# <u>Prefatory Note</u>

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

[2] A two-step process was used. An advanced 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

December 3, 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

Real GDP appears to be advancing at a solid rate in the current quarter—albeit well below its torrid third-quarter pace. Consumer spending began the quarter on a flatter trajectory, but equipment and software spending and residential construction have continued to surge. Meanwhile, the labor market finally seems to be on the mend, and activity in the industrial sector has continued to improve in recent months. Core consumer price inflation has remained quiescent: The twelve-month change in core CPI prices was 1.3 percent in October, almost 1 percentage point less than the increase during the comparable period one year earlier.

## Labor Market Developments

The labor market improved in September and October, and the weekly data on insured unemployment suggest that the improvement was sustained in November. Total nonfarm payroll employment was estimated to have risen 126,000 in October and 125,000 in September, much more than previously reported.[1] Private payroll employment posted solid gains of 117,000 and 116,000 in September and October, respectively, and the average workweek of production or nonsupervisory workers moved up 0.1 hour, to 33.8 hours, in October.[2] Aggregate hours of production or nonsupervisory workers rose 0.4 percent in October and now stand at their highest level since January.

Indicators from the household survey were also generally brighter. The unemployment rate ticked down to 6.0 percent in October. The declines in unemployment in October were widespread, with the sharpest drop recorded among those aged 16 to 19. The number of short-term job losers, as a percent of household employment, fell in October to a level just below the readings seen at the start of the year, and the contribution of the long-term unemployed to the overall unemployment rate edged down. The labor force participation rate held steady at 66.1 percent in October.

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1. Beginning in June, the Bureau of Labor Statistics (BLS) has begun to seasonally adjust the data from the establishment survey on a concurrent basis by reestimating seasonal factors for the three most recent months with each monthly release. As a result, revisions to the data for the two preceding months reflect not only additional reports from establishments but also new seasonal factors. In the October report, the revision to the level of payroll employment in August was quite large, with the bulk of the change resulting from new seasonal factors. Because data for previous months were not revised, the reported *change* in employment in August is distorted, although the *level* reflects the most current information on seasonal patterns.

2. The October employment figure was boosted by an increase in employment in the retail food and beverage industry caused by the strikes and lockouts in Southern California and St. Louis. The BLS estimates that, on net, these labor disputes added 15,000 to 20,000 to payroll counts because both workers on strike or locked out and their replacements were on some establishments' payrolls during the survey reference week.

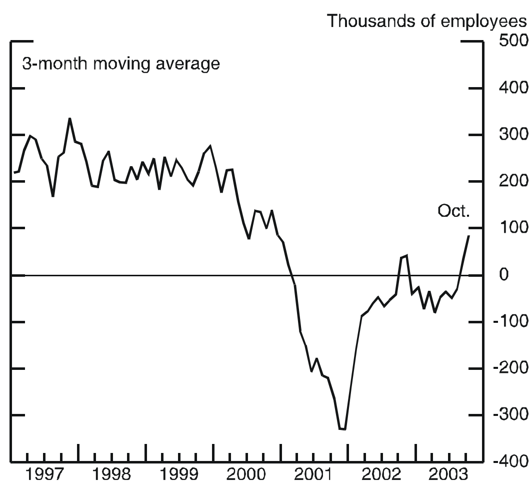
## Changes in Employment

(Thousands of employees; seasonally adjusted)

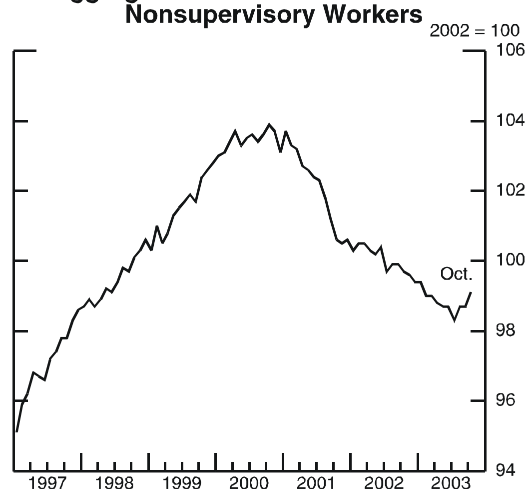
| Measure and sector | 2002 | 2003 H1 | 2003 Q3 | 2003 Aug. | 2003 Sept. | 2003 Oct. |
|---|---|---|---|---|---|---|
| | Average monthly change | | | Monthly change | | |
| Nonfarm payroll employment (establishment survey) | -39 | -49 | 34 | 35 | 125 | 126 |
| Private | -55 | -36 | 34 | 23 | 117 | 116 |
| Previous | -55 | -36 | -2 | -39 | 72 | n.a. |
| Manufacturing | -57 | -55 | -43 | -39 | -28 | -24 |
| Construction | -4 | 12 | 14 | 21 | 16 | 6 |
| Wholesale trade | -7 | -6 | -7 | -10 | -1 | -1 |
| Retail trade | -6 | -7 | 7 | 17 | 10 | 30 |
| Transportation and utilities | -4 | -11 | 1 | -1 | 15 | -1 |
| Information | -14 | -11 | -7 | -11 | -2 | -8 |
| Financial activities | 5 | 14 | 6 | -1 | 9 | -9 |
| Professional and business services | -10 | 6 | 39 | -9 | 70 | 43 |
| Temporary help services | 1 | 8 | 19 | 10 | 28 | 17 |
| Nonbusiness services[1] | 45 | 23 | 25 | 57 | 29 | 79 |
| Total government | 16 | -13 | 1 | 12 | 8 | 10 |
| Total employment (household survey) | 31 | 217 | -55 | 147 | -52 | 441 |
| Memo: | | | | | | |
| Aggregate hours of private production workers (percent change)[2] | -1.0 | -1.7 | -0.7 | 0.4 | 0.0 | 0.4 |
| Average workweek (hours)[3] | 33.9 | 33.7 | 33.7 | 33.7 | 33.7 | 33.8 |
| Manufacturing (hours) | 40.5 | 40.3 | 40.3 | 40.2 | 40.5 | 40.5 |

1. Nonbusiness services comprises education and health, leisure and hospitality, and "other."
2. Establishment survey. Annual data are percent changes from Q4 to Q4. Semiannual data are percent changes from Q4 to Q2. Quarterly data are percent changes from preceding quarter at an annual rate. Monthly data are percent changes from preceding month.
3. Establishment survey.
n.a. Not available.

### Private Payroll Employment Growth




### Aggregate Hours of Production or Nonsupervisory Workers

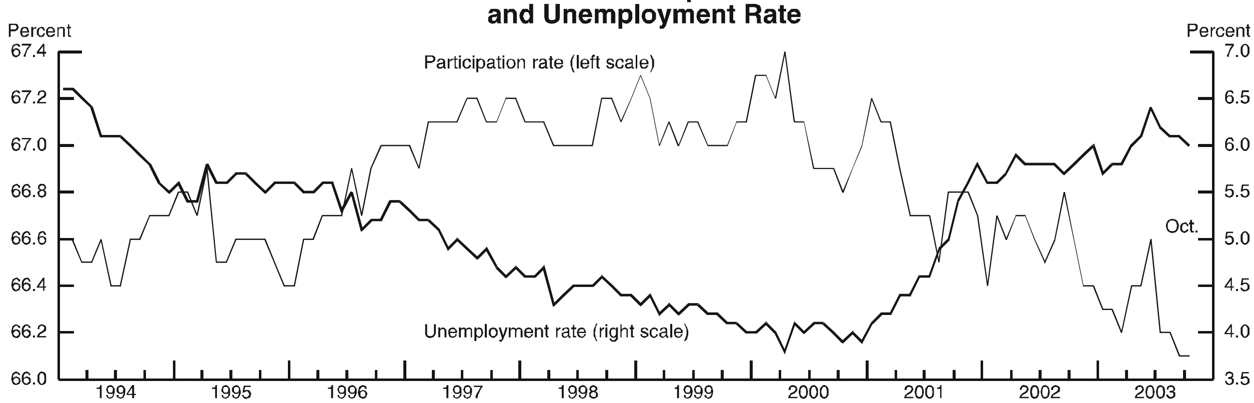


## Selected Unemployment and Labor Force Participation Rates

(Percent; seasonally adjusted)

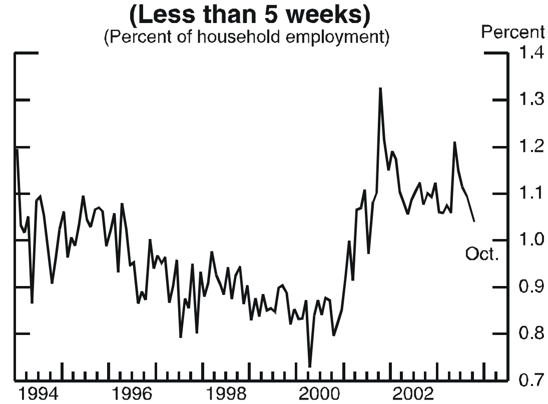
| Rate and group | 2002 | 2003 Q1 | 2003 Q2 | 2003 Q3 | 2003 Aug. | 2003 Sept. | 2003 Oct. |
|---|---|---|---|---|---|---|---|
| *Civilian unemployment rate* | | | | | | | |
| 16 years and older | 5.8 | 5.8 | 6.2 | 6.1 | 6.1 | 6.1 | 6.0 |
| Teenagers | 16.5 | 17.2 | 18.6 | 17.5 | 16.6 | 17.5 | 17.1 |
| 20-24 years old | 9.7 | 9.2 | 10.4 | 10.5 | 10.3 | 10.9 | 10.0 |
| Men, 25 years and older | 4.7 | 4.9 | 5.3 | 5.2 | 5.3 | 5.0 | 5.0 |
| Women, 25 years and older | 4.6 | 4.4 | 4.6 | 4.7 | 4.6 | 4.8 | 4.7 |
| *Labor force participation rate* | | | | | | | |
| Total | 66.6 | 66.3 | 66.4 | 66.2 | 66.2 | 66.1 | 66.1 |
| Teenagers | 47.4 | 45.2 | 45.1 | 44.2 | 44.3 | 43.9 | 43.5 |
| 20-24 years old | 76.4 | 75.5 | 75.9 | 75.5 | 75.3 | 75.7 | 75.2 |
| Men, 25 years and older | 75.9 | 75.3 | 75.6 | 75.5 | 75.5 | 75.4 | 75.5 |
| Women, 25 years and older | 59.4 | 59.6 | 59.8 | 59.5 | 59.6 | 59.2 | 59.5 |

**Labor Force Participation Rate and Unemployment Rate**




**Job Losers (Less than 5 weeks)**

(Percent of household employment)

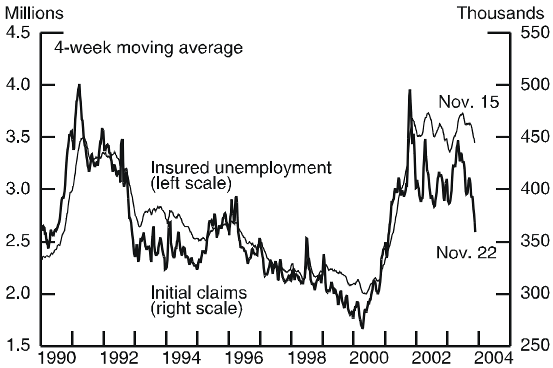



**Long-term Unemployed (More than 26 weeks)**

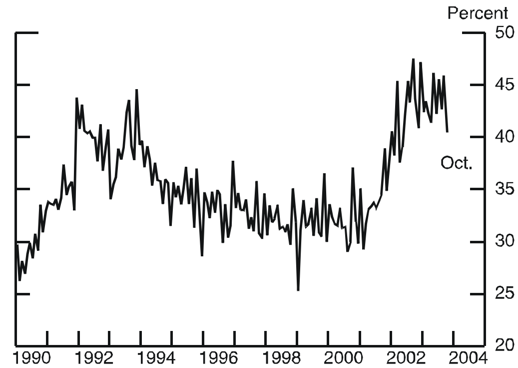
(Percent of labor force)

# Labor Market Indicators

## Unemployment Insurance

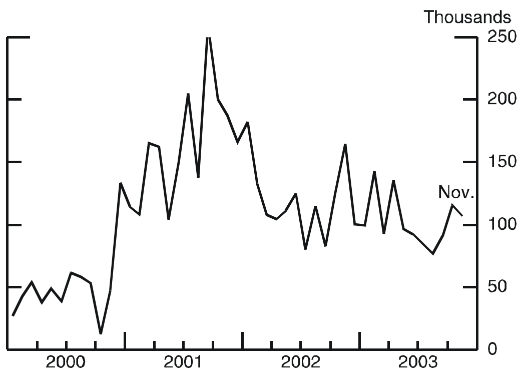



## Exhaustion Rate



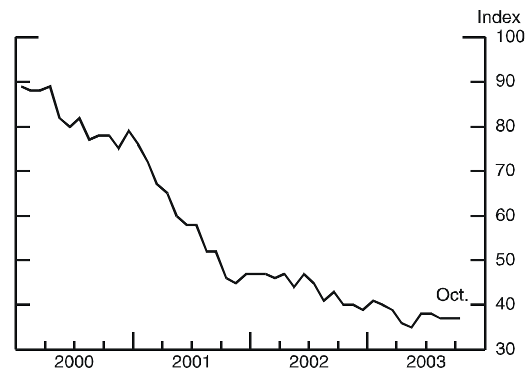

Note. Seasonally adjusted by FRB staff. Exhaustion rate is the number of individuals who exhausted their benefits without finding a job, expressed as a share of the individuals who began receiving benefits six months earlier.

## Layoff Announcements



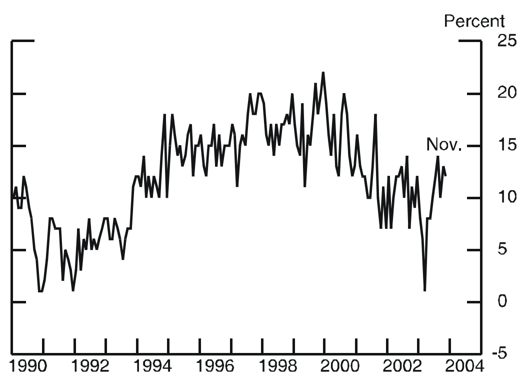

Note. Seasonally adjusted by FRB staff.
Source. Challenger, Gray and Christmas, Inc.

## Help Wanted Index



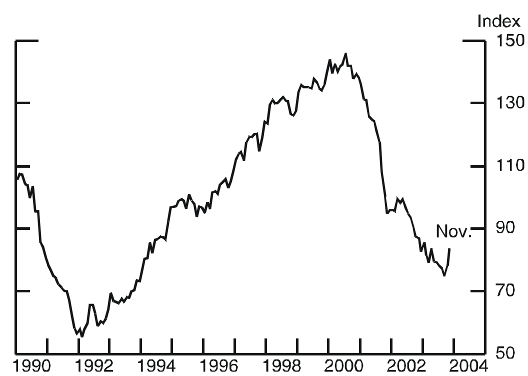

Source. Conference Board.

## Small Business Hiring Plans




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

## Current Labor Market Conditions




Note. The proportion of households believing jobs are plentiful, minus the proportion believing jobs are hard to get, plus 100.
Source. Conference Board.

Since the reference week for the October labor market surveys, the four-week moving average of initial claims for unemployment insurance has dropped substantially—to 359,000 in the week ending November 22, the lowest level since February 2001. Moreover, the four-week moving average of insured unemployment fell to 3.45 million in the week ending November 15, the lowest level since March. The proportion of unemployment insurance recipients who exhausted their benefits also declined significantly in October; the decrease suggests that some of the decline in insured unemployment reflects a step-up in the pace of hiring, although we hesitate to make much of one month's movement of this volatile series.

Recent indicators of labor demand by businesses have also become a little more positive since the last Greenbook. Layoff announcements edged down a bit in November after October's rise. The National Federation of Independent Businesses survey of small businesses showed that hiring plans in October and November were above the depressed levels observed earlier this year, but the October Help Wanted Index remained unchanged for the third consecutive month. Households participating in the Conference Board survey reported an improvement in current labor market conditions in October and November after three years in which they had seen them deteriorate, on balance.

According to the BLS, productivity in the nonfarm business sector soared at an annual rate of 9.4 percent in the third quarter, more than a percentage point higher than the estimate in the preliminary release. Over the four quarters ending last quarter, productivity is estimated to have advanced 5.0 percent after a 6.1 percent rise over the comparable period one year earlier. The BLS report

**Labor Output per Hour**

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

| | | 2002 | | 2003 | | |
|---|---|---|---|---|---|---|
| Sector | 2001 | Year | Q4 | Q1 | Q2 | Q3 |
| Total business | 3.2 | 4.2 | 1.5 | 2.7 | 7.4 | 8.6 |
| Nonfarm business | 3.2 | 4.4 | 1.7 | 2.1 | 7.0 | 9.4 |
| | 3.2 | 4.4 | 1.7 | 2.1 | 7.0 | 8.1 |
| Previous | | | | | | |
| Manufacturing | 3.4 | 5.2 | 0.4 | 5.8 | 2.8 | 9.0 |
| Nonfinancial corporations[1] | 4.2 | 4.4 | 3.8 | 3.4 | 8.4 | 9.2 |

Note. Annual changes are from fourth quarter of preceding year to fourth quarter of year shown.

1. Nonfinancial corporate sector includes all corporations doing business in the United States except banks, stock and commodity brokers, and finance and insurance companies; the sector accounts for about two-thirds of business employment.

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

| Component | Proportion 2002 (percent) | 2002[1] | 2003 Q2 | 2003 Q3 | 2003 Aug. | 2003 Sept. | 2003 Oct. |
|---|---|---|---|---|---|---|---|
| | | | Annual rate | | Monthly rate | | |
| **Total** | **100.0** | **1.3** | **-4.0** | **4.0** | **.2** | **.5** | **.2** |
| Previous | 100.0 | 1.4 | -3.7 | 3.3 | -.1 | .4 | ... |
| Manufacturing | 83.5 | 1.0 | -3.2 | 3.6 | .0 | .7 | .1 |
| Ex. motor veh. and parts | 76.8 | .3 | -2.4 | 2.3 | .1 | .2 | .4 |
| Ex. high-tech industries | 71.6 | -.9 | -3.6 | .5 | -.1 | .2 | .3 |
| Mining | 6.8 | -2.3 | -.7 | 1.5 | -.4 | 1.0 | -.8 |
| Utilities | 9.8 | 6.6 | -13.3 | 10.2 | 1.8 | -2.0 | 2.0 |
| *Selected industries* | | | | | | | |
| High technology | 5.2 | 15.3 | 14.4 | 29.9 | 3.0 | .8 | 2.5 |
| Computers | 1.3 | 24.0 | -4.3 | 19.3 | 1.8 | 1.5 | 1.4 |
| Communications equipment | 1.4 | -5.5 | 2.8 | -7.0 | 1.4 | -1.6 | 1.4 |
| Semiconductors[2] | 2.5 | 24.9 | 33.2 | 61.9 | 4.4 | 1.7 | 3.5 |
| Motor vehicles and parts | 6.7 | 9.9 | -11.2 | 19.2 | -1.4 | 6.5 | -3.8 |
| *Market groups excluding energy and selected industries* | | | | | | | |
| Consumer goods | 22.9 | -1.9 | -2.0 | -1.5 | -.1 | -.4 | -.1 |
| Durables | 4.4 | 1.9 | -4.6 | 1.8 | .5 | -.8 | .6 |
| Nondurables | 18.6 | -2.8 | -1.4 | -2.2 | -.2 | -.3 | -.3 |
| Business equipment | 7.5 | -4.6 | -5.3 | 3.7 | .4 | .3 | -.5 |
| Defense and space equipment | 1.8 | 3.9 | 2.2 | 6.3 | .6 | .5 | .4 |
| Construction supplies | 4.3 | .5 | -4.6 | 4.7 | .4 | .3 | 1.0 |
| Business supplies | 8.5 | .0 | -3.1 | -.4 | -.3 | .2 | .6 |
| Materials | 25.3 | .3 | -5.1 | .4 | -.3 | .7 | .7 |
| Durables | 14.0 | -.3 | -6.2 | 1.3 | -.4 | .7 | 1.2 |
| Nondurables | 11.3 | .9 | -3.8 | -.7 | -.3 | .6 | .1 |

1. Fourth-quarter to fourth-quarter change.
2. Includes related electronic components.
... Not applicable.

## Capacity Utilization
(Percent of capacity)

| Sector | 1972-2002 average | 1982 low | 1990-91 low | 2003 Q1 | 2003 Q2 | 2003 Q3 | 2003 Sept. | 2003 Oct. |
|---|---|---|---|---|---|---|---|---|
| **Total industry** | **81.3** | **70.9** | **78.6** | **75.1** | **74.1** | **74.7** | **74.9** | **75.0** |
| Manufacturing | 80.2 | 68.7 | 77.2 | 73.5 | 72.7 | 73.2 | 73.5 | 73.5 |
| High-tech industries | 79.2 | 75.4 | 74.5 | 61.7 | 62.0 | 64.5 | 65.0 | 66.1 |
| Excluding high-tech industries | 80.2 | 68.2 | 77.3 | 74.7 | 73.9 | 74.3 | 74.6 | 74.5 |
| Mining | 86.9 | 78.6 | 83.4 | 84.7 | 84.7 | 85.1 | 85.6 | 84.9 |
| Utilities | 87.0 | 77.6 | 84.1 | 86.3 | 82.4 | 83.5 | 82.7 | 84.0 |

also included the first estimate of output per hour in the nonfinancial corporate sector for the third quarter. Productivity in this sector rose at an annual rate of 9.2 percent last quarter and has advanced 6.2 percent over the four quarters ended 2003:Q3, similar to the rise posted over the previous four-quarter period.

**Industrial Production**

Activity in the industrial sector has continued to improve in recent months.[3] In the third quarter, industrial production (IP) expanded at an annual rate of 4.0 percent, and, aside from motor vehicles and parts, the momentum continued in October. Production gains have become increasingly widespread in recent months, and the diffusion index of three-month percent changes in IP has now registered above 50 percent for four months in a row. Nevertheless, considerable slack remains among manufacturing industries, and the factory operating rate stands just one percentage point above the 20-year low reached in May.

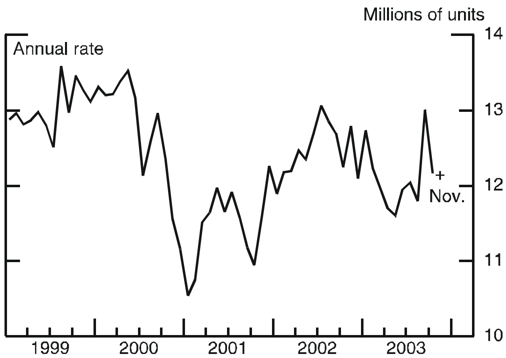
High-tech production accelerated in the third quarter, expanding at the fastest pace since the middle of 2000, and production gains in October continued at a rapid clip. In particular, the production of semiconductors and related equipment rose at an annual rate of more than 60 percent in the third quarter. With the sharp increase in production, capacity utilization at chip plants approached 90 percent in October; industry analysts expect this rate of utilization, if sustained, to induce additions to productive capacity. Indeed, the three-month moving average of orders for semiconductor manufacturing equipment jumped more than 10 percent in October and was up nearly 25 percent from its mid-year level. By contrast, capacity utilization for electronic components such as printed circuit boards—which account for 40 percent of the broad semiconductor and related equipment aggregate, and for which production is increasingly being moved abroad—continued to languish. Elsewhere in the high-tech sector, production of computers and peripheral equipment as well as communications gear posted solid gains in October.

Forward-looking indicators for the high-tech sector have been positive. For semiconductors, Intel's revenue projections are consistent with another increase in production in the fourth quarter; for PCs, the latest projections by Gartner call

3. The annual revision of industrial production, capacity, and capacity utilization was published in November. The revision, which principally affected data beginning in 2000, did not materially alter the picture of the industrial sector in recent years; the average increases in both output and capacity from the final quarter of 1999 to the present were little different from the earlier estimates. Consequently, estimates of capacity utilization were revised very little. Among broad industries, production in the high-tech industries was revised up; the production of other durable goods was little changed; and the output of nondurable goods producers was weaker than previously estimated. The dates of both the peak (June 2000) and the trough (December 2001) of the last production cycle were unchanged.

# Indicators of Manufacturing Activity

Motor Vehicle Assemblies

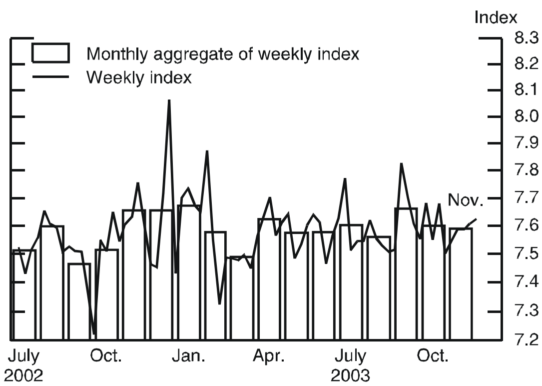



Note. November value is based on weekly data.

Industrial Production Diffusion Index

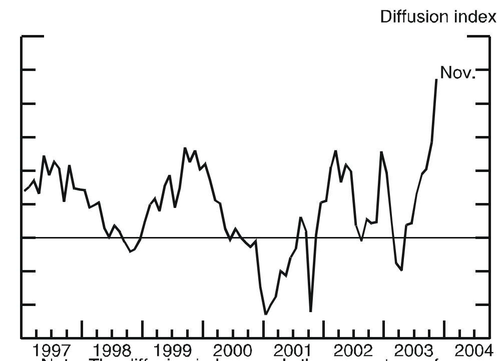

Note. The diffusion index equals the percentage of series that increased over three months plus one-half the percentage that were unchanged.

Weekly Production Index excluding Motor Vehicles and Electricity Generation



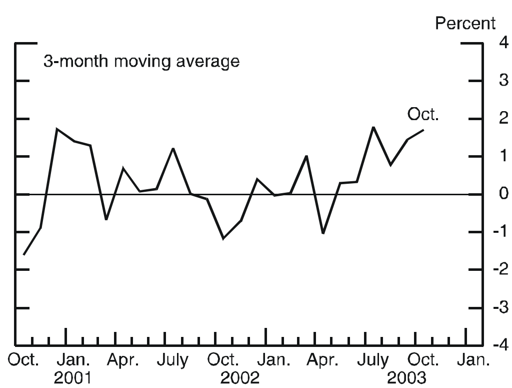

Note. One index point equals 1 percent of 1997 total industrial output.

ISM New Orders Diffusion Index

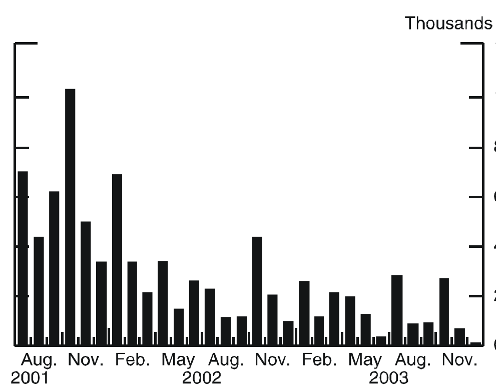



Note. The diffusion index equals the percentage of respondents reporting greater levels of new orders, plus one-half the percentage of respondents reporting that new orders were unchanged.

Change in Real Adjusted Durable Goods Orders



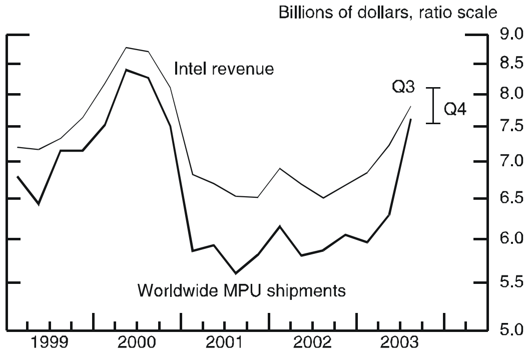

Announced Manufacturing Layoffs




Note. Data are through December 2, 2003.
Source. Compiled by staff from news reports.

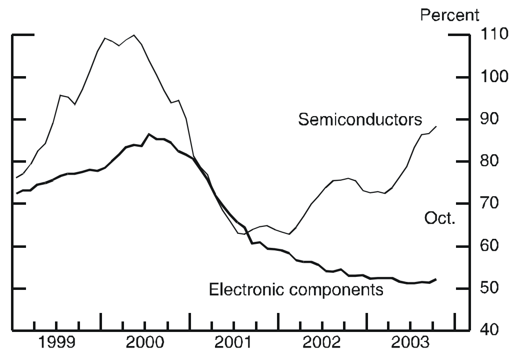
# Indicators of High-Tech Manufacturing Activity

Microprocessor Unit (MPU) Shipments and Intel Revenue

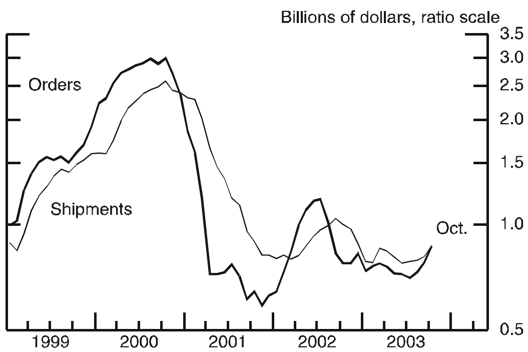



Note. Q4 is the range of Intel's guidance as of October 15, 2003.
Source. Intel and Semiconductor Industry Association.

Semiconductor and Related Equipment Utilization Rates

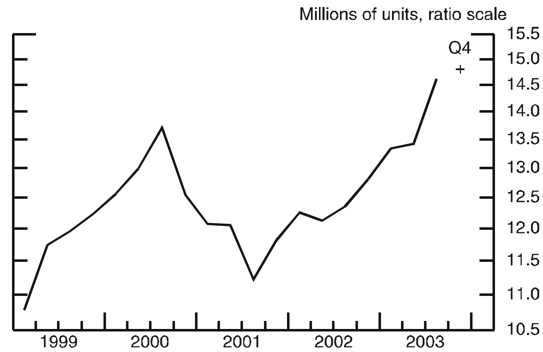



Semiconductor Manufacturing Equipment Orders and Shipments



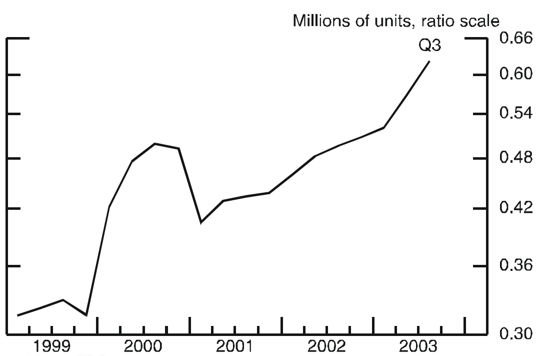

Source. Semiconductor Equipment and Materials International.

U.S. Personal Computer Sales



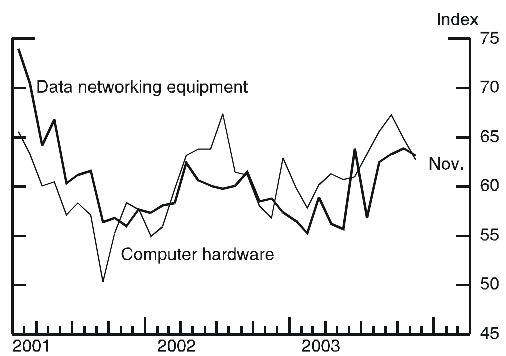

Note. FRB seasonals. Value for Q4 is a Gartner forecast.
Source. Gartner.

U.S. Server Shipments




Note. FRB seasonals.
Source. Gartner.

CIO Magazine Future Spending Diffusion Index




Note. The diffusion index equals the percentage of respondents planning to increase future spending plus one-half the percentage of respondents planning to leave future spending unchanged. The average number of respondents per month from February 2001 to November 2003 was 272.
Source. CIO Magazine.

for PC sales to climb in the fourth quarter; and for communications equipment, the November diffusion indexes of planned future spending compiled by *CIO Magazine* remained in the region associated with increased outlays, and new orders surged in September and October.[4] In addition, anecdotal reports on the high-tech sector from the Beige Book and our business contacts have improved.

Motor vehicle assemblies in November are estimated to be about even with the October level of 12.2 million units and thus likely contributed little to the change in IP last month. Looking ahead, motor vehicle assembly schedules currently call for production to fall in December to an 11-1/2 million-unit pace. For the fourth quarter as a whole, scheduled assemblies are down 1/4 million units from the third-quarter level of 12-1/4 million units.

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

| Item | 2003 | | | | 2003 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4[1] | Aug. | Sept. | Oct. | Nov. |
| U.S. production | 12.3 | 11.8 | 12.3 | 12.0 | 11.8 | 13.0 | 12.2 | 12.2 |
| Autos | 4.7 | 4.4 | 4.6 | 4.5 | 4.3 | 4.9 | 4.5 | 4.7 |
| Trucks | 7.6 | 7.3 | 7.7 | 7.5 | 7.5 | 8.1 | 7.6 | 7.5 |
| Days' supply[2] | 74 | 70 | 62 | n.a. | 55 | 67 | 75 | 73[e] |
| Inventories[3] | 3.01 | 2.96 | 2.88 | n.a. | 2.76 | 2.88 | 3.04 | 3.07[e] |

Note. Components may not sum to totals because of rounding.
1. Production rates reflect Ward's Communications' latest estimates for Q4.
2. Quarterly values calculated with end-of-period stocks and average reported sales; excludes trucks in classes 3-8.
3. End-of-period stocks; excludes trucks in classes 3 to 8.
n.a. Not available.
e Staff estimate.

In the energy sector, the output of utilities rose 2 percent in October, and weekly electricity generation data suggest that output increased further in November. While unseasonably warm weather likely contributed to the October rise, the recent gains in utilities output represent more fundamentally a return to trend following the dip in the second quarter. By contrast, mining output fell

4. New orders for communications equipment increased at a monthly rate of 23.1 percent in October on the heels of a 15.2 percent gain in September. The magnitude of the September-October increase was likely overstated because the orders figures appear to reflect outliers in some large companies' reports. Our contact at Census says that the September and October growth rates are likely to be revised downward to some extent in this Friday's M3 release.

