

Prefatory Note

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

Please note that some material may have been redacted from this document if that material was received on a confidential basis. Redacted material is indicated by occasional gaps in the text or by gray boxes around non-text content. All redacted passages are exempt from disclosure under applicable provisions of the Freedom of Information Act.

August 4, 2006

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Supplemental Notes

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

Contents

The Domestic Nonfinancial Economy 1

Employment Situation 1

Motor Vehicle Production..... 1

Tables

Changes in Employment 2

Selected Unemployment and Labor Force Participation Rates 3

Production of Domestic Light Vehicles..... 5

Charts

Labor Force Participation Rate and Unemployment Rate 3

Persons Working Part Time for Economic Reasons..... 3

Job Leavers Unemployed Less Than Five Weeks 3

Inventories of Light Vehicles..... 5

Days' Supply of Light Vehicles..... 5

The Domestic Financial Economy 6

Table

Selected Financial Market Quotations 6

The International Economy 7

Table

Summary of U.S. International Transactions..... 8

Supplemental Notes

The Domestic Nonfinancial Economy

Employment Situation

Employment on private nonfarm payrolls rose 113,000 in July. The increase was similar to the upward-revised average monthly increase of 99,000 in the second quarter and down from the 169,000 average of the first quarter. The unemployment rate moved up to 4.8 percent—0.1 percentage point above its second-quarter average—and the labor force participation rate held steady at 66.2 percent. In July, jobless rates for younger workers, which tend to be more variable, were somewhat higher than during the second quarter while rates of workers aged 25 and older were unchanged from their second-quarter averages.

Employment in manufacturing fell 15,000 in July, although employment in the related industry of transportation and warehousing rose 10,000. The construction industry added 6,000 jobs, with virtually all the strength continuing to come in the nonresidential components. Employment in retail trade was unchanged in July after three months of substantial decline. Employment in services continued to increase, with computer services, engineering services, and accommodations displaying particular vigor. Government employment was unchanged, on net, despite another increase in federal employment. Employment at state and local governments, which had risen relatively strongly in the first quarter, declined in July, and the increases in May and June are now reported to have been much smaller than previously estimated.

The average workweek remained at 33.9 hours in July. Aggregate hours of production or nonsupervisory workers rose 0.1 percent and were 0.3 percent (not at an annual rate) above their second-quarter average. With the revisions to earlier months, the rise in this measure of aggregate hours for the second quarter was revised up slightly to an annual rate of 2.6 percent.

Average hourly earnings of production or nonsupervisory workers on private nonfarm payrolls rose 0.4 percent in July, close to the average monthly increase in the second quarter. For the twelve months ending in July, average hourly earnings increased 3.8 percent, up from the 2.9 percent pace of the preceding twelve months.

Motor Vehicle Production

On August 4, industry production plans for the third quarter were reduced by 100,000 units (annual rate), to 11½ million units. For July, scheduled production was cut quite

Changes in Employment

(Thousands of employees; seasonally adjusted)

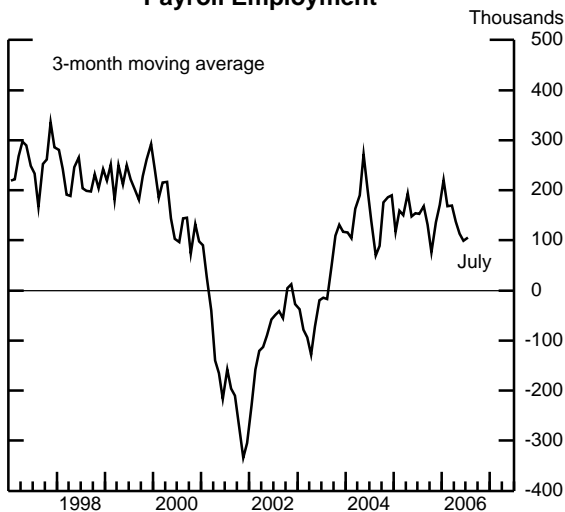
Measure and sector	2005	2005			2006		
		Q4	Q1	Q2	May	June	July
	Average monthly change				Monthly change		
Nonfarm payroll employment (establishment survey)	165	179	176	112	100	124	113
Private	152	171	169	99	94	109	113
Natural resources and mining	4	4	6	5	2	5	7
Manufacturing	-6	12	1	10	-10	22	-15
Construction	25	30	26	1	-4	-4	6
Wholesale trade	7	7	13	9	9	8	1
Retail trade	13	11	2	-28	-35	-4	0
Transportation and utilities	6	6	4	12	13	8	11
Information	-1	-2	2	-4	-9	-1	-9
Financial activities	12	17	20	9	7	-5	6
Professional and business services	41	41	26	38	65	37	43
Temporary help services	14	18	-8	0	17	-10	-2
Nonbusiness services ¹	51	44	69	47	57	44	63
Total government	14	8	7	13	6	15	0
Total employment (household survey)	221	115	287	241	288	387	-34
Memo:							
Aggregate hours of private production workers (percent change) ²	2.3	2.1	3.0	2.6	-.1	.4	.1
Average workweek (hours) ³	33.8	33.8	33.8	33.9	33.8	33.9	33.9
Manufacturing (hours)	40.6	40.9	41.0	41.2	41.2	41.3	41.5

