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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).

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Confidential (FR) Class III FOMC

June 20, 2003

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Supplemental Notes

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

Contents

Supplemental Notes

Domestic Nonfinancial Developments

Monthly Treasury Statement

The federal government recorded a $90 billion deficit last month, bringing the cumulative deficit for the year ending in May to $304 billion—up from a deficit of $155 billion over the preceding twelve months.

Outlays, adjusted for financial transactions and payment timing shifts, rose 6 percent in May over year-earlier levels, boosted again by a high level of defense spending. Outlays for defense were a bit stronger in May than we had anticipated when putting together the June Greenbook forecast because of higher-than-expected personnel costs. With two months of data in hand for the second quarter, overall real defense purchases seem to be on track to increase roughly $4 billion more than we had written down. Outside of defense, spending in most other categories was quite subdued. An exception was the "other" category, which shot up because of increases in foreign aid and in assistance to the airline companies that was included in the fiscal 2003 defense supplemental.

Receipts in May were just 1 percent above a year earlier. Individual income and payroll taxes edged below the year-earlier level because this year had one fewer work day; even after adjusting for the number of work days, these collections posted a very meager gain.

Federal Government Outlays and Receipts

(Unified basis; billions of dollars)

Function or source	May 2002	May 2003	May Percent change	12 months ending in May 2002	12 months ending in May 2003	12 months ending in May Percent change
Outlays	183.1	193.9	5.9	1,986.0	2,098.6	5.7
Financial transactions[1]	-0.5	-0.6	...	-0.1	-1.9	...
Payment timing[2]	11.7	12.2	...	11.1	0.1	...
Adjusted outlays	172.0	182.3	6.0	1,974.9	2,100.4	6.4
Receipts	102.5	103.4	0.9	1,830.8	1,794.5	-2.0
Payment timing	0.0	0.0	...	0.0	0.0	...
Adjusted receipts	102.5	103.4	0.9	1,830.8	1,794.5	-2.0
Surplus/deficit(-)	-80.6	-90.5	...	-155.2	-304.1	...
	Selected components of adjusted outlays and receipts					
Adjusted outlays	172.0	182.3	6.0	1,974.9	2,100.4	6.4
Net interest	15.7	15.4	-1.8	180.1	163.8	-9.1
Non-interest	156.3	166.9	6.8	1,794.8	1,936.7	7.9
National defense	30.4	34.0	12.0	332.5	381.5	14.7
Social security	37.9	39.7	4.9	448.9	468.7	4.4
Medicare	20.5	20.6	0.5	228.7	243.6	6.5
Medicaid	12.6	13.0	3.0	142.0	154.1	8.5
Income security	28.1	26.8	-4.9	296.1	331.0	11.8
Agriculture	0.5	0.8	48.4	28.8	22.8	-20.8
Other	26.4	32.1	21.7	317.8	335.0	5.4
Adjusted receipts	102.5	103.4	0.9	1,830.8	1,794.5	-2.0
Individual income and payroll taxes	79.7	78.3	-1.7	1,513.8	1,484.2	-2.0
Withheld + FICA	113.8	110.3	-3.0	1,386.5	1,368.3	-1.3
Nonwithheld + SECA	5.2	4.0	-22.7	340.3	296.2	-13.0
Refunds (-)	39.2	36.0	-8.3	212.9	180.2	-15.4
Corporate	1.2	2.7	113.3	132.7	124.1	-6.5
Gross	5.3	6.7	25.5	187.4	189.7	1.2
Refunds (-)	4.1	4.0	-1.3	54.7	65.6	19.9
Other	21.6	22.5	4.2	184.3	186.2	1.0
Adjusted surplus/deficit(-)	-69.5	-78.8	...	-144.2	-305.9	...

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

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

2. A shift in payment timing occurs when the first of the month falls on a weekend or holiday, or when the first 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.

International Developments

U.S. International Transactions

U.S. Current Account. The U.S. current account deficit reached $544 billion at a seasonally adjusted annual rate in 2003:Q1, $30 billion larger than in the fourth quarter of last year (revised). The deficit on goods and services accounted for two-thirds of the increase. Net outflows of unilateral transfers increased, and the surplus on net investment income fell slightly.

The deficit on goods and services widened $22 billion, s.a.a.r., in the first quarter as imports rose more than exports. The value of imported goods rose 8.6 percent at an annual rate (mostly oil), and imported services rose 7 percent. Declines in payments for travel-related services were more than offset by increases in other categories of services. Exports of goods rose 6 percent at an annual rate (mostly the value of industrial supplies), but services fell nearly 4 percent (a large decline in receipts from travel-related services was only partly offset by increases in other categories).

