

Prefatory Note

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Part 2

June 21, 2006

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

June 21, 2006

Recent Developments

Domestic Nonfinancial Developments

Domestic Nonfinancial Developments

Economic activity appears to be increasing more slowly in the current quarter, both relative to its average pace over the course of last year and, more noticeably, relative to its elevated pace in the first quarter of this year. The expansion of household demand in particular has moderated: Gains in consumer spending in recent months have been considerably smaller than at the turn of the year, while housing demand and residential construction activity have cooled. In contrast, the underlying pace of business spending has remained strong—well supported by its fundamentals. The demand for labor decelerated in the spring, and available indicators suggest a moderate pace of hiring in the near term. Consumer price inflation has picked up in recent months, not only because of a sharp rise in energy prices but also because of more-rapid increases in core prices.

Labor Market Developments

The May labor market report provided further evidence that the growth of labor demand has stepped down since the start of the year. Employment on private nonfarm payrolls rose 67,000 in May, bringing the average of the past three months to 112,000; this reading compares with gains averaging about 170,000 per month in the preceding several months. The recent slowing in hiring has been most pronounced in retail trade, where many major categories of stores have experienced net employment losses since the start of the year. In addition, slower job gains have been evident in construction, and job losses have occurred in information services. In contrast, establishments in professional and business services, nonbusiness services, and wholesale trade have continued to add jobs at roughly the same pace as earlier in the year.

Average weekly hours of production or nonsupervisory workers edged down 0.1 hour in May to 33.8 hours, reversing April's uptick. The movement in the workweek prompted a similar swing in the aggregate hours of production or nonsupervisory workers, which declined 0.2 percent last month after a 0.4 percent increase in April. On net, aggregate hours in May stood only 0.4 percent (not at an annual rate) above their first-quarter level.

The slowdown in employment growth in recent months has coincided with a leveling off in the unemployment rate. In particular, the jobless rate has hovered in the neighborhood of 4.7 percent since January, although it rounded down to 4.6 percent last month. Meanwhile, the labor force participation rate held steady in May at 66.1 percent for the fourth straight month.

The recent slowdown in employment growth apparently is due more to a reduced pace of hiring than to a significant increase in separations. A bit of evidence in this regard comes from the latest Job Openings and Labor Turnover Survey (JOLTS), which showed a substantial drop in the hires rate in April to its lowest level in a year and a half. Although the JOLTS separations rate has moved up, on balance, in recent months, that increase

Changes in Employment

(Thousands of employees; seasonally adjusted)

Measure and sector	2005		2006				
	2005	Q3	Q4	Q1	Mar.	Apr.	May
	Average monthly change				Monthly change		
Nonfarm payroll employment (establishment survey)	165	155	179	176	175	126	75
Private	152	132	171	169	152	117	67
Natural Resources and Mining	4	3	4	6	8	10	3
Manufacturing	-6	-15	12	1	-1	19	-14
Construction	25	16	30	26	1	16	1
Wholesale trade	7	5	7	13	13	12	14
Retail trade	13	4	11	2	17	-44	-27
Transportation and utilities	6	3	6	4	-4	10	7
Information	-1	3	-2	2	-1	-4	-13
Financial activities	12	19	17	20	14	28	12
Professional and business services	41	51	41	26	43	17	27
Temporary help services	14	21	18	-8	3	-5	-3
Nonbusiness services ¹	51	43	44	69	61	53	57
Total government	14	23	8	7	23	9	8
Total employment (household survey)	221	228	115	287	384	47	288
Memo:							
Aggregate hours of private production workers (percent change) ²	2.3	2.2	2.1	3.0	.2	.4	-.2
Average workweek (hours) ³	33.8	33.8	33.8	33.8	33.8	33.9	33.8
Manufacturing (hours)	40.6	40.6	40.9	41.0	41.1	41.2	41.1

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

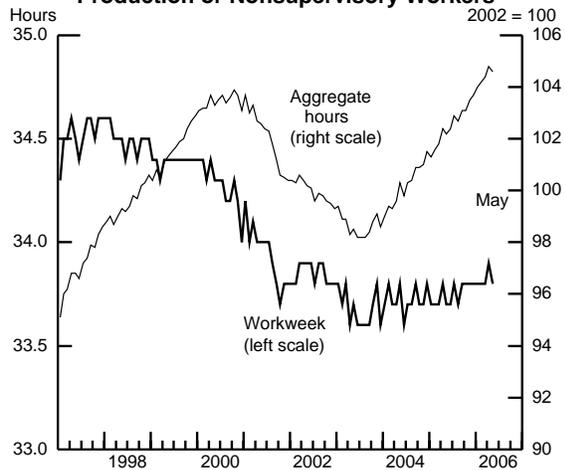
2. Establishment survey. Annual data are percent changes from Q4 to Q4. Quarterly data are percent changes from preceding quarter at an annual rate. Monthly data are percent changes from preceding month.

3. Establishment survey.

Changes in Private Payroll Employment



Aggregate Hours and Workweek of Production or Nonsupervisory Workers

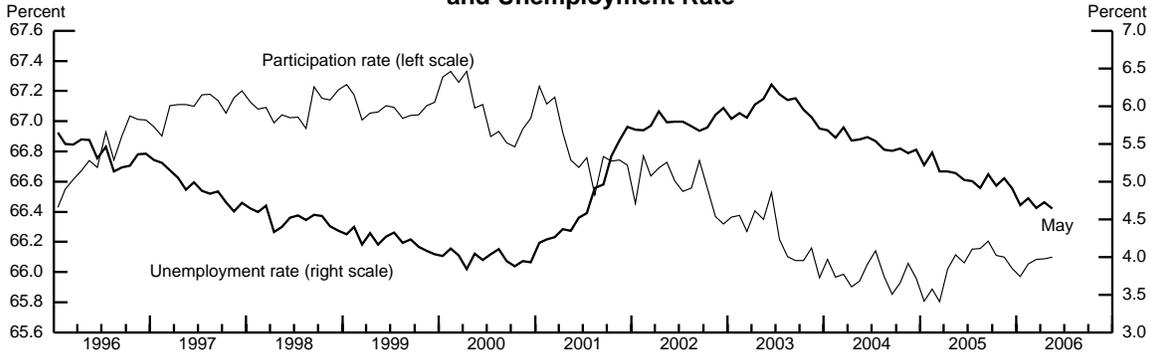


Selected Unemployment and Labor Force Participation Rates

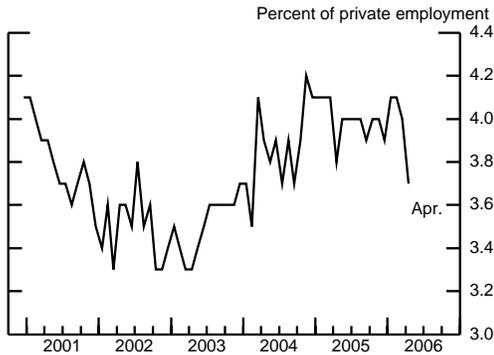
(Percent; seasonally adjusted)

Rate and group	2005	2005		2006			
		Q3	Q4	Q1	Mar.	Apr.	May
<i>Civilian unemployment rate</i>							
Total	5.1	5.0	5.0	4.7	4.7	4.7	4.6
Teenagers	16.6	16.1	16.1	15.5	15.7	14.6	14.0
20-24 years old	8.8	8.6	8.5	8.1	7.6	8.2	8.1
Men, 25 years and older	3.8	3.8	3.7	3.6	3.6	3.6	3.7
Women, 25 years and older	4.2	4.2	4.2	3.9	3.8	3.9	3.8
<i>Labor force participation rate</i>							
Total	66.0	66.2	66.1	66.0	66.1	66.1	66.1
Teenagers	43.7	43.8	43.4	43.7	43.9	43.4	43.5
20-24 years old	74.6	74.6	74.8	74.0	73.9	74.1	74.5
Men, 25 years and older	75.4	75.6	75.3	75.5	75.6	75.6	75.5
Women, 25 years and older	59.4	59.5	59.6	59.4	59.3	59.4	59.4

Labor Force Participation Rate and Unemployment Rate

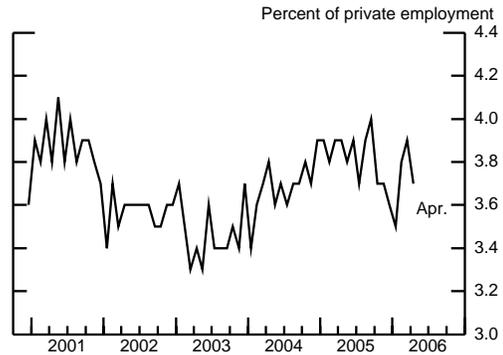


Hires



Source. Job Openings and Labor Turnover Survey.

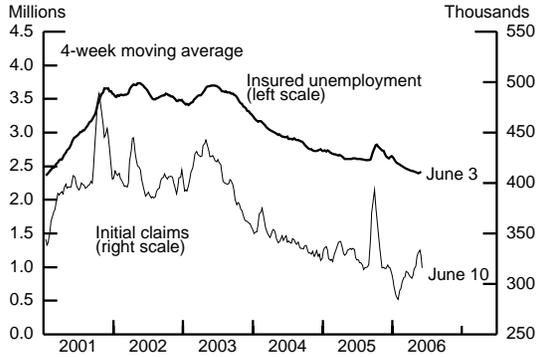
Separations



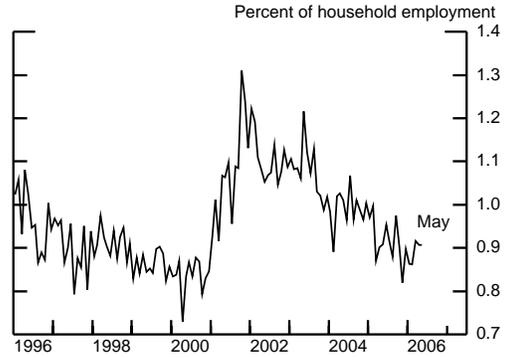
Source. Job Openings and Labor Turnover Survey.

Labor Market Indicators

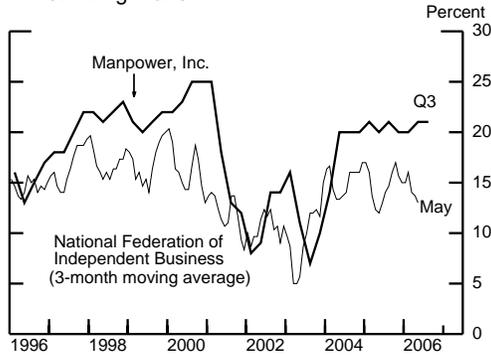
Unemployment Insurance



Job Losers, Unemployed Less Than 5 Weeks

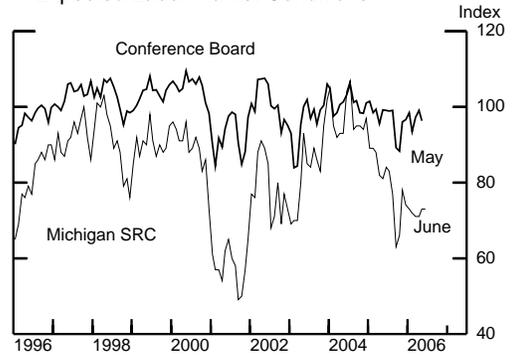


Net Hiring Plans



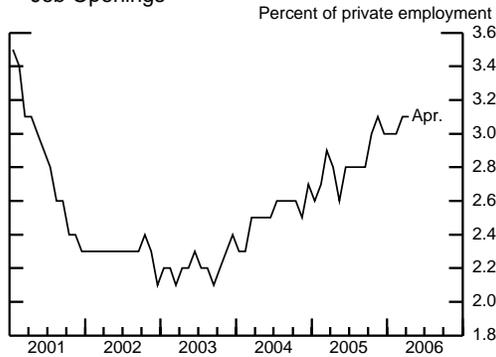
Note. Percent planning an increase in employment minus percent planning a reduction.

Expected Labor Market Conditions



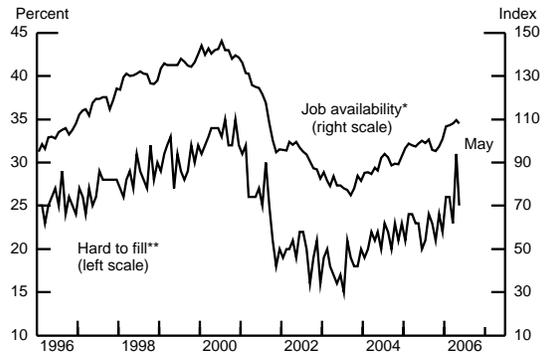
Note. The proportion of households expecting labor market conditions to improve, minus the proportion expecting conditions to worsen, plus 100.

Job Openings



Source. Job Openings and Labor Turnover Survey.

Labor Market Tightness



*Proportion of households believing jobs are plentiful, minus the proportion believing jobs are hard to get, plus 100.

**Percent of small businesses surveyed with at least one "hard to fill" job opening.

Source. For job availability, Conference Board; for hard to fill, National Federation of Independent Business.

follows a sharp dip at the turn of the year, and the level in April was still below the average in 2005. Moreover, other data suggest, at most, a small rise in layoffs. Initial claims for unemployment insurance averaged 316,000 over the four weeks ending on June 10, a reading similar to that in late April.¹ The number of job losers unemployed fewer than five weeks as a percentage of household employment has risen a bit since the start of the year but remains at a low level. And layoff announcements tallied by Challenger, Gray, and Christmas have fallen, on net, in recent months.

Recent indicators of business and household perceptions of the labor market generally point to moderate employment gains in coming months. Both the third-quarter net hiring plans of participants in the Manpower survey and the hiring plans of small businesses as reported to the National Federation of Independent Business (NFIB) remain at favorable levels, although the NFIB index has been edging down since the start of the year. Similarly, household expectations of labor market conditions as measured by the Conference Board ticked down in May but remain at a relatively high level. The one exception to this pattern is the series on expected labor market conditions from the Michigan survey, which has been trending down for the past two years. According to the preliminary reading, this index was unchanged in June.

Other measures of labor market slack are generally consistent with the low but stable unemployment rate. After moving up sharply early last fall, job openings as a percentage of private employment have held fairly steady since October. Similarly, households' perceptions of job availability have changed little this year, while the share of small businesses with a hard-to-fill position dropped back in May from a high April level, leaving it in line with the readings from the first quarter of the year. These measures remain at levels that are consistent with little or no slack in the labor market.

The staff estimates that productivity in the nonfarm business sector rose at an annual rate of 4.4 percent in the first quarter after a 0.3 percent decrease in the fourth quarter. Over the four quarters ending in 2006:Q1, output per hour increased 2.7 percent by our estimate—about ¼ percentage point below the pace recorded during the comparable period four quarters earlier. According to the Bureau of Labor Statistics, output per hour in the nonfinancial corporate sector rose 3.7 percent both in the first quarter of 2006 and

¹ The level of claims was elevated in May by a partial government shutdown in Puerto Rico, but these claims are now largely out of the time frame for calculating the four-week moving average.

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

Component	Proportion 2005 (percent)	2005 ¹	2005	2006	2006		
			Q4	Q1	Mar.	Apr.	May
			Annual rate		Monthly rate		
Total	100.0	3.0	5.3	5.3	.5	.8	-1
Previous	100.0	3.0	5.3	5.4	.6	.8	...
Manufacturing	80.8	4.2	9.1	5.4	.5	.7	-1
Ex. motor veh. and parts	73.7	4.4	10.3	6.0	.4	.8	.0
Ex. high-tech industries	68.9	2.9	9.1	5.3	.3	.8	-1
Mining	9.8	-6.8	-15.0	27.2	.4	1.1	-2
Utilities	9.5	2.9	-5.7	-14.7	1.3	.9	.2
<i>Selected industries</i>							
High technology	4.8	25.7	27.1	14.9	.9	.9	.9
Computers	.8	12.0	14.5	10.7	.5	.7	.7
Communications equipment	1.2	25.4	33.1	30.5	3.5	3.7	2.0
Semiconductors ²	2.8	29.9	28.1	9.6	-.3	-.4	.3
Motor vehicles and parts	7.1	2.3	-2.3	-.2	1.5	-.2	-1.3
<i>Market groups excluding energy and selected industries</i>							
Consumer goods	21.0	2.3	4.8	1.2	.7	.6	-.5
Durables	4.1	2.6	8.2	-2.7	-.1	.4	-.5
Nondurables	16.9	2.2	3.9	2.2	.9	.6	-.5
Business equipment	8.0	9.6	27.5	8.4	.7	2.1	-.4
Defense and space equipment	2.0	9.2	7.4	6.7	-.6	1.3	1.1
Construction supplies	4.4	6.5	17.3	4.2	.7	.3	-.6
Business supplies	7.8	2.7	6.4	3.7	.2	.7	-.2
Materials	24.4	.6	6.9	10.1	.3	.7	-.1
Durables	13.7	3.6	12.9	9.8	.4	1.0	-.3
Nondurables	10.7	-3.1	-.3	10.6	.3	.3	.0

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- 2005 average	1994- 2005 high	2001- 02 low	2005		2006		
				Q3	Q4	Q1	Apr.	May
Total industry	81.0	85.0	73.9	79.8	80.5	81.1	81.9	81.7
Manufacturing	79.8	84.5	72.0	78.5	79.8	80.4	80.8	80.5
Mining	87.3	89.0	85.6	86.1	82.7	88.0	89.7	89.6
Utilities	86.7	93.7	83.7	88.1	86.9	83.5	86.4	86.5
<i>Stage-of-process groups</i>								
Crude	86.4	89.4	83.2	84.2	81.3	85.8	87.2	87.6
Primary and semifinished	82.1	88.1	74.6	81.8	82.6	82.3	82.8	82.7
Finished	77.9	80.5	70.8	76.9	78.3	79.0	79.8	79.2

Labor Output per Hour

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

Sector	2004:Q1 to 2005:Q1	2005:Q1 to 2006:Q1	2005			2006
			Q2	Q3	Q4	Q1
Nonfarm business						
All persons	3.0	2.7 ¹	2.4	4.2	-.3	4.4 ¹
All employees ²	3.1	2.4 ¹	2.3	3.1	-.9	5.4 ¹
Nonfinancial corporations ³	5.4	3.7	4.6	4.1	2.4	3.7

1. Staff estimates.

2. Assumes that the growth rate of hours of non-employees equals the growth rate of hours of employees.

3. All corporations doing business in the United States except banks, stock and commodity brokers, and finance and insurance companies. The sector accounts for about two-thirds of business employment.

over the four quarters ending in 2006:Q1. This rate of increase was down nearly 1¾ percentage points from the gain posted over the previous four quarters.

Industrial Production

Industrial production (IP) surged 0.8 percent in April and then edged down 0.1 percent in May; the limited available indicators thus far for June suggest that IP will rise moderately this month. The choppy pattern primarily reflects changes in manufacturing output, which rose 0.7 percent in April before declining 0.1 percent in May. On average, manufacturing production has increased at a monthly rate of 0.3 percent since the start of 2006, down from the 0.4 percent average pace of expansion from mid-2003 to the end of 2005.

Manufacturing capacity utilization stood at 80.5 percent in May, about ¾ percentage point above its 1972-2005 average and about 1 percentage point below its most recent peak in April 2000. The operating rate for industries at the crude stage of processing has snapped back from the effects of last year's hurricanes and is now a little above its long-run average. The operating rate for industries at the primary and semifinished stages of processing has generally risen since 2003 and is also a little above its long-run average. Capacity utilization for industries in the finished stage of processing has increased more quickly and is now well above its long-run average. Despite the above-average utilization rates at all stages of processing, the Institute for Supply Management's business surveys continue to report very few items in short supply.

The output of energy expanded a solid 0.9 percent in April and 0.7 percent in May, in part the result of continued recovery from last year's hurricanes. In particular, crude oil extraction jumped 2½ percent in April before easing a bit in May. As of early June, the amount of crude oil production capacity in the Gulf of Mexico that remains shut in stood

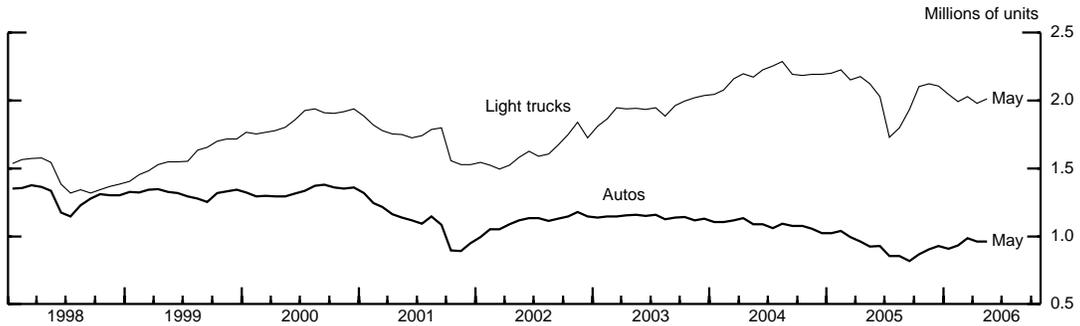
Production of Domestic Light Vehicles
(Millions of units at an annual rate except as noted)

Item	2005	2006						
		Q1	Q2	Q3	Mar.	Apr.	May	June
U.S. production ¹	11.5	11.2	11.1	11.5	11.3	11.2	10.9	11.1
Autos	4.3	4.5	4.3	4.4	4.5	4.5	4.3	4.0
Light trucks	7.2	6.7	6.8	7.0	6.8	6.7	6.5	7.1
Days' supply ²	69	69	n.a.	n.a.	71	70	74	n.a.
Autos	52	53	n.a.	n.a.	57	52	55	n.a.
Light trucks	81	80	n.a.	n.a.	80	84	89	n.a.
Inventories ³	3.04	3.01	n.a.	n.a.	3.01	2.94	2.98	n.a.
Autos	.93	.99	n.a.	n.a.	.99	.96	.96	n.a.
Light trucks	2.11	2.03	n.a.	n.a.	2.03	1.98	2.01	n.a.
Memo: U.S. production, total motor vehicles ⁴	12.0	11.7	11.5	11.8	11.8	11.7	11.3	11.5

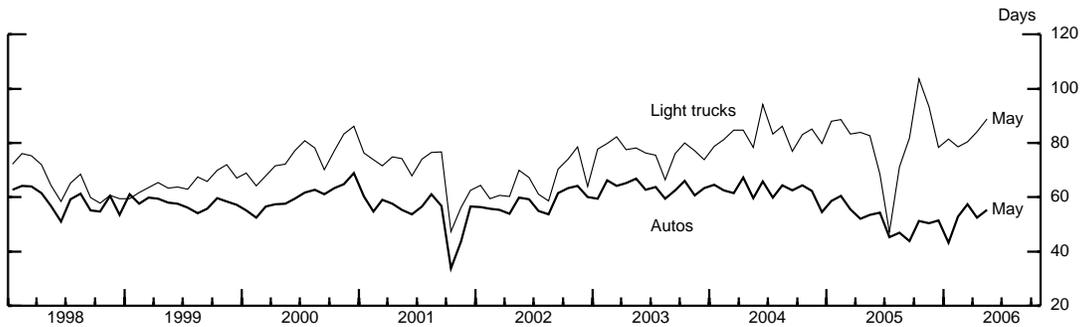
Note. FRB seasonals. Components may not sum to totals because of rounding.

1. Production rates for June and the second and third quarters reflect the latest schedules from Ward's Communications.
 2. Annual and quarterly values are calculated with end-of-period stocks and average reported sales.
 3. End-of-period stocks.
 4. Includes medium and heavy trucks.
- n.a. Not available.

Inventories of Light Vehicles

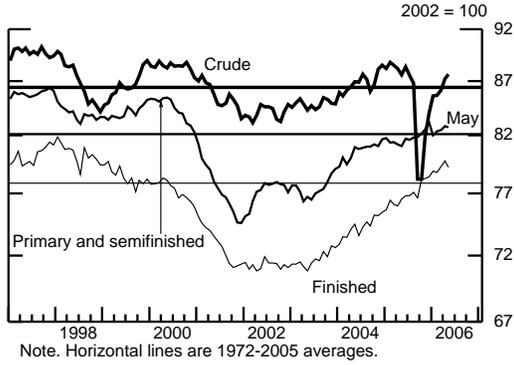


Days' Supply of Light Vehicles

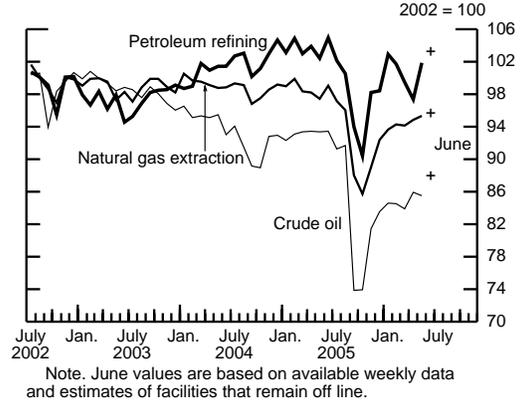


Indicators of Manufacturing Activity

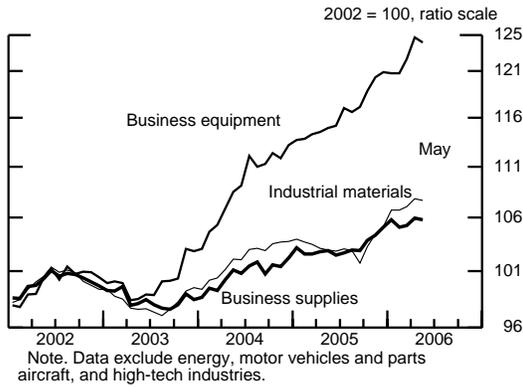
Capacity Utilization by Stage of Processing



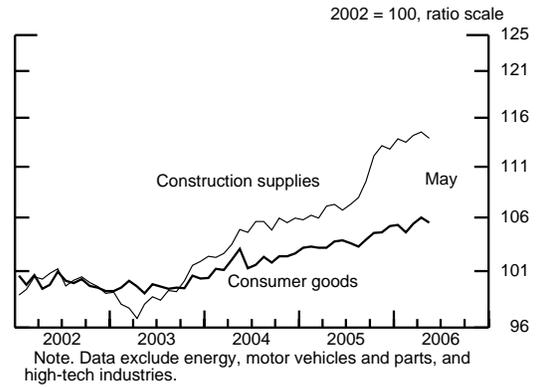
Energy IP



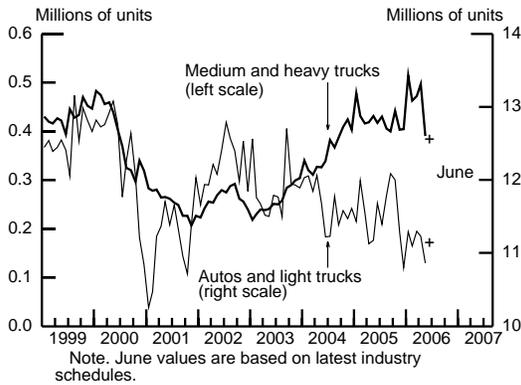
IP: Business Equipment, Industrial Materials, and Business Supplies



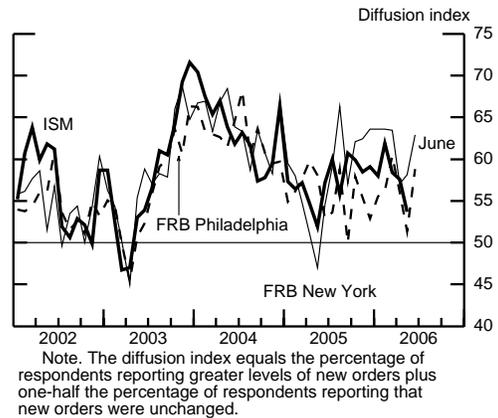
IP: Consumer Goods and Construction Supplies



Motor Vehicle Assemblies

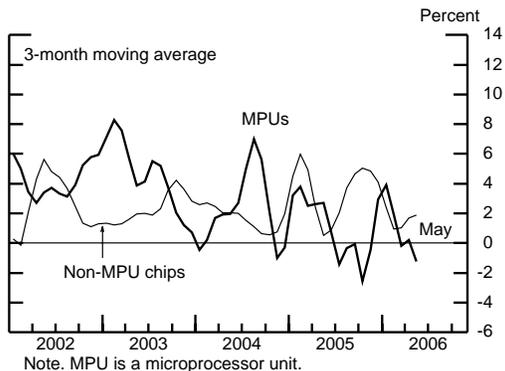


New Orders: ISM, FRB New York, and FRB Philadelphia Surveys

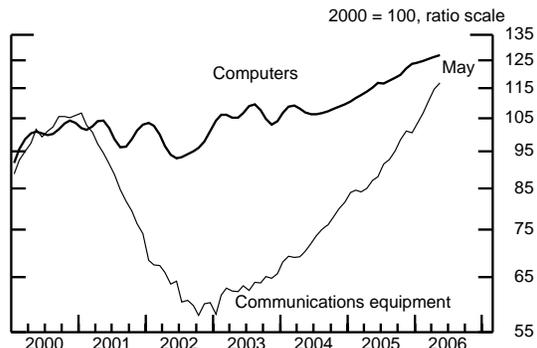


Indicators of High-Tech Manufacturing Activity

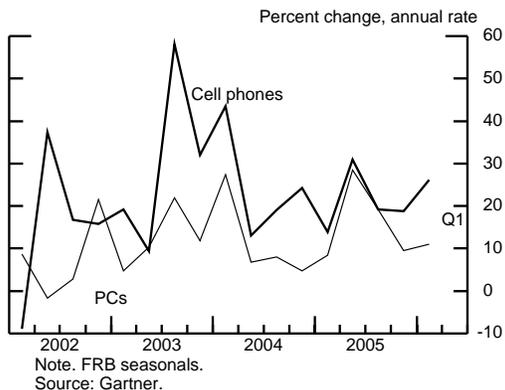
Rate of Change in Semiconductor Industrial Production



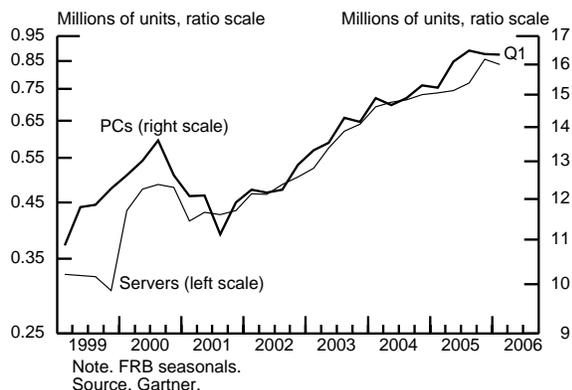
Communications Equipment and Computer IP



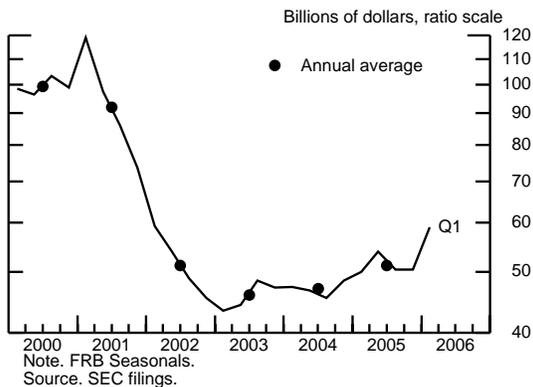
Worldwide Unit Sales of Personal Computers and of Cell Phones



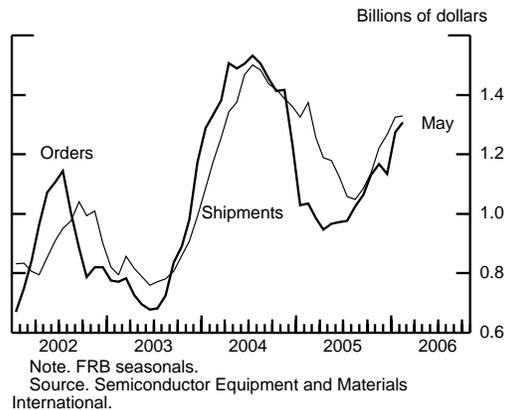
U.S. Personal Computer and Server Sales



Capital Expenditures by Telecommunications Service Providers



Bookings and Billings for Semiconductor Equipment



at 4 percent, down from 7 percent in March; this improvement is mainly the result of the resumption of operations at the Mars drilling platform, which accounts for about 2½ percent of U.S. production when in full operation.² Natural gas extraction has inched forward since the beginning of the year, and only about 2 percent of U.S. production capacity in that industry remains shut in. Within manufacturing, petroleum refining surged more than 4 percent in May, a result of the completion of maintenance that had been delayed in the wake of the hurricanes, the partial return to operation of a major hurricane-idled refinery, and the return to operations of facilities that were being converted to produce ethanol-ready gasoline.³ Meanwhile, electricity generation rose 1.8 percent in April and dropped back 0.2 percent in May as temperatures moved from unusually warm in April to more seasonable last month. Available weekly-frequency data point to a moderate gain in electricity production this month and to more substantial gains in crude oil and refinery output.

Total motor vehicle assemblies slipped about 400,000 units in May to an annual rate of 11.3 million units; as a result, the IP index for motor vehicles declined 1.3 percent last month after falling a little in April. Assemblies are scheduled to rise to 11.5 million units for June and to 11.8 million units for the third quarter as a whole. Elsewhere in transportation, aircraft production increased a robust 0.9 percent per month, on average, from January to April but edged down 0.2 percent in May, as a modest gain in commercial aircraft output was more than offset by a continued decline in military aircraft production.

In the high-tech sector, production has increased at a relatively subdued rate so far this year. The slowing in output growth from last year's pace primarily reflects a sharp deceleration in the production of semiconductors from a 30 percent rise last year to a 2½ percent annual rate of decline so far in 2006. In particular, the production of microprocessors (MPUs), the central logic semiconductor chip in computers, has decelerated sharply since the beginning of 2006 in response to a slowing in the sales and

² The Mars platform is expected to be running at full capacity by the end of June.

³ Three hurricane-idled refineries have not yet returned to full operation. The BP Texas City refinery, accounting for 3 percent of U.S. refinery capacity, restarted about one-fourth of its operation in April. The Murphy Meraux refinery (about 1 percent of U.S. capacity) is slated to resume operation by the end of June. Plans to restart the Belle Chasse refinery (1½ percent of U.S. capacity) have not been made public.

Ethanol-ready gasoline accounts for about 30 percent of U.S. gasoline production. Nearly all refiners have switched to using an ethanol-based formula this year for their reformulated gasoline.