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

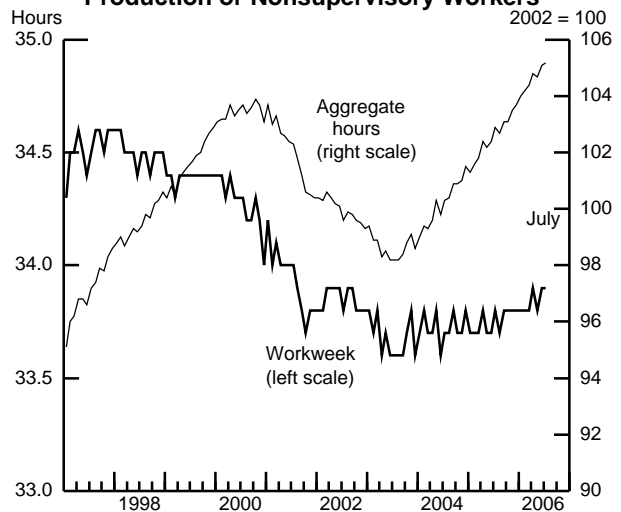
2. Establishment survey. Annual data are percent changes from Q4 to Q4. Quarterly data are percent changes from preceding quarter at an annual rate. Monthly data are percent changes from preceding month.

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	2006					
		Q4	Q1	Q2	May	June	July
<i>Civilian unemployment rate</i>							
Total	5.1	5.0	4.7	4.7	4.6	4.6	4.8
Teenagers	16.6	16.1	15.5	14.7	14.0	15.4	15.5
20-24 years old	8.8	8.5	8.1	8.1	8.1	7.9	8.5
Men, 25 years and older	3.8	3.7	3.6	3.6	3.7	3.5	3.6
Women, 25 years and older	4.2	4.2	3.9	3.8	3.8	3.7	3.8
<i>Labor force participation rate</i>							
Total	66.0	66.1	66.0	66.1	66.1	66.2	66.2
Teenagers	43.7	43.4	43.7	43.8	43.5	44.5	44.0
20-24 years old	74.6	74.8	74.0	74.2	74.5	74.1	74.5
Men, 25 years and older	75.4	75.3	75.5	75.5	75.5	75.4	75.3
Women, 25 years and older	59.4	59.6	59.4	59.5	59.4	59.7	59.9

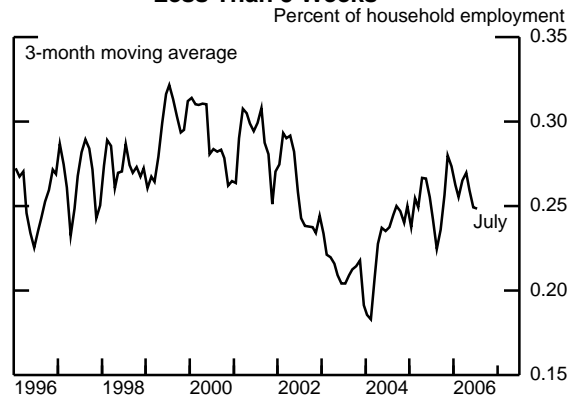
Labor Force Participation Rate and Unemployment Rate



Persons Working Part Time for Economic Reasons



Job Leavers Unemployed Less Than 5 Weeks



dramatically (by 800,000 units) and now stands at an annual rate of about 10.9 million units; however, much of this shortfall in production will be made up later in the third quarter. GM reportedly experienced some unplanned start-up delays last month in the assembly of its redesigned line of pickup trucks.

