Prefatory Note

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Please note that some material may have been redacted from this document if that material was received on a confidential basis. Redacted material is indicated by occasional gaps in the text or by gray boxes around non-text content. All redacted passages are exempt from disclosure under applicable provisions of the Freedom of Information Act.

[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 optical 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.

Content last modified 5/20/2009.

Confidential (FR) Class III FOMC

Part 2

August 6, 2003

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

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Domestic Nonfinancial Developments

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Overview
The available evidence suggests that economic activity around the middle of the year was uneven. In July, manufacturing output growth apparently stalled but sales of automobiles and trucks quickened considerably. The economy continued to shed jobs through the July survey week, but recent readings on initial claims for unemployment insurance have been encouraging. Homebuilding remains robust, although a good portion of the recent strength likely reflects declines through midyear in mortgage rates, and those rates have backed up in recent weeks. Federal government actions on both the tax and spending sides are lending support to aggregate demand, although fiscal restraint by states and localities has provided some offset. Despite an unexpectedly high reading in June for core PCE prices, the year-over-year change in core consumer prices has fallen to 1.3 percent through midyear.

Real GDP
The staff estimates that real GDP grew at an annual rate of 2.6 percent in the second quarter. The estimate for GDP growth in the second quarter is 0.2 percentage point higher than the BEA's advance estimate. The upward revision stems from stronger nonresidential and state and local government construction expenditures in the latest Census data than the BEA had expected at the time it prepared the GDP report. The Census data suggest only a slight downward revision to the BEA's initial estimate of residential investment.

Labor Market Developments
The labor market remained soft in July. Private payroll employment fell for a sixth consecutive month, and average weekly hours of production and nonsupervisory workers edged down. July's drop in the number of workers on private payrolls followed a June loss that was revised from 31,000 to 71,000. Cutbacks in jobs in manufacturing were again large, and the factory workweek dropped 0.2 hour. We believe that the early-July report may overstate the weakness in factory hours worked because of difficulties in adjusting for seasonal plant shutdowns.[1] Nevertheless, outside of manufacturing, industries such as transportation, wholesale trade, retail trade, information, and some components of professional and business services also posted substantial job losses. On the plus side, administrative and support services added 85,000 jobs—half of them in temporary help services—and accommodations registered a second monthly job increase after a string of declines.

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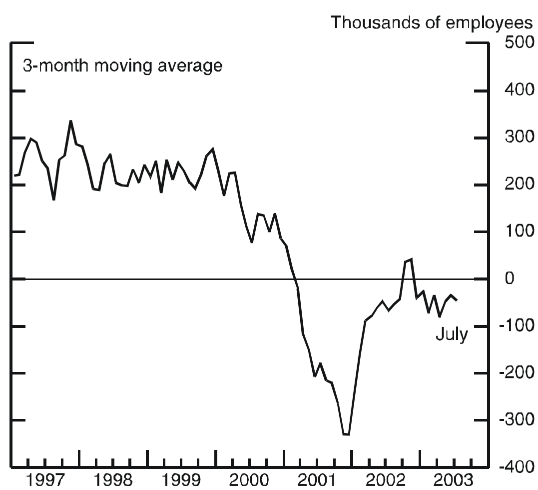
1. Specifically, because the Independence Day holiday fell on a Friday, some firms may have extended their vacation periods to include all or part of the survey reference week, which began the following Sunday. Thus, the survey week may not be representative of the month as a whole. We believe that seasonal adjustment issues in July did not importantly affect hours worked in nonmanufacturing sectors.

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

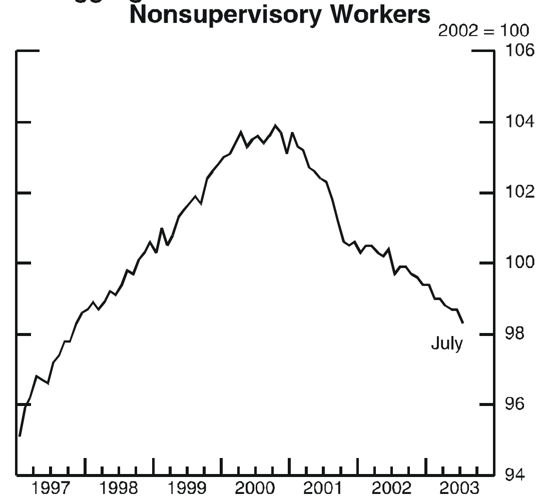
	2002	2003 Q1	2003 Q2	2003 May	2003 June	2003 July
	-Average monthly change-					
Nonfarm payroll employment[1]	-39	-38	-57	-76	-72	-44
Private	-55	-35	-35	-34	-71	-34
Previous	*-55*	*-35*	*-21*	*-32*	*-31*	*n.a.*
Manufacturing	-57	-49	-64	-49	-63	-71
Construction	-4	-4	26	26	12	6
Wholesale trade	-7	-3	-8	-9	-11	-14
Retail trade	-6	-4	-12	-21	-20	-14
Trade, transportation and utilities	-18	-13	-34	-39	-46	-44
Information	-14	-16	-6	-9	-7	-8
Financial activities	5	14	16	15	6	7
Professional and Business services	-10	3	9	13	6	73
Temporary Help Services	1	-8	25	46	34	42
Non-business services[2]	45	33	16	7	19	5
Total government	16	-3	-21	-42	-1	-10
Total employment (household survey)	31	303	130	-200	251	-260
Memo:						
Aggregate hours of private production workers (percent change)[1,3]	-1.0	-1.7	-1.6	-0.1	0.0	-0.4
Average workweek (hours)[1]	33.9	33.8	33.7	33.7	33.7	33.6
Manufacturing (hours)	40.5	40.4	40.2	40.2	40.3	40.1

n.a. Not available.
Note. Average change from final month of preceding period to final month of period indicated.
1. Survey of establishments.
2. Non-business services comprises education and health, leisure and hospitality, and "other."
3. Annual data are percent changes from Q4 to Q4. Quarterly data are percent changes from preceding quarter at an annual rate. Monthly data are percent changes from preceding month.

Private Payroll Employment Growth

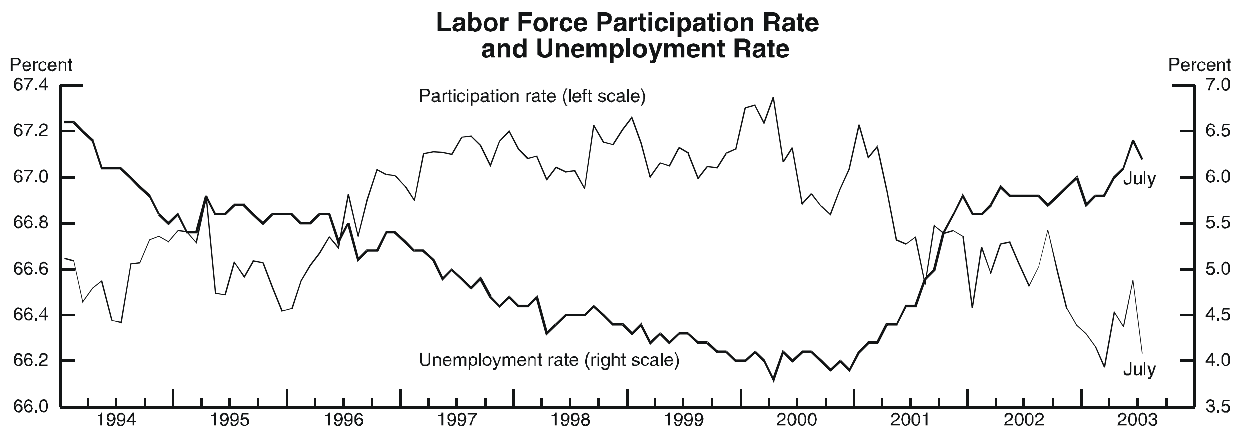


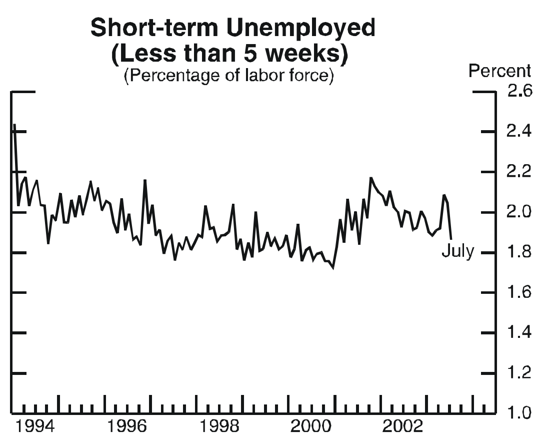
Aggregate Hours of Production or Nonsupervisory Workers

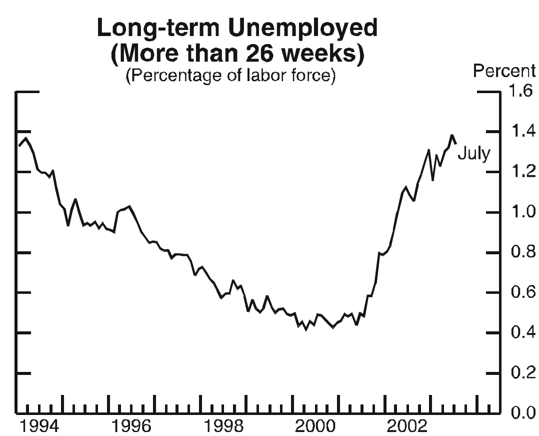


SELECTED UNEMPLOYMENT AND LABOR FORCE PARTICIPATION RATES
(Percent; based on seasonally adjusted data)

		2002	2003		2003		
	2002	Q4	Q1	Q2	May	June	July
Civilian unemployment rate (16 years and older)	5.8	5.9	5.8	6.2	6.1	6.4	6.2
Teenagers	16.5	16.1	17.2	18.6	18.5	19.3	18.4
20-24 years old	9.7	9.9	9.2	10.4	10.5	10.7	10.3
Men, 25 years and older	4.7	4.9	4.9	5.3	5.2	5.5	5.2
Women, 25 years and older	4.6	4.6	4.4	4.6	4.6	4.7	4.7
Labor force participation rate	66.6	66.5	66.3	66.4	66.4	66.6	66.2
Teenagers	47.4	46.8	45.2	45.1	45.1	45.1	44.3
20-24 years old	76.4	75.8	75.5	75.9	76.0	76.2	75.4
Men, 25 years and older	75.9	75.6	75.3	75.6	75.5	75.6	75.4
Women, 25 years and older	59.4	59.4	59.6	59.8	59.7	59.9	59.6

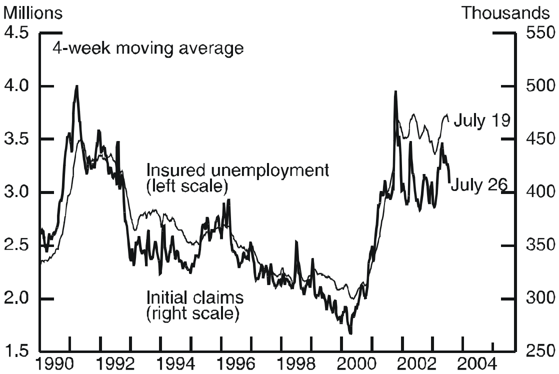




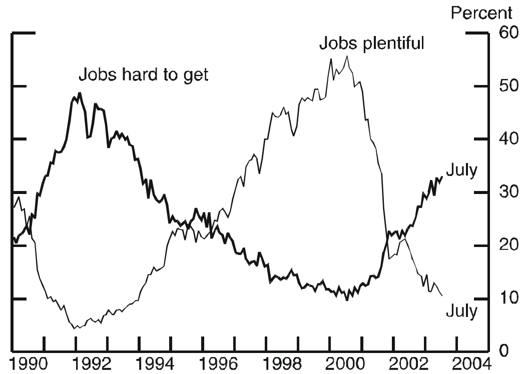


Labor Market Indicators

Unemployment Insurance

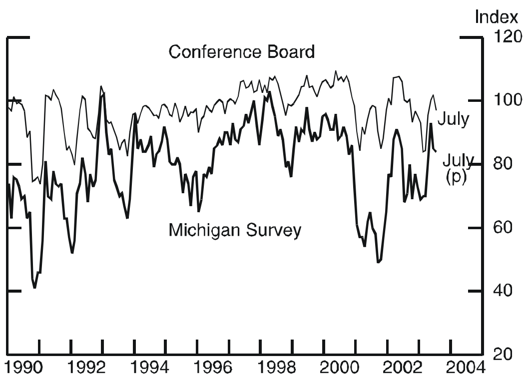


Current Employment Conditions



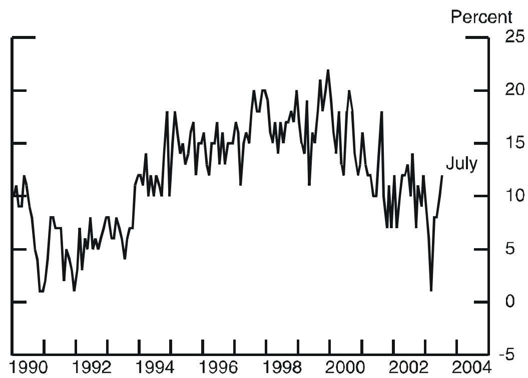
Source. Conference Board.

Expected Labor Market Conditions



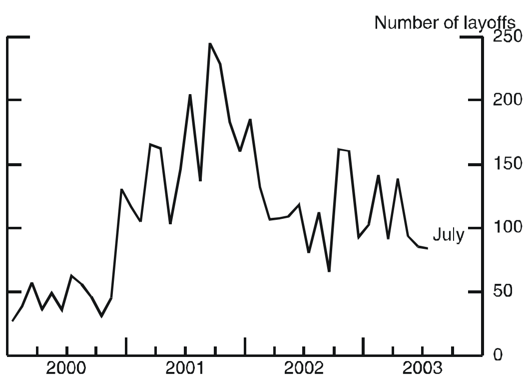
Note. The proportion of households expecting labor market conditions to improve, minus the proportion expecting conditions to worsen, plus 100.

Net Hiring Strength



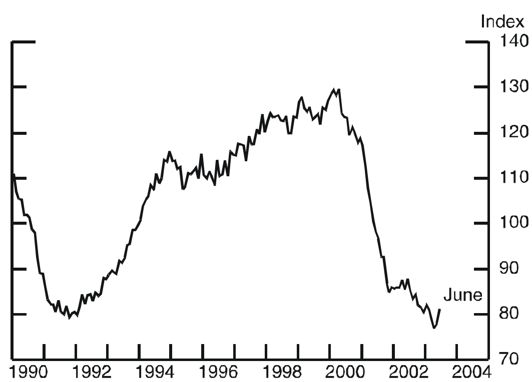
Note. Percent planning an increase in employment minus percent planning a reduction.
Source. National Federation of Independent Businesses.

Layoff Announcements



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

Help Wanted Index



Source. Conference Board.

In the survey of households, the unemployment rate fell back 0.2 percentage point, to 6.2 percent, after having jumped 0.3 percentage point in June. The labor force participation rate dropped back sharply to its March level of 66.2 percent. Since March, when the jobless rate appeared to have flattened out at 5.8 percent, the unemployment rate has crept up 0.1 percentage point per month, on average. Over the period, the number of individuals on temporary layoff has moved up only slightly, while the number of permanent job losers has increased noticeably.

Since the early-July reference week for the household survey, initial claims for unemployment insurance have come down significantly. Although seasonally adjusting the July data can be difficult because of variations in the timing and extent of plant shutdowns, the gradual decline in the four-week moving average through the week of July 26 suggests that the deterioration in the labor market may have slowed or stopped.

Other labor market indicators for July have been mixed. Hiring plans of small businesses moved up further, according to the National Federation of Independent Businesses, and layoff announcements, as reported by the outplacement firm Challenger, Gray, and Christmas, Inc. (as seasonally adjusted by FRB staff) declined slightly in July. In addition, the Conference Board's index of help wanted advertising edged up again in June, although it remained at a low level. However, households' perceptions of current labor market conditions deteriorated again in July, according to the Conference Board survey, and households' expectations of future conditions worsened in both the Conference Board and Michigan surveys.

Industrial Production

Recent indicators suggest that industrial production moved up for a third month in July. The July increase likely was boosted by a surge in electricity generation that largely reflected a return of warm weather after an unseasonably cool June.[2] We currently are estimating that manufacturing output, which increased 0.4 percent in June, was little changed in July. Factory production in industries for which weekly physical product data are available strengthened in July; notably, motor vehicle assemblies and the output of iron and steel were up. In contrast, the drop in hours of manufacturing production workers suggests a decline in factory output more broadly—even adjusting for the extent to which the data for the survey reference week did not reflect activity for the month as a whole. As indicated earlier, we believe that firms in some industries in which output has been weak, such as textile mills and apparel, may have extended their holiday downtime to include at least part of the next week.

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2. The number of cooling degree days in June was 0.9 standard deviation *below* normal, and in July it was 0.6 standard deviation *above* normal.

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

Component	Proportion 2002 (percent)	2002[1]	2003[2]		2003[3]		
			Q1	Q2	Apr.	May	June
Total	**100.0**	**1.4**	**.3**	**-3.2**	**-.5**	**.1**	**.1**
Previous	100.0	1.4	.3	...	-.6	.1	...
Manufacturing	84.7	1.0	-.6	-2.3	-.6	.1	.4
Ex. motor veh. and parts	78.3	.1	-.8	-1.2	-.6	.2	.4
Ex. high-tech industries	71.6	-.5	-1.4	-2.3	-.7	.2	.3
Mining	6.3	-1.9	-2.7	2.1	.1	.6	1.0
Utilities	9.0	7.7	10.3	-14.4	.1	-.8	-3.5
Selected industries							
High technology	6.6	7.1	8.2	14.4	1.1	1.1	1.0
Computers	1.3	19.9	24.5	27.9	1.9	1.9	2.1
Communications equipment	2.3	-16.6	2.8	-7.9	-1.4	-2.0	-1.4
Semiconductors[4]	3.0	19.8	3.9	24.0	2.4	2.7	2.0
Motor vehicles and parts	6.5	10.9	1.6	-12.8	-1.3	-1.1	1.2
Market groups excluding energy and selected industries							
Consumer goods	21.9	-1.3	-.2	-.4	-.5	.0	.9
Durables	3.5	.5	-2.2	-2.9	-.7	.6	-.1
Nondurables	18.5	-1.6	.2	.0	-.5	-.1	1.1
Business equipment	7.8	-6.0	-1.9	-3.2	-.9	.7	.5
Defense and space equipment	1.8	5.1	11.3	4.7	-.3	1.3	.6
Construction supplies	6.6	.9	-6.2	-3.6	-.7	.4	-.1
Business supplies	7.4	.3	-.7	-3.1	-1.4	.7	.2
Materials	25.3	.9	-2.9	-3.8	-.6	-.3	-.1
Durables	13.6	.6	-3.6	-5.1	-.5	-.1	-.4
Nondurables	11.7	1.3	-1.7	-2.6	-.7	-.5	.3

1. Fourth-quarter to fourth-quarter change.
2. Annual rate.
3. Monthly rate.
4. Includes related electronic components.
... Not applicable.

Capacity Utilization
(Percent of capacity)

Sector	1972-2002 average	1982 low	1990-91 low	2002	2003			
				Q4	Q1	Q2	May	June
Total industry	**81.3**	**70.8**	**78.6**	**75.3**	**75.2**	**74.3**	**74.3**	**74.3**
Manufacturing	80.2	68.6	77.2	73.5	73.2	72.7	72.6	72.8
High-tech industries	79.3	75.6	74.6	62.2	62.1	62.8	62.8	62.9
Excluding high-tech industries	80.2	68.1	77.3	75.0	74.7	74.1	74.0	74.3
Mining	86.9	78.6	83.3	85.1	84.4	84.7	84.6	85.4
Utilities	86.7	77.2	84.2	86.0	86.9	82.6	83.4	80.2

In the high-tech sector, production has increased a bit more than 1 percent per month this year, as lackluster readings for communications equipment have been more than offset by increases for other high-tech items. Semiconductor output jumped at an annual rate of 24 percent in the second quarter, a sharp pickup from the 4 percent rate posted in the first quarter; recent gains have primarily come from the production of microprocessor units (MPUs) used in personal computers and the flash memory used in consumer electronics such as cell phones and digital cameras. Intel's seasonally adjusted revenue, which closely tracks worldwide MPU shipments, increased in the second quarter, and the company's guidance for the third quarter suggests a continued strengthening of MPU production.[3] Despite the apparent upturn in demand for MPUs, orders and shipments at North American semiconductor equipment makers remain tepid and are consistent with increments to semiconductor manufacturing capacity that are, at best, moderate.

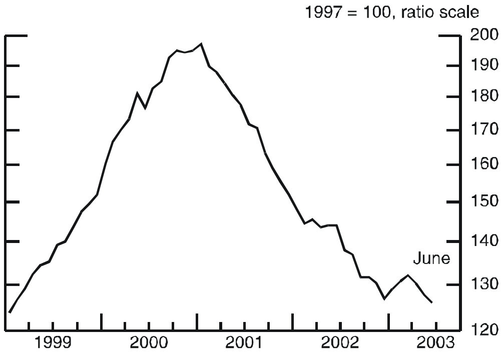
Since January, the industrial production index for computer and peripheral equipment has risen about 2 percent per month; strong consumer sales have compensated for the slow expansion of the output of servers and other high-end machines for businesses. Gartner, a research and advisory firm, estimates that unit shipments of PCs increased 1.7 percent (not an annual rate) in the second quarter, and it projects significant increases in the third and fourth quarters based largely on an improvement in business demand.

Outside of motor vehicles and parts, high-technology industries, and utilities, production has been choppy so far this year and is expected to move down in July. In the early part of the year, particularly in April, broad-based production declines were evident, but these were followed by a period of widespread production gains. In June, the percent change in the three-month moving average of output of business equipment—which includes industrial equipment, commercial and service industry machinery, farm machinery and equipment, office furniture, and medical equipment and supplies—moved into positive territory for the first time since September 2000. The output of defense and space equipment continued to expand in June, with a strong showing from military aircraft, whose output has been elevated for the last couple of months, reflecting recovery from a strike-induced decline in April. In contrast, the indexes for construction supplies and business supplies both remain near their six-year lows and have contracted for three consecutive quarters. Weak spending by state and local governments, together with a two-year decline in nonresidential construction, has restrained the production of construction supplies.

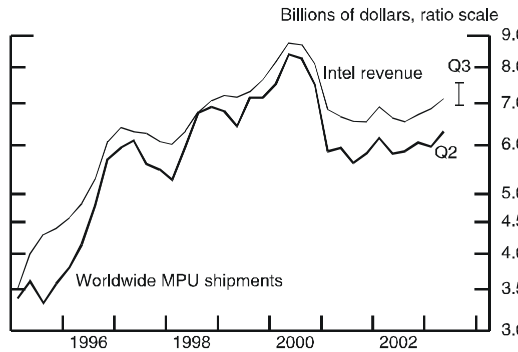
3. Intel accounts for about 80 percent of worldwide MPU shipments, and about 80 percent of Intel's revenue is derived from MPUs.

Indicators of High-Tech Manufacturing Activity

Communication Equipment
Industrial Production

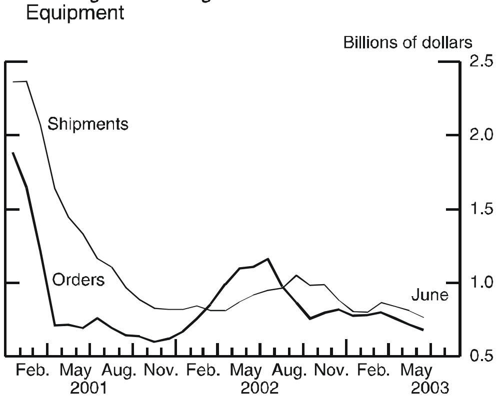


Microprocessor Unit (MPU) Shipments
and Intel Revenue



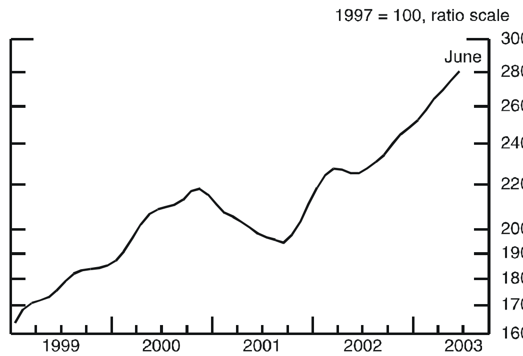
Note. Q3 is the range of Intel's guidance as of July 25, 2003.
Source. Intel and Semiconductor Industry Association.

Bookings and Billings for Semiconductor
Equipment

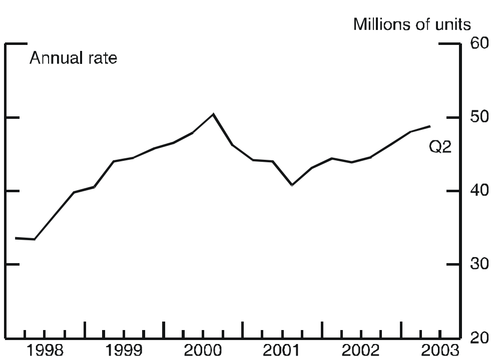


Source. Semiconductor Equipment and Materials International

Computer and Peripheral Equipment
Industrial Production

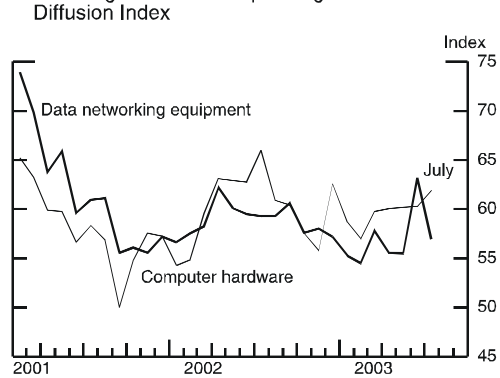


Personal Computer Sales



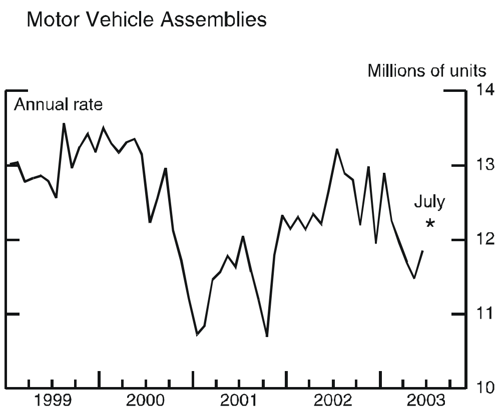
Note. FRB seasonals. Includes notebooks.
Source. Gartner.

CIO Magazine Future Spending
Diffusion Index

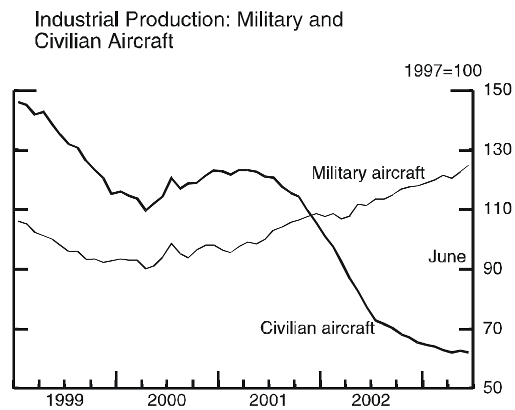


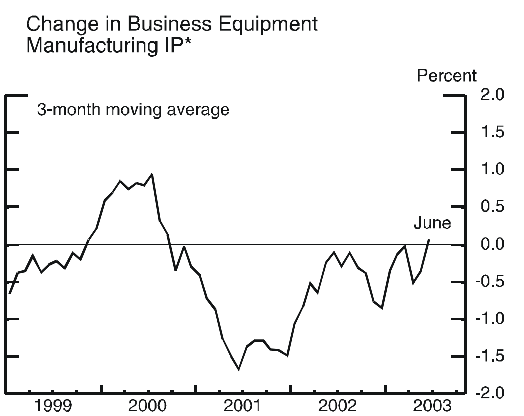
Note. The diffusion index equals 50 plus half the difference between the percentage of respondents planning to increase future spending less the percentage planning to reduce future spending. The average number of respondents per month from February 2001 to July 2003 was 275.
Source. CIO Magazine.

Indicators of Manufacturing Activity

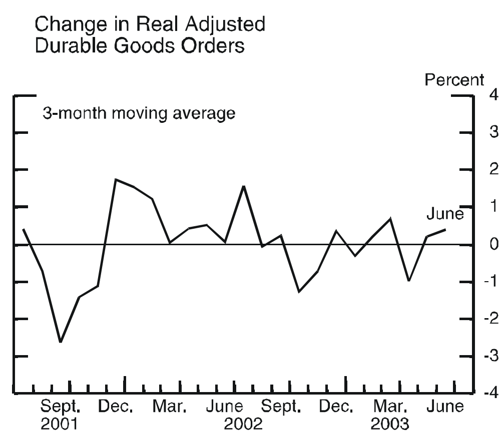


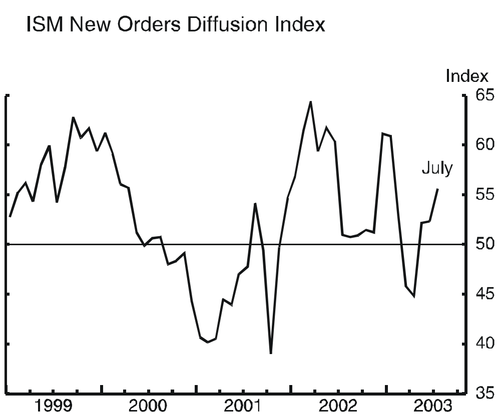
* July value is based on weekly data.



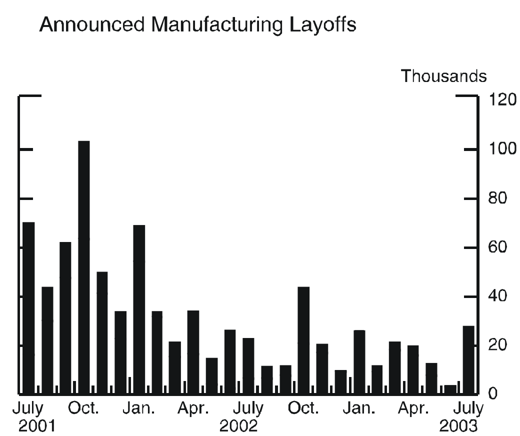


* Excluding motor vehicles and parts and high-techonology goods.





Note. The diffusion index equals 50 plus one-half the percentage of respondents reporting greater levels of new orders, less the percentage of respondents reporting lower levels of new orders.



Note. Data are through July 31, 2003.
Source. Compiled by staff from news reports.

Indicators of future activity in the industrial sector have improved steadily over recent months and are consistent with gains in manufacturing production going forward. Surveys of chief information officers indicate that planned spending on data networking equipment (such as routers, switches, and hubs) and on computers have moved up, on balance, since earlier in the year.[4] In a recent survey of members of the National Association of Business Economists, responses to a question regarding expected spending on computers and communications equipment over the next twelve months also improved noticeably; the number of respondents who said that their company planned to increase spending rose from 43 percent in April to 57 percent in July. Also, the staff's series on real adjusted durable goods orders increased in May and June, more than reversing a sharp drop in April. The new-orders diffusion index from the Institute of Supply Management increased in July for a fourth consecutive

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

Component	Share, 2002: H2 (percent)	2003				
		Q1	Q2	Apr.	May	June
Total orders	**100.0**	**1.1**	**-1.0**	**-2.4**	**0.1**	**2.6**
Adjusted orders[1]	75.0	0.2	-0.7	-2.6	2.0	1.3
Computers	4.0	-4.3	13.5	18.8	0.3	2.3
Communication equipment	3.0	30.9	-9.0	-4.2	-6.2	-5.0
Other capital goods	24.0	2.1	-0.2	-5.7	1.8	2.5
Other[2]	44.0	-2.2	-1.6	-2.5	2.9	0.9
MEMO						
Real adjusted orders	. . .	0.6	-0.4	-2.2	2.0	1.5
Excluding high tech	. . .	-0.15	-1.14	-3.2	1.5	1.9

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

4. However, according to the Census Bureau, new orders for communications equipment slipped further in June, and Cisco reported that demand for its communications products was fragile.

month and has been above 50 for the past three months.[5] However, announced manufacturing layoffs (not seasonally adjusted) increased significantly in July after having slowly declined over the past several months.

Motor Vehicles

Sales of light vehicles moved up sharply in July to an annual rate of 17.2 million units, after sales of 16.2 million units in the second quarter and 15.8 million units in the first quarter. Estimates of the average incentive per vehicle jumped $430, to $2,260, in the second quarter and to $2,400 over the first four weeks of July; the latest increase reflects, in part, new discount plans offered by Ford and GM that are scheduled to last through the end of August. According to the Michigan Survey, car-buying attitudes remained high in July. A large percentage of respondents continue to report that "good buys" are available and that current financing rates remain attractive, consistent with the sweetened incentives offered by automakers.

The incoming data are sending mixed signals regarding business demand. On a positive note, sales of Class 8 (heavy) trucks have been strong of late, and net orders have stepped up from earlier in the year. Industry contacts believe that there is pent-up demand to replace existing heavy trucks; moreover, they believe that demand should be supported by the investment stimulus of the new tax bill. Further, preliminary data indicate that net new orders for medium trucks jumped in July. In contrast, fleet sales of light vehicles were little changed in the second quarter and slipped in July, a falloff partly reflecting GM's shifting of fleet sales from the third to fourth quarter. Cutting through these swings, overall fleet sales so far this year are tracking a little below last year's pace.

Total motor vehicle production rose to an annual rate of 11.9 million units in June, and we estimate output to have moved up a bit further to 12.1 million units in July.[6] Given the strong sales outcome in July, we now are estimating that days' supply of light vehicles moved down in July to sixty-four days, a level within the manufacturers' target range.

