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March 18, 2005

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Supplemental Notes

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

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Supplemental Notes

The Domestic Nonfinancial Economy

Consumer Sentiment

According to the preliminary report, the Michigan Survey Research Center's (SRC) index of consumer sentiment decreased 1.2 points in early March to 92.9, a bit below its average over the previous twelve months.

The March decline reflected a slight weakening in both components of the index. Within the "current conditions" component, consumers' assessments of their current personal financial situation moved lower, while assessments of buying conditions for large household appliances were unchanged. Within the "expected conditions" component, consumers' assessments of expected business conditions over the next twelve months receded. But assessments of expected business conditions over the next five years edged up, and expected personal financial conditions retraced some of last month's decrease.

Among the items not included in the overall index, consumers' expectations about the change in unemployment over the next twelve months worsened slightly. Consumers' appraisals of buying conditions for houses and appraisals of buying conditions for cars both dropped to their lowest levels since 2001.

While the mean of expected inflation over the next twelve months climbed to 4 percent, the median rose less, to 3.2 percent. The mean of expected inflation over the next five to ten years inched up to 3.2 percent, while the median was unchanged at 2.8 percent.

The Domestic Financial Economy

March 18, 2005

University of Michigan Survey Research Center: Survey of Consumer Attitudes
Indexes of consumer sentiment
 (Not seasonally adjusted)

Category	2004					2005		
	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar. ^P
Composite of current and expected conditions ¹	95.9	94.2	91.7	92.8	97.1	95.5	94.1	92.9
Current conditions ¹	107.9	103.7	104.0	104.7	106.7	110.9	109.2	107.3
Expected conditions ¹	88.2	88.0	83.8	85.2	90.9	85.7	84.4	83.6
Personal financial situation								
Now compared with 12 months ago ²	121	113	112	113	112	123	121	116
Expected in 12 months ²	133	128	127	124	130	133	127	131
Expected business conditions								
Next 12 months ²	114	116	113	115	122	114	114	105
Next 5 years ²	108	110	97	104	114	97	98	100
Appraisal of buying conditions								
Cars	144	148	152	138	154	147	144	135
Large household appliances ²	158	155	158	158	165	165	162	162
Houses	156	162	155	155	160	158	151	146
Expected unemployment change - next 12 months	106	105	105	106	103	111	111	114
Prob. household will lose a job - next 5 years	22	22	28	23	22	23	23	22
Expected inflation - next 12 months								
Mean	3.1	3.2	3.6	3.3	3.4	3.5	3.3	4.0
Median	2.8	2.8	3.1	2.8	3.0	2.9	2.9	3.2
Expected inflation - next 5 to 10 years								
Mean	3.1	3.1	3.2	3.1	3.1	3.2	3.1	3.2
Median	2.7	2.8	2.8	2.7	2.8	2.7	2.8	2.8

Note. Figures on financial, business, and buying conditions are the percent reporting 'good times' (or 'better') minus the percent reporting 'bad times' (or 'worse'), plus 100. Expected change in unemployment is the fraction expecting unemployment to rise minus the fraction expecting unemployment to fall, plus 100.

P Preliminary.

1. Feb. 1966 = 100.

2. Indicates the question is one of the five equally-weighted components of the index of sentiment.

Commercial Bank Credit

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

Type of credit	2003	H1 2004	Q3 2004	Q4 2004	Jan. 2005	Feb. 2005	Level, Feb. 2005 (\$ billions)
Total							
1. Adjusted¹	5.9	11.8	5.2	6.3	14.0	20.0	6,704
2. Reported	5.6	10.4	5.8	6.3	11.1	18.4	6,850
<i>Securities</i>							
3. Adjusted ¹	8.6	16.9	-8.1	1.0	30.6	36.4	1,834
4. Reported	7.2	11.6	-4.8	1.3	18.9	29.4	1,979
5. Treasury and agency	8.9	17.9	-4.4	-11.3	31.1	34.6	1,211
6. Other ²	4.8	2.0	-5.6	22.3	.2	21.6	768
<i>Loans³</i>							
7. Total	4.9	9.9	10.3	8.3	8.0	13.9	4,871
8. Business	-9.4	-3.9	7.0	6.0	22.4	12.1	920
9. Real estate	11.1	15.8	8.3	12.9	12.1	11.8	2,588
10. Home equity	30.8	39.9	37.2	37.3	20.8	4.7	407
11. Other	8.8	12.4	3.7	8.7	10.4	13.1	2,181
12. Consumer	5.4	7.9	19.9	-1.8	10.5	-9	679
13. Adjusted ⁴	5.8	4.0	12.3	2.3	11.6	-16.3	1,044
14. Other ⁵	6.7	9.9	12.4	4.6	-29.0	40.1	683

