Prefatory Note

The attached document represents the most complete and accurate version available based on original files from the FOMC Secretariat at the Board of Governors of the Federal Reserve System.

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

Content last modified 05/27/2010.

Confidential (FR) Class III FOMC

Part 2

August 5, 2004

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

August 5, 2004

Recent Developments

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

Domestic Nonfinancial Developments

Domestic Nonfinancial Developments

Overview

Although economic activity in the late spring appears to have been weaker than we had expected as of the last Greenbook, the few indications available for the second half are consistent with a resumption of stronger activity. Initial claims for unemployment insurance have remained in a range consistent with substantial gains in jobs, sales of autos and light trucks rebounded in July, home sales and permits have remained robust, and orders and shipments of nondefense capital goods rose smartly in June. Meanwhile, core consumer price inflation has moderated substantially in recent months, although higher energy prices continue to boost inflation.

Labor Market Developments

Employment gains slowed substantially in June following large increases in the March-May period. The stepdown in private nonfarm payroll gains was widespread, and most major industries posted increases less than half the size of those in the preceding three months. In addition, the average workweek of production or nonsupervisory workers dipped 0.2 hour in June, to 33.6 hours, pushing aggregate hours down 0.6 percent.[1] Even so, for the second quarter as a whole, aggregate hours rose at an annual rate of 2.0 percent, as the average monthly increase in employment was nearly 230,000.

According to the household survey, the labor market situation was little changed in June. The unemployment rate was unchanged at 5.6 percent, about the same level it has held since the start of the year. The labor force participation rate ticked up 0.1 percentage point, to 66.0 percent, with rates for all age groups except teenagers showing small increases. The employment-population ratio, which reflects changes in both the unemployment rate and the labor force participation rate, edged up, although it remained within the low range seen since early last year.

Other indicators point to a more positive tone in the labor market. Since the June reference week, the four-week moving average of initial claims for unemployment insurance has fluctuated in a range just below 350,000, a pace consistent with solid employment gains. The number of job losers unemployed less than five weeks as a percent of household employment, another measure that serves as a proxy for layoffs, edged down in June. And layoff announcements, as measured by Challenger, Gray, and Christmas, Inc., declined in both June and July. The four-week moving average of insured unemployment is down a bit from its level during the June survey week.

---

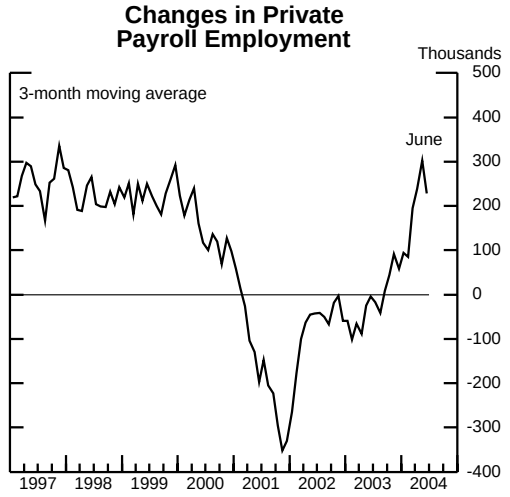
1. According to our contact at the Bureau of Labor Statistics (BLS), the agency does not have an explanation for the decline in average weekly hours last month. In particular, the BLS could not find evidence that hours were depressed by former President Reagan's funeral, which took place during the survey reference week.

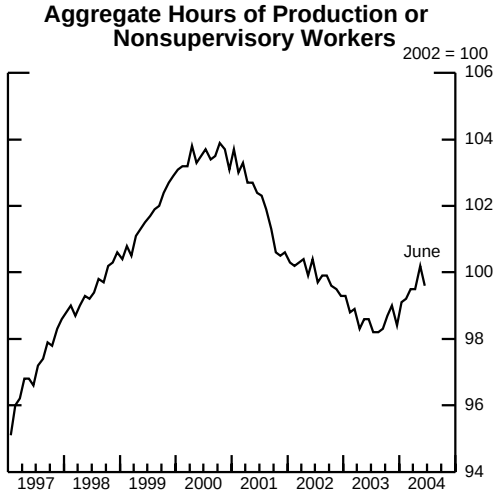
Changes in Employment

(Thousands of employees; seasonally adjusted)

Measure and sector	2003	2004				
		Q1	Q2	Apr.	May	June
	Average monthly change			Monthly change		
Nonfarm payroll employment (establishment survey)	-5	198	224	324	235	112
Private	-1	195	228	305	263	117
Previous	-1	195	...	325	275	...
Manufacturing	-48	7	11	21	24	-11
Construction	7	26	19	19	39	0
Wholesale trade	-3	8	3	9	4	-2
Retail trade	-5	46	16	24	18	7
Transportation and utilities	-5	14	12	0	16	19
Information	-10	-2	3	4	4	1
Financial activities	6	7	12	12	17	6
Professional and business services	23	26	77	126	66	39
Temporary help services	15	8	28	44	30	12
Nonbusiness services[1]	34	59	72	86	73	57
Total government	-4	3	-5	19	-28	-5
Total employment (household survey)	168	-60	244	278	196	259
Memo:						
Aggregate hours of private production workers (percent change)[2]	-0.8	2.3	2.0	0.0	0.7	-0.6
Average workweek (hours)[3]	33.7	33.8	33.7	33.7	33.8	33.6
Manufacturing (hours)	40.4	41.0	40.9	40.7	41.1	40.8

1. Nonbusiness services comprises education and health, leisure and hospitality, and "other."
2. Establishment survey. 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.
... Not applicable.



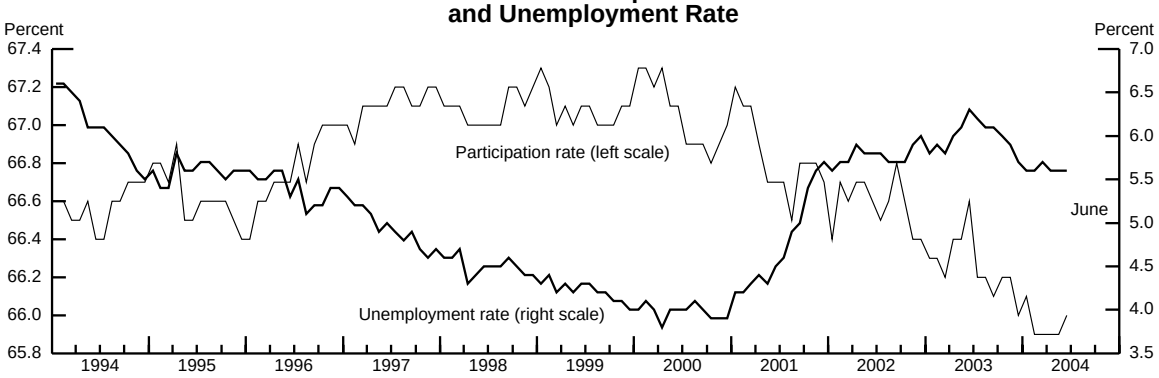


Selected Unemployment and Labor Force Participation Rates

(Percent; seasonally adjusted)

Rate and group	2003	2004				
		Q1	Q2	Apr.	May	June
Civilian unemployment rate						
16 years and older	6.0	5.6	5.6	5.6	5.6	5.6
Teenagers	17.4	16.6	17.0	16.9	17.2	16.9
20-24 years old	10.0	9.6	9.5	9.2	9.7	9.8
Men, 25 years and older	5.1	4.5	4.5	4.4	4.6	4.4
Women, 25 years and older	4.6	4.5	4.4	4.6	4.2	4.5
Labor force participation rate						
Total	66.2	66.0	65.9	65.9	65.9	66.0
Teenagers	44.5	43.6	43.6	43.7	43.9	43.3
20-24 years old	75.4	74.7	75.1	75.1	75.0	75.1
Men, 25 years and older	75.5	75.4	75.2	75.0	75.2	75.3
Women, 25 years and older	59.6	59.2	59.3	59.3	59.2	59.4

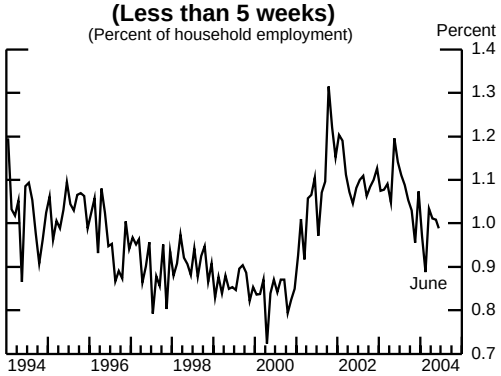
Labor Force Participation Rate and Unemployment Rate



Employment-Population Ratio

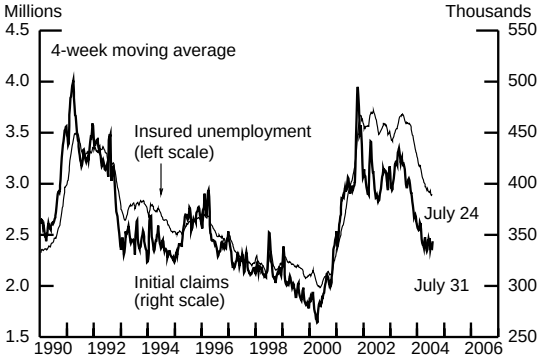
Job Losers (Less than 5 weeks)

(Percent of household employment)

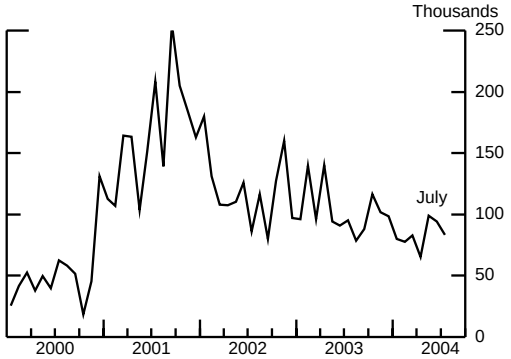


Labor Market Indicators

Unemployment Insurance

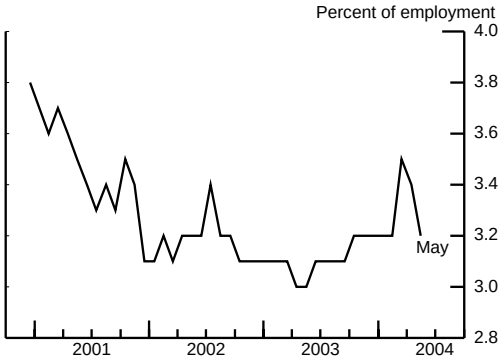


Layoff Announcements



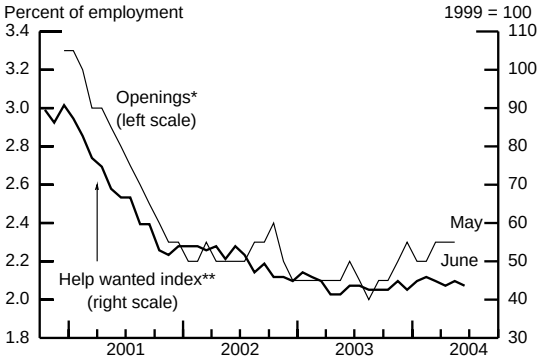
Note. Seasonally adjusted by FRB staff.
Source. Challenger, Gray and Christmas, Inc.

Hires



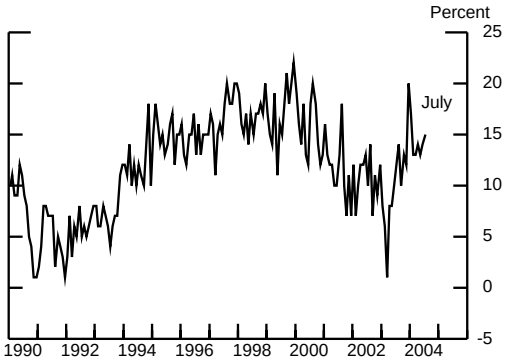
Source. Job Openings and Labor Turnover Survey.

Job Openings and Help Wanted Index



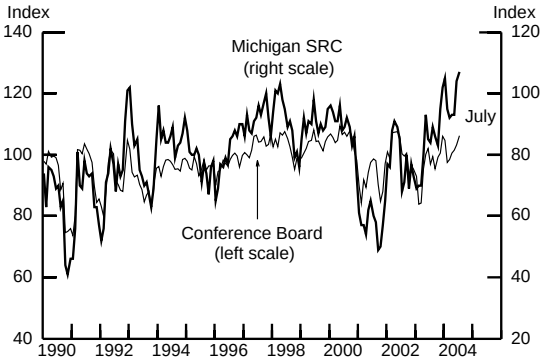
*Job Openings and Labor Turnover Survey.
**Conference Board.

Small Business Hiring Plans



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

Expected Labor Market Conditions



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

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

Sector	2001	2002	2003	2003		2004	
				Q3	Q4	Q1	Q2
Nonfarm businesses							
All persons	3.1	3.7	5.6	8.2	2.8	4.1	3.0
All employees[1]	3.3	4.0	6.1	9.8	3.3	3.1	1.9
Nonfinancial corporations[2]	1.9	5.4	6.6	8.9	5.0	2.0	n.a.

Note. Staff estimates. Annual changes are from fourth quarter of preceding year to fourth quarter of year shown.
1. Assumes that the growth rate of hours of non-employees equals the growth rate of hours of all employees.
2. 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.
n.a. Not available.

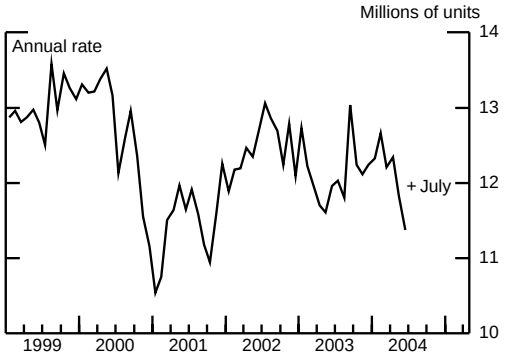
Small-business hiring plans edged up in June and stand at a level well above last year's trough, according to the July report from the National Federation of Independent Businesses. In addition, according to both the Conference Board and Michigan surveys, consumers in July continued by a wide margin to expect the labor market to improve over coming months.

Using the incoming NIPA data, we now estimate that productivity in the nonfarm business sector increased at an annual rate of 4.1 percent in the first quarter and 3.0 percent in the second quarter. Over the four quarters ending in the second quarter of 2004, productivity rose an estimated 4.5 percent, about the same as in the previous four quarters.[2] Looking back further, the revised productivity data now show a slightly more muted dip in productivity in 2001, followed by a slightly weaker recovery in 2002, but the level of output per hour at the end of last year was nearly unchanged from the previous estimate.

2. These figures represent our best estimate of the productivity data to be reported in the BLS Productivity and Cost release on August 10. At that time the BLS will release revised productivity estimates for 2001:Q1 through 2004:Q1 that reflect both the annual revisions to the NIPA (see the appendix) and changes to its method for calculating some of the components of hours. Because of the change in methodology, the hours data will be revised back to 1947, but the effects of these revisions on both the level and the rate of growth of productivity are expected to be small.

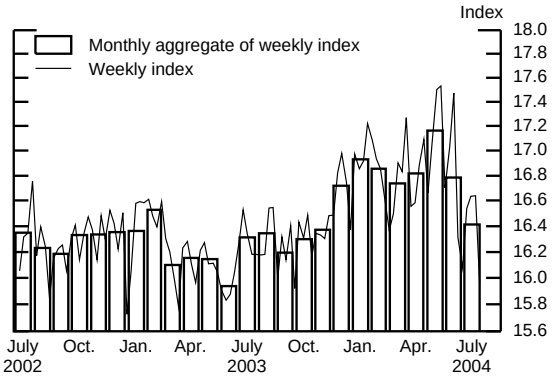
Indicators of Manufacturing Activity

Motor Vehicle Assemblies



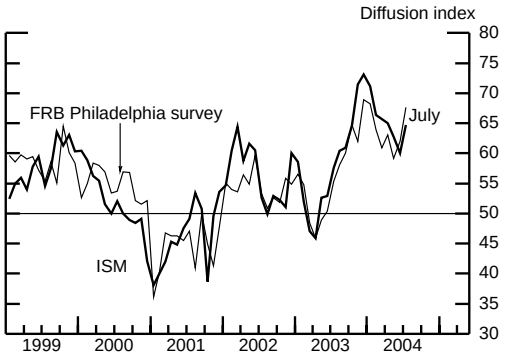
Note. July value is based on weekly data.

Weekly Production Index excluding Motor Vehicles



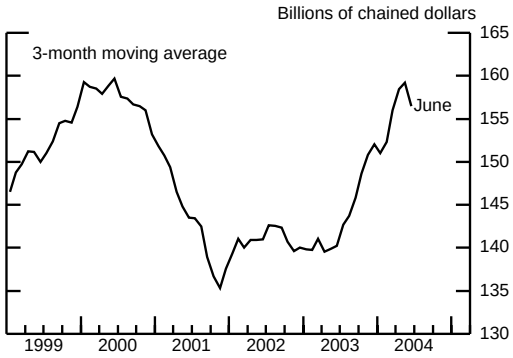
Note. One index point equals 1 percent of 1997 total industrial output.

New Orders: ISM and FRB Philadelphia Surveys

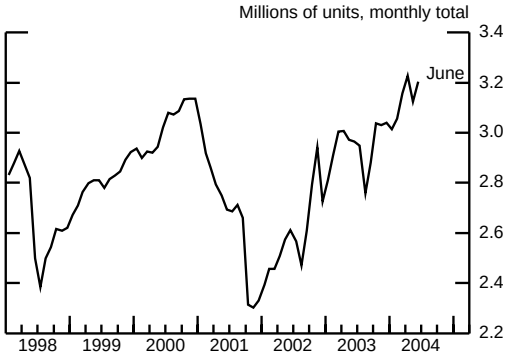


Note. The diffusion index equals the percentage of respondents reporting greater levels of new orders, plus one-half the percentage of respondents reporting that new orders were unchanged.

Real Adjusted Durable Goods Orders

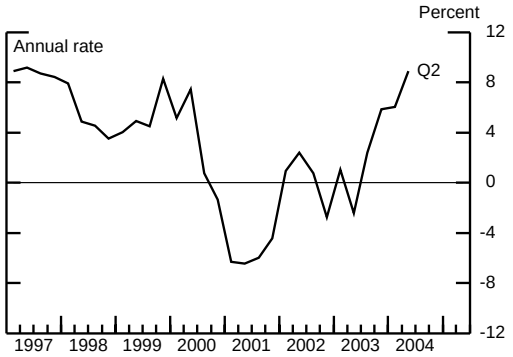


Inventories of Light Vehicles



Note. FRB seasonals.

Manufacturing Production Excluding Motor Vehicles



Industrial Production

Production fell 0.3 percent in June after having risen rapidly in April and May. The recent dip in industrial activity does not appear to have extended beyond June; indeed, the available near-term indicators point to an increase in production in July. Motor vehicle assemblies are on track to increase from the slow pace in June, and the decline in output among other industries for which we have weekly production data is mostly attributable to unseasonably cool weather in July that reduced electricity generation. Elsewhere, manufacturing orders appear to be well maintained and are consistent with solid near-term increases in production. The available new orders diffusion indexes from the Institute for Supply Management (ISM) and the various regional surveys all moved up in July, and although the staff's series on real adjusted durable goods orders has dropped back in recent months, it remains at a high level.

In June, the output of utilities and motor vehicles and parts posted significant declines, which together reduced the change in total IP about 0.4 percentage point. The output at utilities dropped as temperatures returned to more-normal levels after an unseasonably warm May. Motor vehicle and parts production slipped about 2-1/2 percent for a second month in June as automakers scaled back assemblies in response to an elevated level of truck inventories.

Elsewhere in the industrial sector, manufacturing production excluding motor vehicles and parts, which makes up three-fourths of total IP, edged up 0.1 percent in June after having risen by about 0.7 percent per month since the beginning of the year. For the second quarter as a whole, this component of IP rose at an annual rate of nearly 9 percent, the largest gain in seven years.

Production of high-technology goods continued to advance at a solid clip in the second quarter. The gains were concentrated in the output of computers and semiconductors and related equipment, which increased between 35 percent and 40 percent (annual rate); utilization rates in these two industries now stand around 20 percentage points above the lows reached in the last business-cycle downturn. In contrast, utilization rates for manufacturers of communications equipment, who eked out only a small increase in production last quarter, remain stubbornly low.

Looking ahead, unit shipments of personal computers edged down during the second quarter, but research analysts at Gartner are projecting a stronger-than-normal back-to-school season in the third quarter and a sizable pickup in the pace of replacements of aging PCs. The midpoint of Intel’s third-quarter revenue guidance is consistent with another solid increase in worldwide shipments of microprocessor units (MPUs), the high-value semiconductor chips used in personal computers and servers. But that increase in MPU shipments may not translate into markedly higher production in the near term because

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

Component	Proportion 2003 (percent)	2003[1]	2004		2004		
			Q1	Q2	Apr.	May	June
			Annual rate		Monthly rate		
Total	**100.0**	**1.5**	**6.6**	**6.0**	**.8**	**.9**	**-.3**
Previous	100.0	1.5	6.7	...	.8	1.1	...
Manufacturing	82.3	1.9	6.3	7.1	.7	.6	-.1
Ex. motor veh. and parts	75.6	1.7	6.0	8.9	.8	.9	.1
Ex. high-tech industries	70.7	.3	4.6	7.6	.7	.7	.0
Mining	7.6	.4	-1.8	-.2	.4	.0	.1
Utilities	10.1	-.6	15.6	2.1	1.6	3.7	-2.3
Selected industries							
High technology	4.9	21.3	27.3	28.1	1.6	3.0	2.3
Computers	1.2	14.1	28.1	35.9	2.6	2.9	3.0
Communications equipment	1.3	5.8	1.2	2.3	-1.2	3.5	1.9
Semiconductors[2]	2.4	34.3	41.4	37.7	2.4	3.0	2.3
Motor vehicles and parts	6.7	3.8	9.9	-11.6	-.1	-2.3	-2.5
Market groups excluding energy and selected industries							
Consumer goods	22.6	.2	3.6	6.8	.7	.6	-.4
Durables	4.3	1.1	6.9	.5	.4	-.1	-.5
Nondurables	18.3	.0	2.8	8.3	.8	.8	-.4
Business equipment	7.3	1.0	12.1	11.6	.9	1.4	.4
Defense and space equipment	1.9	4.8	-.7	11.7	.6	1.3	.3
Construction supplies	4.2	1.1	2.3	9.8	1.0	1.1	.0
Business supplies	8.5	.2	5.6	8.1	.8	.5	.0
Materials	24.8	-.3	4.0	6.5	.6	.5	.2
Durables	13.6	-.1	5.2	7.0	.5	.6	.4
Nondurables	11.2	-.5	2.4	5.9	.8	.4	.0

1. From fourth quarter of preceding year to fourth quarter of year shown.
2. Includes related electronic components.
... Not applicable.

Capacity Utilization
(Percent of capacity)

Sector	1972-2003 average	1982 low	1990-91 low	2003	2004			
				Q4	Q1	Q2	May	June
Total industry	**81.1**	**70.9**	**78.6**	**75.5**	**76.5**	**77.3**	**77.6**	**77.2**
Manufacturing	80.0	68.7	77.2	74.1	75.1	76.1	76.2	76.0
High-tech industries	78.8	75.4	74.5	67.0	69.1	70.2	70.4	70.7
Excluding high-tech industries	80.1	68.2	77.3	75.2	76.1	77.2	77.3	77.2
Mining	86.9	78.6	83.4	85.3	84.9	84.8	84.8	84.8
Utilities	86.9	77.6	84.1	83.1	85.5	85.6	87.3	85.2

Intel's inventories of MPUs have risen significantly during the past three quarters.[3]

For the semiconductor industry more broadly, the contributions of MPUs to the change in overall semiconductor production have been noticeably less than in the late 1990s, while contributions of non-MPU chips, particularly those used in consumer electronics, such as cell phones, have accounted for a greater share of production gains. Moreover, high utilization rates among chip manufacturers and expectations of future capacity needs have kept orders and shipments of semiconductor manufacturing equipment at their highest levels in three years.[4]

Production excluding energy, high-tech, and motor vehicles and parts, about 70 percent of total IP, increased in all major market groups during the second quarter; in June, only the output of consumer goods declined. Business equipment production moved up in June and rose at double-digit rates in both the first and second quarters. The output of defense and space equipment, which fell in the first quarter, rose nearly 12 percent in the second quarter. The production of business and construction supplies was unchanged in June, but this pause came on the heels of several months of solidly increasing output. Nondurable materials production was also unchanged in June, while the output of durable materials posted another increase.

In June, capacity utilization for total industry was 77.2 percent, 3.2 percentage points above its cyclical low in June 2003 but still 3.9 percentage points below its 1972–2003 average.[5] The operating rates for downstream industries were farther below their long-run averages than those for upstream industries. Indeed, rates for a few significant upstream industries—including iron ore mining, organic chemicals, pulp and paperboard, petroleum refining, and semiconductors—exceed 90 percent and are well above historical averages.

---

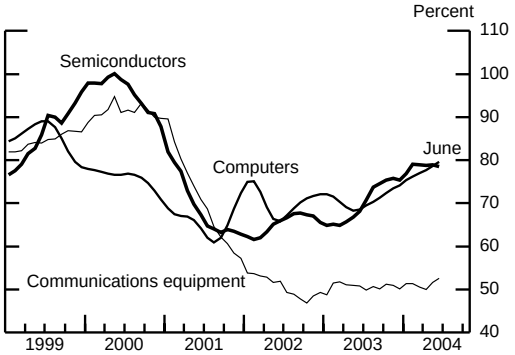
3. Intel attributes the recent increases in inventories to unexpectedly high productivity of newly installed chip fabrication equipment, intentional inventory building in anticipation of a greater-than-usual back-to-school increase in computer sales this year, and weaker-than-anticipated second-quarter demand.

4. Because the MPUs that Intel has slated for production one year from now (about the lead time needed for new semiconductor manufacturing equipment) are physically larger than the currently produced chips (because of the inclusion of multiple processors on a single chip), Intel must significantly retool a number of fabrication facilities.

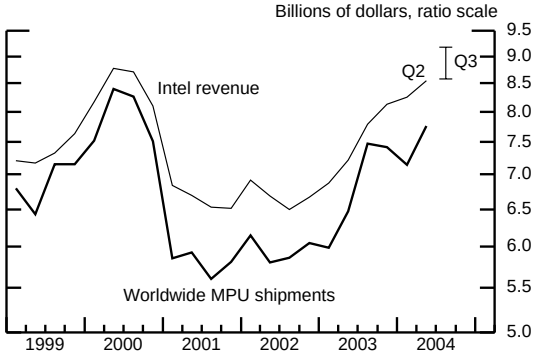
5. A recent conversation with representatives from the Institute for Supply Management (ISM) confirmed our explanation for the widely reported increase in the gap between the ISM and FRB measures of capacity utilization in April. Specifically, the significant increase in the ISM utilization rate apparently reflected a substantial share of respondents taking the sharply lower level of post-recession employment into account when assessing their operating rates. In contrast, the FRB measure, which abstracts from labor and considers only the plants and equipment in place and ready to operate, rose by a smaller amount.

Indicators of High-Tech Manufacturing Activity

Capacity Utilization in the High-Tech Sector

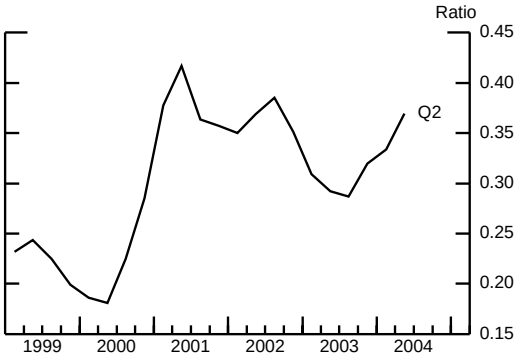


Microprocessor Unit (MPU) Shipments and Intel Revenue

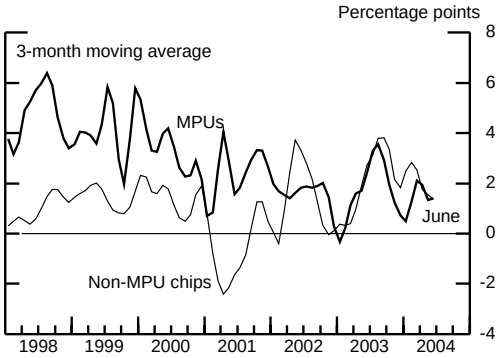


Note. Q3 is the range of Intel's guidance as of July 13, 2004. FRB seasonals.
Source. Intel and Semiconductor Industry Association.

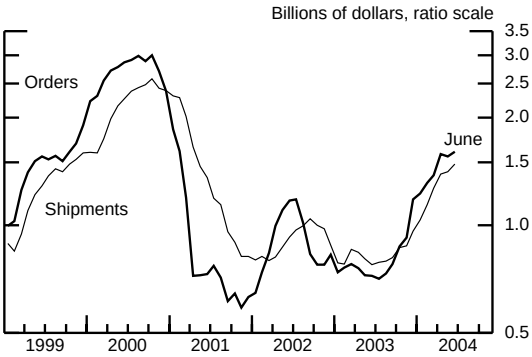
Intel Inventories-to-Shipments Ratio



Contribution to the Rate of Change in Semiconductor Industrial Production

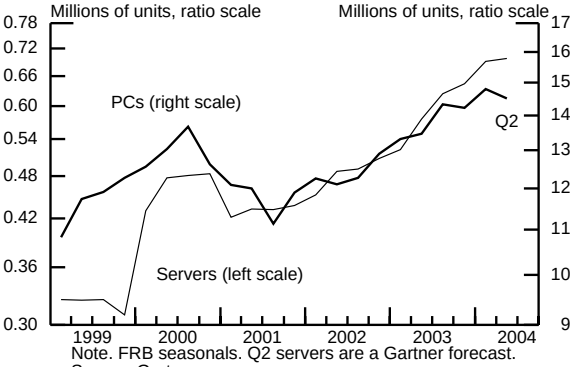


Semiconductor Manufacturing Equipment Orders and Shipments



Source. Semiconductor Equipment and Materials International.

U.S. Personal Computer and Server Sales



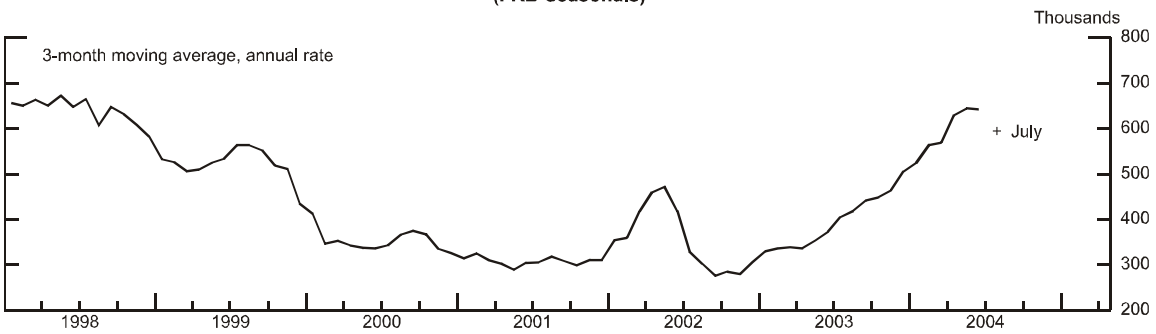
Note. FRB seasonals. Q2 servers are a Gartner forecast.
Source. Gartner.

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

Item	2003	2004			2004		
		Q1	Q2	Q3[1]	May	June	July[1]
U.S. production	12.1	12.4	11.8	11.9	11.8	11.4	11.6
Autos	4.5	4.4	4.2	4.3	4.1	3.9	4.2
Trucks	7.6	8.0	7.7	7.6	7.7	7.4	7.4
Days' supply[2]	73	76	78	n.a.	70	85	73
Autos	63	63	62	n.a.	58	67	60
Trucks	80	84	88	n.a.	78	97	81
Inventories[3]	3.17	3.27	3.32	n.a.	3.24	3.32	3.28
Autos	1.13	1.11	1.08	n.a.	1.07	1.08	1.07
Trucks	2.03	2.16	2.24	n.a.	2.17	2.24	2.21

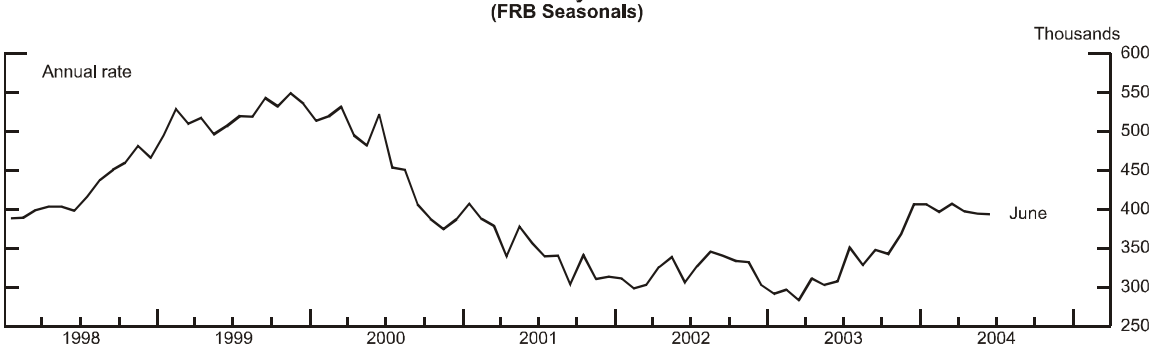
Note. Components may not sum to totals because of rounding.
1. Production rates for the third quarter and July reflect the latest schedules from Ward's Communications. Inventories and days' supply are staff estimates.
2. Quarterly and annual values are calculated with end-of-period stocks and average reported sales; excludes medium and heavy trucks.
3. End-of-period stocks; excludes medium and heavy trucks.
n.a. Not available

Medium and Heavy Truck Orders
(FRB Seasonals)



Note. July value is a preliminary estimate.
Source. ACT Research Co.