Net unilateral transfers were up nearly $7 billion annual rate in the first quarter, largely as a result of an increase in U.S. Government grants.

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				
2001	-357.8	15.7	-51.6	-393.7
2002	-418.0	1.3	-64.1	-480.9
Quarterly				
2002:Q2	-419.6	-12.4	-59.3	-491.3
Q3	-427.9	-1.9	-61.1	-490.9
Q4	-464.5	17.2	-67.1	-514.3
2003:Q1	-486.3	15.8	-73.9	-544.4
Change				
Q2-Q1	-59.3	-14.6	9.6	-64.4
Q3-Q2	-8.4	10.5	-1.7	0.4
Q4-Q3	-36.5	19.1	-6.1	-23.4
Q1-Q4	-21.8	-1.5	-6.8	-30.1

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

The surplus on net investment income declined slightly in the first quarter after having risen moderately (revised data) in the previous two quarters. Income on U.S. direct investment assets abroad was little changed, whereas payments for direct investment assets in the United States rose. However, the increase in direct investment income payments in the first quarter was largely offset by smaller net interest and dividend payments on other assets.

The data for the U.S. international transactions accounts beginning in 1992 have been revised to reflect improved estimating methodologies and newly available source data. The revisions this year include a new methodology for estimating insurance services, the incorporation of results from the U.S. Treasury Department's Benchmark Survey of U.S. Portfolio Investment Abroad as of December 31, 2001, and the incorporation of results of the BEA's Benchmark Survey of U.S. Direct Investment Abroad for 1999.

As a result of these revisions, the current account balance for 2002 was strengthened (smaller deficit) by $23 billion. The largest revisions were $16 billion in net services (primarily revised estimates for insurance services) and $8 billion in net investment income.

U.S. International Financial Transactions. The balance of payments release on June 19th included new data for the first quarter of 2003 and revisions to quarterly data from 1998:Q1 through 2002:Q4. The revisions contained no surprises. Private inflows into U.S. securities were increased by $50 billion in 2002, the bulk of which was a $43 billion increase in foreign purchases of Treasury securities. This reflected revised reporter data that we had already received and incorporated in the April Greenbook. A change in the BEA's methodology reduced U.S. purchases of foreign bonds by about $12 billion per year from 1998 through 2002; in 2002, this increased net sales of foreign securities from $1 billion to $15 billion. A new direct investment benchmark survey prompted minor changes; over the period from 1999 through 2002, revisions added about $20 billion to cumulative net direct investment inflows. Because each of these revisions increased net inflows into the United States and the current account was little changed, the statistical discrepancy was lowered: From 1998 to 2002, the cumulative discrepancy was revised from positive $210 billion to positive $78 billion, with most of the revisions occurring in the last three years.

Data for first-quarter portfolio flows were as expected with one exception. The BEA estimates that private foreigners sold $2 billion in agency bonds in the quarter, whereas we had estimated $22 billion in net purchases.[1] This adjustment brings private net inflows into U.S. securities to $71 billion for the quarter, compared with the $95 billion we had previously reported.

As a result of the first sizable foreign takeover of a U.S. firm since 2001, direct investment inflows (line 7) increased to $26 billion in the first quarter. In line with the amounts of recent years, direct investment outflows (line 6) totaled $29 billion in the quarter, with the strength entirely in reinvested earnings.

Net shipments of U.S. currency to foreigners (line 8) fell somewhat in the first quarter, and the capital account balance changed little.

1. The difference between the estimates stems from the BEA's assumption that the monthly TIC data overstate inflows into U.S. agency bonds in two ways. The first, which is not contentious, is that the TIC system fails to capture liquidations of mortgage-backed securities. The second, that calls and repurchases of straight agency debt are not reported to the TIC system, is disputed by FRBNY, who collects the TIC data. We originally assumed first-quarter offsets of $15 billion, but falling interest rates resulted in a surge in calls of straight debt (and liquidations of mortgage-backed securities), prompting the BEA to estimate $42 billion in offsets for the quarter.

