

## **Prefatory Note**

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December 10, 2004

# CURRENT ECONOMIC AND FINANCIAL CONDITIONS

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## **Supplemental Notes**

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

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## Supplemental Notes

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### The Domestic Nonfinancial Economy

#### Producer Prices

Following October's sharp increase, the producer price index for finished goods rose 0.5 percent in November, led by another sizable increase in energy prices. Over the twelve months ending in November, prices of finished goods rose 5 percent. Excluding food and energy, the PPI rose 0.2 percent in November, following increases of 0.3 percent in each of the preceding three months. Core finished goods prices rose 1.9 percent between November 2003 and November 2004, compared with a 0.5 percent increase over the preceding twelve-month period.

The PPI for energy rose 1.8 percent in November, on the heels of October's jump of 6.8 percent. The increase last month was the result of sharp increases in the prices for residential natural gas and electricity; prices of refined products fell slightly following October's surge. The twelve-month change in the PPI for energy was nearly 20 percent, double the increase of the previous year. However, the collapse in crude oil prices in early December has been matched by large declines in wholesale prices of gasoline and heating oil—pointing to large declines in the PPI and CPI for finished energy in December.

Food prices increased 0.4 percent in November. Vegetable prices climbed higher, but the index for fresh fruits fell 17 percent after the sharp increases of September and October; the decline came as California's orange crop replaced the hurricane-related losses to the Florida citrus fruit harvest. Producer food prices increased nearly 3 percent for the year ending in November, a large deceleration from the previous twelve-month period.

Core consumer goods prices rose 0.2 percent in November, as did the price index for capital goods. The increase in core goods prices was led by a rise of 0.6 percent in the price of autos, but light truck prices fell by a similar amount. Over the period from November 2003 to November 2004, prices of both capital goods and core consumer goods have risen about 2 percent, a noticeable pickup from the previous twelve-month period.

At earlier stages of processing, the index for core intermediate materials rose 0.4 percent in November, following October's 0.3 percent increase. Over the twelve months ending in November, the price index for core intermediate materials rose 8 percent, reflecting sizable increases in the prices of a wide variety of products, especially metals and

**Recent Changes in Producer Prices**  
(Percent change; based on seasonally adjusted data)<sup>1</sup>

Product	Weights <sup>2</sup>	12-month change <sup>3</sup>		2004		2004		
		Nov. 2003	Nov. 2004	Q2	Q3	Sept.	Oct.	Nov.
				Annual rate		Monthly rate		
Finished goods	100.0	3.4	5.0	4.4	.5	.1	1.7	.5
Consumer foods	21.5	7.8	2.9	9.9	-8.0	.1	1.6	.4
Consumer energy	15.9	10.0	19.8	5.6	7.1	-.9	6.8	1.8
Other finished goods	62.6	.5	1.9	2.4	1.6	.3	.3	.2
Consumer goods	37.1	.4	1.9	2.0	1.3	.4	.2	.2
Capital equipment	25.6	.7	2.1	2.9	2.0	.4	.4	.2
Intermediate materials <sup>4</sup>	95.8	3.0	10.4	11.7	9.6	.2	1.0	.7
Excluding food and energy	78.4	1.8	8.0	9.3	9.6	.7	.3	.4
Crude food materials	39.9	26.1	-5.1	9.7	-37.5	-2.1	-.8	1.8
Crude energy	39.8	10.4	58.6	91.6	-27.1	-6.6	7.9	17.0
Other crude materials	20.4	17.9	25.6	-33.2	51.3	-2.5	5.4	2.5

1. Changes are from final month of preceding period to final month of period indicated.

2. Relative importance weights for December 2003, which are based on 1997 shipment levels.

Years prior to 2002 are based on 1992 shipment weights.

