

Prefatory Note

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Part 2

September 15, 2004

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

September 15, 2004

Recent Developments

Domestic Nonfinancial Developments

Domestic Nonfinancial Developments

Overview

The economic expansion appears to have regained some vigor after having slowed in late spring. The August labor market report showed a small upturn in hiring, and other indicators suggest a pickup in the pace of production and sales over the past couple of months. Consumer spending rose sharply in July and appears to have held steady in August, and housing starts bounced back in July after having dipped in June. Orders and shipments of capital goods remained on a solid uptrend through July despite some softening in demand for high-tech equipment. Core price inflation moderated in June and July, and overall inflation in July was further damped by a decline in energy prices.

Labor Market Developments

The labor market continued to improve in August, with private payrolls rising 120,000 and the unemployment rate ticking down to 5.4 percent—nearly 1 percentage point below its recent peak in June 2003. In addition, the payroll figures for June and July were revised up, and as a result the deceleration in hiring no longer seems as abrupt as it appeared a month ago. Still, private employers have added only 97,000 jobs per month on average over the past three months, a pace well below the 293,000 jobs per month over the three months ending in May. In addition, survey evidence and the low level of the labor force participation rate both suggest that households remain concerned about a lack of employment opportunities.

Manufacturing employment rose again in August, as producers of durable goods continued to post gains. Employment also increased last month in construction, financial activities, and both business and nonbusiness services. However, payrolls in the retail trade and information sectors fell again last month; job losses in these industries in July and August largely reversed the gains of the second quarter.

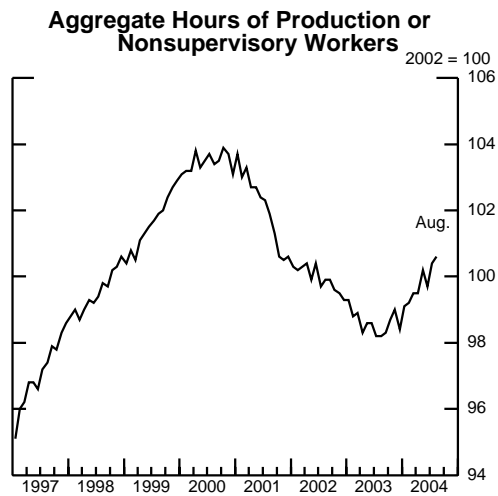
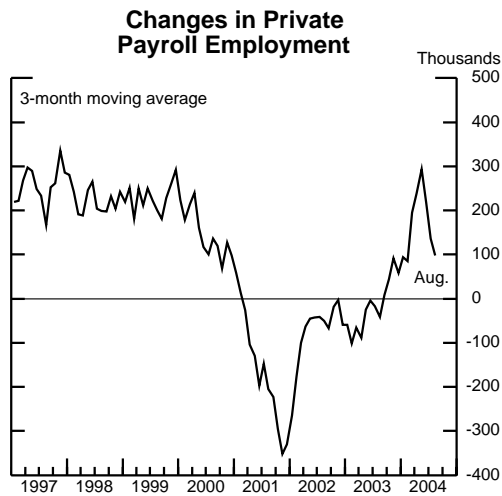
The average workweek of production or nonsupervisory workers was 33.8 hours in August, unchanged from the upward-revised July level and a touch higher than the average workweek in the second quarter. Consequently, even with the relatively modest payroll gains in recent months, the level of aggregate hours of production or nonsupervisory workers in August stood 0.8 percent above the second-quarter average (not at an annual rate).

In addition to the unemployment rate, a number of other indicators suggest that significant slack remains in the labor market. The employment-population ratio, which combines the unemployment rate and the participation rate, is up only a little from its relatively low level in mid-2003. In addition, the number of persons working part-time for economic reasons as a share of total employment has remained elevated.

Changes in Employment
(Thousands of employees; seasonally adjusted)

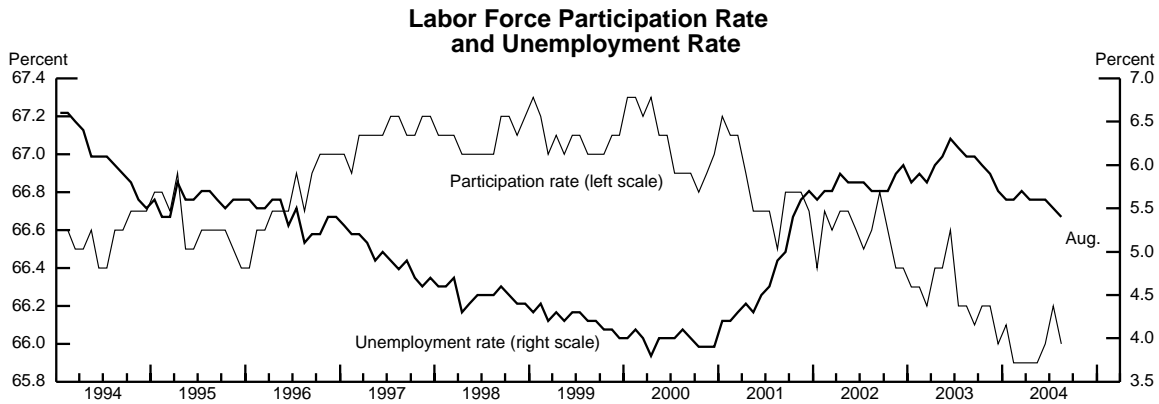
Measure and sector	2003	2004				
		Q1	Q2	June	July	Aug.
	Average monthly change			Monthly change		
Nonfarm payroll employment (establishment survey)	-5	198	209	96	73	144
Private	-1	195	218	112	60	120
Previous	-1	195	211	93	32	...
Manufacturing	-48	7	16	-3	6	22
Construction	7	26	19	2	4	15
Wholesale trade	-3	8	5	3	10	3
Retail trade	-5	46	14	7	-14	-11
Transportation and utilities	-5	14	8	10	6	-3
Information	-10	-2	4	5	-6	-10
Financial activities	6	7	15	20	-10	18
Professional and business services	23	26	73	25	47	32
Temporary help services	15	8	23	-2	5	10
Nonbusiness services ¹	34	59	60	45	12	56
Total government	-4	3	-8	-16	13	24
Total employment (household survey)	168	-60	244	259	629	21
Memo:						
Aggregate hours of private production workers (percent change) ²	-8	2.3	2.2	-5	.7	.2
Average workweek (hours) ³	33.7	33.8	33.7	33.6	33.8	33.8
Manufacturing (hours)	40.4	41.0	40.9	40.8	40.9	40.9

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

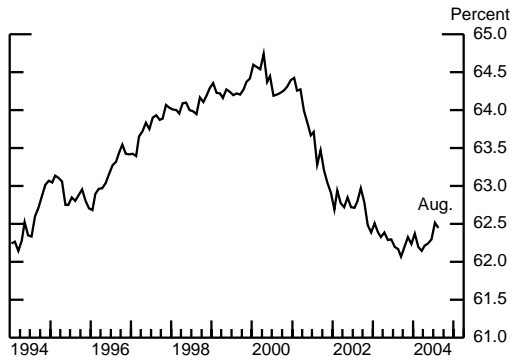


Selected Unemployment and Labor Force Participation Rates
(Percent; seasonally adjusted)

Rate and group	2003	2004				
		Q1	Q2	June	July	Aug.
<i>Civilian unemployment rate</i>						
16 years and older	6.0	5.6	5.6	5.6	5.5	5.4
Teenagers	17.4	16.6	17.0	16.8	17.6	17.0
20-24 years old	10.0	9.6	9.5	9.8	9.3	9.0
Men, 25 years and older	5.1	4.5	4.5	4.4	4.4	4.4
Women, 25 years and older	4.6	4.5	4.4	4.5	4.5	4.3
<i>Labor force participation rate</i>						
Total	66.2	66.0	65.9	66.0	66.2	66.0
Teenagers	44.5	43.6	43.6	43.3	44.1	44.1
20-24 years old	75.4	74.7	75.1	75.1	75.2	74.9
Men, 25 years and older	75.5	75.4	75.2	75.3	75.4	75.4
Women, 25 years and older	59.6	59.2	59.3	59.4	59.5	59.2



Employment-Population Ratio

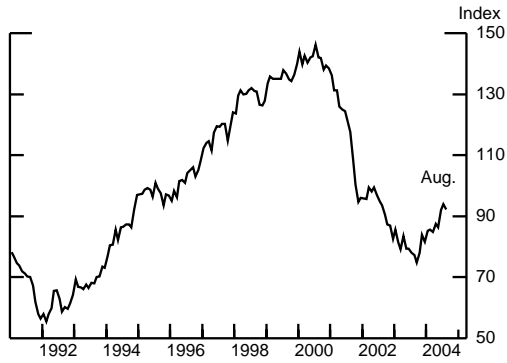


Persons Working Part-Time for Economic Reasons
(Percent of household employment)



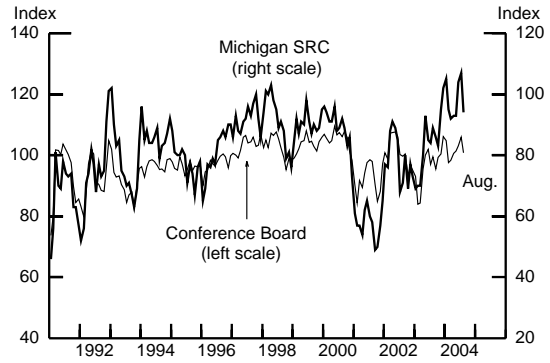
Labor Market Indicators

Current Labor Market Conditions



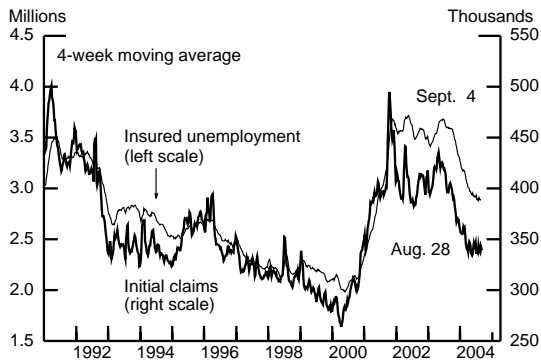
Note. The proportion of households believing jobs are plentiful, minus the proportion believing jobs are hard to get, plus 100.
Source. Conference Board.

Expected Labor Market Conditions

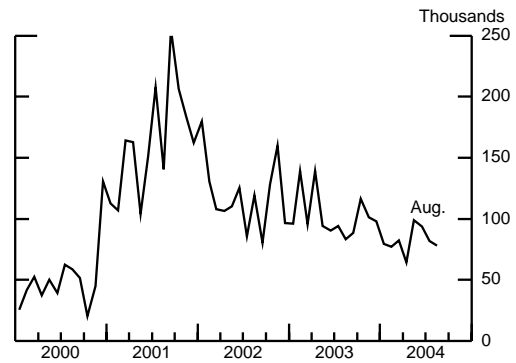


Note. The proportion of households expecting labor market conditions to improve, minus the proportion expecting conditions to worsen, plus 100.

Unemployment Insurance

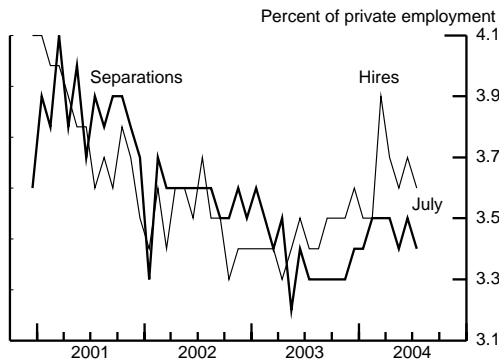


Layoff Announcements



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

Hires and Separations



Source. Job Openings and Labor Turnover Survey.

Job Openings and Help Wanted Index



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

Survey evidence suggests that households perceive that the labor market remains soft. According to the Conference Board, households' appraisals of current employment conditions have recovered a little from the low levels of last year but still are only at the levels that prevailed in 1994 and 1995. However, households have become more optimistic that labor market conditions will improve over the next twelve months, according to both the Michigan and Conference Board surveys.

Meanwhile, layoffs have continued to run substantially below their cyclical peaks, but the pickup in hiring is still modest. The four-week moving average of initial claims for unemployment insurance has changed little, on net, in the past several months, and layoff announcements have fluctuated within a narrow range well below their highs of a few years ago.¹ Similarly, the Job Openings and Labor Turnover Survey (JOLTS) shows that the separations rate has stayed at a low level since falling sharply in 2001. However, since the spring, the JOLTS hiring rate has been only a little above its average of the past two years. In addition, the JOLTS job openings rate has come up from the lows of 2003 but remains well below the levels of 2001. On a more positive note, both the Manpower survey and the National Federation of Independent Businesses survey of small businesses indicate a net improvement in hiring plans over the past year (not shown).

The Bureau of Labor Statistics reported that output per hour in the nonfarm business sector increased at an annual rate of 2-1/2 percent in the second quarter and has risen 4-1/2 percent over the past year; based on more-recent data, we expect productivity growth in the second quarter to be revised up to an annual rate of 3 percent.² The BLS estimates that output per hour in the nonfinancial corporate sector rose at an annual rate of 1-1/2 percent in the second quarter and 4 percent over the past year.

1. For the week ending September 4, the four-week moving average of initial claims was 339,000. Recent volatility in initial claims is due in part to the effects of Hurricane Charley and the difficulty in seasonally adjusting the initial claims series at the end of summer and the start of the school year.

2. The staff estimates that upward revisions to business inventory investment and net exports will raise the growth of output in the nonfarm business sector in the second quarter to an annual rate of approximately 4 percent, compared with an increase of 3-1/2 percent in the most recent BLS release.

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

Component	Proportion 2003 (percent)	2003 ¹	2004		2004		
			Q1	Q2	June	July	Aug.
			Annual rate		Monthly rate		
Total	100.0	1.5	6.6	4.8	-4	.6	.1
Previous	100.0	1.5	6.6	4.9	-5	.4	...
Manufacturing	82.3	1.9	6.3	7.1	-2	.9	.5
Ex. motor veh. and parts	75.6	1.7	6.0	8.9	.0	1.0	.2
Ex. high-tech industries	70.7	.3	4.6	7.8	-1	.9	.1
Mining	7.6	.4	-1.8	-2.5	-9	1.3	-1.1
Utilities	10.1	-6	15.6	-7.6	-1.8	-2.0	-2.4
<i>Selected industries</i>							
High technology	4.9	21.3	27.3	24.4	1.4	1.4	1.8
Computers	1.2	14.1	28.1	17.4	1.1	2.0	1.9
Communications equipment	1.3	5.8	1.2	1.7	1.7	3.2	1.3
Semiconductors ²	2.4	34.3	41.4	39.6	1.5	.3	1.9
Motor vehicles and parts	6.7	3.8	9.9	-10.4	-2.0	-1	3.8
<i>Market groups excluding energy and selected industries</i>							
Consumer goods	22.6	.2	3.6	6.6	-8	.5	.1
Durables	4.3	1.1	6.9	-1	-1.2	.7	-4
Nondurables	18.3	.0	2.8	8.3	-7	.5	.2
Business equipment	7.3	1.0	12.1	13.3	.5	3.0	-1.8
Defense and space equipment	1.9	4.8	-7	10.3	-2	2.2	.1
Construction supplies	4.2	1.1	2.3	8.2	-2	.4	.4
Business supplies	8.5	.2	5.6	9.9	.0	.7	.6
Materials	24.8	-3	4.0	6.3	.2	.7	.5
Durables	13.6	-1	5.2	6.6	.5	.8	.1
Nondurables	11.2	-5	2.4	6.1	-1	.6	1.0

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- 1991 low	2003	2004			
				Q4	Q1	Q2	July	Aug.
				Total industry	81.1	70.9	78.6	75.5	76.5	77.1	77.3	77.3
Manufacturing	80.0	68.7	77.2	74.1	75.1	76.1	76.6	76.8
High-tech industries	78.8	75.4	74.5	67.0	69.1	69.7	69.4	69.3
Excluding high-tech industries	80.1	68.2	77.3	75.2	76.1	77.2	77.8	78.2
Mining	86.9	78.6	83.4	85.3	84.9	84.3	84.8	83.9
Utilities	86.9	77.6	84.1	83.1	85.5	83.5	81.5	79.5

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	3.3	3.5	5.6	9.0	3.1	3.7	2.5
All employees ¹	3.4	3.7	6.1	10.0	3.3	2.9	1.9
Nonfinancial corporations ²	2.0	5.1	6.6	9.4	5.0	.2	1.4

Note. 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.

Industrial Production

Total industrial output has increased moderately so far in the third quarter after a drop in June.³ In August, industrial production was 5.2 percent above its year-earlier level and a bit above the cyclical peak reached in 2000. Within total IP, manufacturing output rose 0.9 percent in July and 0.5 percent in August.⁴ In contrast, the output of electric utilities declined significantly in each of these months for weather-related reasons.

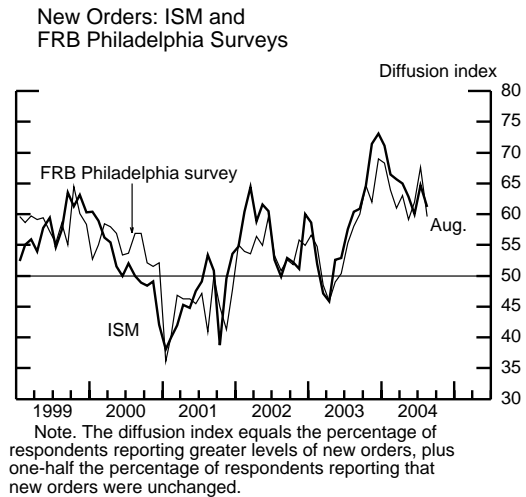
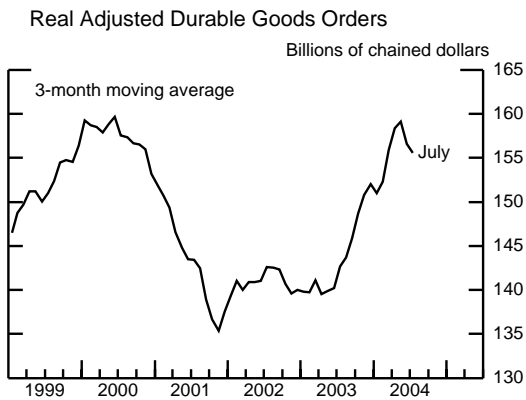
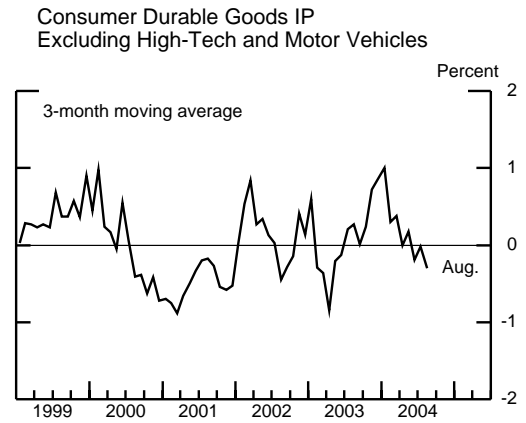
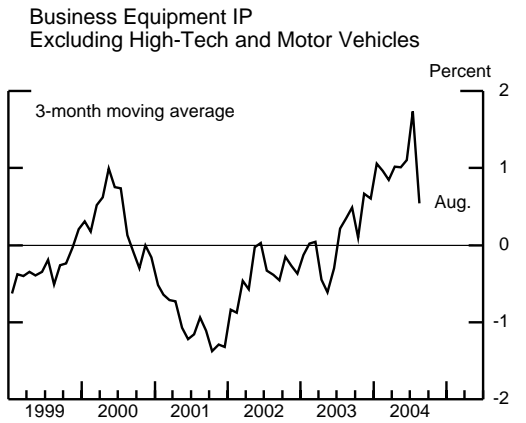
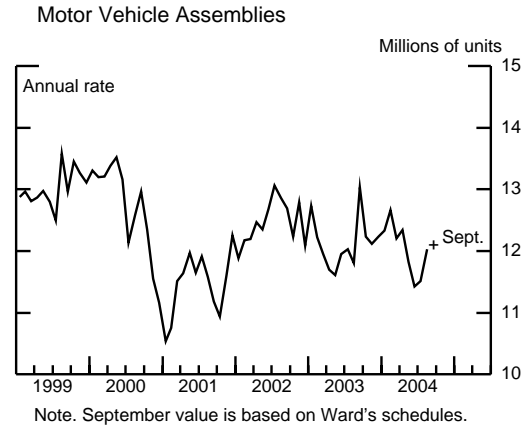
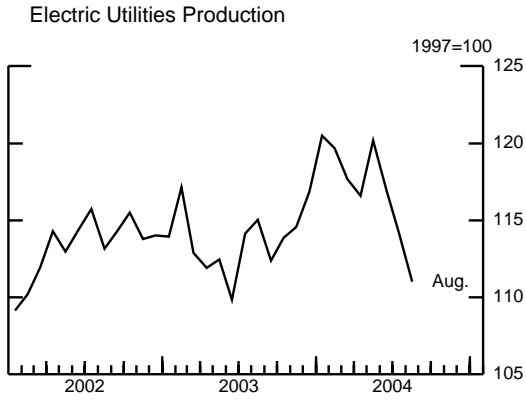
The increases in manufacturing production since the end of the second quarter have been widespread. The output of motor vehicles and parts jumped in August as assemblies rose from an annual rate of 11-1/2 million units in June and July to 12 million units in August. In the high-tech sector, computer production continued to expand in August—albeit less rapidly than earlier in the year—and the output of communications equipment posted its fourth consecutive monthly increase. However, production of semiconductor chips is now estimated to have risen only modestly in June and July, and the increase in August was well below the pace earlier in the year as bloated inventories at Intel likely took a toll on production.

Production in other market groups (that is, excluding high-tech and motor vehicles) has increased, on balance, in recent months. The output of business

3. Hurricane Charley did not have a measurable effect on total industrial production for August, and we do not see any significant evidence of effects at the industry level. Preliminary indications are that Hurricane Frances had little effect on industrial production for September.

4. Manufacturing output for July was originally estimated to have increased 0.6 percent.

Indicators of Manufacturing Activity



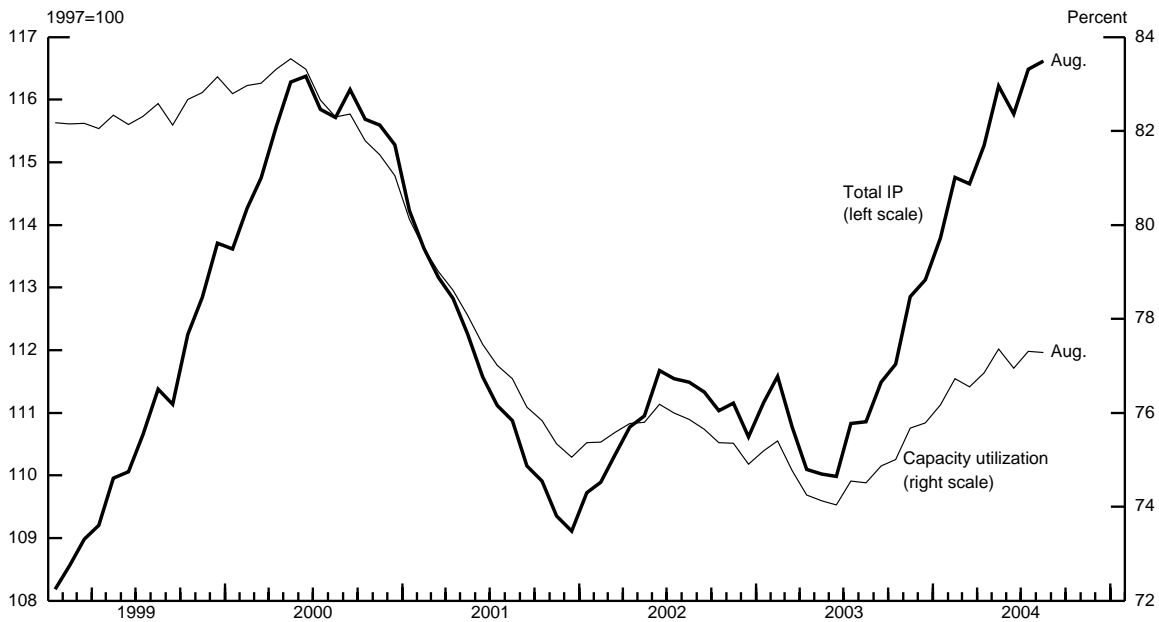
New Orders for Durable Goods

(Percent change from preceding period except as noted; seasonally adjusted)

Component	Proportion, 2004: H1 (percent)	2004		2004		
		Q1	Q2	May	June	July
		Annual Rate		Monthly Rate		
Total orders	100.0	8.8	8.6	-9	1.3	1.6
Adjusted orders ¹	75.6	13.4	8.2	-.6	.3	-.6
Computers	4.4	-14.8	36.9	.9	.2	-5.4
Communication equipment	3.4	48.3	13.5	-17.3	-7.0	6.2
Other capital goods	23.9	18.5	2.4	.0	3.3	1.2
Other ²	43.9	11.7	8.4	.5	-.7	-1.5
Memo:						
Real adjusted orders	...	10.7	1.8	-1.0	-.1	-.9
Excluding high tech	...	10.1	-1.1	-.6	.4	-.5

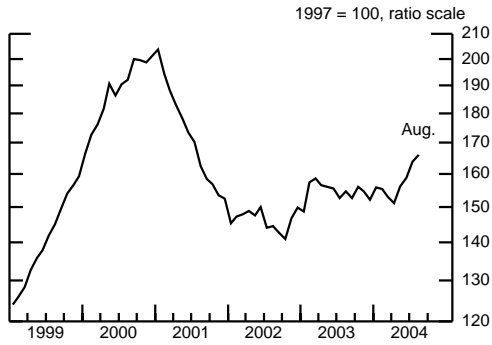
- 1. Orders excluding defense capital goods, nondefense aircraft, and motor vehicle parts.
- 2. Primary metals; most fabricated metals; most stone, clay, and glass products; household appliances; scientific instruments; and miscellaneous durable goods.
- ... Not applicable.

Total IP and Capacity Utilization

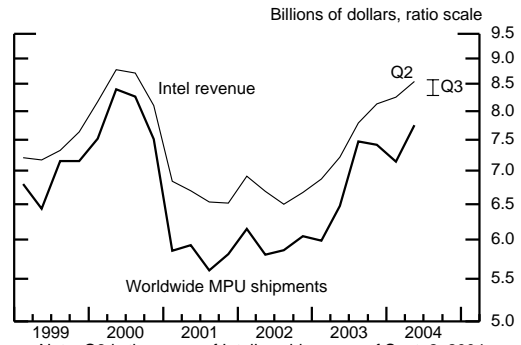


Indicators of High-Tech Manufacturing Activity

Communication Equipment Industrial Production

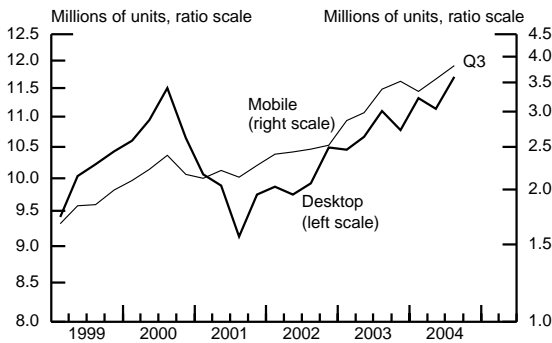


Microprocessor Unit (MPU) Shipments and Intel Revenue



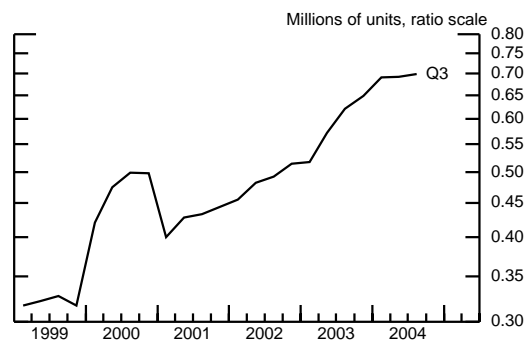
Note. Q3 is the range of Intel's guidance as of Sept. 2, 2004. FRB seasonals.
Source. Intel and Semiconductor Industry Association.

U.S. Personal Computer Sales



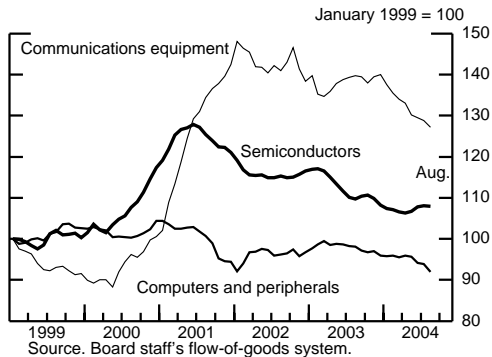
Note. FRB seasonals. Value for Q3 is a Gartner forecast.
Source. Gartner.

U.S. Server Shipments



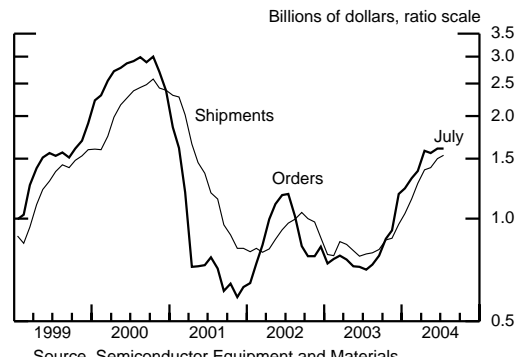
Note. FRB seasonals. Value for Q3 is a Gartner forecast.
Source. Gartner.

Days' Supply of Computers and Peripherals, Communications Equipment, and Semiconductors



Source. Board staff's flow-of-goods system.

Semiconductor Manufacturing Equipment Orders and Shipments



Source. Semiconductor Equipment and Materials International.

equipment, which had risen sharply over the first half of the year, surged in July; it fell back in August but was still appreciably above its second-quarter average. Elsewhere, the output of durable consumer goods has been soft in recent months, while the production of construction supplies, business supplies, and materials have all moved up, as is consistent with expanding production in downstream industries.

Despite the relatively steady rise in industrial production over the past year, the industrial sector as a whole continues to exhibit considerable slack. The overall capacity utilization rate, at 77.3 percent in August, is still 3.8 percentage points below its 1972–2003 average. But conditions vary considerably across the industrial sector. The rate of capacity utilization for industries in the finished goods stage of processing has come up from the record lows reached in mid-2003 but is still more than 4 percentage points below its long-run average. In contrast, the utilization rates among industries in the earlier stages of processing are closer to their long-run averages, and the rates in some significant crude and primary processing industries—iron ore mining, organic chemicals, pulp and paperboard, and petroleum refining—exceeded 90 percent last month and are well above historical averages. Outside the industrial sector, anecdotal information continues to indicate tight capacity for truck and rail shipping, which is not expected to abate in the near term.⁵

The near-term indicators of high-tech manufacturing activity suggest that conditions in this sector have softened somewhat. In particular, Intel sharply lowered the midpoint of its revenue guidance for the third quarter as a result of both a weaker outlook for demand and an inventory correction by its customers. Intel and others in the industry have suggested that the back-to-school season for personal computers (PCs) has been softer than anticipated; Intel has also indicated that the slackening in demand for its products is worldwide and concentrated in the consumer segment. Gartner, an IT research and analysis company, expects unit shipments of servers to be flat in the third quarter, and although it has revised down its forecast for third-quarter unit shipments of desktop and mobile PCs, it still expects a pickup relative to the second quarter.