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

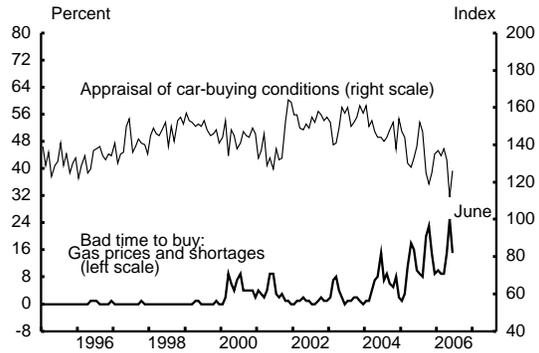
Category	2005	2005		2006			
		Q3	Q4	Q1	Mar.	Apr.	May
Total	16.9	17.9	15.8	16.9	16.5	16.7	16.0
Autos	7.7	8.0	7.5	7.8	7.4	8.0	7.8
Light trucks	9.2	10.0	8.3	9.1	9.1	8.7	8.3
North American ¹	13.5	14.5	12.6	13.5	13.0	12.8	12.3
Autos	5.5	5.7	5.4	5.7	5.3	5.6	5.3
Light trucks	8.0	8.8	7.2	7.7	7.7	7.2	7.0
Foreign-produced	3.4	3.5	3.3	3.4	3.5	3.8	3.8
Autos	2.2	2.3	2.1	2.1	2.1	2.4	2.5
Light trucks	1.2	1.2	1.2	1.3	1.4	1.4	1.3
Memo: Medium and heavy trucks	.50	.50	.51	.55	.56	.53	.53

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

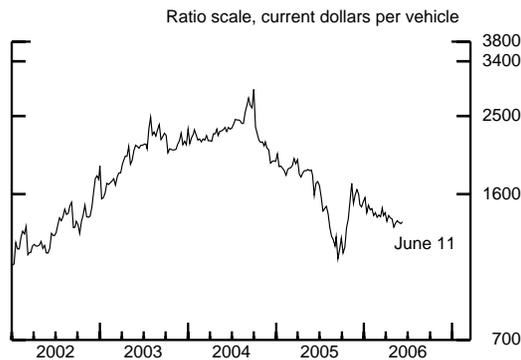
1. Excludes some vehicles produced in Canada that are classified as imports by the industry.

Content redacted.

Michigan Survey Index of Car-Buying Attitudes

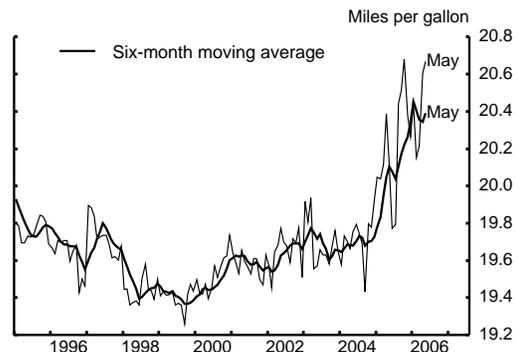


Average Value of Incentives on Light Vehicles



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

New Light Vehicle Fuel Economy



Source. Staff estimate based on a monthly sales-weighted average of city mileage ratings for all new models. Seasonally adjusted.

production of computers.⁴ In contrast, the production of non-MPU chips accelerated in April and May, as worldwide sales of cell phones, a major demand driver for non-MPU chips, surged in the first quarter. In addition, the production of communications equipment in the United States has risen sharply since mid-2005, in part to meet demands from telecommunications service providers for equipment to expand network capacity so that it can accommodate the delivery of a new generation of services over the Internet and cell phones.⁵ The Semiconductor Industry Association's recently updated forecast for worldwide semiconductor sales implies a substantial acceleration in the second half of 2006, and the rising bookings for semiconductor manufacturing equipment reported by Semiconductor Equipment and Materials International suggest that semiconductor producers are adding capacity to meet this projected demand.

Apart from the sectors that produce energy, motor vehicles and parts, aircraft, and high tech, almost all major market groups posted solid output gains in March and April before leveling off or retreating a bit in May. The production of construction supplies posted a moderate gain in April and then dipped 0.6 percent in May, partly because of an unwinding of a first-quarter boost from warm weather; in addition, recent strength in segments such as concrete and architectural and structural steel suggests a possible shift in the composition of output toward nonresidential construction. The production of business equipment has climbed rapidly, on balance, in recent months; output rose about 2 percent in April, having been boosted by a pickup in the output of construction and farm machinery equipment, and then declined a little in May. The index for business equipment now stands 8 percent above its year-ago level.

Among the available near-term indicators, the Institute for Supply Management's new orders diffusion index stepped down noticeably in May to a level consistent with moderate gains in manufacturing output. However, the June readings on new orders from the New York and Philadelphia Fed surveys indicate larger gains.

Motor Vehicles

Sales of light vehicles fell to an annual rate of 16.0 million units in May, significantly below the average pace of sales in the first four months of the year.

⁴ Industry reports have characterized the slowing in computer sales as a pause in anticipation of product releases scheduled for the second half of this year. In particular, several manufacturers will release a new generation of high-end servers in the second half of 2006, and PC manufacturers are slated to produce machines based on improved dual-core Intel MPUs. In addition, the notable decline in Intel's share of world MPU production over the past year has damped domestic semiconductor output. Intel primarily produces its MPUs in the United States, while most MPU production by AMD—Intel's primary rival in the MPU segment—is in Germany.

⁵ Public and private spending to rebuild infrastructure damaged in the 2006 hurricane season and to improve communications among first responders has provided additional impetus to the industry.

Retail and Food Services Sales

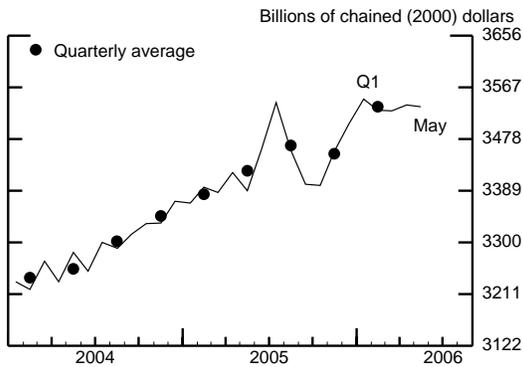
(Percent change from preceding period; seasonally adjusted current dollars)

Category	2005		2006			
	Q3	Q4	Q1	Mar.	Apr.	May
	Annual rate			Monthly rate		
Total sales	8.8	1.9	13.4	.7	.8	.1
Retail control ¹	10.1	6.8	8.9	.4	1.1	.6
Ex. sales at gasoline stations	4.9	8.0	9.4	.4	.4	.4
Memo:						
Real PCE control ²	4.0	5.8	8.6	-.1	.1	.0

1. Total sales less outlays at building material and supply stores and automobile and other motor vehicle dealers.

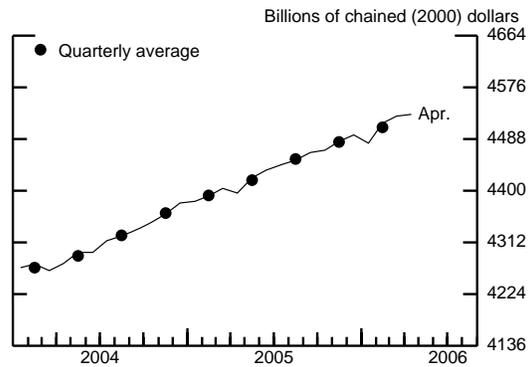
2. Total goods spending excluding autos and trucks. Values for March, April, and Q1 are staff estimates; value for May is a staff forecast.

Real PCE Goods

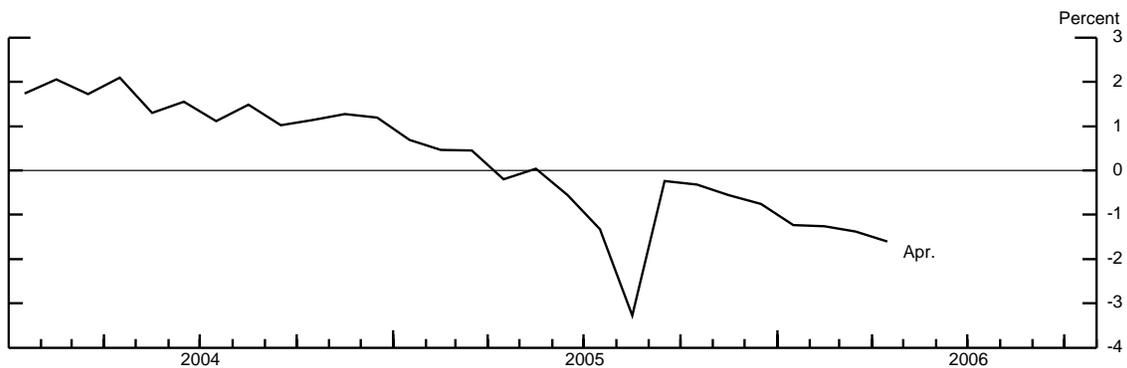


Note. Values for March, April, and Q1 are staff estimates; value for May 2006 is a staff forecast.

Real PCE Services



Personal Saving Rate



Note. Value for December 2004 excludes the effect on income of the special Microsoft dividend in that month.

.⁶ The indicators for light vehicle sales in June are mixed:

;in addition, sales in the first twenty days of June for the three major Japanese automakers weakened somewhat.

According to the University of Michigan Survey of Consumer Attitudes, the percentage of households reporting that it was a bad time to buy a car because of high gasoline prices has trended up in recent years and last month jumped to its highest level since the late 1970s; this reading remained elevated in the preliminary survey for June, although it was down somewhat from May. In line with concerns over gasoline prices, the market share of light trucks has flattened out after increasing steadily throughout the 1990s, and the average fuel economy of new vehicles sold has turned up over the past few years. In the most recent data, the market share of light trucks dropped further in May, and the six-month moving average of fuel economy moved up slightly.

Consumer Spending

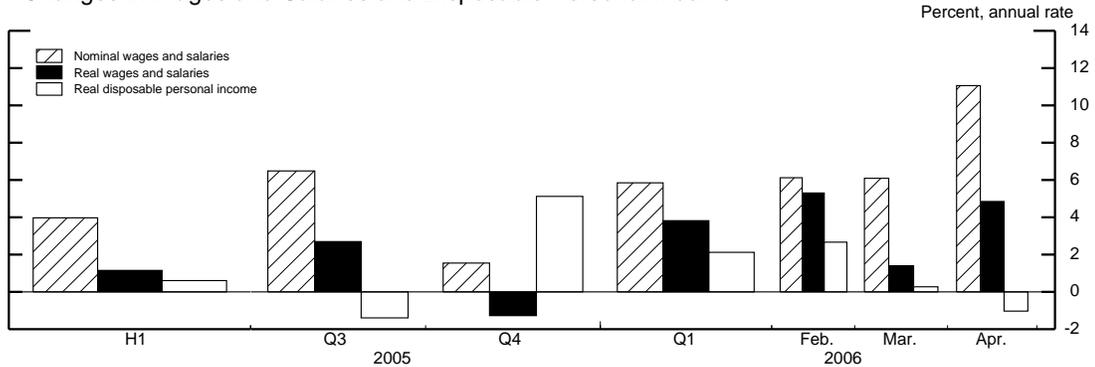
Real consumer spending is on track to decelerate noticeably in the current quarter after increasing at a robust annual rate of 5¼ percent in the first quarter. In addition to a decline in real outlays for motor vehicles in April and May from an elevated first-quarter level, the rate of increase in real expenditures for other goods has slowed in recent months as well. In contrast, real outlays for total PCE services have trended up in recent months after a sizable weather-induced drop in outlays for energy services early in the year.

After posting outsized gains around the turn of the year, real spending on goods other than motor vehicles declined in February and has edged up only slightly in subsequent months. In nominal terms, spending at retailers other than building material and supply outlets and motor vehicle dealers has increased noticeably in recent months, but those increases largely reflected higher prices. Given the changes in consumer prices in May, we estimate that real spending declined last month in the durables category that includes home furnishings—consistent with the cooling off of the housing market—and increased modestly for other goods excluding energy. Real purchases of gasoline fell last month,

⁶ In the first week of June, both Ford and General Motors introduced debit cards guaranteeing a low price of gasoline. However, J.D. Power and Associates reports that the take-up of these cards has been weak so far, and it excludes them from its measure of recent incentives.

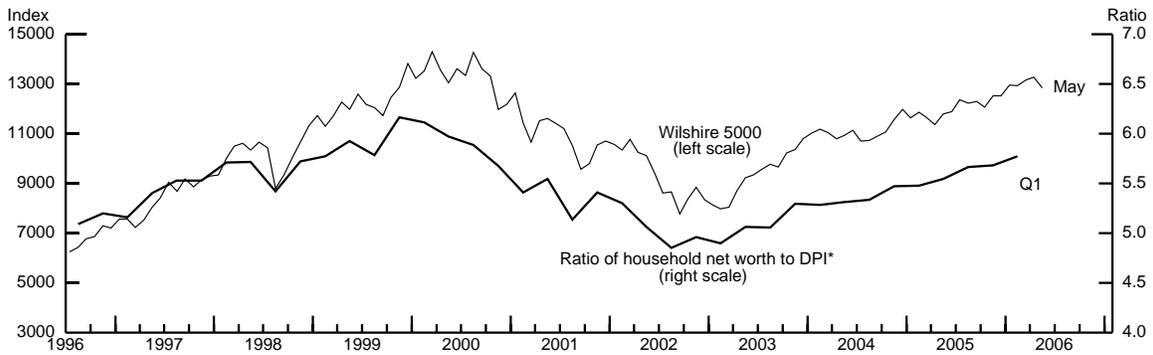
Household Indicators

Changes in Wages and Salaries and Disposable Personal Income



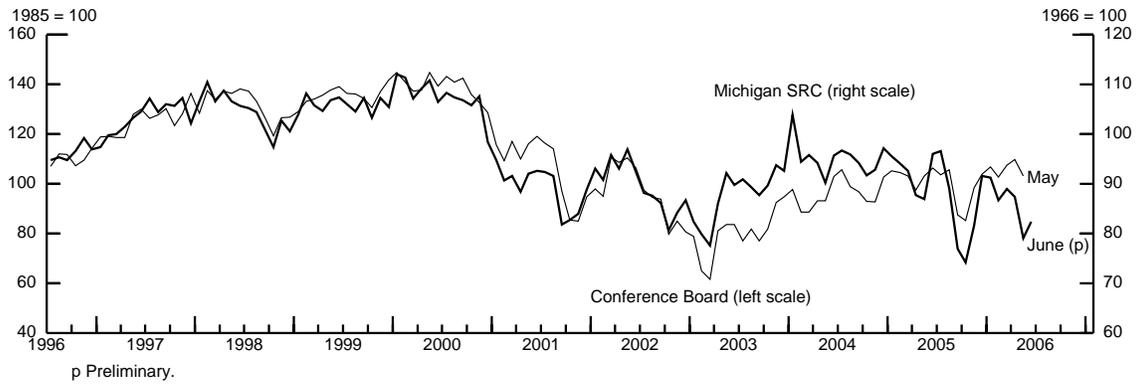
Note. Values for 2005:H1 exclude the effect of the special December 2004 Microsoft dividend payment on real DPI growth.

Household Net Worth and Stock Prices



* Value for 2004:Q4 excludes the effect on income of the one-time Microsoft dividend in December.

Consumer Confidence



p Preliminary.

possibly the result of households' reaction to high energy prices. So far in June, anecdotal reports from retailers have been relatively upbeat.

The recent softness in consumer expenditures has been accompanied by a moderation in the fundamental determinants of spending. Data from unemployment insurance tax records suggest that nominal wages and salaries were considerably weaker in the fourth quarter than previously estimated, and even with the solid gains in wages and salaries now estimated for the first four months of this year, rising consumer prices—driven importantly by higher prices for gasoline—have held down the growth of real disposable income. Higher interest rates have also likely been restraining spending, and the stock market has slipped of late. Still, the stock market gains of the past couple of years, along with ongoing increases in home prices, kept the wealth-to-income ratio in the first quarter well above its historical average. Meanwhile, consumer sentiment dipped in May but rebounded some in early June.

Real disposable personal income expanded at a pace somewhat slower than that of consumer outlays, and the personal saving rate continued to move down; the April rate stood at -1.6 percent, its most recent reading.⁷

Housing Markets

Residential construction activity has moderated noticeably over the past few months, though it remains at a historically high level. Single-family starts in April and May averaged an annual rate of 1.57 million units, well below the record-setting pace in January and February. Although a good portion of the drop since February seems to be the result of starts that were pulled forward by favorable weather conditions early in the year, the evidence also suggests that a slowing in the underlying pace of single-family housing construction is under way. In particular, the level of adjusted permit issuance in the single-family sector—more reliable than starts as an indicator of the underlying pace of housing construction—has trended down since last September, and the backlog of unused permits has dropped sharply after peaking late last year.⁸ In the multifamily sector, starts in May were at an annual rate of 371,000 units—well within the typical range seen since 1995.

The pace of home sales has also been slowing, on balance, for some time now. Sales of existing single-family homes in April were at an annual rate of 5.92 million units, down

⁷ All else being equal, we expect the saving rate to be boosted $\frac{3}{4}$ percentage point by this year's annual retail sales revision, which the Bureau of Economic Analysis will incorporate into the national income and product accounts this summer. This revision does not imply a different contour of the saving rate over the past several months, though it does suggest a somewhat flatter path of the rate in recent years.

⁸ Adjusted permits equal permit issuance plus total starts outside of permit-issuing areas.

Private Housing Activity

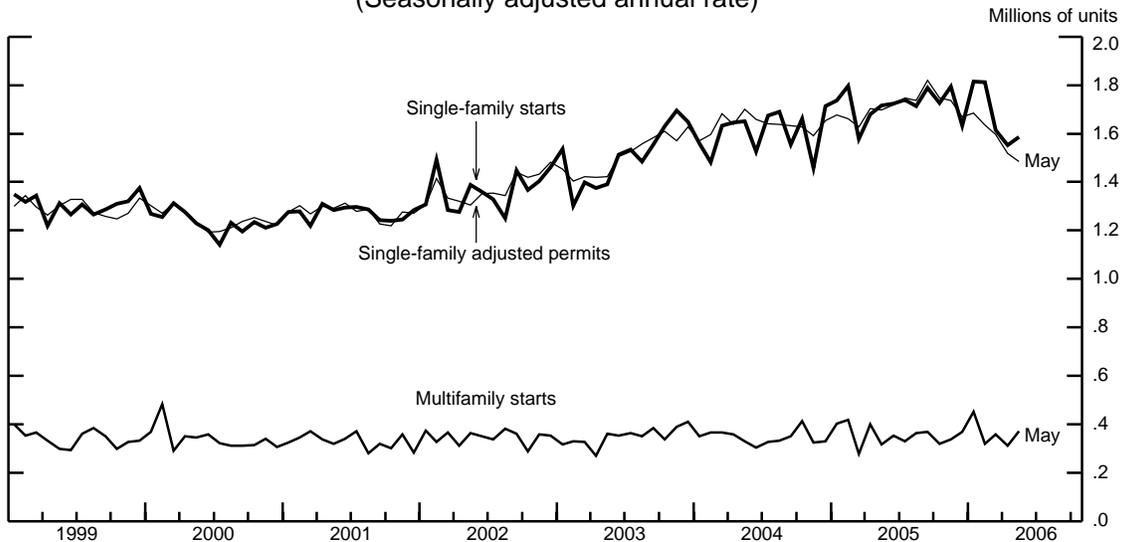
(Millions of units, seasonally adjusted; annual rate except as noted)

Sector	2005	2005	2006			
		Q4	Q1	Mar.	Apr.	May
<i>All units</i>						
Starts	2.07	2.06	2.12	1.97	1.86	1.96
Permits	2.16	2.14	2.14	2.09	1.97	1.93
<i>Single-family units</i>						
Starts	1.72	1.72	1.75	1.62	1.55	1.59
Permits	1.68	1.69	1.61	1.56	1.50	1.47
Adjusted permits ¹	1.71	1.72	1.64	1.60	1.52	1.49
Permit backlog ²	.17	.17	.16	.16	.16	.15
<i>New homes</i>						
Sales	1.28	1.28	1.11	1.14	1.20	n.a.
Months' supply ³	4.43	4.70	5.90	6.00	5.80	n.a.
<i>Existing homes</i>						
Sales	6.18	6.06	5.96	6.04	5.92	n.a.
Months' supply ³	4.40	4.90	5.20	5.40	5.90	n.a.
<i>Multifamily units</i>						
Starts	.35	.34	.38	.36	.31	.37
Permits	.47	.45	.53	.53	.48	.47
Permit backlog ²	.06	.06	.07	.07	.07	.07
<i>Mobile homes</i>						
Shipments	.15	.19	.15	.13	.13	n.a.
<i>Condos and co-ops</i>						
Existing home sales	.90	.88	.83	.86	.84	n.a.

1. Adjusted permits equal permit issuance plus total starts outside of permit-issuing areas.
2. Number outstanding at end of period. Excludes permits that have expired or have been canceled, abandoned, or revoked. Not at an annual rate.
3. At current sales rate. The ratio of n.s.a. inventories to n.s.a. sales is seasonally adjusted by the Census Bureau; as a result, the s.a. ratio may not be the same as the ratio of s.a. inventories to s.a. sales. Quarterly and annual figures are averages of monthly figures.
n.a. Not available.

Private Housing Starts and Permits

(Seasonally adjusted annual rate)



Note. Adjusted permits equal permit issuance plus total starts outside of permit-issuing areas.

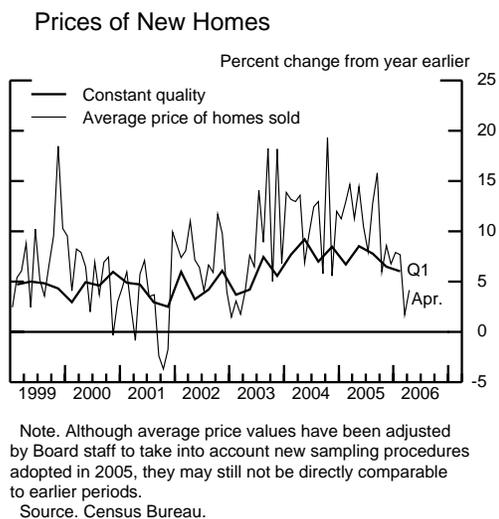
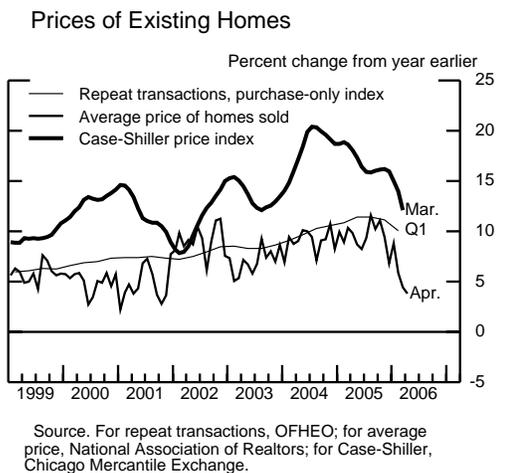
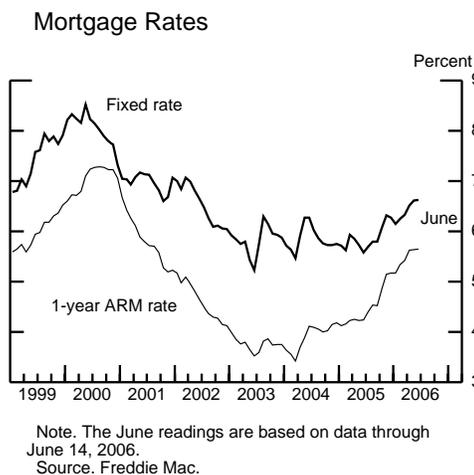
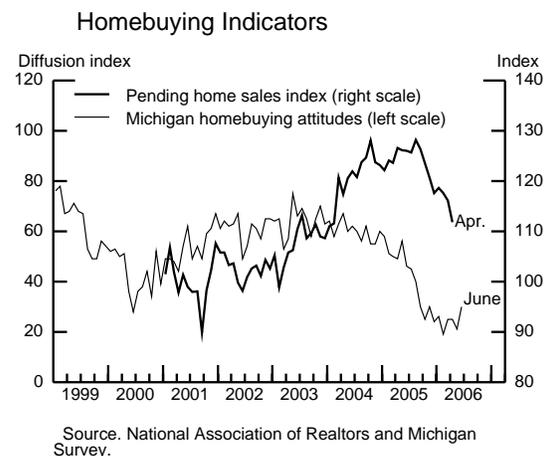
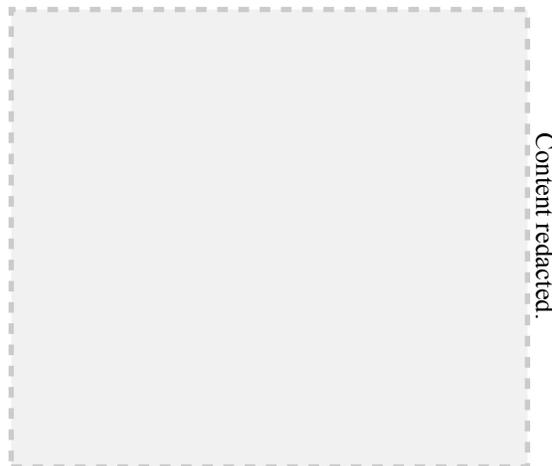
6½ percent from their peak in June 2005. New home sales have regained some ground in recent months after having dipped sharply in February, but the pace of sales in April was still 12½ percent below the record high posted in July of last year.

Near-term indicators suggest that activity in housing markets will continue to ease in the months ahead. Inventories of both new and existing homes have been trending up relative to sales for some time now, and pending home sales—a leading indicator of existing home sales—have slid further in recent months. In addition, the Michigan index of homebuying attitudes has moved down considerably over the past year and is quite low relative to the readings of a couple of years ago. Moreover, higher mortgage rates should continue to damp housing demand in the months ahead. Since home sales peaked about a year ago, the average rate for thirty-year fixed-rate mortgages has risen a little more than 1 percentage point, while the average rate for one-year adjustable-rate mortgages has climbed nearly 1½ percentage points.

House-price appreciation has slowed from the elevated rates seen last year, but the most reliable measures suggest that this deceleration has been modest thus far. The purchase-only version of the price index for existing homes calculated by the Office of Federal Housing Enterprise Oversight (OFHEO)—which controls for differences in quality by tracking repeat sales of houses over time—rose at an annual rate of 7¼ percent in the first quarter, the smallest increase since the fourth quarter of 2001. Although we think that the OFHEO index is, on balance, the most reliable overall gauge of house-price appreciation, it does not fully reflect the highest and lowest ends of the market because it excludes sales financed using jumbo mortgages and mortgages backed by the Department of Veterans Affairs and the Federal Housing Administration. In comparison, the rate of appreciation in the Case-Shiller repeat-sale price index—which includes such purchases but is confined to sales in ten large U.S. cities—has moved down more noticeably over the past year, although it remains appreciably above the OFHEO measure.⁹ The constant-quality price index for new homes—the most reliable measure of quality-adjusted price appreciation in the new home market—rose 6 percent over the four quarters ending in 2006:Q1, its smallest year-over-year increase in two years. More up-to-date measures of house-price increases, which have broad price coverage but are not quality adjusted, suggest steeper declines. The average price of existing homes in April was up only 3¾ percent from the level of twelve months earlier, a steep drop-off from its rise of

⁹ The cities covered by the Case-Shiller index are Boston, Chicago, Denver, Las Vegas, Los Angeles, Miami, New York, San Diego, San Francisco, and Washington.

Indicators of Single-Family Housing



Orders and Shipments of Nondefense Capital Goods

(Percent change; seasonally adjusted current dollars)

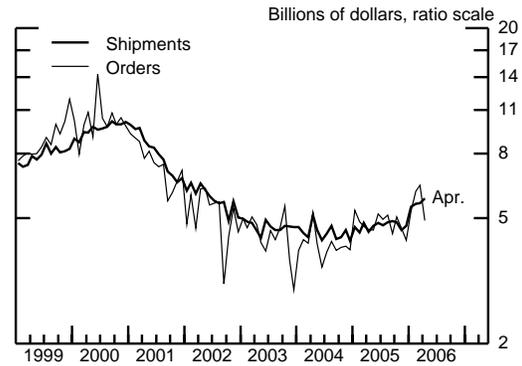
Category	2005	2006			
	Q4	Q1	Feb.	Mar.	Apr.
	Annual rate		Monthly rate		
Shipments	33.9	1.4	1.1	1.5	-.9
Excluding aircraft	13.2	10.6	-.9	2.0	1.0
Computers and peripherals	21.6	-11.7	1.7	3.1	.3
Communications equipment	-8.9	87.7	2.1	.7	3.5
All other categories	14.5	7.9	-1.6	2.0	.9
Orders	82.8	-25.6	4.7	11.6	-5.9
Excluding aircraft	10.0	16.7	-1.0	3.4	-1.7
Computers and peripherals	15.5	-16.3	6.4	4.2	-2.0
Communications equipment	-14.9	159.3	15.5	4.5	-22.5
All other categories	12.1	12.1	-3.6	3.2	.9
Memo: Shipments of complete aircraft ¹	26.9	33.1	34.4	30.8	30.2

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

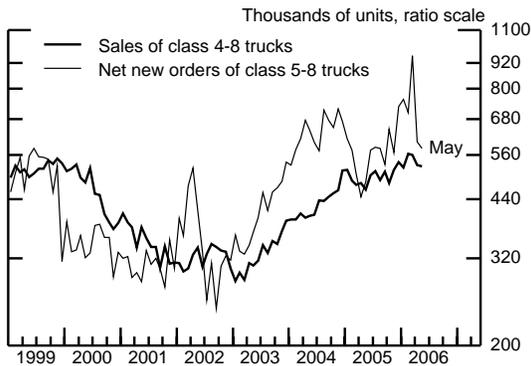
Computers and Peripherals



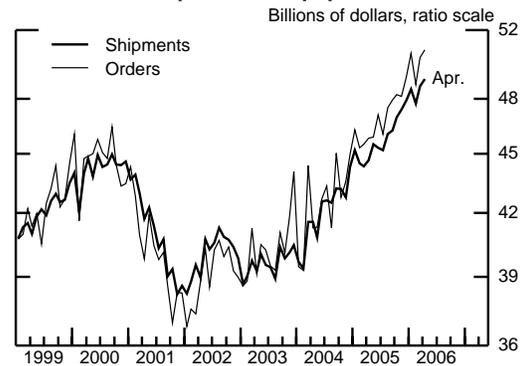
Communications Equipment



Medium and Heavy Trucks



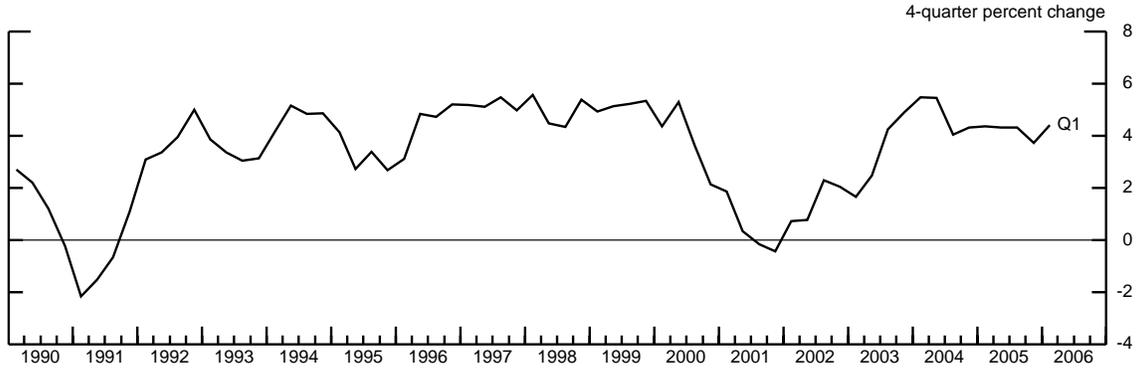
Non-high-tech, Nontransportation Equipment



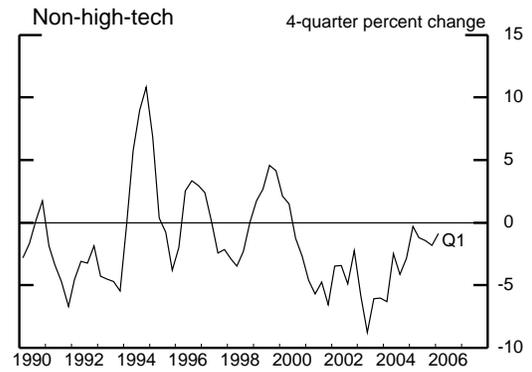
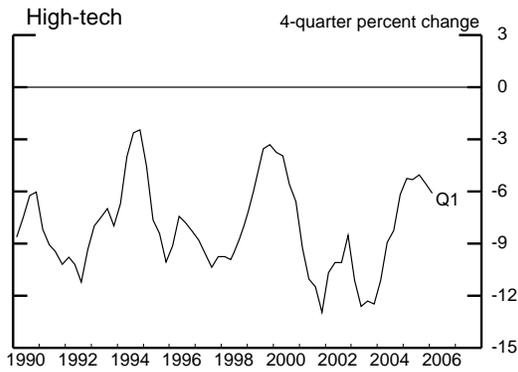
Note. Annual rate, FRB seasonals.
Source. For class 4-8 trucks, Ward's Communications;
for class 5-8 trucks, ACT Research.

Fundamentals of Equipment and Software Investment

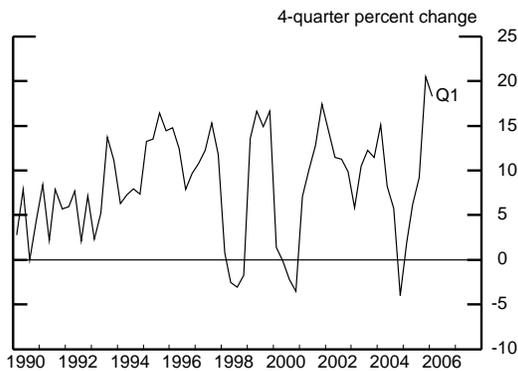
Real Business Output



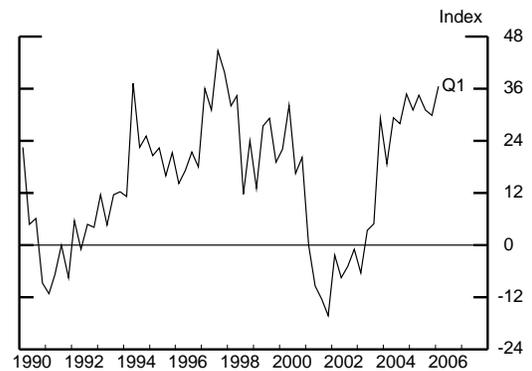
User Cost of Capital



Real Corporate Cash Flow



NABE Capital Spending Diffusion Index



Note. The diffusion index equals the percentage of respondents planning to increase spending minus the percentage of respondents planning to reduce spending.
Source. NABE Industry Survey.

