

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

January 24, 2007

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

January 24, 2007

Recent Developments

Domestic Nonfinancial Developments

Domestic Nonfinancial Developments

The growth of aggregate output appears to have picked up in the fourth quarter, but economic performance remained uneven across sectors. Consumer spending, buoyed by further increases in employment and income, posted robust gains near the end of the year, and the demand for housing seems to have stabilized in recent months. However, business fixed investment, after having risen rapidly earlier in the year, has been soft of late, and output in the industrial sector decelerated sharply in the fourth quarter. A steep run-up in energy prices pushed total inflation significantly higher in December, but a decline in spot prices for crude oil near the turn of the year suggests that retail energy prices should move lower again in the next few months. Core inflation receded markedly in November and December from the elevated levels reached early in 2006.

Labor Market Developments

Private nonfarm payroll employment increased 150,000 in December, bringing the average monthly gain in the fourth quarter to 119,000, in line with the average increase in the prior two quarters.¹ The December rise in private employment was nearly all in services; professional and business services and nonbusiness services again posted notable gains. Job losses in manufacturing and in retail trade were modest, and a decline in residential construction was mostly offset by hiring in nonresidential construction.² The average workweek for production or nonsupervisory workers on private nonfarm payrolls remained at 33.9 hours in December, and aggregate hours moved up 0.2 percent. The fourth-quarter average for aggregate production-worker hours increased 2.2 percent at an annual rate from the third-quarter average.

¹ The Bureau of Labor Statistics (BLS) will revise the March 2006 level of payroll employment in its January 2007 employment report. Based on the BLS preliminary estimate, we expect the revision to be about 800,000, which would be the largest revision recorded since the BLS switched to a random-sample methodology for the payroll survey in 2002. Benchmark revisions since 2002 have been close to zero, on average.

² A strike at Goodyear was settled last month. About 12,500 workers returned to work at the beginning of this month and will be included in January payroll figures.

Changes in Employment

(Thousands of employees; seasonally adjusted)

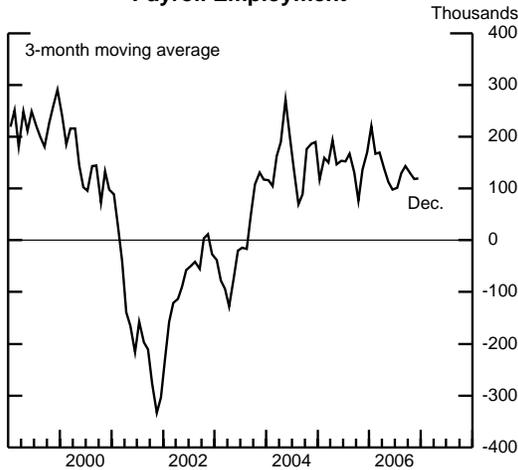
Measure and sector	2006	2006					
		Q2	Q3	Q4	Oct.	Nov.	Dec.
	Average monthly change			Monthly change			
Nonfarm payroll employment (establishment survey)	153	115	185	136	86	154	167
Private	133	98	144	119	64	144	150
Natural resources and mining	5	5	3	4	5	4	4
Manufacturing	-6	11	-12	-24	-41	-20	-12
Construction	3	1	4	-19	-28	-25	-3
Wholesale trade	8	8	7	6	-1	11	7
Retail trade	-5	-28	-5	12	6	39	-9
Transportation and utilities	9	9	9	14	14	11	16
Information	0	-3	-1	4	2	-3	12
Financial activities	13	11	15	5	-1	8	9
Professional and business services	35	40	32	42	29	47	50
Temporary help services	-1	-1	-4	8	3	5	15
Nonbusiness services ¹	70	44	92	76	79	72	76
Total government	21	17	42	16	22	10	17
Total employment (household survey)	262	235	173	340	431	286	303
Memo:							
Aggregate hours of private production workers (percent change) ²	2.2	2.6	1.1	2.2	.4	.1	.2
Average workweek (hours) ³	33.9	33.9	33.8	33.9	33.9	33.9	33.9
Manufacturing (hours)	41.1	41.2	41.3	41.0	41.1	41.0	41.0

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

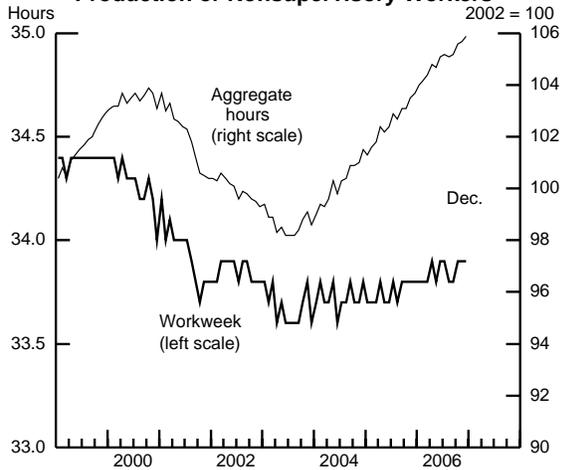
2. Establishment survey. Annual data are percent changes from Q4 to Q4. Quarterly data are percent changes from preceding quarter at an annual rate. Monthly data are percent changes from preceding month.

3. Establishment survey.

Changes in Private Payroll Employment



Aggregate Hours and Workweek of Production or Nonsupervisory Workers

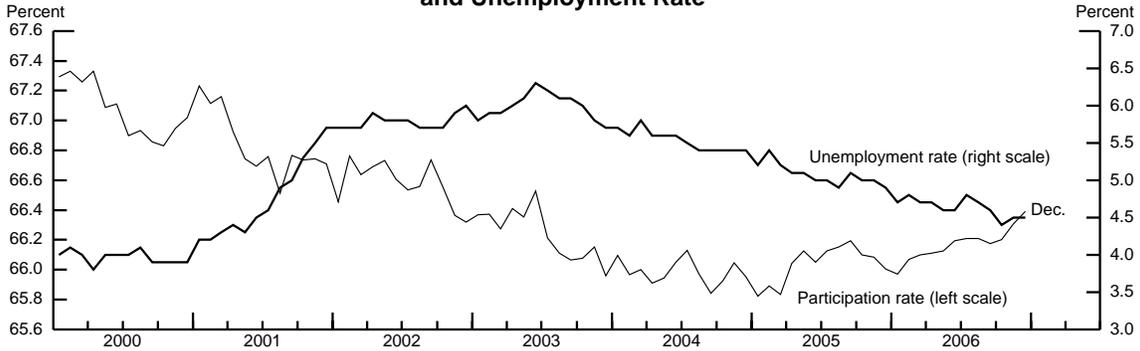


Selected Unemployment and Labor Force Participation Rates

(Percent; seasonally adjusted)

Rate and group	2006	2006					
		Q2	Q3	Q4	Oct.	Nov.	Dec.
<i>Civilian unemployment rate</i>							
Total	4.6	4.7	4.7	4.5	4.4	4.5	4.5
Teenagers	15.4	14.8	16.1	15.1	15.2	15.1	15.2
20-24 years old	8.2	8.1	8.3	8.3	8.4	8.4	7.9
Men, 25 years and older	3.5	3.6	3.5	3.3	3.2	3.3	3.5
Women, 25 years and older	3.7	3.8	3.8	3.5	3.4	3.6	3.5
<i>Labor force participation rate</i>							
Total	66.2	66.1	66.2	66.3	66.2	66.3	66.4
Teenagers	43.6	43.8	43.5	43.4	43.3	43.4	43.4
20-24 years old	74.6	74.3	74.9	75.0	74.6	74.9	75.4
Men, 25 years and older	75.5	75.5	75.4	75.7	75.5	75.7	75.8
Women, 25 years and older	59.6	59.5	59.9	59.8	59.8	59.8	59.7

Labor Force Participation Rate and Unemployment Rate



Gross Flows from Nonparticipation to Employment

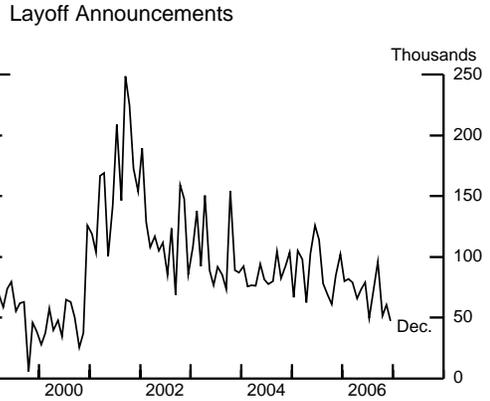
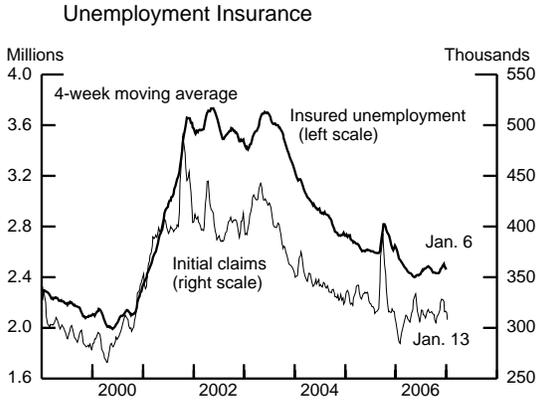


Not in the Labor Force: Percent of Population Who Want a Job



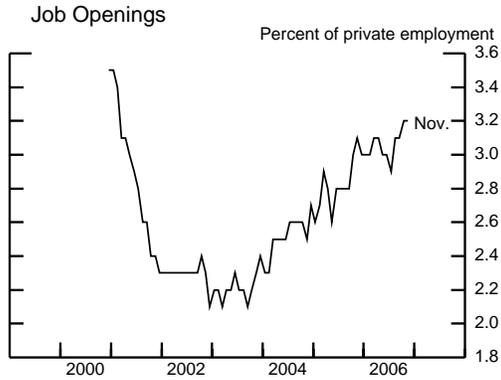
Labor Market Indicators

Layoffs

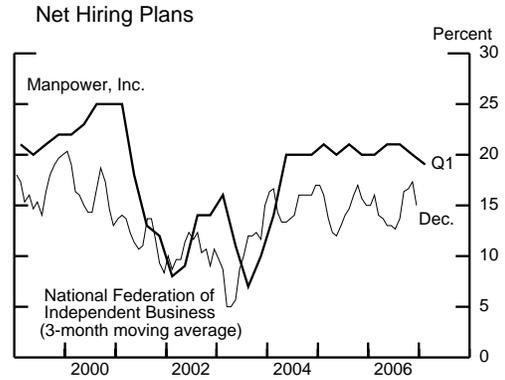


Note. Seasonally adjusted by FRB staff.
 Source. Challenger, Gray, and Christmas, Inc.

Hiring

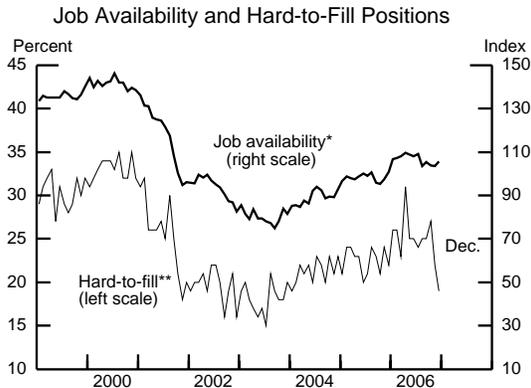


Source. Job Openings and Labor Turnover Survey.



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

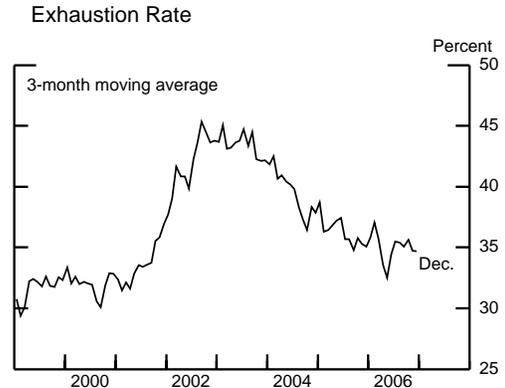
Labor Market Tightness



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

**Percent of small businesses surveyed with at least 1 "hard-to-fill" job opening.

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



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.

In the household survey, the unemployment rate was unchanged in December at 4.5 percent, about 0.2 percentage point lower than its level at the middle of last year.³ The participation rate edged up further and now stands at 66.4 percent, 0.2 percentage point higher than its level at mid-year. A tighter labor market likely induced some individuals who were not in the labor force to take jobs; the gross flow of nonparticipants to employment rose noticeably last year, and these flows appear to have reduced the percentage of the population categorized as out of the labor force but wanting a job.

Other indicators suggest that labor demand has remained solid recently. The four-week moving average of initial claims for unemployment insurance was 308,000 as of mid-January, near its 2006 average, and layoff announcements reported by Challenger, Gray and Christmas remained at a relatively low level at year-end. In addition, job openings, as reported by the BLS, moved up late last year. Net hiring plans, as reported by Manpower and the National Federation of Independent Business (NFIB), have moved lower recently, but they remain in a range consistent with moderate gains in employment.

Other indicators of labor market tightness suggest little has changed in the balance between supply and demand since the middle of 2006. According to the Conference Board, the extent to which individuals view jobs as readily available remained roughly constant over the second half of last year. Similarly, the number of individuals who remain on unemployment insurance rolls until their benefits expire (the exhaustion rate) has changed little, on net, over the past six months. In contrast, the NFIB's measure of hard-to-fill positions suggested that employers saw some loosening in the labor market at the end of last year. However, this series is quite volatile.

Industrial Production

Activity in the industrial sector was soft for several months last fall but firmed in December. Manufacturing output rose 0.7 percent in December after moving down, on

³ The December employment report included revised seasonal factors for labor force series back to January 2002. Revisions to the unemployment rate and the labor force participation rate were small.

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

Component	Proportion 2006 (percent)	2006 ¹	2006		2006		
			Q3	Q4	Oct.	Nov.	Dec.
			Annual rate		Monthly rate		
Total	100.0	3.7	4.0	-5	-1	-1	.4
Previous	100.0	...	4.0	...	.0	.2	...
Manufacturing	80.9	3.5	4.4	-1.4	-.6	.0	.7
Ex. motor veh. and parts	75.0	4.0	5.5	-1.2	-.4	-.3	.6
Ex. high-tech industries	70.3	2.5	4.0	-3.3	-.6	-.4	.4
Mining	9.2	7.7	.6	1.6	.0	-.4	.8
Utilities	9.9	2.4	4.6	4.5	4.6	.2	-2.6
<i>Selected industries</i>							
High technology	4.8	26.3	27.3	31.8	2.2	1.7	2.2
Computers	1.2	14.6	2.3	36.0	2.8	2.9	3.1
Communications equipment	1.1	13.2	6.6	3.6	-.7	.7	-1.7
Semiconductors ²	2.5	37.7	51.3	42.5	3.1	1.4	3.3
Motor vehicles and parts	5.9	-3.6	-9.8	-3.6	-3.7	3.4	2.6
<i>Market groups excluding energy and selected industries</i>							
Consumer goods	21.1	1.4	2.7	.1	.0	-.3	.1
Durables	4.1	-2.0	1.5	-7.9	-1.6	-.5	.7
Nondurables	17.0	2.2	3.0	2.1	.4	-.2	.0
Business equipment	7.2	10.2	13.0	4.1	.2	.6	1.5
Defense and space equipment	1.7	2.7	5.5	-1.2	.1	-1.1	.9
Construction supplies	4.3	-2.3	-1.0	-9.4	-1.1	-1.0	.2
Business supplies	7.9	.8	-.3	-2.3	-.1	-.3	.3
Materials	25.1	2.5	2.3	-6.3	-.9	-.8	.2
Durables	13.6	2.4	2.3	-8.1	-1.0	-1.1	.1
Nondurables	11.5	2.6	2.3	-4.1	-.7	-.4	.3

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

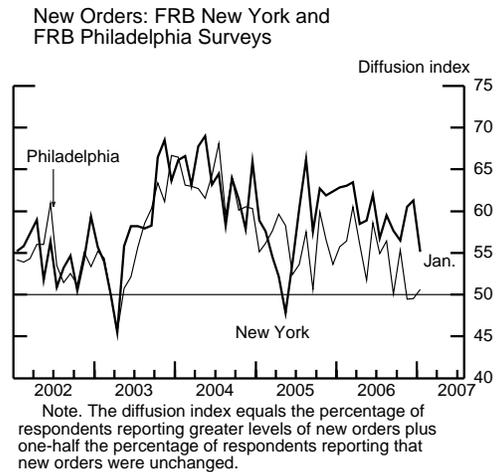
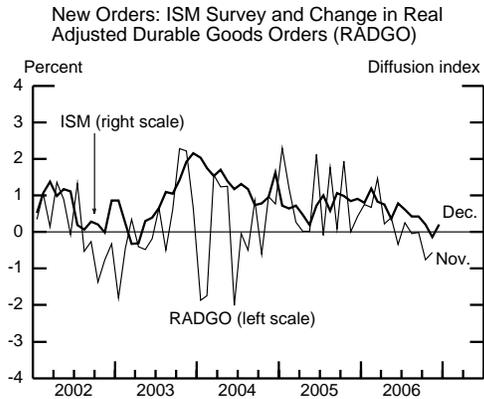
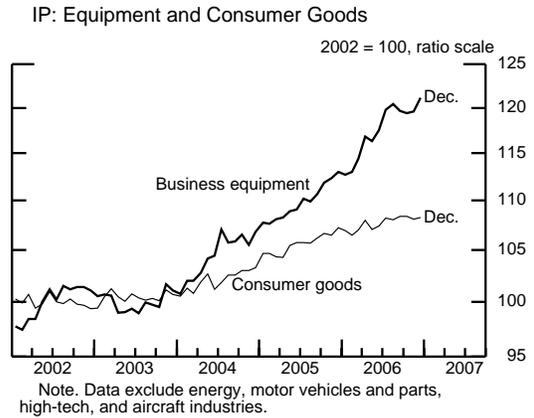
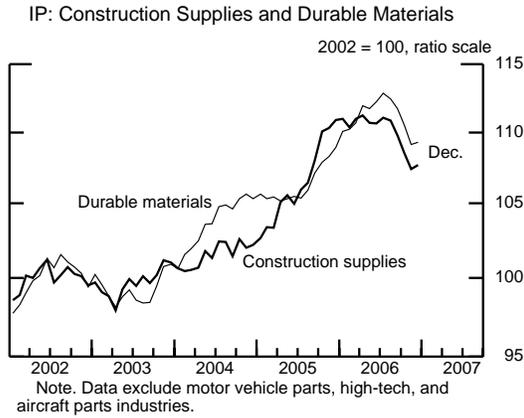
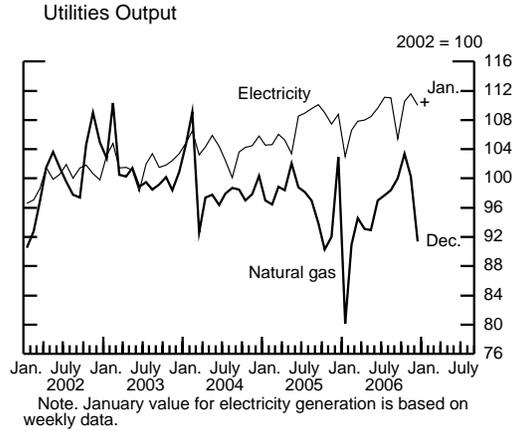
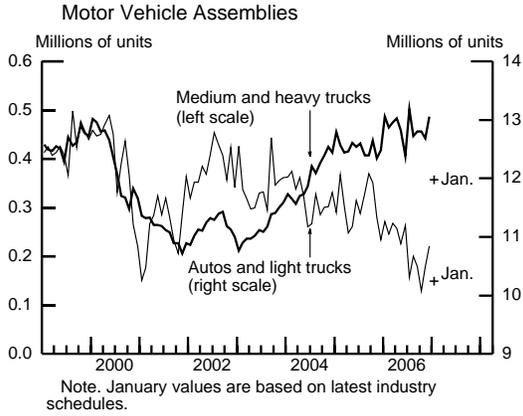
2. Includes related electronic components.

... Not applicable.

Capacity Utilization
(Percent of capacity)

Sector	1972- 2005 average	1994- 95 high	2001- 02 low	2006				
				Q2	Q3	Q4	Nov.	Dec.
Total industry	81.0	85.1	73.6	82.0	82.3	81.7	81.6	81.8
Manufacturing	79.8	84.6	71.6	80.6	80.9	80.2	80.0	80.4
Ex. motor veh. and parts	79.9	84.3	71.4	80.8	81.4	80.6	80.4	80.7
Mining	87.3	88.9	84.8	91.0	90.9	91.0	90.7	91.3
Utilities	86.8	93.7	83.8	85.9	86.4	86.8	87.6	85.1
<i>Stage-of-process groups</i>								
Crude	86.4	89.5	82.0	88.8	89.4	89.1	88.9	89.1
Primary and semifinished	82.2	88.2	74.6	83.9	84.1	82.8	82.7	82.5
Finished	77.8	80.5	70.0	77.6	77.9	78.1	78.1	78.6

Indicators of Industrial Activity



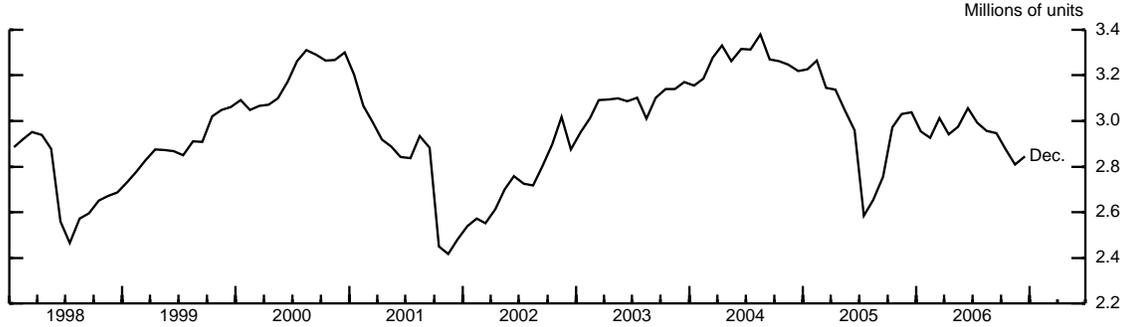
Production of Domestic Light Vehicles
(Millions of units at an annual rate except as noted)

Item	2006			2007	2006	2007		
	Q2	Q3	Q4	Q1	Dec.	Jan.	Feb.	Mar.
U.S. production ¹	11.1	10.5	10.5	10.5	10.8	10.2	10.6	10.7
Autos	4.3	4.3	4.4	4.0	4.4	4.0	4.0	4.1
Light trucks	6.7	6.2	6.1	6.5	6.4	6.3	6.6	6.6
Days' supply ²	75	70	70	n.a.	69	n.a.	n.a.	n.a.
Autos	54	54	60	n.a.	57	n.a.	n.a.	n.a.
Light trucks	90	82	78	n.a.	78	n.a.	n.a.	n.a.
Inventories ³	3.06	2.95	2.84	n.a.	2.84	n.a.	n.a.	n.a.
Autos	.95	.95	1.03	n.a.	1.03	n.a.	n.a.	n.a.
Light trucks	2.10	1.99	1.81	n.a.	1.81	n.a.	n.a.	n.a.
Memo: U.S. production, total motor vehicles ⁴	11.5	11.0	10.9	10.8	11.3	10.6	10.9	11.0

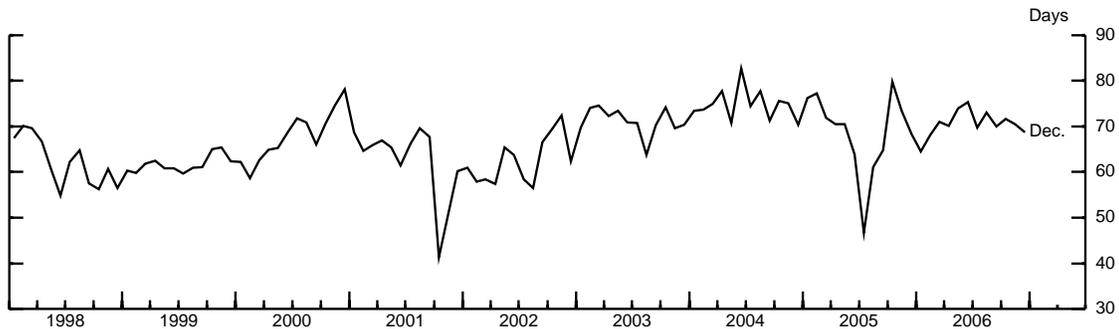
Note. FRB seasonals. Components may not sum to totals because of rounding.

1. Production rates for the first quarter 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



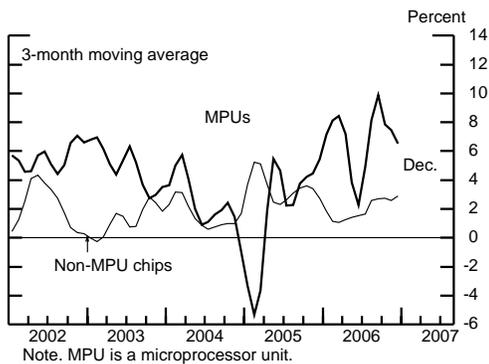
balance, between September and November; for the fourth quarter as a whole, factory output declined at an annual rate of 1.4 percent. Although elevated motor vehicle inventories and the downturn in homebuilding have created a substantial drag on production in some segments of the industrial sector, sizable gains in the output of commercial aircraft and high-tech products continue to provide some offset to that drag. Outside of manufacturing, unseasonably warm weather in December resulted in a sharp cutback in utilities output, which subtracted about ¼ percentage point from the increase in total industrial production. Meanwhile, mining output was boosted last month by an increase in the output of crude oil. Capacity utilization in manufacturing rose 0.4 percentage point in December to 80.4 percent, 0.6 percentage point above its 1972-2005 average.

The pace of light vehicle production remained low in the fourth quarter as automakers continued their efforts to better align inventories with demand.⁴ The effects of these efforts were also felt in industries related to the motor vehicle sector, such as fabricated metal products. As demand maintained a modest pace, days' supply fell from 75 days at the end of the second quarter to around 70 days at the end of the year. Assembly plans for the first quarter of 2007 call for light vehicle production to edge up only slightly from the pace at the end of 2006. In addition, assemblies of medium and heavy trucks are expected to decline about 25 percent (not at an annual rate) in the first quarter. This plunge represents a payback for the bump-up in production that occurred in 2006, in

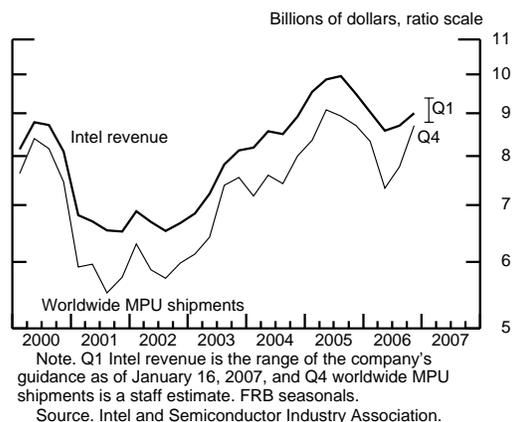
⁴ As mentioned in the December 2006 Greenbook, the Bureau of Economic Analysis (BEA) reported that gross output of new motor vehicles increased at an annual rate of 29 percent in the third quarter, while the industrial production index for motor vehicles excluding parts fell at an annual rate of 17 percent over the same period. This discrepancy appears to have been caused by differences between unit production (on which we rely) and unit sales plus net exports and unit inventory investment (on which the BEA relies) and by large fluctuations in the producer price index for light trucks, which the BEA uses to deflate inventories and sales of trucks to businesses. We believe our estimate of motor vehicle output is more accurate than that of the BEA. Given the most recent data on unit production and prices, we estimate that anomalies in the BEA methodology boosted the contribution of new motor vehicle output to the change in real GDP in the third quarter by about 1 percentage point and will pull down the reported contribution in the fourth quarter by about the same amount.

Indicators of High-Tech Manufacturing Activity

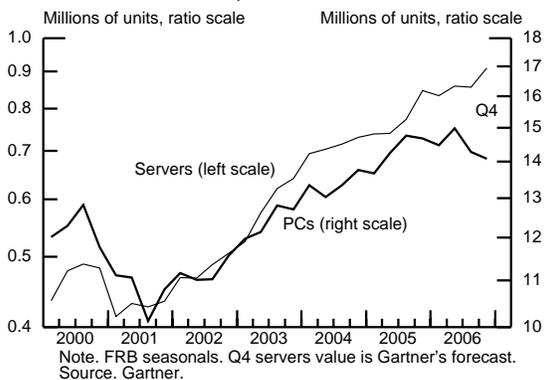
Rate of Change in Semiconductor Industrial Production



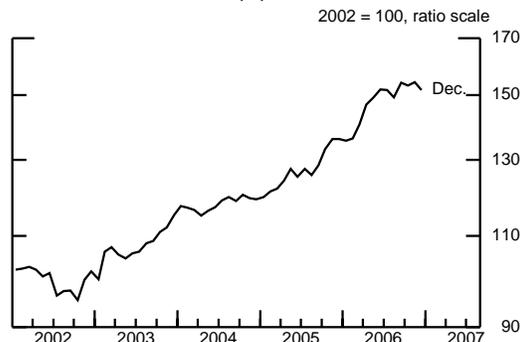
MPU Shipments and Intel Revenue



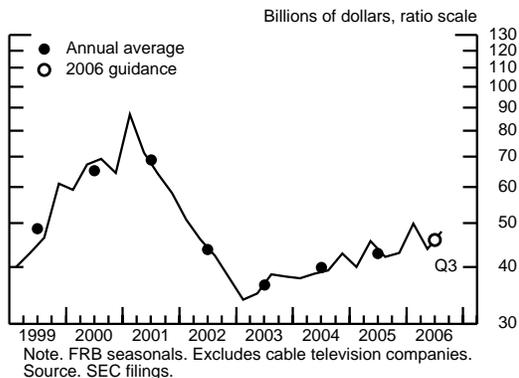
U.S. Personal Computer and Server Sales



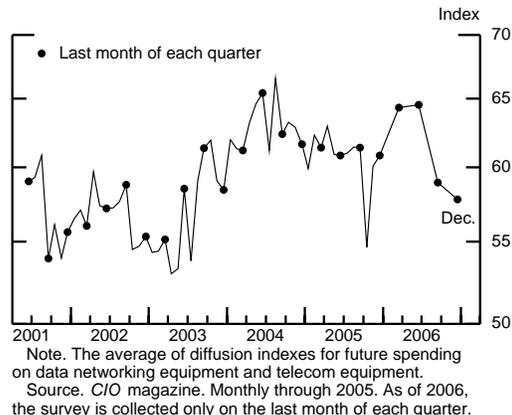
IP: Communications Equipment



Capital Expenditures by Telecommunications Service Providers



CIO Magazine Data Networking Equipment and Telecom Equipment Diffusion Index



advance of the tightening of regulations on emissions by the Environmental Protection Agency (EPA) that took effect on January 1, 2007.⁵

Production in high-technology industries rose more than 30 percent at an annual rate in the fourth quarter, an increase led by robust gains in the output of semiconductors and computers; in contrast, output of communications equipment was soft in the fourth quarter. The expansion of semiconductor output was broadly based. The continued rollout of dual-core chips boosted production of microprocessors, and anticipated demand for computers that are recommended for running Microsoft's new operating system, Vista, pushed up production of memory and graphics chips. The popularity of MP3 players and flat-panel televisions supported production of other types of chips.

The production of computers intended for businesses rose sharply in the fourth quarter. A recent Gartner report that demand for large servers has been strong was corroborated by a jump in fourth-quarter earnings for this product group at both IBM and Sun Microsystems. In contrast, preliminary data from Gartner indicate that PC sales were weak in the fourth quarter, supporting industry anecdotes that consumers have been deferring purchases of new computers until Vista is released.

The production of communications equipment fell nearly 2 percent in December, and production in the fourth quarter as a whole rose at an annual rate of just 3.6 percent. The recent slowing likely reflects, in part, a leveling off of capital spending by telecommunications service providers (TSPs), which had surged earlier in the year. Indicators for the coming year are mixed: The available earnings reports for the TSPs suggest that capital spending, and therefore production, should pick up again in 2007, but the *CIO* magazine diffusion index for future spending on data networking and telecom equipment slipped in December and stood well below its level of early 2006.

⁵ The EPA is tightening emission standards for diesel engines in three stages. The first phase occurred in 2002, the second took effect at the start of this year, and the third is set for 2010. One manufacturer of class 8 vehicles estimates that the new standards add from \$9,000 to \$12,000 to the cost of a new truck.

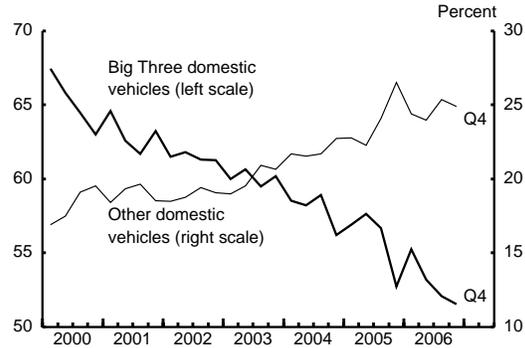
Sales of Light Vehicles
(Millions of units at an annual rate; FRB seasonals)

Category	2006	2006					
		Q2	Q3	Q4	Oct.	Nov.	Dec.
Total	16.5	16.3	16.6	16.3	16.1	16.0	16.7
Autos	7.8	7.8	7.9	7.6	7.3	7.4	8.1
Light trucks	8.7	8.5	8.7	8.6	8.8	8.6	8.6
North American ¹	12.8	12.6	12.8	12.4	12.3	12.2	12.7
Autos	5.4	5.4	5.4	5.2	5.1	5.1	5.6
Light trucks	7.4	7.1	7.4	7.2	7.2	7.2	7.1
Foreign-produced	3.7	3.7	3.7	3.8	3.8	3.8	4.0
Autos	2.3	2.4	2.5	2.4	2.2	2.3	2.5
Light trucks	1.3	1.3	1.3	1.5	1.5	1.4	1.4
Memo: Big Three domestic market share (percent) ²	53.7	53.9	52.8	52.3	53.7	52.0	51.2

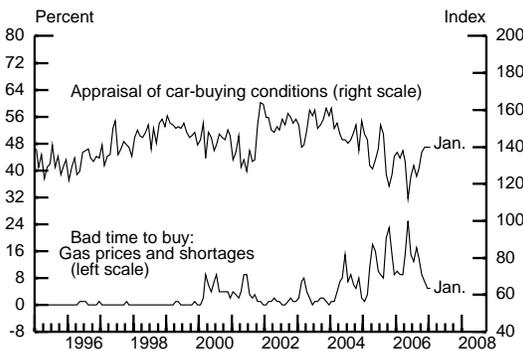
Note. Components may not sum to totals because of rounding.
 1. Excludes some vehicles produced in Canada that are classified as imports by the industry.
 2. Domestic market share excludes sales of foreign brands affiliated with the Big Three.

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Market Share

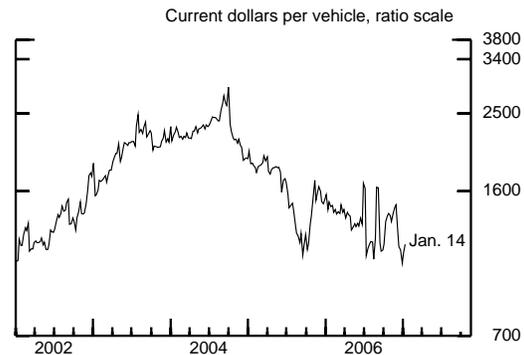


Car-Buying Attitudes



Source. Reuters/University of Michigan Survey.

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.

Outside of energy, motor vehicles and parts, and high-technology, production rose 0.4 percent in December after three consecutive months of decline. Cutbacks in construction activity were felt in industries such as construction supplies, other durable materials, and construction machinery. Elsewhere, output also has softened somewhat in recent months. In particular, the production of business equipment decelerated considerably in the fourth quarter as a whole, although it did jump in December.⁶

The indicators of near-term manufacturing activity, though mixed, ticked up on balance in December and point to modest gains in production in coming months. On the downside, the three-month moving average of the staff's series of real adjusted durable goods orders, which was little changed in the third quarter, declined in October and fell 0.6 percent in November. In contrast, the diffusion index of new orders from the Institute for Supply Management (ISM) moved back up to a bit above 50 in December after having fallen below this level in November for the first time in about 3½ years. The early readings on new orders in January from the regional Federal Reserve surveys were mixed; the Empire State survey deteriorated a bit in January, while the Philadelphia Business Outlook survey improved. However, the responses in both surveys were consistent with continued modest gains in the near term. Finally, the weekly physical data available for first part of January appear, on balance, to suggest a small boost to industrial production for the month.

Light Motor Vehicles

Sales of light motor vehicles jumped 700,000 units in December to an annual rate of 16.7 million units. Sales averaged 16.3 million units for the fourth quarter as a whole, about 300,000 units below the pace for the third quarter.

⁶ Farm machinery producers are reportedly building up stocks of tractors and related harvesting equipment in anticipation of an increase in orders early next year related to anticipated expansion of corn harvests for the production of ethanol.

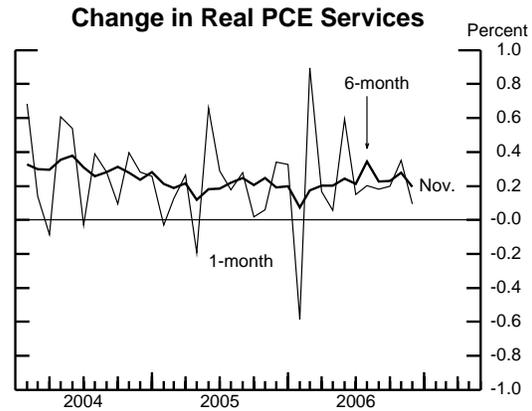
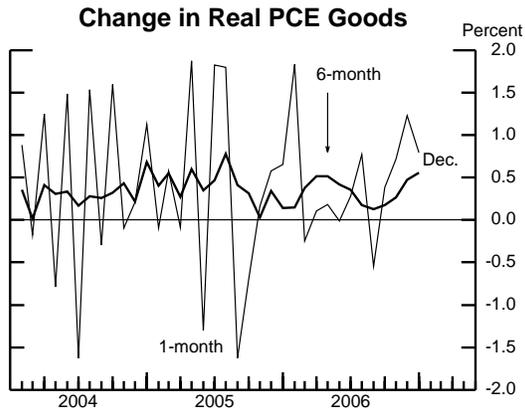
Retail and Food Services Sales

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

Category	2006					
	Q2	Q3	Q4	Oct.	Nov.	Dec.
	Annual rate			Monthly rate		
Total sales	3.3	3.7	.3	-.2	.6	.9
Retail control ¹	8.1	3.7	.1	-.4	.8	1.3
Ex. sales at gasoline stations	4.9	5.6	5.6	.2	.5	.9
Memo:						
Real PCE control ²	1.0	1.9	8.0	.7	1.1	.6

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

2. Total goods spending excluding autos and trucks. Values for October, November, and December are staff estimates.



Note. Values for October, November, and December are staff estimates.