Medium and Heavy Truck Sales
(FRB Seasonals)



Sales of Light Vehicles

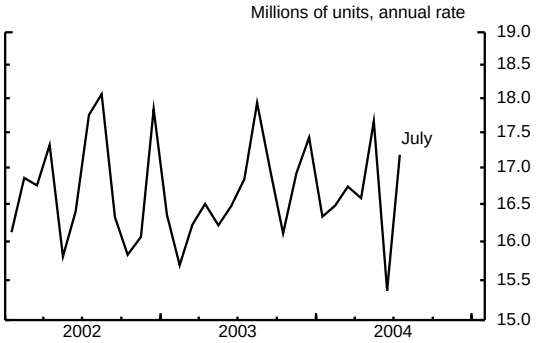
(Millions of units at an annual rate, FRB seasonals)

Category	2003	2003 Q4	2004 Q1	2004 Q2	2004 May	2004 June	2004 July
Total	16.6	16.8	16.5	16.5	17.7	15.4	17.2
Autos	7.6	7.5	7.4	7.5	7.9	7.0	7.5
Light trucks	9.0	9.3	9.1	9.1	9.7	8.3	9.7
North American[1]	13.3	13.6	13.3	13.1	14.1	12.1	13.8
Autos	5.5	5.5	5.4	5.3	5.6	5.0	5.5
Light trucks	7.8	8.1	7.8	7.9	8.5	7.1	8.4
Foreign-produced	3.3	3.2	3.3	3.4	3.5	3.3	3.3
Autos	2.1	2.1	2.0	2.2	2.3	2.1	2.1
Light trucks	1.2	1.2	1.2	1.2	1.3	1.2	1.3
Memo:							
Medium and heavy trucks	.33	.37	.40	.40	.39	.39	n.a.

Note. Components may not sum to totals because of rounding. Data on sales of trucks and imported autos for the most recent month are preliminary and subject to revision.

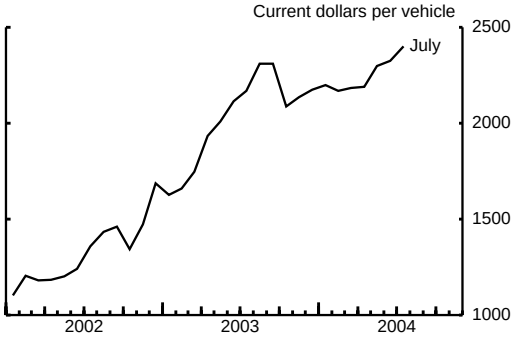
1. Excludes some vehicles produced in Canada that are classified as imports by the industry.

Sales of Light Vehicles



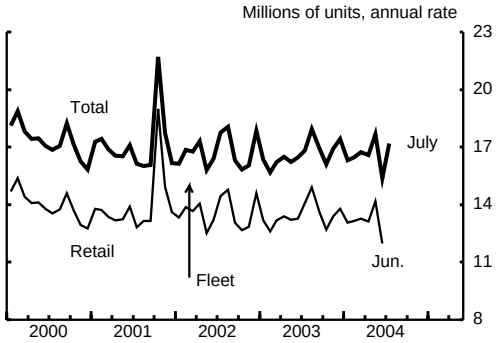
Note. FRB seasonals. Adjusted for shifts in reporting periods.

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.

Fleet and Retail Sales of Light Vehicles



Note. FRB seasonals.

Michigan Survey Index of Car-Buying Attitudes

According to anecdotal reports, bottlenecks have emerged in the transportation sector. Truck production has been below replacement needs since mid-2000 except for a brief period in 2002. As a consequence, the fleet has aged considerably, and capacity is quite tight; moreover, federal rules that restrict the number of hours a driver can be on the road have only exacerbated the situation. The combination of tight capacity along with higher diesel fuel prices and driver shortages has encouraged many large trucking companies to increase their use of railroads to ship truck trailers. So far this year, the substitution of rail for trucking, together with rising imports and exports, has significantly raised the volume of intermodal traffic—the containers and truck trailers shipped by rail—and has caused some considerable delays, especially at Union Pacific.

Motor Vehicles

Light vehicle sales rebounded to an annual rate of 17.2 million units in July after having dropped off sharply in June. General Motors accounted for more than 60 percent of the overall increase, and confidential data indicate that almost all of the gain in that company's sales was in retail. According to the latest report from J.D. Powers and Associates, the average incentive per vehicle rose from $2,330 to $2,400 over the first four weeks of July. Ford and GM, in particular, recently introduced enhanced deals on their large light-truck models. Manufacturers will probably continue to offer substantial discounts on their 2004 model-year lineup to clear out stocks in advance of the arrival of 2005 model-year vehicles late in the third quarter. However, despite the rise in incentives, the Michigan survey reports that car-buying attitudes have dimmed because respondents are concerned about financing rates.

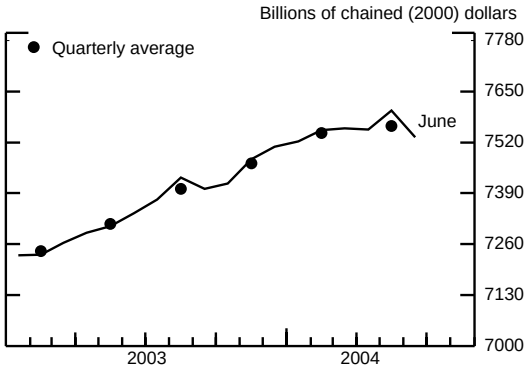
Business demand for motor vehicles has remained firm. So far this year, both fleet sales of light vehicles and sales of medium and heavy trucks have come in above the average for 2003. In light of the current tight freight situation and the recent move by haulers to replace their aging fleets, demand should retain some momentum. Industry contacts report that producers of medium and heavy trucks expect solid sales in the second half of 2004. Indeed, in July, the three-month moving average of medium and heavy truck orders remained high, signaling continued strength in demand.

Total motor vehicle production in the second quarter was 11.8 million units, more than 500,000 million units below the first-quarter pace and the lowest level in a year. Nonetheless, inventories remained elevated at 78 days' supply for the second quarter. Stocks of light trucks, at 2.2 million units, account for all of the excess inventory. With strong sales in July, inventories were pared back to 73 days' supply. The latest schedules from automakers show that the rate for third-quarter assemblies will be about the same as the second-quarter rate, an indication that producers need solid sales to further reduce their inventory overhang.

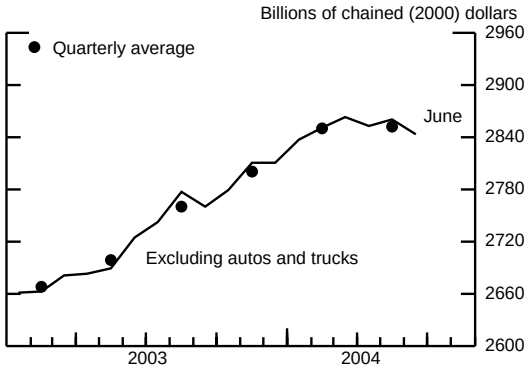
Real Personal Consumption Expenditures
(Percent change from the preceding period)

Expenditure	2003		2004				
	H1	H2	Q1	Q2	Apr.	May	June
	Annual rate				Monthly rate		
Total real PCE	3.3	4.3	4.1	1.0	.0	.6	-.9
Durable goods	9.8	10.0	2.2	-2.5	-1.9	3.7	-5.8
Motor vehicles	8.2	5.5	-5.8	-8.5	-3.7	8.2	-12.3
Excluding motor vehicles	11.2	14.0	9.3	2.6	-.5	.1	-.2
Nondurable goods	3.3	6.0	6.7	-.1	-.2	.3	-.7
Energy	-7.1	12.0	-2.3	-4.8	-.2	2.7	-3.6
Other	4.4	5.4	7.7	.5	-.2	.0	-.3
Services	2.0	2.3	3.3	2.3	.5	.2	.0
Energy	-7.0	8.6	3.5	-18.3	4.3	-.5	-2.8
Transportation	-.4	-.7	2.0	2.2	.3	-.2	.0
Other	2.5	2.3	3.4	3.2	.3	.2	.1
Memo:							
Real disposable personal income	3.0	4.7	3.2	2.9	.4	.1	.0

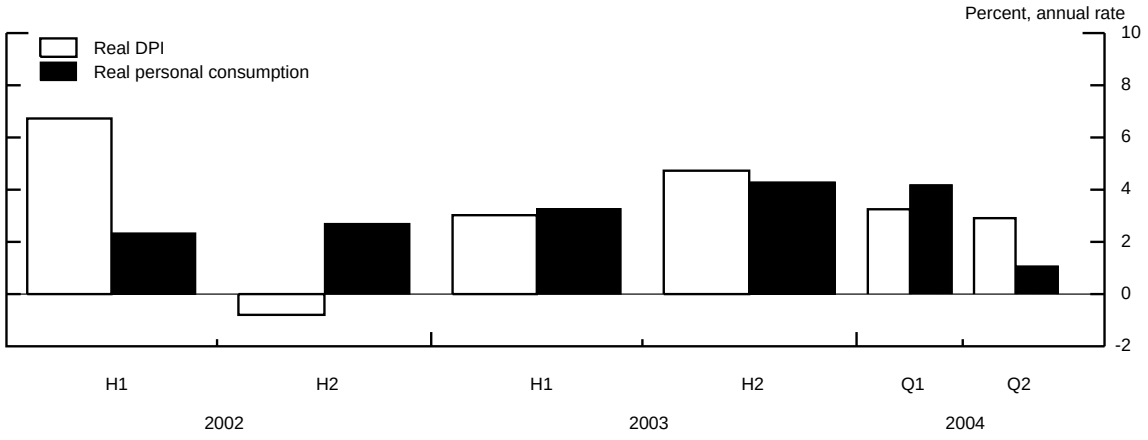
Real PCE



Real PCE Goods



Change in Real DPI and Real Personal Consumption



Consumer Spending

Consumer spending slowed sharply in the second quarter, increasing at an annual rate of just 1.0 percent after having advanced 4.1 percent in the first quarter. Although outlays for services continued to expand at a solid rate in the second quarter, expenditures for goods declined sharply. The sluggish rise in spending was accompanied by a slight deceleration in real disposable personal income—held back by rising food and energy prices—and a decline in equity values.

Total real personal consumption expenditures slumped 0.9 percent in June. As noted above, sales of cars and trucks dropped sharply to their lowest levels since February 2003. At the same time, spending on other goods declined 1/4 percent as expenditures on food fell for a third consecutive month, outlays for apparel dropped, and spending in most other goods categories was also weak. Some retailers have attributed the moderation in spending to unseasonably cool and wet weather in June. Expenditures on services also slowed in June as spending on household electricity and gas moderated.

Recent indicators provide some evidence that spending may have perked up in July. As noted above, purchases of light motor vehicles bounced up. In addition, sales at the largest chain stores are reported to have been brisk. And the July readings of consumer sentiment from both the Michigan Survey Research Center and the Conference Board increased and are consistent with gains in spending.

Real disposable income was unchanged in June, damped by higher energy prices and lower wage and salary disbursements. Real disposable income rose at an annual rate of 2.9 percent for the second quarter as a whole. Nonetheless, the gain in household income outpaced the increase in consumer spending last quarter and boosted the personal saving rate 0.5 percentage point, to 1.7 percent.[6] Although a lackluster stock market has kept increases in household wealth below the pace of income growth this year, the ratio of household wealth to income remains well above its historical average.

Housing Markets

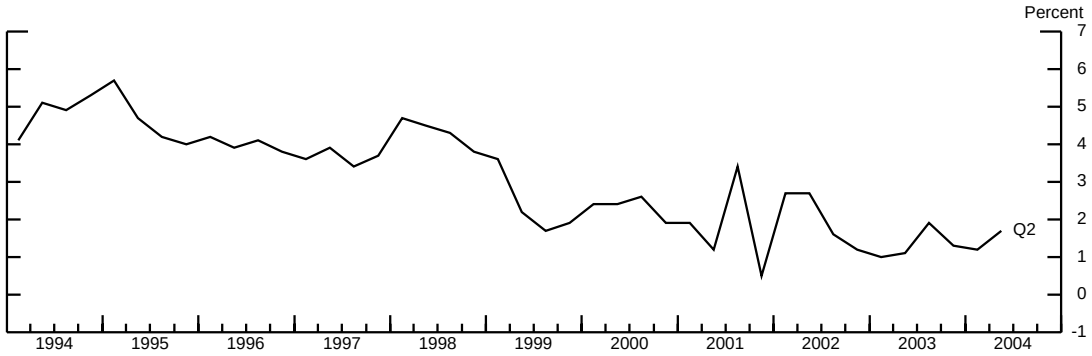
Although housing construction dipped in June, permits and sales remained robust, and recent indicators point to solid demand in July. New single-family homes were started at an annual rate of 1.49 million units in June, a considerably slower pace than in April and May. However, a substantial

6. In the 2004 annual revision, the BEA revised the personal saving rate noticeably downward beginning in mid-2002, largely because of substantial downward revisions to personal income from assets and transfer payments. For the first quarter of 2004, the saving rate is now 1.0 percentage point lower than previously published.

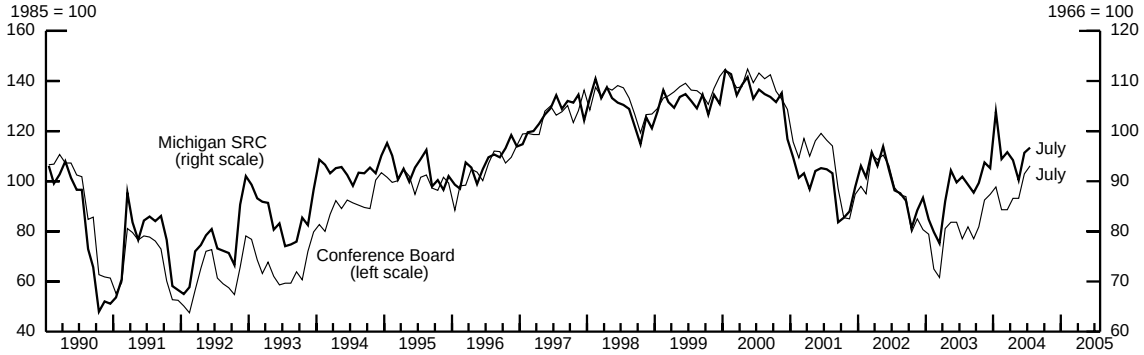
Household Indicators

Household Net Worth and Wilshire 5000

Personal Saving Rate



Consumer Confidence

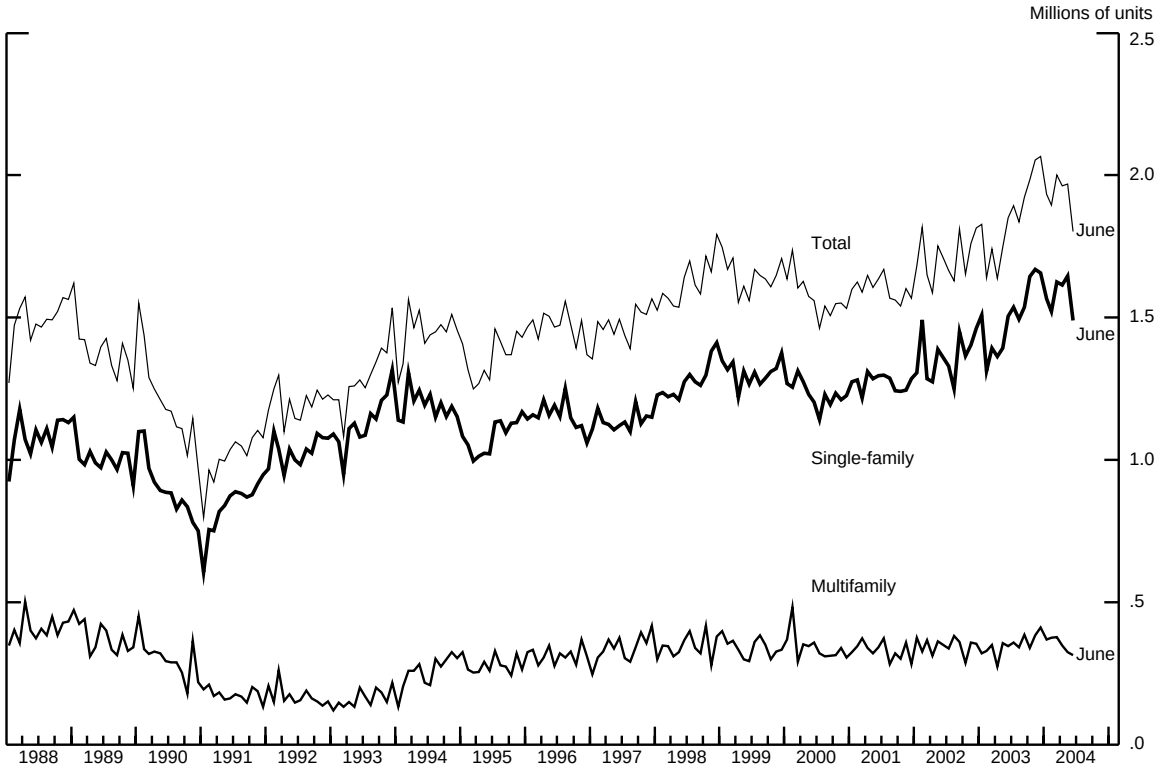


Private Housing Activity
(Millions of units; seasonally adjusted annual rate, except where noted)

Sector	2003	2003 Q4	2004 Q1	2004 Q2	2004 Apr.	2004 May	2004 June
All units							
Starts	1.85	2.04	1.94	1.91	1.96	1.97	1.80
Permits	1.86	1.97	1.93	2.01	2.01	2.10	1.92
Single-family units							
Starts	1.50	1.66	1.57	1.58	1.62	1.65	1.49
Permits	1.44	1.54	1.52	1.56	1.54	1.61	1.51
Adjusted permits[1]	1.50	1.60	1.55	1.59	1.57	1.64	1.55
Permit backlog[2]	.115	.115	.122	.133	.123	.120	.133
New home sales	1.09	1.12	1.20	1.29	1.20	1.34	1.33
Existing home sales	6.10	6.30	6.20	6.80	6.63	6.81	6.95
Multifamily units							
Starts	.35	.38	.37	.33	.35	.33	.31
Permits	.42	.44	.42	.45	.46	.49	.41
Permit backlog[2]	.060	.060	.054	.058	.051	.055	.058
Mobile homes							
Shipments	.131	.126	.126	.127	.129	.126	.127

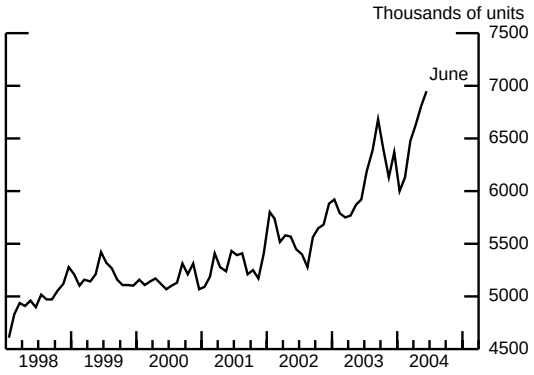
1. Adjusted permits equal permit issuance plus total starts outside of permit-issuing areas.
2. Number outstanding at end of period. Seasonally adjusted by Board staff. Excludes permits that have been cancelled, abandoned, expired or revoked. Not at an annual rate.

Private Housing Starts
(Seasonally adjusted annual rate)



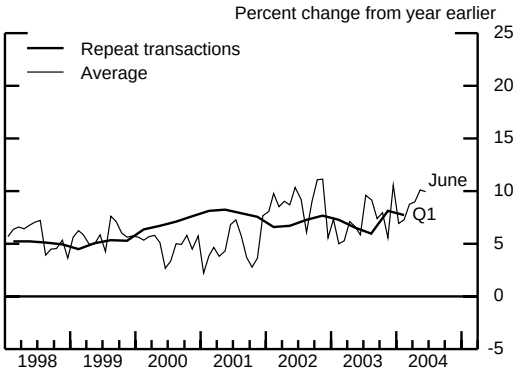
Indicators of Single-Family Housing

Existing Home Sales



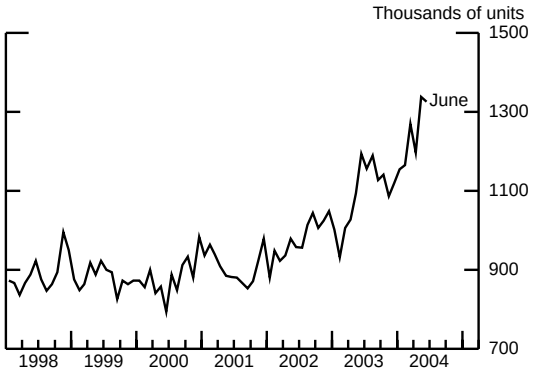
Source. National Association of Realtors.

Prices of Existing Homes



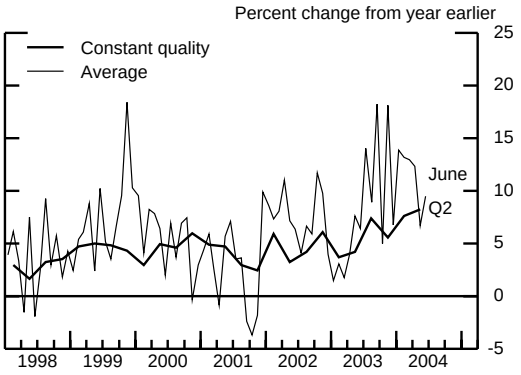
Source. National Association of Realtors and OFHEO.

New Home Sales



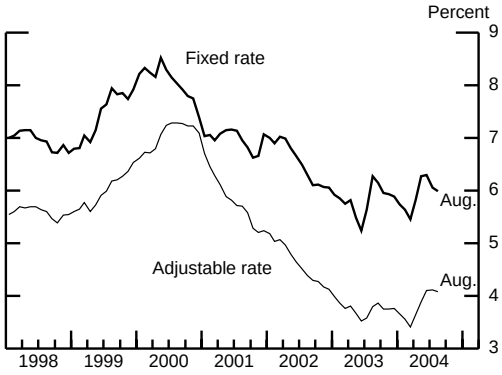
Source. Census Bureau.

Prices of New Homes



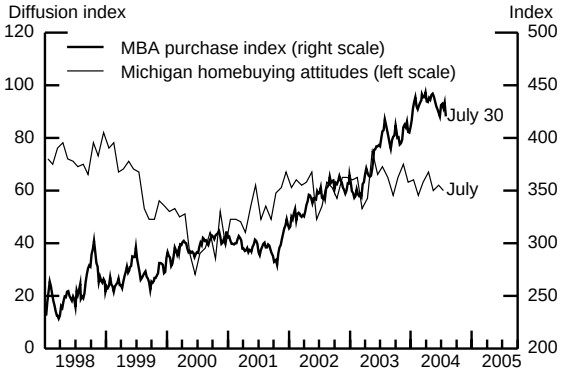
Source. Census Bureau.

Mortgage Rates



Note. The August readings are based on data through August 5.
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.

increase in the permit backlog in June points to a rebound in starts in July. The multifamily sector exhibited a similar pattern: Starts declined in June, but the permit backlog rose, a sign that a bounceback in July is likely.

Home sales remained strong in June. Sales of existing homes increased 2 percent, to an annual rate of 6.95 million units, the highest pace on record. In addition, new homes sold at an annual rate of 1.33 million units in June, just a touch lower than the record high posted in May.

Recent indicators suggest that housing demand will hold up reasonably well in the near term. Although the four-week moving average of mortgage applications to purchase homes has trended down since mid-May, the recent levels are still high by historical standards. And the thirty-year fixed mortgage rate, which has averaged 6.0 percent since the beginning of July, remains relatively low. Moreover, consumers' homebuying attitudes in July remained within the favorable range that has persisted for the past couple of years.

Home prices have continued to rise rapidly. In June, the average price of existing homes sold was up almost 10 percent from the year-earlier level. The average price of a new home advanced 9-1/2 percent during the twelve months ended in June, and the constant-quality price index for new homes, which controls for changes in the geographic composition of sales, home size, and other readily measurable attributes, was 8-1/4 percent higher than it was a year earlier, the fastest rate of increase in more than twenty years.

Equipment and Software

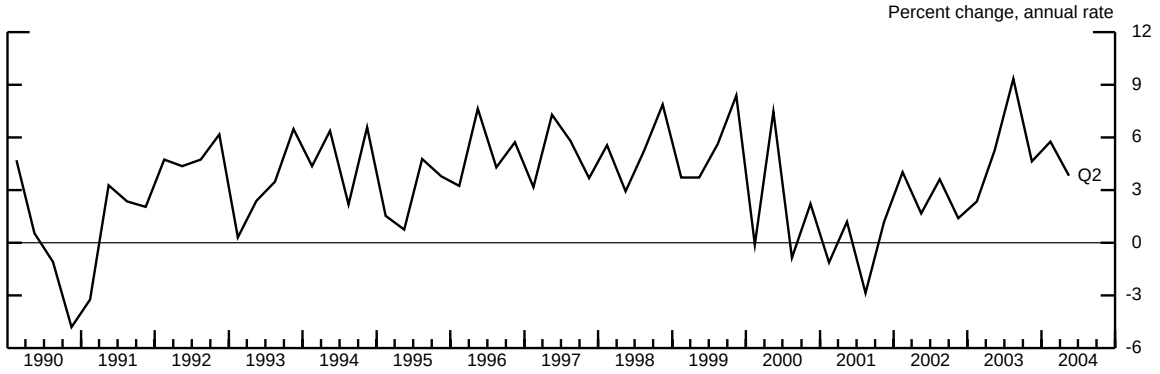
Real business spending on equipment and software is estimated to have increased at an annual rate of 10.2 percent in the second quarter, a little above the 8.0 percent pace posted in the first quarter.[7] The second-quarter pickup was largely the result of a bounceback in spending on transportation equipment. After having risen at a robust rate for several quarters, real outlays for equipment excluding transportation items rose at a more moderate rate last quarter. The deceleration in spending was most pronounced for non-high-tech equipment. Still, fundamentals continue to send strong signals about investment prospects in general: Business output is expanding, financing costs remain low, and the corporate sector has accumulated a large cushion of liquid assets.

In the high-tech sector, real outlays increased at an annual rate of 20.4 percent in the second quarter after having risen around 14-1/2 percent in the first

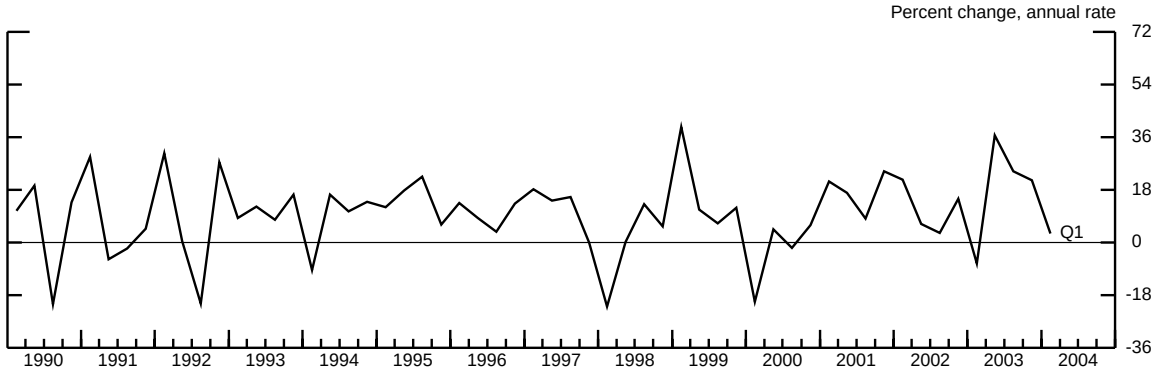
7. The staff's second-quarter estimate of the increase in spending on equipment and software is about 0.3 percentage point higher than the BEA's advance estimate. The upward revision is based on revised June data for shipments of capital goods and new information about aircraft expenditures, which became available after the NIPA report.

Equipment and Software Investment Fundamentals

Real Business Output



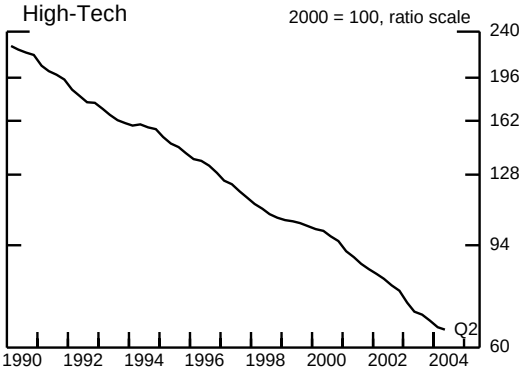
Real Corporate Cash Flow



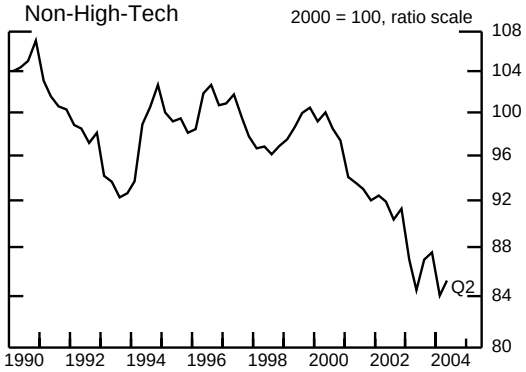
User Cost of Capital

(Excludes the effects of the partial expensing tax incentive)

High-Tech



Non-High-Tech



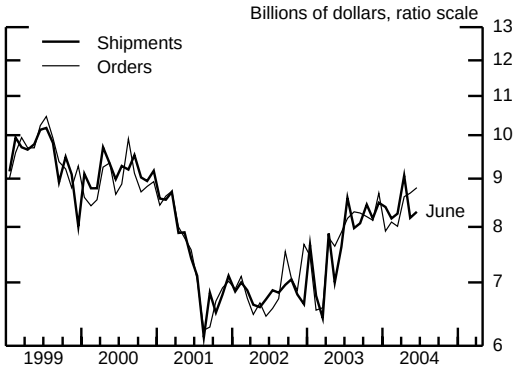
Orders and Shipments of Nondefense Capital Goods

(Percent change; seasonally adjusted current dollars)

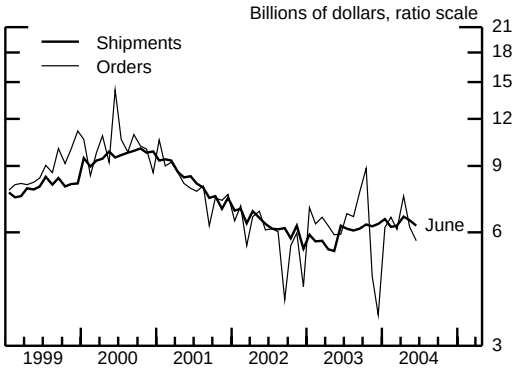
Indicators	2004				
	Q1	Q2	Apr.	May	June
	Annual rate		Monthly rate		
Shipments	10.5	8.4	.8	-2.0	1.4
Excluding aircraft	12.1	8.4	1.4	-2.8	2.0
Computers and peripherals	-4.3	12.2	9.7	-9.8	1.5
Communications equipment	2.6	8.0	5.6	-1.9	-3.3
All other categories	17.1	7.8	-.7	-1.5	2.9
Orders	10.4	14.4	-1.3	-1.4	1.0
Excluding aircraft	15.8	6.9	-2.1	-2.0	1.1
Computers and peripherals	-14.8	38.8	7.4	.9	1.3
Communications equipment	48.3	12.2	22.8	-17.3	-7.9
All other categories	18.5	1.2	-6.8	.0	2.4
Memo:					
Shipments of complete aircraft[1]	2.2	n.a.	24.3	25.8	n.a.

