

Prefatory Note

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Part 2

September 10, 2008

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

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Domestic Nonfinancial Developments

Domestic Nonfinancial Developments

Economic activity appears to have decelerated considerably this quarter. The labor market deteriorated further in July and August, as private payrolls declined and the unemployment rate moved sharply higher. In addition, industrial output likely fell steeply in August, in part because of large cutbacks in motor vehicle assemblies and in energy output. On the spending side, consumer spending appears to be weakening under the ongoing pressures from declining household wealth, sluggish real wages, tight credit conditions, and dismal sentiment. Meanwhile, residential investment has continued to move down at a pace similar to that seen in recent months. In contrast, business investment in equipment (other than motor vehicles) and structures appears to have held up early this quarter. Consumer price inflation has moved up significantly in recent months. However, some of the pressures driving up inflation seem to be easing.

Labor Market Developments

The labor market has continued to deteriorate. According to the August employment report, private payroll employment fell 101,000 last month, a slightly larger decline than the average pace seen from January to July of this year. Most major industry groups shed jobs last month; manufacturing posted a particularly noticeable loss of 61,000.

Employment also fell by 37,000 in the related temporary help services industry. In contrast, job losses in the construction industry diminished over the past two months despite the ongoing contraction in residential investment. Nonbusiness services, which include the education and health industries, and natural resources and mining showed increases in line with those of recent months. With the average workweek of production and nonsupervisory workers holding steady, aggregate hours have edged lower, and in August they stood 1.5 percent at an annual rate below the second-quarter average.

In the household survey, the unemployment rate jumped 0.4 percentage point, to 6.1 percent, last month. Both adult men and adult women experienced large increases in their unemployment rates, while the unemployment rate of teens retraced only a small portion of its steep increase between April and July. We think that part of the rise in the overall unemployment rate in August was due to the emergency unemployment benefits that went into effect in July.¹ However, the remainder seems indicative of a further increase in labor market slack. Another measure of slack, the fraction of workers who

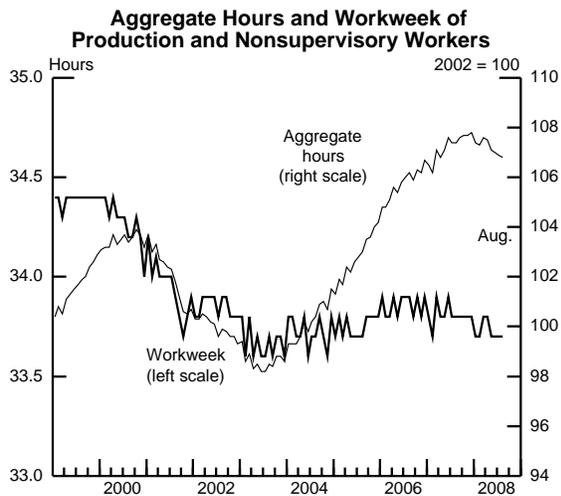
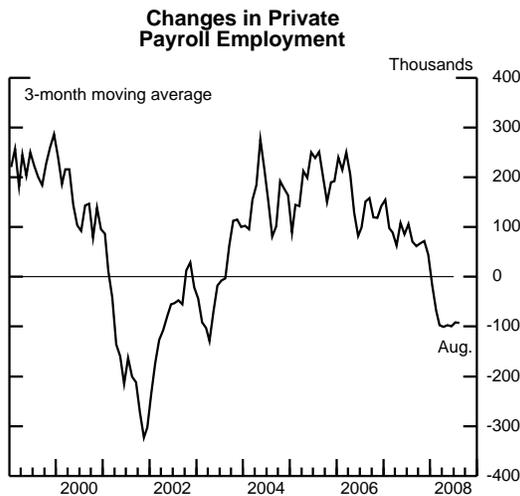
¹ The extended benefits program increases unemployment for two reasons. First, the program draws some individuals who were out of the labor force into unemployment because a person must be looking for work to collect benefits. Second, the program reduces the incentive for benefit recipients to actively seek and accept employment offers.

Changes in Employment

(Thousands of employees; seasonally adjusted)

Measure and sector	2007	2008					
		Q4	Q1	Q2	June	July	Aug.
	Average monthly change			Monthly change			
Nonfarm payroll employment (establishment survey)	91	80	-82	-71	-100	-60	-84
Private	71	45	-97	-100	-110	-66	-101
Natural resources and mining	3	4	4	6	8	10	12
Manufacturing	-22	-17	-43	-39	-44	-38	-61
Ex. motor vehicles	-15	-8	-31	-31	-38	-38	-22
Construction	-19	-41	-41	-49	-50	-20	-8
Residential	-20	-39	-30	-30	-28	-16	-19
Nonresidential	1	-2	-11	-19	-22	-4	10
Wholesale trade	9	6	-6	-7	-4	-16	-11
Retail trade	6	0	-29	-26	-8	-18	-20
Financial activities	-9	-14	-7	-6	-13	-3	-3
Professional and business services	26	44	-39	-29	-55	-17	-53
Temporary help services	-7	4	-24	-30	-36	-24	-37
Nonbusiness services ¹	76	71	66	63	69	50	50
Total government	21	35	15	29	10	6	17
Total employment (household survey)	22	-16	-81	-26	-155	-72	-342
Memo:							
Aggregate hours of private production workers (percent change) ²	1.3	1.0	-1.1	-.9	-.1	-.1	-.1
Average workweek (hours) ³	33.8	33.8	33.7	33.7	33.7	33.7	33.7
Manufacturing (hours)	41.2	41.2	41.1	41.0	41.0	41.0	40.9

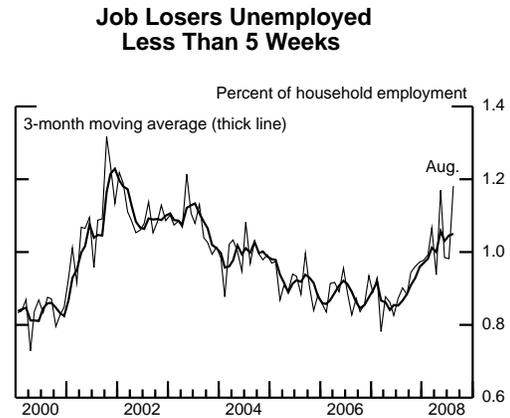
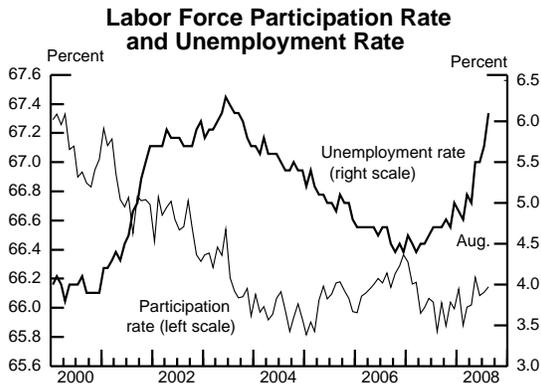
1. Nonbusiness services comprises education and health, leisure and hospitality, and "other."
2. Establishment survey. Annual data are percent changes from Q4 to Q4. Quarterly data are percent changes from preceding quarter at an annual rate. Monthly data are percent changes from preceding month.
3. Establishment survey.



Selected Unemployment and Labor Force Participation Rates

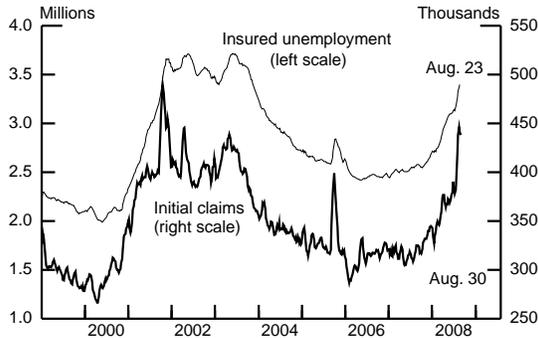
(Percent; seasonally adjusted)

Rate and group	2007	2007	2008				
		Q4	Q1	Q2	June	July	Aug.
<i>Civilian unemployment rate</i>							
Total	4.6	4.8	4.9	5.3	5.5	5.7	6.1
Teenagers	15.7	16.4	16.8	17.4	18.1	20.3	18.9
20-24 years old	8.2	8.6	9.0	9.8	10.1	10.2	10.5
Men, 25 years and older	3.6	3.7	3.8	4.2	4.3	4.6	5.0
Women, 25 years and older	3.6	3.8	3.9	4.1	4.2	4.2	4.8
<i>Labor force participation rate</i>							
Total	66.0	66.0	66.0	66.1	66.1	66.1	66.1
Teenagers	41.3	41.0	40.3	41.4	40.5	40.8	40.2
20-24 years old	74.4	74.0	73.9	74.6	74.8	74.9	74.9
Men, 25 years and older	75.6	75.5	75.5	75.2	75.3	75.6	75.6
Women, 25 years and older	59.7	59.7	59.9	60.0	60.1	59.9	60.1



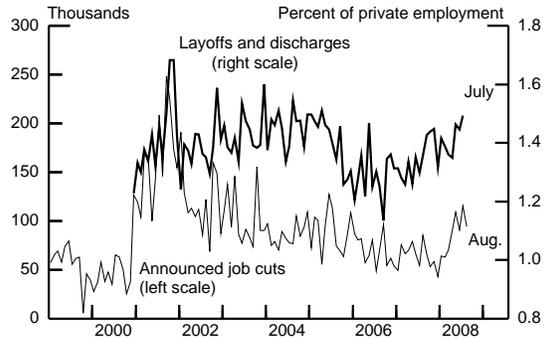
Labor Market Indicators

Unemployment Insurance



Note. 4-week moving averages.

Layoffs and Job Cuts



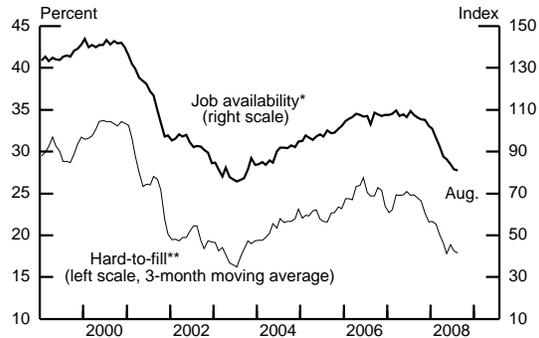
Note. Both series are seasonally adjusted by FRB staff. Source. For layoffs and discharges, Job Openings and Labor Turnover Survey; for job cuts, Challenger, Gray, and Christmas, Inc.

Job Openings and Hires



Source. Job Openings and Labor Turnover Survey.

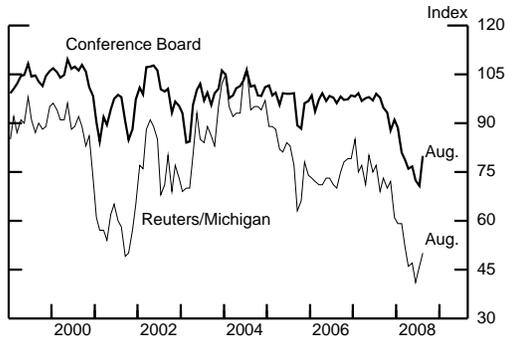
Job Availability and Hard-to-Fill Positions



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

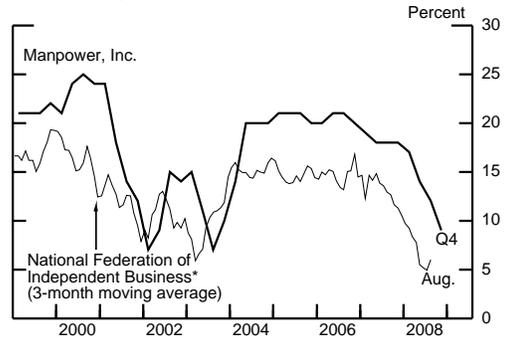
**Percent of small businesses surveyed with at least one "hard-to-fill" job opening. Seasonally adjusted by FRB staff. Source. For job availability, Conference Board; for hard-to-fill, National Federation of Independent Business.

Expected Labor Market Conditions



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

Net Hiring Plans



Note. Percent planning an increase in employment minus percent planning a reduction. *Seasonally adjusted by FRB staff.

are working part time for economic reasons, also continued to rise in August. Meanwhile, the labor force participation rate held steady at 66.1 percent.

Initial claims for unemployment insurance under regular state programs have moved considerably higher since the July/August Greenbook. We think that the level of these claims has also been boosted by the emergency unemployment compensation program, as it was the last time such a program was in place, in 2002, because some individuals who apply for extended benefits turn out to be eligible for regular benefits (for which they must file a claim). However, claims have remained elevated for longer this time than in 2002, an indication that the labor market may have weakened further over the past month.

Most other labor market indicators also suggest a further weakening of the labor market. With regard to separations, the short-term job losers rate has changed little on balance in recent months, but the layoffs and discharges rate, as measured by the Job Openings and Labor Turnover Survey (JOLTS), edged up further in July. In addition, announcements of downsizing plans compiled by Challenger, Gray, and Christmas, Inc., remained at a high level in August.

With regard to hiring, both the JOLTS hiring rate and the JOLTS job openings rate have continued their downward trajectories. Perceptions of job availability in the Conference Board survey edged down further in August, while the National Federation of Independent Business (NFIB) measure of hard-to-fill positions remained at a very low level last month. The outlook for hiring remains gloomy. According to the Manpower survey, firms have lowered their fourth-quarter net hiring plans appreciably. And while hiring plans in the NFIB survey ticked up in August, the three-month moving average stands close to its nadir in the last recession.

According to both the Reuters/University of Michigan and Conference Board surveys, household expectations of future labor market conditions have improved a bit from their very low mid-summer levels. Even so, these expectations remain at lower levels than at any time since the early 1990s.

With real GDP reported to have posted a sizable increase even as hours were declining, the staff estimates that productivity in the nonfarm business sector rose at an annual rate of 4½ percent last quarter after having increased at a rate of 2½ percent in the first quarter.² Over the four quarters ending in the second quarter of this year, productivity

² According to the productivity and cost data based on the preliminary national income and product accounts release, productivity in the nonfarm business sector increased at an annual rate of 4.3 percent last

rose 3½ percent. In the nonfinancial corporate sector, the gain in productivity over the past year was somewhat smaller, at 2¼ percent.

Output per Hour

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

Sector	2006:Q2 to 2007:Q2	2007:Q2 to 2008:Q2	2007		2008	
			Q3	Q4	Q1	Q2
Nonfarm business						
All persons	.5	3.4 ¹	5.8	.8	2.6	4.5 ¹
All employees ²	.6	2.9 ¹	4.9	-.7	2.5	5.0 ¹
Nonfinancial corporations ³	1.0	2.3	1.8	1.9	-.2	5.6

1. Staff estimates.

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

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

Industrial Production

Industrial production (IP) is on track to post another decline in the third quarter after having fallen at an annual rate of more than 3 percent in the second quarter. Output in July edged up 0.2 percent, but the production indicators for August suggest that IP fell sharply last month. In particular, aggregate hours of production workers in manufacturing declined 1.1 percent, and the available weekly production data, which cover about one-quarter of IP, point to a plunge in motor vehicle assemblies and declines in the output of refined petroleum products and electricity generation. The factory operating rate in July, at 77.7 percent, was 2 percentage points below its 1972–2007 average and 2½ percentage points below its recent peak in July 2007; most major industry groups are operating at below-average rates.³

Motor vehicle assemblies fell more than 1½ million units in August to an annual rate of 8.2 million units. The drop in production reflects a decision by the automakers to scale back their production plans following the plunge in July vehicle sales. At a 9 million unit pace, third-quarter schedules are now 1¾ million units below the level of assemblies in

quarter. The staff estimate is based on source data that became available after the GDP release and on revisions to the June employment data.

³ Major industry groups with above-average operating rates in July included aerospace products and parts, which has been supported by the continued rollout of the more fuel-efficient Boeing 787 Dreamliner; energy-related industries, such as petroleum refining and oil and gas extraction; computers and communications equipment; food; and primary metals.

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

Component	Proportion 2007 (percent)	2007 ¹	2008		2008		
			Q1	Q2	May	June	July
			Annual rate		Monthly rate		
Total	100.0	2.1	.4	-3.2	-2	.4	.2
Previous	100.0	2.1	.5	-3.1	-2	.5	...
Manufacturing	78.7	2.3	-1.0	-3.9	.0	.1	.4
Ex. motor veh. and parts	73.6	2.6	.0	-2.1	.0	-.2	.2
Ex. high-tech industries	69.3	1.3	-1.1	-3.3	.0	-.2	.2
Mining	11.6	.2	3.5	2.4	.1	.9	.9
Utilities	9.7	3.1	8.0	-4.1	-2.2	2.3	-1.9
<i>Selected industries</i>							
Energy	24.7	2.3	7.0	-1.0	-8	.9	.2
High technology	4.3	22.3	17.6	16.9	-2	.5	.3
Computers	1.0	16.7	25.0	8.4	.3	.7	.6
Communications equipment	1.3	20.6	6.4	15.7	-.2	.0	-.2
Semiconductors ²	2.0	25.9	21.8	21.9	-.5	.8	.4
Motor vehicles and parts	5.1	-2.2	-14.4	-28.9	.6	4.8	3.6
<i>Total ex. selected industries</i>	65.9	1.1	-2.0	-3.3	.0	-.1	.0
Consumer goods	19.9	.3	-1.7	-1.4	.0	.0	-.2
Durables	3.6	-2.4	-11.7	-5.1	-.1	-.5	-.3
Nondurables	16.3	.9	.6	-.6	.0	.2	-.2
Business equipment	7.3	2.8	2.6	-6.6	.2	.0	.5
Defense and space equipment	1.7	4.2	1.3	-3.3	-.5	.8	.6
Construction supplies	4.2	-1.9	-7.6	-5.1	.4	-.2	.3
Business supplies	7.4	-.1	-3.5	-5.3	-.1	-.9	-.4
Materials	25.4	1.8	-2.5	-2.9	.0	.0	.1
Durables	13.6	2.9	-.4	-3.0	-.5	.3	.2
Nondurables	11.7	.6	-4.9	-2.8	.6	-.4	-.1

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- 2007 average	1994- 95 high	2001- 02 low	2007	2008			
				Q4	Q1	Q2	June	July
Total industry	81.0	85.1	73.6	81.0	80.6	79.7	79.8	79.9
Manufacturing	79.7	84.6	71.5	79.3	78.7	77.6	77.5	77.7
Ex. motor veh. and parts	79.9	84.3	71.2	79.8	79.4	78.6	78.4	78.4
Mining	87.5	88.7	84.8	90.2	90.4	90.9	91.4	92.1
Utilities	86.8	93.9	84.6	85.9	86.7	85.7	86.2	84.4
<i>Stage-of-process groups</i>								
Crude	86.6	89.5	81.9	89.3	89.5	89.4	89.4	90.1
Primary and semifinished	82.2	88.2	74.6	81.3	80.8	79.8	79.8	79.5
Finished	77.7	80.4	69.9	77.6	77.2	75.9	76.1	76.4

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

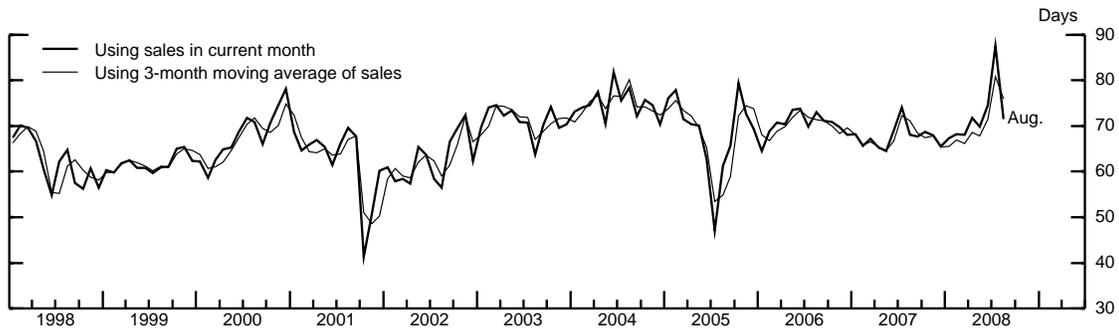
Item	2008							
	Q1	Q2	Q3	Q4	June	July	Aug.	Sept.
U.S. production ¹	9.7	8.5	8.7	8.6	9.0	9.6	8.0	8.7
Autos	3.9	3.6	4.4	4.2	3.7	4.7	4.1	4.4
Light trucks	5.7	4.9	4.3	4.5	5.3	4.9	3.8	4.3
Days' supply ²	66	72	n.a.	n.a.	75	88	71	n.a.
Autos	52	48	n.a.	n.a.	49	59	61	n.a.
Light trucks	77	94	n.a.	n.a.	99	115	80	n.a.
Inventories ³	2.48	2.41	n.a.	n.a.	2.41	2.58	2.42	n.a.
Autos	.86	.78	n.a.	n.a.	.78	.85	.89	n.a.
Light trucks	1.63	1.63	n.a.	n.a.	1.63	1.73	1.54	n.a.
Memo: U.S. production, total motor vehicles ⁴	9.9	8.8	9.0	8.9	9.2	9.8	8.2	8.9

- Note. FRB seasonals. Components may not sum to totals because of rounding.
1. Production rates for September and the fourth 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



2007 and only a little above the second-quarter pace, when strikes severely curtailed production at General Motors. Preliminary schedules for the fourth quarter are for production to remain at about this low level.

Although the number of new vehicles in inventory has not been particularly elevated by historical standards, days' supply reached an uncomfortably high level of 88 days at the end of July, due to the plunge in sales that month. However, the cut in assemblies, combined with a recovery in the pace of sales, caused days' supply to drop back to 71 days in August, a level much closer to the automakers' target of 65 days. The excess stocks that remain are concentrated in light trucks, where days' supply had jumped to an extremely bloated 115 days in July before dropping back to 80 days in August; days' supply of autos stood at a relatively lean 61 days last month.

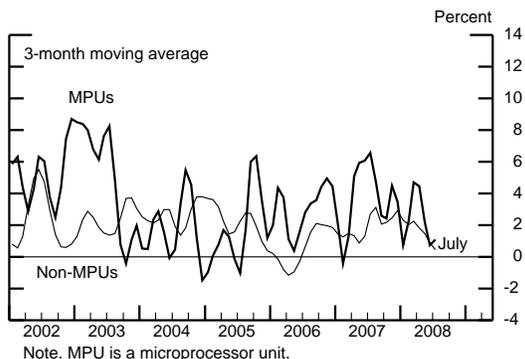
Elsewhere in transportation, the production of aircraft and parts has jumped during the past few months. As of August, Boeing had about 3,700 unfilled orders and was producing about 40 planes per month; Boeing's backlog, all else being equal, would support production for quite some time. However, Boeing's machinists went on strike last week, which idled most domestic capacity for commercial aircraft assembly. Prospects for resolution of the strike are uncertain, but if the strike were to last one month, we estimate that it would take down manufacturing IP by roughly ½ percentage point in September and a small effect on October as well—similar to the experience with the previous strike in 2005.

Following a sizable gain in the second half of last year, the output of high-tech equipment decelerated to a modest annual growth rate of about 17 percent in both the first and second quarters of this year. Computer production decelerated noticeably in the second quarter after having been boosted by strong server sales in the first quarter. Reports from computer manufacturers are mixed, but, on balance, they indicate that foreign demand has been robust and domestic demand has been soft. Looking ahead, International Data Corporation's projection for computer sales suggests that production is likely to increase moderately in the third quarter; however, the mixed tone of recent statements from manufacturers suggests a fair bit of uncertainty. Production of communications equipment stepped up in the second quarter, consistent with a strong increase in revenue at Cisco. However, capital spending guidance for telecommunications service providers (TSPs) suggests little impetus to third-quarter production.⁴

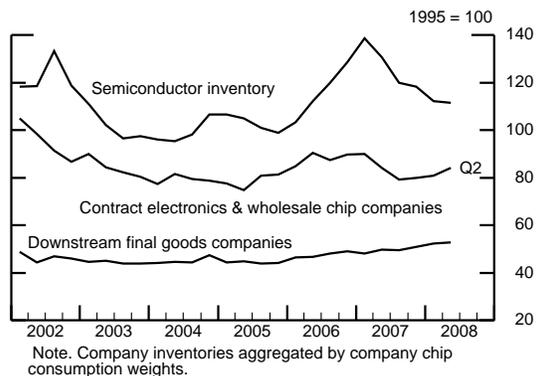
⁴ TSPs are estimated to account for roughly one-third of private communications equipment investment and production.

Indicators of High-Tech Manufacturing Activity

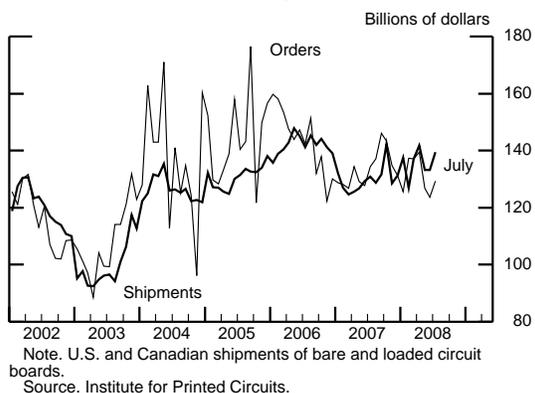
Rate of Change in Semiconductor Industrial Production



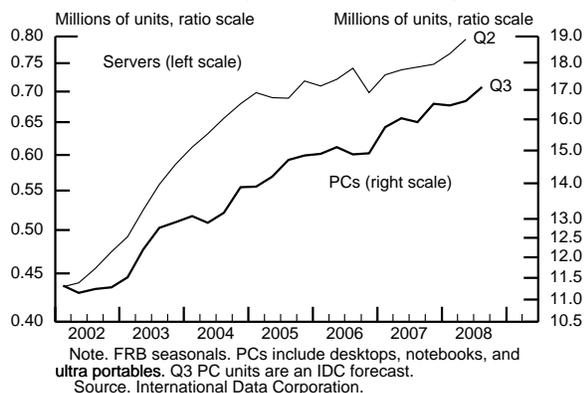
High-Tech Inventory-Sales Ratios



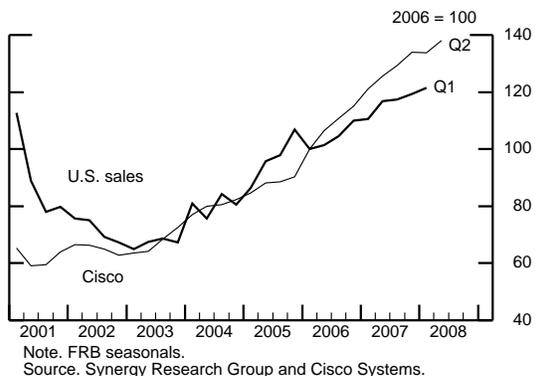
Circuit Board Orders and Shipments



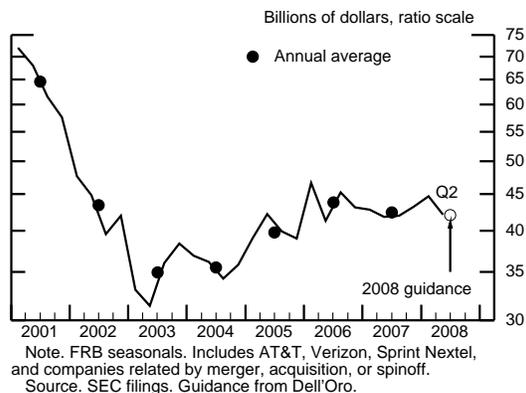
U.S. Personal Computer and Server Absorption



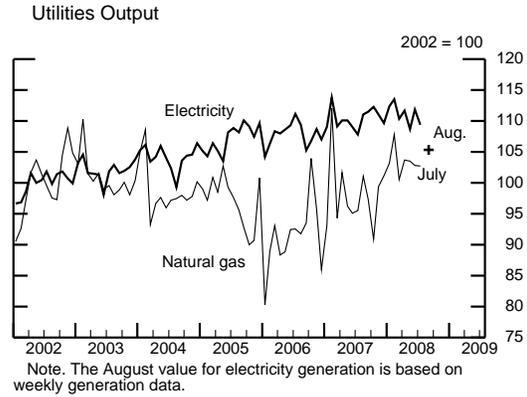
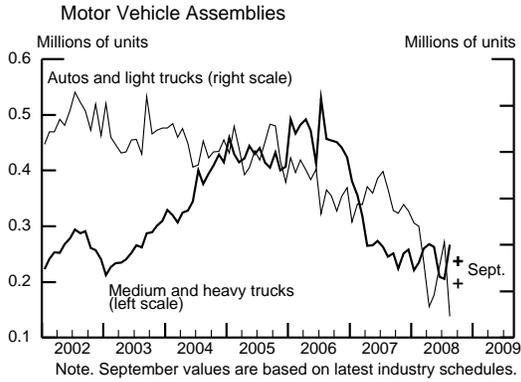
Cisco Revenue and U.S. Sales of High-End Data Networking Equipment



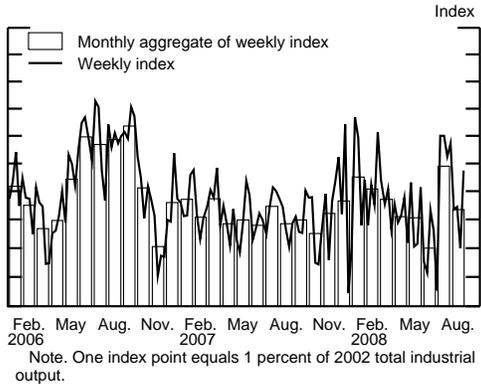
Capital Expenditures by Selected Telecommunications Service Providers



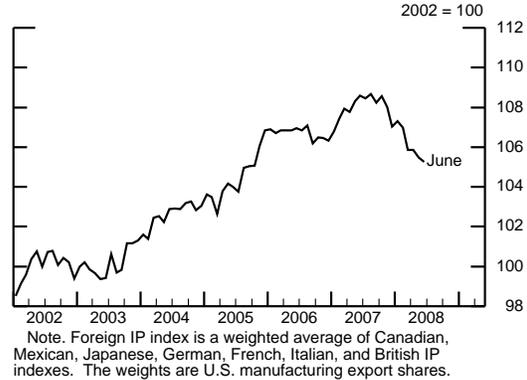
Indicators of Industrial Activity



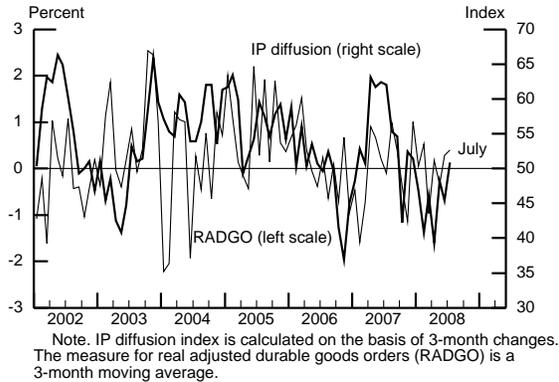
Weekly Production Index excluding Motor Vehicles and Electricity Generation



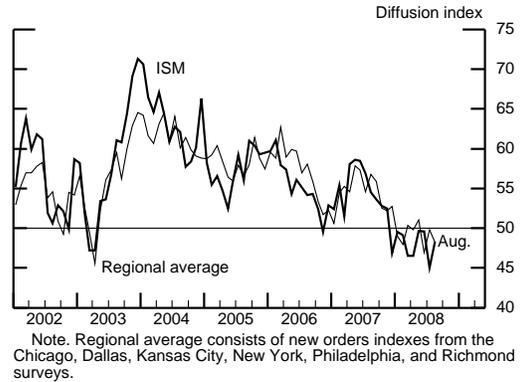
Foreign Industrial Production



IP Diffusion Index and Real Adjusted Durable Goods Orders



ISM Diffusion Index and Average of Regional New Orders Diffusion Indexes



The weaker demand from computer and communications equipment manufacturers contributed to a deceleration in semiconductor production in the first half of this year, after a considerable increase in the second half of last year. For the third quarter, production gains will likely remain relatively subdued; for example, a major manufacturer reported that it is not seeing the usual seasonal boost to orders in advance of the holiday season. In addition, although inventory-sales ratios for semiconductors do not appear excessive, they seem to be creeping up at contract electronics companies and at wholesale chip companies, and some recent reports have cited excess inventories of DRAM (dynamic random-access memory) and flash memories.

Elevated energy prices continue to spur drilling for oil and natural gas. Output in this industry increased at an annual rate of 5½ percent so far this year. Hurricane Gustav, which passed through the center of the Gulf of Mexico at the end of August, led to the evacuation of most oil and natural gas extraction platforms and rigs in the region as well as to the precautionary closure of some oil refineries. These actions appear to have reduced the August change in IP by less than 0.1 percentage point but will have a more noticeable effect in September as the production stoppages extended well into the month.⁵

Output excluding the production of energy, motor vehicles and parts, and high-tech equipment was little changed for a third month in July. The output of consumer goods slipped further, continuing a trend that started in the fourth quarter of 2007. The production of business equipment rose about ½ percent in July after having edged up, on net, over the previous two months, but much of the increase is attributable to a rebound in the volatile farm machinery category. Elsewhere, the production of construction supplies has changed little, on net, over the past several months, as increases in the output of supplies more likely to be associated with nonresidential construction have provided some offset to further sharp declines in the production of supplies typically tied to residential construction. The output of business supplies has continued to trend down, with notable negative contributions from printing and publishing. Lastly, the output of materials to be further processed in the industrial sector was little changed in July.

Near-term indicators of production suggest that the industrial sector is likely to remain soft over the next few months, though output growth will undoubtedly be boosted at some point by a strike-related rebound in production at Boeing and the return to production of energy facilities in the Gulf of Mexico. The new orders diffusion indexes

⁵ As of September 9, nearly 80 percent of crude oil production and about 65 percent of natural gas production in the Gulf of Mexico remained offline; in addition, one petroleum refinery remained entirely shut down. These numbers are likely to increase reflecting the effects of Hurricane Ike.

from the Institute for Supply Management (ISM) and the various regional surveys have generally remained below 50. While the three-month moving average of real orders for durable goods (adjusted to exclude industries for which reported orders have little information content for predicting shipments) has edged up a bit in recent months, it remains consistent with weak IP. In addition, foreign demand, which has helped support IP for much of the past year, shows signs of slowing. For example, a trade-weighted average of the industrial production indexes for some of the United States' major trading partners has been falling since late last year.

Motor Vehicle Sales

Demand for light vehicles improved last month but remained at a relatively low level. After having plunged to an annual rate of just 12.5 million units in July, light vehicle sales rebounded to 13.7 million units in August, about the same pace as in June.

. The August increase in light vehicle sales likely reflected, in part, an expansion of customer incentive programs by the automakers. In particular, sales at General Motors surged more than 800,000 units (annual rate), and the company cited a strong response to its "Employee-Discount-For-Everyone" program.⁶ More generally, the availability of cash rebates and cut-rate financing has risen sharply in the past few weeks. In addition, while concerns over gasoline prices remain high, they appear to have subsided a little as prices have eased; the percentage of respondents to the Reuters/Michigan survey who cited high gasoline prices or gasoline shortages as reasons for their negative view of car-buying conditions moved down somewhat in August, and demand shifted back towards trucks and away from autos last month.

Besides high gasoline prices and weak macroeconomic fundamentals, a number of other forces appear to be weighing on the demand for light vehicles. In particular, lower trade-in values for light trucks have reduced the cash that many consumers expected to have on hand to apply toward the purchase of new vehicles. The lower trade-in values have also prompted several automakers to pull back from leasing, which typically has accounted for about 20 percent of sales, because their lending arms are accruing large losses when consumers return leased vehicles that have fallen out of favor, such as large SUVs.⁷ Finally, consumers also face tighter credit conditions for more traditional financing—both from captive auto finance companies, such as GMAC, and from banks.

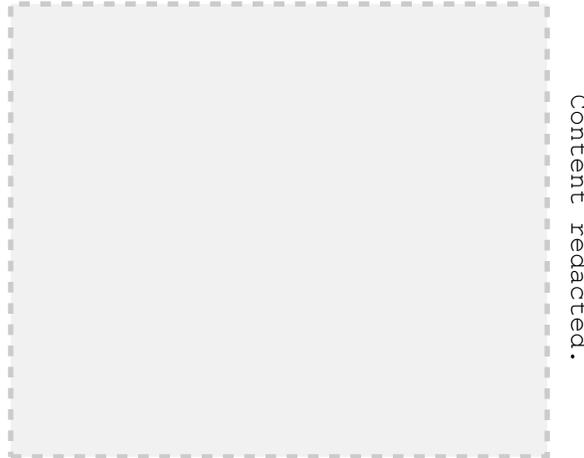
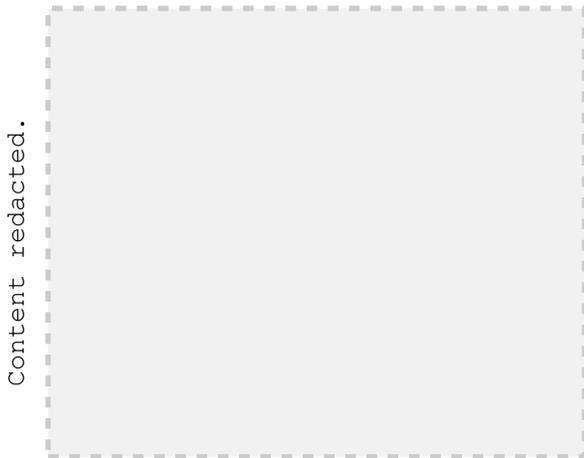
⁶ Although General Motors' employee pricing program was originally scheduled to expire on September 2, the company extended it until the end of September.

⁷ Chrysler has decided to exit the leasing business altogether, and Ford and General Motors have announced plans to scale back vehicle leasing.

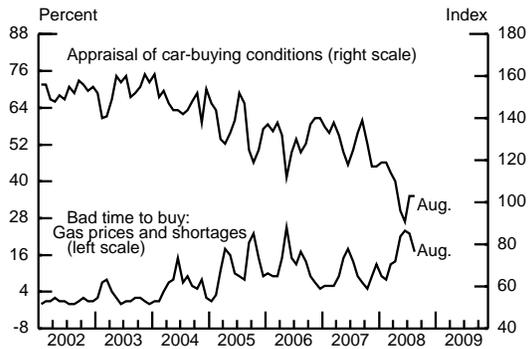
Sales of Light Vehicles
(Millions of units at an annual rate; FRB seasonals)

Category	2007	2008					
		Q4	Q1	Q2	June	July	Aug.
Total	16.1	16.0	15.2	14.1	13.6	12.5	13.7
Autos	7.6	7.7	7.4	7.6	7.5	6.9	6.8
Light trucks	8.5	8.2	7.8	6.5	6.1	5.6	6.9
North American ¹	12.3	12.2	11.5	10.4	9.9	9.1	10.4
Autos	5.2	5.4	5.1	5.0	4.9	4.4	4.5
Light trucks	7.1	6.8	6.5	5.3	5.1	4.6	5.9
Foreign-produced	3.8	3.8	3.7	3.7	3.7	3.5	3.3
Autos	2.4	2.4	2.4	2.6	2.7	2.5	2.3
Light trucks	1.4	1.4	1.3	1.1	1.0	1.0	1.0
Memo: Detroit Three domestic market share (percent) ²	51.3	50.5	50.2	45.9	45.3	42.4	45.9

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

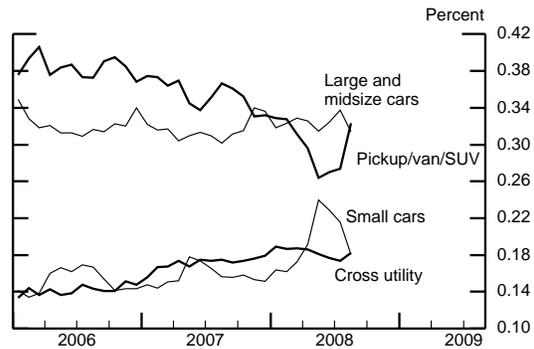


Car-Buying Attitudes



Source. Reuters/University of Michigan Survey.

Market Share of Light Vehicles by Segment



Note. Data through May. FRB seasonals.

Consumer Spending

Consumer spending has weakened noticeably in recent months against the backdrop of a deteriorating labor market, higher food and energy prices, lower equity and housing wealth, and depressed sentiment. Moreover, the temporary boost to spending growth from the tax rebates seems to be waning. Real personal consumption expenditures (PCE) declined 0.4 percent in July after having edged lower in June, as a result of a precipitous drop in motor vehicle outlays and a substantial decline in spending on other goods in those two months. The recent weakness in consumer spending on goods excluding motor vehicles contrasts sharply with surprisingly solid growth in the spring. Meanwhile, outlays for services (excluding the volatile energy components) were reported to have increased modestly in June and July.⁸

The weakness in real consumer spending reflects the challenging conditions that households currently face. In the second quarter, lower equity prices and the ongoing declines in house prices pushed the ratio of wealth to income down for a third consecutive quarter to about its level in early 2004. Subdued gains in wages and salaries, combined with sharply higher food and energy prices, have also restrained the purchasing power of households. Excluding the temporary boost of roughly \$90 billion (current dollars not at an annual rate) in tax rebates disbursed from May through July, real disposable income fell at an annual rate of $\frac{3}{4}$ percent last quarter and continued to move lower in July. Consumer sentiment remains depressed, although readings from both the Reuters/Michigan and Conference Board surveys improved modestly in July and August. In spite of an apparent tightening of lending standards, credit card balances continued to increase at a solid pace in July as households likely borrowed to support their spending.