Personal Saving Rate



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

The loss of these sales contributed to the decline in the domestic market share of the Big Three, which edged down in the fourth quarter.

Looking ahead, preliminary sales data from the transplants suggest that sales of light motor vehicles in January have been about in line with the pace in December despite a sharp decline in incentives. The preliminary release of the Reuters/University of Michigan index indicated that car-buying attitudes were unchanged over the first half of January; however, they were at a level well above the figures observed this past summer, and respondents were less concerned about gasoline prices. The Conference Board survey in December (not shown) indicated that the number of respondents who plan to buy a new vehicle over the next six months rose for the first time since last August.

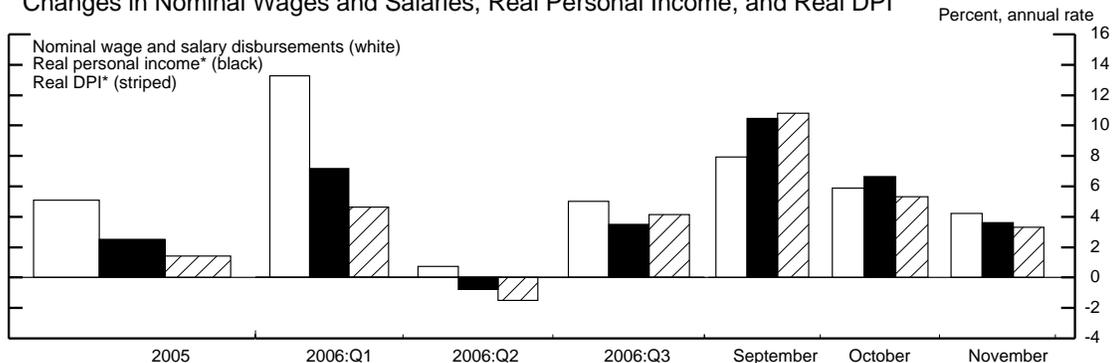
Consumer Spending

Real PCE appears to have moved up at a robust pace last quarter, with notable strength in spending on consumer goods. Nominal outlays for goods in the control group of retail stores, which excludes auto dealerships and building material and supply stores, rose 1.3 percent in December after an increase of 0.8 percent in November. Factoring in our projection of PCE prices, we estimate that real spending on goods excluding motor vehicles rose a robust 0.6 percent in December after sizable increases in each of the previous three months. We estimate that real spending on PCE goods increased at an annual rate of 7¾ percent in the fourth quarter. Real spending on services, in contrast, increased only 0.1 percent in November, the most recent month for which data are available; warmer-than-normal temperatures led to a drop in real outlays for energy services in November and are likely to have damped expenditures in that category again in December.

Indicators of spending in January have been generally favorable. Anecdotal evidence and weekly data on chain store sales suggest that consumer spending on goods other than

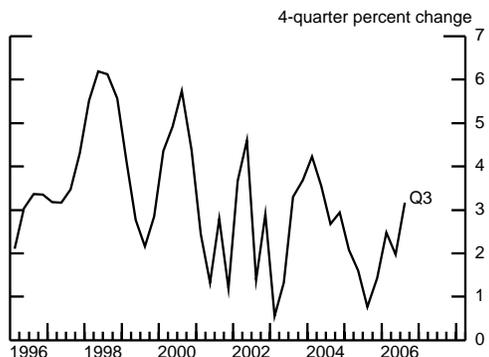
Fundamentals of Household Spending

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



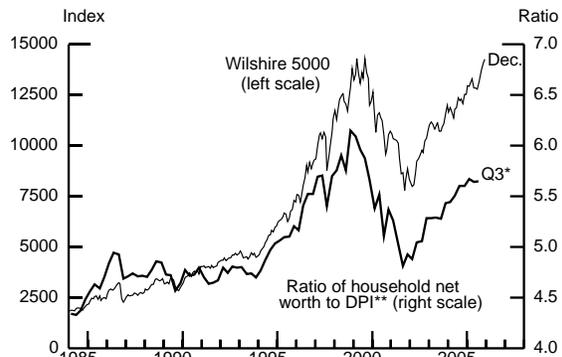
* The value for 2005 is a Q4-to-Q4 percent change and excludes the effect on income of the one-time Microsoft dividend in December 2004.

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.

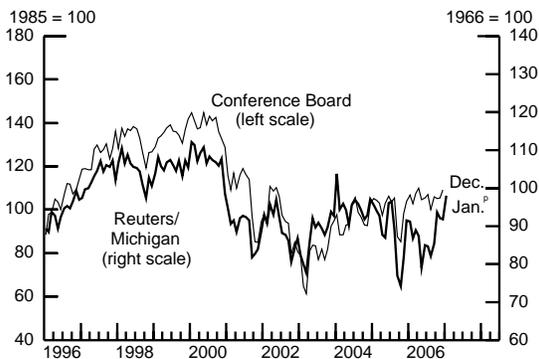
Household Net Worth and Wilshire 5000



* Value for 2006:Q3 is a staff forecast.

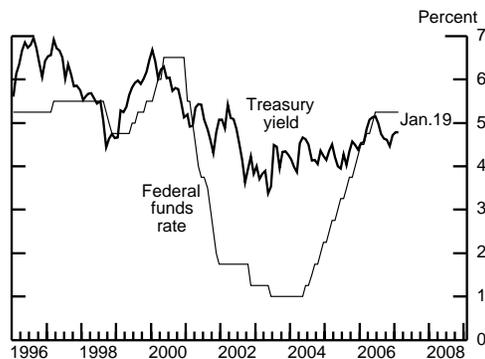
** The value for 2004:Q4 excludes the effect on income of the one-time Microsoft dividend in December 2004.

Consumer Confidence



p Preliminary.

Federal Funds Rate and 10-Year Treasury Yield



motor vehicles has been well maintained. In addition, the most recent readings on consumer sentiment are at a level consistent with strong gains in spending.

The fundamental determinants of spending have been mostly positive. Real disposable personal income posted solid gains in October and November, reflecting increases in wages and salaries and further declines in energy prices. Nonetheless, the saving rate moved down $\frac{1}{4}$ percentage point in November, to negative 1 percent.

Consumer spending has continued to draw support from the increases in household wealth that have taken place over the past two years. Although house prices appear to have decelerated further since the end of the third quarter, robust gains in the stock market at the end of 2006 likely implied a small uptick in the wealth-income ratio for the household sector. The boost to consumer spending from wealth has likely been muted by the lagged effects of the upward trend in borrowing costs over the past few years.

Housing

Single-family starts declined 4 percent in December, reversing about half of November's increase. However, adjusted permit issuance in this sector—which is often a more reliable indicator of the underlying pace of construction activity than are starts—edged up to an annual rate of 1.20 million units after having moved down steadily for the preceding 10 months.⁷ Starts in the much smaller multifamily sector rose sharply in December to the upper end of the range that has prevailed since 1995.

Home sales have been fairly stable since July after having fallen precipitously over the preceding twelve months. In November, sales of existing single-family homes were about unchanged from October at an annual rate of 5.5 million units, while new home sales, which dipped in October, rebounded to an annual rate of about 1.1 million units. After having fallen sharply over the preceding year, the index of pending home sales—an

⁷ Unseasonably warm weather in December across much of the country may have boosted starts a bit last month but likely had a smaller effect on permits.

Private Housing Activity

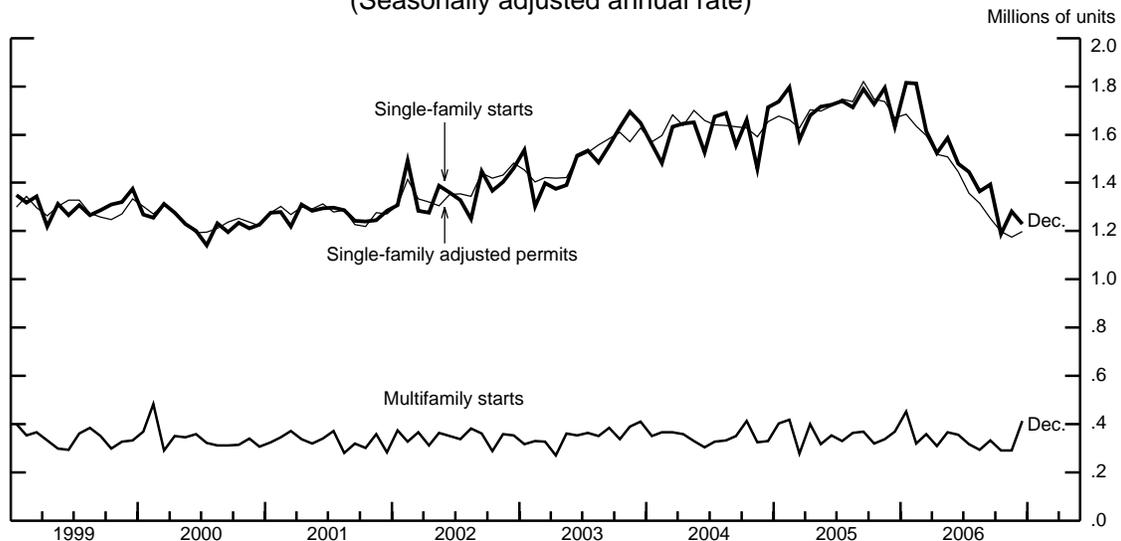
(Millions of units, seasonally adjusted; annual rate except as noted)

Sector	2006	2006					
		Q2	Q3	Q4	Oct.	Nov.	Dec.
<i>All units</i>							
Starts	1.80	1.87	1.71	1.56	1.48	1.57	1.64
Permits	1.83	1.93	1.71	1.55	1.55	1.51	1.60
<i>Single-family units</i>							
Starts	1.46	1.53	1.40	1.23	1.19	1.28	1.23
Permits	1.38	1.46	1.28	1.17	1.18	1.15	1.16
Adjusted permits ¹	1.41	1.49	1.31	1.19	1.20	1.17	1.20
Permit backlog ²	.131	.156	.137	.131	.142	.137	.131
<i>New homes</i>							
Sales	n.a.	1.10	1.02	n.a.	1.01	1.05	n.a.
Months' supply ³	n.a.	6.17	6.69	n.a.	6.55	6.25	n.a.
<i>Existing homes</i>							
Sales	n.a.	5.86	5.48	n.a.	5.51	5.52	n.a.
Months' supply ³	n.a.	6.14	7.02	n.a.	7.03	6.88	n.a.
<i>Multifamily units</i>							
Starts	.337	.343	.313	.331	.291	.290	.412
Permits	.456	.466	.433	.389	.372	.363	.432
Permit backlog ²	.062	.068	.067	.062	.066	.065	.062
<i>Mobile homes</i>							
Shipments	n.a.	.122	.107	n.a.	.098	.096	n.a.
<i>Condos and co-ops</i>							
Existing home sales	n.a.	.828	.796	n.a.	.734	.757	n.a.

- Adjusted permits equal permit issuance plus total starts outside of permit-issuing areas.
 - Number outstanding at end of period. Excludes permits that have expired or have been canceled, abandoned, or revoked. Not at an annual rate.
 - 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.
- n.a. Not available.

Private Housing Starts and Permits

(Seasonally adjusted annual rate)



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

indicator of future sales of existing homes—was about flat, on balance, from July to November. The four-week moving average of the index of mortgage purchase applications moved up sharply over the same period and accelerated further in December and January. In addition, the Reuters/University of Michigan index of homebuying sentiment (not shown) has moved up a fair bit since September. These improved conditions are, in part, the result of a decline in mortgage rates: Despite the uptick in rates in January, the average rate for thirty-year fixed-rate mortgages is now 50 basis points below the level of last July, while average rates for one-year adjustable-rate mortgages are down about 30 basis points.

Despite the apparent stabilization of housing demand, the months' supply of new homes for sale in November was still 30 percent above the upper bound of the relatively narrow range it occupied from 1997 to 2005.

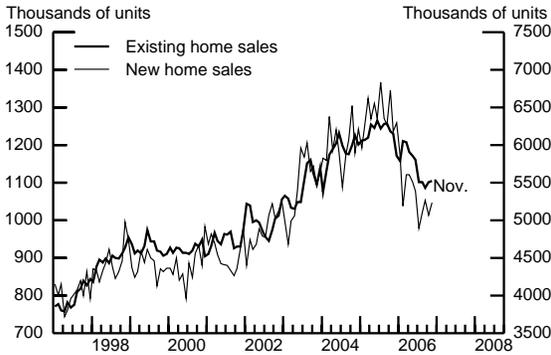
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8

House-price appreciation has slowed markedly in recent quarters, with some measures even showing 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, continuing the deceleration that began in mid 2005. The Case-Shiller home-price index, which uses a similar methodology to the OFHEO index but is limited to sales in ten large U.S. cities,

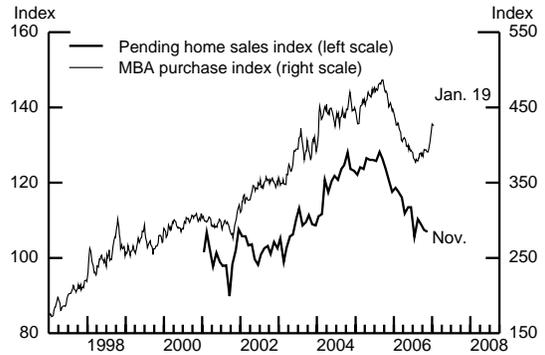
Indicators of Single-Family Housing

Home Sales



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

Homebuying Indicators



Note. Purchase index is a 4-week moving average and is seasonally adjusted by FRB staff.
Source. For pending home sales, National Association of Realtors; for purchase index, Mortgage Bankers Assoc.

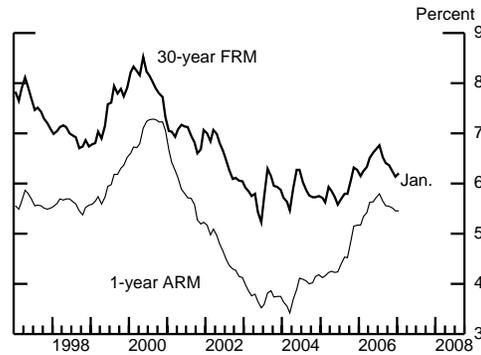
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New Home Sales Months' Supply



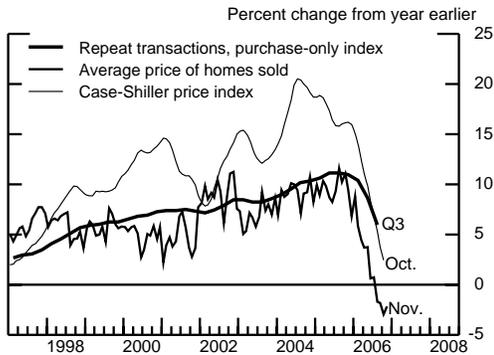
Note. Months' supply is calculated using the 3-month moving average of sales.
Source. ; for months' supply, Census Bureau.

Mortgage Rates



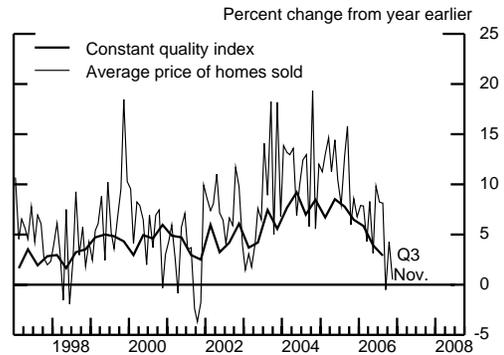
Note. The January readings are based on data through January 17, 2007.
Source. Freddie Mac.

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.

also decelerated sharply over the same period.⁹ More recently, the average price of existing homes sold—which is available on a timelier basis than are the other price measures—posted an outright decline in November relative to the previous year. However, because the measure does not adjust for changes in the average characteristics of homes sold, the declines might reflect a shift in the composition of sales away from higher-end homes. Readings of new home price appreciation have been volatile in the past few months, partly because of changes in the geographic composition and average quality of homes sold. However, on a constant-quality basis, seasonally adjusted new home prices were essentially flat in the third quarter. Yet even this soft reading may be overstated because homebuilders have been granting more-favorable mortgage terms, paying closing costs, offering optional upgrades at no cost, and taking other steps to bolster sales and unload inventory.

Equipment and Software

Real spending on equipment and software appears to have fallen in the fourth quarter after having risen at a solid pace in the previous quarter. The drop was concentrated in the volatile transportation equipment category, but expenditures on equipment outside of the high-tech and transportation sectors also appear to have declined in the fourth quarter. The modest slowdown in the growth of business output during 2006 was broadly consistent with a slowdown in overall outlays for equipment and software. In addition, the index of manufacturing-sector activity from the ISM and the index for general activity from the Philadelphia Fed's Business Outlook Survey both suggest that business sentiment has deteriorated on balance since last summer. However, changes in other fundamentals of business spending, such as the continued decline in the cost of capital for high-tech goods and robust real corporate cash flow, will likely continue to support

⁹ Unlike the OFHEO index, which captures only sales backed by conforming mortgage loans, the Case-Shiller index reflects all arms-length sales transactions in the included cities. 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. A new, twenty-city version of the Case-Shiller index, formed using the same methodology as the ten-city index, was unveiled in December. This monthly index is available only from 2000 onward, and its rate of appreciation over this limited sample is similar to that of the ten-city index.

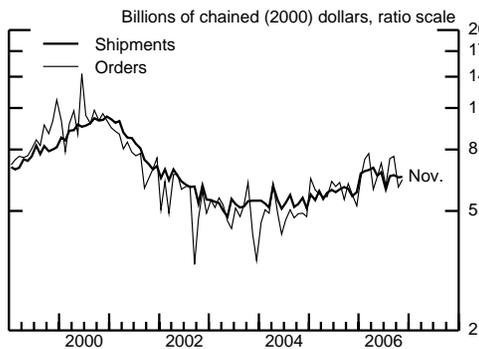
Orders and Shipments of Nondefense Capital Goods

(Percent change; seasonally adjusted current dollars)

Category	2006				
	Q2	Q3	Sept.	Oct.	Nov.
	Annual rate		Monthly rate		
Shipments	5.2	9.9	-.4	-2.3	1.8
Excluding aircraft	5.8	6.9	-1.6	-1.5	2.0
Computers and peripherals	-18.7	25.6	-6.4	-22.9	31.1
Communications equipment	1.0	-21.7	1.1	-2.0	.6
All other categories	10.1	8.3	-1.3	1.2	-.6
Orders	4.6	27.2	24.6	-14.4	-1.1
Excluding aircraft	3.7	14.6	3.1	-4.0	-1.1
Computers and peripherals	-13.2	24.3	1.0	-23.7	32.2
Communications equipment	-31.7	35.7	2.1	-21.3	6.1
All other categories	11.1	11.4	3.5	.3	-4.8
Memo: Shipments of complete aircraft ¹	32.9	34.8	38.8	34.4	34.2

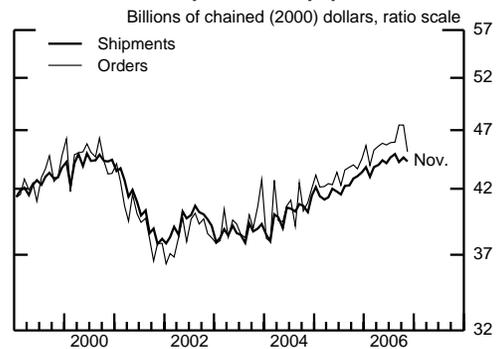
1. From Census Bureau, Current Industrial Reports; billions of dollars, annual rate.

Communications Equipment



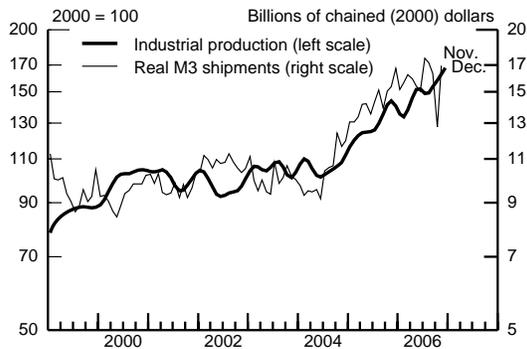
Note. Shipments and orders are deflated by a price index that is derived from the BEA's quality-adjusted price indexes and uses the PPI for communications equipment for monthly interpolation.

Non-High-Tech, Nontransportation Equipment



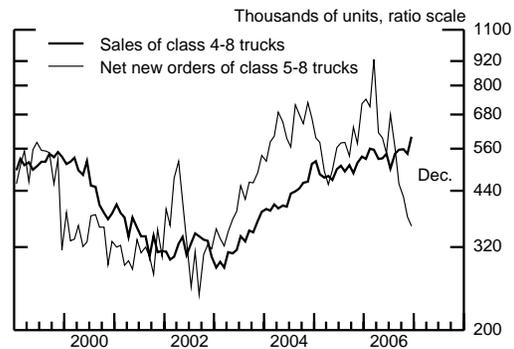
Note. Shipments and orders are deflated by the staff price indexes for the individual equipment types included in this category. Indexes are derived from the BEA's quality-adjusted price indexes.

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.

increases in business spending. The diffusion index of capital spending plans in the ISM semiannual report (released in December) suggests that manufacturers plan to increase capital expenditures in 2007 at about the same rate as in 2006.

Business spending on transportation equipment appears to have declined considerably in the fourth quarter.

business outlays on aircraft are likely to have dropped for a third consecutive quarter.¹⁰ In contrast, sales of medium and heavy trucks (classes 4 through 8) surged to a record-high annual rate of 600,000 units in December after having maintained high levels all year. Much of the strength in truck demand likely reflected the change in EPA regulations on truck engine emissions, which pulled some sales into 2006. Now that the new regulations are in effect, production and sales are expected to recede considerably this quarter; indeed, new orders for medium and heavy trucks fell sharply at the end of the year.

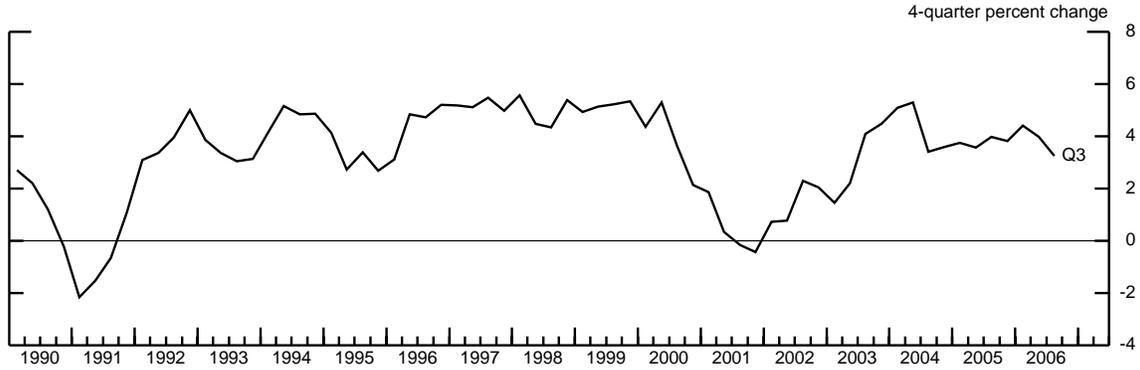
Investment in high-tech capital goods likely posted subpar growth in the fourth quarter. For computing equipment, the level of nominal shipments in November was only a little above the third-quarter average, a sign that real spending for the fourth quarter as a whole will be modest. Weak nominal shipments of communications equipment in October and November point to a deceleration in spending in the fourth quarter as a whole from the brisk pace seen earlier in the year.

Outside of high-tech and transportation, business outlays appear to have declined in the fourth quarter. Domestic shipments have been fairly flat, on balance, in recent months, and imports of these goods have been quite weak. Orders fell sharply in November, largely because of a drop in orders in construction-related industries such as construction machinery and heating and ventilation equipment, in which bookings had been running

¹⁰ Shipments of aircraft from domestic producers to foreign airlines were robust in October and November, but domestic expenditures remained weak.

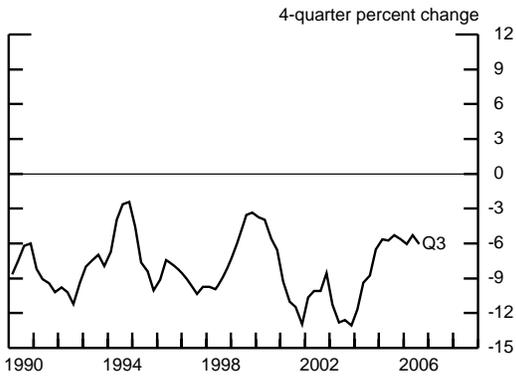
Fundamentals of Equipment and Software Investment

Real Business Output

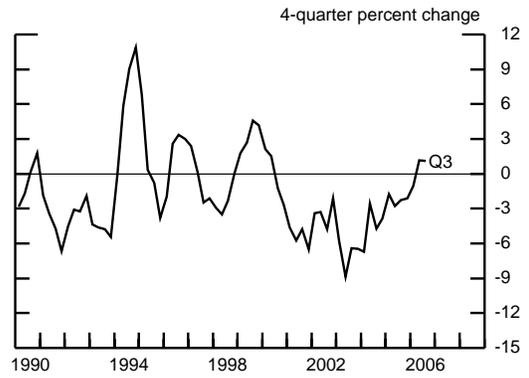


User Cost of Capital

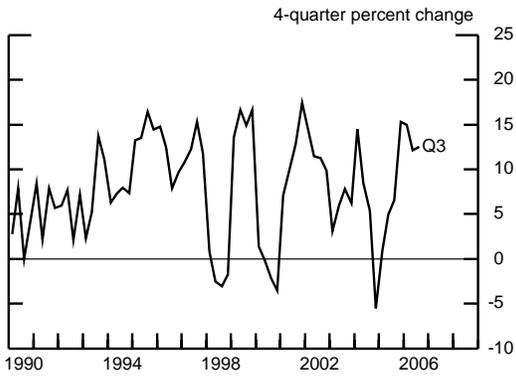
High-Tech



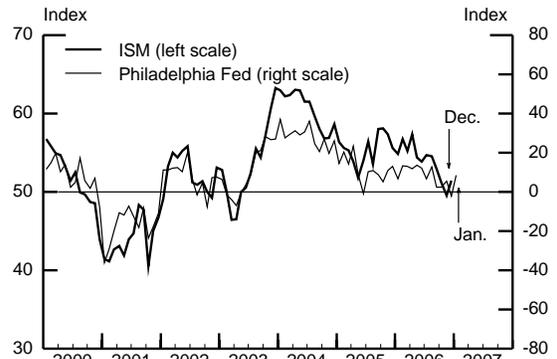
Non-High-Tech



Real Corporate Cash Flow



Business Sentiment



Source: Manufacturing ISM Report on Business;
Philadelphia Fed Business Outlook Survey.

unusually high relative to shipments. Nonetheless, the backlog of unfilled orders remains sizable—a situation that bodes well for shipments in the coming months.

Nonresidential Construction

The available data through November suggest that investment in nonresidential structures decelerated late last quarter after robust increases in the first three quarters of 2006. Nonetheless, fundamentals in the sector remain solid: Vacancy rates in the office and industrial categories have moved down steadily over the past few years and are now somewhat below their historic averages. The vacancy rate in the retail sector has remained at a low level since 2000.¹¹ In addition, the architectural billings index—which is correlated with changes in nonresidential construction at a lead time of about six months—has rebounded in recent months after having dipped substantially last spring.¹²

Drilling and mining activity, which soared over the first half of 2006, has decelerated. In the third quarter, real expenditures on drilling and mining structures rose at an annual rate of 10 percent, down from an increase of nearly 30 percent in the second quarter. The total number of drilling rigs in operation has tracked sideways, on net, since September, which suggests that spending growth in this sector has slowed in recent months. This deceleration may in part reflect the decline in energy prices since last summer and the drag on activity from short-term bottlenecks in equipment and skilled labor.

Business Inventories

Real nonfarm inventory investment excluding motor vehicles was slightly higher in the third quarter than in the second quarter. Our interpretation of the book-value data

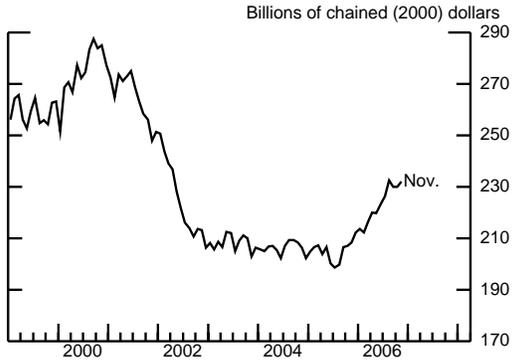
¹¹ In this Greenbook, we have switched measures of vacancy rates—from those produced by Costar to those produced by the National Council of Real Estate Investment Fiduciaries (NCREIF). The NCREIF measures have registered steeper declines in recent years than those from Costar, but the two measures are currently at similar levels.

¹² About 88 percent of the construction projects covered by the architectural billings index are nonresidential.

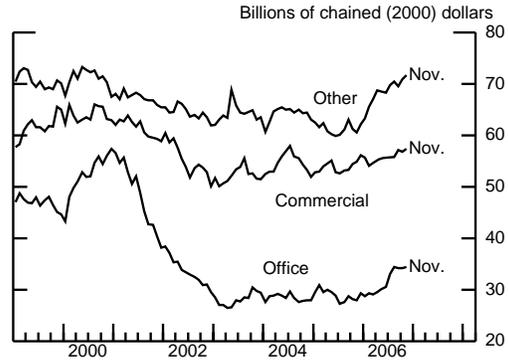
Nonresidential Construction and Indicators

(All spending series are seasonally adjusted at an annual rate; nominal CPIP deflated by BEA prices through Q3 and by staff projection thereafter)

Total Structures

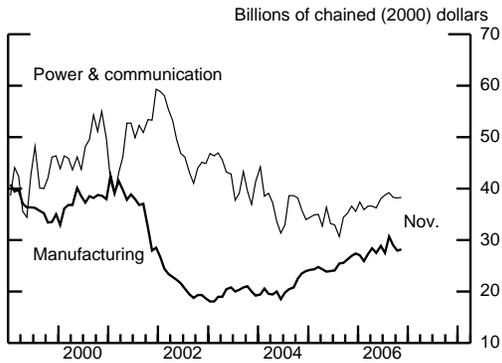


Office, Commercial, and Other

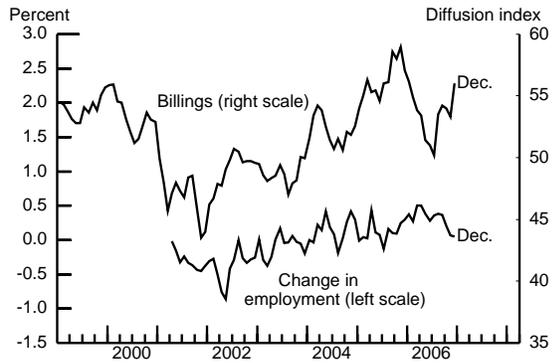


Note. Other includes religious, educational, lodging, amusement and recreation, transportation, and health-care facilities.

Manufacturing and Power & Communication

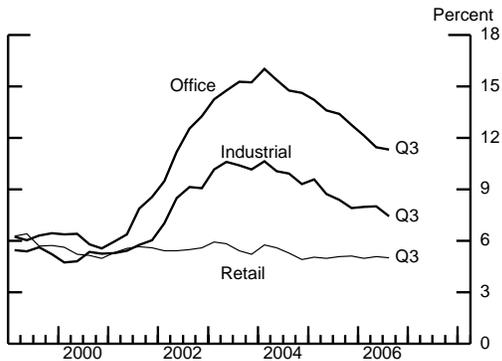


Architectural Billings and Nonresidential Construction Employment



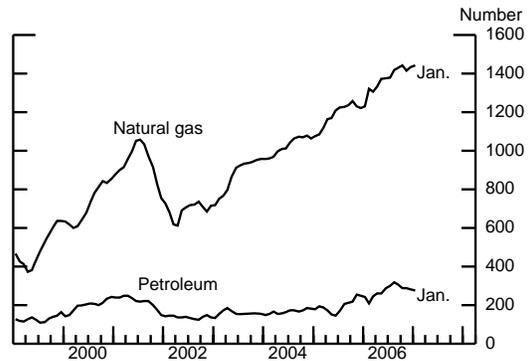
Note. Both series are 3-month moving averages. Employment includes industrial, commercial, and specialty trade construction. Source. For billings, American Institute of Architects; for employment, Bureau of Labor Statistics.

Vacancy Rates



Note. Industrial space includes both manufacturing structures and warehouses. Source. National Council of Real Estate Investment Fiduciaries.

Drilling Rigs in Operation



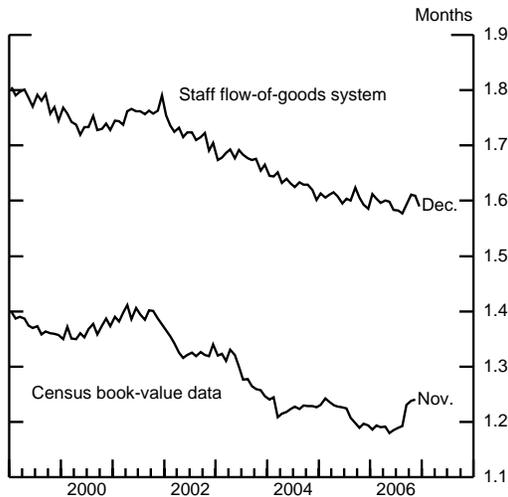
Note. January values are averages through Jan. 19, 2007. Source. DOE/Baker Hughes.

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

Measure and sector	2006					
	Q1	Q2	Q3	Sept.	Oct.	Nov.
<i>Real inventory investment (chained 2000 dollars)</i>						
Total nonfarm business	36.8	52.2	53.3	n.a.	n.a.	n.a.
Motor vehicles	8.5	3.0	-8	n.a.	n.a.	n.a.
Nonfarm ex. motor vehicles	28.3	49.2	54.2	n.a.	n.a.	n.a.
Manufacturing and trade ex. wholesale and retail motor vehicles and parts	22.7	36.3	45.2	52.2	25.1^e	n.a.
Manufacturing	7.6	11.0	10.1	19.4	8.9 ^e	n.a.
Wholesale trade ex. motor vehicles & parts	7.9	18.4	25.7	24.4	7.9 ^e	n.a.
Retail trade ex. motor vehicles & parts	7.2	6.9	9.4	8.3	8.3 ^e	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	91.9	65.7	42.7	81.5
Manufacturing	23.5	48.3	37.2	35.4	18.7	13.0
Wholesale trade ex. motor vehicles & parts	17.9	43.2	40.8	22.3	15.7	58.4
Retail trade ex. motor vehicles & parts	12.0	17.5	13.9	7.9	8.3	10.1

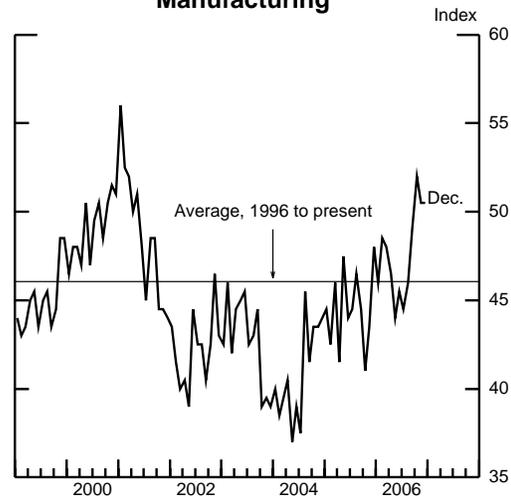
^e Staff estimate of real inventory investment based on revised book-value data.
n.a. Not available.
Source. For real inventory investment, BEA; for book-value data, Census Bureau.

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-December			12 months ending in December		
	2005	2006	Percent change	2005	2006	Percent change
Outlays	649.6	653.9	.7	2518.1	2659.2	5.6
Financial transactions ¹	-.1	-13.3	...	-1.0	-14.2	...
Payment timing ²	-1.2	5.0	...	-.7	-9.2	...
Adjusted outlays	650.9	662.1	1.7	2519.8	2682.5	6.5
Receipts	530.2	573.5	8.2	2196.4	2450.0	11.5
Payment timing	.0	.0	...	.0	-6.0	...
Adjusted receipts	530.2	573.5	8.2	2196.4	2456.0	11.8
Surplus or deficit (-)	-119.4	-80.4	...	-321.8	-209.2	...
<i>Selected components of adjusted outlays and receipts</i>						
Adjusted outlays	650.9	662.1	1.7	2519.8	2682.5	6.5
Net interest	57.0	52.1	-8.6	196.3	221.7	13.0
Non-interest	593.8	610.0	2.7	2323.5	2460.8	5.9
National defense	125.1	140.3	12.1	496.4	539.6	8.7
Social Security	132.4	140.6	6.2	529.7	562.8	6.2
Medicare	72.6	90.4	24.5	297.3	357.3	20.2
Medicaid	46.7	45.5	-2.5	183.4	179.5	-2.1
Income security	77.5	78.4	1.1	346.2	354.5	2.4
Agriculture	19.4	15.6	...	31.0	27.0	-12.8
Other	120.1	99.2	-17.4	439.5	440.2	.2
Adjusted receipts	530.2	573.5	8.2	2196.4	2456.0	11.8
Individual income and payroll taxes	403.2	433.3	7.5	1695.0	1866.6	10.1
Withheld + FICA	391.9	413.5	5.5	1510.5	1612.1	6.7
Nonwithheld + SECA	21.9	29.9	36.4	364.9	440.4	20.7
Less: Refunds	10.6	14.6	38.1	180.4	190.4	5.5
Corporate	80.7	98.8	22.5	294.6	372.0	26.3
Gross	89.7	106.4	18.6	322.2	397.6	23.4
Less: Refunds	9.0	7.6	-15.9	27.6	25.6	-7.4
Other	46.3	41.4	-10.6	206.8	217.4	5.1
Adjusted surplus or deficit (-)	-120.7	-88.6	...	-323.4	-226.5	...

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

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

2. A shift in payment timing occurs when the first of the month falls on a weekend or holiday, or when the first 3 days of a month are nonworking days. Outlays for defense, Social Security, Medicare, income security, and "other" have been adjusted to account for these shifts. In addition, defense outlays for retiree health care have been converted from an annual to a monthly basis.

... Not applicable.

Source. Monthly Treasury Statement.

through November, adjusted for changes in inventory acquisition costs, suggests that the rate of stockbuilding was about unchanged in the fourth quarter.

Business inventories appear to be somewhat elevated relative to sales. The November book-value ratio of inventories to sales for the manufacturing and trade category (excluding motor vehicles) was near its highest level since February 2005. Although many of the industries with elevated inventory-sales ratios in the book-value data are associated with the homebuilding and motor vehicles sectors, imbalances have more recently begun to appear in a few other sectors as well. The staff's flow-of-goods inventory system also suggests that inventories are elevated, though not to the same extent as implied by the Census data; industries that supply the troubled homebuilding and motor vehicle sectors accounted for most of the increase.

