

Prefatory Note

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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.

Part 2

December 6, 2006

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

December 6, 2006

Recent Developments

Domestic Nonfinancial Developments

Domestic Nonfinancial Developments

On balance, the incoming data have left intact our assessment that real activity is increasing at a subdued rate during the second half of this year. Residential construction declined further in October and continues to exert considerable restraint on overall real activity. In contrast, consumer spending and business fixed investment have increased at a moderate pace. Meanwhile, production in the industrial sector was held down by further reductions in motor vehicle output; outside of motor vehicles and utilities, output edged up. More broadly, employment gains have been reasonably well maintained in recent months, and the labor market has tightened further. Additional sharp declines in energy prices pushed total consumer price inflation lower in October; core inflation, however, remained above its year-earlier level.

Labor Market Developments

The demand for labor has continued to increase at a moderate pace. Although employment on private nonfarm payrolls rose just 58,000 in October, upwardly revised estimates for previous months now show that private employers added an average of 135,000 jobs per month in the third quarter—somewhat more than our estimate of the amount required to absorb the trend increase in the labor force. In October, employment declined in goods-producing industries, in which the manufacturing and construction industries posted sizable job losses.¹ In contrast, professional and nonbusiness services industries continued to add jobs at a brisk clip. In addition, government employment jumped 34,000, primarily because of hiring in local education, which has been expanding robustly in recent months. Despite the smaller gain in employment in October, an uptick in the average workweek boosted aggregate hours of production or nonsupervisory workers on private nonfarm payrolls 0.3 percent.

The increases in the household survey measure of employment have outpaced those from the payroll survey in recent months: The unemployment rate fell from 4.7 percent in August to 4.4 percent in October—the lowest level since May 2001. Although the less-volatile estimate from the establishment survey is our preferred measure of monthly employment change, the household survey's measure of employment also contains useful information for medium-term trends in employment, and the recent strength in this indicator highlights the possibility that labor demand might be stronger than what is suggested by the latest payroll data.

¹ About one-fourth of the decline in manufacturing employment was due to a strike at Goodyear.

Changes in Employment

(Thousands of employees; seasonally adjusted)

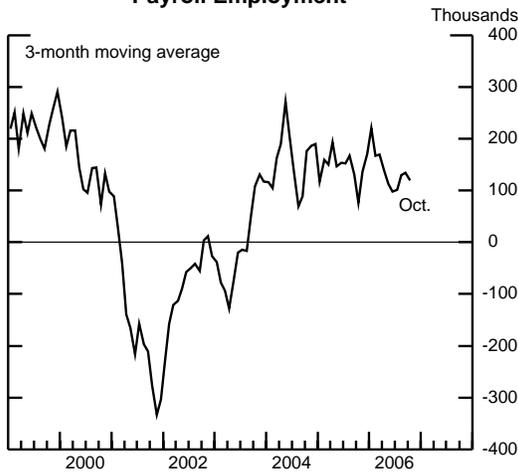
Measure and sector	2005	2006					
		Q1	Q2	Q3	Aug.	Sept.	Oct.
		Average monthly change			Monthly change		
Nonfarm payroll employment (establishment survey)	165	176	115	167	230	148	92
Private	152	169	98	135	180	120	58
Natural resources and mining	4	6	5	2	3	1	5
Manufacturing	-6	1	11	-13	-4	-12	-39
Construction	25	26	1	6	8	5	-26
Wholesale trade	7	13	8	6	8	11	-3
Retail trade	13	2	-28	-7	-10	-12	-4
Transportation and utilities	6	4	9	9	2	12	6
Information	-1	2	-3	-1	10	-3	2
Financial activities	12	20	11	15	12	27	1
Professional and business services	41	26	40	32	38	14	43
Temporary help services	14	-8	-1	-5	4	-12	15
Nonbusiness services ¹	51	69	44	85	113	77	73
Total government	14	7	17	32	50	28	34
Total employment (household survey)	221	287	241	162	250	271	437
Memo:							
Aggregate hours of private production workers (percent change) ²	2.3	3.0	2.6	1.1	-.1	.1	.3
Average workweek (hours) ³	33.8	33.8	33.9	33.8	33.8	33.8	33.9
Manufacturing (hours)	40.6	41.0	41.2	41.3	41.3	41.1	41.2

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

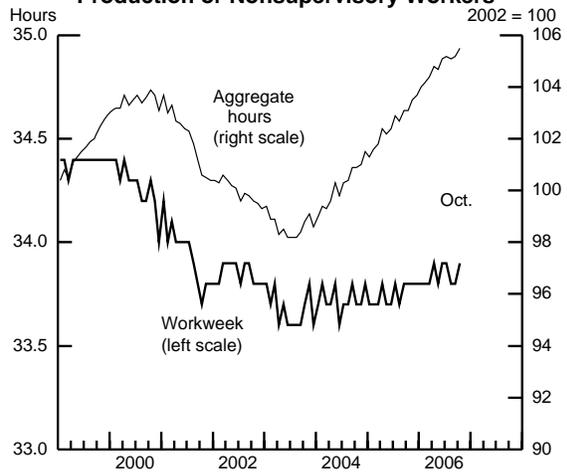
2. Establishment survey. Annual data are percent changes from Q4 to Q4. Quarterly data are percent changes from preceding quarter at an annual rate. Monthly data are percent changes from preceding month.

3. Establishment survey.

Changes in Private Payroll Employment



Aggregate Hours and Workweek of Production or Nonsupervisory Workers

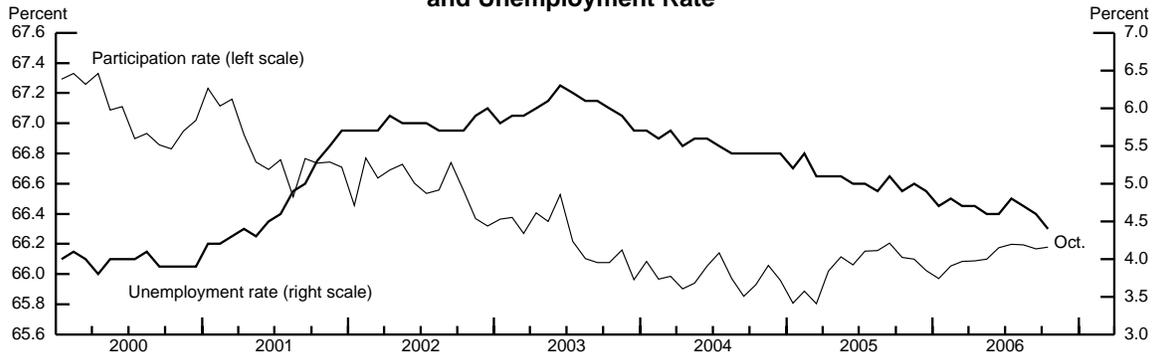


Selected Unemployment and Labor Force Participation Rates

(Percent; seasonally adjusted)

Rate and group	2005	2006					
		Q1	Q2	Q3	Aug.	Sept.	Oct.
<i>Civilian unemployment rate</i>							
Total	5.1	4.7	4.7	4.7	4.7	4.6	4.4
Teenagers	16.6	15.5	14.7	16.1	16.2	16.4	15.4
20-24 years old	8.8	8.1	8.1	8.2	8.2	8.0	8.5
Men, 25 years and older	3.8	3.6	3.6	3.5	3.5	3.3	3.2
Women, 25 years and older	4.2	3.9	3.8	3.8	3.7	3.8	3.4
<i>Labor force participation rate</i>							
Total	66.0	66.0	66.1	66.2	66.2	66.2	66.2
Teenagers	43.7	43.7	43.8	43.6	43.5	43.3	43.3
20-24 years old	74.6	74.0	74.2	74.9	75.5	74.7	74.6
Men, 25 years and older	75.4	75.5	75.5	75.4	75.3	75.5	75.5
Women, 25 years and older	59.4	59.4	59.5	59.8	59.8	59.7	59.8

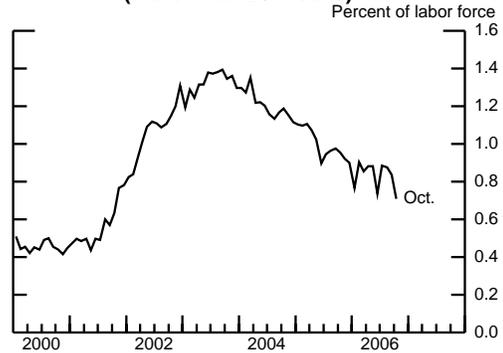
Labor Force Participation Rate and Unemployment Rate



Employment Change in the Household and Payroll Surveys

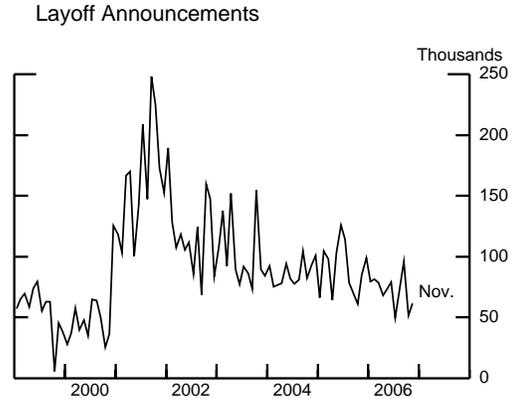
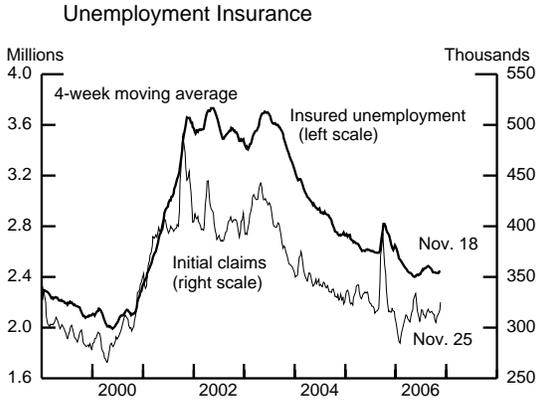


Long-Term Unemployed (More Than 26 Weeks)

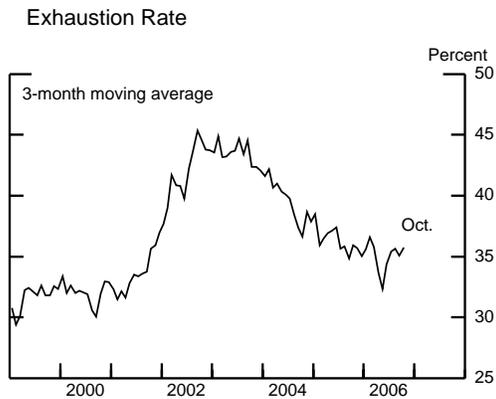


Note. Six-month moving averages.
 * Adjusted to the payroll concept.
 ** Adjusted for benchmark revision.

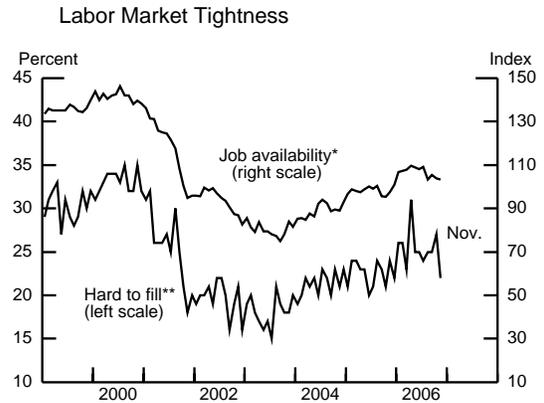
Labor Market Indicators



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



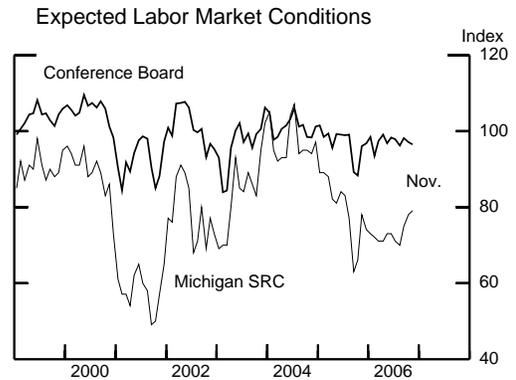
Note. The exhaustion rate is calculated as the number of individuals who were receiving unemployment insurance benefits but reached the end of their potential eligibility expressed as a percent of all individuals who began receiving such benefits 6 months earlier.



*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.



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



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

Other indicators of slack are mixed regarding the extent to which the labor market has further tightened of late. The share of the unemployed who have been out of work more than twenty-six weeks moved down in October, while the fraction of workers who have exhausted their full complement of unemployment insurance benefits—the exhaustion rate—has been little changed over the past few months. In November, the fraction of firms reporting to the National Federation of Independent Business that they had a hard-to-fill position moved down to 22 percent, its lowest level in about a year. Meanwhile, households responding to the Conference Board survey reported that job availability had deteriorated somewhat in November.

The signal from other labor market indicators has deteriorated a touch on balance. The news on layoffs has been mixed. The four-week moving average of initial claims for unemployment insurance moved up 10,000, to 317,000, over the period relevant for predicting unemployment growth for November. For the week ending November 25, the four-week moving average of initial claims rose further, to 325,000; however, we believe this figure was affected by difficulty in seasonally adjusting the initial claims data around the Thanksgiving holiday. Even discounting part of the rise in claims, we are taking some signal from the fact that claims have been elevated for the past two weeks; on net, recent claims data are consistent with further moderate employment gains in November and December. Layoff announcements, as measured by Challenger, Gray, and Christmas, moved down in October and remained at a fairly low level in November; we believe this indicator captures downsizing that will be achieved through layoffs and attrition over the next six to twelve months.

Forward-looking indicators remain favorable on balance. Hiring plans of small businesses moved up in November to their highest level in nearly two years. The fourth-quarter net hiring plans of participants in the Manpower survey edged down but remained in the narrow and relatively high range observed since 2004. The University of Michigan's index of household expectations regarding future developments in labor demand strengthened last month and remains at the high end of the range that has prevailed since the start of the year. The Conference Board measure of expected labor market conditions ticked down last month but has moved little, on net, over the past few months.

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

Component	Proportion 2005 (percent)	2005 ¹	2006		2006		
			Q2	Q3	Aug.	Sept.	Oct.
			Annual rate		Monthly rate		
Total	100.0	3.0	6.6	4.2	.3	-6	.2
Previous	100.0	3.0	6.6	3.6	.0	-6	...
Manufacturing	80.8	4.2	5.1	4.5	.4	-2	-2
Ex. motor veh. and parts	73.7	4.4	5.4	6.2	.3	-1	.1
Ex. high-tech industries	68.9	2.9	4.4	4.4	.1	-3	-1
Mining	9.8	-6.8	10.3	.9	-8	.4	.6
Utilities	9.5	2.9	16.3	5.2	.1	-4.6	4.1
<i>Selected industries</i>							
High technology	4.8	25.7	20.3	33.0	3.5	2.7	2.3
Computers	.8	12.0	16.3	12.7	.8	1.3	1.2
Communications equipment	1.2	25.4	39.2	8.9	-8	2.1	2.4
Semiconductors ²	2.8	29.9	13.4	52.9	6.3	3.3	2.5
Motor vehicles and parts	7.1	2.3	2.2	-11.9	1.8	-1.9	-3.9
<i>Market groups excluding energy and selected industries</i>							
Consumer goods	21.0	2.3	2.7	3.3	.0	-1	.0
Durables	4.1	2.6	-.2	3.3	.6	-1.2	-.8
Nondurables	16.9	2.2	3.5	3.3	-1	.2	.1
Business equipment	8.0	9.6	13.4	14.4	.6	-.5	.8
Defense and space equipment	2.0	9.2	4.5	4.4	-4	.2	.3
Construction supplies	4.4	6.5	-1.2	-1.2	-3	-1.0	.2
Business supplies	7.8	2.7	3.7	.2	-4	-4	.0
Materials	24.4	.6	4.3	2.9	-1	-.4	-.1
Durables	13.7	3.6	6.2	3.4	-2	-.3	-.2
Nondurables	10.7	-3.1	1.9	2.2	.2	-.4	.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- 95 high	2001- 02 low	2006				
				Q1	Q2	Q3	Sept.	Oct.
Total industry	81.0	85.0	73.9	81.1	82.0	82.5	82.1	82.2
Manufacturing	79.8	84.5	72.0	80.3	80.8	81.2	81.0	80.7
Ex. motor veh. and parts	79.9	84.3	71.8	80.5	81.0	81.7	81.6	81.5
Mining	87.3	89.0	85.6	87.9	90.4	91.0	91.1	91.8
Utilities	86.7	93.7	83.7	83.5	86.6	87.5	84.8	88.2
<i>Stage-of-process groups</i>								
Crude	86.4	89.4	83.2	85.8	88.2	89.2	89.3	89.6
Primary and semifinished	82.1	88.1	74.6	82.3	82.9	83.5	82.9	83.2
Finished	77.9	80.5	70.8	78.9	79.7	79.9	79.7	79.3

The staff estimates that productivity in the nonfarm business sector was unchanged in the third quarter after a second-quarter increase of 1.2 percent (annual rate).² Over the past four quarters, output per hour increased 1.3 percent by our estimate—about 1½ percentage points below the pace recorded during the preceding four quarters. According to the Bureau of Labor Statistics, output per hour in the nonfinancial corporate sector rose 5.6 percent in the third quarter of 2006 and 3.8 percent over the four quarters ending in 2006:Q3, just a shade higher than the 3.6 percent pace posted over the previous four quarters.

Output per Hour

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

Sector	2004:Q3	2005:Q3	2005	2006		
	to 2005:Q3	to 2006:Q3	Q4	Q1	Q2	Q3
Nonfarm business						
All persons	2.7	1.3 ¹	-.1	4.3	1.2	.0 ¹
All employees ²	2.4	1.4 ¹	-.7	5.2	1.1	.3 ¹
Nonfinancial corporations ³	3.6	3.8	3.2	11.1	-4.3	5.6

1. Staff estimates.

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

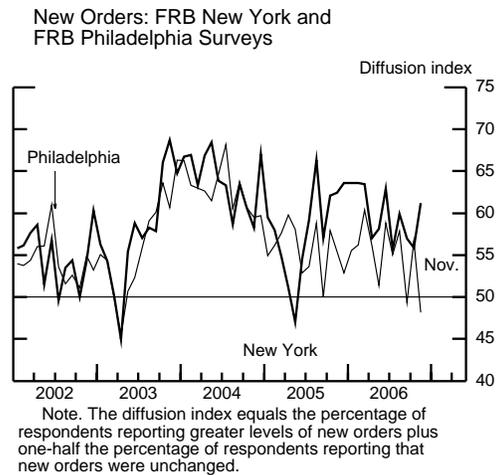
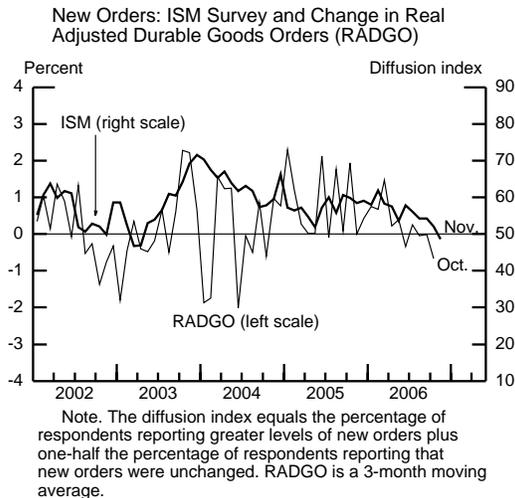
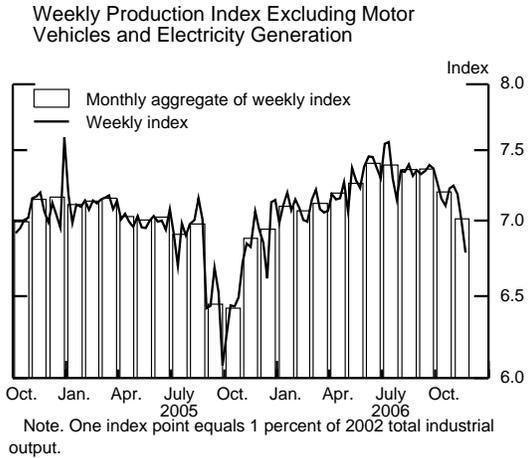
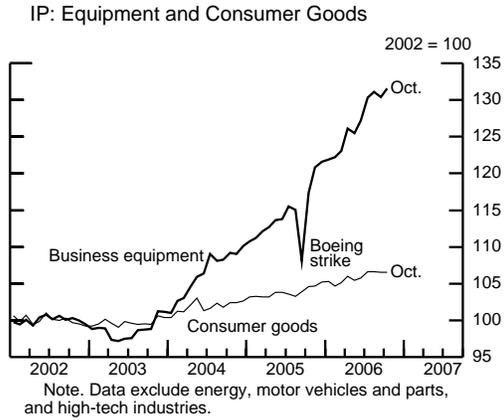
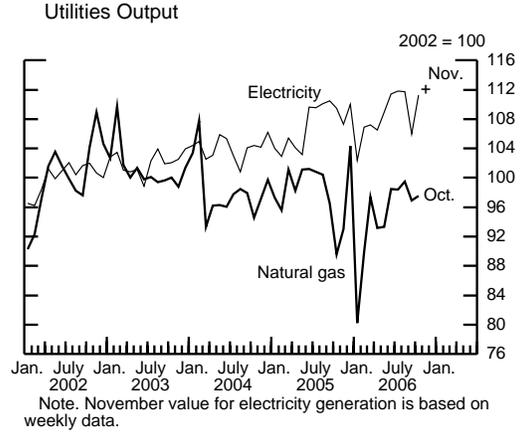
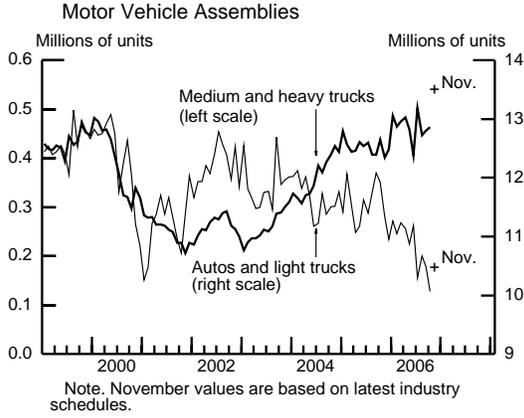
3. All corporations doing business in the United States except banks, stock and commodity brokers, and finance and insurance companies. The sector accounts for about two-thirds of business employment. Nonfinancial corporate output is calculated as an income-side measure.

Industrial Production

Industrial production (IP) advanced at an annual rate of 4¼ percent in the third quarter, a step-down from the pace seen in the first half of the year. Recent monthly changes—an increase of 0.2 percent in October after a sizable drop in September—have been influenced importantly by cutbacks in the motor vehicle sector and weather-related fluctuations in energy output. The available weekly output data for November—principally for motor vehicle assemblies, electricity generation, refining output, steel production, and lumber output—should contribute little, on balance, to the change in IP.

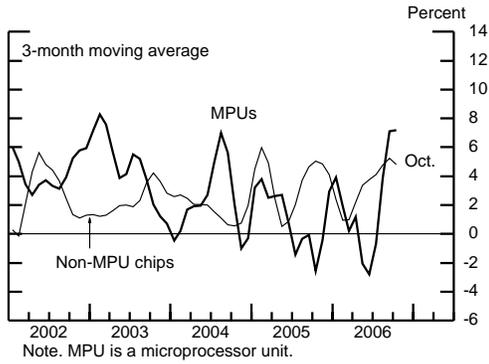
² The Bureau of Labor Statistics (BLS) reported that productivity in the nonfarm business sector rose at an annual rate of 0.2 percent in 2006:Q3. The BLS numbers reflect the nonfarm business output data released by the Bureau of Economic Analysis on November 29; the figures in the text incorporate our latest estimate of output growth.

Indicators of Industrial Activity

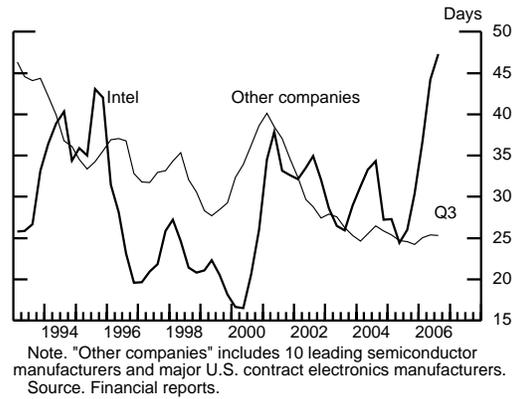


Indicators of High-Tech Manufacturing Activity

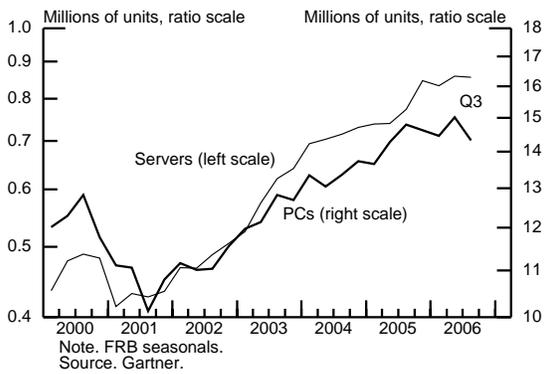
Rate of Change in Semiconductor Industrial Production



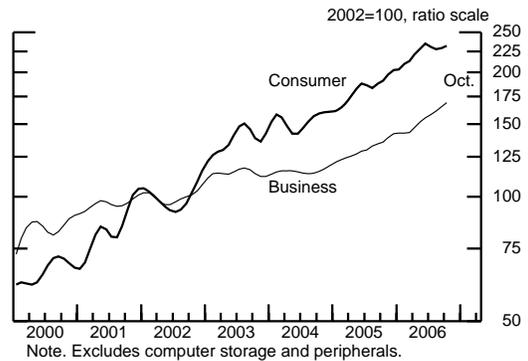
Days' Supply of Semiconductors at Major Manufacturers



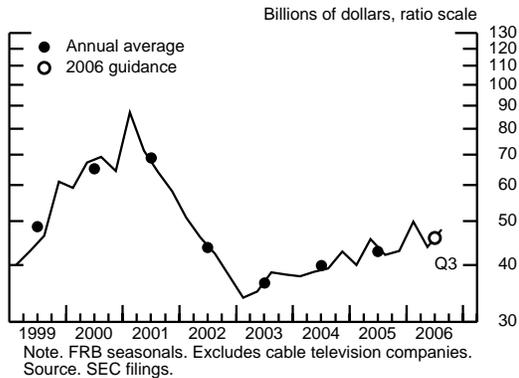
U.S. Personal Computer and Server Sales



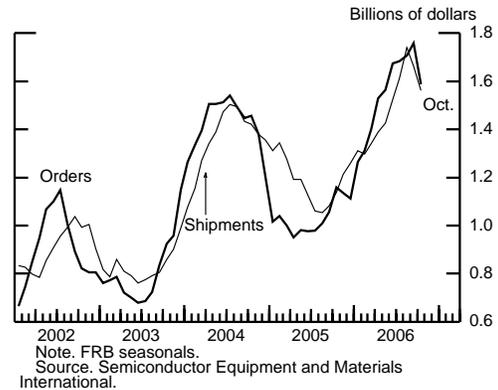
IP: Business and Consumer Computers



Capital Expenditures by Telecommunications Service Providers



Bookings and Billings for Semiconductor Equipment



Manufacturing production posted a second straight monthly decline of 0.2 percent in October, primarily because of continued cutbacks in motor vehicle assemblies. October's decline pushed manufacturing capacity utilization down 0.3 percentage point, to 80.7 percent. This level, however, is still nearly a percentage point above its 1972–2005 average. Excluding the sharp cut in motor vehicle assemblies and related parts production, manufacturing production edged up 0.1 percent after decreasing 0.1 percent in September. Outside of manufacturing, a weather-related rebound in electricity generation contributed nearly 0.4 percentage point to the increase in total IP, while output in the mining sector posted a sizable gain as crude oil extraction in Alaska returned to full production after Prudhoe Bay's partial shutdown.

The IP index for motor vehicles and parts dropped 4 percent in October, as automakers again slashed light truck production in a continued effort to pare back elevated inventories. Total motor vehicle assemblies were 10.5 million units at an annual rate in October, the lowest level of activity since North American automobile production was halted by the United Auto Workers strike in July 1998. Current assembly schedules call for total motor vehicle production to step up to a pace of 11 million units in November and to record a further increase in December. November's rise should contribute roughly 0.2 percentage point to the rate of change of total IP in that month.

IP in high-tech industries increased a solid 2¼ percent in October after having posted average monthly gains of 2¾ percent over the preceding three months. The ongoing rise in the production of semiconductors is being supported by the rollout of a new generation of dual-core microprocessors (MPUs) and by continued stockbuilding at Intel in anticipation of demand for these new MPUs. In addition, other manufacturers have raised the production of memory and graphics-processing chips that are recommended for use with Microsoft's new operating system, Windows Vista.

Computer production posted another moderate increase in October, as solid business demand more than offset further softness in the consumer segment. A recent Gartner forecast suggests that production for the consumer segment will remain tepid through the end of the year because consumers will likely defer purchases in anticipation of the release of Windows Vista.³ Conversely, after several recent launchings of large-server products, output of business computers continued to exhibit solid gains in the third quarter. Production of communications equipment, which softened during July and

³ The final version of Vista was recently released to manufacturers and to large organizations and businesses, but it will not be available to consumers until January 30, 2007.

August, increased more than 2 percent in both September and October, in part because of a pickup in capital expenditures by major telecommunications service providers (TSPs). Annual capital expenditure guidance by TSPs suggests equipment spending—and therefore production—will be muted during the remainder of 2006.

Outside of motor vehicles and parts, energy, and high technology, production among the major market groups was mixed in October after broad-based declines in September. Consumer-goods output was little changed for a third consecutive month, as declines in consumer durables, such as appliances and home-improvement products, offset a small gain in consumer nondurables. Output of business equipment more than reversed its September decline and stood 12 percent above its year-earlier level; it was boosted in part by robust gains in commercial aircraft production. Production of business supplies was unchanged in October, while the output of materials was restrained by a large decline in steel production.⁴ The output of construction supplies edged up in October after having declined in the second and third quarters, as continued decreases in residential construction supplies were more than offset by a gain in supplies more closely associated with nonresidential construction.

Near-term indicators of manufacturing activity suggest little gain in output in the next few months. The Institute for Supply Management's diffusion index for new orders dipped below 50 in November for the first time since April 2003, a sign of little change in near-term manufacturing production, while the corresponding indexes from the Empire State and Philadelphia Business Outlook surveys moved in opposite directions to each other. The three-month moving average of the staff's measure of real adjusted durable goods orders slid in October but was little changed, on balance, over the preceding five months.

Light Motor Vehicles

Sales of light vehicles averaged a modest annual rate of 16 million units in the first two months of the fourth quarter, a half-million units below their third-quarter pace. Concurrently with the recent decline in gasoline prices, sales of large and luxury sport-utility vehicles and pickup trucks have shown renewed signs of life in the past two months. This development may help stem the erosion of market share for the Big Three firms, whose sales are heavily skewed toward these types of vehicles. In line with a shift

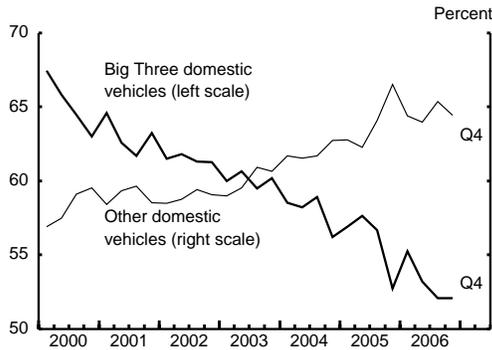
⁴ Industry contacts suggest that steel output will be a drag on materials production through the end of the year, as producers have sharply cut production in response to record levels of imports and to lower demand from automakers, appliance manufacturers, and residential builders.

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

Category	2005	2006					
		Q1	Q2	Q3	Sept.	Oct.	Nov.
Total	16.9	16.9	16.3	16.6	16.6	16.1	16.0
Autos	7.7	7.8	7.8	7.9	7.6	7.3	7.4
Light trucks	9.2	9.1	8.5	8.7	8.9	8.8	8.6
North American ¹	13.5	13.4	12.6	12.8	12.9	12.3	12.2
Autos	5.5	5.7	5.4	5.4	5.3	5.1	5.1
Light trucks	8.0	7.7	7.1	7.4	7.6	7.2	7.2
Foreign-produced	3.4	3.4	3.7	3.7	3.7	3.8	3.8
Autos	2.2	2.1	2.4	2.5	2.3	2.2	2.3
Light trucks	1.2	1.3	1.3	1.3	1.4	1.5	1.4
Memo: Big Three domestic market share (percent) ²	56.8	55.8	53.9	52.8	53.6	53.7	51.9

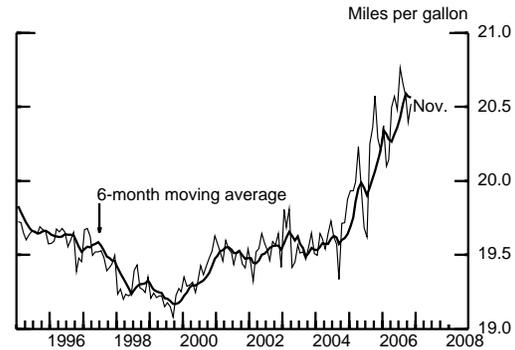
Note. Components may not sum to totals because of rounding.
 1. Excludes some vehicles produced in Canada that are classified as imports by the industry.
 2. Domestic market share excludes sales of foreign brands affiliated with the Big Three.

Market Share



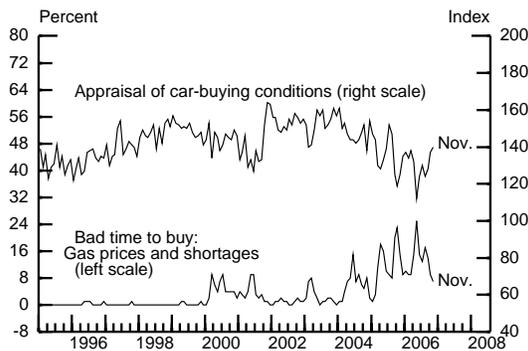
Note. The fourth quarter averages are calculated using October and November values.

New Light Vehicle Fuel Economy

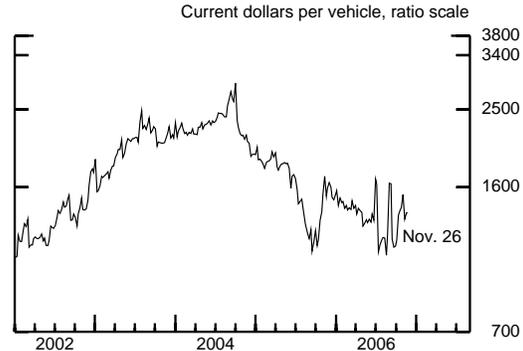


Source. Staff estimate based on a monthly sales-weighted average of city mileage ratings for all new models of light vehicles. Data are seasonally adjusted.

Michigan Survey 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.

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

Item	2006			2007	2006			
	Q2	Q3	Q4	Q1	Aug.	Sept.	Oct.	Nov.
U.S. production ¹	11.1	10.5	10.4	10.7	10.7	10.5	10.1	10.5
Autos	4.3	4.3	4.3	4.0	4.3	4.5	4.4	4.3
Light trucks	6.7	6.2	6.1	6.7	6.4	6.0	5.6	6.2
Days' supply ²	75	70	n.a.	n.a.	73	70	72	n.a.
Autos	54	54	n.a.	n.a.	53	55	60	n.a.
Light trucks	90	82	n.a.	n.a.	88	81	80	n.a.
Inventories ³	3.06	2.95	n.a.	n.a.	2.96	2.95	2.88	n.a.
Autos	.95	.95	n.a.	n.a.	.92	.95	1.00	n.a.
Light trucks	2.10	1.99	n.a.	n.a.	2.04	1.99	1.88	n.a.
Memo: U.S. production, total motor vehicles ⁴	11.5	11.0	10.9	11.0	11.1	10.9	10.5	11.0

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

1. Production rates for November and the fourth and first quarters reflect the latest industry schedules.

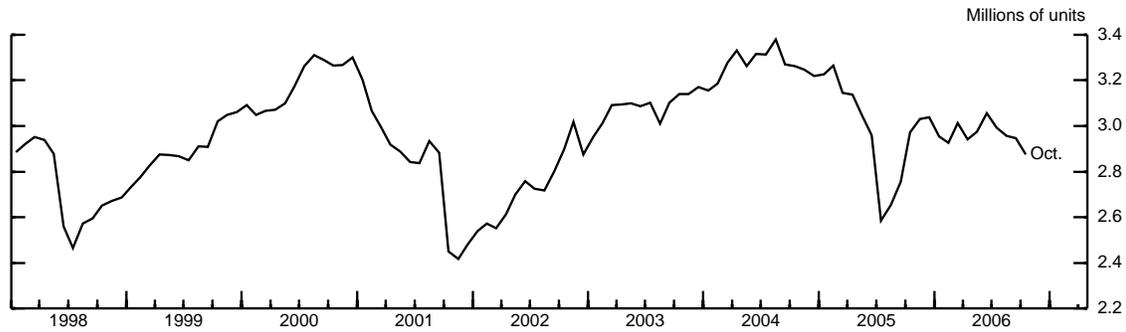
2. Quarterly values are calculated with end-of-period stocks and average reported sales.

3. End-of-period stocks.

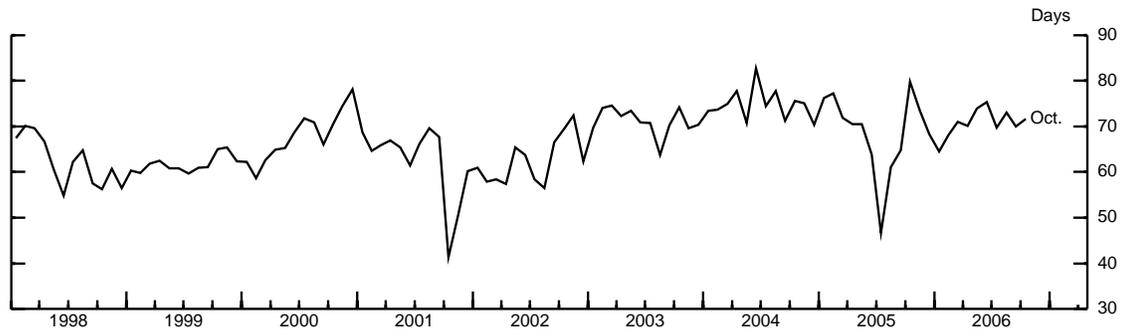
4. Includes medium and heavy trucks.

n.a. Not available.

Inventories of Light Vehicles



Days' Supply of Light Vehicles



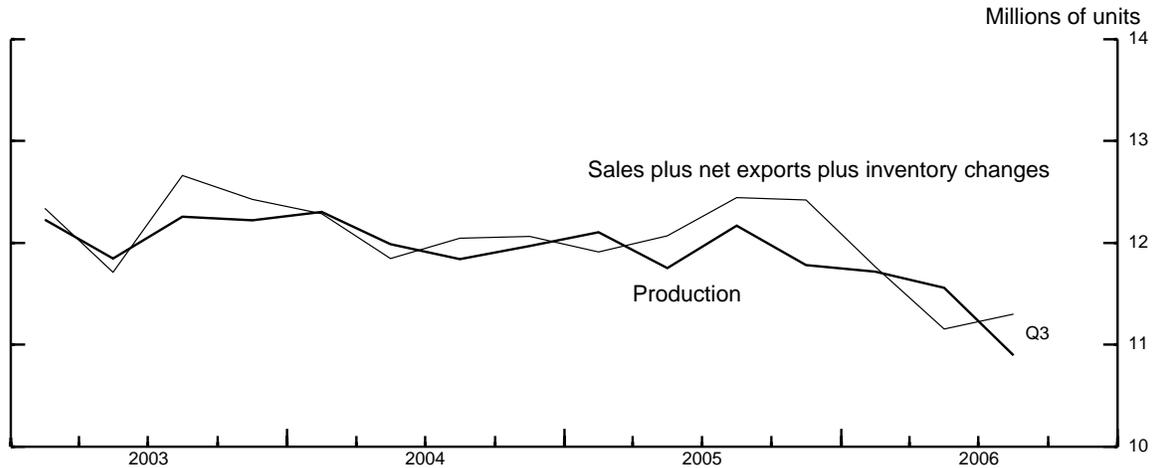
toward larger vehicles, the six-month moving average of mean fuel economy for new vehicles sold ticked down in November after having moved up noticeably over the past two years.

