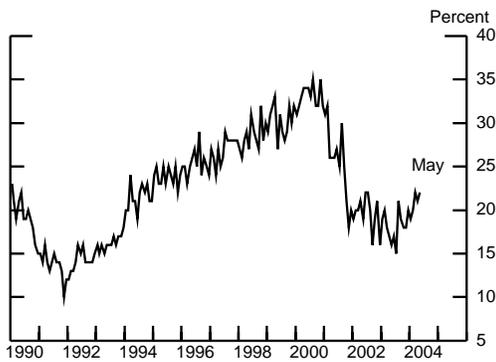
Source. Job Openings and Labor Turnover Survey.

Exhaustion Rate



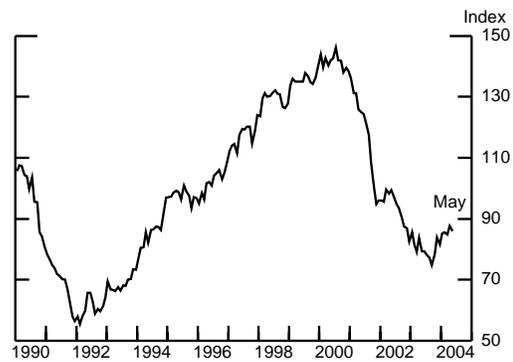
Note. Seasonally adjusted by FRB staff. Exhaustion rate is number of individuals who exhausted benefits without finding a job, expressed as a share of individuals who began receiving benefits six months earlier.

Positions Hard to Fill



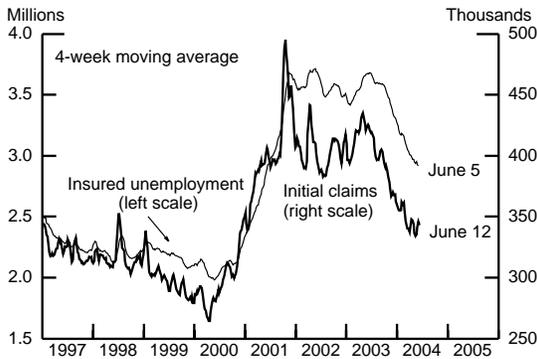
Note. Percent of firms surveyed with at least one "hard to fill" job opening. Source. National Federation of Independent Businesses.

Current Labor Market Conditions

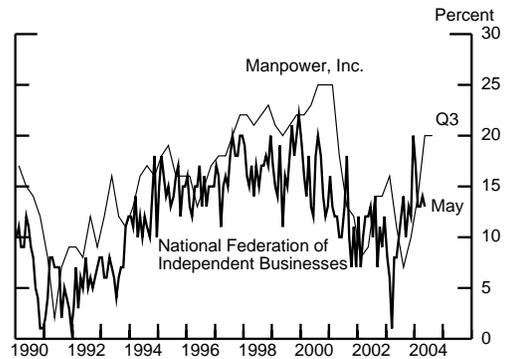


Note. The proportion of households believing jobs are plentiful, minus the proportion believing jobs are hard to get, plus 100. Source. Conference Board.

Unemployment Insurance



Net Hiring Strength



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

quarter. However, this apparent acceleration reflects, in part, a large decline last quarter in non-employee hours, which are volatile. An alternative productivity measure, using the rate of increase in hours of all employees, rose at an annual rate of 2.7 percent in the first quarter, about the same rate as in 2003:Q4.

Industrial Production

Total industrial production rose about 1 percent in both April and May, a noticeable step-up from the average monthly pace of 1/2 percent recorded during the first quarter. IP in the second quarter is on track to post a fourth consecutive quarter of accelerating production. In the past two months, output at utilities surged, reflecting a turn in the weather from unusually mild in March to unseasonably warm in May, and manufacturing production excluding motor vehicles expanded sharply. Motor vehicle assemblies were little changed in April; in May they fell 450,000 units and subtracted 0.2 percentage point from the change in manufacturing output.

Production in high-tech manufacturing industries rose smartly in May. The output of semiconductors and computers continued to post solid gains, and the production of communications equipment rose nearly 3-1/2 percent, more than erasing the declines of the preceding three months.

Production gains elsewhere have been broad-based. The pace of output of consumer nondurables and business supplies, which had generally lagged production increases in other market groups, picked up in recent months, and the production of business equipment, which rose nearly 12 percent (annual rate) in the first quarter, climbed again in April and May.³ Materials output continued the expansion that started in the second half of last year.

For June, the limited available weekly data on physical output are down a bit on net. Although the production of iron, steel products, and coal has risen in the first half of this month, electricity generation has reversed some of the rise in May. More importantly, motor vehicle assemblies appear to have eased back in June to 11-3/4 million units (annual rate), putting the average rate for the second quarter at 12.0 million units. Preliminary third-quarter schedules call for a 12.1 million unit rate. Despite robust sales in May, inventories of light trucks remain uncomfortably high, and as a result some automakers have extended summer downtime at a few plants by one week.

3. To meet demand, John Deere, a maker of farm and construction machinery, is reportedly planning to forgo its usual summer shutdown period, and, similarly, Caterpillar is not planning to temporarily idle any of its plants this summer.

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

| Component | Proportion 2003 (percent) | 2003 ¹ | 2003 | 2004 | 2004 | | |
|---|---------------------------------|-------------------|-------------|------------|--------------|-----------|------------|
| | | | Q4 | Q1 | Mar. | Apr. | May |
| | | | Annual rate | | Monthly rate | | |
| Total | 100.0 | 1.5 | 5.6 | 6.7 | .0 | .8 | 1.1 |
| Previous | 100.0 | 1.5 | 5.6 | 6.3 | -1 | .8 | ... |
| Manufacturing | 82.3 | 1.9 | 6.1 | 6.2 | .3 | .7 | .9 |
| Ex. motor veh. and parts | 75.6 | 1.7 | 5.9 | 5.9 | .5 | .8 | 1.2 |
| Ex. high-tech industries | 70.7 | .3 | 4.6 | 4.5 | .5 | .7 | 1.1 |
| Mining | 7.6 | .4 | 1.1 | -1.5 | -.2 | .9 | -.4 |
| Utilities | 10.1 | -6 | 5.0 | 17.6 | -2.5 | 1.5 | 3.3 |
| <i>Selected industries</i> | | | | | | | |
| High technology | 4.9 | 21.3 | 24.8 | 27.3 | 1.3 | 2.1 | 3.5 |
| Computers | 1.2 | 14.1 | 27.2 | 27.9 | 2.2 | 2.3 | 2.5 |
| Communications equipment | 1.3 | 5.8 | 2.5 | 1.2 | -1.5 | -1.2 | 3.4 |
| Semiconductors ² | 2.4 | 34.3 | 36.4 | 41.4 | 2.1 | 3.4 | 4.0 |
| Motor vehicles and parts | 6.7 | 3.8 | 8.8 | 9.9 | -1.8 | -.3 | -2.3 |
| <i>Market groups excluding energy and selected industries</i> | | | | | | | |
| Consumer goods | 22.6 | .2 | 3.6 | 3.6 | .6 | .5 | 1.0 |
| Durables | 4.3 | 1.1 | 7.6 | 6.9 | -.1 | .6 | .8 |
| Nondurables | 18.3 | .0 | 2.6 | 2.8 | .8 | .5 | 1.1 |
| Business equipment | 7.3 | 1.0 | 5.6 | 11.8 | .0 | 1.1 | 1.5 |
| Defense and space equipment | 1.9 | 4.8 | .4 | -.7 | 1.1 | .1 | .5 |
| Construction supplies | 4.2 | 1.1 | 7.9 | 2.0 | .7 | 1.0 | 1.4 |
| Business supplies | 8.5 | .2 | 1.9 | 5.3 | .5 | .9 | 1.3 |
| Materials | 24.8 | -.3 | 6.3 | 3.9 | .4 | .6 | .9 |
| Durables | 13.6 | -.1 | 8.2 | 5.2 | .5 | .6 | .9 |
| Nondurables | 11.2 | -.5 | 4.0 | 2.3 | .2 | .7 | .8 |

1. From fourth quarter of preceding year to fourth quarter of year shown.

2. Includes related electronic components.

... Not applicable.

Capacity Utilization
(Percent of capacity)

| Sector | 1972- 2003 average | 1982 low | 1990- 91 low | 2003 | | 2004 | | |
|--------------------------------|--------------------------|-------------|--------------------|-------------|-------------|-------------|-------------|-------------|
| | | | | Q3 | Q4 | Q1 | Apr. | May |
| Total industry | 81.1 | 70.9 | 78.6 | 74.6 | 75.5 | 76.5 | 77.1 | 77.8 |
| Manufacturing | 80.0 | 68.7 | 77.2 | 73.2 | 74.1 | 75.1 | 75.9 | 76.4 |
| High-tech industries | 78.8 | 75.4 | 74.5 | 65.0 | 67.0 | 69.1 | 69.8 | 71.0 |
| Excluding high-tech industries | 80.1 | 68.2 | 77.3 | 74.3 | 75.2 | 76.1 | 77.0 | 77.5 |
| Mining | 86.9 | 78.6 | 83.4 | 85.0 | 85.3 | 85.0 | 85.5 | 85.1 |
| Utilities | 86.9 | 77.6 | 84.1 | 82.9 | 83.1 | 85.8 | 85.3 | 88.0 |

Production of Domestic Autos and Trucks

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

| Item | 2003 | 2003 | | 2004 | 2004 | | |
|---------------------------|------|------|------|------|------|------|------|
| | | Q3 | Q4 | Q1 | Mar. | Apr. | May |
| U.S. production | 12.1 | 12.3 | 12.2 | 12.4 | 12.2 | 12.3 | 11.9 |
| Autos | 4.5 | 4.6 | 4.4 | 4.4 | 4.4 | 4.5 | 4.1 |
| Trucks | 7.6 | 7.7 | 7.8 | 8.0 | 7.9 | 7.8 | 7.7 |
| Days' supply ¹ | 70 | 63 | 68 | 74 | 73 | 76 | 68 |
| Inventories ² | 3.04 | 2.88 | 3.04 | 3.16 | 3.16 | 3.23 | 3.12 |

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

1. Quarterly and annual values are calculated with end-of-period stocks and average reported sales; excludes medium and heavy trucks.

2. End-of-period stocks; excludes medium and heavy trucks.

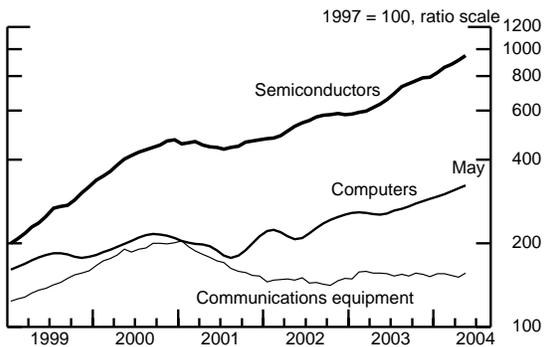
Indicators of production in high-tech industries remain positive. Intel's upward revision to its second-quarter revenue guidance suggests solid near-term increases in semiconductor output, and, according to Gartner, a consulting and research firm, semiconductor vendors are reporting strong orders. Utilization rates among semiconductor producers remain above 90 percent; despite a doubling of bookings for semiconductor manufacturing equipment relative to a year ago, industry contacts are concerned about looming capacity constraints. Indeed, the latest Institute for Supply Management (ISM) manufacturing survey listed several types of semiconductors as up in price, and semiconductors were noted as being in short supply. CIO Magazine's diffusion indexes for future spending on computer hardware and on networking equipment have continued to rise, and orders as reported in the M3 for nondefense communications equipment surged in April.

Other forward-looking indicators for near-term manufacturing activity are consistent with continued production increases. The ISM new orders diffusion index remained relatively high in May, and available regional indexes in June point to further solid gains. Smoothing through the substantial volatility in the staff's series on real adjusted durable goods orders, the three-month moving average increased a solid 1.3 percent in April.

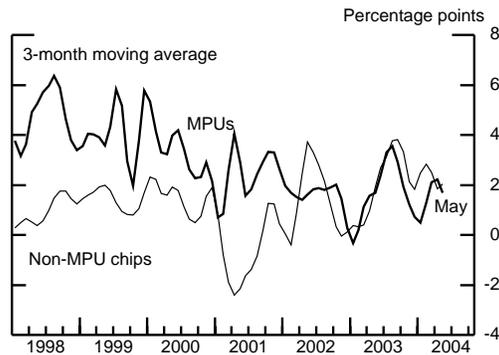
The recent sharp turnaround in manufacturing production has boosted the factory operating rate to 76.4 percent in May. Although the utilization rate has risen rapidly in the past six months, it remains 3-1/2 percentage points below its 1977-2003 average. The slack suggested by this measure stands in contrast to the impression given by the ISM's index of supplier delivery performance, which indicates widespread increases in lead times. A similar gap between the two series opened up in the 1982-84 period, when the supplier deliveries index shot up before the factory operating rate turned up. In both cases, the gap

Indicators of High-Tech Manufacturing Activity

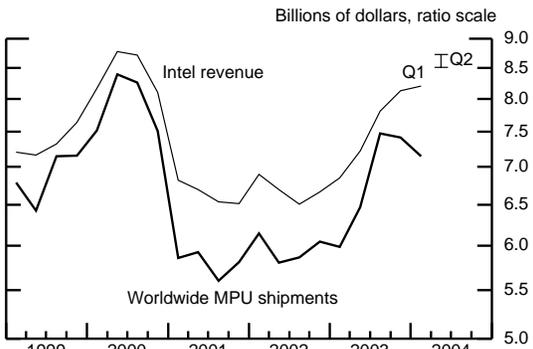
Industrial Production in the High-Tech Sector



Contribution to the Rate of Change in Semiconductor Industrial Production



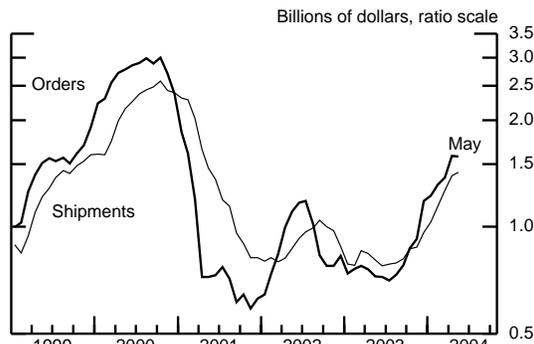
Microprocessor Unit (MPU) Shipments and Intel Revenue



Note. Q2 is the range of Intel's guidance as of June 3, 2004. FRB seasonals.

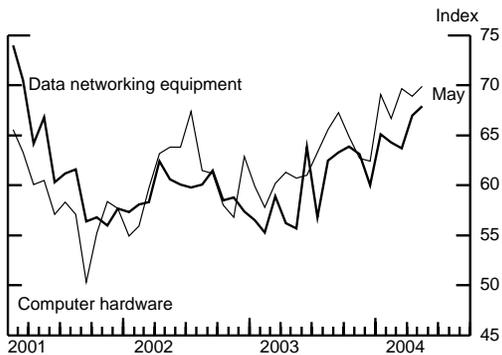
Source. Intel and Semiconductor Industry Association.

Semiconductor Manufacturing Equipment Orders and Shipments



Source. Semiconductor Equipment and Materials International.

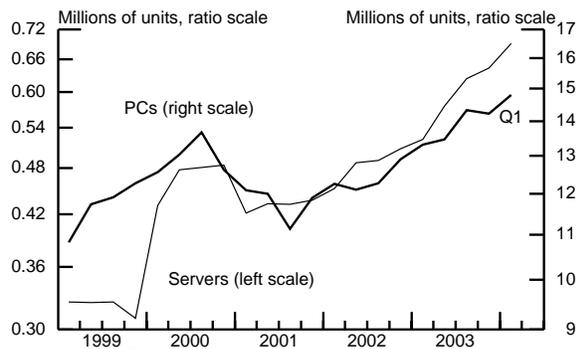
CIO Magazine Future Spending Diffusion Index



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

Source. CIO Magazine.

U.S. Personal Computer and Server Sales



Note. FRB seasonals.

Source. Gartner.

emerged when manufacturing began to rebound from a protracted and substantial downturn and likely reflects short-run constraints of labor and materials on hand due to the cumulative declines in manufacturing employment and inventories.⁴ Indeed, similar cyclical considerations are likely behind the significantly higher utilization rates found in the ISM's recent Semiannual Economic Forecast; consistent with our interpretation, manufacturers reported that they planned to relieve these pressures by working existing personnel longer hours and hiring more workers.

Another factor contributing to lengthening supplier delivery lead times may be tight capacity in the trucking industry. Industry contacts and reports in the Beige Book indicate widespread driver shortages and a relatively low stock of medium and heavy trucks. The Bureau of Transportation's transportation index for freight volume has risen at an annual rate of 12 percent in the six months ending in March (latest observation available).

New Orders for Durable Goods

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

| Component | Proportion, 2003: H2 (percent) | 2003 | 2004 | 2004 | | |
|------------------------------|--------------------------------------|-------------|------------|--------------|------------|-------------|
| | | Q4 | Q1 | Feb. | Mar. | Apr. |
| | | Annual rate | | Monthly rate | | |
| Total orders | 100.0 | 18.4 | 8.8 | 3.9 | 5.9 | -3.2 |
| Adjusted orders ¹ | 75.0 | 19.1 | 13.4 | 2.8 | 6.8 | -3.8 |
| Computers | 5.0 | 4.7 | -14.8 | 2.2 | -1.1 | 4.5 |
| Communication equipment | 4.0 | -56.0 | 48.3 | 6.4 | -7.1 | 18.1 |
| Other capital goods | 23.0 | 27.7 | 18.5 | 1.8 | 9.5 | -7.9 |
| Other ² | 43.0 | 26.0 | 11.7 | 3.1 | 7.2 | -3.8 |
| Memo: | | | | | | |
| Real adjusted orders | ... | 18.0 | 10.7 | 2.5 | 6.3 | -4.4 |
| Excluding high tech | ... | 22.9 | 10.1 | 2.2 | 7.8 | -6.0 |

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

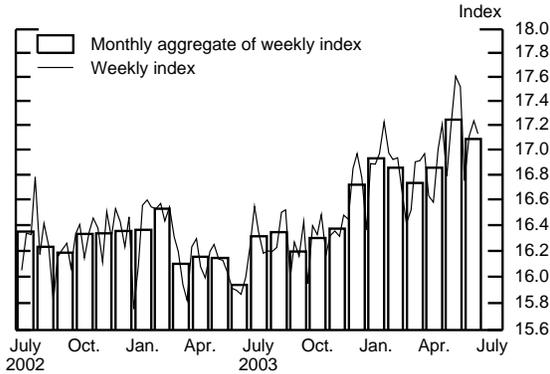
2. Primary metals; most fabricated metals; most stone, clay, and glass products; household appliances; scientific instruments; and miscellaneous durable goods.

... Not applicable.

4. The Federal Reserve's capacity measure abstracts from these short-run constraints by asking respondents to the Survey of Plant Capacity to assume that the requisite labor and materials are available.

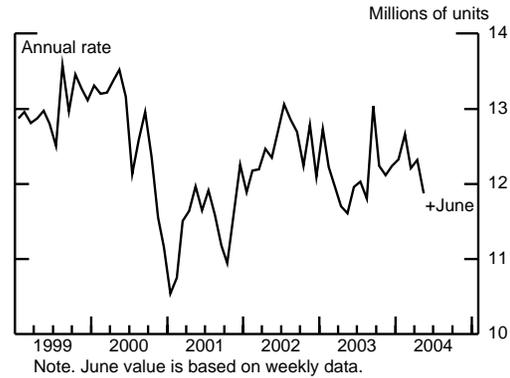
Indicators of Manufacturing Activity

Weekly Production Index excluding Motor Vehicles



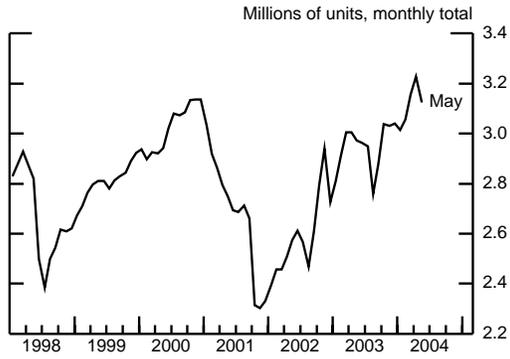
Note. One index point equals 1 percent of 1997 total industrial output.

Motor Vehicle Assemblies



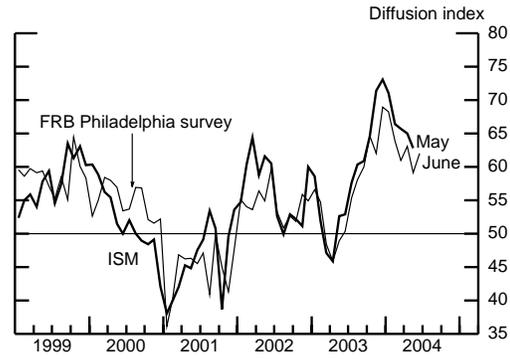
Note. June value is based on weekly data.

Inventories of Light Vehicles



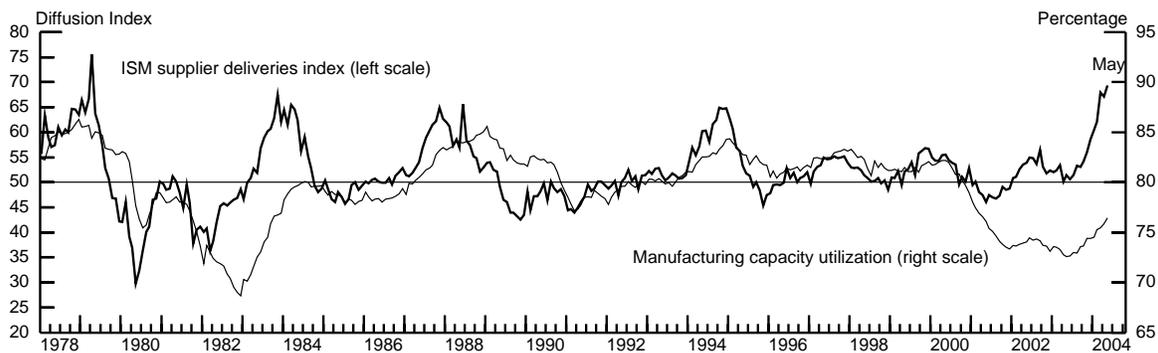
Note. FRB seasonals.

New Orders: ISM and FRB Philadelphia Surveys



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

ISM Supplier Deliveries Index and Manufacturing Capacity Utilization



Note. The diffusion index equals the percentage of respondents reporting slower supplier deliveries, plus one-half the percentage of respondents reporting that supplier deliveries were unchanged.

Motor Vehicles

Sales of light vehicles climbed 1.4 million units in May to an annual rate of 17.8 million units, a blip-up that follows a sales pace of less than 16-1/2 million units in the first four months of the year. More aggressive marketing tactics can account for only a small portion of the jump in sales in May. Incentives on light vehicles did move up after having been flat for several months, but the dollar value of the increase was modest. In addition, fleet sales explain only 130,000 units of the rise in sales. This month, incentives have edged down, and automakers expect light vehicle sales to drop back, with projections ranging from 16.0 to 16.4 million units.

Our industry contacts have told us that high gasoline prices do not appear to have significantly affected consumer behavior to date. Despite their lower fuel efficiency, light trucks have increased their share of light vehicle sales, on net, in the past two months. Although the market share of the sports utility segment has slipped this year, the decline follows a rapid increase in 2003, and the recent pullback is not out of line with historical variation in shares. In the past three months, the number of respondents to the Michigan Survey of Consumer Sentiment who cited rising gasoline prices as a reason that motor vehicle buying conditions are poor has risen from a negligible fraction to 8 percent. Nonetheless, personal finances and general economic conditions, rather than concerns about rising fuel costs, continue to be the dominant reported factors affecting consumers' views of buying conditions.

Consumer Spending

Real personal consumption expenditures appear to have slowed a bit in the current quarter. In particular, purchases of goods excluding cars and trucks declined 0.3 percent in April. Despite a large nominal increase in this category in May, we estimate that real spending was flat, as gasoline and food prices increased sharply.

Real outlays on services moved up in April, the most recent month for which data are available. Spending on energy services increased in April with a return to more normal temperatures from an unseasonably mild March; atypically warm weather in May likely pushed up spending further in this category. Expenditures on non-energy services, which rose briskly again in April, were boosted largely by outlays for medical and brokerage services.

The economic fundamentals underlying consumption still look strong. Gains in equity values and house prices over the past year have boosted the net worth of households. Moreover, despite higher energy prices, real disposable personal income has been rising rapidly so far this year, benefiting from an improved labor market and last year's tax cut. With disposable income advancing faster

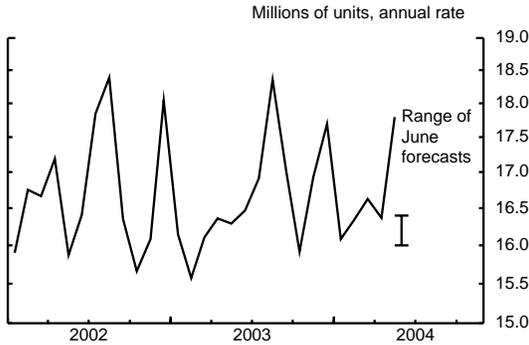
Sales of Light Vehicles
(Millions of units at an annual rate, FRB seasonals)

| Category | 2003 | 2003 | | 2004 | 2004 | | |
|----------------------------------|------|------|------|------|------|------|------|
| | | Q3 | Q4 | Q1 | Mar. | Apr. | May |
| Total | 16.6 | 17.4 | 16.8 | 16.3 | 16.6 | 16.4 | 17.8 |
| Autos | 7.6 | 7.7 | 7.5 | 7.4 | 7.7 | 7.4 | 8.0 |
| Light trucks | 9.0 | 9.7 | 9.3 | 8.9 | 8.9 | 9.0 | 9.8 |
| North American ¹ | 13.3 | 14.1 | 13.6 | 13.1 | 13.2 | 13.0 | 14.2 |
| Autos | 5.5 | 5.7 | 5.5 | 5.4 | 5.6 | 5.2 | 5.7 |
| Light trucks | 7.8 | 8.4 | 8.2 | 7.7 | 7.6 | 7.8 | 8.5 |
| Foreign-produced | 3.3 | 3.4 | 3.2 | 3.2 | 3.4 | 3.3 | 3.6 |
| Autos | 2.1 | 2.1 | 2.0 | 2.0 | 2.1 | 2.2 | 2.3 |
| Light trucks | 1.2 | 1.3 | 1.2 | 1.2 | 1.3 | 1.2 | 1.3 |
| Memo: Medium and heavy trucks | .33 | .34 | .37 | .40 | .41 | .40 | .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.

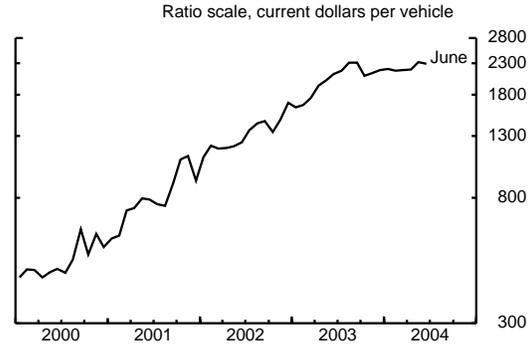
1. Excludes some vehicles produced in Canada that are classified as imports by the industry.

Sales of Light Vehicles



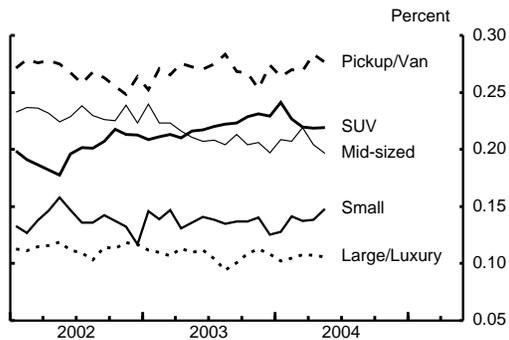
Note. FRB seasonals. Adjusted for shifts in reporting periods.

Average Value of Incentives on Light Vehicles



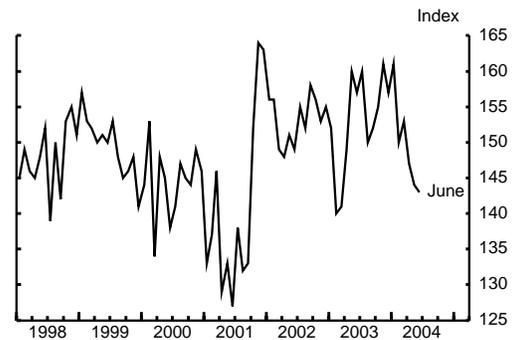
Note. Weighted average of customer cash rebate and interest rate reduction. Data are seasonally adjusted. Source. J.D. Power and Associates.

Market Share of Light Vehicles by Segment



Note. Data through May. FRB seasonals.

Michigan Survey Index of Car-Buying Attitudes



Retail and Food Services Sales

(Percent change from preceding period; seasonally adjusted current dollars)

| Category | 2003 | | | 2004 | | | |
|------------------------------|------|-----|-----|------|------|------|-----|
| | H1 | Q3 | Q4 | Q1 | Mar. | Apr. | May |
| Total sales | 3.0 | 2.6 | 1.1 | 2.3 | 2.1 | -.6 | 1.2 |
| Previous estimate | 3.0 | 2.6 | 1.1 | 2.3 | 2.0 | -.5 | ... |
| Retail control ¹ | 2.1 | 2.4 | 1.5 | 2.7 | 1.0 | -.1 | 1.0 |
| Previous estimate | 2.1 | 2.4 | 1.5 | 2.6 | .7 | .0 | ... |
| GAF ² | 1.4 | 2.7 | 1.2 | 2.7 | .6 | -.7 | .8 |
| Gasoline stations | .9 | 3.4 | 1.6 | 6.5 | 3.7 | .3 | 4.0 |
| Food services | 4.8 | 2.2 | 2.9 | 3.0 | .2 | -.2 | -.3 |
| Other retailers ³ | 2.1 | 2.0 | 1.2 | 1.6 | .8 | .5 | .7 |

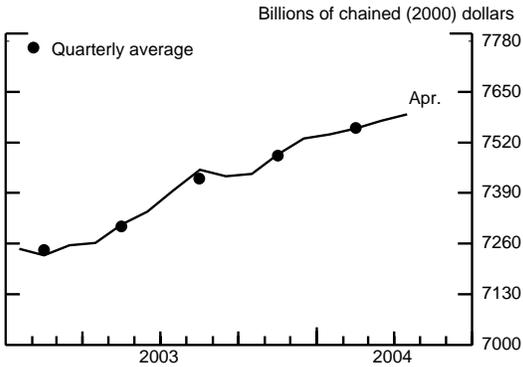
1. Total retail trade and food services less sales at building material and supply stores and automobile and other motor vehicle dealers.

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.

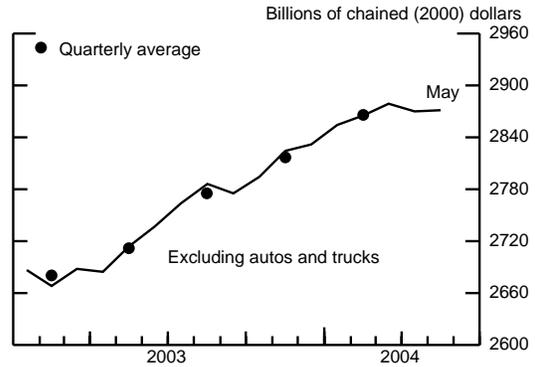
3. Health and personal care stores, food and beverage stores, electronic shopping and mail order houses, and miscellaneous other retailers.

... Not applicable.

Real PCE

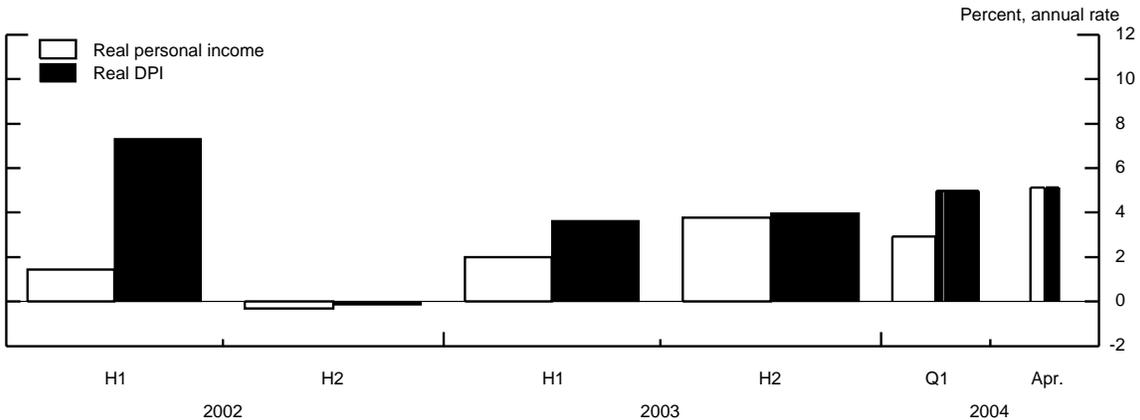


Real PCE Goods



Note. Data for May is a staff estimate.