For the third month in a row, the ISM index on customers' inventories in manufacturing in December remained above 50, a level indicating that the number of purchasing managers viewing such inventories as too high exceeds the number viewing them as too low. That said, about two-thirds of respondents still consider their customers' inventory levels appropriate.

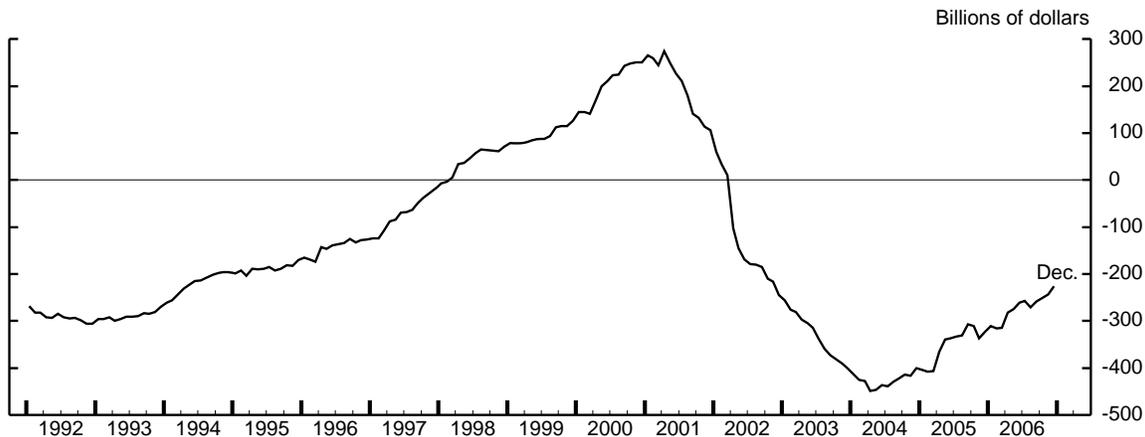
Federal Government Sector

The federal unified budget improved further during the fourth quarter, as outlays decelerated significantly and receipts slowed only a bit; however, a portion of the slowing in outlays reflected temporary factors. Outlays in the fourth calendar quarter were about unchanged from their year-earlier level, a significant deceleration from the rates of increase posted over the past couple of years. However, outlays were held down by transitory factors such as \$13 billion in proceeds from electromagnetic spectrum auctions and delays in spending arising from failure to complete the fiscal 2007 appropriations

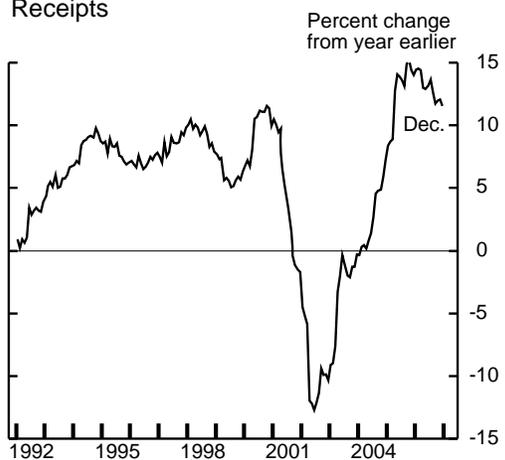
Unified Budget

(Adjusted for payment-timing shifts; all panels based on 12-month moving sum)

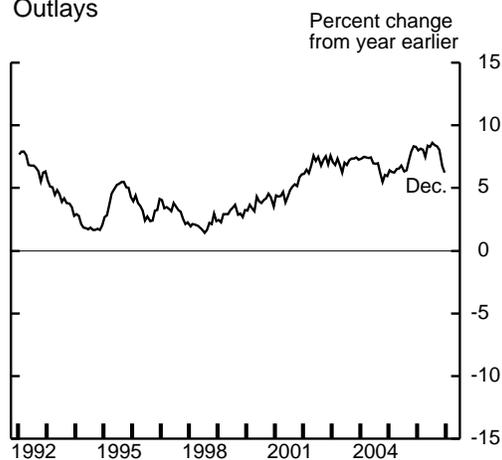
Surplus



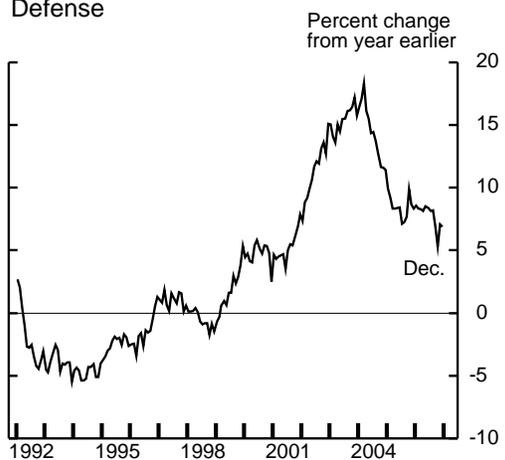
Receipts



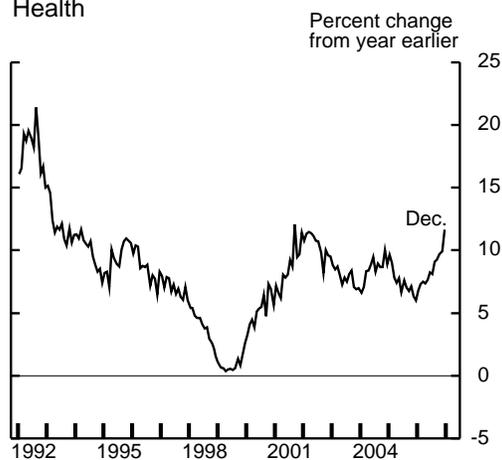
Outlays



Defense



Health



Note. Surplus, outlays, and defense data exclude Defense Cooperation Account and deposit insurance. Health data include Medicaid and Medicare outlays.

bills.¹³ In addition, recent low readings on the consumer price index (CPI) caused low financing costs to be recorded for Treasury inflation-protected securities; spending related to the 2005 hurricane season has tailed off; and Medicaid outlays continue to be unusually subdued.¹⁴ In contrast, defense spending picked up in the fourth quarter and points to a sizable increase in real NIPA defense purchases from the third-quarter level.

Receipts in the fourth calendar quarter were 8 percent above the year-earlier level, a somewhat smaller gain than that recorded over the past two years. The rate of increase in corporate income tax payments slowed over the period but still rose a hefty 22 percent over the past year. Collections have been running ahead of overall profit growth over the past several years, a development that may reflect factors such as changes in the distribution of profits toward firms with positive tax liabilities, a decline in loss carryforwards, and increased corporate capital gains realizations. Individual income tax collections rose 7½ percent, an increase paced by large gains in nonwithheld tax collections. New tax data from the Congressional Budget Office (CBO) indicate that individual capital gains realizations surged in 2005 and were nearly double the 2003 level. Payments on these liabilities likely contributed to the tax surprises in 2005 and 2006.

In December the Congress passed a continuing resolution to fund the government through February 15 because only two of the twelve regular appropriations bills had been completed. The new Congress has yet to take up these appropriations bills, and press reports suggest that a continuing resolution for the balance of the year may be in the offing. The House passed a PAYGO rule that would place some restrictions on tax and mandatory spending bills that increase the deficit over periods of five to ten years; the Senate is expected to pass a similar rule that would probably put more bite on the actual

¹³ Asset sales are recorded as negative entries on the outlays side of the budget.

¹⁴ These expenditures have been even lower than can be explained by the shift in spending for prescription drugs from Medicaid to Medicare.

CBO Budget Projections and Economic Assumptions

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Baseline budget projections¹ (fiscal years)	Billions of dollars										
Total surplus	-172	-98	-116	-137	-12	170	159	185	208	192	249
On-budget	-357	-299	-332	-367	-258	-85	-101	-79	-57	-72	-10
Off-budget	185	201	216	230	246	255	261	264	265	264	259
Adjusted budget (fiscal years)											
Adjusted surplus	-207	-216	-213	-218	-232	-164	-222	-236	-258	-323	-322
Total adjustments	-35	-118	-97	-81	-220	-334	-381	-421	-466	-515	-571
War on terror ^{2,3}	-25	-53	-29	10	33	46	54	59	60	62	63
Expiring taxes	-9	-61	-59	-78	-233	-347	-386	-412	-437	-466	-498
Debt service ³	-1	-4	-9	-13	-20	-33	-49	-68	-89	-111	-136
Memo:	Percent of GDP										
Total surplus	-1.3	-0.7	-0.8	-0.9	-0.1	1.0	0.9	1.0	1.1	0.9	1.2
Adjusted surplus	-1.5	-1.5	-1.4	-1.4	-1.4	-1.0	-1.2	-1.3	-1.3	-1.6	-1.5
Economic assumptions (calendar years)	Percent change, year over year										
Nominal GDP	4.3	4.8	5.0	4.8	4.5	4.5	4.4	4.4	4.3	4.3	4.3
Real GDP	2.3	3.0	3.1	3.0	2.7	2.7	2.6	2.5	2.5	2.5	2.4
CPI-U	1.9	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Core CPI-U	2.6	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Core PCE prices	2.1	1.9	2.0	2.0	2.0	2.0	1.9	2.0	2.0	1.9	1.9
	Percent, annual average										
Unemployment rate	4.7	4.9	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Treasury yields											
Three-month	4.8	4.5	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4
Ten-year	4.8	5.0	5.1	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2

1. The on-budget surplus excludes the Social Security surplus and the Postal Service, which are off-budget. The baseline assumes that budget authority for discretionary programs grows with inflation after fiscal 2006 and that no new mandatory spending or tax legislation is enacted.

2. The adjustment reflects the CBO's estimates of an alternative policy scenario in which additional supplemental funding for the war on terror would increase spending above the baseline projection over the next 3 years, but it also assumes a subsequent phasing down of military activities in Iraq and Afghanistan instead of an extension of current appropriations for such activities.

3. Negative values indicate the effect on the surplus and reflect an increase in outlays.

Source: Congressional Budget Office, *The Budget and Economic Outlook* (January 2007).

legislative process. Indeed, the Senate Finance Committee is considering a minimum wage bill with small business tax cuts offset by some revenue raisers.

According to the new *Budget and Economic Outlook* from the CBO, the budget deficit is estimated to improve further this year. The baseline budget projection, which assumes that current tax law and policies are maintained, shows the deficit falling from \$248 billion in fiscal 2006 to \$172 billion in fiscal 2007 and \$98 billion in fiscal 2008.¹⁵ However, if additional funding for Iraq is approved and the AMT relief as well as other tax provisions are extended, then the deficit is projected to be around \$200 billion in both 2007 and 2008.

State and Local Government Sector

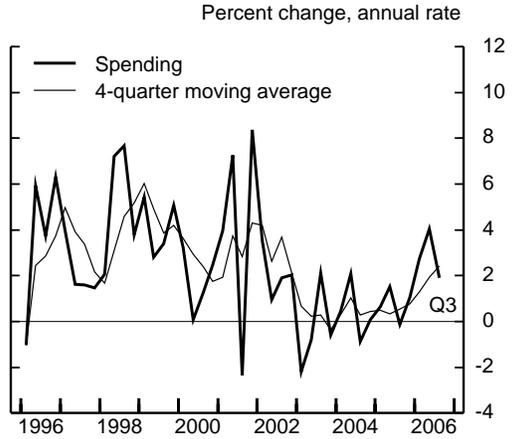
Data on the state and local government sector indicate that real purchases posted solid increases in the latter part of 2006. Employment rose 32,000 per month over the second half of 2006, a sizable pickup from the monthly average of 14,000 during the previous year and a half. Nominal outlays for state and local construction in October and November were about 8 percent (annual rate) above the third-quarter average, though much of the increase likely reflects higher prices for construction-related materials.

Moderate spending increases and robust tax collections contributed to a further improvement in state budget balances in fiscal 2006, which ended on June 30 in most states. The National Association of State Budget Officers (NASBO) reported that fiscal 2006 year-end balances were almost 10 percent of general fund expenditures, a rate significantly above the 5 percent threshold generally considered to constitute adequate fiscal reserves. According to NASBO, the high level of reserves has prompted some states to increase spending and lower taxes, actions suggesting that the exceptional fiscal caution exhibited over the past few years is starting to dissipate.

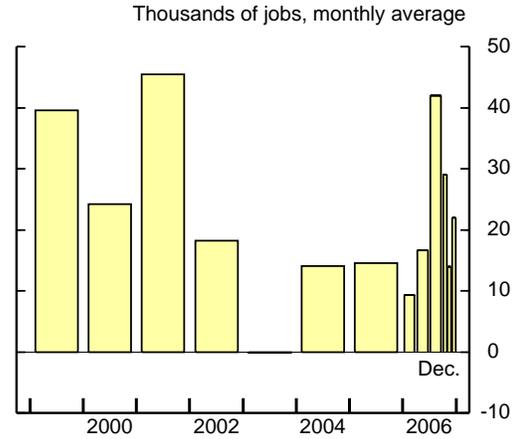
¹⁵ The baseline budget projection assumes that AMT relief lapses after 2006 and that the 2001-03 tax cuts expire as scheduled at the end of 2010. In addition, the CBO assumes that discretionary spending, which includes the \$70 billion approved last fall for operations in Iraq and Afghanistan, rises with inflation.

State and Local Indicators

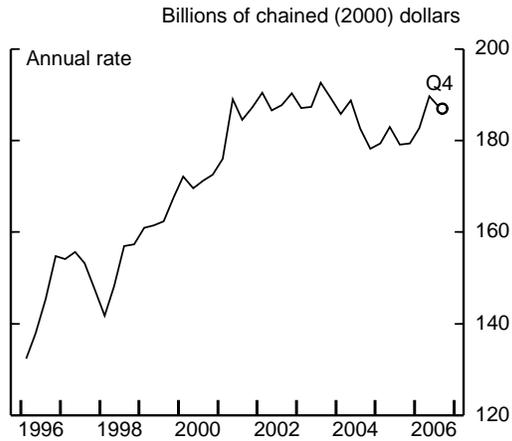
Real Spending on Consumption & Investment



Net Change in Employment

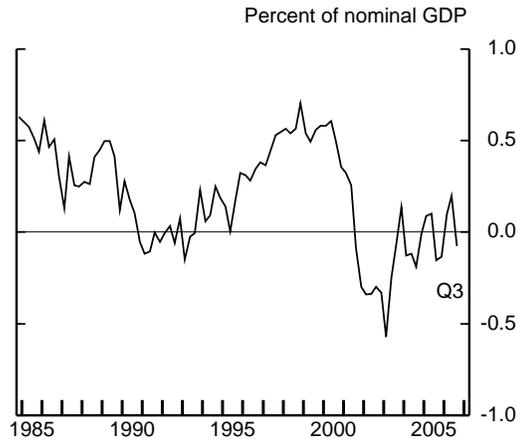


Real Construction

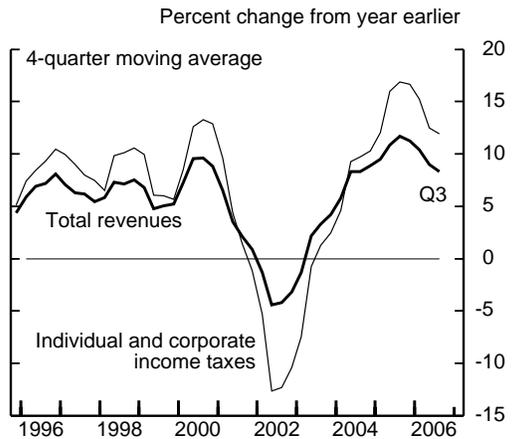


Note. Nominal CIPPI deflated by BEA prices through Q3 and by staff projection thereafter. Q4 is the average for October and November.

Net Saving

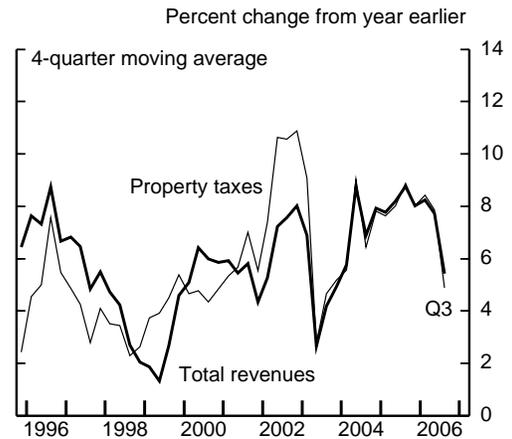


State Revenues



Source. Census Bureau.

Local Revenues



Source. Census Bureau.

Prices

A surge in energy prices pushed up the CPI 0.5 percent in December, the first increase since August; excluding food and energy, consumer prices increased 0.2 percent in December after having been unchanged in November—notably more modest than the increases posted earlier in the year. We estimate that overall PCE prices increased 0.4 percent in December; they rose 2.3 percent over the twelve months of 2006, down 0.6 percentage point from the increase during the preceding year, when energy prices rose sharply. We estimate that core PCE prices increased 0.2 percent in December and that they rose 2.3 percent over the twelve months of 2006, up 0.2 percentage point from a year earlier.

Large swings in energy prices have continued to dominate changes in headline consumer prices. We estimate that the energy component of PCE prices rose 5 percent in December after having fallen in the preceding three months, but the twelve-month change in energy prices rose only an estimated 4 percent, down sharply from the 16.5 percent rise in 2005. Gasoline and motor oil prices appear to have jumped about 8 percent at the retail level last month, as both crude costs and margins moved up. Furthermore, natural gas rates continued their rebound in December, thereby reversing their drop in October. However, warmer-than-expected temperatures this winter have left inventories of petroleum products and natural gas near the top of their historic ranges for the season, while the spot price for crude oil has dropped sharply, on balance, since December. These factors should push down retail prices in January, and the available survey data suggest that consumer energy prices have been moving lower in recent weeks.

Core consumer price inflation has come down from the elevated levels reached earlier this year. We estimate that core PCE prices rose 0.2 percent in December after a flat reading in November; such an increase would bring the three-month change to an annual rate of 1.8 percent, down from its peak of 2.9 percent in May. The slowdown reflects, in large part, a deceleration in core goods prices, which may have been boosted last spring by the pass-through of higher energy costs.

Price Measures
(Percent change)

Measures	12-month change		3-month change		1-month change	
	Dec. 2005	Dec. 2006	Annual rate		Monthly rate	
			Sept. 2006	Dec. 2006	Nov. 2006	Dec. 2006
<i>CPI</i>						
Total	3.4	2.5	.8	.2	.0	.5
Food	2.3	2.1	3.5	1.0	-.1	.0
Energy	17.1	2.9	-15.6	-11.2	-.2	4.6
Ex. food and energy	2.2	2.6	2.7	1.4	.0	.2
Core goods	.2	-.1	.0	-2.8	-.4	.0
Core services	2.9	3.7	3.8	2.9	.2	.2
Shelter	2.7	4.3	4.2	4.5	.4	.4
Other services	3.3	2.9	3.5	1.2	.0	.0
Chained CPI (n.s.a.) ¹	2.9	2.4	...	...	...	...
Ex. food and energy ¹	1.8	2.3	...	...	...	...
<i>PCE prices</i> ²						
Total	2.9	2.3	1.0	.8	.0	.4
Food and beverages	2.2	2.1	2.8	.7	.0	.0
Energy	16.5	3.8	-16.9	-11.5	-.3	5.0
Ex. food and energy	2.1	2.3	2.2	1.8	.0	.2
Core goods	-.2	-.3	.0	-2.3	-.4	.0
Core services	3.1	3.4	3.0	3.6	.2	.3
Shelter	2.7	4.3	4.0	4.2	.4	.3
Other services	3.2	3.0	2.7	3.3	.2	.2
Core market-based	1.8	2.0	1.8	1.5	.0	.2
Core non-market-based	3.6	n.a.	3.8	n.a.	.2	n.a.
<i>PPI</i>						
Total finished goods	5.4	1.1	-4.6	5.1	2.0	.9
Food	1.7	1.8	8.5	4.1	.1	1.7
Energy	23.9	-2.0	-27.2	14.4	6.1	2.5
Ex. food and energy	1.4	2.0	.3	2.3	1.3	.2
Core consumer goods	1.6	1.8	-.2	1.7	1.1	.1
Capital equipment	1.2	2.3	.8	3.0	1.4	.2
Intermediate materials	8.6	2.8	-2.6	.2	.7	.5
Ex. food and energy	4.8	4.7	4.2	-1.4	-.3	-.1
Crude materials	21.1	-2.4	7.5	28.6	15.7	2.9
Ex. food and energy	5.2	16.7	-7.4	.8	.5	1.0

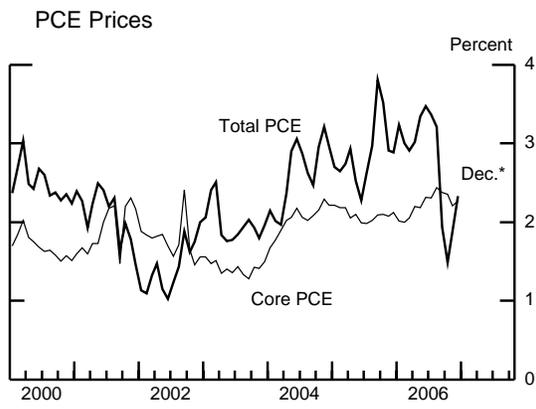
1. Higher-frequency figures are not applicable for data that are not seasonally adjusted.

2. PCE prices in December 2006 are staff estimates.

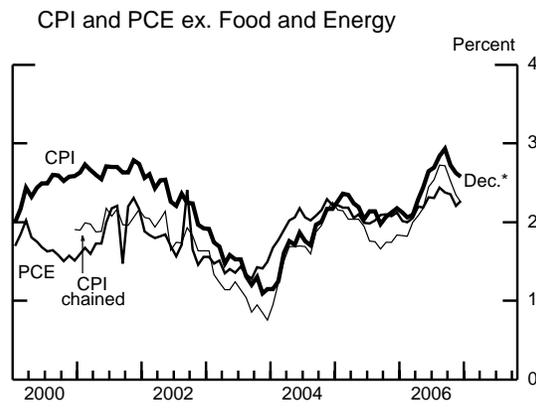
... Not applicable.

n.a. Not available.

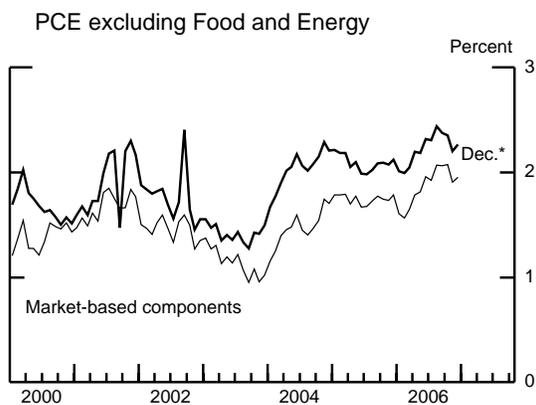
Consumer Prices (12-month change except as noted)



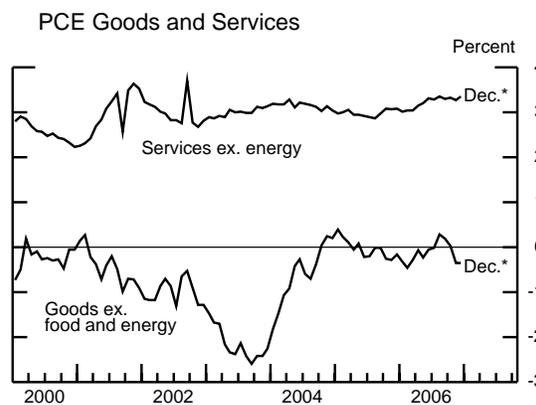
* Staff estimate.



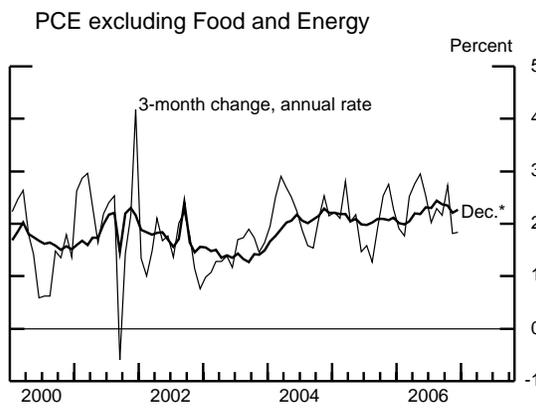
* PCE for December is a staff estimate.



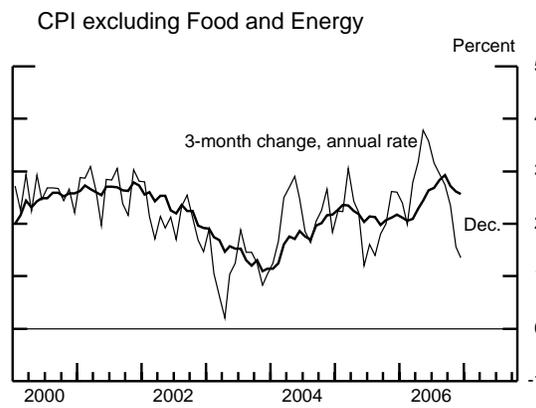
* Staff estimate.



* Staff estimate.



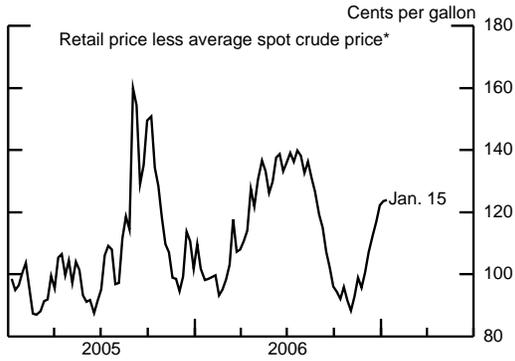
* Staff estimate.



Energy Prices and Inventories

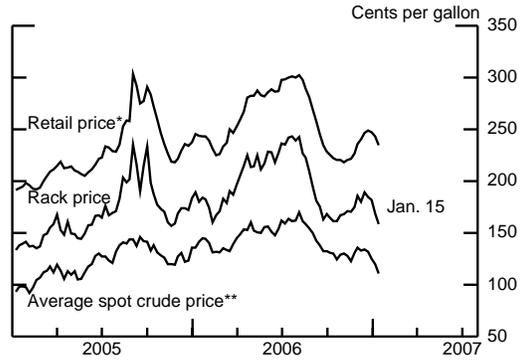
(Data from Energy Information Administration except as noted)

Total Gasoline Margin



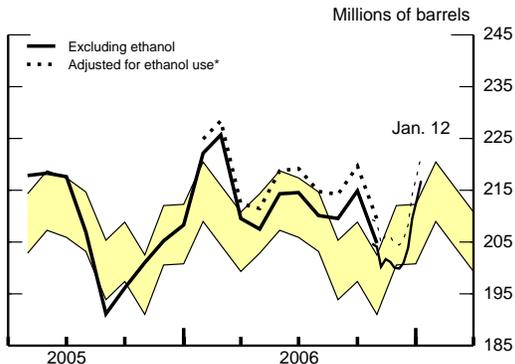
* Regular grade seasonally adjusted by FRB staff, less average spot crude price: 60% WTI, 40% Maya heavy crude.

Gasoline Price Decomposition



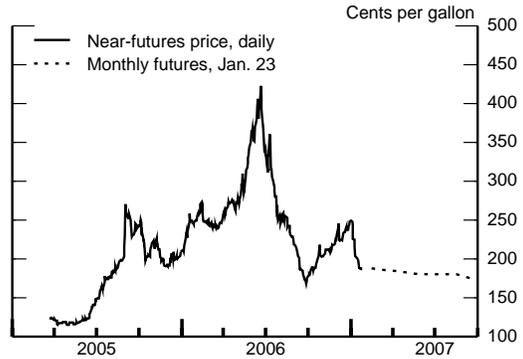
* Regular grade seasonally adjusted by FRB staff.
** 60% WTI, 40% Maya heavy crude.

Gasoline Inventories



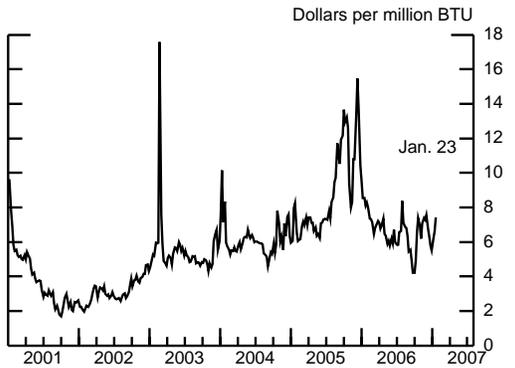
Note. Shaded region is average historical range as calculated by DOE. Monthly data through October 2006, weekly data thereafter, as indicated by line weights.
* Adjustment for approximate amount of fuel ethanol to be blended with RBOB component of inventories; estimated by FRB staff.

Ethanol Prices



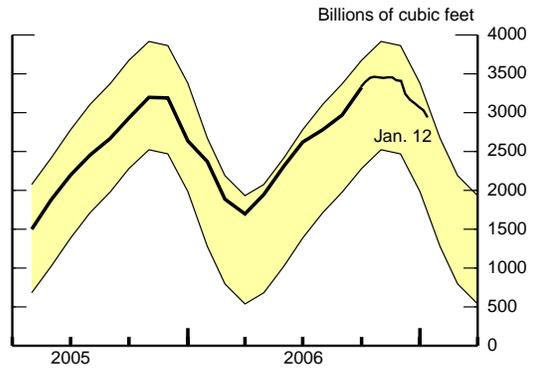
Source: Chicago Board of Trade.

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 September 2006, weekly data thereafter.

We estimate that the PCE price index for food and beverages was flat again in December. The index for fresh fruits and vegetables fell slightly in December after several months of wide swings. Recent winter storms in the plains states hindered livestock production but also provided vital moisture for the winter wheat crop; current estimates by the U.S. Department of Agriculture point to ample supplies of crops and livestock in coming months, a situation that should hold down price increases for food items. An extended freeze in January caused considerable damage to fruits and vegetables in the West. The navel orange crop appears to have suffered the most damage, and spot prices on that product roughly doubled in the days immediately after the freeze.¹⁶

December's reading notwithstanding, the decline in energy prices over recent months seems to have contributed to an easing of inflation expectations as measured by the Reuters/University of Michigan index. Survey data for January show that median one-year-ahead inflation expectations have been unchanged, on balance, since the December Greenbook at 3.0 percent, down from its recent peak of 3.8 percent in August. The median value of five- to ten-year-ahead expectations also held steady at 3.0 percent in January, down from 3.2 percent in August.

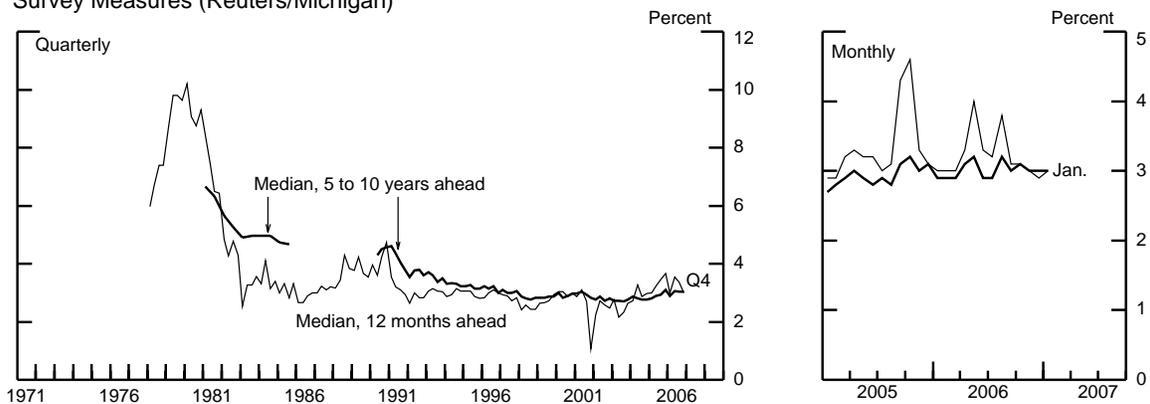
At earlier stages of processing, the producer price index (PPI) for core intermediate materials edged down 0.1 percent in December after a decline of 0.3 percent in November. Some of the downward pressure on the core intermediate PPI can be traced to declines in energy-intensive components, which likely reflect the large fall in energy prices in the preceding months. Prices of core intermediate goods increased 4.7 percent over the twelve months ending in December, about the same percentage as in the preceding year.

After rising sharply over most of 2006, commodity prices have moved down a bit since the December Greenbook. The Commodity Research Bureau spot index of industrial

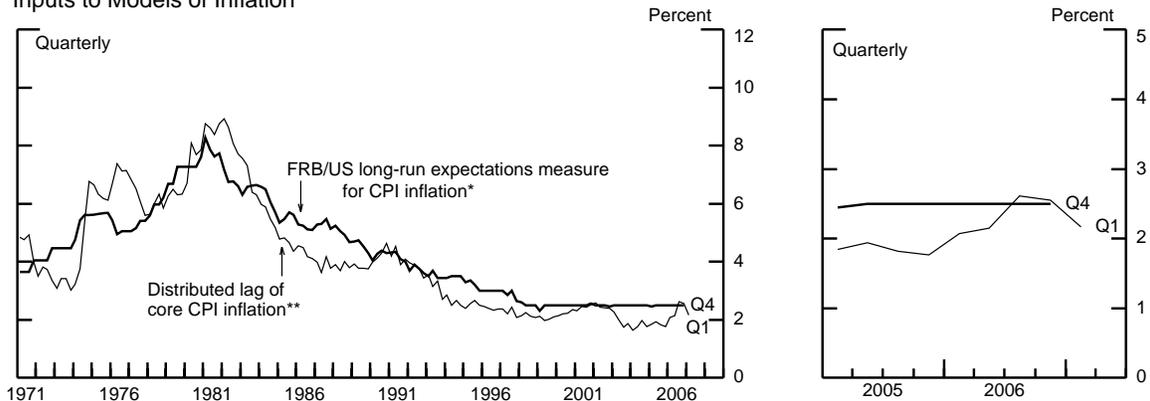
¹⁶ Other crops such as strawberries, lettuce, and broccoli were also damaged; however, these crops typically recover after a month or so.

Measures of Expected Inflation

Survey Measures (Reuters/Michigan)



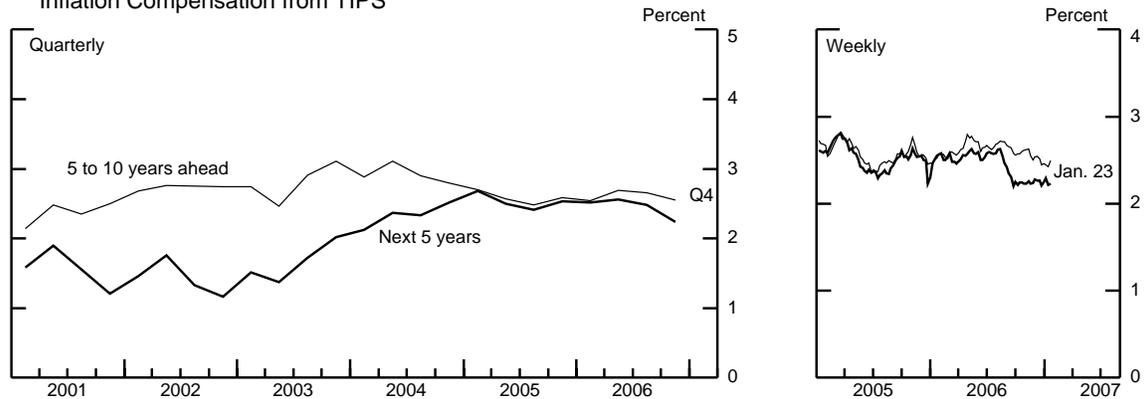
Inputs to Models of Inflation



* 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.

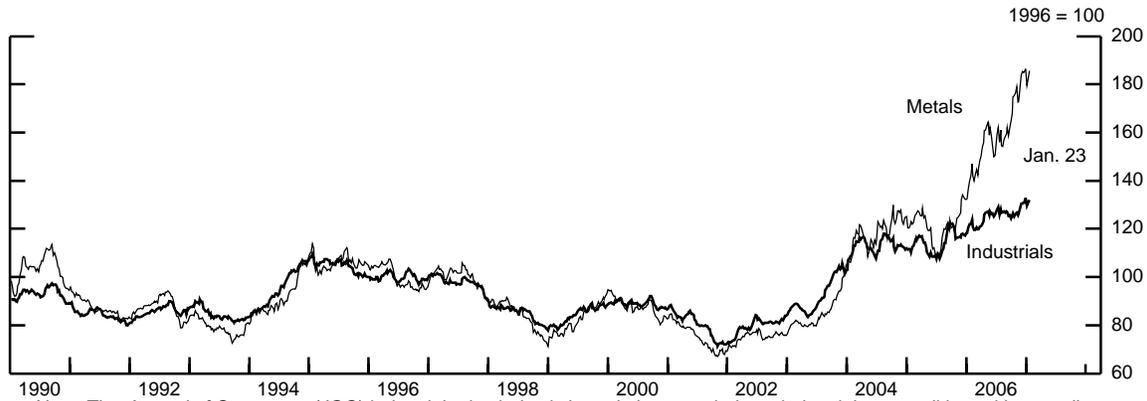
Inflation Compensation from TIPS



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.

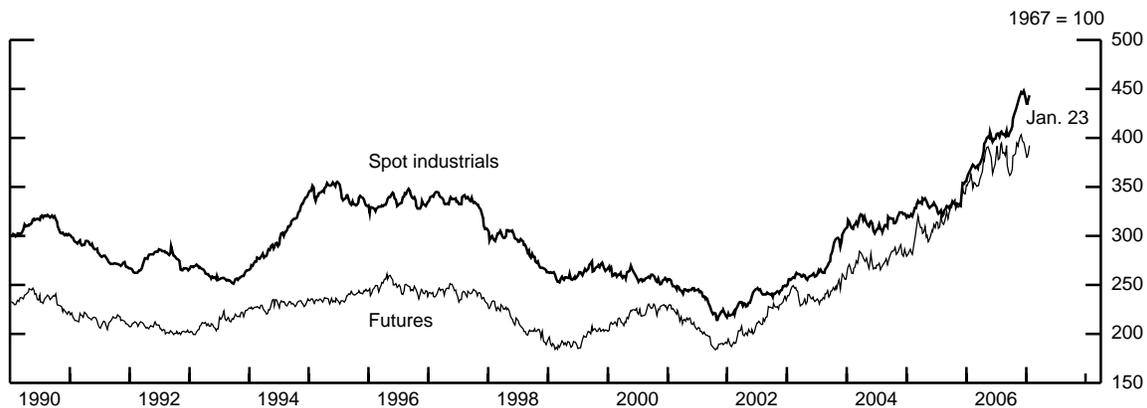
Commodity Price Indexes

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 12/5/06 ²	12/5/06 ² to 1/23/07	52-week change to 1/23/07
JOC industrials	5.3	11.1	1.3	8.1
JOC metals	5.8	38.9	1.1	32.6
CRB spot industrials	10.1	25.8	-.7	21.0
CRB spot foodstuffs	-6.1	14.2	2.2	15.9
CRB futures	20.6	17.6	-2.7	10.3

1. From the last week of the preceding year to the last week of the year indicated.

2. December 5, 2006, is the Tuesday preceding publication of the December 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	2.8
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	Reuters/University of Michigan Index				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	1.9	3.5	3.0	3.5	3.0	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.	2.0	3.3	3.0	3.5	3.0	2.5
Dec.	2.5	3.5	2.9	3.4	3.0	...
2007:Jan.	n.a.	3.6	3.0	3.5	3.0	...

