

## **Prefatory Note**

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## **Part 2**

November 3, 2004

# **CURRENT ECONOMIC AND FINANCIAL CONDITIONS**

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## **Recent Developments**

November 3, 2004

## **Recent Developments**

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## **Domestic Nonfinancial Developments**

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## Domestic Nonfinancial Developments

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### Overview

Overall economic activity continues to increase at a moderate pace despite headwinds caused in large part by the sharp rise in oil prices. Consumer and business fixed investment spending posted solid gains in the third quarter. Furthermore, activity in the housing sector remains strong. Aside from the hurricane-related disruptions, manufacturing production continues to expand but at a pace well below that registered in the first half of the year. Likewise, the labor market has seen four months of subpar hiring, after the surge in employment gains this spring. Consumer price inflation continues to be moderate despite surging oil prices.

### Labor Market Developments

Private nonfarm payroll employment rose 59,000 in September, the fourth consecutive month of sluggish job gains. Over this period, private payrolls increased only 77,000 per month on average, well below the 293,000 average increase posted from March through May.<sup>1</sup> The workweek stood at 33.8 hours throughout the third quarter; this slight increase relative to the second-quarter level contributed to a gain of 3.2 percent at an annual rate in aggregate hours of private production and nonsupervisory workers. The four hurricanes that hit the southeastern states had little net effect on the aggregate labor-market data for August and September, according to the Bureau of Labor Statistics.

In the household survey, the unemployment rate held at 5.4 percent in September, and the labor force participation rate edged down to 65.9 percent, about the same level as at the beginning of this year. The employment-population ratio, which combines the unemployment rate and the participation rate, fell for a second month in September and, at 62.3 percent, stands well below its year 2000 peak and a little below its level in the mid-1990s. In addition, the number of persons working part-time for economic reasons as a share of total employment, although down from its recent peak, remained high in September. On balance, we interpret these recent indicators from the household survey as suggesting that some measurable slack remains in the labor market.

Other labor market indicators have shown mixed signals over the last few months. The four-week moving average of initial claims for unemployment insurance was 343,000 in the week ending October 23. The level of initial claims was elevated in October by the aftereffects of the hurricanes; abstracting from this distortion, initial claims have remained in a narrow range around 340,000 since the start of the year. Households' perceptions of the job market, as measured in the Conference Board Survey, dimmed in October. Moreover, households' expectations of labor market conditions deteriorated a bit in October, according to the Conference Board Survey, and have been flat since August, according to the Michigan Survey.

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<sup>1</sup> The Bureau of Labor Statistics' preliminary estimate of the benchmark revision to the level of payroll employment in March 2004 is an upward revision of 236,000, or 0.2 percent, a bit smaller than the average absolute revision seen over the past decade.

**Changes in Employment**

(Thousands of employees; seasonally adjusted)

| Measure and sector  | 2003                   | 2004 |      |                |      |      |       |
|---|------------------------|------|------|----------------|------|------|-------|
|   |                        | Q1   | Q2   | Q3             | July | Aug. | Sept. |
|   | Average monthly change |      |      | Monthly change |      |      |       |
| Nonfarm payroll employment (establishment survey)                           | -5                     | 198  | 209  | 103            | 85   | 128  | 96    |
| Private   | -1                     | 195  | 218  | 65             | 41   | 96   | 59    |
| Previous  | -1                     | 195  | 218  | ...            | 60   | 120  | ...   |
| Manufacturing   | -48                    | 7    | 16   | -3             | 5    | 4    | -18   |
| Construction  | 7                      | 26   | 19   | 7              | 5    | 11   | 4     |
| Wholesale trade   | -3                     | 8    | 5    | 9              | 10   | 6    | 10    |
| Retail trade  | -5                     | 46   | 14   | -11            | -17  | -2   | -15   |
| Transportation and utilities  | -5                     | 14   | 8    | 5              | 8    | 0    | 7     |
| Information   | -10                    | -2   | 4    | -11            | -9   | -11  | -12   |
| Financial activities  | 6                      | 7    | 15   | 13             | -5   | 19   | 26    |
| Professional and business services  | 23                     | 26   | 73   | 27             | 33   | 15   | 34    |
| Temporary help services   | 15                     | 8    | 23   | 19             | 11   | 13   | 33    |
| Nonbusiness services <sup>1</sup>   | 34                     | 59   | 60   | 27             | 5    | 54   | 22    |
| Total government  | -4                     | 3    | -8   | 38             | 44   | 32   | 37    |
| Total employment (household survey)   | 168                    | -60  | 244  | 150            | 629  | 21   | -201  |
| Memo:   |                        |      |      |                |      |      |       |
| Aggregate hours of private production workers (percent change) <sup>2</sup> | -0.8                   | 2.3  | 2.2  | 3.2            | .8   | .1   | .1    |
| Average workweek (hours) <sup>3</sup>                                       | 33.7                   | 33.8 | 33.7 | 33.8           | 33.8 | 33.8 | 33.8  |
| Manufacturing (hours)   | 40.4                   | 41.0 | 40.9 | 40.8           | 40.8 | 40.9 | 40.8  |

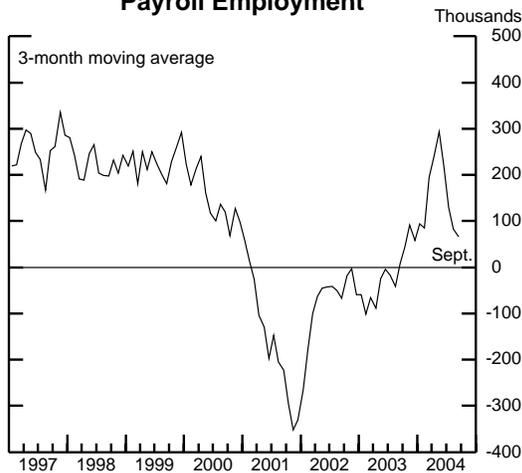
1. Nonbusiness services comprises education and health, leisure and hospitality, and "other."

2. Establishment survey. Annual data are percent changes from Q4 to Q4. Quarterly data are percent changes from preceding quarter at an annual rate. Monthly data are percent changes from preceding month.

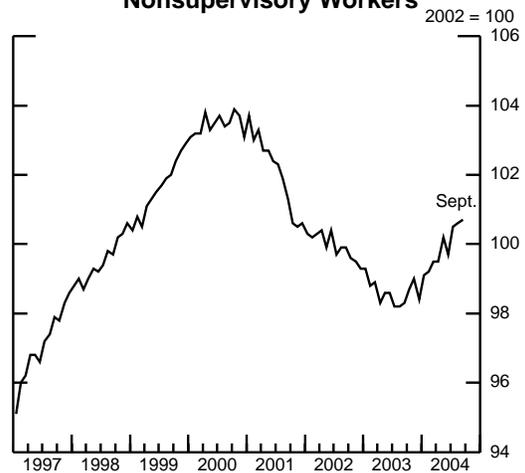
3. Establishment survey.

... Not applicable.

**Changes in Private Payroll Employment**



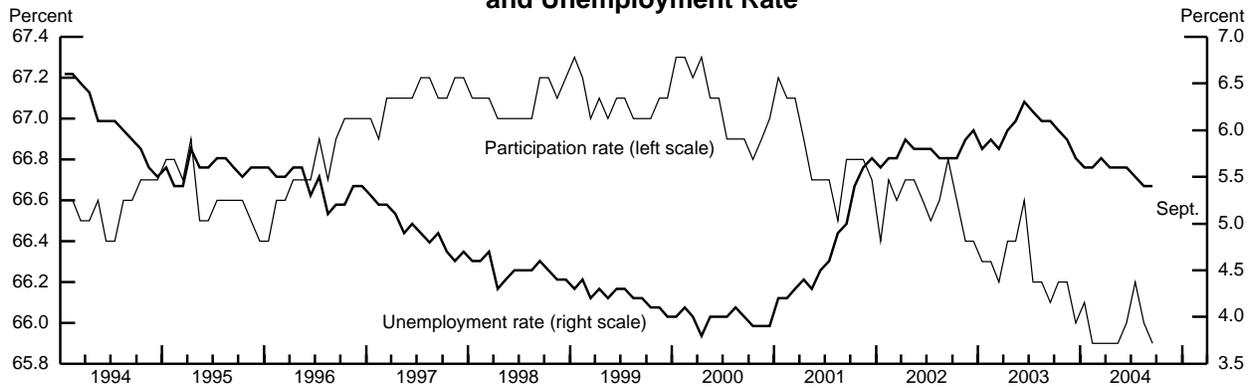
**Aggregate Hours of Production or Nonsupervisory Workers**



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

| Rate and group                        | 2003 | 2004 |      |      |      |       |
|---------------------------------------|------|------|------|------|------|-------|
|                                       |      | H1   | Q3   | July | Aug. | Sept. |
| <i>Civilian unemployment rate</i>     |      |      |      |      |      |       |
| 16 years and older                    | 6.0  | 5.6  | 5.5  | 5.5  | 5.4  | 5.4   |
| Teenagers                             | 17.4 | 16.8 | 17.1 | 17.6 | 17.0 | 16.6  |
| 20-24 years old                       | 10.0 | 9.6  | 9.3  | 9.3  | 9.0  | 9.5   |
| Men, 25 years and older               | 5.1  | 4.5  | 4.4  | 4.4  | 4.4  | 4.3   |
| Women, 25 years and older             | 4.6  | 4.5  | 4.3  | 4.5  | 4.3  | 4.3   |
| <i>Labor force participation rate</i> |      |      |      |      |      |       |
| Total                                 | 66.2 | 65.9 | 66.0 | 66.2 | 66.0 | 65.9  |
| Teenagers                             | 44.5 | 43.6 | 43.9 | 44.1 | 44.1 | 43.4  |
| 20-24 years old                       | 75.4 | 74.9 | 74.9 | 75.2 | 74.9 | 74.5  |
| Men, 25 years and older               | 75.5 | 75.3 | 75.4 | 75.4 | 75.4 | 75.2  |
| Women, 25 years and older             | 59.6 | 59.2 | 59.3 | 59.5 | 59.2 | 59.3  |

**Labor Force Participation Rate and Unemployment Rate**



**Employment-Population Ratio**

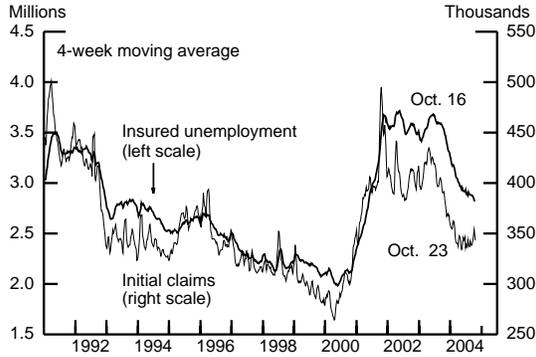


**Persons Working Part-Time for Economic Reasons**  
(Percent of household employment)

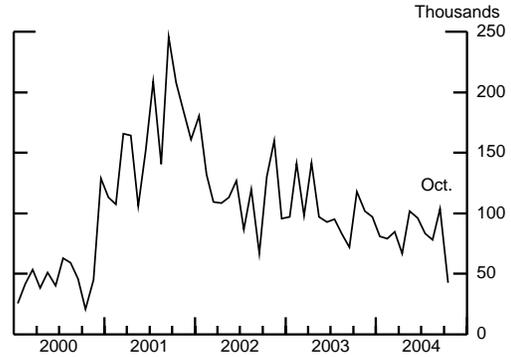


**Labor Market Indicators**

**Unemployment Insurance**

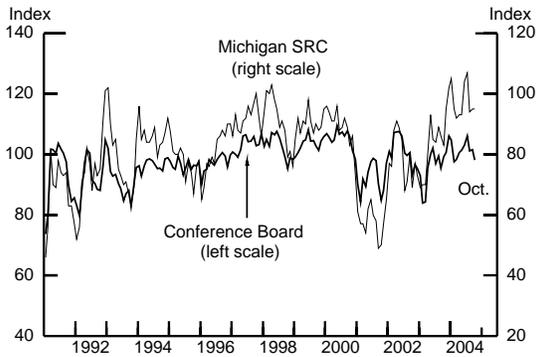


**Layoff Announcements**



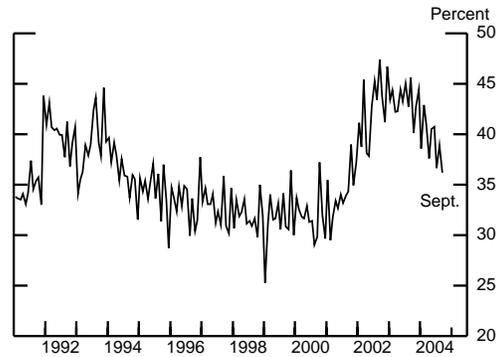
Note. Seasonally adjusted by FRB staff.  
Source. Challenger, Gray, and Christmas, Inc.

**Expected Labor Market Conditions**



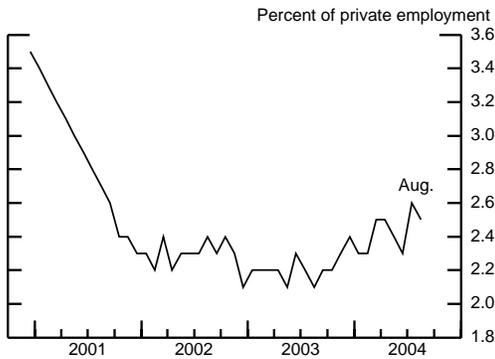
Note. The proportion of households expecting labor market conditions to improve, minus the proportion expecting conditions to worsen, plus 100.

**Exhaustion Rate**



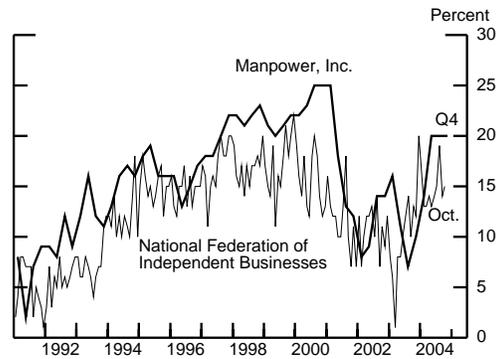
Note. Seasonally adjusted by FRB staff. Exhaustion rate is number of individuals who exhausted benefits without finding a job, expressed as a share of individuals who began receiving benefits six months earlier.

**Job Openings**



Source. Job Openings and Labor Turnover Survey.

**Net Hiring Strength**



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

On a brighter note, fewer individuals exhausted their unemployment insurance benefits without finding a job in September, and the number of exhaustees was well below its elevated levels of a year ago. Layoff announcements plunged in October to their lowest level since 2000. In addition, the job openings series in the JOLTS survey edged up over the summer, although it declined slightly in August. Finally, the Manpower survey of firms' hiring plans for the fourth quarter remained at its recent high, and the more volatile NFIB survey edged up in October, retracing some of its September drop.

### **Industrial Production**

Industrial production in September was restrained by the spate of hurricanes that occurred that month. Total production was up just 0.1 percent as a surge in output at utilities was nearly offset by a drop in manufacturing output. The limited data we have in hand suggest that IP increased in October, and most near-term indicators suggest that activity in the manufacturing sector will expand at a moderate pace in coming months.

Although the exact magnitude of the effect of the hurricanes is difficult to determine, we believe that the change in total IP in September was reduced roughly  $\frac{1}{2}$  percentage point. Sharp declines in oil and gas extraction, petroleum refining, and organic chemical production are directly attributable to shutdowns in the affected areas. Other industries for which a sizable share of shipments originates from hurricane-affected areas, such as textile products, also saw outsized production declines. Utilization rates for many of the affected industries—especially continuous processing industries such as petroleum refining—were high before the hurricanes hit, limiting their capability to make up production losses.<sup>2</sup> In addition, damages to infrastructure have further limited the recovery of energy producing industries in October.

Weekly data for October suggest that electricity generation moved up last month, likely in part because of a rebound in electricity sales in areas that had hurricane-related power outages in September. In addition, the latest data indicate that motor vehicle assemblies rose to an annual rate of 12.2 million units last month, nearly  $\frac{1}{2}$  million units above the pace in September. Accordingly, the production of motor vehicles and parts is expected to directly contribute more than 0.1 percentage point to the change in total IP in October. Excluding electricity and motor vehicles, output in industries for which we have weekly physical product data—principally, crude oil and refinery products, iron and steel, appliances, meat products, and lumber and plywood—was changed little in October.

The output of high-technology products decelerated sharply in the third quarter, because of slower production of semiconductors. Indeed, capacity utilization for the semiconductor industry fell to a level more than 5 percentage points below the rate in the second quarter. Furthermore, industry contacts report that demand for semiconductors was weaker than expected last quarter. With sales weak, Intel reports that inventories are still above desired levels, and it hopes to trim the excess in the fourth quarter by slowing

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<sup>2</sup> Continuous processing industries employ small workforces, and thus their hurricane-related production cutbacks likely had little effect on the aggregate labor market data for August and September.

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

| Component   | Proportion<br>2003<br>(percent) | 2003 <sup>1</sup> | 2004        |            | 2004         |            |           |
|---|---------------------------------|-------------------|-------------|------------|--------------|------------|-----------|
|   |                                 |                   | H1          | Q3         | July         | Aug.       | Sept.     |
|   |                                 |                   | Annual rate |            | Monthly rate |            |           |
| <b>Total</b>  | <b>100.0</b>                    | <b>1.5</b>        | <b>5.8</b>  | <b>2.9</b> | <b>.7</b>    | <b>-.1</b> | <b>.1</b> |
| Previous  | 100.0                           | 1.5               | 5.7         | ...        | .6           | .1         | ...       |
| Manufacturing   | 82.3                            | 1.9               | 6.8         | 4.4        | .9           | .2         | -.3       |
| Ex. motor veh. and parts                                      | 75.6                            | 1.7               | 7.5         | 4.7        | 1.0          | -.1        | -.2       |
| Ex. high-tech industries                                      | 70.7                            | .3                | 6.2         | 4.1        | 1.0          | -.2        | -.3       |
| Mining  | 7.6                             | .4                | -2.1        | -2.2       | 1.4          | -.9        | -2.3      |
| Utilities   | 10.1                            | -.6               | 3.7         | -5.4       | -1.6         | -2.3       | 5.4       |
| <i>Selected industries</i>                                    |                                 |                   |             |            |              |            |           |
| High technology   | 4.9                             | 21.3              | 25.7        | 13.2       | .6           | .7         | 1.0       |
| Computers   | 1.2                             | 14.1              | 22.6        | 17.5       | 1.5          | 1.6        | 1.4       |
| Communications equipment                                      | 1.3                             | 5.8               | 1.5         | 25.6       | 2.7          | 1.4        | -.3       |
| Semiconductors <sup>2</sup>                                   | 2.4                             | 34.3              | 40.2        | 6.2        | -.8          | .0         | 1.5       |
| Motor vehicles and parts                                      | 6.7                             | 3.8               | -.8         | .4         | .1           | 3.4        | -.5       |
| <i>Market groups excluding energy and selected industries</i> |                                 |                   |             |            |              |            |           |
| Consumer goods  | 22.6                            | .2                | 5.1         | 1.4        | .6           | .1         | .0        |
| Durables  | 4.3                             | 1.1               | 3.2         | -2.6       | .6           | -.4        | -.5       |
| Nondurables   | 18.3                            | .0                | 5.5         | 2.3        | .6           | .2         | .1        |
| Business equipment  | 7.3                             | 1.0               | 12.7        | 11.1       | 3.0          | -1.9       | .2        |
| Defense and space equipment                                   | 1.9                             | 4.8               | 4.5         | 12.4       | 2.6          | .1         | .6        |
| Construction supplies   | 4.2                             | 1.1               | 5.0         | 2.8        | .7           | .3         | -.4       |
| Business supplies   | 8.5                             | .2                | 7.9         | 3.8        | .6           | .0         | -.6       |
| Materials   | 24.8                            | -.3               | 5.2         | 4.8        | .8           | .0         | -.3       |
| Durables  | 13.6                            | -.1               | 6.0         | 6.2        | 1.0          | -.1        | -.2       |
| Nondurables   | 11.2                            | -.5               | 4.3         | 3.2        | .6           | .1         | -.3       |

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

2. Includes related electronic components.

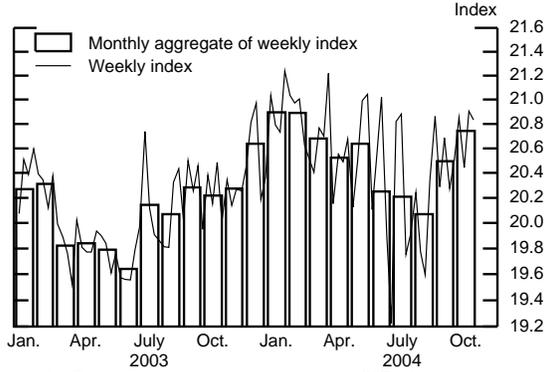
... Not applicable.

**Capacity Utilization**  
(Percent of capacity)

| Sector                         | 1972-<br>2003<br>average | 1982<br>low | 1990-<br>1991<br>low | 2004        |             |             |             |             |
|--------------------------------|--------------------------|-------------|----------------------|-------------|-------------|-------------|-------------|-------------|
|                                |                          |             |                      | Q1          | Q2          | Q3          | Aug.        | Sept.       |
| <b>Total industry</b>          | <b>81.1</b>              | <b>70.9</b> | <b>78.6</b>          | <b>76.5</b> | <b>77.1</b> | <b>77.3</b> | <b>77.2</b> | <b>77.2</b> |
| Manufacturing                  | 80.0                     | 68.7        | 77.2                 | 75.1        | 76.1        | 76.5        | 76.6        | 76.3        |
| High-tech industries           | 78.8                     | 75.4        | 74.5                 | 69.1        | 69.6        | 68.0        | 68.0        | 67.4        |
| Excluding high-tech industries | 80.1                     | 68.2        | 77.3                 | 76.1        | 77.2        | 77.9        | 78.0        | 77.8        |
| Mining                         | 86.9                     | 78.6        | 83.4                 | 84.9        | 84.4        | 83.9        | 84.3        | 82.4        |
| Utilities                      | 86.9                     | 77.6        | 84.1                 | 85.5        | 83.6        | 82.3        | 80.2        | 84.5        |

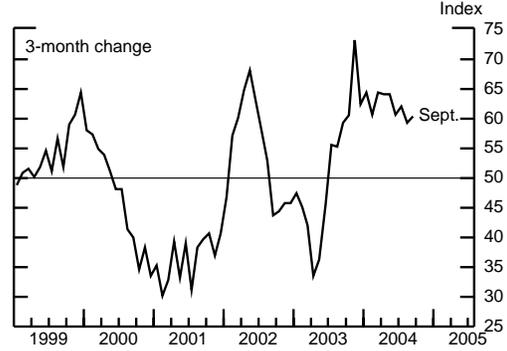
## Indicators of Manufacturing Activity

Weekly Production Index



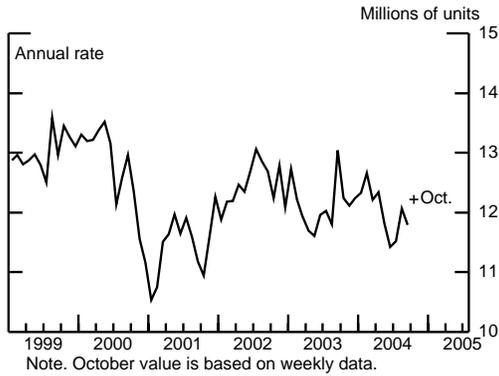
Note. One index point equals 1 percent of 1997 total industrial output.

Industrial Production Diffusion Index



Note. The diffusion index equals the percentage of series that increased over 3 months plus one-half the percentage that were unchanged.

Motor Vehicle Assemblies

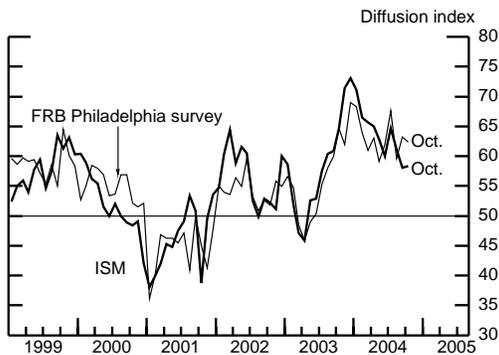


Note. October value is based on weekly data.

Industrial Production: Military and Civilian Aircraft

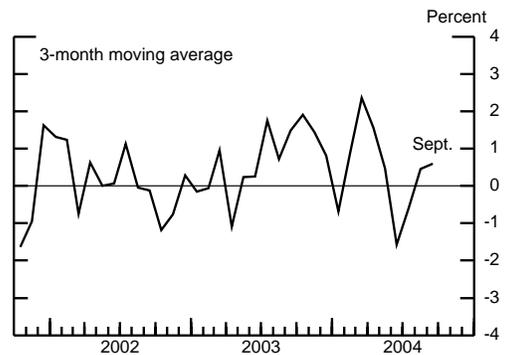


New Orders: ISM and FRB Philadelphia Surveys



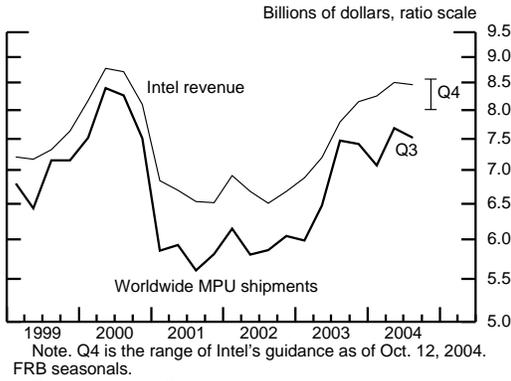
Note. The diffusion index equals the percentage of respondents reporting greater levels of new orders, plus one-half the percentage of respondents reporting that new orders were unchanged.

Change in Real Adjusted Durable Goods Orders

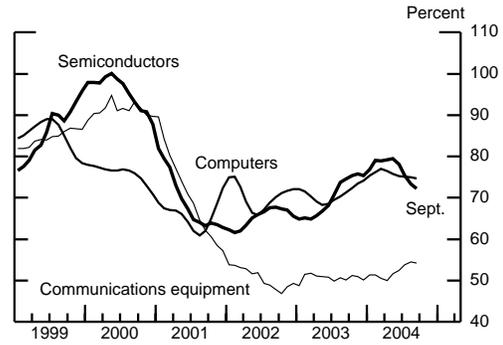


## Indicators of High-Tech Manufacturing Activity

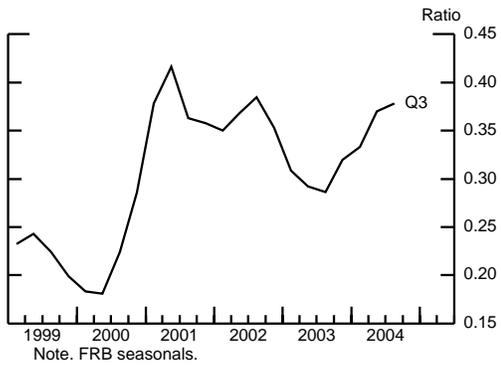
Microprocessor Unit (MPU) Shipments and Intel Revenue



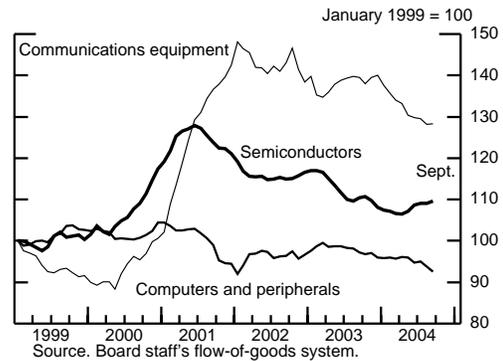
Capacity Utilization in the High-Tech Sector



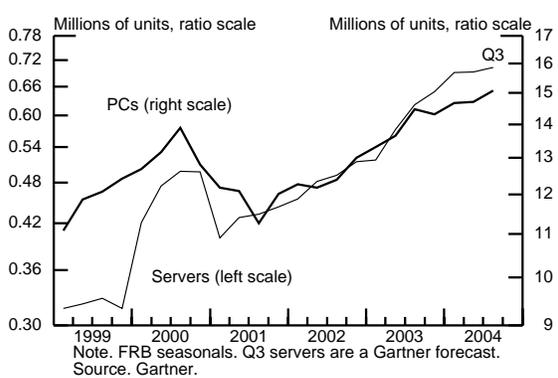
Intel Inventories-to-Shipments Ratio



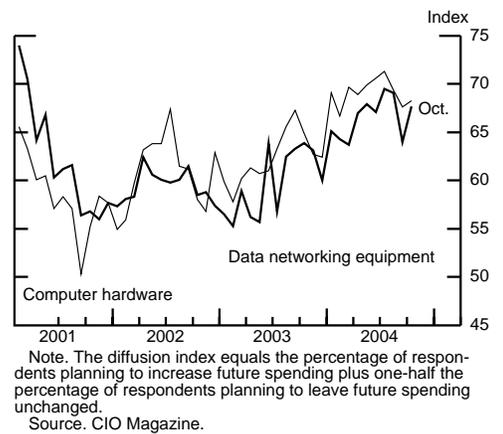
Days' Supply of Computers and Peripherals, Communications Equipment, and Semiconductors



U.S. Personal Computer and Server Sales



CIO Magazine Future Spending Diffusion Index



output growth. Indeed, Intel's latest earnings forecast for the fourth quarter is consistent with only small increases in real semiconductor output. Still, semiconductor manufacturers plan to increase capacity, as evidenced by an increase in the book-to-bill ratio in September of the producers of semiconductor equipment.

Production of computers and communications equipment posted solid gains in the third quarter, but the forward-looking indicators of activity are mixed. In September, orders for computer equipment rose, but orders for communications equipment fell. Gartner's forecast of fourth-quarter PC sales is consistent with a moderate gain in production. Gartner reports that consumer demand has been sluggish, and they expect the holiday shopping season to be a disappointing one, in part because PCs are currently lacking any new "must-have" features. *CIO Magazine* diffusion indexes for future spending on computer hardware and on networking equipment moved up in October after having fallen in the previous month.

Outside of transportation and high-tech, production of business equipment jumped at an annual rate of 11 percent in the third quarter, about the same pace as in the second quarter. Within business equipment, gains were especially pronounced for electrical equipment and farm, construction, and semiconductor machinery. The output of consumer goods was up a bit in the third quarter, as a decrease in consumer durables was more than offset by a gain in consumer nondurables. Construction supplies and business supplies both posted moderate increases.

The forward-looking indicators of near-term production suggest that activity in the industrial sector will continue to expand at a moderate pace in coming months. For example, the ISM index of new orders in October was changed little from its elevated level in the prior month, and the index of new export orders moved up. The various regional diffusion indexes of new orders, some of which are available through October, also point to further gains. Smoothing through the substantial volatility in the staff's series on real adjusted durable goods orders, the three-month moving average moved up 0.6 percent in September.

### **Motor Vehicles**

Sales of new autos and light trucks rose in September to an annual rate of 17.4 million units, fueled by a jump in incentives near the close of the month. For the third quarter as a whole, sales were at a 17.1 million unit rate, about ½ million units stronger than the pace in the first and second quarters. We estimate that the more generous level of consumer incentives, which moved up \$260 per vehicle on average in the third quarter, explains about half the gain. Incentives fell back in October, and industry contacts report, on a confidential basis, that the pace of light vehicle sales last month will likely come in between 16½ and 17 million units.

The Michigan SRC index for motor-vehicle-buying conditions rose in September and in October—an increase supported by the perception of low prices among survey respondents. High gasoline prices remain a concern, though the percentage of

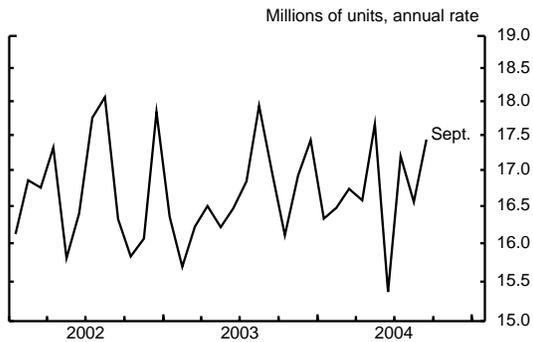
**Sales of Light Vehicles**  
(Millions of units at an annual rate, FRB seasonals)

| Category                         | 2003 | 2004 |      |      | 2004 |      |       |
|----------------------------------|------|------|------|------|------|------|-------|
|                                  |      | Q1   | Q2   | Q3   | July | Aug. | Sept. |
| Total                            | 16.6 | 16.5 | 16.5 | 17.1 | 17.2 | 16.6 | 17.4  |
| Autos                            | 7.6  | 7.4  | 7.5  | 7.3  | 7.5  | 7.2  | 7.3   |
| Light trucks                     | 9.0  | 9.1  | 9.1  | 9.7  | 9.7  | 9.4  | 10.1  |
| North American <sup>1</sup>      | 13.3 | 13.3 | 13.1 | 13.8 | 13.9 | 13.4 | 14.1  |
| Autos                            | 5.5  | 5.4  | 5.3  | 5.3  | 5.5  | 5.2  | 5.3   |
| Light trucks                     | 7.8  | 7.8  | 7.9  | 8.5  | 8.4  | 8.2  | 8.9   |
| Foreign-produced                 | 3.3  | 3.3  | 3.4  | 3.3  | 3.3  | 3.2  | 3.3   |
| Autos                            | 2.1  | 2.0  | 2.2  | 2.0  | 2.0  | 2.0  | 2.1   |
| Light trucks                     | 1.2  | 1.2  | 1.2  | 1.2  | 1.3  | 1.2  | 1.2   |
| Memo:<br>Medium and heavy trucks | .33  | .40  | .40  | .44  | .44  | .44  | .45   |

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.

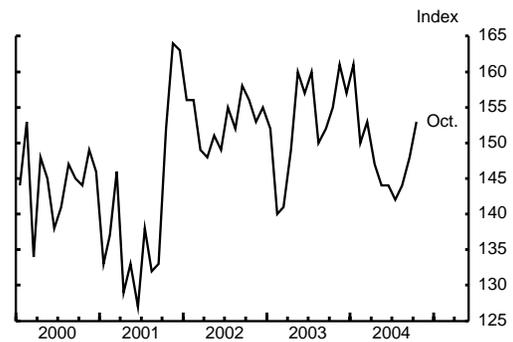
1. Excludes some vehicles produced in Canada that are classified as imports by the industry.

**Sales of Light Vehicles**

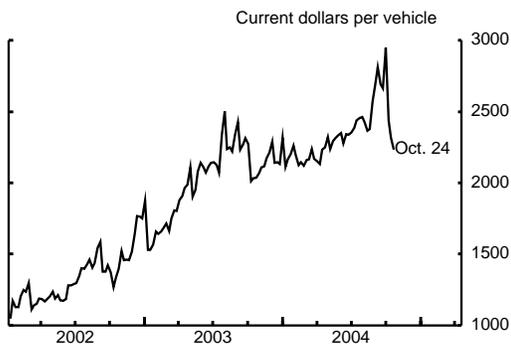


Note. FRB seasonals. Adjusted for shifts in reporting periods.