3. Not seasonally adjusted.

4. Excludes materials for food manufacturing and animal feeds.

**Recent Changes in Producer Prices -- Relative Contribution<sup>1</sup>**  
(Percent change; based on seasonally adjusted data)<sup>2</sup>

Product	Weights <sup>3</sup>	12-month change <sup>4</sup>		2004		2004		
		Nov. 2003	Nov. 2004	Q2	Q3	Sept.	Oct.	Nov.
				Annual rate		Monthly rate		
Finished goods	100.0	3.4	5.0	4.4	.5	.1	1.7	.5
Consumer foods	21.5	1.6	.6	2.0	-1.8	.0	.3	.1
Consumer energy	15.9	1.5	3.1	.9	1.1	-.2	1.1	.3
Other finished goods	62.6	.3	1.2	1.5	1.0	.2	.2	.1
Consumer goods	37.1	.1	.7	.7	.5	.1	.1	.1
Capital equipment	25.6	.2	.5	.7	.5	.1	.1	.1

1. Data may not add due to rounding.

2. Changes are from final month of preceding period to final month of period indicated.

3. Relative importance weights for December 2003, which are based on 1997 shipment levels.

Years prior to 2002 are based on 1992 shipment weights.

4. Not seasonally adjusted.

industrial chemicals. Core crude materials prices rose 2.5 percent in November, on the heels of October's even larger increase, with iron and steel scrap prices once again the main culprit.

### **Consumer Sentiment**

According to the preliminary report, the Michigan Survey Research Center's (SRC) index of consumer sentiment rose nearly 3 points in December to 95.7, about equal to its average since the beginning of the year.

December's increase resulted from stronger readings for both components of the index. Within the "current conditions" component, consumers' assessments of buying conditions for large household appliances improved, while assessments of their current personal financial situation were unchanged. Within the "expected conditions" component, consumers' assessments of expected personal financial conditions ticked up, and the index for expected business conditions moved higher.

Among the items not included in the overall index, consumers' expectations about the change in unemployment over the next twelve months were about unchanged. Consumers' appraisals of buying conditions for houses improved to their highest level in eight months, and consumers' appraisals of buying conditions for cars retraced most of last month's sharp drop.

The mean and median of expected inflation over the next twelve months increased to 3.5 percent and 3 percent, respectively. The mean of expected inflation over the next five to ten years edged down to 3 percent, while the median edged up to 2.8 percent.

### **Business Inventories**

The book value of wholesale inventories increased at an annual rate of \$43 billion in October following a \$22 billion accumulation in September. Sales at non-auto wholesalers increased 1.6 percent in October, and the inventory-sales ratio was unchanged at 1.13 months.

Stocks held by wholesalers of durable goods rose at an annual rate of \$41 billion in October. The rise was led by a large accumulation of \$16 billion in the metals and minerals sector; wholesalers of lumber and building materials also posted a relatively large increase. Wholesalers of nondurable goods added to stocks at an annual rate of

December 10, 2004

**University of Michigan Survey Research Center: Survey of Consumer Attitudes**  
**Indexes of consumer sentiment**  
 (Not seasonally adjusted)

Category	2004							
	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec. <sup>P</sup>
Composite of current and expected conditions <sup>1</sup>	90.2	95.6	96.7	95.9	94.2	91.7	92.8	95.7
Current conditions <sup>1</sup>	103.6	106.7	105.2	107.9	103.7	104.0	104.7	106.3
Expected conditions <sup>1</sup>	81.6	88.5	91.1	88.2	88.0	83.8	85.2	88.8
Personal financial situation								
Now compared with 12 months ago <sup>2</sup>	113	112	115	121	113	112	113	113
Expected in 12 months <sup>2</sup>	125	130	134	133	128	127	124	125
Expected business conditions								
Next 12 months <sup>2</sup>	105	117	124	114	116	113	115	120
Next 5 years <sup>2</sup>	98	108	108	108	110	97	104	112
Appraisal of buying conditions								
Cars	144	144	142	144	148	152	138	150
Large household appliances <sup>2</sup>	156	164	158	158	155	158	158	163
Houses	160	162	160	156	162	155	155	164
Expected unemployment change - next 12 months	107	96	93	106	105	105	106	104
Prob. household will lose a job - next 5 years	27	25	25	22	22	28	23	21
Expected inflation - next 12 months								
Mean	3.9	4.0	3.5	3.1	3.2	3.6	3.3	3.5
Median	3.3	3.3	3.0	2.8	2.8	3.1	2.8	3.0
Expected inflation - next 5 to 10 years								
Mean	3.3	3.4	3.1	3.1	3.1	3.2	3.1	3.0
Median	2.8	2.9	2.8	2.7	2.8	2.8	2.7	2.8

Note. Figures on financial, business, and buying conditions are the percent reporting 'good times' (or 'better') minus the percent reporting 'bad times' (or 'worse'), plus 100. Expected change in unemployment is the fraction expecting unemployment to rise minus the fraction expecting unemployment to fall, plus 100.