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.

materials has declined $\frac{3}{4}$ percent since the December Greenbook, while the *Journal of Commerce* index of industrial materials has increased $1\frac{1}{4}$ percent over the same period despite its inclusion of petroleum products, which have experienced recent price declines.

Labor Costs

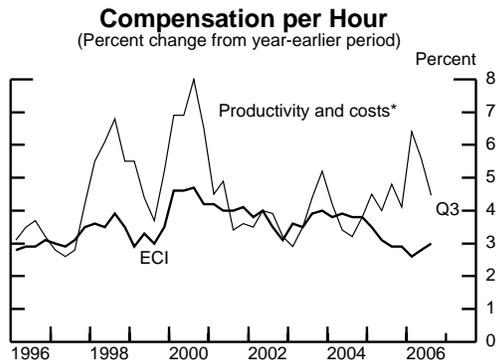
Labor costs have moved up at a moderate pace over the past year, and the markup of prices over unit labor costs remains quite elevated. Relying on the final GDP release for the third quarter, the staff estimates that the third-quarter change in compensation per hour will be revised up 0.5 percentage point, to an annual rate of 3.1 percent. Available data suggest that the increase in compensation per hour in the fourth quarter may be somewhat higher than in the third quarter. Overall, the four-quarter change in compensation per hour for 2006 appears on track for a 4.9 percent increase. Increases in average hourly earnings of 0.3 percent in November and 0.5 percent in December brought the twelve-month change for 2006 to 4.2 percent, up from 3.2 percent in 2005.

Hourly Compensation and Unit Labor Costs

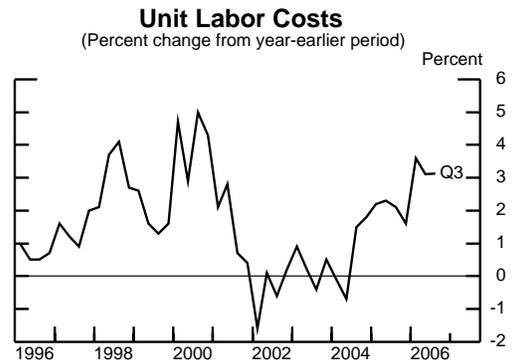
(Percent change from preceding period at compound annual rate; based on seasonally adjusted data)

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	4.5	2.9	13.7	-1.2	3.1
<i>Unit labor costs</i> Nonfarm business	2.1	3.1	3.0	9.0	-2.4	3.2

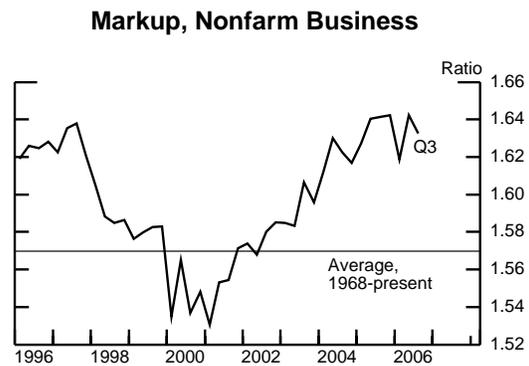
e Staff estimate.



* 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.

Domestic Financial Developments

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

Instrument	2004	2006		2007	Change to Jan. 23 from selected dates (percentage points)		
	June 28	June 29	Dec. 11	Jan. 23	2004 June 28	2006 June 29	2006 Dec. 11
<i>Short-term</i>							
FOMC intended federal funds rate	1.00	5.25	5.25	5.25	4.25	.00	.00
Treasury bills ¹							
3-month	1.36	4.88	4.81	5.01	3.65	.13	.20
6-month	1.74	5.06	4.88	4.98	3.24	-.08	.10
Commercial paper (A1/P1 rates) ²							
1-month	1.28	5.27	5.25	5.24	3.96	-.03	-.01
3-month	1.45	5.37	5.23	5.24	3.79	-.13	.01
Large negotiable CDs ¹							
3-month	1.53	5.47	5.31	5.32	3.79	-.15	.01
6-month	1.82	5.59	5.32	5.35	3.53	-.24	.03
Eurodollar deposits ³							
1-month	1.29	5.33	5.35	5.30	4.01	-.03	-.05
3-month	1.51	5.49	5.35	5.33	3.82	-.16	-.02
Bank prime rate	4.00	8.25	8.25	8.25	4.25	.00	.00
<i>Intermediate- and long-term</i>							
U.S. Treasury ⁴							
2-year	2.88	5.26	4.66	4.95	2.07	-.31	.29
5-year	3.97	5.15	4.46	4.78	.81	-.37	.32
10-year	4.90	5.28	4.59	4.88	-.02	-.40	.29
U.S. Treasury indexed notes							
5-year	1.56	2.49	2.20	2.45	.89	-.04	.25
10-year	2.25	2.61	2.19	2.45	.20	-.16	.26
Municipal general obligations (Bond Buyer) ⁵	5.01	4.71	4.03	4.25	-.76	-.46	.22
Private instruments							
10-year swap	5.21	5.81	5.01	5.26	.05	-.55	.25
10-year FNMA ⁶	5.38	5.59	4.83	5.11	-.27	-.48	.28
10-year AA ⁷	5.60	6.20	5.43	5.68	.08	-.52	.25
10-year BBB ⁷	6.25	6.74	5.99	6.23	-.02	-.51	.24
10-year high yield ⁷	8.41	8.74	8.20	8.17	-.24	-.57	-.03
Home mortgages (FHLMC survey rate) ⁸							
30-year fixed	6.21	6.78	6.12	6.23	.02	-.55	.11
1-year adjustable	4.19	5.82	5.45	5.51	1.32	-.31	.06

Stock exchange index	Record high		2006		2007	Change to Jan. 23 from selected dates (percent)		
	Level	Date	June 29	Dec. 11	Jan. 23	Record high	2006 June 29	2006 Dec. 11
Dow Jones Industrial	12,583	1-16-07	11,191	12,328	12,534	-.39	12.00	1.67
S&P 500 Composite	1,527	3-24-00	1,273	1,413	1,428	-6.51	12.19	1.06
Nasdaq	5,049	3-10-00	2,174	2,443	2,431	-51.84	11.82	-.47
Russell 2000	798	12-27-06	714	793	785	-1.55	9.95	-.97
Wilshire 5000	14,752	3-24-00	12,846	14,248	14,392	-2.44	12.03	1.01

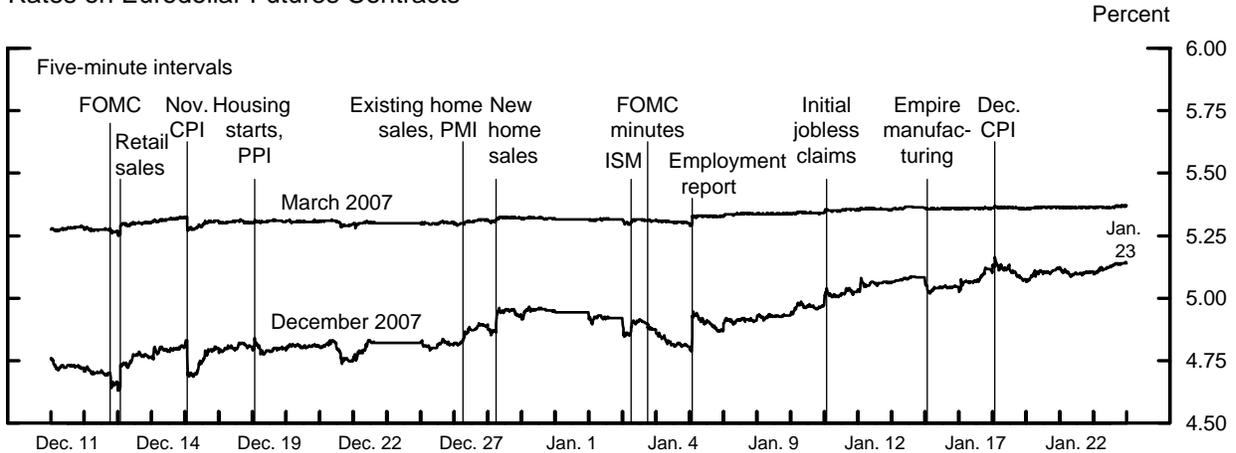
1. Secondary market.
2. Financial commercial paper.
3. Bid rates for Eurodollar deposits collected around 9:30 a.m. eastern time.
4. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
5. Most recent Thursday quote.
6. Constant-maturity yields estimated from Fannie Mae domestic noncallable coupon securities.
7. Derived from smoothed corporate yield curves estimated using Merrill Lynch bond data.
8. Home mortgage rates for January 23, 2007, are for the week ending January 18, 2007.

NOTES:

June 28, 2004, is the day before the most recent policy tightening began.
June 29, 2006, is the day the most recent policy tightening ended.
December 11, 2006, is the day before the most recent FOMC announcement.

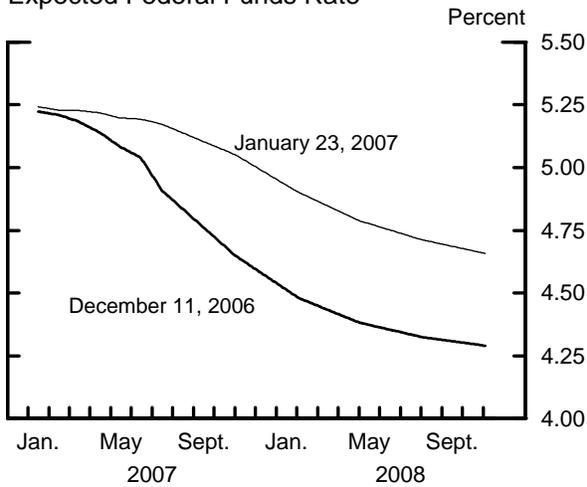
Policy Expectations and Treasury Yields

Rates on Eurodollar Futures Contracts



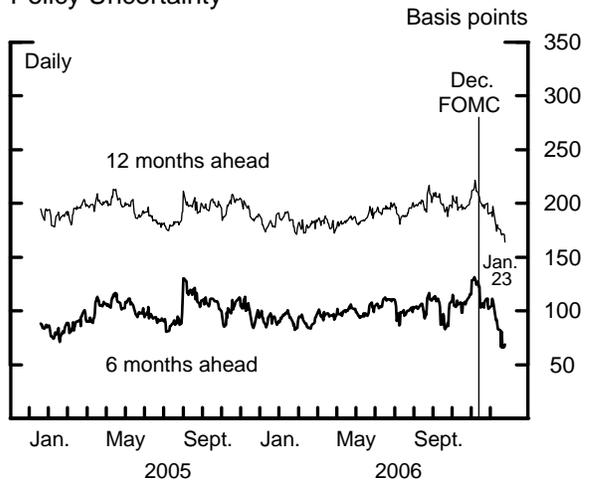
Note. No adjustment made for term premium..

Expected Federal Funds Rate



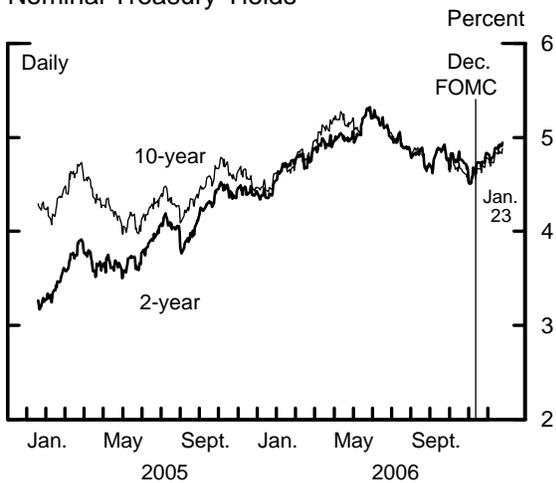
Note. Estimates from federal funds and Eurodollar futures, with an allowance for term premia and other adjustments.

Policy Uncertainty



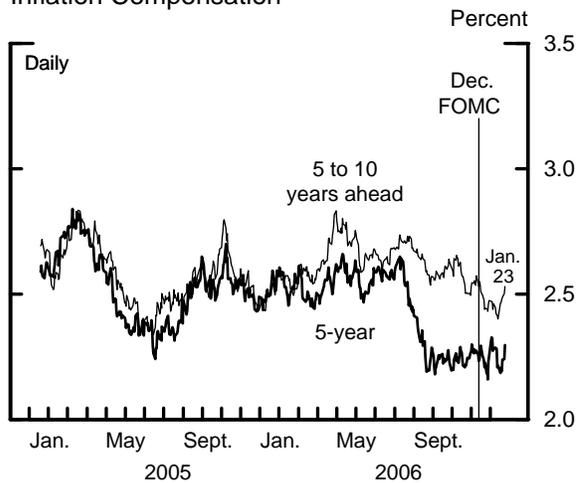
Note. Width of a 90 percent confidence interval for the federal funds rate computed from the term structures for both the expected federal funds rate and Eurodollar implied volatility.

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

Against a backdrop of stronger-than-expected incoming data on economic activity, favorable readings on core inflation, and a sharp drop in oil prices, market participants pushed back the timing and reduced the extent of policy easing that they anticipate this year and next. The term structure of nominal Treasury yields shifted up about a quarter percentage point in a largely parallel fashion over the intermeeting period. Yields on Treasury inflation-protected securities (TIPS) rose by a similar amount, leaving inflation compensation little changed. Equity price indexes were little changed as the impact of generally favorable earnings news was apparently offset by rising interest rates. Risk spreads on corporate bonds remained low as the outlook for corporate credit quality in the near term continued to be solid. Despite a rise in delinquencies on subprime mortgages, household credit quality on the whole remained favorable. Commercial bank credit continued to expand last quarter but at a significantly slower pace than earlier in the year.

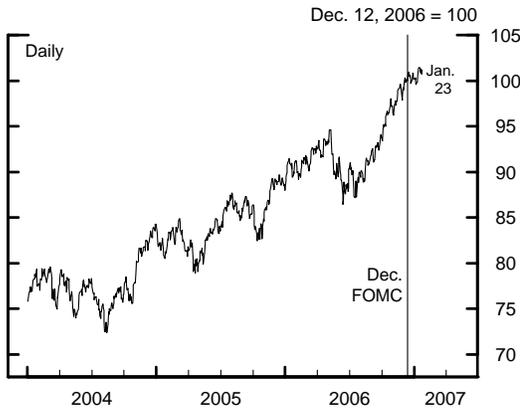
Policy Expectations and Interest Rates

The FOMC's decision at its December meeting to leave the target federal funds rate unchanged and to make only modest changes to the accompanying statement was largely anticipated by market participants. The subsequent release of the minutes from the December meeting elicited little reaction in financial markets. Rather, stronger-than-expected economic data led investors to mark up their expected path for monetary policy. Current quotes indicate that investors continue to place high odds on the FOMC keeping the target federal funds rate at 5.25 percent through the next three meetings. After that, money market futures suggest that investors anticipate about 25 basis points of easing by the end of 2007 and roughly another 25 basis points by the end of 2008—almost 40 basis points less in cumulative easing than investors had priced in at the time of the last FOMC meeting. Option-implied measures of uncertainty about the path of policy dropped to near their historical lows, and the skew toward lower rates in the implied distribution of the funds rate about six months ahead became less pronounced.

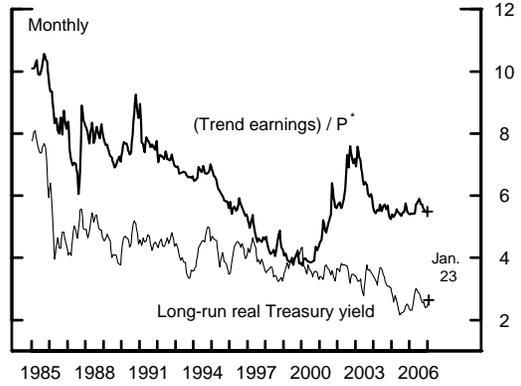
Consistent with the upward shift in policy expectations, two-year nominal Treasury yields increased about 30 basis points over the intermeeting period, and ten-year yields rose a similar amount. Yields on TIPS rose about as much as their nominal counterparts, leaving inflation compensation little changed, as the stronger-than-expected economic outlook offset the effects of the sharp decline in oil prices and the favorable readings on core inflation over the intermeeting period.

Corporate Yields, Risk Spreads, and Stock Prices

Wilshire 5000

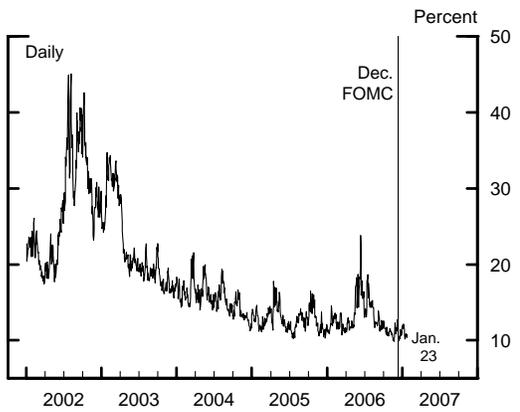


Ratio of Trend Earnings to Price for S&P 500 and Long-Run Treasury Yield

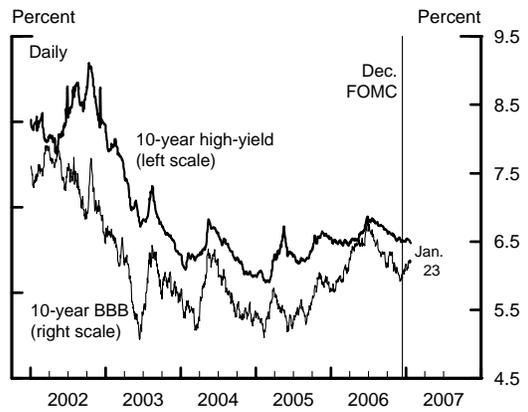


+ Denotes the latest observation using daily interest rates and stock prices and latest earnings data from I/B/E/S.
 * Trend earnings are estimated using analyst forecast of year-ahead earnings from I/B/E/S.

Implied Volatility on S&P 500 (VIX)

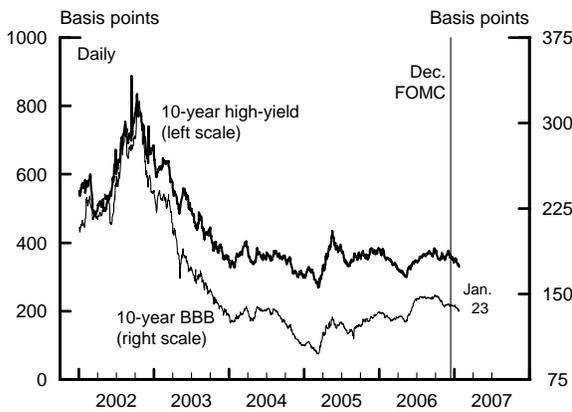


Corporate Bond Yields



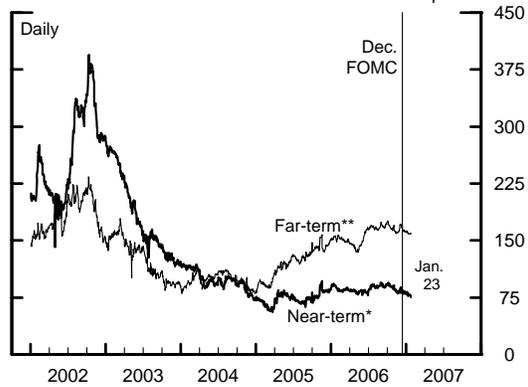
Note. Yields from smoothed yield curves based on Merrill Lynch bond data.

Corporate Bond Spreads



Note. Measured relative to comparable-maturity Treasuries.

Far-Term and Near-Term Forward BBB Credit Spreads



* Forward spread between years 1 and 2.
 ** Forward spread between years 9 and 10.
 Source. Staff estimates.

Stock Prices and Corporate Interest Rates

Broad stock price indexes were little changed over the intermeeting period as the generally favorable earnings news and stronger-than-expected economic data presumably were counterbalanced by the rise in interest rates. The sharp decline in oil prices led to a substantial selloff in energy stocks but appeared to have little effect on the broader equity market. The spread between the twelve-month forward trend earnings-price ratio for S&P 500 firms and a real long-run Treasury yield—a rough gauge of the equity risk premium—narrowed a bit over the intermeeting period but remained within the range that has prevailed over the past few years. Implied volatility on the S&P 500 index remained close to its historical lows.

Yields on investment-grade corporate bonds rose a shade less than those on comparable-maturity Treasury securities, while yields on speculative-grade corporate bonds were little changed. As a result, corporate bond risk spreads moved down slightly from already low levels. Near-term BBB forward spreads are currently near their all-time lows, but comparable far-term forward spreads are about average. The narrow near-term forward spreads suggest that investors perceive little credit risk in the short run, while the wider spreads farther ahead suggest that investors are requiring a typical amount of compensation for credit risk beyond the next few years. Spreads on commercial paper (not shown) remained low across year-end.

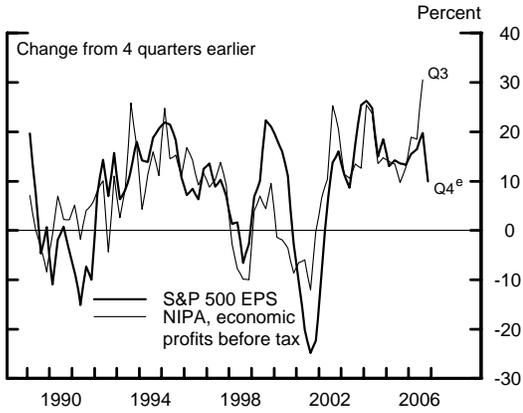
Corporate Earnings and Credit Quality

The fourth-quarter earnings season began with major financial firms announcing results that exceeded analyst estimates by wide margins; aside from a few disappointments in the technology sector, subsequent reports have been generally favorable. Based on the results already in hand and analyst forecasts for firms yet to report, the staff estimates that operating earnings per share for the S&P 500 grew about 10 percent over the year ended in the fourth quarter, a sharp deceleration from the remarkably strong pace earlier last year. Revisions to year-ahead earnings moved into negative territory, although much of the decline was accounted for by the energy sector.

Overall, the credit quality of nonfinancial firms appears to have remained strong. The most recent data on corporate balance sheets (for the third quarter of 2006) indicate that cash holdings relative to assets remained high and that the ratio of debt to assets remained low. In the fourth quarter, bond rating downgrades were modest and nearly balanced by upgrades. In addition, the realized six-month trailing bond default rate was again near zero in December, and the delinquency rate on C&I loans in the third quarter was the

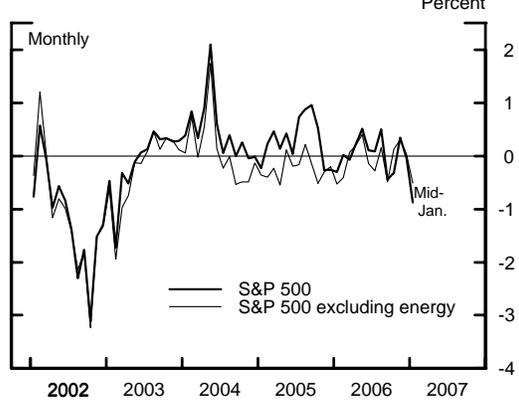
Corporate Earnings and Credit Quality

Corporate Earnings Growth



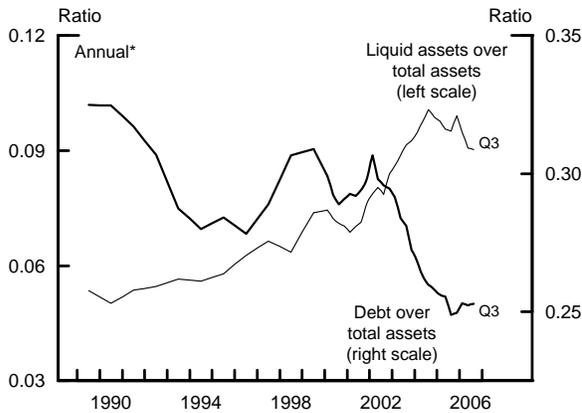
e Analyst forecast.
Source: I/B/E/S for S&P 500 earnings per share.

Revisions to Expected S&P 500 Earnings



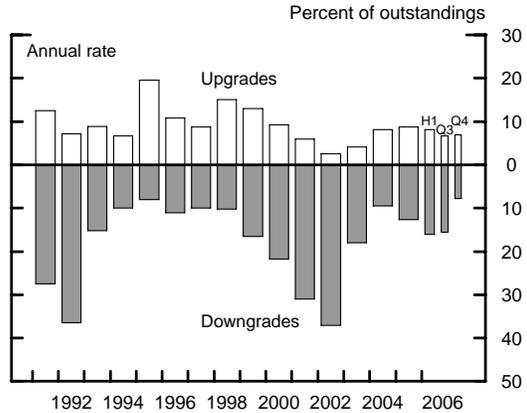
Note. Index is a weighted average of the percent change in the consensus forecasts of current-year and following-year EPS for a fixed sample.

Financial Ratios for Nonfinancial Corporations



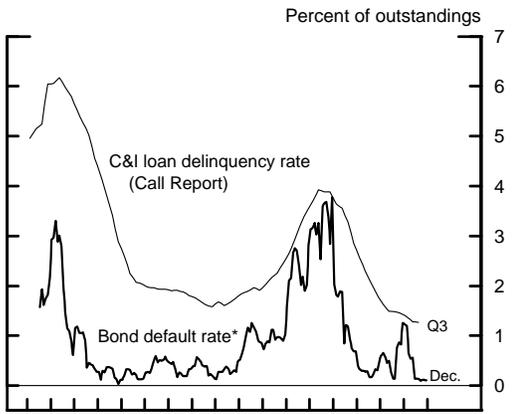
* Data are quarterly starting in 2000:Q1.
Source. Calculated with Compustat data.

Bond Ratings Changes of Nonfinancial Companies



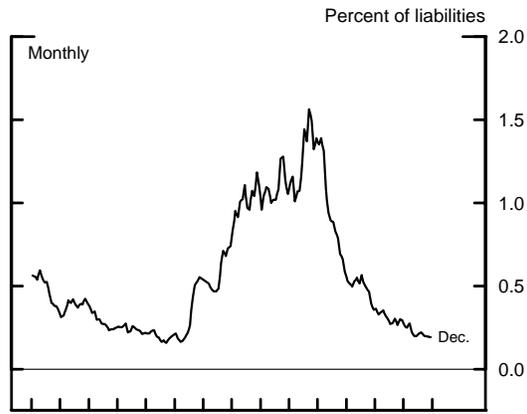
Source. Calculated with data from Moody's Investors Service.

Selected Default and Delinquency Rates



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

Expected Year-Ahead Defaults



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

Business Finance

Gross Issuance of Securities by U.S. Corporations

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

Type of security	2003	2004	2005	2006				2007
				H1	Q3	Q4	Dec.	Jan. ^e
<i>Nonfinancial corporations</i>								
Stocks ¹	3.7	5.4	4.6	5.2	2.6	5.6	5.4	3.0
Initial public offerings	.4	1.6	1.7	1.9	.7	2.7	1.8	n.a.
Seasoned offerings	3.3	3.8	2.8	3.3	1.9	2.9	3.5	n.a.
Bonds ²	31.6	22.7	19.1	30.5	18.7	36.2	29.6	20.0
Investment grade	15.9	8.2	8.4	14.4	10.5	12.7	10.4	n.a.
Speculative grade	11.3	9.7	6.4	8.4	4.8	10.4	15.2	n.a.
Other (sold abroad/unrated)	4.3	4.9	4.3	7.8	3.5	13.2	4.0	n.a.
<i>Memo</i>								
Net issuance of commercial paper ³	-3.4	1.5	-4	3.4	-1.2	9.9	31.1	11.0
Change in C&I loans at commercial banks ^{3,4,5}	-7.7	3.2	9.9	14.5	14.7	7.0	7.2	n.a.
<i>Financial corporations</i>								
Stocks ¹	6.6	6.9	5.0	4.4	5.0	6.8	4.8	n.a.
Bonds ²	111.1	139.3	176.3	190.2	174.8	190.8	220.8	100.0

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

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

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

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

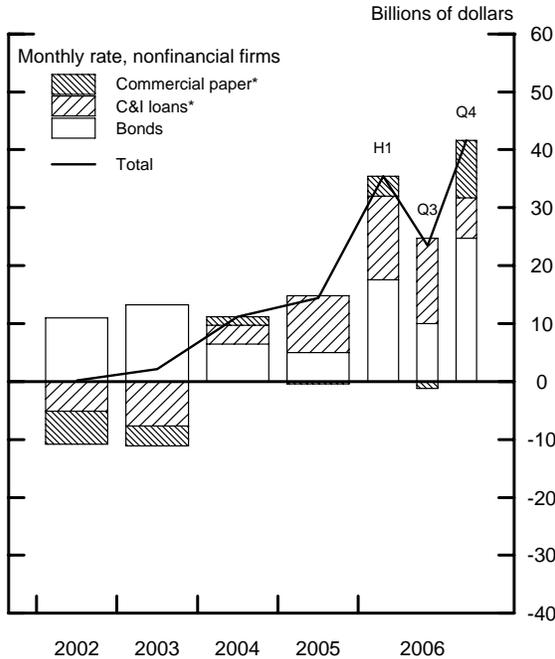
4. Adjusted for FIN 46 effects.

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.

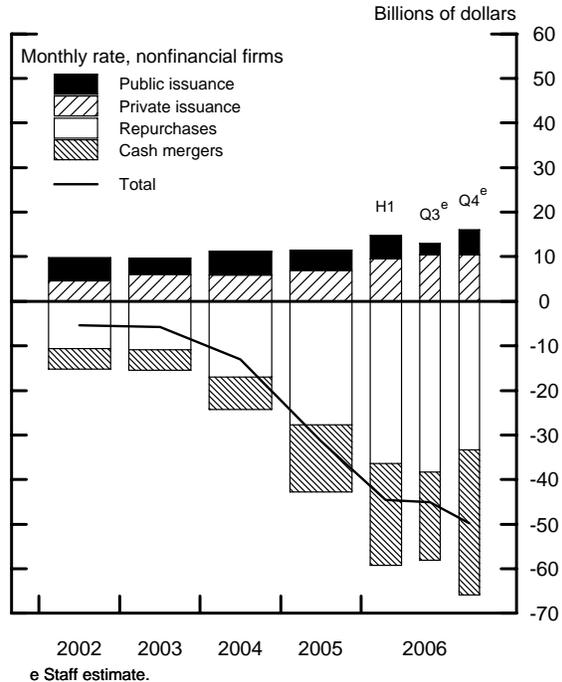
e Staff estimate.

n.a. Not available.

Selected Components of Net Debt Financing

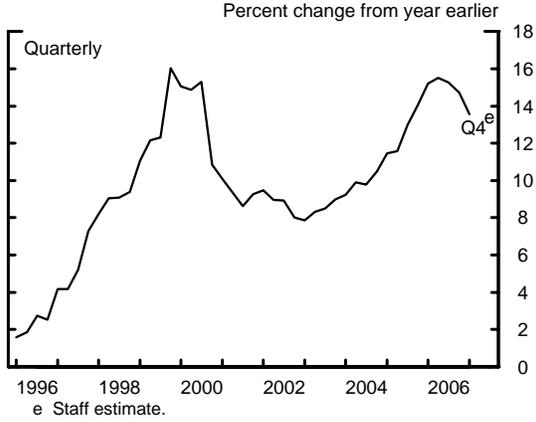


Components of Net Equity Issuance

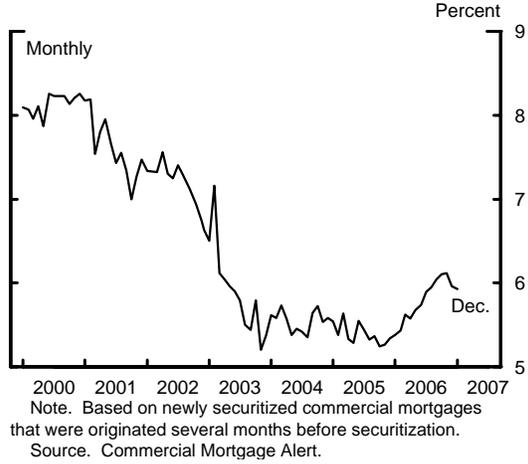


Commercial Real Estate

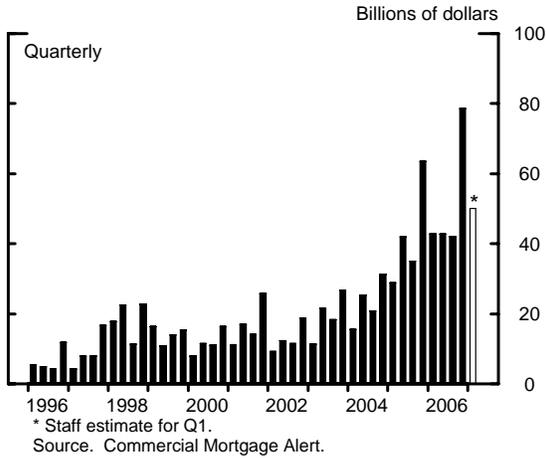
Commercial Mortgage Debt



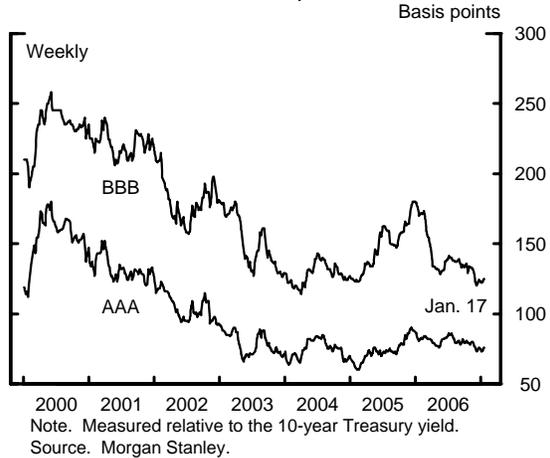
Commercial Mortgage Rate



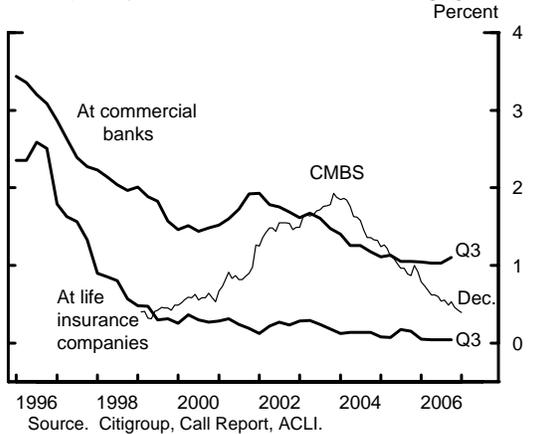
Gross Issuance of CMBS



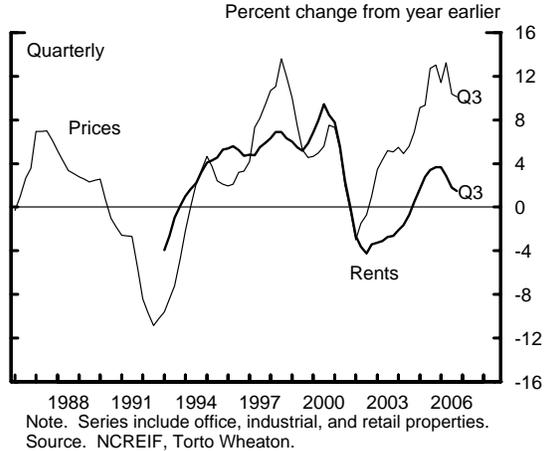
Investment-Grade CMBS Spreads



Delinquency Rates on Commercial Mortgages



Commercial Real Estate Prices and Rents



lowest in the past two decades. The near-term outlook for credit quality also appears extremely favorable, as the December forecast of the aggregate year-ahead default rate based on the KMV model was at its lowest level since 1998.

Business Finance

Gross bond issuance by nonfinancial firms slowed a bit in December from the torrid pace earlier in the quarter and has cooled somewhat further in January. However, the forward calendar includes several sizable deals, suggesting that bond issuance will strengthen in coming months. As has been the case in the past few quarters, issuance of speculative-grade bonds continued to be boosted by hefty merger and acquisition financing, while a notable fraction of the proceeds from investment-grade issuance has been used for refinancings. Commercial paper outstanding surged in December, mostly among firms that had recently announced large acquisitions, and is on track to increase substantially in January as well. C&I loans rose moderately in December, in line with their average rate of increase in the fourth quarter. Aggregating across bonds, commercial paper, and C&I loans, net debt financing was robust in the fourth quarter, exceeding the already strong pace registered over the previous three quarters.

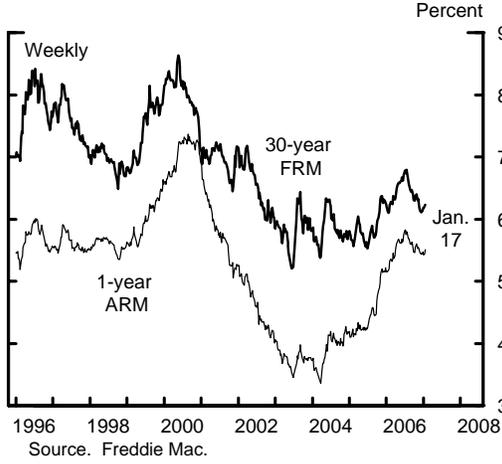
Public equity issuance maintained its recent solid pace in December, mostly on the strength of seasoned equity offerings, followed by the usual seasonal lull around the turn of the year. Private equity issuance in the fourth quarter is estimated to have matched its robust third-quarter pace, fueled in part by strong leveraged buyout (LBO) activity. Still, gross equity issuance continued to be dwarfed by the extraordinary pace of equity retirements. Boosted by strong profits and ample cash on corporate balance sheets, retirements from cash-financed mergers and acquisitions reached a new record high in the fourth quarter, and almost half of these retirements were from LBO deals. Retirements from share repurchases are estimated to be only a bit shy of their record third-quarter pace.

