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Please note that this document may contain occasional gaps in the text. These gaps are the result of a redaction process that removed information obtained on a confidential basis. All redacted passages are exempt from disclosure under applicable provisions of the Freedom of Information Act.

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[1] In some cases, original copies needed to be photocopied before being scanned into electronic format. All scanned images were deskewed (to remove the effects of printer- and scanner-introduced tilting) and lightly cleaned (to remove dark spots caused by staple holes, hole punches, and other blemishes caused after initial printing).

[2] A two-step process was used. An advanced optimal character recognition computer program (OCR) first created electronic text from the document image. Where the OCR results were inconclusive, staff checked and corrected the text as necessary. Please note that the numbers and text in charts and tables were not reliably recognized by the OCR process and were not checked or corrected by staff.

Confidential (FR) Class III FOMC

Part 2

January 23, 2002

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

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

Confidential (FR) Class III FOMC

January 23, 2002

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Domestic Nonfinancial Developments

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Overview

Economic activity appears to have contracted a bit further in the fourth quarter after having dropped at an annual rate of 1.3 percent in the third quarter. Final sales likely posted a moderate gain last quarter, as consumer outlays accelerated sharply and business purchases of equipment and software leveled off after two quarters of steep decline. However, this pickup in final sales was met by a further deepening in the ongoing liquidation of inventories. Looking ahead, some recent data suggest that the economy may be bottoming out. In the manufacturing sector, production fell less steeply in December than in previous months, and the available indicators suggest that an upturn could be near. More broadly, employment losses in December were much smaller than those earlier in the quarter, aggregate hours of production or nonsupervisory workers were unchanged last month, and initial claims for unemployment insurance have fallen significantly below their levels in late November. Meanwhile, inflation has been held down by falling energy prices and widespread discounting of goods prices.

Labor Market Developments

The labor market deteriorated further last month, as private nonfarm payrolls dropped 187,000 and the unemployment rate rose 0.2 percentage point, to 5.8 percent. However, the decline in employment was less severe than in the preceding two months, and aggregate hours of production or nonsupervisory workers on private nonfarm payrolls held steady in December, the first month since May that hours did not decline.

December's level of aggregate hours was held up by an increase in the workweek, which after two consecutive monthly gains has climbed back to 34.2 hours, a level last seen in July. With a 0.4 hour jump in December, the manufacturing workweek, one of the Conference Board's leading indicators, reversed its declines over the three preceding months and returned to its August level. The rise in the factory workweek occurred in concert with a cut in manufacturing jobs of 133,000. History indicates that the workweek in the manufacturing sector often begins rising from recessionary lows while manufacturing employment is still declining.

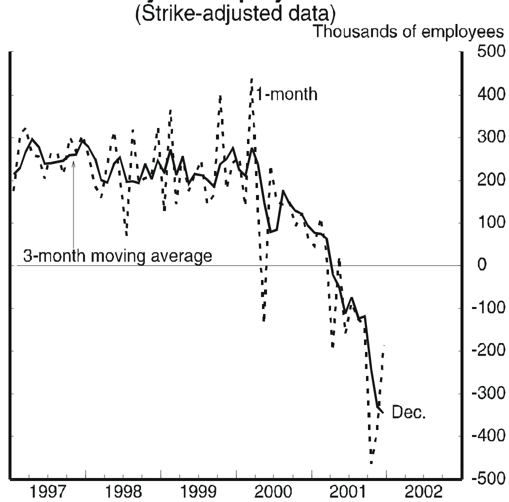
Although the unemployment rate continued to climb in December, other indicators from the household survey were also hinting at a slowing in the pace of reductions in jobs and hours toward year-end. The percentage of job losers unemployed for fewer than five weeks (a proxy for the layoff rate) fell for the second consecutive month in December after having peaked in October. In addition, the proportion of employed persons working part-time for economic reasons has changed little since October after having risen precipitously during the preceding two months.

CHANGES IN EMPLOYMENT
(Thousands of employees; based on seasonally adjusted data)

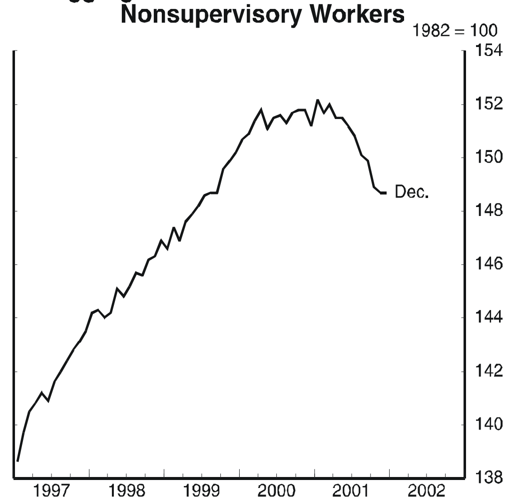
	2000		2001		2001		
	H1	H2	Q3	Q4	Oct.	Nov.	Dec.
	--Average monthly change--						
Nonfarm payroll employment[1]	267	66	-67	-314	-448	-371	-124
Previous	*267*	*66*	*-67*		*-468*	*-331*	
Private	178	121	-118	-345	-465	-382	-187
Mining	1	1	1	-2	0	-1	-5
Manufacturing	5	-29	-103	-140	-123	-165	-133
Construction	16	21	2	-6	-19	-3	5
Transportation and utilities	13	16	-16	-53	-54	-68	-36
Retail trade	31	21	-8	-68	-114	-12	-77
Wholesale trade	9	8	-11	-18	-17	-27	-10
Finance, insurance, real estate	-7	7	1	0	1	3	-3
Services	110	76	16	-59	-139	-109	72
Help supply services	15	-19	-18	-82	-101	-91	-55
Total government	90	-54	51	30	17	11	63
Total employment (household survey)	120	109	0	-316	-389	-362	-198
Nonagricultural	108	131	-45	-338	-411	-313	-290
Memo:							
Aggregate hours of private production workers (percent change)[1,2]	2.1	0.2	-3.0	-3.9	-0.7	-0.1	0.0
Average workweek (hours)[1]	34.5	34.3	34.1	34.1	34.0	34.1	34.2
Manufacturing (hours)	41.8	41.3	40.7	40.5	40.5	40.3	40.7

Note. Average change from final month of preceding period to final month of period indicated.
1. Survey of establishments.
2. Semi-annual data are percent change from Q4 to Q2 and from Q2 to Q4 at an annual rate. Quarterly data are percent changes from preceding quarter at an annual rate. Monthly data are percent change from preceding month.

Private Payroll Employment Growth
(Strike-adjusted data)



Aggregate Hours of Production or Nonsupervisory Workers

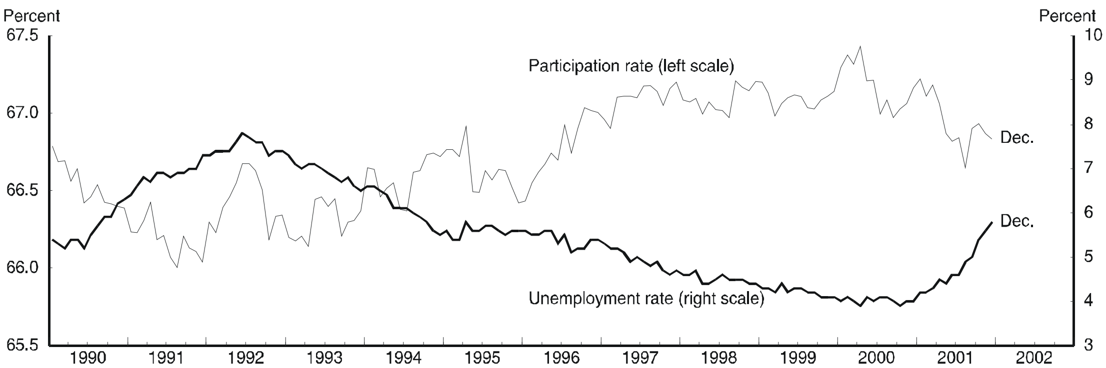


SELECTED UNEMPLOYMENT AND LABOR FORCE PARTICIPATION RATES
(Percent; based on seasonally adjusted data, as published)

	2000	2001	2001 Q2	2001 Q3	2001 Q4	2001 Oct.	2001 Nov.	2001 Dec.
Civilian unemployment rate (16 years and older)	4.0	4.8	4.5	4.8	5.6	5.4	5.6	5.8
Teenagers	13.0	14.7	14.1	15.2	15.8	15.4	15.7	16.2
20-24 years old	7.1	8.3	8.1	8.4	9.5	9.3	9.5	9.6
Men, 25 years and older	2.8	3.6	3.4	3.7	4.4	4.2	4.5	4.5
Women, 25 years and older	3.2	3.7	3.4	3.7	4.4	4.2	4.4	4.6
Labor force participation rate	67.2	66.9	66.9	66.8	66.9	66.9	66.9	66.8
Teenagers	52.2	49.9	50.0	49.1	49.1	49.8	49.4	48.2
20-24 years old	77.9	77.2	76.9	77.0	76.9	76.9	77.1	76.7
Men, 25 years and older	76.0	75.9	75.9	75.8	75.9	76.0	75.8	75.9
Women, 25 years and older	59.7	59.7	59.6	59.6	59.6	59.6	59.6	59.6
Memo:								
Potential worker rate[1]	6.9	7.7	7.4	7.8	8.7	8.4	8.7	8.9

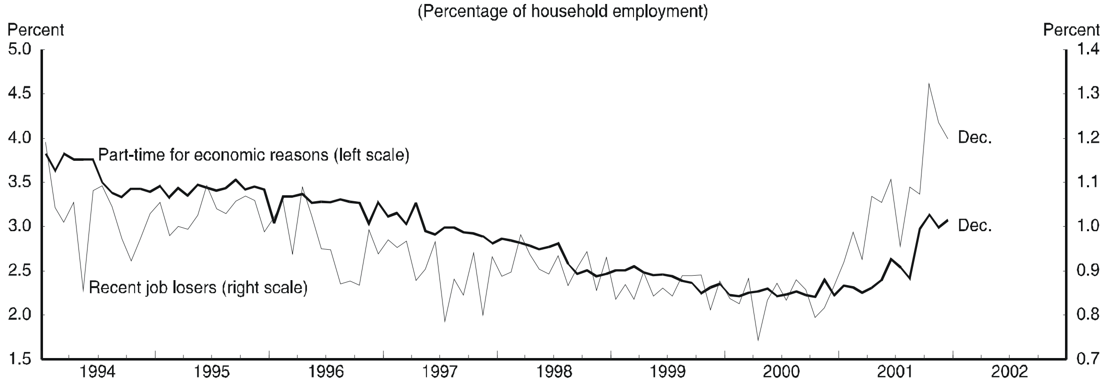
1. The potential worker rate equals the number of civilian unemployed plus those who are not in the labor force and want a job as a percentage of the civilian labor force plus those who are not in the labor force and want a job.

Labor Force Participation Rate and Unemployment Rate



Recent Job Losers and Part-time Workers

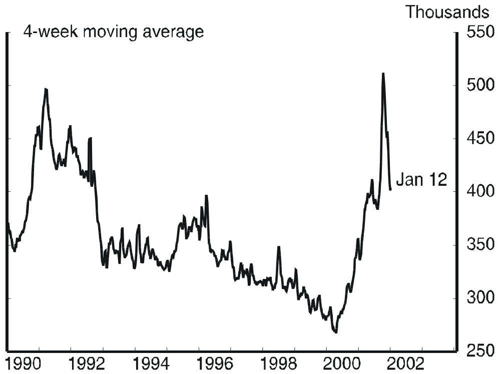
(Percentage of household employment)



Note. Recent job losers are job losers unemployed for less than 5 weeks.

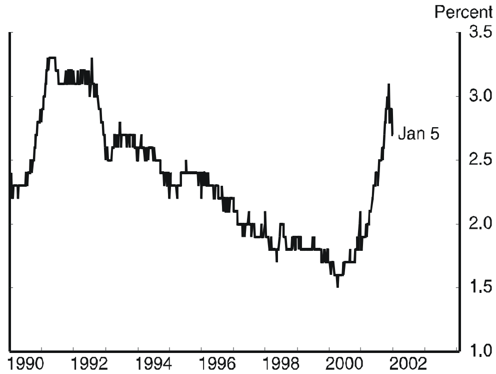
Labor Market Indicators

Initial Claims

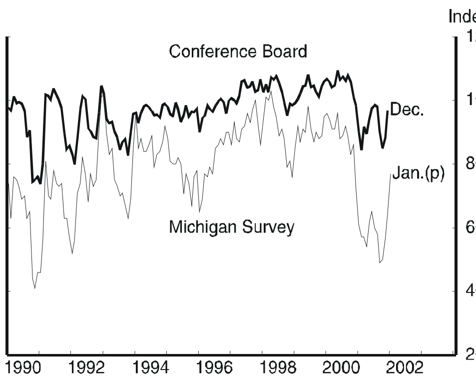


Note. Initial claims are seasonally adjusted using FRB seasonal factors.

Insured Unemployment Rate

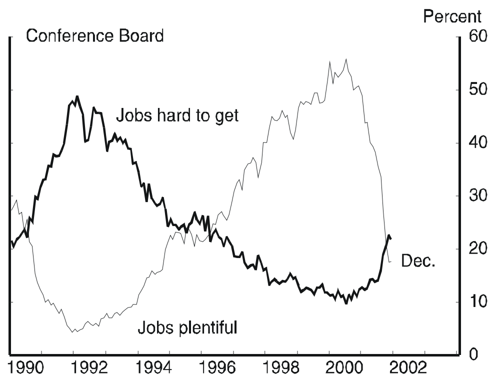


Expected Employment Conditions

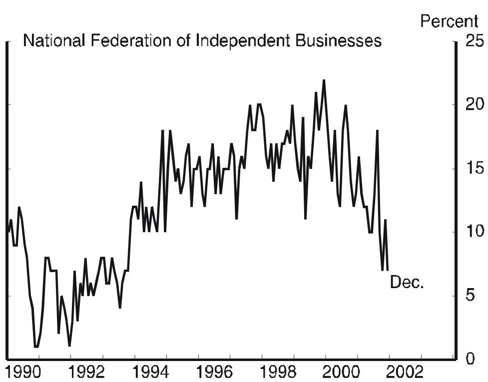


Note. Expected conditions index is the proportion of households expecting unemployment to fall, minus the proportion expecting unemployment to rise, plus 100.

Current Employment Conditions

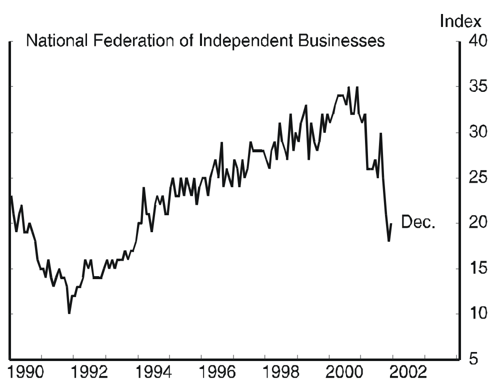


Net Hiring Strength



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

Reporting Positions Hard to Fill



Recent data on initial claims for unemployment insurance and the insured unemployment rate point to a further moderation in payroll employment declines in January. The four-week moving average of initial claims (based on FRB seasonals) for the week ended January 12 was 404,000, nearly 34,000 below the level a month earlier, and the insured unemployment rate for the week ended January 5 was 2.7 percent, 0.2 percentage point below the level in mid-December.[1]

Other indicators of labor market activity have either leveled off or begun to turn up of late. According to the preliminary Michigan Survey Research Center (SRC) survey, expectations of future employment prospects increased sharply in January, following increases in December reported by both the Michigan and Conference Board surveys. The National Federation of Independent Business reported that hiring plans remained depressed in December but that the percentage of firms finding job openings difficult to fill ticked back up last month after having declined in November.

Industrial Production

Output in the industrial sector continued to contract in December, but the rate of decline was not as steep as in previous months. Both total industrial production and manufacturing output edged down 0.1 percent last month after larger declines in October and November. For the fourth quarter as a whole, industrial output dropped at an annual rate of 7.2 percent after declining 4.7 percent in the third quarter. Production has fallen about 7 percent since the most recent peak in June 2000, 2-1/2 percentage points more than the 4-1/2 percent cumulative drop during the 1990-91 recession.

The motor vehicle industry was one of several that showed an increase in production in December. The output of motor vehicles and parts increased 4.1 percent, as assemblies rose to an exceptionally high rate of 12.3 million units, more than a million units above the average assembly rate in October and

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1. As in years past, week-to-week changes in the level of seasonally adjusted initial claims around the Christmas and New Year holidays have been quite large. Using seasonal adjustment factors developed by the Board's staff helps to reduce this volatility because FRB seasonals are allowed to evolve more rapidly over time. FRB-adjusted initial claims have fluctuated between 385,000 and 420,000 over the most recent four-week period, while BLS-adjusted initial claims have fluctuated between 386,000 and 451,000.

Recent week-to-week movements in initial claims may also have been influenced by an increase in unemployment benefits in California for those claimants filing after January 6. The rise in benefits provided an incentive for some individuals to delay filing until after January 6, and may have held down initial claims before this date and increased them in the most recent week. Using seasonal factors developed by the Board's staff, seasonally adjusted initial claims rose 12,000 in California for the week ended January 12.

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

Component	Proportion, 2001	2001[1]	2001[2] Q3	2001[2] Q4	2001[3] Oct.	2001[3] Nov.	2001[3] Dec.
Total	**100.0**	**-6.0**	**-4.7**	**-7.2**	**-.7**	**-.4**	**-.1**
Manufacturing	85.8	-6.3	-4.9	-7.1	-.7	-.2	-.1
Ex. motor veh. and parts	79.5	-6.8	-5.8	-6.9	-.5	-.7	-.5
Ex. high-tech industries	72.3	-5.7	-4.0	-7.5	-.6	-.7	-.5
Mining	7.1	-1.7	-4.1	-9.2	-1.9	-.7	-.8
Utilities	7.1	-5.9	-3.0	-6.3	.6	-2.2	.4
Selected industries							
High technology	7.3	-15.9	-21.8	.2	.6	-.1	.3
Computers	1.7	-10.4	-14.7	-6.2	.0	.5	.7
Communication equipment	1.6	-24.3	-28.1	-25.7	-2.5	-2.3	-3.0
Semiconductors[4]	3.9	-14.4	-22.2	17.2	2.2	.5	1.4
Motor vehicles and parts	6.3	-.3	6.6	-9.8	-4.2	5.4	4.1
Aircraft and parts	2.6	-12.2	-14.8	-28.4	-1.9	-4.5	-5.2
Market groups excluding energy and selected industries							
Consumer goods	23.3	-2.0	-1.7	-4.2	-.1	-.2	-.4
Durables	3.4	-8.3	-5.8	-11.6	-2.9	.3	.2
Nondurables	19.9	-.8	-1.0	-3.0	.4	-.3	-.5
Business equipment	7.7	-10.9	-15.0	-8.9	-.1	.2	-1.0
Defense and space equipment	2.0	-.4	-.7	1.4	.3	-.3	.1
Construction supplies	6.4	-4.6	-1.5	-12.3	-2.9	-.4	-.4
Business supplies	6.9	-8.1	-4.6	-3.8	-.2	-.5	.6
Materials	23.6	-7.0	-2.0	-9.6	-.9	-1.4	-.6
Durables	16.0	-7.5	-3.6	-13.1	-1.3	-1.5	-.6
Nondurables	7.6	-5.9	1.4	-1.7	.0	-1.1	-.5

1. Fourth-quarter to fourth-quarter change.
2. Annual rate.
3. Monthly rate.
4. Includes related electronic components.

Capacity Utilization
(Percent of capacity)

Sector	1967-2001 average	1982 low	1990-91 low	2001 Q2	2001 Q3	2001 Q4	2001 Nov.	2001 Dec.
Total industry	**81.9**	**71.1**	**78.1**	**77.4**	**76.2**	**74.6**	**74.5**	**74.4**
Manufacturing	80.9	69.0	76.6	75.6	74.5	72.9	72.9	72.8
High-tech industries	80.0	77.3	72.4	66.4	61.3	60.5	60.4	60.2
Excluding high-tech industries	81.0	68.0	76.8	76.7	76.1	74.5	74.5	74.4
Utilities	87.6	75.9	83.4	88.1	86.3	83.7	83.0	82.9

November. The strong pace of production in December likely was a response by the automakers to the surprisingly robust sales in the preceding two months.

Production of Domestic Autos and Trucks
(Millions of units at an annual rate except as noted; FRB seasonal basis)

Item	2001		2002	2001		2002	
	Q3	Q4	Q1[1]	Nov.	Dec.	Jan.[1]	Feb.[1]
U.S. production	11.6	11.6	11.9	11.8	12.3	12.4	11.9
Autos	4.7	4.8	5.3	4.9	5.1	5.3	5.4
Trucks	6.9	6.8	6.7	6.9	7.2	7.1	6.5
Days' supply[2]							
Autos	49.1	38.3	n.a.	37.7	47.4	n.a.	n.a.
Light trucks[3]	74.0	52.3	n.a.	55.1	57.6	n.a.	n.a.
Inventories[4]	2.69	2.27	n.a.	2.24	2.27	n.a.	n.a.

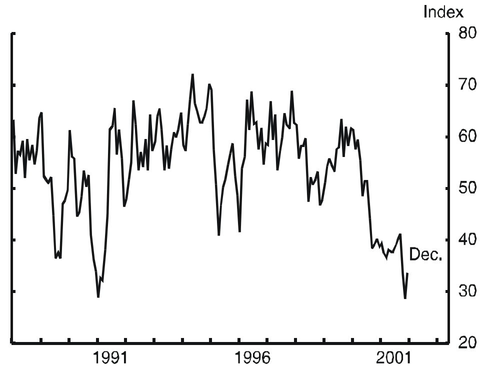
Note. Components may not sum to totals because of rounding.
1. Production rates reflect Ward's Communications' latest estimates for November and schedules for December and the first quarter.
2. Quarterly average calculated using end-of-period stocks and average reported sales.
3. Excludes medium and heavy (classes 3-8) trucks.
4. End-of-period stocks; excludes medium and heavy (class 3-8) trucks.
n.a. Not available.

Another relatively bright spot in industrial production was the output of high-tech goods, which rose 0.3 percent in December. The increase was led by a pickup in the production of semiconductors; output of communications equipment continued to slide, while output of computers posted a moderate gain of 0.7 percent. For the fourth quarter as a whole, production of high-tech goods ticked up slightly, the first quarterly increase in this category in a year and a sharp reversal from the double-digit declines recorded in each of the previous three quarters.

Outside of high tech and motor vehicles, production cutbacks were widespread last month, with the most pronounced weakness evident in consumer nondurables and business equipment. Within business equipment, the largest declines were in commercial aircraft and aircraft equipment, industrial machinery, and farm machinery and equipment. Among the consumer durables categories not previously discussed, production of appliances, furniture, and carpeting rose for the second month in a row.

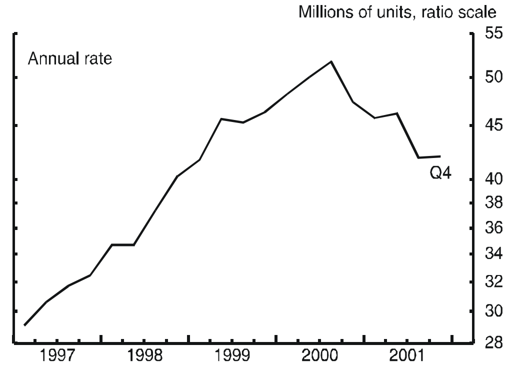
Indicators of Manufacturing Activity

IP Diffusion Index



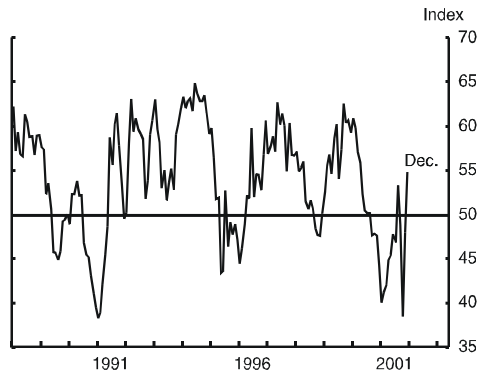
Note. The IP diffusion index equals the percentage of IP series that increased over three months plus one-half the percentage that were unchanged.

Personal Computer Sales



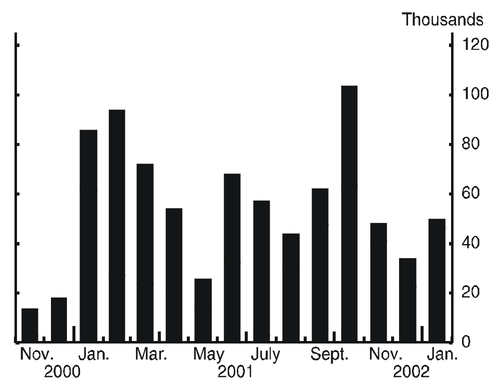
Note. FRB seasonals. Includes notebooks.
Source. Dataquest.

ISM New Orders Diffusion Index



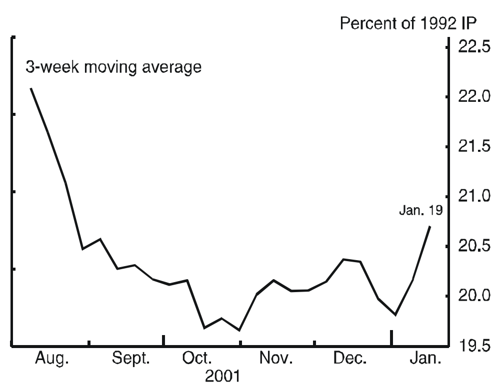
Note. The diffusion index equals fifty plus half the quantity of the percentage of respondents reporting greater levels of new orders, less the percentage of respondents reporting lower levels of new orders.

Announced Manufacturing Layoffs



Note. Data are through January 22, 2002.
Source. Compiled by staff from news reports.

Weekly Production Index



Note. The weekly production index aggregates available weekly physical product data using IP weights; about two-thirds of the index for January 19 uses forecast components.

Weekly Steel Capability Utilization Rates

Source. American Iron and Steel Institute.

Although manufacturing production fell sharply over the fourth quarter as a whole, there are some tentative indications that a recovery of sorts might be in the offing. Real adjusted durable goods orders increased noticeably in October and November. Moreover, the new orders index from the Institute for Supply Management (ISM; formerly the National Association of Purchasing Managers) survey, which has predictive power for near-term changes in manufacturing, increased sharply in December, moving into the region associated with an expansion in manufacturing activity for the first time in three months;[2] the latest Business Outlook Survey from the Federal Reserve Bank of Philadelphia showed a similarly sharp rise in January.

New Orders for Durable Goods
(Percent change from preceding period; seasonally adjusted)

Component	Share, 2001:H1	2001				
		Q2	Q3	Sept.	Oct.	Nov.
Total orders	**100.0**	**-2.3**	**-5.1**	**-9.2**	**12.4**	**-4.8**
Adjusted orders[1]	73.0	-4.2	-5.7	-9.8	5.3	2.2
Computers	5.0	-14.0	-19.4	-7.0	18.7	2.7
Communications equipment	4.0	-26.3	-16.6	-39.8	51.5	.1
Semiconductors and related devices	4.0	-19.4	-3.4	17.1	-16.7	2.3
Other capital goods	24.0	-2.8	-5.3	-6.4	-.3	3.7
Other[2]	37.0	.5	-3.4	-11.9	7.1	1.4
Memo:						
Real adjusted orders	. . .	-3.4	-4.8	-9.3	5.5	2.4
Excluding high tech	. . .	-1.3	-13.9	-9.8	4.2	2.1

1. Orders excluding defense capital goods, nondefense aircraft, and motor vehicle parts.
2. Includes primary metals, most fabricated metals, most stone, clay, and glass products, household appliances, scientific instruments, and miscellaneous durable goods.
. . . Not applicable.

Weekly production data through January 19 suggest that the weekly aggregate, which makes up nearly one-fifth of the IP index, will contribute roughly 0.2 percentage point to the change in total IP this month; in particular, weekly steel production and electricity generation were up noticeably in the first three weeks of the month. Steel capability utilization rates have reached their highest level since the week ending September 8, 2000.

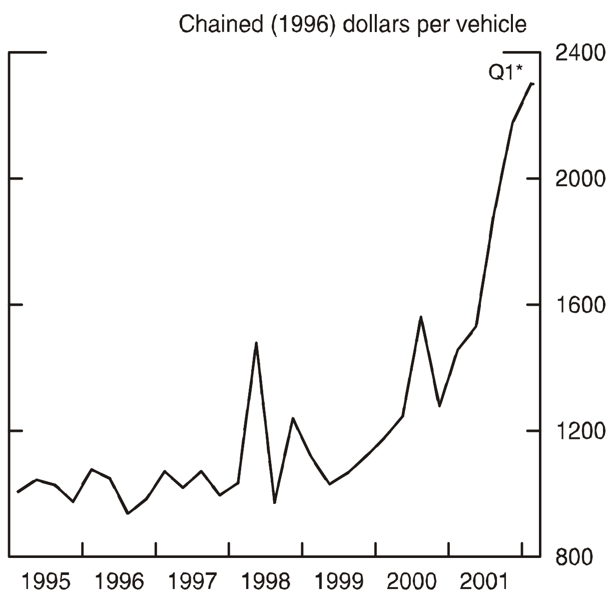
2. In the ISM survey, index values greater than 50 typically are associated with an increase in manufacturing activity.

SALES OF AUTOMOBILES AND LIGHT TRUCKS
(Millions of units at an annual rate, FRB seasonals)

			2001		2001		
	2000	2001	Q3	Q4	Oct.	Nov.	Dec.
Total[1]	17.2	17.0	16.1	18.4	21.1	17.8	16.3
Autos	8.8	8.4	7.9	8.7	10.2	8.6	7.4
Light trucks	8.4	8.6	8.2	9.7	10.9	9.2	8.8
North American[2]	14.4	13.9	13.1	15.0	17.6	14.5	13.0
Autos	6.8	6.3	5.9	6.4	7.8	6.3	5.2
Light trucks	7.5	.0	7.3	8.6	9.8	8.2	7.8
Foreign-produced	2.9	3.1	3.0	3.4	3.6	3.3	3.3
Autos	2.0	2.1	2.0	2.3	2.4	2.3	2.2
Light trucks	.8	1.0	1.0	1.1	1.2	1.0	1.0
Memo:							
Total retail sales (confidential)[3]	13.9	13.9	13.1	15.8	18.7	15.0	13.7

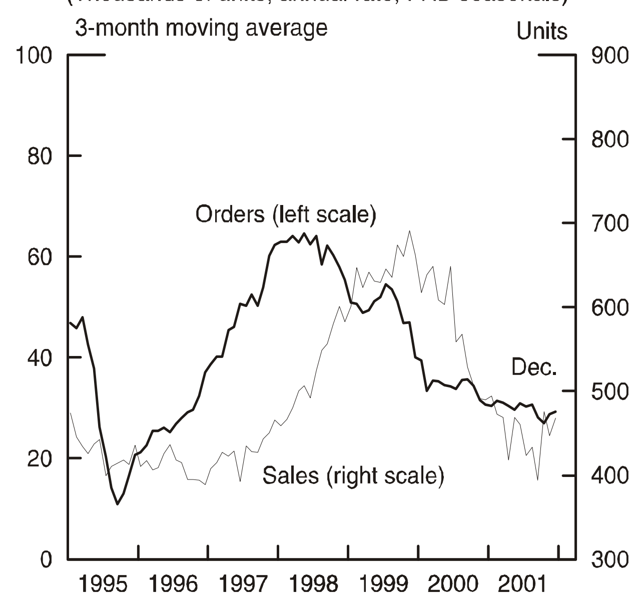
Note. Components may not sum to totals because of rounding. Data on sales of trucks and imported autos for the most recent month are preliminary and subject to revision.
1. The automakers' changes in reporting periods have no effect on the figures shown.
2. Excludes some vehicles produced in Canada that are classified as imports by the industry.
3. Sales include consumer purchases and leases of light vehicles.