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

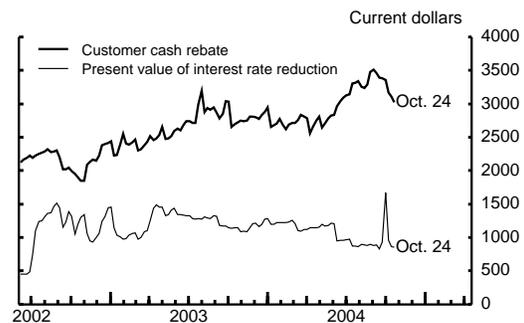


**Average Value of Incentives on Light Vehicles**



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

**Average Value of Cash and Financing Incentives for Vehicles with Incentives**



Source. J.D. Power and Associates.

respondents who cite gasoline prices as a reason that vehicle-buying conditions are poor has declined substantially since June.

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

| Item                      | 2003 | 2004 |      |                 | 2004  |                   |                   |
|---------------------------|------|------|------|-----------------|-------|-------------------|-------------------|
|                           |      | H1   | Q3   | Q4 <sup>1</sup> | Sept. | Oct. <sup>1</sup> | Nov. <sup>1</sup> |
| U.S. production           | 12.1 | 12.1 | 11.8 | 12.1            | 11.8  | 12.2              | 12.1              |
| Autos                     | 4.5  | 4.3  | 4.3  | 4.3             | 4.4   | 4.3               | 4.3               |
| Trucks                    | 7.6  | 7.8  | 7.5  | 7.8             | 7.4   | 7.9               | 7.8               |
| Days' supply <sup>2</sup> | 73   | 77   | 73   | n.a.            | 71    | n.a.              | n.a.              |
| Autos                     | 63   | 62   | 63   | n.a.            | 63    | n.a.              | n.a.              |
| Trucks                    | 80   | 88   | 79   | n.a.            | 76    | n.a.              | n.a.              |
| Inventories <sup>3</sup>  | 3.17 | 3.33 | 3.26 | n.a.            | 3.26  | n.a.              | n.a.              |
| Autos                     | 1.13 | 1.09 | 1.08 | n.a.            | 1.08  | n.a.              | n.a.              |
| Trucks                    | 2.04 | 2.24 | 2.19 | n.a.            | 2.19  | n.a.              | n.a.              |

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

1. Production rates for the fourth quarter and October and November reflect the latest schedules from Ward's Communications.

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

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

n.a. Not available

Because of the relatively strong sales of light motor vehicles in recent months, days' supply fell in the third quarter to about 73 days, although this level was slightly above the target range of manufacturers. Motor vehicle production declined in September, but the latest estimates for October indicate that assemblies jumped to an annual rate of 12.2 million units last month, nearly ½ million units above the pace in September. For the fourth quarter as a whole, the automakers' production schedules call for a step-up in the average pace of assemblies from their third-quarter level. However, General Motors announced plans to take advantage of the winter holiday shutdown by closing several plants for an additional week in the first quarter of 2005 in order to address any remaining inventory overhang.

### Consumer Spending

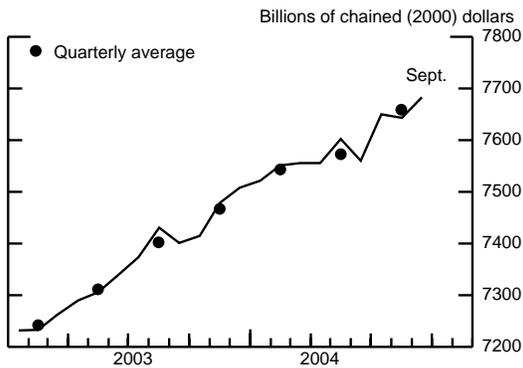
Real consumer spending rebounded strongly in the third quarter, rising at an annual rate of 4.6 percent after having advanced only 1.6 percent in the second quarter. Excluding motor vehicles, outlays increased at a 3.5 percent pace in the third quarter, after a 2.0 percent rise in the second quarter.

Total real PCE moved up 0.5 percent in September. Outlays for motor vehicles ramped up last month, as did purchases of other goods. Spending on services jumped, in part because outlays for electricity were boosted by unseasonably warm weather.

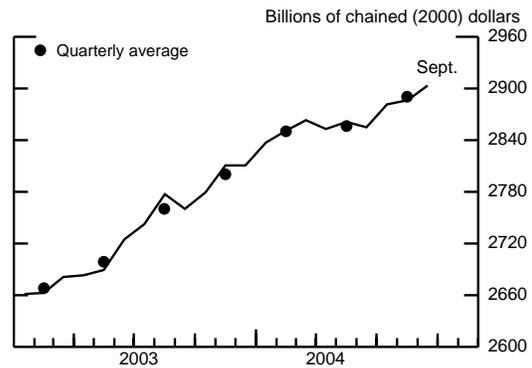
**Real Personal Consumption Expenditures**  
(Percent change from the preceding period)

| Expenditure                              | 2004        | 2004 | 2004  |      |              |      |       |
|--|-------------|------|-------|------|--------------|------|-------|
|  | H1          | H2   | Q2    | Q3   | July         | Aug. | Sept. |
|  | Annual rate |      |       |      | Monthly rate |      |       |
| Total real PCE                           | 2.8         | 2.3  | 1.6   | 4.6  | 1.2          | -.1  | .5    |
| Durable goods                            | .9          | 8.1  | -.3   | 16.8 | 6.2          | -1.5 | 1.5   |
| Motor vehicles                           | -5.9        | 12.8 | -6.0  | 27.2 | 12.5         | -3.0 | 1.8   |
| Excluding motor vehicles                 | 6.9         | 4.4  | 4.6   | 9.0  | 1.4          | -.1  | 1.3   |
| Nondurable goods                         | 3.4         | 1.9  | .1    | 3.9  | .8           | .2   | .4    |
| Energy                                   | -7.9        | 3.3  | -13.2 | 6.8  | 3.2          | 1.9  | -.9   |
| Other                                    | 4.7         | 1.8  | 1.8   | 3.6  | .6           | .0   | .6    |
| Services                                 | 3.0         | 1.3  | 2.7   | 2.7  | .4           | .1   | .4    |
| Energy                                   | -2.4        | -3.2 | -8.0  | -6.3 | -.7          | -1.4 | 4.7   |
| Transportation                           | 2.4         | .8   | 2.9   | 1.6  | .3           | .4   | -.1   |
| Other                                    | 3.3         | 1.5  | 3.1   | 3.1  | .4           | .1   | .2    |
| Memo:<br>Real disposable personal income | 2.4         | .7   | 2.4   | 1.4  | .1           | .2   | .0    |

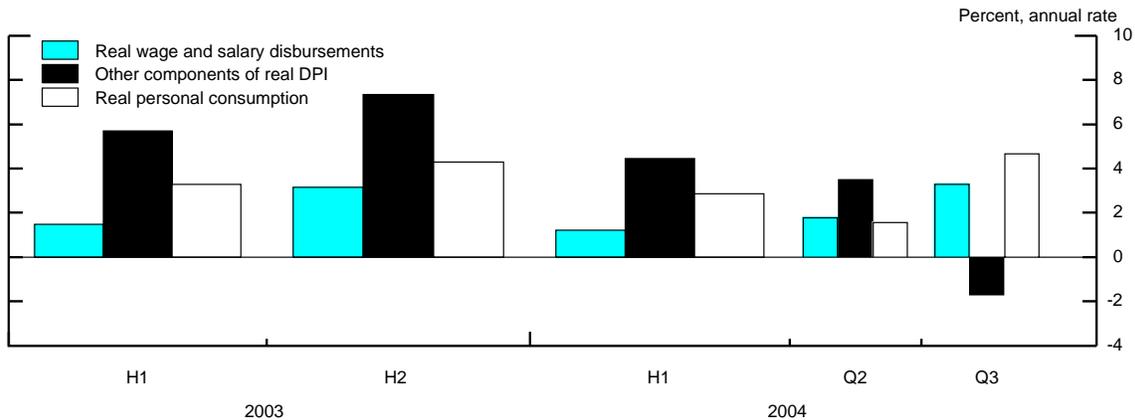
**Real PCE**



**Real PCE Goods Excl. Motor Vehicles**



**Change in Real Wages and Salaries, Other Real DPI, and Real Personal Consumption**



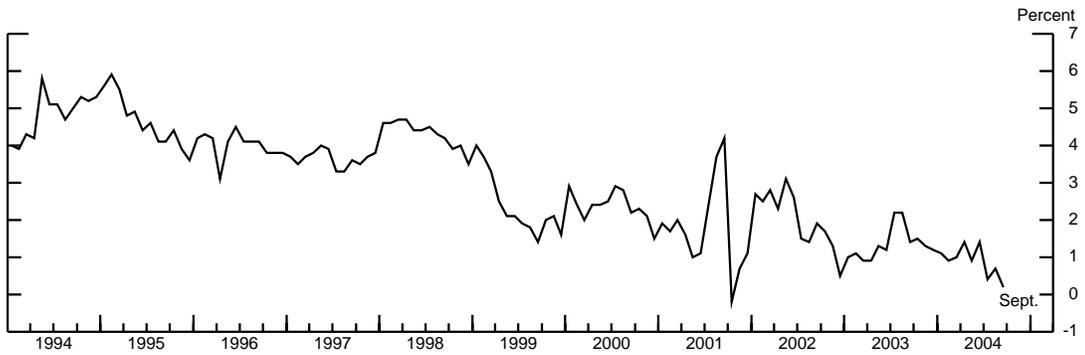
### Household Indicators

#### Household Net Worth and Wilshire 5000



\* 2004:Q3 is a staff estimate.

#### Personal Saving Rate



#### Consumer Confidence



Real disposable personal income increased 1.4 percent in the third quarter, down from the 2.4 percent pace of the second quarter. The hurricanes had a slightly negative effect on income in the third quarter: The boost from additional insurance payouts from firms nearly offset the loss of rental and proprietors' income because of damage to uninsured property. Even excluding hurricane effects, rental and proprietors' income declined in the third quarter. In contrast, real wage and salary disbursements stepped up last quarter as a result of a larger increase in hours worked and an easing of consumer energy prices. Government transfer payments were flat in the third quarter, held back by the BEA's assumption that the expiration on June 30 of the temporary increase in the federal share of Medicaid costs enacted in 2003 would result in a sharp drop in payments to individuals.

On net, the gain in income fell short of the increase in total spending in the third quarter, and the personal saving rate dropped to 0.4 percent. Meanwhile, lower equity prices and rising house prices have combined to hold the ratio of household wealth to income nearly unchanged this year.

Both the Michigan SRC's index of consumer sentiment and the Conference Board's index of consumer confidence moved down in October, damped by deteriorating assessments of expected economic conditions. The levels of the indexes are roughly consistent with the current configuration of economic fundamentals.

### **Housing Markets**

Starts of single-family homes fell to an annual rate of 1.54 million units in September, well below the average of the previous three months. However, permit issuance—adjusted for activity in areas where permits are not required—remained strong at 1.60 million units. In addition, the permit backlog rose substantially, suggesting that starts likely bounced back in October against a backdrop of relatively favorable mortgage rates.<sup>3</sup> In the multifamily sector, starts rose to an annual rate of 360,000 units in September, somewhat higher than the average pace earlier this year. Permit issuance for multifamily units also was strong, and the backlog of permits inched up.

Home sales remained robust in September. Sales of existing homes rose 3 percent in September, to an annual rate of 6.75 million units, while sales of new homes were at an annual rate of 1.21 million units for the month of September. Both sales figures for September were somewhat above the average during the first eight months of this year, though slightly below the record highs posted this last spring. Recent indicators point to continued strong housing demand in the near term. Rates on thirty-year conventional mortgages turned up briefly last spring but have since reversed most of the earlier increase; the most recent reading, at 5.64 percent, is about 24 basis points less than the average since the beginning of 2004. Partly in response to the drop in mortgage rates

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<sup>3</sup> The hurricanes that made landfall in the Gulf region in September—Frances, Ivan, and Jeanne—do not appear to be responsible for the decline in starts in that month: The largest declines in September starts were in the West and Northeast; starts in the South were essentially unchanged.

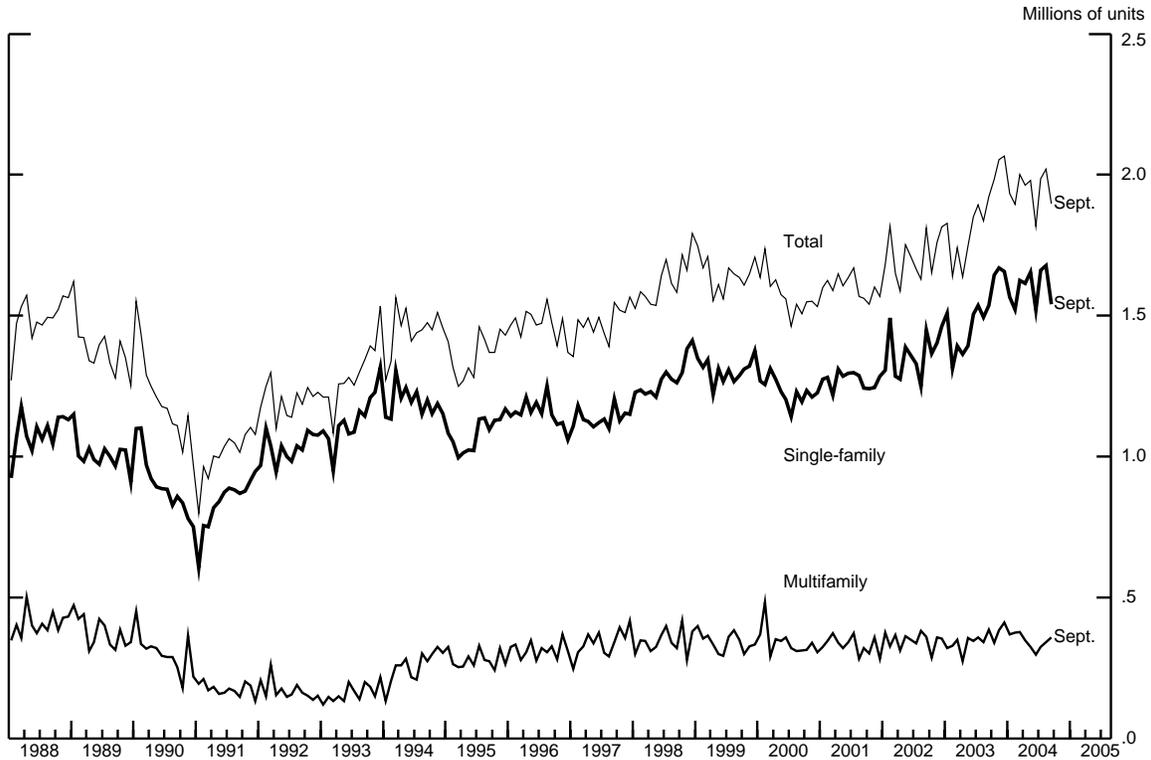
**Private Housing Activity**

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

| Sector                        | 2003 | 2004 |      |      |      |      |       |
|-------------------------------|------|------|------|------|------|------|-------|
|                               |      | Q1   | Q2   | Q3   | July | Aug. | Sept. |
| <i>All units</i>              |      |      |      |      |      |      |       |
| Starts                        | 1.85 | 1.94 | 1.92 | 1.97 | 1.99 | 2.02 | 1.90  |
| Permits                       | 1.89 | 1.93 | 2.02 | 2.01 | 2.07 | 1.97 | 2.01  |
| <i>Single-family units</i>    |      |      |      |      |      |      |       |
| Starts                        | 1.50 | 1.57 | 1.60 | 1.63 | 1.66 | 1.68 | 1.54  |
| Permits                       | 1.46 | 1.52 | 1.57 | 1.57 | 1.59 | 1.56 | 1.56  |
| Adjusted permits <sup>1</sup> | 1.50 | 1.55 | 1.60 | 1.60 | 1.61 | 1.59 | 1.60  |
| Permit backlog <sup>2</sup>   | .115 | .123 | .136 | .144 | .138 | .127 | .144  |
| New home sales                | 1.09 | 1.20 | 1.21 | 1.16 | 1.10 | 1.17 | 1.21  |
| Existing home sales           | 6.10 | 6.20 | 6.79 | 6.67 | 6.72 | 6.55 | 6.75  |
| <i>Multifamily units</i>      |      |      |      |      |      |      |       |
| Starts                        | .35  | .37  | .32  | .34  | .32  | .34  | .36   |
| Permits                       | .43  | .42  | .45  | .45  | .48  | .41  | .45   |
| Permit backlog <sup>2</sup>   | .060 | .054 | .058 | .066 | .065 | .065 | .066  |
| <i>Mobile homes</i>           |      |      |      |      |      |      |       |
| Shipments                     | .131 | .126 | .127 | n.a. | .125 | .125 | n.a.  |

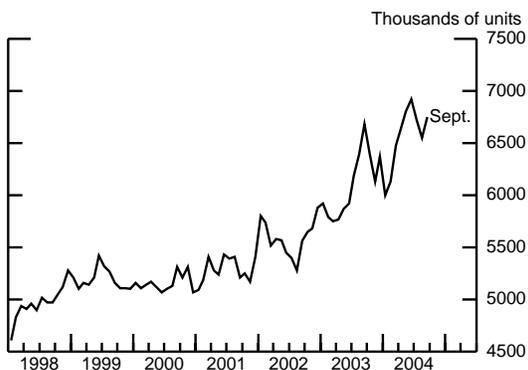
1. Adjusted permits equal permit issuance plus total starts outside of permit-issuing areas.
2. Number outstanding at end of period. Seasonally adjusted by Board staff. Excludes permits that have been cancelled, abandoned, expired, or revoked. Not at an annual rate.

**Private Housing Starts**  
(Seasonally adjusted annual rate)



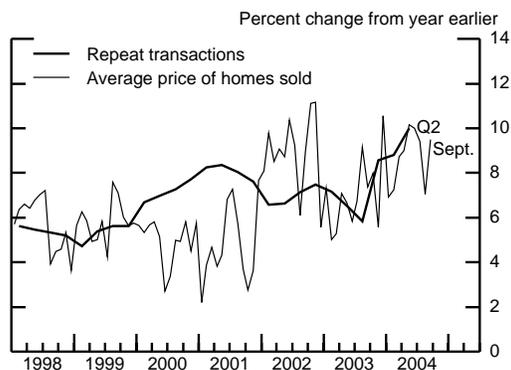
## Indicators of Single-Family Housing

Existing Home Sales



Source: National Association of Realtors.

Prices of Existing Homes



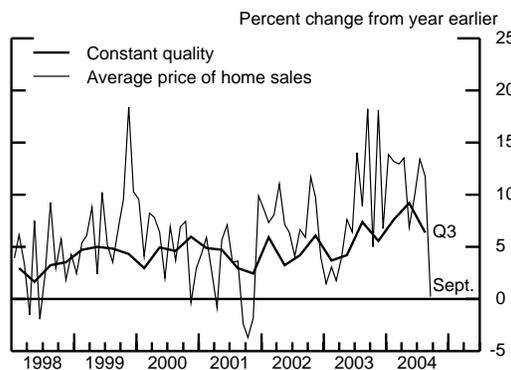
Source: Freddie Mac Conventional Mortgage Home Price Index and National Association of Realtors.

New Home Sales



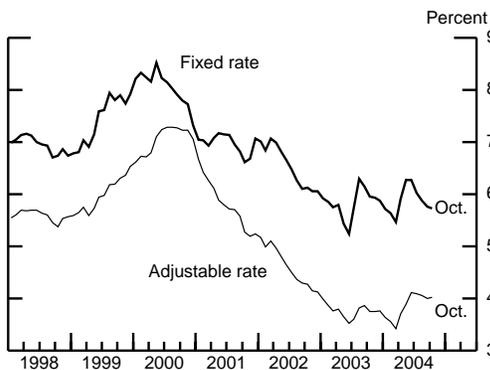
Source: Census Bureau.

Prices of New Homes



Source: Census Bureau.

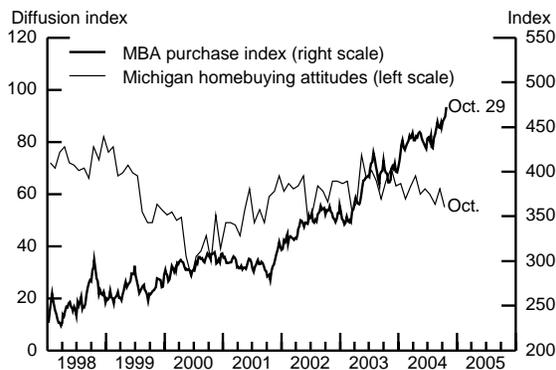
Mortgage Rates



Note: The October readings are based on data through Oct. 27.

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.

during the past few months, the four-week moving average of mortgage applications to purchase homes has risen substantially over the same period. However, the Michigan Survey's gauge of homebuying attitudes dropped in October to the lowest level since early 2003, in part because respondents saw less investment potential in homes and less reason to buy in advance of rising mortgage rates.

Prices of existing homes have continued to post substantial increases, but the most recent data suggest some moderation in prices of new homes. The average price of existing homes purchased in September was up 9½ percent from a year earlier, similar to the year-over-year readings over the past few months. The twelve-month change in the average price of new homes averaged 11¾ percent from June through August but was essentially unchanged in September.<sup>4</sup> The constant-quality price index for new homes, which controls for changes in the geographic composition of sales, home size, and a few other readily measurable attributes, was up 6¼ percent in the third quarter from a year earlier, but down about 2 percentage points from the average pace earlier this year.

### **Equipment and Software**

Real outlays for equipment and software are estimated to have expanded at an annual rate of 15 percent in the third quarter, after a similar-sized gain in the second quarter.<sup>5</sup> The brisk third-quarter pace was consistent with the relatively favorable underlying fundamentals of capital spending: Business output continues to post solid gains, the user cost of capital is low, and corporate coffers are flush with liquid assets.

The partial-expensing provision of the current tax code should be encouraging businesses to accelerate capital expenditures in order to take advantage of the tax incentive before it expires at the end of the year. To date, the evidence suggests that the law is having an effect, although the magnitude of the effect is uncertain. The most recent anecdotes provide mixed signals about the strength of the effect: Although only about 12 percent of the respondents to a special question in the Empire State Manufacturing Survey thought partial expensing was encouraging more capital expenditures, about one-fourth of the respondents to the Philadelphia Fed's Business Outlook Survey gave a favorable response to a similarly worded question. Further, about half of the respondents to a NABE survey question indicated that the impending expiration of the partial-expensing provision was having a small effect on the timing of capital expenditures, while another 10 percent indicated that it was having a significant effect.

Data on purchases of capital goods also lend support to the view that partial expensing may be having some effect. The tax provision allows firms to boost the percentage of the cost of a capital good that can be written off in the first year of service. This provision is

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<sup>4</sup> The twelve-month change in the average price of new homes in September was held down, in part, by a jump in the average price of new homes in the previous September.

<sup>5</sup> The staff's third-quarter estimate of the increase in spending on equipment and software is about 0.2 percentage points more than the BEA's advance estimate. The upward revision is based on revised September data for shipments of capital goods, which became available after the NIPA report.

relatively advantageous for equipment that ordinarily would be depreciated slowly. Indeed, nominal shipments of longer-lived equipment—which includes industrial and metalworking machinery as well as electrical, medical, and certain transportation equipment—accelerated of late, jumping at an annual rate of 15 percent in the third quarter, while shipments of shorter-lived equipment—such as computers and communications equipment—rose only modestly by previous standards. Of course, because other factors besides partial expensing are also affecting business investment decisions, comparisons of this sort do not provide definitive evidence about the magnitude of the partial-expensing effect.

More broadly, real outlays for non-high-tech, non-transportation equipment soared in the third quarter; the 21 percent (annual rate) gain was the largest increase in a decade. Although, as noted above, the category's strong performance is probably in part the result of the partial-expensing tax provision, other forces are also likely driving investment in this category. Nominal shipments of farm machinery and construction machinery have recently been boosted by the vigorous pace of real activity in the agriculture and residential construction sectors. Likewise, shipments of oilfield machinery have probably benefited from high oil prices, and shipments of rail equipment are likely rising in response to high levels of freight demand. Orders of non-high-tech, non-transportation equipment have been above shipments for nearly a year, a trend that bodes well for spending in this category in coming months.

Real business spending on transportation equipment rose at an annual rate of 29 percent in the third quarter despite a sharp drop in domestic deliveries of aircraft. Business-sector demand for motor vehicles remains strong. In particular, sales of medium and heavy trucks moved up to an annual rate of almost 450,000 units in September, a level not seen since July 2000. Orders for these trucks ticked down in September but remained near record levels. Industry sources report that the surge in orders for heavy trucks this year reflects an overall rise in freight shipping as well as some pent-up demand for equipment replacement after three years of weak purchases. Truck manufacturers also report that the partial-expensing provision may be prompting some trucking firms to accelerate the pace of purchases this quarter.

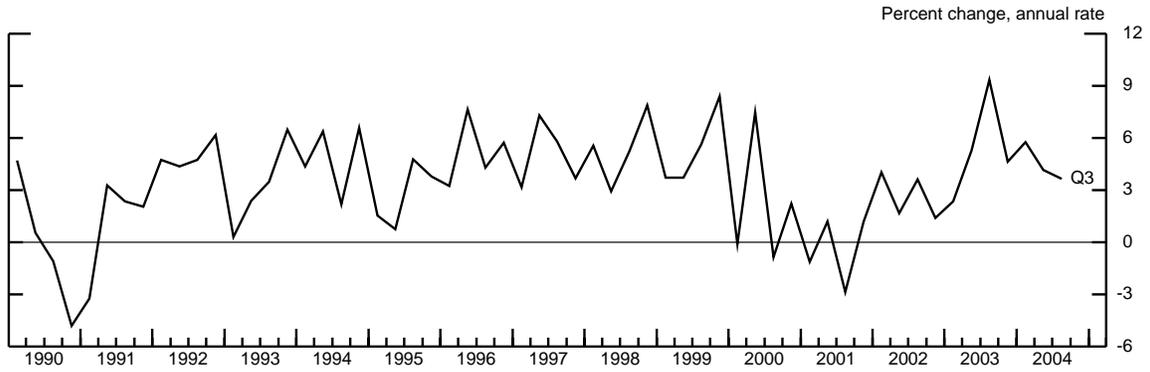
Real outlays for high-tech equipment and software expanded at an annual rate of 4¾ percent in the third quarter, a step-down from the second-quarter pace. The high-tech slowdown last quarter reflected a sharp deceleration in real spending for computers, software, and communications equipment.<sup>6</sup>

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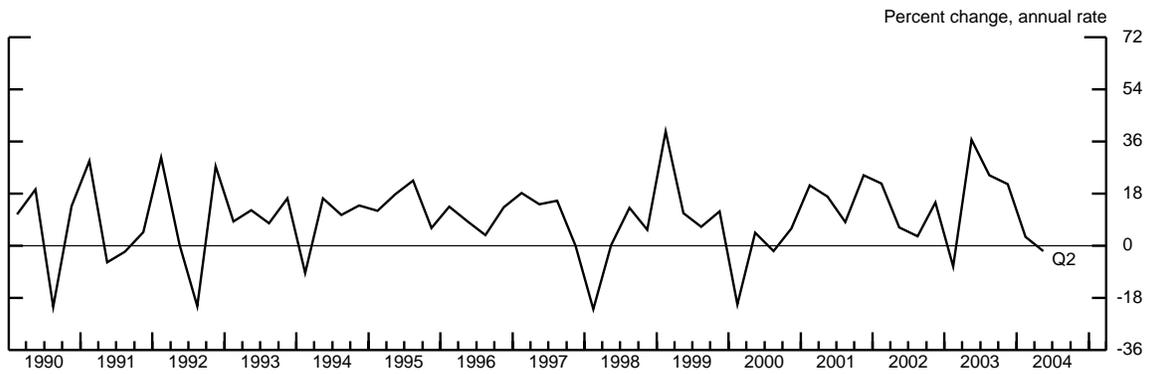
<sup>6</sup> The third-quarter slowdown in spending by businesses on computer and communications equipment contrasts with the pickup in production of this equipment.

## Equipment and Software Investment Fundamentals

Real Business Output

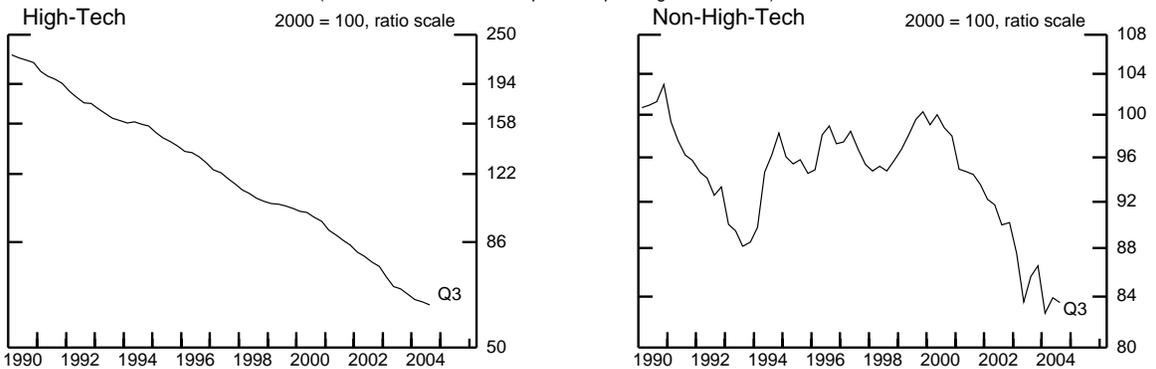


Real Corporate Cash Flow



### User Cost of Capital

(Includes the effects of the partial expensing tax incentive)



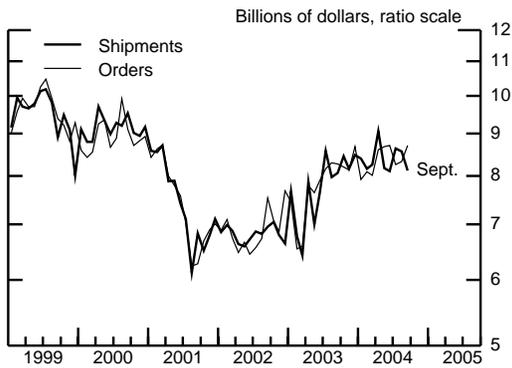
**Orders and Shipments of Nondefense Capital Goods**

(Percent change; seasonally adjusted current dollars)

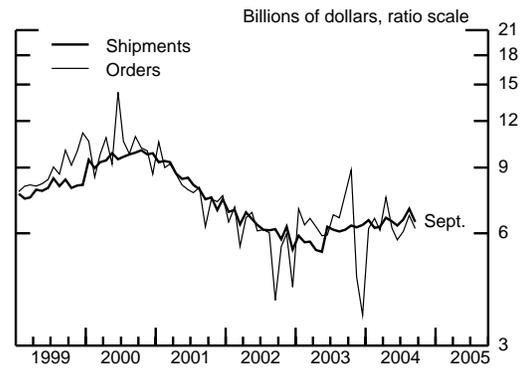
| Indicators   | 2004        |       |              |      |       |
|--|-------------|-------|--------------|------|-------|
|  | Q2          | Q3    | July         | Aug. | Sept. |
|  | Annual rate |       | Monthly rate |      |       |
| Shipments  | 9.0         | 12.4  | 1.8          | 1.8  | -1.4  |
| Excluding aircraft                                   | 9.2         | 13.3  | 2.3          | .9   | -1.4  |
| Computers and peripherals                            | 8.9         | -.3   | 6.5          | -.8  | -5.2  |
| Communications equipment                             | 8.7         | 12.6  | 3.8          | 7.1  | -7.9  |
| All other categories                                 | 9.4         | 16.1  | 1.3          | .3   | .2    |
| Orders   | 15.1        | 21.6  | 9.3          | -7.0 | .8    |
| Excluding aircraft                                   | 7.8         | 10.2  | .6           | .7   | 2.8   |
| Computers and peripherals                            | 36.9        | -10.5 | -5.1         | .8   | 4.5   |
| Communications equipment                             | 13.5        | -10.4 | 5.2          | 10.5 | -7.8  |
| All other categories                                 | 2.4         | 17.8  | 1.1          | -.6  | 4.0   |
| Memo:<br>Shipments of complete aircraft <sup>1</sup> | 25.7        | n.a.  | 27.0         | 29.3 | n.a.  |

1. From Census Bureau, Current Industrial Reports; billions of dollars, annual rate.  
n.a. Not available.

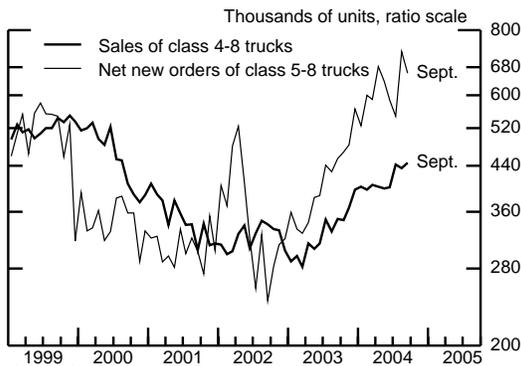
**Computers and Peripherals**



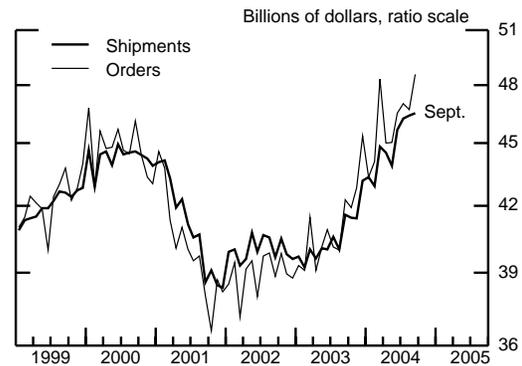
**Communications Equipment**



**Medium and Heavy Trucks**



**Other Equipment**



Note. Annual rate, FRB seasonals.  
Source. Ward's Communications and ACT Research Co.

**Nonresidential Construction**

We estimate that real business investment in nonresidential structures, which had turned up in the second quarter, posted a small decline in the third quarter.<sup>7</sup> Spending for commercial structures, which include retail buildings and warehouses, advanced briskly in both the second and the third quarters. Vacancy rates for retail buildings remained low through the third quarter, and both rents and property values continued to rise. Property values for warehouses also have trended up during the past few years, but rents turned up only recently. In contrast to spending for commercial structures, spending for office buildings has remained weak. The vacancy rate for office buildings has receded somewhat during the past two quarters but remains at a high level; office rents have been declining for some time, although property values recently posted a small increase. Similarly, although outlays for manufacturing structures increased in the third quarter, they remain depressed compared with the levels seen in 2000 and 2001. Spending on drilling and mining structures has risen smartly in recent quarters on the strength of a rising number of natural gas drilling rigs in operation; the number of petroleum rigs has been flat since the beginning of 2002.

**Business Inventories**

We estimate that real holdings of nonfarm inventories excluding finished motor vehicles increased at an annual rate of \$68 billion in the third quarter after a \$42 billion accumulation in the second quarter.<sup>8</sup> The jump in non-auto stockbuilding is estimated to have contributed 1 percentage point to the change in real GDP last quarter. The solid pace of stockbuilding in the third quarter was accompanied by rising sales; accordingly, both book-value ratios and NIPA inventories-sales ratios held fairly steady at low levels.