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.

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

Instrument	2004		2005		Change to Mar. 17 from selected dates (percentage points)		
	June 28	Dec. 31	Feb. 1	Mar. 17	2004 June 28	2004 Dec. 31	2005 Feb. 1
<i>Short-term</i>							
FOMC intended federal funds rate	1.00	2.25	2.25	2.50	1.50	.25	.25
Treasury bills ¹							
3-month	1.36	2.18	2.47	2.73	1.37	.55	.26
6-month	1.74	2.52	2.70	2.99	1.25	.47	.29
Commercial paper (A1/P1 rates) ²							
1-month	1.28	2.29	2.51	2.75	1.47	.46	.24
3-month	1.45	2.28	2.69	2.95	1.50	.67	.26
Large negotiable CDs ¹							
3-month	1.53	2.50	2.71	2.99	1.46	.49	.28
6-month	1.82	2.72	2.94	3.24	1.42	.52	.30
Eurodollar deposits ³							
1-month	1.29	2.32	2.53	2.80	1.51	.48	.27
3-month	1.51	2.49	2.68	2.97	1.46	.48	.29
Bank prime rate	4.00	5.25	5.25	5.50	1.50	.25	.25
<i>Intermediate- and long-term</i>							
U.S. Treasury ⁴							
2-year	2.88	3.08	3.28	3.72	.84	.64	.44
5-year	3.97	3.63	3.70	4.12	.15	.49	.42
10-year	4.90	4.34	4.24	4.57	-.33	.23	.33
U.S. Treasury indexed notes							
5-year	1.56	1.02	1.18	1.22	-.34	.20	.04
10-year	2.23	1.67	1.66	1.73	-.50	.06	.07
Municipal revenue (Bond Buyer) ⁵	5.37	5.04	4.90	4.99	-.38	-.05	.09
Private instruments							
10-year swap	5.21	4.65	4.53	4.91	-.30	.26	.38
10-year FNMA ⁶	5.30	4.61	4.48	4.77	-.53	.16	.29
10-year AA ⁷	5.59	4.98	4.87	5.20	-.39	.22	.33
10-year BBB ⁷	6.18	5.38	5.28	5.58	-.60	.20	.30
5-year high yield ⁷	8.30	7.34	7.46	7.61	-.69	.27	.15
Home mortgages (FHLMC survey rate)							
30-year fixed	6.21	5.77	5.63	5.95	-.26	.18	.32
1-year adjustable	4.19	4.10	4.23	4.20	.01	.10	-.03

Stock exchange index	Record high		2004	2005		Change to Mar. 17 from selected dates (percent)		
	Level	Date	Dec. 31	Feb. 1	Mar. 17	Record high	2004 Dec. 31	2005 Feb. 1
Dow Jones Industrial	11,723	1-14-00	10,783	10,552	10,626	-9.35	-1.45	.71
S&P 500 Composite	1,527	3-24-00	1,212	1,189	1,190	-22.08	-1.79	.07
Nasdaq	5,049	3-10-00	2,175	2,069	2,016	-6.06	-7.31	-2.53
Russell 2000	655	12-28-04	652	628	625	-4.45	-4.01	-.43
Wilshire 5000	14,752	3-24-00	11,971	11,722	11,745	-2.38	-1.89	.20

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.

NOTES:

June 28, 2004, is the day before the most recent policy tightening began.
February 1, 2005, is the day before the most recent FOMC announcement.