Change in Real Personal Income and Real DPI



than personal outlays since the end of last year, the saving rate has moved up this year, reaching 2.4 percent in April.⁵

Consumer confidence also remains at favorable levels. The Michigan Survey Research Center's index of consumer sentiment jumped in early June, more than reversing its decline in the previous month, and the Conference Board index of consumer confidence held steady in May (the most recent reading). The levels of both indexes are well above their lows of early 2003.

Housing Markets

The pace of new homebuilding remained elevated in April and May. New single-family homes were started at annual rates of 1.62 million units in April and 1.64 million units in May, near the high end of the very strong recent range of activity. Issuance of new permits to build single-family homes (adjusted for activity in areas where permits are not required) was roughly in line with starts last month, suggesting that starts remained elevated in June.

In the more-volatile multifamily sector, starts fell about 10 percent in May to an annual rate of 327,000 units, but the pace of new permit issuance points to a rebound in starts this month. Indeed, construction activity in this sector has been surprisingly resilient in the past several months despite a vacancy rate for multifamily units that reached a record high of 11.4 percent in the first quarter. Low interest rates may have helped maintain the profitability of apartment buildings despite the higher vacancy rates.

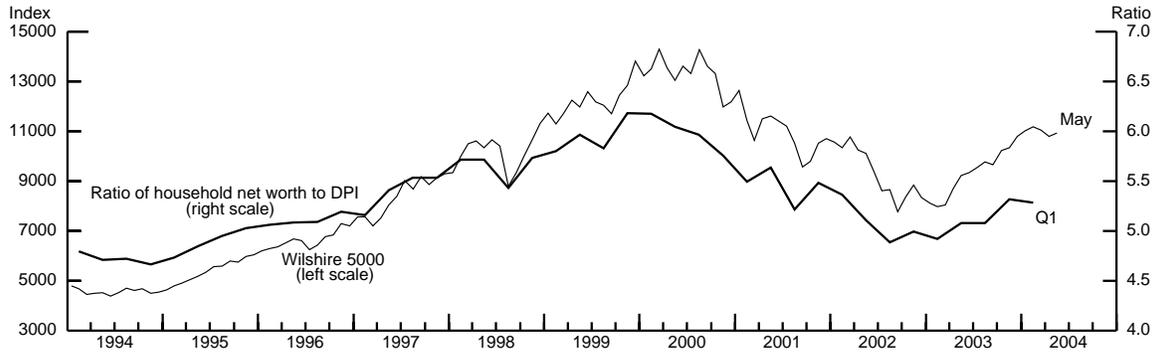
Home sales remained strong in April, and prices continued to rise at a rapid rate. Sales of existing homes increased to an annual rate of 6.64 million units in April, only a bit below the record pace set last September. The average price of an existing home sold in April was 9.8 percent higher than a year before, and the repeat-sales price index (which is less affected by the composition of homes sold) was up 7.7 percent during the year ending last quarter. In the much smaller market for new homes, sales dropped back in April from March's record level but remained elevated. The average price of a new home sold in April was 14 percent higher than a year before, and the quality-adjusted price index for new homes (which controls for changes in some of the characteristics of homes sold) was up 5.8 percent during the year ending in the first quarter.

The recent run-up in mortgage rates has yet to have a noticeable effect on housing activity. The average rate for thirty-year fixed-rate mortgages in the first half of June was almost 85 basis points above the near-record low seen in

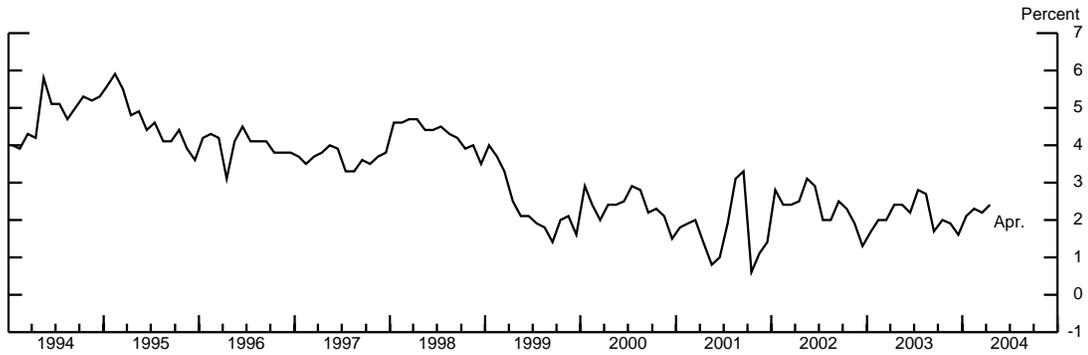
5. In its preliminary report on first-quarter GDP, the BEA revised up its estimate of the saving rate 0.2 percentage point in 2003:Q4 and 0.3 percentage point in 2004:Q1 because of upward revisions to wages and salaries.

Household Indicators

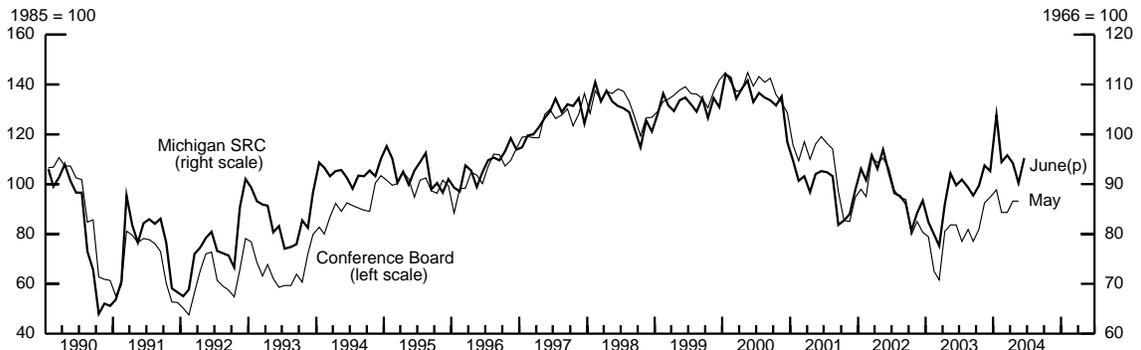
Household Net Worth and Wilshire 5000



Personal Saving Rate



Consumer Confidence



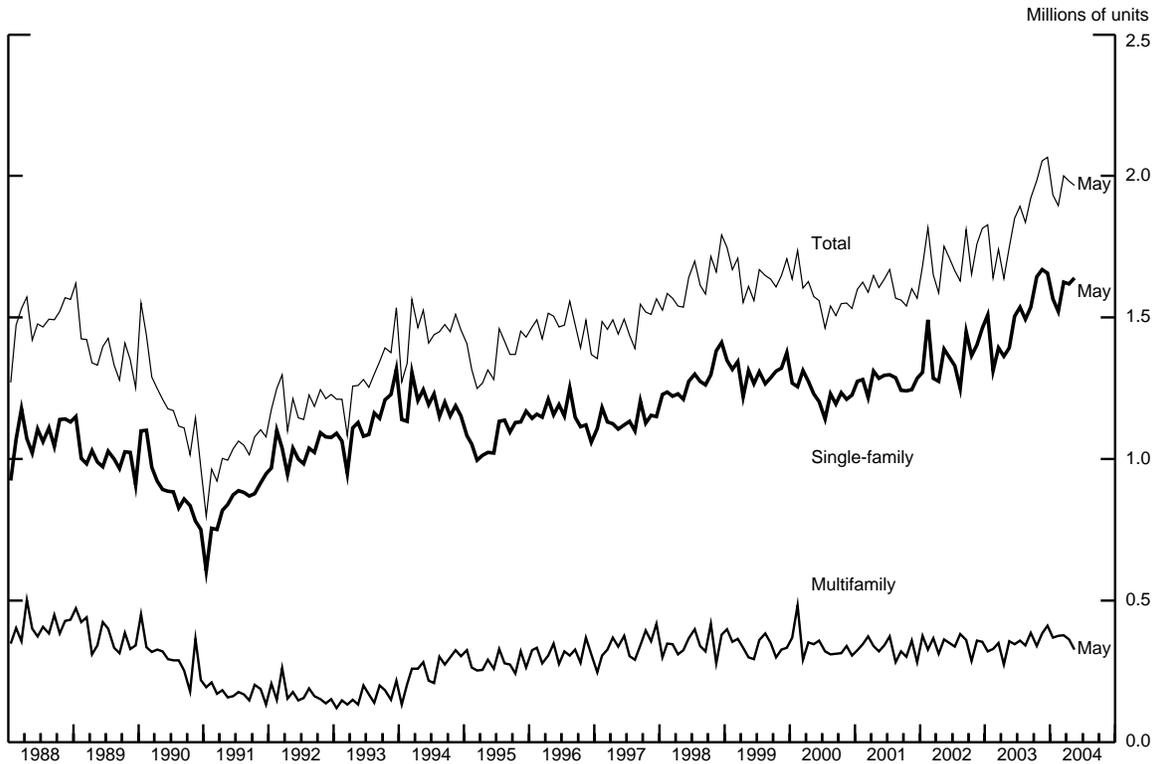
p Preliminary.

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

| Sector | 2003 | 2003 | | 2004 | | | |
|-------------------------------|------|------|------|------|------|------|------|
| | | Q3 | Q4 | Q1 | Mar. | Apr. | May |
| <i>All units</i> | | | | | | | |
| Starts | 1.85 | 1.88 | 2.04 | 1.94 | 2.00 | 1.98 | 1.97 |
| Permits | 1.86 | 1.93 | 1.97 | 1.93 | 1.98 | 2.01 | 2.08 |
| <i>Single-family units</i> | | | | | | | |
| Starts | 1.50 | 1.52 | 1.66 | 1.57 | 1.62 | 1.62 | 1.64 |
| Permits | 1.44 | 1.51 | 1.54 | 1.52 | 1.55 | 1.54 | 1.59 |
| Adjusted permits ¹ | 1.50 | 1.55 | 1.60 | 1.55 | 1.59 | 1.57 | 1.62 |
| New home sales | 1.09 | 1.16 | 1.12 | 1.17 | 1.24 | 1.09 | n.a. |
| Existing home sales | 6.10 | 6.42 | 6.30 | 6.20 | 6.48 | 6.64 | n.a. |
| <i>Multifamily units</i> | | | | | | | |
| Starts | 0.35 | 0.36 | 0.38 | 0.37 | 0.38 | 0.36 | 0.33 |
| Permits | 0.42 | 0.42 | 0.44 | 0.42 | 0.42 | 0.46 | 0.49 |
| <i>Mobile homes</i> | | | | | | | |
| Shipments | 0.13 | 0.13 | 0.13 | 0.13 | 0.13 | 0.13 | n.a. |

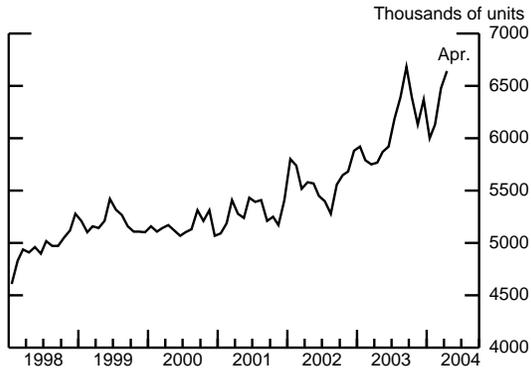
1. Adjusted permits equal permit issuance plus total starts outside of permit-issuing areas.
n.a. Not available.

Private Housing Starts
(Seasonally adjusted annual rate)



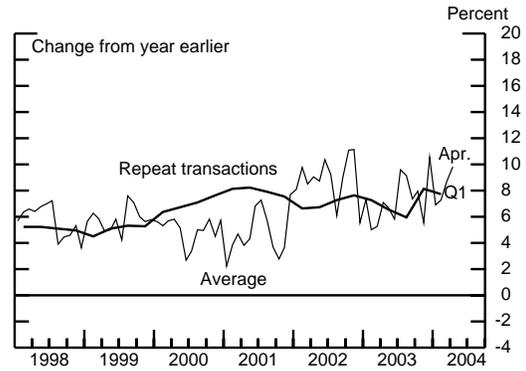
Indicators of Single-Family Housing

Existing Home Sales



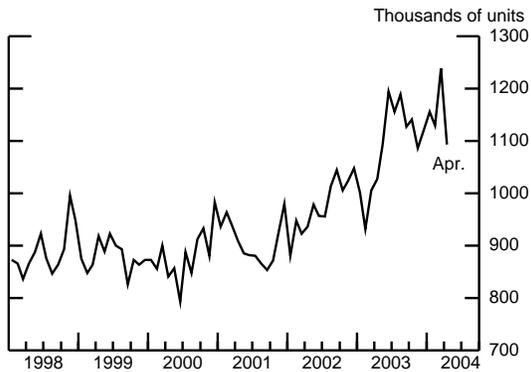
Source. National Association of Realtors.

Prices of Existing Homes



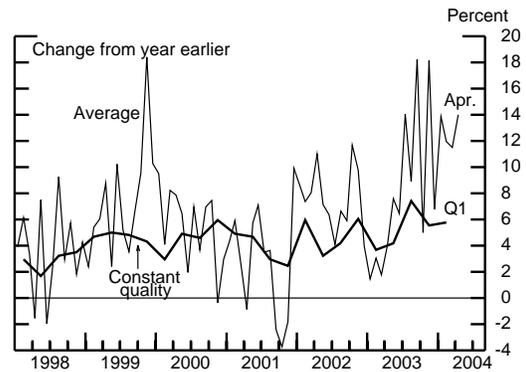
Source. National Association of Realtors and OFHEO.

New Home Sales



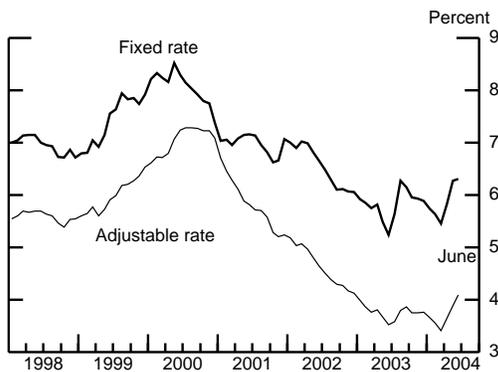
Source. Census Bureau.

Prices of New Homes



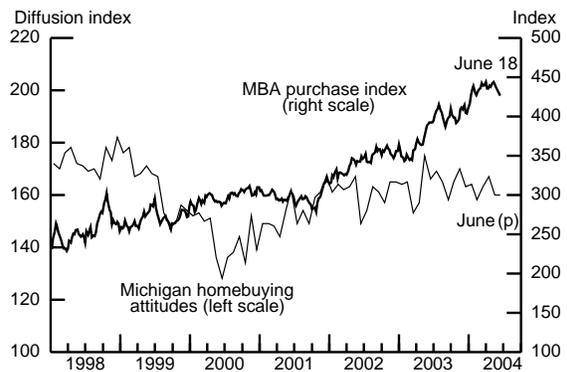
Source. Census Bureau.

Mortgage Rates



Note. The June reading is based on data through June 18.
Source. Freddie Mac.

Homebuying Indicators



Note. MBA index is a 4-week moving average. Michigan Survey data are not seasonally adjusted.
Source. Mortgage Bankers Association and Michigan Survey.

March; over the same period, the average rate for one-year adjustable-rate mortgages rose about 65 basis points. Housing activity normally lags changes in mortgage rates by one to two months. Moreover, the recent jump in rates may be prompting some shoppers to bring forward their purchases to avoid potentially higher rates later on.⁶ Nonetheless, the most recent data from the Mortgage Bankers Association—our most timely indicator of housing demand—show that purchase applications moved down a bit in the first half of June, which suggests that home-buying activity may ease this summer.

Equipment and Software

Real outlays for equipment and software rose at an annual rate of 10 percent in the first quarter and seem poised for a more rapid gain in the current quarter. Spending on transportation equipment, which dropped last quarter, appears likely to make a strong showing, and business expenditures on other equipment look to be advancing at the same brisk pace as observed over the past year. More generally, the current business environment is favorable for capital investment: Business output is rising, corporate coffers are flush with liquid assets, financing costs are low, and the looming expiration of the partial expensing tax provision gives firms an additional incentive to invest before the end of the year. Surveys of business leaders and anecdotes from our industry contacts also point to continued vigorous demand.

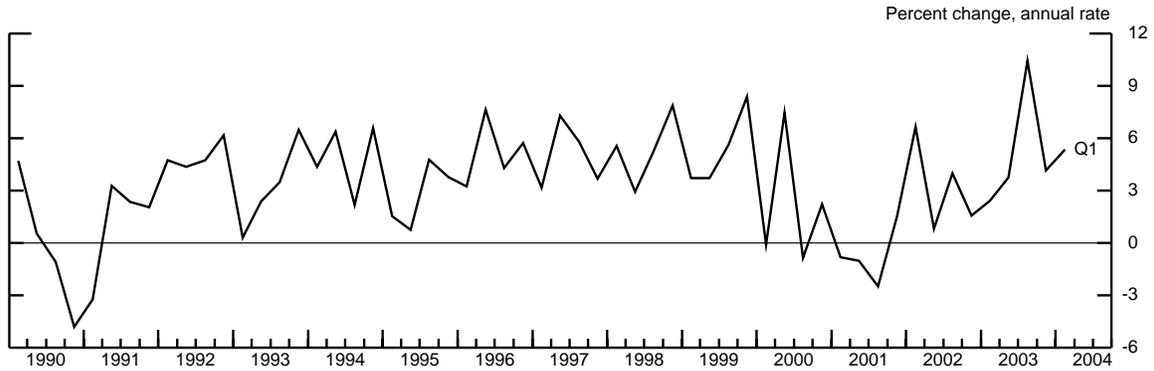
The recent orders and shipments data indicate that firms are investing in high-tech equipment at a rapid clip. In April, nominal shipments of computers and communications equipment jumped, and orders in both categories registered substantial increases. Favorable revenue guidance from major software vendors is also consistent with buoyant activity in the high-tech sector.

Business spending on motor vehicles and aircraft seems likely to rebound in the current quarter after dropping sharply in the first quarter. Sales of light vehicles to businesses appear to have moved up in the second quarter; this should offset a dip in sales of medium and heavy trucks in April and May that is itself likely to be temporary. Tight capacity in the transportation industry and accelerated depreciation schedules have stimulated a rise in orders for medium and heavy trucks to near record levels in April and May. Real outlays on aircraft slumped in the first quarter as airlines purchased fewer planes from foreign manufacturers, but April trade data point to a bounceback in imports for the current quarter. The increase in imports will likely more than offset a decline in domestic shipments.

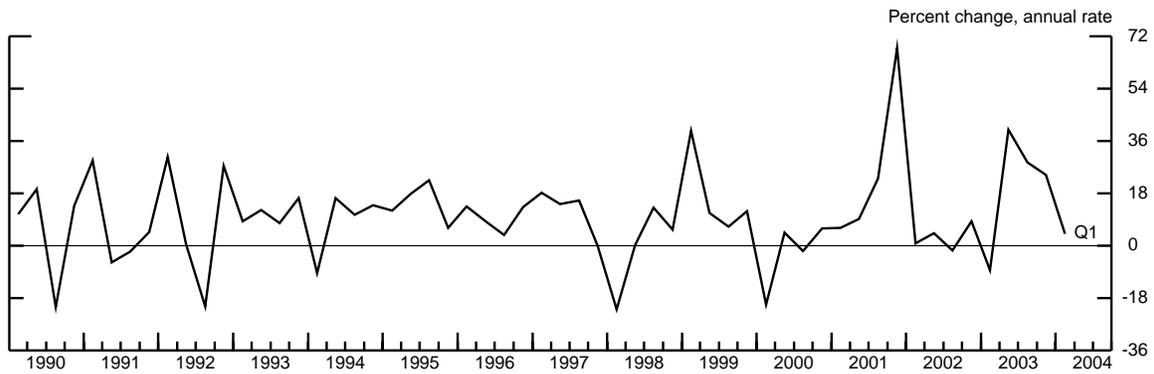
6. Many real estate practitioners think that an increase in mortgage rates that follows a long decline in rates spurs many “fence sitters” to jump into the market. While there is some evidence for a short-lived effect on the sale of existing homes, we cannot find a fence-sitter effect for the construction or sale of new homes.

Equipment and Software Investment Fundamentals

Real Business Output

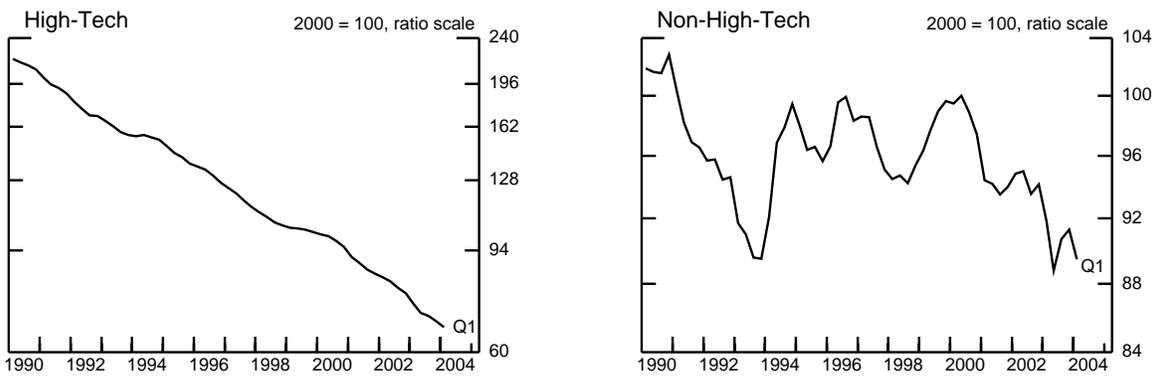


Real Corporate Cash Flow



User Cost of Capital

(Excludes the effects of the partial expensing tax incentive)



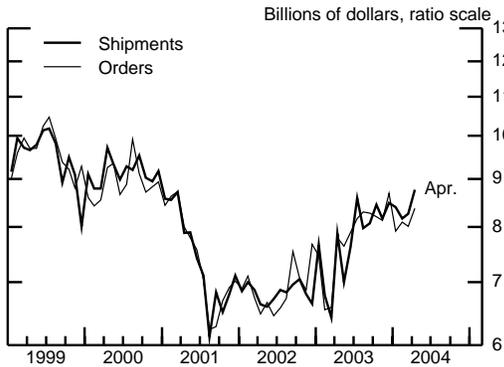
Orders and Shipments of Nondefense Capital Goods

(Percent change; seasonally adjusted current dollars)

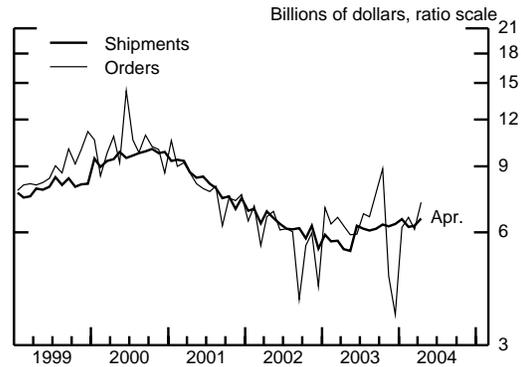
| Indicators | 2003 | 2004 | | | |
|--|-------------|-------|--------------|------|------|
| | Q4 | Q1 | Feb. | Mar. | Apr. |
| | Annual rate | | Monthly rate | | |
| Shipments | 11.2 | 10.5 | -3 | 3.4 | -.1 |
| Excluding aircraft | 12.2 | 12.1 | -1.7 | 3.6 | .5 |
| Computers and peripherals | 7.8 | -4.3 | -2.7 | 1.2 | 6.0 |
| Communications equipment | 11.3 | 2.6 | -4.6 | .7 | 4.5 |
| All other categories | 13.3 | 17.1 | -1.0 | 4.5 | -1.0 |
| Orders | 9.7 | 10.4 | 4.1 | 6.2 | -3.0 |
| Excluding aircraft | 10.2 | 15.8 | 2.3 | 6.2 | -3.8 |
| Computers and peripherals | 4.7 | -14.8 | 2.2 | -1.1 | 4.5 |
| Communications equipment | -56.0 | 48.3 | 6.4 | -7.1 | 18.1 |
| All other categories | 27.7 | 18.5 | 1.8 | 9.5 | -7.9 |
| Memo: Shipments of complete aircraft ¹ | 29.0 | 29.2 | 31.4 | 31.2 | 24.3 |

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

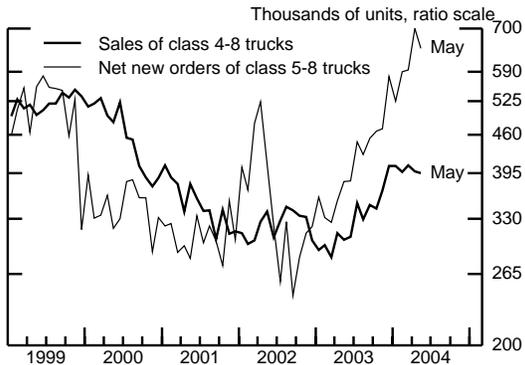
Computers and Peripherals



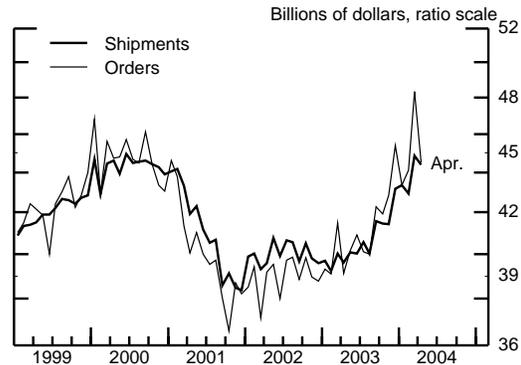
Communications Equipment



Medium and Heavy Trucks



Other Equipment



Note. Annual rate, FRB seasonals.

Source. Ward's Communications and ACT Research Co.

Business outlays on equipment excluding high-tech and transportation equipment appear strong. Although nominal shipments in this category slipped 1 percent in April, they posted a substantial 4-1/2 percent increase the previous month, and the April level stood well above the first-quarter average. Orders have been robust, and the backlog of unfilled orders has moved up.

Nonresidential Construction

Nominal business spending on nonresidential structures posted its third consecutive monthly increase in April but has yet to break out of the fairly narrow range it has occupied for about a year and a half. The recent performance of the major types of construction has been mixed. Nominal spending on office buildings and manufacturing structures fell in April, while outlays for commercial buildings—which include wholesale and retail establishments—communications structures, and various other types of buildings moved up.⁷

Other indicators of nonresidential construction also vary across sectors. Conditions in the office sector remain soft but show some signs of stabilizing. The office vacancy rate flattened out at a high level in the first quarter; rents continued to fall, albeit at a slower rate; and property values eked out modest increases. In the retail sector, low vacancy rates accompanied gains in rents and property values in the first quarter, but the rate of increase for property values moved off the lofty levels seen late last year. An increase in the number of natural gas drilling rigs in operation through early June suggests that spending on drilling and mining structures has likely risen in the past few months. In contrast, the vacancy rate for industrial space edged up further in the first quarter.

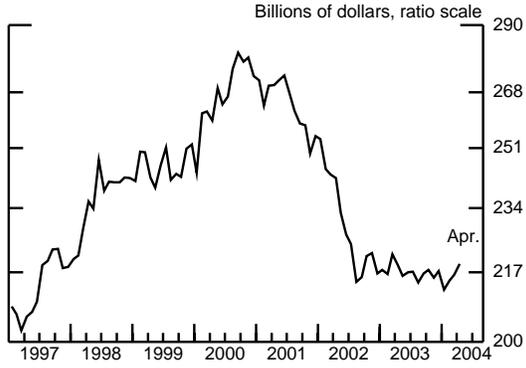
Business Inventories

The pace of inventory accumulation has remained modest. Although the book value of manufacturing and trade inventories rose at an annual rate of \$82 billion in the first quarter, more than half of that increase reflected rising inventory valuations. A large gap between book-value and real measures of inventory investment occurs when the prices of crude and manufactured goods swing rapidly; in this case, a jump in the price of oil and a run-up in the prices of intermediate materials explain the relatively large adjustment to the book-value data last quarter. In April, the book value of stocks of manufacturing and trade businesses rose at about the first-quarter pace, but we believe that most of this increase was also price related.

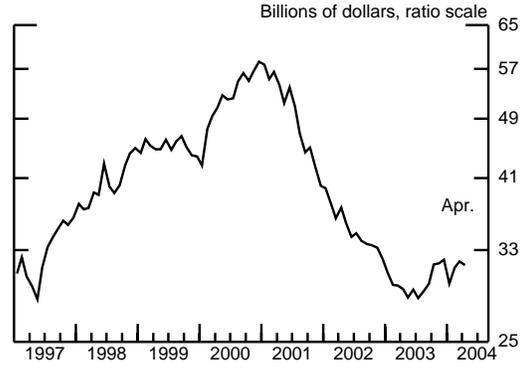
7. The “other” category includes buildings used for a variety of purposes such as religious, educational, lodging, amusement, recreation, transportation, and health care.

Nonresidential Construction

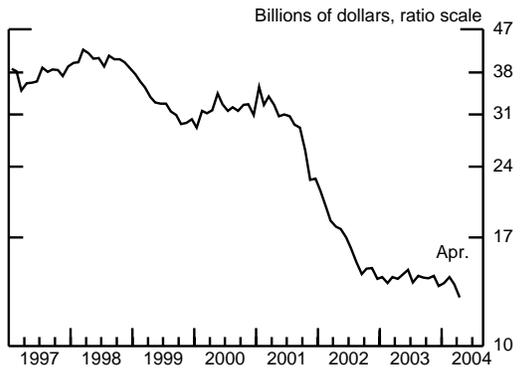
Total Structures



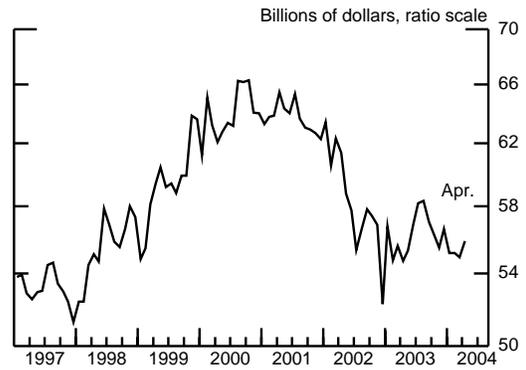
Office



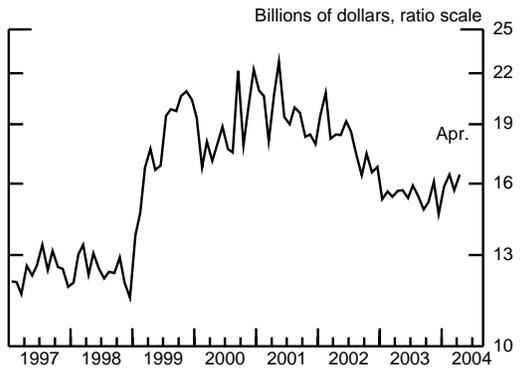
Manufacturing



Commercial



Communication



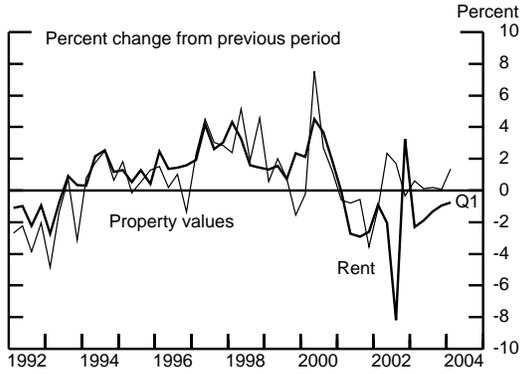
Other



Indicators of Nonresidential Construction

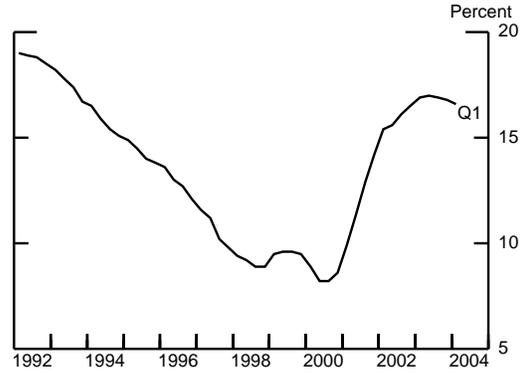
Office Buildings

Rent and Property Values



Source. National Real Estate Index.