Data from the staff's flow-of-goods inventory system indicate that overall days' supply of inventories edged down to a record low in September. Only a few industry groups, including motor vehicles, semiconductors, paper, and chemicals excluding pharmaceuticals, were estimated to have been holding elevated inventories.

**Federal Government Sector**

Since mid-September, two major tax bills and three appropriations bills have cleared the Congress and have been signed into law by the President. In addition, the final Monthly Treasury Statement for fiscal 2004 has been released. For the fiscal year as a whole, the unified budget deficit was \$413 billion, or about 3½ percent of GDP, the largest share of GDP since 1993.

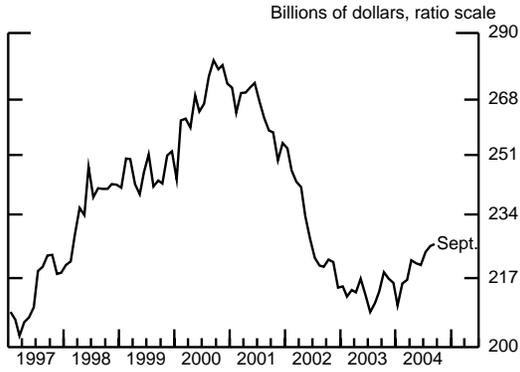
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<sup>7</sup> In the advance GDP estimate, which was released before the September construction data were available, the BEA estimated that real outlays for nonresidential structures increased at an annual rate of 1¼ percent in the third quarter. However, the September construction data were weaker than the BEA had assumed, and the level of spending was revised down in the previous two months. The most recent data indicate that real outlays for nonresidential structures declined at an annual rate of 1.1 percent in the third quarter.

<sup>8</sup> Our third-quarter estimate is \$2 billion less than the figure published by the BEA because we have incorporated data on book-value inventories held by manufacturers; these data were not available in time for the BEA's advance report.

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

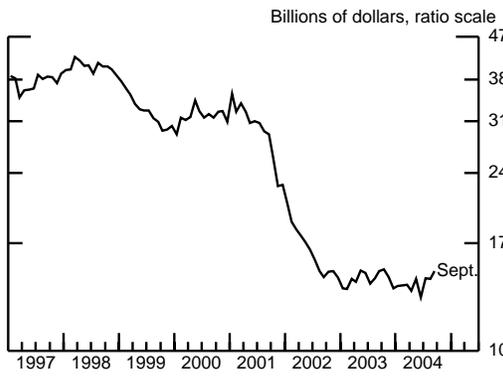
**Total Structures**



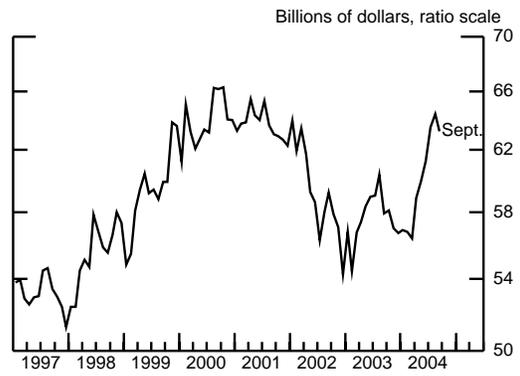
**Office**



**Manufacturing**

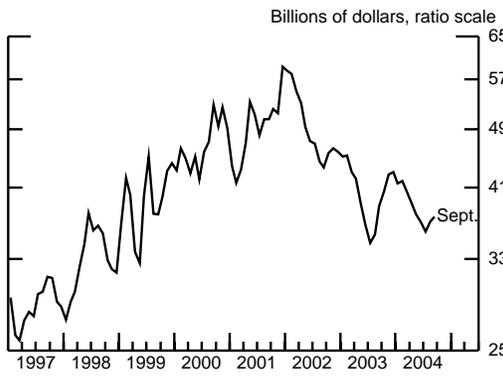


**Commercial**

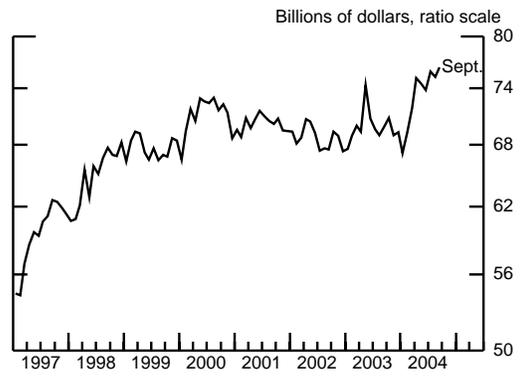


Note. Includes retail, wholesale, and "other" establishments.

**Power and Communication**



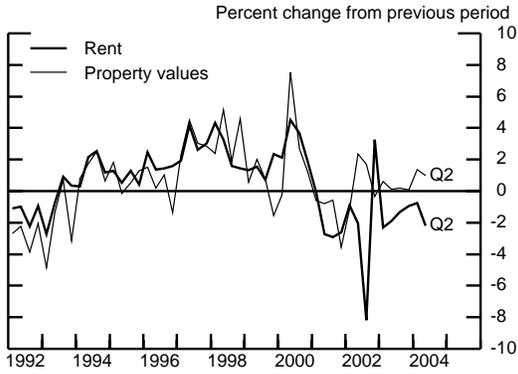
**Other**



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

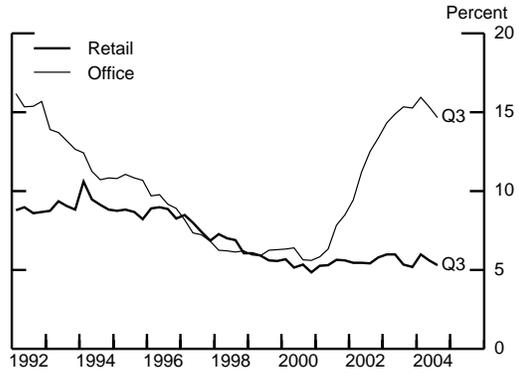
## Indicators of Nonresidential Construction

Office Rent and Property Values



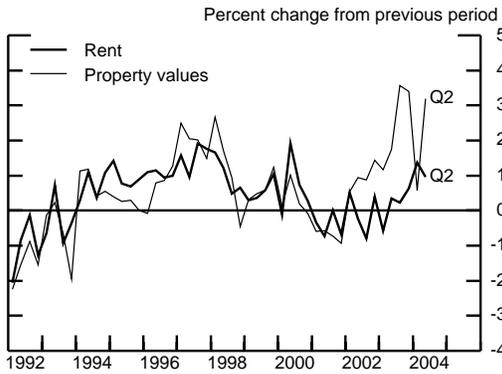
Source. National Real Estate Index.

Retail and Office Vacancy Rates



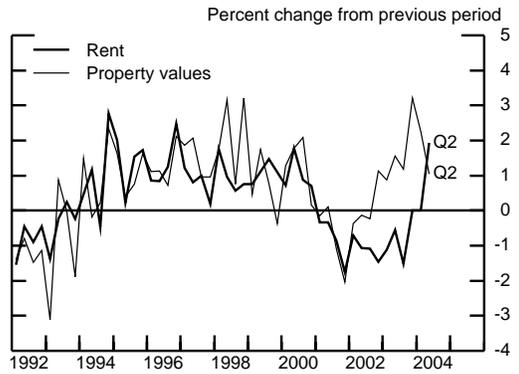
Source. National Council of Real Estate Investment Fiduciaries.

Retail Rent and Property Values



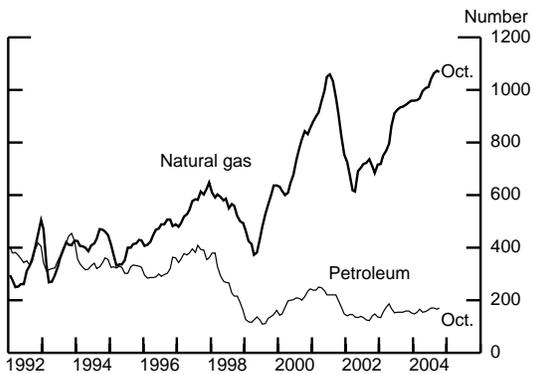
Source. National Real Estate Index.

Warehouse Rent and Property Values



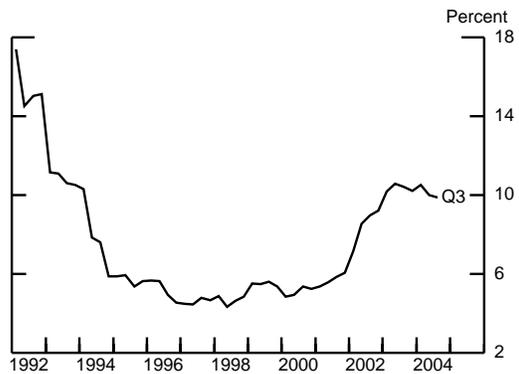
Source. National Real Estate Index.

Drilling Rigs in Operation



Note. Oct. values are averages through Oct. 22.  
Source. DOE/Baker Hughes.

Industrial Vacancy Rate



Source. National Council of Real Estate Investment Fiduciaries.

**Changes in Nonfarm Inventories**  
(Billions of chained (2000) dollars; annual rate)

| Sector                                      | 2003  | 2004 |      |      |
|---|-------|------|------|------|
|   | Q4    | Q1   | Q2   | Q3*  |
| Nonfarm inventory investment                | 4.6   | 34.5 | 58.8 | 46.2 |
| Excluding finished motor vehicles and parts | -5.0  | 6.8  | 41.6 | 68.4 |
| Manufacturing                               | -13.1 | 3.0  | 9.1  | 11.0 |
| Merchant wholesalers                        | -2.1  | 3.9  | 15.1 | 30.1 |
| Retail trade                                | 10.3  | 6.9  | 12.8 | 9.7  |

\* Staff estimate.

**Book-Value Inventories Relative to Shipments and Sales**



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



For the month of September alone, the federal unified budget recorded a surplus, as it typically does.<sup>9</sup> Receipts in September rose 8 percent relative to the year-earlier level. Corporate income tax payments were strong because of a sizable gain in taxable profits over the period as well as an increase in the effective tax rate. For fiscal year 2004 as a whole, receipts rose 5½ percent, only a bit slower than the rise in nominal GDP. Recent tax cuts are estimated to have held down that figure 5 percentage points, and receipts were 16¼ percent of GDP, near the bottom of the range that has prevailed during the postwar period.

Outlays in September, adjusted for payment timing shifts and financial transactions, rose only 1 percent over the year-earlier level; this is a sharp step-down from the pace of spending growth seen earlier in the year and reflects a combination of economic and war-related developments, policy actions, and one-time accounting changes. For the fiscal year as a whole, total outlays rose about 6 percent. Outlays for defense, Medicare, and Medicaid posted relatively large increases; outlays for debt service rose at a slow pace; and outlays for income security actually fell, largely as a result of declining payments of unemployment benefits. In fiscal 2004, outlays were 20 percent of GDP, about the same proportion as in the preceding fiscal year.

In late September, the Working Families Tax Relief Act of 2004 was enacted. The key provisions extend marriage penalty relief, the \$1,000 child tax credit, and the expanded 10 percent individual income tax bracket through 2010. The act also extends AMT relief and several expiring tax provisions, including the research and experimentation tax credit, through 2005. The official ten-year overall budget cost of this bill is estimated to be nearly \$150 billion.

In late October, the American Jobs Creation Act of 2004 was signed into law. It contains a smorgasbord of provisions that on balance were scored by the Joint Committee on Taxation as revenue-neutral over ten years. Its main purpose is to repeal the exclusion from U.S. taxable income of a certain percentage of income from the sale of domestically produced goods abroad—so-called extraterritorial income—that the World Trade Organization had ruled an illegal export subsidy. To compensate firms for this loss of tax benefits, the legislation provides broad-based tax relief for domestic manufacturing firms and U.S. multinationals. Key provisions include a phased-in reduction of 3 percentage points in the effective tax rate on the profits of domestic manufacturers, broadly defined, whether or not they are exporters; an extension of small-business expensing provisions for two more years; a one-time, substantial reduction in the tax rate on repatriated foreign earnings, which is estimated to induce a capital inflow of about \$150 billion next year; several tax breaks for the energy industry; and an extension of certain customs user fees.

Only four of the thirteen regular appropriations bills for fiscal 2005 have cleared the Congress and been signed by the President. Among those signed are the military construction bill that includes \$14½ billion in disaster aid for victims of hurricanes and

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<sup>9</sup> In September, estimated payments are due from both individuals and corporations.

**Federal Government Outlays and Receipts**

(Unified basis; billions of dollars except as noted)

| Function or source  | September |       |                   | 12 months ending<br>in September |        |                   |
|---|-----------|-------|-------------------|----------------------------------|--------|-------------------|
|   | 2003      | 2004  | Percent<br>change | 2003                             | 2004   | Percent<br>change |
| Outlays   | 168.2     | 183.0 | 8.8               | 2159.2                           | 2292.4 | 6.2               |
| Financial transactions <sup>1</sup>                                 | .0        | .3    | ...               | -1.4                             | -1.9   | ...               |
| Payment timing <sup>2</sup>   | -12.9     | .0    | ...               | -.6                              | -.1    | ...               |
| Adjusted outlays  | 181.1     | 182.7 | .9                | 2161.2                           | 2294.4 | 6.2               |
| Receipts  | 191.6     | 207.4 | 8.2               | 1782.1                           | 1879.8 | 5.5               |
| Payment timing  | -6.0      | -6.0  | ...               | -6.0                             | .0     | ...               |
| Adjusted receipts   | 197.6     | 213.4 | 8.0               | 1788.1                           | 1879.8 | 5.1               |
| Surplus or deficit (-)  | 23.4      | 24.4  | ...               | -377.1                           | -412.6 | ...               |
| <i>Selected components<br/>of adjusted outlays<br/>and receipts</i> |           |       |                   |                                  |        |                   |
| Adjusted outlays  | 181.1     | 182.7 | .9                | 2161.2                           | 2294.4 | 6.2               |
| Net interest  | 4.9       | 4.7   | -4.0              | 154.7                            | 160.5  | 3.7               |
| Non-interest  | 176.2     | 178.0 | 1.0               | 2006.5                           | 2133.9 | 6.4               |
| National defense  | 38.4      | 40.5  | 5.6               | 404.5                            | 455.7  | 12.7              |
| Social security   | 39.9      | 41.4  | 3.7               | 474.7                            | 495.6  | 4.4               |
| Medicare  | 22.3      | 23.6  | 5.7               | 249.5                            | 269.4  | 7.9               |
| Medicaid  | 13.7      | 14.9  | 8.2               | 160.7                            | 176.2  | 9.7               |
| Income security   | 23.8      | 22.6  | -5.1              | 335.0                            | 334.7  | -.1               |
| Agriculture   | 1.6       | -.1   | -105.2            | 24.6                             | 17.3   | -29.5             |
| Other   | 36.4      | 35.1  | -3.6              | 357.5                            | 385.1  | 7.7               |
| Adjusted receipts   | 197.6     | 213.4 | 8.0               | 1788.1                           | 1879.8 | 5.1               |
| Individual income and<br>payroll taxes                              | 144.9     | 149.1 | 2.9               | 1464.3                           | 1493.9 | 2.0               |
| Withheld + FICA   | 105.8     | 110.3 | 4.3               | 1368.8                           | 1397.0 | 2.1               |
| Nonwithheld + SECA  | 43.5      | 42.8  | -1.7              | 289.0                            | 284.5  | -1.6              |
| Less: Refunds   | 4.4       | 3.9   | -9.5              | 193.4                            | 187.6  | -3.0              |
| Corporate   | 36.3      | 48.3  | 32.8              | 137.8                            | 189.4  | 37.4              |
| Gross   | 40.5      | 51.6  | 27.4              | 200.5                            | 230.6  | 15.0              |
| Less: Refunds   | 4.1       | 3.3   | -20.6             | 62.7                             | 41.2   | -34.3             |
| Other   | 16.3      | 15.9  | -2.5              | 186.0                            | 196.5  | 5.7               |
| Adjusted surplus or deficit (-)                                     | 16.5      | 30.6  | ...               | -373.1                           | -414.6 | ...               |

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.

for ranchers and farmers affected by drought conditions. Congressional leaders have indicated that their goal is to combine the remaining appropriations bills into a single omnibus bill that would be enacted when the Congress reconvenes after the election. In addition, the Congress will have to pass an increase in the debt ceiling because the legal limit has been reached.

### **State and Local Governments**

Real expenditures by state and local governments are estimated by the BEA to have fallen at an annual rate of 0.5 percent in the third quarter after having risen nearly 2 percent in the second quarter. The entire decline was in construction spending. Moreover, data on construction received after the GDP report suggest that construction spending in the third quarter will be revised down. Much of the weakness in the third quarter was in construction of highways and streets.

The election results for most of the citizen initiatives or legislative referenda affecting taxes went in favor of higher taxes. Five of the seven measures to raise taxes passed. However, all of these measures, including the three cigarette tax hikes, will likely have a relatively minor effect on revenue collections. Both measures that sought to reduce or limit taxes failed.

### **Prices**

Consumer prices have continued to rise at a moderate pace. The overall CPI increased 0.2 percent in September and rose at an annual rate of just  $\frac{1}{2}$  percent over the June-September period, the result of a dip in consumer energy prices. During the twelve months ending in September, consumer prices advanced  $2\frac{1}{2}$  percent, about  $\frac{1}{4}$  percentage point more than in the preceding year. The core CPI moved up 0.3 percent in September. Over the twelve months ending in September, core prices increased 2 percent, about  $\frac{3}{4}$  percentage point more than in the preceding year. Core PCE prices were flat in August and rose 0.1 percent in September. The core PCE price index increased  $1\frac{1}{2}$  percent during the twelve months ending in September,  $\frac{1}{2}$  percentage point more than in the preceding year.

Consumer energy prices fell 0.4 percent in September, the third consecutive monthly decline in this index, as gasoline margins plummeted from their levels at midyear. However, the continued ascent of oil prices is now showing through to gasoline prices. The downward pressure on gasoline markups over the summer, due in part to weak vacation driving, disappeared in mid-September, as gasoline inventories declined from plentiful to normal because of refinery shutdowns related to Hurricane Ivan. Surveys of wholesale and retail gasoline prices point to a sharp upturn in prices in October. The refinery shutdowns also led inventories of fuel oil to be drawn down to very low levels, and, as a result, heating oil markups have risen. Moreover, the increasing prices for fuel oil have spurred some industrial users to switch to natural gas, and this switch has pushed up natural gas prices considerably. Over the twelve months ending in September, energy prices in the CPI rose nearly 7 percent after having climbed 15 percent in the year-earlier twelve-month period. The year-over-year jumps in the PPIs for finished and crude

energy prices are even larger than the rise in the CPI for energy—9 percent and 20 percent, respectively.

Consumer food prices were flat in September and inched up 0.1 percent in August. After large gains earlier in the year, prices for meats and poultry have increased at a moderate pace in recent months, and prices for dairy products have declined. Between September 2003 and September 2004, food prices rose 3¼ percent after their 2½ percent increase in the previous twelve months.

Excluding food and energy, the CPI rose 0.3 percent in September after a 0.1 percent uptick in August. September's increase was led by a 3 percent spurt in the price index for lodging away from home and a 2 percent jump in used-car prices. After its spike in the spring, the annualized three-month change in the core CPI has held below 2 percent since July. Since September 2003, the year-over-year change in the core CPI picked up from 1¼ percent to 2 percent.

Core PCE prices increased 1½ percent in the twelve months ending in September, about ½ percentage point less than the rise in the core CPI. The ½ percentage point acceleration in core PCE prices compared with the year ending in September 2003 is a touch less than the acceleration observed in the core CPI. The acceleration that occurred in prices for shelter, particularly lodging away from home, receives less weight in the PCE price index.

Broader measures of inflation, which had picked up in the first two quarters of this year as energy prices ratcheted up, eased in the third quarter. Over the most recent four quarters, GDP prices rose 2¼ percent, about ½ percentage point more than in the preceding four quarters. Excluding food and energy, GDP prices increased 2 percent in the past four quarters, also ½ percentage point more than in the previous year.

Expectations of near-term inflation, as measured by the Michigan Survey, rose in October: Specifically, median year-ahead expected inflation reached 3.1 percent, compared with 2.8 percent in September. This pickup is consistent with the increase in consumer energy prices in October. Median expected inflation over the next five to ten years, at 2.8 percent, remained within the relatively narrow range observed in the past several years.

Recent readings on the core finished-goods PPI have also been moderate. Over the three months ending in September, this index has increased at an average annual rate of 1.1 percent, substantially below its pace in the first half of the year. At earlier stages of processing, core intermediate materials have continued to experience large price increases (¾ percent in September) fueled by rising energy costs, higher import prices, and the firming in capacity utilization during the first half of the year. Prices for core crude materials declined 2½ percent in September but remain 25 percent higher than they were a year earlier. Since the PPI's September reporting date, prices for steel scrap have jumped again, although prices for lumber and plywood have tumbled. The CRB spot

**Measures of Inflation**  
(Percent)

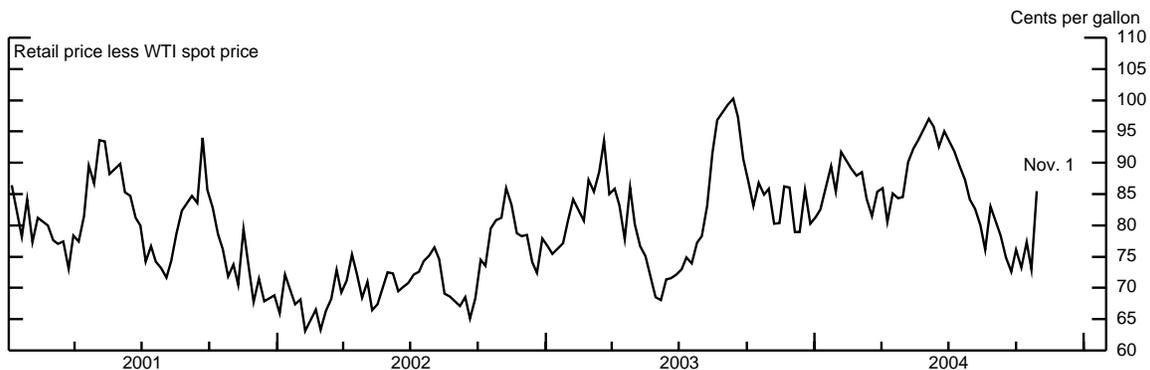
| Measures                          | 12-month change |               | 3-month change |               | 1-month change |               |
|-----------------------------------|-----------------|---------------|----------------|---------------|----------------|---------------|
|                                   | Sept.<br>2003   | Sept.<br>2004 | Annual rate    |               | Monthly rate   |               |
|                                   |                 |               | June<br>2004   | Sept.<br>2004 | Aug.<br>2004   | Sept.<br>2004 |
| <i>CPI</i>                        |                 |               |                |               |                |               |
| <b>Total</b>                      | <b>2.3</b>      | <b>2.5</b>    | <b>4.8</b>     | <b>.6</b>     | <b>.1</b>      | <b>.2</b>     |
| Food                              | 2.4             | 3.3           | 5.1            | 1.3           | .1             | .0            |
| Energy                            | 14.7            | 6.7           | 33.5           | -9.8          | -.3            | -.4           |
| <b>Ex. food and energy</b>        | <b>1.2</b>      | <b>2.0</b>    | <b>2.3</b>     | <b>1.8</b>    | <b>.1</b>      | <b>.3</b>     |
| Ex. tobacco                       | 1.3             | 2.0           | 2.3            | 1.8           | .0             | .3            |
| Core commodities                  | -2.4            | -.6           | .3             | -.9           | -.1            | .2            |
| Core services                     | 2.7             | 3.0           | 3.0            | 3.0           | .1             | .3            |
| Chained CPI (n.s.a.) <sup>1</sup> | 1.9             | 2.1           | ...            | ...           | ...            | ...           |
| Ex. food and energy <sup>1</sup>  | .8              | 1.6           | ...            | ...           | ...            | ...           |
| <i>PCE Prices</i>                 |                 |               |                |               |                |               |
| <b>Total</b>                      | <b>1.8</b>      | <b>2.0</b>    | <b>3.1</b>     | <b>.2</b>     | <b>.0</b>      | <b>.1</b>     |
| Food                              | 2.2             | 3.0           | 4.1            | 1.6           | .2             | .0            |
| Energy                            | 15.0            | 7.2           | 32.7           | -9.3          | -.3            | -.2           |
| <b>Ex. food and energy</b>        | <b>1.0</b>      | <b>1.5</b>    | <b>1.3</b>     | <b>.6</b>     | <b>.0</b>      | <b>.1</b>     |
| Ex. tobacco                       | 1.0             | 1.5           | 1.3            | .5            | .0             | .1            |
| Core commodities                  | -2.6            | -.6           | .1             | -2.1          | -.3            | .1            |
| Core services                     | 2.5             | 2.4           | 1.8            | 1.7           | .1             | .1            |
| Core market-based                 | 1.0             | 1.4           | 1.8            | .7            | .0             | .1            |
| Core non-market-based             | 1.0             | 1.9           | -1.2           | .3            | -.1            | .2            |
| <i>PPI</i>                        |                 |               |                |               |                |               |
| <b>Total finished goods</b>       | <b>3.5</b>      | <b>3.3</b>    | <b>4.7</b>     | <b>.3</b>     | <b>-.1</b>     | <b>.1</b>     |
| Food                              | 6.7             | 2.8           | 8.5            | -6.8          | -.2            | .1            |
| Energy                            | 13.1            | 9.2           | 6.4            | 6.3           | .2             | -.9           |
| <b>Ex. food and energy</b>        | <b>.1</b>       | <b>1.9</b>    | <b>2.9</b>     | <b>1.1</b>    | <b>-.1</b>     | <b>.3</b>     |
| Ex. tobacco                       | .6              | 1.9           | 3.1            | 1.1           | -.1            | .3            |
| Core consumer goods               | -.1             | 1.9           | 2.3            | 1.0           | -.2            | .4            |
| Capital equipment                 | .4              | 1.7           | 3.5            | 1.4           | -.1            | .4            |
| Intermediate materials            | 3.7             | 8.4           | 11.7           | 7.8           | 1.0            | .1            |
| Ex. food and energy               | 1.6             | 7.8           | 9.9            | 9.0           | 1.0            | .7            |
| Crude materials                   | 21.5            | 14.2          | 23.2           | -18.8         | -.7            | -4.2          |
| Ex. food and energy               | 11.2            | 25.5          | -32.8          | 50.3          | 4.5            | -2.5          |

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

... Not applicable.

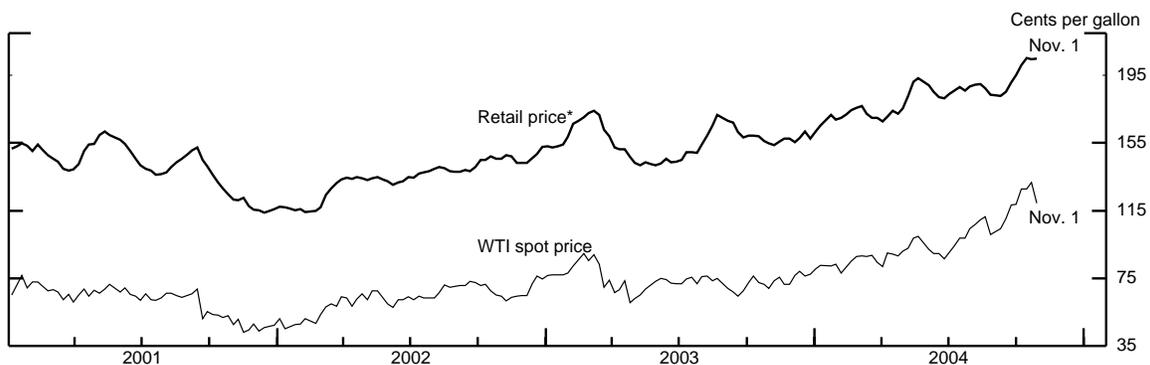
## Energy Prices and Inventories

### Total Gasoline Margin



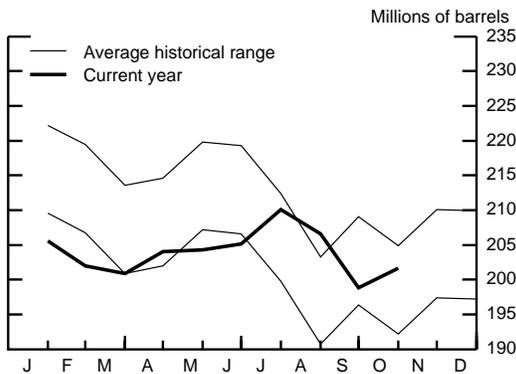
Note. Average of all grades (DOE) seasonally adjusted, less West Texas intermediate spot price.

### Gasoline Price Decomposition



\* Average of all grades (DOE) seasonally adjusted.

### Gasoline Inventories



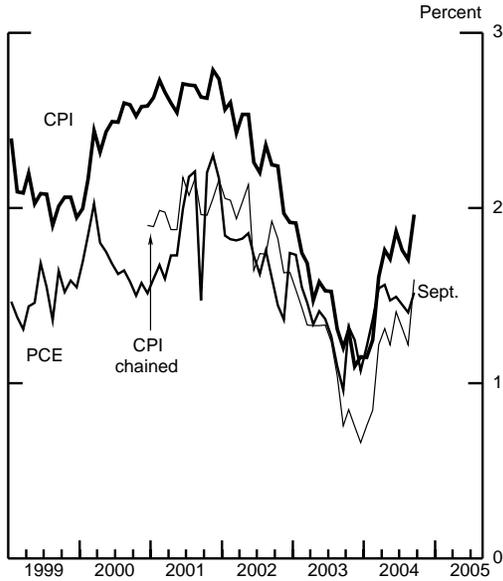
Note. Average historical range calculated by Energy Information Administration.

### Natural Gas Prices

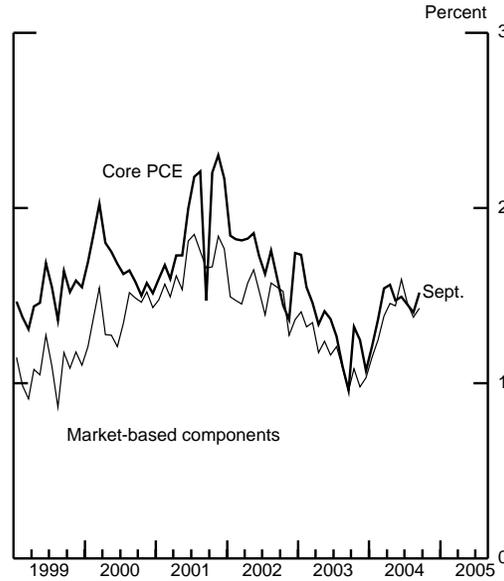


### Core Consumer Price Inflation (12-month change except where noted)

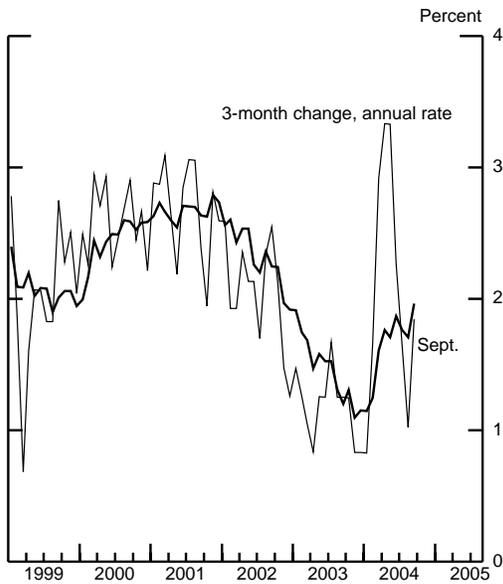
CPI and PCE excluding Food and Energy



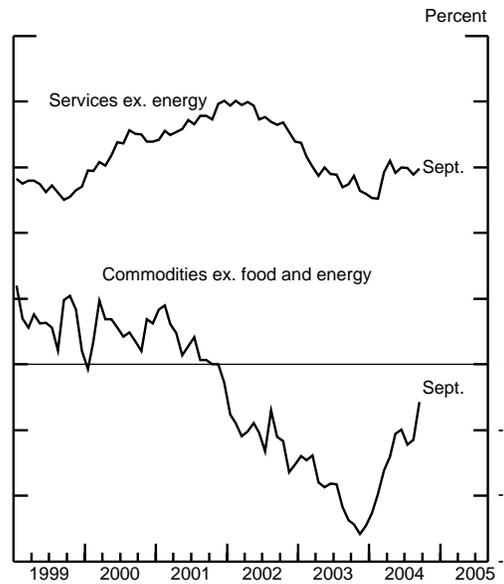
PCE excluding Food and Energy



CPI excluding Food and Energy



CPI Services and Commodities



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

| Measure                                  | 2001 | 2002 | 2003 | 2004 |
|--|------|------|------|------|
| <i>Product prices</i>                    |      |      |      |      |
| GDP price index                          | 2.4  | 1.5  | 1.8  | 2.2  |
| Less food and energy                     | 2.1  | 1.9  | 1.5  | 2.0  |
| Nonfarm business chain price index       | 1.9  | 1.0  | 1.1  | 1.7  |
| <i>Expenditure prices</i>                |      |      |      |      |
| Gross domestic purchases price index     | 1.9  | 1.5  | 1.9  | 2.5  |
| Less food and energy                     | 1.9  | 1.8  | 1.5  | 2.0  |
| PCE price index                          | 2.0  | 1.6  | 1.7  | 2.2  |
| Less food and energy                     | 2.0  | 1.9  | 1.1  | 1.5  |
| PCE price index, market-based components | 1.9  | 1.2  | 1.8  | 2.3  |
| Less food and energy                     | 1.8  | 1.5  | 1.1  | 1.4  |
| CPI                                      | 2.7  | 1.6  | 2.2  | 2.7  |
| Less food and energy                     | 2.7  | 2.2  | 1.3  | 1.8  |
| Chained CPI                              | 2.1  | 1.3  | 1.9  | 2.2  |
| Less food and energy                     | 2.1  | 1.8  | 1.0  | 1.4  |
| Median CPI                               | 3.7  | 3.3  | 2.0  | 2.5  |
| Trimmed mean CPI                         | 2.7  | 2.1  | 1.8  | 2.1  |

**Surveys of Inflation Expectations**  
(Percent)

| Period    | Actual<br>CPI<br>inflation <sup>1</sup> | University of Michigan |        |                            |        | Professional<br>forecasters<br>(10-year) <sup>4</sup> |
|-----------|---|------------------------|--------|----------------------------|--------|---|
|           |   | 1 year <sup>2</sup>    |        | 5 to 10 years <sup>3</sup> |        |   |
|           |   | Mean                   | Median | Mean                       | Median |   |
| 2002: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        | 2.9                                     | 4.0                    | 3.3    | 3.3                        | 2.8    | 2.5   |
| Q3        | 2.7                                     | 3.3                    | 2.9    | 3.1                        | 2.8    | 2.5   |
| 2004:July | 3.0                                     | 3.5                    | 3.0    | 3.1                        | 2.8    | ...   |
| Aug.      | 2.7                                     | 3.1                    | 2.8    | 3.1                        | 2.7    | ...   |
| Sept.     | 2.5                                     | 3.2                    | 2.8    | 3.1                        | 2.8    | 2.5   |
| Oct.      | n.a.                                    | 3.6                    | 3.1    | 3.2                        | 2.8    | ...   |

1. Percent change from the same period in the preceding year.

2. Responses to the question: By about what percent do you expect prices to go up, on average, during the next 12 months?