1. From Census Bureau, Current Industrial Reports; billions of dollars, annual rate.
n.a. Not available.

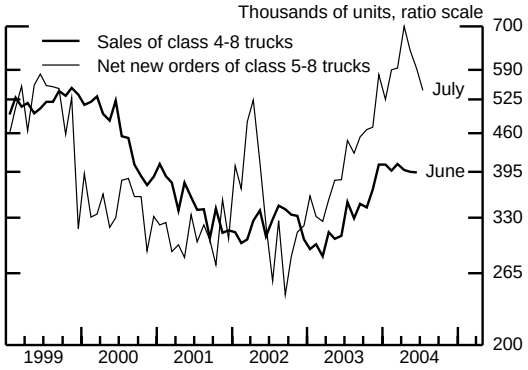
Computers and Peripherals



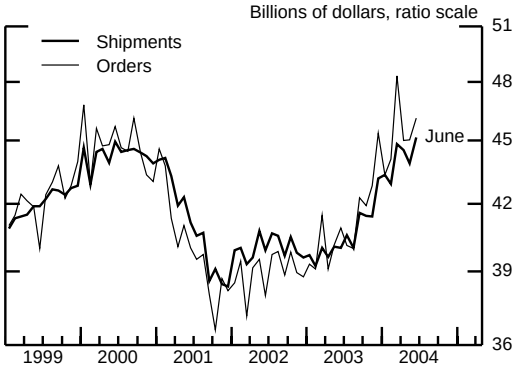
Communications Equipment



Medium and Heavy Trucks



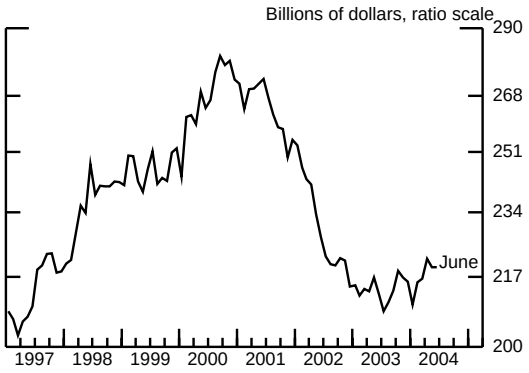
Other Equipment



Note. Annual rate, FRB seasonals.
Source. Ward's Communications and ACT Research Co.

Nonresidential Construction
(Seasonally adjusted, annual rate)

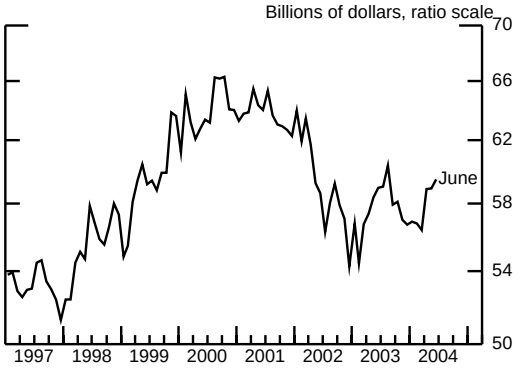
Total Structures



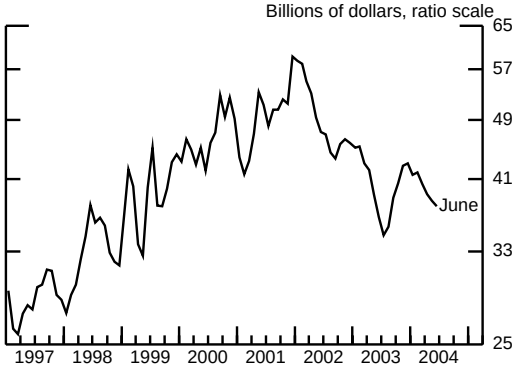
Office

Manufacturing

Commercial



Power and Communication



Other

Note. Includes religious, educational, lodging, amusement and recreation, transportation, and health-care facilities.

quarter. Gains in real spending on computers and peripherals accelerated from their sluggish first-quarter pace amid reports of strong replacement demand for PCs. Outlays for communications equipment skyrocketed in the second quarter, posting a 37-1/2 percent advance. The BEA's outsized figure reportedly is based on source data from the International Trade Commission that point to a surge in imports of telecommunications equipment in April and May. However, in May and June, declines in orders for communications gear, which reversed a sizable portion of their earlier gains, suggested some renewed softness in shipments of this equipment in the near term. Software investment slowed considerably in the second quarter. Large firms like Microsoft and Oracle reported impressive gains in sales, but a host of smaller firms announced disappointing earnings figures. The smaller companies were surprised by last-minute deferrals of corporate outlays by customers that appeared to be waiting for a shakeout among the major players in the industry before making their purchases.

In the transportation category, business spending on motor vehicles was flat in the second quarter, while real aircraft investment is estimated to have increased moderately. Aircraft expenditures continue to linger at levels far below the peaks recorded a few years ago.

Real spending on equipment excluding high-tech and transportation rose at an annual rate of 0.6 percent in the second quarter, down sharply from the 11.6 percent pace posted in the previous quarter. Nominal orders and shipments in this broad category fell in both April and May before turning up noticeably in June. Even with the recent weakness, the increase in the backlog of orders each month since February bodes well for this category in the current quarter. In early July, steel-plate producers reported increased demand from manufacturers of farm equipment, ships, and railroad cars. Moreover, the surveys of manufacturers by the Philadelphia and New York Federal Reserve Banks and the most recent reading from the ISM pointed to a pickup in activity in July and suggested that the second-quarter weakness in demand for capital equipment is unlikely to persist.

Nonresidential Construction

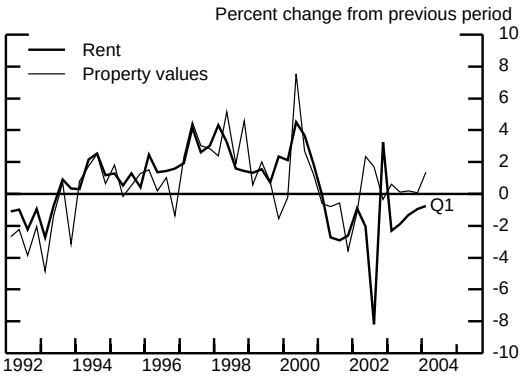
We estimate that real business investment in nonresidential structures rose at an annual rate of 7 percent in the second quarter but remained at a depressed level.[8] Increased spending on office buildings, commercial structures, and various

8. Our estimate incorporates the June data on construction put-in-place, which were not available for the BEA's advance release; the BEA reported a 5-1/2 percent rate of increase.

Indicators of Nonresidential Construction

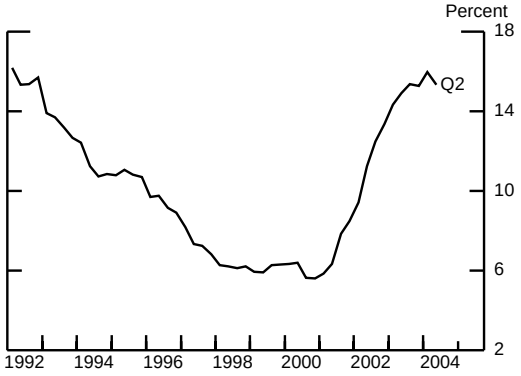
Office Buildings

Rent and Property Values



Source. National Real Estate Index.

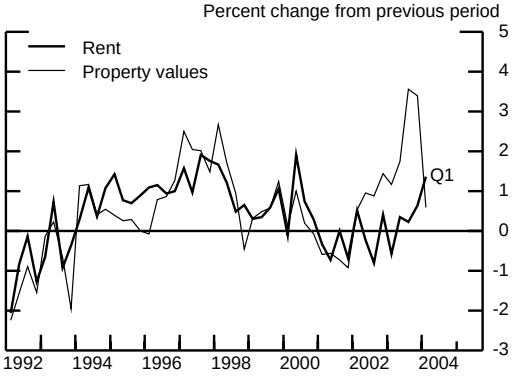
Vacancy Rate



Source. National Council of Real Estate Investment Fiduciaries.

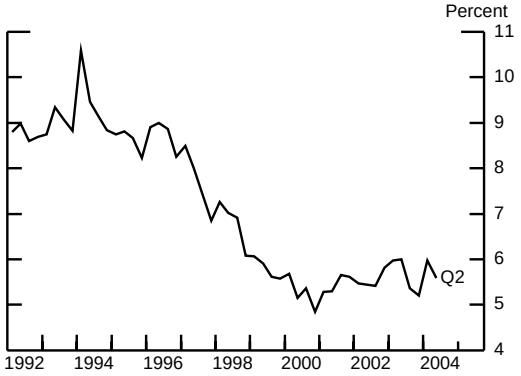
Retail Buildings

Rent and Property Values



Source. National Real Estate Index.

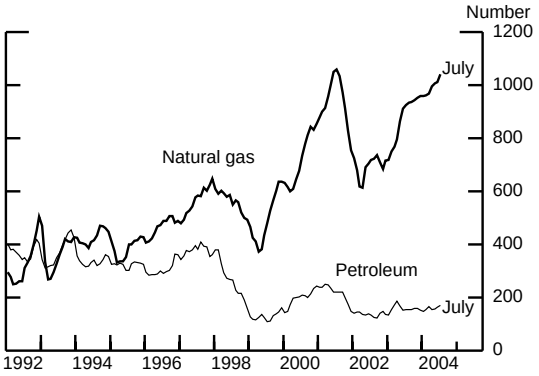
Vacancy Rate



Source. National Council of Real Estate Investment Fiduciaries.

Drilling Activity

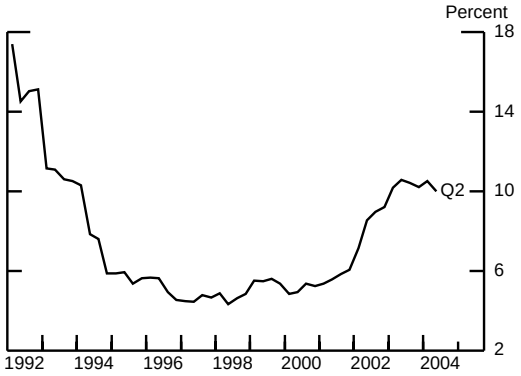
Rigs in Operation



Note. July values are averages through July 30.
Source. DOE/Baker Hughes.

Industrial Buildings

Vacancy Rate



Source. National Council of Real Estate Investment Fiduciaries.

other types of buildings more than offset a sizable decline in the power-generation component.[9]

Recent indicators of market conditions in the nonresidential structures sector paint a mixed picture. Although conditions in the office sector remain soft, they may be bottoming out. The office vacancy rate edged down in the second quarter but remained elevated. Office rents continued to decline in the first quarter but did so less rapidly than during the previous year; property values posted a small increase in the first quarter after showing little change last year. The vacancy rate for industrial space also ticked down in the second quarter. In the retail sector, the vacancy rate also moved down in the second quarter; on balance, vacancy rates for retail properties have been relatively low since the late 1990s. Retail property values recorded a small increase early this year after posting more robust advances last year. The upward trend in the number of natural gas drilling rigs in July suggested that spending on drilling and mining structures is continuing to increase at a robust pace.

Business Inventories

With the June data on manufacturers' inventory investment now in hand, we estimate that real nonfarm inventories excluding finished motor vehicles rose at an annual rate of about $34 billion in the second quarter after a small rise in the first quarter.[10] The change in nonfarm inventory investment is estimated to have boosted the change in real GDP by 0.4 percentage point in the second quarter after having contributed 1.1 percentage points in the first quarter. Inventory investment has been somewhat subdued relative to recent small decreases in sales, and both book-value and NIPA inventory-sales ratios edged up but remained at fairly low levels.

According to the staff's flow-of-goods system, days' supply of inventories edged up in June, largely as a result of the upswing in stocks of motor vehicles. Apart from motor vehicles and parts, only the inventories of paper and communications equipment appear elevated; in marked contrast to other goods, the days' supply of communications equipment has fallen more than 17 percent since early 2002 and now stands at its lowest level since April 2001.

---

9. The "other" category includes religious, educational, lodging, amusement, recreation, transportation, and health-care facilities.

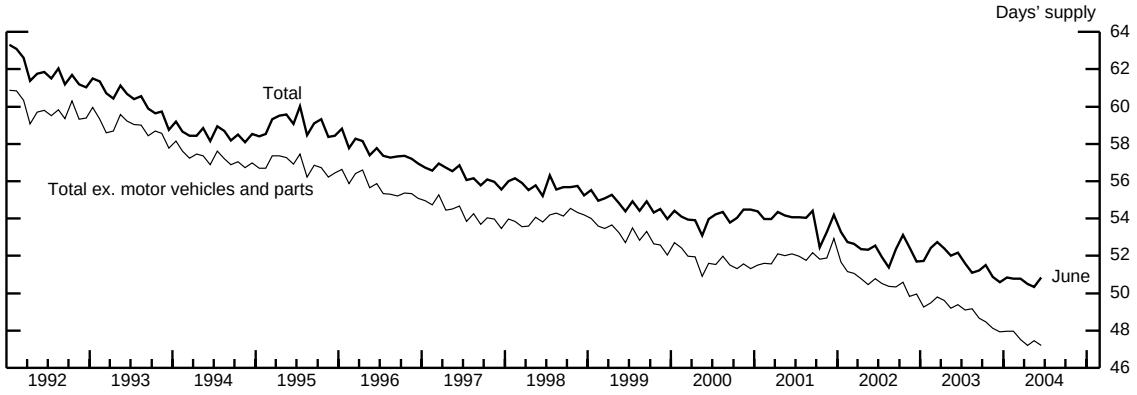
10. The BEA's second-quarter estimate of nonfarm inventory investment—$44.9 billion (annual rate)—incorporated preliminary book-value data on inventories held by manufacturers of durable goods in June. Data on inventories held by manufacturers of nondurable goods, wholesalers, and retailers in June were not available in time for the advance report. The most recent Census figure on nondurable inventories differed little from the one that the BEA pencilled in.

Changes in Nonfarm Inventories
(Billions of chained (2000) dollars; annual rate)

Sector	2003		2004	
	Q3	Q4	Q1	Q2
Nonfarm inventory investment	-2.7	4.6	34.5	44.9
Excluding finished motor vehicles and parts	-5.1	-5.0	6.8	35.6
Manufacturing	-19.3	-13.4	1.8	3.6
Merchant wholesalers	8.4	-2.1	3.9	9.6
Retail trade	9.4	10.3	6.9	10.1

Book-Value Inventories Relative to Shipments and Sales

Inventory-Consumption Ratios, Flow-of-Goods System



Federal Government

The federal unified budget deficit appears to have stabilized in recent months as the inflow of receipts has picked up. In June, buoyant corporate income tax payments caused receipts to jump 11 percent above the level posted a year earlier. Outlays, adjusted for financial transactions and payment timing shifts, were boosted by higher interest payments on the debt and rose 5-3/4 percent relative to the year-earlier level. Among non-interest outlays, Medicaid outlays surged in June; some states may have accelerated payments in order to take advantage of the temporarily higher reimbursement rates from the federal government that expired at the end of that month. Year-over-year increases in defense spending have recently begun to wane: In June, defense outlays were only 7 percent above their level a year earlier; over the previous twelve months, they typically had shown annual increases of about 14 percent. Daily data for July and early August suggest some acceleration again in the current quarter.

The Congress has made little progress on budget-related legislation. The Senate has managed to pass only one of the thirteen regular appropriations bills, compared with an average over the past decade of six bills passed before the summer recess. The defense appropriations bill cleared both houses and includes a 7 percent increase in budget authority for programs outside the war on terrorism, along with a $25 billion downpayment for continued operations in Iraq. Neither corporate tax reform nor the extension of expiring individual income tax provisions has seen much progress, in part because of persistent wrangling over PAYGO.

The Administration now projects a fiscal 2004 unified budget deficit of $445 billion, compared with a $375 billion deficit in fiscal 2003. The Administration projects that the deficit will decline to $331 billion next year, largely reflecting the end of the partial-expensing tax provision, the cyclical improvement in the economy, an assumed falloff in spending on operations in Iraq, and an increase in the effective tax rate. These factors lead to some further improvement in the deficit in 2006 and little change thereafter.

State and Local Governments

The staff estimates that real spending by state and local governments has risen at an annual rate of 2.5 percent in the second quarter, the largest increase since the first quarter of 2002. Essentially all of the strength was the result of a surge in construction spending, which began in March. Meanwhile, employment fell a little in the second quarter after having risen during the previous six months.

Most signs point to overall improvement in state and local financial conditions. Standard and Poor's upgraded three times as many state and local credits in the second quarter as it downgraded. Many states report that revenues have come in higher than expected in recent months, and general fund spending has been held

Federal Government Outlays and Receipts

(Unified basis; billions of dollars except as noted)

Function or source	June 2003	June 2004	June Percent change	12 months ending in June 2003	12 months ending in June 2004	12 months ending in June Percent change
Outlays	171.8	195.2	13.6	2115.6	2260.8	6.9
Financial transactions[1]	-.4	.2	...	-2.4	-1.6	...
Payment timing[2]	-12.2	.0	...	-.6	-.3	...
Adjusted outlays	184.4	195.1	5.8	2118.6	2262.7	6.8
Receipts	193.0	214.4	11.1	1804.4	1829.7	1.4
Payment timing	.0	.0	...	.0	.0	...
Adjusted receipts	193.0	214.4	11.1	1804.4	1829.7	1.4
Surplus or deficit (-)	21.2	19.1	...	-311.2	-431.1	...
Selected components of adjusted outlays and receipts						
Adjusted outlays	184.4	195.1	5.8	2118.6	2262.7	6.8
Net interest	10.6	13.0	22.1	160.2	155.6	-2.9
Non-interest	173.8	182.1	4.8	1958.5	2107.1	7.6
National defense	36.8	39.3	6.9	388.3	443.7	14.3
Social security	43.4	44.4	2.2	470.4	490.3	4.2
Medicare	21.1	24.5	15.8	245.9	262.8	6.9
Medicaid	14.4	18.0	25.4	155.5	176.6	13.5
Income security	22.3	21.4	-3.7	333.7	338.2	1.3
Agriculture	-.6	.5	-181.8	21.9	19.7	-10.1
Other	36.5	34.0	-6.9	342.7	375.9	9.7
Adjusted receipts	193.0	214.4	11.1	1804.4	1829.7	1.4
Individual income and payroll taxes	148.4	155.0	4.5	1490.0	1462.4	-1.9
Withheld + FICA	114.4	120.1	4.9	1377.9	1379.4	.1
Nonwithheld + SECA	36.9	37.7	2.2	292.0	284.9	-2.5
Less: Refunds	3.0	2.8	-5.4	179.9	201.9	12.2
Corporate	32.0	44.3	38.3	129.7	174.6	34.6
Gross	35.9	46.4	29.2	196.3	218.5	11.3
Less: Refunds	3.9	2.1	-46.4	66.6	43.9	-34.1
Other	12.6	15.1	19.5	184.7	192.7	4.3
Adjusted surplus or deficit (-)	8.6	19.3	...	-314.2	-433.0	...

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

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

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

... Not applicable.

Administration Budget Projections and Economic Assumptions

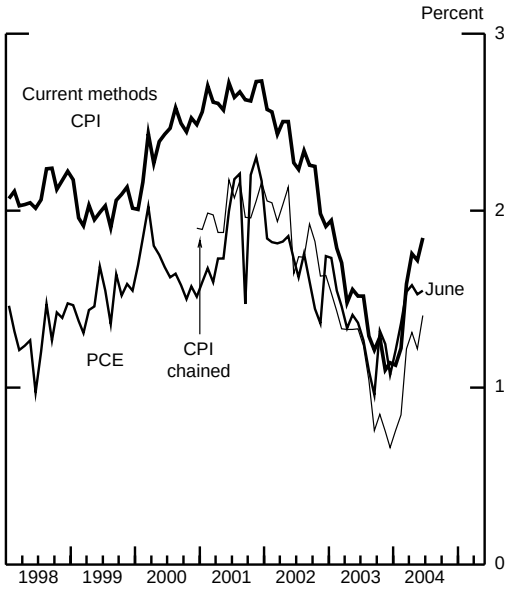
Item	2004	2005	2006	2007	2008	2009
Budget projections (fiscal years)	Billions of dollars					
July projections						
Total surplus	-445	-331	-261	-233	-228	-229
On-budget	-600	-512	-458	-450	-466	-481
Off-budget	155	180	198	217	237	252
February projections						
Total surplus	-521	-364	-268	-241	-239	-237
On-budget	-675	-543	-470	-466	-487	-501
Off-budget	154	179	202	225	248	263
Economic assumptions (calendar years)	Percent change, fourth quarter to fourth quarter					
Real GDP	4.2	3.5	3.3	3.3	3.2	3.1
GDP price index	1.9	2.1	2.1	2.1	2.1	2.1
CPI-U	2.8	2.4	2.4	2.4	2.4	2.5
	Percent, annual average					
Unemployment rate	5.5	5.3	5.3	5.1	5.1	5.1
Treasury yields						
Three-month	1.3	2.6	3.4	3.9	4.3	4.4
Ten-year	4.5	5.1	5.4	5.6	5.7	5.8

Note. The on-budget surplus excludes social security and the Postal Service (which are off-budget).

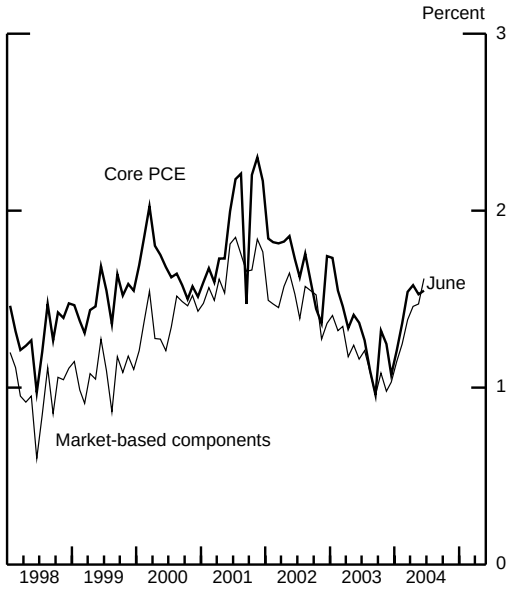
Source. Office of Management and Budget, *Mid-Session Review of the Budget: Fiscal Year 2005* (July 2004).

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

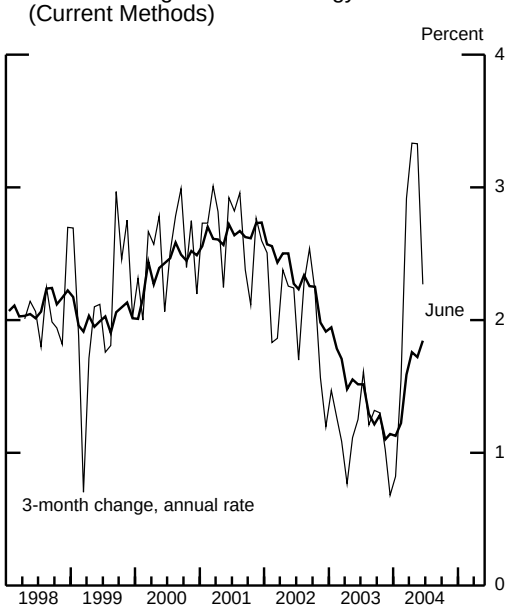
CPI and PCE excluding Food and Energy



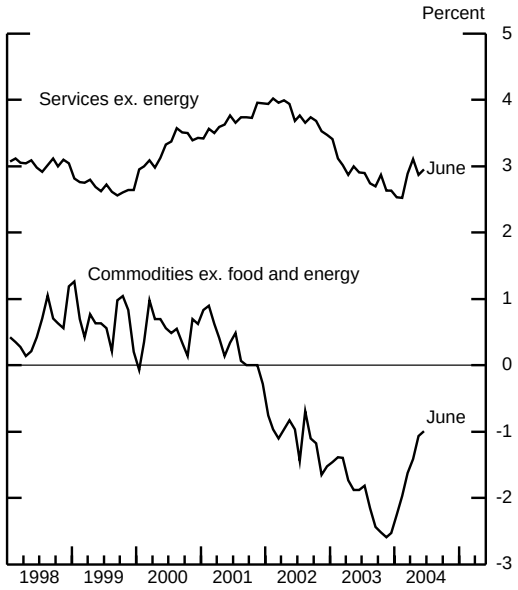
PCE excluding Food and Energy



CPI excluding Food and Energy
(Current Methods)



CPI Services and Commodities



in check. An infusion of federal aid from the Jobs and Growth Tax Relief Reconciliation Act of 2003 also bolstered general fund accounts during fiscal 2004, which ended June 30 in forty-six states. According to a preliminary report from the National Conference of State Legislatures (NCSL), ending general fund balances for fiscal 2004 rose to 5.4 percent of expenditures from 3.7 percent at the end of fiscal 2003; this was the first increase since 2000.[11] Even so, many legislators remain wary about developments in fiscal 2005. In particular, according to NCSL, outlays for Medicaid are expected to increase more than 13 percent this fiscal year despite the many cost-containment measures that were put into effect during the past three years.

Prices and Labor Costs

Core CPI inflation has moderated substantially in recent months. However, sizable increases in food and energy prices have continued to push up overall consumer price inflation.

Consumer energy prices rose 2.6 percent in June after advancing 4.6 percent in the previous month. Although the gains were broad-based, in part because of the pass-through of high crude oil costs, the increases in gasoline prices were especially large. The strength of demand for gasoline over the past year, combined with stagnant gasoline imports through June, left inventories quite lean in the second quarter. In addition, higher production costs associated with higher U.S. refinery utilization rates pushed up pump prices relative to crude oil prices through mid-July. Since then, gasoline imports have begun to rise, bringing wholesale mark-ups down, and retail prices have continued to decline. Among other energy products, natural gas markets softened a bit in July. By July 23, inventories of natural gas had risen to a level 3.1 percent above their long-run average for this time of the year. As a result, the spot price of natural gas at Henry Hub finished the month a touch below its level at the end of June.

Consumer prices for food rose 0.2 percent in June, well below the 0.9 percent spike posted in May. Prices for dairy products advanced rapidly during the three months ending in June because herd reductions over the past couple of years hampered dairy farmers' ability to meet the recent surge in demand. An extraordinary jump of 6.8 percent in May was followed by a 1.7 percent advance in June, even though dairies increased milk supplies by boosting the feed rates of their cows. Crop reports so far this season point to bumper harvests for corn and soybeans, and grain prices have fallen in response. This development has encouraged producers of meats and poultry, which use corn and soybeans as feed, to raise their output a bit. As a result, increases in

11. Forty-four states reported budget data. Analysts at NCSL expect the aggregate year-end balance to be revised down when information is available from the remaining states (California, Illinois, Kentucky, Michigan, New York, and North Carolina).

Measures of Inflation
(Percent)

Measures	12-month change		3-month change		1-month change	
			Annual rate		Monthly rate	
	June 2003	June 2004	Mar. 2004	June 2004	May 2004	June 2004
CPI						
Total	**2.1**	**3.3**	**5.1**	**4.8**	**.6**	**.3**
Food	2.2	3.7	1.3	5.1	.9	.2
Energy	9.3	17.0	38.6	33.5	4.6	2.6
Ex. food and energy	**1.5**	**1.9**	**2.9**	**2.3**	**.2**	**.1**
Ex. tobacco	1.6	1.8	2.9	2.3	.2	.1
Core commodities	-1.8	-1.0	1.4	.3	.1	.0
Core services	2.9	3.0	3.4	3.0	.2	.2
Chained CPI (n.s.a.) [1]	1.9	2.6	...	...	...	...
Ex. food and energy [1]	1.3	1.4	...	...	...	...
PCE Prices						
Total	**1.8**	**2.5**	**3.9**	**3.3**	**.4**	**.2**
Food	2.0	3.2	1.9	4.1	.7	.1
Energy	9.5	18.0	41.9	33.5	4.6	2.7
Ex. food and energy	**1.4**	**1.5**	**2.3**	**1.5**	**.1**	**.1**
Ex. tobacco	1.4	1.5	2.3	1.5	.1	.1
Core commodities	-2.3	-.5	1.8	.1	.1	.0
Core services	2.9	2.4	2.5	2.1	.1	.2
Core market-based	1.2	1.6	2.4	1.9	.1	.2
Core non-market-based	2.3	1.2	1.7	-.4	.1	-.2
PPI						
Total finished goods	**2.9**	**4.0**	**5.1**	**5.0**	**.8**	**-.3**
Food	3.9	6.4	1.1	9.6	1.5	-.6
Energy	14.8	9.4	24.0	6.4	1.6	-1.6
Ex. food and energy	**-.3**	**1.8**	**2.1**	**2.9**	**.3**	**.2**
Ex. tobacco	.2	1.8	2.3	3.1	.4	.2
Core consumer goods	-.4	1.9	1.5	3.3	.4	.1
Capital equipment	-.1	1.7	2.9	2.0	.3	.2
Intermediate materials	4.5	6.9	10.1	12.7	1.1	.5
Ex. food and energy	2.0	5.8	8.9	10.8	.9	.5
Crude materials	29.1	18.9	22.1	34.1	2.8	1.6
Ex. food and energy	5.6	20.8	53.3	-28.5	-3.8	-.5

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

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

Measure	2001	2002	2003	2004
Product prices				
GDP price index	2.5	1.5	1.9	2.3
Less food and energy	2.0	2.0	1.6	1.9
Nonfarm business chain price index	2.0	.9	1.2	1.4
Expenditure prices				
Gross domestic purchases price index	2.3	1.3	1.9	2.5
Less food and energy	1.8	1.8	1.6	1.9
PCE price index	2.4	1.2	1.8	2.3
Less food and energy	1.8	1.8	1.4	1.6
PCE price index, market-based components	2.3	.9	1.8	2.4
Less food and energy	1.7	1.6	1.2	1.5
CPI	3.4	1.3	2.2	2.8
Less food and energy	2.7	2.4	1.5	1.8
Chained CPI	2.7	1.0	1.9	2.3
Less food and energy	2.0	1.9	1.3	1.3
Median CPI	3.5	3.6	2.2	2.5
Trimmed mean CPI	2.9	2.2	1.9	2.1

Surveys of Inflation Expectations
(Percent)

Period	Actual CPI inflation [1]	University of Michigan				Professional forecasters (10-year) [4]
		1 year [2]		5 to 10 years [3]		
		Mean	Median	Mean	Median	
2002: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	1.9	3.0	2.6	3.1	2.8	2.5
2004:Q1	1.8	3.1	2.7	3.4	2.9	2.5
Q2	2.9	4.0	3.3	3.3	2.8	2.5
2004:Jan.	1.9	2.9	2.7	3.4	2.8	...
Feb.	1.7	2.9	2.6	3.3	2.9	...
Mar.	1.7	3.4	2.9	3.4	2.9	2.5
Apr.	2.3	4.0	3.2	3.2	2.7	...
May	3.1	3.9	3.3	3.3	2.8	...
June	3.3	4.0	3.3	3.4	2.9	2.5
July	n.a.	3.5	3.0	3.1	2.8	...

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.

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

Commodity	Current price (dollars)	2002 [1]	2003 [1]	12/30/03 to 6/15/04 [2]	6/15/04 [2] to 8/3/04	Memo: 52-week change to 8/3/04
Metals						
Copper (lb.)	1.380	5.6	47.9	19.7	6.7	64.3
Steel scrap (ton)	236.000	49.2	66.8	2.0	43.0	90.8
Aluminum, London (lb.)	.765	2.8	16.7	3.3	4.1	14.2
Precious metals						
Gold (oz.)	390.950	24.3	20.7	-7.1	1.2	12.2
Silver (oz.)	6.635	3.8	24.6	-4.0	15.8	33.2
Forest products [3]						
Lumber (m. bdft.)	440.000	-8.9	44.5	49.1	2.1	66.7
Plywood (m. sqft.)	500.000	.7	36.7	10.1	14.9	33.7
Petroleum						
Crude oil (barrel)	42.510	66.9	-7.4	16.6	23.0	40.7
Gasoline (gal.)	1.226	69.2	12.5	18.6	8.5	27.5
Fuel oil (gal.)	1.164	63.8	6.3	5.7	19.8	38.9
Livestock						
Steers (cwt.)	84.130	16.5	4.1	18.6	-5.4	6.5
Hogs (cwt.)	56.500	-13.2	18.3	57.7	.9	39.5
Broilers (lb.)	.760	6.5	10.9	28.8	-11.0	22.7
Farm crops						
Corn (bu.)	2.070	18.1	1.7	15.2	-23.0	1.5
Wheat (bu.)	3.738	37.7	-2.1	-2.6	-5.6	6.5
Soybeans (bu.)	5.870	32.2	37.1	15.4	-33.8	9.3
Cotton (lb.)	.439	52.1	42.5	-22.6	-16.8	-15.8
Other foodstuffs						
Coffee (lb.)	.563	1.1	23.1	27.7	-19.6	4.2
Memo:						
JOC Industrials	115.700	16.8	22.3	7.2	5.2	26.9
JOC Metals	121.300	9.7	38.1	7.2	8.1	42.4
CRB Futures	269.290	24.4	9.1	4.2	1.0	14.7
CRB Spot Industrials	306.690	13.7	24.0	-1.0	.5	16.5

1. Changes are from the last week of the preceding year to the last week of the year indicated.
2. June 15, 2004, is the Tuesday preceding publication of the June Greenbook.
3. Prices shown apply to the Friday before the date indicated.

consumer prices for meats and poultry also moderated in June. Similarly, increases in prices for food away from home, which also had ticked up in May, eased back in June to 0.2 percent. Over the twelve months ending in June, food prices rose 3.7 percent, a pickup of 1-1/2 percentage points from the preceding year.

Excluding food and energy, the CPI increased just 0.1 percent in June after a 0.2 percent rise in May and larger increases in March and April. The recent moderation reduced the three-month change to an annual rate of 2.3 percent, a substantial deceleration from the nearly 3 percent rate posted over the first three months of the year. The slowing in core prices reflected a return to outright price declines for durable goods as well as smaller price increases for a variety of services. Over the past twelve months, prices of core goods and services rose 1.9 percent, compared with a 1.5 percent increase in the preceding year.