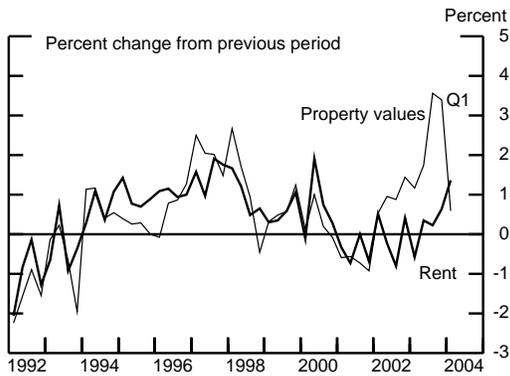
Vacancy Rate



Source. Torto Wheaton Research.

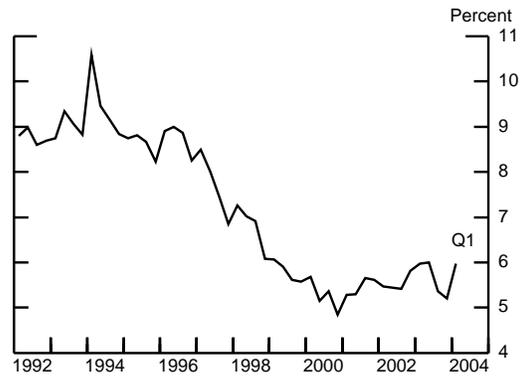
Retail Buildings

Retail Rent and Property Values



Source. National Real Estate Index.

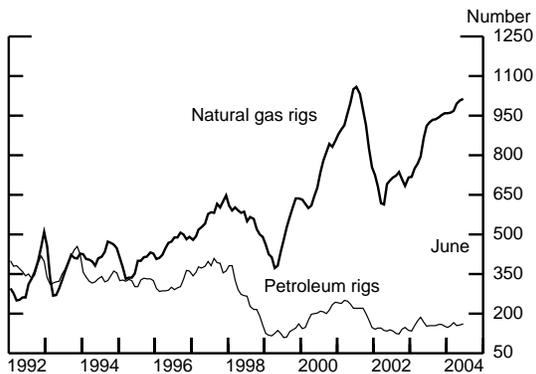
Vacancy Rate



Source. National Council of Real Estate Investment Fiduciaries.

Drilling Activity

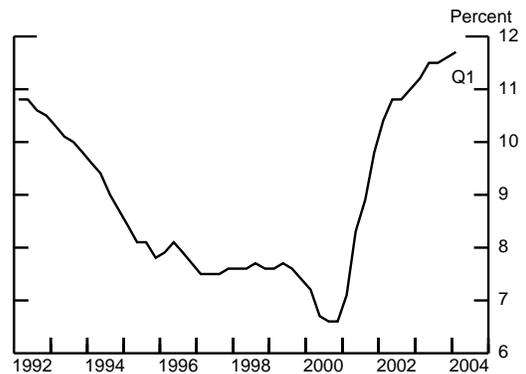
Rigs in Operation



Note. June values are averages through June 18.
Source. DOE/Baker Hughes.

Industrial Buildings

Vacancy Rate



Source. Torto Wheaton Research.

Non-auto inventory-sales ratios appear to be below their trend levels. In addition, the staff's flow-of-goods system, which measures inventories of various products wherever held, indicates that days' supply of all but a handful of goods are below trend. The ISM diffusion index of customers' inventories slipped further in May to its lowest level since the inception of the index in mid-1995; almost one-third of respondents to the survey indicated that they felt that their customers' stocks were too low, while only a handful felt that they were too high.

Federal Government

The budget outlook is a bit less gloomy than it was earlier this year because receipts appear to have firmed somewhat in recent months. The Congressional Budget Office stated that fiscal 2004 receipts may be \$30 billion to \$40 billion higher than it anticipated in March, while incoming data on outlays remain consistent with the earlier forecast.

Receipts in April and May were little changed from a year earlier. The revenue effects of last year's tax-cut legislation seem to have been offset by higher taxable incomes and an upside surprise in the average effective tax rate applied to those incomes.⁸ Corporate income tax receipts have been brisk so far this year, and daily data for June indicate another double-digit increase in payments this month.

Outlays, adjusted for payment timing shifts, rose 5-1/2 percent in April and May relative to a year earlier. Medicaid continued to post large year-over-year increases that reflect the temporary step-up in the federal matching rate enacted last year to funnel more money to the states. Payments should fall back in the third quarter when the increase in the matching rate expires. In contrast, year-over-year increases in defense spending slowed markedly.

The House passed the conference agreement of the Congressional Budget Resolution, but Senate action on this year's resolution appears unlikely. Appropriations committees in both houses are working with the conference agreement's fiscal 2005 discretionary cap of \$821 billion, which excludes any supplemental funding for Iraq and is consistent with the President's February budget proposal. In late May, the Administration requested \$25 billion in new budget authority for Iraq and stated that additional funds will be requested at a later date.

8. Specifically, we estimate that the effective tax rate, on a liability basis, fell from 10.7 percent in 2002 to 9.7 percent in 2003, less than the 1.3 percentage-point drop that would have been the result of the 2003 tax cut, all else being equal.

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

| Sector | 2003 | | 2004 | | | |
|---|-------|------|------|-------|-------|------|
| | Q3 | Q4 | Q1 | Feb. | Mar. | Apr. |
| Manufacturing and trade Ex. wholesale and retail motor vehicles and parts | -4.4 | 48.1 | 82.0 | 116.7 | 106.2 | 77.1 |
| Manufacturing Ex. aircraft | -17.5 | 1.2 | 24.0 | 33.2 | 21.4 | 19.7 |
| Wholesale trade Motor vehicles and parts Ex. motor vehicles and parts | 6.1 | 16.7 | 23.5 | 44.4 | 19.2 | -1.9 |
| Retail trade Motor vehicles and parts Ex. motor vehicles and parts | -4.2 | 6.2 | 3.2 | 5.1 | 3.5 | -3.1 |
| | 10.3 | 10.5 | 20.3 | 39.2 | 15.7 | 1.3 |
| | 7.0 | 30.2 | 34.5 | 39.1 | 65.7 | 59.3 |
| | -4.7 | 16.9 | 23.1 | 25.3 | 40.4 | 38.8 |
| | 11.8 | 13.4 | 11.4 | 13.8 | 25.3 | 20.5 |

Book-Value Inventories Relative to Shipments and Sales

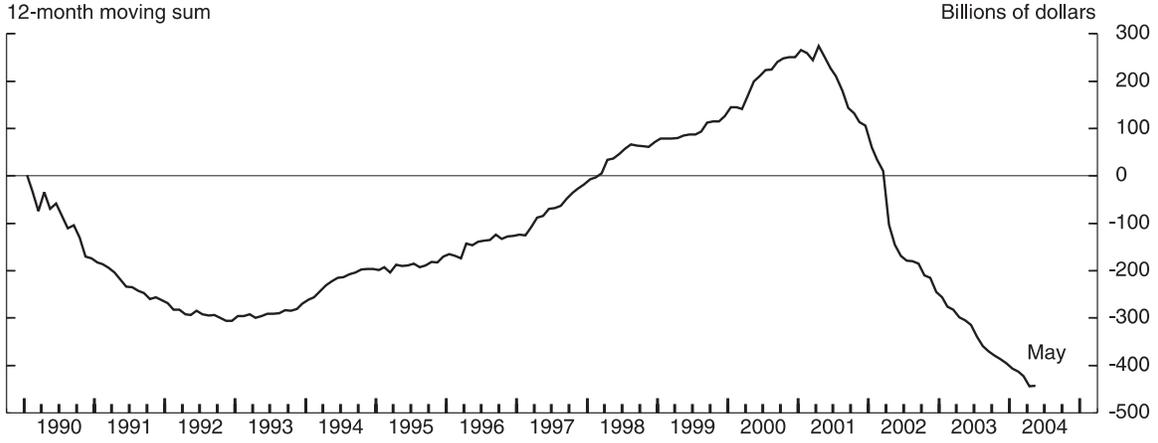


Inventory-Consumption Ratios, Flow-of-Goods System



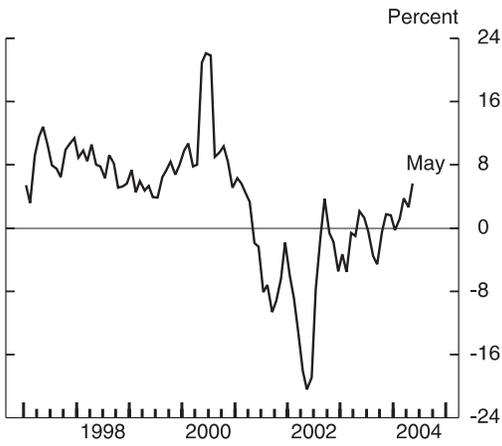
Federal Sector Developments
(Unified budget, adjusted for payment timing shifts)

Surplus or Deficit
12-month moving sum

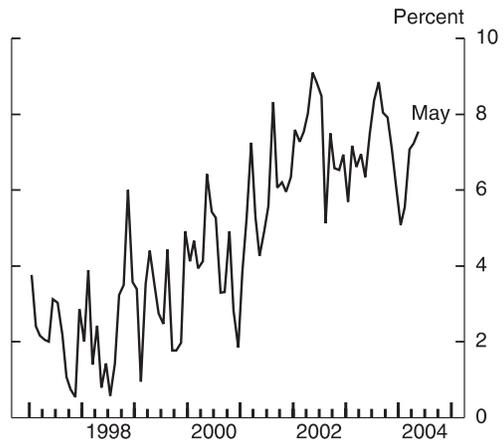


Selected Receipts and Outlays
(3-month moving average of 12-month percent change)

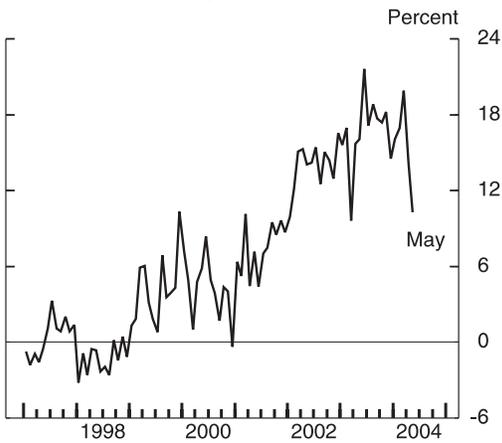
Receipts



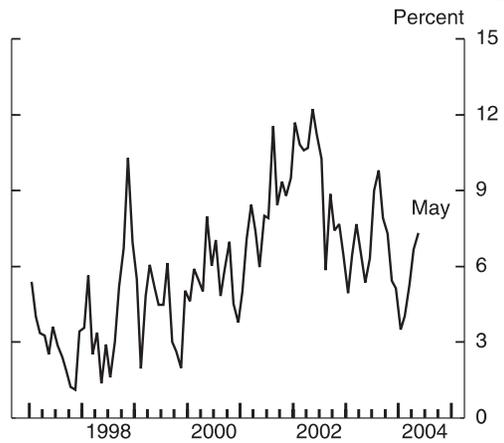
Outlays



Defense Spending



Non-Interest Outlays Ex. Defense Spending



Federal Government Outlays and Receipts

(Unified basis; billions of dollars except as noted)

| Function or source | April-May | | | 12 months ending in May | | |
|---|-----------|-------|----------------|-------------------------|--------|----------------|
| | 2003 | 2004 | Percent change | 2003 | 2004 | Percent change |
| Outlays | 372.4 | 380.4 | 2.2 | 2097.3 | 2236.0 | 6.6 |
| Financial transactions ¹ | -.6 | -.7 | ... | -1.9 | -2.2 | ... |
| Payment timing ² | 12.1 | .0 | ... | .6 | -12.4 | ... |
| Adjusted outlays | 360.9 | 381.1 | 5.6 | 2098.6 | 2250.6 | 7.2 |
| Receipts | 334.6 | 335.5 | .3 | 1794.0 | 1808.4 | .8 |
| Payment timing | .0 | .0 | ... | .0 | .0 | ... |
| Adjusted receipts | 334.6 | 335.5 | .3 | 1794.0 | 1808.4 | .8 |
| Surplus or deficit (-) | -37.8 | -44.8 | ... | -303.3 | -427.6 | ... |
| <i>Selected components of adjusted outlays and receipts</i> | | | | | | |
| Adjusted outlays | 360.9 | 381.1 | 5.6 | 2098.6 | 2250.6 | 7.2 |
| Net interest | 29.9 | 31.4 | 5.0 | 163.8 | 153.2 | -6.4 |
| Non-interest | 331.0 | 349.7 | 5.6 | 1934.8 | 2097.3 | 8.4 |
| National defense | 70.8 | 75.1 | 6.1 | 381.2 | 441.2 | 15.7 |
| Social security | 79.0 | 83.9 | 6.1 | 468.7 | 489.3 | 4.4 |
| Medicare | 42.6 | 44.5 | 4.5 | 243.4 | 259.4 | 6.6 |
| Medicaid | 26.9 | 29.6 | 9.9 | 154.1 | 172.9 | 12.2 |
| Income security | 56.6 | 54.4 | -4.0 | 331.0 | 339.0 | 2.4 |
| Agriculture | 1.7 | -1.4 | -183.6 | 22.8 | 18.5 | -18.8 |
| Other | 53.4 | 63.7 | 19.4 | 333.6 | 377.0 | 13.0 |
| Adjusted receipts | 334.6 | 335.5 | .3 | 1794.0 | 1808.4 | .8 |
| Individual income and payroll taxes | 271.1 | 262.7 | -3.1 | 1484.2 | 1455.8 | -1.9 |
| Withheld + FICA | 222.5 | 220.6 | -.9 | 1368.3 | 1373.8 | .4 |
| Nonwithheld + SECA | 123.9 | 119.4 | -3.6 | 296.2 | 284.0 | -4.1 |
| Less: Refunds | 75.3 | 77.3 | 2.7 | 180.2 | 202.1 | 12.1 |
| Corporate | 20.9 | 28.7 | 37.2 | 124.1 | 162.3 | 30.8 |
| Gross | 31.5 | 35.4 | 12.5 | 189.7 | 208.0 | 9.6 |
| Less: Refunds | 10.5 | 6.7 | -36.4 | 65.6 | 45.7 | -30.4 |
| Other | 42.5 | 44.1 | 3.8 | 185.7 | 190.3 | 2.5 |
| Adjusted surplus or deficit (-) | -26.3 | -45.6 | ... | -304.6 | -442.2 | ... |

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

1. Financial transactions consist of deposit insurance, spectrum auction 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.

The Senate passed a corporate tax bill that, among its 273 provisions, repeals the exclusion for extraterritorial income that was declared in violation of World Trade Organization rules. It also temporarily lowers the taxes paid on repatriated earnings and reduces the top effective tax rate to 32 percent on income derived from domestic production activities. It is roughly budget neutral. A similar bill passed by the House is not budget neutral, in large part because it also lowers corporate income taxes for nondomestic production activities (but not the top rate) and provides \$10 billion to tobacco growers. The Senate leadership hopes to have a conference agreement before the August recess, but the significant differences between the two bills may not be worked out by then.

State and Local Governments

Most information received from state and local governments in recent weeks continues to point to strengthening in the sector after three years of malaise. Employment rose, on average, during April and May, although the increase was below the gains recorded in the previous two quarters. Construction advanced strongly in March and April; outlays for highways, streets, and bridges were especially large.

With the fiscal year ending on June 30 in all but four states, most states have passed fiscal 2005 budgets. The number of states that have had to deal with budget shortfalls this year is smaller than in recent years, as are the projected gaps. Much of the good fiscal news reflects stronger revenue collections than originally forecast. Enacted and proposed strategies to patch prospective shortfalls are similar to those of recent years and include spending cuts (Michigan), tax hikes (Virginia, Alabama), and borrowing from reserve funds (Iowa) and from the market (New York).

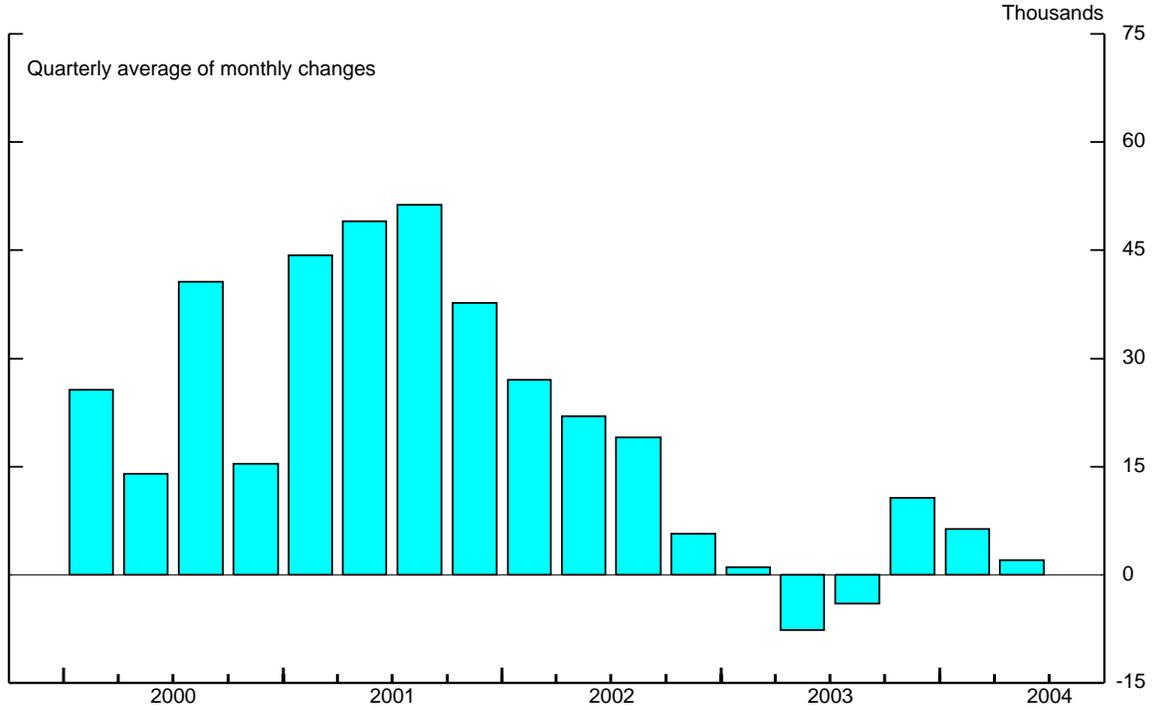
Prices and Labor Costs

Overall consumer price inflation has picked up this year, driven by a surge in energy prices and a rebound from unusually small increases in prices elsewhere. In May, energy prices registered another large increase, but core price inflation moderated. The twelve-month change in the consumer price index was 3.1 percent in May, 1 percentage point above the rate posted for the preceding twelve-month period.

After a pause in April, the CPI for energy rose 4.6 percent in May. As has been the case since the turn of the year, most of the surge in energy prices was driven by a rise in crude oil costs. But the markup of retail prices over crude costs also increased because of strong demand that has kept inventories relatively low and because of the costs of adjusting to some states' new requirements on reformulated gasoline. More recently, the available survey data for June show declines in retail gasoline prices that are roughly in line with the recent drop-off in crude oil prices.

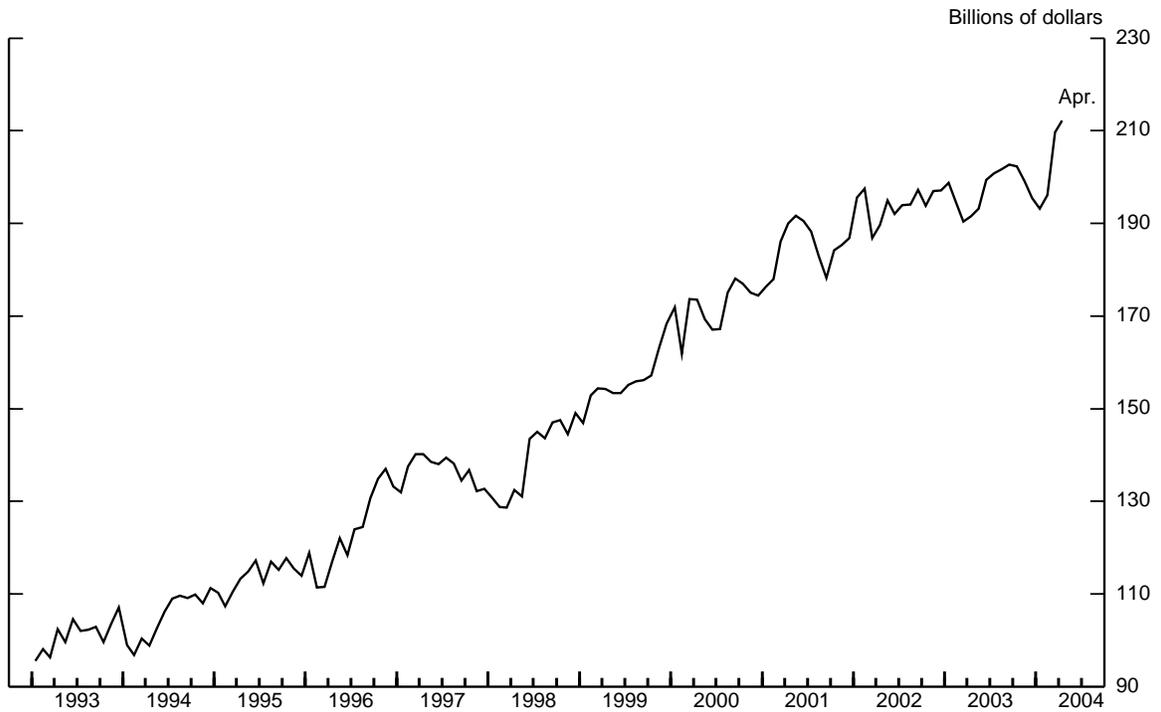
State and Local Employment and Construction

Employment



Note. 2004Q2 is the average of April and May.

Construction Put in Place



Consumer food prices jumped 0.9 percent in May, after having risen only 0.1 percent per month, on average, in the preceding four months. Increases were widespread but were particularly marked for dairy products and meats. Over the twelve months ending in May, the CPI for food rose 4.1 percent, the largest such increase since December 1996 and up considerably from the 1.7 percent rise posted in the previous twelve-month period. Aside from dairy products, where output has been constrained by herd reductions over the past few years, there have been no major disruptions in farm supplies. Because exports of livestock and poultry have been held back by health concerns, this price surge likely reflects strong domestic consumer demand.

Excluding food and energy, consumer prices increased 0.2 percentage point in May, a smaller increase than in the preceding two months. In particular, the rate of inflation for a wide range of services slowed last month. So far this year, the pace of core inflation has outstripped the rate in the second half of last year. In part, this acceleration is due to the pass-through of higher energy and import costs into core consumer prices, but it also likely reflects payback for unusually modest increases or outright price declines in several categories. The twelve-month change in the core CPI was 1.7 percent, 0.1 percentage point above the year-earlier increase.

The CPI data suggest that core PCE prices increased about 0.1 percent in May, bringing the twelve-month inflation rate by that measure to 1.4 percent, also just 0.1 percentage point above the rate observed a year earlier.⁹ Excluding the categories in which prices are not based on market transactions does not change the picture: Market-based core PCE inflation has risen roughly in line with the increase in both core CPI and core PCE inflation over the past year.

Despite a slight decline in commodity prices in the past several weeks, led by considerable drops in prices for steel scrap and plywood, most of the sharp run-up in commodities prices since 2002 remains in place. Since the end of April, the Journal of Commerce industrial commodities price index, which includes energy commodities, has fallen 5.3 percent, while the Commodities Research Bureau index of spot industrial prices, which excludes energy prices, is down 4.3 percent. Nonetheless, these indexes are up 25.5 percent and 17.4 percent, respectively, over the past year.

Core intermediate materials prices in the producer price index accelerated substantially in 2002 and 2003 and have continued to ascend in recent months.

9. The final report on first-quarter GDP—to be issued after Greenbook publication—will contain revisions to PCE prices. A potentially important source of revision will be the BEA's incorporation of the source data for imputed banking services, a volatile component of nonmarket PCE prices that can cause significant swings in core PCE prices.

Measures of Inflation
(Percent)

| Measures | 12-month change | | 3-month change | | 1-month change | |
|-----------------------------------|-----------------|-------------|----------------|-------------|----------------|-------------|
| | May 2003 | May 2004 | Annual rate | | Monthly rate | |
| | | | Feb. 2004 | May 2004 | Apr. 2004 | May 2004 |
| <i>CPI</i> | | | | | | |
| Total | 2.1 | 3.1 | 3.7 | 5.5 | .2 | .6 |
| Food | 1.7 | 4.1 | 2.7 | 5.1 | .2 | .9 |
| Energy | 9.0 | 15.0 | 30.1 | 29.7 | .1 | 4.6 |
| Ex. food and energy | 1.6 | 1.7 | 1.7 | 3.3 | .3 | .2 |
| Ex. tobacco | 1.6 | 1.8 | 1.6 | 3.4 | .3 | .2 |
| Core commodities | -1.9 | -1.1 | .3 | .9 | .0 | .1 |
| Core services | 3.0 | 2.9 | 2.1 | 4.3 | .4 | .2 |
| Chained CPI (n.s.a.) ¹ | 1.8 | 2.4 | ... | ... | ... | ... |
| Ex. food and energy ¹ | 1.3 | 1.2 | ... | ... | ... | ... |
| <i>PCE Prices</i> ² | | | | | | |
| Total | 1.7 | 2.4 | 3.2 | 3.6 | .1 | .5 |
| Food | 1.7 | 3.7 | 2.6 | 5.6 | .2 | .9 |
| Energy | 9.2 | 15.9 | 31.9 | 32.6 | .1 | 4.9 |
| Ex. food and energy | 1.3 | 1.4 | 1.8 | 1.6 | .1 | .1 |
| Ex. tobacco | 1.3 | 1.4 | 1.7 | 1.6 | .1 | .1 |
| Core commodities | -2.5 | -.5 | .3 | 1.0 | .0 | .0 |
| Core services | 2.9 | 2.1 | 2.4 | 1.9 | .2 | .2 |
| Core market-based | 1.3 | n.a. | 1.6 | n.a. | .2 | n.a. |
| Core non-market-based | 1.4 | n.a. | 2.4 | n.a. | -.1 | n.a. |
| <i>PPI</i> | | | | | | |
| Total finished goods | 2.5 | 5.0 | 3.6 | 8.5 | .7 | .8 |
| Food | 3.7 | 7.4 | -3.9 | 19.0 | 1.4 | 1.5 |
| Energy | 11.9 | 15.0 | 28.1 | 16.0 | 1.6 | 1.6 |
| Ex. food and energy | -.1 | 1.7 | .8 | 2.9 | .2 | .3 |
| Ex. tobacco | .3 | 1.7 | .8 | 3.2 | .2 | .4 |
| Core consumer goods | -.2 | 1.7 | .3 | 3.8 | .3 | .4 |
| Capital equipment | -.1 | 1.5 | 1.1 | 2.3 | .0 | .3 |
| Intermediate materials | 4.2 | 7.1 | 8.6 | 13.8 | 1.4 | 1.1 |
| Ex. food and energy | 2.3 | 5.1 | 7.1 | 11.2 | 1.1 | .9 |
| Crude materials | 19.1 | 21.9 | 35.9 | 29.0 | 3.0 | 2.8 |
| Ex. food and energy | 8.6 | 21.7 | 55.1 | -18.9 | -3.9 | -3.8 |

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

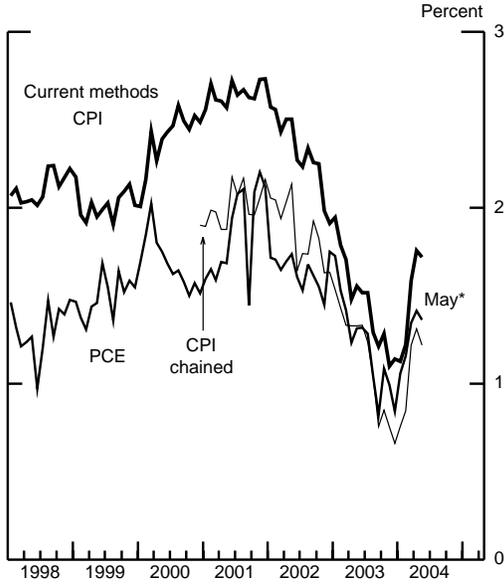
2. PCE prices in May are staff estimates.

... Not applicable.

n.a. Not available.

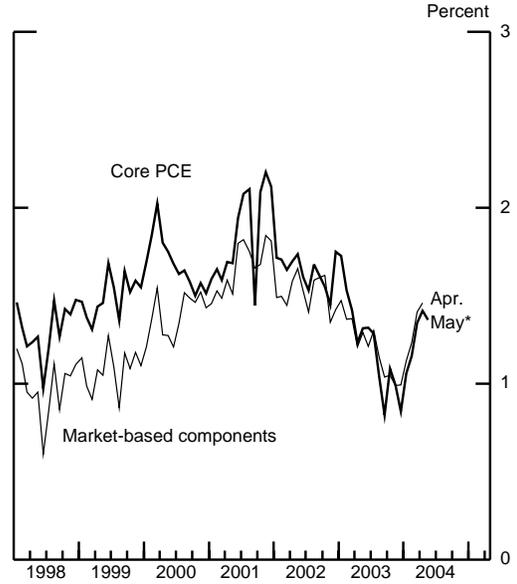
Core Consumer Price Inflation
(12-month change except where noted)

CPI and PCE excluding Food and Energy



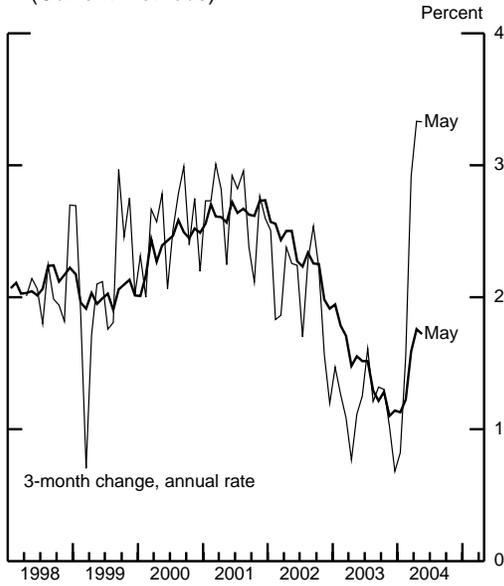
* PCE for May is a staff estimate.

PCE excluding Food and Energy

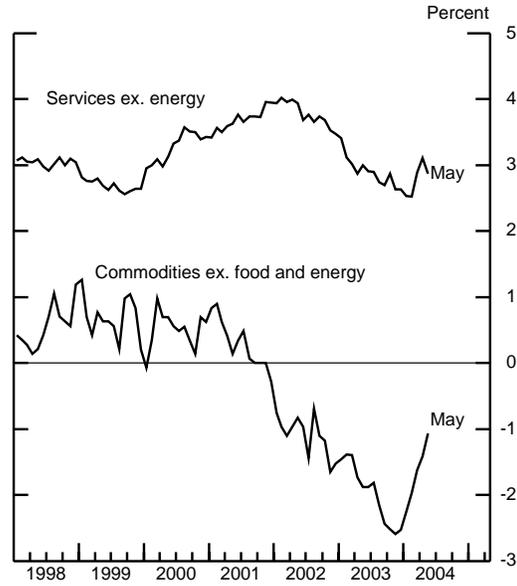


* Staff estimate.