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

	2001	2002	2002			2003		
			Q2	Q3	Q4	Q1	Mar.	Apr.
Official financial flows	**2.4**	**91.0**	**45.3**	**7.1**	**31.5**	**36.6**	**8.3**	**-3.2**
1. Change in foreign official assets in the U.S. (increase, +)	7.3	94.7	47.2	8.5	32.3	36.6	9.4	-3.4
a. G-10 countries	-7.9	30.4	17.6	1.8	6.0	26.5	11.1	-1.4
b. OPEC countries	-1.2	-9.4	.9	-1.4	.7	-7.5	-1.7	-1.6
c. All other countries	16.4	73.7	28.7	8.1	25.7	17.6	.0	-.4
2. Change in U.S. official reserve assets (decrease, +)	-4.9	-3.7	-1.8	-1.4	-.8	.1	-1.2	.2
Private financial flows	**413.2**	**437.0**	**47.3**	**164.1**	**121.1**	**76.1**	**…**	**…**
Banks								
3. Change in net foreign positions of banking offices in the U.S.[1]	-5.9	95.8	-27.2	65.7	51.0	-27.3	-31.5	43.4
Securities[2]								
4. Foreign net purchases of U.S. securities (+)	398.1	392.3	119.4	104.8	80.8	71.1	57.3	37.5
a. Treasury securities	-7.4	97.3	14.5	57.8	13.0	14.9	25.3	9.5
b. Agency bonds	81.8	76.6	33.0	21.8	15.4	-2.1	3.3	3.0
c. Corporate and municipal bonds	201.8	160.3	60.0	17.2	39.9	60.4	26.0	20.6
d. Corporate stocks[3]	121.8	58.1	12.0	8.0	12.6	-2.1	2.8	4.4
5. U.S. net acquisitions (-) of foreign securities	-85.1	15.3	-5.9	21.4	-5.5	-27.3	-14.6	-1.1
a. Bonds	24.6	33.5	13.5	8.8	7.5	7.3	6.4	-2.1
b. Stock purchases	-62.7	-14.9	-19.4	14.0	-13.0	-19.9	-6.4	1.0
c. Stock swaps[3]	-47.0	-3.2	.0	-1.4	.0	-14.7	-14.7	.0
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-120.0	-137.8	-35.5	-31.6	-31.7	-29.0	…	…
7. Foreign direct investment in U.S.	151.6	39.6	-.5	14.2	15.3	25.8	…	…
8. Foreign holdings of U.S. currency	23.8	21.5	7.2	2.6	7.2	4.9	…	…
9. Other (inflow, +)[4]	50.8	10.3	-10.3	-13.0	3.9	57.8	…	…
U.S. current account balance (s.a.)	**-393.7**	**-480.9**	**-122.8**	**-122.7**	**-128.6**	**-136.1**	**…**	**…**
Capital account balance (s.a.)[5]	**-1.1**	**-1.3**	**-.3**	**-.4**	**-.4**	**-.3**	**…**	**…**
Statistical discrepancy (s.a.)	**-20.8**	**-45.8**	**30.4**	**-48.1**	**-23.6**	**23.7**	**…**	**…**

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.

Commercial Bank Credit

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

Type of credit	2002	Q4 2002	Q1 2003	Mar. 2003	Apr. 2003	May 2003	Level, May 2003 ($ billions)
Total							
1. Adjusted[1]	**7.1**	**12.4**	**7.3**	**7.1**	**9.4**	**10.9**	**5,892**
2. Reported	7.1	11.8	8.0	6.1	6.4	17.4	6,112
Securities							
3. Adjusted[1]	13.3	16.2	11.9	11.3	18.7	16.8	1,603
4. Reported	12.7	13.5	13.9	7.4	7.5	38.5	1,822
5. Treasury and agency	19.2	25.2	16.9	11.5	34.9	34.7	1,119
6. Other[2]	4.4	-2.6	9.6	1.4	-33.9	44.9	704
Loans[3]							
7. Total	5.0	11.1	5.6	5.5	6.0	8.7	4,289
8. Business	-6.9	-4.0	-6.0	-8.7	-3.0	-13.6	933
9. Real estate	13.1	20.4	13.5	7.3	8.8	13.2	2,128
10. Home equity	36.7	24.7	26.2	38.3	20.9	18.5	237
11. Other	10.8	19.9	12.0	3.6	7.4	12.6	1,891
12. Consumer	5.5	8.6	4.2	-6.1	-5.1	8.4	593
13. Adjusted[4]	4.1	4.9	7.7	.5	-1.3	12.5	959
14. Other[5]	1.4	8.5	-.7	33.7	21.0	27.4	636

Note. All data are adjusted for breaks caused by reclassifications. Monthly levels are pro rata averages of weekly (Wednesday) 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. The conversion from a thrift to a commercial bank charter added approximately $37 billion to the assets and liabilities of domestically chartered commercial banks in the week ending May 8, 2002.