The current contracts between the United Auto Workers (UAW) and General Motors, Ford, and Chrysler officially end September 14. The UAW has already started meeting with these automakers, although negotiations will probably not begin in earnest until early September, when we expect a target company to be named. The Big Three have all announced their desire to negotiate a contract

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5. Furthermore, the new-orders diffusion indexes from each of the various regional surveys moved up in June, and for those surveys for which we have a July reading, indexes either increased or were little changed. For all of the surveys, the most recent reading is above 50.

6. The shortfall from the scheduled rate of 12.5 million units stemmed in part from a slower-than-planned production of some new models at Ford.

Sales of Automobiles and Light Trucks

(Millions of units at an annual rate, FRB seasonals)

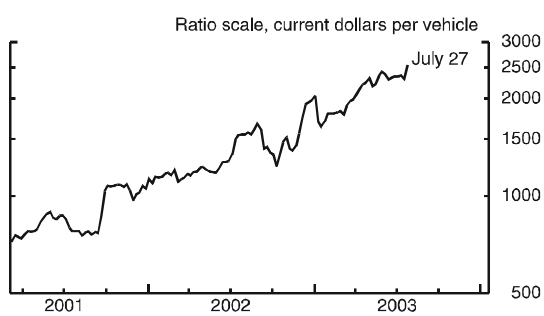
		2002	2003		2003		
	2002	Q4	Q1	Q2	May	June	July
Total	16.7	16.5	15.8	16.2	16.0	16.3	17.2
Autos	8.1	7.9	7.7	7.4	7.3	7.6	7.8
Light trucks	8.6	8.6	8.1	8.8	8.7	8.8	9.4
North American[1]	13.5	13.3	12.5	12.9	12.8	13.0	13.9
Autos	5.9	5.7	5.5	5.4	5.3	5.5	5.8
Light trucks	7.6	7.6	6.9	7.5	7.5	7.5	8.1
Foreign-produced	3.3	3.2	3.4	3.3	3.2	3.3	3.3
Autos	2.2	2.2	2.2	2.0	2.0	2.0	2.0
Light trucks	1.1	1.1	1.2	1.3	1.2	1.3	1.3
Memo:							
Medium and heavy trucks	.40	.41	.37	.39	.39	.39	n.a.

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. Excludes some vehicles produced in Canada that are classified as imports by the industry.

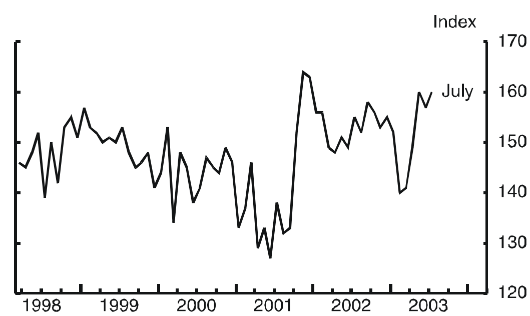
n.a. Not available.

Average Value of Incentives on Light Vehicles

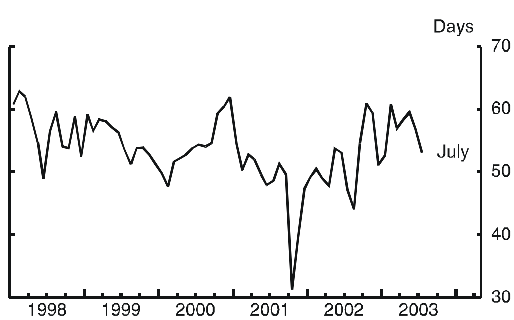


Note. Weighted average of customer cash rebate and interest rate reduction. Data are seasonally adjusted.
Source. J.D. Power and Associates.

Michigan Survey Index of Car-Buying Attitudes

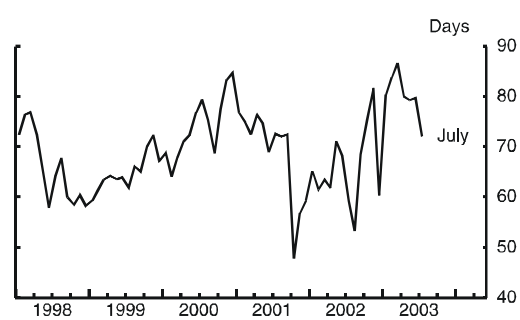


Days' Supply of Autos



Note. July value based on staff estimate.

Days' Supply of Light Trucks



Note. July value based on staff estimate.

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

Item	2002	2003			2003			
	Q4	Q1	Q2	Q3[1]	Apr.	May	June	July[1]
U.S. production	12.4	12.4	11.7	12.5	11.7	11.5	11.9	12.5
Autos	4.9	4.7	4.4	4.7	4.4	4.4	4.5	4.5
Trucks	7.5	7.7	7.3	7.8	7.3	7.1	7.4	7.9
Days' supply[2]	63	74	70	n.a.	71	71	70	64[e]
Inventories[3]	2.73	3.01	2.96	n.a.	3.01	2.97	2.96	2.91[e]

NOTE. Components may not sum to totals because of rounding.
1. Production rates reflect Ward's Communications' latest schedules for Q3 and July.
2. Semiannual and quarterly values calculated with end-of-period stocks and average reported sales; excludes medium and heavy trucks (classes 3-8).
3. End-of-period stocks; excludes medium and heavy trucks.
n.a. Not available
e Staff estimate

with the UAW that will cut labor costs. GM is particularly intent on lowering health care costs. Ford is focusing on shrinking its labor force; indeed, fully a year and a half ago, it released a list of four plants it would like to shutter. Although the UAW acknowledges the difficult economic position of the Big Three, its opening position is to expand workers' and retirees' health care coverage and to propose an immediate and sizable increase in wages. In addition, a major priority of the UAW is to turn around the long-term decline in its membership. Consequently, the UAW would like the Big Three to expand their use of unionized suppliers and to invest more within the United States.

Consumer Spending

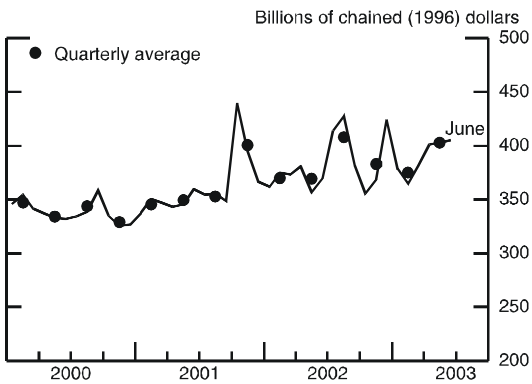
Real personal consumption expenditures picked up to an annual rate of 3.3 percent in the second quarter, after a 2 percent increase in the first quarter. Spending on motor vehicles and other durable goods rose briskly in the second quarter, while other spending increased at a more modest pace. The fundamentals have become a bit more favorable: Although real disposable income posted only a modest gain in the second quarter, it will get a substantial boost in the current quarter from the reduction in tax withholding and from the rebate checks being mailed out in July and August. In addition, the levels of both the stock market and consumer sentiment have recovered substantially from the declines seen earlier in the year.

Total real spending rose 0.1 percent in June, as expenditures on motor vehicles continued at the rapid pace seen in May, and outlays on other goods rose further. However, spending on services remained weak, in part because unseasonably cool weather in June damped demand for energy services. Auto sales, weekly data on chain-store sales, and a return to more seasonable weather provide some

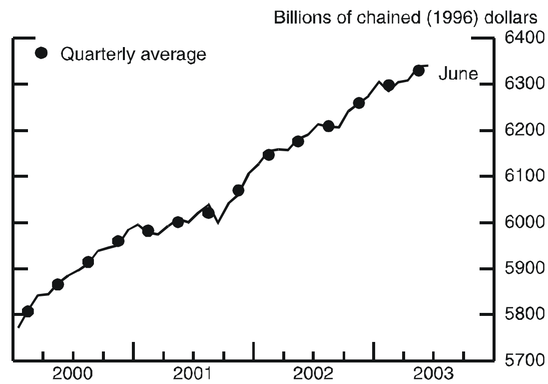
Real Personal Consumption Expenditures
(Percent change from the preceding period)

Expenditure	2002 H1	2002 Q3	2002 Q4	2003 Q1	2003 Q2	2003 May	2003 June
	Annual rate					Monthly rate	
Total real PCE	2.4	4.2	1.7	2.0	3.3	.5	.1
Durable goods	-2.3	22.8	-8.2	-2.0	22.6	1.0	.7
Motor vehicles	-15.0	48.8	-22.2	-8.0	33.2	.4	.5
Excluding motor vehicles	9.0	6.0	4.4	2.7	15.1	1.4	.9
Nondurable goods	3.8	1.0	5.1	6.1	.1	.6	.1
Energy	4.1	2.7	3.6	.7	-10.4	.3	.1
Other	3.8	.9	5.2	6.7	1.2	.6	.1
Services	2.8	2.3	2.2	.9	1.5	.3	-.1
Energy	5.3	6.3	22.8	-5.8	-3.2	.3	-2.2
Transportation	1.4	-.8	.5	.1	-3.2	.2	.0
Other	2.8	2.3	1.6	1.2	2.1	.3	.0
Memo:							
Real disposable personal income	9.1	1.8	1.4	2.1	2.4	.4	.1

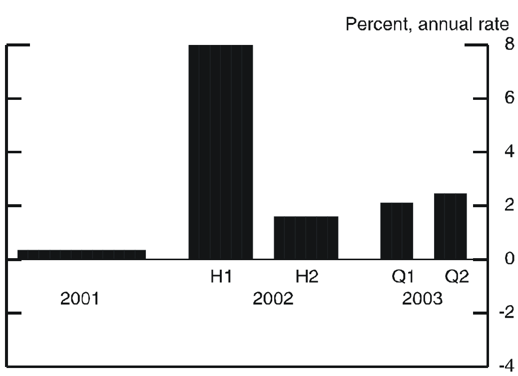
PCE Motor Vehicles



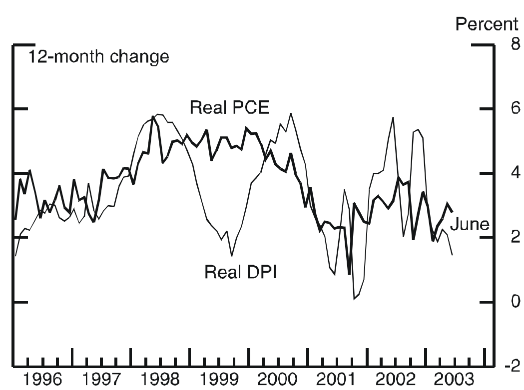
PCE Ex. Motor Vehicles



Change in Real DPI

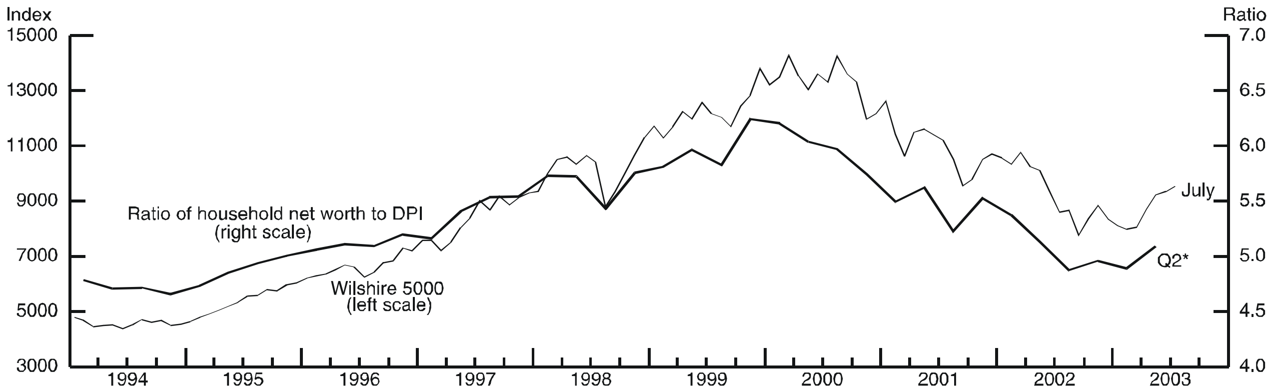


Real Consumer Spending and Income



Household Indicators

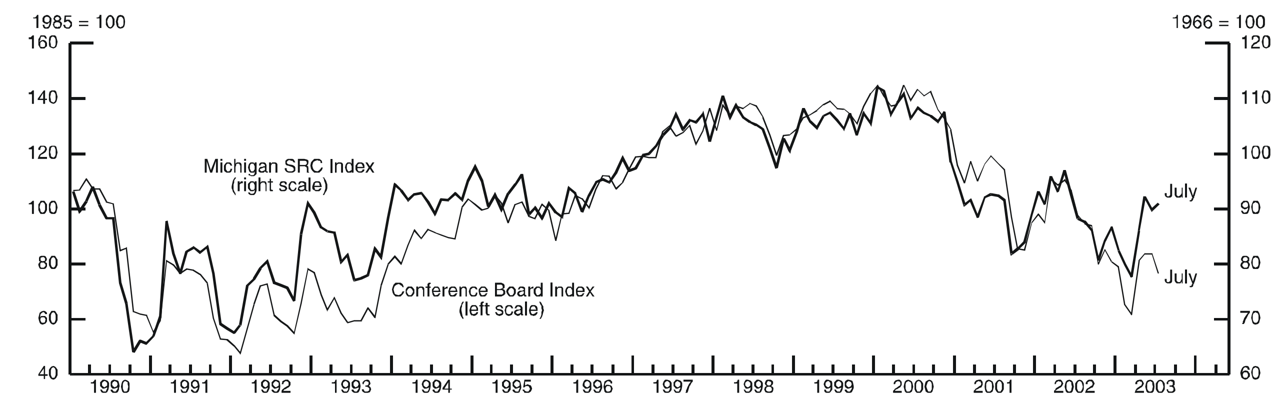
Household Net Worth and Wilshire 5000



*2003:Q2 is a staff estimate

Personal Saving Rate

Consumer Confidence



evidence that spending likely perked up in July, although anecdotes from retailers were mixed.

Real disposable personal income rose 0.1 percent in June, bringing the second-quarter increase to an annual rate of 2.4 percent. In the second quarter, gains in consumer spending were a bit larger than increases in income, and the personal saving rate edged down to 3-1/4 percent.[7] The ratio of net worth to disposable personal income rose in the second quarter, and the stock market has maintained its first-half run-up through July, likely providing additional support to household balance sheets.

The Michigan Survey Research Center's index of consumer sentiment edged up in July. In contrast, the July reading of the Conference Board's index of consumer confidence moved down somewhat. The modest movement in the Michigan index masked large, offsetting changes in the components: A sizable improvement in consumers' assessments of current economic conditions was largely offset by a decline in the expected-conditions component of the index. The Conference Board's index reflected a fall in both components. Both surveys noted a less favorable employment outlook.[8] Over the past few months, the overall indexes have more than reversed the steep declines posted earlier this year and now are more in line with household sector fundamentals.

Housing Markets

Boosted by declining mortgage rates, housing construction and sales were robust through June. Although rates have backed up since then, as yet there is no sign of an impending slowdown: The index of purchase applications compiled by the Mortgage Bankers Association reached a new high in the week ending August 1, and perceived homebuying conditions in the Michigan Survey improved slightly as well.

Starts of single-family houses rose in June to an annual rate of 1.46 million units, one of the highest readings in twenty-five years. New permit issuance—adjusted for activity in areas where permits are not required—increased to an annual rate of 1.47 million units in June, and the backlog of unused permits was only a touch below its record high; these indicators point to continued strength in this sector early in the third quarter. In the multifamily sector, starts were at

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7. Relative to the June Greenbook, the published saving rate has been revised down 0.2 percentage point in 2002:Q4 and 0.3 percentage point in 2003:Q1 owing to the BEA's incorporation of wage and salary data from state unemployment insurance tax records for the third quarter of last year; these data showed that income was lower than the BEA had previously assumed.

8. The Conference Board overall index is a composite of responses to five questions, one of which asks consumers to assess current labor market conditions. By contrast, the headline Michigan index does not include responses to any question about labor market conditions, though Michigan asks such a question separately.

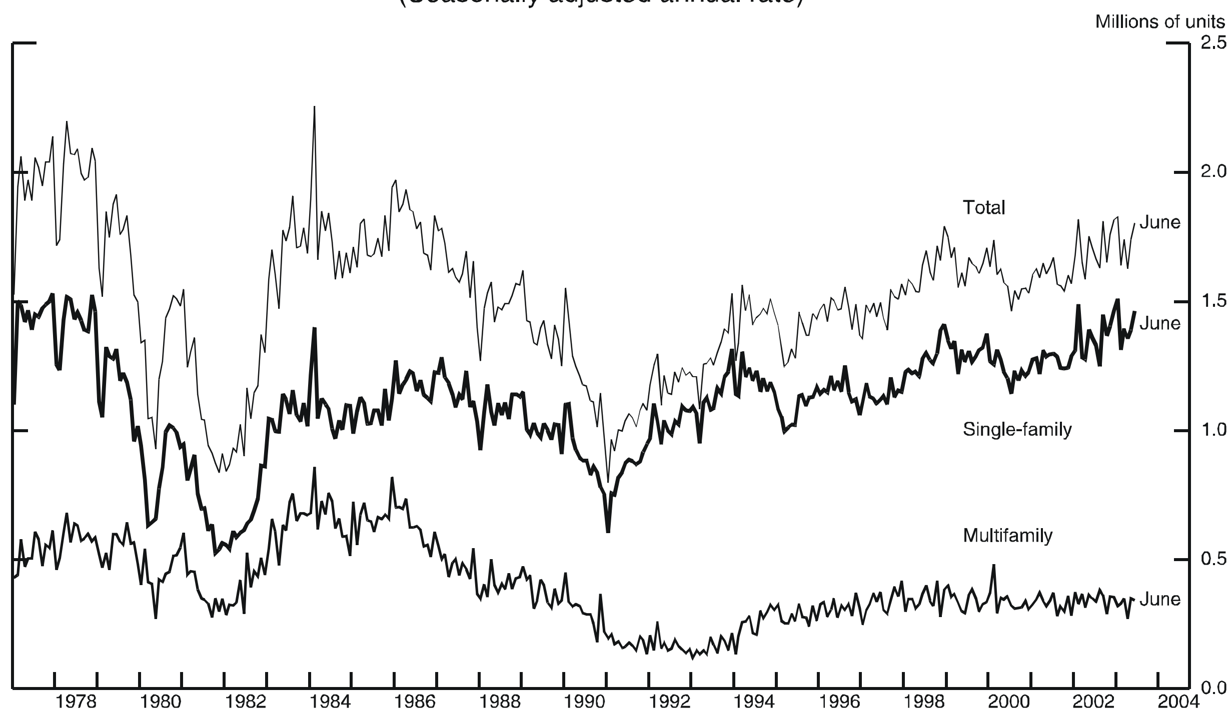
Private Housing Activity
(Millions of units; seasonally adjusted annual rate)

		2002	2003				
	2002	Q4	Q1	Q2[p]	Apr.[r]	May [r]	June[p]
All units							
Starts	1.71	1.74	1.74	1.72	1.63	1.74	1.80
Permits	1.73	1.83	1.75	1.78	1.72	1.80	1.82
Single-family units							
Starts	1.36	1.41	1.41	1.40	1.36	1.39	1.46
Permits	1.32	1.40	1.35	1.37	1.33	1.35	1.42
Adjusted permits[1]	1.37	1.44	1.39	1.40	1.36	1.38	1.47
New home sales	0.97	1.03	0.98	1.09	1.00	1.11	1.16
Exisiting Home Sales	5.57	5.75	5.87	5.83	5.80	5.85	5.83
Multifamily units							
Starts	0.35	0.33	0.33	0.32	0.27	0.35	0.34
Permits	0.41	0.43	0.41	0.41	0.39	0.45	0.40
Mobile homes							
Shipments	0.17	0.15	0.14	n.a.	0.13	0.13	n.a.

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

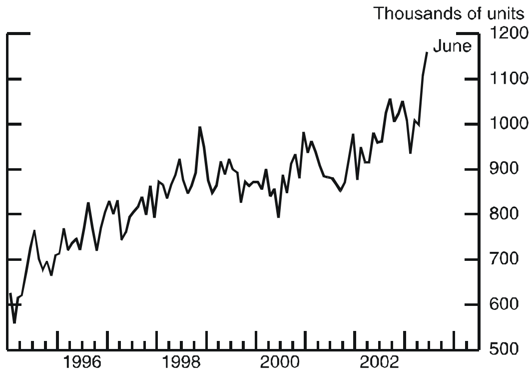
1. Adjusted permits equals permit issuance plus total starts outside of permit-issuing areas.

Private Housing Starts
(Seasonally adjusted annual rate)



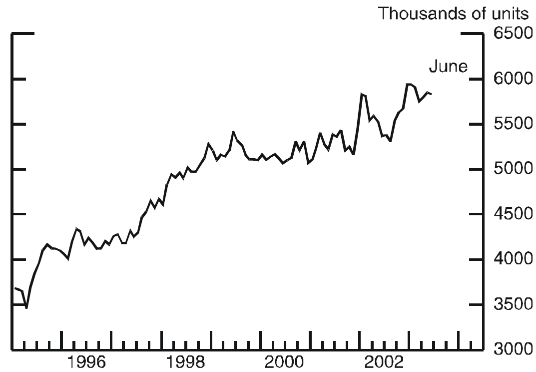
Housing Indicators

New Home Sales



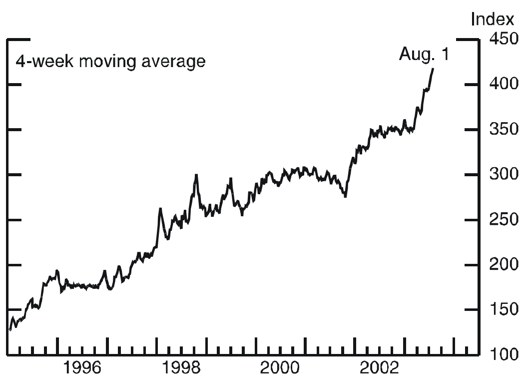
Source. Census Bureau.

Existing Home Sales



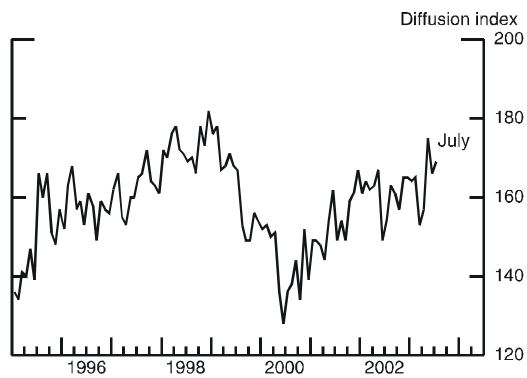
Source. National Association of Realtors.

MBA Index of Purchase Applications



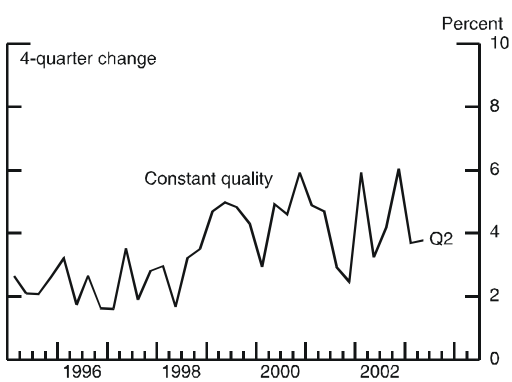
Source. Mortgage Banker's Association.

Perceived Homebuying Conditions



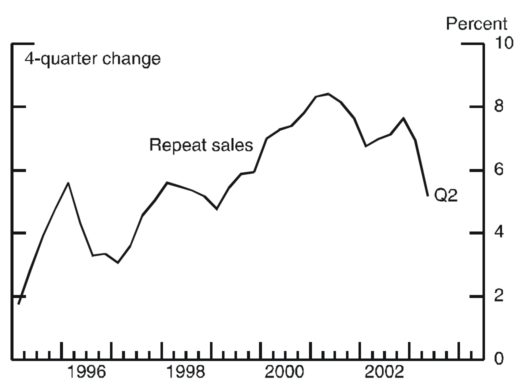
Source. Michigan Survey, not seasonally adjusted.

Prices of New Homes



Source. Census Bureau.

Prices of Existing Homes



Note. The repeat sales price index is preliminary and confidential until publicly released on September 3.
Source. Freddie Mac.

an annual rate of 341,000 units in June, about the same as the average over the past year and a half. The vacancy rate for multifamily rental housing rose to 10.6 percent in the second quarter, the highest level in the thirty-five year history of the series.

New home sales reached a high of 1.16 million units (annual rate) in June. Existing home sales edged down to 5.83 million units (annual rate), but this pace was still the fifth-highest on record.[9]

House prices increased moderately in the second quarter. The four-quarter rise in the quality-adjusted price of new homes sold was 3.8 percent in the second quarter, essentially the same as the preceding quarter and toward the lower end of the range seen in recent years. The four-quarter rise in the repeat-sales price of existing homes was 5.2 percent in the second quarter, the smallest yearly rise since early 1999.[10]

Equipment and Software

We now estimate that real business spending on equipment and software increased at an annual rate of nearly 8 percent in the second quarter, after having fallen nearly 5 percent in the first quarter.[11] Excluding the volatile transportation sector, real outlays increased almost 11 percent in the second quarter, a sizable jump following the lackluster performance of the preceding half-year. Fundamentals are sending mixed signals about investment prospects. The cost of capital is declining rapidly and this, together with the investment incentives contained in the new tax law, should help spur demand. Moreover, business output growth turned up in the second quarter. These positive factors are tempered by slowing gains in corporate cash flow. Nonetheless, the recent data on orders and shipments of capital goods, as well as evidence from the latest NABE industry survey, earnings reports, and our own informal surveys,

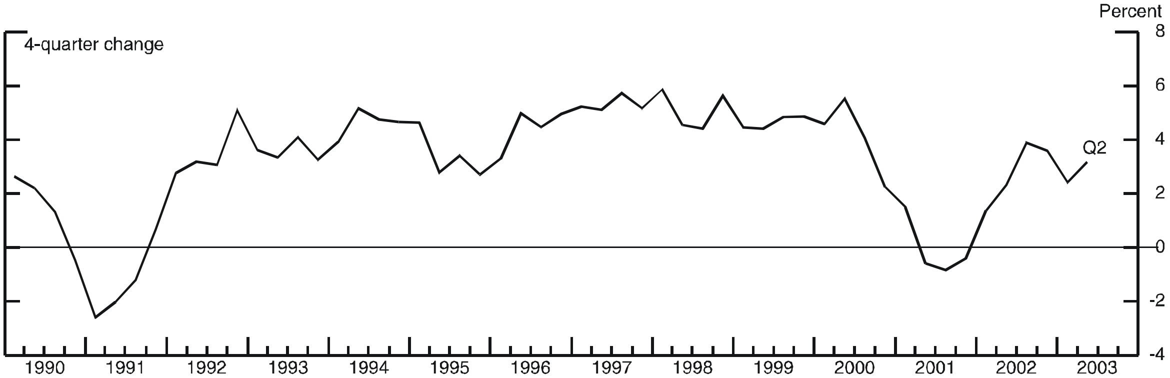
9. The Board staff has been reporting a series for existing home sales that was seasonally adjusted to eliminate trading-day variation, and therefore was preferable to the estimates published by the National Association of Realtors (NAR) that lacked trading-day adjustment. The NAR has now revised its seasonal factors to adjust appropriately for trading days, and we will no longer present the staff series.

10. Staff at Freddie Mac have concluded that the first release of the repeat-sales price index, which occurs shortly after the end of a quarter, has been understating the true price change. This bias stems from the lag between loan origination and closing, which implies that the first reading of the index for a given quarter includes primarily loans originated in the first part of the quarter. In a period when prices are rising rapidly, this effect causes the first release of the repeat-sales measure to underestimate the rate of price increase. For example, the year-over-year change in the repeat-sales price index for the first quarter, initially reported as 6.4 percent, was revised up to 6.9 percent with the release of the second-quarter data. The percent change in the Census Bureau's index of constant-quality new home prices has also tended to be revised upward in recent quarters.

11. The second-quarter estimate for growth in spending on equipment and software is about 1/2 percentage point higher than the BEA's advance estimate. The increase is based on upward-revised June data for shipments of capital goods, particularly in the high-tech category.

Equipment and Software Investment Fundamentals

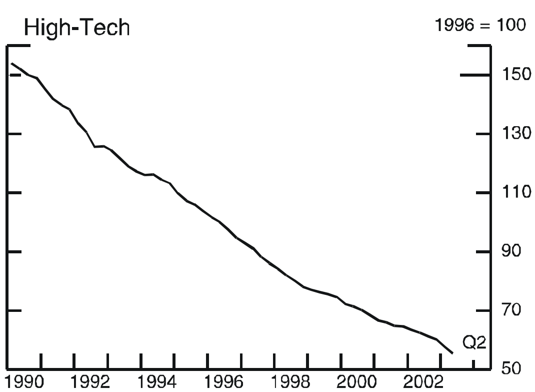
Business Output



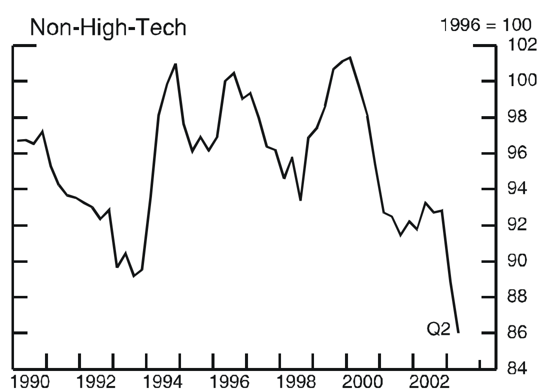
Real Corporate Cash Flow

User Cost of Capital*

High-Tech



Non-High-Tech



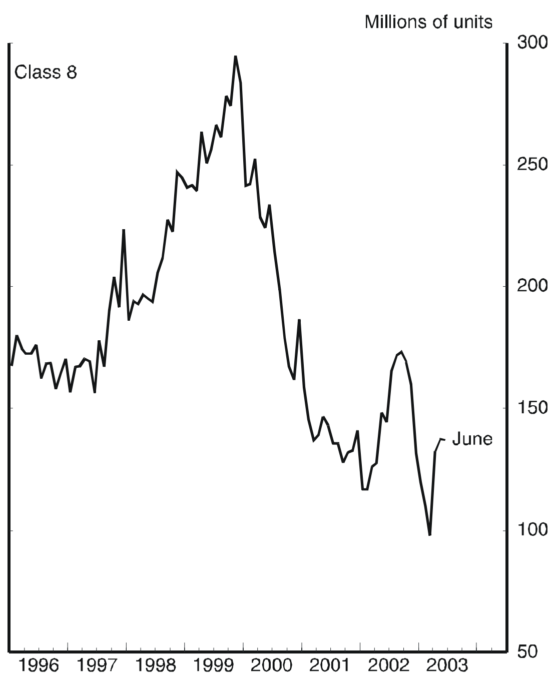
*Excludes the effects of the partial expensing tax incentive.

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

	2003 Q1	2003 Q2	2003 Apr.	2003 May	2003 June
Equipment and software					
Shipments of nondefense capital goods	-1.0	1.6	0.2	0.1	2.8
Excluding aircraft	-0.1	1.5	1.3	-0.4	1.7
Computers and peripherals	1.6	8.4	22.4	-7.0	6.3
Communications equipment	5.5	-2.5	-5.8	1.8	6.2
All other categories	-1.0	0.9	-0.9	0.6	0.3
Shipments of complete aircraft	-1.0	n.a.	-30.6	5.3	n.a.
Medium & heavy truck sales	-8.8	3.9	5.1	2.1	-0.2
Orders for nondefense capital goods	0.7	1.6	-0.1	0.3	3.2
Excluding aircraft	3.7	0.6	-2.8	0.7	1.7
Computers and peripherals	-4.3	13.5	18.8	0.3	2.3
Communications equipment	30.9	-9.0	-4.2	-6.2	-5.0
All other categories	2.1	-0.2	-5.7	1.8	2.5

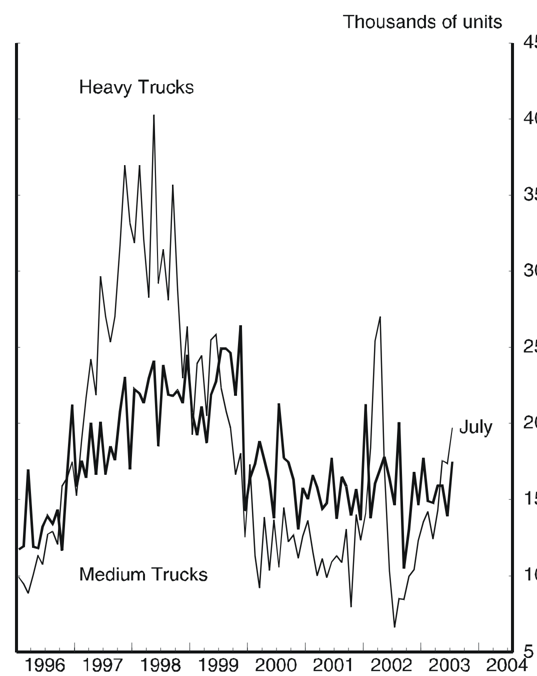
n.a. Not available.

Sales of Heavy Trucks



Note. Annual rate. FRB seasonals.