Housing

Residential construction activity continued to decline steeply through mid-year. In July, single-family housing starts fell to an annual rate of 641,000 units, while adjusted permit issuance—a useful month-ahead indicator of starts—slid to an annual rate of 593,000 units. At an annual rate of decline of 22 percent, the contraction in single-family starts over the three months ending in July was similar to the rate of decline earlier in the year. In the multifamily sector, starts fell to 324,000 units in July, mostly reversing the previous month's outsized gain. June's spike in multifamily starts can be traced to more-

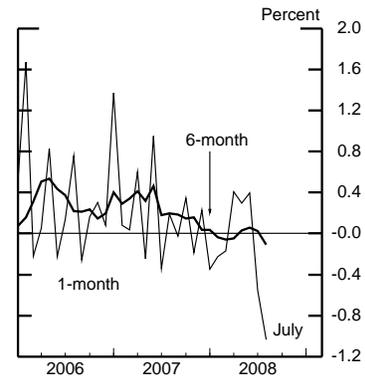
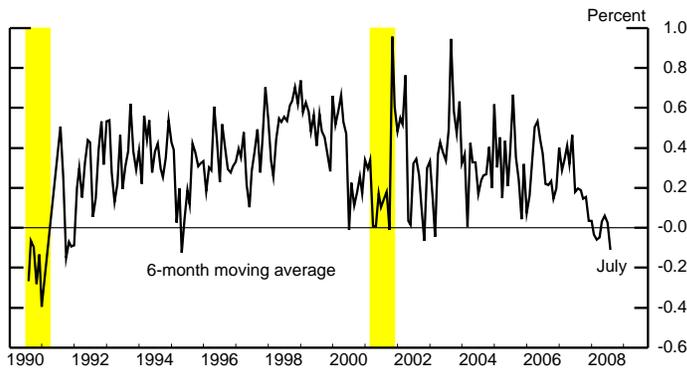
⁸ As always, recent quarters' estimates of real services spending—comprising over 60 percent of total PCE—may not be offering a timely view of the overall spending trajectory, because spending on several categories of services are based on judgmental trends for the period more recent than the 2006 Service Annual Survey.

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

Category	2007	2008		2008		
		Q1	Q2	May	June	July
		Annual rate		Monthly rate		
Total real PCE	2.8	.9	1.8	.3	-.1	-.4
Motor vehicles	2.0	-10.7	-19.3	-.8	-2.4	-4.0
Goods ex. motor vehicles	3.2	-.3	5.1	.5	-.4	-.8
Ex. energy	3.5	.5	6.2	.7	-.6	-.6
Services	2.6	2.4	1.3	.3	.2	.0
Ex. energy	2.6	2.2	1.1	.1	.2	.2
Memo: Nominal retail control ¹	5.2	4.6	10.3	1.1	1.0	.4

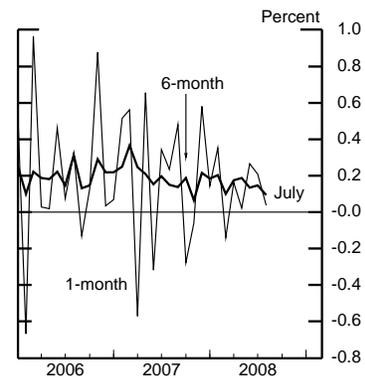
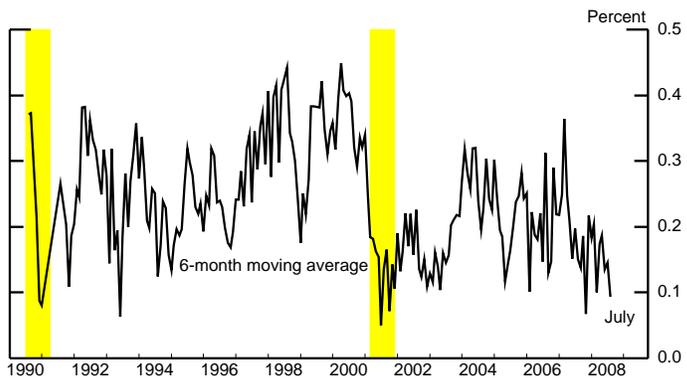
1. Total sales less outlays at building material and supply stores and automobile and other motor vehicle dealers.

Change in Real PCE Goods



Note. Shaded bars indicate periods of business recession as defined by the National Bureau of Economic Research.

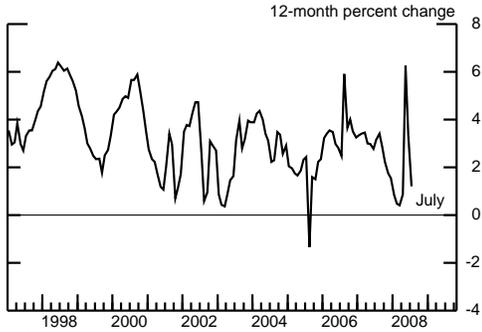
Change in Real PCE Services



Note. Shaded bars indicate periods of business recession as defined by the National Bureau of Economic Research.

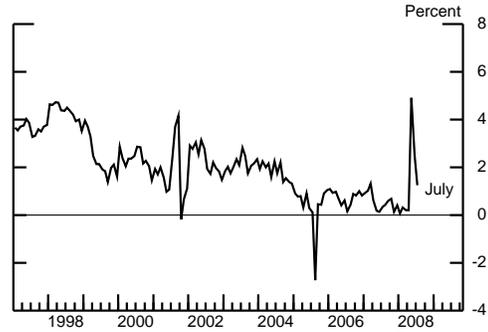
Fundamentals of Household Spending

Change in Real DPI



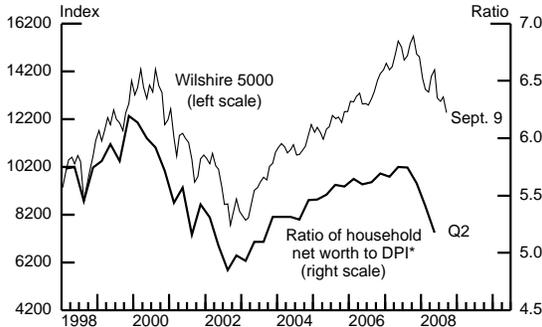
Note. Values for December 2004 and December 2005 exclude the effect on income of the one-time Microsoft dividend in December 2004.

Personal Saving Rate



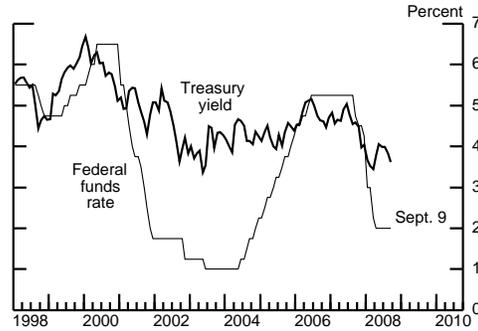
Note. The value for December 2004 excludes the effect on income of the one-time Microsoft dividend in that month.

Household Net Worth and Wilshire 5000

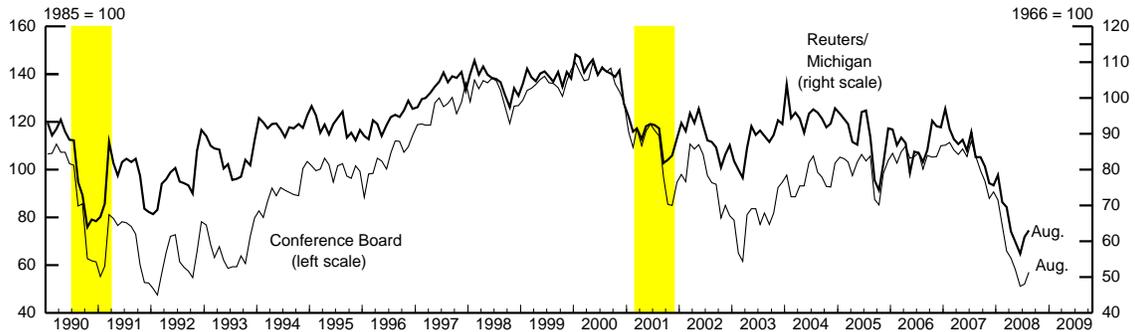


*The value for 2004:Q4 excludes the effect on income of the one-time Microsoft dividend in December 2004.

Target Federal Funds Rate and 10-Year Treasury Yield



Consumer Confidence



Note. Shaded bars indicate periods of business recession as defined by the National Bureau of Economic Research.

Private Housing Activity

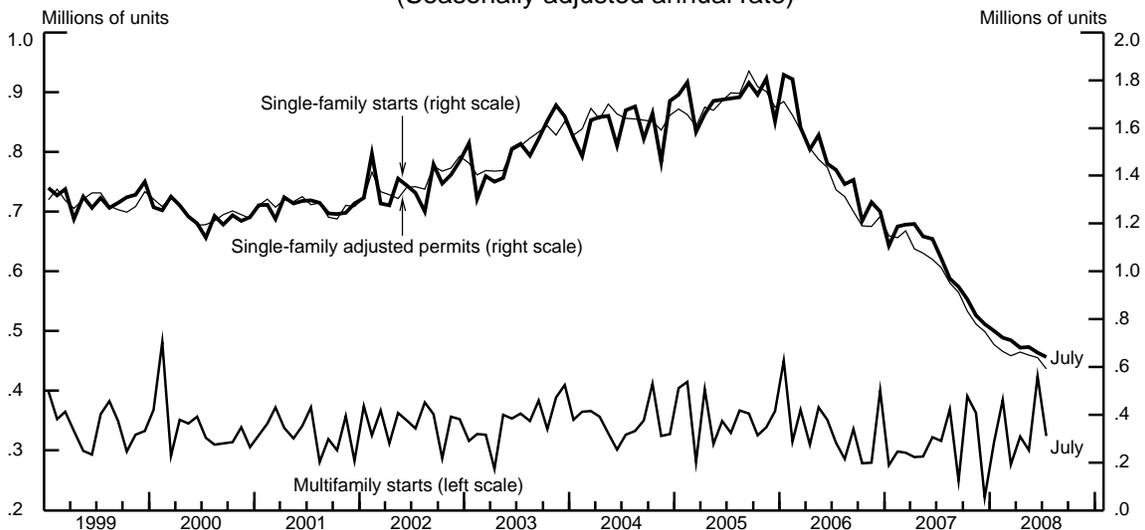
(Millions of units, seasonally adjusted; annual rate except as noted)

Sector	2007	2008				
		Q1	Q2	May	June	July
<i>All units</i>						
Starts	1.36	1.05	1.02	.98	1.08	.97
Permits	1.40	.99	1.03	.98	1.14	.94
<i>Single-family units</i>						
Starts	1.05	.73	.67	.68	.66	.64
Permits	.98	.65	.63	.64	.62	.58
Adjusted permits ¹	.99	.67	.65	.65	.64	.59
Permit backlog ²	.109	.096	.089	.094	.089	.093
New homes						
Sales	.78	.56	.52	.51	.50	.52
Months' supply ³	8.40	10.24	10.45	10.62	10.47	9.69
Existing homes						
Sales	4.94	4.39	4.34	4.41	4.26	4.39
Months' supply ³	8.67	10.24	10.31	10.02	10.39	10.03
<i>Multifamily units</i>						
Starts	.309	.325	.349	.300	.424	.324
Permits	.419	.341	.400	.343	.522	.353
Permit backlog ²	.075	.067	.071	.065	.071	.067
<i>Mobile homes</i>						
Shipments	.096	.092	.088	.087	.084	.085
<i>Condos and co-ops</i>						
Existing home sales	.713	.560	.573	.580	.590	.610

1. Adjusted permits equal permit issuance plus total starts outside of permit-issuing areas.
2. Number outstanding at end of period. Excludes permits that have expired or have been canceled, abandoned, or revoked. Not at an annual rate.
3. At current sales rate; expressed as the ratio of seasonally adjusted inventories to seasonally adjusted sales. Quarterly and annual figures are averages of monthly figures.

Private Housing Starts and Permits

(Seasonally adjusted annual rate)



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

stringent building codes that took effect in New York City on July 1, which apparently led developers to pull forward the start date of some planned apartment projects.

Home sales have moved sideways in recent months at very weak levels. The Census Bureau's measure of sales agreements for new homes—at 515,000 units in July—has changed little in recent months, but is down 35 percent from a year ago. Sales of existing single-family homes have been relatively flat since the end of last year, and recent readings of the pending home sales index suggest that sales will remain at a low level in the near term.⁹

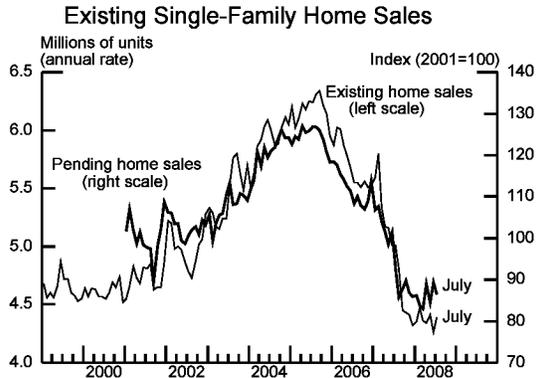
Recent cutbacks in new residential construction have further reduced the level of new-home inventories, and the flat pace of sales in recent months has allowed these inventory reductions to finally start to bring down the months' supply of new homes for sale. Even so, the months' supply of new homes for sale remains extremely elevated at more than double the level that prevailed prior to the downturn in the housing market.

Tight conditions in mortgage credit markets over the summer continued to restrain housing demand. The deterioration has been especially acute for mortgages that cannot be purchased by government-sponsored enterprises (GSEs); securitization of such loans has virtually halted, and lending spreads remain very wide. Conforming mortgage markets had also tightened over the summer. As of last week, the average rate for a standard 30-year fixed-rate conforming mortgage had risen about 30 basis points since May to 6.4 percent; however, rates at some lenders have reportedly retraced most of this increase in the past few days in response to the conservatorship of Fannie Mae and Freddie Mac. Non-price lending terms also tightened considerably over the summer as the GSEs' tighter lending standards made conforming mortgages more difficult to obtain. Moreover, down-payment requirements have become more binding for many potential borrowers (notwithstanding the first-time homebuyer tax credit described in the footnote above) because primary mortgage insurers have tightened standards and are charging higher fees, and because fewer lenders are willing to extend second mortgages that would allow borrowers to sidestep these requirements.

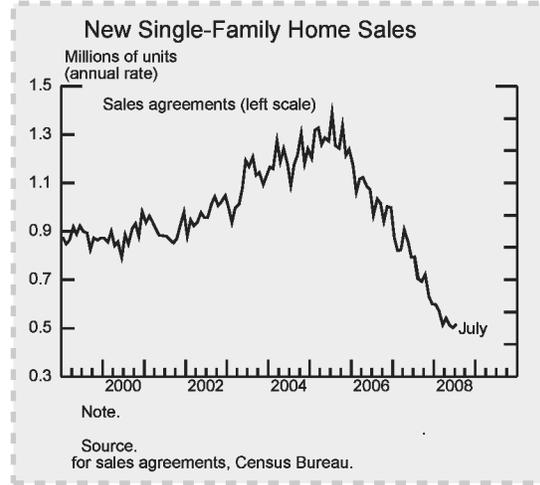
House prices remain on a downward trajectory. For existing homes, the monthly version of the purchase-only repeat-sales price index calculated by the Office of Federal Housing

⁹ A provision of the Housing and Economic Recovery Act of 2008, passed at the end of July, offers first-time home buyers a tax credit of up to \$7,500 on homes purchased between April 9, 2008, and June 30, 2009; the homebuyer must pay back this credit (without interest) in the succeeding 15 years (or sooner if the house is resold). The tax credit is not expected to have any effect on published home sales statistics until August or September.

Indicators of Single-Family Housing

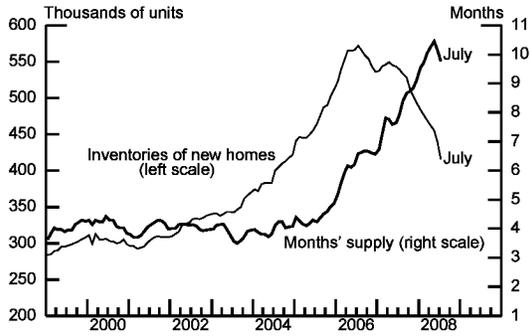


Source: National Association of Realtors.



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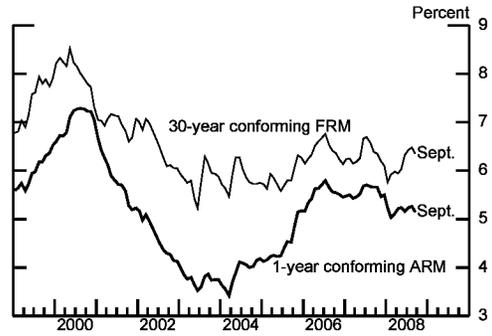
Inventories of New Homes and Months' Supply



Note. Months' supply is calculated using the 3-month moving average of sales.

Source: Census Bureau.

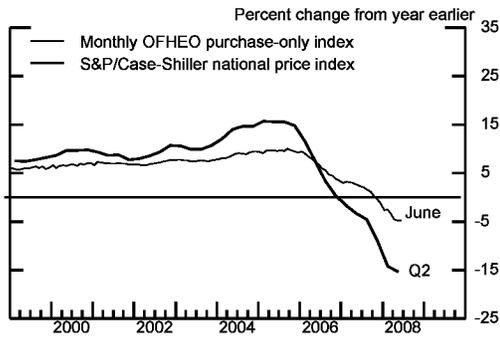
Mortgage Rates



Note. The September reading is a monthly average of data available through Sept. 3, 2008.

Source: Federal Home Loan Mortgage Corporation.

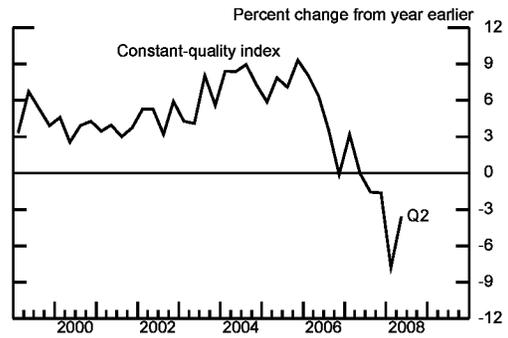
Prices of Existing Homes



Note. The monthly OFHEO indexes is a 12-month percent change. The S&P/Case-Shiller index is a 4-quarter percent change.

Source: For purchase-only indexes, OFHEO; for Case-Shiller, Standard & Poor's.

Price of New Homes



Source: Census Bureau.

Enterprise Oversight (OFHEO) decreased 4.8 percent over the 12 months ending in June. By comparison, the national S&P/Case-Shiller repeat-sales price index—which, unlike the OFHEO index, includes houses financed by nonconforming loans—fell about 15 percent over the past year. As for new homes, the constant-quality price index—which attempts to control for changes in the quality and geographic composition of new homes sold—was down 3½ percent in the second quarter relative to its level a year earlier. Although these lower prices may be starting to bolster sales, survey evidence and anecdotal reports suggest that expectations of further house price declines remain quite prevalent, a consideration that may make potential buyers reluctant to purchase homes until prices show signs of stabilizing.

Equipment and Software

We estimate that investment in equipment and software (E&S) fell at an annual rate of 3½ percent in the second quarter, largely because of a sharp drop in business spending on motor vehicles. In contrast, growth of real outlays for nontransportation E&S held up reasonably well last quarter. More recently, nominal orders and shipments of nondefense capital goods excluding aircraft rose substantially in July, although some of the gain in nominal shipments reflected unusually large price increases. Moreover, as in previous months, July orders and shipments may have reflected increased foreign demand. Thus, the nominal shipments data likely overstates the true strength of domestic investment demand.

Along those lines, the fundamental determinants of E&S investment appear consistent with weak domestic demand. Although business output growth has not decelerated substantially over recent quarters, other determinants of business spending suggest gloomier prospects. The user cost of capital has been rising, as corporate bond yields have edged up this year, despite declining Treasury yields, and capital goods prices have accelerated. In addition, corporate profits have weakened, and cash flow moved down again last quarter. And although monthly readings of business conditions—both national and regional—have edged up over the past few months, they remain downbeat for the most part.

Business outlays on transportation equipment fell sharply in the second quarter as business purchases of light trucks tanked. Spending on light motor vehicles appears to have declined again this quarter, a result of automakers aggressively scaling back deliveries to daily rental companies in August; demand from other businesses remained sluggish as well. Moreover, sales of medium and heavy trucks fell back a good bit in July from the already-subdued rate observed in recent months. The pace of new orders

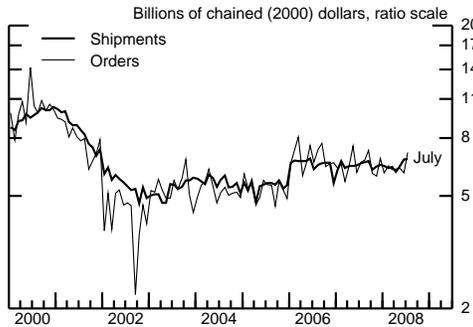
Orders and Shipments of Nondefense Capital Goods

(Percent change; seasonally adjusted current dollars)

Category	2008				
	Q1	Q2	May	June	July
	Annual rate		Monthly rate		
Shipments	-1	3.4	-2	.7	2.5
Excluding aircraft	-4	5.9	.2	.6	1.6
Computers and peripherals	-5.8	-19.0	2.9	-2.4	-2.6
Communications equipment	2.6	5.8	4.9	5.7	.8
All other categories	-1	8.8	-.5	.4	2.0
Orders	-5.6	-6.8	.0	-2.3	6.3
Excluding aircraft	4.7	10.2	-.3	1.6	2.5
Computers and peripherals	-1.7	-5.3	9.3	.3	-11.0
Communications equipment	.6	.2	1.6	-4.1	18.4
All other categories	5.7	12.9	-1.3	2.3	2.5
Memo: Shipments of complete aircraft ¹	43.4	43.1	45.9	41.8	40.9

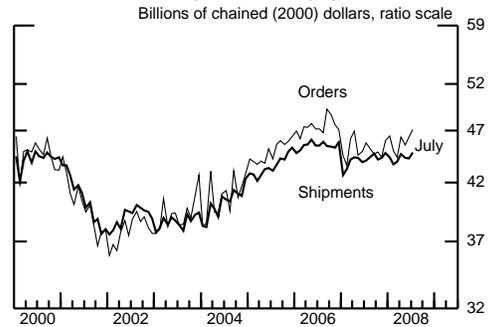
1. From Census Bureau, Current Industrial Reports; billions of dollars, annual rate.
Source: Census Bureau.

Communications Equipment



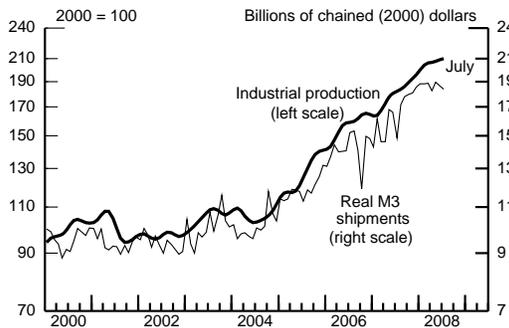
Note. Shipments and orders are deflated by a price index that is derived from the BEA's quality-adjusted price indexes and uses the PPI for communications equipment for monthly interpolation.

Non-High-Tech, Nontransportation Equipment



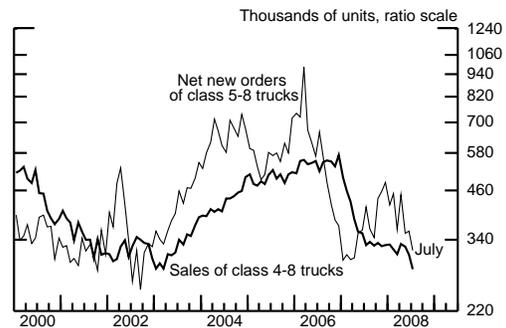
Note. Shipments and orders are deflated by the staff price indexes for the individual equipment types included in this category. Indexes are derived from the BEA's quality-adjusted price indexes.

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.

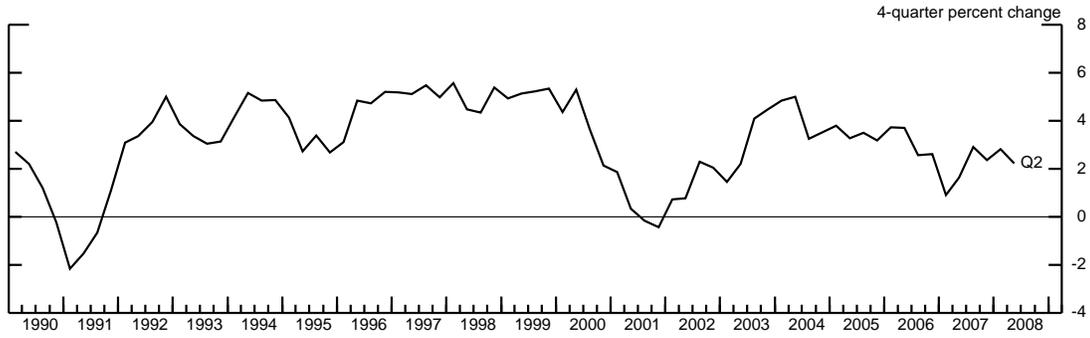
Medium and Heavy Trucks



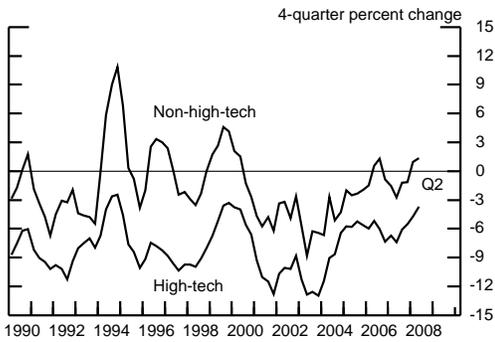
Note. Annual rate, FRB seasonals.
Source. For sales, Ward's Communications; for orders, ACT Research.

Fundamentals of Equipment and Software Investment

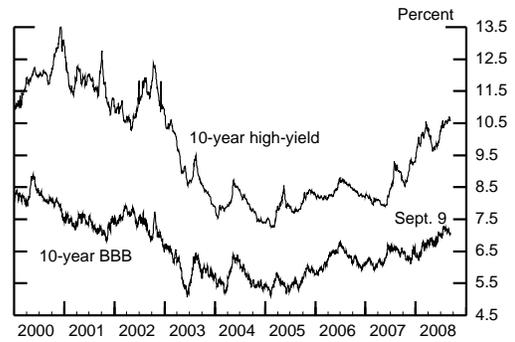
Real Business Output



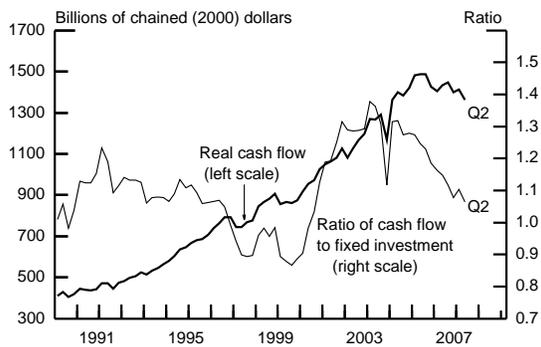
User Cost of Capital



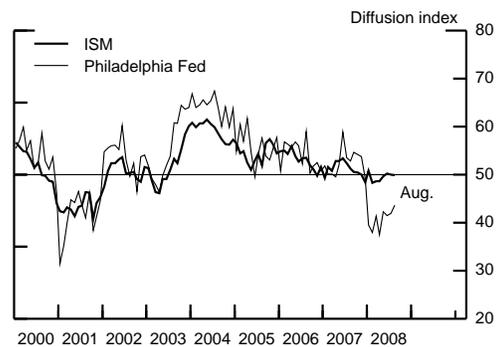
Corporate Bond Yields



Corporate Cash Flow



Surveys of Business Conditions



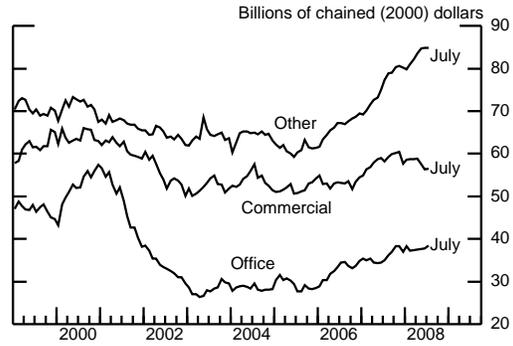
Nonresidential Construction and Indicators

(All spending series are seasonally adjusted at an annual rate; nominal CPIP deflated by BEA prices through Q1 and by staff projection thereafter)

Total Structures

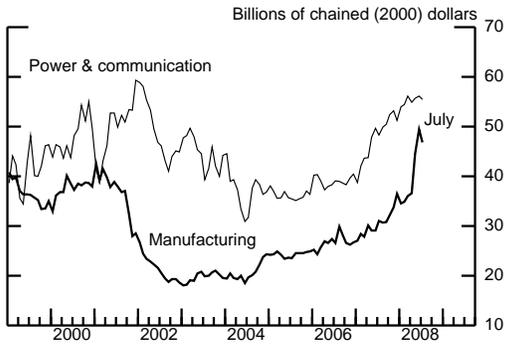


Office, Commercial, and Other

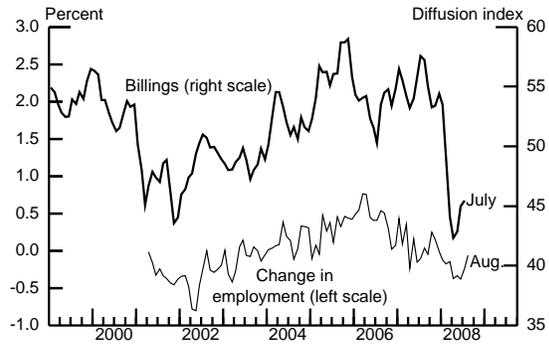


Note. Other consists of structures for religious organizations, education, lodging, amusement and recreation, transportation, and health care.

Manufacturing and Power & Communication

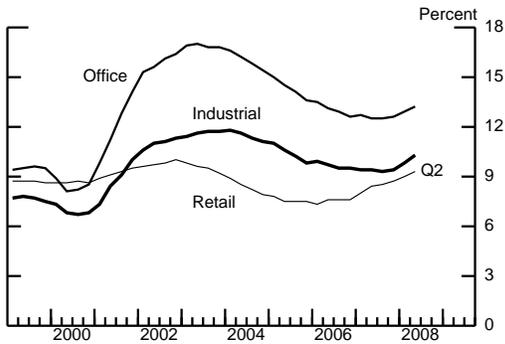


Architectural Billings and Nonresidential Construction Employment



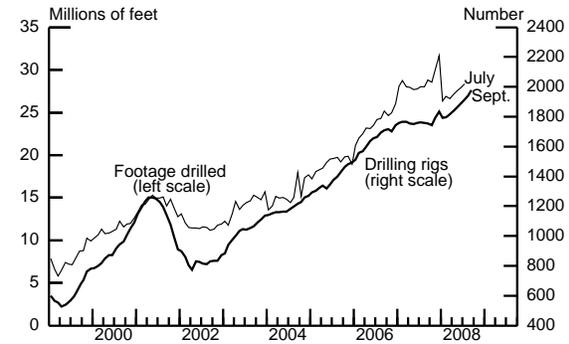
Note. Both series are 3-month moving averages. Employment consists of industrial, commercial, and specialty trade construction. Source. For billings, American Institute of Architects; for employment, Bureau of Labor Statistics.

Vacancy Rates



Note. Industrial space includes both manufacturing structures and warehouses. Source. Torto Wheaton Research.

Drilling and Mining Indicators



Note. The September readings for drilling rigs are based on data through September 5, 2008. Both series are seasonally adjusted by FRB staff. Source. DOE/Baker Hughes.

for these trucks also slumped in July, an indication that sales are unlikely to improve in the near term. Domestic aircraft investment stepped up in the second quarter, but the Boeing machinists' strike, as mentioned above, seems likely to cause a drop in deliveries this quarter.

Spending on high-tech E&S posted a moderate gain in the second quarter, as robust gains in investment in communications equipment were balanced by tepid growth of spending on computers. In the current quarter, the lukewarm 2008 guidance from TSPs (as noted earlier), along with the decline of computer orders and shipments in July, suggests weaker spending may be in store.

Nominal orders and shipments of equipment other than high-tech and transportation jumped in July. Although July's data partly reflected a large rise in prices and perhaps another increase in foreign demand, these factors are probably not large enough to explain the entire nominal increase.¹⁰ Furthermore, orders outpaced shipments by a considerable margin in June and July. July's increase in orders was relatively broad based, with particular strength seen in orders for measuring and controlling devices, heating and ventilation equipment, industrial machinery, and construction machinery.

Nonresidential Construction

Real nonresidential investment (other than drilling and mining) increased at a robust rate in the second quarter. However, nominal expenditures declined in July, and market fundamentals and forward-looking indicators remain downbeat. Vacancy rates in the office and industrial sectors moved higher in the first half of the year after several years of declines, and vacancy rates for retail space continued on an upward trajectory. In the resale market, sales of existing commercial properties have plunged so far this year from 2007's record pace, and prices seem to be softening. On the financing side, issuance of commercial mortgage-backed securities has fallen dramatically this year, corporate bond spreads remain wide, and the Senior Loan Officer Opinion Survey on Bank Lending Practices reported a dramatic tightening of standards for commercial real estate loans over the first half of this year. Meanwhile, construction costs are also surging: The producer price index for materials and components of construction rose at an annual rate of 23 percent over the three months ending in July, and anecdotes from general contractors suggest that price increases for key construction inputs (like asphalt, steel, and plastic materials) are squeezing profit margins. These developments appear to be depressing plans for new projects. Indeed, the three-month average of the architectural

¹⁰ The producer price index for these capital goods rose 0.8 percent in July, which accounted for a sizable portion of the 2 percent increase in July nominal shipments.

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

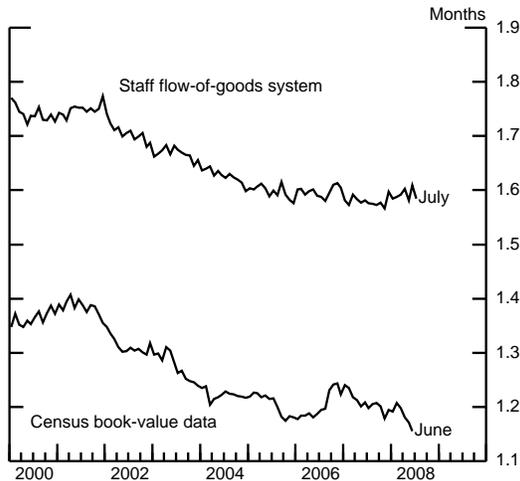
Measure and sector	2007	2008				
	Q4	Q1	Q2	May	June	July
<i>Real inventory investment (chained 2000 dollars)</i>						
Total nonfarm business	-20.6	-17.9	-52.9	n.a.	n.a.	n.a.
Motor vehicles	-21.3	-15.3	-10.2	n.a.	n.a.	n.a.
Nonfarm ex. motor vehicles	.7	-2.6	-42.7	n.a.	n.a.	n.a.
Manufacturing and trade ex. wholesale and retail motor vehicles and parts						
Manufacturing	2.9	13.7	-24.5	-23.5	-7.5 ^e	n.a.
Wholesale trade ex. motor vehicles & parts	-3.3	.0	4.9	2.2	4.1 ^e	n.a.
Retail trade ex. motor vehicles & parts	6.5	-8.2	-4.0	-16.0	-11.2	n.a.
<i>Book-value inventory investment (current dollars)</i>						
Manufacturing and trade ex. wholesale and retail motor vehicles and parts	70.4	95.8	95.3	78.1	129.8	n.a.
Manufacturing	34.7	60.5	39.3	38.3	81.6	31.0
Wholesale trade ex. motor vehicles & parts	23.0	39.0	48.5	45.9	42.8	62.1
Retail trade ex. motor vehicles & parts	12.7	-3.7	7.5	-6.1	5.4	n.a.

n.a. Not available.

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

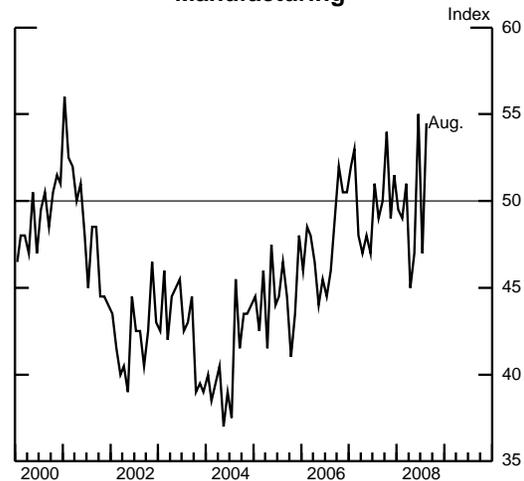
Source. For real inventory investment, BEA; for book-value data, Census Bureau.

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 Customers' Inventories: Manufacturing



Note. A number above 50 indicates inventories are "too high."
Source. Manufacturing ISM Report on Business.

billings index has registered a string of weak readings that are suggestive of outright declines in nonresidential building outlays in the second half of this year.

Supported by rising energy prices, investment in drilling and mining structures increased at an annual rate of nearly 25 percent in the first half of the year. Recent readings for footage drilled and the number of drilling rigs in operation suggest that investment continued its upward climb in July and August.

Business Inventories

Firms drew down their inventories at a rapid pace in the second quarter, and book-value data for the manufacturing and wholesale trade sectors suggest that inventories declined further in July. The indicators we track are not sending a clear signal regarding whether firms are holding excess inventories. The ratio of book-value inventories to sales (excluding motor vehicles) continued to trend down through June. However, information from the staff's flow-of-goods inventory system suggests that months' supply excluding motor vehicles and parts remains elevated, particularly in areas such as construction supplies, business equipment, and, to a lesser degree, consumer goods. Anecdotal reports of inventory imbalances have been limited to light trucks and some categories of semiconductors. Meanwhile, purchasing managers reported that their customers' inventories were high in August, as the ISM's customers' inventories index came back up to about the elevated value it had attained in June.

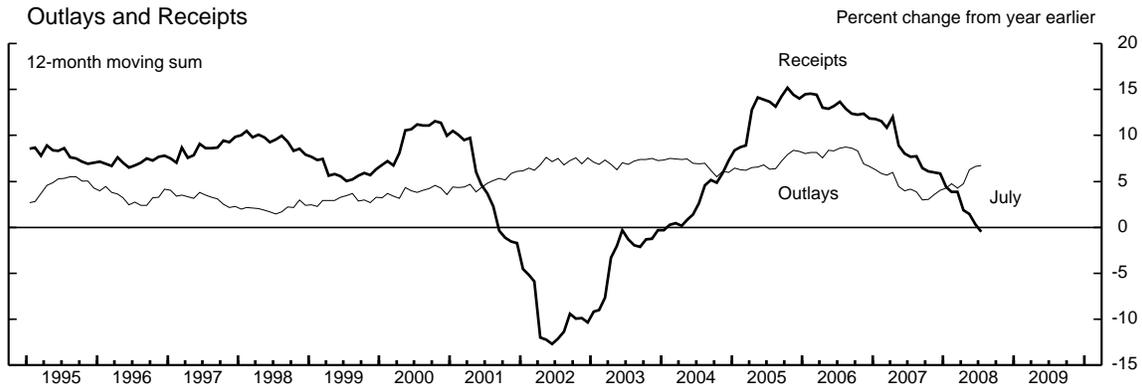
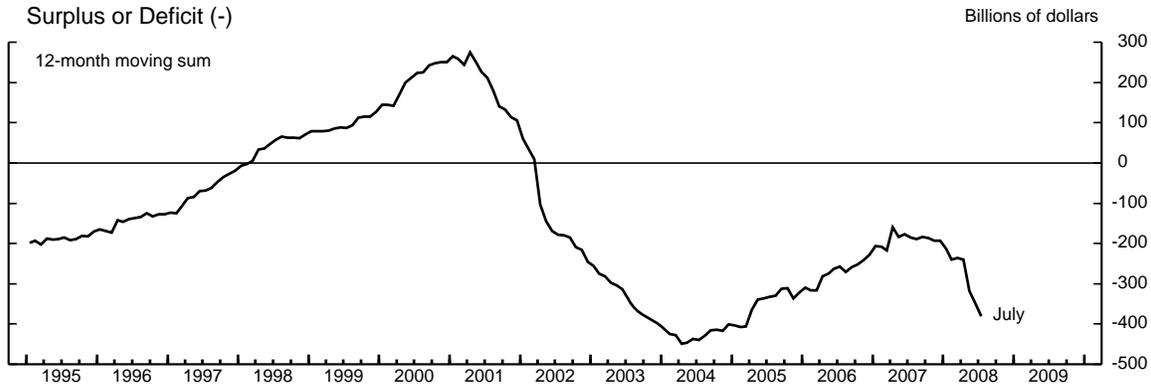
Federal Government Sector

The deficit in the unified federal budget continued to widen in July as outlays surged, the last major wave of stimulus rebates was sent out, and tax receipts were about flat.¹¹ Adjusted for payment-timing shifts and financial transactions, the unified budget deficit in July was \$33 billion larger than the adjusted deficit in July of last year, with the stimulus rebates accounting for almost half the erosion.¹² The Congressional Budget Office, in its updated budget outlook released on September 9, anticipates an unadjusted

¹¹ The Economic Stimulus Act of 2008 authorized an expected total of \$112 billion in stimulus rebates, with \$94 billion already sent out by the end of August, another \$5 billion to be disbursed over the remainder of calendar year 2008, and nearly \$13 billion to be distributed during the 2009 tax-filing season.