Commercial Real Estate

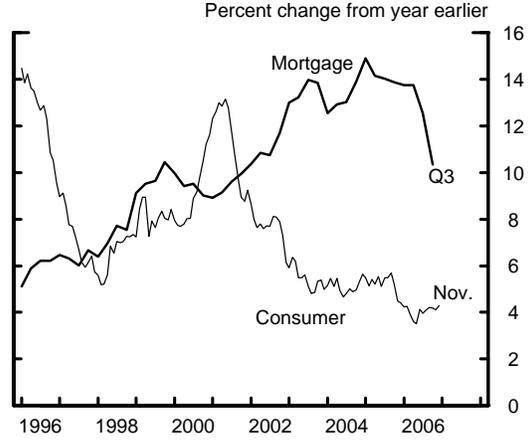
Although the growth of commercial mortgage debt has eased a bit over the past several quarters, perhaps restrained by an upward drift in commercial mortgage rates, debt growth in this sector remains rapid. Issuance of commercial-mortgage-backed securities (CMBS) was very strong last year, and the calendar of scheduled CMBS offerings suggests that issuance will remain heavy this quarter. Spreads of yields on investment-grade CMBS over those on comparable-maturity Treasury securities were little changed at low levels, as delinquency rates on commercial mortgages—including those backing

Household Liabilities

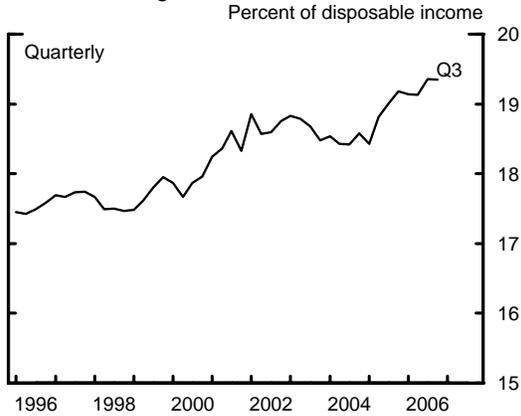
Mortgage Rates



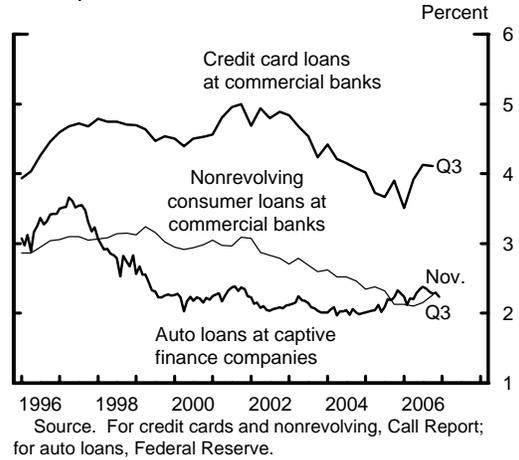
Mortgage Debt and Consumer Credit



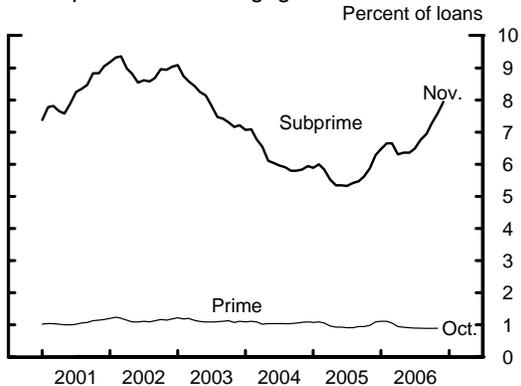
Financial Obligations Ratio



Delinquencies on Consumer Loans



Delinquencies on Mortgages



Note. Percent of loans 90 or more days past due or in foreclosure.
Source: LoanPerformance.

BBB- Subprime Mortgage CDS Spreads



Note. Measured relative to LIBOR. Each index corresponds to pools of mortgages securitized in the 6 months preceding issue date.
Source: JP Morgan.

CMBS—remained low. Growth of commercial real estate prices continued to be rapid through the third quarter, while rents increased only moderately.

Household Finance

Interest rates on both fixed-rate and adjustable-rate mortgages rose slightly over the intermeeting period, but they remained below their recent peaks in mid-2006. Despite the decline in rates since midyear, mortgage debt growth slowed sharply in the third quarter as home prices decelerated and sales softened, and the staff expects that mortgage borrowing moderated further last quarter. Consumer credit has continued to increase at a tepid pace.

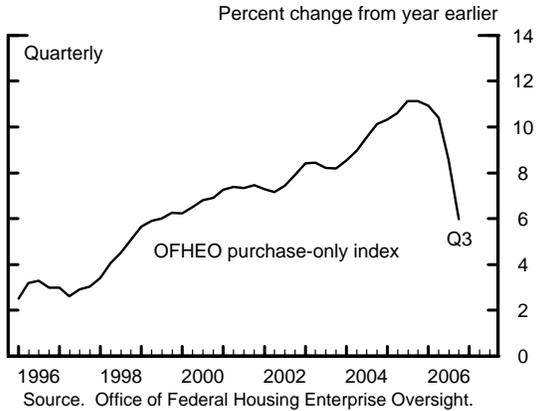
Although the financial obligations ratio for the household sector in the third quarter remained close to its historical high, readings on household credit quality continued to be favorable on the whole. Delinquency rates on consumer loans and prime mortgages—which account for the vast majority of total household debt—remained low, but the delinquency rate on subprime mortgages rose further in November. The spreads relative to LIBOR on newly introduced credit default swap indexes for the lowest-rated tranches of pools of subprime mortgages originated in the first half of 2006 have risen sharply over the past few months. The jump suggests that investors have grown more concerned about the credit quality of recently originated subprime mortgages.

Home-price appreciation as measured by the OFHEO purchase-only index slowed considerably further in the third quarter from its year-ago level. Available indicators suggest that the year-over-year growth of home prices decelerated again in the fourth quarter. The trajectory of expected home prices in ten of the largest metropolitan markets over the next few quarters, derived from futures quotes on the S&P/Case-Shiller home-price index, edged up on net over the intermeeting period, although investors apparently continue to expect price declines in these markets. Despite the deceleration in home prices, the sharp rise in stock prices in the fourth quarter likely nudged up the ratio of household net worth to disposable personal income.

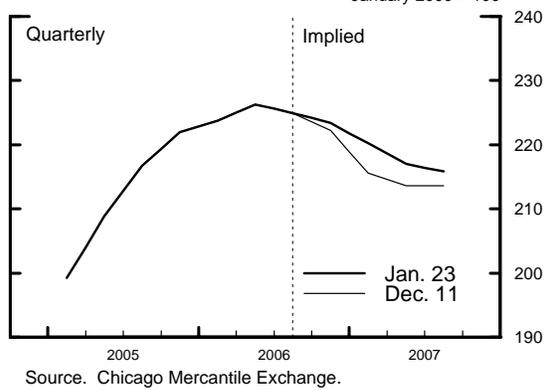
Net inflows to long-term mutual funds were robust late last year and were propelled by strong inflows to international equity funds and bond funds. Inflows to domestic equity funds turned positive in the fourth quarter after two quarters of outflows.

Household Assets

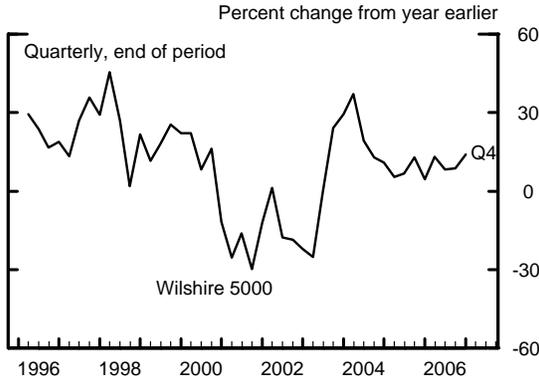
House Prices



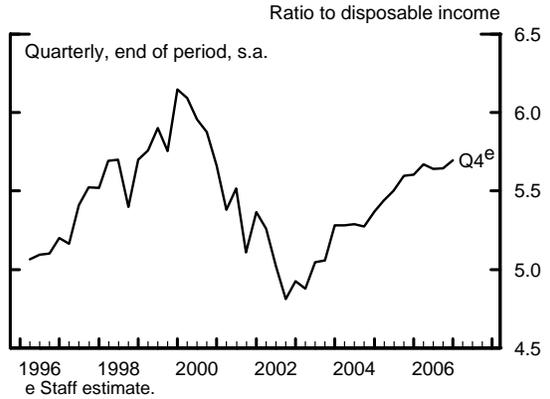
House-Price Path Implied by Futures on S&P/Case-Shiller 10-City Index



Stock Prices



Net Worth



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

Fund type	2004	2005	2006					Assets Nov.
			Q1	Q2	Q3	Q4 ^e	Dec. ^e	
Total long-term funds	17.5	16.0	38.9	6.2	9.2	26.1	32.6	7,971
Equity funds	14.8	11.3	31.1	7.0	4.1	13.5	16.5	5,836
Domestic	9.3	2.6	10.7	-2.4	-3.6	1.0	2.4	4,568
International	5.6	8.7	20.4	9.4	7.7	12.5	14.1	1,268
Hybrid funds	3.6	2.1	0.4	-0.1	0.3	2.0	2.1	647
Bond funds	-0.9	2.6	7.4	-0.7	4.8	10.6	14.0	1,488
High-yield	-0.8	-1.3	-0.4	-1.4	0.4	0.9	1.2	155
Other taxable	1.0	3.5	5.8	0.7	3.3	7.7	11.0	968
Municipals	-1.1	0.4	2.1	0.1	1.0	2.0	1.7	365

Note. Excludes reinvested dividends.

^e Staff estimate based on confidential weekly data.

Source: Investment Company Institute.

Treasury Financing

(Billions of dollars)

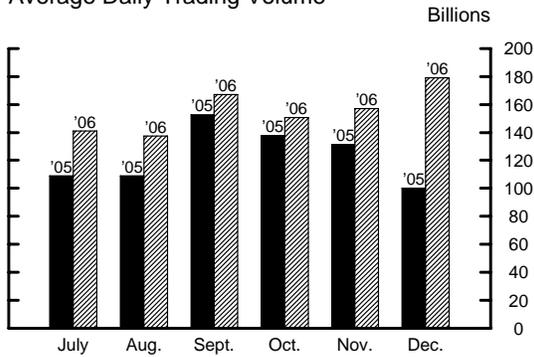
Item	2005	2006					
	Q4	Q1	Q2	Q3	Q4	Nov.	Dec.
Total surplus, deficit (-)	-119.4	-183.6	96.5	-41.7	-106.6	-75.6	18.3
Means of financing deficit							
Net borrowing	112.2	156.1	-74.8	43.4	62.2	51.3	-27.0
Nonmarketable	21.2	-2.3	17.6	-1.5	20.2	6.3	9.8
Marketable	91.0	158.5	-92.4	44.9	42.0	45.0	-36.8
Bills	48.8	78.1	-125.5	-5.3	32.8	59.6	-44.8
Coupons	42.3	80.4	33.1	50.1	9.2	-14.6	8.0
Decrease in cash balance	-0.9	28.4	-37.6	-6.3	21.5	36.4	-9.8
Other ¹	8.1	-1.0	15.9	4.7	23.0	-12.1	18.5
Memo:							
Cash balance, end of period	36.6	8.2	45.8	52.1	30.7	20.9	30.7

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

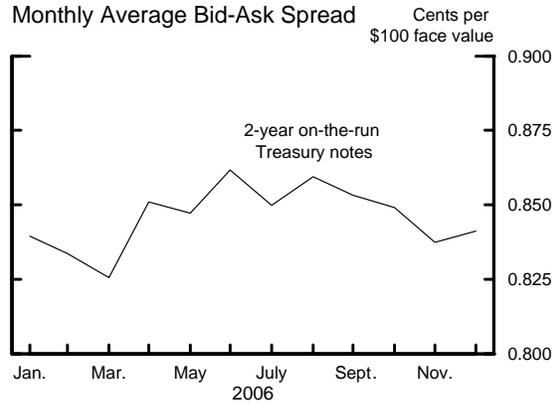
Average Daily Trading Volume



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.

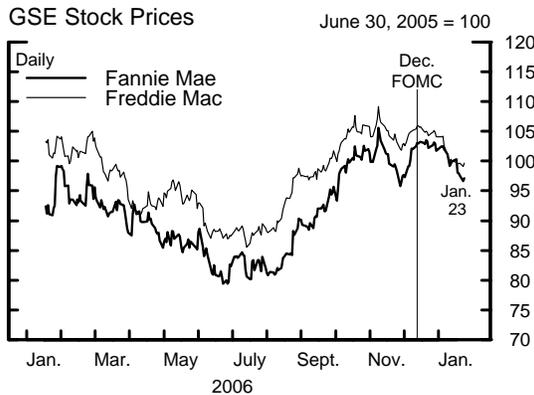
Monthly Average Bid-Ask Spread



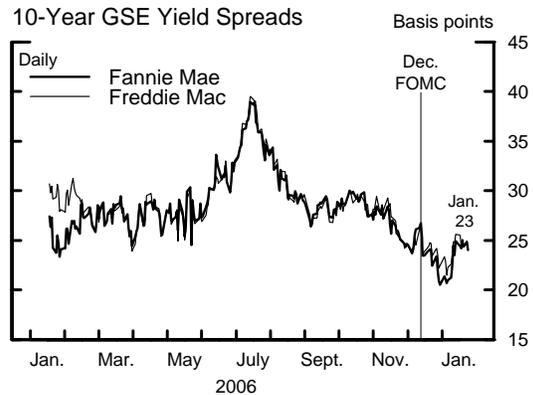
Source. BrokerTec Interdealer Market Data.

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

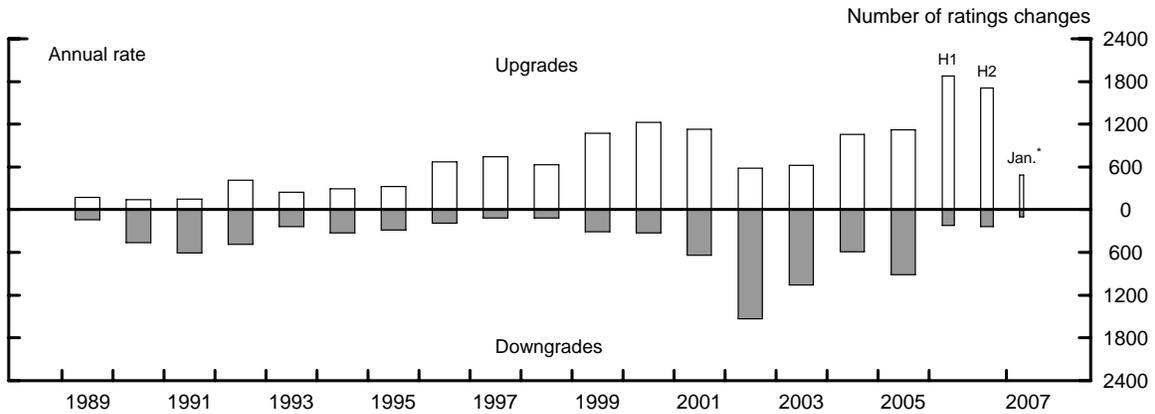
Gross Offerings of Municipal Securities

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

Type of security	2003	2004	2005	2006				2007
				H1	Q3	Q4	Dec.	Jan. ^e
Total	37.9	34.7	38.4	32.9	34.6	43.8	49.7	23.0
Long-term ¹	32.0	29.8	34.1	30.0	29.1	40.3	45.8	22.0
Refundings ²	10.0	10.8	15.5	9.7	8.0	14.1	10.8	9.0
New capital	22.1	19.0	18.7	20.3	21.1	26.2	35.0	13.0
Short-term	5.8	4.9	4.2	2.8	5.5	3.5	3.9	1.0
Memo: Long-term taxable	3.5	2.0	2.1	2.8	2.7	1.7	2.0	.0

- 1. Includes issues for public and private purposes.
- 2. All issues that include any refunding bonds.
- e Staff estimate based on preliminary data through January 18, 2007.

Ratings Changes



Municipal Bond Yields



Municipal Bond Yield Ratio



Treasury and Agency Finance

The Treasury has modestly trimmed auction sizes for some coupon securities amid continued improvements in the federal budget. Also, in preparation for its midquarter refunding, to be announced next week, the Treasury solicited the primary dealers' views on possible further reductions in its auction calendar. During the intermeeting period, the Treasury auctioned two-, five-, and ten-year nominal coupon securities and ten-year TIPS. The auctions for nominal coupon securities were well received, and indirect bids, a rough indicator of demand from foreign official institutions, were generally in line with recent historical averages. However, overall demand and indirect bidder participation were tepid at the ten-year TIPS auction. Other measures of foreign demand for Treasuries held roughly steady, as both foreign custody holdings of Treasury securities at the Federal Reserve Bank of New York (FRBNY) and foreign purchases of notes and bonds, based on the most recent data from the Treasury International Capital reporting system for November, were little changed from the previous month. Bid-ask spreads and volume in the market for on-the-run Treasury securities suggested that trading conditions through year-end remained comparatively liquid.

On January 5, Freddie Mac announced an estimated \$550 million loss for the third quarter; the drop reflects a reversal of earlier mark-to-market gains on derivatives and credit guarantees. The stock prices of both Freddie Mac and Fannie Mae dropped in the wake of that announcement and fell about 5 percent on net over the intermeeting period. Demand for GSE debt from overseas investors reportedly remained robust, and the foreign custody holdings of GSE and agency securities at the FRBNY continued to increase. Agency senior debt spreads over comparable-maturity Treasuries were about unchanged over the intermeeting period.

State and Local Government Finance

Gross issuance of long-term municipal bonds strengthened further in December, largely because of a near-record amount of new capital issuance, as state and local governments continued to invest heavily in transportation and education projects. Meanwhile, advance refundings slowed in December to about their average pace in 2006, partly in response to the rise in interest rates; issuance of short-term municipal bonds continued to be modest. In January, both long-term and short-term municipal bond issuance slowed. However, issuance of long-term municipal bonds, particularly new capital issuance, is likely to pick up in the near future given the sizable bond capacities approved in a number of states in the elections last November.

M2 Monetary Aggregate
(Based on seasonally adjusted data)

Aggregate and components	Percent change (annual rate) ¹						Level (billions of dollars), Jan. (e)
	2005	2006	2006			2007	
			Q3	Q4	Dec.	Jan. (e)	
M2	4.1	5.0	4.2	6.8	7.6	9.0	7,074
Components ²							
Currency	3.6	3.6	1.1	3.1	3.9	1.8	751
Liquid deposits ³	2.0	.6	-1.2	2.7	5.3	8.9	4,329
Small time deposits	18.7	19.7	20.2	17.7	10.3	6.1	1,170
Retail money market funds	-.2	12.9	15.7	17.4	19.7	20.9	817
Memo:							
Institutional money market funds	4.9	15.7	17.2	20.8	26.3	-3.6	1,329
Monetary base	3.5	3.1	.7	2.5	3.9	1.1	813

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.

The credit quality of municipal bonds remained solid over the intermeeting period. The number of bonds with rating upgrades continued to far outpace the number with downgrades, and the ratio of municipal bond yields to Treasury yields remained low.

Money and Bank Credit

M2 expanded at a rather rapid 8¼ percent annual rate over December and January. In part, this vigorous growth reflects the cumulative effect of declines in opportunity costs since the middle of 2006; but the extent of the pickup in growth of liquid deposits -- which account for about 60 percent of M2 assets -- was surprising. Retail money market funds continued their blistering advance. By contrast, small time deposits have slowed of late; currency growth was held down by weak overseas demand.

Commercial bank credit expanded at an annual rate of about 4½ percent in the fourth quarter, a significant step-down from the 11 percent pace posted over the first three quarters of last year.¹ The slowdown was driven by reduced growth in each of the core components of bank lending. C&I loans slowed from their exceptionally strong pace earlier in the year but remained robust, amidst a continued accommodative lending environment. The January Senior Loan Officer Opinion Survey indicated that banks, on net, had further eased some credit terms on C&I loans while leaving lending standards little changed on balance over the past three months. Commercial real estate loans also decelerated in the fourth quarter; survey respondents reported, on net, both a weakening in demand and some tightening of credit standards for such loans. Growth in loans to households also moderated last quarter, as residential mortgage loans only edged up after posting fairly strong increases earlier in the year; consumer loans continued to rise at a moderate pace in the fourth quarter.

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 the fourth quarter.

Commercial Bank Credit

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

Type of credit	2005	H1 2006	Q3 2006	Q4 2006*	Nov. 2006	Dec. 2006	Level, ¹ Dec. 2006*
Total ²	10.5	11.9	9.3	4.6	5.7	5.5	7,903
<i>Loans</i> ³							
Total	11.6	11.6	10.8	6.2	5.4	9.8	5,909
To businesses							
Commercial and industrial	13.1	16.3	20.2	9.7	4.8	9.4	1,167
Commercial real estate	17.1	15.7	13.7	7.1	7.4	7.2	1,433
To households							
Residential real estate	12.0	7.7	7.3	1.6	-2.1	9.7	1,743
Revolving home equity	13.3	.1	3.9	1.3	4.3	7.2	453
Consumer	3.1	6.7	6.5	.3	8.6	11.2	734
Originated ⁴	.7	7.4	5.1	4.5	9.0	9.8	1,124
Other ⁵	8.5	12.0	4.6	14.8	16.1	13.6	832
<i>Securities</i>							
Adjusted ²	7.6	12.6	4.8	-.1	6.5	-7.2	1,994
Reported	5.4	13.3	3.9	-3.4	9.4	1.5	2,144
Treasury and agency	.0	8.3	6.0	-4.0	-3.8	-14.3	1,192
Other ⁶	13.5	20.0	1.6	9.1	26.1	21.2	981

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.

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

Appendix

Senior Loan Officer Opinion Survey on Bank Lending Practices

The January 2007 Senior Loan Officer Opinion Survey on Bank Lending Practices addressed changes in the supply of, and demand for, bank loans to businesses and households over the past three months. The survey also contained special questions about changes in terms on commercial real estate loans during 2006, the effects of the 2005 bankruptcy reforms, and expected changes in asset quality over 2007. This appendix is based on responses from fifty-five domestic banks and twenty-two foreign banking institutions.

Overall, the survey respondents reported mixed changes in lending standards and terms in January, while demand for most loan types was reportedly somewhat weaker. Domestic and foreign institutions noted that they had eased some terms on commercial and industrial (C&I) loans over the past three months, while credit standards on such loans had changed little. By contrast, domestic respondents indicated that they had tightened credit standards on commercial real estate loans over the previous three months. Demand for C&I loans at domestic banks was reportedly little changed, on balance, in the January survey, while demand for commercial real estate loans at these institutions was said to have weakened over the past three months. Foreign institutions, by contrast, reported that they had experienced stronger demand for commercial real estate loans over the same period. In the household sector, domestic respondents noted that they had tightened credit standards on residential mortgage loans over the survey period, while demand for such loans continued to weaken. Lending standards and terms on credit card and non-credit-card consumer loans were little changed in the January survey, but a considerable net fraction of domestic banks reported that they had seen weaker demand for consumer loans over the past three months.

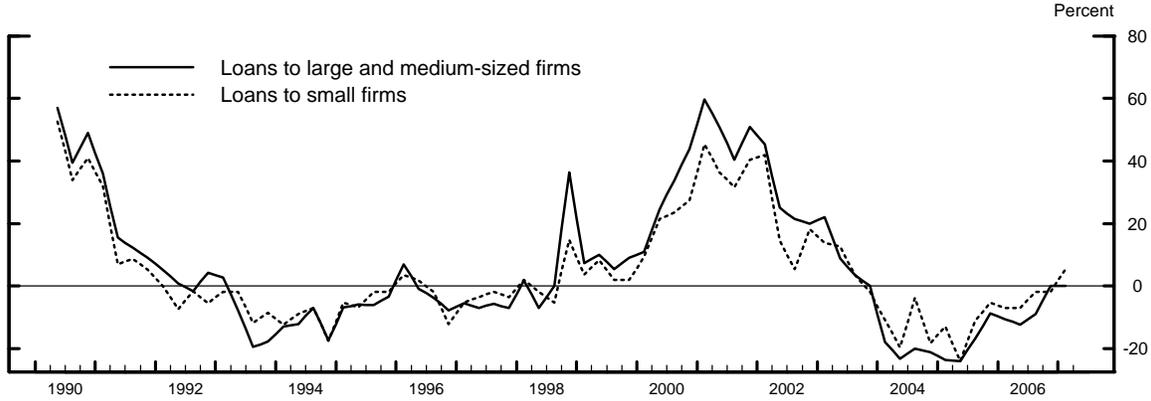
Regarding the special questions, domestic and foreign institutions reported that terms on commercial real estate loans were generally little changed over the past year, although a considerable net fraction of domestic respondents noted that they had trimmed spreads of loan rates over their cost of funds. In response to the special questions on the effects of the 2005 bankruptcy reforms, domestic banks reported that they had not changed their lending policy for credit card loans as a result of the reforms. Nevertheless, a significant fraction of these institutions anticipate that charge-offs on such loans will be somewhat lower in the long term. Considerable net percentages of both foreign and domestic institutions reportedly expect credit quality on loans to businesses and households to deteriorate somewhat in 2007.

Business Lending

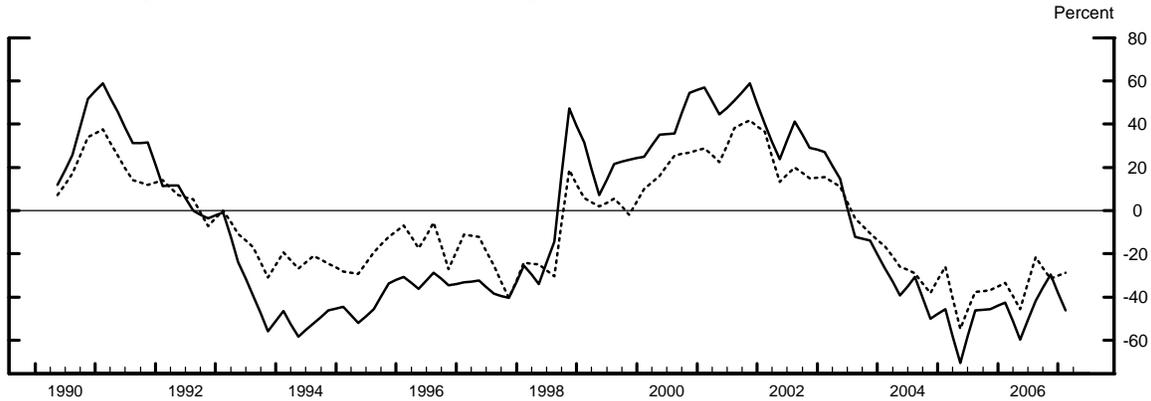
In the January survey, domestic institutions reported that credit standards on C&I loans to large and middle-market firms were unchanged, on net, over the past three months. These respondents, however, noted that they had eased some terms on C&I loans to such firms over the same period. About 45 percent of respondents—a somewhat larger net percentage than in the previous

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

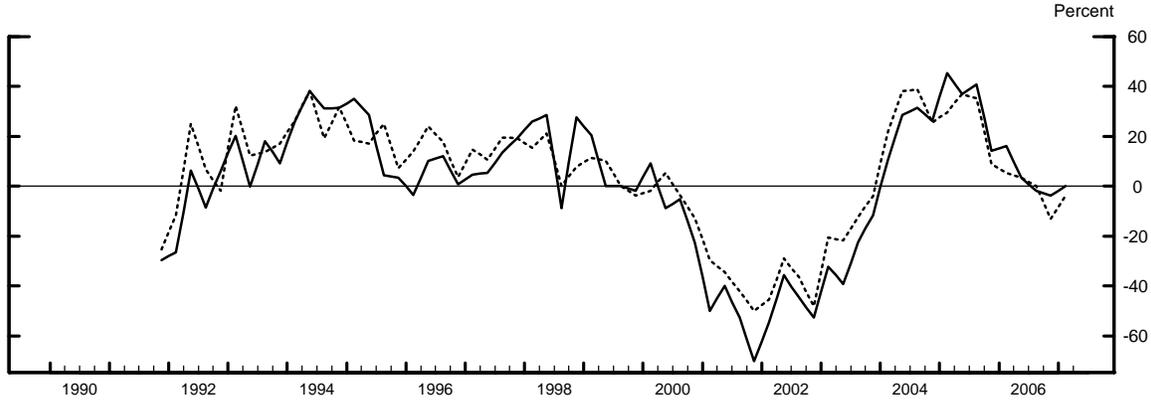
Net Percentage of Domestic Respondents Tightening Standards for C&I Loans



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

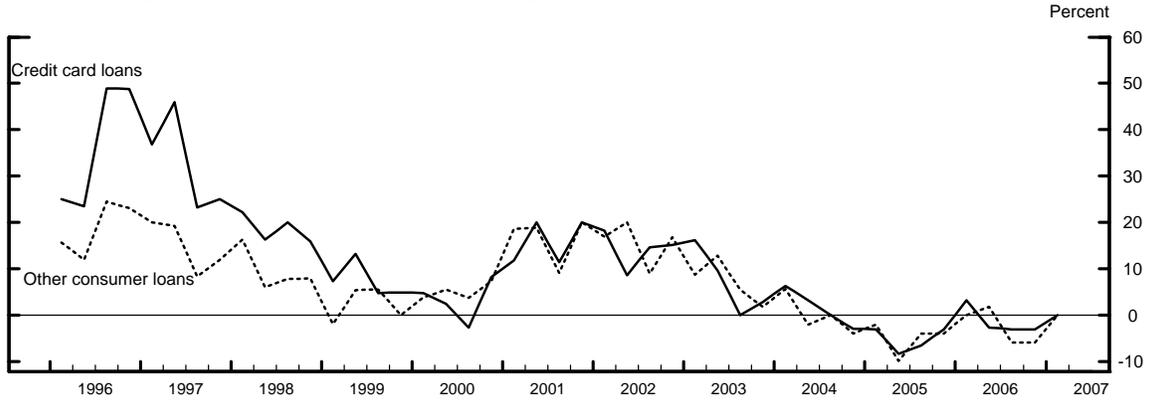


Net Percentage of Domestic Respondents Reporting Stronger Demand for C&I Loans

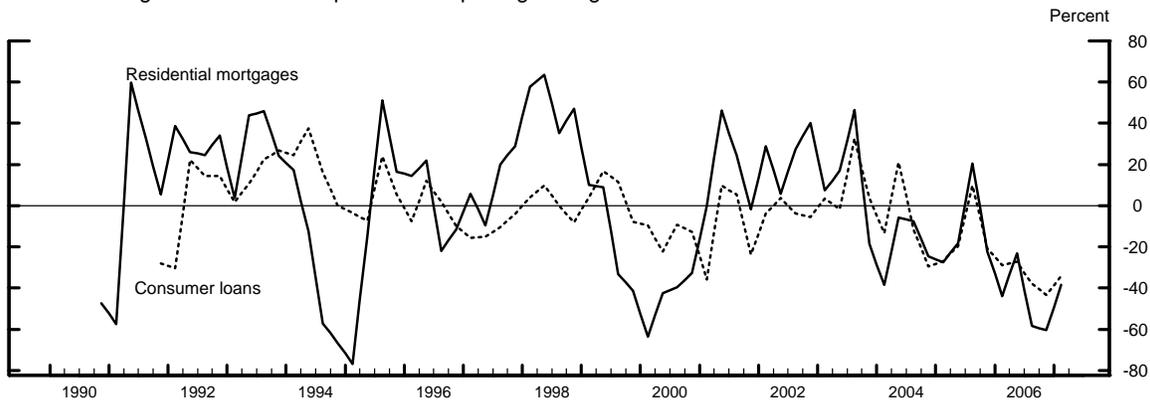


Measures of Supply and Demand for Loans to Households

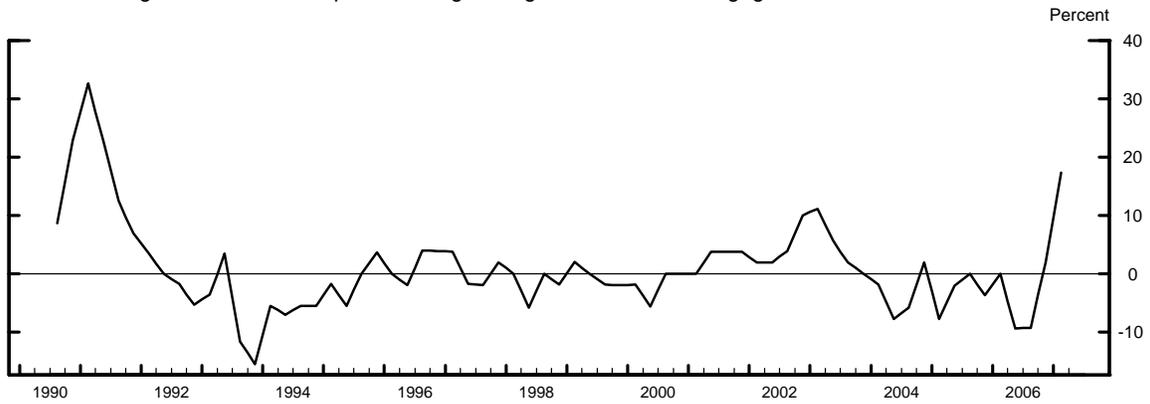
Net Percentage of Domestic Respondents Tightening Standards for Consumer Loans



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



Net Percentage of Domestic Respondents Tightening Standards for Mortgages to Individuals



survey—indicated that they had trimmed spreads of loan rates over their cost of funds over the past three months, while smaller net fractions reported that they had reduced the costs of credit lines or eased loan covenants. Credit standards on C&I loans to small firms were also reportedly little changed, on balance, in the January survey, but almost 30 percent of domestic banks, on net, reported that they had trimmed spreads of loan rates over their cost of funds for such customers over the past three months.

As they did in the previous survey, U.S. branches and agencies of foreign banks reported that their standards on C&I loans had changed little over the past three months. However, significant net fractions of these institutions indicated that they had increased the maximum size of credit lines, eased loan covenants, and narrowed spreads of loan rates over their cost of funds.

Nearly all domestic banks and all U.S. branches and agencies of foreign banks that indicated having eased their lending standards and terms in the January survey cited more-aggressive competition from other banks or nonbank lenders as the most important reason for having done so. A notable percentage of domestic institutions also pointed to a more favorable or a less uncertain economic outlook, while considerable fractions of foreign institutions cited increased liquidity in the secondary market for such loans and increased tolerance for risk as reasons for their move toward a less stringent lending posture.

At both domestic and foreign institutions, demand for C&I loans was reportedly little changed, on balance, over the past three months. Among domestic institutions that experienced stronger demand for C&I loans, more than 80 percent cited a rise in merger and acquisition activity as a reason for stronger loan demand, while about two-thirds pointed to borrowers' increased needs to finance investment in plant or equipment. Among domestic respondents that saw weaker demand for C&I loans, two-thirds attributed the softening to borrowers' decreased needs to finance investment in plant or equipment, while about 50 percent cited borrowers' decreased financing needs for accounts receivable or a shift in customer borrowing to another bank or to nonbank sources of credit.

Regarding future business, a small net fraction of domestic respondents indicated that the number of inquiries from potential business borrowers had decreased over the previous three months. By contrast, 10 percent of foreign respondents, on balance, reported that the number of inquiries from potential business borrowers had increased in January.

About one-fourth of domestic institutions—a somewhat smaller net fraction than in the October survey—reported that they had tightened lending standards on commercial real estate loans over the past three months. About 35 percent of domestic respondents—a slightly larger net percentage than in the previous survey—indicated that they had seen weaker demand for such loans over the same period. At foreign institutions, by contrast, lending standards on commercial

real estate loans were unchanged, on net, in the January survey; in addition, about one-fifth of these institutions reported that they had experienced stronger demand for such loans.

For several years, the January survey has asked banks to report the changes over the past twelve months in various commercial real estate loan terms. This year's responses indicate that at both domestic and foreign institutions most terms on such loans were little changed, on net, over the past year. However, almost 60 percent of domestic respondents, on balance, reported that they had trimmed spreads of loan rates over their cost of funds, while small net fractions of foreign respondents noted that they had reduced debt service coverage ratios and increased maximum loan sizes. Nearly all domestic banks and all foreign institutions that had eased terms on commercial real estate loans over the past twelve months cited more-aggressive competition from other banks or nonbank lenders as the most important reason for having done so.

Household Lending

On balance, almost one-fifth of domestic banks reported that they had tightened credit standards on residential mortgage loans over the past three months, the highest net fraction posted since the early 1990s. About 40 percent of domestic institutions—a somewhat smaller net fraction than in the October survey—indicated that demand for such loans had weakened over the previous three months.

Domestic respondents reported that their willingness to make consumer installment loans was little changed in the January survey. Similarly, standards and terms on credit card and non-credit-card consumer loans had reportedly changed little, on balance, over the previous three months. About one-third of domestic institutions indicated that they had experienced weaker demand for consumer loans, a slightly smaller net percentage than in the previous survey.

A set of special questions asked domestic banks about the effects of the bankruptcy reform legislation that took effect on October 17, 2005. Virtually all domestic respondents reported that they had not changed their lending policies for credit card loans in response to the reforms. Two institutions indicated that they had tightened credit standards for approving applications for credit card loans. One-fourth of domestic institutions indicated that, after accounting for changes in their lending standards and terms, they anticipate that their charge-offs on credit card loans will be lower in the long term as a result of the reforms.

Special Questions on the Outlook for Loan Quality in 2007

A final set of special questions queried banks about their outlook for delinquencies and charge-offs on their loans to businesses and households in 2007 under the assumption that economic activity will progress in line with consensus forecasts. Overall, the responses suggest that banks expect a deterioration in loan quality this year. About 45 percent of domestic respondents, on net, reported that they expect the quality of their loans to businesses—including both C&I and commercial real estate loans—to deteriorate somewhat. At U.S. branches and agencies of foreign

banks, the net fraction of respondents that expected a decline in the credit quality of loans to businesses was somewhat smaller—roughly 30 percent. Almost 40 percent of domestic institutions, on balance, indicated that they anticipate that the quality of both credit card and non-credit-card consumer loans will deteriorate in 2007. A similar net fraction of domestic respondents reported that they expect the quality of their traditional residential mortgages to decline. One-half of domestic banks, on net, reported that they expect a worsening of the quality of their nontraditional residential mortgage loans this year; a few institutions noted that they anticipate that the quality of such loans will deteriorate substantially in 2007. Banks were asked the same set of special questions about their outlook for loan quality in the January 2006 survey. A year ago, the net fraction of institutions that anticipated some deterioration in credit quality was notably smaller for loans to both businesses and households.

Last Page of Domestic Financial Developments

International Developments

International Developments

U.S. International Transactions

Trade in Goods and Services

The U.S. international trade deficit narrowed from \$64.3 billion in September to \$58.8 billion in October and edged down further to \$58.2 billion in November. The November deficit was the smallest since July 2005. The contraction of the deficit in October primarily reflected a decline in both the price and volume of oil imports, whereas the narrowing in November occurred as export growth outpaced a modest increase in non-oil imports and imports of oil remained flat.

