

## **Prefatory Note**

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## **Part 2**

May 2, 2007

# **CURRENT ECONOMIC AND FINANCIAL CONDITIONS**

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## **Recent Developments**

May 2, 2007

## **Recent Developments**

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## **Domestic Nonfinancial Developments**

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## Domestic Nonfinancial Developments

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The incoming data suggest that economic activity is continuing to expand at a below-trend pace. Payroll employment has continued to post solid gains, and manufacturing production stepped up in March after exhibiting considerable softness over the preceding several months. However, housing construction remains under pressure from weak demand and outsized inventories of unsold homes, and consumer spending appears to have moved onto a slower growth track in recent months. In addition, business fixed investment has remained subdued, although the exceptional weakness in some key categories of equipment spending may be starting to dissipate. Total PCE inflation was pushed up in March by rising energy prices, while the twelve-month change in core PCE prices stood at 2.1 percent, just a tenth above the reading for the preceding year.

### Labor Market Developments

Labor demand decelerated in the first quarter but remained relatively strong. Private nonfarm payroll employment increased an average of 124,000 per month, about 40,000 below the average pace recorded in the fourth quarter of 2006. The gains in private employment, in combination with a relatively stable average workweek, contributed to a 1.5 percent (annual rate) increase in aggregate hours in the first quarter.

In the household survey, the unemployment rate edged down 0.1 percentage point in March, to 4.4 percent, and the labor force participation rate held steady at 66.2 percent. The number of job losers unemployed less than five weeks as a percentage of employment—a proxy for the layoff rate—fell in March after having spiked around the turn of the year.

Other indicators of labor demand have remained in a range consistent with moderate employment growth. The four-week moving average of initial claims for unemployment insurance stood at 332,000 for the week ending April 21, just a bit above its fourth-quarter average. Layoff announcements, as measured by Challenger, Gray, and Christmas, have stayed relatively low. According to Manpower and the National Federation of Independent Businesses (NFIB), hiring plans have moved down recently but continue to occupy the favorable range that has prevailed since 2004. Similarly, job openings and new hires, as reported by the Bureau of Labor Statistics, edged down in February but remain at high levels.

Measures of labor market tightness suggest that little has changed lately. The percentage of firms reporting to the NFIB that they had a hard-to-fill position was about flat in March and was about equal to the average level in 2006. According to the Conference

**Changes in Employment**

(Thousands of employees; seasonally adjusted)

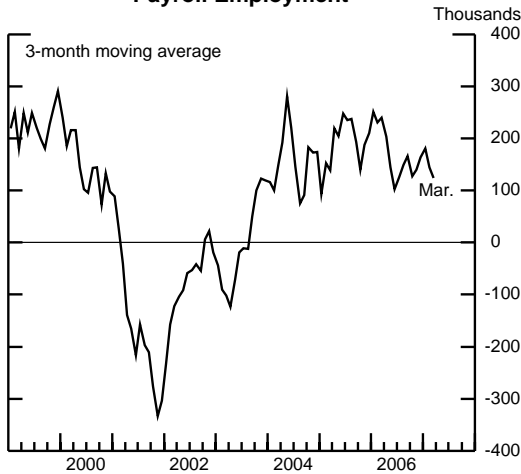
Measure and sector	2006		2007				
	2006	Q3	Q4	Q1	Jan.	Feb.	Mar.
	Average monthly change				Monthly change		
Nonfarm payroll employment (establishment survey)	189	202	177	152	162	113	180
Private	169	166	164	124	136	80	157
Natural resources and mining	5	3	4	3	1	5	3
Manufacturing	-7	-11	-25	-9	-1	-11	-16
Construction	11	11	-14	10	34	-61	56
Wholesale trade	11	9	12	2	-6	7	5
Retail trade	-3	-2	11	29	34	17	36
Transportation and utilities	9	8	11	3	5	-3	6
Information	2	1	7	2	-2	12	-5
Financial activities	16	20	10	4	2	11	0
Professional and business services	42	32	52	12	12	32	-7
Temporary help services	-1	-4	6	-2	0	-6	-1
Nonbusiness services <sup>1</sup>	83	94	96	69	57	71	79
Total government	20	36	13	27	26	33	23
Total employment (household survey)	262	173	340	109	31	-38	335
Memo:							
Aggregate hours of private production workers (percent change) <sup>2</sup>	2.5	1.4	2.0	1.5	-.2	.0	.6
Average workweek (hours) <sup>3</sup>	33.8	33.8	33.9	33.8	33.8	33.8	33.9
Manufacturing (hours)	41.1	41.3	41.1	41.0	40.9	40.9	41.1

1. Nonbusiness services comprises education and health, leisure and hospitality, and "other."

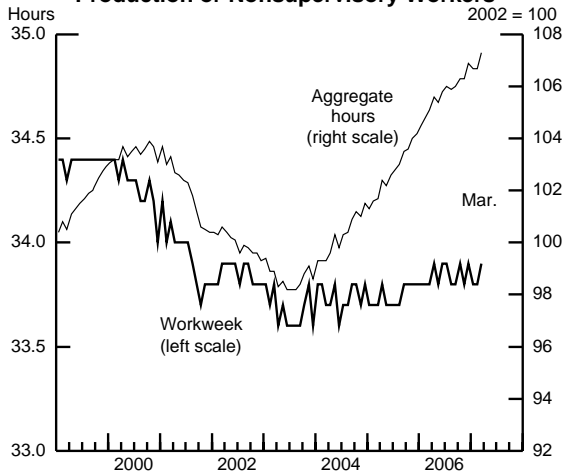
2. Establishment survey. Annual data are percent changes from Q4 to Q4. Quarterly data are percent changes from preceding quarter at an annual rate. Monthly data are percent changes from preceding month.

3. Establishment survey.

**Changes in Private Payroll Employment**



**Aggregate Hours and Workweek of Production or Nonsupervisory Workers**

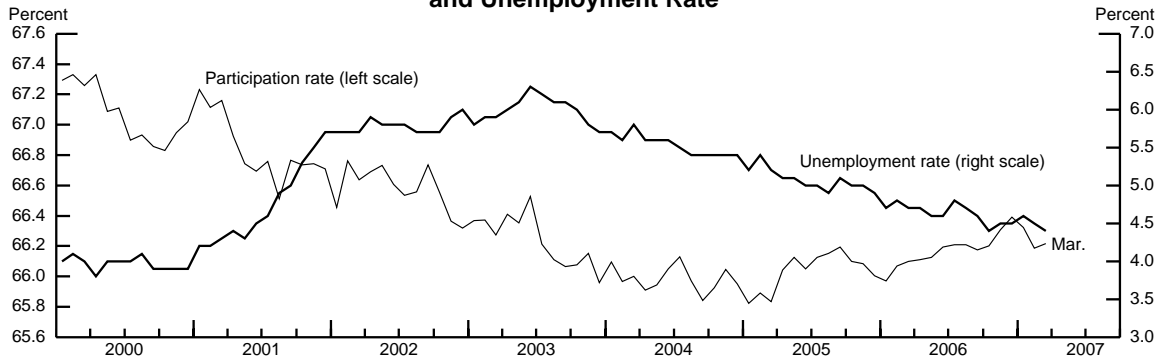


**Selected Unemployment and Labor Force Participation Rates**

(Percent; seasonally adjusted)

Rate and group	2006	2006		2007			
		Q3	Q4	Q1	Jan.	Feb.	Mar.
<i>Civilian unemployment rate</i>							
Total	4.6	4.7	4.5	4.5	4.6	4.5	4.4
Teenagers	15.4	16.1	15.1	14.8	15.0	14.9	14.5
20-24 years old	8.2	8.3	8.3	7.7	8.1	7.4	7.6
Men, 25 years and older	3.5	3.5	3.3	3.6	3.6	3.7	3.5
Women, 25 years and older	3.7	3.8	3.5	3.5	3.6	3.5	3.4
<i>Labor force participation rate</i>							
Total	66.2	66.2	66.3	66.2	66.3	66.2	66.2
Teenagers	43.6	43.5	43.4	42.2	42.8	42.2	41.6
20-24 years old	74.6	74.9	75.0	75.1	75.2	74.8	75.3
Men, 25 years and older	75.5	75.4	75.7	75.7	75.7	75.7	75.7
Women, 25 years and older	59.6	59.9	59.8	59.6	59.7	59.6	59.6

**Labor Force Participation Rate and Unemployment Rate**



**Job Losers Unemployed Less Than 5 Weeks**  
(as a percent of household employment)

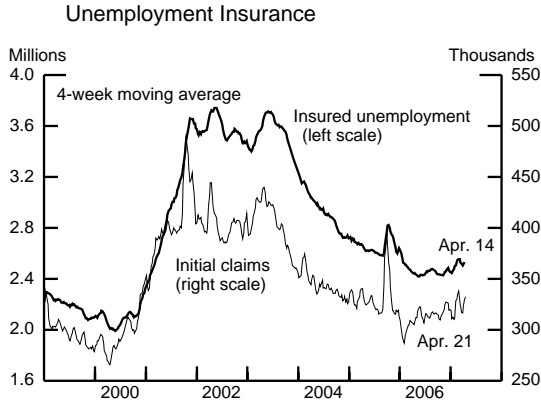


**Unemployed Due to Job Loss**  
(as a percent of the labor force)

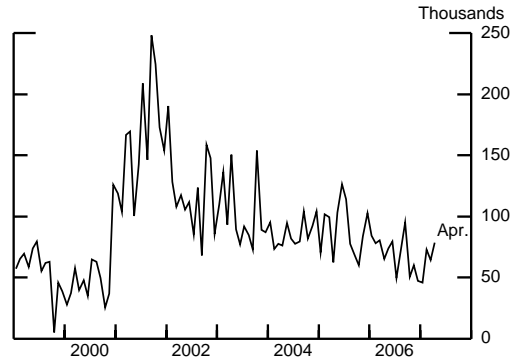


## Labor Market Indicators

### Layoffs



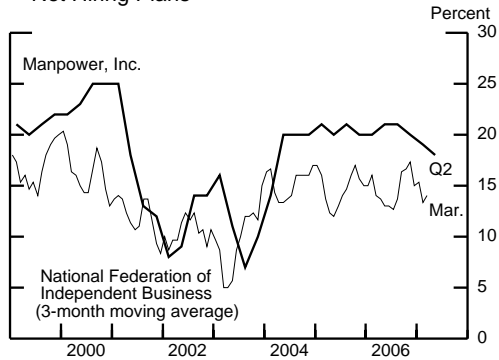
#### Layoff Announcements



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

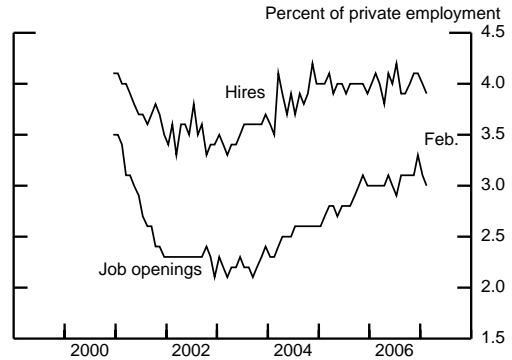
### Hiring

#### Net Hiring Plans



Note. Percent planning an increase in employment minus percent planning a reduction.

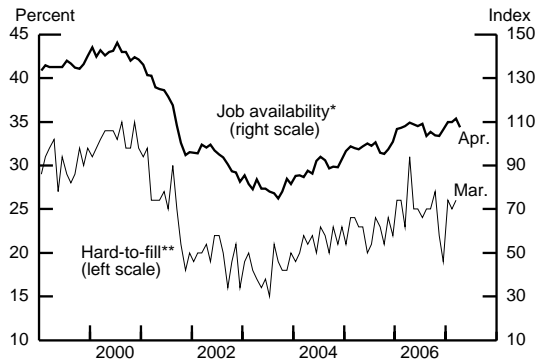
#### Job Openings and Hires



Source. Job Openings and Labor Turnover Survey.

### Labor Market Tightness

#### Job Availability and Hard-to-Fill Positions

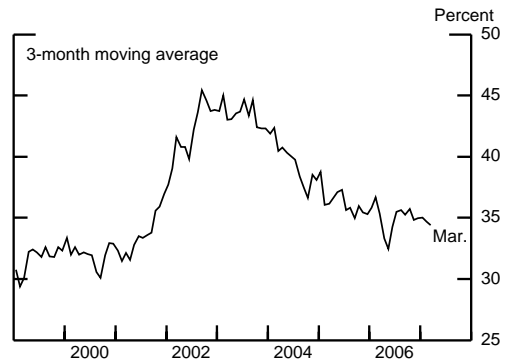


\*Proportion of households believing jobs are plentiful, minus the proportion believing jobs are hard to get, plus 100.

\*\*Percent of small businesses surveyed with at least 1 "hard-to-fill" job opening.

Source. For job availability, Conference Board; for hard-to-fill, National Federation of Independent Business.

#### Exhaustion Rate



Note. The exhaustion rate is calculated as the number of individuals who were receiving unemployment insurance benefits but reached the end of their potential eligibility expressed as a percent of all individuals who began receiving such benefits 6 months earlier.



Board, households' assessments of job availability have not moved much in recent months. Similarly, the number of individuals who remain on unemployment insurance rolls until their benefits expire (the exhaustion rate) has changed little.

The staff estimates that productivity in the nonfarm business sector rose at an annual rate of 1.5 percent in the first quarter. This modest gain would leave the rate of increase over the past four quarters at 1 percent, 1 percentage point lower than the pace recorded during the preceding four quarters.

### Output per Hour

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

Sector	2004:Q4 to 2005:Q4	2005:Q4 to 2006:Q4	2006			
			Q1	Q2	Q3	Q4
Nonfarm business						
All persons	2.1	1.5 <sup>1</sup>	3.5	1.2	-.5	1.9 <sup>1</sup>
All employees <sup>2</sup>	1.6	1.7 <sup>1</sup>	4.5	.9	-.2	1.7 <sup>1</sup>
Nonfinancial corporations <sup>3</sup>	1.8	n.a.	10.4	-4.4	4.1	n.a.

1. Staff estimates.

2. Assumes that the growth rate of hours of non-employees equals the growth rate of hours of employees.

3. 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. Nonfinancial corporate output is calculated as an income-side measure.

n.a. Not available.

### Industrial Production

Total industrial production (IP) rose 1.4 percent (annual rate) in the first quarter after a similarly sized decline in the fourth quarter. The flattening out of production over the past two quarters reflected inventory-related adjustments in a variety of industries, including light motor vehicles, construction supplies, and several upstream materials industries, such as steel and semiconductors. Although indicators of the inventory situation have been mixed, the bulk of the evidence suggests that businesses have significantly reduced—though probably not eliminated—the overhangs that cropped up in late 2006.

In March, IP declined 0.2 percent after a considerable rise in February; the change in IP in March was reduced  $\frac{3}{4}$  percentage point by a steep drop in utilities output because of a sizable swing in weather conditions from unseasonably cold temperatures in February to

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

Component	Proportion 2006 (percent)	2006 <sup>1</sup>	2006	2007	2007		
			Q4	Q1	Jan.	Feb.	Mar.
			Annual rate		Monthly rate		
<b>Total</b>	<b>100.0</b>	<b>3.5</b>	<b>-1.5</b>	<b>1.4</b>	<b>-4</b>	<b>.8</b>	<b>-2</b>
Previous	100.0	3.5	-1.2	...	-3	1.0	...
Manufacturing	81.9	3.4	-1.7	1.2	-6	.1	.7
Ex. motor veh. and parts	76.3	3.9	-1.5	2.0	-2	-1	.7
Ex. high-tech industries	71.5	2.5	-3.2	1.2	-3	-1	.5
Mining	8.6	8.0	3.0	-1.1	-1.6	.3	.1
Utilities	9.6	.3	-3.6	5.0	2.4	7.6	-7.0
<i>Selected industries</i>							
High technology	4.8	24.6	24.7	12.3	.3	.8	3.2
Computers	1.2	12.1	24.4	34.4	2.4	3.4	3.5
Communications equipment	1.1	14.8	9.6	30.0	1.8	3.7	2.2
Semiconductors <sup>2</sup>	2.6	34.8	31.1	-3.1	-1.3	-1.7	3.5
Motor vehicles and parts	5.5	-3.8	-4.0	-8.5	-5.8	2.2	.2
<i>Market groups excluding energy and selected industries</i>							
Consumer goods	20.9	1.8	2.0	2.8	-3	.3	.5
Durables	4.0	-1.9	-7.6	-3.3	-1.1	-6	.2
Nondurables	16.9	2.7	4.4	4.2	-1	.5	.6
Business equipment	7.8	10.2	4.0	-2.1	-2.3	-1	.8
Defense and space equipment	1.7	2.0	-3.5	-7	1.2	-6	-2.2
Construction supplies	4.5	-2.2	-9.1	-.3	-1.0	-8	1.1
Business supplies	7.9	1.0	-1.8	-1.8	-8	-3	.6
Materials	26.1	2.3	-7.0	1.3	-2	.0	.6
Durables	14.5	2.0	-9.3	3.7	.8	-1	.6
Nondurables	11.6	2.6	-4.2	-1.7	-1.3	.2	.6

1. From fourth quarter of preceding year to fourth quarter of year shown.

2. Includes related electronic components.

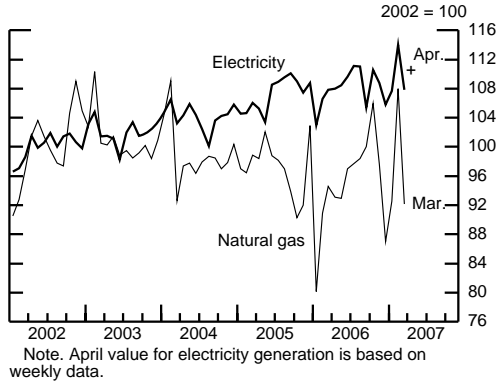
... Not applicable.

**Capacity Utilization**  
(Percent of capacity)

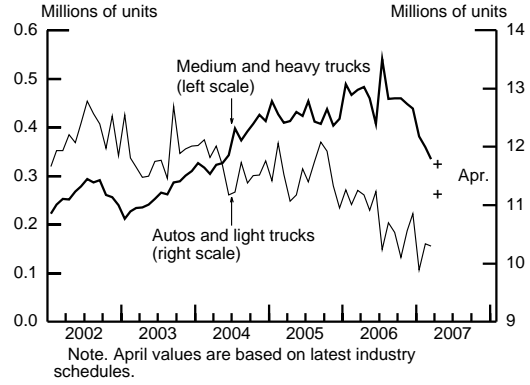
Sector	1972- 2006 average	1994- 95 high	2001- 02 low	2006		2007		
				Q3	Q4	Q1	Feb.	Mar.
				<b>Total industry</b>	<b>81.0</b>	<b>85.1</b>	<b>73.6</b>	<b>82.3</b>
Manufacturing	79.8	84.6	71.6	80.9	80.1	79.9	79.7	80.1
Ex. motor veh. and parts	79.9	84.3	71.4	81.4	80.5	80.4	80.2	80.5
Mining	87.4	88.9	84.8	90.9	91.3	90.8	90.9	90.9
Utilities	86.7	93.7	83.8	86.4	85.0	85.6	89.8	83.5
<i>Stage-of-process groups</i>								
Crude	86.5	89.5	82.0	89.4	89.1	88.2	88.2	88.3
Primary and semifinished	82.2	88.2	74.6	84.1	82.3	82.1	82.7	81.8
Finished	77.8	80.5	70.0	77.9	78.2	78.3	78.3	78.7

## Indicators of Industrial Activity

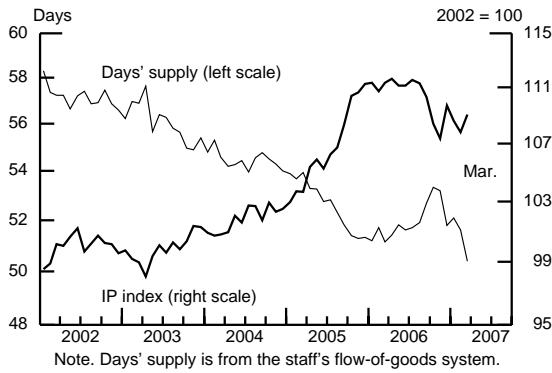
**Utilities Output**



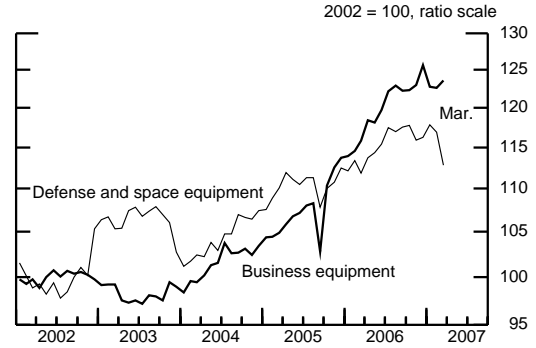
**Motor Vehicle Assemblies**



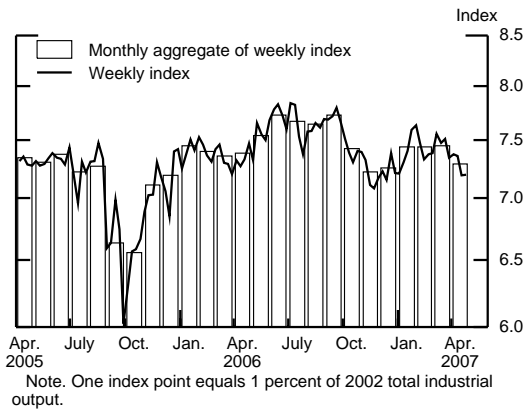
**Construction Supplies**



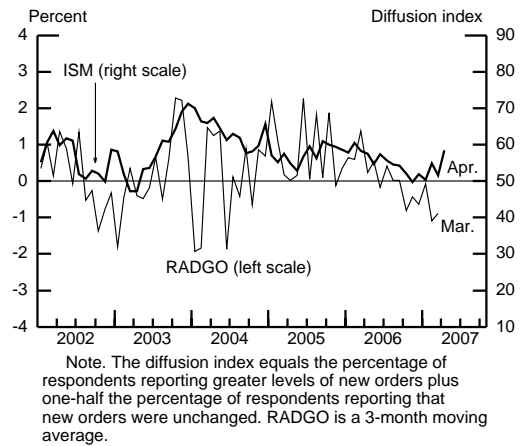
**IP: Business Equipment and Defense and Space Equipment**



**Weekly Production Index excluding Motor Vehicles and Electricity Generation**

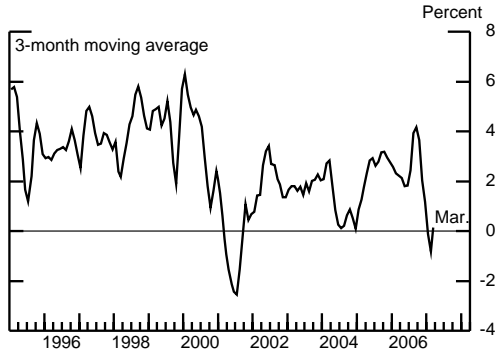


**New Orders: ISM Survey and Change in Real Adjusted Durable Goods Orders (RADGO)**

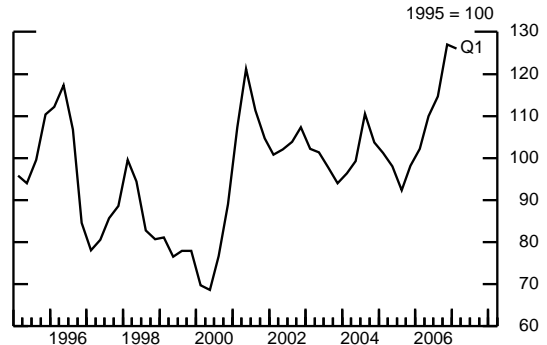


## Indicators of High-Tech Manufacturing Activity

**Rate of Change in Semiconductor Industrial Production**

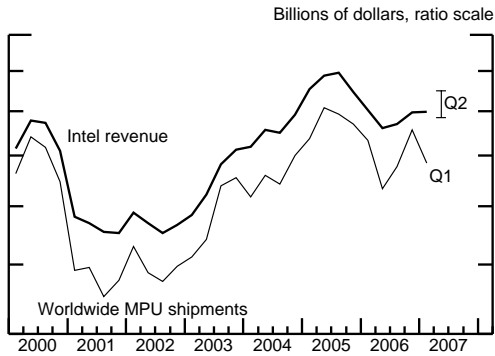


**FRB Chip Inventory Index**



Note. The staff's chip inventory index is a sales-weighted chain-type index constructed from financial data for 10 major chip manufacturers. Q1 value is based on limited data.

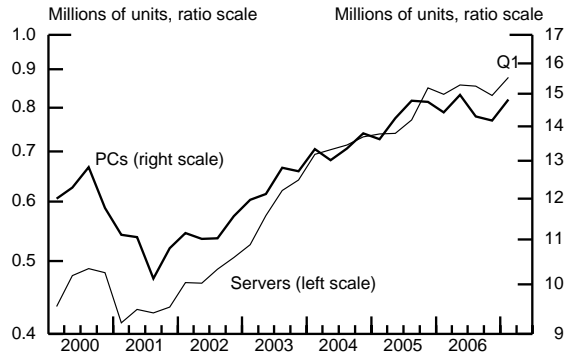
**MPU Shipments and Intel Revenue**



Note. FRB seasonals. Q2 Intel revenue is the range of the company's guidance as of April 17, 2007.

Source. Intel and Semiconductor Industry Association.