¹² The deficit in July on an unadjusted basis that includes financial transactions was even wider, as the Federal Deposit Insurance Corporation spent \$14 billion to cover insured deposits at failed financial institutions. Moreover, the *Daily Treasury Statements* show that another \$4 billion in outlays for deposit insurance were made in August and September. These outlays are expected to be recovered over time as the assets of the failed institutions are sold and the premium payments made by financial institutions to cover deposit insurance are raised.

Federal Government Budget
 (Unified basis; adjusted for payment-timing shifts and financial transactions; data from Monthly Treasury Statement)



Recent Federal Outlays and Receipts
 (Billions of dollars except as noted)

Function or source	July			12 months ending in July		
	2007	2008	Percent change	2007	2008	Percent change
Outlays	226.3	249.0	10.0	2,743.5	2,927.4	6.7
Net interest	24.0	24.1	.1	236.4	245.6	3.9
National defense	46.8	55.1	17.8	556.5	611.9	10.0
Major transfers ¹	122.2	136.0	11.3	1,510.1	1,623.8	7.5
Other	33.3	33.8	1.5	440.6	446.1	1.3
Receipts	170.4	160.5	-5.8	2,559.0	2,546.3	-.5
Individual income and payroll taxes	142.3	131.0	-7.9	1,966.8	1,991.5	1.3
Corporate income taxes	9.6	10.3	6.6	381.9	327.9	-14.1
Other	18.5	19.2	3.9	210.3	227.0	7.9
Surplus or deficit (-)	-55.9	-88.5	...	-184.6	-381.1	...
Memo:						
Unadjusted surplus or deficit (-)	-36.4	-102.8	...	-166.0	-375.6	...

1. Includes Social Security, Medicare, Medicaid, and income security programs.
 ... Not applicable.

deficit for fiscal year 2008 of \$407 billion and projects the deficit to widen to \$438 billion in fiscal 2009, both about 3 percent of nominal GDP.

Federal outlays in July, adjusted for payment-timing shifts and financial transactions, were 10 percent above last July's level. Nominal defense spending increased almost 18 percent from its year-earlier level and is consistent with a robust increase in real defense purchases this quarter as measured in the national income and product accounts. Transfer payments in July moved up briskly relative to a year earlier; they were boosted by outsized increases in outlays for Medicare and Medicaid and also by the portion of the stimulus rebates sent to households with little or no tax liability (such rebates are counted as transfer payments in the budget).¹³

Excluding the effects of the stimulus rebates, tax receipts in July were about unchanged from their year-earlier level and increased only 2 percent in the 12 months ending in July relative to the comparable period a year earlier. The slowdown in the inflow of federal tax receipts has been most pronounced in corporate taxes, probably because of the decline in corporate profits over the past year. Net corporate receipts over the 12 months ending in July were 14 percent below their level in the year-earlier period. Individual income and payroll taxes, excluding the stimulus rebates, posted a gain of only 4 percent, an increase likely consistent with the slowing pace of personal income.

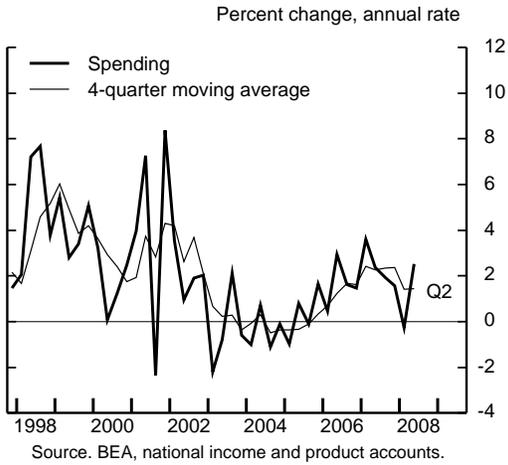
The Congress has been slow to work on the annual appropriations bills necessary to fund discretionary federal spending programs in fiscal 2009, which begins on October 1. So far, the House has passed only one of the 12 appropriations bills, and the Senate has passed none. A continuing resolution will be needed to fund agencies covered by appropriations bills that have not been enacted by the start of the new fiscal year.

The placing of the GSEs Fannie Mae and Freddie Mac into conservatorship will likely lead to additional budgetary costs through purchases by the Treasury of the equity or mortgage-backed securities of the GSEs, which would be counted as outlays in the unified budget. The Treasury reports that it will begin purchasing new GSE mortgage-backed securities in September. The Treasury also has agreements with Fannie Mae and Freddie Mac to purchase up to \$100 billion in senior preferred stock from each GSE in order to help keep each enterprise's assets greater than its liabilities. At this time, however, the magnitude of these costs is highly uncertain.

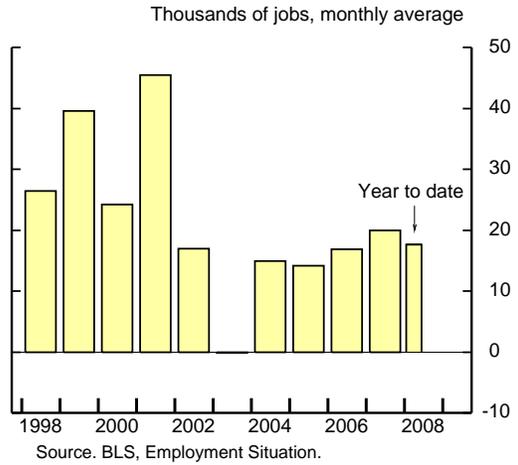
¹³ The Congressional Budget Office estimates that the temporary emergency unemployment insurance program will increase benefits by \$12 billion until the program expires at the end of March 2009.

State and Local Indicators

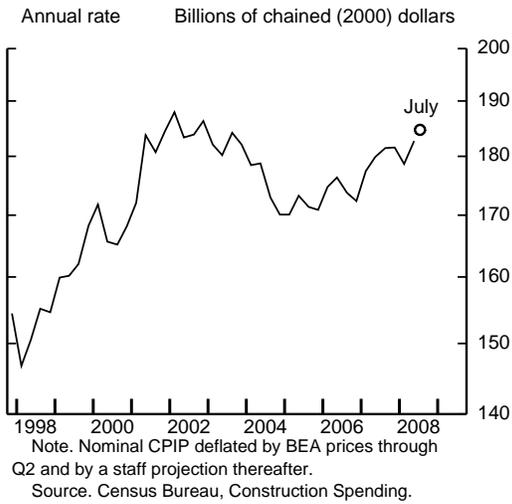
Real Spending on Consumption & Investment



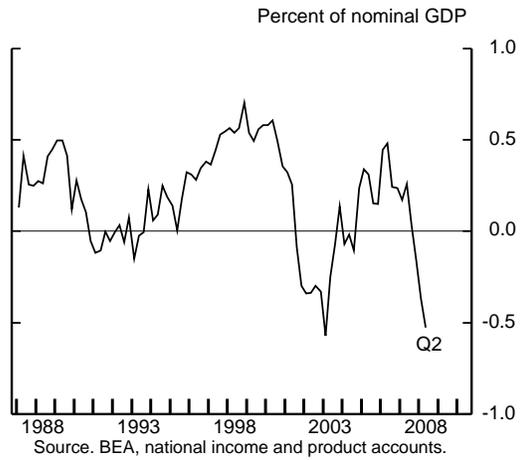
Net Change in Employment



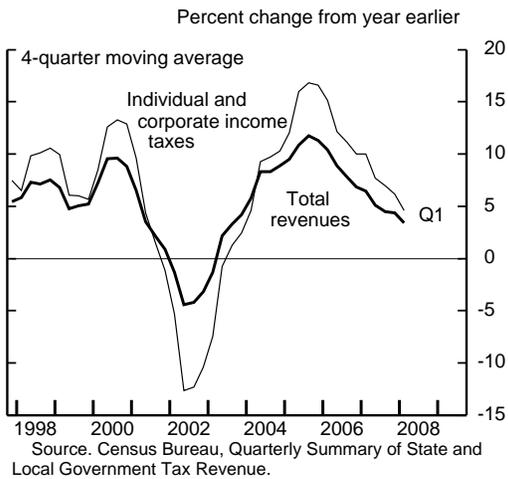
Real Construction



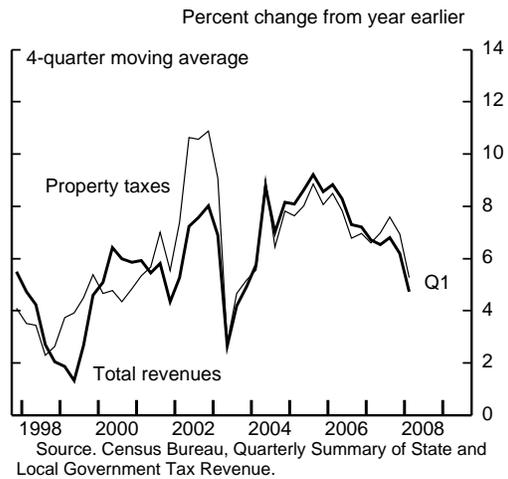
Net Saving



State Revenues



Local Revenues



State and Local Government Sector

The incoming indicators point to a modest rate of increase in real state and local spending in recent months after taking account of both the latest data and the substantial revisions to earlier figures for employment (downward) and construction (upward). According to the latest labor market report, state and local employment rose 18,000 in August, the same as the average gain recorded so far this year.¹⁴ Meanwhile, real construction expenditures now seem to have rebounded sharply in the second quarter after a steep drop earlier in the year. In July, nominal construction spending rose to a level 1¾ percent (not at an annual rate) above its second-quarter average; this gain reflected sizable increases in all major categories but highways and set the stage for a further rise in real construction spending in the third quarter.

On the whole, state and local revenue flows have been reasonably subdued of late, although the available data point to a noticeable—though likely transitory—pickup in receipts growth in the second quarter. Drawing on information from 45 states, the Rockefeller Institute of Government estimates that state tax revenues increased 5 percent on a year-over-year basis in the second quarter after having posted increases in the neighborhood of just 2 percent in the preceding two quarters.¹⁵ Personal income taxes rose 8 percent—an increase that appears to have been boosted by a solid rise in final payments of previous-year tax liabilities and thus is unlikely to be repeated in coming quarters. As for the other major categories, collections of sales and corporate taxes both declined over the year ending in the second quarter, while other revenues rose sharply, especially in energy-producing states like Texas and Alaska.

Prices

Headline consumer prices rose rapidly for a third consecutive month in July. Driven by further large increases in food and energy prices, overall PCE prices rose 0.6 percent in July, thereby bringing the 12-month change to 4.5 percent, 2¼ percentage points higher than the year-earlier increase. After some surprisingly low increases in the spring, core PCE prices saw larger increases in June and July, which likely reflected, in part, further cost pressures and higher import prices. Indeed, prices for goods at intermediate stages of production continued to rise rapidly through July. Nevertheless, some cost pressures

¹⁴ State and local employment is now estimated to have risen just 6,000 in June and 2,000 in July compared with the previous estimates of 41,000 in June and 28,000 in July. The downward revision was concentrated in local education employment, which is often revised substantially over the summer months.

¹⁵ The missing states are New Jersey, New Mexico, North Carolina, Rhode Island, and Virginia. Taken together, these states accounted for 9 percent of state tax revenues in fiscal 2007.

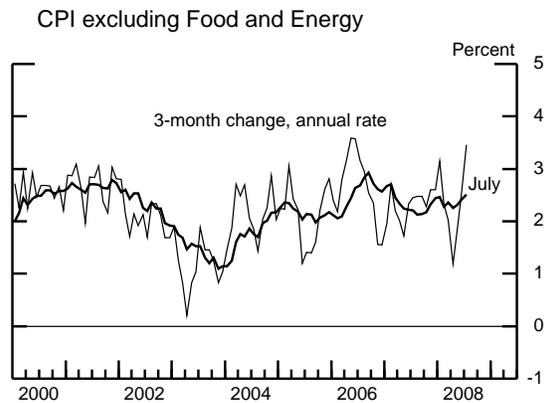
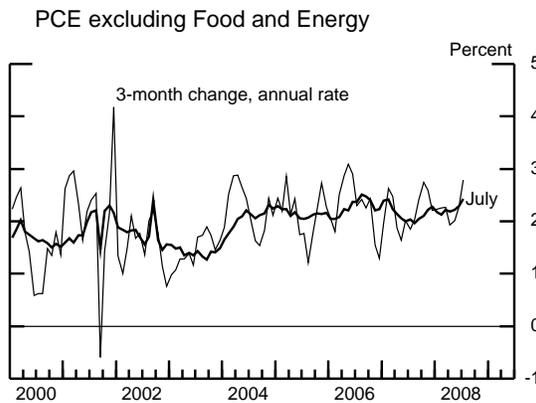
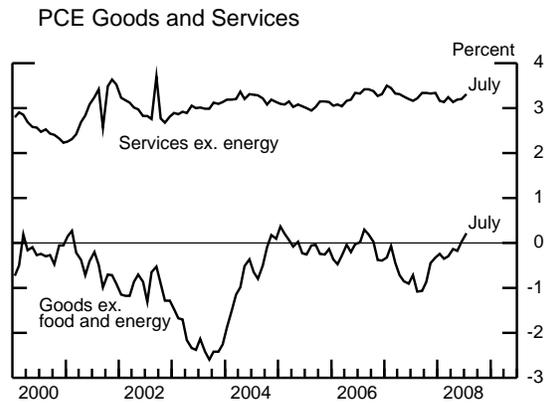
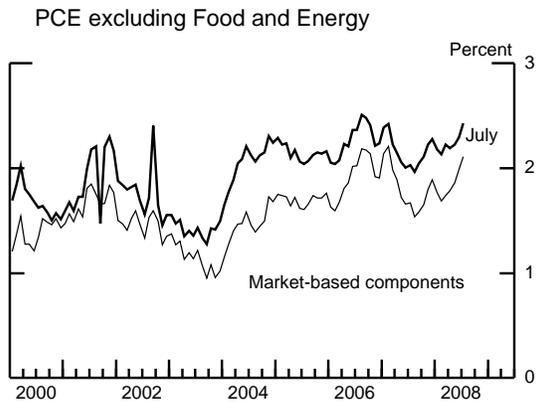
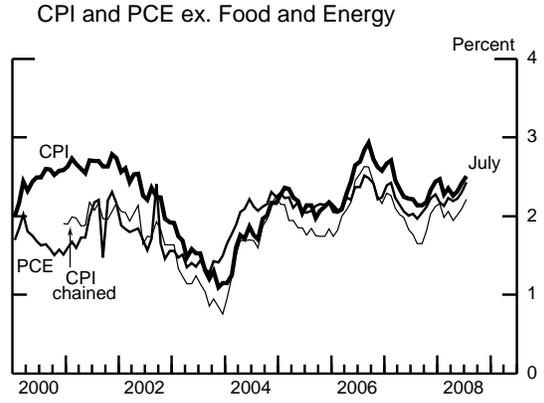
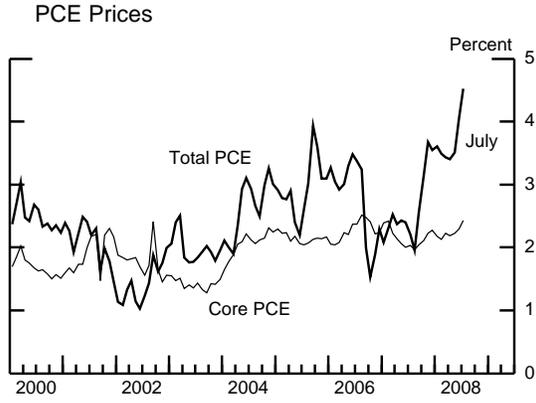
Price Measures
(Percent change)

Measures	12-month change		3-month change		1-month change	
	July 2007	July 2008	Annual rate		Monthly rate	
			Apr. 2008	July 2008	June 2008	July 2008
<i>CPI</i>						
Total	2.4	5.6	2.3	10.6	1.1	.8
Food	4.2	6.0	6.3	8.4	.8	.9
Energy	1.0	29.3	5.6	79.4	6.6	4.0
Ex. food and energy	2.2	2.5	1.2	3.5	.3	.3
Core goods	-.6	.6	-.7	1.7	.1	.5
Core services	3.3	3.3	1.9	4.1	.4	.3
Shelter	3.7	2.5	.8	2.9	.3	.2
Other services	2.9	4.4	3.2	6.0	.5	.4
Chained CPI (n.s.a.) ¹	1.9	4.8	...	...	...	...
Ex. food and energy ¹	1.8	2.2	...	...	...	...
<i>PCE prices</i>						
Total	2.2	4.5	2.8	7.5	.7	.6
Food and beverages	3.9	5.7	6.4	7.6	.6	1.0
Energy	.8	30.0	5.3	79.6	6.8	4.0
Ex. food and energy	2.0	2.4	1.9	2.8	.3	.3
Core goods	-.7	.2	-.4	.5	.1	.2
Core services	3.2	3.3	2.9	3.7	.3	.3
Housing services	3.5	2.7	1.6	2.6	.3	.2
Other services	3.0	3.5	3.4	4.1	.3	.3
Core market-based	1.7	2.1	1.5	2.5	.3	.2
Core non-market-based	3.6	3.8	3.8	3.9	.3	.5
<i>PPI</i>						
Total finished goods	4.2	9.8	6.4	18.9	1.8	1.2
Food	6.4	8.7	2.5	10.9	1.5	.3
Energy	7.1	28.0	14.1	72.6	6.0	3.1
Ex. food and energy	2.5	3.5	4.7	4.7	.2	.7
Core consumer goods	2.6	3.8	5.0	5.1	.3	.6
Capital equipment	2.3	3.0	4.0	4.8	.3	.8
Intermediate materials	4.2	16.6	17.1	36.0	2.1	2.7
Ex. food and energy	2.4	10.2	11.9	23.2	1.3	2.0
Crude materials	12.9	51.2	80.5	76.5	3.7	4.2
Ex. food and energy	9.5	36.3	79.5	37.9	-.2	3.4

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

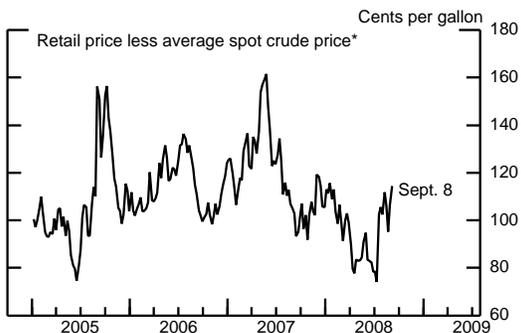
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Consumer Prices (12-month change except as noted)



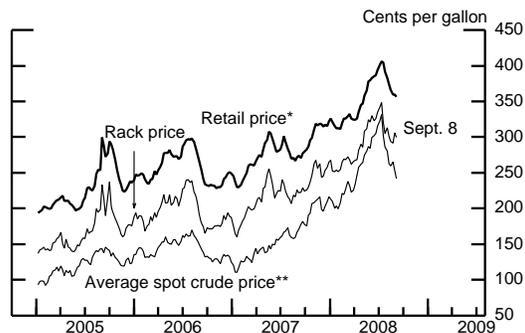
Energy and Food Price Indicators (Data from Energy Information Administration except as noted)

Total Gasoline Margin



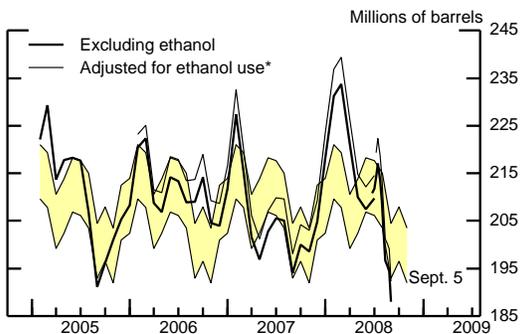
* Regular grade seasonally adjusted by FRB staff, less average spot crude price: 60% WTI, 40% Maya heavy crude. Includes gasoline taxes.

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 June 2008, weekly data thereafter.

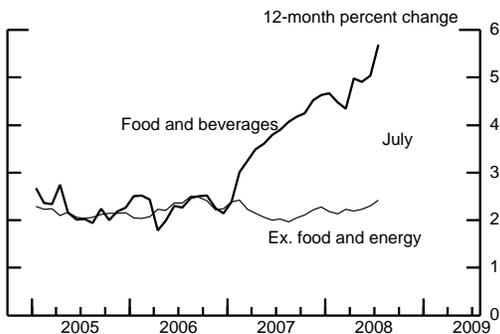
* Adjustment for approximate amount of fuel ethanol to be blended with RBOB component of inventories; estimated by FRB staff.

Ethanol Prices



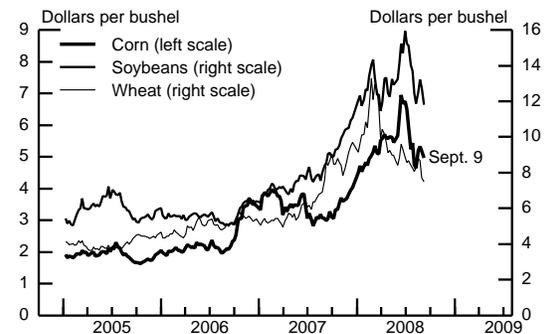
Source. Chicago Board of Trade.

PCE Food Prices



Source. Bureau of Economic Analysis.

Spot Agricultural Commodity Prices



Source. Commodity Research Bureau.

may be weakening: The dollar has strengthened, and spot commodity prices for crude oil, natural gas, and other industrial raw materials have declined recently.

Consumer energy prices rose another 4 percent (not at an annual rate) in July after similarly large gains in May and June. This recent string of increases in energy prices pushed up the 12-month change through July to 30 percent. Recent declines in crude oil prices have eased the pressure on gasoline margins, which had been abnormally tight for some time, and are now leading to lower prices at the pump. Indeed, survey data suggest that retail gasoline prices decreased considerably in August and early September. Spot prices for natural gas have also moved down recently as inventories (seasonally adjusted) have remained ample.

Consumer food prices rose 1 percent in July, an even larger increase than the already elevated readings seen in recent months. The 12-month change through July now stands at 5.7 percent, much higher than the 3.9 percent increase recorded over the preceding 12 months. Although prices for almost all food commodities are substantially above their levels from a year ago, these prices have stepped down, on balance, since the July/August Greenbook (cattle is one notable exception). However, prices for food away from home have accelerated in the past few months; these prices tend to reflect broader inflationary pressures and tend to be relatively persistent.

Core PCE prices increased 0.3 percent for a second month in July. These increases pushed up the three-month change through July to an annual rate of 2.8 percent, up from a pace of only 1.9 percent during the three months ending in April.¹⁶ The 12-month change in core PCE prices, at 2.4 percent, is up nearly ½ percentage point from the year-earlier increase. This acceleration was widespread across prices for goods and most services; one important exception is housing services, for which prices have decelerated over the last 12 months, a slowdown consistent with the general weakness in this sector.

The cost pressures affecting finished goods prices are showing through even more clearly to prices of intermediate materials. The producer price index for core intermediate materials rose 2 percent in July, which brought the three-month change to an annual rate of 23 percent. These price increases have been widespread but are especially noticeable for metals and for energy-intensive categories such as chemicals, plastics, and paints. The string of recent advances pushed the 12-month change through July to 10 percent,

¹⁶ In addition to the larger increases in overall core PCE prices in June and July, data on the non-market component of these prices were revised up earlier in the year as part of the annual revisions to the NIPA.

Broad Measures of Inflation
(Percent change, Q2 to Q2)

Measure	2005	2006	2007	2008
<i>Product prices</i>				
GDP price index	2.9	3.5	2.8	2.0
Less food and energy	3.1	3.4	2.5	1.9
Nonfarm business chain price index	3.1	3.6	2.1	1.5
<i>Expenditure prices</i>				
Gross domestic purchases price index	3.3	3.9	2.6	3.5
Less food and energy	3.0	3.2	2.4	2.2
PCE price index	2.5	3.3	2.4	3.7
Less food and energy	2.1	2.3	2.1	2.2
PCE price index, market-based components	2.2	3.1	2.2	3.6
Less food and energy	1.7	1.9	1.8	1.9
CPI	2.9	3.9	2.6	4.3
Less food and energy	2.2	2.5	2.3	2.3
Chained CPI	2.6	3.6	2.4	3.8
Less food and energy	1.9	2.2	1.9	2.0
Median CPI	2.4	2.9	3.1	3.1
Trimmed mean CPI	2.4	2.6	2.7	3.0
Trimmed mean PCE	2.3	2.7	2.6	2.6

Surveys of Inflation Expectations
(Percent)

Period	Actual CPI inflation ¹	Reuters/Michigan Survey				Professional forecasters (10 years) ⁴	
		1 year ²		5 to 10 years ³		CPI	PCE
		Mean	Median	Mean	Median		
2006:Q4	1.9	3.5	3.0	3.5	3.0	2.5	...
2007:Q1	2.4	3.6	3.0	3.4	2.9	2.4	2.0
Q2	2.7	4.2	3.3	3.5	3.0	2.4	2.0
Q3	2.4	4.1	3.2	3.5	3.0	2.4	2.1
Q4	4.0	4.1	3.3	3.3	2.9	2.4	2.1
2008:Q1	4.1	4.2	3.8	3.3	3.0	2.5	2.2
Q2	4.4	6.4	5.0	3.8	3.3	2.5	2.2
Q3	n.a.	n.a.	n.a.	n.a.	n.a.	2.5	2.2
2008:Apr.	3.9	5.7	4.8	3.5	3.2	...	...
May	4.2	7.0	5.2	4.0	3.4	2.5	2.2
June	5.0	6.5	5.1	4.0	3.4	...	...
July	5.6	6.3	5.1	3.5	3.2	...	...
Aug.	n.a.	5.3	4.8	3.9	3.2	2.5	2.2

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?

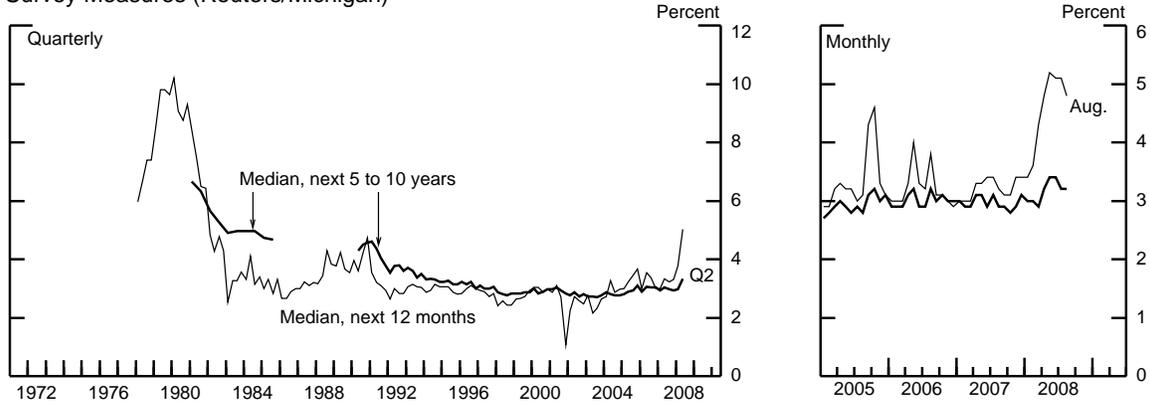
4. Median CPI and PCE price projections compiled by the Federal Reserve Bank of Philadelphia.

... Not applicable.

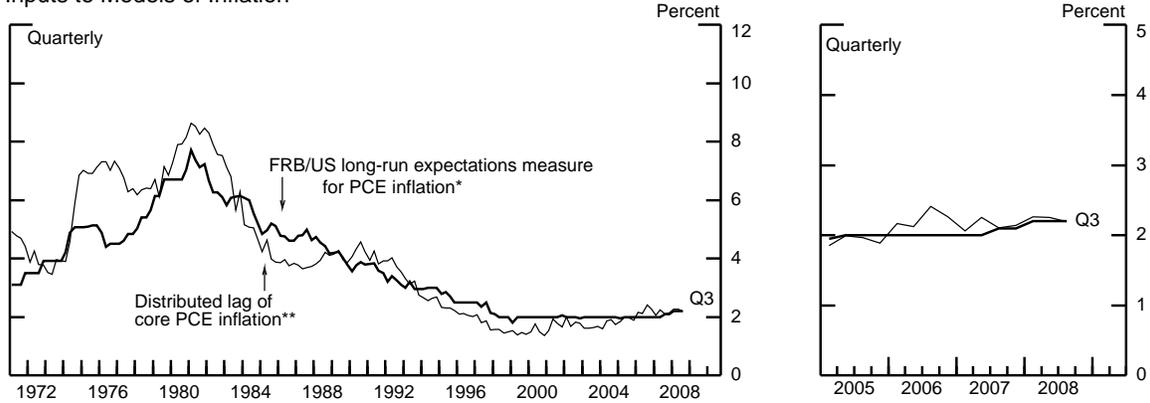
n.a. Not available.

Measures of Expected Inflation

Survey Measures (Reuters/Michigan)



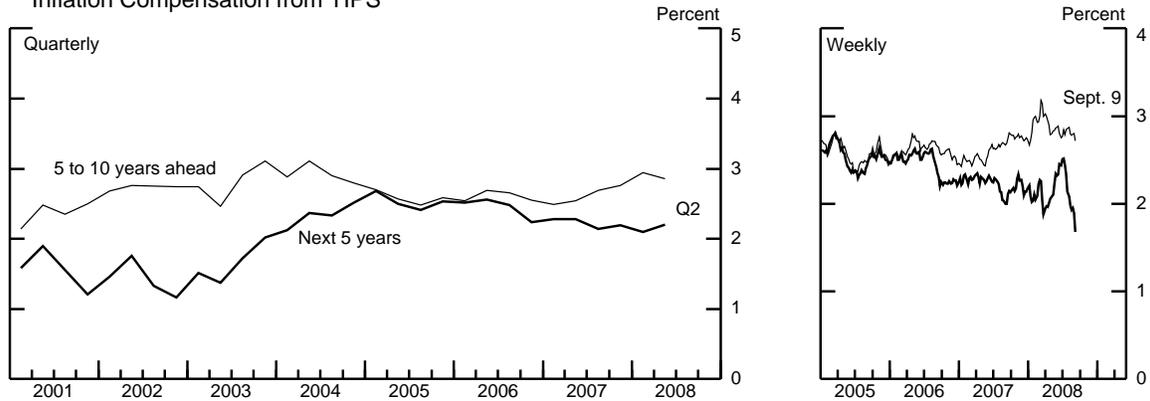
Inputs to Models of Inflation



*For 2007 forward, the median projection for PCE inflation over the next 10 years from the Survey of Professional Forecasters (SPF); for 1991 to 2006, the equivalent SPF projection for the CPI; for 1981 to 1991, a related survey for the CPI conducted by Richard Hoyer; and for the period preceding 1981, a model-based estimate constructed by Board staff. The survey data before 2007 are adjusted down 0.5 percentage point to put the CPI projections approximately on a PCE basis.

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

Inflation Compensation from TIPS

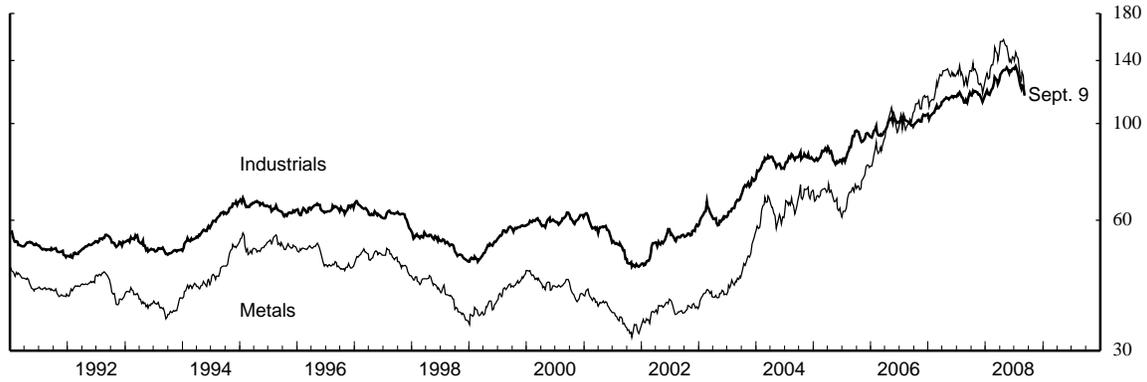


Note. Based on a comparison of an estimated TIPS yield curve with an estimated nominal off-the-run Treasury yield curve, with an adjustment for the indexation-lag effect.

Commodity Price Indexes

Journal of Commerce

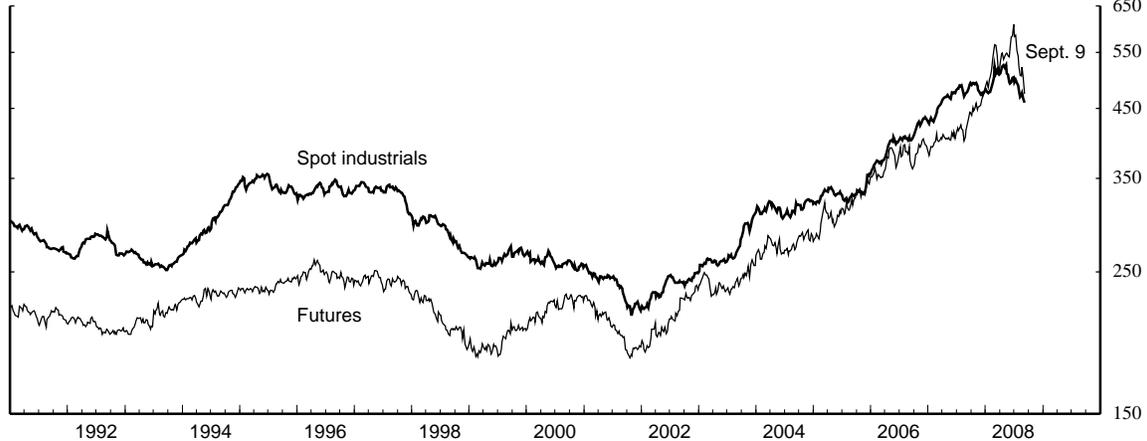
Ratio scale, 2006 = 100



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

Ratio scale, 1967 = 100



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	2007 ¹	12/18/07 to 7/29/08 ²	7/29/08 ² to 9/9/08	52-week change to 9/9/08
JOC industrials	7.6	15.7	-10.5	3.7
JOC metals	2.1	20.4	-17.9	-5.3
CRB spot industrials	8.2	3.6	-6.1	-3.8
CRB spot foodstuffs	25.5	23.4	-7.5	19.7
CRB futures	18.2	16.1	-12.5	11.6

1. From the last week of the preceding year to the last week of the year indicated.
2. July 29, 2008, is the Tuesday preceding publication of the July Greenbook.

nearly 8 percentage points higher than the change over the preceding 12 months. Nevertheless, as with energy and many food commodities, prices of industrial commodities have moved lower in recent weeks. Both the Commodity Research Bureau spot industrials index and the *Journal of Commerce* industrial commodities index have moved down since the July/August Greenbook, declining 6 percent and 10½ percent respectively.

Measures of inflation expectations are flat or down a little since the last Greenbook. In the Reuters/University of Michigan survey, median expectations for year-ahead inflation moved down to 4.8 percent in August but still remain 1½ percentage points higher than they were late last year. The Reuters/Michigan measure of median inflation expectations over the next 5 to 10 years held steady at 3.2 percent last month, down from its recent high of 3.4 percent but still above its January reading of 3.0 percent. As measured by the Survey of Professional Economists, expectations for PCE price inflation over the next 10 years held steady at 2.2 percent in the third quarter. Finally, inflation compensation derived from yields on nominal and inflation-protected Treasury securities has moved down since the last Greenbook, and the 5-year forward measure is now close to its level around the turn of the year.

Labor Costs

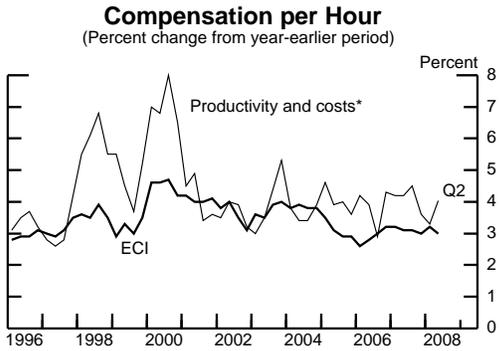
Hourly compensation has continued to increase moderately with no sign of acceleration. Compensation per hour in the nonfarm business sector was revised down in the first half of the year on the basis of earnings data from unemployment insurance records through the first quarter. We now estimate that compensation per hour rose at an annual pace of 3¾ percent in the first half—about the same as the increase over 2007. More recently, average hourly earnings increased 0.4 percent in August and thus brought the 12-month change to 3.6 percent, down from 4.0 percent over the preceding 12 months.

Hourly Compensation and Unit Labor Costs

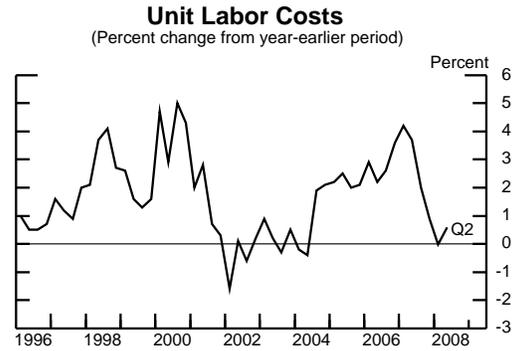
(Percent change from preceding period at compound annual rate; based on seasonally adjusted data)

Category	2006:Q2 to 2007:Q2	2007:Q2 to 2008:Q2 ^e	2007		2008	
			Q3	Q4	Q1	Q2 ^e
<i>Compensation per hour</i> Nonfarm business	4.2	4.0	3.3	5.3	3.8	3.7
<i>Unit labor costs</i> Nonfarm business	3.7	.6	-2.4	4.5	1.2	-.7

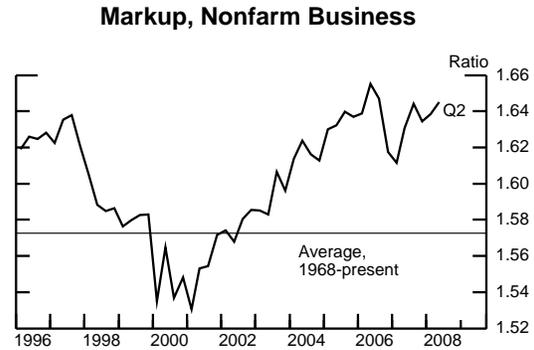
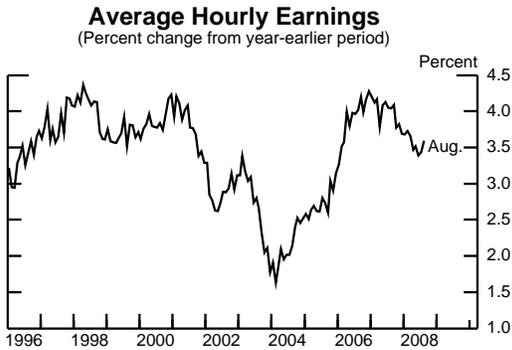
e Staff estimate.



* Value for 2008:Q2 is a staff estimate.



Note. Value for 2008:Q2 is a staff estimate.



Note. The markup is the ratio of output price to unit labor costs. Value for 2008:Q2 is a staff estimate.