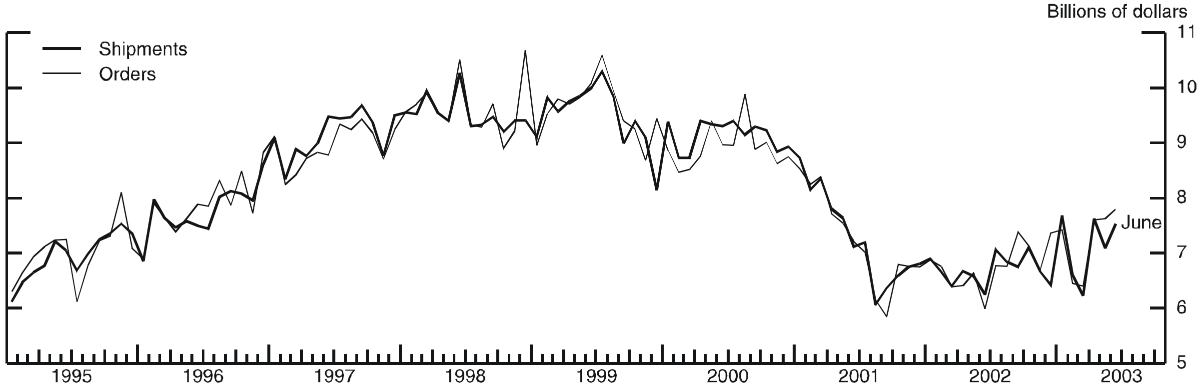
Net New Orders of Medium and Heavy Trucks



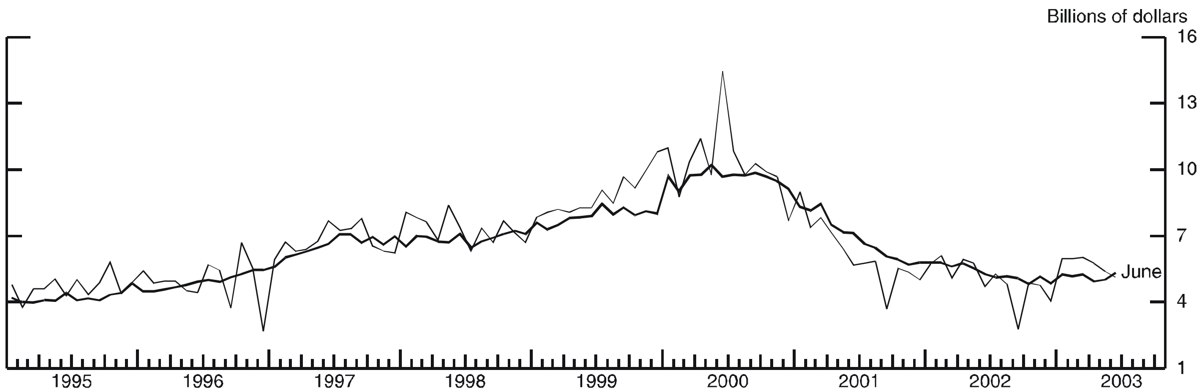
July data are preliminary. Monthly average. FRB seasonals.

Recent Data on Orders and Shipments

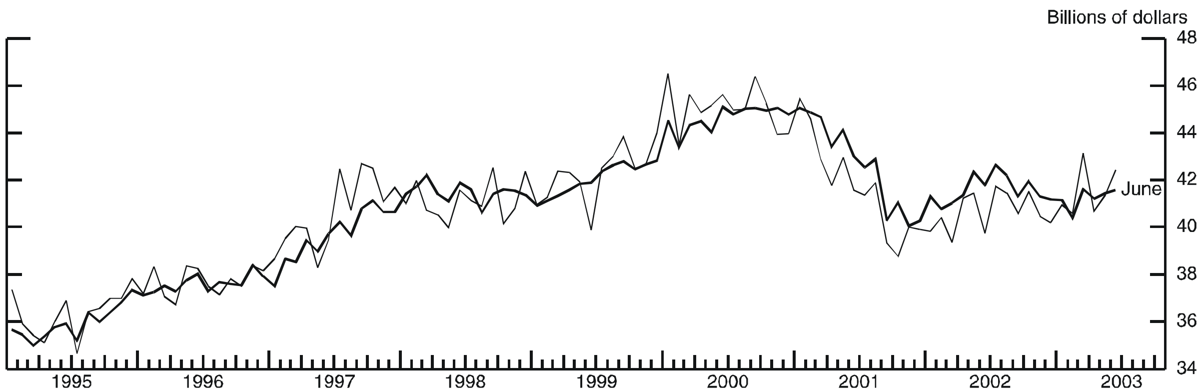
Computers and Peripherals



Communications Equipment



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



suggest a less pessimistic outlook for capital spending than was evident earlier in the year, particularly for high-tech goods.

In the high-tech sector, real outlays increased at an annual rate of 17 percent last quarter after having risen 11 percent in the first quarter. The first-half pickup was led by a sharp acceleration in real purchases of computers and software. In addition, real outlays on communications equipment posted sizable increases in both the first and second quarters.

In the transportation category, business spending on motor vehicles stagnated in the second quarter despite a bounceback in sales of medium and heavy trucks; these sales appear to be reverting to trend after having suffered a payback in the preceding half-year related to the implementation last fall of new EPA regulations. With domestic airlines mired in an air-travel downturn, real business investment in aircraft is estimated to have decreased again in the second quarter to a level less than half that in the fourth quarter of 2001.

Real spending on equipment excluding high-tech and transportation increased at an annual rate of 5-1/2 percent in the second quarter, more than reversing the decline posted in the first quarter. Nominal orders and shipments in this broad category increased in both May and June after having been fairly flat, on balance, over the preceding six months. In June, orders stood above the level of shipments.

Business Inventories

Taking the latest data for inventory investment in manufacturing in June, we now estimate that real nonfarm inventories fell at an annual rate of $17.5 billion in the second quarter, after a $4 billion increase in the first quarter.[12] The change in nonfarm inventory investment is estimated to have subtracted 3/4 of a percentage point from the change in real GDP in the second quarter, about the same drag as in the first quarter. Excluding motor vehicles, declines in nominal stocks were largest for manufacturers and wholesalers, and book-value inventories stand at low levels by historical standards relative to shipments and sales for all categories of manufacturing and trade.

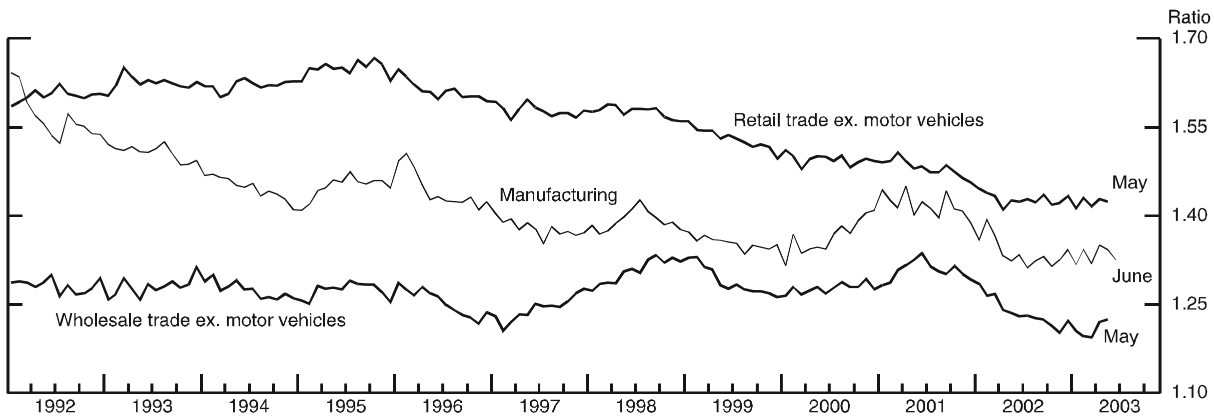
12. The BEA estimates that nonfarm inventory investment fell at an annual rate of $17 billion in the second quarter. This estimate incorporated June book-value data on inventories held by manufacturers of durable goods, but it did not include information on inventories held by retailers, wholesalers, and producers of nondurable goods.

Changes in Nonfarm Inventories
(Billions of chained (1996) dollars, annual rate)

Category	2002 Q3	2002 Q4	2003 Q1	2003 Q2*
Nonfarm inventory investment	20.8	26.5	3.8	-17.5
Excluding motor vehicles	13.9	15.2	-12.6	-23.4
Manufacturing	-3.7	2.4	-4.2	-9.6
Merchant wholesalers ex. motor vehicles	2.0	0.9	0.3	-7.4
Retail trade ex. motor vehicles	10.8	7.4	5.8	-0.4

* Staff estimate.

Book Value Inventories Relative to Shipments and Sales: Manufacturing and Trade



Inventory-Consumption Ratios, Flow-of-Goods System

In June, days' supply in the Board staff's flow-of-goods system edged down for a fourth consecutive month.[13] Excluding motor vehicles and parts, the inventory-consumption ratio has, on balance, trended down since the end of 2001 and now stands at its lowest level since the series began in March 1978. The only industries with elevated levels of days' supply are motor vehicles, paper, communications equipment, and, to a lesser degree, electrical equipment.

Nonresidential Construction

Staff estimates that include monthly construction expenditures for June indicate that real nonresidential structures spending rose at about a 7 percent rate in the second quarter, after having fallen 25 percent from its peak at the end of 2000. However, other indicators suggest that a sustained recovery in this sector has yet to become firmly established.[14]

We estimate that expenditures on office buildings declined at an annual rate of 3 percent last quarter, compared with a 13 percent decline in the first quarter. Also, a rise in the amount of occupied office space of 6 million square feet in the second quarter roughly offset the decline of 7 million square feet in the first quarter, and the vacancy rate for office buildings last quarter was nearly unchanged, albeit at an elevated level. The high level of the vacancy rate offers little incentive for new construction and suggests that spending may slip further in coming quarters.

Real outlays for industrial buildings decreased at an annual rate of 4 percent in the second quarter, after an 8 percent decline during the first quarter. Expenditures for industrial structures have fallen more than 70 percent since early 1998. The amount of occupied space declined 12 million square feet in the second quarter, and the vacancy rate reached 11.6 percent—a little higher than the peak vacancy rate in the early 1990s.

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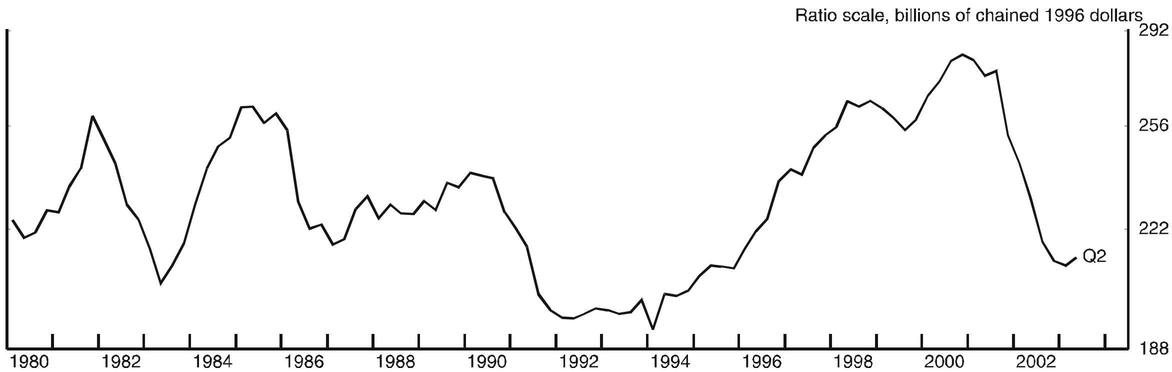
13. The Board staff's flow-of-goods system measures changes in inventories by tracking the flow of goods in the economy. The system divides the output from the staff's industrial production indexes into more than sixty different product categories. For each product category, the system estimates the supply of goods flowing into the economy—that is, domestic production plus imports. The system then estimates how much of the supply flows out, whether as final demand, including exports, or as inputs for other goods. The difference between the amount flowing in and the amount flowing out represents that change in inventories; we find inventory accumulation if inflows exceed outflows and inventory liquidation if outflows exceed inflows. The inventories are measured wherever held and valued at factory-gate prices.

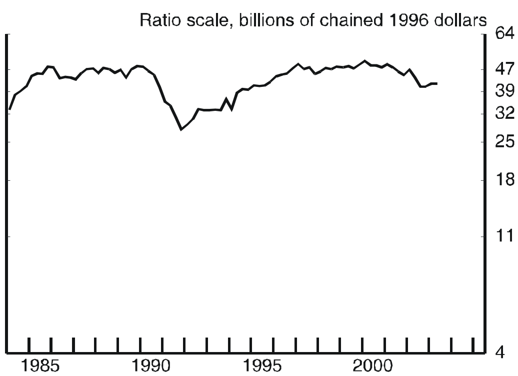
14. New Census data on the value of construction put in place (CPIP) in June, along with revisions to historical figures dating back to 1993, were released after the advance GDP report. The Census Bureau has changed its classification system for reporting data on nonresidential construction. The BEA will not convert its estimates to these new categories until the comprehensive revision late this year. Until then, it is bridging the data from the new categories into the old ones using unpublished data from Census, and we are replicating the BEA's translation method.

Nonresidential Construction
(Seasonally adjusted, annual rate)

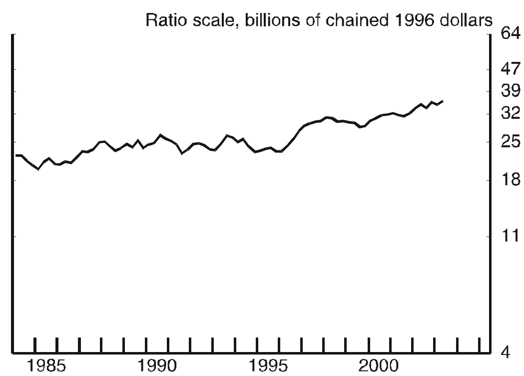
Nonresidential Structures



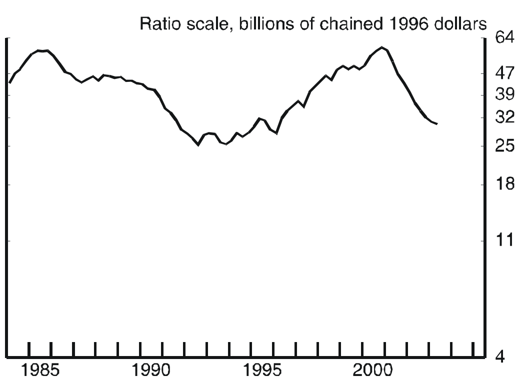
Other Commercial



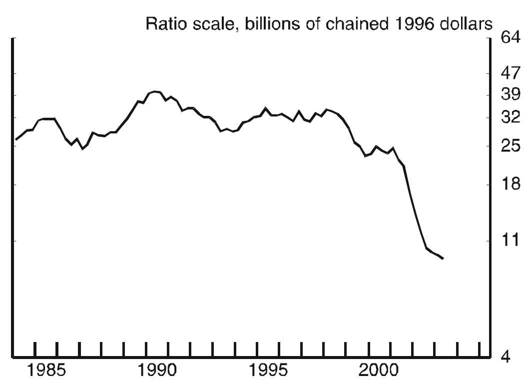
Institutional



Office



Industrial

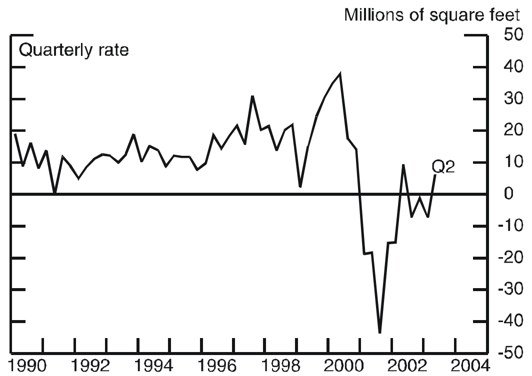


Source. BEA.

Indicators of Nonresidential Construction

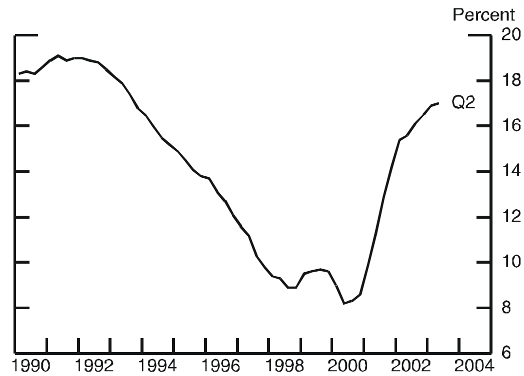
Office

Change in Occupied Space



Source. Torto Wheaton Research.

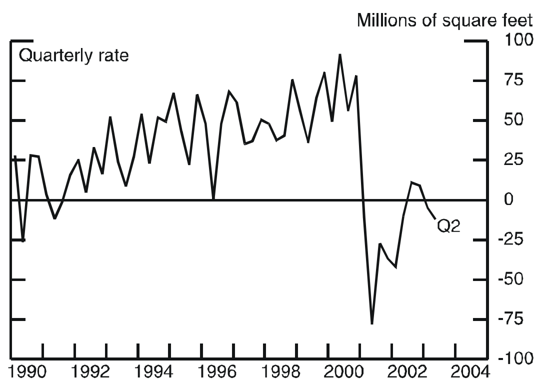
Vacancy Rate



Source. Torto Wheaton Research.

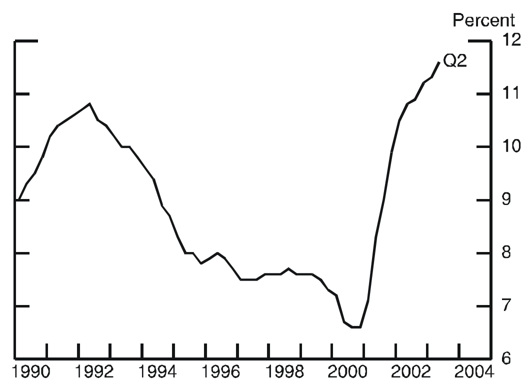
Industrial

Change in Occupied Space



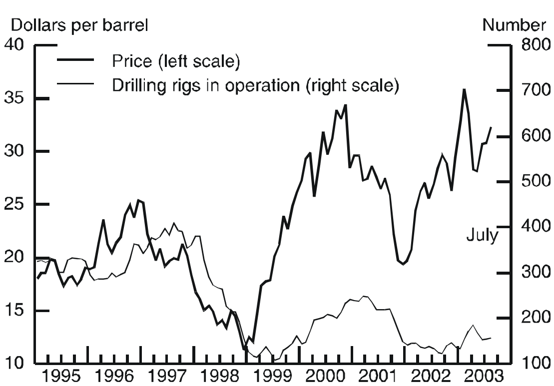
Source. Torto Wheaton Research.

Vacancy Rate



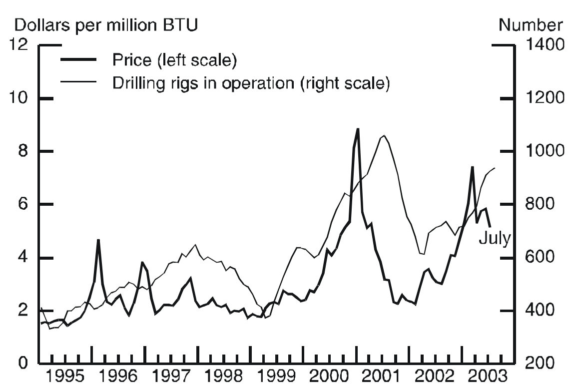
Source. Torto Wheaton Research.

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.

Spending for other commercial structures (which include retail space and warehouses) edged up in the second quarter, the third consecutive quarter in which expenditures have increased. A 16 percent jump in outlays for institutional buildings in the second quarter more than offset a first quarter decline. Expenditures for lodging and miscellaneous structures surged at an annual rate of 33 percent. Spending for drilling and mining structures rose sharply at an annual rate of 55 percent. In July, the number of natural gas drilling rigs in operation increased, and the number of oil rigs was little changed, suggesting that spending in this category continued to rise.

Federal Government Sector
The federal unified budget balance continues to deteriorate; the deficit for the twelve months ending in June deepened to $312 billion on surging outlays. Meanwhile, the Administration released new budget projections showing deficits well in excess of $400 billion for this fiscal year and next.

Federal receipts in June were 6 percent above a year earlier; the rise reflected a jump in corporate income tax collections and a pickup in withheld individual income and payroll taxes that have come from rising profits and wages; in addition, withheld taxes were boosted by an extra working day this June relative to last year. The size of the increases in these categories suggests that the Jobs and Growth Tax Relief Reconciliation Act, enacted in late May, had not yet made a noticeable dent in these receipts, although daily data indicate that withheld tax payments slowed in July. Meanwhile, nonwithheld individual income taxes declined in June, which may indicate that certain taxpayers adjusted their payments for the new law. The IRS began issuing advance refund checks to those who claimed the child tax credit on their 2002 tax returns that sent $4.6 billion in refunds on July 25 and another $4.5 billion on August 1; a final payout of about the same size is expected to be issued August 8.

Outlays, adjusted for financial transactions and payment-timing shifts, rose 12 percent in June over year-earlier levels. Double-digit increases were widespread. Defense spending rose 23 percent relative to a year earlier; the second quarter NIPA data also show an enormous increase in real expenditures. Moreover, the recent daily data indicate that the elevated pace of defense outlays continued through July. Outlays in June also included $3-1/2 billion of the temporary assistance for the states that was provided in the Jobs and Growth Tax Relief Reconciliation Act. State governments are expected to receive a total of $7-1/2 billion this fiscal year from temporary assistance and increased Medicaid reimbursement rates.

The Office of Management and Budget's *Mid-Session Review of the Budget* shows budget deficits of $455 billion in fiscal 2003 and $475 billion in fiscal 2004. Based on data in hand, this projection for fiscal 2003 appears overly gloomy. Indeed, OMB indicated in its report that fiscal 2003 outlays are likely

Federal Government Outlays and Receipts

(Unified basis; billions of dollars)

Function or source	June 2002	June 2003	June Percent change	12 months ending in June 2002	12 months ending in June 2003	12 months ending in June Percent change
Outlays	153.6	171.9	11.9	1,968.5	2,116.5	7.5
Financial transactions[1]	0.0	-0.4	...	0.1	-2.4	...
Payment timing[2]	-11.9	-12.6	...	-10.9	-0.5	...
Adjusted outlays	165.4	185.0	11.8	1,979.3	2,119.4	7.1
Receipts	182.6	193.1	5.7	1,810.5	1,804.9	-0.3
Payment timing	0.0	0.0	...	0.0	0.0	...
Adjusted receipts	182.6	193.1	5.7	1,810.5	1,804.9	-0.3
Surplus/deficit(-)	29.1	21.2	...	-158.0	-311.6	...
	Selected components of adjusted outlays and receipts					
Adjusted outlays	165.4	185.0	11.8	1,979.3	2,119.4	7.1
Net interest	14.2	10.6	-25.3	178.4	160.2	-10.2
Non-interest	151.2	174.3	15.3	1,800.9	1,959.2	8.8
National defense	30.0	36.7	22.5	335.7	388.2	15.6
Social security	41.7	43.4	4.2	451.1	470.4	4.3
Medicare	19.1	21.6	13.0	229.4	245.9	7.2
Medicaid	13.0	14.4	10.8	143.1	155.5	8.7
Income security	19.6	22.3	13.6	296.5	333.7	12.5
Agriculture	0.3	-0.6	-323.2	28.2	21.9	-22.3
Other	27.5	36.6	32.8	316.9	343.6	8.4
Adjusted receipts	182.6	193.1	5.7	1,810.5	1,804.9	-0.3
Individual income and payroll taxes	142.6	148.4	4.1	1,497.0	1,490.0	-0.5
Withheld + FICA	104.8	114.4	9.2	1,378.0	1,377.9	-0.0
Nonwithheld + SECA	41.0	36.9	-10.1	332.0	292.0	-12.0
Refunds (-)	3.2	3.0	-9.0	212.9	179.9	-15.5
Corporate	26.5	32.0	21.0	129.2	129.7	0.4
Gross	29.4	35.9	22.3	185.2	196.3	6.0
Refunds (-)	2.9	3.9	34.1	56.0	66.6	18.9
Other	13.6	12.7	-7.0	184.3	185.3	0.5
Adjusted surplus/deficit(-)	17.2	8.1	...	-168.8	-314.5	...

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

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

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

Administration Budget Projections and Economic Assumptions

Item	2003	2004	2005	2006	2007	2008
Budget projections (fiscal years)	Billions of dollars					
Current proposal						
Total surplus	-455	-475	-304	-238	-213	-226
On-budget	-615	-639	-490	-441	-435	-464
Off-budget	159	164	186	203	222	238
Current services baseline						
Total surplus	-455	-458	-241	-110	-78	-62
On-budget	-614	-621	-427	-313	-300	-300
Off-budget	159	164	186	203	222	238
Economic assumptions (calendar years)	Percent change, fourth quarter to fourth quarter					
Real GDP	2.8	3.7	3.5	3.3	3.2	3.1
GDP price index	1.5	1.3	1.4	1.6	1.7	1.8
CPI-U	1.9	1.8	1.9	2.1	2.3	2.3
	Percent, annual average					
Unemployment rate	5.8	5.5	5.3	5.2	5.1	5.1
Treasury yields						
Three-month	1.2	2.0	2.8	3.6	4.2	4.3
Ten-year	3.7	4.1	4.5	4.8	5.1	5.3

Note. The on-budget surplus excludes social security and the Postal Service (which are off-budget). The current services baseline assumes that budget authority for discretionary spending grows at the rate of inflation after 2003.

Source. Office of Management and Budget, *Budget of the U.S. Government, Mid-Session Review: Fiscal Year 2004* (July 2003).

to be lower than currently estimated, and in the interest of "cautious forecasting" it held the receipts projection below what the data and tax models would forecast. By contrast, the projection for fiscal 2004 does not make any allowance for the supplemental funding widely seen as necessary to support the anticipated scale of operations in Iraq and Afghanistan. Moreover, the Congress is considering a number of proposals that would widen the deficit relative to the Administration's policies. The additional proposals include new personal and corporate income tax cuts, a new Medicare prescription drug plan, and nondefense discretionary spending bills that slightly exceed the Administration's proposals.

State and Local Government Sector

Incorporating the June data on construction put in place, we estimate that real spending by state and local governments fell at an annual rate of 0.5 percent in the second quarter, as construction spending fell sharply and real consumption expenditures remained subdued. Many governments are not filling vacant positions, and some are laying off workers. In July, state and local employment fell again, leaving the level of employment almost 75,000 below its high in February.

Although tax receipts and fees continued to fall short of current expenditures in fiscal 2003 (which, for most jurisdictions, ended on June 30), most states appear to have satisfied the balanced budget requirements governing their general funds accounts. According to a recent survey from the National Conference of State Legislatures (NCSL), forty-two states completed action on their budgets by July 1, and of these only South Carolina and Wisconsin reported that they ended fiscal 2003 with deficits.[15] To help make ends meet during fiscal 2003, many states restrained general fund spending; in roughly one-third of the states, outlays actually declined. In addition, taxes were raised, on net, in fiscal 2003 after seven straight years of tax cuts, and many states once again dipped into rainy-day and other reserve accounts. Further, a number of states passed tax hikes designed to raise fiscal 2004 collections, and apparently by a somewhat greater amount, on net, than was enacted last year.

In late July the California legislature passed a general fund budget designed to close the estimated $38 billion gap for the two-year period spanning fiscal years 2003 and 2004.[16] Most of the deficit-closing centered on borrowing—largely through deficit-reduction bonds—and spending cuts. Even so, in the absence of further corrective actions, the state could end fiscal 2005 with a shortfall of nearly $8 billion, according to estimates from the California Legislative

15. Six states—California, Connecticut, New Hampshire, Nevada, Oregon, and Pennsylvania—missed their July 1 deadlines for passing fiscal 2004 budgets. The other two states were Alabama and Michigan, whose fiscal years begin Oct. 1.

16. California ended fiscal 2003 with about a $10-1/2 billion shortfall in its general fund account.

Analyst's office. The only significant revenue hike in the budget agreement was a tripling of the car tax to pre–1998 levels, which was implemented by administrative order and did not require a vote by legislators.

Prices

Consumer prices have been buffeted by sizable swings in energy prices so far this year. On net, energy prices in the consumer price index are up sharply over the past year, compared with large declines in the preceding year. As a result, the overall CPI was up 2.1 percent over the twelve months ending in June, compared with a 1.1 percent increase recorded during the year-earlier period. In contrast, core rates of inflation have slowed sharply this year.

Consumer energy prices moved up 0.8 percent in June, largely because of increases in the prices of natural gas and motor fuel. The rise in gasoline prices reflects a run-up in spot crude oil prices since early May, and survey data point to a further increase in the gasoline CPI in July. Natural gas inventories have risen rapidly in recent months because of mild temperatures and distributors' desire to rebuild depleted stocks; even so, the level of inventories is still 11 percent below the seasonal norm.

A 0.4 percent rise in consumer food prices in June reflected sharp increases in prices for fruits, vegetables, and meat. The June increases came despite the lack of any obvious upward pressure from spot prices for farm commodities. Since June, good weather has set the stage for bumper harvests, and spot prices for most crops and livestock have fallen (except cattle, for which strong demand, a nascent rebuilding of breeding herds, and a ban on imports from Canada all have lifted prices). Food away from home, about 40 percent of the overall food category, posted a 0.2 percent increase in June.

Excluding food and energy, the CPI was unchanged in June, after an increase of 0.3 percentage point in May. On a twelve-month basis, core consumer prices increased only 1.5 percent, a pace well below the 2.3 percent increase recorded during the comparable year-earlier period, but still about 1/2 percentage point above our point estimate of the measurement bias in this series. The index for core goods continued to decline last month and now stands 1.8 percent below its level a year ago. Declines in goods prices have been widespread over the past year and have even included tobacco, for which prices rose quite rapidly over the previous five years.[17] Core services prices edged up last month after having jumped 1/2 percent in May. On balance, however, these prices have decelerated by the same amount as goods prices over the preceding twelve months. Looking ahead, budget problems have led many states to announce sharp tuition increases

17. The drop in tobacco prices in June will likely be reversed because of increases in state tobacco excise taxes effective in July.

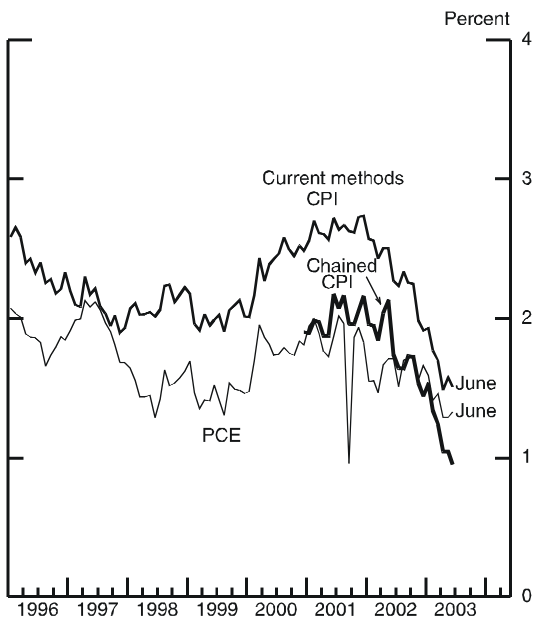
RECENT PRICE INDICATORS
(Percent)

	From 12 months earlier		From 3 months earlier		2003	
	June 2002	June 2003	Mar. 2003	June 2003	May	June
			-Annual rate-		-Monthly rate-	
CPI						
Total	1.1	2.1	5.2	-0.7	0.0	0.2
Food	1.6	2.2	2.7	2.7	0.3	0.4
Energy	-11.1	9.3	76.5	-24.5	-3.1	0.8
Ex. food and energy	2.3	1.5	0.8	1.0	0.3	0.0
Ex. tobacco	2.1	1.5	0.9	1.1	0.3	0.0
Core commodities	-1.0	-1.8	-1.7	-3.1	-0.4	-0.1
Core services	3.7	2.9	1.8	2.9	0.5	0.1
Current-methods total	1.0	2.1	5.2	-0.7	0.0	0.2
Ex. food and energy	2.3	1.5	0.8	1.0	0.3	0.0
Ex. tobacco	2.2	1.5	0.9	1.1	0.3	0.0
Chained CPI (NSA)[1]	0.9	1.7	--	--	--	--
Ex. food and energy[1]	1.7	1.0	--	--	--	--
PCE Prices						
Total	1.1	1.8	3.9	-0.1	-0.1	0.2
Food	1.9	2.0	2.0	2.6	0.3	0.4
Energy	-11.7	10.4	82.8	-26.7	-3.5	0.9
Ex. food and energy	1.7	1.3	0.8	1.3	0.1	0.2
Ex. tobacco	1.6	1.4	0.9	1.4	0.1	0.2
Core commodities	-1.2	-2.2	-2.7	-2.7	-0.5	-0.1
Core services	3.0	2.8	2.3	3.1	0.3	0.3
Core market-based	1.3	0.7	-0.1	0.6	-0.0	0.1
Core nonmarket-based	3.2	3.7	4.1	3.9	0.3	0.5
PPI						
Total finished goods	-2.3	2.9	17.7	-6.7	-0.3	0.5
Food	-1.5	3.9	9.5	5.7	0.1	0.4
Energy	-12.9	15.3	97.5	-28.1	-2.6	3.4
Ex. food and energy	0.2	-0.3	4.9	-3.6	0.1	-0.1
Ex. tobacco	-0.0	0.1	3.5	-2.0	0.1	-0.1
Core consumer goods	0.6	-0.5	6.3	-4.9	0.1	-0.1
Capital equipment	-0.3	0.0	3.5	-2.3	0.1	-0.1
Intermediate materials	-2.8	4.5	23.4	-9.9	-0.8	0.5
Ex. food and energy	-1.0	2.1	5.4	-0.3	-0.1	0.0
Crude materials	-12.4	29.4	172.3	-37.4	1.7	4.5
Ex. food and energy	6.5	4.9	19.6	-9.9	-1.9	0.6

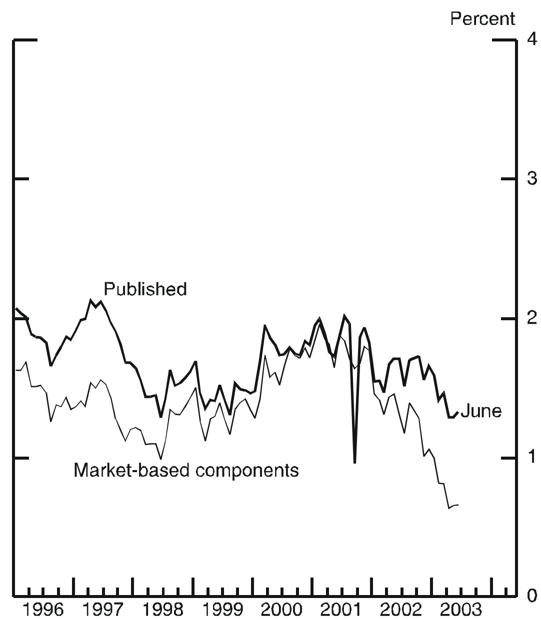
1. Higher frequency figures are not shown for data that are not seasonally adjusted.