3. Responses to the question: By about what percent per year do you expect prices to go up, on average, during the next 5 to 10 years?

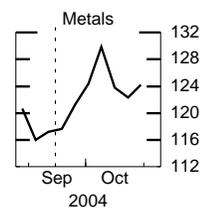
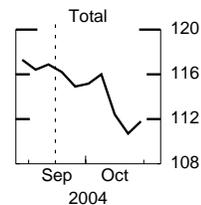
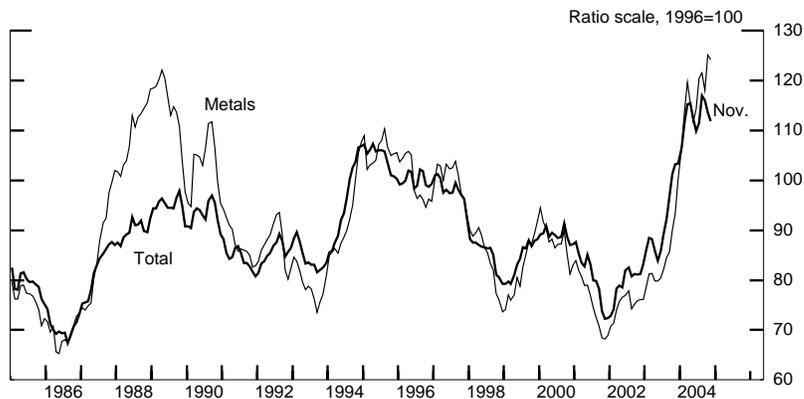
4. Quarterly CPI projections compiled by the Federal Reserve Bank of Philadelphia.

n.a. Not available.

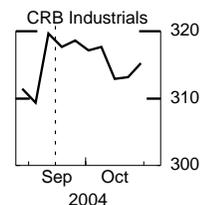
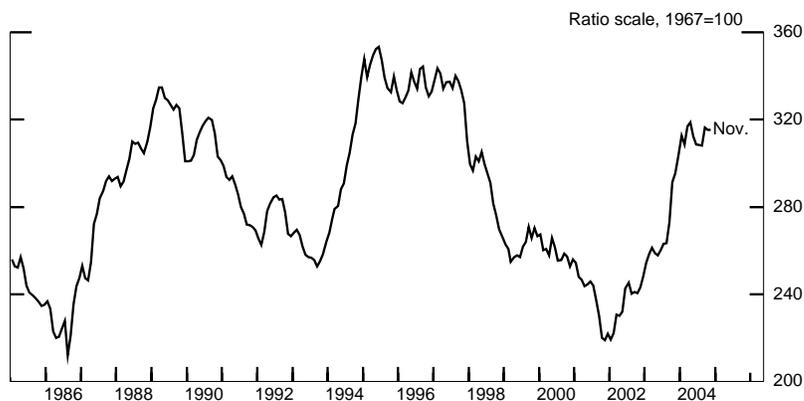
... Not applicable.

## Commodity Price Measures

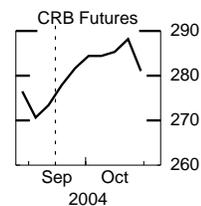
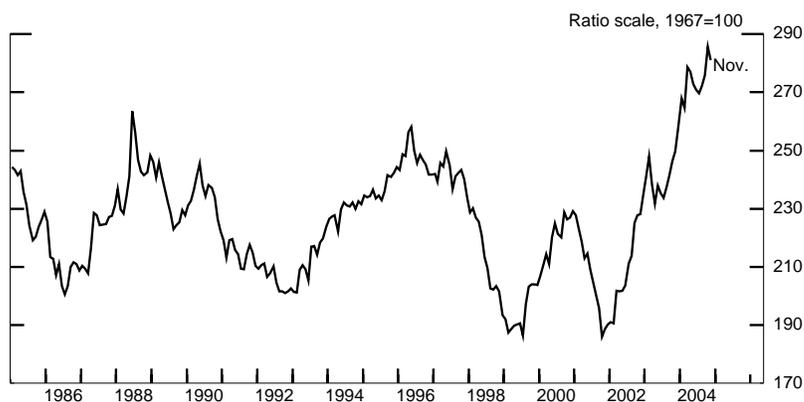
Journal of Commerce Index



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.

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

| Commodity                           | Current price (dollars) | 2002 <sup>1</sup> | 2003 <sup>1</sup> | 12/30/03 to 9/14/04 <sup>2</sup> | 9/14/04 <sup>2</sup> to 11/2/04 | Memo: 52-week change to 11/2/04 |
|-------------------------------------|-------------------------|-------------------|-------------------|----------------------------------|---------------------------------|---------------------------------|
| <i>Metals</i>                       |                         |                   |                   |                                  |                                 |                                 |
| Copper (lb.)                        | 1.380                   | 5.6               | 47.9              | 25.9                             | 1.5                             | 48.4                            |
| Steel scrap (ton)                   | 246.333                 | 49.2              | 66.8              | 25.8                             | 20.9                            | 88.5                            |
| Aluminum, London (lb.)              | .832                    | 2.8               | 16.7              | 7.3                              | 9.0                             | 21.7                            |
| <i>Precious metals</i>              |                         |                   |                   |                                  |                                 |                                 |
| Gold (oz.)                          | 424.200                 | 24.3              | 20.7              | -2.6                             | 4.7                             | 12.3                            |
| Silver (oz.)                        | 6.995                   | 3.8               | 24.6              | 5.2                              | 11.4                            | 40.2                            |
| <i>Forest products</i> <sup>3</sup> |                         |                   |                   |                                  |                                 |                                 |
| Lumber (m. bdft.)                   | 307.000                 | -8.9              | 44.5              | 55.7                             | -31.8                           | 9.6                             |
| Plywood (m. sqft.)                  | 333.000                 | .7                | 36.7              | 40.5                             | -40.0                           | -39.6                           |
| <i>Petroleum</i>                    |                         |                   |                   |                                  |                                 |                                 |
| Crude oil (barrel)                  | 45.920                  | 66.9              | -7.4              | 40.7                             | 10.2                            | 64.9                            |
| Gasoline (gal.)                     | 1.277                   | 69.2              | 12.5              | 31.6                             | 1.8                             | 57.0                            |
| Fuel oil (gal.)                     | 1.376                   | 63.8              | 6.3               | 33.2                             | 12.4                            | 79.5                            |
| <i>Livestock</i>                    |                         |                   |                   |                                  |                                 |                                 |
| Steers (cwt.)                       | 85.440                  | 16.5              | 4.1               | 10.2                             | 3.4                             | -13.6                           |
| Hogs (cwt.)                         | 53.750                  | -13.2             | 18.3              | 50.0                             | .9                              | 51.4                            |
| Broilers (lb.)                      | .622                    | 6.5               | 10.9              | -.3                              | -5.9                            | -.7                             |
| <i>Farm crops</i>                   |                         |                   |                   |                                  |                                 |                                 |
| Corn (bu.)                          | 1.720                   | 18.1              | 1.7               | -14.6                            | -13.8                           | -21.5                           |
| Wheat (bu.)                         | 3.953                   | 37.7              | -2.1              | -1.6                             | -1.2                            | 8.2                             |
| Soybeans (bu.)                      | 5.095                   | 32.2              | 37.1              | -29.3                            | -6.2                            | -31.4                           |
| Cotton (lb.)                        | .434                    | 52.1              | 42.5              | -29.2                            | -10.1                           | -40.1                           |
| <i>Other foodstuffs</i>             |                         |                   |                   |                                  |                                 |                                 |
| Coffee (lb.)                        | .703                    | 1.1               | 23.1              | 25.5                             | 2.3                             | 33.9                            |
| Memo:                               |                         |                   |                   |                                  |                                 |                                 |
| JOC Industrials                     | 111.800                 | 16.8              | 22.3              | 13.9                             | -4.4                            | 9.6                             |
| JOC Metals                          | 124.200                 | 9.7               | 38.1              | 11.9                             | 6.0                             | 35.6                            |
| CRB Futures                         | 281.060                 | 24.4              | 9.1               | 6.9                              | 2.8                             | 14.0                            |
| CRB Spot Industrials                | 315.220                 | 13.7              | 24.0              | 3.7                              | -1.4                            | 6.0                             |

1. Changes are from the last week of the preceding year to the last week of the year indicated.
2. September 14, 2004, is the Tuesday preceding publication of the September Greenbook.
3. Prices shown apply to the Friday before the date indicated.

industrials index (which excludes energy prices) has fallen 1½ percent since the last Greenbook.

**Labor Costs**

The information on labor costs released since the September Greenbook points to continued moderate gains in hourly compensation in the third quarter. The employment cost index (ECI) in private industry rose at an annual rate of 3½ percent over the three months ending in September—slightly less than the average pace over the past two years. Wages and salaries increased at an annual rate of 3½ percent, somewhat above the pace of the past few quarters but close to the average in 2003. Benefit costs moved up 4 percent over the three months ending in September, the smallest increase in benefit costs in the last couple of years and well below the surge in the first three months of the year, which resulted from a substantial run-up in retirement and savings costs as employers replenished defined-benefit pension reserves. Although health insurance costs continue to increase rapidly, the most recent twelve-month increase, at 7¼ percent, was 2¾ percentage points below the year-earlier increase and lower than any twelve-month period in the past four years.

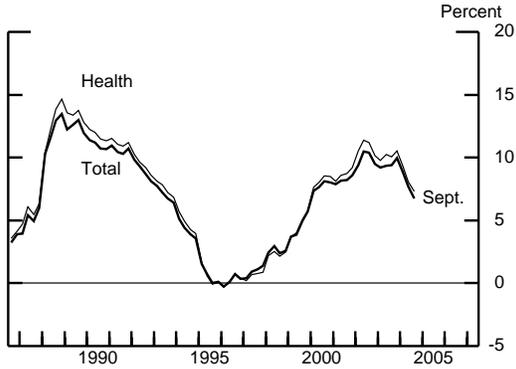
**Change in Employment Cost Index of Hourly Compensation  
for Private-Industry Workers**

| Industry and occupational group        | 2003  |            | 2004       |            |            |
|--|---|------------|------------|------------|------------|
|  | Sept.   | Dec.       | Mar.       | June       | Sept.      |
|  | Quarterly change<br>(compound annual rate) <sup>1</sup> |            |            |            |            |
| <b>Total hourly compensation</b>       | <b>4.4</b>  | <b>3.1</b> | <b>4.3</b> | <b>4.0</b> | <b>3.5</b> |
| Wages and salaries                     | 3.5   | 2.0        | 2.5        | 2.2        | 3.5        |
| Benefits                               | 6.1   | 5.6        | 10.9       | 7.1        | 4.0        |
| <i>By industry</i>                     |   |            |            |            |            |
| Construction                           | 3.3   | 3.0        | 3.5        | 2.2        | 2.9        |
| Manufacturing                          | 3.9   | 2.7        | 9.4        | 3.3        | 5.0        |
| Transportation and<br>public utilities | 2.4   | 2.9        | 6.1        | 5.8        | 2.3        |
| Wholesale trade                        | 3.6   | 1.9        | 2.6        | 2.6        | 6.6        |
| Retail trade                           | 6.2   | 4.1        | 1.7        | 4.0        | 1.0        |
| FIRE                                   | 4.3   | 1.6        | 3.6        | 2.4        | 2.6        |
| Services                               | 4.1   | 3.8        | 4.3        | 3.7        | 3.5        |
| <i>By occupation</i>                   |   |            |            |            |            |
| White collar                           | 4.8   | 3.3        | 3.8        | 3.0        | 4.2        |
| Blue collar                            | 3.8   | 3.5        | 6.7        | 4.1        | 3.6        |
| Service occupations                    | 3.2   | 2.7        | 4.7        | 3.6        | 1.9        |
| Memo:                                  |   |            |            |            |            |
| State and local governments            | 2.2   | 3.2        | 3.9        | 4.4        | 1.9        |
|  | 12-month change   |            |            |            |            |
| <b>Total hourly compensation</b>       | <b>4.0</b>  | <b>4.0</b> | <b>3.9</b> | <b>4.0</b> | <b>3.7</b> |
| Excluding sales workers                | 4.0   | 4.1        | 3.9        | 4.0        | 3.9        |
| Wages and salaries                     | 3.0   | 3.0        | 2.6        | 2.6        | 2.6        |
| Excluding sales workers                | 3.0   | 3.1        | 2.6        | 2.5        | 2.5        |
| Benefits                               | 6.5   | 6.4        | 7.0        | 7.3        | 6.8        |
| <i>By industry</i>                     |   |            |            |            |            |
| Construction                           | 3.8   | 3.4        | 3.5        | 3.0        | 2.9        |
| Manufacturing                          | 4.7   | 4.1        | 4.7        | 4.7        | 5.0        |
| Transportation and<br>public utilities | 3.5   | 3.3        | 4.0        | 4.3        | 4.3        |
| Wholesale trade                        | 3.7   | 3.2        | 2.5        | 2.7        | 3.4        |
| Retail trade                           | 2.5   | 3.3        | 3.5        | 4.0        | 2.7        |
| FIRE                                   | 7.3   | 7.4        | 3.3        | 3.0        | 2.6        |
| Services                               | 3.3   | 3.6        | 3.8        | 4.0        | 3.8        |
| <i>By occupation</i>                   |   |            |            |            |            |
| White collar                           | 4.0   | 4.1        | 3.6        | 3.7        | 3.6        |
| Sales                                  | 3.5   | 3.2        | 3.5        | 3.7        | 3.5        |
| Nonsales                               | 4.1   | 4.3        | 3.7        | 3.7        | 3.6        |
| Blue collar                            | 4.2   | 4.0        | 4.5        | 4.6        | 4.5        |
| Service occupations                    | 3.0   | 3.2        | 3.2        | 3.4        | 3.1        |
| Memo:                                  |   |            |            |            |            |
| State and local governments            | 3.6   | 3.3        | 3.3        | 3.4        | 3.4        |

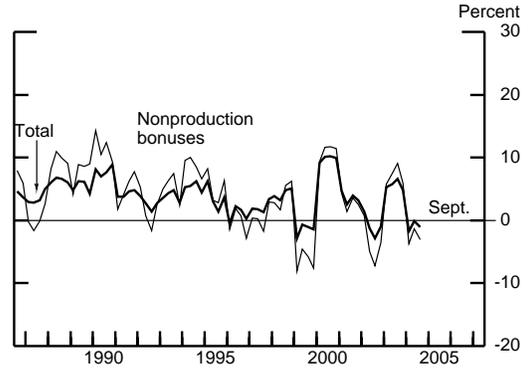
1. Seasonally adjusted by the BLS.

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

Insurance Costs



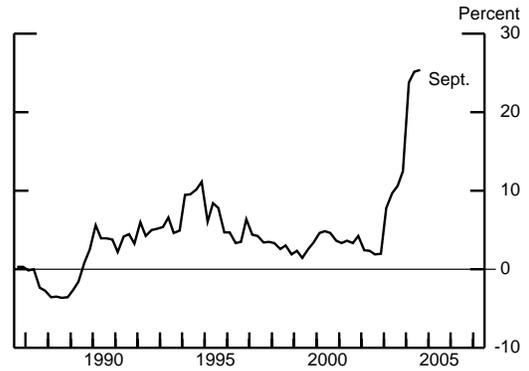
Supplemental Pay



Paid Leave



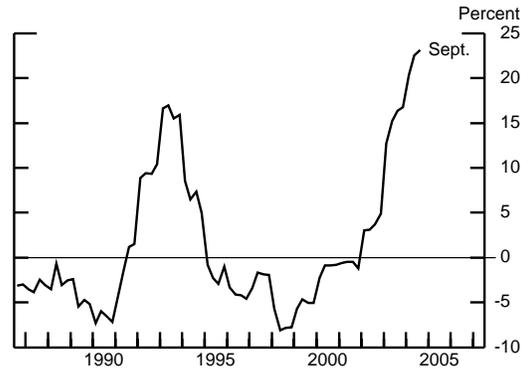
Retirement and Savings



Workers' Compensation Insurance



State Unemployment Insurance



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## **Domestic Financial Developments**

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

| Instrument                                      | 2003    | 2004    |          |        | Change to Nov. 2 from selected dates (percentage points) |              |               |
|---|---------|---------|----------|--------|--|--------------|---------------|
|   | Dec. 31 | June 28 | Sept. 20 | Nov. 2 | 2003 Dec. 31   | 2004 June 28 | 2004 Sept. 20 |
| <i>Short-term</i>                               |         |         |          |        |  |              |               |
| FOMC intended federal funds rate                | 1.00    | 1.00    | 1.50     | 1.75   | .75  | .75          | .25           |
| Treasury bills <sup>1</sup>                     |         |         |          |        |  |              |               |
| 3-month   | 0.93    | 1.36    | 1.70     | 1.94   | 1.01   | .58          | .24           |
| 6-month   | 1.00    | 1.74    | 1.88     | 2.14   | 1.14   | .40          | .26           |
| Commercial paper (A1/P1 rates) <sup>2</sup>     |         |         |          |        |  |              |               |
| 1-month   | 1.00    | 1.28    | 1.74     | 1.93   | .93  | .65          | .19           |
| 3-month   | 1.05    | 1.45    | 1.83     | 2.07   | 1.02   | .62          | .24           |
| Large negotiable CDs <sup>1</sup>               |         |         |          |        |  |              |               |
| 1-month   | 1.06    | 1.30    | 1.78     | 2.00   | .94  | .70          | .22           |
| 3-month   | 1.09    | 1.53    | 1.86     | 2.14   | 1.05   | .61          | .28           |
| 6-month   | 1.16    | 1.82    | 2.02     | 2.29   | 1.13   | .47          | .27           |
| Eurodollar deposits <sup>3</sup>                |         |         |          |        |  |              |               |
| 1-month   | 1.04    | 1.29    | 1.77     | 1.96   | .92  | .67          | .19           |
| 3-month   | 1.07    | 1.51    | 1.87     | 2.12   | 1.05   | .61          | .25           |
| Bank prime rate                                 | 4.00    | 4.00    | 4.50     | 4.75   | .75  | .75          | .25           |
| <i>Intermediate- and long-term</i>              |         |         |          |        |  |              |               |
| U.S. Treasury <sup>4</sup>                      |         |         |          |        |  |              |               |
| 2-year  | 1.83    | 2.88    | 2.43     | 2.60   | .77  | -.28         | .17           |
| 10-year   | 4.40    | 4.90    | 4.21     | 4.23   | -.17   | -.67         | .02           |
| 30-year   | 5.22    | 5.55    | 4.96     | 4.92   | -.30   | -.63         | -.04          |
| U.S. Treasury 10-year indexed note              | 2.00    | 2.23    | 1.80     | 1.64   | -.36   | -.59         | -.16          |
| Municipal revenue (Bond Buyer) <sup>5</sup>     | 5.04    | 5.37    | 5.03     | 4.97   | -.07   | -.40         | -.06          |
| Private instruments                             |         |         |          |        |  |              |               |
| 10-year swap                                    | 4.66    | 5.21    | 4.51     | 4.53   | -.13   | -.68         | .02           |
| 10-year FNMA <sup>6</sup>                       | 4.72    | 5.30    | 4.55     | 4.57   | -.15   | -.73         | .02           |
| 10-year AA <sup>7</sup>                         | 5.05    | 5.59    | 4.86     | 4.86   | -.19   | -.73         | .00           |
| 10-year BBB <sup>7</sup>                        | 5.74    | 6.18    | 5.44     | 5.41   | -.33   | -.77         | -.03          |
| 5-year high yield <sup>7</sup>                  | 7.94    | 8.30    | 7.66     | 7.39   | -.55   | -.91         | -.27          |
| Home mortgages (FHLMC survey rate) <sup>8</sup> |         |         |          |        |  |              |               |
| 30-year fixed                                   | 5.85    | 6.21    | 5.70     | 5.64   | -.21   | -.57         | -.06          |
| 1-year adjustable                               | 3.72    | 4.19    | 4.00     | 3.96   | .24  | -.23         | -.04          |

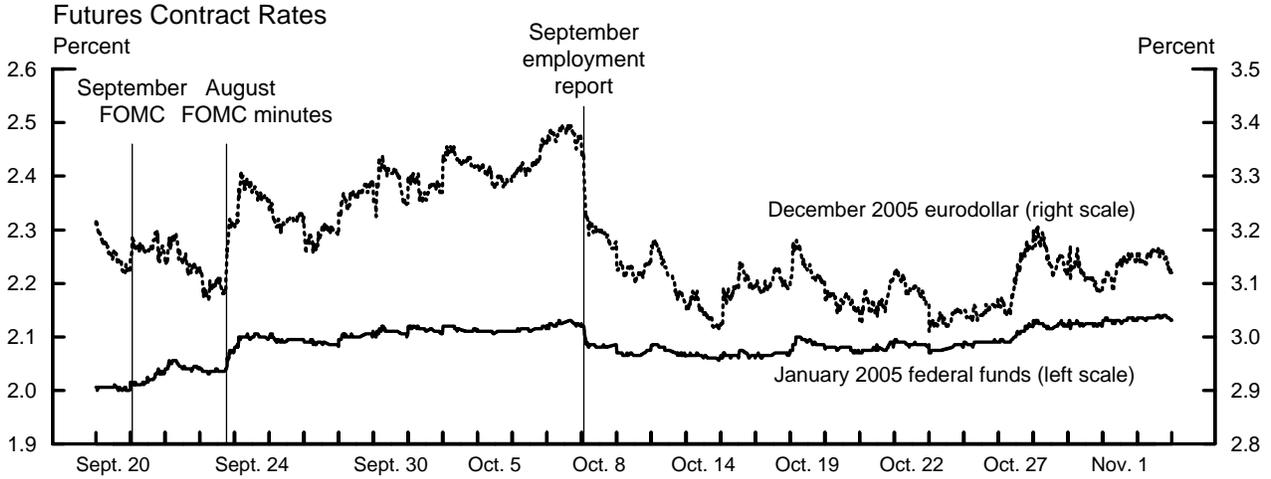
| Stock exchange index | Record high |         | 2004    |          |        | Change to Nov. 2 from selected dates (percent) |              |               |
|----------------------|-------------|---------|---------|----------|--------|--|--------------|---------------|
|                      | Level       | Date    | June 28 | Sept. 20 | Nov. 2 | Record high                                    | 2004 June 28 | 2004 Sept. 20 |
| Dow-Jones Industrial | 11,723      | 1-14-00 | 10,357  | 10,205   | 10,036 | -14.39   | -3.10        | -1.66         |
| S&P 500 Composite    | 1,527       | 3-24-00 | 1,133   | 1,122    | 1,131  | -25.99   | -.25         | .74           |
| Nasdaq               | 5,049       | 3-10-00 | 2,020   | 1,908    | 1,985  | -60.69   | -1.73        | 4.02          |
| Russell 2000         | 606         | 4-5-04  | 584     | 571      | 585    | -3.45  | .23          | 2.58          |
| Wilshire 5000        | 14,752      | 3-24-00 | 11,056  | 10,937   | 11,075 | -24.92   | .18          | 1.26          |

1. Secondary market.
2. Financial commercial paper.
3. Bid rates for Eurodollar deposits collected around 9:30 a.m. eastern time.
4. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
5. Most recent Thursday quote.
6. Constant maturity yields estimated from Fannie Mae domestic noncallable coupon securities.
7. Derived from smoothed corporate yield curves estimated using Merrill Lynch bond data.
8. Home mortgage data for Nov 2, 2004, is from Oct 28, 2004.

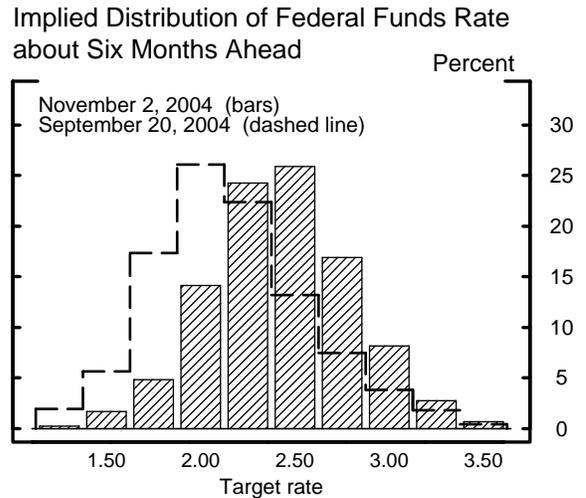
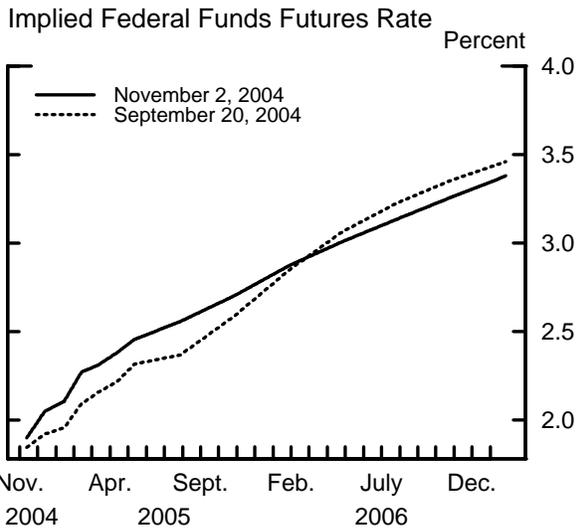
NOTES:

June 28, 2004, is the day before the beginning of the current tightening period.  
September 20, 2004, is the day before the most recent FOMC meeting.

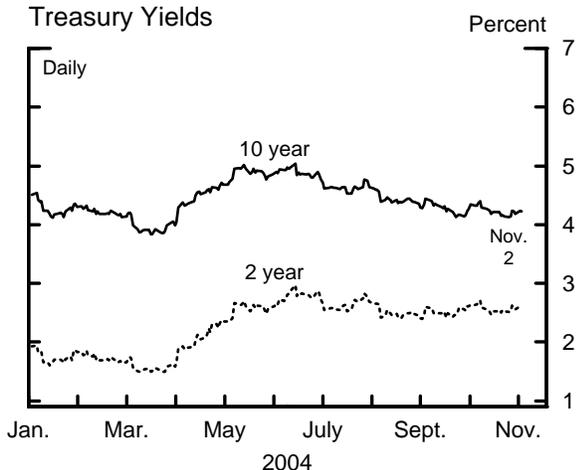
**Policy Expectations and Treasury Yields**



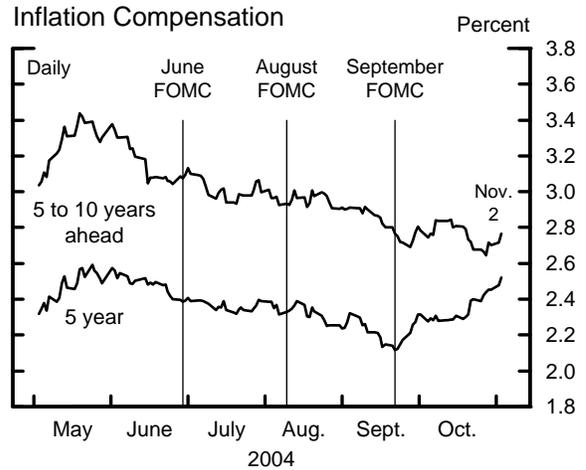
Note. 5-minute intervals.



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



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



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

## Domestic Financial Developments

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### Overview

Investors paid particular attention to higher oil prices, comments by Federal Reserve officials, and mixed economic data during the intermeeting period. While high oil prices seemed to prompt concerns about the near-term prospects for inflation and, at least at times, the outlook for economic activity, they did not appear to fundamentally shake the market's view that the economy remains on a path of moderate growth. On net, policy expectations for the near future firmed somewhat and short-term nominal Treasury yields moved higher, but longer-term yields were little changed. Equity prices, which were buffeted by fluctuations in the oil market, edged up on balance. Corporate risk spreads were little changed for investment-grade bonds but moved down somewhat for lower-rated debt.

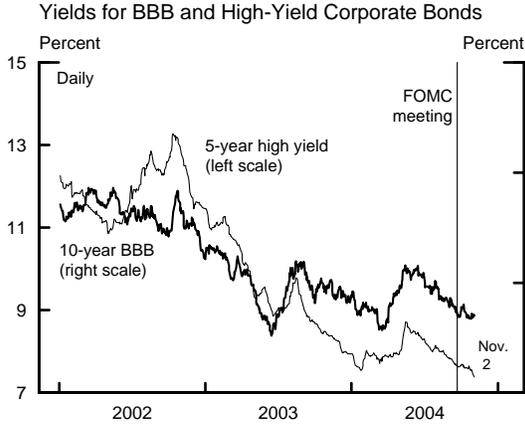
Merger-related corporate borrowing picked up over the intermeeting period, but corporate debt growth otherwise remained tepid. Household debt growth, although not as robust as it was earlier this year, appears to have remained elevated, mostly because of mortgage borrowing. M2 growth has generally been sluggish in recent months.

### Policy Expectations and Interest Rates

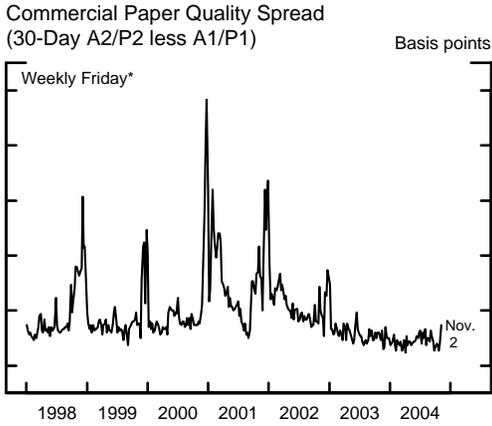
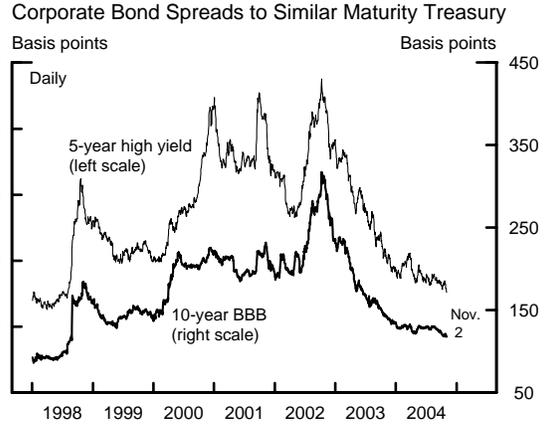
The decision by the FOMC to raise the target federal funds rate 25 basis points at the September meeting had been widely anticipated, and the accompanying statement reportedly was also in line with expectations. The release of the minutes of the August FOMC meeting two days later boosted the expected pace of monetary policy tightening, as investors reportedly focused on the statement that "significant cumulative policy tightening likely would be needed" to achieve the Committee's objectives. Those expectations, however, were subsequently damped by the weaker-than-expected September payroll data. On net, near-term policy expectations firmed somewhat over the intermeeting period, in part because comments by Federal Reserve officials suggested that the economic expansion was likely to remain on track. Quotes on federal funds futures imply that investors currently place a probability of more than 80 percent on a hike of 25 basis points at the November meeting and smaller odds on a tightening at the December meeting. Further out, policy expectations changed little, on net, as the higher oil prices and the mixed data releases did not appear to fundamentally alter investors' economic outlook.

The Treasury yield curve flattened somewhat over the intermeeting period, as the two-year yield rose 17 basis points and the ten-year yield was about unchanged. TIPS inflation compensation over the next five years climbed more than 35 basis points, partly in response to rising oil prices and to higher-than-expected readings on core PPI and core CPI for September. In addition, the size of the October five-year TIPS auction, which was smaller than some market participants had reportedly expected, weighed on the five-year TIPS yield, thereby boosting near-term measured inflation compensation somewhat. In contrast, inflation compensation over the five years starting five years hence was little changed.

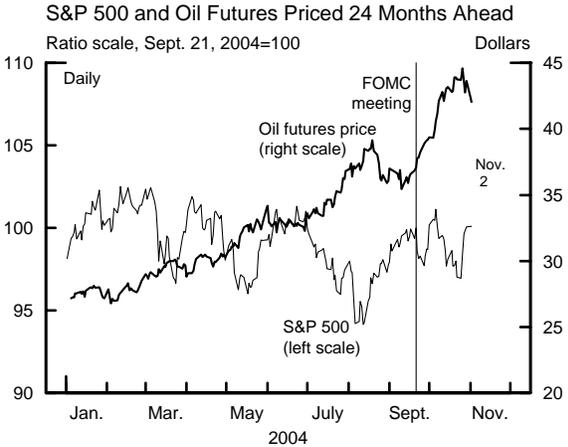
### Corporate Yields, Risk Spreads, and Stock Prices



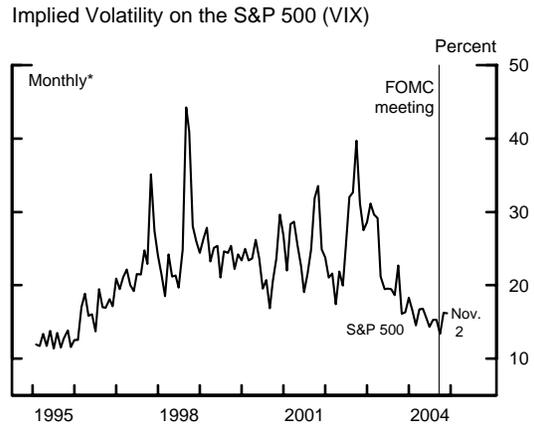
Note. Yields from smoothed yield curves based on Merrill Lynch bond data.



\* Latest observation is for most recent business day.



\* 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.



\* Latest observation is for most recent business day.

**Corporate Yields, Risk Spreads, and Stock Prices**

Yields on investment-grade corporate bonds moved about in line with those on comparable-maturity Treasury securities over the intermeeting period, leaving risk spreads about unchanged. Yields on speculative-grade bonds declined more than 30 basis points and risk spreads on those securities narrowed, reflecting continued improvements in credit quality. The spread of top-rated commercial paper over lower-quality CP issues remained low, as the market has thus far shown little evidence of year-end pressures.

Broad equity indexes, which were buffeted by oil price fluctuations over the intermeeting period, posted a small gain on net. Technology stocks rose somewhat more, but stocks of insurance companies fell sharply after the announcement of an investigation by the New York State attorney general into business practices by some brokers and insurers. The gap between the twelve-month forward earnings-price ratio for S&P 500 firms and the synthetic long-run real Treasury yield, a rough measure of the equity premium, was virtually unchanged over the intermeeting period at a relatively high level. Implied volatility of equity prices has risen slightly in recent weeks but remains low.

**Corporate Earnings and Credit Quality**

Earnings reports, on balance, had little discernible effect on stock prices. Based on results from about 80 percent of S&P 500 firms, earnings per share in the third quarter are now expected to be about 15 percent higher than they were a year earlier; this growth rate implies that earnings are about unchanged from those of the second quarter on a seasonally adjusted basis. Analysts' revisions to year-ahead earnings were modestly positive for the S&P 500 as a whole, as they were boosted by sizable upward revisions for energy firms. For firms outside the energy sector, the revisions were slightly negative, a result consistent with the typical pattern of downward adjustments by analysts.