Marketing Incentives for Light Vehicles



Note. Nominal industry data from GM and deflated by total PCE deflator.
*Staff estimate.

Orders and Sales of Medium and Heavy Trucks
(Thousands of units, annual rate, FRB seasonals)



Capacity utilization in manufacturing edged down to 72.8 percent in December. Despite the anemic rate of capacity expansion in 2001, utilization rates dropped precipitously throughout the year, and the average rate in the fourth quarter was its lowest since 1983; the drop in utilization has been sharpest in the high-tech sector. In contrast to manufacturing, an increase in capacity at utilities in 2001 was the strongest since 1974, reflecting producers' response to the significant shortfall in generating capacity that had opened up in the western states over the past year or so. Accordingly, capacity utilization at utilities in December was 12.7 percentage points below the most recent peak, in December 2000.

Motor Vehicles

Purchases of light vehicles moved lower again in December, but the pace of sales—at an annual rate of 16-1/4 million units—was still above the third-quarter average. For the fourth quarter as a whole, sales of automobiles and light trucks rose to an annual rate of 18.4 million units—a historical high. Demand for motor vehicles has been bolstered in recent months by a continued high level of incentives. Manufacturers scaled incentives back a bit last month, but they appear reluctant to cut them too substantially, likely because of concerns about the underlying strength of vehicle demand and the drop-off in sales volume that they presume would ensue if incentives abruptly returned to more normal levels.[5] The Michigan Survey index of car-buying conditions shot up over the final months of last year—buoyed by highly favorable consumer assessments of motor vehicle prices and financing rates. In early January, the index eased a bit as respondents expressed some dissatisfaction with current financing rates after automakers removed zero percent rates from many models.

Most of the decline in light vehicle sales in December came in retail purchases, which had spiked in October and then dropped back some in November. However, confidential data from automakers indicate that fleet sales also moved lower in December and were down 1/2 million units (annual rate) in the fourth quarter. With demand for travel down, some rental car companies have aggressively trimmed the size of their fleets. In contrast, business purchases of medium and heavy trucks rose in the fourth quarter for the first time since the fourth quarter of 1999, and on a three-month moving average basis, net new orders for medium and heavy trucks ticked up in December.

5. On January 2, GM ended zero percent financing and began offering rebates of $2,002 on many models. Other models were eligible for reduced-rate financing plus a smaller cash rebate. These offers are scheduled to run through February 28. Ford has extended its zero percent financing on thirty-six-month loans until March 5 and has offered cash rebates of $1,000 to $2,500 depending on the model. DaimlerChrysler's zero percent program ended on January 8. Currently, incentives on its vehicles vary by region and by model.

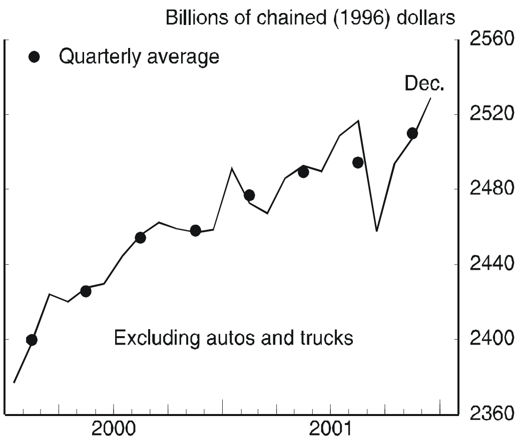
Total Retail Trade and Food Services Sales

(Percent change; seasonally adjusted)

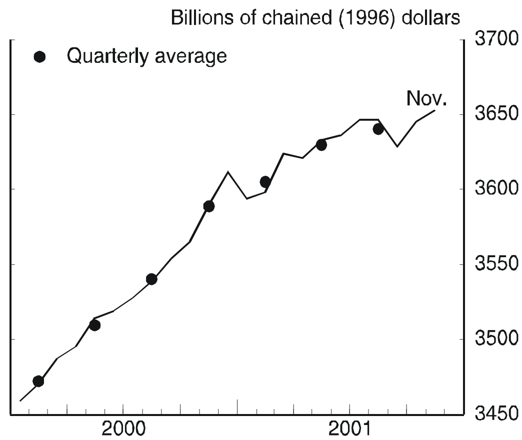
Expenditure	2001 H1	2001 Q3	2001 Q4	2001 Oct.	2001 Nov.	2001 Dec.
Total sales	2.6	-.3	2.7	6.4	-3.0	-.1
Previous estimate	...	...	...	6.4	-3.7	...
Retail control[1]	1.4	-.2	-.2	.7	-.2	.1
Previous estimate	...	...	...	.7	-.6	...
GAF[2]	1.3	.2	1.8	2.2	1.1	.7
Gasoline stations	2.0	-4.5	-11.2	-7.7	-6.7	-4.2
Food services	3.4	.5	1.0	1.3	1.0	1.8
Other retailers[3]	.9	.4	.4	1.2	-.1	.0

1. Total retail trade and food services less sales at building material and supply stores and automobile and other motor vehicle dealers.
2. Furniture and home furnishing stores, electronics and home appliance stores, sporting goods and hobby stores, and general merchandise stores.
3. Health and personal care stores, food and beverage stores, electronic shopping and mail order houses, and miscellaneous other retailers.
... Not applicable.

Real PCE Goods

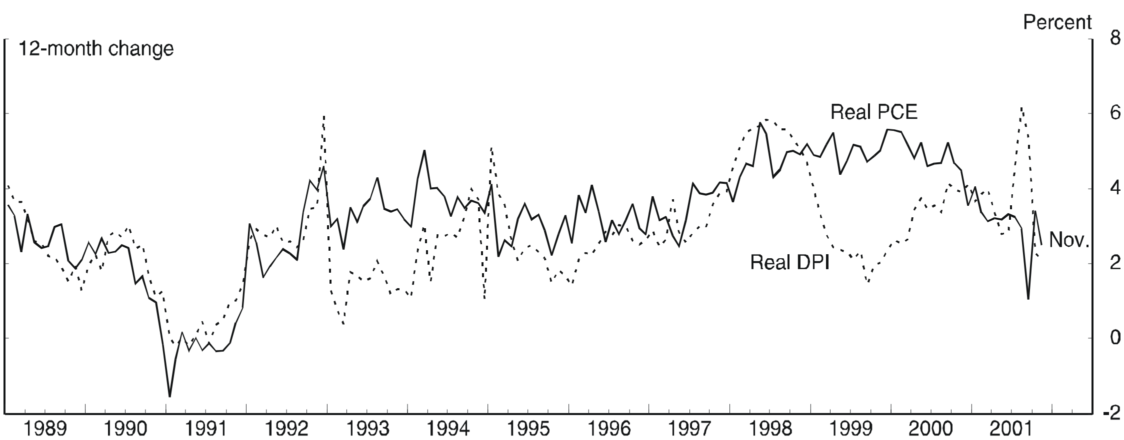


Real PCE Services



Note. October to December is a staff estimate.

Real Consumer Spending and Income



With sales at record levels, inventories of light vehicles fell substantially in the fourth quarter. Stocks of light vehicles are estimated to have declined to 2-1/4 million units last quarter—the lowest level since the first quarter of 1992. The days' supply of light vehicles stood at fifty-four days in December, relatively lean compared with desired levels of about sixty-five days.

Although the Big Three automakers continue to expect sales to drop in the first quarter, their latest production plans call for a robust assembly rate of 11.9 million units, a shade above the average for the fourth quarter. If these schedules are maintained and sales fall back, inventories would likely move up sharply in the near term.[6]

Consumer Spending

Available data indicate that the pace of consumer spending was well maintained through the end of last year. Real personal consumption expenditures are now expected to have risen at an annual rate of 4-3/4 percent in the fourth quarter, mainly on the aforementioned strength of motor vehicle sales. Moreover, recent reports from chain stores suggest that their sales, which exceeded expectations in December, have also held up well through the first three weeks of January.

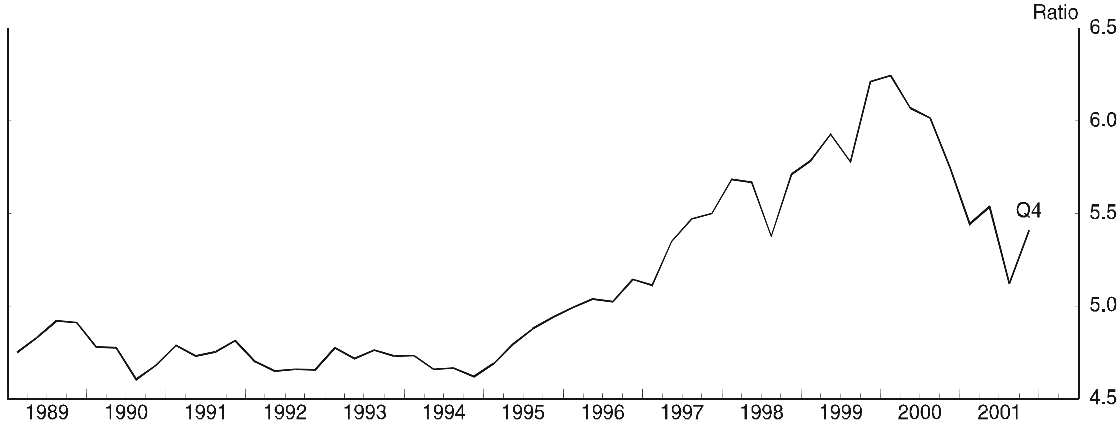
Although total nominal retail sales declined 0.1 percent in December, spending in the nominal retail control category—which excludes auto dealers and building material and supply stores—edged up last month, and revised data for November show a noticeably smaller decline than had been previously estimated. Within retail control, sales at stores in the GAF category (general merchandise, apparel, and furniture and appliance stores) posted another noticeable gain in December, despite rather gloomy reports from retail analysts during the Christmas season. In contrast, nominal retail sales at gasoline stations fell further in December, likely because of lower retail gasoline prices. On the basis of these retail sales data and information showing substantial price declines for goods, we estimate that real PCE for goods excluding autos and trucks increased about 3/4 percent, on average, in November and December.

According to the most recent data, outlays on services rose 0.2 percent in November, as increases in expenditures for medical services, personal business services, and recreation services more than offset a sizable drop in spending on energy services. Although temperatures on balance remained unseasonably warm in December, they were down from November and likely led to higher spending on energy services last month. In contrast, slight decreases in stock

6. Ford recently announced a restructuring plan that involves closing at least three domestic assembly plants in addition to some parts plants. No domestic assembly plant will be closed before the September 2003 expiration of the current labor contract with the United Auto Workers, but Ford could slow the line speed and drop some production shifts as early as March. Ford plans to close some parts plants within the year.

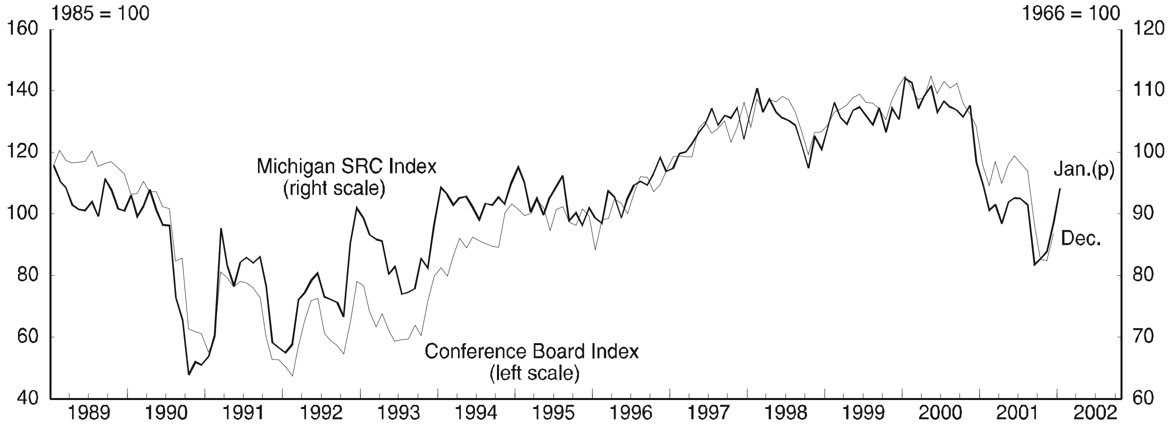
Household Indicators

Ratio of Household Net Worth to DPI

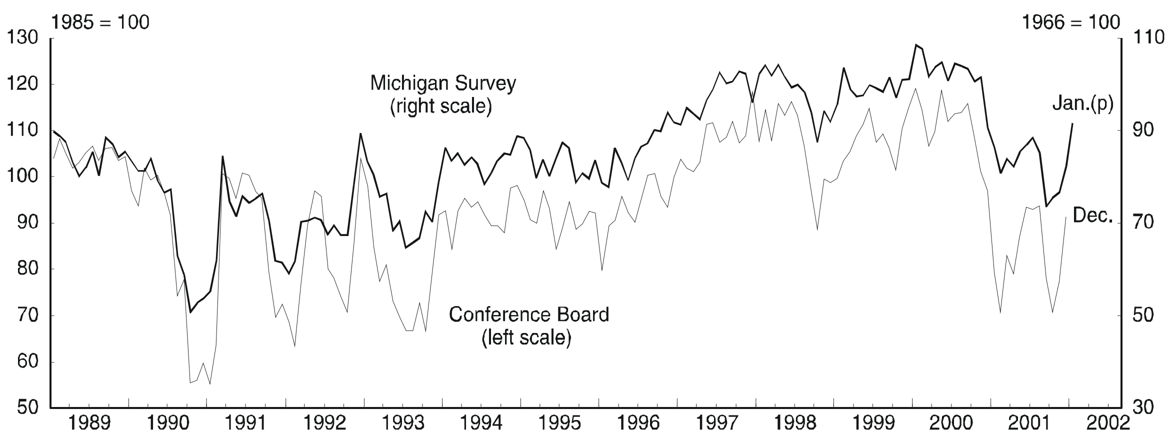


Note. 2001:Q4 is a staff estimate.

Consumer Confidence



Consumer Expectations



market trading volumes last month probably served to damp expenditures on personal business services.

On the income side, private wages and salaries appear to have advanced in December after a small decline in November. Moreover, the overall rise in real disposable personal income last year was well above that seen in previous recessions, aided both by last summer's tax cuts and by the rapid decline in consumer energy prices through the end of the year. Meanwhile, the pickup in equity values over the fourth quarter is estimated to have raised the ratio of household net worth to disposable income to close to the level it registered at the end of 2000.

Sentiment surveys also point to an improvement in the consumer outlook. According to the preliminary report, the Michigan Survey Research Center's index of consumer sentiment moved up again in January after having posted a series of modest increases since mid-September, and the Conference Board's index of consumer confidence popped up in December, interrupting a string of declines. Although assessments of current conditions remain relatively pessimistic, both surveys have shown continued improvements since late last summer in consumers' expectations about future conditions.

Housing Markets

The pace of homebuilding eased slightly last quarter. Although single-family starts are estimated to have moved up in December to an annual rate of 1.29 million units, the average pace of starts for the fourth quarter as a whole was down about 6 percent (annual rate) from the third-quarter pace. Meanwhile, multifamily starts were down sharply in December from November's elevated level, leaving the fourth-quarter pace little changed from that of the third. The available building-permits data—which are typically less erratic than the starts data—painted a slightly softer picture of single-family activity but a somewhat stronger one of the multifamily sector.

The underlying trajectory of starts has been obscured by the fallout from the terrorist attacks—which likely restrained building in October—and unseasonably warm and dry weather—which likely boosted activity in November and December. The exact contributions of these events are uncertain, but it is clear that low mortgage rates helped keep the housing market relatively strong through the end of the year despite the weakening job market.

Although the pace of starts was well maintained in 2001, the average nominal cost of newly started homes decelerated sharply over the year, contributing to a deceleration in the overall pace of both nominal and real residential investment. In particular, industry anecdotes suggest that at least part of the deceleration in

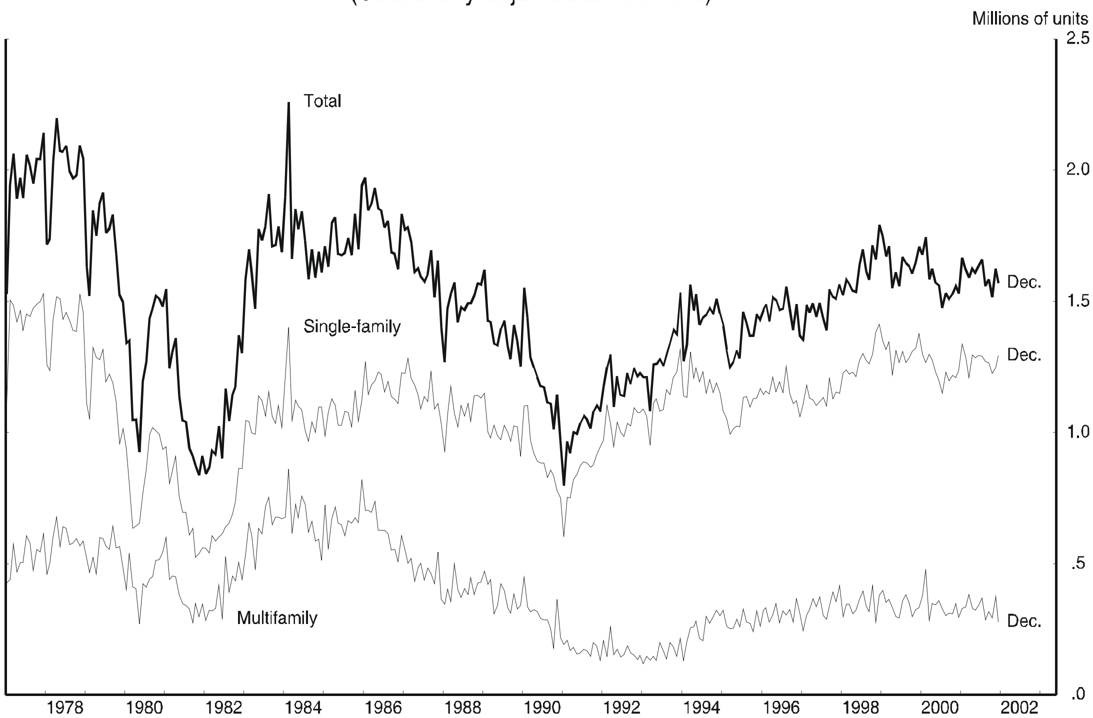
Private Housing Activity
(Millions of units; seasonally adjusted annual rate)

	2001p	2001 Q2	Q3	Q4p	Oct.r	Nov.r	Dec.p
All units							
Starts	1.60	1.62	1.60	1.57	1.52	1.63	1.57
Permits	1.61	1.60	1.56	1.58	1.49	1.60	1.65
Single-family units							
Starts	1.27	1.29	1.28	1.26	1.23	1.25	1.29
Permits	1.22	1.22	1.20	1.20	1.14	1.21	1.25
Adjusted permits[1]	1.25	1.27	1.24	1.23	1.17	1.27	1.26
New home sales	n.a.	.89	.87	n.a.	.88	.93	n.a.
Existing home sales	n.a.	5.30	5.21	n.a.	5.18	5.21	n.a.
Multifamily units							
Starts	.33	.33	.33	.32	.29	.38	.28
Permits	.39	.38	.36	.38	.35	.38	.40
Mobile homes							
Shipments	n.a.	.19	.20	n.a.	.21	.20	n.a.

1. Adjusted permits equals permit issuance plus total starts outside of permit-issuing areas.

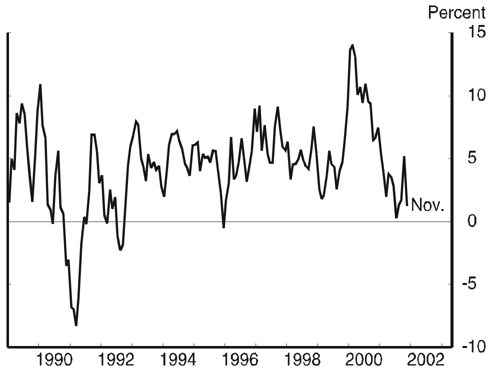
p Preliminary. r Revised. n.a. Not available.

Private Housing Starts
(Seasonally adjusted annual rate)



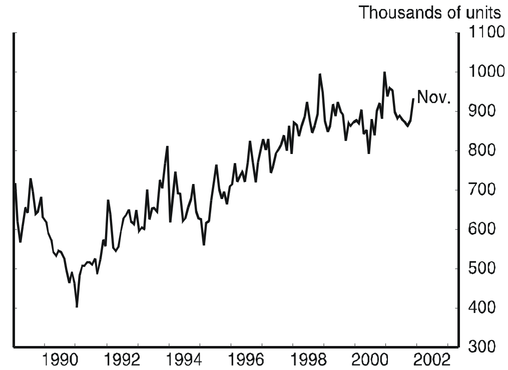
Indicators of Single-Family Housing

Single-Family Cost per Start



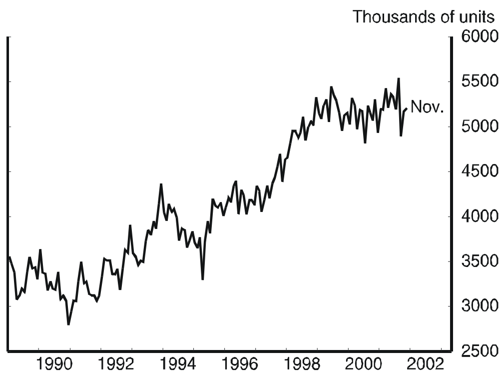
Note. Change in the 3-month moving average from a year earlier.
Source. Census Bureau.

New Home Sales



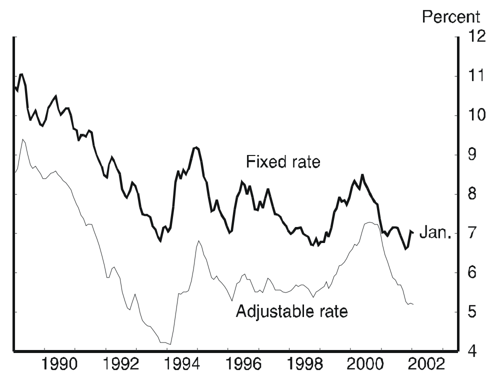
Source. Census Bureau.

Existing Home Sales



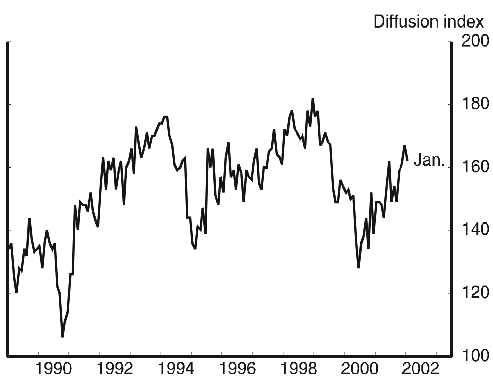
Source. National Association of Realtors.

Mortgage Rates



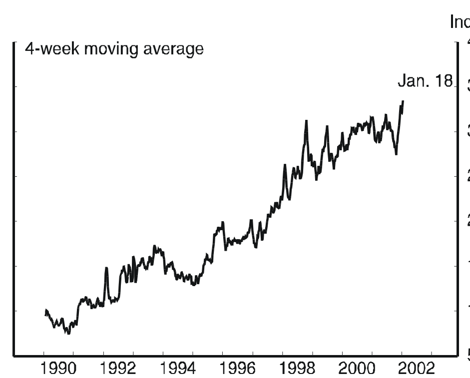
Note. The January reading is based on data through the 18th.
Source. Freddie Mac.

Perceived Homebuying Conditions



Source. Michigan Survey, not seasonally adjusted.

MBA Index of Purchase Applications

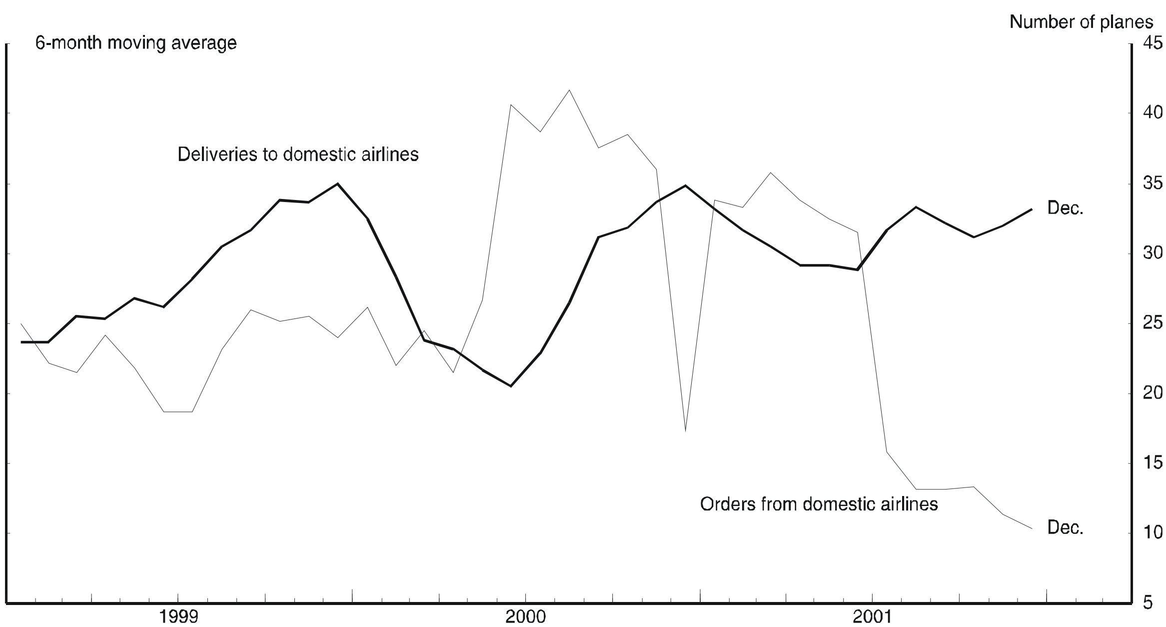


Note. The NSA index for March 16, 1990 is equal to 100. The series shown here is the 4-week moving average of the seasonally adjusted data.

BUSINESS CAPITAL SPENDING INDICATORS
(Percent change from preceding comparable period;
based on seasonally adjusted data, in current dollars)

	2001		2001		
	Q3	Q4	Sept.	Oct.	Nov.
Equipment and software					
Shipments of nondefense capital goods	-6.7	n.a.	-4.1	1.7	-0.6
Excluding aircraft	-7.1	n.a.	-4.9	2.1	-1.6
Computers and related equipment	-15.4	n.a.	6.0	1.2	2.2
Communications equipment	-11.9	n.a.	-6.8	-3.0	-1.7
All other categories	-4.6	n.a.	-6.5	3.0	-2.3
Shipments of complete aircraft	8.8	n.a.	-11.8	14.4	8.6
Medium & heavy truck sales (units)	-6.2	9.6	-6.9	18.4	-7.8
Orders for nondefense capital goods	-10.6	n.a.	-13.0	5.8	5.0
Excluding aircraft	-8.6	n.a.	-9.9	5.9	3.2
Computers and related equipment	-19.4	n.a.	-7.0	18.7	2.7
Communications equipment	-16.6	n.a.	-39.8	51.5	0.1
All other categories	-5.3	n.a.	-6.4	-0.3	3.7

Orders and Deliveries of Aircraft



the cost per single-family start owes to a shift away from construction of high-end homes.[7]

New and existing home sales remained brisk through November. Although the terrorist attacks shook the confidence of both buyers and realtors, the effects were fleeting, with sales rebounding in October and November to their pre-September levels. Mortgage rates backed up somewhat in December, but they have since turned down again, retracing all of the December rise. Indeed, the Mortgage Bankers Association reported that mortgage applications for a home purchase reached an all-time high in the week ended January 18. In addition, respondents to the Michigan Survey continue to perceive homebuying conditions as relatively favorable in January.

Business Fixed Investment

Equipment and software. Although the data are still incomplete, real expenditures on equipment and software appear to have leveled off in the fourth quarter, following substantial declines in both the second and third quarters. Some of the improvement is attributable to a sizable bounceback in business purchases of motor vehicles. Even excluding this erratic sector, however, declines in equipment spending seem to have been less pronounced, despite falling business output and weak corporate cash flow.

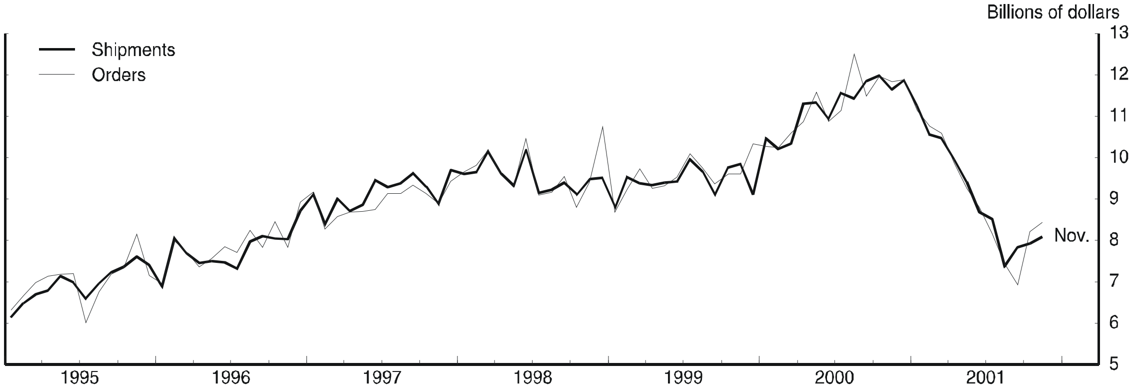
Business spending on high-tech equipment and software looks to have registered a small gain in the fourth quarter—a marked turnaround from the steep drops posted in the second and third quarters. In November, the latest month for which we have data, nominal shipments of computers and related products rose 2.2 percent (not at an annual rate), leaving the average pace for the October-November period 1.2 percent above that for the third quarter. Taking into account the ongoing steep declines in prices, real computer expenditures likely rose at a double-digit annual rate last quarter. In contrast, declines in expenditures on communications equipment show no signs of abating. Shipments fell again in November, the eighth consecutive month of decrease, and although orders were flat in November, the three-month moving average was down 3.5 percent, setting the stage for continued softness in this category.

At this point, we estimate that business expenditures on aircraft were little changed in the fourth quarter. Boeing and Airbus reportedly delivered

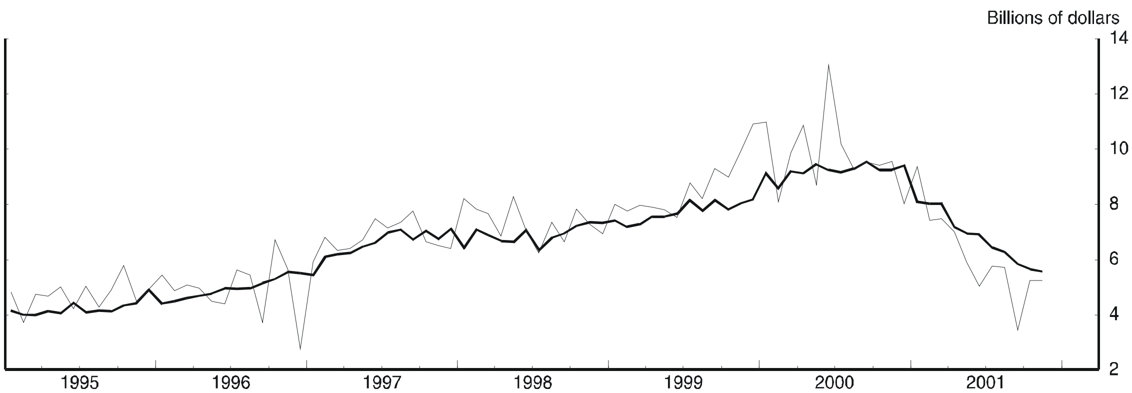
7. The Census Bureau estimates the cost per start using new home prices for homes built for sale, contract prices for homes built for the owner, and an adjustment factor for the cost of land and land development.