1 percent in October, as a large decrease in the production of crude oil more than offset gains in natural gas extraction.

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

| Component | Proportion, 2003: H1 (percent) | 2003 | | | | |
|---|---|---|---|---|---|---|
| | | Q2 | Q3 | Aug. | Sept. | Oct. |
| | | Annual rate | | Monthly rate | | |
| **Total orders** | **100.0** | **-.8** | **17.0** | **-.1** | **2.1** | **3.3** |
| Adjusted orders[1] | 75.0 | -3.3 | 16.7 | -1.0 | 3.7 | 2.5 |
| Computers and peripherals | 4.0 | 65.1 | 25.8 | 1.5 | -.6 | -.3 |
| Communication equipment | 4.0 | -31.2 | 80.0 | -1.7 | 15.2 | 23.1 |
| Other capital goods | 24.0 | 1.0 | 7.5 | -.3 | 5.6 | -1.8 |
| Other[2] | 43.0 | -7.9 | 16.5 | -1.6 | 2.2 | 3.0 |
| Memo: | | | | | | |
| Real adjusted orders | . . . | -1.7 | 17.3 | -.9 | 3.6 | 2.5 |
| Excluding high tech | . . . | -4.3 | 10.6 | -1.6 | 3.1 | 1.0 |

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.

Among the various IP market groups excluding energy, motor vehicles and parts, and high-tech, the production of consumer goods edged down, mostly as a result of weakness in foods, tobacco, and chemicals. Output of business equipment also moved lower, with the decline wholly the result of a plunge in the production of farm machinery: John Deere temporarily closed some plants to help trim excessive dealer inventories. However, production of construction and business supplies and of materials posted solid gains.

The forward-looking indicators of near-term production suggest that the recent expansion in activity in the industrial sector will accelerate in coming months. In November, the Institute for Supply Management (ISM) index of new orders jumped to 73.7, its highest level in almost 20 years. The staff's series for real adjusted orders for durable goods increased again in October, and the three-month moving average rose 1.7 percent. Moreover, announced manufacturing layoffs declined significantly in November after having jumped in October.

## Sales of Automobiles and Light Trucks

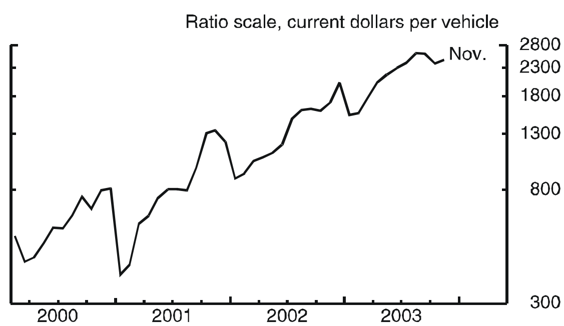
(Millions of units at an annual rate, FRB seasonals)

| Category | 2002 | 2003 Q1 | 2003 Q2 | 2003 Q3 | 2003 Sept. | 2003 Oct. | 2003 Nov. |
|---|---|---|---|---|---|---|---|
| Total | 16.8 | 15.9 | 16.3 | 17.6 | 16.7 | 15.6 | 16.8 |
| Autos | 8.1 | 7.7 | 7.4 | 7.9 | 7.5 | 7.0 | 7.8 |
| Light trucks | 8.7 | 8.2 | 8.9 | 9.8 | 9.2 | 8.6 | 9.0 |
| North American[1] | 13.5 | 12.5 | 13.0 | 14.3 | 13.4 | 12.5 | 13.4 |
| Autos | 5.9 | 5.5 | 5.4 | 5.8 | 5.4 | 5.1 | 5.6 |
| Light trucks | 7.6 | 7.0 | 7.6 | 8.5 | 7.9 | 7.5 | 7.8 |
| Foreign-produced | 3.3 | 3.4 | 3.3 | 3.4 | 3.3 | 3.1 | 3.4 |
| Autos | 2.2 | 2.2 | 2.0 | 2.1 | 2.1 | 1.9 | 2.2 |
| Light trucks | 1.1 | 1.2 | 1.3 | 1.3 | 1.2 | 1.1 | 1.2 |
| Memo: | | | | | | | |
| Medium and heavy trucks | .40 | .38 | .39 | .44 | .44 | .43 | n.a. |

Note. Light trucks include classes 1 through 3. 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.

### 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.

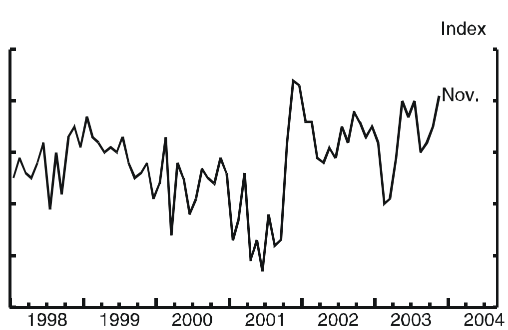
### Average Incentives, by Model Year

(Current dollars, seasonally adjusted)

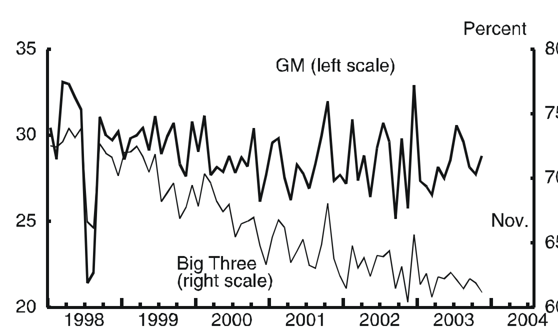
| Period | Total | 2003 | 2004 |
|---|---|---|---|
| Aug. | 2,617 | 2,690 | 1,696 |
| Sept. | 2,599 | 2,831 | 1,750 |
| Oct. | 2,397 | 2,585 | 1,881 |
| Nov. | 2,471 | 2,618 | 2,067 |

Source. J.D. Power and Associates.

### Michigan Survey Index of Car-Buying Attitudes




### Domestic Market Share of GM and Big Three



**Motor Vehicles**

Sales of automobiles and light trucks were 16-3/4 million units (annual rate) in November, following sales of 15-1/2 million units (annual rate) in October.[5] All the major manufacturers reported gains in November, and sales at General Motors were up 1/2 million units (annual rate).[6] Purchases of both autos and light trucks rose briskly. Sales moved higher last month even though incentives were up only modestly, a development suggesting that the drag on demand from the third-quarter surge in sales may be waning. Consistent with this outlook, the Michigan Survey's index of car-buying attitudes jumped in November to the highest level in almost two years.

As measured by J.D. Power and Associates, incentives in October and November were below their August peak. In part, this stepdown may reflect a faster-than-usual increase in the sales share of 2004-model-year vehicles, which generally carry smaller incentives, in the PIN data.[7] In November, however, incentives on 2004-model-year light vehicles moved noticeably higher, driven partly by GM's push to maintain market share.

**Consumer Spending**

Consumer spending slipped a little, on balance, in September and October after having soared at an annual rate of 9.3 percent in the July-August period. Much of the recent weakness was the result of a pullback in sales of motor vehicles; elsewhere, expenditures were flat in September and rose modestly in October. Looking ahead, spending should be supported by the recent uptrend in the labor market, continued impetus from the tax cuts enacted last summer, and current levels of wealth and consumer confidence that are considerably above their values earlier this year.

Real consumer spending on goods excluding motor vehicles increased in October after having fallen in the previous month. Outlays for durables apart from motor vehicles rose 0.7 percent in October, and expenditures for nondurable goods moved up 0.3 percent. Spending on non-energy services posted solid gains in both September and October. More recently, anecdotal evidence and weekly data on chain store sales suggest that the holiday shopping season got off to a good start, in line with retailers' expectations; that said, sales

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5. Light trucks consist of classes 1 through 3 and include SUVs, vans, pickup trucks, and small box trucks. Trucks are defined roughly by their weight in classes that run from 1 for the lightest to 8 for the heaviest. After the upcoming revision to the NIPAs, the BEA will change its definition of a light truck to include classes 1 through 3. Currently, the BEA defines light trucks as only classes 1 and 2. Sales of class 3 trucks have averaged about 100,000 units (annual rate) per month this year.

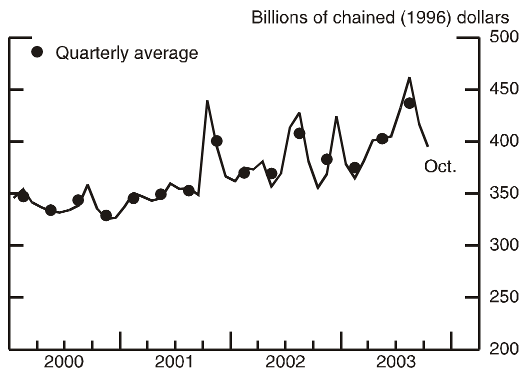
6. According to confidential data from motor vehicle manufacturers, fleet sales rose more than 250,000 units (annual rate) in November, to the highest level in more than 2-1/2 years.

7. Changes in model-year sales shares are not well captured by the seasonal factors for total incentives.

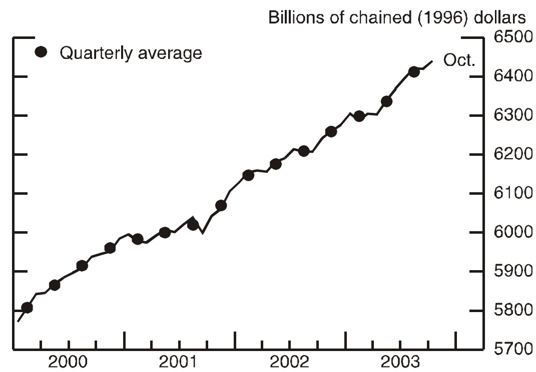
**Real Personal Consumption Expenditures**
(Percent change from the preceding period)

| Expenditure | 2002 H1 | 2002 H2 | 2003 Q1 | 2003 Q2 | 2003 Q3 | 2003 Sept. | 2003 Oct. |
|---|---|---|---|---|---|---|---|
| | Annual rate | | | | | Monthly rate | |
| Total real PCE | 2.4 | 2.9 | 2.0 | 3.8 | 6.4 | -.6 | .0 |
| Excluding motor vehicles | 3.5 | 2.7 | 2.5 | 2.5 | 4.8 | .0 | .3 |
| Durable goods | -2.3 | 6.2 | -2.0 | 24.3 | 26.5 | -4.6 | -1.9 |
| Motor vehicles | -15.0 | 7.6 | -8.0 | 33.5 | 38.2 | -9.8 | -5.2 |
| Excluding motor vehicles | 9.0 | 5.2 | 2.7 | 17.7 | 18.0 | -.1 | .7 |
| Nondurable goods | 3.8 | 3.1 | 6.1 | 1.4 | 7.6 | -.5 | .3 |
| Energy | 4.1 | 3.2 | .7 | -5.7 | 8.0 | -1.0 | .7 |
| Other | 3.8 | 3.0 | 6.7 | 2.1 | 7.6 | -.4 | .2 |
| Services | 2.8 | 2.2 | .9 | 1.4 | 2.1 | .2 | .3 |
| Energy | 5.3 | 14.3 | -5.8 | -17.3 | 1.4 | -1.8 | 1.5 |
| Other | 2.7 | 1.8 | 1.1 | 2.2 | 2.1 | .3 | .3 |
| Memo: | | | | | | | |
| Real disposable personal income | 9.1 | 1.6 | 1.6 | 2.6 | 7.4 | -1.2 | .4 |

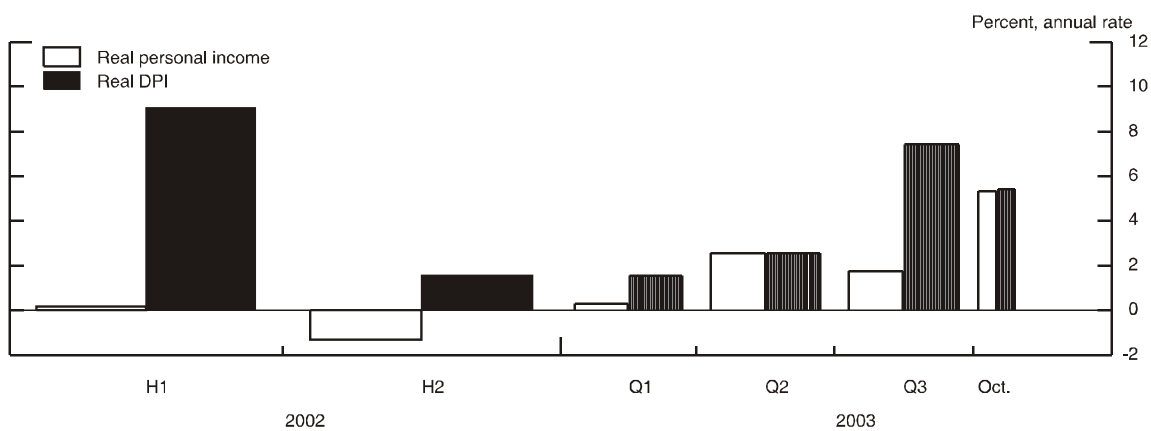
**PCE Motor Vehicles**




**PCE Excluding Motor Vehicles**

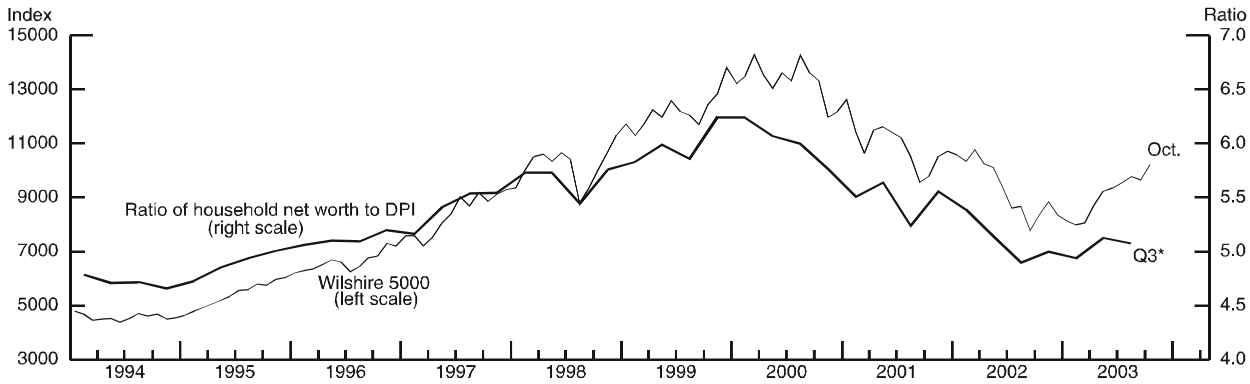



**Change in Real Personal Income and Real DPI**



# Household Indicators

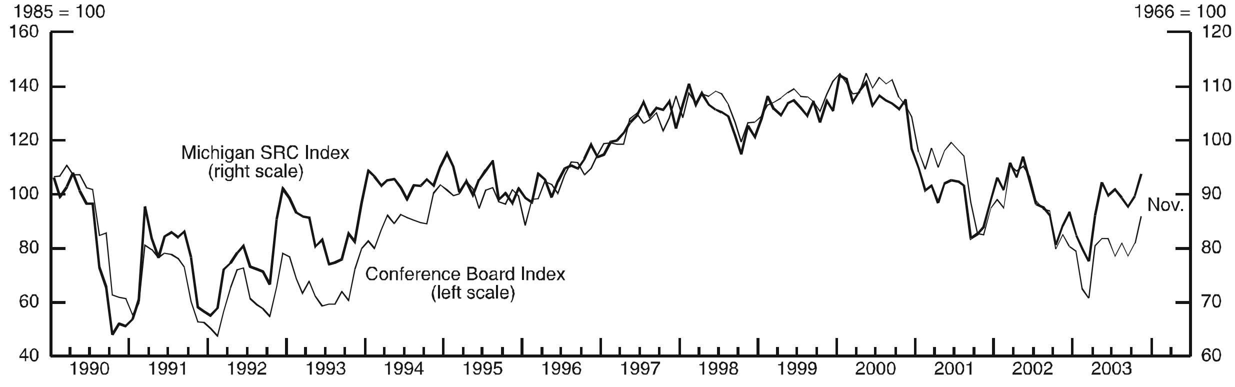
## Household Net Worth and Wilshire 5000




*2003:Q3 is a staff estimate.

## Personal Saving Rate


## Consumer Confidence

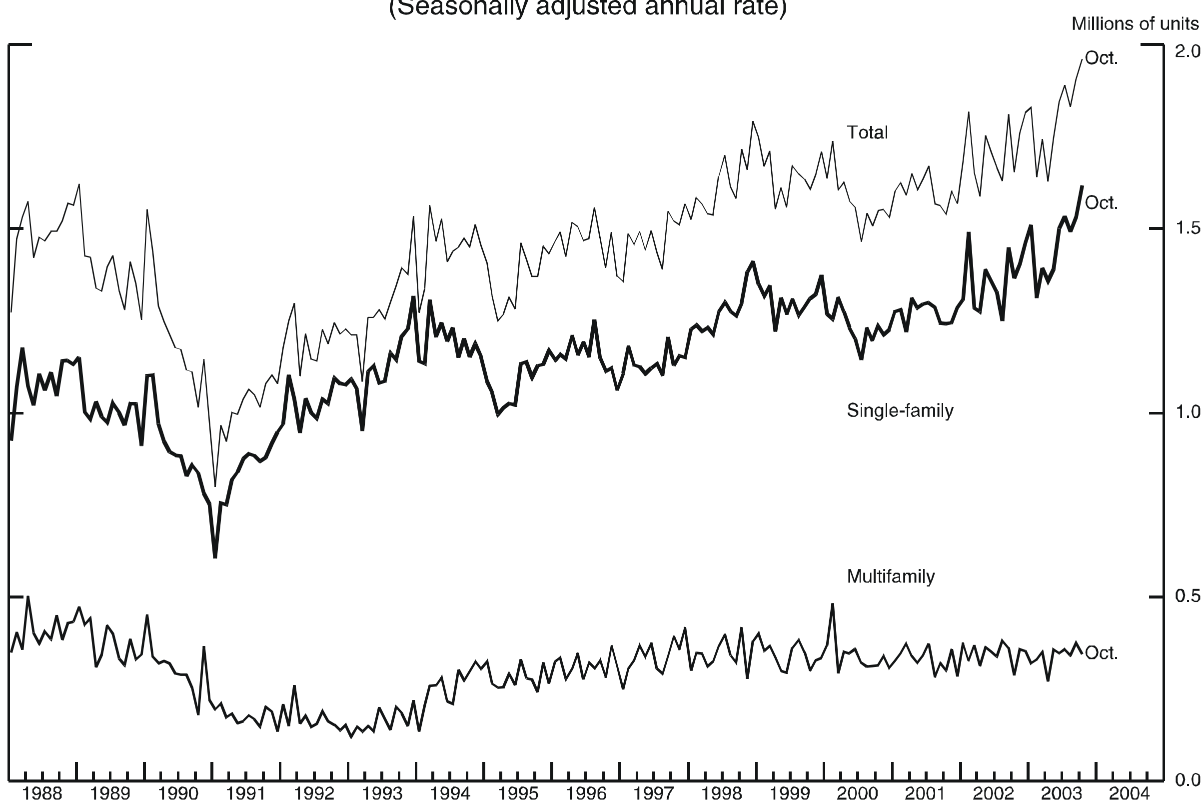


## Private Housing Activity
(Millions of units; seasonally adjusted annual rate)

| Sector | 2002 | 2003 | | | | | |
|---|---|---|---|---|---|---|---|
| | | Q1 | Q2 | Q3r | Aug.r | Sept.r | Oct.p |
| *All units* | | | | | | | |
| Starts | 1.70 | 1.74 | 1.74 | 1.88 | 1.83 | 1.91 | 1.96 |
| Permits | 1.75 | 1.75 | 1.78 | 1.86 | 1.90 | 1.88 | 1.97 |
| *Single-family units* | | | | | | | |
| Starts | 1.36 | 1.41 | 1.42 | 1.52 | 1.49 | 1.53 | 1.62 |
| Permits | 1.33 | 1.35 | 1.37 | 1.47 | 1.48 | 1.49 | 1.54 |
| Adjusted permits[1] | 1.38 | 1.39 | 1.40 | 1.51 | 1.52 | 1.54 | 1.58 |
| New home sales | 0.97 | 0.98 | 1.10 | 1.15 | 1.17 | 1.15 | 1.11 |
| Existing home sales | 5.57 | 5.87 | 5.83 | 6.42 | 6.46 | 6.68 | 6.35 |
| *Multifamily units* | | | | | | | |
| Starts | 0.35 | 0.33 | 0.32 | 0.36 | 0.34 | 0.38 | 0.34 |
| Permits | 0.42 | 0.41 | 0.41 | 0.39 | 0.42 | 0.39 | 0.44 |
| *Mobile homes* | | | | | | | |
| Shipments | 0.17 | 0.14 | 0.13 | 0.13 | 0.13 | 0.13 | n.a. |

1. Adjusted permits equal permit issuance plus total starts outside of permit-issuing areas.
p Preliminary. r Revised. n.a. Not available.

### Private Housing Starts
(Seasonally adjusted annual rate)



around the Thanksgiving holiday have not proven to be a reliable barometer of overall holiday spending.

Real disposable income advanced 0.4 percent in October. Nominal income before taxes posted its largest increase since June; with PCE prices essentially unchanged, this increase translated into a considerable gain in real personal income. In addition, personal taxes were little changed in October following the dramatic swing induced by the advance payments of the child tax credit in the summer. The ratio of net worth to disposable personal income was about unchanged in the third quarter owing to sizable gains in both income and wealth.

Both the Michigan Survey Research Center's index of consumer sentiment and the Conference Board index of consumer confidence rose sharply in the past two months, and each index now stands well above its March low. The recent upturn in both measures is due to gains in consumers' assessments of current and expected economic conditions; both surveys also noted a more favorable employment outlook.

**Housing Markets**

Housing demand surged in October as fixed-rate mortgage rates edged below 6 percent again and the labor market strengthened. In the single-family sector, new homes were started at an annual rate of 1.62 million units in October, a record high. Permit issuance—adjusted for activity in areas where permits are not required—and the backlog of unused permits suggest that single-family starts will remain elevated in coming months. Sales of existing single-family homes in October were at an annual rate of 6.35 million units, only a bit below the record set the month before; the pace of new home sales in October was also quite brisk, albeit down 3-1/2 percent from September.

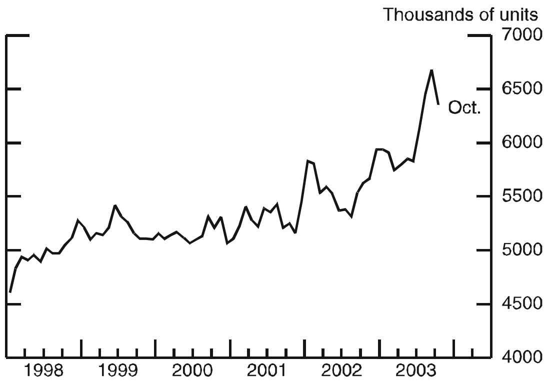
In the multifamily sector, starts moved down to an annual rate of 343,000 units in October, in line with the average pace during the past two years. However, the ratio of permits to starts was a bit above its historical level, a development which suggests that multifamily starts may increase somewhat in the next few months.

Other indicators also point toward a robust pace of housing activity in the fourth quarter. Rates on both fixed-rate and adjustable-rate mortgages have reversed some of their summer run-up, and consumer attitudes toward homebuying, as measured by the Michigan Survey, improved in November. Furthermore, the Mortgage Bankers Association's index of purchase applications remained at a high level.

House prices continue to post sizable increases, with some measures showing that prices are accelerating and others suggesting some deceleration. Both the median price of existing homes and the quality-adjusted price of new homes

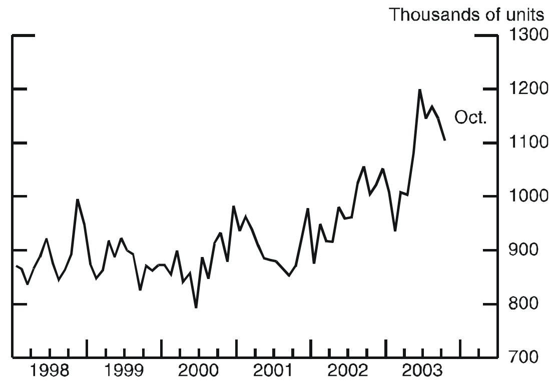
# Indicators of Single-Family Housing

## Existing Home Sales



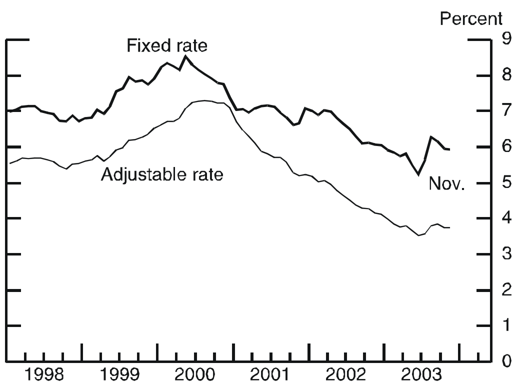

Source. National Association of Realtors.

## New Home Sales



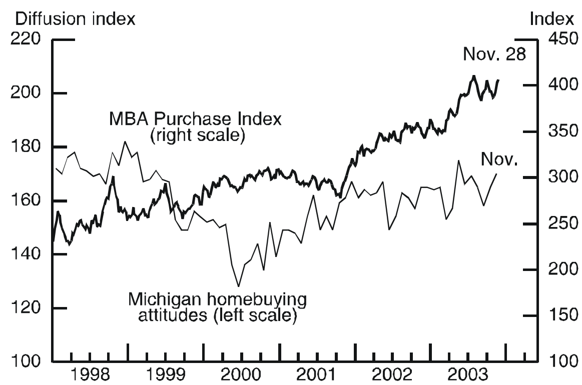

Source. Census Bureau.

## Mortgage Rates



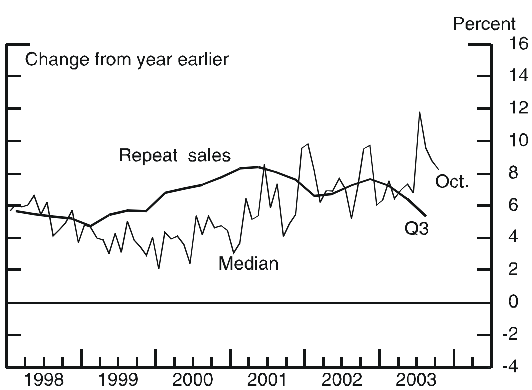

Note. The Nov. reading is based on data through Nov. 28.
Source. Freddie Mac.

## Homebuying Indicators



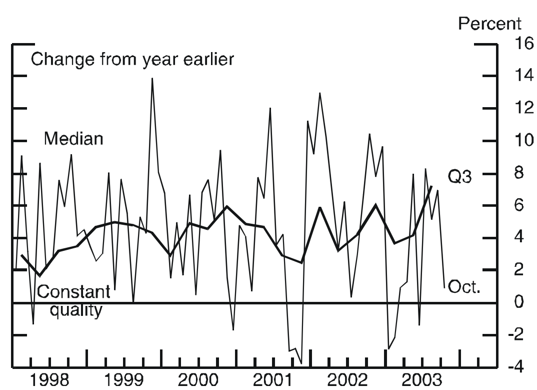

Note. MBA index is a 4-week moving average. Michigan Survey data are not seasonally adjusted.
Source. Mortgage Bankers Association and Michigan Survey.

## Prices of Existing Homes




Source. National Association of Realtors and Freddie Mac.

## Prices of New Homes




Source. Census Bureau.

appear to have accelerated. However, the median price for existing homes can be heavily influenced by composition shifts, and the quality-adjusted price of new homes covers only a small portion of the overall housing market. In contrast, the repeat-sales price index—which probably provides the best reading on prices for the housing market as a whole—has decelerated modestly since the middle of 2001, to a 5-1/2 percent increase during the year ending last quarter.

**Equipment and Software**

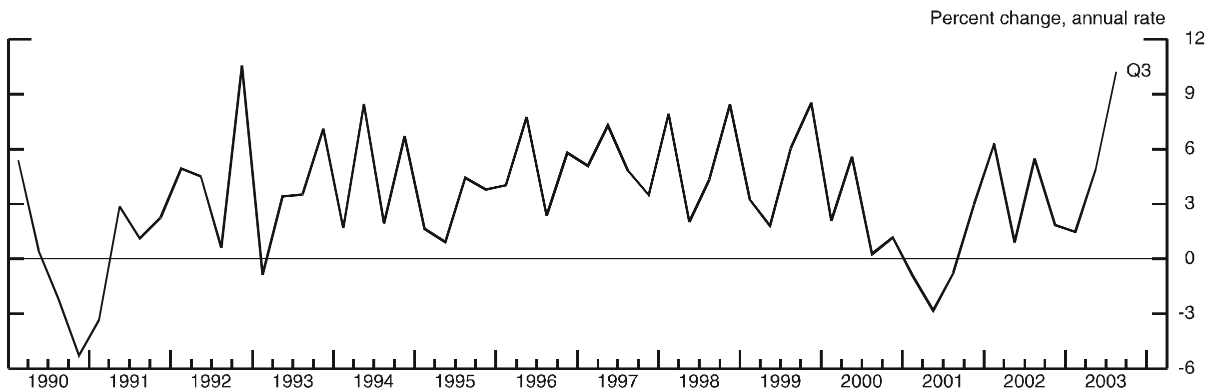
Real business outlays for equipment and software shot up at an annual rate of 18-1/2 percent in the third quarter, the fastest pace since 1998, with robust increases posted in all of the major spending categories except aircraft. Spending on high-tech equipment and software rose at an annual rate of 20 percent for the second consecutive quarter, and outlays on motor vehicles and equipment outside the transportation and high-tech sectors took off. These gains suggest that businesses have begun to respond to the recent increases in business output and corporate cash flow and to the decline this year in the user cost of capital. Nonetheless, anecdotal evidence from the Beige Book and our business contacts, as well as private surveys of business confidence, have not improved as dramatically as the fundamentals, a puzzling development that may reflect a focus by businesses on the *level* of investment, which is still well below its 2000 peak.

In the high-tech sector, nominal shipments of computing equipment climbed 4.8 percent in October, and shipments of communications equipment moved up 2.7 percent. Taken together with the upward trend in orders for these categories, the October data put real outlays for high-tech equipment on a solid footing for another sizable increase in the fourth quarter. In addition, earnings guidance from major software vendors indicates that software spending is likely to expand at a strong pace in the fourth quarter following its rise of 18 percent in the third quarter. Shipments apart from high-tech and aircraft inched down in October, with a fallback in the measuring and controlling devices subcategory more than accounting for the decline. Bookings apart from high-tech and aircraft dropped 1.8 percent in October, a decrease that only partially reversed the sharp rise in September. Nevertheless, new orders have been trending upward since the beginning of the year, suggesting ongoing gains in spending in this category.