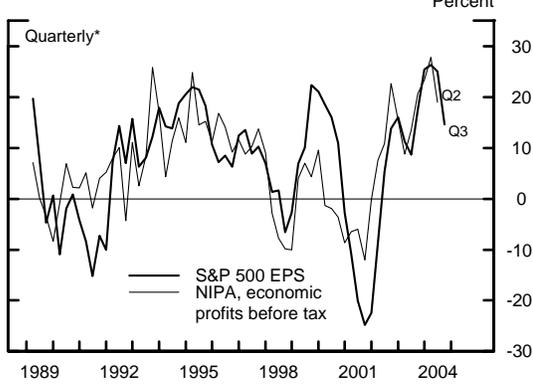
The credit quality of nonfinancial firms continued to improve, and corporate balance sheets remained strong. Net upgrades of corporate bonds were sharply positive in the third quarter, confirming the break from a long trend of net downgrades. Earnings reports of large bank holding companies suggest that delinquency rates on C&I loans continued to decline in the third quarter. Indeed, according to the most recent Senior Loan Officer Opinion Survey, banks largely expect that business loan quality will remain good or perhaps even improve somewhat over the next year. The six-month trailing default rate on corporate bonds remained very low. The expected year-ahead default rate derived from Moody's KMV Corporation was little changed at the relatively low level registered throughout 2004.

**Business Finance**

Commercial paper issuance surged in October, boosted nearly \$15 billion by Cingular's short-term borrowing to complete its acquisition of AT&T Wireless. Excluding the financing of that merger, which also accounted for a significant fraction of net issuance of bonds by nonfinancial corporations, corporate borrowing has remained muted since the

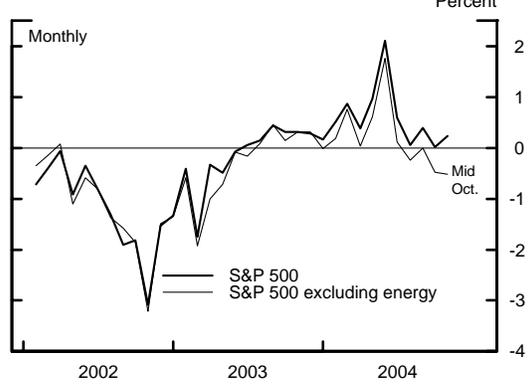
### Corporate Earnings and Credit Quality

Corporate Earnings Growth



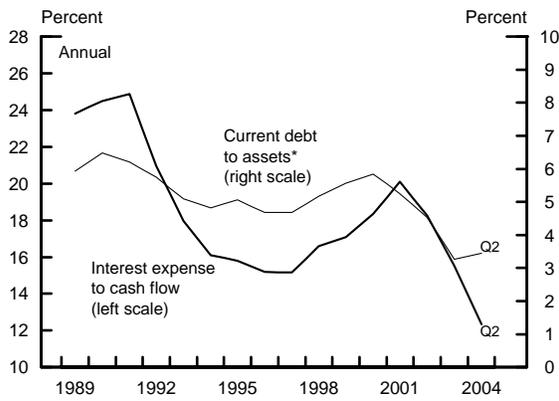
\* Change from four quarters earlier.  
Source: I/B/E/S for S&P 500 EPS.

S&P 500 Revisions Index\*



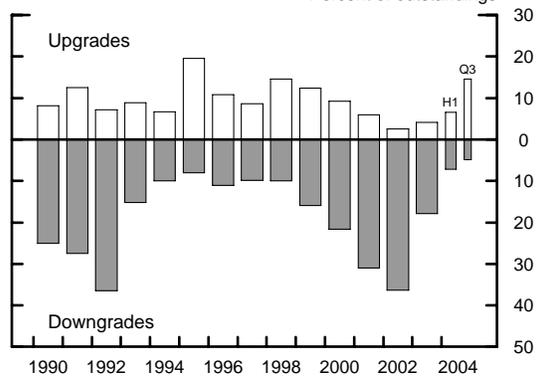
Note. Index is a weighted average of the percent change in the consensus forecasts of current-year and following-year EPS.

Financial Ratios



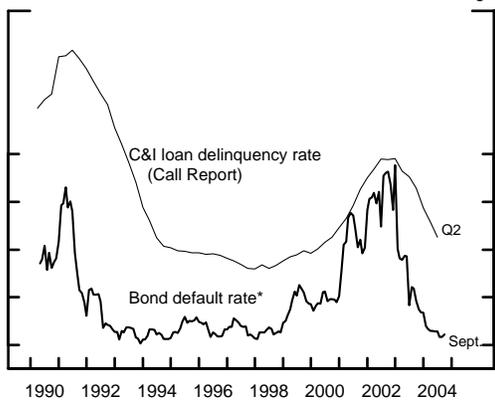
\* Note. Current debt includes short-term notes and long-term debt due in one year.  
Source: Compustat.

Bond Ratings Changes of Nonfinancial Companies



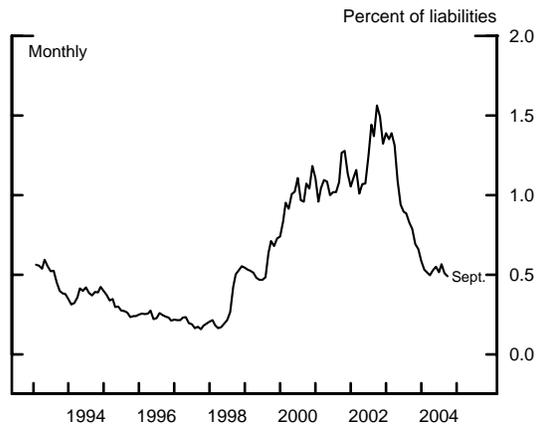
Note. Data are at an annual rate.  
Source: Moody's Investors Service.

Bond Defaults 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: KMV 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    | Q3    | Oct. <sup>e</sup> |
| <i>Nonfinancial corporations</i>                       |      |      |      |       |       |       |                   |
| Stocks <sup>1</sup>                                    | 9.9  | 6.5  | 5.2  | 3.7   | 5.7   | 4.6   | 4.0               |
| Initial public offerings                               | 4.4  | 2.1  | 0.7  | 0.4   | 0.8   | 2.0   | 2.0               |
| Seasoned offerings                                     | 5.5  | 4.4  | 4.4  | 3.2   | 4.9   | 2.6   | 2.0               |
| Bonds <sup>2</sup>                                     | 22.7 | 39.8 | 24.8 | 31.6  | 22.7  | 19.6  | 18.0              |
| Investment grade                                       | 13.2 | 27.5 | 15.7 | 16.0  | 8.2   | 9.8   | 9.0               |
| Speculative grade                                      | 4.7  | 8.9  | 4.8  | 11.3  | 10.5  | 6.3   | 5.0               |
| Other (sold abroad/unrated)                            | 4.9  | 3.4  | 4.2  | 4.3   | 4.0   | 3.6   | 4.0               |
| <i>Memo</i>  |      |      |      |       |       |       |                   |
| Net issuance of commercial paper <sup>3</sup>          | 4.5  | -8.0 | -6.3 | -3.8  | 2.8   | 1.9   | 17.5              |
| Change in C&I loans at commercial banks <sup>3,4</sup> | 7.8  | -5.8 | -5.2 | -7.9  | -0.3  | 5.5   | 3.9               |
| <i>Financial corporations</i>                          |      |      |      |       |       |       |                   |
| Stocks <sup>1</sup>                                    | 1.4  | 4.2  | 4.0  | 6.9   | 8.3   | 4.1   | 5.5               |
| Bonds <sup>2</sup>                                     | 57.8 | 80.2 | 87.0 | 111.1 | 130.9 | 145.0 | 80.0              |

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

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

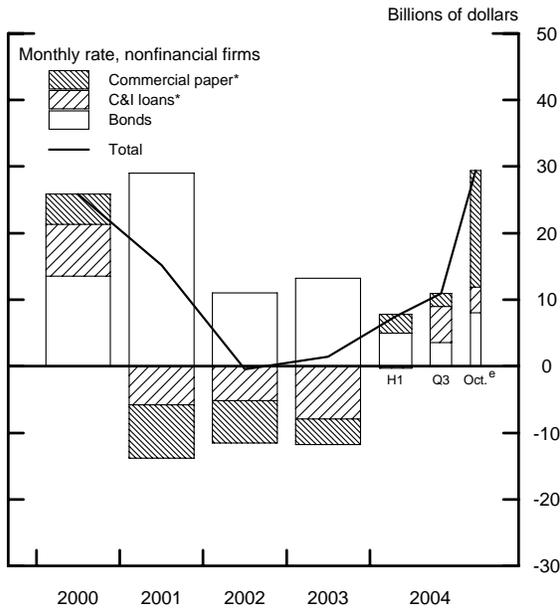
2. Data include regular and 144a private placements. Bond totals reflect gross proceeds rather than par value of original discount bonds. Bonds are categorized according to Moody's bond ratings, or to Standard & Poor's if unrated by Moody's.

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

4. Adjusted for FIN 46 effects.

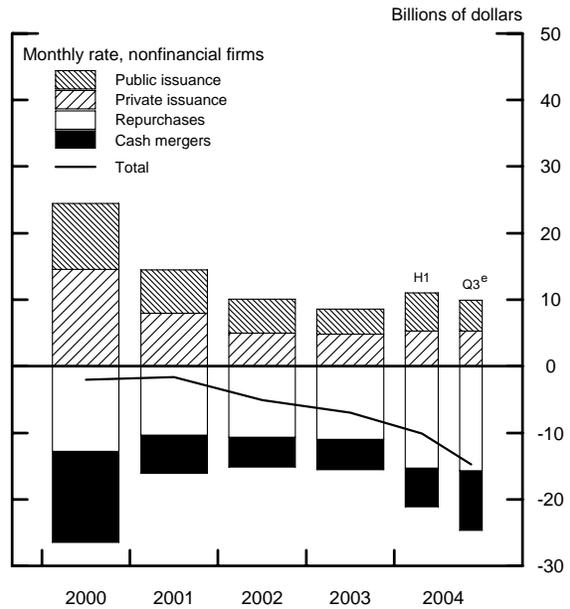
e Staff estimate.

**Selected Components of Net Debt Financing**



\* Seasonally adjusted, period-end basis.  
e Staff estimate.

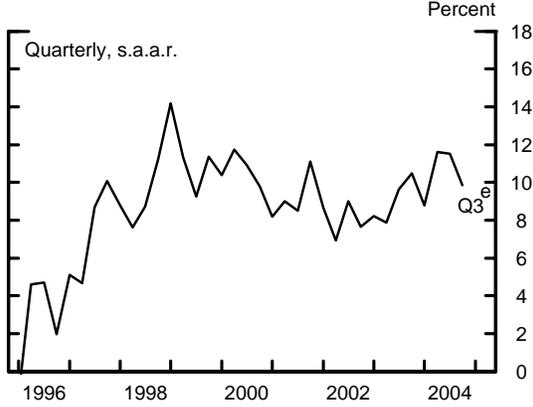
**Components of Net Equity Issuance**



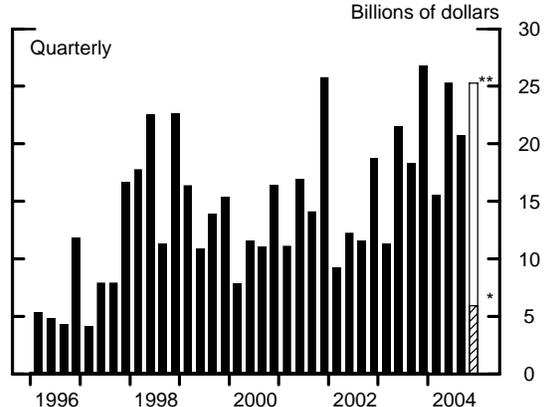
e Staff estimate.

## Commercial Real Estate

Growth of Commercial Mortgage Debt

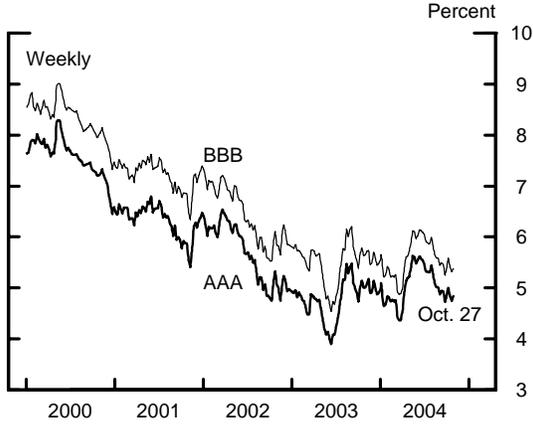


Gross Issuance of CMBS



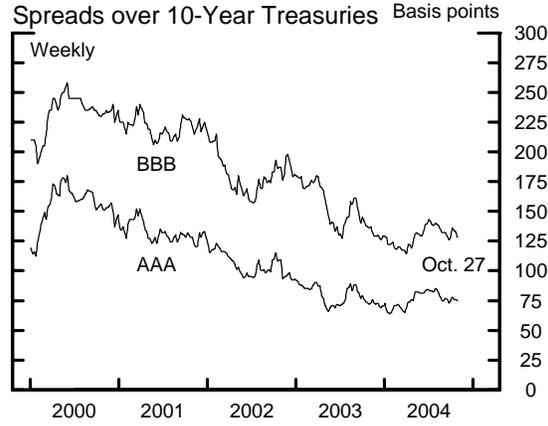
Source. Commercial Mortgage Alert.

Investment-Grade CMBS Yields



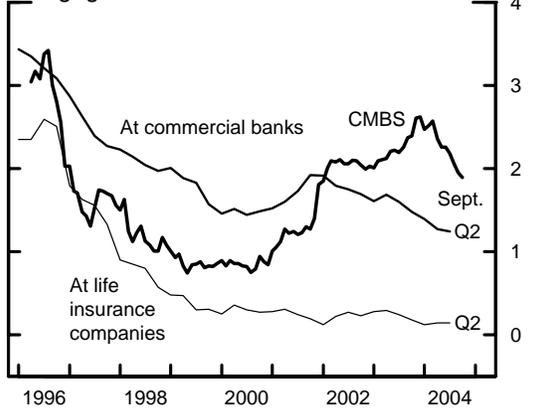
Source. Morgan Stanley.

Investment-Grade CMBS



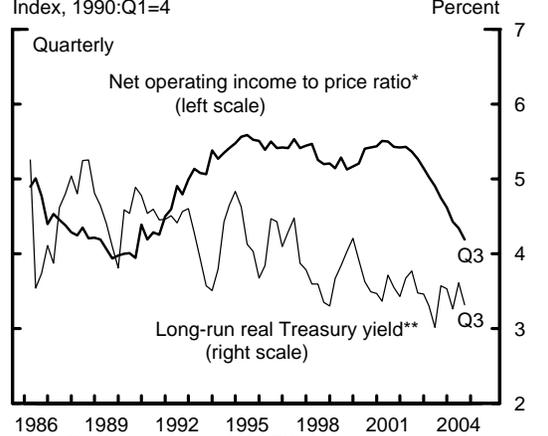
Source. Morgan Stanley.

Delinquency Rates on Commercial Mortgages and CMBS



Source. Call Report, ACLI, Morgan Stanley.

Commercial Real Estate Valuation



\* Staff calculation from NCREIF data.

\*\* Yield on synthetic Treasury perpetuity minus Philadelphia Fed 10-year expected inflation.

last FOMC meeting, as firms have apparently continued to rely on their ample profits and liquid assets. C&I loans advanced again, posting a small increase in October after moving up more strongly in the third quarter.

Gross public equity issuance by nonfinancial firms was sluggish in October. Seasoned equity offerings were down, in part because of the reduced demand for deleveraging by energy firms, which had previously been significant issuers. In contrast, initial public offerings in October maintained their improved third-quarter pace, reflecting a few large deals as well as an increased number of smaller offerings. Meanwhile, equity retirements from both merger-related activities and share repurchases have accelerated notably, and net equity issuance is estimated to have dropped further into negative territory in the third quarter. The newly passed corporate tax bill, which provides incentives for firms to repatriate profits earned overseas, could prompt a further increase in equity retirements in coming quarters.

### **Commercial Real Estate**

Financing activity related to commercial real estate remains strong, as the debt increased at an estimated 10 percent annual rate in the third quarter. Judging from the heavy calendar of commercial-mortgage-backed securities (CMBS) issues, growth in commercial real estate debt is likely to remain elevated in the current quarter.

Investment-grade CMBS yields tracked those on Treasuries and swaps closely over the intermeeting period, leaving spreads little changed at low levels. Credit quality has continued to improve, as delinquency rates on CMBS fell again in September. The cap rate—the ratio of net operating income to property prices—declined further in the third quarter. The spread of this ratio over the real perpetuity Treasury yield, a measure of the risk premium on commercial real estate assets, has narrowed sharply from the peak reached in 2001.

### **Household Finance**

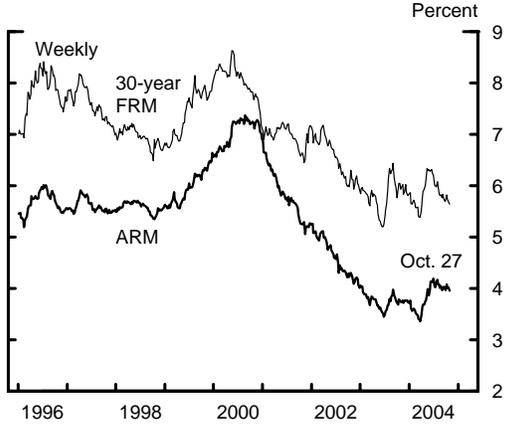
Mortgage rates declined modestly over the intermeeting period to the lowest levels since April. Available information suggests that household mortgage debt rose in the third quarter at an annual rate of around 10 percent, down slightly from the robust 12 percent pace in the first half of the year.

Consumer credit is estimated to have increased at an annual rate of about 5 percent in the third quarter, around the average pace of the past two years. Households have probably continued to pay down high-interest-rate consumer loans with some of the proceeds of cash-out mortgage refinancings, although the tempo of such transactions has moderated substantially in recent quarters. Growth in consumer debt may have been held down recently by increases in consumer loan interest rates, particularly those offered by auto finance companies on new automobiles.

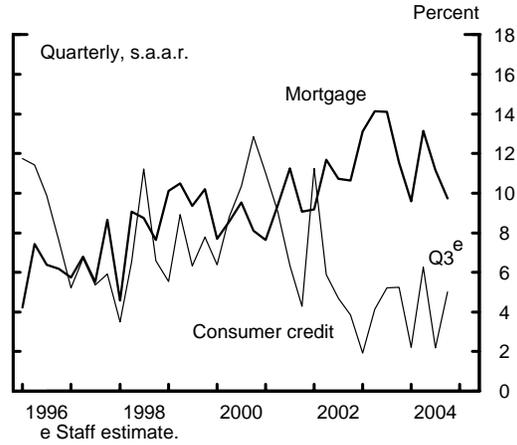
Household credit quality generally remains solid. Delinquencies on credit card loans in securitized pools moved down further in August, while those on loans for new

### Household Liabilities

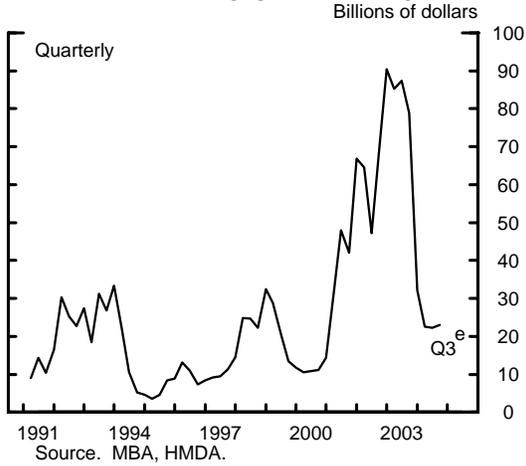
Freddie Mac Mortgage Rates



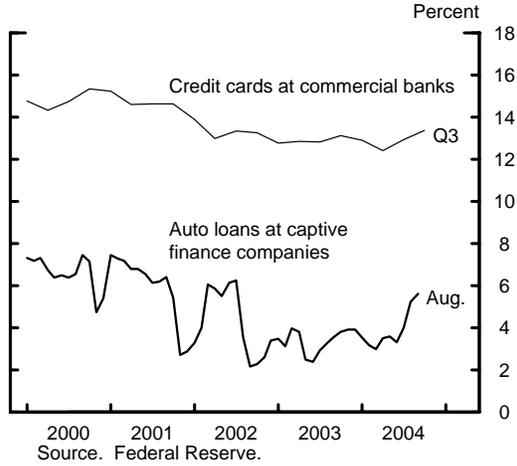
Household Debt Growth



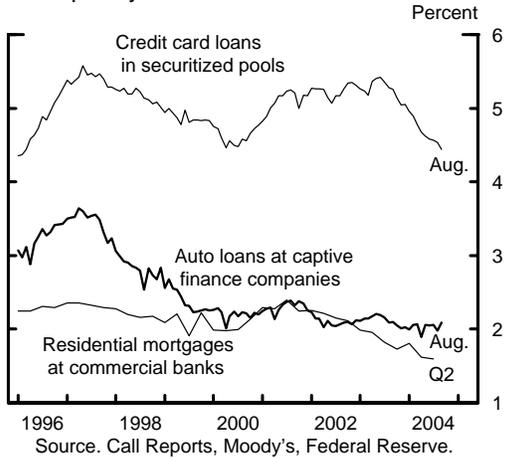
Cash-outs from Mortgage Refinancing



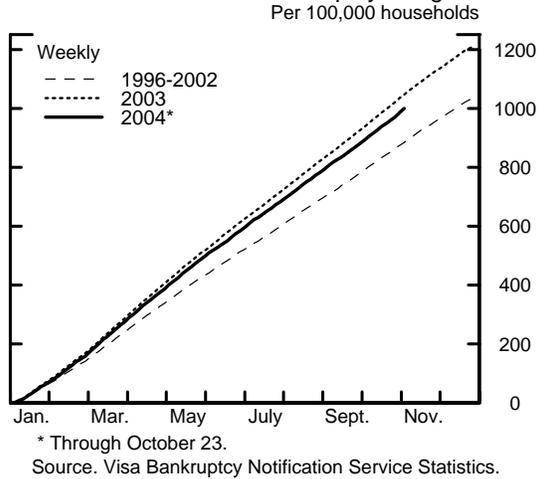
Consumer Loan Interest Rates



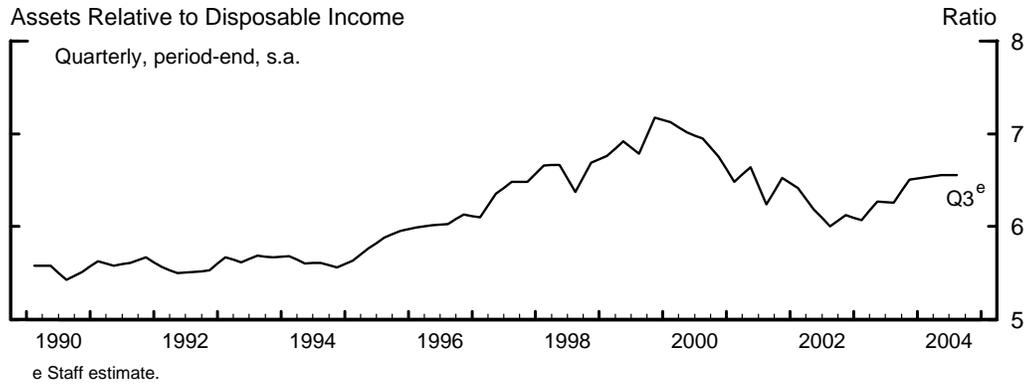
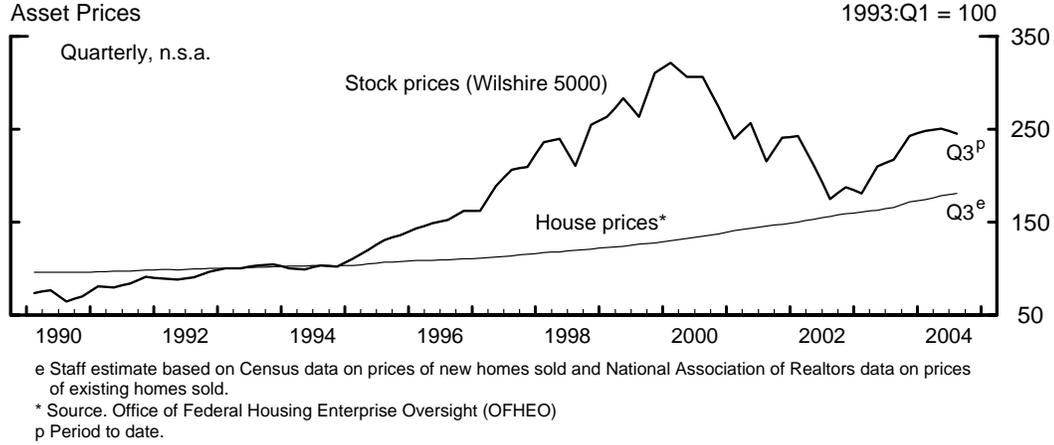
Delinquency Rates



Cumulative Household Bankruptcy Filings



### Household Assets



### Net Flows into Long-Term Mutual Funds (Billions of dollars, monthly rate)

| Fund Type                    | 2002        | 2003        | 2004        |              |             |             |                   | Assets<br>Sept. |
|------------------------------|-------------|-------------|-------------|--------------|-------------|-------------|-------------------|-----------------|
|                              |             |             | Q1          | Q2           | Q3          | Sept.       | Oct. <sup>e</sup> |                 |
| <b>Total long-term funds</b> | <b>10.1</b> | <b>18.0</b> | <b>36.5</b> | <b>3.8</b>   | <b>11.7</b> | <b>15.9</b> | <b>13.0</b>       | <b>5,658</b>    |
| <b>Equity funds</b>          | <b>-2.3</b> | <b>12.7</b> | <b>28.4</b> | <b>11.3</b>  | <b>6.9</b>  | <b>10.1</b> | <b>6.4</b>        | <b>3,916</b>    |
| Domestic                     | -2.1        | 10.7        | 19.9        | 7.6          | 3.8         | 6.0         | 2.9               | 3,332           |
| International                | -0.2        | 2.0         | 8.5         | 3.7          | 3.1         | 4.1         | 3.6               | 584             |
| <b>Hybrid funds</b>          | <b>0.7</b>  | <b>2.7</b>  | <b>5.1</b>  | <b>3.1</b>   | <b>2.8</b>  | <b>3.0</b>  | <b>2.2</b>        | <b>479</b>      |
| <b>Bond funds</b>            | <b>11.7</b> | <b>2.6</b>  | <b>3.0</b>  | <b>-10.5</b> | <b>2.0</b>  | <b>2.8</b>  | <b>4.4</b>        | <b>1,263</b>    |
| High-yield                   | 0.9         | 2.2         | -1.4        | -2.7         | 0.5         | 0.8         | 0.8               | 148             |
| Other taxable                | 9.4         | 1.0         | 4.2         | -4.0         | 2.0         | 1.9         | 2.9               | 789             |
| Municipals                   | 1.4         | -0.6        | 0.2         | -3.9         | -0.5        | 0.1         | 0.7               | 326             |

Note. Excludes reinvested dividends.

e Staff estimates based on confidential ICI weekly data.

Source. Investment Company Institute.

**Treasury Financing**  
(Billions of dollars)

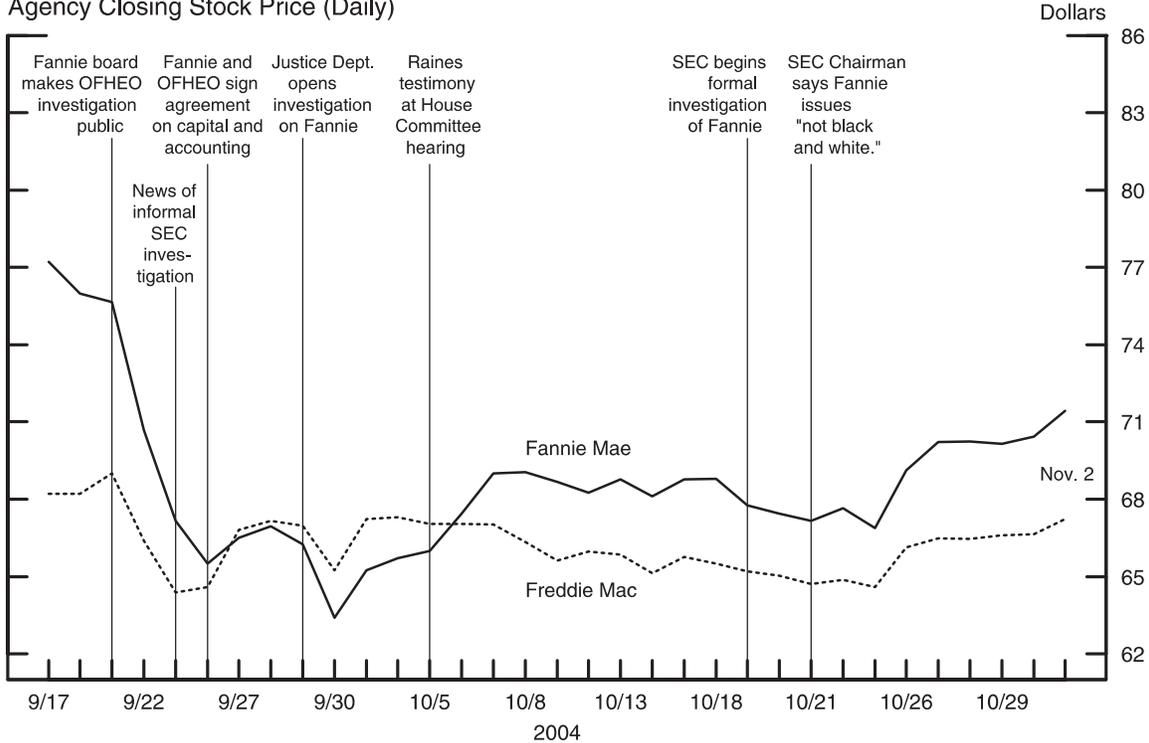
| Item                              | 2003          | 2004          |              |              |              |             |
|-----------------------------------|---------------|---------------|--------------|--------------|--------------|-------------|
|                                   | Q4            | Q1            | Q2           | Q3           | Aug.         | Sept.       |
| <b>Total surplus, deficit (-)</b> | <b>-130.2</b> | <b>-170.8</b> | <b>-25.7</b> | <b>-85.9</b> | <b>-41.1</b> | <b>24.4</b> |
| Means of financing deficit        |               |               |              |              |              |             |
| Net borrowing                     | 118.6         | 135.9         | 40.7         | 83.4         | 30.2         | 5.4         |
| Nonmarketable                     | 6.6           | -10.1         | 6.2          | -5.2         | -1.3         | -.2         |
| Marketable                        | 112.0         | 146.0         | 34.5         | 88.6         | 31.4         | 5.6         |
| Bills                             | 9.2           | 56.1          | -34.9        | 14.3         | 14.2         | -15.4       |
| Coupons                           | 102.8         | 89.9          | 69.4         | 74.3         | 17.3         | 21.0        |
| Decrease in cash balance          | 1.8           | 11.9          | -23.3        | 8.3          | 32.1         | -33.8       |
| Other <sup>1</sup>                | 9.8           | 23.0          | 8.3          | -5.7         | -21.1        | 4.0         |
| Memo:                             |               |               |              |              |              |             |
| Cash balance, end of period       | 33.2          | 21.3          | 44.6         | 36.3         | 2.5          | 36.3        |

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**

Agency Closing Stock Price (Daily)



automobiles at captive finance companies were little changed. Weekly household bankruptcy filings continue to come in around 5 percent lower than they were last year but remain elevated when compared with levels of earlier years.

Working from data for new and existing home sales, we estimate that OFHEO's repeat-transactions index of home prices will show an annualized rise of roughly 7 percent in the third quarter. Such a reading, along with slightly lower stock prices, would suggest that the ratio of household assets to disposable income was about unchanged over the third quarter. Mutual fund flows remained tepid in September and October, a development roughly consistent with our models that link flows to asset returns.

### **Treasury and Agency Finance**

The federal government's debt reached the statutory ceiling of \$7.4 trillion on October 14. As in past debt-limit episodes, the Treasury suspended issuance of state and local government series (SLGS) securities and began using other extraordinary financing devices to continue to fund government operations. These maneuvers should allow the Treasury to operate until the Congress returns from recess in mid-November and can take action to raise the debt ceiling. The Treasury's auction schedule is not expected to be interrupted, and the debt-ceiling announcement has reportedly had little effect on yields on Treasury securities. Treasury auctions during the intermeeting period continued to attract strong demand from indirect bidders—a rough proxy for demand from foreign official institutions.

Early in the intermeeting period, OFHEO released a report critical of Fannie Mae's accounting practices, earnings management, and internal controls. Shortly thereafter, the Justice Department and the SEC opened further investigations of Fannie Mae. Fannie Mae's equity price declined sharply after these announcements, but investors were subsequently reassured somewhat by the agreement between Fannie Mae and OFHEO that addressed some of the regulator's concerns, by the testimony of Fannie Mae's chief executive officer at a House committee hearing, and by the SEC chairman's remarks that the controversy surrounding Fannie Mae's accounting practices was "not black and white." On net, over the intermeeting period, Fannie Mae's stock price declined about 6 percent. The spillover to Freddie Mac's stock price was minimal, and spreads on agency senior debt changed little.

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

Gross issuance of long-term municipal bonds for new capital projects picked up in October, about matching the robust pace in the first half of the year. Short-term issuance dropped back in October after having been boosted in the third quarter by the borrowing needs of Texas and California; the weaker pace in October is consistent with a broader trend of lessened reliance on such borrowing because of the improved budget conditions in many states.