The International Economy

Prices of Internationally Traded Goods

Non-oil imports. In February, the prices of U.S. imports of non-oil goods and of core goods rose 0.2 and 0.3 percent, respectively. Higher prices for food, feeds, and beverages, consumer goods, and non-petroleum industrial supplies were the main contributors to the price increase. The price index for foods, feeds and beverages rose 1.3 percent in February, following no change in the previous month. Prices for consumer goods rose 0.2 percent, down from the 0.5 percent increase in January. (Within consumer goods, apparel prices fell 0.1 percent.) Prices for imported capital goods (excluding computers and semiconductors) rose 0.2 percent, whereas prices for imported automotive products were unchanged. For both computers and semiconductors, import prices fell in February.

The average level of imported core goods prices in January and February was 4½ percent at an annual rate above the fourth-quarter level. All of the major categories, except automotive products, registered substantial price gains. In particular, both capital goods (excluding computers and semiconductors) and consumer goods experienced increases in their inflation rates of more than 2 percentage points.

Oil. The BLS price of imported oil rose 3.9 percent in February. The spot price of West Texas Intermediate crude oil rose 2.4 percent in February—averaging about \$48 per barrel. The spot price began to increase late in the month and continued to rise in March, closing at a nominal record of \$56.47 per barrel on March 16. The increase in oil prices largely reflects indications that oil demand will remain stronger than previously anticipated and remarks by OPEC that imply the cartel is targeting a higher level of oil prices. In addition, concerns about future supplies from Iraq, Iran, Nigeria, Venezuela, and Russia also continue to support oil prices.

Exports. In February, the prices of U.S. exports of total goods and of core goods were unchanged. A sharp 0.9 percent decline in agricultural products was offset by a 0.2 percent increase in industrial supplies. Export prices for consumer goods edged lower. Prices of exported computers ticked up, whereas prices for semiconductors declined.

The average level of exported core goods prices in January and February was 5¼ percent at an annual rate above the fourth-quarter level. Price increases were widespread across

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

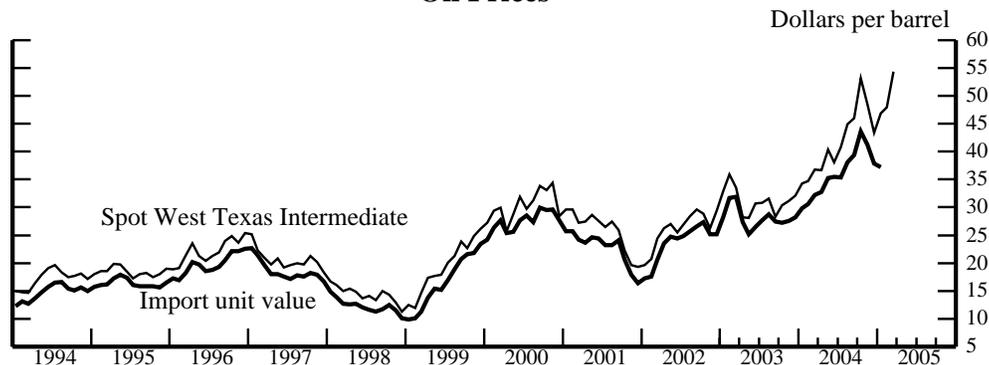
	Annual rate			Monthly rate		
	2004		2005	2004	2005	
	Q3	Q4	Q1 ^e	Dec.	Jan.	Feb.
	----- BLS prices -----					
Merchandise imports	7.9	7.3	-0.0	-1.4	0.7	0.8
Oil	57.1	35.1	-19.0	-11.5	3.4	3.9
Non-oil	1.5	3.2	3.9	0.4	0.3	0.2
Core goods*	2.4	4.2	4.6	0.4	0.4	0.3
Cap. goods ex comp & semi	1.6	2.6	5.5	0.5	0.8	0.2
Automotive products	1.7	2.4	0.4	0.1	0.0	0.0
Consumer goods	-0.4	1.2	3.6	0.3	0.5	0.2
Foods, feeds, beverages	3.3	10.7	6.1	1.1	0.0	1.3
Industrial supplies ex oil	8.3	11.1	8.8	0.8	0.3	0.3
Computers	-9.0	-7.5	-4.4	-0.3	-0.6	-0.6
Semiconductors	-4.4	-4.9	-2.0	-0.2	-0.2	-0.2
Merchandise exports	-0.1	3.6	4.1	0.1	0.9	0.0
Core goods*	0.6	4.8	5.3	0.1	1.1	0.0
Cap. goods ex comp & semi	1.3	3.3	4.2	0.3	0.8	0.0
Automotive products	0.9	1.2	1.6	0.1	0.3	0.0
Consumer goods	2.3	0.1	2.9	0.2	0.6	-0.1
Agricultural products	-31.0	-11.5	-2.0	-1.1	0.6	-0.9
Industrial supplies ex ag	14.5	17.1	10.6	0.3	1.9	0.2
Computers	-7.6	-9.2	-6.5	-0.7	-1.0	0.1
Semiconductors	-3.9	-1.5	-0.9	0.3	-0.3	-0.3
	----- NIPA prices -----					
Chain price index						
Imports of goods & services	5.1	7.9	n.a.	...	...	...
Non-oil merchandise	1.3	3.2	n.a.	...	...	...
Core goods*	2.3	4.2	n.a.	...	...	...
Exports of goods & services	1.6	3.8	n.a.	...	...	...
Total merchandise	1.2	3.9	n.a.	...	...	...
Core goods*	1.8	5.0	n.a.	...	...	...