CPI excluding Food and Energy
(Current Methods)



CPI Services and Commodities



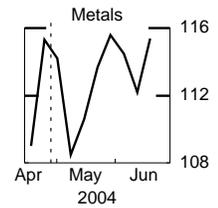
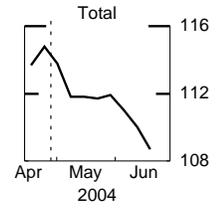
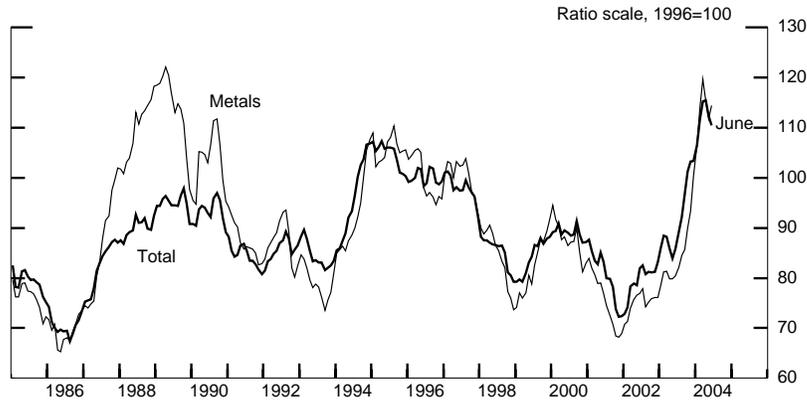
Spot Prices of Selected Commodities
(Percent change except as noted)

| Commodity | Current price (dollars) | 2002 ¹ | 2003 ¹ | 12/30/03 to 4/27/04 ² | 4/27/04 ² to 6/22/04 | Memo: 52-week change to 6/22/04 |
|-------------------------------------|-------------------------|-------------------|-------------------|----------------------------------|---------------------------------|---------------------------------|
| <i>Metals</i> | | | | | | |
| Copper (lb.) | 1.293 | 5.6 | 47.9 | 21.3 | -1.3 | 61.6 |
| Steel scrap (ton) | 165.000 | 49.2 | 66.8 | 27.3 | -19.9 | 55.7 |
| Aluminum, London (lb.) | .768 | 2.8 | 16.7 | 8.9 | -.9 | 21.8 |
| <i>Precious metals</i> | | | | | | |
| Gold (oz.) | 395.750 | 24.3 | 20.7 | -4.8 | -.1 | 13.6 |
| Silver (oz.) | 5.880 | 3.8 | 24.6 | 4.9 | -6.1 | 29.9 |
| <i>Forest products</i> ³ | | | | | | |
| Lumber (m. bdf.) | 418.000 | -8.9 | 44.5 | 47.1 | -1.6 | 57.1 |
| Plywood (m. sqft.) | 415.000 | .7 | 36.7 | 48.1 | -29.1 | 24.6 |
| <i>Petroleum</i> | | | | | | |
| Crude oil (barrel) | 34.620 | 66.9 | -7.4 | 15.9 | .8 | 29.5 |
| Gasoline (gal.) | 1.135 | 69.2 | 12.5 | 22.5 | -2.7 | 49.0 |
| Fuel oil (gal.) | 1.005 | 63.8 | 6.3 | 1.7 | 7.5 | 35.0 |
| <i>Livestock</i> | | | | | | |
| Steers (cwt.) | 86.320 | 16.5 | 4.1 | 11.9 | 2.9 | 17.3 |
| Hogs (cwt.) | 60.250 | -13.2 | 18.3 | 40.1 | 21.1 | 39.3 |
| Broilers (lb.) | .860 | 6.5 | 10.9 | 20.8 | 7.3 | 37.6 |
| <i>Farm crops</i> | | | | | | |
| Corn (bu.) | 2.575 | 18.1 | 1.7 | 25.9 | -12.4 | 8.2 |
| Wheat (bu.) | 3.958 | 37.7 | -2.1 | 2.1 | -4.6 | 21.8 |
| Soybeans (bu.) | 8.995 | 32.2 | 37.1 | 27.9 | -8.5 | 42.7 |
| Cotton (lb.) | .484 | 52.1 | 42.5 | -13.1 | -18.2 | -6.0 |
| <i>Other foodstuffs</i> | | | | | | |
| Coffee (lb.) | .640 | 1.1 | 23.1 | 14.1 | 2.4 | 40.7 |
| Memo: | | | | | | |
| JOC Industrials | 108.700 | 16.8 | 22.3 | 11.9 | -5.3 | 25.5 |
| JOC Metals | 115.400 | 9.7 | 38.1 | 10.1 | .1 | 44.4 |
| CRB Futures | 267.600 | 24.4 | 9.1 | 7.2 | -2.4 | 14.9 |
| CRB Spot Industrials | 303.480 | 13.7 | 24.0 | 2.9 | -4.3 | 17.4 |

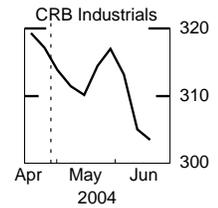
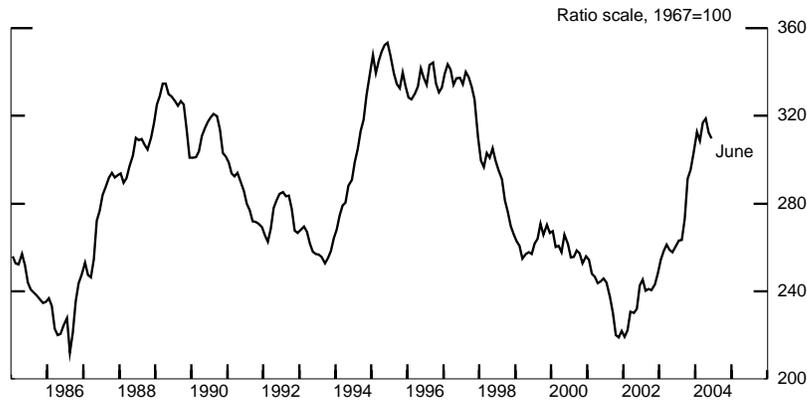
1. Changes are from the last week of the preceding year to the last week of the year indicated.
 2. April 27, 2004, is the Tuesday preceding publication of the April Greenbook.
 3. Prices shown apply to the Friday before the date indicated.

Commodity Price Measures

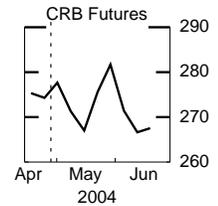
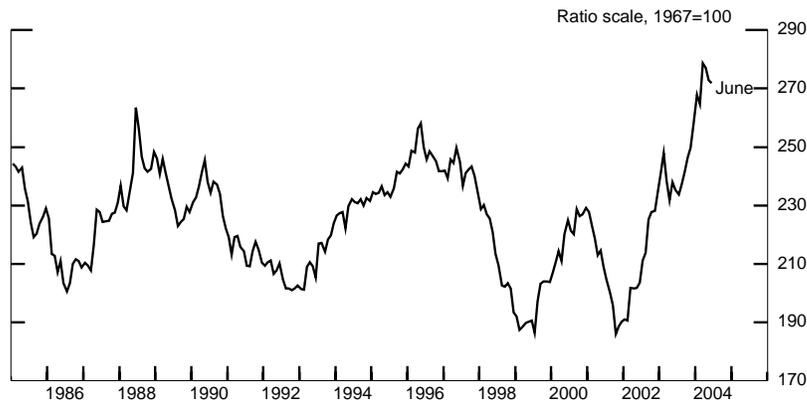
Journal of Commerce Index



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.

In May, core intermediate materials prices climbed 0.9 percent, marking the fifth consecutive month of outsized increases.

Short-run inflation expectations have edged higher in the past few months, perhaps because of the pickup in actual inflation. The median of year-ahead inflation expectations from the Michigan survey was 3.4 percent in the preliminary June release, up slightly from the figures reported in April and May and noticeably above the first-quarter average of 2.7 percent. Median long-run inflation expectations moved up in the first half of June to 3.0 percent, but, assuming this increase is sustained for the full month of June, the second-quarter average would still remain within the range observed over the past few years.

Compensation per hour in the nonfarm business sector is estimated to have increased at an annual rate of 4.6 percent last quarter, the same pace as in 2003. However, with moderate productivity increases in the past two quarters, unit labor costs have turned up. Although these data are fairly volatile and prone to large revisions, current data suggest that nonfarm business unit labor costs rose at an annual rate of 0.9 percent in the first quarter after having fallen 0.9 percent over the four quarters of 2003. In April and May, increases in average hourly earnings for production or nonsupervisory workers were a bit above the monthly gains posted in the first quarter and were well above the increase in the last quarter of 2003.

Broad Measures of Inflation
(Percent change, Q1 to Q1)

| Measure | 2001 | 2002 | 2003 | 2004 |
|--|------|------|------|------|
| <i>Product prices</i> | | | | |
| GDP chain price index | 2.2 | 1.9 | 1.7 | 1.7 |
| Less food and energy | 1.8 | 2.1 | 1.6 | 1.4 |
| Nonfarm business chain price index | 1.8 | 1.0 | 1.5 | 1.1 |
| <i>Expenditure prices</i> | | | | |
| Gross domestic purchases chain price index | 2.1 | 1.2 | 2.3 | 1.7 |
| Less food and energy | 1.7 | 1.8 | 1.6 | 1.5 |
| PCE chain price index | 2.2 | 1.0 | 2.4 | 1.6 |
| Less food and energy | 1.6 | 1.7 | 1.6 | 1.2 |
| PCE chain price index, market-based components | 2.2 | .7 | 2.4 | 1.7 |
| Less food and energy | 1.5 | 1.5 | 1.4 | 1.3 |
| CPI | 3.4 | 1.2 | 2.9 | 1.8 |
| Less food and energy | 2.7 | 2.5 | 1.8 | 1.3 |
| Chained CPI | 2.7 | .9 | 2.5 | 1.5 |
| Less food and energy | 2.0 | 2.0 | 1.4 | .9 |
| Median CPI | 3.3 | 3.8 | 2.7 | 1.9 |
| Trimmed mean CPI | 2.8 | 2.3 | 2.1 | 1.7 |

Surveys of Inflation Expectations
(Percent)

| Period | Actual CPI inflation ¹ | University of Michigan | | | | Professional forecasters (10-year) ⁴ |
|-----------|---|------------------------|--------|----------------------------|--------|---|
| | | 1 year ² | | 5 to 10 years ³ | | |
| | | Mean | Median | Mean | Median | |
| 2002: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 | 2.1 | 2.6 | 2.2 | 3.1 | 2.7 | 2.5 |
| Q3 | 2.2 | 2.8 | 2.3 | 3.1 | 2.7 | 2.5 |
| Q4 | 1.9 | 3.0 | 2.6 | 3.1 | 2.8 | 2.5 |
| 2004:Q1 | 1.8 | 3.1 | 2.7 | 3.4 | 2.9 | 2.5 |
| Q2 | n.a. | 4.0 | 3.3 | 3.3 | 2.8 | 2.5 |
| 2004:Jan. | 1.9 | 2.9 | 2.7 | 3.4 | 2.8 | ... |
| Feb. | 1.7 | 2.9 | 2.6 | 3.3 | 2.9 | ... |
| Mar. | 1.7 | 3.4 | 2.9 | 3.4 | 2.9 | 2.5 |
| Apr. | 2.3 | 4.0 | 3.2 | 3.2 | 2.7 | ... |
| May | 3.1 | 3.9 | 3.3 | 3.3 | 2.8 | ... |
| June | n.a. | 4.2 | 3.4 | 3.4 | 3.0 | 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 average, during the next twelve months?

3. Responses to the question: By about what percent per year do you expect prices to go up, on average, during the next five to ten years?

4. Quarterly CPI projections compiled by the Federal Reserve Bank of Philadelphia.

n.a. Not available.

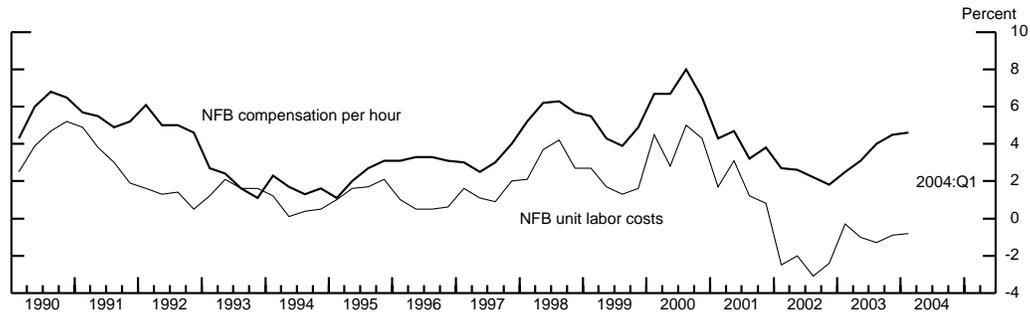
... Not applicable.

Hourly Compensation and Unit Labor Costs
(Percent change, annual rate; based on seasonally adjusted data)

| Category | 2002 ¹ | 2003 ¹ | 2003 | | | 2004 | 2003:Q1 to 2004:Q1 ² |
|--|-------------------|-------------------|------|------|-----|-----------------|---------------------------------------|
| | | | Q2 | Q3 | Q4 | Q1 ² | |
| Compensation per hour | | | | | | | |
| Nonfarm business | 1.8 | 4.5 | 4.9 | 4.7 | 4.2 | 4.6 | 4.6 |
| Nonfinancial corporations ³ | 2.2 | 4.6 | 5.7 | 4.9 | 3.9 | 5.1 | 4.9 |
| Unit labor costs | | | | | | | |
| Nonfarm business | -2.4 | -.9 | -1.3 | -4.3 | 1.7 | .9 | -.8 |
| Nonfinancial corporations ³ | -2.8 | -1.8 | -3.7 | -4.2 | -.4 | 2.6 | -1.4 |

1. Changes are from fourth quarter of preceding year to fourth quarter of year shown.
2. Staff estimate
3. The nonfinancial corporate sector includes all corporations doing business in the United States with the exception of banks, stock and commodity brokers, finance and insurance companies; the sector accounts for about two-thirds of business employment.

Compensation and Unit Labor Costs
(4-quarter change)



**Average Hourly Earnings of
Production or Nonsupervisory Workers**
(Percent change; seasonally adjusted data)

| Industry | 12-month change | | | 3-month change | | 1-month change | |
|-------------------------------------|-----------------|----------|----------|----------------|----------|----------------|----------|
| | May 2002 | May 2003 | May 2004 | Annual rate | | Monthly rate | |
| | | | | Feb. 2004 | May 2004 | Apr. 2004 | May 2004 |
| Total private nonfarm | 2.6 | 3.0 | 2.2 | 1.6 | 3.1 | .3 | .3 |
| Manufacturing | 3.7 | 3.0 | 2.5 | 2.5 | 2.0 | .4 | -.1 |
| Construction | 2.7 | 2.9 | 1.4 | 2.5 | .6 | .2 | .0 |
| Trade, transportation and utilities | 2.1 | 2.4 | 2.1 | 1.4 | 3.1 | .5 | .2 |
| Financial activities | 3.0 | 6.4 | 2.9 | .5 | 4.7 | .2 | .5 |
| Professional and business services | 2.4 | 3.4 | .9 | -.9 | 2.8 | .1 | .5 |
| Education and health services | 3.8 | 2.8 | 3.3 | 3.3 | 4.3 | .3 | .4 |
| Leisure and hospitality | 2.5 | 2.3 | 1.5 | 1.8 | .9 | -.1 | .2 |

Domestic Financial Developments

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

| Instrument | 2003 | | 2004 | | Change to June 22 from selected dates (percentage points) | | |
|---|---------|---------|-------|---------|---|--------------|------------|
| | June 24 | Dec. 31 | May 3 | June 22 | 2003 June 24 | 2003 Dec. 31 | 2004 May 3 |
| <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 | 0.99 | 1.30 | .49 | .37 | .31 |
| 6-month | 0.82 | 1.00 | 1.19 | 1.66 | .84 | .66 | .47 |
| Commercial paper (A1/P1 rates) ² | | | | | | | |
| 1-month | 0.95 | 1.00 | 1.02 | 1.18 | .23 | .18 | .16 |
| 3-month | 0.91 | 1.05 | 1.08 | 1.44 | .53 | .39 | .36 |
| Large negotiable CDs ¹ | | | | | | | |
| 1-month | 0.96 | 1.06 | 1.04 | 1.25 | .29 | .19 | .21 |
| 3-month | 0.93 | 1.09 | 1.11 | 1.50 | .57 | .41 | .39 |
| 6-month | 0.92 | 1.16 | 1.31 | 1.80 | .88 | .64 | .49 |
| Eurodollar deposits ³ | | | | | | | |
| 1-month | 0.94 | 1.04 | 1.03 | 1.24 | .30 | .20 | .21 |
| 3-month | 0.91 | 1.07 | 1.10 | 1.48 | .57 | .41 | .38 |
| 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 | 2.35 | 2.81 | 1.67 | .98 | .46 |
| 10-year | 3.46 | 4.40 | 4.68 | 4.87 | 1.41 | .47 | .19 |
| 30-year | 4.53 | 5.22 | 5.42 | 5.53 | 1.00 | .31 | .11 |
| U.S. Treasury 10-year indexed note | 1.70 | 2.00 | 2.09 | 2.15 | .45 | .15 | .06 |
| Municipal revenue (Bond Buyer) ⁵ | 4.89 | 5.04 | 5.28 | 5.40 | .51 | .36 | .12 |
| Private instruments | | | | | | | |
| 10-year swap | 3.67 | 4.66 | 4.97 | 5.20 | 1.53 | .54 | .23 |
| 10-year FNMA ⁶ | 3.84 | 4.72 | 5.00 | 5.25 | 1.41 | .53 | .25 |
| 10-year AA ⁷ | 4.13 | 5.05 | 5.33 | 5.56 | 1.43 | .51 | .23 |
| 10-year BBB ⁷ | 5.16 | 5.74 | 5.91 | 6.16 | 1.00 | .42 | .25 |
| 5-year high yield ⁷ | 8.95 | 7.94 | 8.04 | 8.34 | -.61 | .40 | .30 |
| Home mortgages (FHLMC survey rate) ⁸ | | | | | | | |
| 30-year fixed | 5.21 | 5.81 | 6.01 | 6.32 | 1.11 | .51 | .31 |
| 1-year adjustable | 3.51 | 3.73 | 3.75 | 4.13 | .62 | .40 | .38 |

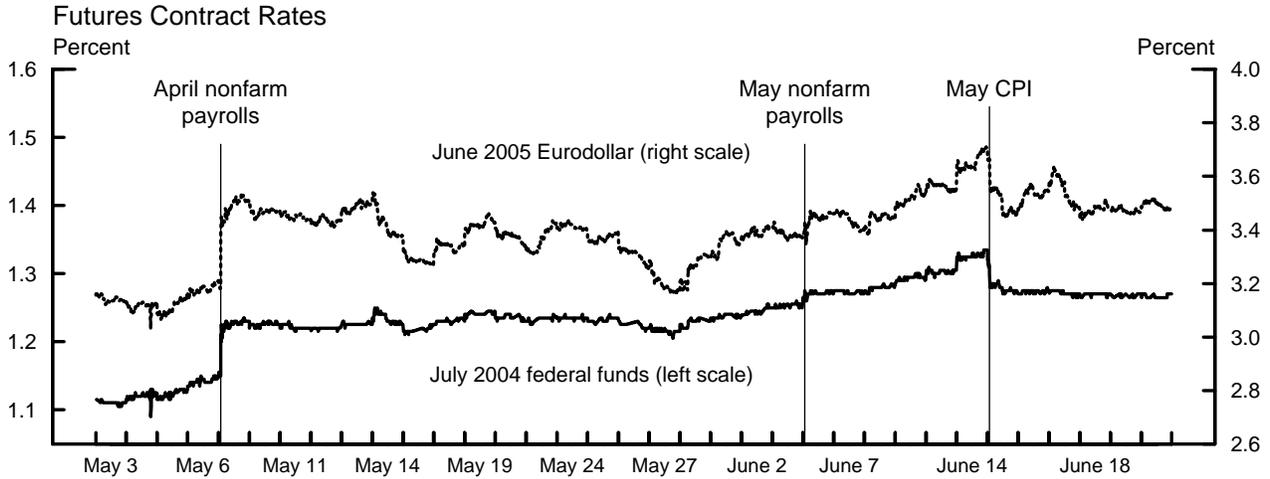
| Stock exchange index | Record high | | 2003 | 2004 | | Change to June 22 from selected dates (percent) | | |
|----------------------|-------------|---------|---------|--------|---------|---|--------------|------------|
| | Level | Date | Dec. 31 | May 3 | June 22 | Record high | 2003 Dec. 31 | 2004 May 3 |
| Dow-Jones Industrial | 11,723 | 1-14-00 | 10,454 | 10,314 | 10,395 | -11.33 | -.56 | .79 |
| S&P 500 Composite | 1,527 | 3-24-00 | 1,112 | 1,117 | 1,134 | -25.73 | 2.02 | 1.51 |
| Nasdaq | 5,049 | 3-10-00 | 2,003 | 1,939 | 1,994 | -60.50 | -.46 | 2.86 |
| Russell 2000 | 606 | 4-5-04 | 557 | 565 | 572 | -5.69 | 2.69 | 1.13 |
| Wilshire 5000 | 14,752 | 3-24-00 | 10,800 | 10,890 | 11,032 | -25.21 | 2.15 | 1.30 |

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.

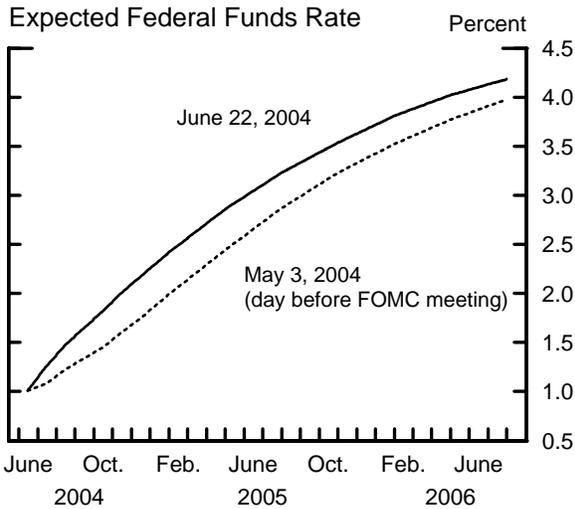
NOTES:

June 24, 2003, is the last day before the most recent policy easing.
May 3, 2004, is the day before the most recent FOMC meeting.

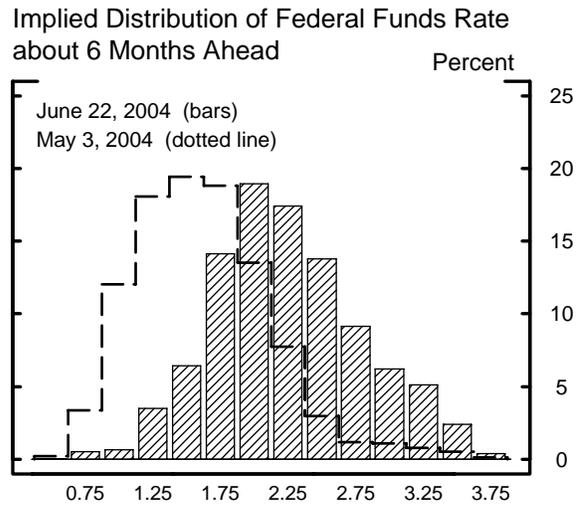
Policy Expectations and Treasury Yields



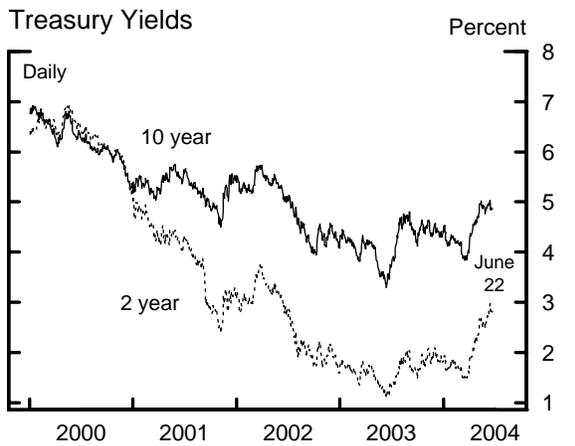
Note. 5-minute intervals.



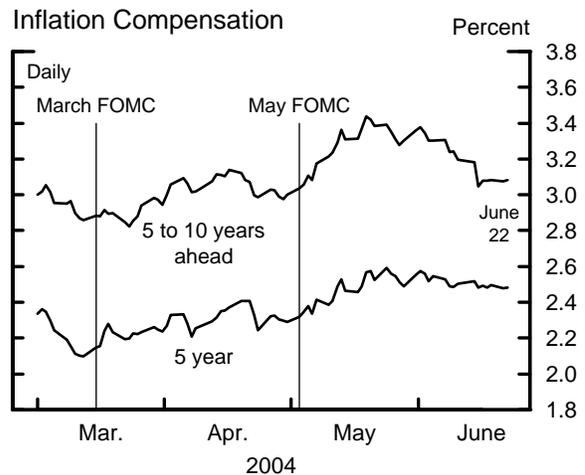
Note. Estimates from federal funds and Eurodollar futures, with an allowance for term premia and other adjustments.



Note. Based on the distribution of the 3-month Eurodollar rate 5 months ahead (adjusted for a risk premium), as implied by options on Eurodollar futures contracts.



Note. Off-the-run issues.



Note. Estimates based on smoothed nominal and inflation-indexed Treasury yield curves.

Domestic Financial Developments

Overview

Further signs of strengthening in economic activity, along with indications of a pickup in inflation pressures, prompted a significant upward revision in investors' expectations about the path of the federal funds rate. Market participants appear virtually certain of a quarter-point tightening at the upcoming meeting and anticipate roughly 200 basis points of cumulative policy firming over the next year. The upward revision to the anticipated path of policy drove up the two-year Treasury yield about 1/2 percentage point and the ten-year yield 20 basis points, producing a considerable flattening in the term structure. Readings based on nominal and inflation-indexed Treasury securities suggest that inflation compensation over the next five years moved up moderately but remained relatively well anchored over intervals beyond that horizon. Broad stock prices edged higher as an improved earnings outlook apparently offset the effects of the rise in longer-term yields.

Reflecting slowing mortgage refinancings, household debt growth appears to have moderated somewhat from the rapid first-quarter pace. Borrowing by nonfinancial corporations has remained light as firms have continued to fund spending with strong profits and sizable holdings of cash.

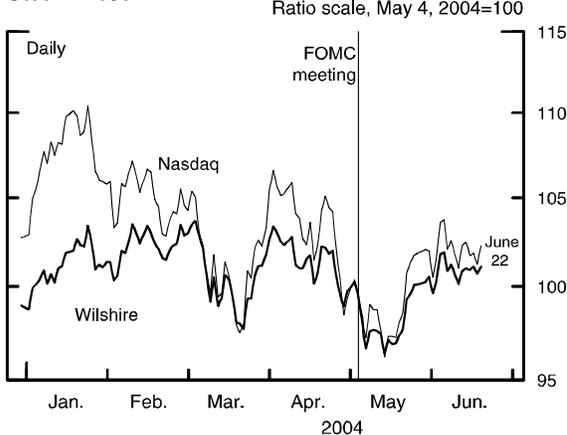
Policy Expectations and Treasury Yields

The unexpectedly strong gains in nonfarm payrolls in April, reported a few days after the May FOMC meeting, caused investors to move forward the expected date of the onset of policy tightening to the June meeting, a view that was cemented by the subsequent employment release. Investors also seemed especially attuned to inflation data and to statements by Federal Reserve policymakers for information on the pace and ultimate extent of tightening. On balance, federal funds and Eurodollar futures rates moved up 25 to 45 basis points over the intermeeting period. Judging from options prices, investors see a 25 basis point policy tightening as almost certain at the upcoming meeting. In recent surveys, the preponderance of respondents anticipate that the FOMC will view risks to the outlook for both economic growth and inflation as balanced and that the FOMC will retain the "measured pace" language—or some variant thereof—in the announcement following the June meeting. Futures quotes further out moved higher and suggest that market participants expect a series of tightenings that would put the federal funds rate at about 3 percent by the middle of next year, although the distribution of likely outcomes is fairly wide.

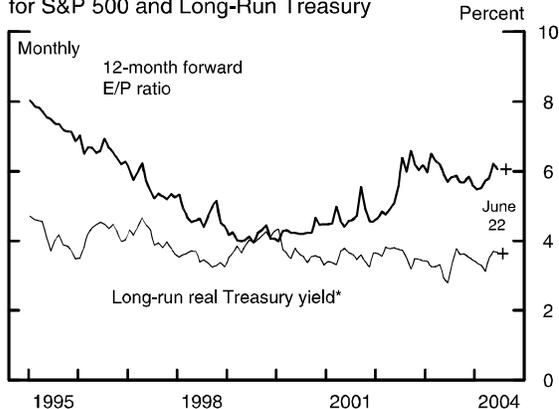
Upward revisions to the expected policy path showed through to Treasury yields. On balance, yields on two- and ten-year nominal Treasury securities increased about 45 and 20 basis points, respectively, over the intermeeting period. Inflation compensation, as measured by the difference between nominal Treasury yields and their inflation-indexed counterparts, drifted higher in the

Stock Prices and Corporate Risk Spreads

Stock Prices

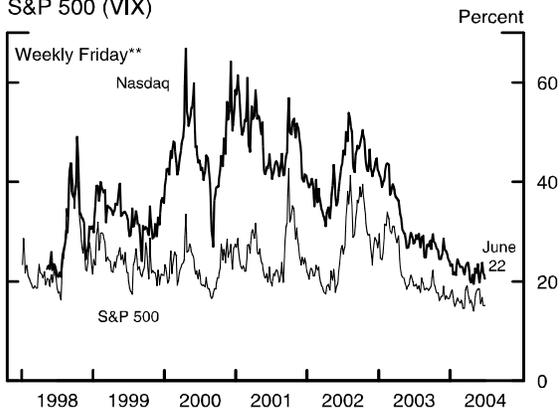


12-Month Forward Earnings-Price Ratio for S&P 500 and Long-Run Treasury



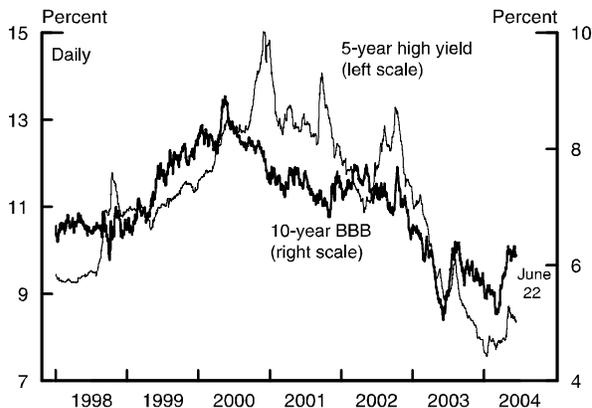
* Yield on synthetic Treasury perpetuity minus Philadelphia Fed 10-year expected inflation.
 + Denotes the latest observation using daily interest rates and stock prices and latest earnings data from I/B/E/S.

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

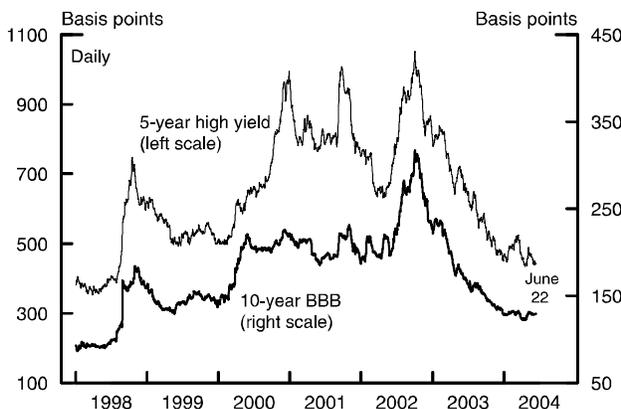


* Implied volatility calculated from one to four month options.
 ** Latest observation is for most recent business day.

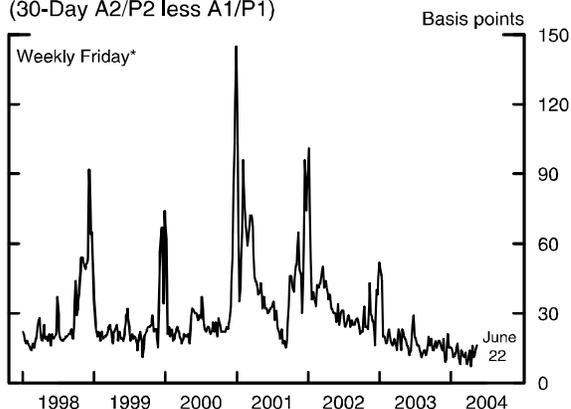
Corporate Bond Yields for BBB and High Yield Bonds



Corporate Bond Spreads to Similar Maturity Treasury



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



* Latest observation is for most recent business day.

first half of the intermeeting period, partly in response to stronger-than-expected incoming data and to record highs in oil prices. Some of this rise was reversed with the May CPI release and comments by FOMC members suggesting that the Committee would tighten policy as required to contain inflation pressures. On net, inflation compensation over the next five years rose about 15 basis points but ticked up only a bit over the following five-year period.

Stock Prices and Corporate Interest Rates

Broad stock price indexes edged up, on net, over the intermeeting period, as generally favorable news about the economy was largely offset by the influence of higher interest rates. Stock prices dipped in early May in response to the jump in interest rates and to heightened inflation fears triggered by the April labor market report and rising oil prices. Later in the period, stock prices reversed their earlier losses as oil prices receded and inflation fears eased somewhat.

The spread of the forward earnings-price ratio for the S&P 500 over a long-term real Treasury yield—a rough measure of the equity premium—was essentially unchanged over the intermeeting period. Implied volatilities of the S&P 500 and Nasdaq 100 remained quite low.