8¾ percent in January. The rate of increase in the average price of new homes has also been low for the past few months.¹⁰

Equipment and Software

Real spending on equipment and software (E&S) appears on track for a modest gain in the second quarter after surging 13¾ percent in the first quarter. However, smoothing through some sharp swings in spending on motor vehicles and communications equipment, it appears that E&S spending has maintained a solid underlying pace of expansion so far this year.

The fundamental determinants of E&S spending have remained supportive of ongoing spending gains: Business output has continued to expand, firms remain flush with cash, and ongoing declines in relative prices have further reduced the cost of capital (albeit to a lesser extent than earlier this decade). In addition, both the capital spending diffusion index derived from a survey of the National Association of Business Economists and the Philadelphia Fed survey point to continued growth in real outlays for new equipment.

Real outlays on transportation equipment jumped at an annual rate of 30 percent in the first quarter of this year, as truck sales surged and domestic expenditures on aircraft stepped up from their very low fourth-quarter level. The average pace of sales of medium and heavy trucks in April and May fell below the first-quarter level but remained well above the average for the past five years. Demand for medium and heavy trucks reportedly has been pulled forward in advance of new Environmental Protection Agency regulations on engines scheduled to take effect in 2007, and industry analysts indicate that orders already in hand are sufficient to fully use available production capacity for the rest of 2006.

Total civilian aircraft shipments in April and Boeing deliveries in May point to a further rise in the current quarter, while the available trade data imply that net exports of aircraft have declined. As a result, we estimate that domestic outlays on aircraft have continued to expand in the current quarter.

Real outlays on high-tech equipment and software surged at an annual rate of 23 percent in the first quarter, an increase led by a jump of 77 percent in outlays on communications equipment. This exceptional pace of growth likely reflects rapid rates of spending by telecommunications service providers on fiber-optic networks, replacement spending on communications infrastructure destroyed in last year's hurricanes, and some outdoor installation that, because of the mild winter, was brought forward from the spring. In

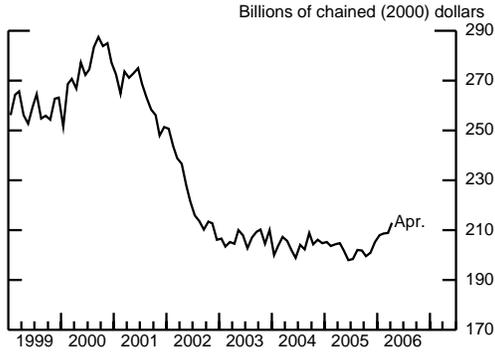
¹⁰ The interpretation of the recent deceleration in this series is clouded by the fact that sampling procedures were revised in 2005.

Nonresidential Construction and Indicators

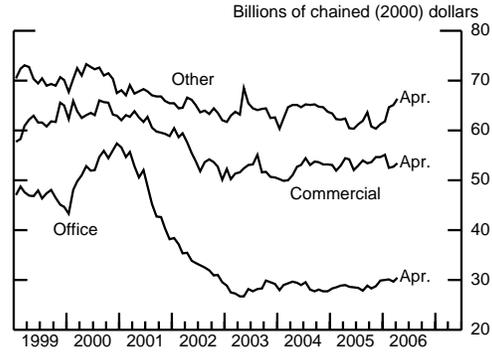
Real Construction

(All spending series are seasonally adjusted, annual rate; nominal CPIP deflated by BEA prices through Q4 and by staff projection thereafter)

Total Structures

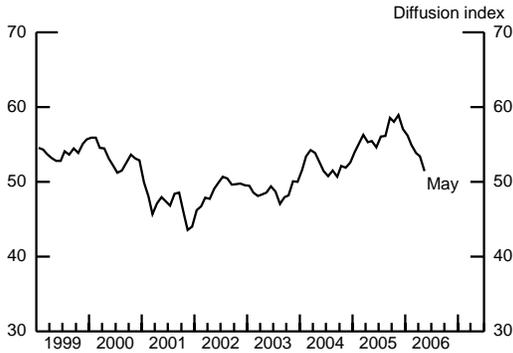


Office, Commercial, and Other



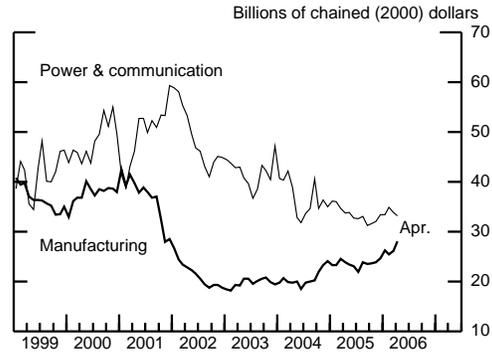
Note. Other includes religious, educational, lodging, amusement and recreation, transportation, and health-care facilities.

Architectural Billings

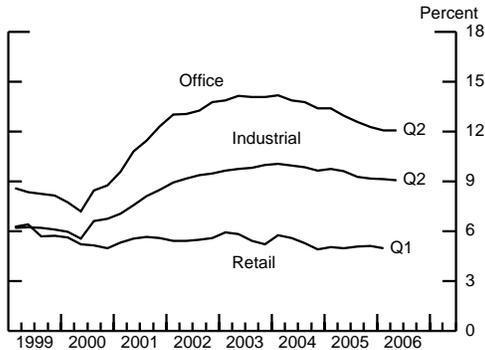


Note. 3-month moving average.
Source. American Institute of Architects

Manufacturing and Power & Communication

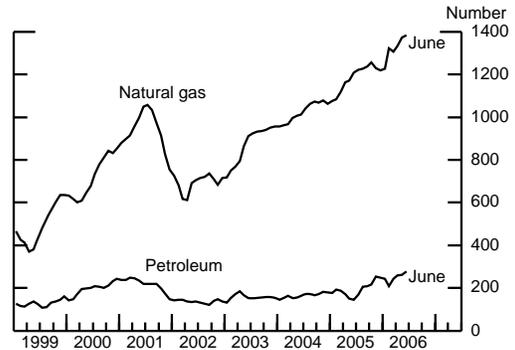


Vacancy Rates



Note. The Q2 readings are based on data through June 8.
Source. For office and industrial, CoStar Property Professional; for retail, National Council of Real Estate Investment Fiduciaries.

Drilling Rigs in Operation



Note. June values are averages through June 16, 2006.
Source. DOE/Baker Hughes.

April, nominal shipments of communications equipment posted another strong gain, while nominal orders, continuing their erratic pattern, dropped sharply. Respondents to the quarterly tech poll in April's *CIO Magazine* reported that they plan to increase spending on communications equipment over the next twelve months. Taken together, these data and indicators suggest that the level of spending on communications equipment has remained robust during the current quarter, though the pace of its expansion has no doubt moderated significantly from the first quarter.

In contrast, demand for computers and software has been relatively weak in real terms so far this year. Real outlays on computers and peripherals increased at an annual rate of 15½ percent in the first quarter—a modest pace for this category of spending—and software spending expanded at a similarly restrained 5¾ percent rate. Likewise, shipments of computers rose only a little in April, and second-quarter revenue-guidance statements issued by various major software vendors point to a moderate pace of business spending in the current quarter. According to industry analysts, computer and peripheral spending in the first half of this year has likely been postponed in anticipation of the release of several key hardware and software products later in the year and in early 2007—most notably, new lines of faster and more-energy-efficient servers and significantly enhanced dual-core processor chips.

Real outlays for equipment outside of the high-tech and transportation categories were flat in the first quarter after rising sharply at the end of last year. Notably, spending on industrial equipment fell modestly last quarter after rising 13½ percent in the fourth quarter. However, the sharp run-up in recent months in unfilled orders for equipment outside of the high-tech and transportation categories points to a very strong rate of spending growth in the coming months.

Nonresidential Construction

Outlays for the construction of nonresidential buildings have picked up noticeably so far this year. Expenditures on manufacturing structures have strengthened considerably over the past two quarters despite little change in vacancy rates in this sector. The “other” category—which includes construction outlays on buildings for health care, lodging, and education—has also registered strong growth of late, while spending on office construction has gained some traction as vacancy rates in this sector continue to drift down. By contrast, the commercial category has posted an uneven spending pattern in recent months despite vacancy rates in this sector that remain low by historical standards. Forward-looking indicators suggest that outlays for nonresidential building construction will continue to rise over the next few quarters, but at a more subdued pace. The four-month moving average of the architectural billings index—a new diffusion index from the American Institute of Architects that measures whether billings by architectural firms are increasing or decreasing—has slipped in recent months but remains at a relatively

Nonfarm Inventory Investment
(Billions of dollars; seasonally adjusted annual rate)

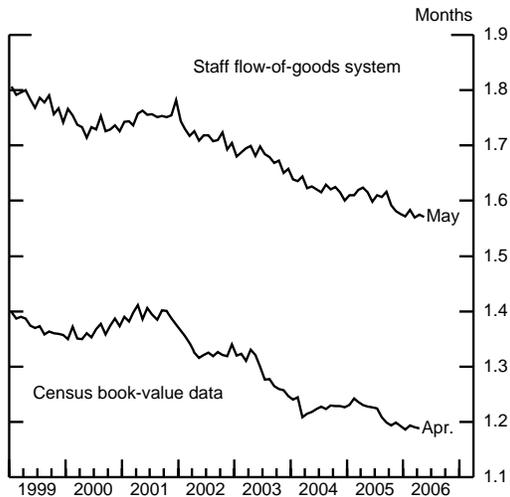
Measure and sector	2005		2006			
	Q3	Q4	Q1	Feb.	Mar.	Apr.
<i>Real inventory investment (chained 2000 dollars)</i>						
Total nonfarm business	-8.1	43.0	40.5^e	n.a.	n.a.	n.a.
Motor vehicles	-19.6	26.7	-.8 ^e	n.a.	n.a.	n.a.
Nonfarm ex. motor vehicles	11.5	16.3	41.3 ^e	n.a.	n.a.	n.a.
Manufacturing and trade ex. wholesale and retail motor vehicles and parts	10.9	14.6	24.5^e	-11.7^e	45.9^e	n.a.
Manufacturing	-2.5	.6	10.3 ^e	-30.8 ^e	30.7 ^e	n.a.
Wholesale trade ex. motor vehicles & parts	11.6	7.3	6.6 ^e	21.9 ^e	2.1 ^e	n.a.
Retail trade ex. motor vehicles & parts	1.8	6.7	7.6 ^e	-2.9 ^e	13.1 ^e	n.a.
<i>Book-value inventory investment (current dollars)</i>						
Manufacturing and trade ex. wholesale and retail motor vehicles and parts	35.2	56.2	53.3	6.7	82.0	69.9
Manufacturing	5.3	23.3	23.5	-25.7	46.8	35.9
Wholesale trade ex. motor vehicles & parts	20.4	20.7	17.9	28.6	15.4	28.5
Retail trade ex. motor vehicles & parts	9.5	12.2	12.0	3.8	19.8	5.5

^e Staff estimates of real inventory investment based on revised book-value data.

n.a. Not available.

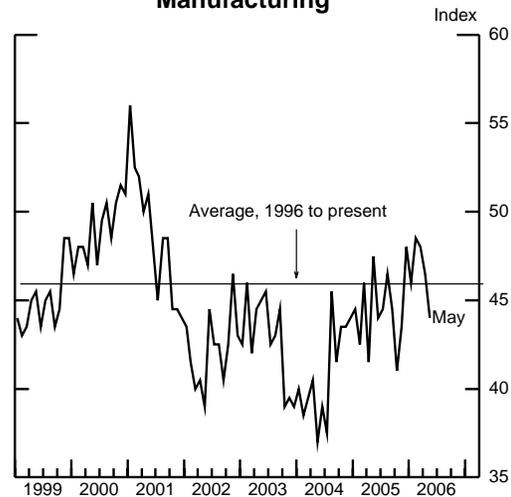
Source. For real inventory investment, BEA. For book-value data, Census Bureau.

Inventory Ratios Ex. Motor Vehicles



Note. Flow-of-goods system covers total industry ex. motor vehicles and parts, and inventories are relative to consumption. Census data cover manufacturing and trade ex. motor vehicles and parts, and inventories are relative to sales.

ISM Customer Inventories: Manufacturing



Note. A number above 50 indicates inventories are "too high."

favorable level.¹¹ This index is well correlated with nominal expenditure growth in the nonresidential construction sector and has a lead of about two quarters.

Outlays on drilling and mining structures have continued to climb in response to high projected energy prices. In the first quarter, real spending in this sector rose at an annual rate of 7¼ percent after posting a double-digit gain in 2005. The number of rigs drilling for natural gas and petroleum has recently moved up at a good clip after a lull early this year; this rise suggests that the growth in outlays in this sector will pick up again in the current quarter.

Business Inventories

The real value of manufacturing and trade inventories outside of the motor vehicles sector increased at an annual rate of \$25 billion in the first quarter, about double the pace of accumulation seen over the second half of last year. More recently, the book value of inventories is reported to have increased at a \$70 billion rate in April; we estimate that just over one-half of this increase represents an accumulation in real stocks.

Since the turn of the year, the ratio of book-value inventories to sales has held steady after falling noticeably last year. Information from the staff's flow-of-goods inventory system also suggests that—excluding motor vehicles and parts—months' supply has changed little this year after declining rapidly toward the end of last year. Except for paper products, inventories appear to be well aligned with demand. Similarly, business surveys suggest that firms view the current level of their customers' inventories as being within a comfortable range.

Federal Government

The federal budget deficit narrowed further in April and May. According to the Monthly Treasury Statement, the federal government recorded a surplus of \$76 billion over the past two months, compared with a \$22 billion surplus in the same period last year. Over the twelve months ending in May, the deficit was \$273 billion, \$66 billion smaller than the deficit over the same period a year ago.

The improvement in the federal budget balance has resulted from strong inflows of tax receipts, which have outpaced the growth in nominal income so far this year. After adjusting for payment-timing shifts, total receipts were 16 percent higher in April and May than in the comparable period last year. Individual tax payments were up significantly in April and May, with particular strength in nonwithheld payments—which

¹¹ First published last fall, the architectural billings index includes billings for both nonresidential and residential construction projects, but the overwhelming majority of these projects (about 88 percent) are nonresidential.

Federal Government Outlays and Receipts

(Unified basis; billions of dollars except as noted)

Function or source	April-May			12 months ending in May		
	2005	2006	Percent change	2005	2006	Percent change
Outlays	408.1	431.7	5.8	2402.2	2602.4	8.3
Financial transactions ¹	-.8	-.3	...	-.8	-1.1	...
Payment timing ²	1.4	-17.1	...	1.3	-.3	...
Adjusted outlays	407.4	449.0	10.2	2401.7	2603.8	8.4
Receipts	430.3	507.7	18.0	2063.3	2329.4	12.9
Payment timing ²	.0	-9.0	...	.0	.0	...
Adjusted receipts	430.3	498.7	15.9	2063.3	2329.4	12.9
Surplus or deficit (-)	22.3	76.0	...	-338.9	-273.1	...
<i>Selected components of adjusted outlays and receipts</i>						
Adjusted outlays	407.4	449.0	10.2	2401.7	2603.8	8.4
Net interest	36.5	38.8	6.2	172.9	207.7	20.2
Non-interest	370.9	410.3	10.6	2228.8	2396.1	7.5
National defense	79.3	86.8	9.5	477.5	514.4	7.7
Social Security	87.7	92.9	5.9	512.6	543.2	6.0
Medicare	47.4	56.6	19.4	284.7	322.4	13.2
Medicaid	30.4	29.0	-4.6	180.3	180.0	-.1
Income security	57.5	61.2	6.3	342.4	351.5	2.6
Agriculture	1.4	1.3	...	26.2	32.0	22.4
Other	67.2	82.5	22.9	405.2	452.6	11.7
Adjusted receipts	430.3	498.7	15.9	2063.3	2329.4	12.9
Individual income and payroll taxes	340.2	400.4	17.7	1627.1	1790.7	10.1
Withheld + FICA	237.9	256.2	7.7	1460.0	1564.1	7.1
Nonwithheld + SECA	172.1	206.9	20.2	345.4	413.9	19.8
Less: Refunds	69.8	71.8	2.8	180.5	187.3	3.8
Corporate	41.6	53.7	29.2	234.7	320.9	36.7
Gross	45.3	56.8	25.2	265.4	348.8	31.4
Less: Refunds	3.8	3.1	-17.8	30.7	28.0	-9.0
Other	48.6	44.7	-8.0	201.5	217.8	8.1
Adjusted surplus or deficit (-)	22.9	49.7	...	-338.4	-274.5	...

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

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

2. A shift in payment timing occurs when the first of the month falls on a weekend or holiday, or when the first 3 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. In addition, defense outlays for retiree health care have been converted from an annual to a monthly basis. Tax refunds and EITC outlays have been adjusted to reflect a calendar anomaly that held down refund payments in April.

... Not applicable.

Source. Monthly Treasury Statement.

are mostly final payments on last year's individual tax liability. Corporate tax payments were a robust 25 percent higher in April and May than a year earlier. Data from Daily Treasury Statements for June show an increase of about 15 percent in corporate quarterly payments of estimated tax liability relative to last year's level.

Federal outlays also have increased at a faster pace than nominal income over the past year, but at a slower pace than receipts. Outlays in the past two months, adjusted for payment-timing shifts, were 10 percent higher than during the same period last year. Defense spending in April and May was 9½ percent higher than the year-ago level. Medicare spending in the past two months was 19½ percent above its year-ago level and has been boosted significantly by payments for the new Part D prescription drug benefit. Medicaid spending was about 5 percent lower in April and May than it was last year; this decline reflects the shift to Medicare of drug spending for elderly Medicaid patients as well as an apparent overall deceleration in underlying Medicaid spending.

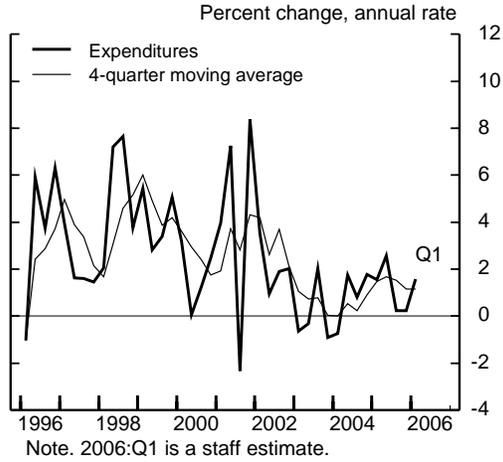
The Congress has passed two pieces of legislation that affect the budget. The tax reconciliation bill enacted in May is estimated to reduce revenues by about \$70 billion over the next five years. This legislation extended relief from the alternative minimum tax through 2006 for many individuals and delayed the expiration of the reduced tax rates on capital gains and dividends from 2008 to 2010. The Congress also passed a supplemental appropriations bill that provides about \$70 billion in additional funding for activities related to the war in Iraq and Afghanistan, \$20 billion for additional hurricane disaster relief, about \$2½ billion for avian flu preparedness, and \$2 billion for increased border patrols. Finally, in response to recent court rulings, the Treasury has decided to eliminate the 3 percent excise tax on long-distance telephone service beginning in August, which will likely reduce revenues by about \$5 billion per year. In addition, the Treasury will refund an estimated \$13 billion in excise tax payments made by individuals and businesses over the past three years; these refunds will take place during the tax refund season in 2007.

State and Local Government Sector

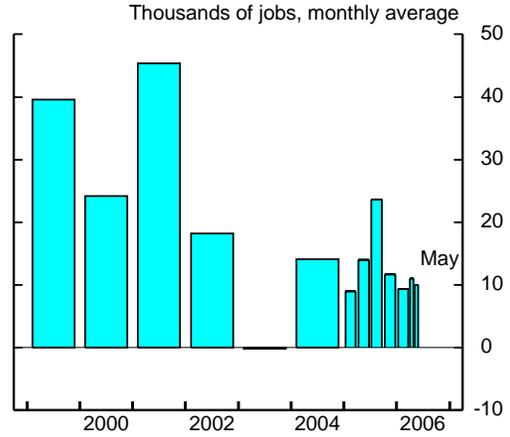
Real purchases by state and local governments have risen sluggishly over the past several years, and the recent monthly data suggest a continuation of this trend. Employment rose about 10,000 per month in April and May, a rate of increase similar to that of the past two quarters. As has been the case for some time, most of the hiring was done by local governments. Similarly, real construction is estimated to have posted a small increase in the first quarter after little change, on balance, in 2005. In April, construction spending was 0.7 percent above the average level in the first quarter in nominal terms, but we estimate that increases in the prices of construction-related materials more than accounted for this rise.

State and Local Indicators

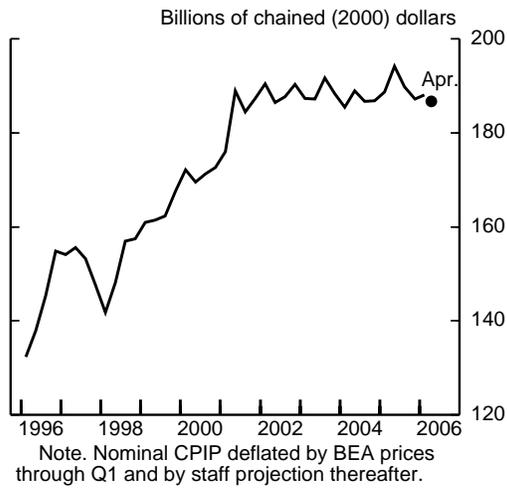
Real Expenditures on Consumption and Investment



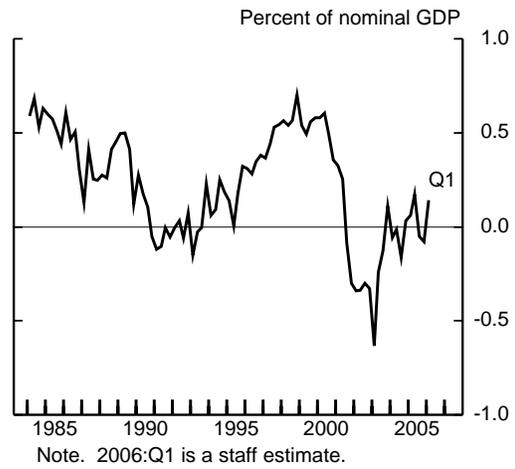
Net Change in Employment



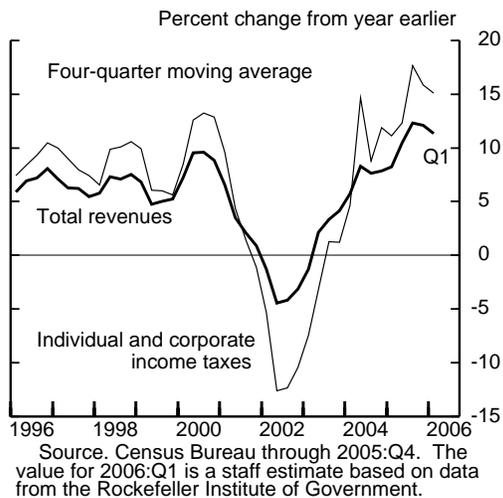
Real Construction



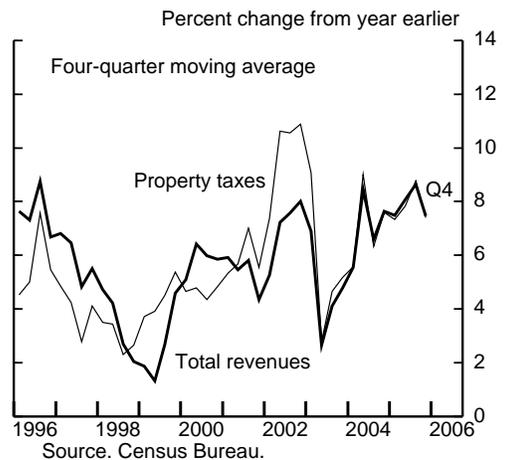
Net Saving



State Revenues



Local Revenues



Recently, states have reported surprisingly strong tax collections. The National Association of State Budget Officers (NASBO) expects that state revenues for the 2006 fiscal year, which ends on June 30 for forty-six states, will be 3½ percent higher than anticipated by states at the time budgets were enacted. The revenue surprise is the result of stronger-than-expected personal and corporate income tax receipts. NASBO also reported that, despite significant increases in nominal spending, state year-end balances are expected to equal 8 percent of general fund expenditures, a figure significantly above the 5 percent threshold generally considered to constitute adequate fiscal reserves.¹² In addition, the Rockefeller Institute's *State Revenue Report* suggests that revenues increased briskly in most states over the year ending in the first quarter. And for the second quarter, the available evidence points to unusually strong personal income tax collections.¹³

Prices

Rates of price inflation have picked up in recent months. The overall CPI rose 0.4 percent in May and was boosted for a third straight month by a sharp increase in energy prices. Moreover, the CPI for items excluding food and energy posted its third consecutive increase of 0.3 percent after average increases of 0.2 percent per month during the preceding three months. On the basis of these CPI data, we estimate that core PCE prices rose about 0.3 percent last month, putting the twelve-month change in that measure at 2.2 percent in May, a touch higher than the increase over the previous twelve-month period. However, we estimate that core PCE prices rose at a much more rapid annual rate of 3.4 percent over the three months ending in May.

Consumer food prices have decelerated markedly since January because of slower price increases for food away from home and because of a reversal of earlier run-ups in the prices of fruits and vegetables. Although strong demand has boosted prices for wheat and corn recently, higher grain prices have as yet had little effect on retail prices of food; furthermore, ample supplies of livestock and poultry have helped to moderate increases in consumer prices for meat and poultry products.

The jump in consumer energy prices in May extended the pattern of exceptionally steep increases seen in the preceding few months. Over the first five months of the year, we estimate that the index of PCE energy prices rose at an annual rate in excess of 30 percent, compared with the 17 percent increase posted over the twelve months of both 2004 and 2005.

¹² General fund expenditures constitute 43 percent of total state expenditures.

¹³ For example, California reported that final payments of personal income tax liabilities were 40 percent above the previous year. More broadly, state personal income tax payments are correlated with federal income tax payments, which were unusually strong this spring.

Measures of Inflation
(Percent)

Measures	12-month change		3-month change		1-month change	
	May 2005	May 2006	Annual rate		Monthly rate	
			Feb. 2006	May 2006	Apr. 2006	May 2006
<i>CPI</i>						
Total	2.8	4.2	2.7	5.7	.6	.4
Food	2.4	1.9	2.7	.6	.0	.1
Energy	9.9	23.6	6.3	35.0	3.9	2.4
Ex. food and energy	2.2	2.4	2.0	3.8	.3	.3
Core goods	.6	.3	.3	1.7	.1	.1
Core services	2.7	3.3	3.0	4.4	.3	.4
Chained CPI (n.s.a.) ¹	2.4	3.4	...	...	...	...
Ex. food and energy ¹	2.0	2.2	...	...	...	...
<i>PCE prices</i> ²						
Total	2.5	3.3	2.1	5.2	.5	.4
Food	2.2	2.0	2.5	1.8	.1	.2
Energy	10.1	23.3	6.4	41.3	4.5	2.8
Ex. food and energy	2.0	2.2	1.7	3.4	.2	.3
Core goods	.2	-.2	-.3	1.5	.1	.0
Core services	2.8	3.1	2.6	4.2	.3	.3
Core market-based	1.7	1.8	1.3	3.2	.2	.3
Core non-market-based	3.6	n.a.	3.4	n.a.	.4	n.a.
<i>PPI</i>						
Total finished goods	3.6	4.5	-1.5	6.7	.9	.2
Food	.8	-1.5	-7.7	.8	.1	-.5
Energy	10.5	20.6	-9.1	27.8	4.0	.4
Ex. food and energy	2.8	1.5	3.4	2.0	.1	.3
Core consumer goods	2.8	1.6	3.9	1.9	.1	.2
Capital equipment	2.8	1.4	2.5	2.5	.2	.3
Intermediate materials	6.3	8.9	3.8	7.6	.9	1.1
Ex. food and energy	5.4	6.3	6.8	6.9	.4	1.1
Crude materials	5.4	8.6	-40.2	1.5	1.2	2.0
Ex. food and energy	10.7	26.7	20.4	57.3	4.7	6.2

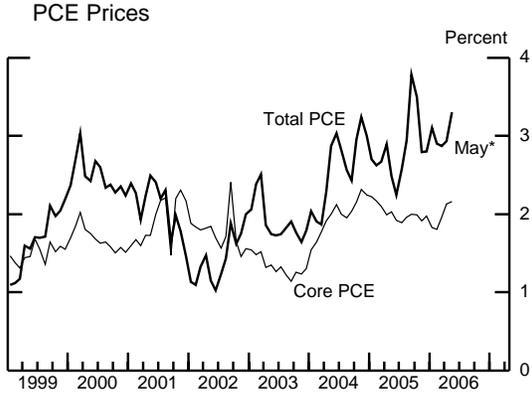
1. Higher-frequency figures are not applicable for data that are not seasonally adjusted.

2. PCE prices in May are staff estimates.

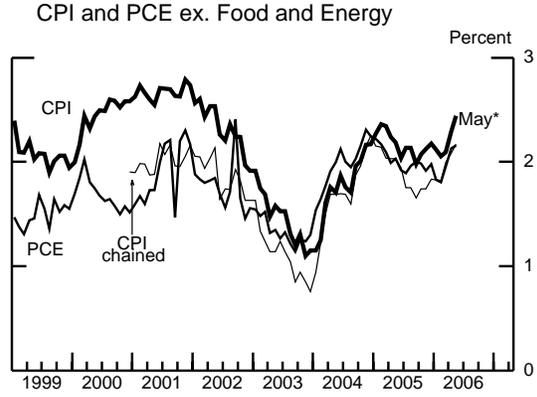
... Not applicable.

n.a. Not available.

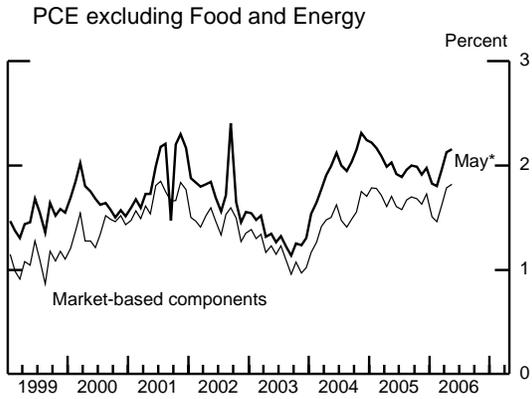
Consumer Price Inflation (12-month change except as noted)



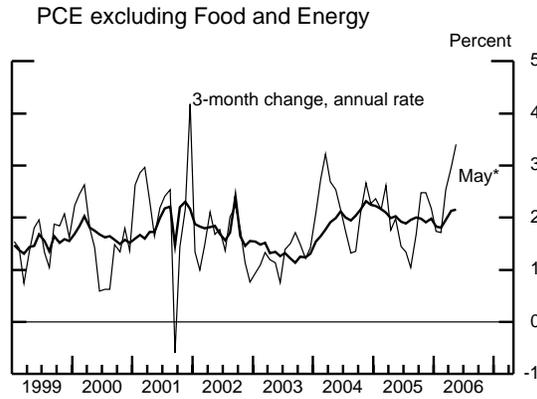
* Staff estimate.



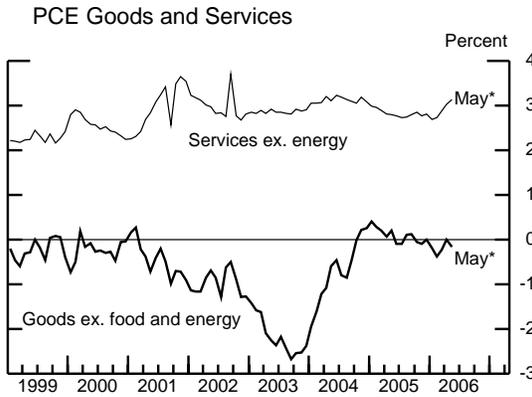
* PCE for May is a staff estimate.



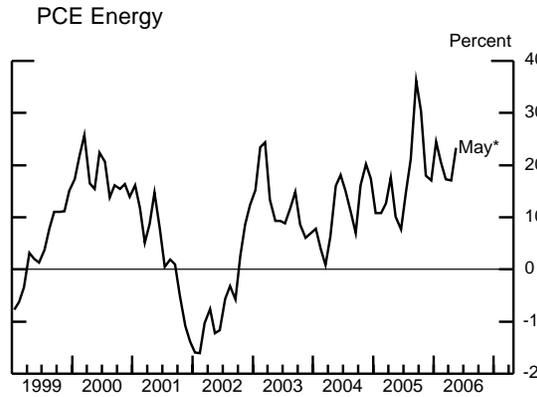
* Staff estimate.



* Staff estimate.



* Staff estimate.

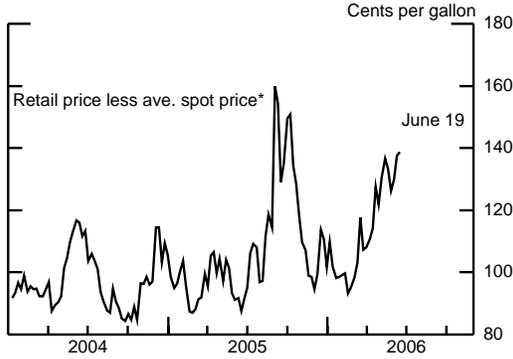


* Staff estimate.

Energy Prices and Inventories

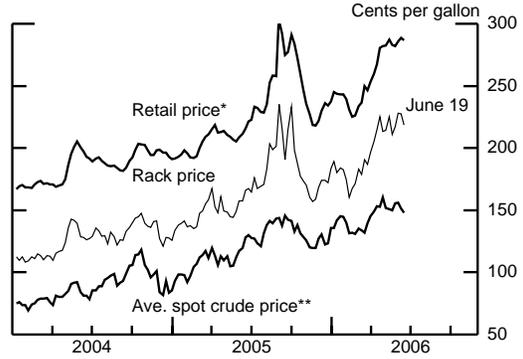
(Data from Energy Information Administration except as noted)

Total Gasoline Margin



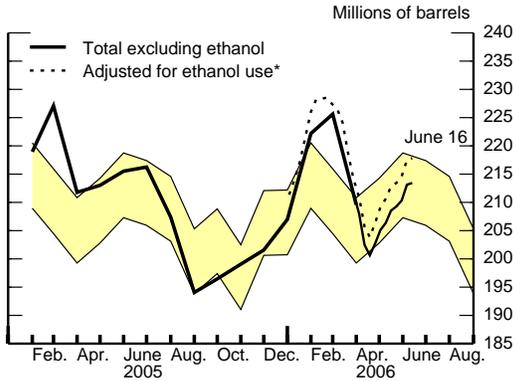
* Regular grade seasonally adjusted by FRB staff, less average spot crude price: 60% WTI, 40% Maya heavy crude.