Recent gains in employment and income suggest that vehicle demand will be fairly well maintained in the near term. Survey data, by contrast, give mixed indications about whether consumers' buying perceptions have improved from their recent lows: Although the Michigan SRC index of car-buying attitudes moved up in November to its highest level in more than a year (in part because concerns about fuel prices eased), the percentage of Conference Board survey respondents who plan to buy a new vehicle dropped sharply in November.

Light vehicle production has been quite weak in the second half of this year as the Big Three automakers have worked to address their inventory overhangs. Assemblies of light motor vehicles dropped to a sluggish annual rate of 10.5 million units in the third quarter; the latest schedules indicate that they will remain near this pace in the fourth quarter and then edge up in the first quarter to 10.7 million units.

The Bureau of Economic Analysis (BEA) currently estimates that gross new motor vehicle output increased at an annual rate of 28 percent in the third quarter, a figure that stands in sharp contrast to the drop of 20 percent at an annual rate in the IP index for motor vehicles (excluding parts production) in the same period. Much of the difference can be traced to the BEA's method of inferring motor vehicle output from separate data on sales, net international trade, and inventory changes rather than measuring it directly using data on production. On a quarterly basis, the unit flows implied by the direct and indirect measures can differ markedly: In the first half of 2006, the indirect measure understated the level of production by about 150,000 units; in the second half of the year, we estimate that the indirect measure will overstate production by about 250,000 units. In addition, an exceptionally large (and likely anomalous) drop in the PPI for light trucks in the third quarter resulted in a jump in the BEA's implied unit values of light trucks in inventory. On balance, we believe that measurement issues caused the BEA to overstate the rate of increase in real gross domestic output in the third quarter by about 1 percentage point. Looking ahead, we expect that the gradual unraveling of these issues will cause the BEA to understate GDP growth over the next two quarters but to a much lesser extent.

Measures of Motor Vehicle Production (Seasonally adjusted annual rate)



Source. Production, inventories, and sales are from Ward's Communications. Trade data are from U.S. Census Bureau.

Consumer Spending

According to the latest data, real PCE rose a strong 0.4 percent in October after a smaller gain in September. Although personal outlays for motor vehicles softened in October, spending for nondurable goods such as gasoline, food, and apparel rose briskly. Expenditures for electricity services also jumped as temperatures swung from unseasonably warm to unseasonably cool. After having edged down over the summer, the six-month change in real PCE excluding motor vehicles recently moved back up to a pace more in line with its average over the past few years.

Anecdotal evidence and weekly data on chain store sales suggest that the holiday shopping season got off to a good start; that said, sales reports around previous Thanksgiving holidays have not proven to be a particularly reliable barometer of overall holiday spending. Moreover, sales for November as a whole were reportedly soft. Still, consumer sentiment has moved up after ebbing late last summer, and November's readings were at a level consistent with solid gains in spending.

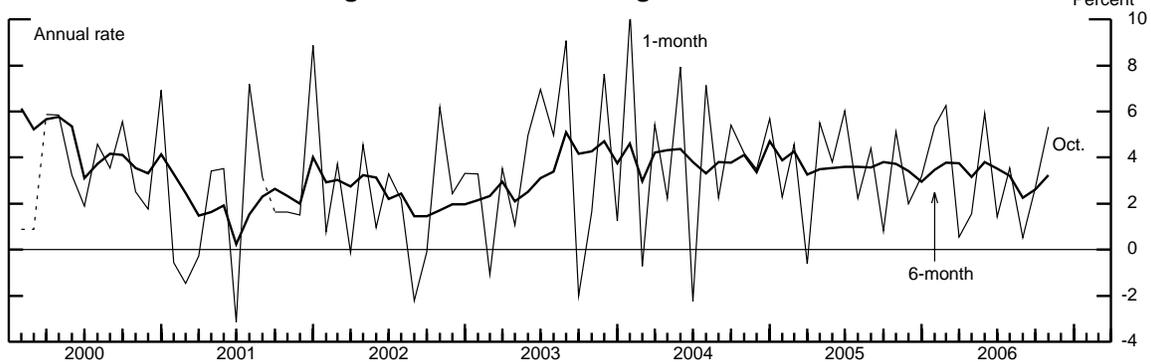
Real Personal Consumption Expenditures
(Percent change from the preceding period)

	2005	2006					
		Q1	Q2	Q3	Aug.	Sept.	Oct. ¹
		Annual rate			Monthly rate		
Total real PCE	3.5	4.8	2.6	2.9	-.1	.2	.4
Durable goods	5.5	19.8	-.1	6.0	-1.6	.6	.5
Motor vehicles	.6	18.9	-1.2	8.8	-3.7	-.9	.7
Excluding motor vehicles	9.5	20.5	.8	4.0	.0	1.7	.4
Nondurable goods	4.5	5.9	1.4	1.1	-.2	-.1	.7
Energy	-.5	-1.3	.7	4.9	-2.3	1.2	1.6
Other	5.1	6.9	1.5	.6	.2	-.2	.5
Services	2.6	1.6	3.7	3.1	.2	.2	.3
Energy	2.6	-29.7	15.8	22.7	-1.5	-2.6	6.5
Other	2.6	3.2	3.2	2.4	.2	.3	.1
Memo:							
Real PCE ex. motor vehicles	3.6	4.2	2.8	2.6	.0	.2	.4

1. The October value for motor vehicles is a staff estimate

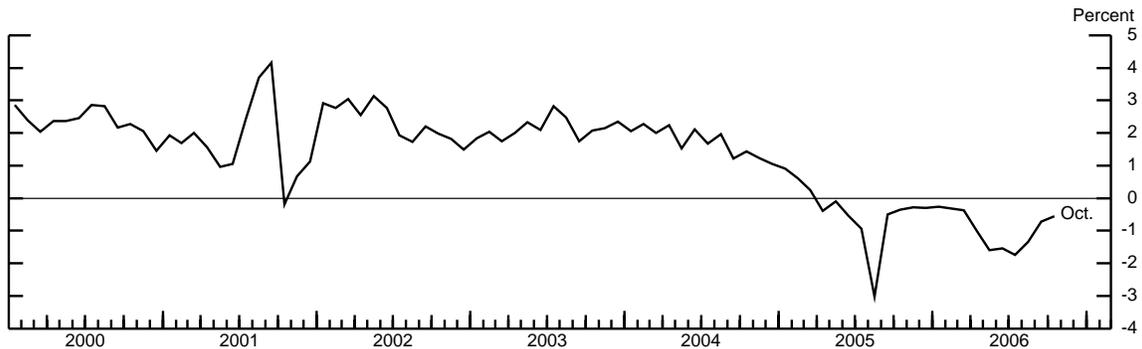
. Consequently, aggregates that include motor vehicles differ slightly from published values.

Change in Real PCE excluding Motor Vehicles



Note. To keep the vertical scale within a range that reveals the variation in the 6-month change, we have smoothed the large 1-month changes in January and March 2000 and September 2001, periods indicated by the dotted lines.

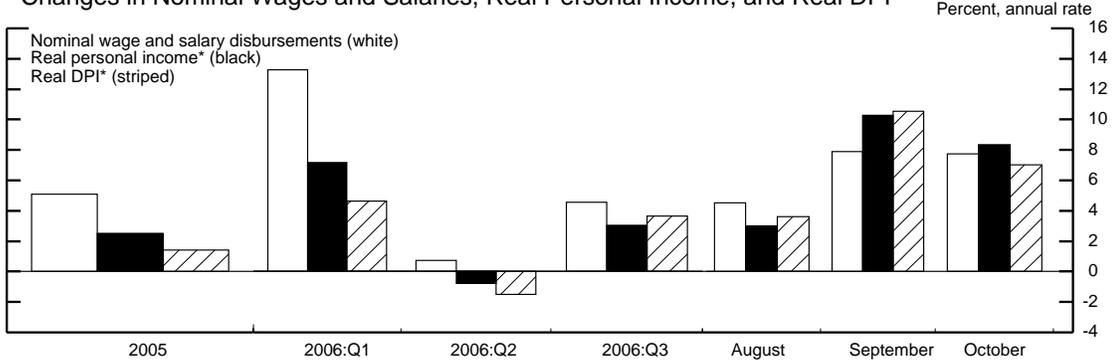
Personal Saving Rate



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

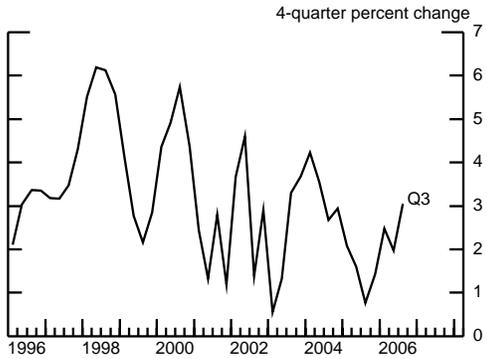
Fundamentals of Household Spending

Changes in Nominal Wages and Salaries, Real Personal Income, and Real DPI



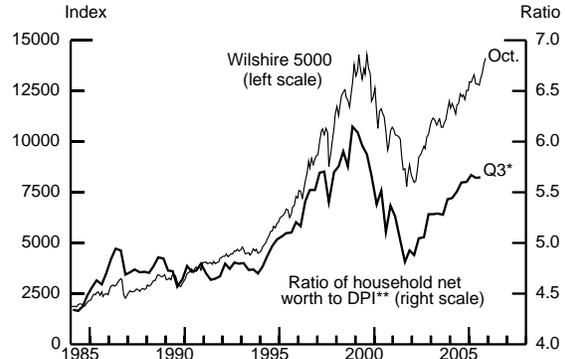
* The value for 2005 is a Q4-to-Q4 percent change and excludes the effect on income of the one-time Microsoft dividend in December 2004.

Change in Real DPI



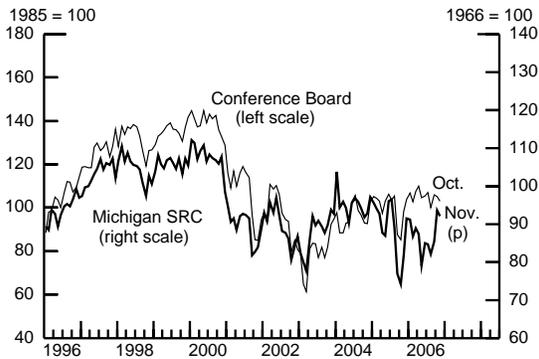
Note. Values for 2004:Q4 and 2005:Q4 exclude the effect on income of the one-time Microsoft dividend in December 2004.

Household Net Worth and Wilshire 5000



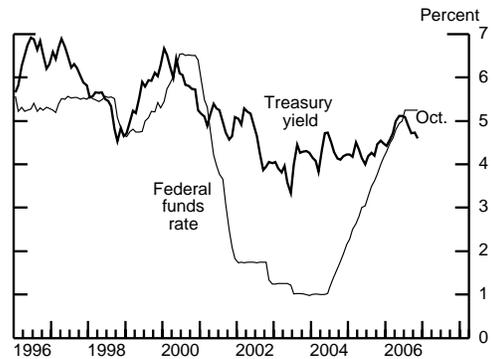
* Value for 2006:Q3 is a staff forecast.
 ** The value for 2004:Q4 excludes the effect on income of the one-time Microsoft dividend in December 2004.

Consumer Confidence



p Preliminary.

Federal Funds Rate and 10-Year Treasury Yield



Private Housing Activity

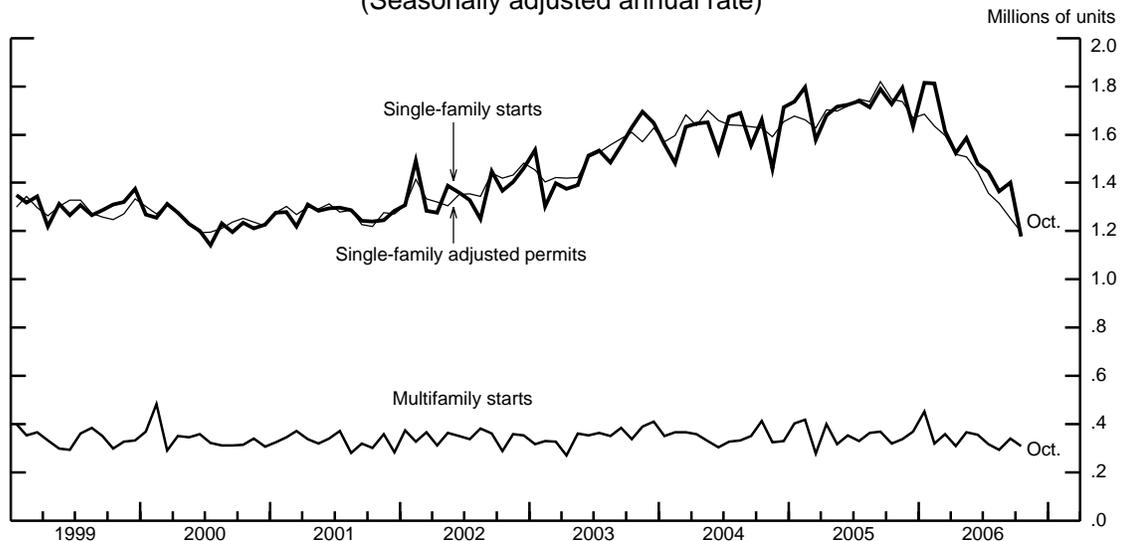
(Millions of units, seasonally adjusted; annual rate except as noted)

Sector	2005	2006					
		Q1	Q2	Q3	Aug.	Sept.	Oct.
<i>All units</i>							
Starts	2.07	2.12	1.87	1.72	1.66	1.74	1.49
Permits	2.16	2.14	1.93	1.71	1.73	1.64	1.55
<i>Single-family units</i>							
Starts	1.72	1.75	1.53	1.40	1.37	1.40	1.18
Permits	1.68	1.61	1.46	1.28	1.28	1.22	1.18
Adjusted permits ¹	1.71	1.64	1.49	1.31	1.32	1.25	1.20
Permit backlog ²	.171	.163	.156	.136	.153	.136	.141
<i>New homes</i>							
Sales	1.28	1.11	1.10	1.01	1.00	1.04	1.00
Months' supply ³	4.39	5.83	6.17	6.79	6.85	6.50	6.67
<i>Existing homes</i>							
Sales	6.18	5.96	5.86	5.48	5.51	5.43	5.50
Months' supply ³	4.41	5.39	6.14	7.03	6.88	7.21	7.06
<i>Multifamily units</i>							
Starts	.353	.376	.343	.317	.294	.340	.309
Permits	.473	.528	.466	.433	.443	.419	.372
Permit backlog ²	.060	.066	.068	.068	.070	.068	.067
<i>Mobile homes</i>							
Shipments	.147	.147	.122	.107	.108	.103	.099
<i>Condos and co-ops</i>							
Existing home sales	.896	.832	.828	.796	.788	.778	.741

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; expressed as the ratio of seasonally adjusted inventories to seasonally adjusted sales. Quarterly and annual figures are averages of monthly figures.

Private Housing Starts and Permits

(Seasonally adjusted annual rate)



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

Wages and salaries, which expanded at an annual rate of 4.5 percent in the third quarter, rose a robust 0.6 percent in October.⁵ Moreover, as energy prices fell sharply in both September and October, real DPI leaped 0.8 percent in September and moved up an additional 0.6 percent in October. Increases in income outpaced consumer spending in October, and the personal saving rate moved up, to negative 0.6 percent.

Consumer spending has continued to draw support from the lagged effects of higher household wealth over the past two years. Indeed, although house prices decelerated further in the third quarter, robust gains in the stock market maintained the ratio of household wealth to disposable income at a level well above its historical average. Although both short- and long-term loan rates have moved down recently, borrowing costs remain above year-ago levels.

Housing

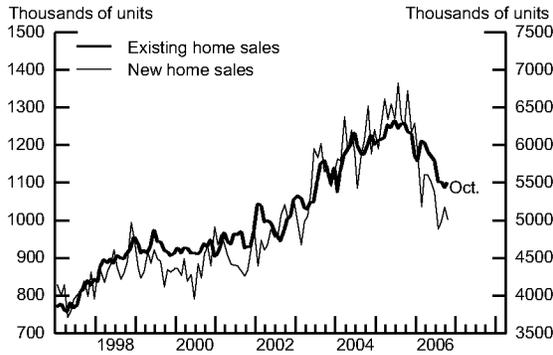
Despite tentative signs that home sales may be stabilizing, residential construction remains very weak. Single-family starts dropped 16 percent in October to an annual rate of 1.18 million units, down 35 percent from their peak last January. In addition, adjusted permit-issuance in this sector, which tends to be a more reliable indicator of the underlying pace of homebuilding than starts, fell to an annual rate of 1.20 million units in October, down 32 percent from a year earlier and close to its lowest level in the past ten years. Starts in the much smaller multifamily sector remained within the range that has prevailed over the past decade, though adjusted permit-issuance in the sector—which is linked much more loosely to starts than is the case in the single-family sector—has moved down considerably of late.

Following a sharp fall since their peak in the summer of 2005, sales of new and existing homes have recently shown tentative signs of leveling off. Sales of existing single-family homes in October were at an annual rate of 5.5 million units and have tracked a fairly flat trajectory since July. New home sales, which have been subject to considerable revisions in recent months, came in at an annual rate of 1.0 million units in October, in line with the average pace seen during the third quarter. Moreover, the index of pending home sales—an indicator of future sales of existing homes—has improved, on balance, since

⁵ After incorporating unemployment insurance data from the second quarter, the BEA revised down the level of wages and salaries \$100 billion beginning in that quarter. Although we had expected a large downward revision, the magnitude was much larger than expected. On net, the October level of wages and salaries is about \$60 billion lower than we had expected in the October Greenbook.

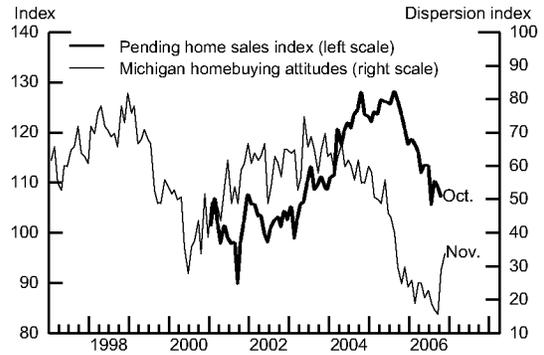
Indicators of Single-Family Housing

Home Sales



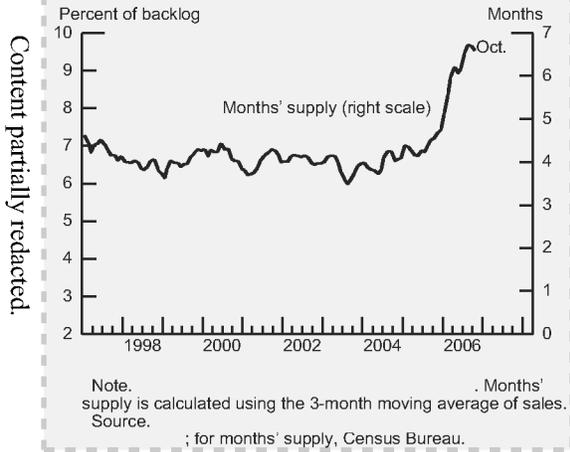
Source. For existing homes, National Association of Realtors; for new homes, Census Bureau.

Homebuying Indicators

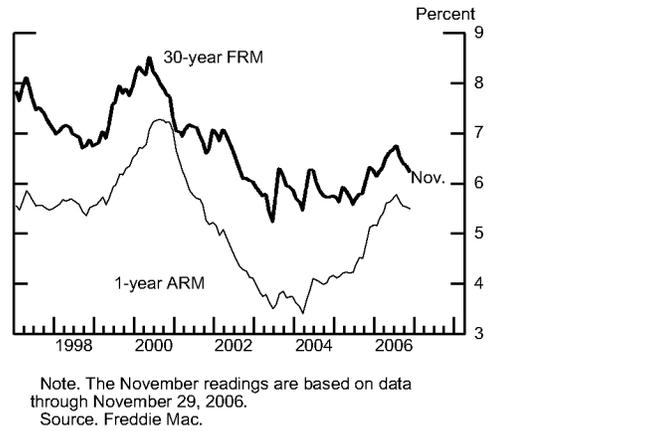


Source. For pending home sales, National Association of Realtors; for homebuying attitudes, Michigan survey.

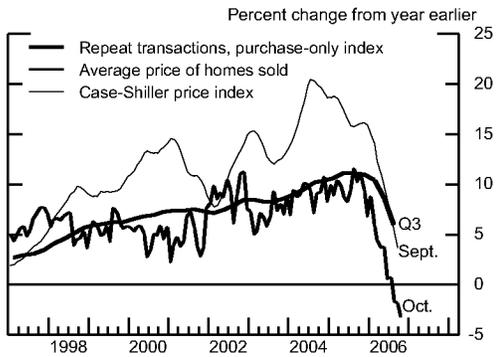
New Home Sales Months' Supply



Mortgage Rates

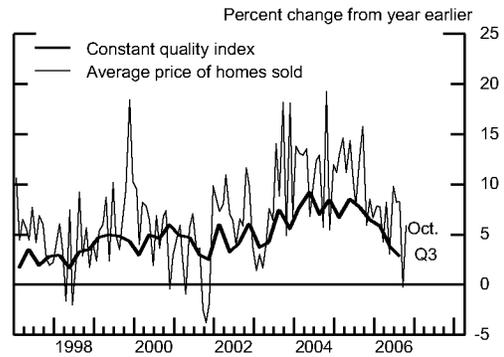


Prices of Existing Homes



Source. For repeat transactions, OFHEO; for average price, National Association of Realtors; for Case-Shiller, Chicago Mercantile Exchange.

Prices of New Homes



Note. Average price values have been adjusted by Board staff to take into account new sampling procedures adopted in 2005.
Source. Census Bureau.

July, while the index of homebuying sentiment from the Michigan survey has moved up in each of the past two months to its highest level in more than a year. These improving conditions seem to be, at least in part, the result of a decline in mortgage rates: The average rate for thirty-year fixed-rate mortgages has fallen 50 basis points since July, while average rates for one-year adjustable-rate mortgages are down about 30 basis points.

Even if sales do stabilize, homebuilders may hold the line on production to eliminate the substantial overhang of new homes for sale that has accumulated over the past few years. The dramatic cuts to construction so far this year have caused the level of the stock of new homes for sale to turn down a bit in recent months, a departure from the pronounced upward trend in inventories that began in early 2001. Despite this encouraging sign, inventories remained quite elevated in October: The months' supply of new homes for sale was still 45 percent above the upper bound of the relatively narrow (and historically low) range it occupied from 1997 to 2005. Moreover, these published figures probably understate the true inventory position of this sector because they do not account for the effect of sales cancellations on the stock of unsold homes.

House-price appreciation has slowed markedly in recent quarters after quickening for much of the preceding decade; some price measures show outright declines. The purchase-only version of the price index for existing homes calculated by the Office of Federal Housing Enterprise Oversight (OFHEO) moved up at an annual rate of just 1½ percent in the third quarter, the smallest one-quarter increase in the index since 1994. The Case-Shiller home-price index, which uses a methodology similar to that of the OFHEO index but is limited to sales in ten large U.S. cities, has also decelerated markedly over the past year.⁶ More recently, the average price of existing homes sold—which is available on a timelier basis than these measures—posted an outright decline over the twelve months ending in October. However, this measure does not adjust for changes in the characteristics of homes sold, so the decline might reflect a shift in the composition of sales away from higher-end homes. Monthly readings of new-home price

⁶ 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. Unlike the OFHEO index, which captures only sales backed by a conforming mortgage loan, the Case-Shiller measure captures all arms-length sales in the ten areas.

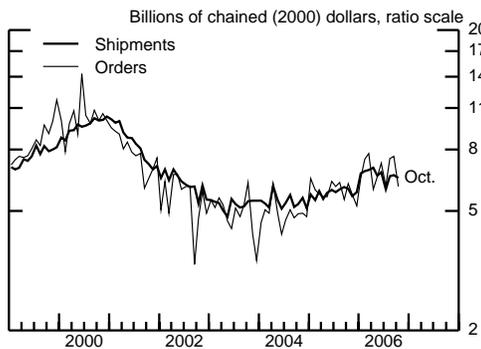
Orders and Shipments of Nondefense Capital Goods

(Percent change; seasonally adjusted current dollars)

Category	2006				
	Q2	Q3	Aug.	Sept.	Oct.
	Annual rate		Monthly rate		
Shipments	5.2	9.9	2.0	-.4	-2.4
Excluding aircraft	5.8	6.9	1.3	-1.6	-1.6
Computers and peripherals	-18.7	25.6	-3.2	-6.4	-24.5
Communications equipment	1.0	-21.7	10.4	1.1	-2.3
All other categories	10.1	8.3	1.0	-1.3	1.3
Orders	4.6	27.2	-2.0	24.6	-15.5
Excluding aircraft	3.7	14.6	1.1	3.1	-4.9
Computers and peripherals	-13.2	24.3	-10.1	1.0	-25.2
Communications equipment	-31.7	35.7	23.2	2.1	-21.0
All other categories	11.1	11.4	.5	3.5	-.6
Memo: Shipments of complete aircraft ¹	32.9	33.3	34.8	34.5	n.a.

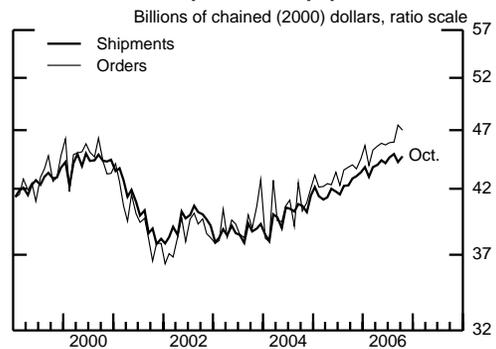
1. From Census Bureau, Current Industrial Reports; billions of dollars, annual rate.
n.a. Not available.

Communications Equipment



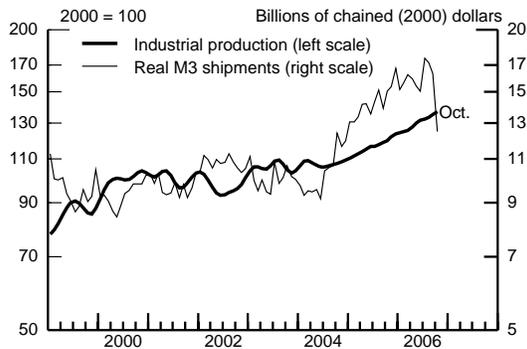
Note. Shipments and orders are deflated by a price index that is derived from the BEA's quality-adjusted price indexes and uses the PPI for communications equipment for monthly interpolation.

Non-High-Tech, Nontransportation Equipment



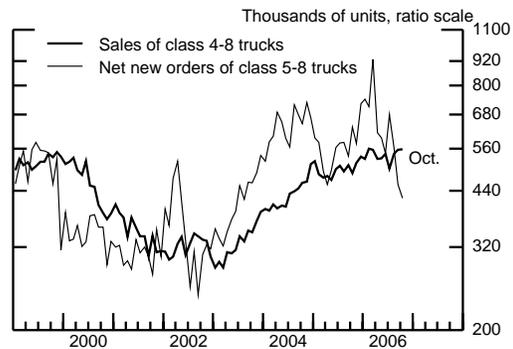
Note. Shipments and orders are deflated by the staff price indexes for the individual equipment types included in this category. Indexes are derived from the BEA's quality-adjusted price indexes.

Computers and Peripherals



Note. Ratio scales. Shipments are deflated by the staff price index for computers and peripheral equipment, which is derived from the BEA's quality-adjusted price indexes.

Medium and Heavy Trucks



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

appreciation have fluctuated wildly of late, in part because of changes in the geographic composition and average quality of homes sold. However, on a constant-quality basis, new home prices (seasonally adjusted) were essentially flat in the third quarter. In reality, prices might be softer than indicated by this index because it does not capture the fact that homebuilders have increased their use of incentives—such as granting more favorable mortgage terms, paying closing costs, and including optional upgrades at no cost—to bolster sales and unload inventory.

Equipment and Software

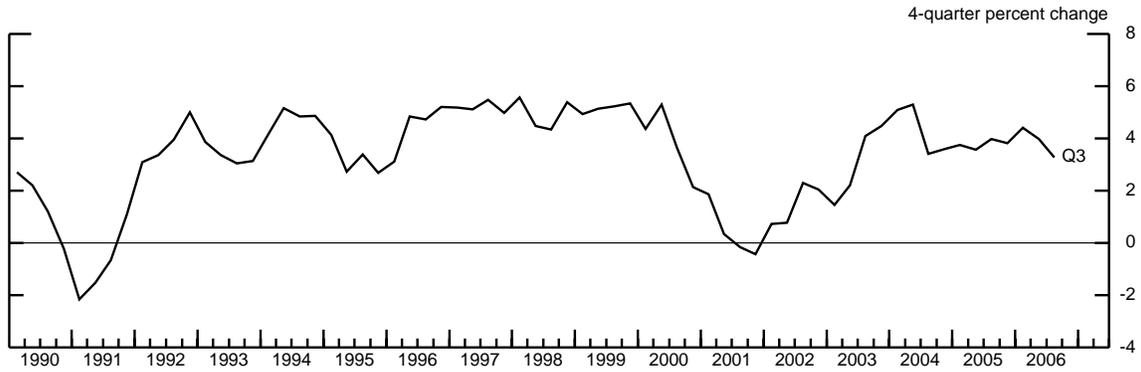
Real equipment and software spending expanded a solid 7.2 percent (annual rate) in the third quarter. However, incoming data suggest some deceleration is under way: Sales of light vehicles stepped down some in the first two months of the fourth quarter, and both orders and shipments of nondefense capital goods fell in October. Among the key determinants of equipment spending, the user cost of capital and corporate cash positions are supportive of further increases in near-term outlays, while business output has decelerated of late. Moreover, some surveys, including those by the Institute for Supply Management and the Philadelphia Fed, have shown a considerable weakening of business conditions.

Business outlays on transportation equipment increased at an annual rate of 11.2 percent in the third quarter, as motor vehicle outlays bounced back after a second-quarter decline. More recently, fleet sales of light vehicles edged down in October and November, although the average sales rate was still strong by historical standards. In the commercial-truck sector, sales of medium and heavy trucks (classes 4 to 8) rose to a near-record pace of 560,000 units (annual rate) in October. Sales of medium and heavy trucks should remain brisk through the end of the year as firms rush to obtain vehicles ahead of the implementation of the upcoming 2007 EPA regulations on truck engines; however, this pull-forward of demand likely implies a significant drop in truck sales early next year. Indeed, with no available build slots left in 2006, new orders for medium and heavy trucks plummeted in October to their lowest level in three years. Elsewhere in the transportation category, Boeing reports that October deliveries of aircraft were above their third-quarter average—a good start to the quarter after declines in outlays in each of the preceding two quarters.

High-tech spending rose at an annual rate of 10 percent in the third quarter, but incoming spending indicators point to some weakening since then. After rising briskly in the third quarter, nominal orders and shipments of computers plunged 25 percent in October (not

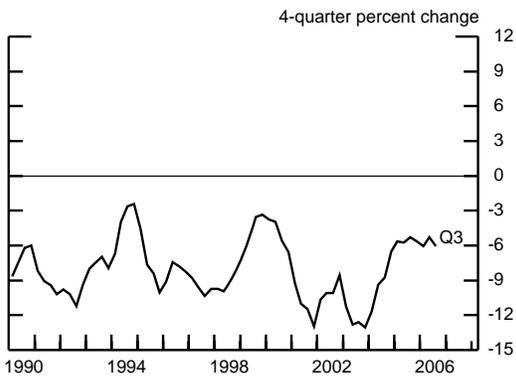
Fundamentals of Equipment and Software Investment

Real Business Output

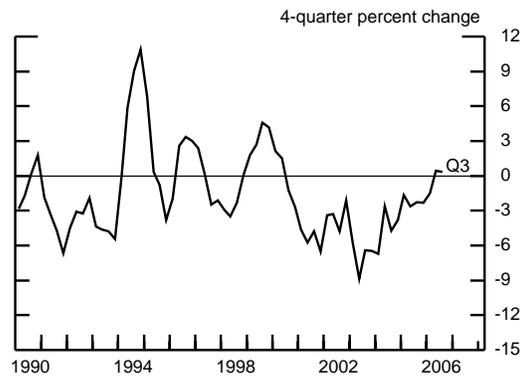


User Cost of Capital

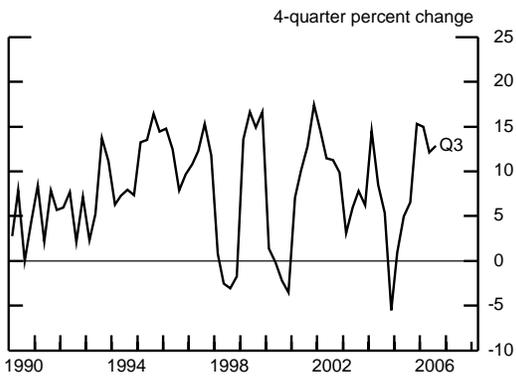
High-Tech



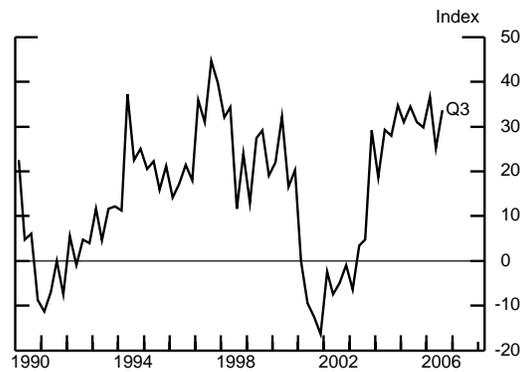
Non-High-Tech



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.

at an annual rate). These outsized declines are likely to prove transitory because they seem at odds with the continued moderate gains in our IP measures of computer production and the generally upbeat anecdotes in this sector. Real spending on communications equipment expanded at an annual rate of 11 percent in the third quarter after a surge in the first half of the year. However, nominal shipments of communications equipment decreased 2.3 percent in October (not at an annual rate), and orders dropped. On the basis of their capital expenditures guidance for 2006—and given their equipment purchases so far this year—telecommunications service providers, which account for about one-fourth of total spending in this category, are likely to damp fourth-quarter growth.

Real spending on equipment other than high-tech and transportation remained on a solid upward trajectory in the third quarter despite a considerable step-down from the brisk increases in the first half of the year. In October, nominal shipments rose 1.3 percent (not at an annual rate), and gains were widespread across categories. Orders slipped in October, but they continued to outpace shipments by a wide margin and point to continued gains in spending in the near term.

Nonresidential Construction

Activity in the nonresidential construction sector has shown signs of moderating in recent months on the heels of the substantial and broad-based increases seen for much of this year. The three-month moving average of the architectural billings index—which is well correlated with growth in spending on nonresidential construction about six months into the future—moved down sharply in the spring of this year, foreshadowing some of this recent slowing. A more subdued pace of growth in this sector would be in line with market conditions, which continue to show only modest improvements: Vacancy rates in the office and industrial categories have edged down over the past few years but remain quite high, while the vacancy rate in the retail sector has been essentially flat at a low level for some time now. Although the architectural billings index has rebounded some recently, it remains well off the highs seen in late 2005.⁷ This indicator, combined with the slower rate of growth in nonresidential construction employment seen in recent months, points to more-restrained spending gains in the coming quarters.

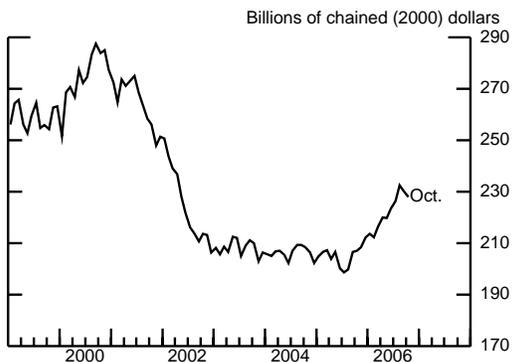
In the drilling and mining sector, spending rose at an annual rate of 10 percent in the third quarter—down from the nearly 30 percent increase in the second quarter. The number of

⁷ About 88 percent of the construction projects covered by the architectural billings index are nonresidential.

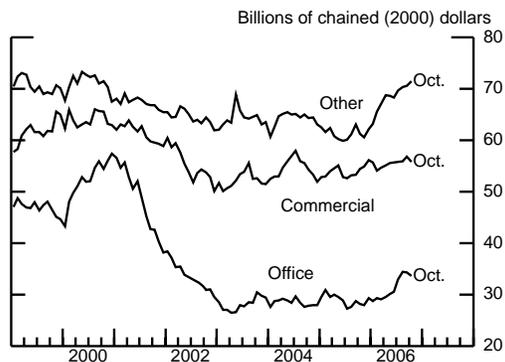
Nonresidential Construction and Indicators

(All spending series are seasonally adjusted at an annual rate; nominal CPIP deflated by BEA prices through Q2 and by staff projection thereafter)

Total Structures

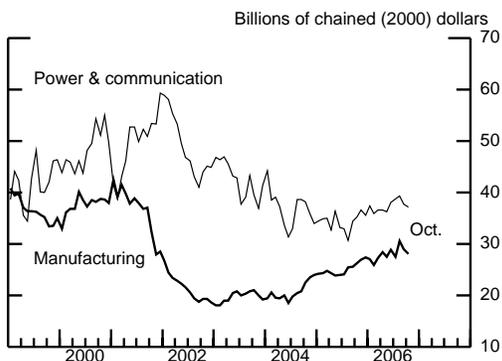


Office, Commercial, and Other

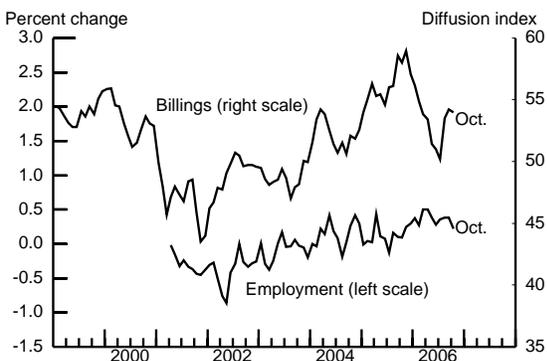


Note. Other includes religious, educational, lodging, amusement and recreation, transportation, and health-care facilities.