Yields of investment- and speculative-grade bonds rose about 25 to 30 basis points over the period and largely tracked the movements of comparable-maturity Treasuries. On net, risk spreads on corporate bonds edged up just a few basis points.

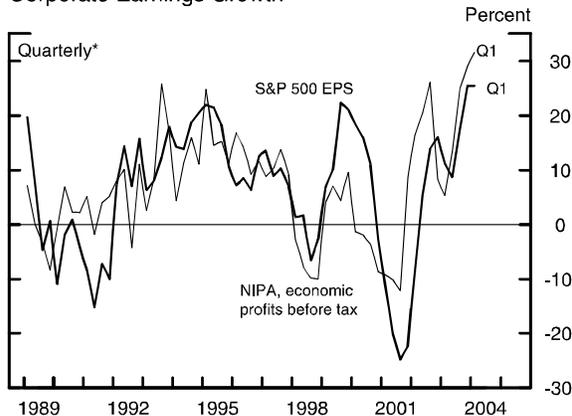
Corporate Earnings and Credit Quality

Analysts' earnings forecasts have been marked up on the heels of exceptionally strong first-quarter earnings reports. The revisions index for current and year-ahead earnings for the month ending in mid-May, most of which occurred before the May FOMC meeting, jumped to its highest level in more than two decades. Revisions were also positive through mid-June, although they were mostly concentrated among petroleum firms. Despite the positive revisions, analysts' forecasts of second-quarter earnings for S&P 500 firms appear conservative and suggest that another spell of upward revisions is in the offing.

Corporate credit quality remains solid. Nonfinancial corporations' short-term debt ratios remained low, and the ratio of interest-expense to cash flow dropped further in the first quarter. Bond upgrades in the current quarter, measured as the share of the par value of outstanding bonds, are on pace to exceed bond downgrades for the first time since 1998. C&I delinquency rates fell in the first quarter, and the bond default rate remained near zero in April and May.

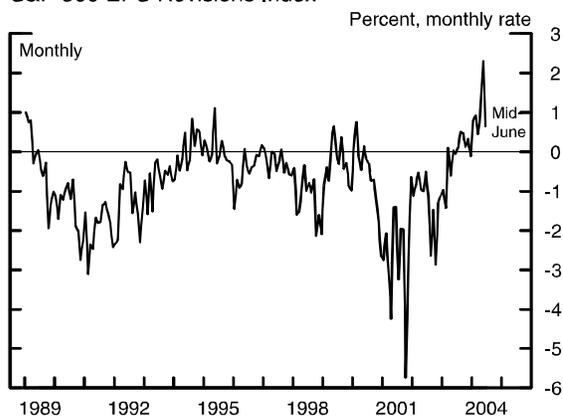
Corporate Earnings and Credit Quality

Corporate Earnings Growth



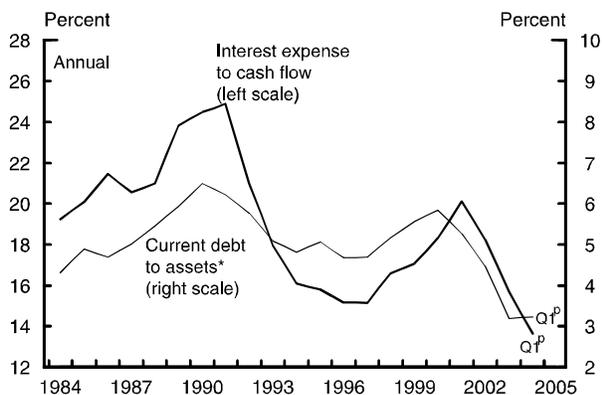
* Change from four quarters earlier.
Source: I/B/E/S for S&P 500 EPS.

S&P 500 EPS Revisions Index



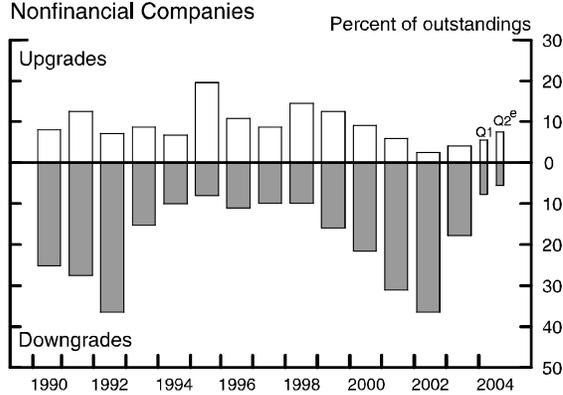
Note. Index is a weighted average of the percent change in the consensus forecasts of current-year and following-year EPS.

Financial Ratios



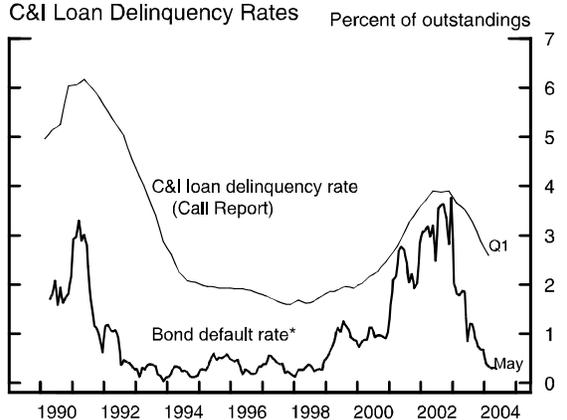
p Preliminary.
*Note. Current debt includes short-term notes and long-term debt due in one year.
Source: Compustat.

Bond Ratings Changes of Nonfinancial Companies



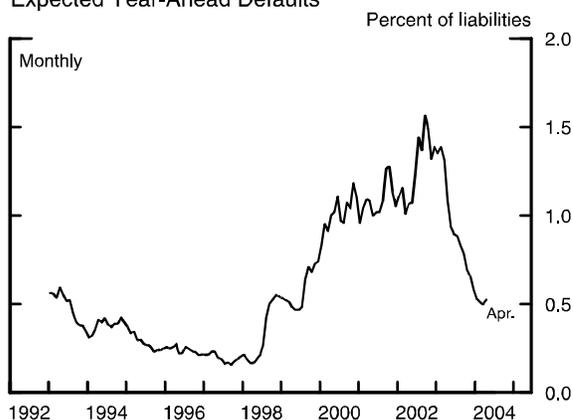
e. Estimate based on April and May.
Note. Data are at an annual rate.
Source: Moody's Investors Service.

Bond Default and C&I Loan Delinquency Rates



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

Expected Year-Ahead Defaults



Note. Firm-level estimates of default weighted by firm liabilities as a percent of total liabilities, excluding defaulted firms.
Source: KVM Corporation.

Business Finance

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

| Type of security | 2000 | 2001 | 2002 | 2003 | | 2004 | | |
|--|------|------|------|-------|-------|-------|-------|-------|
| | | | | H1 | H2 | Q1 | Apr. | May |
| <i>Nonfinancial corporations</i> | | | | | | | | |
| Stocks ¹ | 9.9 | 6.5 | 5.2 | 2.8 | 4.6 | 6.9 | 4.1 | 4.9 |
| Initial public offerings | 4.4 | 2.1 | 0.7 | 0.0 | 0.9 | 0.8 | 0.6 | 0.6 |
| Seasoned offerings | 5.5 | 4.4 | 4.4 | 2.8 | 3.7 | 6.0 | 3.6 | 4.3 |
| Bonds ² | 22.7 | 39.8 | 24.8 | 36.5 | 27.4 | 25.8 | 21.8 | 13.7 |
| Investment grade | 13.2 | 27.5 | 15.7 | 20.1 | 11.9 | 10.4 | 6.0 | 5.4 |
| Speculative grade | 4.7 | 8.9 | 4.8 | 11.5 | 11.1 | 12.3 | 10.8 | 5.0 |
| Other (sold abroad/unrated) | 4.9 | 3.4 | 4.2 | 4.9 | 4.5 | 3.0 | 5.0 | 3.3 |
| <i>Memo</i> | | | | | | | | |
| Net issuance of commercial paper ³ | 4.5 | -8.0 | -6.3 | -4.3 | -3.4 | 2.9 | 0.3 | 9.4 |
| Change in C&I loans at commercial banks ^{3,4} | 7.8 | -5.8 | -5.3 | -6.7 | -9.3 | -0.9 | 2.6 | -0.4 |
| <i>Financial corporations</i> | | | | | | | | |
| Stocks ¹ | 1.4 | 4.2 | 4.0 | 6.0 | 7.8 | 10.9 | 5.7 | 6.3 |
| Bonds ² | 57.8 | 80.2 | 87.0 | 114.1 | 108.2 | 128.5 | 107.0 | 118.0 |

Note. Components may not sum to totals due to rounding.

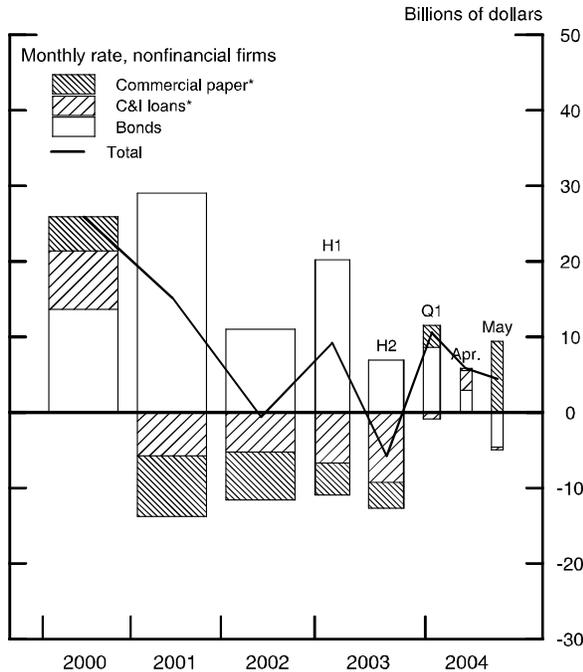
1. Excludes private placements and equity-for-equity swaps that occur in restructurings.

2. Data include regular and 144a private placements. Bond totals reflect gross proceeds rather than par value of original discount bonds. Bonds are categorized according to Moody's bond ratings, or to Standard & Poor's if unrated by Moody's.

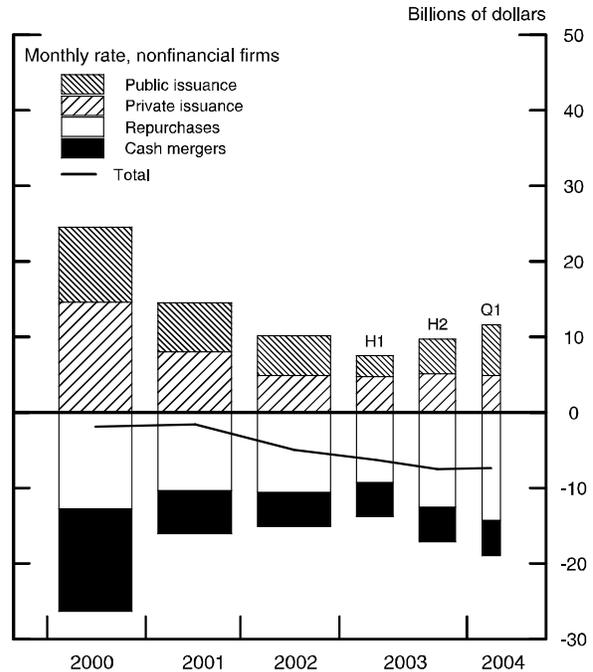
3. End-of-period basis, seasonally adjusted.

4. Adjusted for FIN 46 effects.

Selected Components of Net Debt Financing



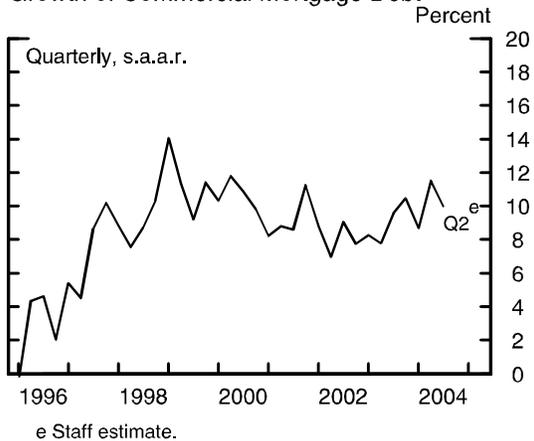
Components of Net Equity Issuance



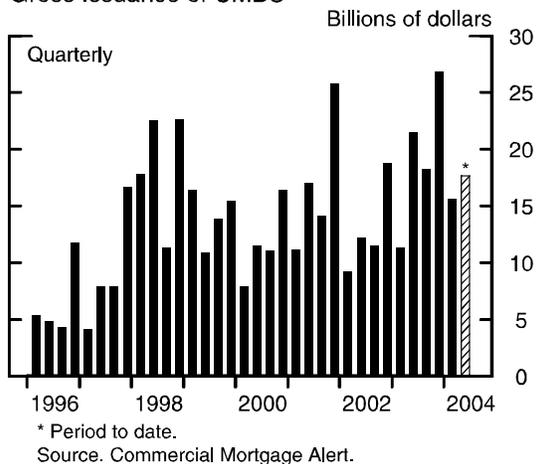
* Seasonally adjusted, period-end basis.

Commercial Real Estate

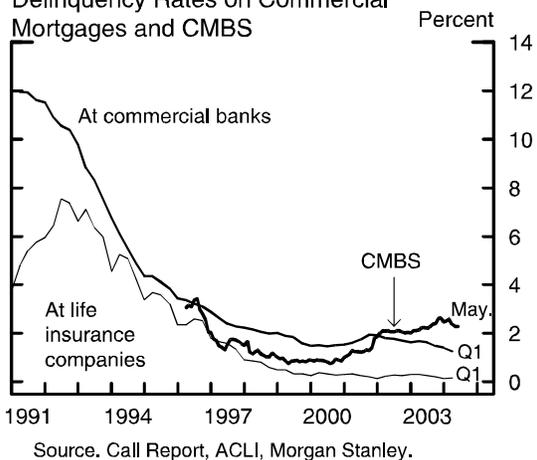
Growth of Commercial Mortgage Debt



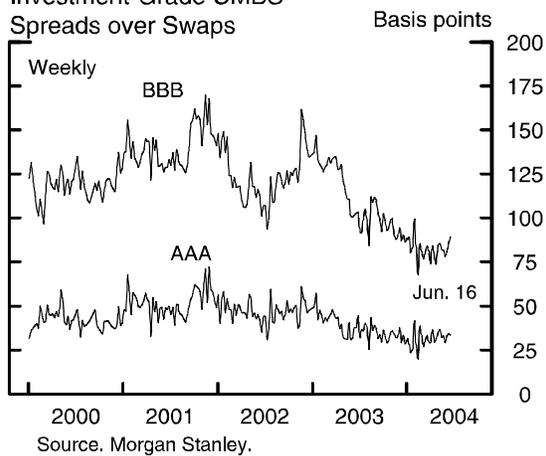
Gross Issuance of CMBS



Delinquency Rates on Commercial Mortgages and CMBS



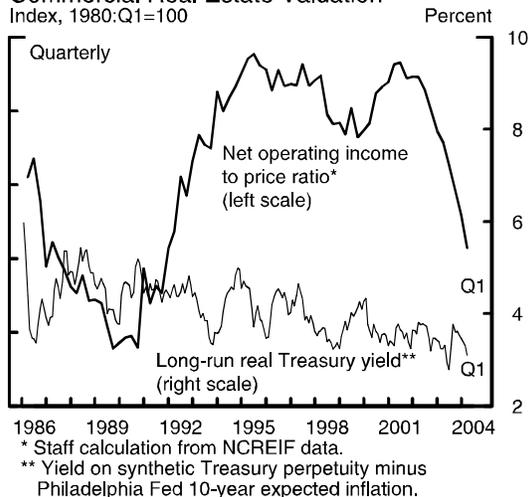
Investment-Grade CMBS Spreads over Swaps



REIT Equity Price Index



Commercial Real Estate Valuation



KMV's expected year-ahead default rate has hovered at about its four-year low in recent months, indicating that market-based measures of risk do not portend a decline in credit quality from the anticipated tightening of monetary policy. This outlook is consistent with the experience in the 1994 tightening episode, when the combination of higher interest rates and robust earnings had little net effect on credit performance. Indeed, bond rating changes and interest coverage ratios continued to improve following the rise in rates in 1994. More recently, firms that rely on floating rate debt, and thus are more vulnerable to rising rates, have tended to use derivatives to hedge their interest rate exposure.

Business Finance

Investment- and speculative-grade bond issuance was sluggish in May and has remained so in June, as higher interest rates have choked off the already dwindling flow of opportunistic issuance. With proceeds still being used to repay higher-rate debt, net bond issuance was negative in May and June. Short-term credit has continued the slow turnaround that began in the first quarter, with outstanding commercial paper and C&I loans combined increasing in May. Overall, nonfinancial corporate debt appears to have grown at a very subdued pace in recent weeks, as earnings have continued to outpace spending, and many firms remain flush with cash.

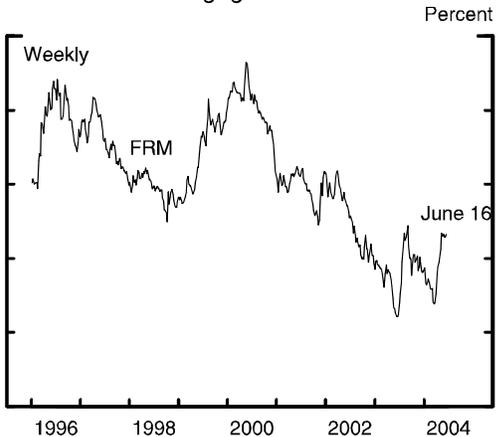
Gross equity issuance by nonfinancial firms remained muted in May and June. IPOs have continued to trickle out, but many have been priced under the initial filing range, reflecting weak demand. At the same time, share repurchases were likely bolstered again by strong profits, and announcements of leveraged buyouts and other cash-financed M&A deals have picked up. As a result, net equity issuance will likely remain substantially negative in the second quarter.

Commercial Real Estate

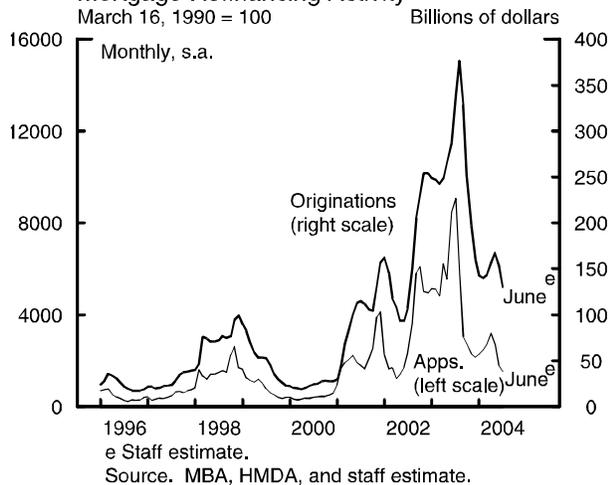
Commercial mortgage debt continued to expand at a rapid clip in the first quarter, and debt growth is estimated to have remained brisk in the current quarter. Delinquency rates on commercial mortgages held by banks and insurance companies are low and have been declining of late; CMBS delinquency rates through May have also edged down. CMBS spreads remain low. REIT equity prices moved up over the intermeeting period, reversing about half of the sharp decline registered in the previous intermeeting period. The ratio of net operating income to price—often called the "cap rate"—on commercial properties declined further in the first quarter to stand at a level last seen in the early 1990s. The spread of this ratio to the real perpetuity Treasury yield—an indicator of the risk premium on commercial real estate assets—has narrowed considerably recently but remains well above that seen in the late 1980s.

Household Liabilities

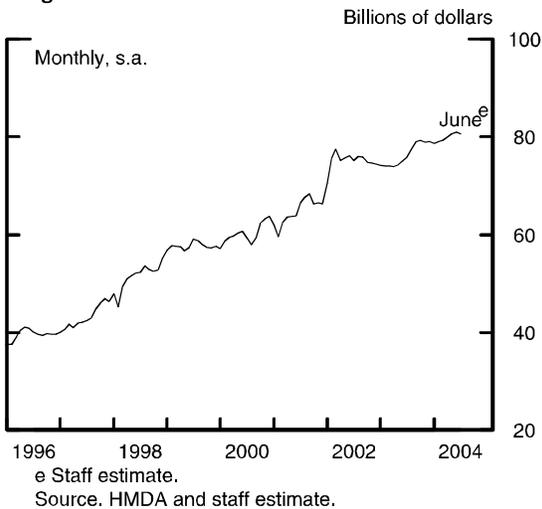
Freddie Mac Mortgage Rate



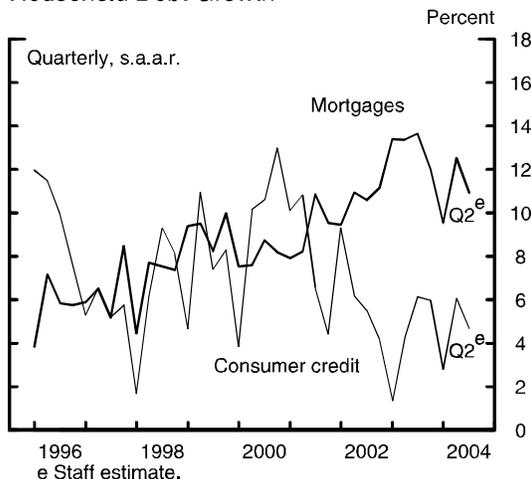
Mortgage Refinancing Activity



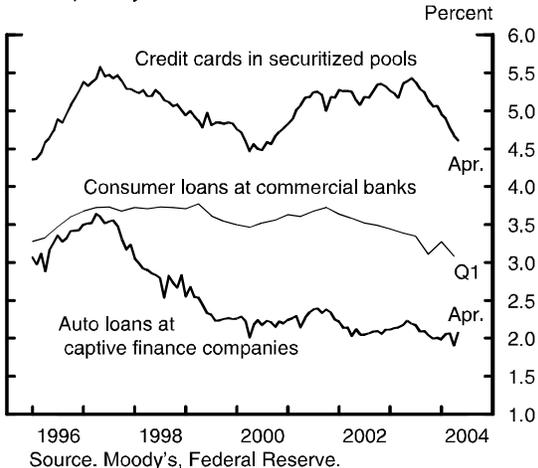
Originations for Home Purchases



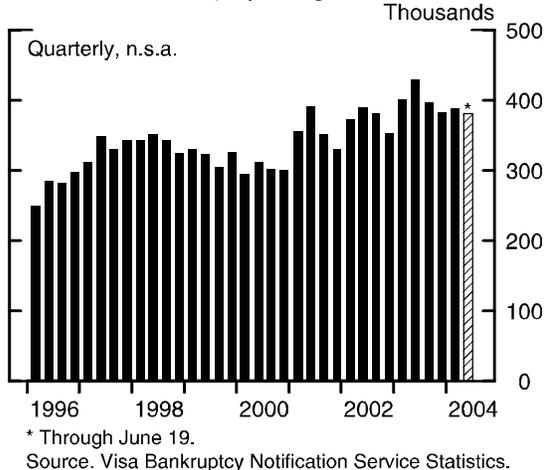
Household Debt Growth



Delinquency Rates



Household Bankruptcy Filings



* Through June 19.

Source. Visa Bankruptcy Notification Service Statistics.

Household Finance

Interest rates on thirty-year fixed-rate mortgages have risen about 85 basis points from the lows reached in the first quarter and have dampened refinancing activity. The further drop in refinancing applications this month indicates that refinancings will continue to moderate. At the same time, purchase originations have only edged off, suggesting that mortgage debt growth in the second quarter will not be far below the rapid 12-1/2 percent pace in the first quarter. Consumer credit expanded at a 6 percent rate in the first quarter and is expected to remain fairly brisk.

On balance, recent indicators suggest some improvement in household credit quality. Delinquency rates on consumer loans at commercial banks declined in the first quarter and those on securitized credit card pools fell again in April. Delinquencies on auto loans at captive finance companies ticked up in April but remain low by historical standards. In addition, estimated bankruptcy filings were lower in the second quarter from the same period last year.

The combination of flat stock prices and strong income growth in the current quarter suggests a slight decline in the ratio of net household worth to disposable income. Bond mutual funds registered outflows in May, and flows into equity mutual funds were slightly negative as well, as households apparently shifted funds into other savings instruments such as money market mutual funds. Data for the first half of June indicate that households moved out of money market mutual funds as inflows to equity funds were renewed and outflows from bond funds moderated.

State and Local Government Finance

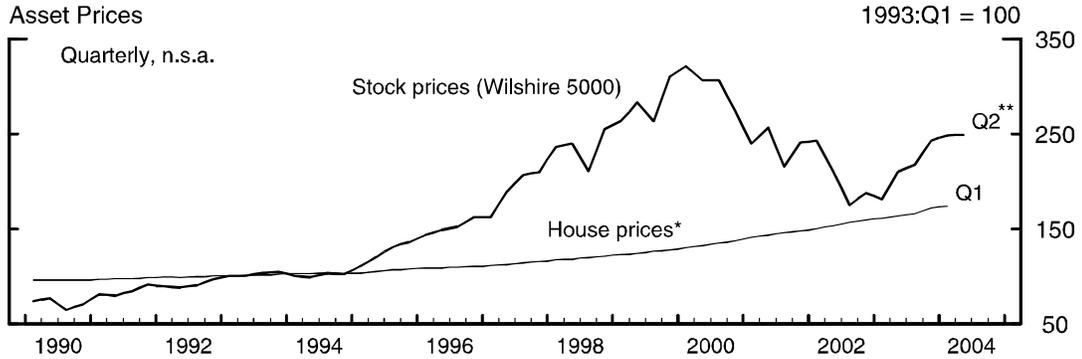
Gross municipal bond issuance remained rapid in May and in June to date, as states and municipalities continued to raise substantial amounts of funds for new capital projects. Although advance refundings were fairly strong in April and May, they remained well below the level in March, when interest rates were lower. Short-term issuance in recent months has been very light, consistent with reports of improved fiscal positions of states and municipalities.

Yield ratios on longer-term general obligations were unchanged over the intermeeting period and remain somewhat elevated. Revenue bond spreads ticked down, and municipal bond upgrades have continued to outpace downgrades since early February.

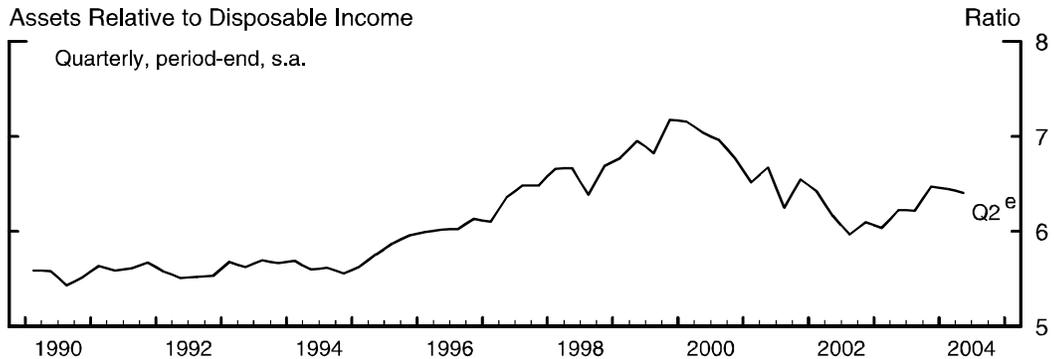
Treasury and Agency Finance

The Treasury borrowed less in the first quarter than it had projected earlier, and it revised down its estimated borrowing needs for the second quarter in response to higher-than-expected tax receipts. Treasury auctions over the intermeeting

Household Assets



* Source. Office of Federal Housing Enterprise Oversight (OFHEO).
** As of June 22.



^e Staff estimate.

Net Flows into Long-Term Mutual Funds

(Billions of dollars, monthly rate)

| Fund Type | 2001 | 2002 | 2003 | | 2004 | | | Assets Apr |
|------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|------------------|---------------|
| | | | H1 | H2 | Q1 | Apr | May ^e | |
| Total long-term funds | 10.8 | 10.1 | 19.2 | 16.9 | 36.5 | 20.1 | -12.9 | 5,514 |
| Equity funds | 2.7 | -2.3 | 5.9 | 19.4 | 28.4 | 23.3 | -0.7 | 3,814 |
| Domestic | 4.5 | -2.1 | 5.5 | 15.9 | 19.9 | 16.0 | -1.8 | 3,253 |
| International | -1.8 | -0.2 | 0.5 | 3.5 | 8.5 | 7.3 | 1.1 | 560 |
| Hybrid funds | 0.8 | 0.7 | 2.0 | 3.6 | 5.1 | 4.6 | 2.3 | 453 |
| Bond funds | 7.3 | 11.7 | 11.3 | -6.1 | 3.0 | -7.8 | -14.5 | 1,247 |
| High-yield | 0.6 | 0.9 | 3.7 | 0.7 | -1.4 | -2.1 | -5.5 | 148 |
| Other taxable | 5.7 | 9.4 | 7.1 | -5.1 | 4.2 | -2.3 | -4.4 | 770 |
| Municipals | 1.0 | 1.4 | 0.5 | -1.6 | 0.2 | -3.4 | -4.7 | 328 |

Note. Excludes reinvested dividends.

^e Staff estimates based on confidential ICI weekly data.

Source. Investment Company Institute.

State and Local Government Finance

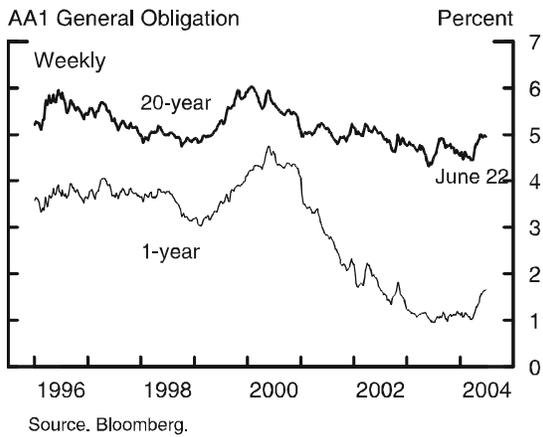
Gross Offerings of Municipal Securities

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

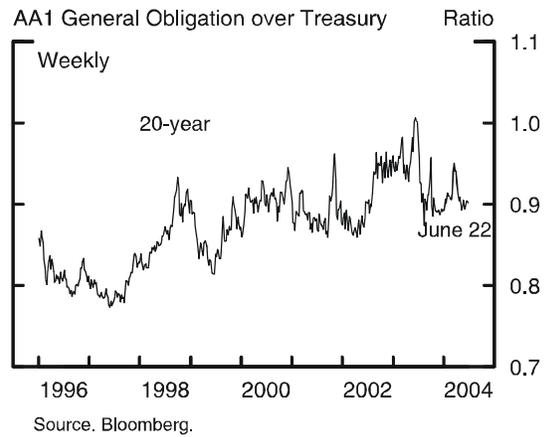
| Type of security | 2001 | 2002 | 2003 | | 2004 | | |
|-------------------------|------|------|------|------|------|------|------|
| | | | H1 | H2 | Q1 | Apr. | May |
| Total | 29.0 | 36.3 | 40.7 | 35.0 | 31.1 | 31.0 | 42.0 |
| Long-term ¹ | 24.3 | 30.3 | 34.5 | 29.5 | 28.3 | 29.5 | 40.6 |
| Refundings ² | 7.6 | 10.1 | 11.6 | 8.1 | 10.4 | 9.0 | 11.6 |
| New capital | 16.7 | 20.2 | 22.9 | 21.4 | 17.9 | 20.5 | 29.0 |
| Short-term | 4.7 | 6.0 | 6.2 | 5.5 | 2.8 | 1.5 | 1.3 |
| Memo: Long-term taxable | 1.4 | 1.7 | 3.9 | 3.1 | 2.1 | 1.9 | 2.4 |

- 1. Includes issues for public and private purposes.
- 2. All issues that include any refunding bonds.