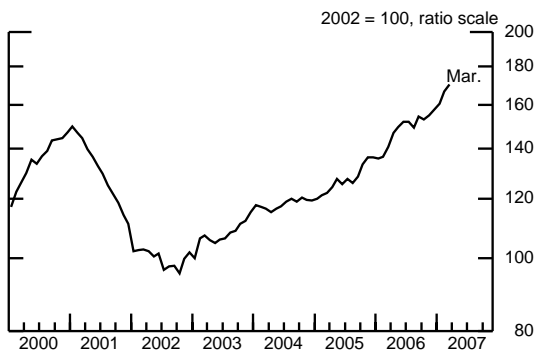
**U.S. Personal Computer and Server Sales**



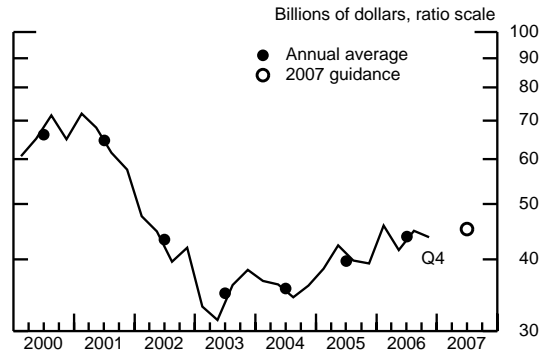
Note. FRB seasonals.

Source. Gartner.

**IP: Communications Equipment**



**Capital Expenditures by Selected Telecommunications Service Providers**



Note. FRB seasonals. Includes AT&T, Verizon, Sprint Nextel, and companies related by merger, acquisition, and spin-off.

Source. SEC filings.

unseasonably mild temperatures in March. In the manufacturing sector, production increased 0.7 percent in March after having declined, on balance, over the previous six months. The gains in manufacturing IP in March were spread widely and pushed up the factory operating rate 0.4 percentage point, to 80.1 percent, a level 0.3 percentage point above its 1972–2006 average.

The limited weekly information on IP for April suggests that the total index was likely boosted by an increase in electricity output and the scheduled pickup in motor vehicle assemblies; weekly data on output in other industries—principally crude oil, petroleum refining, steel, and meat products—appear likely to have been a small drag on balance.

The output of high-tech industries rose more than 3 percent in March after several months of sluggish gains. Much of the weakness earlier in the quarter reflected declining semiconductor production as manufacturers moved to correct inventory imbalances that arose when cell phone sales softened unexpectedly and as the accumulation of chips needed for the roll-out of computers running the new Microsoft Vista operating system ran its course.<sup>1</sup> Although semiconductor inventories appear to have remained elevated throughout the quarter, production turned up in March. Intel's latest revenue guidance points to a moderate increase in microprocessor production in the second quarter.

Elsewhere in the high-tech sector, production accelerated during the first quarter. Gartner reports that faster gains in the production of computers were related to the release of the consumer version of Microsoft Vista, which had led some buyers to delay purchases until this year. On the business side, sales of small servers moved up smartly, but production of large servers decelerated, a move that Gartner attributes to a nearly completed replacement cycle. The output of communications equipment rose 30 percent (annual rate) in the first quarter, a marked step-up from the second half of last year. However, this rate of increase in production is not likely to continue for much longer in light of the relatively moderate increase in capital expenditures planned by telecommunication service providers (TSPs) this year.<sup>2</sup>

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<sup>1</sup> Microsoft Vista requires a more complex, and more expensive, mix of hardware, particularly semiconductors.

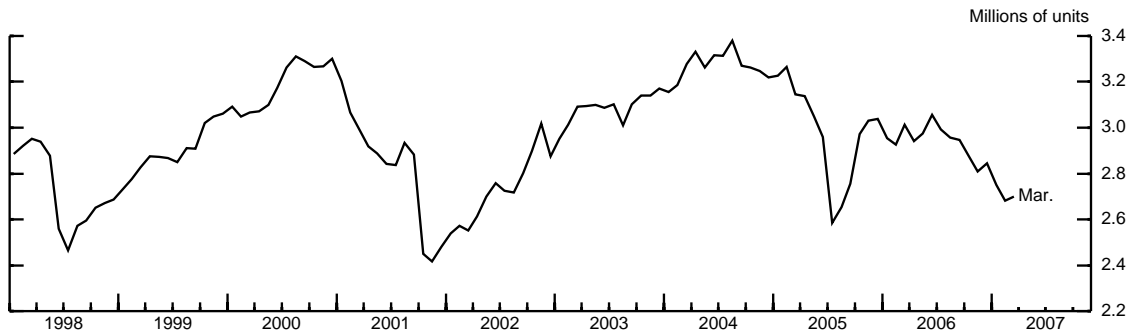
<sup>2</sup> TSPs account for less than 20 percent of domestic production of communications equipment, but because TSP spending is volatile, it accounts for a relatively large share of changes in investment in, and production of, communications equipment.

**Production of Domestic Light Vehicles**  
(Millions of units at an annual rate except as noted)

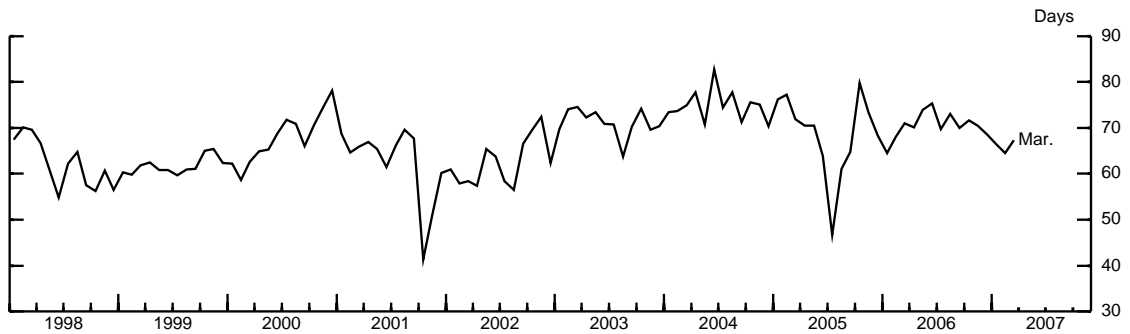
Item	2006		2007					
	Q3	Q4	Q1	Q2	Feb.	Mar.	Apr.	May
U.S. production <sup>1</sup>	10.5	10.5	10.2	11.1	10.3	10.3	11.2	11.1
Autos	4.3	4.4	3.9	4.1	3.9	3.7	4.0	4.2
Light trucks	6.2	6.1	6.2	6.9	6.4	6.6	7.2	6.9
Days' supply <sup>2</sup>	70	70	66	n.a.	64	67	n.a.	n.a.
Autos	54	60	61	n.a.	62	62	n.a.	n.a.
Light trucks	82	77	69	n.a.	66	71	n.a.	n.a.
Inventories <sup>3</sup>	2.95	2.84	2.70	n.a.	2.68	2.70	n.a.	n.a.
Autos	.95	1.03	1.03	n.a.	1.02	1.03	n.a.	n.a.
Light trucks	1.99	1.81	1.67	n.a.	1.66	1.67	n.a.	n.a.
Memo: U.S. production, total motor vehicles <sup>4</sup>	11.0	11.0	10.5	11.4	10.7	10.6	11.5	11.4

- Note. FRB seasonals. Components may not sum to totals because of rounding.
1. Production rates for April, May, and the second quarter reflect the latest industry schedules.
  2. Quarterly values are calculated with end-of-period stocks and average reported sales.
  3. End-of-period stocks.
  4. Includes medium and heavy trucks.
- n.a. Not available.

**Inventories of Light Vehicles**



**Days' Supply of Light Vehicles**



The production of motor vehicles and parts fell 8½ percent in the first quarter, as assemblies sank to their lowest level since the third quarter of 1993. However, with inventories back down to desirable levels at the end of the quarter, assemblies of light vehicles are estimated to have picked up to an annual rate of about 11 million units in April and are scheduled to remain at about this level in May and June. Despite the sizable increase in production, days' supply of light vehicles should remain in check this quarter if sales remain close to the first-quarter pace.<sup>3</sup> Meanwhile, production of medium and heavy trucks has continued to move lower in response to a falloff in demand after the new EPA regulations went into effect earlier this year.

Excluding energy, motor vehicles and parts, and high-tech products, output rose in March in nearly all of the major market groups. The production of consumer goods increased ½ percent: Continued strength in nondurables accompanied a small gain in durables that followed weak production earlier in the quarter. The output of business equipment rose 0.8 percent in March, thereby partly reversing declines over the previous two months. The production of construction supplies popped up in March, though it remained well below levels observed from late 2005 to mid-2006; the March gain was likely due, at least in part, to unseasonably warm weather. The output of materials rose 0.6 percent, a move that likely reflects the recent rise in construction supplies and the upturn in motor vehicle assemblies in April. The only major market group that declined in March was defense and space equipment, which was pulled down by a one-month strike at a Northrop Grumman shipyard in Pascagoula, Mississippi.

Near-term indicators suggest modest production gains in coming months. In April, the new orders diffusion index from the Institute for Supply Management (ISM) jumped, while the corresponding indexes from the various regional surveys were little changed on balance. In addition, a variety of materials-related industries—such as primary metals and plastics and rubber products—should benefit from the scheduled step-up in motor vehicle assemblies this quarter. However, the staff's series on real adjusted durable goods orders has declined, on balance, since the end of last summer.

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<sup>3</sup> Given net imports of about 5½ million units and sales of about 16½ million units, replacement-level production—the amount of production needed to keep inventories unchanged—would be about 11 million units, a level roughly in line with industry schedules for the second quarter. In the past three quarters, production was far below replacement levels, and inventories declined.

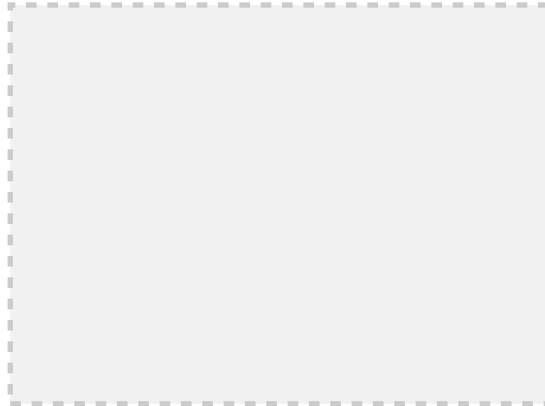
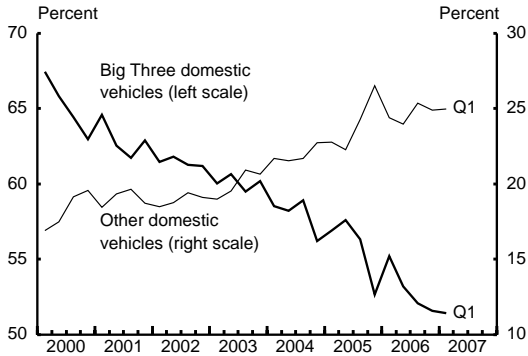
**Sales of Light Vehicles**  
(Millions of units at an annual rate; FRB seasonals)

Category	2006	2006		2007			
		Q3	Q4	Q1	Feb.	Mar.	Apr.
Total	16.5	16.6	16.3	16.5	16.6	16.3	16.2
Autos	7.8	7.9	7.6	7.6	7.4	7.6	7.3
Light trucks	8.7	8.7	8.7	8.9	9.1	8.7	8.9
North American <sup>1</sup>	12.8	12.8	12.4	12.6	12.8	12.3	12.5
Autos	5.4	5.4	5.2	5.1	5.1	5.1	5.0
Light trucks	7.4	7.4	7.2	7.5	7.7	7.2	7.5
Foreign-produced	3.7	3.7	3.8	3.9	3.8	3.9	3.7
Autos	2.3	2.5	2.4	2.4	2.4	2.5	2.3
Light trucks	1.3	1.3	1.5	1.5	1.4	1.4	1.4
Memo: Big Three domestic market share (percent) <sup>2</sup>	53.7	52.8	52.3	52.1	53.5	51.7	53.7

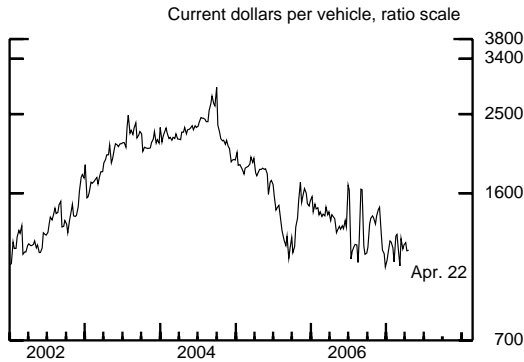
Note. Components may not sum to totals because of rounding.

1. Excludes some vehicles produced in Canada that are classified as imports by the industry.
2. Domestic market share excludes sales of foreign brands affiliated with the Big Three.

**Market Share**

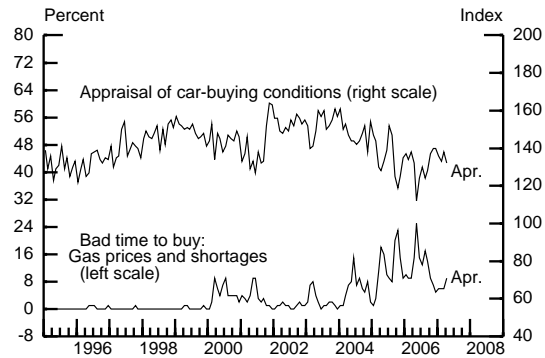


**Average Value of Incentives on Light Vehicles**



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

**Car-Buying Attitudes**



Source. Reuters/University of Michigan Survey.



**Light Motor Vehicles**

Sales of automobiles and light trucks averaged an annual rate of 16½ million units in the first quarter, a little above the pace in the fourth quarter of last year and the same as that over 2006 as a whole.

.<sup>4</sup> In April, sales declined a bit, mainly because of lower sales of foreign-produced vehicles. As a result, the Big Three's domestic market share moved back up to its level of last year.

The Conference Board measure of new car purchases improved in April, while the Reuters/University of Michigan index of car-buying attitudes remained in the neutral range seen over the past several months. According to the Reuters/Michigan survey, high gasoline prices are not as big a deterrent to car buying as they were in 2006, although respondents to recent surveys have expressed concern about higher financing rates. Manufacturers' pricing incentives for light vehicles remained at a relatively low level in April.

**Consumer Spending**

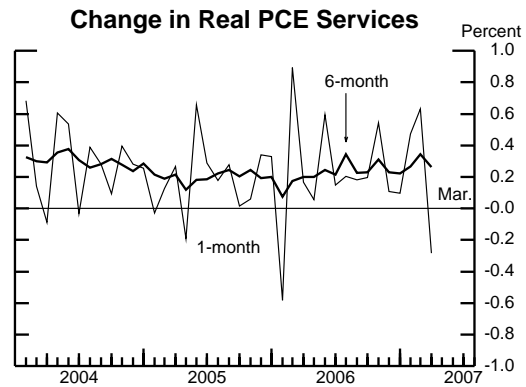
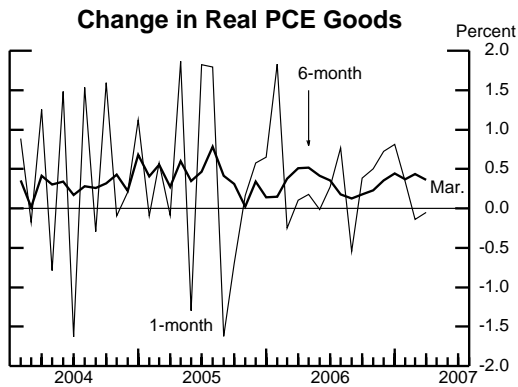
Real personal consumption expenditures increased at an annual rate of 3¾ percent in the first quarter, but spending growth slowed over the course of the quarter, in part because of swings in weather-related outlays on energy goods (such as fuel oil) and energy services (such as natural gas and electricity). Real spending on goods other than motor vehicles, which had shown exceptional vigor late last year, was little changed, on balance, between December and March. However, real outlays on non-energy services were reported to have posted solid gains, especially in March.

Consumer spending appears to have entered the second quarter on a soft note. Chain store sales were up just a little, on balance, in recent weeks. In addition, the Conference Board and the Reuters/Michigan surveys reported small declines in consumer confidence in April, perhaps because of the run-up in gasoline prices. Even so, both sentiment measures remain consistent with modest gains in spending in the near term.

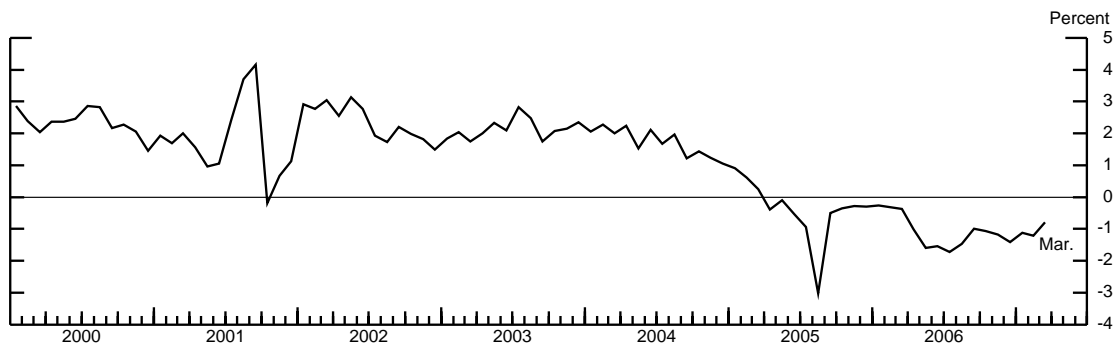
With regard to the fundamentals, real disposable personal income rose at an annual rate of 4½ percent in the first quarter. Although roughly half of this gain reflects an estimate by the Bureau of Economic Analysis (BEA) of unusually large bonus payments and stock option exercises in January, wages and salaries increased solidly, on average, over

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

Category	2006		2007				
	2006	Q3	Q4	Q1	Jan.	Feb.	Mar.
	Annual rate			Monthly rate			
Total real PCE	3.2	2.8	4.2	3.8	.4	.3	-.2
Durable goods	5.0	6.4	4.4	7.3	1.2	-.4	.1
Motor vehicles	-1.2	8.6	-4.4	11.4	1.9	.6	-.5
Excluding motor vehicles	9.8	4.9	11.1	4.5	.8	-1.2	.6
Nondurable goods	3.7	1.5	5.9	2.9	.0	.0	-.1
Gasoline and motor oil	-.4	6.9	-.4	5.8	.2	1.3	-1.3
Fuel oil and coal	-8.1	-18.4	24.4	60.3	9.4	32.5	-19.3
Other	4.4	1.0	6.6	2.1	-.1	-.5	.3
Services	2.6	2.8	3.4	3.7	.5	.6	-.3
Energy	-2.5	21.9	5.3	10.1	6.7	9.6	-14.4
Other	2.8	2.1	3.3	3.4	.2	.3	.4
Memo: Real PCE goods ex. motor vehicles	4.8	1.9	7.0	3.2	.1	-.2	.0



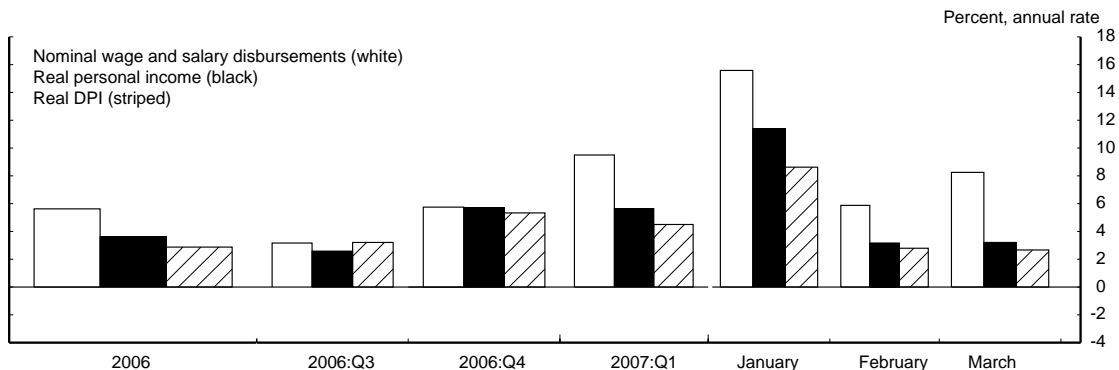
**Personal Saving Rate**



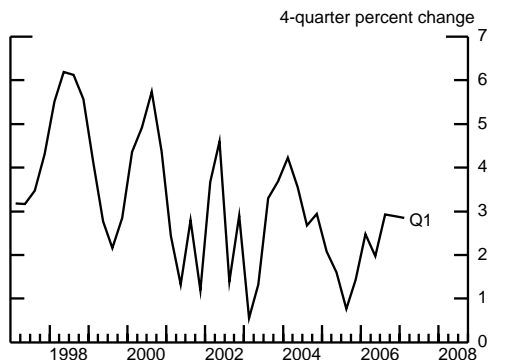
Note. Value for December 2004 excludes the effect on income of the one-time Microsoft dividend in that month.

## Fundamentals of Household Spending

Changes in Nominal Wages and Salaries, Real Personal Income, and Real DPI

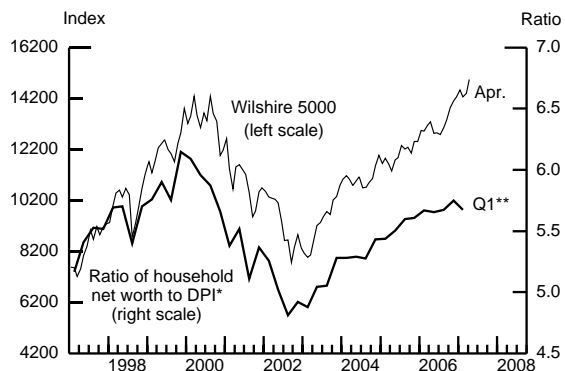


Change in Real DPI



Note. Values for 2004:Q4 and 2005:Q4 exclude the effect on income of the one-time Microsoft dividend in December 2004.

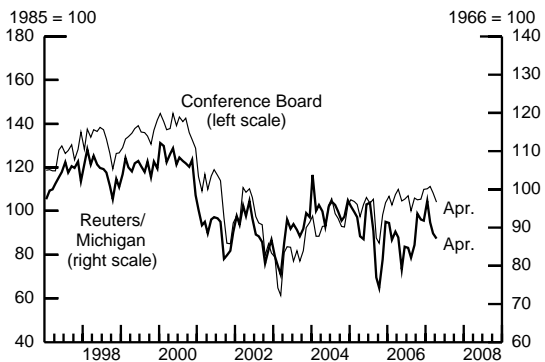
Household Net Worth and Wilshire 5000



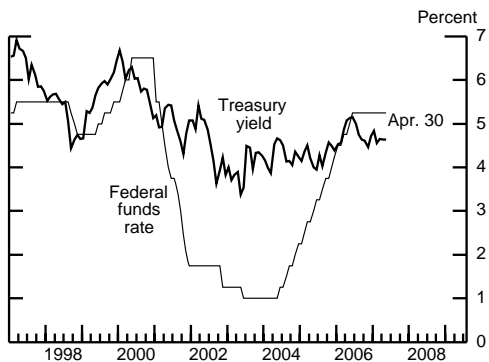
\* The value for 2004:Q4 excludes the effect on income of the one-time Microsoft dividend in December 2004.

\*\* Value for 2007:Q1 is a staff estimate.

Consumer Confidence



Federal Funds Rate and 10-Year Treasury Yield



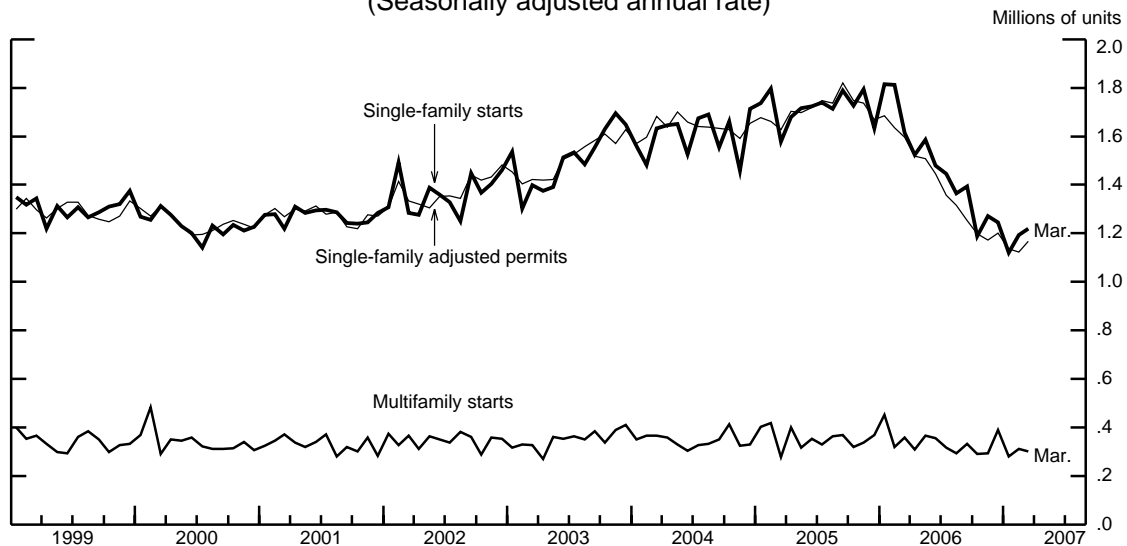
**Private Housing Activity**

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

Sector	2006	2006		2007			
		Q3	Q4	Q1	Jan.	Feb.	Mar.
<i>All units</i>							
Starts	1.80	1.71	1.56	1.47	1.40	1.51	1.52
Permits	1.84	1.71	1.56	1.56	1.57	1.53	1.56
<i>Single-family units</i>							
Starts	1.47	1.40	1.23	1.18	1.12	1.19	1.22
Permits	1.38	1.28	1.17	1.12	1.12	1.10	1.13
Adjusted permits <sup>1</sup>	1.41	1.31	1.19	1.14	1.14	1.12	1.17
Permit backlog <sup>2</sup>	.133	.137	.133	.131	.140	.137	.131
<i>New homes</i>							
Sales	1.05	1.01	.99	.86	.87	.84	.86
Months' supply <sup>3</sup>	6.33	6.76	6.58	7.60	7.37	7.81	7.62
<i>Existing homes</i>							
Sales	5.68	5.50	5.50	5.62	5.67	5.88	5.32
Months' supply <sup>3</sup>	6.36	6.98	6.91	7.04	6.87	6.78	7.45
<i>Multifamily units</i>							
Starts	.336	.313	.325	.297	.280	.312	.300
Permits	.457	.433	.394	.438	.447	.433	.433
Permit backlog <sup>2</sup>	.062	.067	.062	.073	.069	.072	.073
<i>Mobile homes</i>							
Shipments	.117	.107	.097	n.a.	.094	.093	n.a.
<i>Condos and co-ops</i>							
Existing home sales	.801	.789	.759	.790	.769	.800	.800

1. Adjusted permits equal permit issuance plus total starts outside of permit-issuing areas.
  2. Number outstanding at end of period. Excludes permits that have expired or have been canceled, abandoned, or revoked. Not at an annual rate.
  3. At current sales rate; expressed as the ratio of seasonally adjusted inventories to seasonally adjusted sales. Quarterly and annual figures are averages of monthly figures.
- n.a. Not available.