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

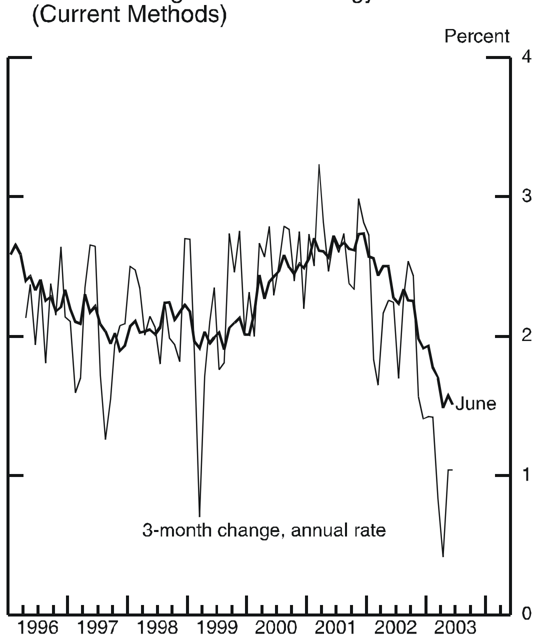
CPI and PCE excluding Food and Energy



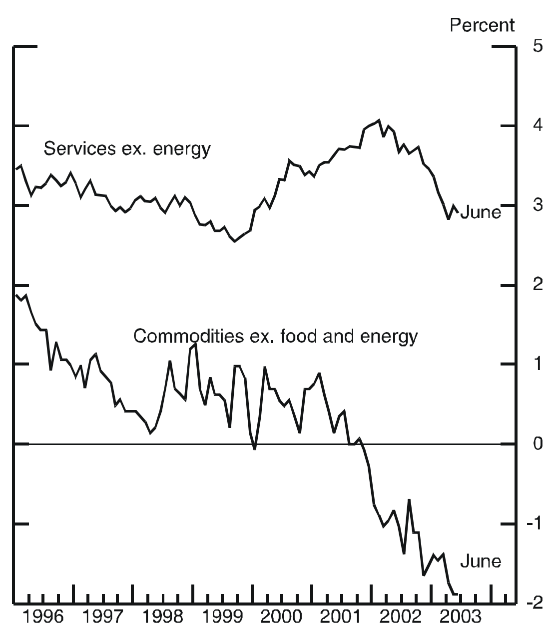
PCE excluding Food and Energy



CPI excluding Food and Energy
(Current Methods)



CPI Services and Commodities



at state universities for the coming school year; such increases should show up in the CPI in August and September.

Core PCE prices rose 0.2 percent in June and increased 1.3 percent over the twelve months ending in June, compared with a 1.7 percent increase over the preceding year. The 0.4 percentage point deceleration in the PCE measure of core inflation is half the size of the deceleration in the core CPI over the same period, a difference that largely reflects the wider scope of PCE prices. Over the past year, there has been a noticeable acceleration in the prices of PCE items that are not included in the CPI and for which no market-based prices exist. By contrast, the market-based component of the core PCE price index increased only 0.7 percent over the twelve months ending in June, and has decelerated by about the same amount as has the core CPI. The latest twelve-month reading is only a few tenths of a percentage point above our estimate of the measurement bias in this index. The core portion of the chained CPI, which, like the PCE measure, uses a superlative aggregation formula to take account of substitution by consumers in response to changes in relative prices, rose 1 percent over the twelve months ending in June, a deceleration of 3/4 percentage point from the previous year.

According to the PPI, capital equipment prices edged down in June after a slight increase in May. On balance, these prices are unchanged from their level in June 2002. Although the prices of transportation equipment have been quite volatile (owing to changing incentives for purchases of light motor vehicles), they decelerated on net over the first half of this year. Computer prices continued to fall rapidly over the twelve months ending in June, but at a slightly slower pace than a year ago. However, the prices of capital equipment apart from high-tech have firmed somewhat, on balance.

After rising briskly in the first quarter of the year, the PPI for core intermediate materials was essentially unchanged from April through June; the measure was held down by the indirect effects of the April and May declines in the cost of oil inputs for plastics, fertilizers, industrial chemicals and other energy-intensive products. The major indexes of spot commodity prices have moved up since the June Greenbook. The Journal of Commerce industrial price index is up 6 percent, partly because of a pickup in prices of metals and crude oil but mostly because of a supply-related jump in the price of plywood. The Commodity Research Bureau's spot industrial commodity price index, which excludes energy and forest products, increased 0.6 percent over the past month and a half.

The past year's rise in a number of broad measures of inflation mainly reflects the surge in energy prices, while core price indexes have generally decelerated. For example, the four-quarter change in the chain-type price index for GDP was 1.5 percent in the second quarter, compared with 1.1 percent in the second quarter of 2002. Excluding food and energy, however, the four-quarter change in

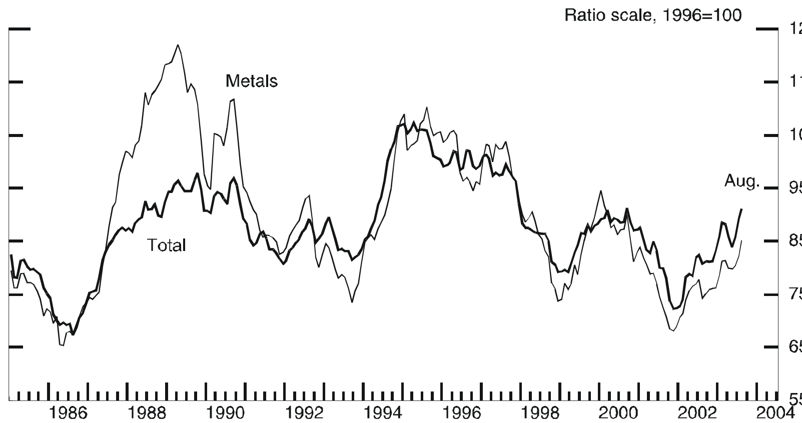
SPOT PRICES OF SELECTED COMMODITIES

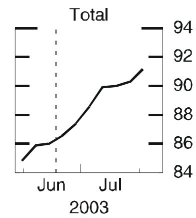
	Current price (dollars)	Percent change[1] 2001	2002	Dec. 31 to June 17[2]	June 17[2] to Aug. 05	Memo: Year earlier to date
Metals						
Copper (lb.)	0.840	-22.0	2.8	8.2	6.3	18.3
Steel scrap (ton)	123.667	-17.7	49.2	9.3	16.7	21.6
Aluminum, London (lb.)	0.670	-14.3	0.7	3.7	6.0	15.2
Precious metals						
Gold (oz.)	348.400	1.2	24.7	5.2	-4.0	13.9
Silver (oz.)	4.980	-3.5	3.0	-2.8	7.0	7.2
Forest products[3]						
Lumber (m. bdft.)	264.000	25.0	-13.0	32.0	0.0	11.9
Plywood (m. sqft.)	374.000	3.2	-0.3	10.7	16.9	21.8
Petroleum						
Crude oil (barrel)	30.220	-16.3	65.8	-15.8	12.2	17.6
Gasoline (gal.)	0.961	-28.0	54.6	-7.0	22.1	23.2
Fuel oil (gal.)	0.838	-42.6	57.4	-13.5	12.1	27.2
Livestock						
Steers (cwt.)	79.000	-19.7	12.9	5.4	4.0	26.8
Hogs (cwt.)	40.500	-9.9	-18.9	60.0	-15.6	15.7
Broilers (lb.)	0.619	3.7	7.4	1.6	1.9	18.6
U.S. farm crops						
Corn (bu.)	2.040	-4.1	19.2	4.4	-14.8	-14.8
Wheat (bu.)	3.510	-8.9	30.4	-16.7	1.5	-15.8
Soybeans (bu.)	5.370	-13.4	35.6	9.6	-12.6	-2.8
Cotton (lb.)	0.521	-45.7	53.8	11.6	-2.3	33.4
Other foodstuffs						
Coffee (lb.)	0.540	-35.3	1.1	9.6	10.8	31.7
Memo:						
JOC Industrials	91.200	-17.1	16.2	2.5	6.0	13.4
JOC Metals	85.200	-17.0	9.5	5.0	7.0	15.4
CRB Futures	234.810	-16.3	23.0	0.4	-0.3	12.0
CRB Spot Industrials	263.260	-14.6	14.4	5.2	0.6	9.6

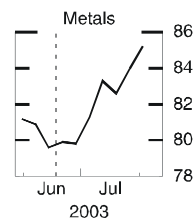
1. Changes, if not specified, are from the last week of the preceding year to the last week of the period indicated.
2. Week of the June Greenbook.
3. Reflects prices on the Friday before the date indicated.

Commodity Price Measures

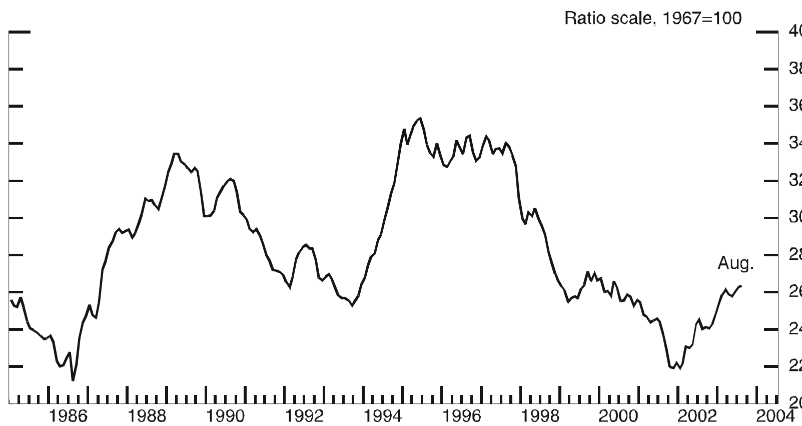
Journal of Commerce Index

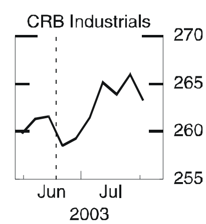




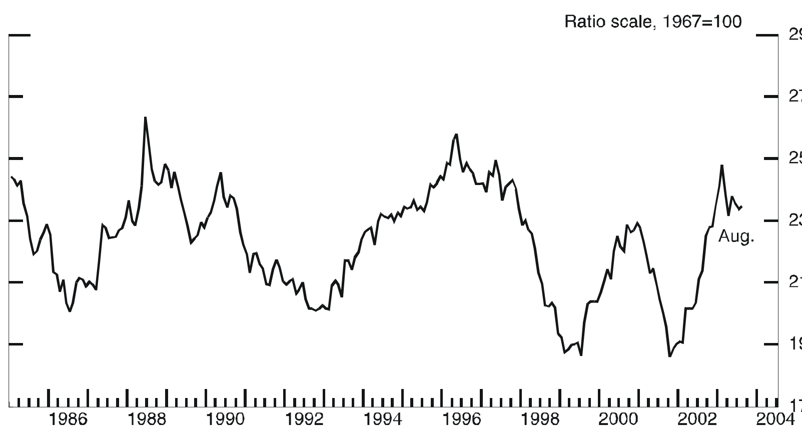


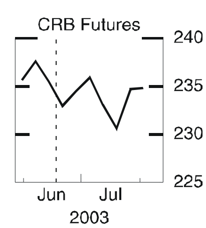
CRB Spot Industrials





CRB Futures





Note. Larger panels show monthly average of weekly data through last available week. Smaller panels show 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 Commodity Research Board (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.

BROAD MEASURES OF INFLATION
(4-quarter percent change)

	2000 Q2	2001 Q2	2002 Q2	2003 Q2
Product prices				
GDP chain price index	2.1	2.5	1.1	1.5
Less food and energy	2.0	2.0	1.5	1.3
Nonfarm business chain price index[1]	1.8	2.0	0.4	0.9
Expenditure prices				
Gross domestic purchases chain price index	2.5	2.3	0.9	1.7
Less food and energy	1.9	1.9	1.4	1.3
PCE chain price index	2.6	2.4	1.1	1.8
Less food and energy	1.8	1.8	1.7	1.3
PCE chain price index, market-based components	2.5	2.5	0.8	1.4
Less food and energy	1.6	1.8	1.4	0.7
CPI	3.3	3.4	1.3	2.2
Less food and energy	2.4	2.6	2.4	1.5
Chained CPI	n.a.	2.7	1.1	1.7
Less food and energy	n.a.	2.0	2.0	1.0
Median CPI	2.5	3.5	3.6	2.2
Trimmed mean CPI	2.4	2.8	2.2	1.9

1. Excluding housing.

SURVEYS OF (CPI) INFLATION EXPECTATIONS
(Percent)

		University of Michigan				
		1 year		5 to 10 years		
	Actual inflation[1]	Mean[2]	Median[2]	Mean[3]	Median[3]	Professional forecasters (10-year)[4]
2001-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
2002-Q1	1.3	2.6	2.2	3.1	2.8	2.5
Q2	1.3	3.1	2.7	3.4	2.9	2.5
Q3	1.6	2.8	2.6	3.2	2.7	2.5
Q4	2.2	2.7	2.5	3.3	2.8	2.5
2003-Q1	2.9	3.2	2.8	3.0	2.7	2.5
Q2	2.1	2.6	2.2	3.1	2.7	2.5
2003-Jan.	2.6	2.7	2.5	3.1	2.7	
Feb.	3.0	3.2	2.7	3.1	2.7	
Mar.	3.0	3.8	3.1	2.9	2.8	2.5
Apr.	2.2	2.7	2.4	3.1	2.7	
May	2.1	2.5	2.0	3.1	2.8	
June	2.1	2.5	2.1	3.0	2.7	2.5
July		2.3	1.7	3.2	2.7	

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.

the core GDP price index was 1.3 percent, down 0.2 percentage point from the pace recorded a year earlier. Price indexes for components of GDP apart from consumer expenditures, particularly for investment in both residential and nonresidential structures, have firmed, on balance, over the past year.

Inflation expectations for the coming year turned down sharply in July, according to the Michigan Survey. Median expected one-year inflation, at 1.7 percent, was lower than any reading on record except for the ones that were taken in the immediate aftermath of September 11th. (This series had its inception in 1978). As usual, though, the survey showed little movement in median consumer expectations of inflation over the next five to ten years, which stand at 2.7 percent. The Philadelphia Fed's most recent quarterly survey of professional forecasters' long-term inflation expectations likewise remained unchanged at 2.5 percent.[18]

Labor Costs

The Employment Cost Index (ECI) for hourly compensation in private industry rose at an annual rate of 3.4 percent over the three months ending in June after posting a 5.5 percent increase over the previous three-month period. The wage and salary component of the index rose at an annual rate of 2.5 percent for the three months ending in June, while benefit costs rose at a 5.5 percent rate.

Over the twelve months ending in June, private-industry hourly compensation rose 3.5 percent, 0.5 percentage point less than in the preceding year. The slower rise in compensation reflected a deceleration in wages and salaries; the twelve-month change in this series fell to 2.6 percent from 3.6 percent in June 2002. Wage deceleration was widespread but was most marked for service-producing industries such as trade; by contrast, wages accelerated sharply for workers in construction and in the finance, insurance, and real estate industries.

In contrast to wages and salaries, hourly benefit costs accelerated 1 percentage point over the past year; the latest twelve-month change now stands at 6.1 percent. Although the cost of private-sector health insurance rose a bit less rapidly than in the previous twelve-month period, the increase still was sizable—10.3 percent.[19] At the same time, a number of other benefit components rose substantially faster. In particular, over the twelve months ending in June, workers' compensation accelerated in response to the earlier pickup in health insurance costs; retirement and savings costs accelerated as firms replenished defined-benefit pension reserves that had been depleted by the earlier stock

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18. The five-to-ten-year inflation compensation built into indexed Treasury bonds has increased about 3/4 percentage point since the June FOMC meeting and currently stands at about 3 percent.

19. Looking forward to 2004, health insurance premiums for California's public employees retirement system (Calpers) are set to increase 16 percent after having risen 24 percent in 2003.

market slump; and the increase in state unemployment insurance costs was boosted by the rise in the level of claims.

Very little information on labor costs is available for the third quarter. Average hourly earnings of production or nonsupervisory workers on private nonfarm payrolls rose 0.3 percent in July. Over the twelve months ending in July, average hourly earnings increased 3.1 percent, a shade above the pace a year earlier.

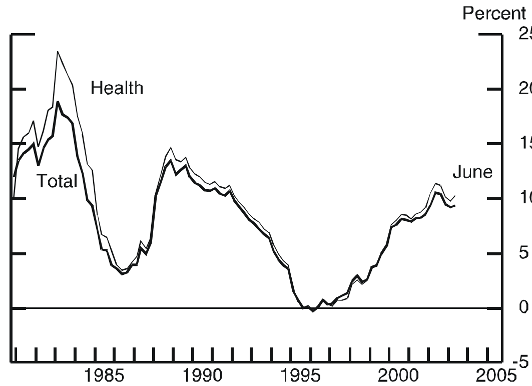
EMPLOYMENT COST INDEX OF HOURLY COMPENSATION
FOR PRIVATE INDUSTRY WORKERS

	2002			2003	
	June	Sept.	Dec.	Mar.	June
	-----Quarterly percent change------- (Compound annual rate)				
Total hourly compensation[1]	4.4	2.5	3.0	5.5	3.4
Wages and salaries	3.7	1.8	2.1	4.1	2.5
Benefit costs	5.3	4.3	5.0	10.0	5.5
By industry					
Construction	2.4	3.1	4.2	3.3	4.6
Manufacturing	3.9	3.3	4.3	7.4	3.5
Trans., comm., and public utilities	3.9	4.6	3.5	3.0	5.2
Wholesale trade	8.9	0.5	2.7	6.9	2.1
Retail trade	5.3	1.6	1.5	-0.3	1.8
FIRE	5.2	1.7	1.2	20.9	3.7
Services	2.7	2.5	2.5	3.4	3.1
By occupation					
White collar	4.3	2.5	2.7	5.9	2.6
Blue collar	3.4	3.4	3.6	5.4	3.8
Service occupations	2.8	3.9	2.3	4.8	2.8
Memo:					
State and local governments	3.6	5.2	4.1	3.8	4.0
	-----Twelve-month percent change----				
Total hourly compensation	4.0	3.7	3.2	3.8	3.5
Excluding sales workers	4.0	3.6	3.3	3.8	3.8
Wages and salaries	3.6	3.2	2.7	3.0	2.6
Excluding sales workers	3.5	3.2	2.7	2.9	2.8
Benefit costs	5.1	4.8	4.7	6.1	6.1
By industry					
Construction	3.3	3.0	3.2	3.2	3.8
Manufacturing	3.6	3.8	3.8	4.7	4.6
Trans., comm., and public utilities	4.3	4.8	4.0	3.8	4.1
Wholesale trade	5.4	4.6	4.5	4.7	3.0
Retail trade	3.9	3.4	1.7	2.0	1.2
FIRE	4.9	4.4	4.5	7.0	6.6
Services	3.7	3.1	2.7	2.8	2.9
By occupation					
White collar	4.1	3.7	3.2	3.8	3.4
Sales	4.6	4.3	3.3	3.7	2.2
Nonsales	3.9	3.6	3.1	3.9	3.7
Blue collar	3.9	3.5	3.6	4.0	4.1
Service occupations	4.0	4.2	3.2	3.4	3.3
Memo:					
State and local governments	3.6	3.8	4.1	4.2	4.1

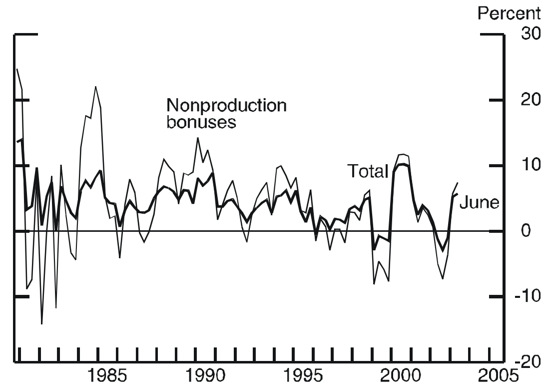
1. Seasonally adjusted by the BLS.

Components of ECI Benefits Costs (CONFIDENTIAL)
(Private industry workers; 12-month change)

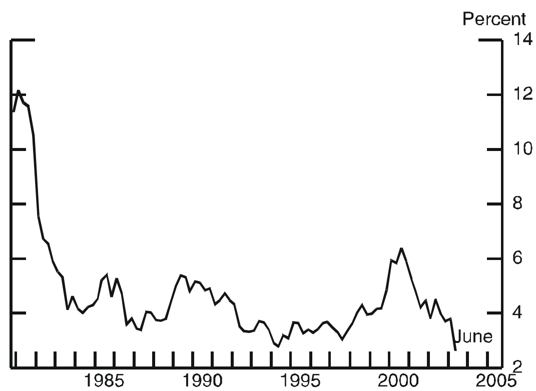
Insurance Costs



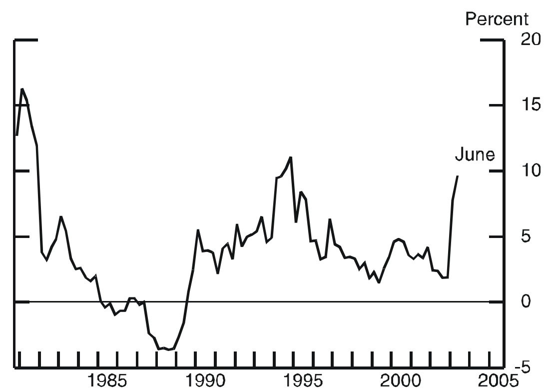
Supplemental Pay



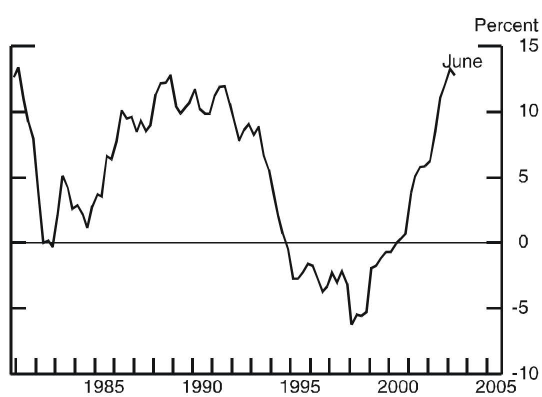
Paid Leave



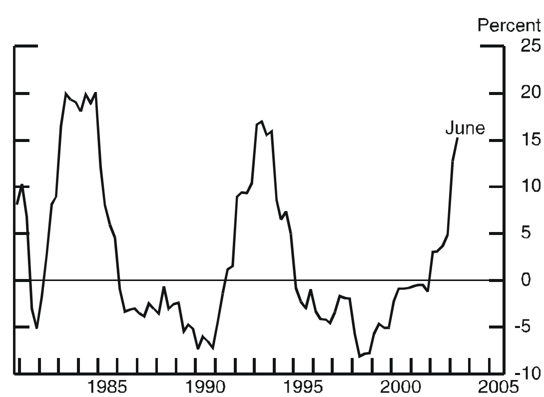
Retirement and Savings



Workers' Compensation Insurance



State Unemployment Insurance



Domestic Financial Developments

Selected Financial Market Quotations

(One-day quotes in percent except as noted)

Instrument	2000 June 26	2001 Sept. 10	2003 June 24	2003 Aug. 5	Change to Aug. 5 from selected dates (percentage points) 2000 June 26	2001 Sept. 10	2003 June 24
Short-term							
FOMC intended federal funds rate	6.50	3.50	1.25	1.00	-5.50	-2.50	-.25
Treasury bills [1]							
3-month	5.66	3.19	0.81	0.94	-4.72	-2.25	.13
6-month	5.94	3.13	0.82	1.03	-4.91	-2.10	.21
Commercial paper (A1/P1 rates)							
1-month	6.56	3.42	0.91	1.03	-5.53	-2.39	.12
3-month	6.56	3.24	0.88	1.04	-5.52	-2.20	.16
Large negotiable CDs [1]							
1-month	6.64	3.46	0.96	1.07	-5.57	-2.39	.11
3-month	6.73	3.26	0.93	1.08	-5.65	-2.18	.15
6-month	6.89	3.24	0.92	1.14	-5.75	-2.10	.22
Eurodollar deposits [2]							
1-month	6.63	3.41	0.94	1.05	-5.58	-2.36	.11
3-month	6.69	3.26	0.91	1.07	-5.62	-2.19	.16
Bank prime rate	9.50	6.50	4.25	4.00	-5.50	-2.50	-.25
Intermediate- and long-term							
U.S. Treasury[3]							
2-year	6.54	3.59	1.14	1.91	-4.63	-1.68	.77
10-year	6.35	5.14	3.46	4.70	-1.65	-.44	1.24
30-year	6.22	5.55	4.53	5.53	-.69	-.02	1.00
U.S. Treasury 10-year indexed note	4.08	3.28	1.70	2.44	-1.64	-.84	.74
Municipal revenue (Bond Buyer) [4]	5.99	5.25	4.89	5.42	-.57	.17	.53
Private instruments							
10-year swap	7.38	5.62	3.67	4.95	-2.43	-.67	1.28
10-year FNMA[5]	7.19	5.68	3.84	5.06	-2.13	-.62	1.22
10-year AA [6]	7.64	6.30	4.13	5.37	-2.27	-.93	1.24
10-year BBB [6]	8.40	7.11	5.16	6.27	-2.13	-.84	1.11
High-yield [7]	12.30	12.72	9.03	9.57	-2.73	-3.15	.54
Home mortgages (FHLMC survey rate) [8]							
30-year fixed	8.14	6.89	5.21	6.14	-2.00	-.75	.93
1-year adjustable	7.22	5.64	3.51	3.68	-3.54	-1.96	.17

Stock exchange index	Record high Level	Record high Date	2001 Sept. 10	2003 June 24	2003 Aug. 5	Change to Aug. 5 from selected dates (percent) Record high	2001 Sept. 10	2003 June 24
Dow-Jones Industrial	11,723	1-14-00	9,606	9,110	9,036	-22.92	-5.93	-.81
S&P 500 Composite	1,527	3-24-00	1,093	983	965	-36.79	-11.63	-1.83
Nasdaq (OTC)	5,049	3-10-00	1,695	1,606	1,674	-66.85	-1.29	4.23
Russell 2000	606	3-9-00	441	441	457	-24.53	3.79	3.76
Wilshire 5000	14,752	3-24-00	10,104	9,388	9,306	-36.91	-7.90	-.87

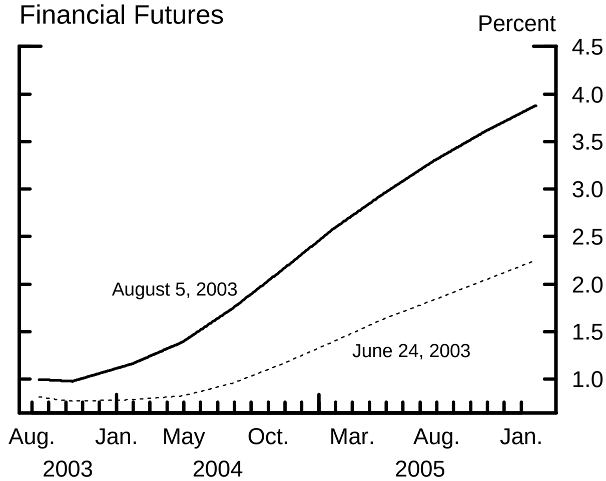
1. Secondary market.
2. Bid rates for eurodollar deposits collected around 9:30 a.m. Eastern time.
3. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
4. Most recent Thursday quote.
5. Constant maturity yields estimated from Fannie Mae domestic non-callable coupon 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.
June 21, 2003, is the day before the most recent FOMC meeting.

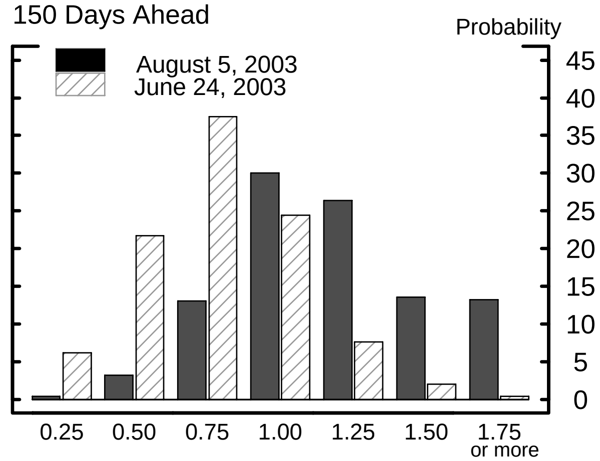
Selected Interest Rates

Expected Federal Funds Rates Estimated from Financial Futures



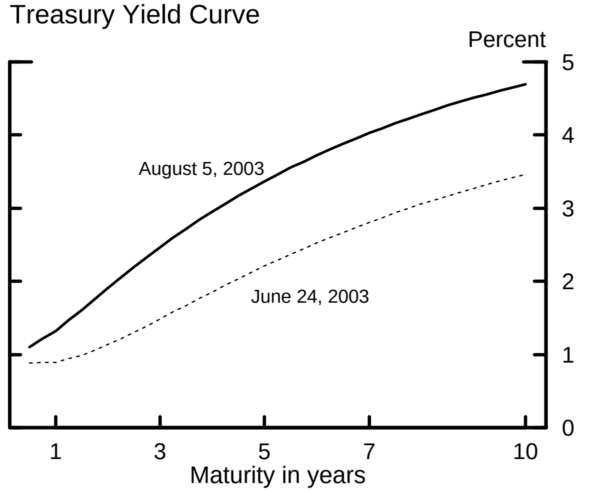
Note. Estimates from federal funds and eurodollar futures rates with an allowance for term premia and other adjustments.

Implied Distribution of Federal Funds Rate, 150 Days Ahead



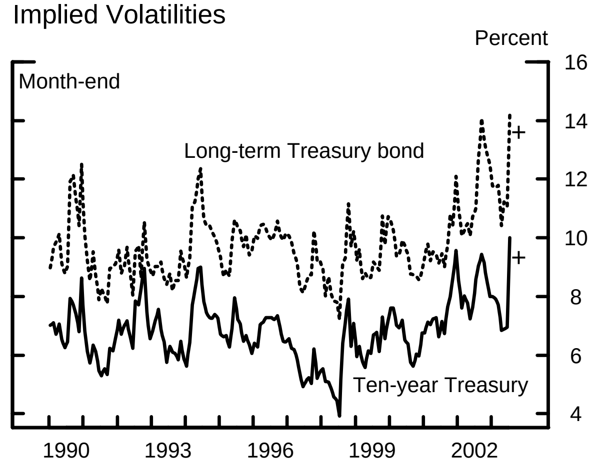
Note. Derived from options on eurodollar futures contracts, adjusted to estimate expectations for the federal funds rate.

Treasury Yield Curve



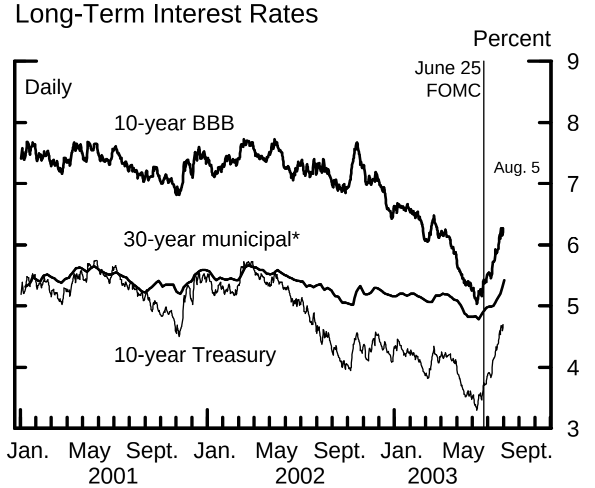
Note. Smoothed yield curve estimated using off-the-run Treasury coupon securities. Yields shown are those on notional par Treasury securities with semiannual payments.

Implied Volatilities



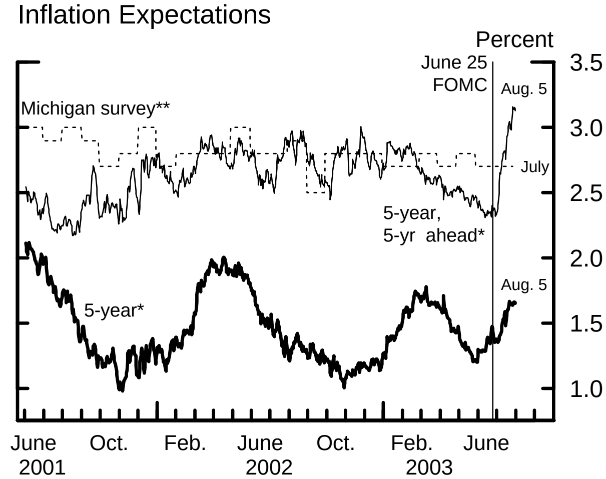
+ August 5.

Long-Term Interest Rates



*Bond Buyer Revenue, weekly Thursday frequency.

Inflation Expectations



*Daily TIIS-based inflation rate at which the price of the indexed security equals the value of a portfolio of zero-coupon securities that replicates its payments. **Monthly median 5- to 10-year inflation expectations.