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

Item	2005	2006						
		Q1	Q2	Q3	May	June	July	Aug.
U.S. production ¹	11.5	11.2	11.1	11.1	10.9	11.3	10.5	11.2
Autos	4.3	4.5	4.3	4.5	4.3	4.1	4.4	4.5
Light trucks	7.2	6.7	6.8	6.5	6.5	7.1	6.0	6.6
Days' supply ²	69	69	74	n.a.	74	75	n.a.	n.a.
Autos	52	53	54	n.a.	55	55	n.a.	n.a.
Light trucks	81	80	90	n.a.	88	90	n.a.	n.a.
Inventories ³	3.04	3.01	3.05	n.a.	2.98	3.05	n.a.	n.a.
Autos	.93	.99	.95	n.a.	.96	.95	n.a.	n.a.
Light trucks	2.11	2.03	2.09	n.a.	2.01	2.09	n.a.	n.a.
Memo: U.S. production, total motor vehicles ⁴	12.0	11.7	11.6	11.5	11.3	11.6	10.9	11.6

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

1. Production rates for the third quarter reflect the latest industry schedules.

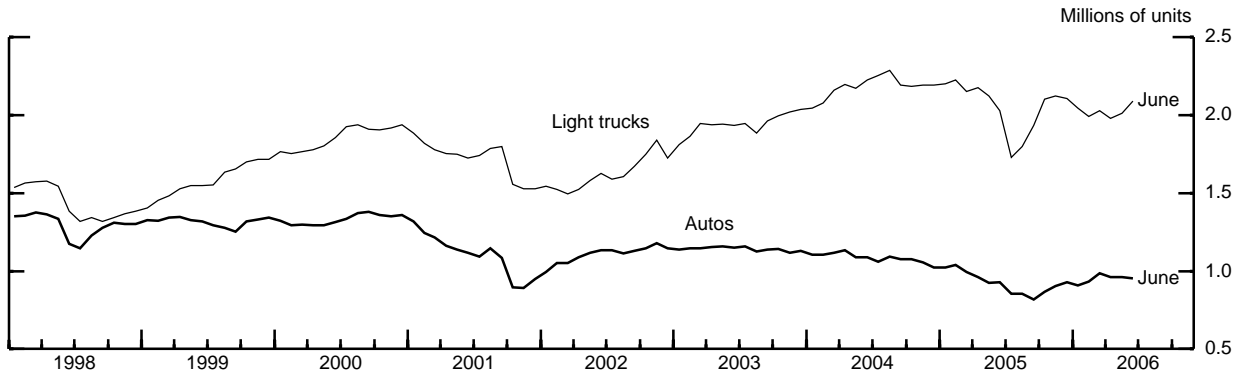
2. Annual and quarterly values are calculated with end-of-period stocks and average reported sales.

3. End-of-period stocks.

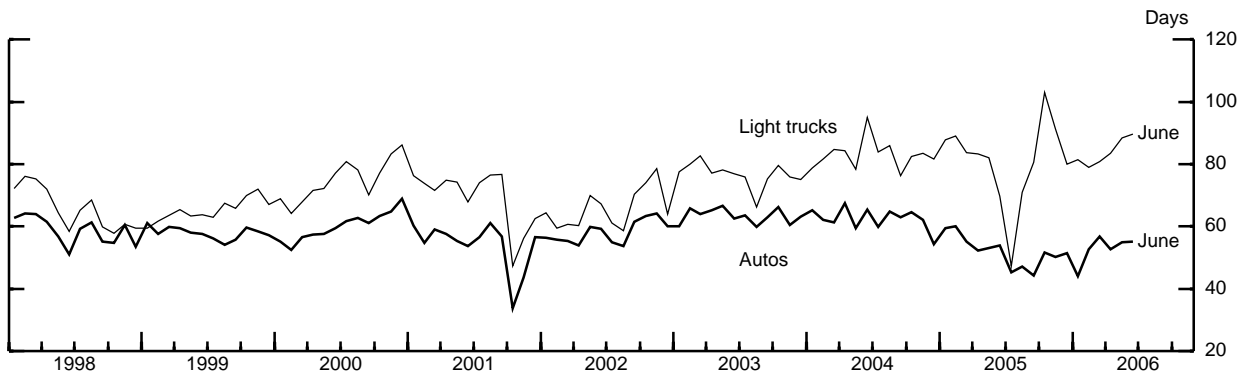
4. Includes medium and heavy trucks.

n.a. Not available.