Trade in Goods and Services

	2005	Annual rate			Monthly rate		
		2006			2006		
		Q2	Q3	Q4 ^e	Sept.	Oct.	Nov.
		Percent change					
<i>Nominal BOP</i>							
Exports	10.4	14.1	11.9	7.4	.5	.3	.9
Imports	12.6	10.5	13.2	-12.2	-1.9	-2.7	.3
<i>Real NIPA</i>							
Exports	6.7	6.2	6.8	n.a.	...	...	...
Imports	5.2	1.4	5.6	n.a.	...	...	...
		Billions of dollars					
<i>Nominal BOP</i>							
Net exports	-716.7	-772.5	-801.3	-702.2	-64.3	-58.8	-58.2
Goods, net	-782.7	-842.4	-874.4	-778.4	-70.3	-65.0	-64.7
Services, net	66.0	69.9	73.2	76.1	6.0	6.2	6.5

e. BOP data are two months at an annual rate.

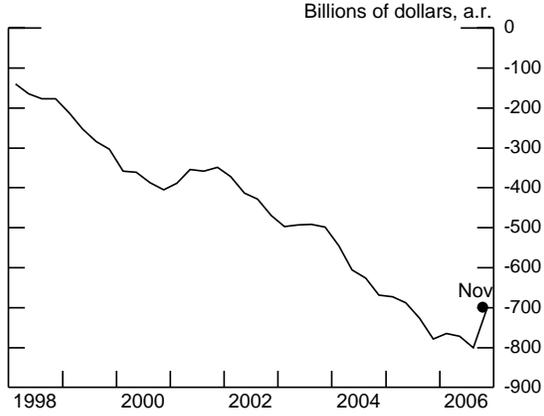
Source. U.S. Department of Commerce, Bureau of Economic Analysis and Census.

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

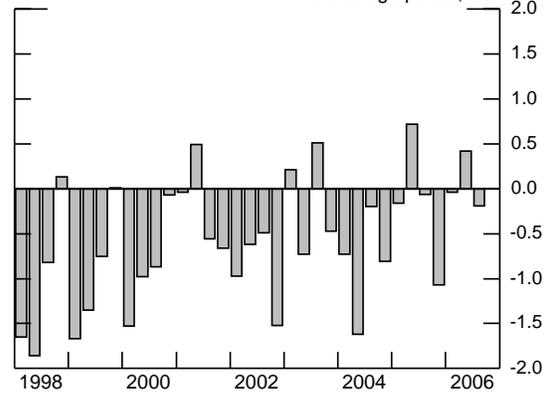
The value of exports of goods and services increased 0.9 percent in November following a 0.3 percent increase in October. The November increase was split between higher exports of services and exports of goods, whereas the October increase reflected higher exports of services, as exports of goods fell slightly during the month. Exports in November were boosted by a large jump in exports of aircraft, and were also supported by a rise in exports of automotive products and consumer goods. In contrast, exports of industrial supplies fell back in November, depressed in part by the continued retreat of exports of fuel oil following a surge in September.

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

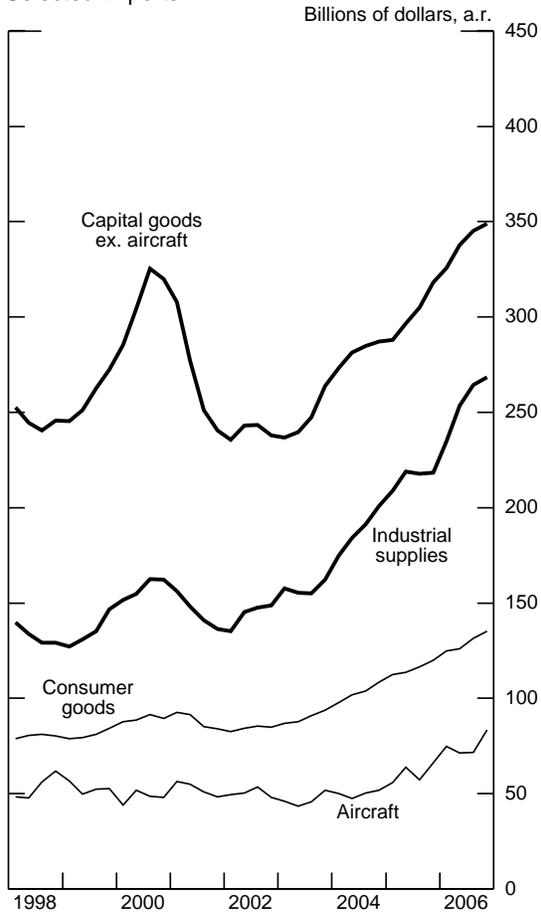
Trade Balance



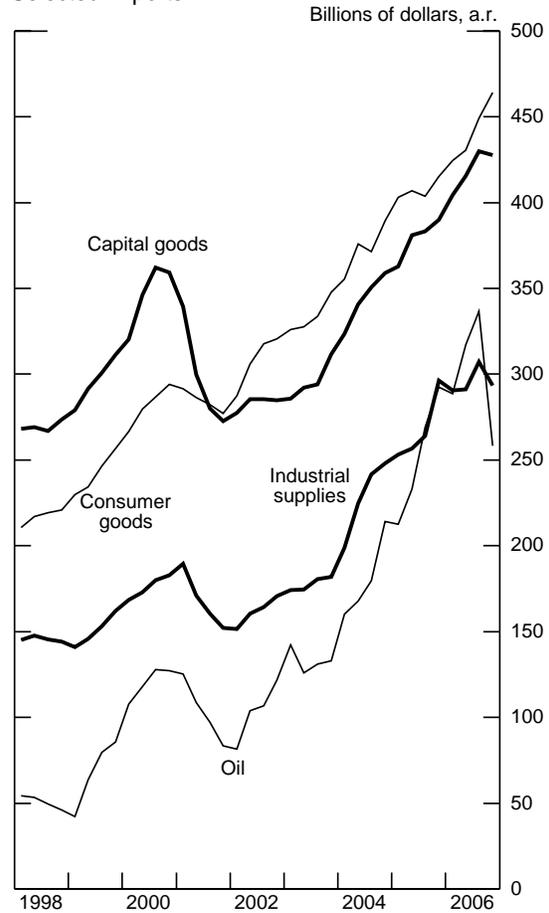
Contribution of Net Exports to Real GDP Growth



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	
	Q3	Q4 ^e	Oct.	Nov.	Q3	Q4 ^e	Oct.	Nov.
Exports of G&S	1464.3	1490.6	1484.0	1497.2	40.6	26.2	3.8	13.2
Goods exports	1048.3	1065.6	1062.0	1069.1	36.9	17.3	-1.1	7.1
Gold	9.6	8.7	9.3	8.2	.8	-.9	-1.5	-1.1
Other goods	1038.7	1056.8	1052.7	1060.9	36.1	18.1	.5	8.2
Capital goods	417.0	432.3	428.3	436.3	7.6	15.3	.5	8.1
Aircraft & parts	71.8	83.5	79.7	87.3	.3	11.7	-.4	7.6
Computers & accessories	47.4	49.3	49.7	48.9	-.4	1.9	1.8	-.8
Semiconductors	53.7	51.3	51.0	51.7	-1.2	-2.3	-1.2	.7
Other capital goods	244.2	248.2	247.9	248.5	9.0	4.0	.4	.6
Automotive	111.5	106.7	104.8	108.7	6.8	-4.8	-.8	3.9
Ind. supplies (ex. ag., gold)	264.4	268.3	269.6	267.0	11.1	3.9	-3.5	-2.6
Consumer goods	131.6	135.4	134.4	136.3	5.5	3.8	4.8	1.9
Agricultural	75.8	74.5	75.7	73.3	2.7	-1.3	.6	-2.4
All other goods	38.4	39.6	39.9	39.3	2.4	1.1	-4.7	-.6
Services exports	416.1	425.0	422.0	428.1	3.6	9.0	4.8	6.1
Imports of G&S	2265.6	2192.8	2189.6	2196.0	69.4	-72.8	-61.7	6.3
Goods imports	1922.7	1843.9	1842.3	1845.5	69.0	-78.8	-64.3	3.2
Oil	336.7	258.3	258.8	257.8	19.5	-78.4	-56.0	-1.0
Gold	5.6	5.1	5.5	4.7	-.6	-.5	-.3	-.7
Other goods	1580.5	1580.5	1578.1	1583.0	50.0	.1	-8.0	4.9
Capital goods	429.9	427.7	425.7	429.7	14.3	-2.2	-3.5	4.0
Aircraft & parts	27.6	30.4	29.1	31.6	-.1	2.8	-3.1	2.5
Computers & accessories	104.4	102.3	100.7	103.9	3.0	-2.1	-3.1	3.3
Semiconductors	28.5	27.3	27.5	27.1	1.6	-1.3	-.6	-.5
Other capital goods	269.3	267.7	268.4	267.1	9.8	-1.6	3.1	-1.3
Automotive	253.7	251.1	249.2	253.1	-4.6	-2.5	-3.4	3.8
Ind. supplies (ex. oil, gold)	307.1	293.6	298.7	288.4	15.7	-13.5	-8.1	-10.3
Consumer goods	449.1	464.0	458.6	469.3	18.5	14.9	2.1	10.7
Foods, feeds, bev.	76.4	77.3	77.9	76.6	3.2	.9	1.5	-1.3
All other goods	64.4	66.9	67.8	65.9	2.9	2.5	3.4	-1.9
Services imports	342.9	348.9	347.3	350.5	.4	6.0	2.6	3.2
<i>Memo:</i>								
Oil quantity (mb/d)	13.86	12.81	12.52	13.11	.23	-1.05	-1.15	.59
Oil import price (\$/bbl)	66.51	55.22	56.61	53.83	2.84	-11.26	-6.46	-2.78

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

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

The average value of exports in October and November increased 7.4 percent (a.r.) from the third quarter. Exports of aircraft and services exhibited particular strength. In contrast, exports of automotive products fell back from their elevated third-quarter level.

The value of imported goods and services rose 0.3 percent in November after falling 2.7 percent in October. The increase in November reflected higher imports of both goods and services, whereas the decline in October occurred as lower imports of goods, especially oil, more than offset a slight increase in imports of services. Imports in November increased in most major categories with the exception of non-oil industrial supplies, which recorded a large decline. Imports of consumer goods were particularly robust in November.

The average value of imports in October and November fell 12.2 percent (a.r.) from the third quarter. The decline primarily reflects a fall in both the volume and price of imported oil. Additionally, imports of non-oil industrial supplies, capital goods, and automotive products also fell, offsetting a strong increase in imports of consumer goods.

Prices of Internationally Traded Goods

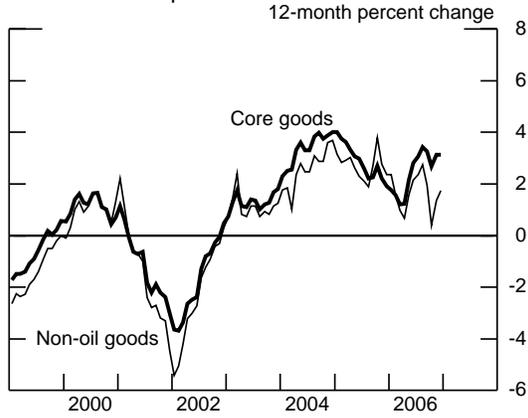
Non-oil imports. In December, import prices of non-oil goods and core goods rose 0.4 and 0.2 percent, respectively. Prices for non-fuel industrial supplies increased 0.5 percent in December, as higher prices for metals were partly offset by falling prices for building materials. Food prices were up 0.6 percent in December. In contrast, prices for imported finished goods edged up only 0.1 percent while prices for imported computers fell 0.2 percent, and prices for semiconductors fell 0.3 percent.

The average level of core import prices in the fourth quarter was 1½ percent (a.r.) above the third-quarter average, as prices increased in all major sub-categories. Prices for material-intensive goods were up 3¾ percent, while prices for finished goods increased less than 1 percent.

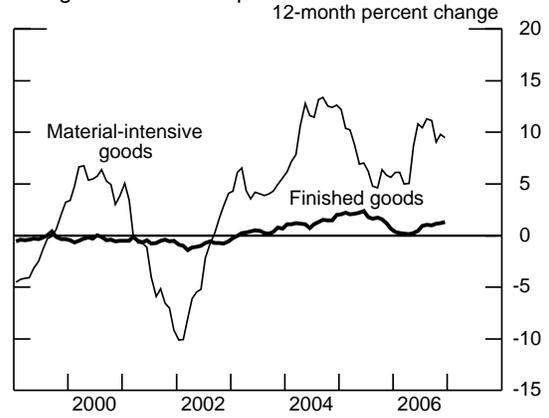
Oil. After falling more than 20 percent over the previous three months, the BLS price index of imported oil rose 4.8 percent in December. The spot price of West Texas Intermediate (WTI) crude oil rose to a similar extent in December and averaged \$62 per barrel for the month. Thus far in January, however, the spot price of WTI has fallen

Prices of U.S. Imports and Exports

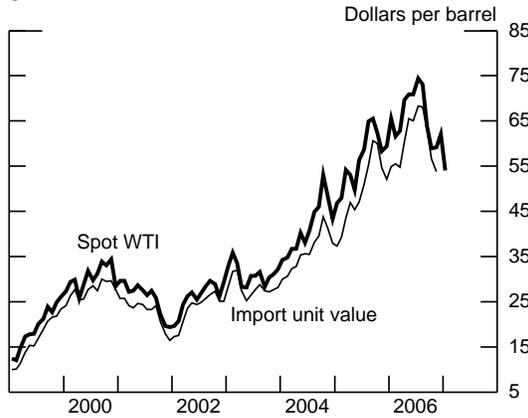
Merchandise Imports



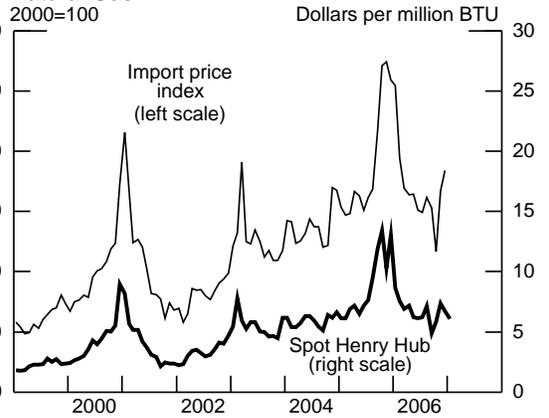
Categories of Core Imports



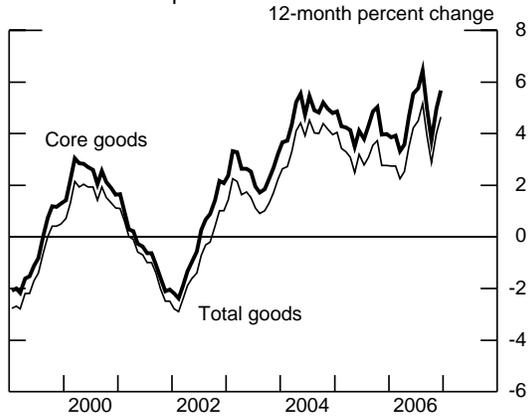
Oil



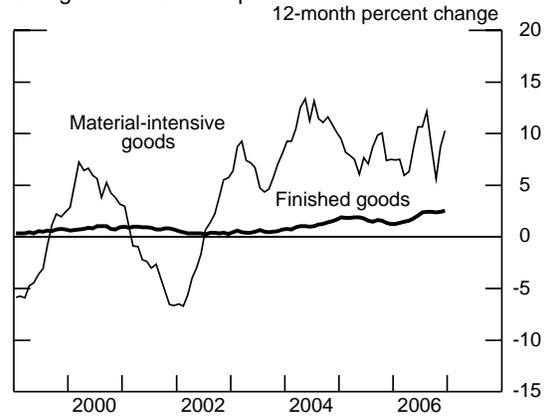
Natural Gas



Merchandise Exports



Categories of Core Exports



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

	Annual rate			Monthly rate		
	2006			2006		
	Q2	Q3	Q4	Oct.	Nov.	Dec.
	----- BLS prices -----					
Merchandise imports	12.8	4.2	-12.0	-2.6	.5	1.1
Oil	79.1	7.0	-51.7	-10.8	-1.2	4.8
Non-oil	1.0	3.4	1.4	-.6	.9	.4
Core goods ¹	3.9	4.2	1.6	-.2	.3	.2
Finished goods	.8	2.5	.9	.1	-.0	.1
Cap. goods ex. comp. & semi.	2.5	2.9	.9	.1	-.1	.2
Automotive products	1.0	1.4	.6	.2	.0	-.1
Consumer goods	-.4	3.0	1.1	.1	.0	.2
Material-intensive goods	14.9	9.7	3.8	-.7	.8	.5
Foods, feeds, beverages	-.7	8.5	6.0	.1	.5	.6
Industrial supplies ex. fuels	20.7	10.0	2.3	-.8	.6	.5
Computers	-7.4	-5.2	-2.9	-.5	.2	-.2
Semiconductors	-.3	3.2	2.0	.8	.0	-.3
Natural gas	-63.8	-12.5	3.9	-23.6	43.2	10.1
Merchandise exports	6.7	5.2	.7	-.3	.4	.7
Core goods ²	8.0	6.6	1.1	-.3	.5	.8
Finished goods	2.8	2.5	1.8	.2	.1	.2
Cap. goods ex. comp. & semi.	3.0	2.4	3.2	.4	.3	.2
Automotive products	1.9	1.5	.8	.1	-.1	.3
Consumer goods	3.0	3.0	.3	-.1	.0	.1
Material-intensive goods	15.7	12.7	-.2	-1.1	1.2	1.7
Agricultural products	2.2	18.8	20.3	.9	4.4	2.2
Industrial supplies ex. ag.	20.1	11.3	-4.9	-1.6	.4	1.6
Computers	-3.5	-3.1	-2.2	-.3	-.7	-.5
Semiconductors	-5.9	-10.8	-3.5	.0	-.1	-.3
	----- NIPA prices -----					
Chain price index						
Imports of goods & services	9.8	5.4	n.a.	...	...	...
Non-oil merchandise	.7	3.3	n.a.	...	...	...
Core goods ¹	3.8	4.3	n.a.	...	...	...
Exports of goods & services	6.1	4.5	n.a.	...	...	...
Total merchandise	6.2	5.3	n.a.	...	...	...
Core goods ²	6.9	5.8	n.a.	...	...	...

1. Excludes computers, semiconductors, and natural gas.

2. Excludes computers and semiconductors.

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

sharply to close at \$53.90 per barrel on January 23. The plunge in oil prices appears to reflect reduced oil demand, which largely has been caused by above-average temperatures in much of the northern hemisphere. Additionally, although violence continues to disrupt oil production in Iraq and Nigeria, market participants may have reevaluated the willingness of Saudi Arabia to defend elevated oil prices.

Exports. In December, prices of U.S. exports of total goods and core goods rose 0.7 and 0.8 percent, respectively. Both numbers are up strongly for the second consecutive month, after falling in both of the prior two months. The December increase was driven by higher prices for fuels, building materials, and agricultural products. Export prices for finished goods increased only 0.2 percent in December. Prices of exported computers fell 0.5 percent, and prices of exported semiconductors fell 0.3 percent.

The average level of core export prices in the fourth quarter was about 1 percent (a.r.) above the third-quarter average, as a 1¾ percent increase in the prices of finished goods was partly offset by a ¼ percent decline in the prices of material-intensive goods. Within material-intensive goods, a 5 percent decline in export prices for nonagricultural industrial supplies roughly offset a 20 percent increase in prices for agricultural exports.

U.S. Current Account

The U.S. current account deficit was \$902 billion (a.r.) in the third quarter of 2006, \$34 billion wider than in the second quarter (revised). The trade deficit widened by \$29 billion, as increased imports outpaced increased exports. These increases were observed in all major import and export categories, with the exception of a decline in imports of automotive vehicles and parts. There was only a slight change in net unilateral transfers to foreigners.

The investment income balance was negative \$9 billion (a.r.) in the third quarter, and the second-quarter investment income balance was revised upward by \$8 billion to negative \$2 billion. Although interest, dividend, and direct investment income receipts increased in the third quarter, there were even larger increases in payments.

U.S. Current Account				
(Billions of dollars, seasonally adjusted annual rate)				
Period	Goods and services, net	Investment income, net	Other income and transfers, net	Current account balance
<i>Annual</i>				
2004	-611.3	33.6	-87.6	-665.3
2005	-716.7	17.6	-92.4	-791.5
<i>Quarterly</i>				
2005:Q4	-779.1	-2.3	-111.0	-892.4
2006:Q1	-764.6	-3.6	-84.7	-852.8
Q2	-772.5	-2.1	-93.9	-868.5
Q3	-801.3	-8.7	-92.3	-902.2
<i>Change</i>				
Q4-Q3	-51.9	-40.2	-66.7	-158.8
Q1-Q4	14.5	-1.3	26.4	39.6
Q2-Q1	-7.9	1.4	-9.3	-15.7
Q3-Q2	-28.8	-6.5	1.6	-33.7

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

U.S. International Financial Transactions

The financial flows associated with the current account are presented in the Summary of U.S. International Transactions table. Recorded net private financial inflows moved up to \$96 billion in the third quarter but remained well below the pace recorded in 2005. Measured official financial inflows also increased slightly to \$80 billion. In sum, third-quarter recorded net financial inflows increased by a larger amount than did the recorded current account. As a result the statistical discrepancy narrowed, measuring \$50 billion for the quarter, but remained large and positive for the third consecutive quarter. This positive statistical discrepancy indicates some combination of under-recorded net financial inflows or over-recorded net imports of goods and services and other transactions measured in the current account balance.

U.S. direct investment abroad in the third quarter (line 6) remained near its trend level on continued strength in reinvested earnings. Foreign direct investment flows into the United States (line 7) also remained robust.

With respect to more recent monthly data, foreign official flows into the United States were relatively weak in November, totaling only \$13 billion (line 1). As shown in the top left panel of the Foreign Official Financial Flows chart, however, the 2006 pace of foreign official inflows exceeded the 2005 pace.

Net private foreign purchases of U.S. securities increased in November (line 4), the result of stronger foreign appetite for U.S. debt securities. Purchases of Treasury securities (line 4a) were up sharply, and purchases of corporate bonds (line 4c) reached a record level in November as foreign investors responded to strong issuance of U.S. corporate debt abroad. Increased demand for U.S. debt was partially offset by an easing in demand for U.S. equities (line 4d). As shown in the top left panel of the Private Securities Flows chart, the six-month average of total net private foreign purchases of U.S. securities approached the high recorded earlier in 2006. 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 November (line 5 of the table and the bottom panels of the chart on Private Securities Flows) reached a record level as demand for both foreign stocks and bonds increased. Although the bulk of foreign bonds were transacted through the U.K. financial center, there were also significant net purchases related to bond issuance by counterparties in Brazil and Australia. As with foreign bonds, U.S. investors purchased foreign stocks primarily through the U.K. financial center. As shown on the chart, the six-month average of U.S. private acquisitions of foreign securities has remained in a narrow, elevated range throughout 2006.

The trend of net inflows recorded by the banking sector (line 3) continued in November. Although these flows are typically volatile, there were net banking inflows in each of the first three quarters of 2006 and in the first two months of the fourth quarter.

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

	2004	2005	2005	2006				
			Q4	Q1	Q2	Q3	Oct	Nov
Official financial flows	388.2	214.7	78.6	75.1	77.8	80.2	6.0	13.2
1. Change in foreign official assets in the U.S. (increase, +)	385.4	200.6	73.8	74.6	78.3	79.2	5.0	12.9
a. G-10 countries + ECB	161.7	-21.3	-4.8	-8.4	-18.7	-6.0	3.7	-3.6
b. OPEC	12.1	7.5	10.6	12.0	13.9	11.4	-4.1	-1.0
c. All other countries	211.6	214.5	67.9	71.1	83.1	73.7	5.4	17.6
2. Change in U.S. official reserve assets (decrease, +)	2.8	14.1	4.8	.5	-.6	1.0	.9	.3
Private financial flows	194.3	570.7	164.1	96.4	75.4	96.2	...	...
Banks								
3. Change in net foreign positions of banking offices in the U.S. ¹	-3.8	15.4	60.9	.9	58.3	36.9	11.3	10.8
Securities²								
4. Foreign net purchases (+) of U.S. securities	489.5	611.3	185.5	187.0	160.5	140.2	62.8	90.0
a. Treasury securities	104.2	178.1	59.4	-5.9	13.7	-11.7	2.7	23.8
b. Agency bonds	67.9	66.9	16.4	42.1	28.1	26.1	1.5	4.1
c. Corporate and municipal bonds	255.0	274.3	83.1	93.6	101.7	96.0	33.9	56.6
d. Corporate stocks ³	62.4	92.0	26.5	57.3	17.0	29.8	24.6	5.4
5. U.S. net acquisitions (-) of foreign securities	-146.2	-197.0	-48.7	-61.2	-59.2	-53.3	-20.7	-40.8
a. Bonds	-60.9	-53.1	-5.7	-16.3	-36.3	-44.0	-8.2	-18.5
b. Stock purchases	-97.6	-139.9	-43.0	-40.9	-20.5	-9.2	-12.5	-22.3
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	-46.8	-63.1	...	...
7. Foreign direct investment in the U.S.	133.2	109.8	26.5	45.3	45.8	44.1	...	...
8. Foreign acquisitions of U.S. currency	14.8	19.4	9.2	1.9	1.1	1.1	...	...
9. Other (inflow, +) ⁴	-49.1	20.9	-95.1	-16.4	-84.4	-9.8	...	...
U.S. current account balance (s.a.)	-665.3	-791.5	-223.1	-213.2	-217.1	-225.6	...	...
Capital account balance (s.a.)⁵	-2.3	-4.4	-.5	-1.8	-1.0	-.6	...	...
Statistical discrepancy (s.a.)	85.1	10.4	-19.1	43.4	64.9	49.7	...	...

Note. Data in lines 1 through 5 differ in timing and coverage from the balance of payments data published by the Department of Commerce. Details may not sum to totals because of rounding.

1. Changes in dollar-denominated positions of all depository institutions and bank holding companies plus certain transactions between broker-dealers and unaffiliated foreigners (particularly borrowing and lending under repurchase agreements). Includes changes in custody liabilities other than U.S. Treasury bills.

2. Includes commissions on securities transactions and therefore does not match exactly the data on U.S. international transactions published by the Department of Commerce.

3. Includes (4d) or represents (5c) stocks acquired through non-market means such as mergers and reincorporations.

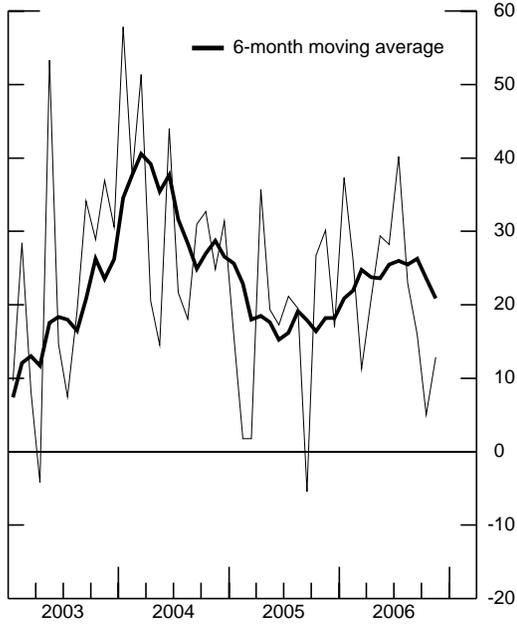
4. Transactions by nonbanking concerns and other banking and official transactions not shown elsewhere plus amounts resulting from adjustments made by the Department of Commerce and revisions in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.

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

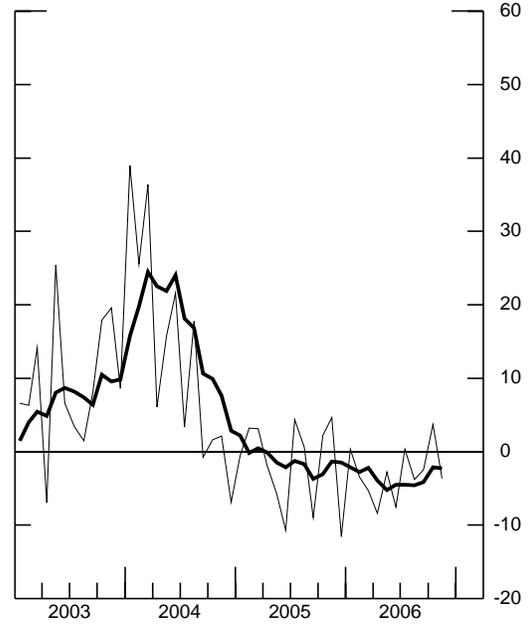
n.a. Not available. ... Not applicable.

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

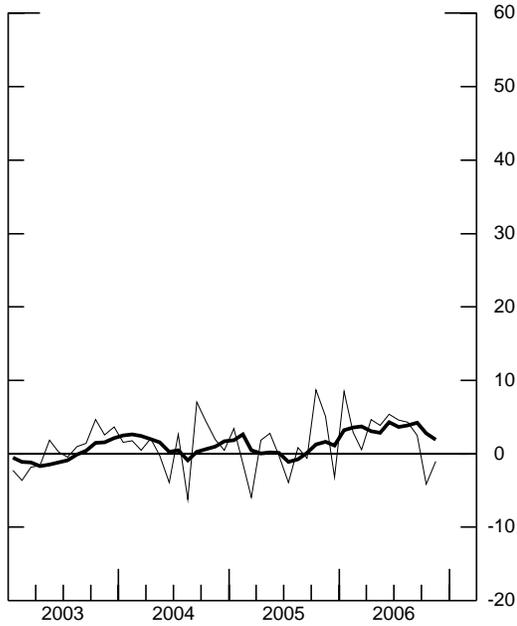
Total



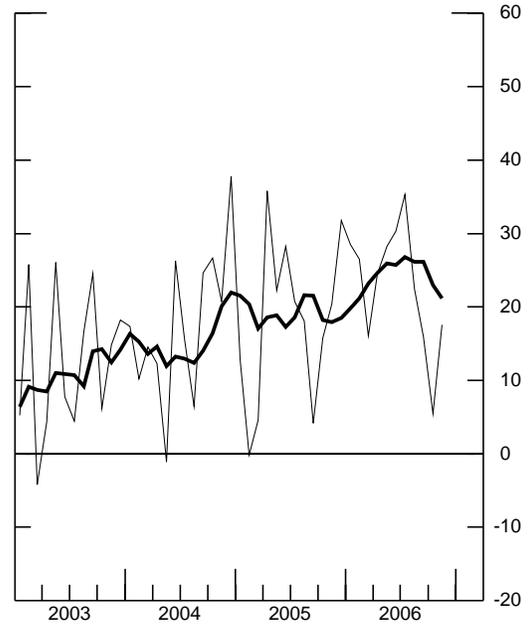
G-10 + ECB



OPEC



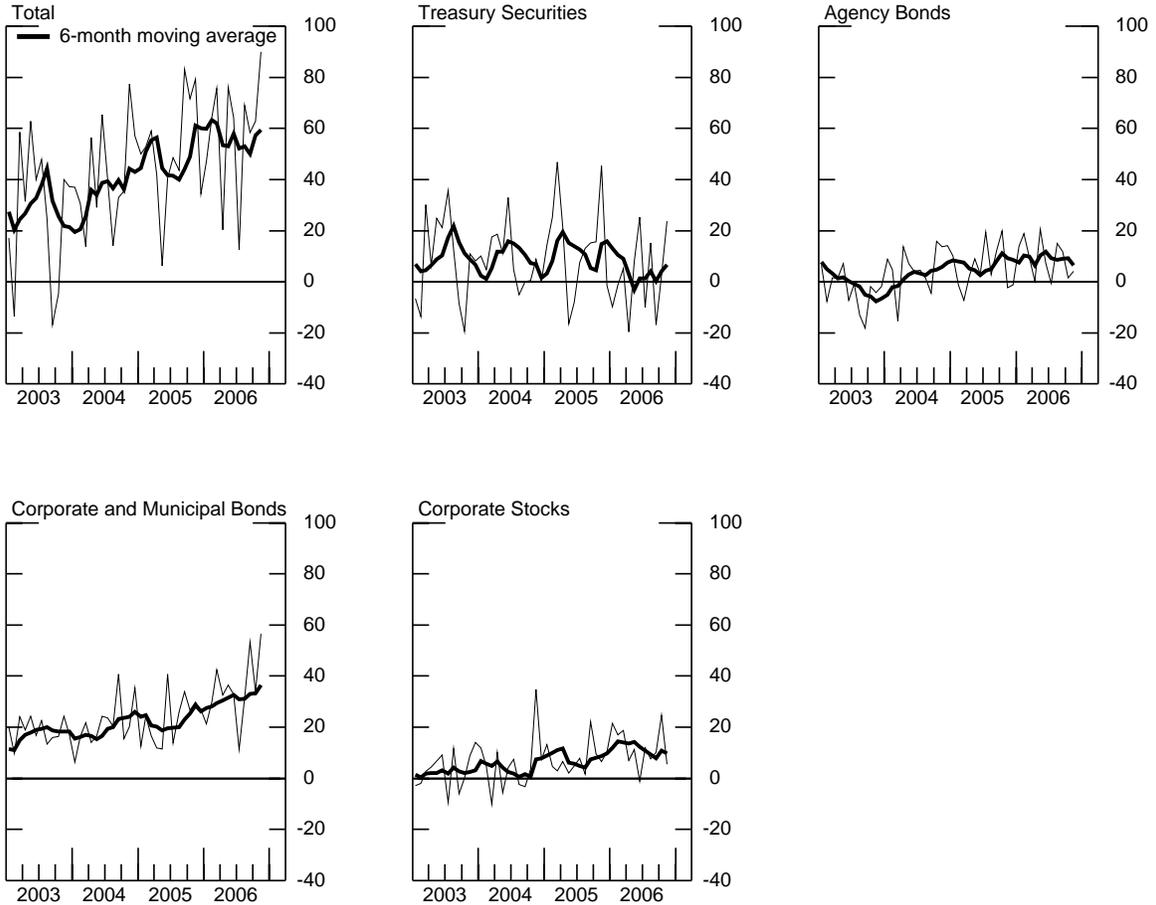
All other countries



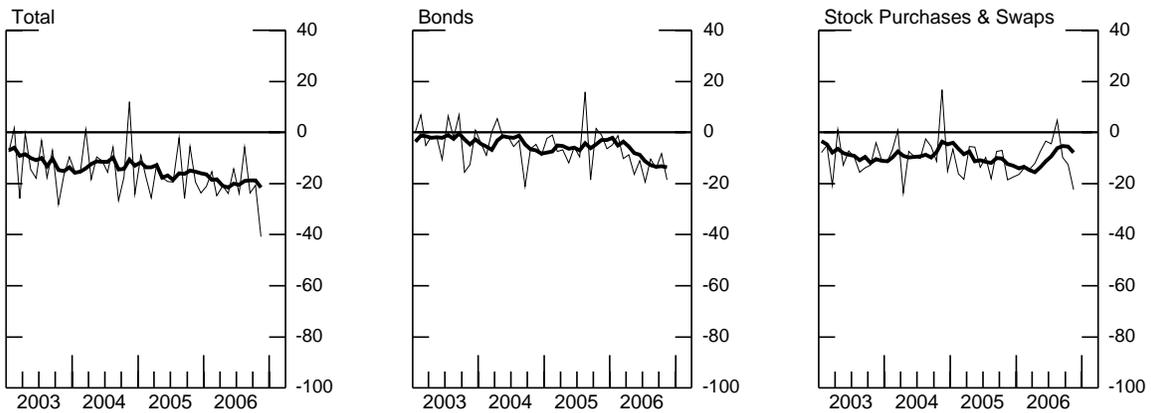
Private Securities Flows Through November 2006

(\$ Billions, monthly, not seasonally adjusted)

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



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



Foreign Financial Markets

Over the intermeeting period, the major currencies index of the dollar's exchange value rose $2\frac{1}{4}$ percent on net. The appreciation of the dollar was linked to several releases of U.S. economic data, including the stronger-than-expected December reports on employment and retail sales, several lower-than-expected weekly initial jobless claims reports, and a lower-than-expected merchandise trade deficit for November. Relative changes in expectations for the near-term monetary policy in the United States and in most major foreign countries also favored the dollar. On a bilateral basis, the dollar appreciated $3\frac{3}{4}$ percent against the yen, $2\frac{1}{4}$ percent against the Canadian dollar, and 2 percent against the euro, but it depreciated $\frac{1}{4}$ percent against sterling. The dollar's appreciation against the yen was supported by the scaling back by some market participants of their expectations for a near-term rate hike by the Bank of Japan. Indeed, the Bank of Japan did not change its policy stance at its meeting on January 18, surprising some market participants. In contrast, the dollar's depreciation against sterling was tied to the surprise 25-basis-point hike by the Bank of England on January 11. The option-implied volatility of the euro-dollar and dollar-yen exchange rates fluctuated little and remained close to historically low levels.

Headline equity indexes rose $2\frac{1}{2}$ to 4 percent in Europe and about 6 percent in Japan. Perhaps these increases were supported by declines in energy prices. Ten-year nominal sovereign yields rose 25 to 30 basis points in Germany, the United Kingdom, Canada, and the United States, but were little changed on net in Japan. Long-term inflation breakeven rates, measured as the difference between nominal and inflation-indexed ten-year sovereign yields, were little changed on net in the major foreign countries. Realized volatilities on headline equity indexes and ten-year bond remained low during the intermeeting period.

The dollar's trade-weighted exchange value against the currencies of our other important trading partners was unchanged on balance over the intermeeting period. The dollar depreciated 1 percent against the Brazilian *real*, but it appreciated 1 percent against the Mexican peso and also appreciated somewhat against the currencies of several East-Asian emerging market economies. The dollar depreciated $\frac{3}{4}$ percent against the Chinese renminbi. EMBI+ spreads declined 12 and 25 basis points in Mexico and Brazil, respectively, over the intermeeting period. The overall EMBI+ spread and the spread on the Brazilian EMBI+ subindex both declined to new all-time lows late in the intermeeting

period, and the spread on the Mexican EMBI+ subindex fluctuated around 100 basis points, near its all-time low.

Share price indexes in most major emerging market economies rose modestly over the intermeeting period, but they exhibited great volatility in Thailand, Venezuela, and China. Thai financial asset prices were volatile over the intermeeting period in reaction to several policy announcements (e.g., discouraging capital inflows, encouraging capital outflows, and reducing the policy interest rate) designed to stem the recent currency appreciation. Several bombings in Bangkok on New Year's Eve also imparted volatility to asset prices. Asset prices in other major East Asian countries reacted, but only temporarily, to the developments in Thailand. On net, the Thai stock market index declined 11 percent over the period, and the Thai baht appreciated ½ percent against the dollar. Venezuela's stock market index was volatile over the period, dropping almost 19 percent following announcements from President Chavez that he plans to accelerate his "socialist revolution" by seeking increased powers from Congress, nationalizing companies in the utilities, telecommunications, and energy sectors, and stripping the central bank of its statutory autonomy. Venezuela's stock index, however, rebounded subsequently, and on net it declined about 5 percent over the period. In contrast, the Shanghai equity market index rose 34 percent, outperforming all other countries' equity markets. This surge did not appear to be linked to news about economic fundamentals. The Korean authorities announced new measures to liberalize capital outflows. On net, the Korean stock market index rose ½ percent over the period, and the Korean won depreciated 1½ percent against the dollar.