Manufacturing and Power & Communication

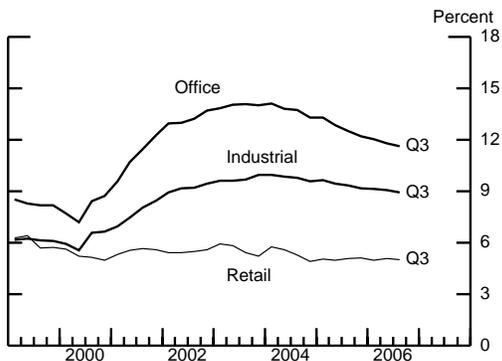


Architectural Billings and Nonresidential Construction Employment



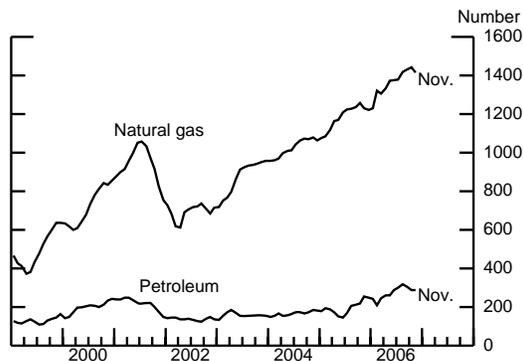
Note. Both series are 3-month moving averages. Employment includes industrial, commercial, and specialty trade construction. Source. For billings, American Institute of Architects; for employment, Bureau of Labor Statistics.

Vacancy Rates



Note. Industrial space includes both manufacturing structures and warehouses. Source. For office and industrial, CoStar Property Professional; for retail, National Council of Real Estate Investment Fiduciaries.

Drilling Rigs in Operation



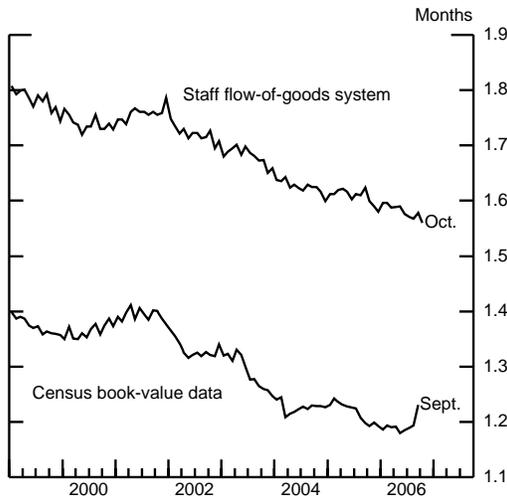
Source. DOE/Baker Hughes.

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

Measure and sector	2006					
	Q1	Q2	Q3	Aug.	Sept.	Oct.
<i>Real inventory investment (chained 2000 dollars)</i>						
Total nonfarm business	36.8	52.2	54.9^e	n.a.	n.a.	n.a.
Motor vehicles	8.5	3.0	-1.1	n.a.	n.a.	n.a.
Nonfarm ex. motor vehicles	28.3	49.2	56.0 ^e	n.a.	n.a.	n.a.
Manufacturing and trade ex. wholesale and retail motor vehicles and parts						
Manufacturing	7.6	11.0	10.4^e	3.4^e	19.9^e	n.a.
Wholesale trade ex. motor vehicles & parts	7.9	18.4	27.8	44.3	28.1	n.a.
Retail trade ex. motor vehicles & parts	7.2	6.9	8.6	19.7	5.8	n.a.
<i>Book-value inventory investment (current dollars)</i>						
Manufacturing and trade ex. wholesale and retail motor vehicles and parts	53.3	109.1	92.8	113.1	70.9	n.a.
Manufacturing	23.5	48.3	37.2	31.7	35.4	21.3
Wholesale trade ex. motor vehicles & parts	17.9	43.2	42.8	59.7	30.7	n.a.
Retail trade ex. motor vehicles & parts	12.0	17.5	12.8	21.7	4.9	n.a.

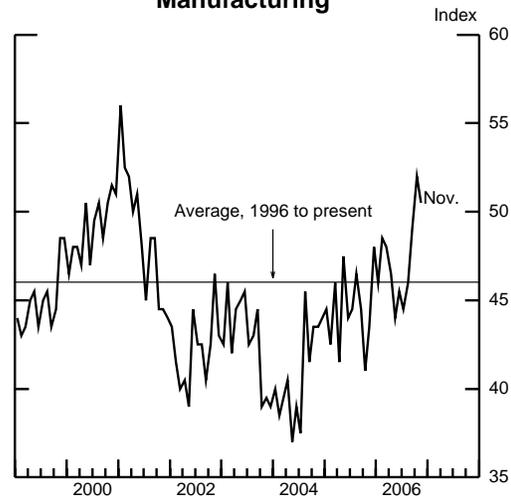
^e Staff estimate of real inventory investment based on revised book-value data.
n.a. Not available.
Source. For real inventory investment, BEA. For book-value data, Census Bureau.

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."

Federal Government Outlays and Receipts

(Unified basis; billions of dollars except as noted)

Function or source	October			12 months ending in October		
	2005	2006	Percent change	2005	2006	Percent change
Outlays	196.8	217.0	10.3	2475.3	2675.1	8.1
Financial transactions ¹	.0	-.1	...	-1.2	-1.1	...
Payment timing ²	-12.3	-4.2	...	-.5	-6.1	...
Adjusted outlays	209.1	221.3	5.8	2477.0	2682.3	8.3
Receipts	149.5	167.7	12.2	2165.9	2424.9	12.0
Payment timing	.0	.0	...	.0	-6.0	...
Adjusted receipts	149.5	167.7	12.2	2165.9	2430.9	12.2
Surplus or deficit (-)	-47.3	-49.3	...	-309.4	-250.2	...
<i>Selected components of adjusted outlays and receipts</i>						
Adjusted outlays	209.1	221.3	5.8	2477.0	2682.3	8.3
Net interest	17.7	18.9	7.3	185.5	227.9	22.9
Non-interest	191.4	202.4	5.7	2291.5	2454.4	7.1
National defense	39.5	44.3	12.1	492.3	529.2	7.5
Social Security	44.1	46.7	5.9	525.7	557.2	6.0
Medicare	23.3	29.0	24.3	296.5	343.9	16.0
Medicaid	15.4	15.5	.4	182.0	180.7	-.7
Income security	25.4	26.4	4.1	346.1	354.7	2.5
Agriculture	9.7	9.1	...	30.3	30.2	-.3
Other	34.0	31.4	-7.6	418.5	458.6	9.6
Adjusted receipts	149.5	167.7	12.2	2165.9	2430.9	12.2
Individual income and payroll taxes	128.9	143.0	10.9	1686.3	1850.5	9.7
Withheld + FICA	120.8	129.7	7.3	1498.3	1599.3	6.7
Nonwithheld + SECA	10.8	16.9	56.2	366.3	438.5	19.7
Less: Refunds	2.7	3.6	32.7	180.4	187.2	3.8
Corporate	6.1	9.4	53.0	276.7	357.2	29.1
Gross	10.5	13.3	25.7	303.7	383.6	26.3
Less: Refunds	4.4	3.9	-11.9	27.0	26.5	-2.0
Other	14.4	15.4	6.4	202.9	223.2	10.0
Adjusted surplus or deficit (-)	-59.6	-53.6	...	-311.1	-251.4	...

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. For August 2006, receipts and outlays have been adjusted to reflect a one-time accounting correction by the Treasury that reduced both individual income taxes and Social Security benefits by \$6 billion.

... Not applicable.

Source. Monthly Treasury Statement.

rigs in operation has moved down, on balance, since September in response to the recent moderation in projected energy prices, and anecdotes point to concerns about the rising costs of drilling activity. Taken together, this evidence points to a more subdued pace of spending growth in the months ahead.

Business Inventories

We estimate that, excluding motor vehicles, real nonfarm inventory investment edged up in the third quarter to an annual rate of \$56 billion; as a consequence, these inventories made only a small positive contribution to the change in real GDP in the third quarter. More recently, October book-value inventory investment in manufacturing—the only piece of fourth-quarter inventory data that we have at this point—stepped down to \$21 billion.

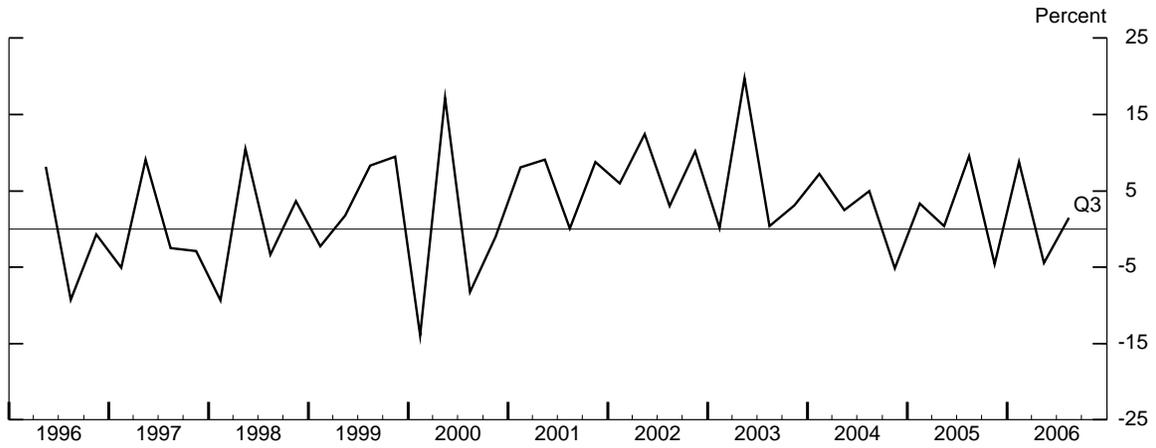
September saw an increase in the book-value inventory-sales ratios for a number of industries; indeed, the overall inventory-sales ratio for the manufacturing and trade sector (excluding motor vehicles) moved up to a level last seen in the middle of 2005. Whether this increase is a signal of widespread inventory imbalances is unclear, however. The ISM customers' inventory index also has moved up, on net, in recent months, though almost three-fourths of respondents indicated that their customers' inventory levels are in a comfortable range. In addition, information from the staff's flow-of-goods inventory system suggests that—excluding motor vehicles and parts—months' supply continued to move lower in October; except for paper, inventories remain well aligned with demand. Other data indicate that the inventory-sales ratio at Intel is elevated—most likely in anticipation of strong prospective sales—while the inventory-shipments ratio at steel service centers has risen rapidly in recent months and probably reflects an unanticipated accumulation of stocks.

Federal Government Sector

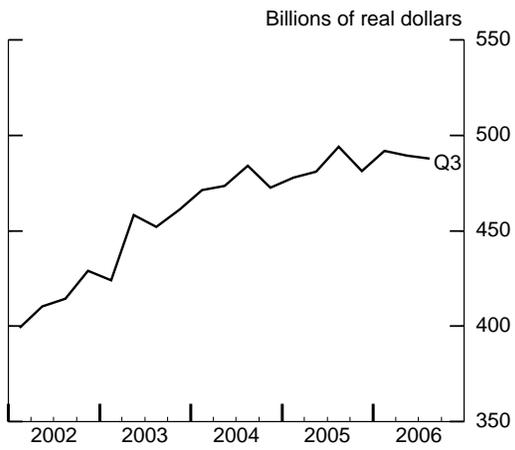
The unified federal budget deficit improved in October. According to the Monthly Treasury Statement, the adjusted deficit—which controls for payment-timing shifts and financial transactions—was \$6 billion smaller in that month than it was in the year-earlier period. Over the twelve months ending in October, the adjusted deficit was \$251 billion, or about 2 percent of nominal GDP. The adjusted primary deficit—equal to the adjusted deficit less net interest outlays—declined to just \$23 billion over the same twelve-month

Federal Purchases in the National Income and Product Accounts (Billions of chained (2000) dollars, annual rate)

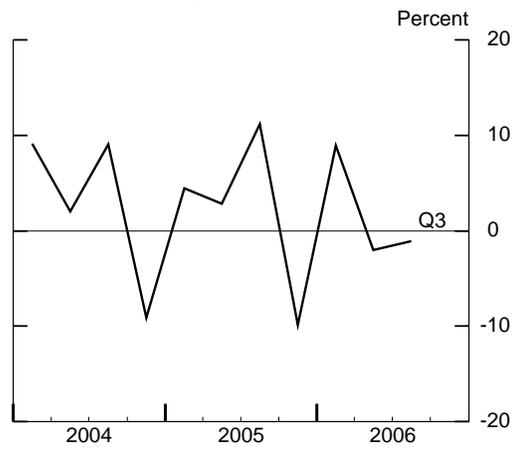
Total, Change



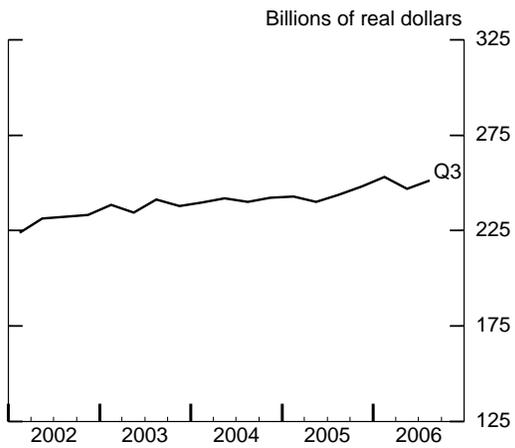
Defense, Level



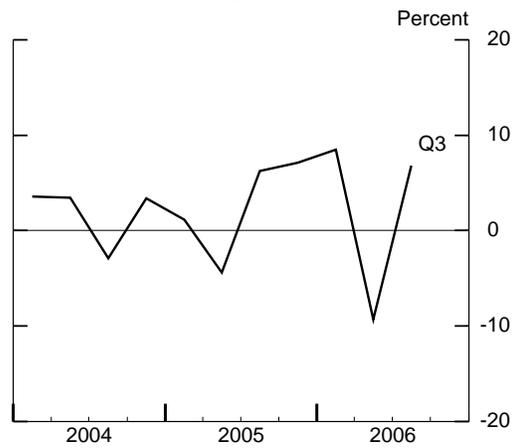
Defense, Change



Nondefense, Level



Nondefense, Change



period.⁸ In contrast to the near-term improvement in the federal deficit, long-term projections of the federal budget—such as those by the Congressional Budget Office—suggest an eventual erosion in the deficit and a rising debt-to-GDP ratio as the baby-boom generation retires and projected per-beneficiary health-care costs continue to increase faster than incomes.

Tax receipts continued to outpace increases in both federal spending and nominal incomes. Receipts in October were more than 12 percent above their year-earlier level; individual income and payroll tax revenue, which accounted for most of the receipts in October, were 11 percent greater than those of a year earlier. Corporate tax receipts from the small number of firms that make payments in October were more than 25 percent above their year-earlier level.

Federal outlays, adjusted for payment-timing shifts and financial transactions, increased almost 6 percent in October relative to the year-earlier period. Net interest outlays increased 7 percent over that time period, reflecting higher interest rates and greater debt. Non-interest outlays in October rose 5½ percent above their year-earlier level, mainly because of sizable increases in Medicare and defense spending. In contrast, spending by FEMA for disaster relief and flood insurance—included in the “other outlays” category—was more than \$2 billion lower in October than it was a year earlier.

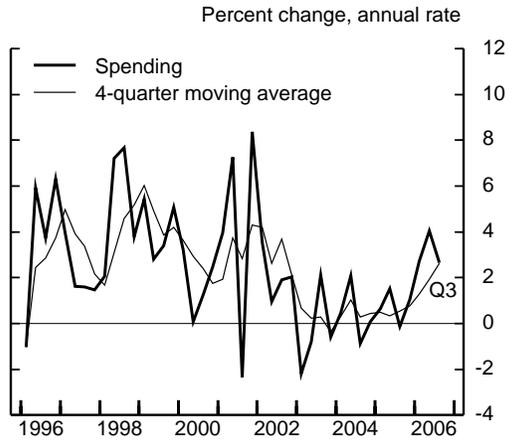
In the NIPAs, total real federal purchases increased at an annual rate of 1½ percent in the third quarter, as real defense spending edged down but real nondefense purchases rebounded.

Legislative activity has been negligible recently because the Congress has mostly been out of session; as a result, much unfinished budget business for fiscal year 2007 probably will have to be taken up next year by the new Congress. So far, only two of the twelve regular appropriations bills—those for defense and homeland security—have been passed for fiscal 2007. The Congress did pass another continuing resolution to provide funding through December 8 for the other programs usually covered under the annual appropriations process, and an additional continuing resolution is expected to be enacted to go through mid-February.

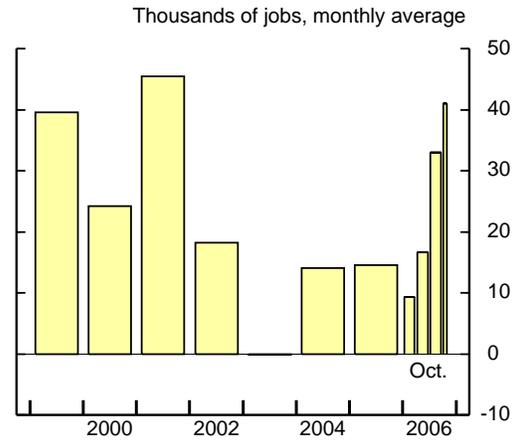
⁸ A primary deficit close to zero is a condition suggesting a relatively stable ratio of federal debt to nominal GDP. (If the primary deficit is equal to zero, and the average nominal interest rate on federal debt is equal to the growth rate in nominal GDP, then the debt-to-GDP ratio remains constant.)

State and Local Indicators

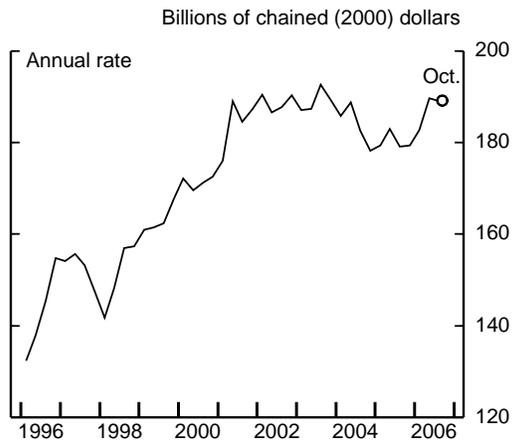
Real Spending on Consumption & Investment



Net Change in Employment

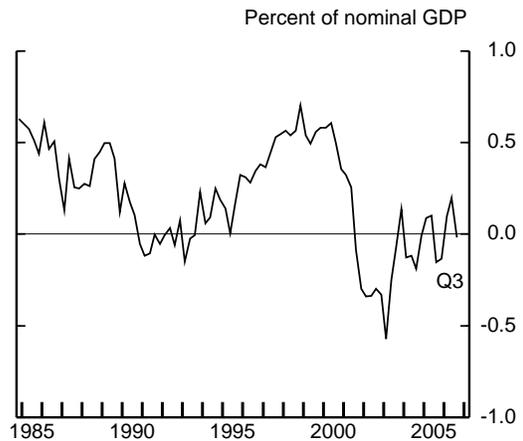


Real Construction

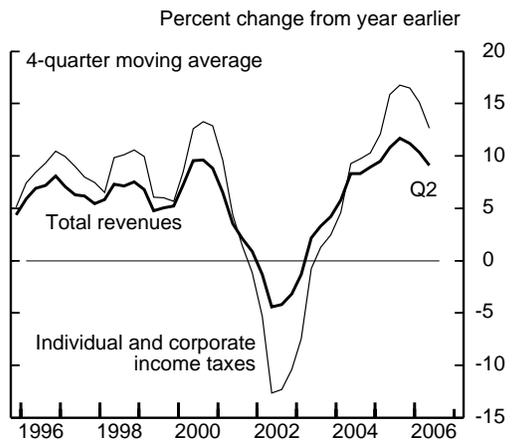


Note. Nominal CIPPI deflated by BEA prices through Q3 and by staff projection thereafter.

Net Saving

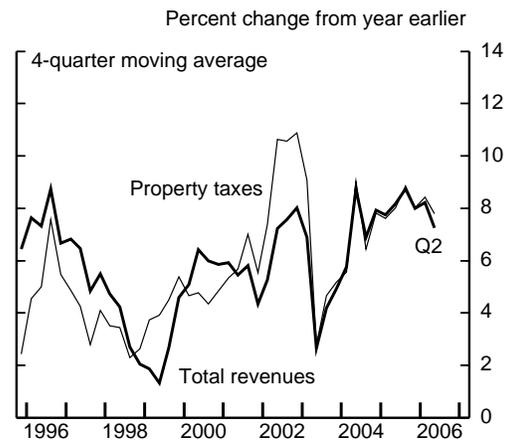


State Revenues



Source. Census Bureau.

Local Revenues



Source. Census Bureau.

State and Local Government Sector

We estimate that real purchases by state and local governments increased at an annual rate of about 2½ percent in the third quarter, a step-down from the robust 4 percent second-quarter pace but still significantly above the average pace recorded over the past few years. After an explosive increase in the second quarter, real construction spending fell a bit in the third quarter, but employment rose a robust 33,000 per month on average, well above the average monthly pace seen during the previous few years. In October, real construction spending appears to have been about equal to its third-quarter average, while employment continued to increase sharply. In the November elections, proposed constitutional amendments that would have imposed tight controls on state spending and taxes were defeated in the three states in which they appeared on the ballot: Nebraska, Oregon, and Maine.

Prices

PCE prices moved down 0.3 percent in September and 0.2 percent in October; the decreases were led by sharp declines in energy prices in both months. Over the twelve months ending in October, PCE prices rose just 1.5 percent, down from a 3.5 percent rate of increase over the preceding twelve-month period; this step-down also reflected the large swings in energy prices. In contrast, core PCE prices rose 2.4 percent over the twelve months ending in October, up from the 2.1 percent of a year earlier. The pickup in core PCE prices over the past year largely reflects a marked acceleration in shelter costs.

More-recent core inflation readings remain below the elevated levels reached earlier this year, although the extent of that slowing differs considerably between core PCE prices and the core CPI. Excluding food and energy, PCE prices rose 0.2 percent in October for the second month in a row, thereby bringing the three-month change to an annual rate of 2.7 percent, down only slightly from its peak rate of 2.9 percent in May. The slightly tamer recent readings reflect a notable deceleration over the past few months in the prices for core goods and for shelter, which has been partially offset by an acceleration in the prices of medical services (including the nonmarket component of these prices) and a

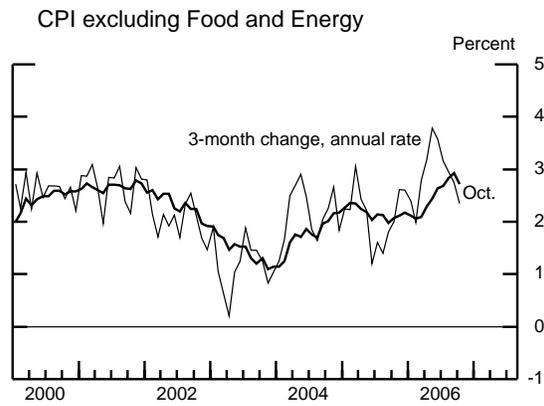
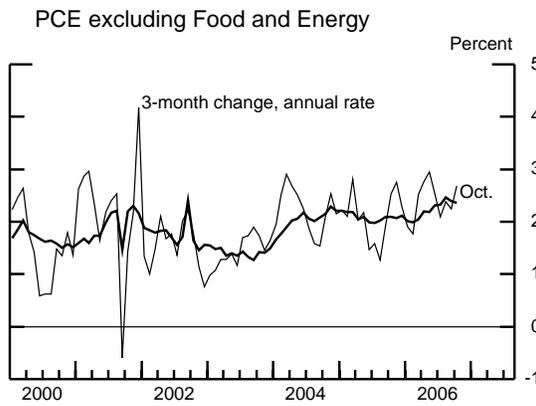
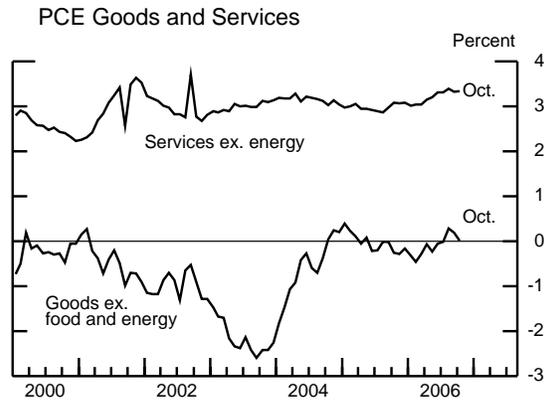
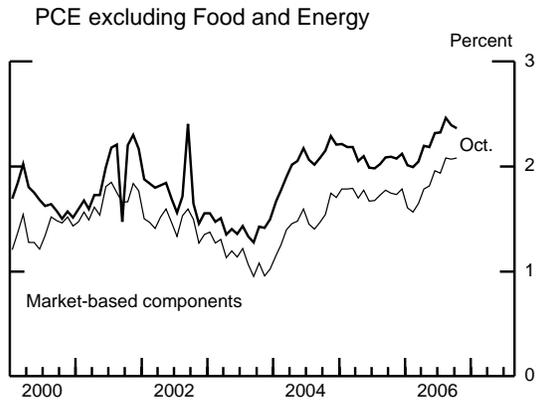
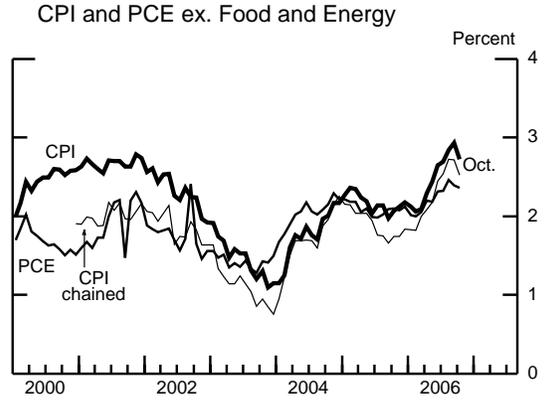
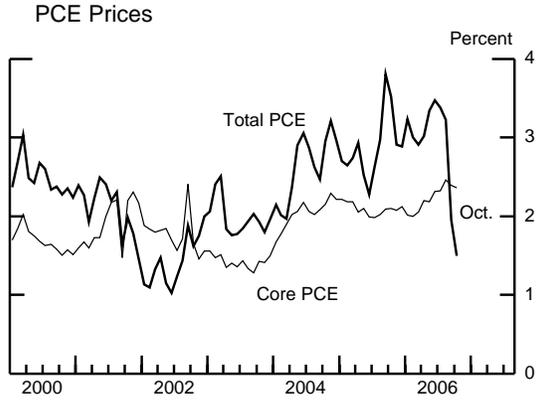
Price Measures
(Percent change)

Measures	12-month change		3-month change		1-month change	
	Oct. 2005	Oct. 2006	Annual rate		Monthly rate	
			July 2006	Oct. 2006	Sept. 2006	Oct. 2006
<i>CPI</i>						
Total	4.3	1.3	4.5	-2.9	-.5	-.5
Food	2.2	2.6	2.5	4.0	.3	.3
Energy	29.5	-11.3	19.1	-43.8	-7.2	-7.0
Ex. food and energy	2.1	2.7	3.2	2.3	.2	.1
Core goods	.4	.1	.0	-.6	-.1	-.3
Core services	2.7	3.8	4.7	3.5	.3	.3
Chained CPI (n.s.a.) ¹	3.4	1.6	...	...	...	...
Ex. food and energy ¹	1.7	2.5	...	...	...	...
<i>PCE prices</i>						
Total	3.5	1.5	3.3	-1.1	-.3	-.2
Food and beverages	2.0	2.5	2.8	3.1	.2	.2
Energy	29.5	-11.4	20.7	-45.7	-7.7	-7.3
Ex. food and energy	2.1	2.4	2.1	2.7	.2	.2
Core goods	-.3	.0	-1.0	.3	.0	-.1
Core services	3.1	3.3	3.4	3.7	.3	.4
Core market-based	1.7	2.1	1.9	2.4	.1	.2
Core non-market-based	3.7	3.6	2.8	4.0	.3	.3
<i>PPI</i>						
Total finished goods	5.9	-1.6	3.0	-10.9	-1.3	-1.6
Food	.5	1.5	1.6	5.2	.7	-.8
Energy	25.8	-10.4	10.3	-41.8	-8.4	-5.0
Ex. food and energy	1.8	.6	1.0	-2.7	.6	-.9
Core consumer goods	2.0	.6	1.0	-3.1	.5	-.8
Capital equipment	1.7	.6	1.1	-2.2	.6	-.9
Intermediate materials	10.9	.4	8.3	-8.2	-1.4	-1.1
Ex. food and energy	4.7	5.9	9.5	1.9	.1	.0
Crude materials	31.8	-22.0	8.8	-38.8	-3.4	-10.5
Ex. food and energy	1.4	20.1	36.9	-11.6	1.0	-1.3

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

... Not applicable.

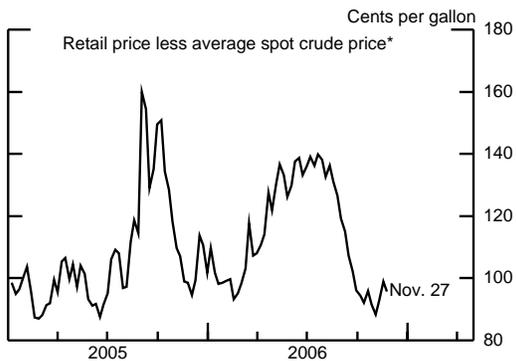
Consumer Prices (12-month change except as noted)



Energy Prices and Inventories

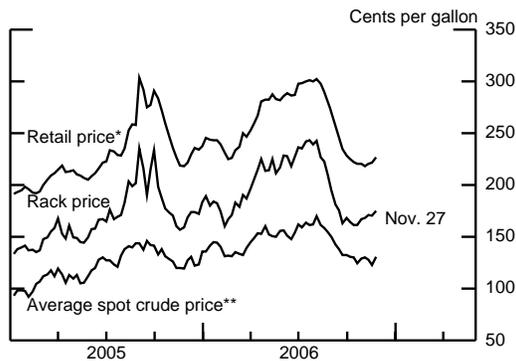
(Data from Energy Information Administration except as noted)

Total Gasoline Margin



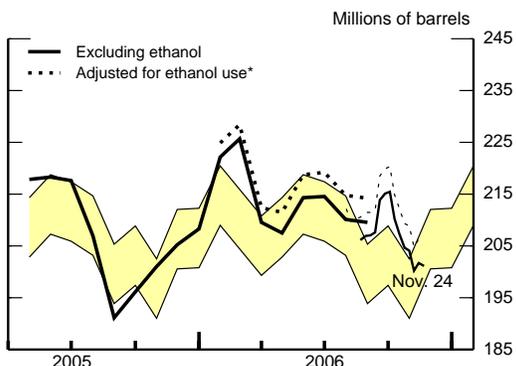
* Regular grade seasonally adjusted by FRB staff, less average spot crude price: 60% WTI, 40% Maya heavy crude.

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. Monthly data through August 2006, weekly data thereafter.

* Inventories of RBOB gasoline augmented to reflect fuel ethanol to be blended; estimated by FRB staff.

Ethanol Prices



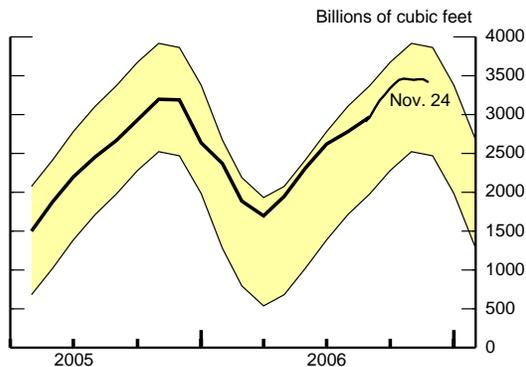
Source. Chicago Board of Trade.

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. Monthly data through August 2006, weekly data thereafter.

variety of other services. By contrast, the three-month change in the core CPI was 2.3 percent (annual rate) in October, down from its peak rate of 3.8 percent in May.⁹

The PCE price index for food and beverages also rose 0.2 percent in October, in line with the average monthly gains over the summer. The USDA has marked down its estimate of this year's corn crop, which has resulted in rising spot prices for corn as well as for soybeans (on the anticipation that higher corn prices will result in reduced planting of soybeans next season in favor of corn). However, the small share of these commodities in total value of food production limits their effect on overall food prices.

PCE energy prices fell 7.3 percent in October after a similar-sized decline in September. Gasoline prices tumbled 13 percent in September and 11 percent in October as both crude oil prices and margins moved lower. Survey data through the end of the month point to another—albeit smaller—decline in November. The index for natural gas fell back 7.7 percent in October as earlier sharp declines in spot prices were passed through to consumer prices. Recently, natural gas inventories, which had been elevated as a result of precautionary stockbuilding during hurricane season, moved back to a more typical seasonal level, prompting a rebound in spot prices.

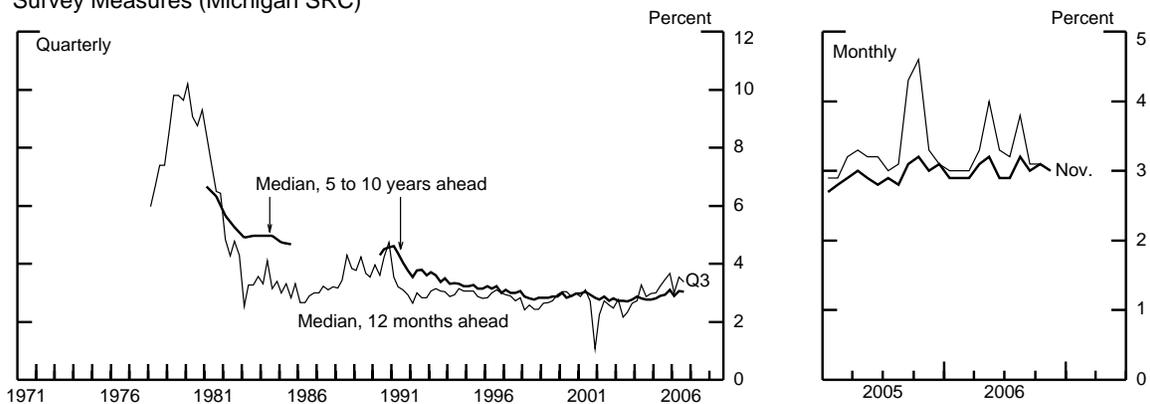
The four-quarter change in the GDP price index was 2.9 percent in the third quarter, down slightly from the year-earlier pace. Excluding food and energy, the increase in GDP prices was also 2.9 percent, unchanged from a year earlier. Although core PCE prices rose more rapidly over this period, other prices, especially the index for residential investment, decelerated.

The sustained fall in gasoline prices in recent months has likely contributed to a decline in inflation expectations. The Michigan Survey Research Center reported that median one-year-ahead inflation expectations fell to 3.0 percent in November, down from its recent peak of 3.8 percent in August. Median five- to ten-year-ahead expectations also

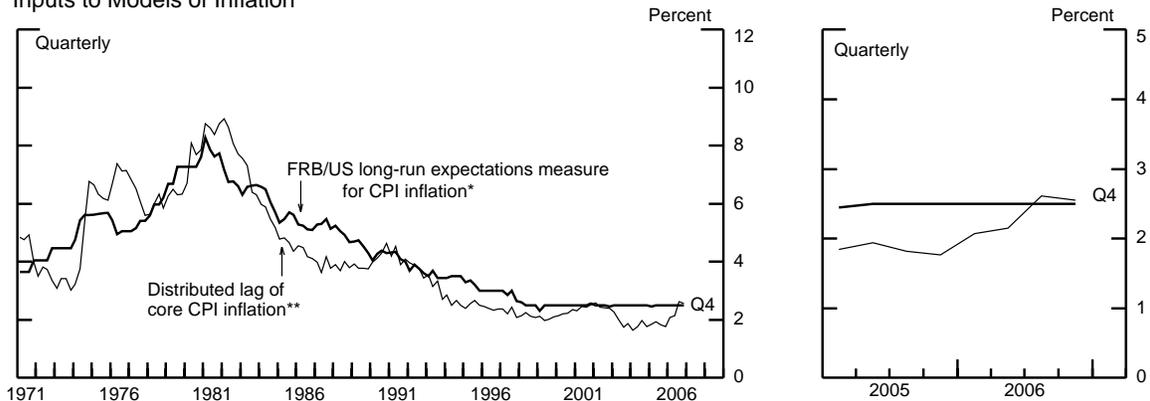
⁹ The CPI's more-pronounced deceleration than the PCE price measure stems from several sources. First, PCE medical services prices (which receive a relatively larger weight) have accelerated far more rapidly than the corresponding CPIs for medical services; this difference reflects the PCE index's use of alternative price indicators for the market and nonmarket portions of medical services. Second, shelter prices receive a greater weight in the CPI, implying that their deceleration has acted as a larger drag on this index. Third, the recent deceleration in core goods prices has been greater for the CPI because of both weighting and scope differences.

Measures of Expected Inflation

Survey Measures (Michigan SRC)



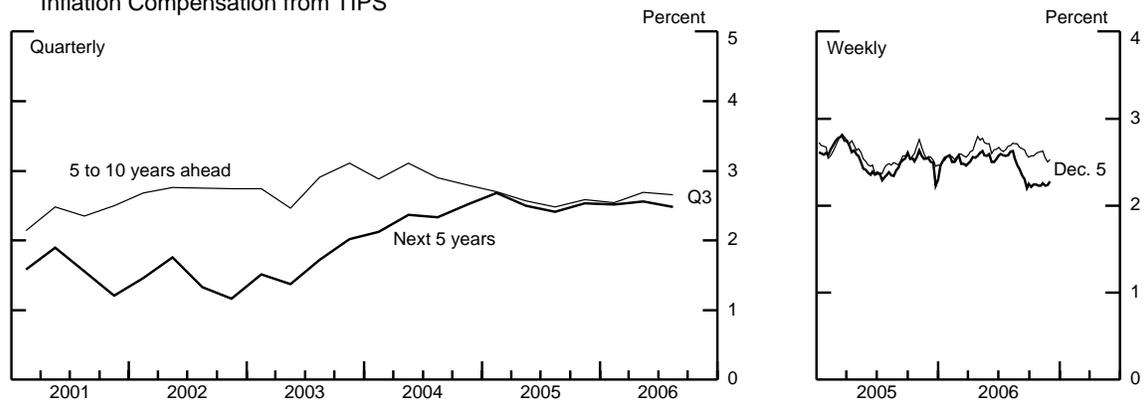
Inputs to Models of Inflation



* For 1991 forward, the median projection for CPI inflation over the next 10 years from the Survey of Professional Forecasters; for 1981 to 1991, a related survey conducted by Richard Hoey; and for the period preceding 1981, a model-based estimate constructed by Board staff.

** Derived from one of the reduced-form Phillips curves used by Board staff.

Inflation Compensation from TIPS



Note. Based on a comparison of an estimated TIPS yield curve with an estimated nominal off-the-run Treasury yield curve, with an adjustment for the indexation-lag effect since March 2004.

edged down to 3.0 percent in November from 3.2 percent in August and remained within the narrow range it has occupied for some time.

Expected Inflation

In the September Greenbook, we introduced a new exhibit showing three types of measures of expected inflation. To recap, the top two panels show the median responses to two familiar questions from the Michigan Survey Research Center: one about inflation twelve months ahead and one about inflation five to ten years ahead. The questions are asked of approximately 500 households per month and do not refer to any particular price index. (Specifically, the questions ask, “By about what percent [per year] do you expect prices to go up/down, on the average, during the next twelve months [five to ten years]?”)