Recent Data on Orders and Shipments

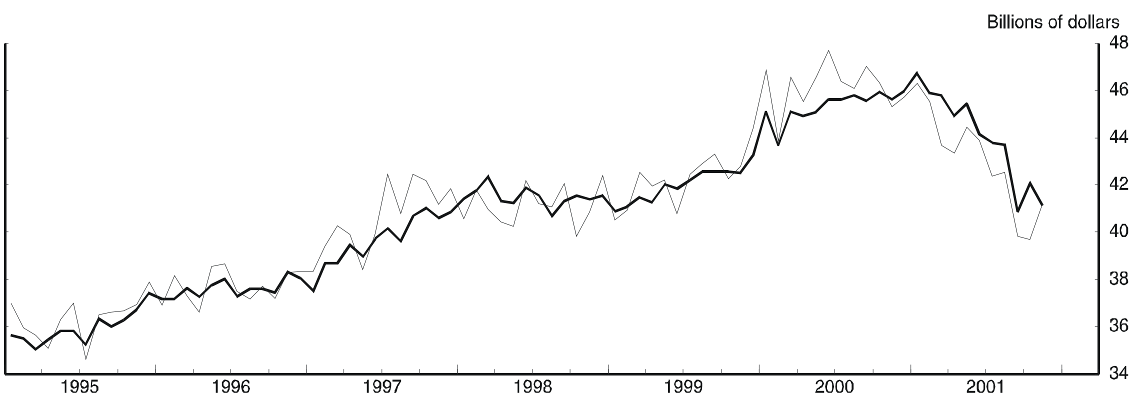
Computers and Related Equipment



Communications Equipment

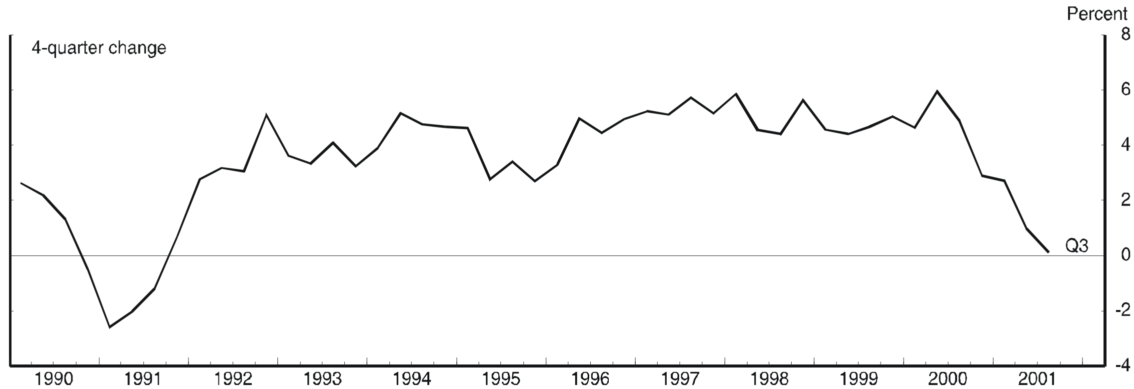


Other Equipment (Total Ex. Transportation, Computers, Communications)

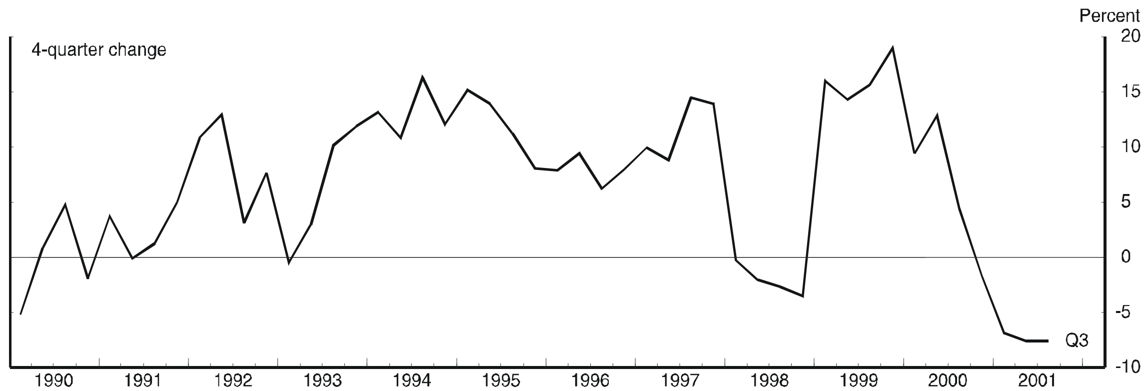


Equipment Investment Fundamentals

Business Output

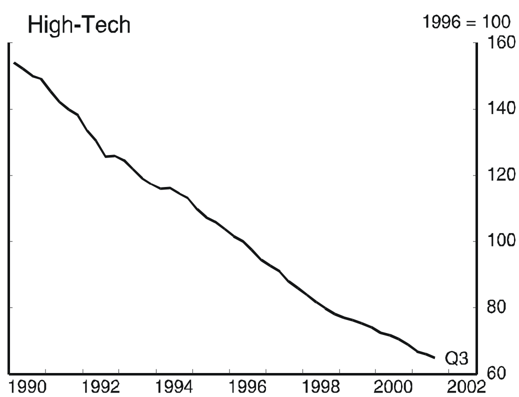


Real Cash Flow

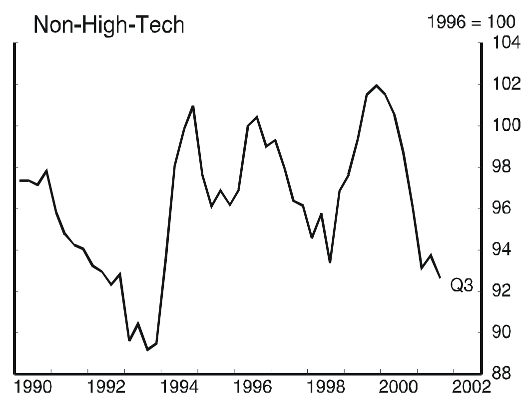


User Cost of Capital

High-Tech



Non-High-Tech



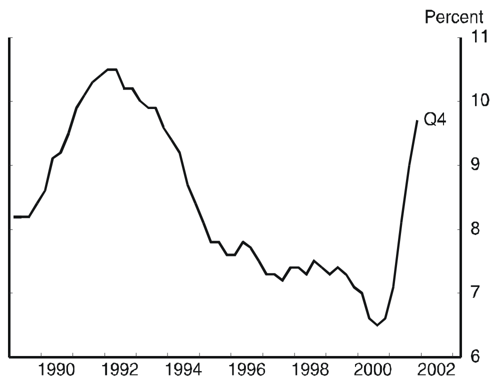
Nonresidential Buildings Investment
(Billions of dollars, annual rate)

	2001				
	Q2	Q3	Sept.	Oct.	Nov.
Current dollars					
Private construction put in place, buildings	214.4	205.0	202.0	196.8	197.7
Office	56.3	51.1	50.0	50.3	50.1
Other commercial	63.8	61.6	61.3	61.2	61.5
Lodging and miscellaneous	24.8	23.8	23.6	22.5	22.9
Industrial	33.2	32.6	31.3	25.6	25.6
Fixed-weight 1996 dollars[1]					
Private construction put in place, buildings	178.6	170.0	167.1	162.5	163.5
Office	46.9	42.3	41.3	41.6	41.5
Other commercial	53.2	51.1	50.7	50.5	50.8
Lodging and miscellaneous	20.7	19.8	19.5	18.6	19.0
Industrial	27.7	27.0	25.9	21.2	21.2

Source. Census Bureau.
1. Census does not report chain-weighted data for construction put in place.

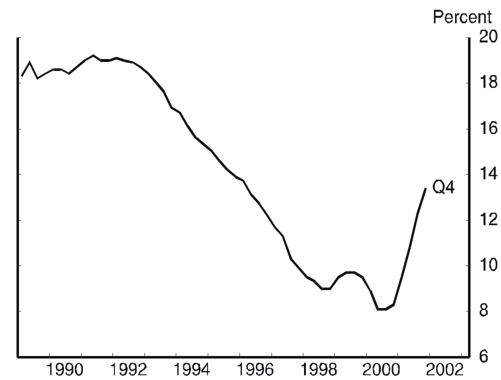
Indicators for Nonresidential Structures

Industrial Vacancy Rate



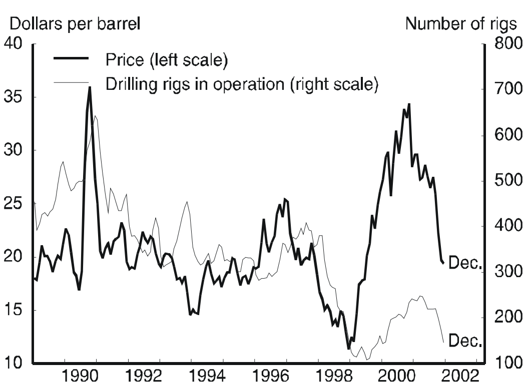
Source. Torto Wheaton Research.

Office Vacancy Rate



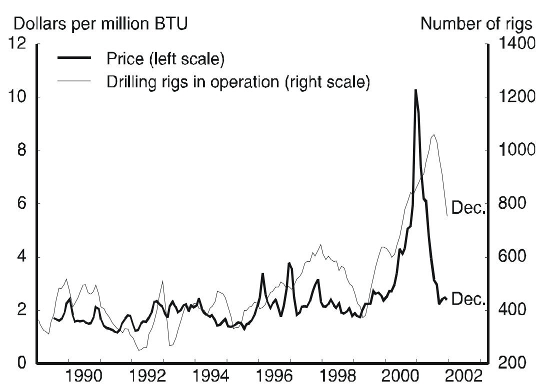
Source. Torto Wheaton Research.

Petroleum Prices and Drilling



Source. WTI spot price and DOE/Baker Hughes.

Natural Gas Prices and Drilling



Source. Henry Hub spot price and DOE/Baker Hughes.

101 planes to domestic airlines last quarter, similar to the number of deliveries in the previous quarter. However, most of the planes delivered last quarter were ordered in 2000. Orders have fallen sharply since mid-2001, and given the long lags between orders and deliveries, shipments of aircraft are likely to be down substantially this year.

Outside of the high-tech and transportation sectors, nominal shipments fell 2.3 percent in November, and the October-November average was 2.7 percent (not at an annual rate) below the third-quarter pace. Orders, however, rose 3.7 percent in November, led by sizable increases in bookings of new machinery, electrical equipment, ships and boats, and furniture. The three-month moving average of orders fell less rapidly in November than in earlier months, perhaps signaling smaller spending declines in coming months.

Nonresidential construction. The incoming data point to another large decline in real spending on private nonresidential construction in the fourth quarter, November and December's favorable weather notwithstanding.[8] In particular, real outlays for private nonresidential buildings fell, on net, over the first two months of the fourth quarter, leaving the level of spending in November down at an annual rate of 14-1/4 percent from the third-quarter average. By sector, spending has fallen precipitously in the industrial building category, reflecting low capacity-utilization rates and rising vacancies. For office buildings, for which vacancy rates also moved up further in the fourth quarter, the level of construction in November was about 8 percent at an annual rate below the third-quarter average. In contrast, spending for other commercial construction—which includes retail, wholesale, and warehouse space—was down only about 2 percent in November from the third quarter.

Real spending on new drilling and mining structures declined at an annual rate of 5.3 percent in the third quarter, and given the decline in November and December in the number of oil and gas drilling rigs in operation, another drop seems to have ensued in the fourth quarter.

Inventories

The book value of manufacturing and trade inventories (excluding motor vehicles) fell at an annual rate of $99.9 billion in November following a $92.0 billion liquidation in October. The average runoff for the two months was

8. The level of spending in the third quarter was boosted by the lease in July of the World Trade Center by the Port Authority to the private sector. The Bureau of Economic Analysis (BEA) treated the transaction as a purchase, raising the level of private nonresidential construction spending in the third quarter by $10.7 billion. Reported spending growth in the fourth quarter will be restrained by an offsetting amount. These accounting effects are exactly offset in the state and local government sector; total GDP is unaffected.

CHANGES IN MANUFACTURING AND TRADE INVENTORIES
(Billions of dollars; annual rate except as noted;
based on seasonally adjusted Census book value)

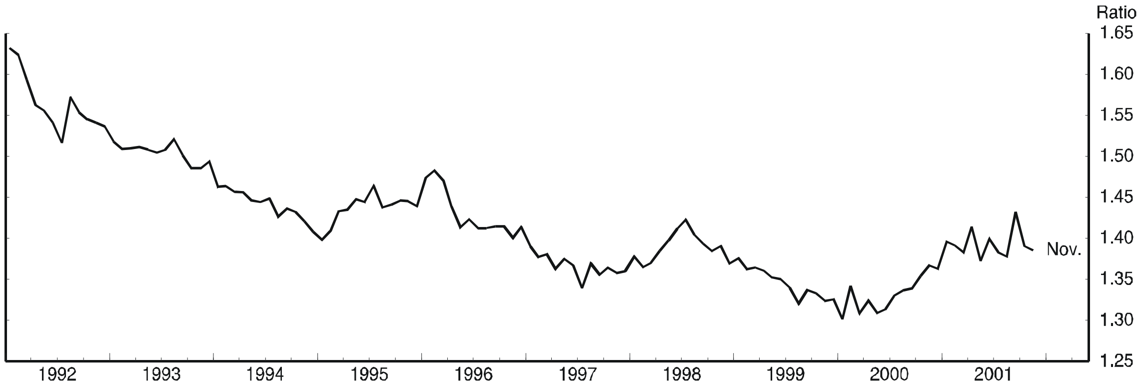
Category	2001 Q1	2001 Q2	2001 Q3	2001 Sept.	2001 Oct.	2001 Nov.
Manufacturing and trade	-24.0	-43.3	-61.5	-81.5	-226.8	-137.2
Less wholesale and retail motor vehicles	-10.0	-40.4	-66.2	-80.6	-92.0	-99.9
Manufacturing	-11.9	-34.4	-45.3	-51.5	-39.6	-50.8
Merchant wholesalers	-5.0	.2	-18.8	-13.9	-42.3	-38.8
Less motor vehicles	-2.4	3.3	-19.1	-21.0	-46.0	-28.6
Retail trade	-7.2	-9.0	2.6	-16.1	-144.9	-47.7
Automotive dealers	-11.5	.3	4.4	-8.0	-138.6	-27.2
Less automotive dealers	4.3	-9.3	-1.8	-8.2	-6.3	-20.5

SELECTED INVENTORY-SALES RATIOS IN MANUFACTURING AND TRADE
(Months' supply, based on seasonally adjusted Census book value)

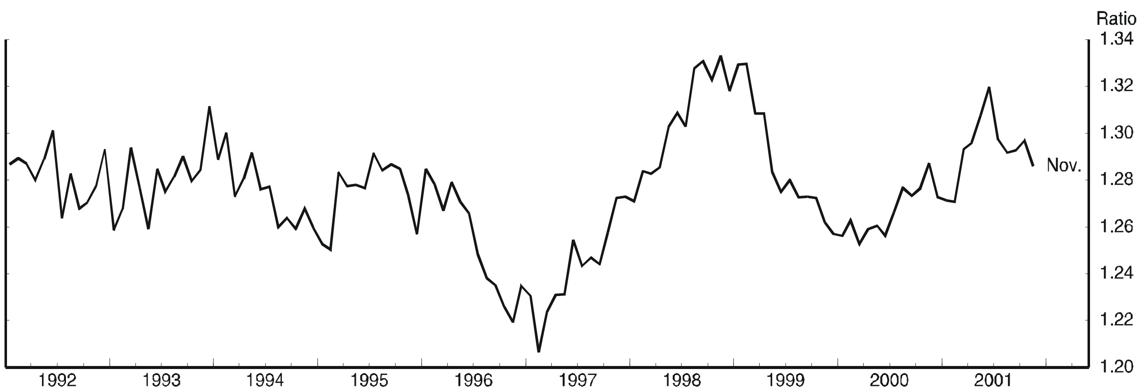
Category	2001 Q1	2001 Q2	2001 Q3	2001 Sept.	2001 Oct.	2001 Nov.
Manufacturing and trade	1.42	1.42	1.42	1.45	1.39	1.39
Less wholesale and retail motor vehicles	1.38	1.38	1.38	1.41	1.39	1.38
Manufacturing	1.38	1.38	1.38	1.43	1.39	1.39
Primary metals	1.80	1.76	1.73	1.80	1.75	1.77
Steel	2.30	2.20	2.19	2.25	2.21	2.23
Machinery	2.01	2.06	2.09	2.22	2.11	2.13
Computers and electronics	1.38	1.52	1.56	1.61	1.57	1.54
Electrical equipment	1.41	1.39	1.46	1.53	1.48	1.54
Transportation equipment	1.49	1.42	1.42	1.52	1.43	1.36
Motor vehicles	.62	.59	.58	.65	.58	.54
Aircraft	4.02	3.84	3.77	3.69	3.94	3.62
Fabricated metals	1.71	1.69	1.67	1.70	1.65	1.65
Textiles	1.75	1.68	1.60	1.60	1.58	1.55
Paper	1.17	1.18	1.20	1.23	1.20	1.22
Chemicals	1.41	1.43	1.46	1.50	1.47	1.46
Petroleum	.68	.68	.70	.71	.73	.73
Rubber and plastics	1.25	1.22	1.18	1.21	1.19	1.20
Merchant wholesalers	1.30	1.32	1.30	1.31	1.31	1.30
Less motor vehicles	1.28	1.31	1.29	1.29	1.30	1.29
Durable goods	1.62	1.61	1.59	1.62	1.61	1.57
Nondurable goods	.97	1.03	1.02	1.02	1.02	1.02
Retail trade	1.59	1.56	1.57	1.59	1.45	1.48
Less automotive dealers	1.50	1.47	1.48	1.49	1.48	1.47
Automotive dealers	1.85	1.80	1.83	1.89	1.39	1.52
General merchandise	1.94	1.92	1.91	1.92	1.91	1.90
Apparel	2.41	2.41	2.44	2.56	2.40	2.38
Food	.85	.86	.85	.85	.85	.85
Memo: Manufacturing and trade shipments and sales (billions of dollars)	841.2	834.5	824.1	807.8	830.3	819.0

Inventory-Sales Ratios
(Seasonally adjusted book value)

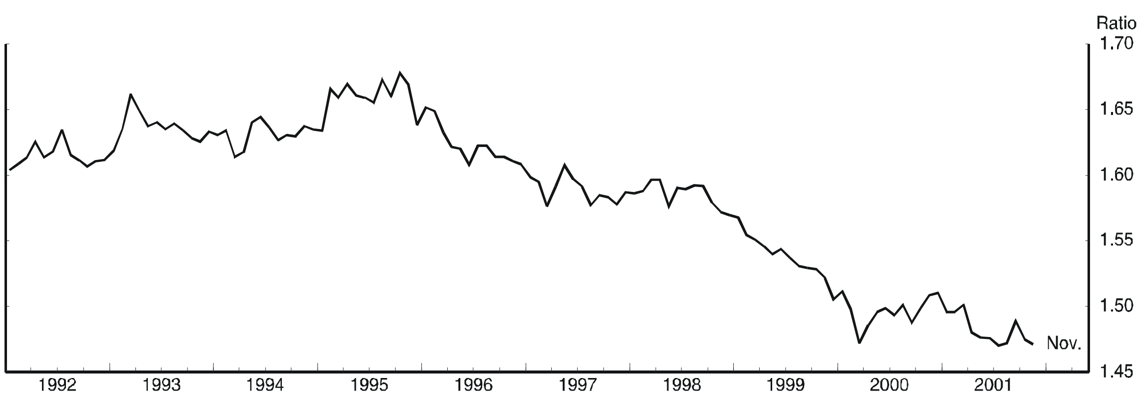
Manufacturing



Wholesale Trade Excluding Motor Vehicles



Retail Trade Excluding Motor Vehicles



nearly $30 billion greater than the pace of reduction during the third quarter and the fastest since the beginning of the series in the mid-1960s.

In manufacturing, the pace of liquidation has been hefty since spring, but inventory-sales ratios have remained stubbornly high. The ratios of inventories to shipments were still elevated in November at manufacturers of metals, minerals, lumber, furniture, computers and electronics products, machinery, and electrical goods, although in all but the last two of these categories, stock-sales ratios are down from their earlier peaks. For manufacturing as a whole, the ratio appears to have declined somewhat in the first two months of the fourth quarter after having spiked in September.

The pace of liquidation at wholesalers appears to have steepened in recent months. The book value of distributors' inventories (excluding motor vehicles) fell at an average pace of $37.3 billion in the October-November period, about twice the third-quarter rate of reduction. As a consequence, the ratio of wholesalers' stocks to sales has diminished. Nonetheless, distributors in several sectors—such as furniture, hardware, machinery, paper, drugs, and chemicals—still appear to have a worrisome level of inventories relative to sales.

The book value of retail inventories (excluding stocks held by auto dealers) fell at an annual rate of $20.5 billion in November after having declined $6.3 billion in October. The average decrease for the two months, $13.4 billion, was steeper than the small liquidation posted in the third quarter. Despite fairly weak nominal sales, the inventory-sales ratio edged down further in November and appeared to be at a fairly comfortable level.

Government Expenditures

Federal sector. The budget position of the federal government continues to deteriorate. According to the Monthly Treasury Statements, the federal budget deficit for the November-December period totaled $28 billion, compared with a $9 billion surplus for the same period last year.

The less-favorable budget outcome owes primarily to declines in revenue, although a strong increase in government outlays has also been a factor. On the revenue side, receipts during the November-December period fell 5.2 percent relative to a year earlier. Net corporate receipts continued their recent decline, falling 33 percent. Individual tax receipts rose 1.5 percent, reflecting in part an extra Monday, a key day for payroll processing, in December. According to the Daily Treasury Statements, non-withheld income tax receipts for January 2002 are similar to those of last January.

Federal Government Outlays and Receipts

(Unified basis; billions of dollars)

Function or source	November-December			12 months ending in Dec.		
	2000	2001	Percent change	2000	2001	Percent change
Outlays	317.2	336.8	6.2	1,788.6	1,903.0	6.4
Deposit insurance	-0.6	0.2	...	-4.5	-0.7	...
Spectrum auctions	0.0	0.0	...	-0.2	-1.0	...
Sale of major assets	0.0	0.0	...	0.0	0.0	...
Other	317.7	336.6	5.9	1,793.2	1,904.7	6.2
Receipts	326.2	309.1	-5.2	2,043.4	1,995.2	-2.4
Surplus	9.0	-27.7	...	254.9	92.3	-63.8
	Outlays excluding deposit insurance, spectrum auction, and sale of major assets are adjusted for payment timing shifts[1]					
Outlays	307.7	326.2	6.0	1,792.3	1,901.5	6.1
National defense	51.1	55.3	8.3	290.5	314.0	8.1
Net interest	36.0	29.7	-17.6	220.2	197.5	-10.3
Social security	69.3	73.6	6.2	415.2	439.0	5.7
Medicare	33.3	36.3	9.0	199.0	217.5	9.3
Medicaid	19.6	23.1	17.8	119.8	134.9	12.6
Other health	6.5	8.2	26.1	37.5	44.9	19.8
Income security	40.4	43.1	6.9	247.1	271.2	9.7
Agriculture	7.2	9.3	30.5	32.1	30.8	-4.2
Other	44.4	47.6	7.2	230.9	251.7	9.0
Receipts	326.2	309.1	-5.2	2,043.4	1,995.2	-2.4
Individual income and payroll taxes	244.9	248.6	1.5	1,635.5	1,658.3	1.4
Withheld + FICA	241.5	246.9	2.2	1,374.7	1,421.6	3.4
Nonwithheld + SECA	9.2	9.0	-2.0	395.0	421.5	6.7
Refunds (-)	5.8	7.3	26.5	134.1	184.7	37.7
Corporate	53.4	36.0	-32.6	213.6	151.7	-29.0
Gross	57.5	41.6	-27.5	243.1	193.9	-20.2
Refunds (-)	4.1	5.7	37.9	29.6	42.2	42.8
Other	27.9	24.6	-11.9	194.3	185.2	-4.7
Surplus	18.5	-17.0	...	251.1	93.8	-62.7

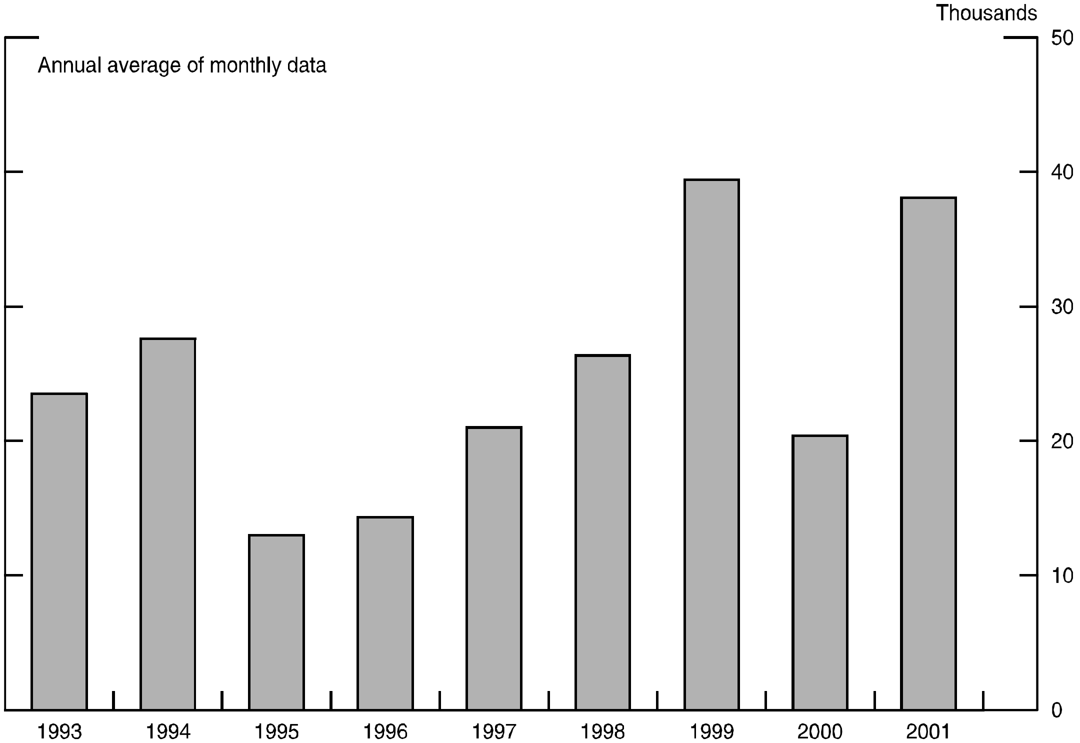
Note. Components may not sum to totals because of rounding.

1. A shift in payment timing occurs when the first of the month falls on a weekend or holiday, or when the first three days of a month are nonworking days. Outlays for defense, social security, Medicare, income security, and "other" have been adjusted to account for these shifts.

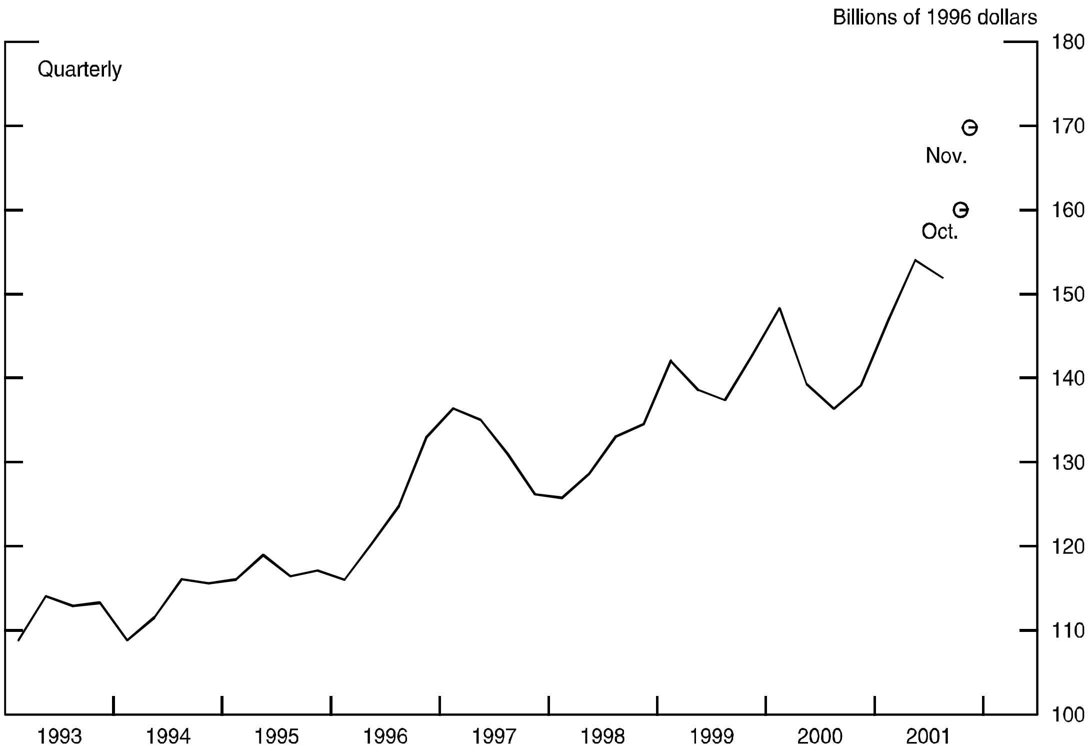
... Not applicable.

State and Local Employment and Construction

Change in Employment



Construction Put in Place



On the spending side, after adjusting for routine payment-timing shifts, outlays in the November-December period rose 6 percent over last year. National defense outlays rose 8.3 percent, in part because of U.S. military activity in Afghanistan. Health-related spending also rose rapidly, with increases of 9 percent for Medicare and 17.8 percent for Medicaid. In contrast, net interest payments have continued to fall, a result of both lower short-term interest rates and declines in the federal debt over the past year.

After having failed to reach agreement in December on an economic stimulus package, Congress completed the appropriations process and adjourned. These appropriations bills, which President Bush has signed, provide $684 billion in non-emergency budget authority for fiscal year 2002, up nearly 8 percent from fiscal 2001. The largest category, defense, is slated to rise more than 8 percent, to $317 billion, in fiscal 2002. In addition, Congress appropriated $20 billion in emergency funds, the second half of the $40 billion supplemental appropriation passed in September. These funds are earmarked primarily for homeland security initiatives and disaster-related assistance for New York.

The Congressional Budget Office has released a summary of “The Budget and Economic Outlook: Fiscal Years 2003-2012.” The full report will be published January 31. The CBO now forecasts that in the absence of future legislation, the federal government will run small unified deficits in fiscal years 2002 and 2003 before returning to surplus in fiscal 2004. Over the coming decade (2002-11), the CBO projects a unified surplus of $1.6 trillion, a significant downward revision from the $5.6 trillion surplus projected in January 2001. The $4 trillion downward revision is attributed to legislative changes ($2.4 trillion), changes in economic assumptions ($0.9 trillion), and technical factors ($0.7 trillion).