Domestic Financial Developments

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

Instrument	2007	2008			Change to Sept. 9 from selected dates (percentage points)		
	Aug. 6	June 24	Aug. 4	Sept. 9	2007 Aug. 6	2008 June 24	2008 Aug. 4
<i>Short-term</i>							
FOMC intended federal funds rate	5.25	2.00	2.00	2.00	-3.25	.00	.00
Treasury bills ¹							
3-month	4.74	1.80	1.72	1.63	-3.11	-.17	-.09
6-month	4.72	2.20	1.93	1.85	-2.87	-.35	-.08
Commercial paper (A1/P1 rates) ²							
1-month	5.26	2.36	2.41	2.44	-2.82	.08	.03
3-month	5.29	2.78	2.72	2.78	-2.51	.00	.06
Large negotiable CDs ¹							
3-month	5.34	2.80	2.80	2.80	-2.54	.00	.00
6-month	5.27	3.17	3.10	3.11	-2.16	-.06	.01
Eurodollar deposits ³							
1-month	5.33	2.70	2.60	2.65	-2.68	-.05	.05
3-month	5.35	3.00	3.00	3.00	-2.35	.00	.00
Bank prime rate	8.25	5.00	5.00	5.00	-3.25	.00	.00
<i>Intermediate- and long-term</i>							
U.S. Treasury ⁴							
2-year	4.49	2.80	2.49	2.22	-2.27	-.58	-.27
5-year	4.52	3.55	3.25	2.88	-1.64	-.67	-.37
10-year	4.82	4.29	4.15	3.80	-1.02	-.49	-.35
U.S. Treasury indexed notes ⁵							
5-year	2.43	1.10	1.15	1.25	-1.18	.15	.10
10-year	2.48	1.76	1.71	1.67	-.81	-.09	-.04
Municipal general obligations (Bond Buyer) ⁶	4.51	4.76	4.74	4.62	.11	-.14	-.12
Private instruments							
10-year swap	5.44	4.84	4.66	4.22	-1.22	-.62	-.44
10-year FNMA ⁷	5.34	4.98	4.82	4.31	-1.03	-.67	-.51
10-year AA ⁸	6.12	6.54	6.62	6.40	.28	-.14	-.22
10-year BBB ⁸	6.57	7.00	7.17	7.01	.44	.01	-.16
10-year high yield ⁸	9.21	10.13	10.57	10.57	1.36	.44	.00
Home mortgages (FHLMC survey rate) ⁹							
30-year fixed	6.59	6.45	6.52	6.35	-.24	-.10	-.17
1-year adjustable	5.65	5.27	5.22	5.15	-.50	-.12	-.07

Stock exchange index	Record high		2008			Change to Sept. 9 from selected dates (percent)		
	Level	Date	June 24	Aug. 4	Sept. 9	Record high	2008 June 24	2008 Aug. 4
Dow Jones Industrial	14,165	10-9-07	11,807	11,284	11,231	-20.71	-4.88	-.47
S&P 500 Composite	1,565	10-9-07	1,314	1,249	1,225	-21.76	-6.83	-1.96
Nasdaq	5,049	3-10-00	2,368	2,286	2,210	-56.23	-6.69	-3.31
Russell 2000	856	7-13-07	708	704	707	-17.35	-.09	.45
Wilshire 5000	15,807	10-9-07	13,421	12,738	12,477	-21.07	-7.04	-2.06

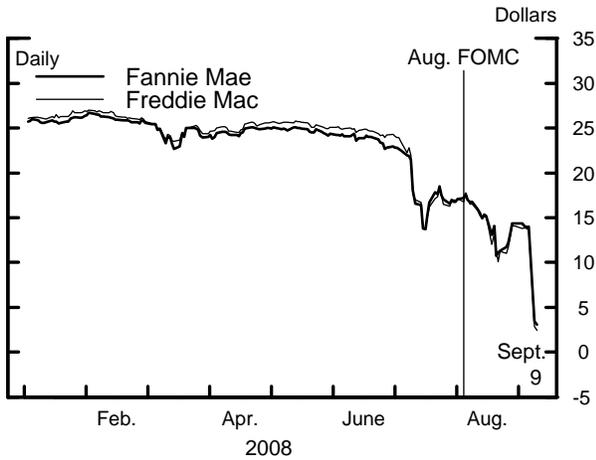
1. Secondary market.
2. Financial commercial paper.
3. Bid rates for Eurodollar deposits collected around 9:30 a.m. eastern time.
4. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
5. Derived from a smoothed Treasury yield curve estimated using all outstanding securities and adjusted for the carry effect.
6. Most recent Thursday quote.
7. Constant-maturity yields estimated from Fannie Mae domestic noncallable coupon securities.
8. Derived from smoothed corporate yield curves estimated using Merrill Lynch bond data.
9. Home mortgage rates for September 9, 2008, are for the week ending September 4, 2008.

NOTES:

August 6, 2007, is the day before the August 2007 FOMC meeting.
June 24, 2008, is the day before the June 2008 FOMC monetary policy announcement.
August 4, 2008, is the day before the most recent FOMC monetary policy announcement.

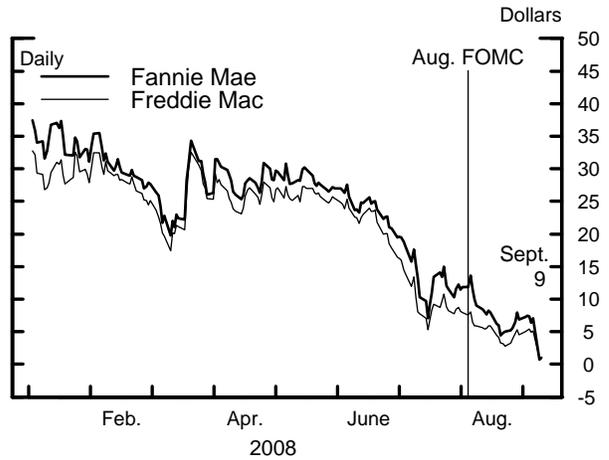
Financial Institutions

GSE Preferred Stock Prices



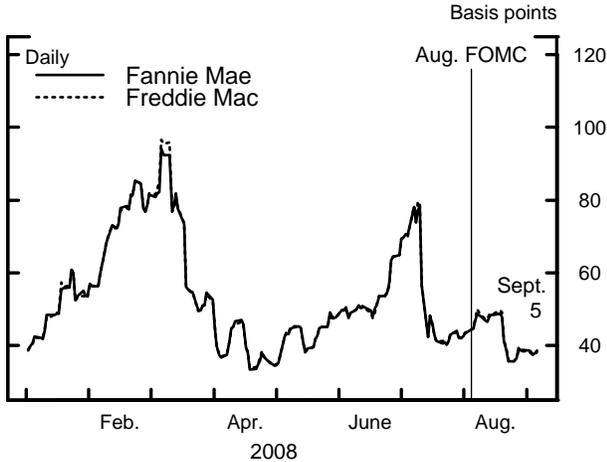
Source: Bloomberg.

GSE Common Stock Prices



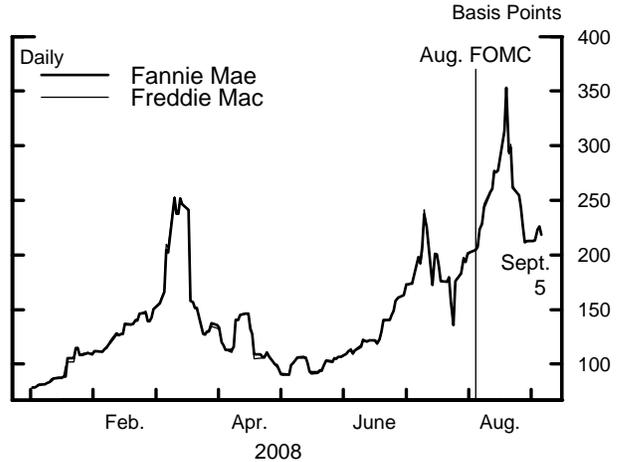
Source: Bloomberg.

CDS Senior Debt Spreads for GSEs



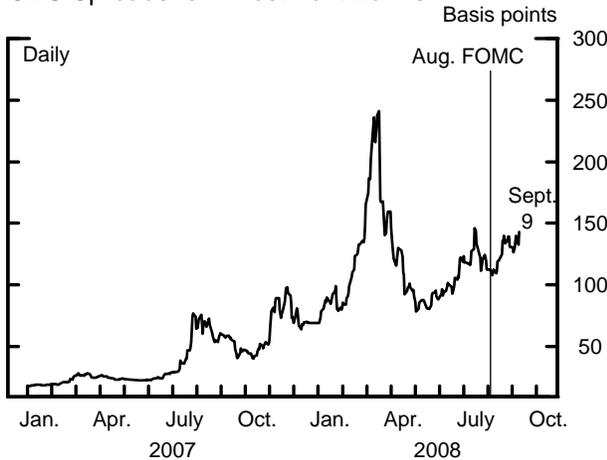
Note. Trading essentially halted after FHFA placed Fannie Mae and Freddie Mac in conservatorship.
Source: Markit.

CDS Subordinated Debt Spreads for GSEs



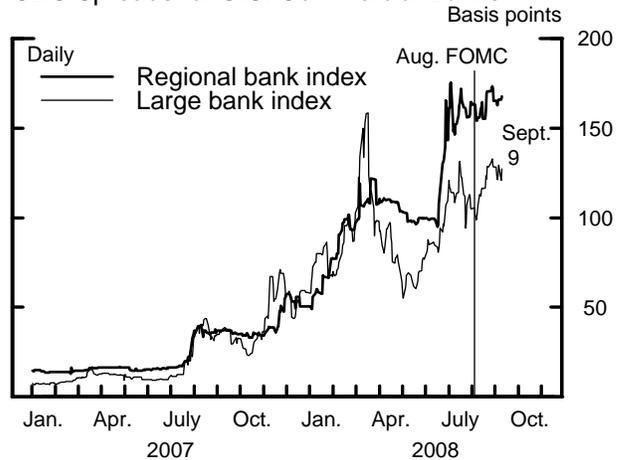
Note. Trading essentially halted after FHFA placed Fannie Mae and Freddie Mac in conservatorship.
Source: Markit.

CDS Spreads for Investment Banks



Note. Median spread for 10 investment banks.
Source: Markit.

CDS Spreads for U.S. Commercial Banks



Note. Median spreads for 7 regional and 5 large commercial banks.
Source: Markit.

Domestic Financial Developments

Overview

Over much of the intermeeting period, financial markets were strained by concerns about Fannie Mae and Freddie Mac and about the prospect of continued write-downs and credit losses at financial institutions more broadly. Some uncertainty was resolved on September 7, when the Treasury Department and the Federal Housing Finance Agency announced that Fannie Mae and Freddie Mac had been placed into conservatorship and that Treasury would establish a backstop lending facility for Fannie and Freddie and initiate a program to purchase mortgage-backed securities (MBS). In the two days following the announcement, spreads on Fannie Mae and Freddie Mac debt and on agency MBS decreased significantly, while share prices for their common and preferred stock plunged.

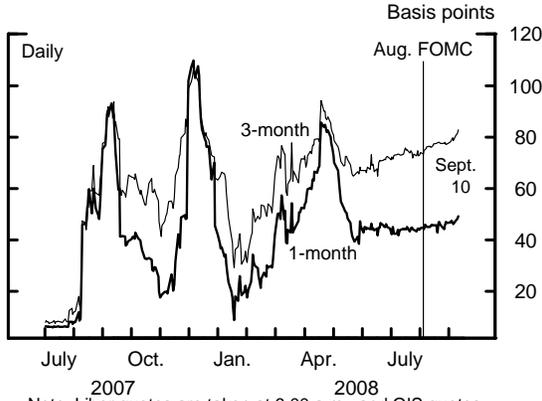
On net over the intermeeting period, investors pushed back their expectation for the onset of monetary policy tightening to the third quarter of next year and marked down their expected level of the federal funds rate at the end of 2010 about 60 basis points. Yields on both intermediate- and long-term nominal Treasury securities decreased over the intermeeting period, and inflation compensation derived from yields on Treasury inflation-indexed securities fell in the near- and far-term. Broad equity indexes moved a bit lower, on net, while risk spreads on corporate bonds increased somewhat. Indicators of business and household credit quality pointed to a further deterioration, and the pace of borrowing generally continued to slow.

Financial Institutions and Market Functioning

Fannie Mae's and Freddie Mac's lower-than-expected second-quarter earnings results intensified concerns about the ability of the two housing government-sponsored enterprises (GSEs) to raise fresh capital to offset mounting losses on their mortgage exposures. Before the conservatorship announcement, prices for the GSEs' preferred and common stock had declined on balance since the August meeting of the Federal Open Market Committee (FOMC), while credit default swap (CDS) spreads on the GSEs' senior debt narrowed further, as market participants speculated that a possible government intervention regarding the GSEs could significantly dilute the existing shares but protect payments on senior debt. In response to the announcement, risk spreads on the GSEs' debt and MBS dropped further, while the value of their common and preferred stock plunged. Fannie Mae's auction of \$1 billion of 3- and 6-month bills on September 9 was reportedly well-received by the market.

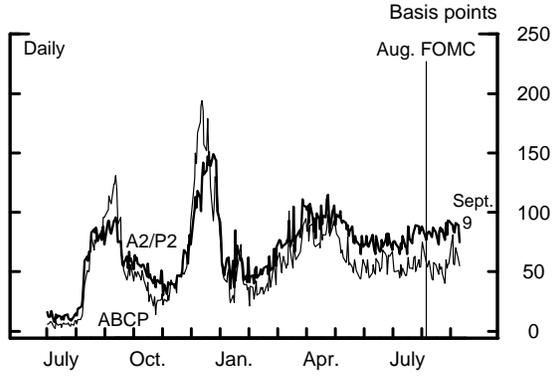
Short-Term Funding and Interbank Markets

Spread between Libor and OIS Rates



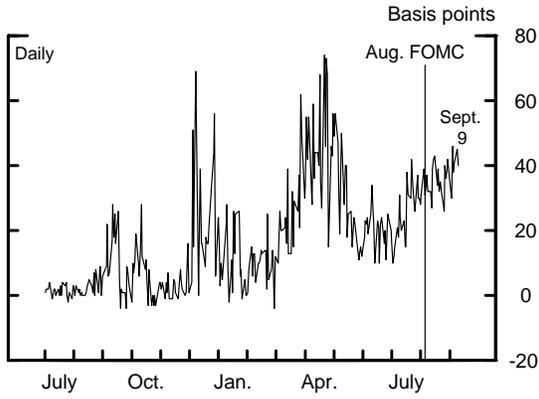
Note. Libor quotes are taken at 6:00 a.m., and OIS quotes are observed at the close of business of the previous trading day.
Source. British Banker's Association.

Spreads on 30-Day Commercial Paper



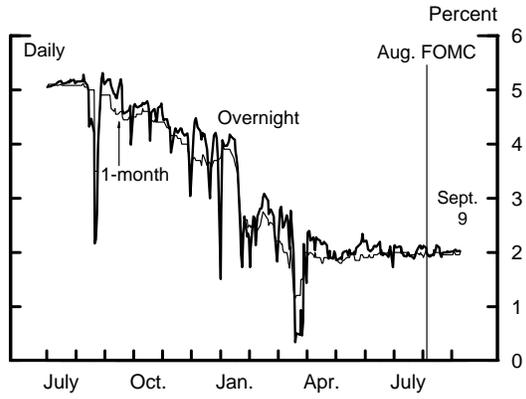
Note. The ABCP spread is the AA ABCP rate minus the AA nonfinancial rate. The A2/P2 spread is the A2/P2 nonfinancial rate minus the AA nonfinancial rate.
Source. Depository Trust & Clearing Corporation.

Commercial Paper Spread for Financial Firms



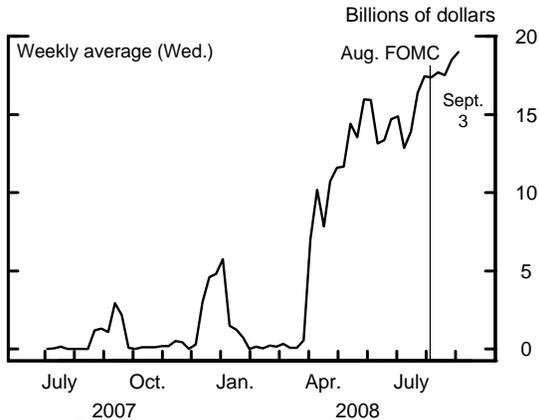
Note. 30-day AA financial rate minus 30-day AA nonfinancial rate.
Source. Markit.

Repo Rates on Treasury General Collateral



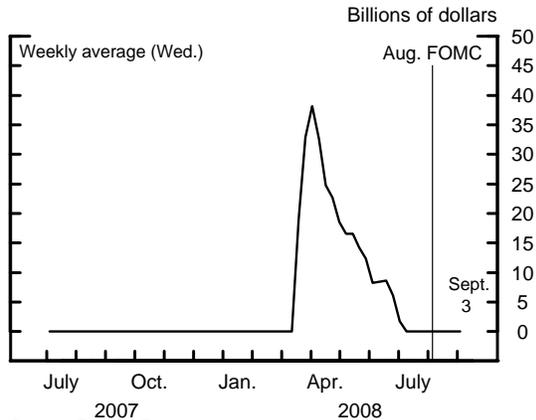
Source. Bloomberg.

Primary Credit Outstanding



Source. Federal Reserve.

Primary Dealer Credit Facility



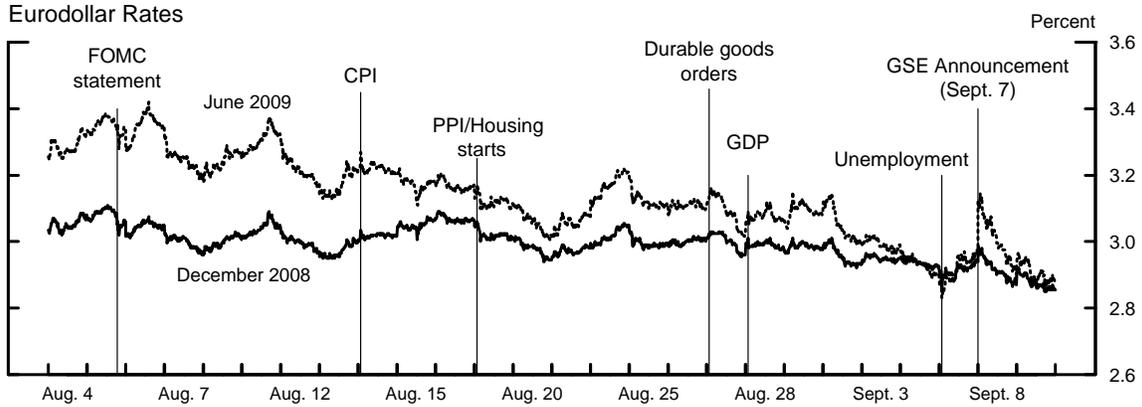
Source. Federal Reserve.

CDS spreads for U.S. investment banks widened over the intermeeting period, but generally remained well below their March peaks. Lehman Brothers was the focus of much market commentary, as investors anticipated significant writedowns in the third quarter and speculated about the firm's ability to raise capital. Lehman's stock price plunged in recent days and its CDS spread jumped. CDS spreads for commercial banks increased somewhat, on balance, with spreads for regional banks remaining substantially above spreads for large banks, likely reflecting greater concern about asset quality at the former and the implications for their funding.

Conditions in short-term funding markets remained strained over the intermeeting period. Spreads of the London interbank offered rate (Libor) over comparable-maturity overnight index swap (OIS) rates edged higher from their already elevated levels. In the commercial paper market, spreads on A2/P2 nonfinancial and asset-backed commercial paper fluctuated in a high range, as did spreads on financial commercial paper. The repo market for Treasury collateral continued to function reasonably well over the intermeeting period, and there were indications that conditions in the repo market for agency debt and agency MBS may have improved a little after Fannie Mae and Freddie Mac were placed in conservatorship. However, over the intermeeting period as whole, median "haircuts" on agency MBS and private-label subprime and alt-A MBS repo transactions increased slightly.

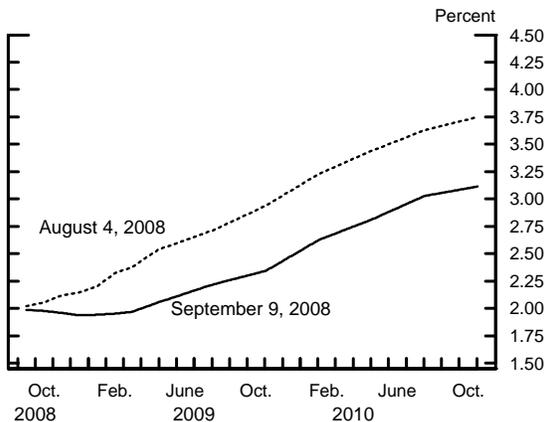
With regard to the Federal Reserve's liquidity facilities, the 28-day Term Auction Facility (TAF) auctions conducted over the intermeeting period were again oversubscribed, and stop-out rates were well above the primary credit rate and just below one-month Libor rates. The Federal Reserve conducted two auctions of 84-day TAF credit, both of which were oversubscribed. Primary credit borrowing has climbed further since the August meeting of the Federal Open Market Committee (FOMC), likely because of the facility's relatively favorable terms. However, no credit was extended through the Primary Dealer Credit Facility over the intermeeting period. Demand was strong for the three Term Security Lending Facility (TSLF) auctions against Schedule 1 collateral held over the period, while, as in previous auctions, the TSLF auctions against Schedule 2 collateral were undersubscribed. On August 27, the first auction was held under the TSLF Options Program (TOP): dealers bid on the option to draw on the TSLF for a one-week term period bracketing the quarter-end. Demand at the TOP auction was

Policy Expectations and Treasury Yields



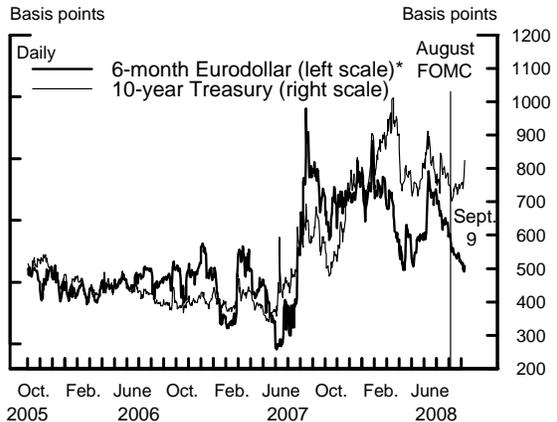
Note. 5-minute intervals. 8:00 a.m. to 4:00 p.m. No adjustments for term premiums.
Source. Bloomberg.

Implied Federal Funds Rate



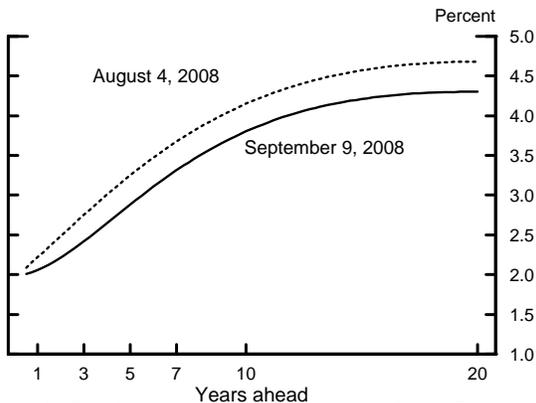
Note. Estimated from federal funds and Eurodollar futures, with an allowance for term premiums and other adjustments.
Source. Chicago Mercantile Exchange; CBOT.

Implied Volatility of Interest Rates



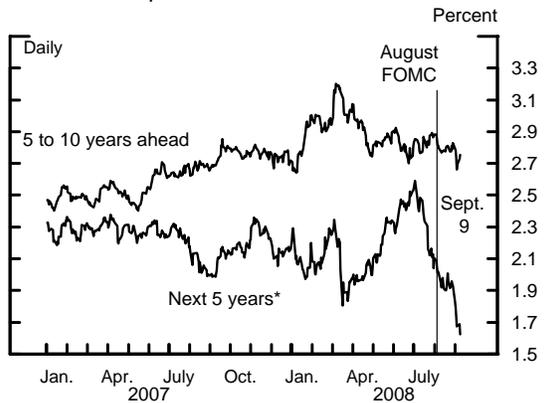
*Width of a 90 percent confidence interval computed from the term structures for the expected federal funds rate and implied volatility.

Treasury Yield Curve



Note. Smoothed yield curve estimated from off-the-run Treasury coupon securities. Yields shown are those on notional par Treasury securities with semiannual coupons.
Source. Federal Reserve Bank of New York.

Inflation Compensation



Note. Estimates based on smoothed nominal and inflation-indexed Treasury yields.
*Adjusted for lagged indexing of TIPS.
Source. Federal Reserve Bank of New York.

strong, with propositions easily exceeding the \$25 billion maximum quantity of TSLF draws afforded by the options.¹

Policy Expectations and Interest Rates

The market's expected onset of monetary policy tightening was pushed back to the third quarter of next year amid heightened concerns about the health of financial institutions and against a backdrop of deteriorating labor market conditions and a further decline in oil prices, which was seen as tempering inflation pressures. Futures quotes suggest that market participants expect slightly more than 1 percentage point of policy tightening by the end of 2010, about 60 basis points less than at the time of the last FOMC meeting. Uncertainty about the expected path of policy decreased, as the option-implied distribution of the federal funds rate six months ahead narrowed somewhat and became less skewed toward higher policy rates. FOMC communications over the intermeeting period elicited very little market reaction, as the Committee's decision to leave the federal funds rate unchanged at the August FOMC meeting, as well as the accompanying statement and the subsequent release of the minutes, were in line with investor expectations.

Yields on 2- and 10-year nominal Treasury securities declined about 25 basis points and 35 basis points, respectively. Yields on 2- and 10-year inflation-indexed securities rose and were little changed, respectively, leaving inflation compensation notably lower across the term structure. The decrease in inflation compensation was most pronounced at shorter horizons, reflecting the expected effects of the drop in oil prices.

Stock Prices, Corporate Yields, and Risk Spreads

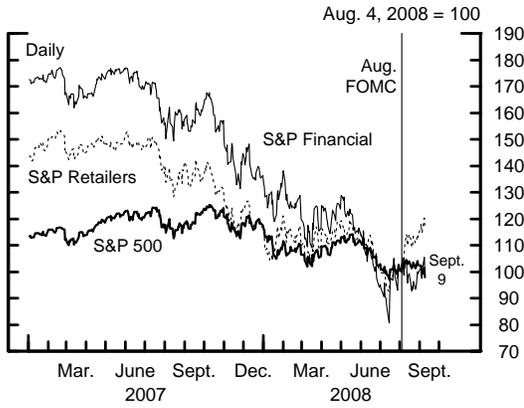
Broad equity price indexes decreased about 2 percent over the intermeeting period, with shares of retail firms widely outperforming the market. Financial sector indexes ended the period down 1½ percent, but were very volatile. The spread between the 12-month forward trend-earnings-price ratio for S&P 500 firms and a real long-run Treasury yield—a rough gauge of the equity risk premium—remained at the top of its range over the past 25 years. Options-implied volatility on the S&P 500 index remained in the elevated range of the past year.

Over the intermeeting period, yields on investment-grade corporate bonds decreased slightly, while yields on speculative-grade bonds were little changed. Given the

¹ Results from the second TOP auction, scheduled for September 10, were not available in time for the Greenbook publication.

Corporate Yields, Risk Spreads, and Stock Prices

Selected Stock Price Indexes

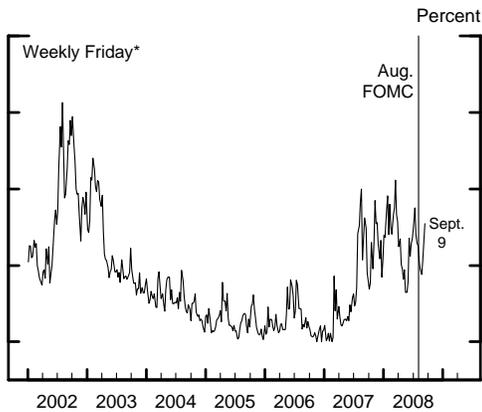


Ratio of Trend Earnings to Price for S&P 500 and Long-Run Treasury Yield



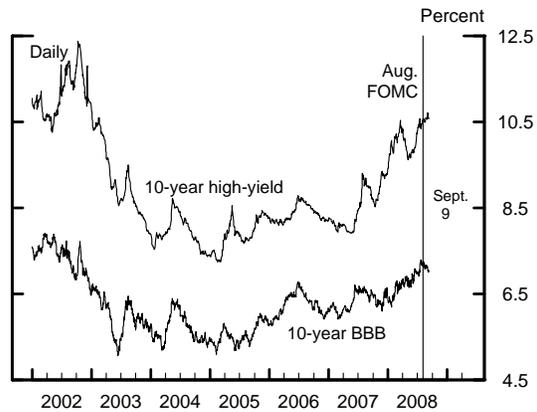
* Trend earnings are estimated using analysts' forecasts of year-ahead earnings from I/B/E/S.
 + Denotes the latest observation using daily interest rates and stock prices and latest earnings data from I/B/E/S.

Implied Volatility on S&P 500 (VIX)

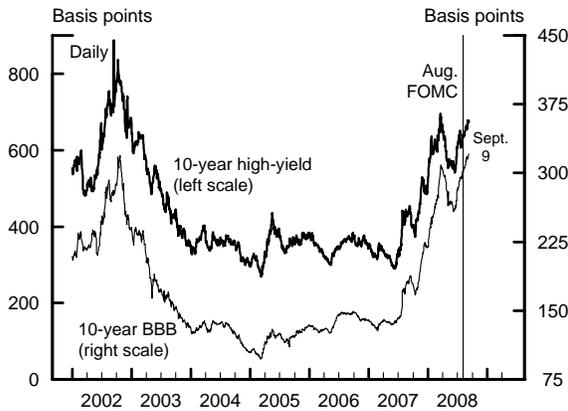


* Latest observation is for most recent business day.

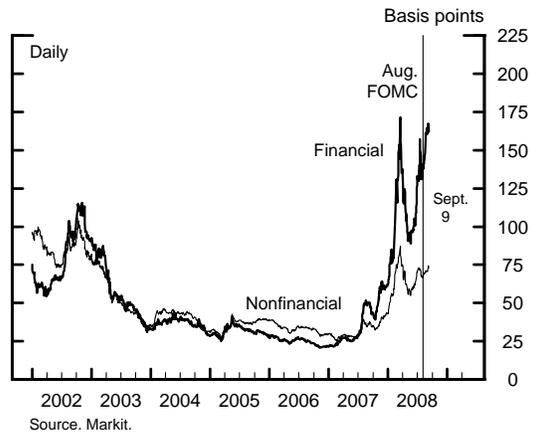
Corporate Bond Yields



Corporate Bond Spreads

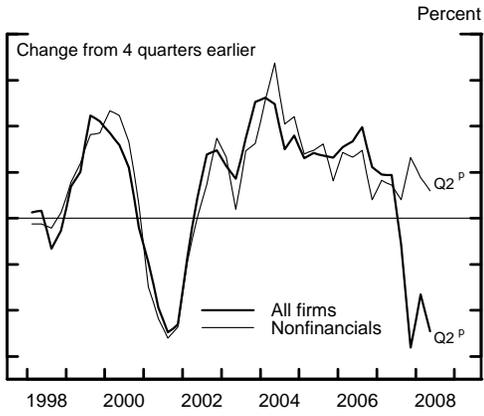


Investment-Grade CDS Indexes



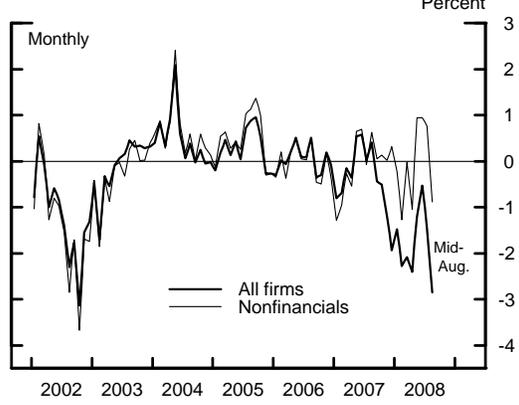
Corporate Earnings and Credit Quality

S&P 500 Earnings Per Share



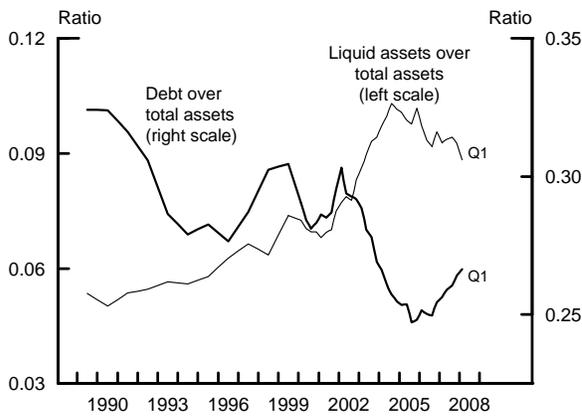
p Preliminary.
Source: Thomson Financial.

Revisions to Expected S&P 500 Earnings



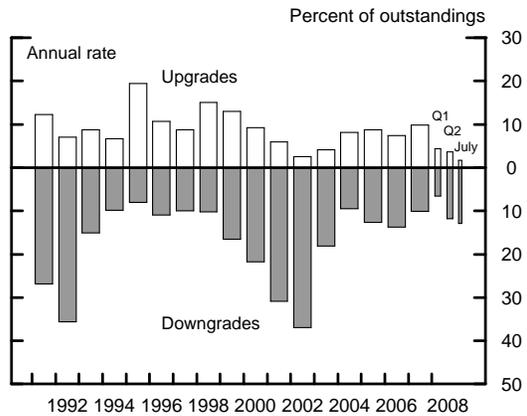
Note: Index is a weighted average of the percent change in the consensus forecasts of current-year and following-year EPS for a fixed sample.
Source: Thomson Financial.

Financial Ratios for Nonfinancial Corporations



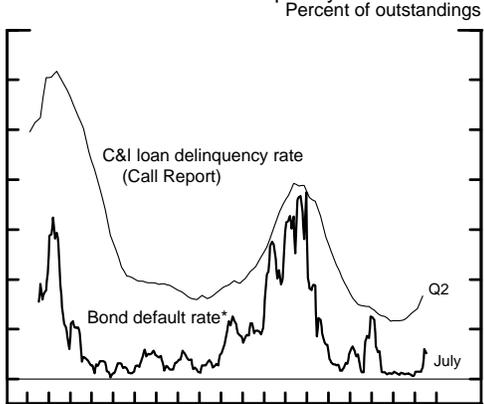
Note: Data are annual through 1999 and quarterly starting in 2000:Q1.
Source: Calculated using Compustat data.

Bond Ratings Changes of Nonfinancial Companies



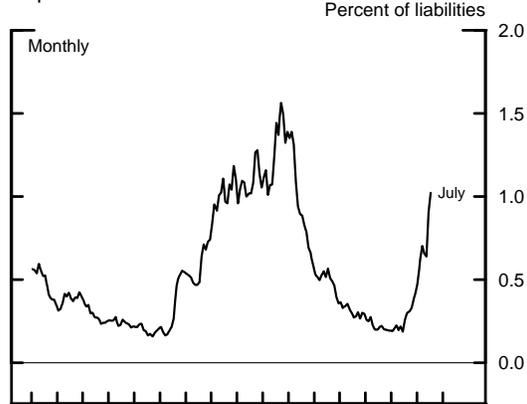
Source: Calculated using data from Moody's Investors Service.

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: Calculated using Moody's KMV.

Business Finance

Gross Issuance of Securities by U.S. Corporations

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

Type of security	2004	2005	2006	2007		2008			
				H1	H2	Q1	Q2	July	Aug.
<i>Nonfinancial corporations</i>									
Stocks ¹	5.4	4.6	4.7	5.5	5.4	2.3	4.6	4.4	2.4
Initial public offerings	1.6	1.7	1.8	1.7	1.6	.3	.9	.1	.2
Seasoned offerings	3.8	2.8	2.9	3.9	3.8	2.0	3.7	4.4	2.2
Bonds ²	22.4	18.7	29.3	37.6	32.5	29.5	39.9	18.3	13.3
Investment grade	8.3	8.7	13.1	14.9	20.2	24.1	25.6	11.9	10.9
Speculative grade	8.2	5.2	6.2	11.8	3.3	1.3	4.9	.7	.4
Other (sold abroad/unrated)	5.9	4.8	10.1	10.9	9.0	4.1	9.4	5.7	2.0
<i>Memo</i>									
Net issuance of commercial paper ³	1.7	-.2	2.4	1.1	-2.0	4.5	-5.5	-.3	27.2
Change in C&I loans at commercial banks ^{3,4}	2.4	9.6	11.6	13.9	28.7	16.8	9.8	6.6	-3.1
<i>Financial corporations</i>									
Stocks ¹	6.9	5.0	5.3	9.3	7.9	13.2	21.1	10.3	1.0
Bonds ²	134.1	170.4	180.6	200.5	102.8	54.9	77.0	14.8	25.7

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

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

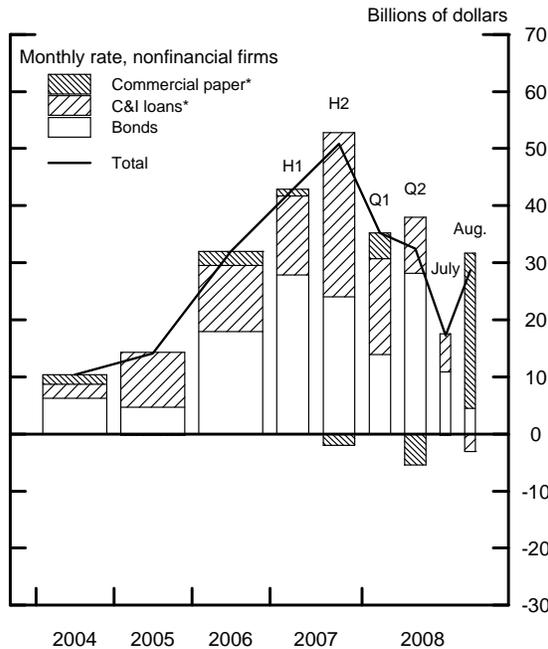
2. Data include regular and 144a private placements. Bond totals reflect gross proceeds rather than par value of original discount bonds. Bonds are categorized according to Moody's bond ratings or to Standard & Poor's if unrated by Moody's.

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

4. Based on adjusted commercial bank credit data through Aug. 2008.

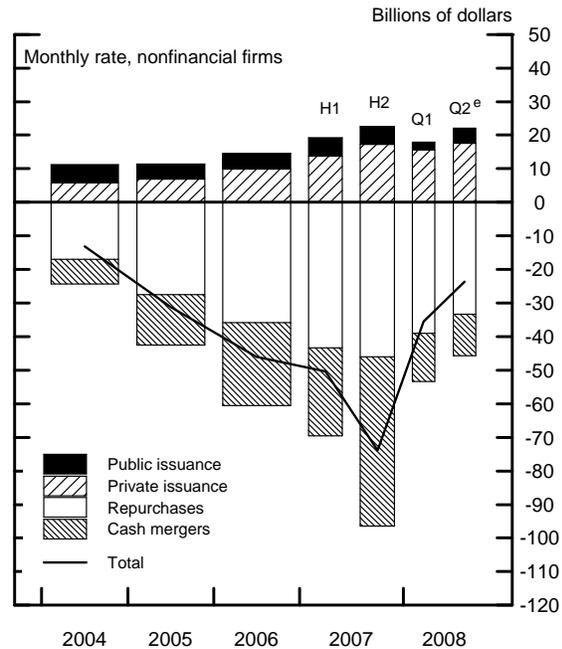
Source. Depository Trust & Clearing Corporation; Thomson Financial; Federal Reserve Board.

Selected Components of Net Debt Financing



* Seasonally adjusted, period-end basis.
Source. Depository Trust & Clearing Corporation; Thomson Financial; Federal Reserve Board.

Components of Net Equity Issuance



e Staff estimate.
Source. Thomson Financial; Investment Benchmark Report; Money Tree Report by PricewaterhouseCoopers, National Venture Capital Association, and Venture Economics.

relatively large decreases in comparable-maturity Treasury yields, risk spreads on investment-grade bonds rose to the top of their historical range, and speculative-grade spreads nearly returned to their March peaks. CDS spreads suggest that compensation for default risk for investment-grade financial firms rose markedly since the August FOMC meeting, while that for investment-grade nonfinancial firms was little changed.

Corporate Earnings and Credit Quality

With nearly all second-quarter earnings reports in hand, earnings per share for S&P 500 firms are estimated to have dropped about 25 percent from their year-ago level because of a plunge in financial sector profits. Earnings per share for nonfinancial firms are estimated to have increased about 7 percent over the past year, with roughly half the gain accounted for by the oil and gas industry. An index of analysts' expectations of earnings for S&P 500 firms over the coming year showed a sharp downward revision in August, largely reflecting significant further markdowns for the financial sector.

The credit quality of nonfinancial corporations has deteriorated some in recent months. The net rate of nonfinancial corporate bond downgrades by Moody's in July was a little higher than in the second quarter. The six-month trailing bond default rate and the delinquency rate on commercial and industrial (C&I) loans at commercial banks have both risen noticeably since the spring, although they remain at low levels by historical standards. The aggregate expected default rate over the next year projected by Moody's KMV rose in July, reaching its highest level since 2003.

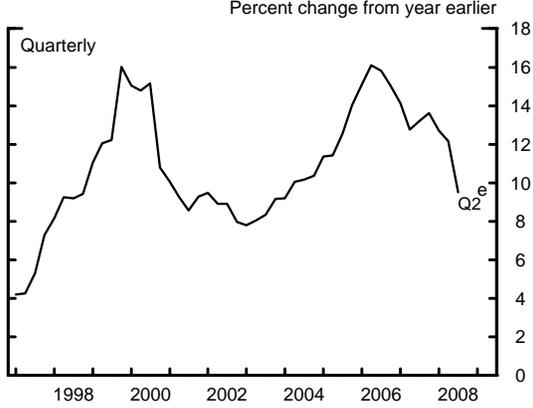
Business Finance

Net debt financing by nonfinancial businesses picked up in August from the weak pace in July, with the increase accounted for by a jump in nonfinancial commercial paper (CP) outstanding. Last month, some highly rated firms reportedly tapped the CP market to finance dividend payments and to fund, at least temporarily, a large acquisition. Investment-grade bond issuance moderated a bit further in August, while speculative-grade issuance remained very light. Bank lending to business through C&I loans was about flat during the July–August period, likely reflecting both reduced demand for bank-intermediated credit and the tighter terms and standards on these categories of loans that banks have reported in the past several Senior Loan Officer Opinion Surveys.