Gasoline Price Decomposition



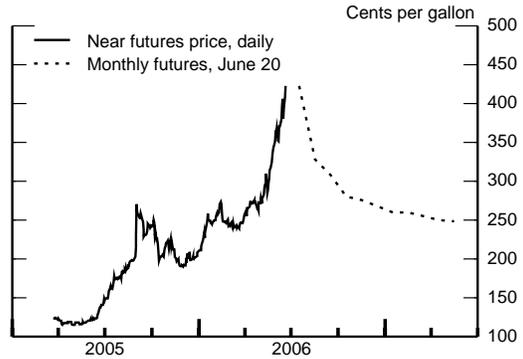
* Regular grade seasonally adjusted by FRB staff.
** 60% WTI, 40% Maya heavy crude.

Gasoline Inventories



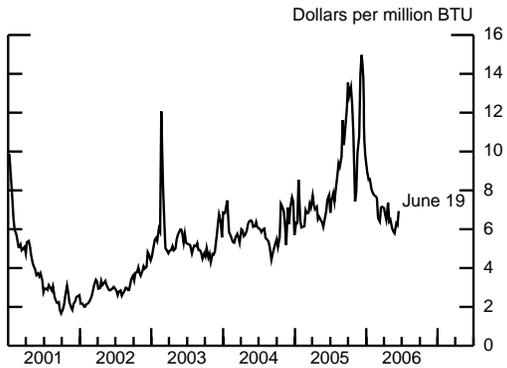
Note. Shaded region is average historical range as calculated by DOE. Weekly data as of April 2006.
* Inventories of RBOB gasoline augmented to reflect fuel ethanol to be blended; estimated by FRB staff.

Ethanol Prices



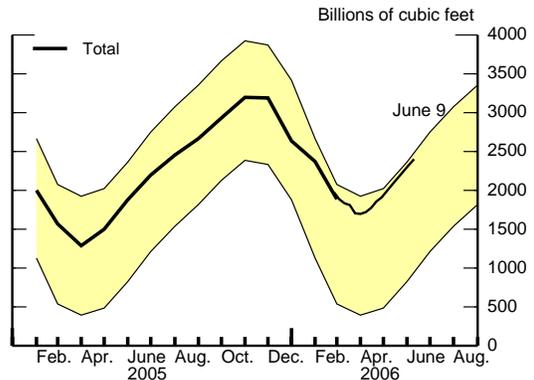
Source. Chicago Board of Trade.

Natural Gas Prices



Note. National average spot price.
Source. Bloomberg.

Natural Gas Inventories



Note. Shaded region is historical range for 2000 to 2004 as calculated by FRB staff. Weekly data as of March 2006.

Almost all of the increase in PCE energy prices since the beginning of this year reflects higher prices of petroleum-based products. Most notably, the index for consumer gasoline prices increased an estimated 4.9 percent in May and has risen more than 20 percent (not at an annual rate) so far this year. For June, however, preliminary survey data suggest little change in retail gasoline prices. The recent rise in retail gasoline prices is due in roughly equal measure to higher crude oil costs and to higher margins between retail and crude prices. This unusually wide gap does not reflect an unusual shortfall in gasoline supplies; gasoline inventories seem typical for the season. Rather, it reflects both the extra cost of producing and distributing reformulated gasoline with ethanol (relative to gasoline with MTBE, which was in common use before May) and concerns about possible shortfalls in ethanol supplies this summer.¹⁴

In marked contrast with gasoline, a surprisingly persistent glut of natural gas supplies has caused spot prices of natural gas to plunge since the beginning of the year, a full reversal of last autumn's sharp increases. This collapse of spot prices has led to a substantial downturn in consumer prices for natural gas, which have declined nearly 15 percent since January.

The extent to which the pass-through of higher petroleum prices has contributed to the recent pickup in core consumer price inflation is difficult to estimate. However, many businesses clearly are experiencing higher costs, and energy prices have shown through to PPIs for a variety of energy-intensive intermediate goods—including industrial chemicals, asphalt, plastics, and fertilizers—and intermediate services such as transportation. Among finished core consumer goods and services, energy constitutes an especially large fraction of input costs for transportation services such as airline travel, in which both CPI and PCE prices (which are measured independently and differently) have risen sharply over the past twelve months.

An acceleration in housing rents—both tenant-occupied and especially owner-occupied—has also contributed significantly to the increase in core inflation in recent months (particularly for the CPI, in which the weight of housing is higher than in the PCE price index). Tenants' rents are likely inversely related to the affordability of owner-occupied housing, and the deterioration of housing affordability (due to rising house prices and

¹⁴ Strong demand has pushed spot prices of ethanol sharply higher in recent months. For July delivery, ethanol is about \$2 per gallon more expensive than gasoline at the point of production, which—because ethanol accounts for one-tenth of the new reformulated gasoline—adds about 20 cents per gallon to the retail cost of reformulated gasoline; in addition, transport and blending costs are higher for gasoline-ethanol mixes than for conventional or MTBE-based gasoline. However, ethanol production capacity is expanding rapidly, and futures prices suggest a marked downturn in ethanol prices over the coming year.

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

Measure	2003	2004	2005	2006
<i>Product prices</i>				
GDP price index	2.1	2.1	2.8	3.2
Less food and energy	2.0	1.9	2.7	3.0
Nonfarm business chain price index	1.6	1.5	2.6	3.1
<i>Expenditure prices</i>				
Gross domestic purchases price index	2.6	2.1	3.1	3.5
Less food and energy	1.9	1.9	2.6	2.7
PCE price index	2.3	1.9	2.7	3.0
Less food and energy	1.5	1.7	2.2	1.9
PCE price index, market-based components	2.3	1.7	2.4	2.9
Less food and energy	1.3	1.3	1.8	1.5
CPI	2.9	1.8	3.0	3.7
Less food and energy	1.8	1.3	2.3	2.1
Chained CPI	2.5	1.7	2.7	3.1
Less food and energy	1.4	1.2	2.1	1.9
Median CPI	2.7	2.0	2.3	2.6
Trimmed mean CPI	2.1	1.7	2.3	2.6

Surveys of Inflation Expectations
(Percent)

Period	Actual CPI inflation ¹	University of Michigan				Professional forecasters (10 years) ⁴
		1 year ²		5 to 10 years ³		
		Mean	Median	Mean	Median	
2004:Q3	2.7	3.3	2.9	3.1	2.8	2.5
Q4	3.3	3.4	3.0	3.1	2.8	2.5
2005:Q1	3.0	3.6	3.0	3.2	2.8	2.5
Q2	2.9	3.9	3.2	3.3	2.9	2.5
Q3	3.8	4.3	3.5	3.5	2.9	2.5
Q4	3.7	4.6	3.7	3.5	3.1	2.5
2006:Q1	3.6	3.7	3.0	3.3	2.9	2.5
Q2	n.a.	4.6	3.6	3.6	3.1	2.5
Feb.	3.6	3.6	3.0	3.3	2.9	...
Mar.	3.4	3.8	3.0	3.3	2.9	2.5
Apr.	3.5	4.4	3.3	3.6	3.1	...
May	4.2	4.7	4.0	3.8	3.2	...
June	n.a.	4.6	3.4	3.5	3.0	2.5

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.

... Not applicable.

n.a. Not available.

mortgage rates) may be a factor contributing to the acceleration in rents.¹⁵ Although the CPI for owners' equivalent rent is derived from quotes on tenants' rents, owners' equivalent rent has increased substantially more than tenants' rent in recent months. This difference apparently reflects steeper rent increases for rental units in predominantly owner-occupied neighborhoods, as these obtain a larger weight in owners' equivalent rent.¹⁶

Although faster increases for the rent categories have been especially pronounced, the recent acceleration in core PCE prices has been evident in goods prices as well, with prices of apparel and a variety of other nondurable goods posting faster increases so far this year than they did in 2005. In addition, the nonmarket component of the PCE price index has increased at an annual rate of more than 4 percent during the first four months of this year after rising 3¼ percent in 2005. Within this category, increases in the imputed index for financial services provided without a specific fee have been especially noteworthy.

After rising in April and May, inflation expectations have recently eased a little as energy prices have leveled off. The Michigan Survey Research Center's preliminary June figure for median one-year inflation expectations moved down 0.6 percentage point, to 3.4 percent, and median five- to ten-year expectations fell 0.2 percentage point, to 3.0 percent. As of June 16, inflation compensation implied by rate spreads on nominal and CPI-indexed Treasury bonds was about 2½ percent for both five- and ten-year maturities. Both are down about 10 basis points since the May Greenbook.

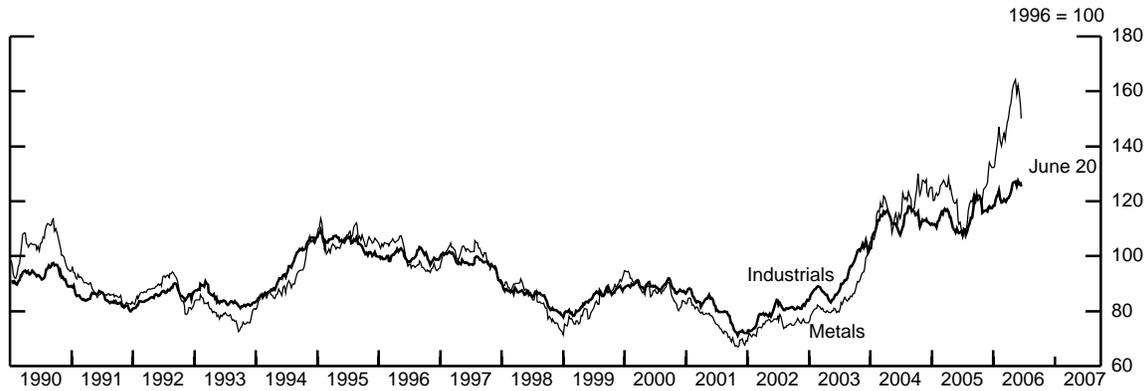
At earlier stages of processing, the PPI for core intermediate materials rose 1.1 percent in May—the largest increase since last October. Prices for core crude materials rose 6.2 percent in May after sizable increases earlier in the year; like the earlier increases, May's jump reflected large increases in prices for commodities, especially metals. Since the PPI pricing date in mid-May, prices for non-energy commodities have softened. In particular, the Journal of Commerce metals index now stands 8½ percent below its level in mid-May, reflecting widespread price declines among industrial metals. Meanwhile, spot prices of construction materials such as lumber, plywood, and oriented strand board turned down sharply during May but have flattened out more recently.

¹⁵ The National Association of Realtors' measure of housing affordability moved down substantially over the course of 2005 and has continued to decline through April of this year (the most recent reading).

¹⁶ Because some rents include utilities costs, and owners' equivalent rent is conceptually a "pure rent" measure, the BLS subtracts utility costs from these quotes before incorporating them into owners' equivalent rent. However, this utilities adjustment appears to explain only a small part of the rising discrepancy between increases in owners' equivalent rent and tenants' rent over the past several months.

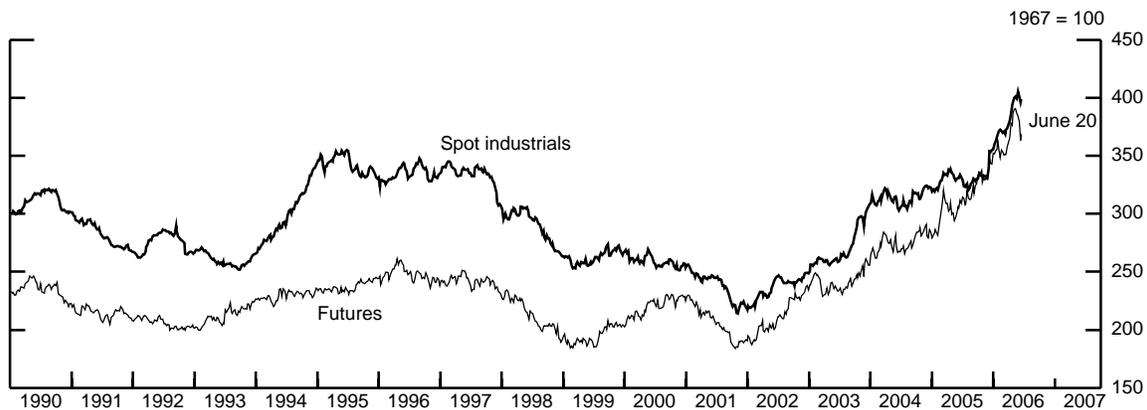
Commodity Price Indexes

Journal of Commerce



Note. The Journal of Commerce (JOC) industrial price index is based almost entirely on industrial commodities, with a small weight given to energy commodities. Copyright for Journal of Commerce data is held by CIBC, 1994.

Commodity Research Bureau



Note. The Commodity Research Bureau (CRB) spot industrials 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.

Selected Commodity Price Indexes (Percent change)

Index	2005 ¹	12/27/05 to 5/2/06 ²	5/2/06 ² to 6/20/06	52-week change to 6/20/06
JOC industrials	5.3	7.9	-1.1	15.4
JOC metals	5.8	21.9	-6.9	33.7
CRB spot industrials	10.1	11.6	.8	19.7
CRB spot foodstuffs	-6.1	3.8	2.7	-1.4
CRB futures	20.6	12.7	-4.6	18.3

1. From the last week of the preceding year to the last week of the year indicated.
2. May 2, 2006, is the Tuesday preceding publication of the May Greenbook.

Labor Costs

The sharp downward revision to private wages and salaries in the fourth quarter of last year led to a similar revision to hourly compensation.¹⁷ In particular, compensation per hour in the nonfarm business sector is now reported to have declined at an annual rate of 0.9 percent in the fourth quarter, compared with the previously reported estimate of a 2.7 percent increase. The first-quarter increase was also revised down a bit; over the year ending in the first quarter, compensation per hour is now estimated to have risen only 2.7 percent. For the moment, this revised compensation estimate is in line with the four-quarter rise in hourly compensation reported in the employment cost index (ECI). However, in contrast to the experience with the ECI, which has been posting subdued increases for some time, this small increase in nonfarm compensation per hour follows an especially large jump in the preceding year that likely reflected a surge in stock-option exercises and bonuses.

The downward revision to fourth-quarter hourly compensation does not necessarily portend any such revision to this year's data.¹⁸ We currently estimate that nonfarm compensation per hour increased at an annual rate of about 5 percent in the first quarter, and the latest readings on average hourly earnings of production or nonsupervisory workers point to a similar increase this quarter. Average hourly earnings were little changed in May after a large rise in April, and, in general, average hourly earnings have accelerated over the past year.

¹⁷ As noted earlier, this downward revision reflected the incorporation of new information on wages and salaries from unemployment insurance tax records.

¹⁸ Revisions to private wages and salaries exhibit no apparent serial correlation.

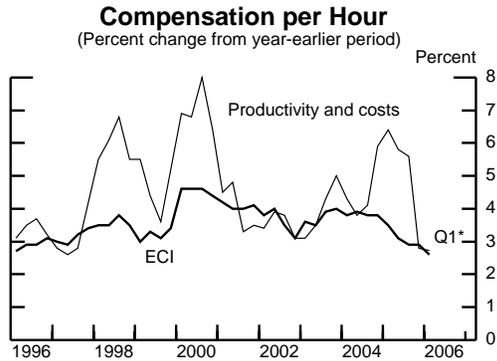
Hourly Compensation and Unit Labor Costs

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

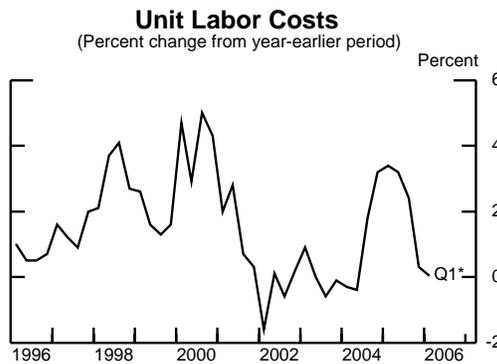
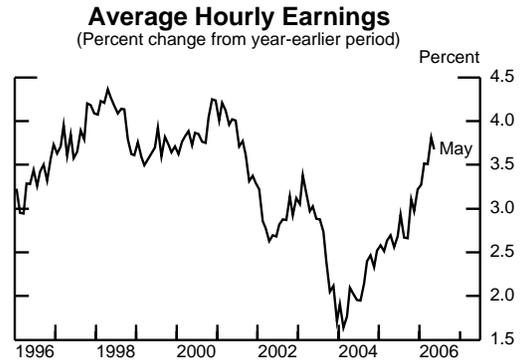
Category	2004:Q1 to 2005:Q1	2005:Q1 to 2006:Q1 ^e	2005			2006
			Q2	Q3	Q4	Q1 ^e
<i>Compensation per hour</i>						
Nonfarm business	6.4	2.7	1.3	5.5	-9	5.1
Nonfinancial corporations ¹	6.7	2.8	1.1	6.3	-8	5.0
<i>Unit labor costs</i>						
Nonfarm business	3.4	.0	-1.0	1.2	-6	.6
Nonfinancial corporations ¹	1.2	-8	-3.4	2.1	-3.2	1.3

1. All corporations doing business in the United States except banks, stock and commodity brokers, and finance and insurance companies. The sector accounts for about two-thirds of business employment.

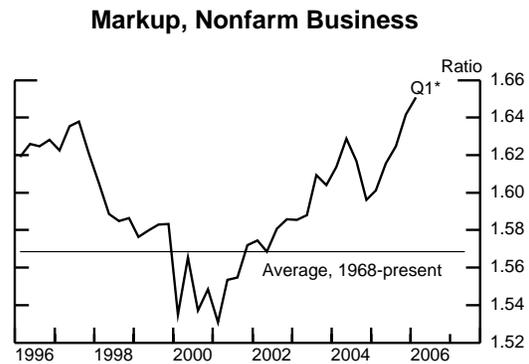
e Staff estimate.



* P&C value for 2006:Q1 is staff estimate.



* ULC value for 2006:Q1 is staff estimate.



Note. The markup is the ratio of output price to unit labor costs.

* Values for 2006:Q1 are staff estimates.

Domestic Financial Developments

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

Instrument	2004	2005	2006		Change to June 20 from selected dates (percentage points)		
	June 28	Dec. 30	May 9	June 20	2004 June 28	2005 Dec. 30	2006 May 9
<i>Short-term</i>							
FOMC intended federal funds rate	1.00	4.25	4.75	5.00	4.00	.75	.25
Treasury bills ¹							
3-month	1.36	3.99	4.76	4.80	3.44	.81	.04
6-month	1.74	4.22	4.84	5.04	3.30	.82	.20
Commercial paper (A1/P1 rates) ²							
1-month	1.28	4.23	4.98	5.22	3.94	.99	.24
3-month	1.45	4.37	5.07	5.29	3.84	.92	.22
Large negotiable CDs ¹							
3-month	1.53	4.49	5.12	5.40	3.87	.91	.28
6-month	1.82	4.65	5.24	5.52	3.70	.87	.28
Eurodollar deposits ³							
1-month	1.29	4.36	5.08	5.29	4.00	.93	.21
3-month	1.51	4.52	5.16	5.43	3.92	.91	.27
Bank prime rate	4.00	7.25	7.75	8.00	4.00	.75	.25
<i>Intermediate- and long-term</i>							
U.S. Treasury ⁴							
2-year	2.88	4.43	5.01	5.23	2.35	.80	.22
5-year	3.97	4.35	5.00	5.10	1.13	.75	.10
10-year	4.90	4.47	5.19	5.23	.33	.76	.04
U.S. Treasury indexed notes							
5-year	1.56	2.03	2.25	2.49	.93	.46	.24
10-year	2.25	2.10	2.43	2.59	.34	.49	.16
Municipal general obligations (Bond Buyer) ⁵	5.01	4.38	4.63	4.58	-.43	.20	-.05
Private instruments							
10-year swap	5.21	4.92	5.64	5.73	.52	.81	.09
10-year FNMA ⁶	5.30	4.82	5.38	5.45	.15	.63	.07
10-year AA ⁷	5.59	5.25	5.98	6.08	.49	.83	.10
10-year BBB ⁷	6.18	5.84	6.47	6.65	.47	.81	.18
5-year high yield ⁷	8.30	8.28	8.21	8.67	.37	.39	.46
Home mortgages (FHLMC survey rate) ⁸							
30-year fixed	6.21	6.21	6.58	6.63	.42	.42	.05
1-year adjustable	4.19	5.16	5.62	5.66	1.47	.50	.04

Stock exchange index	Record high		2005	2006		Change to June 20 from selected dates (percent)		
	Level	Date	Dec. 30	May 9	June 20	Record high	2005 Dec. 30	2006 May 9
Dow Jones Industrial	11,723	1-14-00	10,718	11,640	10,975	-6.38	2.40	-5.71
S&P 500 Composite	1,527	3-24-00	1,248	1,325	1,240	-18.81	-.65	-6.42
Nasdaq	5,049	3-10-00	2,205	2,338	2,107	-58.26	-4.46	-9.89
Russell 2000	782	5-5-06	673	781	678	-13.34	.64	-13.22
Wilshire 5000	14,752	3-24-00	12,518	13,457	12,459	-15.54	-.47	-7.41

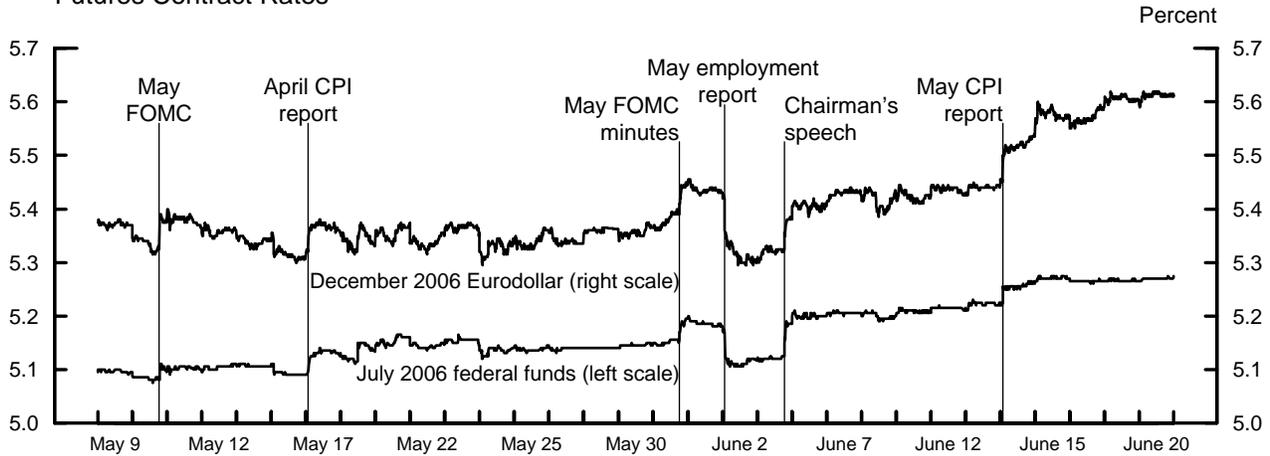
1. Secondary market.
2. Financial commercial paper.
3. Bid rates for Eurodollar deposits collected around 9:30 a.m. eastern time.
4. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
5. Most recent Thursday quote.
6. Constant-maturity yields estimated from Fannie Mae domestic noncallable coupon securities.
7. Derived from smoothed corporate yield curves estimated using Merrill Lynch bond data.
8. Home-mortgage rates for June 20, 2006, are for the week ending June 15, 2006.

NOTES:

June 28, 2004, is the day before the most recent policy tightening began.
May 9, 2006, is the day before the most recent FOMC meeting.

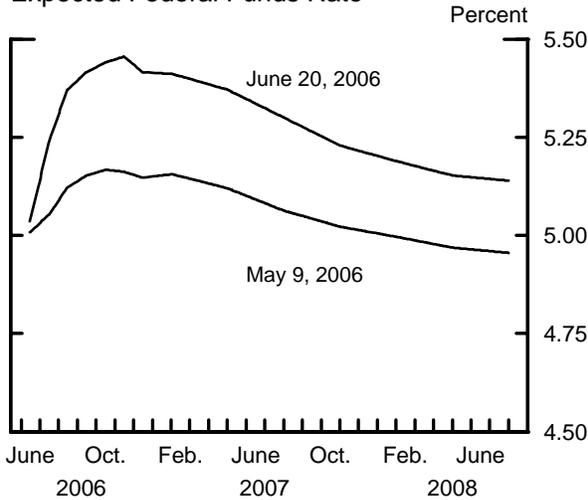
Policy Expectations and Treasury Yields

Futures Contract Rates



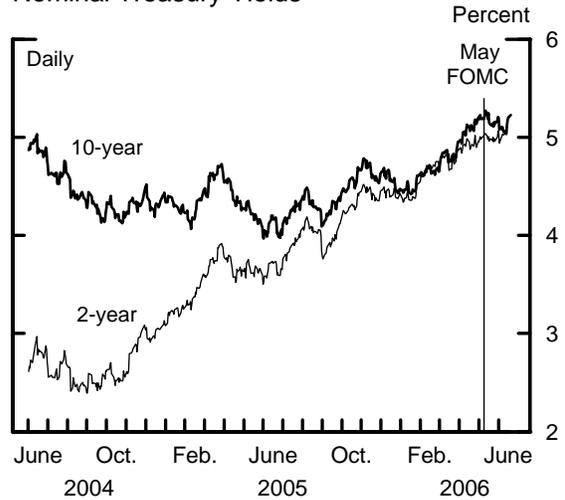
Note. 5-minute intervals.

Expected Federal Funds Rate



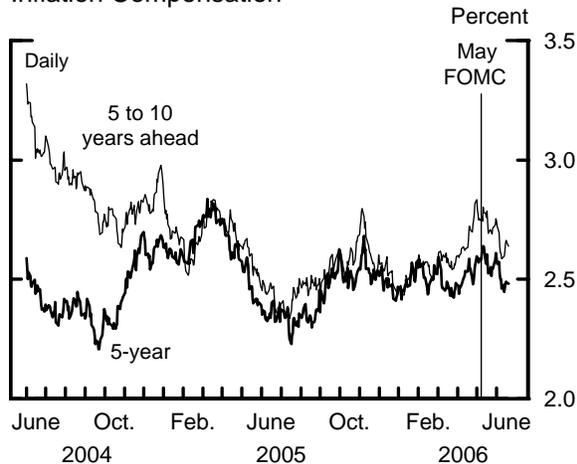
Note. Estimates from federal funds and Eurodollar futures, with an allowance for term premia and other adjustments.

Nominal Treasury Yields



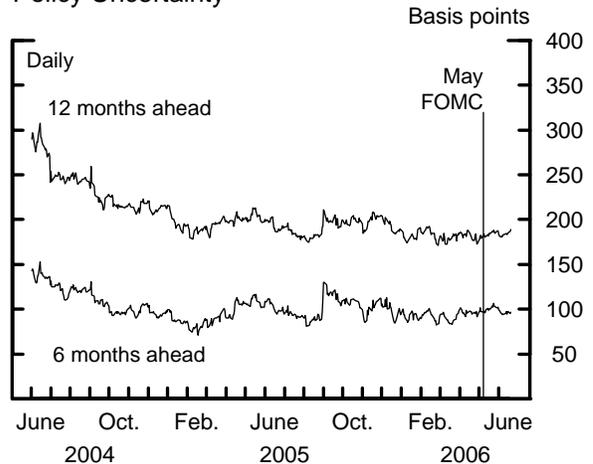
Note. Estimates from smoothed Treasury yield curve based on off-the-run securities.

Inflation Compensation



Note. Estimates based on smoothed nominal and inflation-indexed Treasury yield curves and adjusted for the indexation-lag effect.

Policy Uncertainty



Note. Width of a 90 percent confidence interval for the federal funds rate computed from the term structures for both the expected federal funds rate and implied volatility.

Domestic Financial Developments

Overview

The expected path of the federal funds rate shifted up over the intermeeting period, particularly for the near term, as market participants interpreted Federal Reserve communications and higher-than-anticipated readings on core consumer price inflation as pointing to further tightening of monetary policy. Data on real activity generally fell short of market expectations over the intermeeting period. The resulting perceived reduction in economic momentum, along with expectations of tighter monetary policy, led investors to reduce the inflation compensation built into market yields. Although near-term indicators of corporate credit quality remained quite favorable, spreads on corporate bonds widened a bit and equity prices dropped appreciably over the intermeeting period, likely reflecting the less favorable prospects for economic growth and some increase in risk premiums. Rapid growth of household mortgage debt earlier this year pushed the financial obligations ratio higher, but household delinquency rates continued to be low.

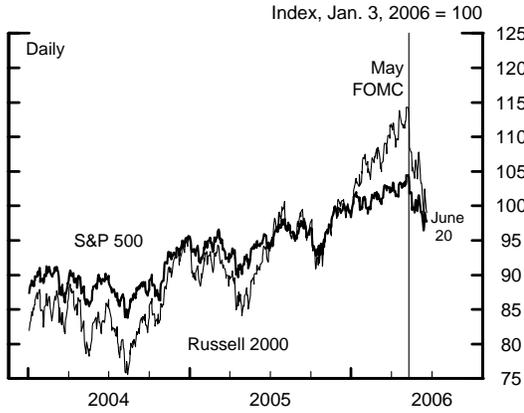
Policy Expectations and Interest Rates

Although the decision at the May FOMC meeting to increase the target federal funds rate 25 basis points was anticipated, market participants marked up the expected path of policy, particularly in the near term, as investors reportedly focused on the indication of upside risks to inflation in the accompanying statement. FOMC communications over the intermeeting period, including speeches by policymakers and the minutes of the May meeting, were also interpreted as signaling an increased probability of further policy tightening. Market participants are now virtually certain of a 25 basis point increase at the June FOMC meeting and place better-than-even odds on a further tightening in August. The expected federal funds rate at the end of 2006 climbed about 25 basis points, to 5.4 percent, while the expected policy path at the end of 2007 moved up 20 basis points to 5.2 percent. Despite increased volatility in other markets, uncertainty about the future path of policy, as inferred from Eurodollar-implied volatilities, was little changed over the intermeeting period.

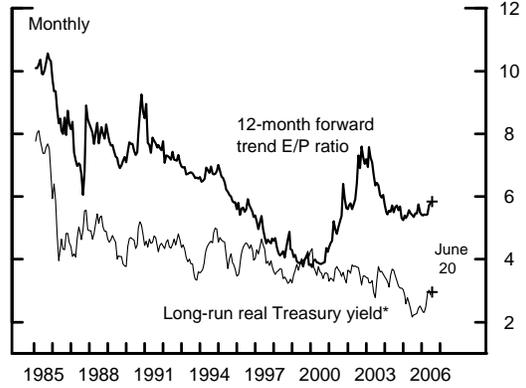
In line with the upward revision to the expected policy path in the near term, two-year Treasury yields rose about 20 basis points over the intermeeting period. The configuration of rate changes in the Treasury market suggests that investors have revised up their outlook for real interest rates and believe that this restraint will keep inflation in check. Nominal ten-year Treasury yields were little changed, while those on ten-year indexed notes were up about 15 basis points. Despite higher-than-expected core CPI data

Corporate Yields, Risk Spreads, and Stock Prices

S&P 500 and Russell 2000

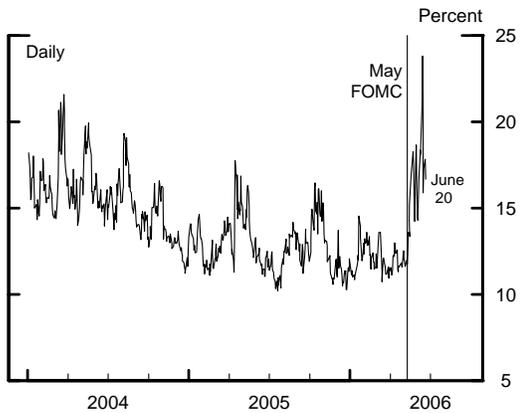


Trend Earnings-Price Ratio for S&P 500 and Long-Run Treasury Yield

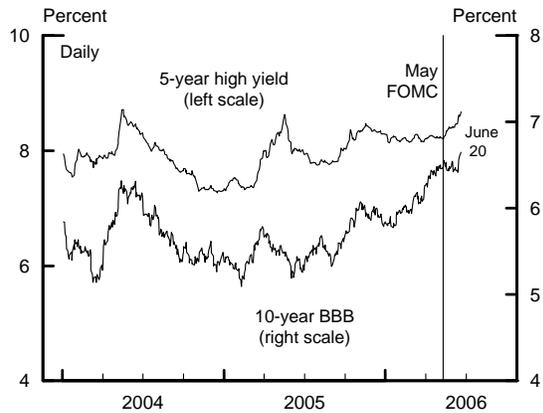


* Yield on synthetic Treasury perpetuity minus Philadelphia Fed 10-year expected inflation.
 + Denotes the latest observation using daily interest rates and stock prices and latest earnings data from I/B/E/S.

Implied Volatility on S&P 500 (VIX)

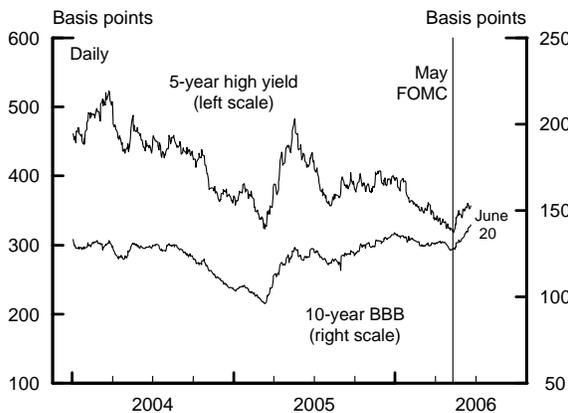


Yields for BBB and High-Yield Corporate Bonds



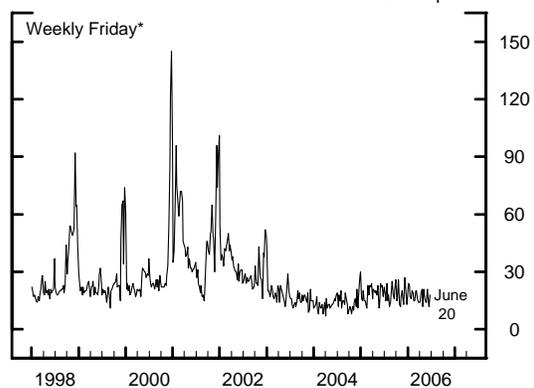
Note. Yields from smoothed yield curves based on Merrill Lynch bond data.

Corporate Bond Spreads



Note. Measured relative to comparable-maturity Treasuries.