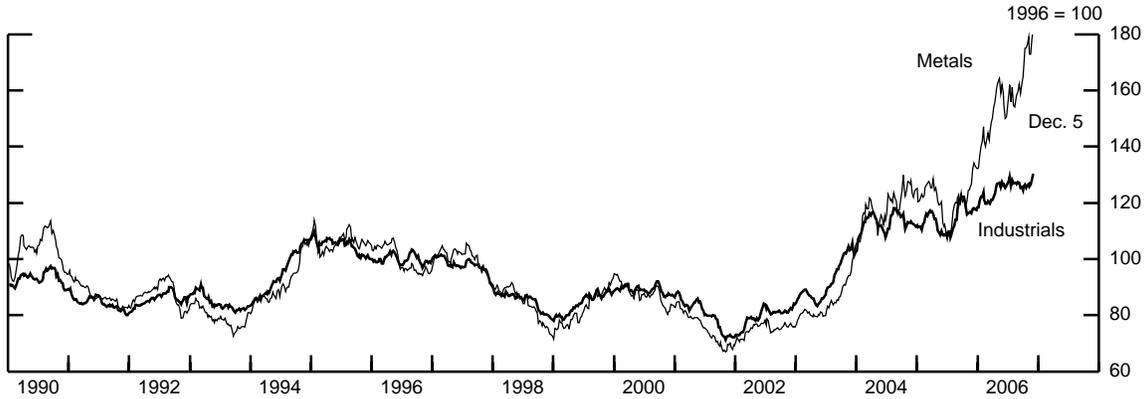
The middle panels show two series that are important inputs into our inflation models: the FRB/US long-run expectations measures for CPI inflation and a distributed lag of core CPI inflation. The FRB/US variable is constructed by splicing together three different series: for 1991 forward, the median projection for CPI inflation over the next ten years from the Survey of Professional Forecasters conducted by the Federal Reserve Bank of Philadelphia; for 1981 through 1991, a related survey conducted by Richard Hoey, of Drexel Burnham Lambert; and for years preceding 1981, a model-based estimate constructed by the Board staff. The distributed-lag measure is derived from one of the staff’s reduced-form Phillips curve models of core CPI inflation; multiplying the lagged inflation terms by the estimated coefficients on those terms (which are constrained to sum to one) generates the measure shown. This distributed lag, although not a direct measure of expected inflation, is highly correlated with actual inflation and likely includes an important expectations component.

Finally, in the bottom pair of panels, we show two series for inflation compensation derived from a comparison of yields on nominal Treasury securities with yields from Treasury inflation-protected securities (TIPS). These series, one for the next five years and one for five to ten years ahead, provide a market-derived measure of expected inflation, albeit one that also includes premiums for liquidity and for inflation risk. Beginning with March 2004, the series on inflation compensation over the next five years is adjusted for the indexation-lag effect.

Turning to prices at earlier stages of processing, the producer price index (PPI) for core intermediate materials rose 6 percent over the twelve months ending in October, compared with a 4¾ percent increase in the preceding year. However, most of this step-

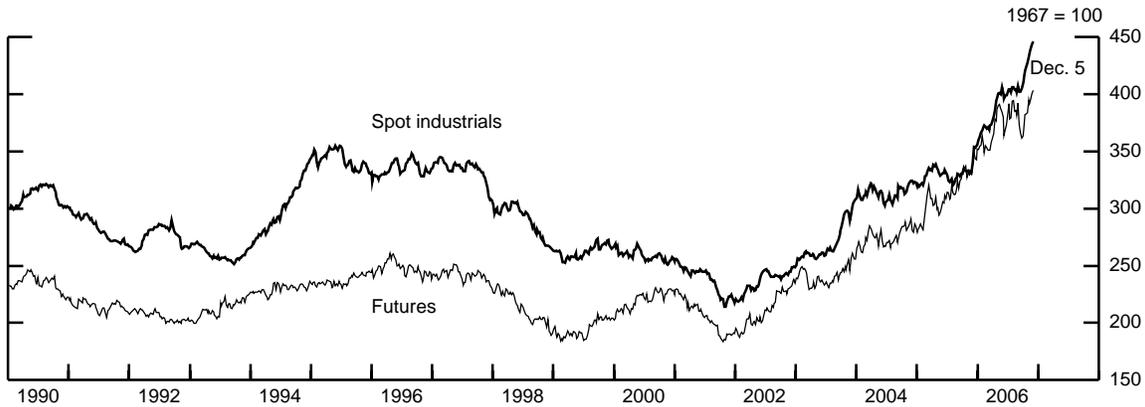
Commodity Price Indexes

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 CIBCR, 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 10/17/06 ²	10/17/06 ² to 12/5/06	52-week change to 12/5/06
JOC industrials	5.3	7.7	3.1	10.6
JOC metals	5.8	32.2	5.1	39.0
CRB spot industrials	10.1	18.2	6.3	31.4
CRB spot foodstuffs	-6.1	11.2	2.7	9.6
CRB futures	20.6	11.4	5.6	18.8

1. From the last week of the preceding year to the last week of the year indicated.
2. October 17, 2006, is the Tuesday preceding publication of the October Greenbook.

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

Measure	2003	2004	2005	2006
<i>Product prices</i>				
GDP price index	2.2	2.9	3.1	2.9
Less food and energy	1.9	2.9	2.9	2.9
Nonfarm business chain price index	1.3	2.5	3.3	2.6
<i>Expenditure prices</i>				
Gross domestic purchases price index	2.3	3.2	3.6	3.1
Less food and energy	1.9	2.8	2.8	2.7
PCE price index	1.9	2.7	3.1	2.8
Less food and energy	1.3	2.1	2.0	2.4
PCE price index, market-based components	1.8	2.3	3.1	2.6
Less food and energy	1.1	1.4	1.7	2.0
CPI	2.2	2.7	3.8	3.3
Less food and energy	1.3	1.8	2.1	2.8
Chained CPI	2.0	2.5	3.1	3.0
Less food and energy	1.0	1.7	1.7	2.7
Median CPI	2.1	2.4	2.3	3.4
Trimmed mean CPI	1.8	2.1	2.3	2.9
Trimmed mean PCE	1.7	2.3	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	
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	4.0	4.5	3.5	3.6	3.1	2.5
Q3	3.3	4.0	3.4	3.3	3.0	2.5
Q4	n.a.	n.a.	n.a.	n.a.	n.a.	2.5
2006:July	4.1	3.8	3.2	3.2	2.9	...
Aug.	3.8	4.6	3.8	3.5	3.2	2.5
Sept.	2.1	3.6	3.1	3.2	3.0	...
Oct.	1.3	3.7	3.1	3.5	3.1	...
Nov.	n.a.	3.3	3.0	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.

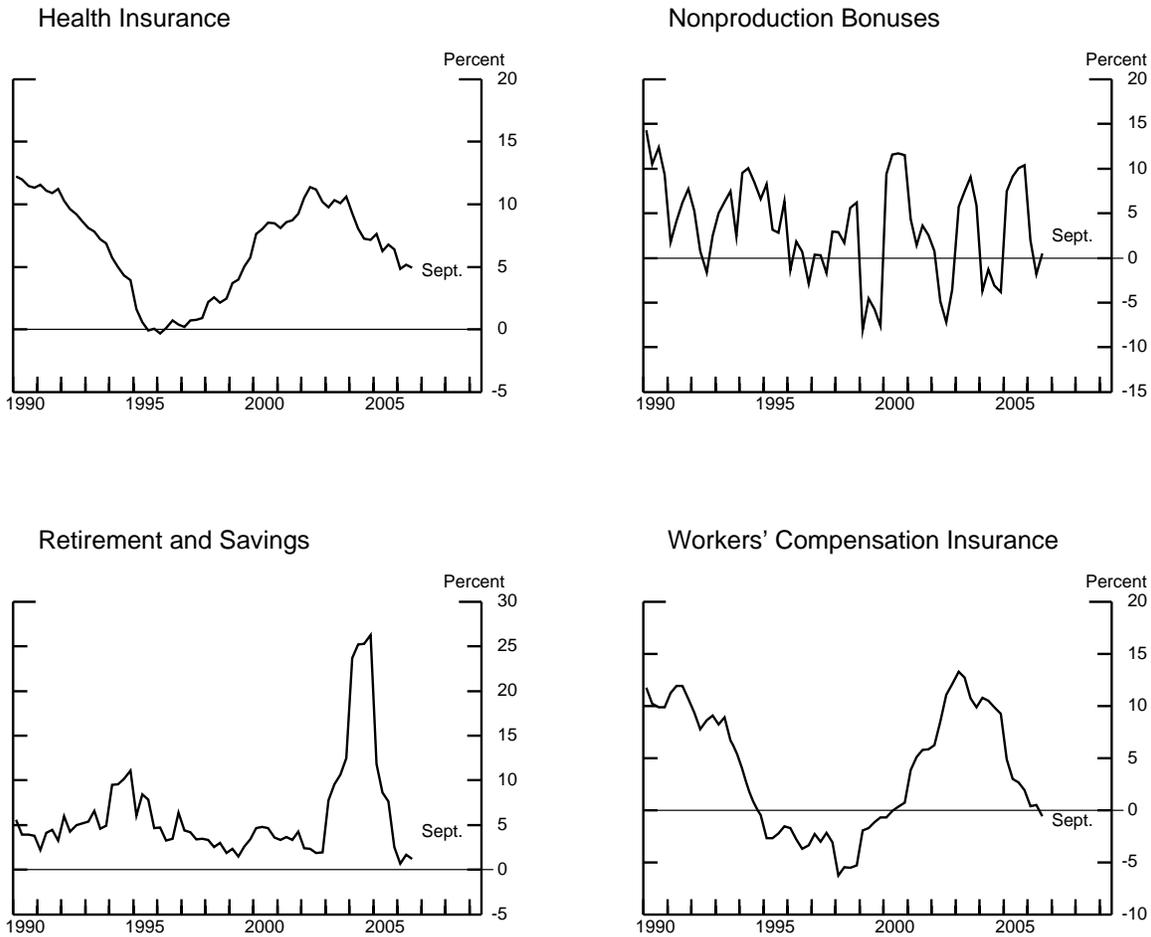
n.a. Not available.

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

Measure	2005		2006		
	Sept.	Dec.	Mar.	June	Sept.
Quarterly change (compound annual rate) ¹					
Total hourly compensation	2.9	2.8	2.4	3.2	3.6
Wages and salaries	2.5	2.8	2.8	3.6	3.2
Benefits	3.3	3.3	1.6	2.8	4.0
12-month change					
Total hourly compensation	2.9	2.9	2.6	2.8	3.0
Wages and salaries	2.3	2.5	2.4	2.8	3.0
Benefits	4.5	4.0	3.0	2.7	2.8

1. Seasonally adjusted by the Bureau of Labor Statistics.

Change in ECI Benefits (confidential)
(Private-industry workers; 12-month change)



up occurred earlier in the year; more recently, prices have flattened out. Core intermediate material prices held steady in October after having risen only 0.1 percent in September. The recent subdued readings likely reflect some pass-through of falling energy costs; the indexes of several energy-intensive goods and services, particularly those that react more quickly to energy costs, rose less rapidly, or even declined outright, in October.

Producer prices in other categories also declined in October. The index for prices of capital equipment turned down 0.9 percent; this decline primarily reflected a drop in the PPI for light trucks. Typically, on a not-seasonally-adjusted basis, prices of motor vehicles increase in October as new models are brought into the index; however, prices of light trucks declined.¹⁰ Prices for core crude materials fell 1.3 percent as metals prices dipped.

Other price indexes for materials at earlier stages of production have moved up recently. The Commodity Research Bureau spot index of industrial materials is up 6¼ percent since the October Greenbook, while the *Journal of Commerce* (JOC) index of industrial materials has risen 3 percent during the same period. Both indexes have been pushed up because of across-the-board increases in metals prices; the JOC index has risen by less because it also includes petroleum products, whose prices have decreased.

Labor Costs

As has been the case for some time, the compensation data do not give a particularly clear reading of the magnitude of labor-cost inflation. As measured by the employment cost index, hourly compensation of private industry workers rose at an annual rate of 3.6 percent over the three months ending in September; this pace was higher than that posted over the preceding several quarters and left the twelve-month change in the ECI at 3 percent. Although the recent pickup in the ECI is consistent with a tight labor market and continued pass-through of the high headline inflation of the past few years, its rate of increase over the past year remains below that of other labor-cost measures.

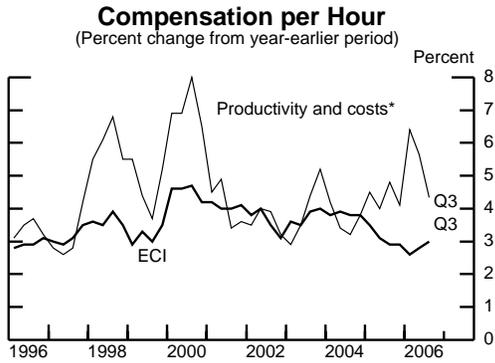
¹⁰ This price decline appears to reflect a sampling anomaly in the PPI. For the 2007 model year, General Motors significantly redesigned two popular pickup truck models that together account for more than 10 percent of domestic light truck production. GM is continuing to produce the original versions of these trucks as well but has heavily discounted their prices to reflect the availability of the improved models. The BLS appears to have included the original versions of these trucks—not the redesigned ones—in their sample, thereby capturing the large price declines for the original models in the PPI.

Hourly Compensation and Unit Labor Costs

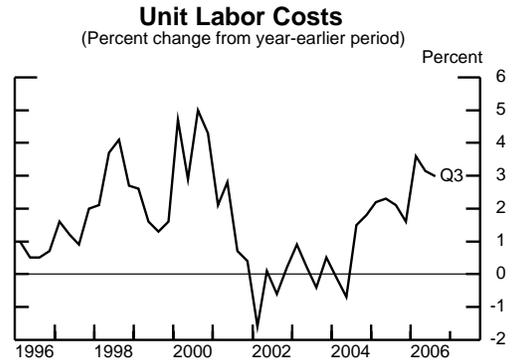
(Percent change from preceding period at compound annual rate; based on seasonally adjusted data)

Category	2004:Q3 to 2005:Q3	2005:Q3 to 2006:Q3 ^e	2005	2006		
			Q4	Q1	Q2	Q3 ^e
<i>Compensation per hour</i> Nonfarm business	4.8	4.3	2.9	13.7	-1.2	2.6
<i>Unit labor costs</i> Nonfarm business	2.1	3.0	3.0	9.0	-2.4	2.6

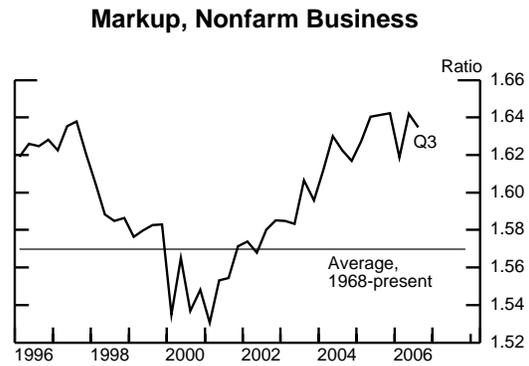
e Staff estimate.



* Value for 2006:Q3 is a staff estimate.



Note. Value for 2006:Q3 is a staff estimate.



Note. The markup is the ratio of output price to unit labor costs. Value for 2006:Q3 is a staff estimate.

Consistent with the Productivity and Costs release, the staff estimates that compensation per hour in the nonfarm business sector increased at an annual rate of 2.6 percent in the third quarter. In addition, the BEA's incorporation of the state unemployment insurance data into the second-quarter compensation figures caused the second-quarter change in hourly compensation to be revised down nearly 8 percentage points; the measure is now estimated to have declined at an annual rate of 1.2 percent. This lower rate suggests that the transitory factors that boosted first-quarter hourly compensation—namely, a surge in stock option exercises and bonus payments—have largely gone away. Smoothing through these swings puts the four-quarter change in hourly compensation at 4.3 percent in the third quarter. More recently, average hourly earnings moved up 0.4 percent in October, roughly in line with recent months; this increase brought the twelve-month change to 3¾ percent.

According to the ECI, employer contributions for health insurance rose about 5 percent over the twelve months ending in September—1¾ percentage points less than the increase over the previous year. Taken together, the available indicators provide no evidence that any dramatic change in the rate of increase in health insurance costs is in the offing. Private surveys suggest that premiums will rise in the neighborhood of 6 to 8 percent in 2007, about the same as the survey results for 2006. Among the major plans for public employees, premiums in the Federal Employees Health Benefits Program are expected to rise less than 2 percent, on average, in 2007 after an increase of 6½ percent in 2006, while premiums for the California Public Employees' Retirement System are slated to move up 12 percent, on average, in 2007 after an increase of 9 percent in 2006.

Domestic Financial Developments

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

Instrument	2004	2005	2006		Change to Dec. 5 from selected dates (percentage points)		
	June 28	Dec. 30	Oct. 24	Dec. 5	2004 June 28	2005 Dec. 30	2006 Oct. 24
<i>Short-term</i>							
FOMC intended federal funds rate	1.00	4.25	5.25	5.25	4.25	1.00	.00
Treasury bills ¹							
3-month	1.36	3.99	5.00	4.86	3.50	.87	-.14
6-month	1.74	4.22	4.99	4.84	3.10	.62	-.15
Commercial paper (A1/P1 rates) ²							
1-month	1.28	4.23	5.25	5.25	3.97	1.02	.00
3-month	1.45	4.37	5.24	5.23	3.78	.86	-.01
Large negotiable CDs ¹							
3-month	1.53	4.49	5.33	5.30	3.77	.81	-.03
6-month	1.82	4.65	5.37	5.25	3.43	.60	-.12
Eurodollar deposits ³							
1-month	1.29	4.36	5.32	5.35	4.06	.99	.03
3-month	1.51	4.52	5.38	5.35	3.84	.83	-.03
Bank prime rate	4.00	7.25	8.25	8.25	4.25	1.00	.00
<i>Intermediate- and long-term</i>							
U.S. Treasury ⁴							
2-year	2.88	4.43	4.93	4.52	1.64	.09	-.41
5-year	3.97	4.35	4.78	4.37	.40	.02	-.41
10-year	4.90	4.47	4.90	4.52	-.38	.05	-.38
U.S. Treasury indexed notes							
5-year	1.56	2.03	2.61	2.12	.56	.09	-.49
10-year	2.25	2.10	2.52	2.12	-.13	.02	-.40
Municipal general obligations (Bond Buyer) ⁵	5.01	4.38	4.33	4.04	-.97	-.34	-.29
Private instruments							
10-year swap	5.21	4.92	5.36	4.91	-.30	-.01	-.45
10-year FNMA ⁶	5.38	4.84	5.19	4.74	-.64	-.10	-.45
10-year AA ⁷	5.60	5.27	5.78	5.37	-.23	.10	-.41
10-year BBB ⁷	6.25	5.82	6.34	5.93	-.32	.11	-.41
10-year high yield ⁷	8.41	8.30	8.39	8.23	-.18	-.07	-.16
Home mortgages (FHLMC survey rate) ⁸							
30-year fixed	6.21	6.21	6.40	6.14	-.07	-.07	-.26
1-year adjustable	4.19	5.16	5.60	5.46	1.27	.30	-.14

Stock exchange index	Record high		2005	2006		Change to Dec. 5 from selected dates (percent)		
	Level	Date	Dec. 30	Oct. 24	Dec. 5	Record high	2005 Dec. 30	2006 Oct. 24
Dow Jones Industrial	12,343	11-17-06	10,718	12,128	12,332		15.06	1.68
S&P 500 Composite	1,527	3-24-00	1,248	1,377	1,415	-7.38	13.34	2.71
Nasdaq	5,049	3-10-00	2,205	2,345	2,452	-51.42	11.20	4.59
Russell 2000	797	12-5-06	673	762	797	.00	18.45	4.59
Wilshire 5000	14,752	3-24-00	12,518	13,802	14,272	-3.25	14.02	3.41

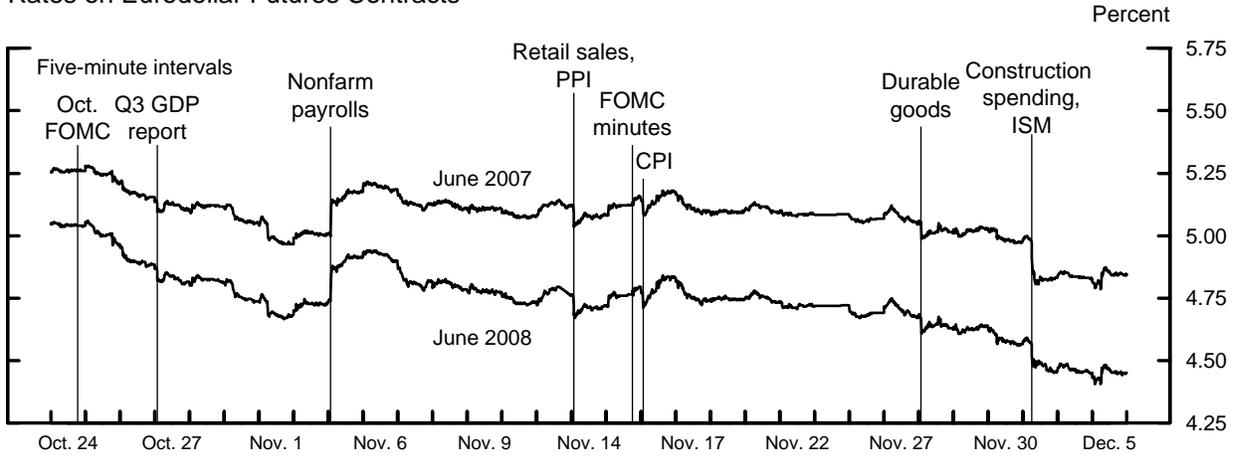
1. Secondary market.
2. Financial commercial paper.
3. Bid rates for Eurodollar deposits collected around 9:30 a.m. eastern time.
4. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
5. Most recent Thursday quote.
6. Constant-maturity yields estimated from Fannie Mae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

NOTES:

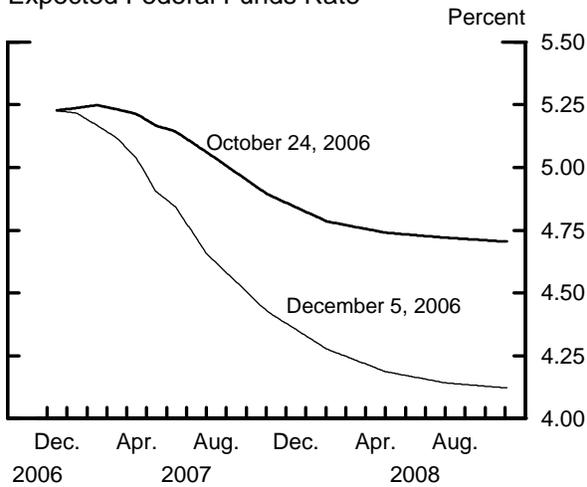
June 28, 2004, is the day before the most recent policy tightening began.
October 24, 2006, is the day before the most recent FOMC announcement.

Policy Expectations and Treasury Yields

Rates on Eurodollar Futures Contracts

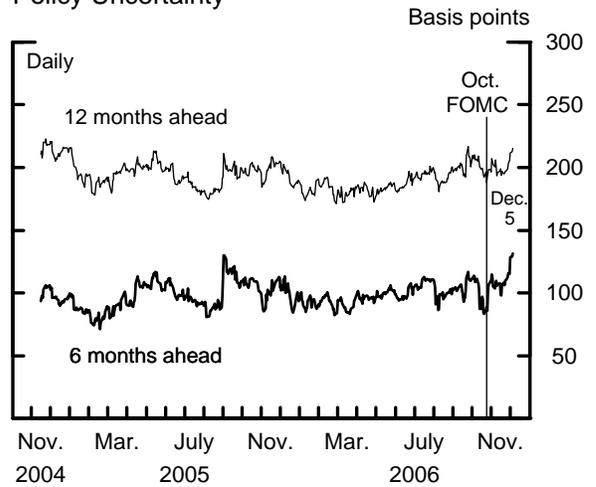


Expected Federal Funds Rate



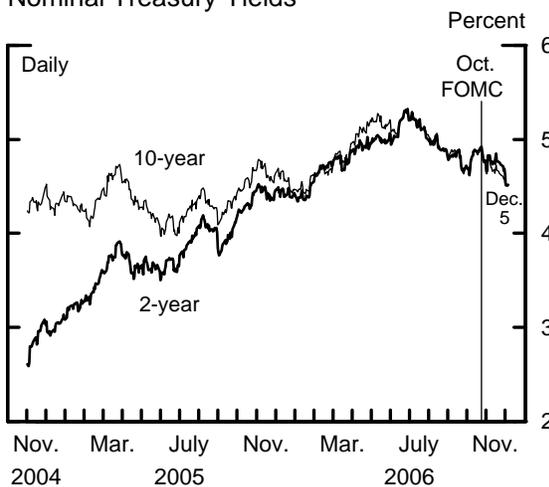
Note. Estimates from federal funds and Eurodollar futures, with an allowance for term premia and other adjustments.

Policy Uncertainty



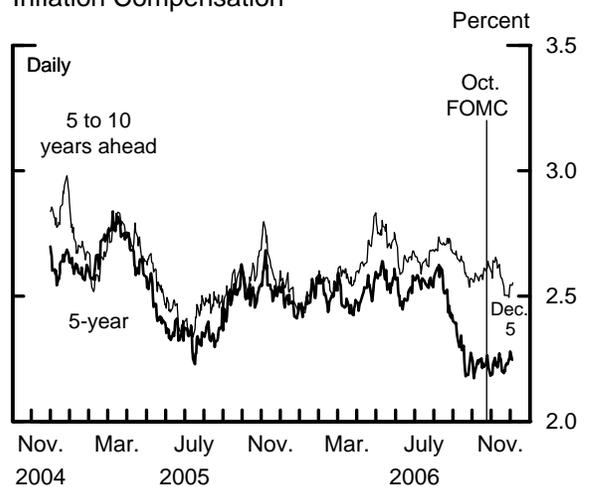
Note. Width of a 90 percent confidence interval for the federal funds rate computed from the term structures for both the expected federal funds rate and Eurodollar implied volatility.

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.

Domestic Financial Developments

Overview

Investors continued to anticipate that the FOMC will maintain the current stance of policy at its December meeting, but the anticipated trajectory of policy beyond early 2007 shifted down substantially over the intermeeting period amid some indicators of economic activity that were weaker than market participants had been expecting. Nominal Treasury yields also dropped considerably, with real yields moving lower and inflation compensation little changed. Equity prices rose moderately on the strength of favorable earnings news and lower interest rates. Risk spreads on corporate bonds remained at low levels, as corporate credit quality continued to be solid. Household borrowing stepped down in the third quarter, and indicators of credit quality remained favorable on the whole. Profits of commercial banks edged lower in the third quarter from a high level, and loan performance was generally solid.

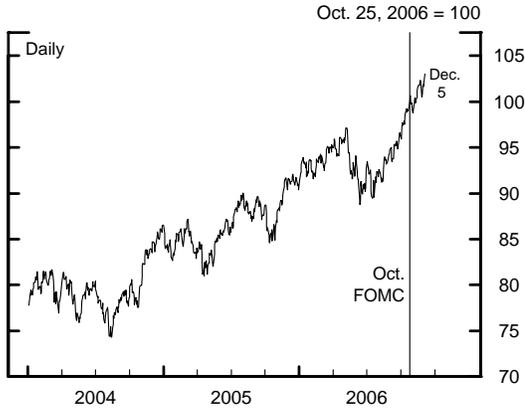
Policy Expectations and Interest Rates

The Committee's decision at its October meeting to leave the target federal funds rate unchanged and to make only modest changes to the accompanying policy statement was largely anticipated by market participants and elicited little reaction. Similarly, the minutes of the meeting left little imprint on financial markets. Current quotes on federal funds futures contracts indicate that investors continue to expect the Committee to maintain the current target at its December meeting. However, investors reportedly perceived a weakening in the expansion, responding partly to incoming data on spending, and consequently both moved up the timing and increased the amount of policy easing that they had previously anticipated. Options prices indicate that investors now see about a 30 percent chance of a 25 basis point easing at the January meeting, and, over the intermeeting period, the expected path for policy further ahead shifted substantially lower. Assuming our typical adjustment for term premiums, futures quotes imply that investors now expect 100 basis points of easing by mid-2008, considerably more than was expected at the time of the last FOMC meeting. A survey conducted by the Trading Desk indicates that primary dealers anticipate policy easing next year as well, albeit less than that currently embedded in futures rates.

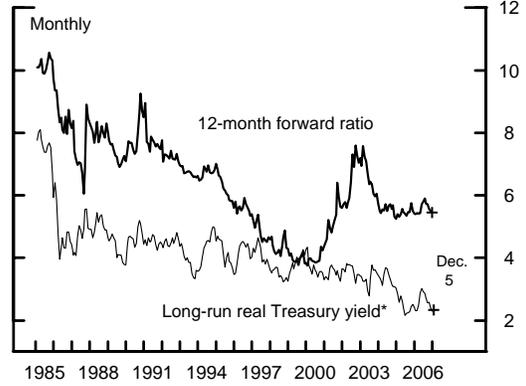
Over the intermeeting period, the distribution of the target federal funds rate about six months ahead derived from options on Eurodollar futures became somewhat more skewed to the downside. Measures of uncertainty about the future path of policy rose to their highest levels in more than a year.

Corporate Yields, Risk Spreads, and Stock Prices

Wilshire 5000

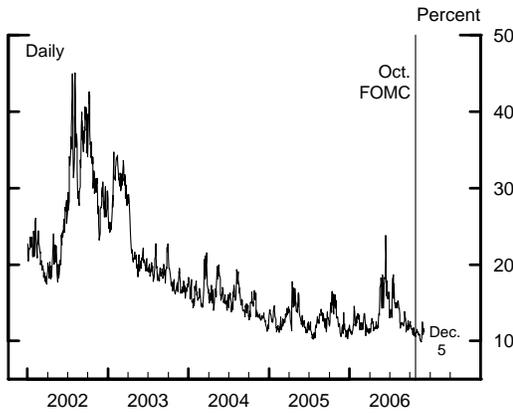


Ratio of Trend Earnings to Price for S&P 500 and Long-Run Treasury Yield

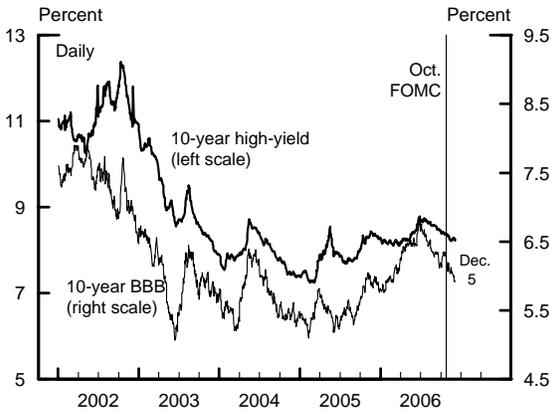


* Estimated yield on synthetic Treasury perpetuity minus Philadelphia Fed 10-year expected inflation.
 + Denotes the latest observation using daily interest rates and stock prices and latest earnings data from I/B/E/S.

Implied Volatility on S&P 500 (VIX)

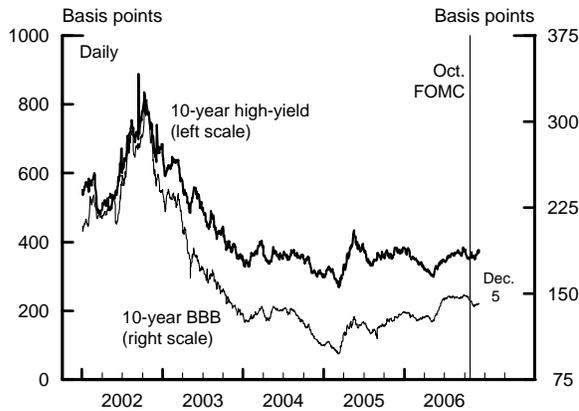


Corporate Bond Yields



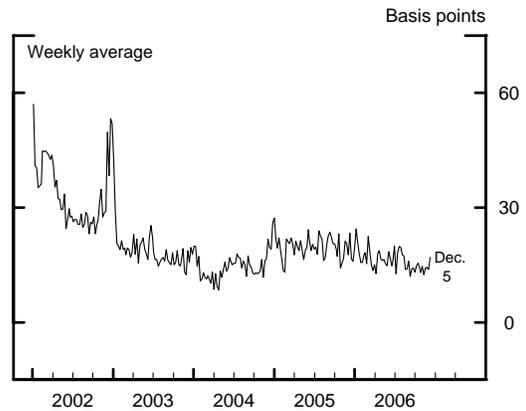
Note. Yields from smoothed yield curves based on Merrill Lynch bond data.

Corporate Bond Spreads



Note. Measured relative to comparable-maturity Treasuries.

Commercial Paper Quality Spread



Note. Measured by the difference between yields on 30-day A2/P2 paper and A1/P1 paper.

Two- and ten-year Treasury yields declined about 40 basis points, on net, over the intermeeting period. Market commentary suggested that the declines were driven importantly by perceptions of a softening of the economic outlook. According to the staff's three-factor model, as well as other measures, a substantial portion of the drop in rates over the intermeeting period was accounted for by a decline in term premiums. Amid moderately higher oil prices and benign readings on consumer price inflation, near-term measures of inflation compensation based on Treasury inflation-protected securities were little changed—after adjusting for carry effects—while far-forward measures of inflation compensation inched down.

Stock Prices and Corporate Interest Rates

In response to generally favorable earnings news and lower long-term interest rates, broad stock price indexes rose 2½ percent to 4½ percent, on net, over the intermeeting period. The ratio of trend-forward earnings to share prices for S&P 500 firms held steady, but its spread over a long-run real Treasury yield—a rough gauge of the equity risk premium—widened a bit. On net, implied volatility on the S&P 500 index remained close to its historical lows.

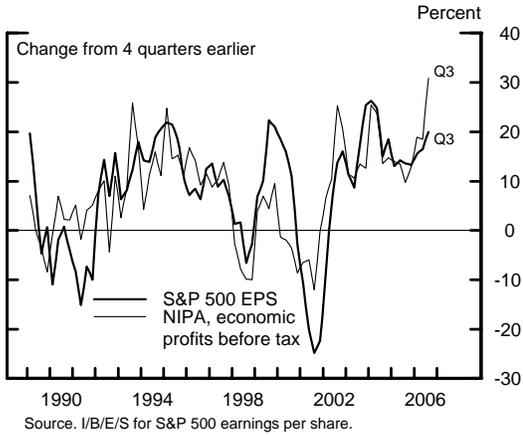
Yields on investment-grade corporate bonds fell about in line with those on comparable-maturity Treasury securities, while yields on speculative-grade corporate bonds declined a bit less. Risk spreads remained at the low end of their range over the past several years. Risk spreads on commercial paper, measured by the difference between yields on thirty-day A2/P2 and A1/P1 paper, were also low—even spreads on paper set to mature over year-end.

Corporate Earnings and Credit Quality

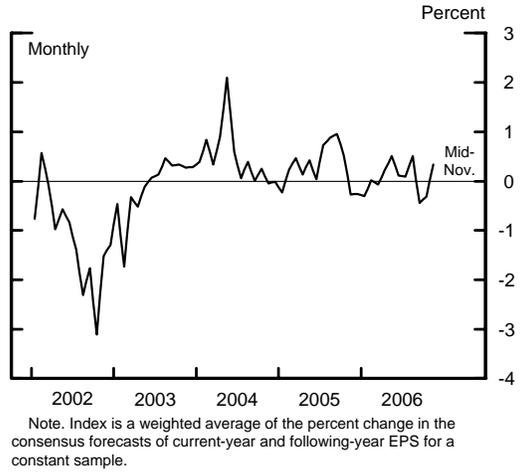
With the remainder of third-quarter reports now in hand, operating earnings per share for S&P 500 firms rose about 20 percent from four quarters earlier, up from the 15 percent increase anticipated at the time of the October Greenbook. The rate implies a solid seasonally adjusted quarterly increase of 3½ percent. Actual reports beat analysts' forecasts by quite a wide margin, and surprises were widespread across sectors. Analysts' revisions to year-ahead earnings for the S&P 500 firms were about unchanged in November. Growth in third-quarter NIPA profits was also high, indicating profit growth was broad-based, although the comparison with year-earlier results is affected by last year's hurricane-related losses.

Corporate Earnings and Credit Quality

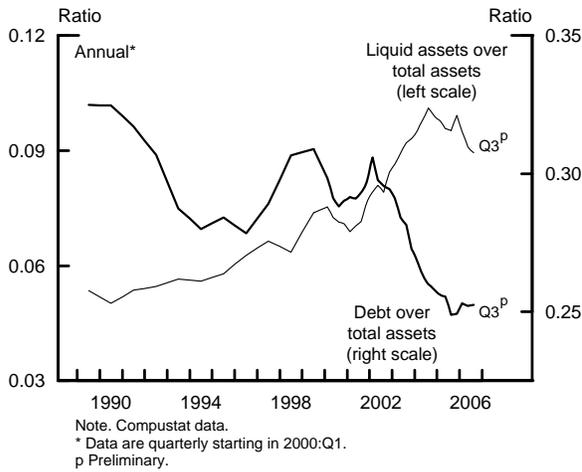
Corporate Earnings Growth



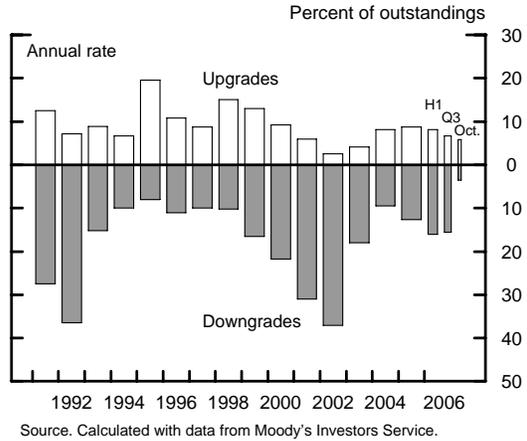
S&P 500 EPS Revisions Index



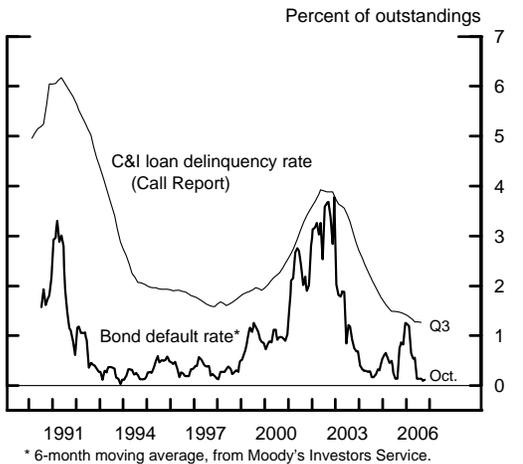
Financial Ratios for Nonfinancial Corporations



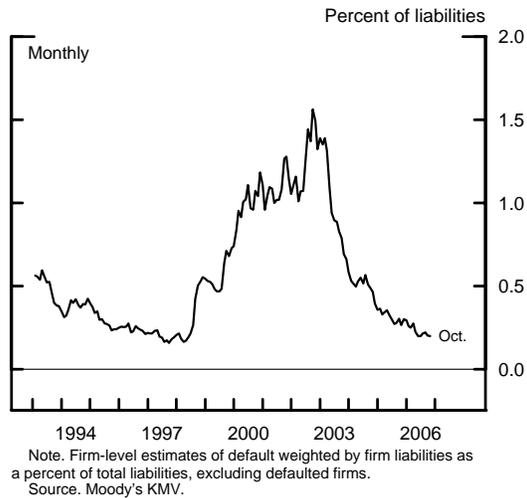
Bond Ratings Changes of Nonfinancial Companies



Selected Default and Delinquency Rates



Expected Year-Ahead Defaults



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	Q3	Oct.	Nov. ^P
<i>Nonfinancial corporations</i>								
Stocks ¹	5.2	3.7	5.4	4.6	5.2	2.6	3.9	7.1
Initial public offerings	.7	.4	1.6	1.7	1.9	.7	2.8	3.3
Seasoned offerings	4.4	3.3	3.8	2.8	3.3	1.9	1.1	3.8
Bonds ²	24.8	31.6	22.7	19.1	30.5	18.7	22.2	50.8
Investment grade	15.7	15.9	8.2	8.4	14.4	10.5	8.1	18.7
Speculative grade	4.9	11.3	9.7	6.4	8.4	4.8	5.9	8.9
Other (sold abroad/unrated)	4.2	4.3	4.9	4.3	7.8	3.5	8.1	23.2
<i>Memo</i>								
Net issuance of commercial paper ³	-5.7	-3.4	1.5	-4	3.4	-1.2	-18.0	16.7
Change in C&I loans at commercial banks ^{3,4,5}	-5.2	-7.7	3.2	10.0	14.6	12.9	17.4	-6
<i>Financial corporations</i>								
Stocks ¹	4.0	6.6	6.9	5.0	4.4	5.0	5.7	10.8
Bonds ²	87.0	111.1	139.3	176.3	190.2	174.8	165.3	127.6

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.