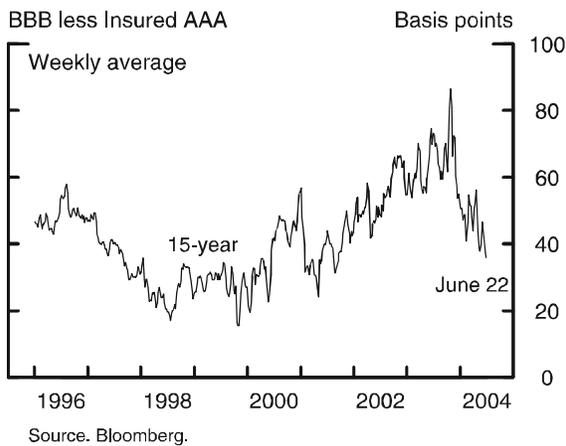
Municipal Bond Yields



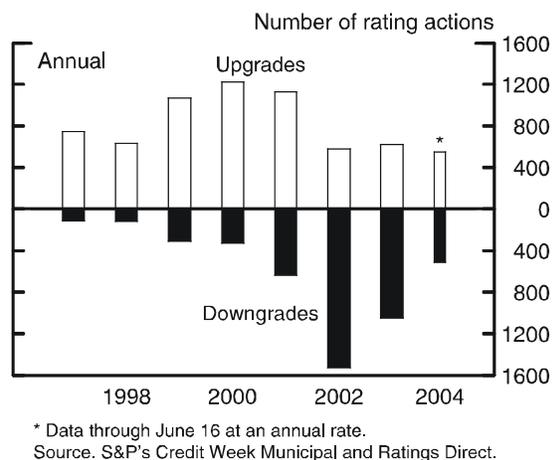
Municipal Bond Yield Ratios



Revenue Bond Spread



Bond Rating Changes

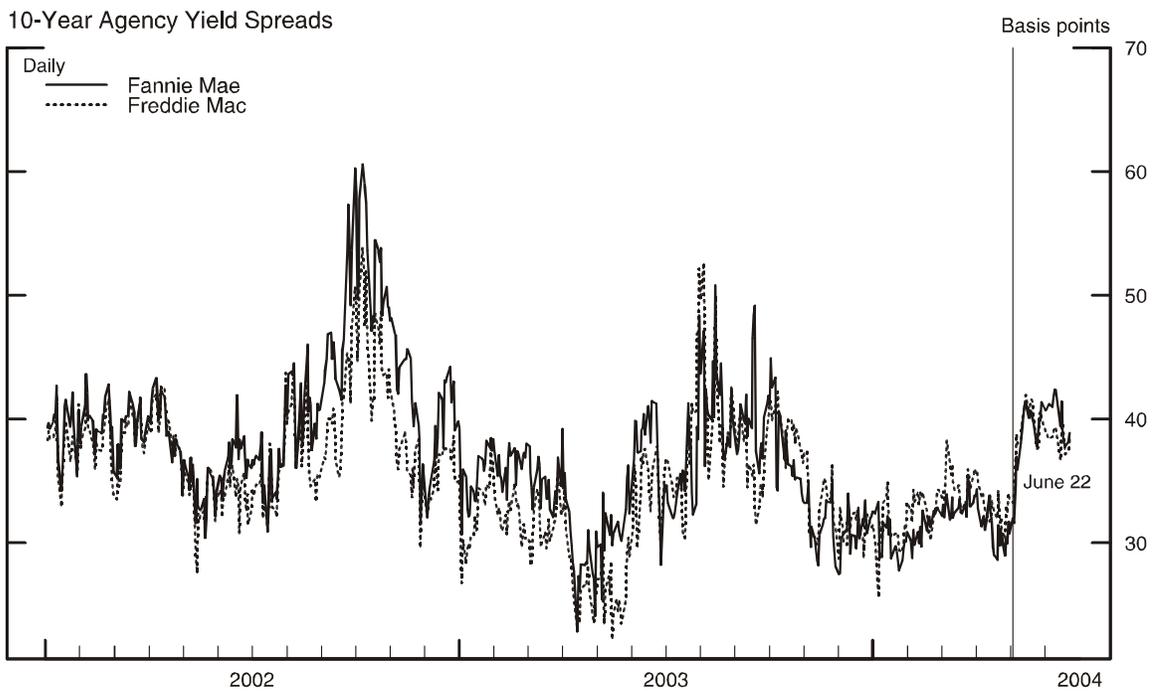


Treasury Financing
(Billions of dollars)

| Item | 2003 | | | 2004 | | |
|-----------------------------------|--------------|---------------|---------------|---------------|-------------|--------------|
| | Q2 | Q3 | Q4 | Q1 | Apr. | May |
| Total surplus, deficit (-) | -16.6 | -104.5 | -128.7 | -170.8 | 17.6 | -62.5 |
| Means of financing deficit | | | | | | |
| Net borrowing | 106.3 | 107.6 | 118.6 | 135.9 | -17.9 | 47.8 |
| Nonmarketable | 45.9 | 31.4 | 6.6 | -10.1 | 7.0 | 2.1 |
| Marketable | 60.4 | 76.2 | 112.0 | 146.0 | -24.9 | 45.7 |
| Bills | -27.2 | -14.9 | 9.2 | 56.1 | -51.6 | 24.5 |
| Coupons | 87.6 | 91.1 | 102.8 | 89.9 | 26.7 | 21.2 |
| Decrease in cash balance | -16.8 | -4.9 | 1.8 | 11.9 | -19.2 | 24.6 |
| Other ¹ | -73.0 | 1.9 | 8.3 | 23.0 | 19.5 | -9.9 |
| Memo: | | | | | | |
| Cash balance, end of period | 30.0 | 35.0 | 33.2 | 21.3 | 40.4 | 15.9 |

Note. Components may not sum to totals because of rounding.
1. Direct loan financing, accrued items, checks issued less checks paid, and other transactions.

Agency Market Developments



Note. Vertical line indicates May FOMC meeting.

period were generally well received. Strong indirect bidding suggests that foreign official institutions continued to purchase large amounts of the issues, even though reported intervention in the foreign exchange market has ground to a halt.

In its May quarterly refunding statement, the Treasury announced that it would issue TIPS at two new maturity points—five and twenty years. These securities will be auctioned semiannually, with the first auction of the twenty-year security scheduled for July and that of the five-year security for October. The Treasury also noted that it is considering eliminating the reopenings of the nominal ten-year note in light of the new TIPS issuance and smaller-than-anticipated borrowing needs.

Net borrowing by the housing GSEs continued to be quite light. Agency spreads widened early in the intermeeting period, concurrent with a widening of swap spreads; nonetheless, these spreads remained well within their historical range. In regulatory developments, Fannie Mae reached an agreement with the SEC regarding its accounting for manufactured housing loans and aircraft leases that allowed the company to avoid any restatement of past earnings as demanded by OFHEO. Fannie agreed to adopt stricter accounting rules for future statements. To account for losses associated with this change, Fannie Mae will take a charge of up to \$260 million in the second quarter.

Money and Bank Credit

The growth of M2 stepped up to an annual rate of 13 percent in May following strong gains in March and April. Last month's acceleration was driven largely by a surge in retail money market funds, which rose at a 12-1/2 percent rate after a year and a half of consecutive declines. The rise likely reflects a combination of large deposits of income tax refunds and a reallocation of funds away from the equity market. Currency growth picked up to a 5-1/2 percent rate, well above the pace earlier in the year and apparently supported by increased domestic demand. Preliminary data for the first half of June show a sharp slowing in M2 growth to around an estimated 3 percent annual rate.

The growth of bank credit fell in May to an annual rate of 4 percent as bank's holdings of securities contracted and loan growth slowed. The deceleration in loans was concentrated mainly in real estate credits and partly reflected heavy securitizations. Consumer loans on banks' books expanded at just under a 4 percent pace, but originations fell for the second consecutive month, reflecting weakness in credit card lending. C&I loans fell again in May, albeit at a slower pace than earlier in the year.

Monetary Aggregates
(Based on seasonally adjusted data)

| Aggregate or component | 2003 | 2003 | 2004 | 2004 | | | Level | |
|---|-------|---|-------|-------|-------|---------|--------------------------|--|
| | | Q4 | Q1 | Mar | Apr | May (p) | (\$ billions) May (p) | |
| | | Percent change (annual rate) ¹ | | | | | | |
| <i>Aggregate</i> | | | | | | | | |
| 1. M2 ² | 5.2 | -1.5 | 3.2 | 8.9 | 8.8 | 13.0 | 6,269 | |
| 2. M3 ³ | 4.5 | -1.4 | 4.9 | 9.7 | 9.6 | 14.4 | 9,194 | |
| <i>Components of M2⁴</i> | | | | | | | | |
| 3. Currency | 5.9 | 6.3 | 2.8 | 1.6 | 3.4 | 5.6 | 672 | |
| 4. Liquid deposits ⁵ | 13.8 | 4.0 | 10.3 | 19.3 | 16.7 | 18.7 | 4,046 | |
| 5. Small time deposits | -9.3 | -9.4 | -4.6 | -3.7 | -5.7 | -8.3 | 793 | |
| 6. Retail money market funds | -11.9 | -23.5 | -22.0 | -24.1 | -12.0 | 12.6 | 750 | |
| <i>Components of M3</i> | | | | | | | | |
| 7. M3 minus M2 ⁶ | 2.8 | -1.1 | 8.8 | 11.4 | 11.3 | 17.2 | 2,925 | |
| 8. Large time deposits, net ⁷ | 3.5 | 9.8 | 30.4 | 26.1 | 39.5 | 32.6 | 987 | |
| 9. Institutional money market funds | -5.8 | -16.4 | -7.9 | 9.4 | 9.6 | -1.7 | 1,119 | |
| 10. RPs | 12.8 | 8.8 | 6.9 | 3.0 | -40.1 | 28.7 | 518 | |
| 11. Eurodollars | 26.1 | 13.9 | 13.7 | -11.0 | 20.6 | 19.0 | 301 | |
| <i>Memo</i> | | | | | | | | |
| 12. Monetary base | 6.0 | 5.3 | 3.0 | 2.5 | 5.0 | 5.8 | 732 | |
| | | Average monthly change (billions of dollars) ⁸ | | | | | | |
| <i>Selected managed liabilities at commercial banks</i> | | | | | | | | |
| 13. Large time deposits, gross | -1.6 | -3.9 | 15.6 | 14.2 | 25.4 | 21.0 | 1,094 | |
| 14. Net due to related foreign institutions | 3.0 | 9.3 | -15.9 | -14.1 | 3.1 | -17.0 | 78 | |
| 15. U.S. government deposits at commercial banks | -.4 | .3 | 2.4 | 6.4 | -1.7 | -6.3 | 18 | |

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.

Asset quality at domestic commercial banks improved in the first quarter of 2004 as delinquency rates continued to trend lower across all major loan categories. Data from the Federal Reserve's May Survey of Terms of Business Lending indicate that the spread over estimated funding costs for all C&I loans ticked down in the second quarter. Adjusted for the effects of changes in loan composition, this spread was about unchanged at a fairly low level.

Commercial Bank Credit

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

| Type of credit | 2003 | Q4 2003 | Q1 2004 | Mar. 2004 | Apr. 2004 | May 2004 | Level, May 2004 (\$ billions) |
|---------------------------|------|------------|------------|--------------|--------------|-------------|-------------------------------------|
| Total | | | | | | | |
| 1. Adjusted ¹ | 5.9 | -0.5 | 10.3 | 13.0 | 9.6 | 4.1 | 6,265 |
| 2. Reported | 5.6 | .1 | 11.3 | 14.9 | 1.4 | -0.6 | 6,417 |
| <i>Securities</i> | | | | | | | |
| 3. Adjusted ¹ | 8.7 | 6.9 | 16.9 | 26.6 | 8.3 | -2.0 | 1,749 |
| 4. Reported | 7.4 | 8.1 | 19.5 | 31.6 | -18.6 | -17.2 | 1,901 |
| 5. Treasury and agency | 8.8 | 2.6 | 24.9 | 36.6 | -5.9 | -11.9 | 1,190 |
| 6. Other ² | 5.3 | 16.9 | 11.2 | 23.6 | -39.3 | -25.8 | 711 |
| <i>Loans³</i> | | | | | | | |
| 7. Total | 4.9 | -3.2 | 7.9 | 7.7 | 10.2 | 6.5 | 4,516 |
| 8. Business | -9.3 | -11.9 | -5.1 | -5.0 | -4.9 | -3.2 | 859 |
| 9. Real estate | 11.1 | -2.2 | 9.4 | 20.2 | 26.1 | 15.1 | 2,376 |
| 10. Home equity | 30.7 | 31.4 | 38.2 | 42.7 | 35.4 | 34.0 | 327 |
| 11. Other | 8.8 | -6.6 | 5.4 | 16.7 | 24.6 | 12.2 | 2,050 |
| 12. Consumer | 5.6 | 10.7 | 11.6 | 10.2 | 2.4 | 3.8 | 641 |
| 13. Adjusted ⁴ | 6.0 | 9.4 | 10.5 | 10.2 | -7.3 | -8.6 | 1,003 |
| 14. Other ⁵ | 6.7 | -7.3 | 16.8 | -20.2 | -18.0 | -9.3 | 640 |

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).

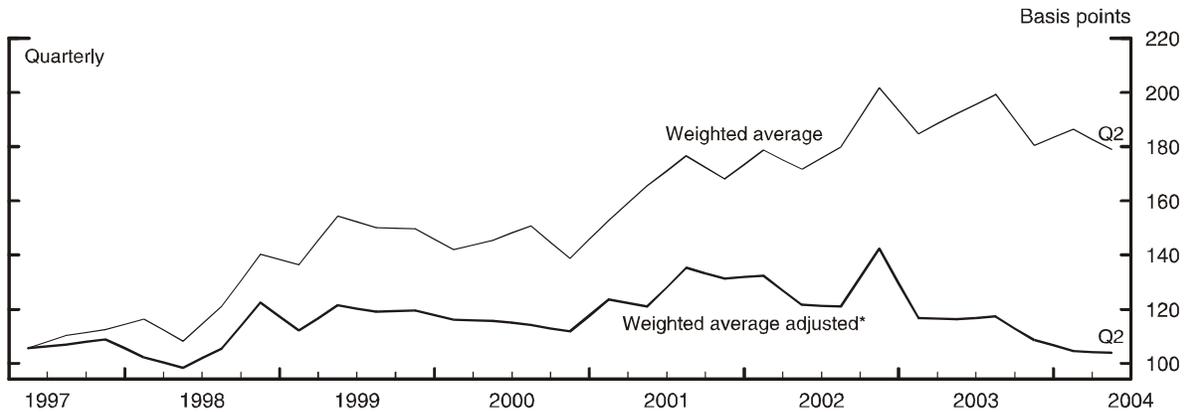
2. Includes private mortgage-backed securities, securities of corporations, state and local governments, foreign governments, and any trading account assets that are not Treasury or agency securities, including revaluation gains on derivative contracts.

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.

C&I Loan Rate Spreads



Note. Spreads over estimated cost of funds.

* Adjusted for changes in nonprice loan characteristics.

International Developments

International Developments

U.S. International Transactions

Trade in Goods and Services

The U.S. international trade deficit in April jumped to \$48.3 billion, a new record high.

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

| | 2003 | Annual rate | | | Monthly rate | | |
|------------------------------|--------|-------------|--------|--------|--------------|-------|-------|
| | | 2003 | | 2004 | 2004 | | |
| | | Q3 | Q4 | Q1 | Feb. | Mar. | Apr. |
| <i>Real NIPA¹</i> | | | | | | | |
| Net exports of G&S | -509.1 | -505.2 | -515.2 | -525.2 | ... | ... | ... |
| <i>Nominal BOP</i> | | | | | | | |
| Net exports of G&S | -496.5 | -489.0 | -502.0 | -547.7 | -45.2 | -46.6 | -48.3 |
| Goods, net | -547.6 | -538.5 | -557.8 | -603.1 | -49.8 | -51.4 | -53.2 |
| Services, net | 51.0 | 49.5 | 55.8 | 55.3 | 4.6 | 4.8 | 4.8 |

1. Billions of chained (2000) dollars.

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

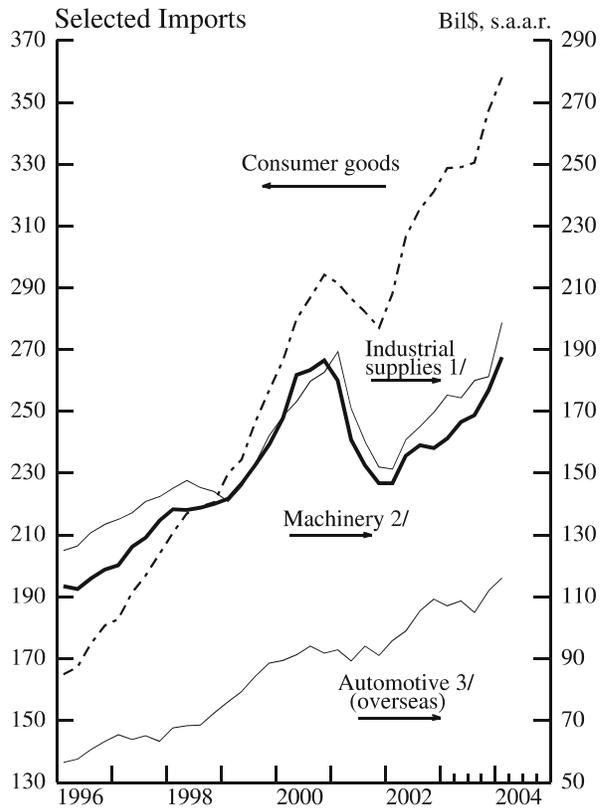
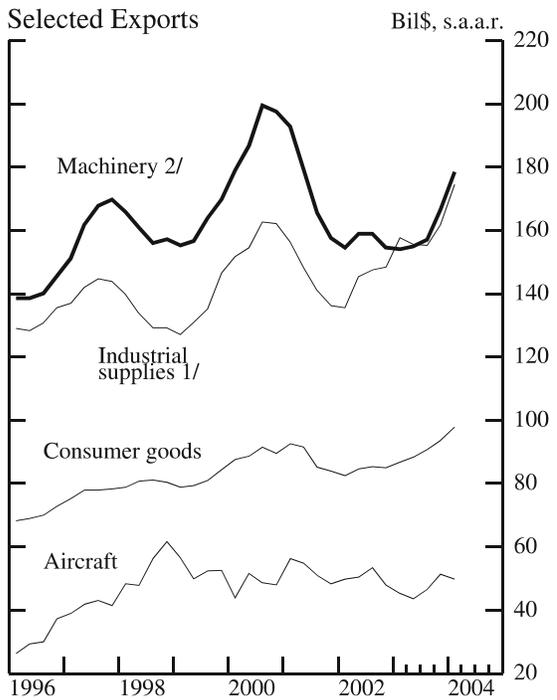
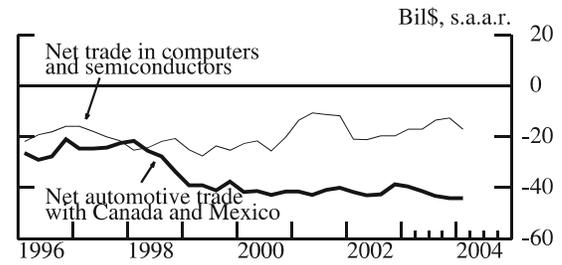
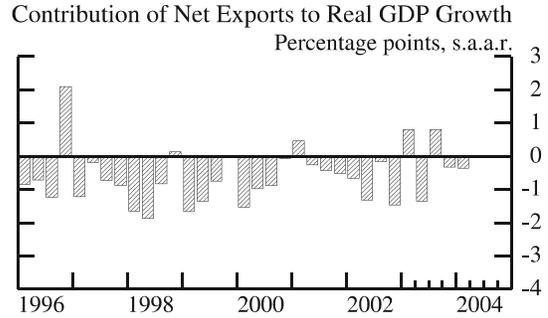
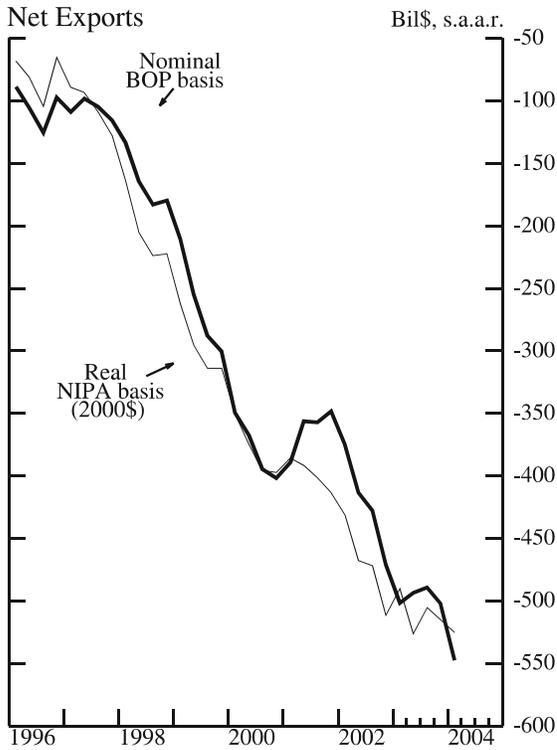
n.a. Not available. ... Not applicable.

The value of exported goods and services decreased 1.5 percent in April, reflecting a 2.2 percent drop in the exports of goods. The fall in exported goods was widespread, with notable decreases in capital goods (particularly aircraft), industrial supplies, and agricultural products. Exports of consumer goods and automotive products also edged down. Exports of services, in contrast, increased in April.

The value of imported goods and services ticked up 0.2 percent in April from March's strong level, as a large decline in the value of imported petroleum was offset by a rise in imports of non-oil goods. The fall in the value of imported petroleum resulted from a decline in volume. Within imports of non-oil goods, notable increases were registered in capital goods, consumer goods, and industrial supplies. Imports of services edged up in April.

The April trade release also included revisions to historical data back to 1992. The trade deficit in goods and services in 2004:Q1 is now \$548 billion at an annual rate, \$22 billion larger than published previously. The larger deficit in the first quarter reflects upward revisions to imports caused by a different treatment of insurance services and a new seasonal adjustment procedure for petroleum. For 2003, the trade deficit now stands at \$497 billion, about \$6 billion larger than previously published.

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.

IV-3
U.S. Exports and Imports of Goods and Services

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

| | Levels | | | | Amount Change ¹ | | | |
|------------------------------|---------------|---------------|---------------|---------------|----------------------------|-------------|-------------|--------------|
| | 2003 | 2004 | 2004 | | 2003 | 2004 | 2004 | |
| | Q4 | Q1 | Mar. | Apr. | Q4 | Q1 | Mar. | Apr. |
| Exports of G&S | 1073.2 | 1107.3 | 1144.8 | 1127.3 | 50.3 | 34.1 | 34.3 | -17.5 |
| Goods exports | 747.4 | 775.7 | 807.6 | 789.1 | 34.4 | 28.2 | 28.4 | -18.6 |
| Gold | 4.7 | 4.4 | 4.1 | 3.4 | -0.7 | -0.3 | 0.2 | -0.7 |
| Other goods | 742.8 | 771.3 | 803.5 | 785.6 | 35.1 | 28.5 | 28.2 | -17.8 |
| Aircraft & parts | 51.3 | 49.9 | 51.4 | 47.4 | 4.7 | -1.4 | 0.0 | -4.1 |
| Computers & accessories | 42.7 | 42.0 | 41.5 | 41.5 | 2.0 | -0.8 | -0.1 | -0.0 |
| Semiconductors | 49.9 | 50.1 | 51.2 | 50.3 | 3.1 | 0.3 | 0.4 | -0.9 |
| Other capital goods | 169.4 | 181.4 | 188.4 | 185.8 | 9.7 | 12.0 | 5.4 | -2.7 |
| Automotive | 82.4 | 83.6 | 86.9 | 85.8 | 2.9 | 1.1 | 3.2 | -1.1 |
| to Canada | 47.9 | 46.4 | 48.5 | 47.3 | 3.4 | -1.4 | 3.1 | -1.2 |
| to Mexico | 13.7 | 15.3 | 17.6 | 16.0 | 0.3 | 1.6 | 2.8 | -1.6 |
| to ROW | 20.9 | 21.8 | 20.7 | 22.5 | -0.8 | 1.0 | -2.6 | 1.8 |
| Agricultural | 65.2 | 63.6 | 66.2 | 63.5 | 2.6 | -1.6 | 2.9 | -2.7 |
| Ind supplies (ex. ag, gold) | 161.8 | 174.5 | 183.3 | 180.4 | 6.5 | 12.7 | 8.2 | -2.9 |
| Consumer goods | 93.7 | 97.9 | 103.8 | 102.8 | 2.8 | 4.2 | 5.9 | -1.0 |
| All other goods | 26.4 | 28.4 | 30.8 | 28.2 | 0.8 | 2.0 | 10.4 | -2.6 |
| Services exports | 325.8 | 331.7 | 337.2 | 338.2 | 15.9 | 5.9 | 5.9 | 1.1 |
| Imports of G&S | 1575.2 | 1655.1 | 1703.6 | 1707.2 | 63.3 | 79.9 | 50.9 | 3.6 |
| Goods imports | 1305.2 | 1378.8 | 1424.5 | 1427.2 | 53.6 | 73.6 | 48.0 | 2.7 |
| Petroleum | 134.4 | 162.4 | 171.9 | 154.4 | 3.8 | 28.0 | 6.8 | -17.5 |
| Gold | 3.8 | 4.1 | 3.7 | 3.8 | -0.3 | 0.3 | -0.7 | 0.1 |
| Other goods | 1167.0 | 1212.3 | 1248.9 | 1269.0 | 50.1 | 45.3 | 41.9 | 20.1 |
| Aircraft & parts | 26.3 | 21.6 | 23.3 | 23.4 | 3.3 | -4.7 | 5.7 | 0.0 |
| Computers & accessories | 80.5 | 82.7 | 83.5 | 85.7 | 4.3 | 2.1 | 1.5 | 2.2 |
| Semiconductors | 24.8 | 26.5 | 27.0 | 27.6 | 0.1 | 1.7 | 0.4 | 0.6 |
| Other capital goods | 179.2 | 190.2 | 193.1 | 196.6 | 8.3 | 11.1 | 3.8 | 3.5 |
| Automotive | 217.8 | 222.1 | 227.2 | 227.8 | 11.7 | 4.3 | 2.0 | 0.6 |
| from Canada | 64.4 | 64.0 | 66.9 | 68.5 | 4.2 | -0.4 | 0.5 | 1.6 |
| from Mexico | 41.3 | 41.9 | 45.9 | 43.0 | 0.5 | 0.6 | 3.7 | -3.0 |
| from ROW | 112.1 | 116.2 | 114.3 | 116.3 | 7.0 | 4.1 | -2.3 | 2.0 |
| Ind supplies (ex. oil, gold) | 181.3 | 198.8 | 206.4 | 211.7 | 1.2 | 17.5 | 1.1 | 5.3 |
| Consumer goods | 347.4 | 358.0 | 374.6 | 380.7 | 17.0 | 10.6 | 27.9 | 6.1 |
| Foods, feeds, bev. | 58.5 | 60.2 | 61.8 | 61.3 | 2.8 | 1.7 | 0.7 | -0.5 |
| All other goods | 51.2 | 52.2 | 52.0 | 54.4 | 1.3 | 1.0 | -1.2 | 2.3 |
| Services imports | 270.0 | 276.3 | 279.2 | 280.1 | 9.7 | 6.3 | 2.9 | 0.9 |
| <i>Memo:</i> | | | | | | | | |
| Oil quantity (mb/d) | 13.30 | 14.38 | 14.61 | 12.91 | 0.50 | 1.09 | -0.18 | -1.71 |
| Oil import price (\$/bbl) | 27.66 | 30.88 | 32.20 | 32.75 | -0.30 | 3.22 | 1.65 | 0.55 |

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)

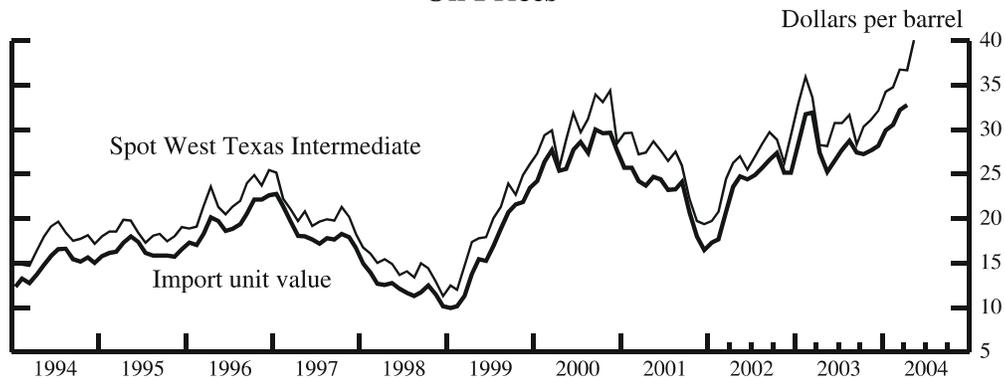
| | Annual rates | | | Monthly rates | | |
|-----------------------------|--|------|-----------------|---------------|------|------|
| | 2003 | 2004 | | 2004 | | |
| | Q4 | Q1 | Q2 ^e | Mar. | Apr. | May |
| | ----- BLS prices (2000 weights)----- | | | | | |
| Merchandise imports | 1.4 | 11.5 | 6.9 | 0.8 | 0.2 | 1.6 |
| Oil | 5.3 | 67.7 | 37.4 | 4.9 | -0.4 | 10.3 |
| Non-oil | 1.0 | 5.9 | 3.1 | 0.2 | 0.3 | 0.4 |
| Core goods* | 2.0 | 7.1 | 4.3 | 0.3 | 0.5 | 0.4 |
| Cap. goods ex comp & semi | 0.1 | 2.7 | 0.3 | 0.2 | -0.1 | 0.1 |
| Automotive products | 2.8 | 1.7 | 0.8 | 0.1 | 0.1 | 0.0 |
| Consumer goods | 0.3 | 2.6 | -0.5 | 0.0 | -0.1 | -0.1 |
| Foods, feeds, beverages | 3.9 | 10.0 | 8.2 | 0.6 | 1.2 | -0.3 |
| Industrial supplies ex oil | 5.6 | 25.3 | 18.0 | 0.6 | 2.1 | 2.1 |
| Computers | -9.5 | -1.7 | -7.6 | -0.3 | -1.7 | -0.1 |
| Semiconductors | -3.0 | -8.2 | -4.8 | -0.1 | -1.4 | 0.8 |
| Merchandise exports | 3.7 | 7.4 | 6.5 | 0.8 | 0.7 | 0.3 |
| Core goods* | 5.1 | 8.4 | 6.9 | 0.9 | 0.8 | 0.3 |
| Cap. goods ex comp & semi | 0.5 | 2.2 | 0.5 | 0.1 | 0.0 | 0.0 |
| Automotive products | 0.3 | 0.3 | 0.7 | -0.1 | 0.2 | 0.0 |
| Consumer goods | 1.8 | 0.9 | 0.7 | 0.0 | 0.2 | 0.0 |
| Agricultural products | 39.6 | 18.9 | 25.1 | 3.4 | 2.7 | 0.5 |
| Industrial supplies ex ag | 5.6 | 21.3 | 14.0 | 1.7 | 1.2 | 0.9 |
| Computers | 0.9 | 1.2 | 2.3 | 0.2 | 0.2 | 0.0 |
| Semiconductors | -10.8 | -1.7 | 4.0 | 0.6 | 0.3 | 0.0 |
| | ---Prices in the NIPA accounts (2000 weights)--- | | | | | |
| Chain price index | | | | | | |
| Imports of goods & services | 0.9 | 9.6 | n.a. | ... | ... | ... |
| Non-oil merchandise | 0.8 | 5.6 | n.a. | ... | ... | ... |
| Core goods* | 1.5 | 6.5 | n.a. | ... | ... | ... |
| Exports of goods & services | 2.6 | 5.6 | n.a. | ... | ... | ... |
| Total merchandise | 3.6 | 6.4 | n.a. | ... | ... | ... |
| Core goods* | 5.3 | 7.9 | n.a. | ... | ... | ... |

*/ Excludes computers and semiconductors.

e/ Average of two months.

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

Oil Prices



Prices of Internationally Traded Goods

Non-oil imports. In May, the prices of U.S. imports of non-oil goods and of core goods rose 0.4 percent. As in previous months, the price increases were concentrated in the commodity-intensive categories, particularly non-oil industrial supplies. The price index for industrial supplies rose 2.1 percent in both April and May, largely reflecting higher prices for imported unfinished metals. Prices for foods, feeds and beverages edged down 0.3 percent in May, the first decrease in eight months. Prices of capital goods (excluding computers and semiconductors) edged up 0.1 percent. In contrast, prices for automotive products were unchanged, and prices of consumer goods fell 0.1 percent. Whereas import prices for computers ticked down 0.1 percent, import prices for semiconductors rose 0.8 percent.

The average level of imported core goods prices in April and May was 4.3 percent at an annual rate above the first-quarter level. The rise was concentrated in non-oil industrial supplies and, to a lesser extent, foods, feeds and beverages.

Oil. The BLS price of imported oil rose 10.3 percent in May, and the spot price of West Texas Intermediate (WTI) crude oil also rose about 10 percent, averaging \$40.29 per barrel. The spot price has edged down in June in response to rising oil inventories and reports of increased production from OPEC, particularly from Saudi Arabia. However, strong world oil demand driven by increased economic activity, geopolitical events in the Middle East, and concerns about the reliability of oil supplies from Venezuela and Nigeria continue to keep upward pressure on oil prices.