The forward-looking indicators of manufacturing production and reports from the staff's industry contacts have generally been positive. Preliminary data suggest that electricity generation for early September was up significantly relative to the previous month, and motor vehicle assemblies apparently are holding close to the elevated August pace. The new orders diffusion index from the Institute for Supply Management (ISM), which is useful for forecasting near-term changes in industrial production, declined in August but remained

5. The manufacturing purchasing managers surveyed by the Institute for Supply Management have noted rising prices for freight transportation in every month since March.

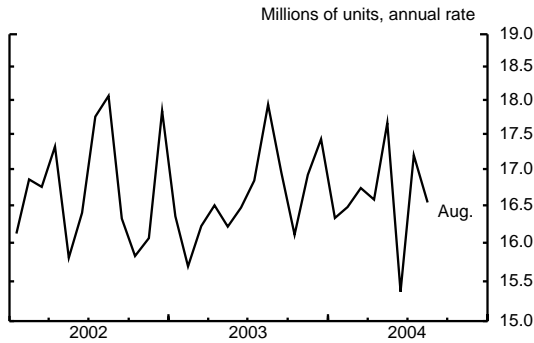
Sales of Light Vehicles
(Millions of units at an annual rate, FRB seasonals)

Category	2003	2003	2004		2004		
		Q4	Q1	Q2	June	July	Aug.
Total	16.6	16.8	16.5	16.5	15.4	17.2	16.5
Autos	7.6	7.5	7.4	7.5	7.0	7.5	7.2
Light trucks	9.0	9.3	9.1	9.1	8.3	9.7	9.4
North American ¹	13.3	13.6	13.3	13.1	12.1	13.9	13.3
Autos	5.5	5.5	5.4	5.3	5.0	5.5	5.2
Light trucks	7.8	8.1	7.8	7.9	7.1	8.4	8.2
Foreign-produced	3.3	3.2	3.3	3.4	3.3	3.3	3.2
Autos	2.1	2.1	2.0	2.2	2.1	2.0	2.0
Light trucks	1.2	1.2	1.2	1.2	1.2	1.3	1.2
Memo: Medium and heavy trucks	.33	.37	.40	.40	.40	.44	.44

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.

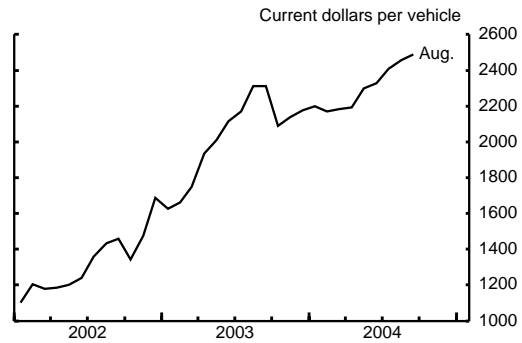
1. Excludes some vehicles produced in Canada that are classified as imports by the industry.

Sales of Light Vehicles



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

Average Value of Incentives on Light Vehicles

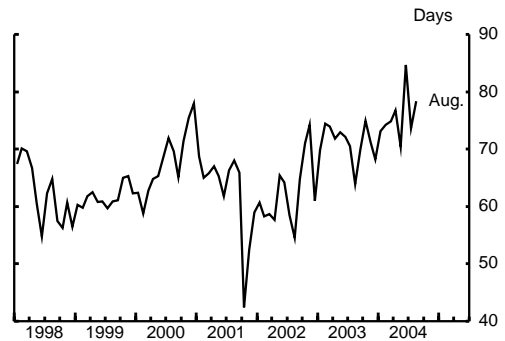


Note. Weighted average of customer cash rebate and interest rate reduction. Data are seasonally adjusted. Source: J.D. Power and Associates.

Michigan Survey Index of Car-Buying Attitudes



Days' Supply of Light Vehicles



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	July	Aug.	Sept. ¹
U.S. production	12.1	12.4	11.9	11.9	11.5	12.0	12.1
Autos	4.5	4.4	4.2	4.3	4.1	4.3	4.5
Trucks	7.6	8.0	7.7	7.6	7.4	7.7	7.6
Days' supply ²	73	75	78	n.a.	74	78	n.a.
Autos	63	63	63	n.a.	59	65	n.a.
Trucks	80	84	88	n.a.	83	87	n.a.
Inventories ³	3.17	3.26	3.33	n.a.	3.33	3.41	n.a.
Autos	1.13	1.11	1.09	n.a.	1.05	1.09	n.a.
Trucks	2.04	2.14	2.24	n.a.	2.28	2.32	n.a.

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

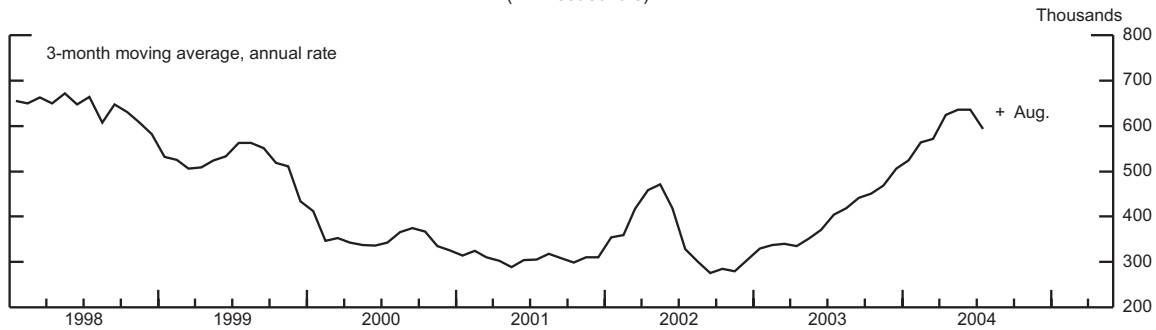
1. Production rates for the third quarter and September reflect the latest schedules from Ward's Communications.

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.

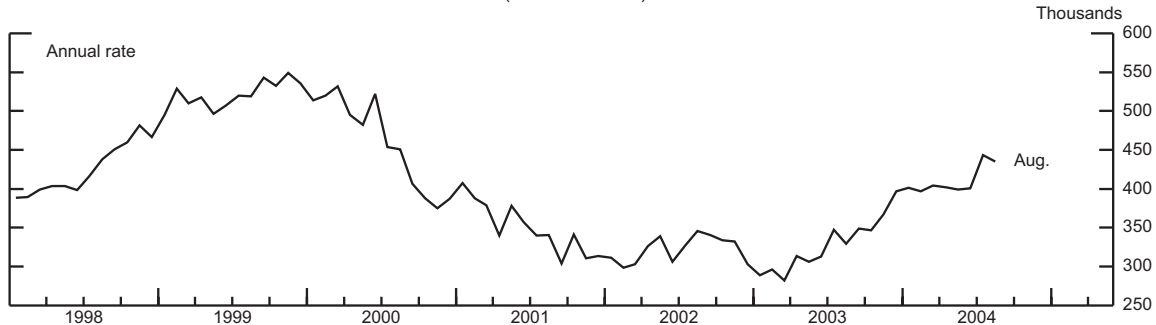
n.a. Not available

Medium and Heavy Truck Orders
(FRB seasonals)



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

Medium and Heavy Truck Sales
(FRB seasonals)



Retail and Food Services Sales

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

Category	2003	2004				
	H2	Q1	Q2	June	July	Aug.
Total sales	3.7	2.3	1.6	-.7	.8	-.3
Previous estimate	3.7	2.3	1.7	-.5	.7	...
Retail control ¹	4.0	2.7	1.4	.1	.5	.2
Previous estimate	4.0	2.7	1.4	.2	.4	...
GAF ²	3.9	2.7	.2	.0	.8	-.4
Gasoline stations	5.3	6.5	6.1	.3	-.4	.3
Food services	5.3	3.0	.8	.0	1.1	-.3
Other retailers ³	3.3	1.6	1.6	.3	.2	.9

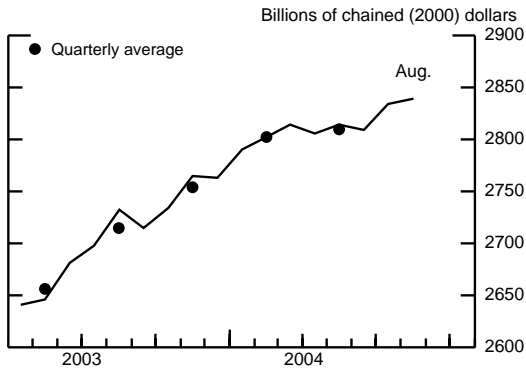
1. Total retail trade and food services less sales at building material and supply stores and automobile and other motor vehicle dealers.

2. Furniture and home furnishing stores; electronics and home appliance stores; clothing and accessories stores; sporting goods, hobby, book, and music stores; and general merchandise stores.

3. Health and personal care stores, food and beverage stores, electronic shopping and mail order houses, and miscellaneous other retailers.

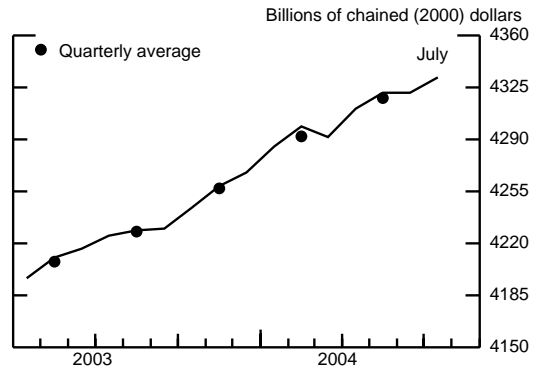
... Not applicable.

Real PCE Goods Excl. Motor Vehicles

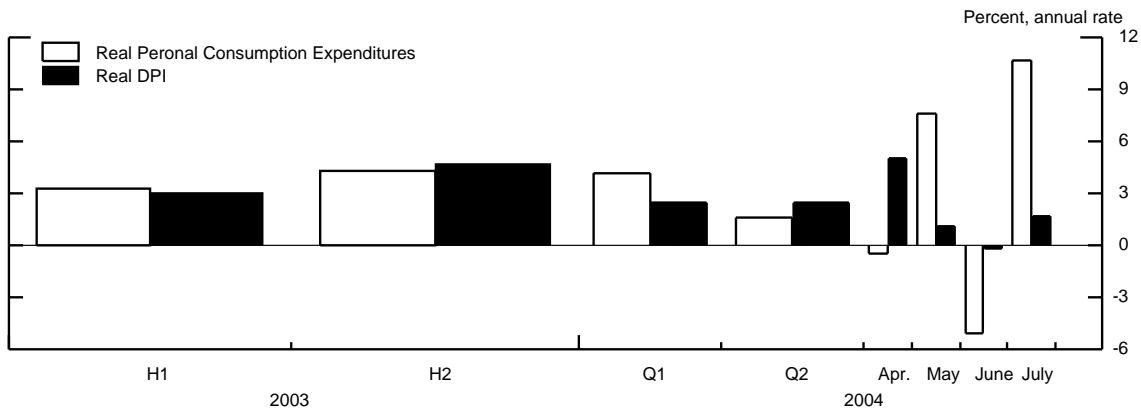


Note. August value is a staff estimate.

Real PCE Services



Change in Real Personal Consumption Expenditures and Real DPI



well above 50; more recently, the new orders diffusion index in the Empire State survey turned back up in September. And although the staff's series on real adjusted durable goods orders has slipped since the spring, it was still at a high level in July.

Motor Vehicles

Sales of light vehicles fell in August to an annual rate of 16.5 million units after having surged to 17.2 million units in July. Taken together, the average pace of sales in July and August was nearly 1/2 million units above that in the first half of the year, an increase likely reflecting some strengthening in demand as well as a further sweetening of incentives. The latest report from J.D. Power and Associates showed that the average incentive per vehicle was \$183 larger in August than in the second quarter. Industry contacts anticipate that sales in September will be at an annual rate of about 17 million units (confidential).

Business-sector demand for motor vehicles remains strong. Sales of medium and heavy trucks climbed in July and August to their highest levels in four years, and industry contacts expect sales of these vehicles to remain vigorous over the remainder of the year. Indeed, orders for medium and heavy trucks have been at an annual rate of about 600,000 units since the spring, nearly 50 percent above the pace for 2003 as a whole. Fleet sales of light vehicles declined about 200,000 units in August, but their pace so far this year is still above the average of 2003.

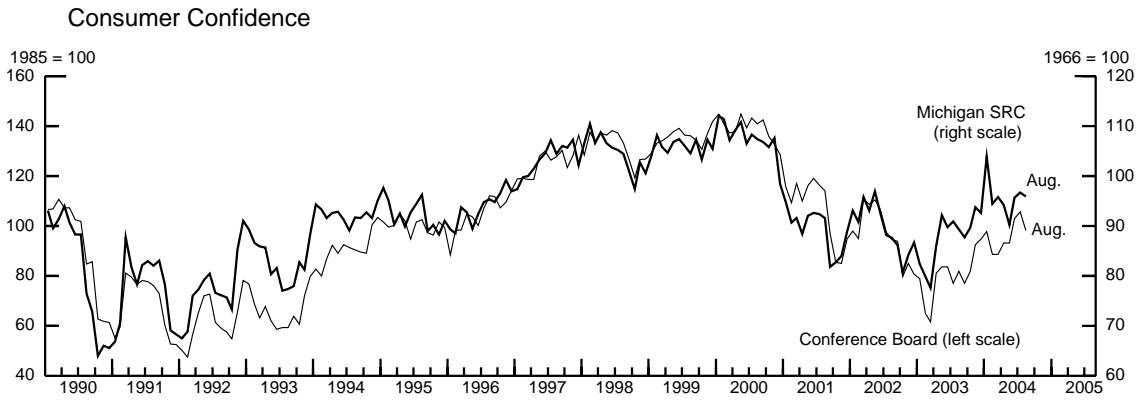
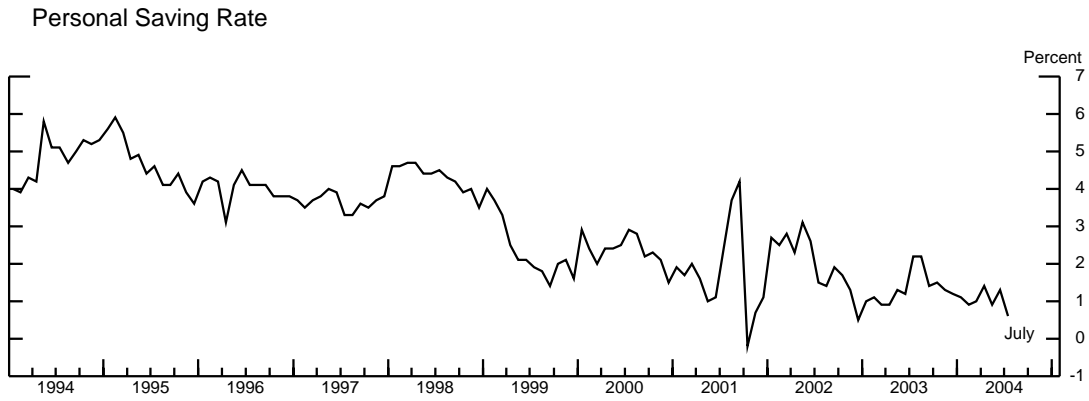
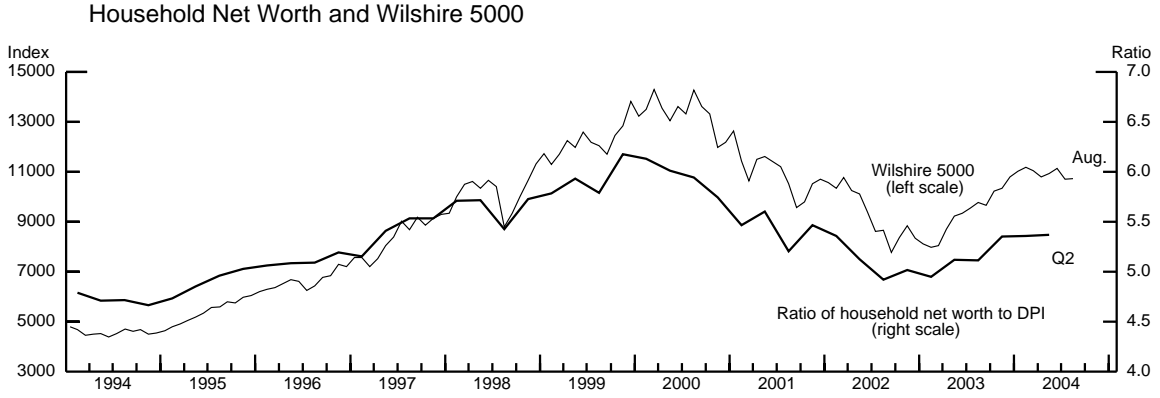
Despite the relatively robust pace of sales in recent months, inventories of light vehicles (especially trucks) have remained high, and at the end of August, days' supply stood at 78. The automakers have scheduled production in the fourth quarter at a 12.2 million annual rate; however, given the elevated level of inventories, an underbuild would not be surprising.

Consumer Spending

After a slowdown in the spring, consumer spending appears on track to accelerate in the current quarter. Real PCE rose sharply in July, and the available data suggest that spending held fairly steady in August. Although sales of light vehicles dropped back last month from July's heady pace, nominal spending in the control category of retail sales—which excludes auto dealers and building material and supply stores—increased 0.2 percent. After accounting for the staff's projection of price changes, we estimate that real spending on goods excluding cars and trucks rose 0.2 percent in August after having jumped 0.9 percent in July. Real expenditures on services moved up 0.2 percent in July, according to the latest available data.

Real disposable income has increased at a sluggish rate so far this year. On the basis of unemployment insurance tax records for the first quarter and labor market data for the second quarter, the BEA now estimates that real DPI rose at

Household Indicators



an annual rate of just under 2-1/2 percent in the first half of the year, 1/2 percentage point below its earlier estimates. In July, real DPI inched up just 0.1 percent as increases in compensation were largely offset by declines in proprietors' income and transfer payments.⁶ As a result of the revisions to income, the personal saving rate was marked down over the first half of the year, and it fell to 0.6 percent in July. Household net worth has been rising about in line with income so far this year, although the lagged effects of the substantial increase in wealth in 2003 should be providing support to consumer spending. Consumer sentiment has exhibited relatively small movements in recent months after having moved up in the first half of the year.

Housing Markets

Housing activity rebounded in July after a dip in June. Starts of new single-family homes bounced back to an annual rate of 1.65 million units, the same as in May. Permit issuance—adjusted for activity in areas where permits are not required—stayed at a high level in July, and the backlog of permits increased; these data suggest that single-family starts were probably strong in August. Indicators of activity in the multifamily sector followed much the same contour, with starts recovering in July from a June stumble and with the permit backlog rising.

Home sales remained robust in July, although sales of both existing and new homes were below the monthly peaks of earlier this year. Sales of existing homes in July were about 3-1/2 percent above the average pace during the first half of the year. Sales of new homes, which tend to lead sales of existing homes by a month or two, set a record in May but then fell sharply in the following two months.⁷ Although sales of new homes in July were below their average in the first half of the year, they were about 3-1/2 percent above the pace for 2003 as a whole.

Recent indicators suggest that housing demand will stay relatively brisk in the near term. Rates on thirty-year conventional mortgages, which had risen above 6 percent in the spring, have receded over the past couple of months and now stand at 5.83 percent, around the middle of the low range that has prevailed since early 2003. In addition, the four-week moving average of mortgage applications to purchase homes moved up sharply in early September. And although consumers' home-buying attitudes have deteriorated a bit of late, they are still in the favorable range that has persisted for the past couple of years.

6. The drop in transfer payments primarily reflected the BEA's assessment that the expiration on June 30 of the temporary increase in the federal share of Medicaid costs that went into effect during 2003 would result in a sharp drop in payments to individuals in July.

7. New home sales are recorded when a contract is signed, which generally occurs before the sale is closed. In contrast, most sales of existing homes are recorded at closing.

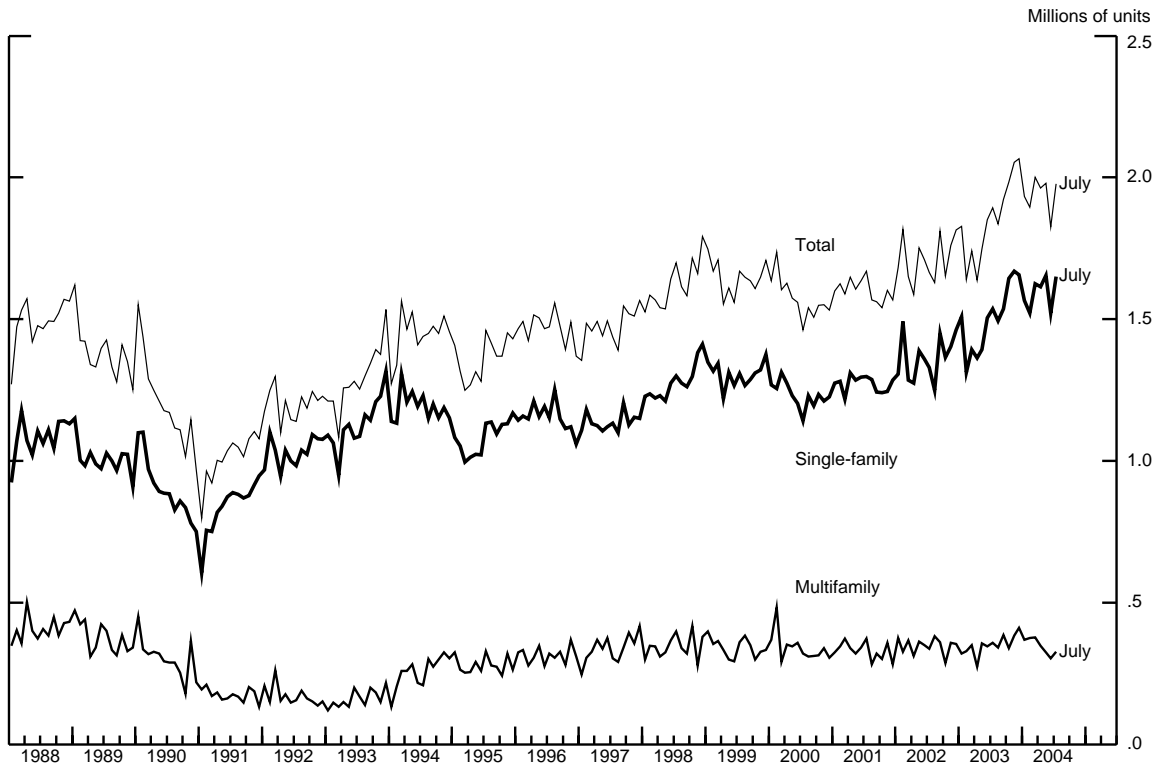
Private Housing Activity

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

Sector	2003	2004					
		Q4	Q1	Q2	May	June	July
<i>All units</i>							
Starts	1.85	2.04	1.94	1.92	1.98	1.83	1.98
Permits	1.89	1.97	1.93	2.02	2.10	1.95	2.06
<i>Single-family units</i>							
Starts	1.50	1.66	1.57	1.60	1.65	1.52	1.65
Permits	1.46	1.54	1.52	1.57	1.61	1.55	1.57
Adjusted permits ¹	1.50	1.60	1.55	1.60	1.64	1.59	1.59
Permit backlog ²	.115	.115	.123	.135	.118	.135	.136
New home sales	1.09	1.12	1.20	1.22	1.28	1.21	1.13
Existing home sales	6.10	6.30	6.20	6.79	6.81	6.92	6.72
<i>Multifamily units</i>							
Starts	.35	.38	.37	.33	.33	.30	.33
Permits	.43	.44	.42	.45	.49	.40	.49
Permit backlog ²	.061	.061	.054	.057	.056	.057	.066
<i>Mobile homes</i>							
Shipments	.131	.126	.126	.127	.126	.127	.125

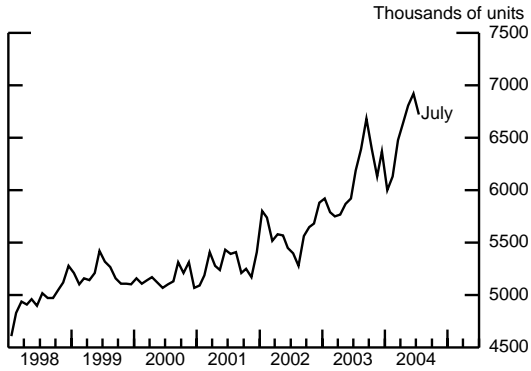
1. Adjusted permits equal permit issuance plus total starts outside of permit-issuing areas.
2. Number outstanding at end of period. Seasonally adjusted by Board staff. Excludes permits that have been cancelled, abandoned, expired, or revoked. Not at an annual rate.

Private Housing Starts
(Seasonally adjusted annual rate)



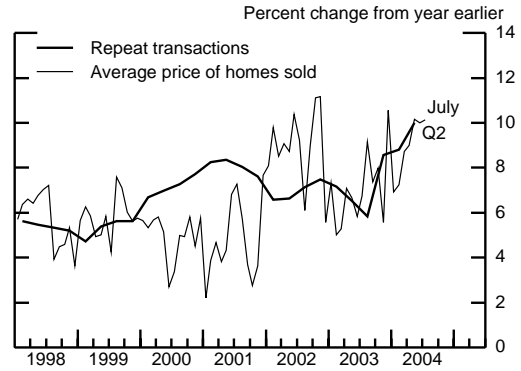
Indicators of Single-Family Housing

Existing Home Sales



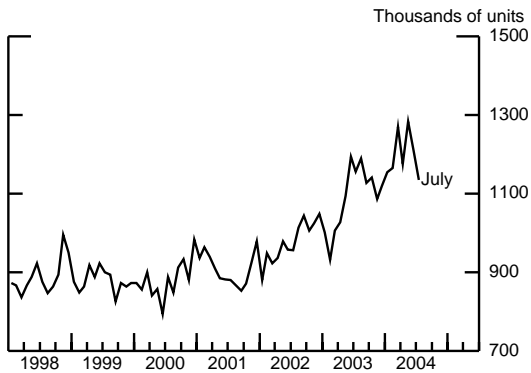
Source. National Association of Realtors.

Prices of Existing Homes



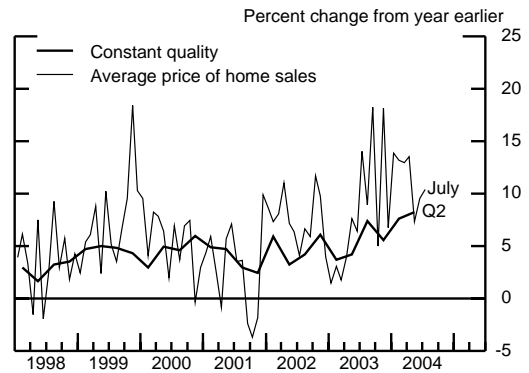
Source. Freddie Mac Conventional Mortgage Home Price Index and National Association of Realtors.

New Home Sales



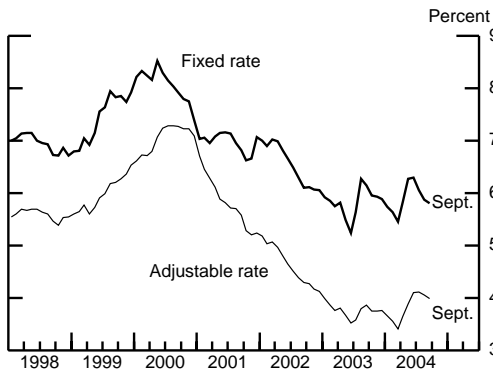
Source. Census Bureau.

Prices of New Homes



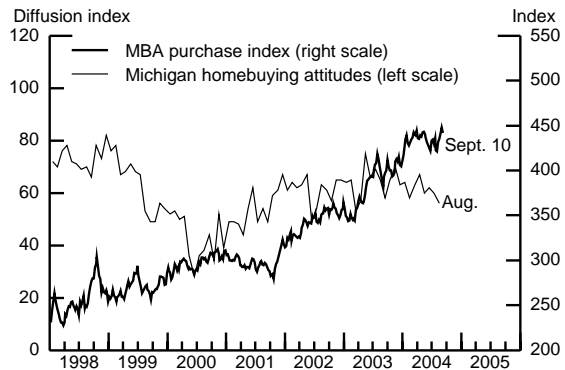
Source. Census Bureau.

Mortgage Rates



Note. The September readings are based on data through Sept. 9.
Source. Freddie Mac.

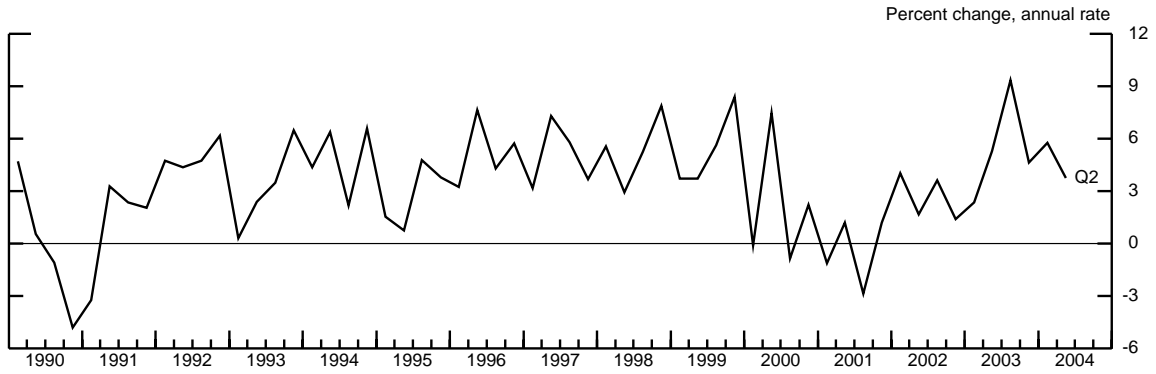
Homebuying Indicators



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

Equipment and Software Investment Fundamentals

Real Business Output

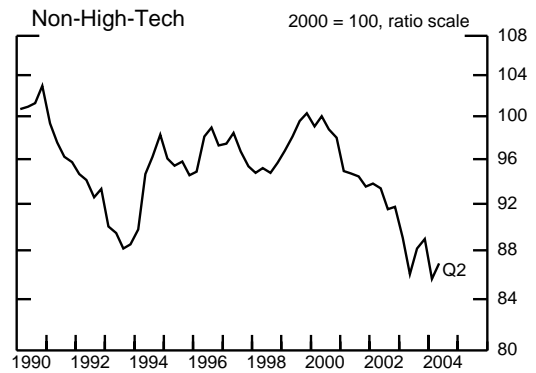
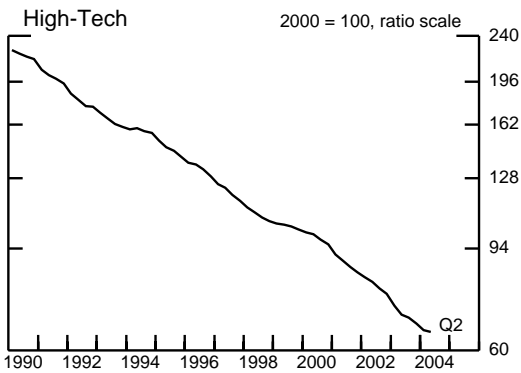


Real Corporate Cash Flow



User Cost of Capital

(Excludes the effects of the partial expensing tax incentive)



Home prices have continued to rise rapidly. In July, the average prices of both new and existing homes sold were about 10 percent higher than a year earlier. Measures that are less affected by changes in the composition of homes sold have also registered large increases. For example, in the second quarter, the repeat-transactions price index for existing homes was 10 percent higher than a year earlier, and the constant-quality price index for new homes was 8-1/4 percent higher.⁸ As has been true for some time, the largest increases in home prices over the past year generally have been in cities near the East and West coasts.