Domestic Financial Developments

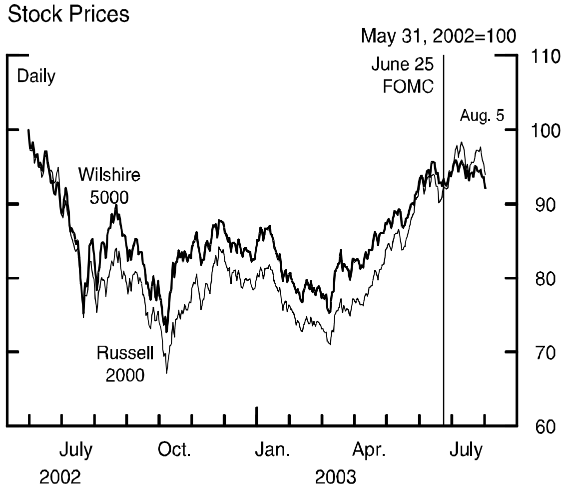
Overview
During the intermeeting period, investors read a confluence of developments as signaling more favorable economic prospects and a reduced chance of "substantial unwelcome disinflation." Investors appear to have keyed in on the June FOMC announcement of a smaller-than-expected quarter-point policy easing, the Chairman's subsequent monetary policy testimony coupled with the economic forecasts of FOMC members, and the generally upbeat tone of incoming economic data and earnings news. Against this backdrop, interest rates rose substantially across the maturity and credit spectrum, with Treasuries and other high-grade instruments—especially swaps—recording the largest increases. The more sanguine economic outlook also resulted in further significant declines in risk spreads for speculative-grade bonds. Broad stock price indexes were down slightly, but small-cap and technology shares outperformed the broader market.

The increase in longer-term interest rates put a damper on the issuance of investment-grade corporate bonds, and total net borrowing by nonfinancial business has been weak. In the household sector, the rise in mortgage rates has pared the volume of new applications for mortgage refinancing in recent weeks, but overall, the growth of household debt appears to have slowed only moderately from the rapid pace earlier this year. State and local governments have continued to issue substantial amounts of debt, and federal borrowing has remained brisk.

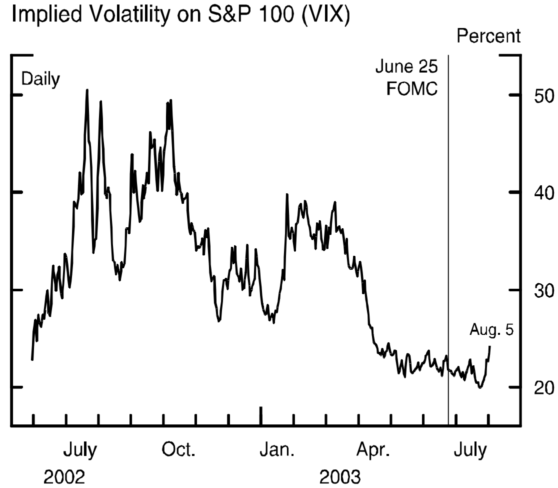
Policy Expectations and Interest Rates
Market participants had priced in substantial odds of a 50 basis point cut in the federal funds rate target at the June FOMC meeting, and the announcement of a quarter-point ease prompted a backup in interest rates. News reports following the announcement also cited the absence of any mention of "unconventional" monetary policy as being a factor in the initial rise in yields. Investors later noted the statement in the Chairman's monetary policy testimony that cited the FOMC's intent to maintain a highly accommodative stance of monetary policy for as long as necessary to foster a return to satisfactory economic performance. But they seemed to be more impressed by statements that deflationary scenarios were quite remote and by the economic forecasts of FOMC members, which were more optimistic than market participants had anticipated. The expected path for the funds rate moved up substantially again after the testimony and still more over the remainder of the intermeeting period on generally stronger-than-expected economic data. On net, the expected path of policy shifted up about 50 basis points by the spring of next year and more than 150 basis points by the latter part of 2005.

Stock Prices and Corporate Risk Spreads

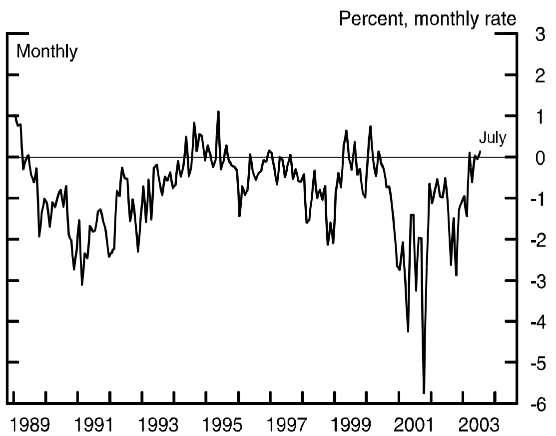
Stock Prices



Implied Volatility on S&P 100 (VIX)

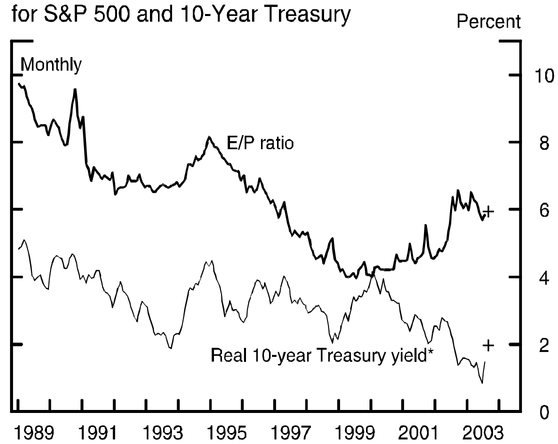


S&P 500 EPS Revisions Index



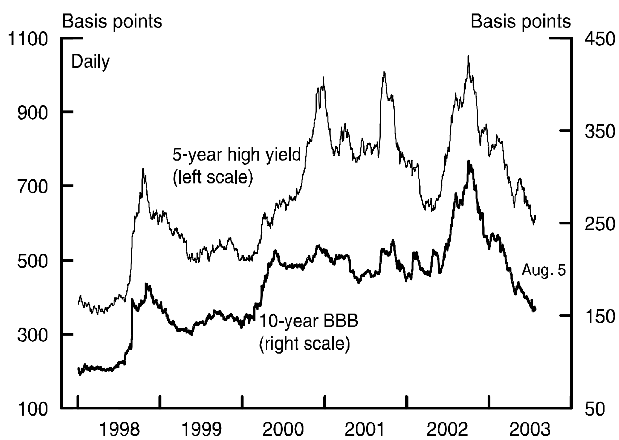
Note. Index is a weighted average of the percent change in the consensus forecasts of current-year and following-year EPS.

12-Month Forward Earnings-Price Ratio
for S&P 500 and 10-Year Treasury

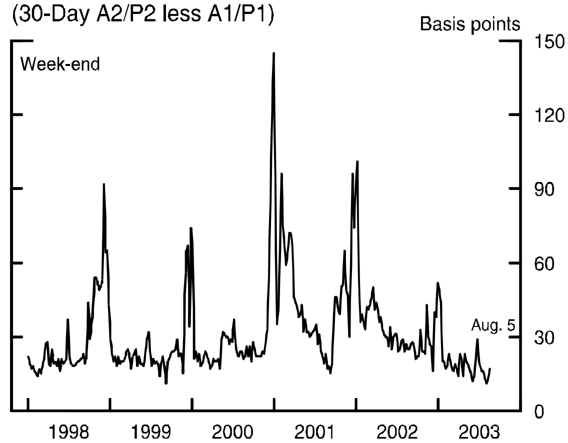


* 10-year Treasury yield minus Philadelphia Fed 10-year expected inflation.
+ Denotes the latest observation using daily interest rates and stock prices and latest earnings data from I/B/E/S.

Corporate Bond Spreads to Similar Maturity Treasury



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



The change in policy expectations and economic outlook spurred a sharp steepening of the Treasury yield curve, and trading conditions were, at times, volatile and choppy. Judging from indexed debt yields, most of the increase in nominal yields reflected a rise in real interest rates. Changes in TIIS yields suggest that inflation compensation moved higher as well, particularly five to ten years ahead, despite little change in survey measures of longer-term inflation expectations. Market commentary cited hedging-related transactions by investors in mortgage-backed securities as an important factor that amplified the rise in longer-term yields over this period and that contributed to the recent run-up in implied volatilities of these yields. A worsening fiscal outlook also may have played some role in boosting long-term rates.

Stock Prices and Corporate Interest Rates

Broad indexes of equity prices were down slightly, on net, over the intermeeting period. Technology and small-cap stocks significantly outperformed the overall market, as market participants continued to believe that those sectors would be a prime beneficiary of an economic upturn. At the same time, the implied volatility index on the S&P 100 (VIX) has edged up a little since the last FOMC meeting but remained near the low end of its range in recent years.

Early in the intermeeting period, equity prices rose on expectations that second-quarter earnings reports would handily beat earlier forecasts, which they did. Despite the favorable earnings news, the recent run-up in bond yields weighed on the stock market, leaving the Wilshire 5000 down 0.9 percent over the intermeeting period. With the small decline in stock prices, the gap between the year-ahead earnings-price ratio and the real ten-year Treasury yield—a rough measure of the equity premium—has narrowed somewhat further recently, though it remains wide by historical standards.

Yields on investment-grade corporate bonds rose about as much as those on comparable Treasury securities over the intermeeting period, leaving their spreads unchanged or down a touch. In contrast, spreads for speculative-grade issues fell substantially and are at their lowest level since the spring of 2000.

Business Finance

Bond issuance by investment-grade nonfinancial firms slowed abruptly in July, depressed by the spike in long-term yields. In contrast, the issuance of high-yield bonds continued at a robust pace, as yields on these bonds rose much less than Treasury rates. Commercial paper outstanding turned up in July after four consecutive months of decline. On a reported basis, C&I loans outstanding also rose last month; however, it appears that these loans would have declined by

Business Finance

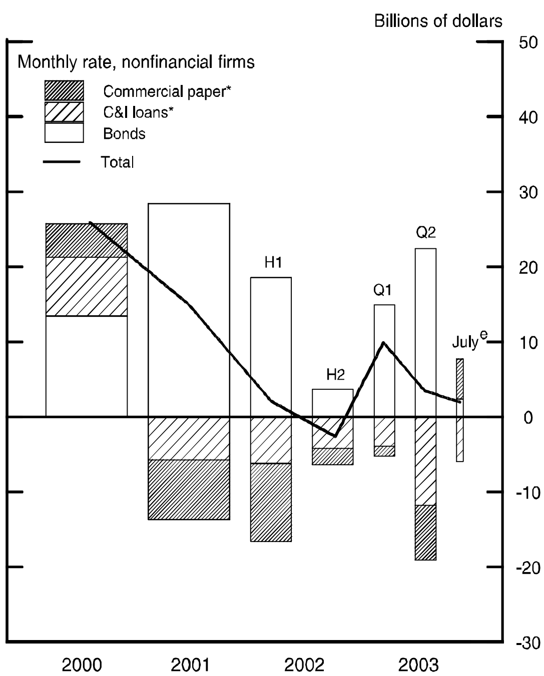
Gross Issuance of Securities by U.S. Corporations

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

Type of security	2000	2001	2002 H1	2002 H2	2003 Q1	2003 Q2	2003 July [e]
Nonfinancial corporations							
Stocks [1]	9.9	6.5	7.4	2.9	2.5	3.1	3.2
Initial public offerings	4.4	2.1	1.2	0.3	0.0	0.0	0.9
Seasoned offerings	5.5	4.4	6.3	2.6	2.5	3.1	2.3
Bonds	22.6	39.1	31.4	18.0	29.2	40.6	23.4
Investment grade [2]	13.2	27.5	19.8	11.6	18.8	22.0	5.6
Speculative grade [2]	4.7	8.9	6.4	3.3	6.8	16.4	14.6
Other (sold abroad/unrated)	4.8	2.7	5.3	3.1	3.6	2.2	3.2
Memo							
Net issuance of commercial paper [3]	4.5	-8.0	-10.4	-2.2	-1.3	-7.3	5.4
Change in C&I loans at commercial banks [3]	7.8	-5.7	-6.2	-4.2	-3.9	-11.8	11.2
Removing FIN 46 effects							*-5.9*
Financial corporations							
Stocks [1]	1.4	4.2	4.2	3.8	4.2	7.9	4.3
Bonds [4]	57.9	80.2	89.8	83.9	105.4	105.6	62.8

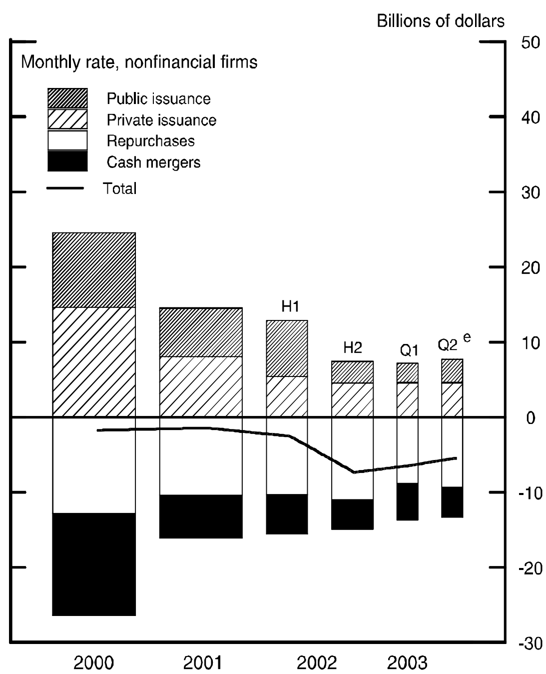
Note. Components may not sum to totals because of rounding. These data include bonds issued privately under Rule 144A. All other private placements are excluded. Total reflects gross proceeds rather than par value of original discount bonds.
1. Excludes equity issues associated with equity-for-equity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

Components of Net Debt Financing



* Seasonally adjusted.
e Staff estimate.

Components of Net Equity Issuance



e Staff estimate.

roughly $6 billion if not for changes in accounting required by FIN 46.[1] This run-off occurred in the first week of July; in more recent weeks, C&I loans have been relatively stable. All told, net borrowing by businesses appears to have been quite weak in July.

This picture of sluggish borrowing is consistent with responses to the August 2003 Senior Loan Officer Opinion Survey, which indicated that demand for C&I loans weakened further over the past three months. At the same time, the net fraction of banking institutions that reported having tightened lending standards on C&I loans declined to a very low level in August, and domestic banks reported easing spreads on these loans, on net, for the first time since 1998.

Gross issuance of public equity by nonfinancial firms inched up over the intermeeting period, as the IPO market began to show signs of life after a long drought. Although the numbers are nothing like those in the go-go period from mid-1998 to mid-2001, several IPOs by nonfinancial firms—totaling about $1 billion—were well received by the market in recent weeks, and $1 billion in new offerings are on the calendar for the near future. In contrast to the pickup in IPOs, seasoned equity offerings continued to be sluggish in July. Venture-capital investment rose slightly in the second quarter, the first increase after a three-year plunge in funding. Merger completions remained sluggish in the second quarter as did actual share repurchases. With gross new equity offerings still at a low level, net equity issuance remained firmly in negative territory in the second quarter.

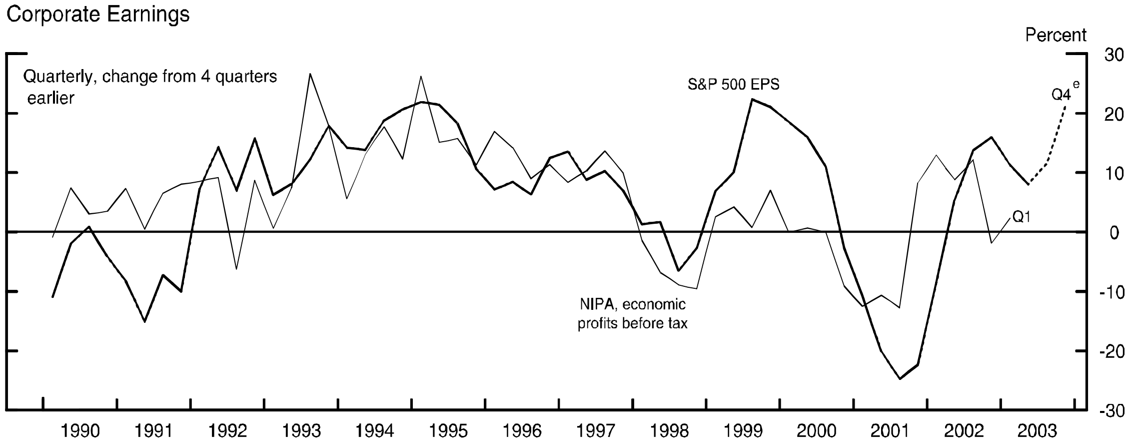
Focusing on the most recent trends, announcements of new merger deals rose appreciably over the intermeeting period. On the other hand, announcements of new share repurchase programs ground to a halt, perhaps because of the elimination of preferential tax treatment for share buybacks relative to dividends.

Corporate Earnings and Credit Quality

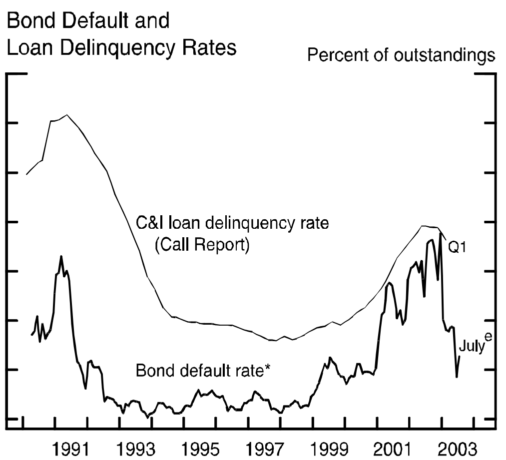
With about 400 of the S&P 500 firms reporting so far, second-quarter earnings have exceeded analysts' forecasts by a wide margin, leaving quarterly earnings up about 8 percent compared with a year earlier. Moreover, even though the forward-looking guidance in these reports was fairly limited, July was the third straight month with no downward revisions, on balance, to the year-ahead forecasts of S&P earnings; this pattern contrasts sharply with that of recent years. The financial sector has remained the standout performer, helped by

1. Under FASB's recent accounting guidance on special-purpose entities (FIN 46), domestic commercial banks are required to consolidate the assets and liabilities of certain special-purpose entities onto their balance sheets, unless these entities are restructured. The bulk of the consolidation to date was reflected in the bank credit data for the week of July 2, 2003.

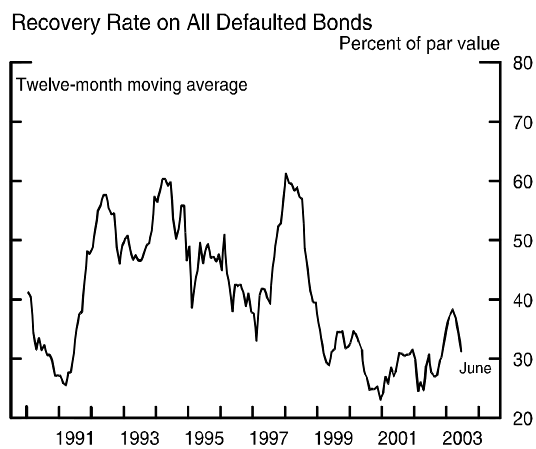
Corporate Credit Quality and Earnings



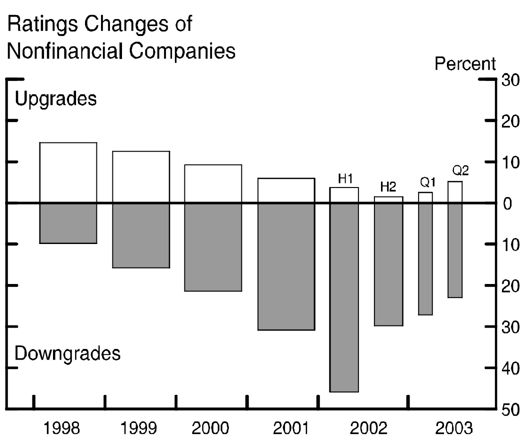
e Analysts' estimate as of July 24.
Source. I/B/E/S for S&P 500 EPS.



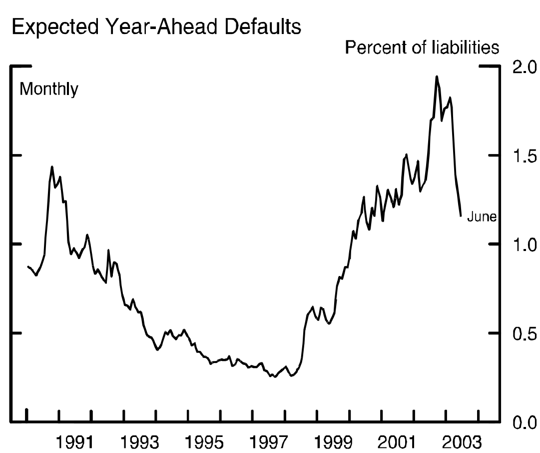
*6-month moving average, from Moody's Investors Service.



Note. Weighted-average market price at default.
Sources. Moody's Investors Service and Merrill Lynch.



Note. Data are at an annual rate. Debt upgrades and downgrades as a percentage of par value of all bonds outstanding.
Source. Moody's Investors Service.



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

mortgage refinancing activity, bond underwriting fees, and reduced credit losses. Outside of the financial sector, profit increases were achieved mainly through continued cost-cutting measures in the face of tepid revenue growth. Multinational industrial firms also have reported stronger-than-expected revenues and earnings, which were boosted in part by the weak dollar.

Measures of corporate credit quality, while still indicative of heightened stress, have continued to improve recently. The volume of bond ratings upgrades—a backward-looking indicator—increased modestly in the second quarter, while downgrades shrank further. Although the bond default rate ticked up in July, it has fallen substantially this year and has unwound the run-up that began in early 2001. The forecast of aggregate year-ahead defaults based on the KMV model continued its descent in June owing to higher equity prices and lower market volatility.

Commercial Real Estate

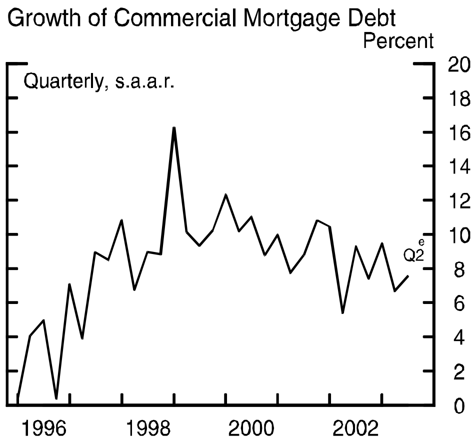
Commercial mortgage debt increased at an estimated 7.5 percent annual rate in the second quarter of this year. Focusing on the CMBS market—for which we have more timely data than for other types of commercial mortgage debt—gross issuance was strong in the second quarter. CMBS offerings have held up so far in the third quarter, even though yields on all grades of CMBS rose sharply over the intermeeting period, mirroring the rise in longer-term Treasuries. The most recent delinquency indicators suggest continued slow erosion, on net, in the credit quality of commercial mortgages, but delinquency rates remain far below the levels recorded in the early 1990s, and spreads of CMBS over swaps are still at the low end of their range in the past several years.

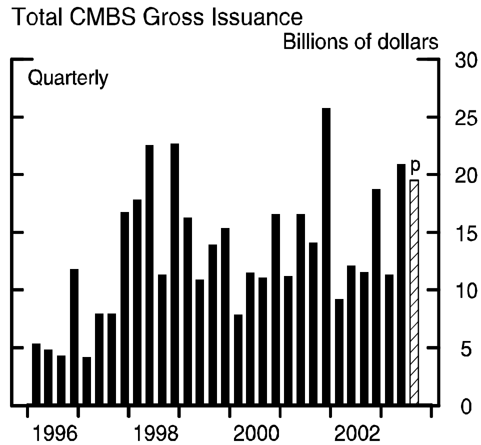
Household Finance

Rates on thirty-year fixed-rate mortgages have risen steeply from their mid-June lows. ARM rates also have increased over this period, although more modestly. With higher rates, new applications for refinancings dropped back significantly in July, but the estimated dollar volume of mortgage refinancings remained at a high level in July as earlier deals were completed. In the second quarter, home mortgage debt grew at an annual rate of about 10 percent, not quite as robust as the first quarter's 12 percent pace.

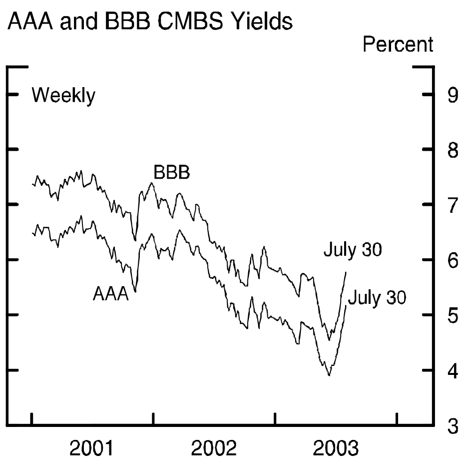
Consumer credit continued to expand at a moderate pace, growing about 5 percent (annual rate) in the second quarter. In recent months, captive auto finance companies continued to offer zero percent financing and cash-back incentives, and consumers responded by financing larger shares of their vehicle purchases and extending loan maturity. The average loan-to-value ratio of new car loans financed by these companies rose from 90 percent in January 2001 to a

Commercial Real Estate

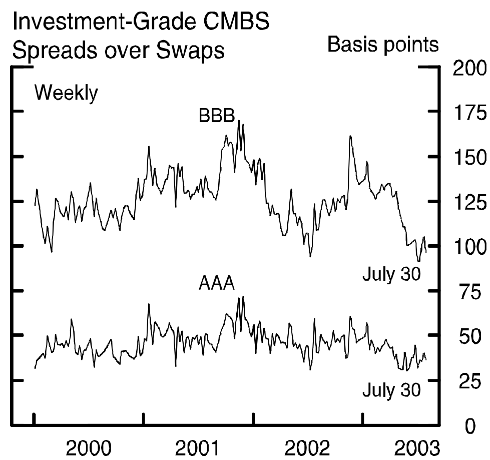




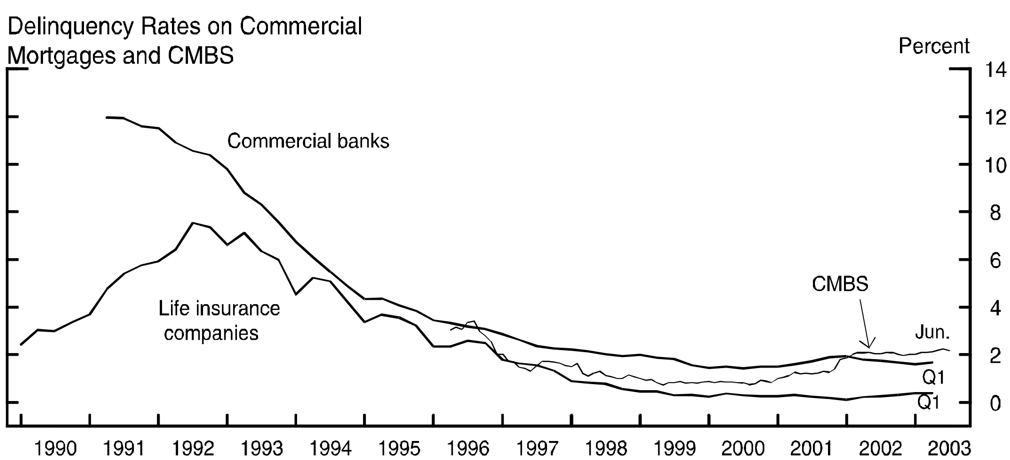
p Period to date.
Source. Commercial Mortgage Alert.



Source. Morgan Stanley.

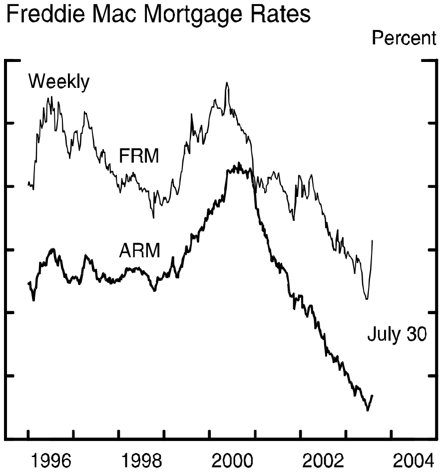


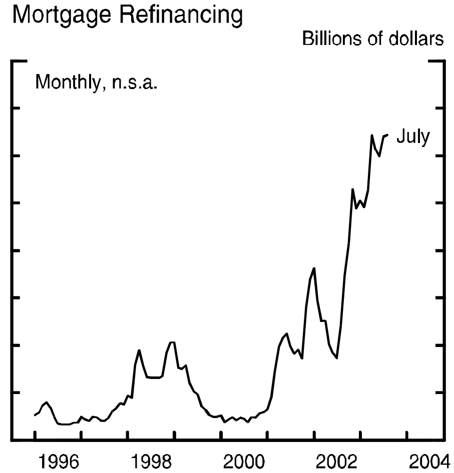
Source. Morgan Stanley.



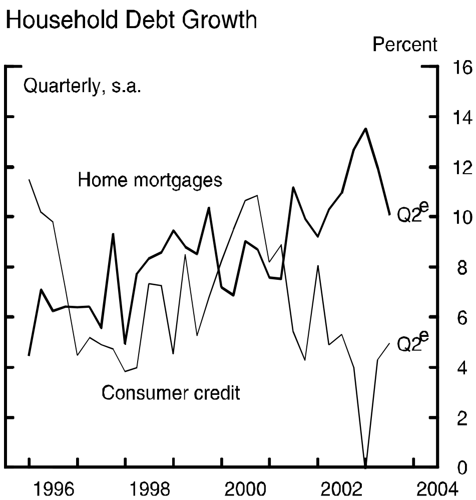
Source. Call Report, ACLI, Morgan Stanley.

Household Liabilities

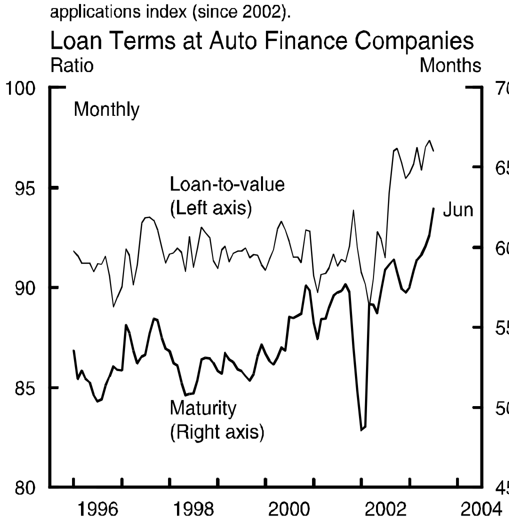




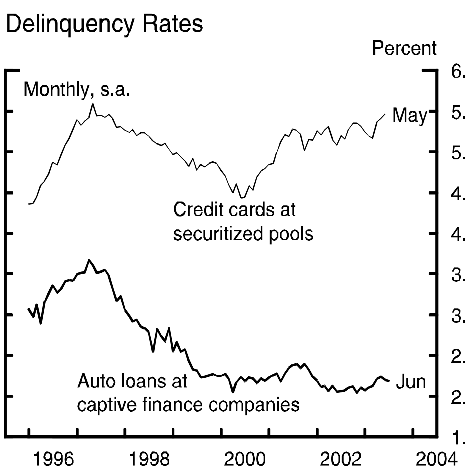
Source. Staff estimates based on Home Mortgage Disclosure Act records (1996-2002) and on the MBA applications index (since 2002).



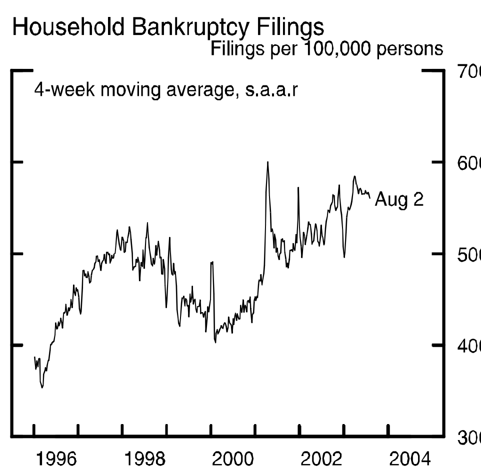
e Staff estimate.



Source. Federal Reserve.



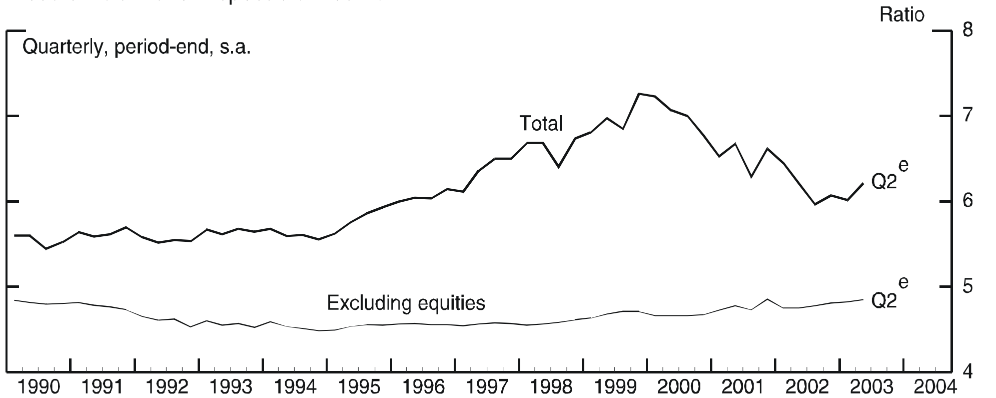
Source. Moody's, Federal Reserve.



Source. Visa Bankruptcy Notification Service Statistics.

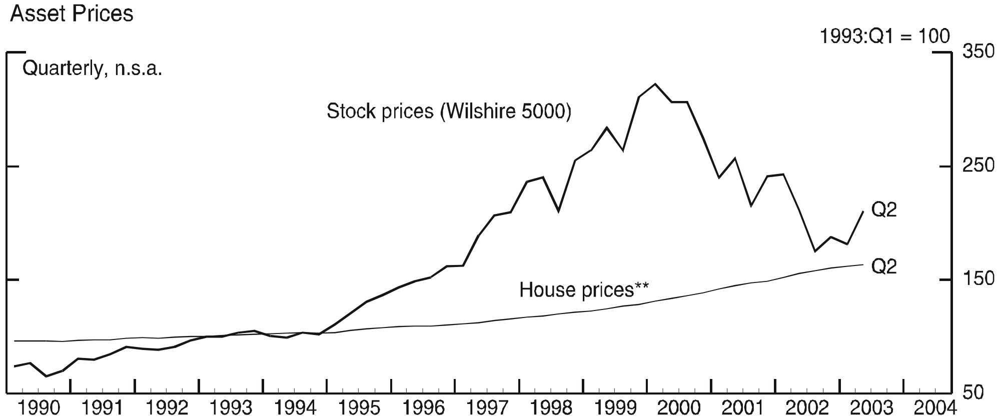
Household Assets

Assets Relative to Disposable Income



e Staff estimate.