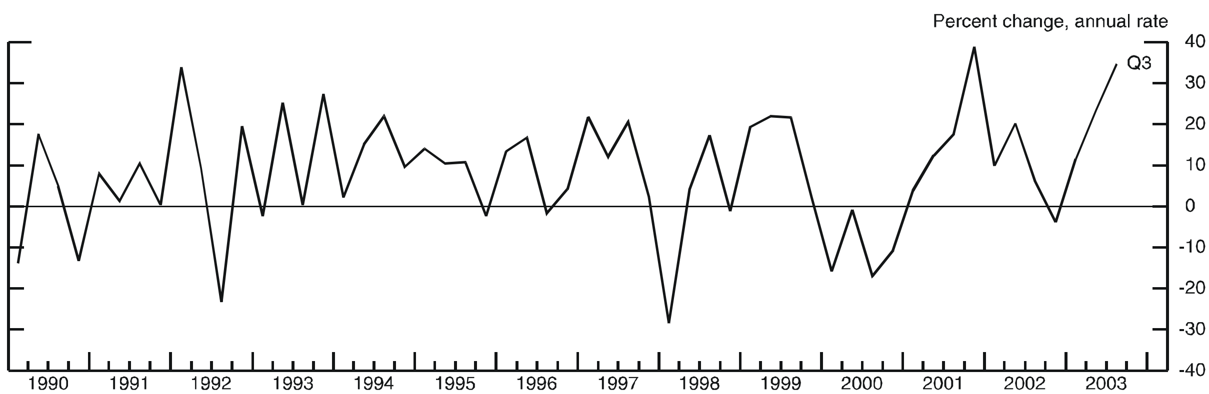
Business demand for motor vehicles has edged higher in recent months. Fleet sales of autos and light trucks ticked up in October and rose further in November, and orders for medium trucks (classes 5 to 7) remained high. In contrast, orders for heavy trucks (class 8) have moved lower, on balance, since late summer, but manufacturers believe that this decline represents only a

# Equipment and Software Investment Fundamentals

Real Business Output



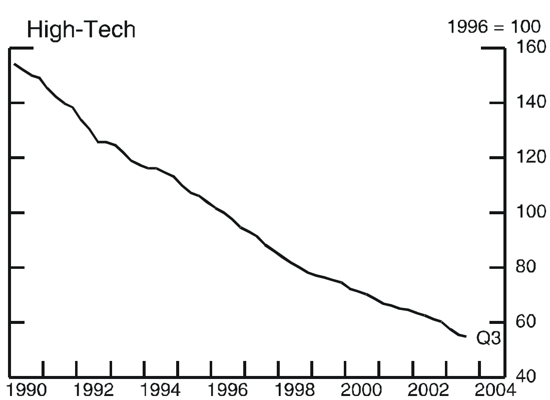

Real Corporate Cash Flow



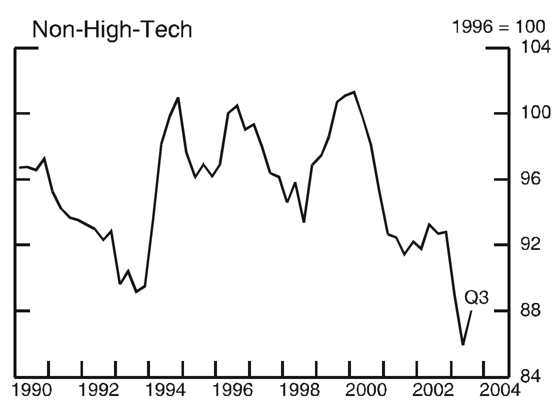

## User Cost of Capital

(Excludes the effects of the partial expensing tax incentive)

High-Tech




Non-High-Tech



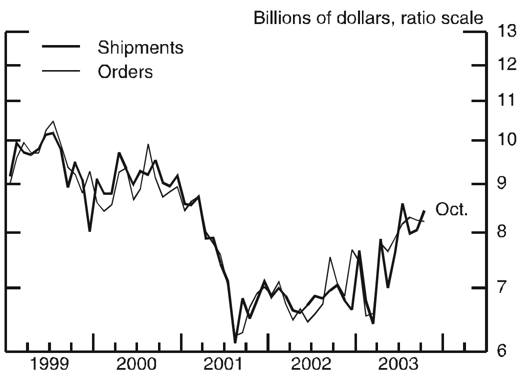
## Orders and Shipments of Nondefense Capital Goods

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

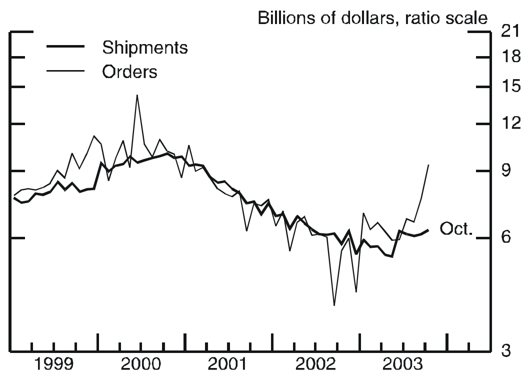
| Indicators | 2003 Q2 | 2003 Q3 | 2003 Aug. | 2003 Sept. | 2003 Oct. |
|---|---|---|---|---|---|
| | Annual rate | | Monthly rate | | |
| Shipments | 5.7 | 16.2 | -2.8 | 3.4 | .3 |
| Excluding aircraft | 5.6 | 15.5 | -2.2 | 3.0 | .8 |
| Computers and peripherals | 35.8 | 42.8 | -7.1 | .9 | 4.8 |
| Communications equipment | -6.5 | 35.2 | -.8 | .9 | 2.7 |
| All other categories | 2.7 | 8.3 | -1.3 | 3.8 | -.3 |
| Shipments of complete aircraft[1] | -41.5 | 38.8 | -24.1 | -4.4 | n.a. |
| Orders | 12.9 | 17.7 | -1.6 | 5.1 | 2.8 |
| Excluding aircraft | 3.2 | 16.9 | -.2 | 5.8 | 1.7 |
| Computers and peripherals | 65.1 | 25.8 | 1.5 | -.6 | -.3 |
| Communications equipment | -31.2 | 80.0 | -1.7 | 15.2 | 23.1 |
| All other categories | 1.0 | 7.5 | -.3 | 5.6 | -1.8 |

1. From Census Bureau, Current Industrial Reports.
n.a. Not available.

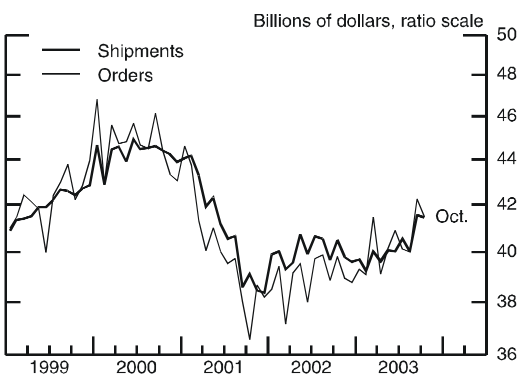
### Computers and Peripherals



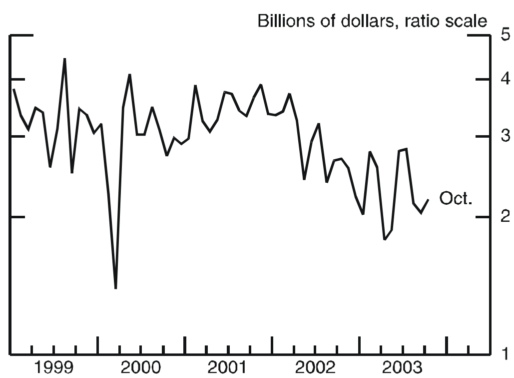

### Communications Equipment




### Other Equipment




### Aircraft Shipments

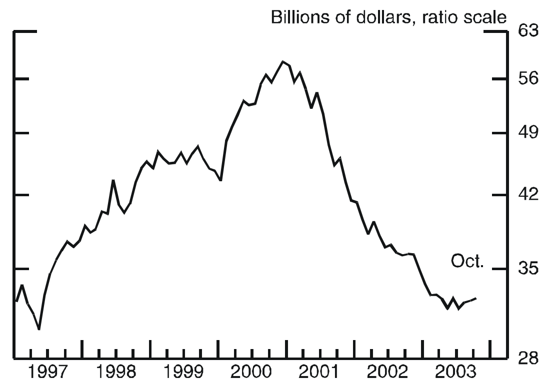



Source. Census Bureau, Current Industrial Reports.

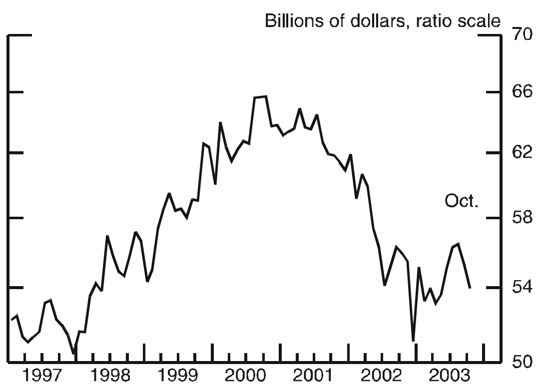
## Nonresidential Construction
(Staff translation of CPIP data into traditional NIPA categories; seasonally adjusted annual rate)

### Total Building

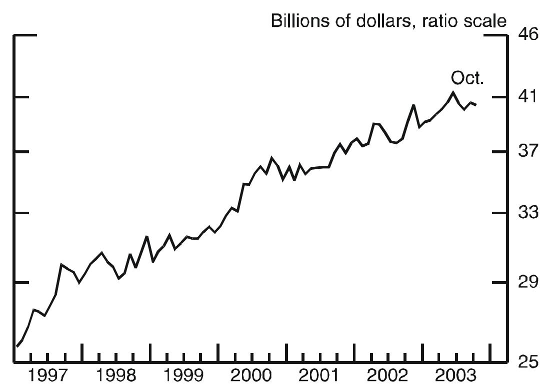

### Office




### Other Commercial




### Institutional




### Industrial


### Lodging and Miscellaneous

temporary lull.[8] Part of their optimism reflects industry estimates that the overall age of the current fleet is close to six years, almost twice the historical norm; in addition, manufacturers suggest that the utilization rate of the current fleet is well above the maximum recommended rate of 89 percent. In contrast, real business outlays on aircraft last quarter dropped to the lowest level in nine years.

**Nonresidential Construction**

The extended contraction in spending on nonresidential construction, which has reduced outlays by about 25 percent, appears to be ending. In the office sector, nominal spending edged up in September and October as the year-over-year declines in office construction continued to moderate. Nevertheless, rents fell again in the third quarter, and vacancy rates remained high in the office sector, which suggests that the level of activity in this sector is unlikely to improve markedly in the near future. Outlays for the construction of other commercial buildings (such as those for retail and wholesale establishments) moved lower in September and October as rents for retail space were about flat and rents for wholesale space continued to slide during the year ending last quarter. Spending on institutional buildings (such as schools, churches, and hospitals) has flattened out a bit in recent months but still appears to be on a solid uptrend.

In the smaller subsectors of nonresidential construction, a sharp October drop in spending mostly offset recent gains. The pace of construction of industrial buildings remained extremely slow in October, and, with capacity utilization among manufacturers still at very low levels, construction spending in this sector will likely remain quite low in coming months. Outlays for hotels and motels remained depressed in October, but they appear to have bottomed out earlier this year. Elsewhere, the reported increase in active drilling rigs through November suggests that outlays for drilling and mining structures are increasing at a robust pace so far this quarter.

**Business Inventories**

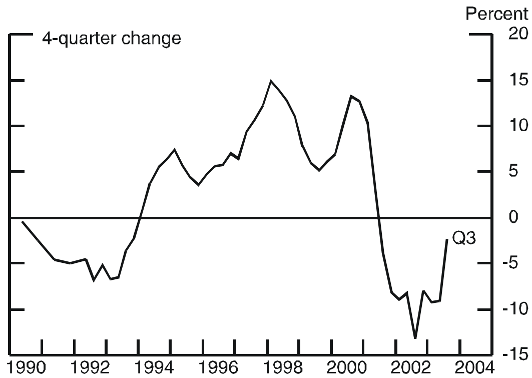
Real nonfarm inventories excluding motor vehicles fell at an annual rate of $9.9 billion in the third quarter after having declined $24.4 billion in the second quarter. The diminished pace of liquidation contributed about 1/2 percentage point to the increase in real GDP in the third quarter. Manufacturers ran off stocks in each month of the quarter, reducing inventories even more than in the preceding quarter. However, manufacturers of durable goods appear to be betting on stronger demand going into the current quarter; they built up stocks

8. The drop in orders is due at least partly to capacity constraints at two major manufacturers. These manufacturers are still producing engines that are not in compliance with the EPA's new standards that went into effect in October 2002. (One producer was temporarily exempted, while another continued production but paid government-imposed fines.) As of January 1, 2004, both producers have agreed to make engines under the new EPA standards.

# Indicators of Nonresidential Construction

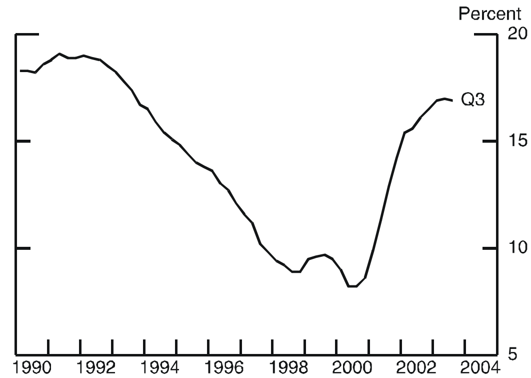
## Office Buildings

### Property Rent




Source. National Real Estate Index.

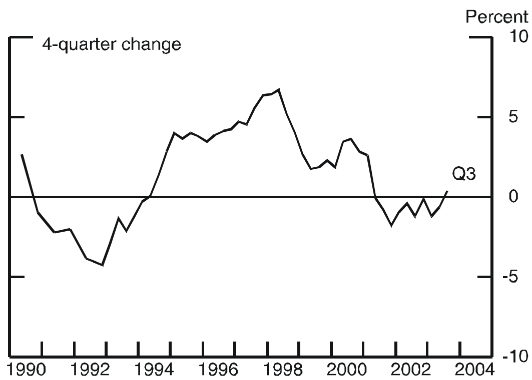
### Vacancy Rate




Source. Torto Wheaton Research.

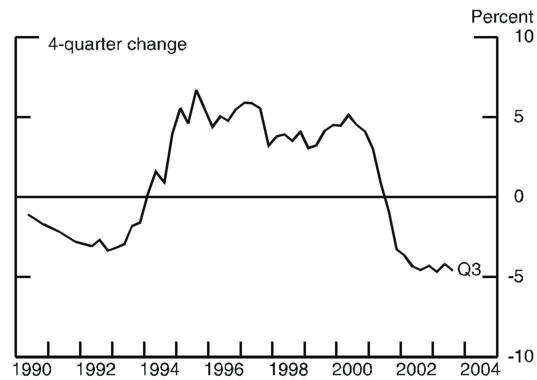
## Other Commercial Buildings

### Retail Property Rent




Source. National Real Estate Index.

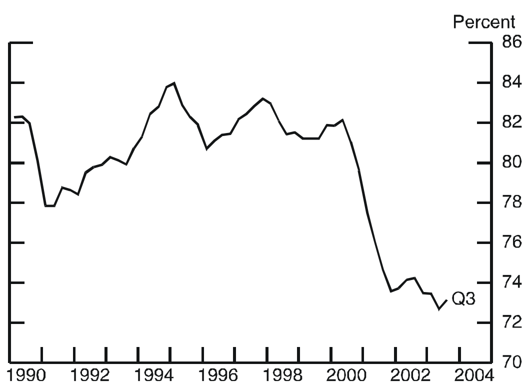
### Warehouse Property Rent




Source. National Real Estate Index.

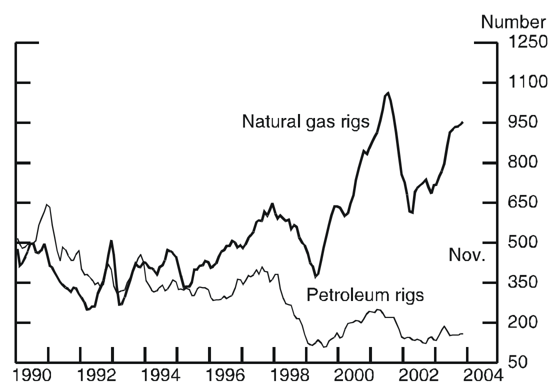
## Industrial Buildings

### Manufacturing Capacity Utilization




## Drilling Activity

### Rigs in Operation



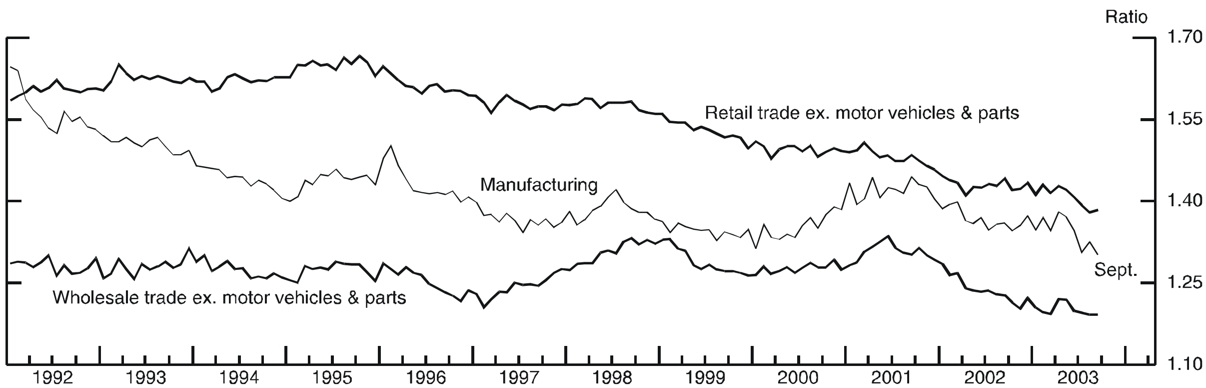

Note. November values are averages through November 26.
Source. DOE/Baker Hughes.

## Changes in Nonfarm Inventories

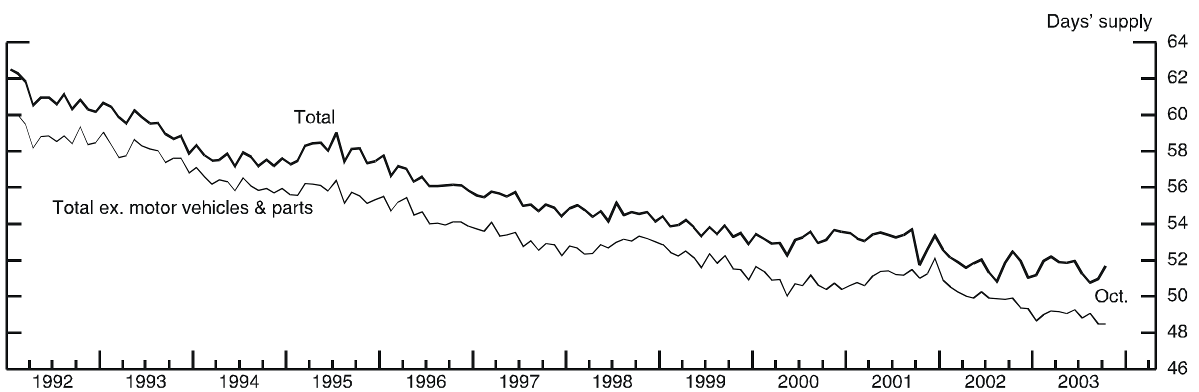
(Billions of chained (1996) dollars, annual rate)

| Sector | 2002 Q4 | 2003 Q1 | 2003 Q2 | 2003 Q3 |
|---|---|---|---|---|
| Nonfarm inventory investment | 26.4 | 3.7 | -17.2 | -14.4 |
| Excluding motor vehicles & parts | 15.2 | -12.6 | -24.4 | -9.9 |
| Manufacturing | 2.4 | -4.2 | -14.6 | -18.4 |
| Wholesale trade | .9 | .3 | -8.4 | 3.3 |
| Retail trade | 7.4 | 5.8 | .2 | 8.3 |

### Book-Value Inventories Relative to Shipments and Sales




### Inventory-Consumption Ratios, Flow-of-Goods System



## Federal Government Outlays and Receipts

(Unified basis; billions of dollars except as noted)

| Function or source | October 2002 | October 2003 | October Percent change | 12 months ending in October 2002 | 12 months ending in October 2003 | 12 months ending in October Percent change |
|---|---|---|---|---|---|---|
| Outlays | 178.6 | 205.4 | 15.0 | 2,024.8 | 2,183.3 | 7.8 |
| Financial transactions[1] | -0.3 | -0.2 | ... | -1.2 | -1.2 | ... |
| Payment timing[2] | 0.0 | 12.6 | ... | -0.3 | 12.0 | ... |
| Adjusted outlays | 178.9 | 193.0 | 7.9 | 2,026.3 | 2,172.6 | 7.2 |
| Receipts | 124.6 | 135.8 | 9.1 | 1,820.6 | 1,793.6 | -1.5 |
| Payment timing[3] | 0.0 | 6.0 | ... | 4.0 | 0.0 | ... |
| Adjusted receipts | 124.6 | 129.8 | 4.2 | 1,816.6 | 1,793.6 | -1.3 |
| Surplus or deficit (-) | -54.1 | -69.5 | ... | -204.2 | -389.7 | ... |
| *Selected components of adjusted outlays and receipts* | | | | | | |
| Adjusted outlays | 178.9 | 193.0 | 7.9 | 2,026.3 | 2,172.6 | 7.2 |
| Net interest | 14.5 | 13.9 | -4.3 | 169.6 | 154.1 | -9.1 |
| Non-interest | 164.4 | 179.1 | 8.9 | 1,856.8 | 2,018.5 | 8.7 |
| National defense | 30.4 | 35.3 | 16.2 | 351.8 | 409.4 | 16.4 |
| Social security | 38.2 | 39.8 | 4.0 | 458.4 | 476.2 | 3.9 |
| Medicare | 21.7 | 21.7 | -0.1 | 235.4 | 249.5 | 6.0 |
| Medicaid | 14.4 | 15.4 | 7.5 | 148.4 | 161.8 | 9.0 |
| Income security | 25.9 | 25.6 | -1.1 | 313.6 | 334.7 | 6.7 |
| Agriculture | 4.4 | 7.1 | 60.4 | 23.5 | 26.8 | 14.0 |
| Other | 29.4 | 34.2 | 16.3 | 325.6 | 360.0 | 10.6 |
| Adjusted receipts | 124.6 | 129.8 | 4.2 | 1,816.6 | 1,793.6 | -1.3 |
| Individual income and payroll taxes | 115.7 | 116.8 | 1.0 | 1,510.2 | 1,465.4 | -3.0 |
| Withheld + FICA | 109.2 | 111.2 | 1.8 | 1,370.1 | 1,370.7 | 0.0 |
| Nonwithheld + SECA | 8.5 | 8.3 | -2.5 | 319.5 | 288.8 | -9.6 |
| Less: Refunds | 2.0 | 2.7 | 33.0 | 179.3 | 194.1 | 8.2 |
| Corporate[3] | -4.5 | -2.3 | -48.1 | 123.8 | 139.9 | 13.0 |
| Gross | 6.7 | 6.7 | -0.6 | 188.0 | 200.5 | 6.6 |
| Less: Refunds | 11.2 | 9.0 | -19.7 | 64.2 | 60.5 | -5.7 |
| Other | 13.4 | 15.4 | 15.1 | 182.6 | 188.2 | 3.1 |
| Adjusted surplus or deficit (-) | -54.3 | -63.1 | ... | -209.7 | -379.0 | ... |

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.

3. Under the 2003 tax act, shift of the deadline for payment of estimated corporate income tax from September 2003 to October 2003.

... Not applicable.

for the first time this year in October, with the increase concentrated in goods at the early stages of processing. Wholesalers and retailers (excluding motor vehicles and parts dealers) built up inventories in the third quarter. Still, inventory-sales ratios in all three categories declined a bit further last quarter.

Days' supply in the staff's flow-of-goods system moved up in October for the second consecutive month as a result of a surge in the supply of motor vehicles and parts. Excluding motor vehicles and parts, the inventory-consumption ratio was essentially unchanged and remained at a record low. Among the various industries, only paper, communications equipment, and to a lesser extent electrical equipment appear to have elevated inventory-consumption ratios.

**Federal Government Sector**

Higher defense spending and the income tax cuts enacted under the Jobs and Growth Tax Relief Reconciliation Act continue to put upward pressure on the federal unified budget deficit. Adjusted for payment timing shifts, the federal deficit was about $63 billion in October, up about $9 billion from the year before. Adjusted outlays were about $14 billion higher than last year; the rise was fueled by sharp increases in defense spending and agriculture payments, as well as by a $5 billion payment to the states for emergency fiscal relief. Last spring's tax cuts held the increase in adjusted receipts at about 4 percent, substantially less than nominal income growth. In particular, individual income and payroll taxes were just 1 percent higher than the level recorded last October.

On the legislative front, the Congress passed a continuing resolution that will fund the government through January 31, 2004. To date, six of the thirteen appropriations bills for fiscal 2004 have been passed, and the remaining seven bills will likely be combined into an omnibus bill for consideration before the December recess. The Congress has passed a Medicare reform bill, estimated to cost about $395 billion over ten years. The bill institutes a voluntary prescription drug benefit and makes a number of other important changes to the Medicare program. Although the prescription drug program does not begin until 2006, several provisions of the bill will have budgetary consequences before then. In particular, the bill provides subsidies for drug purchases for low-income beneficiaries in 2004 and 2005. The bill was also used as a vehicle to raise payment rates for certain Medicare providers (for example, physicians and rural hospitals) for whom current rates were viewed as unduly low. The Congressional Budget Office estimates the cost of the bill at $4 billion in 2004 and $6-1/2 billion in 2005.

**State and Local Governments**

Real purchases by state and local governments rose 2-1/4 percent in the third quarter after having been flat in the first half of the year. Most of the third-quarter strength was in construction. For the fourth quarter, the available monthly indicators of spending point to a further increase. Construction put in

## Measures of Inflation
(Percent)

| Measures | 12-month change | | 3-month change | | 1-month change | |
|---|---|---|---|---|---|---|
| | | | Annual rate | | Monthly rate | |
| | Oct. 2002 | Oct. 2003 | July 2003 | Oct. 2003 | Sept. 2003 | Oct. 2003 |
| *CPI* | | | | | | |
| **Total** | **2.0** | **2.0** | **1.3** | **2.4** | **.3** | **.0** |
| Food | .9 | 2.9 | 3.4 | 4.5 | .2 | .6 |
| Energy | 3.0 | 8.8 | -7.1 | 7.0 | 3.0 | -3.9 |
| **Ex. food and energy** | **2.2** | **1.3** | **1.9** | **1.5** | **.1** | **.2** |
| Ex. tobacco | 2.2 | 1.3 | 1.9 | 1.5 | .1 | .2 |
| Core commodities | -1.2 | -2.4 | -2.2 | -3.1 | -.4 | -.3 |
| Core services | 3.7 | 2.9 | 3.7 | 3.3 | .2 | .4 |
| Current-methods total | 2.0 | 2.0 | 1.3 | 2.4 | .3 | .0 |
| Ex. food and energy | 2.3 | 1.3 | 1.9 | 1.5 | .1 | .2 |
| Ex. tobacco | 2.2 | 1.3 | 1.9 | 1.5 | .1 | .2 |
| Chained CPI (n.s.a.) [1] | 1.6 | 1.6 | ... | ... | ... | ... |
| Ex. food and energy [1] | 1.7 | .8 | ... | ... | ... | ... |
| *PCE Prices* | | | | | | |
| **Total** | **1.7** | **1.7** | **1.3** | **2.0** | **.3** | **-.1** |
| Food | 1.2 | 2.5 | 2.7 | 3.7 | .2 | .4 |
| Energy | 2.5 | 9.3 | -8.3 | 8.0 | 3.2 | -4.0 |
| **Ex. food and energy** | **1.7** | **1.2** | **1.6** | **1.3** | **.1** | **.1** |
| Ex. tobacco | 1.6 | 1.2 | 1.6 | 1.3 | .1 | .1 |
| Core commodities | -1.2 | -2.3 | -1.9 | -2.0 | -.2 | -.2 |
| Core services | 3.0 | 2.7 | 3.1 | 2.8 | .2 | .2 |
| Core market-based | 1.3 | .6 | .9 | 1.3 | .1 | .1 |
| Core non-market-based | 3.3 | 3.2 | 4.1 | 1.4 | .1 | .2 |
| *PPI* | | | | | | |
| **Total finished goods** | **.7** | **3.4** | **1.1** | **6.0** | **.3** | **.8** |
| Food | -2.1 | 8.5 | .8 | 17.6 | 1.2 | 2.2 |
| Energy | 5.0 | 9.2 | 2.4 | 4.8 | .1 | -.1 |
| **Ex. food and energy** | **.5** | **.5** | **1.1** | **2.7** | **.0** | **.5** |
| Ex. tobacco | .3 | .9 | 1.1 | 2.7 | .0 | .5 |
| Core consumer goods | 1.0 | .1 | .5 | 3.1 | .1 | .6 |
| Capital equipment | -.1 | .9 | 2.0 | 2.3 | -.1 | .6 |
| Intermediate materials | 1.6 | 3.4 | -.3 | 3.0 | -.1 | .4 |
| Ex. food and energy | 1.0 | 1.8 | -.3 | 2.3 | .1 | .3 |
| Crude materials | 15.4 | 22.8 | 12.4 | 19.8 | 3.4 | 2.6 |
| Ex. food and energy | 10.7 | 14.0 | -2.2 | 43.3 | 2.3 | 3.1 |

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

place, which is available only in nominal terms, rose 1 percent in October, a move that continues the string of advances seen since April. In addition, state and local employment increased 35,000 in October after having trended down for seven months.

A number of recent surveys suggest that the fiscal position of most states is improving but that city finances still appear to be deteriorating. The Rockefeller Institute reported that state tax receipts were 4-1/2 percent higher in the third quarter of this year than they were a year earlier, the largest year-over-year rise since the beginning of 2001. The November survey from the National Conference of State Legislatures (NCSL) indicated that budgetary distress appears to be considerably less widespread than it was at the same time last year: Only ten states anticipate that they will have to close shortfalls in their general fund budgets before the end of the current fiscal year, compared with thirty-one states at the same time last year. However, after the NCSL report was published, California developed a budget shortfall when the new governor rolled back the vehicle license fee; moreover, California's proposed $10.7 billion "deficit reduction" financing looks increasingly unlikely in the face of legal challenges.

Results of a recent survey from the National League of Cities indicate that city finances have continued to erode; the leading causes of the deterioration include reductions in state aid, cost increases for employee health benefits, and increased infrastructure and public safety needs.

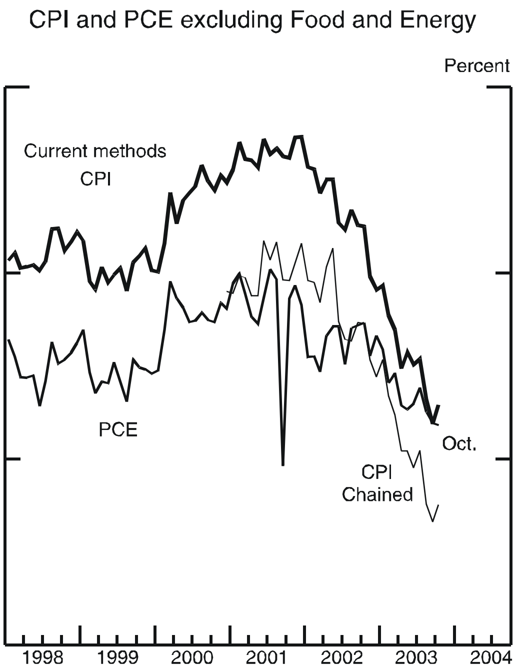
**Prices and Labor Costs**

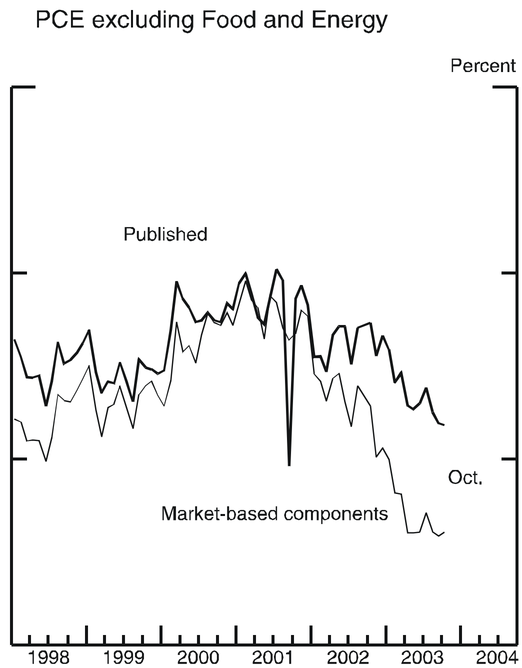
Broad measures of price inflation remain quiescent. The CPI was unchanged in October, as reductions in energy prices offset increases in food prices and core prices. Over the twelve months ending in October, the CPI was up 2.0 percent, the same rate of increase as in the previous twelve months; accelerations in food and energy prices over that period offset a marked deceleration in core prices.

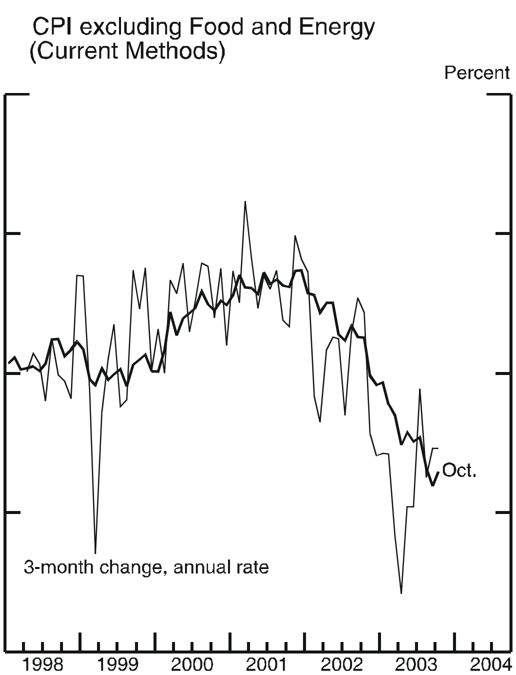
Consumer energy prices dropped 3.9 percent in October. The decline reflected a return to near-normal gasoline inventories and markups after temporary supply disruptions had trimmed inventories and pushed wholesale and retail gasoline prices sharply higher in the previous two months. Inventories of natural gas have also rebounded from the very low levels seen earlier this year and now are about normal for the season, as are inventories of heating oil.

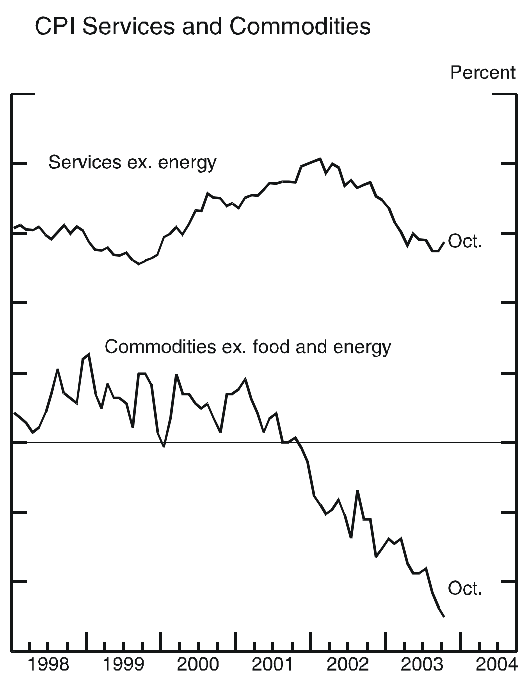
The CPI for food climbed 0.6 percent in October, with pronounced price increases for a wide variety of items. In particular, beef prices jumped again in October, but daily data from the USDA suggest that in November they have retraced much of the October increase. In the rest of the food category (also excluding the volatile price of fruits and vegetables), prices rose 0.3 percent in

# Core Consumer Price Inflation
(12-month change except where noted)



October, boosting the twelve-month increase to 1.8 percent, an acceleration of 1/2 percentage point from the preceding year.

Excluding food and energy, the CPI increased 0.2 percent in October following a 0.1 percent increase in September. Although core consumer price inflation has rebounded from even lower levels in the first part of the year, when it was depressed by transitory factors, it remains quite low. The twelve-month change in the core CPI through October was 1.3 percent, well below the 2.2 percent increase recorded during the comparable period a year earlier. The index for core commodities fell again last month and was 2.4 percent below its year-earlier level. Core services prices rose 0.4 percent last month after a 0.2 percent increase in September. One notable contributor to higher inflation last month was a pickup in owners' equivalent rent (OER). After having been depressed in the spring by rising household energy prices, OER moved up 0.3 percent in October and has increased at a 2-3/4 percent annual pace over the past three months.[9]

Core PCE inflation has also remained subdued. These prices increased only 0.1 percent in both September and October, and over the twelve months ending in October, they have risen just 1.2 percent, a 0.5 percentage point deceleration from the year-earlier period. The deceleration in core PCE prices over the past year is less than the 0.9 percentage point deceleration in the core CPI over the same period. The difference between the two inflation measures occurs, in part, because the core PCE index includes non-market-based prices whereas the core CPI does not; these non-market-based prices have not decelerated in the past year.[10] The twelve-month change in the market-based component of the core PCE index has fallen 3/4 percentage point over the past year to a 0.6 percent rate of increase. The core portion of the chained CPI (which, like PCE prices, uses a superlative aggregation formula to account for substitution by consumers in response to changes in relative prices) rose 0.8 percent over the twelve months ending in October, an increase similar to the rise in PCE and half the rate of the previous year.