**Private Housing Starts and Permits**  
(Seasonally adjusted annual rate)



Note. Adjusted permits equal permit issuance plus total starts outside of permit-issuing areas.

February and March. Consumer spending has also continued to draw support from the increases in household wealth that have occurred over the past two years, although the boost to spending from wealth has likely been offset to some extent by the lagged effects of the upward trend in borrowing costs since 2004. In the first quarter of this year, the wealth-income ratio likely ticked down, as the stock market rose only a little and house prices remained soft. However, much of the lost ground has probably since been made up as a result of the surge in stock prices in April.

The personal saving rate averaged negative 1 percent in the first quarter after having been in the vicinity of negative 1¼ percent to negative 1½ percent over the preceding three quarters. All else being equal, this year's annual retail sales revision implies a small downward adjustment to consumer spending and a small upward adjustment to the saving rate in recent years. The revision is expected to raise the saving rate in the first quarter about ¼ percentage point, but it is not expected to significantly alter its pattern over the past few quarters.

### **Housing**

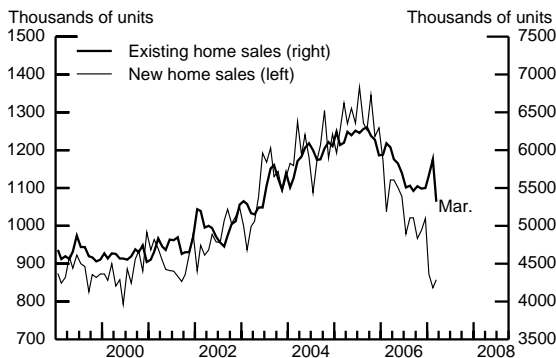
Residential construction activity remains soft overall as builders attempt to work off an elevated inventory of unsold new homes. Recent readings on home sales suggest that housing demand has continued to weaken, and the tightening of lending standards for nonprime borrowers that began in February will likely further restrain home sales in the coming months.

Single-family housing starts rose 2 percent in March, and adjusted permit issuance in this sector increased. Unusually warm and dry weather almost certainly boosted the level of single-family starts in March; it may have raised permit issuance as well. Although the correlation between permit issuance and weather patterns is not typically strong, the only increases in the number of permits issued since September 2005 have been in January 2006, December 2006, and March 2007—all months that were unseasonably warm.

The incoming data on home sales are sending mixed signals about the current tenor of housing demand. Although existing home sales declined in March, that drop followed sizable increases in January and February, and the level of sales in March was only slightly below the steady pace that prevailed in the second half of 2006. New home sales present a considerably less sanguine view of demand: They fell sharply in the first two months of the year and recovered only a bit in March, developments that left their level about 14 percent below the average of the second half of last year.

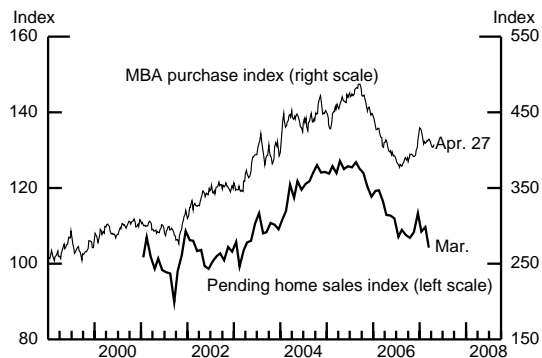
## Indicators of Single-Family Housing

### Home Sales



Source. For existing homes, National Association of Realtors; for new homes, Census Bureau.

### Homebuying Indicators



Note. Purchase index is a 4-week moving average and is seasonally adjusted by FRB staff.  
Source. For pending home sales, National Association of Realtors; for purchase index, Mortgage Bankers Assoc.

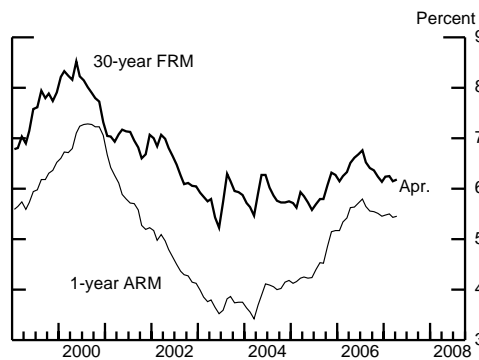
### New Home Sales Months' Supply

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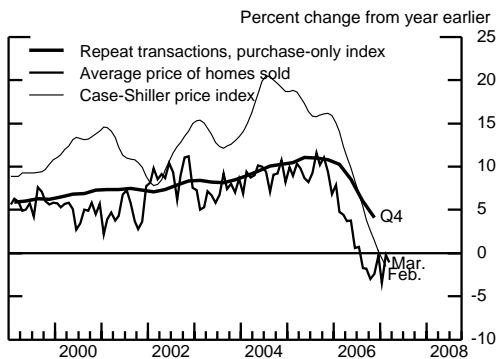
Note. Months' supply is calculated using the 3-month moving average of sales.  
Source. ; for months' supply, Census Bureau.

### Mortgage Rates



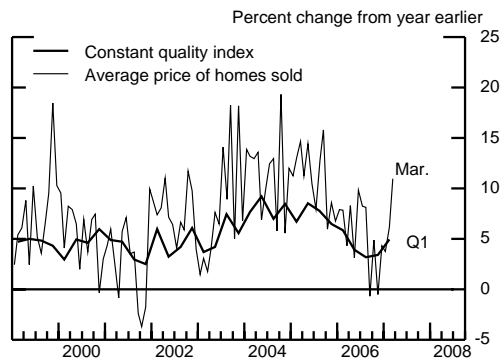
Note. The April readings are based on data through April 25, 2007.  
Source. Freddie Mac.

### Prices of Existing Homes



Note. The Case-Shiller price index is the 10-city index.  
Source. For repeat transactions, OFHEO; for average price, National Association of Realtors; for Case-Shiller, Chicago Mercantile Exchange.

### Prices of New Homes



Note. Average price values have been adjusted by Board staff to take into account new sampling procedures adopted in 2005.  
Source. Census Bureau.

The recent tightening of lending standards may have exerted some restraint on new home sales in March, and it will likely show up in the existing home sales statistics (which are based on closings) in the second quarter. The decline in the pending home sales index in March may partly reflect reduced sales to nonprime borrowers. The four-week moving average of the MBA index of mortgage purchase applications has also slipped a little since the end of February.<sup>5</sup> However, in contrast to the difficulties faced by nonprime borrowers and lenders, relatively low mortgage rates should help to support housing demand among prime borrowers: The average rate for thirty-year fixed-rate mortgages is currently about 60 basis points below the level of last July, while average rates for one-year adjustable-rate mortgages are about 30 basis points lower.

Combined with a large remaining inventory of new homes for sale, the contraction in new home sales has noticeably raised the months' supply of new homes for sale. Relative to the three-month average pace of sales, the months' supply in March was more than 60 percent above the high end of the relatively narrow range it occupied from 1997 to 2005. Moreover, these published figures probably understate the true inventory overhang in this sector because they do not account for last year's surge in canceled sales, which return homes to the unsold inventory but are not incorporated in the official statistics. High inventories and low sales in March suggest that homebuilders may have to reduce their construction plans even further to work off their excess inventories of unsold homes.

House-price appreciation continues to slow. On a constant-quality basis, the average price of new homes was 5 percent above year-earlier levels in the first quarter, compared with an average annual increase of nearly 7 percent in the preceding three years. Furthermore, these figures may understate the actual deceleration in the cost to purchasers of new homes because homebuilders have reportedly stepped up their use of nonprice measures—such as granting more-favorable mortgage terms, paying closing costs, and including optional upgrades at no cost—to bolster sales and unload inventory. For existing homes, the Case-Shiller home-price index—which uses a methodology similar to that of the OFHEO index but is limited to sales in ten large U.S. cities—has decelerated substantially since last summer, slipping further in the first two months of this year, and pointing to some further deceleration in the OFHEO index in the first

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<sup>5</sup> Although the sample used to calculate the MBA index does not include a large fraction of the institutions that deal with subprime borrowers, the reduced housing demand of this group may still affect the index by making it more difficult for all current homeowners to sell their homes when they want to move.

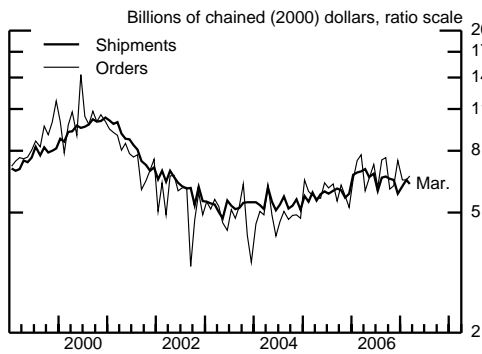
**Orders and Shipments of Nondefense Capital Goods**

(Percent change; seasonally adjusted current dollars)

Category	2006	2007			
	Q4	Q1	Jan.	Feb.	Mar.
	Annual rate		Monthly rate		
Shipments	-4.0	-9.4	-2.3	-.9	.9
Excluding aircraft	-4.0	-10.2	-3.1	-.1	.6
Computers and peripherals	-36.0	21.9	-1.3	2.8	-8.7
Communications equipment	-7.4	2.2	5.7	5.1	-2.9
All other categories	1.3	-14.7	-4.1	-1.0	2.3
Orders	5.3	-20.7	-20.2	9.6	11.8
Excluding aircraft	-4.2	-15.6	-6.2	-2.4	4.8
Computers and peripherals	-31.1	17.5	-3.7	2.4	-2.9
Communications equipment	-26.3	-2.6	-13.6	-.2	3.3
All other categories	2.4	-20.0	-5.7	-3.3	6.0
Memo: Shipments of complete aircraft <sup>1</sup>	33.2	n.a.	58.3	42.1	n.a.

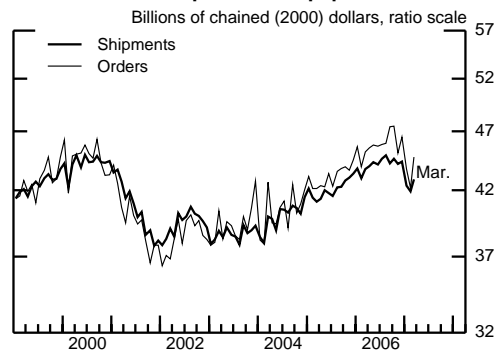
1. From Census Bureau, Current Industrial Reports; billions of dollars, annual rate.  
n.a. Not available.

**Communications Equipment**



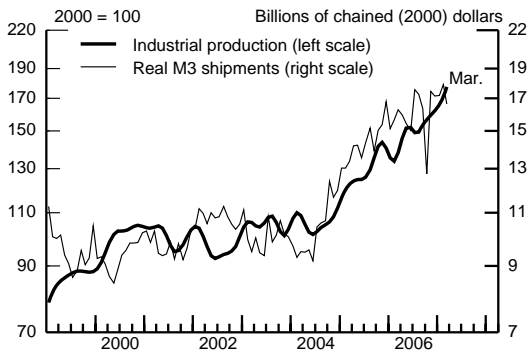
Note. Shipments and orders are deflated by a price index that is derived from the BEA's quality-adjusted price indexes and uses the PPI for communications equipment for monthly interpolation.

**Non-High-Tech, Nontransportation Equipment**



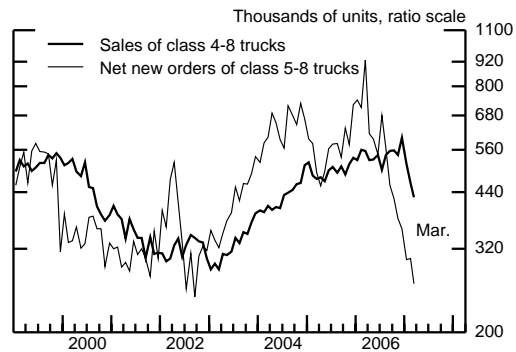
Note. Shipments and orders are deflated by the staff price indexes for the individual equipment types included in this category. Indexes are derived from the BEA's quality-adjusted price indexes.

**Computers and Peripherals**



Note. Ratio scales. Shipments are deflated by the staff price index for computers and peripheral equipment, which is derived from the BEA's quality-adjusted price indexes.

**Medium and Heavy Trucks**



Note. Annual rate, FRB seasonals.  
Source. For class 4-8 trucks, Ward's Communications; for class 5-8 trucks, ACT Research.



quarter. Meanwhile, the average price of existing homes sold—which does not adjust for changes in the quality of homes—moved down in March to a level that was 1.1 percent below that of a year earlier.

### **Equipment and Software**

Real spending on equipment and software (E&S) rose at an annual rate of less than 2 percent last quarter after having fallen 4¾ percent in the fourth quarter. Spending on high-tech equipment posted a substantial increase in the first quarter. But spending on transportation equipment was dragged down by a plunge in purchases of medium and heavy trucks. Outlays outside these categories continued to contract steeply, though the upturn in shipments and orders in March may be a signal that equipment spending is starting to improve as we move into the second quarter.

To be sure, the fundamental determinants of equipment spending have turned less supportive in recent quarters in light of the sharp deceleration in business output. But with robust corporate cash reserves and with the user cost of high-tech goods continuing to decline, the fundamentals in the aggregate are still consistent with a faster underlying pace of equipment spending than has been seen in recent quarters. In addition, the deterioration in surveys of business conditions that was evident in 2006 appears to have ended; in fact, the ISM index has rebounded lately.

Real spending on high-tech E&S expanded at an annual rate of 20 percent last quarter, and sharp gains were observed in all major categories. Real outlays on computers rose at an annual rate of more than 50 percent, in part because of the retail release of Microsoft Vista in January. As noted, the IP index for computers—the major input into the BEA estimate of computer spending—increased significantly in the first quarter, and shipments and imports also posted solid gains.<sup>6</sup> The BEA advance estimate of spending on software, which is based in part on outlays for computers, also showed a substantial increase—in fact, anecdotal reports on company earnings point to an even larger number than the BEA estimate. In addition, purchases of communications equipment—which tend to be volatile quarter to quarter—sped up after a fourth-quarter dip.

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<sup>6</sup> Note that the BEA estimate of business investment in computers last quarter was biased upward because the BEA uses the *overall* IP index for computers, which includes both business spending and consumer spending, while the Vista-related surge in sales of computers was primarily associated with consumer purchases.

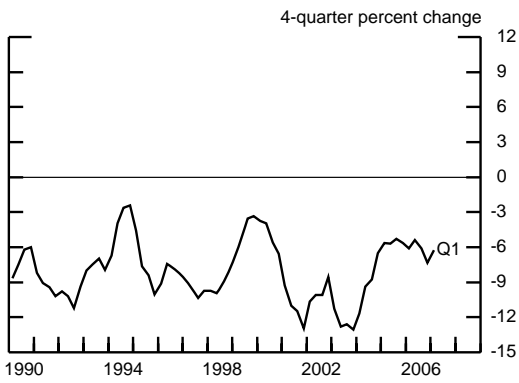
## Fundamentals of Equipment and Software Investment

Real Business Output

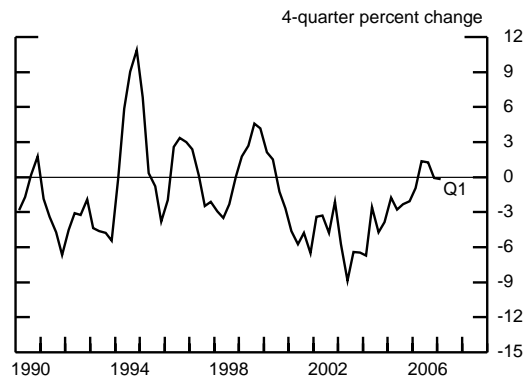


### User Cost of Capital

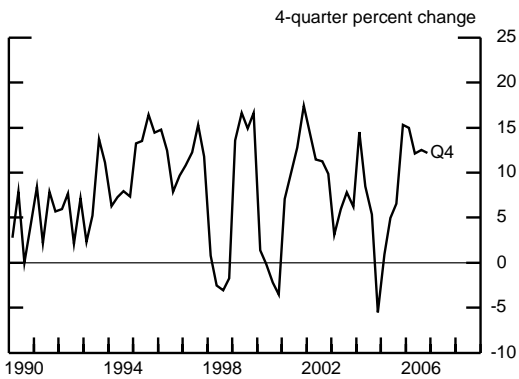
High-Tech



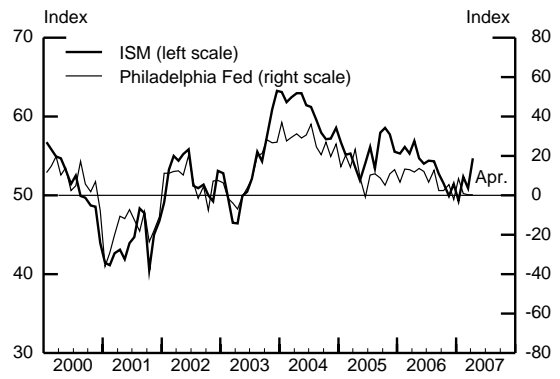
Non-High-Tech



Real Corporate Cash Flow



Business Conditions



Source. Manufacturing ISM Report on Business;  
Philadelphia Fed Business Outlook Survey.

Real business outlays on transportation equipment declined at an annual rate of 13½ percent last quarter. Although domestic spending on aircraft jumped after three weak quarters, spending on motor vehicles contracted significantly as the tightening of emissions standards that took effect in January led to a dramatic drop in purchases of medium and heavy trucks. Another sharp decline in truck orders in March suggests that these purchases will fall further in the second quarter.

Business investment in equipment other than high-tech and transportation dropped at an annual rate of 8 percent in the first quarter after a fall of nearly 5 percent in the previous quarter. The weakness in this broad category appears to have been especially pronounced around the turn of the year and to have lessened somewhat over the course of the quarter. In March, shipments of construction and motor-vehicle-related equipment (such as metalworking machinery and construction machinery), which had played a major role in the earlier weakness, continued to decrease. Orders for these items rose sharply as a result of a surprising jump in bookings for construction machinery. That said, reports from our contacts suggest that demand for construction-related machinery and supplies remains weak. Outside of construction and motor vehicles, orders and shipments both posted widespread—albeit modest—gains in March.

### **Nonresidential Construction**

Real outlays for nonresidential construction excluding drilling and mining regained some steam in the first quarter after having hit a lull in late 2006: After incorporating data on construction spending in March, we estimate that they rose at an annual rate of 12 percent.<sup>7</sup> The fundamentals in this sector remain solid and point to further increases in the near term, although they will likely be smaller than that recorded in the first quarter of this year. Vacancy rates in the industrial and office categories have moved down over the past few years. In the retail sector, the vacancy rate has drifted up since the end of 2005 but remains well below its peak in 2002. Furthermore, the architectural billings index—which is correlated with changes in nonresidential construction about six months hence—rebounded in the second half of last year.<sup>8</sup>

Real drilling and mining investment dropped sharply in the first quarter; this decrease continued a deceleration in activity that began in the second half of last year and may

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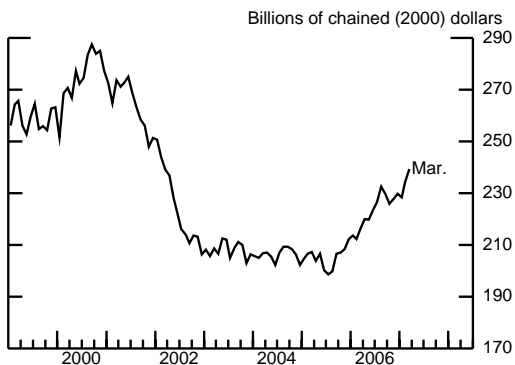
<sup>7</sup> The advance NIPA estimate, which did not include data on construction spending in March, showed an increase of 7½ percent for these outlays.

<sup>8</sup> About 88 percent of the construction projects covered by the architectural billings index are nonresidential.

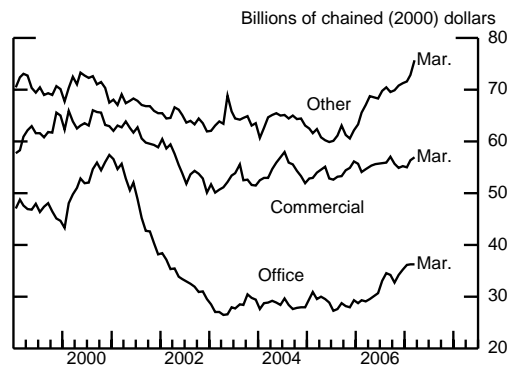
### Nonresidential Construction and Indicators

(All spending series are seasonally adjusted at an annual rate; nominal CPIP deflated by BEA prices through Q4 and by staff projection thereafter)

Total Structures

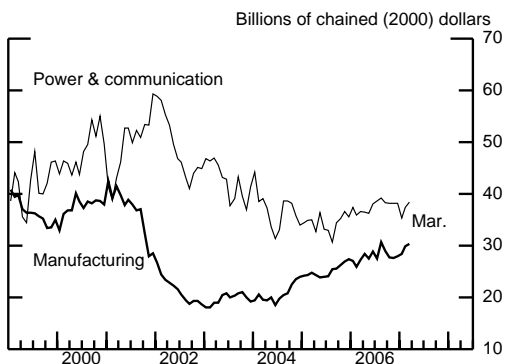


Office, Commercial, and Other

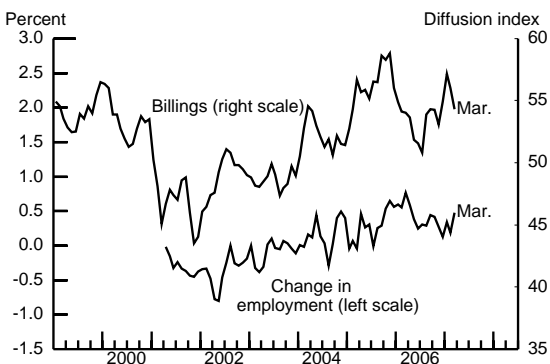


Note. Other includes religious, educational, lodging, amusement and recreation, transportation, and health-care facilities.

Manufacturing and Power & Communication

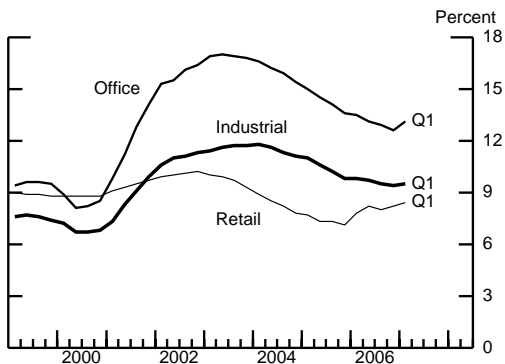


Architectural Billings and Nonresidential Construction Employment



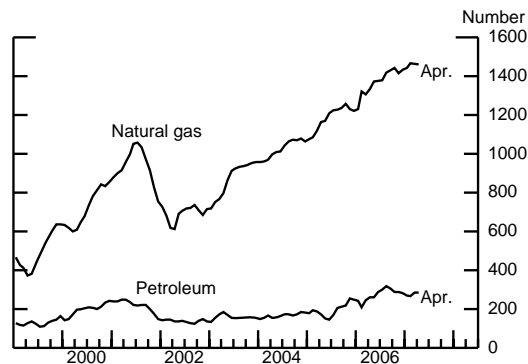
Note. Both series are 3-month moving averages. Employment includes industrial, commercial, and specialty trade construction. Source. For billings, American Institute of Architects; for employment, Bureau of Labor Statistics.

Vacancy Rates



Note. Industrial space includes both manufacturing structures and warehouses. Source. Torto Wheaton Research.

Drilling Rigs in Operation



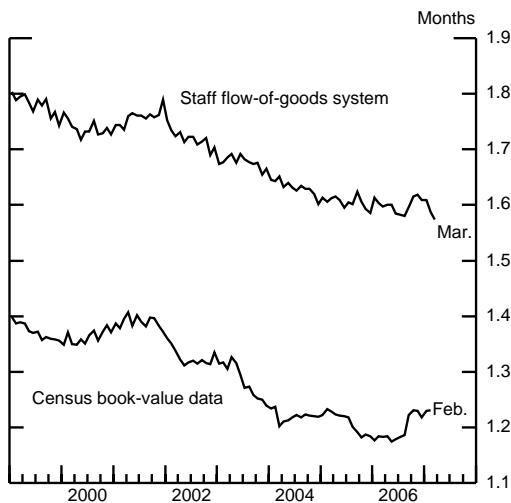
Note. The April readings are based on data through April 27, 2007. Source. DOE/Baker Hughes.