Core PCE price inflation, which did not pick up as much as its CPI counterpart in February and March of this year, has also decelerated less than the CPI in recent months. The core PCE price index rose 0.1 percent in June, and the twelve-month change was 1.5 percent. This increase represents only a 0.1 percentage point step-up from the twelve-month change a year earlier, a little smaller than the 0.3 percentage point rise in core CPI inflation. The market-based component of the core PCE price index increased 0.2 percent in June, a bit more than the core CPI; however, over the past twelve months, the market-based core PCE price index accelerated 0.4 percentage point.

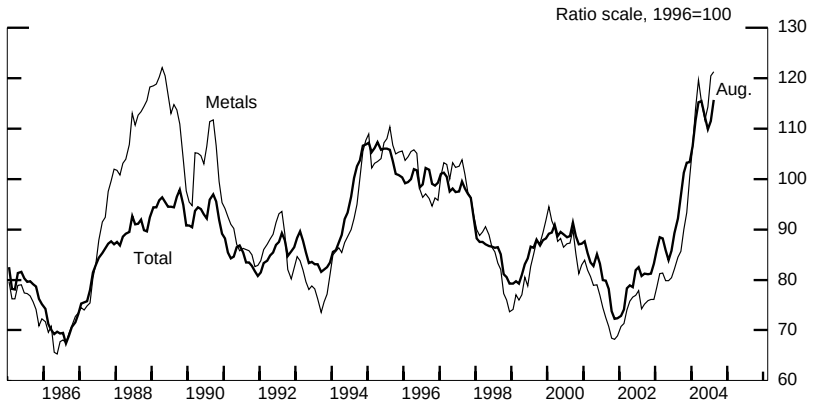
The BEA's recent annual revision made a large change to non-market-based core PCE prices. The level of nonmarket price inflation was boosted in 2002, and thus the index decelerated 0.4 percentage point in June, on a twelve-month basis. This is a dramatic revision from the 0.8 percentage point increase in the twelve-month change previously reported for May of this year relative to May 2003.

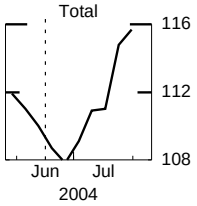
The prices of goods purchased by businesses decelerated in June. In particular, capital equipment prices, which rose just 0.2 percent, were damped by sizable declines in prices of high-tech equipment. Core intermediate materials prices also slowed in June, posting the smallest monthly increase yet this year. Likewise, commodity prices were little changed in June after having increased for several months.

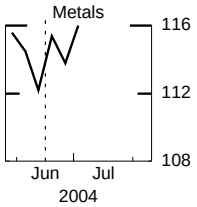
More recently, however, commodity prices have resumed their rapid increases. The JOC industrials index rose 6.5 percent over the four weeks of July and was up 3.8 percent from the July average during the first week of August. The biggest increase has been in petroleum and metals prices, especially steel scrap. Demand for steel plate has been strong in recent weeks; in addition, the normal

Commodity Price Measures

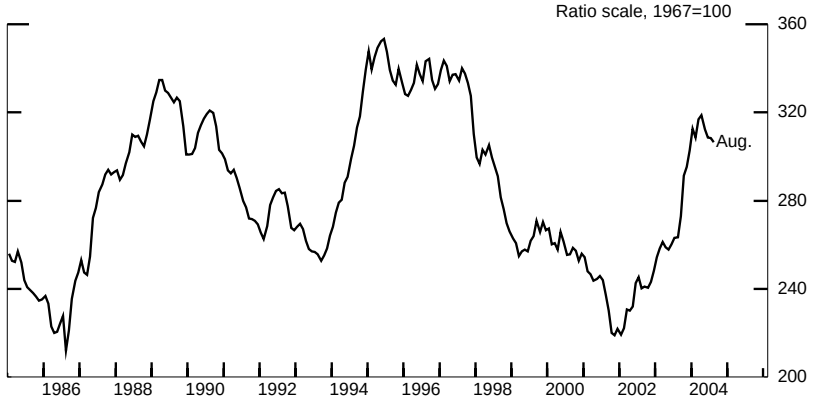
Journal of Commerce Index

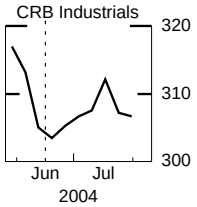




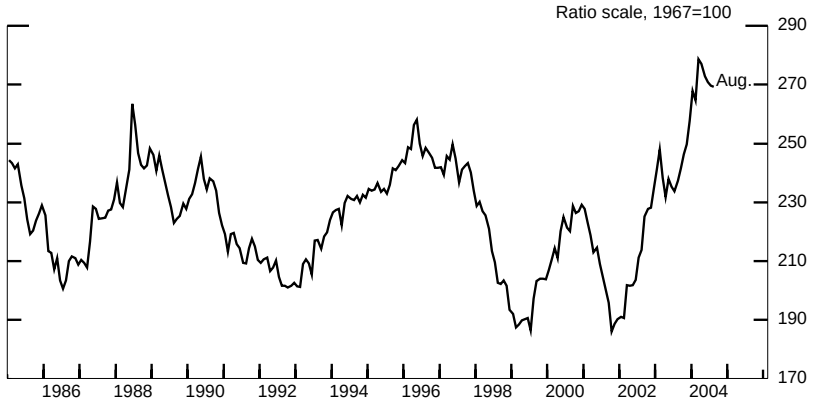


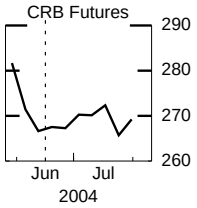
CRB Spot Industrials





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.

seasonal drop-off in auto production has reduced the “cutouts” portion of steel-scrap supplies. Because strong demand from China and Korea had already eroded steel-scrap inventories over the past year, the price response was especially sharp. The Commodity Research Bureau price index, which excludes energy and forest products, also rose in July.

Inflation expectations receded in July, according to the Michigan Survey. Median year-ahead expected inflation dropped to 3.0 percent, 0.3 percentage point below the median in May and June. Median expected inflation over the next five to ten years also ticked down last month; at 2.8 percent, it is still within the narrow range observed over the past two years.

The information on labor costs released since the June Greenbook suggests little movement in the overall rate of change in hourly compensation so far this year. The Employment Cost Index (ECI) for hourly compensation in private industry rose at an annual rate of 4.0 percent over the three months ending in June—similar to the average pace over the preceding year and a half. In recent quarters, the rise in the wage and salary component of the index has moderated, but that slowing has been offset by sizable run-ups in benefits costs.

Over the three months ending in June, ECI wages and salaries rose at an annual rate of 2.2 percent and held the twelve-month change in this component to 2.6 percent. In contrast, benefit costs, which jumped at an annual rate of 10.9 percent over the first three months of the year, climbed 7.1 percent in the March-to-June period. The year-over-year change in ECI benefits stood at 7.3 percent in June—the fastest pace in twenty years. The recent acceleration in benefit costs stems largely from the ongoing rapid increases in costs for retirement and savings that employers are incurring as they replenish their defined-benefit pension reserves that had been depleted by the earlier slump in the stock market. At the same time, employer costs for health care have continued to rise rapidly, although the increase of 8.1 percent over the twelve months ending in June was down slightly from the double-digit increase posted over the preceding twelve-month period.

Based on the NIPA data on employee compensation for the second quarter of 2004, the staff estimates that the BLS Productivity and Cost release for the second quarter will show an increase of 4.4 percent (annual rate) in compensation per hour in the nonfarm business sector after a rise of 4.2 percent in the first quarter. With productivity estimated to have slowed in the second quarter, we believe that unit labor costs increased faster last quarter than in the first quarter.

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

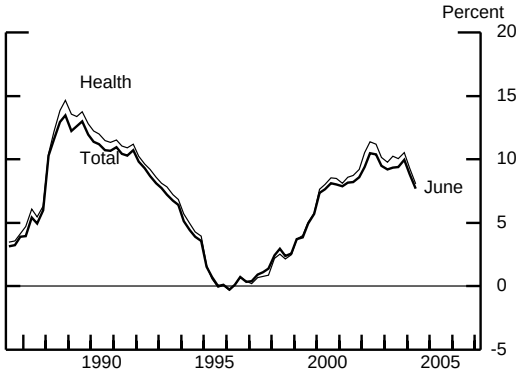
Industry and occupational group	2003 June	2003 Sept.	2003 Dec.	2004 Mar.	2004 June
	Quarterly change (compound annual rate) [1]				
Total hourly compensation	**3.4**	**4.4**	**3.1**	**4.3**	**4.0**
Wages and salaries	2.5	3.5	2.0	2.5	2.2
Benefits	5.7	6.1	5.6	10.9	7.1
By industry					
Construction	4.1	3.3	3.0	3.5	2.2
Manufacturing	3.2	3.9	2.7	9.4	3.3
Transportation and public utilities	4.7	2.4	2.9	6.1	5.8
Wholesale trade	2.1	3.6	1.9	2.6	2.6
Retail trade	2.1	6.2	4.1	1.7	4.0
FIRE	3.7	4.3	1.6	3.6	2.4
Services	3.1	4.1	3.8	4.3	3.7
By occupation					
White collar	2.6	4.8	3.3	3.8	3.0
Blue collar	4.1	3.8	3.5	6.7	4.1
Service occupations	2.8	3.2	2.7	4.7	3.6
Memo:					
State and local governments	4.0	2.2	3.2	3.9	4.4
	12-month change				
Total hourly compensation	**3.5**	**4.0**	**4.0**	**3.9**	**4.0**
Excluding sales workers	3.8	4.0	4.1	3.9	4.0
Wages and salaries	2.6	3.0	3.0	2.6	2.6
Excluding sales workers	2.8	3.0	3.1	2.6	2.5
Benefits	6.1	6.5	6.4	7.0	7.3
By industry					
Construction	3.8	3.8	3.4	3.5	3.0
Manufacturing	4.6	4.7	4.1	4.7	4.7
Transportation and public utilities	4.1	3.5	3.3	4.0	4.3
Wholesale trade	3.0	3.7	3.2	2.5	2.7
Retail trade	1.2	2.5	3.3	3.5	4.0
FIRE	6.6	7.3	7.4	3.3	3.0
Services	2.9	3.3	3.6	3.8	4.0
By occupation					
White collar	3.4	4.0	4.1	3.6	3.7
Sales	2.2	3.5	3.2	3.5	3.7
Nonsales	3.7	4.1	4.3	3.7	3.7
Blue collar	4.1	4.2	4.0	4.5	4.6
Service occupations	3.3	3.0	3.2	3.2	3.4
Memo:					
State and local governments	4.1	3.6	3.3	3.3	3.4

1. Seasonally adjusted by the BLS.

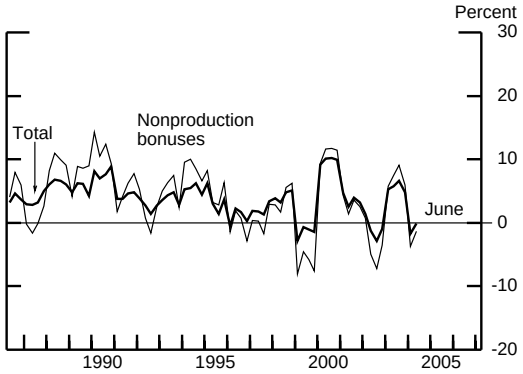
ECI Benefits Costs (confidential)

(Private-industry workers; 12-month change)

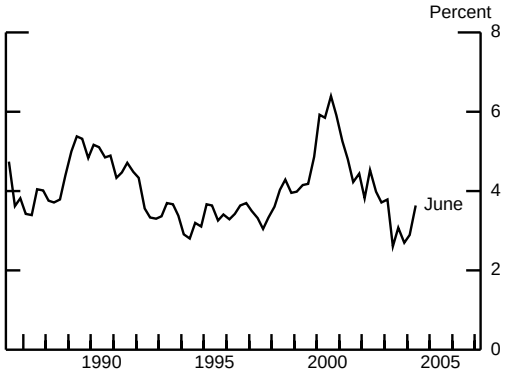
Insurance Costs



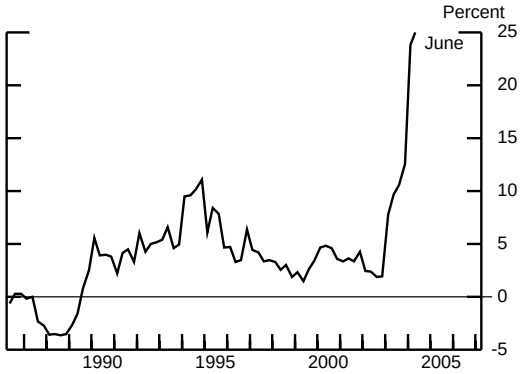
Supplemental Pay



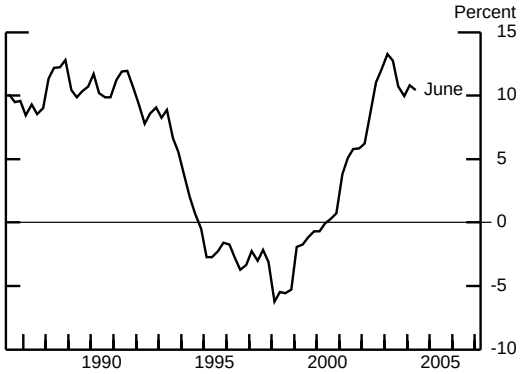
Paid Leave



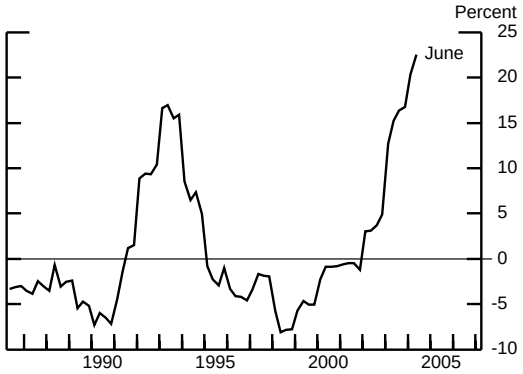
Retirement and Savings



Workers' Compensation Insurance



State Unemployment Insurance

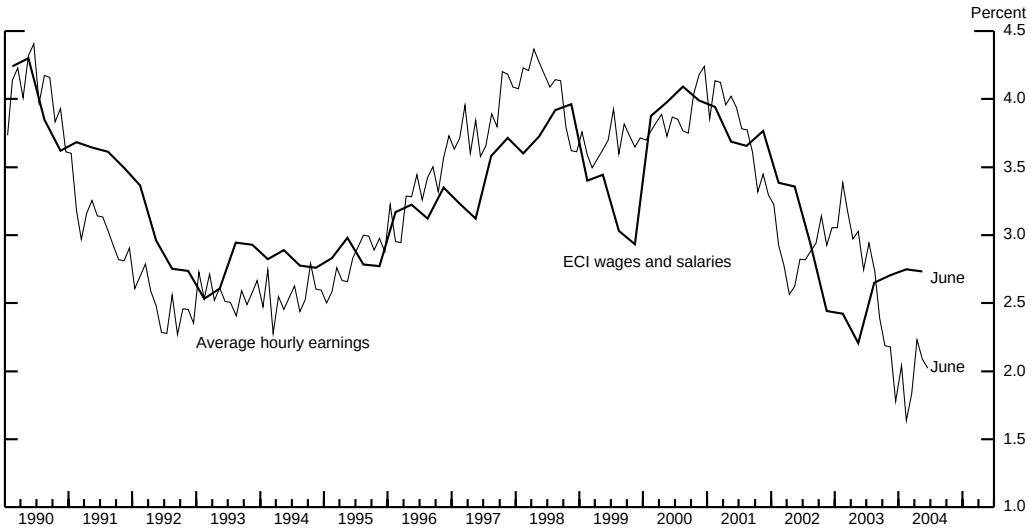


Hourly Compensation and Unit Labor Costs
(Percent change from preceding period at compound annual rate; based on seasonally adjusted data)

Category	2002	2003	2003 Q3	2003 Q4	2004 Q1	2004 Q2	2003:Q2 to 2004:Q2
Compensation per hour							
Nonfarm business	3.0	5.3	5.6	4.6	4.2	4.4	4.7
Nonfinancial corporations [1]	2.8	5.0	5.6	4.1	4.7	n.a.	n.a.
Unit labor costs							
Nonfarm business	-.7	-.2	-2.4	1.7	.1	1.3	.2
Nonfinancial corporations [1]	-2.4	-1.5	-3.0	-.8	2.7	n.a.	n.a.

Note. Staff estimates. Annual changes are from fourth quarter of preceding year to fourth quarter of year shown.
1. 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.
n.a. Not available.

Labor Costs
Production or Nonsupervisory Workers
(12-month change)



Appendix

Annual Revision of the National Income and Product Accounts

The annual revision of the national income and product accounts (NIPA), released on July 30, affected data back to 2001. The revision allows the Bureau of Economic Analysis (BEA) to incorporate more-comprehensive source data, including data from tax records and from economic surveys. From 2000:Q4 to 2004:Q1, the average annual rate of increase of real GDP is unchanged at 2.5 percent, and revisions to year-to-year growth rates were small. Nevertheless, the portrait of the business cycle changed in important ways. The 2001 downturn and the subsequent recovery are both milder than previously estimated. In the previously published estimates, real GDP peaked in the fourth quarter of 2000 and then decreased in each of the next three quarters; in the revised estimates, real GDP decreased in the first quarter of 2001 but increased in the second before decreasing again in the third quarter. The cumulative decline in real GDP during these three quarters is now estimated to have been 0.4 percent, well below the average 2.3 percent drop in real GDP during post-1955 recessions. From the third quarter of 2001 to the first quarter of 2004, the revised estimates show that real GDP increased at an average annual rate of 3.3 percent, compared with the previously estimated rate of 3.4 percent.

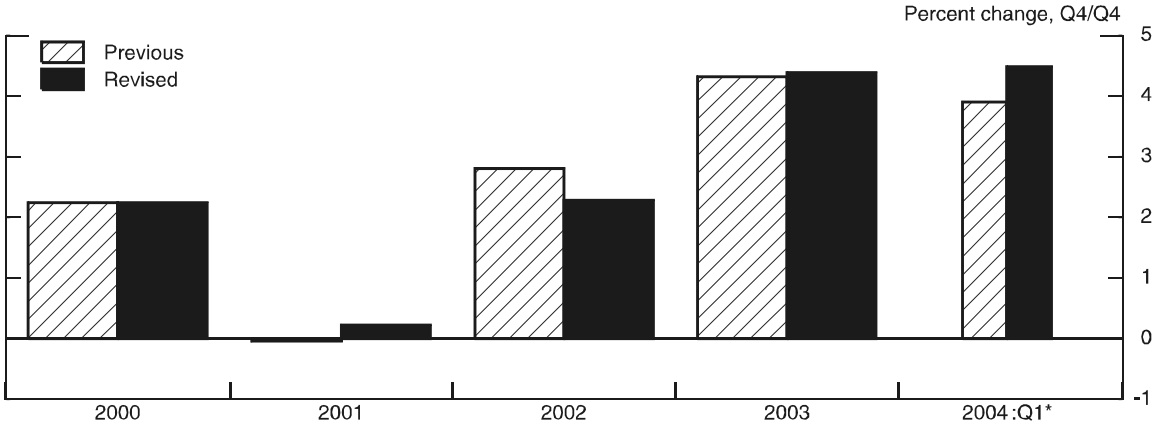
For 2001, the largest contributor to the upward revision to real GDP was state and local consumption and investment, but most other components also contributed. For 2002, the largest contributors to the downward revisions were spending on equipment and software and personal consumption expenditures (PCE). For 2003, the slight upward revision was attributable to small and mostly offsetting revisions to many components. The revised estimate of real GDP in the first quarter of 2004 reflected the BEA's introduction of an improved methodology for accounting for the production of light trucks. The new procedure uses unit production data as well as FRB seasonal factors and is similar to the BEA's methodology for automobiles. The new figures now show that real gross motor vehicle output increased at an annual rate of 8.8 percent in the first quarter rather than declining 8.2 percent as reported earlier; the revised estimate is broadly consistent with our estimate that industrial production of new motor vehicles increased at an annual rate of 8.4 percent in the first quarter.

The revisions to real GDP imply little change to the trend increase in output per hour in the nonfarm business sector in recent years. However, we expect that the Bureau of Labor Statistics will show a new pattern of productivity changes when it releases its revised data on August 10. Measured from fourth quarter to fourth quarter, the NIPA data imply an upward revision to the growth rate of labor productivity of 0.2 percentage point in 2001, a downward revision of 0.6 percentage point in 2002, and an upward revision of 0.2 percentage point in 2003.

The annual NIPA revision also included new estimates of income-related measures. Gross domestic income (GDI) was revised down in 2001 and revised up in 2002 and 2003. These revisions, combined with those for GDP, changed the pattern of the statistical discrepancy (GDP-GDI)—most noticeably, it is now estimated to have begun narrowing in 2001 and has remained in positive territory since 2002:Q3. Among the components of personal income, the BEA's estimates of private wages and salaries, a major source of revisions in previous annual revisions, were little changed. However,

Annual Revision to the National Income and Product Accounts

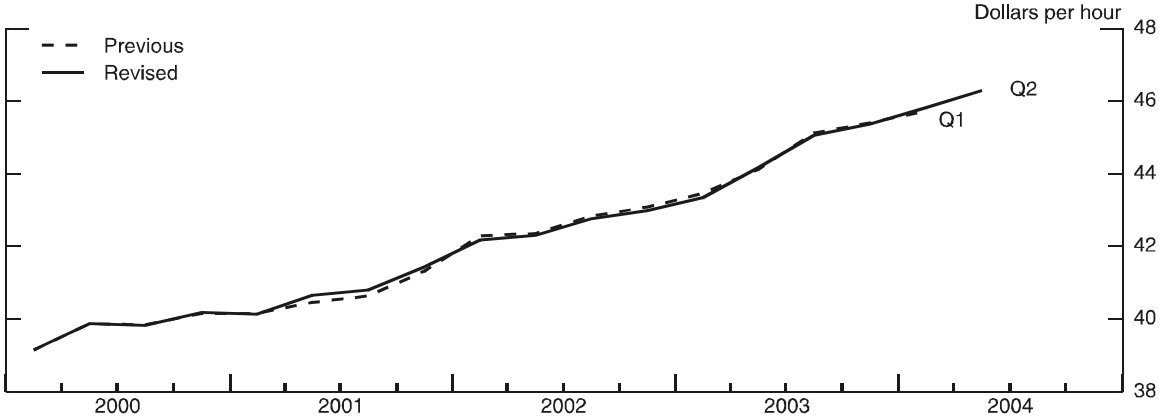
Real GDP



*Percent change, annual rate.

Real GDP

NFB Output per Hour*



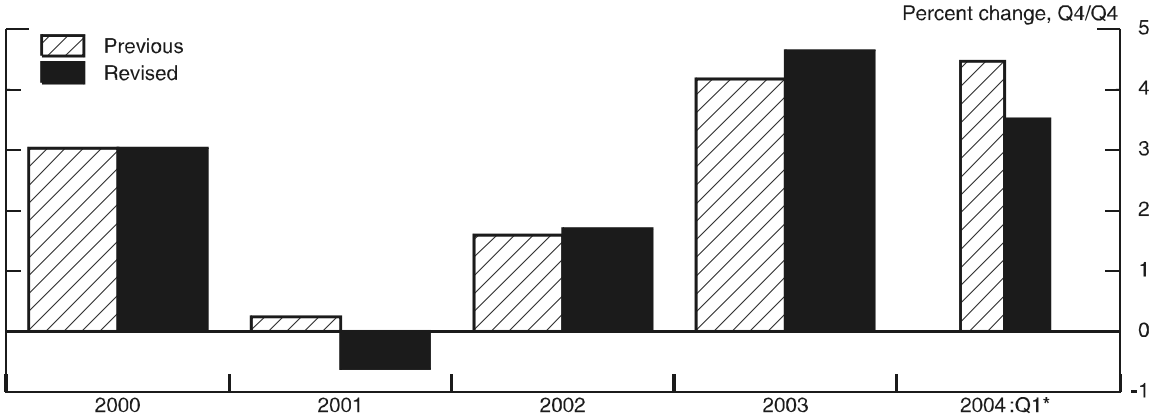
*Staff estimates.

other components of personal income were revised substantially. In particular, the BEA revised up its estimate of employer contributions to defined-benefit pension plans, which boosted supplements to wages and salaries in 2002 and 2003; and it revised down personal income receipts on assets in 2002 and 2003 (principally, interest and dividends). Because personal tax payments were little revised, the revisions in disposable personal income (DPI) mimic the changes in personal income; by the end of 2003, the level of current-dollar DPI is $56.6 billion less than previously estimated. Taken together, the revisions to DPI and PCE added 0.1 percentage point to the personal saving rate in 2001 but cut it substantially in 2002 and 2003. Corporate economic profits were revised down in all three years as upward revisions in before-tax profits were more than offset by downward revisions in capital consumption allowances. As a result, the profit share as a percent of GNP (excluding Federal Reserve Banks) was revised down in all three years.

Overall, our view of core inflation over the past several years is little affected by the new data. Core PCE prices now decelerate slightly less from 2001 to 2003. More recently, the level of core inflation is a little higher than before, and its turning point occurs one quarter earlier.

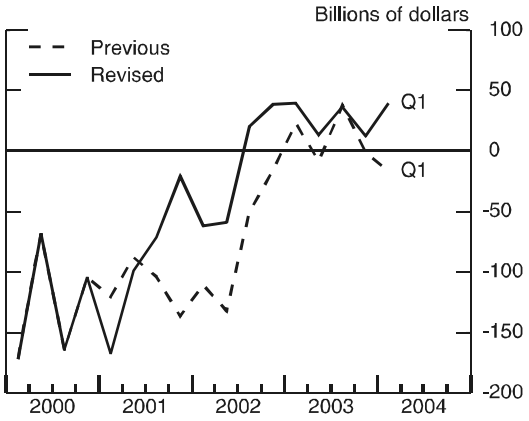
Annual Revision to the National Income and Product Accounts

Real GDI

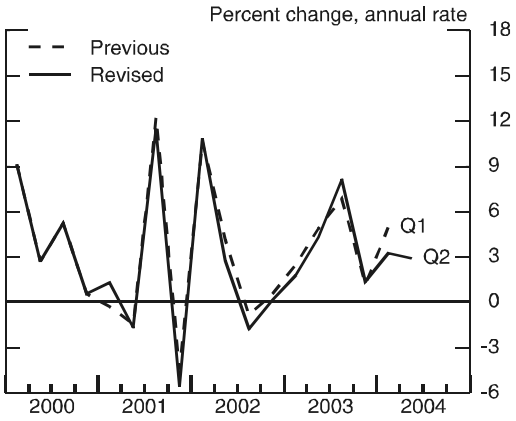


*Percent change, annual rate.

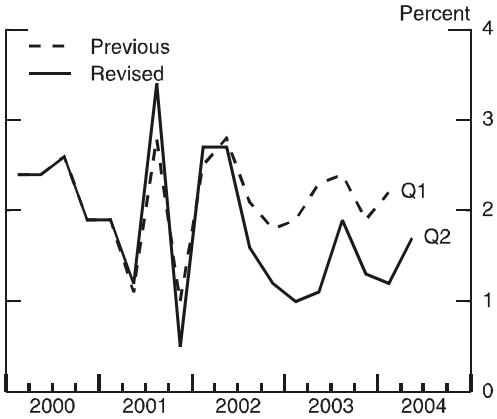
Statistical Discrepancy



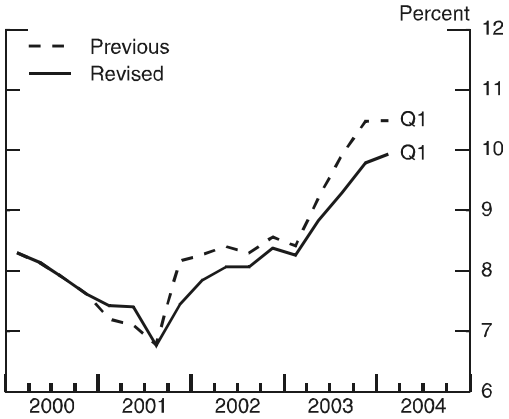
Real DPI



Personal Saving Rate



Profits as a Share of GNP*



*Excluding FR banks.

Domestic Financial Developments

III-T-1

Selected Financial Market Quotations

(One-day quotes in percent except as noted)

Instrument	2003 June 24	2003 Dec. 31	2004 June 29	2004 Aug. 4	Change to Aug. 4 from selected dates (percentage points) 2003 June 24	2003 Dec. 31	2004 June 29
Short-term							
FOMC intended federal funds rate	1.25	1.00	1.00	1.25	.00	.25	.25
Treasury bills [1]							
3-month	0.81	0.93	1.36	1.46	.65	.53	.10
6-month	0.82	1.00	1.71	1.72	.90	.72	.01
Commercial paper (A1/P1 rates)[2]							
1-month	0.95	1.00	1.31	1.45	.50	.45	.14
3-month	0.91	1.05	1.48	1.65	.74	.60	.17
Large negotiable CDs [1]							
1-month	0.96	1.06	1.32	1.51	.55	.45	.19
3-month	0.93	1.09	1.56	1.66	.73	.57	.10
6-month	0.92	1.16	1.88	1.91	.99	.75	.03
Eurodollar deposits [3]							
1-month	0.94	1.04	1.29	1.49	.55	.45	.20
3-month	0.91	1.07	1.53	1.66	.75	.59	.13
Bank prime rate	4.25	4.00	4.00	4.25	.00	.25	.25
Intermediate- and long-term							
U.S. Treasury[4]							
2-year	1.14	1.83	2.84	2.66	1.52	.83	-.18
10-year	3.46	4.40	4.85	4.59	1.13	.19	-.26
30-year	4.53	5.22	5.50	5.33	.80	.11	-.17
U.S. Treasury 10-year indexed note	1.70	2.00	2.19	2.00	.30	.00	-.19
Municipal revenue (Bond Buyer) [5]	4.89	5.04	5.37	5.31	.42	.27	-.06
Private instruments							
10-year swap	3.67	4.66	5.22	4.90	1.23	.24	-.32
10-year FNMA[6]	3.84	4.72	5.29	4.95	1.11	.23	-.34
10-year AA [7]	4.13	5.05	5.54	5.30	1.17	.25	-.24
10-year BBB [7]	5.16	5.74	6.14	5.89	.73	.15	-.25
5-year high yield [7]	8.95	7.94	8.31	8.06	-.89	.12	-.25
Home mortgages (FHLMC survey rate) [8]							
30-year fixed	5.21	5.81	6.25	5.99	.78	.18	-.26
1-year adjustable	3.51	3.73	4.13	4.08	.57	.35	-.05

Stock exchange index	Record high Level	Record high Date	2003 Dec. 31	2004 June 29	2004 Aug. 4	Change to Aug. 4 from selected dates (percent) Record high	2003 Dec. 31	2004 June 29
Dow-Jones Industrial	11,723	1-14-00	10,454	10,413	10,127	-13.62	-3.13	-2.76
S&P 500 Composite	1,527	3-24-00	1,112	1,136	1,099	-28.07	-1.20	-3.31
Nasdaq	5,049	3-10-00	2,003	2,035	1,855	-63.26	-7.40	-8.84
Russell 2000	606	4-5-04	557	588	543	-10.51	-2.56	-7.68
Wilshire 5000	14,752	3-24-00	10,800	11,084	10,646	-27.83	-1.42	-3.96

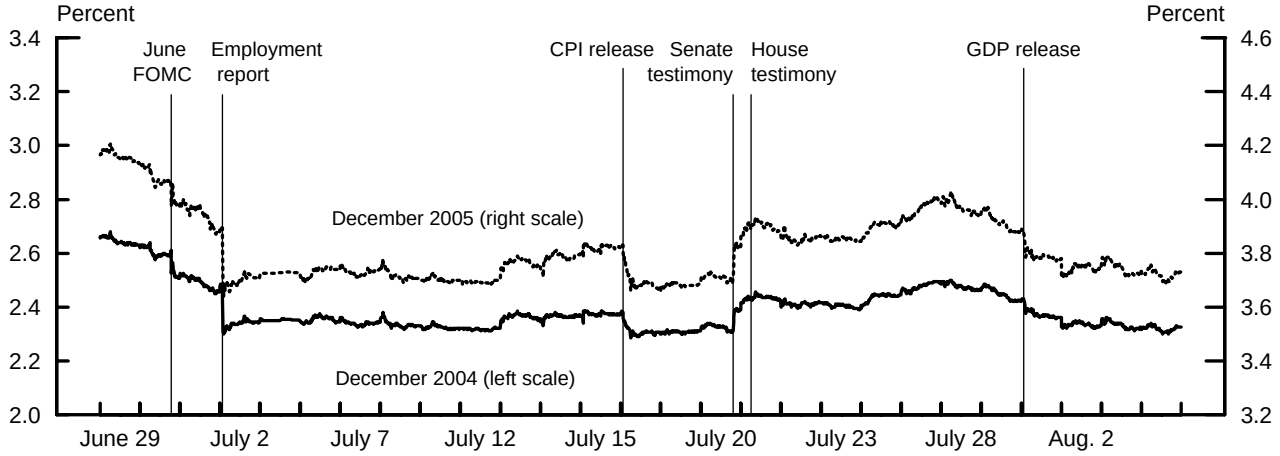
1. Secondary market.
2. Financial commercial paper.
3. Bid rates for eurodollar deposits collected around 9:30 a.m. Eastern time.
4. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
5. Most recent Thursday quote.
6. Constant maturity yields estimated from Fannie Mae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

NOTES:

June 24, 2003, is the day before the most recent policy easing.
June 29, 2004, is the day before the most recent FOMC meeting.