Exports. In May, the prices of U.S. exports of total goods and of core goods increased 0.3 percent. Rising 0.9 percent in May, prices for nonagricultural industrial supplies (particularly petroleum products, but also iron and chemicals) contributed most of the increase. After increasing 2.7 percent in April, the price index for agricultural products rose only 0.5 percent in May, reflecting more moderate increases in prices for soybeans and corn. Prices for all other major categories of exports were unchanged.

The average level of exported core goods prices in April and May was 6.9 percent at an annual rate above the first-quarter level. Agricultural products and industrial supplies were the main contributors to this quarterly increase.

Current Account

The U.S. current account deficit was \$580 billion (s.a.a.r.) in the first quarter of 2004, up from \$508 billion in the fourth quarter of 2003 (revised). Much of the change was driven by a widening of the trade deficit on goods and services.

Changes in both net investment income and net outflows of unilateral transfers also contributed to the widening of the deficit.

The deficit on goods and services widened \$46 billion in the first quarter as a \$74 billion increase in imported goods was only partially offset by a \$28 billion increase in exported goods. The increase in the value of imported goods largely reflected strong increases in petroleum, industrial supplies, capital goods, and consumer goods. The increase in the value of exported goods was concentrated in industrial supplies and capital goods. Growth in imports and exports of services offset each other, with each increasing about \$6 billion.

The surplus on net investment income fell \$14 billion in the first quarter, as a \$2 billion rise in receipts was swamped by a \$16 billion rise in payments. The sizable increase in payments was driven by an \$11 billion increase in direct investment payments. The modest rise in receipts was a result of a \$6 billion increase in portfolio income, which was partially offset by declines in government and direct investment receipts.

Net unilateral transfers to foreigners rose \$12.1 billion, as a result of an increase in U.S. government grants.

| U.S. Current Account | | | | |
|--|-------------------------|------------------------|---------------------------------|-------------------------|
| (Billions of dollars, seasonally adjusted annual rate) | | | | |
| Period | Goods and services, net | Investment income, net | Other income and transfers, net | Current account balance |
| <i>Annual</i> | | | | |
| 2002 | -418.0 | 1.3 | -64.1 | -480.9 |
| 2003 | -490.2 | 21.9 | -73.6 | -541.8 |
| <i>Quarterly</i> | | | | |
| 2003:Q2 | -493.5 | 29.1 | -71.0 | -535.5 |
| Q3 | -489.0 | 34.5 | -72.0 | -526.5 |
| Q4 | -502.0 | 70.1 | -76.0 | -507.8 |
| 2004:Q1 | -547.7 | 56.3 | -88.1 | -579.5 |
| <i>Change</i> | | | | |
| Q2-Q1 | 8.0 | 7.5 | 1.8 | 17.3 |
| Q3-Q2 | 4.5 | 5.4 | -0.9 | 9.0 |
| Q4-Q3 | -13.0 | 35.6 | -4.0 | 18.7 |
| Q1-Q4 | -45.7 | -13.8 | -12.1 | -71.7 |

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

U.S. International Financial Transactions

Private foreign purchases of U.S. securities (line 4 of the Summary of U.S. International Transactions table) remained very strong in April at \$43 billion, led by unusually high net purchases of agency securities (line 4b). Demand for Treasuries (line 4a) and corporate debt securities (line 4c) were below their

recent elevated norms, while acquisitions of equities (line 4d), which included a merger-related stock swap, rebounded from net sales in March. For the first four months of the year, private foreign acquisitions of U.S. securities are on a pace well above that of the previous two years.

Net foreign official inflows (line 1) were extremely large in the first quarter, primarily because of Japanese intervention activity. These inflows abated significantly in April as Japanese intervention activity apparently ended. Partial data from the Federal Reserve Bank of New York (FRBNY) show additional inflows of \$25 billion in May and a further \$2 billion inflow through June 22.

The data presented above were affected by revisions included in BEA's June 18 balance of payments release. These revisions had the effect of decreasing recorded net private inflows into U.S. debt securities while increasing recorded official inflows. For the first four months of the year, private inflows were reduced by \$36 billion (agencies by \$21 billion), while official inflows were increased by \$8 billion. These changes were made based on portfolio survey results and to account for official flows that are mistakenly recorded as private flows.

At \$17 billion, U.S. investors acquired foreign securities (line 5) at an unusually brisk pace in April, led by net purchases of foreign equities (line 5b) and merger-related stock swap activity (line 5c). April also saw U.S. investors continue their well-established trend of modest net sales of foreign debt securities (line 5a). Activity during the first quarter was similar to that seen in April but at a more subdued pace, with net acquisitions of foreign equities exceeding net sales of foreign debt securities. Although U.S. investors have been consistently reducing their holdings of foreign debt securities, through the first four months of the year U.S. investors have been net purchasers of European debt securities (\$12 billion) while selling primarily Asian debt securities (\$15 billion).

The banking sector (line 3) recorded essentially offsetting flows in April following moderate net outflows in the first quarter.

The recently released balance of payments data for the first quarter show that U.S. direct investment abroad (line 6) remained relatively steady at \$57 billion while foreign direct investment in the United States (line 7) increased modestly to \$18 billion. The direct investment data have been revised such that for 2003 estimated U.S. direct investment abroad was increased by almost \$20 billion while estimated foreign direct investment in the United States was reduced by

over \$40 billion. The disparity between these direct investment flows is mainly attributable to differing levels of reinvested earnings in the U.S. and abroad rather than to differences in new cross-border acquisitions.

The statistical discrepancy was negative for the second consecutive quarter, indicating some combination of underreporting of the current account deficit or overreporting of net capital inflows.

| Summary of U.S. International Transactions | | | | | | | | |
|--|---------------|---------------|---------------|---------------|---------------|---------------|-------------|-------------|
| (Billions of dollars, not seasonally adjusted except as noted) | | | | | | | | |
| | 2002 | 2003 | 2003 | | | 2004 | | |
| | | | Q2 | Q3 | Q4 | Q1 | Mar | Apr |
| Official financial flows | 113.0 | 247.2 | 65.1 | 50.1 | 86.0 | 126.0 | 40.2 | 21.9 |
| 1. Change in foreign official assets in the U.S. (increase, +) | 116.7 | 245.7 | 65.3 | 50.7 | 83.8 | 125.4 | 40.0 | 21.1 |
| a. G-10 countries | 30.7 | 115.7 | 26.0 | 15.9 | 47.3 | 94.9 | 33.9 | 9.4 |
| b. OPEC countries | -7.5 | 6.1 | 1.1 | 2.1 | 10.5 | 3.3 | -3 | 1.6 |
| c. All other countries | 93.5 | 123.9 | 38.1 | 32.8 | 26.0 | 27.2 | 6.5 | 10.2 |
| 2. Change in U.S. official reserve assets (decrease, +) | -3.7 | 1.5 | -2 | -6 | 2.2 | .6 | .2 | .8 |
| Private financial flows | 457.2 | 298.6 | 42.5 | 76.0 | 82.7 | 32.3 | ... | ... |
| Banks | | | | | | | | |
| 3. Change in net foreign positions of banking offices in the U.S. ¹ | 116.8 | 89.9 | -22.4 | 19.2 | 99.9 | -40.1 | -46.4 | -8 |
| Securities² | | | | | | | | |
| 4. Foreign net purchases of U.S. securities (+) | 390.1 | 369.4 | 147.0 | 65.9 | 89.8 | 130.3 | 31.2 | 43.3 |
| a. Treasury securities | 101.5 | 114.8 | 53.6 | 46.9 | 5.0 | 66.8 | 30.1 | 4.7 |
| b. Agency bonds | 84.2 | -13.0 | 10.9 | -30.9 | 2.7 | 7.0 | -10.9 | 19.2 |
| c. Corporate and municipal bonds | 145.7 | 227.5 | 61.3 | 52.5 | 58.4 | 51.6 | 25.5 | 12.2 |
| d. Corporate stocks ³ | 58.8 | 40.1 | 21.2 | -2.7 | 23.6 | 5.0 | -13.5 | 7.2 |
| 5. U.S. net acquisitions (-) of foreign securities | 15.5 | -72.8 | 8.2 | -28.5 | -26.0 | -13.6 | -2.3 | -17.1 |
| a. Bonds | 33.5 | 28.4 | 25.0 | 2.2 | -6.6 | 9.1 | 2.7 | 6.3 |
| b. Stock purchases | -14.8 | -83.7 | -16.8 | -30.7 | -16.7 | -22.7 | -5.0 | -12.4 |
| c. Stock swaps ³ | -3.2 | -17.4 | .0 | .0 | -2.8 | .0 | .0 | -11.1 |
| Other flows (quarterly data, s.a.) | | | | | | | | |
| 6. U.S. direct investment (-) abroad | -134.8 | -173.8 | -34.0 | -45.2 | -53.7 | -57.2 | ... | ... |
| 7. Foreign direct investment in U.S. | 72.4 | 39.9 | -.5 | -2.8 | 10.7 | 18.0 | ... | ... |
| 8. Foreign holdings of U.S. currency | 21.5 | 16.6 | 1.5 | 2.8 | 7.5 | -1.8 | ... | ... |
| 9. Other (inflow, +) ⁴ | -24.4 | 29.2 | -57.2 | 64.7 | -45.6 | -3.3 | ... | ... |
| U.S. current account balance (s.a.) | -473.9 | -530.7 | -133.9 | -131.6 | -127.0 | -144.9 | ... | ... |
| Capital account balance (s.a.)⁵ | -1.3 | -3.1 | -1.6 | -.8 | -.3 | -.3 | ... | ... |
| Statistical discrepancy (s.a.) | -95.0 | -12.0 | 27.8 | 6.4 | -41.4 | -13.1 | ... | ... |

NOTE: Data in lines 1 through 5 differ in timing and coverage from the balance of payments data published by the Department of Commerce. Details may not sum to totals because of rounding.

1. Changes in dollar-denominated positions of all depository institutions and bank holding companies plus certain transactions between broker-dealers and unaffiliated foreigners (particularly borrowing and lending under repurchase agreements). Includes changes in custody liabilities other than U.S. Treasury bills.

2. Includes commissions on securities transactions and therefore does not match exactly the data on U.S. international transactions published by the Department of Commerce.

3. Includes (4d) or represents (5c) stocks acquired through mergers.

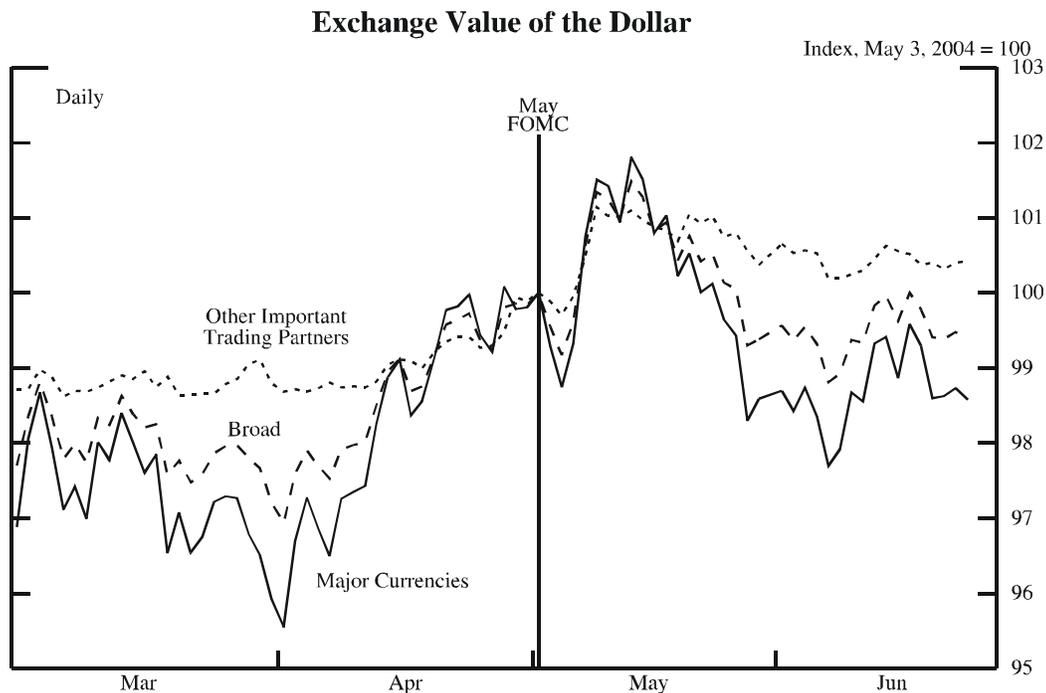
4. Transactions by nonbanking concerns and other banking and official transactions not shown elsewhere plus amounts resulting from adjustments made by the Department of Commerce and revisions in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business

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

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

Foreign Exchange Markets

The exchange value of the dollar, as measured by the major currencies index, declined 1½ percent, on balance, over the intermeeting period. At the beginning of the period, the dollar rallied following the release of the robust April U.S. employment report, which led market participants to move up their projected path of FOMC tightening. The dollar did not sustain these gains, however, as the U.S. trade deficit reached a record monthly high in April and the difficulties in Iraq eroded some of the positive sentiment towards the dollar. On a bilateral basis, the dollar depreciated 1½ percent, on balance, against the euro, yen, and Canadian dollar. The U.S. dollar fell by a larger amount against the currencies of two countries that tightened monetary policy over the period – Switzerland and the United Kingdom – depreciating 3¾ percent against the franc and 2½ percent vis-à-vis sterling.



Short-term interest rates rose 40 basis points in the United Kingdom, as the Bank of England's Monetary Policy Committee raised its policy rate 25 basis points on May 6 and again on June 10, lifting the rate to 4.5 percent. U.K. economic data were quite strong, with retail sales growing robustly and the unemployment rate falling to 2.8 percent, its lowest level since 1975. In explaining its policy actions, the Bank of England also expressed concern over the boom in housing prices. Swiss short-term rates, which have risen 20 basis points on net since the last FOMC meeting, began increasing in early June ahead of the Swiss National Bank's monetary policy meeting on June 17. At that

meeting the SNB tightened monetary policy, raising the top of its target range for three-month Swiss franc Libor by 25 basis points, to 1 percent, and stated that it would now aim to keep the rate close to the center of its 0 to 1 percent target range.

Amid further signs that the global economic expansion will be sustained, long-term interest rates rose about 20 basis points in Europe and almost 40 basis points in Japan and Canada over the intermeeting period. Japan reported economic growth of 5.6 percent in the first quarter, above market expectations. Sanguine data on Japanese manufacturing activity, labor market, and corporate profits led the Bank of Japan to upgrade its assessment of the economic outlook in its latest monthly report. Market participants noted that the BOJ removed the word “gradual” from its description of the recovery. Canadian economic data were also strong, as the April and May labor market reports showed much-larger-than-expected gains in employment and the unemployment rate declined from 7.5 percent to 7.2 percent. Headline inflation in Canada was also above market expectations.

Major equity indexes were little changed, on net, over the intermeeting period,

Financial Indicators in Major Industrial Countries

| Country | Three-month rate | | Ten-year yield | | Equities |
|--------------------------------------|----------------------|-----------------|----------------------|-----------------|-------------------|
| | Jun. 23 (Percent) | Point Change | Jun. 23 (Percent) | Point Change | Percent Change |
| Canada | 2.09 | .04 | 4.98 | .38 | 3.58 |
| Japan | .05 | .00 | 1.90 | .37 | -2.54 |
| Euro area | 2.12 | .05 | 4.37 | .20 | -.59 |
| United Kingdom | 4.76 | .41 | 5.17 | .18 | -.04 |
| Switzerland | .43 | .21 | 2.88 | .21 | -2.01 |
| Australia | 5.48 | -.13 | 5.92 | -.01 | 4.64 |
| United States | 1.50 | .39 | 4.72 | .19 | 1.53 |
| Memo: Weighted-average foreign | 1.79 | .07 | 4.44 | .29 | n.a. |

NOTE. Change is from May 3 to June 23 (10 a.m. EDT).
n.a. Not available.

as higher interest rates and concerns over the run-up in oil prices offset expectations of robust economic growth. Fluctuations over the period were generally subdued in the major stock markets, with the exception of Japan, where share prices fell sharply in early May following statements by Chinese authorities that they would take action to slow their economy. However, Japanese share prices subsequently recovered most of that decline.

Higher oil prices and rising global interest rates also weighed on equity prices in the emerging markets. Asian share prices had their sharpest one-day decline since September 2001 on May 10 in reaction to the spike in global interest rates after the release of the U.S. employment report for April. The prospect of tighter monetary policy in China damped sentiment, most notably in Indonesia and Korea, where stock market indexes fell 11 and 15 percent, respectively on net. Amid the decline in share prices, the Indonesian rupiah depreciated 8 percent relative to the dollar, leading the Indonesian central bank to intervene to stem the currency's decline.

In Latin America, the Brazilian *real* depreciated 5½ percent against the dollar over the period, despite a report showing that the Brazilian economy grew at a 6.8 percent annual rate in the first quarter. Market participants again pointed to oil prices and global interest rates, as well as some political difficulties for the Lula administration, to explain the weakness of the currency. Share prices in Argentina fell 11 percent over the period as several leading firms reported lower-than-expected first-quarter earnings.

. The Desk did not intervene on behalf of the System or the Treasury during the period.

Financial Indicators in Latin America, Asia, and Russia

| Economy | Currency/ US dollar | | Short-term Interest rates ¹ | | Dollar-denominated bond spread ² | | Equity prices |
|-------------|------------------------|-------------------|---|-------------------------------|--|-------------------------------|-------------------|
| | Jun. 23 | Percent Change | Jun.22/23 (Percent) | Percentage Point Change | Jun.22/23 (Percent) | Percentage Point Change | Percent Change |
| Mexico | 11.35 | -.83 | 6.57 | -.01 | 2.13 | .00 | -.47 |
| Brazil | 3.12 | 5.44 | 15.65 | .15 | 6.52 | -.49 | 3.12 |
| Argentina | 2.95 | 3.62 | n.a. | n.a. | 50.12 | 3.18 | -11.09 |
| Chile | 642.80 | 3.05 | 1.69 | .00 | .71 | -.08 | 1.34 |
| China | 8.28 | .00 | n.a. | n.a. | .62 | .09 | -9.71 |
| Korea | 1159.70 | -1.13 | 4.08 | .09 | ... | ... | -14.68 |
| Taiwan | 33.78 | 1.56 | 1.29 | .05 | ... | ... | -4.98 |
| Singapore | 1.72 | .95 | .69 | .00 | ... | ... | -2.92 |
| Hong Kong | 7.80 | -.02 | .19 | -.03 | ... | ... | -.84 |
| Malaysia | 3.80 | -.01 | 2.84 | -.11 | .75 | .02 | -1.92 |
| Thailand | 40.97 | 2.48 | 1.25 | .00 | .75 | .12 | -3.23 |
| Indonesia | 9418.00 | 8.28 | 7.40 | -.03 | 2.96 | .72 | -10.68 |
| Philippines | 56.20 | .95 | 6.81 | -.19 | 4.47 | .19 | .69 |
| Russia | 29.02 | .08 | n.a. | n.a. | 2.74 | -.35 | -4.03 |

NOTE. Change is from May 3 to June 22/23.

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

Growth in the major foreign industrial economies was solid in the first quarter. Japanese output rose 6.1 percent, led by a large increase in personal consumption. Indicators for the second quarter continue to be strong. Real GDP in the United Kingdom expanded 2.5 percent in the first quarter, boosted by strong increases in consumption, government expenditure, and investment. The euro area posted a 2.3 percent rise in GDP in the first quarter. Domestic demand was led by strong household consumption expenditure, although indicators for the second quarter are somewhat mixed. Canadian real GDP grew 2.4 percent, as robust final domestic demand offset a dramatic slowdown in the rate of inventory accumulation. Indicators of growth in the second quarter have been favorable.

Consumer price inflation has moved up a bit in the second quarter mainly as a result of higher energy prices. Twelve-month headline inflation in Canada increased to 2.5 percent. Inflation in the euro area also rose to 2.5 percent in May, well above the ECB's 2 percent ceiling. In the United Kingdom inflation rose somewhat, but remained below the Bank of England's 2 percent inflation target. Slight CPI deflation persisted in Japan.

In the United Kingdom, the Monetary Policy Committee increased its policy rate 25 basis points in June, the fourth such hike since last November. Monetary policy in the euro area, Japan, and Canada remained on hold.

In **Japan**, real GDP continued its recent strong growth, rising 6.1 percent in the first quarter, led by personal consumption, which rose 4 percent. Business fixed investment advanced 7 percent, while government investment continued to contract sharply. A large increase in inventories contributed 2 percentage points to growth. Exports soared 17 percent, boosted by buoyant growth in emerging Asia (especially China). The gain in exports outpaced a 12 percent increase in imports, and net exports added 1 percentage point to growth. Nominal GDP rose 4.2 percent, marking the fourth consecutive quarter of increase. The GDP deflator fell 2.5 percent below its year-ago level.

Indicators suggest that activity continued to expand strongly in the second quarter. Real exports increased a further 2.7 percent in May on a monthly basis following a strong increase in April. Real imports fell in May after rising the previous two months, but were up 5.6 percent from May 2003, reflecting solid domestic demand. Household expenditures surged 5.8 percent in April from the previous month, registering the largest monthly gain on record, and measures of consumer confidence continued to rise. New car registrations moved down in April and May following a jump in the first quarter, but remained at relatively

high levels. Industrial production rose 3.5 percent in April from the previous month. The broader all-industries index of output rose roughly 1 percent in March. Core machinery orders, a leading indicator of business fixed investment, rebounded nearly 12 percent in April from the previous month.¹

Japanese Real GDP

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

| Component | 2002 ¹ | 2003 ¹ | 2003 | | | 2004 |
|--------------------------|-------------------|-------------------|-------|-------|------|-------|
| | | | Q2 | Q3 | Q4 | Q1 |
| GDP | 1.8 | 3.5 | 3.8 | 2.7 | 7.3 | 6.1 |
| Total domestic demand | .8 | 2.6 | 2.6 | 2.0 | 5.9 | 5.3 |
| Consumption | .9 | 1.8 | .8 | 2.5 | 4.3 | 4.0 |
| Private investment | -1.0 | 11.9 | 16.2 | 2.2 | 23.4 | 6.4 |
| Public investment | -4.0 | -12.5 | -15.2 | -20.0 | -5.0 | -11.3 |
| Government consumption | 1.6 | 1.1 | -.7 | 2.5 | 1.5 | 1.5 |
| Inventories ² | .5 | -.1 | .2 | .9 | -1.0 | 2.0 |
| Exports | 17.3 | 11.4 | 7.4 | 14.7 | 21.9 | 16.7 |
| Imports | 8.7 | 4.9 | -3.8 | 10.8 | 11.0 | 11.9 |
| Net exports ² | 1.0 | .9 | 1.2 | .7 | 1.6 | 1.0 |

1. Q4/Q4.

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

Labor market conditions continued to improve. The unemployment rate remained at 4.7 percent in April, as both the level of employment and the size of the labor force expanded strongly. The job-offers-to-applicants ratio, a leading indicator of employment, was unchanged, but remained at a ten-year high. Core consumer goods prices in the Tokyo area (which exclude fresh food but include energy) were unchanged in May from the previous month but were down 0.1 percent from a year earlier. Wholesale prices were up 1.1 percent in May compared with the same month a year ago, the largest twelve-month increase since 1997.

1. Core machinery orders exclude orders for ships and orders from electric power companies.

| Japanese Economic Indicators | | | | | | | |
|--|-------|-------|------|------|------|------|------|
| (Percent change from previous period, except as noted, s.a.) | | | | | | | |
| Indicator | 2003 | | 2004 | | | | |
| | Q3 | Q4 | Q1 | Feb. | Mar. | Apr. | May |
| Industrial production ¹ | 1.0 | 3.9 | .5 | -3.8 | .6 | 3.5 | n.a. |
| All-industries index | .0 | 1.7 | -.2 | -3.7 | 1.1 | n.a. | n.a. |
| Housing starts | -6.5 | 4.9 | 2.8 | -6.4 | 2.1 | -6.7 | n.a. |
| Machinery orders ² | -1.0 | 8.5 | -5.6 | 2.8 | -3.2 | 11.8 | n.a. |
| Machinery shipments ³ | 2.5 | 7.6 | -.4 | -6.4 | -.3 | 5.6 | n.a. |
| New car registrations | .7 | -2.0 | 12.6 | -6.1 | .3 | -7.7 | -1.1 |
| Unemployment rate ⁴ | 5.2 | 5.1 | 4.9 | 5.0 | 4.7 | 4.7 | n.a. |
| Job offers ratio ⁵ | .65 | .73 | .77 | .77 | .77 | .77 | n.a. |
| Business sentiment ⁶ | -21.0 | -15.0 | n.a. | ... | ... | ... | ... |
| CPI (Core, Tokyo area) ⁷ | -.3 | -.1 | -.2 | -.2 | -.1 | -.1 | -.1 |
| Wholesale prices ⁷ | -.7 | -.4 | .0 | .0 | .2 | .6 | 1.1 |

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.

Japanese banks continued to make progress in reducing bad-debt levels. As of March 2004, Japan's four "mega" banks classified 5 percent of total outstanding loans as "non-performing", down from 7 percent in the previous year. Most large Japanese banks also reported substantial net profits and improved regulatory capital ratios for the fiscal year that ended in March. However, the increase in reported profits largely reflected realized gains on equity portfolio holdings, a one-time tax rebate from the Tokyo metropolitan government, and reduced credit costs. Core operating earnings remained flat, suggesting that Japanese banks have not yet begun to improve operating performance.

In the **euro area**, real GDP rose 2.3 percent in the first quarter, while GDP growth in the fourth quarter of 2003 was revised upward to 1.5 percent. During the first quarter, domestic demand was led by household consumption expenditure, which grew 2.3 percent, the best result in three years. Investment

decreased, following moderate growth in the previous quarter. Net exports contributed positively to growth, as exports picked up while imports decelerated. German domestic demand remained stagnant.

Euro-Area Real GDP¹

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

| Component | 2002 ² | 2003 ² | 2003 | | | 2004 |
|--------------------------|-------------------|-------------------|------|-----|------|------|
| | | | Q2 | Q3 | Q4 | Q1 |
| GDP | 1.1 | .7 | -.3 | 1.7 | 1.5 | 2.3 |
| Total domestic demand | 1.2 | 1.3 | .2 | .1 | 3.0 | .8 |
| Consumption | .9 | .6 | -.3 | .5 | .5 | 2.3 |
| Investment | -1.5 | -.4 | -1.1 | .2 | 2.3 | -.5 |
| Government consumption | 2.4 | 2.1 | 2.3 | 2.8 | 1.6 | -.9 |
| Inventories ³ | .5 | .6 | .1 | -.8 | 1.9 | -.2 |
| Exports | 3.4 | .1 | -3.4 | 9.3 | .6 | 6.9 |
| Imports | 3.7 | 1.7 | -2.2 | 5.3 | 4.6 | 3.0 |
| Net exports ³ | .0 | -.5 | -.5 | 1.6 | -1.4 | 1.5 |
| <i>Memo: GDP</i> | | | | | | |
| France | 1.4 | 1.1 | -1.2 | 2.4 | 2.5 | 3.1 |
| Germany | .5 | .1 | -.7 | .8 | 1.1 | 1.8 |
| Italy | .9 | .1 | -.4 | 1.7 | .0 | 1.8 |

1. Includes Greece as of 2001 Q1.

2. Q4/Q4.

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

Indicators of economic activity for the second quarter are somewhat mixed. Euro-area industrial production rose modestly in April. Retail sales rebounded in April, increasing 1.3 percent after falling in both February and March. Survey measures for May indicate a slightly less rosy picture. The German IFO business climate index fell in May, leaving its level well below the first quarter average. The European Commission's confidence survey also showed declines in both consumer and industrial confidence.

Twelve-month consumer price inflation jumped to 2.5 percent in May, moving well above the ECB's 2 percent target ceiling. Core inflation, excluding energy, food, alcohol, and tobacco remained at 1.9 percent in May.

| Euro-Area Economic Indicators | | | | | | | |
|---|-------|-------|-------|-------|-------|-------|-------|
| (Percent change from previous period except as noted, s.a.) | | | | | | | |
| Indicator | 2003 | | 2004 | | | | |
| | Q3 | Q4 | Q1 | Feb. | Mar. | Apr. | May |
| Industrial production ¹ | .6 | .9 | .2 | .3 | .3 | .2 | n.a. |
| Retail sales volume ² | -1.1 | -2 | .6 | -1.1 | -2 | 1.3 | n.a. |
| Unemployment rate ³ | 8.9 | 8.9 | 8.9 | 8.9 | 9.0 | 9.0 | n.a. |
| Consumer confidence ⁴ | -17.3 | -16.0 | -14.3 | -14.0 | -14.0 | -14.0 | -16.0 |
| Industrial confidence ⁴ | -11.3 | -7.3 | -6.7 | -7.0 | -7.0 | -4.0 | -5.0 |
| Mfg. orders, Germany | 1.5 | 3.3 | .5 | .7 | -.3 | 1.9 | n.a. |
| CPI ⁵ | 2.0 | 2.0 | 1.7 | 1.6 | 1.7 | 2.0 | 2.5 |
| Producer prices ⁵ | 1.2 | 1.1 | .3 | .0 | .4 | 1.4 | n.a. |
| M3 ⁵ | 7.6 | 7.1 | 6.3 | 6.3 | 6.3 | 5.6 | n.a. |

1. Excludes construction.

2. Excludes motor vehicles.

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

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

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

n.a. Not available.

Real GDP in the **United Kingdom** expanded 2.5 percent in the first quarter, marked by strong increases in consumption, government expenditure, and investment. These increases were partly offset by a 1.7 percentage point negative arithmetic contribution from net exports, as exports contracted sharply.

Data for the current quarter on net point to continued strong growth. Industrial production and manufacturing output expanded in April, and May manufacturing PMI ticked up further. Business confidence rose appreciably in May. Retail sales grew at a brisk pace in May.

According to the two leading private surveys, housing price inflation has picked up in recent months, with the average twelve-month rise at around 20 percent in May. Household net mortgage and consumer borrowing remained elevated in April.

| U.K. Real GDP | | | | | | |
|--|-------------------|-------------------|-------|------|------|------|
| (Percent change from previous period, except as noted, s.a.a.r.) | | | | | | |
| Component | 2002 ¹ | 2003 ¹ | 2003 | | | 2004 |
| | | | Q2 | Q3 | Q4 | Q1 |
| GDP | 1.9 | 2.7 | 2.4 | 3.4 | 3.7 | 2.5 |
| Total domestic demand | 3.3 | 2.5 | 1.0 | 4.8 | 5.4 | 4.0 |
| Consumption | 2.8 | 2.5 | 3.0 | 3.6 | 3.5 | 3.6 |
| Investment | 5.3 | 3.7 | 5.5 | 8.0 | 10.0 | 4.4 |
| Government consumption | .5 | 3.2 | .5 | .7 | 7.8 | 2.8 |
| Inventories ² | .6 | -.3 | -2.2 | 1.2 | .1 | .3 |
| Exports | -1.3 | 3.3 | -7.6 | .3 | 5.3 | -8.1 |
| Imports | 4.3 | 2.5 | -10.8 | 5.2 | 11.1 | -1.8 |
| Net exports ² | -1.7 | .1 | 1.4 | -1.5 | -1.9 | -1.7 |

1. Q4/Q4.

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

The labor market continued to be tight, as both the official-claims-based and the labor-force-survey measures of the unemployment rate remained near their lowest points since 1975. The twelve-month CPI inflation rate rose to 1.5 percent in May, still well below the Bank of England's 2 percent target.

On June 10, the Monetary Policy Committee (MPC) raised the official repo rate another 25 basis points to 4.5 percent. This tightening is the fourth 25-basis-point increase since November. The MPC's statement noted that strong consumption, investment, and a buoyant housing market have all supported growth at, or above, trend. The statement cited a "small and diminishing margin of spare capacity" and the continued build-up of inflationary pressures as motivation for the hike.

| U.K. Economic Indicators | | | | | | | |
|---|------|------|------|------|------|------|------|
| (Percent change from previous period except as noted, s.a.) | | | | | | | |
| Indicator | 2003 | | 2004 | | | | |
| | Q3 | Q4 | Q1 | Feb. | Mar. | Apr. | May |
| Industrial production | .0 | -.1 | -.4 | -.3 | .2 | .6 | n.a. |
| Retail sales volume ¹ | 1.2 | 1.6 | 2.0 | .0 | .8 | .3 | .8 |
| Unemployment rate ² | | | | | | | |
| Claims-based | 3.1 | 3.0 | 2.9 | 2.9 | 2.9 | 2.8 | 2.8 |
| Labor force survey ³ | 5.0 | 4.9 | 4.8 | 4.7 | 4.8 | n.a. | n.a. |
| Business confidence ⁴ | -3.3 | -.3 | 16.7 | 14.0 | 15.0 | 12.0 | 22.0 |
| Consumer confidence ⁵ | -5.0 | -3.3 | -2.3 | -2.0 | -2.0 | -2.0 | -5.0 |
| Consumer prices ⁶ | 1.4 | 1.3 | 1.3 | 1.3 | 1.1 | 1.2 | 1.5 |
| Producer input prices ⁷ | 1.2 | 2.9 | -.4 | -1.7 | .8 | 2.9 | 5.3 |
| Average earnings ⁷ | 3.6 | 3.5 | 5.2 | 3.9 | 4.3 | 4.7 | n.a. |

1. Excludes motor vehicles.

2. Percent.

3. Three-month average centered on month shown.

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

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

6. Consumer prices index (CPI). Percent change from year earlier.

7. Percent change from year earlier.

n.a. Not available.