State and local governments. Despite deteriorating budget positions, real spending by state and local governments has been quite robust in recent months. Employment rose 55,000 in December, bringing the monthly average during the fourth quarter to 35,000, and real construction outlays jumped more than 6 percent at a monthly rate in November following an even stronger surge the month before. The strong construction activity in November, which was widespread across all major components, was probably facilitated by the unusually warm and dry weather.

Most state legislatures begin their new sessions in January, and many states that have not yet acted will be forced to deal with projected gaps in their general fund budgets. It appears that a variety of strategies will be adopted, including budget cuts, transfers from rainy-day funds and funds backed by tobacco-settlement money, greater-than-expected use of tax-exempt debt offerings, and some tax and fee increases. Major sources of budget pressures include heightened security, greater expenditures for Medicaid, and increased pension-

RECENT PRICE INDICATORS
(Percent)

	From 12 months earlier		From 3 months earlier		2001	
	Dec. 2000	Dec. 2001[1]	Sept. 2001[1]	Dec. 2001[1]	Nov.	Dec.[1]
			-Annual rate-		-Monthly rate-	
CPI						
Total	3.4	1.6	0.7	-2.0	0.0	-0.2
Food	2.8	2.8	2.8	1.2	-0.1	-0.1
Energy	14.2	-13.0	-18.2	-43.6	-4.4	-3.2
Ex. food and energy	2.6	2.7	2.4	2.6	0.4	0.1
Ex. tobacco	2.5	2.6	2.0	2.8	0.3	0.2
Core commodities	0.6	-0.3	0.3	-0.8	0.2	-0.3
Ex. tobacco	0.2	-0.8	-1.1	-0.1	-0.0	-0.1
Core services	3.4	4.0	3.1	4.0	0.5	0.3
Current-methods total	3.3	1.6	0.7	-2.0	0.0	-0.2
Ex. food and energy	2.5	2.7	2.4	2.6	0.4	0.1
Ex. tobacco	2.4	2.6	2.0	2.8	0.3	0.2
PCE Prices						
Total	2.5	1.1	-2.0	1.8	-0.1	-0.1
Food	2.6	2.9	3.1	1.4	-0.0	-0.1
Energy	13.9	-13.9	-17.1	-46.1	-5.0	-3.5
Ex. food and energy	1.9	1.6	-1.9	5.4	0.1	0.1
Ex. tobacco	1.8	1.5	-2.2	5.6	0.1	0.1
Core commodities	-0.2	-0.9	-0.6	-1.2	0.1	-0.3
Ex. tobacco	-0.6	-1.4	-1.7	-0.7	-0.1	-0.2
Core services	2.8	2.8	-2.4	8.4	0.2	0.2
Core market-based	1.8	1.7	1.8	1.7	0.2	0.1
Core nonmarket-based	2.2	1.1	-18.3	26.3	-0.1	0.1
PPI						
Total finished goods	3.6	-1.8	-1.4	-10.8	-0.6	-0.7
Food	1.7	1.8	2.0	-5.2	-0.8	-0.1
Energy	16.6	-17.2	-16.3	-47.0	-3.8	-4.0
Ex. food and energy	1.3	0.7	1.3	-1.8	0.2	-0.1
Ex. tobacco	1.2	0.1	1.4	-2.4	0.1	-0.1
Core consumer goods	1.4	1.3	1.3	-1.3	0.3	-0.1
Ex. tobacco	1.4	0.2	1.4	-2.1	0.1	-0.1
Capital equipment	1.2	-0.1	1.7	-2.8	0.1	-0.1
Intermediate materials	4.1	-4.0	-5.1	-11.0	-0.5	-0.9
Ex. food and energy	1.6	-1.6	-3.7	-3.2	-0.2	-0.2
Crude materials	35.5	-32.4	-33.3	-39.1	7.3	-9.5
Ex. food and energy	-5.5	-9.9	-4.5	-9.3	-0.8	0.1

1. PCE prices in December are staff estimates. The changes in PCE prices from three months earlier are distorted because of BEA's treatment of insurance payments associated with the terrorist attacks in September.

funding requirements resulting from poor equity market performance. Adding to fiscal concern is the fact that welfare rolls in many states have begun to increase again after having dropped substantially during the 1990s. Official statistics from the Department of Health and Human Services, available only through June of last year, indicate that the number of families on welfare rose in twenty-one states. Many of these states are in the Midwest and Southeast, the same regions for which a slowing in tax receipts was first apparent last winter and spring. Indications are that more states experienced growing welfare rolls as the economic weakness spread last year.

Prices and Labor Costs

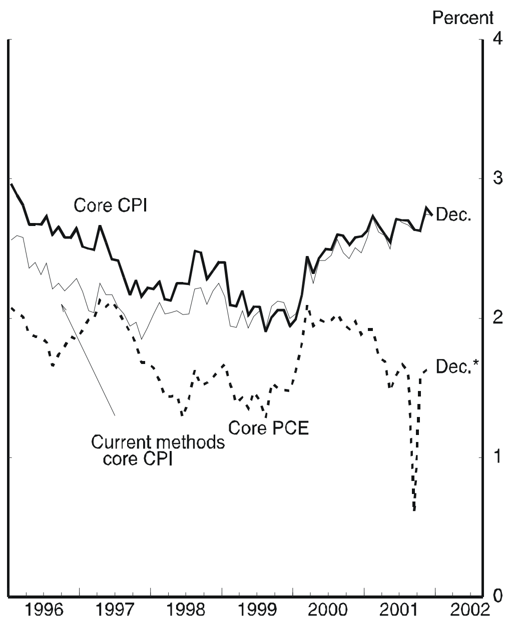
Prices. Inflation dropped back at year-end, reflecting widespread discounting and a further decline in energy prices. With the plunge in energy prices in recent months, the twelve-month change in the consumer price index slowed to 1.6 percent in 2001, a considerably smaller rise than the 3.4 percent increase in 2000. The core CPI rose 2.7 percent over the twelve months of 2001, a bit higher than the rate for 2000. By contrast, the core PCE price index appears to have risen only about 1.6 percent last year (official estimates available January 31), down from 1.9 percent in 2000. In December, the overall CPI fell 0.2 percent, led by another drop in gasoline prices, while the core CPI edged up 0.1 percent after jumping 0.4 percent in November.

Consumer energy prices dropped 3.2 percent last month following even larger declines in the previous two months. The prices of both motor fuel and heating oil fell about 6 percent in December. However, survey data suggest that retail prices of gasoline turned up in early January. Elsewhere, the index for natural gas declined 2.1 percent last month, nearly offsetting November’s rise, and electricity rates decreased for the fifth consecutive month. For the year as a whole, overall consumer energy prices fell 13 percent, compared with a rise of more than 14 percent over 2000. Among components, prices of petroleum-based products plunged last year, and natural gas prices dropped considerably but did not entirely reverse their run-up in 2000; only electricity rates increased on balance last year, reflecting higher coal input costs and tight generating capacity in the western region.

Consumer food prices edged down 0.1 percent in December, the same as in November. Prices of fresh fruits and vegetables dropped sharply, while moderate price declines were posted for many other categories of food at home, reflecting in part the pass-through of the sharp declines in farm prices last fall to the retail level. The index for food away from home edged up slightly in December for the second month following large increases earlier in

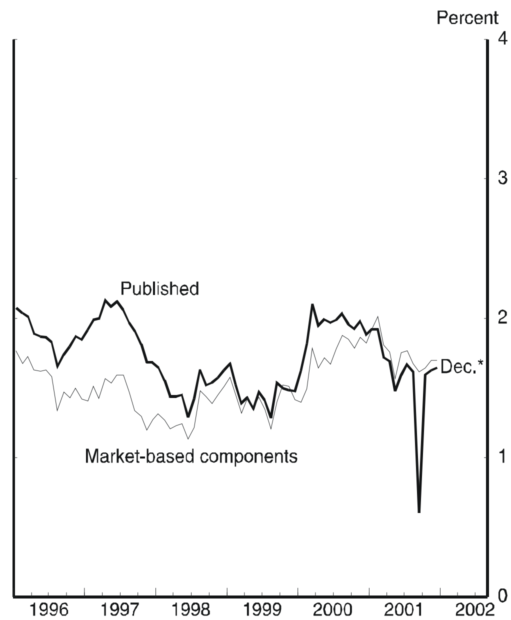
Measures of Core Consumer Price Inflation
(12-month change except as noted)

CPI and PCE Excluding Food and Energy



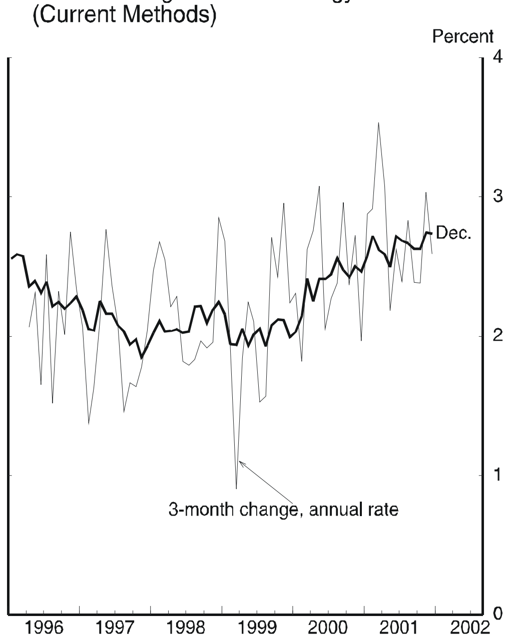
* Staff estimate

PCE Excluding Food and Energy

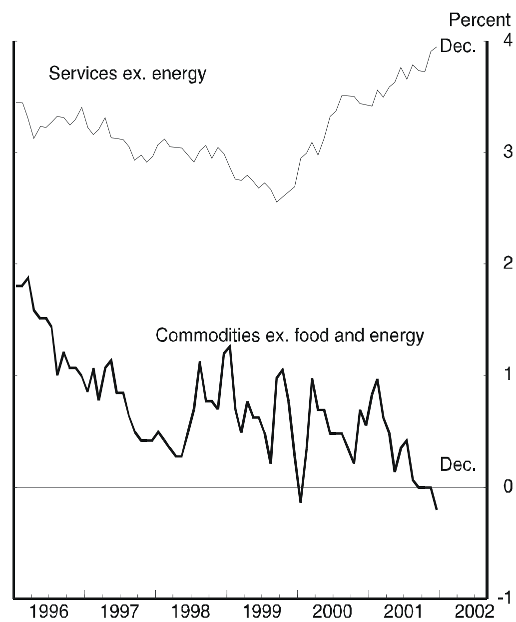


* Staff estimate

CPI Excluding Food and Energy
(Current Methods)



CPI Services and Commodities



the year. Over the twelve months of 2001, the overall index for food increased 2.8 percent, the same as in 2000.

The index for commodities other than food and energy fell 0.3 percent in December, continuing the see-saw movements brought about by large monthly swings in tobacco prices. Over the twelve months of 2001, core goods prices moved down 0.3 percent, the largest twelve-month decline in core goods prices in forty years; excluding tobacco, core goods prices edged down in December and declined 3/4 percent last year. Although discounting of goods was fairly extensive last month, prices for new motor vehicles increased for the third consecutive month and used vehicle prices turned up after having fallen for eight months. As a result, increases in new vehicle prices in the last three months of 2001 offset nearly all of the decline posted during the first nine months.[9]

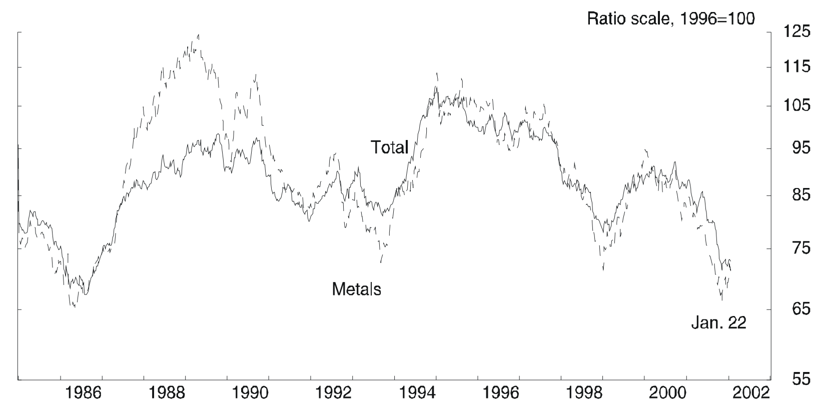
The CPI for non-energy services rose 0.3 percent last month following November's 0.5 percent increase. This index has accelerated considerably over the past two years; indeed, the twelve-month change in 2001—at 4 percent—was the largest increase in eight years. Owner's equivalent rent and renter's rent rose another 0.4 percent in December; during 2001, these indexes were up 4-1/2 percent and 4-3/4 percent, respectively, a marked pickup from their pace in 2000. The index for lodging away from home also increased last month, but it remained slightly lower than its year-earlier level. Elsewhere, airfares declined further in December and are nearly 4 percent lower than a year ago, while prices of medical services edged up 0.1 percent last month after having increased rapidly in the previous two months.

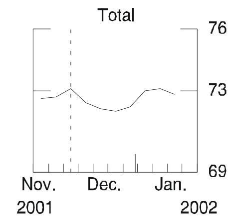
In contrast to the CPI, changes in core PCE prices slowed last year because, unlike the CPI, PCE prices for non-energy services did not accelerate. As a result, the gap between twelve-month changes in the core CPI and core PCE prices rose to 1.1 percentage points in 2001, from 0.7 percentage point in 2000. About half of this larger gap reflects the inclusion in PCE services of a number of non-market transactions, whose prices have decelerated markedly over the past year. Much of the remainder reflects differences in weights—particularly for housing, which is more heavily weighted in the CPI and has accelerated sharply. In addition, PCE prices for medical services, which are based on

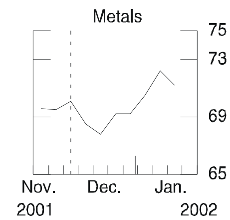
9. Although we cannot assign weights to the various factors affecting motor vehicle prices, some of the recent increases reflect the shift in the mix of the CPI sample toward 2002 models, which are less heavily discounted than 2001 models. Another factor is that the CPI may not fully capture the value of financing incentives, which have been large in recent months. Financing incentives are reflected in the CPI only to the extent that these deals include an option for cash rebates. While many of the recent incentive programs have also offered cash back, the cash rebates have not always been as generous as the financing incentives.

Commodity Price Measures

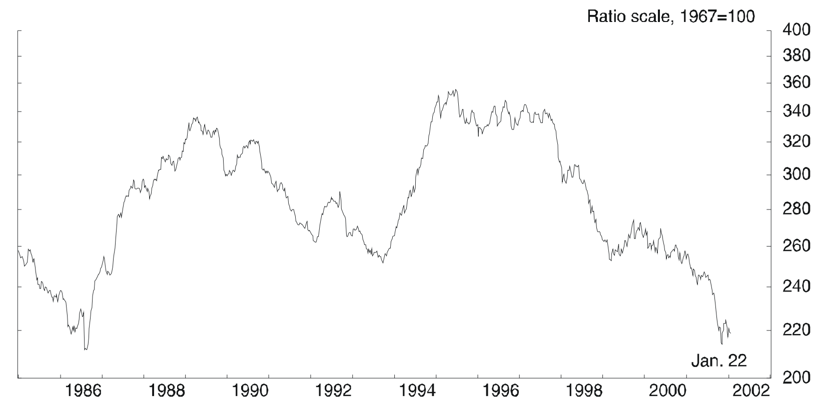
Journal of Commerce Index

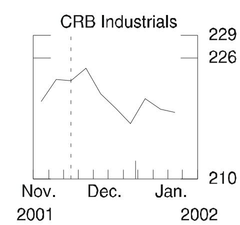




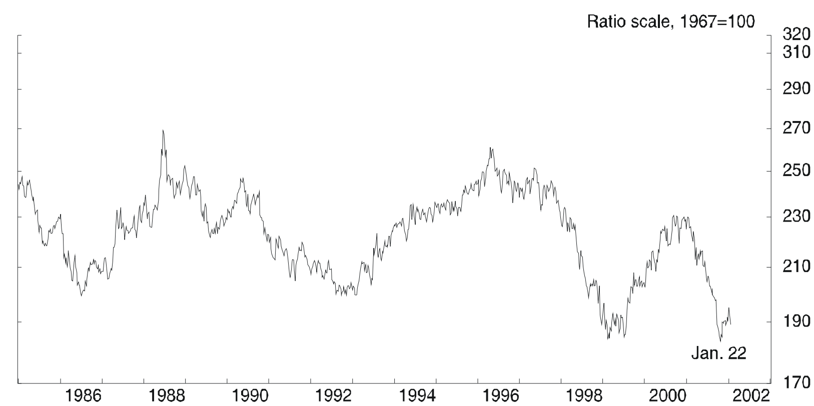


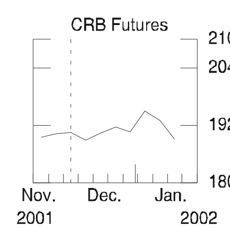
CRB Spot Industrials





CRB Futures





Note. Weekly data, Tuesdays. Vertical lines on small panels indicate week of last Greenbook. The Journal of Commerce index is based almost entirely on industrial commodities, with a small weight given to energy commodities, and the CRB spot price 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. Copyright for Journal of Commerce data is held by CIBCR, 1994.

SPOT PRICES OF SELECTED COMMODITIES

	Current price (dollars)	Percent change[1] 1999	2000	End 2000 to Dec. 04[2]	Dec. 04[2] to Jan. 22	Memo: Year earlier to date
Metals						
Copper (lb.)	0.740	26.1	3.4	-18.7	0.0	-16.9
Steel scrap (ton)	71.333	61.5	-32.7	-17.7	9.7	-17.1
Aluminum, London (lb.)	0.617	27.7	-0.8	-11.9	-0.8	-17.3
Precious metals						
Gold (oz.)	282.050	-1.6	-5.7	0.9	2.0	6.0
Silver (oz.)	4.320	5.5	-10.9	-10.3	3.1	-10.3
Forest products[3]						
Lumber (m. bdft.)	230.000	8.3	-44.6	18.3	8.0	31.4
Plywood (m. sqft.)	297.000	-3.2	-8.2	5.4	0.7	8.0
Petroleum						
Crude oil (barrel)	18.680	163.3	-13.0	-13.8	-2.6	-31.0
Gasoline (gal.)	0.516	132.9	5.2	-29.0	-1.1	-37.8
Fuel oil (gal.)	0.513	140.7	34.4	-45.5	-0.9	-40.7
Livestock						
Steers (cwt.)	67.970	15.7	13.2	-14.5	3.3	-15.0
Hogs (cwt.)	42.000	194.0	7.1	-13.9	29.2	8.4
Broilers (lb.)	0.559	-4.0	-13.7	3.2	9.0	2.7
U.S. farm crops						
Corn (bu.)	1.935	-10.2	10.1	-3.6	-3.3	-0.3
Wheat (bu.)	3.250	-17.4	31.9	-6.0	-0.8	-7.4
Soybeans (bu.)	4.250	-17.6	10.8	-11.5	-2.3	-5.9
Cotton (lb.)	0.320	-20.9	27.0	-44.6	-1.6	-42.6
Other foodstuffs						
Coffee (lb.)	0.433	5.1	-43.1	-40.4	6.8	-38.7
Memo:						
JOC Industrials	72.800	11.0	-1.5	-15.8	-0.4	-17.6
JOC Metals	71.200	26.3	-10.3	-15.9	1.6	-16.0
CRB Futures	189.090	7.8	12.1	-16.8	-0.7	-17.5
CRB Spot Industrials	218.860	-0.1	-3.5	-13.1	-1.9	-14.0

1. Changes, if not specified, are from the last week of the preceding year to the last week of the period indicated.
2. Week of the December Greenbook.
3. Reflects prices on the Friday before the date indicated.

SURVEYS OF (CPI) INFLATION EXPECTATIONS
(Percent)

	Actual inflation[1]	University of Michigan: 1 year Mean[2]	University of Michigan: 1 year Median[2]	University of Michigan: 5 to 10 years Mean[3]	University of Michigan: 5 to 10 years Median[3]	Professional forecasters (10-year)[4]
2000-Q1	3.2	3.6	3.0	3.5	3.0	2.5
Q2	3.3	3.5	3.0	3.3	2.8	2.5
Q3	3.5	3.6	2.9	3.4	2.9	2.5
Q4	3.4	3.8	3.0	3.7	3.0	2.5
2001-Q1	3.4	3.4	2.9	3.6	3.0	2.5
Q2	3.4	3.9	3.1	3.6	3.0	2.5
Q3	2.7	3.1	2.7	3.5	2.9	2.5
Q4	1.9	1.5	1.1	3.1	2.8	2.6
July	2.7	3.0	2.6	3.4	2.9	
Aug.	2.7	3.1	2.7	3.6	3.0	
Sept.	2.6	3.2	2.8	3.4	2.9	2.5
Oct.	2.1	1.6	1.0	2.8	2.7	
Nov.	1.9	1.0	0.4	3.2	2.8	
Dec.	1.6	1.9	1.8	3.4	3.0	2.6
2002-Jan.		2.2	1.9	2.9	2.6	

1. CPI; 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 the 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 the average, during the next 5 to 10 years?
4. Compiled by the Federal Reserve Bank of Philadelphia.

producer prices indexes (PPIs), have not moved up as quickly as the CPI for medical services in recent years.

Prices for capital goods as measured by the producer price index edged down in December and decelerated sharply in the last three months of the year, largely because of sizable declines in producer prices of motor vehicles. Prices of many other capital goods have also softened in recent months. The pace of computer price declines has eased a bit in recent months from the very rapid clip of summer. Still, over the twelve months of 2001, the PPI for computers dropped a record 31 percent, more than twice the rate of decline in 2000.

At earlier stages of processing, the producer price index for core intermediate materials declined another 0.2 percent in December. Over the past twelve months, this index fell 1.6 percent, a marked reversal of the 1.6 percent rise recorded during 2000. Meanwhile, the PPI for core crude materials dropped nearly 10 percent over the past year. Since the last Greenbook, metal prices—particularly those for steel scrap—have turned up, but indexes of industrial materials prices (such as the Journal of Commerce and Commodity Research Bureau commodity price indexes) have remained unchanged or declined somewhat further.

Near-term inflation expectations from the preliminary Michigan survey moved up somewhat in December and January after plunging in October and November. The median expectation for inflation over the coming year rose to 1.9 percent in January but remained well below the median recorded in September. The mean of these expectations also moved above its October level but remained below September's response. The median expectation of inflation over a five- to ten-year horizon increased in December but fell to 2.6 percent in January, its lowest level ever.

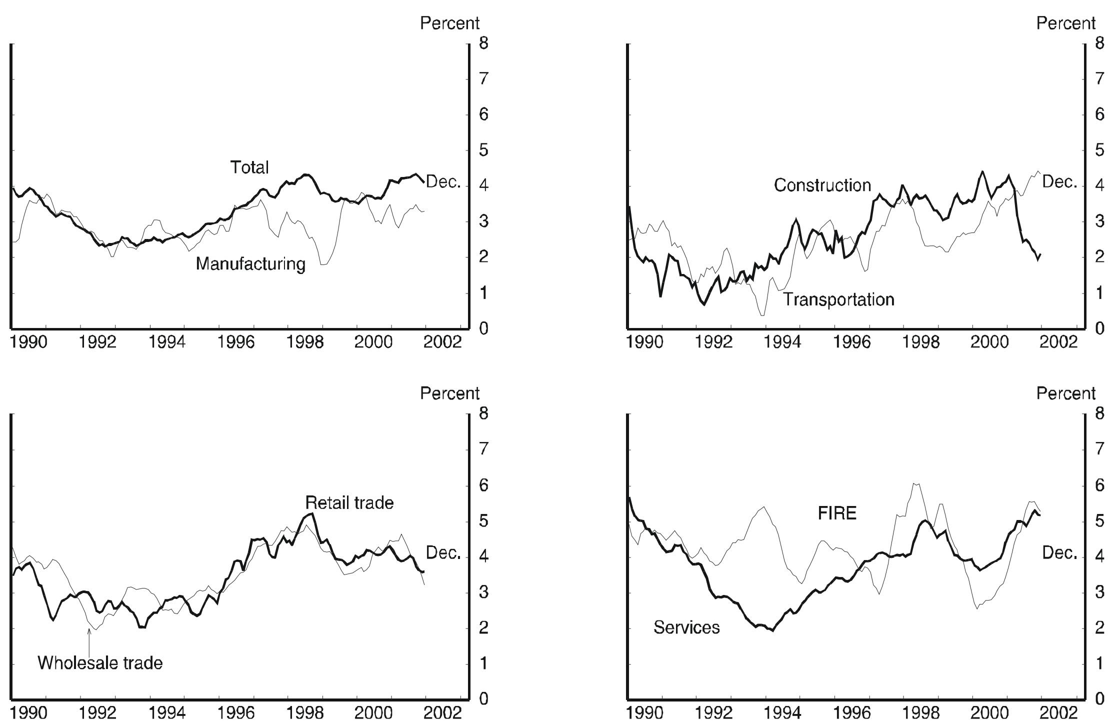
Labor costs. Average hourly earnings of production or nonsupervisory workers on private payrolls rose 0.5 percent in both November and December after having increased only 0.1 percent in October. These recent increases brought the twelve-month change in average hourly earnings to 4.1 percent in December, down only slightly from the change in 2000. Wage increases in the construction and trade sectors slowed considerably last year, but the slowing was mostly offset by faster wage growth in other industries.

In contrast to average hourly earnings, compensation per hour in the nonfarm business sector decelerated considerably last year. Indeed, the BEA reported that third-quarter compensation per hour increased at a slower pace than average hourly earnings for the first time in more than two years, and, on the basis of October and November data on wages and salaries, we estimate that the rise in nonfarm compensation per hour will be considerably smaller than the rise in

AVERAGE HOURLY EARNINGS
(Percent change; based on seasonally adjusted data)

	12-month percent change			Percent change to Dec. 2001 from month indicated		Percent change	
	Dec. 1999	Dec. 2000	Dec. 2001	June 2001	Sept. 2001	Nov. 2001	Dec. 2001
	-Annual rate-					-Monthly rate-	
Total private nonfarm	3.5	4.3	4.1	4.2	4.5	0.5	0.5
Manufacturing	3.8	3.3	3.6	4.1	4.1	0.5	0.4
ex overtime	3.6	3.9	3.7	3.9	3.4	0.5	0.1
Construction	3.6	4.1	2.6	4.1	6.5	0.5	1.0
Transportation and public utilities	2.9	3.5	4.1	3.1	3.6	0.6	-0.1
Finance, insurance, and real estate	2.5	3.8	5.1	3.4	3.0	0.1	0.4
Retail trade	4.2	4.3	3.5	3.3	5.0	0.6	0.2
Wholesale trade	3.8	4.8	3.2	2.4	2.5	0.1	0.9
Services	3.9	4.8	5.2	6.0	5.8	0.4	0.7

Average Hourly Earnings
(3-month moving average of 12-month change)



average hourly earnings in the fourth quarter as well. Differences between these measures of labor costs may reflect the exclusion from average hourly earnings of white collar pay and non-wage benefits, such as health insurance, as well as various types of labor income, such as bonuses and stock option exercises. Although employer surveys suggest that health insurance costs have continued to rise more rapidly than wages, anecdotal reports suggest that bonuses and stock option exercises have declined. In particular, for some large high-tech firms for which stock options are important, option exercises dropped substantially over the year ended in the third quarter of 2001.[10]

10. In its construction of the wage and salary data in the national accounts, the BEA uses state unemployment insurance (UI) records as its primary source, but because these records are available only with a lag, the BEA uses information about average hourly earnings (AHE) to estimate changes in the most recent quarters. When the BEA saw the UI records for the second quarter of 2001, reported earnings apparently were much lower than implied by the AHE data, suggesting that changes in the types of labor income that are missing from average hourly earnings might be holding down the change in overall compensation. As a result, the BEA reduced the adjustment factor it applies to average hourly earnings when putting together its estimates of wages and salaries for the third and fourth quarters.

Domestic Financial Developments

Domestic Financial Developments

Overview

Economic data releases over the intermeeting period tended to be on the positive side of expectations, but financial markets also had to absorb other more negative signals of future economic activity. In particular, speeches by Federal Reserve officials that were interpreted as emphasizing the downside risks for the economy, along with fading odds of a fiscal stimulus package, contributed to a decline in yields on Treasury and investment-grade corporate bonds. Moreover, disappointing corporate announcements regarding prospects for the year ahead kept equity prices in check and contributed to some widening of risk spreads on speculative-grade bonds.

The fiscal position of the federal government moved into temporary surplus over the intermeeting period, facilitating a net paydown of Treasury debt. In contrast, state and local governments tapped the credit markets in size, reflecting in part continued deterioration in fiscal positions at the state and local levels. In the private sector, net debt issuance by nonfinancial corporations slowed, and according to the January Senior Loan Officer Opinion Survey, demand for bank loans by businesses continued to weaken. Household borrowing apparently remained robust in December.

Policy Expectations, Interest Rates, and Stock Prices

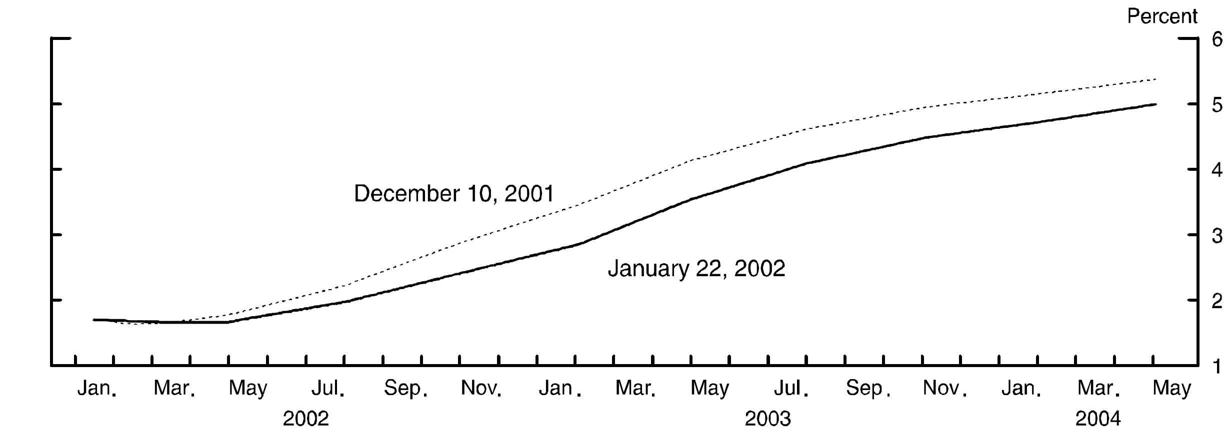
The nearest-term fed funds futures quotes imply that investors attach about a 20 percent probability to a quarter-point rate cut at the upcoming FOMC meeting. Looking beyond this meeting, futures quotes indicate that investors now expect somewhat less policy tightening over the coming year than they did at the time of the last FOMC meeting. Uncertainty about the future path of policy implied by options on interest rate futures dropped appreciably over the period but remains elevated.

Consistent with the downward revision in policy expectations, Treasury coupon yields fell 15 to 27 basis points over the intermeeting period. The drop in Treasury yields was reportedly amplified somewhat by a sense that the odds had lengthened against the passage of a fiscal stimulus package. In early January, dealers reported that liquidity had improved relative to the end of last year but remained depressed relative to levels prior to September 11.