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



* Latest observation is for most recent business day.

for April and May, five-year TIPS-based inflation compensation fell 14 basis points, and inflation compensation over the subsequent five years declined nearly as much.

Stock Prices and Corporate Interest Rates

Broad equity indexes were weighed down by tighter expected monetary policy, weaker-than-anticipated economic data, and an apparent pullback from risk-taking by investors. Equity-market indexes sank 6 to 13 percent, on net, over the intermeeting period, reversing roughly all the gains that had been registered earlier this year. The fall in equity prices left the forward earnings-price ratio a bit higher, and the gap between this ratio and the long-run real Treasury yield—a rough measure of the equity premium—widened slightly over the intermeeting period. Share prices fell the most in the cyclically sensitive sectors that had logged the largest gains in the previous months, including basic materials producers and small-cap firms. After hovering at very low levels earlier in the year, implied volatility on the S&P 500 increased sharply, a move consistent with greater uncertainty about the outlook.

Price movements for corporate bonds were less pronounced, as concern over near-term credit risk has apparently remained subdued. Although risk spreads on BBB corporate bonds widened about 15 basis points over the intermeeting period and spreads on high-yield bonds moved up about 35 basis points, these spreads remain relatively low. The increases were generally larger in the portion of the forward curve more than five years ahead, which suggests that the rise in spreads largely reflects an increase in risk premiums rather than the perception of heightened default risk (which would tend to be concentrated in the nearer-dated part of the curve). In the commercial paper market, the thirty-day quality spread remained low.

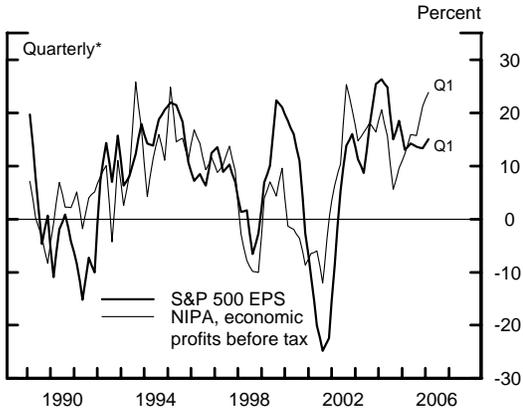
Corporate Earnings and Credit Quality

In the first quarter, aggregate earnings per share for the S&P 500 increased 15 percent from its year-earlier level. The increase in NIPA profits over the same period came in at 25 percent, having been boosted by particularly large gains among smaller firms. Analysts revised up their year-ahead earnings expectations through mid-May on the broadly positive news in the first-quarter earnings reports. Revisions to S&P 500 earnings forecasts so far in June have been slightly positive on balance.

Robust earnings continue to sustain strong corporate balance sheets. Corporate leverage has remained very low, and liquidity has stayed quite high; the first-quarter data showed only small reversals in these trends. Meanwhile, downgrades of bond ratings subsided in

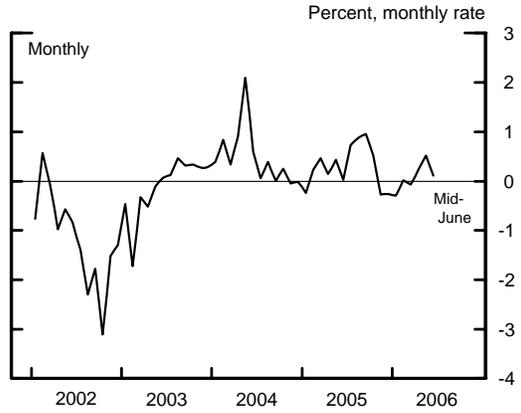
Corporate Earnings and Credit Quality

Corporate Earnings Growth



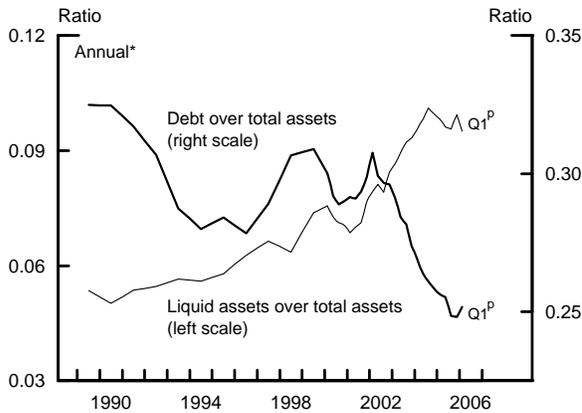
* Change from four quarters earlier.
Source: I/B/E/S for S&P 500 EPS.

S&P 500 EPS Revisions Index



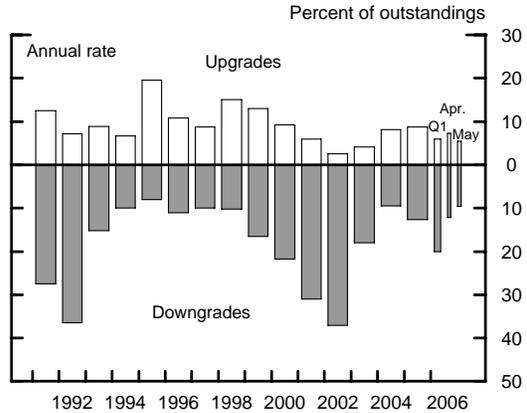
Note. Index is a weighted average of the percent change in the consensus forecasts of current-year and following-year EPS for constant sample.

Financial Ratios for Nonfinancial Corporations



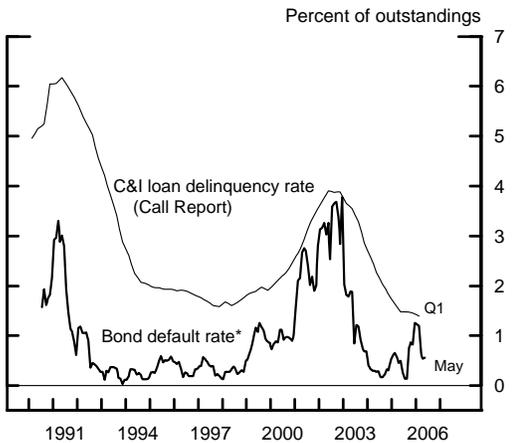
Note. Compustat data.
* Data are quarterly starting in 2000:Q1.
p Preliminary.

Bond Ratings Changes of Nonfinancial Companies



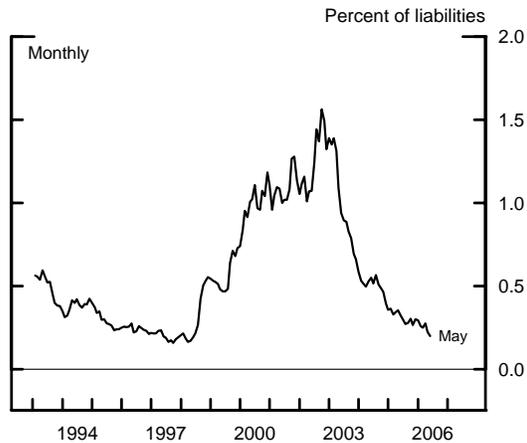
Source. Calculated with data from Moody's Investors Service.

Bond Default and C&I Loan Delinquency Rates



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

Expected Year-Ahead Defaults



Note. Firm-level estimates of default weighted by firm liabilities as a percent of total liabilities, excluding defaulted firms.
Source. Moody's KMV.

Business Finance

Gross Issuance of Securities by U.S. Corporations

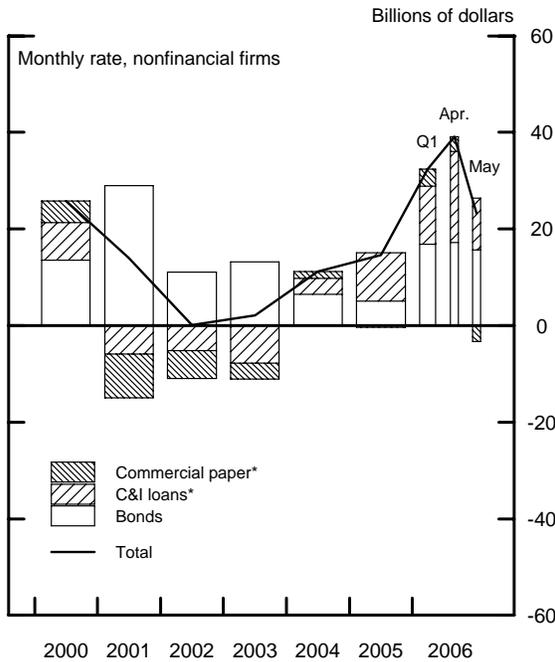
(Billions of dollars; monthly rates, not seasonally adjusted)

Type of security	2002	2003	2004	2005		2006		
				H1	H2	Q1	Apr.	May
<i>Nonfinancial corporations</i>								
Stocks ¹	5.2	3.7	5.4	3.8	5.3	5.6	3.3	5.4
Initial public offerings	.7	.4	1.6	1.6	1.8	1.7	1.7	2.7
Seasoned offerings	4.4	3.3	3.8	2.1	3.5	3.9	1.6	2.7
Bonds ²	24.8	31.6	22.8	18.1	20.3	29.1	26.6	32.6
Investment grade	15.7	16.0	8.3	7.9	9.0	15.7	11.0	18.5
Speculative grade	4.8	11.3	9.5	6.2	6.5	6.8	6.0	7.1
Other (sold abroad/unrated)	4.2	4.3	4.9	4.0	4.8	6.6	9.5	7.0
<i>Memo</i>								
Net issuance of commercial paper ³	-5.7	-3.4	1.5	2.6	-3.4	3.5	3.0	-3.3
Change in C&I loans at commercial banks ^{3,4}	-5.2	-7.7	3.3	9.4	10.5	12.0	18.9	10.8
<i>Financial corporations</i>								
Stocks ¹	4.0	6.6	6.9	5.3	4.8	3.6	4.4	6.3
Bonds ²	87.0	111.1	139.4	167.3	185.7	180.1	138.3	138.0

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

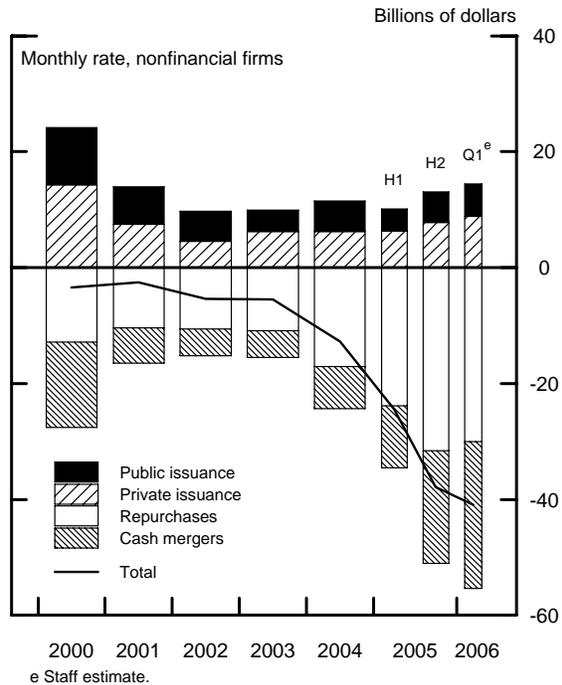
1. Excludes private placements and equity-for-equity swaps that occur in restructurings.
2. Data include regular and 144a private placements. Bond totals reflect gross proceeds rather than par value of original discount bonds. Bonds are categorized according to Moody's bond ratings, or to Standard & Poor's if unrated by Moody's.
3. End-of-period basis, seasonally adjusted.
4. Adjusted for FIN 46 effects.

Selected Components of Net Debt Financing



* Seasonally adjusted, period-end basis.

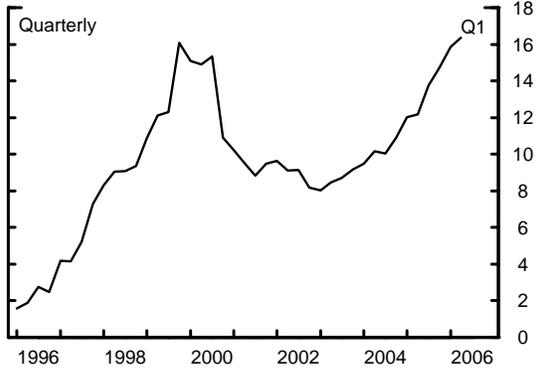
Components of Net Equity Issuance



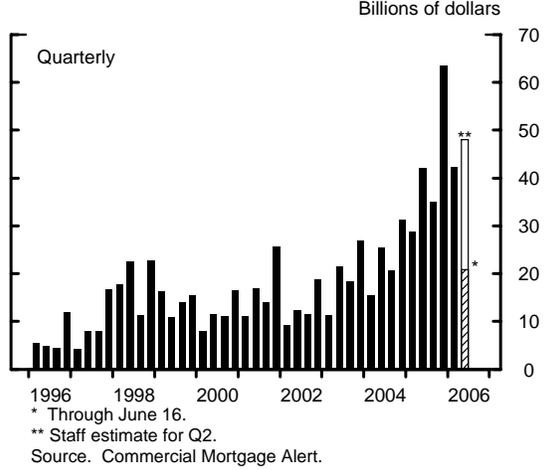
e Staff estimate.

Commercial Real Estate

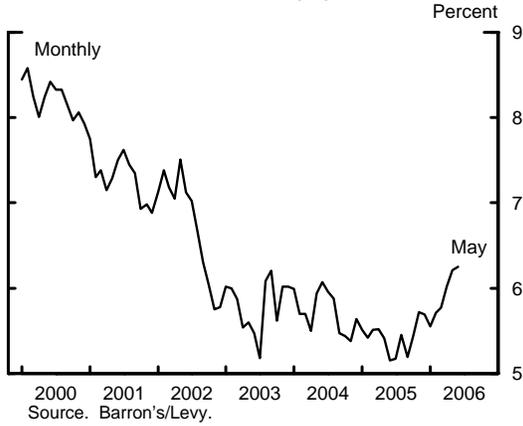
Growth of Commercial Mortgage Debt
Percent change from year earlier



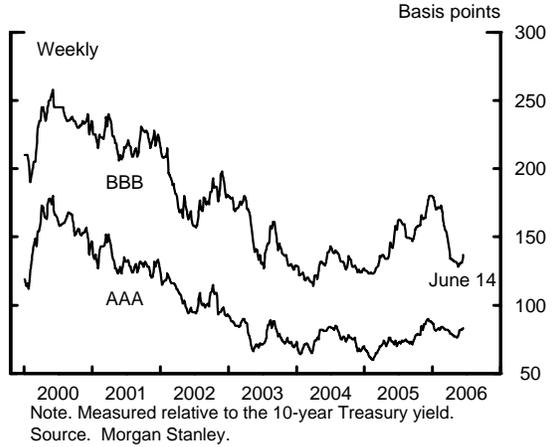
Gross Issuance of CMBS



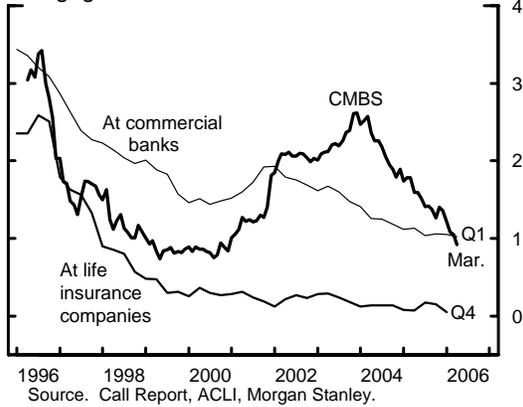
Ten-Year Commercial Mortgage Rates



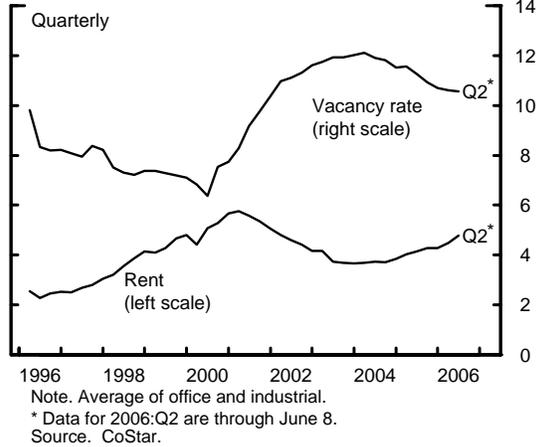
Investment-Grade CMBS Spreads



Delinquency Rates on Commercial Mortgages and CMBS



Average Rent and Vacancy Rate



April and May from their slightly elevated first-quarter pace, and the six-month trailing bond default rate remained low. Expected year-ahead defaults, as measured by Moody's KMV, continued to drift down in May, though the recent fall in stock prices and rise in equity market volatility portend an uptick in the June reading. Still, the level should remain low, an indication that the strength in aggregate credit quality is viewed as likely to persist over the near term.

Business Finance

Gross bond issuance by nonfinancial firms has remained brisk, as both investment-grade and speculative-grade companies continue to view financing conditions as favorable. C&I loans have risen smartly so far in the second quarter, while commercial paper outstanding has been about flat on balance. Overall, net debt financing by nonfinancial corporations through mid-June has nearly maintained its robust first-quarter pace.

Gross public equity issuance resumed a moderate pace in May and the first half of June, after a lull in April. Share repurchases have been supported by robust earnings and liquid balance sheets, while cash mergers have continued to be driven in large part by leveraged buyout activity. Recent data suggest that equity retirements associated with cash mergers have come down a bit from their blistering first-quarter pace, but the level of merger activity remains high.

Commercial Real Estate

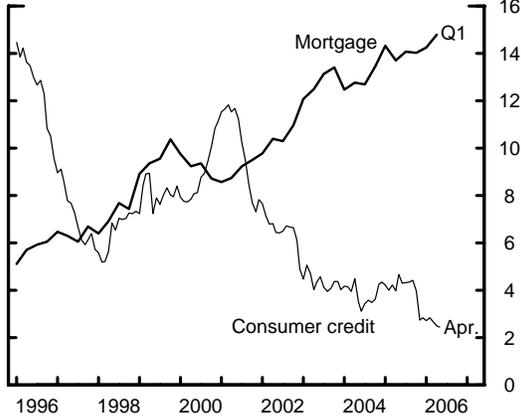
Commercial mortgage borrowing was strong again in the first quarter, reaching a level 16 percent above its year-earlier reading. The issuance calendar for commercial-mortgage-backed securities (CMBS) suggests continued strength in borrowing in the second quarter despite a rise in commercial mortgage interest rates in recent months to their highest levels in several years. Spreads of rates on investment-grade CMBS over those on comparable-maturity Treasuries have increased slightly in recent weeks but remain quite narrow. Delinquency rates on commercial mortgages and CMBS are very low by historical standards, and a decline in vacancy rates and some firming in rents in the current quarter indicate continued improvement in the fundamentals of the commercial real estate market.

Household Finance

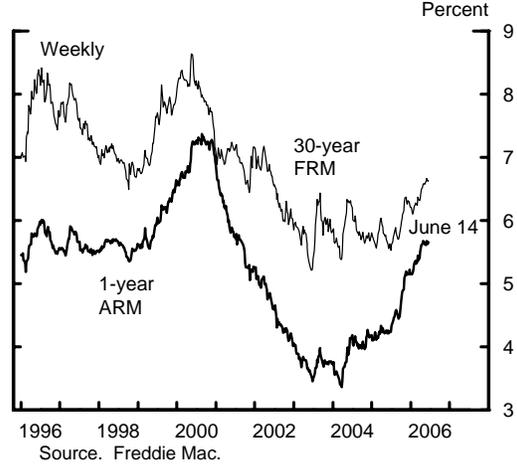
Household mortgage debt expanded rapidly in the first quarter, evidently propelled by further substantial gains in house prices and related strength in cash-out refinancing activity. Although little hard data are in hand concerning mortgage borrowing in the

Household Liabilities

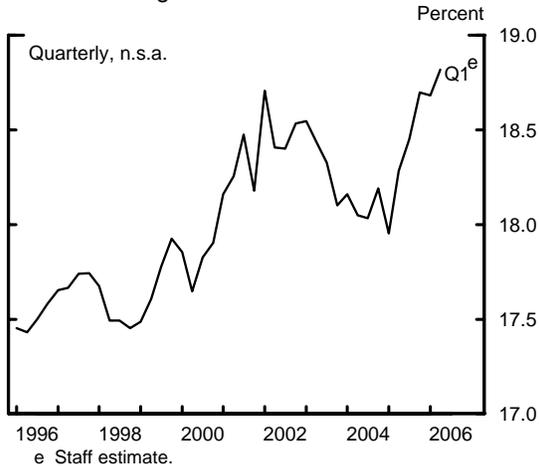
Mortgage and Consumer Debt
Percent change from year earlier



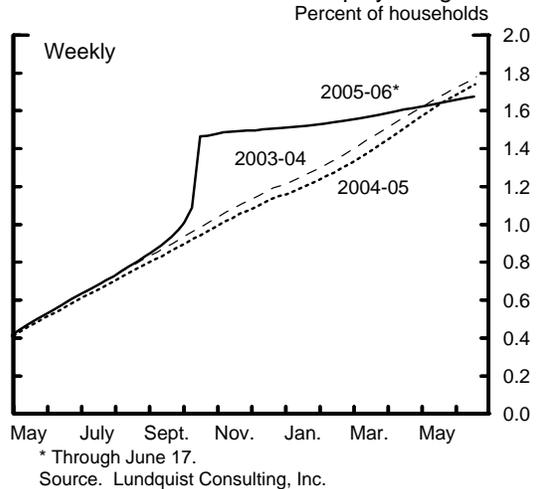
Mortgage Rates



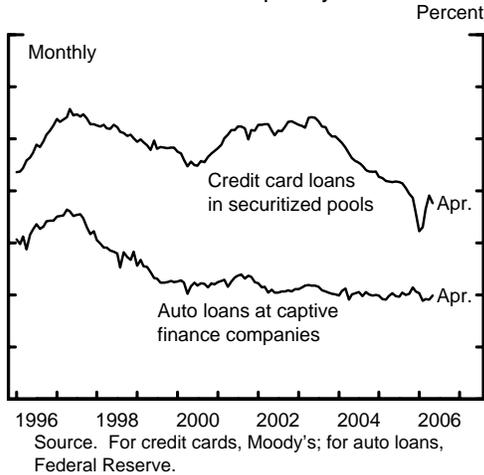
Financial Obligations Ratio



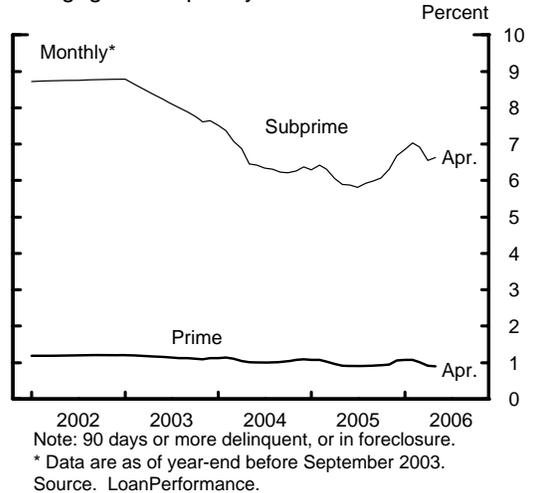
Cumulative Household Bankruptcy Filings



Consumer Credit Delinquency Rates



Mortgage Delinquency Rates



second quarter, increases in mortgage rates in recent months should be a moderating influence. Meanwhile, consumer credit was only modestly above its year-earlier level in April, as households apparently continued to shift toward mortgage debt as a means of holding down debt service payments through lower interest rates and longer amortization schedules.

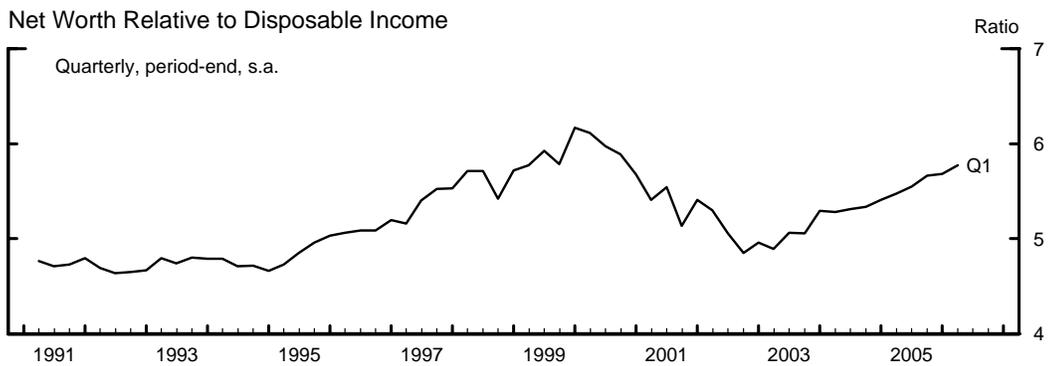
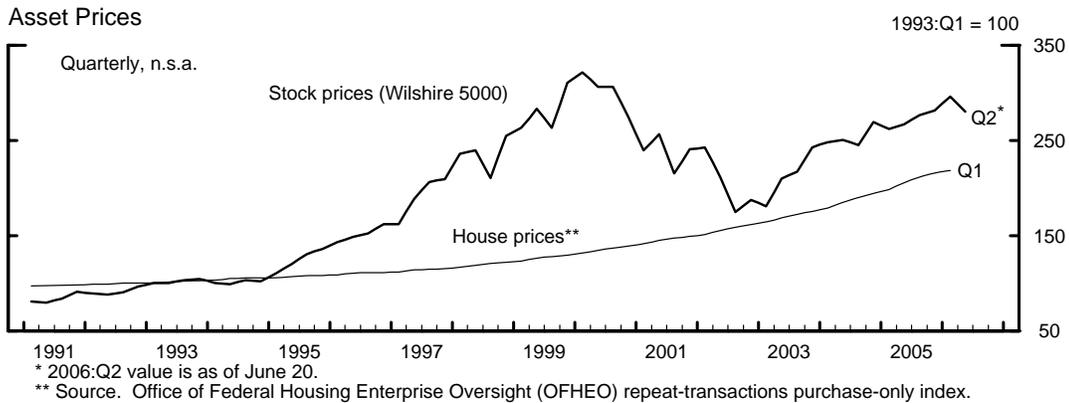
Even with the shift toward lower-cost mortgage debt, the financial obligations ratio moved up in the first quarter to a level just above the top of its historical range. However, delinquency rates on credit cards, auto loans, and prime residential mortgages have stayed low in recent months, which suggests little or no deterioration in underlying credit quality for the majority of households. Delinquencies on subprime mortgages edged down in the first quarter but remain somewhat higher than they were a year ago, even after allowing for the delinquencies induced by last fall's hurricanes.

Bankruptcy filings have been low since their spike preceding the implementation of reform in mid-October. The low levels are consistent with the view that last fall's surge represented an acceleration of planned filings to avoid the higher costs and more-stringent standards imposed by the reform. However, evidence is mounting that the lower filing numbers may represent more than just changes in timing. In the past three months, new filings have ranged between 9,000 and 13,000 per week (with no apparent trend), compared with about 25,000 to 30,000 filings per week in the period before reform began to seem likely. Filings could be down because at-risk households have been strengthening their balance sheets to avoid bankruptcy or, less favorably, because they have been deferring payments on their bills without declaring bankruptcy. Until we have further evidence on the relative roles of these explanations, it will be difficult to interpret the recent low levels of bankruptcy filings.

In the first quarter, existing home prices, as measured by the repeat-purchase index from the Office of Federal Housing Enterprise Oversight (OFHEO), increased at a seasonally adjusted annual rate of 7¼ percent. This pace, while solid, represents a deceleration from preceding quarters. Increases in prices of homes and equities contributed to a rise in net worth relative to disposable income in the first quarter. However, the drop in the stock market since early May and the expected slowing in house-price appreciation imply that this gain will be reversed in the current quarter.

Estimated net inflows to equity and bond mutual funds were sharply lower in May than in recent months. Domestic equity funds had net outflows for the month, and flows to

Household Assets



Net Flows into Long-Term Mutual Funds

(Billions of dollars, monthly rate)

Fund type	2004		2005		2006			Assets Apr.
	H1	H2	H1	H2	Q1	Apr.	May ^e	
Total long-term funds	20.0	15.0	18.1	13.7	38.9	27.9	0.2	7,459
Equity funds	19.7	9.9	12.2	10.3	31.1	26.4	0.3	5,473
Domestic	13.7	4.8	4.1	1.0	10.7	8.0	-9.6	4,337
International	6.0	5.1	8.1	9.2	20.4	18.4	10.0	1,136
Hybrid funds	4.1	3.0	3.4	0.9	0.4	0.4	-1.0	596
Bond funds	-3.8	2.0	2.5	2.6	7.4	1.1	0.9	1,389
High-yield	-2.1	0.5	-1.6	-1.0	-0.4	-0.4	-1.5	147
Other taxable	0.1	2.0	3.7	3.1	5.8	1.7	1.8	898
Municipals	-1.9	-0.4	0.4	0.4	2.1	-0.3	0.6	344

Note. Excludes reinvested dividends.

^e Staff estimates based on confidential ICI weekly data.

Source. Investment Company Institute.

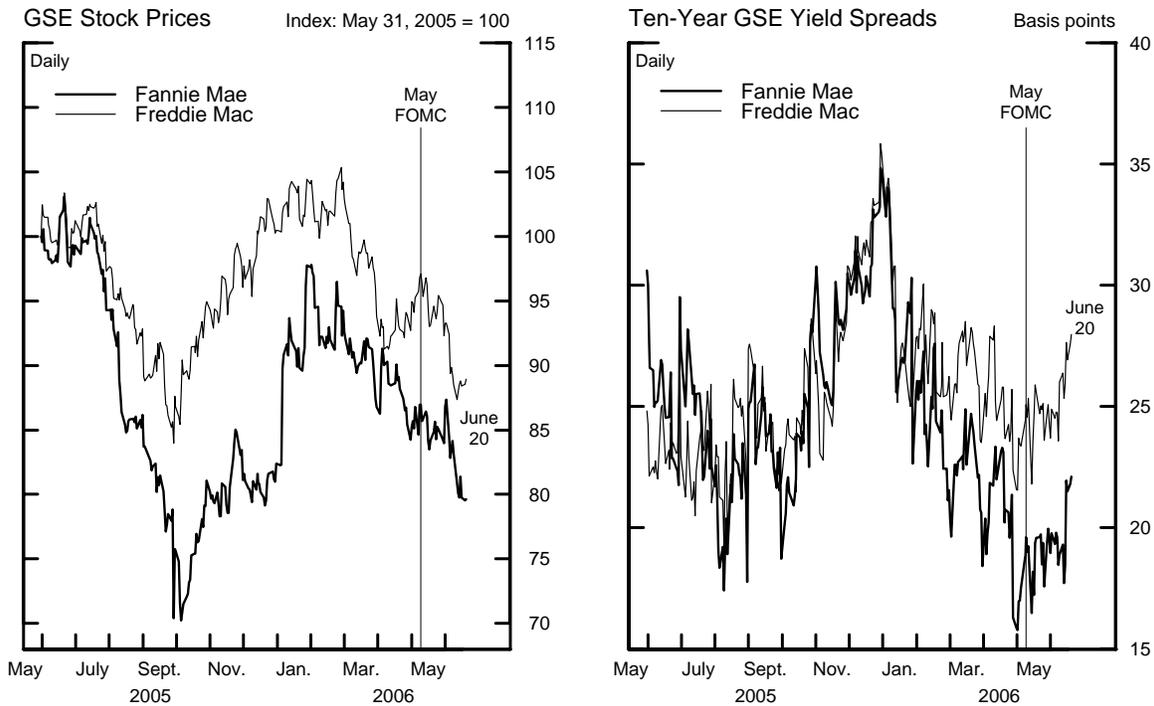
Treasury Financing
(Billions of dollars)

Item	2005				2006		
	Q1	Q2	Q3	Q4	Q1	Apr.	May
Total surplus, deficit (-)	-176.6	45.2	-69.0	-119.3	-183.7	118.9	-42.8
Means of financing deficit							
Net borrowing	164.7	-42.8	72.8	112.2	156.1	-52.7	-11.5
Nonmarketable	20.8	35.9	20.6	21.2	-2.3	5.3	4.6
Marketable	143.9	-78.7	52.1	91.0	158.5	-58.0	-16.0
Bills	55.7	-135.8	-9.3	48.8	78.1	-77.0	-10.7
Coupons	88.2	57.1	61.4	42.3	80.4	19.0	-5.3
Decrease in cash balance	2.2	-10.7	-2.5	-0.9	28.4	-70.8	50.9
Other ¹	9.7	8.3	-1.2	8.0	-0.9	4.6	3.4
Memo:							
Cash balance, end of period	22.4	33.2	35.7	36.6	8.2	79.0	28.1

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

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

GSE Market Developments



Note. GSE yields based on senior unsecured debt. Spreads measured relative to the 10-year Treasury yield.

State and Local Government Finance

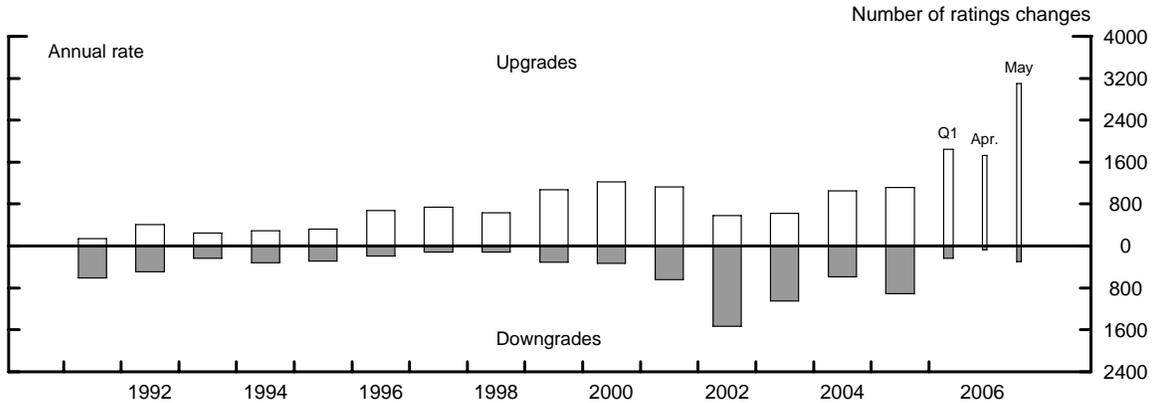
Gross Offerings of Municipal Securities

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

Type of security	2002	2003	2004	2005		2006		
				H1	H2	Q1	Apr.	May
Total	36.3	37.9	34.7	38.1	38.6	25.8	31.3	34.3
Long-term ¹	30.3	32.0	29.8	35.0	33.3	23.9	30.3	33.4
Refundings ²	10.1	10.0	10.8	17.1	13.8	8.8	9.3	10.1
New capital	20.2	22.1	19.0	17.9	19.5	15.2	20.9	23.3
Short-term	6.0	5.8	4.9	3.1	5.3	1.9	1.0	.9
Memo: Long-term taxable	1.7	3.5	2.0	2.0	2.2	1.2	1.4	2.5

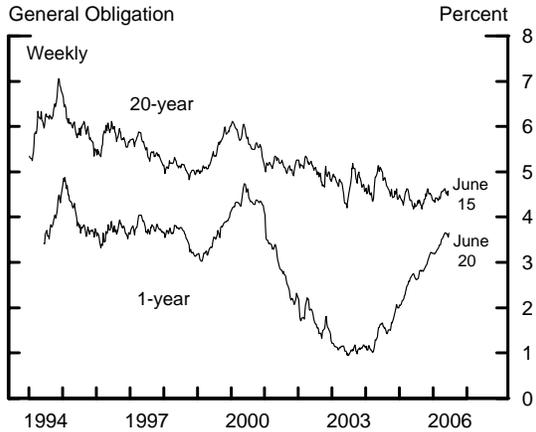
- 1. Includes issues for public and private purposes.
- 2. All issues that include any refunding bonds.