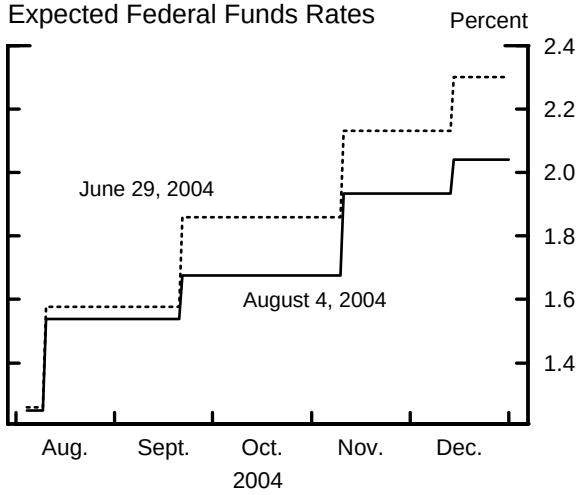
Policy Expectations and Treasury Yields

Eurodollar Futures



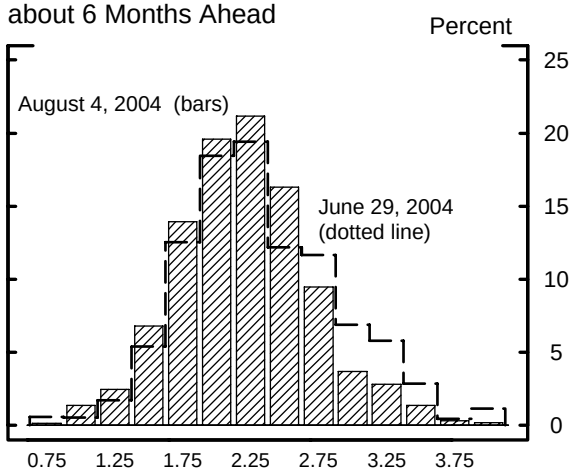
Note. 5-minute intervals.

Expected Federal Funds Rates



Note. Based on federal funds futures rates at the close of trading. Estimates assume a 1.0 basis point per month term premium and zero probability of intermeeting moves.

Implied Distribution of Federal Funds Rate about 6 Months Ahead

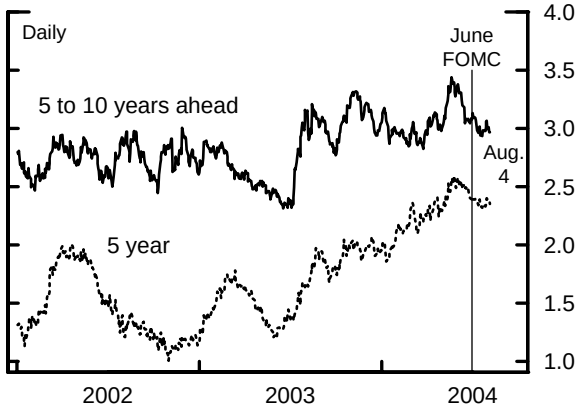


Note. Based on the distribution of the 3-month Eurodollar rate 5 months ahead (adjusted for a risk premium), as implied by options on Eurodollar futures contracts.

Treasury Yields

Note. Based on smoothed yield curve estimated using off-the-run issues.

Inflation Compensation



Note. Estimates based on smoothed nominal and inflation-indexed Treasury yield curves.

Domestic Financial Developments

Overview

Over the intermeeting period, the market's expected path for the federal funds rate shifted down and longer-term interest rates declined somewhat in response to weaker-than-expected economic data releases. Still, market participants are virtually certain that the FOMC will raise the federal funds rate 25 basis points at the August meeting and have priced in 75 basis points of tightening between now and year-end. Stock prices declined over the intermeeting period, while risk spreads on corporate bonds were little changed.

Corporate debt growth has picked up recently on the strength of short-term financing. Household debt growth has slowed from its double-digit pace in the first quarter but has remained relatively brisk.

Policy Expectations and Treasury Yields

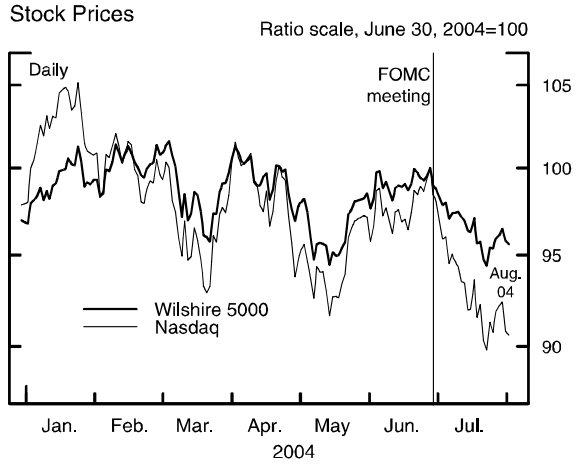
The FOMC's decision to raise the target federal funds rate 25 basis points at the June meeting was widely anticipated. However, the accompanying statement—which characterized recent inflation as partly the result of transitory factors and retained language indicating that the pace of policy tightening could be measured—led investors to expect a more gradual pace of tightening. That shift in the expected policy path was subsequently reinforced by economic data releases that were softer, on net, than the market had expected, although the generally favorable economic outlook conveyed in the Chairman's monetary policy testimony provided some offset. Over the intermeeting period, federal funds and Eurodollar futures rates declined on net by 20 to 40 basis points beyond the very near term. Options prices suggest that the declines reflected reduced odds on particularly rapid increases in the funds rate. Market participants now expect the funds rate to reach about 2 percent by the end of this year and 3-1/4 percent by the end of 2005. A recent survey suggests that market participants also anticipate that at the August meeting the FOMC will continue to view risks to the outlook for both economic growth and inflation as balanced and will retain the "measured pace" language—or some variant.

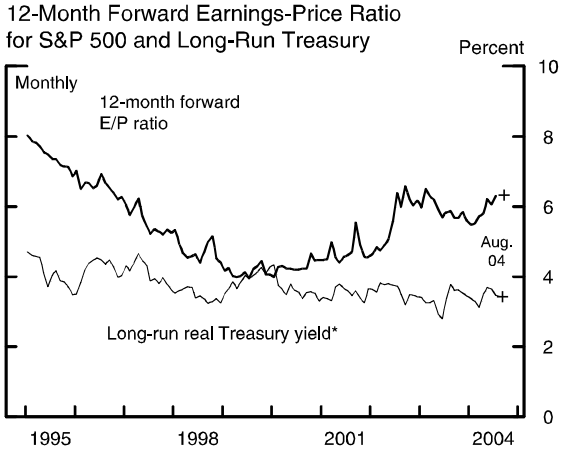
Yields on intermediate- and longer-term nominal Treasuries moved down with the change in policy expectations over the intermeeting period, declining 15 to 25 basis points on net. Similar decreases in yields on inflation-indexed Treasury securities decreased a bit less, leaving inflation compensation down slightly. Implied volatilities of Treasury bond prices increased a bit over the intermeeting period.

Stock Prices and Corporate Interest Rates

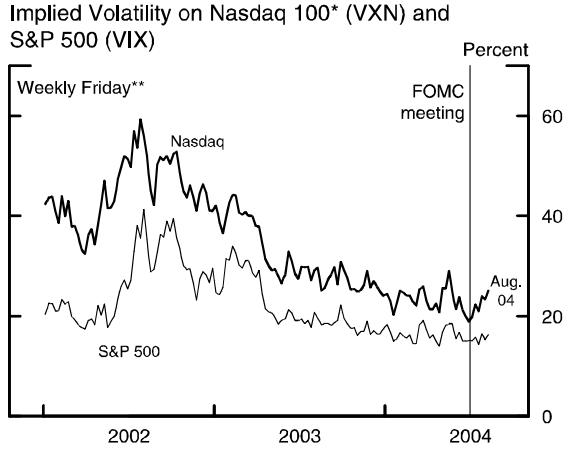
Despite generally strong earnings reports for the second quarter, major stock price indexes fell 3 to 9 percent on net over the intermeeting period, with the Nasdaq index leading the decline. Market participants had apparently expected

Stock Prices and Corporate Risk Spreads

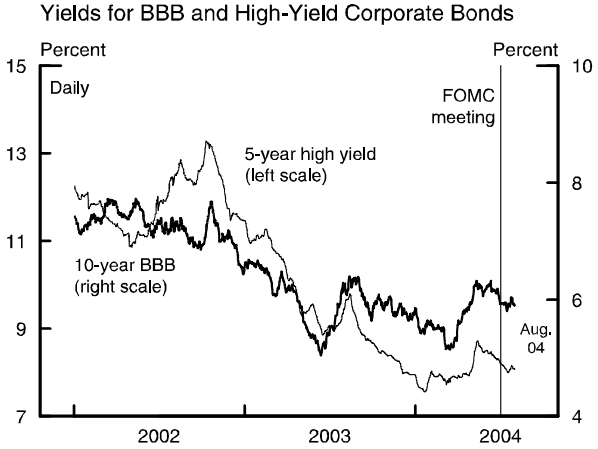


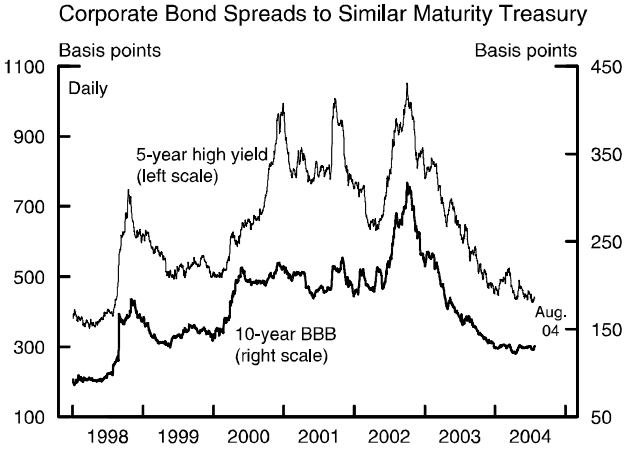


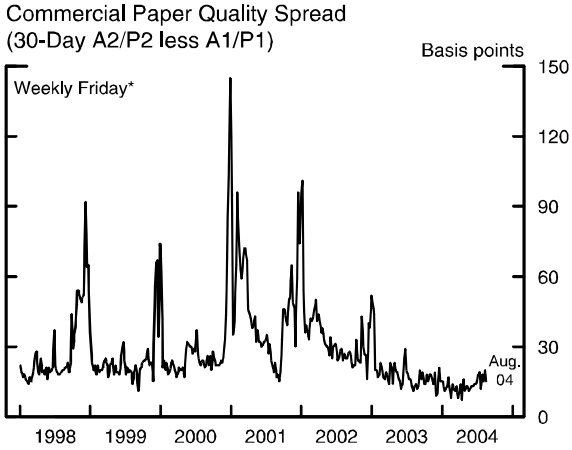
* Yield on synthetic Treasury perpetuity minus Philadelphia Fed 10-year expected inflation.
+ Denotes the latest observation using daily interest rates and stock prices and latest earnings data from I/B/E/S.



* Implied volatility calculated from one to four month options.
** Latest observation is for most recent business day.







* Latest observation is for most recent business day.

even stronger second-quarter results and were disappointed by the cautious revenue outlooks from some major companies. Steadily rising oil prices also contributed to the declines in stock prices.

Even as stock prices broke through their 2004 lows, expected and realized volatilities on both the Nasdaq 100 and the S&P 500 remained muted. At the same time, the twelve-month forward earnings-price ratio for firms in the S&P 500 ticked up, and its spread over a long-run Treasury yield, a rough measure of the equity premium, widened a bit further.

Yields on investment- and speculative-grade corporate bonds declined roughly in line with those on comparable-maturity Treasuries over the intermeeting period. As a result, risk spreads have changed little, as expectations of more-moderate earnings growth evidently have not shaken the view that corporate credit quality will remain strong. Risk spreads on commercial paper have remained low.

Corporate Earnings and Credit Quality

Based on results for the 400 firms in the S&P 500 that have already reported second-quarter earnings, operating earnings per share for the S&P 500 are estimated to have risen about 25 percent from four quarters earlier. Although more than two-thirds of the reports exceeded consensus estimates, this fraction was below that posted in recent quarters. In addition, analysts' forecasts of year-ahead corporate earnings have hardly budged of late after several months of strong upward revisions.

Credit quality of nonfinancial firms has remained strong. Among the recent news on credit quality, upgrades outpaced downgrades in the second quarter--the first net upgrade since 1998--and the bond default rate has remained very low. A forecast of aggregate year-ahead default rates based on the KMV model also has changed little in recent months, holding at its lowest level since the late 1990s. Expected default rates have dropped substantially for the vast majority of firms but have remained elevated for a troubled minority.

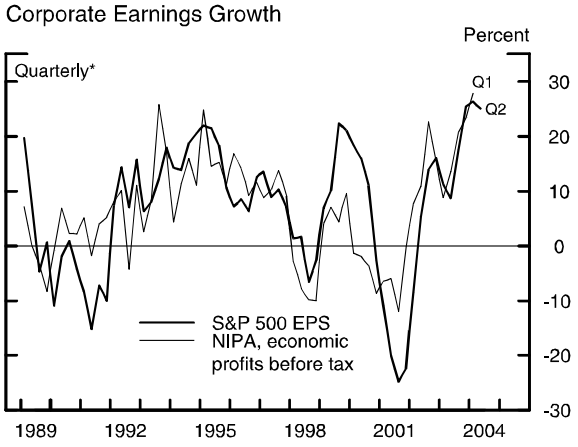
Business Finance

Gross bond issuance has slowed in recent months. Given the steady pace of bond retirements, net bond issuance was close to zero in the second quarter and was negative in July, as nonfinancial firms continued to rely on robust earnings, shorter-term debt, and ample cash assets to fund their investments.

In contrast, short-term debt has continued its turnaround. Net issuance of commercial paper has been robust in recent months, reportedly boosted by increased merger activity. C&I loans on banks' books were about unchanged in

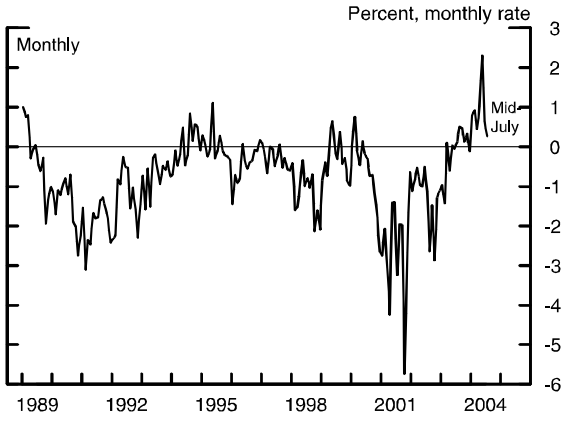
Corporate Earnings and Credit Quality

Corporate Earnings Growth



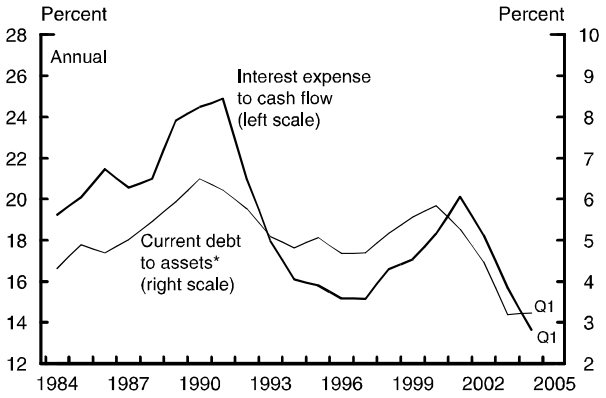
* Change from four quarters earlier.
Source. I/B/E/S for S&P 500 EPS.

S&P 500 EPS Revisions Index



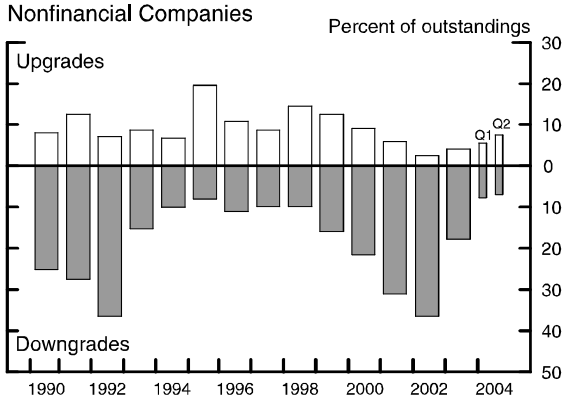
Note. Index is a weighted average of the percent change in the consensus forecasts of current-year and following-year EPS.

Financial Ratios



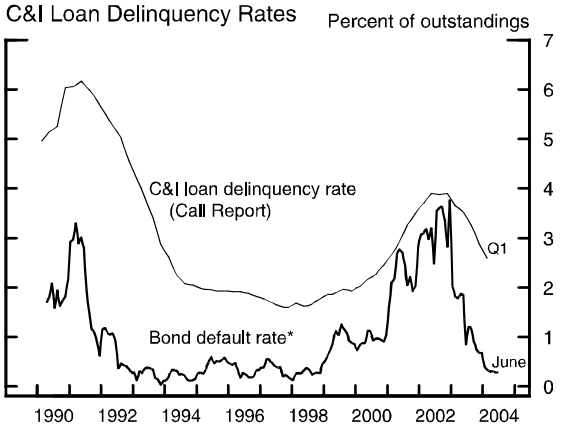
*Note. Current debt includes short-term notes and long-term debt due in one year
Source. Compustat.

Bond Ratings Changes of Nonfinancial Companies



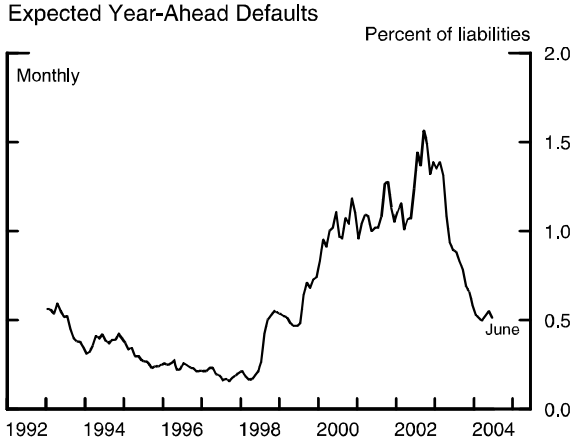
Note. Data are at an annual rate.
Source. Moody's Investors Service.

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, excluding defaulted firms.
Source. KMV Corporation.

Business Finance

Gross Issuance of Securities by U.S. Corporations

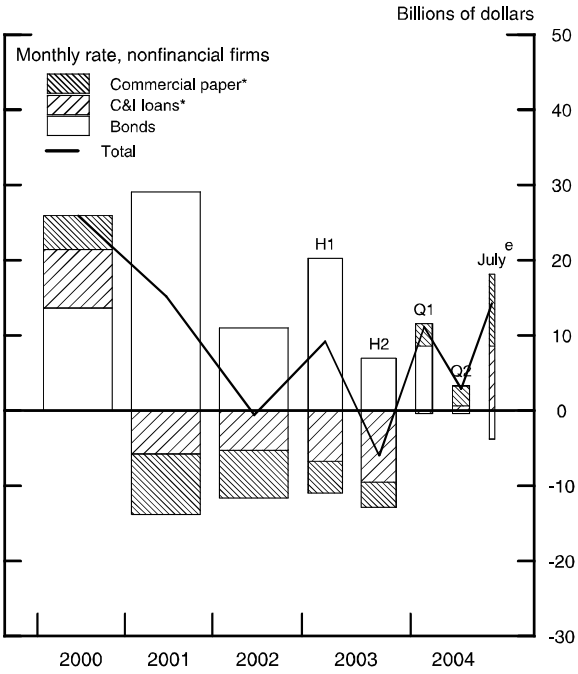
(Billions of dollars; monthly rates, not seasonally adjusted)

Type of security	2000	2001	2002	2003 H1	2003 H2	2004 Q1	2004 Q2	2004 July[e]
Nonfinancial corporations								
Stocks[1]	9.9	6.5	5.2	2.8	4.6	6.9	4.7	5.4
Initial public offerings	4.4	2.1	0.7	0.0	0.9	0.8	0.9	3.3
Seasoned offerings	5.5	4.4	4.4	2.8	3.7	6.0	3.8	2.1
Bonds[2]	22.7	39.8	24.8	36.5	27.4	25.8	17.9	11.4
Investment grade	13.2	27.5	15.7	20.1	11.9	10.4	5.9	5.1
Speculative grade	4.7	8.9	4.8	11.5	11.1	12.3	8.8	5.2
Other (sold abroad/unrated)	4.9	3.4	4.2	4.9	4.5	3.0	3.2	1.1
Memo								
Net issuance of commercial paper[3]	4.5	-8.0	-6.3	-4.3	-3.4	2.9	2.7	9.5
Change in C&I loans at commercial banks[3,4]	7.8	-5.8	-5.3	-6.7	-9.5	-0.4	0.6	8.6
Financial corporations								
Stocks[1]	1.4	4.2	4.0	6.0	7.8	10.9	5.7	3.1
Bonds[2]	57.8	80.2	87.0	114.1	108.2	128.5	133.9	123.6

Note. Components may not sum to totals due to rounding.
1. Excludes private placements and equity-for-equity swaps that occur in restructurings.
2. Data include regular and 144a private placements. Bond totals reflect gross proceeds rather than par value of original discount bonds. Bonds are categorized according to Moody's bond ratings, or to Standard & Poor's if unrated by Moody's.
3. End-of-period basis, seasonally adjusted.
4. Adjusted for FIN 46 effects.

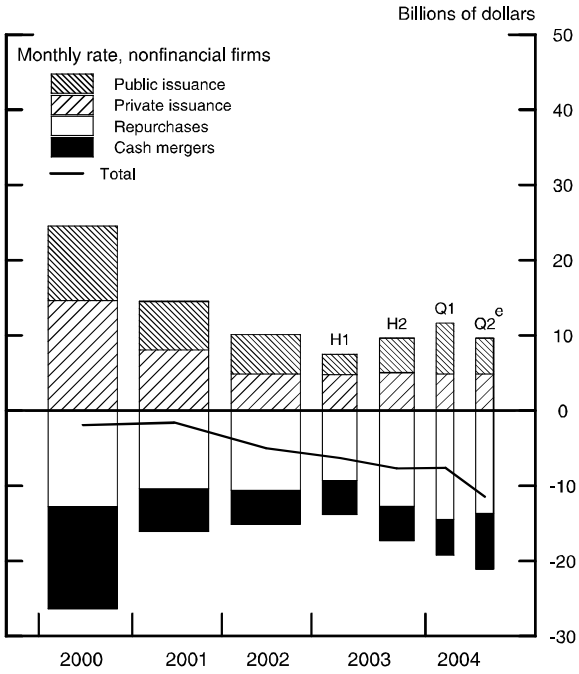
e Staff estimate.

Selected Components of Net Debt Financing



* Seasonally adjusted, period-end basis.
e Staff estimate.

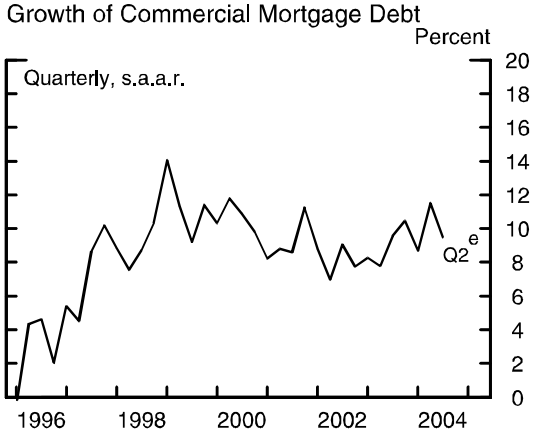
Components of Net Equity Issuance



e Staff estimate.

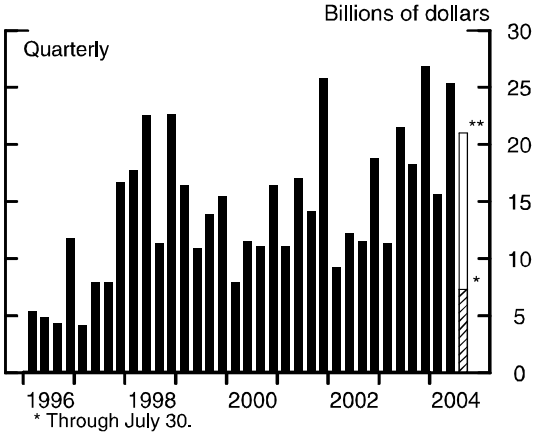
Commercial Real Estate

Growth of Commercial Mortgage Debt



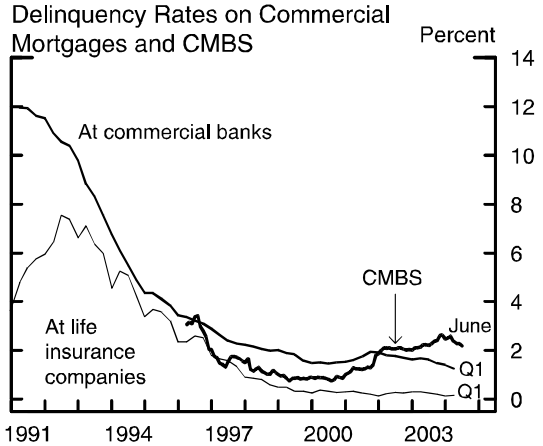
e Staff estimate.

Gross Issuance of CMBS



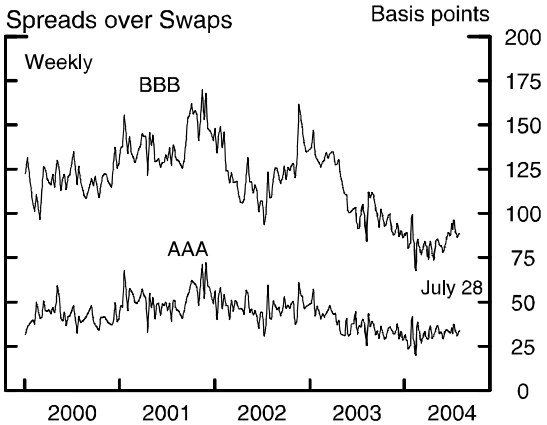
* Through July 30.
** Staff estimate.
Source. Commercial Mortgage Alert.

Delinquency Rates on Commercial Mortgages and CMBS



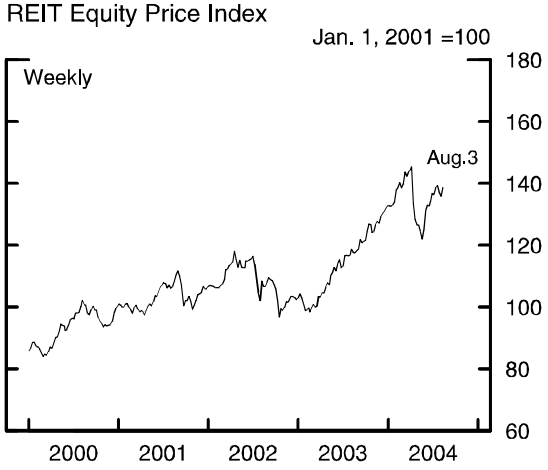
Source. Call Report, ACLI, Morgan Stanley.

Investment-Grade CMBS Spreads over Swaps



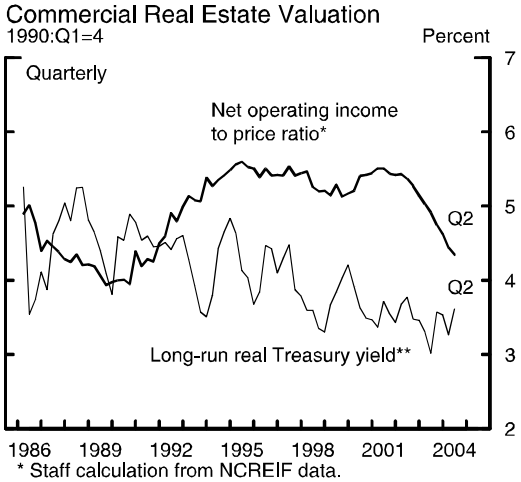
Source. Morgan Stanley.

REIT Equity Price Index



Source. NAREIT.

Commercial Real Estate Valuation



* Staff calculation from NCREIF data.
** Yield on synthetic Treasury perpetuity minus Philadelphia Fed 10-year expected inflation.

the second quarter after thirteen consecutive quarterly declines and appear to have expanded in July. According to the July Senior Loan Officer Opinion Survey, banks continued to ease lending terms and standards, and nearly half of the responding banks, on net, reported stronger demand for C&I loans over the past three months. Banks pointed to rising accounts receivable, inventories, and capital expenditures among their loan customers as factors contributing to increased loan demand. With the rebound in short-term credit, total net debt financing for nonfinancial firms picked up in July from its weak second-quarter pace.

Gross public equity issuance by nonfinancial firms has been sluggish in recent months. The pace of IPOs has risen, but most deals have been small, and nearly half were sold at prices below their filing ranges. At the same time, equity retirements appeared to have picked up in the second quarter, leaving net equity issuance more firmly negative. Completions of cash-financed mergers totaled $7 billion at a monthly rate, a 50 percent increase over the first-quarter volume, and a spate of new deals announced in July indicates that merger completions will remain elevated. Stock repurchases are estimated to have been robust again in the second quarter; they have been buoyed by ample corporate profits and cash holdings and will be boosted a bit over the next couple of years by Microsoft's recently expanded share repurchase program.

Commercial Real Estate

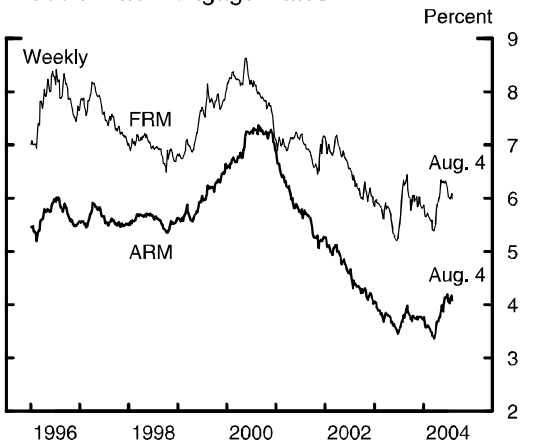
Commercial mortgage debt is estimated to have grown at a robust 9 percent pace in the second quarter, a view based largely on the strength of CMBS issuance, which totaled a near-record $25 billion. CMBS deals completed in July, along with those now in the pipeline, indicate continued strength in the current quarter. CMBS credit quality has remained solid, as delinquency rates on CMBS issues edged down again in June, and CMBS spreads have remained low. REIT equity prices rose slightly over the intermeeting period, remaining well above their second-quarter lows. The ratio of net operating income to price on commercial properties fell in the second quarter, and its spread over the real long-run Treasury rate narrowed further, a move consistent with declining risk premiums on commercial real estate assets.

Household Finance

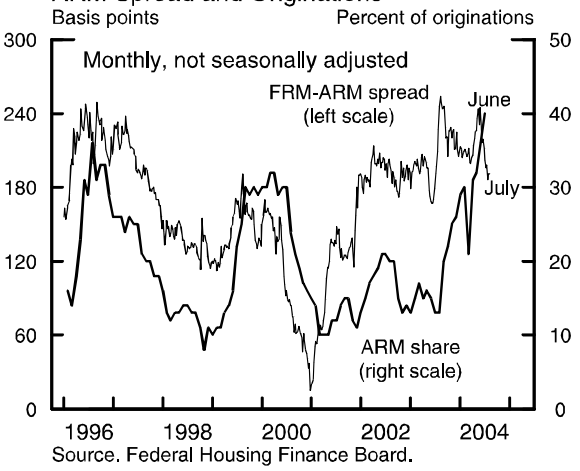
Interest rates on thirty-year fixed-rate mortgages declined about 25 basis points over the intermeeting period, and the spread between rates on fixed- and adjustable-rate mortgages narrowed a bit. However, at around 190 basis points, this spread remains relatively wide and has likely continued to fuel ARM originations, which have been climbing sharply since the beginning of the year. Although the growth rates of mortgage and consumer credit are estimated to

Household Liabilities

Freddie Mac Mortgage Rates

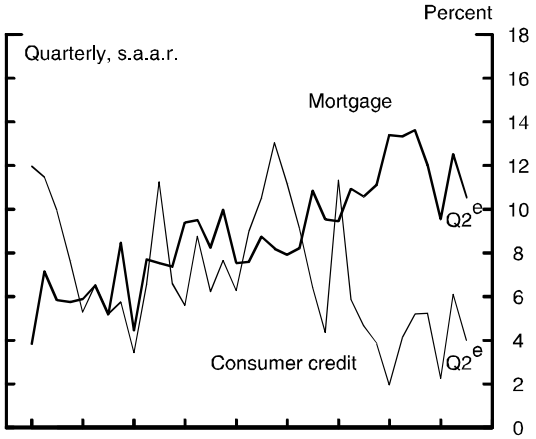


ARM Spread and Originations



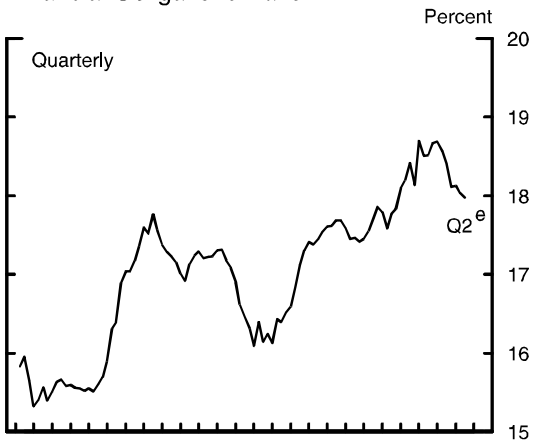
Source. Federal Housing Finance Board.