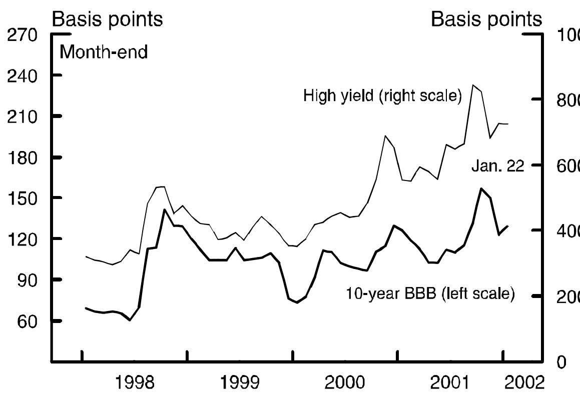
Yields on investment-grade corporate bonds fell in line with those on Treasuries over the intermeeting period, leaving risk spreads about unchanged. In contrast, spreads for high-yield bonds rose after disappointing earnings news for some lower-rated firms, but they stayed well below their recent highs of September. Risk spreads on commercial paper, while retracing their typical year-end runup, remained considerably above pre-September 11 levels.

Policy Expectations, Corporate Risk Spreads, and Stock Prices

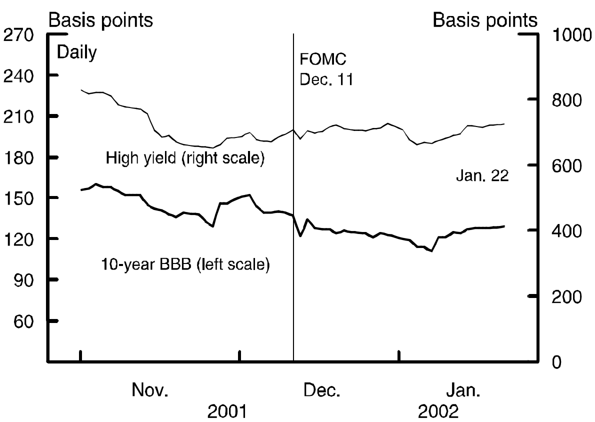
Expected Federal Funds Rate Estimated from Financial Futures



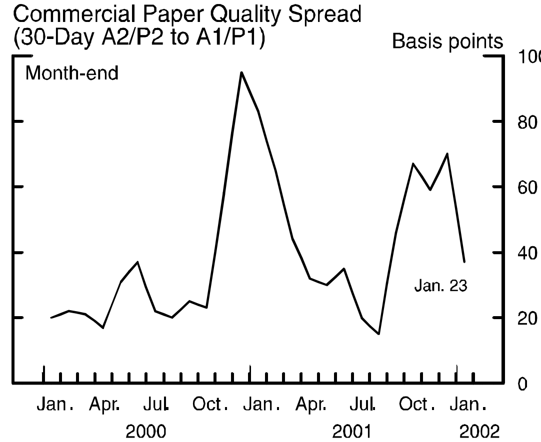
Corporate Risk Spreads to 10-Year AAA Yield



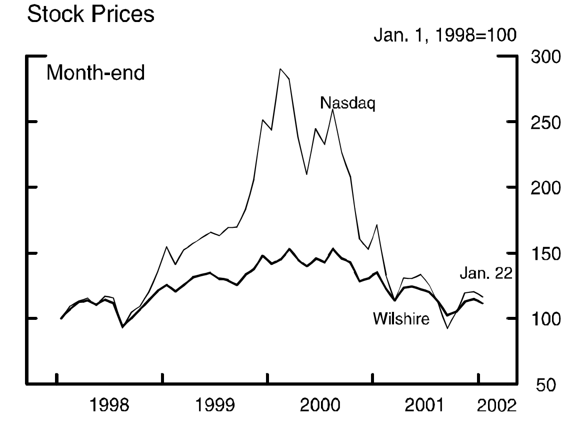
Source. Merrill Lynch



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



Stock Prices



Equity prices posted modest gains in December, with investors reportedly encouraged by the positive tone to economic data. But those gains were erased in January, in part as investors reacted to pessimistic news from a number of prominent corporations, especially in the technology sector, about expected sales and earnings over the coming year. On net, the Nasdaq Composite fell more than 5 percent, while broad stock market indexes were down between 1 and 2 percent over the intermeeting period.

Business Finance

Overall, net debt financing by nonfinancial businesses moderated in December from the rapid pace set earlier in the fourth quarter, and the data so far in January suggest another month of subdued borrowing. Gross issuance of investment-grade corporate bonds in December and January, while well below the extraordinary November pace, was still reasonably strong, with firms continuing to use bond proceeds to refinance long-term debt and to replace short-term debt. High-yield firms in a number of industries also issued bonds, although new issues generally tended to be from corporations on the upper rungs of the speculative-grade ladder.

Outstanding nonfinancial commercial paper rose on net in December and early January but was more than offset by a decline in C&I loans at commercial banks. In the January Senior Loan Officer Survey, nearly half of the banks reported that, over the past three months, they continued to tighten their terms and conditions on C&I loans, mostly in response to the less favorable economic outlook. Just over half of the banks reported weaker demand for C&I loans, down from three-fourths in the October survey. Banks again cited reductions in capital spending, diminished M&A activity, and inventory liquidation as reasons for the weaker loan demand.

Gross equity issuance continued at a brisk pace in December but has slackened since year-end. Seasoned offerings in December were boosted by energy companies issuing shares in an attempt to reduce leverage after the Enron debacle prompted closer investor scrutiny of their books and downgrades by the major rating agencies. So far in January, seasoned offerings have slowed as share prices have declined. Initial public offerings picked up slightly over the intermeeting period, but remained at only about a third the rate in 1999 and 2000. Announcements of share repurchase programs slowed in the fourth quarter, and cash-financed mergers and acquisitions were also subdued, suggesting that actual equity retirements are likely to have fallen somewhat.

S&P earnings in the fourth quarter appear to be bleak, consistent with analysts' expectations. With about one-third of the companies reporting, S&P 500 earnings are expected to drop about 20 percent from a year ago. Revisions of analysts' year-ahead forecasts of corporate earnings were generally small in

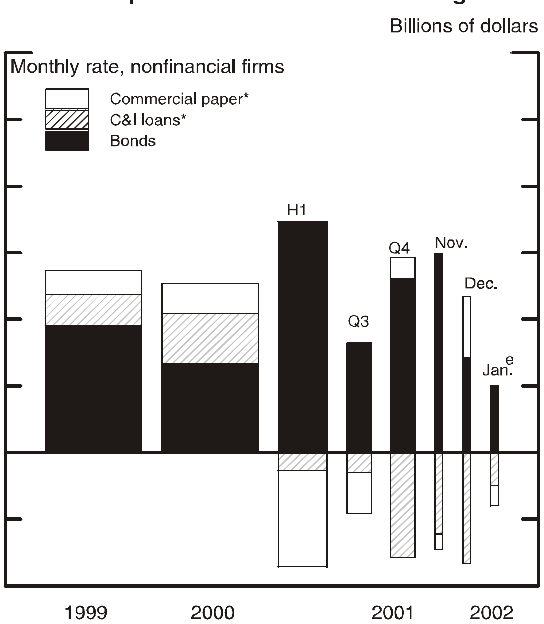
GROSS ISSUANCE OF SECURITIES BY U.S. CORPORATIONS

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

Type of security	1999	2000	2001 H1	2001 Q3	2001 Q4	2001 Nov.	2001 Dec.	2002 Jan. e
All U.S. corporations	89.4	78.5	123.6	93.7	120.1	123.3	97.7	77.6
Stocks [1]	11.0	11.2	10.5	7.3	14.4	12.6	14.7	4.2
Bonds	78.4	67.3	113.1	86.5	105.7	110.7	83.0	73.4
Nonfinancial corporations								
Stocks [1]	9.2	9.9	7.5	3.3	7.6	7.6	7.5	2.2
Initial public offerings	4.2	4.4	3.2	1.0	0.9	0.6	1.6	0.6
Seasoned offerings	5.0	5.5	4.2	2.3	6.7	7.0	5.9	1.6
Bonds [2]	24.5	20.2	43.2	26.5	35.9	42.1	21.9	21.4
Investment grade [3]	13.9	12.0	28.9	20.9	27.0	33.1	12.2	16.0
Speculative grade [3]	7.5	4.5	11.9	3.8	7.9	7.3	8.7	5.4
Other (Sold Abroad/Unrated)	3.1	3.7	2.4	1.7	1.1	1.7	0.9	0.0
Financial corporations								
Stocks [1]	1.8	1.4	3.0	4.0	6.8	5.0	7.1	2.0
Bonds	53.9	47.1	69.9	60.0	69.8	68.6	61.2	52.0
Memo:								
Net issuance of commercial paper, nonfinancial corporations [4]	3.6	4.5	-14.5	-6.2	3.1	-2.4	9.2	-3.0
Change in C&I loans at commercial banks [4]	4.7	7.6	-2.7	-3.0	-15.8	-12.2	-16.7	-5.0

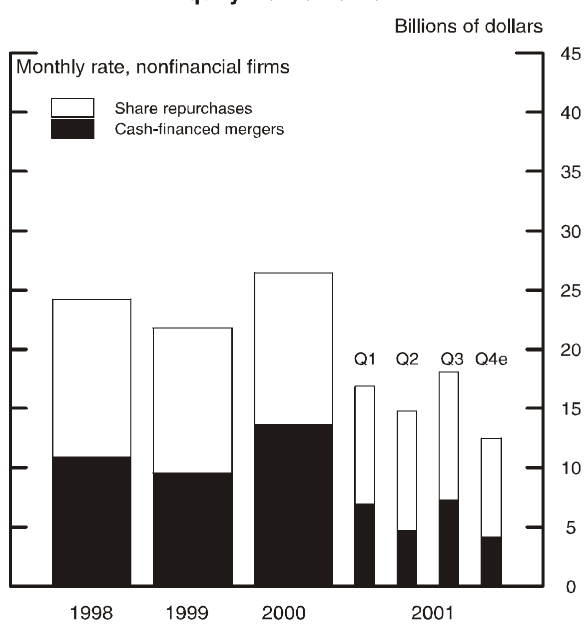
Note. Components may not sum to totals because of rounding. These data include speculative-grade bonds issued privately under Rule 144A. All other private placements are excluded. Total reflects gross proceeds rather than par value of original discount bonds.
1. Excludes equity issues associated with equity-for-equity swaps that have occurred in restructurings.
2. Excludes mortgage-backed and asset-backed bonds.
3. Bonds sold in U.S. categorized according to Moody's bond ratings, or to Standard & Poor's if unrated by Moody's.
4. End-of-period basis, seasonally adjusted.
e Staff estimate.

Components of Net Debt Financing



* Seasonally adjusted.
e Staff estimate.

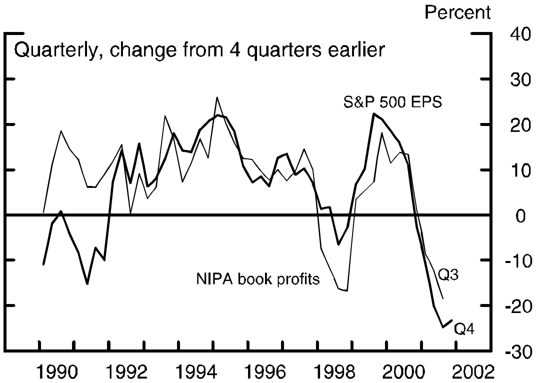
Equity Retirements



e Staff estimate.

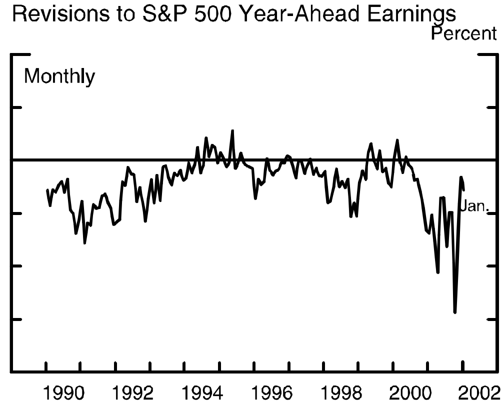
Corporate Earnings and Credit Quality

After-Tax Corporate Earnings



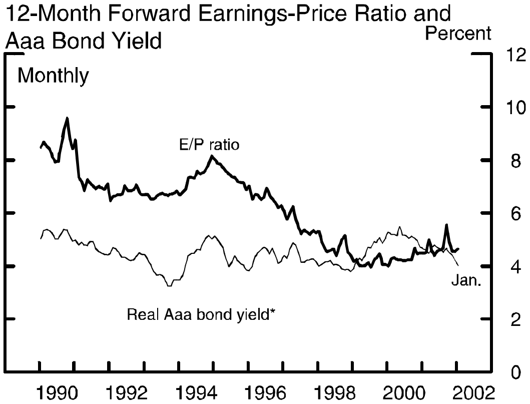
Source. I/B/E/S.

Revisions to S&P 500 Year-Ahead Earnings



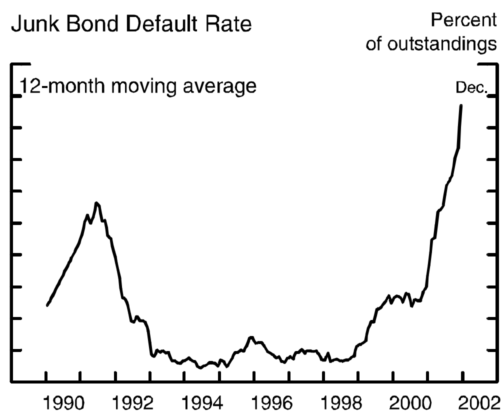
Source. I/B/E/S.

12-Month Forward Earnings-Price Ratio and Aaa Bond Yield



*Aaa bond yield minus Philadelphia Fed 10-year expected inflation.

Junk Bond Default Rate



Source. Moody's.

Downgrades by Sector, 2001

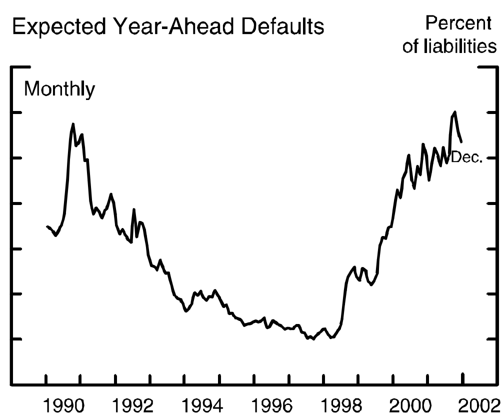
Percent of outstandings

Monthly rate

	Jan.-Oct.	Nov.	Dec.
1. Energy	1	6	1
2. Motor vehicles & parts	6	32	4
3. Telecom	3	7	11
4. Technology	4	5	1
5. Other	2	3	5
TOTAL	2	5	5

Note. Relative to par value outstanding at beginning of each period.
Source. Merrill Lynch

Expected Year-Ahead Defaults

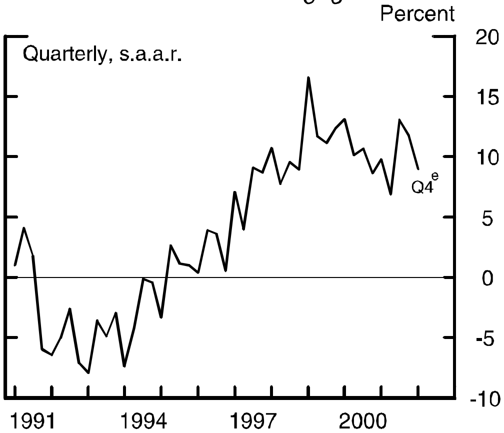


Source. KMV Corp.

Note. Firm-level estimates of default weighted by firm liabilities as a percent of total liabilities.

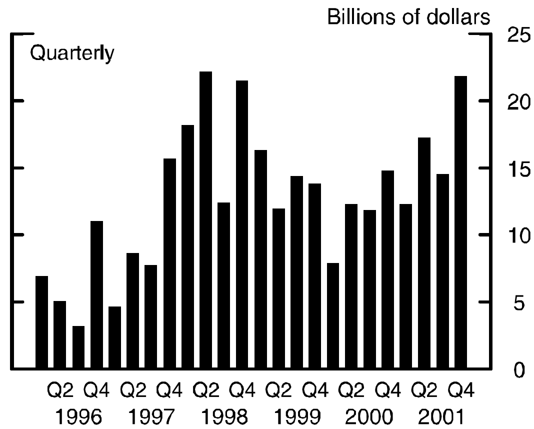
Commercial Real Estate

Growth of Commercial Mortgage Debt



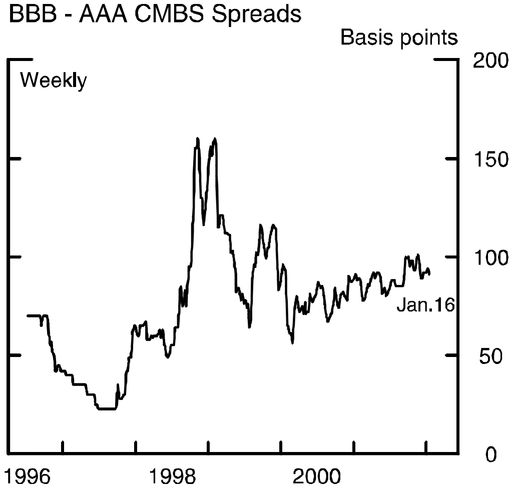
e. Staff estimate.

Total CMBS Gross Issuance



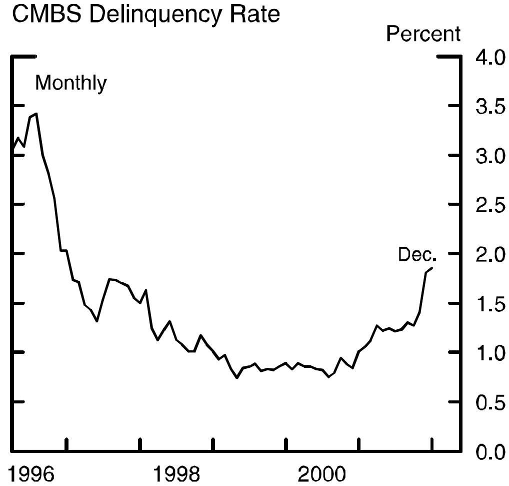
Source. Commercial Mortgage Alert.

BBB - AAA CMBS Spreads



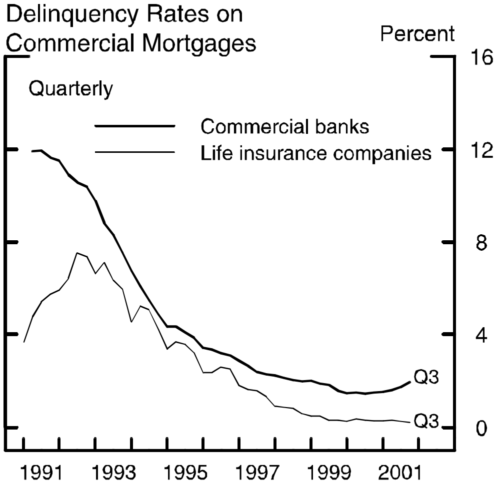
Source. Morgan Stanley.

CMBS Delinquency Rate



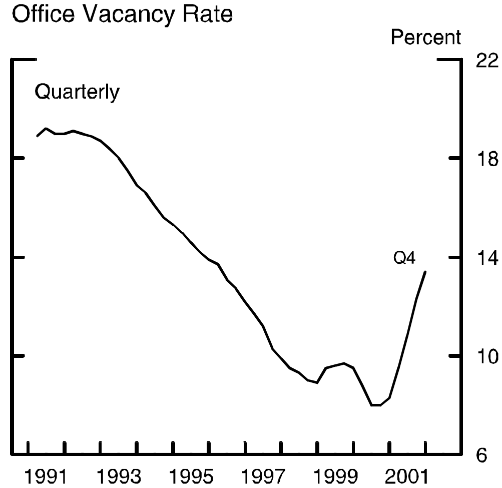
Source. Morgan Stanley.

Delinquency Rates on Commercial Mortgages



Source. ACLI, Call Report.

Office Vacancy Rate



Source. Torto Wheaton Research.

December and the first half of January, coming on the heels of the sizable negative revisions made in October and November. Even with these downward revisions, analysts currently project a substantial recovery in earnings in 2002. Given the current expectations, the ratio of year-ahead earnings to price remains low—only slightly above the real long-term AAA-rated bond yield—implying that stock valuations remain rich.

The twelve-month trailing average of the rate of junk bond defaults rose to an all-time high in December, boosted by the $10 billion Enron failure. The junk bond default rate is likely to remain elevated in January, owing to the default of K-Mart, the largest ever by a domestic retailer. Ratings downgrades continued at a rapid rate in December, with telecom companies disproportionately represented, while very few upgrades were issued. Despite these downgrades, an estimate of one-year ahead defaults as a percent of firm liabilities dropped further in December from its record high in October, reflecting higher firm valuations.

Commercial Real Estate

Commercial mortgage debt is estimated to have grown a bit less rapidly in the fourth quarter than in the third quarter. Nevertheless, originations have been strong for some time, and CMBS issuance in the fourth quarter totaled $22 billion, close to the record set in the second quarter of 1998. The spread of BBB over AAA CMBS yields narrowed a few basis points over the intermeeting period, but remains somewhat elevated by historical standards. CMBS delinquency rates increased in December to their highest level since early 1997, perhaps reflecting the rise in office vacancy rates, which rose to nearly 14 percent in the fourth quarter.

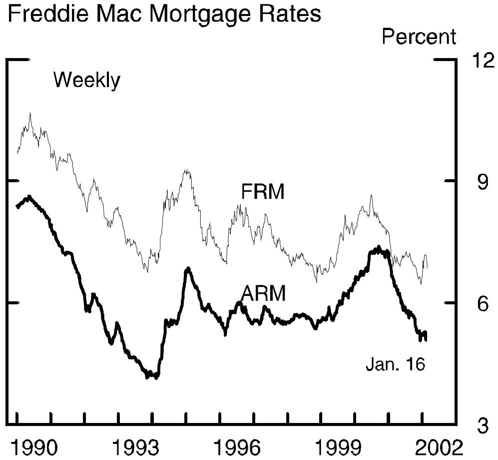
Household Finance

Interest rates on thirty-year fixed-rate mortgages continued to rise through mid-December from the low recorded in October, damping the elevated pace of refinancing activity. In January, however, mortgage rates have retraced their increases last month, and refinancing activity again has ticked up. Meanwhile, the MBA purchase index moved up to a record level over the intermeeting period.

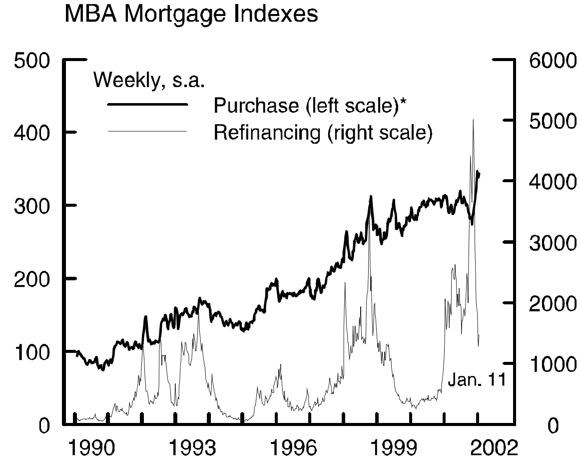
Residential mortgage growth in the fourth quarter is estimated to have moderated from its rapid third-quarter pace, while the growth in consumer credit turned up smartly, stimulated by aggressive auto incentives. The considerable rise in debt, together with an unwinding of the boost to incomes from the tax rebate, pushed the estimated household debt service burden to 14-1/2 percent in the fourth quarter, close to its record high in 1986.

Household Liabilities

Freddie Mac Mortgage Rates

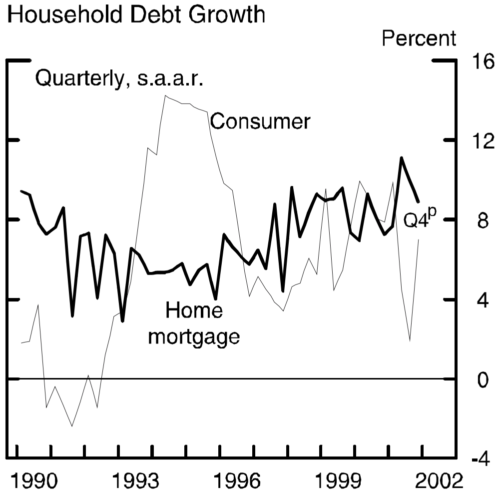


MBA Mortgage Indexes



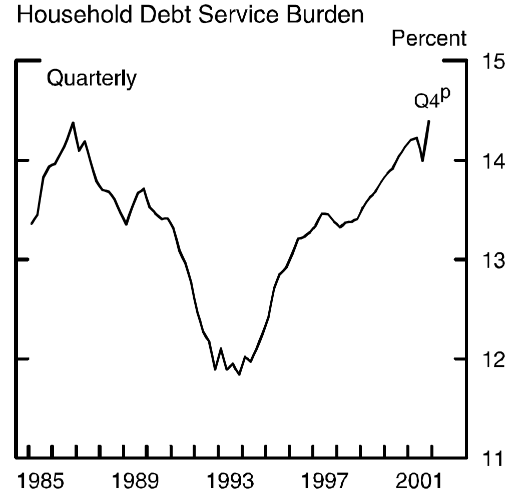
* 4-week moving average.
Note. March 16, 1990 = 100 for n.s.a. series.

Household Debt Growth



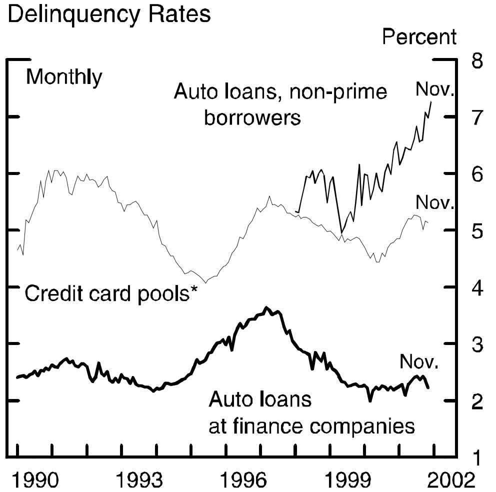
p. Staff projection.

Household Debt Service Burden



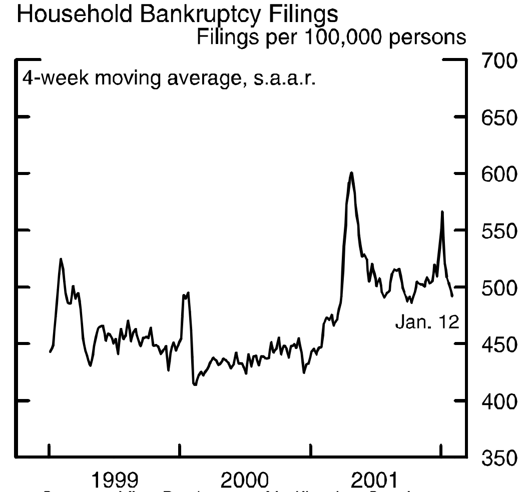
Note. Required debt payments relative to disposable personal income.

Delinquency Rates



* Securitized receivables (Moody's, seasonally adjusted).

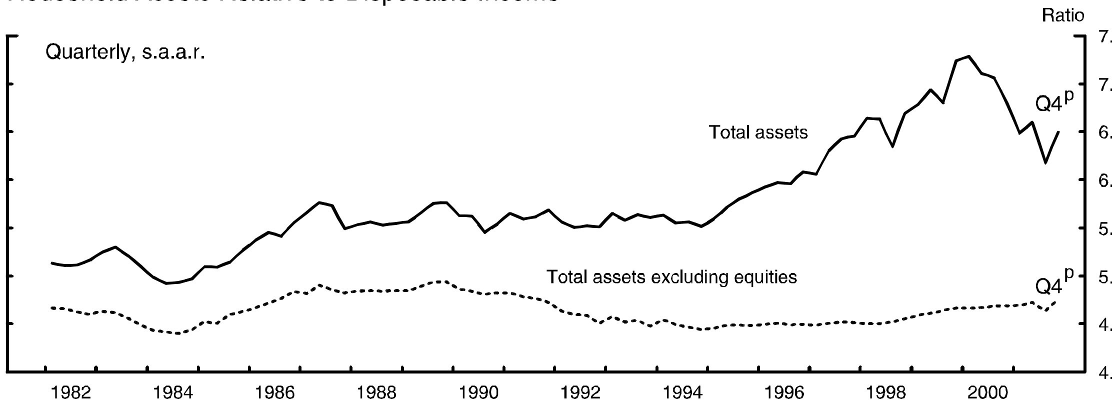
Household Bankruptcy Filings



Source. Visa Bankruptcy Notification Service.

Household Assets

Household Assets Relative to Disposable Income



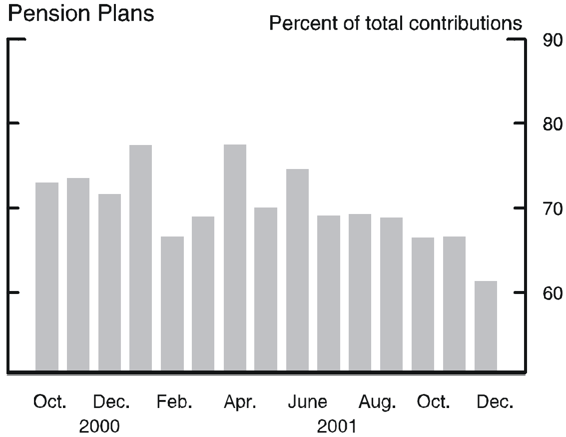
p. Staff projection.

Net Flows into Long-Term Mutual Funds
(Excluding reinvested dividends; billions of dollars, monthly rates)

	2000	2001 H1	2001 Q3	2001 Oct.	2001 Nov.	2001 Dec. e	Assets Nov.
Total long-term funds	**18.4**	**15.2**	**-0.6**	**16.0**	**22.5**	**3.1**	**4,625**
Equity funds	**25.1**	**8.3**	**-11.6**	**0.9**	**14.9**	**-1.2**	**3,349**
Domestic	21.2	9.2	-8.3	5.2	13.1	3.9	2,925
Capital appreciation	25.5	5.3	-8.3	1.4	8.7	1.2	1,752
Total return	-4.3	3.9	-0.0	3.8	4.4	2.8	1,173
International	3.9	-0.8	-3.3	-4.3	1.9	-5.2	424
Hybrid funds	**-2.6**	**1.0**	**-0.2**	**1.5**	**1.0**	**1.5**	**343**
Bond funds	**-4.0**	**5.9**	**11.3**	**13.5**	**6.6**	**2.9**	**934**
International	-0.2	0.0	-0.1	-0.2	-0.2	-0.2	20
High-yield	-1.0	0.9	-0.3	0.6	2.7	0.0	95
Other taxable	-1.6	4.2	10.0	11.2	3.1	3.2	519
Municipals	-1.2	0.8	1.7	1.9	0.8	-0.2	299

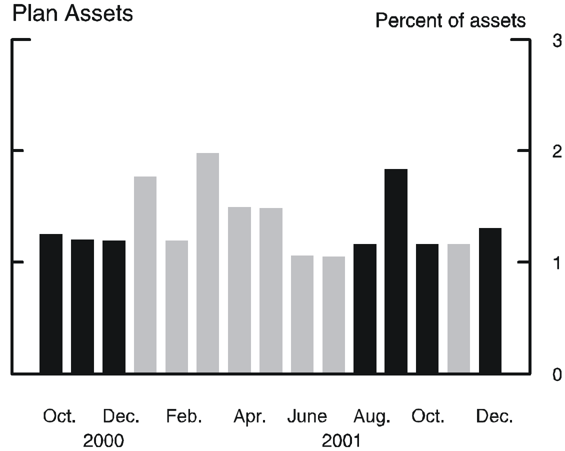
e. Staff estimates based on confidential ICI weekly data. Source. Investment Company Institute (ICI).