The PPI for capital equipment rose 0.6 percent in October and stood 0.9 percent above its level of a year earlier. Prices of new cars and light trucks increased considerably due to smaller incentives on 2004-model-year vehicles, which are

9. The BLS removes an estimate of landlord-provided utilities costs from the rent quotes that it uses to construct OER. Hence, a deceleration in utilities prices will tend to raise OER relative to tenants' rent.

10. In addition, the twelve months ending in October saw a sharp deceleration in shelter rents, which receive a greater weight in the CPI than in the PCE indexes.

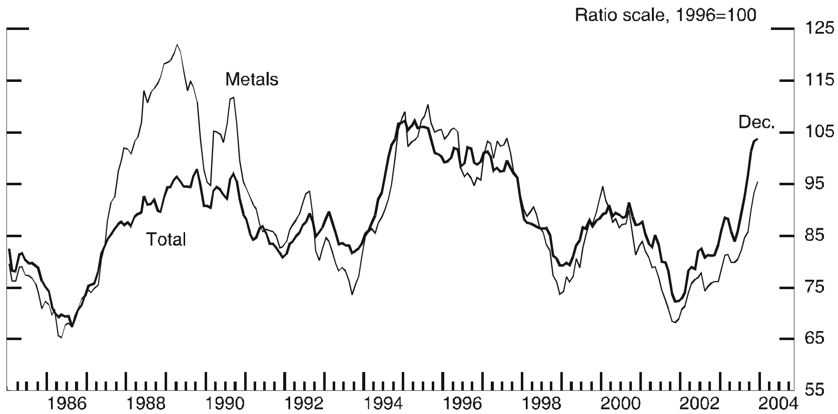
**Spot Prices of Selected Commodities**
(Percent change except as noted)

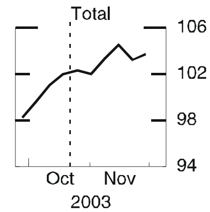
| Commodity | Current price (dollars) | 2001 [1] | 2002 [1] | 12/31/02 to 10/21/03 [2] | 10/21/03 [2] to 12/2/03 | Memo: 52-week change to 12/2/03 |
|---|---|---|---|---|---|---|
| *Metals* | | | | | | |
| Copper (lb.) | .960 | -22.0 | 2.8 | 24.7 | 5.5 | 24.7 |
| Steel scrap (ton) | 146.833 | -17.7 | 49.2 | 34.7 | 12.4 | 51.4 |
| Aluminum, London (lb.) | .700 | -14.3 | .7 | 11.5 | 2.9 | 12.7 |
| *Precious metals* | | | | | | |
| Gold (oz.) | 401.350 | 1.2 | 24.7 | 9.7 | 6.1 | 25.5 |
| Silver (oz.) | 5.500 | -3.5 | 3.0 | 6.5 | 7.8 | 21.1 |
| *Forest products* [3] | | | | | | |
| Lumber (m. bdft.) | 310.000 | 25.0 | -13.0 | 46.5 | 5.8 | 71.3 |
| Plywood (m. sqft.) | 545.000 | 3.2 | -.3 | 90.3 | -.9 | 85.4 |
| *Petroleum* | | | | | | |
| Crude oil (barrel) | 29.090 | -16.3 | 65.8 | -7.5 | -1.7 | 12.5 |
| Gasoline (gal.) | .854 | -28.0 | 54.6 | 4.4 | -3.4 | 15.9 |
| Fuel oil (gal.) | .855 | -42.6 | 57.4 | -3.9 | 2.9 | 10.2 |
| *Livestock* | | | | | | |
| Steers (cwt.) | 99.420 | -19.7 | 12.9 | 51.2 | -8.8 | 37.3 |
| Hogs (cwt.) | 35.500 | -9.9 | -18.9 | 20.0 | -1.4 | 12.7 |
| Broilers (lb.) | .645 | 3.7 | 7.4 | 4.8 | 2.9 | 26.8 |
| *Farm crops* | | | | | | |
| Corn (bu.) | 2.365 | -4.1 | 19.2 | -11.8 | 16.8 | 1.9 |
| Wheat (bu.) | 4.363 | -8.9 | 30.4 | -13.3 | 21.2 | -2.7 |
| Soybeans (bu.) | 7.615 | -13.4 | 35.6 | 27.0 | 7.0 | 37.3 |
| Cotton (lb.) | .664 | -45.7 | 53.8 | 47.3 | -5.8 | 51.3 |
| *Other foodstuffs* | | | | | | |
| Coffee (lb.) | .553 | -35.3 | 1.1 | 18.0 | 5.2 | 2.8 |
| Memo: | | | | | | |
| JOC Industrials | 103.700 | -17.1 | 16.2 | 21.6 | 1.7 | 25.7 |
| JOC Metals | 95.500 | -17.0 | 9.5 | 19.9 | 5.1 | 23.7 |
| CRB Futures | 256.740 | -16.3 | 23.0 | 4.4 | 4.9 | 11.0 |
| CRB Spot Industrials | 294.880 | -14.6 | 14.4 | 18.6 | .1 | 20.3 |

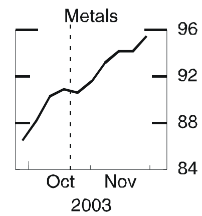
1. Changes are from the last week of the preceding year to the last week of the year indicated.
2. Oct. 21, 2003, is the day preceding publication of the October Greenbook.
3. Prices shown apply to the Friday before the date indicated.

# Commodity Price Measures

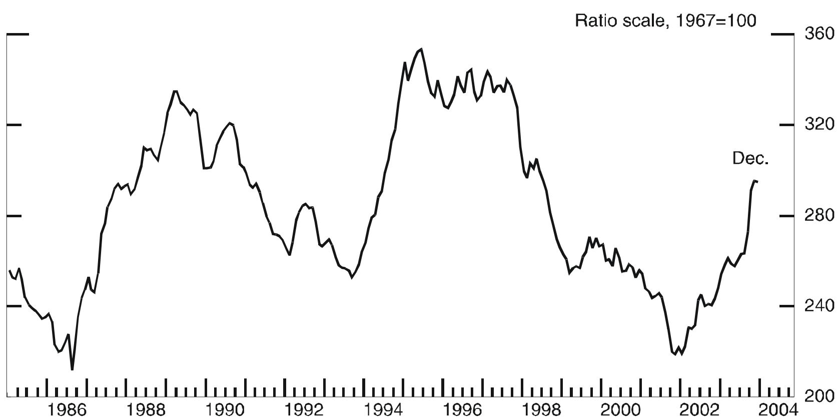
## Journal of Commerce Index

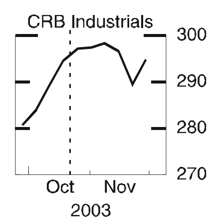


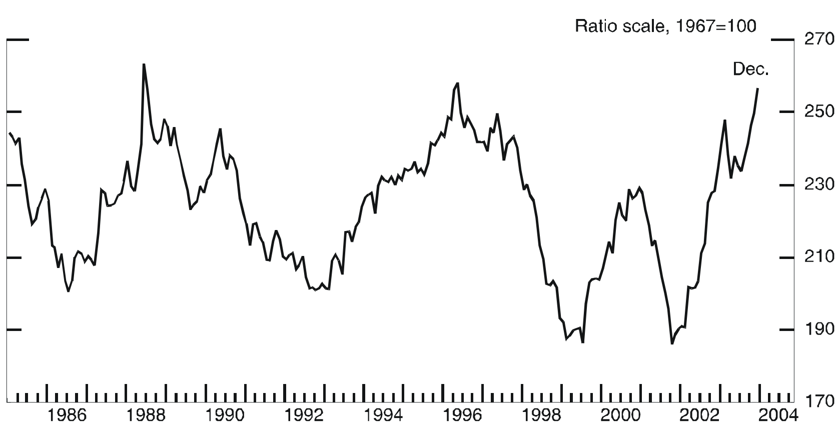



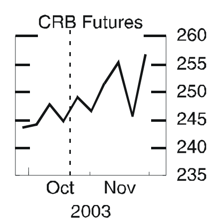

## CRB Spot Industrials




## 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
(Percent change, Q3 to Q3)

| Measure | 2000 | 2001 | 2002 | 2003 |
|---|---|---|---|---|
| *Product prices* | | | | |
| GDP chain price index | 2.2 | 2.6 | .8 | 1.7 |
| Less food and energy | 2.0 | 2.3 | 1.0 | 1.3 |
| Nonfarm business chain price index [1] | 1.8 | 2.1 | .0 | 1.2 |
| *Expenditure prices* | | | | |
| Gross domestic purchases chain price index | 2.6 | 1.7 | 1.3 | 1.8 |
| Less food and energy | 2.0 | 1.6 | 1.5 | 1.4 |
| PCE chain price index | 2.5 | 1.8 | 1.6 | 1.9 |
| Less food and energy | 1.8 | 1.6 | 2.0 | 1.3 |
| PCE chain price index, market-based components | 2.7 | 1.9 | 1.0 | 1.5 |
| Less food and energy | 1.7 | 1.7 | 1.3 | .6 |
| CPI | 3.5 | 2.7 | 1.6 | 2.2 |
| Less food and energy | 2.5 | 2.7 | 2.3 | 1.3 |
| Chained CPI | n.a. | 2.1 | 1.2 | 1.7 |
| Less food and energy | n.a. | 2.1 | 1.7 | .8 |
| Median CPI | 2.8 | 3.7 | 3.3 | 2.0 |
| Trimmed mean CPI | 2.6 | 2.7 | 2.1 | 1.9 |

1. Excluding housing.
n.a. Not available.

### Surveys of Inflation Expectations
(Percent)

| Period | Actual CPI inflation [1] | University of Michigan: 1 year [2] Mean | University of Michigan: 1 year [2] Median | University of Michigan: 5 to 10 years [3] Mean | University of Michigan: 5 to 10 years [3] Median | Professional forecasters (10-year) [4] |
|---|---|---|---|---|---|---|
| 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 |
| Q3 | 2.2 | 2.8 | 2.3 | 3.1 | 2.7 | 2.5 |
| Q4 | | | | | | 2.5 |
| 2003:July | 2.1 | 2.3 | 1.7 | 3.2 | 2.7 | ... |
| Aug. | 2.2 | 2.8 | 2.5 | 3.0 | 2.7 | ... |
| Sept. | 2.3 | 3.4 | 2.8 | 3.0 | 2.7 | 2.5 |
| Oct. | 2.0 | 3.1 | 2.6 | 3.1 | 2.8 | ... |
| Nov. | n.a. | 3.1 | 2.7 | 3.1 | 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 average, during the next twelve months?
3. Responses to the question: By about what percent per year do you expect prices to go up, on average, during the next five to ten years?
4. Quarterly CPI projections compiled by the Federal Reserve Bank of Philadelphia.
n.a. Not available.
... Not applicable.

brought into the PPI sample in October.[11] Prices for core intermediate materials increased 0.3 percent and were up 1.8 percent from a year earlier. The increases in the prices of core intermediates in the PPI have been broadly consistent with movements in capacity utilization, core import prices, and energy prices (which feed through to prices of fertilizers, plastics, and other petroleum-based items).

Commodity prices have moved up strongly since midyear. The Journal of Commerce industrial price index has risen 1.7 percent since the October Greenbook, owing to a pickup in prices for metals and farm crops, and is about 26 percent higher than it was a year ago. The Commodity Research Bureau's price index for spot industrial commodities, which excludes energy and forest products, is at about the same level as at the time of the last Greenbook but is up 20 percent from a year ago. Although jumps in commodity prices of the magnitude seen recently are typical when industrial activity accelerates, they tend to have only a small direct impact on overall price inflation.

Broad measures of inflation in the NIPAs have picked up over the past year owing to a surge in energy prices, but core inflation measures have been about unchanged or have moved lower after adjusting for the BEA's treatment of insurance payments associated with the terrorist attacks in the third quarter of 2001.[12] Excluding food and energy, the price index for GDP rose 1.3 percent over the past four quarters. While this pace was 0.3 percentage point higher than the published rate over the previous year, both rates are about the same after adjusting for the effects of the terrorist attacks.

After having dipped noticeably during the summer, median year-ahead expected inflation, as measured by Michigan Survey, has returned to levels recorded earlier in the year. At 2.7 percent in November, year-ahead inflation expectations are in line with its average for the past ten years. Median expected consumer price inflation over the next five to ten years also stood at 2.7 percent, its average level in each of the past three quarters.

The employment cost index (ECI) for hourly compensation in private industry rose at an annual rate of 4.2 percent over the three months ending in September after having posted a 3.4 percent increase during the previous three months. The wage and salary component of the index increased at an annual rate of 3.5 percent for the three months ending in September, while benefits costs rose

11. In contrast with the PPI, which switches to the new-model-year vehicles completely in one month and includes financing incentives, the CPI brings new-model-year vehicles in incrementally as the mix of sales across model years changes and does not include financing incentives.

12. Because a large share of insurance services are purchased from abroad, the BEA's downward adjustment to nominal insurance services boosted GDP prices in the third quarter of 2001 even as it reduced consumption prices.

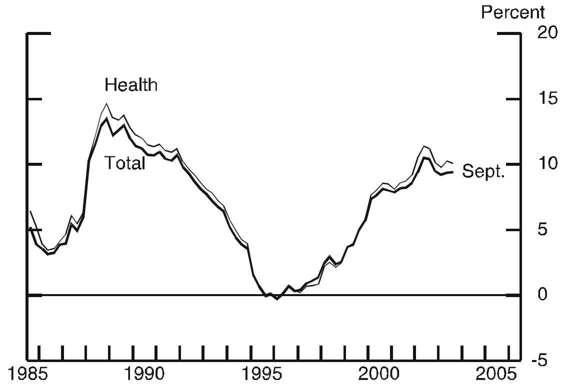
**Change in Employment Cost Index of Hourly Compensation for Private-Industry Workers**

| Industry and occupational group | 2002 Sept. | 2002 Dec. | 2003 Mar. | 2003 June | 2003 Sept. |
|---|---|---|---|---|---|
| | Quarterly change (compound annual rate) [1] | | | | |
| **Total hourly compensation** | **2.5** | **3.0** | **5.5** | **3.4** | **4.2** |
| Wages and salaries | 1.8 | 2.1 | 4.1 | 2.5 | 3.5 |
| Benefits | 4.3 | 5.0 | 10.0 | 5.5 | 5.6 |
| *By industry* | | | | | |
| Construction | 3.1 | 4.2 | 3.3 | 4.6 | 3.3 |
| Manufacturing | 3.3 | 4.3 | 7.4 | 3.5 | 3.4 |
| Transportation and public utilities | 4.6 | 3.5 | 3.0 | 5.2 | 2.4 |
| Wholesale trade | .5 | 2.7 | 6.9 | 2.1 | 3.1 |
| Retail trade | 1.6 | 1.5 | -.3 | 1.8 | 7.1 |
| FIRE | 1.7 | 1.2 | 20.9 | 3.7 | 4.3 |
| Services | 2.5 | 2.5 | 3.4 | 3.1 | 4.3 |
| *By occupation* | | | | | |
| White collar | 2.5 | 2.7 | 5.9 | 2.6 | 4.8 |
| Blue collar | 3.4 | 3.6 | 5.4 | 3.8 | 3.8 |
| Service occupations | 3.9 | 2.3 | 4.8 | 2.8 | 3.0 |
| Memo: | | | | | |
| State and local governments | 5.2 | 4.1 | 3.8 | 4.0 | 2.7 |
| | 12-month change | | | | |
| **Total hourly compensation** | **3.7** | **3.2** | **3.8** | **3.5** | **4.0** |
| Excluding sales workers | 3.6 | 3.3 | 3.8 | 3.8 | 4.0 |
| Wages and salaries | 3.2 | 2.7 | 3.0 | 2.6 | 3.0 |
| Excluding sales workers | 3.2 | 2.7 | 2.9 | 2.8 | 3.0 |
| Benefits | 4.8 | 4.7 | 6.1 | 6.1 | 6.5 |
| *By industry* | | | | | |
| Construction | 3.0 | 3.2 | 3.2 | 3.8 | 3.8 |
| Manufacturing | 3.8 | 3.8 | 4.7 | 4.6 | 4.7 |
| Transportation and public utilities | 4.8 | 4.0 | 3.8 | 4.1 | 3.5 |
| Wholesale trade | 4.6 | 4.5 | 4.7 | 3.0 | 3.7 |
| Retail trade | 3.4 | 1.7 | 2.0 | 1.2 | 2.5 |
| FIRE | 4.4 | 4.5 | 7.0 | 6.6 | 7.3 |
| Services | 3.1 | 2.7 | 2.8 | 2.9 | 3.3 |
| *By occupation* | | | | | |
| White collar | 3.7 | 3.2 | 3.8 | 3.4 | 4.0 |
| Sales | 4.3 | 3.3 | 3.7 | 2.2 | 3.5 |
| Nonsales | 3.6 | 3.1 | 3.9 | 3.7 | 4.1 |
| Blue collar | 3.5 | 3.6 | 4.0 | 4.1 | 4.2 |
| Service occupations | 4.2 | 3.2 | 3.4 | 3.3 | 3.0 |
| Memo: | | | | | |
| State and local governments | 3.8 | 4.1 | 4.2 | 4.1 | 3.6 |

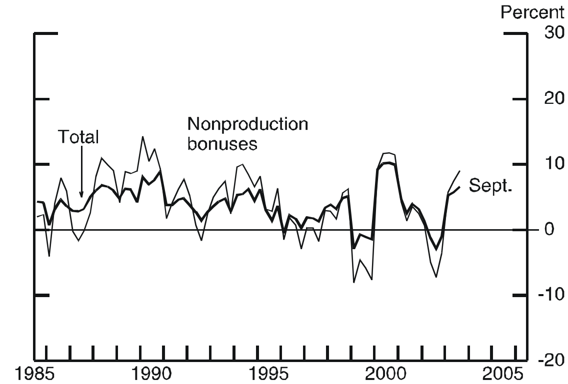
1. Seasonally adjusted by the BLS.

# ECI Benefits Costs
(Private-industry workers; 12-month change)

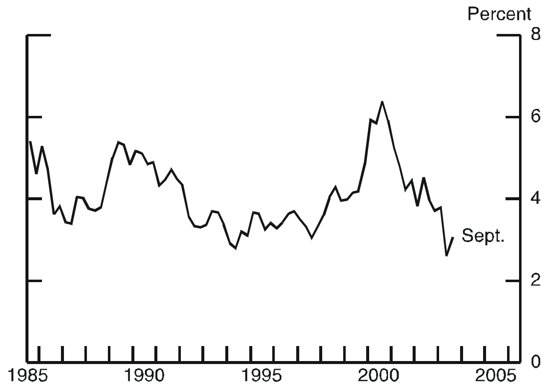
Insurance Costs



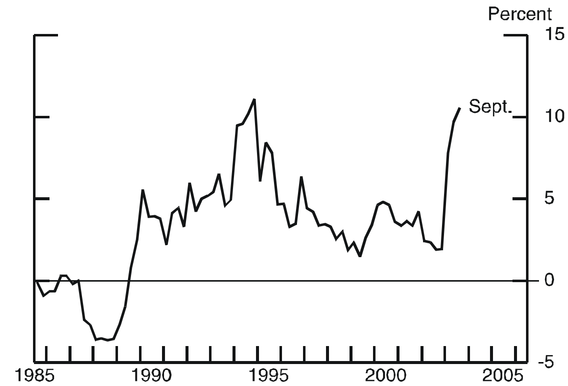

Supplemental Pay



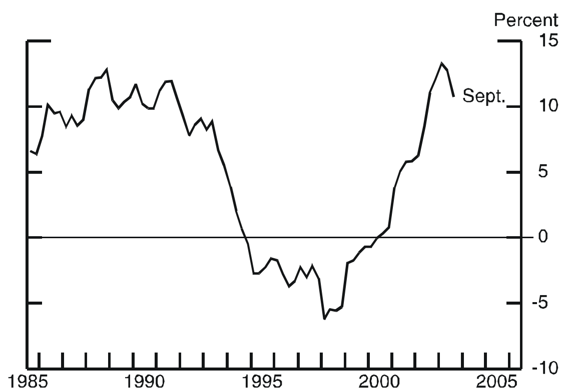

Paid Leave



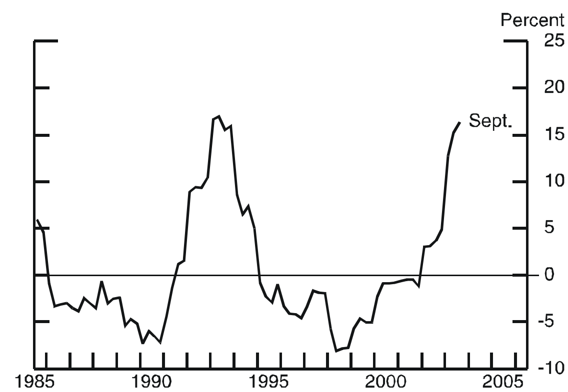

Retirement and Savings




Workers' Compensation Insurance




State Unemployment Insurance

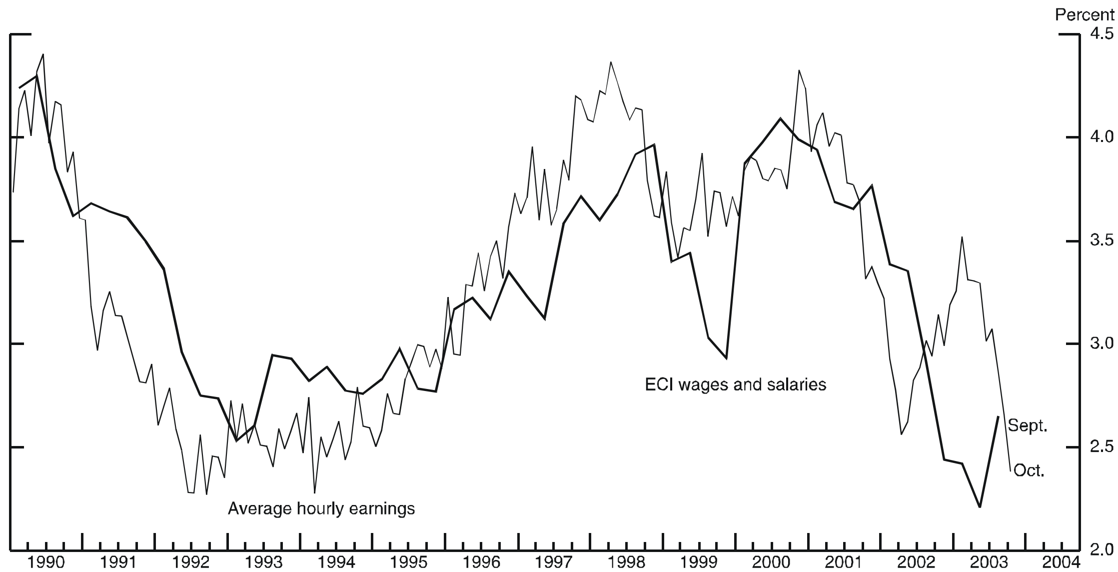


**Hourly Compensation and Unit Labor Costs**
(Percent change, annual rate; based on seasonally adjusted data)

| Category | 2001 [1] | 2002 [1] | 2002 Q4 | 2003 Q1 | 2003 Q2 | 2003 Q3 | 2002:Q3 to 2003:Q3 |
|---|---|---|---|---|---|---|---|
| *Compensation per hour* | | | | | | | |
| Total business | 2.9 | 2.8 | 1.6 | 3.2 | 4.1 | 2.3 | 2.8 |
| Nonfarm business | 2.7 | 2.8 | 1.6 | 2.6 | 3.6 | 3.0 | 2.7 |
| Nonfinancial corporations [2] | 2.4 | 3.3 | 2.8 | 3.8 | 3.7 | 3.0 | 3.3 |
| *Unit labor costs* | | | | | | | |
| Total business | -.3 | -1.4 | .1 | .5 | -3.1 | -5.8 | -2.1 |
| Nonfarm business | -.5 | -1.6 | -.1 | .4 | -3.2 | -5.8 | -2.2 |
| Nonfinancial corporations [2] | -1.8 | -1.0 | -1.0 | .4 | -4.3 | -5.6 | -2.7 |

1. Changes are from fourth quarter of preceding year to fourth quarter of year shown.
2. The nonfinancial corporate sector includes all corporations doing business in the United States with the exception of banks, stock and commodity brokers, finance and insurance companies; the sector accounts for about two-thirds of business employment.

**Average Hourly Earnings for Production or Nonsupervisory Workers**
(12-month change)



at a 5.6 percent rate. Over the twelve months ending in September, ECI hourly compensation in private industry rose 4.0 percent—about 1/4 percentage point higher than the level a year ago. The increase in wages and salaries slipped slightly from 3.2 percent to 3.0 percent, but this slowing was more than offset by an acceleration in benefits costs, which picked up from a 4.8 percent pace to a 6.5 percent pace.

Compensation per hour in the nonfarm business sector as measured in the BLS productivity and cost release increased at an annual rate of 3.0 percent in the third quarter; the rise brings the four-quarter change in this series to 2.7 percent, 0.2 percentage point less than in the preceding year. Average hourly earnings of production or nonsupervisory workers on private nonfarm payrolls rose 2.4 percent from October 2002 to October 2003; this increase was 3/4 percentage point less than in the corresponding 2001-02 period.

# Domestic Financial Developments

III-T-1

**Selected Financial Market Quotations**

(One-day quotes in percent except as noted)

| Instrument | 2002 Dec. 31 | 2003 June 24 | 2003 Oct. 27 | 2003 Dec. 2 | Change to Dec. 2 from selected dates (percentage points) 2002 Dec. 31 | 2003 June 24 | 2003 Oct. 27 |
|---|---|---|---|---|---|---|---|
| *Short-term* | | | | | | | |
| FOMC intended federal funds rate | 1.25 | 1.25 | 1.00 | 1.00 | -.25 | -.25 | .00 |
| Treasury bills [1] | | | | | | | |
| 3-month | 1.20 | 0.81 | 0.96 | 0.92 | -.28 | .11 | -.04 |
| 6-month | 1.21 | 0.82 | 1.03 | 1.02 | -.19 | .20 | -.01 |
| Commercial paper (A1/P1 rates) | | | | | | | |
| 1-month | 1.28 | 0.91 | 1.02 | 1.00 | -.28 | .09 | -.02 |
| 3-month | 1.36 | 0.88 | 1.09 | 1.07 | -.29 | .19 | -.02 |
| Large negotiable CDs [1] | | | | | | | |
| 1-month | 1.34 | 0.96 | 1.05 | 1.10 | -.24 | .14 | .05 |
| 3-month | 1.31 | 0.93 | 1.10 | 1.11 | -.20 | .18 | .01 |
| 6-month | 1.32 | 0.92 | 1.15 | 1.21 | -.11 | .29 | .06 |
| Eurodollar deposits [2] | | | | | | | |
| 1-month | 1.30 | 0.94 | 1.05 | 1.10 | -.20 | .16 | .05 |
| 3-month | 1.30 | 0.91 | 1.09 | 1.10 | -.20 | .19 | .01 |
| Bank prime rate | 4.25 | 4.25 | 4.00 | 4.00 | -.25 | -.25 | .00 |
| *Intermediate- and long-term* | | | | | | | |
| U.S. Treasury[3] | | | | | | | |
| 2-year | 1.60 | 1.14 | 1.83 | 2.07 | .47 | .93 | .24 |
| 10-year | 4.09 | 3.46 | 4.44 | 4.55 | .46 | 1.09 | .11 |
| 30-year | 4.96 | 4.53 | 5.29 | 5.31 | .35 | .78 | .02 |
| U.S. Treasury 10-year indexed note | 2.32 | 1.70 | 1.96 | 2.06 | -.26 | .36 | .10 |
| Municipal revenue (Bond Buyer) [4] | 5.16 | 4.89 | 5.25 | 5.09 | -.07 | .20 | -.16 |
| Private instruments | | | | | | | |
| 10-year swap | 4.22 | 3.67 | 4.68 | 4.81 | .59 | 1.14 | .13 |
| 10-year FNMA[5] | 4.49 | 3.84 | 4.79 | 4.82 | .33 | .98 | .03 |
| 10-year AA [6] | 5.06 | 4.13 | 5.09 | 5.18 | .12 | 1.05 | .09 |
| 10-year BBB [6] | 6.45 | 5.16 | 5.88 | 5.90 | -.55 | .74 | .02 |
| High-yield [7] | 12.03 | 9.03 | 8.56 | 8.32 | -3.71 | -.71 | -.24 |
| Home mortgages (FHLMC survey rate) [8] | | | | | | | |
| 30-year fixed | 5.93 | 5.21 | 6.05 | 5.89 | -.04 | .68 | -.16 |
| 1-year adjustable | 4.01 | 3.51 | 3.76 | 3.77 | -.24 | .26 | .01 |

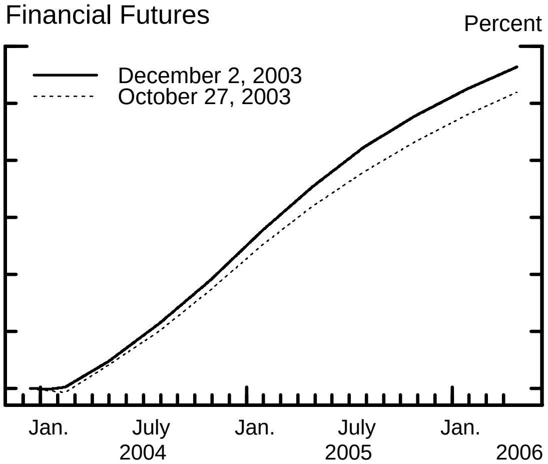
| Stock exchange index | Record high Level | Record high Date | 2003 June 24 | 2003 Oct. 27 | 2003 Dec. 2 | Change to Dec. 2 from selected dates (percent) Record high | 2003 June 24 | 2003 Oct. 27 |
|---|---|---|---|---|---|---|---|---|
| Dow-Jones Industrial | 11,723 | 1-14-00 | 9,110 | 9,608 | 9,854 | -15.95 | 8.16 | 2.55 |
| S&P 500 Composite | 1,527 | 3-24-00 | 983 | 1,031 | 1,067 | -30.17 | 8.46 | 3.44 |
| Nasdaq (OTC) | 5,049 | 3-10-00 | 1,606 | 1,883 | 1,980 | -60.78 | 23.32 | 5.16 |
| Russell 2000 | 606 | 3-9-00 | 441 | 515 | 554 | -8.66 | 25.56 | 7.42 |
| Wilshire 5000 | 14,752 | 3-24-00 | 9,388 | 10,027 | 10,442 | -29.22 | 11.22 | 4.13 |

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 noncallable 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:
December 31, 2002, is the end of the last calendar year.
June 24, 2003, is the day before the most recent policy easing.
October 27, 2003, is the day before the most recent FOMC meeting.

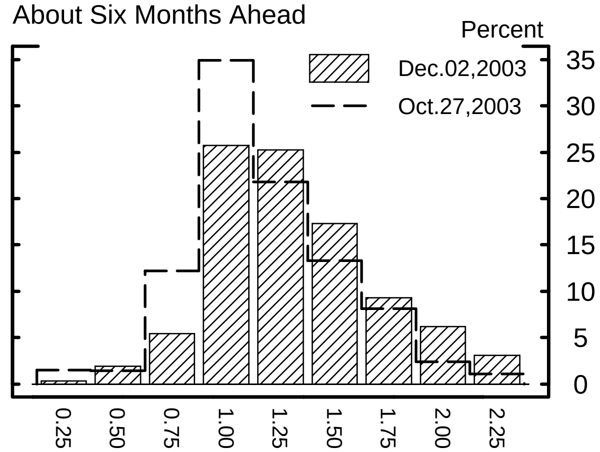
# Interest Rates and Policy Expectations

Expected Federal Funds Rate Estimated from Financial Futures



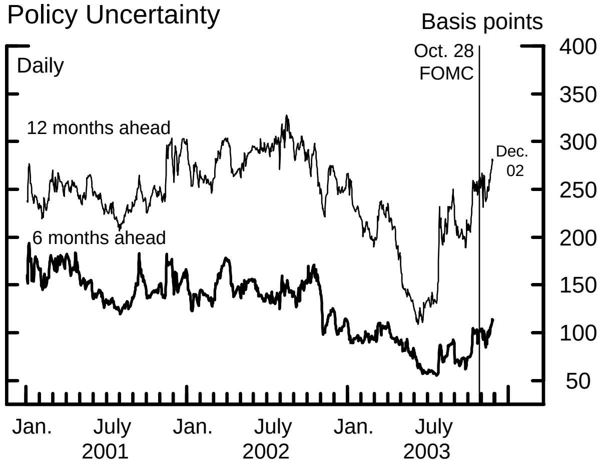

Note. Estimates from federal funds and eurodollar futures rates with an allowance for term premia and other adjustments.

Implied Distribution of Federal Funds Rate About Six Months Ahead



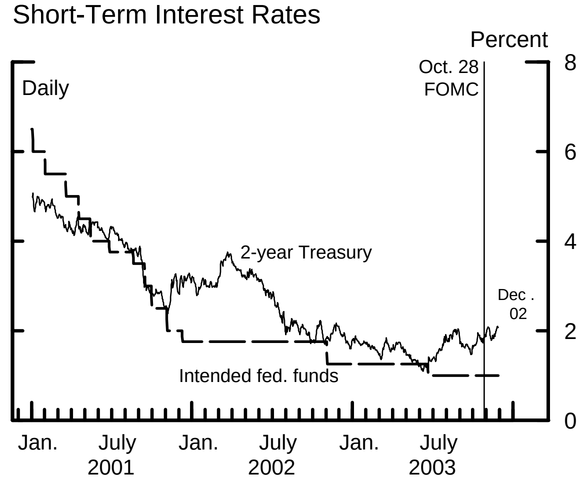

Note. Based on the distribution of the 3-month eurodollar rate 5 months ahead (adjusted for a risk premium), as implied by options on eurodollar futures contracts.