P Preliminary.

1. Feb. 1966 = 100.

2. Indicates the question is one of the five equally-weighted components of the index of sentiment.

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\$2 billion in October as modest accumulations in a variety of sectors were mostly offset by a \$12 billion runoff in farm products.

**Production of Motor Vehicles**

The final estimate of motor vehicle production for November showed assemblies at an annual rate of 11.9 million units, slightly below the October rate. On balance, dealer inventories of light vehicles ended the month unchanged from the high level that prevailed at the end of the third quarter.

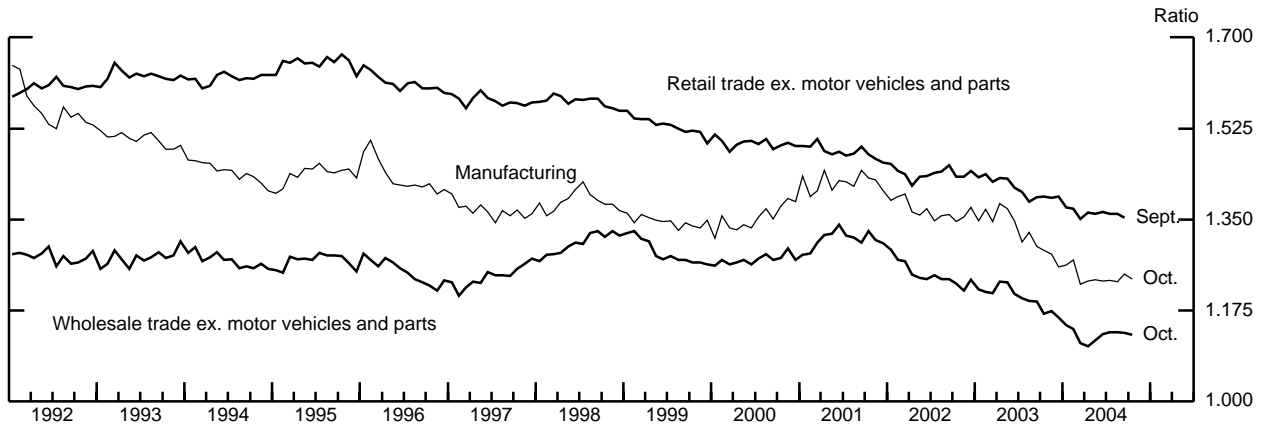


**Changes in Manufacturing and Trade Inventories**  
(Billions of dollars; seasonally adjusted book value; annual rate)

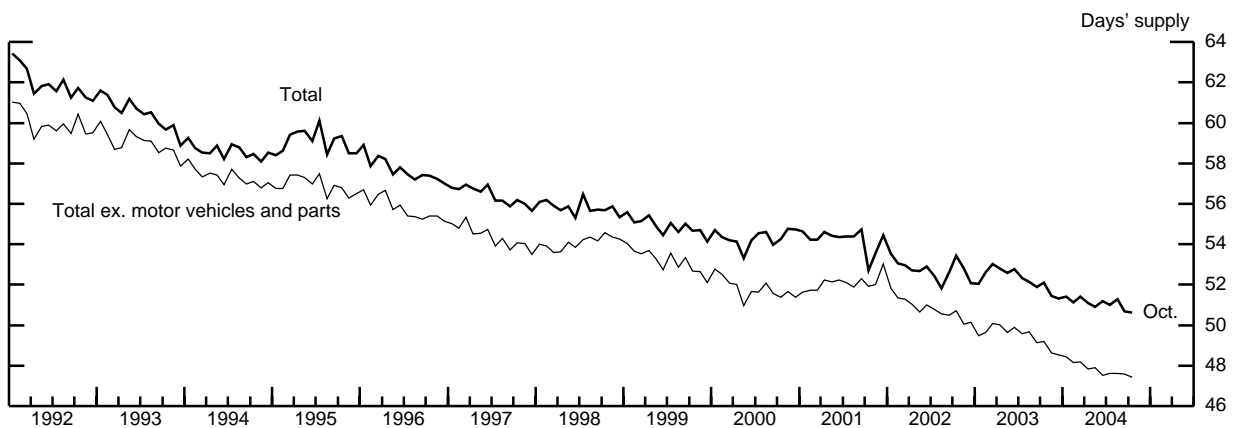
Sector	2004					
	Q1	Q2	Q3	Aug.	Sept.	Oct.
Manufacturing and trade	82.0	120.4	86.4	106.3	6.4	n.a.
Ex. wholesale and retail						
motor vehicles and parts	55.6	94.1	76.4	90.5	36.7	n.a.
Manufacturing	24.0	38.9	32.3	39.5	4.8	26.3
Ex. aircraft	25.6	39.0	33.9	43.8	15.1	26.1
Wholesale trade	23.5	33.7	39.1	39.9	21.9	42.9
Motor vehicles and parts	3.2	1.3	3.3	5.2	-3.2	-2.4
Ex. motor vehicles and parts	20.3	32.4	35.7	34.7	25.2	45.3
Retail trade	34.5	47.7	15.0	26.9	-20.4	n.a.
Motor vehicles and parts	23.1	25.0	6.6	10.6	-27.1	n.a.
Ex. motor vehicles and parts	11.4	22.7	8.4	16.2	6.7	n.a.

n.a. Not available.

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



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



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

Item	2004			2005	2004		