Equipment and Software

Real business outlays for equipment and software increased at an annual rate of 13-1/2 percent in the second quarter, and the data in hand point to another sizable advance in the current quarter. Although high-tech spending seems to have decelerated, outlays for transportation equipment are rising briskly, and spending on other capital goods is on track for a significant increase this quarter. In general, investment in equipment and software has been supported by the continued gains in business output, low financing costs, ongoing price declines for high-tech capital, and the corporate sector's large cushion of liquid assets.

In the high-tech sector, nominal shipments of both computing and communications equipment rose in July, but the increases reversed only part of the declines in these series over the preceding two months. Orders for high-tech equipment have also been on the soft side in recent months; several bellwether companies—including Intel, Cisco, and Hewlett-Packard—have become less optimistic about their near-term sales prospects. In contrast, orders and shipments of capital goods outside of high-tech moved up substantially in June and July, particularly in the machinery sector. Orders have exceeded shipments in this broad category for six consecutive months, and the resulting upward trend in unfilled orders shows no signs of abating.

As noted, a sizable ramp-up in outlays for medium and heavy trucks appears to be under way this quarter, partly in response to high levels of freight demand and a faster pace of replacement of aging fleets. Business spending on aircraft, while still far below its peak of a few years ago, rose in the second quarter, and July data on shipments by domestic producers of aircraft suggest that the aircraft component of equipment and software investment is holding up in the current quarter.

8. The repeat-transactions price index, which is sometimes referred to as a "repeat sales" price index, is based on repeated observations of the value of a home, either through sales prices or appraisals.

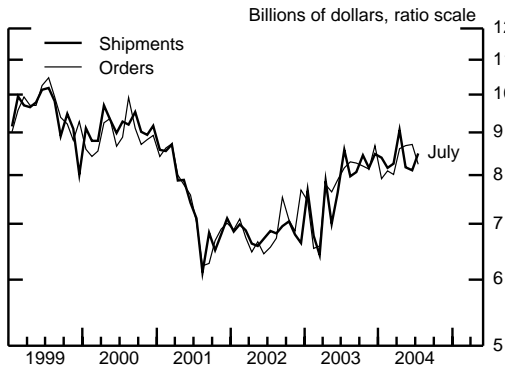
Orders and Shipments of Nondefense Capital Goods

(Percent change; seasonally adjusted current dollars)

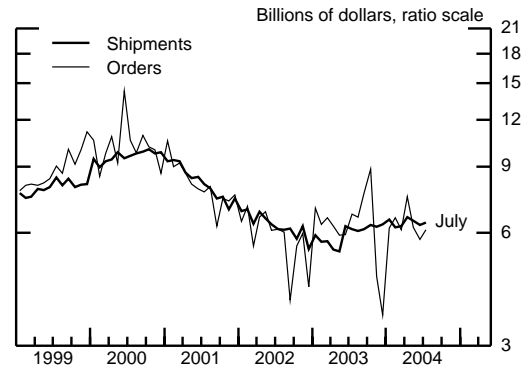
Indicators	2004				
	Q1	Q2	May	June	July
	Annual rate		Monthly rate		
Shipments	10.5	9.0	-2.0	1.8	1.0
Excluding aircraft	12.1	9.2	-2.8	2.6	1.5
Computers and peripherals	-4.3	8.9	-9.8	-.8	4.7
Communications equipment	2.6	8.7	-1.9	-2.8	1.5
All other categories	17.1	9.4	-1.5	4.0	.9
Shipments of complete aircraft ¹	29.2	25.7	25.8	26.8	27.0
Orders	10.4	15.1	-1.4	1.5	9.2
Excluding aircraft	15.8	7.8	-2.0	1.8	.7
Computers and peripherals	-14.8	36.9	.9	.2	-5.4
Communications equipment	48.3	13.5	-17.3	-7.0	6.2
All other categories	18.5	2.4	.0	3.3	1.2

1. From Census Bureau, Current Industrial Reports; billions of dollars, annual rate.

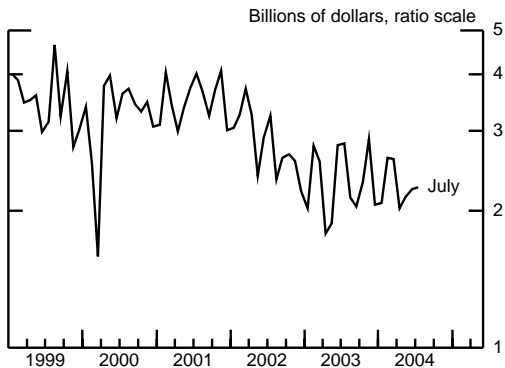
Computers and Peripherals



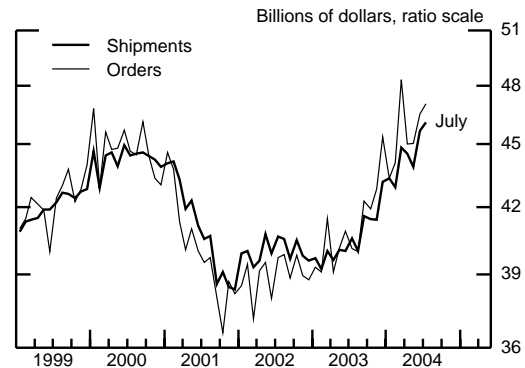
Communications Equipment



Aircraft Shipments



Other Equipment



Source. Census Bureau, Current Industrial Reports.

Nonresidential Construction

In broad terms, real business investment in nonresidential structures has remained around the depressed levels that have prevailed since the steep decline in 2001 and 2002. However, the most recent data may be hinting that some improvement is starting to take hold. Real nonresidential construction spending rose at an annual rate of 7 percent in the second quarter and apparently increased further in July.

Indicators of market conditions for nonresidential structures continued to be mixed in the second quarter. In the office sector, the vacancy rate was only a little below its recent peak, and rents continued to decline, although property values have inched up recently. The vacancy rate for industrial space also remained near its high. Conditions were brighter in the retail sector: The vacancy rate stayed low, and rents and property values both rose further. Spending on drilling and mining structures likely has continued to increase at a robust pace in the current quarter, mainly because of the continued uptrend in the number of natural gas drilling rigs in operation.

Business Inventories

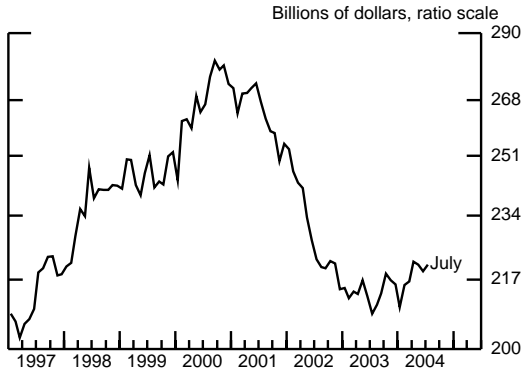
We now estimate that real nonfarm NIPA inventories excluding motor vehicles increased at an annual rate of \$48 billion in the second quarter, and the data for July suggest that inventory rebuilding is continuing apace in the current quarter. Led by accumulations at aircraft manufacturers and at producers of petroleum and coal products, the book value of manufacturing inventories rose at an annual rate of \$45 billion in July; given the rise in oil prices, the nominal figures for the latter category likely overstate real inventory investment. The book value of wholesale and retail trade inventories excluding motor vehicles increased at an annual rate of \$41 billion in July, although these gains were also likely inflated by price movements in the petroleum sector.

Some of the stockbuilding in recent months may have been the unintended consequence of slower-than-expected sales. Nevertheless, the recent accumulation may not have been entirely unwelcome. In particular, manufacturers likely built stocks, especially at earlier stages of processing, to keep up with the ongoing rise in factory production. And although the ISM's index of customer inventories rose dramatically in August, the percentage of purchasing managers who reported that their customers' inventories were too low continued to exceed the percentage that characterized them as too high.

According to the staff's flow-of-goods system, days' supply of inventories edged down in July. Among industry groups, the inventories of motor vehicles and paper remain elevated. Inventories of communications equipment also remained high, although days' supply has fallen nearly 20 percent since early 2002.

Nonresidential Construction
(Seasonally adjusted, annual rate)

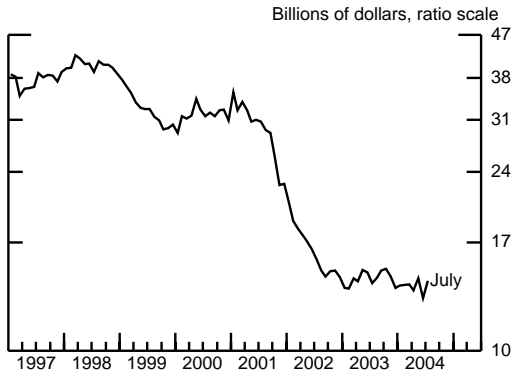
Total Structures



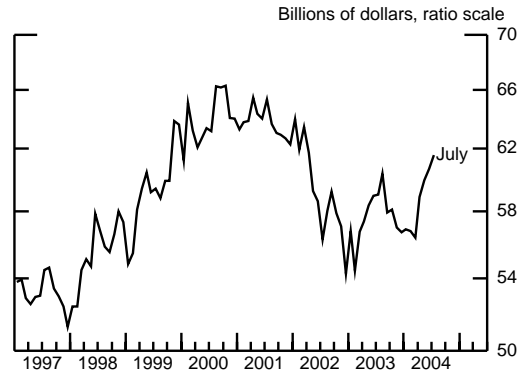
Office



Manufacturing

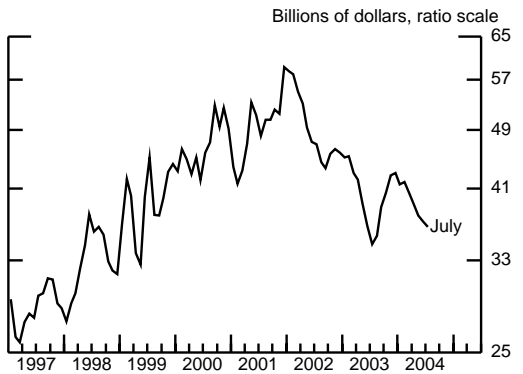


Commercial

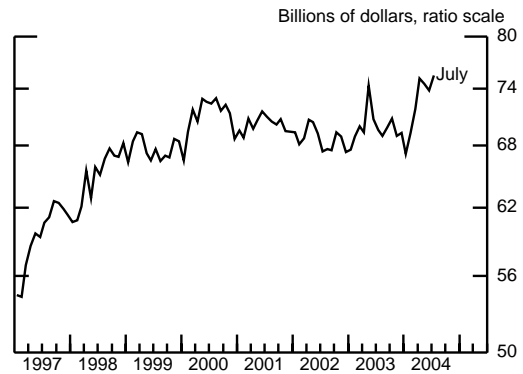


Note. Includes retail, wholesale, and "other" establishments.

Power and Communication



Other

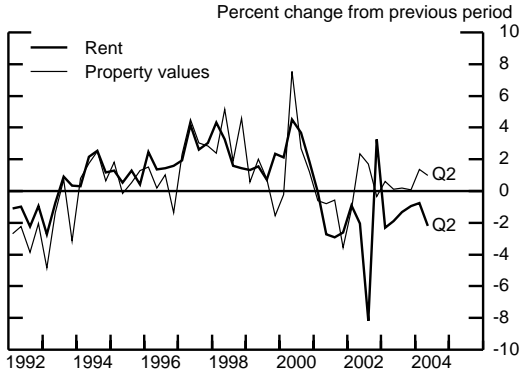


Note. Includes religious, educational, lodging, amusement and recreation, transportation, and health-care facilities.

Indicators of Nonresidential Construction

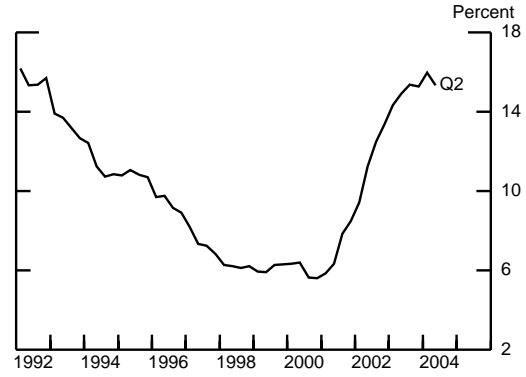
Office Buildings

Rent and Property Values



Source. National Real Estate Index.

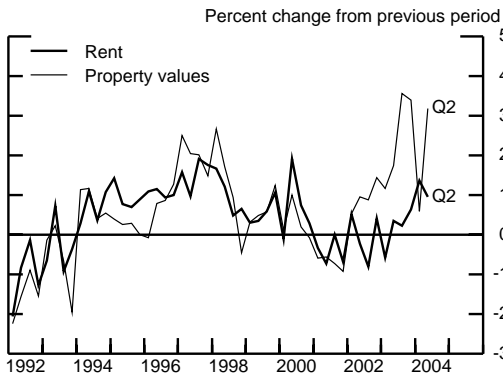
Vacancy Rate



Source. National Council of Real Estate Investment Fiduciaries.

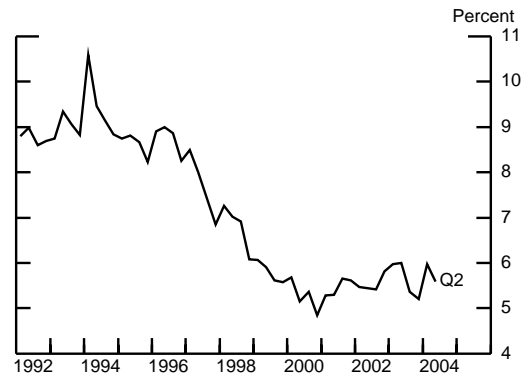
Retail Buildings

Rent and Property Values



Source. National Real Estate Index.

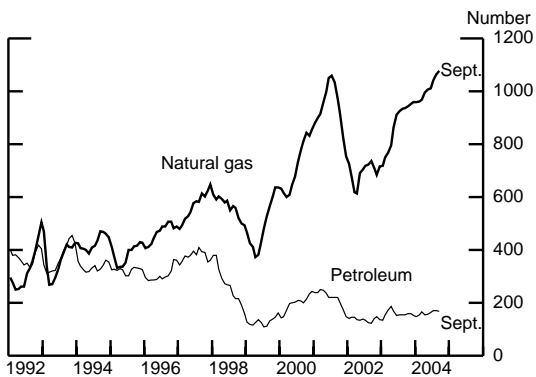
Vacancy Rate



Source. National Council of Real Estate Investment Fiduciaries.

Drilling Activity

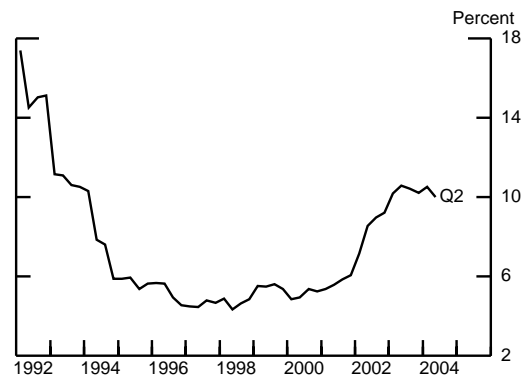
Rigs in Operation



Note. Sept. values are averages through Sept. 10.
Source. DOE/Baker Hughes.

Industrial Buildings

Vacancy Rate

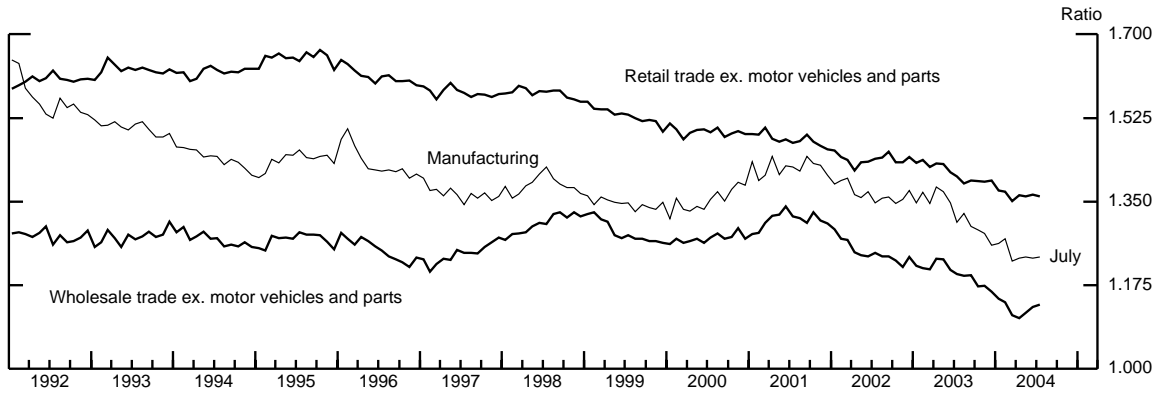


Source. National Council of Real Estate Investment Fiduciaries.

Changes in Manufacturing and Trade Inventories
(Billions of dollars; seasonally adjusted book value; annual rate)

Sector	2003	2004				
	Q4	Q1	Q2	May	June	July
Manufacturing and trade	48.1	82.0	120.4	98.0	159.9	129.0
Ex. wholesale and retail motor vehicles and parts	25.1	55.6	94.1	111.0	111.0	85.2
Manufacturing	1.2	24.0	38.9	39.0	52.4	44.6
Ex. aircraft	4.3	24.0	39.3	41.5	52.9	34.3
Wholesale trade	16.7	23.5	33.7	50.9	42.2	48.6
Motor vehicles and parts	6.2	3.2	1.3	3.9	2.5	7.4
Ex. motor vehicles and parts	10.5	20.3	32.4	47.0	39.7	41.2
Retail trade	30.2	34.5	47.7	8.1	65.3	35.9
Motor vehicles and parts	16.9	23.1	25.0	-16.9	46.4	36.5
Ex. motor vehicles and parts	13.4	11.4	22.7	25.0	18.9	-5

Book-Value Inventories Relative to Shipments and Sales



Inventory-Consumption Ratios, Flow-of-Goods System



Federal Government Sector

The federal budget picture continues to show modest improvement. Adjusted for payment-timing shifts, the federal budget recorded a deficit of \$111 billion in July and August combined, \$11 billion lower than for the same period last year. Receipts were about 14 percent above their year-earlier level. While most of the increase relative to a year ago can be traced to the drain on revenue last July and August from the mail-out of individual-income-tax rebate checks, other tax receipts did increase robustly over the past year. Withheld and FICA taxes, which were unaffected by the rebate checks, were 6 percent higher in July and August than in the same period last year.

Outlays in July and August, adjusted for payment-timing shifts, were 7-1/2 percent over year-earlier levels. Defense spending once again posted large increases—averaging 14 percent over the year-earlier level—after a brief lull in June. Outlays for net interest and Medicare also rose sharply. Nevertheless, Medicaid spending in July and August fell below year-earlier levels with the expiration on June 30 of the temporary increase in the federal matching rate.

According to the Congressional Budget Office's (CBO) midyear update of the budget outlook, the federal budget will post a deficit of \$422 billion in fiscal year 2004, about \$56 billion lower than projected last January. Nevertheless, the CBO's longer-term baseline deficit outlook has deteriorated a bit, with the cumulative deficit from 2005 to 2014 now projected to equal 1.5 percent of nominal GDP, compared with 1.3 percent of GDP in last January's projection. However, much of the deterioration in the outlook since January is the result of the rules governing the way in which the CBO puts together its baseline projections; under these rules, the CBO is required to assume that the budget authority for discretionary spending will increase with inflation throughout the forecast period. Thus, the recently passed Department of Defense Appropriations Act, which provided an additional \$28 billion for spending in Iraq in 2004, boosted the CBO's projection of defense spending through 2014.

State and Local Government Sector

Indicators of spending by state and local governments have been positive in recent months. Employment was up 18,000 in August, about the same as in July. Nominal construction spending edged up in July after having risen at a 5 percent quarterly rate in the second quarter, the largest quarterly advance since the second quarter of 2001. All major categories of state and local construction spending have posted solid gains in recent months.

The improvement in aggregate spending by the sector is consistent with reports of strengthening fiscal positions among the states. Revenue collections in the final months of the last fiscal year (which ended on June 30 in all but a few states) came in strong. As a result, many states ended fiscal 2004 with higher-than-expected balances and were able to begin rebuilding rainy-day funds. All

Federal Government Outlays and Receipts

(Unified basis; billions of dollars except as noted)

Function or source	July-August			12 months ending in August		
	2003	2004	Percent change	2003	2004	Percent change
Outlays	368.6	382.4	3.7	2141.3	2274.7	6.2
Financial transactions ¹	-.1	-.7	...	-1.7	-2.2	...
Payment timing ²	6.7	.0	...	.4	-6.7	...
Adjusted outlays	362.0	383.2	5.8	2142.7	2283.7	6.6
Receipts	237.8	272.1	14.4	1783.2	1864.1	4.5
Payment timing	.0	.0	...	.0	.0	...
Adjusted receipts	237.8	272.1	14.4	1783.2	1864.1	4.5
Surplus or deficit (-)	-130.8	-110.3	...	-358.2	-410.6	...
<i>Selected components of adjusted outlays and receipts</i>						
Adjusted outlays	362.0	383.2	5.8	2142.7	2283.7	6.6
Net interest	26.2	31.3	19.4	155.4	160.7	3.4
Non-interest	335.8	351.8	4.8	1987.3	2123.0	6.8
National defense	68.9	78.8	14.3	397.9	453.6	14.0
Social security	79.4	83.2	4.8	473.2	494.1	4.4
Medicare	42.1	47.0	11.6	247.0	267.7	8.4
Medicaid	28.6	27.2	-5.1	159.9	175.1	9.5
Income security	50.0	47.7	-4.5	334.3	335.9	.5
Agriculture	2.5	1.4	-44.8	23.7	18.6	-21.7
Other	64.2	66.6	3.7	351.4	378.1	7.6
Adjusted receipts	237.8	272.1	14.4	1783.2	1864.1	4.5
Individual income and payroll taxes	201.9	229.2	13.5	1467.6	1489.7	1.5
Withheld + FICA	212.6	225.6	6.1	1369.5	1392.5	1.7
Nonwithheld + SECA	10.0	10.4	3.8	291.4	285.2	-2.1
Less: Refunds	20.7	6.8	-67.1	193.3	188.0	-2.7
Corporate	3.9	6.7	73.0	132.3	177.4	34.2
Gross	9.2	10.2	11.6	195.4	219.5	12.4
Less: Refunds	5.3	3.5	-34.0	63.1	42.1	-33.3
Other	32.0	36.2	13.1	183.3	196.9	7.4
Adjusted surplus or deficit (-)	-124.2	-111.0	...	-359.5	-419.6	...

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

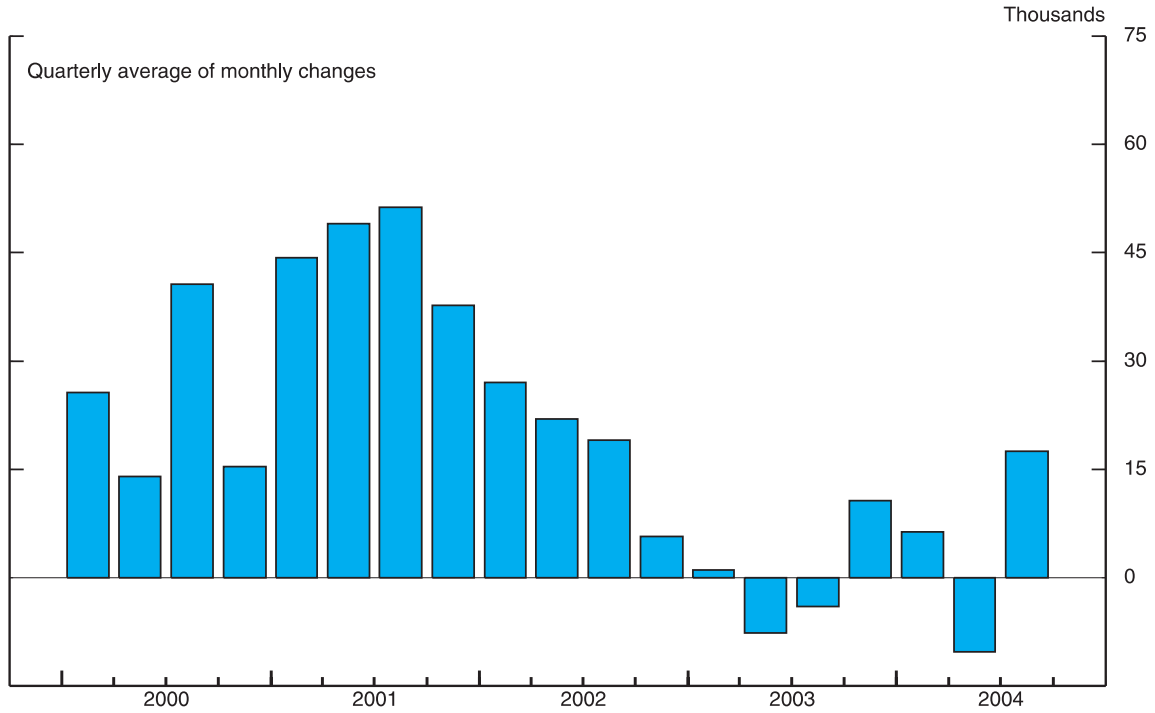
1. Financial transactions consist of deposit insurance, spectrum auction and sales of major assets.

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.

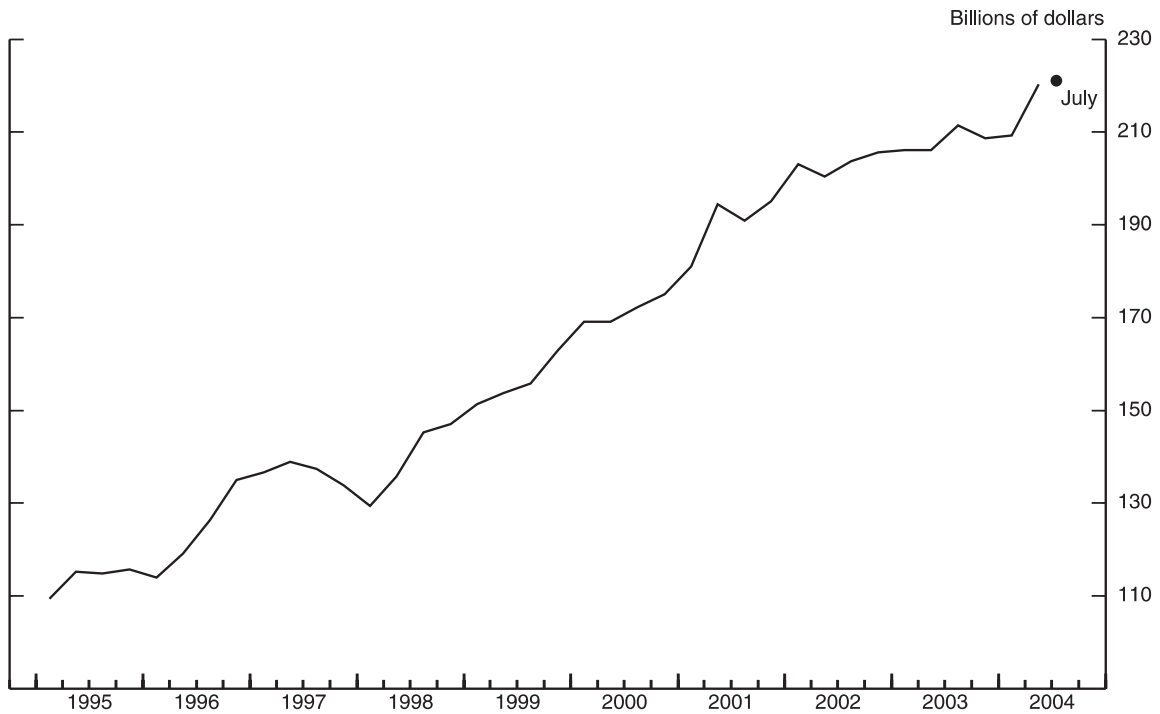
State and Local Employment and Construction

Employment



Note. 2004:Q3 is the average of July and August.

Construction Put in Place



Measures of Consumer Price Inflation
(Percent)

Measures	12-month change		3-month change		1-month change	
	July 2003	July 2004	Annual rate		Monthly rate	
			Apr. 2004	July 2004	June 2004	July 2004
<i>CPI</i>						
Total	2.1	3.0	3.9	3.7	.3	-.1
Food	2.1	4.0	2.0	5.5	.2	.3
Energy	9.0	14.3	16.0	22.9	2.6	-1.9
Ex. food and energy	1.5	1.8	3.3	1.6	.1	.1
Ex. tobacco	1.5	1.8	3.4	1.6	.1	.1
Core commodities	-1.8	-1.2	1.4	-.9	.0	-.3
Core services	2.9	3.0	4.1	2.5	.2	.3
Chained CPI (n.s.a.) ¹	1.9	2.4	...	...	...	...
Ex. food and energy ¹	1.2	1.3	...	...	...	...
<i>PCE prices</i>						
Total	1.7	2.4	2.8	2.5	.2	.0
Food	1.9	3.4	2.8	4.1	.1	.2
Energy	9.0	15.2	16.7	22.6	2.7	-2.0
Ex. food and energy	1.3	1.5	2.0	1.1	.1	.0
Ex. tobacco	1.3	1.5	2.0	1.0	.1	.0
Core commodities	-2.1	-.9	1.5	-1.3	.0	-.4
Core services	2.7	2.5	2.2	2.1	.2	.2
Core market-based	1.2	1.5	2.3	1.5	.2	.1
Core non-market-based	1.6	1.5	.7	-.9	-.2	-.1

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

Measures of Producer Price Inflation
(Percent)

Measures	12-month change		3-month change		1-month change	
	Aug. 2003	Aug. 2004	Annual rate		Monthly rate	
			May 2004	Aug. 2004	July 2004	Aug. 2004
<i>PPI</i>						
Total finished goods	3.5	3.4	8.5	-1.1	.1	-.1
Food	5.0	4.0	17.7	-9.2	-1.6	-.2
Energy	14.7	9.9	16.0	3.2	2.3	.2
Ex. food and energy	.4	1.5	3.2	.5	.1	-.1
Ex. tobacco	.9	1.6	3.5	.5	.1	-.1
Core consumer goods	.3	1.6	3.1	.0	.1	-.2
Capital equipment	.7	1.4	4.1	.9	.1	-.1
Intermediate materials	4.4	8.1	13.1	9.3	.8	1.0
Ex. food and energy	1.6	7.3	11.2	8.5	.5	1.0
Crude materials	20.8	22.4	23.0	2.8	-.2	-.7
Ex. food and energy	8.2	32.3	-23.4	63.0	8.6	4.5

states except Kentucky have enacted fiscal 2005 budgets. State officials appear to be generally upbeat about the prospects for the current year, although some have expressed concern about budgets in 2006 and beyond in light of anticipated increases in Medicaid caseloads, school enrollments, and prison populations.

Many cities are still dealing with serious fiscal problems. According to a survey soon to be released by the National League of Cities, the percentage of cities reporting deteriorating fiscal conditions remained high in fiscal 2004, and officials in more than half of the reporting cities think that their fiscal situations will remain strained in 2005. Although these governments are benefiting from the boom in real estate values, they remain under pressure from rapidly rising health-care and pension costs, increased spending on public safety, and marked declines in state aid. In fiscal 2004, many cities raised or instituted new fees and charges and cut spending on services.