Policy Uncertainty

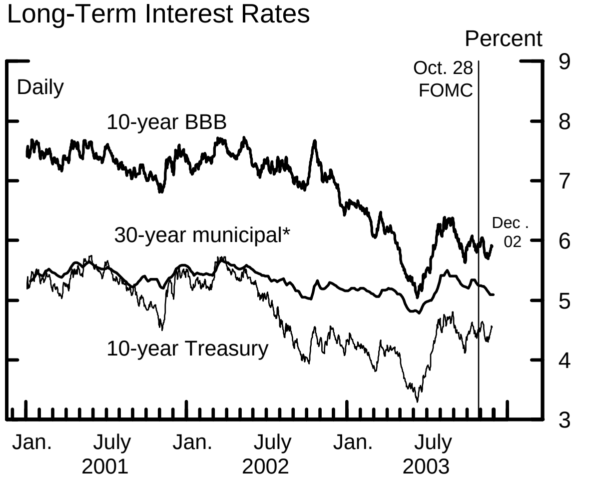



Note. Width of a 90 percent confidence interval computed from the term structures for the expected federal funds rate and implied volatility.

Short-Term Interest Rates

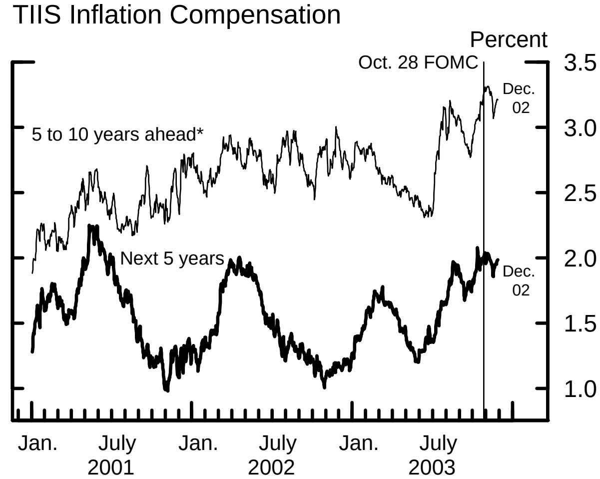



Long-Term Interest Rates




*Bond Buyer Revenue, weekly Thursday frequency.

TIIS Inflation Compensation




*Estimates based upon smoothed nominal and inflation-indexed yield curves.

# Domestic Financial Developments

## Overview

Near-term monetary policy expectations and money-market interest rates were little changed over the intermeeting period, tethered by policymakers' assurances that the stance of policy could remain accommodative for a considerable period. However, longer-term policy expectations and Treasury rates rose somewhat, reflecting the strengthening economic outlook. Domestic financial conditions have continued to move in a favorable direction: Broad stock price indexes posted moderate gains, risk spreads narrowed a bit further, market volatility remained low, and indicators of asset quality strengthened in the business and household sectors. With profits continuing to rise sharply, business borrowing picked up only slightly in October and November. Household debt growth appears to have moderated somewhat in the current quarter but remained quite brisk by historical standards. In contrast, M2 contracted over the intermeeting period, but the weakness likely reflects a falloff in mortgage refinancing activity and a shift in portfolio preferences to securities markets rather than current or prospective weakness in the economy.

## Policy Expectations and Treasury Yields

Very near-term policy expectations remained anchored near 1 percent over the intermeeting period, but expectations further ahead oscillated, rising on better-than-expected economic data and falling, on net, in response to statements by Federal Reserve officials suggesting that policy tightening was not imminent. On balance, the expected path for policy shifted up as much as 1/4 percentage point beyond the middle of next year. Current futures quotes suggest that investors continue to place significant odds on a quarter-point tightening by mid-2004 and anticipate a funds rate in the neighborhood of 2 percent by the end of 2004. Market uncertainty regarding future policy, measured by the implied volatility on eurodollar options contracts, rose some but remained at moderate levels, especially at near horizons.

Like policy expectations, intermediate and long-term Treasury yields moved up on incoming data and down on Federal Reserve statements. On balance, nominal Treasury coupon yields increased 2 to 24 basis points, with the larger increases at intermediate maturities. Yields on Treasury inflation-indexed securities closely tracked nominal yields over the period, leaving measures of inflation compensation about unchanged. Long-term interest rates were somewhat less volatile than they had been in recent months, and option prices indicated that expected volatility going forward also declined some.

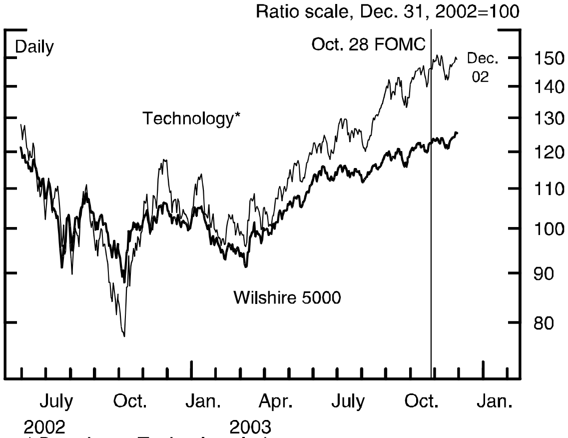
## Stock Prices and Corporate Risk Spreads

Broad equity price indexes rose moderately over the intermeeting period, and implied forward-looking stock market volatility remained low. Generally favorable economic data provided a boost to stock prices, which was partly offset by concerns about global terrorism, trade disputes, and periods of dollar

12/03/03

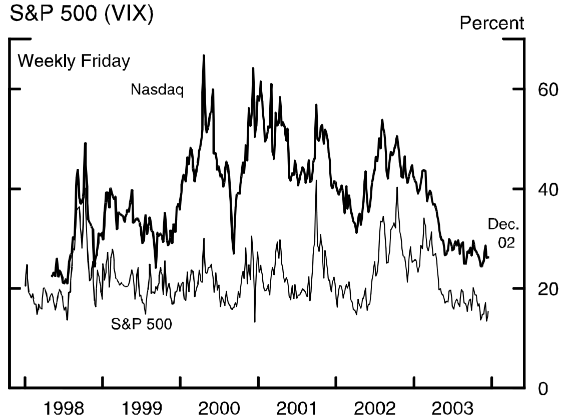
# Stock Prices and Corporate Risk Spreads

## Stock Prices

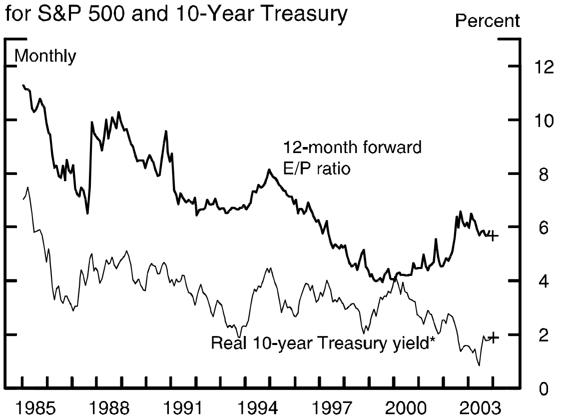



* Dow Jones Technology Index.

## Implied Volatility on Nasdaq 100 (VXN) and S&P 500 (VIX)

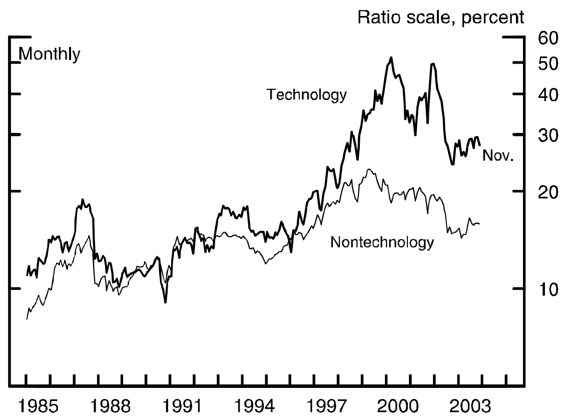



## 12-Month Forward Earnings-Price Ratio for S&P 500 and 10-Year Treasury



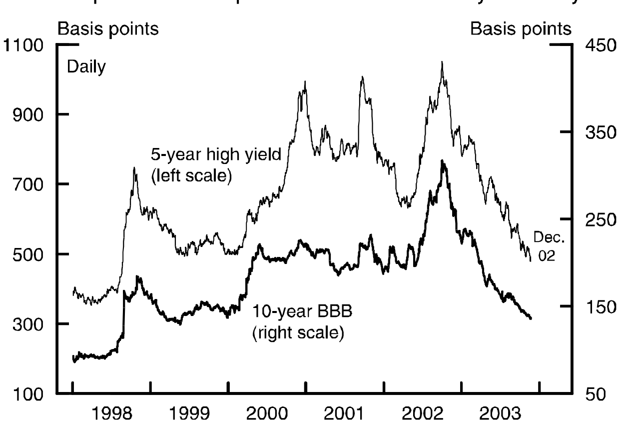

* 10-year Treasury yield minus Philadelphia Fed 10-year expected inflation.
\+ Denotes the latest observation using daily interest rates and stock prices and latest earnings data from I/B/E/S.

## Selected S&P 500 Price-Earnings Ratios

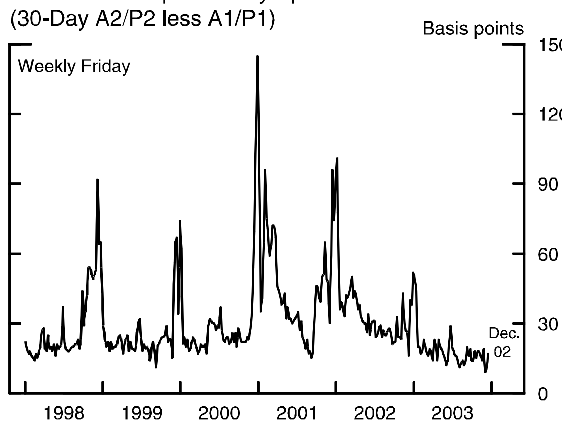



Note. Using expected earnings for 12 months ahead.
Source: I/B/E/S.

## Corporate Bond Spreads to Similar Maturity Treasury




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



weakness. The small-cap sector and technology stocks posted stronger gains than the broader indexes. The growing scope of the investigations into mutual fund practices did not appear to affect the broad market for equities, although stock prices fell for some of the fund management companies under investigation. The expected forward-earnings yield on the S&P 500 index changed little over the intermeeting period, and the gap over the real Treasury yield held steady within the upper part of its range of the past two decades.

Risk spreads on corporate bonds continued to decline, with investment-grade spreads edging down and speculative grades falling more substantially. Spreads on five-year speculative-grade corporate bonds narrowed another 49 basis points, a drop that brought them down to levels last seen in 1999. Risk spreads for commercial paper remained low, even as thirty-day paper began to be placed over year-end. The light year-end pressures in the commercial paper market to date appear to be the lowest seen in at least six years, likely reflecting greater liquidity and reduced rollover concerns now that some of the riskier issuers have exited the market.

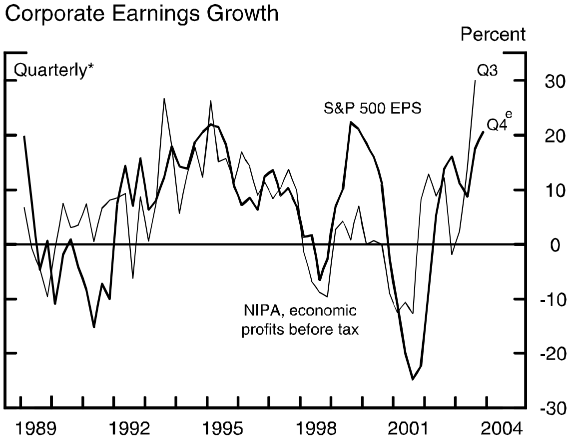
**Corporate Earnings and Credit Quality**

Reports at the end of the third-quarter earnings season provided few surprises. Earnings of retailers and other late reporters were consistent with investors' elevated expectations, and the paucity of forward-looking guidance gave little basis for revising those expectations for the fourth quarter. Accordingly, the expected year-over-year growth rate in S&P 500 earnings per share for the fourth quarter was about unchanged at 21 percent, with revisions to year-ahead earnings forecasts similarly negligible. Expected growth rates over the longer term were little changed in November but have now retraced virtually the entire run-up in the second half of the 1990s.

Corporate credit quality continued to improve. Moody's downgrades of nonfinancial firms' bond ratings have been muted in recent months relative to the pace of the first half of the year. Even the headline-grabbing downgrade of Ford to a "BBB-" by Standard and Poor's had a positive market effect because the accompanying text made it clear that the rating outlook for Ford going forward was stable. Delinquency rates on C&I loans at banks fell again in the third quarter, and realized default rates on corporate bonds also dropped further. Indeed, only $170 million of corporate bonds defaulted in October, the lowest monthly total since 1997. Expected year-ahead default rates based on firm-specific measures from the KMV Corporation continued their sharp downward trend.

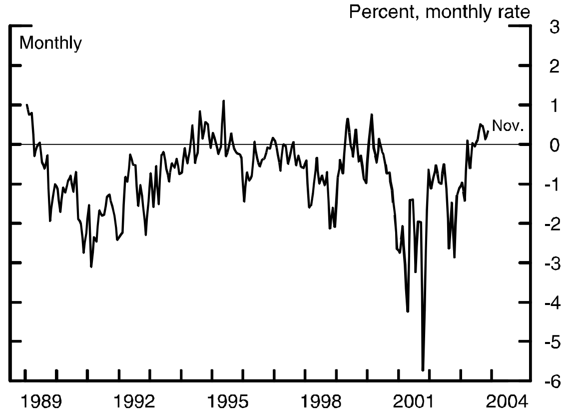
# Corporate Credit Quality and Earnings

## Corporate Earnings Growth



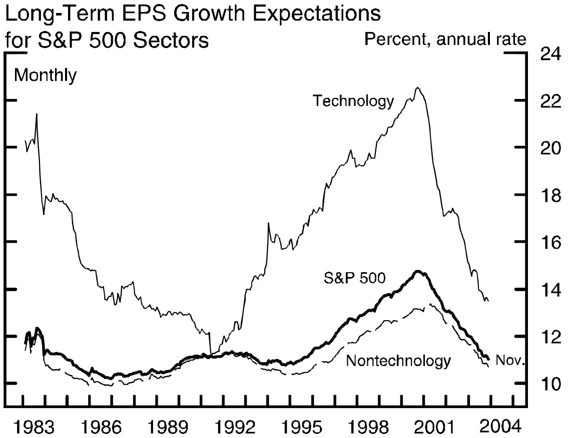

e Analysts' estimate as of December 2, 2003.
* Change from 4 quarters earlier.
Source. I/B/E/S for S&P 500 EPS.

## S&P 500 EPS Revisions Index



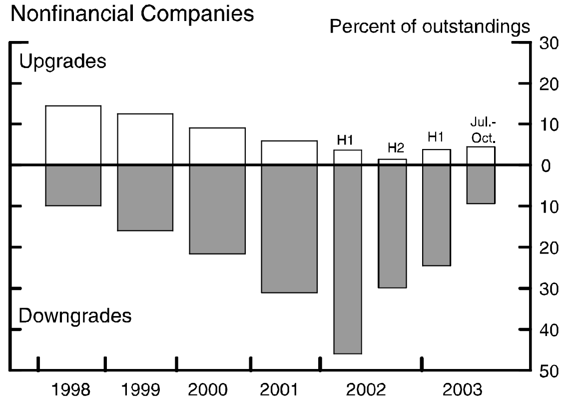

Note. Index is a weighted average of the percent change in the consensus forecasts of current-year and following-year EPS.

## Long-Term EPS Growth Expectations for S&P 500 Sectors



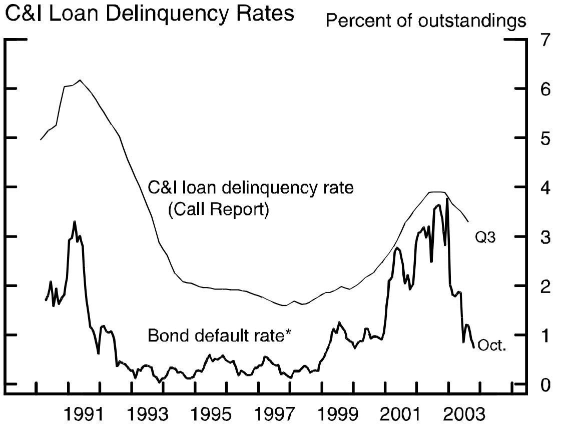

Note. Earnings-weighted average of I/B/E/S consensus firm-level 5-year growth forecasts.

## Bond Ratings Changes of Nonfinancial Companies



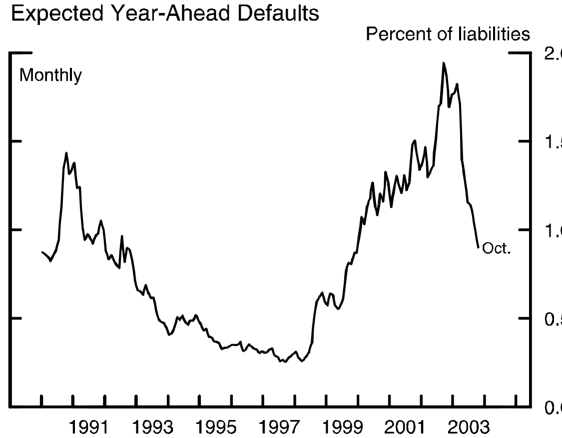

Note. Data are at an annual rate.
Source. Moody's Investors Service

## Bond Default and C&I Loan Delinquency Rates




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

## Expected Year-Ahead Defaults




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

# Business Finance

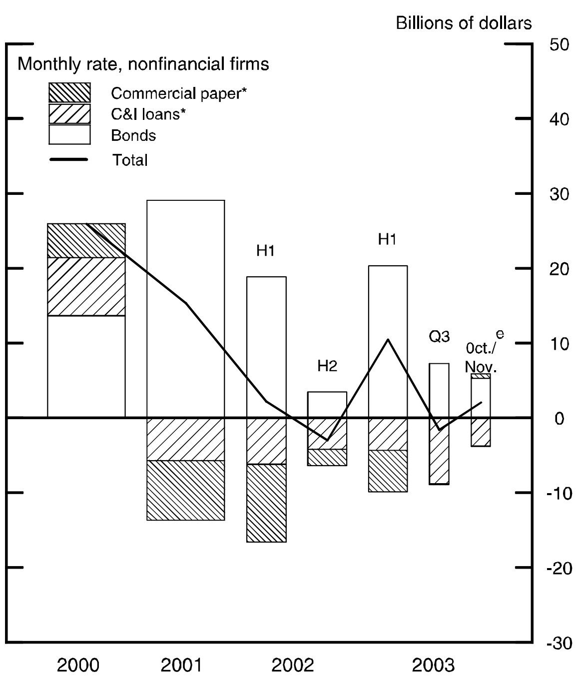
## Gross Issuance of Securities by U.S. Corporations

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

| Type of security | 2000 | 2001 | 2002 H1 | 2002 H2 | 2003 H1 | 2003 Q3 | 2003 Oct. | 2003 Nov. e |
|---|---|---|---|---|---|---|---|---|
| *Nonfinancial corporations* | | | | | | | | |
| Stocks [1] | 9.9 | 6.5 | 7.4 | 2.9 | 2.8 | 3.9 | 4.8 | 7.0 |
| Initial public offerings | 4.4 | 2.1 | 1.2 | 0.3 | 0.0 | 0.7 | 0.6 | 1.4 |
| Seasoned offerings | 5.5 | 4.4 | 6.3 | 2.6 | 2.8 | 3.2 | 4.1 | 5.6 |
| Bonds | 22.7 | 39.8 | 31.7 | 17.8 | 36.3 | 26.1 | 27.5 | 23.1 |
| Investment grade [2] | 13.2 | 27.5 | 19.8 | 11.6 | 20.0 | 10.3 | 14.0 | 12.0 |
| Speculative grade [2] | 4.7 | 8.9 | 6.4 | 3.3 | 11.5 | 12.2 | 8.6 | 10.4 |
| Other (sold abroad/unrated) | 4.9 | 3.4 | 5.6 | 2.9 | 4.9 | 3.7 | 4.8 | 0.6 |
| *Memo* | | | | | | | | |
| Net issuance of commercial paper [3] | 4.5 | -8.0 | -10.4 | -2.2 | -4.3 | -0.1 | 0.8 | 0.2 |
| Change in C&I loans at commercial banks [3] | 7.8 | -5.7 | -6.2 | -4.4 | -5.7 | -8.9 | -8.2 | -0.9 |
| *Removing FIN 46 effects* | | | | | | | | |
| *Financial corporations* | | | | | | | | |
| Stocks [1] | 1.4 | 4.2 | 4.2 | 3.8 | 6.0 | 6.7 | 4.3 | 4.0 |
| Bonds [4] | 57.8 | 80.2 | 90.0 | 83.9 | 106.3 | 102.7 | 106.1 | 109.5 |

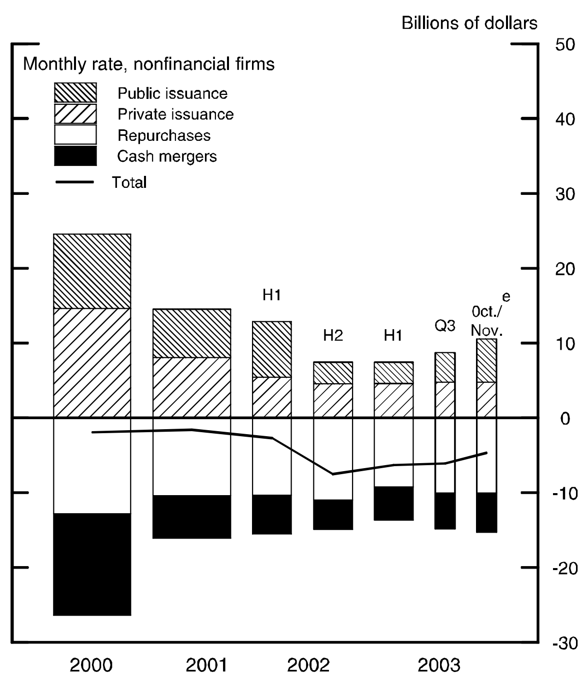
Note. Components may not sum to totals because of rounding. These data include bonds issued privately under Rule 144A. All other private placements are excluded. Total reflects gross proceeds rather than par value of original discount bonds.
1. Excludes equity issues associated with equity-for-equity 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.

### Selected Components of Net Debt Financing




* Seasonally adjusted.
e Staff estimate.

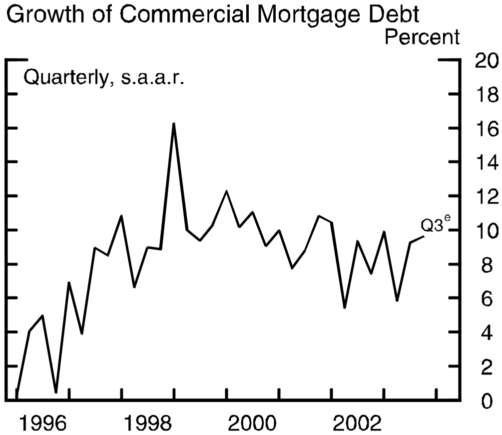
### Components of Net Equity Issuance




e Staff estimate.

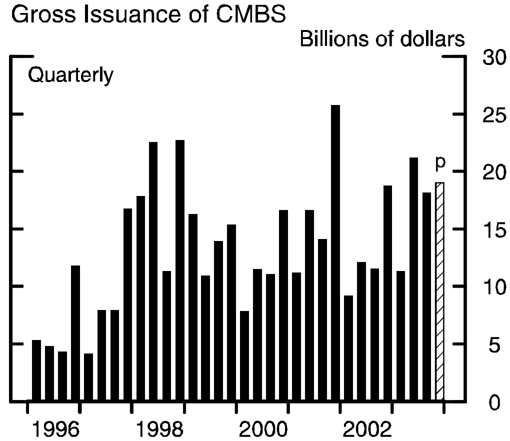
# Commercial Real Estate

## Growth of Commercial Mortgage Debt



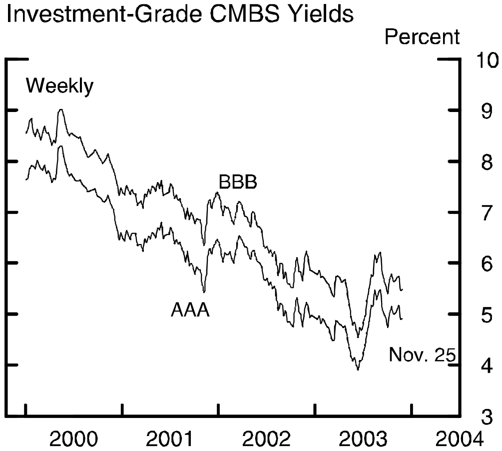

e Staff estimate.

## Gross Issuance of CMBS



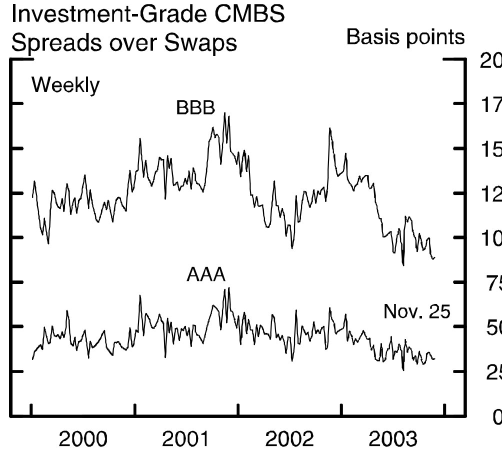

p Period to date at a quarterly rate.
Source. Commercial Mortgage Alert.

## Investment-Grade CMBS Yields



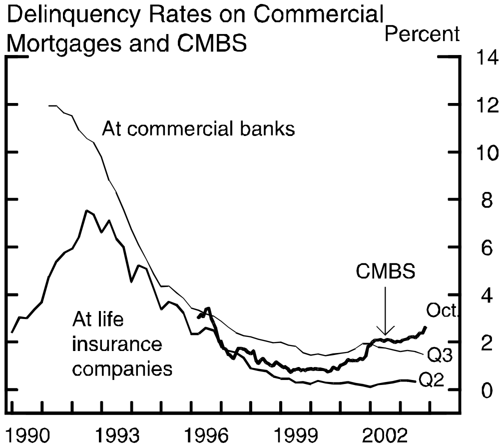

Source. Morgan Stanley.

## Investment-Grade CMBS Spreads over Swaps



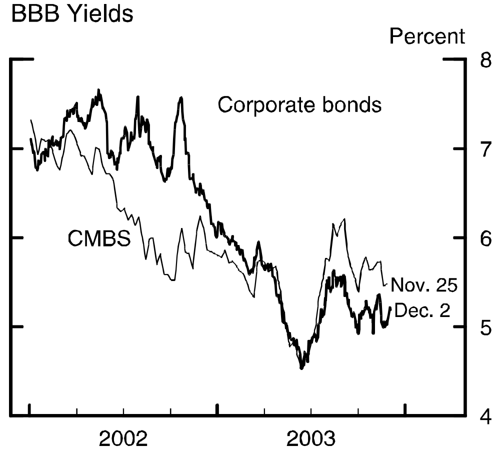

Source. Morgan Stanley.

## Delinquency Rates on Commercial Mortgages and CMBS




Source. Call Report, ACLI, Morgan Stanley.

## BBB Yields




Source. Merrill Lynch, Morgan Stanley.

**Business Finance**
Gross bond issuance by nonfinancial firms held steady in October and November at about the third-quarter pace, with strong issuance in both the investment-grade and speculative-grade sectors. A large part of the proceeds were used to pay down outstanding debt, and net bond issuance remained sluggish. In shorter-term funding markets, outstanding commercial paper was about flat in October and November, while outstanding C&I loans contracted again but at a slower pace than in the third quarter. On balance, net debt financing by nonfinancial businesses has been slightly positive in the fourth quarter to date.

Gross equity issuance by nonfinancial firms in October and November picked up from its third-quarter pace, with November registering the largest monthly total in more than a year. Seasoned offerings were especially robust in November, although a significant share of the proceeds was earmarked for reducing debt. The IPO market continued to recover, and filings for planned issuance picked up. Equity retirements from share repurchases appear to have ticked up slightly since mid-year, as have announcements of cash-financed mergers. Overall, net equity issuance in the fourth quarter appears to be slightly less negative than during the prior year.

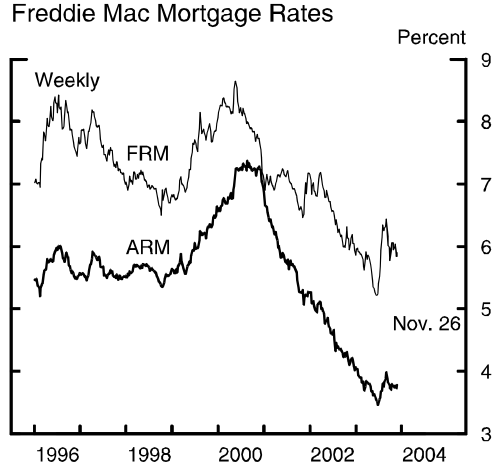
**Commercial Real Estate**
Commercial mortgage debt is estimated to have grown at a 9-1/2 percent annual rate in the third quarter, and the data in hand suggest a similarly robust pace in the fourth quarter. CMBS issuance remained brisk in the first two months of the quarter, and the pipeline for December indicates continued strong issuance. Yields on CMBS declined on net over the intermeeting period, and credit spreads remained at low levels. CMBS delinquency rates edged up in October, but overall commercial mortgage delinquency rates stayed low. BBB-rated CMBS generally continued to trade at a yield premium over similarly rated corporate debt, likely reflecting some concern about commercial real estate fundamentals and the rapid pace of CMBS issuance.

**Household Finance**
Interest rates on thirty-year fixed-rate mortgages remained around 6 percent during the intermeeting period, up from record lows touched at mid-year. Refinancing activity moved down in November but was still reasonably high by historical standards. The growth of home mortgage debt slowed only slightly, to a 13 percent rate, in the third quarter. With interest rates remaining attractive, mortgage debt is estimated to be growing at a still brisk pace in the fourth quarter.

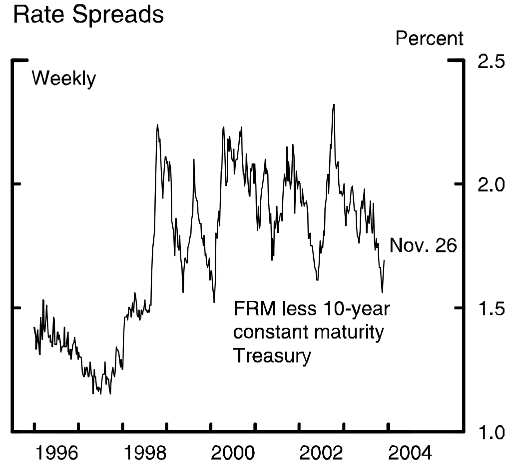
Consumer credit growth picked up to about a 6-1/2 percent annual rate in the third quarter, owing in part to a surge in auto loans that was supported by

# Household Liabilities

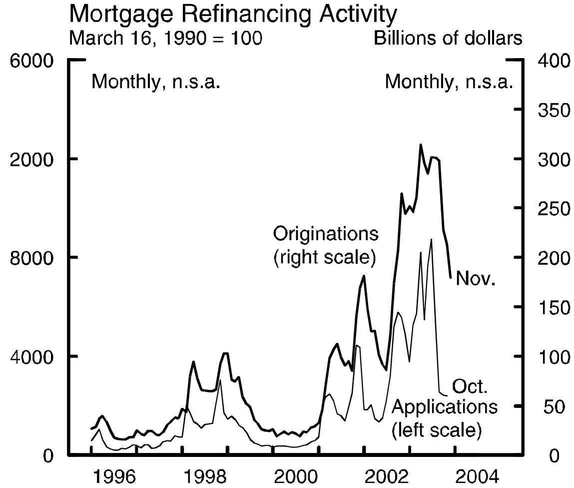
Freddie Mac Mortgage Rates




Rate Spreads

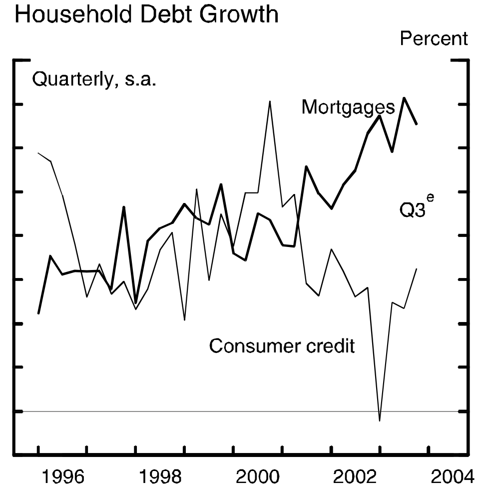



Mortgage Refinancing Activity



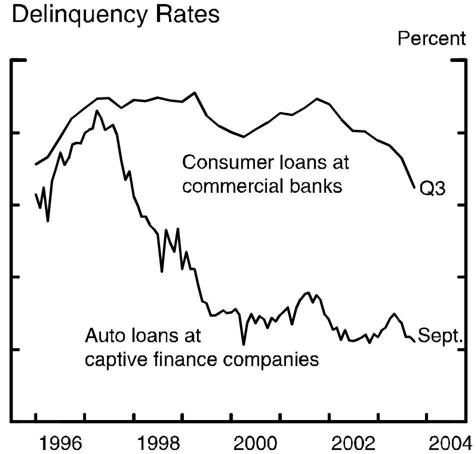

Source. Staff estimates.