Asset Prices



** From the Office of Federal Housing Enterprise Oversight.

Net Flows into Long-Term Mutual Funds

(Billions of dollars, monthly rate)

	2000	2001	2002		2003			Assets
			H1	H2	Q1	Q2	July e	June
Total long-term funds	**18.5**	**10.8**	**21.0**	**-0.5**	**11.2**	**27.1**	**14.4**	**4,653**
Equity funds	**25.2**	**2.8**	**9.1**	**-13.4**	**-3.9**	**15.6**	**17.9**	**3,031**
Domestic	21.3	4.6	7.9	-11.8	-3.6	14.3	17.2	2,633
International	3.9	-1.8	1.2	-1.6	-0.3	1.2	0.7	399
Hybrid funds	**-2.6**	**0.7**	**2.2**	**-0.7**	**0.7**	**3.3**	**3.3**	**373**
Bond funds	**-4.0**	**7.3**	**9.7**	**13.7**	**14.4**	**8.2**	**-6.8**	**1,248**
High-yield	-1.0	0.6	0.9	0.9	3.5	3.9	0.0	139
Other taxable	-1.8	5.7	7.6	11.4	10.3	4.0	-5.1	770
Municipals	-1.2	1.0	1.3	1.5	0.6	0.3	-1.7	340

Note. Excludes reinvested dividends.

Source. Investment Company Institute.

e Staff estimates based on confidential ICI weekly data.

record 97 percent in recent months, while the average maturity rose from fifty-four months to a record sixty-two months.

Consumer credit quality has held steady, on balance, with delinquencies at securitized pools of credit card receivables ticking up in May and those at auto finance companies edging down in June. However, some pockets of distress remain, as bankruptcy filings are still running above last year's levels.

Responses to the August Senior Loan Officer Survey suggest that banks' concerns about household credit quality have, if anything, diminished somewhat of late. According to the survey, the net fraction of banks that reported tightening standards on loans to households fell from its already low levels of the past few surveys, and small net fractions of financial institutions reported easing spreads on consumer loans.

The ratio of household assets to disposable income rose in the second quarter, reflecting the run-up in equity prices. In July, investors continued to put money into equity mutual funds. In contrast, bond funds—which suffered capital losses as rates rose—experienced outflows last month, particularly in the latter part of the month.

State and Local Government Finance

The pace of municipal bond issuance remained robust over the intermeeting period, as persistent fiscal pressures generated record levels of short-term borrowing and an increased reliance on long-term bond financing of capital projects. Nonetheless, municipal yields rose less than Treasuries, and muni-to-Treasury yield ratios retreated somewhat from recent highs.

With the exception of California, news about the credit quality of municipal issues has been generally positive since the last FOMC meeting. In California, budget problems and political uncertainty surrounding the upcoming recall election led S&P to downgrade $26.8 billion of the state's general-obligation debt in late July to just a bit above speculative grade. Apart from bonds issued by the State of California, the number of upgrades relative to downgrades increased substantially during the past few months, and the yield spread of BBB-rated over AAA-rated municipal bonds has edged off a little, though it remains elevated by historical standards.

Treasury and Agency Finance

The pace of federal borrowing remained brisk over the intermeeting period, and the Treasury boosted its estimate of federal funding needs over the third quarter. Failures to deliver securities in the Treasury market recently reached their highest level since the turmoil after September 11, 2001. In the market for

State and Local Government Finance

Gross Offerings of Municipal Securities

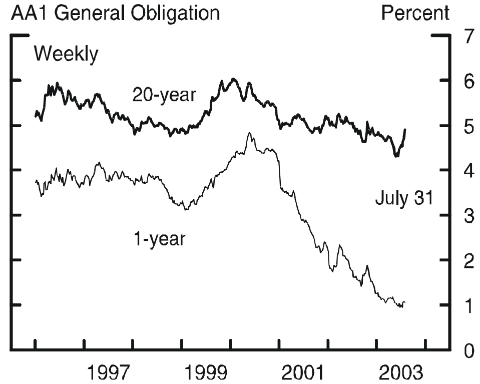
(Billions of dollars; monthly rate, not seasonally adjusted)

Type of security	2000	2001	2002	2003 Q1	2003 Q2	2003 July
Total	17.9	29.0	36.3	30.9	47.8	31.7
Long-term [1]	15.0	24.3	30.3	28.4	38.5	28.6
Refundings [2]	2.2	7.6	10.1	10.0	11.6	9.7
New capital	12.9	16.7	20.3	18.3	26.8	18.9
Short-term	2.8	4.7	6.0	2.6	9.3	3.1
Memo: Long-term taxable	0.7	1.4	1.7	1.8	5.9	1.4

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

Municipal Bond Yields

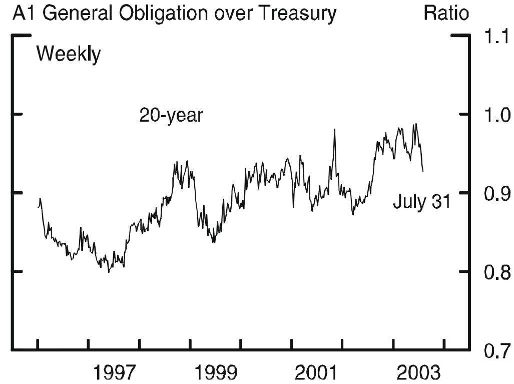
AA1 General Obligation — Percent



Source. Bloomberg.

Municipal Bond Ratios

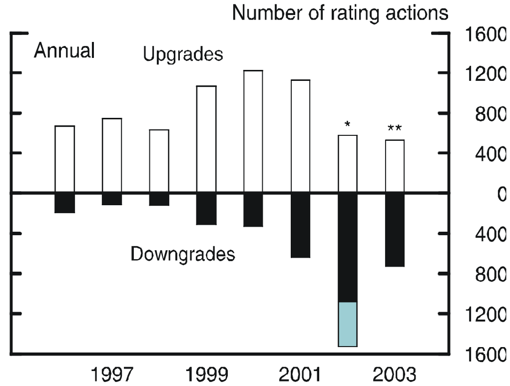
A1 General Obligation over Treasury — Ratio



Source. Bond Buyer.

Bond Rating Changes

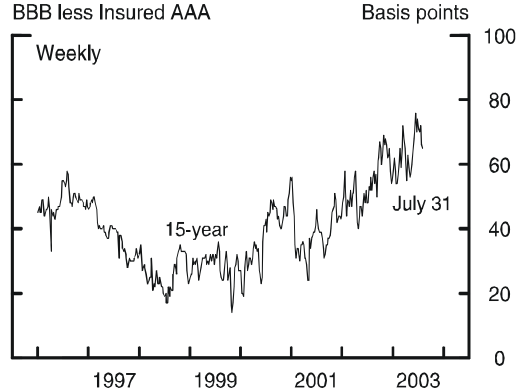
Number of rating actions



* Lightly shaded region shows a staff estimate of the number of downgrades related to downgrades of financial institutions that provided financial support for the bonds.
** Data through July 30 at an annual rate.
Source. S&P's Credit Week Municipal and Ratings Direct.

Revenue Bond Spread

BBB less Insured AAA — Basis points

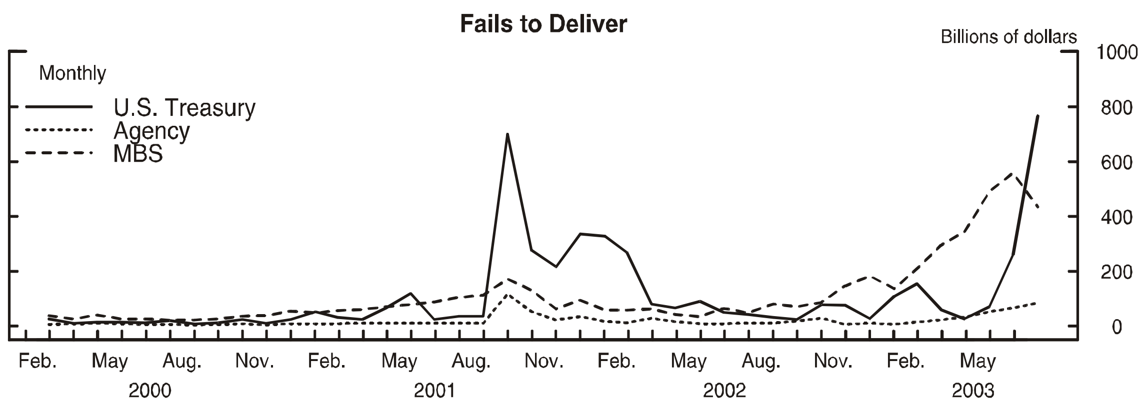


Source. Bloomberg.

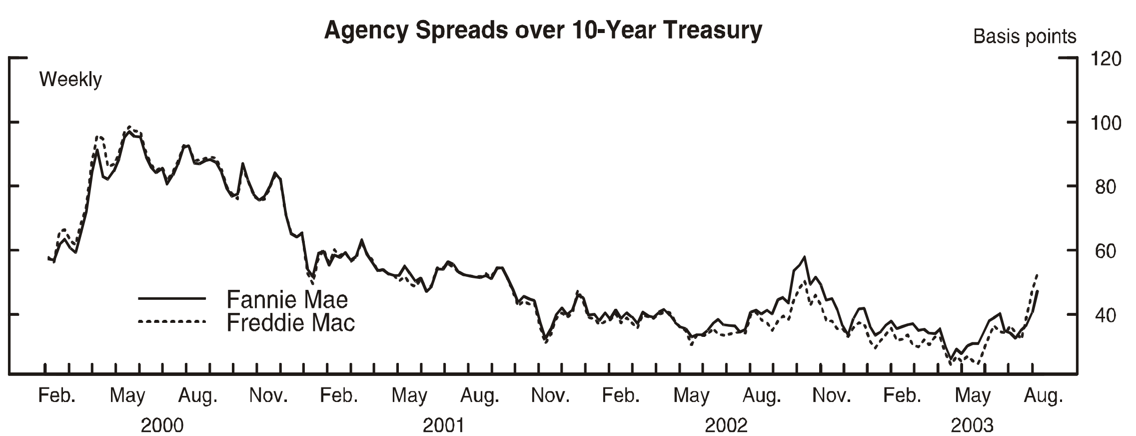
Treasury Financing
(Billions of dollars)

Item	2002	2003			
	Q4	Q1	Apr.	May	Jun.
Total surplus, deficit (−)	**-108.3**	**-143.9**	**51.0**	**-90.0**	**21.2**
Means of financing deficit					
Net borrowing	96.9	63.5	-8.7	73.8	41.2
Nonmarketable	14.9	-50.5	7.9	37.2	0.8
Marketable	82.0	114.0	-16.6	36.6	40.4
Bills	20.0	67.0	-25.0	-19.1	17.0
Coupons[1]	62.0	47.0	8.4	55.7	23.5
Debt buybacks	0.0	0.0	0.0	0.0	0.0
Decrease in cash balance	27.9	19.8	-15.2	20.9	-22.5
Other[2]	-16.4	60.6	-27.2	-4.7	-39.9
MEMO					
Cash balance, end of period	33.0	13.3	28.4	7.5	30.0

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.



July 2003 values calculated using data through July 23.



mortgage-backed instruments, fails have trended up since late last year. With interest rates at low levels, the cost of failing to deliver securities is modest, contributing to the high level of fails. In any case, market participants report that the elevated level of fails does not seem to have had much of an effect on liquidity in fixed-income markets.

Agency market participants continued to concentrate on management and accounting problems at Freddie Mac and on whether such problems could also affect Fannie Mae. Fannie and Freddie have not faced difficulties in issuing new securities; although liquidity in secondary markets for their debt is said to have deteriorated, the worsening was due in part to the volatility in general market conditions. Late in the intermeeting period, reports that foreign central banks were selling agency debt pushed risk spreads for Fannie and Freddie to the highest levels of the year. In addition, an internal investigation of Freddie Mac's problems released in the latter part of July raised concerns about the involvement of its current management in accounting deceits.

Money and Bank Credit

M2 continued to grow briskly in June and July. The strong growth seemed to arise in large part from the near-zero opportunity cost of holding money, the reduction in personal income tax withholdings that became effective in the middle of June, and a bulge in escrow accounts related to MBS prepayments. This growth was concentrated in liquid deposits, as the three-year runoff of small time deposits accelerated after the policy easing in June. Recent demand for currency has been weak, in part because of a large drop in demand from abroad.

Although M3 grew moderately in June, it surged in July owing to a jump in both institutional money funds and large time deposits. Institutional money funds swelled in response to the temporary widening of the spread between money fund yields and short-term market rates after the June monetary policy easing. Large time deposits were boosted dramatically in July by the consolidation of special-purpose entities onto bank balance sheets as required by the recently implemented FIN 46 accounting rule.[2] After removing the effects of FIN 46, M3 rose at a 10-3/4 percent pace in July, a rate just a bit above that of M2.

On a reported basis, bank credit expanded rapidly in June and July, reflecting accounting changes brought about by FIN 46; after correcting for these effects, we estimate that bank credit rose at about a 6-1/4 percent annual rate in June and

2. Our rough estimate is that FIN 46 has boosted banks' assets and liabilities by $77 billion thus far, with the liabilities reported almost entirely in the large-time-deposit component of M3.

Monetary Aggregates

(Based on seasonally adjusted data)

Aggregate or component	2002	2003 Q1	2003 Q2	2003 May	2003 June	2003 July (e)	Level ($ billions) July 03 (e)
Aggregate	Percent change (annual rate)[1]						
1. M2[2]	6.8	6.5	8.5	17.6	9.3	9.2	6,093
2. M3[3]	6.3	5.6	6.1	12.3	8.7	21.2	8,915
2a. Removing FIN 46 effects[4]						*10.7*	*8,838*
Components of M2[5]							
3. Currency	8.2	7.6	5.9	4.9	1.3	-.2	646
4. Liquid deposits[6]	16.4	14.3	17.6	29.4	20.2	23.1	3,717
5. Small time deposits	-9.0	-6.9	-8.2	-10.2	-11.2	-17.7	844
6. Retail money market funds	-6.0	-8.8	-7.7	7.7	-9.4	-15.5	878
Components of M3							
7. M3 minus M2[7]	5.4	3.6	.8	.8	7.4	48.2	2,823
8. Large time deposits, net[8]	3.0	-2.6	4.5	10.1	1.6	127.6	902
8a. Removing FIN 46 effects[4]						*14.3*	*825*
9. Institutional money market funds	2.2	-4.9	-14.7	-20.1	20.3	42.1	1,184
10. RPs	19.8	29.8	23.7	13.4	3.1	-53.9	485
11. Eurodollars	7.0	18.8	19.3	42.4	-22.9	23.3	252
Memo							
12. Monetary base	7.2	7.6	5.9	5.1	3.4	.5	703
	Average monthly change (billions of dollars)[8]						
Selected managed liabilities at commercial banks							
13. Large time deposits, gross	1.8	1.5	-4.4	8.8	-5.4	77.9	1,063
14. Net due to related foreign institutions	-3.2	6.8	-3.0	5.6	-21.4	8.2	132
15. U.S. government deposits at commercial banks	-1.0	-4.2	.7	-1.3	9.2	-.9	17

1. For the years shown, Q4 to Q4 percent change. For the quarters shown, based on quarterly averages.
2. Sum of currency, liquid deposits (demand, other checkable, savings), small time deposits, retail money market funds, and non-bank travelers checks.
3. Sum of M2, net large time deposits, institutional money market funds, RP liabilities of depository institutions, and eurodollars held by U.S. addressees.
4. Adjusted to remove estimated effects of consolidation related to FIN 46.
5. Non-bank travelers checks not listed.
6. Sum of demand deposits, other checkable deposits, and savings deposits.
7. Sum of large time deposits, institutional money market funds, RP liabilities of depository institutions, and eurodollars held by U.S. addressees.
8. Net of holdings of depository institutions, money market funds, U.S. government, and foreign banks and official institutions.
9. 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.

e Estimated.

Commercial Bank Credit

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

Type of credit	2002	Q1 2003	Q2[7] 2003	May 2003	June[7] 2003	July[p] 2003	Level, July 2003[p] ($ billions)
Total							
1. Adjusted[1]	**7.2**	**7.8**	**9.7**	**13.4**	**6.2**	**2.9**	**5,950**
2. Reported	7.3	8.3	10.8	19.8	10.3	7.1	6,215
Securities							
3. Adjusted[1]	13.9	13.2	16.0	17.6	8.1	-6.1	1,617
4. Reported	13.3	14.4	18.3	38.5	14.1	-27.3	1,814
5. Treasury and agency	20.1	18.5	29.1	34.2	16.8	-33.0	1,120
6. Other[2]	4.3	8.4	1.7	45.6	9.6	-18.0	695
Loans[3]							
7. Total	5.0	5.8	7.8	11.9	8.6	21.9	4,401
7a. Removing FIN 46 effects[4]			*7.4*		*5.4*	*6.3*	
8. Business	-6.9	-5.1	-8.4	-13.7	-18.2	2.5	924
8a. Removing FIN 46 effects[4]			*-8.8*		*-22.0*	*-16.3*	
9. Real estate	13.1	14.4	11.6	13.1	12.8	16.4	2,186
10. Home equity	36.6	28.1	28.1	18.4	32.2	16.7	248
11. Other	10.9	12.7	9.6	12.4	10.4	16.2	1,937
12. Consumer	5.5	2.7	-1.4	8.2	9.6	-.8	592
13. Adjusted[5]	4.1	6.6	2.9	12.7	5.8	.8	959
14. Other[6]	1.5	-2.6	29.5	51.1	33.3	88.8	700
14a. Removing FIN 46 effects[4]			*27.6*		*17.1*	*11.7*	

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), as well as the estimated effects of consolidation related to FIN 46.
2. Includes private mortgage-backed securities, securities of corporations, state and local governments, foreign governments, and any trading account assets that are not Treasury or agency securities, including revaluation gains on derivative contracts.
3. Excludes interbank loans.
4. Adjusted to remove estimated effects of consolidation related to FIN 46.
5. Includes an estimate of outstanding loans securitized by commercial banks.
6. Includes security loans and loans to farmers, state and local governments, and all others not elsewhere classified. Also includes lease financing receivables.
7. Banks implemented FIN 46 on July 1, but because of the staff's standard interpolation procedure for weekly bank credit series, this change also affected the levels and growth rates of bank credit and various components in June.

p Preliminary.

at about a 3 percent rate in July. Business loans were especially weak both months, possibly because of paydowns from heavy bond issuance.

Appendix

August 2003 Senior Loan Officer Opinion Survey

The August 2003 Senior Loan Officer Opinion Survey on Bank Lending Practices addressed changes in the supply of, and demand for, bank loans to businesses and households over the past three months. In addition, the survey contained a supplementary question on potential demand for commercial and industrial (C&I) loans, as well as special questions on measures taken by banks to support the returns on their business loans in response to declining net interest margins. This appendix is based on responses from fifty-six domestic and seventeen foreign banking institutions.

The net fraction of banking institutions reporting that they tightened lending standards on C&I loans over the past three months declined to very low levels in August. In addition, domestic banks reported having eased spreads on those loans, on net, for the first time since 1998. Banks that eased terms reported that they had done so in response to increased competition from nonbank lenders, which is consistent with reports of increased institutional involvement in the syndicated loan market. Demand for C&I loans weakened further over the past three months in large part because of decreased investment in plant and equipment. However, banks reported a small increase, on net, in inquiries regarding new financing. More than half the respondents reported having used higher upfront fees to support returns on C&I loans, and some banks indicated that they had made limited use of interest rate floors for the same purpose.

The net fractions of banks reporting that they tightened standards on loans to households fell from their moderate levels of the past few surveys. Moreover, small net fractions of financial institutions reported having eased spreads on consumer loans. Compared with the two previous surveys, significantly larger net fractions of banks in the August survey reported increased demand both for home mortgages and for consumer loans.

Lending to Businesses
In the August survey, the net percentage of domestic banks that reported having tightened standards on C&I loans to large and middle-market firms over the past three months fell further, to 2 percent, from 9 percent in the April survey. Similarly, a significantly smaller net fraction of domestic banks reported having tightened standards to small firms. On net, lending standards at branches and agencies of foreign banks were unchanged in August, whereas in April, 33 percent of those institutions, on net, had reported having tightened.

In addition, markedly fewer domestic banks indicated that they had tightened terms on C&I loans, and some terms were eased, on net. Indeed, for the first time since the market turmoil of 1998, small net fractions of domestic banks reported having reduced spreads of loan rates over cost of funds for borrowers of all sizes. On net, banks reported that the costs of credit lines to large and middle-market borrowers were about unchanged, compared with 18 percent that indicated tightening in the previous survey; however, a notable net fraction of respondents have continued to reduce the size of those lines. Despite the narrowing of risk spreads in secondary markets, a significant net fraction of domestic banks continued to report having increased premiums charged on riskier loans to borrowers of all sizes. Similarly, the net fraction of foreign banks reporting that they tightened lending terms was smaller in the August survey than in the April survey, although the fraction that reduced the size of credit lines and charged higher premiums on riskier loans remained elevated.

Sixty-four percent of the domestic banks that tightened lending standards and terms indicated concern about the economic outlook as an important reason for doing so, down from more than 90 percent in April. In addition, somewhat fewer banks than in April indicated that industry-specific problems were a reason for tightening. Despite reduced fractions of banks expressing concern about the economic outlook and industry-specific problems, and in contrast to an apparent decline in risk aversion by other classes of investors, banks continued to reduce their tolerance for risk. Indeed, about 75 percent of domestic banks that tightened standards and terms on C&I loans cited a lower tolerance for risk, making it the most commonly reported reason. By contrast, almost all of the foreign institutions that tightened standards and terms remained concerned about the economic outlook and industry-specific problems while also reporting a reduced tolerance for risk.

Domestic banks, on net, continued to report that demand from large and middle-market firms had weakened over the past three months, but that fraction declined noticeably from almost 40 percent in April to about 20 percent in the current survey. Similarly, a somewhat smaller net fraction of banks reported weaker demand from small firms. For banks that reported weaker demand, the most important reason continued to be decreased investment in plant and equipment by their customers. Banks that experienced increased demand cited numerous reasons for the rise. In contrast to the experience of domestic banks, the same number of foreign institutions reported that demand had weakened as reported that it had increased. In response to a special question about the prospective demand for C&I loans, both domestic respondents and branches and agencies of foreign banks indicated that, on net, the number of inquiries from potential borrowers had risen somewhat over the past three months.

With interest rates having recently reached historically low levels, banks have been reporting downward pressure on their net interest margins. More than 60 percent of foreign and domestic banks said that increased fees charged on credit lines have been important in supporting the return on business lending. About 40 percent of domestic banks and a few foreign banks reported that they had increased their use of interest rate floors; however, most banks reported that fewer than 5 percent of their C&I loans had interest rate floors. Moreover, of the sixteen domestic banks that stated that a material fraction of their C&I loans were subject to an interest rate floor, half of those banks indicated that the floors were binding on less than 40 percent of those loans. The vast majority of respondents reported that they had not increased the average maturity or the risk profile of their C&I loan portfolio to support their net interest margins.

Commercial real estate lending. The net fraction of domestic banks that reported tightening standards on commercial real estate loans fell to 12 percent, a level near the bottom of its recent range. Only one foreign institution reported having tightened standards in August. Demand for commercial real estate loans continued to erode; in the August survey, 9 percent of domestic banks, on net, reported a decline in demand, down from 29 percent in April. At foreign banks, demand was also weaker.

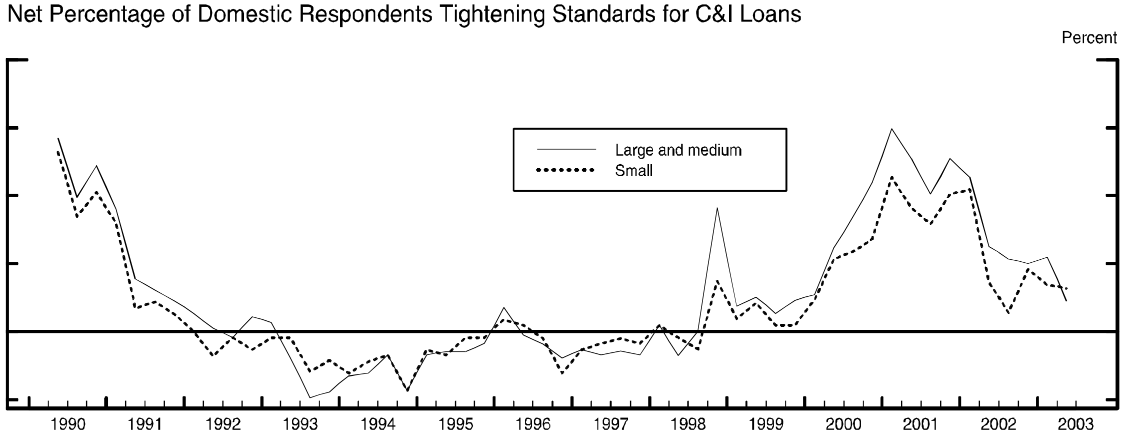
Lending to Households

The net share of banks that reported stronger demand for residential mortgage loans increased for the second consecutive survey, to about 45 percent, compared with 17 percent in April and 8 percent in January. Three banks said that demand was substantially stronger during the past three months. Concurrently, the net fraction of banks that reported having tightened standards on residential mortgages fell from 12 percent in January to 6 percent in April to 2 percent in the current survey.

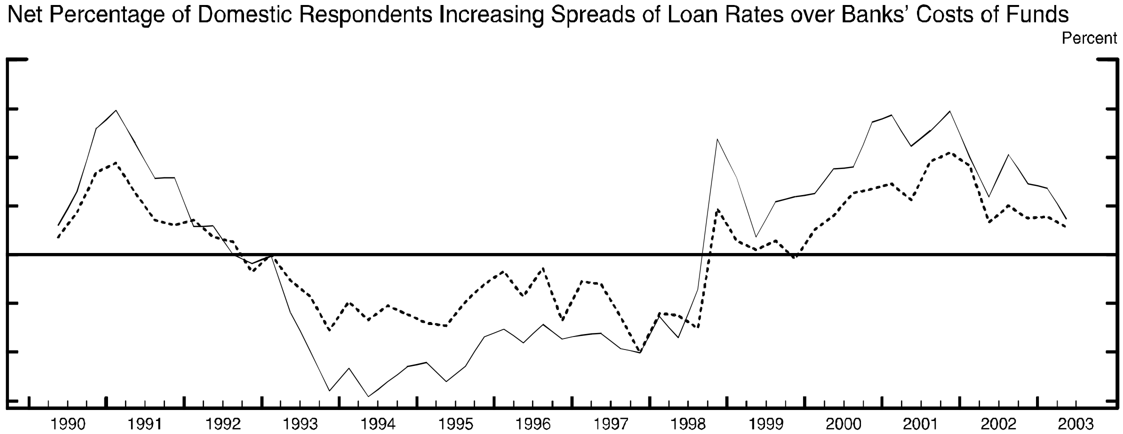
A significantly larger net fraction of banks indicated that they were more willing to make consumer loans in the current survey than had been the case since 1999. Consistent with this report, no banks tightened standards on credit card loans, while small fractions of banks again reported having eased spreads and reduced the required minimum monthly payments on these loans. Six percent of banks, on net, tightened standards for consumer loans other than credit cards, down from 12 percent in April. In addition, a few banks, on net, reported that they had narrowed spreads and had extended maturities on these loans. Reported demand for consumer loans jumped in the current survey; about 30 percent of respondents, on net, indicated an increase in demand, compared with a small reported net decrease in demand during the previous survey period.

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

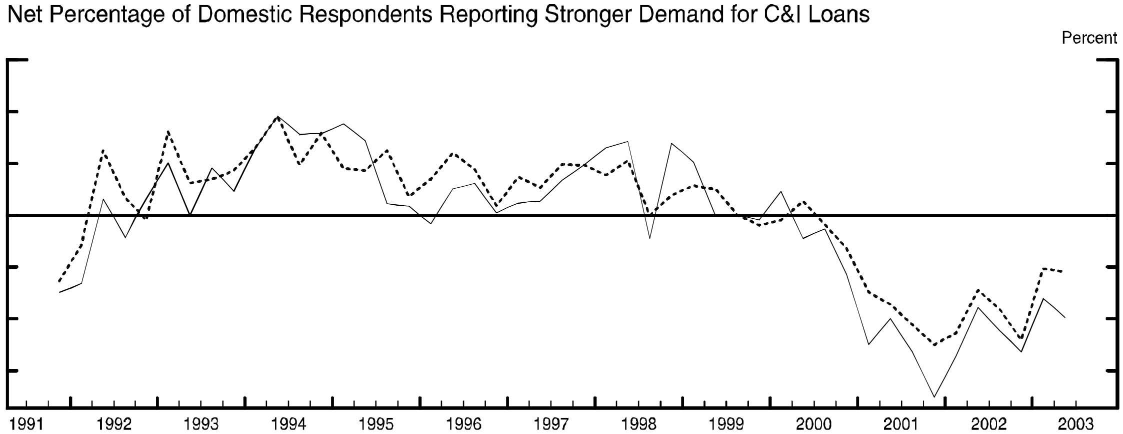
Net Percentage of Domestic Respondents Tightening Standards for C&I Loans



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

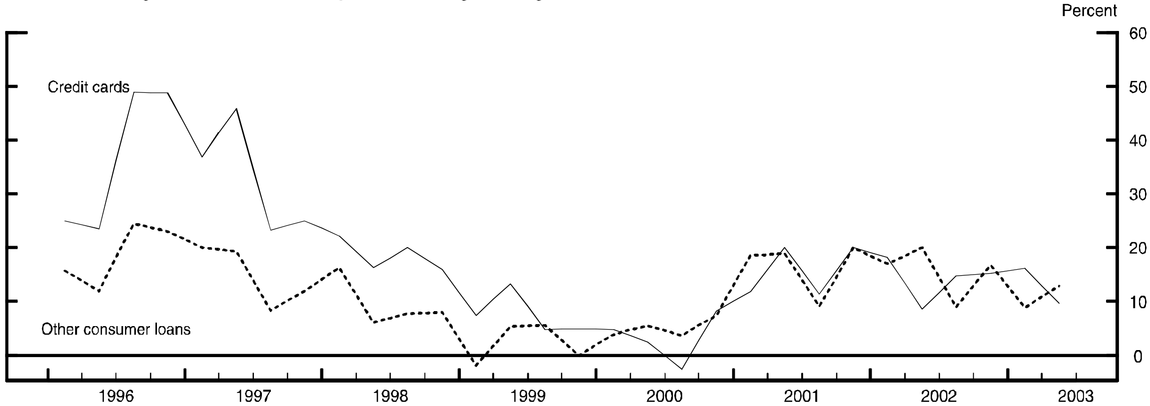


Net Percentage of Domestic Respondents Reporting Stronger Demand for C&I Loans

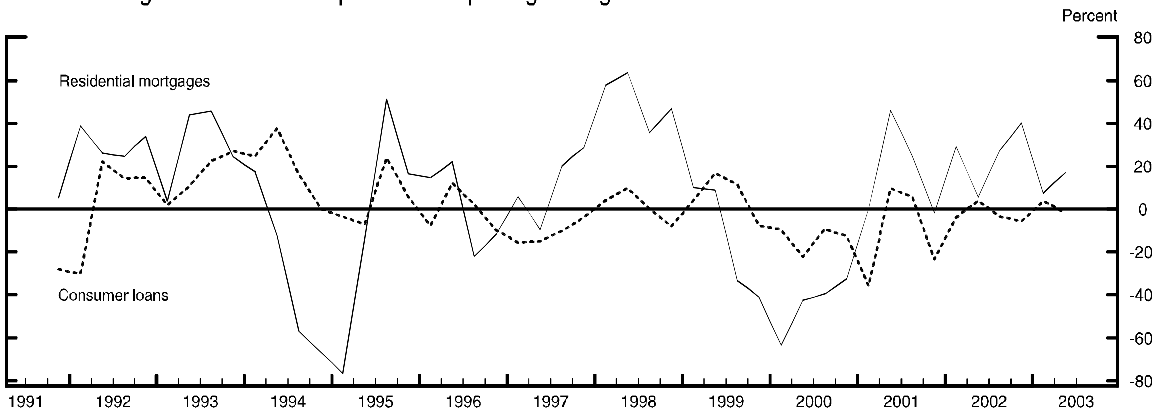


Measures of Supply and Demand for Loans to Households

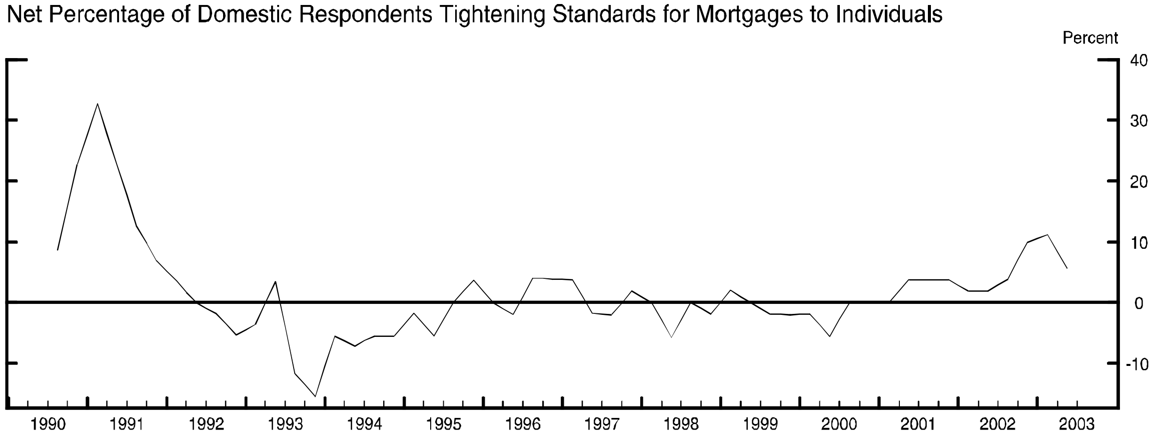
Net Percentage of Domestic Respondents Tightening Standards on Consumer Loans



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



Net Percentage of Domestic Respondents Tightening Standards for Mortgages to Individuals



International Developments

International Developments

U.S. International Transactions

Trade in Goods and Services

The U.S. international trade deficit in May was $41.8 billion, $0.2 billion larger than in April (revised), as imports of goods and services increased slightly more than exports. For April-May, on average, the deficit was $501 billion at an annual rate, $15 billion larger than in the first quarter.