Prices and Labor Costs

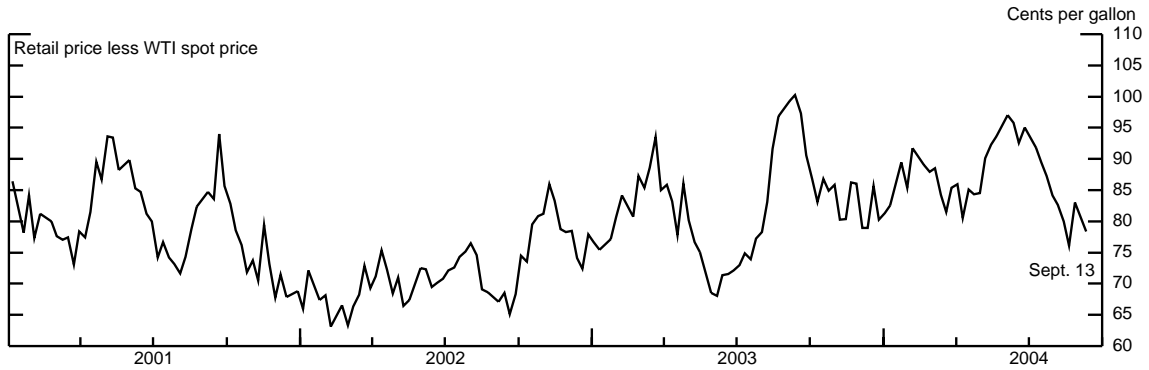
The overall CPI edged down 0.1 percent in July as energy prices fell and the core component rose just 0.1 percent for a second month. Over the twelve months ending in July, the overall CPI rose 3 percent, nearly 1 percentage point faster than over the preceding year. The acceleration in part reflected a sharper increase in energy prices, but food prices also rose more rapidly, and the twelve-month change in the core CPI moved up from 1-1/2 percent in July 2003 to 1-3/4 percent in July 2004.

Retail energy prices fell nearly 2 percent in July after large increases in a number of earlier months; a drop of 4-1/4 percent in gasoline prices led the decline. As summer began, gasoline inventories were quite lean by historical standards, but during the summer, lower demand and increased imports pushed inventories above the levels usually seen at that time of year. The resulting downward pressure on margins led gasoline prices to fall even as crude oil prices moved higher. Available survey evidence points to an additional small decline in the CPI for gasoline in August. Retail prices apparently continued to fall through early September, though the declines lagged the drop in crude oil prices since mid-August and thus resulted in a small uptick in margins. With inventories of natural gas remaining high through August, the spot price for natural gas at Henry Hub fell sharply last month. This week, Hurricane Ivan caused a temporary shutdown of oil and gas rigs in the Gulf of Mexico, and spot natural gas prices rose 13 percent on September 14. However, the level of spot natural gas prices remains below the August average.

Consumer food prices rose 0.3 percent in July after an increase of 0.2 percent in June. Prices for meats and poultry have moved up sharply for several months, although recent large declines in the spot prices for livestock and poultry should help to reverse some of these increases. Retail dairy prices had also accelerated in the spring, but suppliers subsequently boosted milk production and, as a

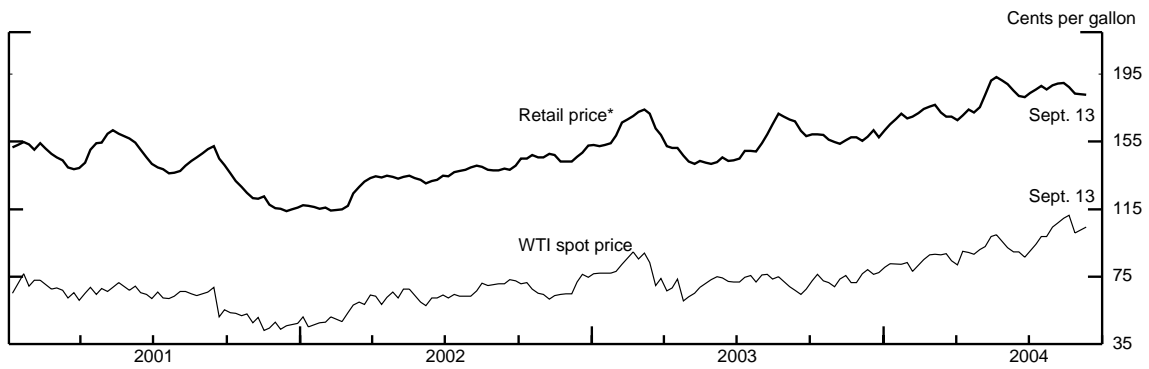
Energy Prices and Inventories

Total Gasoline Margin



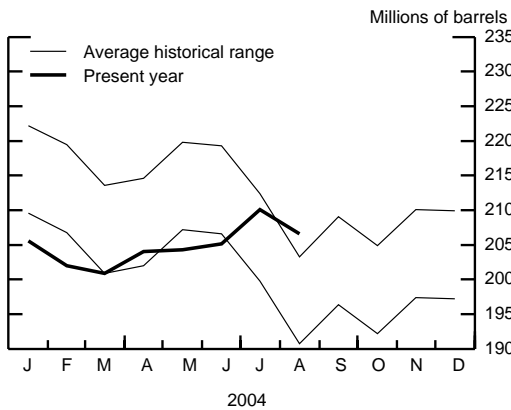
Note. Average of all grades (DOE) seasonally adjusted, less West Texas intermediate spot price.

Gasoline Price Decomposition



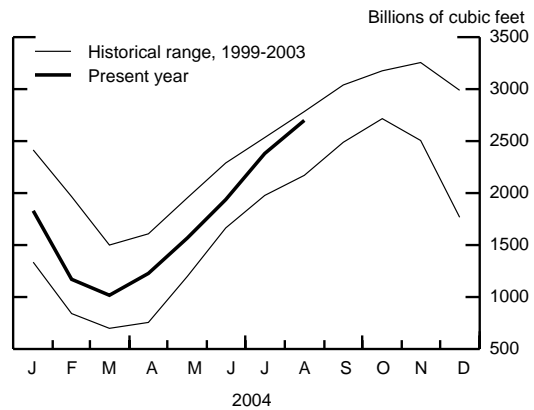
* Average of all grades (DOE) seasonally adjusted.

Gasoline Inventories



Note. Average historical range calculated by Energy Information Administration.

Natural Gas Inventories



Note. Historical range calculated by FRB staff.

result, dairy prices declined 0.6 percent in July. Food away from home—which accounts for about 40 percent of the CPI for food—rose 0.4 percent in July after smaller increases in May and June. Over the twelve months ending in July, consumer food prices rose 4 percent, compared with a year-earlier rate of increase of about 2 percent. The main effect of the recent hurricanes on food-related products has been damage to the citrus crop in Florida, where groves of oranges used for juice apparently were hard hit; futures prices for frozen concentrated orange juice are up more than 20 percent since just before the first storm.

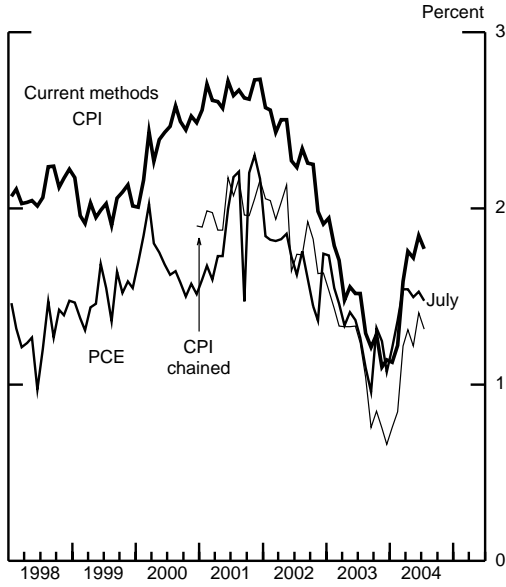
Excluding food and energy, the CPI edged up 0.1 percent in July after a similar increase in June. On a three-month-change basis, core CPI inflation stood at an annual rate of 1-1/2 percent in July, down from 3-1/4 percent over the three months ending in April. Both goods and services contributed to this moderation: Core commodity prices declined at an annual rate of 1 percent over the three months ending in July after increasing 1-1/2 percent over the preceding three-month period, and core services prices rose 2-1/2 percent after climbing 4 percent during the earlier period. We had interpreted the sharp step-up in core inflation earlier this year as partly reflecting the pass-through of higher energy and import costs into core consumer prices and partly as payback for 2003's unusually modest price increases. While, on our estimates, the contribution of these pass-through effects is only just starting to crest, the moderation in inflation evident in the recent data suggests that much of the payback from the unusually modest increases last year is complete.

Core PCE prices were flat in July. These prices rose 1-1/2 percent over the twelve months ending in July, an acceleration of 1/4 percentage point relative to the preceding year. Both the market-based and nonmarket components of the core PCE price index rose 1-1/2 percent over the past twelve months; for the market-based index, this increase represented a small pickup from a year ago, while core nonmarket price inflation was little changed.

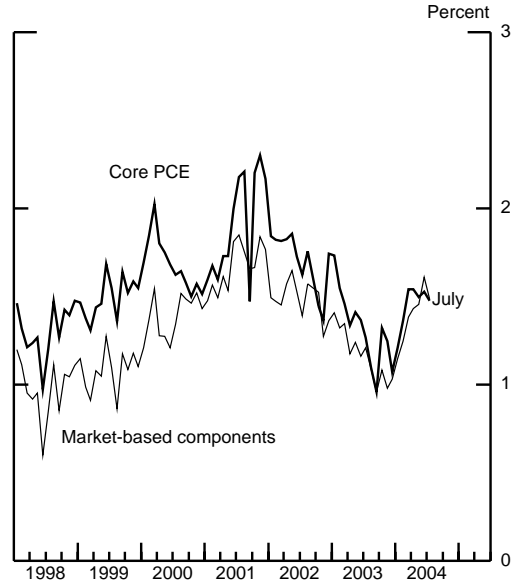
The PPI for core finished goods edged down 0.1 percent in August after a 0.1 percent increase in July. Over the year ending in August, the core PPI increased 1-1/2 percent, about 1 percentage point faster than the year-earlier increase, as both core consumer and capital goods prices accelerated. At the earlier stages of processing, the prices for core intermediate materials—led by large increases for building materials, chemicals, and nitrogenates—rose 1 percent in August. Prices for core crude materials increased 4-1/2 percent last month and are up more than 32 percent over the past year, in large part because of a surge in prices for iron and steel scrap (although spot prices for scrap have eased a little in recent weeks). Since the PPI's reporting date, commodity prices have moved up again, with the CRB spot industrials index (which excludes energy items) rising more than 5 percent over the past five weeks.

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

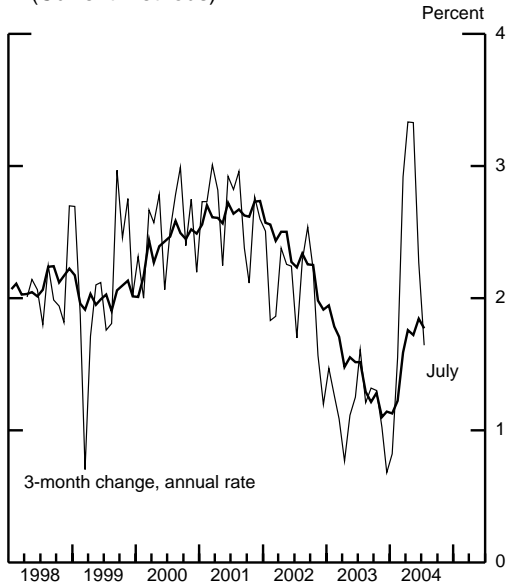
CPI and PCE excluding Food and Energy



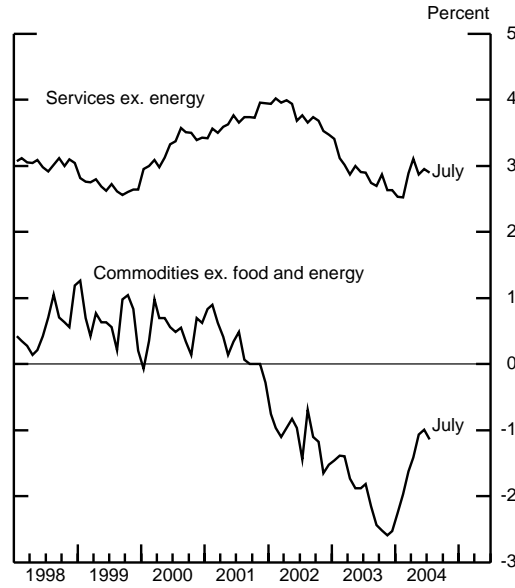
PCE excluding Food and Energy



CPI excluding Food and Energy
(Current Methods)



CPI Services and Commodities



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

Measure	2001	2002	2003	2004
<i>Product prices</i>				
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	1.5
<i>Expenditure prices</i>				
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	1.5
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: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
Q3	n.a.	n.a.	n.a.	n.a.	n.a.	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	3.0	3.5	3.0	3.1	2.8	...
Aug.	n.a.	3.1	2.8	3.1	2.7	...

1. CPI; percent change from the same period in the preceding year.

2. Responses to the question: By about what percent do you expect prices to go up, on average, during the next 12 months?

3. Responses to the question: By about what percent per year do you expect prices to go up, on average, during the next 5 to 10 years?

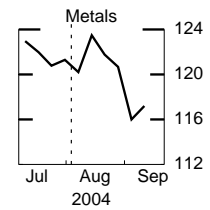
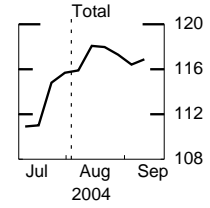
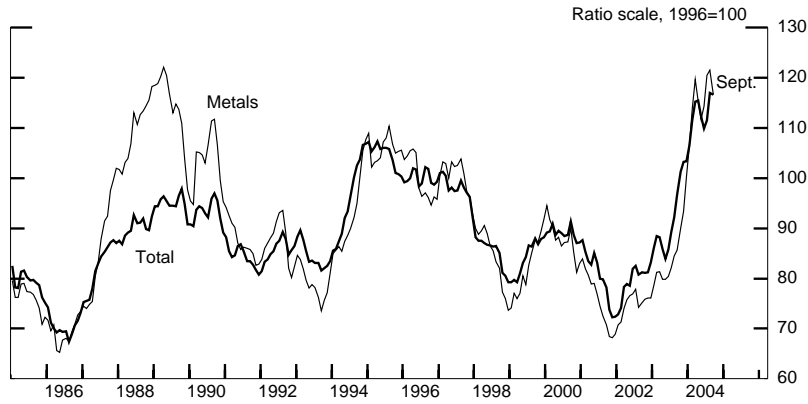
4. Quarterly CPI projections compiled by the Federal Reserve Bank of Philadelphia.

n.a. Not available.

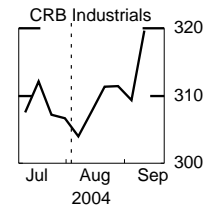
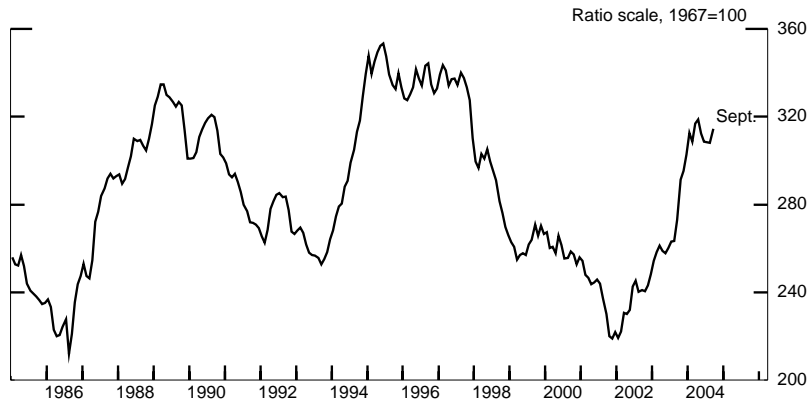
... Not applicable.

Commodity Price Measures

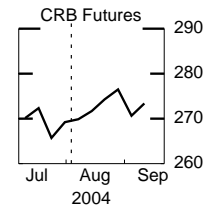
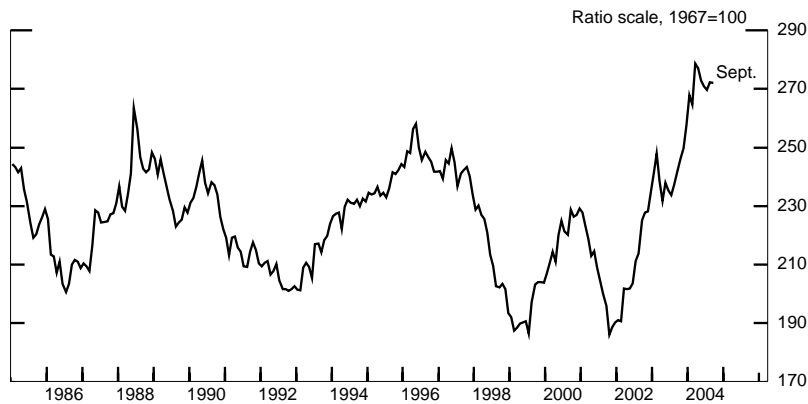
Journal of Commerce Index



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.

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

Commodity	Current price (dollars)	2002 ¹	2003 ¹	12/30/03 to 8/3/04 ²	8/3/04 ² to 9/14/04	Memo: 52-week change to 9/14/04
<i>Metals</i>						
Copper (lb.)	1.360	5.6	47.9	27.8	-1.4	65.9
Steel scrap (ton)	203.667	49.2	66.8	45.8	-13.7	58.3
Aluminum, London (lb.)	.763	2.8	16.7	7.5	-.2	20.9
<i>Precious metals</i>						
Gold (oz.)	405.250	24.3	20.7	-6.1	3.7	8.2
Silver (oz.)	6.280	3.8	24.6	11.1	-5.4	20.4
<i>Forest products</i> ³						
Lumber (m. bdf.)	450.000	-8.9	44.5	52.2	2.3	27.5
Plywood (m. sqft.)	555.000	.7	36.7	26.6	11.0	3.7
<i>Petroleum</i>						
Crude oil (barrel)	41.680	66.9	-7.4	43.5	-2.0	70.6
Gasoline (gal.)	1.254	69.2	12.5	28.7	2.3	40.4
Fuel oil (gal.)	1.224	63.8	6.3	26.7	5.1	68.9
<i>Livestock</i>						
Steers (cwt.)	82.630	16.5	4.1	12.2	-1.8	-5.8
Hogs (cwt.)	53.250	-13.2	18.3	59.2	-5.8	29.9
Broilers (lb.)	.661	6.5	10.9	14.6	-13.1	2.9
<i>Farm crops</i>						
Corn (bu.)	1.995	18.1	1.7	-11.3	-3.6	-3.4
Wheat (bu.)	4.000	37.7	-2.1	-8.1	7.0	13.5
Soybeans (bu.)	5.430	32.2	37.1	-23.6	-7.5	-8.6
Cotton (lb.)	.483	52.1	42.5	-35.6	10.0	-16.7
<i>Other foodstuffs</i>						
Coffee (lb.)	.688	1.1	23.1	2.6	22.2	25.0
<i>Memo:</i>						
JOC Industrials	116.900	16.8	22.3	12.8	1.0	21.1
JOC Metals	117.200	9.7	38.1	15.9	-3.4	37.6
CRB Futures	273.390	24.4	9.1	5.3	1.5	15.0
CRB Spot Industrials	319.690	13.7	24.0	-.5	4.2	17.3

1. Changes are from the last week of the preceding year to the last week of the year indicated.

2. August 3, 2004, is the Tuesday preceding publication of the August Greenbook.

3. Prices shown apply to the Friday before the date indicated.

Hourly Compensation and Unit Labor Costs

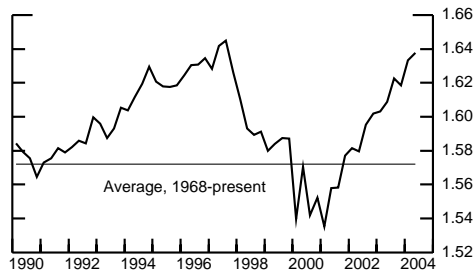
(Percent change from preceding period at compound annual rate; based on seasonally adjusted data)

Category	2002	2003	2003		2004		2003:Q2 to 2004:Q2
			Q3	Q4	Q1	Q2	
<i>Compensation per hour</i>							
Nonfarm business	2.9	5.4	6.1	4.4	2.0	4.3	4.2
Nonfinancial corporations ¹	2.5	5.0	6.2	4.2	2.3	4.0	4.1
<i>Unit labor costs</i>							
Nonfarm business	-6	-2	-2.7	1.2	-1.6	1.8	-3
Nonfinancial corporations ¹	-2.4	-1.5	-3.0	-8	2.1	2.6	.2

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

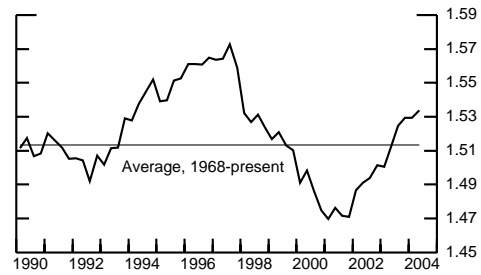
1. All corporations doing business in the United States except banks, stock and commodity brokers, and finance and insurance companies. The sector accounts for about two-thirds of business employment.

Markup, Nonfarm Businesses



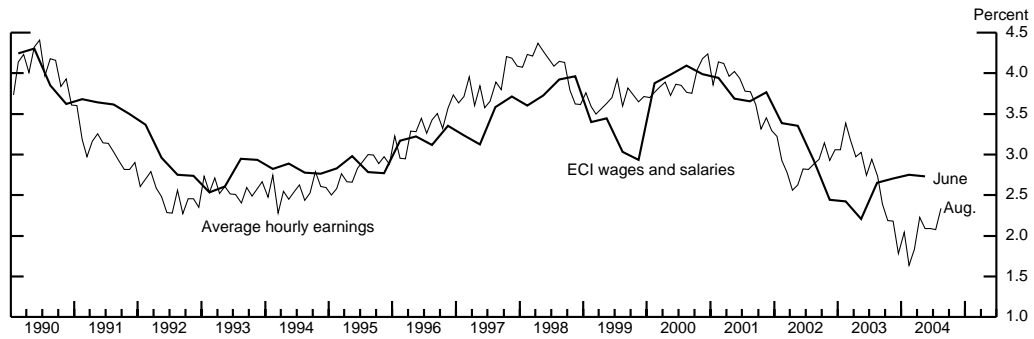
Note. Markup defined as ratio of output price to unit labor costs.

Markup, Nonfinancial Corporations



Note. Markup defined as ratio of output price to unit labor costs.

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



Inflation expectations as measured by the Michigan survey edged lower in August. Median year-ahead expected inflation was 2.8 percent last month, down 0.2 percentage point from July and similar to its first-quarter readings. Median expected inflation over the next five to ten years ticked down 0.1 percentage point, to 2.7 percent; this series has remained in a relatively narrow range over the past several years.

On labor costs, the BLS reported that hourly compensation in the nonfarm business sector rose at an annual rate of 4-1/4 percent in the second quarter; this rate was considerably higher than the downward-revised first-quarter pace but was in line with the average rate of increase seen over the preceding four quarters. After factoring in the anticipated revision to productivity growth, we estimate that unit labor costs rose at an annual rate of 1-1/4 percent in the second quarter and almost reversed their first-quarter decline. (The published data showed an increase of 1-3/4 percent in unit labor costs in the second quarter.) Taking a longer perspective, unit labor costs have edged lower over the past several years, and with prices in the nonfarm business sector increasing at a slow, but steady, rate, the markup of prices over unit labor costs has risen to a level significantly above the long-term average. The markup in the nonfinancial corporate sector has not risen as rapidly and is currently only little above its historical mean.

Average hourly earnings of production or nonsupervisory workers rose 0.3 percent in August, a pace in line with the average rate of increase over the past several months but well above the very low readings over much of 2003. As a result, the twelve-month change in this series has moved back up since the start of the year and stood at 2-1/4 percent in August.

Recent indicators suggest that health insurance costs are continuing to rise rapidly, although some slowing from the outsized increases of the past few years appears to be in train. The Survey of Employer-Sponsored Health Benefits conducted annually by the Kaiser Family Foundation and the Health Research and Educational Trust (HRET) showed that health insurance premiums increased 11-1/4 percent, on average, between the spring of 2003 and the spring of 2004 after having risen about 14 percent over the preceding year. For 2005, premiums in the Federal Employees Health Benefits Program are expected to rise a bit less than 8 percent, compared with an increase of 9-1/2 percent in 2004. Earlier this year, the California Public Employees Retirement System announced that its premiums (for non-Medicare enrollees) would go up about 10 percent, on average, in 2005 after having risen 16-1/2 percent in 2004.

Domestic Financial Developments

III-T-1
Selected Financial Market Quotations
(One-day quotes in percent except as noted)

Instrument	2003	2004			Change to Sept. 14 from selected dates (percentage points)		
	Dec. 31	June 28	Aug. 9	Sept. 14	2003 Dec. 31	2004 June 28	2004 Aug. 9
<i>Short-term</i>							
FOMC intended federal funds rate	1.00	1.00	1.25	1.50	.50	.50	.25
Treasury bills ¹							
3-month	0.93	1.36	1.49	1.64	.71	.28	.15
6-month	1.00	1.74	1.69	1.84	.84	.10	.15
Commercial paper (A1/P1 rates) ²							
1-month	1.00	1.28	1.50	1.68	.68	.40	.18
3-month	1.05	1.45	1.58	1.78	.73	.33	.20
Large negotiable CDs ¹							
1-month	1.06	1.30	1.54	1.74	.68	.44	.20
3-month	1.09	1.53	1.61	1.84	.75	.31	.23
6-month	1.16	1.82	1.75	2.01	.85	.19	.26
Eurodollar deposits ³							
1-month	1.04	1.29	1.50	1.71	.67	.42	.21
3-month	1.07	1.51	1.60	1.82	.75	.31	.22
Bank prime rate	4.00	4.00	4.25	4.50	.50	.50	.25
<i>Intermediate- and long-term</i>							
U.S. Treasury ⁴							
2-year	1.83	2.88	2.44	2.46	.63	-.42	.02
10-year	4.40	4.90	4.42	4.28	-.12	-.62	-.14
U.S. Treasury 10-year indexed note	2.00	2.23	1.85	1.81	-.19	-.42	-.04
Municipal revenue (Bond Buyer) ⁵	5.04	5.37	5.24	5.07	.03	-.30	-.17
Private instruments							
10-year swap	4.66	5.21	4.71	4.59	-.07	-.62	-.12
10-year FNMA ⁶	4.72	5.30	4.77	4.62	-.10	-.68	-.15
10-year AA ⁷	5.05	5.59	5.12	4.94	-.11	-.65	-.18
10-year BBB ⁷	5.74	6.18	5.71	5.53	-.21	-.65	-.18
5-year high yield ⁷	7.94	8.30	8.01	7.69	-.25	-.61	-.32
Home mortgages (FHLMC survey rate) ⁸							
30-year fixed	5.81	6.25	5.99	5.83	.02	-.42	-.16
1-year adjustable	3.73	4.13	4.08	4.00	.27	-.13	-.08

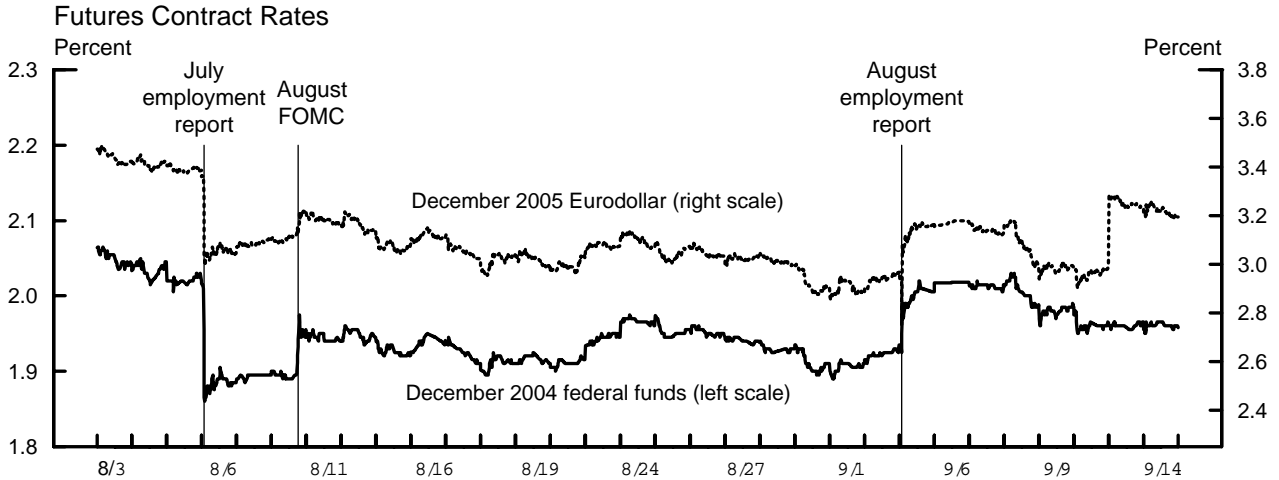
Stock exchange index	Record high		2004			Change to Sept. 14 from selected dates (percent)		
	Level	Date	June 28	Aug. 9	Sept. 14	Record high	2004 June 28	2004 Aug. 9
Dow-Jones Industrial	11,723	1-14-00	10,357	9,815	10,318	-11.98	-.38	5.13
S&P 500 Composite	1,527	3-24-00	1,133	1,065	1,128	-26.13	-.44	5.92
Nasdaq	5,049	3-10-00	2,020	1,775	1,915	-62.06	-5.17	7.93
Russell 2000	606	4-5-04	584	518	571	-5.84	-2.25	10.14
Wilshire 5000	14,752	3-24-00	11,056	10,312	10,982	-25.55	-.66	6.50

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.

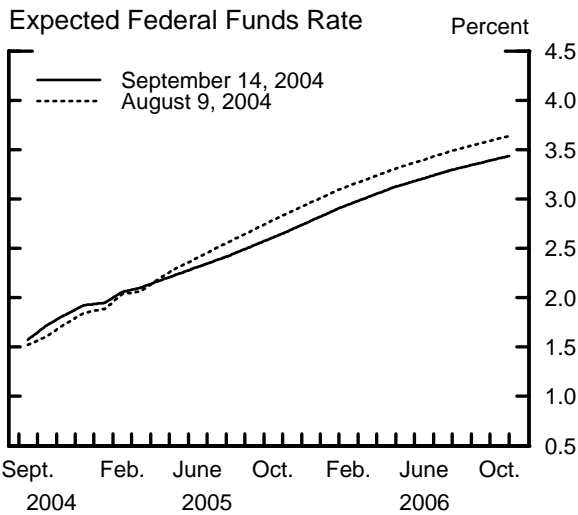
NOTES:

June 28, 2004, is the day before the beginning of the current tightening period.
August 9, 2004, is the day before the most recent FOMC meeting.