Household Debt Growth



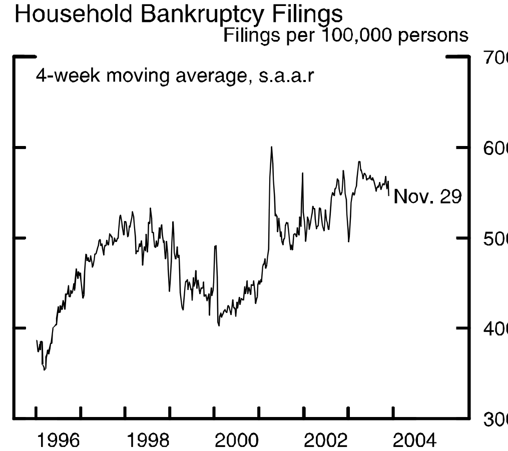

e Staff estimate.

Delinquency Rates




Source. Call Report, Federal Reserve.

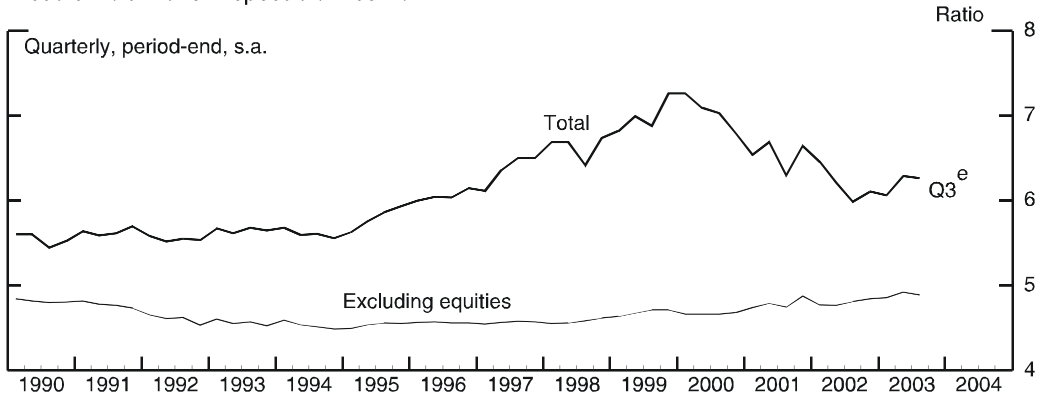
Household Bankruptcy Filings




Source. Visa Bankruptcy Notification Service Statistics.

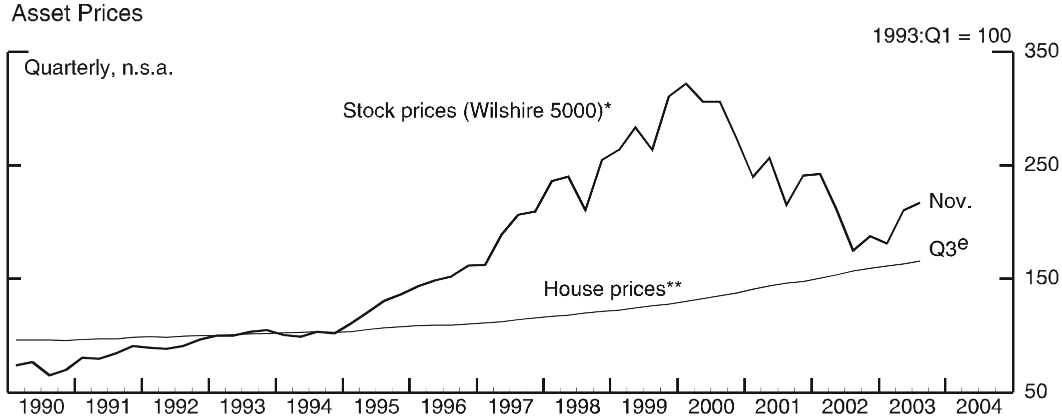
## Household Assets

Assets Relative to Disposable Income




e Staff estimate.

Asset Prices




* Based on data through December 2.
** Office of Federal Housing Enterprise Oversight (OFHEO).
e Staff estimate.

## Net Flows into Long-Term Mutual Funds

(Billions of dollars, monthly rate)

| | 2001 | 2002 | 2003 | | | | Assets |
|---|---|---|---|---|---|---|---|
| | | | H1 | Q3 | Oct. | Nov.e | Oct. |
| **Total long-term funds** | **10.8** | **10.2** | **19.1** | **14.5** | **28.1** | **14.6** | **5,072** |
| **Equity funds** | **2.8** | **-2.2** | **5.8** | **20.7** | **25.5** | **13.6** | **3,441** |
| Domestic | 4.6 | -2.0 | 5.4 | 18.2 | 19.4 | 11.1 | 2,971 |
| International | -1.8 | -0.2 | 0.5 | 2.5 | 6.1 | 2.5 | 470 |
| **Hybrid funds** | **0.7** | **0.7** | **2.0** | **3.5** | **3.9** | **3.0** | **404** |
| **Bond funds** | **7.3** | **11.7** | **11.3** | **-9.8** | **-1.3** | **-2.0** | **1,227** |
| High-yield | 0.6 | 0.9 | 3.7 | -0.1 | 2.1 | 1.5 | 146 |
| Other taxable | 5.7 | 9.5 | 7.1 | -7.5 | -2.3 | -2.1 | 749 |
| Municipals | 1.0 | 1.4 | 0.5 | -2.1 | -1.1 | -1.3 | 332 |

Note. Excludes reinvested dividends.
e Staff estimates based on confidential ICI weekly data.
Source. Investment Company Institute.

# State and Local Government Finance

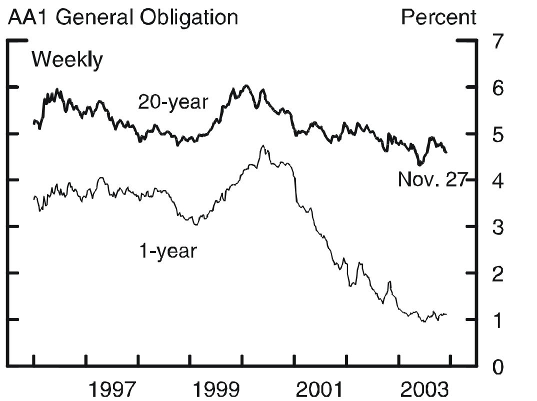
## Gross Offerings of Municipal Securities

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

| Type of security | 2000 | 2001 | 2002 | 2003 H1 | 2003 Q3 | 2003 Oct. | 2003 Nov. |
|---|---|---|---|---|---|---|---|
| Total | 17.9 | 29.0 | 36.4 | 40.3 | 34.5 | 41.1 | 23.3 |
| Long-term [1] | 15.0 | 24.3 | 30.3 | 34.1 | 28.3 | 33.9 | 22.1 |
| Refundings [2] | 2.2 | 7.6 | 10.1 | 11.3 | 8.1 | 10.0 | 4.2 |
| New capital | 12.9 | 16.7 | 20.3 | 22.8 | 20.2 | 23.8 | 17.9 |
| Short-term | 2.8 | 4.7 | 6.0 | 6.1 | 6.2 | 7.2 | 1.2 |
| Memo: Long-term taxable | 0.7 | 1.4 | 1.7 | 3.9 | 2.6 | 3.6 | 1.1 |

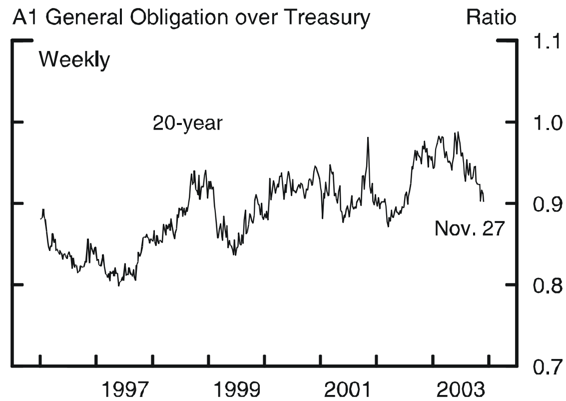
1. Includes issues for public and private purposes.
2. All issues that include any refunding bonds.

**Municipal Bond Yields**



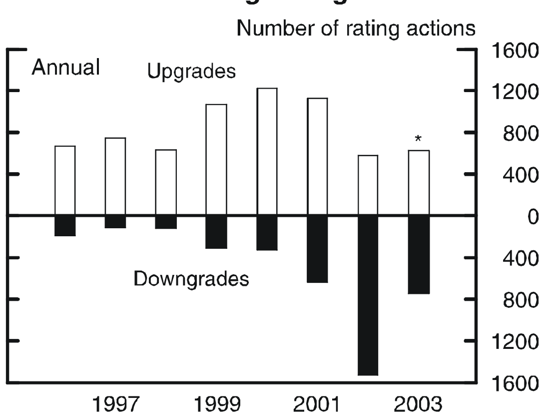

Source. Bloomberg.

**Municipal Bond Ratios**



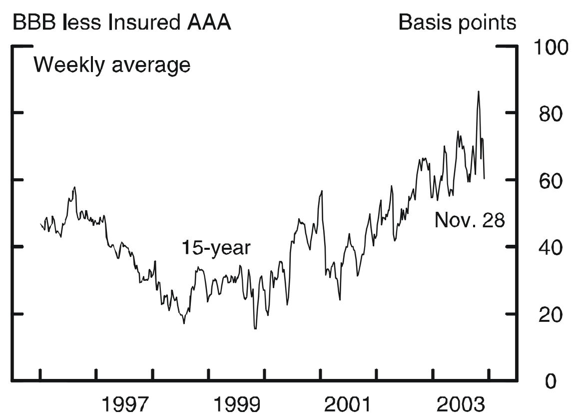

Source. Bond Buyer.

**Bond Rating Changes**




* Data through November 26 at an annual rate.
Source. S&P's Credit Week Municipal and Ratings Direct.

**Revenue Bond Spread**




Source. Bloomberg.

interest-rate incentives. Since September, a reduction in incentives has pushed auto loan rates up, pointing to a slowdown in loan growth in the fourth quarter.

According to the latest available information, household credit quality has continued to improve on balance. Delinquency rates on consumer loans and home mortgages at commercial banks fell for the third consecutive quarter. Delinquency rates on auto loans at the captive finance companies remained at low levels in September, and household bankruptcy filings have stabilized over the fourth quarter, albeit at still elevated levels.

Appreciation in the value of housing and equities boosted household net worth substantially over the third quarter. Meanwhile, the additional tax cuts lifted households' disposable income, leaving the ratio of household assets to disposable income about unchanged. In October and November, households continued to shift their mutual fund assets from bond funds to equity funds. To date, news of investigations into mutual fund trading practices has evidently not prompted a significant pullback by mutual fund investors, although some of the affected funds have seen sizable withdrawals.

**State and Local Government Finance**

Gross municipal bond issuance was strong in October but appears to have moderated in November, leaving issuance over the two months roughly on par with that of the third quarter. Issuance for long-term capital projects remained particularly robust, while refunding deals apparently declined as interest rates held steady.

Bond rating changes over the intermeeting period were similar to those seen earlier this year, with nearly as many upgrades as downgrades. Revenue-bond credit spreads eased from their recent highs, though they remain elevated, reflecting the ongoing stress on municipal finances. News that California might expand its borrowing next year reportedly had no effect on its outstanding bond spreads.

**Treasury and Agency Finance**

The Treasury's refunding announcement in November did not contain any changes in debt management policy, and the refunding auctions themselves proceeded smoothly. Fails to deliver in the May 2013 Treasury note, which have been elevated for some time, moved down recently, apparently as certain investors were enticed by the issue's scarcity premium to make their holdings available to the RP market. The fails in this issue remain an isolated problem, with little reported spillover into other securities or markets.

Freddie Mac announced on November 21 the long-awaited restatement of its earnings for 2000, 2001, and 2002. However, to the disappointment of some

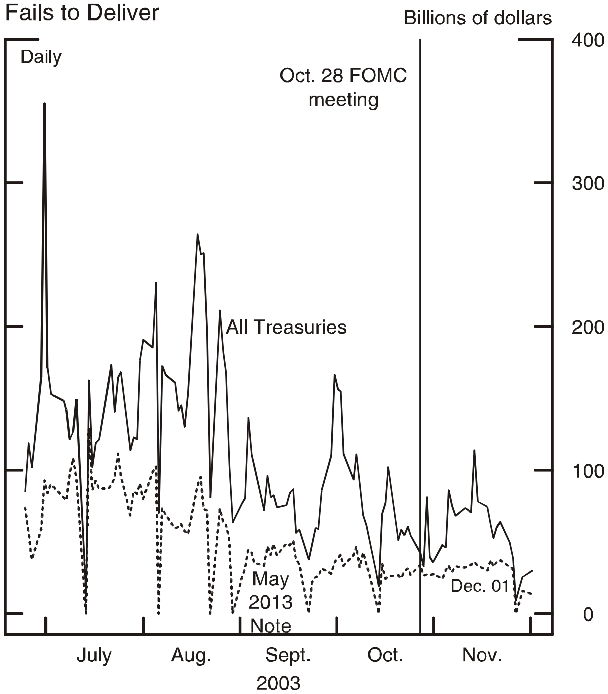
## Treasury Financing
(Billions of dollars)

| Item | 2002 | 2003 | | | | |
|---|---|---|---|---|---|---|
| | Q4 | Q1 | Q2 | Q3 | Sep. | Oct. |
| **Total surplus, deficit (−)** | **-108.2** | **-144.9** | **-16.6** | **-104.5** | **26.3** | **-69.5** |
| Means of financing deficit | | | | | | |
| Net borrowing | 96.9 | 63.5 | 106.3 | 107.6 | -23.4 | 64.6 |
| Nonmarketable | 14.9 | -50.5 | 45.9 | 31.4 | -26.9 | 6.7 |
| Marketable | 82.0 | 114.0 | 60.4 | 76.2 | 3.5 | 57.9 |
| Bills | 20.0 | 67.0 | -27.2 | -14.9 | -46.3 | 25.7 |
| Coupons[1] | 62.0 | 47.0 | 87.6 | 91.1 | 49.8 | 32.2 |
| Debt buybacks | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Decrease in cash balance | 27.9 | 19.8 | -16.8 | -4.9 | -29.5 | 0.0 |
| Other[2] | -16.5 | 61.6 | -73.0 | 1.9 | 26.6 | 4.9 |
| MEMO | | | | | | |
| Cash balance, end of period | 33.0 | 13.3 | 30.0 | 35.0 | 35.0 | 35.0 |

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.

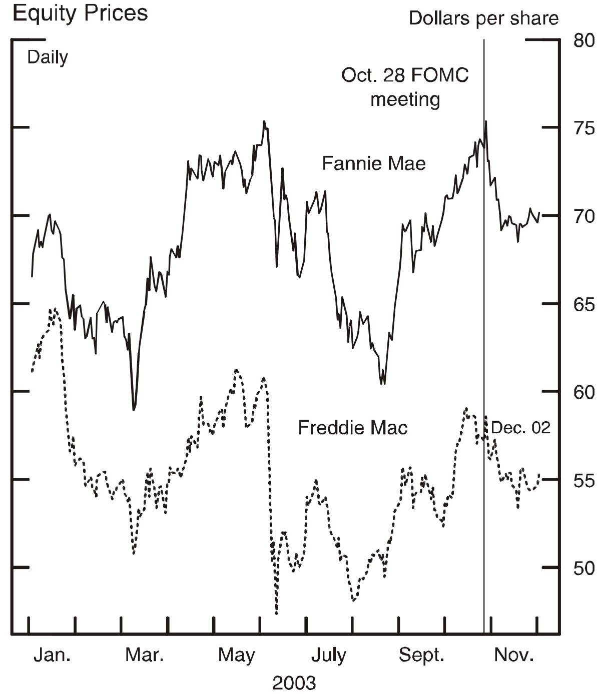
## Treasury and Agency Market Developments

Fails to Deliver




Note. Includes only those transactions cleared through the Fixed Income Clearing Corporation.

Equity Prices



investors, it indicated that quarterly earnings reports for 2003 will not be available until next year. The restatement produced a $5 billion upward revision to Freddie's earnings for the 2000-02 period as a whole, although earnings for 2001 were reduced. The magnitude of the revision was largely anticipated by market participants, but the agency's stock price moved up on the day of the restatement as a result of the resolution of the uncertainty.

**Money and Bank Credit**

M2 has declined at an average rate of 4-3/4 percent over the last three months. The staff estimates that a sizable part of the decrease owes to the falloff in mortgage refinancing activity, which depressed the growth of liquid deposits. Some of the weakness may also have reflected shifting portfolio preferences: The runoff of retail money market funds accelerated in October, perhaps reflecting the relative attractiveness of equity investments. Currency continued to rebound from its unusually sluggish pace this summer.

Bank credit appears to have rebounded in November after posting declines in the previous two months. Bank credit had been held down in September and October by heavy securitization of residential mortgages, but is estimated to have grown in November as banks reduced securitizations and rebuilt their MBS portfolios. A large purchase of a credit card portfolio from a nonbank contributed about five percentage points to November's estimated 10 percent growth rate for bank credit.

## Monetary Aggregates
(Based on seasonally adjusted data)

| Aggregate or component | 2002 | 2003 Q1 | 2003 Q2 | 2003 Q3 | 2003 Oct. | 2003 Nov. (e) | Level ($ billions) Dec. 01 (e) |
|---|---|---|---|---|---|---|---|
| | Percent change (annual rate)[1] | | | | | | |
| *Aggregate* | | | | | | | |
| 1. M2[2] | 6.8 | 6.4 | 8.5 | 9.1 | -6.0 | -4.3 | 6,070 |
| 2. M3[3] | 6.4 | 5.6 | 6.4 | 10.7 | -8.1 | -4.9 | 8,846 |
| *2a. Removing FIN 46 effects* [4] | | | | *8.4* | *-7.8* | *-4.8* | *8,796* |
| *Components of M2* [5] | | | | | | | |
| 3. Currency | 8.2 | 7.6 | 5.9 | 2.7 | 9.6 | 6.0 | 662 |
| 4. Liquid deposits[6] | 16.4 | 14.4 | 17.5 | 19.8 | -.3 | -.3 | 3,768 |
| 5. Small time deposits | -9.0 | -6.8 | -8.7 | -14.1 | -10.0 | -11.2 | 809 |
| 6. Retail money market funds | -6.0 | -10.0 | -7.2 | -6.8 | -38.4 | -23.4 | 824 |
| *Components of M3* | | | | | | | |
| 7. M3 minus M2[7] | 5.6 | 3.9 | 1.9 | 14.2 | -12.8 | -6.4 | 2,776 |
| 8. Large time deposits, net[8] | 3.0 | -2.6 | 1.7 | 32.2 | -14.5 | 13.3 | 875 |
| *8a. Removing FIN 46 effects* [4] | | | | *7.3* | *-11.5* | *16.1* | *825* |
| 9. Institutional money market funds | 2.3 | -4.8 | -14.5 | 13.6 | -31.0 | -25.2 | 1,125 |
| 10. RPs | 20.6 | 31.4 | 27.8 | -15.0 | 17.8 | 4.0 | 508 |
| 11. Eurodollars | 7.0 | 19.2 | 32.0 | 19.6 | 16.2 | -8.5 | 268 |
| *Memo* | | | | | | | |
| 12. Monetary base | 7.2 | 7.6 | 5.9 | 4.1 | 7.7 | 5.6 | 719 |
| | Average monthly change (billions of dollars)[9] | | | | | | |
| *Selected managed liabilities at commercial banks* | | | | | | | |
| 13. Large time deposits, gross | 1.7 | 1.6 | -4.2 | 16.3 | -25.7 | -1.0 | 1,009 |
| 14. Net due to related foreign institutions | -3.2 | 6.8 | -2.5 | -1.3 | 33.9 | 24.0 | 189 |
| 15. U.S. government deposits at commercial banks | -1.0 | -4.2 | .7 | 1.2 | -2.0 | 1.1 | 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 | Q3 2003 | Oct. 2003 | Nov.p 2003 | Level, Nov. 2003p ($ billions) |
|---|---|---|---|---|---|---|---|
| **Total** | | | | | | | |
| **1. Adjusted[1]** | **7.2** | **7.6** | **10.9** | **5.0** | **-4.4** | **10.0** | **5,990** |
| 2. Reported | 7.3 | 8.2 | 11.7 | 4.8 | -3.6 | 8.4 | 6,217 |
| *Securities* | | | | | | | |
| 3. Adjusted[1] | 13.6 | 13.6 | 17.7 | -1.2 | 16.9 | 25.5 | 1,640 |
| 4. Reported | 13.3 | 14.7 | 18.9 | -8.6 | 18.9 | 18.7 | 1,833 |
| 5. Treasury and agency | 20.2 | 18.5 | 29.0 | -16.3 | 17.8 | 19.6 | 1,094 |
| 6. Other[2] | 4.3 | 9.0 | 3.5 | 3.8 | 20.8 | 17.3 | 740 |
| *Loans[3]* | | | | | | | |
| 7. Total | 5.0 | 5.5 | 8.6 | 10.4 | -12.6 | 4.1 | 4,383 |
| *7a. Removing FIN 46 effects[4]* | | | | *8.5* | *-12.1* | *4.3* | |
| 8. Business | -7.0 | -6.0 | -6.9 | -9.2 | -15.1 | -7.5 | 887 |
| *8a. Removing FIN 46 effects[4]* | | | | *-7.3* | *-15.2* | *-7.1* | |
| 9. Real estate | 13.1 | 14.5 | 11.6 | 18.0 | -10.9 | -5.8 | 2,225 |
| *9a. Removing FIN 46 effects[4]* | | | | *11.6* | *-12.9* | *-5.8* | |
| 10. Home equity | 36.6 | 28.1 | 28.1 | 23.7 | 31.6 | 36.2 | 273 |
| 11. Other | 10.9 | 12.9 | 9.6 | 17.3 | -16.3 | -11.4 | 1,952 |
| 12. Consumer | 5.5 | 2.8 | 2.0 | 6.6 | -7.3 | 58.9 | 633 |
| 13. Adjusted[5] | 4.1 | 6.6 | 4.9 | 3.7 | 1.7 | 36.0 | 996 |
| 14. Other[6] | 1.6 | -3.4 | 30.2 | 17.5 | -19.8 | 3.0 | 639 |
| *14a. Removing FIN 46 effects[4]* | | | | *29.4* | *-9.4* | *3.7* | |

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.

# International Developments

# International Developments

## U.S. International Transactions

### Trade in Goods and Services

The U.S. international trade deficit in September rose to $41.3 billion, higher than during the previous three months.

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

| | 2002 | Annual rate 2003 | | | Monthly rate 2003 | | |
|---|---|---|---|---|---|---|---|
| | | Q1 | Q2 | Q3 | July | Aug. | Sept. |
| *Real NIPA*[1] | | | | | | | |
| Net exports of G&S | -488.5 | -510.3 | -546.1 | -524.2 | ... | ... | ... |
| *Nominal BOP* | | | | | | | |
| Net exports of G&S | -418.0 | -486.5 | -494.1 | -483.3 | -40.0 | -39.5 | -41.3 |
| Goods, net | -482.9 | -544.1 | -552.4 | -544.9 | -45.0 | -44.7 | -46.5 |
| Services, net | 64.8 | 57.6 | 58.3 | 61.6 | 5.0 | 5.2 | 5.2 |

1. Billions of chained (1996) dollars.
Source: U.S. Department of Commerce, Bureaus of Economic Analysis and Census.
n.a. Not available. ... Not applicable.

The value of exports of goods and services increased 2.8 percent in September, reversing the drop recorded in August. The rise was spread among all major trade categories, particularly automotive products and capital goods (especially semiconductors and computer accessories). Services receipts inched up from August levels. In the third quarter, the value of exported goods and services rose 13 percent at an annual rate, following three quarters of only small changes. Double-digit increases were recorded in services, computers, and semiconductors. Exported core goods rose 6 percent at an annual rate.

Nominal imports of goods and services jumped 3.3 percent in September, rebounding from the drop recorded in August, with increases in all major trade categories except oil. The largest increases were in automotive products (reversing nearly all of the drop recorded in August) and capital goods (especially computers and aircraft). Services payments were slightly above August levels. In the third quarter, the value of imported goods and services increased 6 percent at an annual rate, about twice the rate recorded in the second quarter but less than rates recorded in the previous five quarters. Double-digit increases were recorded in the third quarter for services and the value of oil, but imported core goods declined marginally.

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

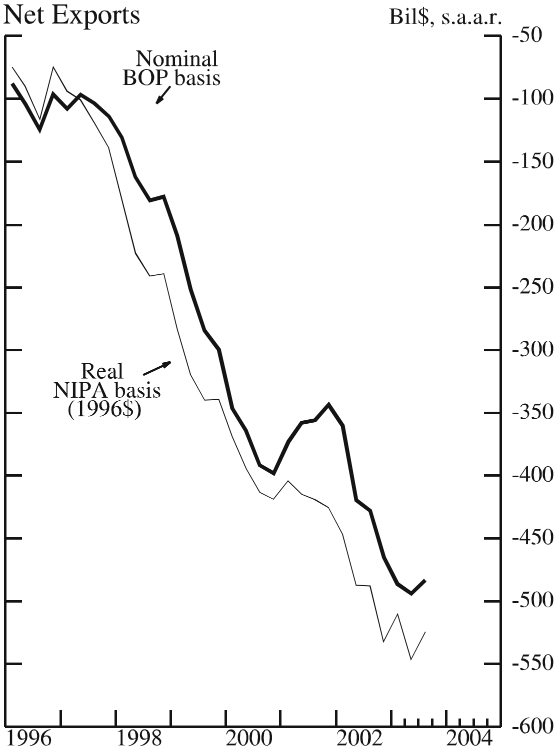
| | Levels | | | | Amount Change[1] | | | |
|---|---|---|---|---|---|---|---|---|
| | 2003 | | 2003 | | 2003 | | 2003 | |
| | Q2 | Q3 | Aug. | Sept. | Q2 | Q3 | Aug. | Sept. |
| **Exports of G&S** | **992.8** | **1023.9** | **1005.5** | **1033.9** | **3.3** | **31.0** | **-26.6** | **28.4** |
| Goods exports | 697.0 | 711.4 | 692.1 | 717.9 | 3.6 | 14.4 | -32.1 | 25.8 |
| Gold | 5.6 | 5.3 | 7.0 | 5.1 | 1.8 | -0.3 | 3.3 | -1.9 |
| Other goods | 691.4 | 706.1 | 685.1 | 712.8 | 1.8 | 14.7 | -35.4 | 27.7 |
| Aircraft & parts | 43.8 | 47.8 | 45.1 | 45.6 | -1.9 | 4.0 | -7.5 | 0.5 |
| Computers & accessories | 37.2 | 40.8 | 39.3 | 42.2 | -1.1 | 3.5 | -1.4 | 2.9 |
| Semiconductors | 45.3 | 46.9 | 44.7 | 48.1 | 2.5 | 1.6 | -3.2 | 3.4 |
| Other capital goods | 155.7 | 158.2 | 158.1 | 160.6 | -0.5 | 2.4 | 2.3 | 2.5 |
| Automotive | 79.8 | 78.7 | 73.4 | 80.9 | -0.0 | -1.1 | -8.4 | 7.6 |
| to Canada | 45.2 | 43.0 | 37.6 | 45.9 | -1.5 | -2.2 | -8.0 | 8.2 |
| to Mexico | 14.4 | 13.4 | 13.9 | 14.8 | 1.3 | -1.0 | 2.5 | 0.9 |
| to ROW | 20.2 | 22.2 | 21.8 | 20.3 | 0.1 | 2.1 | -2.8 | -1.5 |
| Agricultural | 57.5 | 60.8 | 56.4 | 58.5 | 0.6 | 3.3 | -11.2 | 2.1 |
| Ind supplies (ex. ag, gold) | 156.0 | 154.9 | 152.2 | 155.6 | -1.1 | -1.1 | -4.7 | 3.4 |
| Consumer goods | 88.1 | 90.9 | 89.4 | 92.7 | 1.7 | 2.7 | -1.1 | 3.3 |
| All other goods | 28.0 | 27.3 | 26.5 | 28.6 | 1.7 | -0.7 | -13.1 | 2.0 |
| Services exports | 295.8 | 312.4 | 313.4 | 316.0 | -0.3 | 16.6 | 5.5 | 2.6 |
| **Imports of G&S** | **1486.9** | **1507.1** | **1479.7** | **1529.2** | **10.9** | **20.3** | **-32.8** | **49.5** |
| Goods imports | 1249.3 | 1256.4 | 1228.8 | 1275.7 | 11.9 | 7.0 | -35.8 | 46.9 |
| Petroleum | 130.5 | 137.1 | 137.6 | 134.1 | -5.4 | 6.6 | -1.9 | -3.5 |
| Gold | 4.1 | 4.1 | 5.3 | 4.4 | 1.7 | -0.0 | 2.8 | -1.0 |
| Other goods | 1114.7 | 1115.2 | 1085.9 | 1137.2 | 15.6 | 0.5 | -36.7 | 51.4 |
| Aircraft & parts | 23.7 | 23.6 | 21.4 | 24.8 | 0.2 | -0.1 | -3.3 | 3.4 |
| Computers & accessories | 75.2 | 76.6 | 74.2 | 78.8 | 2.0 | 1.4 | -2.5 | 4.6 |
| Semiconductors | 24.6 | 24.8 | 24.3 | 25.5 | 0.1 | 0.2 | -0.3 | 1.2 |
| Other capital goods | 168.3 | 171.0 | 168.7 | 176.7 | 5.8 | 2.7 | 1.1 | 8.0 |
| Automotive | 211.6 | 203.1 | 186.9 | 206.7 | 7.0 | -8.5 | -28.7 | 19.8 |
| from Canada | 59.6 | 60.2 | 54.3 | 63.0 | 0.4 | 0.7 | -9.2 | 8.7 |
| from Mexico | 42.8 | 40.7 | 42.5 | 42.7 | 2.7 | -2.1 | 5.5 | 0.2 |
| from ROW | 109.2 | 102.1 | 90.1 | 101.1 | 3.9 | -7.1 | -25.1 | 11.0 |
| Ind supplies (ex. oil, gold) | 177.3 | 182.1 | 181.5 | 185.8 | -2.0 | 4.8 | 2.4 | 4.2 |
| Consumer goods | 328.3 | 328.1 | 326.1 | 330.8 | 0.9 | -0.2 | -1.4 | 4.7 |
| Foods, feeds, bev. | 55.0 | 55.7 | 54.4 | 57.6 | 0.7 | 0.7 | -0.6 | 3.1 |
| All other goods | 50.8 | 50.2 | 48.4 | 50.6 | 0.9 | -0.5 | -3.3 | 2.3 |
| Services imports | 237.5 | 250.8 | 251.0 | 253.5 | -1.0 | 13.2 | 3.1 | 2.5 |
| *Memo:* | | | | | | | | |
| Oil quantity (mb/d) | 13.50 | 13.39 | 13.07 | 13.31 | 1.39 | -0.11 | -0.71 | 0.23 |
| Oil import price ($/bbl) | 26.46 | 28.05 | 28.82 | 27.59 | -4.28 | 1.59 | 1.10 | -1.23 |

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

# U.S. International Trade in Goods and Services

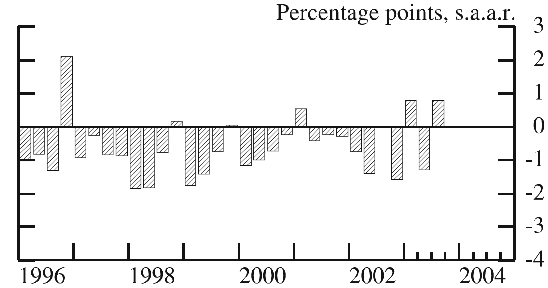
Net Exports

Bil$, s.a.a.r.

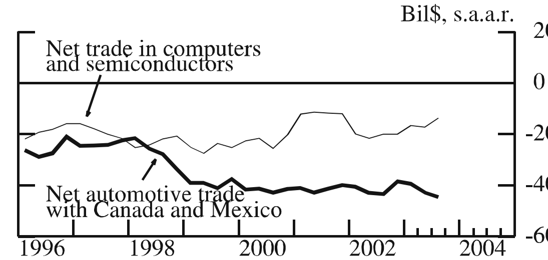



Contribution of Net Exports to Real GDP Growth

Percentage points, s.a.a.r.

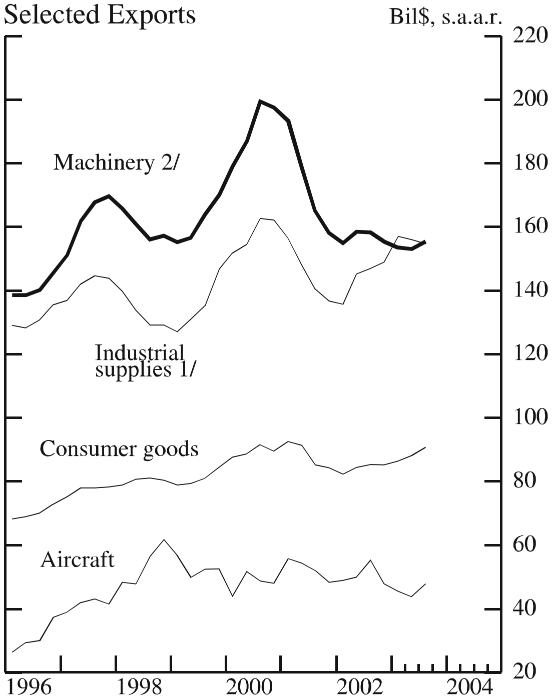



Bil$, s.a.a.r.




Selected Exports

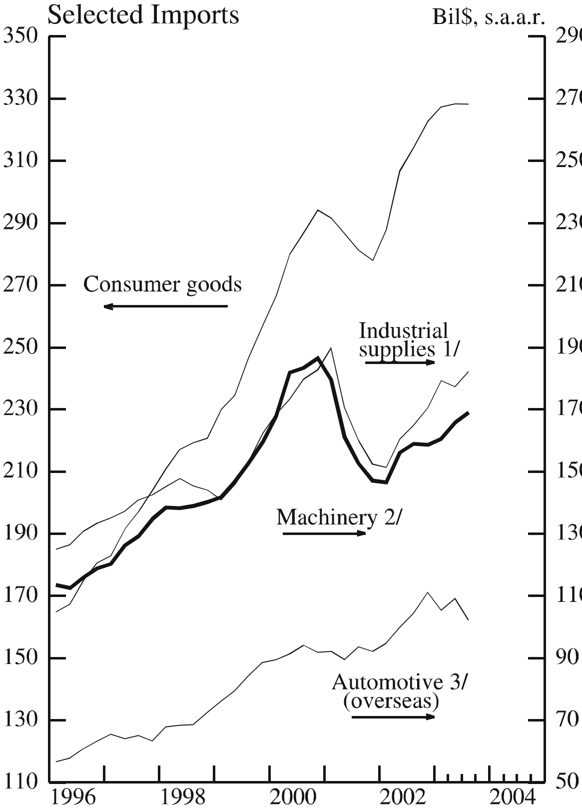
Bil$, s.a.a.r.