*/ Excludes computers and semiconductors.

e/ Average of two months.

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

Oil Prices



categories, with the exception of agricultural products, which fell. Prices for industrial supplies posted the largest increase.

U.S. Current Account

In the fourth quarter of 2004, the U.S. current account deficit widened \$88 billion to \$752 billion at an annual rate, equivalent to 6¼ percent of GDP. The change was concentrated in the trade balance on goods and services, which fell \$61 billion. The balances on income and transfers also declined.

The widening of the trade deficit occurred as an \$84 billion rise in imports outweighed a \$23 billion increase in exports. Nearly half of the gain in imports reflected a surge in oil imports as both oil prices and import volumes strengthened.

U.S. Current Account (Billions of dollars, seasonally adjusted annual rate)				
Period	Goods and services, net	Investment income, net	Other income and transfers, net	Current account balance
<i>Annual</i>				
2003	-496.5	38.8	-72.9	-530.7
2004	-617.1	29.8	-78.7	-665.9
<i>Quarterly</i>				
2004:Q1	-555.4	53.9	-88.4	-589.9
Q2	-605.3	25.9	-79.5	-658.8
Q3	-623.4	25.3	-65.3	-663.4
Q4	-684.2	14.2	-81.6	-751.6
<i>Changes</i>				
Q1-Q4	-53.4	-16.2	-12.5	-82.1
Q2-Q1	-49.9	-28.0	9.0	-68.9
Q3-Q2	-18.1	-0.6	14.2	-4.6
Q4-Q3	-60.8	-11.1	-16.3	-88.2

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

The surplus on net investment income fell \$11 billion as a rise in receipts was outpaced by higher payments. Payments and receipts were both lifted by higher earnings on direct investment positions and higher average interest rates. In addition, U.S. dividend payments to foreigners were boosted by Microsoft's special dividend in the quarter.

Net transfer payments to foreigners rose more than \$16 billion in the fourth quarter. This strong increase reflected a rebound from the unusually low level in the third quarter, which was held down by sizable inflows of insurance claims to cover hurricane-related losses.

U.S. International Financial Transactions

The March 16 balance of payments press release included new data for the fourth quarter of 2004.

U.S. direct investment abroad (line 6 of the Summary of U.S. International Transactions table) increased to \$101 billion in the fourth quarter, owing in large part to the re-incorporation in the United States of News Corporation Ltd. (Australia). For the year, record reinvested earnings helped to raise direct investment outflows to \$249 billion from \$174 billion in 2003. Foreign direct investment into the United States (FDIUS) was little changed during the fourth quarter at \$36 billion (line 7); for the year it increased to \$116 billion from \$40 billion in 2003, due to new equity investment and reinvested earnings. The increase in U.S. direct investment abroad during 2004 was roughly offset by increased FDIUS, resulting in net direct investment outflows of approximately \$135 billion in both 2003 and 2004.