Equity Allocation of New Contributions to 401(k) Pension Plans



Note. Consists of equity mutual funds and company stock.
Source. Hewitt Associates.

Transfers Among Existing 401(k) Pension Plan Assets



Note. Shading indicates predominant direction of transfers: dark bars indicate transfers toward fixed income investments, light bars indicate transfers toward equity.
Source. Hewitt Associates.

Treasury Financing

(Billions of dollars)

Item	2001					2002
	Q2	Q3	Q4	Nov.	Dec.	Jan.(e)
Total surplus, deficit (−)	**193.7**	**-41.9**	**-37.1**	**-54.3**	**26.6**	**n.a.**
Means of financing deficit						
Net borrowing	-157.4	68.6	59.5	72.0	-8.8	-24.3
Nonmarketable	6.2	-5.7	10.5	2.6	2.1	-1.7
Marketable	-163.6	74.4	49.0	69.4	-10.9	-22.6
Bills	-92.1	114.8	73.3	77.1	-5.1	-26.5
Coupons[1]	-62.3	-32.6	-15.8	-5.9	-1.5	3.9
Debt buybacks	-9.2	-7.7	-8.5	-1.7	-4.2	0.0
Decrease in cash balance	-15.4	-.5	-8.1	-2.9	-21.8	-24.8
Other[2]	-20.9	-26.2	-14.3	-14.9	4.1	n.a.
MEMO						
Cash balance, end of period	43.7	44.2	52.4	30.5	52.4	77.1

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

1. Does not include Treasury debt buybacks.

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

e. Estimated.

n.a. Not available.

Net Borrowing of Government-Sponsored Enterprises

(Billions of dollars)

Agency	2001					2002
	Q2	Q3	Q4	Nov.	Dec.	Jan.(e)
FHLBs	-7.7	19.2	n.a.	-.9	n.a.	n.a.
Freddie Mac	35.4	37.7	n.a.	6.2	n.a.	n.a.
Fannie Mae	35.7	24.7	36.5	11.3	26.0	n.a.
Farm Credit Banks	2.2	.1	.3	-.5	.9	n.a.
Sallie Mae	.4	1.7	n.a.	n.a.	n.a.	n.a.
MEMO						
Outstanding noncallable reference and benchmark securities						
Notes and bonds	384.1	411.5	449.9	440.9	449.9	463.4
Bills	278.0	288.5	292.0	287.0	292.0	295.0
Total	662.1	700.0	741.9	727.9	741.9	758.4

NOTE. Excludes mortgage pass-through securities issued by Fannie Mae and Freddie Mac.

e. Estimated

n.a. Not available

The most recent readings on household debt-servicing problems have been somewhat mixed. Although delinquency rates on auto loans at captive finance companies dropped slightly in October and November, delinquency rates on auto loans extended to nonprime borrowers remained on a sharp uptrend through November. Delinquency rates on credit card pools edged up, on net, in October and November. Personal bankruptcy rates—for which we have more timely data—moved down in December and January, but remain high by historical standards. According to the January Senior Loan Officer Survey, about 20 percent of banks, on net, tightened their standards for credit card and other consumer loans, similar to the results from the October survey.

The ratio of household assets to disposable income rose in the fourth quarter. The rise reflects small gains in the equity market as well as the reduction in disposable income from the unwinding of the third-quarter tax rebate. Flows into equity and bond mutual funds slowed late in the fourth quarter, as the equity market stalled and rising rates reduced bond fund returns. So far in January, flows into mutual funds appear to have strengthened somewhat. Capital gains paid on long-term mutual funds totaled an estimated $73 billion in 2001, a sharp decline from previous years.

Government and Agency Finance

Somewhat stronger-than-expected tax receipts in December and January pushed the Treasury's budget position back into surplus over the intermeeting period. As a result, the Treasury paid down marketable debt over the period, with most of the adjustment concentrated at the shortest maturities. The influx of cash pushed the Treasury's balances held at commercial banks up to the capacity of the Treasury Tax and Loan System in late January. In order to improve its ability to manage its cash flows the Treasury is finalizing the details of a program that it intends to implement in early April, in which it will offer term deposits at auction to depository institutions.[1]

Freddie Mac and Fannie Mae issued revised 2002 calendars for benchmark debt issuance. Both agencies have scaled back their planned issuance of thirty-year bonds relative to recent years. This development reportedly reflects their desire to better manage the duration of their liabilities. The GSE's pullback from thirty-year bond issuance in recent months seems to have affected market liquidity. Despite the Treasury's cancellation of the long bond—which might have been expected to strengthen the demand for long-term agency debt—yields

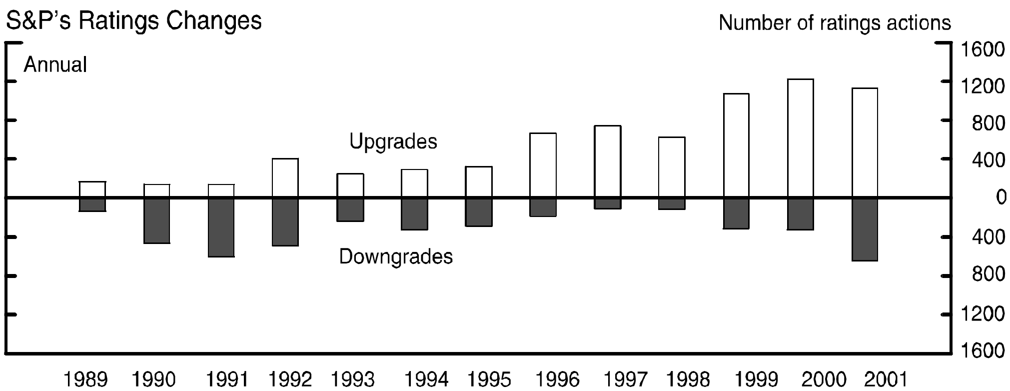
1. Currently, the Treasury's balances at depository institutions are held mostly in demand accounts bearing an interest rate set at 25 basis points below the effective federal funds rate. It is expected that the new time deposits offered by the Treasury under this program will be attractive to banks and give the Treasury more flexibility in managing its cash flows around tax payment dates.

State and Local Government Finance

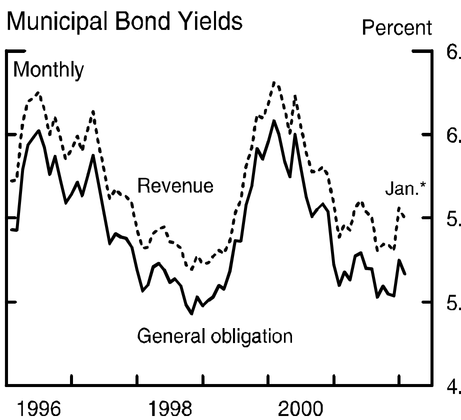
Gross Offerings of Municipal Securities
(Billions of dollars; monthly rates, not seasonally adjusted)

			2001				2002
	2000	2001	H1	H2	Nov.	Dec.	Jan. [e]
Long-term [1]	15.0	22.5	21.4	23.7	30.1	28.4	17.1
Refundings [2]	2.2	6.5	6.4	6.7	9.1	7.0	4.5
New capital	12.9	16.0	15.0	17.1	21.0	21.4	12.5
Short-term	2.8	4.3	3.7	5.0	2.8	2.4	2.5
Total tax-exempt	17.9	26.9	25.0	28.7	33.0	30.8	19.5
Total taxable	0.7	1.1	1.2	1.0	2.0	0.6	1.0

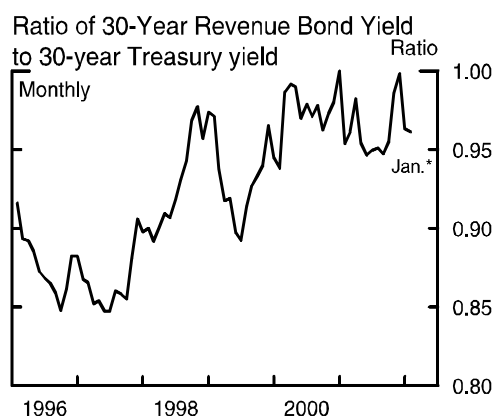
1. Includes issues for public and private purposes.
2. All issues that include any refunding bonds.
e. Staff estimate based on data through Jan. 18.



Source. S&P's Credit Week Municipal.



Note. Average of weekly data.
* Data through Jan. 17.



Note. Average of weekly data.
* Data through Jan. 17.

on thirty-year agency debt are greater than comparable swap rates, contrary to the patterns for shorter maturities.

Gross issuance of long-term debt by state and local governments, both for new capital and refundings, totaled a hefty $28 billion in December, down a bit from the very rapid pace in November. Partial data for January suggest some further slowing. Muni yields declined over the intermeeting period, but by less than Treasuries, reflecting perhaps the large supply of recently issued debt, and perceptions of more supply to come as states rely more on bond financing for capital projects. The credit quality of many state and local governments has begun to erode as economic activity has weakened and tax receipts have flagged.

Money and Bank Credit

In December, M2 grew just under 9 percent at an annual rate, down from its pace in November, and below the average growth rate for 2001 as a whole.[2] While the weaker economy likely exerted a drag on M2 growth, other factors—including overseas demand for currency, an earlier surge in mortgage refinancing, and continued stimulus from past policy easings—boosted its growth.

Currency grew rapidly as the crisis in Argentina and continued demand from Russia generated noteworthy overseas shipments. Liquid deposits remained strong in December, continuing to grow at a 20 percent annual rate. The peak in mortgage refinancings in mid-November likely contributed significantly to the December growth in liquid deposits, as normal delays in the disbursement of funds from refinanced mortgages underlying mortgage-backed securities caused a swelling in demand deposit escrow accounts.

In contrast, growth of retail money funds slowed in December, as money fund yield spreads over bank deposit rates narrowed. Small time deposits continued to contract at a fairly rapid pace; low interest rates make these types of deposits especially unattractive, given their relatively low liquidity. Data for the first week of January suggest some further slowing in M2, but it is too early to tell how the month as a whole will shape up.

The rate of expansion of the non-M2 component of M3 slowed significantly in December. Institution-only money funds grew less rapidly, and large time deposits continued to shrink.

2. These data incorporate the effects of the annual seasonal review and are confidential until their release that is scheduled for January 31.

Monetary Aggregates

(Based on seasonally adjusted data)

Aggregate or component	2001	2001 Q3	2001 Q4	2001 Oct.	2001 Nov.	2001 Dec.	Level (bil. $) Dec. 01
Aggregate	Percent change (annual rate)[1]						
1. M2[2]	10.3	11.3	9.3	-2.5	9.4	8.9	5454.8
2. M3	12.9	10.7	12.4	7.0	13.4	9.6	8042.7
Selected components							
3. Currency	9.1	11.4	10.3	8.2	8.0	10.8	580.6
4. Liquid deposits[3]	17.9	21.1	17.5	-6.2	21.3	20.4	2896.5
5. Small time deposits	-5.2	-8.5	-12.8	-13.2	-17.1	-18.5	969.3
6. Retail money market funds	8.5	6.2	9.1	12.9	3.9	2.2	1000.7
7. M3 minus M2[4]	19.1	9.3	19.2	28.0	22.0	10.9	2587.9
8. Large time deposits, net[5]	-2.0	-3.4	-7.2	-8.0	-9.3	-2.1	792.5
9. Institution-only money market mutual funds	50.7	27.2	49.2	76.1	33.0	26.2	1197.2
10. RPs	1.0	-7.6	-1.6	-14.3	52.8	0.6	372.5
11. Eurodollars	14.6	6.1	8.9	-4.9	28.7	-4.8	225.8
Memo							
12. M1	6.9	15.5	2.1	-39.6	-0.5	18.9	1179.9
13. Sweep-adjusted M1[6]	7.8	13.3	5.9	-19.8	1.5	14.4	1633.0
14. Demand deposits	4.0	28.7	-5.8	-123.6	-18.9	22.9	331.2
15. Other checkable deposits	6.2	7.7	-4.3	-25.6	6.2	33.1	260.4
16. Savings deposits	21.8	21.6	23.8	15.7	29.0	18.7	2304.9
17. Monetary base	8.5	14.7	6.5	-18.3	-1.8	10.2	634.4
	Average monthly change (billions of dollars)[7]						
Selected managed liabilities at commercial banks							
18. Large time deposits, gross	3.3	-4.4	8.5	17.4	16.2	8.7	984.8
19. Net due to related foreign institutions	-6.6	-3.2	-7.5	7.1	-15.4	-13.7	147.5
20. U.S. government deposits at commercial banks	1.5	5.3	0.1	11.3	1.9	-0.3	33.8

1. For the years shown, Q4 to Q4 precent change. For the quarters shown, based on quarterly averages.
2. Sum of M1, retail money market funds, saving deposits, and small time deposits.
3. Sum of demand deposits, other checkable deposits, and saving deposits.
4. Sum of large time deposits, institutional money funds, RP liabilities of depository institutions, and Eurodollars held by U.S. addressees.
5. Net of holdings of depository institutions, money market mutual funds, U.S. government and foreign banks and official institutions.
6. Sweep figures used to adjust these series are the estimated national total of transaction account balances initially swept into MMDAs owing to the introduction of new sweep programs on the basis of monthly averages of daily data.
7. For the years shown, "average monthly change" is the Q4 to Q4 dollar change divided by 12. For the quarters shown, it is the quarter-to-quarter dollar change, divided by 3.

p--Preliminary

Note: These data incorporate the effect of the annual seasonal review and are confidential until their release that is scheduled for January 31.

Bank credit growth slowed in December, falling to 2-3/4 percent at an annual rate. Total loans contracted at a 4-3/4 percent pace, pulled down by another sharp reduction in business loans. The runoff in business loans and commercial paper last year was accompanied by a decline in inventories. Changes in short-term credit and changes in inventories have moved together over the past decade, suggesting that the continued contraction in short-term credit in December and early January signals that businesses were still liquidating inventories.

Incoming reports for large bank holding companies show that fourth-quarter earnings fell from levels a year ago, but only a few firms have reported losses—in particular, those with heavy exposure to Enron and Argentina. More broadly, higher net interest income was offset by higher loan loss provisions.

Commercial Bank Credit

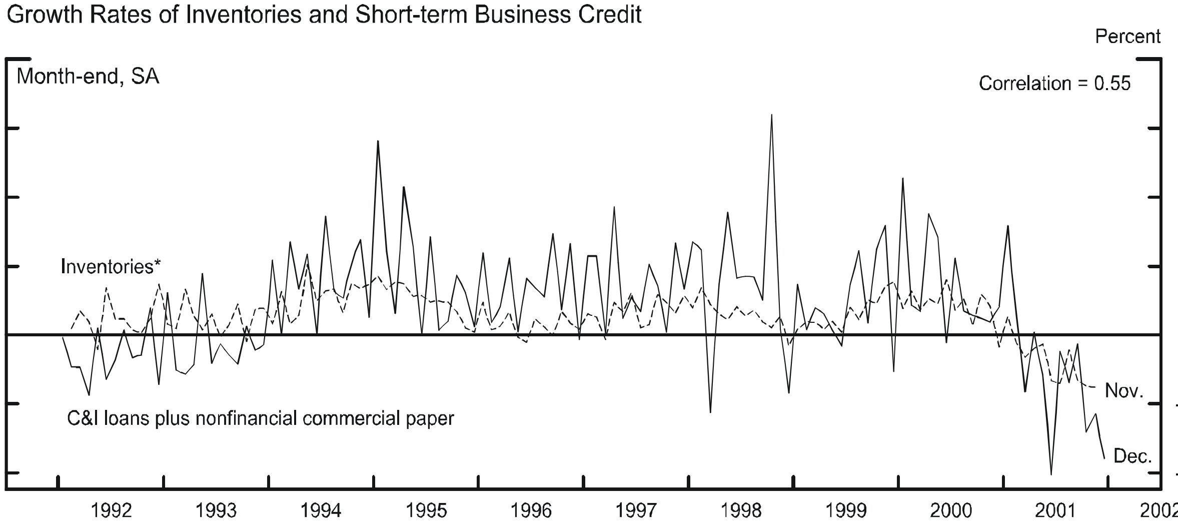
(Percent change, annual rate, except as noted; seasonally adjusted)

Type of credit	2001	Q3 2001	Q4 2001	Oct. 2001	Nov. 2001	Dec. 2001	Level, Dec. 2001 ($ billions)
Total							
1. Adjusted[1]	**3.7**	**2.3**	**2.7**	**-6.8**	**6.1**	**2.8**	**5,263**
2. Reported	4.6	2.6	3.7	-4.1	6.9	-4.2	5,409
Securities							
3. Adjusted[1]	8.8	11.5	14.6	16.3	10.3	25.4	1,329
4. Reported	11.5	11.4	17.4	23.6	12.8	-2.7	1,474
5. Treasury & Agency	3.9	9.4	19.2	29.3	1.9	22.7	831
6. Other[2]	22.9	14.1	15.0	16.3	26.5	-34.1	643
Loans[3]							
7. Total	2.2	-.5	-1.1	-14.1	4.7	-4.7	3,935
8. Business	-4.2	-9.4	-10.6	-18.1	-14.0	-15.1	1,026
9. Real estate	5.8	3.8	6.4	6.7	11.3	5.8	1,757
10. Home equity	15.8	13.3	22.3	44.8	20.4	-37.6	145
11. Other	5.0	3.0	5.0	3.3	10.4	9.8	1,612
12. Consumer	4.1	-1.7	6.6	9.8	15.0	.6	561
13. Adjusted[4]	6.7	1.6	9.6	14.3	18.2	3.2	900
14. Other[5]	1.8	4.5	-12.5	-83.9	9.2	-21.9	591

Note. All data are adjusted for breaks caused by reclassifications. Monthly levels are pro rata averages of weekly (Wednes day) levels. Quarterly levels (not shown) are simple averages of monthly levels. Annual levels (not shown) are levels for the fourth quarter. Growth rates are percentage changes in consecutive levels, annualized but not compounded.

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

Growth Rates of Inventories and Short-term Business Credit



*Inventories are for manufacturing and wholesale and retail trade excluding motor vehicles.

International Developments

International Developments

U.S. International Transactions

Trade in Goods and Services

In November, the U.S. trade deficit in goods and services was $27.9 billion, down $1.4 billion from October (revised). For October and November combined, the trade deficit was $343 billion at an annual rate, up $35 billion from the third quarter. Excluding September's one-time insurance payment related to the events of September 11, the trade deficit in October-November decreased about $10 billion at an annual rate from the third quarter.

Net Trade in Goods and Services
(Billions of dollars, seasonally adjusted)

	2000	Annual rate 2001			Monthly rate 2001		
		Q2	Q3	Q4[e]	Sept.	Oct.	Nov.
Real NIPA[1]							
Net exports of G&S	-399.1	-406.7	-411.0	n.a.	...	...	...
Nominal BOP							
Net exports of G&S	-375.7	-362.2	-308.8	-343.3	-19.0	-29.3	-27.9
Goods, net	-452.2	-430.6	-421.8	-414.1	-35.5	-35.0	-34.0
Services, net	76.5	68.5	113.0	70.8	16.5	5.7	6.1

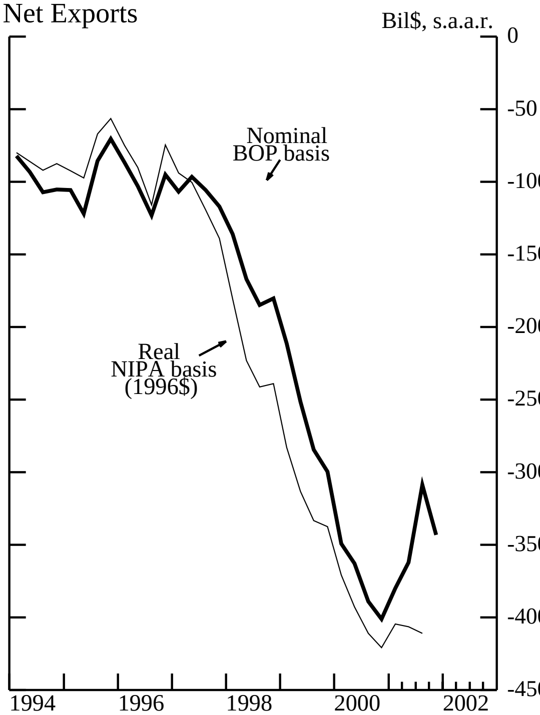
1. Billions of chained (1996) dollars.
e. BOP data are two months at an annual rate.
Source: U.S. Department of Commerce, Bureaus of Economic Analysis and Census.
n.a. Not available. ... Not applicable.

The value of exported goods and services rose 0.7 percent in November following a 1.1 percent increase in October, but remained 6 percent below the average level in July and August. The rise in exports in November was driven by a 4½ percent increase in services receipts, which more than offset a ¾ percent drop in goods exports. A partial recovery of receipts in travel and passenger fares from the lows of September and October accounted for the increase in services exports, though receipts in these two categories, taken together, remained 25 percent below their July-August average. The value of goods exports declined in most categories of trade in November, with the exception of machinery, which rose. For October and November on average, goods exports were down 2¾ percent from the third quarter, with declines recorded in all major categories of trade except agricultural products.

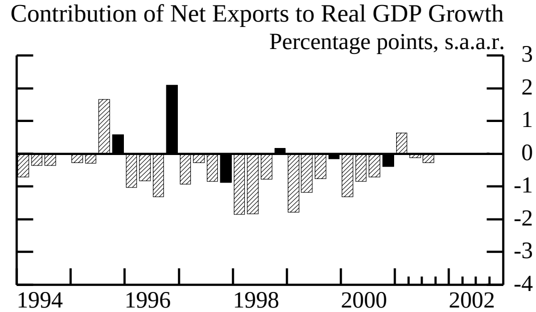
The value of imported goods and services decreased 0.8 percent in November and was 5½ percent below the average level in July and August. Excluding the large drop in the value of imported oil (owing primarily to a lower price, but

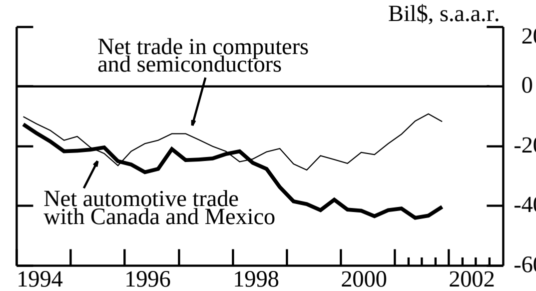
U.S. International Trade in Goods and Services

Net Exports

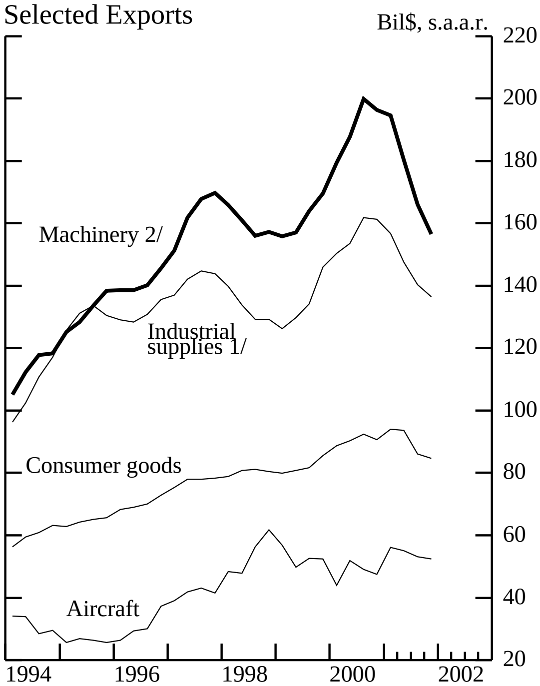


Contribution of Net Exports to Real GDP Growth



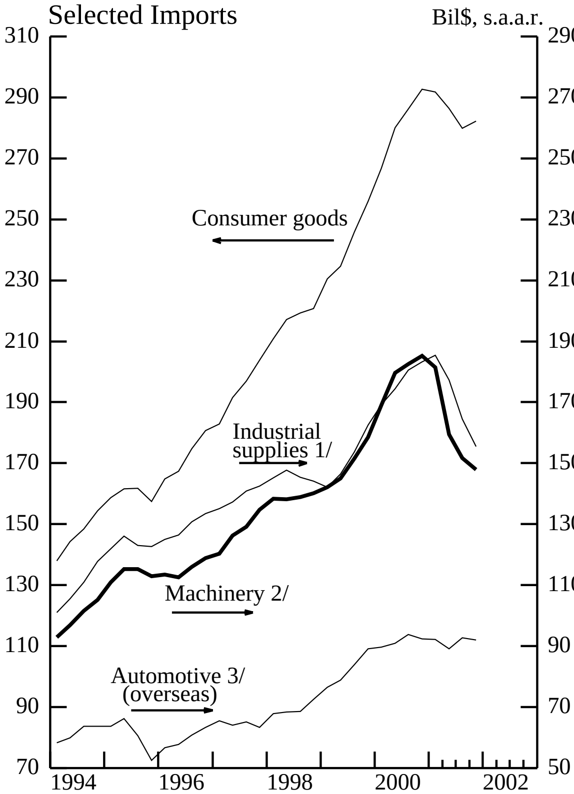


Selected Exports



1. Excludes agriculture and gold.
2. Excludes computers and semiconductors.

Selected Imports



1. Excludes oil and gold.
2. Excludes computers and semiconductors.
3. Excludes Canada and Mexico.

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

	Levels				Amount Change[1]			
	2001		2001		2001		2001	
	Q3	Q4[e]	Oct.	Nov.	Q3	Q4[e]	Oct.	Nov.
Exports of G&S	**973.7**	**935.1**	**931.7**	**938.4**	**-63.5**	**-38.7**	**10.4**	**6.8**
Goods exports	695.3	676.8	679.1	674.6	-48.2	-18.4	11.9	-4.5
Gold	2.4	2.7	2.5	3.0	-5.2	0.4	0.9	0.5
Other goods	692.9	674.1	676.6	671.6	-43.0	36.1	11.0	-5.0
Aircraft & parts	53.1	52.4	54.0	50.8	-2.0	-0.7	3.0	-3.2
Computers	44.5	41.8	42.3	41.3	-4.1	-2.7	-0.3	-1.0
Semiconductors	38.9	38.7	38.7	38.6	-7.5	-0.3	1.7	-0.2
Other capital gds	168.4	159.4	156.6	162.2	-14.2	-9.0	-2.8	5.6
Automotive	77.4	75.2	75.5	74.8	1.1	-2.2	-1.8	-0.7
to Canada	40.3	39.0	38.5	39.5	-2.0	-1.3	-0.1	1.0
to Mexico	15.6	18.3	19.2	17.5	-0.3	2.7	2.7	-1.7
to ROW	21.5	17.8	17.8	17.8	3.3	-3.7	-4.4	0.1
Agricultural	54.9	57.6	57.5	57.7	1.0	2.7	4.8	0.2
Ind supplies (ex. ag)	140.4	136.4	138.3	134.5	-7.2	-4.0	2.8	-3.8
Consumer goods	86.0	84.7	85.4	83.9	-7.6	-1.4	2.8	-1.5
All other goods	29.2	28.0	28.2	27.7	-2.5	-1.3	5.1	-0.5
Services exports	278.5	258.2	252.6	263.9	-15.3	-20.2	-1.5	11.3
Imports of G&S	**1282.5**	**1278.3**	**1283.6**	**1273.1**	**-116.9**	**-4.2**	**134.1**	**-10.5**
Goods imports	1117.0	1090.9	1099.6	1082.2	-57.0	-26.1	6.1	-17.4
Petroleum	102.7	86.7	95.0	78.5	-11.6	-16.0	-7.7	-16.5
Gold	2.2	2.9	2.9	2.8	-4.3	0.7	0.6	-0.1
Other goods	1012.2	1001.3	1001.8	1000.9	-41.2	-10.8	13.1	-0.8
Aircraft & parts	30.7	32.0	31.5	32.5	-0.3	1.3	4.7	1.0
Computers	67.9	68.7	69.4	68.0	-7.9	0.8	5.8	-1.4
Semiconductors	24.7	23.5	23.2	23.8	-6.1	-1.2	-1.9	0.6
Other capital gds	154.0	150.2	150.6	149.9	-8.0	-3.8	-1.3	-0.7
Automotive	192.0	189.8	188.7	190.9	0.8	-2.2	1.5	2.2
from Canada	59.0	55.4	54.2	56.7	-2.0	-3.6	-0.7	2.4
from Mexico	40.2	42.3	43.7	40.9	-0.9	2.1	3.4	-2.8
from ROW	92.8	92.0	90.7	93.3	3.7	-0.8	-1.2	2.5
Ind supplies	164.5	155.4	157.1	153.7	-12.7	-9.1	-0.1	-3.4
Consumer goods	279.9	282.2	281.9	282.5	-6.4	2.3	2.7	0.6
Foods, feeds, bev.	48.0	47.9	47.9	48.0	2.2	-0.0	-0.0	0.0
All other goods	50.4	51.5	51.4	51.6	-2.6	1.1	1.9	0.2
Services imports	165.5	187.4	184.0	190.9	-59.8	21.9	128.0	6.9
Memo:								
Oil quantity (mb/d)	11.96	12.26	12.59	11.93	-0.96	0.31	0.94	-0.66
Oil import price ($/bbl)	23.52	19.33	20.64	18.01	-0.70	-4.20	-3.46	-2.63

1. Change from previous quarter or month. e. Average of two months.
Source: U.S. Department of Commerce, Bureaus of Economic Analysis and Census.

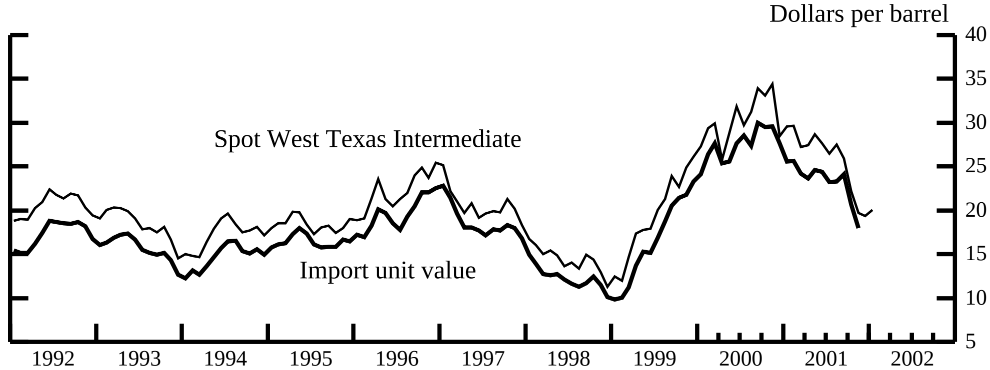
Prices of U.S. Imports and Exports

(Percentage change from previous period)

	Annual rates 2001 Q2	Annual rates 2001 Q3	Annual rates 2001 Q4	Monthly rates 2001 Oct.	Monthly rates 2001 Nov.	Monthly rates 2001 Dec.
	------------- BLS prices (1995 weights)-------------					
Merchandise imports	-6.9	-7.3	-13.4	-2.3	-1.4	-0.9
Oil	-10.9	-12.3	-64.0	-15.3	-11.4	-6.3
Non-oil	-6.4	-6.3	-4.0	-0.6	-0.2	-0.3
Core goods*	-6.1	-6.2	-3.8	-0.5	-0.3	-0.3
Cap. goods ex comp & semi	-0.6	-1.3	-0.1	0.2	-0.2	-0.3
Automotive products	-1.0	-0.5	1.3	0.2	-0.1	0.1
Consumer goods	-1.2	-1.1	-1.5	-0.2	-0.1	-0.1
Foods, feeds, beverages	-8.8	-7.1	0.0	-0.6	0.6	-0.7
Industrial supplies ex oil	-18.1	-21.1	-14.8	-2.3	-0.8	-0.9
Computers	-12.6	-13.5	-12.5	-1.5	0.0	-0.4
Semiconductors	-6.2	-1.1	-0.6	0.2	0.0	0.0
Merchandise exports	-2.1	-2.8	-4.3	-0.7	-0.4	-0.2
Core goods*	-1.7	-2.1	-3.7	-0.6	-0.4	-0.2
Cap. goods ex comp & semi	1.3	-0.4	0.0	0.0	0.1	0.0
Automotive products	0.5	0.0	0.1	0.1	-0.1	0.0
Consumer goods	-1.0	0.7	0.7	-0.1	0.1	0.0
Agricultural products	-2.9	6.1	-8.5	-1.7	-1.4	1.1
Industrial supples ex ag	-6.3	-10.9	-10.9	-1.6	-1.3	-1.2
Computers	-4.9	-8.1	-5.7	0.0	-0.6	-1.9
Semiconductors	-7.1	-7.0	-16.2	-4.5	0.0	0.3
Chain price index	---Prices in the NIPA accounts (1996 weights)---					
Imports of goods & services	-6.0	-17.1	n.a.	...	...	...
Non-oil merchandise	-5.6	-6.7	n.a.	...	...	...
Core goods*	-5.0	-6.2	n.a.	...	...	...
Exports of goods & services	-1.0	-1.7	n.a.	...	...	...
Total merchandise	-1.5	-2.2	n.a.	...	...	...
Core goods*	-1.0	-1.5	n.a.	...	...	...