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

Selected Imports

Bil$, s.a.a.r.



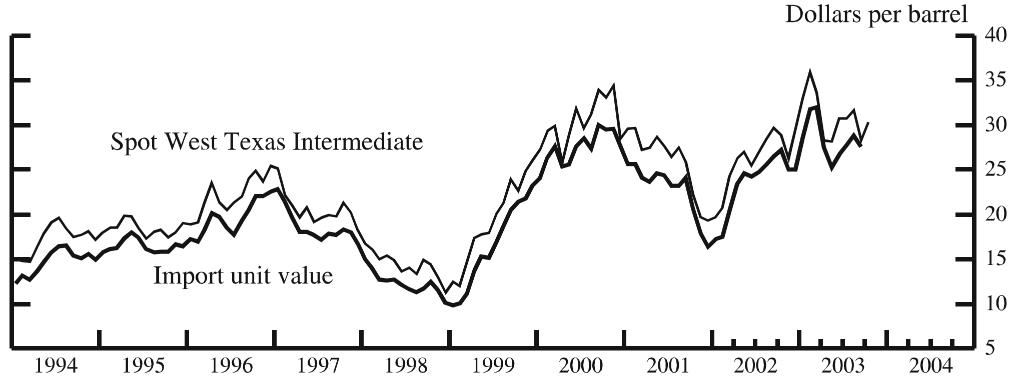

1. Excludes oil and gold.
2. Excludes computers and semiconductors.
3. Excludes Canada and Mexico.

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

| | Annual rates 2003 | | | Monthly rates 2003 | | |
|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Aug. | Sept. | Oct. |
| | ------------- BLS prices (2000 weights)------------- | | | | | |
| **Merchandise imports** | 13.5 | -9.2 | 3.1 | 0.0 | -0.4 | 0.1 |
| Oil | 133.7 | -54.6 | 28.5 | 1.8 | -5.0 | 2.3 |
| Non-oil | 3.9 | -1.0 | 0.3 | -0.3 | 0.2 | -0.1 |
| Core goods* | 5.3 | -0.5 | 0.8 | -0.3 | 0.2 | 0.0 |
| Cap. goods ex comp & semi | 2.1 | 1.7 | 1.1 | -0.2 | -0.3 | 0.0 |
| Automotive products | -0.4 | 0.5 | 0.0 | 0.0 | -0.1 | 0.6 |
| Consumer goods | -0.3 | 0.1 | 0.0 | -0.2 | 0.0 | -0.1 |
| Foods, feeds, beverages | 7.1 | -1.0 | -0.3 | -0.3 | 0.4 | 0.1 |
| Industrial supplies ex oil | 25.3 | -5.1 | 2.7 | -0.8 | 1.3 | -0.2 |
| Computers | -5.7 | -5.5 | -7.3 | -0.1 | 0.1 | -2.0 |
| Semiconductors | -4.0 | -1.0 | 4.4 | -0.2 | 0.2 | -0.5 |
| **Merchandise exports** | 2.7 | 0.9 | -0.3 | 0.0 | 0.4 | 0.3 |
| Core goods* | 3.6 | 1.6 | 0.9 | 0.0 | 0.6 | 0.4 |
| Cap. goods ex comp & semi | 0.9 | 0.1 | 1.2 | 0.1 | 0.0 | 0.1 |
| Automotive products | 0.7 | 0.1 | 0.8 | 0.0 | -0.1 | 0.2 |
| Consumer goods | -0.1 | 0.5 | 0.3 | -0.2 | 0.1 | 0.2 |
| Agricultural products | 0.2 | 6.1 | 6.4 | -1.0 | 5.6 | 2.5 |
| Industrial supples ex ag | 12.4 | 3.4 | 0.0 | 0.4 | 0.0 | 0.6 |
| Computers | 3.1 | -0.6 | -3.4 | -0.1 | -0.5 | 0.0 |
| Semiconductors | -5.8 | -6.3 | -12.3 | 0.0 | -0.5 | -1.5 |
| **Chain price index** | ---Prices in the NIPA accounts (1996 weights)--- | | | | | |
| Imports of goods & services | 11.7 | -3.9 | 2.9 | ... | ... | ... |
| Non-oil merchandise | 4.6 | -0.6 | 0.0 | ... | ... | ... |
| Core goods* | 5.5 | -0.3 | 0.5 | ... | ... | ... |
| Exports of goods & services | 3.9 | 0.8 | 1.7 | ... | ... | ... |
| Total merchandise | 3.4 | 1.6 | -0.3 | ... | ... | ... |
| Core goods* | 4.6 | 2.2 | 1.1 | ... | ... | ... |

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

### Oil Prices



## Prices of Internationally Traded Goods

**Non-oil imports.** In October, the prices of U.S. imports of non-oil goods declined 0.1 percent. The prices of imported core goods were unchanged from September. Within core goods, the largest price change was for automotive products. Prices of automotive products rose 0.6 percent, reflecting the weaker U.S. dollar and the change in the model year. In the other major trade categories within core goods, price changes were small. Prices for consumer goods and industrial supplies declined 0.1 and 0.2 percent, respectively. Prices for foods, feeds, and beverages increased 0.1 percent. The prices of U.S. imports of computers declined sharply in October, falling 2 percent. Prices for semiconductors declined 0.5 percent.

**Oil.** The BLS price of imported oil rose 2.3 percent in October, after falling a revised 5 percent in September. The spot price of West Texas Intermediate (WTI) crude oil was also higher in October, averaging about $30.35 per barrel, up around 7 percent from September. The spot price averaged a little more than $31 per barrel in November, but has edged down recently, closing at $30.78 per barrel on December 2. Oil prices remain elevated owing in part to a lack of security in Iraq, where oil exports have only slowly returned to the market.

**Exports.** In October, the prices of U.S. exports of total goods and of core goods increased 0.3 and 0.4 percent, respectively. The largest prices changes were for agricultural products and industrial supplies. Following a 5.6 percent increase in September, prices of agricultural products increased another 2.5 percent in October. The increase was driven by higher prices for soybeans, meat, and cotton. Prices for exported industrial supplies rose 0.6 percent in October, reflecting higher prices for precious metals, paper, and chemicals. In the other major trade categories within core goods, prices increased modestly. The prices of U.S. exports of computers were unchanged. Prices for semiconductors were down sharply, falling 1.5 percent.

## U.S. International Financial Transactions

In September, foreign private investors on net sold U.S. securities (line 4 of the Summary of U.S. International Transactions table) for the first time in five years.[1] These net sales followed unusually large net purchases, averaging $50 billion a month, during the preceding six months. Foreigners were net sellers of

1. The data presented here are from the TIC Reporting System and include offsets applied by the BEA based on observed differences between transactions data and survey results. The BEA offsets vary by instrument. For private purchases of U.S. debt securities in September, BEA subtracted $10 billion from agency bonds, $2 billion from Treasuries, and $1 billion from corporate bonds. For U.S. purchases of foreign stocks, BEA added $1 billion.

agency securities (line 4b) for the second consecutive month, and net sales in September ($16 billion) were the highest yet recorded. Net sales of Treasuries (line 4a) totaled $6 billion and followed exceptionally high net foreign purchases during the preceding six-month period. There were also net sales of equities (line 4d) of $6 billion. Foreign purchases of corporate debt (line 4c) continued at about the same high level seen throughout 2003.

We view the net sales of U.S. securities by private foreigners in September as an aberration. They followed, as noted above, extremely strong net purchases over the preceding six months, and for the third quarter as a whole net foreign purchases were in line with the high levels of recent years. Going forward, indications from issuance and secondary market performance point to increased foreign demand in the fourth quarter. For bonds, issuance of all types—Treasury, agency, and corporate—were strong in October, with anecdotal evidence of strong foreign demand. For equities, the recent performance of the U.S. equity markets suggests the dearth of foreign demand in September may have been short-lived.

U.S. investors continued their recent enthusiasm for foreign securities in September, purchasing on net $13 billion in foreign equities and bonds (line 5). For the third quarter as a whole, U.S. net purchases of foreign securities totaled $29 billion, comparable to the first quarter amount and only slightly lower than the quarterly averages from 1995 - 2001. During the third quarter, U.S. net acquisitions were entirely in foreign equities. These equity purchases were concentrated in Japan ($17 billion) and Taiwan ($10 billion).

Net foreign official inflows (line 1) continued at a robust pace in September, with the largest net inflows from Japan, Taiwan, and China. Through the first nine months of 2003, foreign official inflows totaled $139 billion, exceeding the previous annual record of $129 billion in 1996. Partial data from the Federal Reserve Bank of New York indicate that foreign official reserves in custody there increased by an additional $15 billion during October and by another $30 billion during November. .

The highly volatile banking sector (line 3) saw net outflows of $32 billion during September but net inflows of $26 billion for the third quarter.

Summing official flows, banking flows, and U.S. and foreign net securities purchases (the only third quarter data currently available), there were net foreign inflows of $129 billion for the quarter, an amount slightly above the average for these components in recent years.

## Summary of U.S. International Transactions

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

| | 2001 | 2002 | 2002 | 2003 | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | Q4 | Q1 | Q2 | Q3 | Aug | Sept |
| **Official financial flows** | **-.5** | **90.5** | **28.5** | **39.0** | **56.8** | **43.3** | **8.9** | **25.5** |
| 1. Change in foreign official assets in the U.S. (increase, +) | 4.4 | 94.2 | 29.3 | 39.0 | 57.0 | 43.9 | 9.0 | 26.3 |
| a. G-10 countries | -8.4 | 30.7 | 6.0 | 26.9 | 25.2 | 16.1 | 1.7 | 8.4 |
| b. OPEC countries | -3.1 | -7.5 | .7 | -7.5 | 1.1 | 2.1 | .6 | 1.9 |
| c. All other countries | 15.9 | 70.9 | 22.7 | 19.5 | 30.7 | 25.7 | 6.7 | 16.1 |
| 2. Change in U.S. official reserve assets (decrease, +) | -4.9 | -3.7 | -.8 | .1 | -.2 | -.6 | -.1 | -.8 |
| **Private financial flows** | **416.1** | **437.5** | **124.1** | **101.6** | **91.8** | **n.a.** | **...** | **...** |
| Banks | | | | | | | | |
| 3. Change in net foreign positions of banking offices in the U.S.[1] | -6.2 | 139.1 | 35.5 | -32.4 | -36.3 | 25.9 | 13.0 | -31.5 |
| Securities[2] | | | | | | | | |
| 4. Foreign net purchases of U.S. securities (+) | 398.1 | 403.5 | 82.9 | 68.5 | 142.3 | 89.3 | 48.9 | -10.2 |
| a. Treasury securities | -7.4 | 106.4 | 14.2 | 13.4 | 55.4 | 50.3 | 24.0 | -5.6 |
| b. Agency bonds | 81.8 | 78.1 | 15.5 | -2.3 | -1.7 | -15.9 | -1.5 | -16.3 |
| c. Corporate and municipal bonds | 201.8 | 160.3 | 39.8 | 59.5 | 67.3 | 57.6 | 15.1 | 17.9 |
| d. Corporate stocks[3] | 121.8 | 58.8 | 13.3 | -2.1 | 21.2 | -2.7 | 11.4 | -6.2 |
| 5. U.S. net acquisitions (-) of foreign securities | -85.1 | 15.5 | -5.3 | -27.5 | 8.9 | -29.0 | -13.6 | -12.7 |
| a. Bonds | 24.6 | 33.5 | 7.6 | 7.0 | 26.0 | 1.3 | 1.0 | -2.7 |
| b. Stock purchases | -62.7 | -14.8 | -12.9 | -19.9 | -17.1 | -30.3 | -14.6 | -9.9 |
| c. Stock swaps[3] | -47.0 | -3.2 | .0 | -14.7 | .0 | .0 | .0 | .0 |
| Other flows (quarterly data, s.a.) | | | | | | | | |
| 6. U.S. direct investment (-) abroad | -120.0 | -137.8 | -31.7 | -34.4 | -32.0 | n.a. | ... | ... |
| 7. Foreign direct investment in U.S. | 151.6 | 39.6 | 15.3 | 34.4 | 12.1 | n.a. | ... | ... |
| 8. Foreign holdings of U.S. currency | 23.8 | 21.5 | 7.2 | 4.9 | 1.5 | n.a. | ... | ... |
| 9. Other (inflow, + )[4] | 53.9 | -43.9 | 20.2 | 88.2 | -4.7 | n.a. | ... | ... |
| **U.S. current account balance (s.a.)** | **-393.7** | **-480.9** | **-128.6** | **-138.7** | **-138.7** | **n.a.** | **...** | **...** |
| **Capital account balance (s.a.)[5]** | **-1.1** | **-1.3** | **-.4** | **-.4** | **-.3** | **n.a.** | **...** | **...** |
| **Statistical discrepancy (s.a.)** | **-20.8** | **-45.8** | **-23.6** | **-1.6** | **-9.6** | **n.a.** | **...** | **...** |

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

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

2. Includes commissions on securities transactions and 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.

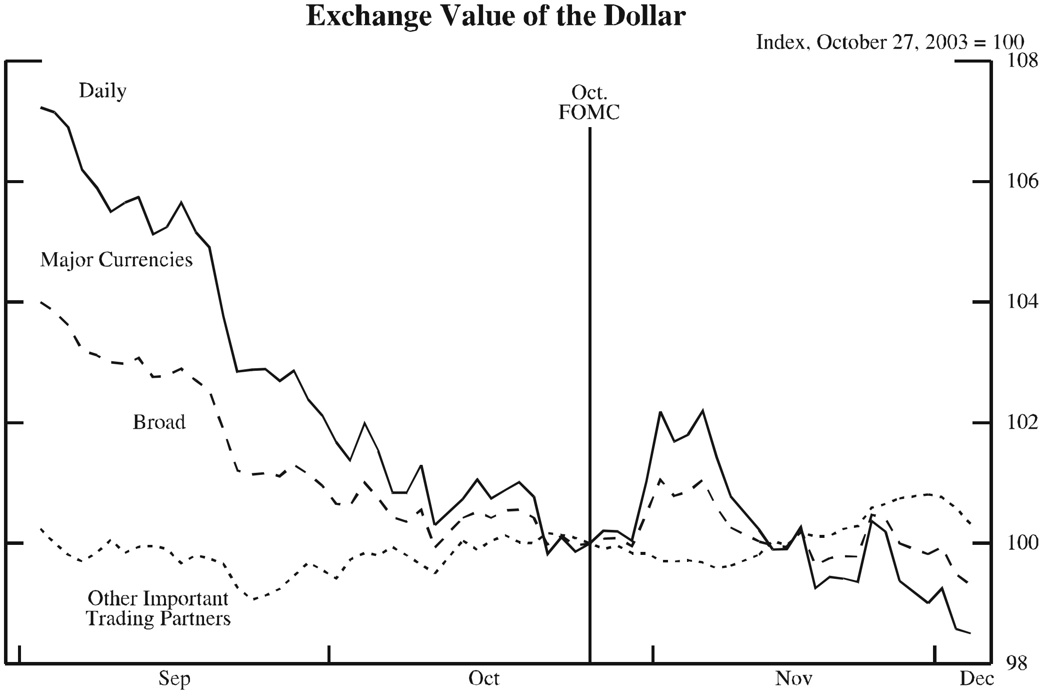
4. Transactions by nonbanking concerns and other banking and official transactions not shown elsewhere plus amounts resulting from adjustments made by the Department of Commerce and revisions in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business

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

## Foreign Exchange Markets

The exchange value of the dollar, as measured by the major currencies index, declined 1½ percent on net over the intermeeting period while experiencing considerable day-to-day volatility. The dollar appreciated in late October and early November following several stronger-than-expected U.S. economic data releases. Since November 6, however, despite continued positive U.S. economic data the dollar has declined 3½ percent on net. Market participants reportedly attributed the dollar's depreciation to heightened concerns over geopolitical risks stemming from developments in Afghanistan, Iraq, and Turkey, and an escalation of trade frictions prompted by the Administration's decision to impose import quotas on Chinese textiles. The dollar rebounded briefly following news reports on November 24 that Congress would repeal the export tax breaks that had been ruled illegal by the World Trade Organization, but soon resumed its decline. The major currencies index fell to a seven-year low late in the intermeeting period. Against the currencies of our other important trading partners, the dollar appreciated more than ¼ percent on net over the intermeeting period.

**Exchange Value of the Dollar**




The dollar depreciated 2 percent to 4 percent on net against the European currencies, responding in part to economic data releases in the euro area that signaled a pickup in economic activity. The dollar depreciated 4¼ percent against the Australian dollar on a rise in the pace of economic activity in

Australia and two 25-basis-point policy tightenings by the Reserve Bank of Australia. In contrast, the dollar was little changed on net against the yen. The Japanese monetary authorities resumed intervention operations early in the intermeeting period and purchased a total of about $16 billion for yen over the period.

**Financial Indicators in Major Industrial Countries**

| Country | Three-month rate: Dec. 3 (Percent) | Three-month rate: Percentage Point Change | Ten-year yield: Dec. 3 (Percent) | Ten-year yield: Percentage Point Change | Equities: Percent Change |
|---|---|---|---|---|---|
| Canada | 2.70 | .04 | 4.81 | -.01 | 3.96 |
| Japan | .08 | .00 | 1.45 | .10 | -1.63 |
| Euro area | 2.16 | .00 | 4.46 | .14 | 6.93 |
| United Kingdom | 3.91 | .10 | 5.04 | .01 | 3.22 |
| Switzerland | .20 | .04 | 2.75 | .04 | 5.24 |
| Australia | 5.42 | .37 | 5.93 | .26 | -1.07 |
| United States | 1.11 | .01 | 4.39 | .09 | 3.87 |
| Memo: Weighted-average foreign | 1.85 | .03 | 4.20 | .07 | n.a. |

NOTE. Change is from October 27 to December 3 (10 a.m. EDT).
n.a. Not available.

Three-month interest rates moved little on net over the intermeeting period in major industrial countries except in Australia and in the United Kingdom, where the Bank of England raised its policy rate 25 basis points on November 6. As had been widely expected, the European Central Bank and the Bank of Japan left their respective monetary policy stances unchanged. Long-term benchmark yields were little changed on net in Canada and the United Kingdom, but moved up 10 to 15 basis points in the euro area and Japan.

Since the October FOMC meeting, broad share price indexes of most major industrial economies have risen 3 percent to 8 percent, as evidence of a strong global economic recovery has accumulated and corporate risk spreads have declined further. The exception was in Japan, where the Topix index declined about 1½ percent as investors reportedly raised concerns about the earnings prospects of export-oriented firms owing to the yen's strength.

**Financial Indicators in Latin America, Asia, and Russia**

| | Currency/ US dollar | | Short-term Interest rates[1] | | Dollar-denominated bond spread[2] | | Equity prices |
|---|---|---|---|---|---|---|---|
| Economy | Dec. 3 | Percent Change | Dec.2/3 (Percent) | Percentage Point Change | Dec.2/3 (Percent) | Percentage Point Change | Percent Change |
| Mexico | 11.27 | 1.36 | 5.56 | .76 | 2.05 | -.08 | 9.28 |
| Brazil | 2.93 | 1.95 | 16.64 | -1.78 | 5.04 | -1.49 | 15.73 |
| Argentina | 2.98 | 5.11 | n.a. | n.a. | 62.04 | 5.89 | 12.05 |
| Chile | 605.00 | -4.83 | 2.92 | .00 | .86 | .06 | -4.28 |
| China | 8.28 | .00 | n.a. | n.a. | .34 | .00 | 5.52 |
| Korea | 1195.00 | 1.01 | 4.07 | -.03 | ... | ... | 6.14 |
| Taiwan | 34.00 | .15 | 1.18 | .05 | ... | ... | -1.23 |
| Singapore | 1.72 | -1.52 | .56 | -.25 | ... | ... | .01 |
| Hong Kong | 7.76 | .12 | .13 | .00 | ... | ... | 5.20 |
| Malaysia | 3.80 | -.01 | 3.00 | .00 | .66 | -.01 | -.99 |
| Thailand | 39.89 | -.25 | 1.31 | .06 | .47 | -.03 | 7.11 |
| Indonesia | 8485.00 | -.71 | 8.66 | -.06 | 2.82 | .09 | 2.35 |
| Philippines | 55.30 | -.14 | 7.13 | .56 | 4.58 | .24 | -.03 |
| Russia | 29.69 | -1.16 | n.a. | n.a. | 2.70 | .04 | -8.35 |

NOTE. Change is from October 27 to December 2/3.

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.

The Brazilian *real* depreciated 2 percent against the dollar over the intermeeting period, the Brazilian equity market index gained almost 16 percent, and the spread over Treasury yields of Brazilian sovereign debt, as measured by the country's EMBI+ index, fell about 150 basis points to near 500 basis points, a level last reached in the spring of 1998. The Brazilian central bank unexpectedly cut its policy rate 150 basis points on November 19, citing a more favorable projected trajectory for inflation. News that the Brazilian government reached an agreement on a one-year extension of its IMF program and that Standard & Poor's could soon revise its outlook for credit rating of Brazilian sovereign debt from stable to positive also supported Brazilian financial markets. Late in the period, the report that Brazilian GDP grew only modestly in the third quarter dampened investor enthusiasm somewhat. The Mexican peso depreciated almost 1½ percent against the dollar amid a sharp slowdown in Mexico's growth in the third quarter. Still, Mexican share prices were up almost 10 percent over the intermeeting period.

The spot price of gold has increased about 4½ percent since the October FOMC meeting, to above $400 per ounce. The price of gold last closed above the $400 level in March 1996.

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

## Developments in Foreign Industrial Countries

Recent data suggest that a recovery in the major foreign industrial countries has taken hold. Japan's economy grew faster than expected during the third quarter, and recent readings on exports and industrial production suggest that the expansion is continuing. In the euro area, third-quarter GDP data also surprised on the upside, and sentiment indicators have shown improvement. In the United Kingdom, GDP growth picked up in the third quarter, driven by continued strength in private consumption. Economic activity also firmed in Canada during the third quarter, where confidence has rebounded amid improved labor-market conditions.

Twelve-month rates of consumer price inflation generally moved down in recent months. Canadian headline inflation dropped to 1.6 percent in October, as energy price inflation moderated. The U.K. inflation rate declined slightly, but remained just above the 2½ percent target level. In the euro area, inflation edged up to 2.2 percent in November, just above the ECB's 2 percent ceiling. In Japan, mild deflation continued.

The Bank of England raised its official repo interest rate 25 basis points to 3.75 percent in early November.

In **Japan**, real GDP rose a stronger-than-expected 2.2 percent during the third quarter. Growth was led by a double-digit advance in private investment. The strength of real investment may be overstated, however, as distortions in the calculation of the deflator for investment may exaggerate the fall in the price used to deflate nominal investment spending. Net exports added 0.7 percentage point to growth, with soaring exports outpacing a sizable increase in imports. Private consumption was roughly flat. Public investment continued to contract sharply. Nominal GDP was about unchanged in the third quarter relative to the second quarter.

Recent indicators, while mixed, suggest that the expansion continued in the fourth quarter. Industrial production rose 0.8 percent in October, on the heels of a hefty increase in September. The broader all-industries index also advanced smartly in September. Workers' household expenditures declined in October but remained above the third-quarter average. New car registrations fell sharply in November. Core machinery orders, a leading indicator of business fixed investment, fell in September for the third consecutive month, suggesting that the heady pace of investment may be easing. Housing starts jumped in October, partly in anticipation that the government will soon reduce tax breaks for new homeowners. Real exports continued to rise briskly in October, boosted by buoyant growth in emerging Asia, while imports declined.

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

| Component | 2001[1] | 2002[1] | 2002 | 2003 | | |
|---|---|---|---|---|---|---|
| | | | Q4 | Q1 | Q2 | Q3 |
| GDP | -2.4 | 2.5 | 1.7 | 1.9 | 3.5 | 2.2 |
| Total domestic demand | -1.8 | 1.5 | .1 | 2.0 | 2.4 | 1.6 |
| Consumption | 1.4 | 1.4 | -1.1 | .9 | .5 | .2 |
| Private investment | -10.5 | 2.7 | 11.3 | 8.1 | 16.7 | 11.6 |
| Public investment | -1.1 | -5.8 | -10.2 | -14.6 | -9.8 | -14.9 |
| Government consumption | 2.3 | 1.5 | -.1 | 1.3 | .2 | .0 |
| Inventories[2] | -.6 | .3 | -.7 | .6 | -.5 | .0 |
| Exports | -11.0 | 17.7 | 20.3 | 1.8 | 6.1 | 11.5 |
| Imports | -7.1 | 8.8 | 6.1 | 3.0 | -4.8 | 6.8 |
| Net exports[2] | -.6 | 1.1 | 1.6 | -.1 | 1.1 | .7 |

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

Recent readings on the labor market have been mixed. In October, the unemployment rate edged up to 5.2 percent. More encouragingly, the job-offers-to-applicants ratio, a leading indicator of employment, jumped to its highest level in six years. Core consumer goods prices in the Tokyo area (which exclude fresh food but include energy) fell marginally in November and were down 0.2 percent from a year earlier. Higher prices for rice owing to a poor harvest helped to push nationwide core consumer prices up 0.1 percent in October from a year ago, marking the first increase on a twelve-month basis since April 1998. Wholesale prices for domestic goods fell 0.4 percent in October from a year earlier.

The Japanese ruling coalition lost 12 seats in the Lower House election on November 9, but still maintained a comfortable majority with 275 out of 480 seats. Prime Minister Koizumi retained his position, and policies are generally expected to be little changed.

The government decided in late November to nationalize Ashikaga Bank, a large regional bank. The bank reported that its capital adequacy ratio had fallen to well below zero. Ashikaga's equity will be written to zero and a management team made up of Financial Services Agency and local officials will run the bank for an interim period. The government plans eventually to sell the bank.

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

| Indicator | 2003 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Aug. | Sept. | Oct. | Nov. |
| Industrial production[1] | .3 | -.7 | 1.3 | -.7 | 3.8 | .8 | n.a. |
| All-industries index | .7 | .0 | .1 | .3 | 2.2 | n.a. | n.a. |
| Housing starts | .7 | 4.3 | -6.9 | -8.5 | 6.3 | 6.8 | n.a. |
| Machinery orders[2] | 5.8 | 3.4 | -2.9 | -4.3 | -1.6 | n.a. | n.a. |
| Machinery shipments[3] | .2 | 1.5 | 2.2 | 3.4 | 2.3 | 4.8 | n.a. |
| New car registrations | .9 | -6.1 | 2.2 | .0 | 5.0 | -1.4 | -5.4 |
| Unemployment rate[4] | 5.4 | 5.4 | 5.2 | 5.1 | 5.1 | 5.2 | n.a. |
| Job offers ratio[5] | .60 | .61 | .64 | .63 | .66 | .70 | n.a. |
| Business sentiment[6] | -26 | -26 | -21 | ... | ... | ... | ... |
| CPI (Core, Tokyo area)[7] | -.7 | -.4 | -.3 | -.3 | -.3 | -.1 | -.2 |
| Wholesale prices[7] | -.9 | -1.0 | -.7 | -.7 | -.5 | -.4 | 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.

**Euro-area** real GDP grew above expectations in the third quarter, as significant positive contributions from net exports and government spending outweighed a fall in private domestic demand. Investment fell nearly 2 percent, while private consumption was flat. Inventories made a sizeable negative contribution to growth. The weakness in private consumption was particularly apparent in Germany, where it fell 2.3 percent, while the surprise increase in government expenditure is primarily attributable to France.

Indicators point to continued recovery in the euro area. The euro-area PMI for manufacturing rose to 52.2 in November, remaining above the 50 level that is

**Euro-Area Real GDP**[1]
(Percent change from previous period, except as noted, s.a.a.r.)

| Component | 2001[2] | 2002[2] | 2002 | 2003 | | |
|---|---|---|---|---|---|---|
| | | | Q4 | Q1 | Q2 | Q3 |
| GDP | .8 | 1.1 | .1 | -.1 | -.4 | 1.5 |
| Total domestic demand | .1 | .9 | 1.5 | 1.4 | .2 | -2.5 |
| Consumption | 1.2 | .6 | 1.3 | 2.1 | .3 | -.1 |
| Investment | -2.0 | -1.9 | 1.1 | -4.5 | -2.1 | -1.9 |
| Government consumption | 2.7 | 2.2 | .7 | 1.6 | 1.7 | 1.9 |
| Inventories[3] | -.6 | .5 | .3 | .8 | .1 | -2.4 |
| Exports | -2.0 | 4.1 | -.7 | -5.8 | -2.5 | 9.2 |
| Imports | -3.8 | 3.8 | 3.1 | -2.5 | -.9 | -1.5 |
| Net exports[3] | .6 | .2 | -1.4 | -1.4 | -.6 | 4.0 |
| *Memo:* | | | | | | |
| France | .7 | 1.3 | -1.1 | .2 | -1.4 | 1.5 |
| Germany | .5 | .5 | -.2 | -1.0 | -.6 | .9 |
| Italy | .6 | .9 | 1.5 | -.7 | -.6 | 2.0 |

1. Includes Greece as of 2001 Q1.
2. Q4/Q4.
3. Percentage point contribution to GDP growth, s.a.a.r.

the benchmark for expansion. The euro-area PMI for services moved up to 57.5 in November, close to its highest level in three years. The European Commission's measures of industrial and consumer confidence showed improvement in November. The German IFO survey of business confidence increased in November to its highest level since January 2001. The current conditions component of the IFO survey also showed strong gains in November.

Euro-area twelve-month consumer price inflation rose to 2.2 percent in November, according to the preliminary estimate, just above the ECB's 2 percent ceiling. Elevated food prices continued to push up headline inflation. Core inflation, excluding food, energy, alcohol and tobacco, remained at about 1.7 percent in October on a twelve-month basis.

European Union finance ministers (ECOFIN) decided in late November to defer disciplinary action against France and Germany over their persistent excessive deficits. Germany and France agreed to cut their structural deficits 0.6 and 0.8

percentage points, respectively, in 2004, but would not automatically be subject to fines if they fail to do so. While ECOFIN is free to take up the matter again in future meetings, this action effectively ends implementation of the excessive deficit procedures stipulated by the Stability and Growth Pact. The European Commission (EC) vehemently opposed the decision while the ECB announced that the decision risks undermining the credibility of the institutional framework of the euro area.

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

| Indicator | 2003 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Aug. | Sept. | Oct. | Nov. |
| Industrial production[1] | .0 | -.7 | -.0 | -.7 | -.6 | n.a. | n.a. |
| Retail sales volume[2] | .6 | -.2 | n.a. | -.1 | n.a. | n.a. | n.a. |
| Unemployment rate[3] | 8.7 | 8.8 | 8.8 | 8.8 | 8.8 | 8.8 | n.a. |
| Consumer confidence[4] | -19.3 | -19.3 | -17.3 | -17.0 | -17.0 | -17.0 | -16.0 |
| Industrial confidence[4] | -11.0 | -12.0 | -11.3 | -11.0 | -9.0 | -8.0 | -7.0 |
| Mfg. orders, Germany | -.1 | -1.8 | 1.5 | -.1 | 1.9 | n.a. | n.a. |
| CPI[5] | 2.3 | 1.9 | 2.0 | 2.1 | 2.2 | 2.0 | 2.2 |
| Producer prices[5] | 2.4 | 1.5 | 1.2 | 1.4 | 1.1 | .9 | n.a. |
| M3[5] | 8.0 | 8.4 | 7.6 | 8.2 | 7.6 | 8.0 | 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.

Economic activity in the **United Kingdom** has picked up, with real GDP expanding 3 percent in the third quarter. Growth was supported by continued robust consumption spending and considerable government expenditure. Inventories also made a sizable contribution. These bright spots were offset by a sharp contraction in investment and a negative contribution from net exports, as imports outpaced a modest gain in exports.

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

| Component | 2001[1] | 2002[1] | 2002 Q4 | 2003 Q1 | 2003 Q2 | 2003 Q3 |
|---|---|---|---|---|---|---|
| GDP | 1.9 | 2.0 | 2.1 | .7 | 2.4 | 3.0 |
| Total domestic demand | 2.9 | 3.3 | 5.8 | -.2 | 2.0 | 4.0 |
| Consumption | 4.6 | 3.3 | 5.2 | -.6 | 2.7 | 3.1 |
| Investment | -1.8 | 4.8 | 3.4 | -2.8 | 5.1 | -5.3 |
| Government consumption | 4.2 | .3 | 2.0 | 10.7 | 2.1 | 2.6 |
| Inventories[2] | -.5 | .4 | 1.6 | -1.3 | -1.2 | 2.6 |
| Exports | -2.9 | -1.9 | -17.2 | 12.1 | -9.9 | .4 |
| Imports | .6 | 3.6 | -3.9 | 6.8 | -9.7 | 4.1 |
| Net exports[2] | -1.0 | -1.6 | -3.9 | 1.0 | .4 | -1.1 |

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

Data for the fourth quarter suggest continued expansion. Business confidence improved slightly in October, and the manufacturing PMI strengthened further in November. The services PMI climbed in November to its highest level since June 1997. Retail sales moved up briskly in October, as consumers continued their robust spending. In November, consumer confidence ticked down, and a leading survey suggests some slowing in retail sales.

While recent data on housing prices have been mixed, surveys suggest that prices are still rising at a robust twelve-month rate. Household net mortgage and consumer borrowing remained elevated in October.

The labor market continued to be tight as both the official claims-based and the labor force survey measures of the unemployment rate held steady near 28-year lows. The twelve-month rate of retail price inflation (excluding mortgage interest payments) edged down in October and remained just above the Bank of England's 2½ percent target. The harmonized index of consumer prices (HICP) rose 1.4 percent in the twelve months ending in October.