	H1	Q3	Q4 <sup>1</sup>	Q1 <sup>1</sup>	Oct.	Nov.	Dec. <sup>1</sup>
U.S. production	12.1	11.8	12.0	12.3	12.1	11.9	12.2
Autos	4.3	4.3	4.2	4.5	4.1	4.1	4.4
Trucks	7.8	7.6	7.9	7.8	8.0	7.8	7.8
Days' supply <sup>2</sup>	77	72	n.a.	n.a.	76	78	n.a.
Autos	62	62	n.a.	n.a.	66	64	n.a.
Trucks	88	79	n.a.	n.a.	83	87	n.a.
Inventories <sup>3</sup>	3.33	3.26	n.a.	n.a.	3.27	3.26	n.a.
Autos	1.09	1.08	n.a.	n.a.	1.09	1.06	n.a.
Trucks	2.24	2.18	n.a.	n.a.	2.18	2.20	n.a.

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

1. Production rates for the fourth and first quarters and December 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.

### Commercial Bank Credit

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

Type of credit	2003	Q1 2004	Q2 2004	Q3 2004	Oct. 2004	Nov. 2004	Level, Nov. 2004 (\$ billions)
<b>Total</b>							
<b>1. Adjusted<sup>1</sup></b>	<b>5.9</b>	<b>11.3</b>	<b>11.8</b>	<b>4.8</b>	<b>2.3</b>	<b>10.2</b>	<b>6,498</b>
2. Reported	5.6	11.9	8.7	5.4	2.5	8.2	6,662
<i>Securities</i>							
3. Adjusted <sup>1</sup>	8.7	17.9	14.3	-7.9	-4.7	11.5	1,735
4. Reported	7.3	19.5	3.6	-5.1	-3.4	4.5	1,899
5. Treasury and agency	8.8	24.2	11.1	-4.1	-29.4	-2.4	1,147
6. Other <sup>2</sup>	5.0	12.2	-8.2	-6.7	39.1	15.1	752
<i>Loans<sup>3</sup></i>							
7. Total	4.9	8.8	10.8	9.7	4.9	9.7	4,763
8. Business	-9.4	-5.2	-2.8	5.9	1.6	6.4	881
9. Real estate	11.1	10.1	21.1	7.9	16.0	11.8	2,515
10. Home equity	30.8	37.8	38.5	37.2	45.1	30.0	393
11. Other	8.8	6.2	18.5	3.3	10.9	8.4	2,122
12. Consumer	5.4	11.4	4.2	19.7	-7.5	-8.4	665
13. Adjusted <sup>4</sup>	5.8	10.4	-2.2	12.4	3.0	.9	1,040
14. Other <sup>5</sup>	6.7	20.7	-.4	11.7	-18.2	23.9	702

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.