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

	2002	Annual rate 2002 Q4	2003 Q1	2003 Q2e	Monthly rate 2003 Mar.	2003 Apr.	2003 May
Real NIPA[1]							
Net exports of G&S	-488.5	-532.2	-510.3	-553.6	...	...	...
Nominal BOP							
Net exports of G&S	-418.0	-464.5	-486.4	-500.9	-42.9	-41.6	-41.8
Goods, net	-482.9	-529.0	-544.1	-558.8	-47.5	-46.4	-46.8
Services, net	64.8	64.5	57.7	57.9	4.6	4.7	4.9

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

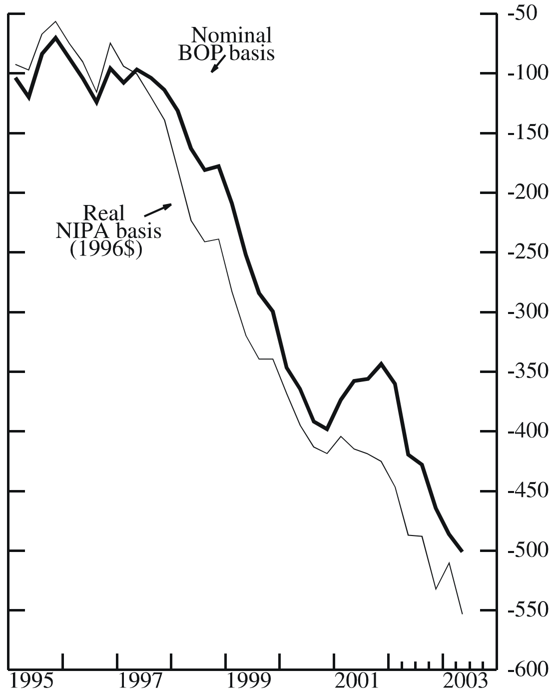
Following a decline in April, exports of goods and services rose 0.9 percent in May, with both the value of exported goods and the value of services receipts rising. The largest movements in goods were increases in capital goods (machinery) and automotive products. These increases were partly offset by declines in the value of exported agricultural products, industrial supplies, and aircraft. For April-May combined, the level of goods exports was 2½ percent (a.r.) lower than in the first quarter. Large decreases in capital goods accounted for most of the decline. Services receipts for April-May combined were down 9 percent relative to the first quarter, reflecting a falloff in travel-related services.

Imports of goods and services rose 0.7 percent in May, with both the value of imported goods and the value of services payments rising. The largest increases in goods were in capital goods (machinery), automotive products, and industrial supplies. These increases were partially offset by decreases in imported petroleum. For April-May combined, the level of nominal goods imports was nearly 3½ percent (a.r.) higher than in the first quarter, boosted by increases in capital goods (mainly machinery), consumer goods, and, to a lesser extent, automotive products. Imports of petroleum declined, entirely reflecting lower oil prices. Services payments in April-May on average dropped 11½ percent (a.r.) relative to the first quarter, largely from reduced travel.

U.S. International Trade in Goods and Services

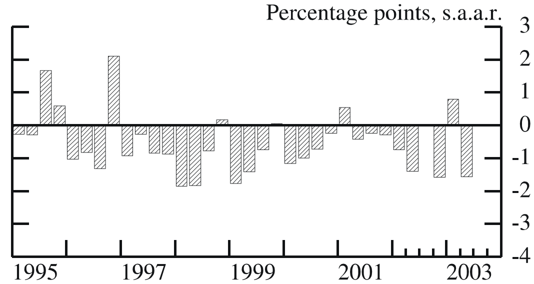
Net Exports

Bil$, s.a.a.r.

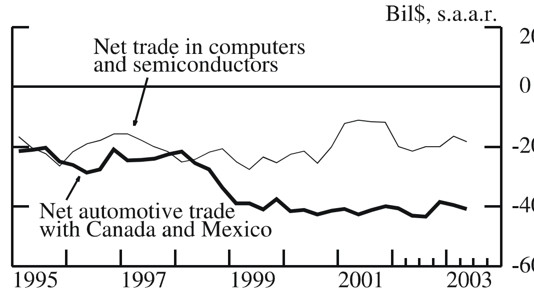


Contribution of Net Exports to Real GDP Growth

Percentage points, s.a.a.r.

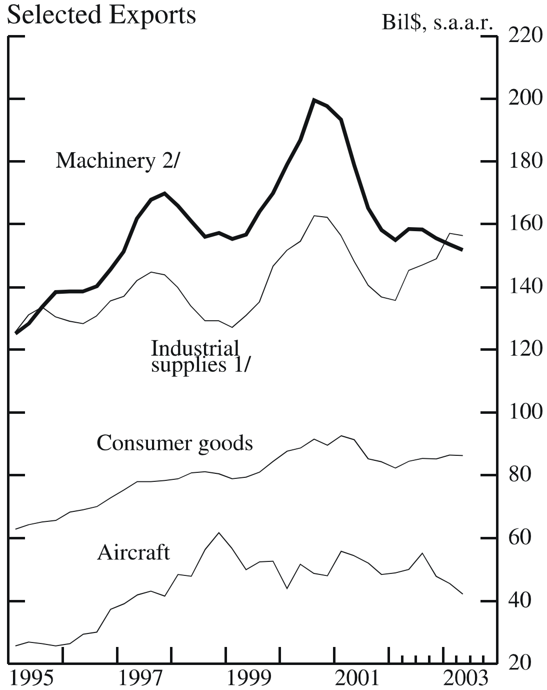


Bil$, s.a.a.r.



Selected Exports

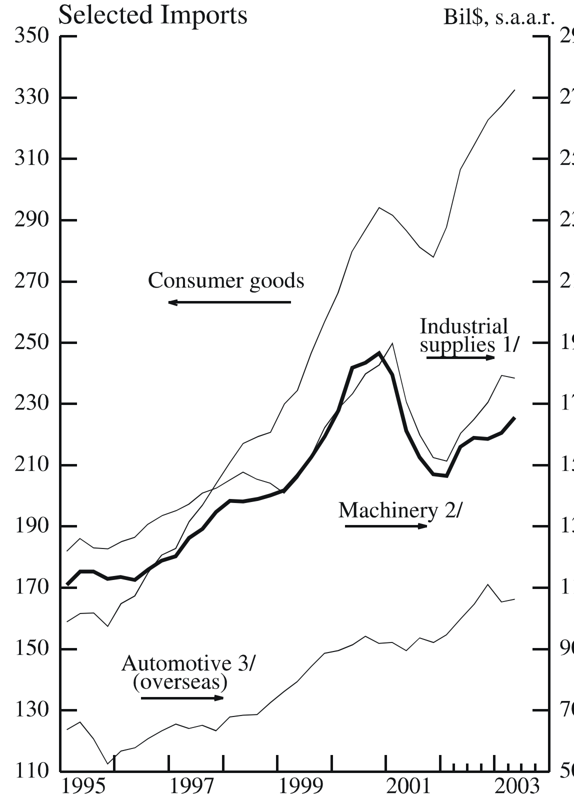
Bil$, s.a.a.r.



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

Selected Imports

Bil$, s.a.a.r.



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]			
	2003		2003		2003		2003	
	Q1	Q2e	Apr.	May	Q1	Q2e	Apr.	May
Exports of G&S	**991.8**	**980.3**	**976.0**	**984.6**	**7.2**	**-11.5**	**-18.1**	**8.6**
Goods exports	693.4	688.9	686.8	691.0	10.0	-4.5	-12.8	4.2
Gold	3.8	4.5	3.9	5.2	-0.1	0.8	0.7	1.4
Other goods	689.6	684.3	682.9	685.8	10.1	51.6	-13.5	2.9
Aircraft & parts	45.6	42.1	42.6	41.6	-2.3	-3.5	-0.2	-1.0
Computers & accessories	38.4	36.4	36.1	36.7	-0.5	-2.0	-2.1	0.6
Semiconductors	42.8	45.2	44.9	45.5	2.4	2.4	-0.3	0.6
Other capital goods	156.2	154.3	152.7	156.0	-2.0	-1.9	-5.0	3.2
Automotive	79.8	80.4	79.7	81.1	1.3	0.6	-0.3	1.4
to Canada	46.7	45.6	44.5	46.8	1.7	-1.1	-0.9	2.3
to Mexico	13.1	14.5	14.1	15.0	-1.7	1.4	-0.0	0.9
to ROW	20.0	20.2	21.1	19.3	1.3	0.2	0.6	-1.8
Agricultural	56.9	56.9	57.2	56.7	2.0	0.0	-0.0	-0.4
Ind supplies (ex. ag, gold)	157.1	156.4	156.7	156.1	8.2	-0.7	-3.8	-0.6
Consumer goods	86.5	86.2	86.0	86.3	1.3	-0.3	-1.6	0.3
All other goods	26.3	26.4	27.0	25.8	-0.3	0.1	-3.4	-1.3
Services exports	298.4	291.4	289.2	293.6	-2.9	-7.0	-5.3	4.4
Imports of G&S	**1478.1**	**1481.2**	**1475.7**	**1486.6**	**29.1**	**3.1**	**-32.8**	**10.9**
Goods imports	1237.5	1247.7	1243.1	1252.3	25.1	10.2	-26.6	9.3
Petroleum	135.9	129.7	135.3	124.1	18.4	-6.2	-14.8	-11.3
Gold	2.4	3.2	2.9	3.6	-0.6	0.9	0.8	0.7
Other goods	1099.1	1114.7	1104.8	1124.7	7.3	15.6	-12.6	19.8
Aircraft & parts	23.5	23.4	23.1	23.8	-2.8	-0.1	1.0	0.6
Computers & accessories	73.2	75.3	74.9	75.7	-1.3	2.1	5.4	0.9
Semiconductors	24.5	24.6	24.5	24.7	-0.3	0.1	-0.2	0.2
Other capital goods	162.5	168.1	166.4	169.8	2.4	5.6	4.0	3.4
Automotive	204.6	207.3	202.5	212.0	-4.8	2.7	-5.5	9.5
from Canada	59.2	58.4	57.0	59.7	1.8	-0.8	-3.2	2.7
from Mexico	40.1	42.6	41.1	44.1	-0.7	2.5	-2.6	3.0
from ROW	105.3	106.3	104.4	108.2	-5.9	1.0	0.3	3.9
Ind supplies (ex. oil, gold)	179.3	178.4	175.3	181.5	9.0	-0.9	-13.4	6.1
Consumer goods	327.3	332.4	332.2	332.7	4.7	5.1	-3.9	0.5
Foods, feeds, bev.	54.3	55.6	56.1	55.2	2.4	1.3	0.5	-0.9
All other goods	49.9	49.6	49.9	49.3	-1.9	-0.3	-0.3	-0.5
Services imports	240.7	233.5	232.7	234.3	3.9	-7.2	-6.3	1.7
Memo:								
Oil quantity (mb/d)	12.11	13.45	13.50	13.39	-0.38	1.36	0.65	-0.11
Oil import price ($/bbl)	30.74	26.40	27.44	25.36	4.98	-4.37	-4.54	-2.08

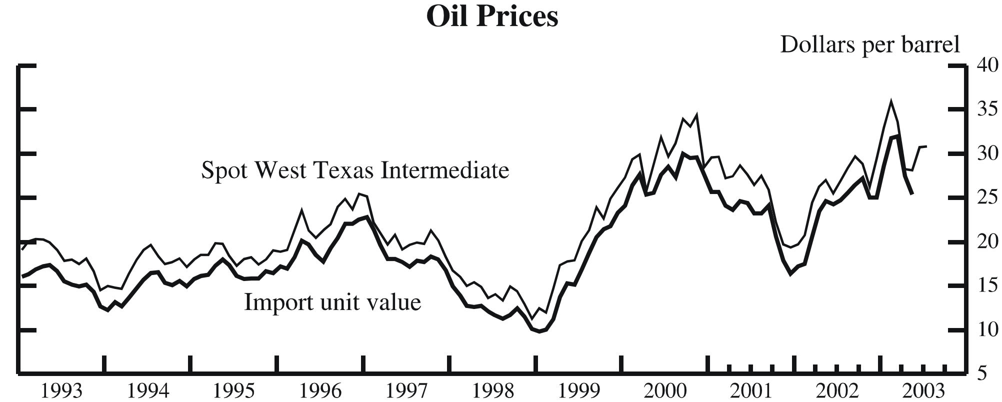
1. Change from previous quarter or month. e. Average of two months.
Source: U.S. Department of Commerce, Bureaus of Economic Analysis and Census.

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

	Annual rates			Monthly rates		
	2002	2003		2003		
	Q4	Q1	Q2	Apr.	May	June
	------------- BLS prices (2000 weights)-------------					
Merchandise imports	0.7	13.5	-9.6	-3.1	-0.8	0.8
Oil	3.8	133.7	-55.3	-18.7	-5.4	4.7
Non-oil	0.4	3.9	-1.1	-1.0	-0.3	0.5
Core goods*	1.5	5.3	-0.5	-1.2	-0.2	0.6
Cap. goods ex comp & semi	-0.8	2.1	1.7	0.0	0.0	0.6
Automotive products	1.2	-0.4	0.8	0.0	0.1	0.2
Consumer goods	-0.7	-0.3	0.1	0.0	0.0	0.2
Foods, feeds, beverages	9.3	7.1	0.5	-0.1	-1.1	0.4
Industrial supplies ex oil	5.8	25.3	-5.3	-5.3	-0.6	1.4
Computers	-9.3	-5.7	-7.2	-0.2	-1.0	-0.6
Semiconductors	-4.6	-4.0	-2.3	0.7	-1.4	0.0
Merchandise exports	0.7	2.7	0.9	-0.1	0.1	-0.2
Core goods*	1.3	3.6	1.4	-0.1	0.1	0.2
Cap. goods ex comp & semi	0.5	0.9	0.3	0.0	0.1	0.1
Automotive products	1.3	0.7	0.3	0.1	-0.1	0.2
Consumer goods	0.4	-0.1	0.8	-0.1	0.1	0.4
Agricultural products	8.2	0.2	5.9	0.4	2.6	-0.8
Industrial supples ex ag	1.5	12.4	3.3	-0.5	-0.6	0.4
Computers	-5.8	3.1	-0.2	-0.1	0.1	-0.7
Semiconductors	-2.8	-5.8	-5.7	0.1	-0.2	-4.3
Chain price index	---Prices in the NIPA accounts (1996 weights)---					
Imports of goods & services	0.9	11.7	-3.9	...	...	...
Non-oil merchandise	0.7	4.6	-0.9	...	...	...
Core goods*	1.5	5.5	-0.3	...	...	...
Exports of goods & services	0.9	3.9	1.2	...	...	...
Total merchandise	0.9	3.4	1.6	...	...	...
Core goods*	1.7	4.6	2.2	...	...	...

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

Oil Prices



Prices of Internationally Traded Goods

Non-oil imports. In June, the price of imported non-oil goods rose 0.5 percent. Prices of imported computers continued to move lower, whereas prices of semiconductors were unchanged. The price of imported non-oil core goods rose 0.6 percent, led by increases in the prices of industrial supplies (primarily natural gas and unfinished metals). Import prices in other major trade categories increased modestly. In the second quarter, the NIPA price index for core goods declined a percent (a.r), after rising more than 5 percent in the first quarter. The swing in core import price inflation from the first to second quarter primarily reflects the spike in natural gas prices that occurred in the first quarter. Prices for machinery (excluding computers and semiconductors) offset some of the second quarter decline as they rose 1½ percent (a.r.). For the first half of the year, prices of imported non-oil core goods rose 2½ percent (a.r.), up from about 1½ percent (a.r.) in the second half of 2002.

Oil. The BLS price of imported oil rose 4.7 percent in June following a revised 5.4 percent fall in May, ending three consecutive months of declining oil prices. The spot price of West Texas Intermediate (WTI) crude oil also rose in June, averaging $30.72 per barrel, about $2.50 per barrel more than in May. In July, the average spot price was $30.76 per barrel, and spot WTI closed at $32.23 per barrel on August 5. Prices have remained relatively elevated owing to a slower return of Iraqi exports than the market anticipated at the conclusion of the war, strong Japanese oil demand resulting from the temporary shutdown of nuclear reactors, and low oil inventories in the OECD, particularly in the United States.

Exports. In June, the price of exported goods fell slightly as declines in prices of computers and semiconductors more than offset a small rise in exported core goods. Within core goods, a fall in the price of exported agricultural products was outweighed by modest increases in all other major trade categories. For the second quarter, the NIPA price index of exported core goods rose about 2 percent (a.r.), driven largely by higher prices for agricultural products and industrial supplies. Prices for machinery (excluding computers and semiconductors) offset some of the second quarter increase as they declined ½ percent (a.r.).

U.S. International Financial Transactions

Portfolio inflows into the United States were huge in May, with record foreign official inflows of $50 billion (line 1 of the Summary of U.S. International Transactions table) and record private foreign inflows into U.S. securities totaling $73 billion (line 4). Through May, year-to-date foreign official inflows

($86 billion) and private inflows into U.S. securities ($181 billion) were both on record paces.[1]

The private inflows into U.S. securities in May were comparable in magnitude to recent *quarterly* amounts. Private demand for corporate bonds continued at the exceptionally strong pace of recent months and net purchases of Treasury securities and agency bonds surged. Net purchases of U.S. equities were modest, but the largest amount since last July. U.S. net purchases of foreign securities (line 5) were near zero in May, as substantial sales of foreign bonds by U.S. investors were offset by purchases of foreign equities.

About half of the foreign official inflows in May was associated with Japanese exchange market intervention. Official inflows from China, Russia, and Norway were also quite large. Data from custody accounts at the Federal Reserve Bank of New York show a large increase in official holdings in June that was undone in July;

.

Net capital flows through the banking sector (line 3) amounted to an outflow of $15 billion in May, bringing net banking inflows to $2 billion for the year. TIC data for June will be reported in the Greenbook Supplement.

1. It should be noted that $21 billion of this year's private purchases of U.S. securities are attributed to China; given China's severe restrictions on outward portfolio investment, recorded inflows from China's private sector are likely made by public entities not included in the official sector.

Summary of U.S. International Transactions

(Billions of dollars, not seasonally adjusted except as noted)

	2001	2002	2002 Q2	2002 Q3	2002 Q4	2003 Q1	2003 Apr.	2003 May
Official financial flows	**2.4**	**87.0**	**46.7**	**7.5**	**28.2**	**38.0**	**-1.3**	**50.0**
1. Change in foreign official assets in the U.S. (increase, +)	7.3	90.7	48.5	8.9	29.0	38.0	-1.5	50.0
a. G-10 countries	-7.9	30.2	17.6	1.8	6.0	26.7	-1.4	24.8
b. OPEC countries	-1.2	-9.4	.9	-1.4	.7	-7.5	-1.6	2.0
c. All other countries	16.4	69.8	30.1	8.4	22.4	18.8	1.6	23.2
2. Change in U.S. official reserve assets (decrease, +)	-4.9	-3.7	-1.8	-1.4	-.8	.1	.2	.0
Private financial flows	**413.2**	**441.0**	**46.0**	**163.7**	**124.4**	**74.7**	**...**	**...**
Banks								
3. Change in net foreign positions of banking offices in the U.S.[1]	-5.9	98.7	-26.3	65.7	52.6	-25.9	43.2	-15.2
Securities[2]								
4. Foreign net purchases of U.S. securities (+)	398.1	398.1	119.4	104.9	81.4	70.8	37.5	72.9
a. Treasury securities	-7.4	101.8	14.5	57.9	13.6	14.5	9.5	23.0
b. Agency bonds	81.8	78.0	33.0	21.8	15.4	-2.1	3.0	15.9
c. Corporate and municipal bonds	201.8	160.3	60.0	17.2	39.9	60.4	20.6	27.5
d. Corporate stocks[3]	121.8	58.1	11.9	8.0	12.6	-2.1	4.4	6.5
5. U.S. net acquisitions (-) of foreign securities	-85.1	15.3	-5.9	21.4	-5.5	-27.3	-1.1	.8
a. Bonds	24.6	33.5	13.5	8.8	7.5	7.3	-2.1	12.8
b. Stock purchases	-62.7	-14.9	-19.4	14.0	-13.0	-19.9	1.0	-11.9
c. Stock swaps[3]	-47.0	-3.2	.0	-1.4	.0	-14.7	.0	.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	5.5	-12.5	-13.4	5.0	55.3	...	...
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.

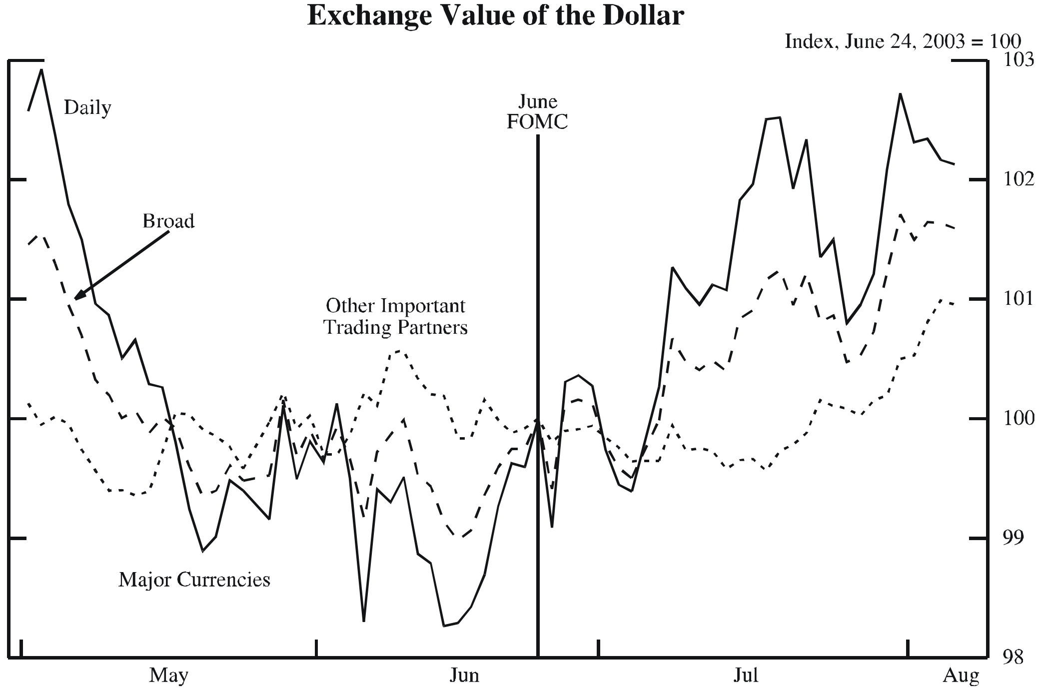
Foreign Exchange Markets

The exchange value of the dollar, as measured by the major currencies index, rose 2 percent over the intermeeting period, interrupting a weakening trend that has been in place for more than a year. The dollar appreciated against all seven currencies in the major currencies index, as long-term interest rate differentials moved sharply in favor of dollar-denominated assets.

The sharpest gains occurred against the British pound and the Canadian dollar amid unexpected policy easing in these two countries. The Bank of England lowered rates 25 basis points on July 10, a move which it justified by signs of slowing domestic and external demand. The sterling interest rate futures curve is currently positively sloped over the whole term structure, suggesting that market participants no longer expect further rate cuts from the Bank of England. The Bank of Canada cut its target for the overnight rate 25 basis points on July 15, citing a decline in inflation, weaker economic activity, and damping effects of the recent strength of the Canadian dollar. Economic data showing a deceleration in prices reinforced expectations for additional rate cuts, and another 25 basis points of easing by year-end is currently priced in.

The dollar strengthened 2 percent against the yen over the intermeeting period amid several days of yen sales for dollars by Japan's Ministry of Finance.

Exchange Value of the Dollar



Comments by Treasury Secretary Snow early in the period, which were interpreted as indicating that the U.S. administration would not object to Japanese intervention, reportedly also weighed on the yen's exchange value. Market participants' estimates of relatively heavy intervention were confirmed by Ministry of Finance data, showing it purchased $17.2 billion in July. Sales of yen so far this year exceed $75 billion (equivalent), eclipsing the previous yearly record, set in 1999.

Comments by Treasury Secretary Snow, urging a widening of the renminbi's trading band against the dollar, gave further impetus to market discussion of the sustainability of U.S. external financing needs. Japan's and China's foreign currency reserves reached $550 and $340 billion, respectively, by the end of June, with this year's accumulation being especially rapid. Separately, the ECB's recommendation in mid-July that the national central banks of the euro area reduce their holdings of U.S. agency debt – to which some market observers attributed a widening in agency spreads over Treasuries – highlighted potential implications of asset allocation decisions by foreign central banks for U.S. interest rates. Market participants noted that Federal Reserve data showed a slowing pace of foreign central bank purchases of Treasury and agency securities in July. However, this development may merely be a result of the higher exchange value of the dollar.

Longer-dated government debt yields of the major foreign economies rose less sharply over the intermeeting period than comparable U.S. Treasury yields; while the yield on the benchmark ten-year Treasury soared more than 100 basis points, yields rose 45 to 70 basis points in Europe and Britain and 30 basis points in Japan. The FOMC's 25 basis point ease in June was less than some had expected and suggested a reduced likelihood of unconventional monetary easing measures. In mid-July, Chairman Greenspan's monetary policy testimony was widely viewed as optimistic toward the U.S. growth outlook. While government bond yields in other industrial countries followed Treasury yields higher over the intermeeting period, hedging-induced selling of Treasuries by mortgage-industry firms appeared to exacerbate the rise in U.S. yields relative to European yields. Nevertheless, European yields were relatively volatile over the intermeeting period. The 10-year German government debt yield rose from a low of 3.47 percent in mid-June to a high of 4.28 percent on August 1. Yields implied by euro and sterling interest rate futures also rose sharply on balance, to levels above those that prevailed at the time of the May FOMC meeting. By the end of the period there was no further monetary easing priced in for the European Central Bank or the Bank of England. Movements in Japanese government bond yields over the intermeeting period were also quite volatile, with the 10-year JGB yield briefly reaching an intra day high of 140 basis points on July 4, after having fallen as low as 42 basis points in mid-June.

Financial Indicators in Major Industrial Countries

Country	Three-month rate: Aug. 6 (Percent)	Three-month rate: Percentage Point Change	Ten-year yield: Aug. 6 (Percent)	Ten-year yield: Percentage Point Change	Equities: Percent Change
Canada	2.94	-.19	4.95	.67	2.24
Japan	.08	.00	.92	.29	4.50
Euro area	2.14	-.01	4.17	.49	1.47
United Kingdom	3.40	-.13	4.52	.45	1.28
Switzerland	.20	-.01	2.59	.17	4.11
Australia	4.80	.19	5.51	.76	2.75
United States	1.08	.15	4.40	1.11	-2.05
Memo: Weighted-average foreign	1.86	-.07	3.95	.51	n.a.

NOTE. Change is from June 24 to August 6 (10 a.m. EDT).
n.a. Not available.

Global equity indices rose, boosted by second quarter U.S. corporate earnings and profit reports which came in above expectations on balance. Many European companies still report earnings at a lower frequency and slower pace than U.S. companies, and foreign equity market developments therefore have been partly driven by news from industry leaders domiciled in the United States. In Europe, industry groups that suffered the greatest losses earlier in the year, such as insurance and technology, have benefitted the most from the recent rally. Major Japanese indices rose sharply in late June and early July, as Japanese government bond prices fell, but have since retraced much of these moves. Nevertheless, the Nikkei index rose the most of industrial countries, at 4.5 percent. Japanese Ministry of Finance data showed that foreign investors accounted for the largest share of net Japanese equity purchases over the period.

The performance of emerging market equity indices was mixed. Most emerging Asian indices rose sharply while Latin American indices were little changed to modestly lower. Share prices of large exporter companies outperformed, reportedly boosted by expectations for a rebound in global demand. Broad market indices in Korea, Taiwan, and Thailand gained between 6 and 9 percent.

The dollar strengthened 1 percent against the currencies of our other important trading partners. Toward the end of the period, investor losses associated with the volatility of interest rate markets in industrial countries reportedly prompted some market participants to reduce their risk taking and scale back their emerging market positions. Most Latin American sovereign bond spreads over Treasuries were little changed on net over the period. However, Brazilian and Argentine assets generally underperformed. The Brazilian *real* weakened

Financial Indicators in Latin America, Asia, and Russia

	Currency/ US dollar		Short-term Interest rates[1]		Dollar-denominated bond spread[2]		Equity prices
Economy	Aug. 6	Percent Change	Aug.5/6 (Percent)	Percentage Point Change	Aug.5/6 (Percent)	Percentage Point Change	Percent Change
Mexico	10.73	1.86	3.96	-.84	2.55	.19	1.92
Brazil	3.02	5.70	23.65	-1.85	8.56	1.01	-.25
Argentina	2.93	5.60	n.a.	n.a.	50.19	4.14	-6.60
Chile	711.50	1.27	2.92	.00	3.63	-1.13	6.13
China	8.28	.00	n.a.	n.a.	2.34	.15	-1.73
Korea	1185.00	-.67	4.02	-.58	...	...	6.61
Taiwan	34.38	-.64	1.19	-.18	...	...	6.45
Singapore	1.76	1.27	.75	.25	...	...	3.27
Hong Kong	7.80	.01	1.13	.11	...	...	3.72
Malaysia	3.80	-.01	3.00	.00	2.43	-.03	5.92
Thailand	42.06	1.25	1.25	-.50	1.00	.11	8.83
Indonesia	8590.00	4.63	9.39	-.63	2.55	-.65	-1.15
Philippines	54.69	2.51	6.56	-.56	4.36	.01	-.04
Russia	30.29	-.06	n.a.	n.a.	3.13	.28	-5.86

NOTE. Change is from June 24 to August 5/6.
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.
n.a. Not available. ... Not applicable.

5¾ percent against the dollar over the period in part in response to policy easing by Brazil's central bank. An escalation of terrorist activities in Indonesia weighed on the rupiah, which depreciated 4½ percent against the dollar.

In other monetary policy actions, the Norwegian central bank lowered its policy interest rate 100 basis points and Sweden's Riksbank reduced its target rate 25 basis points. The central bank of Taiwan and the Hong Kong Monetary Authority also cut policy rates by 25 basis points. In contrast, the Reserve Bank of Australia surprised markets by leaving policy unchanged, while consensus market expectations had been for policy easing.

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

Developments in Foreign Industrial Countries

Recent data generally show that second-quarter growth was weak, and indications for improvement in the current quarter are mixed. Canadian growth in the second quarter was hit by the SARS outbreak and the discovery of mad cow disease, but a rebound in employment in June suggests that the slowdown may have been temporary. The economies of Japan and the euro area appear to have remained stagnant in the second quarter, with external trade exerting a drag on growth. Whereas a weakening of consumer spending was the biggest concern in Japan, the dormant manufacturing sector was the most negative factor in the euro area. The United Kingdom was a relatively bright spot, with a moderate rebound in GDP growth in the second quarter and indications of continued recovery.

Twelve-month rates of consumer price inflation have continued to edge lower, reflecting both declines in oil prices and local currency appreciations. Canadian headline inflation fell to near 2½ percent in June, and euro-area inflation dipped back below 2 percent in July. U.K. inflation edged lower but remained just above the 2½ percent target. In Japan, deflation continued.

In **Japan**, indicators for the second quarter suggest that economic activity remained sluggish. Industrial production fell in June, and the average for the second quarter was 0.6 percent below the first-quarter average. The broader all-industry index fell about 0.2 percent in April and May on average relative to the first-quarter average. Consumption indicators were weak in the second quarter. Household expenditures rose slightly. New car registrations dropped about 7 percent during the second quarter but rose marginally in July. In contrast, indicators of investment have been more positive. Core machinery orders, a leading indicator of business fixed investment, rose 1.5 percent in April and May on average from the first-quarter average. Non-residential building starts rose 7 percent in June, for a gain of 1.4 percent in the second quarter. External trade has continued to be a drag on the Japanese economy: real exports declined 1.3 percent in the second quarter from the first, while imports rose about 2 percent.

The Bank of Japan's Tankan index of business conditions held steady in June, with the level of the aggregate diffusion index for business sentiment among firms of all sizes and across all industries remaining at its March level of -26. Survey respondents project a slight improvement in the index for September. Sentiment among large manufacturers improved from -10 in March to -5 in June, which some interpreted as a positive sign for business prospects. Other survey indicators are generally consistent with economic sluggishness. There was only a modest decline in the number of manufacturing firms that see "excess supply" for their products versus those that see "excess demand." Indicators of excessive inventory levels for small and large manufacturers rose slightly, as did the indicator of excessive employment levels for firms of all sizes and across all industries.

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

Indicator	2002	2003					
	Q4	Q1	Q2	Apr.	May	Jun.	July
Industrial production[1]	.4	.4	-.6	-1.5	2.6	-1.2	n.a.
All-industries index	-.3	.7	n.a.	-.6	.2	n.a.	n.a.
Housing starts	1.7	.7	4.3	5.6	.6	8.7	n.a.
Machinery orders[2]	-.1	5.8	n.a.	-1.8	6.5	n.a.	n.a.
Machinery shipments[3]	2.3	.2	1.4	1.2	3.6	-1	n.a.
New car registrations	-.6	1.5	-6.6	-11.2	11.2	-6	.8
Unemployment rate[4]	5.4	5.4	5.4	5.4	5.4	5.3	n.a.
Job offers ratio[5]	.57	.60	.61	.60	.61	.61	n.a.
Business sentiment[6]	-28	-26	-26	...	...	...	...
CPI (Core, Tokyo area)[7]	-.7	-.7	-.4	-.4	-.4	-.4	-.4
Wholesale prices[7]	-1.3	-.9	-1	-.8	-1	-1	n.a.