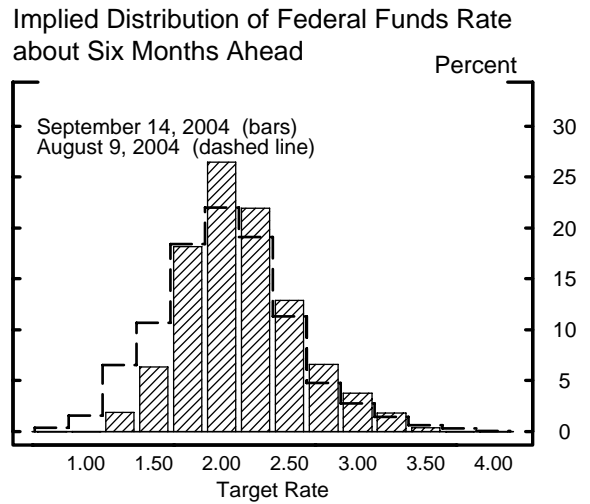
Policy Expectations and Treasury Yields



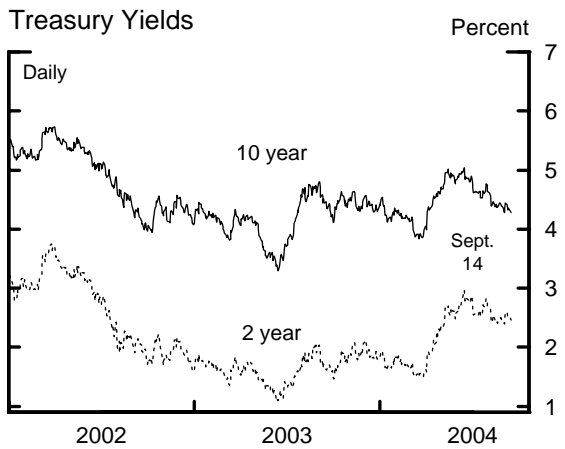
Note. 5-minute intervals.



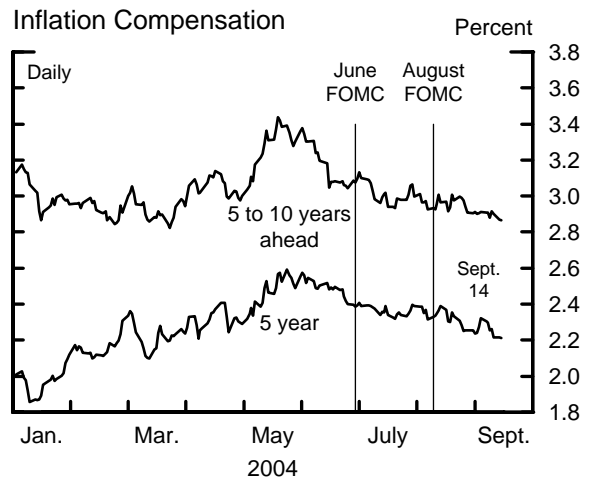
Note. Estimates from federal funds and Eurodollar futures, with an allowance for term premia and other adjustments.



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



Note. Estimates from smoothed Treasury yield curve based on off-the-run securities.



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

Domestic Financial Developments

Overview¹

Near-term policy expectations firmed over the intermeeting period, as investors apparently placed greater weight on the relatively optimistic August FOMC announcement, comments by Federal Reserve officials expressing confidence in the economic outlook, and the reassuring August employment report than on other economic data that came in on the soft side of expectations. Federal funds futures rates now suggest that market participants are nearly certain of a 25 basis point tightening at the September FOMC meeting. At the same time, the anticipated path of policy further ahead edged lower as investors apparently marked down their outlook for inflation. Longer-term Treasury yields dropped with the lower path for policy expectations beyond the middle of next year. Corporate risk spreads narrowed over the intermeeting period, and broad equity price indexes posted solid gains.

Corporate borrowing has strengthened somewhat in recent months from its fairly sluggish first-half pace. Household debt growth stayed robust in the second quarter, although it was a bit below the first quarter's double-digit pace, and low mortgage rates suggest that household borrowing has remained strong in the current quarter. Growth in M2 has ebbed in recent months, a decrease reflecting in part the typical widening of opportunity cost that accompanies rising short-term market rates.

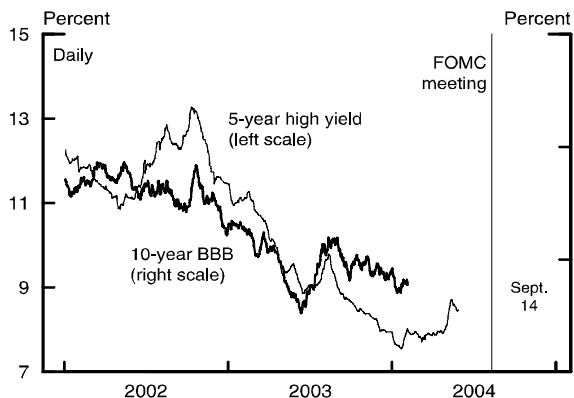
Policy Expectations and Interest Rates

The FOMC's decision at the August meeting to increase the funds rate target by 25 basis points, maintain a balanced assessment of risk, and retain the "measured pace" language was widely anticipated, but investors reportedly viewed the tone of the accompanying statement as optimistic and marked up their expectations for the path of policy. The employment report released earlier this month and a series of comments from Federal Reserve officials expressing confidence about the economic expansion helped to solidify the view that the economy was likely emerging from a "soft patch," even though the economic data releases over the intermeeting period were seen as mixed. At the same time, subdued readings on core price inflation and comments by the Chairman suggesting that inflation pressures were well contained appeared to ease concerns about the inflation outlook. The estimated path for the funds rate implied by futures contracts

1. This review focuses on the period since the last FOMC meeting, as is standard practice for the Greenbook. Accordingly, the effects of the employment report for July, which was released on the Friday between the August Greenbook publication date and the August FOMC meeting, are omitted from the discussion that follows. Nonetheless, we would note that, on the release of the report, the market's expected path for the federal funds rate flattened substantially, and intermediate- and longer-term yields fell as much as 1/4 percentage point. In addition, broad stock price indexes fell about 3 percent between the Greenbook publication date and the FOMC meeting.

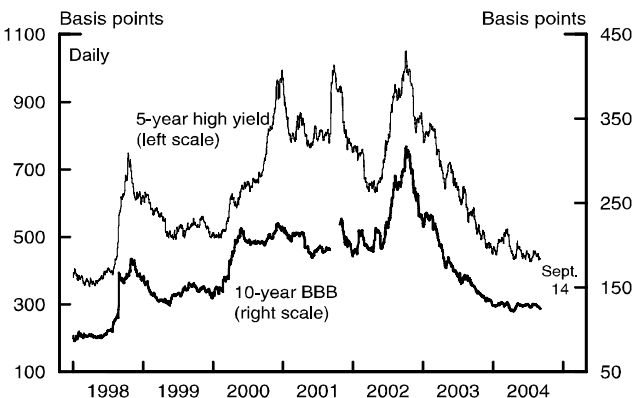
Corporate Yields, Risk Spreads, and Stock Prices

Yields for BBB and High-Yield Corporate Bonds

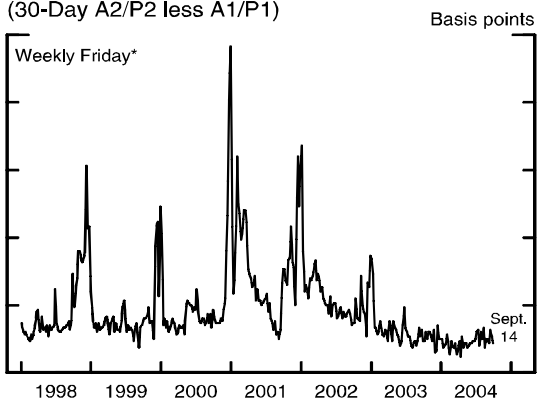


Note. Yields from smoothed yield curves based on Merrill Lynch bond data.

Corporate Bond Spreads to Similar Maturity Treasury

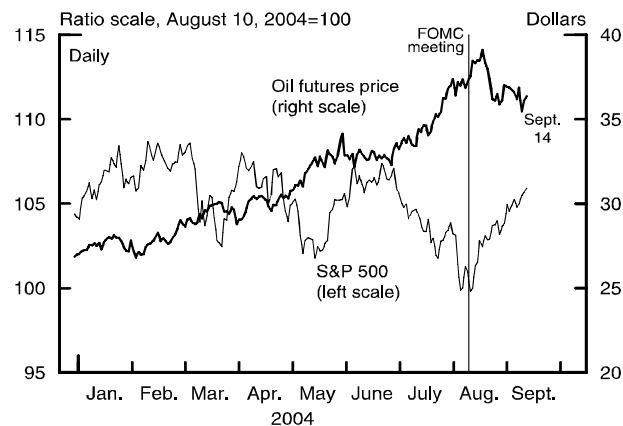


Commercial Paper Quality Spread (30-Day A2/P2 less A1/P1)

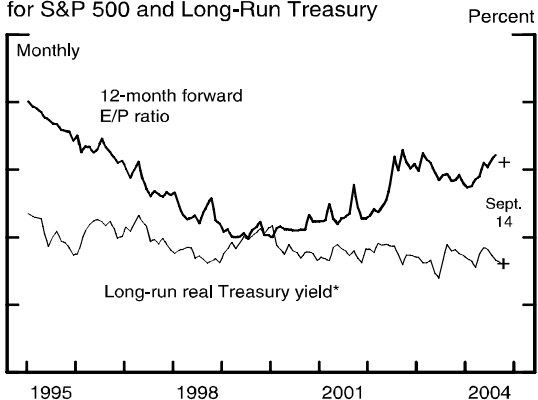


* Latest observation is for most recent business day.

S&P 500 and Oil Futures Priced 24 Months Ahead

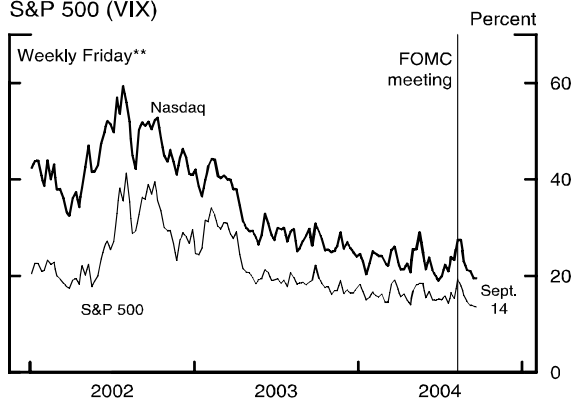


12-Month Forward Earnings-Price Ratio for S&P 500 and Long-Run Treasury



* 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 on Nasdaq 100 (VXN) and S&P 500 (VIX)



Note. Latest observation is for most recent business day.

moved up slightly through the first quarter of next year but shifted down somewhat at longer horizons: Investors now expect the funds rate to reach almost 2 percent by the end of this year and about 2-3/4 percent by the end of 2005. All of the respondents to the New York Fed's Primary Dealer Survey anticipate a 25 basis point hike accompanied by a statement of balanced risks to growth and inflation at the upcoming FOMC meeting.

The Treasury yield curve flattened in line with the shallower slope of the funds rate path and, given the decline in implied volatilities on bond futures, perhaps lower term premiums. The two-year Treasury yield edged up 2 basis points and the ten-year yield fell 14 basis points. TIPS yields were unchanged at the short end and declined less than nominal yields further out, reducing inflation compensation 12 basis points over the next five years and 6 basis points over the subsequent five years.

Yields on investment-grade corporate bonds fell a touch more than those on comparable-maturity Treasury securities over the intermeeting period. Yields on speculative-grade bonds fell about 30 basis points, narrowing risk spreads somewhat. Conditions in commercial paper markets remained accommodative.

Stock Prices, Earnings, and Credit Quality

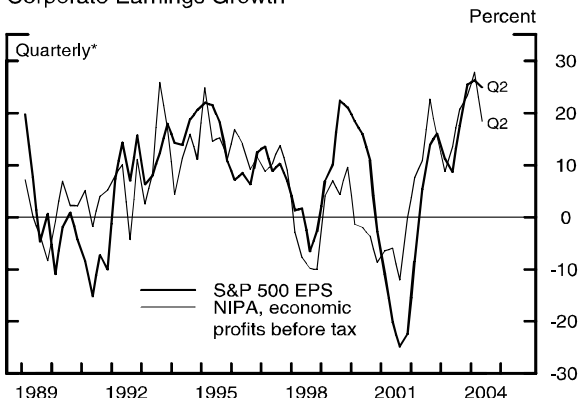
Broad stock price indexes were up about 6 percent, on net, over the intermeeting period, in part because of a pullback of oil prices from their recent peaks, leaving stock prices still shy of recent highs in late June. The rise in stock prices brought the twelve-month forward earnings-price ratio for S&P 500 firms down a touch, and its spread over a real long-run Treasury yield, a rough measure of the equity premium, narrowed a bit. Implied volatility on both the Nasdaq 100 and S&P 500 indexes touched eight-year lows.

Operating earnings per share for S&P 500 firms rose 25 percent over the four quarters ended in the second quarter. Analysts' forecasts in August of year-ahead corporate earnings were little changed from their July levels, which marked the end of an unusually long run of sizable upward revisions. August year-ahead forecasts imply a considerable slowdown in earnings growth over the next few quarters, albeit to a pace that is still relatively strong.

The credit quality of nonfinancial firms continued to improve. The ratio of interest expense to cash flow declined further in the second quarter, dropping to its lowest level in more than two decades. Net upgrades of corporate bonds turned positive in the second quarter, the first positive quarterly reading since 1998, and in July, upgrades outpaced downgrades by an even wider margin. Delinquencies on C&I loans continued to decline in the second quarter, and the six-month trailing default rate on corporate bonds held steady in August at a

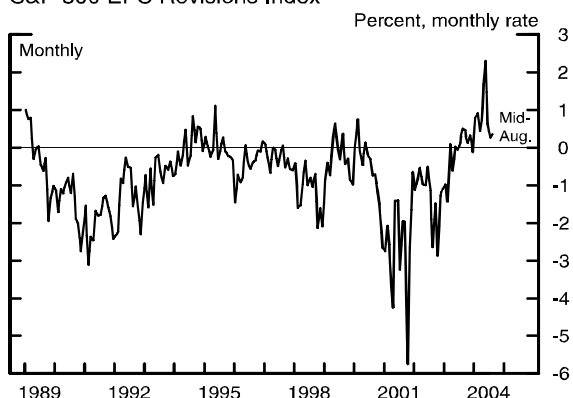
Corporate Earnings and Credit Quality

Corporate Earnings Growth



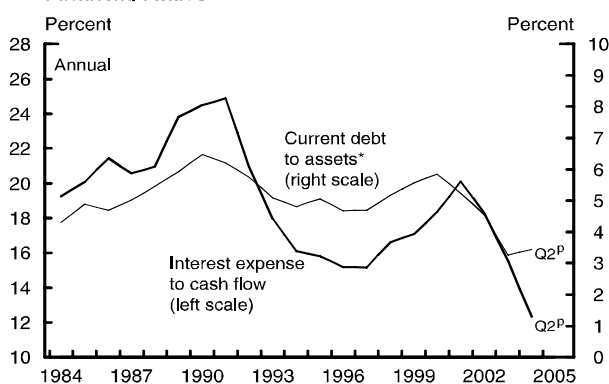
* Change from four quarters earlier.
Source: I/B/E/S for S&P 500 EPS.

S&P 500 EPS Revisions Index



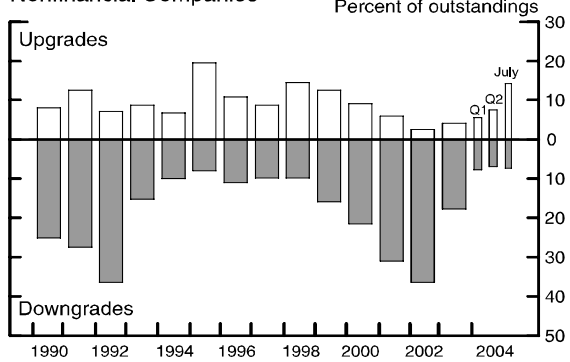
Note. Index is a weighted average of the percent change in the consensus forecasts of current-year and following-year EPS.

Financial Ratios



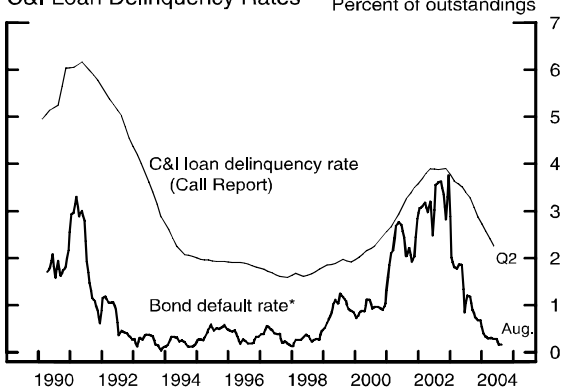
*Note. Current debt includes short-term notes and long-term debt due in one year.
Source: Compustat.
p Preliminary.

Bond Ratings Changes of Nonfinancial Companies



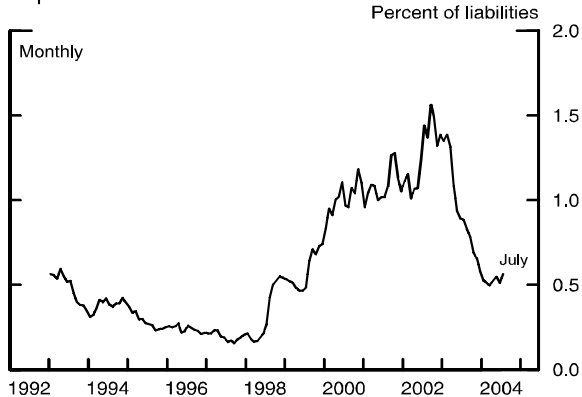
Note. Data are at an annual rate.
Source: Moody's Investors Service.

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	2004		
					H1	July	Aug.
<i>Nonfinancial corporations</i>							
Stocks ¹	9.9	6.5	5.2	3.7	5.7	5.5	5.1
Initial public offerings	4.4	2.1	0.7	0.4	0.8	3.3	2.0
Seasoned offerings	5.5	4.4	4.4	3.2	4.9	2.2	3.1
Bonds ²	22.7	39.8	24.8	31.6	22.7	11.7	22.5
Investment grade	13.2	27.5	15.7	16.0	8.2	5.3	12.1
Speculative grade	4.7	8.9	4.8	11.3	10.5	5.2	7.6
Other (sold abroad/unrated)	4.9	3.4	4.2	4.3	4.0	1.1	2.8
<i>Memo</i>							
Net issuance of commercial paper ³	4.5	-8.0	-6.3	-3.8	2.8	9.5	-3.0
Change in C&I loans at commercial banks ^{3,4}	7.8	-5.8	-5.3	-8.1	-0.9	11.3	6.3
<i>Financial corporations</i>							
Stocks ¹	1.4	4.2	4.0	6.9	8.3	3.2	3.1
Bonds ²	57.8	80.2	87.0	111.1	130.9	138.7	131.7

Note. Components may not sum to totals due to rounding.

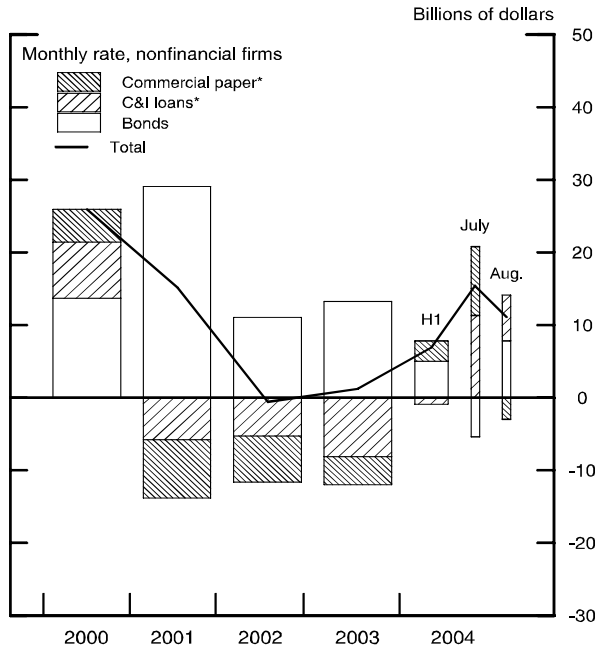
1. Excludes private placements and equity-for-equity swaps that occur in restructurings.

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.

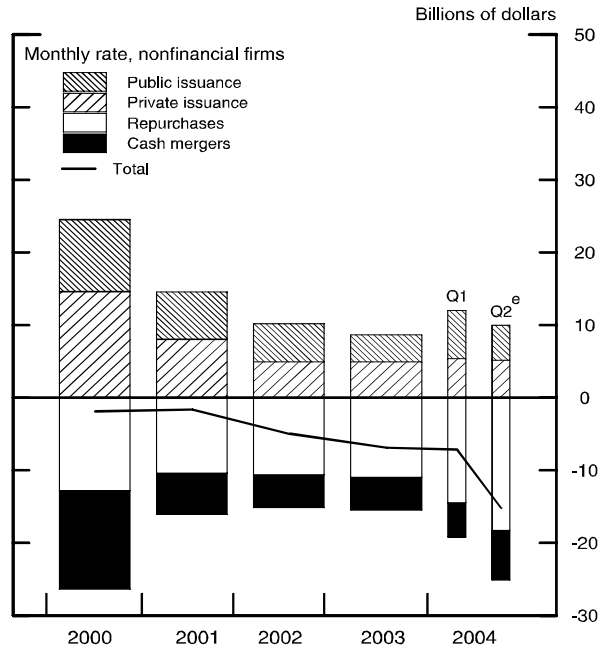
4. Adjusted for FIN 46 effects.

Selected Components of Net Debt Financing



* Seasonally adjusted, period-end basis.

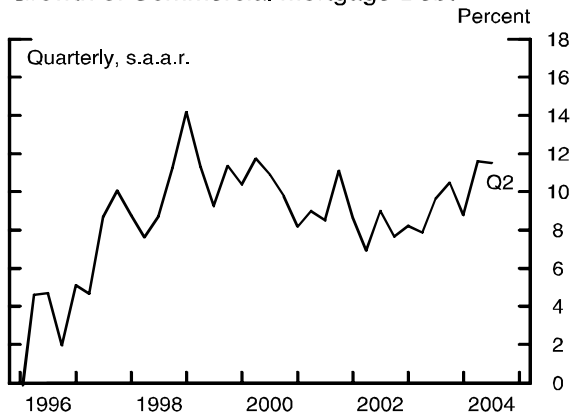
Components of Net Equity Issuance



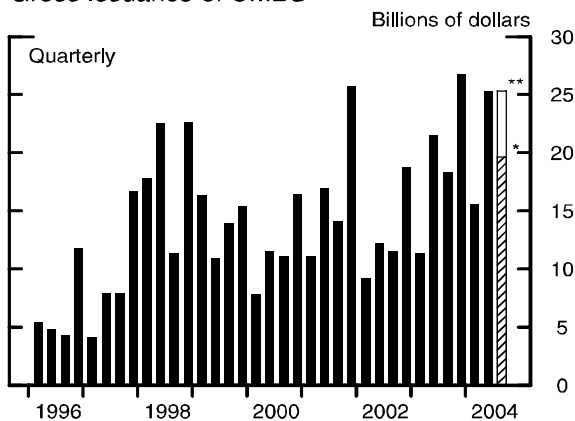
^e Staff estimate.

Commercial Real Estate

Growth of Commercial Mortgage Debt

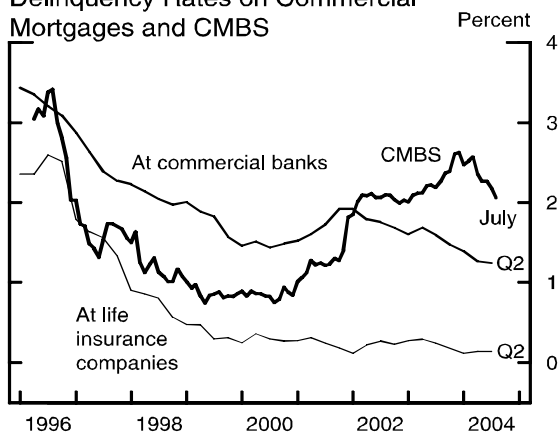


Gross Issuance of CMBS



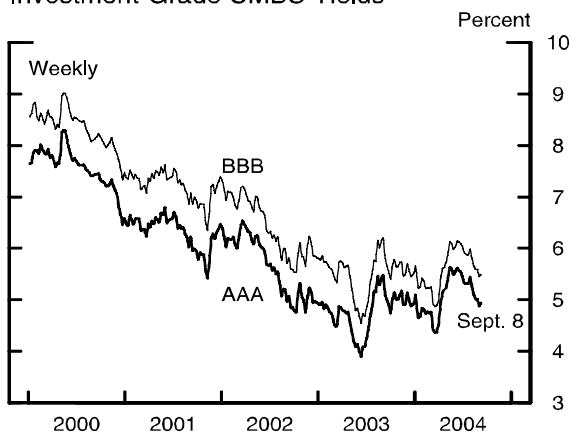
* Through September 9.
 ** Staff estimate.
 Source. Commercial Mortgage Alert.

Delinquency Rates on Commercial Mortgages and CMBS



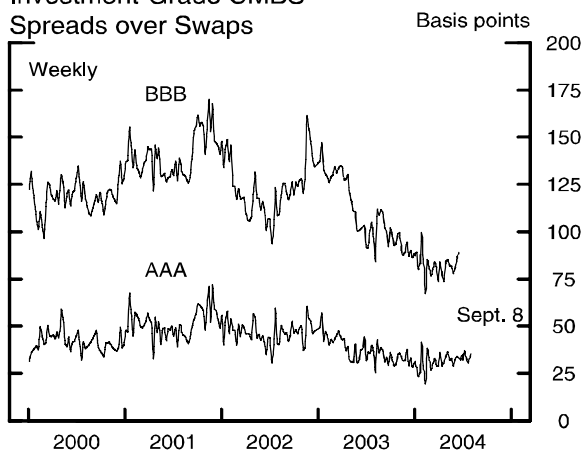
Source. Call Report, ACLI, Morgan Stanley.

Investment-Grade CMBS Yields



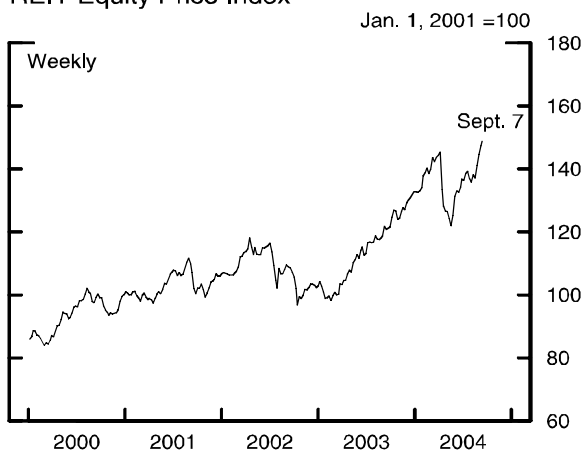
Source. Morgan Stanley.

Investment-Grade CMBS Spreads over Swaps



Source. Morgan Stanley.

REIT Equity Price Index



Source. NAREIT.

very low level. The forecast of aggregate year-ahead default rates based on the KMV model also stayed relatively low in July.

Business Finance

On net, debt growth of nonfinancial firms in recent months has been above the pace of the first half of the year. Gross bond issuance by nonfinancial firms jumped in early August as bond yields dropped substantially. A few firms issued bonds to pay down commercial paper, prompting a small decline in commercial paper in August; most of the decline was reversed early this month. C&I loans expanded briskly in July and August after a moderate gain in the second quarter—the first quarterly increase in more than three years. Responses to the Survey of Terms of Business Lending conducted in August indicated that, adjusted for loan characteristics, the average spread of C&I loan rates was essentially unchanged from the narrow reading in the May survey.

Gross public equity issuance by nonfinancial firms has been sluggish in recent months. Seasoned equity offerings in August were at the lower end of their recent range, and initial public offerings were minimal apart from Google's highly anticipated debut. In contrast to the slow pace of gross public issuance, second-quarter equity retirements picked up on the strength of continued robust corporate profits and ample cash on firms' balance sheets. Both cash-financed mergers and share repurchases increased in the second quarter and will likely be even stronger in the third quarter given the recent pace of announcements. As a result, net equity issuance is estimated to have dropped in the second quarter and is likely to come in even more negative in the current quarter.

Commercial Real Estate

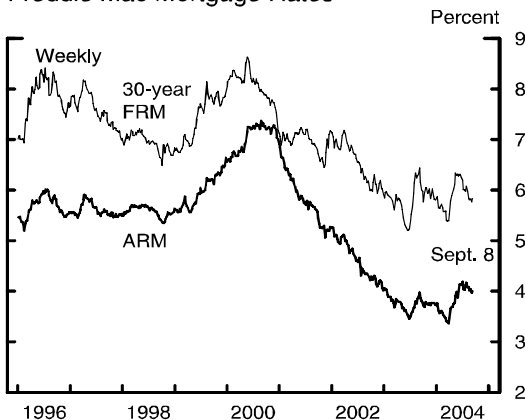
Commercial mortgage debt expanded at a rapid annual rate of 11-1/2 percent in the second quarter, and the available information points to continued strength in the third quarter. Meanwhile, credit quality remained favorable, with the delinquency rate on commercial-mortgage-backed securities (CMBS) maintaining its downward trend in July and the delinquency rates on commercial mortgages held by banks and insurance companies remaining at low levels in the second quarter. CMBS spreads have stayed low, and REIT equity prices have now fully reversed their spring decline.