On November 6, the Bank of England's Monetary Policy Committee (MPC) raised the repo rate 25 basis points to 3.75 percent, the first increase in official rates since February 2000. The MPC noted the broadening of the pick-up in

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

| Indicator | 2003 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Aug. | Sep. | Oct. | Nov. |
| Industrial production | -.3 | .2 | -.2 | -.8 | .0 | n.a. | n.a. |
| Retail sales volume[1] | -.6 | 1.5 | 1.2 | .4 | .8 | .6 | n.a. |
| Unemployment rate[2] | | | | | | | |
| Claims-based | 3.1 | 3.1 | 3.1 | 3.1 | 3.1 | 3.0 | n.a. |
| Labor force survey[3] | 5.1 | 5.0 | n.a. | 5.0 | n.a. | n.a. | n.a. |
| Business confidence[4] | -1.3 | -6.3 | -3.3 | -3.0 | -3.0 | -4.0 | -2.0 |
| Consumer confidence[5] | -10.0 | -6.7 | -5.0 | -6 | -3 | -3 | -4 |
| Retail prices[6] | 2.9 | 2.9 | 2.9 | 2.9 | 2.8 | 2.7 | n.a. |
| Producer input prices[7] | 1.8 | -.5 | 1.2 | 1.9 | .6 | 1.8 | n.a. |
| Average earnings[7] | 3.5 | 3.0 | 3.6 | 3.4 | 3.7 | n.a. | n.a. |

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.

growth both at home and abroad, and observed that household spending and the housing market have not slowed as much as the Committee expected.

In **Canada**, real GDP rose 1.1 percent in the third quarter. Final domestic demand jumped 5.8 percent, the fastest rate since early 1999, led by sharp increases in purchases of consumer durables and investment. However, a large reduction in the pace of inventory accumulation took 5.1 percentage points off growth. Exports fell for the fourth consecutive quarter, but net exports still provided a slight positive contribution to growth as imports declined even more. The fall in imports was led by a large drop in automotive imports, as dealers met strong consumer demand out of inventories.

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

| Component | 2001[1] | 2002[1] | 2002 | 2003 | | |
|---|---|---|---|---|---|---|
| | | | Q4 | Q1 | Q2 | Q3 |
| GDP | 1.4 | 3.5 | 1.6 | 2.0 | -.7 | 1.1 |
| Total domestic demand | .8 | 5.7 | 4.5 | 6.7 | 2.5 | .4 |
| Consumption | 2.3 | 3.8 | 4.4 | 3.9 | 3.8 | 5.1 |
| Investment | 3.4 | 2.0 | .1 | 5.0 | 3.2 | 12.4 |
| Government consumption | 3.5 | 2.8 | 2.4 | 2.5 | 6.9 | 1.3 |
| Inventories[2] | -1.9 | 2.3 | 1.4 | 2.7 | -1.5 | -5.1 |
| Exports | -5.4 | .7 | -8.7 | -5.5 | -3.7 | -.9 |
| Imports | -8.4 | 6.5 | -1.4 | 3.8 | 6.8 | -2.1 |
| Net exports[2] | .8 | -2.0 | -3.2 | -3.6 | -3.9 | .4 |

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

Indicators for the fourth quarter have been positive. Employment rose 0.4 percent in October, the largest monthly gain since early 2002, pushing the unemployment rate down to 7.6 percent. Housing starts remained robust, with October starts reaching their second highest level in 14 years. Recent readings on consumer and business confidence moved up sharply. In addition, both the Business Conditions Survey and PMI diffusion index indicated expansion in October. The composite leading indicator rose in September and October, recording the largest back-to-back increase since early 2002.

In October, the twelve-month rate of headline CPI inflation declined to 1.6 percent, reflecting a moderation in the rate of increase in the energy component of the index. Twelve-month core inflation, excluding food, energy, and indirect taxes, remained at 1.8 percent.

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

| Indicator | 2003 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Jul. | Aug. | Sept. | Oct. |
| GDP by industry | .6 | .1 | .3 | .4 | -.8 | 1.1 | n.a. |
| Industrial production | .0 | -1.7 | .1 | .8 | -.8 | 2.0 | n.a. |
| New mfg. orders | 1.5 | -4.6 | 1.5 | 2.2 | -5.4 | 8.0 | n.a. |
| Retail sales | 1.8 | -.1 | 1.1 | .9 | .3 | -.8 | n.a. |
| Employment | .5 | .1 | .1 | -.1 | -.1 | .3 | .4 |
| Unemployment rate[1] | 7.4 | 7.7 | 7.9 | 7.8 | 8.0 | 8.0 | 7.6 |
| Consumer prices[2] | 4.5 | 2.8 | 2.1 | 2.2 | 2.0 | 2.2 | 1.6 |
| Core Consumer Prices[2,3] | 3.2 | 2.4 | 1.7 | 1.7 | 1.6 | 1.8 | 1.8 |
| Consumer attitudes[4] | 114.5 | 115.1 | 121.8 | ... | ... | ... | ... |
| Business confidence[4] | 131.4 | 109.9 | 127.2 | ... | ... | ... | ... |

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.

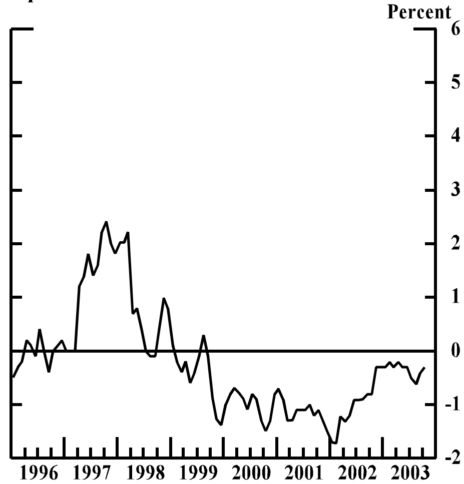
**External Balances**
(Billions of U.S. dollars, s.a.a.r.)

| Country and balance | 2003 | | | | | |
|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Aug. | Sept. | Oct. |
| *Japan* | | | | | | |
| Trade | 73.3 | 77.2 | 90.1 | 91.4 | 102.9 | 113.7 |
| Current account | 117.3 | 133.6 | 151.2 | 148.1 | 156.2 | n.a. |
| *Euro area* | | | | | | |
| Trade[1] | 31.2 | 69.2 | 131.8 | 100.4 | 114.3 | n.a. |
| Current account[1] | 11.1 | -29.4 | 72.9 | 65.6 | 125.7 | n.a. |
| *Germany* | | | | | | |
| Trade | 125.7 | 139.1 | 177.6 | 163.8 | 198.6 | n.a. |
| Current account[1] | 41.9 | 39.2 | 57.7 | 30.8 | 125.6 | n.a. |
| *France* | | | | | | |
| Trade | .4 | -.3 | 1.9 | 1.4 | 1.9 | n.a. |
| Current account | 3.5 | .6 | 3.1 | 3.9 | 3.3 | n.a. |
| *Italy* | | | | | | |
| Trade | .9 | -3.3 | 1.5 | 1.2 | 3.9 | n.a. |
| Current account[1] | -30.2 | -42.3 | 8.0 | -11.3 | -3.0 | n.a. |
| *United Kingdom* | | | | | | |
| Trade | -69.1 | -71.1 | -75.0 | -65.4 | -93.1 | n.a. |
| Current Account | -14.9 | -55.7 | n.a. | ... | ... | ... |
| *Canada* | | | | | | |
| Trade | 43.0 | 42.5 | 46.0 | 45.9 | 49.7 | n.a. |
| Current Account | 18.7 | 14.5 | 21.2 | ... | ... | ... |

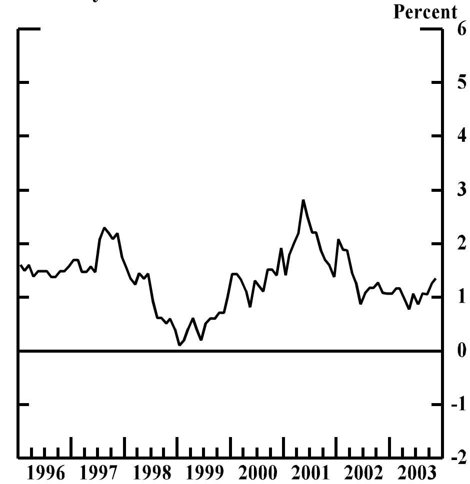
1. Not seasonally adjusted.
n.a. Not available. ... Not applicable.

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

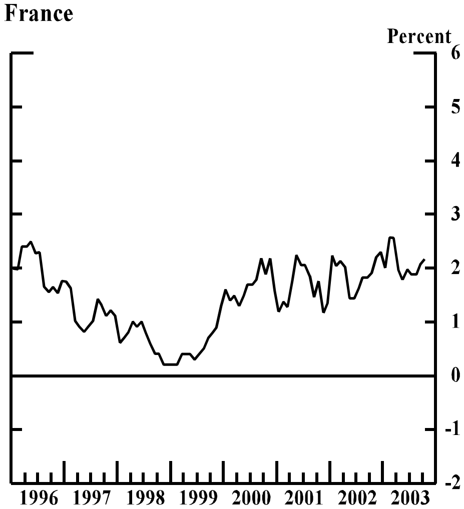
**Japan**



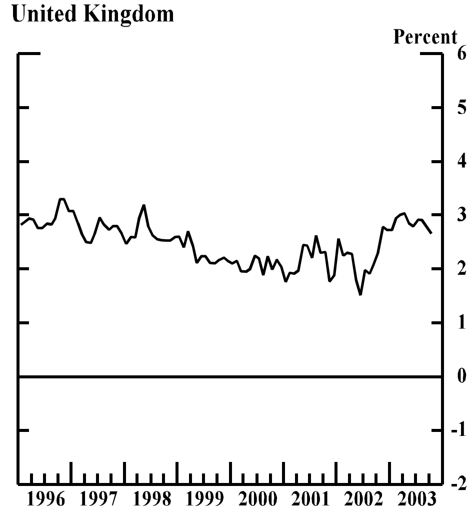

**Germany**



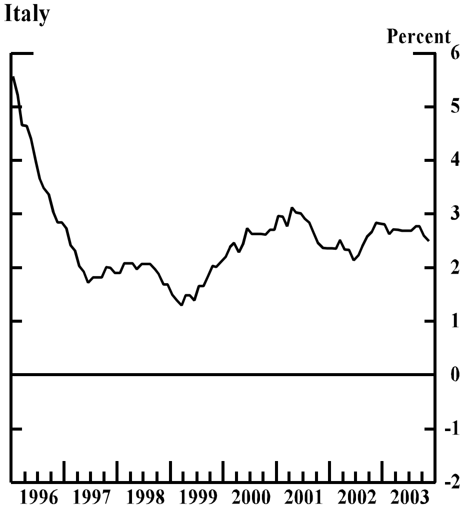

**France**



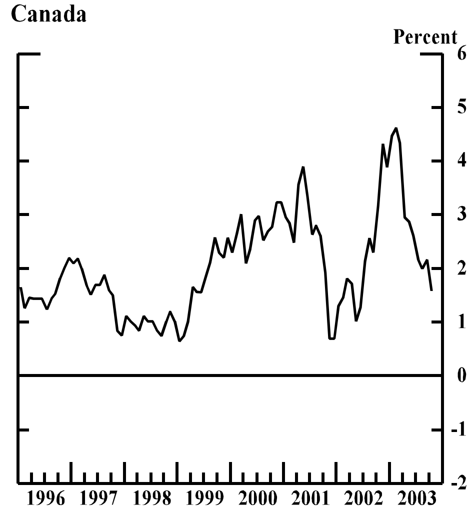

**United Kingdom**



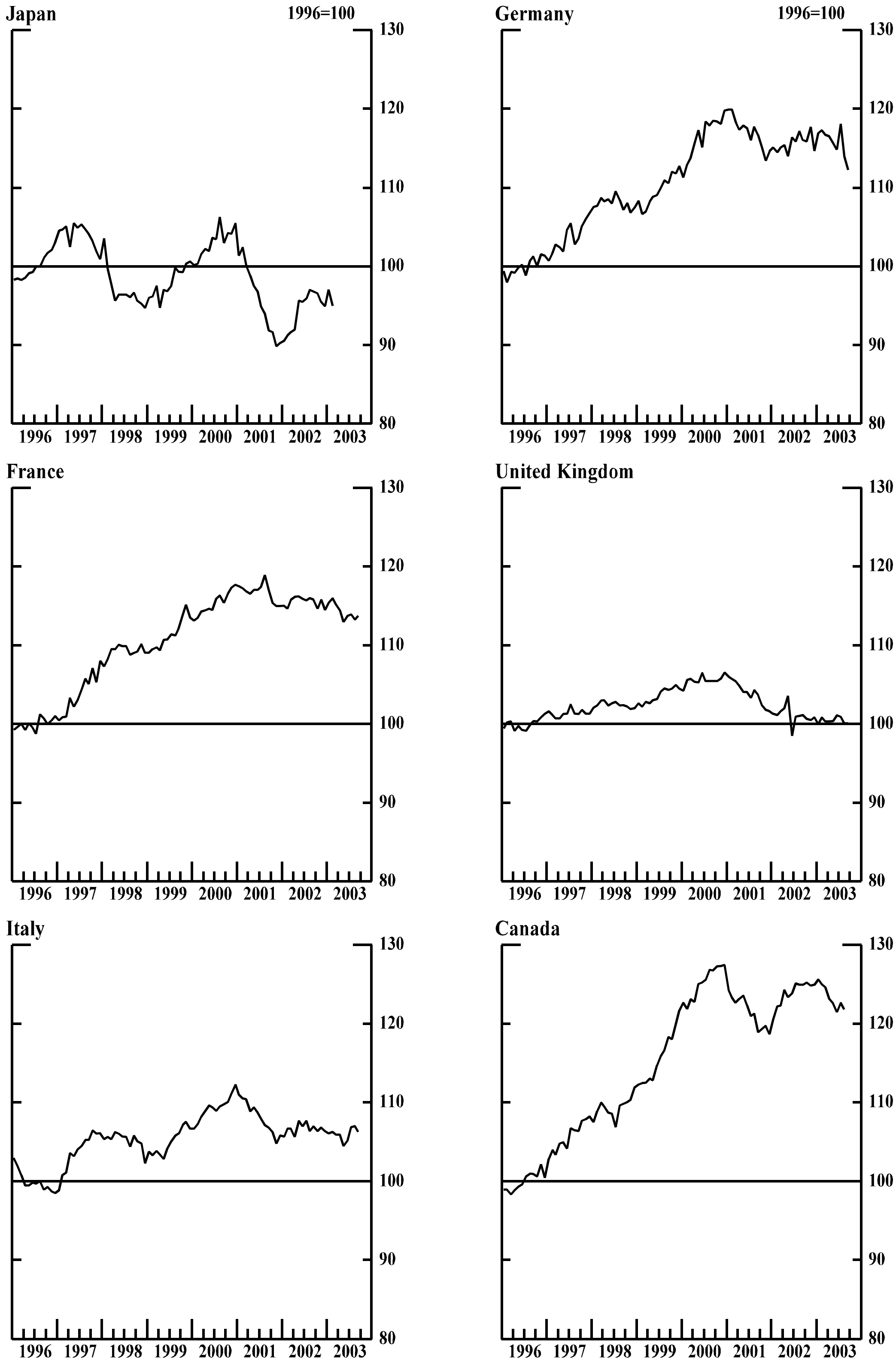

**Italy**




**Canada**



**Industrial Production in Selected Industrial Countries**



## Economic Situation in Other Countries

Third-quarter GDP releases confirmed a strong rebound in growth in developing Asia, with Hong Kong, Singapore, and Taiwan posting stellar performances. In Korea, solid export growth was recorded, along with some strengthening in consumption. In Latin America, economic performance is still mixed. Argentina's recovery has continued and third-quarter real GDP growth turned positive in Brazil. In Mexico, real GDP contracted in the third quarter, although October data hint at some improvement. Inflation has remained subdued in most of the developing world.

The **Chinese** economy continued to expand at a robust pace in October, with production up about 17 percent over the previous year level. Tourism remained strong in the early fall after bouncing back from last spring's SARS-induced decline, and retail sales in October were more than 10 percent above their low point during the epidemic. Twelve-month consumer price inflation jumped to 1.8 percent in October from 1.1 percent in September, largely reflecting higher food prices, as heavy rains caused shortages of vegetables in some areas. However, prices of many other goods, including clothing and consumer durables, continued to fall on a year-over-year basis. In contrast, twelve-month inflation remained positive in the housing sector, where there have been some concerns about overheating. China's trade deficit narrowed in October as exports grew slightly more than imports. Nevertheless, China's year-to-date trade surplus is considerably smaller than last year's surplus, and some analysts are forecasting that the trade balance will be close to zero for the year as a whole.

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

| Indicator | 2001 | 2002 | 2003 | | | | |
|---|---|---|---|---|---|---|---|
| | | | Q2 | Q3 | Aug. | Sept. | Oct. |
| Real GDP[1] | 7.5 | 8.0 | -2.9 | 17.5 | ... | ... | ... |
| Industrial production[2] | 8.9 | 11.8 | 15.1 | 16.6 | 17.1 | 16.3 | 17.2 |
| Consumer prices[2] | -.3 | -.4 | .7 | .8 | .9 | 1.1 | 1.8 |
| Trade balance[3] | 23.1 | 30.3 | 12.5 | 7.0 | 19.1 | -3.7 | -1.5 |

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.

Despite the narrowing of the overall trade balance, attention has remained focused on China's large bilateral surplus with the United States, and the Commerce Department recently imposed restrictions on several categories of textile imports from China. U.S. officials have also suggested that they will press China to move to counteract illegal copying of U.S. products and to further open its markets to foreign competition. Pressure on China to allow greater flexibility in its exchange rate regime has continued as well. Chinese officials insist, however, that no changes to the exchange rate regime will be made in the near future, and the IMF recently indicated that it sees no clear evidence that the renminbi is undervalued.

In **Hong Kong**, third-quarter real GDP skyrocketed as the economy recovered from the effects of SARS. Exports of goods and services led the way, and private consumption also rose strongly. Tourist arrivals in October reached a new record high. The unemployment rate has continued to fall. The property sector has also continued to show signs of revival, with nonresidential building permits in August at their highest level since 1996. This reflects, in part, recent changes in Chinese laws that now allow some investment in the Hong Kong property market by Chinese companies. Twelve-month consumer price inflation remained negative in October, but the rate of deflation has slowed somewhat in the past two months. The trade deficit widened again in October, as robust growth in imports slightly outpaced that of exports. Total trade—a good indicator of economic activity for Hong Kong's entrepôt economy—rose 4½ percent to an historical high.

**Hong Kong Economic Indicators**

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

| Indicator | 2001 | 2002 | 2003 | | | | |
|---|---|---|---|---|---|---|---|
| | | | Q2 | Q3 | Aug. | Sept. | Oct. |
| Real GDP[1] | -1.3 | 5.2 | -14.0 | 28.2 | ... | ... | ... |
| Unemployment rate[2] | 4.9 | 7.3 | 8.6 | 8.3 | 8.6 | 8.3 | 8.0 |
| Consumer prices[3] | -3.7 | -1.6 | -2.5 | -3.7 | -3.8 | -3.2 | -2.6 |
| Trade balance[4] | -11.4 | -7.7 | -6.8 | -8.4 | -10.5 | -12.1 | -13.0 |

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.
... Not applicable.

The **Taiwanese** economy has continued to expand at a rapid clip after shaking off the effects of SARS. Real GDP was up 25 percent in the third quarter, much more than reversing the second-quarter decline. Industrial production rose moderately in October following a sharp increase in September, with continued robust growth in production of high-tech goods. In addition, export orders reached a record high in October, powered by strong pre-Christmas demand for electronic goods. The recent expansion has contributed to continued incremental reduction in the unemployment rate, which is now down a little more than ½ percentage point from its peak last year. The renewed economic strength has also contributed to further easing of deflationary pressures, with consumer prices about unchanged in October on a twelve-month basis. The trade surplus narrowed by about $6 billion in October, as total goods exports dropped back a bit after two months of rapid gains, while imports fell by a smaller amount.

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

| Indicator | 2001 | 2002 | 2003 | | | | |
|---|---|---|---|---|---|---|---|
| | | | Q2 | Q3 | Aug. | Sept. | Oct. |
| Real GDP[1] | -1.9 | 4.3 | -8.1 | 25.1 | ... | ... | ... |
| Unemployment rate[2] | 4.6 | 5.2 | 5.2 | 5.0 | 5.0 | 4.9 | 4.8 |
| Industrial production | -7.3 | 6.4 | -1.0 | 7.1 | .1 | 1.6 | .8 |
| Consumer prices[3] | -1.7 | .8 | -.1 | -.6 | -.6 | -.2 | -.1 |
| Trade balance[4] | 15.6 | 18.1 | 16.2 | 20.0 | 18.7 | 21.3 | 15.2 |
| Current account[5] | 17.9 | 25.7 | 26.1 | 27.7 | ... | ... | ... |

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.
... Not applicable.

**Korean** real GDP rebounded 4.7 percent in the third quarter, following two consecutive quarters of contraction. Exports were the main contributor to growth, but private consumption also increased. Investment, on the contrary, was still a significant drag on growth. Industrial production was up nearly 2.5 percent in October, the third consecutive monthly increase, boosted by strong exports of automobiles, semiconductors, and chemical products. Nevertheless, a high level of household debt, a housing price correction, and political uncertainty remain key risks to a gradual recovery in domestic demand. In addition, the unemployment rate rose to 3.7 percent in October, as the rebound in labor force participation outpaced employment gains. However, consumer and business confidence indicators continued to rise in October. Due to strong export growth, Korea has continued to register sizeable trade surpluses.

After a temporary increase in October, largely reflecting higher food prices, twelve-month consumer price inflation dropped back to 3.4 percent in November. Concerned about surging housing prices, the government introduced anti-speculative measures at the beginning of November that include higher capital gains taxes on owners of three or more properties, lower loan-to-value ratios for mortgage lending, and an increase in the supply of housing units in Seoul.

**Korean Economic Indicators**

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

| Indicator | 2001 | 2002 | 2003 | | | | |
|---|---|---|---|---|---|---|---|
| | | | Q2 | Q3 | Sept. | Oct. | Nov. |
| Real GDP[1] | 4.2 | 7.0 | -2.7 | 4.7 | ... | ... | ... |
| Industrial production | .4 | 8.3 | -.4 | .9 | 2.9 | 2.4 | n.a. |
| Unemployment rate[2] | 3.8 | 3.1 | 3.4 | 3.5 | 3.5 | 3.7 | n.a. |
| Consumer prices[3] | 3.2 | 3.8 | 3.3 | 3.2 | 3.3 | 3.8 | 3.4 |
| Trade balance[4] | 13.5 | 14.2 | 19.3 | 27.9 | 34.6 | 36.5 | n.a. |
| Current account[5] | 8.2 | 6.1 | 10.1 | 16.3 | 27.0 | 30.2 | 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.

Third-quarter GDP releases for the **ASEAN** region have shown robust growth. Singapore posted a stellar performance, driven primarily by high-tech manufacturing and a recovery in the SARS-affected service sector. Malaysia's strong output growth was fueled by an expansion in agriculture coupled with continued positive performance in the manufacturing sector. Growth in Indonesia was led by the mining sector, while the Philippines benefitted from an increase in agricultural output. In October, industrial production expanded briskly in Singapore, following a contraction in September led by the pharmaceutical industry, whereas production posted only moderate gains in Thailand and declined sharply in the Philippines. Recent trade data have been mixed. Inflation in the region remained subdued.

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

| Indicator and country | 2001 | 2002 | 2003 | | | | |
|---|---|---|---|---|---|---|---|
| | | | Q2 | Q3 | Aug. | Sept. | Oct. |
| *Real GDP*[1] | | | | | | | |
| Indonesia | 1.7 | 3.8 | 6.6 | 6.7 | ... | ... | ... |
| Malaysia | -.9 | 5.3 | 7.2 | 8.4 | ... | ... | ... |
| Philippines | 3.6 | 5.8 | 3.2 | 7.0 | ... | ... | ... |
| Singapore | -6.0 | 3.0 | -9.8 | 17.3 | ... | ... | ... |
| Thailand | 2.2 | 6.4 | 3.5 | n.a. | ... | ... | ... |
| *Industrial production*[2] | | | | | | | |
| Indonesia[3] | .7 | -1.1 | -2.5 | .8 | -2.7 | -.5 | n.a. |
| Malaysia | -4.1 | 4.6 | 4.3 | 2.1 | -.6 | 2.1 | n.a. |
| Philippines | -5.7 | -6.1 | 1.7 | -1.3 | -1.9 | -6.4 | n.a. |
| Singapore | -11.6 | 8.5 | -4.9 | 6.5 | 18.0 | -11.9 | 16.3 |
| Thailand | 1.3 | 8.5 | 3.4 | -.7 | -3.6 | 4.6 | 2.4 |

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 | | | | |
|---|---|---|---|---|---|---|---|
| | | | Q2 | Q3 | Aug. | Sept. | Oct. |
| Indonesia | 25.4 | 25.9 | 29.2 | 26.7 | 25.7 | 25.8 | 25.4 |
| Malaysia | 14.2 | 13.5 | 20.8 | 15.0 | 17.0 | 11.8 | n.a. |
| Philippines | -.9 | -.2 | -1.2 | -.4 | -1.0 | 1.7 | n.a. |
| Singapore | 5.8 | 8.7 | 13.2 | 18.7 | 14.5 | 22.8 | 13.8 |
| Thailand | 2.5 | 3.4 | 5.8 | 3.7 | 1.6 | 5.2 | .9 |

n.a. Not available.

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

| Country | 2001[1] | 2002[1] | 2003 | | | | |
|---|---|---|---|---|---|---|---|
| | | | Q2 | Q3 | Sept. | Oct. | Nov. |
| Indonesia | 12.5 | 10.0 | 7.0 | 6.1 | 6.2 | 6.2 | 5.3 |
| Malaysia | 1.2 | 1.7 | .9 | 1.0 | 1.1 | 1.3 | n.a. |
| Philippines | 4.1 | 2.6 | 3.0 | 3.1 | 2.9 | 3.1 | n.a. |
| Singapore | -.6 | .4 | .2 | .5 | .7 | .6 | n.a. |
| Thailand | .8 | 1.6 | 1.8 | 1.9 | 1.7 | 1.2 | 1.8 |

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

In **Mexico**, incoming data since the last Greenbook have been mixed. Real GDP contracted nearly 1½ percent in the third quarter, reflecting persistent sluggishness in the manufacturing sector, where output shrank by about 8 percent. Service-oriented sectors have performed better, with wholesale and retail trade and the financial services sector posting a gain of about 4 percent each. Exports appear to have sharply accelerated in October, rising over 2 percent at a monthly rate. This, together with a slight decline in the unemployment rate and the fact that business confidence has held up, suggests that the economy may have started to turn around in the fourth quarter. Twelve-month inflation remains near the upper end of the government's 2-4 percent target range.

In early November, the government sent to congress an austere budget proposal that aims to cut the public sector deficit from this year's 0.6 percent of GDP to 0.3 percent of GDP. The government decided to incorporate a fiscal reform in the proposed budget that includes the introduction of a VAT on food and medicine. The VAT proposal, however, has been rejected by the main opposition party (the PRI), which has submitted an alternative plan expected to generate only half the extra revenue of the government's proposal (0.4 percent instead of 0.8 percent of GDP). Negotiations about the budget have been complicated by widening divisions within the PRI.

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

| Indicator | 2001 | 2002 | 2003 | | | | |
|---|---|---|---|---|---|---|---|
| | | | Q2 | Q3 | Aug. | Sept. | Oct. |
| Real GDP[1] | -1.5 | 2.0 | 4.9 | -1.4 | ... | ... | ... |
| Overall economic activity | -.1 | .9 | .6 | -.2 | -.5 | .1 | n.a. |
| Industrial production | -3.2 | -.1 | -.1 | -1.3 | .2 | -.6 | n.a. |
| Unemployment rate[2] | 2.5 | 2.7 | 3.0 | 3.6 | 3.7 | 3.6 | 3.5 |
| Consumer prices[3] | 4.4 | 5.7 | 4.7 | 4.1 | 4.0 | 4.0 | 3.9 |
| Trade balance[4] | -10.0 | -7.9 | -7.5 | -6.3 | -6.3 | -3.6 | -3.7 |
| Imports[4] | 168.4 | 168.7 | 168.8 | 170.0 | 169.7 | 168.2 | 171.9 |
| Exports[4] | 158.4 | 160.8 | 161.2 | 163.6 | 163.3 | 164.6 | 168.1 |
| Current account[5] | -18.1 | -14.0 | -5.6 | -8.6 | ... | ... | ... |

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**, real GDP rose 1.6 percent in the third quarter, following two quarters of declines. Growth was led by a strong increase in industrial output. Monthly indicators have pointed to continued growth into the fourth quarter, partly driven by special circumstances. Auto production and sales rose in October for the second consecutive month, due to a temporary tax break. Suggesting an improvement in domestic demand, October federal government tax revenues were strong. Unemployment, however, remains high. Brazil has continued to register sizeable trade surpluses.

Prompted by a continued favorable inflation trend, the central bank reduced its overnight interest rate, the Selic, by 100 basis points in late October and by another 150 basis points in late November. The Selic now stands at 17.5 percent, down from 26.5 percent last June. The government's inflation target for 2004 is 5½ percent (plus or minus 2½ percentage points). According to the central bank's survey of forecasters, twelve-month-ahead expected inflation has fallen from 12 percent early this year to under 6 percent.

In mid-November, Brazil reached a tentative agreement with the IMF on a one-year extension of its $30 billion program, which was to expire at the end of this year. The program would make available $14½ billion on a precautionary basis (i.e., Brazil will only draw the funds if economic and financial conditions worsen), including $8 billion not yet disbursed from the current program. Brazil would also obtain a one-year extension on about $4 billion in payment obligations to the Fund due in 2005-06. In return, Brazil would be required to maintain the current target for the primary fiscal surplus of 4¼ percent of GDP for the consolidated public sector, preserve its flexible exchange rate regime, and make progress on needed bankruptcy and other structural reforms.

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

| Indicator | 2001 | 2002 | 2003 | | | | |
|---|---|---|---|---|---|---|---|
| | | | Q2 | Q3 | Sept. | Oct. | Nov. |
| Real GDP[1] | -.8 | 3.7 | -4.7 | 1.6 | ... | ... | ... |
| Industrial production | 1.6 | 2.5 | -2.5 | 1.8 | 4.3 | n.a. | n.a. |
| Unemployment rate[2] | 12.4 | 12.5 | 12.1 | 13.0 | 13.4 | 13.4 | n.a. |
| Consumer prices[3] | 7.7 | 12.5 | 16.9 | 15.2 | 15.1 | 14.0 | n.a. |
| Trade balance[4] | 2.7 | 13.1 | 24.6 | 26.8 | 25.6 | 27.0 | 26.0 |
| Current account[5] | -23.2 | -7.7 | 1.6 | 13.2 | 16.1 | 1.0 | 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**, economic recovery has continued. Real GDP rose 6.6 percent in the second quarter. Although industrial production fell in September as a result of weaker-than-expected performances of some basic industries (mainly metals and plastics), it was up 2.6 percent in October. Twelve-month consumer price inflation remained low in October, at 3.9 percent.

In late October, Argentina’s congress approved the issuance of up to 2.8 billion pesos ($977 million) in bonds to compensate the banking sector for last year’s asymmetric indexation of assets and liabilities. The law, part of the recent agreement with the IMF, is considered crucial for stabilizing the banking sector. Argentina has met all of the quantitative criteria of its IMF program and has made some advances in structural reforms. The country, however, has yet to show that it is pursuing debt restructuring negotiations with private creditors in good faith. The Argentine government's proposal of a 75 percent haircut has already received a negative reaction from bondholders.

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

| Indicator | 2001 | 2002 | 2003 | | | | |
|---|---|---|---|---|---|---|---|
| | | | Q2 | Q3 | Aug. | Sept. | Oct. |
| Real GDP[1] | -10.3 | -3.3 | 6.6 | n.a. | ... | ... | ... |
| Industrial production | -7.6 | -10.6 | .3 | 2.0 | 1.3 | -1.3 | 2.6 |
| Unemployment rate[2] | 18.1 | 20.4 | 16.4 | n.a. | ... | ... | ... |
| Consumer prices[3] | -1.4 | 41.0 | 14.5 | 5.2 | 4.9 | 3.5 | 3.9 |
| Trade balance[4] | 7.5 | 16.7 | 19.0 | 15.1 | 15.5 | 13.6 | 15.9 |
| Current account[5] | -4.5 | 9.6 | 11.7 | 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,** real GDP jumped around 32 percent in the third quarter, reflecting the economy's continued rebound from the strikes that crippled the country in late 2002 and early 2003. The third-quarter increase, nevertheless, still puts output 10 percent below its pre-strike level. Recent anecdotal information indicates that oil production, the main contributor to growth, remains below the level prevailing before the strikes. Twelve-month consumer price inflation in October was almost unchanged at around 26 percent despite price controls and the fixed exchange rate regime that was established last February. News reports that the government plans to devalue the bolivar by 20 percent in coming months seem to have contributed to inflationary pressures. In addition, some goods are being imported at the black market exchange rate.

In early December, political tensions heated up over the results of a petition drive to force President Chavez to face a recall referendum. Although opposition leaders announced that the drive was successful and that a referendum would be held by April 2004, Chavez has challenged the results. So far, there has been little reaction in financial markets.

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

| Indicator | 2001 | 2002 | 2003 | | | | |
|---|---|---|---|---|---|---|---|
| | | | Q2 | Q3 | Sept. | Oct. | Nov. |
| Real GDP[1] | .9 | -16.7 | 87.5 | 31.8 | ... | ... | ... |
| Unemployment rate[2] | 13.4 | 16.0 | 18.4 | 17.6 | 17.4 | 16.8 | n.a. |
| Consumer prices[3] | 12.3 | 31.2 | 34.3 | 29.5 | 26.5 | 25.7 | 26.1 |
| Non-oil trade balance[4] | -14.1 | -8.5 | -3.4 | -5.2 | ... | ... | ... |
| Trade balance[4] | 7.6 | 13.0 | 18.3 | 15.5 | ... | ... | ... |
| Current account[5] | 2.1 | 7.4 | 13.4 | 11.1 | ... | ... | ... |

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.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. ... Not applicable.