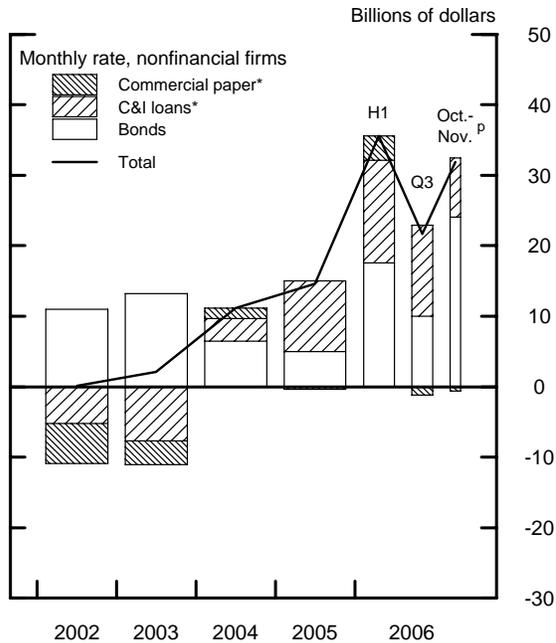
3. End-of-period basis, seasonally adjusted.

4. Adjusted for FIN 46 effects.

5. Adjusted to remove the effects of a consolidation of a sizable amount of thrift assets onto a commercial bank's books in October 2006.

p Preliminary.

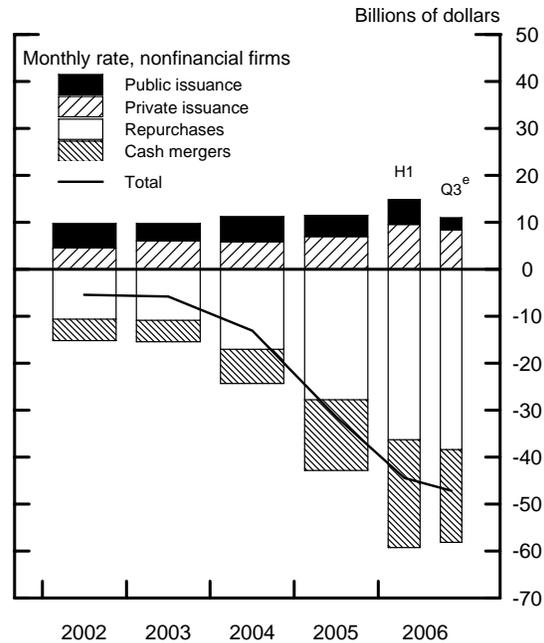
Selected Components of Net Debt Financing



* Seasonally adjusted, period-end basis.

p Preliminary.

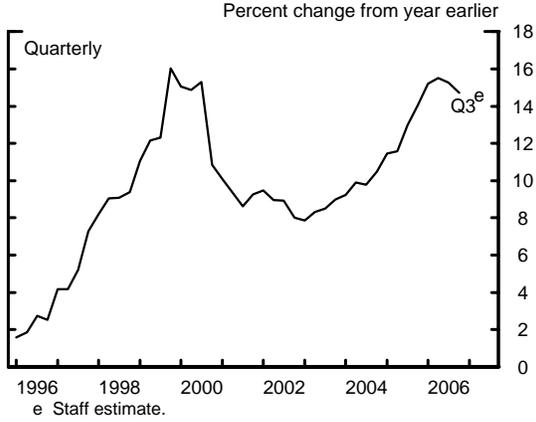
Components of Net Equity Issuance



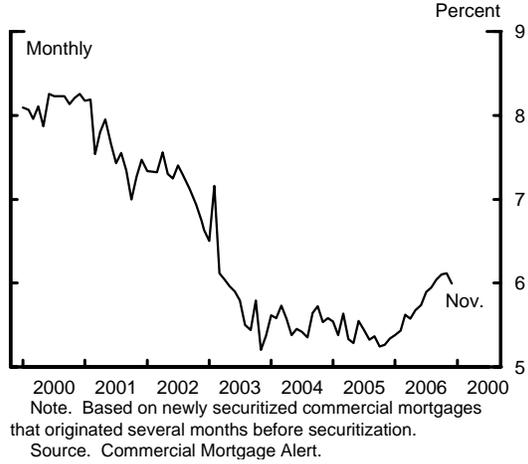
e Staff estimate.

Commercial Real Estate

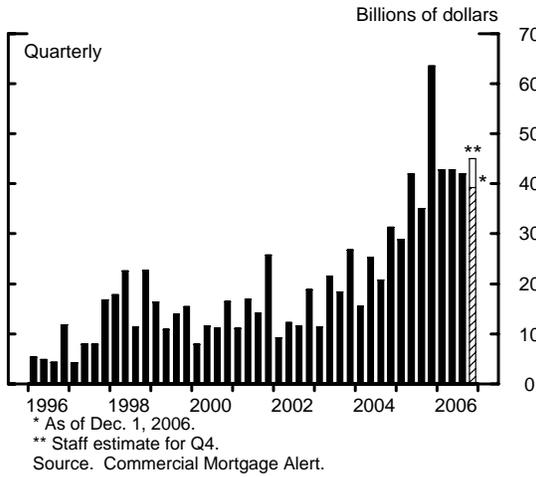
Commercial Mortgage Debt



Commercial Mortgage Rate



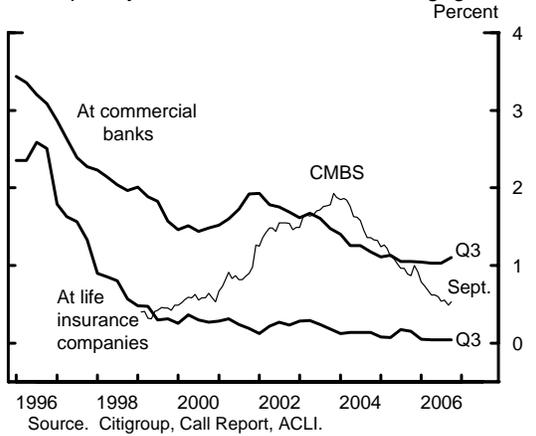
Gross Issuance of CMBS



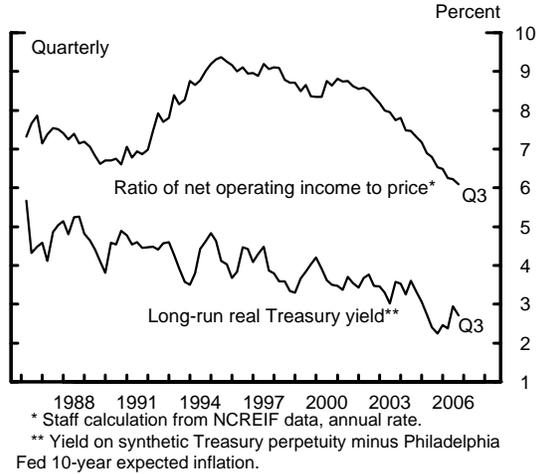
Investment-Grade CMBS Spreads



Delinquency Rates on Commercial Mortgages



Commercial Real Estate Valuation



The credit quality of nonfinancial firms has stayed solid overall. Data for large corporations in the third quarter indicate that, in the aggregate, firms' balance sheets remained highly liquid while corporate leverage stayed low. Bond rating upgrades outpaced downgrades in October, and the realized six-month trailing bond default rate was again near zero. Third-quarter Call Reports showed the lowest delinquency rate on C&I loans in the past two decades. The near-term outlook for credit quality also remained very favorable, as the KMV-based forecast of the aggregate year-ahead default rate continued to hover around historical lows.

Business Finance

Net funds raised by nonfinancial firms in credit markets in October and November exceeded the strong third-quarter pace. Gross bond issuance surged in November—to more than double its October pace—because of robust issuance by both investment-grade and speculative-grade firms. Reportedly, a significant share of the proceeds from investment-grade issues was intended to refinance existing debt, whereas a large amount of the speculative-grade issuance was linked to merger and acquisition activity. On net, commercial paper outstanding declined modestly over October and November, while the expansion of C&I loans moderated some during the same period.

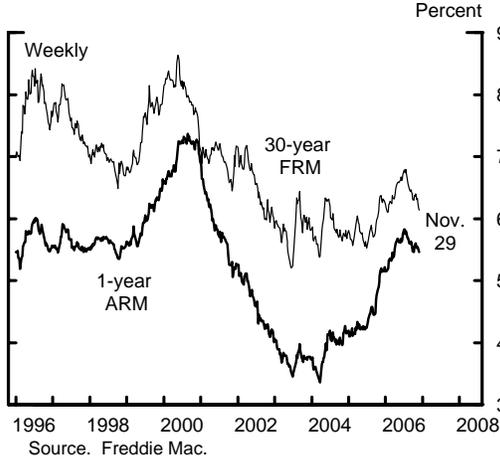
Public equity issuance increased further in November, augmented by the strongest pace of IPO activity so far this year. Private equity issuance has also likely remained vigorous owing to continued investments by buyout and venture capital firms. Even so, gross equity issuance has been dwarfed by the continued extraordinary pace of equity retirements. Fueled by strong profits and ample cash on corporate balance sheets, announcements of cash-financed mergers continued apace in October and November, while announcements of new repurchase programs have declined only a bit.

Commercial Real Estate

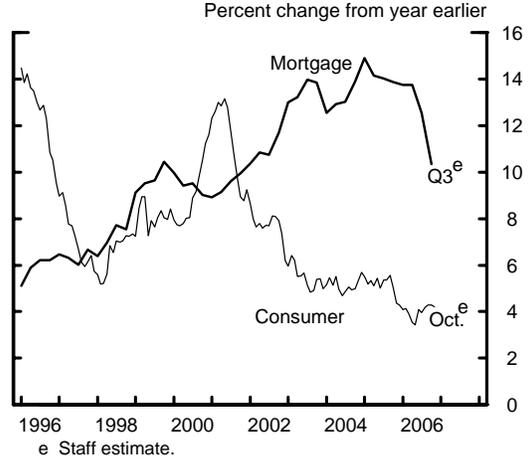
The recent expansion of commercial mortgage debt has been rapid, and, at the end of the third quarter, debt outstanding stood about 14 percent above its year-earlier level. On net, growth has moderated a little this year, likely a reflection of the rise in commercial mortgage rates. Completed CMBS deals to date and the calendar of scheduled offerings indicate that issuance will be robust in the current quarter. Delinquency rates on commercial mortgages—including those backing CMBS—remained low by historical standards, and spreads of yields on investment-grade CMBS over those on comparable-maturity Treasury securities ticked down over the intermeeting period.

Household Liabilities

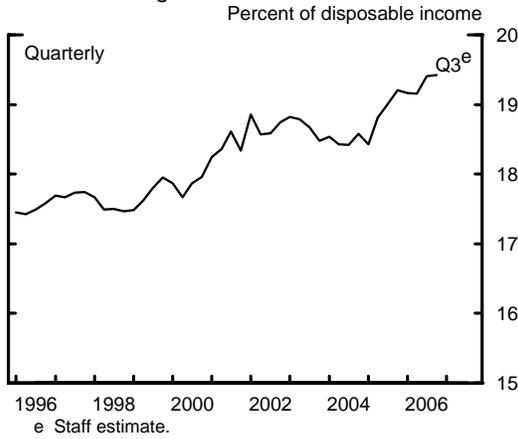
Mortgage Rates



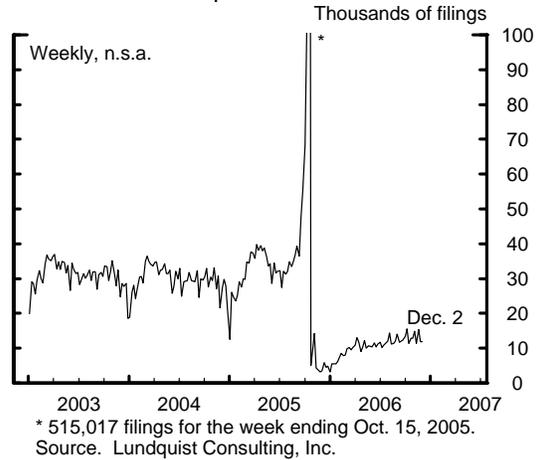
Mortgage Debt and Consumer Credit



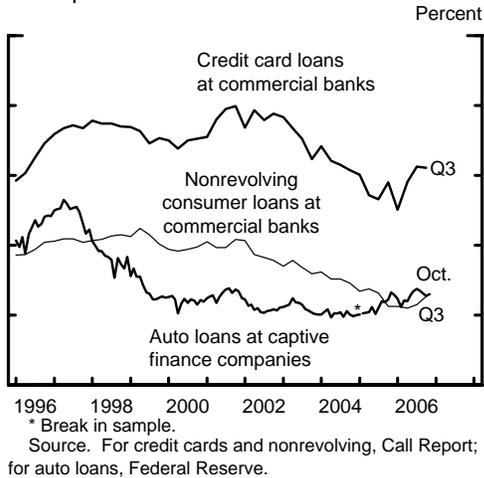
Financial Obligations Ratio



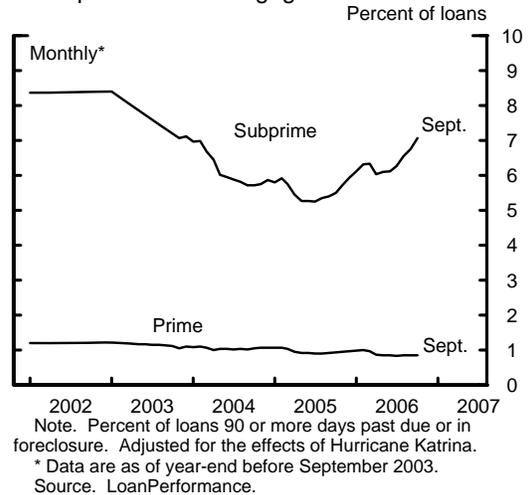
Household Bankruptcies



Delinquencies on Consumer Loans



Delinquencies on Mortgages



Prices of commercial real estate posted another solid increase in the third quarter, thereby contributing to a slight further decline in the ratio of net operating income to property prices. The spread of this ratio over the real perpetuity Treasury yield—a rough measure of the risk premium on commercial real estate assets—was little changed last quarter, staying near its historical average.

Household Finance

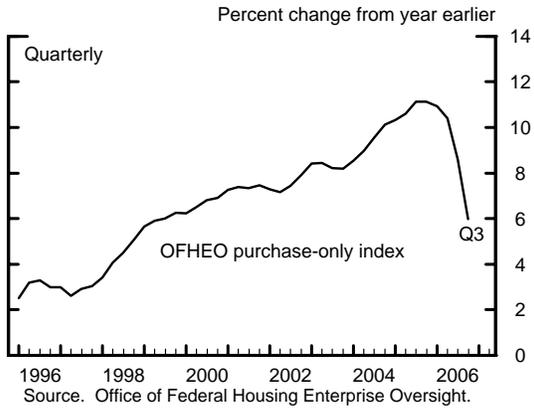
Growth of home mortgage debt declined further in the third quarter, in line with the slowdown in home-price appreciation and in housing activity; indeed, on a quarterly basis, home mortgage borrowing was the slowest since 1998. Interest rates on both thirty-year fixed-rate and one-year adjustable-rate mortgages declined over the intermeeting period, likely providing some support to mortgage refinancing activity in the current quarter. Over the year ending in October, growth of consumer credit remained modest.

Although growth of total household debt in the third quarter was slow by recent standards, it outpaced income growth, nudging the financial obligations ratio to a new high. Nevertheless, on the whole, credit quality remained favorable, indicating that most households are on a solid footing to meet their financial obligations. The pace of bankruptcy filings was subdued, and delinquency rates generally remained low for prime-rated mortgages and several types of consumer loans. However, a further increase in the delinquency rate on subprime mortgages in September hints at pockets of financial stress. On a dollar-weighted basis, the deterioration in subprime mortgages was somewhat larger than on an unweighted basis, suggesting that the larger subprime mortgages were more likely to have turned delinquent.

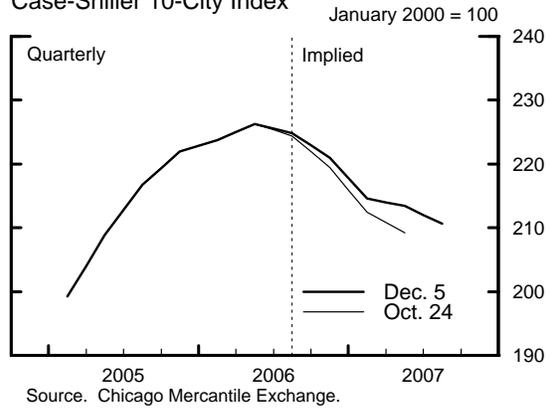
Nationwide, prices of existing homes rose in the third quarter, but the rate of increase in the OFHEO purchase-only price index was the lowest in many years. Futures quotes on the S&P/Case-Shiller home price index suggest that market participants continue to anticipate an outright price decline in coming quarters across ten of the largest metropolitan markets, but over the intermeeting period they have become a bit less bearish about prices in the first half of 2007. Even with the notable rise in stock prices in the third quarter, the ratio of household net worth to disposable personal income was virtually the same as in the second quarter.

Household Assets

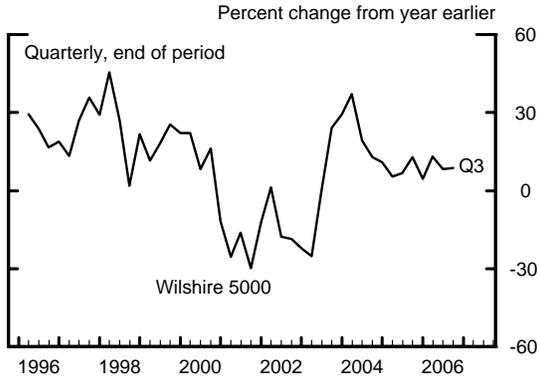
House Prices



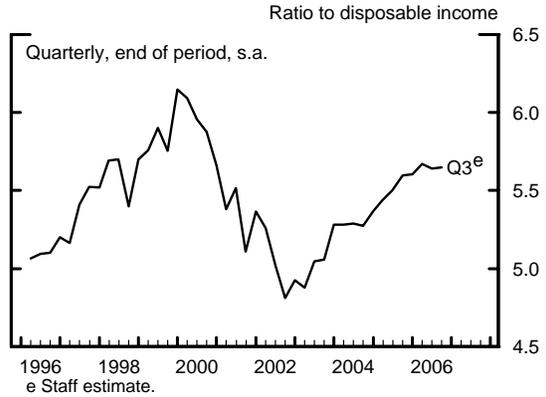
House-Price Path Implied by Futures on Case-Shiller 10-City Index



Stock Prices



Net Worth



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

Fund type	2004	2005	2006					Assets Oct.
			Q1	Q2	Q3	Oct.	Nov. ^e	
Total long-term funds	17.5	16.0	38.9	6.2	9.2	24.4	19.1	7,767
Equity funds	14.8	11.3	31.1	7.0	4.1	12.2	10.4	5,670
Domestic	9.3	2.6	10.7	-2.4	-3.6	0.4	0.4	4,456
International	5.6	8.7	20.4	9.4	7.7	11.8	10.0	1,213
Hybrid funds	3.6	2.1	0.4	-0.1	0.3	1.6	1.8	633
Bond funds	-0.9	2.6	7.4	-0.7	4.8	10.6	6.8	1,464
High-yield	-0.8	-1.3	-0.4	-1.4	0.4	0.7	1.0	150
Other taxable	1.0	3.5	5.8	0.7	3.3	7.6	3.6	953
Municipals	-1.1	0.4	2.1	0.1	1.0	2.2	2.2	361

Note. Excludes reinvested dividends.

^e Staff estimate based on confidential weekly data.

Source. Investment Company Institute.

Treasury Financing
(Billions of dollars)

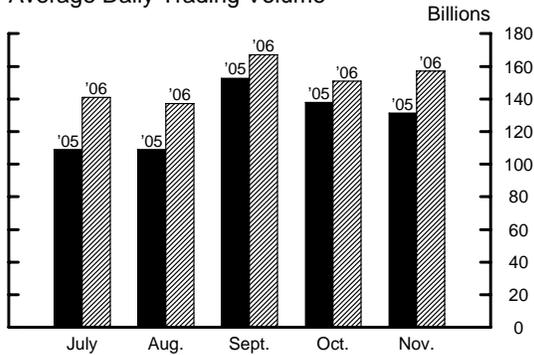
Item	2005		2006				
	Q3	Q4	Q1	Q2	Q3	Oct.	Nov.
Total surplus, deficit (-)	-69.2	-119.4	-183.6	96.5	-41.7	-49.3	-64.6
Means of financing deficit							
Net borrowing	72.8	112.2	156.1	-74.8	43.4	37.9	25.3
Nonmarketable	20.6	21.2	-2.3	17.6	-1.5	4.1	5.4
Marketable	52.1	91.0	158.5	-92.4	44.9	33.8	20.0
Bills	-9.3	48.8	78.1	-125.5	-5.3	18.0	32.5
Coupons	61.4	42.3	80.4	33.1	50.1	15.8	-12.6
Decrease in cash balance	-2.5	-0.9	28.4	-37.6	-6.3	-5.1	46.8
Other ¹	-1.1	8.1	-1.0	15.9	4.7	16.6	-7.6
Memo:							
Cash balance, end of period	35.7	36.6	8.2	45.8	52.1	57.3	10.5

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

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

Treasury Market Conditions

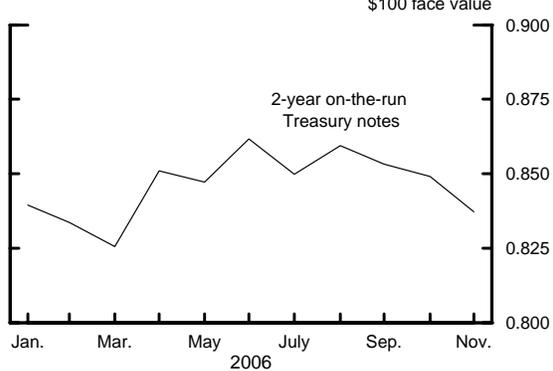
Average Daily Trading Volume



Note. Monthly average of daily trading volume in 2-, 5-, and 10-year on-the-run coupon securities in interdealer market.

Source. BrokerTec Interdealer Market Data.

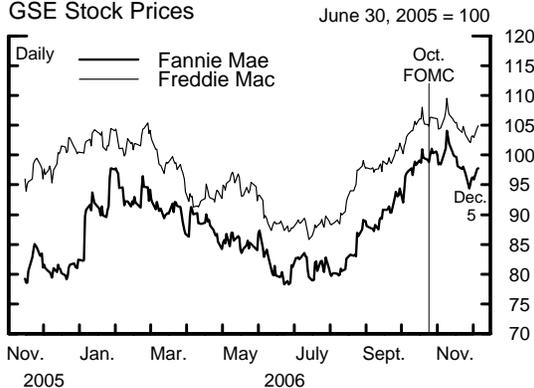
Monthly Average Bid-Ask Spread



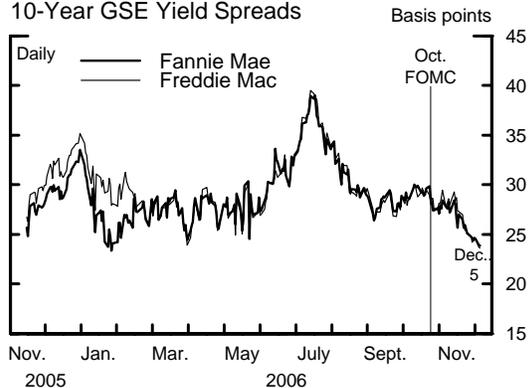
Source. BrokerTec Interdealer Market Data.

GSE Market Developments

GSE Stock Prices



10-Year GSE Yield Spreads



Note. GSE yields based on on-the-run securities. Spreads measured relative to the 10-year Treasury yield.

State and Local Government Finance

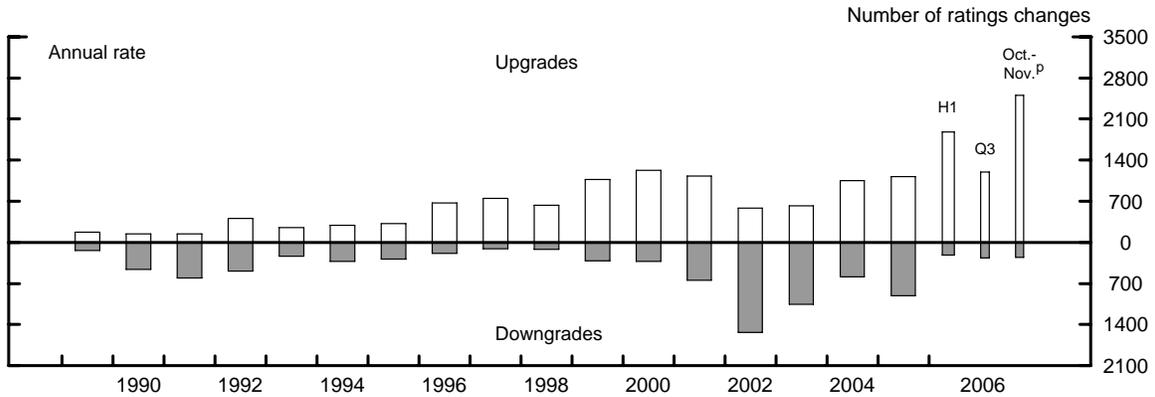
Gross Offerings of Municipal Securities

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

Type of security	2002	2003	2004	2005	2006			
					H1	Q3	Oct.	Nov.
Total	36.3	37.9	34.7	38.3	32.9	34.5	34.0	37.9
Long-term ¹	30.3	32.0	29.8	34.1	30.1	29.0	31.3	34.9
Refundings ²	10.1	10.0	10.8	15.5	9.7	8.0	12.1	13.2
New capital	20.2	22.1	19.0	18.7	20.4	21.0	19.2	21.7
Short-term	6.0	5.8	4.9	4.2	2.8	5.5	2.7	2.9
Memo: Long-term taxable	1.7	3.5	2.0	2.1	2.8	2.7	.8	1.4

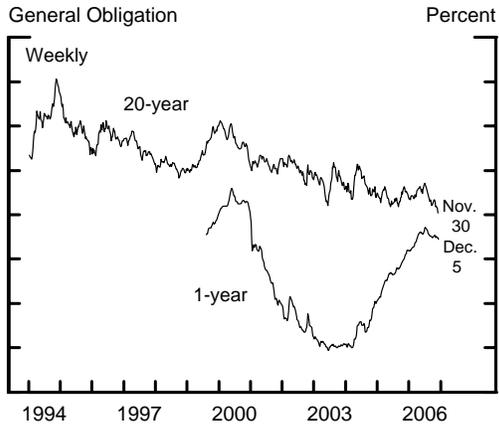
- 1. Includes issues for public and private purposes.
- 2. All issues that include any refunding bonds.

Ratings Changes



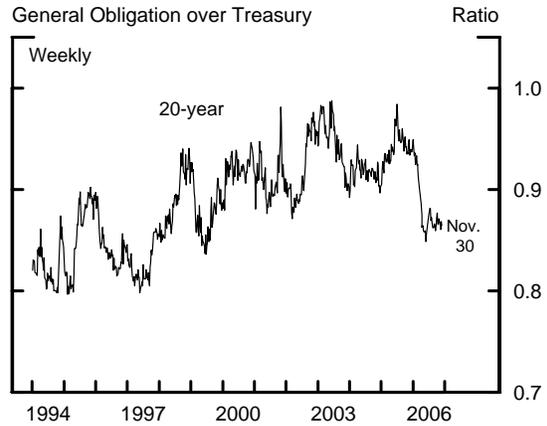
Source: S&P's Credit Week Municipal and Ratings Direct.
p Preliminary.

Municipal Bond Yields



Source: Municipal Market Advisors and Bond Buyer.

Municipal Bond Yield Ratio



Source: Bond Buyer.

Net withdrawals from domestic equity mutual funds abated in October and November, and international equity funds and bond funds continued to register substantial net inflows.

Treasury and Agency Finance

The Treasury auctioned coupon securities of several maturities over the intermeeting period. Overall demand at the auctions was solid, and bid-to-cover ratios were in line with or above recent averages. Over the intermeeting period, indicators of foreign demand for U.S. Treasuries were mixed. Evidence generally pointed to elevated foreign participation in the two-year nominal note auctions. Indicators of foreign participation in auctions of longer-maturity Treasury coupon securities, however, were in line with recent ranges. Also, the most recent Treasury International Capital data showed little change in foreign purchases of U.S. Treasury securities in September.

Trading conditions in the market for nominal Treasury securities remained favorable. Average daily trading volumes have been running a bit higher than last year, and bid-ask spreads have stayed near their average level this year. Fannie Mae's and Freddie Mac's stock prices edged down, on net, over the intermeeting period, and spreads on agency debt narrowed.

State and Local Government Finance

Gross issuance of long-term municipal bonds remained robust through November. New capital issuance picked up from its solid pace in October, with state and local governments continuing to raise funds mainly for investment in transportation and education. Refundings, supported by declines in long-term interest rates, remained above their pace over the first three quarters of the year. Issuance of short-term municipal bonds was modest in October and November.

The credit quality of municipal bonds has continued to look solid so far in the fourth quarter. Rating upgrades outpaced downgrades by a wide margin, and the ratio of municipal bond yields to comparable Treasury securities remained low.

Money and Bank Credit

M2 growth picked up to an average annual rate of 8¼ percent during October and November. The acceleration reflected increased demand for liquid deposits and currency, which had been quite weak in the third quarter. Small time deposits and retail

M2 Monetary Aggregate
(Based on seasonally adjusted data)

Aggregate and components	Percent change (annual rate) ¹						Level (billions of dollars), Nov. (e)
	2004	2005	2006				
			Q2	Q3	Oct.	Nov. (e)	
M2	5.3	4.0	3.0	3.8	10.5	6.1	6,974
Components ²							
Currency	5.5	3.5	4.1	-1	3.2	5.0	746
Liquid deposits ³	10.0	2.0	-1.9	-3.1	7.3	2.4	4,254
Small time deposits	-3	18.8	17.2	21.9	22.2	14.3	1,159
Retail money market funds	-11.3	-2	11.7	22.0	18.0	14.3	808
Memo:							
Institutional money market funds	-5.8	5.0	11.5	16.8	20.7	15.5	1,302
Monetary base	5.6	3.5	4.4	-4	1.8	4.5	808

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

Commercial Bank Credit

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

Type of credit	2004	2005	H1 2006	Q3 2006	Oct. 2006*	Nov. 2006*e	Level, ¹ Nov. 2006*e
Total ²	8.9	10.5	11.9	8.0	-1.1	5.3	7,791
<i>Loans³</i>							
Total	9.7	11.6	11.7	10.0	3.5	4.4	5,830
To businesses							
Commercial and industrial	1.2	13.2	16.4	18.9	9.1	5.5	1,163
Commercial real estate	11.7	17.1	15.6	12.9	2.2	7.7	1,409
To households							
Residential real estate	15.6	12.0	7.7	7.0	6.4	-2.8	1,725
Revolving home equity	43.8	13.3	.1	3.2	.3	4.0	449
Consumer	8.8	3.1	6.7	5.8	-10.9	8.3	725
Originated ⁴	6.0	.5	7.1	5.5	-1.6	8.3	1,112
Other ⁵	7.4	8.4	12.0	3.0	4.8	9.4	809
<i>Securities</i>							
Adjusted ²	6.7	7.6	12.8	2.2	-14.9	7.8	1,961
Reported	5.2	5.3	13.0	2.1	-12.4	9.2	2,122
Treasury and agency	4.9	.0	8.3	4.2	-27.5	-.4	1,172
Other ⁶	5.7	13.3	19.4	-.6	7.0	21.4	949

* Adjusted to remove the effects of a consolidation of a sizable amount of thrift assets onto a commercial bank's books in October 2006.

Note. Yearly annual rates are Q4 to Q4; quarterly and monthly annual rates use corresponding average levels. Data are adjusted to remove estimated effects of consolidation related to FIN 46 and for breaks caused by reclassifications.

1. Billions of dollars. Pro rata averages of weekly (Wednesday) levels.

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

3. Excludes interbank loans.

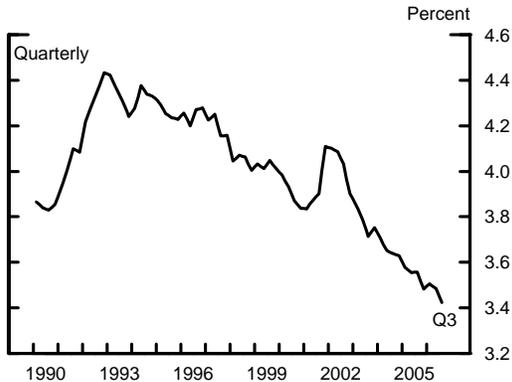
4. Includes an estimate of outstanding loans securitized by commercial banks.

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

6. 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.

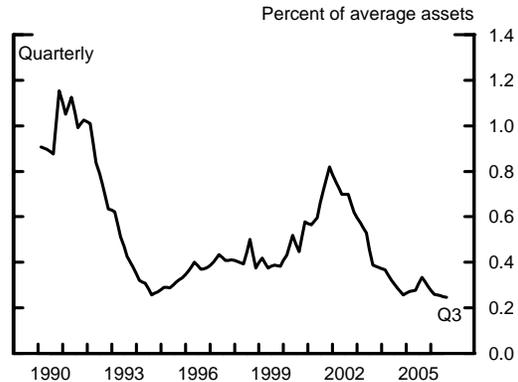
e Estimated.

Net Interest Margin



Note. Net interest margin is net interest income divided by average interest-earning assets.
Source. Call Report.

Loan-Loss Provisioning



Source. Call Report.

money funds, whose yields tend to follow market rates relatively closely, continued to grow briskly over the two months ending in November.

Bank credit is estimated to have decelerated markedly to an annual rate of about 2 percent over October and November, considerably below the 8 percent pace in the third quarter.¹ The slowdown reflected reduced growth in each of the core components of bank lending. The expansion of C&I loans moderated to an annual rate of about 7 percent, and the step-down was concentrated at smaller banks. Nonetheless, the Survey of Terms of Business Lending in November indicated that C&I loan rate spreads generally remained low. Commercial real estate loans increased at a moderate annual rate of 5 percent over the past two months. During that period, loans to households backed by real estate expanded only slightly. Loans to fund consumer purchases, adjusted for securitization, expanded modestly.

According to third-quarter Call Reports, bank profitability—measured by both return on assets and return on equity—edged down but remained at a high level, while asset quality generally stayed strong. A further decline in net interest margins last quarter, a likely consequence of the flatter yield curve, weighed importantly on bank profits. Although delinquency rates on all loans and leases edged a bit higher, charge-off rates held about steady at very low levels. In addition, the continued low provisioning for loan losses in the third quarter suggests that banks do not foresee a marked deterioration in asset quality.

Last Page of Domestic Financial Developments

¹ The bank credit data have been adjusted to remove the effects of a consolidation of a sizable volume of thrift assets onto a commercial bank's books in October.

International Developments

International Developments

U.S. International Transactions

Trade in Goods and Services

The U.S. international trade deficit narrowed to \$64.3 billion in September from a record \$69 billion in August (revised). The narrowing of the deficit primarily reflected a sharp falloff in the value of imported oil.

Trade in Goods and Services

	2005	Annual rate			Monthly rate		
		2006			2006		
		Q1	Q2	Q3	July	Aug.	Sept.
Percent change							
<i>Nominal BOP</i>							
Exports	10.8	17.0	14.0	11.3	-1.3	2.4	.5
Imports	12.6	7.5	11.0	13.0	.9	2.0	-2.1
<i>Real NIPA</i>							
Exports	6.8	14.0	6.2	6.3	...	...	...
Imports	4.9	9.1	1.4	5.3	...	...	...
Billions of dollars							
<i>Nominal BOP</i>							
Net exports	-716.7	-764.6	-775.3	-805.0	-68.0	-69.0	-64.3
Goods, net	-782.7	-831.9	-842.4	-873.7	-73.5	-74.9	-70.1
Services, net	66.0	67.3	67.1	68.7	5.5	5.9	5.8

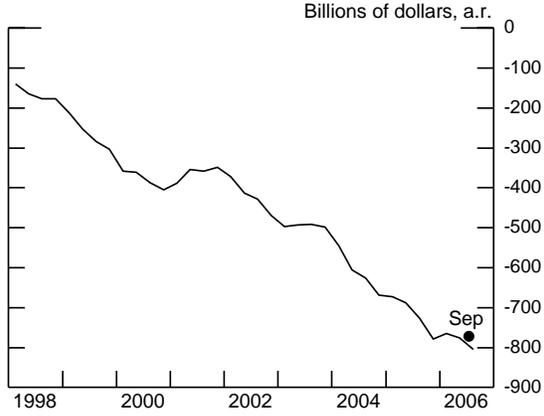
Source. U.S. Department of Commerce, Bureaus of Economic Analysis and Census.
n.a. Not available. ... Not applicable.

In September, the value of exports of goods and services increased 0.5 percent, following a 2.4 percent increase in August. The September increase was led by stronger exports of industrial supplies and capital goods. Among industrial supplies, exports of fuels exhibited particularly robust growth, notwithstanding the decline in oil prices, while the increase in capital goods exports was accounted for by a surge in aircraft. In contrast, exports of automotive products, consumer goods, and semiconductors registered sizable declines in September; and exports of agricultural products, computers, and services also moved down, but by smaller amounts.

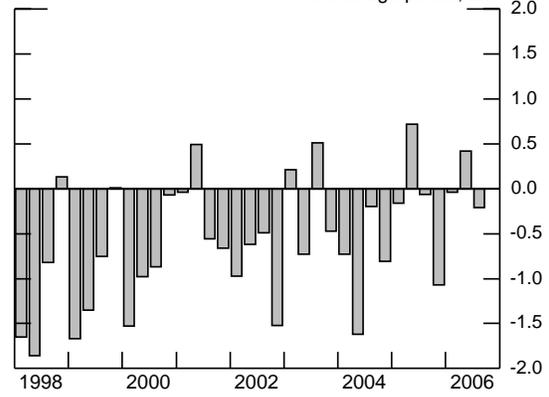
In the third quarter, the value of exports of goods and services increased at an annual rate of 11¼ percent. Strength was widely distributed across categories, with exports of industrial supplies, automotive products, and consumer goods exhibiting particularly robust growth. Based on the preliminary NIPA release, real exports of goods and services rose 6¼ percent in the quarter.