Both seasoned and initial equity offerings by nonfinancial corporations remained weak in August, with almost no issuance outside the energy sector. In the second quarter, equity retirements from cash-financed mergers fell a bit further, but announcements of new

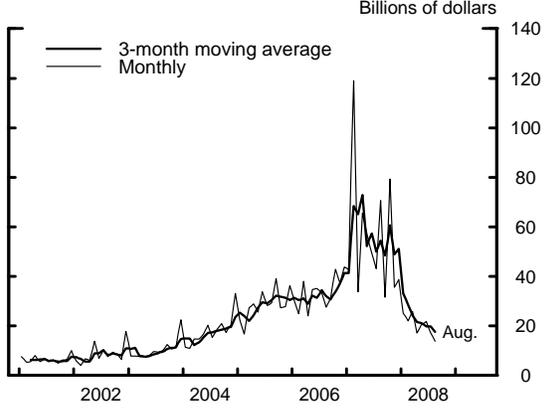
Commercial Real Estate

Commercial Mortgage Debt



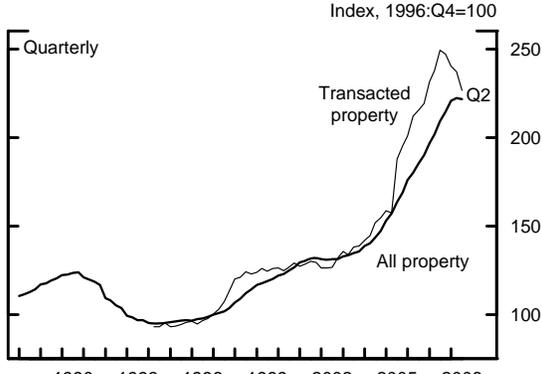
Staff Estimate.
Source: Federal Reserve.

Sales of Commercial Real Estate



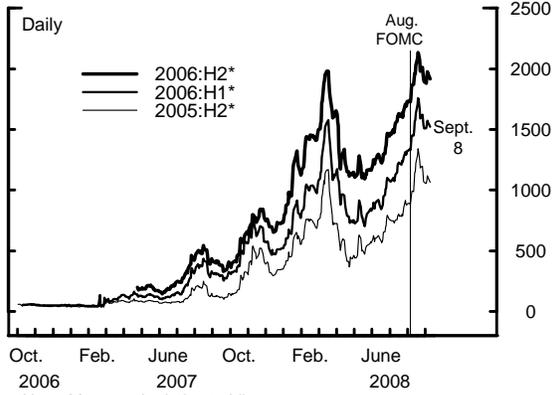
Source: Real Capital Analytics.

Prices



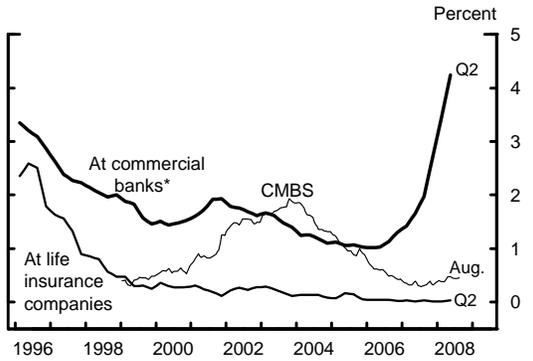
Note: All-property index based on entire NCREIF portfolio.
Transacted-property index based on sales involving NCREIF portfolio.
Source: NCREIF; MIT Center for Real Estate.

BBB Commercial Mortgage CDS Index Spreads



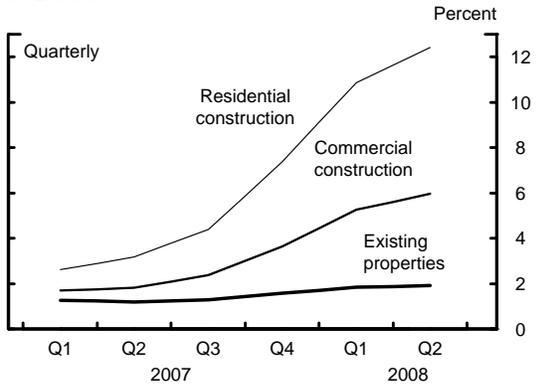
Note: Measured relative to Libor.
*Corresponds to pools of mortgages originated in that period.
Source: JP Morgan.

Delinquency Rates on Commercial Mortgages



*Excluding farmland.
Source: Citigroup; Call Report; ACLI.

Delinquency Rates on Commercial Mortgages at Banks



Note: Data series for residential and commercial construction begin in 2007:Q1. Existing properties include nonresidential and multifamily.
Source: Call Report.

deals continued apace. Retirements from share repurchases are also estimated to have continued their decline in the second quarter. As a result, on net, nonfinancial firms retired equity in the second quarter at the slowest pace since 2004.

Commercial Real Estate

The growth of commercial mortgage debt slowed sharply in the second quarter and appears to have come down further this quarter. In August, the value of commercial real estate transactions slipped to its lowest level since early 2004, a decline reflecting the much tighter supply of financing for these transactions and lower prices of commercial properties. In the second quarter, prices of transacted properties were about 10 percent below their year-ago peaks. Issuance of commercial mortgage-backed securities (CMBS) was zero in July and August, and yield spreads for CDS indexes of BBB-rated tranches of CMBS reached a new high in mid-August before moving down in recent weeks.

Delinquency rates on commercial mortgages held by commercial banks climbed to 4¼ percent in the second quarter, the highest level since 1995, as delinquencies for construction loans, particularly those associated with residential projects, rose further. In contrast, the delinquency rate for commercial mortgages held in CMBS remained quite low in August, and almost no loans held by life insurance companies were delinquent in the second quarter.

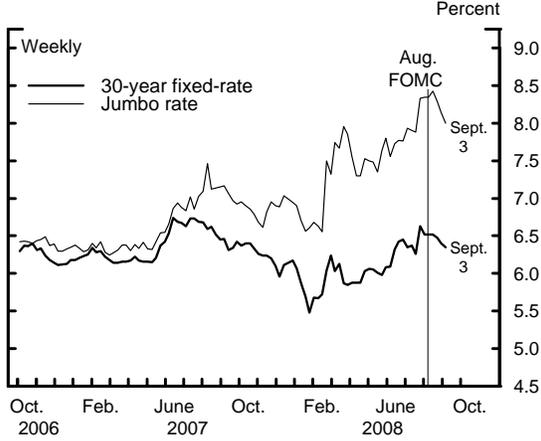
Household Finance

Before the GSE conservatorship announcement was made, interest rates on 30-year fixed-rate jumbo mortgages and conforming mortgages had decreased about a quarter percentage point since the August FOMC meeting. The decline in the conforming mortgage rate was less than that on comparable-maturity Treasury securities, thereby leaving the mortgage spread at the top of its range over the past two decades. In part, the elevated primary market spreads reflected unusually high option-adjusted spreads for agency MBS amid unsettled conditions in the secondary market. Following the Treasury announcement, option-adjusted spreads on agency MBS dropped substantially and reports indicated that some lenders lowered rates on conforming mortgages around 20 basis points.

The very soft housing market has continued to weigh on mortgage credit quality. Two national indexes, one published by the Office of Federal Housing Enterprise Oversight and the other by S&P/Case-Shiller, of existing home prices declined further in the second quarter, albeit not as sharply as in the previous quarter. In June, the delinquency rate on

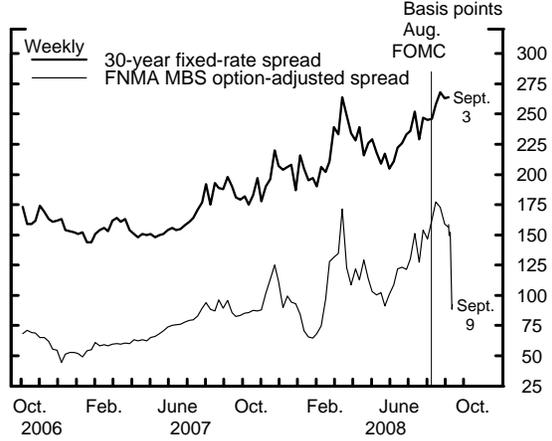
Residential Mortgages

Mortgage Interest Rates



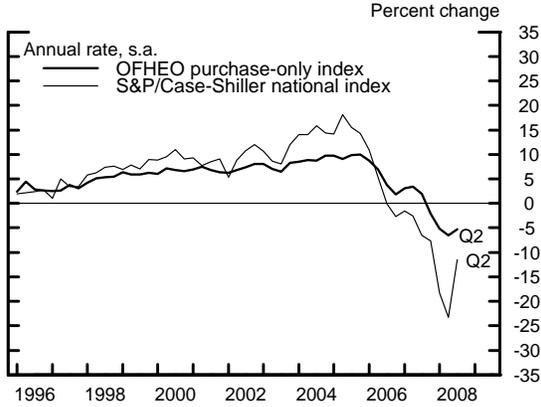
Source: Freddie Mac; Inside Mortgage Finance.

Mortgage Rate Spreads



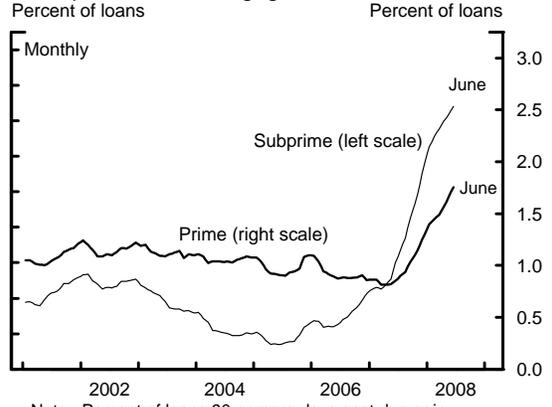
Source: Bloomberg; Freddie Mac.

House Prices



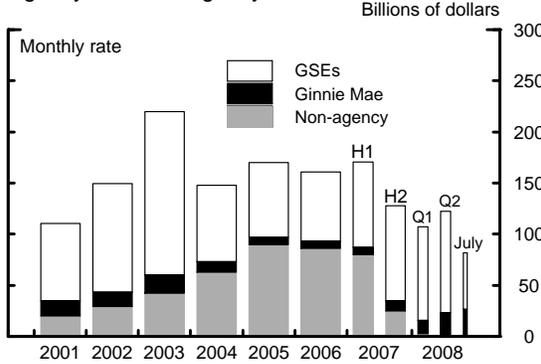
Source: Office of Federal Housing Enterprise Oversight (OFHEO); Standard & Poor's.

Delinquencies on Mortgages



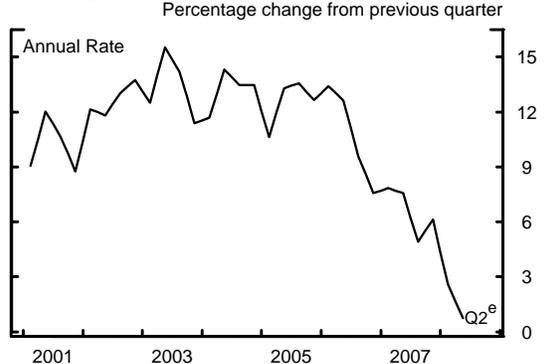
Note: Percent of loans 90 or more days past due or in foreclosure. Prime includes near-prime mortgages.
Source: First American LoanPerformance.

Agency and Non-Agency MBS Issuance



Source: For agency issuance, Fannie Mae, Freddie Mac, and Ginnie Mae. For non-agency issuance, Inside Mortgage Finance.

Mortgage Debt



^e Staff estimate.
Source: Federal Reserve.

prime (and near-prime) residential mortgages edged up 10 basis points, to 1¾ percent, and the delinquency rate on subprime mortgages increased about 45 basis points, to 18¾ percent. Preliminary data (not shown) indicate that the delinquency rate on subprime variable-rate mortgages increased further in July.

Issuance of MBS by Ginnie Mae continued to move up in July, while issuance by the GSEs that month was somewhat below the pace earlier in the year. No private-label MBS was issued that month. In the second quarter, mortgage debt expanded at an annual rate below 1 percent, the slowest recorded pace since 1952. The steep decline in total mortgage borrowing reflects a number of factors, including the tight supply of nonconforming loans, the rise in mortgage rates since the beginning of the year, the continuing drop in home prices, and sluggish home sales.

Delinquency rates for revolving and nonrevolving consumer loans at commercial banks edged up in the second quarter. Delinquencies on auto loans at the domestic captive finance companies remained elevated in July, and the charge-off rate on prime auto loans estimated by Moody's (not shown) rose in June to its highest level since December 2003.

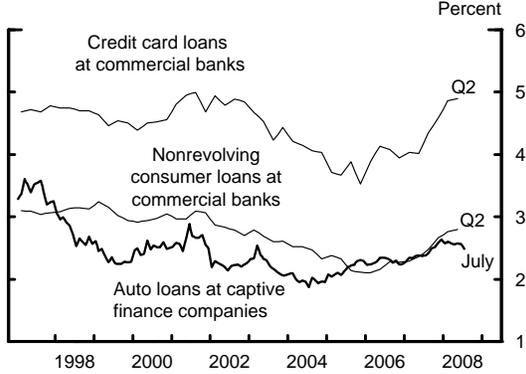
Growth of consumer credit stepped down a little in July. Growth of nonrevolving credit slowed markedly, even as a large captive finance company launched aggressive auto financing incentives in July. Since the August FOMC meeting, interest rates on credit card and auto loans were little changed, generally remaining below the levels seen earlier this year. Separately, new government-backed funding facilities appear to have largely assuaged concerns about the availability of student loans for the autumn semester.

The secondary market for consumer loans continues to show signs of strain. Issuance of asset-backed securities (ABS) collateralized by credit card receivables and by auto loans was substantially weaker in July and August than earlier this year. Although issuance of student loan ABS has held up, on net, the August figure reflected a single deal that was not widely distributed among investors. Spreads on consumer ABS jumped in August and now stand above their March peaks, suggesting that investors may have grown more concerned about the likely performance of the underlying loans.

As in July, long-term mutual funds saw sizable outflows last month, which reflected large withdrawals from equity funds and moderate inflows to bond funds. For the second consecutive month, money market funds attracted inflows exceeding \$40 billion in August.

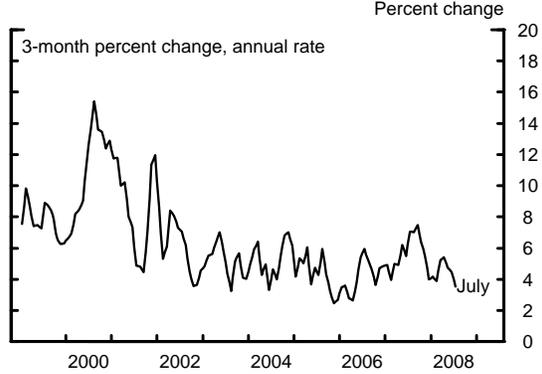
Consumer Credit and Household Wealth

Delinquencies on Consumer Loans



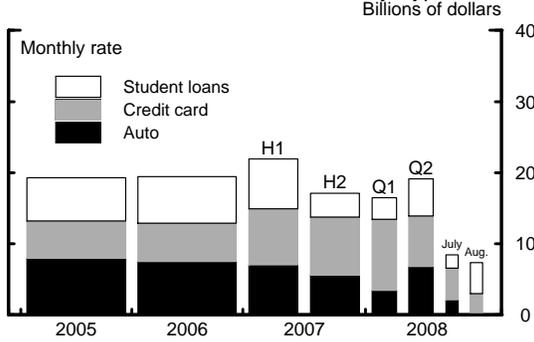
Source. For auto loans, Federal Reserve; for credit cards and nonrevolving consumer loans, Call Report.

Consumer Credit



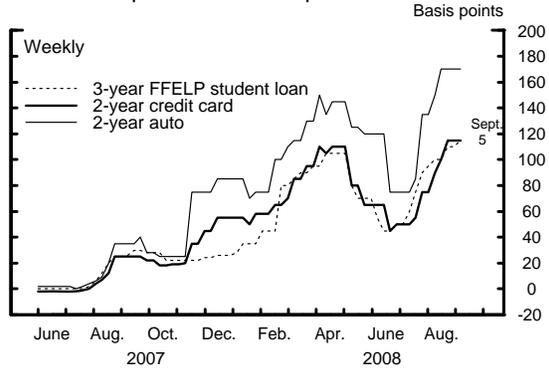
Source. Federal Reserve.

Gross Issuance of Consumer ABS by Type



Note. Auto includes car loans, leases, and financing for buyers of motorcycles, trucks, and other vehicles.
Source. Inside Mortgage Finance; Merrill Lynch.

AAA ABS Spreads over Swaps



Source. For credit cards and auto, Citigroup Global Markets; for student loans, Merrill Lynch.

Net Flows into Mutual Funds

(Billions of dollars, monthly rate)

Fund type	2007		2008		July	Aug. ^e	Assets July
	H1	H2	Q1	Q2			
Total long-term funds	31.5	5.8	1.7	22.6	-26.0	-11.0	8,100
Equity funds	14.3	1.1	-14.9	7.8	-26.4	-18.7	5,686
Domestic	0.8	-8.5	-13.4	3.3	-18.7	-2.7	4,243
International	13.5	9.6	-1.5	4.4	-7.7	-16.0	1,443
Hybrid funds	2.6	1.1	0.7	2.0	-1.5	-0.3	664
Bond funds	14.6	3.5	16.0	12.9	1.8	8.0	1,751
High-yield	0.2	-0.7	-1.3	0.9	-0.6	0.1	147
Other taxable	12.0	4.8	15.2	8.2	-0.1	5.4	1,218
Municipals	2.4	-0.6	2.1	3.7	2.5	2.5	386
Money market funds	26.3	98.8	126.9	-14.8	54.4	42.7	3,535

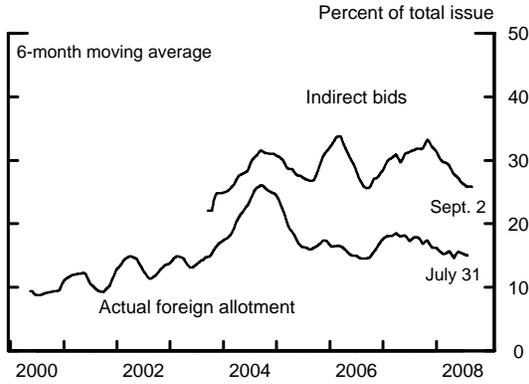
Note. Excludes reinvested dividends.

e Staff estimate.

Source. Investment Company Institute.

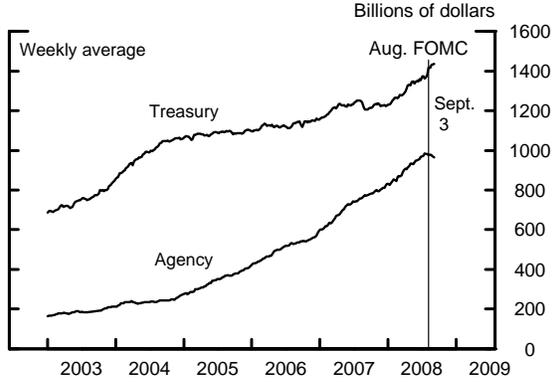
Treasury Finance

Foreign Participation in Treasury Auctions



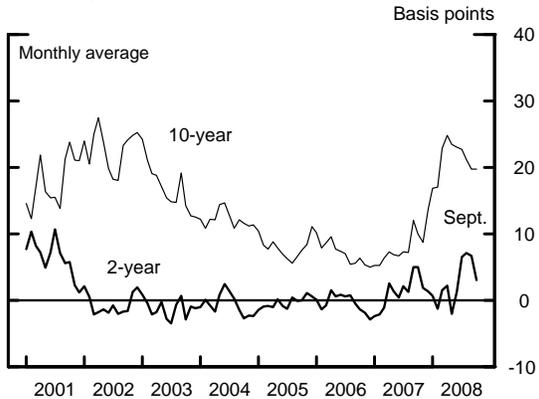
Note. Indirect bids and actual allotment are a percentage of the total amount accepted, including the amount tendered to the Federal Reserve. Moving averages include 2-, 5-, and 10-year original auctions and reopenings.

Foreign Custody Holdings



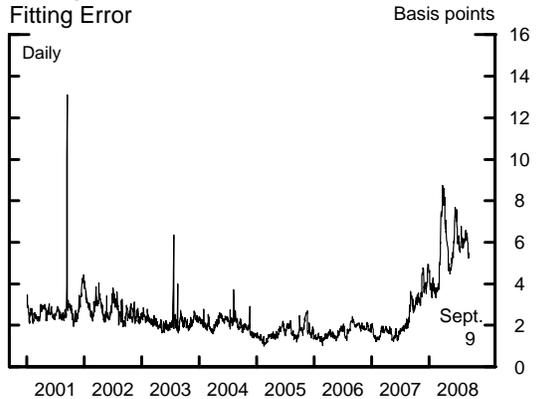
Note. Securities held in custody at the Federal Reserve Bank of New York on behalf of foreign official institutions.
Source. Federal Reserve Bank of New York.

Treasury On-the-Run Premiums



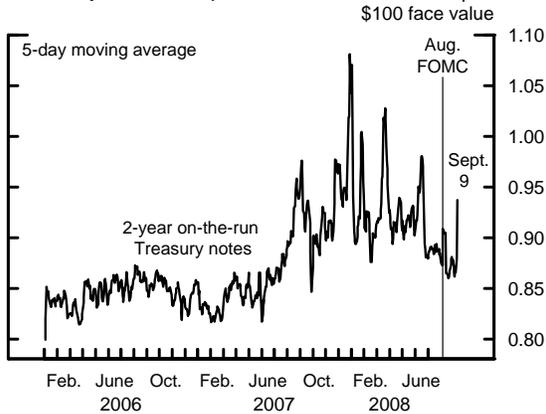
Note. Computed as the spread of the yield read from an estimated off-the-run yield curve over the on-the-run Treasury yield. September observation is the month-to-date average.
Source. Federal Reserve Bank of New York.

Average Absolute Nominal Yield Curve Fitting Error



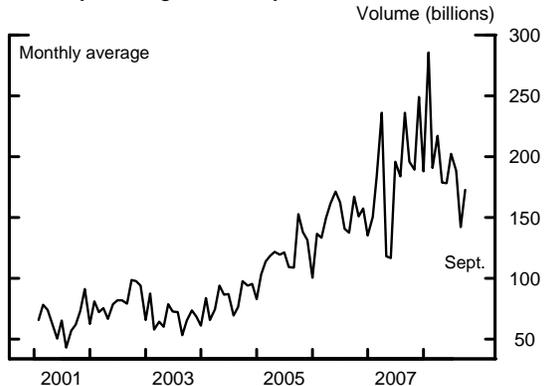
Note. Calculated from securities with 2 to 10 years until maturity, excluding on-the-run and first off-the-run securities.

Treasury Bid-Ask Spread



Source. BrokerTec Interdealer Market Data.

Monthly Average Treasury Market Volume



Note. September observation is average for month to date.
Source. BrokerTec Interdealer Market Data.

State and Local Government Finance

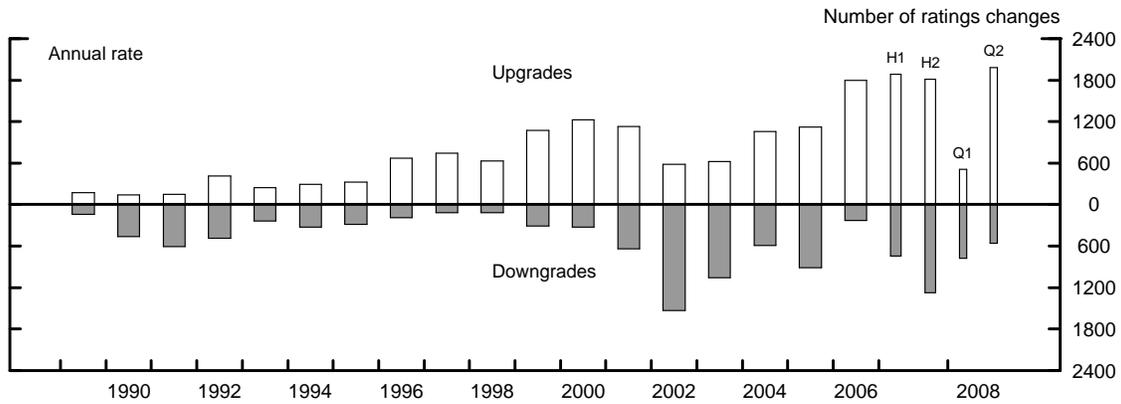
Gross Offerings of Municipal Securities

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

Type of security	2004	2005	2006	2007		2008			
				H1	H2	Q1	Q2	July	Aug.
Total	34.7	38.4	36.1	41.8	38.9	29.5	52.5	41.8	38.9
Long-term ¹	29.8	34.2	32.5	38.5	32.6	28.1	47.0	36.5	29.6
Refundings ²	10.8	15.6	10.6	16.5	8.7	11.0	24.5	15.6	13.4
New capital	19.0	18.6	21.9	22.0	23.9	17.0	22.4	20.8	16.3
Short-term	4.9	4.2	3.7	3.4	6.3	1.5	5.5	5.4	9.3
Memo: Long-term taxable	2.0	2.1	2.5	2.2	2.6	1.8	3.1	4.0	1.1

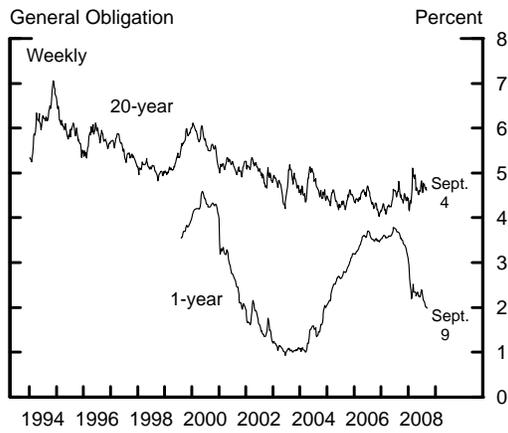
- 1. Includes issues for public and private purposes.
 - 2. All issues that include any refunding bonds.
- Source: Thomson Financial.

Ratings Changes



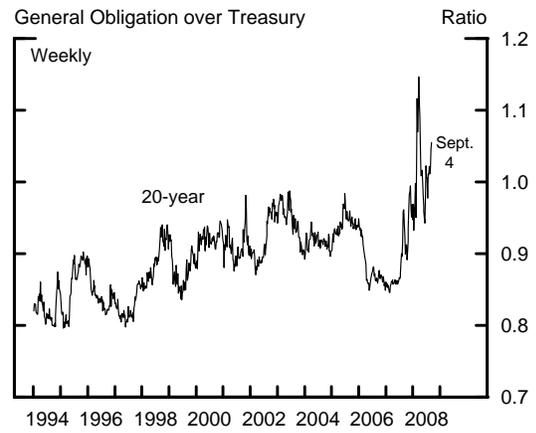
Source: S&P's Credit Week Municipal; S&P's Ratings Direct.

Municipal Bond Yields



Source: Municipal Market Advisors; Bond Buyer.

Municipal Bond Yield Ratio



Source: Bond Buyer.

Treasury Finance

During the intermeeting period, the Treasury conducted auctions of nominal coupon securities across a range of maturities, and these auctions were generally well received. Indirect bids, a rough measure of demand from foreign official institutions, stayed near the bottom of the range seen over the past several years. However, foreign custody holdings of Treasury securities at the Federal Reserve Bank of New York—another indicator of foreign demand—increased notably over the intermeeting period, while such holdings of agency securities declined.

Liquidity in the secondary market for Treasury securities remained somewhat strained during the period. Spreads between on- and off-the-run Treasury notes generally stayed elevated, an indication of continued high demand for the most liquid securities. In addition, fitting errors from the estimated nominal yield curve remained sizable; that is, there continued to be unusually large differences between yields on Treasury securities with similar maturities. However, there were some signs of improvement. Average bid-asked spreads for on-the-run nominal Treasury notes declined a bit further and now have nearly returned to levels seen before the onset of the financial turmoil last year, and trading volumes for on-the-run Treasury securities rebounded in early September from last month's low level.

State and Local Government Finance

Issuance of long-term municipal bonds for both advance refundings and new capital projects was sizable in August. Short-term issuance was also strong last month, a result of greater-than-typical revenue shortfalls for state and local governments.

Nonetheless, credit quality in the municipal bond sector appears to have remained solid on the whole, as the number of rating upgrades continued to outpace the number of downgrades in the second quarter. Yields on long-term municipal bonds decreased slightly over the intermeeting period, even as those on comparable-maturity Treasury securities moved down, pushing the ratio of a representative municipal bond yield to a comparable-maturity Treasury yield to the middle of this year's elevated range.

Money and Bank Credit

M2 contracted at an annual rate of 1½ percent in August after having expanded 6 percent in the previous month. Smoothing through the monthly volatility, money growth has stepped down since the second quarter. The August data showed a considerable reallocation among the components of M2. Liquid deposits and retail money funds fell at

M2 Monetary Aggregate
(Based on seasonally adjusted data)

Aggregate and components	Percent change (annual rate) ¹						Level (billions of dollars),
	2006	2007	2008				Aug. (e)
			Q1	Q2	July	Aug. (e)	
M2	4.9	5.8	9.5	5.7	6.1	-1.5	7,717
Components ²							
Currency	3.5	2.0	-5	2.3	8.7	2.2	776
Liquid deposits ³	.7	4.5	7.0	7.5	4.8	-8.2	4,649
Small time deposits	18.6	4.3	2.4	-6.2	9.5	25.3	1,234
Retail money market funds	13.0	19.2	38.9	14.6	5.9	-5.0	1,051
Memo:							
Institutional money market funds	15.7	39.4	46.8	33.1	-4	13.2	2,271
Monetary base	3.1	2.0	-4	2.0	8.1	5.0	842

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.

Source. Federal Reserve.

annual rates of 8¼ percent and 5 percent, respectively. In stark contrast, small time deposits surged at a nearly 25 percent pace, as some banks and thrifts apparently continued to bid aggressively for these deposits to help stabilize their core deposit base. Last month, growth of currency slowed from the robust pace in July that had reflected unusual demand from abroad.

In July and August, commercial bank credit expanded at about the same pace as in the second quarter, as faster growth of securities holdings offset a slower expansion in loans.² Growth of commercial real estate and C&I loans was tepid, on average, during the July-August period, while residential real estate loans and consumer loans on banks' books grew at a pace similar to that in the second quarter.

Data from the Survey of Terms of Business Lending conducted during the week of August 4 indicated that the average spread on C&I loan originations of less than \$25 million—adjusted for changes in nonprice loan characteristics—was about unchanged since the May survey.³ The absence of a pronounced widening of yield spreads on those C&I loans is broadly consistent with the recent NFIB survey, which showed that concerns among small firms about future credit conditions and current availability of credit have receded somewhat in recent months. By contrast, terms on large leveraged syndicated loans have remained very tight.

Commercial bank profitability, as measured by industry return on assets, fell to about 0.4 percent at an annual rate in the second quarter of 2008, the lowest level since the end of 1990. This year's decrease has been somewhat more pronounced among the 25 largest institutions (as measured by assets), a segment of the industry in which a sharp increase in loan-loss provisions and large write-downs of asset values have weighed heavily on profits. For the industry as a whole, loan-loss provisions increased to 1.3 percent of total loans and leases in the second quarter, about three times the year-earlier rate. Despite the rapid pace of loan-loss provisioning, the ratio of loan-loss reserves to net charge-offs—a rough gauge of reserve adequacy—fell to a very low level.

² Recent fluctuations in bank credit and its components reflect larger-than-usual movements in the estimated seasonal factors. The seasonal factors for recent months are difficult to estimate—particularly for commercial real estate loans—because of the timing of changes in the panel of respondent banks.

³ Because there are too few loans over \$25 million, and their terms vary so widely, these loans are excluded from our analysis.

Commercial Bank Credit

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

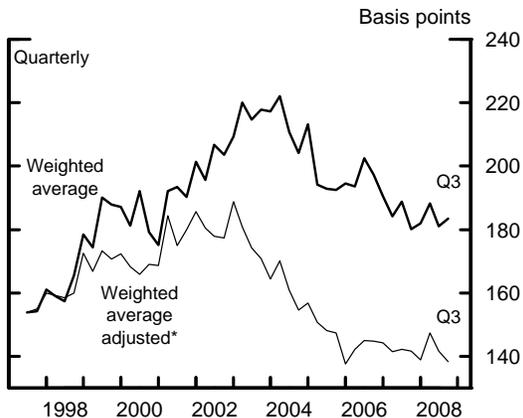
Type of credit	H1 2007	H2 2007	Q1 2008	Q2 2008	July 2008	Aug. 2008 ^e	Level ¹ Aug. 2008 ^e
Total	6.2	11.3	6.0	3.6	1.9	5.3	9,059
<i>Loans²</i>							
Total	7.2	11.5	9.5	4.4	.9	5.1	6,846
To businesses							
Commercial and industrial	6.9	26.2	15.5	13.0	5.7	-.1	1,511
Commercial real estate	6.2	10.3	9.9	10.2	-9.2	4.8	1,657
To households							
Residential real estate	8.8	-1.1	3.4	3.3	-5.6	9.1	1,856
Revolving home equity	3.0	6.5	11.5	16.1	12.1	6.0	522
Other	10.7	-3.7	.7	-1.3	-12.3	10.2	1,334
Consumer	2.9	10.8	8.8	6.0	11.0	8.5	842
Originated ³	3.1	9.2	8.2	6.8	5.9	2.2	1,251
Other ⁴	9.6	19.9	12.1	-16.3	14.3	3.6	980
<i>Securities</i>							
Total	3.3	10.7	-4.2	.9	4.9	5.6	2,213
Treasury and agency	-5.0	-4.3	-11.2	8.4	15.4	41.1	1,186
Other ⁵	14.5	28.9	3.0	-6.6	-6.2	-32.9	1,027

Note. Yearly annual rates are Q4 to Q4; quarterly and monthly annual rates use corresponding average levels. Data have been adjusted to remove the effects of mark-to-market accounting rules (FIN 39 and FAS 115), the initial consolidation of certain variable interest entities (FIN 46), the initial adoption of fair value accounting (FAS 159), and the effects of sizable thrift-to-bank and bank-to-thrift structure activity in October 2006, March 2007, and October 2007. Data also account for breaks caused by reclassifications.

1. Billions of dollars. Pro rata averages of weekly (Wednesday) levels.
2. Excludes interbank loans.
3. Includes an estimate of outstanding loans securitized by commercial banks.
4. Includes security loans and loans to farmers, state and local governments, and all others not elsewhere classified. Also includes lease financing receivables.
5. Includes private mortgage-backed securities; securities of corporations, state and local governments, and foreign governments; and any trading account assets that are not Treasury or agency securities.

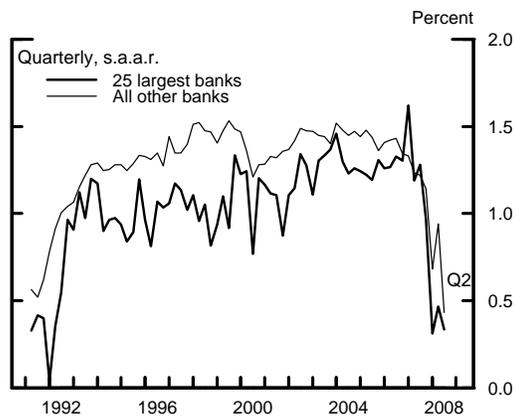
^e Estimated.
Source. Federal Reserve.

C&I Loan Rate Spreads



Note. Spreads over market interest rate on an instrument of comparable maturity on loans less than \$25 million (2006\$).
*Adjusted for changes in nonprice loan characteristics.
Source. Survey of Terms of Business Lending.

Return on Assets at Commercial Banks



Source. Call Report.

International Developments

International Developments

U.S. International Transactions

Trade in Goods and Services

The U.S. international trade deficit narrowed to \$56.8 billion in June, as a large increase in exports of goods and services more than offset a more moderate increase in imports.

Trade in Goods and Services

	2007	Annual rate			Monthly rate		
		2007	2008		2008		
		Q4	Q1	Q2	Apr.	May	June
Percent change							
<i>Nominal BOP</i>							
Exports	14.5	10.4	18.4	23.2	3.7	1.2	4.0
Imports	9.7	11.4	13.8	17.5	4.6	.3	1.8
<i>Real NIPA</i>							
Exports	8.9	4.4	5.1	13.2	...	...	...
Imports	1.1	-2.3	-.8	-7.6	...	...	...
Billions of dollars							
<i>Nominal BOP</i>							
Net exports	-700.3	-695.1	-699.7	-705.9	-60.5	-59.2	-56.8
Goods, net	-819.4	-835.7	-844.1	-860.4	-73.0	-72.1	-70.0
Services, net	119.1	140.5	144.5	154.5	12.5	12.9	13.3

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

BOP Balance of Payments.

NIPA National Income and Product Accounts.

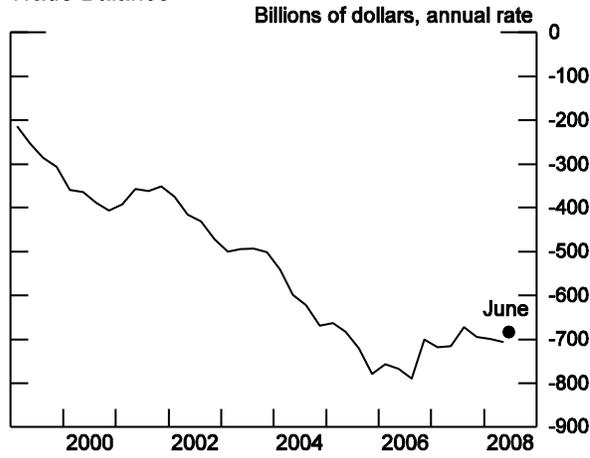
Source. U.S. Department of Commerce, Bureau of Economic Analysis (BEA) and Census Bureau.

In June, exports rose 4 percent, supported by strength in exports of industrial supplies (particularly petroleum products), agricultural products, and capital goods. Exports of automotive products were pushed up by increased shipments of trucks to Canada, while strong exports of pharmaceutical products boosted consumer goods. Exports of services also climbed.

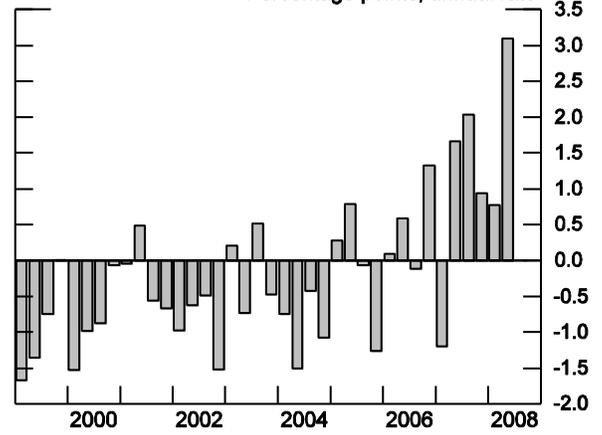
The value of exports in the second quarter increased 23¼ percent at an annual rate. Strong growth was recorded across most major categories; exports of industrial supplies and agricultural products were particularly robust. In real terms, exports rose 13¼ percent in the second quarter, contributing 1.6 percentage points to U.S. real GDP growth.