Ratings Changes



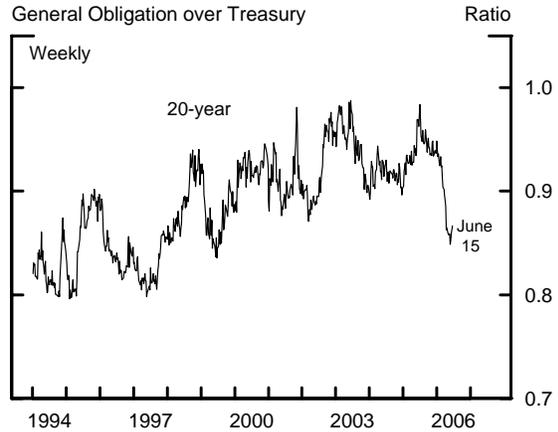
Source: S&P's Credit Week Municipal and Ratings Direct.

Municipal Bond Yields



Source: Bloomberg and Bond Buyer.

Municipal Bond Yield Ratio



Source: Bond Buyer.

international equity funds fell back from the elevated pace seen in the first four months of the year.

Treasury and Agency Finance

Auctions of two-, three-, and ten-year nominal Treasury notes over the intermeeting period were well received, with higher than normal bid-to-cover ratios. The proportion of Treasury coupon securities awarded to foreign investors at auctions held in April and May continued to drift down. In addition, Treasury securities held in custody at the Federal Reserve Bank of New York on behalf of foreign official institutions fell modestly, on net, over the intermeeting period.

There was much news during the intermeeting period about Fannie Mae's misdeeds and possible reforms of government-sponsored enterprises (GSEs); however, Fannie Mae's and Freddie Mac's stock prices declined about in line with broad market indexes, and their debt spreads to comparable Treasuries stayed within the range seen this year. OFHEO released the results of a three-year inquiry into Fannie Mae's accounting practices that detailed improper smoothing of past earnings to boost executive compensation. As a remedial measure for the improper accounting, Fannie Mae signed a consent decree with its regulator that included limiting the mortgage holdings in its portfolio to \$727 billion. Treasury officials also called for a review of the approval process for bond sales by GSEs and raised the possibility of a new process that might limit GSE debt to the funding of mission-related activities. Prospects for GSE reform remain uncertain at this point.

State and Local Government Finance

Gross issuance of long-term municipal bonds stepped up a bit in May, led by new capital financing. Short-term issuance remained light in May, as budget conditions in many states improved.

Changes in municipal bond ratings continue to indicate very strong credit quality. Upgrades far exceeded downgrades, in part because of an upgrade of general-obligation bonds in California as a result of increased revenue. Municipal bond yields fell slightly during the intermeeting period, and the ratio of municipal bond yields to Treasury yields remained low, perhaps as a result of stronger ratings.

M2 Monetary Aggregate
(Based on seasonally adjusted data)

Aggregate and components	Percent change (annual rate) ¹						Level (billions of dollars),
	2004	2005	2005	2006			May (p)
			Q4	Q1	Apr.	May (p)	
M2	5.2	3.9	5.1	6.6	3.6	-.3	6,797
Components ²							
Currency	5.5	3.5	4.2	7.1	3.7	6.0	743
Liquid deposits ³	10.0	2.0	3.0	3.8	.6	-6.0	4,264
Small time deposits	-.3	18.7	15.4	17.0	17.6	16.1	1,049
Retail money market funds	-11.7	-.9	4.7	9.0	1.3	2.9	734
Memo:							
Institutional money market funds	-5.7	5.0	12.1	9.0	14.4	15.7	1,184
Monetary base	5.6	3.4	4.2	6.4	4.4	6.8	807

Note. M2 is the sum of currency, liquid deposits, small time deposits, retail money market funds, and nonbank traveler's checks. Acting on its announcement of November 10, 2005, the Board of Governors ceased publishing the M3 monetary aggregate on March 23, 2006.

1. For years, Q4 to Q4; for quarters and months, calculated from corresponding averages.
 2. Nonbank traveler's checks are not listed.
 3. Sum of demand deposits, other checkable deposits, and savings deposits.
- p Preliminary.

Commercial Bank Credit

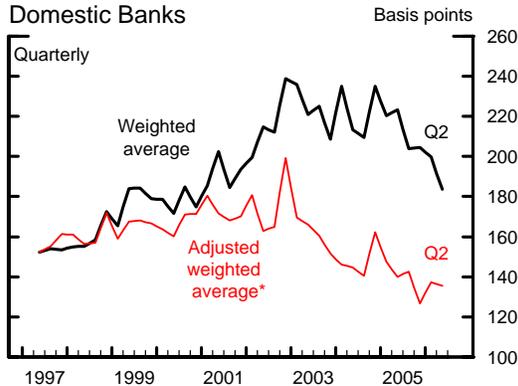
(Percent change, annual rate, except as noted; seasonally adjusted)

Type of credit	2004	2005	2005: Q4	2006: Q1	Apr. 2006	May 2006	Level (billions of dollars), May 2006
Total							
Adjusted¹	8.9	10.4	6.0	11.1	13.4	14.3	7,624
Reported	8.4	9.8	5.9	10.1	14.5	18.4	7,789
<i>Securities</i>							
Adjusted ¹	6.6	7.3	-1.5	10.8	27.3	4.9	1,983
Reported	5.2	5.3	-1.3	7.4	30.5	20.5	2,147
Treasury and agency	4.9	-1	-8.8	8.4	11.2	-3.4	1,193
Other ²	5.7	13.4	9.3	6.0	56.7	51.8	954
<i>Loans³</i>							
Total	9.8	11.6	8.7	11.2	8.5	17.7	5,642
Business	1.3	13.1	10.3	15.0	18.5	22.2	1,088
Real estate	13.9	14.1	8.9	10.5	9.8	10.9	3,037
HELOCs	43.7	11.3	-1.6	-2.2	-9.9	-7.5	428
Other	9.7	14.7	10.9	12.8	13.2	13.9	2,608
Consumer	8.8	3.1	-2.9	3.2	7.8	11.5	716
Adjusted ⁴	5.6	.8	-3.1	8.3	1.4	2.9	1,085
Other ⁵	7.7	8.4	17.2	16.0	-9.4	43.2	801

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

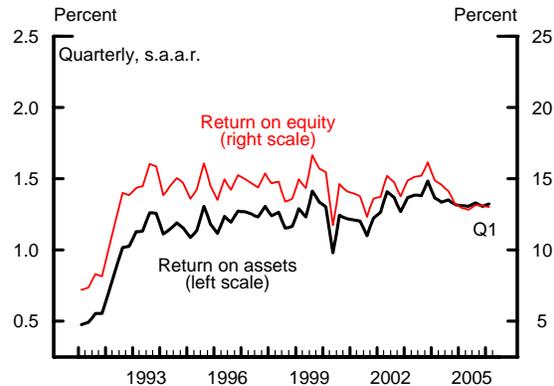
1. Adjusted to remove effects of mark-to-market accounting rules (FIN 39 and FAS 115).
2. Includes private mortgage-backed securities, securities of corporations, state and local governments, foreign governments, and any trading account assets that are not Treasury or agency securities, including revaluation gains on derivative contracts.
3. Excludes interbank loans.
4. Includes an estimate of outstanding loans securitized by commercial banks.
5. Includes security loans and loans to farmers, state and local governments, and all others not elsewhere classified. Also includes lease financing receivables.

C&I Loan Rate Spreads at Domestic Banks



Note. Spread over banks' estimated cost of funds.
* Adjusted for changes in nonprice loan characteristics.
Source. Survey of Terms of Business Lending.

Bank Profitability



Source. Call Report.

Money and Bank Credit

M2 growth slowed in April and May, likely because of the deceleration of nominal GDP and continued increases in opportunity costs. Currency and retail money market funds expanded more slowly compared with the first quarter of the year, while liquid deposits ran off. In contrast, small time deposits continued their rapid advance, probably in part because rates on these deposits have risen along with other short-term rates. M2 velocity had been well below the level predicted by its historical relationship with opportunity cost for several quarters, but the recent slowing of M2 growth partly closed that gap.

Bank credit expanded briskly again in May. Growth of C&I loans was rapid and was likely supported by still-strong merger and acquisition activity. In addition, according to the Survey of Terms of Business Lending conducted in May, the lending environment has stayed accommodative, with spreads of rates on C&I loans at banks quite low. Commercial and residential mortgages at banks posted further sizable increases in May, while consumer loans adjusted for securitizations only edged up.

Bank profitability remained strong in the first quarter amid excellent asset quality, according to Call Report data. Profits were supported by increases in non-interest income and reductions in loan-loss provisions. These factors more than offset the drag on profitability from a further narrowing of net interest margins. Delinquency and charge-off rates stayed low across all loan types. Charge-off rates on consumer loans declined to the lowest level seen in recent years, held down by the low level of bankruptcy filings.

Last Page of Financial Developments

International Developments

International Developments

U.S. International Transactions

Trade in Goods and Services

The U.S. international trade deficit widened to \$63.4 billion in April from \$61.9 billion in March (revised). The widening of the deficit in April resulted from a large increase in imports, as well as a slight decline in exports.

Trade in Goods and Services

	2005	Annual rate			Monthly rate		
		2005		2006	2006		
		Q3	Q4	Q1	Feb.	Mar.	Apr.
Percent change							
<i>Nominal BOP</i>							
Exports	10.5	5.4	13.5	17.3	-.8	1.8	-.2
Imports	14.8	11.9	19.9	7.4	-2.5	.7	.7
<i>Real NIPA</i>							
Exports	6.7	2.5	5.1	14.7	...	...	...
Imports	9.4	2.4	12.1	12.8	...	...	...
Billions of dollars							
<i>Nominal BOP</i>							
Net exports	-716.7	-727.2	-779.1	-763.0	-62.7	-61.9	-63.4
Goods, net	-782.7	-795.0	-850.0	-831.9	-68.0	-67.7	-69.5
Services, net	66.0	67.8	70.9	68.9	5.4	5.9	6.0

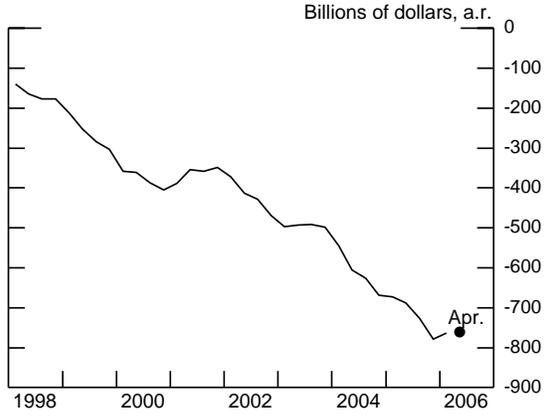
Source. U.S. Department of Commerce, Bureaus of Economic Analysis and Census.
n.a. Not available. ... Not applicable.

In April, the value of exports of goods and services fell 0.2 percent following a strong 1.8 percent gain in March. Exports in April were held back by a decline in exports of aircraft, which, after sizable gains in the beginning of the year, retreated in March and April. After recording strong growth in March, exports of consumer goods, computers, and agricultural goods slipped back in April. In contrast, exports of certain industrial supplies, including chemicals and fuels, grew strongly in both months, whereas exports of semiconductors shot up in April after a flat March. Services exports increased briskly in both months, with exports of travel services showing particularly strong growth.

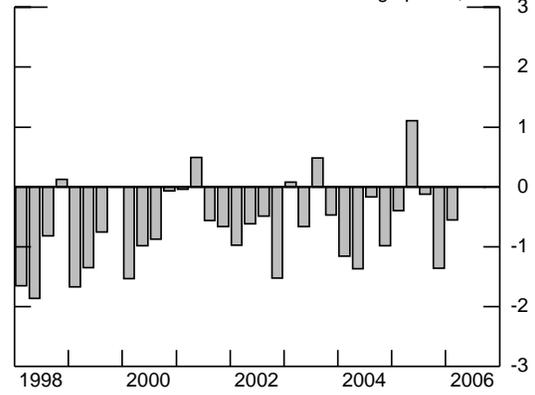
Incorporating the annual revisions to the historical data that were released with the April trade data, real NIPA exports of goods and services are now estimated to have increased 14.9 percent (a.r.) in the first quarter, little changed from the preliminary NIPA release, which reported a gain of 14.7 percent. Strong exports of aircraft and a rebound in exports

U.S. International Trade in Goods and Services (Quarterly)

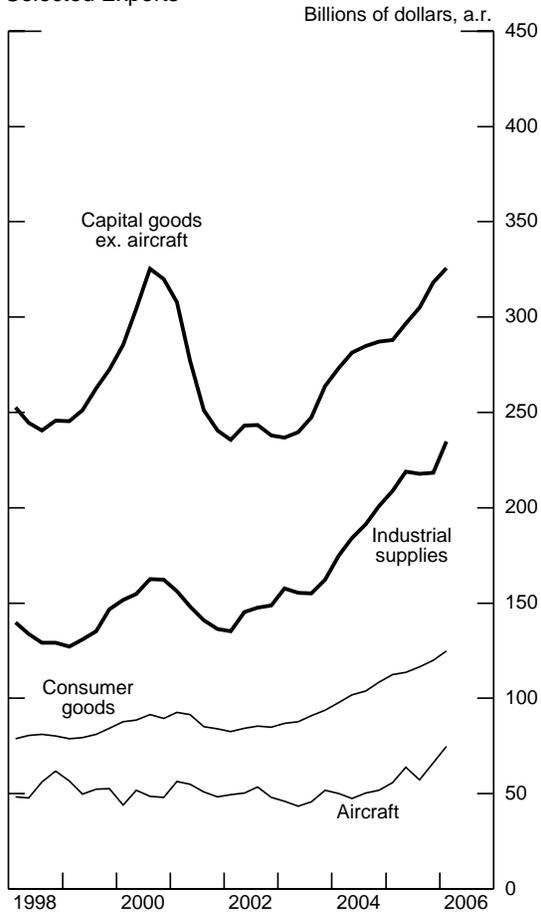
Trade Balance



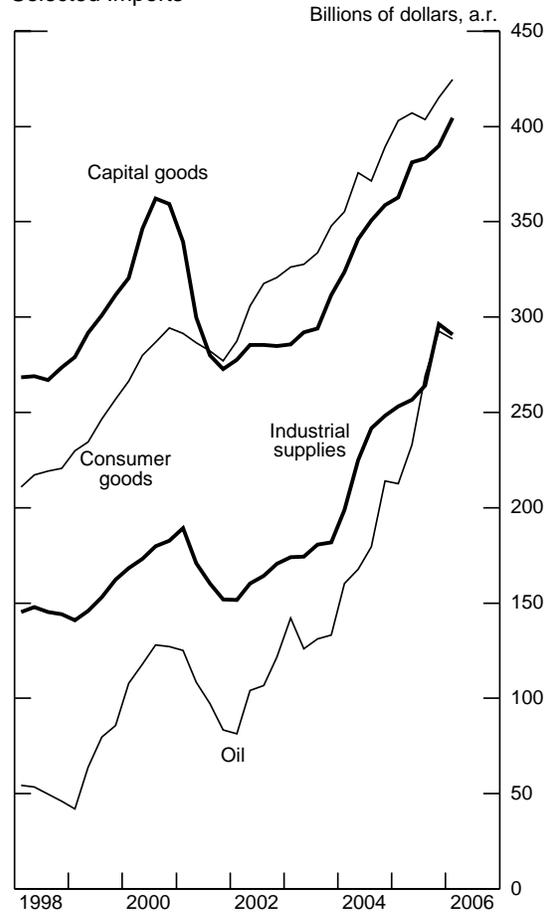
Contribution of Net Exports to Real GDP Growth



Selected Exports



Selected Imports



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

	Levels				Change ¹			
	2005	2006	2006		2005	2006	2006	
	Q4	Q1	Mar.	Apr.	Q4	Q1	Mar.	Apr.
Exports of G&S	1324.7	1378.6	1391.3	1387.9	41.2	53.9	24.7	-3.4
Goods exports	931.6	978.0	988.3	982.3	31.8	46.4	19.2	-6.0
Gold	5.8	7.6	8.4	6.9	.5	1.8	1.7	-1.5
Other goods	925.8	970.5	979.8	975.3	31.4	44.6	17.5	-4.5
Capital goods	384.3	400.6	401.3	399.2	21.9	16.3	.0	-2.1
Aircraft & parts	66.1	74.9	70.5	67.3	8.7	8.8	-10.0	-3.2
Computers & accessories	45.8	47.0	47.3	45.5	-.7	1.2	2.1	-1.8
Semiconductors	50.5	50.9	50.8	55.2	1.8	.4	.1	4.3
Other capital goods	221.9	227.8	232.7	231.2	12.1	5.9	7.9	-1.5
Automotive	104.5	105.5	102.9	104.0	3.6	1.0	-4.5	1.0
Ind supplies (ex. ag, gold)	218.2	234.8	243.2	246.9	.5	16.5	14.9	3.7
Consumer goods	120.0	124.9	126.2	121.1	3.5	4.8	2.6	-5.0
Agricultural	65.9	69.5	70.7	68.9	.7	3.7	3.8	-1.8
All other goods	32.9	35.2	35.5	35.2	1.2	2.3	17.5	-.3
Services exports	393.0	400.5	403.0	405.6	9.4	7.5	5.5	2.6
Imports of G&S	2103.8	2141.5	2133.6	2149.0	93.2	37.8	15.1	15.4
Goods imports	1781.6	1809.9	1800.8	1815.9	86.9	28.3	15.5	15.0
Oil	292.6	288.5	268.9	286.1	23.5	-4.1	-29.4	17.2
Gold	5.4	5.7	5.9	5.4	1.0	.3	.6	-.5
Other goods	1483.6	1515.7	1526.1	1524.4	62.4	32.1	44.3	-1.7
Capital goods	389.9	404.4	413.0	414.2	6.7	14.5	22.5	1.2
Aircraft & parts	25.4	28.4	30.0	27.1	1.2	3.1	3.4	-2.8
Computers & accessories	94.2	99.5	105.7	104.2	.0	5.4	10.4	-1.5
Semiconductors	26.7	27.1	27.0	28.2	.7	.4	-.2	1.2
Other capital goods	243.7	249.4	250.3	254.6	4.8	5.7	9.0	4.3
Automotive	250.4	258.3	252.1	257.0	9.2	7.9	-3.0	4.9
Ind supplies (ex. oil, gold)	296.4	290.7	282.4	294.6	32.4	-5.7	-8.7	12.1
Consumer goods	415.1	424.5	438.7	423.5	11.4	9.4	26.3	-15.3
Foods, feeds, bev.	70.6	74.1	76.3	74.6	1.6	3.5	4.8	-1.7
All other goods	61.1	63.6	63.5	60.5	1.0	2.5	2.4	-2.9
Services imports	322.1	331.6	332.8	333.1	6.3	9.5	-.3	.3
<i>Memo:</i>								
Oil quantity (mb/d)	14.44	14.32	13.43	12.96	1.19	-.12	-1.26	-.47
Oil import price (\$/bbl)	55.60	55.10	54.81	60.45	-.02	-.51	-.77	5.64

1. Change from previous quarter or month.

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

of certain industrial supplies following a weak fourth quarter supported the rapid pace of export growth in the first quarter.

The value of imported goods and services increased 0.7 percent in April, following a similar-sized gain in March. In April, the increase in imports primarily reflected a sharp rise in the value of imported oil and natural gas. April's increase was also supported by stronger imports of automotive products and capital goods. Imports of consumer goods declined in April, however, as imports of pharmaceuticals fell back following a surge in March. Imports of services were essentially unchanged in April and have remained flat since February.

The preliminary NIPA release reported that real imports of goods and services increased 12.8 percent in the first quarter at an annual rate, but more recent data indicate that first-quarter growth was 10.5 percent. During the first quarter, declines in imports of oil and natural gas were more than offset by widespread gains in imports of other goods and a strong increase in services imports. Imports of computers, consumer goods, and automotive products all increased briskly.

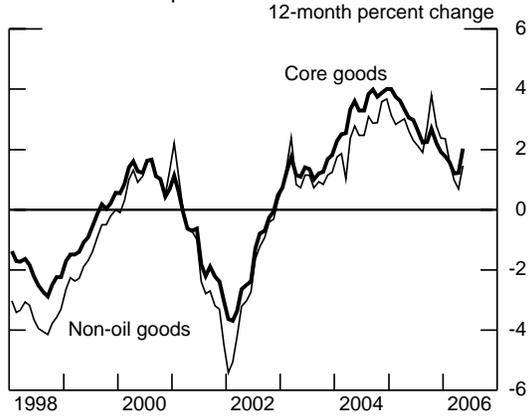
Prices of Internationally Traded Goods

Non-oil imports. In May, prices of U.S. imports of non-oil goods and core goods rose 0.6 and 0.7 percent, respectively. Prices for material-intensive goods were up sharply. After increasing 1 percent in April, prices for non-fuel industrial supplies rose another 2.9 percent in May, primarily reflecting a 7.8 percent increase in prices for unfinished metals, the largest monthly increase since the BLS began monthly publication in 1988. The increase in the metals index reflected the steep rise in spot markets early in the month; subsequently, spot prices retraced some of their gains. After falling 0.7 percent in April, food prices recovered, rising 1.3 percent. Prices of imported finished goods also rose in May. After falling in March and April, prices for imported consumer goods were up 0.3 percent in May. Prices for capital goods (excluding computers and semiconductors) and automotive products each increased 0.1 percent. In contrast, prices for imported computers and semiconductors each fell 0.5 percent.

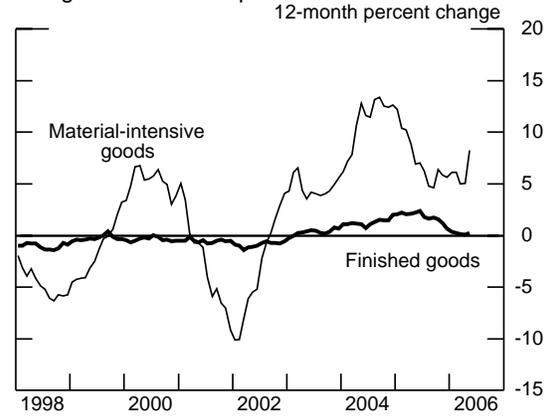
The average level of core import prices in April and May was 2¼ percent at an annual rate above the first-quarter average, mostly reflecting a 14 percent (a.r.) increase in prices for non-fuel industrial supplies. In addition, prices for capital goods (excluding computers and semiconductors) and automotive products were up slightly. Import prices for foods and consumer goods each declined.

Prices of U.S. Imports and Exports

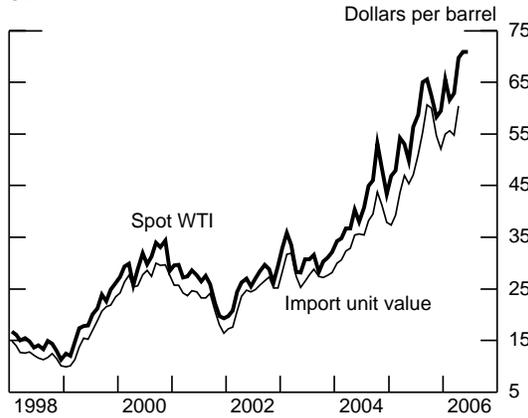
Merchandise Imports



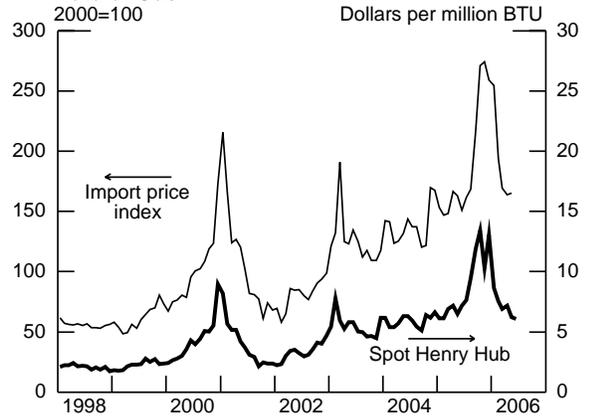
Categories of Core Imports



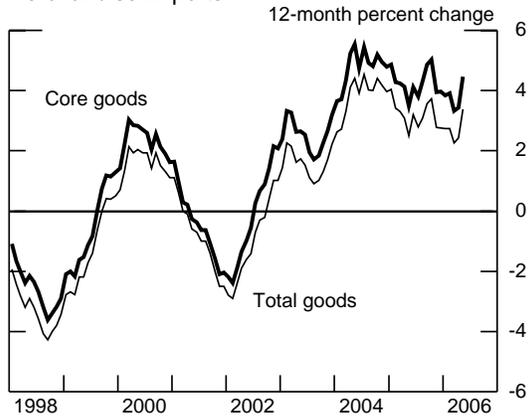
Oil



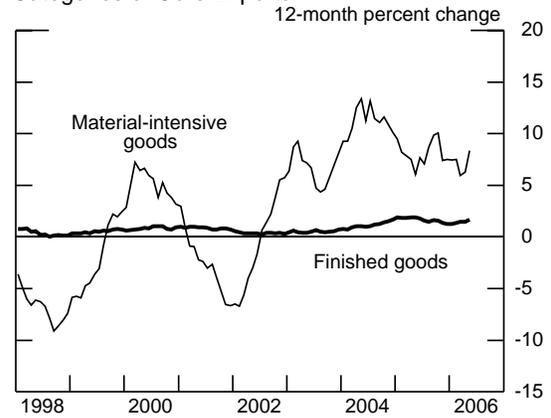
Natural Gas



Merchandise Exports



Categories of Core Exports



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

	Annual rate			Monthly rate		
	2005	2006		2006		
	Q4	Q1	Q2 ^e	Mar.	Apr.	May
	----- BLS prices -----					
Merchandise imports	2.5	.1	10.8	-.1	2.1	1.6
Oil	-11.3	6.7	71.5	.5	11.5	5.2
Non-oil	6.3	-1.2	-.1	-.3	.1	.6
Core goods ¹	2.7	2.2	2.3	-.0	.2	.7
Finished goods	.0	.6	.2	-.2	.0	.2
Cap. goods ex. comp. & semi.	.0	1.7	1.0	.0	.1	.1
Automotive products	.6	-.8	.7	.0	.1	.1
Consumer goods	-.3	.8	-.5	-.3	-.1	.3
Material-intensive goods	9.6	9.7	9.3	.5	.6	2.4
Foods, feeds, beverages	7.5	5.5	-2.3	.3	-.7	1.3
Industrial supplies ex. fuels	8.0	11.8	14.2	.7	1.0	2.9
Computers	-7.7	-6.9	-5.6	-.3	-.8	-.5
Semiconductors	-3.4	2.2	-1.6	.2	-.4	-.5
Natural gas	367.1	-65.2	-59.3	-12.7	-3.1	.7
Merchandise exports	3.4	2.9	4.7	.2	.6	.7
Core goods ²	4.7	3.6	5.5	.2	.7	.8
Finished goods	1.7	2.7	1.9	.1	.2	.2
Cap. goods ex. comp. & semi.	2.6	4.0	3.0	.2	.5	.1
Automotive products	1.4	.9	1.0	.1	.1	.1
Consumer goods	1.2	1.3	.6	-.2	.0	.5
Material-intensive goods	8.3	5.2	10.9	.4	1.5	1.6
Agricultural products	-4.4	-1.4	-1.9	-.1	-.6	.8
Industrial supplies ex. ag	13.0	7.2	15.1	.6	2.1	1.7
Computers	-8.3	1.2	-3.1	.0	-.8	.1
Semiconductors	-6.4	-7.7	-1.6	.0	.1	-.1
	----- NIPA prices -----					
Chain price index						
Imports of goods & services	4.4	-.6	n.a	...	...	...
Non-oil merchandise	5.8	-1.1	n.a	...	...	...
Core goods ¹	2.5	1.8	n.a	...	...	...
Exports of goods & services	2.7	2.3	n.a	...	...	...
Total merchandise	2.1	2.6	n.a	...	...	...
Core goods ²	4.0	3.6	n.a	...	...	...

1. Excludes computers, semiconductors, and natural gas.

2. Excludes computers and semiconductors.

e/ Average of two months.

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

Oil. The BLS price index of imported oil jumped 5.2 percent in May. The spot price of West Texas Intermediate (WTI) crude oil closed at \$68.94 per barrel on June 20, down about \$2 from its May average. Early last month, oil prices neared \$75 per barrel on increased supply fears, particularly as negotiations over Iran's nuclear program became more heated and attacks continued against Nigerian oil infrastructure. Since that time, some progress in negotiations with Iran and the death of a leader of Iraq's insurgency have contributed to lower prices. In general, however, oil prices remain elevated as market participants remain concerned that world production capacity will have difficulty keeping pace with relatively robust global oil demand growth.

Exports. In May, prices of U.S. exports of total goods and core goods increased 0.7 and 0.8 percent, respectively. Prices for nonagricultural industrial supplies increased 1.7 percent in May, on higher prices for metals, fuels, and chemicals. After falling in each of the last three months, agricultural export prices rose 0.8 percent. Within finished goods, the most notable price increase was a 0.5 percent rise for consumer goods. Prices for automotive products, capital goods (excluding computers and semiconductors), and computers all increased 0.1 percent. In contrast, prices of exported semiconductors fell 0.1 percent.

The average level of core export prices in April and May was 5½ percent at an annual rate above the first-quarter average, as prices increased in all subcategories, with the exception of agricultural products. A 15 percent (a.r.) increase in prices for nonagricultural industrial supplies was the main contributor to the overall price increase. In addition, export prices for capital goods (excluding computers and semiconductors) rose 3 percent (a.r.).

U.S. Current Account

The U.S. current account deficit was \$835 billion (a.r.) in the first quarter of 2006, about \$58 billion narrower than recorded in the fourth quarter of 2005 (revised). The trade deficit narrowed \$16 billion, as increases in imports of goods and services were more than offset by increases in exports. A \$25 billion net decrease in outflows from unilateral transfers added to the improvement in the current account. The majority of the decrease in transfers was associated with a reduction in grants for military purchases of almost \$16 billion.

The investment income balance was a positive \$14 billion (a.r.) in the first quarter, a reversal from the negative balance in the fourth quarter that had followed positive but

downward trending net investment income balances in previous quarters. The improvement was more than accounted for by an increase in direct investment receipts and a decrease in direct investment payments. The balance on other investment income continued to worsen.

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>				
2004	-611.3	33.6	-87.6	-665.3
2005	-716.7	17.6	-92.4	-791.5
<i>Quarterly</i>				
2005:Q2	-688.2	14.2	-99.0	-773.0
Q3	-727.2	37.9	-44.3	-733.7
Q4	-779.1	-2.3	-111.0	-892.4
2006:Q1	-763.0	14.0	-85.7	-834.7
<i>Change</i>				
Q2-Q1	-15.8	-6.5	16.2	-6.1
Q3-Q2	-38.9	23.7	54.7	39.4
Q4-Q3	-51.9	-40.2	-66.7	-158.8
Q1-Q4	16.1	16.3	25.3	57.7

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

U.S. International Financial Transactions

With the release of the first-quarter current account transactions data, BEA also released data on the associated financial flows. These data are reported in the Summary of U.S. International Transactions table. Recorded net private financial inflows in the first quarter totalled nearly \$82 billion, only half those of the fourth quarter, while official inflows were roughly unchanged at \$76 billion. As the current account deficit narrowed only slightly, the statistical discrepancy swung from negative \$19 billion in the fourth quarter to a positive \$53 billion in the first quarter.

In large part, the smaller first-quarter net private financial inflows reflect a swing from net inflows through direct investment in the fourth quarter of 2005 to the more normal pattern of net outflows. U.S. direct investment abroad (line 6), which recorded atypical inflows in the second half of last year, recorded a very large outflow in the first quarter. Over the past few quarters, direct investment abroad has been affected by the partial tax holiday established in the 2004 American Jobs Creation Act (also known as the

Homeland Investment Act, HIA). Under this one-fiscal-year tax holiday, multinational corporations that repatriate previously retained earnings from foreign affiliates and reinvest them in the United States are subject to a reduced effective tax rate on those earnings. As multinationals took advantage of this tax provision, sizable repatriated earnings were recorded in the third and fourth quarters of 2005. By our estimate, foreign affiliates have remitted over \$200 billion of previously retained earnings under the HIA. While it appears that some firms continued to take advantage of the HIA in the first quarter, it also appears that some firms retained an unusually large portion of their earnings abroad in an effort to unwind the balance-sheet impact of their use of the HIA. On net, retained earnings, and hence financial flows associated with U.S. direct investment abroad, returned to a more typical pattern in the first quarter. Flows of foreign direct investment into the United States (line 7) moved up in the first quarter to a bit above the average level recorded in 2005.

The financial flows data also included some modest revisions to foreign official inflows (line 1) and foreign private net purchases of U.S. securities (line 4), based on results of the newly-released survey of foreign holdings of U.S. securities as of June 2005. The survey indicated somewhat lower foreign holdings of U.S. securities, especially Treasury securities, than previously available data suggested. Both foreign official and private securities inflows for 2005 were revised down by about \$10 billion.

The most recent data on securities transactions show that foreign private purchases of U.S. securities slowed noticeably in April from the robust pace recorded in the first quarter. Foreign private demand for all types of securities weakened, as investors on net sold Treasury securities (line 4a) and acquired very limited amounts of agency bonds (line 4b) and equities (line 4d). Net purchases of corporate bonds (line 4c) fell back from the near-record inflow posted in March but remained near the healthy average pace of the past several months. Weaker net securities purchases were recorded primarily against the United Kingdom and the Caribbean banking centers, but as the monthly transactions data are recorded against country of first transactor, the slowdown in activity against these financial centers provides little information about the residence of the ultimate foreign purchasers or sellers.