The credit quality of municipal bonds continued to improve over the intermeeting period, as upgrades of municipal bonds far outpaced downgrades. Longer-term municipal bond

## State and Local Government Finance

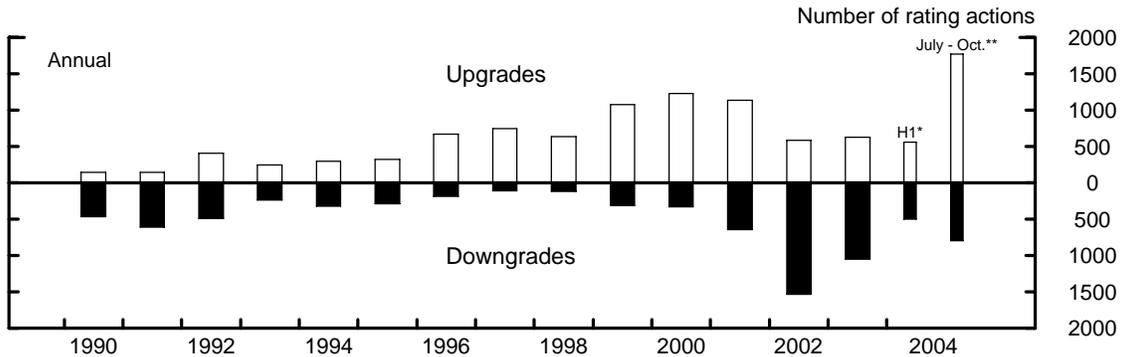
### Gross Offerings of Municipal Securities

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

| Type of security        | 2001 | 2002 | 2003 | 2004 |      |      |                   |
|-------------------------|------|------|------|------|------|------|-------------------|
|                         |      |      |      | H1   | Q3   | Sep. | Oct. <sup>e</sup> |
| Total                   | 29.0 | 36.3 | 37.9 | 35.5 | 33.9 | 33.7 | 33.1              |
| Long-term <sup>1</sup>  | 24.3 | 30.3 | 32.0 | 31.7 | 25.6 | 24.5 | 30.9              |
| Refundings <sup>2</sup> | 7.6  | 10.1 | 10.0 | 11.2 | 9.7  | 11.2 | 11.3              |
| New capital             | 16.7 | 20.2 | 22.1 | 20.5 | 16.0 | 13.4 | 19.7              |
| Short-term              | 4.7  | 6.0  | 5.8  | 3.8  | 8.3  | 9.1  | 2.2               |
| Memo: Long-term taxable | 1.4  | 1.7  | 3.5  | 2.5  | 1.2  | 1.1  | 1.6               |

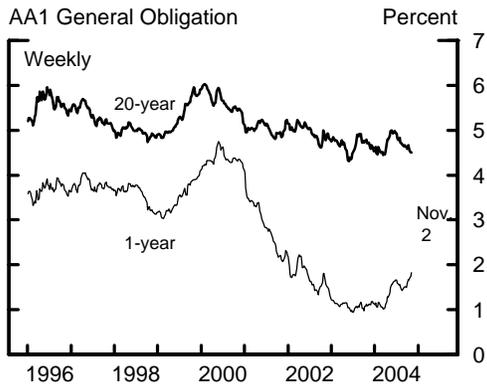
- 1. Includes issues for public and private purposes.
- 2. All issues that include any refunding bonds.
- e. Staff estimate based on preliminary data through October 28.

### Bond Rating Changes



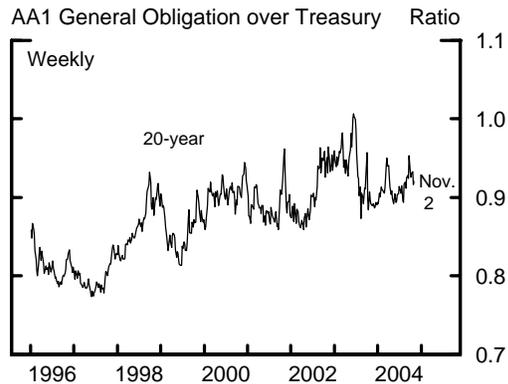
\* At an annual rate.  
 \*\* Data through October 27 at an annual rate.  
 Source: S&P's Credit Week Municipal and Ratings Direct.

### Municipal Bond Yields



Source: Bloomberg.

### Municipal Bond Yield Ratio



Source: Bloomberg.

yields declined a bit and, as yields on comparable-maturity Treasury securities were about unchanged, the municipal bond yield ratio edged slightly lower.

**Money and Bank Credit**

Growth in M2 has generally been sluggish in recent months, in keeping with rising opportunity costs in the wake of the recent policy tightenings and a moderate pace of advance in nominal income. Growth in September was boosted some by an uptick in mortgage refinancing, but this effect has since waned.

Bank credit expanded robustly in September but likely decelerated significantly in October, a result of runoffs in both securities holdings and the volatile “other loans” category. Business loans are on track for a sixth consecutive month of expansion in October and conditions in that market appear generally favorable. Evidence from the latest Senior Loan Officer Opinion Survey indicates that, on balance, domestic commercial banks continue to see stronger demand for C&I loans from customers of all sizes. Also, as has been the case for some time, the latest survey evidence shows that banks have continued to ease standards and terms for these loans on net.

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

| Aggregate or component                                  | 2003  | 2004  |       |       |       |       | Level |
|---|---|-------|-------|-------|-------|-------|-------|
|   |   | Q1    | Q2    | Q3    | Sept  | Oct   | Oct   |
|   |   |       |       |       |       | (e)   | (e)   |
|   | Percent change (annual rate) <sup>1</sup>                 |       |       |       |       |       |       |
| <i>Aggregate</i>  |   |       |       |       |       |       |       |
| 1. M2 <sup>2</sup>                                      | 5.3   | 3.5   | 9.7   | 2.5   | 5.6   | 2.7   | 6,344 |
| 2. M3 <sup>3</sup>                                      | 4.6   | 6.1   | 10.8  | 2.5   | 4.0   | -2.2  | 9,295 |
| <i>Components of M2<sup>4</sup></i>                     |   |       |       |       |       |       |       |
| 3. Currency   | 5.9   | 2.8   | 4.0   | 9.3   | 7.0   | 4.0   | 694   |
| 4. Liquid deposits <sup>5</sup>                         | 13.8  | 10.4  | 17.4  | 4.5   | 8.3   | 6.6   | 4,126 |
| 5. Small time deposits                                  | -9.3  | -4.5  | -5.9  | .1    | 5.0   | 2.0   | 797   |
| 6. Retail money market funds                            | -11.6   | -19.4 | -7.2  | -11.3 | -9.9  | -19.9 | 719   |
| <i>Components of M3</i>                                 |   |       |       |       |       |       |       |
| 7. M3 minus M2 <sup>6</sup>                             | 3.1   | 11.7  | 12.9  | 2.5   | .7    | -12.6 | 2,950 |
| 8. Large time deposits, net <sup>7</sup>                | 3.6   | 28.9  | 27.3  | 15.6  | 4.7   | 15.5  | 1,030 |
| 9. Institutional money market funds                     | -5.8  | -7.8  | 2.5   | -8.4  | -11.9 | -32.1 | 1,059 |
| 10. RPs   | 14.1  | 13.7  | 6.1   | 4.7   | 16.5  | -40.0 | 533   |
| 11. Eurodollars   | 27.4  | 33.7  | 19.4  | -2.2  | 4.1   | 11.1  | 329   |
| <i>Memo</i>   |   |       |       |       |       |       |       |
| 12. Monetary base                                       | 6.0   | 3.1   | 4.9   | 8.8   | 8.3   | 7.5   | 758   |
|   | Average monthly change (billions of dollars) <sup>8</sup> |       |       |       |       |       |       |
| <i>Selected managed liabilities at commercial banks</i> |   |       |       |       |       |       |       |
| 13. Large time deposits, gross                          | -1.5  | 15.4  | 20.6  | 15.0  | -1.2  | 9.1   | 1,150 |
| 14. Net due to related foreign institutions             | 3.1   | -16.6 | -11.1 | -9.0  | 3.1   | -12.1 | 33    |
| 15. U.S. government deposits at commercial banks        | -0.4  | 2.4   | 0.0   | -3.8  | 7.7   | 7.5   | 21    |

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.
- e Estimated.

**Commercial Bank Credit**

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

| Type of credit                 | 2003       | Q1<br>2004  | Q2<br>2004  | Q3<br>2004 | Sept.<br>2004 | Oct. <sup>e</sup><br>2004 | Level,<br>Oct. 2004 <sup>e</sup><br>(\$ billions) |
|--------------------------------|------------|-------------|-------------|------------|---------------|---------------------------|---|
| <b>Total</b>                   |            |             |             |            |               |                           |   |
| <b>1. Adjusted<sup>1</sup></b> | <b>5.9</b> | <b>11.3</b> | <b>11.8</b> | <b>4.8</b> | <b>12.6</b>   | <b>1.2</b>                | <b>6,439</b>                                      |
| 2. Reported                    | 5.6        | 11.9        | 8.7         | 5.4        | 12.5          | 2.5                       | 6,618   |
| <i>Securities</i>              |            |             |             |            |               |                           |   |
| 3. Adjusted <sup>1</sup>       | 8.7        | 17.9        | 14.4        | -7.7       | 6.9           | -5.6                      | 1,719   |
| 4. Reported                    | 7.3        | 19.5        | 3.7         | -4.9       | 7.2           | -8                        | 1,898   |
| 5. Treasury and agency         | 8.8        | 24.2        | 11.1        | -4.0       | -4.7          | -30.2                     | 1,149   |
| 6. Other <sup>2</sup>          | 5.0        | 12.2        | -8.1        | -6.3       | 27.1          | 47.4                      | 750   |
| <i>Loans<sup>3</sup></i>       |            |             |             |            |               |                           |   |
| 7. Total                       | 4.9        | 8.8         | 10.8        | 9.7        | 14.7          | 3.8                       | 4,719   |
| 8. Business                    | -9.4       | -5.1        | -2.6        | 6.3        | 4.0           | 3.4                       | 879   |
| 9. Real estate                 | 11.1       | 10.1        | 21.1        | 7.8        | 11.9          | 12.8                      | 2,483   |
| 10. Home equity                | 30.8       | 37.8        | 38.5        | 37.2       | 37.8          | 33.8                      | 380   |
| 11. Other                      | 8.8        | 6.2         | 18.5        | 3.1        | 7.4           | 9.1                       | 2,103   |
| 12. Consumer                   | 5.4        | 11.4        | 4.2         | 19.7       | 2.9           | -6.6                      | 670   |
| 13. Adjusted <sup>4</sup>      | 5.8        | 10.4        | -2.2        | 12.4       | 1.6           | 2.1                       | 1,039   |
| 14. Other <sup>5</sup>         | 6.7        | 20.5        | -5          | 11.4       | 50.5          | -17.7                     | 688   |

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

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

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

3. Excludes interbank loans.

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

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

e Estimated.

## Appendix

### Senior Loan Officer Opinion Survey on Bank Lending Practices

The October 2004 Senior Loan Officer Opinion Survey on Bank Lending Practices addressed changes in the supply of, and demand for, bank loans to businesses and households over the past three months. The survey also contained additional questions on recent changes in the degree of competition from alternative sources of funds in the commercial and industrial (C&I) loan market and on banks' outlook for business loan credit quality over the next year. This appendix is based on responses received from fifty-six domestic and twenty foreign banking institutions.

Both domestic banks and U.S. branches and agencies of foreign banks further eased lending standards and terms for C&I loans over the past three months. Banks that eased standards or terms reported having done so in response to increased competition from other U.S. banks as well as from a wide range of alternative sources of business credit. A sizable net fraction of domestic and foreign institutions also reported an easing of lending standards for commercial real estate loans. On balance, domestic and foreign banks reported stronger demand for both C&I and commercial real estate loans. Standards and terms on loans to households were little changed. Demand for residential mortgages and consumer loans reportedly declined, on net.

#### **C&I lending**

In the October survey, both domestic banks and U.S. branches and agencies of foreign banks reported a further net easing of credit standards on C&I loans. More than one-fifth of domestic banks, on net, reported having eased their lending standards for large and middle-market firms, about the same fraction as in the July survey. A similar percentage of these institutions also indicated that they had eased their lending standards for small firms, a noticeable increase from the 4 percent net easing in the previous survey. The share of U.S. branches and agencies of foreign banks that reported easier lending standards for C&I loans was 35 percent, little changed from the July survey.

Both domestic and foreign institutions indicated that they had continued easing many lending terms on C&I loans over the past three months. On net, about 50 percent of domestic banks reported that they had narrowed spreads of loan rates over their cost of funds for large and middle-market borrowers, and nearly 40 percent had done so for small firms, up from about 30 percent in each case in the July survey. More than half of the foreign institutions reported narrower spreads on their C&I loans in the latest survey. In addition, roughly one-third of both domestic and foreign respondents indicated that they had eased terms on credit lines by reducing the costs of these lines and increasing their maximum size.

Almost all domestic and all foreign respondents cited more aggressive competition from other banks or nonbank lenders as the most important reason for easing their lending standards and terms over the previous three months. About three-quarters of domestic banks that had eased their lending posture also cited a more favorable or less uncertain economic outlook as a reason. Foreign institutions, on balance, were not as optimistic about the economy, but 60 percent, on net, pointed to an increased tolerance for risk as a reason for easing. The few domestic banks that tightened standards or terms over the

past three months said they were motivated to do so by a worsening of industry-specific problems or reduced tolerance for risk.

Because respondent banks have consistently reported that they have eased standards or terms in response to increased competition from other sources of business credit, this survey included two special questions on the nature of this competition. Forty-two domestic respondents and fifteen foreign respondents indicating that they had experienced increased competition from other sources of credit this year reported that the greatest increases came from the U.S. commercial banking sector. For domestic institutions, and especially for the largest commercial banks in the sample, the second-most-cited competitor was investment banks. At foreign institutions, the second biggest increase in competitive pressure came from other foreign banks. Both domestic and foreign institutions also indicated increased competitive pressure from a wide range of other sources of business credit. The majority of those respondents expressing an opinion indicated that the increased competitive pressure reflected a permanent, rather than a temporary, change in the structure of the C&I loan market. However, one-half of domestic respondents and about one-third of foreign bank respondents felt that the nature of this shift was not clear at this point.

An additional question asked banks about their outlook for the credit quality of business loans over the next year. A majority of the domestic and foreign respondents indicated that loan quality is likely to stabilize around current levels if economic activity progresses in line with consensus forecasts. On net, the remaining domestic and foreign banks indicated that loan quality would likely continue to improve.

On net, 25 percent of domestic institutions reported an increase in demand for C&I loans from large and middle-market firms, and 24 percent reported an increase in demand from small firms, smaller fractions than in the July survey. In addition, 37 percent, on net, reported an increase in the number of inquiries from potential business borrowers. In contrast, only 5 percent of foreign respondents, on net, indicated that demand for C&I loans was stronger, while the number of inquiries from potential borrowers at these institutions decreased.

As was the case in previous surveys, most of the domestic respondents that had experienced stronger loan demand cited as an important reason borrowers' increased financing needs for accounts receivable and inventories as well as for investment in plant and equipment. Moreover, almost two-thirds of domestic respondents indicated that customer borrowing had shifted to their banks from other banks or nonbank sources of credit because these other sources had become less attractive. On the other hand, a large majority of the domestic banks that reported weaker demand pointed to borrowers leaving their banks for more attractive sources of credit as an important reason. Additionally, these banks indicated that their customers' investment activity had declined and that internally generated funds had increased.

### **Commercial real estate lending**

Almost one-fifth of domestic banks, on net, reported an easing of lending standards on commercial real estate loans over the past three months, double the fraction in the previous two surveys. The net percentage of domestic banks that had experienced an

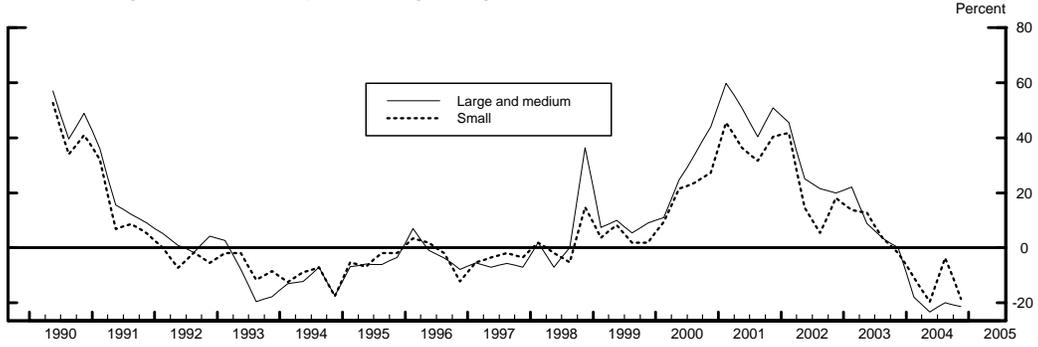
increase in demand for this type of loan was about unchanged from July at 23 percent in October. In addition, 15 percent of foreign institutions, on net, reported stronger demand for commercial real estate loans over the past three months.

**Lending to Households**

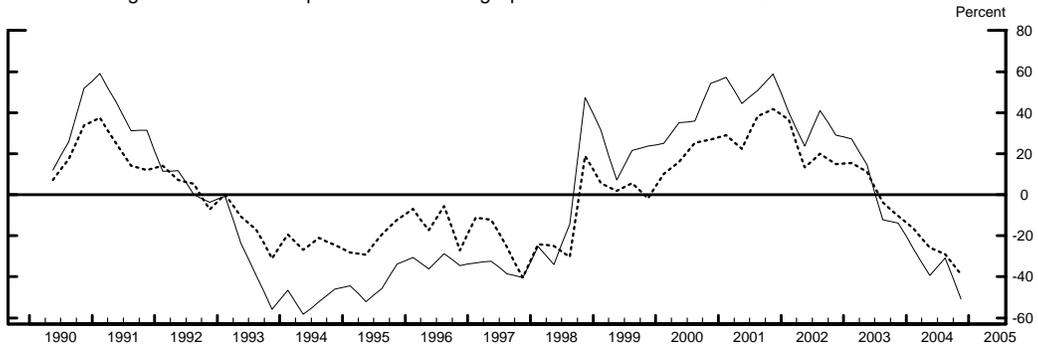
In the October survey, credit standards on residential mortgage loans and other loans to consumers were little changed, on net, at domestic banks. Terms on credit card and other consumer loans were also little changed, on net, but a modest fraction of banks reported an increased willingness to make consumer installment loans. Demand for residential mortgages and consumer loans continued to weaken. About 23 percent of banks, on net, reported weaker demand for mortgages to purchase homes, compared with 8 percent in July. Nearly a third of domestic respondents reported weaker demand for consumer loans, up from 12 percent in the previous survey.

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

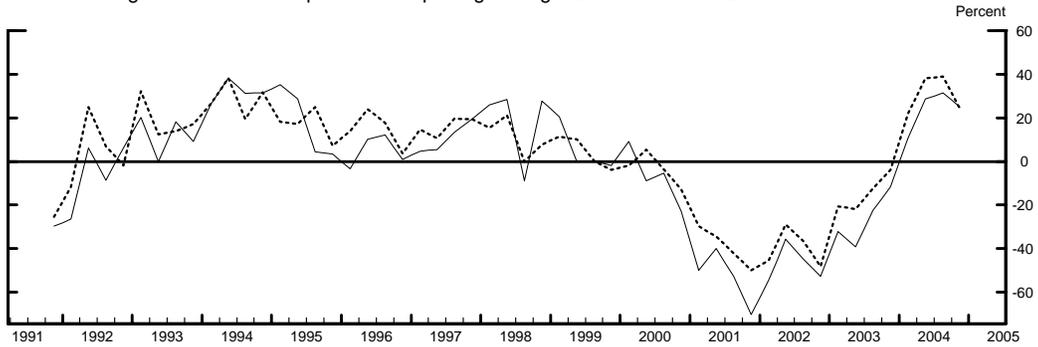
Net Percentage of Domestic Respondents Tightening Standards for C&I Loans



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

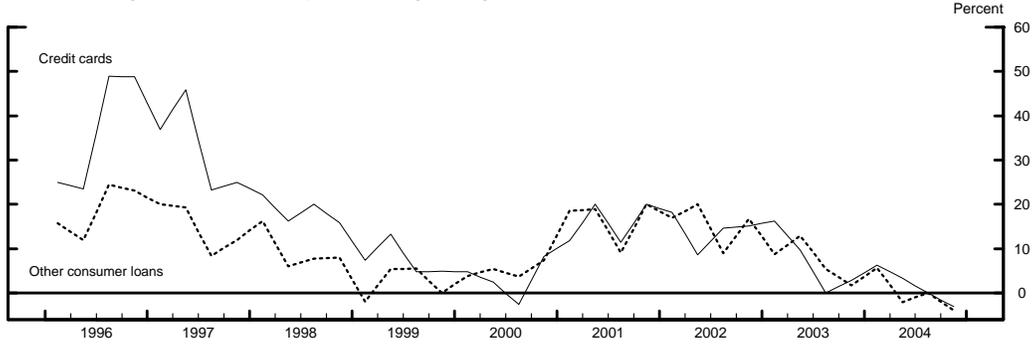


Net Percentage of Domestic Respondents Reporting Stronger Demand for C&I Loans

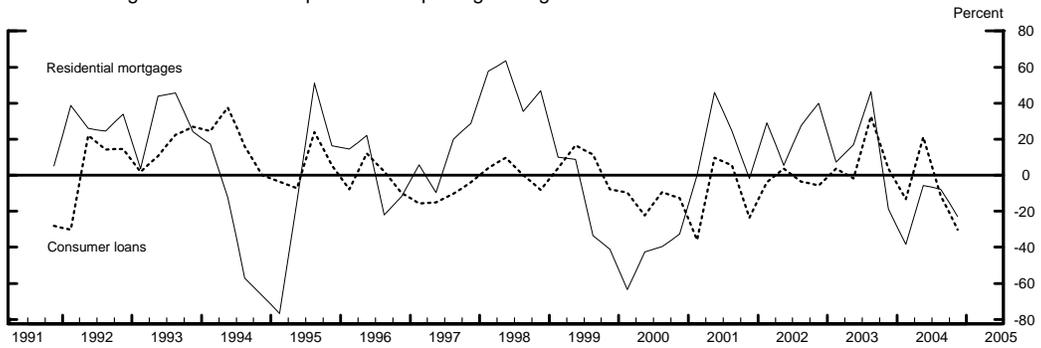


### Measures of Supply and Demand for Loans to Households

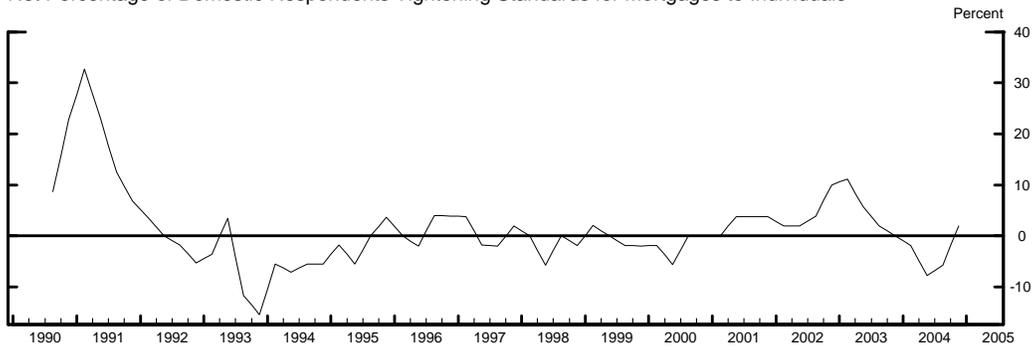
Net Percentage of Domestic Respondents Tightening Standards on Consumer Loans



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



Net Percentage of Domestic Respondents Tightening Standards for Mortgages to Individuals



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## **International Developments**

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## International Developments

### U.S. International Transactions

#### Trade in Goods and Services

The U.S. international trade deficit rose to \$54 billion in August from \$50.5 billion in July (revised).

#### Net Trade in Goods and Services

(Billions of dollars, seasonally adjusted)

|                              | 2003   | Annual rate |        |                 | Monthly rate |       |       |
|------------------------------|--------|-------------|--------|-----------------|--------------|-------|-------|
|                              |        | 2004        |        |                 | 2004         |       |       |
|                              |        | Q1          | Q2     | Q3 <sup>e</sup> | June         | July  | Aug.  |
| <i>Real NIPA<sup>1</sup></i> |        |             |        |                 |              |       |       |
| Net exports of G&S           | -518.5 | -550.1      | -580.3 | -598.0          | ...          | ...   | ...   |
| <i>Nominal BOP</i>           |        |             |        |                 |              |       |       |
| Net exports of G&S           | -496.5 | -554.4      | -601.1 | -627.5          | -55.0        | -50.5 | -54.0 |
| Goods, net                   | -547.6 | -603.1      | -654.3 | -673.2          | -59.1        | -54.8 | -57.4 |
| Services, net                | 51.0   | 48.7        | 53.2   | 45.7            | 4.1          | 4.2   | 3.4   |

1. Billions of chained (2000) dollars.

e. BOP data are two months at an annual rate; NIPA data are BEA's advance estimate.

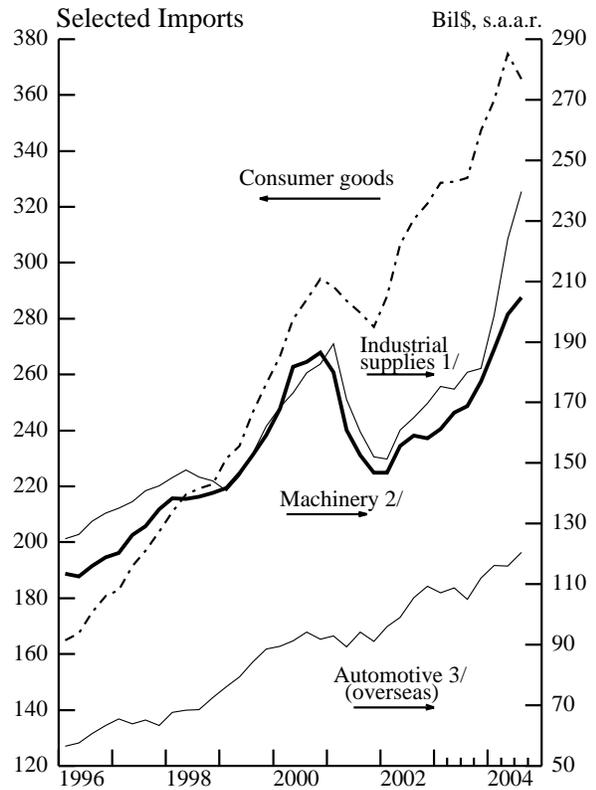
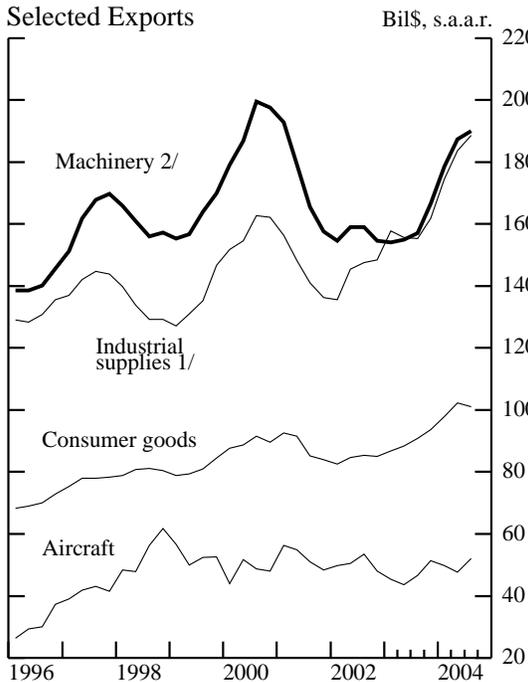
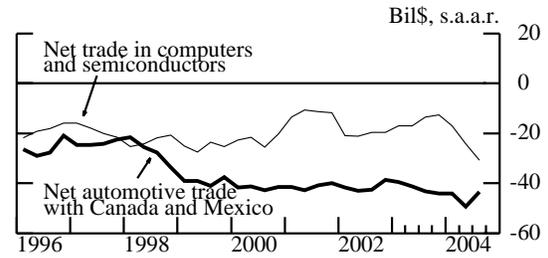
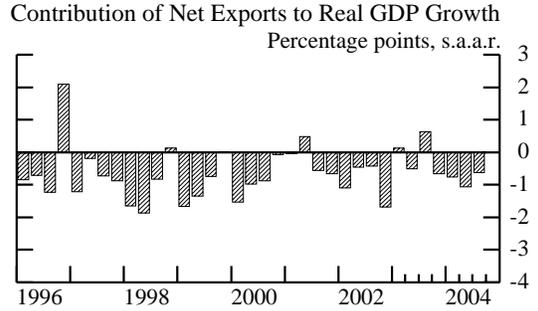
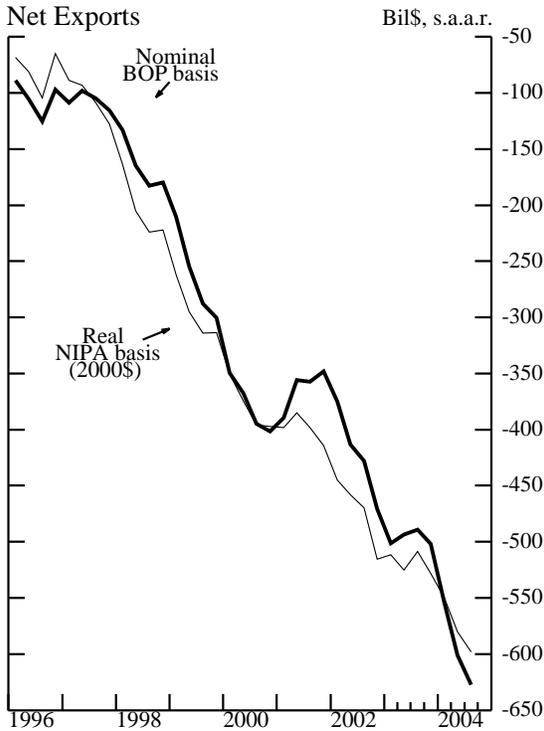
Source. U.S. Department of Commerce, Bureau of Economic Analysis and Census.

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

In August, the value of exported goods and services ticked up 0.1 percent following a robust 3 percent rise in July. A decline in agricultural exports was largely offset by a rise in exports of consumer goods, particularly pharmaceuticals, and automotive products. Exports of capital goods edged up as declines in high-tech goods were offset by stronger exports of civilian aircraft and other capital goods. Exports of services edged up slightly. At an annual rate, the average value of exported goods and services in July and August was about 5 percent above the second-quarter level. The increase was widespread, except for exports of agricultural products and consumer goods, both of which fell.

The value of imported goods and services jumped 2.5 percent in August, following a 1.1 percent fall in July. A large increase in the value of imported oil contributed slightly less than half of the gain, reflecting both higher prices and quantities. Imports of non-oil goods also moved higher, led by an increase in industrial supplies. Imports of capital goods edged down entirely on account of decreased imports of aircraft. Imports of computers and semiconductors were essentially unchanged. Services imports were boosted by a one-time payment for the rights to broadcast the 2004 Summer Olympic Games. At an annual rate, the average value of imported goods and services in July and August was about 10 percent above the second-quarter level. The rise was fairly widespread, with the main exception being consumer goods, which declined.