**Nonfarm Inventory Investment**  
(Billions of dollars; seasonally adjusted annual rate)

Measure and sector	2006		2007			
	Q3	Q4	Q1	Jan.	Feb.	Mar.
<i>Real inventory investment (chained 2000 dollars)</i>						
<b>Total nonfarm business</b>	<b>53.3</b>	<b>20.0</b>	<b>8.1<sup>e</sup></b>	<b>n.a.</b>	<b>n.a.</b>	<b>n.a.</b>
Motor vehicles	-8	-19.7	-19.3 <sup>e</sup>	n.a.	n.a.	n.a.
Nonfarm ex. motor vehicles	54.2	39.7	27.4 <sup>e</sup>	n.a.	n.a.	n.a.
<b>Manufacturing and trade ex. wholesale and retail motor vehicles and parts</b>						
<b>Manufacturing</b>	<b>10.1</b>	<b>8.4</b>	<b>n.a.</b>	<b>10.4<sup>e</sup></b>	<b>39.9<sup>e</sup></b>	<b>n.a.</b>
Wholesale trade ex. motor vehicles & parts	25.7	6.5	n.a.	2.4 <sup>e</sup>	-3.3 <sup>e</sup>	n.a.
Retail trade ex. motor vehicles & parts	9.4	9.7	n.a.	6.7	20.4	n.a.
<i>Book-value inventory investment (current dollars)</i>						
<b>Manufacturing and trade ex. wholesale and retail motor vehicles and parts</b>	<b>87.0</b>	<b>46.5</b>	<b>n.a.</b>	<b>23.2</b>	<b>67.1</b>	<b>n.a.</b>
Manufacturing	37.2	14.4	4.4	-3	1.9	11.4
Wholesale trade ex. motor vehicles & parts	36.6	17.5	n.a.	18.9	34.3	n.a.
Retail trade ex. motor vehicles & parts	13.1	14.6	n.a.	4.6	30.8	n.a.

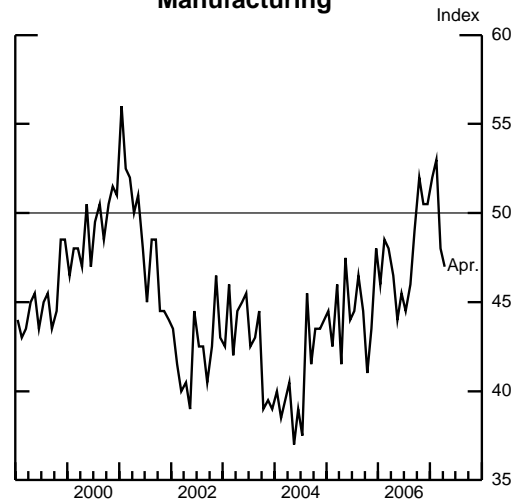
<sup>e</sup> Staff estimate of real inventory investment based on revised book-value data.  
n.a. Not available.  
Source. For real inventory investment, BEA; for book-value data, Census Bureau.

**Inventory Ratios ex. Motor Vehicles**



Note. Flow-of-goods system covers total industry ex. motor vehicles and parts, and inventories are relative to consumption. Census data cover manufacturing and trade ex. motor vehicles and parts, and inventories are relative to sales.

**ISM Customer Inventories: Manufacturing**



Note. A number above 50 indicates inventories are "too high."

**Federal Government Outlays and Receipts**  
(Unified basis; billions of dollars except as noted)

Function or source	March			12 months ending in March		
	2006	2007	Percent change	2006	2007	Percent change
Outlays	249.8	262.8	5.2	2579.9	2693.6	4.4
Financial transactions <sup>1</sup>	.3	.1	...	-1.7	-14.3	...
Payment timing <sup>2</sup>	15.5	15.8	...	15.2	-5.8	...
Adjusted outlays	234.0	246.8	5.5	2566.4	2713.7	5.7
Receipts	164.6	166.5	1.2	2251.9	2489.9	10.6
Payment timing	.0	.0	...	.0	-6.0	...
Adjusted receipts	164.6	166.5	1.2	2251.9	2495.9	10.8
Surplus or deficit (-)	-85.3	-96.3	...	-327.9	-203.7	...
<i>Selected components of adjusted outlays and receipts</i>						
Adjusted outlays	234.0	246.8	5.5	2566.4	2713.7	5.7
Net interest	19.4	21.1	8.8	205.5	229.4	11.6
Non-interest	214.6	225.7	5.2	2360.9	2484.3	5.2
National defense	48.4	49.6	2.5	506.9	545.8	7.7
Social Security	46.2	48.9	5.9	538.0	570.2	6.0
Medicare	32.4	34.3	6.0	314.5	361.2	14.9
Medicaid	15.6	17.1	9.7	181.4	185.3	2.2
Income security	38.6	39.4	2.2	349.7	362.2	3.6
Agriculture	1.7	.6	...	32.2	24.7	-23.4
Other	31.8	35.7	12.4	438.1	434.9	-8
Adjusted receipts	164.6	166.5	1.2	2251.9	2495.9	10.8
Individual income and payroll taxes	110.0	110.8	.7	1730.5	1905.2	10.1
Withheld + FICA	150.2	154.9	3.2	1545.7	1646.6	6.5
Nonwithheld + SECA	12.0	11.4	-5.0	379.2	450.0	18.7
Less: Refunds	52.2	55.5	6.4	194.4	195.7	.7
Corporate	35.9	40.2	11.8	308.7	377.7	22.3
Gross	39.2	44.0	12.4	337.4	403.8	19.7
Less: Refunds	3.2	3.8	18.1	28.7	26.1	-9.0
Other	18.6	15.5	-16.8	212.7	213.0	.1
Adjusted surplus or deficit (-)	-69.5	-80.3	...	-314.4	-217.8	...

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

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

2. A shift in payment timing occurs when the first of the month falls on a weekend or holiday, or when the first 3 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. In addition, defense outlays for retiree health care have been converted from an annual to a monthly basis.

... Not applicable.

Source. Monthly Treasury Statement.

partly reflect the net decline in energy prices since last summer. In April, the total number of drilling rigs in operation was flat, suggesting that drilling and mining investment did not change significantly early in the second quarter.

### **Business Inventories**

After factoring in the most recent information on manufacturing inventories, we estimate that real nonfarm inventory investment excluding motor vehicles increased at an annual rate of \$27 billion in the first quarter, \$13 billion less than in the fourth quarter of 2006.<sup>9</sup> The apparent downshift in inventory investment has helped to reduce the overhangs that emerged in late 2006, although the available measures provide conflicting signals on how much progress has been made to date. The ratio of book-value inventories to sales in the manufacturing and trade sector (excluding motor vehicles) was little changed between September and February, and the ratio for the manufacturing sector remained elevated in March. In contrast, information from the staff's flow-of-goods inventory system suggests that the run-up in days' supply was reversed by the end of March, largely eliminating the overhangs. In addition, the ISM customers' inventories index remained below 50 for a second month in April, indicating that the net number of firms who view the level of their customers' inventories as too high has dropped back from its elevated readings over the previous two quarters.

### **Federal Government Sector**

Incoming data suggest that the federal unified budget deficit continues to narrow, but that revenue growth may be moderating a bit from the fast pace of recent years. The moderation in revenues has primarily been concentrated in corporate payments, which appear to have decelerated after a period of very rapid increases. Indeed, the 12 percent rise in corporate receipts in March was only about half the size of the gains seen over the past year.<sup>10</sup> And according to daily Treasury data, corporate receipts in April, which are essentially the first quarterly estimates on 2007 liabilities, were no higher than they were in April 2006, consistent with an easing in profits growth. In contrast, individual income tax and social insurance collections remained strong in the first quarter. In addition, daily Treasury data point to another solid increase in withheld individual and social insurance taxes in April. Nonwithheld individual income tax payments in April and early May—

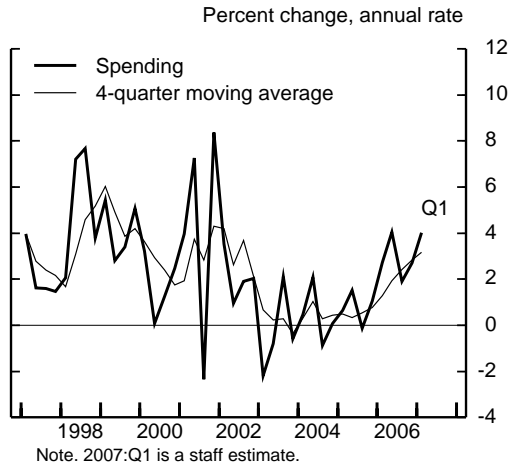
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<sup>9</sup> This estimate is \$3 billion smaller than the BEA advance estimate because it incorporates data for manufacturing inventories in March, which were unavailable at the time of the advance release of first-quarter GDP.

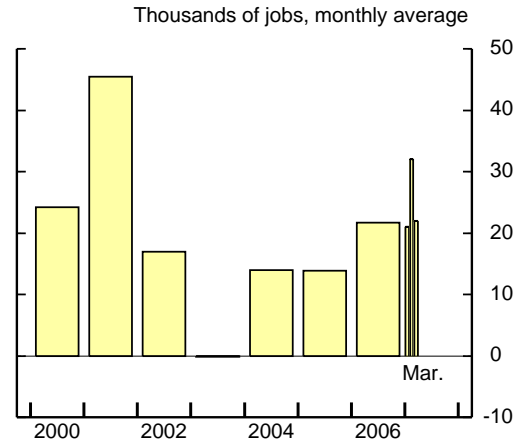
<sup>10</sup> The March collections are largely final payments on 2006 liability. When they are combined with earlier payments, they indicate that corporate income tax liabilities rose about 20 percent in 2006, the same as the NIPA measure of taxable book profits.

### State and Local Indicators

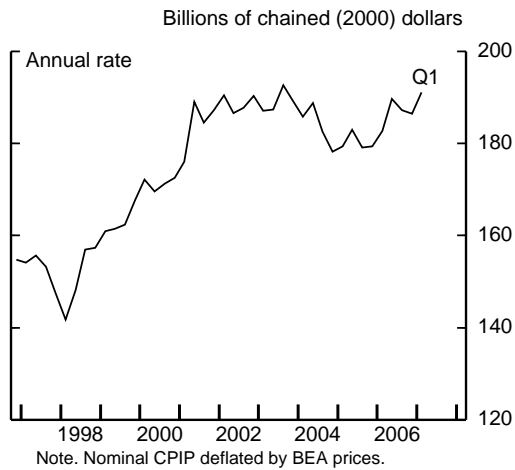
Real Spending on Consumption & Investment



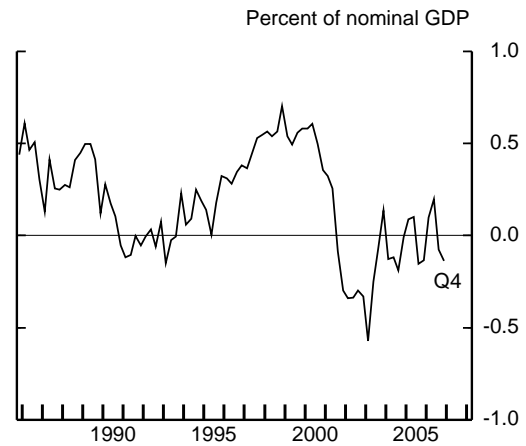
Net Change in Employment



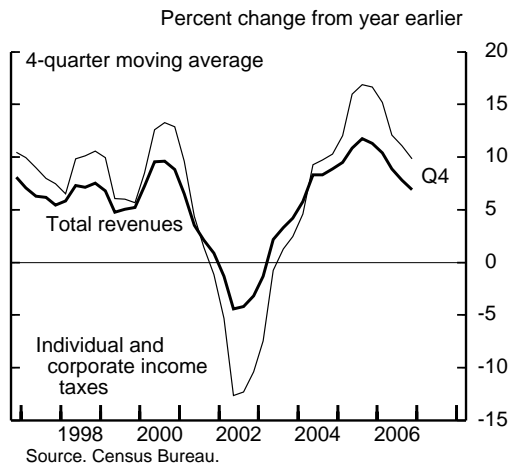
Real Construction



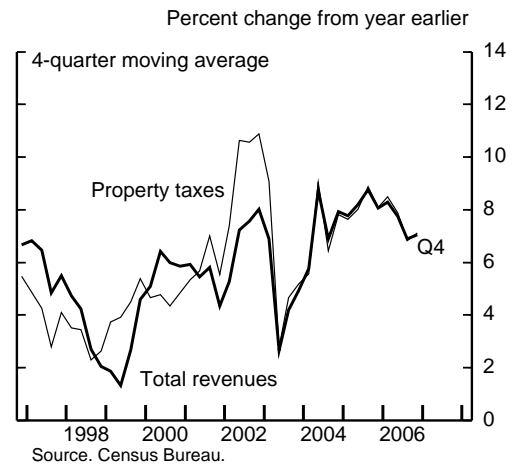
Net Saving



State Revenues



Local Revenues





which are largely net final payments on 2006 liabilities—were running around 15 percent higher than a year earlier.

Federal outlays in March were 5½ percent above their year-earlier level as defense spending continued to fall short of expectations. The level of defense spending in recent months has been low compared with fiscal-year projections by the Administration; it has also been below projections from the Congressional Budget Office that assume enactment of an additional \$100 billion in budget authority for defense in fiscal 2007. In the NIPA, real federal spending fell at an annual rate of 3 percent in the first quarter, as a 6½ percent (annual rate) drop in real defense expenditures more than offset a moderate increase in nondefense purchases.

On the legislative front, the Congress passed a \$124 billion supplemental near the end of April, of which about \$100 billion was for the Department of Defense. It was vetoed by President Bush, and a revised bill is currently in the works. We believe that the weakness in defense outlays in the first quarter reflects the usual volatility of these purchases and is not attributable to the delay in enacting the supplemental. Nonetheless, some reports have suggested that spending may be constrained in the second quarter if these additional funds are not enacted soon.

### **State and Local Government Sector**

Consistent with the sector's generally favorable financial situation, near-term indicators suggest brisk growth in the state and local government sector in the first quarter of this year. Real construction outlays rose at an annual rate of about 10 percent, and employment increased 25,000 per month, on average—similar to the relatively strong pace of hiring in 2006. After factoring in the March construction data, we estimate that real state and local purchases increased at an annual rate of 4 percent in the first quarter, compared with a rise of 3¼ percent in the advance NIPA release.

State and local revenue inflows have remained fairly robust but have decelerated a bit from the torrid pace in 2005. According to the Census Bureau, state tax revenues posted another sizable increase in the fourth quarter of 2006, and the National Conference of State Legislators reported that revenues are coming in above expectations in many states. At the local level, property tax receipts have continued to rise rapidly despite the deceleration in house values and the increasing political pressure to reduce property taxes; in 2006, twenty-two states moved to reduce property tax collections, and virtually all ballot measures for property tax relief were approved by voters. The continued

**Price Measures**  
(Percent change)

Measures	12-month change		3-month change		1-month change	
	Mar. 2006	Mar. 2007	Annual rate		Monthly rate	
			Dec. 2006	Mar. 2007	Feb. 2007	Mar. 2007
<i>CPI</i>						
<b>Total</b>	<b>3.4</b>	<b>2.8</b>	<b>.2</b>	<b>4.7</b>	<b>.4</b>	<b>.6</b>
Food	2.6	3.3	.6	7.3	.8	.3
Energy	17.3	4.4	-11.5	22.9	.9	5.9
<b>Ex. food and energy</b>	<b>2.1</b>	<b>2.5</b>	<b>1.6</b>	<b>2.3</b>	<b>.2</b>	<b>.1</b>
Core goods	.3	-.3	-2.5	.4	.1	-.1
Core services	2.8	3.6	3.3	2.9	.3	.1
Shelter	2.5	4.0	4.3	2.5	.3	.0
Other services	3.3	3.0	2.1	3.2	.3	.2
Chained CPI (n.s.a.) <sup>1</sup>	3.1	2.5	...	...	...	...
Ex. food and energy <sup>1</sup>	2.1	2.1	...	...	...	...
<i>PCE prices</i>						
<b>Total</b>	<b>2.9</b>	<b>2.4</b>	<b>.4</b>	<b>4.2</b>	<b>.4</b>	<b>.4</b>
Food and beverages	2.4	3.2	.7	6.9	.7	.3
Energy	17.0	3.6	-11.8	23.4	.8	6.2
<b>Ex. food and energy</b>	<b>2.0</b>	<b>2.1</b>	<b>1.4</b>	<b>2.4</b>	<b>.3</b>	<b>.0</b>
Core goods	-.3	-.4	-2.0	.4	.1	-.2
Core services	3.0	3.2	2.8	3.3	.4	.2
Shelter	2.8	4.1	4.2	3.1	.3	.2
Other services	3.1	2.8	2.3	3.3	.5	.2
Core market-based	1.6	2.0	1.1	2.4	.4	.0
Core non-market-based	3.9	2.8	2.4	2.5	.2	.2
<i>PPI</i>						
<b>Total finished goods</b>	<b>3.6</b>	<b>3.2</b>	<b>3.5</b>	<b>6.9</b>	<b>1.3</b>	<b>1.0</b>
Food	-1.2	7.8	3.6	18.7	1.9	1.4
Energy	15.6	2.8	6.6	9.4	3.5	3.6
<b>Ex. food and energy</b>	<b>1.7</b>	<b>1.7</b>	<b>2.3</b>	<b>2.3</b>	<b>.4</b>	<b>.0</b>
Core consumer goods	1.8	1.5	1.7	3.1	.5	.1
Capital equipment	1.5	2.0	2.7	1.9	.3	-.1
Intermediate materials	7.2	3.5	.7	6.0	1.1	1.0
Ex. food and energy	4.7	3.5	-1.0	1.7	.2	.2
Crude materials	4.7	15.6	29.0	23.5	8.9	3.2
Ex. food and energy	13.9	24.6	-7.0	59.8	2.7	7.7

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

... Not applicable.

strength in property tax revenue likely reflects the fact that many localities are subject to state limits on the annual increases in total property tax payments and property value assessments; thus, they may continue to experience rising revenues from property taxes for another few years as tax bills catch up to the earlier increases in market prices.

### **Prices**

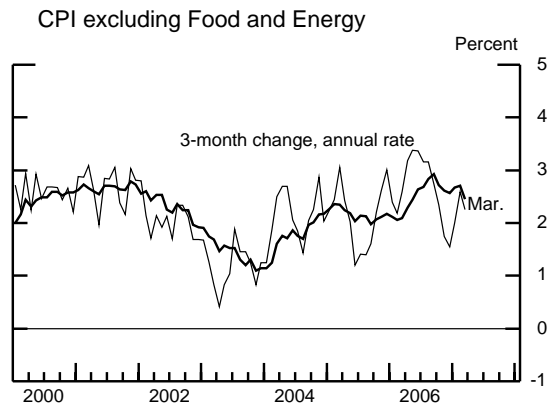
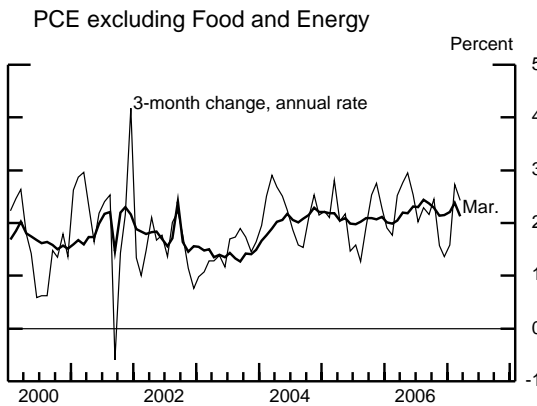
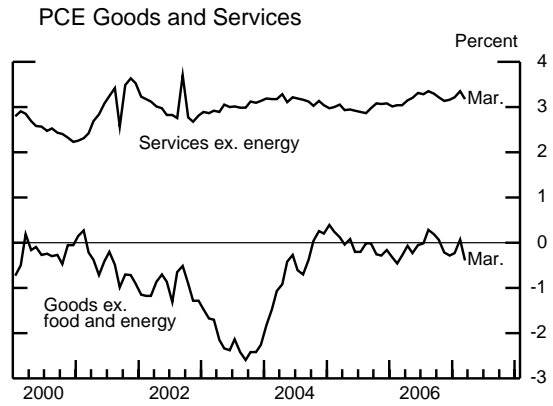
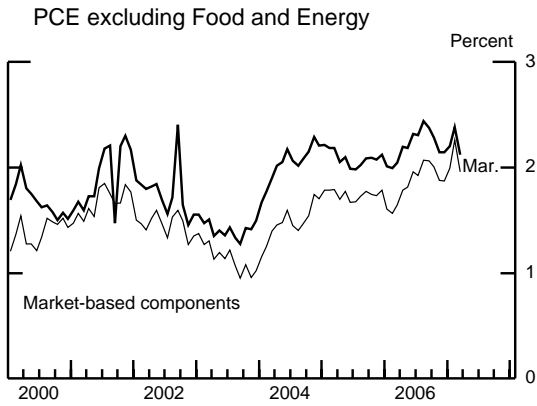
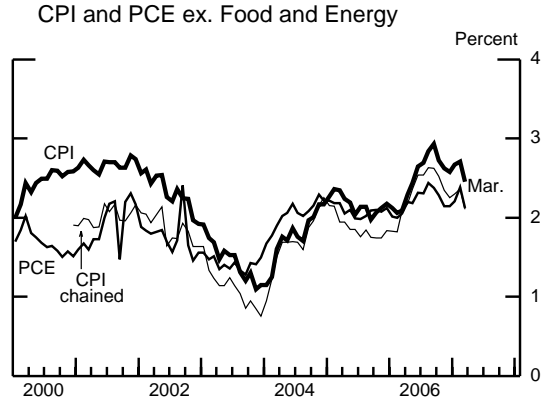
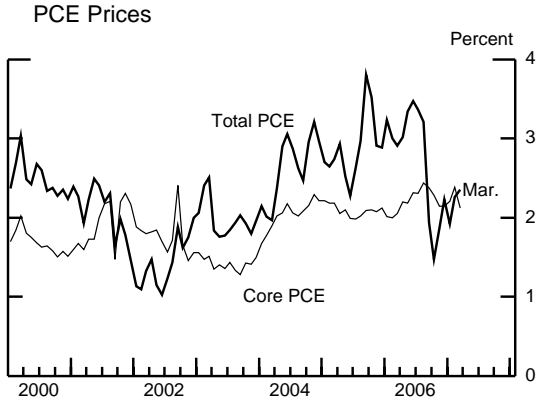
The total PCE price index rose 0.4 percent in March after a similar increase in February. The March increase was driven largely by an increase of more than 6 percent in the price of energy, while the February increase was more broadly distributed across categories. On a twelve-month-change basis, PCE price inflation was 2.4 percent in March, down 0.5 percentage point from a year earlier; a deceleration in energy prices more than accounted for the reduction.

Core PCE prices were unchanged in March after a 0.3 percent increase in February; over the past three months, these prices have risen at an annual pace of 2.4 percent. The low March reading was largely the result of flat prices for medical services, which had increased sharply in the previous two months, and a decline in the prices for apparel, which tend to be especially volatile this time of year. On balance, price increases in other categories were also a touch lower than in other recent months, most notably in lodging away from home, tobacco, and various non-motor-vehicle-related durable goods. Smoothing through the high-frequency movements, the twelve-month change in the core PCE price index was 2.1 percent in March, just a touch higher than the increase over the year-earlier period.

Over the twelve months ending in March, the core CPI accelerated noticeably more than the core PCE price measure. Accelerations in the costs of housing and medical services have pushed up both measures over the past year. Taking account of the relative weights in the two series, housing costs have had an especially large effect on the CPI, while medical costs have had an especially large effect on the PCE measure. However, the acceleration in core PCE price has been muted by a deceleration in its nonmarket portion—in fact, market-based core PCE price inflation has increased nearly as much as core CPI inflation over the past year.

The energy component of the PCE price index increased substantially in March after a much smaller rise in February. The twelve-month change in energy prices was 3½ percent, appreciably less than the 17 percent rise during the preceding twelve months. The March increase in energy prices was driven by a 10½ percent jump in the price for

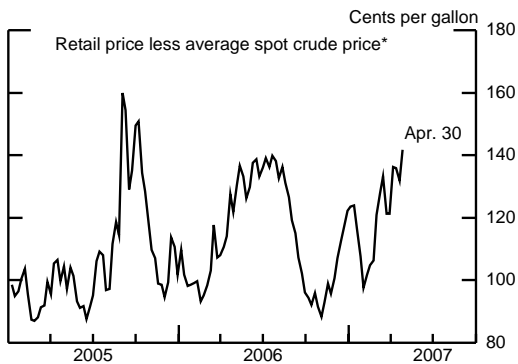
### Consumer Prices (12-month change except as noted)



## Energy Prices and Inventories

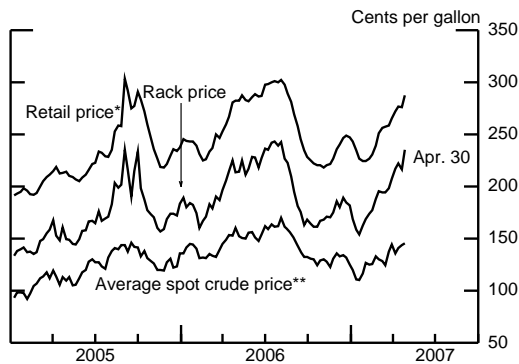
(Data from Energy Information Administration except as noted)

**Total Gasoline Margin**



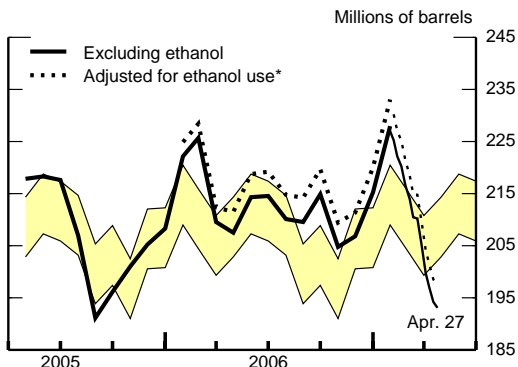
\* Regular grade seasonally adjusted by FRB staff, less average spot crude price: 60% WTI, 40% Maya heavy crude.

**Gasoline Price Decomposition**



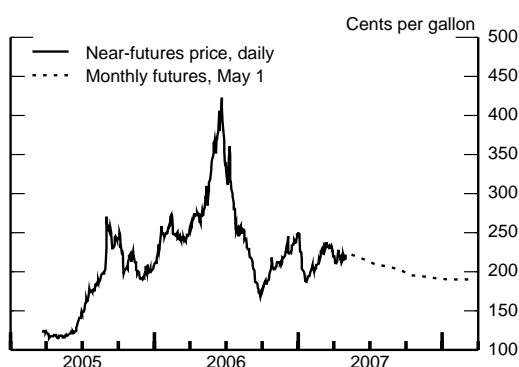
\* Regular grade seasonally adjusted by FRB staff.  
\*\* 60% WTI, 40% Maya heavy crude.