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

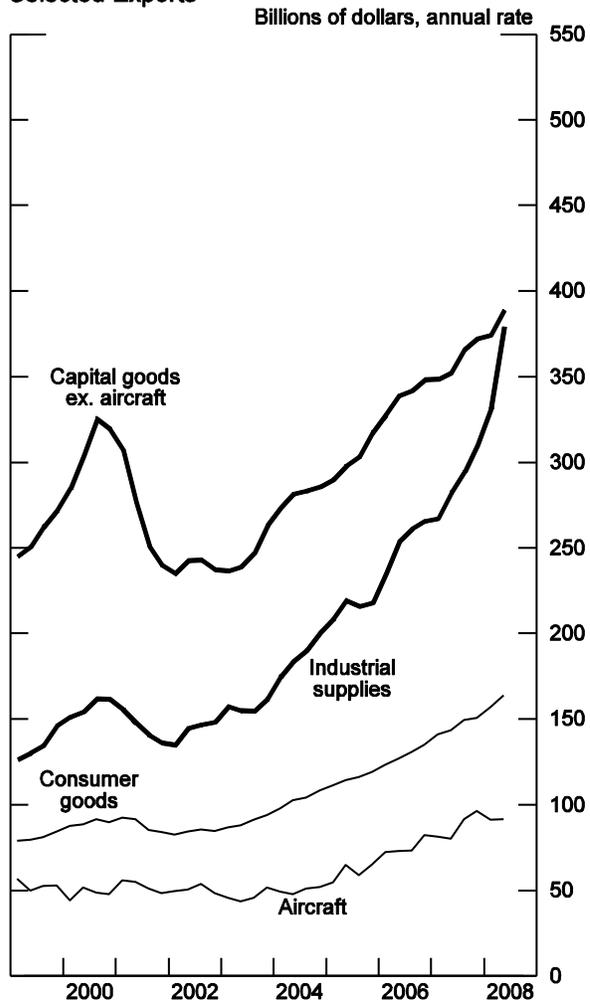
Trade Balance



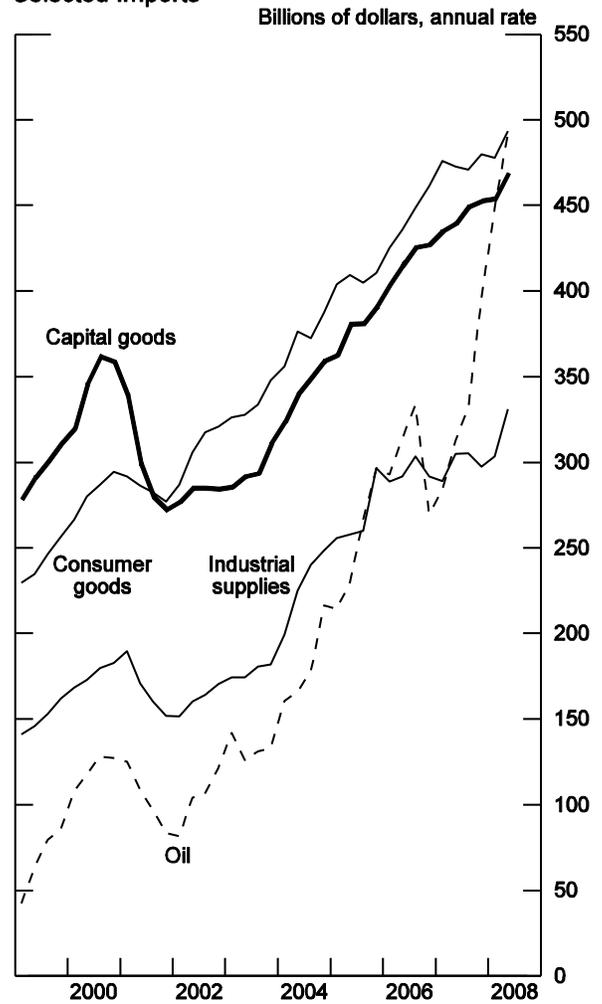
Contribution of Net Exports to Growth of Real Gross Domestic Product



Selected Exports



Selected Imports



Source. Bureau of Economic Analysis and Census Bureau.

U.S. Exports and Imports of Goods and Services
(Billions of dollars; annual rate, Balance of Payments basis)

	Levels				Change ¹			
	2008		2008		2008		2008	
	Q1	Q2	May	June	Q1	Q2	May	June
Exports of Goods and Services	1817.1	1914.4	1896.4	1973.0	75.2	97.3	22.5	76.6
Goods exports	1271.3	1351.0	1332.0	1400.4	58.5	79.8	11.3	68.4
Gold	24.6	19.0	19.3	13.3	12.6	-5.6	-5.4	-6.0
Other goods	1246.6	1332.0	1312.7	1387.2	45.9	85.3	16.6	74.4
Capital goods	466.2	480.7	473.3	487.5	-2.7	14.6	-8.1	14.3
Aircraft & parts	91.3	91.4	91.6	91.4	-5.0	.1	.4	-.3
Computers & accessories	43.2	47.2	47.0	46.9	-1.3	3.9	-.7	-.1
Semiconductors	52.3	51.3	50.3	53.4	-.9	-1.0	.0	3.1
Other capital goods	279.3	290.9	284.4	295.9	4.5	11.5	-7.8	11.5
Automotive	122.4	124.2	122.6	129.5	-3.4	1.8	2.2	6.9
Ind. supplies (ex. ag., gold)	332.5	379.9	375.4	412.6	22.1	47.4	23.7	37.1
Consumer goods	156.9	164.0	161.1	169.7	6.4	7.0	-.0	8.7
Agricultural	117.8	130.3	125.0	137.1	15.0	12.5	-3.9	12.1
All other goods	50.8	53.0	55.4	50.7	8.4	2.1	25.4	-4.7
Services exports	545.8	563.4	564.4	572.6	16.7	17.5	11.3	8.1
Imports of Goods and Services	2516.8	2620.3	2606.8	2654.2	79.8	103.5	7.0	47.4
Goods imports	2115.4	2211.4	2197.3	2240.8	67.0	96.0	1.2	43.5
Oil	448.7	491.7	466.1	534.3	52.6	43.0	-8.4	68.2
Gold	17.9	12.7	9.6	9.7	10.9	-5.2	-9.2	.1
Other goods	1648.8	1707.0	1721.6	1696.8	3.6	58.2	18.9	-24.9
Capital goods	454.4	469.2	477.4	460.9	1.3	14.8	8.0	-16.4
Aircraft & parts	37.0	38.1	35.7	39.4	1.9	1.1	-3.5	3.7
Computers & accessories	104.2	109.4	113.7	106.3	-1.2	5.1	5.6	-7.4
Semiconductors	26.3	26.8	27.4	25.7	-.7	.6	-.0	-1.7
Other capital goods	286.9	294.9	300.6	289.6	1.4	8.1	6.0	-11.0
Automotive	257.3	249.9	245.7	246.4	-2.7	-7.4	-12.0	.7
Ind. supplies (ex. oil, gold)	303.6	330.9	332.5	331.4	6.1	27.4	3.6	-1.2
Consumer goods	478.2	493.2	502.1	495.2	-1.9	15.0	19.7	-6.9
Foods, feeds, beverages	85.4	90.1	91.7	90.0	1.7	4.7	3.1	-1.7
All other goods	69.9	73.7	72.3	73.0	-1.1	3.8	-3.7	.7
Services imports	401.4	408.9	409.5	413.5	12.8	7.5	5.8	3.9
Memo:								
Oil quantity (mb/d)	14.06	12.41	11.77	12.36	.59	-1.64	-1.37	.59
Oil import price (\$/bbl)	87.59	108.56	108.44	118.36	7.17	20.97	9.55	9.92

1. Change from previous quarter or month.

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

The value of imports of goods and services rose 1.8 percent in June, as a strong increase in imports of oil (both on account of higher volumes as well as an increase in price) more than offset a sharp decline in non-oil goods. Imports of capital goods fell, as computers slipped back after surging in May and other capital goods were weak. Imports of consumer goods declined despite a jump in pharmaceutical products, whereas industrial supplies and automotive products were flat. Services increased moderately.

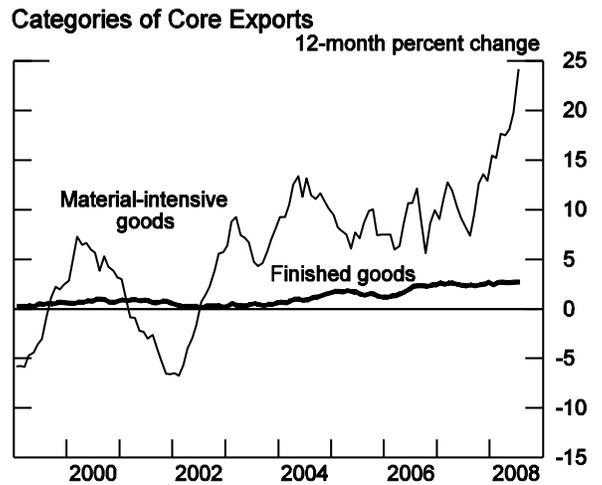
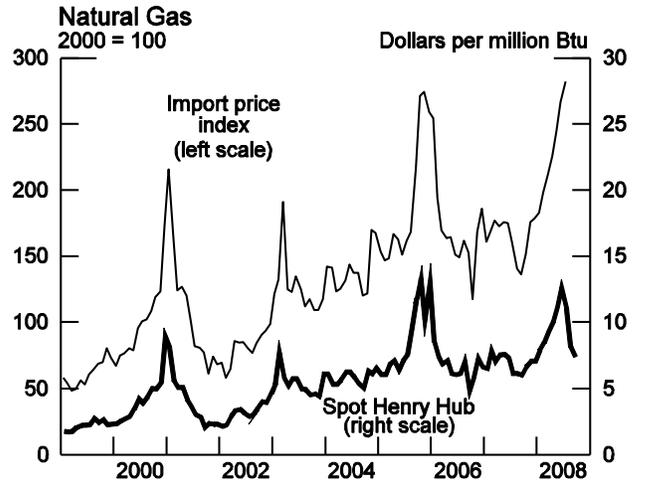
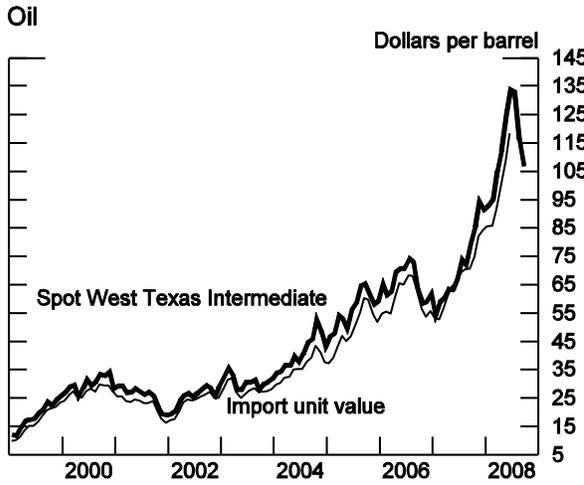
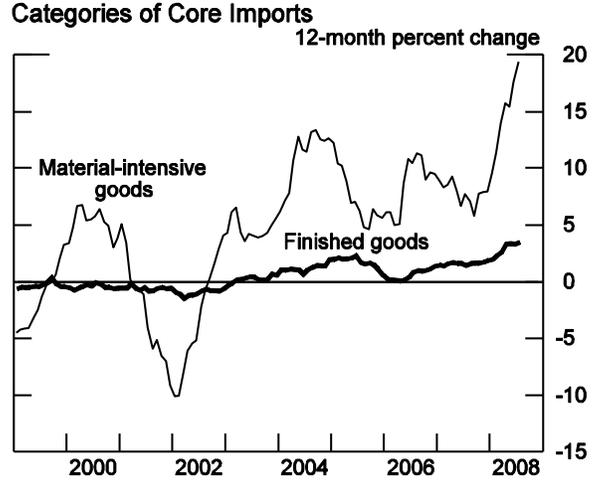
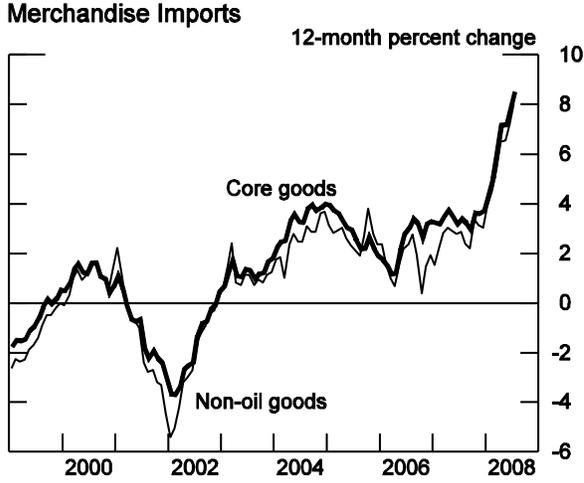
The value of imports in the second quarter increased 17½ percent at an annual rate, led by an increase in oil imports, as an increase in the price of imported oil more than offset a decline in the volume. In real terms, however, imports contracted 7½ percent, resulting in a positive contribution to U.S. real GDP growth of 1.4 percentage points.

Prices of Internationally Traded Goods

Non-oil imports. In July, for the second consecutive month, prices of core imports rose 0.9 percent. Compared with the June increase, July's rise featured a relatively large contribution from finished goods, mostly reflecting a 0.8 percent increase in the prices for capital goods excluding computers and semiconductors. Prices for consumer goods also accelerated, increasing 0.3 percent in July following 0.1 percent in June. As in previous months most of the increase in the prices of core goods was due to material-intensive goods; prices for these goods increased 1.8 percent in July following 2.4 percent in June. Higher prices for chemicals and steel and iron products more than offset falling prices for nonferrous metals. Higher prices for meat and vegetables also contributed to the increase.

Oil. The BLS price index for imported oil rose 4 percent in July, amid considerable volatility in underlying spot prices. The spot price of West Texas intermediate (WTI) crude oil surged to \$145 per barrel in mid July but then reversed course, leaving the monthly average price for July unchanged from June's \$133 per barrel. Oil prices have fallen from an average of \$117 in August to \$103.26 as of September 9. The rapid fall in oil prices that has occurred since mid-July appears to reflect a continued weakening of the outlook for global oil demand as well as increases in supply. Part of this increase stems from Saudi Arabia, which raised crude production for the third consecutive month.

Prices of U.S. Imports and Exports



Source. Bureau of Labor Statistics, Wall Street Journal, and Commodity Research Bureau.

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

	Annual rate			Monthly rate		
	2007	2008		2008		
	Q4	Q1	Q2	May	June	July
	----- BLS prices -----					
Merchandise imports	16.3	15.4	36.3	2.8	2.9	1.7
Oil	73.6	44.3	150.3	9.6	8.9	4.0
Non-oil	4.6	8.4	12.6	.6	.9	.9
Core goods ¹	3.7	9.5	13.8	.6	.9	.9
Finished goods	2.0	3.9	5.7	.2	.1	.4
Cap. goods ex. comp. & semi.	2.5	4.1	8.5	.4	.2	.8
Automotive products	4.7	3.9	2.3	.0	.1	.1
Consumer goods	1.8	4.5	4.9	.2	.1	.3
Material-intensive goods	7.6	22.1	32.1	1.3	2.4	1.8
Foods, feeds, beverages	10.3	17.7	18.9	.9	1.7	1.5
Industrial supplies ex. fuels	6.8	23.1	35.5	1.5	2.6	1.8
Computers	-2.7	-10.6	-4.1	-.4	-.9	-.7
Semiconductors	1.6	-7.3	-5.2	1.0	-1.3	-.8
Natural gas	78.5	88.2	138.9	8.2	9.1	5.8
Merchandise exports	7.7	12.6	10.2	.3	1.0	1.4
Core goods ²	9.1	15.4	12.2	.5	1.2	1.9
Finished goods	2.6	3.7	2.7	.2	.1	.3
Cap. goods ex. comp. & semi.	3.1	5.8	4.0	.3	.2	.3
Automotive products	1.3	1.6	1.9	.0	.0	.1
Consumer goods	2.4	2.8	2.1	.0	.1	.4
Material-intensive goods	17.5	30.1	23.2	.8	2.3	3.6
Agricultural products	40.9	58.1	14.6	.2	2.4	6.7
Industrial supplies ex. ag.	11.2	21.9	26.9	1.1	2.2	2.6
Computers	-3.9	-10.3	-9.1	-.6	-.8	-1.1
Semiconductors	1.0	.6	-1.2	-.4	2.4	-2.3
	----- NIPA prices -----					
Chain price index						
Imports of goods & services	12.8	12.8	28.5	...	...	...
Non-oil merchandise	4.6	8.0	11.0	...	...	...
Core goods ¹	4.0	8.5	10.6	...	...	...
Exports of goods & services	6.2	9.1	10.9	...	...	...
Total merchandise	6.0	10.0	12.6	...	...	...
Core goods ²	7.6	12.0	14.2	...	...	...

1. Excludes computers, semiconductors, and natural gas.

2. Excludes computers and semiconductors.

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

BLS Bureau of Labor Statistics.

NIPA National Income and Product Accounts.

Source. Bureau of Economic Analysis and Bureau of Labor Statistics.

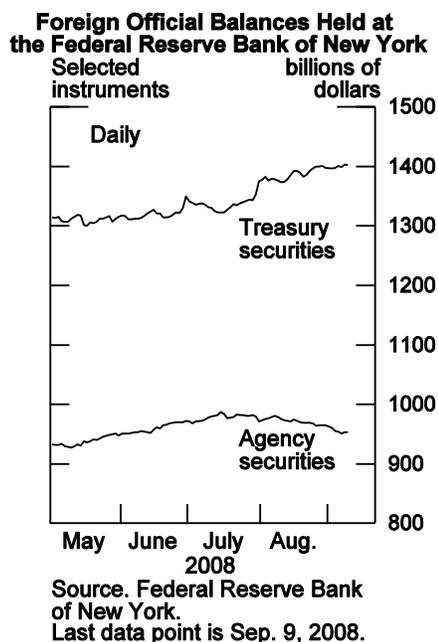
This apparent easing of the global oil balance has more than offset any upward price pressure stemming from increased geopolitical tensions due to the conflict between Russia and Georgia, as well as tropical storm activity in the Gulf of Mexico.

Exports. Core export prices rose 1.9 percent in July. Almost all of the increase was due to higher prices for material-intensive goods. Prices for agricultural products soared 6.7 percent in July, reflecting sharp price increases for corn and soybeans. Prices for nonagricultural industrial supplies rose 2.6 percent, supported by higher prices for fuels and chemicals. After increasing 0.1 percent in June, prices for finished goods rose 0.3 percent in July.

U.S. International Financial Transactions

Since the July/August Greenbook, we have received data on U.S. international financial transactions for June and July, along with partial and confidential data on custody accounts at the Federal Reserve Bank of New York (FRBNY) through early September.

After slowing sharply in the second half of 2007, foreign official flows into the United States surged during the first half of 2008 (line 1 of the Summary of U.S. International Financial Transactions table and the chart on Foreign Official Financial Flows). As market attention increasingly focused on concerns about Fannie Mae and Freddie Mac, official investors slightly reduced their holdings of agency securities in July. However, these outflows from agency securities were more than offset by inflows into Treasury and other short-term securities. All told, foreign official inflows were on trend in July, registering \$41 billion, with nearly all coming from China, Russia, and members of the Organization of Petroleum Exporting Countries. Data on custody accounts at FRBNY indicate that official holdings of agency securities continued to decline through early September, even as holdings of Treasuries continued to rise (see inset chart). In the two days following the announcement that Fannie Mae and Freddie Mac would be placed into conservatorship, foreign official holdings of agency securities at FRBNY increased slightly, but it is too early to tell if this signals a return to previous trends.



Foreign private net purchases of U.S. securities have continued to slow since the financial turmoil began in mid-2007 and were weak in the first half of 2008, averaging about half of those recorded in the second half of 2007 (line 4 of the Summary of U.S. International Financial Transactions table; see also the chart on Private Securities Flows). Foreign private investors have been selling agency bonds since March, but the pace accelerated in July to a record \$51 billion (line 4b). There were also small outflows from net foreign private sales of corporate and municipal bonds and corporate stocks (lines 4c and 4d), but these were mostly offset by net purchases of Treasury securities (line 4a). Overall, private foreign net sales of U.S. securities in July resulted in a record outflow of \$53 billion (line 4).

Since early 2007, financial outflows associated with U.S. private investors' net acquisitions of foreign securities have been decreasing on average (bottom left panel of the chart). In July U.S. private investors sold, on net, \$30 billion of foreign securities (line 5), which resulted in an inflow.

The volatile banking sector (line 3) registered an inflow of \$21 billion in June, which was followed by a large outflow of \$83 billion in July. Most of the outflow in July was due to decreased funding from affiliated branches in the Caribbean.

Complete U.S. balance of payments data for the second quarter will not be published until September 17. However, some partial data have come in, including changes in quarterly reported custody holdings. These data (which will be included in line 10 of the table) indicate a further \$50 billion in inflows during the second quarter, primarily the result of a decrease in U.S. residents' deposits in the Caribbean.

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

	2006	2007	2007		2008			
			Q3	Q4	Q1	Q2	June	July
Official financial flows	487.2	362.6	6.1	115.7	168.1	94.8	50.4	41.2
1. Change in foreign official assets in the U.S. (increase, +)	484.8	386.7	6.2	139.7	165.3	137.0	50.6	41.2
a. G-10 countries + ECB	26.1	36.8	3.3	11.8	-1.5	0.2	7.4	-1.8
b. OPEC	45.2	30.9	2.8	16.3	18.1	16.7	5.1	6.7
c. All other countries	413.5	319.1	0.1	111.5	148.8	120.1	38.1	36.2
2. Change in U.S. official assets (decrease, +) ¹	2.4	-24.1	-0.1	-24.0	2.7	-42.3	-0.2	0.0
Private financial flows	351.9	411.7	95.8	97.8	-43.7	n.a.	...	...
Banks								
3. Change in net foreign positions of banking offices in the U.S. ²	122.7	-98.5	-49.9	-38.3	-145.9	-69.1	20.6	-82.6
Securities³								
4. Foreign net purchases (+) of U.S. securities	634.2	750.5	32.5	190.9	46.7	67.4	-12.5	-52.9
a. Treasury securities	-58.2	156.6	60.5	66.7	64.7	55.8	1.1	10.7
b. Agency bonds	25.8	19.4	-2.6	16.4	-18.4	-52.1	-10.0	-50.7
c. Corporate and municipal bonds	517.8	383.5	-7.3	49.4	-10.7	53.5	-1.3	-6.2
d. Corporate stocks ⁴	148.9	191.1	-18.1	58.4	11.1	10.2	-2.3	-6.6
5. U.S. net acquisitions (-) of foreign securities	-362.4	-287.2	-99.2	-4.7	-35.2	-30.3	-11.0	30.0
a. Bonds	-224.5	-168.0	-42.6	-13.6	-7.8	-10.4	-11.5	12.9
b. Stock purchases	-119.1	-107.9	-52.1	11.5	-26.7	-19.9	0.5	17.0
c. Stock swaps ⁴	-18.8	-11.3	-4.5	-2.6	-0.8	0.0	0.0	0.0
Other flows⁵								
6. U.S. direct investment (-) abroad	-241.2	-333.3	-62.0	-110.9	-85.6	n.a.	...	...
7. Foreign direct investment in the U.S.	242.0	237.5	105.9	55.7	46.6	n.a.	...	...
8. Net derivatives (inflow, +)	29.7	6.5	5.9	-13.5	-8.0	n.a.	...	...
9. Foreign acquisitions of U.S. currency	2.2	-10.7	0.7	-3.5	-0.9	n.a.	...	...
10. Other (inflow, +) ⁶	-75.3	146.8	161.9	22.0	138.6	n.a.	...	...
U.S. current account balance⁷	-788.1	-731.2	-173.0	-167.2	-176.4	n.a.	...	...
Capital account balance⁸	-3.9	-1.8	-0.6	-0.6	-0.6	n.a.	...	...
Statistical discrepancy⁷	-47.1	-41.3	71.6	-45.6	52.6	n.a.	...	...

Source: U.S. Department of Commerce, Bureau of Economic Analysis; U.S. Treasury International Capital reports with staff adjustments.

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. Includes changes in U.S. official reserve assets and in outstanding reciprocal currency swaps with certain foreign central banks.

2. 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.

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

4. Includes (4d) or represents (5c) stocks acquired through nonmarket means such as mergers and reincorporations.

5. Quarterly data; seasonally adjusted.

6. 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 and 8) since publication of the quarterly data in the Survey of Current Business.

7. Seasonally adjusted.

8. Seasonally adjusted; consists of transactions in nonproduced nonfinancial assets and capital transfers.

G-10 Group of Ten (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, United Kingdom, United States).

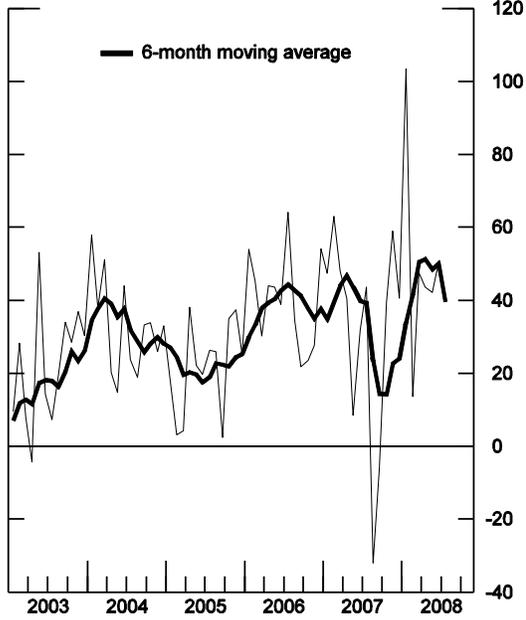
ECB European Central Bank.

OPEC Organization of the Petroleum Exporting Countries.

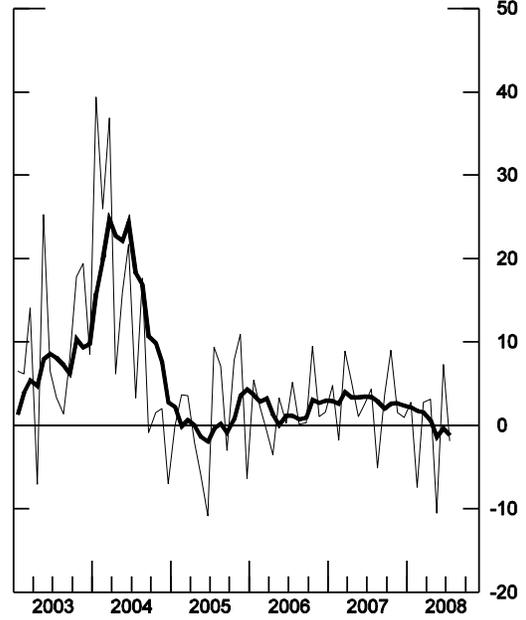
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Foreign Official Financial Inflows (+) through July 2008
 (Billions of dollars; monthly rate, not seasonally adjusted)

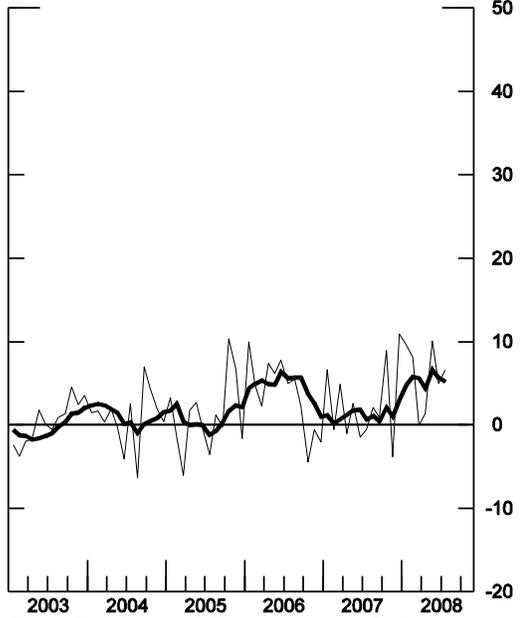
Total



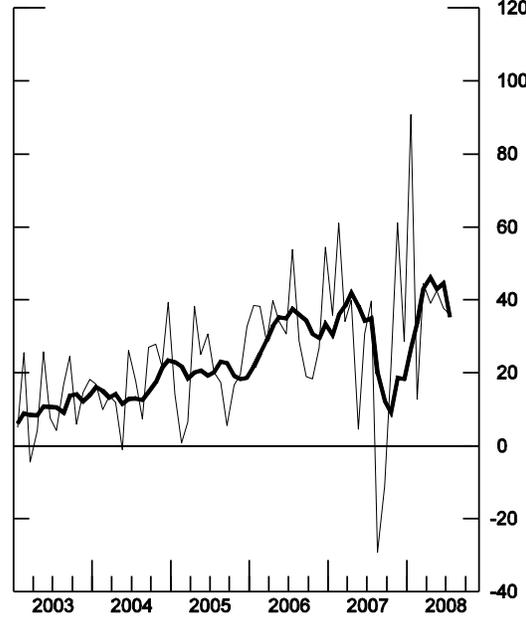
Group of Ten + European Central Bank



Organization of the Petroleum Exporting Countries



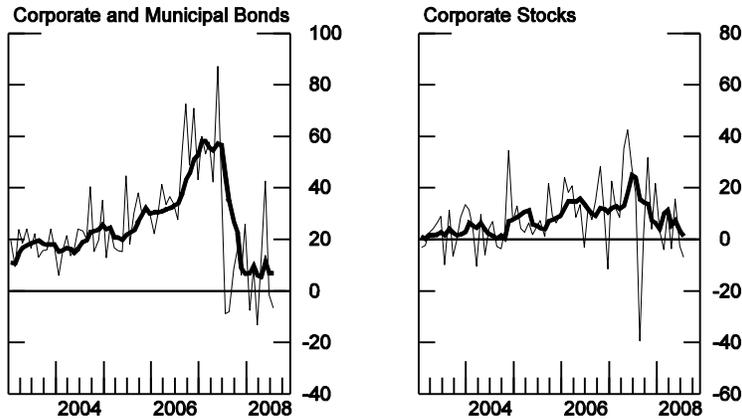
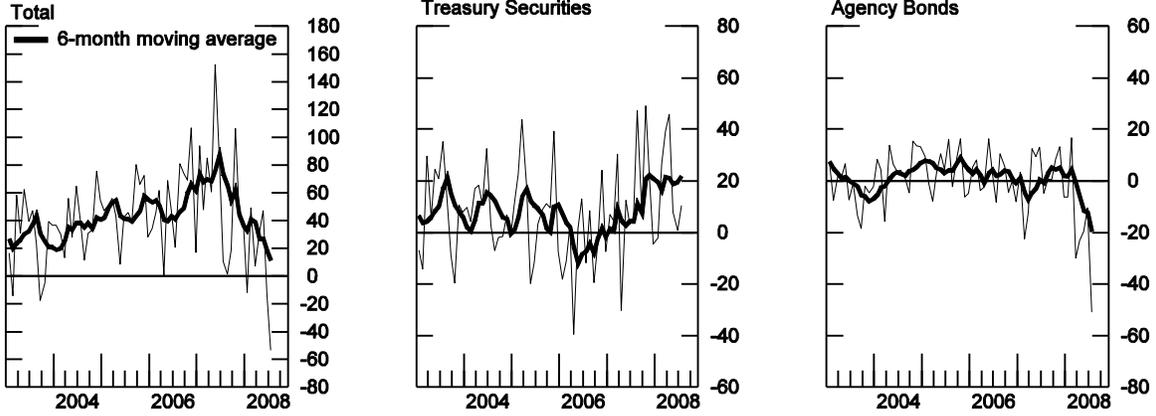
All other countries



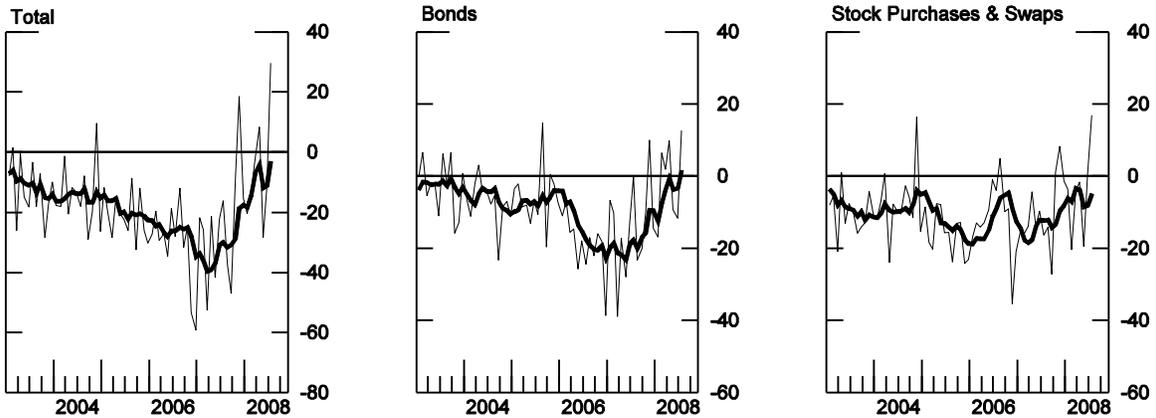
Source. For all figures, U.S. Treasury International Capital reports with staff adjustments.

Private Securities Flows through July 2008
 (Billions of dollars; monthly rate, not seasonally adjusted)

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



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



Source. For all figures, U.S. Treasury International Capital reports with staff adjustments.

Foreign Financial Markets

The dollar has appreciated sharply since the time of the last Greenbook in accordance with the deterioration of the foreign economic outlook. The major currencies index increased by 6½ percent, with the dollar gaining over 12 percent against sterling and 10 percent against the euro after the release of weaker-than-expected macroeconomic data for Europe and the news of downward adjustments to the growth forecasts of the Bank of England (BoE), the European Central Bank (ECB), and the Organisation for Economic Co-operation and Development (OECD). The appreciation of the dollar against the yen has been modest.

Despite gloomier growth expectations, the BoE and the ECB left their policy rates unchanged over the period, citing concerns about inflation being well above target. Medium-term policy expectations have declined, however, since the July/August Greenbook, especially for the Bank of England. The twelve month sterling overnight index swap (OIS) rate has declined by 44 basis points. The comparable euro rate declined only 17 basis points amid statements by several ECB Governing Council Members that some of these expectations are premature due to continued inflationary pressures. In line with expected easing by central banks, sovereign bond yields have declined since the end of July, reflecting declines both in real rates and in expected inflation. Ten-year inflation compensation has declined by roughly 20 basis points in the euro area and 10 basis points in the United Kingdom. Inflation compensation in Japan has declined as well, by 15 basis points.

Conditions in money markets deteriorated somewhat since the time of the last Greenbook. Spreads between three-month sterling Libor and OIS rates increased by 11 basis points, likely driven at least in part by the worsening economic outlook for the United Kingdom. U.K. housing prices have continued to fall, and Moody's downgraded \$3.6 billion of nonconforming U.K. residential mortgage-backed securities in August due to rising delinquencies. The United Kingdom's financial regulator, the Financial Services Authority, also fined Credit Suisse for incorrect securities valuations in mid-August and announced that next year it will start probing "a large number" of London banks for similar problems. Euro Libor to OIS spreads increased only modestly. The demand for dollar funding in continental Europe still appears to be substantial. The initial 84-day U.S. dollar auctions of the ECB and the Swiss National Bank (SNB), held in conjunction with the 84-day Term Auction Facility (TAF) auctions by the Federal Reserve, were substantially oversubscribed. The ECB and SNB also held three 28-day auctions during the period, and these drew substantial bids as well. On concern that some

European financial institutions might be taking advantage of the ECB's broad collateral rules, the ECB announced several changes to its rules. These changes are scheduled to take effect in February 2009.

Apparently reflecting the same concerns about weakening growth abroad that boosted the major currencies index of the dollar, the dollar rose nearly 4 percent against the currencies of our other important trading partners. Currencies throughout the emerging markets declined, most notably the Brazilian *real* and the Korean won, which are 13¾ percent and 8¼ percent lower against the dollar, respectively, since the previous Greenbook. The renminbi, however, depreciated only modestly against the dollar. These depreciations occurred in spite of the fact that the central banks of Indonesia, Israel, Korea, Mexico, Philippines, Thailand, and Vietnam tightened policy in an attempt to curb mounting inflation. A number of countries, including Russia, Korea, and Indonesia, are believed to have intervened in foreign exchange markets to support their currencies in the face of downward pressures.

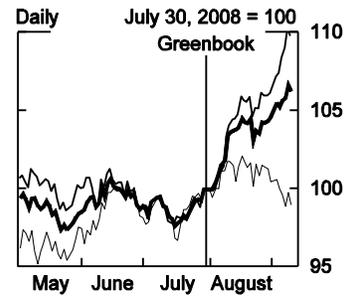
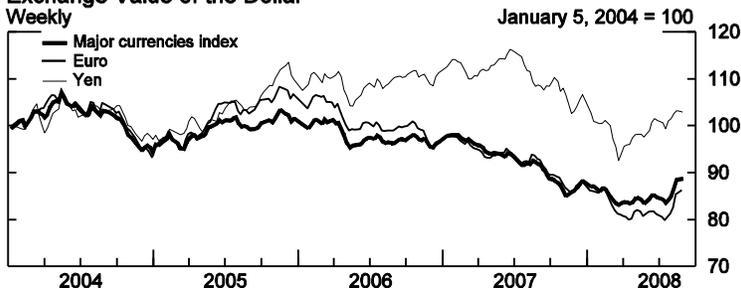
Despite the fact that stock markets rallied after the Treasury Department's actions regarding Fannie Mae and Freddie Mac, equity prices around the world have, on net, declined since the July/August Greenbook. The Dow Jones Eurostoxx index declined by 2½ percent whereas the Nikkei index lost over 7 percent. The Shanghai composite index fell by as much as 24 percent. Financial stocks in the euro area have risen slightly over this period. European banks reported second-quarter write-downs totaling around \$40 billion, although earnings reports in early August were better than had been expected.

Exchange Value of the Dollar and Stock Market Indexes

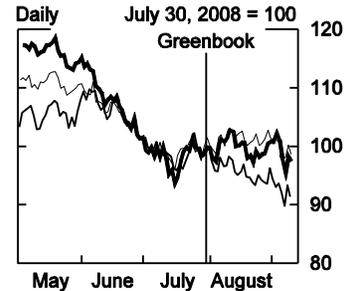
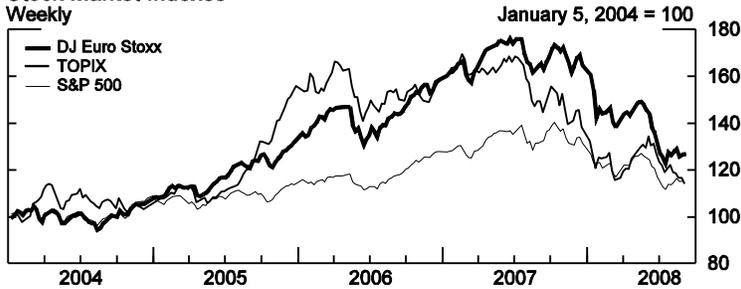
	Latest	Percent change since July Greenbook
<i>Exchange rates*</i>		
Euro (\$/euro)	1.4173	9.8
Yen (¥/\$)	107.1	-1.0
Sterling (\$/£)	1.7672	12.1
Canadian dollar (C\$/\\$)	1.0677	4.3
<i>Nominal dollar indexes*</i>		
Broad index	100.5	4.9
Major currencies index	76.3	6.3
OITP index	125.8	3.6
<i>Stock market indexes</i>		
DJ Euro Stoxx	308.8	-2.3
TOPIX	1191.6	-8.5
FTSE 100	5415.6	-0.1
S&P 500	1248.2	-1.2

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

Exchange Value of the Dollar
Weekly



Stock Market Indexes
Weekly

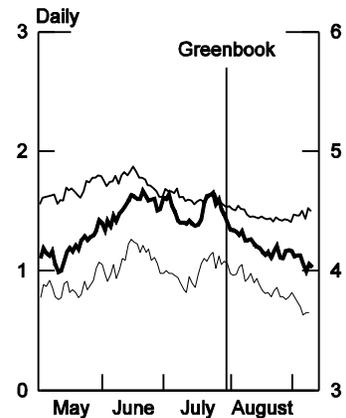
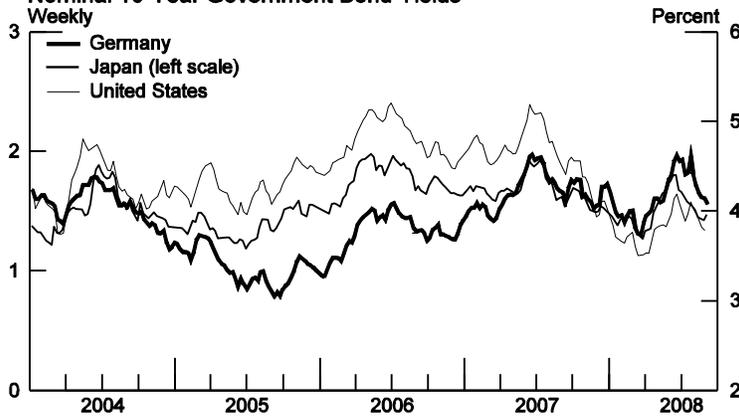


Industrial Countries: Nominal and Real Interest Rates

	3-month Libor		10-year nominal		10-year indexed		Percent
	Latest	Change since July Greenbook	Latest	Change since July Greenbook	Latest	Change since July Greenbook	
Germany	4.96	-0.01	4.04	-0.37	1.92	-0.19	
Japan	0.90	-0.01	1.50	-0.04	1.28	0.12	
United Kingdom	5.73	-0.06	4.44	-0.41	1.00	-0.45	
Canada	3.45	0.16	3.46	-0.33	...	...
United States	2.82	0.02	3.66	-0.43	1.74	-0.05	

... Not applicable.
 Libor London interbank offered rate.