... Not applicable.

In **Canada**, real GDP grew 2.4 percent in first quarter, as robust domestic demand offset the effects of a dramatic slowdown in the rate of inventory accumulation. Investment was supported by the continued strength of residential construction, while consumption surged. A sharp increase in machinery and equipment shipments pushed up export growth, whereas a large decrease in automotive imports restrained overall import growth.

Indicators for the second quarter have been favorable. Employment increased rapidly in both April and May, with hours worked increasing at a near record rate in May. Average housing starts in April and May were 6.5 percent above the first-quarter average. Exports shot 8 percent above their first-quarter average in April, while imports increased 3 percent. Manufacturing shipments rose for the fifth consecutive month in April, while new orders jumped 2.4 percent. In May, a composite index of leading indicators recorded its strongest increase in two years.

| Canadian Real GDP | | | | | | |
|--|-------------------|-------------------|------|------|------|------|
| (Percent change from previous period, except as noted, s.a.a.r.) | | | | | | |
| Component | 2002 ¹ | 2003 ¹ | 2003 | | | 2004 |
| | | | Q2 | Q3 | Q4 | Q1 |
| GDP | 3.8 | 1.7 | -7 | 1.4 | 3.3 | 2.4 |
| Total domestic demand | 5.9 | 3.9 | 2.6 | .9 | 5.7 | .6 |
| Consumption | 3.6 | 2.8 | 3.2 | 4.4 | .7 | 5.5 |
| Investment | 3.6 | 7.0 | 2.6 | 12.9 | 5.3 | 6.7 |
| Government consumption | 3.2 | 3.5 | 5.9 | .4 | 3.9 | 1.1 |
| Inventories ² | 2.2 | .1 | -1.0 | -4.1 | 3.2 | -4.1 |
| Exports | 2.0 | -8 | -5.1 | -1.9 | 9.4 | 6.3 |
| Imports | 7.1 | 5.0 | 3.4 | -3.0 | 17.8 | .5 |
| Net exports ² | -1.7 | -2.1 | -3.3 | .4 | -2.5 | 2.3 |

1. Q4/Q4.

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

In May, the twelve-month rate of headline CPI inflation increased to 2.5 percent from 1.6 percent in April. The increase was largely due to a 30 percent year-over-year increase in the price of gasoline. Twelve-month core inflation, excluding food, energy, and indirect taxes, edged up only slightly to 1.3 percent.

Canadian Economic Indicators

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

| Indicator | 2003 | | 2004 | | | | |
|-------------------------------------|-------|-------|-------|------|------|------|------------|
| | Q3 | Q4 | Q1 | Feb. | Mar. | Apr. | May |
| GDP by industry | .2 | 1.1 | .5 | .0 | .8 | n.a. | n.a. |
| Industrial production | .0 | 2.1 | .4 | -6 | .7 | n.a. | n.a. |
| New mfg. orders | 1.2 | .1 | 5.6 | .1 | 3.2 | 2.4 | n.a. |
| Retail sales | 1.0 | -1.2 | 3.0 | 2.6 | 1.2 | n.a. | n.a. |
| Employment | .2 | .9 | .3 | -1 | -1 | .3 | .4 |
| Unemployment rate ¹ | 7.9 | 7.5 | 7.4 | 7.4 | 7.5 | 7.3 | 7.2 |
| Consumer prices ² | 2.1 | 1.7 | .9 | .7 | .7 | 1.6 | 2.5 |
| Core Consumer Prices ^{2,3} | 1.7 | 1.6 | 1.1 | 1.0 | 1.1 | 1.3 | x.x |
| Consumer attitudes ⁴ | 122.0 | 124.1 | 123.2 | ... | ... | ... | ... |
| Business confidence ⁴ | 127.2 | 146.3 | 144.8 | ... | ... | ... | ... |

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 | 2003 | | 2004 | | | |
|------------------------------|-------|-------|--------|-------|--------|-------|
| | Q3 | Q4 | Q1 | Mar. | Apr. | May |
| <i>Japan</i> | | | | | | |
| Trade | 87.2 | 114.1 | 120.4 | 110.9 | 109.7 | 137.4 |
| Current account | 145.5 | 157.8 | 182.9 | 164.1 | 173.8 | n.a. |
| <i>Euro area</i> | | | | | | |
| Trade ¹ | 132.2 | 102.2 | 95.4 | 158.3 | 86.8 | n.a. |
| Current account ¹ | 51.9 | 88.4 | n.a. | n.a. | n.a. | n.a. |
| <i>Germany</i> | | | | | | |
| Trade | 172.8 | 155.8 | 199.8 | 204.7 | 218.2 | n.a. |
| Current account ¹ | 44.6 | 92.9 | 105.6 | 195.6 | 146.6 | n.a. |
| <i>France</i> | | | | | | |
| Trade | .8 | .7 | 1.7 | 1.9 | -1.0 | n.a. |
| Current account | 1.3 | -.3 | .6 | -1.5 | .4 | n.a. |
| <i>Italy</i> | | | | | | |
| Trade | 2.1 | 4.3 | -1.6 | 7.2 | 7.2 | n.a. |
| Current account ¹ | 6.8 | -16.5 | -14.1 | 10.5 | -27.5 | n.a. |
| <i>United Kingdom</i> | | | | | | |
| Trade | -77.5 | -88.5 | -103.0 | -91.0 | -101.0 | n.a. |
| Current Account | -40.4 | -35.7 | n.a. | ... | ... | ... |
| <i>Canada</i> | | | | | | |
| Trade | 43.2 | 42.8 | 52.0 | 56.3 | 67.8 | n.a. |
| Current Account | 19.2 | 20.2 | 28.8 | ... | ... | ... |

1. Not seasonally adjusted.

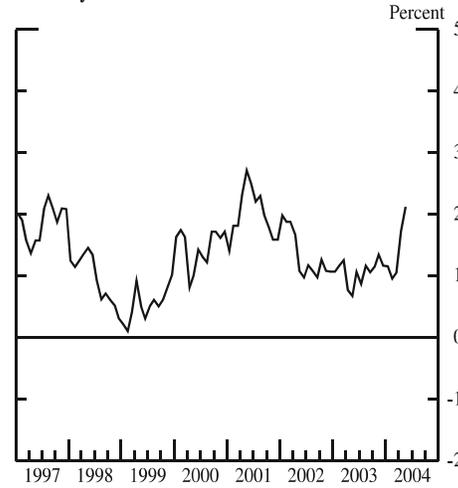
n.a. Not available. ... Not applicable.

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

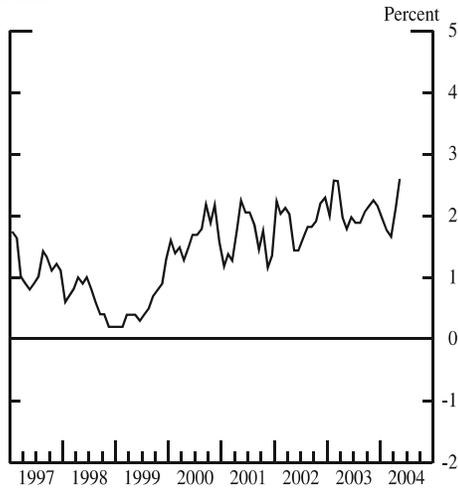
Japan



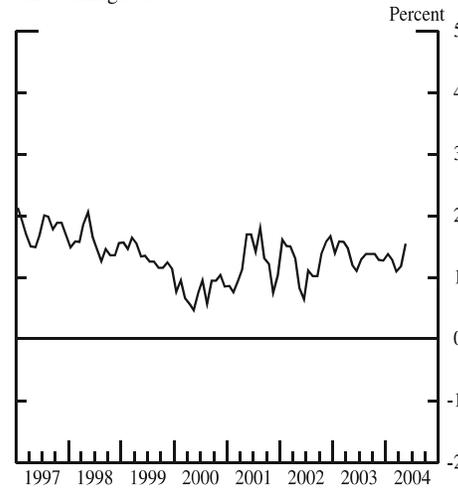
Germany



France



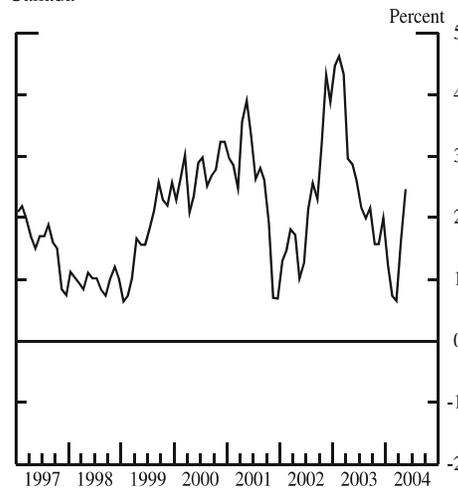
United Kingdom



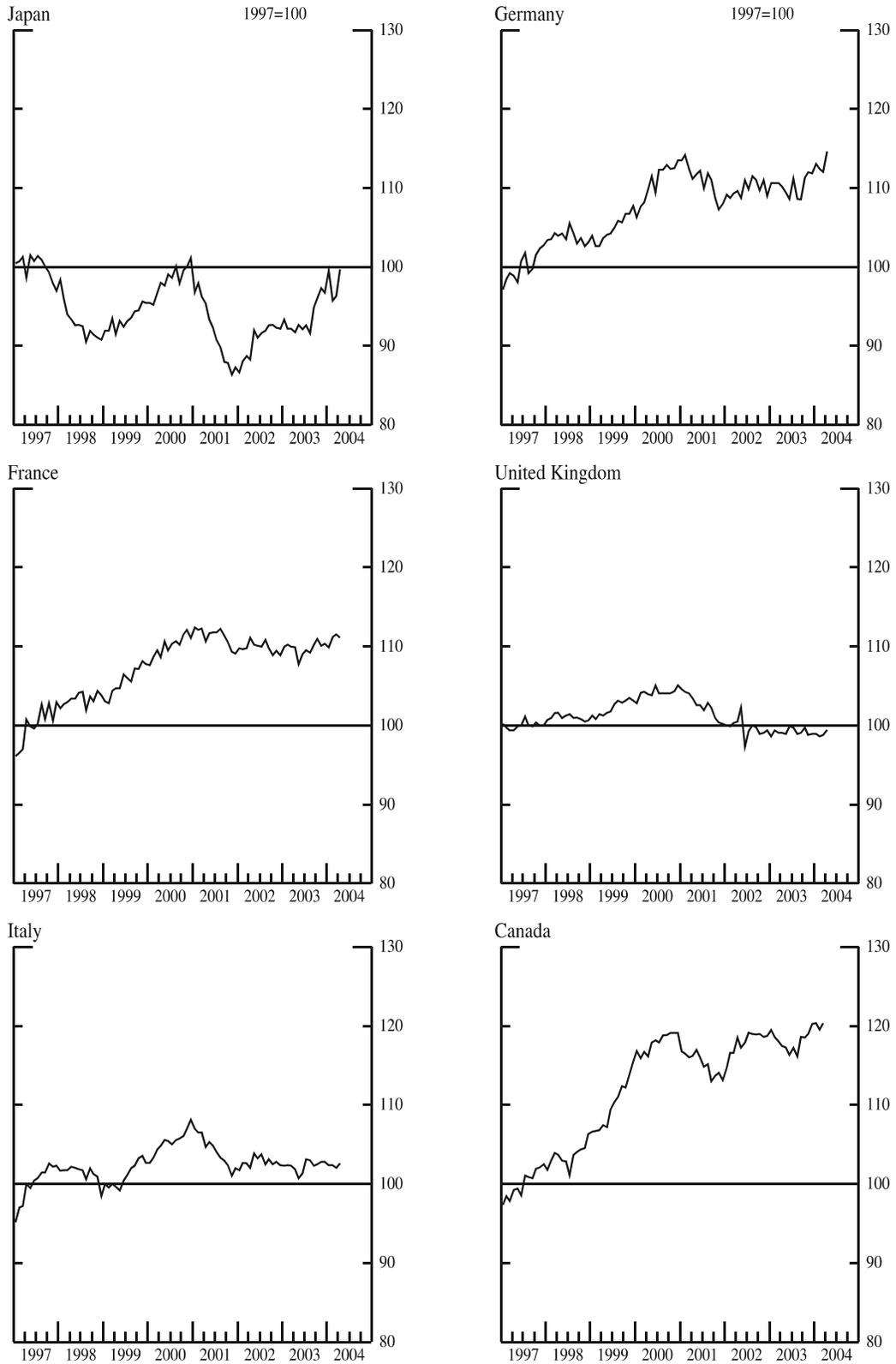
Italy



Canada



Industrial Production in Selected Industrial Countries



Economic Situation in Other Countries

Economic growth in the developing economies generally has remained robust, supported by strong demand from the United States and a buoyant high-tech sector. There have been recent indications, however, that policy tightening may be slowing the expansion of the Chinese economy, which itself has been a significant source of demand for the other Asian economies. In Latin America, the Mexican economy appears to be firing on all cylinders, while growth in Brazil has occurred despite weak domestic demand. Across the developing economies, inflation has remained moderate despite increases in energy prices.

There are clear signs that the **Chinese** economy is slowing from the blistering pace it has maintained since the end of the SARS epidemic last year. Twelve-month growth in investment, industrial production, the money supply (M2), lending, and imports all decelerated in May, indicating that the administrative and quantitative measures taken by the government are having the desired effect. Because the deceleration in activity has not been too sharp and because retail sales and exports have continued to post very strong gains, most analysts think that the Chinese economy is on course for a soft landing.

Price data provide additional evidence that the Chinese economy is cooling. One measure of producer prices fell in May, the first month-to-month decline in almost a year. Overall consumer prices were up 4.4 percent over the same period, but the lion's share of that increase came from food prices, which rose almost 12 percent due to supply shocks; non-food consumer prices were up less than ½ percent in May from a year ago.

Chinese Economic Indicators

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

| Indicator | 2002 | 2003 | 2003 | 2004 | | | |
|------------------------------------|------|------|------|------|------|-------|------|
| | | | Q4 | Q1 | Mar. | Apr. | May |
| Real GDP ¹ | 8.0 | 9.9 | 7.9 | 15.9 | ... | ... | ... |
| Industrial production ² | 14.2 | 18.2 | 17.7 | 14.9 | 19.4 | 20.1 | 17.3 |
| Consumer prices ² | -.4 | 3.2 | 2.7 | 2.8 | 3.0 | 3.8 | 4.4 |
| Trade balance ³ | 30.4 | 25.5 | 38.2 | 1.3 | 20.1 | -12.5 | 32.3 |

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, except annual figures, which are Dec./Dec.

3. Billions of U.S. dollars, annual rate. Imports are c.i.f.

... Not applicable.

The **Hong Kong** economy grew a bit more than 4 percent in the first quarter. Booming tourism from China boosted retail sales and consumer confidence in recent months, and trade volumes (an important indicator for the entrepôt economy) remain near record highs. The unemployment rate has fallen more than 1½ percentage points below its peak last year during the SARS epidemic. Economic growth has put upward pressure on consumer prices, which have been rising on a monthly basis for several quarters now, although they are still down from a year ago.

Hong Kong Economic Indicators

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

| Indicator | 2002 | 2003 | 2003 | 2004 | | | |
|--------------------------------|------|------|-------|-------|-------|-------|------|
| | | | Q4 | Q1 | Mar. | Apr. | May |
| Real GDP ¹ | 4.7 | 4.8 | 6.1 | 4.1 | ... | ... | ... |
| Unemployment rate ² | 7.2 | 7.9 | 7.3 | 7.2 | 7.2 | 7.1 | 7.0 |
| Consumer prices ³ | -1.6 | -1.8 | -2.3 | -1.9 | -2.1 | -1.6 | -0.9 |
| Trade balance ⁴ | -7.7 | -8.5 | -14.1 | -13.0 | -11.1 | -19.2 | 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.

Taiwan's economy grew more than 7 percent in the first quarter, with exports to China and investment spending giving the economy a significant boost. The high-tech sector has been an important part of the economy's resurgence, with exports in this sector now exceeding the peaks reached during the boom in 2000, and high-tech production continuing to move upward despite the decline in overall production in recent months. Consumer price increases have leveled off at a twelve-month change of just under 1 percent.

Taiwan Economic Indicators

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

| Indicator | 2002 | 2003 | 2003 | 2004 | | | | |
|--------------------------------|------|------|------|------|------|------|------|------|
| | | | Q4 | Q1 | Mar. | Apr. | May | |
| Real GDP ¹ | 4.3 | 5.1 | 5.9 | 7.3 | ... | ... | ... | ... |
| Unemployment rate ² | 5.2 | 5.0 | 4.7 | 4.6 | 4.5 | 4.6 | 4.5 | 4.5 |
| Industrial production | 7.9 | 7.2 | 4.7 | .8 | -.1 | -.6 | n.a. | n.a. |
| Consumer prices ³ | .8 | -.1 | -.2 | .5 | .9 | .9 | .9 | .9 |
| Trade balance ⁴ | 18.1 | 16.9 | 12.6 | 9.7 | 7.2 | 20.0 | 12.2 | 12.2 |
| Current account ⁵ | 25.6 | 29.2 | 32.1 | 23.3 | ... | ... | ... | ... |

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** point to moderation in economic activity. GDP rose 3.2 percent in the first quarter, following a torrid 11.3 percent pace in the fourth quarter. Growth was entirely concentrated in the trade and government sectors; private consumption and investment declined. Indicators for the second quarter show a similar pattern. Retail sales for April and business and consumer confidence for April and May remained low. Industrial production rose 1.1 percent in April, supported by growth in the export-related industries. Exports and imports continued to be strong and the trade balance remained high at an annual rate of \$39 billion in April. Inflation in April and May held near the first-quarter average of 3.3 percent. The Korean stock market index has declined markedly recently, in part reflecting concerns about weak domestic demand and fears of a hard landing in China. Markets reacted little to the reinstatement of President Roh on May 14 immediately following the Korean Supreme Court's ruling overturning his impeachment.

| Korean Economic Indicators | | | | | | | |
|--|------|------|------|------|------|------|------|
| (Percent change from previous period, s.a., except as noted) | | | | | | | |
| Indicator | 2002 | 2003 | 2003 | 2004 | | | |
| | | | Q4 | Q1 | Mar. | Apr. | May |
| Real GDP ¹ | 7.7 | 4.1 | 11.3 | 3.2 | ... | ... | ... |
| Industrial production | 8.3 | 5.0 | 5.4 | 3.8 | -2.1 | 1.1 | n.a. |
| Unemployment rate ² | 3.1 | 3.4 | 3.6 | 3.3 | 3.4 | 3.4 | 3.5 |
| Consumer prices ³ | 3.8 | 3.4 | 3.5 | 3.3 | 3.1 | 3.2 | 3.3 |
| Trade balance ⁴ | 14.8 | 22.2 | 33.2 | 40.1 | 32.4 | 38.9 | n.a. |
| Current account ⁵ | 5.4 | 12.3 | 30.6 | 24.6 | 11.0 | 14.4 | 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** economies, Singapore, the Philippines, and Indonesia recorded very strong growth in the first quarter, supported by both external demand and domestic consumption. Activity in Malaysia and Thailand also continued to grow, but at rates that disappointed expectations. In the case of Malaysia, this partly reflected a change in the quarterly pattern, with fourth-quarter growth being revised substantially upwards. For Thailand, the slowing of growth reflects the adverse effect of higher oil prices, weakness in the agriculture sector, and political unrest in the southern states. Recent data on industrial production are generally encouraging, with the exception of the Philippines. Spurred by demand for electronics and high-tech products, exports have remained buoyant through much of the region. There is some evidence of increased inflation pressures in the region.

In political developments, President Arroyo was officially declared the winner of the Philippine elections held in mid-May, although the margin of victory was slim. The Indonesian parliamentary elections resulted in a defeat for President Megawati's party. This leaves the field wide open for the presidential elections to be held on July 5, which is a source of considerable uncertainty that is weighing on financial markets. Indonesia's central bank took measures in early June to drain excess liquidity, including an increase in reserve requirements, in an attempt to stem the slide of the Indonesian rupiah.

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

| Indicator and country | 2002 | 2003 | 2003 | 2004 | | | | |
|--|------|------|------|------|------|-------|------|--|
| | | | Q4 | Q1 | Feb. | Mar. | Apr. | |
| <i>Real GDP¹</i> | | | | | | | | |
| Indonesia | 3.6 | 4.3 | -2.2 | n.a. | ... | ... | ... | |
| Malaysia | 5.6 | 6.6 | 10.4 | 3.3 | ... | ... | ... | |
| Philippines | 5.5 | 4.8 | 6.2 | 8.9 | ... | ... | ... | |
| Singapore | 2.8 | 4.9 | 11.0 | 11.2 | ... | ... | ... | |
| Thailand | 6.0 | 7.8 | 10.2 | 3.4 | ... | ... | ... | |
| <i>Industrial production²</i> | | | | | | | | |
| Indonesia ³ | -1.1 | -1.1 | -2.7 | 3.8 | -2.8 | 1.8 | n.a. | |
| Malaysia | 4.6 | 9.3 | 3.9 | 3.6 | -1.4 | 1.0 | 1.7 | |
| Philippines | -6.1 | .0 | -8.3 | 3.9 | -1.8 | -7.0 | n.a. | |
| Singapore | 8.4 | 3.0 | 4.2 | 2.0 | -5.4 | -11.8 | 20.5 | |
| Thailand | 8.5 | 12.3 | 4.3 | 3.7 | 2.8 | -3.0 | 2.6 | |

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 | 2002 | 2003 | 2003 | 2004 | | | | |
|-------------|------|------|------|------|------|------|------|--|
| | | | Q4 | Q1 | Mar. | Apr. | May | |
| Indonesia | 25.9 | 28.5 | 29.4 | 25.7 | 22.7 | 23.4 | n.a. | |
| Malaysia | 13.5 | 21.4 | 19.8 | 18.5 | 16.8 | 22.4 | n.a. | |
| Philippines | -.2 | -1.5 | -3.5 | -1.7 | -.1 | -.8 | n.a. | |
| Singapore | 8.7 | 16.2 | 17.2 | 14.1 | 9.1 | 7.1 | 9.4 | |
| Thailand | 2.7 | 4.2 | 1.4 | 2.5 | -3.1 | .5 | n.a. | |

n.a. Not available.

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

| Country | 2002 ¹ | 2003 ¹ | 2003 | 2004 | | | |
|-------------|-------------------|-------------------|------|------|------|------|-----|
| | | | Q4 | Q1 | Mar. | Apr. | May |
| Indonesia | 9.9 | 5.2 | 5.7 | 4.8 | 5.1 | 5.9 | 6.5 |
| Malaysia | 1.7 | 1.2 | 1.2 | .9 | 1.0 | 1.0 | 1.2 |
| Philippines | 2.6 | 3.0 | 3.0 | 3.4 | 3.8 | 4.1 | 4.5 |
| Singapore | .4 | .8 | .7 | 1.4 | 1.3 | 1.3 | 2.0 |
| Thailand | 1.6 | 1.8 | 1.6 | 1.9 | 2.3 | 2.5 | 2.4 |

1. December/December.

In **Mexico**, GDP growth continued at a robust pace of more than 5 percent in the first quarter, and recent indicators suggest that growth remained strong in the current quarter. Industrial production rose 1.3 percent in April and exports picked up sharply, as the manufacturing sector continued to be buoyed by demand from the United States. Construction activity strengthened in April as well, consistent with a pickup in investment spending. Labor market conditions have begun to improve—the rise in maquiladora employment that began last fall has accelerated, and the national unemployment rate edged down in April—contributing to a considerable increase in retail sales in the first quarter.

The Bank of Mexico has left its monetary stance unchanged since tightening policy on April 27, but short-term market interest rates have moved up somewhat. Mexican twelve-month consumer price inflation edged up to 4.3 percent in May, and inflation expectations and one-year wage settlements remain just above 4 percent, the upper end of the 2 to 4 percent band for the Bank of Mexico's inflation target. High oil prices boosted the Mexican public sector fiscal surplus to a record high during the first four months of this year, and the government has increased transfers to the states for infrastructure spending, implying greater fiscal stimulus even as the government deficit remains on target.

| Mexican Economic Indicators | | | | | | | |
|--|-------|-------|-------|-------|-------|-------|------|
| (Percent change from previous period, s.a., except as noted) | | | | | | | |
| Indicator | 2002 | 2003 | 2003 | 2004 | | | |
| | | | Q4 | Q1 | Mar. | Apr. | May |
| Real GDP ¹ | 1.9 | 2.0 | 5.6 | 5.4 | ... | ... | ... |
| Overall economic activity | .7 | 1.3 | 1.5 | .2 | 2.5 | n.a. | n.a. |
| Industrial production | -.3 | -.7 | 1.9 | 1.3 | 1.7 | 1.3 | n.a. |
| Unemployment rate ² | 2.7 | 3.3 | 3.6 | 3.7 | 3.8 | 3.7 | 3.7 |
| Consumer prices ³ | 5.7 | 4.0 | 4.0 | 4.3 | 4.2 | 4.2 | 4.3 |
| Trade balance ⁴ | -7.9 | -5.6 | -4.6 | -4.4 | -6.3 | -3.7 | n.a. |
| Imports ⁴ | 168.7 | 170.5 | 176.6 | 182.8 | 186.3 | 186.6 | n.a. |
| Exports ⁴ | 160.8 | 164.9 | 171.9 | 178.4 | 180.1 | 182.9 | n.a. |
| Current account ⁵ | -14.0 | -9.2 | -13.4 | -7.5 | ... | ... | ... |

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

2. Percent; counts as unemployed those working one hour a week or less.

3. Percent change from year-earlier period, except annual figures, which are Dec./Dec.

4. Billions of U.S. dollars, annual rate.

5. Billions of U.S. dollars, n.s.a., annual rate.

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

In **Brazil**, real GDP grew 6.8 percent in the first quarter after rising a revised 5.9 percent in the fourth quarter. The first-quarter increase largely reflected a rise in net exports, while growth in domestic demand was weak. Industrial production declined 1.4 percent in the first quarter, on average, but rose sharply in March and edged up further in April. Other indicators, such as capital goods production, also point to expansion in industrial activity in April. Although urban unemployment has remained high, employment growth has been solid, particularly in the agricultural sector. Twelve-month headline inflation continued to fall, but monthly inflation picked up in May and is widely expected to rise further in June and July as a result of mid-June hikes in fuel prices.

Declines in Brazilian asset prices, including the depreciation of the *real*, since early April prompted the central bank to leave its policy rate unchanged at 16 percent at its June 15-16 meeting. The policy rate was cut from 26½ percent to 16½ percent over the second half of 2003, but concerns about inflation have prompted the central bank to slow the pace of interest rate declines. Survey measures of average twelve-month ahead expected inflation have moved up from 5½ percent in early May to over 6 percent in mid-June. The Brazilian government has not auctioned any fixed-rate domestic debt since late April and

has resorted to its usual practice of shortening the maturity structure of the domestic debt in times of financial stress.

Brazilian Economic Indicators

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

| Indicator | 2002 | 2003 | 2003 | 2004 | | | |
|--------------------------------|------|------|------|------|------|------|------|
| | | | Q4 | Q1 | Mar. | Apr. | May |
| Real GDP ¹ | 3.8 | -1 | 5.9 | 6.8 | ... | ... | ... |
| Industrial production | 2.7 | -1 | 5.3 | -1.4 | 2.0 | .1 | n.a. |
| Unemployment rate ² | 12.5 | 12.4 | 13.2 | 11.6 | 11.8 | 12.2 | n.a. |
| Consumer prices ³ | 12.5 | 9.3 | 11.4 | 6.8 | 5.9 | 5.3 | 5.2 |
| Trade balance ⁴ | 13.1 | 24.8 | 28.2 | 29.4 | 34.5 | 26.4 | 32.7 |
| Current account ⁵ | -7.7 | 4.0 | 1.2 | 6.7 | 9.8 | -8.8 | n.a. |

1. Annual rate. Annual figures are Q4/Q4.
 2. Percent. Break in October 2001 as a result of change in methodology.
 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.

The **Argentine** economy grew 6.8 percent in the first quarter. However, recent data suggest that the ongoing economic recovery could be adversely affected by the country's energy problems. Industrial production fell 4 percent in April, following a sharp increase in the first quarter that was apparently the result of firms' anticipation of energy price increases and potential energy shortages during the winter months of the southern hemisphere. Capacity pressures in the energy sector are a result of limited investment over the past few years because of utility price controls and general economic disruption. Argentina has so far responded to the energy crisis by importing electricity from Brazil, natural gas from Bolivia, and fuel oil from Venezuela; by cutting natural gas exports to Chile; and by taxing exports of hydrocarbon products to finance the creation of a state-run energy company. Despite this, Argentina has continued to run sizable trade surpluses, and twelve-month consumer price inflation remained low in April, at just over 4 percent.

Although Argentina has met all quantitative targets agreed with the IMF with comfortable margins, it has lagged behind in other areas, such as reform of the federal-provincial fiscal structure, bank compensation, and debt restructuring. In early June, the Argentine government unveiled a new debt restructuring plan that is somewhat more favorable to creditors than the original proposal last year.

The most significant concession by the Argentine government is the offer to recognize most, if not all, of the roughly \$20 billion in past-due interest that has accrued since the December 2001 default. The new offer would result in a net-present-value reduction of the defaulted debt of about 75 percent. The original proposal implied a reduction of about 90 percent in net present value terms. The offer would also include “growth coupons” on the new bonds, which would result in higher interest payments if GDP growth were to exceed certain thresholds.

Argentine Economic Indicators

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

| Indicator | 2002 | 2003 | 2003 | 2004 | | | |
|--------------------------------|-------|------|------|------|------|------|------|
| | | | Q4 | Q1 | Mar. | Apr. | May |
| Real GDP ¹ | -3.3 | 12.1 | 12.7 | 6.8 | ... | ... | ... |
| Industrial production | -10.7 | 16.2 | 3.8 | 5.5 | 1.8 | -3.9 | n.a. |
| Unemployment rate ² | 22.5 | 17.3 | 14.5 | 14.4 | ... | ... | ... |
| Consumer prices ³ | 41.4 | 3.8 | 3.8 | 2.5 | 2.3 | 3.1 | 4.2 |
| Trade balance ⁴ | 16.7 | 15.7 | 12.2 | 10.6 | 12.0 | 14.3 | n.a. |
| Current account ⁵ | 9.1 | 7.8 | 4.6 | 1.5 | ... | ... | ... |

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

2. Percent, n.s.a.

3. Percent change from year-earlier period, except annual figures, which are Dec./Dec.

4. Billions of U.S. dollars, annual rate.

5. Billions of U.S. dollars, n.s.a., annual rate.

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

In **Venezuela**, despite political uncertainties, activity this year has expanded, fueled by expansionary fiscal policies. It was announced that President Hugo Chavez will face a recall referendum on August 15, ending months of disputes over whether the opposition had collected enough valid signatures to force the referendum. There are strong concerns that Chavez will manage to delay the referendum, which by law must be held before August 19 or it will be too close to the 2006 end of Chavez’s term. In addition, opinion polls do not give clear signals on whether there is sufficient popular support for a regime change. Poor economic performance under Chavez led to a failed coup attempt in 2002 and to debilitating national strikes later that year; activity has not fully recovered since then. Oil production is still believed to be about 15 percent below pre-strike levels.

Venezuelan Economic Indicators

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

| Indicator | 2002 | 2003 | 2003 | 2004 | | | |
|------------------------------------|-------|------|------|------|------|------|------|
| | | | Q4 | Q1 | Mar. | Apr. | May |
| Real GDP ¹ | -16.7 | 8.6 | 17.4 | 7.9 | ... | ... | ... |
| Unemployment rate ² | 16.0 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| Consumer prices ³ | 31.2 | 27.1 | 26.3 | 24.0 | 23.5 | 23.1 | 21.8 |
| Non-oil trade balance ⁴ | -8.5 | -5.8 | 19.4 | n.a. | n.a. | n.a. | n.a. |
| Trade balance ⁴ | 13.0 | 15.0 | 46.0 | n.a. | n.a. | n.a. | n.a. |
| Current account ⁵ | 7.4 | 9.6 | 10.8 | 13.8 | ... | ... | ... |

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.

5. Billions of U.S. dollars, n.s.a., annual rate.

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