**Gasoline Inventories**



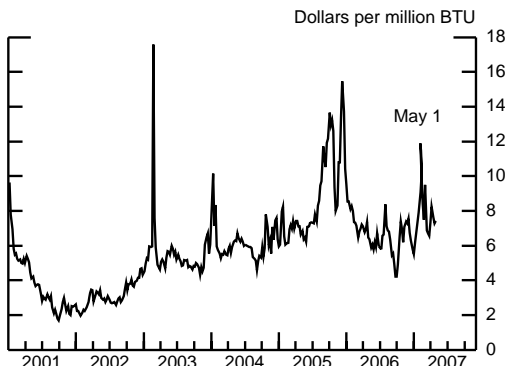
Note. Shaded region is average historical range as calculated by DOE. Monthly data through January 2007, weekly data thereafter, as indicated by line weights.  
\* Adjustment for approximate amount of fuel ethanol to be blended with RBOB component of inventories; estimated by FRB staff.

**Ethanol Prices**



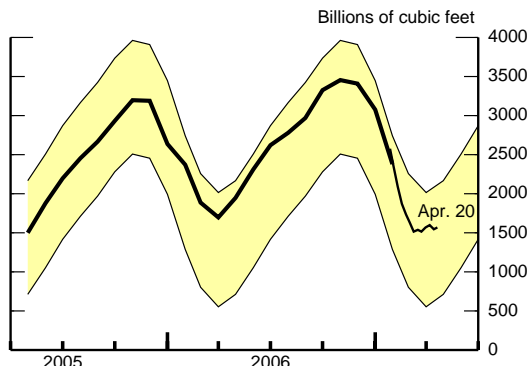
Source. Chicago Board of Trade.

**Natural Gas Prices**



Note. National average spot price.  
Source. Bloomberg.

**Natural Gas Inventories**



Note. Shaded region is defined as 5-year average plus seasonal factors +/- one standard deviation. Monthly data through January 2007, weekly data thereafter, as indicated by line weights.

**Broad Measures of Inflation**  
(Percent change, Q1 to Q1)

Measure	2004	2005	2006	2007
<i>Product prices</i>				
GDP price index	2.3	3.1	3.1	2.7
Less food and energy	2.1	3.1	2.9	2.6
Nonfarm business chain price index	1.6	3.1	3.0	2.0
<i>Expenditure prices</i>				
Gross domestic purchases price index	2.2	3.4	3.5	2.5
Less food and energy	2.1	3.0	2.7	2.6
PCE price index	2.0	2.7	3.0	2.2
Less food and energy	1.8	2.2	2.0	2.2
PCE price index, market-based components	1.7	2.5	2.9	2.0
Less food and energy	1.3	1.8	1.6	2.1
CPI	1.8	3.0	3.7	2.4
Less food and energy	1.3	2.3	2.1	2.6
Chained CPI	1.7	2.6	3.2	2.2
Less food and energy	1.2	2.1	1.9	2.3
Median CPI	2.0	2.4	2.5	3.6
Trimmed mean CPI	1.7	2.3	2.6	2.7
Trimmed mean PCE	1.9	2.4	2.4	2.4

**Surveys of Inflation Expectations**  
(Percent)

Period	Actual CPI inflation <sup>1</sup>	Reuters/Michigan Index				Professional forecasters (10 years) <sup>4</sup>
		1 year <sup>2</sup>		5 to 10 years <sup>3</sup>		
		Mean	Median	Mean	Median	
2005:Q2	2.9	3.9	3.2	3.3	2.9	2.5
Q3	3.8	4.3	3.5	3.5	2.9	2.5
Q4	3.7	4.6	3.7	3.5	3.1	2.5
2006:Q1	3.6	3.7	3.0	3.3	2.9	2.5
Q2	4.0	4.5	3.5	3.6	3.1	2.5
Q3	3.3	4.0	3.4	3.3	3.0	2.5
Q4	1.9	3.5	3.0	3.5	3.0	2.5
2007:Q1	2.4	3.6	3.0	3.4	2.9	2.4
2006:Dec.	2.5	3.5	2.9	3.4	3.0	...
2007:Jan.	2.1	3.6	3.0	3.5	3.0	...
Feb.	2.4	3.6	3.0	3.3	2.9	2.4
Mar.	2.8	3.6	3.0	3.3	2.9	...
Apr.	n.a.	4.0	3.3	3.6	3.1	...

1. 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.

... Not applicable.

n.a. Not available.

motor fuel, although prices for natural gas and heating fuel also rose noticeably. Inventories of gasoline have tumbled since the early part of the year because of high demand and both scheduled and unscheduled refinery outages. In response to the inventory declines, gasoline margins have increased significantly over the past few months. In part for this reason, available survey data point to a continued increase in motor fuel prices during April.

The PCE price index for food and beverages rose 0.3 percent in March after much more rapid increases in the previous two months. Compared with twelve months earlier, food prices were up  $3\frac{1}{4}$  percent, a step-up from the  $2\frac{1}{2}$  percent increase over the preceding twelve-month period. Prices for meat have risen appreciably in recent months, likely because of higher costs for feed, most notably corn. Since the end of March, however, corn prices have retreated somewhat on news of a considerable increase in acreage intended for planting. However, freeze damage affecting winter wheat and some fruit crops in the South may boost food prices in the next few months.

Broader measures of inflation show a slowing of inflation relative to four quarters ago. Despite the small increase in core PCE price inflation, the price index for GDP less food and energy decelerated, reflecting slower rates of increase in the prices for other components of final demand, especially construction.

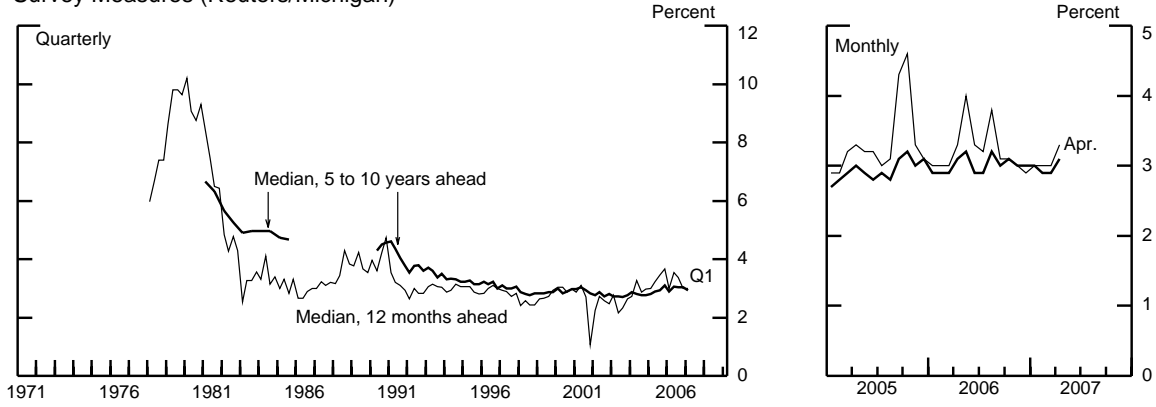
As measured by the Reuters/Michigan index, the median expectation for year-ahead inflation moved up  $\frac{1}{4}$  percentage point in April, to 3.3 percent. This step-up is consistent with the larger, energy-driven increases in overall consumer prices of late. Median five-to ten-year expectations have moved up 0.2 percentage point, to 3.1 percent, but this level is still in the narrow range seen over the past few years. Inflation compensation from TIPS is about 0.1 percentage point higher than at the time of the March Greenbook.

At earlier stages of processing, the producer price index (PPI) for core intermediate goods increased just 0.2 percent for a second month in March. Over the twelve months ending in March, the index for core intermediate materials increased  $3\frac{1}{2}$  percent,  $1\frac{1}{4}$  percentage points less than the year-earlier increase. Part of this slowdown reflected a deceleration in the prices for a number of energy-intensive goods, such as industrial chemicals and plastics.

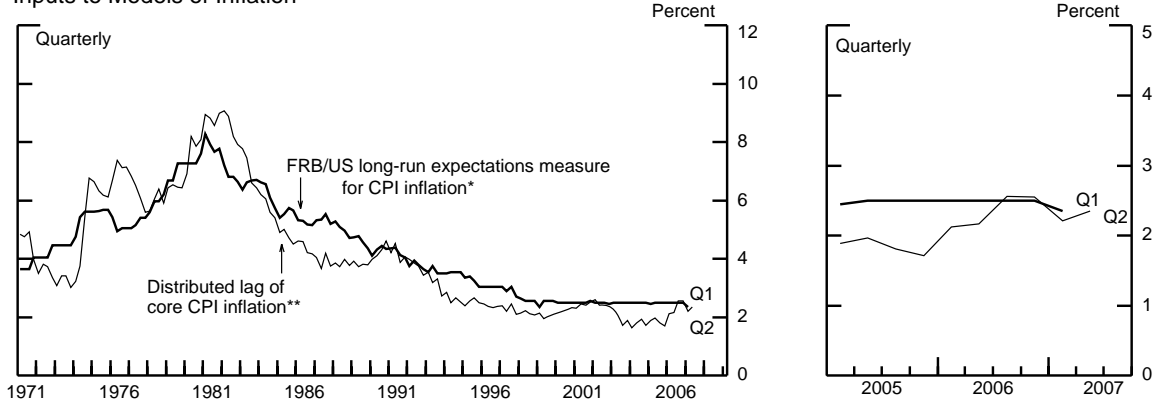
Commodity prices continue to trend upward. The Commodity Research Bureau's spot index of industrial materials is up  $3\frac{3}{4}$  percent since the March Greenbook, and the

## Measures of Expected Inflation

Survey Measures (Reuters/Michigan)

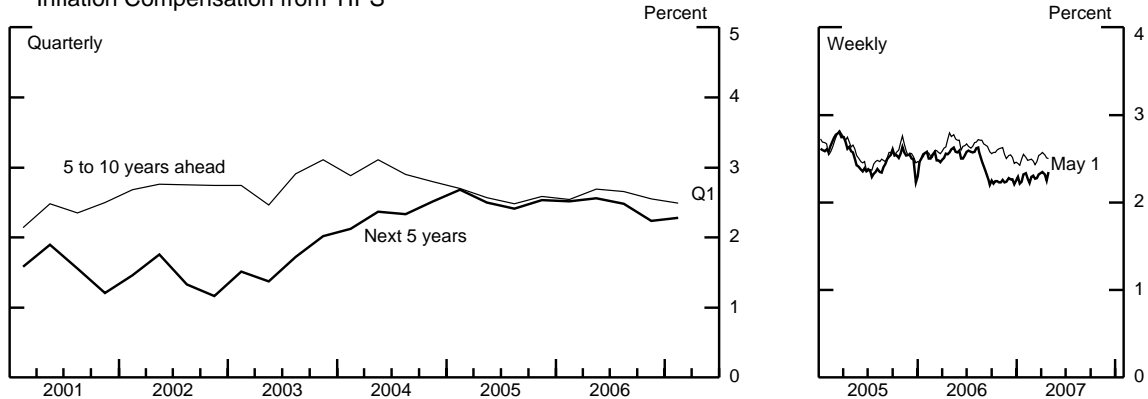


Inputs to Models of Inflation



\* For 1991 forward, the median projection for CPI inflation over the next 10 years from the Survey of Professional Forecasters; for 1981 to 1991, a related survey conducted by Richard Hoey; and for the period preceding 1981, a model-based estimate constructed by Board staff.  
 \*\* Derived from one of the reduced-form Phillips curves used by Board staff.

Inflation Compensation from TIPS

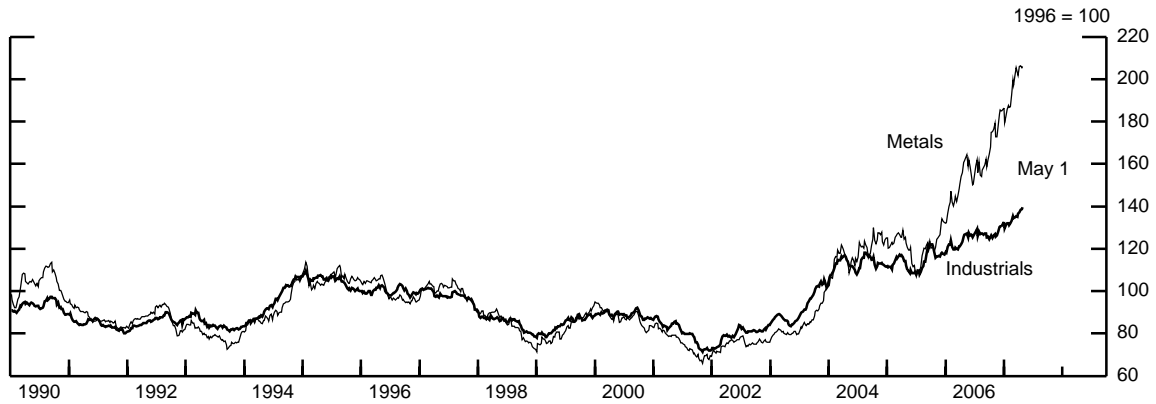


Note. Based on a comparison of an estimated TIPS yield curve with an estimated nominal off-the-run Treasury yield curve, with an adjustment for the indexation-lag effect since March 2004.



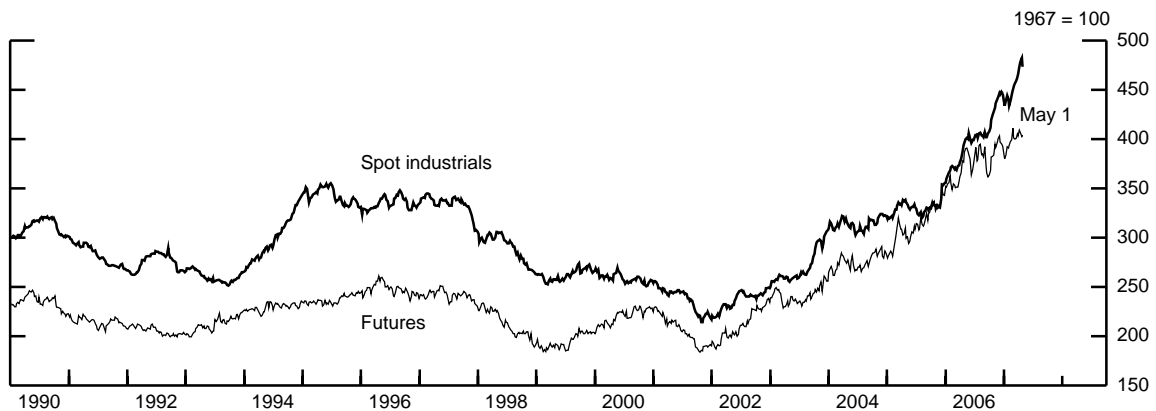
## Commodity Price Indexes

### Journal of Commerce



Note. The *Journal of Commerce* (JOC) industrial price index is based almost entirely on industrial commodities, with a small weight given to energy commodities. Copyright for *Journal of Commerce* data is held by CIBCR, 1994.

### Commodity Research Bureau



Note. The Commodity Research Bureau (CRB) spot industrials 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.

### Selected Commodity Price Indexes (Percent change)

Index	2006 <sup>1</sup>	12/19/06 to 3/13/07 <sup>2</sup>	3/13/07 <sup>2</sup> to 5/1/07	52-week change to 5/1/07
JOC industrials	11.0	3.2	3.5	10.1
JOC metals	38.9	9.0	2.3	27.8
CRB spot industrials	26.9	1.9	3.7	19.5
CRB spot foodstuffs	13.0	8.2	4.6	22.8
CRB futures	15.0	1.1	1.0	4.5

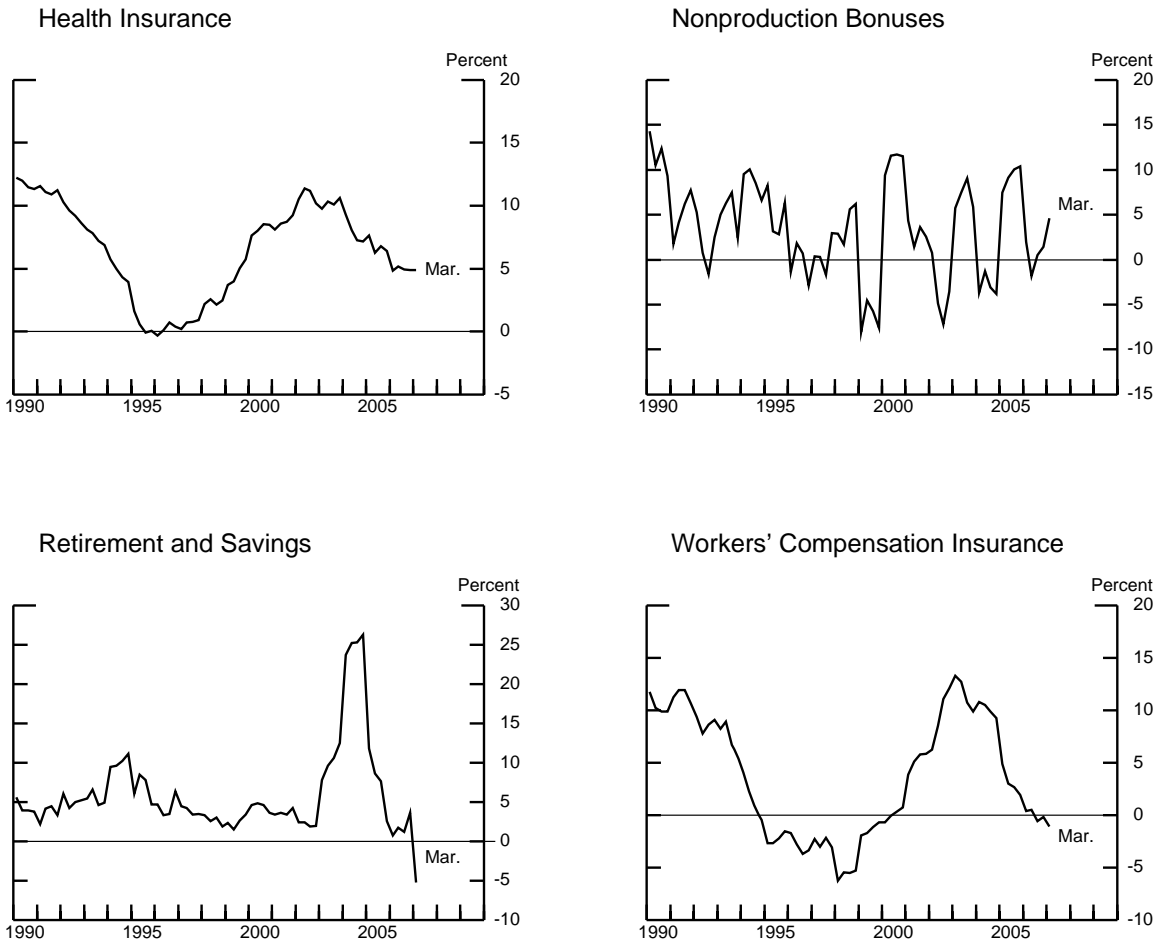
1. From the last week of the preceding year to the last week of the year indicated.
2. March 13, 2007, is the Tuesday preceding publication of the March Greenbook.

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

Measure	2006				2007
	Mar.	June	Sept.	Dec.	Mar.
	Quarterly change (compound annual rate) <sup>1</sup>				
<b>Total hourly compensation</b>	<b>2.8</b>	<b>3.2</b>	<b>3.6</b>	<b>3.2</b>	<b>2.3</b>
Wages and salaries	2.8	3.2	3.2	3.2	4.3
Benefits	2.0	2.8	4.0	3.6	-1.2
	12-month change				
<b>Total hourly compensation</b>	<b>2.6</b>	<b>2.8</b>	<b>3.0</b>	<b>3.2</b>	<b>3.2</b>
Wages and salaries	2.4	2.8	3.0	3.2	3.6
Benefits	3.0	2.7	2.8	3.1	2.2

1. Seasonally adjusted by the Bureau of Labor Statistics.

**Change in ECI Benefits (confidential)**  
(Private-industry workers; 12-month change)



*Journal of Commerce* index of industrial materials has risen 3½ percent. Strong international demand has helped drive up metals prices, which continue to contribute to the rise in both indexes.

### **Labor Costs**

Measures of hourly compensation have been heavily influenced by special factors—as well as by a good deal of noise—in recent quarters. But smoothing through the volatility in the data, the underlying pace of compensation gains seems to have picked up somewhat. To be sure, the employment cost index (ECI) for private industry workers rose at an annual rate of just 2¼ percent over the three months ending in March. However, the low reading stemmed largely from a sharp drop in contributions to retirement plans as the strong performance of the stock market in 2006, along with a high level of employer contributions over the past several years, boosted the funding levels of defined-benefit plans and allowed firms to lower their payments to these plans in early 2007. Even with the very small increase for the three months ending in March, the twelve-month change in the ECI moved up to 3¼ percent, ½ percentage point more than the increase over the preceding twelve months.

In contrast to the performance of benefits, the wages and salaries component of the ECI picked up noticeably in March. The three-month increase in wages—which was at an annual rate of 4¼ percent—was the largest in several years, and it lifted the twelve-month change in this series to 3½ percent, 1¼ percentage points more than the increase over the year-earlier period. Average hourly earnings for production or nonsupervisory workers have also accelerated over the past couple of years, although the rate of increase shows some signs of leveling out in recent months: Over the twelve months ending in March, average hourly earnings increased 4 percent, ½ percentage point more than a year earlier.

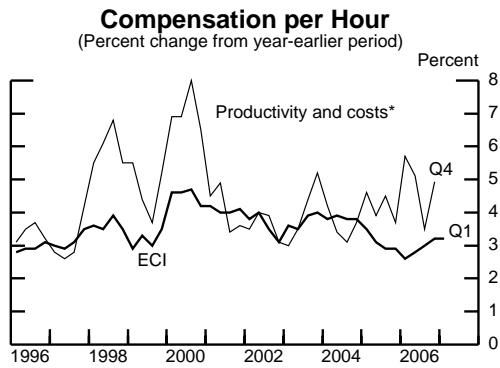
Like the ECI, hourly compensation in the nonfarm business as measured in the Productivity and Costs (P&C) release appears to have moved up only a little in the first quarter—indeed, using the most recent NIPA data, we estimate that this measure rose at an annual rate of just 1¾ percent after an increase of more than 8 percent in the fourth quarter of 2006. This pattern reflects the BEA’s incorporation of an assumed \$50 billion in bonus payments and stock options into its estimate of wage and salary accruals in the

### Hourly Compensation and Unit Labor Costs

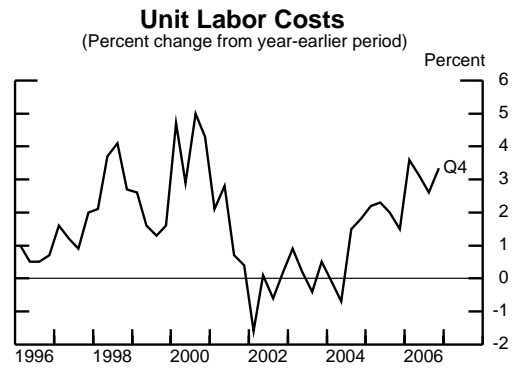
(Percent change from preceding period at compound annual rate; based on seasonally adjusted data)

Category	2004:Q4 to 2005:Q4	2005:Q4 to 2006:Q4 <sup>e</sup>	2006			
			Q1	Q2	Q3	Q4 <sup>e</sup>
<i>Compensation per hour</i> Nonfarm business	3.7	4.9	12.9	-1.4	.6	8.2
<i>Unit labor costs</i> Nonfarm business	1.5	3.3	9.1	-2.5	1.1	6.2

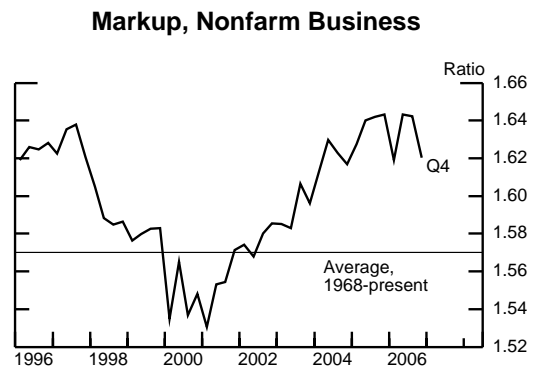
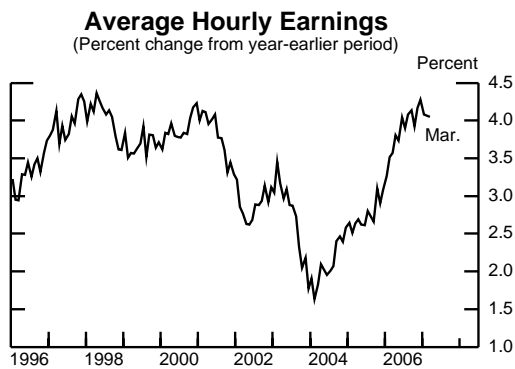
e Staff estimate.



\* Value for 2006:Q4 is a staff estimate.



Note. Value for 2006:Q4 is a staff estimate.



Note. The markup is the ratio of output price to unit labor costs. Value for 2006:Q4 is a staff estimate.

fourth quarter and the subsequent unwinding of these one-time payments in the first quarter.<sup>11</sup> Smoothing through the large spikes in early 2006 and 2007, we estimate that P&C hourly compensation rose at an annual rate of 4 percent over the six quarters since mid-2005—about the same pace as during the preceding three years.

#### Last Page of Domestic Nonfinancial Developments

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<sup>11</sup> As noted in the Consumer Spending section, the bonuses were paid—and showed up as wage and salary disbursements—in the first quarter of 2007. However, the BEA assumed that the bonuses represented remuneration for productive activity in the fourth quarter of 2006 and thus imputed them to that period's compensation bill. In any event, note that the BEA will not have actual source data for wage and salary disbursements in the first quarter until August.