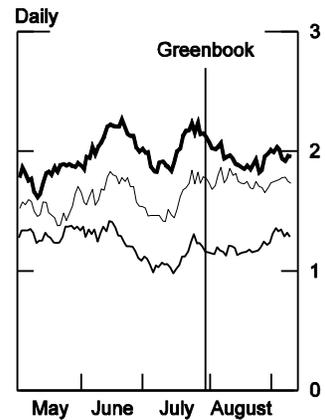
Nominal 10-Year Government Bond Yields
 Weekly



Inflation-Indexed 10-Year Government Bond Yields
 Weekly

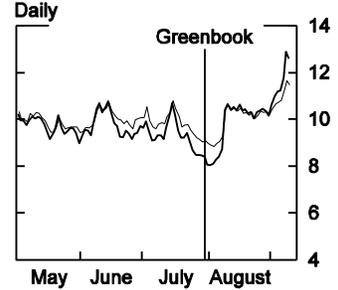
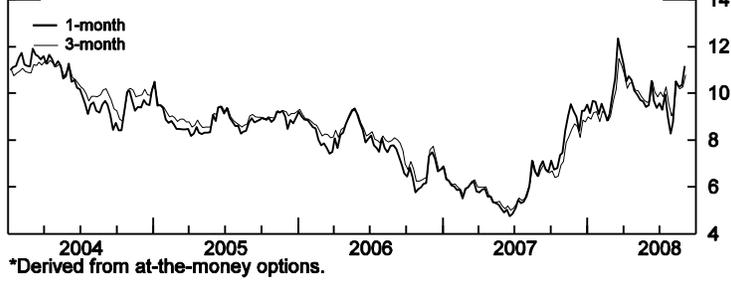


*Japan first issued inflation-indexed debt in March 2004.

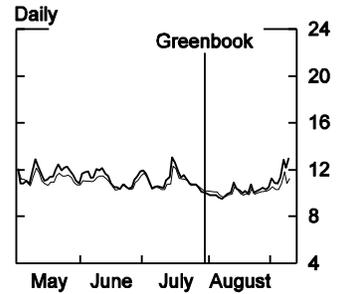
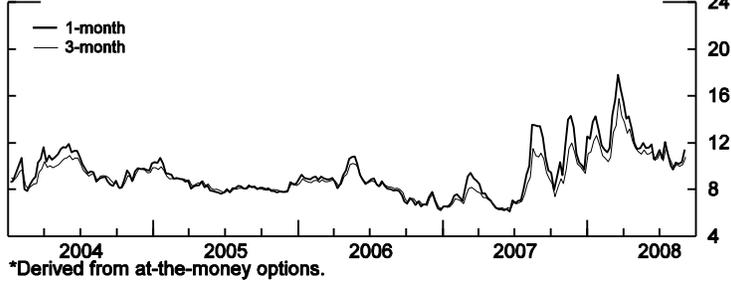


Measures of Market Volatility

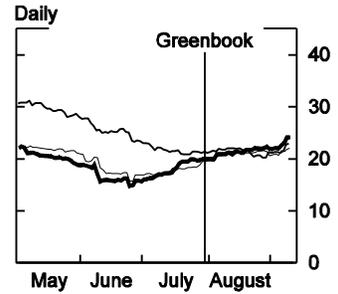
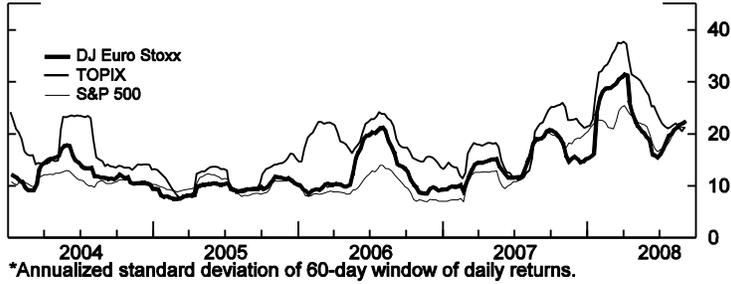
Dollar-Euro Options-Implied Volatility*
Weekly



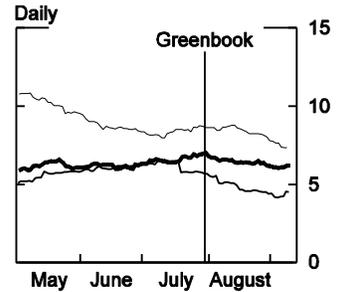
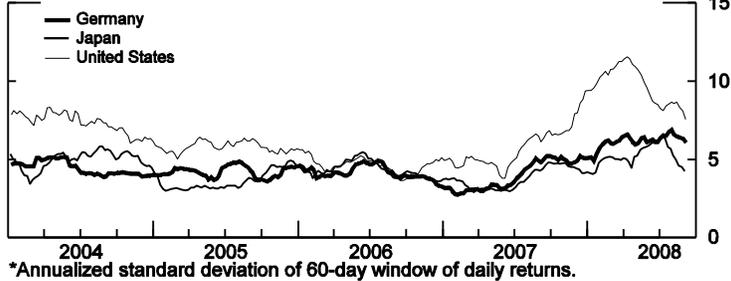
Yen-Dollar Options-Implied Volatility*
Weekly



Realized Stock Market Volatility*
Weekly



Realized 10-Year Bond Volatility*
Weekly

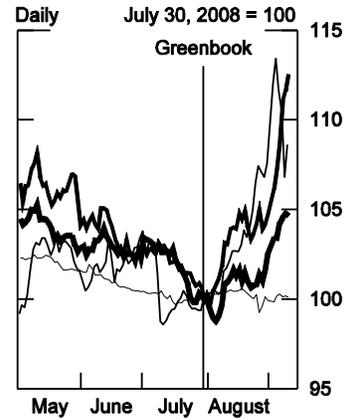
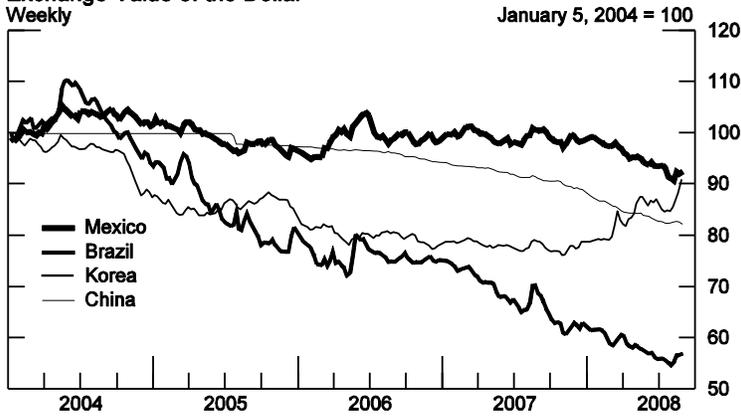


Emerging Markets: Exchange Rates and Stock Market Indexes

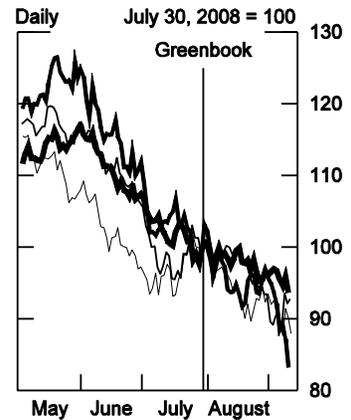
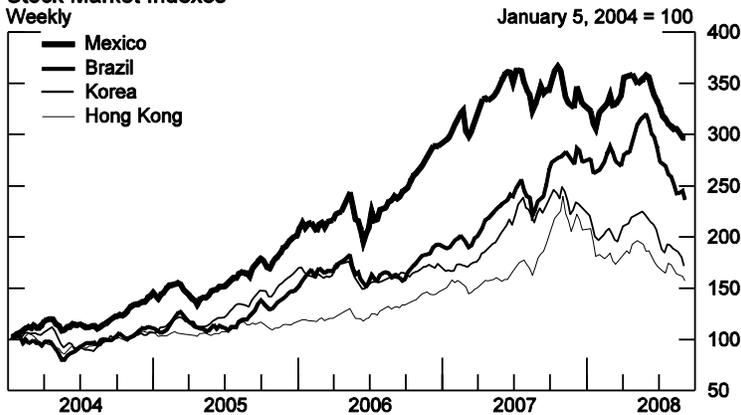
	<u>Exchange value of the dollar</u>		<u>Stock market index</u>	
	Latest	Percent change since July Greenbook*	Latest	Percent change since July Greenbook
Mexico	10.5070	4.7	25630	-6.2
Brazil	1.7569	12.6	48435	-16.6
Venezuela	2.14	-0.0	40606	2.8
China	6.8381	0.2	2151	-24.2
Hong Kong	7.7977	-0.1	20000	-11.9
Korea	1099.5	8.6	1465	-7.1
Taiwan	31.86	4.1	6458	-8.7
Singapore	1.4323	4.7	940	-0.0
Thailand	34.47	2.9	656	-2.1

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

Exchange Value of the Dollar
Weekly



Stock Market Indexes
Weekly



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

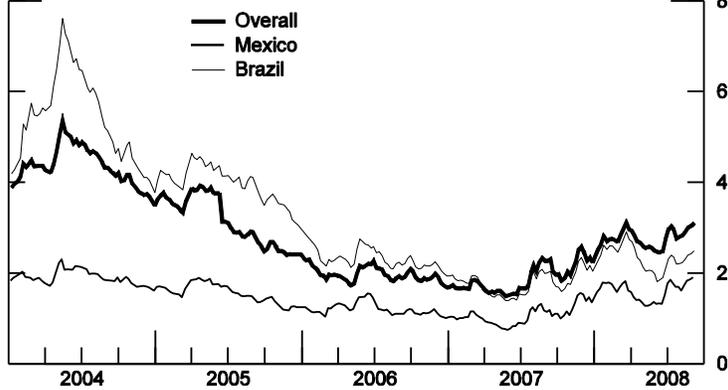
	Short-term interest rates*		Dollar-denominated bond spreads**	
	Latest	Change since July Greenbook	Latest	Change since July Greenbook
Mexico	8.19	0.37	2.04	0.35
Brazil	14.06	0.95	2.71	0.54
Argentina	13.00	-0.13	7.54	1.43
China	...	...	1.84	0.40
Korea	5.35	0.25	...	...
Taiwan	2.61	0.02	...	...
Singapore	1.00	0.25	...	...
Hong Kong	1.86	-0.06	...	...

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

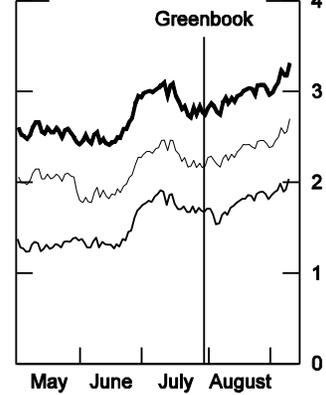
**EMBI+ Spreads or EMBI Global Spreads over similar-maturity U.S. Treasury securities.

... Not applicable. Korea, Taiwan, and Hong Kong have no outstanding dollar-denominated sovereign bonds.

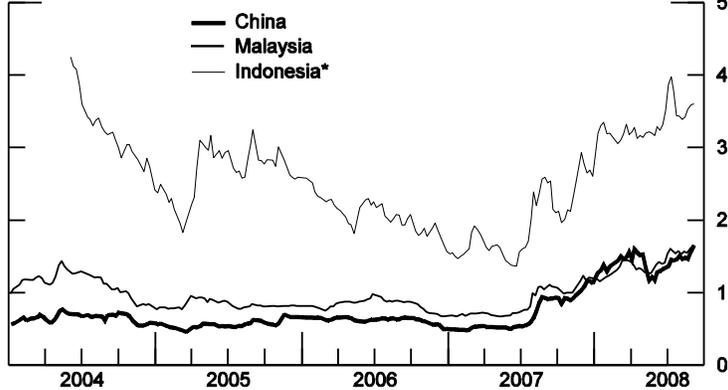
EMBI+ Spreads
Weekly



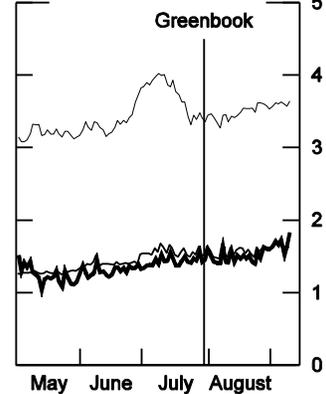
Daily



EMBI Global Spreads
Weekly



Daily

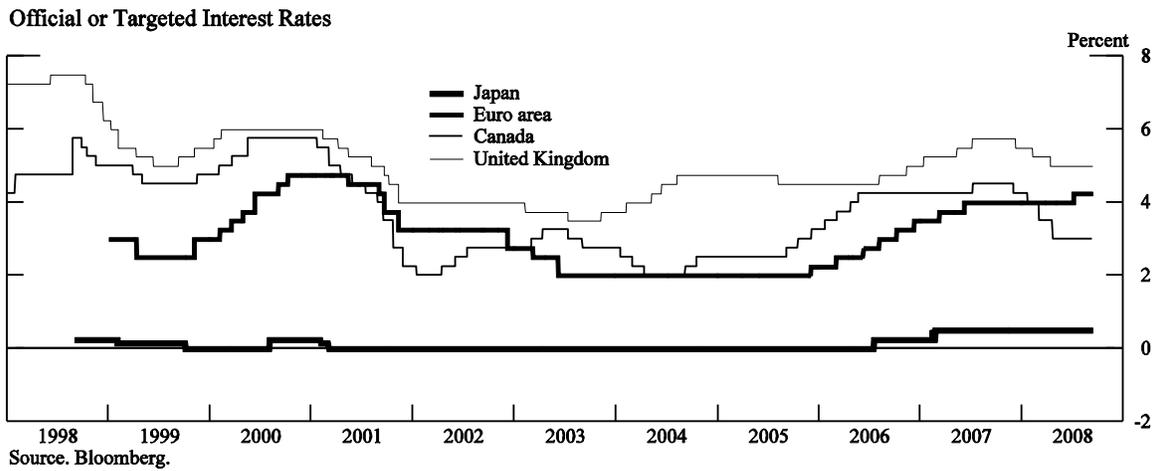
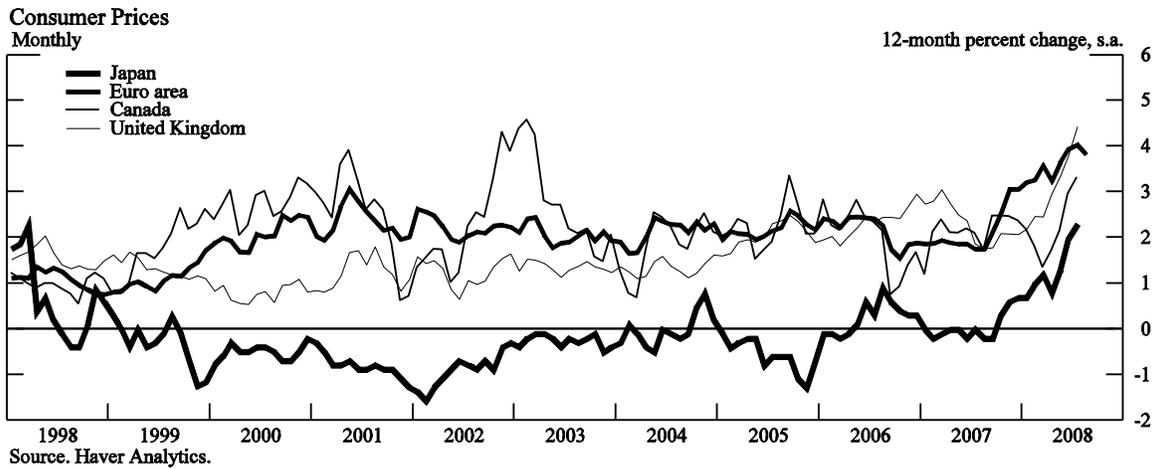
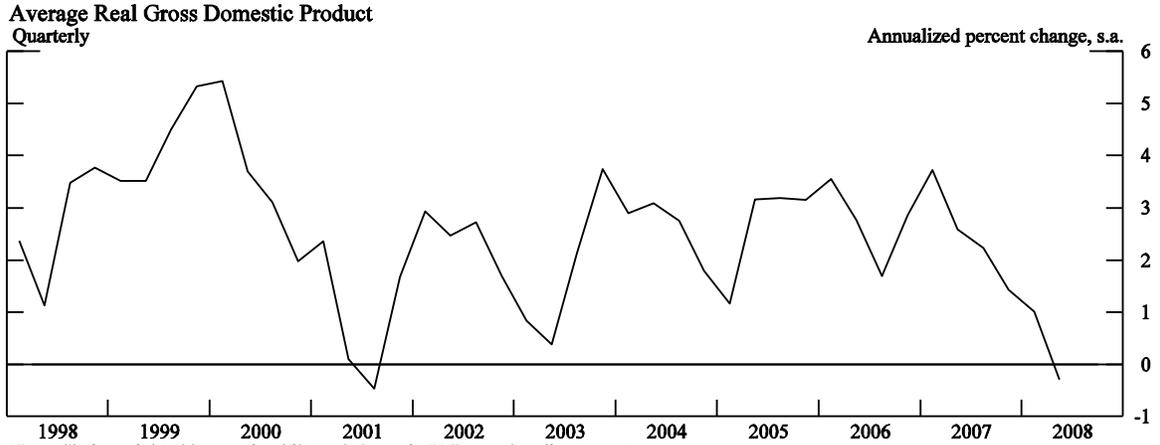


*Begins May 2004.

Developments in Advanced Foreign Economies

Economic indicators received since the last Greenbook point to marked deterioration in the pace of economic activity in the advanced foreign economies. Second-quarter GDP was flat in Canada and the United Kingdom and fell in both Japan and the euro area. The weakness in the advanced foreign economies appears to have continued into the third quarter. Confidence and survey indicators declined considerably in recent months in most of these economies. In July, employment continued to weaken in Japan, and retail sales fell in the euro area and decelerated in the United Kingdom. Headline inflation in the major advanced foreign economies stayed elevated, although it edged down in August in the euro area. Since the last Greenbook, inflation excluding food and energy was generally little changed for the major economies. No major central bank changed its policy rate during the intermeeting period.

Advanced Foreign Economies



In **Japan**, real GDP contracted 2.4 percent (a.r.) in the second quarter following a downward-revised growth rate of 3.2 percent in the first quarter. All major components of domestic demand except government consumption fell sharply. Private consumption declined almost 2 percent, and private investment contracted more than 2½ percent. Net exports also made a small negative contribution to growth.

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

Component	2006 ¹	2007 ¹	2007		2008	
			Q3	Q4	Q1	Q2
GDP	2.5	1.4	1.0	2.4	3.2	-2.4
Total domestic demand	1.9	0.0	-1.0	1.0	1.4	-2.5
Consumption	1.6	1.2	0.0	1.4	2.8	-1.9
Private investment	5.8	-3.9	-3.0	-2.6	2.3	-2.7
Public investment	-9.9	-1.5	-7.7	0.6	3.9	-19.3
Government consumption	0.1	1.4	0.3	3.4	-1.8	0.3
Inventories²	0.3	0.0	-0.1	0.2	-0.5	-0.0
Exports	6.6	10.4	11.0	11.1	14.4	-8.9
Imports	2.7	2.3	-1.2	3.3	4.8	-10.7
Net Exports²	0.6	1.3	1.8	1.3	1.7	-0.3

1. Q4/Q4

2. Percentage point contribution to GDP growth.

Source. Haver Analytics.

For the third quarter, trade data suggest a rebound in net exports. After falling sharply earlier in the year, real exports grew steadily in May, June, and July, while real imports were up only slightly over the same period. Elsewhere in the economy, recent data point to continued weakness. Industrial production rose only 0.8 percent over the 12 months ending in July, well below the 2.2 percent in the previous 12 months. Business and consumer confidence indicators have deteriorated sharply over the last year and are both at or near their 2001 lows.

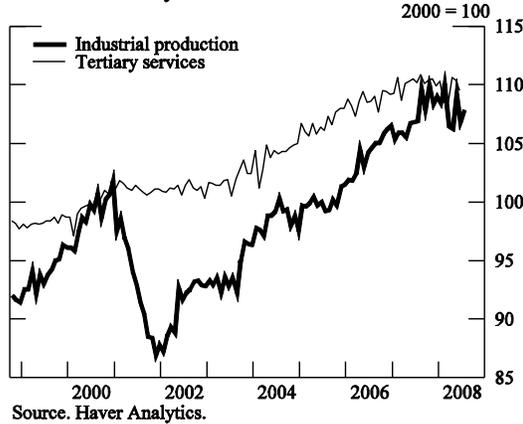
The labor market has continued to weaken. Although the unemployment rate fell back 0.1 percentage point to 4.0 percent in July, the job openings-to-applicants ratio (the number of officially posted job openings relative to the number of officially registered job seekers) declined to 0.89, its lowest level since October 2004.

Rising energy and food prices have been the primary reason for a 2.3 percent increase in Japanese consumer prices over the 12 months ending in July. Consumer prices excluding fresh food (Japan's official definition of core inflation) rose nearly as much, but prices excluding food and energy were up only 0.2 percent from last year. The timelier 12-month core CPI inflation for Tokyo slowed from 1.6 percent in July to 1.3 percent in August.

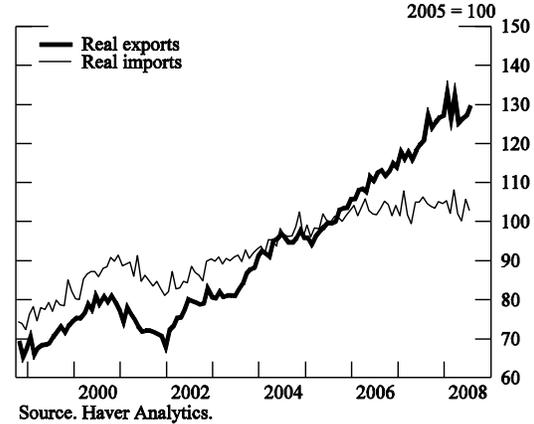
On August 29, the Japanese government announced a \$106 billion stimulus package in response to the weakening economy. Although details remain sketchy, the bulk of the stimulus is likely to be allotted to loan guarantees to small and medium-sized enterprises. However, the stimulus is likely too small to have a substantial impact on Japan's economy. Japan's Prime Minister Fukuda announced his resignation on September 1 in an effort to break political deadlock. His party, the Liberal Democratic Party, has called an election for September 22.

Japan

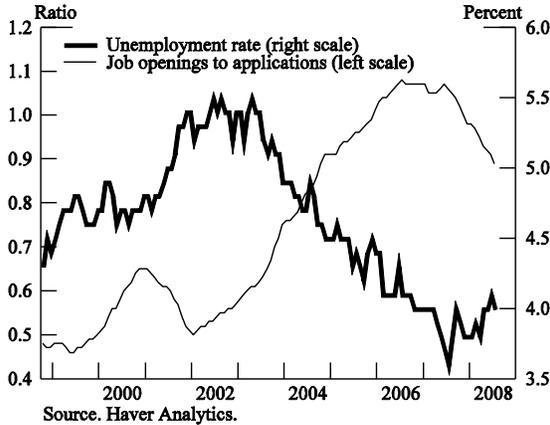
Economic Activity



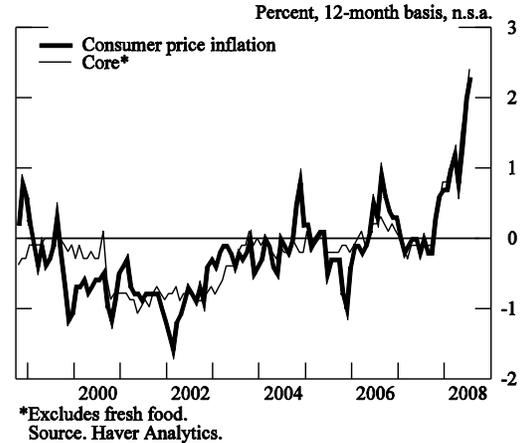
Real Trade



Labor Market



Consumer Price Inflation



Economic Indicators
(Percent change from previous period except as noted; seasonally adjusted)

Indicator	2007	2008		2008			
	Q4	Q1	Q2	May	June	July	Aug.
Housing starts	18.1	19.6	-2.1	-6.8	5.4	1.2	n.a.
Machinery orders ¹	0.6	2.2	0.6	10.4	-2.6	n.a.	n.a.
Household expenditures	0.6	0.7	-3.3	-0.9	1.5	0.9	n.a.
New car registrations	3.8	-1.8	-2.1	-10.7	0.4	7.4	-10.9
Business sentiment ²	2.0	-4.0	-7.0	...	...	...	...
Wholesale prices ³	2.4	3.5	4.8	4.7	5.7	7.3	7.2

1. Private sector excluding ships and electric power.
 2. Tankan survey, diffusion index. Level.
 3. Percent change from year earlier; not seasonally adjusted.
 n.a. Not available. ... Not applicable.
 Source: Haver Analytics.

Euro-area real GDP contracted 0.8 percent (a.r.) in the second quarter, with larger-than-expected declines in France, Italy, and particularly Germany. A collapse in investment was the main factor behind the second-quarter weakness. Private consumption also posted a decline, partially offset by gains in government consumption. The most recent ECB bank lending survey indicates credit standards in the euro area remained tight in the second quarter, mainly reflecting deteriorating expectations about the euro-area economic outlook.

Euro-Area Real GDP
(Percent change from previous period except as noted, s.a.a.r.)

Component	2006 ¹	2007 ¹	2007		2008	
			Q3	Q4	Q1	Q2
GDP	3.3	2.1	2.3	1.4	2.7	-0.8
Total domestic demand	2.5	2.1	3.1	0.1	2.8	-0.8
Consumption	2.3	1.2	1.7	0.7	-0.1	-0.6
Investment	6.3	3.2	3.8	4.5	6.1	-4.6
Government consumption	2.3	2.1	2.1	1.2	1.2	2.2
Inventories²	-0.6	0.2	0.7	-0.6	0.8	n.a.
Exports	9.1	4.1	7.3	1.7	7.3	-1.5
Imports	7.3	4.0	9.2	-1.4	7.9	-1.6
Net Exports²	0.8	0.1	-0.7	1.4	-0.1	0.0
Memo:						
GDP of selected countries						
France	2.3	2.2	2.7	1.5	1.6	-1.2
Germany	4.1	1.7	2.4	1.4	5.2	-2.0
Italy	2.5	0.1	0.6	-1.7	2.0	-1.1

1. Q4/Q4

2. Percentage point contribution to GDP growth.

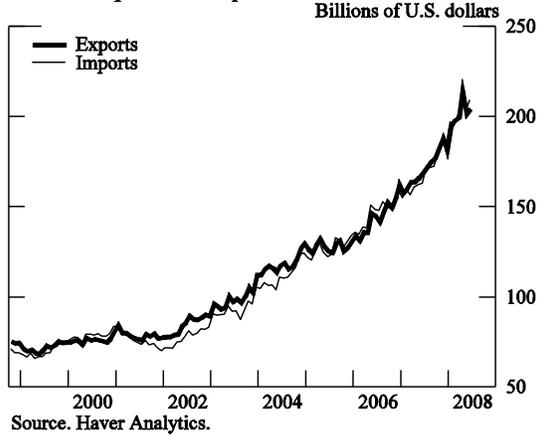
Source: Haver Analytics.

Recent indicators point to continued softness in the third quarter. Euro-area economic sentiment dropped further in August, reaching its lowest level in over five years. Purchasing managers' indexes (PMIs) for both manufacturing and services in August indicated that these sectors contracted for the third consecutive month. Retail sales declined 0.4 percent in July. Particularly worrisome is the clear deterioration in the German economy, which had shown resilience until recently. The German Ifo business climate index dropped in August for the third consecutive month, the manufacturing PMI fell below 50, and manufacturing new orders have been decreasing sharply in recent months.

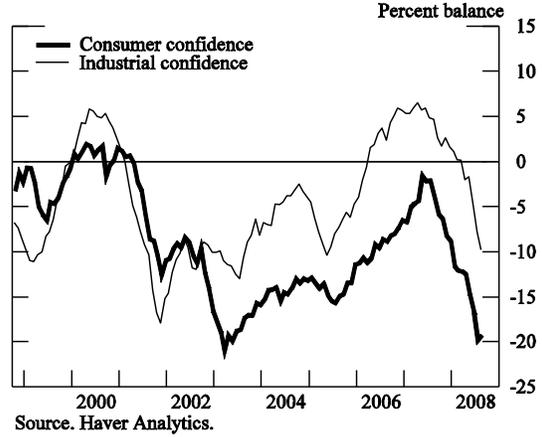
Euro-area 12-month headline inflation, as measured by the harmonized index of consumer prices (HICP), reached 4 percent in July, a record high. Excluding energy and unprocessed food, inflation continued to hover around 2½ percent. According to a preliminary estimate, headline inflation edged down to 3.8 percent in August. The ECB Council left its policy rate unchanged at 4.25 percent at its August and September meetings.

Euro Area

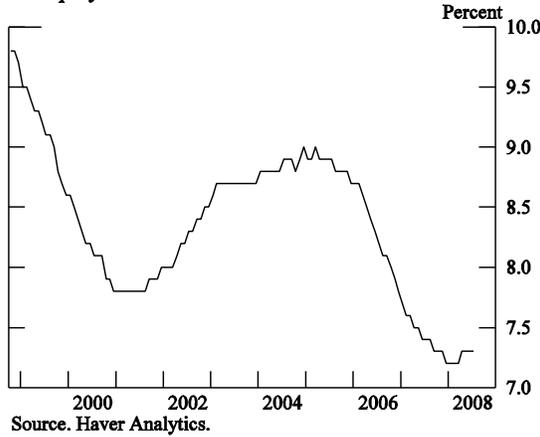
Nominal Exports and Imports



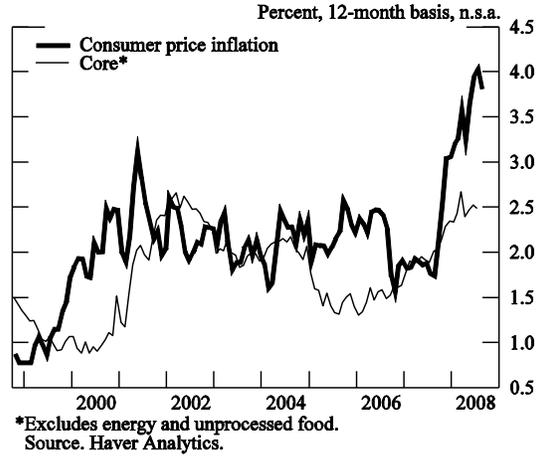
Economic Sentiment



Unemployment Rate



Consumer Price Inflation



Economic Indicators
(Percent change from previous period except as noted; seasonally adjusted)

Indicator	2007	2008		2008			
	Q4	Q1	Q2	Apr.	May	June	July
Industrial production ¹	-0.1	0.3	-0.7	0.9	-1.8	-0.3	n.a.
Retail sales volume ²	-1.0	-0.1	-0.9	-0.1	0.6	-0.8	-0.4
New car registrations	0.6	-2.8	-0.7	8.0	-5.1	-1.5	n.a.
Employment	0.2	n.a.	n.a.	...	...	...	...
Producer prices ³	4.0	5.4	7.1	6.2	7.1	8.1	9.0
M3 ³	11.5	10.1	n.a.	10.6	n.a.	n.a.	n.a.

1. Excludes construction.
 2. Excludes motor vehicles.
 3. Eurostat harmonized definition. Percent change from year earlier.
 n.a. Not available. ... Not applicable.
 M3 Manufacturers' shipments, inventories, and orders.
 Source. Haver Analytics.

In the **United Kingdom**, growth of real GDP in the second quarter was revised down to a meager 0.2 percent (a.r.), held down by flat consumption and plunging housing and government investment. The fall in domestic demand was offset by positive contributions from net exports and inventories. Recent data point to further weakness in the third quarter. In July, retail sales stood below their second-quarter level, the claim-based measure of the unemployment rate edged up, and industrial production continued to fall. Confidence indicators have weakened, on balance, since the last Greenbook to very low levels.

U.K. Real GDP
(Percent change from previous period except as noted, s.a.a.r.)

Component	2006 ¹	2007 ¹	2007		2008	
			Q3	Q4	Q1	Q2
GDP	3.2	2.8	2.3	2.2	1.1	0.2
Total domestic demand	3.4	3.9	6.3	2.7	-1.1	-1.1
Consumption	2.8	2.7	3.4	1.6	4.5	-0.1
Investment	9.6	4.4	11.3	9.0	-5.7	-19.6
Government consumption	1.4	1.7	1.4	0.9	3.7	1.6
Inventories ²	-0.3	1.1	2.3	-0.1	-3.8	2.2
Exports	-1.3	0.2	5.3	-5.1	2.6	-1.8
Imports	-0.4	4.0	19.3	-2.8	-4.8	-5.6
Net Exports ²	-0.2	-1.2	-4.1	-0.6	2.2	1.3

1. Q4/Q4

2. Percentage point contribution to GDP growth.

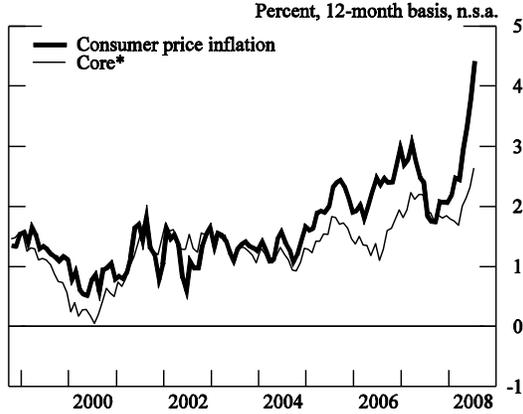
Source: Haver Analytics.

On September 2, the Chancellor of the Exchequer announced a one-year suspension of taxes on housing transactions of £175,000 or less, a measure that will cost the government an estimated £600 million. The Chancellor also brought forward £1 billion in spending to fund a series of measures aimed at accelerating public housing construction, encouraging first-time buyers, and assisting families facing repossession. House price indexes fell more than 10 percent in the year to August, and the value of loans for house purchases in July was only a quarter of its year-earlier level.

The 12-month rate of headline inflation climbed to 4.4 percent in July. Food and energy prices, the largest contributors to the run up in inflation, rose 10 percent and 21 percent, respectively, over the same period. Although inflation outside of energy and both processed and unprocessed food crept up in recent months, it remained contained at 1.9 percent. Average earnings, both including and excluding bonuses, stood about 3½ percent higher in July than 12 months earlier.

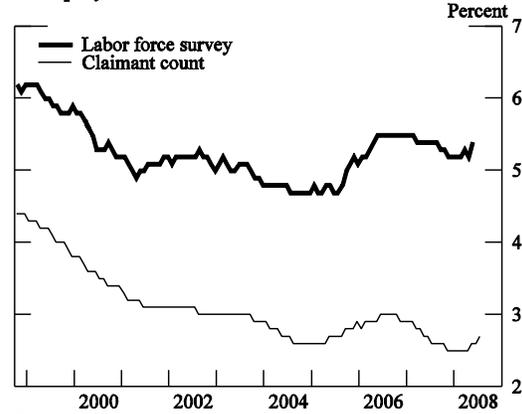
United Kingdom

Consumer Price Inflation



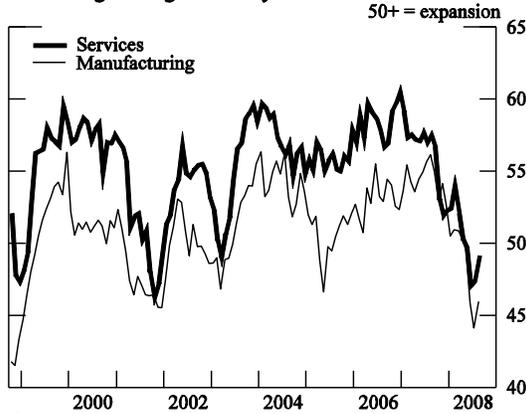
*Excludes energy and unprocessed food.
Source: Haver Analytics.

Unemployment Rates



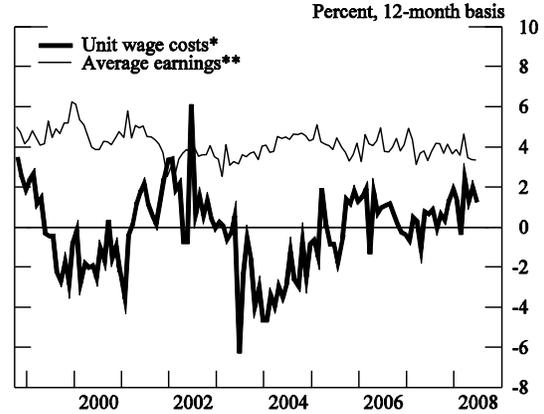
Source: Haver Analytics.

Purchasing Managers Survey



Source: Reuters.

Labor Costs



*Manufacturing industries.
**Whole economy, including bonuses.
Source: Haver Analytics.

Economic Indicators
(Percent change from previous period except as noted; seasonally adjusted)

Indicator	2007	2008		2008			
	Q4	Q1	Q2	May	June	July	Aug.
Producer input prices ¹	10.7	19.7	28.0	28.8	30.9	29.3	26.0
Industrial production	0.2	-0.4	-0.7	-0.7	-0.1	-0.5	n.a.
Business confidence ²	7.3	12.7	0.7	0.0	2.0	-7.0	-13.0
Consumer confidence ²	-3.8	-8.6	-16.0	-14.6	-20.2	-26.0	-23.9
Trade balance ³	-29.6	-27.6	-27.0	-8.7	-9.8	-9.1	n.a.
Current account ³	-25.0	-16.6	n.a.	...	...	...	...

1. Percent change from year earlier.
2. Percent balance.
3. Level in billions of U.S. dollars.
n.a. Not available. ... Not applicable.
Source: Haver Analytics and FRB staff calculations.

In **Canada**, real GDP rose a tepid 0.3 percent (a.r.) in the second quarter, after a downward-revised fall of 0.8 percent in the first quarter. Second-quarter GDP was restrained by a large negative contribution from net exports (2.8 percentage points), as exports – particularly to the United States – continued to fall sharply. Investment also fell, partly reflecting a decline in residential construction. In contrast, consumption growth was strong, at 2.4 percent, although half of its 2007 pace.

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

Component	2006 ¹	2007 ¹	2007		2008	
			Q3	Q4	Q1	Q2
GDP	2.2	2.8	2.3	0.8	-0.8	0.3
Total domestic demand	3.7	6.3	9.7	6.2	-2.7	3.6
Consumption	4.6	5.3	4.2	7.5	3.1	2.4
Investment	4.6	4.2	5.6	3.8	0.0	-1.7
Government consumption	3.7	4.6	7.2	5.8	2.4	5.1
Inventories²	-0.7	1.5	4.6	0.0	-5.3	1.6
Exports	-1.0	-1.4	-1.1	-7.4	-4.1	-5.9
Imports	3.0	8.6	20.6	8.6	-9.0	2.3
Net Exports²	-1.4	-3.2	-6.7	-5.3	1.6	-2.8

1. Q4/Q4

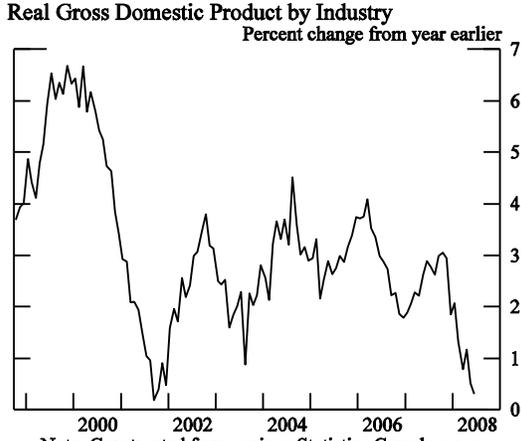
2. Percentage point contribution to GDP growth.

Source: Haver Analytics.

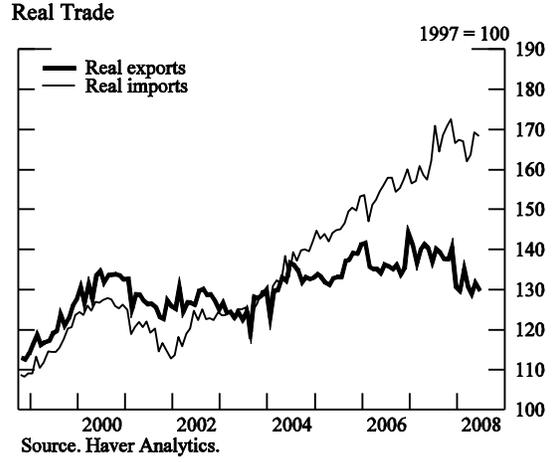
Following a loss of 55 thousand jobs in July, employment increased 15 thousand in August. Since the start of the year, employment has grown 0.5 percent, a much smaller increase compared to the first eight months of 2007. The unemployment rate remained unchanged at 6.1 percent.

The 12-month rate of consumer price inflation rose to 3.3 percent in July, up from 1.4 percent in March, reflecting escalating energy prices and an end to the extremely low rates of food-price inflation over the past year. The Bank of Canada's preferred measure of core inflation, which excludes the eight most volatile components of the consumer price index as well as the effects of indirect taxes, remained muted at 1.5 percent.