1. Mining and manufacturing.
2. Private sector, excluding ships and electric power.
3. Excluding ships and railway vehicles.
4. Percent.
5. Level of indicator.
6. Tankan survey, diffusion index.
7. Percent change from year earlier, n.s.a.

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

Japanese labor market conditions remain unfavorable amid continued deflation. The unemployment rate fell slightly to 5.3 percent in June, only a bit below the record-high 5.5 percent rate in January. The job-offers-to-applicants ratio, a leading indicator of employment, held steady in June. Core consumer goods prices in the Tokyo area (which exclude fresh food but include energy) rose slightly in July from the previous month, but were down 0.4 percent from a year earlier. Wholesale prices for domestic goods fell 1 percent in June from a year earlier.

On July 28, the Bank of Japan launched its program to purchase securities backed by the assets of small and medium-sized enterprises (SMEs). Consideration of such an initiative was originally announced on April 8; the program's aim is to improve financing opportunities for SMEs and to help Japan's nascent asset-backed securities market.

In the **euro area,** recent data suggest that the economy barely grew in the second quarter, as in the previous quarter. Euro-area industrial production in April and May on average was 0.5 percent below the first quarter average, and German industrial orders fell nearly 2 percent in the second quarter despite a rebound in June. German firms reported a particularly large drop in foreign orders, consistent with continued weakness in exports owing in part to past appreciation of the euro.

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

Indicator	2002	2003					
	Q4	Q1	Q2	Apr.	May	Jun.	July
Industrial production[1]	.0	.0	n.a.	.4	-.9	n.a.	n.a.
Retail sales volume[2]	-.4	.7	n.a.	1.5	-.6	n.a.	n.a.
Unemployment rate[3]	8.6	8.7	8.9	8.8	8.9	8.9	n.a.
Consumer confidence[4]	-14	-19.3	-19.3	-19	-20	-19	-18
Industrial confidence[4]	-10	-11.3	-12.7	-12	-13	-13	-15
Mfg. orders, Germany	.3	.0	-1.9	1.5	-2.6	2.3	n.a.
CPI[5]	2.3	2.3	2	2.1	1.9	2	1.9
Producer prices[5]	1.3	2.4	1.5	1.7	1.4	1.4	n.a.
M3[5]	6.9	8	8.3	8.7	8.5	8.3	n.a.

1. Excludes construction.
2. Excludes motor vehicles.
3. Percent. Euro area standardized to ILO definition. Includes Eurostat estimates in some cases.
4. Diffusion index based on European Commission surveys in individual countries.
5. Eurostat harmonized definition. Percent change from year earlier.
n.a. Not available.

Survey measures of economic sentiment have been mixed. Consumer sentiment has improved somewhat following its sharp decline late last year and early this year, and sentiment in the services sector (particularly in retail trade) also has improved. In contrast, sentiment in the manufacturing sector has been mixed. The euro-area purchasing managers' index for manufacturing rose in July for the first time since February, but the European Commission's measure of industrial confidence declined to its lowest level in a year and a half. The bellwether German IFO survey measure of business sentiment rose for the third straight month in July. However, all of the IFO's rise owed to an improvement in expectations of conditions over the next six months; firms' assessment of current conditions was about the same in July as it had been in April.

Euro-area twelve-month consumer price inflation ticked back below the ECB's 2 percent target ceiling in July, according to the flash estimate. Excluding energy and unprocessed food, inflation was 2.0 percent in June. Labor market conditions remained a moderately negative factor for the euro-area economy, with the unemployment rate holding steady at a 3½ year high of 8.9 percent in July and survey data showing that consumers remain very concerned about employment prospects.

The German government announced that it will bring forward into 2004 tax cuts that had been scheduled for 2005, in an attempt to jump-start the stagnant German economy. Partially-offsetting increases in indirect taxes and reductions in spending are expected to reduce the stimulus of the tax cuts to about 0.5 percent of GDP in 2004 . Although German authorities still assert a strong commitment to meeting the 3 percent deficit criteria required by the Stability and Growth Pact, the move represents a departure from previous German attempts to toe the line on fiscal deficits and significantly reduces the probability of meeting the limit in 2004.

In the **United Kingdom**, preliminary second-quarter real GDP growth rose modestly, recovering from a weak first quarter. Manufacturing output was unchanged, while overall production in the second quarter ticked up in part because of a sizable increase in electricity generation in June. Growth remained at 1.5 percent (s.a.a.r.) in the service sector with strong gains in the distribution, hotels and catering sectors.

Limited indicators for the third quarter suggest continued recovery. The long-downtrodden manufacturing sector is showing signs of firming. July's purchasing managers index (PMI) for manufacturing indicates expansion for the first time since November 2002, and business confidence edged up in July. Consumers look to be heading back to the stores. Although consumer confidence has remained flat since rising in April, the services PMI has trended up and the leading survey of retail sales suggests further improvement from already buoyant June sales.

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

Indicator	2002	2003					
	Q4	Q1	Q2	Apr.	May	Jun.	July
Real GDP*	2	.4	1.2	...	...	...	...
Industrial production	-.9	-.4	.1	.3	-.1	.7	n.a.
Retail sales volume[1]	1.6	.0	1.4	.4	-.1	2	n.a.
Unemployment rate[2]							
Claims-based	3.1	3.1	3.1	3.1	3.1	3.1	n.a.
Labor force survey[3]	5.1	5.1	n.a.	5	n.a.	n.a.	n.a.
Business confidence[4]	3	-1.3	-6.3	-10	-3	-6	-4
Consumer confidence[5]	-3	-10	-6.7	-8	-6	-6	-6
Retail prices[6]	2.6	2.9	2.9	3	2.9	2.8	n.a.
Producer input prices[7]	1.4	4.9	1.4	.8	1.4	1.9	n.a.
Average earnings[7]	3.7	3.4	n.a.	2.6	3.1	n.a.	n.a.

* Preliminary. s.a.a.r.
1. Excludes motor vehicles.
2. Percent
3. Three-month average centered on month shown.
4. Percentage of firms expecting output to increase in the next four months less percentage expecting output to decrease.
5. Average of the percentage balance from consumers' expectations of their financial situation, general economic situation, unemployment, and savings over the next 12 months.
6. Excluding mortgage interest payments. Percent change from year earlier.
7. Percent change from year earlier.
... Not applicable. n.a. Not available.

The trend in housing price growth is slowing. Housing prices rose 17.9 percent in the twelve months ending in July, down from 19.3 percent in June, and the slowest twelve-month increase since May 2002. In the second quarter, housing prices fell in London, but held up or even accelerated in most other regions of the country. Net mortgage lending and consumer credit ramped up in June, to their highest levels since the series began in April 1993. Mortgage equity withdrawals rose to 7.3 percent of net income in the first quarter.

The labor market continues to be tight as both the official claims-based and the labor force survey measures of the unemployment rate remain near record lows. The twelve-month rate of retail price inflation (excluding mortgage interest payments) ticked down in June but remained above the Bank of England's

2½ percent target. The harmonized index of consumer prices (HICP) rose 1.1 percent in the twelve months ending in June.

On July 10, the Bank of England's Monetary Policy Committee (MPC) cut the official repo rate 25 basis points to 3.5 percent. This cut was the first change in the rate since February 6 of this year and brought the repo rate to its lowest level in 48 years. In its statement, the MPC noted that it was concerned about sluggish conditions in the world economy and that "slower consumer demand and subdued private investment have so far offset the impact of higher public spending." Furthermore, the MPC noted that inflation would likely be dampened somewhat by the recent rebound of the sterling exchange rate.

In **Canada**, real GDP by industry rose 1.8 percent (s.a.a.r.) in May, rebounding from a 3.2 percent decline in April. Growth was supported by a large increase in retailing and wholesaling activity, particularly in regard to motor vehicles. Manufacturing remained weak, as the strong Canadian dollar hampered production in the wood and pulp industries and the discovery of mad cow disease in late May precipitated a large decline in meat-processing activity. Activity in travel-related industries continued to be restrained by the April outbreak of SARS in Toronto.

Recent indicators suggest that growth was weak in the second quarter but that the quarter ended on an upswing. Employment grew slightly over the quarter, as robust growth in June more than offset earlier SARS-related declines in April and May. Housing starts decreased in the second quarter, but remained high by historical standards. Commercial and industrial construction increased in the second quarter, breaking a string of declines that stretched back to mid-2001. A recent survey of investment intentions reported that businesses and government expect to increase capital spending on plant and equipment by 3.9 percent in 2003. Exports, however, were weak in April and May, hurt by both the strong Canadian dollar and a wide-scale ban on the importation of Canadian beef following the discovery of mad cow disease in May.

In June, the twelve-month rate of headline CPI inflation declined to 2.6 percent from 2.9 percent in May. The twelve-month rate had reached 4.6 percent in February, far above the Bank of Canada’s 1 to 3 percent target band, but has declined rapidly on lower energy prices and the leveling off of a recent dramatic rise in auto insurance premiums. Twelve-month core inflation, excluding food, energy prices, and indirect taxes, also moved down in June. Citing the recent rapid decrease in inflation and weaker-than-expected economic activity, the Bank of Canada cut the overnight rate, its key policy rate, 25 basis points on July 15 to 3 percent.

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

Indicator	2002	2003					
	Q4	Q1	Q2	Mar.	Apr.	May	Jun.
GDP by industry	.4	.6	n.a.	.0	-.3	.1	n.a.
Industrial production	-.3	.1	n.a.	-.2	-.8	-.3	n.a.
New mfg. orders	-2.5	1.8	n.a.	1.5	-4.9	-2.5	n.a.
Retail sales	.8	1.8	n.a.	-.7	-.8	.3	n.a.
Employment	.8	.5	.1	.1	-.1	-.1	.3
Unemployment rate[1]	7.5	7.4	7.7	7.3	7.5	7.8	7.7
Consumer prices[2]	3.8	4.5	2.8	4.3	3	2.9	2.6
Core Consumer Prices[2,3]	3	3.2	2.4	3.1	2.7	2.5	2
Consumer attitudes[4]	121.8	114.3	n.a	...	...	...	...
Business confidence[4]	136	131.4	n.a	...	...	...	...

1. Percent.
2. Percent change from year earlier, n.s.a.
3. Excluding food, energy, and indirect taxes.
4. Level of index, 1991 = 100.

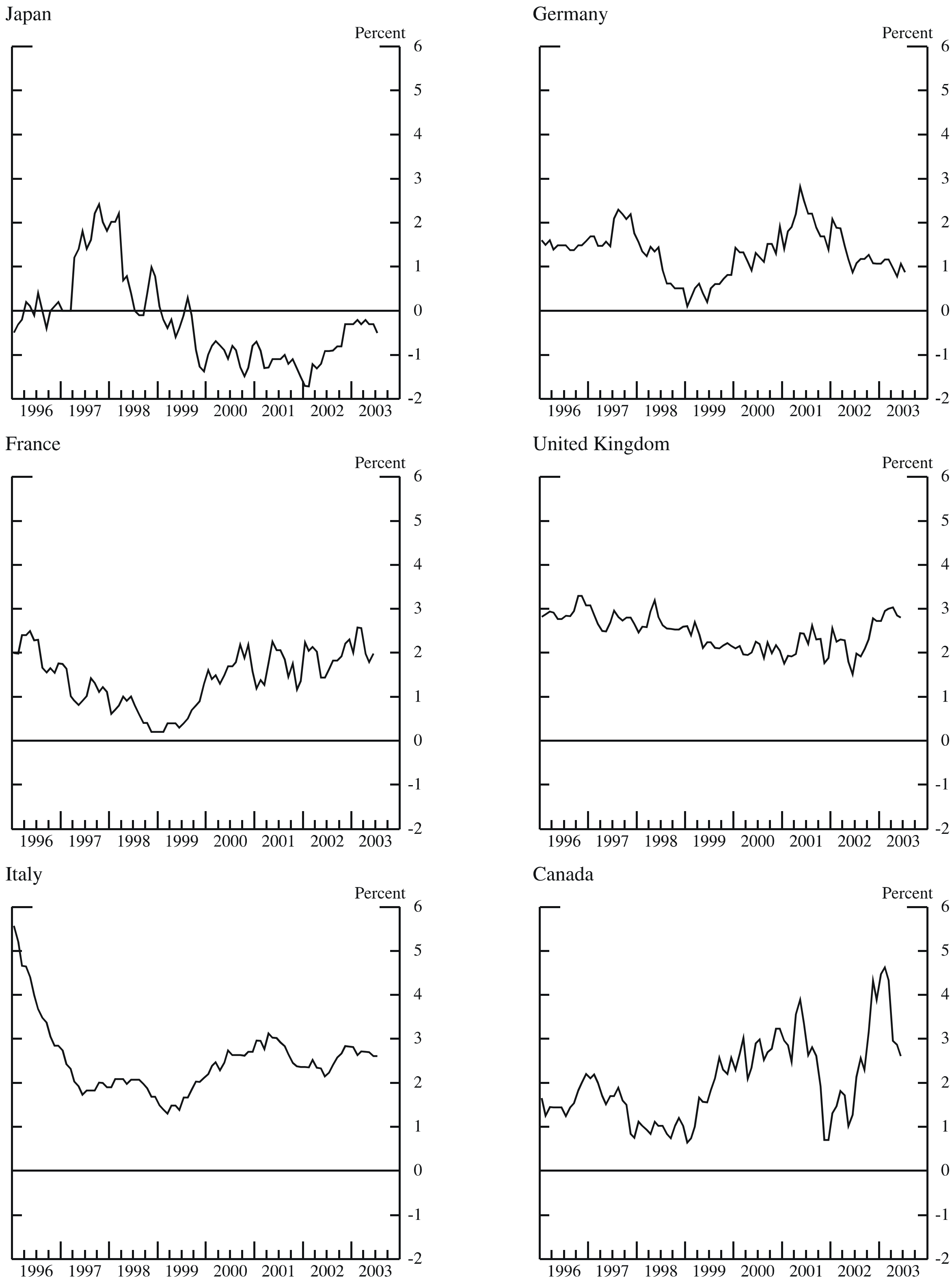
n.a. Not available. ... Not applicable.

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

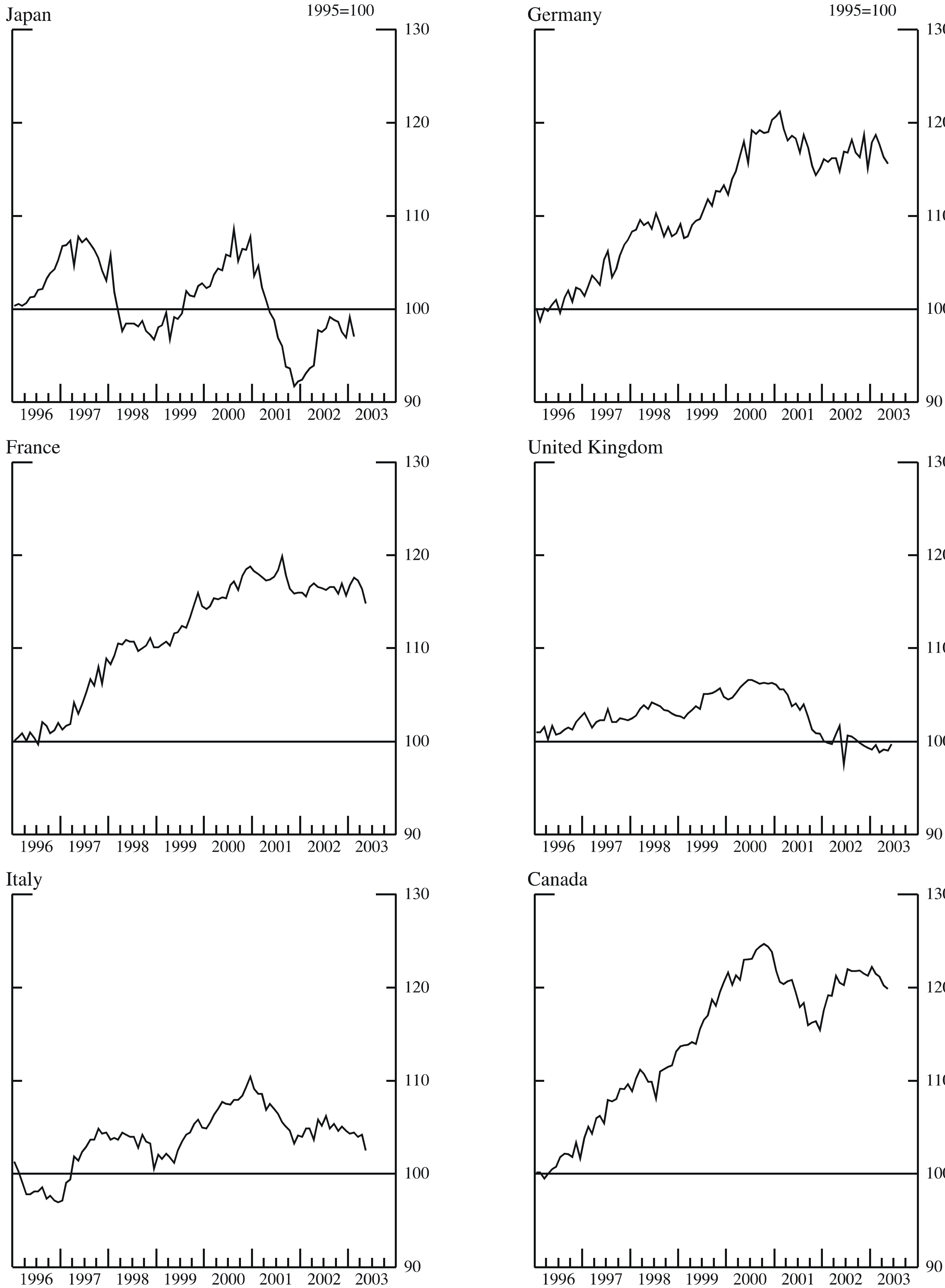
Country and balance	2002	2003				
	Q4	Q1	Q2	April	May	June
Japan						
Trade	84.9	73.3	77.2	80.2	77.5	73.9
Current account	102.2	117.3	n.a.	120.9	159.6	n.a.
Euro area						
Trade[1]	103.8	29.6	n.a.	45.3	51.1	n.a.
Current account[1]	89.9	12.0	n.a.	-112	-5.5	n.a.
Germany						
Trade	127.9	125.8	n.a.	125.4	148.2	n.a.
Current account[1]	87.0	41.9	n.a.	40.9	42.8	n.a.
France						
Trade	1.1	.6	n.a.	1.0	.7	n.a.
Current account	4.6	3.9	n.a.	-3.9	5.4	n.a.
Italy						
Trade	5.2	1.3	n.a.	-1.0	-4.0	n.a.
Current account[1]	-15.8	-30.2	n.a.	-33.5	-29.2	n.a.
United Kingdom						
Trade	-83.9	-70.9	n.a.	-63.6	-80.0	n.a.
Current Account	-11.0	15.6	n.a.	...	...	...
Canada						
Trade	34.7	39.3	n.a.	37.9	34.6	n.a.
Current Account	12.4	21.3	n.a.	...	...	...

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

Consumer Price Inflation in Selected Industrial Countries
(12-month change)



Industrial Production in Selected Industrial Countries



Economic Situation in Other Countries

In developing Asia, although the negative effects of SARS appear to be waning, we have yet to see evidence of solid recoveries in these economies. However, Chinese growth seems to be resuming, and Malaysian production has remained fairly strong. Economic activity continues to be soft in Mexico and has weakened in Brazil and Argentina. Sluggish demand has contributed to lower inflation in much of the developing world, with deflation in a few Asian economies in recent months.

Real GDP in **China** contracted about 3 percent in the second quarter, reflecting the negative economic effects of SARS and payback from a very strong first quarter. All indications are that the impact of SARS has now dissipated. Retail sales and travel rebounded strongly in June, and industrial production, which was less affected by SARS, also picked up sharply. Imports fell in the second quarter after rising at an extraordinary pace in the first quarter, while exports continued to grow, though not as quickly as in the first few months of this year. The net result was a trade surplus in the second quarter that more than offset the first-quarter trade deficit.

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

Indicator	2001	2002	2003				
			Q1	Q2	Apr.	May	June
Real GDP[1]	7.5	8.0	16.3	-2.9	...	...	...
Industrial production[2]	8.9	11.8	17.0	15.1	14.9	13.7	16.9
Consumer prices[2]	-.3	-.4	.5	.7	1.0	.7	.3
Trade balance[3]	23.1	30.3	-13.1	21.3	23.8	13.1	27.0

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.

The trade surplus and continued strength in foreign direct investment has brought in a steady stream of foreign currency. The Chinese authorities have sterilized the inflows of foreign exchange through issuance of central bank debt, expressing concerns that such inflows could lead to inflationary pressures. Although consumer prices have risen just 0.3 percent over the twelve months ending in June, less than earlier this year, anecdotal evidence suggests that property prices in some areas of China may be experiencing a bubble. Many analysts believe that the possibility of such a bubble may be the real concern of the Chinese monetary authorities.

In **Hong Kong**, the negative economic effects of SARS appear to be waning. Information on tourism, business travel, and retail sales indicate significant rebounds in June. However, the impact of SARS on the labor market has persisted, with the unemployment rate hitting a new record high in June. Consumer prices fell further in recent months, with a twelve-month decline of more than 3 percent in June, as retailers slashed prices in an attempt to retain customers. The trade deficit was roughly unchanged in the second quarter from the previous quarter, but the total volume of trade was down considerably.

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

Indicator	2001	2002	2003				
			Q1	Q2	Apr.	May	June
Real GDP[1]	-1.3	5.2	-1.2	n.a.	...	...	...
Unemployment rate[2]	4.9	7.3	7.5	8.6	7.8	8.3	8.6
Consumer prices[3]	-3.7	-1.6	-.9	-2.5	-1.9	-2.4	-3.1
Trade balance[4]	-11.4	-7.7	-6.9	-6.1	-5.0	-4.3	-9.1

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.

In **Taiwan,** although the economy was hurt in the second quarter by the SARS outbreak, economic conditions do not appear to have weakened as much as in other countries. Recent indicators have been mixed. Industrial production fell in the second quarter on average but was up strongly in June. In particular, output and export orders in the high-tech goods sector increased in June. In addition, unemployment has held steady. Consumer prices fell only a touch in the second quarter, but declined more in July. After decreasing in the second quarter, both exports and imports were up in June.

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

Indicator	2001	2002	2003				
			Q1	Q2	May	June	July
Real GDP[1]	-1.8	4.1	-.1	n.a.	...	...	...
Unemployment rate[2]	4.6	5.2	5.2	5.2	5.2	5.2	n.a.
Industrial production	-7.3	6.4	.0	-1.6	-2.1	3.7	n.a.
Consumer prices[3]	-1.7	.8	-.2	-.1	.3	-.4	-1.0
Trade balance[4]	15.6	18.1	13.5	16.9	19.2	12.9	n.a.
Current account[5]	17.9	25.7	29.0	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.

Incoming data for **Korea** since the last Greenbook have been mixed. Industrial production was down for the second quarter on average, but jumped nearly 5 percent in June, largely driven by increases in the production of vehicles, semiconductors, and machinery equipment. However, consumer and business confidence indicators were weak in June, and the unemployment rate edged up to 3.6 percent. Moreover, recent data on retail sales signal that the retrenchment in consumer spending persisted through the first half of the year, although the twelve-month rate of consumer price inflation has held steady at a little over 3 percent. Concerned by the weakness of domestic demand, the Bank of Korea lowered its overnight call rate target in July by 25 basis points to a record low of 3.75 percent. The finance ministry has also announced a string of tax breaks intended to boost the economy in the second half of the year. The trade surplus increased sharply in June, reflecting both rising exports and slowing imports. The strong export performance partly reflected payback from a weak May level, which was held down by one-off special factors (labor unrest and two extra holidays during that month). In addition, exports benefitted from the fading of the regional SARS epidemic.

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

Indicator	2001	2002	2003				
			Q1	Q2	May	June	July
Real GDP[1]	4.2	7.0	-1.4	n.a.	...	...	...
Industrial production	1.0	7.4	.5	-1.0	-1.7	4.7	n.a.
Unemployment rate[2]	3.8	3.1	3.1	3.4	3.4	3.6	n.a.
Consumer prices[3]	3.2	3.8	4.1	3.3	3.2	2.9	3.2
Trade balance[4]	13.5	14.2	9.4	19.5	12.9	27.1	n.a.
Current account[5]	8.2	6.1	-6.9	10.3	14.2	21.1	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, economic indicators in the **ASEAN** region have generally not improved. With the exception of Malaysia, where high-tech production has been driving manufacturing growth for the past several months, industrial production contracted in the region in May. In June, industrial production continued to decline in Thailand, but rose in Singapore, although not enough to offset the April and May declines. Trade balances across the region did generally increase in June, but this largely reflected a drop in imports. In Singapore, there have been some encouraging signs of a revival of exports (particularly of electronics); however, the economy’s trade surplus narrowed in June due to a rise in imports. Inflation has remained low in the ASEAN region, with Singapore slipping back into mild deflation for the first time this year.

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

Indicator and country	2001	2002	2003 Q1	2003 Q2	2003 Apr.	2003 May	2003 June
Real GDP[1]							
Indonesia	1.8	3.8	5.6	n.a.	...	...	...
Malaysia	-.9	5.3	.9	n.a.	...	...	...
Philippines	3.6	5.7	-2.0	n.a.	...	...	...
Singapore	-6.0	3.0	1.1	n.a.	...	...	...
Thailand	2.2	6.4	6.3	n.a.	...	...	...
Industrial production[2]							
Indonesia[3]	.7	-1.1	1.0	n.a.	-.6	-2.1	n.a.
Malaysia	-4.1	4.2	2.4	n.a.	7.5	4.6	n.a.
Philippines	-5.7	-6.1	-1.2	n.a.	5.5	-4.1	n.a.
Singapore	-11.6	8.5	2.8	-3.4	-2.1	-5.5	2.6
Thailand	1.3	8.5	4.8	2.8	3.4	-2.5	-3.4

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	2001	2002	2003 Q1	2003 Q2	2003 Apr.	2003 May	2003 June
Indonesia	25.4	25.9	29.3	27.9	27.6	25.0	31.2
Malaysia	14.2	13.4	19.6	21.9	21.8	20.7	23.3
Philippines	-.9	-.2	-2.1	n.a.	-1.1	-5.0	n.a.
Singapore	5.8	8.7	16.7	13.2	11.9	15.0	12.8
Thailand	2.5	3.4	5.5	6.8	5.4	4.9	10.0

n.a. Not available.

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

Country	2001[1]	2002[1]	2003				
			Q1	Q2	May	June	July
Indonesia	12.5	10.0	7.7	7.0	6.9	6.6	5.8
Malaysia	1.2	1.7	1.3	.9	1.0	.8	n.a.
Philippines	4.1	2.6	2.9	3.0	2.7	3.4	3.3
Singapore	-.6	.4	.7	.2	.0	-.3	n.a.
Thailand	.8	1.6	2.0	1.8	1.9	1.7	1.8

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

In **Mexico**, data releases since the last Greenbook continue to point to general weakness in the economy. Both industrial production and overall economic activity (a monthly proxy for real GDP) fell in May, and exports declined substantially in the second quarter. Retail sales were also disappointing in May, suggesting that consumer spending--a source of relative strength in the first quarter--lost momentum in the second quarter. Moreover, labor market conditions deteriorated, with a sharp increase in the unemployment rate in June.[2] However, there is some faint evidence that hints at recovery; after falling in May, business confidence rose in June and exports in that month also turned up. Inflationary concerns appear to be receding, which should allow for more accommodative monetary policy; the 12-month inflation rate in June was 4.3 percent, and survey expectations of inflation for end-2003 fell to the top of the central bank's 2-4 percent target range in June for the first time in many months.

In early July, Mexicans elected a new lower house in Congress, which will take office in September for the next three years. President Fox's National Action Party (PAN) lost ground to both the former ruling Institutional Revolutionary Party (PRI) as well as other parties (including the left-wing Party of the Democratic Revolution), a result which was largely expected. As in the previous Congress, no single party holds an absolute majority. It is not clear that the reduced number of PAN seats will significantly increase the difficulties already facing President Fox's reform agenda.

2. Although at 3.4 percent the unemployment rate is not high by international standards, it should be noted that anyone working more than one hour a week is counted as employed in Mexico.

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

Indicator	2001	2002	2003				
			Q1	Q2	Apr.	May	June
Real GDP[1]	-1.5	2.0	-2.0	n.a.	...	...	...
Overall economic activity	-.1	.8	.2	n.a.	.5	-.5	n.a.
Industrial production	-3.3	-.2	.2	n.a.	.4	-.5	n.a.
Unemployment rate[2]	2.5	2.7	2.7	3.0	2.9	2.8	3.4
Consumer prices[3]	4.4	5.7	5.4	4.7	5.2	4.7	4.3
Trade balance[4]	-10.0	-7.9	-3.9	-7.9	-9.9	-6.7	-7.1
Imports[4]	168.4	168.7	169.0	168.3	169.9	166.1	168.9
Exports[4]	158.4	160.8	165.1	160.4	160.0	159.4	161.8
Current account[5]	-18.0	-13.9	-8.6	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**, data releases since the last Greenbook indicate that the economy weakened during the second quarter. Industrial output fell more than 2½ percent in that quarter, and the unemployment rate rose to 12½ percent in June. Brazil has continued to post sizable trade surpluses, reflecting both lackluster domestic demand, as well as the effects of the last year's significant net depreciation of the currency. The headline CPI posted a slight monthly decline in June, reflecting a fall in domestic prices of fuel and food; excluding fuel and food, monthly core inflation has been about 0.5 percent in recent months. However, twelve-month inflation remains well above the target of 8.5 percent for December 2003, probably reflecting the effect of last year's decline in the Brazilian *real* on prices earlier this year. In late June, the government raised the upper bound of its inflation target for 2004 from 6.25 percent to 8 percent, probably prompted by reluctance to push for too fast a reduction in inflation in the face of the weak economy. However, an upper bound of 6 percent was established for 2005.

In late July, the central bank reduced its benchmark interest rate, the Selic, 150 basis points, to 24.5 percent, consistent with market expectations; futures contracts are pricing in further cuts through the end of 2003. The government has continued to comply with its IMF program, recording fiscal surpluses, but has experienced some difficulties amassing support for social security reform, which is considered critical to long-term fiscal stability. Congress is expected to vote on the reform by the end of this year.

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

Indicator	2001	2002	2003				
			Q1	Q2	May	June	July
Real GDP[1]	-.7	3.4	-.2	n.a.	...	...	...
Industrial production	1.6	2.4	-1.0	-2.6	.1	-2.6	n.a.
Unemployment rate[2]	n.a.	11.7	11.1	12.1	12.1	12.6	n.a.
Consumer prices[3]	7.7	12.5	15.6	16.9	17.2	16.6	n.a.
Trade balance[4]	2.7	13.1	17.0	23.6	25.5	24.8	22.8
Current account[5]	-23.2	-7.7	.3	1.6	10.6	5.7	n.a.

1. Annual rate. Annual figures are Q4/Q4.
2. Percent. Break in October 2001 as a result of change in methodology. Thus, 2001 is average for Q4 only.
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.

In **Argentina**, real GDP jumped 10 percent at an annual rate in the first quarter and was up 5.1 percent from a year earlier. This rebound was mainly driven by industrial production and construction activity. However, industrial production fell 0.5 percent in the second quarter, suggesting that the recovery might be losing steam. Consumer prices rose 0.3 percent in July from the previous month, and twelve-month inflation declined to just over 7 percent. The peso appreciated about 19 percent against the U.S. dollar in the first half of the year, raising concerns about export competitiveness; however, it appears to have stabilized in recent weeks. Although fiscal and monetary targets in the IMF program have been met, the government continues to lag in the implementation of key structural reforms. In particular, there has been little progress on debt restructuring discussions with external creditors and the bank restructuring agenda also continues to be plagued by delays. Argentina's interim agreement with the IMF expires at the end of August. Talks between Argentina and the Fund on a medium-term new financial assistance package are underway.

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

Indicator	2001	2002	2003				
			Q1	Q2	May	June	July
Real GDP[1]	-10.3	-3.3	10.0	n.a.	...	...	...
Industrial production	-7.6	-10.7	7.6	-.5	-1.2	-.3	n.a.
Unemployment rate[2]	18.1	20.4	16.4	16.4	...	...	...
Consumer prices[3]	-1.4	41.0	35.8	14.5	14.3	10.2	7.3
Trade balance[4]	7.5	16.7	15.7	19.1	16.7	18.6	n.a.
Current account[5]	-4.5	9.6	7.8	n.a.	...	...	...

1. Annual rate. Annual figures are Q4/Q4.
2. Percent, n.s.a. Data for Greater Buenos Aires. Data released semi-annually.
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 **Venezuela**, oil output rebounded in the second quarter following disruptions during the general strike from December to February. Although oil production appears to have reached capacity, estimated capacity is 15 percent below pre-strike levels because of damage to wells and reservoirs during the strike. Non-oil activity remains very depressed and has shown no signs of recovery. Since stringent capital controls were imposed last January (when the bolivar was pegged to the dollar), an illegal parallel currency market has emerged. In late July, the parallel market exchange rate was 40 percent more depreciated than the official exchange rate. Motivated by the weak economy, the central bank has reduced its overnight interest rate 350 basis points to 28.5 percent in two moves since mid-July. In late July, the Venezuelan government bought back $1.5 billion in external bonds and issued $1.5 billion in a new dollar-denominated bond. Although the debt exchange reduces debt servicing requirements over the next several years, the debt service reduction was financed in part by a reduction in the central bank's reserves.

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

Indicator	2001	2002	2003				
			Q1	Q2	May	June	July
Real GDP[1]	.9	-16.7	-52.4	n.a.	...	...	...
Unemployment rate[2]	13.4	16.0	19.4	18.4	19.3	17.8	n.a.
Consumer prices[3]	12.3	31.2	35.5	34.2	35.0	34.2	31.8
Non-oil trade balance[4]	-12.2	-7.4	-2.5	n.a.	n.a.	n.a.	n.a.
Trade balance[4]	9.3	13.9	12.8	n.a.	n.a.	n.a.	n.a.
Current account[5]	3.9	7.7	7.8	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.