Household Debt Growth



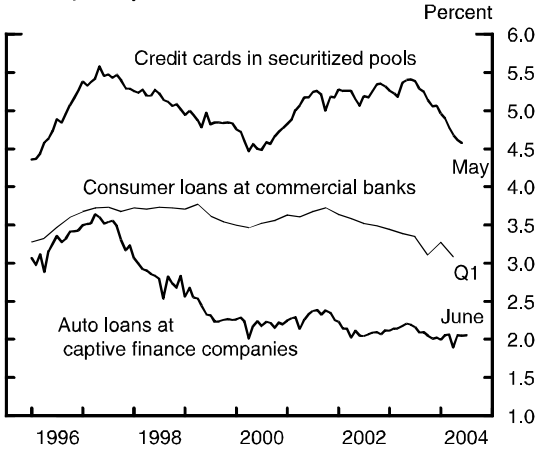
e Staff estimate.

Financial Obligations Ratio



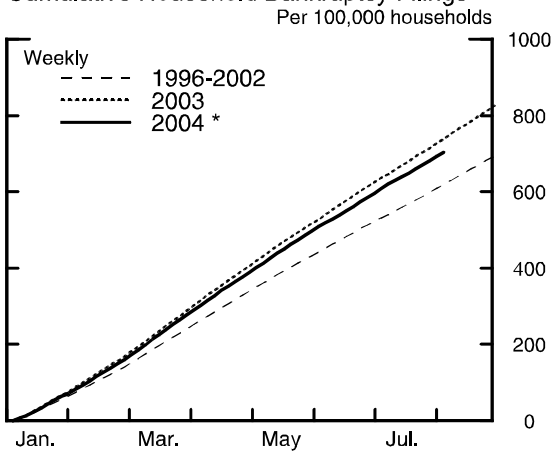
e Estimate.

Delinquency Rates



Source. Moody's, Federal Reserve.

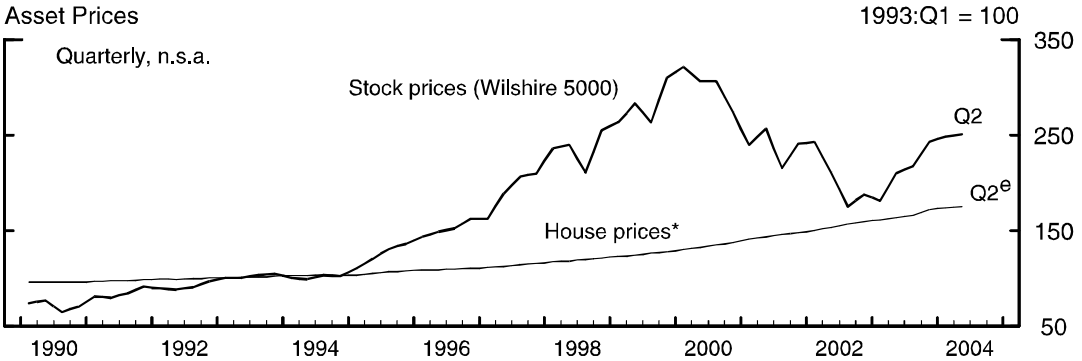
Cumulative Household Bankruptcy Filings



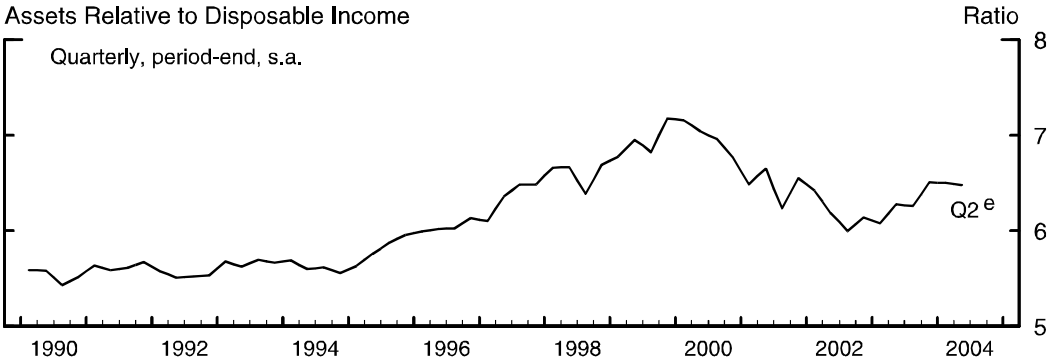
* Through July 31.

Source. Visa Bankruptcy Notification Service Statistics.

Household Assets



* Source. Office of Federal Housing Enterprise Oversight (OFHEO).
e Preliminary Freddie Mac estimate.



e Staff estimate.

Net Flows into Long-Term Mutual Funds

(Billions of dollars, monthly rate)

Fund Type	2001	2002	2003	2004				Assets
				Q1	Q2	June	July[e]	June
Total long-term funds	**10.8**	**10.1**	**18.0**	**36.5**	**3.9**	**5.4**	**11.3**	**5,638**
Equity funds	**2.7**	**-2.3**	**12.7**	**28.4**	**11.3**	**10.4**	**7.9**	**3,949**
Domestic	4.5	-2.1	10.7	19.9	7.6	7.7	4.7	3,377
International	-1.8	-0.2	2.0	8.5	3.7	2.8	3.2	572
Hybrid funds	**0.8**	**0.7**	**2.7**	**5.1**	**3.1**	**2.4**	**2.5**	**467**
Bond funds	**7.3**	**11.7**	**2.6**	**3.0**	**-10.5**	**-7.4**	**0.8**	**1,222**
High-yield	0.6	0.9	2.2	-1.4	-2.7	-0.6	0.5	142
Other taxable	5.7	9.4	1.0	4.2	-3.9	-3.6	1.4	761
Municipals	1.0	1.4	-0.6	0.2	-3.9	-3.2	-1.1	319

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

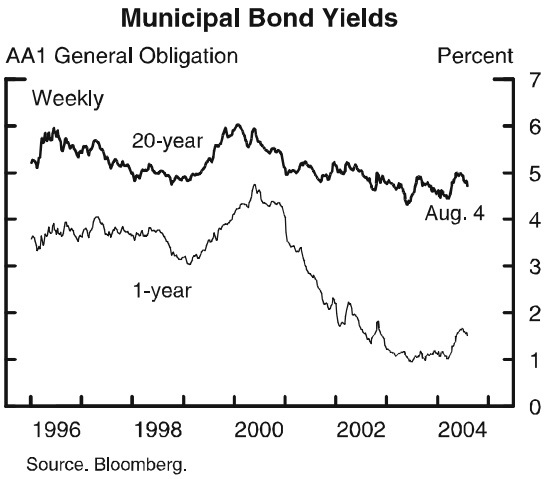
State and Local Government Finance

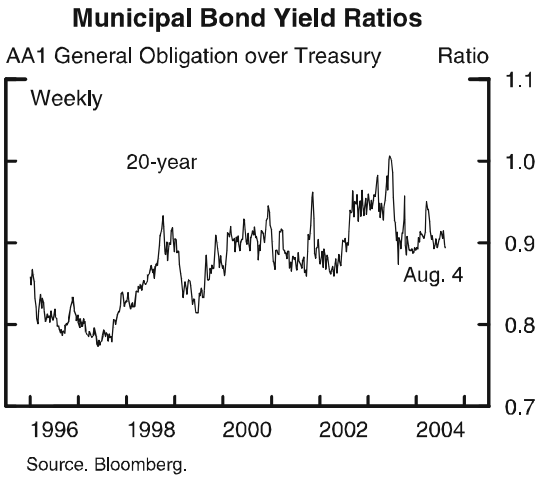
Gross Offerings of Municipal Securities

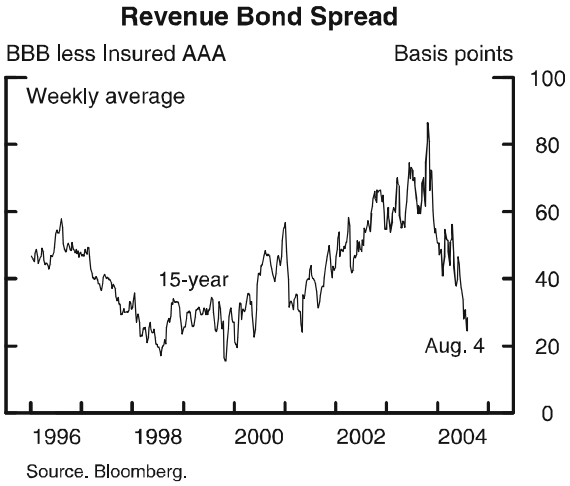
(Billions of dollars; monthly rate, not seasonally adjusted)

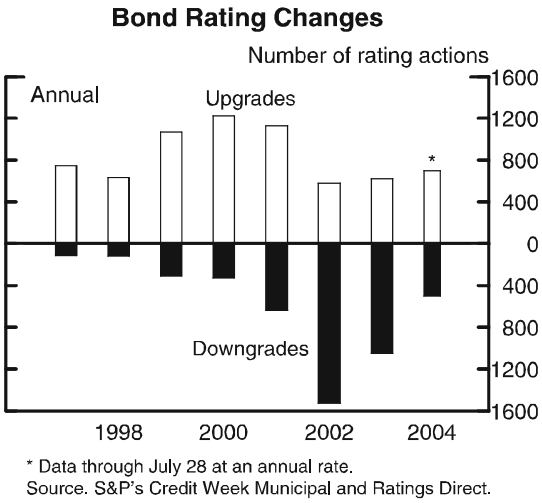
Type of security	2002	2003	2004			
			Q1	Q2	June	July [e]
Total	36.3	37.8	31.4	39.2	45.5	26.7
Long-term [1]	30.3	32.0	28.6	34.7	35.2	22.6
Refundings [2]	10.1	10.0	10.8	9.6	6.8	5.6
New capital	20.2	22.0	17.8	25.2	28.4	17.0
Short-term	6.0	5.8	2.8	4.4	10.3	4.0
Memo: Long-term taxable	1.7	3.5	2.1	3.0	3.9	0.8

1. Includes issues for public and private purposes.
2. All issues that include any refunding bonds.
e Staff estimate based on preliminary data through July 29.









have slowed somewhat in the second quarter, household debt growth has remained strong.

Household credit quality continues to be solid. The financial obligations ratio is estimated to have ticked down further in the second quarter, as a decline in the average interest rate on household debt more than offset an increase in the ratio of debt to disposable income. In addition, delinquency rates on securitized credit card pools, as well as those on auto loans at captive finance companies, stayed at relatively low levels in the second quarter. A more up-to-date measure, household bankruptcy filings, has consistently been a shade lower than its year-ago levels but has remained somewhat elevated.

Growth in household wealth appears to have stalled. The combination of lower stock prices and the likely continued slowing of house price appreciation suggest that the ratio of household net worth to disposable income was about unchanged in the second quarter. Despite the lackluster performance of stock prices, flows into equity mutual funds were strong in July, albeit at a slower pace than earlier in the year.

State and Local Government Finance

Gross issuance of long-term municipal bonds slowed in July, as new capital issuance dropped back from a very rapid pace in June. The issuance of short-term debt jumped in June, as it typically does, to cover budget shortfalls at the end of the fiscal year; but it rose only to about half its year-ago pace, as fiscal positions of states and municipalities have improved.

Yields on highly rated municipal bonds declined roughly in line with Treasuries over the intermeeting period, and measures of municipal bond credit quality improved. The spread between yields on BBB-rated and AAA-rated municipal bonds declined to its lowest level since 2001, and upgrades of municipal bonds continued to outpace downgrades.

Treasury and GSE Finance

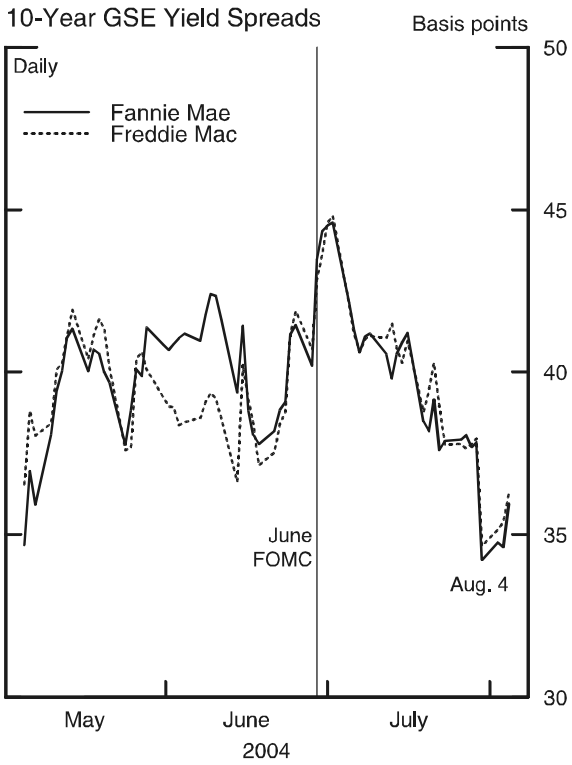
The federal budget situation showed continued signs of improvement over the intermeeting period. The $19 billion surplus for June exceeded consensus expectations. Market participants expect favorable year-over-year comparisons of budget data in July and August because of improving receipts and the adverse effect of the 2003 fiscal stimulus package on last year's monthly budget numbers. In its midquarter refunding announcement, the Treasury retained the reopenings of ten-year nominal securities but indicated it might trim auction sizes for coupon securities if the budget situation continues to improve.

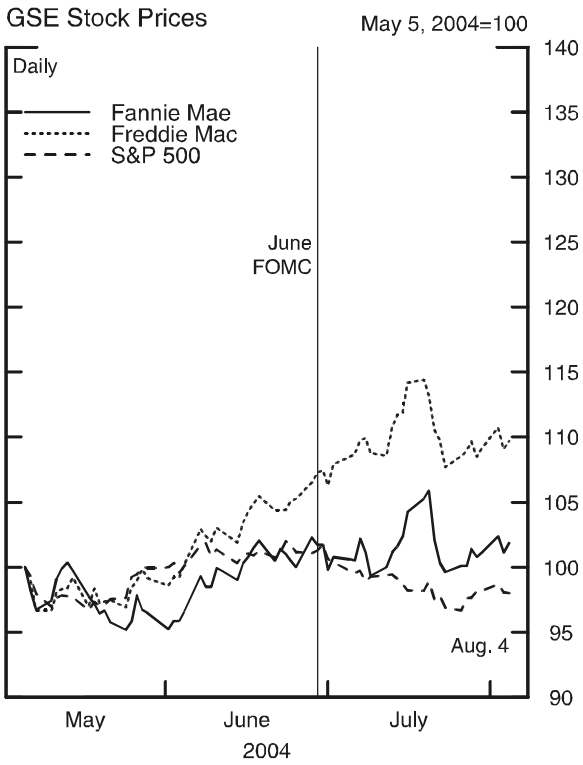
Treasury Financing
(Billions of dollars)

Item	2003		2004			
	Q3	Q4	Q1	Q2	May	June
Total surplus, deficit (–)	**-104.5**	**-128.7**	**-170.8**	**-25.7**	**-62.5**	**19.1**
Means of financing deficit						
Net borrowing	107.6	118.6	135.9	43.9	47.8	14.1
Nonmarketable	31.4	6.6	-10.1	9.4	2.1	0.4
Marketable	76.2	112.0	146.0	34.5	45.7	13.7
Bills	-14.9	9.2	56.1	-34.9	24.5	-7.9
Coupons	91.1	102.8	89.9	69.4	21.2	21.5
Decrease in cash balance	-4.9	1.8	11.9	-23.3	24.6	-28.8
Other[1]	1.9	8.3	23.0	5.1	-9.9	-4.4
Memo:						
Cash balance, end of period	35.0	33.2	21.3	44.6	15.9	44.6

Note. Components may not sum to totals because of rounding.
1. Direct loan financing, accrued items, checks issued less checks paid, and other transactions.

GSE Market Developments





Over the intermeeting period, the GSEs weathered a slew of negative news about their earnings, accounting practices, and regulatory compliance. In addition, investors shrugged off Fannie Mae's decision in mid-July to break with its previously announced calendar of benchmark debt issuance. Indeed, yield spreads on GSE-issued bonds relative to comparable-maturity Treasuries narrowed substantially, on net, over the intermeeting period, and their stock prices outperformed broad equity market indexes.

Money and Bank Credit

The growth of M2 slowed sharply in June to about a 1-1/2 percent pace, and the aggregate is estimated to have contracted slightly in July. The deceleration was due mainly to weaker liquid deposit growth, which likely reflected a moderation in mortgage refinancing activity. In addition, retail money market fund assets resumed their more-than-two-year downward trend in June and July. The slowdown in M2 would have been even more pronounced if not for a spike in currency demand from Russia and Iraq.

While real estate lending at banks has slowed of late, the growth rates of business and consumer loans (adjusted for securitization) have picked up. Excluding the effects of sizable litigation-related provisions at two large banking firms, second-quarter net income at large bank holding companies remained very strong. Loan-loss provisions continued to decline, reflecting further improvements in asset quality.

Monetary Aggregates

(Based on seasonally adjusted data)

Aggregate or component	2003	2004 Q1	2004 Q2	2004 May	2004 June	2004 July (e)	Level ($ billions) July (e)
Aggregate	Percent change (annual rate)[1]						
1. M2[2]	5.3	3.5	9.5	13.5	1.4	-1.1	6,287
2. M3[3]	4.5	5.8	11.3	14.4	5.1	-1.0	9,279
Components of M2[4]							
3. Currency	5.9	2.8	4.0	5.7	8.8	14.2	685
4. Liquid deposits[5]	13.8	10.3	17.0	19.2	3.0	0.1	4,060
5. Small time deposits	-9.3	-4.5	-4.9	-7.7	-2.9	1.7	793
6. Retail money market funds	-11.6	-19.4	-8.2	12.9	-9.4	-24.1	742
Components of M3							
7. M3 minus M2[6]	2.9	10.8	15.0	16.4	12.9	-0.8	2,991
8. Large time deposits, net[7]	3.5	30.4	32.0	33.1	22.7	25.2	1,030
9. Institutional money market funds	-5.8	-7.9	2.6	-1.7	-7.4	-17.9	1,096
10. RPs	12.8	6.9	1.9	25.4	44.2	-28.5	522
11. Eurodollars	27.4	33.7	31.7	15.9	3.6	21.3	344
Memo							
12. Monetary base	6.0	3.1	4.9	5.9	9.0	23.8	752
	Average monthly change (billions of dollars)[8]						
Selected managed liabilities at commercial banks							
13. Large time deposits, gross	-1.6	15.6	20.2	21.3	25.2	19.3	1,139
14. Net due to related foreign institutions	3.1	-16.6	-14.6	-17.7	-52.0	19.7	44
15. U.S. government deposits at commercial banks	-0.4	2.4	0.0	-6.3	3.3	-10.2	11

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. Non-bank travelers checks not listed.
5. Sum of demand deposits, other checkable deposits, and savings deposits.
6. Sum of large time deposits, institutional money market funds, RP liabilities of depository institutions, and eurodollars held by U.S. addressees.
7. Net of holdings of depository institutions, money market funds, U.S. government, and foreign banks and official institutions.
8. 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	2003	Q1 2004	Q2 2004	May 2004	June 2004	July[e] 2004	Level, July 2004[e] ($ billions)
Total							
1. Adjusted[1]	**5.9**	**11.2**	**10.7**	**4.3**	**7.8**	**-.1**	**6,319**
2. Reported	5.6	11.8	7.4	-.4	6.4	2.8	6,480
Securities							
3. Adjusted[1]	8.6	18.0	13.3	-2.4	3.4	-7.0	1,743
4. Reported	7.3	19.5	2.1	-17.4	-.9	3.5	1,904
5. Treasury and agency	8.8	24.1	10.2	-12.4	.1	-5.8	1,180
6. Other[2]	5.0	12.4	-10.5	-25.5	-2.9	19.2	724
Loans[3]							
7. Total	4.9	8.6	9.7	6.9	9.5	2.5	4,577
8. Business	-9.3	-5.0	-2.0	-1.5	5.0	6.0	868
9. Real estate	11.1	10.2	19.4	14.9	5.9	5.4	2,408
10. Home equity	30.8	37.8	36.7	33.7	35.3	32.9	345
11. Other	8.8	6.3	16.7	12.0	1.2	1.0	2,063
12. Consumer	5.6	11.8	4.8	4.3	4.5	-3.2	642
13. Adjusted[4]	6.0	10.6	-1.8	-8.3	-.1	3.2	1,006
14. Other[5]	6.7	19.0	-3.7	-8.5	33.5	-7.2	659

Note. Data are adjusted to remove estimated effects of consolidation related to FIN 46 and 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.

1. Adjusted to remove effects of mark-to-market accounting rules (FIN 39 and FAS 115).

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. Includes an estimate of outstanding loans securitized by commercial banks.

5. Includes security loans and loans to farmers, state and local governments, and all others not elsewhere classified. Also includes lease financing receivables.

e Estimated.

Appendix

July 2004 Senior Loan Officer Opinion Survey

The July 2004 Senior Loan Officer Opinion Survey on Bank Lending Practices addressed changes in the supply of, and demand for, bank loans to businesses and households over the past three months. In addition, the survey queried banks about the extent to which the recent developments in the bond markets have affected their C&I lending patterns. Responses were received from fifty domestic and nineteen foreign banking institutions.

Both domestic banks and U.S. branches and agencies of foreign banks further eased lending standards and terms for C&I loans over the past three months. A small net fraction of domestic institutions also reported an easing of lending standards for commercial real estate loans, while standards for this type of loan at foreign institutions were essentially unchanged. In July, the net proportion of domestic banks that reported stronger demand for C&I loans was a bit higher than in April. But a considerably larger net fraction of domestic banks reported stronger demand for commercial real estate loans compared with the April survey. Foreign respondents indicated a sharp turnaround in C&I loan demand over the past three months; in contrast, demand for commercial real estate loans at these institutions was reportedly unchanged over the survey period. In the household sector, a notable net fraction of domestic banks reported an easing of credit standards on residential mortgage loans. The demand for this type of loan was about unchanged, on net, whereas demand for consumer loans of all types reportedly deteriorated over the past three months.

Lending to Businesses

In the July survey, both domestic and foreign institutions reported a further net easing of credit standards on C&I loans. On net, about one-fourth of domestic banks indicated that they had eased standards for large and middle-market business borrowers over the past three months, roughly the same net percentage as in the April survey. In contrast, only 4 percent of domestic institutions, on net, eased their lending standards for small firms, a notable decline from the 20 percent net easing reported in April. The net percentage of U.S. branches and agencies of foreign banks that reported having eased their lending standards for C&I loans rose from 30 percent in April to 42 percent in the current survey.

Domestic and foreign respondents also indicated that they had eased a number of lending terms on business loans over the past three months. On net, 45 percent of domestic commercial banks reported that they had lowered spreads of loan rates over their cost of funds for large and middle-market firms, and more than one-fourth, on net, reported having done so for small firms. Among foreign institutions, more than one-half of respondents, on net, reported having narrowed spreads on their C&I loans over the past three months. In addition, sizable net fractions of both domestic and foreign institutions reported that they had eased covenants on C&I loans, especially for loans to large and middle-market firms. As in the April survey, domestic and foreign respondents indicated that they had eased terms on credit lines, both by increasing the size of credit lines and by reducing their cost.

About 90 percent of domestic and almost 70 percent of foreign respondents cited more aggressive competition from other banks or nonbank lenders as the most important reason for easing lending standards and terms over the previous three months. In addition, about three-fourths of domestic and foreign institutions pointed to a more favorable economic outlook as a reason for easing their business lending policies. Domestic institutions also frequently pointed to improvement in industry-specific problems and increased tolerance for risk as reasons for their move toward a less stringent lending posture. A small number of domestic banks that tightened their business lending standards or terms over the past three months generally cited a reduced tolerance for risk or a worsening of industry-specific problems.

C&I loan demand. On net, one-third of domestic banks reported an increase in demand for C&I loans from large and middle-market borrowers over the past three months, a slightly higher net percentage than in the April survey; about 45 percent also reported stronger loan demand from small firms. In addition, almost one-half of domestic respondents reported an increase in inquiries from potential business borrowers over the same period, about the same fraction as in the April survey. Domestic respondents that experienced stronger loan demand pointed to their borrowers' increased financing needs for accounts receivable and inventories as well as for investment in plant and equipment. In the current survey, demand for business loans was also stronger at branches and agencies of foreign banks, which in April reported a weakening in demand. More than one-fourth of these institutions reported stronger demand in July, most frequently attributing it to an increase in customer needs for M&A financing. These survey results are consistent with bank credit data, which show a notable pickup in the growth of C&I loans in recent months.

In light of the sharp decline in net bond issuance in the second quarter, a special question on business financing asked banks about the extent to which developments in the bond market had affected their C&I lending. Although only 12 percent of domestic banks reported a moderate reduction in loan paydowns, more than one-fifth of foreign respondents noted that the decline in bond issuance caused a moderate or a substantial reduction in the paydowns of C&I loans.

Commercial real estate lending. On net, 8 percent of domestic banks reported that they had eased lending standards on commercial real estate loans over the past three months, about the same net proportion as in the April survey. The net percentage of domestic banks that experienced an increase in demand for this type of loan moved up from 20 percent in April to 32 percent in July. In contrast, demand for commercial real estate loans at foreign institutions was reportedly unchanged, on net, over the past three months.

Lending to Households

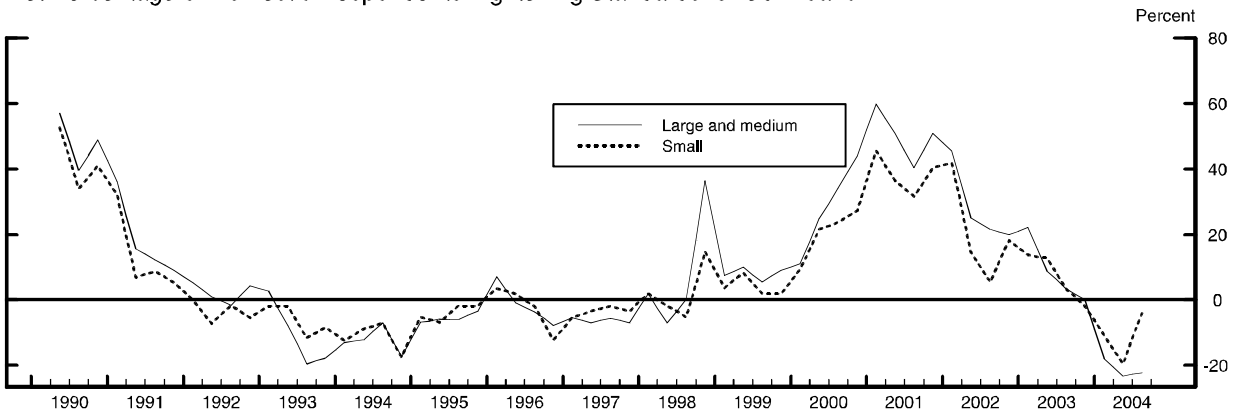
The net proportion of banks indicating increased willingness to make consumer installment loans declined to 8 percent in July from 17 percent in the April survey. Standards for approving applications for credit cards and other consumer loans, as well as most terms on these loans, were unchanged, on net, in the July survey. Demand for consumer loans of all types reportedly slackened over the past three months: On net,

15 percent of banks experienced weaker consumer loan demand in the current survey, compared with 22 percent of institutions, on net, that reported stronger demand in April.

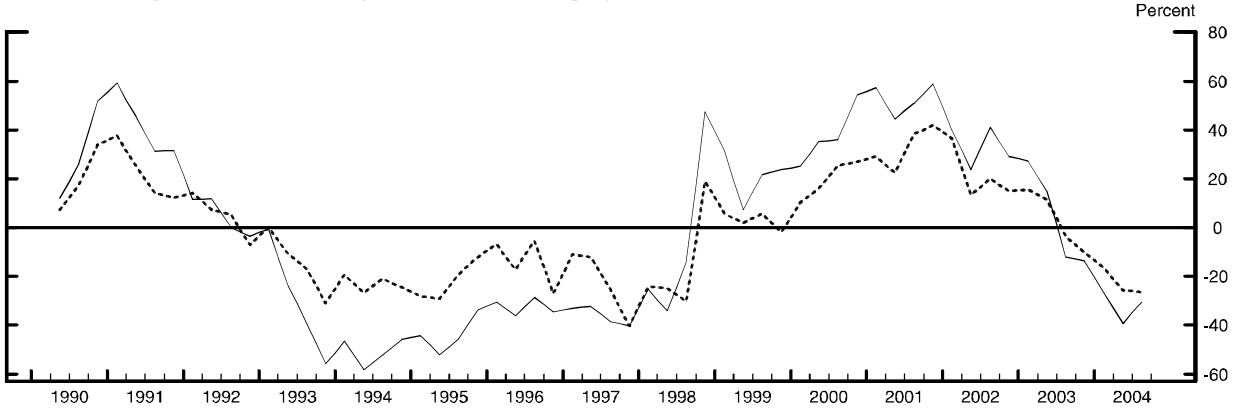
In the current survey, 9 percent of domestic banks, on net, indicated that they had eased credit standards on residential mortgage loans, about the same net percentage as in April. Reported demand for residential real estate loans was about unchanged, on net.