1. Adjusted to remove effects of mark-to-market accounting rules (FIN 39 and FIN 115).
2. Includes private mortgage-backed securities, securities of corporations, state and local governments, and foreign governments and any trading account assets that are not Treasury or agency securities, including revaluation gains on derivative contracts.
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.

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Selected Financial Market Quotations

(One-day quotes in percent except as noted)

Instrument	2000 June 26	2001 Sept. 10	2003 May 5	2003 June 18	Change to June 18 from selected dates (percentage points) 2000 June 26	2001 Sept. 10	2003 May 5
Short-term							
FOMC intended federal funds rate	6.50	3.50	1.25	1.25	-5.25	-2.25	.00
Treasury bills [1]							
3-month	5.66	3.19	1.11	0.87	-4.79	-2.32	-.24
6-month	5.94	3.13	1.14	0.87	-5.07	-2.26	-.27
Commercial paper (A1/P1 rates)							
1-month	6.56	3.42	1.21	1.01	-5.55	-2.41	-.20
3-month	6.56	3.24	1.20	0.98	-5.58	-2.26	-.22
Large negotiable CDs [1]							
1-month	6.64	3.46	1.26	1.05	-5.59	-2.41	-.21
3-month	6.73	3.26	1.24	1.00	-5.73	-2.26	-.24
6-month	6.89	3.24	1.22	0.97	-5.92	-2.27	-.25
Eurodollar deposits [2]							
1-month	6.63	3.41	1.25	1.02	-5.61	-2.39	-.23
3-month	6.69	3.26	1.21	0.97	-5.72	-2.29	-.24
Bank prime rate	9.50	6.50	4.25	4.25	-5.25	-2.25	.00
Intermediate- and long-term							
U.S. Treasury[3]							
2-year	6.54	3.59	1.56	1.27	-5.27	-2.32	-.29
10-year	6.35	5.14	4.09	3.54	-2.81	-1.60	-.55
30-year	6.22	5.55	4.97	4.56	-1.66	-.99	-.41
U.S. Treasury 10-year indexed note	4.09	3.26	2.08	1.69	-2.40	-1.57	-.39
Municipal revenue (Bond Buyer) [4]	5.99	5.25	5.09	4.78	-1.21	-.47	-.31
Private instruments							
10-year swap	7.38	5.62	4.29	3.70	-3.68	-1.92	-.59
10-year FNMA[5]	7.19	5.68	4.39	3.92	-3.27	-1.76	-.47
10-year AA [6]	7.64	6.30	4.83	4.22	-3.42	-2.08	-.61
10-year BBB [6]	8.40	7.11	5.84	5.24	-3.16	-1.87	-.60
High-yield [7]	12.30	12.72	9.54	8.94	-3.36	-3.78	-.60
Home mortgages (FHLMC survey rate) [8]							
30-year fixed	8.14	6.89	5.70	5.21	-2.93	-1.68	-.49
1-year adjustable	7.22	5.64	3.74	3.54	-3.68	-2.10	-.20

Stock exchange index	Record high Level	Record high Date	2001 Sept. 10	2003 May 5	2003 June 18	Change to June 18 from selected dates (percent) Record high	2001 Sept. 10	2003 May 5
Dow-Jones Industrial	11,723	1-14-00	9,606	8,532	9,294	-20.72	-3.25	8.93
S&P 500 Composite	1,527	3-24-00	1,093	927	1,010	-33.87	-7.55	9.02
Nasdaq (OTC)	5,049	3-10-00	1,695	1,504	1,677	-66.78	-1.08	11.51
Russell 2000	606	3-9-00	441	410	458	-24.52	3.81	11.64
Wilshire 5000	14,752	3-24-00	10,104	8,817	9,646	-34.61	-4.53	9.40

1. Secondary market.
2. Bid rates for eurodollar deposits collected around 9:30 a.m. Eastern time.
3. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
4. Most recent Thursday quote.
5. Constant maturity yields estimated from Fannie Mae domestic non-callable coupon securities.
6. Derived from smoothed corporate yield curves estimated using Merrill Lynch bond data.
7. Merrill Lynch Master II high-yield bond.
8. For week ending Friday previous to date shown.

NOTES:

June 26, 2000, is the day before the FOMC meeting that ended the most recent period of policy tightening.
September 10, 2001 is the day before the terrorist attacks.
May 5, 2003, is the day before the most recent FOMC meetings.

BA:DAM