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

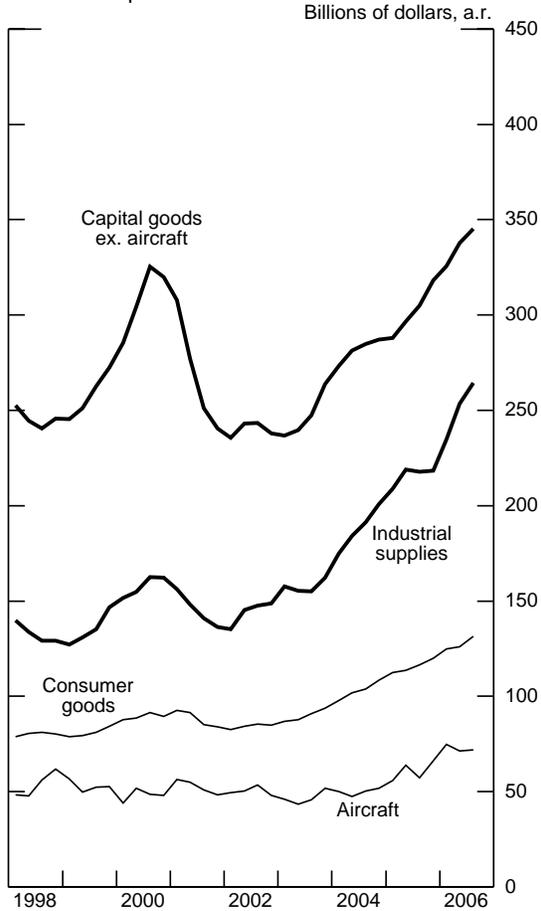
Trade Balance



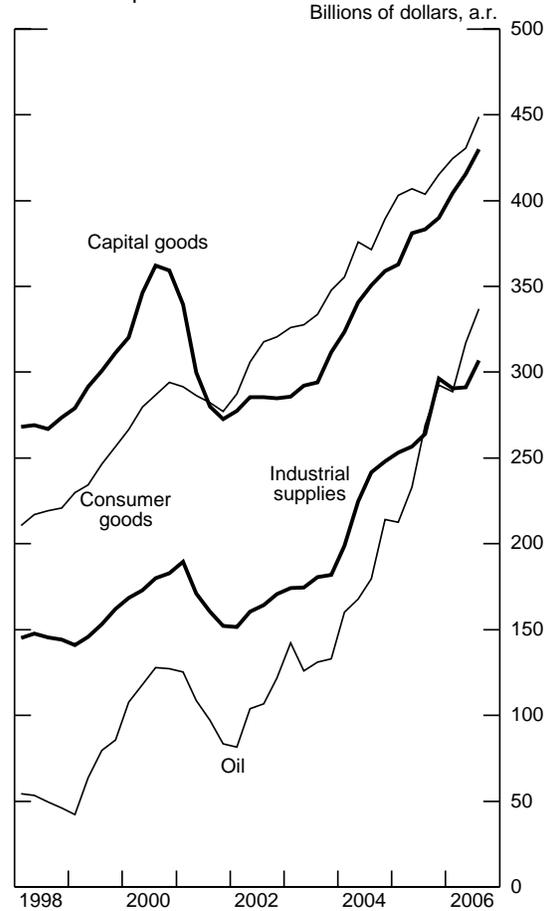
Contribution of Net Exports to Real GDP Growth



Selected Exports



Selected Imports



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

	Levels				Change ¹			
	2006		2006		2006		2006	
	Q2	Q3	Aug.	Sept.	Q2	Q3	Aug.	Sept.
Exports of G&S	1423.5	1462.0	1471.3	1478.0	45.8	38.5	34.6	6.6
Goods exports	1011.4	1048.4	1056.3	1063.5	33.3	37.0	30.8	7.2
Gold	8.8	9.6	10.3	10.8	1.2	.8	2.7	.5
Other goods	1002.5	1038.8	1046.0	1052.7	32.1	36.3	28.1	6.7
Capital goods	409.3	417.0	419.3	427.8	8.7	7.7	15.4	8.6
Aircraft & parts	71.5	71.8	69.0	80.3	-3.4	.4	2.8	11.3
Computers & accessories	47.8	47.4	48.3	47.9	.8	-.4	2.4	-.4
Semiconductors	54.8	53.7	54.9	52.2	4.0	-1.2	1.1	-2.7
Other capital goods	235.2	244.1	247.0	247.4	7.4	8.9	9.1	.4
Automotive	104.7	111.5	113.7	105.6	-.8	6.8	-1.6	-8.1
Ind. supplies (ex. ag., gold)	253.3	264.5	263.5	273.4	18.6	11.1	7.0	9.9
Consumer goods	126.0	131.6	133.9	129.6	1.2	5.5	2.8	-4.3
Agricultural	73.1	75.7	76.2	74.7	3.6	2.6	.2	-1.5
All other goods	36.1	38.6	39.3	41.5	.9	2.5	8.1	2.2
Services exports	412.1	413.6	415.0	414.5	12.5	1.4	3.8	-.6
Imports of G&S	2198.8	2267.0	2298.8	2249.6	56.5	68.2	46.2	-49.2
Goods imports	1853.8	1922.1	1954.7	1904.9	43.8	68.4	47.8	-49.8
Oil	317.2	336.8	352.0	315.2	28.7	19.7	8.7	-36.9
Gold	6.2	5.6	5.0	5.8	.4	-.6	-1.0	.8
Other goods	1530.4	1579.8	1597.7	1583.9	14.8	49.3	40.1	-13.8
Capital goods	415.6	429.8	435.8	429.1	11.1	14.3	11.3	-6.7
Aircraft & parts	27.7	27.6	24.9	32.2	-.8	-.1	-.7	7.2
Computers & accessories	101.4	104.4	105.8	103.7	1.9	3.0	2.0	-2.1
Semiconductors	27.0	28.5	29.5	28.1	-.1	1.6	1.5	-1.4
Other capital goods	259.5	269.3	275.6	265.2	10.1	9.8	8.5	-10.4
Automotive	258.2	253.4	256.9	252.0	-.1	-4.8	5.6	-5.0
Ind. supplies (ex. oil, gold)	291.4	307.0	313.4	306.6	.6	15.7	12.3	-6.8
Consumer goods	430.6	448.7	448.8	455.5	6.2	18.1	6.8	6.7
Foods, feeds, bev.	73.2	76.4	77.6	76.4	-.9	3.2	2.5	-1.2
All other goods	61.5	64.3	65.2	64.3	-2.2	2.8	1.7	-.9
Services imports	345.0	344.9	344.1	344.7	12.7	-.2	-1.7	.6
<i>Memo:</i>								
Oil quantity (mb/d)	13.63	13.86	14.16	13.65	-.69	.23	.40	-.50
Oil import price (\$/bbl)	63.67	66.55	68.07	63.19	8.57	2.88	-.22	-4.88

1. Change from previous quarter or month.

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

The value of imported goods and services fell 2.1 percent in September after rising 2 percent in August. A sharp fall in the value of imported oil and natural gas accounted for most of the decrease, but non-oil imports also declined. Within capital goods, lower imports of computers, semiconductors, telecommunications equipment, and other capital goods more than offset a jump in aircraft. Imports of automotive products and non-oil industrial supplies also fell back, whereas imports of consumer goods climbed.

In the third quarter, the value of imports of goods and services increased at an annual rate of 13 percent. The value of imported oil rose substantially, as oil prices were up, on average, from the previous quarter. Imports of consumer goods, non-oil industrial supplies, and capital goods also increased robustly in the quarter, whereas imports of automotive products fell back and services imports were flat. Based on the preliminary NIPA release, real imports of goods and services rose 5¼ percent in the quarter.

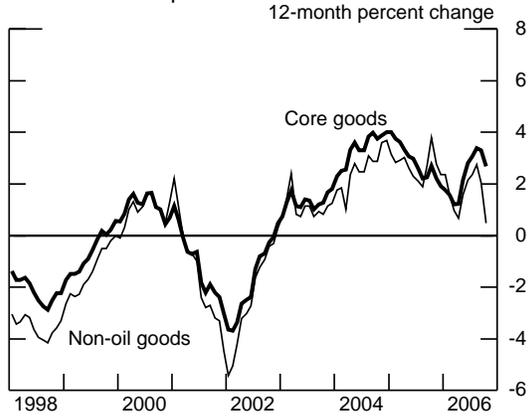
Prices of Internationally Traded Goods

Non-oil imports. Since the last Greenbook, we received BLS trade price data for October. After rising 0.2 percent in September, prices of non-oil imports fell 0.6 percent in October, reflecting in large part a 20 percent decline in import prices for natural gas. Import prices of core goods were up about 0.1 percent on net over the two months, as a decline in October—the first in nearly a year—partially offset a small increase in September. These movements in prices of core goods were dominated by changes in prices for material-intensive goods. In September, import prices for non-fuel industrial supplies increased 0.9 percent, as higher prices for metals were partly offset by falling prices for chemicals. In October, prices of non-fuel industrial supplies fell 0.8 percent, reflecting lower prices for building materials and metals. Prices for finished goods edged up just 0.1 percent in both September and October. Prices for imported computers cumulatively fell more than 1.5 percent in those two months, while prices for semiconductors were up close to 1 percent on net.

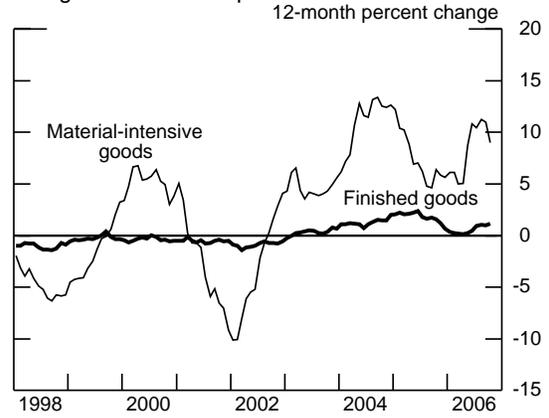
In the third quarter, according to the preliminary NIPA release, core import prices rose at an annual rate of 4¼ percent, primarily reflecting higher prices for non-fuel industrial supplies. Prices for capital goods (excluding computers and semiconductors) rose almost 3 percent, the largest increase in over a year.

Prices of U.S. Imports and Exports

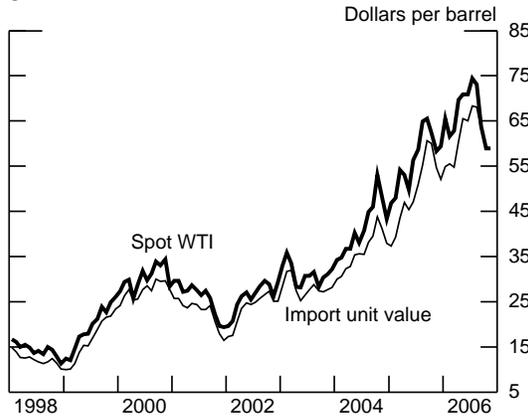
Merchandise Imports



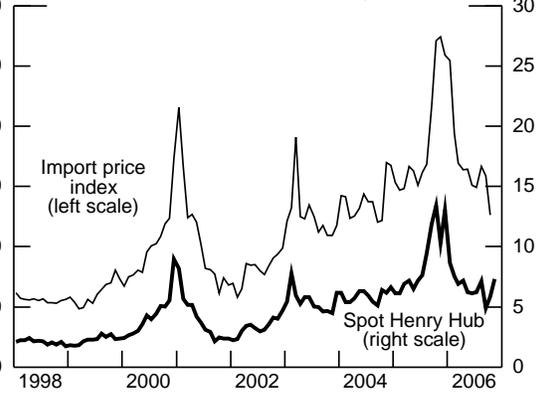
Categories of Core Imports



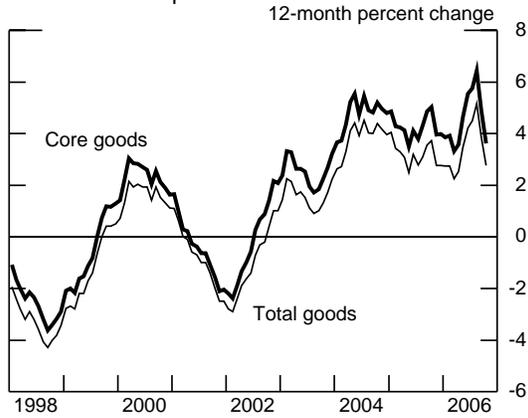
Oil



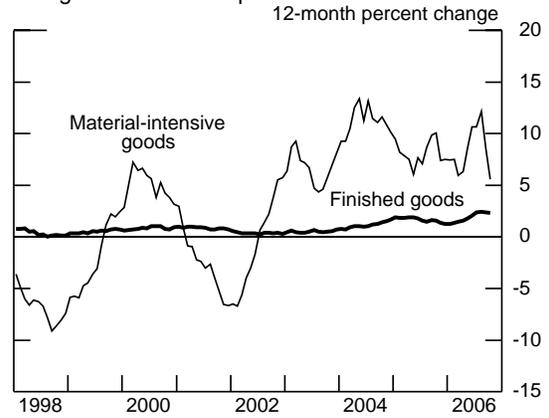
Natural Gas



Merchandise Exports



Categories of Core Exports



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

	Annual rate			Monthly rate		
	2006			2006		
	Q1	Q2	Q3	Aug.	Sept.	Oct.
	----- BLS prices -----					
Merchandise imports	.1	12.8	4.9	.7	-2.0	-2.0
Oil	6.8	79.1	10.4	1.5	-9.7	-8.3
Non-oil	-1.2	1.0	3.5	.5	.2	-.6
Core goods ¹	2.2	3.9	4.2	.3	.3	-.2
Finished goods	.7	.8	2.5	.0	.1	.1
Cap. goods ex. comp. & semi.	1.7	2.5	2.8	.0	.1	.2
Automotive products	-.8	1.0	1.4	.0	.0	.3
Consumer goods	.8	-.4	3.0	.1	.1	.1
Material-intensive goods	9.6	14.9	9.5	.9	.9	-.6
Foods, feeds, beverages	5.5	-.7	8.5	2.1	.2	.2
Industrial supplies ex. fuels	11.8	20.7	9.6	.5	.9	-.8
Computers	-6.9	-7.4	-5.4	.0	-.6	-1.0
Semiconductors	2.4	-.3	3.3	-.1	-.1	.9
Natural gas	-65.2	-63.8	-4.0	11.6	-4.7	-20.5
Merchandise exports	2.9	6.7	5.2	.4	-.4	-.4
Core goods ²	3.6	8.0	6.6	.6	-.4	-.4
Finished goods	2.6	2.8	2.4	.1	.1	.2
Cap. goods ex. comp. & semi.	4.0	3.0	2.4	.2	.2	.3
Automotive products	1.0	1.9	1.7	.1	.0	.1
Consumer goods	1.4	3.0	2.7	.1	.1	.0
Material-intensive goods	5.2	15.7	12.7	1.3	-1.1	-1.1
Agricultural products	-1.4	2.2	18.8	.9	-.5	1.1
Industrial supplies ex. ag.	7.2	20.1	11.4	1.4	-1.2	-1.8
Computers	1.2	-3.5	-2.9	-.3	.5	-.1
Semiconductors	-7.9	-5.9	-10.8	-2.0	.0	.0
	----- NIPA prices -----					
Chain price index						
Imports of goods & services	-.7	9.8	5.4	--	--	--
Non-oil merchandise	-1.8	.7	3.4	--	--	--
Core goods ¹	1.6	3.8	4.2	--	--	--
Exports of goods & services	2.3	6.1	4.5	--	--	--
Total merchandise	2.8	6.2	5.3	--	--	--
Core goods ²	3.7	6.9	5.8	--	--	--

1. Excludes computers, semiconductors, and natural gas.

2. Excludes computers and semiconductors.

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

Oil. The BLS price index of imported oil plummeted 9.7 percent in September and 8.3 percent in October. The spot price of West Texas Intermediate (WTI) crude oil also fell about 8 percent in October and was flat in November, averaging about \$59 per barrel each month. Thus far in December, the spot price of WTI has edged higher to close at \$62.44 per barrel on December 5. The sharp decline in oil prices in September and October appears to have reflected an improved outlook for oil supply. However, a long-running supply disruption in Nigeria, risks to oil production in Iraq and Iran, and a recent cut in OPEC production continue to support oil prices at historically elevated levels.

Exports. Export prices for total goods and core goods each fell 0.4 percent in both September and October. These were the first declines in the indexes since last year, and to a large extent they reflect lower prices for exported petroleum products. As a result of the fall in fuel prices, prices for nonagricultural industrial supplies fell an average of about 1½ percent per month in September and October. Chemicals prices were also down in both months, whereas metals prices were mixed. Prices of agricultural exports were up on net over the two months. Exports prices for finished goods rose slightly in September and October. Prices of exports of semiconductors were unchanged during those months, while computer prices were up slightly.

In the third quarter, according to the preliminary NIPA release, core export prices rose at an annual rate of 5¾ percent, as prices increased in all sub-categories. Prices of food and industrial supplies led the way as each rose at a double-digit pace.

U.S. International Financial Transactions

Foreign official flows into the United States (line 1 of the Summary of U.S. International Transactions table) were sizeable in the third quarter, but slowed over the months of the quarter and dropped to only \$5 billion in October. Year-to-date, however, foreign official inflows have exceeded those for all of 2005 by roughly \$40 billion, with inflows from China (included in line 1c) accounting for nearly 70 percent of the total. Partial and confidential data on custody accounts at FRBNY indicate sizable foreign official inflows in November,

The chart on Foreign Official Financial Flows provides a broader perspective on these data. The G-10 countries recorded a small inflow into the United States in October, but these flows are volatile and the trend still remains a modest outflow. OPEC countries registered a small outflow in October – an abrupt change from fairly strong inflows

earlier in the year. Inflows from countries other than the G-10 and OPEC slowed for the third consecutive month in October, but as the chart makes clear, such dips are common even during a period of general rising inflows.

Net private foreign purchases of U.S. securities (line 4 of the table) slowed slightly in the third quarter but then gained some momentum in October, as private foreigners returned to purchasing a small amount of Treasury securities (line 4a). Purchases of corporate bonds (line 4c) slowed from their high in September but remained robust, while there was a noticeable pickup in demand for U.S. equities (line 4d). As shown in the top portion of the chart on Private Securities Flows, the 6-month average of total net private foreign purchases of U.S. securities moved up in October, but remained below the high recorded earlier this year. Year-to-date, total net private purchases are running at about the pace of 2005, with demand having shifted away from Treasuries and toward corporate bonds.

U.S. private acquisitions of foreign securities in October (line 5 of the table and the bottom panels of the chart on Private Securities Flows) continued at their pace of recent quarters. This year, especially in the last six months, increases in bond purchases have offset declines in stock purchases. In the last two months, however, stock purchases have strengthened slightly. Year-to-date, U.S. private acquisitions are recording a slightly stronger pace than that of 2005.

Flows recorded by the banking sector (line 3) tend to be volatile. That said, this year we have seen primarily inflows, although these have slackened from the strong second quarter pace.

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

	2004	2005	2005	2006				
			Q4	Q1	Q2	Q3	Sep	Oct
Official financial flows	388.2	214.6	78.5	74.8	77.2	80.7	16.0	6.0
1. Change in foreign official assets in the U.S. (increase, +)	385.4	200.5	73.7	74.3	77.7	79.7	16.0	5.0
a. G-10 countries + ECB	161.7	-21.3	-4.8	-8.5	-18.7	-5.9	-2.5	3.7
b. OPEC	12.1	7.5	10.6	12.0	13.9	11.4	2.5	-4.1
c. All other countries	211.6	214.4	67.8	70.9	82.5	74.1	15.9	5.4
2. Change in U.S. official reserve assets (decrease, +)	2.8	14.1	4.8	.5	-.6	1.0	-.0	.9
Private financial flows	194.3	570.8	164.2	96.7	76.9	n.a.	...	...
Banks								
3. Change in net foreign positions of banking offices in the U.S. ¹	-3.8	15.8	61.3	2.4	54.4	40.0	6.5	14.3
Securities²								
4. Foreign net purchases (+) of U.S. securities	489.5	610.4	184.6	183.5	140.9	135.3	57.6	62.4
a. Treasury securities	104.2	178.5	59.8	-6.6	12.9	-9.4	-16.9	2.8
b. Agency bonds	67.9	67.1	16.6	42.0	27.8	27.3	12.3	2.1
c. Corporate and municipal bonds	255.0	274.4	83.2	92.6	99.6	95.1	53.0	33.5
d. Corporate stocks ³	62.4	90.5	25.0	55.6	.6	22.2	9.2	24.0
5. U.S. net acquisitions (-) of foreign securities	-146.2	-197.0	-48.7	-54.4	-53.5	-53.8	-24.1	-21.4
a. Bonds	-60.9	-53.1	-5.7	-12.0	-36.1	-44.3	-14.2	-8.5
b. Stock purchases	-97.6	-139.9	-43.0	-38.5	-15.0	-9.5	-9.9	-12.9
c. Stock swaps ³	12.2	-4.0	.0	-4.0	-2.4	.0	.0	.0
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-244.1	-9.1	25.8	-61.3	-47.1	n.a.	...	...
7. Foreign direct investment in the U.S.	133.2	109.8	26.5	45.3	48.4	n.a.	...	...
8. Foreign acquisitions of U.S. currency	14.8	19.4	9.2	1.9	1.1	n.a.	...	...
9. Other (inflow, +) ⁴	-49.1	21.5	-94.5	-20.7	-67.4	n.a.	...	...
U.S. current account balance (s.a.)	-665.3	-791.5	-223.1	-213.2	-218.4	n.a.	...	...
Capital account balance (s.a.)⁵	-2.3	-4.4	-.5	-1.8	-.9	n.a.	...	...
Statistical discrepancy (s.a.)	85.1	10.4	-19.1	43.4	65.2	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.

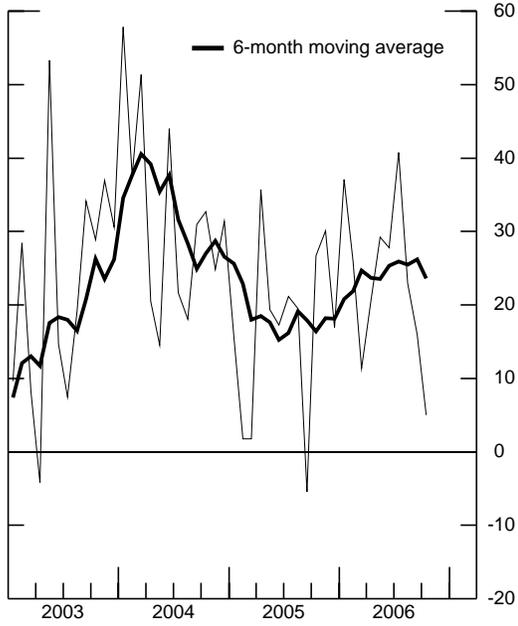
4. Transactions by nonbanking concerns and other banking and official transactions not shown elsewhere plus amounts resulting from adjustments made by the Department of Commerce and revisions in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.

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

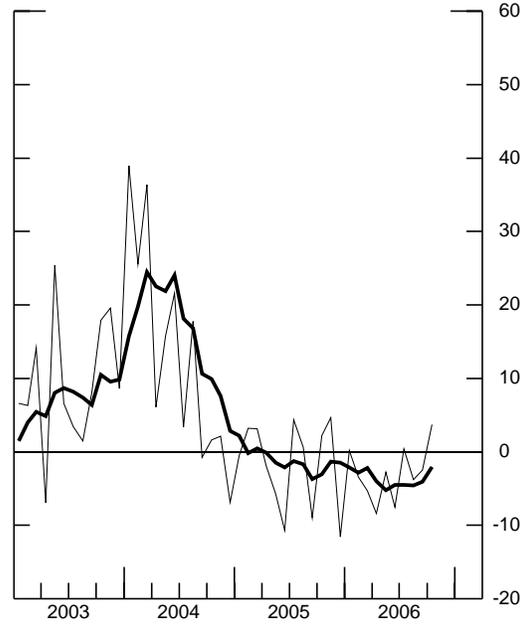
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Foreign Official Financial Flows Through October 2006 (increase, +)
 (\$ Billions, monthly, not seasonally adjusted)

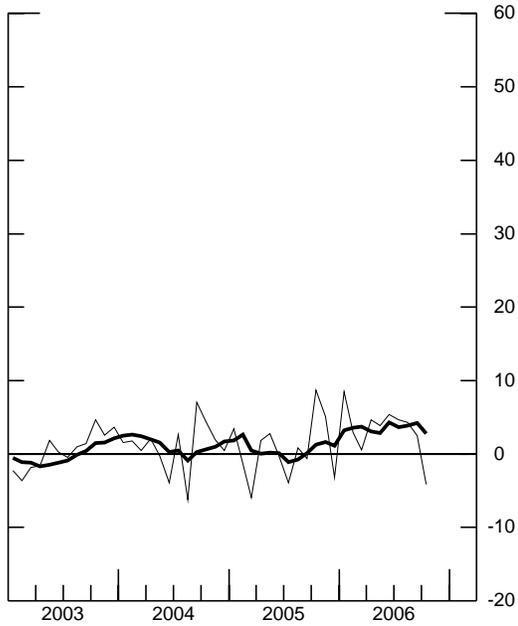
Total



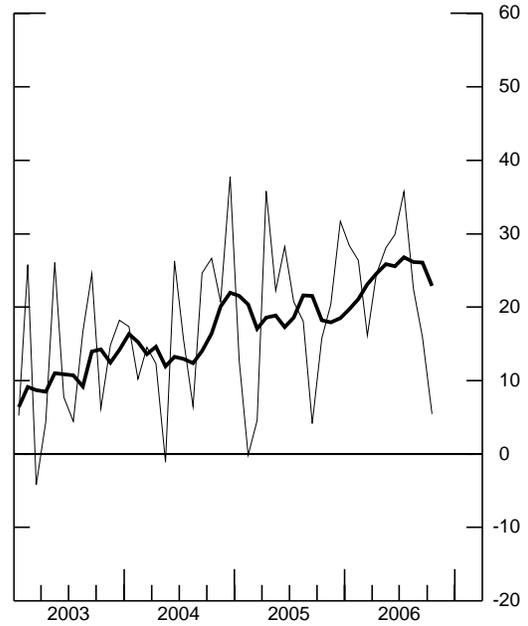
G-10 + ECB



OPEC



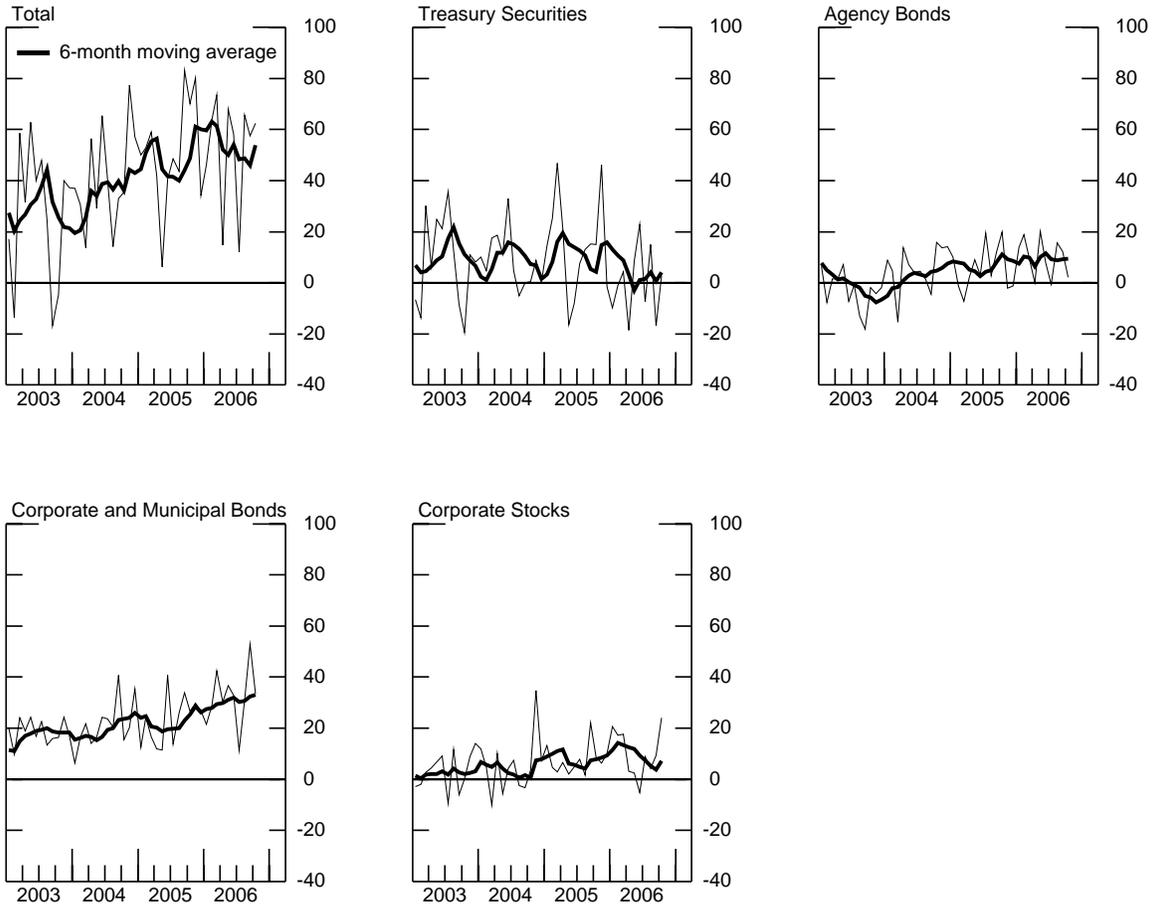
All other countries



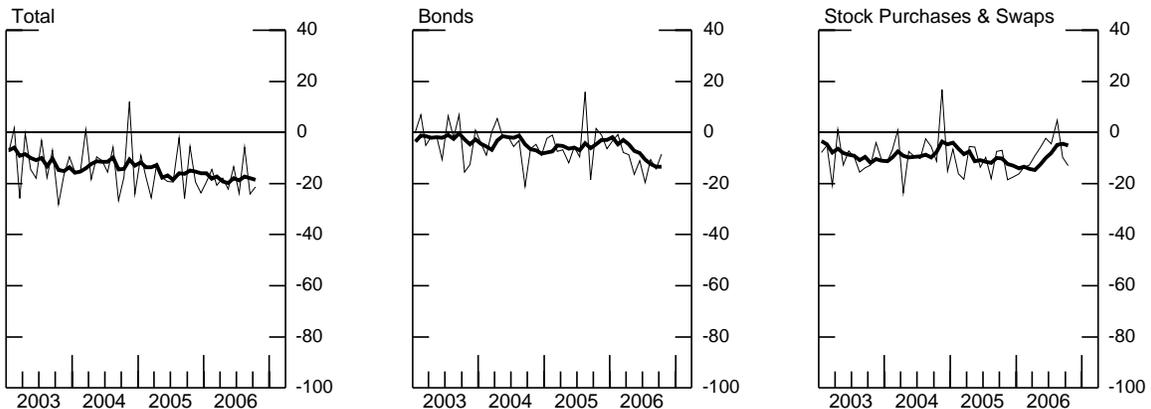
Private Securities Flows Through October 2006

(\$ Billions, monthly, not seasonally adjusted)

Foreign Net Purchases (+) of U.S. Securities



U.S. Net Acquisitions (-) of Foreign Securities



Foreign Financial Markets

After reaching a five-month high in mid October, the dollar's weighted-average exchange value against the other major currencies declined in the second half of October, fluctuated little during most of November, and then depreciated abruptly over the past two weeks.

On net, the major currencies index fell $2\frac{3}{4}$ percent over the intermeeting period.

Moderate downward pressure on the dollar was provided early in the period by the FOMC statement and the releases of a larger-than-expected decline in the median price of new homes in U.S. for September and of a lower-than-expected advance estimate of U.S. GDP growth in Q3. The dollar recovered slightly at the beginning of November in reaction to the release of the U.S. nonfarm payrolls report for October. The abrupt depreciation of the dollar later in the period, which was especially pronounced against the European currencies, did not coincide with particular data releases that would have indicated a change in economic fundamentals. However, long-term yields in the United States declined much more than in most major industrial economies, apparently reflecting a downgrade in U.S. growth prospects by investors. On a bilateral basis, the dollar depreciated $5\frac{1}{4}$ percent against the euro, $4\frac{1}{2}$ percent against sterling, and $3\frac{1}{4}$ percent vis-à-vis the yen. In contrast, the dollar appreciated about $1\frac{3}{4}$ percent versus the Canadian dollar, in part in reaction to several weaker-than-expected Canadian data releases. After holding steady for most of the intermeeting period, options-implied volatilities of the dollar-euro and yen-dollar exchange rates spiked up in late November, during the period of rapid dollar depreciation; nevertheless, these volatilities remain close to historically-low levels.

Headline equity indexes in the United Kingdom and in the euro area rose early in the period to new year-to-date highs but fell back later in the period, in part as market participants expressed concerns about the potential influence of the appreciation of the euro and sterling on the earning outlooks of firms. In Japan, the TOPIX fell $2\frac{1}{4}$ percent on balance, in part on growing concerns that the economy may not be as robust as had previously been thought. Realized volatilities on headline equity indexes remained low during the intermeeting period.

On October 26, Sweden's Riksbank raised its policy rate 25 basis points, to 2.75 percent. The Reserve Bank of Australia and the Bank of England raised their policy rates 25 basis points, to 6.25 percent and to 5 percent, respectively, on November 8 and 9. The European Central Bank, the Bank of Japan, and the Bank of Canada all kept their policy stances on hold. Three-month spot interest rates declined 5 and 3 basis points in Canada and in the United States, respectively, whereas they increased 9 to 11 basis points in the

euro area, the United Kingdom, and Japan. Ten-year nominal sovereign yields declined between 13 and 20 basis points on balance in Japan, the United Kingdom, and Germany, but they fell more than 30 basis points in the United States and Canada. Yields on inflation-indexed sovereign bonds also declined during the intermeeting period, and breakeven rates were generally little changed in most foreign industrial economies. Realized volatilities of ten-year government bonds changed little in most foreign industrial economies.

The dollar's trade-weighted exchange value against the currencies of our other important trading partners declined 1¼ percent on balance over the intermeeting period. The dollar depreciated between 3 and 4 percent against the Korean won, the Thai baht, and the Taiwan dollar. The dollar depreciated 1 percent against the renminbi over the intermeeting period, with much of the move occurring in recent days concurrently with the dollar's depreciation against the major foreign currencies. In contrast, the dollar appreciated ¾ percent on net against the Mexican peso. The Mexican peso's weakness appeared to be linked to political instability related to the presidential succession, although Mexican stock prices rose on balance. Headline stock market indexes in Latin America and emerging Asia increased during the intermeeting period, despite a moderate increase in EMBI spreads.

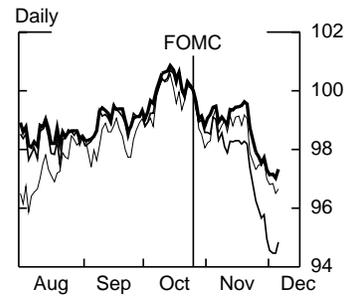
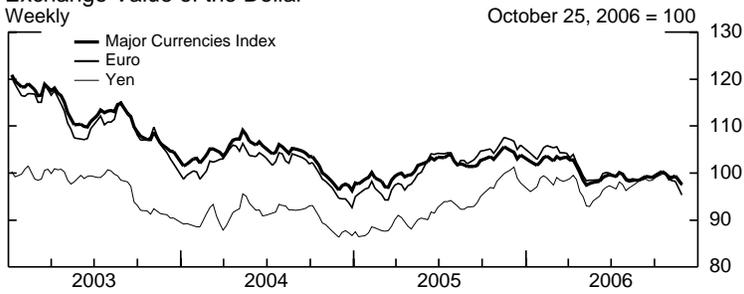
. The Desk did not intervene during the period for the accounts of the System or the Treasury.

Exchange Value of the Dollar and Stock Market Indexes

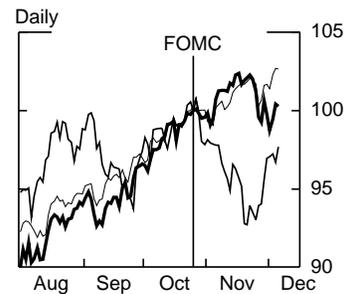
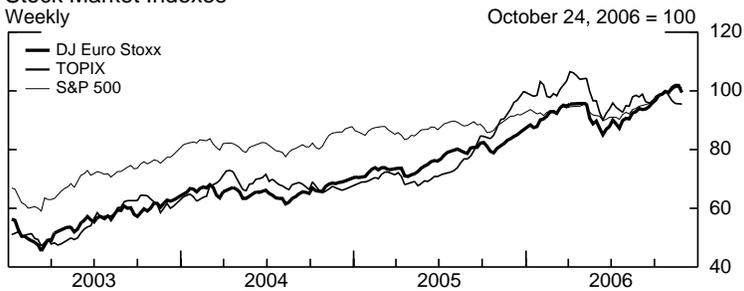
	Latest	Percent change since October FOMC
<i>Exchange rates*</i>		
Euro (\$/euro)	1.3275	-5.2
Yen (¥/\$)	115.2	-3.3
Sterling (\$/£)	1.9646	-4.4
Canadian dollar (C\$/\\$)	1.1445	1.7
<i>Nominal dollar indexes*</i>		
Broad index	106.2	-2.0
Major currencies index	80.3	-2.7
OITP index	133.0	-1.2
<i>Stock market indexes</i>		
DJ Euro Stoxx	381.9	0.3
TOPIX	1615.2	-2.3
FTSE 100	6083.8	-2.1
S&P 500	1414.0	2.7

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

Exchange Value of the Dollar
Weekly



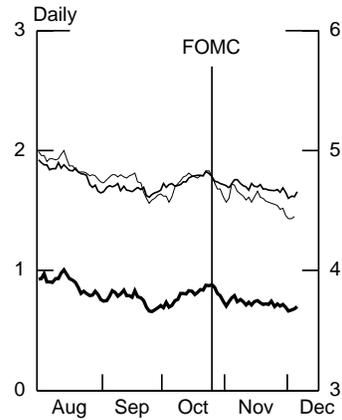
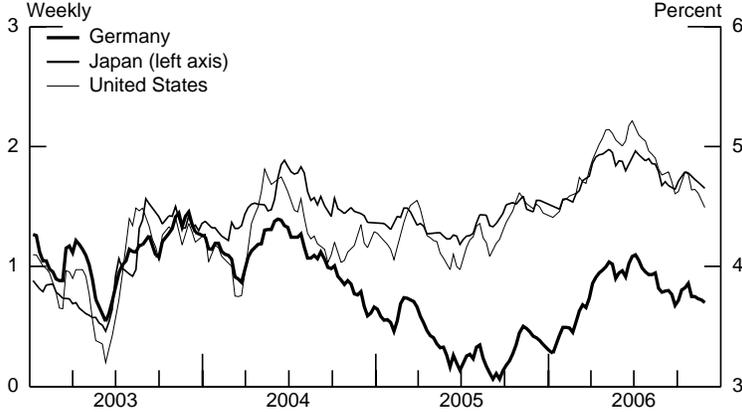
Stock Market Indexes
Weekly



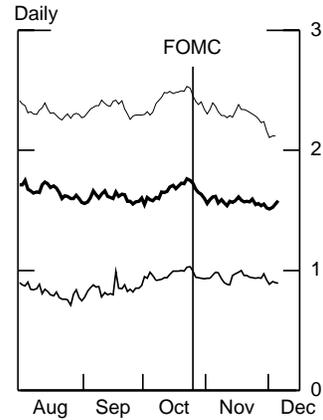
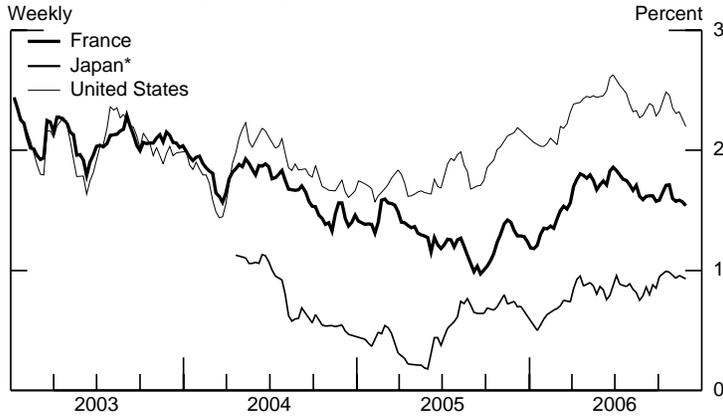
Industrial Countries: Nominal and Real Interest Rates

	3-month LIBOR		10-year nominal		10-year indexed		Percent
	Latest	Change since October FOMC	Latest	Change since October FOMC	Latest	Change since October FOMC	
Germany	3.65	0.11	3.70	-0.19	1.64	-0.15	
Japan	0.56	0.11	1.66	-0.13	0.89	-0.10	
United Kingdom	5.27	0.09	4.52	-0.18	1.51	-0.19	
Canada	4.25	-0.05	3.89	-0.31	...	...
United States	5.35	-0.03	4.45	-0.38	2.12	-0.40	

Nominal 10-Year Government Bond Yields



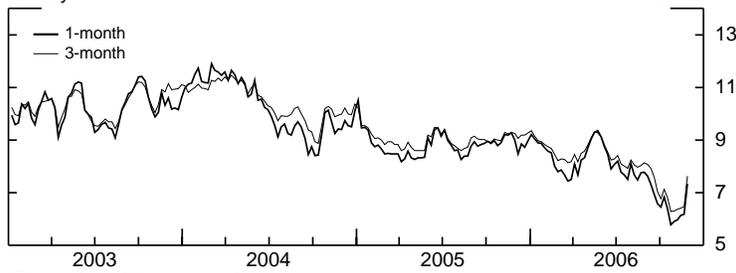
Inflation-Indexed 10-Year Government Bond Yields



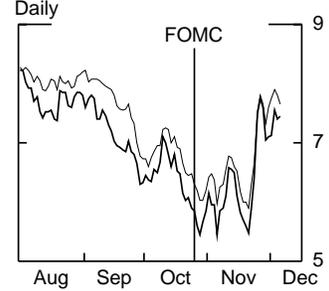
*Japan first issued inflation-indexed debt in March 2004.