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## **Domestic Financial Developments**

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

Instrument	2004	2006	2007		Change to May 1 from selected dates (percentage points)		
	June 28	June 29	Mar. 20	May 1	2004 June 28	2006 June 29	2007 Mar. 20
<i>Short-term</i>							
FOMC intended federal funds rate	1.00	5.25	5.25	5.25	4.25	.00	.00
Treasury bills <sup>1</sup>							
3-month	1.36	4.88	4.92	4.76	3.40	-.12	-.16
6-month	1.74	5.06	4.91	4.81	3.07	-.25	-.10
Commercial paper (A1/P1 rates) <sup>2</sup>							
1-month	1.28	5.27	5.24	5.24	3.96	-.03	.00
3-month	1.45	5.37	5.23	5.23	3.78	-.14	.00
Large negotiable CDs <sup>1</sup>							
3-month	1.53	5.47	5.30	5.31	3.78	-.16	.01
6-month	1.82	5.59	5.30	5.31	3.49	-.28	.01
Eurodollar deposits <sup>3</sup>							
1-month	1.29	5.33	5.32	5.32	4.03	-.01	.00
3-month	1.51	5.49	5.34	5.35	3.84	-.14	.01
Bank prime rate	4.00	8.25	8.25	8.25	4.25	.00	.00
<i>Intermediate- and long-term</i>							
U.S. Treasury <sup>4</sup>							
2-year	2.88	5.26	4.64	4.68	1.80	-.58	.04
5-year	3.97	5.15	4.45	4.50	.53	-.65	.05
10-year	4.90	5.28	4.64	4.71	-.19	-.57	.07
U.S. Treasury indexed notes							
5-year	1.56	2.49	2.03	2.03	.47	-.46	.00
10-year	2.25	2.61	2.19	2.23	-.02	-.38	.04
Municipal general obligations (Bond Buyer) <sup>5</sup>	5.01	4.71	4.13	4.26	-.75	-.45	.13
Private instruments							
10-year swap	5.21	5.81	5.08	5.21	.00	-.60	.13
10-year FNMA <sup>6</sup>	5.38	5.59	4.93	5.01	-.37	-.58	.08
10-year AA <sup>7</sup>	5.60	6.20	5.56	5.61	.01	-.59	.05
10-year BBB <sup>7</sup>	6.25	6.74	6.01	6.09	-.16	-.65	.08
10-year high yield <sup>7</sup>	8.41	8.74	8.11	7.97	-.44	-.77	-.14
Home mortgages (FHLMC survey rate) <sup>8</sup>							
30-year fixed	6.21	6.78	6.16	6.16	-.05	-.62	.00
1-year adjustable	4.19	5.82	5.40	5.43	1.24	-.39	.03

Stock exchange index	Record high		2006	2007		Change to May 1 from selected dates (percent)		
	Level	Date	June 29	Mar. 20	May 1	Record high	2006 June 29	2007 Mar. 20
Dow Jones Industrial	13,136	5-1-07	11,191	12,288	13,136	.00	17.38	6.90
S&P 500 Composite	1,527	3-24-00	1,273	1,411	1,486	-2.69	16.77	5.34
Nasdaq	5,049	3-10-00	2,174	2,408	2,532	-49.86	16.43	5.12
Russell 2000	834	4-26-07	714	794	816	-2.10	14.27	2.85
Wilshire 5000	15,110	4-25-07	12,846	14,302	14,984	-.84	16.64	4.77

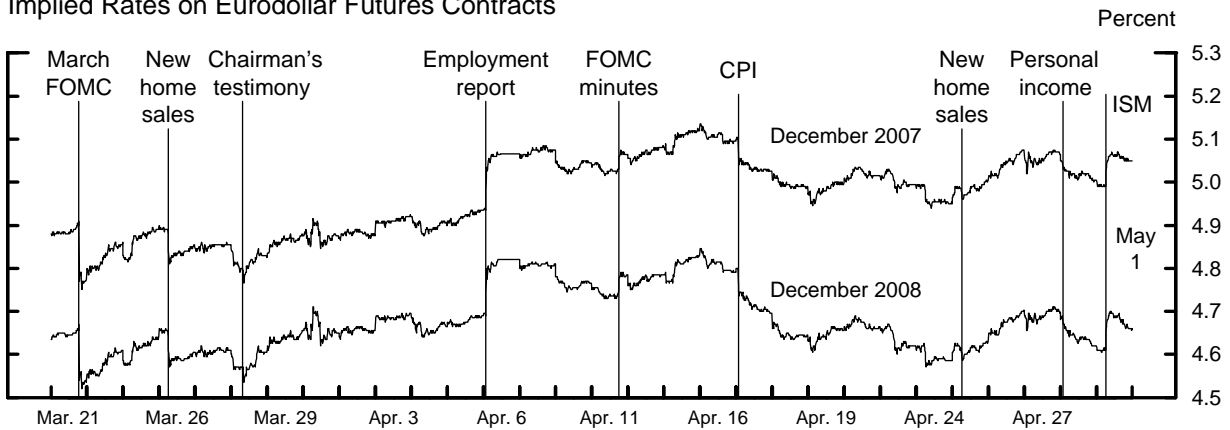
1. Secondary market.
2. Financial commercial paper.
3. Bid rates for Eurodollar deposits collected around 9:30 a.m. eastern time.
4. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
5. Most recent Thursday quote.
6. Constant-maturity yields estimated from Fannie Mae domestic noncallable coupon securities.
7. Derived from smoothed corporate yield curves estimated using Merrill Lynch bond data.
8. Home mortgage rates for May 1, 2007, are for the week ending April 26, 2007.

NOTES:

June 28, 2004, is the day before the most recent policy tightening began.  
June 29, 2006, is the day the most recent policy tightening ended.  
March 20, 2007, is the day before the most recent FOMC announcement.

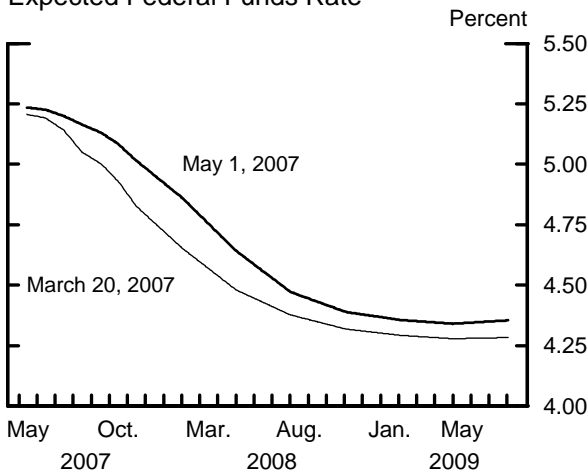
### Policy Expectations and Treasury Yields

Implied Rates on Eurodollar Futures Contracts



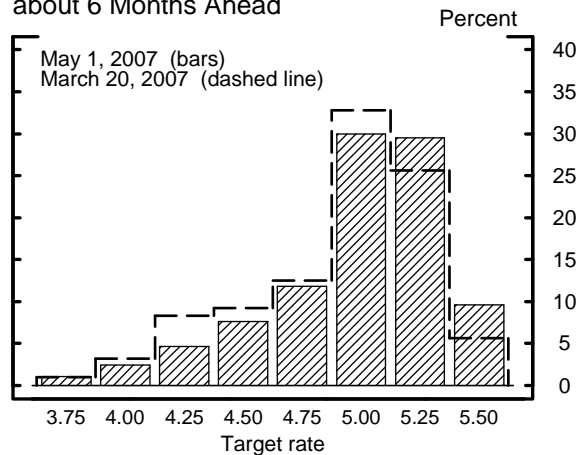
Note. 5-minute intervals. No adjustment made for term premiums.

Expected Federal Funds Rate



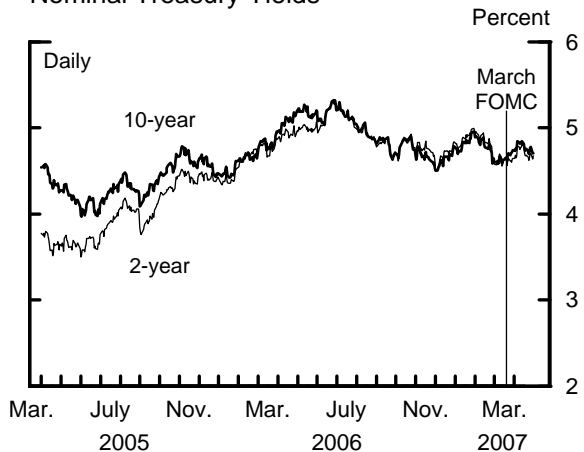
Note. Estimates from federal funds and Eurodollar futures, with an allowance for term premia and other adjustments.

Implied Distribution of Federal Funds Rate about 6 Months Ahead



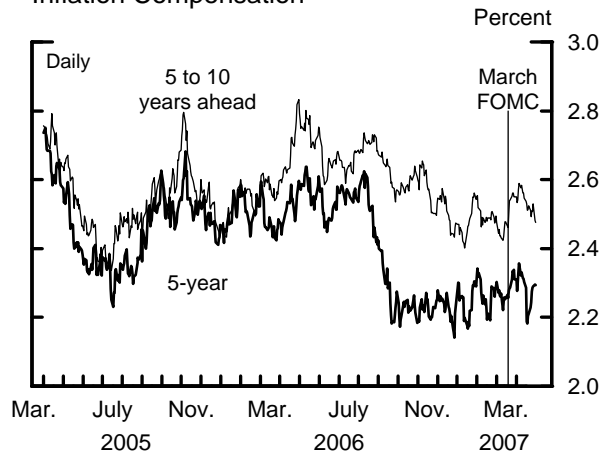
Note. Based on the distribution of the 3-month Eurodollar rate 5 months ahead (adjusted for a term premium) as implied by options on Eurodollar futures contracts.

Nominal Treasury Yields



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

Inflation Compensation



Note. Estimates based on smoothed nominal and inflation-indexed Treasury yield curves and adjusted for the indexation-lag effect.



## Domestic Financial Developments

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### Overview

Over the intermeeting period, financial markets largely recovered from the turbulence that preceded the March meeting of the FOMC. On net, investors pushed up somewhat the expected path of monetary policy beyond the near term. Market participants now expect between 75 basis points and 100 basis points of easing by the end of 2008, a little less than at the time of the March FOMC meeting. On balance, nominal Treasury yields edged up slightly along the term structure. Inflation compensation based on Treasury inflation-protected securities (TIPS) were little changed even as oil prices rose markedly. Equity prices climbed steeply amid solid earnings reports and improved sentiment, more than reversing the declines in the previous intermeeting period. Risk spreads on investment-grade corporate bonds were about unchanged, while spreads on speculative-grade corporate bonds narrowed somewhat. Delinquency rates on subprime variable-rate home mortgages remained elevated, but rates for the much larger group of prime borrowers stayed low.

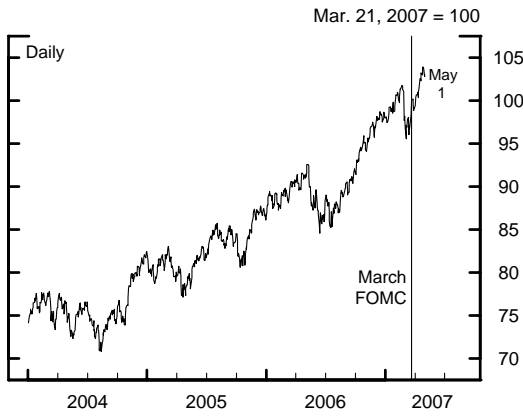
### Policy Expectations and Interest Rates

Market participants largely anticipated the FOMC's decision at its March meeting to leave the target federal funds rate unchanged. Nevertheless, the expected path for monetary policy moved lower on the announcement, as investors apparently were surprised by the somewhat softer tone of the description of economic conditions in the accompanying statement, and by the replacement of the reference to "additional firming" with language that was interpreted as more balanced. However, data releases, sent mixed signals and short-term interest rates rose a little, as subsequent FOMC communications—including the Chairman's testimony before the Joint Economic Committee, speeches by various FOMC members, and the minutes of the March meeting—were seen as emphasizing the Committee's concern about upside risks to inflation. Market participants attach only a small probability to a cut in the target federal funds rate at the May FOMC meeting. Beyond the near term, investors pushed up somewhat the expected path of monetary policy. Market participants now seem to anticipate between 75 basis points and 100 basis points of policy easing by the end of 2008, a little less than at the time of the March FOMC meeting.

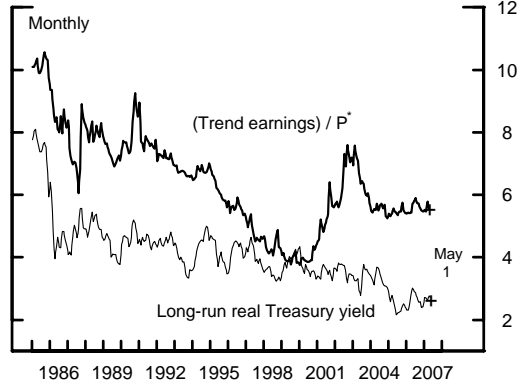
Option-implied measures of market uncertainty about the path of policy were little changed over the intermeeting period and remained within recent historical ranges. Implied probability distributions for the target funds rate between six and twelve months ahead remained skewed toward lower rates.

### Corporate Yields, Risk Spreads, and Stock Prices

Wilshire 5000

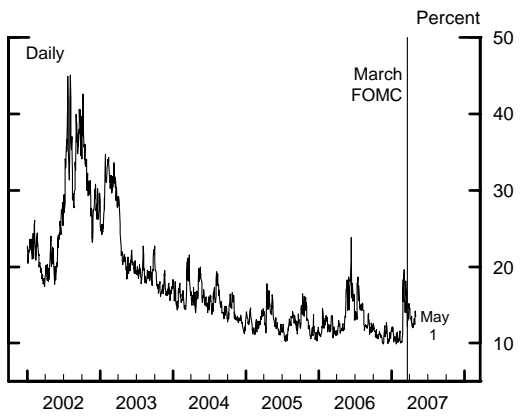


Ratio of Trend Earnings to Price for S&P 500 and Long-Run Treasury Yield

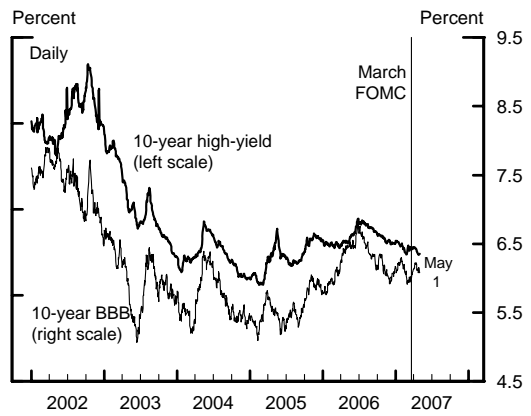


+ Denotes the latest observation using daily interest rates and stock prices and latest earnings data from I/B/E/S.  
\* Trend earnings are estimated using analyst forecast of year-ahead earnings from I/B/E/S.

Implied Volatility on S&P 500 (VIX)

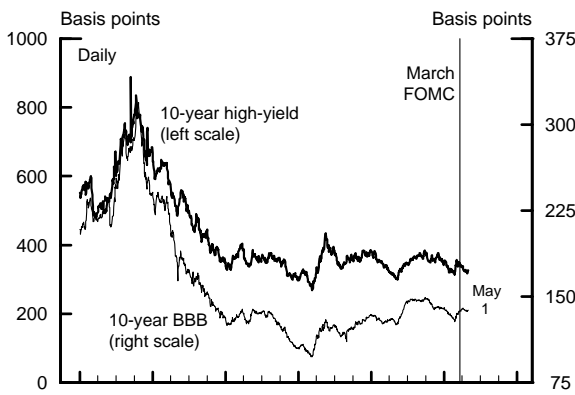


Corporate Bond Yields



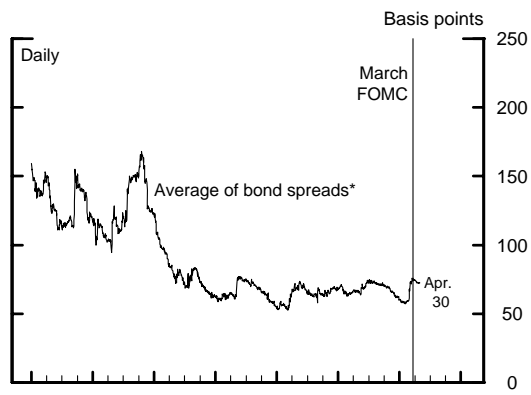
Note. Yields from smoothed yield curves based on Merrill Lynch bond data.

Corporate Bond Spreads



Note. Measured relative to comparable-maturity Treasuries.

Investment Bank Bond Spreads



Source: Merrill Lynch.  
\* Spreads measured relative to comparable-maturity Treasuries for bonds with 3-7 years in remaining maturity for Merrill Lynch, Bear Stearns, Goldman Sachs, Morgan Stanley, and Lehman Brothers.

Over the intermeeting period, yields on nominal Treasury securities edged up at all maturities. On net, TIPS-based measures of inflation compensation over the next 5 years and 5 to 10 years ahead were little changed despite a significant rise in oil prices.

### **Stock Prices and Corporate Interest Rates**

Over the intermeeting period, broad stock price indexes climbed about 5 percent. The rise was driven by solid first-quarter earnings reports, which mostly exceeded expectations. Overall market sentiment also seemed to improve some because of reduced anxiety about spillovers from problems in the subprime mortgage market. Equity prices rose in most industries, although energy firms outperformed the broader market. Implied volatility on the S&P 500 generally trended lower and is now only a little above the historically low levels that prevailed early this year. The spread between the twelve-month forward trend earnings-price ratio for S&P 500 firms and a real long-run Treasury yield—a rough gauge of the equity risk premium—narrowed a touch but remained within its range over the past few years.

Over the intermeeting period, yields on investment-grade corporate bonds rose in line with those on comparable-maturity Treasury securities, and so their spreads were little changed at fairly low levels. Meanwhile, spreads on speculative-grade corporate bonds narrowed about 25 basis points. Spreads on bonds for five investment banks with reported exposure to the subprime mortgage market—all of which carry an investment-grade rating—remained slightly above the levels that prevailed earlier this year.

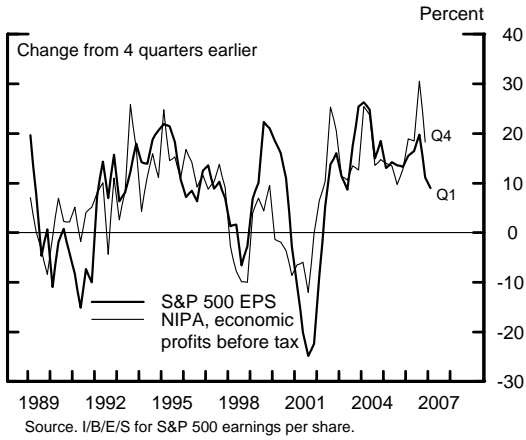
### **Corporate Earnings and Credit Quality**

On the basis of reports from more than 300 companies, earnings per share for firms in the S&P 500 are estimated to have increased 9 percent through the year ending in the first quarter—the first single-digit rate of increase since 2003. A further deceleration in corporate earnings had been widely anticipated, and, indeed, more than the usual share of company reports exceeded analysts' forecasts. Through mid-April, analysts seem to have made just small revisions to forecasts of year-ahead earnings for the S&P 500 as a whole.

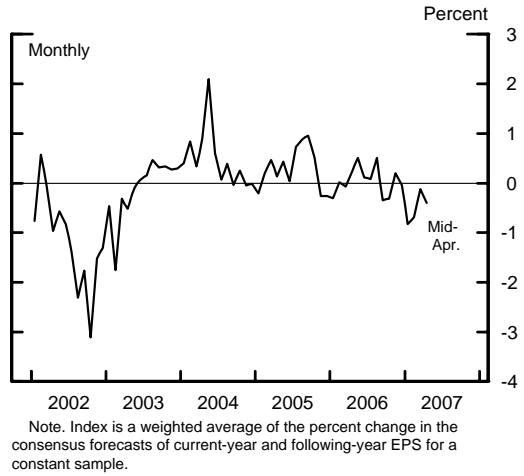
Overall, the credit quality of nonfinancial firms continued to be solid. Balance sheet liquidity ticked up from an already elevated level in the fourth quarter, while aggregate corporate leverage remained low. In March, the volume of bond upgrades significantly outpaced that of downgrades, and the realized six-month trailing bond default rate stayed near zero. In the fourth quarter of last year, the delinquency rate on C&I loans at commercial banks was the lowest in more than a decade. The near-term outlook for

### Corporate Earnings and Credit Quality

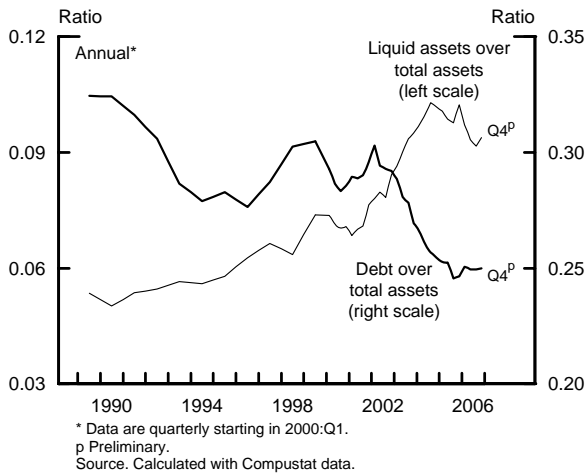
Corporate Earnings Growth



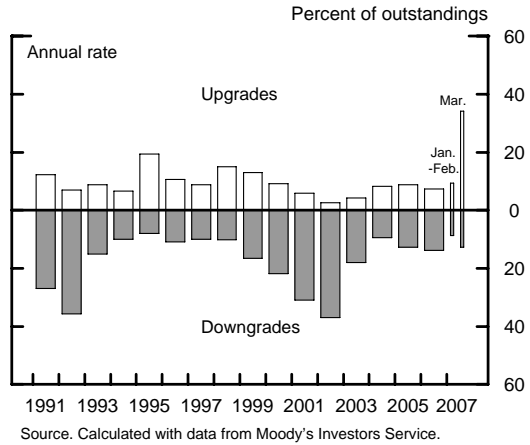
S&P 500 EPS Revisions Index



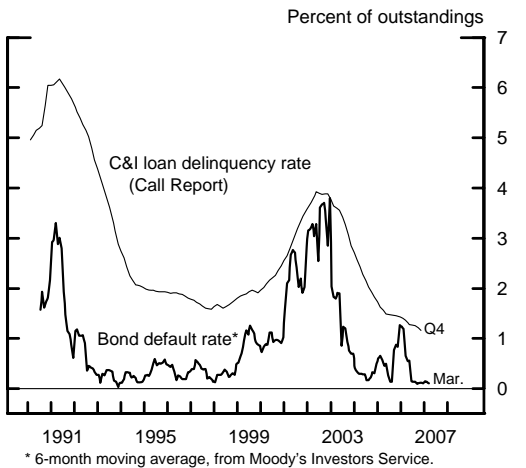
Financial Ratios for Nonfinancial Corporations



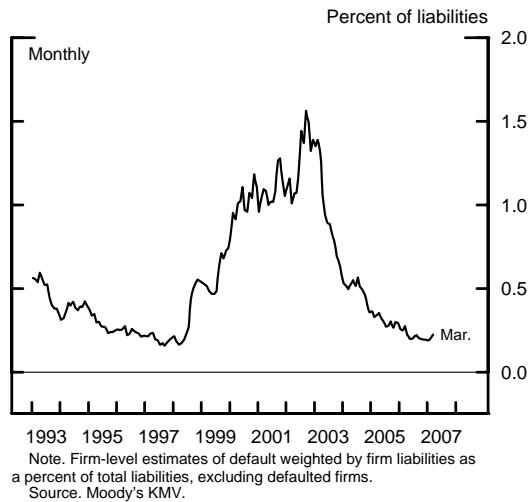
Bond Ratings Changes of Nonfinancial Companies



Selected Default and Delinquency Rates



Expected Year-Ahead Defaults



**Business Finance**

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

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

Type of security	2003	2004	2005	2006		2007	
				H1	H2	Q1	Apr. P
<i>Nonfinancial corporations</i>							
Stocks <sup>1</sup>	3.7	5.4	4.6	5.2	4.1	5.9	3.0
Initial public offerings	.4	1.6	1.7	1.9	1.7	1.3	1.8
Seasoned offerings	3.3	3.8	2.8	3.3	2.4	4.6	1.3
Bonds <sup>2</sup>	31.6	22.7	19.1	30.3	29.5	31.4	26.0
Investment grade	15.9	8.2	8.4	14.4	11.6	13.0	9.0
Speculative grade	11.3	9.7	6.4	8.4	7.6	13.0	11.0
Other (sold abroad/unrated)	4.3	4.9	4.3	7.6	10.4	5.4	6.0
<i>Memo</i>							
Net issuance of commercial paper <sup>3</sup>	-3.4	1.5	-.4	3.4	4.4	-.1	-6.9
Change in C&I loans at commercial banks <sup>3,4</sup>	-7.7	3.2	9.9	14.5	11.0	7.0	9.1
<i>Financial corporations</i>							
Stocks <sup>1</sup>	6.6	6.9	5.0	4.4	6.2	8.7	9.0
Bonds <sup>2</sup>	111.1	139.3	176.3	190.2	185.3	200.3	100.0

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

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

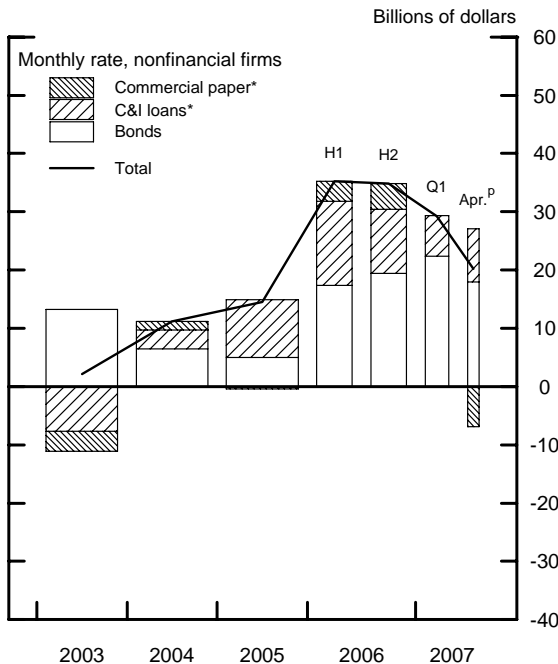
2. Data include regular and 144a private placements. Bond totals reflect gross proceeds rather than par value of original discount bonds. Bonds are categorized according to Moody's bond ratings or to Standard & Poor's if unrated by Moody's.