Household Finance

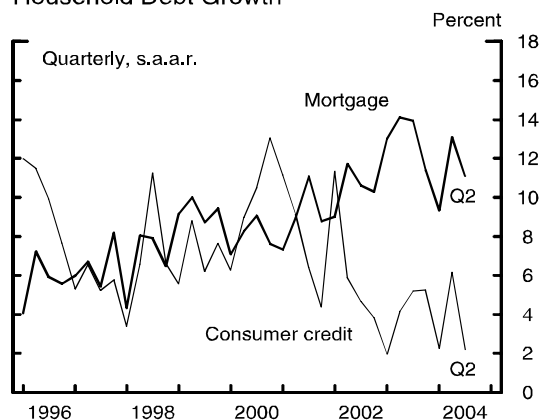
Interest rates on adjustable-rate and thirty-year fixed-rate home mortgages fell slightly over the intermeeting period. With rates at attractive levels and mortgage applications well maintained, it appears likely that mortgage debt growth will remain robust through the current quarter. While still relatively high, the spread between rates on fixed-rate and adjustable-rate mortgages has declined about 10 basis points since the last FOMC and more than 60 basis

Household Liabilities

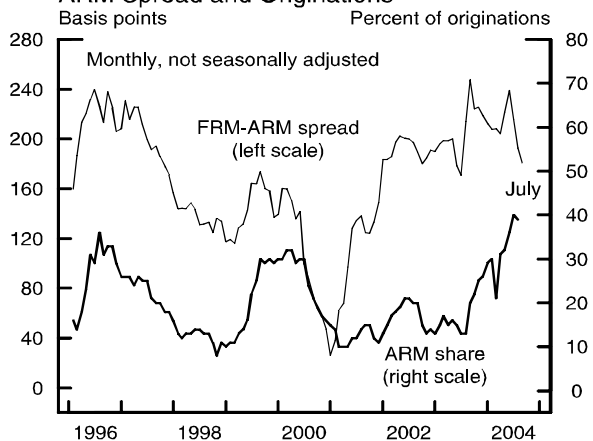
Freddie Mac Mortgage Rates



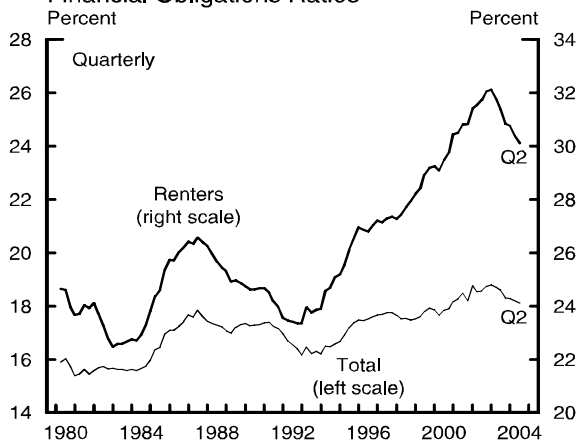
Household Debt Growth



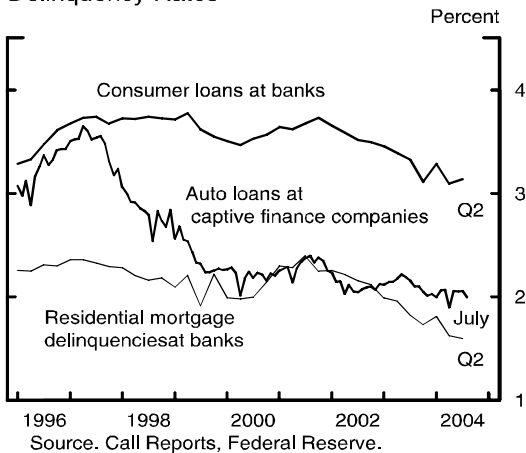
ARM Spread and Originations



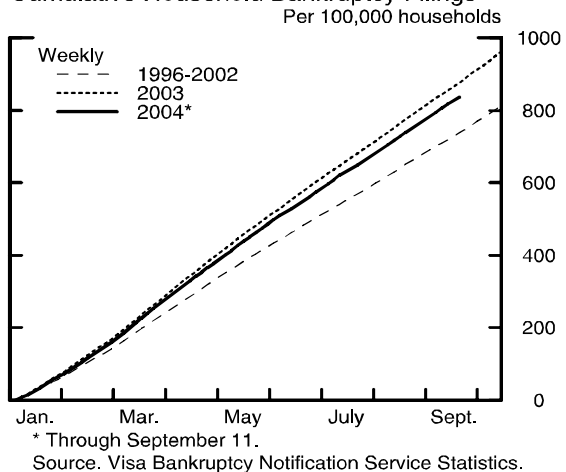
Financial Obligations Ratios



Delinquency Rates



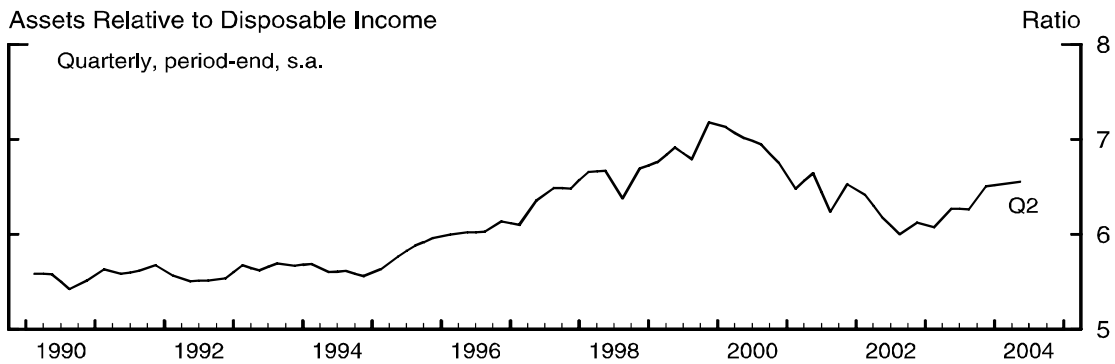
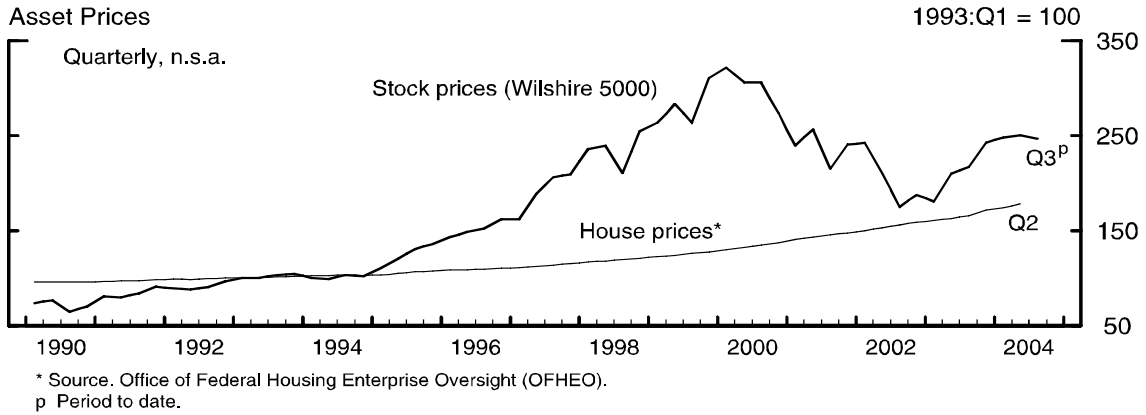
Cumulative Household Bankruptcy Filings



Source. Call Reports, Federal Reserve.

* Through September 11.
Source. Visa Bankruptcy Notification Service Statistics.

Household Assets



Net Flows into Long-Term Mutual Funds (Billions of dollars, monthly rate)

Fund Type	2001	2002	2003	2004				Assets July
				Q1	Q2	July	Aug. ^e	
Total long-term funds	10.8	10.1	18.0	36.5	3.8	10.9	9.4	5,488
Equity funds	2.7	-2.3	12.7	28.4	11.3	7.4	1.1	3,796
Domestic	4.5	-2.1	10.7	19.9	7.6	4.3	-1.2	3,240
International	-1.8	-0.2	2.0	8.5	3.7	3.1	2.3	556
Hybrid funds	0.8	0.7	2.7	5.1	3.1	2.5	2.6	463
Bond funds	7.3	11.7	2.6	3.0	-10.5	1.1	5.7	1,230
High-yield	0.6	0.9	2.2	-1.4	-2.7	0.4	0.8	142
Other taxable	5.7	9.4	1.0	4.2	-4.0	1.6	5.0	767
Municipals	1.0	1.4	-0.6	0.2	-3.9	-1.0	-0.0	320

Note. Excludes reinvested dividends.

e Staff estimates based on confidential ICI weekly data.

Source. Investment Company Institute.

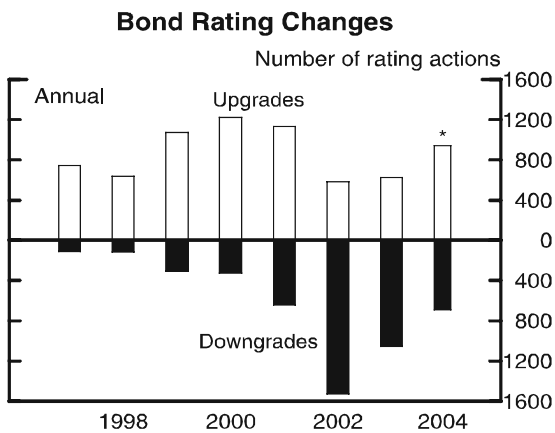
State and Local Government Finance

Gross Offerings of Municipal Securities

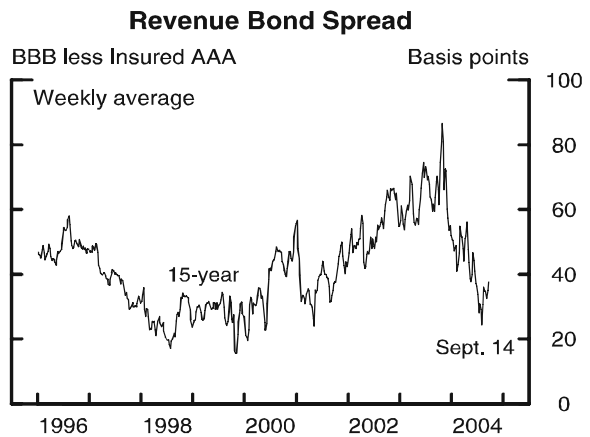
(Billions of dollars; monthly rate, not seasonally adjusted)

Type of security	2001	2002	2003	2004			
				Q1	Q2	July	Aug.
Total	29.0	36.3	37.8	31.4	39.3	28.9	36.9
Long-term ¹	24.3	30.3	32.0	28.5	34.9	24.5	25.8
Refundings ²	7.6	10.1	10.0	10.8	10.0	7.7	9.1
New capital	16.7	20.2	22.0	17.7	24.9	16.8	16.7
Short-term	4.7	6.0	5.8	2.8	4.5	4.3	11.1
Memo: Long-term taxable	1.4	1.7	3.5	2.1	3.0	0.9	1.3

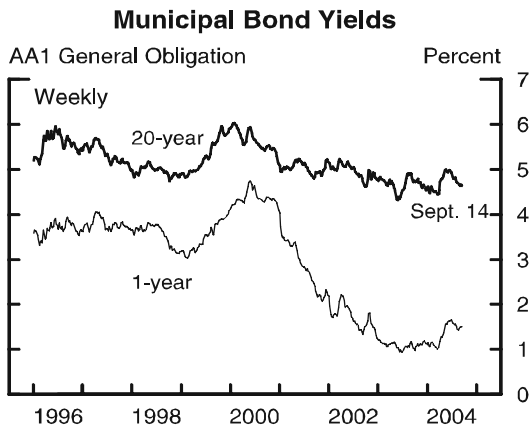
- 1. Includes issues for public and private purposes.
- 2. All issues that include any refunding bonds.



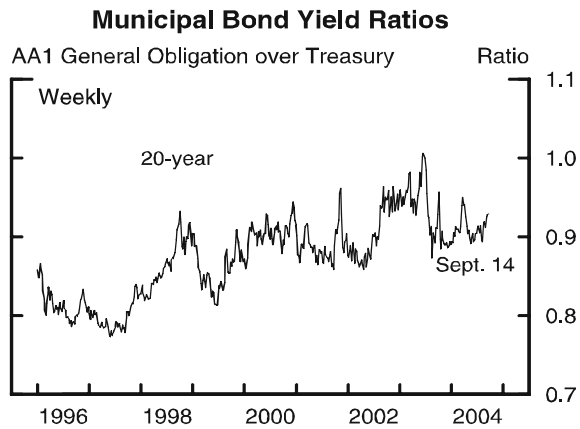
* Data through September 8 at an annual rate.
Source: S&P's Credit Week Municipal and Ratings Direct.



Source: Bloomberg.



Source: Bloomberg.



Source: Bloomberg.

points since its recent high in May. Accordingly, the ARM share of originations has likely continued to decline after its tick down in July.

The ratio of households' financial obligations to their disposable income edged down further in the second quarter. This ratio had declined 2/3 percentage point since the end of 2002, in part because of slow growth in rent payments relative to income. The relative slowing of rent payments suggests some easing of financial pressure for renters, who tend to have more burdensome financial obligations than other households. Indeed, the estimated financial obligations ratio for renters declined by 2 percentage points since the end of 2002.

Measures of household credit quality held steady over the intermeeting period. Delinquency rates on auto loans at captive finance companies remained low in July, while those on consumer loans and residential mortgages at commercial banks were little changed during the second quarter. Estimated year-to-date household bankruptcy filings were nearly 5 percent lower than they were over the same period last year, but they remained somewhat elevated compared with the pace in previous years.

Modest gains in stock prices, brisk house-price appreciation, and moderate income growth resulted in an essentially unchanged ratio of household net worth to disposable income over the second quarter. The only available indicator of household net worth for the third quarter is stock prices, which are at about the same level as they were at the end of the second quarter.

Aggregate estimated inflows to capital market mutual funds were tepid in August and slightly off July's pace. Sharp increases in flows to bond funds in August were balanced by declines in flows to equity funds.

State and Local Government Finance

Gross issuance of long-term municipal bonds was moderate in July and August, holding at a level considerably below the elevated pace seen over the preceding few years. Short-term debt issuance rose in August, but the bulk of the increase came from a single \$6.6 billion issue by the state of Texas, which typically issues short-term bonds in late summer to cover funding needs at the start of its fiscal year until tax revenues arrive in January. Aside from this deal, the level of short-term issuance remained low, reflecting the improved budget situations in many states.

Municipal bond credit quality continued to strengthen. Upgrades of municipal bonds again outpaced downgrades in August and early September, as they have since February. In particular, S&P upgraded California's general obligation

Treasury Financing
(Billions of dollars)

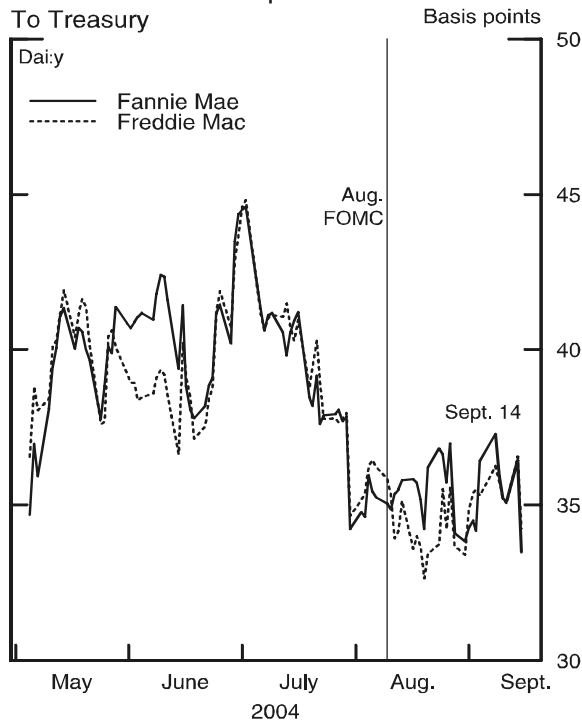
Item	2003		2004			
	Q3	Q4	Q1	Q2	July	Aug
Total surplus, deficit (-)	-104.5	-128.7	-170.8	-25.7	-69.2	-44.6
Means of financing deficit						
Net borrowing	107.6	118.6	135.9	43.9	47.8	29.0
Nonmarketable	31.4	6.6	-10.1	9.4	-3.7	-2.4
Marketable	76.2	112.0	146.0	34.5	51.5	31.4
Bills	-14.9	9.2	56.1	-34.9	15.5	14.2
Coupons	91.1	102.8	89.9	69.4	36.0	17.3
Decrease in cash balance	-4.9	1.8	11.9	-23.3	10.0	32.1
Other ¹	1.9	8.3	23.0	5.1	11.4	11.4
Memo:						
Cash balance, end of period	35.0	33.2	21.3	44.6	34.6	2.5

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

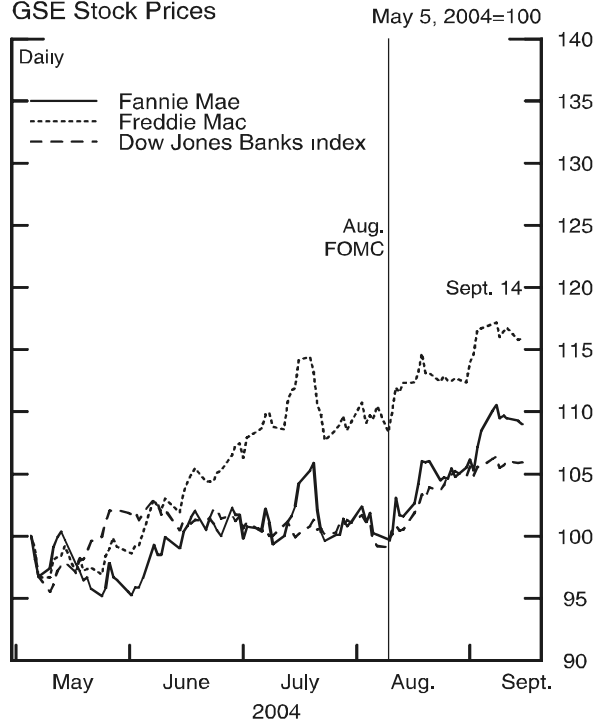
1. Direct loan financing, accrued items, checks issued less checks paid, and other transactions.

GSE Market Developments

Ten-Year GSE Yield Spreads To Treasury



GSE Stock Prices



bonds from BBB to A. Risk spreads of BBB-rated municipal bond yields over AAA yields were little changed and remained near multiyear lows.

Treasury and GSE Finance

After a somewhat larger-than-anticipated monthly federal budget surplus in June, the deficits for July and August were close to market expectations. The Treasury's midquarter refunding was reportedly well received by investors, and the continuing solid level of indirect bidding indicated that foreign demand for Treasury securities remained strong.

The level of federal debt again has begun to approach its statutory limit, and current staff estimates suggest that the ceiling will be reached by the middle of October. If, as expected, the Congress fails to raise the debt limit by then, the Treasury will likely be forced to employ accounting maneuvers similar to those used in past years to keep debt under the limit for a few weeks.

Despite uncertainty about the outcomes of ongoing investigations into their accounting practices, the spreads of yields of Fannie Mae and Freddie Mac bonds over comparable Treasury securities were little changed over the intermeeting period. Their stock prices rose slightly more than those of commercial banks.

Money and Bank Credit

Growth in M2 was essentially flat over July and August, a sharp deceleration from the rapid growth in the second quarter. This slowing apparently resulted from increases in the opportunity cost of M2 with the move to tighter monetary policy and the lingering effects of the late-spring dropoff in mortgage refinancing. In particular, retail money funds and liquid deposits, whose rates of return are slow to adjust to increases in market rates, posted minimal growth or outright declines. In contrast, small time deposits, whose rates of return adjust more promptly, posted positive growth in July for the first time in more than two years and strengthened further in August.

After stalling in July, bank credit increased at an annual rate of almost 4 percent in August as a contraction in banks' securities holdings was more than offset by moderate loan growth.² C&I loans originated by banks grew for the third consecutive month. Real estate loan growth slowed from its second-quarter pace, partly reflecting securitizations. Consumer loans adjusted for securitizations edged down.

2. In July, the composition of bank credit was affected by a \$30 billion reclassification; two institutions reclassified the seller's interest portion of securitized credit card loans from other securities to consumer loans.

Monetary Aggregates
(Based on seasonally adjusted data)

Aggregate or component	2003	2004					Level (\$ billions) Aug (e)
		Q1	Q2	June	July	Aug (e)	
<i>Aggregate</i>							
Percent change (annual rate) ¹							
1. M2 ²	5.3	3.5	9.7	1.8	-1.5	1.4	6,299
2. M3 ³	4.6	6.1	10.7	3.9	-2.9	2.9	9,279
<i>Components of M2⁴</i>							
3. Currency	5.9	2.8	4.0	8.8	14.4	4.9	688
4. Liquid deposits ⁵	13.8	10.4	17.4	3.6	-9	3.1	4,074
5. Small time deposits	-9.3	-4.5	-5.9	-5.0	1.7	4.0	792
6. Retail money market funds	-11.6	-19.4	-7.2	-6.9	-22.4	-13.5	738
<i>Components of M3</i>							
7. M3 minus M2 ⁶	3.1	11.7	12.9	8.3	-5.7	5.9	2,980
8. Large time deposits, net ⁷	3.6	28.9	27.3	14.4	22.0	7.4	1,013
9. Institutional money market funds	-5.8	-7.8	2.5	-7.2	-18.0	3.0	1,099
10. RPs	14.1	13.7	6.1	46.8	-38.6	11.6	544
11. Eurodollars	27.4	33.7	19.4	-19.4	8.9	1.5	325
<i>Memo</i>							
12. Monetary base	6.0	3.1	4.9	9.0	12.7	4.2	748
Average monthly change (billions of dollars) ⁸							
<i>Selected managed liabilities at commercial banks</i>							
13. Large time deposits, gross	-1.5	15.4	20.5	25.4	19.8	1.0	1,141
14. Net due to related foreign institutions	3.1	-16.6	-13.7	-46.5	10.1	-17.6	23
15. U.S. government deposits at commercial banks	-0.4	2.4	0.0	3.3	-10.2	-5.8	5

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	June 2004	July 2004	Aug. 2004	Level, Aug. 2004 (\$ billions)
Total							
1. Adjusted¹	5.9	11.4	10.9	7.4	-7	3.9	6,342
2. Reported	5.6	12.0	7.2	6.8	2.8	5.7	6,512
<i>Securities</i>							
3. Adjusted ¹	8.6	18.0	14.5	2.7	-30.5	-2.1	1,710
4. Reported	7.3	19.5	2.0	.9	-16.4	5.0	1,880
5. Treasury and agency	8.8	24.1	10.5	.1	-6.3	2.6	1,183
6. Other ²	5.0	12.4	-11.4	2.4	-33.0	8.8	697
<i>Loans³</i>							
7. Total	4.9	8.9	9.5	9.2	10.8	6.1	4,632
8. Business	-9.3	-6.0	-3.7	5.2	6.7	9.2	869
9. Real estate	11.1	10.2	19.5	5.9	4.2	7.7	2,421
10. Home equity	30.8	37.8	36.8	35.3	35.0	39.2	357
11. Other	8.8	6.3	16.8	1.3	-9	2.4	2,064
12. Consumer	5.6	11.5	4.3	5.4	53.6	1.1	672
13. Adjusted ⁴	6.0	10.4	-2.1	.7	40.4	-5	1,035
14. Other ⁵	6.7	22.6	-2.6	30.3	-1.3	1.1	670

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.

International Developments

International Developments

U.S. International Transactions

Trade in Goods and Services

Since the August Greenbook, trade data were released for June and July. In June, the U.S. international trade deficit reached a record high of \$55.0 billion, (revised down from a preliminary estimate of \$55.8 billion). The trade deficit shrank to \$50.1 billion in July, but was still much larger than May's deficit.

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

	2003	Annual rate			Monthly rate		
		2003	2004		2004		
		Q4	Q1	Q2	May	June	July
<i>Real NIPA¹</i>							
Net exports of G&S	-518.5	-528.3	-550.1	-588.7	...	...	...
<i>Nominal BOP</i>							
Net exports of G&S	-496.5	-502.0	-554.4	-601.1	-47.1	-55.0	-50.1
Goods, net	-547.6	-557.8	-603.1	-654.3	-51.5	-59.1	-54.5
Services, net	51.0	55.8	48.7	53.2	4.4	4.1	4.4

1. Billions of chained (2000) dollars.

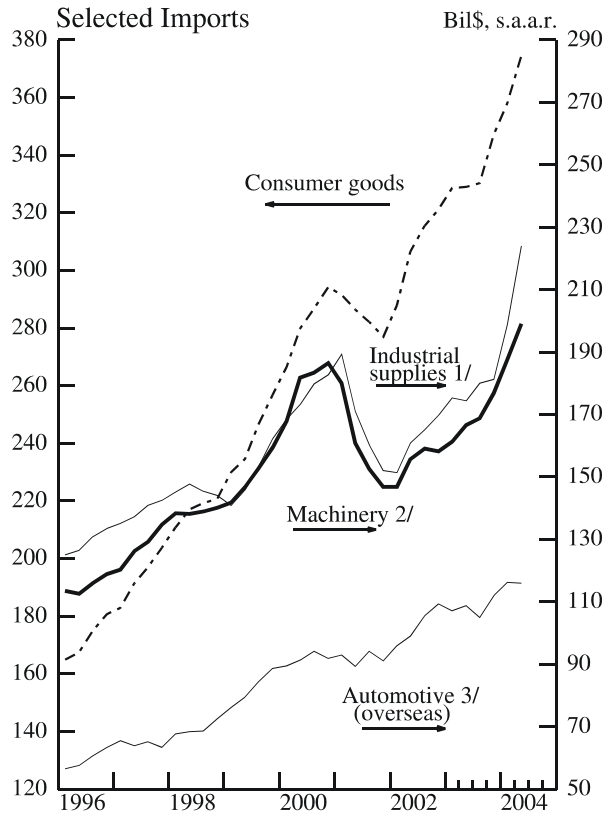
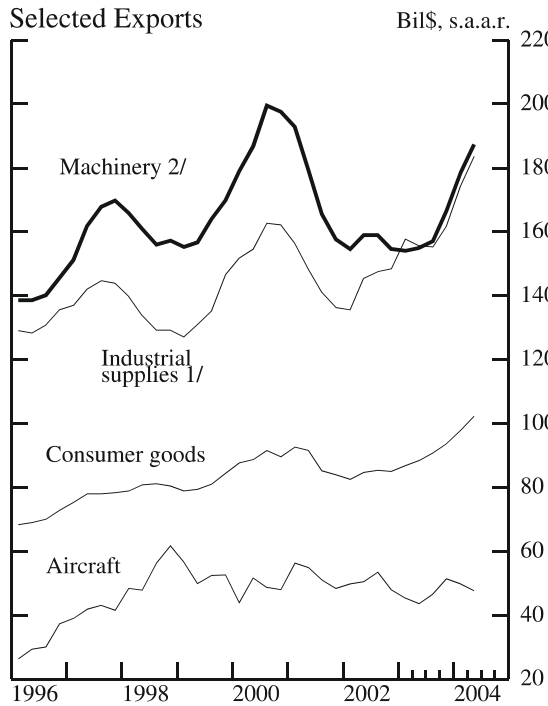
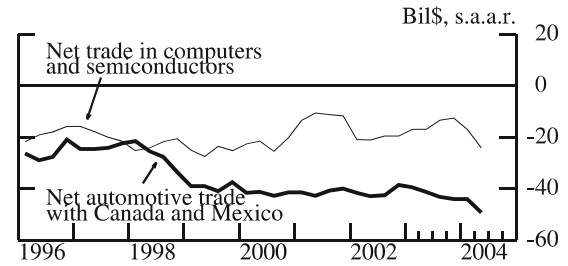
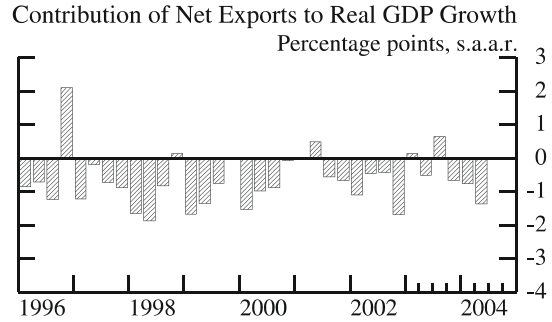
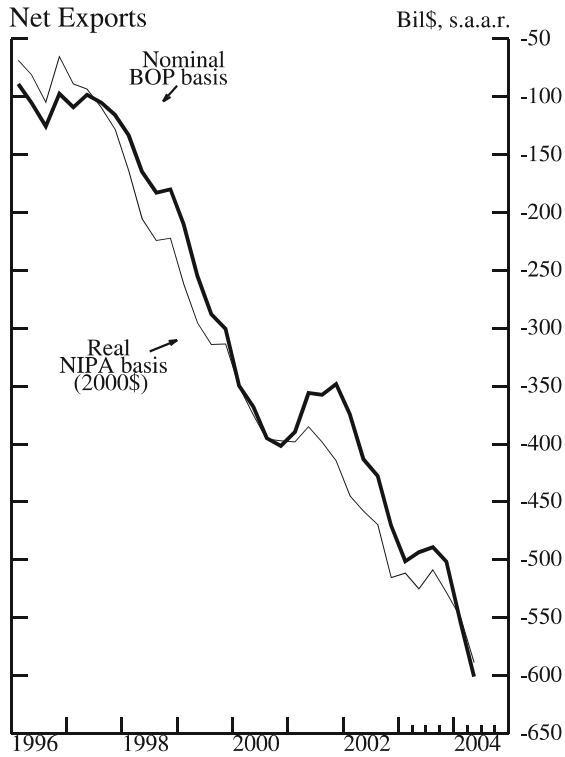
Source: U.S. Department of Commerce, Bureau of Economic Analysis and Census.

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

In June, the value of exports of goods and services decreased 3.9 percent, with exports of goods accounting for the entire fall, as exports of services edged up. The decrease in the value of exported goods was widespread. The largest declines occurred in capital goods, industrial supplies, and agricultural products. Within capital goods, aircraft and "other" capital goods showed the steepest declines, though computers and semiconductors also fell. Overall, for the second quarter, the value of exported goods and services was about 12½ percent at an annual rate above its first quarter level. The quarterly increase was concentrated in services, industrial supplies, and capital goods. Exports of automotive products and consumer goods also rose, but exports of agricultural products fell.

After the sharp fall in June, the value of exports of goods and services partially recovered in July, increasing 3.0 percent. Exports of goods more than accounted 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 (particularly aircraft), industrial supplies, and automotive products. Exports of agricultural products also increased. However, the category of automotive products was the only one for which July's recovery was sufficient to result in exports being greater than May's value. For the fourth consecutive month, exports of consumer goods declined.

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	June	July	Q1	Q2	June	July
Exports of G&S	1104.3	1137.2	1117.0	1150.4	31.1	32.9	-45.7	33.3
Goods exports	775.7	797.3	776.1	809.8	28.2	21.6	-48.2	33.7
Gold	4.4	3.5	3.3	4.7	-0.3	-0.9	-0.4	1.4
Other goods	771.3	793.8	772.8	805.1	28.5	22.5	-47.8	32.3
Aircraft & parts	49.9	47.7	42.0	50.8	-1.4	-2.2	-11.6	8.8
Computers & accessories	42.0	41.8	41.2	43.9	-0.8	-0.2	-1.5	2.6
Semiconductors	50.1	49.0	45.7	46.3	0.3	-1.1	-5.3	0.6
Other capital goods	181.4	190.4	187.7	193.6	12.0	9.0	-9.9	5.9
Automotive	83.6	85.5	83.8	91.2	1.1	2.0	-3.2	7.4
to Canada	46.4	47.1	46.7	52.0	-1.4	0.7	-0.7	5.4
to Mexico	15.3	16.0	14.8	12.0	1.6	0.7	-2.4	-2.9
to ROW	21.8	22.4	22.3	27.2	1.0	0.5	-0.1	4.9
Agricultural	63.6	62.8	60.0	62.4	-1.6	-0.8	-4.9	2.4
Ind supplies (ex. ag, gold)	174.5	183.6	178.5	189.0	12.7	9.1	-13.3	10.5
Consumer goods	97.9	102.2	101.2	99.1	4.2	4.3	-1.1	-2.1
All other goods	28.4	30.8	32.6	28.8	2.0	2.4	-11.6	-3.8
Services exports	328.6	339.9	340.9	340.6	2.8	11.3	2.5	-0.3
Imports of G&S	1658.7	1738.3	1777.3	1752.1	83.5	79.6	49.7	-25.2
Goods imports	1378.8	1451.6	1485.5	1463.9	73.6	72.8	43.5	-21.6
Petroleum	162.4	164.2	182.2	165.0	28.0	1.8	26.3	-17.2
Gold	4.1	3.3	3.2	4.3	0.3	-0.8	0.5	1.1
Other goods	1212.3	1284.1	1300.1	1294.6	45.3	71.8	16.7	-5.5
Aircraft & parts	21.6	24.4	28.3	26.4	-4.7	2.8	6.5	-1.9
Computers & accessories	82.7	87.7	88.4	91.7	2.1	5.1	-0.4	3.3
Semiconductors	26.5	27.3	27.9	27.7	1.7	0.8	1.5	-0.2
Other capital goods	190.2	201.2	207.6	205.1	11.1	11.0	8.4	-2.5
Automotive	222.1	228.4	224.5	229.1	4.3	6.3	-8.6	4.7
from Canada	64.0	67.7	67.8	67.5	-0.4	3.7	0.4	-0.3
from Mexico	41.9	44.7	45.9	36.3	0.6	2.8	0.5	-9.5
from ROW	116.2	116.0	110.8	125.3	4.1	-0.2	-9.5	14.5
Ind supplies (ex. oil, gold)	198.8	224.0	235.3	234.6	17.5	25.2	10.8	-0.7
Consumer goods	358.0	374.6	371.5	366.2	10.6	16.6	-1.0	-5.3
Foods, feeds, bev.	60.2	62.5	63.0	61.7	1.7	2.3	-0.2	-1.2
All other goods	52.2	54.0	53.6	51.9	1.0	1.8	-0.3	-1.7
Services imports	280.0	286.7	291.8	288.2	10.0	6.8	6.2	-3.6
<i>Memo:</i>								
Oil quantity (mb/d)	14.38	13.01	14.04	12.81	1.09	-1.38	1.95	-1.23
Oil import price (\$/bbl)	30.88	34.53	35.52	35.26	3.22	3.64	0.23	-0.26

1. Change from previous quarter or month.

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

The value of imports of goods and services rose 2.9 percent in June, as imports of goods surged and imports of services rose modestly. Within goods, the largest increases were in imports of petroleum (mostly from higher quantity, but also from higher prices), capital goods, and non-oil industrial supplies. Imports of consumer goods and of foods, feeds and beverages edged down. Imports of automotive products (particularly from non-NAFTA partners) fell more sharply. At an annual rate, the value of imported goods and services in the second quarter was nearly 21 percent above its first quarter level. The quarterly rise was driven largely by increases in imports of non-oil industrial supplies, capital goods, and consumer goods.