Measures of Market Volatility

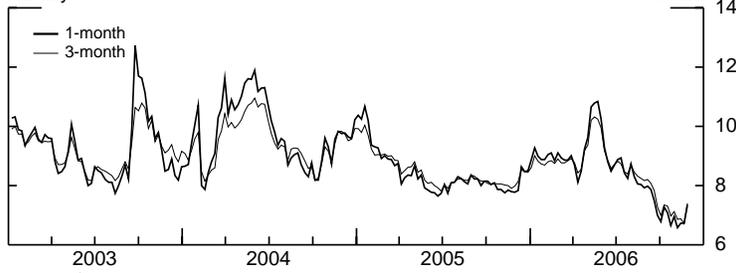
Dollar-Euro Options-Implied Volatility*
Weekly



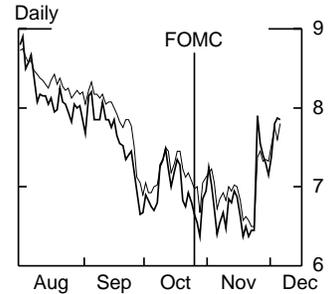
*Derived from at-the-money options.



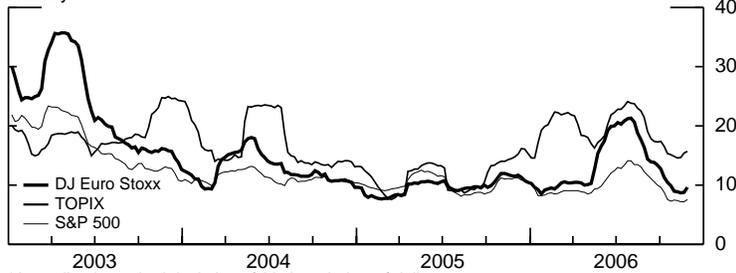
Yen-Dollar Options-Implied Volatility*
Weekly



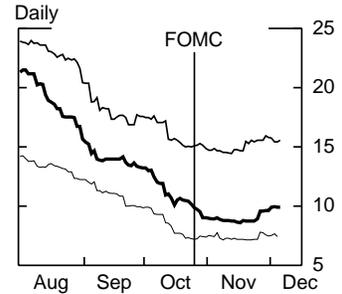
*Derived from at-the-money options.



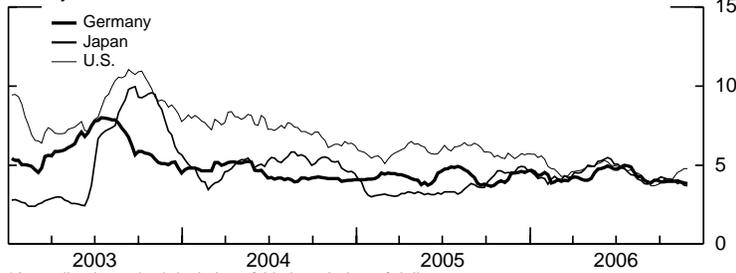
Realized Stock Market Volatility*
Weekly



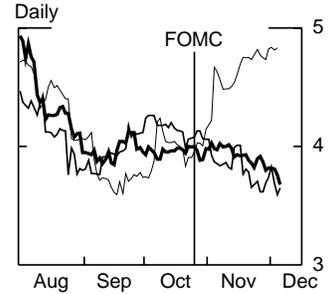
*Annualized standard deviation of 60-day window of daily returns.



Realized 10-Year Bond Volatility*
Weekly



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

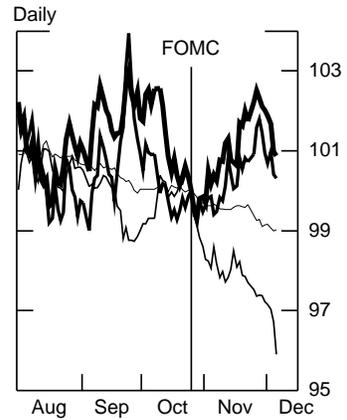
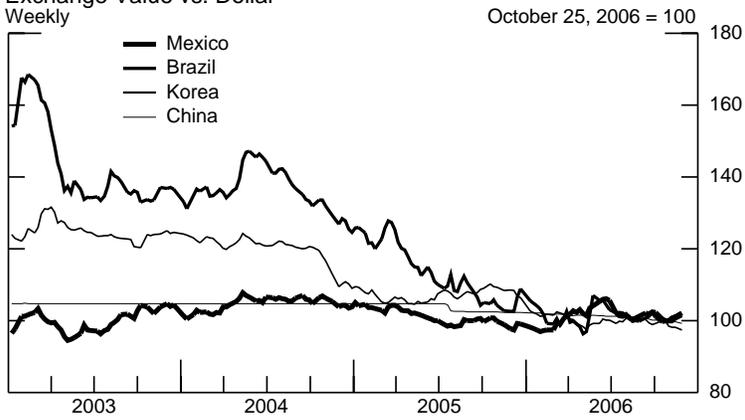


Emerging Markets: Exchange Rates and Stock Market Indexes

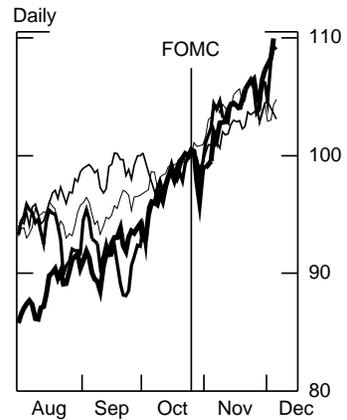
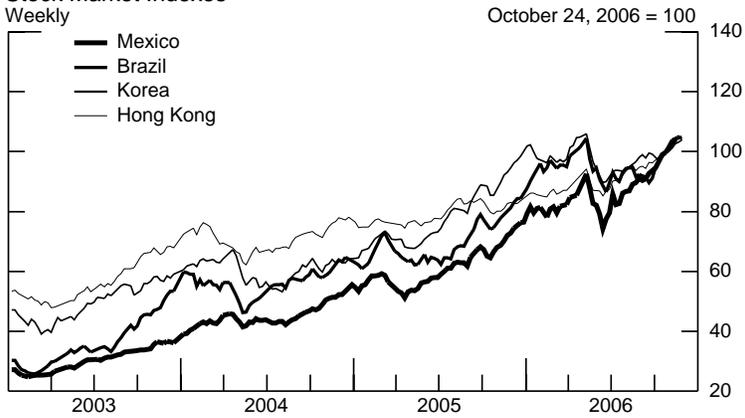
	Exchange value vs. dollar		Stock market index	
	Latest	Percent change since October FOMC*	Latest	Percent change since October FOMC
Mexico	10.8771	0.9	25594	9.9
Brazil	2.1530	0.3	43061	9.0
China	7.8234	-1.0	2157	19.4
Hong Kong	7.7706	-0.1	19026	4.8
Korea	916.3	-4.1	1414	3.1
Taiwan	32.29	-3.1	7693	9.0
Singapore	1.5407	-2.0	757	7.7
Thailand	35.64	-3.9	746	1.8
India	44.70	-1.5	13949	10.5

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

Exchange Value vs. Dollar
Weekly



Stock Market Indexes
Weekly

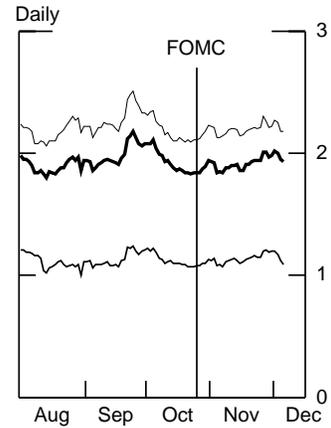
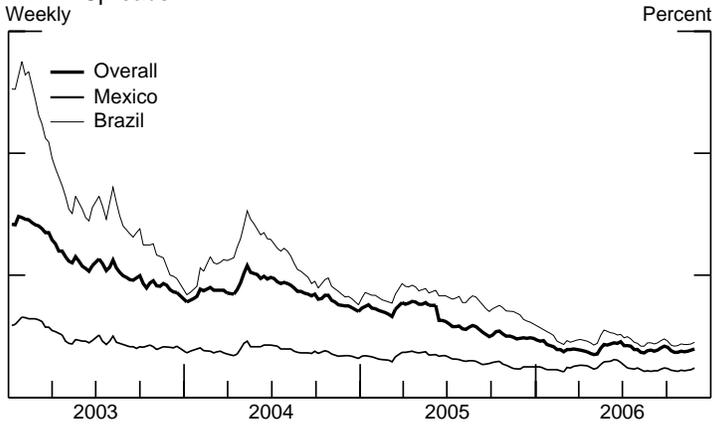


Emerging Markets: Short-Term Interest Rates and Dollar-Denominated Bond Spreads

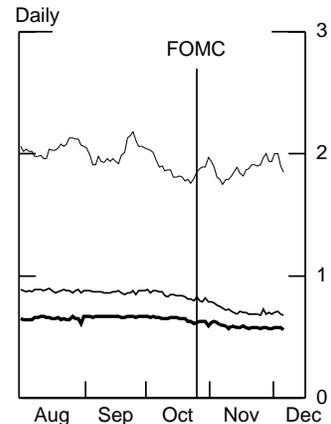
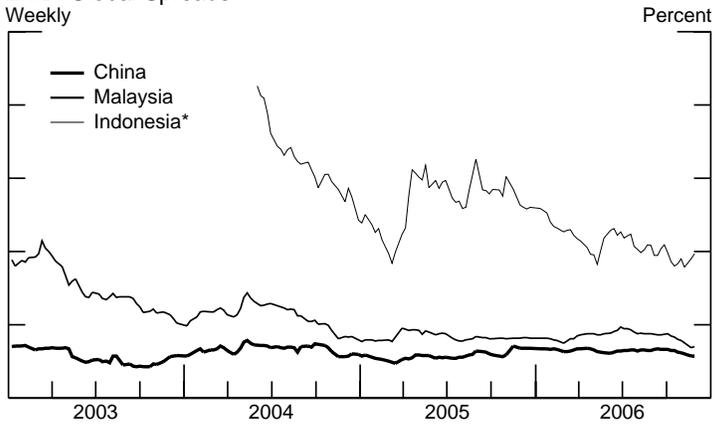
	Short-term interest rates*		Dollar-denominated bond spreads**	
	Latest	Change since October FOMC	Latest	Change since October FOMC
Mexico	7.02	-0.05	1.09	0.02
Brazil	13.43	-0.47	2.18	0.07
Argentina	10.44	0.63	2.91	0.02
China	...	...	0.56	-0.05
Korea	4.53	0.00	...	...
Taiwan	1.82	0.00	...	...
Singapore	3.50	0.00	...	...
Hong Kong	4.08	0.02	...	...

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



*Begins May 2004.

Developments in Advanced Foreign Economies

Real GDP in the advanced foreign economies decelerated further in the third quarter from its rapid pace earlier this year, but nonetheless posted a moderate increase of 2.1 percent (weighted by U.S. exports) at an annual rate. Euro area growth declined to 2.1 percent and Canadian growth softened to 1.7 percent. Japanese and U.K. GDP rose 2 percent and 2.7 percent respectively, both with large rises in investment. The limited indicators for the fourth quarter have been mixed, but on balance point to continued expansion abroad. In particular, Japanese industrial production rose strongly in October, euro-area confidence and the German IFO hit multi-year highs, and the unemployment rate declined in the euro area and Japan.

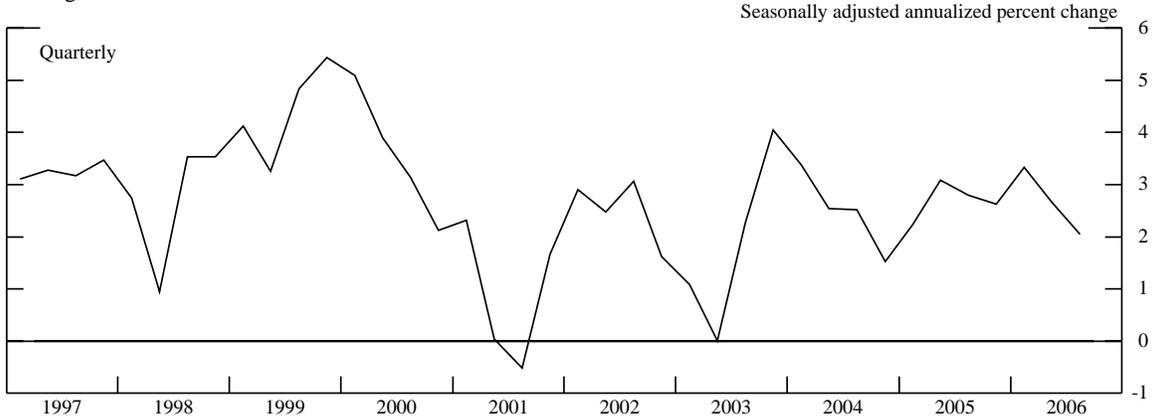
Headline inflation moved up a bit in most advanced foreign economies, after recent declines associated with falls in oil and gasoline prices. Euro-area twelve-month inflation ticked up to 1.8 percent in November. In October, inflation inched up to 0.9 percent in Canada and to 2.5 percent in the United Kingdom. In Japan, by contrast, food prices and energy prices fell in October, pushing headline inflation back down to 0.4 percent. As expected, the Bank of England raised its policy interest rate 25 basis points on November 9.

Japan's economy accelerated in the third quarter, growing at an annual rate of 2 percent. Real GDP growth for the second quarter was also revised up to 1.5 percent. The pickup in growth in the third quarter came despite a 2.9 percent decline in consumption and was mainly driven by strong exports and robust private investment. Nonresidential investment rose 12 percent in the third quarter, while residential investment posted a modest gain after dropping nearly 10 percent in the second quarter. Exports increased 11.2 percent as merchandise exports to the United States and the Middle East picked up and export growth to Asia remained strong. Inventory investment made a 1.2 percentage point contribution to growth, but the public sector nearly offset this as government investment continued to decline steeply, falling 24.2 percent.

Early indicators for the fourth quarter point toward continued strength in investment and a further boost from net exports. Industrial production rose 1.6 percent in October, with particular strength in production of investment goods. Production of high-tech goods also rose, and inventories-to-shipments ratios fell slightly, allaying some concern over a recent build up in high-tech inventories. The Bank of Japan's measure of real exports rose 0.3 percent in October while real imports fell 2.3 percent. There was also some sign that

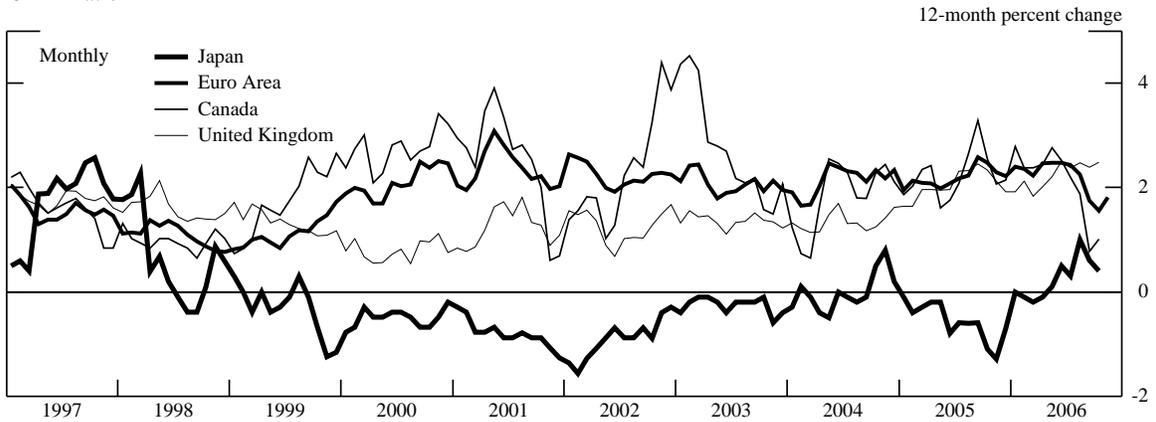
Advanced Foreign Economies

Average Real GDP*

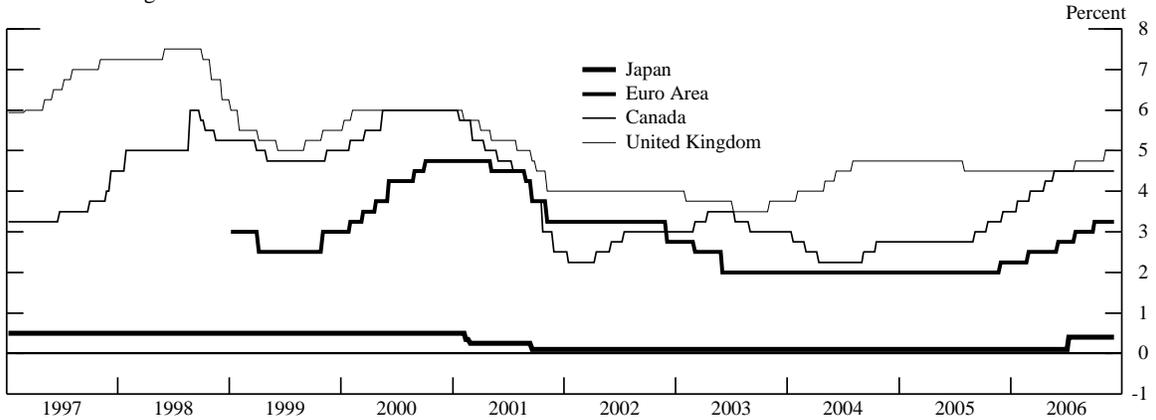


*Chain weighted by moving bilateral shares in U.S. merchandise exports.

CPI Inflation



Official or Targeted Interest Rates



the recent weakness in consumer demand has abated; real spending by all households increased 4.1 percent in October following four consecutive months of decline.

The unemployment rate fell back to 4.1 percent in October and the economy added 220,000 thousand jobs. The job offers-to-applicants ratio (the number of officially posted job openings relative to the number of officially registered job seekers) fell slightly but remained at an elevated level. Despite these improvements, gross earnings, which include bonuses, were 0.1 percent below the year-ago level in October.

Japanese Real GDP

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

Component	2004 ¹	2005 ¹	2005	2006		
			Q4	Q1	Q2	Q3
GDP	0.4	4.1	4.1	3.2	1.5	2.0
Total domestic demand	0.3	3.4	1.6	3.1	1.9	0.5
Consumption	0.6	3.7	2.7	-0.2	2.0	-2.9
Private investment	1.4	5.1	1.8	13.5	9.9	9.9
Public investment	-9.5	-1.8	-13.6	-3.3	-23.6	-24.2
Government consumption	1.4	1.6	0.5	0.1	0.8	0.4
Inventories ²	-0.1	0.0	0.3	0.8	-0.1	1.2
Exports	9.0	10.4	15.8	10.2	3.7	11.2
Imports	9.7	4.7	-3.1	9.9	5.5	-0.6
Net Exports ²	0.1	0.9	2.4	0.4	-0.1	1.6

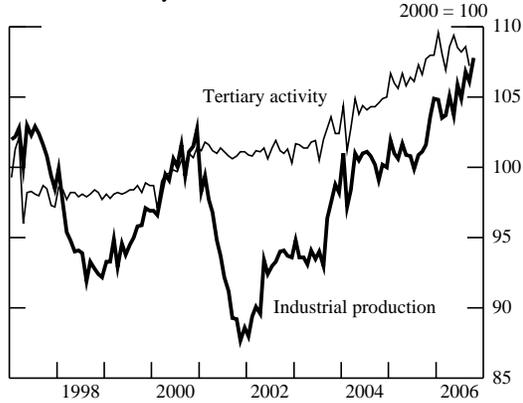
1. Q4/Q4

2. Percentage point contribution to GDP growth.

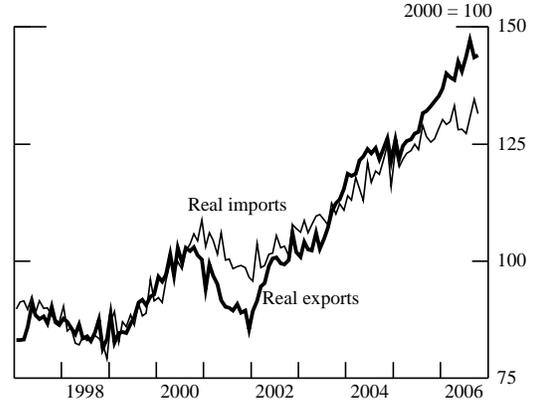
The headline consumer price index fell 0.3 percent in October amid declines in both food and energy prices, causing the twelve-month rate of inflation to subside to 0.4 percent. Twelve-month core inflation (excluding fresh food only) was 0.1 percent and consumer prices excluding both fresh food and energy fell 0.4 percent from a year ago. Other indicators of inflation were also subdued. Year-over-year wholesale price inflation slowed to 2.8 percent in October, while corporate service price inflation remained slightly positive for a third consecutive month. Although the total domestic demand deflator increased 0.1 percent from a year ago in the third quarter, the GDP deflator continued to decline, falling 0.8 percent.

Japan

Economic Activity



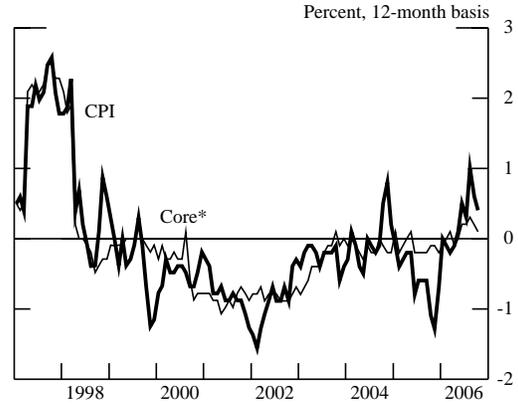
Real Trade



Labor Market



Consumer Price Inflation



*Excludes fresh food (n.s.a.)

Economic Indicators

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

Indicator	2006			2006			
	Q1	Q2	Q3	Aug.	Sept.	Oct.	Nov.
Housing starts	1.7	2.5	-2.8	7.2	0.2	0.8	n.a.
Machinery orders ¹	-0.4	8.9	-11.1	6.7	-7.4	n.a.	n.a.
Machinery shipments ¹	-0.2	3.6	1.7	2.1	-3.1	3.0	n.a.
New car registrations	2.5	-3.8	-3.8	4.3	-0.6	-1.8	0.5
Business sentiment ²	5.0	6.0	6.0	...	...	...	...
Wholesale prices ³	2.8	3.1	3.4	3.5	3.5	2.8	n.a.

1. Private sector, excluding ships and electric power.

2. Tankan survey, diffusion index. Level.

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

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

Euro-area GDP growth slowed more than expected in the third quarter to a 2.1 percent annual rate. The slowdown, however, was exaggerated by a statistical quirk in the French data.¹ Moreover, final domestic demand in the euro area generally remained strong in the third quarter, consistent with other economic indicators. The growth rate of private consumption spending rose in the third quarter while growth of investment spending slowed to a still-solid pace from the very rapid rate in the previous quarter. Net exports subtracted 0.6 percentage points from GDP growth in the third quarter, and inventory adjustment exerted a slight drag on GDP growth.

Euro-Area Real GDP

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

Component	2004 ¹	2005 ¹	2005	2006		
			Q4	Q1	Q2	Q3
GDP	1.5	1.8	1.4	3.4	4.0	2.1
Total domestic demand	1.8	2.1	2.9	1.7	3.9	2.7
Consumption	1.6	1.1	0.4	2.9	1.2	2.6
Investment	1.9	3.3	2.2	4.2	9.4	3.3
Government consumption	0.7	1.6	1.4	3.6	0.6	3.1
Inventories ²	0.2	0.3	1.7	-1.5	1.2	-0.2
Exports	6.3	4.9	2.8	16.1	4.5	7.2
Imports	7.2	5.6	6.4	11.8	4.4	8.8
Net Exports ²	-0.3	-0.3	-1.4	1.7	0.1	-0.6
Memo:						
GDP of selected countries						
France	2.1	0.9	0.7	2.0	4.8	-0.1
Germany	0.2	1.7	1.1	3.2	4.4	2.6
Italy	0.5	0.5	-0.1	3.1	2.6	1.3

1. Q4/Q4

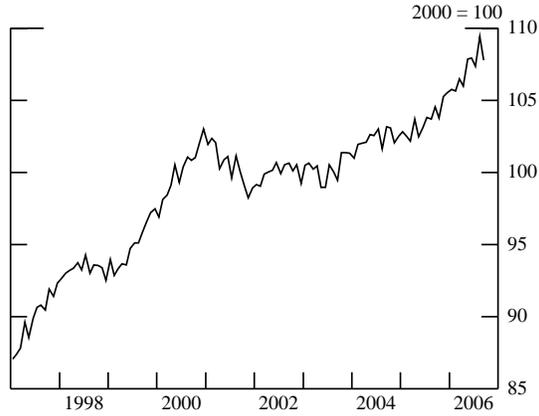
2. Percentage point contribution to GDP growth.

At the country level, French real GDP was measured to be flat in the third quarter; declines in inventory accumulation and net exports subtracted 1.4 percentage points and 0.9 percentage point from GDP growth, respectively. In contrast, final domestic demand continued to rise at a relatively solid rate, with private consumption and fixed investment each rising more than 2 percent. Third-quarter German GDP growth came in slightly

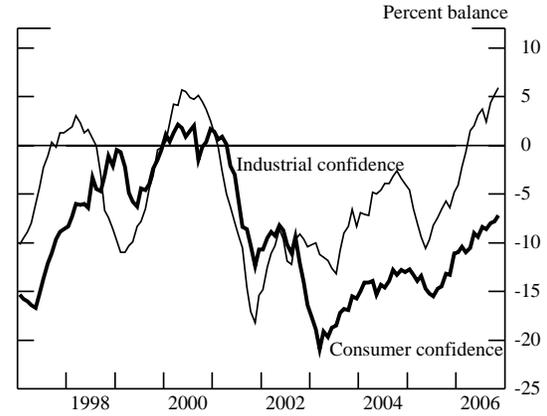
¹ A number of analysts have argued that an inaccurate correction for the Pentecostal holiday in June boosted second-quarter growth while depressing third-quarter growth.

Euro Area

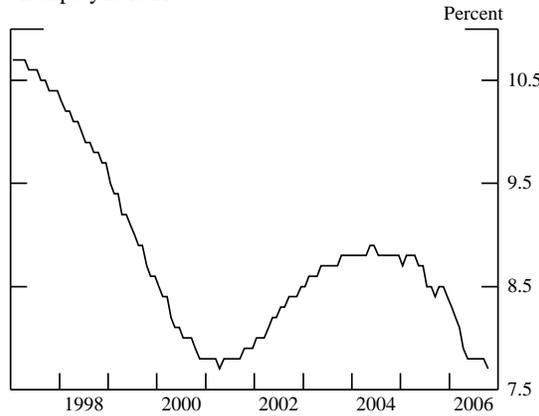
Industrial Production



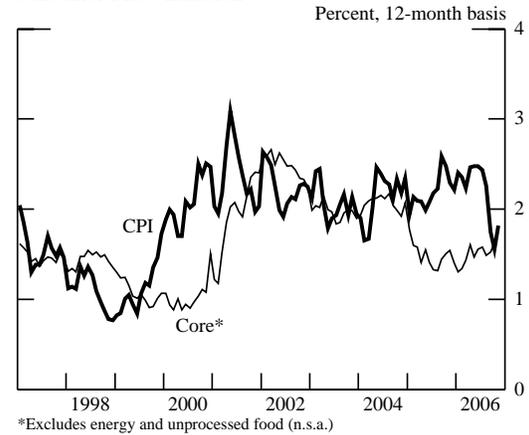
Economic Sentiment



Unemployment Rate



Consumer Price Inflation



*Excludes energy and unprocessed food (n.s.a.)

Economic Indicators

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

Indicator	2006			2006			
	Q1	Q2	Q3	Aug.	Sept.	Oct.	Nov.
Industrial production ¹	1.1	1.2	0.9	1.9	-1.5	n.a.	n.a.
Retail sales volume ²	0.1	0.5	0.7	0.6	-0.9	0.3	n.a.
Unemployment rate ³	8.2	7.8	7.8	7.8	7.8	7.7	n.a.
CPI ⁴	2.3	2.5	2.1	2.3	1.7	1.6	1.8
Producer prices ⁴	5.2	5.8	5.4	5.7	4.6	4.0	n.a.
M3 ⁴	8.5	8.5	8.5	8.2	8.5	8.5	n.a.

1. Excludes construction.

2. Excludes motor vehicles.

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

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

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

weaker than expected, at a 2.6 percent annual rate. Foreign trade regained its dynamism in the third quarter, with net exports contributing 1.8 percentage points to growth. Private consumption grew at a solid 2.7 percent annual rate in the third quarter, but inventory draw-downs subtracted 2 percentage points from growth.

Recent indicators are consistent with a pickup in euro-area economic growth in the current quarter. The European Commission survey of euro-area economic sentiment surprised on the upside in October, rising to its highest level in 5½ years, and remained near that level in November. Industrial confidence moved up further in November to just shy of the record level reached in 1989 (and just above the business cycle peaks in 1994 and 2000). Germany's IFO Business Climate Index moved back up in November to the 15-year peak reached in June. The IFO current conditions index continued to surge higher; business expectations for the next six months edged up to an above-average level, but remained subdued by concerns over the impact of the VAT increase scheduled for January.

The euro-area unemployment rate edged down in October to 7.7 percent, the lowest rate since Eurostat began measuring it in 1993. Continued improvement in households' perceptions of the employment situation contributed to a pickup in euro-area consumer confidence for the third straight month in November. Consumer confidence is at the highest level in more than five years but remains well below the previous business cycle peak reached in 2000.

Euro-area consumer prices ticked up in November from the previous month, according to a preliminary estimate. The twelve-month rate of inflation rose to 1.8 percent from 1.6 percent in October. Core inflation, excluding energy and unprocessed food, was 1.6 percent in October, near where it has been in recent months.

In the **United Kingdom**, GDP moved up 2.7 percent (a.r.) in the third quarter, continuing a period of moderate expansion that began a year ago. A surge in gross fixed capital formation compensated for more subdued personal consumption growth. The business services and finance sector expanded 6.1 percent, indicating strong business-to-business activities. The reported levels of exports and imports fell by annual rates of 37 and 32 percent, respectively, as the Treasury intensified its fight against a form of VAT evasion that had been inflating official trade statistics.

UK Real GDP

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

Component	2004 ¹	2005 ¹	2005	2006		
			Q4	Q1	Q2	Q3
GDP	2.6	1.9	2.7	2.6	2.8	2.7
Total domestic demand	3.1	1.3	1.9	4.1	1.8	3.5
Consumption	3.2	1.3	2.6	1.5	3.7	1.7
Investment	3.5	4.6	3.1	8.1	2.4	9.4
Government consumption	1.9	2.7	1.5	1.3	3.1	4.1
Inventories ²	-0.0	-0.8	-0.7	1.7	-2.1	0.5
Exports	5.8	10.3	13.9	38.6	19.3	-37.0
Imports	7.2	7.5	9.8	40.4	14.2	-32.0
Net Exports ²	-0.6	0.5	0.7	-1.5	0.9	-1.0

1. Q4/Q4

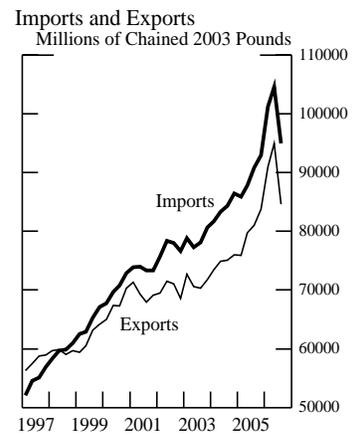
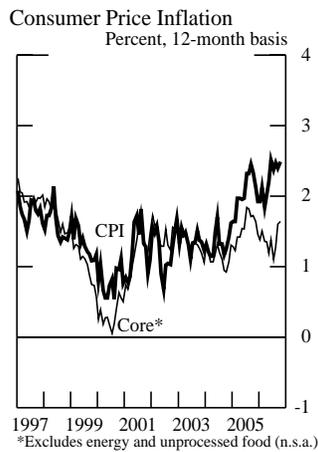
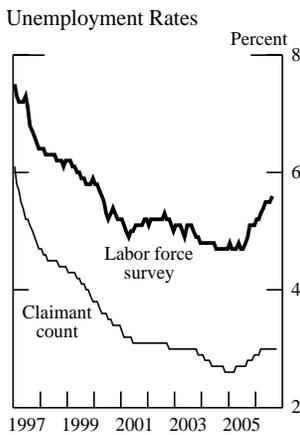
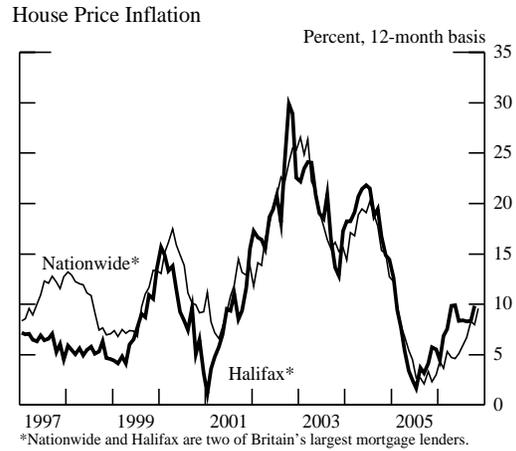
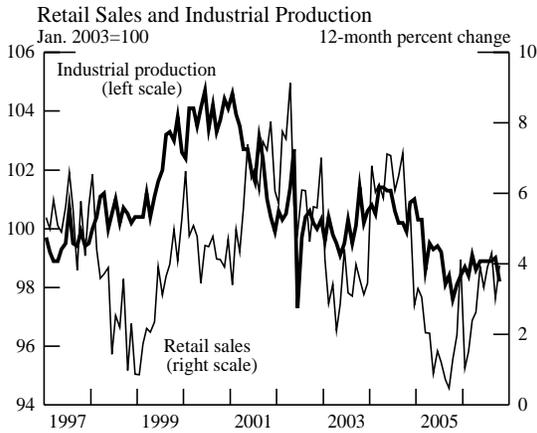
2. Percentage point contribution to GDP growth.

Overall economic activity appears to be continuing to rise at a healthy pace in the fourth quarter, with consumption expanding solidly and the growth in business investment remaining relatively strong. In October, retail sales rebounded, expanding 0.9 percent after a 0.5 percent decline in September. Housing prices kept increasing briskly with Halifax and Nationwide, two major British lenders, both reporting twelve-month price increases of nearly 10 percent in October and November, respectively. In November, the Purchasing Managers' Index (PMI) for services firmed to 59.8 (50 is the threshold for expansion). Industrial production fell 0.8 percent in October, while the manufacturing PMI in November slid further to 52.6.

The Labor Force Survey measure of the unemployment rate ticked up in August to 5.6 percent, as the increase in labor force participation outpaced job creation. Overall, employment growth remained solid, with total employment standing 0.7 percent higher than a year earlier. The claimant-count measure of the unemployment rate was 3.0 percent in October, a figure unchanged since March. Wage inflation remains contained with average earnings including bonuses rising 3.9 percent in the year to September.

The twelve-month rate of headline CPI inflation ticked up to 2.5 percent in October despite a large downward contribution from the fuels component. Inflation was pushed up mainly by a hike in tuition fees and rising food prices. The twelve-month rate of core CPI inflation held steady at 1.6 percent and is now running around 1 percentage point

United Kingdom



Economic Indicators

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

Indicator	2006		2006				
	Q1	Q2	Q3	Aug.	Sept.	Oct.	Nov.
Producer prices ¹	14.5	13.3	7.9	7.9	4.9	3.8	n.a.
Average earnings ¹	4.1	4.3	4.0	3.8	4.1	n.a.	n.a.
Business confidence ²	8.0	12.0	13.0	11.0	14.0	9.0	5.0
Consumer confidence ³	-3.8	-4.7	-6.0	-5.8	-6.8	-3.5	-5.3
Trade balance ⁴	-25.1	-24.5	-25.0	-8.6	-7.7	n.a.	n.a.
Current account ⁴	-15.3	-12.8	n.a.	...	...	...	...

1. Percent change from year earlier.
 2. Confederation of British Industry, percent balance.
 3. Eurostat, percent balance.
 4. Level in billions of US Dollars.
 n.a. Not available. ... Not applicable.

below headline inflation. Unprocessed food prices and energy prices have risen 6.3 percent and 9.8 percent in the year to October, respectively.

The Monetary Policy Committee (MPC) raised the official rate paid on commercial bank reserves 25 basis points to 5 percent on November 9, a decision widely anticipated by financial markets. The MPC cited the need to bring inflation back to its target in the medium term as the main reason for the hike.

Canadian Real GDP

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

Component	2004 ¹	2005 ¹	2005	2006		
			Q4	Q1	Q2	Q3
GDP	3.7	2.8	2.6	3.8	2.0	1.7
Total domestic demand	5.6	3.8	4.7	4.4	5.9	1.7
Consumption	3.8	3.8	3.6	4.8	3.8	4.2
Investment	7.0	7.2	7.9	9.8	1.8	1.1
Government consumption	3.2	3.0	4.4	3.3	4.9	0.7
Inventories ²	1.2	-0.6	-0.0	-1.2	2.4	-1.1
Exports	2.7	4.5	6.4	-3.8	-1.7	3.6
Imports	8.1	6.9	12.7	-2.0	8.6	4.1
Net Exports ²	-2.0	-0.9	-2.4	-0.7	-4.2	-0.3

1. Q4/Q4

2. Percentage point contribution to GDP growth.

Canadian real GDP rose 1.7 percent at an annual rate in the third quarter. Growth was dragged down mainly by a sharp deceleration in government spending, which was attributed to lower expenditures associated with the winding down of the 2006 Census; government expenditures contributed only 0.1 percentage point to growth after contributing 0.9 percentage point in the second quarter. In the private sector, personal consumption and non-residential business investment, which have provided solid support to domestic demand for the past few years, accelerated. Led by spending on durables, consumption contributed 2.4 percentage points to overall growth. In contrast, after a housing boom lasting nearly five years, residential construction activity posted a second consecutive decline. The drag from the external sector waned as exports advanced for the first time since the fourth quarter of 2005 and import growth slowed; net exports subtracted 0.3 percentage points from growth, a substantially smaller drag than in the second quarter.