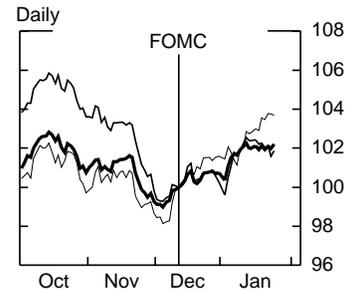
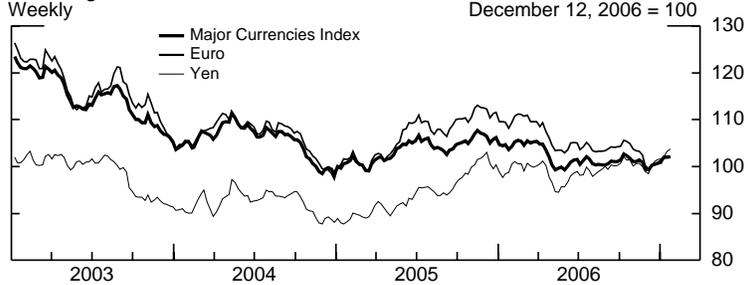
. The Desk did not intervene during the period for the accounts of the System or the Treasury.

Exchange Value of the Dollar and Stock Market Indexes

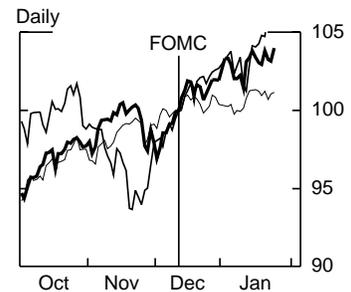
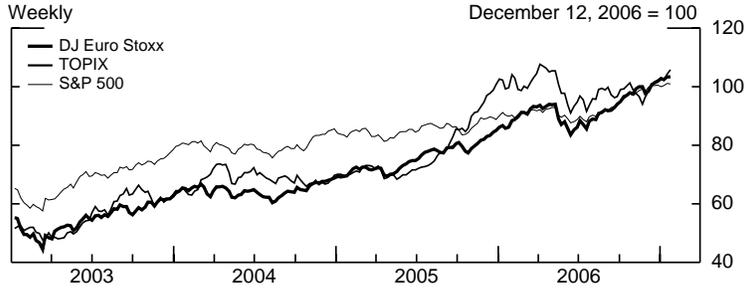
	Latest	Percent change since December FOMC
<i>Exchange rates*</i>		
Euro (\$/euro)	1.2989	1.9
Yen (¥/\$)	121.5	3.7
Sterling (\$/£)	1.9689	-0.2
Canadian dollar (C\$/\\$)	1.1817	2.3
<i>Nominal dollar indexes*</i>		
Broad index	107.7	1.1
Major currencies index	82.6	2.2
OITP index	133.0	0.0
<i>Stock market indexes</i>		
DJ Euro Stoxx	403.6	4.0
TOPIX	1738.6	6.2
FTSE 100	6306.6	2.4
S&P 500	1429.3	1.1

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

Exchange Value of the Dollar



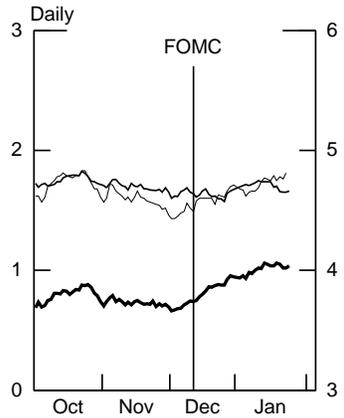
Stock Market Indexes



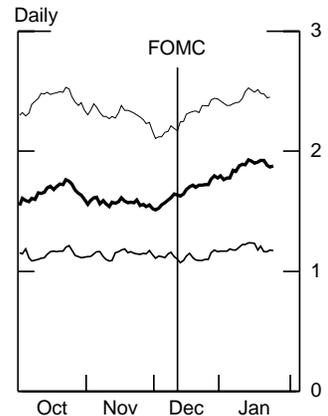
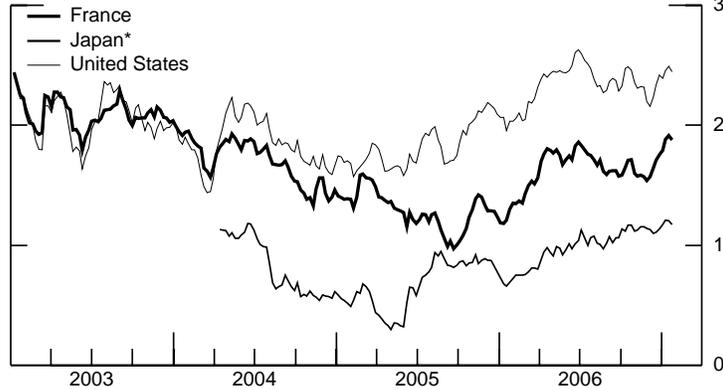
Industrial Countries: Nominal and Real Interest Rates

	3-month LIBOR		10-year nominal		10-year indexed		Percent
	Latest	Change since December FOMC	Latest	Change since December FOMC	Latest	Change since December FOMC	
Germany	3.76	0.08	4.04	0.30	1.94	0.25	
Japan	0.54	-0.03	1.66	0.02	1.17	0.07	
United Kingdom	5.58	0.30	4.90	0.28	1.78	0.23	
Canada	4.28	0.01	4.16	0.25	...	...
United States	5.36	0.00	4.81	0.29	2.45	0.26	

Nominal 10-Year Government Bond Yields
Weekly



Inflation-Indexed 10-Year Government Bond Yields
Weekly

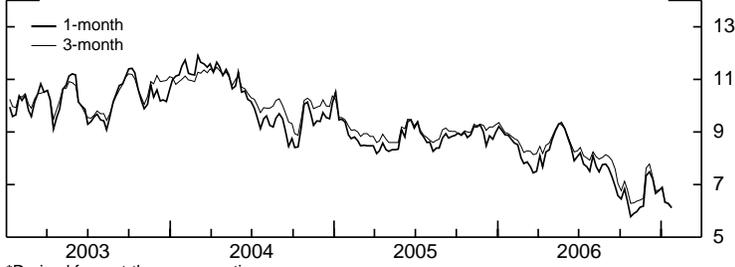


*Japan first issued inflation-indexed debt in March 2004.

Measures of Market Volatility

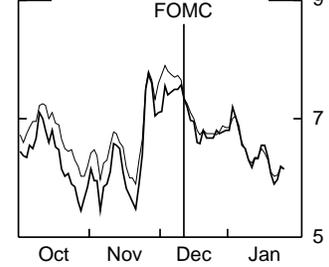
Dollar-Euro Options-Implied Volatility*

Weekly



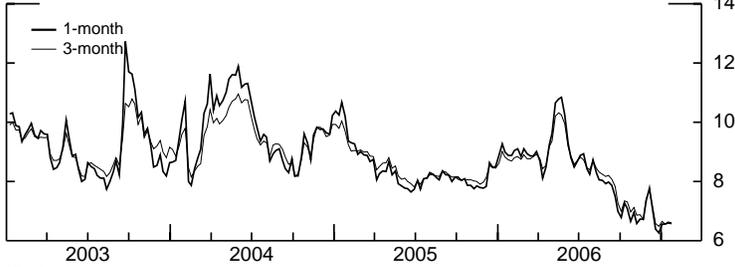
*Derived from at-the-money options.

Daily



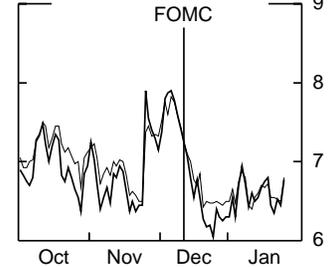
Yen-Dollar Options-Implied Volatility*

Weekly



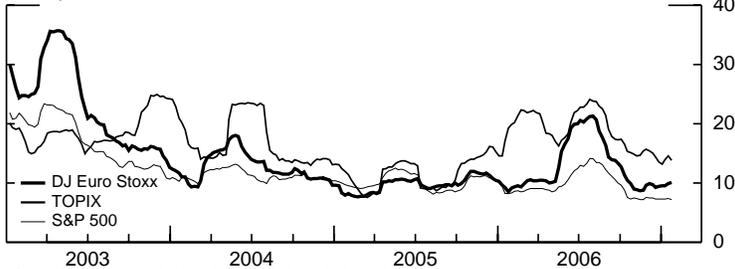
*Derived from at-the-money options.

Daily



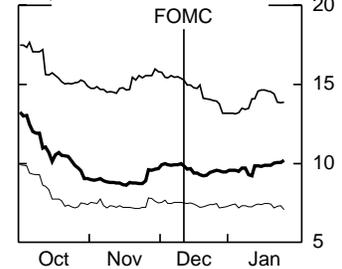
Realized Stock Market Volatility*

Weekly



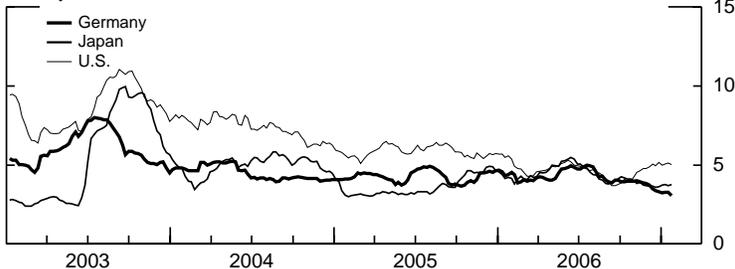
*Annualized standard deviation of 60-day window of daily returns.

Daily



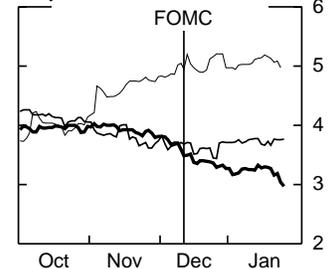
Realized 10-Year Bond Volatility*

Weekly



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

Daily

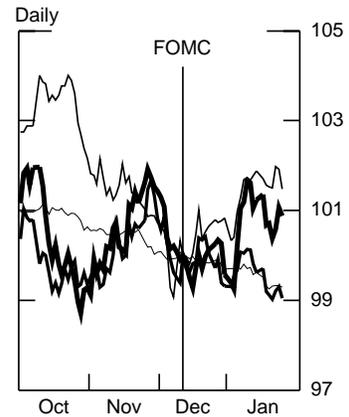
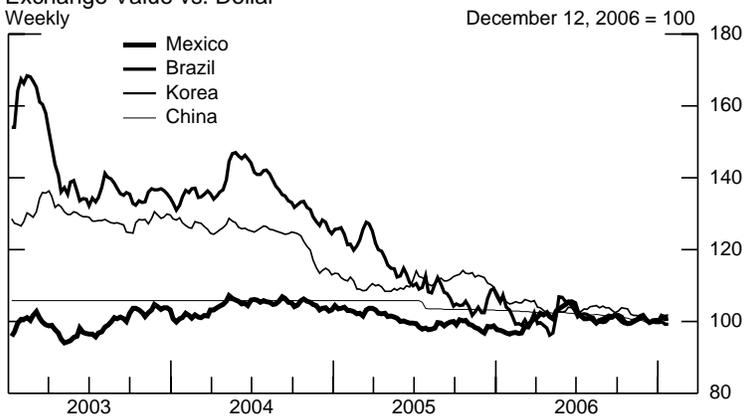


Emerging Markets: Exchange Rates and Stock Market Indexes

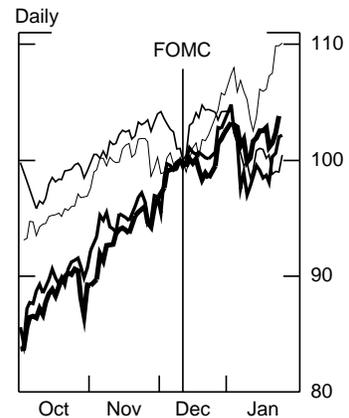
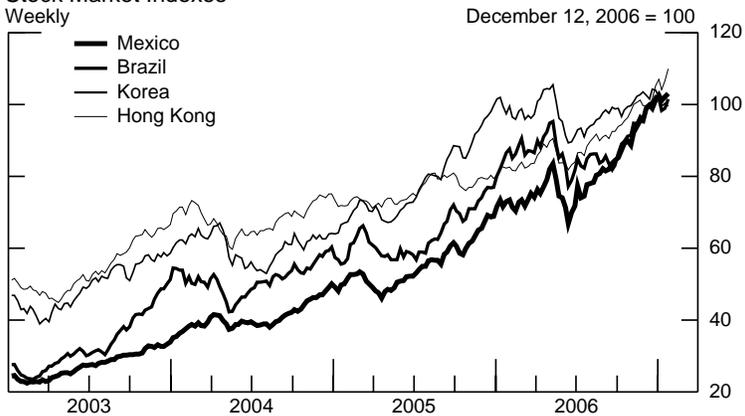
	Exchange value vs. dollar		Stock market index	
	Latest	Percent change since December FOMC*	Latest	Percent change since December FOMC
Mexico	10.9400	0.9	26810	3.8
Brazil	2.1285	-1.0	44240	2.2
Venezuela	2144.60	0.0	43154	-5.3
China	7.7725	-0.7	2975	34.1
Hong Kong	7.8031	0.4	20821	10.1
Korea	935.9	1.5	1383	0.4
Taiwan	32.80	1.0	7936	6.4
Singapore	1.5355	-0.5	838	10.4
Thailand	35.07	-0.6	657	-11.0

* 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

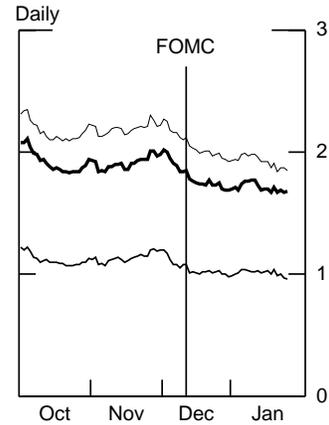
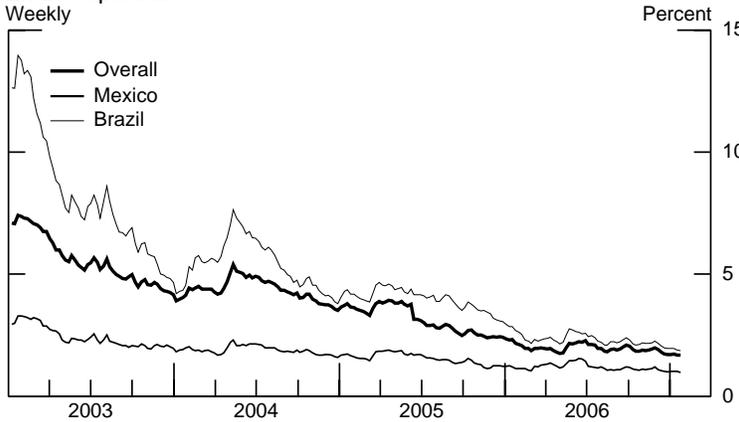
	Short-term interest rates*		Dollar-denominated bond spreads**	
	Latest	Change since December FOMC	Latest	Change since December FOMC
Mexico	7.01	-0.01	0.96	-0.12
Brazil	12.80	-0.61	1.85	-0.25
Argentina	9.75	-0.69	1.88	-0.67
China	...	...	0.50	-0.04
Korea	4.70	0.17	...	...
Taiwan	1.83	0.03	...	...
Singapore	3.50	0.00	...	...
Hong Kong	3.89	-0.08	...	...

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

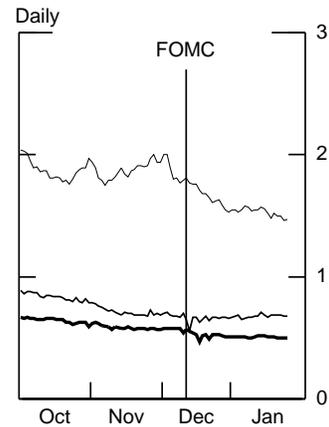
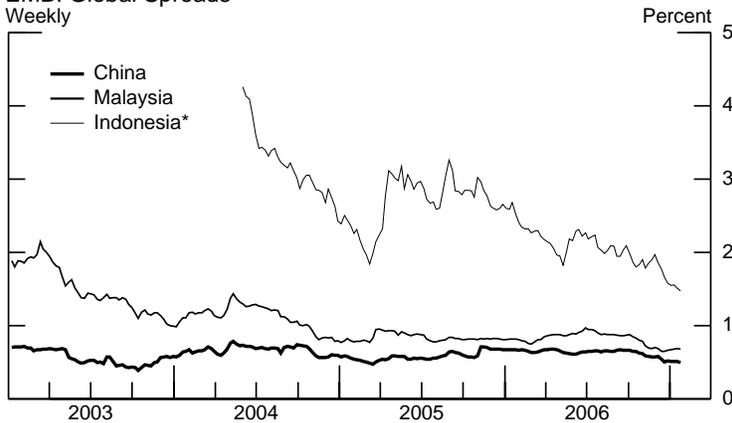
**EMBI+ or EMBI Global Spreads over similar-maturity U.S. Treasuries.

... 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

After expanding moderately in the third quarter, overall economic activity in the advanced foreign economies appears to have accelerated in the fourth quarter, supported by a firming of domestic demand and strong employment gains. In Japan, private consumption seems to have rebounded after contracting in the third quarter. Economic growth is continuing at a solid pace in the euro area, with lower unemployment boosting consumer sentiment. In the United Kingdom, the expansion is accelerating, led by an apparent pick up in consumption growth. Output growth seems to have firmed in Canada but likely remains below trend.

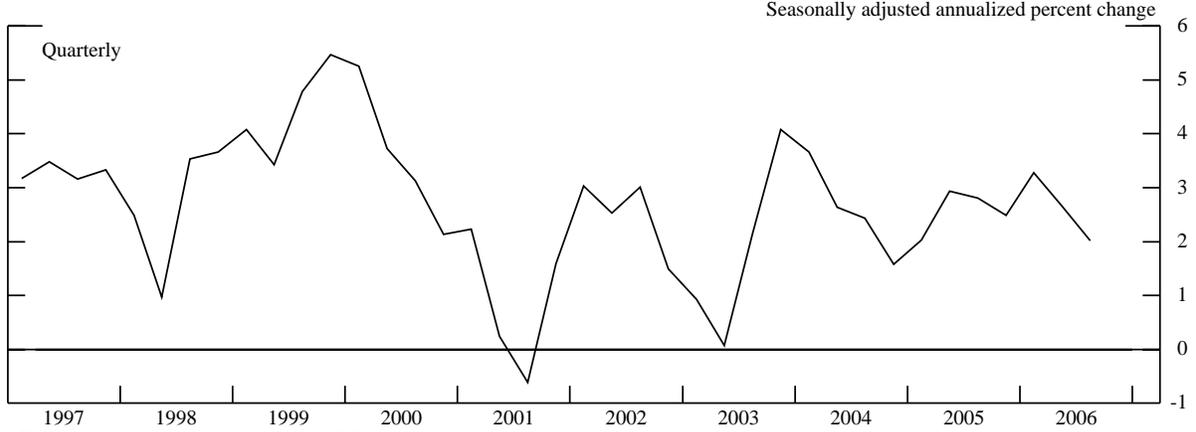
Inflation continued to be contained in most advanced foreign economies in November and December, helped by lower fuel prices. The United Kingdom was the major exception, with CPI inflation reaching 3 percent in December, its highest level in twelve years. The Bank of England raised its interest rate $\frac{1}{4}$ percentage point in January.

In **Japan**, recent indicators point to a rebound in consumption spending and an acceleration of production in the fourth quarter. Following a 4.1 percent increase in October, real household expenditures rose 0.5 percent in November. Retail sales were flat in November after declining 0.2 percent in October. Industrial production rose 0.8 percent in November, driven by increased production of transport equipment, petroleum products, and electronics, while shipments were up 1.8 percent. Machinery orders increased 3.8 percent in November and were 0.7 percent higher than a year earlier. Housing starts also jumped 3.7 percent in November, following more moderate increases in the previous two months. The Bank of Japan's measure of real exports rose 2.6 percent in November, while real imports contracted 4 percent.

The labor market continued to improve in November, as the economy added seventy thousand new jobs and the unemployment rate fell to 4 percent. The job-offers-to-applicants ratio remained at the elevated level of 1.06. Nevertheless, gross earnings, which include bonuses, were 0.3 percent lower than a year earlier.

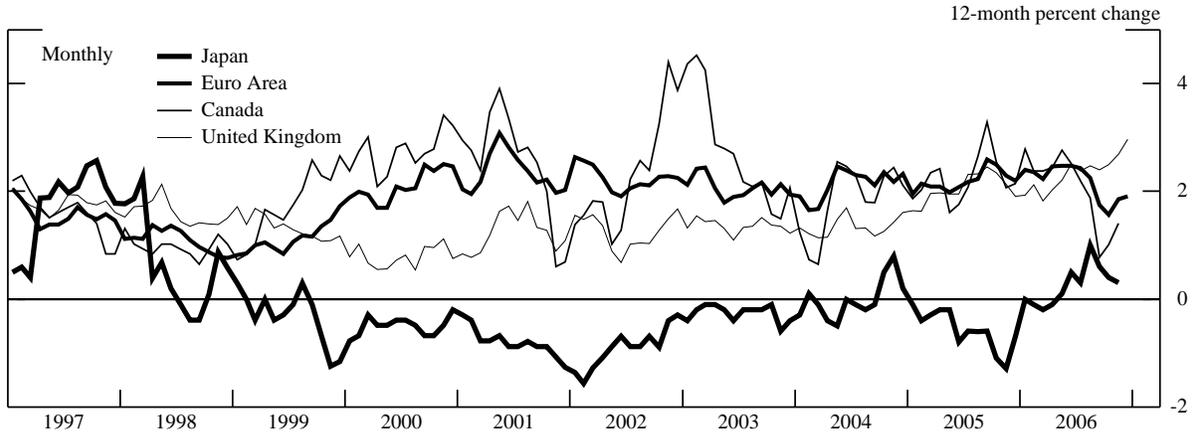
Advanced Foreign Economies

Average Real GDP*

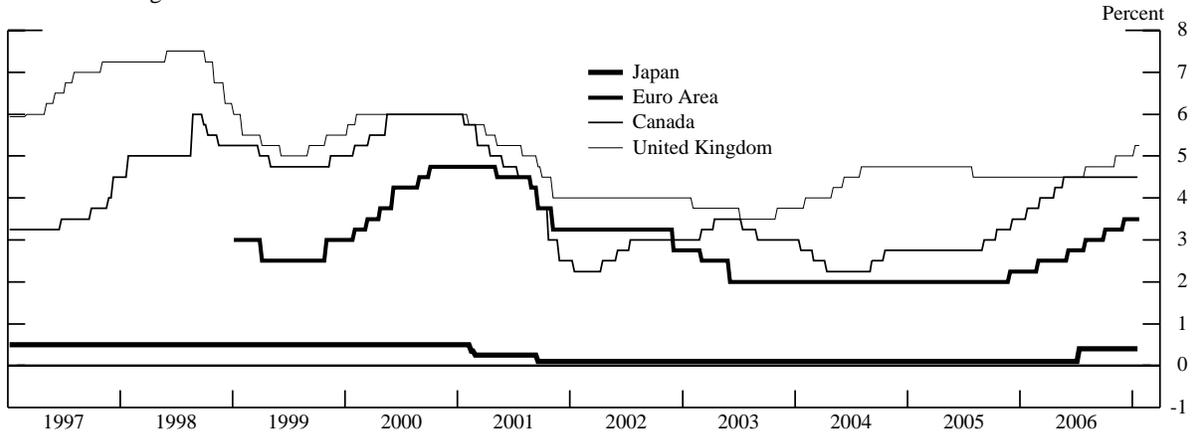


*Chain weighted by moving bilateral shares in U.S. merchandise exports.

CPI Inflation



Official or Targeted Interest Rates



An increase in the December Tankan survey offered further evidence that the economy continues to firm. Both manufacturing and non-manufacturing firms reported improved conditions, and the headline index for large manufacturers reached its highest level in two years. Firms revised their expectations of capital spending during the current fiscal year (April 2006 through March 2007) up from 8.4 percent to 10.5 percent, as small firms substantially increased their planned investment. Sales and profit expectations for this fiscal year were both revised up and the number of firms reporting labor shortages also rose, indicating that strong labor market conditions should continue.

Recent indicators point to weak inflationary pressures. The headline consumer price index fell 0.1 percent in November, reflecting a drop in food prices, but was 0.3 percent higher than a year earlier. Core CPI inflation (excluding fresh food only) was flat in November but rose 0.2 percent from a year earlier. However, excluding both fresh food and energy, consumer prices fell 0.2 percent over the preceding year. The twelve-month rate of wholesale price inflation continued to moderate in December, falling 0.2 percentage point to 2.5 percent.

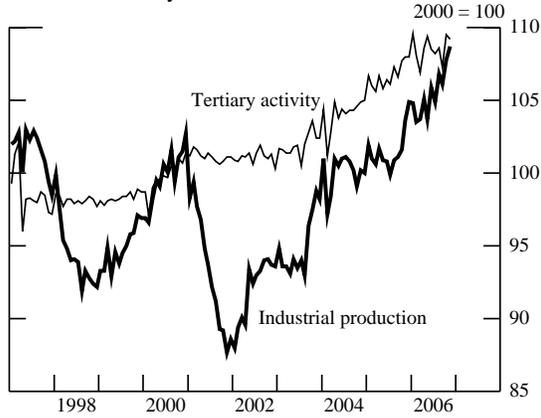
Recent indicators for the **euro area** generally have remained robust, with consumer spending appearing to have taken over the lead in driving euro-area growth. The European Commission survey of euro-area economic sentiment edged down in December, but remained near the cyclical peak reached in October. Industrial and construction confidence declined slightly, but consumer confidence continued to increase. Household spending picked up in November, with the volume of euro-area retail sales rising 0.3 percent from the previous month and 1.3 percent from a year earlier. In December, French households' consumption of manufactured goods rose 1.3 percent on a monthly basis, far surpassing economists' consensus forecast of a 0.2 percent gain.

The euro-area purchasing managers' index for manufacturing edged down in December to 56.5 but remained near its recent high. The euro-area purchasing managers' index for services also edged down in December, to 57.2.

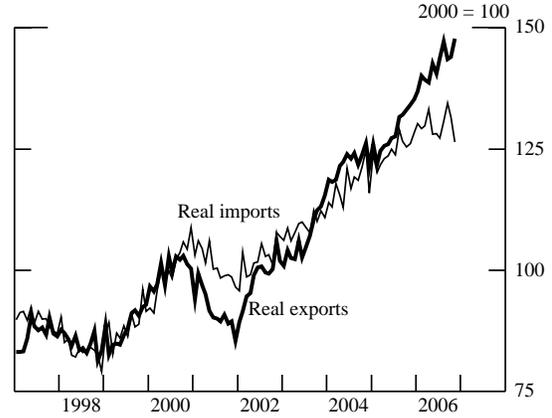
Germany's economic performance improved notably over the past year. The German IFO Business Climate Index continued to surprise on the upside, posting an all-time high of 108.7 in December. German industrial production bounced back with a 1.8 percent increase in November. In contrast, French industrial production excluding construction edged down in November from the previous month.

Japan

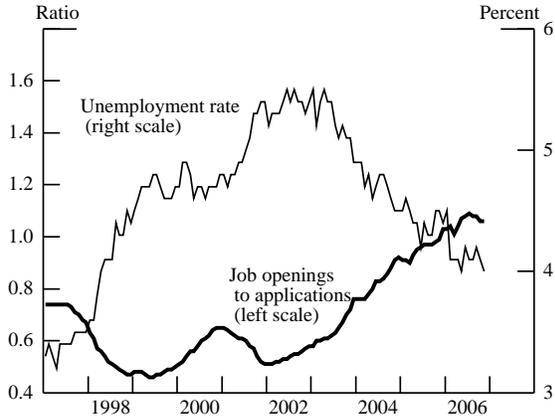
Economic Activity



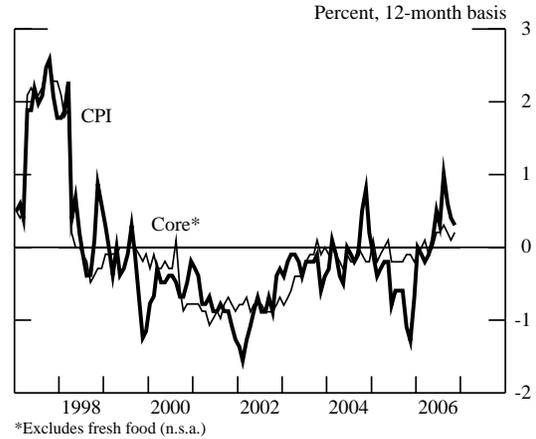
Real Trade



Labor Market Ratio



Consumer Price Inflation



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

Economic Indicators

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

Indicator	2006			2006			
	Q2	Q3	Q4	Sept.	Oct.	Nov.	Dec.
Housing starts	2.5	-2.8	n.a.	0.2	0.8	3.7	n.a.
Machinery orders ¹	8.9	-11.1	n.a.	-7.4	2.8	3.8	n.a.
Machinery shipments ¹	3.6	1.7	n.a.	-3.1	2.9	2.0	n.a.
New car registrations	-4.0	-3.7	-1.6	-0.6	-1.8	0.3	-3.1
Business sentiment ²	6.0	6.0	8.0	...	...	...	...
Wholesale prices ³	3.1	3.5	2.7	3.6	2.8	2.7	2.5

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.

In November, the euro-area unemployment rate declined to 7.6 percent, down nearly a percentage point over the past year and the lowest rate since Eurostat began measuring it in 1993. In Germany, the national measure of the unemployment rate fell to 9.8 percent in December, down from 11.3 percent a year earlier. German employment rose for the ninth straight month in November and had increased more than 1 percent over the preceding twelve months.

The twelve-month rate of euro-area consumer price inflation remained at 1.9 percent in December, just below the ECB's 2 percent ceiling. Core inflation, excluding energy and unprocessed food, remained at 1.6 percent in November. The ECB kept its policy rate unchanged at its January meeting and signaled that its next rate hike may not occur until March. ECB policymakers continued to express concern over rapid growth in the money supply. In November, the twelve-month percentage change of euro-area M3 rose to 9.3 percent in November from 8.5 percent in October, well above the ECB's reference value of 4.5 percent.

In the **United Kingdom**, the chained volume measure of GDP grew 3.4 percent (a.r.) in the fourth quarter, according to the preliminary estimate. The service sector expanded by 4.4 percent, led by a rebound in the output of the distribution, hotels and restaurants sector, which grew 7.5 percent in the fourth quarter compared with 0.7 percent a quarter earlier. Output growth in the transport, storage and communication industries was also solid, at 6 percent. By contrast, the output of production industries declined 1.2 percent, reversing the gains over the previous two quarters.

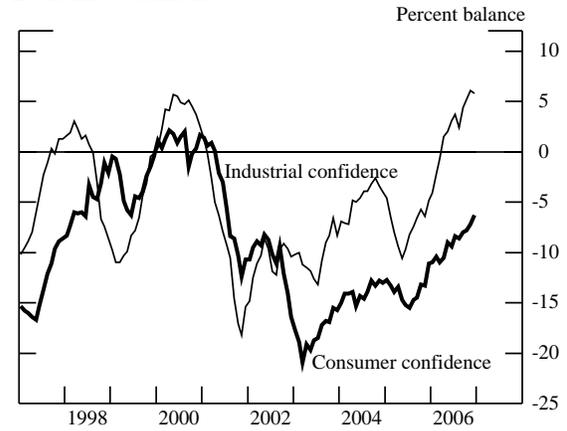
Recent economic indicators point to continued economic expansion supported by robust investment and a firming of consumption. In December, business confidence was buoyant, and the PMI for services increased for a fourth consecutive month, reaching its highest value since June 1997. The PMI for manufacturing edged down to 51.9 but continues to indicate expansion. Retail sales grew 1.1 percent in December as a result of strong Christmas-time sales in predominantly non-food stores. Consumer confidence slid further, however, as households worried about the general economic situation, but remains slightly above its third-quarter average. Halifax and Nationwide, two major British lenders, reported twelve-month house price increases of 8.4 and 10.5 percent in December, respectively.

Euro Area

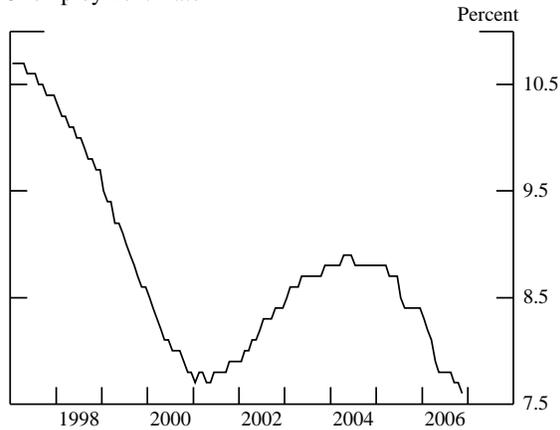
Industrial Production



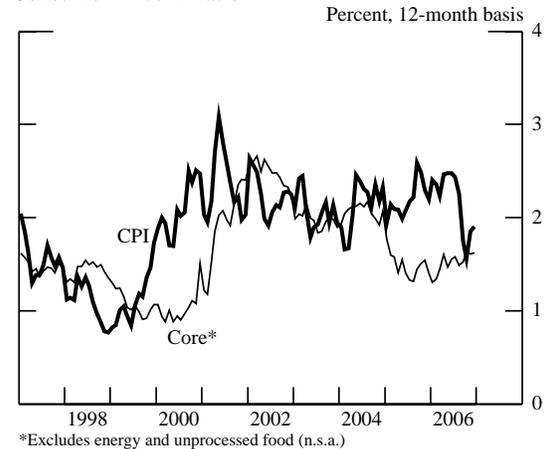
Economic Sentiment



Unemployment Rate



Consumer Price Inflation



Economic Indicators

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

Indicator	2006			2006			
	Q2	Q3	Q4	Sept.	Oct.	Nov.	Dec.
Industrial production ¹	1.2	0.8	n.a.	-1.0	-0.1	0.2	n.a.
Retail sales volume ²	0.5	0.6	n.a.	-0.8	0.2	0.4	n.a.
Unemployment rate ³	7.8	7.8	n.a.	7.7	7.7	7.6	n.a.
CPI ⁴	2.5	2.1	1.8	1.7	1.6	1.9	1.9
Producer prices ⁴	5.8	5.4	n.a.	4.6	4.0	4.3	n.a.
M3 ⁴	8.5	8.5	n.a.	8.5	8.5	9.3	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.

The Labor Force Survey measure of the unemployment rate ticked down to 5.5 percent in November as employment growth continued to be strong. The claimant count measure of the unemployment rate was 3 percent in December, a level unchanged since March.

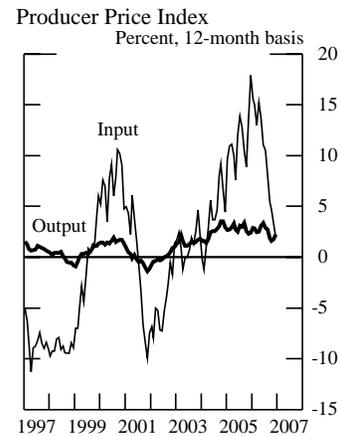
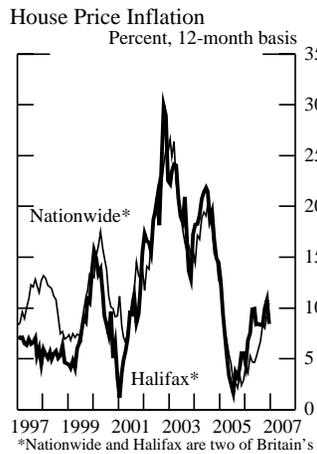
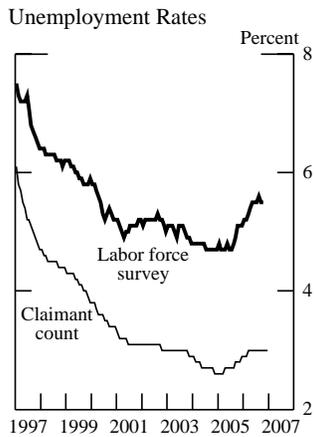
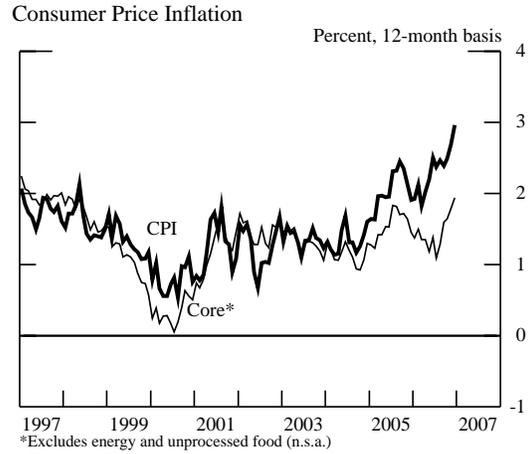
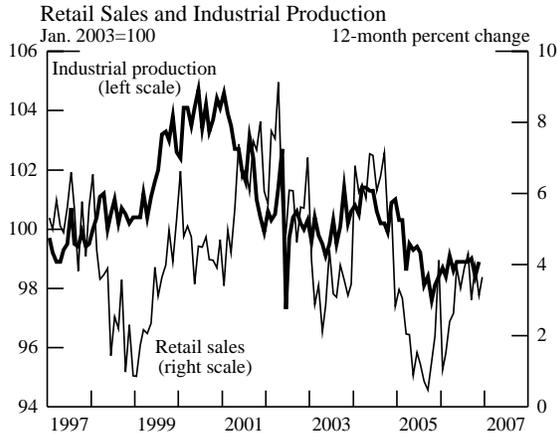
The twelve-month rate of headline CPI inflation climbed to 3 percent in December. The index was pushed up mainly by the introduction of new fuel duties on December 6, increased household and furniture prices, and strong base effects associated with a relatively large fall in the price of gasoline twelve months earlier. Producers' input prices rose 2 percent in the year to December, the smallest twelve-month increase since March 2004. Average earnings growth, at 4.1 percent in November, remained contained.

On January 11, the Monetary Policy Committee raised the official rate paid on commercial bank reserves 25 basis points to 5¼ percent. The Committee justified its decision by citing a thin margin of spare capacity in the economy, a likely rise of inflation further above the target in the near term, and an increase in upside risks to inflation relative to its November *Inflation Report*.