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

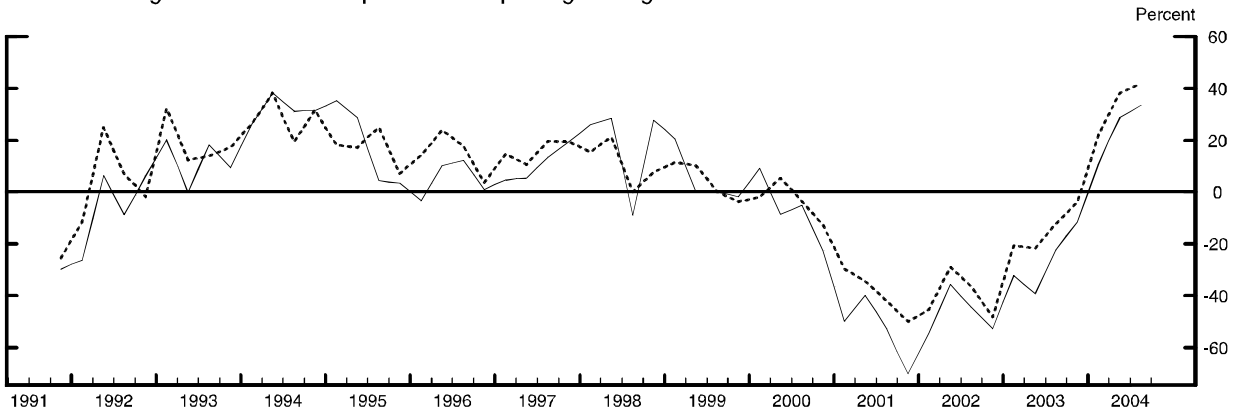
Net Percentage of Domestic Respondents Tightening Standards for C&I Loans



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

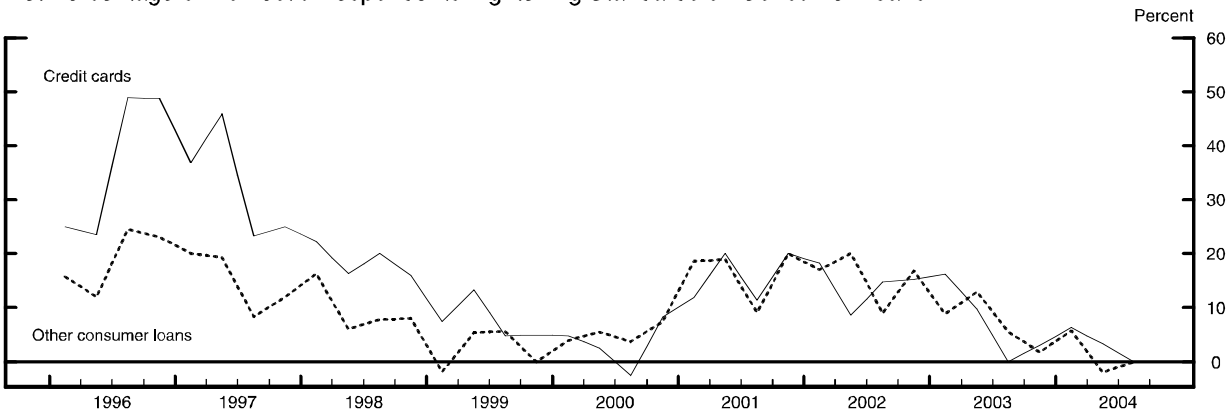


Net Percentage of Domestic Respondents Reporting Stronger Demand for C&I Loans

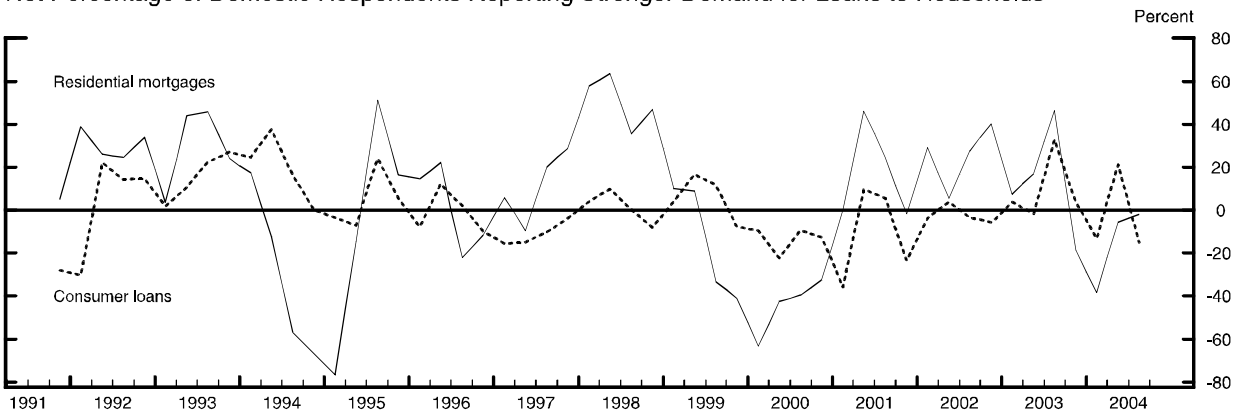


Measures of Supply and Demand for Loans to Households

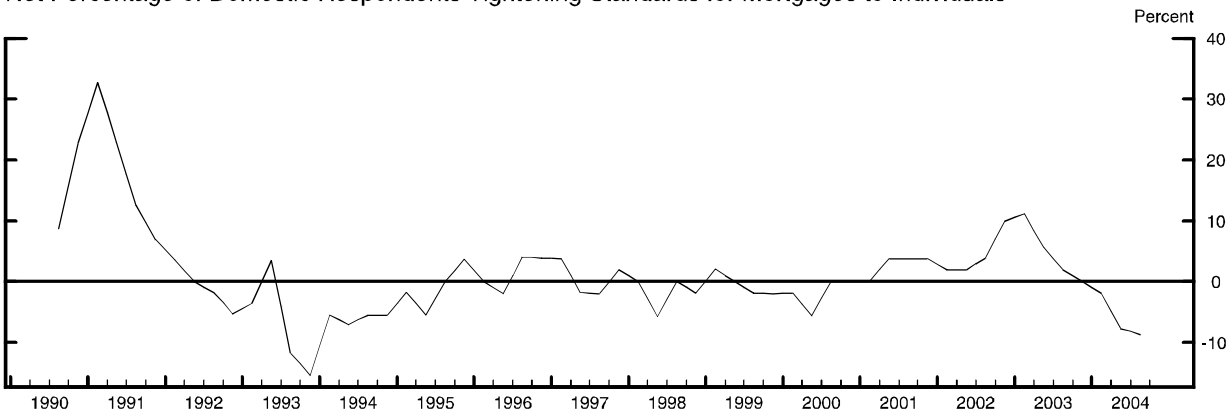
Net Percentage of Domestic Respondents Tightening Standards on Consumer Loans



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



Net Percentage of Domestic Respondents Tightening Standards for Mortgages to Individuals



International Developments

International Developments

U.S. International Transactions

Trade in Goods and Services

The U.S. international trade deficit shrank to $46.0 billion in May from $48.1 billion in April (revised).

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

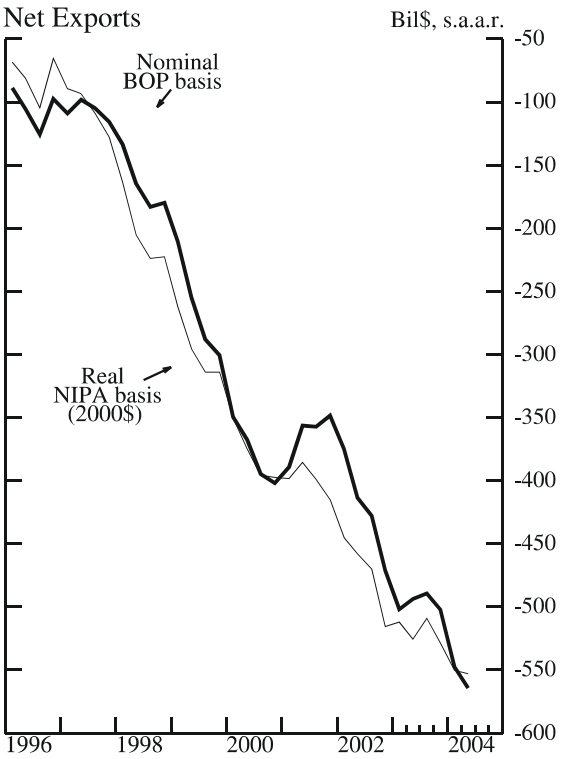
	2003	Annual rate 2003	Annual rate 2004		Monthly rate 2004		
		Q4	Q1	Q2[e]	Mar.	Apr.	May
Real NIPA[1]							
Net exports of G&S	-518.5	-528.3	-550.1	-552.8	...	...	...
Nominal BOP							
Net exports of G&S	-496.5	-502.0	-547.7	-564.3	-46.6	-48.1	-46.0
Goods, net	-547.6	-557.8	-603.1	-622.8	-51.4	-53.0	-50.8
Services, net	51.0	55.8	55.3	58.5	4.8	4.9	4.9

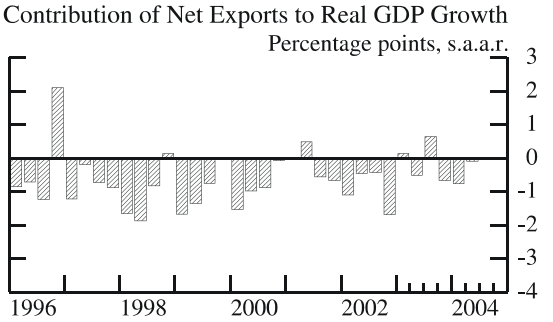
1. Billions of chained (2000) dollars.
e. BOP data are two months at an annual rate; NIPA data are BEA's advance estimate.
Source: U.S. Department of Commerce, Bureaus of Economic Analysis and Census.
n.a. Not available. ... Not applicable.

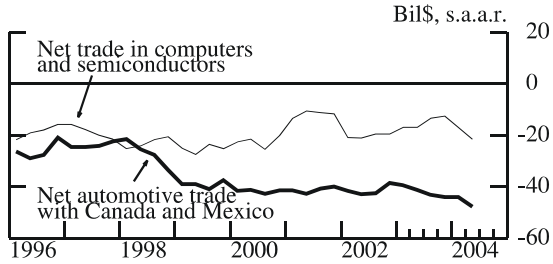
In May, the value of exports of goods and services increased 2.9 percent to a record high, with exports of goods more than accounting for the entire rise, as exports of services edged down slightly. The increase in the value of exported goods was driven by increases in capital goods and industrial supplies. Exports of agricultural and automotive products also edged up, whereas exports of consumer goods dropped a bit. At an annual rate, the average value of exported goods and services in April and May was about 16 percent above the first-quarter level. The increase was widespread with all major trade categories registering increases, particularly industrial supplies, capital goods, and services.

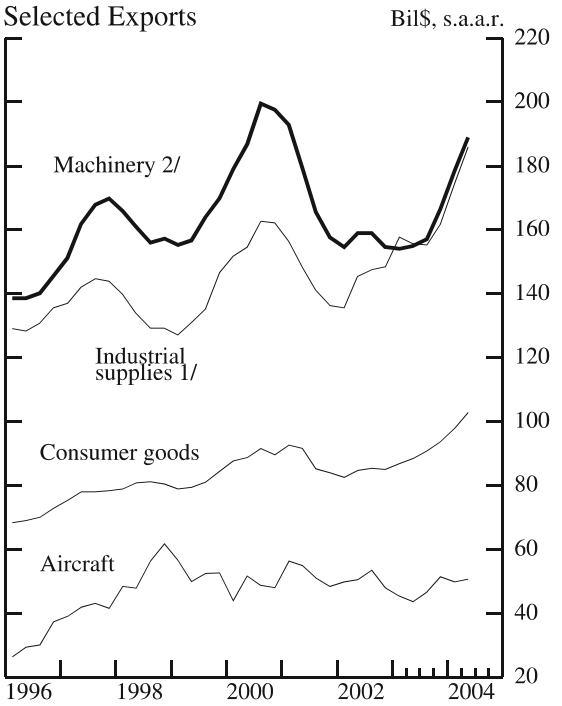
The value of imports of goods and services rose 0.4 percent in May, as an increase in imports of goods more than offset a slight decrease in services. Within goods, imports of industrial supplies and automotive products showed the largest increases. Imports of capital goods and foods also edged up. Imports of consumer goods, however, fell. Oil imports were little changed as an increase in price offset a decrease in volume. At an annual rate, the average value of imported goods and services in April and May was about 15 percent above the first quarter level. The rise was widespread across most major categories of trade with the main exception of oil, which fell.

U.S. International Trade in Goods and Services

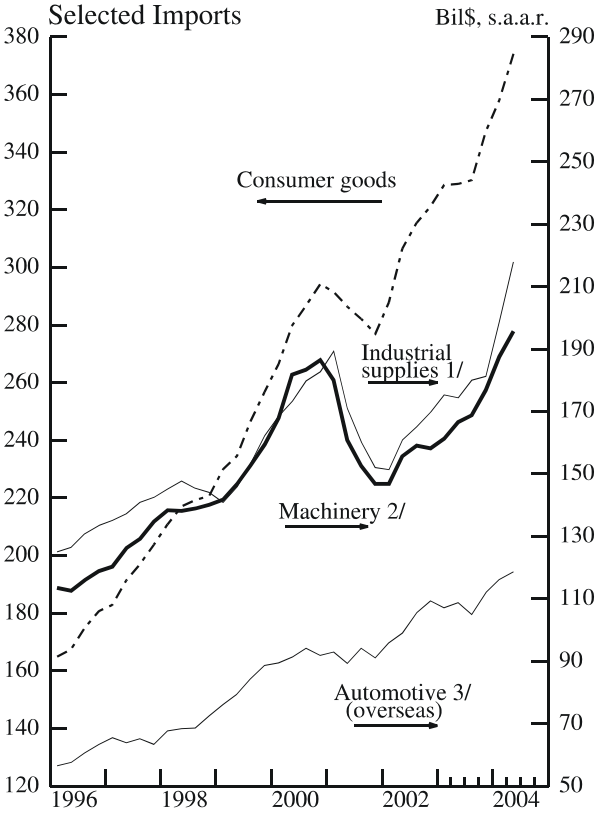








1. Excludes agriculture and gold.
2. Excludes computers and semiconductors.



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

U.S. Exports and Imports of Goods and Services

(Billions of dollars, s.a.a.r., BOP basis)

	Levels				Amount Change[1]			
	2004		2004		2004		2004	
	Q1	Q2[e]	Apr.	May	Q1	Q2[e]	Apr.	May
Exports of G&S	**1107.3**	**1149.4**	**1133.2**	**1165.7**	**34.1**	**42.1**	**-11.6**	**32.5**
Goods exports	775.7	807.9	791.4	824.5	28.2	32.3	-16.3	33.1
Gold	4.4	3.6	3.4	3.7	-0.3	-0.8	-0.7	0.2
Other goods	771.3	804.4	787.9	820.8	28.5	96.7	-15.6	32.9
Aircraft & parts	49.9	50.6	47.5	53.7	-1.4	0.7	-4.0	6.3
Computers & accessories	42.0	42.1	41.5	42.8	-0.8	0.1	-0.0	1.3
Semiconductors	50.1	50.6	50.3	50.9	0.3	0.5	-0.9	0.6
Other capital goods	181.4	191.9	185.8	198.0	12.0	10.5	-2.6	12.2
Automotive	83.6	86.4	85.8	87.0	1.1	2.8	-1.1	1.1
to Canada	46.4	47.3	47.3	47.4	-1.4	0.9	-1.2	0.1
to Mexico	15.3	16.6	16.0	17.2	1.6	1.3	-1.6	1.2
to ROW	21.8	22.4	22.5	22.4	0.9	0.6	1.7	-0.2
Agricultural	63.6	64.3	63.4	65.2	-1.6	0.7	-2.8	1.8
Ind supplies (ex. ag, gold)	174.5	185.9	180.5	191.3	12.7	11.4	-2.8	10.8
Consumer goods	97.9	102.7	103.0	102.5	4.2	4.8	-0.8	-0.5
All other goods	28.4	29.8	30.2	29.4	2.0	1.4	-4.4	-0.8
Services exports	331.7	341.5	341.8	341.2	5.9	9.8	4.7	-0.7
Imports of G&S	**1655.1**	**1713.7**	**1710.4**	**1717.1**	**79.9**	**58.7**	**6.7**	**6.7**
Goods imports	1378.8	1430.7	1427.2	1434.2	73.6	51.9	2.7	6.9
Petroleum	162.4	154.7	154.6	154.8	28.0	-7.7	-17.3	0.3
Gold	4.1	3.3	3.8	2.8	0.3	-0.8	0.1	-1.0
Other goods	1212.3	1272.7	1268.8	1276.5	45.3	60.4	20.0	7.7
Aircraft & parts	21.6	21.6	23.1	20.0	-4.7	-0.0	-0.2	-3.1
Computers & accessories	82.7	87.4	85.9	88.9	2.1	4.7	2.4	3.0
Semiconductors	26.5	27.0	27.6	26.4	1.7	0.5	0.6	-1.1
Other capital goods	190.2	197.8	196.9	198.8	11.1	7.6	3.8	1.9
Automotive	222.1	230.6	227.8	233.4	4.3	8.5	0.6	5.6
from Canada	64.0	67.7	68.1	67.3	-0.4	3.7	1.2	-0.8
from Mexico	41.9	44.1	43.0	45.3	0.6	2.3	-3.0	2.4
from ROW	116.2	118.7	116.7	120.7	4.1	2.5	2.4	4.0
Ind supplies (ex. oil, gold)	198.8	217.9	212.0	223.7	17.5	19.1	5.7	11.7
Consumer goods	358.0	374.2	379.8	368.6	10.6	16.1	5.2	-11.2
Foods, feeds, bev.	60.2	62.1	61.4	62.9	1.7	2.0	-0.4	1.6
All other goods	52.2	54.1	54.4	53.8	1.0	1.9	2.4	-0.6
Services imports	276.3	283.0	283.1	282.9	6.3	6.7	4.0	-0.2
Memo:								
Oil quantity (mb/d)	14.38	12.48	12.92	12.03	1.09	-1.92	-1.69	-0.89
Oil import price ($/bbl)	30.88	33.99	32.74	35.23	3.22	3.11	0.54	2.49

1. Change from previous quarter or month. e. Average of two months.

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

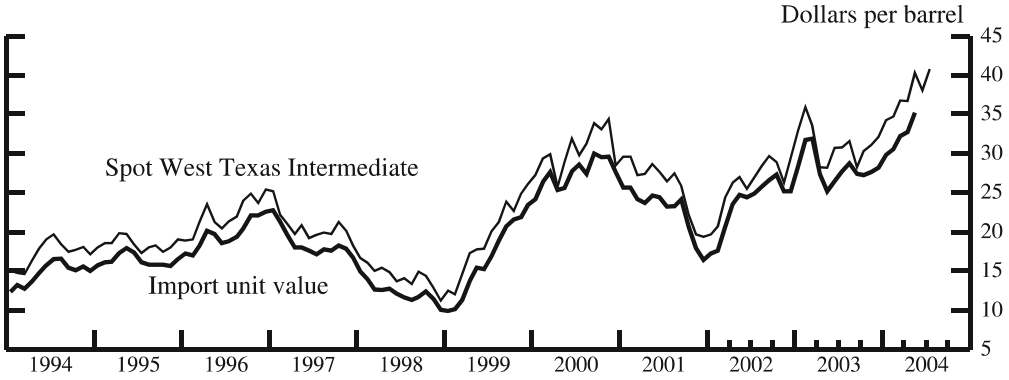
Prices of U.S. Imports and Exports

(Percentage change from previous period)

	Annual rates			Monthly rates		
	2003	2004		2004		
	Q4	Q1	Q2	Apr.	May	June
	---------- BLS prices (2000 weights)----------					
Merchandise imports	1.4	11.5	7.1	0.2	1.4	-0.2
Oil	5.3	68.1	41.9	-0.4	9.4	-1.0
Non-oil	1.0	5.9	2.7	0.2	0.3	0.0
Core goods*	2.0	7.1	3.9	0.4	0.3	0.0
Cap. goods ex comp & semi	0.1	2.6	-0.1	0.0	-0.1	-0.1
Automotive products	2.8	1.7	1.4	0.2	0.0	0.2
Consumer goods	0.3	2.6	-0.5	-0.1	-0.1	0.0
Foods, feeds, beverages	3.9	10.0	7.0	1.2	-0.4	-0.5
Industrial supplies ex oil	5.6	25.3	17.1	1.9	1.7	-0.1
Computers	-9.5	-1.7	-7.0	-1.6	0.0	-0.1
Semiconductors	-3.0	-8.2	-6.6	-1.8	0.5	-0.1
Merchandise exports	3.7	7.4	6.1	0.7	0.4	-0.6
Core goods*	5.1	8.4	6.6	0.8	0.4	-0.6
Cap. goods ex comp & semi	0.5	2.2	0.8	0.0	0.0	0.2
Automotive products	0.3	0.3	1.3	0.3	0.1	0.0
Consumer goods	1.8	1.1	0.9	0.2	0.0	0.0
Agricultural products	39.6	19.0	18.7	2.8	0.5	-4.6
Industrial supples ex ag	5.6	21.3	14.2	1.1	1.2	-0.6
Computers	0.9	1.2	2.0	0.2	-0.1	0.0
Semiconductors	-10.8	-1.7	3.1	0.3	0.0	-0.6
Chain price index	---Prices in the NIPA accounts (2000 weights)---					
Imports of goods & services	0.9	9.6	5.9	...	...	...
Non-oil merchandise	0.9	5.6	2.5	...	...	...
Core goods*	1.7	6.4	3.5	...	...	...
Exports of goods & services	3.2	5.7	4.5	...	...	...
Total merchandise	4.2	6.4	5.5	...	...	...
Core goods*	5.7	7.9	6.0	...	...	...

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

Oil Prices



Prices of Internationally Traded Goods

Non-oil imports. In June, the prices of U.S. imports of non-oil goods and of core goods remained unchanged from their May levels, following seven consecutive monthly increases. After dropping 0.4 percent in May, prices of imported foods fell another 0.5 percent in June. After two months of large increases, prices of imported non-oil industrial supplies ticked down 0.1 percent. Prices of imported capital goods (excluding computers and semiconductors) also edged down 0.1 percent, whereas prices of imported consumer goods were unchanged. Import prices of automotive products rose 0.2 percent. Prices of imported computers and semiconductors decreased 0.1 percent.

In the second quarter, on a NIPA basis, the prices of imported core goods increased 3.5 percent at an annual rate. Much of this increase was concentrated in the commodity-intensive categories of industrial supplies and foods, feeds and beverages.

Oil. The BLS price of imported oil edged down 1 percent in June after surging nearly 10 percent in May. The spot price of West Texas Intermediate (WTI) crude oil averaged $38 per barrel in June, but rose steadily in July to average more than $40 per barrel for the month. On August 4, the spot price of WTI closed at $42.83 per barrel. Recent oil price increases have been driven in part by concerns about oil production in Russia, where authorities have seized the main production assets of Yukos, Russia's largest oil company. Reports suggest that, to pay Yukos' tax bill, these assets may be sold, which may bankrupt the company and could lead to supply disruptions. In addition, strong world oil demand, violence in the Middle East, and doubts about the reliability of oil supplies from Nigeria and Venezuela continue to keep upward pressure on oil prices.

Exports. In June, the prices of U.S. exports of total goods and of core goods fell 0.6 percent, following nine consecutive monthly increases. Falling 4.6 percent in June, prices for exported agricultural products (particularly soybeans) accounted for most of the decline. Prices of exported industrial supplies also contributed to the decline, falling 0.6 percent. Prices of exported capital goods (excluding computers and semiconductors) rose 0.2 percent in June. Prices of exported semiconductors fell 0.6 percent. Prices for all other major categories of exports were unchanged.

In the second quarter, on a NIPA basis, the prices of exported core goods increased 6.0 percent at an annual rate. Agricultural products and industrial supplies were the main contributors to this quarterly increase.

U.S. International Financial Transactions

Private foreign purchases of U.S. securities (line 4 of the Summary of U.S. International Transactions table) weakened in May. After averaging over $40 billion per month in the first four months of the year, private foreign inflows into U.S. securities in May totaled only $22 billion. Most of the decline in May owed to a shift in equities (line 4d) from net purchases to net sales. Demand for agency securities (line 4b) and corporate debt securities (line 4c) remained robust but not spectacular. Private foreign purchases of Treasury securities (line 4a) remained weak; these purchases, after totaling $66 billion in the first quarter, amounted to a combined $6 billion in April and May.

Net foreign official inflows (line 1) remained brisk at $18 billion in May, though far below the white-hot pace of the first quarter, as Japan has not intervened in foreign exchange markets since March. Partial data from the Federal Reserve Bank of New York (FRBNY) suggest a further slowing, as monthly inflows averaged $12 billion in June and July.

.

U.S. investors acquired on net virtually no foreign securities (line 5) in May, following unusually large acquisitions of $17 billion in April. In what has become the norm, U.S. investors purchased foreign equities and sold foreign bonds.

The banking sector (line 3) recorded sizeable inflows in May, bringing year-to-date flows to near balance.

[TIC data for June, which should be available on August 5, will be discussed in the Greenbook supplement.]

Summary of U.S. International Transactions

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

	2002	2003	2003			2004		
			Q2	Q3	Q4	Q1	Apr	May
Official financial flows	**113.0**	**247.3**	**65.1**	**50.1**	**85.9**	**127.9**	**21.6**	**17.8**
1. Change in foreign official assets in the U.S. (increase, +)	116.7	245.8	65.3	50.8	83.7	127.3	20.7	17.7
a. G-10 countries	30.7	115.7	26.1	15.9	47.3	95.1	9.3	14.3
b. OPEC countries	-7.5	6.1	1.1	2.1	10.5	3.6	1.7	.4
c. All other countries	93.5	124.0	38.1	32.8	25.9	28.6	9.7	3.0
2. Change in U.S. official reserve assets (decrease, +)	-3.7	1.5	-.2	-.6	2.2	.6	.8	.1
Private financial flows	**457.2**	**298.5**	**42.5**	**75.9**	**82.8**	**30.4**	**…**	**…**
Banks								
3. Change in net foreign positions of banking offices in the U.S.[1]	116.8	64.3	-23.5	25.4	101.5	-44.8	2.3	34.0
Securities[2]								
4. Foreign net purchases of U.S. securities (+)	390.1	371.1	148.5	65.9	90.1	129.4	43.3	21.6
a. Treasury securities	101.5	115.9	54.9	46.6	5.2	65.5	4.7	1.3
b. Agency bonds	84.2	-12.9	10.9	-30.8	2.8	7.0	19.1	12.3
c. Corporate and municipal bonds	145.7	227.8	61.4	52.7	58.5	51.7	12.2	15.7
d. Corporate stocks[3]	58.8	40.3	21.4	-2.6	23.6	5.2	7.2	-7.8
5. U.S. net acquisitions (-) of foreign securities	15.5	-73.3	8.1	-28.8	-26.2	-17.4	-17.3	.5
a. Bonds	33.5	28.5	25.0	2.2	-6.5	5.3	6.1	7.4
b. Stock purchases	-14.8	-84.4	-16.9	-31.0	-16.9	-22.7	-12.4	-6.8
c. Stock swaps[3]	-3.2	-17.4	.0	.0	-2.8	.0	-11.1	.0
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-134.8	-173.8	-34.0	-45.2	-53.7	-57.2	…	…
7. Foreign direct investment in U.S.	72.4	39.9	-.5	-2.8	10.7	18.0	…	…
8. Foreign holdings of U.S. currency	21.5	16.6	1.5	2.8	7.5	-1.8	…	…
9. Other (inflow, +)[4]	-24.4	53.6	-57.6	58.6	-47.2	4.3	…	…
U.S. current account balance (s.a.)	**-473.9**	**-530.7**	**-133.9**	**-131.6**	**-127.0**	**-144.9**	**…**	**…**
Capital account balance (s.a.)[5]	**-1.3**	**-3.1**	**-1.6**	**-.8**	**-.3**	**-.3**	**…**	**…**
Statistical discrepancy (s.a.)	**-95.0**	**-12.0**	**27.8**	**6.4**	**-41.4**	**-13.1**	**…**	**…**

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 therefore does not match exactly the data on U.S. international transactions published by the Department of Commerce.

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

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

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

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

Foreign Financial Markets

On net, the dollar's trade-weighted exchange value against major foreign currencies was little changed over the intermeeting period. The dollar was also little changed on balance against the currencies of our other important trading partners, as modest gains against a number of emerging Asian currencies were offset by losses against several Latin American currencies.

Exchange Value of the Dollar

The dollar fluctuated during the period, depreciating in response to the lower-than-expected June U.S. employment and core CPI data reports early in the period, and appreciating in reaction to Chairman Greenspan's semi-annual testimony to Congress on July 20-21, which market participants interpreted as generally reflective of a positive outlook for the U.S. economy, as well as stronger U.S. consumer confidence and manufacturing surveys. U.S. economic data late in the period were more mixed, leading to a slight retracement in the dollar, but this loss was limited by several weaker-than-expected data releases in a number of foreign industrial economies.

On balance, the dollar was mixed against major foreign currencies, appreciating 3 percent against the yen, depreciating 2 percent against the Canadian dollar, and changing little on balance against sterling and the euro. The yen experienced a bout of broad-based weakness early in the period. Analysts

ascribed this weakness, in part, to commentary by Japanese officials that reinforced the view that there would be no urgency to tighten monetary policy. In addition, investors expressed concerns about the duration of a slowdown in China and its effects on the Japanese economy. Economic data from Canada during the intermeeting period generally met or exceeded expectations, helping to support the Canadian dollar against the U.S. dollar.

Financial Indicators in Major Industrial Countries

	Three-month rate		Ten-year yield		Equities
Country	Aug. 5 (Percent)	Percentage Point Change	Aug. 5 (Percent)	Percentage Point Change	Percent Change
Canada	2.14	.04	4.68	-.26	-1.60
Japan	.05	.00	1.72	-.13	-5.86
Euro area	2.12	-.01	4.18	-.20	-3.79
United Kingdom	4.87	.12	5.05	-.13	-1.73
Switzerland	.50	.06	2.68	-.26	-2.92
Australia	5.46	-.02	5.73	-.21	.82
United States	1.66	.10	4.41	-.29	-3.31
Memo: Weighted-average foreign	1.81	.02	4.21	-.22	n.a.

NOTE. Change is from June 29 to August 5 (10 a.m. EDT).
n.a. Not available.

The European Central Bank left its policy rate unchanged at two meetings this intermeeting period, as had been expected. After the Bank of England decided to leave its policy rate unchanged at its meeting in early July (as had also been expected), short-term sterling interest rates increased in response to stronger-than-expected U.K. retail sales data and the release of the minutes from the previous meeting, which revealed that policymakers believed the British labor market was tightening and that the economy had little spare capacity. The Bank of England increased its policy rate 25 basis points, to 4.75 percent, at the August 5th meeting. Short-sterling rates declined modestly and sterling depreciated slightly after the announcement, as market participants reportedly interpreted the BoE statement as indicating a less rapid pace of future rate increases.

Market measures of the expected near-term path for monetary policy in other foreign industrial economies were generally little changed on net, while (except for Japan) such measures at farther horizons generally shifted down. Movements in long-term European and Canadian yields during the period often followed movements in U.S. yields, with Canadian yields showing net declines in line with U.S. yields and European yields declining less. In addition to weak U.S. data, market analysis attributed the net declines in global yields to investor concerns about the effect of record oil prices on global economic activity.

Equity indexes in most foreign industrial countries registered losses this period, weighed down early in the period by the weak U.S. data and later by oil price increases and concerns about a softening outlook for the technology sector. Equity prices in Canada, an oil exporter, declined only modestly. Technology shares significantly underperformed broader indexes following disappointing earnings news from several major global technology and telecom corporations.

Brazilian asset prices saw solid gains this period, with the Brazilian *real* up 2 percent, Brazil's EMBI+ spread down about 60 basis points, and Brazil's equity index up about 7 percent. Analysts attributed these gains in part to several stronger-than-expected domestic data releases. In addition, the Brazilian *real* was supported following the release of the minutes of the July 20th policy meeting of Brazil's central bank; market participants interpreted the minutes as indicating that policymakers have ruled out further interest rate cuts and that they would even consider undertaking rate hikes if inflation keeps accelerating. Mexican spreads also declined this period (although more modestly than the Brazilian spread) and the Mexican peso appreciated modestly against the dollar. The Mexican central bank decided to tighten monetary policy on July 23, citing inflation risks. The Mexican stock market decreased slightly on balance.

Emerging Asian equity prices were mixed; share prices in Korea and Taiwan were weighed down by global declines in technology shares. Russian equity prices declined sharply on balance over the period, led by a 40 percent decline in the share price of Yukos, the large Russian oil producer engaged in a dispute with the government over payment of back taxes. A minor banking crisis expanded slightly in Russia early in the intermeeting period when two major banks experienced significant deposit outflows. The crisis appears to have subsided, however, following government efforts to support liquidity and extend deposit insurance to a broader category of banks. On net, Russia's EMBI+ spread rose about 20 basis points over the period.

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

Financial Indicators in Latin America, Asia, and Russia

Economy	Currency/ US dollar		Short-term Interest rates[1]		Dollar-denominated bond spread[2]		Equity prices
	Aug. 5	Percent Change	Aug.4/5 (Percent)	Percentage Point Change	Aug.4/5 (Percent)	Percentage Point Change	Percent Change
Mexico	11.45	-.63	7.19	.44	1.95	-.21	-.61
Brazil	3.06	-1.86	15.76	.13	5.98	-.57	6.62
Argentina	3.02	2.04	n.a.	n.a.	51.07	-.26	5.39
Chile	641.50	.71	1.69	-.12	.67	-.12	4.85
China	8.28	.00	n.a.	n.a.	.63	.09	-1.39
Korea	1163.20	.97	4.04	.01	...	...	-4.54
Taiwan	34.15	1.38	1.25	-.07	...	...	-5.47
Singapore	1.72	.30	1.00	.38	...	...	2.74
Hong Kong	7.80	-.01	.63	.50	...	...	3.10
Malaysia	3.80	.00	2.84	.01	.76	.07	.13
Thailand	41.46	1.32	1.31	.06	.71	-.09	-4.73
Indonesia	9175.00	-2.39	7.39	-.02	2.55	-.40	5.50
Philippines	55.73	-.88	6.38	-.25	4.28	-.20	-.54
Russia	29.19	.52	n.a.	n.a.	3.17	.18	-3.75

NOTE. Change is from June 29 to August 4/5.

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.

Developments in Foreign Industrial Countries

Available data indicate that the major foreign industrial economies continued to grow at a solid pace in recent months. In Japan, gains in exports and household expenditures strengthened the expansion, while surveys of business and consumer confidence were also favorable. Indicators of economic activity in the euro area suggest moderating growth in the second quarter. Domestic demand remained weak in Germany and strong in France. In the United Kingdom, real GDP accelerated in the second quarter according to the preliminary release. Economic activity grew at a solid pace in Canada, led by a surge in investment.

High energy prices have contributed to maintaining consumer price inflation elevated. In Canada, headline inflation was unchanged at 2.5 percent. Inflation in the euro area remained well above the ECB's 2 percent ceiling. In the United Kingdom, inflation edged up to 1.6 percent, but remained below the Bank of England's 2 percent inflation target. Slight deflation persisted in Japan.

On August 5, in the United Kingdom, the Monetary Policy Committee increased its policy rate 25 basis points to 4.75 percent, while, in the euro area, the European Central Bank announced no change.

In **Japan**, recent indicators suggest that economic activity continued to expand strongly. Real exports surged 5 percent during the second quarter, while real imports were up about 3 percent. Workers' household expenditures fell in June but rose more than 3 percent during the second quarter and measures of consumer confidence continued to move up. New car registrations bounced back in July following a drop in the second quarter. Industrial production fell 1.3 percent in June, but was up sharply for the second quarter as a whole. The all-industries index of output rose 1.7 percent in April and May on average compared with the first-quarter average. Core machinery orders, a leading indicator of business fixed investment, fell 2.1 percent in May. Despite the monthly decline, average orders for April and May were more than 9 percent above the first-quarter average.

Labor market conditions continued to improve and consumer price deflation remained mild. While the unemployment rate was unchanged at 4.6 percent in June, employment increased during the second quarter and the job-offers-to-applicants ratio moved up to 0.82 in June, an eleven-year high. Core consumer goods prices in the Tokyo area (which exclude fresh food but include energy) were flat in July from the previous month and were down 0.1 percent from a year earlier. Higher commodity prices helped to push wholesale

prices up to 1.4 percent in June on an annual basis, the largest twelve-month rate of increase since 1997.