3. End-of-period basis, seasonally adjusted.

4. Adjusted commercial bank credit data.

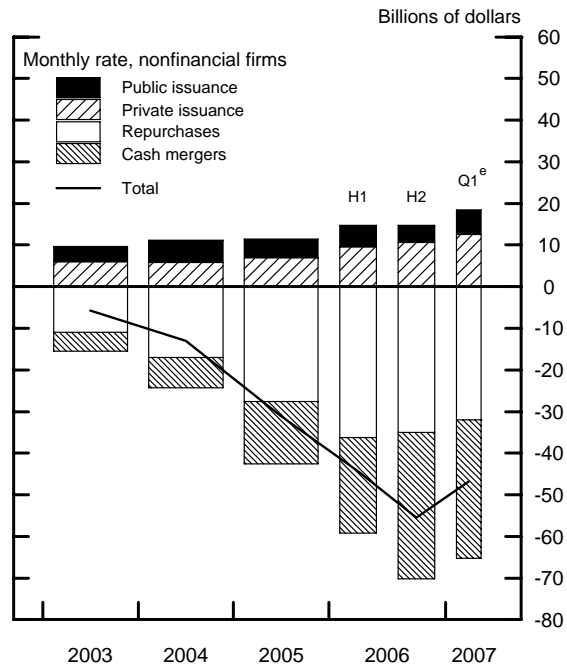
p Preliminary.

**Selected Components of Net Debt Financing**



\* Seasonally adjusted, period-end basis.  
p Preliminary.

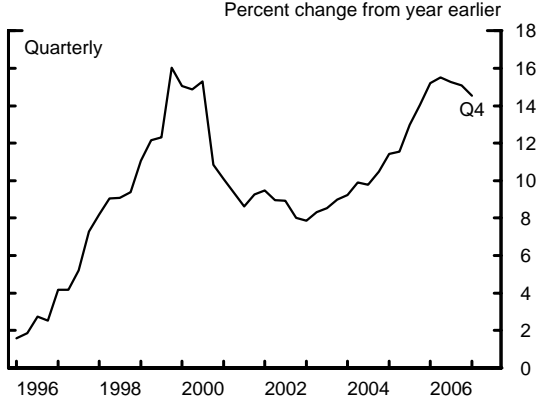
**Components of Net Equity Issuance**



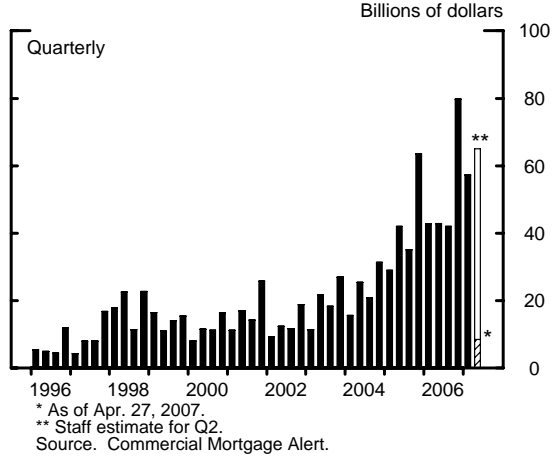
e Staff estimate.

### Commercial Real Estate

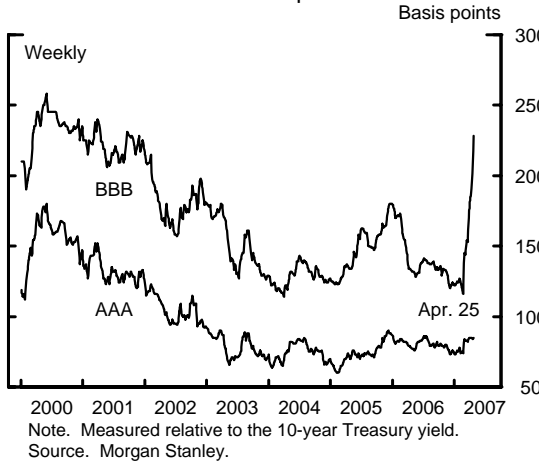
Commercial Mortgage Debt



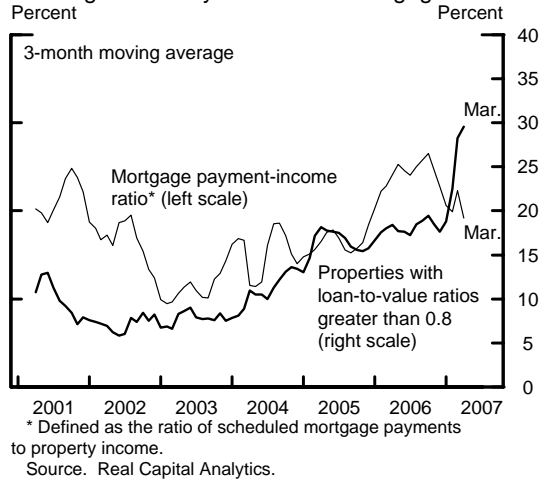
Gross Issuance of CMBS



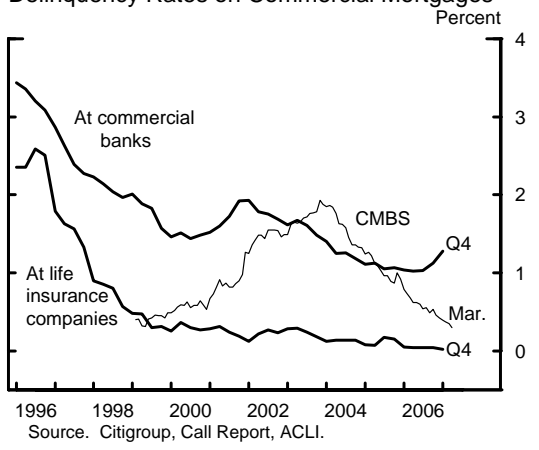
Investment-Grade CMBS Spreads



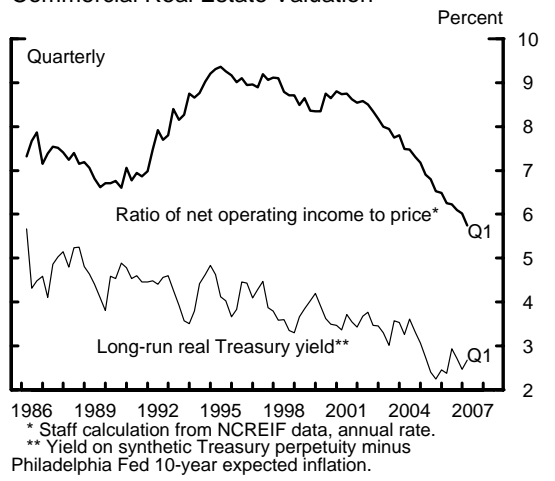
Leverage on Newly Securitized Mortgages



Delinquency Rates on Commercial Mortgages



Commercial Real Estate Valuation



corporate credit quality also remains good, as the aggregate year-ahead default rate based on the KMV model stayed low in March.

### **Business Finance**

Gross bond issuance by nonfinancial corporations slowed in April from its torrid first-quarter pace. Acquisition-related financing has continued to fuel the issuance of both investment- and speculative-grade corporate bonds. Commercial paper outstanding declined last month, but C&I loans accelerated, a pattern broadly consistent with the easing of some terms on such loans that was reported in the April Senior Loan Officer Opinion Survey. Overall, net debt financing in April was well below the volume in the first quarter.

Gross public equity issuance by nonfinancial corporations was tepid again in April. The calendar of planned offerings suggests that the pace of IPOs will pick up in coming months. Private equity issuance is estimated to have increased a bit in the first quarter, as leveraged buyout activity continued to climb. Even so, given that estimated share repurchases and actual retirements from cash-financed mergers and acquisitions continued at near-record levels, equity retirements likely dwarfed total issuance again in the first quarter.

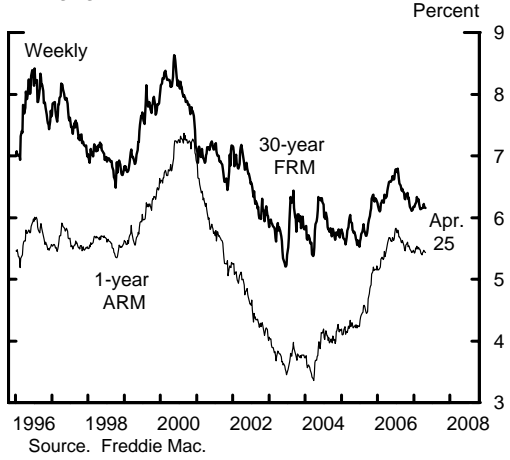
### **Commercial Real Estate**

Total commercial mortgage borrowing has likely remained robust so far this year, as indicated by the pace of commercial-mortgage-backed securities (CMBS) issuance. Gross CMBS issuance was quite strong in the first quarter, and the issuance calendar points to a similar pace in the current quarter.

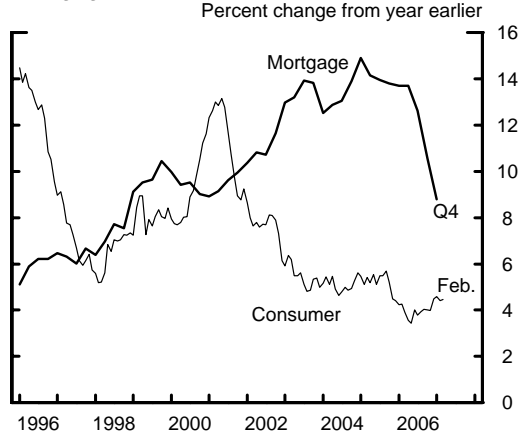
Spreads on BBB-rated CMBS have soared since late February, reportedly in part because of reduced demand for collateralized debt obligations, which, in recent years, have been large purchasers of these tranches of CMBS. Rising leverage in pools of commercial mortgages underlying CMBS may also have been a factor in the recent widening in spreads. The share of newly securitized commercial mortgages with loan-to-value ratios at or above 0.8 has increased significantly over the past several months. In response, rating agencies recently announced plans to increase the level of credit support required for CMBS. Despite the greater leverage, increases in commercial property rents have kept the ratio of mortgage payments to rental income on newly securitized commercial mortgages within its range of the past several years. In March, delinquency rates on CMBS remained very low.

### Household Liabilities

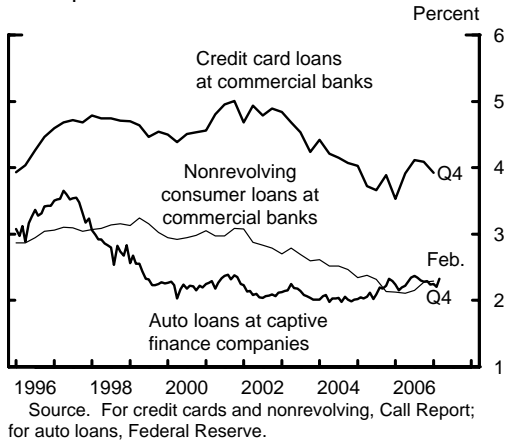
Mortgage Rates



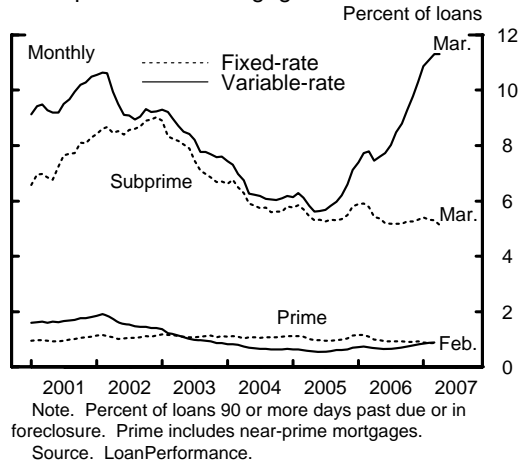
Mortgage Debt and Consumer Credit



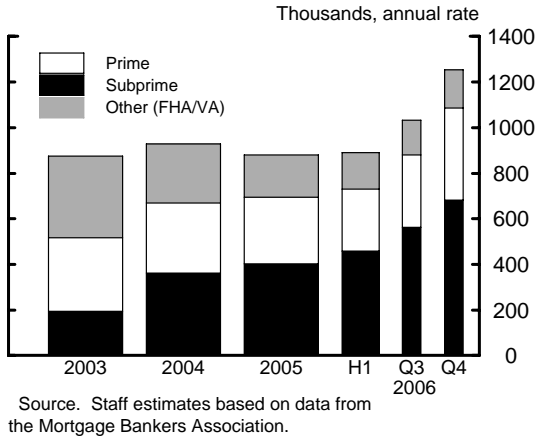
Delinquencies on Consumer Loans



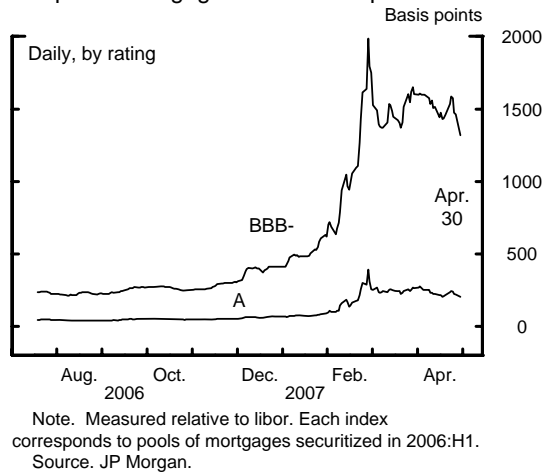
Delinquencies on Mortgages



Number of New Foreclosures



Subprime Mortgage CDS Index Spreads





Increases in commercial property prices in the first quarter led to a further decline in the ratio of net operating income to property prices. The spread of this ratio over the real perpetuity Treasury yield—a rough measure of the risk premium on commercial real estate assets—declined in the first quarter to its lowest level since 1992.

### **Household Finance**

Over the intermeeting period, interest rates available to prime borrowers for thirty-year fixed-rate and one-year adjustable-rate mortgages increased slightly, and for both, the spreads over Treasuries were little changed. The growth of home mortgage debt likely slowed a bit further in the first quarter, as home price appreciation appears to have remained sluggish. Growth of consumer credit continued to be moderate early in the year.

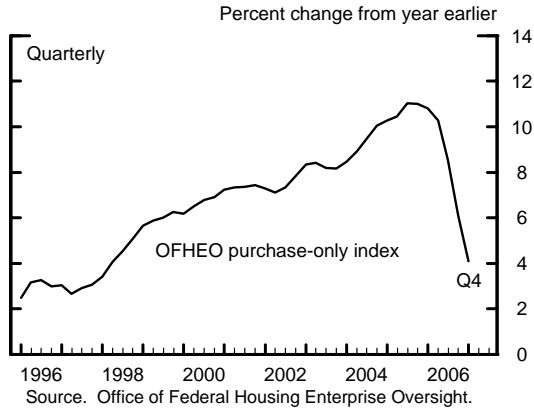
The most recent data continued to show very low delinquency rates on prime and subprime fixed-rate mortgages. However, in March, delinquencies on subprime variable-rate mortgages were roughly unchanged at high levels. Foreclosures started on properties climbed in the fourth quarter; all told, we estimate that about 1 million properties began the foreclosure process in 2006. A substantial increase in the subprime segment has accounted for most of the increase in new foreclosures overall.

Respondents to the April Senior Loan Officer Opinion Survey reported having tightened standards on residential mortgages over the past three months, particularly for nontraditional and subprime loans. Spreads on indexes of subprime mortgage credit default swaps remained in the elevated range that has prevailed since late February. Spreads for newly issued securities used to fund subprime mortgage pools also stayed elevated as investors continue to scrutinize pools more closely.

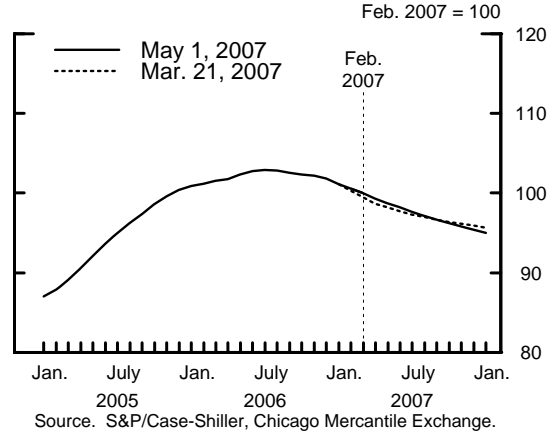
The handful of monthly indicators of home prices available for the first quarter suggest a very small aggregate price increase. The trajectory of expected home prices in ten of the largest metropolitan markets, derived from futures quotes on the S&P/Case-Shiller home-price index, was essentially unchanged over the intermeeting period and continues to imply an expectation of moderate price declines in these markets over 2007. On balance, the combination of solid stock market returns and sluggish home-price appreciation has left the ratio of household net worth to disposable personal income at a relatively high level in recent quarters. Propelled by strong inflows to both equity and bond funds, net inflows to long-term mutual funds have been approaching record levels so far this year.

### Household Assets

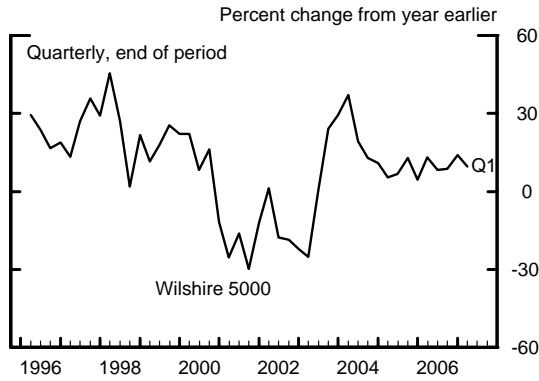
House Prices



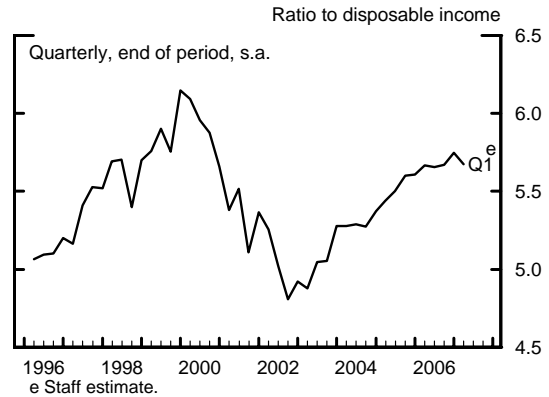
S&P/Case-Shiller House Price Futures



Stock Prices



Net Worth



### Net Flows into Long-Term Mutual Funds

(Billions of dollars, monthly rate)

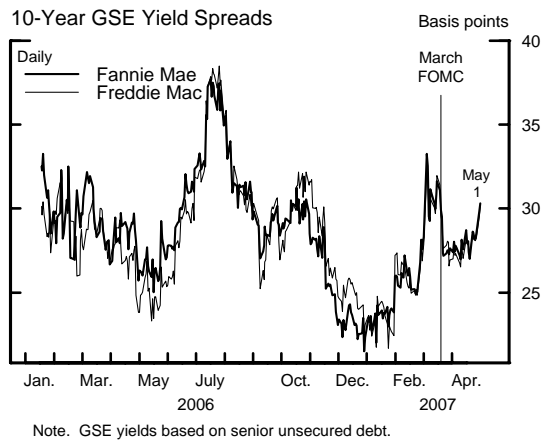
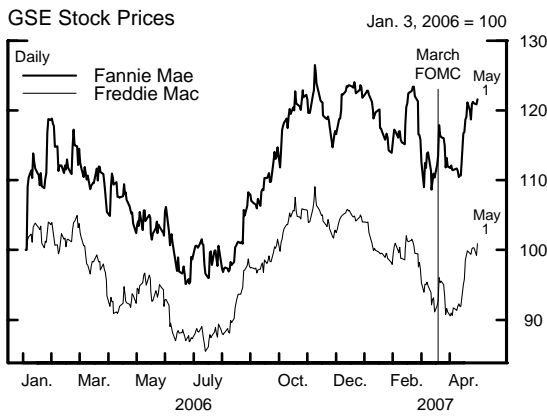
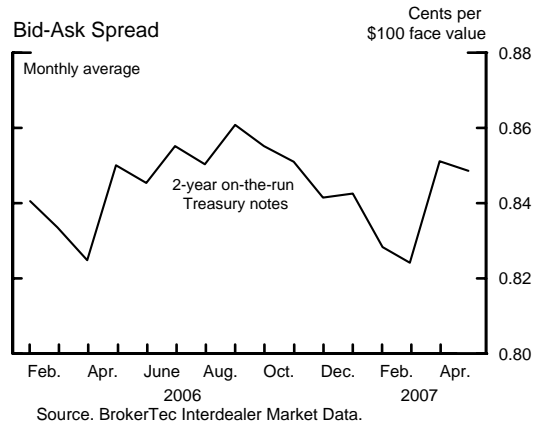
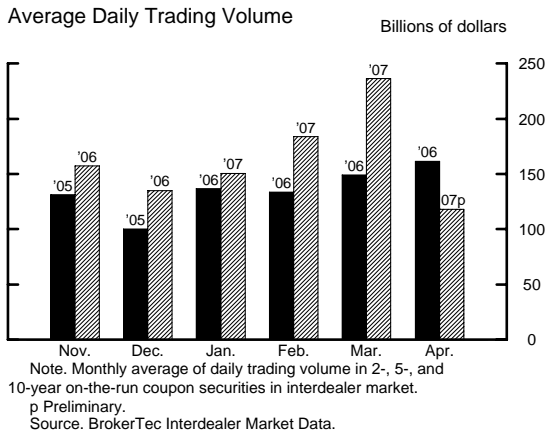
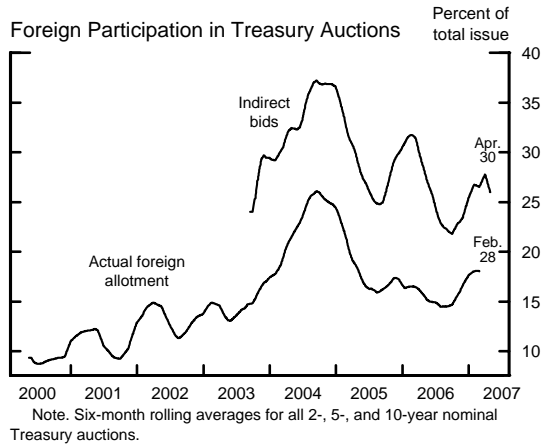
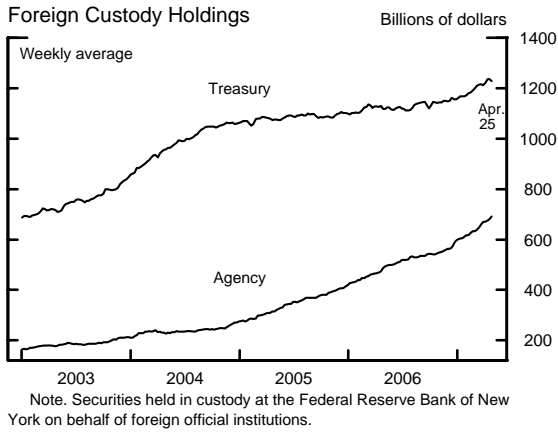
Fund type	2004	2005	2006	2006		2007		Assets Mar.
				Q3	Q4	Mar.	Apr. <sup>e</sup>	
<b>Total long-term funds</b>	<b>17.5</b>	<b>16.0</b>	<b>18.9</b>	<b>9.2</b>	<b>21.6</b>	<b>25.4</b>	<b>37.5</b>	<b>8,330</b>
<b>Equity funds</b>	<b>14.8</b>	<b>11.3</b>	<b>13.3</b>	<b>4.1</b>	<b>11.2</b>	<b>8.2</b>	<b>18.5</b>	<b>6,104</b>
Domestic	9.3	2.5	0.9	-3.6	-0.9	1.6	5.8	4,703
International	5.6	8.7	12.4	7.7	12.1	6.6	12.8	1,401
<b>Hybrid funds</b>	<b>3.6</b>	<b>2.1</b>	<b>0.6</b>	<b>0.3</b>	<b>1.8</b>	<b>2.7</b>	<b>3.3</b>	<b>666</b>
<b>Bond funds</b>	<b>-0.9</b>	<b>2.6</b>	<b>5.0</b>	<b>4.8</b>	<b>8.6</b>	<b>14.6</b>	<b>15.7</b>	<b>1,561</b>
High-yield	-0.8	-1.3	-0.2	0.4	0.5	0.4	1.1	162
Other taxable	1.0	3.5	4.0	3.3	6.3	11.4	12.5	1,023
Municipals	-1.1	0.4	1.3	1.0	1.8	2.8	2.0	375

Note. Excludes reinvested dividends.

e Staff estimate based on confidential weekly data.

Source: Investment Company Institute.