Inventories of Light Vehicles



Days' Supply of Light Vehicles



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

Instrument	2004	2005	2006		Change to Aug. 3 from selected dates (percentage points)		
	June 28	Dec. 30	June 28	Aug. 3	2004 June 28	2005 Dec. 30	2006 June 28
<i>Short-term</i>							
FOMC intended federal funds rate	1.00	4.25	5.00	5.25	4.25	1.00	.25
Treasury bills ¹							
3-month	1.36	3.99	4.88	4.98	3.62	.99	.10
6-month	1.74	4.22	5.10	4.99	3.25	.77	-.11
Commercial paper (A1/P1 rates) ²							
1-month	1.28	4.23	5.26	5.29	4.01	1.06	.03
3-month	1.45	4.37	5.37	5.37	3.92	1.00	.00
Large negotiable CDs ¹							
3-month	1.53	4.49	5.47	5.44	3.91	.95	-.03
6-month	1.82	4.65	5.58	5.50	3.68	.85	-.08
Eurodollar deposits ³							
1-month	1.29	4.36	5.34	5.38	4.09	1.02	.04
3-month	1.51	4.52	5.48	5.47	3.96	.95	-.01
Bank prime rate	4.00	7.25	8.00	8.25	4.25	1.00	.25
<i>Intermediate- and long-term</i>							
U.S. Treasury ⁴							
2-year	2.88	4.43	5.32	5.00	2.12	.57	-.32
5-year	3.97	4.35	5.20	4.87	.90	.52	-.33
10-year	4.90	4.47	5.32	5.01	.11	.54	-.31
U.S. Treasury indexed notes							
5-year	1.56	2.03	2.60	2.29	.73	.26	-.31
10-year	2.25	2.10	2.68	2.37	.12	.27	-.31
Municipal general obligations (Bond Buyer) ⁵	5.01	4.38	4.68	4.49	-.52	.11	-.19
Private instruments							
10-year swap	5.21	4.92	5.80	5.54	.33	.62	-.26
10-year FNMA ⁶	5.30	4.82	5.55	5.36	.06	.54	-.19
10-year AA ⁷	5.59	5.25	6.19	5.90	.31	.65	-.29
10-year BBB ⁷	6.18	5.84	6.76	6.46	.28	.62	-.30
5-year high yield ⁷	8.30	8.28	8.81	8.62	.32	.34	-.19
Home mortgages (FHLMC survey rate)							
30-year fixed	6.21	6.21	6.78	6.63	.42	.42	-.15
1-year adjustable	4.19	5.16	5.82	5.69	1.50	.53	-.13

Stock exchange index	Record high		2005	2006		Change to Aug. 3 from selected dates (percent)		
	Level	Date	Dec. 30	June 28	Aug. 3	Record high	2005 Dec. 30	2006 June 28
Dow Jones Industrial	11,723	1-14-00	10,718	10,974	11,243	-4.10	4.90	2.45
S&P 500 Composite	1,527	3-24-00	1,248	1,246	1,280	-16.18	2.56	2.75
Nasdaq	5,049	3-10-00	2,205	2,112	2,092	-58.56	-5.12	-.92
Russell 2000	782	5-5-06	673	688	704	-9.91	4.63	2.37
Wilshire 5000	14,752	3-24-00	12,518	12,554	12,826	-13.05	2.46	2.17

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

NOTES:

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

The International Economy

U.S. International Financial Transactions

Foreign official flows into the United States (line 1 of the Summary of U.S. International Transactions table) moved up a touch in June, and the pace of official inflows for the first half of 2006 is well above the average pace of 2005.

Official inflows from OPEC (line 1.b) picked up in June, as did inflows from other oil-producing countries including Mexico, Norway, and Russia. G-10 countries and the ECB (line 1a) continued to reduce their official holdings in the United States.