The re-incorporation of News Corporation has four balance of payments components which net to zero. The most visible is increased U.S. direct investment abroad (USDIA), reflecting the newly-formed Delaware corporation's holdings of the Australian corporation. A small part of this USDIA is offset by new foreign direct investment into the United States, reflecting the Murdoch trust's interests in the new Delaware corporation. In addition, private equity holdings in the Australian corporation were swapped for equity in the new entity. U.S. residents had an estimated \$22 billion swapped, which reduced U.S. equity claims on foreigners (line 5c); and foreigners were estimated to have had about \$23 billion in foreign equity swapped for U.S. equity (included in line 4d).

The statistical discrepancy (last line) was positive \$5 billion for the fourth quarter and positive \$52 billion for the year. A positive statistical discrepancy indicates some combination of over-reporting of the current account deficit or under-reporting of net capital inflows.

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

	2003	2004	2004					2005	
			Q1	Q2	Q3	Q4	Dec.	Jan.	
Official financial flows	250.1	363.3	137.0	71.5	71.9	82.8	29.5	18.6	
1. Change in foreign official assets in the U.S. (increase, +)	248.6	360.5	136.4	70.4	71.5	82.1	28.8	14.8	
a. G-10 countries	114.7	162.7	96.8	46.2	20.1	-.4	-3.7	.4	
b. OPEC countries	6.1	12.1	3.3	-2.1	3.2	7.7	.6	3.2	
c. All other countries	127.9	185.7	36.4	26.3	48.1	74.8	31.9	11.2	
2. Change in U.S. official reserve assets (decrease, +)	1.5	2.8	.6	1.1	.4	.7	.7	3.8	
Private financial flows	295.6	252.2	1.4	93.0	56.8	101.0	...	...
Banks									
3. Change in net foreign positions of banking offices in the U.S. ¹	64.7	-5.8	-39.9	35.6	-17.7	16.1	7.0	-68.1	
Securities²									
4. Foreign net purchases of U.S. securities (+)	369.0	521.6	94.8	149.6	94.3	182.9	62.2	54.6	
a. Treasury securities	114.0	120.0	42.9	63.2	1.2	12.6	.4	13.1	
b. Agency bonds	-10.1	96.3	1.9	33.3	5.8	55.3	19.8	9.9	
c. Corporate and municipal bonds	224.7	245.0	44.2	49.5	81.7	69.5	35.4	14.5	
d. Corporate stocks ³	40.4	60.4	5.7	3.6	5.6	45.5	6.7	17.2	
5. U.S. net acquisitions (-) of foreign securities	-90.5	-88.8	-7.1	-33.3	-20.5	-27.9	-23.1	-2.1	
a. Bonds	21.9	3.2	11.9	8.3	-3.2	-13.8	-6.6	5.5	
b. Stock purchases	-95.0	-101.1	-19.0	-28.9	-16.7	-36.5	-16.5	-7.6	
c. Stock swaps ³	-17.4	9.1	.0	-12.7	-.6	22.4	.0	.0	
Other flows (quarterly data, s.a.)									
6. U.S. direct investment (-) abroad	-173.8	-248.5	-48.0	-55.9	-43.3	-101.3	...	...
7. Foreign direct investment in U.S.	39.9	115.5	10.5	32.9	35.9	36.3	...	...
8. Foreign holdings of U.S. currency	16.6	14.8	-1.8	8.8	2.6	5.3	...	...
9. Other (inflow, +) ⁴	69.7	-56.6	-7.0	-44.6	5.4	-10.5	...	...
U.S. current account balance (s.a.)	-530.7	-665.9	-147.5	-164.7	-165.9	-187.9	...	...
Capital account balance (s.a.)⁵	-3.1	-1.5	-0.4	-0.3	-0.4	-0.4	...	...
Statistical discrepancy (s.a.)	-12.0	51.9	9.4	0.5	37.5	4.5	...	...

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 non-market means such as mergers and reincorporations.

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.