Following the sizable increase in June, the value of imports of goods and services fell 1.4 percent in July, with declines in both imports of goods and services. Within the major categories of goods, only imports of automotive products increased in July. Imports of foods and consumer goods had the sharpest percentage declines. Imports of capital goods and industrial supplies also edged downward. In July, the value of oil imports fell as a sharp decline in volume was reinforced with a small decline in price.

Prices of Internationally Traded Goods

Since the August Greenbook, price data for traded goods were released for July and August.

Non-oil imports.

In July, the prices of U.S. imports of non-oil goods were unchanged, but prices of core goods increased 0.1 percent. Prices of imported core goods rose slightly faster than in June, but still below the rates of increase seen earlier in the year. The largest contribution to core import prices came from prices of imported capital goods (excluding computers and semiconductors), which, after having been about flat throughout most of this year, rose 0.4 percent in July (mostly from higher prices for imported industrial and service machinery). Prices of imported foods also increased 0.4 percent in July. Import prices for consumer goods and automotive products saw little change in July. Prices of imported computers and semiconductors continued to decline in July.

In August, the prices of U.S. imports of non-oil goods and of core goods increased 0.4 and 0.5 percent, respectively. Prices of imported core goods picked up noticeably from July and rose at the fastest monthly rate since April. After increasing only 0.2 percent in July, prices of imported non-oil industrial supplies contributed the most to the acceleration, rising 2.0 percent in August, largely reflecting a surge in lumber prices. Import prices of capital goods (excluding computer and semiconductors) rose 0.2 percent in August, the second consecutive month of price increases. Prices of imported foods,

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

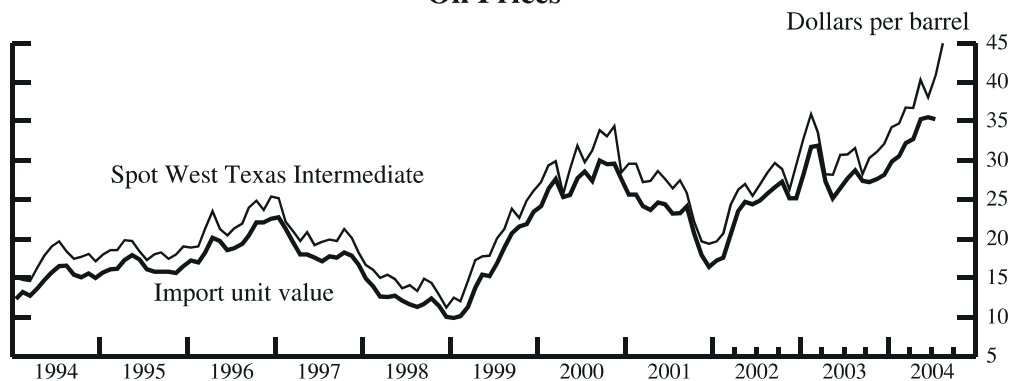
	Annual rates			Monthly rates		
	2004			2004		
	Q1	Q2	Q3 ^e	June	July	Aug.
	----- BLS prices -----					
Merchandise imports	11.5	7.4	6.1	-0.2	0.3	1.7
Oil	68.1	43.1	42.1	-1.2	2.0	9.6
Non-oil	5.9	3.0	1.3	0.1	0.0	0.4
Core goods*	7.1	4.3	2.2	0.2	0.1	0.5
Cap. goods ex comp & semi	2.6	0.0	1.9	0.0	0.4	0.2
Automotive products	1.7	1.4	0.5	0.2	0.0	0.0
Consumer goods	2.6	-0.7	0.0	-0.1	0.1	0.0
Foods, feeds, beverages	10.0	7.7	1.2	0.0	0.4	0.1
Industrial supplies ex oil	25.3	18.7	8.5	0.4	0.2	2.0
Computers	-1.7	-8.6	-7.7	-1.2	-0.8	-0.7
Semiconductors	-8.2	-6.9	-4.5	-0.1	-1.2	0.1
Merchandise exports	7.4	5.9	-0.6	-0.8	0.5	-0.5
Core goods*	8.4	6.5	-0.1	-0.7	0.6	-0.6
Cap. goods ex comp & semi	2.2	0.9	1.2	0.1	0.1	0.2
Automotive products	0.3	1.4	1.0	0.1	0.1	0.1
Consumer goods	1.1	1.1	2.3	-0.1	0.5	0.2
Agricultural products	19.0	17.5	-28.6	-4.7	-1.0	-8.5
Industrial supplies ex ag	21.3	14.3	10.6	-0.3	1.9	0.8
Computers	1.2	0.0	-7.3	-1.9	-0.5	-0.1
Semiconductors	-1.7	2.3	-1.9	-0.9	0.1	0.0
	----- NIPA prices -----					
Chain price index						
Imports of goods & services	9.6	6.3	n.a.	...	...	...
Non-oil merchandise	5.6	2.8	n.a.	...	...	...
Core goods*	6.4	4.0	n.a.	...	...	...
Exports of goods & services	5.7	4.6	n.a.	...	...	...
Total merchandise	6.4	5.4	n.a.	...	...	...
Core goods*	7.9	5.8	n.a.	...	...	...

* / Excludes computers and semiconductors.

^e / Average of two months.

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

Oil Prices



following a strong July, edged up just 0.1 percent in August. Import prices of computers continued to decline in August, whereas prices of imported semiconductors edged up 0.1 percent. Import prices for consumer goods and automotive products were unchanged in August.

Overall, the average level of imported core goods prices in July and August was 2¼ percent at an annual rate above the second-quarter level. This rate of increase is much smaller than the increases in the first and second quarters. In July and August, the rise was concentrated in non-oil industrial supplies and, to a lesser extent, capital goods (excluding computers and semiconductors), and foods.

Oil. After increasing 2 percent in July, the BLS price of imported oil rose nearly 10 percent in August, in line with the average monthly increase in the spot price of West Texas Intermediate (WTI) crude oil. The spot price of WTI surged to a record high of \$48.70 per barrel in mid-August amid concerns about the availability of supply to meet surprisingly strong demand. Since then, the spot price of WTI has dropped back to about \$44 per barrel, but remains volatile. Factors influencing oil prices include ongoing violence in Iraq, uncertainty about future oil production and exports by Yukos in Russia, recent declines in U.S. crude oil inventories, and storm activity in the Gulf of Mexico.

Exports.

In July, the prices of U.S. exports of total goods and of core goods rose 0.5 and 0.6 percent, respectively. Rising 1.9 percent in July, prices for exported non-agricultural industrial supplies (particularly steel and iron products) contributed to most of the increase. Export prices of consumer goods also contributed, rising 0.5 percent. These increases more than offset a 1.0 percent drop in the price of agricultural exports, the second consecutive month of price declines. Prices of exported capital goods (excluding computers and semiconductors) ticked up 0.1 percent. Export prices of computers fell 0.5 percent, whereas export prices of semiconductors increase 0.1 percent.

In August, the prices of U.S. exports of total goods and of core goods retraced their increases in July, falling 0.5 and 0.6 percent, respectively. The fall in export prices is entirely attributable to a fall in the prices of U.S. agricultural exports, particularly soybeans and corn. Following strong increases in July, prices of exported non-agricultural industrial supplies rose 0.8 percent in August. Export prices of consumer goods and capital goods (excluding computers and semiconductors) each rose 0.2 percent. In August, prices of exported automotive products ticked up 0.1 percent. Export prices of computers fell 0.1 percent, whereas export prices of semiconductors were unchanged.

The average level of exported core goods prices in July and August was about unchanged from the second-quarter level, which is a considerable step-down from the price increases that occurred earlier this year. A decline in prices of exported agricultural products offset moderate increases in industrial supplies and small increases in other categories.

Current Account

The U.S. current account deficit was \$665 billion (s.a.a.r.) in the second quarter of 2004, up from \$589 billion in the first quarter of 2004 (revised). The change was driven by a widening of the trade deficit on goods and services and a fall in the surplus on investment income.

The deficit on goods and services widened \$47 billion in the second quarter, as an \$80 billion increase in imports was only partially offset by a \$33 billion increase in exports. The increase in the value of imported goods largely reflected strong increases in industrial supplies, capital goods, and consumer goods. Imports of services rose \$4 billion. The value of exported goods increased \$22 billion, with much of the increase concentrated in industrial supplies, capital goods and consumer goods. Exports of services moved up \$11 billion.

U.S. Current Account				
(Billions of dollars, seasonally adjusted annual rate)				
Period	Goods and services, net	Investment income, net	Other income and transfers, net	Current account balance
<i>Annual</i>				
2002	-421.7	12.6	-64.8	-473.9
2003	-496.5	38.8	-72.9	-530.7
<i>Quarterly</i>				
2003:Q3	-489.0	34.5	-72.0	-526.5
Q4	-502.0	70.1	-76.0	-507.8
2004:Q1	-554.4	54.3	-88.5	-588.7
Q2	-601.1	16.7	-80.3	-664.7
<i>Change</i>				
Q3-Q2	4.5	5.4	-0.9	9.0
Q4-Q3	-13.0	35.6	-4.0	18.7
Q1-Q4	-52.4	-15.8	-12.5	-80.8
Q2-Q1	-46.7	-37.6	8.2	-76.1

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

The surplus on net investment income fell \$38 billion in the second quarter, as a \$13 billion rise in receipts was swamped by a \$52 billion rise in payments. The sizable increase in payments reflects a \$27 billion increase in direct investment payments and a \$24 billion increase in portfolio payments. The rise in receipts

was a result of a \$10 billion increase in portfolio income and a \$4 billion increase in direct investment receipts.

Net unilateral transfers to foreigners fell \$9 billion as a result of a \$11 billion decline in U.S. government grants being only partially offset by a \$2 billion increase in private remittances. The decline in government grants follows a \$12 billion increase in U.S. government grants in the first quarter.

U.S. International Financial Transactions

Private foreign net purchases of U.S. securities (line 4 of the Summary of U.S. International Transactions table) remained very strong in July. Inflows were driven by foreign purchases of corporate bonds (line 4c), which continued at an elevated pace, and Treasury securities (line 4a), which remained robust. Private purchases of agency bonds (line 4b) and equities (line 4d) moved up from their modest levels of recent quarters. Euro-area countries increased their holdings of U.S. securities in July, while private inflows from Japan, which picked up substantially in the second quarter, remained elevated.

Net foreign official inflows (line 1) slowed to \$13 billion in July, following monthly averages of roughly \$25 billion in the second quarter and \$43 billion in the first quarter.

. Total holdings at the FRBNY increased for August, and averaging this increase with the inflows recorded for July yields a significant inflow, similar to the rate of the second quarter.

U.S. acquisition of foreign securities picked up a bit in July (line 5). The increase was primarily driven by U.S. investors' demand for equities (line 5b), but U.S. investors bought foreign bonds (line 5a) for the second consecutive month as well.

The banking sector (line 3), which is volatile, recorded modest outflows in July.

The recently released balance of payments data for the second quarter show that U.S. direct investment abroad (line 6) moved up to nearly \$61 billion while foreign direct investment in the United States (line 7) jumped up to \$32 billion. The disparity between these flows is mainly attributable to differing levels of reinvested earnings in the U.S. and abroad rather than difference in new cross-border acquisitions.

The statistical discrepancy was positive for the second consecutive quarter, indicating some combination of overreporting of the current account deficit or underreporting of net capital inflows.

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

	2002	2003	2003		2004			
			Q3	Q4	Q1	Q2	June	July
Official financial flows	113.0	247.3	50.1	85.9	128.6	74.5	34.8	13.2
1. Change in foreign official assets in the U.S. (increase, +)	116.7	245.8	50.8	83.7	128.0	73.4	34.7	12.7
a. G-10 countries	30.7	115.7	15.9	47.3	95.5	45.6	20.9	3.4
b. OPEC countries	-7.5	6.1	2.1	10.5	3.7	-2.6	-4.4	.6
c. All other countries	93.5	124.0	32.8	25.9	28.8	30.3	18.1	8.7
2. Change in U.S. official reserve assets (decrease, +)	-3.7	1.5	-6	2.2	.6	1.1	.2	.5
Private financial flows	457.2	298.5	75.9	82.8	10.1	72.3	...	...
Banks								
3. Change in net foreign positions of banking offices in the U.S. ¹	116.8	64.3	25.4	101.5	-44.4	32.9	-4.3	-8.1
Securities²								
4. Foreign net purchases of U.S. securities (+)	390.1	372.8	65.5	92.3	128.9	120.4	52.9	60.2
a. Treasury securities	101.5	121.2	46.7	8.8	65.8	30.3	22.6	15.2
b. Agency bonds	84.2	-14.8	-31.1	2.2	6.8	36.3	5.2	11.7
c. Corporate and municipal bonds	145.7	226.1	52.5	57.6	51.3	51.1	22.9	23.5
d. Corporate stocks ³	58.8	40.3	-2.5	23.6	5.0	2.7	2.2	9.7
5. U.S. net acquisitions (-) of foreign securities	15.5	-64.6	-24.3	-22.3	-16.8	-24.9	-11.4	-16.3
a. Bonds	33.5	36.6	6.3	-2.9	4.9	15.7	-5.2	-6.4
b. Stock purchases	-14.8	-83.7	-30.6	-16.6	-21.7	-27.9	-6.2	-9.9
c. Stock swaps ³	-3.2	-17.4	.0	-2.8	.0	-12.7	.0	.0
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-134.8	-173.8	-45.2	-53.7	-47.6	-60.7	...	...
7. Foreign direct investment in U.S.	72.4	39.9	-2.8	10.7	10.2	32.7	...	...
8. Foreign holdings of U.S. currency	21.5	16.6	2.8	7.5	-1.8	8.8	...	...
9. Other (inflow, +) ⁴	-24.4	43.3	54.6	-53.2	-18.4	-36.8	...	...
U.S. current account balance (s.a.)	-473.9	-530.7	-131.6	-127.0	-147.2	-166.2	...	...
Capital account balance (s.a.)⁵	-1.3	-3.1	-.8	-.3	-.4	-.3	...	...
Statistical discrepancy (s.a.)	-95.0	-12.0	6.4	-41.4	8.9	19.7	...	...

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.

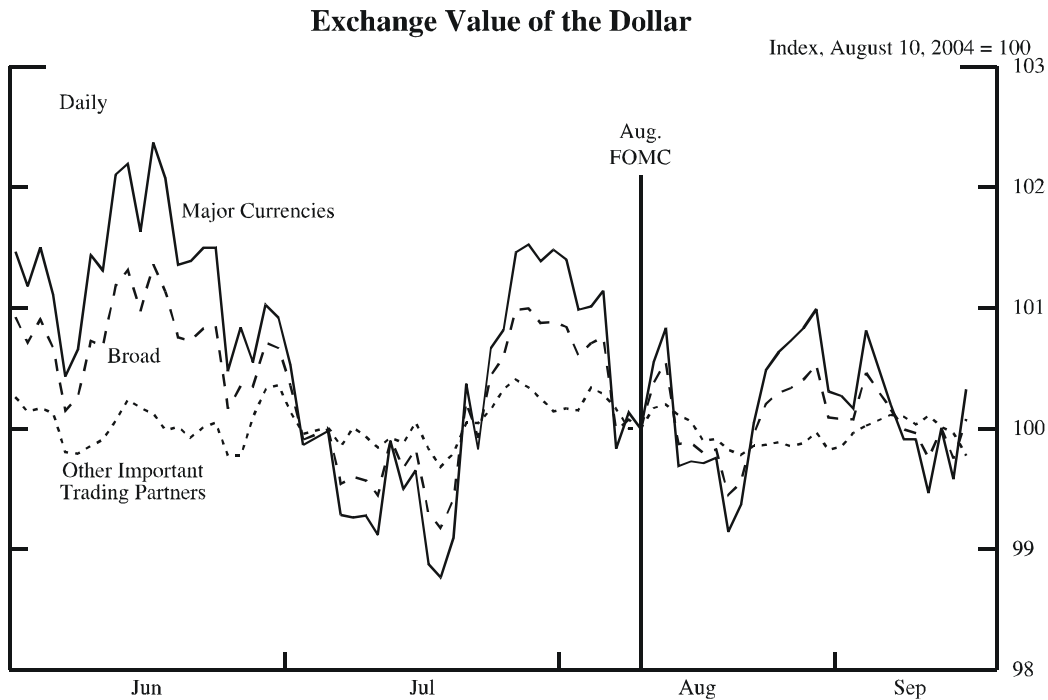
4. Transactions by nonbanking concerns and other banking and official transactions not shown elsewhere plus amounts resulting from adjustments made by the Department of Commerce and revisions in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business

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

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

Foreign Financial Markets

The dollar's trade-weighted exchange value changed little, on net, over the intermeeting period. The dollar depreciated in mid-August following the release of data showing a much larger than expected trade deficit for June, but later retraced much of that decline. Although the price of the NYMEX front-month crude oil futures contract fluctuated widely over the period, reaching an intraday peak near \$50 per barrel on August 20, oil prices did not appear to be systematically associated with exchange rate movements.



On a bilateral basis, the dollar appreciated more than 3 percent on balance versus sterling, as the Bank of England held its policy stance unchanged and market participants scaled back expectations for future tightening. The dollar depreciated about $\frac{3}{4}$ percent against the Canadian dollar. The Bank of Canada raised its main policy rate 25 basis points, to 2.25 percent, on September 8, citing concerns about inflation arising in part from oil prices. The dollar appreciated 1 percent against the euro and Swiss franc, and depreciated about $\frac{3}{4}$ percent vis-a-vis the yen.

Movements in short-term spot interest rates in foreign industrial countries were, with the exception of Canada, generally modest over the period. Market measures of expected future short-term interest rates declined moderately for sterling, in part on reports showing a slowdown in the rate of increase of

Financial Indicators in Major Industrial Countries

Country	Three-month rate		Ten-year yield		Equities
	Sep. 15 (Percent)	Percentage Point Change	Sep. 15 (Percent)	Percentage Point Change	Percent Change
Canada	2.42	.35	4.64	.04	2.97
Japan	.05	.00	1.49	-.17	2.12
Euro area	2.12	.00	4.06	-.01	5.56
United Kingdom	4.84	-.03	4.91	-.03	4.96
Switzerland	.61	.12	2.63	-.01	3.09
Australia	5.41	-.02	5.34	-.31	3.63
United States	1.84	.21	4.16	-.16	4.19
Memo: Weighted-average foreign	1.89	.10	4.08	-.04	n.a.

NOTE. Change is from August 10 to September 15 (10 a.m. EDT).

n.a. Not available.

housing prices. Implied rates rose slightly for the euro; several ECB Governing Council members expressed concerns about the potential impact of rising oil prices on inflation. However, in the absence of salient economic news, ten-year benchmark yields for the United Kingdom and the euro area were little changed on net. In Japan, benchmark yields and money market futures rates for 2005 and 2006 declined on new concerns about the strength of the current economic recovery, as GDP and machinery orders data came in well below market expectations. Japan's benchmark equity index nevertheless rose about 2 percent. Equity prices rose about 5 percent in the euro area and the United Kingdom.

Asset prices rose substantially over the period in a number of emerging-market countries. The Brazilian *real* appreciated 4 percent against the dollar and Brazil's EMBI+ spread over Treasuries fell about 90 basis points. These price movements appeared to be driven in part by renewed optimism about the government's ability to implement fiscal reforms following a favorable decision by Brazil's supreme court regarding the government's authority to tax pensions of public sector employees. The Mexican peso depreciated about 1¼ percent on balance versus the dollar, but equity prices in Mexico rose almost 8 percent.

Financial Indicators in Latin America, Asia, and Russia

Economy	Currency/ US dollar		Short-term Interest rates ¹		Dollar-denominated bond spread ²		Equity prices
	Sep. 15	Percent Change	Sep.14/15 (Percent)	Percentage Point Change	Sep.14/15 (Percent)	Percentage Point Change	Percent Change
Mexico	11.54	1.17	7.25	.00	1.84	-.14	7.92
Brazil	2.90	-4.00	16.11	.38	4.98	-.84	2.76
Argentina	2.99	-1.13	n.a.	n.a.	54.06	.97	7.26
Chile	616.00	-3.27	2.18	.24	.58	-.03	4.13
China	8.28	.00	n.a.	n.a.	.50	.04	-3.25
Korea	1144.10	-.95	3.75	-.30	...	...	13.63
Taiwan	33.79	-.59	1.24	-.01	...	...	8.85
Singapore	1.69	-1.31	1.38	.31	...	...	6.02
Hong Kong	7.80	-.01	.77	.27	...	...	5.45
Malaysia	3.80	-.01	2.83	.00	.66	-.05	3.95
Thailand	41.22	-.53	1.69	.38	.62	-.07	9.12
Indonesia	9105.00	-1.09	7.37	.00	2.08	-.59	8.38
Philippines	56.05	.77	6.56	.69	4.49	.22	8.03
Russia	29.21	-.13	n.a.	n.a.	2.95	-.19	12.39

NOTE. Change is from August 10 to September 14/15.

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.

There was little market reaction to news in mid-August that a referendum to recall Venezuela's President Chavez had failed by a wide margin. In emerging Asia, equity prices, led by the technology sector, rose sharply in a number of countries, more than reversing the declines registered in the previous intermeeting period. Prices appeared to be also supported by abating concerns about the likelihood of a hard landing for China's economy and by the moderation in crude oil prices in late August. Stock prices rose about 9 percent on net in Taiwan and close to 14 percent in Korea. Korean financial assets were also supported by an unexpected 25-basis-point cut in the Bank of Korea's policy rate on August 12. In Russia, equity prices were up about 12 percent and the sovereign yield spread over Treasuries declined slightly, despite a series of terrorist attacks and continued uncertainty over the future of Yukos, Russia's top oil producer.

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

Developments in Foreign Industrial Countries

Economic activity in the major foreign industrial economies continued to expand in the second quarter, though growth slowed in Japan and the euro area. Indicators for the third quarter have been mixed. In Japan, growth stepped down appreciably in the second quarter, and recent readings on activity have been soft. Growth in the euro area slowed a bit in the second quarter, with domestic demand remaining sluggish, and indicators for July and August suggest a continued lackluster recovery. Real GDP accelerated in Canada, largely reflecting a boom in exports. In the United Kingdom, domestic demand continued to expand briskly.

Driven by the sharp rise in energy costs, headline rates of consumer price inflation have moved up sharply since the first quarter, before weakening a bit recently. In Canada, headline inflation eased to 2.3 percent in July. Inflation in the euro area is edging down gradually but remains above the ECB's 2 percent ceiling. In the United Kingdom, inflation inched down to 1.3 percent in August, well below the Bank of England's 2 percent inflation target. Slight deflation persisted in Japan.

On September 8, the Bank of Canada raised its key policy interest rate 25 basis points to 2.25 percent.

In **Japan**, revised estimates show that real GDP rose 1.3 percent during the second quarter. Personal consumption advanced about 2½ percent, and business fixed investment rose 5 percent. However, growth was depressed by a steep drop in government investment, which plunged 25 percent. In addition, a deceleration in inventory accumulation subtracted 1 percentage point from growth. Exports surged 15 percent, outpacing an 8 percent increase in imports, and net exports added about 1 percentage point to growth. Nominal GDP declined 2.1 percent, following four consecutive quarters of increases. The GDP deflator fell 2.7 percent below its year-ago level.

Indicators suggest an anemic start to the third quarter. Industrial production was flat in July, after falling sharply in June. Data on consumer spending were mixed; household expenditures fell for a third straight month in July, though new car registrations rebounded in July and August. Real exports fell roughly 1½ percent in July, and real imports were down about 3 percent. Core machinery orders, a leading indicator of business fixed investment, dropped about 11 percent in July from the previous month.

The unemployment rate rose to 4.9 percent in July, with employment retracing only some of the steep losses recorded in June. Conversely, the

Japanese Real GDP						
(Percent change from previous period, except as noted, s.a.a.r.)						
Component	2002 ¹	2003 ¹	2003		2004	
			Q3	Q4	Q1	Q2
GDP	1.8	3.5	2.2	7.6	6.4	1.3
Total domestic demand	.8	2.6	1.5	6.2	5.4	.1
Consumption	.9	1.8	2.6	4.4	4.2	2.6
Private investment	-1.0	11.9	1.8	23.4	7.3	4.4
Public investment	-4.1	-12.5	-21.7	-6.9	-13.7	-25.2
Government consumption	1.6	1.1	2.4	1.7	2.1	1.3
Inventories ²	.5	-.1	.6	-.8	1.8	-1.0
Exports	17.3	11.5	15.4	22.6	19.2	14.8
Imports	8.7	4.9	11.0	11.2	12.8	7.9
Net exports ²	1.0	.9	.8	1.6	1.2	1.1

1. Q4/Q4.

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

job-offers-to-applicants ratio, a leading indicator of employment, moved up to 0.83 in July, marking an eleven-year high. Nominal wages continued to fall through July, depressed by cuts in summer bonuses. Consumer price deflation remained mild. Core consumer goods prices in the Tokyo area (which exclude fresh food but include energy) were unchanged in August from the previous month and were down 0.2 percent from a year earlier. Higher commodity prices helped to push wholesale prices up 1.7 percent in August compared with the same month a year ago, the largest twelve-month increase since 1991.

The government has begun the budget process for FY2005. It aims to keep overall spending fairly close to the FY2004 level. Debt-servicing costs will likely increase, but the government hopes to cut discretionary spending 2 percent. Spending on public works is slated for a reduction of about 3 percent.

Japanese Economic Indicators							
(Percent change from previous period, except as noted, s.a.)							
Indicator	2003	2004					
	Q4	Q1	Q2	May	June	July	Aug.
Industrial production ¹	3.9	.5	2.7	.8	-1.3	.0	n.a.
All-industries index	1.1	-.1	1.8	-.8	.6	n.a.	n.a.
Housing starts	4.9	2.8	-4.4	4.7	.8	5.4	n.a.
Machinery orders ²	8.5	-5.6	10.3	-2.1	3.9	-11.3	n.a.
Machinery shipments ³	7.6	-.4	4.3	2.4	-1.4	-.8	n.a.
New car registrations	-1.5	12.2	-8.4	-.3	3.3	4.1	1.0
Unemployment rate ⁴	5.1	4.9	4.6	4.6	4.6	4.9	n.a.
Job offers ratio ⁵	.73	.77	.80	.80	.82	.83	n.a.
Business sentiment ⁶	-11.0	-5.0	.0	...	...	...	...
CPI (Core, Tokyo area) ⁷	-.1	-.2	-.1	-.1	-.1	-.1	-.2
Wholesale prices ⁷	-.4	.0	1.0	.9	1.4	1.6	1.7

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

Euro-area real GDP rose 2.1 percent in the second quarter, slightly below the first-quarter pace. Growth in total domestic demand slowed to 0.6 percent. Net exports accounted for most of the GDP growth, with a surge in exports outpacing a large increase in imports. Growth among the major member countries was varied. German GDP accelerated slightly, but domestic demand made a negative contribution to growth. Growth in France remained robust, and was almost entirely attributable to domestic demand. Italian real GDP rose 1.1 percent.

Early indicators of activity for the third quarter have been generally positive. Euro-area retail sales rose 0.4 percent in July, with most member countries showing an increase. After falling sharply in June, German orders of manufacturing goods increased 3 percent in July, returning to near their May

Euro-Area Real GDP¹						
(Percent change from previous period, except as noted, s.a.a.r.)						
Component	2002 ²	2003 ²	2003		2004	
			Q3	Q4	Q1	Q2
GDP	1.1	.7	1.9	1.5	2.6	2.1
Total domestic demand	1.2	1.3	-.1	3.8	1.0	.6
Consumption	.9	.8	.9	.1	2.4	1.1
Investment	-1.4	-.1	.0	3.3	-.7	.3
Government consumption	2.4	2.0	2.5	1.8	.4	2.3
Inventories ³	.1	.7	-1.2	2.6	-.4	-.6
Exports	3.4	.7	10.4	1.4	5.6	15.7
Imports	3.8	2.4	5.2	7.6	1.4	12.3
Net exports ³	.0	-.6	2.0	-2.2	1.6	1.5
<i>Memo: GDP</i>						
France	1.5	1.0	3.0	2.1	3.4	3.4
Germany	.5	.0	1.1	1.2	1.7	1.9
Italy	.8	.1	1.6	.0	2.1	1.1

1. Includes Greece as of 2001 Q1.

2. Q4/Q4.

3. Percentage point contribution to GDP growth, s.a.a.r.

level, boosted by a jump in foreign orders. German industrial production followed a similar pattern, increasing 1.6 percent in July.

In contrast, third-quarter sentiment indicators have been somewhat disappointing. The German IFO business climate index resumed its downward trend in July. The IFO index peaked in January and has fallen considerably since. The current conditions component of the survey has been more robust and has risen over the course of the year. The euro-area manufacturing PMI fell to 53.9 in August, marking its lowest level since March.

Labor market conditions remained weak in the euro area, with the unemployment rate unchanged at 9 percent in July. The German unemployment rate increased slightly to 10.6 percent in July and remained at that level in August.

Euro-Area Economic Indicators							
(Percent change from previous period except as noted, s.a.)							
Indicator	2003	2004					
	Q4	Q1	Q2	May	June	July	Aug.
Industrial production ¹	1.0	.1	.8	.6	-.4	n.a.	n.a.
Retail sales volume ²	-.1	.8	-.4	-2.6	2.1	.4	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	-16.0	-14.0	-14.0	n.a.
Industrial confidence ⁴	-7.3	-6.7	-4.7	-5.0	-4.0	-4.0	n.a.
Mfg. orders, Germany	3.4	.7	1.7	1.5	-3.3	3.0	n.a.
CPI ⁵	2.0	1.7	2.3	2.5	2.4	2.3	2.3
Producer prices ⁵	1.0	.2	2.0	2.4	2.4	2.8	n.a.
M3 ⁵	7.1	6.2	5.4	4.8	5.4	5.5	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.

Twelve-month consumer price inflation in the euro area remained at 2.3 percent in August, still above the ECB's 2 percent target ceiling. The pickup in inflation since the first quarter has been 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 and processed food, edged down to 2.1 percent.