*/ Excludes computers and semiconductors.
n.a. Not available. ... Not applicable.

Oil Prices



also to a smaller quantity), goods imports declined only slightly. A modest decrease in imports of industrial supplies was mostly offset by increased automotive imports (mainly parts). Imports of capital goods and consumer goods were little changed. Services imports increased 3.8 percent in November, resulting from a modest rebound in travel and passenger fares (receipts in these two categories remained 30 percent below the July-August average). For October and November on average, non-oil goods imports fell 1 percent from the third quarter. The largest decline occurred in industrial supplies, which was driven mainly by a drop in the value of imported natural gas.

Prices of Internationally Traded Goods

Oil. The BLS price of imported oil continued to fall in December, although not as sharply as in the two preceding months. For the fourth quarter on average the price of imported oil was down more than 60 percent at an annual rate from the third quarter. The spot price of West Texas Intermediate has recently been trading between $18 and $19 per barrel, down about $3 per barrel from early January, but about unchanged from early December. Oil prices generally moved higher during December as OPEC and several non-OPEC producers worked out a production restraint arrangement, with OPEC agreeing to cut its production target 1.5 million barrels per day. More recently, however, the spot price of WTI has retraced those gains as increases in U.S. crude oil inventories, along with doubts that OPEC will sharply cut production, have weighed on oil prices.

Non-oil imports. The price of imported non-oil (and core) goods fell again in December, the eleventh consecutive month of declining or unchanged prices. Among major categories of core goods, the largest decline was in prices for industrial supplies and materials, particularly lumber and natural gas. The price index for food also fell sharply in December, reversing the previous month's increase. The price indexes for imported capital equipment (other than computers and semiconductors) and consumer goods both fell slightly in December, while the price index for automotive products edged up. For the fourth quarter on average, the price of core goods was down nearly 4 percent at an annual rate from the third quarter, somewhat less than the decline recorded in the second and third quarters. The price decline over this period was again led by a decrease in the price of imported industrial supplies. The price of consumer goods showed a small decline in the fourth quarter, whereas prices for capital goods excluding computers and semiconductors were little changed, and the price for automotive products rose slightly.

Exports. Prices of U.S. goods exports (total and core) also fell again in December, although the decline was not as steep as in November. The decrease in December was again led by sharp declines in prices of industrial supplies, particularly for exported fuels. Prices in other major categories were unchanged, with the exception of the price index for agricultural products, which largely reversed its November decline. For the fourth quarter on average, the price of exported core goods fell nearly 4 percent at an annual rate from the third quarter, primarily reflecting declines in prices of industrial supplies and agricultural products.

U.S. Current Account

In the third quarter of 2001, the U.S. current account deficit narrowed, for the third consecutive quarter, to $380 billion at a seasonally adjusted annual rate. The $50 billion decline largely resulted from the one-time recording of estimated foreign insurance payments related to the events of September 11, which reduced reported service imports by $44 billion. The remaining decline of $6 billion resulted from a non-insurance related decline in the trade deficit.

The trade deficit narrowed as the world economic slowdown, along with transactions disruptions stemming from September 11, decreased exports less than imports. Income on investments also reflected sagging global conditions, with declines in income receipts on U.S.-owned assets abroad (both portfolio and direct) slightly exceeding decreases in income payments on foreign-owned assets in the United States. Unilateral transfer payments rose slightly, primarily due to an increase in private remittances and other private transfers.

U.S. Current Account
(Billions of dollars, seasonally adjusted annual rate)

Period	Goods and services, net	Investment income, net	Other income and transfers, net	Current account balance
Annual				
1999	-261.8	-8.5	-54.0	-324.4
2000	-375.7	-9.6	-59.3	-444.7
Quarterly				
2000:Q4	-401.2	7.9	-72.0	-465.3
2001:Q1	-380.1	-14.6	-52.4	-447.1
Q2	-362.2	-14.6	-53.5	-430.3
Q3	-310.3	-14.9	-54.7	-379.9
Change				
Q4-Q3	-11.8	22.4	-14.6	-4.1
Q1-Q4	21.1	-22.5	19.6	18.2
Q2-Q1	17.9	0.0	-1.1	16.8
Q3-Q2	51.8	-0.2	-1.2	50.4

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

U.S. International Financial Transactions

Foreign private net purchases of U.S. securities set a record in October and remained at a high level in November, in sharp contrast to the unusually low level of net purchases recorded in September (line 4 of the Summary of U.S. International Transactions table). Through November, foreign net purchases have already exceeded the record level set in 2000. The pattern of foreign net purchases suggests some flight-to-quality after the events of September 11th. Net purchases of Treasuries (line 4a) in October-November were the highest for any two-month period since November-December 1998. Net purchases of agency securities (line 4b) were also strong, with record purchases in October, perhaps fueled in part by an unusually high level of new issuances by Fannie Mae and Freddie Mac. Of note in October were large net purchases from Japan of both Treasury ($10 billion) and agency securities ($14 billion). In November, most of the activity in Treasury securities was through the Caribbean financial centers. Foreign net purchases of corporate debt (line 4c) continued strong and foreign net purchases of equities (line 4d) returned to their pre-September trend levels after net sales were recorded in September for the first time since September 1998.

U.S. residents made modest net purchases of foreign securities in October-November (line 5) following large net sales in the third quarter, especially in September. Purchases of foreign equities (line 5b) returned to approximately their pre-September levels in October, but were largely offset by net sales in November. U.S. residents made small net purchases of foreign bonds in November following seven straight months of sales totaling $35 billion.

Foreign official assets held in the United States (line 1) increased in both October and November. Gains were recorded over the period for Japan ($12 billion) and Venezuela ($5 billion) that exceeded a decline in Argentina's holdings ($5 billion). While increases in official Japanese holdings in the United States over the September-October period were significantly less than the reported size of the Japanese intervention late in the third quarter, published Japanese reserve data show an increase in foreign securities holdings on the order of the intervention, indicating a substantial amount of foreign securities were acquired from non-U.S. sources. To the extent that private Japanese supplied these securities, part of the large inflow attributed to private Japanese purchases of Treasuries and agencies could represent replenishment of their holdings. (The U.S. reporting system will not capture the official/private transactions outside the United States and will thus overstate private holdings and understate official holdings.) Partial data from FRBNY indicate that in December foreign official assets decreased by $2 billion.

There were large net banking inflows (line 3) in both October and November, resulting primarily from deposits and other interoffice activity with Caribbean branches of both U.S.-chartered and foreign-based institutions.

In the third quarter, U.S. direct investment abroad (line 6) was the highest ever recorded and exceeded foreign direct investment in the United States (line 7) for the first time since the first quarter of 2000. U.S. direct investment abroad was bolstered by $20 billion in retained earnings and the $13 billion Citigroup takeover of a Mexican bank. Foreign direct investment in the United States was unusually low, reflecting a reduced level of foreign acquisitions of U.S. firms in the quarter.

The statistical discrepancy in the third quarter was positive $58 billion, following a negative $47 billion discrepancy in the second quarter.

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

	1999	2000	2000	2001				
			Q4	Q1	Q2	Q3	Oct.	Nov.
Official financial flows	**55.0**	**39.3**	**-5.4**	**4.8**	**-21.3**	**13.2**	**8.7**	**7.4**
1. Change in foreign official assets in the U.S. (increase, +)	46.4	39.6	-4.0	4.6	-20.0	16.8	8.3	7.2
a. G-10 countries	49.7	12.3	-.8	-5.5	-6.1	-5.6	10.4	3.5
b. OPEC countries	2.0	10.7	.6	.8	-2.1	-4.7	1.3	2.4
c. All other countries	-5.3	16.6	-3.8	9.2	-11.8	27.0	-3.4	1.3
2. Change in U.S. official reserve assets (decrease, +)	8.6	-.3	-1.4	.2	-1.3	-3.6	.4	.1
Private financial flows	**321.7**	**404.0**	**119.2**	**98.8**	**175.7**	**23.5**	**...**	**...**
Banks								
3. Change in net foreign positions of banking offices in the U.S.[1]	-12.4	-6.7	13.4	-79.4	29.1	-12.1	31.7	54.2
Securities[2]								
4. Foreign net purchases of U.S. securities (+)	333.2	435.7	117.8	149.0	125.8	74.0	67.2	50.1
a. Treasury securities	-19.9	-52.4	-10.1	.7	-8.5	-9.3	15.2	8.0
b. Agency bonds	71.9	111.9	38.3	38.8	29.4	33.1	25.3	11.0
c. Corporate and municipal bonds	158.8	182.1	50.8	68.9	70.4	37.3	19.6	18.0
d. Corporate stocks[3]	122.4	194.0	38.8	40.7	34.5	12.9	7.1	13.1
5. U.S. net acquisitions (-) of foreign securities	-112.9	-101.1	-17.8	-21.0	-44.1	19.2	-2.8	1.8
a. Bonds	-5.7	-4.1	3.3	-2.0	8.8	25.4	.3	-.9
b. Stock purchases	15.6	-13.1	3.6	-16.4	-18.7	-6.1	-3.1	2.7
c. Stock swaps[3]	-122.9	-84.0	-24.7	-2.6	-34.2	.0	.0	.0
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-155.4	-152.4	-39.1	-40.9	-41.1	-52.1	...	...
7. Foreign direct investment in U.S.	301.0	287.7	84.7	52.5	65.2	26.4	...	...
8. Foreign holdings of U.S. currency	22.4	1.1	6.2	2.3	2.8	8.2	...	...
9. Other (inflow, +)[4]	-54.2	-60.2	-46.1	36.3	38.0	-40.1	...	...
U.S. current account balance (s.a.)	**-324.4**	**-444.7**	**-116.3**	**-111.8**	**-107.6**	**-95.0**	**...**	**...**
Capital account balance (s.a.)[5]	**-3.5**	**.7**	**.2**	**.2**	**.2**	**.2**	**...**	**...**
Statistical discrepancy (s.a.)	**-48.8**	**.7**	**2.4**	**8.1**	**-47.0**	**58.1**	**...**	**...**

NOTE. The sum of official and private financial flows, the current account balance, the capital account balance, and the statistical discrepancy is zero. Details may not sum to totals because of rounding.

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

2. Includes commissions on securities transactions and excludes adjustments BEA makes to account for incomplete coverage; therefore does not match exactly the data on U.S. international transactions published by the Department of Commerce.

3. Includes (4d) or represents (5c) stocks acquired through mergers.

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

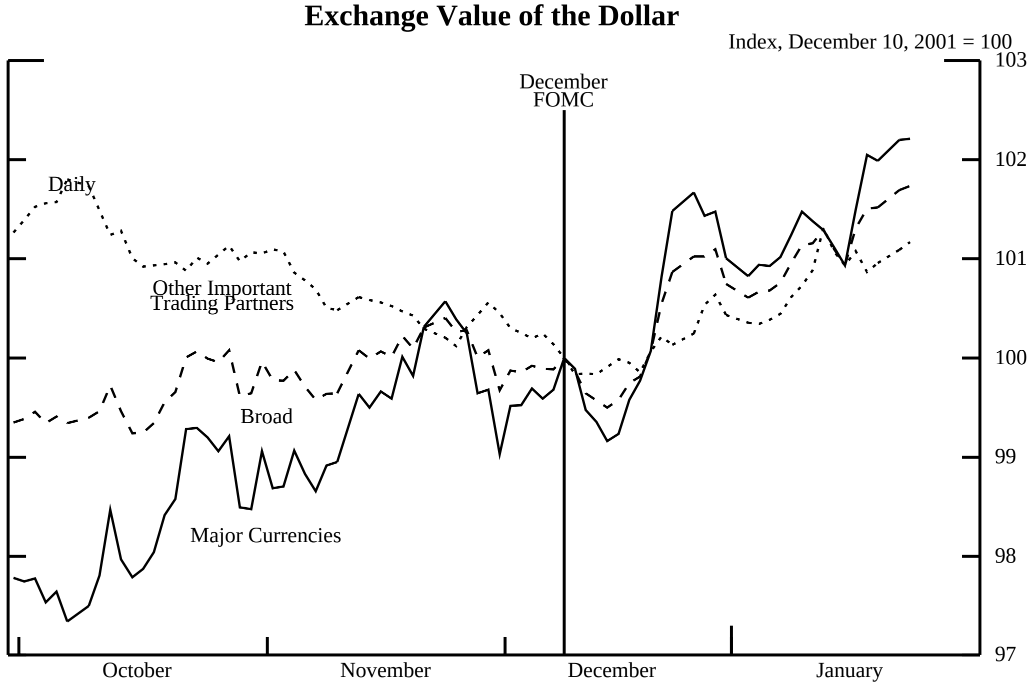
5. Consists of transactions in nonproduced nonfinancial assets and capital transfers.

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

Foreign Exchange Markets

The major currencies index of the exchange value of the dollar has risen 2 percent on balance since the December FOMC meeting. This gain was due, in large part, to a 6 percent appreciation versus the yen. Market participants have interpreted an absence of objections from Japanese officials while the yen was falling as an implicit endorsement for a weaker yen. The moribund state of the Japanese economy also continued to weigh on the yen, particularly as optimism in the market waned that the Koizumi administration would undertake many of the sweeping structural changes called for during the election campaign last year. Even the Japanese government, which has perennially been more optimistic than private forecasters, expects Japan's economy to stagnate over the coming fiscal year which begins in April. The Bank of Japan decision to increase its target for balances held at the BOJ to around ¥10 trillion-15 trillion at its policy meeting on December 19 may also have helped to weaken the yen.

Exchange Value of the Dollar



The dollar appreciated ½ percent, on balance, against the euro over the intermeeting period. At the turn of the new year, the euro rose against the dollar after the successful introduction of the notes and coins. These gains were retraced, however, as the focus in the market shifted back to the character of the global recovery, with a firm consensus believing that the U.S. economy will come out of this slowdown sooner and more forcefully than the euro area.

The U.S. dollar has appreciated 2 percent, on net, against the Canadian dollar since the December FOMC meeting, eclipsing the previous record high reached last year. On January 15, the Bank of Canada lowered its overnight target rate 25 basis points, to 2 percent.

The index of the exchange value of the dollar in terms of the currencies of our other important trading partners rose 1 percent over the intermeeting period, in part due to the Argentine peso, which depreciated sharply against the dollar after Argentine authorities ceased to support one-to-one convertibility between the peso and dollar. In early January a dual exchange rate system was created, with a fixed exchange rate of 1.40 pesos per dollar for some foreign trade and government-sanctioned transactions, and a floating exchange rate for other transactions. On January 11, trading at the floating rate began, and the currency immediately weakened to a value below that of the fixed rate.

. Nonetheless, the floating peso has weakened to as much as 2 pesos per dollar. Other Latin American currencies appeared to be little affected by these developments. The Brazilian *real* depreciated 2 percent, the Chilean peso weakened slightly, and the Mexican peso appreciated ½ percent. The Korean won depreciated 4 percent against the dollar amid comments from Chinese and Korean officials expressing concern over the yen's weaker level and warning of potential domino effects from competitive devaluation.

Financial Indicators in Major Industrial Countries

	Three-month rate		Ten-year yield		Equities
Country	Jan. 23 (Percent)	Percentage Point Change	Jan. 23 (Percent)	Percentage Point Change	Percent Change
Canada	2.01	-.11	5.35	-.17	-.01
Japan	.04	.01	1.44	.08	-4.70
Euro area	3.36	.00	4.84	.01	-2.00
United Kingdom	3.91	-.05	4.86	-.08	-.46
Switzerland	1.65	-.04	3.51	.00	-.58
Australia	4.31	.00	5.88	.05	1.88
United States	1.73	-.08	4.89	-.28	-1.81
Memo: Weighted-average foreign	2.02	-.03	4.54	-.04	n.a.

NOTE. Change is from December 10 to January 23 (10 a.m. EDT).
n.a. Not available.

Long-term interest rates in the foreign industrial countries, as measured by the yield on ten-year government bonds, were little changed, on average, over the intermeeting period. The yield of the Canadian government ten-year bond fell 17 basis points, largely mirroring movements of Treasuries. Japanese equities were among the worst performing of the industrial countries over the period, with the broad-based Topix index setting a new post-bubble low, falling to a level last seen in 1985. A wide range of sectors declined over the period, with retailers hurt the most. The Japanese banking sector was among the worst performers throughout 2001, with share prices falling to a new 17-year low over the period as investors appeared to grow impatient with the slow pace of financial reform. Prime Minister Koizumi suggested that further capital infusions into the banking sector could be forthcoming. Amid these discussions, the yield on the benchmark Japanese government bond rose 8 basis points.

Financial Indicators in Latin America, Asia, and Russia

	Currency/ US dollar		Short-term Interest rates[1]		Dollar-denominated bond spread[2]		Equity prices
Economy	Jan. 23	Percent Change	Jan.22/23 (Percent)	Percentage Point Change	Jan.22/23 (Percent)	Percentage Point Change	Percent Change
Mexico	9.15	-.44	6.74	.72	2.94	-.24	7.57
Brazil	2.39	1.81	18.90	-.15	8.34	-.45	-3.12
Argentina[3]	1.40	40.14	6.75	-4.75	43.65	...	89.64
Chile	667.70	.48	5.54	-.89	2.36	.21	-3.21
China	8.28	-.01	n.a.	n.a.	1.50	.02	-17.37
Korea	1331.50	3.81	4.15	.00	1.17	-.16	11.04
Taiwan	35.08	1.74	2.58	.02	...	...	8.43
Singapore	1.84	.33	.88	-.06	...	...	3.51
Hong Kong	7.80	.00	1.81	-.04	...	...	-8.68
Malaysia	3.80	.01	2.90	.00	1.64	-.04	3.22
Thailand	44.20	.71	2.13	-.88	3.66	-.25	7.52
Indonesia	10395.00	1.66	17.55	-.23	5.22	.23	16.08
Philippines	51.25	-1.16	7.25	-2.56	4.70	-.23	17.54
Russia	30.57	1.53	n.a.	n.a.	6.03	-.99	23.88

NOTE. Change is from December 10 to January 22/23.

1. One month interbank interest rate, except Chile: 30-day deposit rate; Korea: 1-week call rate. No reliable short-term interest rates exist for China or Russia.

2. Spread over similar maturity U.S. Treasury security yield. Mexico, Brazil, Argentina, Korea, the Philippines and Russia: EMBI+ yield. Chile and China: Global bond yield. Malaysia: Eurobond yield. Thailand and Indonesia: Yankee bond yield. Taiwan, Singapore, and Hong Kong do not have outstanding sovereign bonds denominated in dollars.

3. The fixed exchange rate in Argentina's dual rate system used for some trade and government transactions. It was set at 1.40 pesos/dollar in early January. The Argentina sub-component of J.P. Morgan's EMBI+ index was reweighted on December 31, reducing the spread and making a precise comparison over the intermeeting period difficult.

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

Optimism over an impending global recovery helped share prices in Asia, particularly in the countries with substantial exports of information technology goods. A sharp rebound in the price of semiconductor memory chips helped lift shares on the Malaysian, Taiwan and Korean stock markets 3 to 11 percent, continuing a rally that began in late September. Share prices performed even better in Indonesia and the Philippines, rising more than 15 percent over the period.

Owing primarily to uncertainty over changing banking and exchange rate regulations and a lack of liquidity with which to conduct transactions, the stock market in Argentina was closed for much of the intermeeting period. It reopened last week to soaring gains, as Argentine residents sought protection from a depreciating peso, particularly in light of the government's announcement that dollar deposits will be converted to pesos at a rate that has yet to be determined. Following the default on some of its debt, the prices of Argentina's bonds, which were at distressed levels before the December FOMC meeting, have fallen even further. Thus far, there has been little sign of spillover to other markets from the default and devaluation in Argentina. Share prices have declined about 3 percent in Brazil and Chile since the December FOMC meeting and have risen more than 7 percent in Mexico. The yield spread over Treasuries of Brazilian and Mexican debt has narrowed a bit, while Chilean debt widened a touch.

The price of gold rose 3 percent, on balance, over the intermeeting period. A short squeeze in the silver market had driven 1-month silver lease rates above 20 percent for a couple of weeks, but more supply came on the lease market, sending silver lease rates back below 5 percent.

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

Developments in Foreign Industrial Countries

The latest GDP data confirm that activity in foreign industrial countries was weak in the third quarter and indicators point to a slightly weaker fourth quarter. In Japan, third-quarter real GDP declined sharply, and more recent data suggest the economy continued to deteriorate in the last three months of the year. Euro-area data suggest that fourth-quarter activity may have contracted, while the United Kingdom's rate of expansion likely slowed. Canadian activity is recovering from a steep fall in September, but remains below third-quarter levels, suggesting a contraction on average in the last three months of 2001.

Inflation continued to decline, primarily reflecting lower oil prices. The twelve-month rate of consumer price inflation fell below the Bank of Canada's target range in the fourth quarter, while retail price inflation in the United Kingdom remained below the Bank of England's 2½ percent target. Euro-area inflation retreated to 2.1 percent, just above the European Central Bank's (ECB) target ceiling. Deflation continued in Japan.

Data released late in the previous intermeeting period revealed that **Japanese** real GDP declined 2.2 percent (s.a.a.r.) in the third quarter of last year, following a revised 4.8 percent drop in the second quarter. Personal consumption dropped markedly, as households curtailed spending amid rising unemployment and falling real income. A sharp rundown in inventories subtracted ½ percentage point from growth. Private investment showed surprising strength, however, with business fixed investment rising about 4 percent. Residential investment also rose about 4 percent, albeit from depressed levels. Public investment rebounded following a steep drop in the second quarter, adding about ¾ percentage point to growth. Both exports and imports continued to slide, with net exports making a slight positive contribution to growth.

Indicators suggest that the economy continued to deteriorate in recent months. The all-industry index fell 1 percent in October and November on average from the third quarter, with industrial production declining 2.8 percent over the same period. On average, core machinery orders in October and November were roughly 10 percent below their third-quarter average level. Shipments of machinery declined 2.1 percent in November. Residential and nonresidential building starts also posted declines in October and November on average compared with the third-quarter. Personal consumption presents a mixed picture, with household expenditures up about 3½ percent on average in October and November from the third-quarter, while new passenger car registrations ticked up in October but were still down slightly from their average third-quarter pace.

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

Component	2000[1]	2000		2001		
		Q3	Q4	Q1	Q2	Q3
GDP	2.3	-2.9	1.1	4.1	-4.8	-2.2
Total domestic demand	2.2	-3.0	2.9	4.9	-3.6	-2.4
Consumption	.3	-5.4	2.6	7.7	-4.3	-6.6
Private investment	11.0	5.3	12.8	-11.3	3.8	4.4
Public investment	-11.3	-11.8	-17.3	40.5	-35.4	13.5
Government consumption	4.1	.7	.4	4.5	6.4	.4
Inventories[2]	.1	-.2	.2	.1	-.0	-.5
Exports	9.7	4.1	-1.0	-6.9	-18.4	-12.4
Imports	10.7	4.3	19.0	-1.7	-10.0	-17.1
Net exports[2]	.1	.1	-1.7	-.6	-1.2	.2

1. Q4/Q4.
2. Percentage point contribution to GDP growth, s.a.a.r.

Conditions in the labor market also worsened. The unemployment rate rose to a record 5.5 percent in November, and the job-offers-to-applicants ratio fell to 0.53, its lowest level since March 2000. Prices have continued to decline. Core consumer goods prices in the Tokyo area (which exclude fresh food but include energy) were down 1 percent in December from a year earlier. Deflation in wholesale prices for domestic goods has intensified, in part owing to lower energy prices. The merchandise trade surplus (customs-clearance basis) widened in November, as exports ticked up and weakening domestic demand continued to push imports lower.

The Bank of Japan's Tankan index of business conditions worsened further in December, with the diffusion index for all enterprises falling to -40 from -36 in September. Survey respondents project a further decline in the index for March. The deterioration in December was broad based, with similar declines recorded in the manufacturing and non-manufacturing sectors. Other indicators from the Tankan survey suggest that deflationary conditions are expected to persist. Expectations for sales growth in FY2001, which ends in March 2002, were revised down and profits are now expected to slump 18.7 percent in FY2001, worse than the 9.2 percent fall expected in September. Capital investment is expected to fall about 6 percent in FY2001, roughly unchanged from projections in September.

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

Indicator	2001						
	Q2	Q3	Q4	Sept.	Oct.	Nov.	Dec.
Industrial production[1]	-4.1	-4.3	n.a.	-2.9	-.2	-1.7	n.a.
All-industry index	-2.0	-1.9	n.a.	-.9	-.5	.4	n.a.
Housing starts	-2.9	5.4	n.a.	-3.4	-3.0	8.0	n.a.
Machinery orders[2]	1.1	-5.7	n.a.	-13.2	-10.1	14.9	n.a.
Machinery shipments	-7.2	-5.3	n.a.	-5.7	.0	-2.1	n.a.
New car registrations	1.7	-.3	n.a.	-13.7	1.2	n.a.	n.a.
Unemployment rate[3]	4.9	5.1	n.a.	5.3	5.4	5.5	n.a.
Job offers ratio[4]	.61	.59	n.a.	.57	.55	.53	n.a.
Business sentiment[5]	-27	-36	-40	...	...	...	...
CPI (Core, Tokyo area)[6]	-1.3	-1.2	-1.0	-1.2	-1.0	-1.0	-1.0
Wholesale prices[6]	-.7	-1.0	-1.3	-1.1	-1.1	-1.4	-1.4

1. Mining and manufacturing.
2. Private sector, excluding ships and electric power.
3. Percent.
4. Level of indicator.
5. Tankan survey, diffusion index.
6. Percent change from year earlier, n.s.a.
n.a. Not available. ... Not applicable.

On December 19, the Bank of Japan (BOJ) voted to ease monetary policy, raising its target for the outstanding balance of financial institutions' accounts held at the BOJ to ¥10 trillion-15 trillion from "above ¥6 trillion." Since then, the balance has been around ¥14 trillion-15 trillion. As part of the effort to ease policy, the BOJ voted to increase the monthly amount of outright purchases of long-term JGBs from ¥600 billion to ¥800 billion. In addition, the BOJ decided to increase the amount of commercial paper it will accept under repurchase agreements. The BOJ also announced measures to broaden the range of instruments that can be used in open-market operations to include asset-backed commercial paper and real-estate backed securities. The BOJ cited the "deterioration in the financial environment", including a tightening in credit conditions, as the explanation for its decision. On January 16, the BOJ voted to expand the range of government bonds eligible for outright purchase to include bonds issued within the past year, excluding the two most recent issues. Previously, the BOJ only bought bonds that had not been issued within the past twelve months.

The Cabinet approved the draft budget outline for FY2002 on December 24. The budget was submitted to the Diet in late January, with final approval expected in March. The budget implies a slightly contractionary stance, even when FY2001's second supplementary budget (the spending from which will not occur until FY2002) is included. Expenditures would be reduced 1.7 percent (about ¼ percent of GDP) relative to FY2001's initial budget. Public works spending is slated to decline about 10 percent, while outlays to public corporations would be cut roughly 20 percent, reflecting the government's efforts to streamline such corporations. Tax revenues are projected to decline about 5½ percent from recently revised FY2001 estimates, although an increase in non-tax revenues is assumed. The budget will require new bond issues totaling ¥30 trillion, consistent with Prime Minister Koizumi's pledge to cap new bond issuance at that amount.

In the **euro area,** economic activity likely contracted in the fourth quarter of last year following third-quarter GDP growth of only ½ percent. Industrial production declined 1.4 percent in October and a further .8 percent in November; for the two months on average, production was 1.8 percent below the average in the third quarter. The purchasing managers index (PMI) for euro-area manufacturing edged up in December, but remained below its third-quarter average, and signaled contraction in the manufacturing sector for the ninth consecutive month. Service sector PMIs recovered more vigorously in December to slightly below September levels, but for the fourth quarter on average are also consistent with contracting activity.

More forward-looking indicators provide tentative signs of improvement. The volume of German industry orders picked up in November for the first time since August. Foreign orders recovered more than 2 percent but domestic orders weakened a bit further. Although euro-area economic sentiment remains at relatively depressed levels, it edged up in December, the first monthly improvement in a year. In the industrial survey, production expectations edged up slightly although levels of inventory stocks appear to remain high. In the consumer survey, the outlook for the general economic situation also improved somewhat.

Labor market data for the euro area as a whole continue to show only slight deterioration, as the harmonized unemployment rate edged up to 8.5 percent in September and remained at that rate in October and November. National statistics show more pronounced increases in the French and German unemployment rates, while the Italian unemployment rate moved a bit lower.

Euro-Area Economic Indicators[1]
(Percent change from previous period except as noted, s.a.)

Indicator	2001						
	Q2	Q3	Q4	Sept.	Oct.	Nov.	Dec.
Industrial production[2]	-1.0	-.6	n.a.	-.6	-1.4	-.8	n.a.
Retail sales volume	.2	.3	n.a.	.0	-1.1	n.a.	n.a.
Unemployment rate[3]	8.5	8.4	n.a.	8.5	8.5	8.5	n.a.
Consumer confidence[4]	-1.7	-7.7	-10.7	-9.0	-10.0	-12.0	-10.0
Industrial confidence[5]	-5.3	-10.0	-17.0	-11.0	-16.0	-18.0	-17.0
Mfg. orders, Germany	-1.5	-2.7	n.a.	-4.1	-.4	.7	n.a.
CPI[6]	3.1	2.7	2.2	2.5	2.4	2.1	2.1
Producer prices[6]	3.9	1.7	n.a.	.9	-.5	-1.1	n.a.
M3[6]	5.4	6.8	n.a.	6.8	7.4	8.0	n.a.

1. Euro-area indicators include Greece only from January 2001.
2. Excludes construction.
3. Euro-area standardized to ILO definition. Includes Eurostat estimates in some cases.
4. Diffusion index based on European Commission surveys in individual countries; Averages of responses to questions on financial situation, general economic situation, and purchasing attitudes.
5. Diffusion index based on European Commission surveys in individual countries; Averages of responses to questions on production expectations, orders, and stocks.
6. Eurostat harmonized definition, 12-month percent change.
n.a. Not available.

The twelve-month rate of euro-area consumer price inflation moved down to 2.1 percent in November and remained at that rate in December, just above the ECB's 2 percent target ceiling. Core consumer price inflation (which excludes food, energy, alcohol and tobacco) edged up to 2.3 percent in December on a twelve-month basis. Producer prices continued to move lower, declining in October and November from their year-earlier levels.