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

Instrument	2003	2004			Change to Dec. 9 from selected dates (percentage points)		
	Dec. 31	June 28	Nov. 9	Dec. 9	2003 Dec. 31	2004 June 28	2004 Nov. 9
<i>Short-term</i>							
FOMC intended federal funds rate	1.00	1.00	1.75	2.00	1.00	1.00	.25
Treasury bills <sup>1</sup>							
3-month	.93	1.36	2.04	2.20	1.27	.84	.16
6-month	1.00	1.74	2.24	2.36	1.36	.62	.12
Commercial paper (A1/P1 rates) <sup>2</sup>							
1-month	1.00	1.28	2.01	2.26	1.26	.98	.25
3-month	1.05	1.45	2.16	2.37	1.32	.92	.21
Large negotiable CDs <sup>1</sup>							
1-month	1.06	1.30	2.05	2.34	1.28	1.04	.29
3-month	1.09	1.53	2.23	2.43	1.34	.90	.20
6-month	1.16	1.82	2.42	2.61	1.45	.79	.19
Eurodollar deposits <sup>3</sup>							
1-month	1.04	1.29	2.03	2.32	1.28	1.03	.29
3-month	1.07	1.51	2.20	2.38	1.31	.87	.18
Bank prime rate	4.00	4.00	4.75	5.00	1.00	1.00	.25
<i>Intermediate- and long-term</i>							
U.S. Treasury <sup>4</sup>							
2-year	1.83	2.88	2.81	2.94	1.11	.06	.13
10-year	4.40	4.90	4.35	4.29	-.11	-.61	-.06
30-year	5.22	5.55	5.01	4.90	-.32	-.65	-.11
U.S. Treasury 10-year indexed note	2.00	2.23	1.75	1.64	-.36	-.59	-.11
Municipal 20-year G.O. <sup>5</sup>	4.61	4.94	4.56	4.63	.02	-.31	.07
Private instruments							
10-year swap	4.66	5.21	4.65	4.51	-.15	-.70	-.14
10-year FNMA <sup>6</sup>	4.72	5.30	4.69	4.52	-.20	-.78	-.17
10-year AA <sup>7</sup>	5.05	5.59	4.99	4.89	-.16	-.70	-.10
10-year BBB <sup>7</sup>	5.74	6.18	5.51	5.36	-.38	-.82	-.15
5-year high yield <sup>7</sup>	7.94	8.30	7.32	7.30	-.64	-1.00	-.02
Home mortgages (FHLMC survey rate)							
30-year fixed	5.85	6.21	5.76	5.71	-.14	-.50	-.05
1-year adjustable	3.72	4.19	4.16	4.15	.43	-.04	-.01

Stock exchange index	Record high		2004			Change to Dec. 9 from selected dates (percent)		
	Level	Date	June 28	Nov. 9	Dec. 9	Record high	2004 June 28	2004 Nov. 9
Dow Jones Industrial	11,723	1-14-00	10,357	10,386	10,553	-9.98	1.89	1.60
S&P 500 Composite	1,527	3-24-00	1,133	1,164	1,189	-22.14	4.93	2.16
Nasdaq	5,049	3-10-00	2,020	2,043	2,129	-57.83	5.41	4.19
Russell 2000	644	12-1-04	584	607	629	-2.25	7.72	3.72
Wilshire 5000	14,752	3-24-00	11,056	11,397	11,691	-20.75	5.75	2.58

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. AA1 rated. Source: Bloomberg.
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.

NOTES:

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

## **The International Economy**

### **Prices of Internationally Traded Goods**

**Non-Oil Imports.** In November, the prices of U.S. imports of non-oil goods and of core goods rose 0.7 and 0.8 percent, respectively, the largest monthly increases since January. Although every major category saw a price increase, the main contribution came from industrial supplies, whose prices rose 2.8 percent, mostly because of higher natural gas prices. For both capital goods (excluding computers and semiconductors) and foods, feeds and beverages, prices increased 0.3 percent. After a 0.4 percent increase in October, prices for automotive products rose another 0.2 percent. Prices for imported consumer goods, which had not increased since February 2004, ticked up 0.1 percent. Import prices of computers continued to decline, whereas prices for semiconductors edged up.