Foreign official flows into the United States (line 1) moved up a bit in April, primarily reflecting larger inflows from OPEC and Russia

. For the first four months of the year, official inflows have been running at a pace well above that of 2005.

. Although official inflows from OPEC over the past few quarters are small relative to their oil revenues, we have seen a pickup this year in inflows identified with middle-eastern oil producers. Official inflows from other oil producers, especially Norway and Russia, have been volatile, most likely reflecting active portfolio management of oil revenues. Partial and confidential information on custody holdings at the Federal Reserve Bank of New York indicate moderately strong foreign official inflows in May and strong inflows in the first half of June, .

U.S. residents' acquisitions of foreign securities (line 5) eased a bit in April, but for the year to date acquisitions of foreign securities are running a bit above the pace of last year. Demand for foreign equity (line 5b), primarily from Asia, remained strong.

The banking sector (line 3) posted an unusually large net inflow in April, primarily reflecting record inflows from affiliated banking offices. These data tend to be volatile on a monthly basis, with large inflows one month often followed by large outflows the next. Nonetheless, the sizable banking inflow recorded in April may in part reflect an offset of the swing to net outflows in direct investment in the first quarter, as U.S. multinationals returned to placing funds in overseas banking offices, thus providing an ample source of funding for U.S.-based banking offices.

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

	2004	2005	2005			2006		
			Q2	Q3	Q4	Q1	Mar	Apr
Official financial flows	388.5	214.4	73.6	38.6	77.0	76.0	16.9	20.6
1. Change in foreign official assets in the U.S. (increase, +)	385.7	200.3	74.4	33.8	72.3	75.5	16.6	20.4
a. G-10 countries + ECB	161.7	-22.7	-18.2	-5.1	-4.9	-8.9	-5.4	-8.1
b. OPEC	12.1	7.0	4.4	-3.8	10.3	11.6	0.4	4.5
c. All other countries	211.9	216.1	88.2	42.8	66.8	72.8	21.7	24.0
2. Change in U.S. official reserve assets (decrease, +)	2.8	14.1	-0.8	4.8	4.8	0.5	0.3	0.2
Private financial flows	193.9	571.0	76.2	217.6	165.6	81.7	...	...
Banks								
3. Change in net foreign positions of banking offices in the U.S. ¹	-3.8	17.0	-65.3	22.4	56.0	11.1	5.2	86.6
Securities²								
4. Foreign net purchases of U.S. securities (+)	489.3	668.0	124.2	188.3	193.3	181.3	74.1	13.9
a. Treasury securities	104.2	199.6	14.1	37.3	62.0	-1.9	5.7	-18.1
b. Agency bonds	67.6	69.9	19.6	33.1	16.5	41.1	9.3	1.3
c. Corporate and municipal bonds	255.0	309.2	76.2	86.6	90.3	87.1	41.6	27.5
d. Corporate stocks ³	62.4	89.4	14.4	31.3	24.4	54.9	17.5	3.2
5. U.S. net acquisitions (-) of foreign securities	-146.2	-183.0	-46.6	-37.5	-47.7	-53.4	-20.8	-13.6
a. Bonds	-60.9	-39.6	-21.7	-2.4	-4.5	-12.1	-7.8	-2.8
b. Stock purchases	-97.6	-139.4	-23.0	-35.0	-43.1	-37.3	-13.0	-10.8
c. Stock swaps ³	12.2	-4.0	-1.9	0.0	0.0	-4.0	0.0	0.0
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-244.1	-9.1	-34.0	30.3	25.8	-61.8	...	...
7. Foreign direct investment in the U.S.	133.2	109.8	8.2	44.5	26.5	33.3	...	...
8. Foreign acquisitions of U.S. currency	14.8	19.4	4.5	4.7	9.2	1.9	...	...
9. Other (inflow, +) ⁴	-49.2	-51.1	85.0	-35.1	-97.4	-30.6	...	...
U.S. current account balance (s.a.)	-665.3	-791.5	-193.3	-183.4	-223.1	-208.7	...	...
Capital account balance (s.a.)⁵	-2.3	-4.4	-0.6	-0.6	-0.5	-1.8	...	...
Statistical discrepancy (s.a.)	85.1	10.4	44.0	-72.2	-19.1	52.8	...	...

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.

Foreign Financial Markets

After moving little on balance during much of May, the dollar's weighted-average exchange value against other major currencies moved up in early June, rising 1-3/4 percent on net over the intermeeting period. The dollar appreciated following Chairman Bernanke's comments on June 5, which were interpreted by market participants as suggesting a higher likelihood of policy tightening at the late-June FOMC meeting. On a bilateral basis, the dollar appreciated about 4 percent against the yen, as Governor Fukui reiterated that the Bank of Japan's policy rate would likely remain close to zero for some time. The dollar appreciated 1-1/4 percent on net against the euro, as market expectations of further monetary tightening by the ECB reportedly decreased in early June. The dollar appreciated 3/4 percent against the Canadian dollar, in part in response to signals from the Bank of Canada that the latest increase of its policy rate should be sufficient to keep inflation contained and the economy on track.

Over the intermeeting period, headline equity indexes fell 8 to 13 percent on net in the euro area, Japan, the United Kingdom, and Canada, and about 6 percent in the United States. They dropped even more in the emerging market economies, where share prices had previously moved up sharply. With no major negative corporate earnings surprises, market participants attributed the drops in share prices to increased uncertainty about prospective inflation and global economic growth. Consistent with these drops in share prices and heightened uncertainty, implied and realized volatilities on headline equity indexes increased. With these drops, headline equity indexes are currently roughly unchanged on balance in Europe and North America, in local-currency terms, since the beginning of the year, but are down about 9 percent in Japan.

The Bank of England did not change its monetary policy stance over the intermeeting period. By early June, the Bank of Japan had run down the current account balances held by commercial banks to about ¥10 trillion. It raised these balances to ¥13 trillion on June 16 and to ¥17.6 trillion on June 20 to keep the interbank overnight rate close to zero. The European Central Bank, the Bank of Canada, the Swiss National Bank, and Sweden's Riksbank each raised their policy rates 25 basis points; short-term market interest rates in the respective economies rose 10 to 20 basis points over the intermeeting period.

Realized volatility of ten-year government bonds was little changed in most industrial economies over the intermeeting period, despite mixed data releases on inflation and economic growth. On balance, benchmark bond yields dropped 15 basis points in Japan

and were little changed in Canada, the euro area, and the United Kingdom. In contrast, inflation-indexed benchmark bond yields were little changed in Japan and rose 7 to 12 basis points in the euro area, Canada, and the United Kingdom. In mid-May, sovereign bond yields in Europe and Canada decreased following a statement by French Finance Minister Thierry Breton that “everything must be done to prevent the euro from strengthening against the dollar, since the euro’s strength would be harmful to economic growth in Europe,” and on lower-than-expected Canadian core CPI data for April. Later in the intermeeting period, these yields increased on several higher-than-expected euro-area and Canadian data releases. Yields moved down on the lower-than-expected May U.S. employment report, but rose on Chairman Bernanke’s statements on June 5 on inflation concerns, a much better-than-expected Canadian employment report for May, and a higher-than-expected rate of Canadian core inflation in May.

Consistent with market reports of flight-to-quality moves in mid to late May, the dollar appreciated over the intermeeting period against most emerging market currencies; Latin American and emerging Asian equity indexes fell even more steeply than those in the industrial countries, and risk spreads on dollar-denominated sovereign debt widened. The EMBI+ spreads increased about 35 basis points for Mexico and Brazil, and 60 basis points for Argentina, more than reversing the declines to multi-year lows that these spreads had registered earlier this year.

Since May 9, spot gold prices have tumbled \$125 per ounce, or almost 18 percent. Silver and copper prices have fallen 28 percent and 16 percent, respectively, retracing some but not all of their sharp rises since the start of the year. Prices of other precious and base metals also dropped sharply over the intermeeting period.

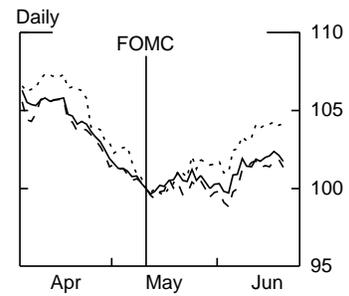
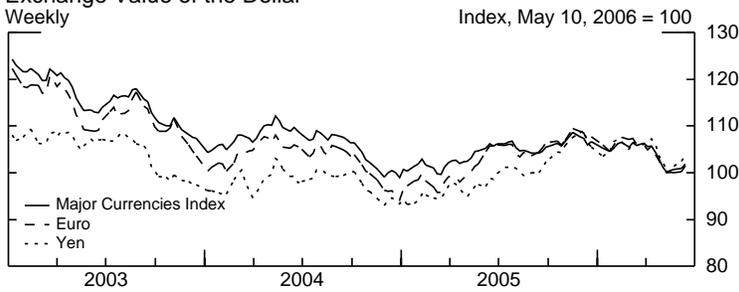
. The Desk did not intervene during the period for the accounts of the System or the Treasury.

Exchange Value of the Dollar and Stock Market Indexes

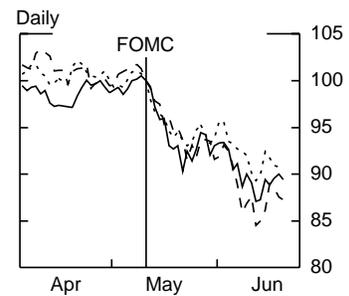
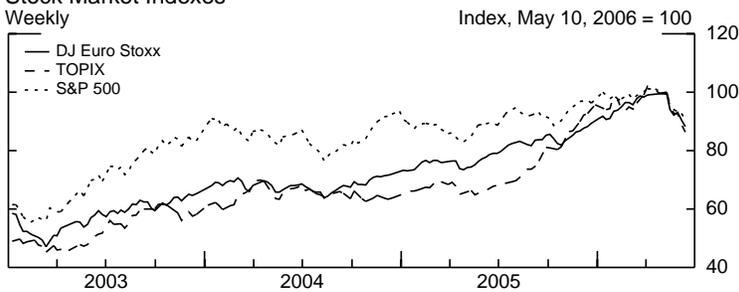
	Latest	Percent change since May FOMC
<u>Exchange Rates*</u>		
Euro (\$/Euro)	1.2630	1.3
Yen (¥/\$)	115.1	4.1
Sterling (\$/£)	1.8415	1.3
Canadian Dollar (C\$/\\$)	1.1084	0.7
<u>Nominal Dollar Indexes*</u>		
Broad index	108.9	2.2
Major currencies index	81.7	1.7
OITP index	137.6	2.8
<u>Stock Market Indexes</u>		
DJ Euro Stoxx	328.2	-10.6
TOPIX	1505.5	-12.7
FTSE 100	5625.6	-7.5
S&P 500	1240.9	-6.4

* Positive percent change denotes appreciation of U.S. dollar.

Exchange Value of the Dollar
Weekly



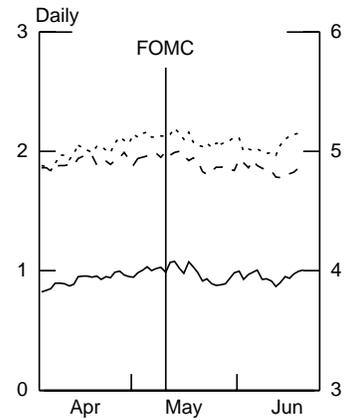
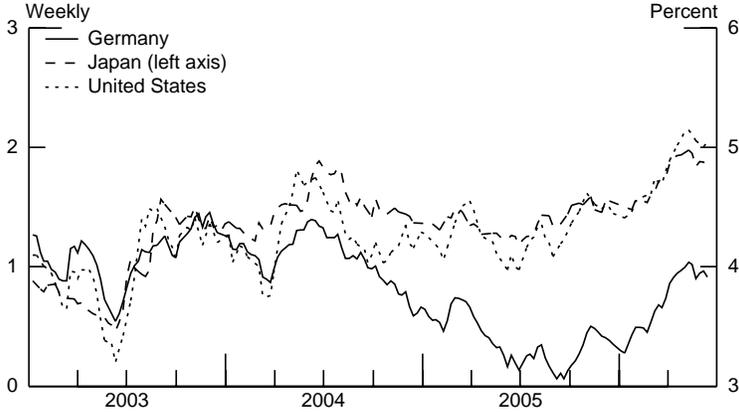
Stock Market Indexes
Weekly



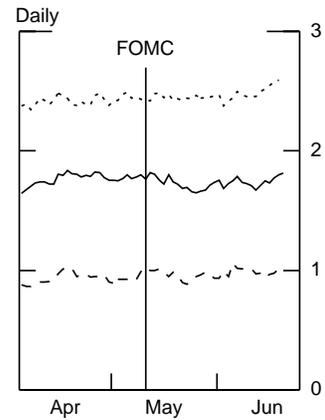
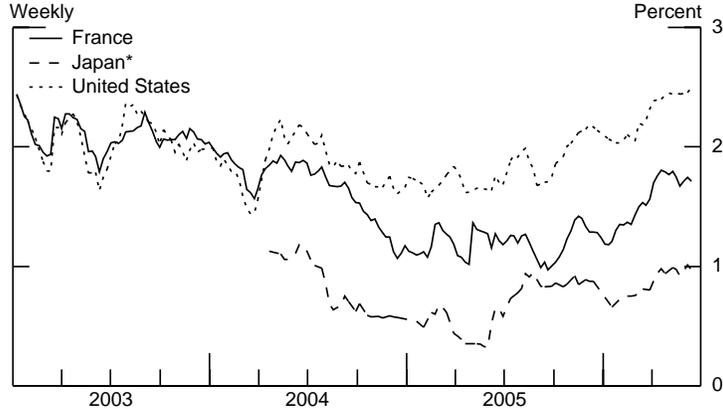
Industrial Countries: Nominal and Real Interest Rates

	3-month LIBOR		10-year nominal		10-year indexed		Percent
	Latest	Change Since May FOMC	Latest	Change Since May FOMC	Latest	Change Since May FOMC	
Germany	2.98	0.11	4.01	0.02	1.90	0.07	
Japan	0.34	0.17	1.85	-0.15	1.01	-0.02	
United Kingdom	4.75	0.05	4.72	0.02	1.78	0.12	
Canada	4.39	0.17	4.53	0.06	--	--	
United States	5.45	0.28	5.15	0.02	2.59	0.16	

Nominal 10-Year Government Bond Yields



Inflation-Indexed 10-Year Government Bond Yields



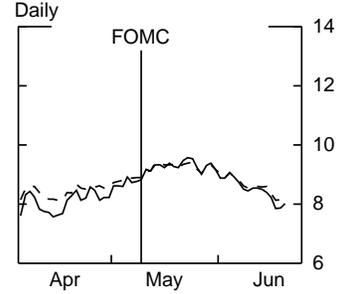
*Japan first issued inflation-indexed debt in March 2004.

Measures of Market Volatility

Dollar-Euro Options-Implied Volatility*
Weekly



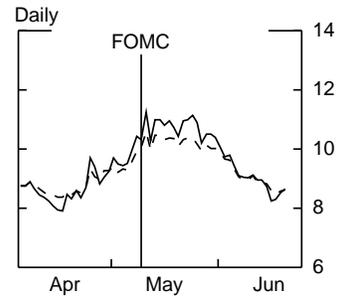
*Derived from at-the-money options.



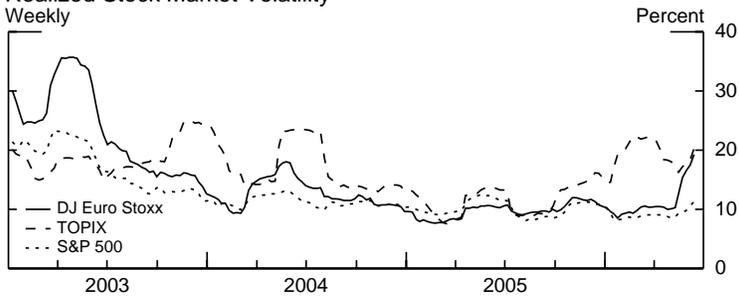
Yen-Dollar Options-Implied Volatility*
Weekly



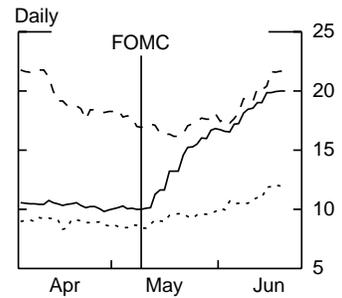
*Derived from at-the-money options.



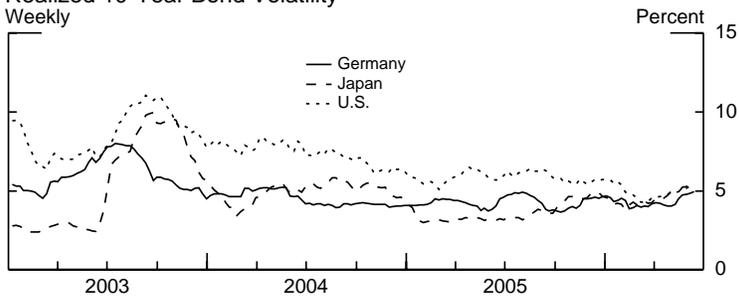
Realized Stock Market Volatility*
Weekly



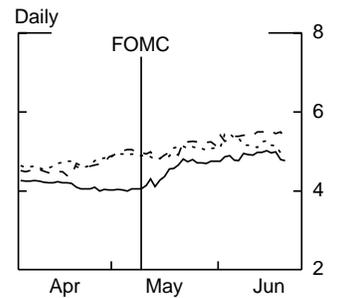
*Annualized standard deviation of 60-day window of daily returns.



Realized 10-Year Bond Volatility*
Weekly



*Annualized standard deviation of 60-day window of daily returns.

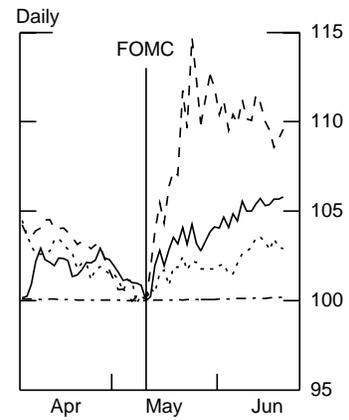
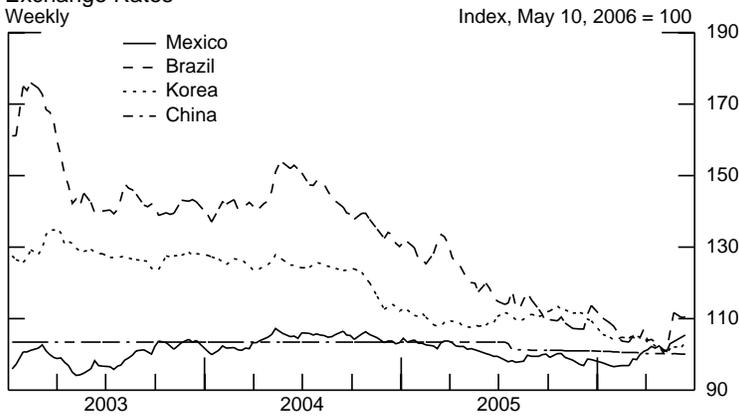


Emerging Markets: Exchange Rates and Stock Market Indexes

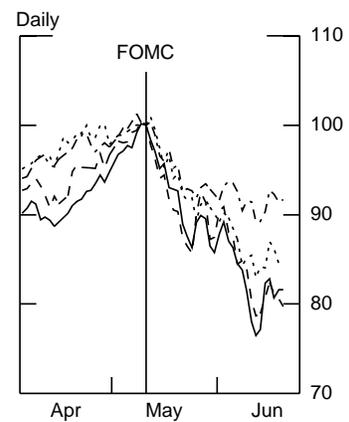
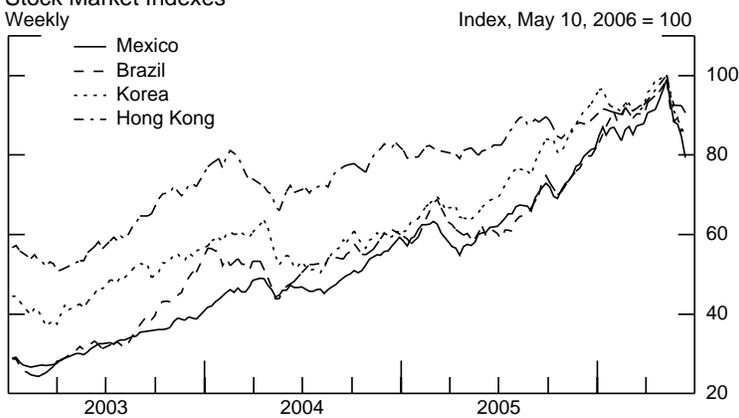
	Exchange Rate vs. Dollar		Stock Market Index	
	Latest	Percent Change Since May FOMC*	Latest	Percent Change Since May FOMC
Mexico	11.4694	5.8	17781	-18.5
Brazil	2.2525	9.6	33277	-20.7
China	7.9970	-0.1	1598	3.4
Hong Kong	7.7668	0.2	15659	-8.3
Korea	955.7	2.9	1227	-15.4
Taiwan	32.59	4.2	6300	-14.0
Singapore	1.5926	1.9	603	-11.2
Thailand	38.36	2.0	650	-17.2
India	45.96	2.5	10040	-20.4

* Positive percent change denotes appreciation of U.S. dollar.

Exchange Rates
Weekly



Stock Market Indexes
Weekly



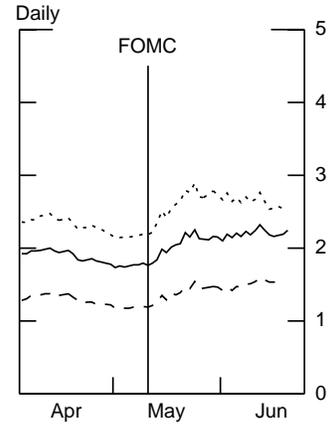
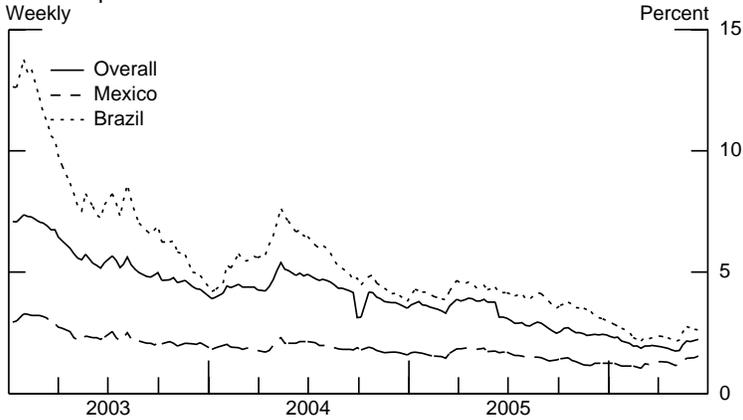
Emerging Markets: Short-Term Interest Rates and Dollar-Denominated Bond Spreads

	Short-Term Interest Rates*		Dollar-Denominated Bond Spreads**	
	Latest	Change Since May FOMC	Latest	Change Since May FOMC
Mexico	7.14	0.20	1.52	0.33
Brazil	15.11	-0.39	2.54	0.36
Argentina	9.63	0.06	3.76	0.59
China	--	--	0.64	0.01
Korea	4.28	0.23	--	--
Taiwan	1.73	0.05	--	--
Singapore	3.38	0.06	--	--
Hong Kong	4.28	-0.12	--	--

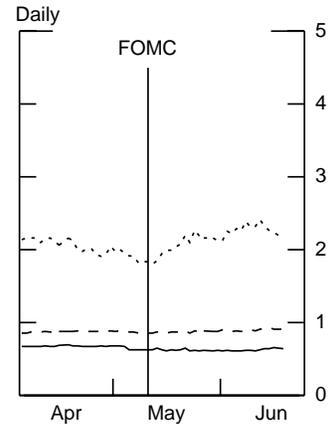
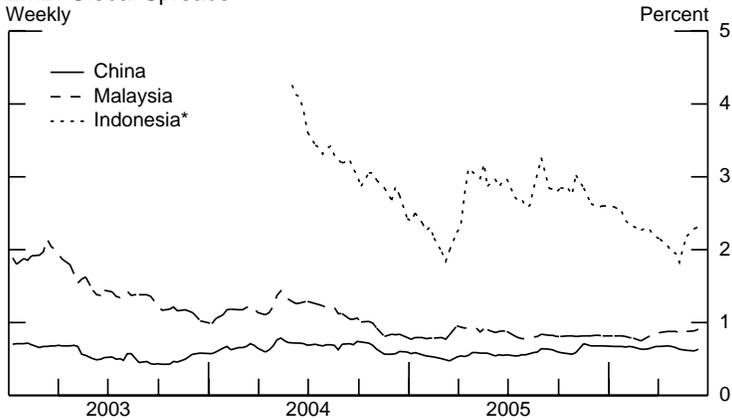
*One month interest rate except 1-week rate for Korea. No reliable short-term interest rate exists for China.

**EMBI+/EMBI Global Spreads over similar-maturity U.S. Treasuries. Korea, Taiwan, Singapore, and Hong Kong have no outstanding dollar-denominated sovereign bonds.

EMBI+ Spreads
Weekly



EMBI Global Spreads
Weekly



*Indonesia EMBI Global series begins May 2004.

Developments in Foreign Industrial Countries

The foreign industrial countries grew at healthy rates in the first quarter. GDP in the euro area and Canada accelerated, while the United Kingdom maintained its pace from the fourth quarter. Although growth in Japan slowed, it was on the high side of most analysts' expectations and domestic demand remained strong. Data on real economic activity in the second quarter point to a possible slowing in Canada, but there are signs of a further pick-up in the euro area and of continued growth in Japan and the United Kingdom, notwithstanding sharp declines in equity indexes in these countries.

The central banks of the euro area and Canada both tightened policy in the intermeeting period. The European Central Bank cited inflation fears in enacting its rate hike. The Bank of Canada, at the time of its tightening, stated that inflation was evolving in line with its expectations, but subsequent data indicate that inflation has risen further. Inflation in the United Kingdom moved above the Bank of England's target. Inflation in Japan rose slightly, helping to solidify confidence that deflation in consumer prices has ended. Despite the increases in headline inflation, core inflation remained below 2 percent in most countries.

First-quarter GDP in **Japan** grew at an annual rate of 3.1 percent. Although overall growth slowed from the pace in the fourth quarter, private domestic demand accelerated. Household consumption rose 2 percent and private gross fixed investment rose 11.2 percent. In contrast, public spending changed little, and net exports were flat despite a 15 percent increase in imports as exports nearly matched this pace. The GDP deflator fell 1.2 percent from a year ago, close to its average rate over the last two years; however, there were some signs for optimism as the deflator for household consumption fell only 0.2 percent, the smallest decline in six years.

Indicators point to a strong start for investment spending in the second quarter. Production of capital goods rose 8.9 percent in April, while shipments of capital goods rose 12.9 percent and core machinery orders (excluding ships and orders from electric power plants) rebounded 10.8 percent. The construction sector also appeared strong, as housing starts rose 9.1 percent. Indicators of household demand were weaker, however; average new car registrations for the first two months of the quarter declined 2.9 percent from the first quarter's average, and although real spending by households rose 0.4 percent in April, retail sales fell slightly. The external sector also registered a weak beginning to the quarter; real exports edged down 0.6 percent in April while real imports

rose 2.9 percent. Despite this somewhat mixed data, the labor market continued to improve, with the unemployment rate remaining at 4.1 percent in April and the offers-to-applicants ratio (the number of officially posted job openings relative to the number of officially registered job seekers) returning to a thirteen-year high.

Japanese Real GDP

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

Component	2004 ¹	2005 ¹	2005			2006
			Q2	Q3	Q4	Q1
GDP	.5	4.0	5.5	1.0	4.5	3.1
Total domestic demand	.3	3.2	4.8	.8	2.1	3.4
Consumption	.6	3.3	3.1	1.9	2.6	2.0
Private investment	1.3	5.6	6.6	6.3	2.3	11.2
Public investment	-9.4	-1.8	4.4	2.4	-9.6	-2.5
Government consumption	1.4	1.6	.4	2.0	.4	.6
Inventories ²	-.1	.1	1.4	-1.9	.5	.1
Exports	10.2	10.5	14.5	12.9	16.2	11.4
Imports	9.7	4.7	9.2	13.2	-2.3	15.0
Net exports ²	.3	.9	.9	.3	2.4	.0

1. Q4/Q4.

2. Percentage point contribution to GDP growth.

Core consumer prices (which exclude fresh food but include energy) in the Tokyo area rose 0.2 percent in May and were 0.4 percent higher than a year ago, while nation-wide core consumer prices remained 0.5 percent higher than a year earlier in April. Trends in energy prices continued to play an important role in inflation, as twelve-month inflation in consumer prices for the country excluding both fresh food and energy was only 0.2 percent. In a further sign that deflation is ending, urban land prices in Japan's six largest cities rose 3.8 percent from a year ago in the first quarter of 2006, marking the first increase since 1991.

The Bank of Japan maintained its policy of keeping overnight rates near zero. The Bank temporarily halted the decline in its outstanding balance of reserves accounts when overnight interest rates approached the Bank's ceiling of 0.1 percent. The outstanding balance of reserve accounts is now about ¥17 trillion, down from a range of ¥30 - ¥35 trillion under the Bank's previous policy of quantitative easing.

Japanese Economic Indicators

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

Indicator	2005		2006	2006			
	Q3	Q4	Q1	Feb.	Mar.	Apr.	May
Industrial production ¹	-.5	2.7	.6	-1.2	.2	1.4	n.a.
All-industries index	.2	1.1	.5	-.9	-.4	n.a.	n.a.
Housing starts	6.5	-2.0	1.7	6.0	-8.2	9.1	n.a.
Machinery orders ²	3.2	2.8	-.4	1.5	-5.2	10.8	n.a.
Machinery shipments ³	1.7	4.0	-.2	-1.9	.4	5.0	n.a.
New car registrations	-5.0	-4.5	2.9	-.6	.1	-2.4	-2.4
Unemployment rate ⁴	4.3	4.5	4.2	4.1	4.1	4.1	n.a.
Job offers ratio ⁵	.97	1.00	1.03	1.04	1.01	1.04	n.a.
Business sentiment ⁶	2.0	5.0	5.0	...	...	...	...
CPI (core, Tokyo area) ⁷	-.4	-.3	.2	.2	.2	.3	.4
Wholesale prices ⁷	1.7	2.1	2.8	3.0	2.7	2.5	3.3

1. Mining and manufacturing.
 2. Private sector, excluding ships and electric power.
 3. Excluding orders for ships and from electric power companies.
 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.

Euro-area real GDP accelerated to an annual growth rate of 2.4 percent in the first quarter from 1.2 percent in the previous quarter. Final domestic demand contributed 2.2 percentage points to GDP growth, fueled by a 2.8 percent rise in private consumption. International trade also supported the first-quarter rebound; export growth outpaced import growth, on net adding 1.1 percentage points to GDP growth.

Recent data suggest that household spending has continued to buoy activity in the second quarter. The average volume of euro-area retail sales rose 1.3 percent in April from the previous month, paced by continued strong sales in France and by resurgent sales in Germany, which jumped 4.3 percent. Euro-area consumer confidence moved up further in May to a 3½-year high, buoyed by a sharp improvement in perceptions of employment prospects as the euro-area harmonized unemployment rate remained at a four-year low of 8 percent in April. German industrial production rose 1.6 percent in April, as output in the construction industry rebounded sharply from a decline in March caused by poor weather, but production fell more than 1 percent in France and Italy, leading overall euro-area IP to fall 0.6 percent. Other indicators, however, point to rising production; the

euro-area PMI advanced further in May for both the manufacturing and services sectors, reaching the highest levels since 2000.

Euro-area consumer prices rose 0.3 percent in May from the previous month. The 12-month rate of inflation edged up to 2.5 percent. Core inflation, excluding energy and unprocessed food, fell back to 1.5 percent in May after reaching 1.6 percent in April. The European Central Bank raised its main refinancing rate to 2.75 percent at its June policy meeting, citing elevated inflation pressures and strong credit growth.

Euro-Area Real GDP

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

Component	2004 ¹	2005 ¹	2005			2006
			Q2	Q3	Q4	Q1
GDP	1.6	1.7	1.6	2.6	1.2	2.4
Total domestic demand	2.0	1.9	2.4	2.8	2.2	1.3
Consumption	1.8	1.0	1.3	2.1	.4	2.8
Investment	1.9	2.9	5.6	4.2	1.0	1.0
Government consumption	.5	1.6	2.5	3.0	-1	1.9
Inventories ²	.4	.3	-1	-1	1.7	-9
Exports	5.7	4.8	6.2	11.6	2.8	13.0
Imports	6.9	5.3	8.4	12.1	5.5	10.4
Net exports ²	-4	-1	-7	-1	-1.0	1.1
Memo:						
<i>GDP of selected countries</i>						
France	2.0	1.1	.2	2.5	1.1	2.2
Germany	.5	1.7	1.7	2.5	.0	1.5
Italy	.5	.5	2.5	1.2	-0	2.4

1. Q4/Q4.

2. Percentage point contribution to GDP growth.

Euro-Area Economic Indicators

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

Indicator	2005		2006	2006			
	Q3	Q4	Q1	Feb.	Mar.	Apr.	May
Industrial production ¹	.9	.5	1.0	.0	.6	-.6	n.a.
Retail sales volume ²	.7	.4	.1	-.2	-.7	1.3	n.a.
Unemployment rate ³	8.5	8.3	8.1	8.1	8.0	8.0	n.a.
Consumer confidence ⁴	-14.7	-12.3	-10.7	-10.0	-11.0	-10.0	-9.0
Industrial confidence ⁴	-7.7	-6.0	-2.3	-2.0	-1.0	1.0	2.0
CPI ⁵	2.3	2.3	2.3	2.3	2.2	2.4	2.5
Producer prices ⁵	4.2	4.4	5.3	5.4	5.1	5.4	n.a.
M3 ⁵	8.4	7.4	8.5	8.0	8.5	8.8	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, s.a.

n.a. Not available.

Real GDP in the **United Kingdom** rose 2.3 percent (a.r.) in the first quarter, revised down from a preliminary estimate of 2.6 percent. Private consumption grew only 1.2 percent, after increasing 3.2 percent in the fourth quarter, but fixed investment surged 6.2 percent, well above its 2005 pace. Net exports subtracted 1.8 percentage points from growth, as imports and exports rose 24 and 20 percent, respectively.