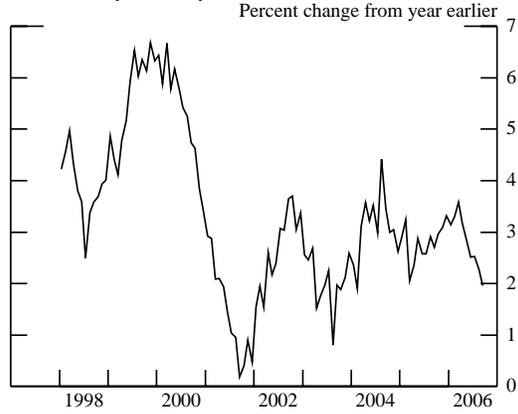
Early indicators for the fourth quarter suggest continued expansion at about the same pace. Housing starts in October were a bit higher than their third-quarter average, although the year-long trend in starts is downward. The Ivey PMI slipped a bit in November but still indicates expansion of business spending. The composite index of leading indicators rose by 0.2 percent in October, continuing its string of signals of moderate growth since the spring, with household demand remaining the driving force behind growth.

In November, total employment posted a solid gain, following strong growth in October as well. Full-time employment fell a bit, but this comes after smart gains throughout much of the year, including through the summer lull in headline employment growth. The unemployment rate edged up to 6.3 percent, still near the 32-year-low of 6.1 percent touched in June.

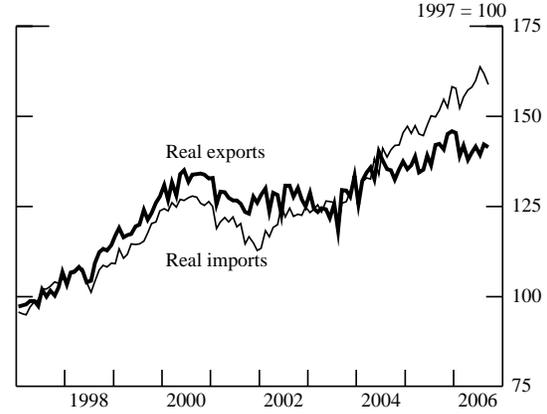
The twelve-month rate of consumer price inflation edged up to 1 percent in October. An 18-percent plunge in retail gasoline prices in September was followed by another 3 percent decline in October, holding down headline inflation. In contrast, the twelve-month rate of core inflation, which excludes the eight most volatile components and indirect taxes, rose slightly to 2.3 percent in October, extending its moderate upswing since early this year. The acceleration in core prices has been driven by a rise in homeowners' replacement costs, which are estimated using, among other data, prices for new homes. New home price inflation climbed to 12 percent in September, although large regional disparities underlie the national index; home prices in the western provinces, especially the oil-producing province of Alberta, have risen much more rapidly than elsewhere in the country.

Canada

Real GDP by Industry



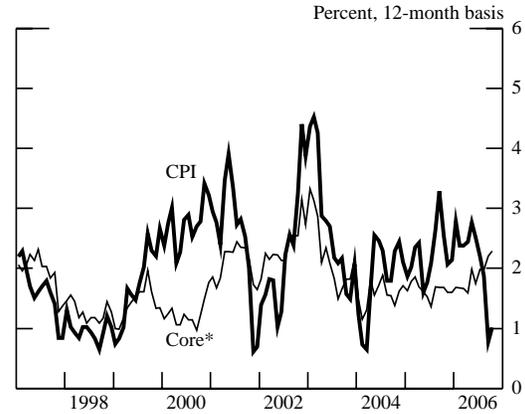
Real Trade



Unemployment Rate



Consumer Price Inflation



*Excludes 8 volatile components and effects of indirect taxes (n.s.a.)

Economic Indicators

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

Indicator	2006			2006			
	Q1	Q2	Q3	Aug.	Sept.	Oct.	Nov.
Industrial production	-0.4	-1.0	0.1	0.1	-1.4	n.a.	n.a.
New manufacturing orders	-1.5	-1.7	0.4	-2.4	-2.8	n.a.	n.a.
Retail sales	2.3	2.0	0.9	0.8	0.2	n.a.	n.a.
Employment	0.4	0.8	0.1	-0.1	0.1	0.3	0.1
Consumer attitudes ¹	120.9	122.4	121.0	...	...	...	...
Business confidence ¹	146.0	142.9	135.6	...	...	...	...

1. 1991=100.

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

Economic Situation in Other Countries

Recent data indicate that third-quarter growth was strong across much of Asia, supported in part by high-tech demand, although Chinese growth slowed considerably.

Performance was a bit more mixed elsewhere. Mexican growth slowed a little from its strong first half. In much of South America, high prices of commodities continued to boost activity, but Brazilian performance was disappointing. Inflationary pressures have remained subdued across much of the emerging market world, aided in part by declines in domestic energy prices, but inflation in Argentina, Venezuela, and Turkey remained in the double digits.

In **China**, more evidence has emerged that economic activity has slowed in response to the recent administrative and other tightening measures. Real GDP growth in the third quarter declined sharply to 7 percent (s.a.a.r.), according to staff estimates. (China does not publish a series showing the quarterly level of real GDP, so seasonally-adjusted growth numbers must be estimated.) The evidence of slowing is bolstered by other incoming data as well. Fixed investment growth (four-quarter change) slowed from about 30 percent in the second quarter to 22 percent in the third quarter. Industrial output increased just 2.8 percent (s.a.) in the third quarter, compared with a 4.1 percent pace in the previous quarter. Further, the moderation in fixed asset investment and in industrial output has continued in October, although Chinese monthly data can be very noisy.

The trade surplus has continued to balloon, averaging more than \$200 billion at an annual rate over the three months from August to October, compared with about \$160 billion in the second quarter and \$100 billion in 2005. The most recent trade data show a 6 percent decline in imports in October, with exports roughly flat. Inflation has remained benign in recent months, with consumer prices increasing 1.5 percent over the twelve months ended in October. The slowing of imports and economic activity appears to have eased, to some degree, Chinese policymakers' concerns about the extent of overinvestment.

Chinese Economic Indicators

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

Indicator	2004	2005	2006				
			Q2	Q3	Aug.	Sept.	Oct.
Real GDP ¹	9.6	9.9	12.0	7.0	...	...	...
Industrial production	14.4	17.2	4.1	2.8	.6	1.6	-8
Consumer prices ²	2.5	1.6	1.4	1.2	1.3	1.4	1.5
Merch. trade balance ³	32.1	102.0	159.8	187.2	198.5	189.7	237.6

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 in the third quarter, after nearly flat growth in the second quarter. The growth pickup was boosted by external demand. In October, the trade deficit widened, which might be a sign that activity in this entrepôt economy has moderated. Twelve-month inflation declined in October, in part reflecting moderating inflation in food prices and a fall in domestic gasoline prices.

Hong Kong Economic Indicators

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

Indicator	2004	2005	2006				
			Q2	Q3	Aug.	Sept.	Oct.
Real GDP ¹	7.3	7.4	1.2	14.8	...	...	...
Unemployment rate ²	6.9	5.7	5.0	4.7	4.8	4.7	4.5
Consumer prices ³	.4	1.4	2.1	2.3	2.5	2.2	2.0
Merch. trade balance ⁴	-12.0	-10.5	-21.7	-12.7	-21.4	-12.5	-21.3

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.

... Not applicable.

In **Taiwan**, third-quarter output surged after registering moderate growth in the second quarter. Investment (particularly in machinery) contributed the most to the acceleration. However, industrial production fell in October, partly reflecting some cooling in the construction sector. The October trade surplus narrowed a bit, although export orders increased, particularly for information and communications products. Twelve-month inflation reached positive territory in November.

Taiwan Economic Indicators

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

Indicator	2004	2005	2006				
			Q2	Q3	Sept.	Oct.	Nov.
Real GDP ¹	2.6	6.5	4.6	8.1	...	...	...
Unemployment rate ²	4.4	4.1	3.9	3.9	3.8	3.8	n.a.
Industrial production	9.8	4.1	.6	.7	.3	-1.7	n.a.
Consumer prices ³	1.6	2.2	1.5	-.3	-1.2	-1.2	.2
Merch. trade balance ⁴	6.1	7.8	12.7	15.0	24.9	20.3	n.a.
Current account ⁵	18.5	16.1	19.7	25.7	...	...	...

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

2. Percent.

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

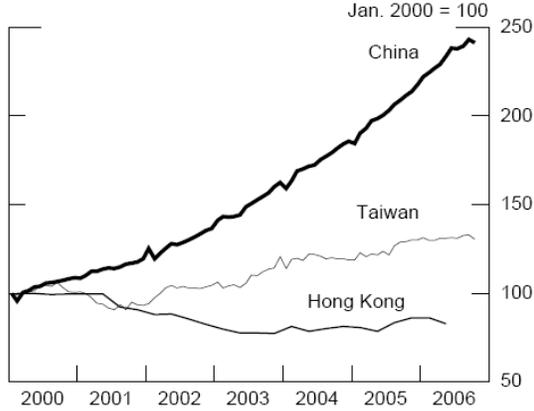
4. Billions of U.S. dollars, annual rate. Imports are c.i.f.

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

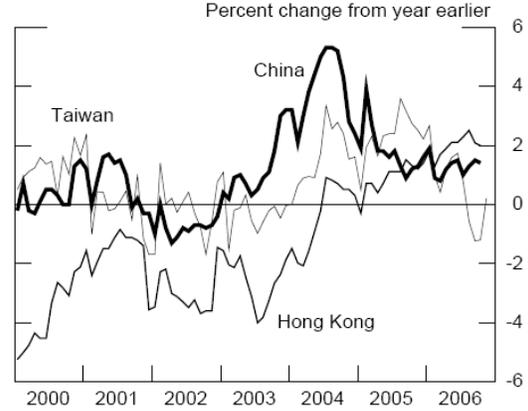
n.a. Not available. . . . Not applicable.

China, Hong Kong, and Taiwan

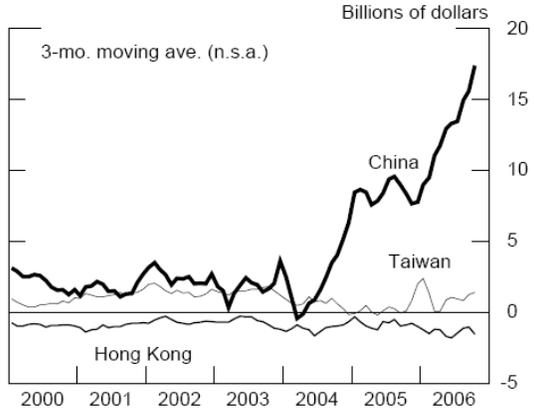
Industrial Production



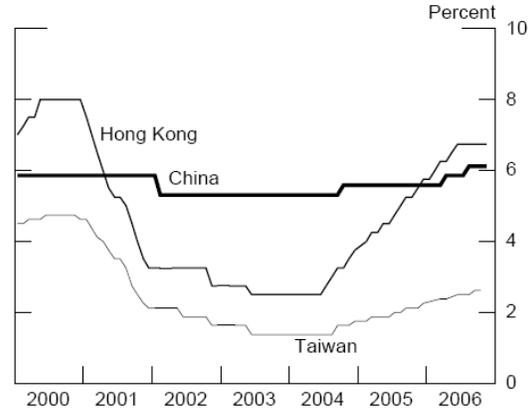
Consumer Prices



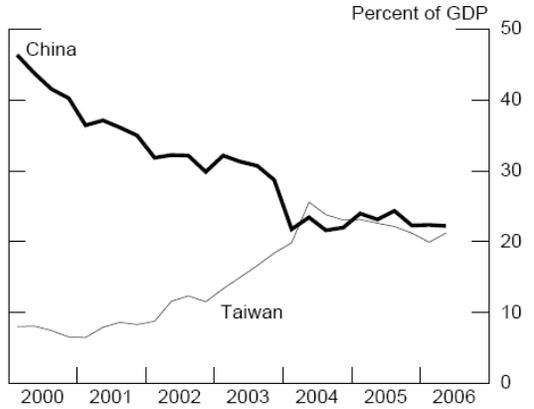
Merchandise Trade Balances



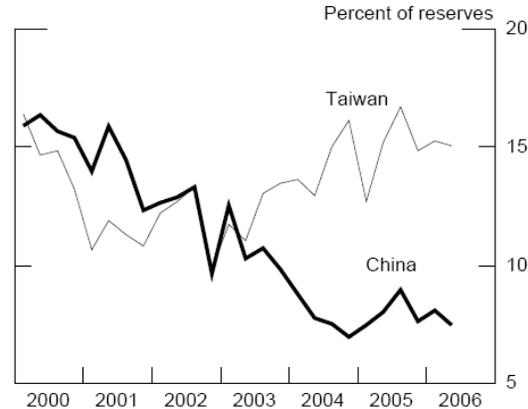
Benchmark Interest Rates



Gross External Debt



Short-Term External Debt



In **Korea**, economic data continue to indicate moderate growth. GDP rose 4.4 percent in the third quarter, as consumption was weak, net exports were flat, but investment soared. In the current quarter, industrial production rose 2.6 percent in October, supported by strong gains in communications equipment. Sentiment indicators held steady or were up in October, despite the nuclear test in North Korea. The merchandise trade balance improved slightly in September and October, and high-tech exports have remained strong, particularly to China. Consumer price inflation has declined in recent months, reflecting the retrenchment in oil prices and a decline in food prices after a weather-related spike in the summer. In late November, the Bank of Korea announced it would raise reserve requirements on short-term deposits for the first time in almost a decade from 5 percent to 7 percent, while lowering reserve requirements on long-term deposits, effective December 23. The Bank indicated the move was necessary to curb lending growth, and many analysts attributed the change to concern over increases in housing prices.

Korean Economic Indicators

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

Indicator	2004	2005	2006				
			Q2	Q3	Sept.	Oct.	Nov.
Real GDP ¹	2.9	5.3	3.4	4.4	...	...	...
Industrial production	10.0	5.9	-4	1.1	3.1	2.6	n.a.
Unemployment rate ²	3.5	3.7	3.5	3.5	3.5	3.5	n.a.
Consumer prices ³	3.0	2.6	2.3	2.5	2.4	2.1	2.2
Merch. trade balance ⁴	37.6	33.5	24.9	23.6	29.3	29.8	n.a.
Current account ⁵	28.2	16.6	2.8	1.5	16.9	20.8	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.

Indian GDP rose 8 percent in the third quarter, as strong performance in the industrial and service sectors more than offset considerable weakness in agriculture and mining. The trade balance deteriorated significantly further in October. Twelve-month inflation, as measured by both the consumer price index and the closely-watched wholesale price index, has risen in recent months, reflecting strong domestic demand. In response to higher inflation, the Reserve Bank of India raised its short-term repurchase rate $\frac{1}{4}$ percentage point to 7.25 percent in late October but left its key target rate, the reverse repo rate, unchanged at 6 percent. Market participants interpret the widening of the

spread between the central bank's lending and borrowing rates as a signal that bank would like to slow loan growth. In addition, the government announced in late November that it will slightly reduce prices for gasoline and diesel fuel. A sharp improvement in September's central government fiscal balance brought the deficit in line with the government's 3.8 percent of GDP target for 2006.

Indian Economic Indicators

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

Indicator	2004	2005	2006				
			Q2	Q3	Aug.	Sept.	Oct.
Real GDP ¹	7.0	7.5	6.9	8.0	...	...	...
Industrial production	8.5	7.9	5.5	.3	.8	2.3	n.a.
Consumer prices ²	3.8	5.6	5.9	5.6	5.0	5.5	6.0
Wholesale prices ²	6.7	4.4	4.6	5.1	5.1	5.3	5.3
Merch. trade balance ³	-21.7	-40.8	-43.5	-48.9	-39.2	-61.3	-70.7
Current account ⁴	.8	-8.3	-24.4	n.a.	...	...	...

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

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

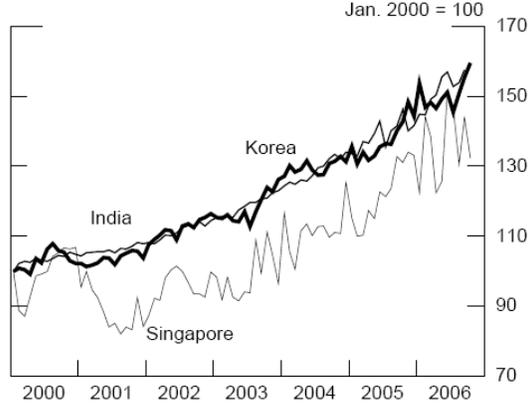
3. Billions of U.S. dollars, annual rate.

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

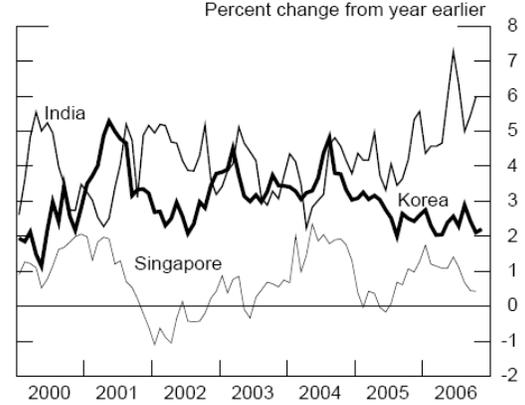
n.a. Not available. . . . Not applicable.

India, Korea, and Singapore

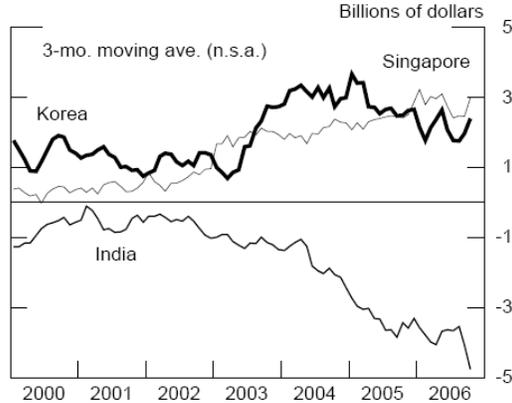
Industrial Production



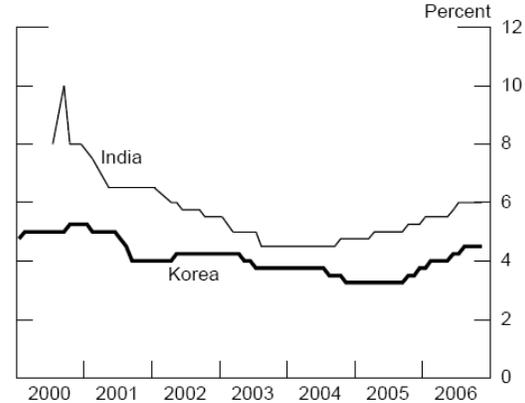
Consumer Prices



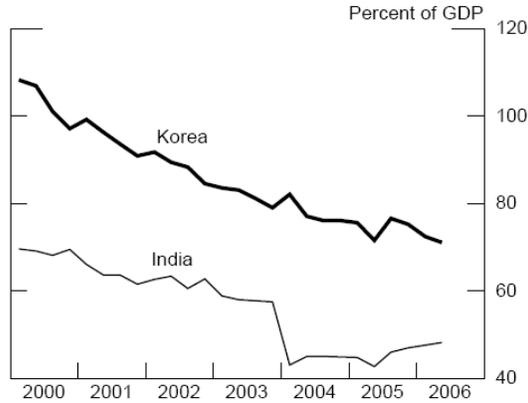
Merchandise Trade Balances



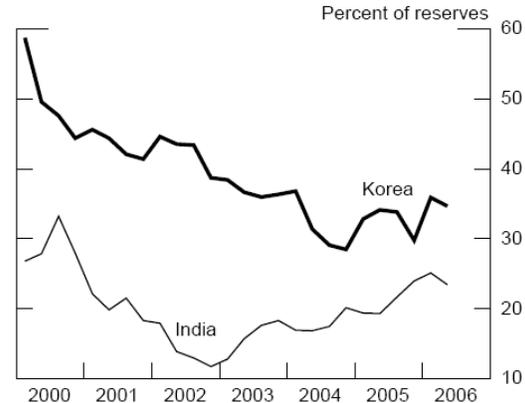
Benchmark Interest Rates



Gross External Debt



Short-Term External Debt



Data from the **ASEAN** region indicate that economic activity picked up in the third quarter as trade balances generally improved and domestic demand, notably consumption, strengthened in some countries. Real GDP growth rebounded to approximately 6 percent in Malaysia, Singapore, and Thailand, soared to 9 percent in Indonesia, but fell back in the Philippines from the strong second quarter rate. More recently, the October trade balances continue to be strong, but industrial production fell in Singapore and Thailand.

Twelve-month consumer price inflation in the region continued to decline due mostly to waning effects of last year's energy price realignments and the previous tightening of monetary policy. In Indonesia, twelve-month inflation plunged to 6.4 percent and 5.4 percent in October and November respectively, after running in double digits for the previous year, as the effect of the sharp reduction in fuel subsidies in October of last year dropped out of the calculation. Citing the moderation in inflation and the need to stimulate domestic demand, Bank Indonesia lowered interest rates 50 basis points to 10.25 percent on November 7, the sixth rate reduction since May.

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

Indicator	2004	2005	2006				
			Q2	Q3	Aug.	Sept.	Oct.
<i>Real GDP¹</i>							
Indonesia	7.0	5.0	6.0	9.0	...	...	...
Malaysia	5.9	5.2	1.0	5.6	...	...	...
Philippines	5.5	5.5	8.0	1.3	...	...	...
Singapore	6.6	8.5	3.9	5.7	...	...	...
Thailand	5.8	4.4	4.5	6.0	...	...	...
<i>Industrial production²</i>							
Indonesia ³	3.3	1.3	6.9	n.a.	-5	n.a.	n.a.
Malaysia	11.7	4.1	.2	1.3	4.8	-2.5	n.a.
Philippines	1.0	2.2	1.4	n.a.	6.3	n.a.	n.a.
Singapore	13.9	9.5	-1.4	5.5	-11.1	10.2	-7.9
Thailand	11.7	9.1	1.7	2.6	2.9	-1.1	-1.5

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: Merchandise Trade Balance
(Billions of U.S. dollars, s.a.a.r.)

Indicator	2004	2005	2006				
			Q2	Q3	Aug.	Sept.	Oct.
Indonesia	25.1	28.0	34.2	37.9	38.4	34.8	43.1
Malaysia	21.2	26.4	27.0	31.5	26.8	34.1	27.6
Philippines	-4.4	-6.2	-3.6	-4.8	-6.1	-4.5	n.a.
Singapore	25.1	29.6	33.0	29.5	28.0	32.8	46.9
Thailand	1.5	-8.5	-3.0	4.7	5.2	7.6	3.9

n.a. Not available.

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

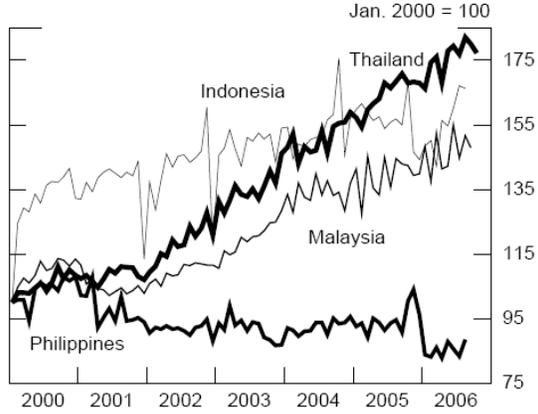
Indicator	2004 ¹	2005 ¹	2006				
			Q2	Q3	Sep.	Oct.	Nov.
Indonesia	6.6	17.0	15.5	14.8	14.3	6.4	5.4
Malaysia	2.2	3.3	4.1	3.6	3.3	3.1	n.a.
Philippines	8.6	6.7	6.9	6.1	5.7	5.4	4.7
Singapore	1.3	1.3	1.2	.7	.4	.4	n.a.
Thailand	2.9	5.8	6.0	3.6	2.7	2.8	3.5

1. Dec./Dec.

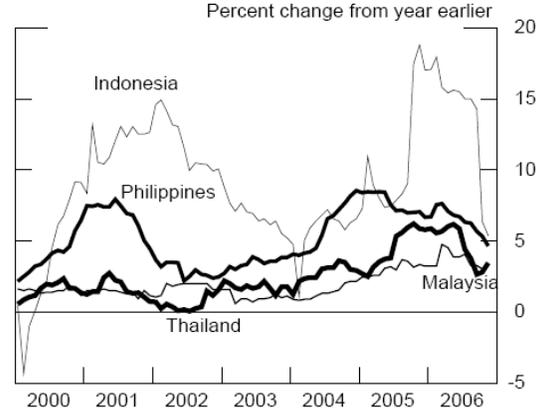
n.a. Not available

ASEAN-4

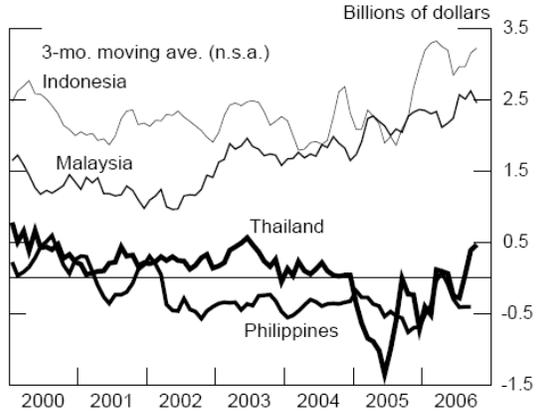
Industrial Production



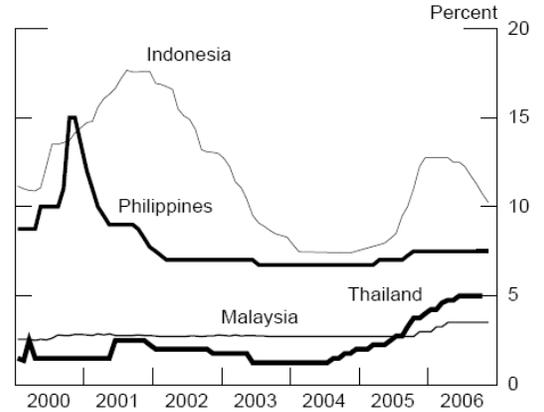
Consumer Prices



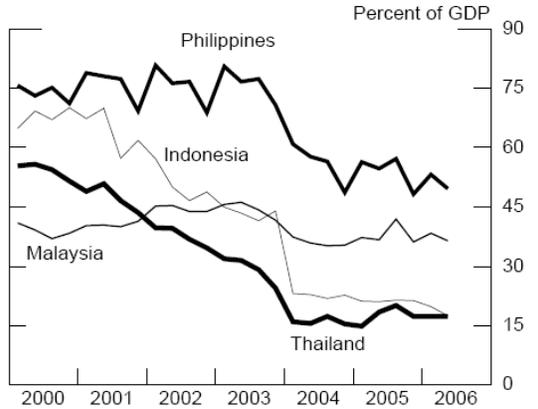
Merchandise Trade Balances



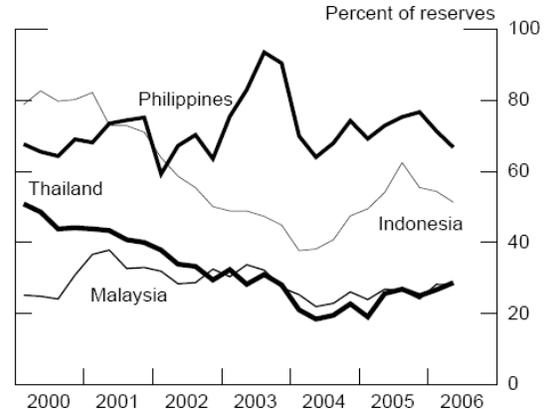
Benchmark Interest Rates



Gross External Debt



Short-Term External Debt



In **Mexico**, real GDP rose 4.1 percent (a.r.) in the third quarter, a mild slowing from the strong first half. While manufacturing activity moderated somewhat and agricultural production contracted, the construction and services sectors continued to expand strongly. Twelve-month headline inflation was 4.3 percent in October, the second consecutive month where inflation has been above the central bank's target range of 2 to 4 percent. The recent higher-than-expected inflation readings have been the result of some food price increases, mainly for tomatoes. In late October, Mexico's government issued its first-ever 30-year fixed rate peso-denominated bond; an equivalent of roughly \$200 million was issued at a yield of 8.1 percent.

Mexican Economic Indicators

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

Indicator	2004	2005	2006				
			Q2	Q3	Aug.	Sept.	Oct.
Real GDP ¹	4.8	2.7	5.6	4.1	...	...	...
Overall economic activity	3.8	3.3	1.0	1.0	.1	.7	n.a.
Industrial production	3.5	1.9	1.4	.5	-.1	1.0	n.a.
Unemployment rate ²	3.9	3.6	3.4	3.6	3.7	3.7	3.8
Consumer prices ³	5.2	3.3	3.1	3.5	3.5	4.1	4.3
Merch. trade balance ⁴	-8.8	-7.6	-5.9	-9.9	-6.8	-17.0	-12.2
Merchandise imports ⁴	196.8	221.8	256.6	264.6	265.2	269.2	265.2
Merchandise exports ⁴	188.0	214.2	250.7	254.8	258.4	252.2	253.0
Current account ⁵	-6.6	-5.0	4.3	-4.5	...	...	...

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 rose only 2.0 percent in the third quarter, following equally lackluster growth in the second quarter. Growth was led by solid performance in agriculture, while manufacturing output rose only slightly, depressed in part by auto strikes in September. On the demand side, consumption growth slowed considerably from the second quarter, suggesting that the influence of government measures aimed at boosting consumption in recent years may be waning. One bright spot was that gross fixed capital formation jumped 10 percent in the third quarter, following a tepid second quarter, but this series is particularly volatile. October industrial production was up 0.8 percent, but that increase in large part reflected a recovery in auto production

following strikes in September. Twelve-month consumer price inflation continued to decline and was 3.3 percent in October, well below the 4.5 percent midpoint of the inflation target. Core inflation, which excludes energy and other administered prices and home meals, has shown a similar trajectory.

At its November 29 meeting, the Brazilian central bank's monetary policy committee (Copom) lowered its target for the overnight interest rate 50 basis points to 13.25 percent. However, three of the eight committee members preferred only a 25 basis points decline, fueling the perception among market observers that the central bank may soon reduce the pace of monetary easing. Lula won his re-election bid in late October by a large margin against the conservative candidate but has not yet laid out the economic priorities for his second term.

Brazilian Economic Indicators

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

Indicator	2004	2005	2006				
			Q2	Q3	Sept.	Oct.	Nov.
Real GDP ¹	4.8	1.6	1.7	2.0	...	...	...
Industrial production	8.3	3.1	.8	.5	-1.1	.8	n.a.
Unemployment rate ²	11.5	9.8	10.0	10.5	10.0	9.8	n.a.
Consumer prices ³	7.6	5.7	4.3	3.8	3.7	3.3	n.a.
Merch. trade balance ⁴	33.7	44.8	38.6	49.8	42.6	43.9	50.1
Current account ⁵	11.7	14.2	4.7	29.8	27.3	18.3	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**, the index of economic activity (a monthly proxy of GDP) through September suggests that growth continued to be strong in the third quarter. Also in the third quarter, unemployment edged down further and industrial production continued to climb, albeit more slowly than in the second quarter. Twelve-month inflation through November remained elevated, although less than at the end of last year, perhaps partly reflecting the price agreements that the government has secured with firms and representatives of several sectors.

Argentine Economic Indicators

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

Indicator	2004	2005	2006				
			Q2	Q3	Sept.	Oct.	Nov.
Real GDP ¹	9.0	8.9	8.8	n.a.	...	...	...
Industrial production	10.7	7.6	2.7	1.7	1.1	.4	n.a.
Unemployment rate ²	13.6	11.6	10.4	10.2	...	...	...
Consumer prices ³	5.9	12.2	11.4	10.6	10.5	10.5	10.0
Merch. trade balance ⁴	12.1	11.4	15.0	11.4	11.3	14.2	n.a.
Current account ⁵	3.4	5.8	10.0	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**, GDP growth continued to be in the double digits, up 11 percent in the third quarter at an annual rate. On a year-over-year basis, oil production declined 2 percent as private oil output plunged by over 11 percent and the output of the government-owned firm, PDVSA, was up a meager 1 percent. Non-oil activity, in contrast, was up 12 percent, driven by extremely expansionary fiscal policies that have been supported by high oil prices. Monetary policies remain very expansionary as well, fueling inflation, which reached nearly 16 percent in November on a twelve-month basis. On December 3, as expected, President Chavez was re-elected for another six-year term by a wide margin (61 to 38 percent) over Manual Rosales.

Venezuelan Economic Indicators

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

Indicator	2004	2005	2006				
			Q2	Q3	Sept.	Oct.	Nov.
Real GDP ¹	12.9	10.9	14.9	10.8	...	...	...
Unemployment rate ²	15.1	12.2	10.1	10.0	9.7	8.9	n.a.
Consumer prices ³	19.2	14.4	11.2	14.6	15.4	15.5	15.8
Non-oil trade balance ⁴	-10.2	-16.3	-27.5	-32.9	n.a.	n.a.	n.a.
Merch. trade balance ⁴	22.6	31.8	40.7	30.0	n.a.	n.a.	n.a.
Current account ⁵	15.5	25.5	32.9	30.8	...	...	...

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.

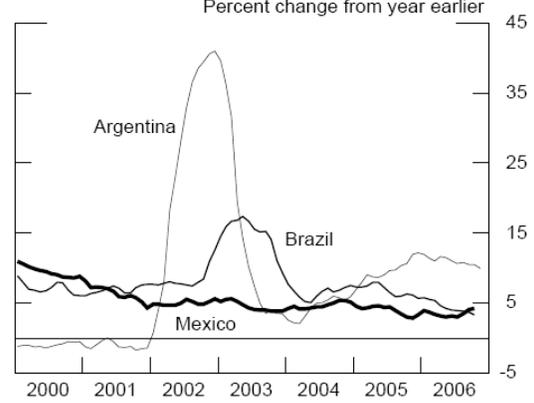
n.a. Not available. . . . Not applicable.

Latin America

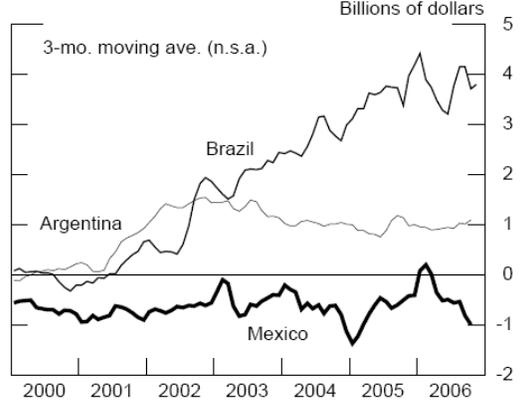
Industrial Production



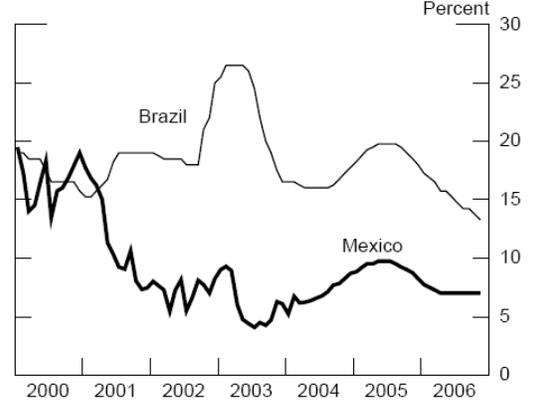
Consumer Prices



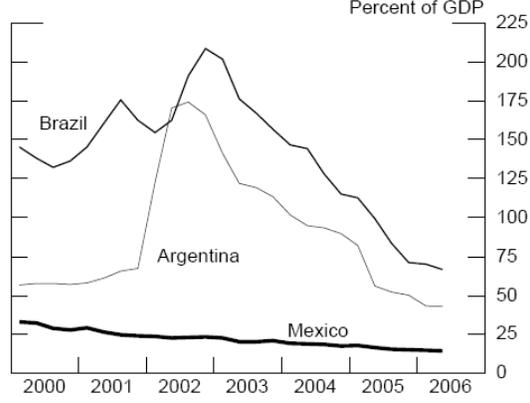
Merchandise Trade Balances



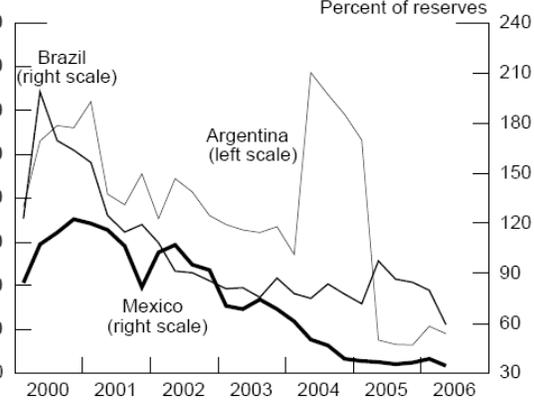
Benchmark Interest Rates



Gross External Debt



Short-Term External Debt



In **Turkey**, industrial production fell 2.7 percent in the third quarter, in part reflecting the effects of sharp increases in interest rates in the second quarter. The large current account deficit, which stood at over 9 percent of GDP in the third quarter, remains a major concern. Twelve-month consumer price inflation in November stood at about 10 percent, well above the 7 percent ceiling of the government's inflation target, although on a monthly basis, inflation has fallen sharply in recent months. Nevertheless, the Central Bank of Turkey left its policy rate, the overnight lending rate, unchanged at 22.5 percent at its November meeting. Turkey remains on track with its IMF program, but EU accession talks have stalled; further progress appears conditioned on resolution of the dispute with Cyprus.

Turkey Economic Indicators

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

Indicator	2004	2005	2006				
			Q2	Q3	Sept.	Oct.	Nov.
Real GDP ¹	9.0	7.4	7.4	n.a.	...	...	...
Industrial production	9.8	5.4	6.8	-2.7	-1	n.a.	n.a.
Consumer prices ²	9.4	7.7	9.6	10.8	10.5	10.0	9.9
Merch. trade balance ³	-34.4	-43.3	-59.7	-54.6	-57.2	-60.3	n.a.
Current account ⁴	-15.6	-23.1	-36.7	-37.6	-42.9	n.a.	n.a.
Unemployment rate	10.3	10.3	9.7	9.9	...	...	...

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.

In **South Africa**, real GDP slowed slightly in the third quarter to 4.7 percent. Growth of mining production declined despite the recent high prices for metals. Headline consumer price inflation declined on a twelve-month basis, primarily due to falling petroleum prices, but inflation remains an issue because of rising food prices and rapid growth in credit to the private sector. The South African rand strengthened about 10 percent in October and November against the dollar, partially reversing its 20 percent decline over the second and third quarters.

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

Indicator	2004	2005	2006				
			Q2	Q3	Aug.	Sept.	Oct.
Real GDP ¹	5.8	4.9	5.5	4.7	...	...	...
Manuf. Production	4.1	3.6	1.5	1.4	-.2	.4	.2
Mining Production	3.7	1.3	1.7	.8	3.0	-1.0	n.a.
Consumer Prices ²	4.5	4.1	4.3	5.1	5.1	5.0	4.7
Merch. trade Balance ³	-1.3	-2.9	-9.7	-6.4	-9.0	1.4	-11.8
Current Account ⁴	-7.5	-10.1	-16.9	n.a.	...	...	...

1. Annual Rate. Annual data are Q4/Q4.

2. Percent change from year-earlier period for the CPIX, except annual data, which are Dec./Dec. CPIX excludes interest rates on mortgage bonds.

3. Billions of U.S. dollars, s.a.a.r.

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

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