Canadian real GDP by industry fell 0.2 percent (a.r.) in October, with output declining in both the goods-producing and service sectors. Continuing its year-long trend, manufacturing output declined, led by significant cutbacks in auto production. Output of the retail sector also receded in October, with declines registered across most trade groups. Activity in the construction sector rose, however; increased engineering and repair work offset declines in both residential and non-residential construction. A bright spot was the energy sector, in which output advanced briskly, led in particular by gains in the production and distribution of natural gas, electricity production, and refinery output.

Other indicators for the fourth quarter also have been more upbeat. After falling nearly five percent in the third quarter, housing starts edged up in the fourth quarter. The nominal merchandise trade balance widened in November, keeping the fourth-quarter trade surplus on track to increase after three straight quarters of declines. The manufacturing sector also rebounded smartly in November, with shipments, new orders, and unfilled orders all rising sharply, led especially by the motor vehicle sector. After contracting in October, retail sales expanded in November, although gains were concentrated in the auto sector. The composite index of leading indicators advanced again in December after surging in November.

United Kingdom



Economic Indicators

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

Indicator	2006			2006			2007
	Q2	Q3	Q4	Oct.	Nov.	Dec.	Jan.
Real GDP ¹	3.0	2.8	3.4	...	...	...	...
Producer prices ²	13.3	7.9	3.3	4.5	3.5	2.0	n.a.
Average earnings ²	4.3	4.0	n.a.	4.2	3.9	n.a.	n.a.
Business confidence ³	12.0	13.0	8.3	9.0	5.0	11.0	12.0
Consumer confidence ⁴	-4.7	-6.0	-4.9	-3.5	-5.3	-5.8	n.a.
Trade balance ⁵	-26.3	-25.0	n.a.	-7.7	-9.0	n.a.	n.a.

1. Q4 figure is preliminary estimate (s.a.a.r.). 2. Percent change from year earlier.

3. Confederation of British Industry, percent balance.

4. Eurostat, percent balance.

5. Level in billions of US Dollars.

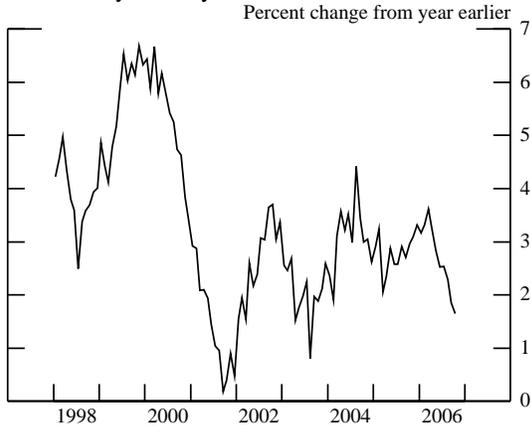
n.a. Not available. ... Not applicable.

The labor market also posted another strong advance in the fourth quarter. In December, total employment recorded another large gain, putting fourth-quarter job gains about four times larger than in the third quarter. Full-time employment, after falling a bit in November, resumed its strong year-long climb. The unemployment rate edged down to 6.1 percent, matching a thirty-two-year low also reached in May and June.

The twelve-month rate of consumer price inflation moved up to 1.6 percent in December, after being depressed the previous few months due to rapidly-falling gasoline prices. The twelve-month rate of core inflation, which excludes the eight most volatile components and indirect taxes, moved down to 2 percent in December from 2.2 percent in November. Despite easing over the past two months, core prices inflation accelerated during the second half of 2006, driven largely by a rise in homeowners' replacement costs, which are estimated using, among other data, prices for new homes. The twelve-month rate of new home price inflation remained elevated at 11 percent in November, about where it had been since August. These increases were sustained largely by the western provinces, especially the oil-producing province of Alberta.

Canada

Real GDP by Industry



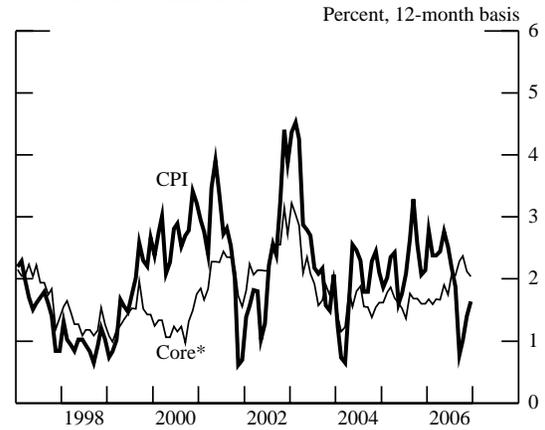
Real Trade



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			
	Q2	Q3	Q4	Sept.	Oct.	Nov.	Dec.
Industrial production	-1.0	-0.1	n.a.	-1.8	-0.0	n.a.	n.a.
New manufacturing orders	-1.7	0.7	n.a.	-2.9	0.9	3.9	n.a.
Retail sales	2.0	0.9	n.a.	0.2	-0.6	-0.2	n.a.
Employment	0.8	0.1	0.6	0.1	0.3	0.1	0.4
Consumer attitudes ¹	122.0	121.2	122.6	...	...	...	...
Business confidence ¹	142.9	135.6	n.a.	...	...	...	...

1. 1991=100.

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

Economic Situation in Other Countries

Recent data for some emerging Asian economies – particularly Hong Kong, Taiwan, Korea, and India – point to some moderation in the pace of growth. However, Chinese economic activity seems to be picking up from its recent slowdown, and the ASEAN region appears to have expanded at a solid pace in recent months. In Latin America, Mexican indicators signal a slowdown in fourth-quarter growth; however, Brazilian activity seems to be accelerating. In Venezuela, President Chavez recently announced the nationalization of some major companies. Falling oil prices led to a reduction in inflation in several countries, but food price inflation in some economies exerted an offsetting effect.

In **China**, the economic slowdown experienced during the third quarter continued into the early part of the fourth, but activity appears to have picked up again more recently. After slowing to 2.8 percent in the third quarter, industrial production declined in October but jumped 2.1 percent in November. Similarly, twelve-month fixed asset investment growth slowed to 16 percent in October but increased to 24 percent in November. The effects of last year's administrative measures to cool the economy were also reflected in growth of imports, which decreased sharply in the fourth quarter. Export growth also slowed, but not as much. For 2006 as a whole, the growth rate of exports (27 percent) again exceeded the growth rate of imports (20 percent), resulting in an increase in the trade surplus to \$178 billion from \$102 billion in 2005.

Driven by an increase in volatile food prices, consumer prices increased 2 percent over the twelve months ended in November compared with 1½ percent over the comparable period ending in October. However, underlying pressures on non-food prices continued to be fairly benign. In early January, the People's Bank of China (PBOC) raised reserve requirement for banks another 50 basis points, the fourth such increase since June. This takes the required reserve ratio for large banks to 9.5 percent. The move was not a surprise, as the PBOC had earlier indicated its intention to use reserve requirements to a greater extent as a monetary policy tool to temper credit growth.

Chinese Economic Indicators

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

Indicator	2005	2006	2006				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP ¹	9.9	n.a.	7.0	n.a.	...	...	...
Industrial production	17.2	n.a.	2.8	n.a.	-0.8	2.1	n.a.
Consumer prices ²	1.6	n.a.	1.2	n.a.	1.5	2.0	n.a.
Merch. Trade balance ³	102.0	177.5	187.3	215.2	237.6	210.1	197.8

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.

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

In **Hong Kong**, output growth in the third quarter surged, supported by external demand, after little change in the second. In October and November, the trade deficit widened, which may be a sign that the contribution of net exports to output growth moderated in the fourth quarter, an important development in this entrepôt economy. Twelve-month inflation edged up in November, in part reflecting higher food price inflation.

Hong Kong Economic Indicators

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

Indicator	2005	2006	2006				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP ¹	7.4	n.a.	14.8	n.a.	...	...	...
Unemployment rate ²	5.7	4.9	4.7	4.4	4.5	4.4	4.4
Consumer prices ³	1.4	2.3	2.3	2.1	2.0	2.2	2.3
Merch. trade balance ⁴	-10.5	n.a.	-12.7	n.a.	-21.3	-22.4	n.a.

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

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

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

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

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

In **Taiwan**, third-quarter real GDP growth was about 8 percent, boosted mainly by strong investment. The fourth-quarter trade surplus widened slightly, and export orders increased in October and November, particularly for high-tech products. However, industrial production in the fourth quarter was 1 percent below its third-quarter level, partly reflecting some cooling in the construction sector. Twelve-month inflation reached

positive territory in November and continued increasing in December, partly reflecting food price increases.

Taiwan Economic Indicators

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

Indicator	2005	2006	2006				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP ¹	6.5	n.a.	8.1	n.a.	...	...	...
Unemployment rate ²	4.1	3.9	3.9	3.9	3.8	3.9	3.9
Industrial production	4.1	4.9	.7	-1.0	-1.5	.6	-1.3
Consumer prices ³	2.2	.7	-.3	-.1	-1.2	.2	.7
Merch. trade balance ⁴	7.8	11.5	15.1	16.7	20.3	6.1	23.7
Current account ⁵	16.1	n.a.	25.7	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.

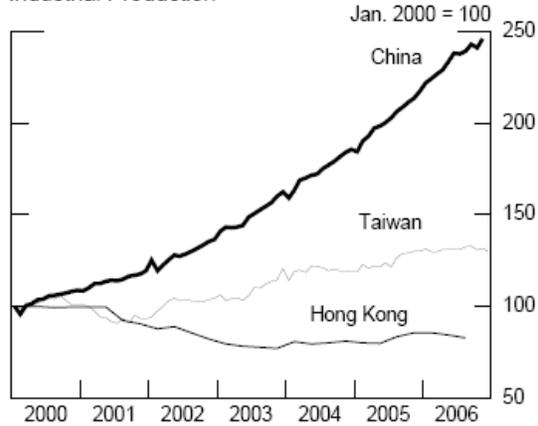
4. Billions of U.S. dollars, annual rate. Imports are c.i.f.

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

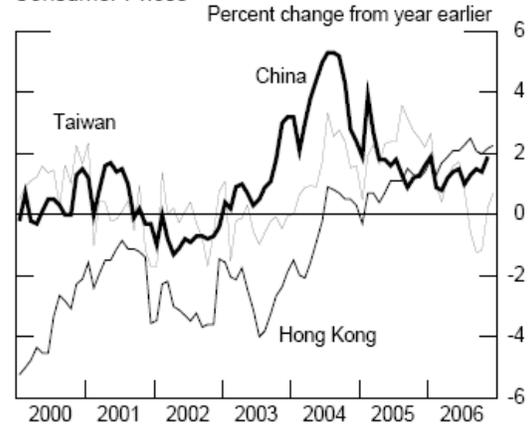
n.a. Not available. . . . Not applicable.

China, Hong Kong, and Taiwan

Industrial Production



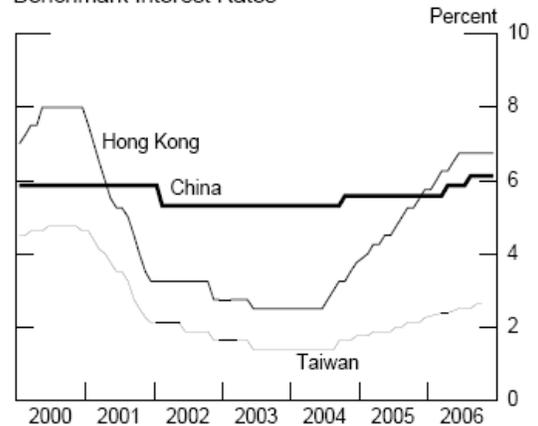
Consumer Prices



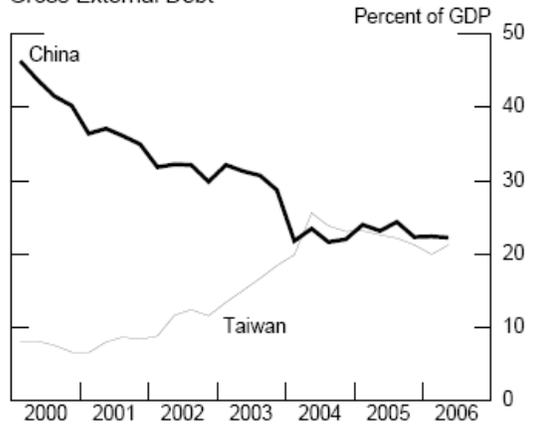
Merchandise Trade Balances



Benchmark Interest Rates



Gross External Debt



Short-Term External Debt



In **Korea**, incoming data suggest further moderate growth. Industrial production dropped back some in November after strong performance in previous months. Consumer and business confidence edged down in December, but retail sales for October and November were strong. The merchandise trade balance surged in November, reflecting a sharp pick-up in exports, although evidence points to some slowing in December. Consumer price inflation has declined recently, as has the unemployment rate. In mid-January, the Finance Ministry loosened several restrictions on overseas investment by Koreans, in hopes of reducing upward pressure on the won. Also in January, the government announced stricter loan standards and ceilings on the prices of new homes, in its continuing effort to control house prices.

Korean Economic Indicators

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

Indicator	2005	2006	2006				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP ¹	5.3	n.a.	4.4	n.a.	...	...	...
Industrial production	5.9	n.a.	1.1	n.a.	2.5	-1.4	n.a.
Unemployment rate ²	3.7	3.5	3.5	3.4	3.5	3.4	3.3
Consumer prices ³	2.7	2.1	2.5	2.1	2.2	2.1	2.1
Merch. Trade balance ⁴	32.7	n.a.	23.6	n.a.	30.1	61.4	n.a.
Current account ⁵	15.0	n.a.	1.5	n.a.	21.1	50.9	n.a.

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

2. Percent.

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

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 economic indicators point to some moderation in the fourth quarter from a strong third-quarter pace. Average industrial production in October and November was up 1 percent from the third-quarter level, and the December Purchasing Managers' Index fell to its lowest level in five months. The trade balance continued to deteriorate into the fourth quarter. Twelve-month inflation of the closely watched wholesale price index remained near 5½ percent in December, despite falling oil prices.

Indian Economic Indicators

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

Indicator	2005	2006	2006				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP ¹	7.5	n.a.	8.0	n.a.	...	...	...
Industrial production	7.9	n.a.	.6	n.a.	-3.1	5.1	n.a.
Consumer prices ²	5.6	n.a.	5.9	n.a.	6.0	5.0	n.a.
Wholesale prices ²	4.4	5.4	5.1	5.4	5.4	5.4	5.4
Merch. Trade balance ³	-40.6	n.a.	-49.2	n.a.	-70.7	-76.5	n.a.
Current account ⁴	-6.9	n.a.	-27.7	n.a.	...	...	...

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

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

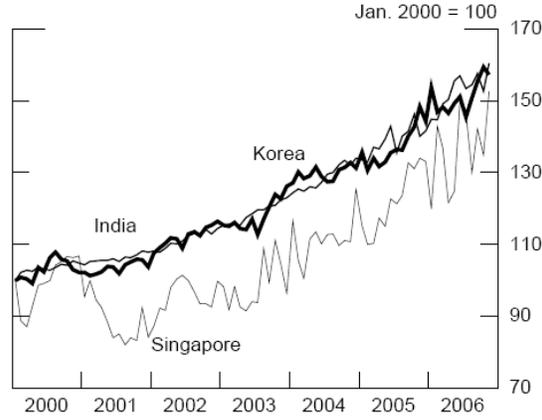
3. Billions of U.S. dollars, annual rate.

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

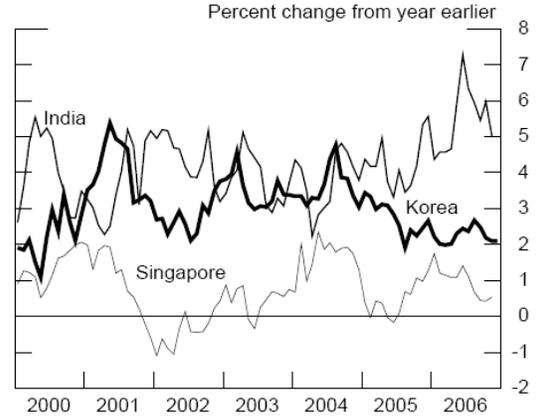
n.a. Not available. ... Not applicable.

India, Korea, and Singapore

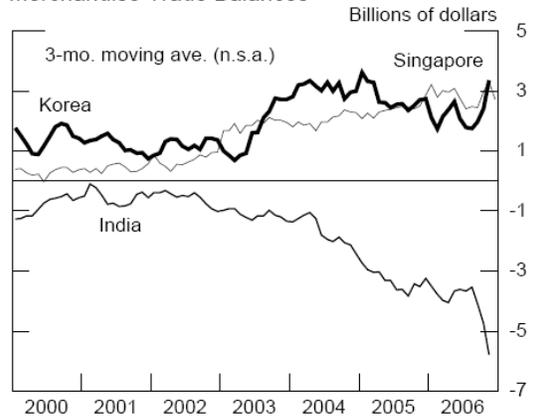
Industrial Production



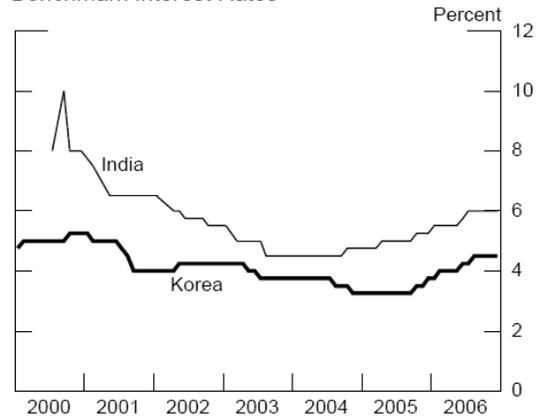
Consumer Prices



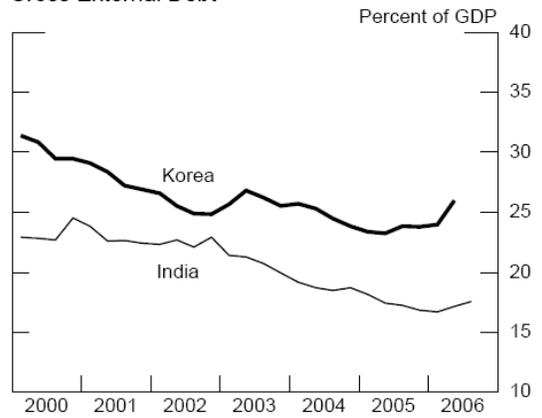
Merchandise Trade Balances



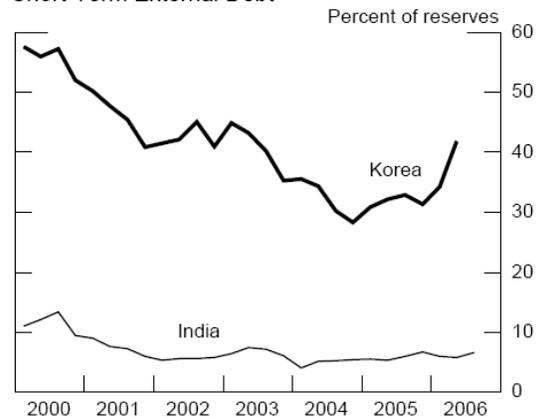
Benchmark Interest Rates



Gross External Debt



Short-Term External Debt



Incoming data for the **ASEAN** region suggest that economic activity expanded at a solid pace in the fourth quarter. In Singapore, the advance unofficial estimate indicates that real GDP rose 7.6 percent in the fourth quarter. Recent strong readings for the Singapore electronics PMI signal a continued expansion of activity going forward. Elsewhere in the region, industrial production was down in October, but rebounded in November in Malaysia and Thailand, and trade balances were generally strong.

Twelve-month consumer price inflation across the region fell below third-quarter levels, due in part to lower energy prices and, in some countries, unwinding of previous food price increases. Citing the moderation in inflation, central banks in Indonesia and Thailand eased monetary policy. The Bank of Thailand lowered its target interest rate 25 basis points on January 17. Bank Indonesia cut rates 50 basis points in early December and again by 25 basis points in early January, bringing the cumulative decrease to 300 basis points since the easing phase began in May of last year.

The last month has been a volatile one for Thailand. On December 18, Thailand announced a 30-percent unremunerated reserve requirement on foreign currency capital inflows. The following day, the stock market plunged 16 percent to its lowest level in several years and bond yields spiked, forcing the authorities to partially rescind the measure. On January 16, the government announced measures to liberalize capital outflows in an effort to stem the appreciation of the local currency. Separately, on New Year's Day, multiple bombings took place across Bangkok, and on January 9, the Thai authorities approved a revision to the Foreign Business Act that will cap to 50 percent the nominal shares and voting rights foreign entities can hold in a local subsidiary.

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

Indicator	2004	2005	2006				
			Q2	Q3	Sept.	Oct.	Nov.
<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	1.7	1.5	1.2	-4.4	n.a.
Malaysia	11.7	4.1	1.5	.8	-.7	-4.5	7.9
Philippines	1.0	2.2	1.3	-.9	-7.1	-3.7	n.a.
Singapore	13.9	9.5	-.9	5.7	9.3	-5.1	13.2
Thailand	11.7	9.1	1.7	2.5	-1.2	-1.2	1.9

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	2005	2006	2006				
			Q3	Q4	Oct.	Nov.	Dec.
Indonesia	28.0	n.a.	38.2	n.a.	43.1	40.1	n.a.
Malaysia	26.4	n.a.	31.5	n.a.	27.7	30.2	n.a.
Philippines	-6.2	n.a.	-4.8	n.a.	-9.3	n.a.	n.a.
Singapore	29.6	33.1	29.5	32.7	46.7	39.8	11.5
Thailand	-8.5	n.a.	4.7	n.a.	3.9	15.5	n.a.

n.a. Not available.

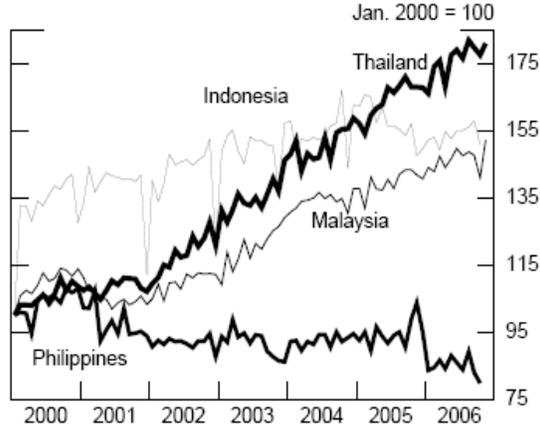
ASEAN Economic Indicators: CPI Inflation
(Percent change from year earlier, except as noted)

Indicator	2005 ¹	2006 ¹	2006				
			Q3	Q4	Oct.	Nov.	Dec.
Indonesia	17.0	6.7	14.8	6.1	6.4	5.4	6.7
Malaysia	3.3	3.1	3.6	3.0	3.1	3.0	3.1
Philippines	6.7	4.3	6.1	4.8	5.4	4.7	4.3
Singapore	1.3	.8	.7	.6	.4	.5	.8
Thailand	5.8	3.5	3.6	3.3	2.8	3.5	3.5

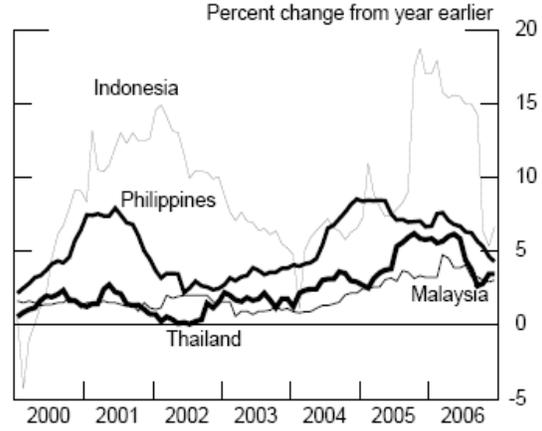
1. Dec./Dec.

ASEAN-4

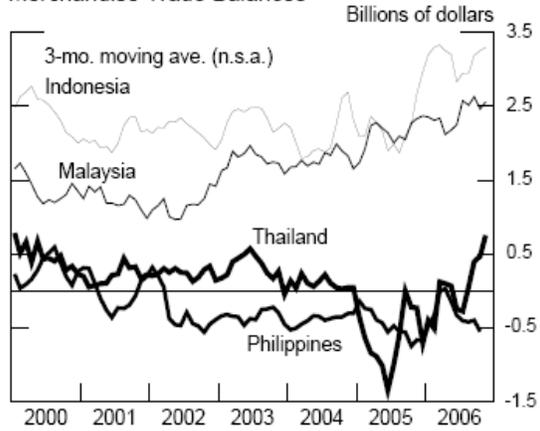
Industrial Production



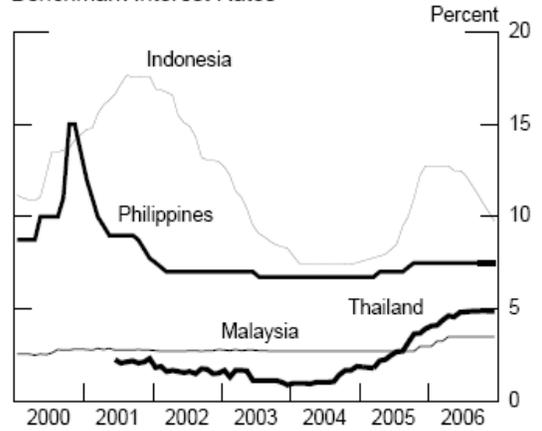
Consumer Prices



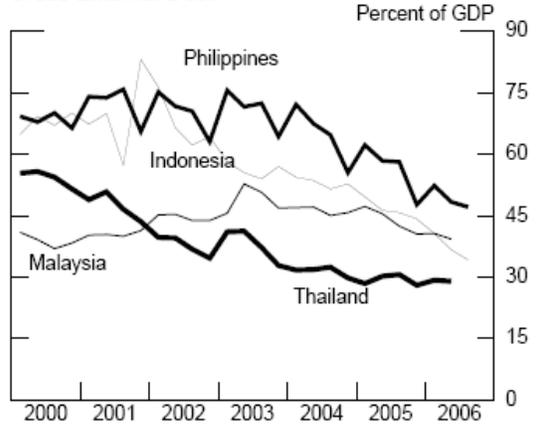
Merchandise Trade Balances



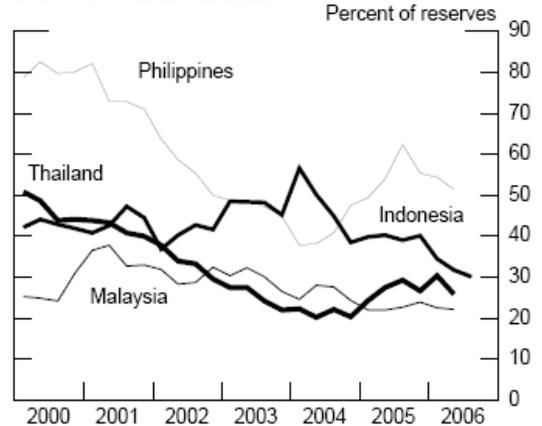
Benchmark Interest Rates



Gross External Debt



Short-Term External Debt



In **Mexico**, recent indicators point to a slowdown in the pace of economic growth. Industrial production contracted 0.6 percent in October, mainly as a result of the cooling of U.S. demand for Mexican manufacturing exports, but recovered in November on the back of continued strength in the construction sector. More broadly, the index of overall economic activity (a monthly proxy for GDP) ticked up in October, due to recovery in agricultural production. Twelve-month headline inflation was 4 percent in December, the fourth consecutive month where inflation was at or above the upper limit of the central bank's 2-to-4 percent inflation target range. The higher-than-expected inflation readings in recent months were the result of some food price increases, mainly for tomatoes and corn tortillas; however, these increases are seen as temporary, and monetary policy has remained unchanged.

Mexican Economic Indicators

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

Indicator	2005	2006	2006				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP ¹	2.7	n.a.	4.1	n.a.	...	...	...
Overall economic activity	3.3	n.a.	.9	n.a.	.1	n.a.	n.a.
Industrial production	1.9	n.a.	.5	n.a.	-.6	.9	n.a.
Unemployment rate ²	3.6	3.6	3.7	3.9	3.8	3.9	4.0
Consumer prices ³	3.3	4.1	3.5	4.1	4.3	4.1	4.0
Merch. trade balance ⁴	-7.6	n.a.	-9.2	n.a.	-10.9	-5.4	n.a.
Merchandise imports ⁴	221.8	n.a.	264.1	n.a.	264.3	261.0	n.a.
Merchandise exports ⁴	214.2	n.a.	254.9	n.a.	253.3	255.6	n.a.
Current account ⁵	-5.0	n.a.	-4.5	n.a.	...	...	...

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**, incoming data are somewhat mixed but on net point to a pickup in activity in the fourth quarter. In November, industrial production was up 0.8 percent, boosted by strong performance in oil production and refining, and retail sales were strong. However, December vehicle sales and production were down. The trade balance for 2006 reached a record high, \$46 billion, boosted by higher prices for export commodities. Twelve-month consumer price inflation ended the year at about 3 percent, well below the

4.5 percent mid-point of the government's inflation target range and the lowest level since the inflation targeting regime was adopted in 1999.

Brazilian Economic Indicators

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

Indicator	2005	2006	2006				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP ¹	1.6	n.a.	2.0	n.a.	...	...	...
Industrial production	3.1	n.a.	.7	n.a.	1.0	.8	n.a.
Unemployment rate ²	9.8	n.a.	10.5	n.a.	9.8	9.7	n.a.
Consumer prices ³	5.7	3.1	3.8	3.1	3.3	3.0	3.1
Merch. trade balance ⁴	44.8	46.1	50.1	51.0	44.1	50.3	58.4
Current account ⁵	14.2	n.a.	29.8	n.a.	18.3	18.2	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 November suggests that growth continued to be strong in the fourth quarter. Industrial production in October and November on average was 2 percent above its third-quarter level, a notable acceleration from the pace registered in the previous quarter. Twelve-month inflation ended 2006 in the single digits, down from 2005. The food and beverages sector was responsible for about one-third of the 2006 inflation rate, the largest contribution of any sector; however, its contribution also fell the most relative to the previous year, explaining the bulk of the overall reduction in inflation. The government's price agreements with representatives from several food sectors in early 2006 may partly explain the reduction. Recently, the government has suggested that some of those price agreements may be allowed to expire in 2007.

Argentine Economic Indicators

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

Indicator	2005	2006	2006				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP ¹	8.9	n.a.	10.9	n.a.	...	...	...
Industrial production	8.0	n.a.	1.0	n.a.	.2	1.3	n.a.
Unemployment rate ²	11.6	n.a.	10.2	n.a.	...	...	...
Consumer prices ³	12.2	9.8	10.6	10.1	10.5	10.0	9.8
Merch. trade balance ⁴	11.7	12.4	11.4	13.3	14.2	14.6	18.7
Current account ⁵	5.4	n.a.	7.0	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**, President Chavez took office for a new six-year term on January 8, and over that week he made a number of announcements to further consolidate power. He announced that the government will nationalize the country's largest telecommunications company, CANTV, as well as the electricity companies that had been privatized in the 1990s. Chavez also suggested that the government may take a majority stake in the oil operations in the Orinoco Basin currently controlled by foreign companies, asked the national congress to change the business code to "regulate profits," and refused to renew a broadcasting license to a local television network that had been sympathetic to the opposition. Chavez also proposed legislation that would formally strip the central bank of its autonomy, although the central bank has had little *de facto* autonomy since Chavez came to power in 1999.

Monetary and fiscal policies have been very expansionary and, as a result, inflation has been persistently high, ending 2006 at 17 percent. The Chavez government is expected to transfer about \$7 billion of the central bank's \$40 billion in international reserves to a government development bank.

Venezuelan Economic Indicators

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

Indicator	2005	2006	2006				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP ¹	10.9	n.a.	10.8	n.a.	...	...	...
Unemployment rate ²	12.2	n.a.	10.0	n.a.	8.9	8.3	n.a.
Consumer prices ³	14.4	17.0	14.6	16.1	15.5	15.8	17.0
Non-oil trade balance ⁴	-16.3	n.a.	-32.9	n.a.	n.a.	n.a.	n.a.
Merch. trade balance ⁴	31.8	n.a.	30.0	n.a.	n.a.	n.a.	n.a.
Current account ⁵	25.5	n.a.	30.8	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.

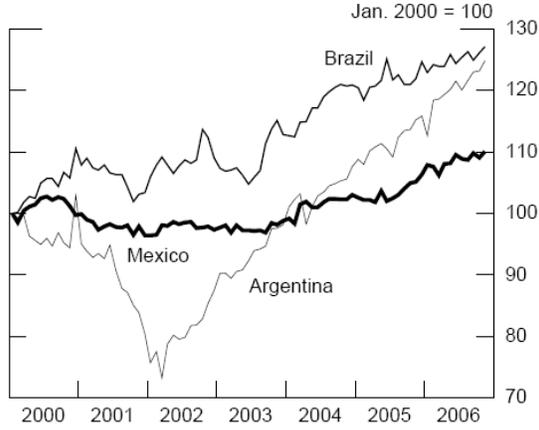
4. Billions of U.S. dollars, annual rate.

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

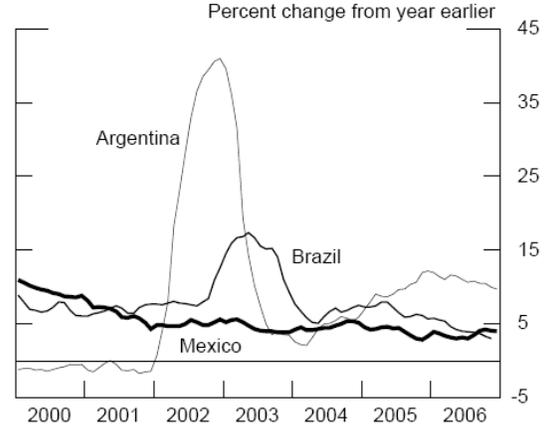
n.a. Not available. . . . Not applicable.

Latin America

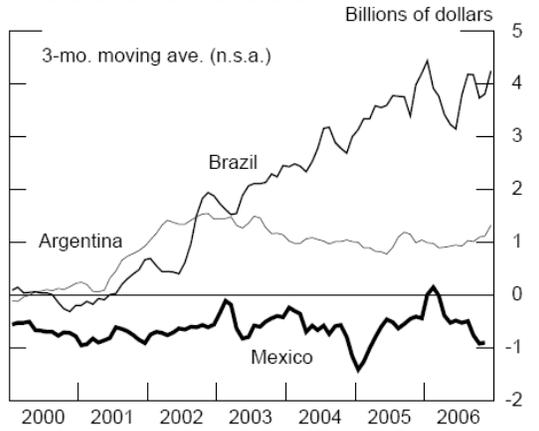
Industrial Production



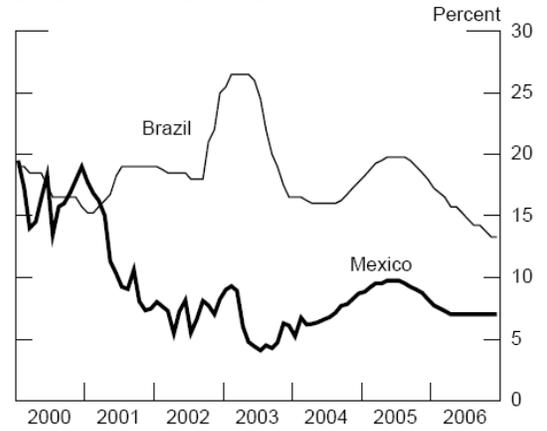
Consumer Prices



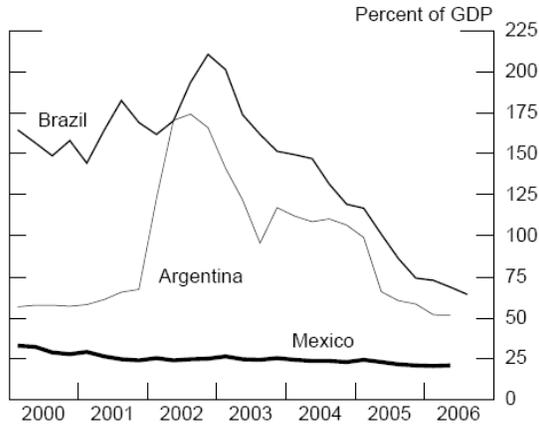
Merchandise Trade Balances



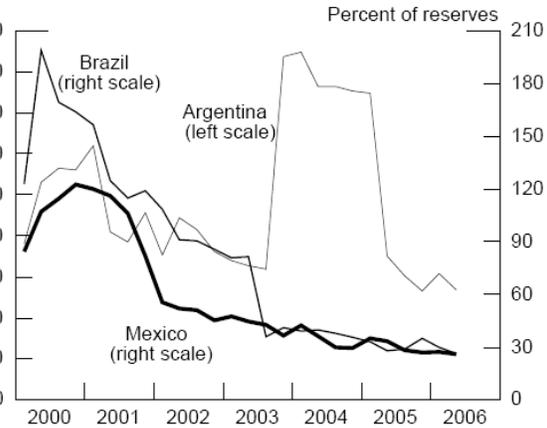
Benchmark Interest Rates



Gross External Debt



Short-Term External Debt



In **Turkey**, economic activity slowed during the third quarter. Real GDP grew 3.4 percent while industrial production fell 2.9 percent. Industrial production surged in November, however, and falling commodity prices have contributed to improvements in the trade balance. Despite monetary tightening and slowing economic growth, inflation remained high, with twelve-month consumer price inflation at 9.7 percent in 2006. EU accession talks have been suspended until further progress is made with Cyprus.

Turkey Economic Indicators

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

Indicator	2005	2006	2006				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP ¹	7.4	n.a.	3.4	n.a.	...	...	...
Industrial production	5.4	n.a.	-2.9	n.a.	-2.6	10.8	n.a.
Consumer prices ²	7.7	9.7	10.8	9.8	10.0	9.9	9.7
Merch. trade balance ³	-43.3	n.a.	-54.5	n.a.	-60.5	-49.9	n.a.
Current account ⁴	-23.1	n.a.	-33.3	n.a.	-43.8	-32.3	n.a.
Unemployment rate	10.3	n.a.	9.9	n.a.	...	...	...

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**, recent indicators suggest that fourth-quarter non-gold mining output rose, but manufacturing growth was weak. Consumer price inflation was steady at 5 percent in the fourth quarter, although inflationary pressures persist. The current account deficit was 6 percent of GDP in the third quarter, driven by soaring imports. The South African rand strengthened in November and December after its rapid depreciation in the second and third quarters of 2006, but weakened again in recent weeks.

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

Indicator	2005	2006	2006				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP ¹	4.9	n.a.	4.7	n.a.	...	...	...
Manuf. Production	3.6	n.a.	1.4	n.a.	.3	-.2	n.a.
Mining Production	1.3	n.a.	.5	n.a.	1.4	3.8	n.a.
Consumer Prices ²	4.0	4.6	5.0	5.0	5.0	5.0	5.0
Merch. trade Balance ³	-2.9	n.a.	-6.4	n.a.	-11.8	-9.5	n.a.
Current Account ⁴	-9.1	n.a.	-15.9	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.