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



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

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

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

|                              | Levels        |                 |               |               | Change <sup>1</sup> |                 |              |             |
|------------------------------|---------------|-----------------|---------------|---------------|---------------------|-----------------|--------------|-------------|
|                              | 2004          |                 | 2004          |               | 2004                |                 | 2004         |             |
|                              | Q2            | Q3 <sup>e</sup> | July          | Aug.          | Q2                  | Q3 <sup>e</sup> | July         | Aug.        |
| <b>Exports of G&amp;S</b>    | <b>1137.2</b> | <b>1151.7</b>   | <b>1151.0</b> | <b>1152.3</b> | <b>32.9</b>         | <b>14.5</b>     | <b>34.0</b>  | <b>1.4</b>  |
| Goods exports                | 797.3         | 809.1           | 809.5         | 808.7         | 21.6                | 11.9            | 33.4         | -0.9        |
| Gold                         | 3.5           | 4.3             | 4.7           | 3.9           | -0.9                | 0.8             | 1.4          | -0.8        |
| Other goods                  | 793.8         | 804.8           | 804.9         | 804.8         | 22.5                | 73.8            | 32.0         | -0.1        |
| Aircraft & parts             | 47.7          | 52.0            | 50.5          | 53.5          | -2.2                | 4.3             | 8.5          | 2.9         |
| Computers & accessories      | 41.8          | 43.1            | 43.9          | 42.3          | -0.2                | 1.2             | 2.6          | -1.6        |
| Semiconductors               | 49.0          | 45.7            | 46.2          | 45.1          | -1.1                | -3.3            | 0.5          | -1.2        |
| Other capital goods          | 190.4         | 192.8           | 192.6         | 193.0         | 9.0                 | 2.4             | 4.9          | 0.4         |
| Automotive                   | 85.5          | 92.2            | 90.8          | 93.6          | 2.0                 | 6.7             | 7.0          | 2.8         |
| to Canada                    | 47.1          | 52.5            | 52.0          | 52.9          | 0.7                 | 5.3             | 5.4          | 0.9         |
| to Mexico                    | 16.0          | 13.8            | 11.9          | 15.7          | 0.7                 | -2.2            | -3.0         | 3.9         |
| to ROW                       | 22.4          | 25.9            | 26.9          | 25.0          | 0.5                 | 3.6             | 4.6          | -1.9        |
| Agricultural                 | 62.8          | 59.1            | 62.0          | 56.2          | -0.8                | -3.7            | 2.0          | -5.7        |
| Ind supplies (ex. ag, gold)  | 183.6         | 188.6           | 188.6         | 188.7         | 9.1                 | 5.0             | 10.0         | 0.1         |
| Consumer goods               | 102.2         | 101.0           | 99.0          | 103.0         | 4.3                 | -1.2            | -2.3         | 4.1         |
| All other goods              | 30.8          | 30.4            | 31.3          | 29.4          | 2.4                 | -0.4            | 11.7         | -2.0        |
| Services exports             | 339.9         | 342.5           | 341.4         | 343.7         | 11.3                | 2.6             | 0.5          | 2.2         |
| <b>Imports of G&amp;S</b>    | <b>1738.3</b> | <b>1779.2</b>   | <b>1757.6</b> | <b>1800.8</b> | <b>79.6</b>         | <b>40.9</b>     | <b>-19.7</b> | <b>43.3</b> |
| Goods imports                | 1451.6        | 1482.3          | 1466.7        | 1498.0        | 72.8                | 30.8            | -18.8        | 31.3        |
| Petroleum                    | 164.2         | 177.6           | 167.4         | 187.8         | 1.8                 | 13.4            | -14.7        | 20.4        |
| Gold                         | 3.3           | 3.9             | 4.3           | 3.4           | -0.8                | 0.6             | 1.1          | -0.9        |
| Other goods                  | 1284.1        | 1300.9          | 1294.9        | 1306.8        | 71.8                | 16.8            | -5.2         | 11.9        |
| Aircraft & parts             | 24.4          | 23.1            | 25.9          | 20.2          | 2.8                 | -1.4            | -2.4         | -5.7        |
| Computers & accessories      | 87.7          | 91.7            | 91.7          | 91.8          | 5.1                 | 4.0             | 3.3          | 0.1         |
| Semiconductors               | 27.3          | 27.7            | 27.7          | 27.7          | 0.8                 | 0.4             | -0.2         | 0.0         |
| Other capital goods          | 201.2         | 206.7           | 204.9         | 208.6         | 11.0                | 5.5             | -2.8         | 3.8         |
| Automotive                   | 228.4         | 230.3           | 229.5         | 231.2         | 6.3                 | 1.9             | 5.1          | 1.6         |
| from Canada                  | 67.7          | 69.8            | 67.5          | 72.1          | 3.7                 | 2.1             | -0.3         | 4.6         |
| from Mexico                  | 44.7          | 40.0            | 36.3          | 43.8          | 2.8                 | -4.7            | -9.5         | 7.4         |
| from ROW                     | 116.0         | 120.5           | 125.7         | 115.3         | -0.2                | 4.6             | 14.9         | -10.4       |
| Ind supplies (ex. oil, gold) | 224.0         | 239.7           | 235.3         | 244.2         | 25.2                | 15.8            | -0.0         | 8.9         |
| Consumer goods               | 374.6         | 365.7           | 365.8         | 365.7         | 16.6                | -8.9            | -5.7         | -0.2        |
| Foods, feeds, bev.           | 62.5          | 61.5            | 61.7          | 61.2          | 2.3                 | -1.0            | -1.2         | -0.5        |
| All other goods              | 54.0          | 54.3            | 52.4          | 56.2          | 1.8                 | 0.4             | -1.1         | 3.8         |
| Services imports             | 286.7         | 296.9           | 290.9         | 302.8         | 6.8                 | 10.1            | -0.9         | 12.0        |
| <i>Memo:</i>                 |               |                 |               |               |                     |                 |              |             |
| Oil quantity (mb/d)          | 13.01         | 14.76           | 12.98         | 16.53         | -1.38               | 1.74            | -1.06        | 3.55        |
| Oil import price (\$/bbl)    | 34.53         | 36.65           | 35.31         | 37.99         | 3.64                | 2.13            | -0.21        | 2.68        |

1. Change from previous quarter or month. e. Average of two months.

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

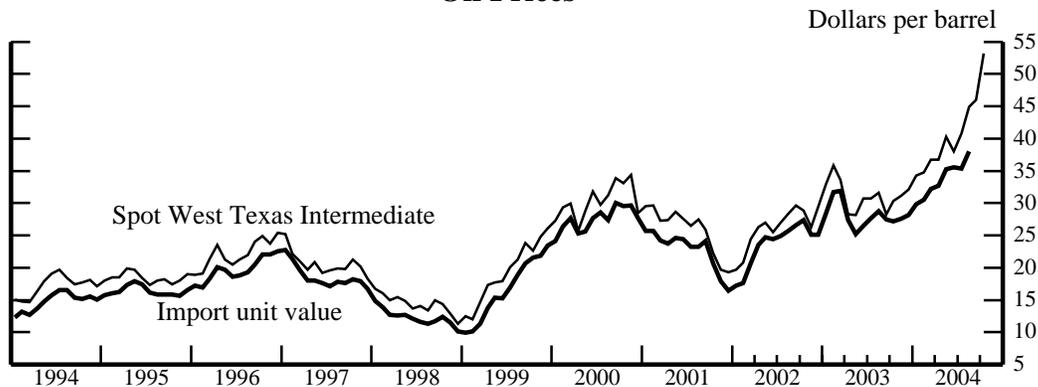
**Prices of U.S. Imports and Exports**  
(Percentage change from previous period)

|                             | Annual rate             |      |       | Monthly rate |      |       |
|-----------------------------|-------------------------|------|-------|--------------|------|-------|
|                             | 2004                    |      |       | 2004         |      |       |
|                             | Q1                      | Q2   | Q3    | July         | Aug. | Sept. |
|                             | ----- BLS prices -----  |      |       |              |      |       |
| <b>Merchandise imports</b>  | 11.5                    | 7.4  | 7.2   | 0.4          | 1.4  | 0.2   |
| Oil                         | 68.1                    | 43.2 | 49.0  | 2.2          | 8.3  | 0.6   |
| Non-oil                     | 5.9                     | 3.0  | 1.5   | 0.0          | 0.3  | 0.1   |
| Core goods*                 | 7.1                     | 4.3  | 2.4   | 0.1          | 0.4  | 0.1   |
| Cap. goods ex comp & semi   | 2.6                     | 0.0  | 2.0   | 0.4          | 0.2  | 0.0   |
| Automotive products         | 1.7                     | 1.4  | 0.9   | 0.0          | 0.0  | 0.3   |
| Consumer goods              | 2.6                     | -0.5 | -0.1  | 0.0          | 0.0  | 0.0   |
| Foods, feeds, beverages     | 10.0                    | 7.8  | 3.2   | 0.6          | 0.0  | 0.8   |
| Industrial supplies ex oil  | 25.3                    | 18.7 | 8.9   | 0.1          | 1.7  | 0.1   |
| Computers                   | -1.7                    | -8.6 | -8.2  | -0.7         | -0.8 | -0.1  |
| Semiconductors              | -8.2                    | -7.0 | -4.7  | -1.1         | 0.1  | -0.3  |
| <b>Merchandise exports</b>  | 7.4                     | 6.0  | -0.1  | 0.5          | -0.5 | 0.4   |
| Core goods*                 | 8.4                     | 6.6  | 0.6   | 0.6          | -0.5 | 0.5   |
| Cap. goods ex comp & semi   | 2.2                     | 0.8  | 1.2   | 0.2          | 0.1  | 0.0   |
| Automotive products         | 0.3                     | 1.3  | 1.2   | 0.2          | 0.1  | 0.0   |
| Consumer goods              | 1.1                     | 1.1  | 3.0   | 0.6          | 0.2  | 0.1   |
| Agricultural products       | 19.0                    | 17.5 | -31.5 | -1.1         | -8.5 | 1.6   |
| Industrial supplies ex ag   | 21.3                    | 14.4 | 14.9  | 2.3          | 1.1  | 0.7   |
| Computers                   | 1.2                     | 0.3  | -6.9  | -0.5         | -0.1 | -0.1  |
| Semiconductors              | -1.7                    | 2.1  | -4.2  | -0.1         | -0.3 | -0.3  |
|                             | ----- NIPA prices ----- |      |       |              |      |       |
| <b>Chain price index</b>    | 9.6                     | 6.4  | 5.5   | ...          | ...  | ...   |
| Imports of goods & services | 5.6                     | 2.8  | 1.4   | ...          | ...  | ...   |
| Non-oil merchandise         | 6.4                     | 4.0  | 2.3   | ...          | ...  | ...   |
| Core goods*                 | 5.7                     | 4.6  | 2.0   | ...          | ...  | ...   |
| Exports of goods & services | 6.4                     | 5.3  | 1.6   | ...          | ...  | ...   |
| Total merchandise           | 7.9                     | 5.8  | 2.2   | ...          | ...  | ...   |
| Core goods*                 |                         |      |       |              |      |       |

\*/ Excludes computers and semiconductors.

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

**Oil Prices**



**Prices of Internationally Traded Goods**

**Non-oil imports.** In September, the prices of U.S. imports of non-oil goods and of core goods both increased 0.1 percent. Foods, feeds and beverages had the largest increase, rising 0.8 percent, led by higher vegetable prices. Automotive products increased 0.3 percent, the largest monthly increase in this category since October 2003. After increasing a revised 1.7 percent in August, the prices of imported non-oil industrial supplies rose a modest 0.1 percent. The prices of capital goods and consumer goods were unchanged in September. Import prices of both computers and semiconductors declined in September, falling 0.1 and 0.3 percent, respectively.

For the third quarter, on a NIPA basis, the prices of imported core goods increased 2¼ percent at an annual rate. The rise was concentrated in non-oil industrial supplies and, to a lesser extent, capital goods (excluding computers and semiconductors) and foods.

**Oil.** The BLS price of imported oil rose 0.6 percent in September. In the second half of September, the spot price of West Texas Intermediate (WTI) crude oil, a light, sweet crude, climbed sharply as the extent of hurricane damage to U.S. oil production and pipeline infrastructure in the Gulf of Mexico became evident. The spot price of WTI averaged \$53 per barrel in October, a nominal record, but the prices of heavier, more sour (greater sulfur content) types of crude oil did not increase as much as that of WTI. The sweet-sour price spread has widened considerably because production of sweet crude in the Gulf of Mexico remains diminished, refiners faced with limited capacity prefer sweeter crude, and because much of OPEC's increased production is sour. Oil prices in general remain elevated because of strong world oil demand and concerns about future supply, particularly from Iraq, Nigeria, and Russia. Supply concerns are heightened because of low inventories, particularly of heating oil, and meager OPEC spare production capacity. After reaching record nominal dollar prices in October, the spot price of WTI has edged down recently and, as of November 2, stood at \$49.63 per barrel.

**Exports.** In September, the prices of U.S. exports of total goods and of core goods increased 0.4 and 0.5 percent, respectively, a partial recovery from August's declines. Much of September's increase was due to a 0.7 percent increase in industrial supplies that

reflected higher prices for chemicals. In addition, after falling 8.5 percent in August, the prices of agricultural exports increased 1.6 percent. Export prices of consumer goods, automotive products, and capital goods (excluding computers and semiconductors) showed little change. Export prices of computers and semiconductors fell 0.1 and 0.3 percent, respectively.

In the third quarter, on a NIPA basis, the prices of exported core goods increased 2¼ percent at an annual rate. A sharp decline in prices of exported agricultural products offset much of the moderate increase in prices of industrial supplies and small increases in other categories.

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

Private foreign purchases of U.S. securities (line 4 of the Summary of U.S. International Transactions table) slowed to \$26 billion in August from the strong \$59 billion inflow recorded in July. For the two months taken together, private inflows continued at about the same rate as in the first half of the year. The slowdown in private inflows in August primarily reflected a shift from sizable net purchases to modest net sales of both Treasury securities (line 4a) and equities (line 4d); for both types of securities, modest purchases from Asia were more than offset by sales through European and Caribbean financial centers. Private foreign demand for agency and corporate bonds (lines 4b and 4c) remained strong.

Net foreign official inflows (line 1) were a robust \$29 billion in August, reflecting sizable inflows from Japan, China, and Thailand, which were only partially offset by outflows from Norway and Taiwan. Partial data on confidential custody holdings at FRBNY indicate that foreign official inflows slowed in September and October, bringing official inflows for the third quarter to about \$50 billion, a further moderation from the blistering pace recorded in the first quarter of the year.

U.S. net purchases of foreign securities (line 5) eased a bit to \$4 billion in August from the \$17 billion outflow recorded in July. U.S. investors made modest net purchases of foreign bonds (line 5a) and acquired equities, primarily through a merger-related stock-swap (line 5c). A series break in reported data on U.S. net purchases of foreign bonds makes it difficult to compare the net purchases in recent months with the net sales recorded in previous quarters. Reported U.S. net sales of foreign bonds in 2003 have been revised down from \$36 billion to the currently recorded \$24 billion, and further revisions are expected.

The volatile banking sector (line 3) recorded a moderate inflow of \$13 billion in August, about offsetting the outflow recorded in July.

When the August TIC data were publicly released on October 18, financial market participants appeared to interpret the data as showing weakness in foreign private inflows. TIC data for September are expected in the first week of November and should provide more perspective on the trend in financial flows. These data will be included in a Greenbook supplement.

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

|  | 2002          | 2003          | 2003          |               | 2004          |               |             |             |
|--|---------------|---------------|---------------|---------------|---------------|---------------|-------------|-------------|
|  |               |               | Q3            | Q4            | Q1            | Q2            | July        | Aug.        |
| <b>Official financial flows</b>  | <b>113.0</b>  | <b>246.5</b>  | <b>50.1</b>   | <b>85.1</b>   | <b>129.4</b>  | <b>74.5</b>   | <b>13.2</b> | <b>28.8</b> |
| 1. Change in foreign official assets in the U.S. (increase, +)                 | 116.7         | 245.0         | 50.8          | 82.9          | 128.8         | 73.3          | 12.7        | 29.3        |
| a. G-10 countries  | 30.7          | 114.7         | 15.9          | 46.6          | 96.5          | 45.6          | 3.4         | 19.3        |
| b. OPEC countries  | -7.5          | 6.1           | 2.1           | 10.5          | 3.7           | -2.6          | .6          | -1.3        |
| c. All other countries   | 93.5          | 124.2         | 32.8          | 25.8          | 28.6          | 30.3          | 8.7         | 11.3        |
| 2. Change in U.S. official reserve assets (decrease, +)                        | -3.7          | 1.5           | -.6           | 2.2           | .6            | 1.1           | .5          | -.5         |
| <b>Private financial flows</b>   | <b>457.2</b>  | <b>299.3</b>  | <b>75.9</b>   | <b>83.5</b>   | <b>9.3</b>    | <b>72.3</b>   | <b>...</b>  | <b>...</b>  |
| <b>Banks</b>   |               |               |               |               |               |               |             |             |
| 3. Change in net foreign positions of banking offices in the U.S. <sup>1</sup> | 116.8         | 64.3          | 22.3          | 100.7         | -42.2         | 35.0          | -9.2        | 13.5        |
| <b>Securities<sup>2</sup></b>  |               |               |               |               |               |               |             |             |
| 4. Foreign net purchases of U.S. securities (+)                                | 390.1         | 372.8         | 65.5          | 92.3          | 128.9         | 120.2         | 59.2        | 26.5        |
| a. Treasury securities   | 101.5         | 121.2         | 46.7          | 8.8           | 65.8          | 30.4          | 15.3        | -4.7        |
| b. Agency bonds  | 84.2          | -14.8         | -31.1         | 2.2           | 6.7           | 36.0          | 10.7        | 11.6        |
| c. Corporate and municipal bonds   | 145.7         | 226.1         | 52.5          | 57.6          | 51.4          | 51.1          | 23.5        | 21.8        |
| d. Corporate stocks <sup>3</sup>   | 58.8          | 40.3          | -2.5          | 23.6          | 5.1           | 2.7           | 9.7         | -2.1        |
| 5. U.S. net acquisitions (-) of foreign securities                             | 15.5          | -76.9         | -26.7         | -26.3         | -18.3         | -27.1         | -17.2       | -3.8        |
| a. Bonds   | 33.5          | 24.2          | 4.4           | -7.0          | 3.1           | 13.5          | -7.3        | -2.6        |
| b. Stock purchases   | -14.8         | -83.6         | -31.1         | -16.5         | -21.4         | -27.9         | -9.9        | .2          |
| c. Stock swaps <sup>3</sup>  | -3.2          | -17.4         | .0            | -2.8          | .0            | -12.7         | .0          | -1.5        |
| <b>Other flows (quarterly data, s.a.)</b>                                      |               |               |               |               |               |               |             |             |
| 6. U.S. direct investment (-) abroad   | -134.8        | -173.8        | -45.2         | -53.7         | -47.6         | -60.7         | ...         | ...         |
| 7. Foreign direct investment in U.S.   | 72.4          | 39.9          | -2.8          | 10.7          | 10.2          | 32.7          | ...         | ...         |
| 8. Foreign holdings of U.S. currency   | 21.5          | 16.6          | 2.8           | 7.5           | -1.8          | 8.8           | ...         | ...         |
| 9. Other (inflow, +) <sup>4</sup>  | -24.4         | 56.3          | 60.1          | -47.6         | -20.0         | -36.4         | ...         | ...         |
| <b>U.S. current account balance (s.a.)</b>                                     | <b>-473.9</b> | <b>-530.7</b> | <b>-131.6</b> | <b>-127.0</b> | <b>-147.2</b> | <b>-166.2</b> | <b>...</b>  | <b>...</b>  |
| <b>Capital account balance (s.a.)<sup>5</sup></b>                              | <b>-1.3</b>   | <b>-3.1</b>   | <b>-.8</b>    | <b>-.3</b>    | <b>-.4</b>    | <b>-.3</b>    | <b>...</b>  | <b>...</b>  |
| <b>Statistical discrepancy (s.a.)</b>  | <b>-95.0</b>  | <b>-12.0</b>  | <b>6.4</b>    | <b>-41.4</b>  | <b>8.9</b>    | <b>19.7</b>   | <b>...</b>  | <b>...</b>  |

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.

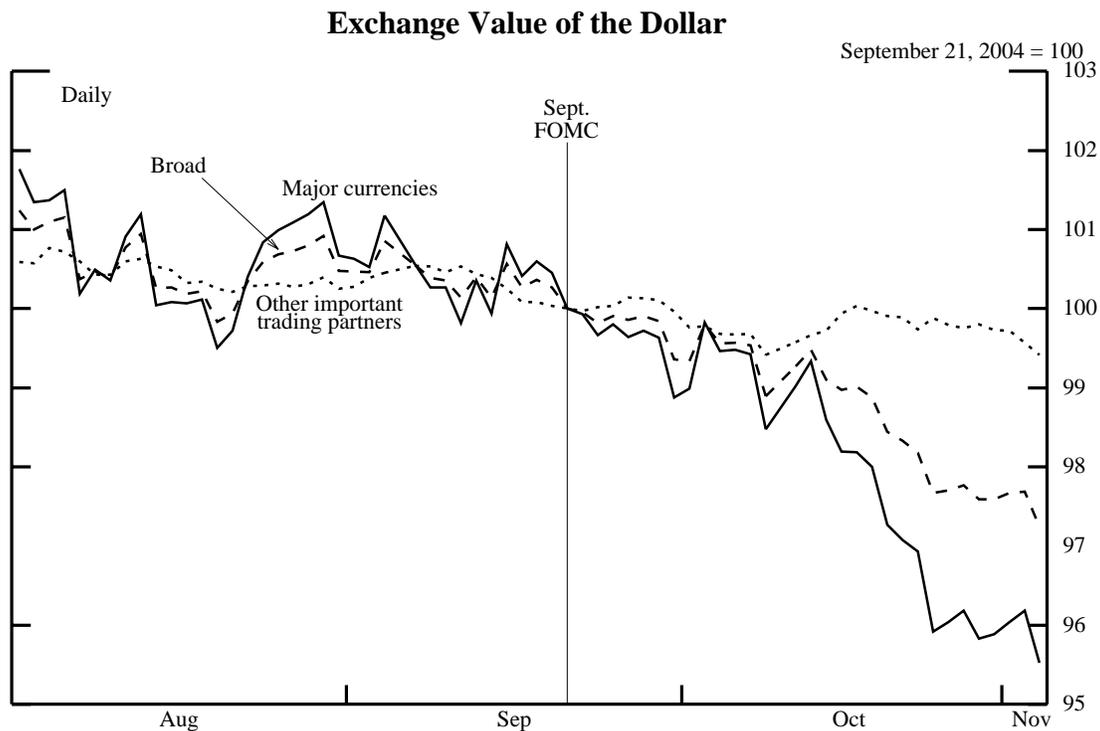
4. Transactions by nonbanking concerns and other banking and official transactions not shown elsewhere plus amounts resulting from adjustments made by the Department of Commerce and revisions in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business

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

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

## Foreign Financial Markets

On net, the dollar's trade-weighted exchange value against the major foreign currencies fell 4½ percent over the intermeeting period. The staff's major currencies index is now at its lowest level since mid-1995. The dollar depreciated against the currencies of several emerging Asian economies, leading the dollar's trade-weighted exchange value to slip ½ percent versus our other important trading partners.



The dollar moved down in response to several weaker-than-expected U.S. economic data releases, particularly the employment report for September (released on October 8). The dollar was also pressured by concerns over the financing of the U.S. current account deficit. This issue attracted greater prominence following the releases in mid-October of data showing a larger-than-expected U.S. trade deficit for August and of Treasury International Capital data for the same month, which showed a decline from the previous month in private net foreign purchases of U.S. securities. The increase in the price of crude oil was also viewed by some market participants as a negative influence on the dollar.

On a bilateral basis, the dollar depreciated against all of the currencies in the major currencies index. The sharpest declines were 7 percent against the Australian dollar and

6 percent versus the Canadian dollar. Australian export prospects were buoyed by greater-than-expected Chinese economic growth in the third quarter. A 4 percent rise in the dollar price of gold, a major Australian export, also supported the Australian dollar. Robust Canadian economic data, including a stronger-than-expected purchasing manager's report for September, as well as a rate hike by the Bank of Canada, provided a boost to the Canadian currency, which reached a 12-year high against the U.S. dollar.

Despite generally lackluster Japanese economic data, the dollar slipped 3¼ percent relative to yen over the intermeeting period. With the yen within striking range of a multi-year high against the dollar, Japanese financial officials began to express concern over the move and left the door open for "taking action" should the yen continue to appreciate. The dollar also depreciated 4¼ percent vis-à-vis the euro.

### Financial Indicators in Major Industrial Countries

| Country                              | Three-month rate    |                               | Ten-year yield      |                               | Equities          |
|--------------------------------------|---------------------|-------------------------------|---------------------|-------------------------------|-------------------|
|                                      | Nov. 3<br>(Percent) | Percentage<br>point<br>change | Nov. 3<br>(Percent) | Percentage<br>point<br>change | percent<br>change |
| Canada                               | 2.66                | .18                           | 4.52                | -.06                          | 3.14              |
| Japan                                | --                  | --                            | --                  | --                            | --                |
| Euro area                            | 2.16                | .04                           | 3.91                | -.11                          | 2.48              |
| United Kingdom                       | 4.78                | -.07                          | 4.81                | -.10                          | 2.34              |
| Switzerland                          | .67                 | .05                           | 2.49                | -.14                          | -.99              |
| Australia                            | 5.44                | .04                           | 5.40                | .05                           | 5.41              |
| United States                        | 2.14                | .25                           | 4.12                | .07                           | 1.48              |
| Memo:<br>Weighted-average<br>foreign | --                  | --                            | --                  | --                            | n.a.              |

NOTE. Change is from September 21 to November 3 (10 a.m. EDT).  
n.a. Not available.

Three-month interest rates for the major industrial countries were little changed over the period for the countries that did not change monetary policy. In addition to the FOMC, the other central bank to adjust its stance was the Bank of Canada, which raised its key policy interest rate 25 basis points, to 2.50 percent, on October 19. The BOC cited a need to reduce stimulus to keep inflation within target. Despite concerns in the currency

market that higher oil prices would weigh more heavily on the U.S. economy than on the economies of our major trading partners, implied rates on the December 2005 three-month sterling and euro futures contracts have fallen 20 and 30 basis points, respectively, since the September FOMC meeting, in contrast to little net change in the comparable dollar rate. In addition, European bellwether bond yields declined over 10 basis points over the period, compared to a modest increase, on balance, in the yield on the ten-year U.S. Treasury note.

The rise in oil prices weighed on the share prices of firms most sensitive to energy prices. In Europe and Japan, automotive-sector sub-indexes fell 5 to 6 percent over the intermeeting period. Companies in other heavy-manufacturing industries also felt a strong negative impact from the higher energy prices. For the euro-area, losses in the shares of energy-sensitive firms were offset by gains in the technology sector, leaving the Euro Stoxx index slightly higher, on balance. Sharp price declines over the period in the S&P 500 insurance and pharmaceutical sub-indexes were not matched overseas, as market participants deemed the stumbles of several underperforming U.S. companies to be firm specific.

In emerging Asia, the People's Bank of China raised its one-year lending rate 27 basis points, to 5.58 percent, on October 29. This was the first time this rate had been increased since 1995. The 12-month Chinese yuan non-deliverable forward contract now prices a 3½ percent appreciation versus the dollar, up from a 3 percent implied appreciation at the beginning of the period. The Korean won and Singapore dollar each reached four-year highs against the dollar, appreciating 3 percent and 1½ percent, respectively, over the period. The Taiwan dollar also rose 1¼ percent against the dollar. Market participants report that, for the past several years, the financial authorities of these countries have intervened to keep the strength of their currencies in check. As their export competitiveness vis-à-vis Japan has been a long-standing concern, the 3¼ percent appreciation of the yen against the dollar may have led these authorities to be less aggressive in their intervention operations. Higher energy prices weighed heavily on the share prices of oil-importing emerging Asian economies. In contrast, share prices in Indonesia, an oil exporter, rose 8 percent. The rise in the price of oil also helped the Russian economy, as share prices rose 6 percent and Russia's EMBI+ spread narrowed 40 basis points over the period.

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

| Economy     | Currency/<br>US dollar |                   | Short-term<br>interest rates <sup>1</sup> |                               | Dollar-denominated<br>bond spread <sup>2</sup> |                               | Equity<br>prices  |
|-------------|------------------------|-------------------|---|-------------------------------|--|-------------------------------|-------------------|
|             | Nov. 3                 | Percent<br>change | Nov.2/3<br>(Percent)                      | Percentage<br>point<br>change | Nov.2/3<br>(Percent)                           | Percentage<br>point<br>change | Percent<br>change |
| Mexico      | 11.42                  | -.10              | 8.02                                      | .72                           | 1.76   | .02                           | 7.67              |
| Brazil      | 2.84                   | -1.39             | 16.85                                     | .73                           | 4.48   | -.15                          | 2.51              |
| Argentina   | 2.95                   | -1.73             | --  | --                            | 51.57  | -4.31                         | 20.60             |
| Chile       | 606.90                 | -1.09             | 2.18                                      | .24                           | .62  | .00                           | 5.36              |
| China       | 8.28                   | .00               | n.a.                                      | n.a.                          | .57  | -.11                          | -8.41             |
| Korea       | 1116.00                | -2.70             | 3.80                                      | .00                           | ...  | ...                           | .45               |
| Taiwan      | 33.47                  | -1.36             | 1.33                                      | .10                           | ...  | ...                           | -1.45             |
| Singapore   | 1.67                   | -1.42             | 1.25                                      | -.13                          | ...  | ...                           | .22               |
| Hong Kong   | 7.78                   | -.24              | .14                                       | -.79                          | ...  | ...                           | .70               |
| Malaysia    | 3.79                   | -.26              | 2.82                                      | -.01                          | .54  | -.09                          | 1.54              |
| Thailand    | 41.18                  | -.28              | 1.85                                      | .16                           | .60  | .00                           | -2.97             |
| Indonesia   | 9120.00                | 1.11              | 7.41                                      | .01                           | 1.24   | -.36                          | 8.07              |
| Philippines | 56.35                  | .23               | 6.50                                      | -.06                          | 4.84   | .22                           | 6.20              |
| Russia      | 28.78                  | -1.48             | n.a.                                      | n.a.                          | 2.54   | -.38                          | 5.81              |

NOTE. Change is from September 21 to November 2/3.

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.

The Mexican central bank has tightened monetary policy twice since the September FOMC meeting, citing inflation pressures. So far this year, the Mexican central bank has raised its “corto” seven times. Despite these moves, Mexico’s stock market index hit a record high during the period, rising almost 8 percent. The Brazilian central bank also cited inflation pressures when it raised its key policy interest rate 50 basis points, to 16.75 percent, on October 20.

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

## Developments in Foreign Industrial Countries

Indicators of economic activity in the major foreign industrial economies generally suggest a third-quarter slowdown in growth. While labor conditions continued to gradually improve in Japan, monthly measures of industrial production and household expenditure have either been flat or have fallen. Similarly, in the euro area the most recent data on industrial production and retail sales were both below their second-quarter levels. The preliminary estimate of third-quarter GDP for the United Kingdom showed growth falling to less than half of its second-quarter rate. Incoming data for Canada have been better, with retail sales and employment both posting gains. Real merchandise export growth slowed from second-quarter rates in all of the major foreign industrial countries, while import growth remained near second-quarter rates in all countries but Canada.

Headline rates of consumer price inflation have edged down from their recent peaks. Inflation in the euro area slowed to 2.1 percent in September, while Canadian inflation fell to 1.9 percent, and inflation in the United Kingdom fell to 1.1 percent. Slight deflation persisted in Japan despite rising oil and commodity prices.

On October 19, the Bank of Canada raised its key policy interest rate 25 basis points to 2.5 percent.

In **Japan**, indicators suggest anemic growth in the third quarter. Industrial production fell 0.7 percent in September and was down 0.8 percent for the third quarter as a whole. Workers' household expenditures dropped nearly 4 percent in the third quarter. Real exports were flat during the quarter, while real imports rose about 2 percent. Average core machinery orders for July and August were down 8.3 percent from the second-quarter average.

On a more positive note, the Bank of Japan's Tankan index of business conditions posted a larger-than-expected gain in September, with the level of the aggregate diffusion index for business sentiment among firms of all sizes and across all industries increasing to 2 from 0 in June. However, survey respondents project a slight decline in the index, back to 0, for December. The index for large manufacturers increased to 26, from 22 in June; the index is now at its highest level since 1991, although the comparison is complicated by a break in the series. Improvements in confidence among other firms were more modest.

Labor conditions also continued to improve. The unemployment rate declined to 4.6 percent in September. The job-offers-to-applicants ratio, a leading indicator of employment, rose to an eleven-year high. Nominal wages continued to fall through September.

### Japanese Economic Indicators

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

| Indicator                           | 2004 |      |      |       |      |       |      |
|-------------------------------------|------|------|------|-------|------|-------|------|
|                                     | Q1   | Q2   | Q3   | July  | Aug. | Sept. | Oct. |
| Industrial production <sup>1</sup>  | .5   | 2.7  | -8   | .0    | .1   | -.7   | n.a. |
| All-industries index                | -.1  | 1.8  | n.a. | -.6   | 0.2  | n.a.  | n.a. |
| Housing starts                      | 2.8  | -4.4 | n.a. | 5.4   | -5.5 | n.a.  | n.a. |
| Machinery orders <sup>2</sup>       | -5.6 | 10.3 | n.a. | -11.3 | 3.1  | n.a.  | n.a. |
| Machinery shipments <sup>3</sup>    | .5   | 5.0  | -1.6 | -1.0  | 1.5  | -2.5  | n.a. |
| New car registrations               | 12.1 | -8.2 | 8.7  | 4.4   | 1.4  | 2.6   | n.a. |
| Unemployment rate <sup>4</sup>      | 4.9  | 4.6  | 4.8  | 4.9   | 4.8  | 4.6   | n.a. |
| Job offers ratio <sup>5</sup>       | .77  | .80  | .83  | .83   | .83  | .84   | n.a. |
| Business sentiment <sup>6</sup>     | -5.0 | .0   | 2.0  | ...   | ...  | ...   | ...  |
| CPI (Core, Tokyo area) <sup>7</sup> | -.2  | -.1  | -.1  | -.1   | -.2  | -.1   | -.3  |
| Wholesale prices <sup>7</sup>       | .1   | 1.0  | 1.7  | 1.6   | 1.7  | 1.8   | n.a. |

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

Core consumer goods prices in the Tokyo area (which exclude fresh food but include energy) were unchanged in October from the previous month and were down 0.3 percent from a year earlier. Higher commodity prices helped to push wholesale prices up 1.8 percent in September compared with the same month a year ago, the largest twelve-month increase since 1990.

In late October, the Bank of Japan (BOJ) released its semi-annual "Outlook and Risk Assessment of the Economy and Prices." The BOJ expects growth in FY2004 (April 2004 to March 2005) to come in between 3.4 percent and 3.7 percent, and to moderate to between 2.2 percent and 2.6 percent in FY2005. The report calls for core consumer price inflation of -0.2 percent to -0.1 percent in FY2004. Notably, inflation is projected to be between -0.1 percent and 0.2 percent in FY2005, with a median forecast of 0.1 percent. This forecast of positive inflation fulfills one condition for ending the Bank's quantitative easing policy. However, the report noted that "it is not certain whether or not the occasion will arise during FY2005 to change the present monetary policy framework," suggesting that an exit from quantitative easing is not imminent.

Indicators of third-quarter activity in the **euro area** have generally been downbeat. Industrial production fell in August in each of the five largest member countries, causing the euro-area aggregate to register its biggest decline since May 2003. Euro-area retail sales also fell in August, led by sharp declines in Italy and Spain. September data showing a decline in French consumption of manufactured goods point toward further weakness in household demand. Demand from the external sector appears to have weakened as well: euro-area export growth slowed in July and August from its second-quarter rate, while import growth has remained high. German manufacturing orders fell 1.7 percent in August, led by a 2.1 percent decline in foreign orders.

Euro-area consumer confidence was flat and remained at a depressed level. In contrast, business survey measures have been more positive. While remaining below the long-term average, surveys of euro-area business confidence rose over the period and now stand at a level not seen since 2001. After falling for several months, the German IFO survey of business conditions unexpectedly ticked up in October.

Labor market conditions remain weak in the euro area, with the unemployment rate unchanged at 9 percent in August. The German unemployment rate remained steady in October at 10.7 percent after rising slightly the previous month. Although German employment rose slightly in July, the Manpower Employment Outlook Survey found that only 5 percent of German employers plan to increase staff in the fourth quarter.

Likely reflecting the recent run-up in oil prices, the preliminary estimate of twelve-month consumer price inflation in the euro area jumped to 2.5 percent in October, after temporarily dipping to 2.1 percent the previous month. The ECB measure of twelve-

month core inflation, excluding energy and unprocessed foods, was 2.1 percent in September and has remained at or near this level for most of the year.

### Euro-Area Economic Indicators

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

| Indicator                          | 2004  |       |       |       |       |       |       |
|------------------------------------|-------|-------|-------|-------|-------|-------|-------|
|                                    | Q1    | Q2    | Q3    | July  | Aug.  | Sept. | Oct.  |
| Industrial production <sup>1</sup> | .1    | .9    | n.a.  | .2    | -.6   | n.a   | n.a   |
| Retail sales volume <sup>2</sup>   | .8    | -.3   | n.a.  | .0    | -1.3  | n.a   | n.a   |
| Unemployment rate <sup>3</sup>     | 8.9   | 9.0   | n.a.  | 9.0   | 9.0   | n.a   | n.a   |
| Consumer confidence <sup>4</sup>   | -14.3 | -14.7 | -13.7 | -14.0 | -14.0 | -13.0 | -14.0 |
| Industrial confidence <sup>4</sup> | -6.7  | -4.7  | -3.7  | -4.0  | -4.0  | -3.0  | -2.0  |
| Mfg. orders, Germany               | .6    | 1.8   | n.a.  | 2.8   | -1.7  | n.a   | n.a   |
| CPI <sup>5</sup>                   | 1.7   | 2.3   | 2.2   | 2.3   | 2.3   | 2.1   | 2.5   |
| Producer prices <sup>5</sup>       | .2    | 2.0   | n.a   | 2.9   | 3.1   | n.a   | n.a   |
| M3 <sup>5</sup>                    | 6.2   | 5.3   | 6.0   | 55    | 5.6   | 6.0   | 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** rose a much lower-than-expected 1.5 percent in the third quarter, according to the preliminary estimate. Industrial production is estimated to have tumbled around 4½ percent, offset by an estimated rise in service sector activity of just over 3 percent. Growth in the “distribution, hotels and restaurants” sector slowed to just under 3 percent from over 4½ percent, consistent with recent retail sales data.

Indicators for the fourth quarter hint at a pick-up in activity. Business confidence, which has been especially volatile of late, edged up in October, as did consumer confidence. October's manufacturing PMI recovered somewhat after several months of declines and the services PMI rose strongly. The leading survey of retail sales rebounded in October, though it remained below its average level in recent years.

One of the leading private indexes of housing prices fell 0.4 percent in October after tiny increases in August and September. Household net mortgage borrowing declined again in September, falling to the levels seen during the first half of 2003.

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

| Indicator                          | 2004 |      |      |      |      |       |      |
|------------------------------------|------|------|------|------|------|-------|------|
|                                    | Q1   | Q2   | Q3   | July | Aug. | Sept. | Oct. |
| GDP*                               | 2.7  | 3.6  | 1.5  | ...  | ...  | ...   | ...  |
| Industrial production              | -4   | 1.2  | n.a. | -5   | -8   | n.a.  | n.a. |
| Retail sales volume <sup>1</sup>   | 2.0  | 1.8  | 1.1  | -6   | .6   | 1.0   | n.a. |
| Unemployment rate <sup>2</sup>     |      |      |      |      |      |       |      |
| Claims-based                       | 2.9  | 2.8  | 2.7  | 2.7  | 2.7  | 2.7   | n.a. |
| Labor force survey <sup>3</sup>    | 4.8  | 4.8  | n.a. | 4.7  | n.a. | n.a.  | n.a. |
| Business confidence <sup>4</sup>   | 16.7 | 16.3 | 12.3 | 6.0  | 19.0 | 12.0  | 14.0 |
| Consumer confidence <sup>5</sup>   | -2.3 | -4.3 | -4.0 | -4.0 | -5.0 | -3.0  | -2.0 |
| Consumer prices <sup>6</sup>       | 1.3  | 1.4  | 1.2  | 1.4  | 1.3  | 1.1   | n.a. |
| Producer input prices <sup>7</sup> | -4   | 3.8  | 5.2  | 3.7  | 4.6  | 7.3   | n.a. |
| Average earnings <sup>7</sup>      | 5.2  | 4.3  | n.a. | 3.4  | 4.1  | n.a.  | n.a. |

\* Preliminary estimate (s.a.a.r.)