The average level of imported core goods prices in October and November was 2½ percent at an annual rate above the third-quarter level. The main contributions to the increase were from foods and non-oil industrial supplies. Both automotive products and, to a lesser extent, capital goods (excluding computers and semiconductors) also experienced price gains.

**Oil.** The BLS price of imported oil fell 2.6 percent in November. The spot price of West Texas Intermediate (WTI), a light, low-sulfur crude oil, fell 8.8 percent in November, to average about \$48.50 per barrel. Since October, the spot price of WTI has fallen sharply, due in part to rising oil inventories and the return of some oil production in the Gulf of Mexico. The spot price of WTI closed at \$42.54 per barrel on December 9. The prices of more sulfurous grades of crude oil, which had not increased as rapidly as WTI in October, have not fallen as much recently. The price of imported oil tends to be more closely aligned with the prices of higher sulfur crude oils than with WTI.

**Exports.** In November, the prices of U.S. exports of total goods and of core goods increased 0.3 and 0.4 percent, respectively. Much of November's rise was due to a 1 percent increase in industrial supplies, reflecting higher prices for chemicals and metals. After declining 1.3 percent in October, prices of agricultural exports edged down another 0.1 percent. Export prices of capital goods (excluding computers and semiconductors) increased 0.3 percent, and prices for consumer goods edged up

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0.1 percent. Export prices of computers continued to decline, but prices for semiconductors were unchanged.

The average level of exported core goods prices in October and November was 4 percent at an annual rate above the third-quarter level. A large increase in prices for industrial supplies more than offset a large decline in the prices for exported agricultural products. Additional positive contributions came from both capital goods (excluding computers and semiconductors) and automotive products.

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

	Annual rate			Monthly rate		
	2004			2004		
	Q2	Q3	Q4 <sup>e</sup>	Sept.	Oct.	Nov.
	----- BLS prices -----					
<b>Merchandise imports</b>	7.4	7.9	10.6	0.5	1.6	0.2
Oil	43.2	56.5	77.9	3.0	11.6	-2.6
Non-oil	3.0	1.5	1.7	0.1	-0.1	0.7
Core goods*	4.3	2.4	2.4	0.1	0.0	0.8
Cap. goods ex comp & semi	0.0	1.6	1.3	0.0	0.1	0.3
Automotive products	1.4	1.7	2.8	0.2	0.4	0.2
Consumer goods	-0.5	-0.4	0.1	0.0	0.0	0.1
Foods, feeds, beverages	7.8	3.3	8.9	1.3	1.2	0.3
Industrial supplies ex oil	18.7	8.4	5.1	0.1	-0.8	2.8
Computers	-8.6	-8.8	-7.1	-0.6	-1.1	-0.3
Semiconductors	-7.0	-4.4	-3.7	-0.2	-0.9	0.2
<b>Merchandise exports</b>	6.0	-0.1	3.7	0.4	0.7	0.3
Core goods*	6.6	0.6	4.0	0.5	0.7	0.4
Cap. goods ex comp & semi	0.8	1.3	2.6	0.1	0.4	0.3
Automotive products	1.3	0.9	1.2	-0.1	0.3	0.0
Consumer goods	1.1	2.3	-0.6	-0.1	-0.2	0.1
Agricultural products	17.5	-31.1	-12.0	1.7	-1.3	-0.1
Industrial supplies ex ag	14.4	14.5	16.2	0.7	2.4	1.0
Computers	0.3	-7.3	-3.6	-0.2	-0.5	-0.5
Semiconductors	2.1	-3.7	4.7	-0.1	1.3	0.0
	----- NIPA prices -----					
<b>Chain price index</b>						
Imports of goods & services	6.4	5.0	n.a.	...	...	...
Non-oil merchandise	2.8	1.1	n.a.	...	...	...
Core goods*	4.0	2.1	n.a.	...	...	...
Exports of goods & services	4.6	1.5	n.a.	...	...	...
Total merchandise	5.3	1.2	n.a.	...	...	...
Core goods*	5.8	1.8	n.a.	...	...	...

\*/ Excludes computers and semiconductors.

e/ Average of two months.

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

**Oil Prices**