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

Indicator	2003	2004					
	Q4	Q1	Q2	Apr.	May	June	July
Industrial production[1]	3.9	.5	2.7	3.5	.8	-1.3	n.a.
All-industries index	1.1	-.1	n.a.	2.3	-.7	n.a.	n.a.
Housing starts	4.9	2.8	-4.4	-6.7	4.7	.8	n.a.
Machinery orders[2]	8.5	-5.6	n.a.	11.8	-2.1	n.a.	n.a.
Machinery shipments[3]	7.6	-.4	4.3	5.6	2.4	-1.4	n.a.
New car registrations	-1.8	12.5	-9.1	-7.9	-0.7	3.4	4.5
Unemployment rate[4]	5.1	4.9	4.6	4.7	4.6	4.6	n.a.
Job offers ratio[5]	.73	.77	.80	.77	.80	.82	n.a.
Business sentiment[6]	-11.0	-5.0	.0	...	...	...	...
CPI (Core, Tokyo area)[7]	-.1	-.2	-.1	-.1	-.1	-.1	-.1
Wholesale prices[7]	-.4	.0	1.0	.6	.9	1.4	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.

The Bank of Japan's Tankan index of business conditions rose in June, with the level of the aggregate diffusion index for business sentiment among firms of all sizes and across all industries increasing to 0 from -5 in March. The closely watched index for large manufacturers improved from 12 to 22 over the same period. The June strengthening of the aggregate index was broadly based, with increases for both manufacturers and non-manufacturers across all firm sizes.

Japan's ruling Liberal Democratic Party (LDP) won 49 seats in the Upper House election on July 11, losing only one of its 50 contested seat. The results left the ruling coalition with control of 139 seats, more than the 122 seats needed to secure a majority. Following the results, Prime Minister Koizumi announced

that he will stay in office and disclosed plans to reshuffle his cabinet in September.

Mitsubishi Tokyo Financial Group and UFJ Financial Group announced in July their intention to merge operations by September 2005. If completed, the merger would create the world's largest financial firm by assets. However, merger negotiations have been put on hold as UFJ appeals a Tokyo District Court injunction against the merger. The court ruled that the new merger would breach an earlier agreement for UFJ to sell its trust assets to Sumitomo Trust & Banking.

Indicators suggests that growth in the **euro area** has edged down from its first-quarter pace of 2.3 percent. Industrial production increased in April and May, led by German production of capital goods. In Germany, over the same period, merchandise exports continued to grow at a rapid pace but imports also moved up, suggesting some moderation in the contribution of net exports to GDP growth from the very high first-quarter rate. Euro-area retail sales dropped in May but bounced back in June. In Germany, June's retail sales remained below the first-quarter average, pointing to continued weakness in domestic demand. In contrast, French consumption of manufactured goods surged in June, indicating that household demand in France has remained solid.

The European Commission's surveys of industrial and consumer confidence were unchanged in July. In Germany, the IFO business climate index fell in June to a nine-month low, recovered somewhat in July but was still below both the first and the second-quarter averages. According to market research group GfK, German consumer confidence was weaker than expected in July and is set to drop in August. In France, conversely, the INSEE business confidence index rose in July to a three-year high, confirming the strength of the French recovery.

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

Indicator	2003	2004					
	Q4	Q1	Q2	Apr.	May	June	July
Industrial production[1]	1.1	.2	n.a.	.3	.7	n.a.	n.a.
Retail sales volume[2]	-.2	.8	-.3	1.4	-2.2	1.8	n.a.
Unemployment rate[3]	8.9	8.9	9.0	9.0	9.0	9.0	n.a.
Consumer confidence[4]	-16.0	-14.3	-14.7	-14.0	-16.0	-14.0	-14.0
Industrial confidence[4]	-7.3	-6.7	-4.7	-5.0	-5.0	-4.0	-4.0
Mfg. orders, Germany	3.4	.6	1.8	1.9	1.5	-3.5	n.a.
CPI[5]	2.0	1.7	2.3	2.0	2.5	2.4	2.4
Producer prices[5]	1.0	.2	2.0	1.4	2.4	2.4	n.a.
M3[5]	7.1	6.1	5.4	5.5	4.8	5.4	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.

The labor market remained weak in the euro area, with the unemployment rate unchanged at 9 percent in June**.** Meanwhile, recent wage agreements in Germany and France have seen labor unions accepting wage moderation and increased working-time flexibility in exchange for no job cuts.

Twelve-month consumer price inflation in the euro area was unchanged at 2.4 percent in July, well above the ECB's 2 percent target ceiling. The rise in inflation since the first quarter was mainly the result of a surge in energy and administered prices. The ECB is closely monitoring price developments for second-round effects of these increases. In June, core inflation, excluding energy, food, alcohol, and tobacco edged up to 2.0 percent.

Real GDP in the **United Kingdom** expanded 3.8 percent in the second quarter according to the preliminary estimate. Estimated output in the service sector increased at around the same pace as overall activity. Despite declining in June,

industrial production rose at a pace roughly consistent with the initial estimate in the second quarter.

Limited indicators for July point to somewhat slower growth on balance in the third quarter. The manufacturing PMI rose to its highest level since October 1994 and consumer confidence inched up. In contrast, business confidence dipped somewhat below the average level during the first half of the year. Services PMI ticked down for the third consecutive month, but continues to indicate strong expansion. One of the leading surveys of retail sales suggests the pace of sales dropped.

U.K. Economic Indicators

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

Indicator	2003	2004					
	Q4	Q1	Q2	Apr.	May	Jun.	Jul.
GDP*	4.2	2.9	3.8	...	...	...	...
Industrial production	.2	-.5	1.0	.8	.3	-.3	n.a.
Retail sales volume[1]	1.6	2.0	1.9	.5	.7	1.1	n.a.
Unemployment rate[2]							
Claims-based	2.9	2.9	2.8	2.8	2.8	2.7	n.a.
Labor force survey[3]	4.9	4.8	n.a.	4.8	n.a.	n.a.	n.a.
Business confidence[4]	-.3	16.7	16.3	12.0	22.0	15.0	6.0
Consumer confidence[5]	-3.3	-2.3	-4.3	-2.0	-5.0	-6.0	-4.0
Consumer prices[6]	1.3	1.3	1.4	1.2	1.5	1.6	n.a.
Producer input prices[7]	2.9	-.4	3.8	2.8	5.4	3.3	n.a.
Average earnings[7]	3.5	5.2	n.a.	4.6	4.1	n.a.	n.a.

* Preliminary estimate (s.a.a.r.).

1. Excludes motor vehicles.
2. Percent.
3. Three-month average centered on month shown.
4. Percentage of firms expecting output to increase in the next four months less percentage expecting output to decrease.
5. Average of the percentage balance from consumers' expectations of their financial situation, general economic situation, unemployment, and savings over the next 12 months.
6. Consumer prices index (CPI). Percent change from year earlier.
7. Percent change from year earlier.

n.a. Not available.

... Not applicable.

According to the two leading private surveys, housing prices rose 21 percent in the twelve months ending in July. Household net mortgage and consumer borrowing remained elevated in June.

The labor market continued to be tight, as both the official-claims-based and the labor-force-survey measures of the unemployment rate remained near their lowest points since 1975. The twelve-month consumer price inflation rate rose to 1.6 percent in June, still well below the Bank of England's 2 percent target.

On July 22, the Bank of England announced upcoming changes to its operations in money markets aimed at reducing volatility in overnight sterling interest rates. The Bank plans to introduce standing lending and borrowing facilities with rates 25 basis points above and below the official repo rate. Commercial banks will be able to choose a positive average target level for the reserve balances that they will hold during the month-long maintenance period, and the Bank will start paying interest (equal to the repo rate) on those balances. The Bank will reduce the number of open market operations from up to four a day to once a week, and change the maturity of the operations to one week. The Bank intends to release further details in a consultative paper this fall, before enacting the change.

In **Canada**, monthly GDP growth moved up to 0.3 percent in May from 0.1 percent in April, suggesting that the expansion continued in the second quarter. Growth was especially strong in the mining and oil and gas extraction sectors due to rising energy prices. The end of public-sector labor disputes in May also led to a rebound in activity in education service. Real exports increased 4.5 percent on average in April and May from the first-quarter average, while strong domestic demand fueled an almost 6 percent jump in real imports over the same period. Imports of machinery and equipment were particularly strong, indicating a steep rise in business fixed investment. Housing starts reached a 14-year high in the second quarter, showing the continued strength of residential investment. In contrast, retail and wholesale trade continued to shrink in May. Employment increased steadily throughout the quarter, with construction exhibiting large gains.

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

Indicator	2003	2004					
	Q4	Q1	Q2	Mar.	Apr.	May	June
GDP by industry	1.0	.6	n.a.	.9	.1	.3	n.a.
Industrial production	1.5	.5	n.a.	.8	.3	.6	n.a.
New mfg. orders	.1	5.6	n.a.	3.2	2.4	-.8	n.a.
Retail sales	-.9	2.0	n.a.	1.1	-1.2	-0.2	n.a.
Employment	.9	.3	.5	-.1	.3	.4	.2
Unemployment rate[1]	7.5	7.4	7.3	7.5	7.3	7.2	7.3
Consumer prices[2]	1.7	.9	2.2	.7	1.6	2.5	2.5
Core Consumer Prices[2,3]	1.7	1.2	1.3	1.1	1.2	1.2	1.4
Consumer attitudes[4]	124.1	123.2	n.a.	...	...	...	...
Business confidence[4]	146.3	144.8	145.6	...	...	...	...

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.

In June, the twelve-month rate of headline CPI inflation remained at 2.5 percent. Gasoline prices were the primary contributor to the increase in the second quarter from the first-quarter average. Twelve-month core inflation, excluding food, energy, and indirect taxes, edged up only slightly to 1.4 percent.

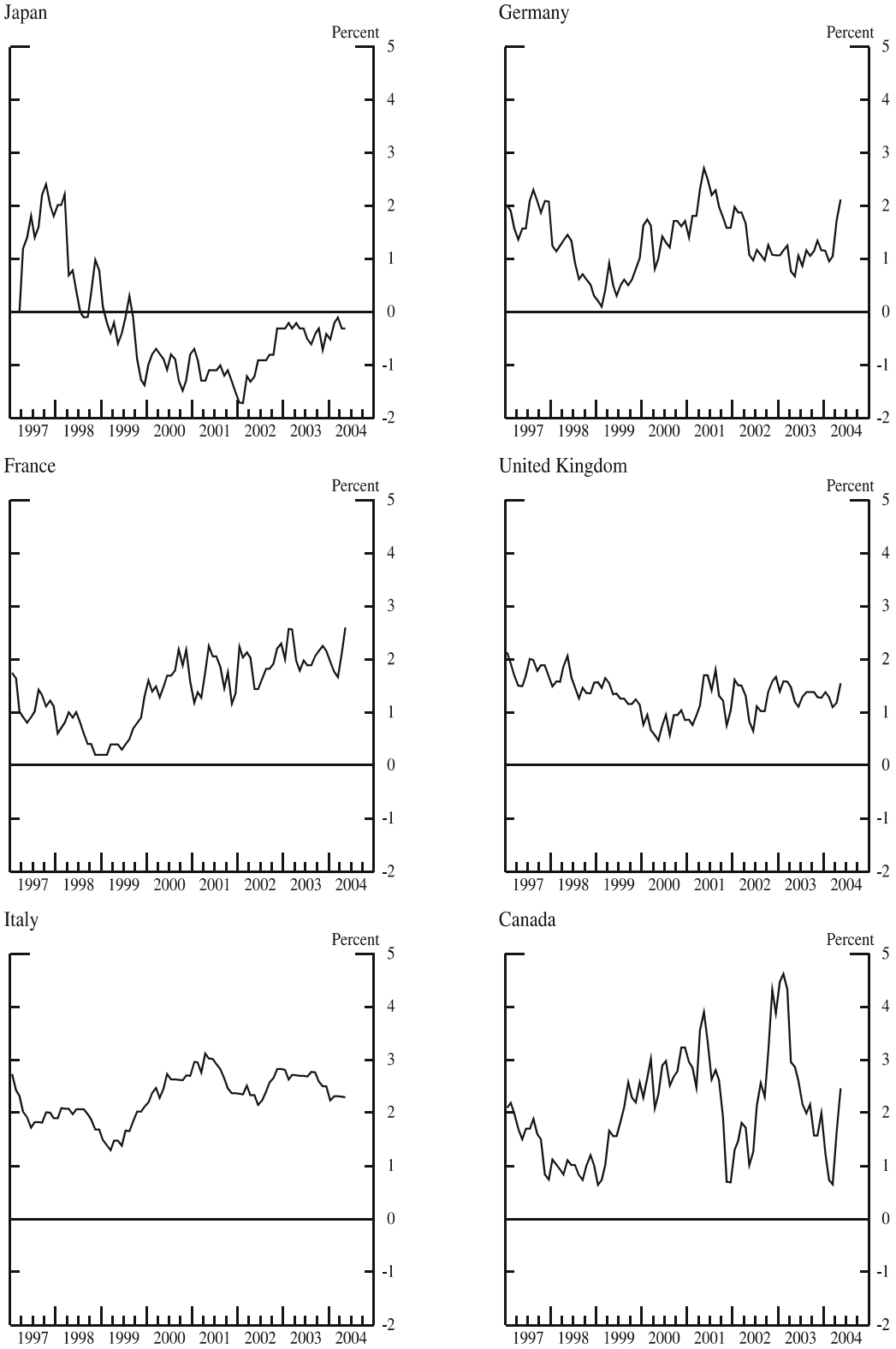
External Balances
(Billions of U.S. dollars, s.a.a.r.)

Country and balance	2003	2004				
	Q4	Q1	Q2	Apr.	May	June
Japan						
Trade	114.1	120.4	116.6	109.6	137.1	103.1
Current account	157.8	184.1	n.a.	173.8	201.7	n.a.
Euro area						
Trade[1]	102.0	95.7	n.a.	100.1	104.8	n.a.
Current account[1]	88.4	n.a.	n.a.	n.a.	n.a.	n.a.
Germany						
Trade	160.2	196.2	n.a.	208.8	219.2	n.a.
Current account[1]	90.0	105.6	n.a.	140.1	126.1	n.a.
France						
Trade	.8	1.7	n.a.	-.7	-.6	n.a.
Current account	-.3	.6	n.a.	.4	-1.6	n.a.
Italy						
Trade	5.3	-0.3	n.a.	7.2	5.7	n.a.
Current account[1]	-16.5	-20.7	n.a.	-27.5	-18.6	n.a.
United Kingdom						
Trade	-88.5	-103.0	n.a.	-99.4	-99.0	n.a.
Current Account	-36.4	-39.1	n.a.	...	...	...
Canada						
Trade	42.8	50.9	n.a.	62.8	45.4	n.a.
Current Account	20.2	28.8	n.a.	...	...	...

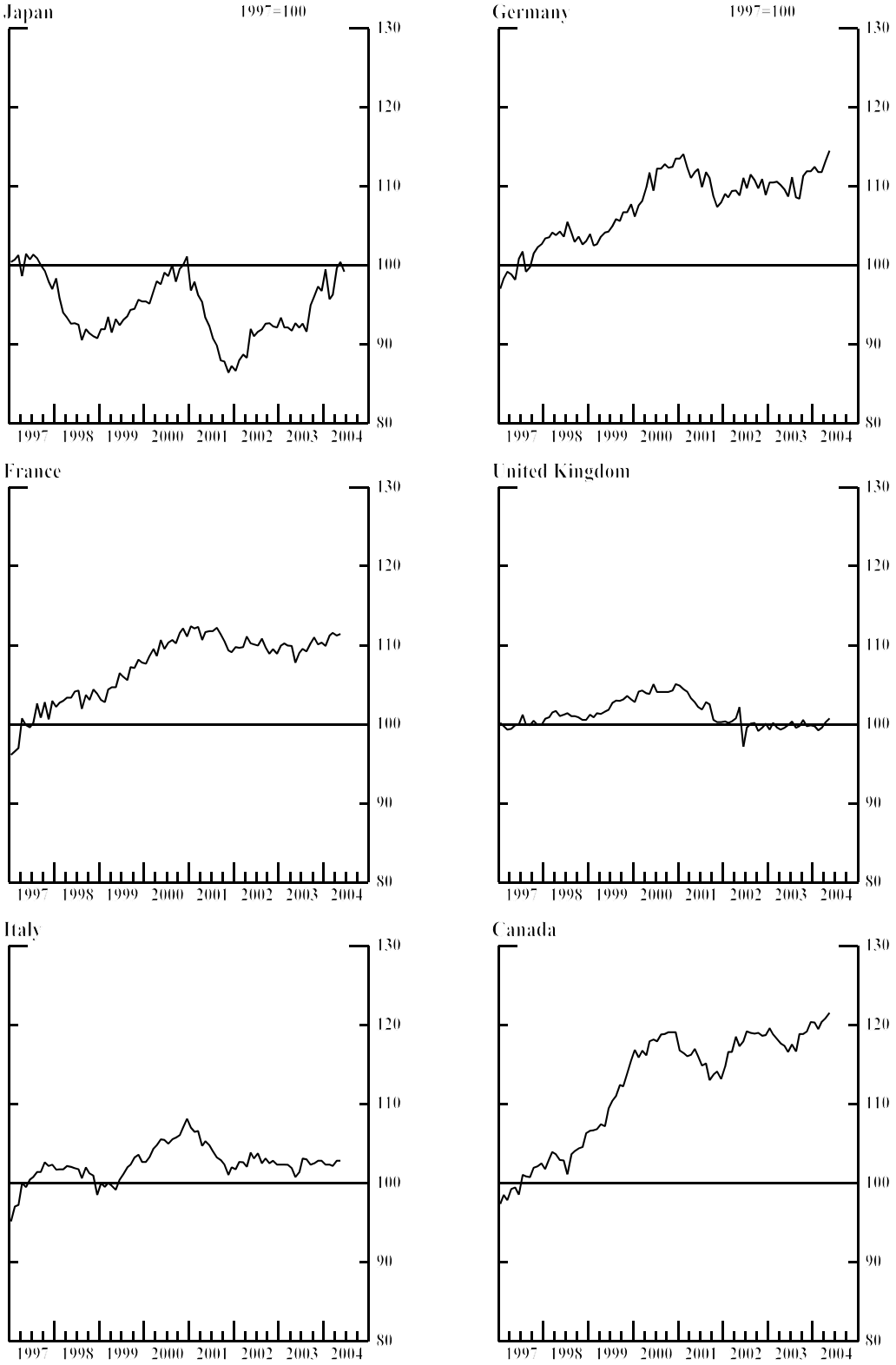
1. Not seasonally adjusted.
n.a. Not available. ... Not applicable.

Consumer Price Inflation in Selected Industrial Countries

(12-month change)



Industrial Production in Selected Industrial Countries



Economic Situation in Other Countries

In emerging Asia, buoyant external demand has continued to support robust economic performance, although Chinese growth has slowed significantly following policy measures taken to temper the pace of investment. Economic activity in Latin America has remained fairly strong, boosted by manufacturing exports to the United States, particularly in Mexico, and by a pickup in domestic demand in Brazil and Argentina. Increases in energy and food prices have contributed to a further rise in inflation across the developing world, but inflation rates are still moderate.

Real GDP growth in **China** slowed to just under 3 percent in the second quarter, considerably lower than the double-digit pace maintained since the end of the SARS epidemic last year. Chinese authorities' efforts to slow investment appear to have been effective; after soaring in the first quarter, investment was roughly flat in the second quarter. Money and loan growth have also been checked. Indicators of personal consumption, however, show a pickup; growth of retail sales is now hovering around 15 percent on a twelve-month basis. Exports and imports so far have been surprisingly unaffected by the investment slowdown, with twelve-month growth rates approaching 50 percent in recent months.

Inflation has moved up recently, with consumer prices rising 5 percent over the twelve months ending in June. However, excluding food prices, consumer prices have been nearly flat. There are also signs that recent increases in raw material and producer prices have flattened out.

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

Indicator	2002	2003	2004				
			Q1	Q2	Apr.	May	June
Real GDP[1]	8.3	10.0	14.4	2.8	...	...	...
Industrial production[2]	14.2	18.5	14.8	17.8	19.5	17.6	16.4
Consumer prices[2]	-.4	3.2	2.8	4.4	3.8	4.4	5.0
Trade balance[3]	30.4	25.5	1.2	13.0	-12.4	32.3	19.2

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, except annual figures, which are Dec./Dec.
3. Billions of U.S. dollars, annual rate. Imports are c.i.f.
... Not applicable.

The **Hong Kong** economy continued to benefit from its links to China. Chinese tourists have provided an enormous boost to retail sales and consumer confidence, and trade volumes remain near record highs. The unemployment rate fell further in June to its lowest level in more than two years. Consumer prices inched up in June, bringing the twelve-month rate of change to just less than zero, suggesting that deflationary pressures are finally abating.

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

Indicator	2002	2003	2004				
			Q1	Q2	Apr.	May	June
Real GDP[1]	4.7	4.8	4.1	n.a.	...	...	...
Unemployment rate[2]	7.2	7.9	7.2	6.9	7.1	7.0	6.9
Consumer prices[3]	-1.6	-1.8	-1.9	-.9	-1.6	-.9	-.1
Trade balance[4]	-7.7	-8.5	-13.0	-15.9	-19.2	-15.8	-12.7

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

Taiwan's economy was supported by further growth in global high-tech demand in the second quarter. Indicators of production of high-tech goods continued to move upward, and orders for these goods reached record levels in recent months. Imports of electronic components and higher oil prices pushed the trade balance into deficit in June, but for the second quarter as a whole the trade surplus increased slightly, propelled by high-tech exports. Driven primarily by the recent rise in energy prices, consumer price inflation has stepped up but remains relatively low.

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

Indicator	2002	2003	2004				
			Q1	Q2	May	June	July
Real GDP[1]	4.3	5.1	7.3	n.a.	...	...	...
Unemployment rate[2]	5.2	5.0	4.6	4.6	4.5	4.6	n.a.
Industrial production	7.9	7.1	1.0	2.4	3.6	-.3	n.a.
Consumer prices[3]	.8	-.1	.5	1.2	.9	1.8	3.3
Trade balance[4]	18.1	16.9	9.6	10.5	12.2	-.5	n.a.
Current account[5]	25.6	29.2	23.3	n.a.	...	...	...

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

Incoming data for **Korea** were mixed. Indicators for domestic demand suggested an improvement in sales, but consumer and business confidence remained weak. Industrial production fell in June as manufacturers of computer chips scaled back output after a surge earlier in the quarter. The unemployment rate has edged up to 3½ percent in recent months. Inflation has also picked up, reflecting higher prices of oil and other commodities. The trade and current account surpluses moved lower in June but remained at high levels. The Korean parliament approved a stimulus package of more than $1½ billion in July, in part directed toward increasing funding for small and medium-sized firms.

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

Indicator	2002	2003	2004				
			Q1	Q2	May	June	July
Real GDP[1]	7.7	4.1	3.2	n.a.	...	...	...
Industrial production	8.3	5.0	3.8	1.2	1.9	-2.0	n.a.
Unemployment rate[2]	3.1	3.4	3.3	3.5	3.5	3.5	n.a.
Consumer prices[3]	3.8	3.4	3.3	3.4	3.3	3.6	4.4
Trade balance[4]	14.8	22.2	40.1	33.2	32.9	28.4	n.a.
Current account[5]	5.4	12.3	24.6	28.3	44.5	26.7	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.

Incoming data from the **ASEAN** countries suggest continuing strength of economic activity, fueled largely by external demand. According to the advance GDP release, Singapore's economy is estimated to have grown 9 percent at an annual rate in the second quarter, following three quarters of double-digit growth. For industrial production, the monthly pattern has been volatile, but average output levels available so far during the second quarter are significantly above their first-quarter averages, with the exception of Thailand. Indications are that ASEAN exports continued to rise in the second quarter but, in some cases, such as Thailand which is one of the more oil-dependent economies in the region, imports also have been increasing rapidly. Inflation has continued to increase in the region but generally remains moderate. A substantial part of the acceleration in consumer prices is accounted for by rising food prices, but other categories such as transport and communications, utilities, and services have also contributed.

Indonesia's first-ever elections to directly elect a president were held in early July and did not result in a clear-cut majority for any candidate. As a result, there will be a runoff in September. With the first round of the elections concluded without violence, Indonesian financial markets have rebounded considerably from their earlier weakness.

ASEAN Economic Indicators: Growth

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

Indicator and country	2002	2003	2004				
			Q1	Q2	Apr.	May	June
Real GDP[1]							
Indonesia	5.2	4.3	7.1	n.a.	...	...	...
Malaysia	5.6	6.6	3.3	n.a.	...	...	...
Philippines	5.5	4.8	8.9	n.a.	...	...	...
Singapore	2.8	4.9	11.2	9.1	...	...	...
Thailand	6.0	7.8	3.4	n.a.	...	...	...
Industrial production[2]							
Indonesia[3]	-1.1	-1.1	3.8	n.a.	n.a.	n.a.	n.a.
Malaysia	4.6	9.3	3.6	n.a.	2.2	2.5	n.a.
Philippines	-6.1	.0	4.5	n.a.	14.5	-2.5	n.a.
Singapore	8.4	3.0	3.3	5.2	19.9	-.6	-3.4
Thailand	8.5	12.3	3.8	-.3	1.6	-1.4	1.4

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	2002	2003	2004				
			Q1	Q2	Apr.	May	June
Indonesia	25.9	28.5	20.7	23.1	20.3	28.6	20.2
Malaysia	14.3	21.4	21.5	20.2	23.0	22.8	14.9
Philippines	-.2	-1.5	-1.7	n.a.	-.8	2.4	n.a.
Singapore	8.7	16.2	14.1	14.6	7.1	9.4	27.2
Thailand	2.7	4.2	2.5	-1.0	.5	-3.8	.4

n.a. Not available.

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

Country	2002[1]	2003[1]	2004				
			Q1	Q2	May	June	July
Indonesia	9.9	5.2	4.8	6.4	6.5	6.8	7.2
Malaysia	1.7	1.2	.9	1.2	1.2	1.3	n.a.
Philippines	2.6	3.0	3.5	4.5	4.5	5.1	6.0
Singapore	.4	.8	1.4	1.8	2.0	2.3	n.a.
Thailand	1.6	1.8	1.9	2.6	2.4	3.0	3.1

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

In **Mexico,** recent economic indicators have been generally consistent with a continuation of robust economic growth led by manufacturing exports to the United States. Industrial production declined in May following two very strong months, but the April-May average stood more than 1½ percent above the first-quarter average. Exports rose at a quarterly rate of about 5½ percent in the second quarter, the fastest pace in more than four years, reflecting increases in both oil and non-oil exports. Second-quarter imports were up nearly 6 percent; imports of both consumer goods and capital goods accelerated, suggesting a pickup in Mexican domestic demand. Consistent with that, retail sales rose more than ½ percent in May, with the April-May average up 1¼ percent from the first quarter.

The Bank of Mexico (BOM) tightened monetary policy on July 23, raising the "corto" (the daily amount that it shorts the interbank market) to 41 million pesos from 37 million pesos; one-month interest rates rose 45 basis points following the move. The central bank cited rising inflation expectations and a recent increase in core inflation (to above 3½ percent) as reasons for the policy tightening. In addition, in recent months, headline inflation has been running a bit above the upper end of the BOM's 2-4 percent target range. The BOM has noted that the rise in inflation comes against the background of a rebound in Mexican consumer and investment spending.

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

Indicator	2002	2003	2004				
			Q1	Q2	Apr.	May	June
Real GDP[1]	1.9	2.0	5.4	n.a.	...	...	...
Overall economic activity	.7	1.4	.2	n.a.	.7	-.5	n.a.
Industrial production	-.3	-.7	1.1	n.a.	1.5	-1.2	n.a.
Unemployment rate[2]	2.7	3.3	3.7	3.7	3.7	3.7	3.7
Consumer prices[3]	5.7	4.0	4.3	4.3	4.2	4.3	4.4
Trade balance[4]	-7.9	-5.6	-5.2	-6.1	-6.1	-3.9	-8.4
Imports[4]	168.7	170.5	183.4	194.3	189.7	196.6	196.6
Exports[4]	160.8	164.9	178.2	188.2	183.6	192.7	188.2
Current account[5]	-14.0	-9.2	-7.5	n.a.	...	...	...

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

In **Brazil**, data releases pointed to continued expansion in economic activity over the second quarter. Average industrial production in April and May was nearly 2½ percent above its first-quarter average. The unemployment rate declined to about 11½ percent in June. Although growth continued to be fueled largely by net exports, there has been increasing evidence of a recovery in domestic demand. The twelve-month increase in consumer prices was more than 6 percent in June, above the 5½ percent mid-point of the inflation target for this year. In part, the most recent rise in inflation reflects hikes in domestic prices of energy and other government-regulated prices. This has resulted in an increase in one-year ahead expectations of inflation, but longer-term expectations have moved up only a little. Despite very high real interest rates, concerns about inflation prompted the central bank to maintain its policy rate at 16 percent in its late July meeting; the rate has been at this level since April.

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

Indicator	2002	2003	2004				
			Q1	Q2	May	June	July
Real GDP[1]	3.8	-.1	6.8	n.a.	...	...	...
Industrial production	2.7	-.1	-.5	n.a.	2.2	n.a.	n.a.
Unemployment rate[2]	12.5	12.4	11.6	11.7	11.6	11.4	n.a.
Consumer prices[3]	12.5	9.3	6.8	5.5	5.2	6.1	n.a.
Trade balance[4]	13.1	24.8	29.3	33.0	32.7	40.0	40.8
Current account[5]	-7.6	4.1	6.7	11.2	17.7	24.7	n.a.

1. Annual rate. Annual figures are Q4/Q4.
2. Percent. Break in October 2001 as a result of change in methodology.
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**, recent data releases suggest that the economic recovery has continued, albeit at a more moderate pace. Industrial production fell sharply in April from a very high level in March, but picked up again in May. Recent performance suggests that the economy has not yet been severely affected by structural problems in the country's energy sector. Twelve-month consumer price inflation increased in recent months, to about 5 percent. Argentina has continued to run sizable trade surpluses.

Although Argentina has met all the quantitative targets outlined in its IMF program by comfortable margins, performance has lagged in other areas, such as debt restructuring, reform of federal-provincial fiscal relations, and bank compensation. Given Argentina's lack of progress in these key areas, the IMF mission that visited Buenos Aires in June has not yet recommended approval of the third review under the current program. It is likely that Argentina will ask for waivers for these incomplete reforms, and the negotiation process with the IMF could prove to be protracted.

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

Indicator	2002	2003	2004				
			Q1	Q2	May	June	July
Real GDP[1]	-3.3	12.1	6.8	n.a.	...	...	...
Industrial production	-10.7	16.2	5.6	n.a.	1.7	n.a.	n.a.
Unemployment rate[2]	22.5	17.3	14.4	n.a.	...	...	...
Consumer prices[3]	41.4	3.8	2.5	4.0	4.2	4.9	4.9
Trade balance[4]	16.7	15.7	10.6	15.4	15.8	8.5	n.a.
Current account[5]	9.1	7.8	1.5	n.a.	...	...	...

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

In **Venezuela**, the upcoming August 15 referendum on whether President Chavez should be recalled remains on center stage. Polls indicate that Chavez's popularity has risen in recent months; analysts attribute this result to a fiscal expansion financed by the oil boom. Monthly inflation declined to about 1 percent in July, bringing the twelve-month change to nearly 22 percent. Oil production is still believed to be about 15 percent below the level prevailing before a disruptive national strike in late 2002.

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

Indicator	2002	2003	2004				
			Q1	Q2	May	June	July
Real GDP[1]	-16.7	8.6	7.9	n.a.	...	...	...
Unemployment rate[2]	16.0	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Consumer prices[3]	31.2	27.1	24.0	22.4	21.8	22.4	21.8
Non-oil trade balance[4]	-8.5	-5.8	n.a.	n.a.	n.a.	n.a.	n.a.
Trade balance[4]	13.0	15.0	n.a.	n.a.	n.a.	n.a.	n.a.
Current account[5]	7.4	9.6	13.8	n.a.	...	...	...

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

In **Russia**, real GDP increased at a robust pace of more than 6½ percent in the first quarter. More recent indicators of production have also been strong. Consumer price inflation decreased slightly to about 10 percent in the second quarter. The recent liquidity problems of Russian banks appear to have subsided with the passage of a supplementary deposit insurance arrangement. However, the tax-evasion dispute between the Kremlin and Yukos, a major oil company, has intensified, roiling world oil markets. The authorities have seized key production facilities of Yukos, and the trials of two major shareholders have begun.

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

Indicator	2002	2003	2004				
			Q1	Q2	Apr.	May	June
Real GDP[1]	5.9	7.5	6.6	n.a.	...	...	...
Industrial Production	3.8	6.7	2.8	2.2	1.0	-.2	3.5
Unemployment Rate[2]	8.0	8.5	7.6	8.3	8.3	8.4	8.3
Consumer Prices[3]	15.3	12.1	10.7	10.1	10.1	10.0	10.1
Trade Balance[4]	46.3	60.5	72.6	n.a.	87.7	73.3	n.a.
Current Account[4]	28.9	36.0	49.9	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.

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