Incoming data paint a mixed picture for the second quarter. Industrial production fell 0.5 percent in April, with manufacturing production falling 0.2 percent. In contrast, retail sales grew a robust 0.5 percent in May, the fourth successive month-on-month increase. Housing demand also appears to be growing moderately. The twelve-month change in house prices in May was 10 percent according to the Halifax House Price Index, and net mortgage lending has been fairly stable between £8 and £9 billion since late 2005, compared with a high of nearly £10 billion reached at the peak of housing market activity in 2003. However, the number of loans approved for house purchase dropped from 119,000 in January to 106,000 in April, indicating some risk of a slowdown in the housing market over the next several months.

The twelve-month change in consumer prices rose to 2.2 percent in May, above the Bank of England's target of 2 percent. In its May meeting, the Bank of England's Monetary Policy Committee voted to keep its policy rate constant at 4.5 percent.

UK Real GDP

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

Component	2004 ¹	2005 ¹	2005			2006
			Q2	Q3	Q4	Q1
GDP	2.6	1.8	2.1	2.1	2.3	2.3
Total domestic demand	3.3	1.3	1.5	3.9	1.0	3.9
Consumption	3.8	1.5	.8	2.1	3.2	1.2
Investment	4.1	3.1	-1	11.4	-2.1	6.2
Government consumption	1.2	4.3	5.1	5.8	4.8	2.6
Inventories ²	0	-1.0	-.3	.1	-1.8	1.8
Exports	6.0	7.4	15.4	3.7	9.3	20.1
Imports	7.9	4.8	11.2	9.7	4.0	24.1
Net exports ²	-.8	.5	.6	-1.9	1.2	-1.8

1. Q4/Q4.

2. Percentage point contribution to GDP growth.

U.K. Economic Indicators

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

Indicator	2005		2006	2006			
	Q3	Q4	Q1	Feb.	Mar.	Apr.	May
Real GDP*	1.9	2.2	2.6	...	...	...	...
Industrial production	-.8	-.6	.7	-.4	.7	-.5	n.a.
Retail sales volume ¹	.4	1.6	-.5	.2	.9	.6	.5
Unemployment rate ²							
Claims-based	2.7	2.8	2.9	2.9	3.0	3.0	3.0
Labor force survey ³	4.8	5.0	5.2	5.2	5.3	n.a.	n.a.
Business confidence ⁴	5.0	-2.0	8.0	10.0	13.0	12.0	10.0
Consumer confidence ⁵	-2.0	-4.0	-4.0	-2.0	-6.0	-3.0	-6.0
Consumer prices ⁶	2.4	2.1	2.0	2.1	1.8	2.0	2.2
Producer input prices ⁷	12.5	13.5	14.4	14.9	12.7	15.3	13.8
Average earnings ⁷	4.1	3.6	4.2	5.0	4.4	3.6	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.

In **Canada**, real GDP grew 3.8 percent (a.r.) in the first quarter, led by a jump in consumer spending on durables and housing. Investment in residential structures grew at its fastest rate in over two years, and business investment continued its strength of the previous two quarters, contributing 1.9 percentage points to growth. The level of exports fell a bit, but because imports declined by more, net exports contributed 0.3 percentage point to overall GDP growth, only the second positive contribution of net exports to growth in the past seven quarters.

Overall, indicators for the second quarter point to a deceleration of GDP. Housing starts fell sharply between March and April and remained at this lower level in May, although starts continued to be elevated. The merchandise trade balance declined for a fourth consecutive month in April. The volume of manufacturing new orders and shipments both fell in April, with shipments declining in two-thirds of manufacturing industries. In contrast, the labor market continued its strength of the past year, adding about 20,000 jobs in April and nearly 100,000 jobs in May, most of which were full-time positions in the service sector. The very strong May pushed the unemployment rate down to 6.1 percent, a 32-year-low, and the employment rate (the fraction of the working-age population that is employed) to a record-high of 63.2 percent. The retail sector provided another clear bright spot, as the volume of retail sales rose 1.2 percent in April.

On May 24, the Bank of Canada increased its target for the overnight rate $\frac{1}{4}$ -percentage point to 4.25 percent, following $\frac{1}{4}$ percentage point increases at each of its previous six meetings. In its accompanying statement, the Bank said that "...both CPI and core inflation are evolving largely in line with the Bank's expectations" and that the policy rate is "...now at a level that is expected to keep the Canadian economy on the base-case path..." Market participants appeared to interpret these statements as a signal the Bank might pause in its rate-hike campaign; however, participants may have become more wary of that interpretation as recent inflation data has exceeded expectations. The twelve-month rate of consumer price inflation jumped to 2.8 percent in May while the twelve-month rate of core inflation, which excludes the eight most volatile components, rose to 2 percent.

Canadian Real GDP

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

Component	2004 ¹	2005 ¹	2005			2006
			Q2	Q3	Q4	Q1
GDP	3.7	2.8	3.4	3.2	2.6	3.8
Total domestic demand	5.6	3.7	2.3	4.4	4.6	3.3
Consumption	3.8	3.8	3.4	2.6	3.6	4.6
Investment	7.0	7.2	4.5	9.6	7.9	8.4
Government consumption	3.2	3.0	2.6	3.0	4.4	2.3
Inventories ²	1.3	-.6	-1.1	.2	-.0	-1.7
Exports	2.7	4.5	-1.8	8.5	6.4	-.9
Imports	8.1	6.9	-3.7	11.2	12.7	-1.6
Net exports ²	-2.0	-.9	.8	-1.0	-2.4	.3

1. Q4/Q4.

2. Percentage point contribution to GDP growth.

Canadian Economic Indicators

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

Indicator	2005		2006	2006			
	Q3	Q4	Q1	Feb.	Mar.	Apr.	May
GDP by industry	.9	.7	.8	.3	.1	n.a.	n.a.
Industrial production	1.0	.6	-.3	.3	-.1	n.a.	n.a.
New manufacturing orders	1.2	.7	-1.3	2.5	1.2	-2.3	n.a.
Retail sales	.2	.6	2.0	.2	1.2	1.2	n.a.
Employment	.4	.6	.4	.2	.3	.1	.6
Unemployment rate ¹	6.8	6.5	6.4	6.4	6.3	6.4	6.1
Consumer prices ²	2.6	2.3	2.4	2.2	2.2	2.4	2.8
Core consumer prices ^{2,3}	1.6	1.6	1.7	1.7	1.7	1.7	2.0
Consumer attitudes (1991 = 100)	108.3	118.4	121.0	...	...	...	...
Business confidence (1991 = 100)	127.1	147.2	146.0	...	...	...	...

1. Percent.

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

3. Excluding the 8 most volatile components (fruits, vegetables, gasoline, fuel oil, natural gas, mortgage interest, intercity transportation, and tobacco).

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

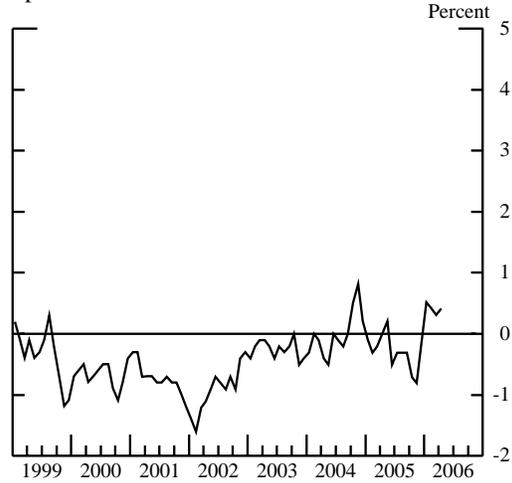
External Balances
(Billions of U.S. dollars, s.a.a.r.)

Country and balance	2005		2006	2006		
	Q3	Q4	Q1	Feb.	Mar.	Apr.
<i>Japan</i>						
Trade	67.3	67.1	62.4	64.1	64.0	39.4
Current account	158.7	182.0	166.6	164.3	173.0	116.5
<i>Euro area</i>						
Trade	11.1	-9.4	-20.1	-40.2	-5.1	-12.8
Current account	-45.0	-97.8	-37.9	-57.3	-46.2	n.a.
<i>Germany</i>						
Trade	199.3	181.1	170.2	177.0	158.8	184.6
Current account	106.7	100.1	107.7	148.9	77.8	109.3
<i>France</i>						
Trade	-28.0	-32.7	-30.2	-29.1	-26.4	-33.7
Current account	-25.8	-48.1	-28.8	-4.5	-5.1	33.4
<i>Italy</i>						
Trade	-18.4	-17.5	-25.3	-29.1	-23.5	-24.5
Current account	-32.0	-27.4	-33.6	-42.0	-26.6	-33.6
<i>United Kingdom</i>						
Trade	-126.8	-125.1	-137.5	-150.6	-119.5	-122.0
Current account	-78.4	-76.6	n.a.	...	...	...
<i>Canada</i>						
Trade	58.7	69.9	58.8	55.8	55.3	42.7
Current account	26.9	44.4	36.9	...	...	...

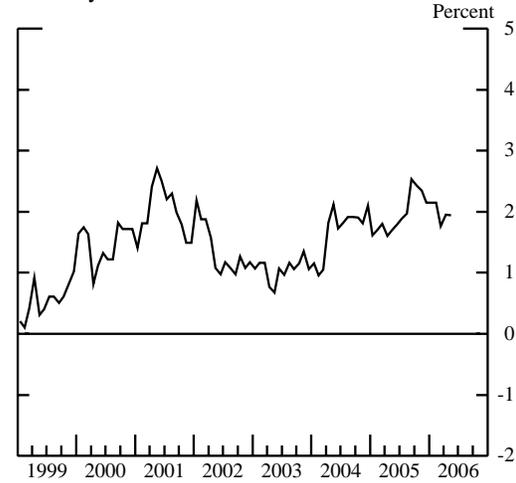
n.a. Not available. ... Not applicable.

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

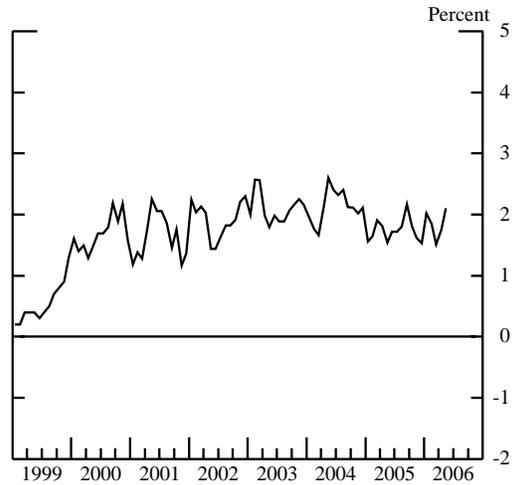
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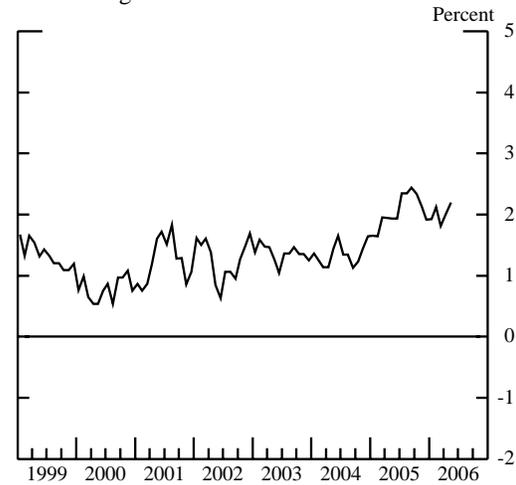
Germany



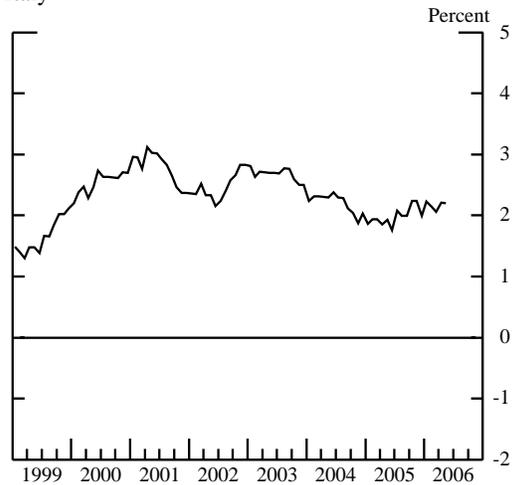
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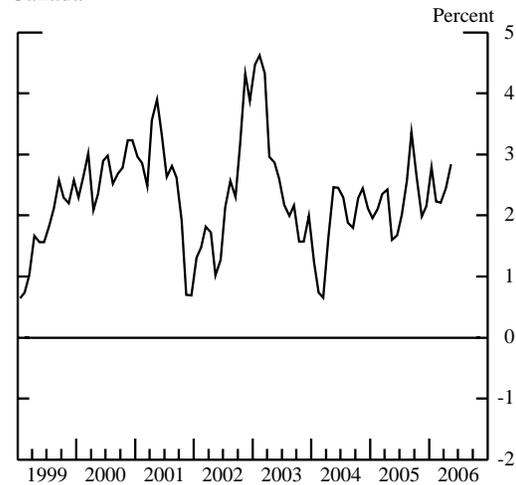
United Kingdom



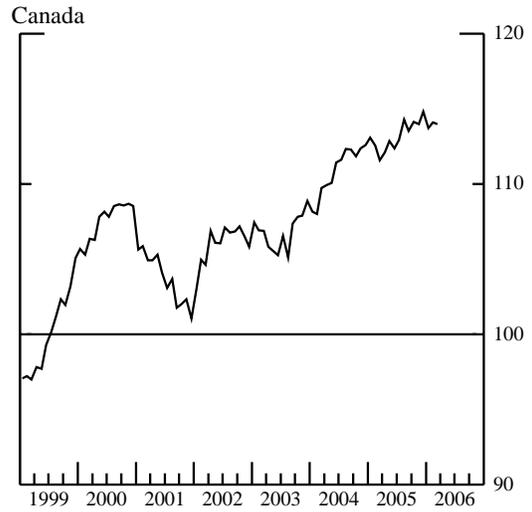
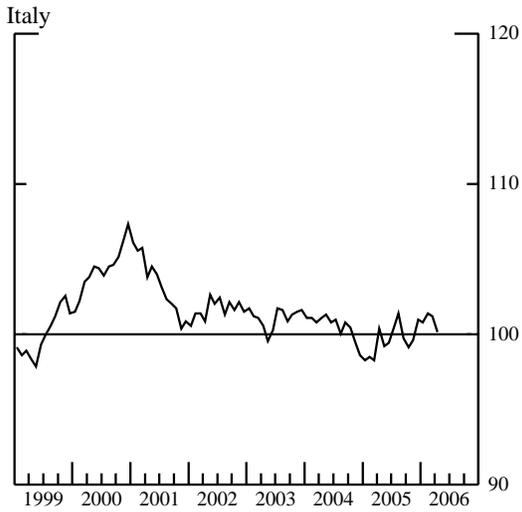
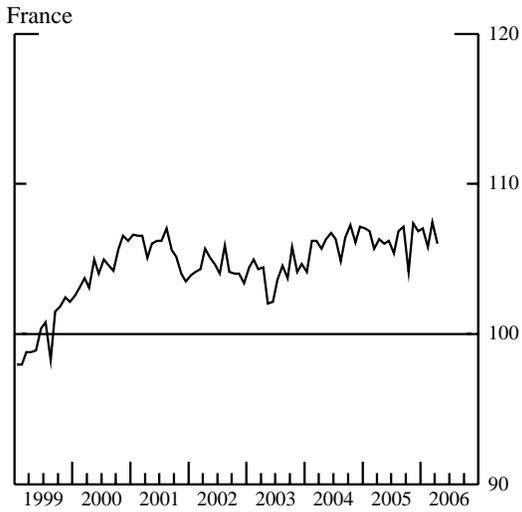
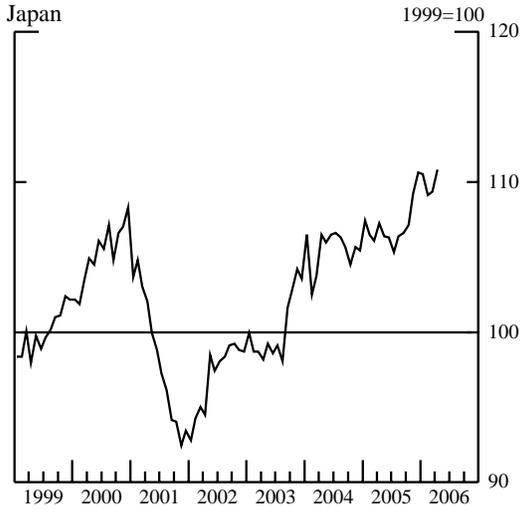
Italy



Canada



Industrial Production in Selected Industrial Countries



Economic Situation in Other Countries

Incoming data for emerging market economies indicate activity accelerated moderately in the first quarter, led by a strong performance in Latin America, particularly in Mexico and Brazil. Average economic growth in emerging Asia continued at the same strong pace of the fourth quarter, as Chinese growth surged but activity in Singapore, Korea, and Taiwan decelerated. In the second quarter, economic indicators are consistent with moderation and with a slight rise in inflation, particularly in Asia. Sharp declines in asset prices have led to difficulties in some vulnerable emerging markets countries, particularly Turkey, but do not appear to have had more generalized effects to date.

Chinese economic data point to continued rapid growth. In May, industrial production jumped over 3 percent, after holding flat the previous month. In the twelve-month period ending May, retail sales rose 14 percent, the fastest pace in over a year, while bank loan and M2 growth picked up, the latter to 20 percent. In response, the central bank raised reserve requirements for commercial banks ½ percentage point. The trade surplus moderated a bit to \$145 billion (a.r.) in May after sluggish import performance contributed to a record-setting April surplus of almost \$170 billion. Investment rose more than 30 percent over the twelve months ending in May, despite recent government measures to slow growth. The government recently enacted a series of additional measures to slow investment in real estate, including raising down payment requirements, tightening lending restrictions on developers, and levying a tax on homes sold within five years of purchase. The government's target for investment growth in 2006 is 18 percent. Consumer price inflation edged up to 1.4 percent over the twelve months ending in May.

Chinese Economic Indicators

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

Indicator	2004	2005	2005	2006			
			Q4	Q1	Mar.	Apr.	May
Real GDP ¹	10.1	9.9	11.5	13.3	...	...	...
Industrial production	14.4	17.1	4.0	5.3	1.0	-.1	3.1
Consumer prices ²	2.5	1.6	1.4	1.2	.8	1.2	1.4
Trade balance ³	32.1	102.0	93.3	132.4	151.9	169.1	145.3

1. Annual rate. Quarterly data estimated by staff from reported four-quarter growth rates. Annual data are Q4/Q4.

2. Percent change from year-earlier period, except annual data, which are Dec./Dec.

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

... Not applicable.

In **Hong Kong**, real GDP jumped 10 percent (a.r.) in the first quarter, driven largely by strong growth in real exports of goods and services. In April, twelve-month inflation rose to 2.3 percent, largely reflecting rising housing rents, while the trade deficit widened as import growth outpaced export growth. In May, the unemployment rate edged down to its lowest level in almost five years.

Hong Kong Economic Indicators

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

Indicator	2004	2005	2005	2006			
			Q4	Q1	Mar.	Apr.	May
Real GDP ¹	7.3	7.4	2.4	10.0	...	...	...
Unemployment rate ²	6.9	5.7	5.3	5.2	5.2	5.1	4.9
Consumer prices ³	.2	1.8	1.8	2.0	1.8	2.3	n.a.
Trade balance ⁴	-12.0	-10.5	-12.2	-14.2	-10.8	-16.6	n.a.

1. Annual rate. Annual data are Q4/Q4.

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

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

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

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

In **Taiwan**, real GDP contracted slightly in the first quarter, largely due to a decline in net exports. In April, however, export orders for electronics increased smartly, contributing to sizeable trade surpluses in April and May. Twelve-month inflation bottomed out in March before rising to 1.6 percent in May, as food and energy prices increased.

Taiwan Economic Indicators

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

Indicator	2004	2005	2005	2006			
			Q4	Q1	Mar.	Apr.	May.
Real GDP ¹	2.6	6.4	7.7	-7	...	...	...
Unemployment rate ²	4.4	4.1	4.0	4.0	3.9	3.9	n.a.
Industrial production	9.8	4.1	.4	2.1	-.7	2.6	n.a.
Consumer prices ³	1.6	2.2	2.5	1.3	.4	1.2	1.6
Trade balance ⁴	6.1	7.8	24.0	1.0	2.0	19.2	9.7
Current account ⁵	18.5	16.1	36.5	25.5	...	...	...

1. Annual rate. Annual data are Q4/Q4.

2. Percent.

3. Percent change from year-earlier period, except annual data, 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 **Korea**, incoming data suggest continued moderation in economic growth from last year's fast pace. Industrial production fell 1.5 percent in April. Outside of the high-tech and energy sectors, losses were widespread, particularly in the auto sector, which experienced labor-related disruptions. Moreover, recent consumer and business confidence surveys have fallen sharply from their Q4 peaks. In April, a current account deficit of over \$18 billion (not-seasonally adjusted), in part, reflected sluggish exports. Consumer prices rose 2.4 percent over the twelve months ending in May. The Bank of Korea raised its target rate 25 basis points to 4.25 percent in early June, citing continued economic recovery, persistently high oil prices, and a rebound in real estate prices.

Korean Economic Indicators

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

Indicator	2004	2005	2005	2006			
			Q4	Q1	Mar.	Apr.	May
Real GDP ¹	2.9	5.3	6.7	4.9	...	...	...
Industrial production	10.0	5.9	5.5	3.1	.9	-1.5	n.a.
Unemployment rate ²	3.5	3.7	3.6	3.5	3.5	3.5	3.4
Consumer prices ³	3.0	2.6	2.5	2.4	2.0	2.0	2.4
Trade balance ⁴	37.6	33.5	31.9	25.8	41.8	25.7	n.a.
Current account ⁵	28.2	16.6	21.7	-4.5	-5.1	-18.4	n.a.

1. Annual rate. Annual data are Q4/Q4.

2. Percent.

3. Percent change from year-earlier period, except annual data, 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 **ASEAN** GDP data indicate that growth moderated in the first quarter, except in Malaysia. The external sector supported growth; however, domestic factors, such as Indonesia's earlier monetary tightening and removal of fuel subsidies, a higher VAT in the Philippines, and political instability in Thailand, weighed on activity. More recently, industrial production fell in Malaysia, Singapore, and Thailand in April and trade surpluses narrowed.

Consumer price inflation remained elevated in much of the region, mainly due to a run-up in food and energy prices. In Indonesia, inflation remained below its peak in the fourth quarter, when the government sharply reduced fuel subsidies. Citing the moderation in inflation and weakness in domestic demand, the central bank of Indonesia cut interest rates 25 basis points in early May. In contrast, the Bank of Thailand further

raised its benchmark interest rate 25 basis points in early June to contain inflationary pressures, but signaled it will likely pause before raising rates again.

In late May, Indonesia announced plans to use foreign reserves held at the central bank to pay off by 2007 the remaining \$7.8 billion in outstanding debt owed to the IMF. The original payment schedule called for final payment by 2010.

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

Indicator	2004	2005	2005	2006			
			Q4	Q1	Feb.	Mar.	Apr.
<i>Real GDP¹</i>							
Indonesia	7.0	5.0	4.0	3.0	...	...	...
Malaysia	5.9	5.2	4.5	9.4	...	...	...
Philippines	5.5	5.5	5.6	3.8	...	...	...
Singapore	6.6	8.5	12.5	6.8	...	...	...
Thailand	5.4	4.7	3.1	3.0	...	...	...
<i>Industrial production²</i>							
Indonesia ³	3.3	1.3	-1.9	.2	5.9	-2.7	.8
Malaysia	11.7	4.1	-.3	3.9	-7.2	10.7	-6.9
Philippines	1.0	2.2	7.7	-17.0	-1.8	1.4	n.a.
Singapore	13.9	9.5	5.4	1.8	18.5	-3.7	-11.5
Thailand	11.6	9.1	-1.3	2.6	5.2	.4	-1.2

1. Annual rate. Annual data are Q4/Q4.

2. Annual data 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	2004	2005	2005	2006			
			Q4	Q1	Mar.	Apr.	May
Indonesia	25.1	28.0	35.5	40.1	40.9	36.0	n.a.
Malaysia	21.2	26.4	25.1	29.4	27.9	25.8	n.a.
Philippines	-4.4	-6.2	-8.2	-.4	2.8	n.a.	n.a.
Singapore	25.1	29.6	33.0	40.7	48.7	35.2	21.7
Thailand	1.5	-8.6	-8.6	1.4	6.8	2.5	n.a.

n.a. Not available.

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

Indicator	2004 ¹	2005 ¹	2005	2006			
			Q4	Q1	Mar.	Apr.	May
Indonesia	6.6	17.0	17.8	17.0	15.8	15.4	15.6
Malaysia	2.1	3.3	3.3	3.8	4.8	4.6	3.9
Philippines	8.6	6.7	6.9	7.3	7.6	7.1	6.9
Singapore	1.3	1.3	1.1	1.4	1.2	1.1	n.a.
Thailand	2.9	5.8	6.0	5.7	5.7	6.0	6.2

1. Dec./Dec.

n.a. Not available

Performance of the **Indian** economy remains robust. GDP growth soared 15.6 percent (a.r.) in the first quarter, led by sharp increases in agriculture and services. More recently, industrial production rose 1 percent in April after an almost 2½ percent gain in March. In early June, the government announced it was raising gasoline and diesel prices by over 9 and 6 percent, respectively. Possibly in response to this, as well as the strong GDP figure, the Bank of India surprised markets in early June by hiking the reverse repo rate 25 basis points to 5.75 percent, in advance of its scheduled policy meeting in July.

Indian Economic Indicators

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

Indicator	2004	2005	2005	2006			
			Q4	Q1	Mar.	Apr.	May
Real GDP ¹	7.0	7.5	6.4	15.6	...	...	...
Industrial production	8.5	7.9	2.6	2.3	2.4	1.0	n.a.
Consumer prices ²	3.8	5.6	5.0	4.2	3.6	3.7	n.a.
Wholesale prices ²	6.7	4.4	4.5	4.0	3.9	3.7	4.4
Trade balance ³	-21.7	-38.7	-32.5	-42.1	-44.7	-48.2	-39.2
Current account ⁴	1.4	-12.9	-15.4	n.a.	...	...	...

1. Annual rate. Annual data are Q4/Q4.

2. Percent change from year-earlier period, except annual data, which are Dec./Dec.

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

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

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

In **Mexico**, first-quarter real GDP rose a higher-than-expected 6.3 percent (a.r.), with gains widespread across sectors. In April, industrial production more than reversed its March decline, rising to a level about $\frac{3}{4}$ percent above the first-quarter average, following a gain of nearly 2 percent in the first quarter. Recent data on U.S. manufacturing IP, which tracks Mexican GDP growth relatively well, also suggest growth moderated in the second quarter. The trade balance was positive in the first quarter on the back of a surge in automobile exports, but was negative in April, as imports increased.

Twelve-month headline inflation declined to 3 percent in May, at the center of the Bank of Mexico's 2-to-4 percent target range, despite the noticeable depreciation of the peso in recent months. On the political front, recent opinion polls suggest that conservative Felipe Calderon is in a statistical tie with leftist Andres Manuel Lopez-Obrador heading into the July 2 presidential election.

Mexican Economic Indicators

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

Indicator	2004	2005	2005	2006			
			Q4	Q1	Mar.	Apr.	May
Real GDP ¹	4.8	2.7	2.7	6.3	...	...
Overall economic activity	3.8	3.3	.5	2.0	.1	n.a.	n.a.
Industrial production	3.9	1.9	2.1	1.7	-1.2	1.7	n.a.
Unemployment rate ²	3.9	3.6	3.3	3.4	3.5	3.4	n.a.
Consumer prices ³	5.2	3.3	3.1	3.7	3.4	3.2	3.0
Trade balance ⁴	-8.8	-7.6	-5.2	1.2	-6.4	-1.1	n.a.
Imports ⁴	196.8	221.8	237.8	243.9	243.8	252.9	n.a.
Exports ⁴	188.0	214.2	232.6	245.2	237.4	251.9	n.a.
Current account ⁵	-6.5	-4.7	-8.0	3.5	...	...	...

1. Annual rate. Annual data 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 data, which are Dec./Dec.

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

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

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

In **Brazil**, real GDP jumped 5.7 percent (a.r.) in the first quarter, supported by very strong performance in manufacturing, mining, and construction. Incoming second-quarter indicators are mixed. April industrial production was flat following a dip the previous month, but auto sales for April and May were strong. Twelve-month inflation continued its decline, falling to 4.2 percent in May, aided by declining prices for ethanol.

In late May, the central bank reduced its target for the overnight interest rate by 50 basis points to 15.25 percent, bringing the cumulative decline to 450 basis points since the current easing phase began last September. The minutes of the meeting, released a week later, indicated that the onset of market volatility over the past month had increased the committee's uncertainty about inflation prospects, prompting it to temper the extent of easing. The Brazilian government also responded to the volatility by canceling its scheduled auctions of fixed-rate and CPI-linked debts, by buying back some of its CPI-linked debt, and by reinstating auctions of floating rate debt in late May. So far this year, the government has retired \$13 billion in external debt (mostly through debt buybacks and the exercise of call options on Brady bonds) out of \$20 billion it announced earlier in the year. Recent polls suggest Lula remains comfortably in the lead in the run up to the October presidential election.

Brazilian Economic Indicators

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

Indicator	2004	2005	2005	2006			
			Q4	Q1	Mar.	Apr.	May
Real GDP ¹	4.7	1.5	3.8	5.7	...	...	...
Industrial production	8.3	3.1	.6	1.1	-3	.0	n.a.
Unemployment rate ²	11.5	9.8	9.6	9.8	9.8	9.6	n.a.
Consumer prices ³	7.6	5.7	6.1	5.5	5.3	4.6	4.2
Trade balance ⁴	33.6	44.8	50.3	45.3	46.0	40.0	33.6
Current account ⁵	11.7	14.2	12.7	7.2	16.2	2.9	n.a.

1. Annual rate. Annual data are Q4/Q4.

2. Percent.

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

Price index is IPCA.

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**, after a strong fourth quarter, output growth subsided to 4.7 percent (a.r.) in the first quarter, with the deceleration widespread across sectors. At the same time, the unemployment rate moved up, on a non-seasonally adjusted basis, as it has in the first quarter of previous years. In April, industrial production rose modestly from the previous month; on a twelve-month basis, IP was up 7¾ percent, owing largely to increased production of automobiles, cement and agricultural chemicals. In May, twelve-month inflation edged down to 11.5 percent, in part due to the voluntary price agreements the government has secured in several sectors.

Argentine Economic Indicators

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

Indicator	2004	2005	2005	2006			
			Q4	Q1	Mar.	Apr.	May.
Real GDP ¹	9.0	8.9	8.0	4.7	...	...	...
Industrial production	10.7	7.7	2.5	.5	.3	.3	n.a.
Unemployment rate ²	13.6	11.6	10.1	11.4	...	...	...
Consumer prices ³	5.9	12.2	11.6	11.5	11.1	11.7	11.5
Trade balance ⁴	12.1	11.4	9.9	9.5	10.6	10.5	n.a.
Current account ⁵	3.3	5.4	5.9	n.a.	...	...	...

1. Annual rate. Annual data are Q4/Q4.

2. Percent; n.s.a.

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

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

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

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

In **Venezuela**, real GDP decelerated in the first quarter, but growth was still high at 8.6 percent (a.r.). High petroleum prices and expansionary fiscal and monetary policies have supported the strong growth seen over the past two years. Inflation declined on a twelve-month basis to 10.4 percent in May. Despite high oil prices, the central bank's international reserves have remained below \$30 billion over the past year, as the Chavez government transferred oil profits to off-budget funds used to support spending. In June, the government proposed replacing the bolivar, which has been pegged at 2,150 to the dollar since early 2005, with a new currency that would be worth 2.15 to the dollar, starting in 2008.

Venezuelan Economic Indicators

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

Indicator	2004	2005	2005	2006			
			Q4	Q1	Mar.	Apr.	May
Real GDP ¹	12.1	10.2	14.4	8.6	...	...	...
Unemployment rate ²	15.1	12.2	11.8	n.a.	n.a.	n.a.	n.a.
Consumer prices ³	19.2	14.4	15.2	12.5	12.1	11.3	10.4
Non-oil trade balance ⁴	-10.5	-16.5	-25.6	-26.1	n.a.	n.a.	n.a.
Trade balance ⁴	21.4	31.5	35.7	41.8	n.a.	n.a.	n.a.
Current account ⁵	13.8	25.4	25.6	29.9	...	...	...

1. Annual rate. Annual data are Q4/Q4.

2. Percent.

3. Percent change from year-earlier period, except annual data, 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 **Turkey**, real GDP rose almost 9.4 percent in the fourth quarter from a year earlier, driven in part by increases in private consumption and investment. Reflecting strong domestic demand and the depreciation of the Turkish lira (24 percent since the beginning of the year), twelve-month inflation reached almost 10 percent in May (led by increases in clothing prices), well above the central bank's year-end upper target of 7 percent. Producer price inflation for May suggests that supply shocks from metals and energy prices may also be fuelling overall inflation. However, the weaker lira should help narrow the current account deficit, which reached 7 percent of GDP in April.

In response to rising inflation and to recent financial market turbulence, in early June the central bank raised its key interest rates 175 basis points to 15 percent for the borrowing rate and 18 percent for the lending rate. In its latest auction, the Turkish Treasury paid roughly 400 basis points more on its 2-year bond than in the last auction about a month earlier. The main equity index has fallen about 15 percent (year-to-date), and the sovereign bond spread has risen about 60 basis points over the past month (although it is still about 10 basis points lower than a year ago). In addition, though there have been some delays, Turkey remains on-track in both its IMF review and EU-accession talks.

Turkey Economic Indicators

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

Indicator	2004	2005	2005	2006			
			Q4	Q1	Mar.	Apr.	May.
Real GDP ¹	9.0	7.4	9.4	n.a.	...	...	...
Industrial production	9.8	5.4	2.5	-.6	.3	-.2	n.a.
Consumer prices ²	9.4	7.7	7.6	8.1	8.2	8.8	9.9
Trade balance ³	-34.4	-43.1	-43.1	-50.7	-48.1	-64.0	n.a.
Current account ⁴	-15.6	-23.1	-23.9	-31.9	-21.9	-40.7	n.a.
Unemployment rate	10.3	10.3	10.6	10.2	...	...	...

1. Percent change from year-earlier period. Annual data are annual averages.
 2. Percent change from year-earlier period, except annual data, which are Dec./Dec.
 3. Billions of U.S. dollars, annual rate. Imports are c.i.f.
 4. Billions of U.S. dollars, n.s.a., annual rate.
- n.a. Not available. ... Not applicable.