Real GDP in the **United Kingdom** expanded 3.8 percent in the second quarter, led by substantial rises in consumption, investment, and government spending. These increases were partly offset by a small negative contribution from inventories.

Limited indicators point to somewhat slower growth in the third quarter. The manufacturing PMI fell back in August, after several months of increases, and industrial production declined in July. Business confidence, which has been especially volatile of late, jumped in August. August's services PMI recovered

U.K. Real GDP						
(Percent change from previous period, except as noted, s.a.a.r.)						
Component	2002 ¹	2003 ¹	2003		2004	
			Q3	Q4	Q1	Q2
GDP	1.9	2.9	3.8	4.2	2.9	3.8
Total domestic demand	3.4	2.7	5.1	6.1	2.7	3.6
Consumption	3.1	2.2	3.2	2.5	2.5	4.4
Investment	6.8	1.7	4.5	7.9	6.8	5.8
Government consumption	2.4	5.6	6.4	8.6	4.9	4.1
Inventories ²	-0	-0	1.4	1.6	-1.1	-7
Exports	-1.4	4.3	.9	6.7	-3.4	9.1
Imports	4.2	3.5	5.8	13.1	-3.3	7.8
Net exports ²	-1.6	.0	-1.5	-2.1	.1	-0

1. Q4/Q4.

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

slightly, but remains below its level during the first half of the year. Retail sales edged down in July, though one of the leading surveys of retail sales suggests that sales moved up a touch in August.

According to the two main private surveys, the monthly increase in housing prices dropped sharply, and perhaps even turned slightly negative in August. Household net mortgage and consumer borrowing slowed in July, though to a still rapid rate.

The labor market continued to be tight, as the official-claims-based measure of the unemployment rate remained near its lowest points since 1975 and the labor-force-survey measure stayed close to its nadir. The twelve-month rate of consumer price inflation edged down to 1.3 percent in August, well below the Bank of England's 2 percent target.

U.K. Economic Indicators							
(Percent change from previous period except as noted, s.a.)							
Indicator	2003	2004					
	Q4	Q1	Q2	May	Jun.	Jul.	Aug.
Industrial production	.2	-.4	1.2	.4	-.3	-.3	n.a.
Retail sales volume ¹	1.6	2.0	1.7	.7	1.0	-.3	n.a.
Unemployment rate ²							
Claims-based	2.9	2.9	2.8	2.8	2.7	2.7	2.7
Labor force survey ³	4.9	4.8	4.8	4.8	4.7	n.a.	n.a.
Business confidence ⁴	-.3	16.7	16.3	22.0	15.0	6.0	19.0
Consumer confidence ⁵	-3.3	-2.3	-4.3	-5.0	-6.0	-4.0	n.a.
Consumer prices ⁶	1.3	1.3	1.4	1.5	1.6	1.4	1.3
Producer input prices ⁷	2.9	-.4	3.8	5.3	3.5	3.7	4.8
Average earnings ⁷	3.5	5.2	4.3	4.2	4.1	3.3	n.a.

1. Excludes motor vehicles.

2. Percent.

3. Three-month average centered on month shown.

4. Percentage of firms expecting output to increase in the next four months less percentage expecting output to decrease.

5. Average of the percentage balance from consumers' expectations of their financial situation, general economic situation, unemployment, and savings over the next 12 months.

6. Consumer prices index (CPI). Percent change from year earlier.

7. Percent change from year earlier.

n.a. Not available.

... Not applicable.

In **Canada**, real GDP accelerated to 4.3 percent in the second quarter, as a broad-based surge in exports more than offset a slowing of final domestic demand. Exports of machinery, equipment, and forestry products were especially strong, and net exports contributed 3.4 percentage points to growth. Domestic demand was depressed by a deceleration in both residential investment and personal consumption.

Indicators for the third quarter suggest some slowing in activity. Average housing starts in July and August were 1.1 percent below the second-quarter average, pulling back from a fourteen-year high. Total employment was roughly unchanged in August, and the unemployment rate held steady at 7.2 percent. The trade surplus narrowed in July as rising imports outpaced exports. The growth in the composite index of leading indicators moderated in July after very strong increases in the second quarter. New manufacturing orders continued to move up in July.

Canadian Real GDP						
(Percent change from previous period, except as noted, s.a.a.r.)						
Component	2002 ¹	2003 ¹	2003		2004	
			Q3	Q4	Q1	Q2
GDP	3.8	1.7	1.4	3.3	3.0	4.3
Total domestic demand	5.9	3.9	.9	5.7	1.6	1.4
Consumption	3.6	2.8	4.4	.7	6.4	1.3
Investment	3.6	7.0	12.9	5.3	7.2	3.3
Government consumption	3.2	3.5	.4	3.9	3.2	1.2
Inventories ²	2.2	.1	-4.1	3.2	-4.1	-3
Exports	2.0	-8	-1.9	9.4	6.1	21.6
Imports	7.1	5.0	-3.0	17.8	3.8	13.3
Net exports ²	-1.7	-2.1	.4	-2.5	1.0	3.4

1. Q4/Q4.

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

In July, the twelve-month rate of headline CPI inflation eased to 2.3 percent from 2.5 percent in June. The decrease reflected a moderation of the year-over-year rise in the price of gasoline, as twelve-month core inflation, excluding food, energy, and indirect taxes, moved up to 1.5 percent.

On September 8, the Bank of Canada increased the targeted overnight rate (its key policy rate) and the Bank Rate 25 basis points each, to 2.25 percent and 2.5 percent, respectively. The move was the Bank's first since the end of an easing cycle in April. The Bank stated that its decision was based on stronger-than-expected growth in the first half of the year, particularly in the external sector, that brought the economy close to full capacity. The increase was also characterized as needed to "avoid a buildup of inflationary pressures." The statement added that headline inflation "has remained above expectations, primarily because oil prices have been persistently higher than the Bank had assumed."

Canadian Economic Indicators

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

Indicator	2003	2004					
	Q4	Q1	Q2	May	June	July	Aug.
GDP by industry	.9	.6	1.1	.3	.3	n.a.	n.a.
Industrial production	1.5	.6	1.5	.9	.4	n.a.	n.a.
New mfg. orders	.1	5.7	5.1	-.9	1.9	1.4	n.a.
Retail sales	-.9	1.9	.3	-.3	.3	n.a.	n.a.
Employment	.9	.3	.5	.4	.2	.1	.0
Unemployment rate ¹	7.5	7.4	7.3	7.2	7.3	7.2	7.2
Consumer prices ²	1.7	.9	2.2	2.5	2.5	2.3	n.a.
Core Consumer Prices ^{2,3}	1.7	1.2	1.3	1.2	1.4	1.5	n.a.
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.

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

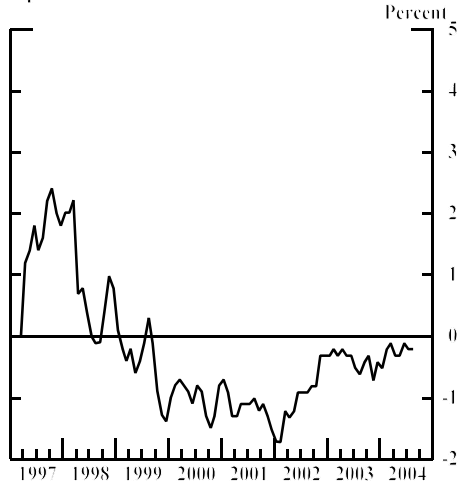
Country and balance	2003	2004				
	Q4	Q1	Q2	June	July	Aug.
<i>Japan</i>						
Trade	114.1	120.4	116.5	103.0	106.4	n.a.
Current account	157.8	184.1	173.1	143.8	152.1	n.a.
<i>Euro area</i>						
Trade	88.9	133.8	114.0	106.4	n.a.	n.a.
Current account	56.9	82.4	68.6	-7.3	n.a.	n.a.
<i>Germany</i>						
Trade	160.5	200.2	205.1	195.2	188.1	n.a.
Current account ¹	90.0	105.6	126.2	112.4	45.0	n.a.
<i>France</i>						
Trade	.8	1.4	-.9	-1.1	-1.0	n.a.
Current account	-.3	.6	-.8	-1.1	n.a.	n.a.
<i>Italy</i>						
Trade	5.7	-.7	-1.2	-9.7	n.a.	n.a.
Current account ¹	-16.5	-20.7	-26.3	-36.2	38.2	n.a.
<i>United Kingdom</i>						
Trade	-88.5	-105.0	-105.0	-111.0	-114.0	n.a.
Current Account	-36.4	-39.1	n.a.	...	...	...
<i>Canada</i>						
Trade	42.8	49.6	56.4	66.7	56.7	n.a.
Current Account	20.2	25.0	30.7	...	...	...

1. Not seasonally adjusted.

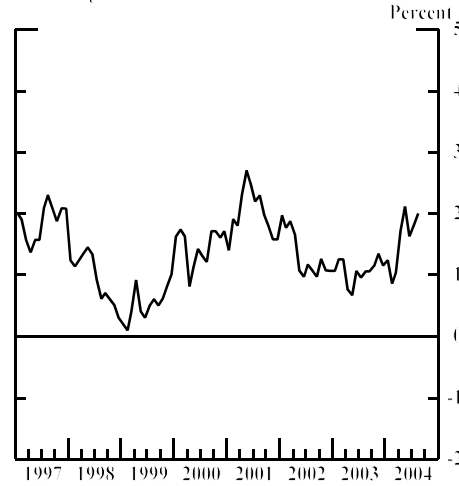
n.a. Not available. ... Not applicable.

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

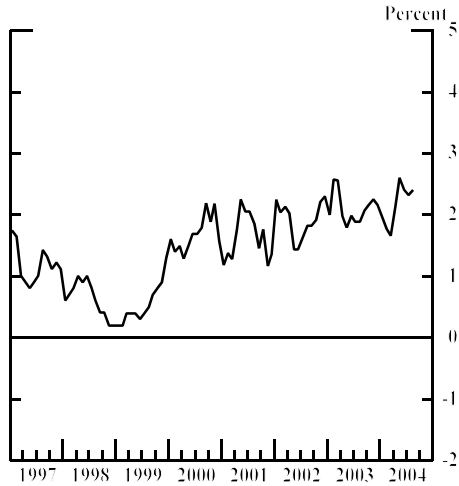
Japan



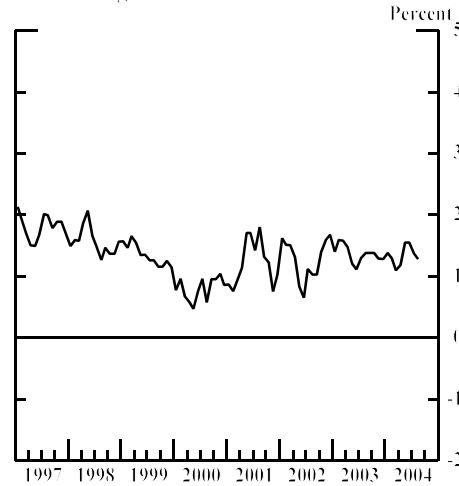
Germany



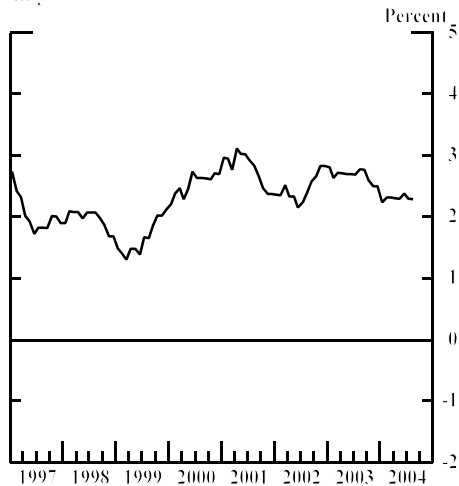
France



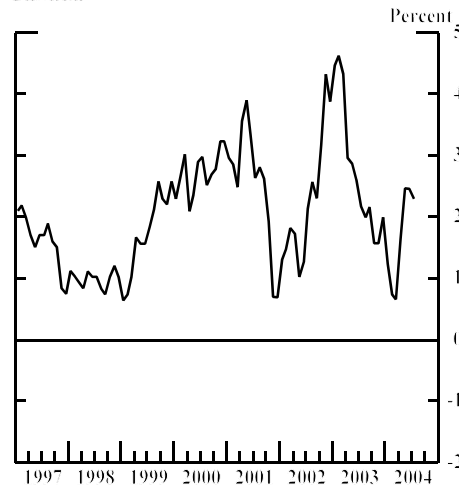
United Kingdom



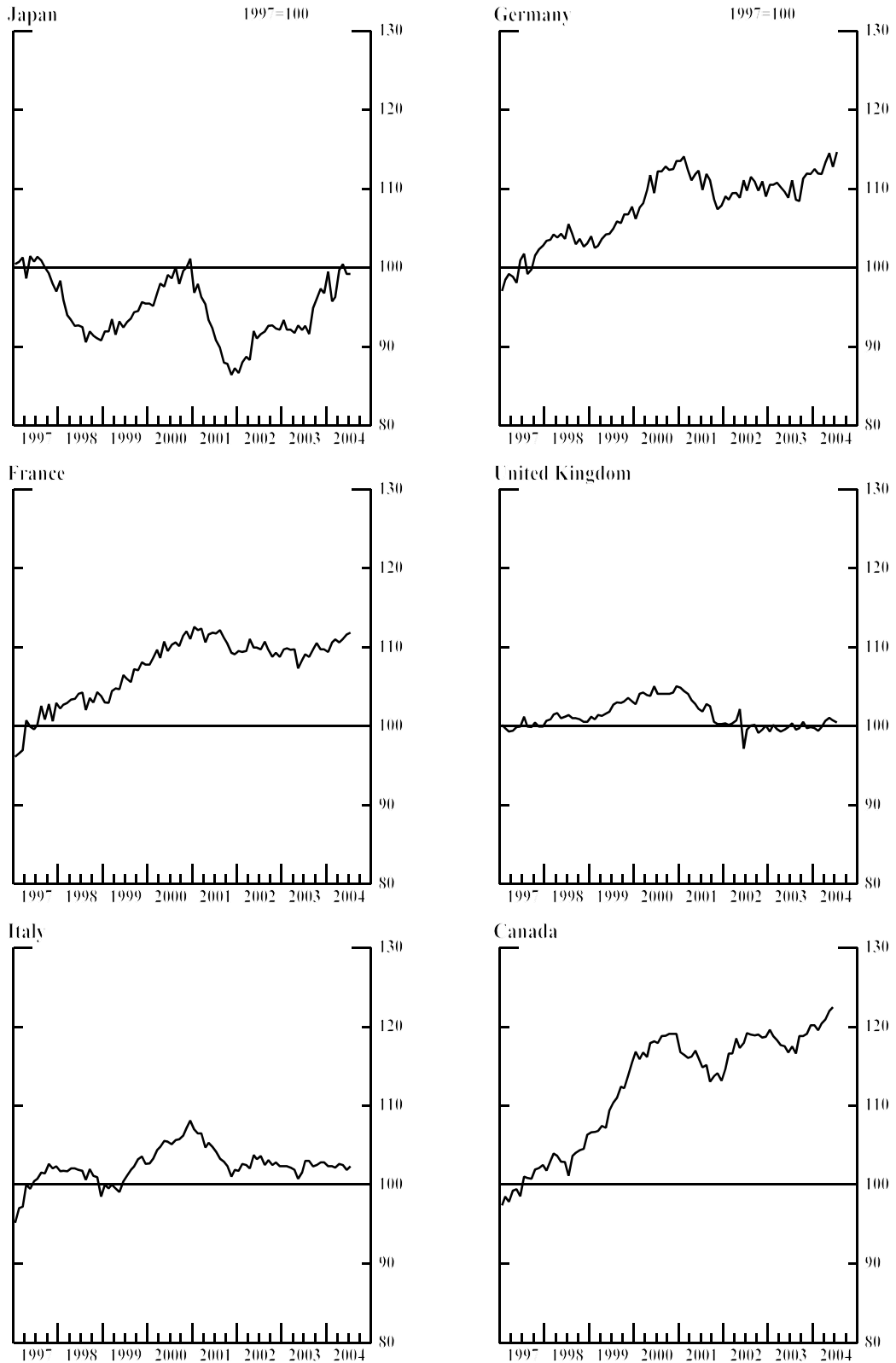
Italy



Canada



Industrial Production in Selected Industrial Countries



Economic Situation in Other Countries

In emerging Asia, the pace of economic performance has varied markedly across countries in recent months. While Hong Kong enjoyed strong growth, China registered mixed indicators; activity in Taiwan and Korea slowed. Economic performance in Latin America remained robust, particularly in Mexico and Brazil. Inflation in the developing world moved upward, mainly as a result of increases in energy and food prices, but the level of inflation remained moderate.

Recent indicators of **Chinese** economic performance have been mixed. Administrative and quantitative measures to control investment and bank lending remain in place, and lending has contracted in the last two months. Money supply growth has also slowed and industrial production has cooled a tad. However, investment surged in July, after decelerating for several months, and import growth has slowed only modestly. Exports continue to rise at a breakneck pace. Inflation inched up further, with consumer prices rising 5.3 percent in the twelve months ending in July. However, excluding food prices, consumer prices have been little changed over that period.

Chinese Economic Indicators

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

Indicator	2002	2003	2004				
			Q1	Q2	June	July	Aug.
Real GDP ¹	8.3	10.0	14.4	2.8	...	...	...
Industrial production ²	14.2	18.6	14.8	17.8	16.4	16.8	16.0
Consumer prices ²	-.4	3.2	2.8	4.4	5.0	5.3	5.3
Trade balance ³	30.4	25.5	1.0	12.8	19.3	21.5	50.3

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.

Real GDP in **Hong Kong** rose almost 11 percent at an annual rate in the second quarter, supported by strong exports and tourism. Private consumption also moved up, in line with recent increases in consumer confidence. While consumer prices have been rising on a monthly basis for almost a year, in July twelve-month inflation turned positive for the first time in almost six years. A recent turnaround in property prices, rising fuel prices, and strong domestic demand have helped push prices into positive territory.

Hong Kong Economic Indicators

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

Indicator	2002	2003	2004				
			Q1	Q2	May	June	July
Real GDP ¹	4.7	4.7	4.9	10.8	...	...	...
Unemployment rate ²	7.2	7.9	7.2	6.9	7.0	6.9	6.9
Consumer prices ³	-1.6	-1.8	-1.9	-9	-9	-1	.9
Trade balance ⁴	-7.7	-8.5	-13.0	-15.9	-15.8	-12.7	-11.1

1. Annual rate. Annual figures are Q4/Q4.

2. Percent. Monthly numbers are averages of the current and previous two months.

3. Percent change from year-earlier period, except annual figures, which are Dec./Dec.

4. Billions of U.S. dollars, annual rate. Imports are c.i.f.

... Not applicable.

Real GDP in **Taiwan** fell 4.5 percent in the second quarter, as consumption spending contracted in the wake of the confusion surrounding the March presidential election results. While overall production fell in July, indicators of high-tech production were down only slightly, and new export orders for high-tech goods reached record highs in June and July. Twelve-month consumer price inflation rose 2.5 percent in August on the back of increases in food and energy prices.

Taiwan Economic Indicators

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

Indicator	2002	2003	2004				
			Q1	Q2	June	July	Aug.
Real GDP ¹	4.3	5.6	5.0	-6	...	...	...
Unemployment rate ²	5.2	5.0	4.6	4.6	4.6	4.5	n.a.
Industrial production	7.9	7.1	1.0	2.5	-1	-1.1	n.a.
Consumer prices ³	.8	-1	.5	1.2	1.7	3.3	2.5
Trade balance ⁴	18.1	16.9	9.6	10.5	-6	19.6	6.1
Current account ⁵	25.6	29.2	23.4	20.6	...	...	...

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.

For **Korea**, data since the last Greenbook have been relatively weak. GDP growth continued to decelerate in the second quarter, with output up just 2.3 percent at an annual rate. Industrial production for July was roughly unchanged after a sizable drop in June, reflecting further poor performance in the automobile and high-tech sectors. Output in the services industries also declined in July from a year earlier. The unemployment rate ticked up in July and consumer price inflation climbed in July and August as a result of higher food and oil prices. The trade balance soared in July but indications are for some moderation in August. In response to the anemic economic performance, the Bank of Korea lowered its target interest rate 25 basis points to 3.50 percent in mid-August and the government recently announced a series of stimulus measures, including a 1 percent reduction in income taxes starting in 2005.

Korean Economic Indicators

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

Indicator	2002	2003	2004				
			Q1	Q2	June	July	Aug.
Real GDP ¹	7.7	4.1	3.0	2.3	...	...	...
Industrial production	8.3	5.0	3.8	1.2	-2.0	-.1	n.a.
Unemployment rate ²	3.1	3.4	3.3	3.5	3.5	3.6	n.a.
Consumer prices ³	3.8	3.4	3.3	3.4	3.6	4.4	4.8
Trade balance ⁴	14.8	22.2	40.1	33.0	27.9	58.3	n.a.
Current account ⁵	5.4	12.3	24.6	28.1	26.2	38.8	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 that economic activity continued to grow, but performance varied. In Singapore, real GDP rose nearly 12 percent in the second quarter, the fourth consecutive quarter of double-digit growth, on the back of strong performance in electronics. Industrial production was volatile, growing 3 percent in July after a 3½ percent decline in June. Second-quarter real GDP growth increased to 8 percent in Malaysia and to 5½ percent in Indonesia, while growth was about 3 percent in the Philippines and Thailand. Indonesia, Malaysia, and Singapore continued to record large trade balances in the second quarter, while in Thailand the balance shifted to deficit. Average monthly inflation over July-August moderated relative to the second quarter, apparently as the effects of earlier oil price and food price increases wane, although twelve-month inflation continued to rise.

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

Indicator and country	2002	2003	2004				
			Q1	Q2	May	June	July
<i>Real GDP¹</i>							
Indonesia	4.9	4.2	4.7	5.6	...	...	...
Malaysia	5.5	6.6	7.4	7.9	...	...	...
Philippines	5.5	4.8	8.9	2.9	...	...	...
Singapore	2.8	4.9	11.2	11.9	...	...	...
Thailand	6.0	7.8	3.1	3.1	...	...	...
<i>Industrial production²</i>							
Indonesia ³	-1.1	-1.1	3.8	-4.4	-4.0	-6	n.a.
Malaysia	4.6	9.3	3.6	3.4	2.3	-1.5	-1.2
Philippines	-6.1	.0	4.5	5.6	-2.5	-4.7	n.a.
Singapore	8.4	3.0	3.3	5.1	-7	-3.5	2.9
Thailand	8.5	12.3	3.8	-3	-1.3	1.4	1.3

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	May	June	July
Indonesia	25.9	28.5	20.7	21.7	26.2	20.2	n.a.
Malaysia	14.3	21.4	21.4	20.2	22.5	15.2	27.2
Philippines	-.2	-1.5	-1.7	-.2	2.4	-2.1	n.a.
Singapore	8.7	16.2	14.1	14.6	9.4	27.4	14.9
Thailand	2.7	4.2	2.5	-1.0	-3.8	.4	7.1

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	June	July	Aug.
Indonesia	9.9	5.2	4.8	6.4	6.8	7.2	6.7
Malaysia	1.7	1.2	.9	1.2	1.3	1.3	1.4
Philippines	2.5	3.1	3.5	4.5	5.1	6.0	6.3
Singapore	.4	.8	1.4	1.8	2.3	1.6	n.a.
Thailand	1.6	1.8	1.9	2.6	3.0	3.1	3.1

1. December/December.

n.a. Not available.

In **Mexico**, GDP expanded at a 4.9 percent annual rate in the second quarter, the third consecutive quarter of growth near or above 5 percent. Other recent indicators of economic activity have been mixed. Industrial production rose about 1 percent in July after declining in May and June. In contrast, Mexican exports decreased in July for the second month in a row, with manufacturing exports particularly weak. Imports of intermediate goods (which are mostly for assembly and re-export) also fell in July. Imports of consumer and capital goods remained at high levels in July, consistent with continued strength in domestic demand; however, retail sales data showed a 1½ percent decline in June. Government spending also has supported domestic demand; high oil prices have boosted government revenues, and part of that has been allocated to increased infrastructure spending and transfers to the states.

The Bank of Mexico tightened monetary policy on August 27. The move came after data from the first half of August showed twelve-month inflation rising to nearly 5 percent, well above the 2 to 4 percent target. The Bank said that, although largely due to temporary factors, the rise in inflation "contributed to the perception that it will be difficult to reach the target established for this year." The Bank is apparently concerned about surveys showing that the rise in inflation has fed into an increase in inflation expectations.

Mexican Economic Indicators							
(Percent change from previous period, s.a., except as noted)							
Indicator	2002	2003	2004				
			Q1	Q2	June	July	Aug.
Real GDP ¹	1.9	2.0	5.5	4.9	...	...	...
Overall economic activity	.7	1.4	.4	1.8	.4	n.a.	n.a.
Industrial production	-.4	-.7	1.1	1.5	-.2	.8	n.a.
Unemployment rate ²	2.7	3.3	3.7	3.7	3.7	3.7	n.a.
Consumer prices ³	5.7	4.0	4.3	4.3	4.4	4.5	4.8
Trade balance ⁴	-7.9	-5.6	-5.2	-6.1	-8.2	-7.4	n.a.
Imports ⁴	168.7	170.5	183.3	194.0	196.0	193.6	n.a.
Exports ⁴	160.8	164.9	178.0	187.9	187.8	186.2	n.a.
Current account ⁵	-13.7	-8.9	-7.1	-2.0	...	...	...

1. Annual rate. Annual figures are Q4/Q4.

2. Percent; counts as unemployed those working one hour a week or less.

3. Percent change from year-earlier period, except annual figures, which are Dec./Dec.

4. Billions of U.S. dollars, annual rate.

5. Billions of U.S. dollars, n.s.a., annual rate.

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

In **Brazil**, real GDP rose 6 percent in the second quarter, supported by strength in private consumption. Data releases for the third quarter point to continued expansion; July industrial production was up 0.5 percent and August vehicle sales reached record highs for the month. Brazil also continued to record sizable trade surpluses, reflecting strong export growth. Monthly consumer price inflation has been rising since the first quarter and reached 0.9 percent in July, driven in part by increases in domestic prices of energy and government-regulated prices. Twelve-month inflation reached 7.2 percent in August, well above the 5½ percent midpoint inflation target for end-2004.

The Brazilian central bank maintained its benchmark interest rate at 16 percent in its late August meeting; the rate has been at this level since April. Robust growth has quelled concerns that monetary policy has been too tight. Brazil's EMBI+ spreads decreased about 90 basis points, apparently driven in part by renewed optimism about the government's ability to implement fiscal reform following a mid-August decision by the supreme court that allows the government to tax the pensions of retired civil servants.

Brazilian Economic Indicators							
(Percent change from previous period, s.a., except as noted)							
Indicator	2002	2003	2004				
			Q1	Q2	June	July	Aug.
Real GDP ¹	3.8	-.1	7.2	6.1	...	...	...
Industrial production	2.7	.0	-1.1	3.1	.7	.5	n.a.
Unemployment rate ²	12.5	12.4	11.6	11.7	11.4	11.1	n.a.
Consumer prices ³	12.5	9.3	6.8	5.5	6.1	6.8	7.2
Trade balance ⁴	13.1	24.8	29.3	33.0	39.9	40.8	39.5
Current account ⁵	-7.6	4.1	6.7	11.2	24.7	21.8	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 continue to point to a moderation in the pace of economic recovery. Industrial production fell slightly in July, following a soft performance in previous months. The energy shortages earlier in the year appear to have had a moderate impact on economic activity. Twelve-month consumer price inflation increased in recent months, and now stands at about 5 percent. The country has continued to run sizable trade surpluses.

In mid-August, Argentina announced that the delayed third review of its agreement with the IMF would be rescheduled to December or January, after the country restructures its debt with private creditors. Argentine authorities argued that this postponement would ensure that talks between the IMF and Argentina would not interfere with the accord that the country aims to reach with its private creditors. The Argentine government stated that it would continue making its scheduled payments to the IMF of about \$2 billion for the rest of this year. The IMF will not make its scheduled disbursements, since they are conditional on the approval of program reviews.

Argentine Economic Indicators							
(Percent change from previous period, s.a., except as noted)							
Indicator	2002	2003	2004				
			Q1	Q2	June	July	Aug.
Real GDP ¹	-3.3	12.1	6.8	n.a.	...	...	...
Industrial production	-10.7	16.2	5.7	-1.4	.8	-.2	n.a.
Unemployment rate ²	22.5	17.3	14.4	n.a.	...	...	...
Consumer prices ³	41.4	3.8	2.5	4.0	4.9	4.9	5.2
Trade balance ⁴	16.7	15.7	10.6	15.4	8.5	13.7	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**, President Hugo Chavez survived the August 15 recall referendum, winning 58 percent of the popular vote. This result will enable him to complete his term, which expires at the end of 2006. The vote culminated nearly a year of efforts by the opposition to remove Chavez by peaceful means after a failed coup attempt and national strikes in 2002. Chavez's victory seems to have quelled concerns about political instability. Oil production is still about 15 percent below the level prevailing before the national strike in late 2002, when Chavez fired much of the national oil company's skilled personnel.

Venezuelan Economic Indicators							
(Percent change from previous period, s.a., except as noted)							
Indicator	2002	2003	2004				
			Q1	Q2	June	July	Aug.
Real GDP ¹	-15.8	7.0	7.9	n.a.	...	...	...
Unemployment rate ²	16.0	18.0	16.0	15.5	15.2	15.1	n.a.
Consumer prices ³	31.2	27.1	24.0	22.4	22.4	21.8	21.9
Non-oil trade balance ⁴	-8.1	-5.5	n.a.	n.a.	n.a.	n.a.	n.a.
Trade balance ⁴	13.4	16.5	n.a.	n.a.	n.a.	n.a.	n.a.
Current account ⁵	7.6	11.5	14.9	13.5	...	...	...

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.

Recent data from **Russia** suggest waning growth in the third quarter. Industrial production declined 0.3 percent in July, due in part to the inability of some firms to access credit during this summer's bank runs, and early indicators suggest that August production was also weak. Twelve-month inflation increased to more than 11 percent in August, raising concerns that Russia will fail to meet its year-end 10 percent inflation target.

In the oil sector, the Kremlin-Yukos standoff continued. In August, the Justice Ministry contracted with a private firm to assess the value of Yukos' main oil production facility, increasing the possibility of a transparent auction of Yukos' assets. Russian courts froze more of Yukos' accounts in early September, prompting the company to warn that it may be forced to cease operations. Despite this warning, President Vladimir Putin stated that Russia would increase its oil output this year.

Russian Economic Indicators							
(Percent change from previous period, s.a., except as noted)							
Indicator	2002	2003	2004				
			Q1	Q2	June	July	Aug.
Real GDP ¹	5.9	7.5	6.6	n.a.	...	...	...
Industrial Production	3.8	6.7	2.8	2.2	3.5	-3	n.a.
Unemployment Rate ²	8.0	8.5	7.6	8.3	8.3	7.5	n.a.
Consumer Prices ³	15.3	12.1	10.7	10.1	10.1	10.3	11.3
Trade Balance ⁴	46.3	60.5	72.6	76.0	66.9	n.a.	n.a.
Current Account ⁴	28.9	36.0	47.3	n.a.	...	...	....

1. Annual rate. Annual figures are Q4/Q4.

2. Percent.

3. Percent change from year earlier, except annual changes, which are Dec./Dec.

4. Billions of U.S. dollars, annual rate.

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