The introduction of euro notes and coins is proceeding smoothly. The ECB said that by mid-January almost 95 percent of all cash transactions were conducted in euros. The ECB also stated that by January 17 the value of euro banknotes in circulation rose to 58 percent of the total value of all banknotes in circulation, including the national banknotes issued but not yet redeemed by national central banks. For most euro-area countries, the change-over period, during which old national currencies can continue to be used, extends through the end of February.

Usage of cash machines in the euro area was two to four times the normal volume in the first few days of the new year, and banks experienced long lines of customers. At the same time many people instead spent their remaining old currency notes at retail establishments, which were supposed to give change in euros, and for that reason the number of cash transactions was higher than normal in many countries while credit card and debit payments declined, contrary to forecasts. While the new euro notes are being introduced mainly by banks and their ATMs, retailers have borne the burden of introducing the bulk of the euro coins and retiring the national currency coins. Large retailers generally had prepared well in advance and reported few difficulties. Smaller retailers, on the other hand, were generally less well prepared and faced some initial difficulties, including occasional shortages of euros for change.

Recent data for the fourth quarter in the **United Kingdom** are mixed. British consumers continued to spend, as retail sales rose 1.3 percent for the quarter, though December sales were disappointing. Although service sector growth has been robust in recent quarters, the latest surveys suggest growth in this sector slowed in the fourth quarter. In contrast, the manufacturing sector continues to be very weak with industrial production declining substantially in recent months.

Indicators for the current quarter remain mixed. Both December consumer confidence and January manufacturing business confidence recovered from recent lows to levels closer to their September values. This recovery indicates manufacturing firms remain relatively pessimistic about the future, but suggests that the manufacturing sector may have bottomed out after declining for the past year.

Notwithstanding the recent slowing in activity, labor market conditions remain tight. The official claims-based unemployment rate remained at 3.2 percent in December, while the labor force survey measure of the unemployment rate remained at 5.1 percent for the three months centered in October. Both unemployment rates are near record lows.

The twelve-month rate of retail price inflation (excluding mortgage interest payments) rose slightly to 1.9 percent in December but still remains well below the Bank of England's official target of 2.5 percent. Growth in average earnings dropped to 3.9 percent in November, below the 4.5 percent rate (from a year earlier) that the Bank of England believes to be compatible with its inflation target.

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

Indicator	2001						2002
	Q2	Q3	Q4	Oct.	Nov.	Dec.	Jan.
Industrial production	-1.1	-.8	n.a.	-1.5	-.3	n.a.	n.a.
Retail sales	1.7	1.5	1.3	.2	1.1	-.4	n.a.
Unemployment rate[1]							
Claims-based	3.2	3.1	3.2	3.2	3.2	3.2	n.a.
Labor force survey[2]	5.0	5.1	n.a.	5.1	n.a.	n.a.	n.a.
Business confidence[3]	-.7	-6.0	-24.0	-23.0	-21.0	-28.0	-13
Retail prices[4]	2.3	2.4	2.0	2.3	1.8	1.9	n.a.
Producer input prices[5]	4.4	-3.4	-9.1	-9.0	-10.8	-7.5	n.a.
Average earnings[5]	4.7	4.4	n.a.	4.4	3.9	n.a.	n.a.

1. Percent.
2. Three-month average centered on month shown.
3. Percentage of firms expecting output to increase in the next four months less percentage expecting output to decrease.
4. Excluding mortgage interest payments. Percent change from year earlier.
5. Percent change from year earlier.
n.a. Not available.

In **Canada**, indicators for the fourth quarter have been mixed. GDP declined 0.3 percent in October from its average third-quarter level, but rebounded somewhat from September's depressed figure. Industrial production followed a similar pattern in October, partially recovering from September's steep fall but remaining 1.4 percent below the third-quarter average. In November merchandise exports increased 1.3 percent from October, ending a seven-month string of declines. Imports fell slightly, reaching a level last seen in September 1999. Manufacturing shipments increased 1.7 percent in November, ending a five-month period of negative or flat manufacturing sector indicators. Encouraged by local "zero-percent financing" incentives, motor vehicle sales surged 8.5 percent in November, with preliminary industry data indicating further increases in December. Retail sales excluding motor vehicles increased 1.1 percent in October, more than reversing September's fall. In November, however, the large increase in auto sales masked a 0.6 percent decline in nonauto sales. Residential construction, driven by low vacancy rates and low financing costs, remained strong in the fourth quarter with December housing starts reaching the highest level since 1991.

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

Indicator	2001						
	Q2	Q3	Q4	Sep.	Oct.	Nov.	Dec.
GDP at basic prices	.2	-.4	n.a.	-.8	.3	n.a.	n.a.
Industrial production	-.1	-2.3	n.a.	-2.3	.2	n.a.	n.a.
New mfg. orders	1.2	-3.4	n.a.	-1.4	-4.0	2.7	n.a.
Retail sales	2.1	-.8	n.a.	-1.5	1.8	1.4	n.a.
Employment	.3	-.1	.1	.1	.0	.1	-.1
Unemployment rate[1]	7.0	7.1	7.6	7.2	7.3	7.5	8.0
Consumer prices[2]	3.6	2.7	1.1	2.6	1.9	.7	.7
Consumer attitudes[3]	113.1	108.0	n.a.	...	...	...	...
Business confidence[3]	131.6	93.0	n.a.	...	...	...	...

1. Percent.
2. Percent change from year earlier, n.s.a.
3. Level of index, 1991 = 100.
n.a. Not available. ... Not applicable.

Labor market conditions softened dramatically in December as the unemployment rate jumped to 8 percent, reflecting both declining employment and a large increase in the labor force. The fall in employment was the largest monthly decline since 1998, and the first sign of reversal in what previously had been a remarkably resilient labor market.

The twelve-month rate of consumer price inflation declined to 0.7 percent in November, and remained at that level in December. This places the rate of inflation slightly below the Bank of Canada's 1 to 3 percent target range. The drop primarily reflects lower energy prices, though other prices decelerated a bit as well.

On January 15, the Bank lowered its policy rate 25 basis points to 2 percent, bringing the cumulative reduction since the beginning of last year to 375 basis points. The accompanying statement cited weak business confidence both in

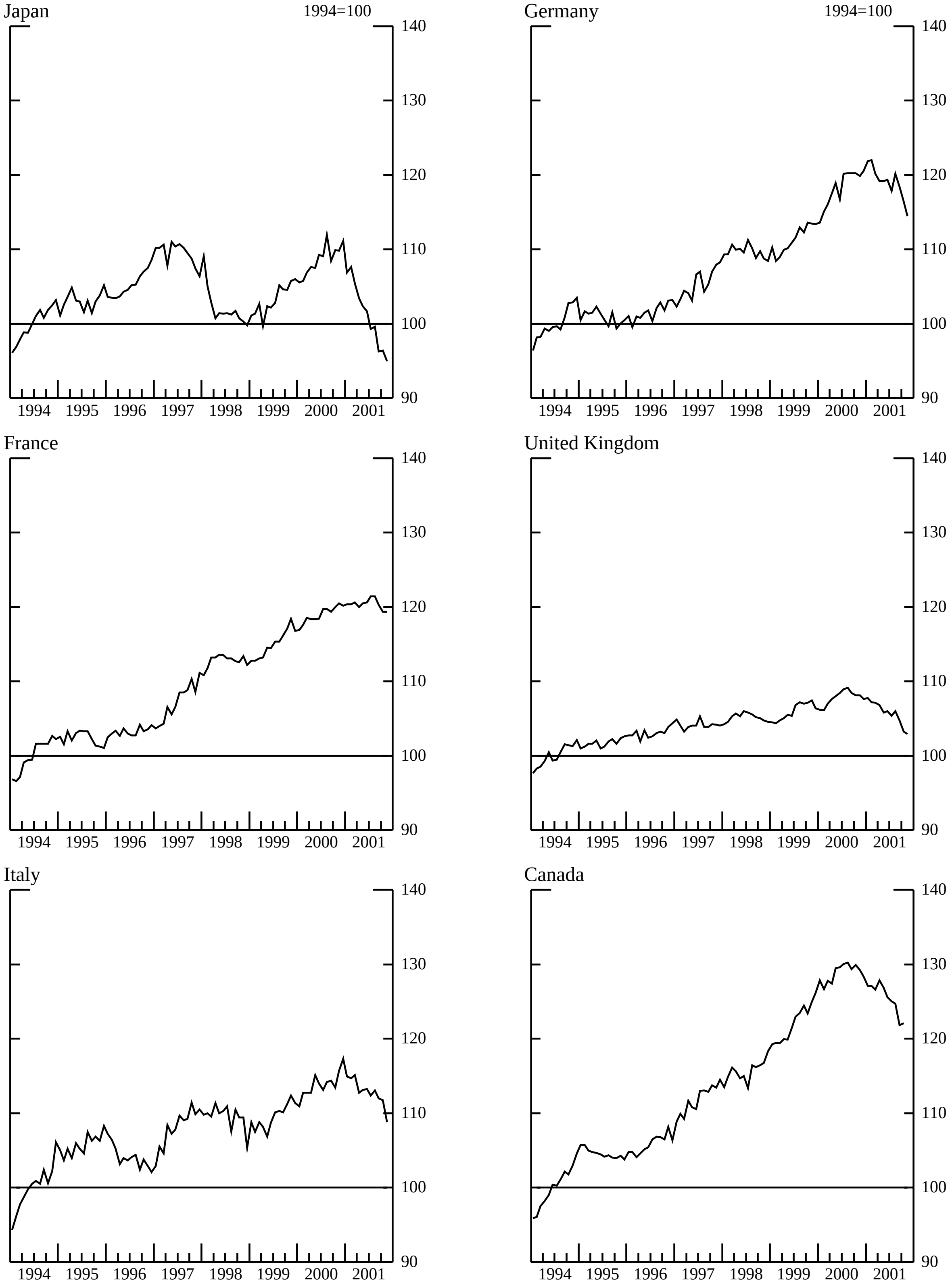
Canada and abroad as the motivation for the latest cut, while also stating that the move was consistent with returning the rate of inflation to its target level.

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

Country and balance	2001						
	Q2	Q3	Q4	Sep.	Oct.	Nov.	Dec.
Japan							
Trade	50.3	55.6	n.a.	72.1	37.3	55.9	n.a.
Current account	67.0	97.8	n.a.	119.8	118.0	132.9	n.a.
Euro area							
Trade[1]	26.4	61.5	n.a.	48.7	104.0	59.0	n.a.
Current account[1]	-39.9	-3.7	n.a.	-14.2	1.1	n.a.	n.a.
Germany							
Trade	66.1	87.4	n.a.	73.8	89.4	49.6	n.a.
Current account	-8.0	.1	n.a.	-4.1	50.7	1.4	n.a.
France							
Trade	-.5	.9	n.a.	.3	2.8	3.5	n.a.
Current account	1.5	5.6	n.a.	3.2	n.a.	n.a.	n.a.
Italy							
Trade	6.5	-1.5	n.a.	10.9	n.a.	n.a.	n.a.
Current account[1]	-5.4	9.3	n.a.	-2.7	25.0	n.a.	n.a.
United Kingdom							
Trade	-52.8	-46.0	n.a.	-39.6	-40.3	n.a.	n.a.
Current Account	-26.0	-11.7	n.a.	...	...	...	...
Canada							
Trade	44.2	32.2	n.a.	33.1	31.0	34.4	n.a.
Current Account	23.4	14.3	n.a.	...	...	...	...

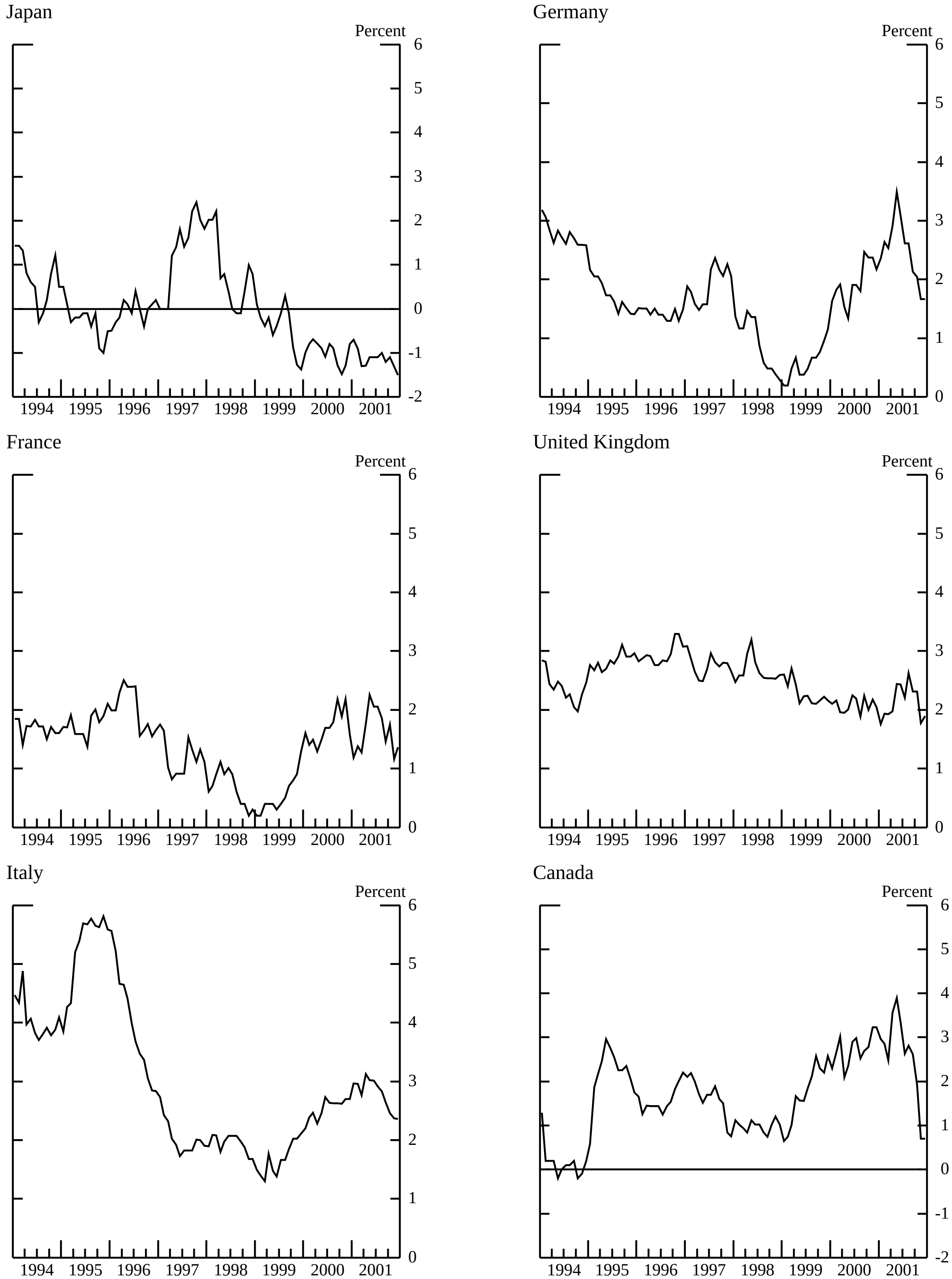
1. Not seasonally adjusted.
n.a. Not available. ... Not applicable.

Industrial Production in Selected Industrial Countries



Consumer Price Inflation in Selected Industrial Countries

(12-month change)



Economic Situation in Other Countries

Economic conditions in Latin America remain unfavorable. Continued political turmoil in Argentina has taken a further toll on the country's already collapsing economy, and indicators point to stagnant growth in Brazil and Mexico. In the Asian developing countries, conditions are mixed. Growth in China remains robust, while Korea and the ASEAN countries are beginning to show signs of recovery from last year's economic downturn. In Hong Kong and Taiwan, however, indicators suggest continued weakness.

The situation in **Argentina** worsened considerably over the intermeeting period. The implementation of capital controls, including limits on bank account withdrawals, in early December led to widespread protests and violence that brought down the de la Rua government on December 21. Three presidents followed in quick succession before the current president, Eduardo Duhalde, was elected by a national assembly to serve out the final two years of de la Rua's term. One of the first acts of the new government was to suspend Argentina's currency board and establish a temporary dual exchange rate system comprised of a fixed exchange rate of 1.4 pesos per dollar primarily for trade and government transactions and a floating rate for other transactions. The government has indicated its intention to remove the exchange rate peg within six months and implement a single floating exchange rate system.

Following the resignation of de la Rua, the government announced the suspension of debt payments to its private creditors. Payments to the international financial institutions have so far been met, however. To relieve some of the financing burden, the IMF board voted in mid-January to approve Argentina's request for a year deferment of a $900 million repayment due under the Supplemental Reserve Facility. The IMF has sent several advisory teams to Argentina to help the new government, but formal negotiations regarding a new IMF program have not yet begun.

Amid changes in leadership and domestic unrest, the government has yet to submit a 2002 budget for discussion. The Duhalde government has lessened only slightly the significant restrictions placed on bank accounts. Tension over the importance of placating angry depositors versus protecting the financial sector led to the resignation of the central bank president. Public protests targeted at banks continue, and the political situation in the country remains highly volatile.

In tandem with the political upheaval has come severe economic disruption. International transactions, including trade, have all but ceased over the past month. Domestic output has also been impeded as payment systems have broken down. There is some evidence that prices are already moving up in the aftermath of the exchange rate depreciation.

Incoming data, which generally reflect conditions prior to the resignation of de la Rua, are uniformly bad–imports fell 40 percent from their year-earlier level in November, tax revenues were abysmal for December, and prices dropped 1.5 percent over the twelve months ended December. Argentine foreign-currency-denominated sovereign debt is trading at about a quarter of its face value. The local stock market was closed from January 4 through January 16. Since reopening, the market is up about 25 percent, on balance, as Argentine residents seek to switch from cash to other assets. Transactions on the foreign exchange market, which opened on January 11, have so far been very limited but have pushed the floating exchange rate toward 2 pesos per dollar, despite intervention by the central bank.

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

Indicator	2000	2001	2001				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP[1]	-1.9	n.a.	-14.1	n.a.	...	...	...
Industrial production	-1.8	n.a.	-3.1	n.a.	-2.9	-.9	n.a.
Unemployment rate[2]	15.1	17.4	...	18.3	18.3	...	...
Consumer prices[3]	-.7	-1.5	-1.1	-1.6	-1.7	-1.6	-1.5
Trade balance[4]	2.6	n.a.	9.5	n.a.	10.7	12.5	n.a.
Current account[5]	-8.9	n.a.	-3.3	n.a.	...	...	...

1. Annual rate. Annual figures are Q4/Q4.
2. Percent, n.s.a. Data are released for May and October only. Figures for Q4 reflect data for October.
3. Percent change from year-earlier period, except annual figures, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. ... Not applicable.

In **Mexico**, weak external demand continued to sap the economy, although production data provided some tentative signs of an improvement. Overall economic activity (a monthly proxy for real GDP) declined in October and exports fell over 3½ percent in November. However, industrial production rose more than 1 percent in November. The trade deficit widened considerably in

November as imports fell much less than exports. Inflation continued on its downward trend; the twelve-month inflation rate for December was around 4½ percent–half the rate in 2000 and well below the government's 2001 year-end target of 6½ percent.

In early January, the Mexican congress passed the fiscal budget for 2002 and approved new tax measures. The fiscal deficit for this year is targeted at 0.65 percent of GDP. This is the same as last year's deficit and indicates a continued commitment to fiscal discipline. The new tax package is estimated by the government to bolster tax revenues by over 1 percent of GDP, but it falls well short of the tax reform bill proposed by the government last April and fails to address the fundamental issue of how to improve tax collection. In early January, the Mexican government issued $1.5 billion in 10-year global bonds at a spread of just 270 basis points above comparable U.S. treasuries.

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

Indicator	2000	2001	2001				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP[1]	5.2	n.a.	-.9	n.a.	...	...	...
Overall economic activity	6.7	n.a.	-.3	n.a.	-.7	n.a.	n.a.
Industrial production	6.4	n.a.	-.6	n.a.	-1.0	1.2	n.a.
Unemployment rate[2]	2.2	2.4	2.4	2.8	3.0	2.6	2.8
Consumer prices[3]	9.0	4.4	6.0	5.2	5.9	5.4	4.4
Trade balance[4]	-8.0	n.a.	-9.5	n.a.	-10.7	-14.3	n.a.
Imports[4]	174.5	n.a.	165.6	n.a.	164.0	162.0	n.a.
Exports[4]	166.5	n.a.	156.1	n.a.	153.3	147.6	n.a.
Current account[5]	-18.1	n.a.	-12.6	n.a.	...	...	n.a.

1. Annual rate. Annual figures are Q4/Q4.
2. Percent; counts as unemployed those working one hour a week or less.
3. Percent change from year-earlier period, except annual figures, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. ... Not applicable.

In **Brazil**, incoming data point to continued weakness in the fourth quarter. Industrial output rose 1.4 percent in November, reflecting the end of the Petrobras strike, but was down significantly from year-earlier levels. The unemployment rate edged up to 7 percent in November. Inflation nevertheless ended the year at 7.7 percent, up from 6 percent in 2000, and above the 6 percent upper limit of the government's target range for inflation. The rise reflected, in part, the strong depreciation of the currency through the third quarter of 2001. The depreciation, as well as weak activity, contributed to an improvement in the trade balance, which shifted from a small deficit in 2000 to a surplus of about $2½ billion in 2001.

So far, Brazil has been affected relatively little by the turmoil in Argentina, with asset prices boosted by good news on the fiscal front and the improving trade balance. The primary (non-interest) fiscal balance for the combined public sector in 2001 through November was over 4 percent of GDP. Although a public sector deficit is anticipated for December, for the year as a whole, the primary fiscal surplus is expected to be over the country's IMF program target of 3.4 percent of GDP. The central bank has nevertheless kept its benchmark overnight interest rate at 19 percent to curb inflationary pressures. In early January, the Brazilian government issued $1.25 billion in 10-year bonds in global markets at a spread of 750 basis points above U.S. Treasuries.

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

Indicator	2000	2001	2001				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP[1]	4.3	n.a.	.5	n.a.	...	...	...
Industrial production	6.6	n.a.	-1.8	n.a.	-1.8	1.4	n.a.
Unemployment rate[2]	7.1	n.a.	6.1	n.a.	6.8	7.0	n.a.
Consumer prices[3]	6.0	7.7	6.6	7.5	7.2	7.6	7.7
Trade balance[4]	-.7	2.6	6.3	9.2	8.0	10.0	9.7
Current account[5]	-24.6	n.a.	-16.3	n.a.	-29.2	-19.1	n.a.

1. Annual rate. Annual figures are Q4/Q4.
2. Percent. "Open" unemployment rate.
3. Percent change from year-earlier period, except annual figures, which are Dec./Dec. Price index is IPC-A.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. ... Not applicable.

Indications are that **Venezuelan** GDP for 2001 likely rose at a rate well below the almost 6 percent registered in 2000. Inflation remained relatively subdued, coming in at 12.3 percent for the year ended December. Government revenues have been declining in step with oil prices, and projections are for a sizable fiscal imbalance in 2002. In response, President Chavez proposed tax increases in January, including the imposition of a bank transaction tax. With the weakening economy and heightened political uncertainty, capital continues to leave the country and the exchange rate is coming under increasing pressure. For 2001, reserves (including the macroeconomic stabilization fund) fell $2 billion. In the first few weeks of January, the decline was almost $1 billion. The rate of crawl of the peg has been adjusted to 10 percent in 2002 compared with 7 percent last year.

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

Indicator	2000	2001	2001				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP[1]	5.7	n.a.	1.3	n.a.	...	...	...
Unemployment rate[2]	13.4	n.a.	13.4	n.a.	n.a.	n.a.	n.a.
Consumer prices[3]	13.4	12.3	12.7	12.4	12.3	12.7	12.3
Non-oil trade balance[4]	-10.8	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Trade balance[4]	18.0	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Current account[5]	13.4	n.a.	3.2	n.a.	...	...	...

1. Annual rate. Annual figures are Q4/Q4.
2. Percent, n.s.a.
3. Percent change from year-earlier period, except annual figures, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. ... Not applicable.

In **Korea**, recent indicators suggest that activity has continued to move up. Industrial production increased strongly in November, more than reversing the decline of the previous month. Department store sales and producers' shipments also rose in November, as the inventory to shipments ratio declined further. Production has held up this year despite a substantial fall off of exports. This divergence between production and exports–unusual in Korea's history–has reflected the strength of domestic demand. Domestic demand has been surprisingly robust this past year, with demand shifting in recent months from consumption to construction investment and government spending. Both business and consumer sentiment moved up smartly in November, the latter probably boosted by a further decline in the unemployment rate.

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

Indicator	2000	2001	2001				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP[1]	5.2	n.a.	5.1	n.a.	...	...	...
Industrial production	17.0	n.a.	1.6	n.a.	-1.5	1.9	n.a.
Unemployment rate[2]	4.1	3.7	3.5	3.4	3.5	3.5	3.3
Consumer prices[3]	3.1	3.2	4.3	3.4	3.5	3.4	3.2
Trade balance[4]	16.9	n.a.	11.9	n.a.	6.6	12.0	n.a.
Current account[5]	11.4	n.a.	3.8	n.a.	3.0	8.3	n.a.

1. Annual rate. Annual figures are Q4/Q4.
2. Percent.
3. Percent change from year earlier, except annual changes, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. ... Not applicable.

Since the last Greenbook, data from the **ASEAN** region indicate that last year's steep economic downturn may have ended in the fourth quarter. Recent industrial production data have been positive in much of the region, and for Malaysia and Singapore–the countries hit hardest by last year's economic swoon–the surge in production has been particularly strong. Recent trade data have been mixed, with trade surpluses in Indonesia and Malaysia, the region's net oil exporters, shrinking somewhat in November, and surpluses widening in the rest of the region. Inflation has slowed in every country in the region except for Malaysia, where it is still at a very low level.

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

Indicator and country	1999	2000	2001				
			Q2	Q3	Sept.	Oct.	Nov.
Real GDP[1]							
Indonesia	6.4	5.7	6.2	-1.0	...	...	
Malaysia	11.5	6.4	-8.5	1.0	...	...	
Philippines	5.1	3.9	6.4	2.7	...	...	
Singapore	8.0	11.0	-9.7	-11.1	...	...	
Thailand	6.4	3.1	.8	.9	...	...	
Industrial production[2]							
Indonesia[3]	-.9	11.6	3.1	-1.9	-.4	2.4	.5
Malaysia	9.1	19.1	-5.3	1.2	-1.3	.2	3.1
Philippines	3.6	14.9	-1.1	5.2	-6.6	1.1	n.a.
Singapore	13.9	15.3	-6.3	-8.5	-4.8	7.7	7.7
Thailand	12.5	3.2	-.3	.3	-.1	1.5	1.0

1. Annual rate. Annual figures are Q4/Q4.
2. Annual figures are annual averages.
3. Staff estimate.
n.a. Not available. ... Not applicable.

ASEAN Economic Indicators: Trade Balance
(Billions of U.S. dollars, s.a.a.r.)

Country	2000	2001	2001				
			Q3	Q4	Oct.	Nov.	Dec.
Indonesia	28.6	n.a.	27.8	n.a.	29.8	23.2	n.a.
Malaysia	16.0	n.a.	15.0	n.a.	13.0	11.4	n.a.
Philippines	6.7	n.a.	-.1	n.a.	6.0	6.2	n.a.
Singapore	3.3	5.8	4.7	6.5	2.0	8.4	9.0
Thailand	5.5	n.a.	3.7	n.a.	1.6	1.9	n.a.

n.a. Not available.

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

Country	2000[1]	2001[1]	2001				
			Q3	Q4	Oct.	Nov.	Dec.
Indonesia	9.3	12.5	12.8	12.6	12.5	12.9	12.5
Malaysia	1.3	1.2	1.4	1.2	.9	1.5	1.2
Philippines	6.7	3.9	6.4	4.6	5.4	4.4	3.9
Singapore	2.1	n.a.	.8	n.a.	.2	-.2	n.a.
Thailand	1.3	.8	1.6	1.0	1.4	1.0	.8

1. December/December.
n.a. Not available.

In **China**, recent indicators point to continued growth. China's GDP rose 7.5 percent in 2001 supported, in part, by fixed-asset investment by state-owned enterprises and inflows of foreign direct investment (FDI). Indicators of future inflows of FDI remain strong. Industrial production edged up in December, but consumer prices declined modestly in November and December, largely as a result of a government freeze on school fees and a price liberalization, which lowered the cost of some services. Exports and imports fell in December, but both were up significantly relative to a year earlier.

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

Indicator	2000	2001	2001				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP[1]	8.0	7.5	7.1	7.1	...	...	...
Industrial production[2]	11.4	8.9	8.5	8.5	8.8	7.9	8.7
Consumer prices[2]	1.5	-.3	.8	-.1	.2	-.3	-.3
Trade balance[3]	24.1	23.1	8.3	36.3	30.6	42.4	35.9

1. Annual rate. Quarterly data estimated by staff from reported four-quarter growth rates. Annual figures are Q4/Q4.
2. Percent change from year earlier. Annual figures are year over year.
3. Billions of U.S. dollars, annual rate. Imports are c.i.f.
... Not applicable.

China announced that, in light of the expected pickup in investment following entry into the WTO, it plans to abolish the favorable tax treatment granted to foreign firms for the past two decades. Foreign firms currently pay 15 percent in income tax, as compared with 33 percent for domestic firms. Various proposals are under consideration, but the most likely would be to raise the corporate tax rate for foreign firms while lowering the rate for domestic corporations.

Data received since the last FOMC meeting suggest that economic conditions in **Hong Kong** have deteriorated. The unemployment rate increased to 6.1 percent in the fourth quarter, the highest level since 1999. The index of retail sales volume was up nearly 2 percent in November, but remains well below the level at the end of the summer. The trade deficit widened in November as exports and imports both declined modestly, and consumer prices fell 3.5 percent over the twelve months ended December.

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

Indicator	2000	2001	2001				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP[1]	6.6	n.a.	1.6	n.a.	...	...	...
Unemployment rate[2]	5.1	4.9	5.3	6.1	5.5	5.8	6.1
Consumer prices[3]	-2.1	-3.5	-1.0	-2.1	-1.2	-1.4	-3.5
Trade balance[4]	-11.0	n.a.	-14.0	n.a.	-9.9	-11.8	n.a.

1. Annual rate. Annual figures are Q4/Q4.
2. Percent. Monthly numbers are averages of the current and previous two months.
3. Percent change from year-earlier period, except annual figures, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate. Imports are c.i.f.
n.a. Not available. ... Not applicable.

Indicators released over the past month for **Taiwan** were negative, on balance. The unemployment rate edged up to 5.3 percent in November, industrial production fell 3.7 percent in December, and consumer prices declined in November and December from a year earlier. However, the trade balance improved with exports and imports both registering significant increases in December, and the Council of Economic Planning and Development's index of leading indicators rose in November.

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

Indicator	2000	2001	2001				
			Q3	Q4	Oct.	Nov.	Dec.
Real GDP[1]	3.8	n.a.	-3.1	n.a.	...	...	...
Unemployment rate[2]	3.0	n.a.	4.9	n.a.	5.2	5.3	n.a.
Industrial production	7.4	-7.5	-1.6	1.8	8.0	-1.3	-3.7
Consumer prices[3]	1.7	-1.7	.0	-.6	1.0	-1.1	-1.7
Trade balance[4]	8.3	15.7	11.7	21.3	16.4	21.9	25.6
Current account[5]	8.9	n.a.	17.9	n.a.	...	...	...

1. Annual rate. Annual figures are Q4/Q4.
2. Percent.
3. Percent change from year-earlier period, except annual figures, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate. Imports are c.i.f.
5. Billions of U.S. dollars, n.s.a., annual rate.

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