1. Excludes motor vehicles.

2. Percent.

3. Three-month average centered on month shown.

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

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

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

7. Percent change from year earlier.

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

The labor market continued to be tight, as the official-claims-based measure of the unemployment rate remained near its lowest point since 1975 and the labor-force-survey measure stayed close to its nadir. The twelve-month rate of consumer price inflation edged down to 1.1 percent in September, well below the Bank of England's 2 percent target.

In **Canada**, indicators for the third quarter have been positive. Canadian real GDP by industry rose a stronger-than-expected 0.5 percent in August. Manufacturing activity recorded a 1 percent gain and industrial production moved up 0.9 percent. Wholesale and retail trade also both advanced robustly. Residential and non-residential construction activity, in contrast, experienced their fifth-straight monthly declines. In August, retail sales posted the strongest monthly increase since the first quarter. Despite a second consecutive month of declining exports, the merchandise trade surplus rose in August, after narrowing in July, as imports declined sharply.

### Canadian Economic Indicators

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

| Indicator                           | 2004  |       |       |      |      |      |       |
|-------------------------------------|-------|-------|-------|------|------|------|-------|
|                                     | Q1    | Q2    | Q3    | June | July | Aug. | Sept. |
| GDP by industry                     | .8    | .9    | n.a.  | .5   | .2   | .5   | n.a.  |
| Industrial production               | .4    | 1.4   | n.a.  | .9   | .4   | .9   | n.a.  |
| New mfg. orders                     | 5.7   | 5.1   | n.a.  | 1.9  | 1.5  | -1.0 | n.a.  |
| Retail sales                        | 1.9   | .6    | n.a.  | .3   | .4   | 1.1  | n.a.  |
| Employment                          | .3    | .5    | .3    | .2   | .1   | .0   | .3    |
| Unemployment rate <sup>1</sup>      | 7.4   | 7.3   | 7.2   | 7.3  | 7.2  | 7.2  | 7.1   |
| Consumer prices <sup>2</sup>        | .9    | 2.2   | 2.0   | 2.5  | 2.3  | 1.9  | 1.8   |
| Core consumer prices <sup>2,3</sup> | 1.2   | 1.3   | 1.2   | 1.4  | 1.5  | 1.1  | 1.1   |
| Consumer attitudes <sup>4</sup>     | 122.9 | 115.1 | 123.0 | ...  | ...  | ...  | ...   |
| Business confidence <sup>4</sup>    | 144.8 | 145.6 | 151.4 | ...  | ...  | ...  | ...   |

1. Percent.

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

3. Excluding food, energy, and indirect taxes.

4. Level of index, 1991 = 100.

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

Total employment grew by a robust 43,000 in September, following two months of little change, and the unemployment rate eased to 7.1 percent. Overall, third-quarter employment growth was in line with the pace of the first half of the year.

In September, the twelve-month rate of headline CPI inflation continued its recent easing, falling to 1.8 percent from 1.9 percent in August, as gasoline prices declined moderately

for the fourth consecutive month. The twelve-month rate of core inflation, excluding food, energy, and indirect taxes, held steady at 1.1 percent in September.

On October 19, the Bank of Canada increased the target for the overnight rate, its key policy rate, 25 basis points to 2.5 percent. The move follows a 25-basis-point increase in September. The Bank stated that because the economy is near full capacity, “further reduction of monetary stimulus will be required over time to keep inflation on target, with the pace depending on the Bank’s continuing assessment of the prospects for factors that affect pressures on capacity and, hence, inflation.”

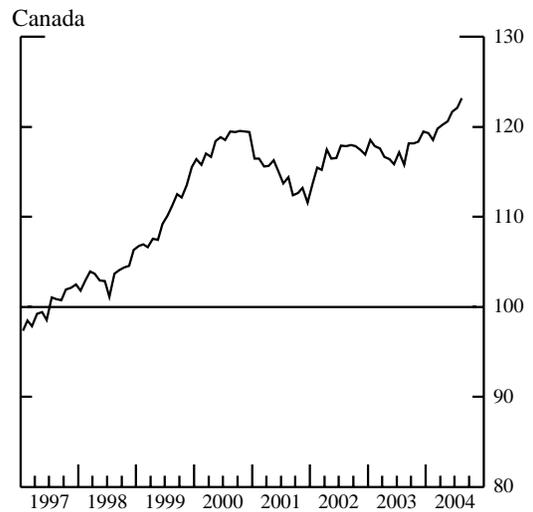
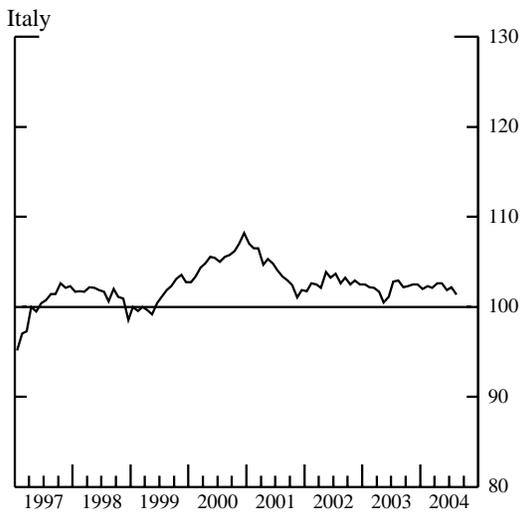
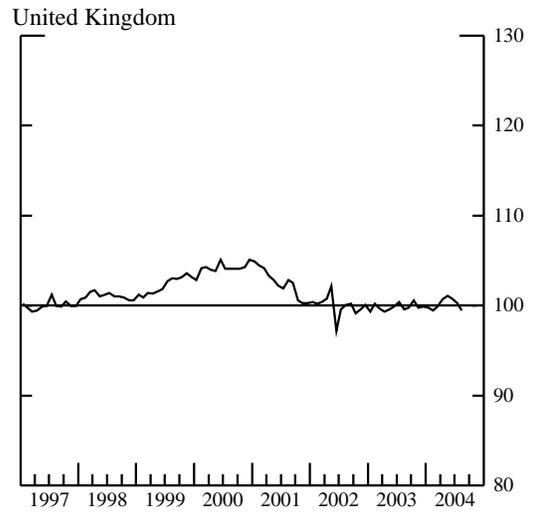
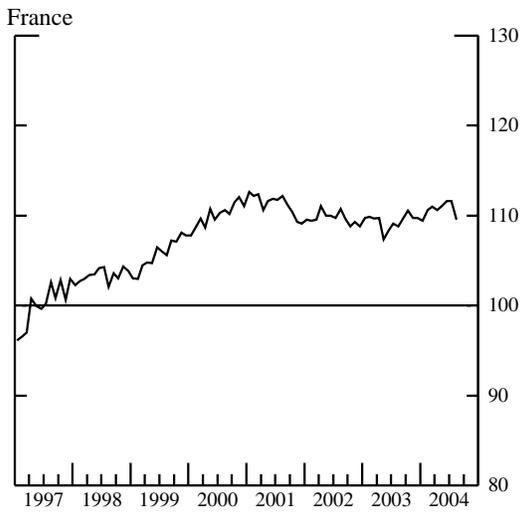
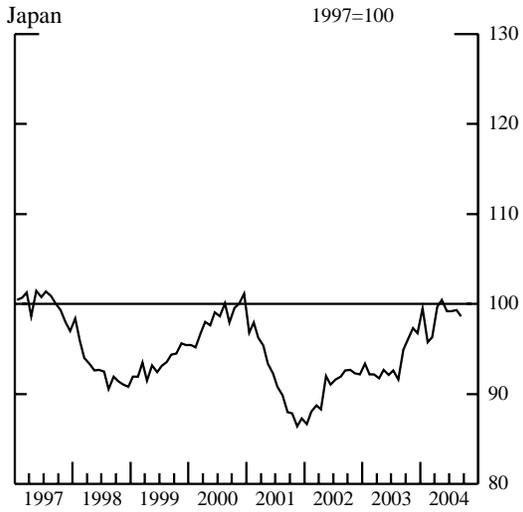
**External Balances**  
(Billions of U.S. dollars, s.a.a.r.)

| Country and balance          | 2004   |        |       |        |        |       |
|------------------------------|--------|--------|-------|--------|--------|-------|
|                              | Q1     | Q2     | Q3    | July   | Aug.   | Sept. |
| <i>Japan</i>                 |        |        |       |        |        |       |
| Trade                        | 120.4  | 116.4  | 103.0 | 106.3  | 113.6  | 89.0  |
| Current account              | 184.1  | 171.7  | n.a.  | 152.1  | 188.8  | n.a.  |
| <i>Euro area</i>             |        |        |       |        |        |       |
| Trade                        | 135.0  | 117.0  | n.a.  | 80.9   | 42.8   | n.a.  |
| Current account              | 88.4   | 78.3   | n.a.  | 14.7   | -5.9   | n.a.  |
| <i>Germany</i>               |        |        |       |        |        |       |
| Trade                        | 201.6  | 203.2  | n.a.  | 187.4  | 173.9  | n.a.  |
| Current account              | 110.5  | 112.5  | n.a.  | 63.7   | 53.6   | n.a.  |
| <i>France</i>                |        |        |       |        |        |       |
| Trade                        | 9.0    | -6.5   | n.a.  | -6.8   | -35.9  | n.a.  |
| Current account              | 4.0    | -3.1   | n.a.  | -11.3  | -21.7  | n.a.  |
| <i>Italy</i>                 |        |        |       |        |        |       |
| Trade                        | 0.1    | -0.4   | n.a.  | -4.9   | -8.5   | n.a.  |
| Current account <sup>1</sup> | -20.7  | -30.0  | n.a.  | 38.2   | 18.6   | n.a.  |
| <i>United Kingdom</i>        |        |        |       |        |        |       |
| Trade                        | -105.2 | -105.1 | n.a.  | -110.0 | -114.0 | n.a.  |
| Current Account              | -40.3  | -46.5  | n.a.  | ...    | ...    | ...   |
| <i>Canada</i>                |        |        |       |        |        |       |
| Trade                        | 48.9   | 57.7   | n.a.  | 55.8   | 67.8   | n.a.  |
| Current Account              | 25.0   | 30.6   | n.a.  | ...    | ...    | ...   |

1. Not seasonally adjusted.

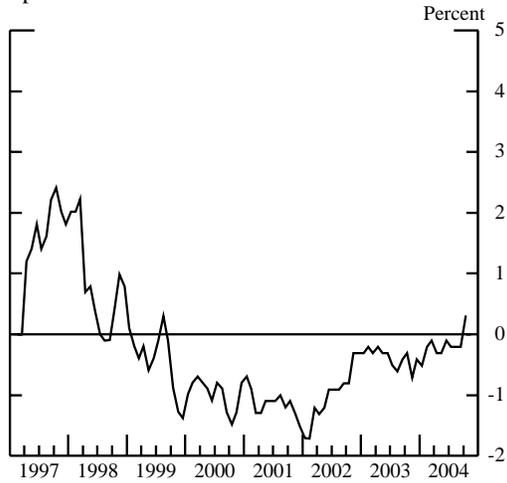
n.a. Not available. ... Not applicable.

**Industrial Production in Selected Industrial Countries**



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

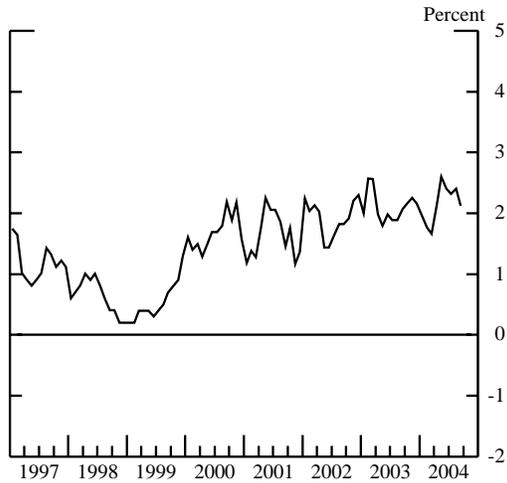
Japan



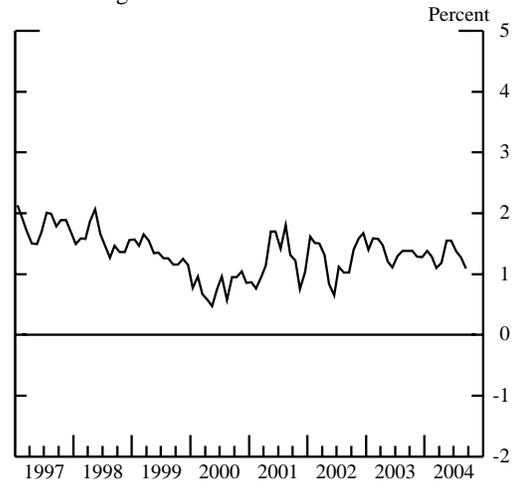
Germany



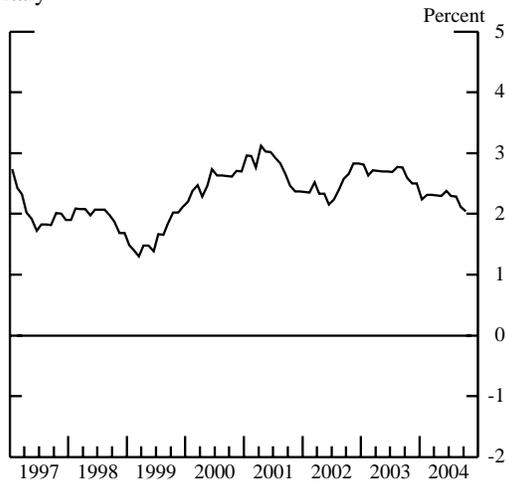
France



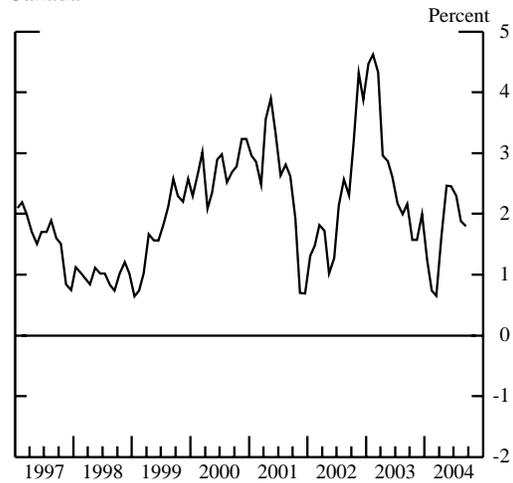
United Kingdom



Italy



Canada



## Economic Situation in Other Countries

Indications from emerging market economies are mixed but generally point to a slowing of economic growth in the third quarter from the recent robust pace. China was a notable exception, with real GDP growth rebounding sharply in the third quarter. Consumer prices in emerging market economies have risen on average in recent months, partly due to higher oil prices and to a lesser extent to higher food prices.

**Chinese** real GDP growth surprised on the upside in the third quarter, rebounding to 10.1 percent (staff estimate). The rate of investment growth, which led to the administrative tightening earlier this year, appeared to pick up again slightly in the third quarter. This is consistent with anecdotes indicating that investors have found ways around the bank financing restrictions the government imposed. Other indicators, however, point to slowing in the economy. Money (M2) and loan growth have both decelerated significantly in recent months, and import growth has finally begun to taper off. The slower pace of import growth coupled with continued rapid export growth widened the trade surplus significantly in the third quarter. Twelve-month inflation eased slightly in September to 5.2 percent. Food price inflation has come down from its peak, as expected, but non-food prices have moved up recently and are now about 1 percent above their year-ago levels. In response to falling real interest rates, at the end of October, the central bank raised the benchmark one-year deposit and lending rates by 27 basis points, the first increase in about ten years.

### Chinese Economic Indicators

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

| Indicator                          | 2002 | 2003 | 2004 |      |      |      |       |
|------------------------------------|------|------|------|------|------|------|-------|
|                                    |      |      | Q2   | Q3   | July | Aug. | Sept. |
| Real GDP <sup>1</sup>              | 8.3  | 10.0 | 2.8  | 10.1 | ...  | ...  | ...   |
| Industrial production <sup>2</sup> | 14.2 | 18.6 | 17.8 | 16.3 | 16.8 | 16.0 | 16.1  |
| Consumer prices <sup>2</sup>       | -4   | 3.2  | 4.4  | 5.3  | 5.3  | 5.3  | 5.2   |
| Trade balance <sup>3</sup>         | 30.4 | 25.5 | 10.5 | 44.0 | 20.8 | 50.2 | 61.2  |

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.

Indicators for the **Hong Kong** economy remained positive in recent months, although less so than during the first half of this year. Retail sales growth has slowed, after booming earlier this year, and the unemployment rate decreased a touch in the third quarter. Trade volumes are reaching new record highs almost every month, as trade with China and other Asian economies soars, although the pace of this growth has eased a bit. September consumer prices were up a little less than 1 percent on a twelve-month basis.

### Hong Kong Economic Indicators

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

| Indicator                      | 2002 | 2003 | 2004  |       |       |       |       |
|--------------------------------|------|------|-------|-------|-------|-------|-------|
|                                |      |      | Q2    | Q3    | July  | Aug.  | Sept. |
| Real GDP <sup>1</sup>          | 4.7  | 4.7  | 10.8  | n.a.  | ...   | ...   | ...   |
| Unemployment rate <sup>2</sup> | 7.2  | 7.9  | 6.9   | 6.8   | 6.9   | 6.8   | 6.8   |
| Consumer prices <sup>3</sup>   | -1.6 | -1.8 | -.9   | .8    | .9    | .8    | .8    |
| Trade balance <sup>4</sup>     | -7.7 | -8.5 | -15.9 | -13.4 | -11.1 | -14.6 | -14.6 |

1. Annual rate Annual figures are Q4/Q4.

2. Percent. Monthly numbers are averages of the current and previous two months.

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

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

... Not applicable.

Recent indicators of **Taiwanese** economic performance have been mixed. Industrial production fell slightly in the third quarter, and production of high-tech goods was roughly flat. New orders data, however, point to higher production in the coming months. The unemployment rate moved down a bit in the third quarter. Both exports and imports rose rapidly in the quarter, and the trade surplus widened slightly. Consumer prices are up about 3 percent over the last twelve months, but recent increases in oil prices have not yet completely passed through to Taiwanese consumer prices.

**Taiwan Economic Indicators**

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

| Indicator                      | 2002 | 2003 | 2004 |      |      |      |       |
|--------------------------------|------|------|------|------|------|------|-------|
|                                |      |      | Q2   | Q3   | July | Aug. | Sept. |
| Real GDP <sup>1</sup>          | 4.3  | 5.6  | -6   | n.a. | ...  | ...  | ...   |
| Unemployment rate <sup>2</sup> | 5.2  | 5.0  | 4.6  | 4.4  | 4.5  | 4.4  | 4.4   |
| Industrial production          | 7.9  | 7.1  | 2.5  | -3   | -1.4 | -2   | .4    |
| Consumer prices <sup>3</sup>   | .8   | -.1  | 1.2  | 2.9  | 3.3  | 2.6  | 2.8   |
| Trade balance <sup>4</sup>     | 18.1 | 16.9 | 10.5 | 11.6 | 19.5 | 6.1  | 9.2   |
| Current account <sup>5</sup>   | 25.6 | 29.2 | 20.6 | n.a. | ...  | ...  | ...   |

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** show few signs of a pickup in the recent sluggish pace of activity. Industrial production was little changed in the third quarter, despite a trade-related jump in output in September. Consumer and business confidence remain at low levels, and recent indicators of retail sales and service-sector demand have been mixed. Twelve-month consumer price inflation was 3.8 percent in October, in part reflecting higher food and fuel prices, and core inflation has been trending up. Despite rising oil prices, the trade and current account surpluses remained at elevated levels in the third quarter.

**Korean Economic Indicators**

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

| Indicator                      | 2002 | 2003 | 2004 |      |      |       |      |
|--------------------------------|------|------|------|------|------|-------|------|
|                                |      |      | Q2   | Q3   | Aug. | Sept. | Oct. |
| Real GDP <sup>1</sup>          | 7.7  | 4.1  | 2.3  | n.a. | ...  | ...   | ...  |
| Industrial production          | 8.3  | 5.0  | 1.2  | -.2  | -.6  | 2.3   | n.a. |
| Unemployment rate <sup>2</sup> | 3.1  | 3.4  | 3.5  | 3.6  | 3.6  | 3.5   | n.a. |
| Consumer prices <sup>3</sup>   | 3.8  | 3.4  | 3.4  | 4.3  | 4.8  | 3.8   | 3.8  |
| Trade balance <sup>4</sup>     | 14.8 | 22.2 | 33.0 | 42.6 | 25.9 | 43.7  | n.a. |
| Current account <sup>5</sup>   | 5.4  | 12.3 | 28.1 | 28.6 | 12.7 | 34.3  | n.a. |

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.

In the **ASEAN** region, recent performance has been mixed. In Singapore, real GDP declined 2.3 percent in the third quarter according to the advance release, following growth of 12 percent in the previous quarter. Industrial production also fell in recent months, but the September PMI signaled expansion of production going forward. Elsewhere in the region, recent data on industrial production have been mixed. Data and anecdotes from the region's high-tech sector generally point to a moderation of growth. Recent trade data show the ASEAN economies running trade surpluses.

Consumer price inflation has generally risen across the region, partly in response to a jump in food prices in some countries. The effects of the rise in fuel prices on consumer prices have been somewhat mitigated by government subsidies in Indonesia, Malaysia, the Philippines, and Thailand. The resulting strain on the government budget has worsened already-serious fiscal problems in Indonesia and the Philippines. With growth weakening, monetary policy has remained accommodative in both countries. In contrast, the Thai central bank raised its policy rate 50 basis points in two moves since August to 1.75 percent.

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

| Indicator                                | 2002 | 2003 | 2004 |      |      |      |       |      |
|--|------|------|------|------|------|------|-------|------|
|  |      |      | Q2   | Q3   | July | Aug. | Sept. |      |
| <i>Real GDP<sup>1</sup></i>              |      |      |      |      |      |      |       |      |
| Indonesia                                | 4.9  | 4.2  | 5.6  | n.a. | ...  | ...  | ...   | ...  |
| Malaysia                                 | 5.5  | 6.6  | 7.9  | n.a. | ...  | ...  | ...   | ...  |
| Philippines                              | 5.5  | 4.8  | 2.9  | n.a. | ...  | ...  | ...   | ...  |
| Singapore                                | 2.8  | 4.9  | 11.9 | -2.3 | ...  | ...  | ...   | ...  |
| Thailand                                 | 6.0  | 7.8  | 3.1  | n.a. | ...  | ...  | ...   | ...  |
| <i>Industrial production<sup>2</sup></i> |      |      |      |      |      |      |       |      |
| Indonesia <sup>3</sup>                   | -7.1 | 3.9  | -7.7 | n.a. | .2   | n.a. | n.a.  | n.a. |
| Malaysia                                 | 4.6  | 9.3  | 2.9  | n.a. | -1.1 | .1   | n.a.  | n.a. |
| Philippines                              | -6.1 | .0   | 2.4  | n.a. | 1.1  | -5.8 | n.a.  | n.a. |
| Singapore                                | 8.4  | 3.0  | 5.2  | -1.2 | 2.4  | -1.3 | -1.2  | -1.2 |
| Thailand                                 | 8.5  | 12.3 | -.4  | .7   | 1.5  | -3.8 | 4.1   | 4.1  |

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.)

| Indicator   | 2002 | 2003 | 2004 |      |      |      |       |
|-------------|------|------|------|------|------|------|-------|
|             |      |      | Q2   | Q3   | July | Aug. | Sept. |
| Indonesia   | 25.9 | 28.5 | 20.9 | 25.4 | 15.3 | 26.6 | 34.4  |
| Malaysia    | 14.3 | 21.4 | 21.2 | 23.7 | 25.9 | 23.4 | 21.9  |
| Philippines | -.2  | -1.5 | -.6  | n.a. | -1.9 | 1.7  | n.a.  |
| Singapore   | 8.7  | 16.2 | 15.1 | 16.5 | 9.6  | 16.2 | 23.8  |
| Thailand    | 2.7  | 3.8  | -.3  | 1.2  | 6.2  | -3.1 | .5    |

n.a. Not available.

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

| Indicator   | 2002 <sup>1</sup> | 2003 <sup>1</sup> | 2004 |     |      |       |      |
|-------------|-------------------|-------------------|------|-----|------|-------|------|
|             |                   |                   | Q2   | Q3  | Aug. | Sept. | Oct. |
| Indonesia   | 9.9               | 5.2               | 6.4  | 6.7 | 6.7  | 6.3   | 6.2  |
| Malaysia    | 1.7               | 1.2               | 1.2  | 1.5 | 1.4  | 1.6   | n.a. |
| Philippines | 2.5               | 3.1               | 4.5  | 6.4 | 6.3  | 6.9   | n.a. |
| Singapore   | .4                | .8                | 1.8  | 1.7 | 1.7  | 2.0   | n.a. |
| Thailand    | 1.6               | 1.8               | 2.6  | 3.3 | 3.1  | 3.6   | 3.5  |

1. December/December.  
n.a. Not available.

In **Mexico**, recent indications are that economic growth has stepped down a bit from the rapid first-half pace. Industrial production was flat in August, and growth so far in the third quarter is below the growth rates in the previous two quarters. Similarly, manufacturing export growth slowed to a 1 percent annual rate in the third quarter, following average gains of 18 percent during the previous three quarters. However, domestic demand appears to have offset some of the slowing in external demand. Retail sales in July and August rose at an 8½ percent annual rate, more than twice as fast as in the previous three quarters, and construction activity strengthened further.

Consumer price inflation has continued to increase. Twelve-month inflation picked up to 5.4 percent in the first half of October, well above the 2 to 4 percent inflation target, driven largely by higher energy and food (primarily vegetable) prices. Core inflation has risen only to about 3-3/4 percent, but the Bank of Mexico has expressed concern that the rise in headline inflation could feed into faster wage increases. Consequently, the Bank of Mexico tightened monetary policy on October 22, the seventh tightening move this year.

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

| Indicator                      | 2002  | 2003  | 2004  |       |       |       |       |
|--------------------------------|-------|-------|-------|-------|-------|-------|-------|
|                                |       |       | Q2    | Q3    | July  | Aug.  | Sept. |
| Real GDP <sup>1</sup>          | 1.9   | 2.0   | 4.9   | n.a.  | ...   | ...   | ...   |
| Overall economic activity      | .7    | 1.4   | 1.9   | n.a.  | .0    | .6    | n.a.  |
| Industrial production          | -.4   | -.7   | 1.5   | n.a.  | 1.0   | .0    | n.a.  |
| Unemployment rate <sup>2</sup> | 2.7   | 3.3   | 3.7   | 3.9   | 3.7   | 4.0   | 3.9   |
| Consumer prices <sup>3</sup>   | 5.7   | 4.0   | 4.3   | 4.8   | 4.5   | 4.8   | 5.0   |
| Trade balance <sup>4</sup>     | -7.9  | -5.6  | -6.2  | -8.3  | -7.5  | -10.8 | -6.7  |
| Imports <sup>4</sup>           | 168.7 | 170.5 | 194.4 | 199.8 | 194.5 | 204.9 | 200.1 |
| Exports <sup>4</sup>           | 160.8 | 164.9 | 188.2 | 191.5 | 187.0 | 194.0 | 193.4 |
| Current account <sup>5</sup>   | -13.7 | -8.9  | -2.0  | n.a.  | ...   | ...   | ...   |

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

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

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

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

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

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

In **Brazil**, data releases since the last Greenbook have largely pointed to continuing expansion, although probably at a slower pace. Industrial production rose in both July and August. However, August retail sales disappointed, with twelve-month growth slowing to 7.5 percent, and September vehicle production declined. Brazil has continued to record sizeable trade surpluses, reflecting strong export growth--over 22 percent on a twelve-month basis.

Inflation remains a significant concern; headline consumer price inflation was 6.7 percent over the twelve months ending in September, well above the 2005 inflation target of 5.1 percent that was set by the central bank in mid-September. The central bank has raised its policy rate 75 basis points since August in two moves. The most recent change, a 50 basis point increase in mid-October, exceeded expectations, reflecting the central bank's concerns that recent increases in domestic fuel prices are feeding into longer-term inflation expectations. Twelve-month-ahead inflation as measured by the central bank's survey of forecasters has recently risen to over 6¼ percent.

**Brazilian Economic Indicators**

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

| Indicator                      | 2002 | 2003 | 2004 |      |      |      |       |
|--------------------------------|------|------|------|------|------|------|-------|
|                                |      |      | Q2   | Q3   | July | Aug. | Sept. |
| Real GDP <sup>1</sup>          | 3.8  | -1   | 6.1  | n.a. | ...  | ...  | ...   |
| Industrial production          | 2.7  | -1   | 3.3  | n.a. | .7   | 1.1  | n.a.  |
| Unemployment rate <sup>2</sup> | 12.5 | 12.4 | 11.7 | 11.2 | 11.1 | 11.3 | 11.3  |
| Consumer prices <sup>3</sup>   | 12.5 | 9.3  | 5.5  | 6.9  | 6.8  | 7.2  | 6.7   |
| Trade balance <sup>4</sup>     | 13.1 | 24.8 | 33.0 | 36.7 | 40.8 | 39.5 | 29.8  |
| Current account <sup>5</sup>   | -7.6 | 4.1  | 11.2 | 21.3 | 21.8 | 21.1 | 20.9  |

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.

In **Argentina**, the gradual economic recovery has continued. Industrial production grew 2 percent in the third quarter, after contracting in the previous quarter. The country has continued to run sizable trade surpluses. Twelve-month consumer price inflation has increased in recent months, and now stands at just under 6 percent.

There have also been some notable political and legal developments in recent weeks. First, in mid-October the federal government announced that it had made progress in securing the support of provincial governors for a reform of federal-provincial fiscal relations set to take place next year. Second, in late October the country's Supreme Court ruled that the forced conversion of dollar-denominated deposits into pesos at a disadvantageous exchange rate after the collapse of the currency board in 2002 was legal. This decision is expected to reduce the threat of thousands of lawsuits that has hovered over Argentina's banking system for more than two years. Third, the Argentine government has made some progress on its debt restructuring, including reaching agreements to ensure the participation of some domestic holders of its defaulted debt and completing the regulatory requirements needed to conduct an exchange of defaulted debt issued in the United States.

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

| Indicator                      | 2002  | 2003 | 2004 |      |      |      |       |
|--------------------------------|-------|------|------|------|------|------|-------|
|                                |       |      | Q2   | Q3   | July | Aug. | Sept. |
| Real GDP <sup>1</sup>          | -3.3  | 12.1 | 2.0  | n.a. | ...  | ...  | ...   |
| Industrial production          | -10.7 | 16.2 | -1.3 | 2.0  | -4   | 1.2  | .7    |
| Unemployment rate <sup>2</sup> | 22.5  | 17.3 | 14.8 | n.a. | ...  | ...  | ...   |
| Consumer prices <sup>3</sup>   | 41.4  | 3.8  | 4.0  | 5.3  | 4.9  | 5.2  | 5.9   |
| Trade balance <sup>4</sup>     | 16.7  | 15.7 | 15.6 | 11.7 | 12.7 | 12.6 | 12.1  |
| Current account <sup>5</sup>   | 9.1   | 7.5  | 6.7  | n.a. | ...  | ...  | ...   |

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**, there have been few data releases since the last Greenbook. The policy environment continues to be poor and inflation continues to be high, despite the fixed exchange rate in place since early 2003. Oil production is still about 15 percent below the level prevailing before the national strikes in late 2002.

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

| Indicator                          | 2002  | 2003 | 2004 |      |      |       |      |
|------------------------------------|-------|------|------|------|------|-------|------|
|                                    |       |      | Q2   | Q3   | Aug. | Sept. | Oct. |
| Real GDP <sup>1</sup>              | -15.8 | 7.0  | n.a. | n.a. | ...  | ...   | ...  |
| Unemployment rate <sup>2</sup>     | 16.0  | 18.0 | 15.5 | 14.5 | 14.0 | 14.3  | n.a. |
| Consumer prices <sup>3</sup>       | 31.2  | 27.1 | 22.4 | 21.5 | 21.9 | 20.8  | 19.7 |
| Non-oil trade balance <sup>4</sup> | -8.1  | -5.5 | n.a. | n.a. | n.a. | n.a.  | n.a. |
| Trade balance <sup>4</sup>         | 13.4  | 16.5 | n.a. | n.a. | n.a. | n.a.  | n.a. |
| Current account <sup>5</sup>       | 7.6   | 11.5 | 13.5 | n.a. | ...  | ...   | ...  |

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.

Recent indicators for **Russia** have been mixed. Industrial production fell sharply in August and September and indicators of domestic investment and construction have also slowed. However, the unemployment rate has been declining recently. Consumer price inflation jumped in the last two months, led by food prices. Both import and export demand have been strong, and the August trade balance stood at \$85 billion.

There were a number of important developments in the ongoing tax case between the Kremlin and Yukos, the largest Russian oil exporter. On the basis of an appraisal of Yukos' main production facility by an independent accounting firm, government officials said that they plan on auctioning shares of just over three-quarters of Yukos' main production facility to settle Yukos' tax arrears. It is not clear whether the government will entertain bids from foreigners or whether a state-owned company will ultimately take possession of the production unit. Yukos hoped to avert the auction by making a \$3.5 billion payment to settle the remainder of its 2000 tax bill; however, on the same day as the payment, the Russian government served Yukos with a \$6.7 billion tax claim for 2002. Although a sale is increasingly likely, statements made by officials indicate that it would likely not take place this month.

**Russian Economic Indicators**

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

| Indicator                      | 2002 | 2003 | 2004 |      |      |      |       |
|--------------------------------|------|------|------|------|------|------|-------|
|                                |      |      | Q2   | Q3   | July | Aug. | Sept. |
| Real GDP <sup>1</sup>          | 5.9  | 7.5  | 8.2  | n.a. | ...  | ...  | ...   |
| Industrial production          | 3.8  | 6.7  | 2.2  | 0.0  | -3   | -2.1 | -1.4  |
| Unemployment rate <sup>2</sup> | 8.0  | 8.5  | 8.3  | 7.7  | 7.5  | 7.8  | 7.7   |
| Consumer prices <sup>3</sup>   | 15.3 | 12.1 | 10.1 | 11.0 | 10.3 | 11.3 | 11.4  |
| Trade balance <sup>4</sup>     | 46.3 | 60.5 | 78.1 | n.a. | 78.4 | 84.7 | n.a.  |
| Current account <sup>4</sup>   | 28.9 | 36.0 | 42.6 | n.a. | ...  | ...  | ...   |

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.

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