Net private foreign purchases of U.S. securities (line 4) decreased slightly in June from May's robust level. However, total second-quarter securities purchases were well below those of recent quarters because of very weak inflows in April. Flows into U.S. Treasury securities (line 4a) picked up considerably in June, although purchases for the first half of 2006 were noticeably lower than those recorded in recent years. Following extremely strong May inflows, private foreign purchases of agency bonds (line 4b) eased in June. Even with this easing, agency bond purchases in the first half of 2006 exceeded those recorded for all of 2005. Foreign purchases of corporate bonds in June (line 4c) maintained the robust pace of recent months, and were primarily recorded against the United Kingdom. Private foreigners on net sold corporate stocks in June (line 4d), and net purchases for the second quarter were nil. Because of strong purchases in the first quarter, however, stock inflows for the first half of 2006 remained sizable relative to historical levels.

U.S. acquisitions of foreign securities (line 5) fell back in June, although purchases for the first half of 2006 were slightly above last year's robust pace. Flows into foreign bonds (line 5a) eased, and on net there were minimal stock flows (line 5b). U.S. investors purchased a fair amount of European equities in June, but these purchases were offset by sales of Asian equities.

There were strong net outflows recorded by the banking sector (line 3) in June after two months of net inflows. This volatility is not unusual, however, as the magnitude and direction of banking flows often vary significantly from month to month.

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

	2004	2005	2005		2006			
			Q3	Q4	Q1	Q2	May	Jun
Official financial flows	388.2	214.6	39.4	79.1	76.2	73.8	26.7	25.7
1. Change in foreign official assets in the U.S. (increase, +)	385.4	200.5	34.6	74.3	75.7	74.4	26.0	27.1
a. G-10 countries + ECB	161.7	-20.7	-4.0	-4.1	-8.1	-18.2	-2.8	-6.7
b. OPEC	12.1	7.5	-3.7	10.6	12.0	13.7	3.9	5.2
c. All other countries	211.6	213.8	42.3	67.9	71.8	78.9	25.0	28.7
2. Change in U.S. official reserve assets (decrease, +)	2.8	14.1	4.8	4.8	.5	-.6	.6	-1.4
Private financial flows	194.2	570.8	216.8	163.6	81.5	n.a.	...	...
Banks								
3. Change in net foreign positions of banking offices in the U.S. ¹	-3.8	18.3	22.6	56.6	-2.7	44.4	21.3	-67.1
Securities²								
4. Foreign net purchases of U.S. securities (+)	489.5	610.5	175.1	184.9	176.0	129.1	62.3	55.6
a. Treasury securities	104.2	179.1	35.7	60.4	-3.8	11.5	8.9	20.7
b. Agency bonds	67.9	67.5	34.6	17.0	40.4	28.2	20.2	8.1
c. Corporate and municipal bonds	255.0	274.2	73.6	83.2	84.3	88.9	30.7	32.1
d. Corporate stocks ³	62.4	89.7	31.2	24.4	55.0	.5	2.5	-5.2
5. U.S. net acquisitions (-) of foreign securities	-146.2	-197.2	-47.5	-48.8	-53.3	-49.5	-22.3	-11.3
a. Bonds	-60.9	-53.1	-12.3	-5.5	-11.9	-34.0	-16.3	-11.0
b. Stock purchases	-97.6	-140.1	-35.1	-43.3	-37.4	-15.5	-6.0	-3
c. Stock swaps ³	12.2	-4.0	.0	.0	-4.0	.0	.0	.0
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-244.1	-9.1	30.3	25.8	-61.8	n.a.	...	...
7. Foreign direct investment in the U.S.	133.2	109.8	44.5	26.5	33.3	n.a.	...	...
8. Foreign acquisitions of U.S. currency	14.8	19.4	4.7	9.2	1.9	n.a.	...	...
9. Other (inflow, +) ⁴	-49.1	19.1	-12.9	-90.6	-11.8	n.a.	...	...
U.S. current account balance (s.a.)	-665.3	-791.5	-183.4	-223.1	-208.7	n.a.	...	...
Capital account balance (s.a.)⁵	-2.3	-4.4	-.6	-.5	-1.8	n.a.	...	...
Statistical discrepancy (s.a.)	85.1	10.4	-72.2	-19.1	52.8	n.a.	...	...

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.