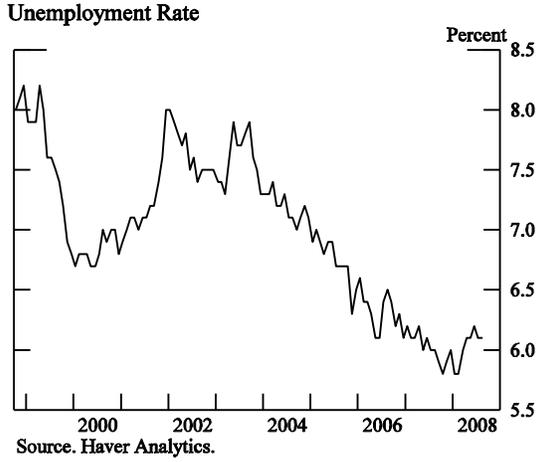
Canada



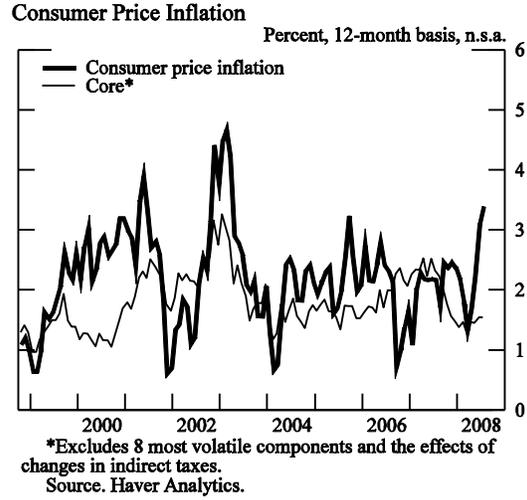
Note. Constructed from various Statistics Canada surveys and supplements to the quarterly income and expenditure-based estimates. Source. Haver Analytics.



Source. Haver Analytics.



Source. Haver Analytics.



*Excludes 8 most volatile components and the effects of changes in indirect taxes. Source. Haver Analytics.

Economic Indicators
(Percent change from previous period except as noted; seasonally adjusted)

Indicator	2007	2008		2008			
	Q4	Q1	Q2	May	June	July	Aug.
Industrial production	-1.4	-2.2	-1.2	-0.7	-0.3	n.a.	n.a.
New manufacturing orders	-0.5	-3.5	-1.9	-0.0	1.5	n.a.	n.a.
Retail sales	1.8	1.0	0.4	-0.1	-0.4	n.a.	n.a.
Employment	0.7	0.5	0.3	0.0	-0.0	-0.3	0.1
Consumer attitudes ¹	97.2	92.8	79.6	...	...	...	...
Business confidence ¹	101.0	96.4	91.5	...	...	...	...

1. 2002 = 100.
n.a. Not available. ... Not applicable.
Source. Haver Analytics and Bank for International Settlements.

Economic Situation in Other Countries

Data since the July/August Greenbook generally have showed continued slowing in emerging market economies. Revised data for Mexico indicate that real GDP contracted in the first quarter and that growth was quite low in the second quarter as well. In Asia, second-quarter output contracted sharply in Hong Kong and Singapore, and decelerated significantly in India, Malaysia, and Thailand. However, in a few countries, including the Philippines, Indonesia, and Venezuela, output rebounded from below-trend rates in the first quarter. In the current quarter, emerging market economies appear to have continued to grow at a subdued pace, weighed down by weak external sectors and varying degrees of weakness in domestic demand.

Headline inflation in the developing world may be beginning to crest. Although inflation rose in some countries, it fell in several Asian economies including China, Korea, Singapore, Taiwan, and Thailand. Inflation in Mexico edged just a touch higher in July. Monetary authorities in several emerging market economies, including Korea and Mexico, have raised policy rates since the time of the July/August Greenbook.

In **China**, data thus far in the third quarter have been mixed. In July, industrial production contracted and bank lending expanded at about its second-quarter pace, which was the lowest since 2006. On the other hand, the trade balance has jumped higher to average about \$310 billion at an annual rate over July and August, well above the second-quarter average, as exports rebounded and imports contracted. Exports were higher to all regions including the United States. In addition, retail sales were up more than 23 percent from a year earlier.

In August, 12-month consumer price inflation fell to 4.9 percent, down from more than 8 percent early in the year, as food price inflation continued to wane. Excluding food and energy, inflation has remained subdued at a little over 1 percent. With headline inflation coming down, authorities have issued statements indicating a shifting of concern away from inflation and towards slowing growth. Thus far, the authorities have taken limited actions aimed at aiding the export sector. For example, in early August, China increased tax rebates for textile and clothing exporters. Monetary authorities have also reportedly raised banks' lending quotas 5 percent, with the new funds to be directed toward small and medium-sized enterprises.

Chinese Economic Indicators
(Percent change from previous period, seasonally adjusted, except as noted)

Indicator	2006	2007	2008				
			Q1	Q2	June	July	Aug.
Real GDP ¹	10.6	11.3	11.7	9.9	...	...	...
Industrial production	14.6	18.6	5.0	3.3	.2	-1.0	n.a.
Consumer prices ²	2.8	6.5	8.0	7.8	7.1	6.3	4.9
Merch. trade balance ³	177.5	262.2	253.2	216.2	162.8	295.6	327.6

1. Gross Domestic Product. Annual rate. Quarterly data estimated by staff from reported 4-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 valued at cost, insurance, and freight. Source. CEIC.

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

India's GDP growth fell in the second quarter to 5½ percent from 9 percent in the first. The slowdown reflected, in part, the response of domestic demand to three consecutive interest rate increases by the authorities. Growth also slowed in agriculture and the export-oriented services sector. Industrial production in the second quarter was flat. Both consumer and wholesale price inflation increased in July, although the pickup in wholesale price inflation was small compared with recent months. On August 14, the government announced a 28 percent increase in employee salaries, which will likely stimulate consumption but also increase inflation pressures. Imports grew faster than exports in July, and the trade deficit widened considerably relative to the first and second quarters.

Indian Economic Indicators
(Percent change from previous period, seasonally adjusted, except as noted)

Indicator	2006	2007	2008				
			Q1	Q2	May	June	July
Real GDP ¹	9.3	8.8	9.1	5.4	...	...	...
Industrial production	10.5	9.9	2.1	.0	-1.1	.6	n.a.
Consumer prices ²	6.5	5.5	6.3	7.1	6.8	6.7	7.4
Wholesale prices ²	5.7	3.8	5.8	9.6	8.9	11.8	12.0
Merch. trade balance ³	-53.1	-69.6	-100.3	-113.1	-111.4	-113.0	-136.6
Current account ⁴	-9.5	-12.1	-4.2	n.a.	...	...	...

1. Gross Domestic Product. 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.

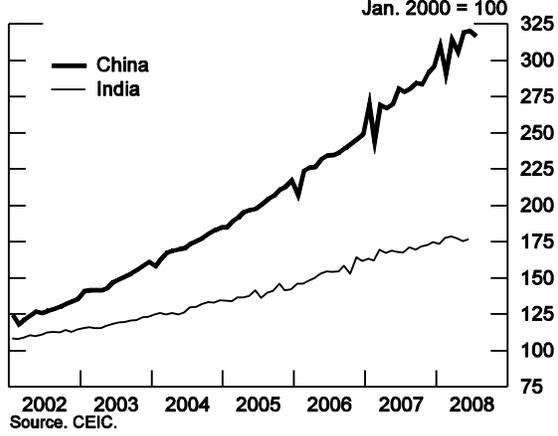
4. Billions of U.S. dollars, not seasonally adjusted, annual rate.

Source. CEIC.

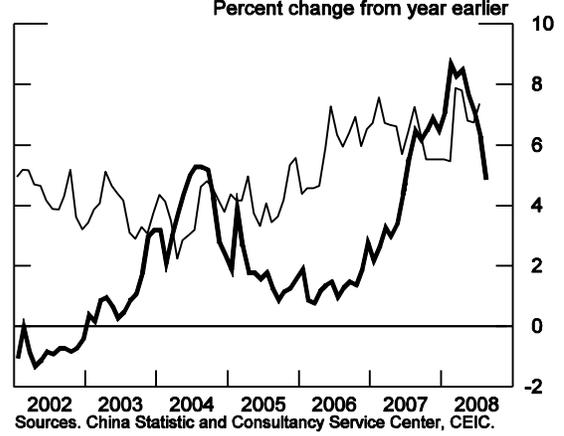
n.a. Not available. ... Not applicable.

China and India

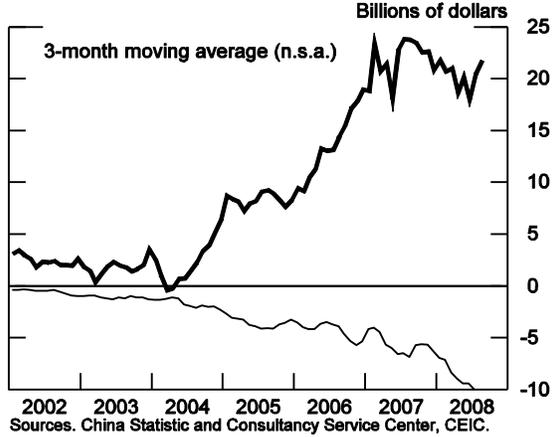
Industrial Production



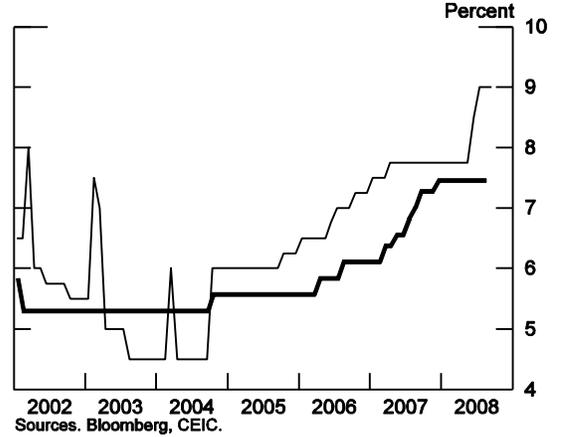
Consumer Prices



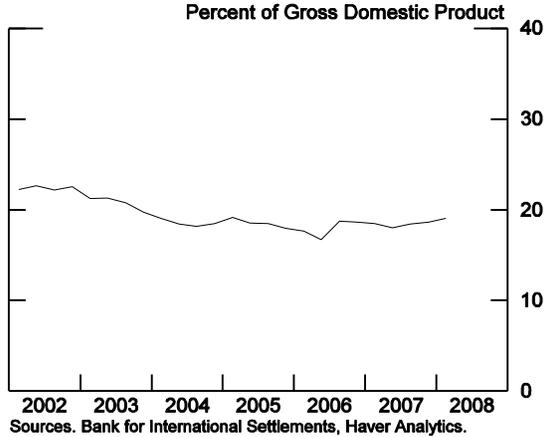
Merchandise Trade Balances



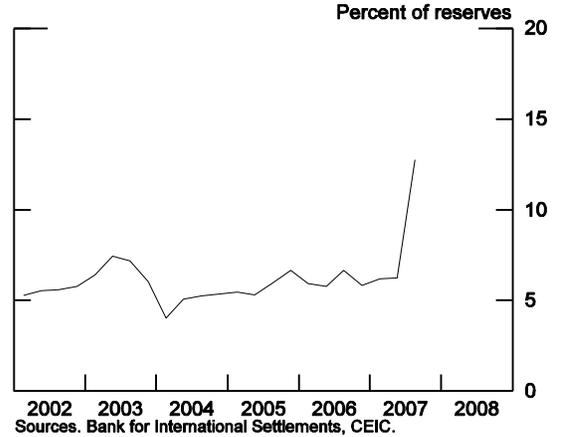
Benchmark Interest Rates



Gross External Debt



Short-Term External Debt



In the NIEs¹, second-quarter growth slowed in Taiwan and contracted in both Hong Kong and Singapore. The slowing in Taiwan was broad-based and reflected weaker domestic and external demand. The same was true in Hong Kong, only to a greater extent, with output falling 5½ percent. Activity contracted 6 percent in Singapore, due in part to the volatile biomedical sector, but electronics also slowed, and a decline in government expenditures weighed on domestic demand. In July, industrial production edged lower in Korea and showed a sharp contraction in Taiwan. In contrast, production in Singapore rebounded in July. Trade balances worsened in July except in Singapore, with Korean and Taiwanese balances moving from a surplus to a deficit.

12-month consumer price inflation remained elevated in Hong Kong, largely reflecting higher food and energy prices. In Korea, Singapore, and Taiwan, there are some indications that headline inflation may have peaked. Korean inflation jumped to 5.9 percent in July but moved down to 5.6 percent in August on lower energy prices. On August 5, the Korean central bank raised its official rate 25 basis points, the first increase in a year, in order to contain inflation, which remains well above the country's target. 12-month inflation fell about 1 percentage point in Singapore in July and fell about the same in Taiwan in August.

Economic Indicators for Newly Industrialized Economies: Growth
(Percent change from previous period, seasonally adjusted, except as noted)

Indicator	2006	2007	2008				
			Q1	Q2	May	June	July
<i>Real GDP¹</i>							
Hong Kong	6.5	7.0	8.2	-5.5	...	...	...
Korea	4.2	5.9	3.3	3.4	...	...	...
Singapore	7.0	5.5	15.7	-6.0	...	...	...
Taiwan	4.0	6.5	2.4	1.0	...	...	...
<i>Industrial production</i>							
Hong Kong	2.4	-1.6	-3.6	n.a.	...	...	...
Korea	8.9	6.9	2.1	1.4	-6	.2	-2
Singapore	11.9	5.9	11.3	-14.8	-5.2	1.0	4.1
Taiwan	4.7	7.8	.9	.1	-5	.7	-2.1

1. Gross Domestic Product. Annual rate. Annual data are Q4/Q4.
Sources. CEIC, Reuters.
... Not applicable.

¹ Newly industrialized economies: Hong Kong, South Korea, Singapore, and Taiwan

Economic Indicators for Newly Industrialized Economies: Merchandise Trade Balance
(Billions of U.S. dollars; seasonally adjusted annual rate)

Indicator	2006	2007	2008				
			Q1	Q2	June	July	Aug.
Hong Kong	-17.9	-23.5	-34.1	-31.4	-42.1	-42.5	n.a.
Korea	27.9	29.4	2.4	24.6	30.6	-1.9	n.a.
Singapore	33.1	36.2	22.8	25.1	22.2	25.0	n.a.
Taiwan	11.6	16.8	3.0	14.5	15.0	-3.3	-16.5

Source. CEIC.
n.a. Not available.

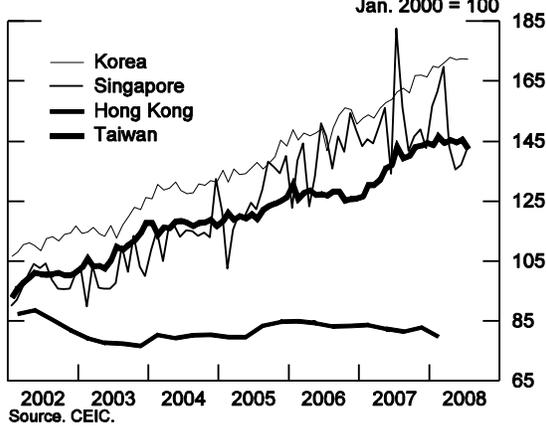
Economic Indicators for Newly Industrialized Economies: Consumer Price Inflation
(Percent change from year earlier except as noted)

Indicator	2006 ¹	2007 ¹	2008				
			Q1	Q2	June	July	Aug.
Hong Kong	2.3	3.8	4.5	5.7	6.1	6.2	n.a.
Korea	2.1	3.6	3.8	4.8	5.5	5.9	5.6
Singapore	.8	4.4	6.6	7.5	7.5	6.5	n.a.
Taiwan	.7	3.3	3.6	4.2	5.0	5.9	4.8

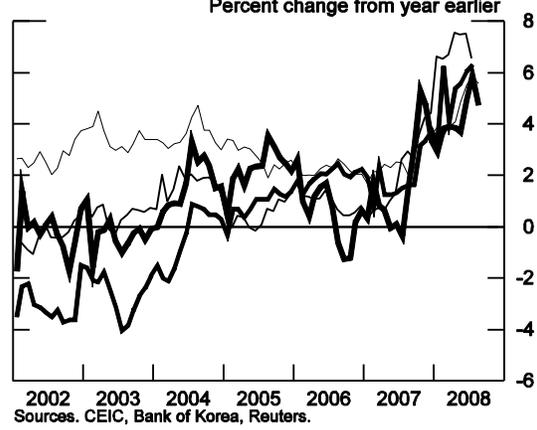
1. Percent change from year-earlier period, except annual data, which are Dec./Dec.
Source. CEIC.
n.a. Not available.

Newly Industrialized Economies

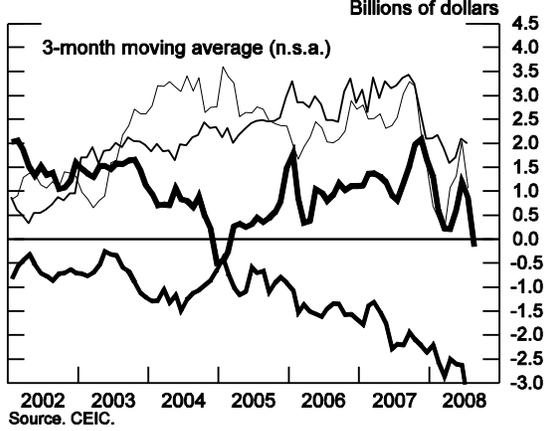
Industrial Production



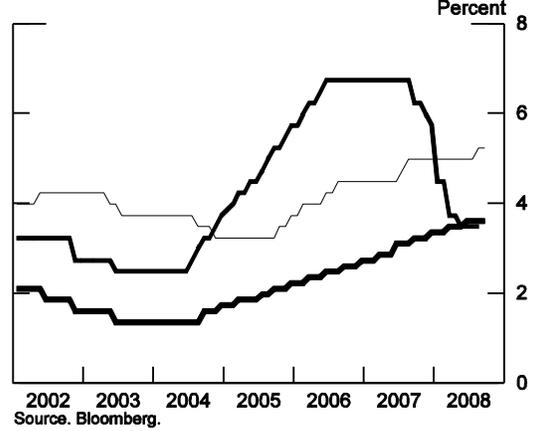
Consumer Prices



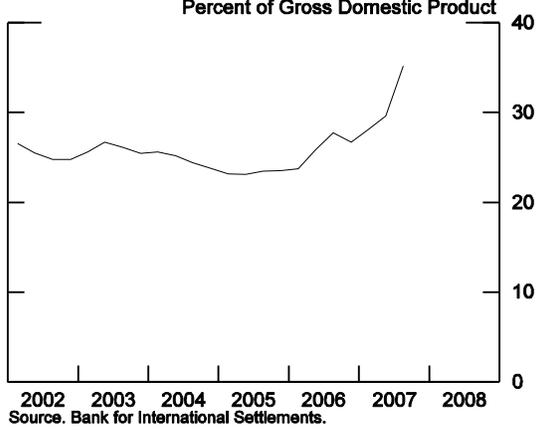
Merchandise Trade Balances



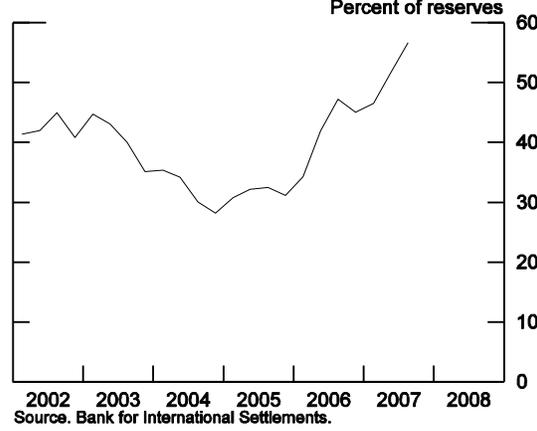
Benchmark Interest Rates



Gross External Debt



Short-Term External Debt



In the **ASEAN-4**, real GDP growth in the second quarter slowed markedly in Malaysia and Thailand, but growth rebounded from slow first quarters in Indonesia and the Philippines. In July, industrial production in Thailand was flat, and the trade balance swung from a surplus to a sizable deficit. Indonesia's trade surplus also narrowed in July.

Consumer price inflation rose significantly in all of the ASEAN countries in July, reaching about 12 percent on a 12-month basis in Indonesia and the Philippines. In August, inflation in Indonesia and the Philippines was little changed but Thailand recorded a sharp drop, which was primarily due to increased government subsidies on energy. Similarly, Malaysian authorities cut retail fuel prices a bit in August to quiet political unrest ignited by a massive fuel price hike in June. To combat high inflation, the central banks of Indonesia, the Philippines, and Thailand raised interest rates in August.

The political environment in Thailand deteriorated rapidly in late August and early September. The Thailand Election Committee found that the ruling People's Power Party committed election fraud in the December elections. Following increased anti-government demonstrations, Prime Minister Sundaravej declared a state of emergency, which allows the military more leeway to contain rioting in the capital.

ASEAN-4¹ Economic Indicators: Growth
(Percent change from previous period, seasonally adjusted, except as noted)

Indicator	2006	2007	2008				
			Q1	Q2	May	June	July
<i>Real GDP²</i>							
Indonesia	5.8	6.1	3.2	11.1	...	...	...
Malaysia	5.4	7.4	6.0	3.7	...	...	...
Philippines	5.6	6.5	1.3	8.4	...	...	...
Thailand	4.3	5.8	5.5	2.9	...	...	...
<i>Industrial production³</i>							
Indonesia ⁴	-1.6	5.6	2.0	.0	-8	2.0	n.a.
Malaysia	4.6	2.1	1.4	-1.0	.5	-1.9	n.a.
Philippines	-8.5	-2.7	-1.8	3.1	-1.0	.3	n.a.
Thailand	7.4	8.2	3.9	-5.1	7.9	1.0	.0

1. Association of Southeast Asian Nations.

2. Gross Domestic Product. Annual rate. Annual data are Q4/Q4.

3. Annual data are annual averages.

4. Staff estimate.

Source: CEIC.

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

ASEAN-4¹ Economic Indicators: Merchandise Trade Balance
(Billions of U.S. dollars; seasonally adjusted annualized rate)

Indicator	2006	2007	2008				
			Q1	Q2	May	June	July
Indonesia	39.7	39.6	44.9	32.2	36.8	35.4	21.3
Malaysia	29.5	29.2	33.9	56.0	63.6	50.9	58.0
Philippines	-4.4	-5.0	-10.6	-5.0	-6.1	-5.9	n.a.
Thailand	1.0	11.6	.3	12.7	25.7	18.5	-8.9

1. Association of Southeast Asian Nations.

Sources. CEIC, Bank of Thailand, Philippines Economic Indicators Telegram (PEIT), Monetary Authority of Singapore.

n.a. Not available.

ASEAN-4¹ Economic Indicators: Consumer Price Inflation
(Percent change from year earlier except as noted)

Indicator	2006 ²	2007 ²	2008				
			Q1	Q2	June	July	Aug.
Indonesia	6.5	5.7	7.6	10.2	11.1	11.9	11.9
Malaysia	3.1	2.4	2.6	4.9	7.7	8.5	n.a.
Philippines	4.3	3.9	5.5	9.7	11.4	12.3	12.5
Thailand	3.5	3.2	5.0	7.5	8.9	9.2	6.4

1. Association of Southeast Asian Nations.

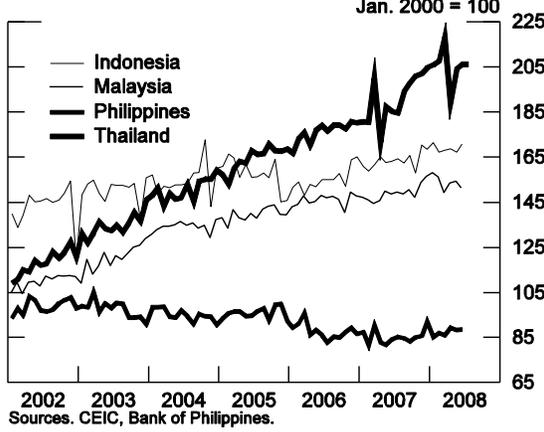
2. Dec./Dec.

Sources. CEIC, IMF International Financial Statistics database.

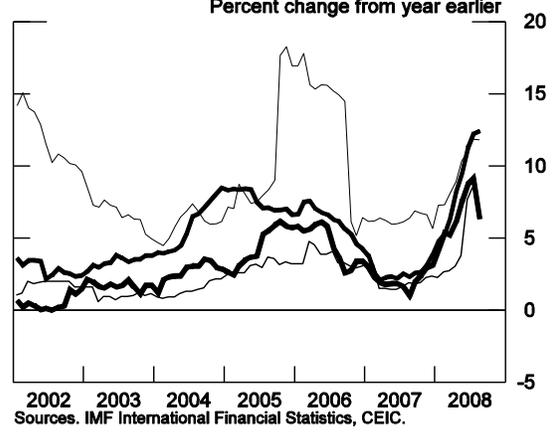
n.a. Not available.

ASEAN-4

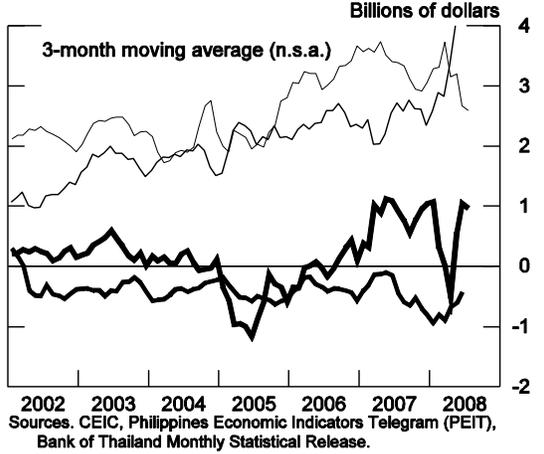
Industrial Production



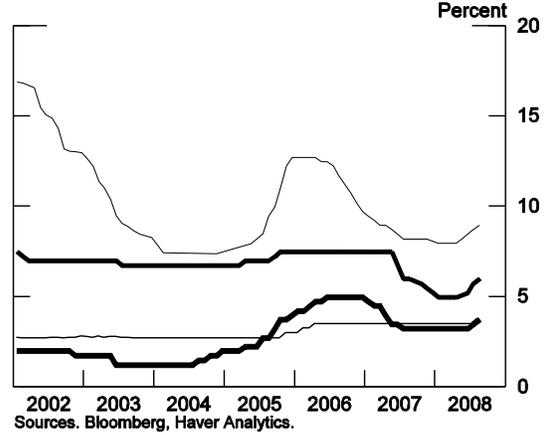
Consumer Prices



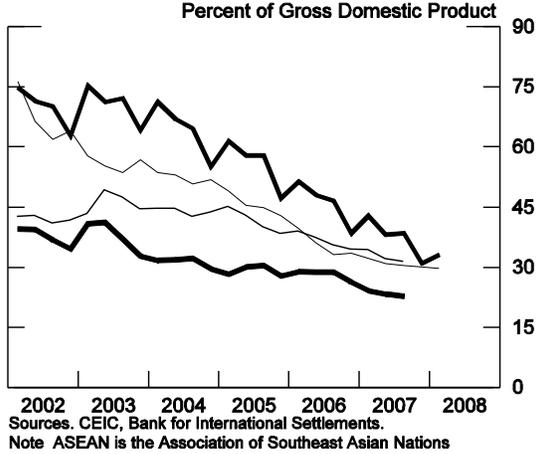
Merchandise Trade Balances



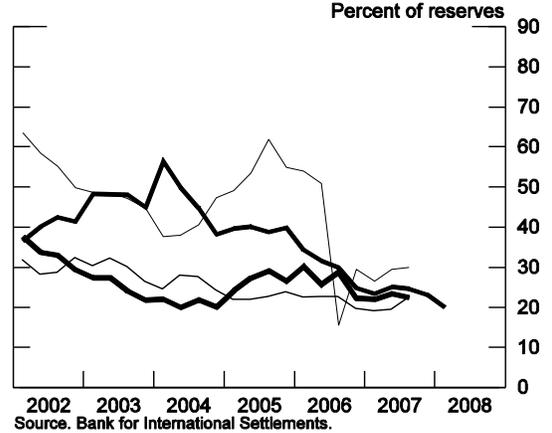
Benchmark Interest Rates



Gross External Debt



Short-Term External Debt



In **Mexico**, real GDP growth in the first quarter was revised sharply lower, from about 2 percent to $-\frac{1}{2}$ percent, and output remained anemic in the second quarter, rising only 0.6 percent. Manufacturing, mining, utilities, and the construction sector all contracted in the second quarter. Retail sales slowed as employment fell and real disposable income deteriorated owing to the rise in consumer prices. In July, the trade deficit widened as import growth outweighed the increase in exports. Although overall exports increased in July, there was a significant contraction in automobile exports.

Headline and core inflation continued to increase in July, with both measures higher than 5 percent on a 12-month basis. With inflation above its 4 percent target, the Bank of Mexico raised its policy rate $\frac{1}{4}$ percentage point in mid-August, bringing the rate to $8\frac{1}{4}$ percent. This increase was the third consecutive one.

Mexican Economic Indicators
(Percent change from previous period, seasonally adjusted, except as noted)

Indicator	2006	2007	2008				
			Q1	Q2	June	July	Aug.
Real GDP ¹	3.7	4.2	-5	.6	...	...	...
Overall economic activity	5.1	3.1	-4	.4	.3	n.a.	n.a.
Industrial production	5.4	1.8	-2	-1.0	.3	n.a.	n.a.
Unemployment rate ²	3.6	3.7	3.7	3.8	3.9	3.8	n.a.
Consumer prices ³	4.1	3.8	3.9	4.9	5.3	5.4	5.6
Merch. trade balance ⁴	-6.1	-10.1	-12.6	-6.7	-6.9	-10.3	n.a.
Merchandise imports ⁴	256.1	281.9	310.1	315.6	320.0	343.8	n.a.
Merchandise exports ⁴	249.9	271.9	297.5	308.9	313.1	333.5	n.a.
Current account ⁵	-2.1	-5.7	-6.0	-8.1	...	...	...

1. Gross Domestic Product. Annual rate. Annual data are Q4/Q4.

2. Percent; counts as unemployed those working 1 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, not seasonally adjusted, annual rate.

Sources. Haver Analytics, Bank of Mexico.

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

In **Brazil**, second-quarter real GDP rose 6½ percent following an upward-revised 3.4 percent increase in the first quarter. Consumption was robust, up 4.2 percent, while gross fixed capital formation soared 23 percent. Net exports posted a neutral contribution to growth, with both exports and imports rebounding after a weak first quarter when trade was depressed by a customs strike. Rapid growth in credit and rising incomes from high commodity prices continued to boost domestic demand. Headline consumer price inflation declined in August to 6.2 percent on a 12-month basis, driven in part by falling food prices.

Brazilian Economic Indicators
(Percent change from previous period, seasonally adjusted, except as noted)

Indicator	2006	2007	2008				
			Q1	Q2	June	July	Aug.
Real GDP ¹	5.0	6.1	3.4	6.5	...	...	...
Industrial production	2.8	6.0	.6	.9	2.8	1.0	n.a.
Unemployment rate ²	10.0	9.3	8.4	7.8	7.6	8.0	n.a.
Consumer prices ³	3.3	4.5	4.6	5.5	6.0	6.4	6.2
Merch. trade balance ⁴	46.5	40.0	22.2	33.5	29.3	21.3	21.6
Current account ⁵	13.6	1.7	-43.0	-26.6	-31.1	-25.3	n.a.

1. Gross Domestic Product. 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, not seasonally adjusted, annual rate.

Sources: Haver Analytics, IMF International Financial Statistics database,

Instituto Brasileiro de Geografia e Estatística.

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

In **Argentina**, industrial production recovered in the second quarter, and it increased sharply in July following a resolution to the conflict between farmers and the government over a proposal to tax exports; the conflict subsided after the Congress rejected the export tax bill. The trade surplus narrowed in the second quarter, in part reflecting a strike-related fall in exports, but widened in July. The financial condition of the government, however, has deteriorated. The government borrowed \$1 billion from Venezuela at a rate 2 percentage points higher than the average of its current outstanding debt, signaling that the government faces difficulty issuing new bonds at competitive rates in international markets. In addition, Standard and Poor's downgraded Argentina's sovereign debt rating to B from B+. To restore credibility, the government announced that it would use some of its international reserves to pay off \$6.7 billion of Paris Club debt, which has been in default since the 2001-02 economic crisis. Headline consumer price inflation remained around 9 percent in July on a 12-month basis, but the reliability of the official inflation data remains questionable.

Argentine Economic Indicators
(Percent change from previous period, seasonally adjusted, except as noted)

Indicator	2006	2007	2008				
			Q1	Q2	May	June	July
Real GDP ¹	8.5	9.2	2.6	n.a.	...	...	...
Industrial production	8.4	7.5	-1.7	1.3	-0.8	-4.3	4.3
Unemployment rate ²	10.2	8.5	8.4	8.0	...	...	...
Consumer prices ³	9.6	8.4	8.4	9.1	9.1	9.3	9.2
Merch. trade balance ⁴	12.3	11.1	11.8	8.8	5.5	6.0	12.4
Current account ⁵	8.0	7.5	6.2	n.a.	...	...	...

1. Gross Domestic Product. Annual rate. Annual data are Q4/Q4.

2. Percent; not seasonally adjusted.

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, not seasonally adjusted, annual rate.

Sources: Haver Analytics, IMF International Financial Statistics database, Ministerio de economía, U.S. State Department.

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

In **Venezuela**, second-quarter real GDP rebounded following a large first-quarter decline. Output rose at an annual rate of 14 percent, despite a contraction in the volatile petroleum sector of 7 percent. Headline inflation continued to be very high, coming in at more than 33 percent on a 12-month basis in August. The bolivar declined 20 percent against the dollar in the parallel market over the second half of August. A number of developments appear to have contributed to the currency drop. These include the government takeover of Mexican-owned cement company Sidor and the announcement that the government will acquire Banco de Venezuela, the country's third largest bank (whose Spanish owners had been looking for a buyer). Also, in early August, the Chavez-appointed Supreme Court ruled as constitutional the disqualification of roughly 300 opposition candidates from the upcoming November local elections.

Venezuelan Economic Indicators
(Percent change from previous period, seasonally adjusted, except as noted)

Indicator	2006	2007	2008				
			Q1	Q2	June	July	Aug.
Real GDP ¹	11.4	8.5	-8.9	14.1	...	...	...
Consumer prices ²	17.0	22.5	25.4	29.7	30.8	32.7	33.6
Non-oil trade balance ³	-23.0	-34.6	-33.9	-34.5	...	...	...
Merch. trade balance ³	32.7	23.7	49.4	68.2	...	...	...
Current account ⁴	27.1	20.0	38.9	67.3	...	...	...

1. Gross Domestic Product. 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.

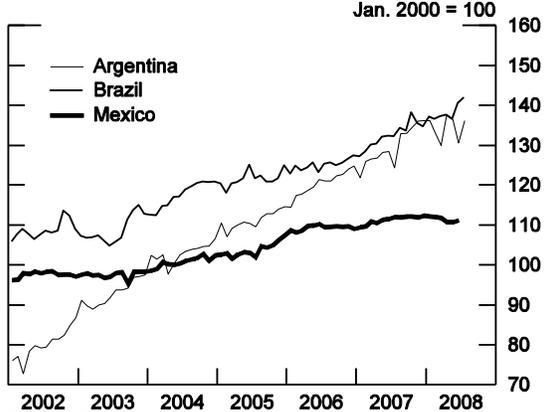
4. Billions of U.S. dollars, not seasonally adjusted, annual rate.

Sources. IMF International Financial Statistics database, Bank of Venezuela, Reuters and Embassy cables.

... Not applicable.

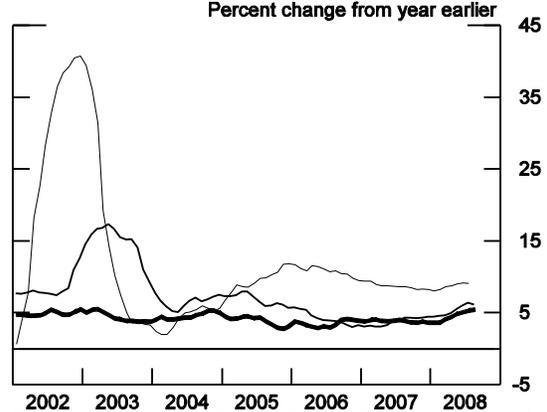
Latin America

Industrial Production



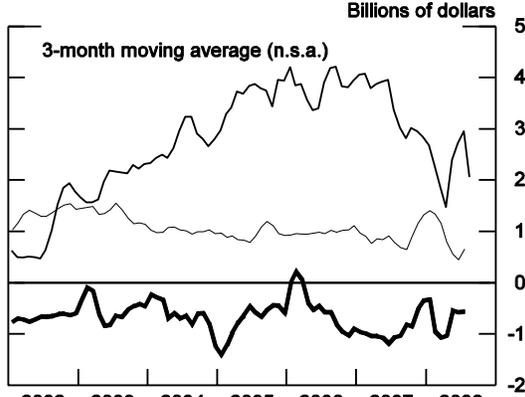
Sources. Fundacion de Investigaciones Economicas Latinoamericanas, Haver Analytics

Consumer Prices



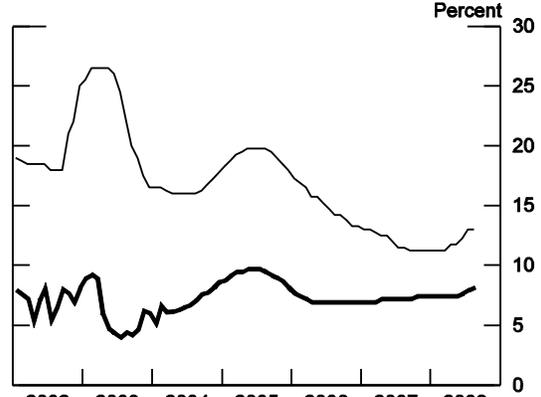
Sources. IMF International Financial Statistics, Getulio Vargas Foundation, Haver Analytics, Bank of Mexico.

Merchandise Trade Balances



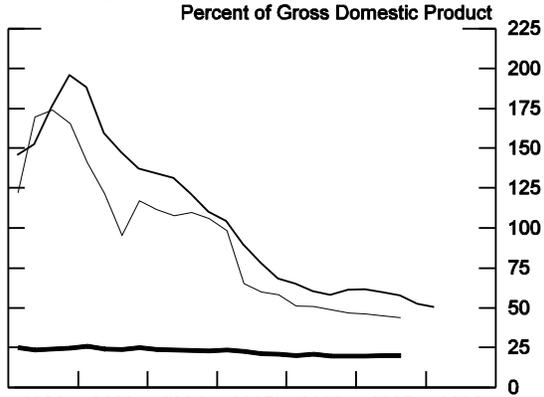
Sources. IMF International Financial Statistics, Bank of Mexico.

Benchmark Interest Rates



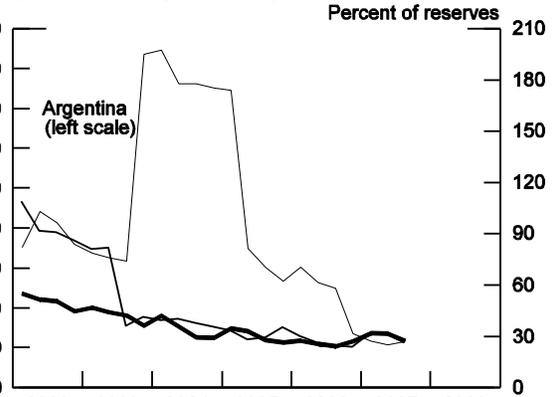
Source. Bloomberg.

Gross External Debt



Sources. Haver Analytics, Bank for International Settlements.

Short-Term External Debt



Source. Bank for International Settlements.

Tensions remain high in **Russia**, after the invasion of Georgia in mid-August. In early August, Georgia attempted to regain control over the breakaway region of South Ossetia by force. The Russian response was to send its own troops to this region and to neighboring Abkhazia, also a separatist province, and then continue into the heart of Georgia to occupy strategic military locations. The military conflict and political tensions have exacerbated concerns about the investment climate in Russia and stoked worries within the EU about the reliability of Russia as a source of energy. Over several days in August and September, the Russian authorities intervened to support the ruble. As a result, international reserves fell about \$14 billion in August. Despite the intervention, the ruble has depreciated about 10 percent against the dollar since end-July. The Russian stock market has been on a downward trend since May. Inflation remains uncomfortably high, coming in at a 12-month rate of nearly 15 percent in August. Falling oil prices and rising interest rates could weigh on activity in the future.

In **Pakistan**, the economic situation is precarious. An overheating of the economy, together with the sharp rise in world oil and other commodity prices, took 12-month inflation to nearly 25 percent in July. In its latest monetary policy report, the State Bank of Pakistan estimates that the government fiscal deficit rose sharply to about 8 percent of GDP in fiscal year 2007-08 (which runs from July to June), and the current account deficit rose to about 8½ percent of GDP. Until recently, sufficiently high capital inflows easily financed the current account deficit, but with intense political uncertainty since late last year, investor sentiment has turned against the country. The Pakistani rupee has moved sharply down against the dollar since last October, and there has been a massive loss of international reserves resulting from efforts to prevent a free-fall of the currency; reserves are at a critically low level. President Musharraf resigned in mid-August under pressure from the new ruling coalition, but the coalition broke up soon after his resignation. In early September, Mr. Zardari (the husband of the assassinated Ms. Bhutto) was elected President. There does not appear to be a quick end in sight to political uncertainty, security problems, and severe economic difficulties.