Treasury and Agency Finance



## State and Local Government Finance

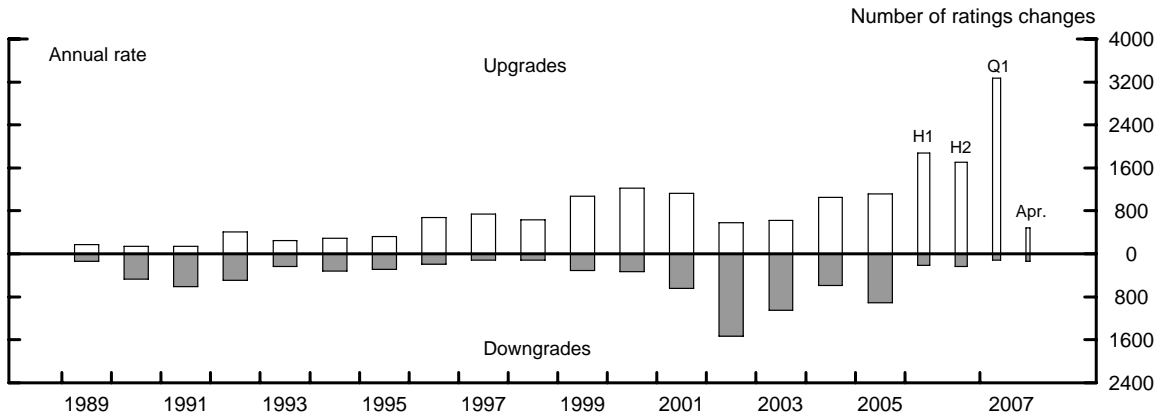
### Gross Offerings of Municipal Securities

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

Type of security	2003	2004	2005	2006		2007	
				H1	H2	Q1	Apr. <sup>p</sup>
Total	37.9	34.7	38.4	32.9	39.4	37.6	23.2
Long-term <sup>1</sup>	32.0	29.8	34.1	30.0	34.9	35.7	22.6
Refundings <sup>2</sup>	10.0	10.8	15.5	9.7	11.4	17.7	8.8
New capital	22.1	19.0	18.7	20.3	23.4	18.0	13.8
Short-term	5.8	4.9	4.2	2.8	4.5	1.9	.6
Memo: Long-term taxable	3.5	2.0	2.1	2.8	2.3	1.2	.7

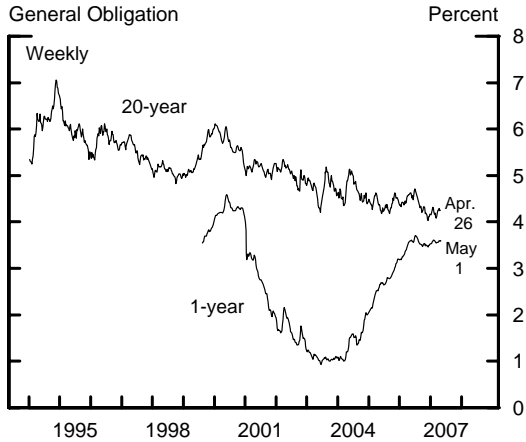
- 1. Includes issues for public and private purposes.
- 2. All issues that include any refunding bonds.
- p Based on preliminary data through April 26, 2007.

### Ratings Changes



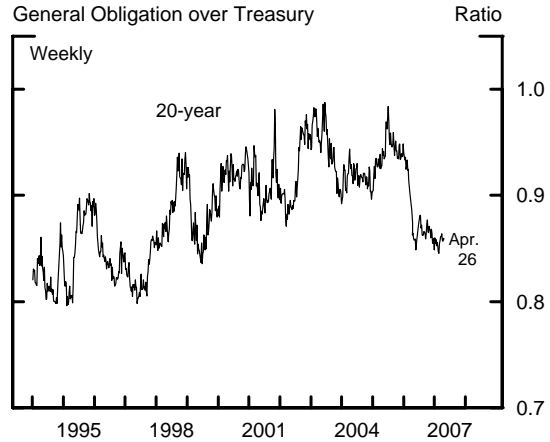
Source: S&P's Credit Week Municipal and Ratings Direct.

### Municipal Bond Yields



Source: Municipal Market Advisors and Bond Buyer.

### Municipal Bond Yield Ratio



Source: Bond Buyer.

**Treasury and Agency Finance**

Nonwithheld federal receipts have been very strong this tax season, and the Treasury scaled back regular issuance of bill and coupon securities in anticipation of further strong revenues. During the intermeeting period, the Treasury auctioned two- and five-year nominal securities as well as five-year TIPS and reopened January's ten-year TIPS offering; most issues were well received. At its mid-quarter refunding, the Treasury announced that it was discontinuing issuance of the three-year nominal note—a move that most primary dealers reportedly had anticipated. The proportion of the issues awarded to indirect bidders—a rough gauge of interest by foreign investors—was somewhat below recent values, while custody holdings by the Federal Reserve Bank of New York on behalf of foreign official institutions edged up over the intermeeting period. Although secondary-market volumes were subdued last month, bid-ask spreads were in normal range, and markets functioned well.

Fannie Mae's and Freddie Mac's stock prices rose over the intermeeting period even as the Office of Federal Housing Enterprise Oversight continued to express concerns over internal controls at the government-sponsored enterprises (GSEs) and as regulatory-reform legislation moved ahead in the Congress. However, yields on long-term agency debt fell slightly relative to those on Treasury securities of comparable maturity, and GSE credit default swap spreads held steady.

**State and Local Government Finance**

Gross issuance of long-term municipal bonds slowed in April from the rapid first-quarter pace. Advance refundings, which surged in March because of a drop in interest rates, decelerated last month. New capital issuance also moderated in April; the bulk of the proceeds were targeted to support spending on education and transportation. Short-term issuance was negligible last month, a development consistent with healthy state and local budgets and the typical seasonal pattern. The credit quality of municipal bonds remained solid, as the number of bond-rating upgrades continued to outpace the number of downgrades. The ratio of municipal bond yields to those on comparable Treasury securities remained at the low end of its range over the past decade.

**Money and Bank Credit**

M2 accelerated to an average annual growth rate of 9 percent during March and April. The acceleration was due primarily to faster growth in liquid deposits, which were likely boosted in April by tax-related flows. Retail money market funds surged at the beginning of March after the turbulence in financial markets in late February, but flows slowed in

**M2 Monetary Aggregate**  
(Based on seasonally adjusted data)

Aggregate and components	Percent change (annual rate) <sup>1</sup>						Level (billions of dollars), Apr. (e)
	2005	2006	2006	2007			
			Q4	Q1	Mar.	Apr. (e)	
M2	4.1	5.0	6.9	8.0	9.3	8.7	7,222
Components <sup>2</sup>							
Currency	3.6	3.6	3.0	1.7	2.1	3.5	753
Liquid deposits <sup>3</sup>	2.0	.8	3.2	7.1	8.7	10.3	4,427
Small time deposits	18.8	19.3	16.6	8.6	6.1	6.8	1,188
Retail money market funds	-.2	12.9	17.1	18.1	23.5	7.4	848
Memo:							
Institutional money market funds	4.9	15.8	21.1	11.0	26.0	33.6	1,410
Monetary base	3.5	3.1	2.4	1.7	2.3	3.5	816

1. For years, Q4 to Q4; for quarters and months, calculated from corresponding average levels.

2. Nonbank traveler's checks are not listed.

3. Sum of demand deposits, other checkable deposits, and savings deposits.

e Estimated.

April. In both March and April, small time deposits expanded moderately, while currency continued to grow slowly, largely because of soft foreign demand.

Growth of commercial bank credit continued to be solid during March and April but was down a bit from earlier in the year. The slowdown primarily reflected reduced lending to households, most notably a contraction in residential real estate loans on banks' books. However, the runoff in residential real estate loans was attributable, in part, to sales of such loans to nonbank institutions—transactions that frequently cause large swings in this category of loans. Adjusted for securitizations, consumer loans have also slowed of late. The pace of lending to businesses picked up a bit, on balance, as C&I loans accelerated and commercial real estate loans continued to expand briskly.

**Commercial Bank Credit**

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

Type of credit	2005	2006	Q4 2006	Q1 2007	Mar. 2007	Apr. 2007 <sup>e</sup>	Level, <sup>1</sup> Apr. 2007 <sup>e</sup>
Total	10.5	9.2	3.2	7.3	6.4	6.0	8,070
<i>Loans</i> <sup>2</sup>							
Total	11.6	10.4	6.4	8.0	2.8	6.7	6,048
To businesses							
Commercial and industrial	13.2	16.4	10.2	6.3	7.9	8.4	1,195
Commercial real estate	16.9	13.5	7.0	9.0	9.0	9.3	1,480
To households							
Residential real estate	12.0	6.4	2.5	5.5	-6.8	-3.6	1,756
Revolving home equity	13.3	1.4	1.3	2.9	6.6	-4.5	454
Other	11.5	8.3	3.0	6.4	-11.3	-3.3	1,303
Consumer	3.1	5.1	.3	6.9	-5.0	10.4	745
Originated <sup>3</sup>	.7	6.3	4.7	7.5	2.4	2.5	1,142
Other <sup>4</sup>	8.6	11.1	14.4	15.1	11.7	17.6	871
<i>Securities</i>							
Total	7.6	5.8	-6.3	4.9	17.2	4.1	2,022
Treasury and agency	.0	4.9	-3.0	-.9	7.6	-27.0	1,182
Other <sup>5</sup>	13.5	12.4	7.1	8.1	23.0	44.7	1,032

Note. Yearly annual rates are Q4 to Q4; quarterly and monthly annual rates use corresponding average levels. Data have been adjusted to remove the effects of mark-to-market accounting rules (FIN 39 and FAS 115), the consolidation of certain variable interest entities (FIN 46), the adoption of fair value accounting (FAS 159), and the effects of sizable thrift-to-bank and bank-to-thrift structure activity in October 2006 and March 2007, respectively. Data also account for breaks caused by reclassifications.

1. Billions of dollars. Pro rata averages of weekly (Wednesday) levels.

2. Excludes interbank loans.

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

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

5. 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.

e Estimated.



## Appendix

### Senior Loan Officer Opinion Survey on Bank Lending Practices

The April 2007 Senior Loan Officer Opinion Survey on Bank Lending Practices addressed changes in the supply of, and demand for, bank loans to businesses and households over the past three months. In light of recent developments in the subprime mortgage market, banks were queried separately about standards on and demand for prime, nontraditional, and subprime residential mortgages. This appendix is based on responses from fifty-one domestic banks and nineteen foreign banking institutions.

Overall, the respondent banks reported mixed changes in lending standards and terms over the past three months and somewhat weaker demand for most loan types. Domestic and foreign institutions indicated that they had eased terms on commercial and industrial (C&I) loans over the past three months and that credit standards on such loans had changed little. Domestic respondents reported that they had tightened credit standards on commercial real estate loans over the previous three months. Demand for both C&I and commercial real estate loans at domestic banks was reportedly weaker, on net, in the April survey. By contrast, foreign institutions noted that the demand for both C&I and commercial real estate loans had changed little over the survey period.

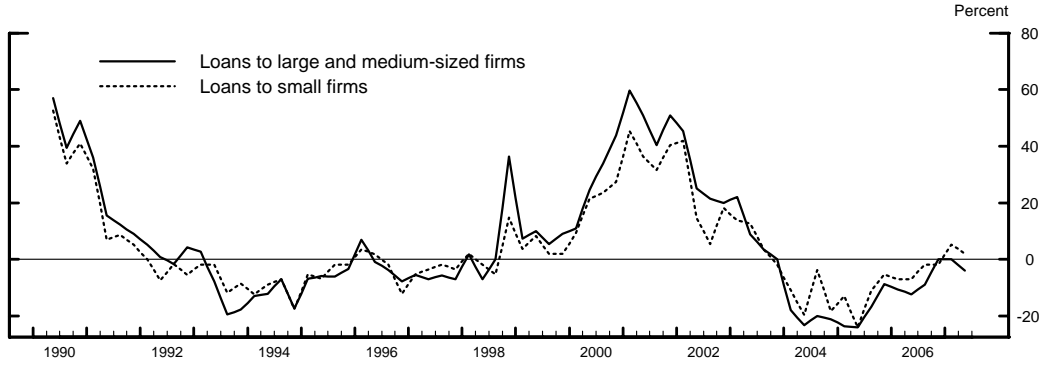
With regard to loans to households, a relatively small net fraction of respondents reported having tightened lending standards on prime residential mortgages over the past three months, while considerable net fractions of respondents indicated that they had tightened lending standards on nontraditional and subprime mortgage loans. The banks reported that demand for subprime residential mortgages was little changed, on net, whereas significant net fractions of respondents reported that they had seen weaker demand for both prime and nontraditional residential mortgages over the past three months. A significant net percentage of institutions also reported weaker demand for consumer loans over the same period.

#### **Business Lending**

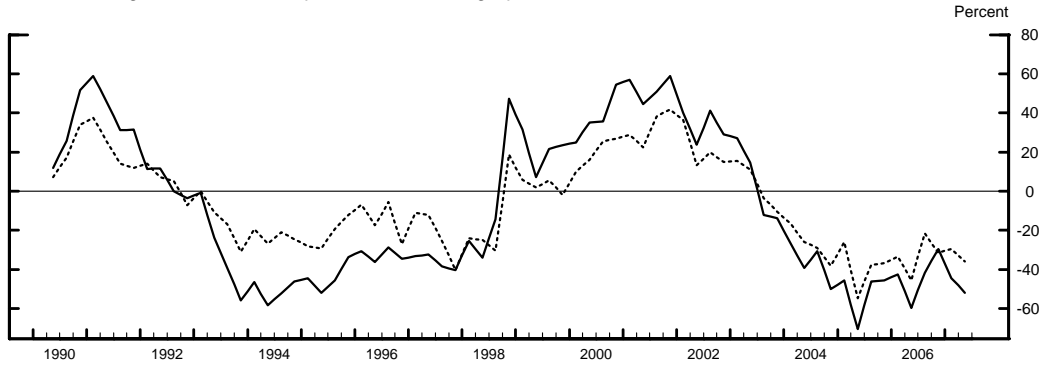
In the April survey, domestic institutions reported that lending standards on C&I loans to large and middle-market firms were about unchanged, on net, over the past three months. The respondents noted, however, that they had further eased some terms on C&I loans to such firms over the same period. About half of respondents—a slightly larger net fraction than in the January survey—indicated that they had trimmed spreads of loan rates over their cost of funds over the previous three months, and smaller net fractions reported that they had reduced the costs of credit lines and eased loan covenants.

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

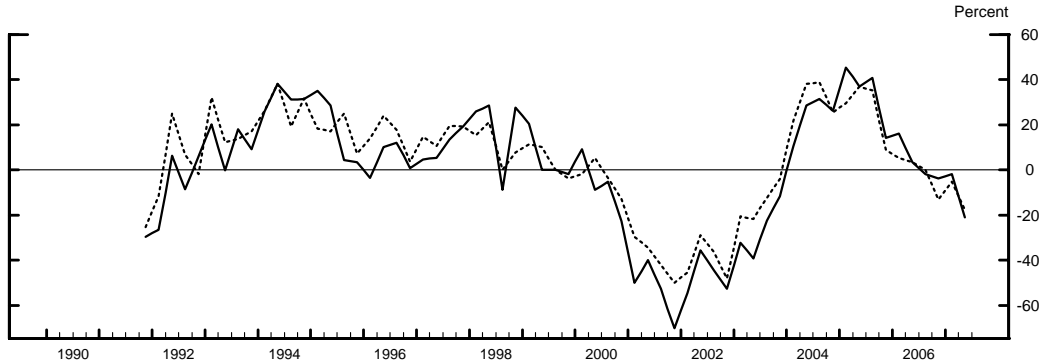
Net Percentage of Domestic Respondents Tightening Standards for C&I Loans



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

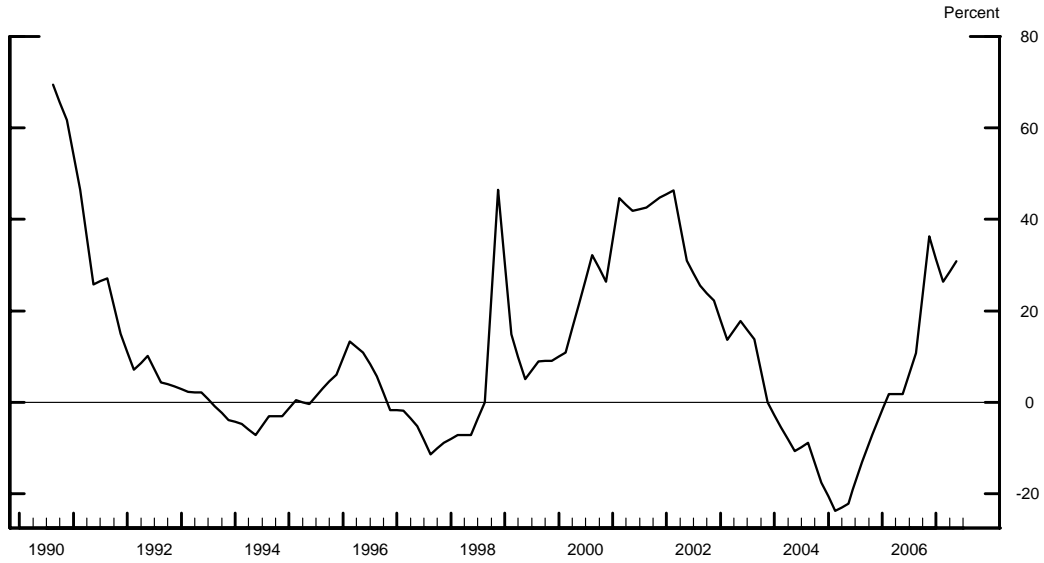


Net Percentage of Domestic Respondents Reporting Stronger Demand for C&I Loans



## Measures of Supply and Demand for Commercial Real Estate Loans

Net Percentage of Domestic Respondents Tightening Standards for Commercial Real Estate Loans

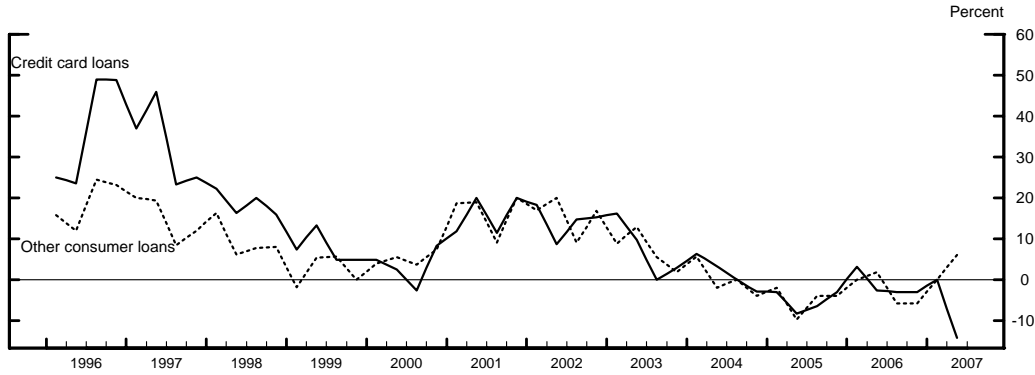


Net Percentage of Domestic Respondents Reporting Stronger Demand for Commercial Real Estate Loans

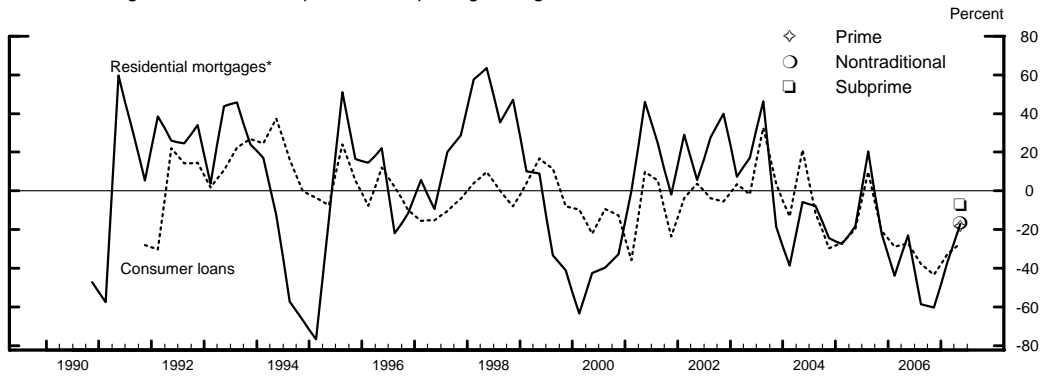


## Measures of Supply and Demand for Loans to Households

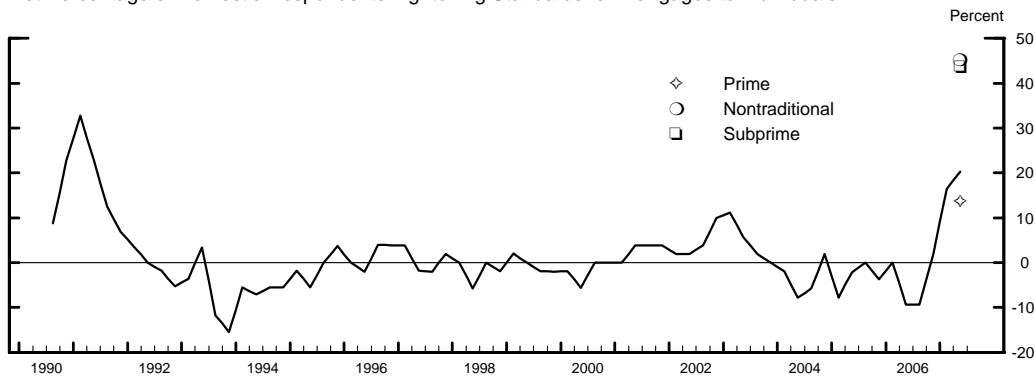
Net Percentage of Domestic Respondents Tightening Standards for Consumer Loans



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



Net Percentage of Domestic Respondents Tightening Standards for Mortgages to Individuals\*



\* The questions on residential mortgages were separated into three questions (for prime, nontraditional, and subprime mortgages) in the latest survey. Responses to the new questions are shown separately. For the lines, values for 2007:Q2 have been constructed using weights based on answers to questions in the July 2006 Senior Loan Officer Opinion Survey (see text note for details).

Credit standards on C&I loans to small firms were also reportedly unchanged, on balance, in the April survey. Nonetheless, about one-third of the domestic banks, on net, indicated that they had trimmed spreads of loan rates over their cost of funds over the past three months, and smaller net fractions reported that they had reduced the cost of credit lines and reduced premiums charged on riskier loans.

As they did in previous surveys, U.S. branches and agencies of foreign banks reported that their standards on C&I loans were essentially unchanged. However, significant net fractions of these institutions indicated that they had eased loan covenants, increased the maximum size of credit lines, and narrowed spreads of loan rates over their cost of funds.

In the April survey, nearly all domestic banks and all U.S. branches and agencies of foreign banks that reported having eased their lending standards and terms pointed to more-aggressive competition from other banks or nonbank lenders as the most important reason for having done so. Considerable fractions of domestic and foreign institutions also cited increased liquidity in the secondary market for these loans as a reason for their move toward less-stringent business lending policies.

On net, about one-fifth of the domestic respondents noted that they had experienced weaker demand for C&I loans from large and middle-market firms and from small firms. Among domestic respondents that saw weaker demand for such loans, about four-fifths attributed the softening in part to borrowers' decreased need to finance investment in plant or equipment, and about two-thirds pointed to borrowers' increased use of internally generated funds. The U.S. branches and agencies of foreign banks reported that demand for C&I loans was about unchanged, on net, over the past three months.

Regarding future business, 12 percent of domestic respondents, on net, reported that the number of inquiries from potential business borrowers had decreased over the previous three months, a somewhat larger net percentage than in the January survey. By contrast, foreign respondents indicated that the number of inquiries from potential business borrowers was little changed in the April survey.

About one-third of domestic institutions—a larger net fraction than in the previous survey—indicated that they had tightened lending standards on commercial real estate loans over the past three months. As in the January survey, about 40 percent of domestic respondents noted that they had experienced weaker demand for such loans over the same period. By contrast, the vast majority of foreign respondents reported that lending standards on commercial real estate loans had remained basically

unchanged in the April survey. Demand for such loans at these institutions was also said to be about unchanged over the past three months.

### **Household Lending**

In order to track developments regarding the major categories of residential real estate loans, the April survey asked banks to report changes in standards on and demand for prime, nontraditional, and subprime residential mortgages.<sup>1</sup> A large majority of respondents indicated that standards on prime residential mortgages had remained basically unchanged over the past three months, with about 15 percent reporting somewhat tighter standards. Of the forty-two domestic institutions that originated nontraditional residential mortgages, about 45 percent noted a tightening of standards on such loans, whereas the rest reported that their standards had remained basically unchanged. Similarly, of the sixteen institutions that indicated they had originated subprime residential mortgages, about 45 percent, on net, reported that they had tightened standards on such loans.<sup>2</sup>

A tightening of standards for subprime and nontraditional mortgage loans did not appear to prompt a move toward more-stringent lending policies for prime mortgages. Indeed, of the nine institutions that reported having tightened standards on subprime residential mortgages, only one indicated that it had also tightened standards on prime residential mortgages. Five of the nineteen institutions that reported tightening standards on nontraditional mortgages also tightened standards on prime mortgages.

On net, about one-fifth of domestic institutions indicated that they had seen weaker demand for prime and nontraditional residential mortgages over the past three months, while the demand for subprime mortgages was reportedly little changed.

On balance, 10 percent of domestic respondents indicated that their willingness to make consumer installment loans had increased in the April survey. A small fraction of

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<sup>1</sup> Special questions in the July 2006 Senior Loan Officer Opinion Survey on Bank Lending Practices addressed domestic banks' holdings of subprime and nontraditional residential mortgages. The answers to these questions can be used to calculate estimates of the average shares of subprime and nontraditional residential mortgages in total residential mortgages for the survey respondents as of June 30, 2006. These estimates suggest that subprime mortgages accounted for about 7 percent of all residential mortgages for the survey respondents, and nontraditional residential mortgages accounted for about 15 percent of all residential mortgages. In the third exhibit, these shares are used as weights to construct the net percentage of domestic respondents reporting stronger demand (middle panel) and tighter standards (lower panel) on all residential mortgage products taken together for 2007:Q2.

<sup>2</sup> These sixteen institutions accounted for 45 percent of residential mortgage loans on the books of all commercial banks as of December 31, 2006.

institutions reported that they had eased lending standards on credit card loans; standards and terms on non-credit-card loans were reportedly little changed over the past three months. About one-fourth of domestic institutions indicated that they had experienced weaker demand for consumer loans, a somewhat smaller net percentage than in the January survey.

Last Page of Domestic Financial Developments

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## **International Developments**

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## International Developments

### U.S. International Transactions

#### Trade in Goods and Services

In February, the trade deficit narrowed to \$58.4 billion from \$58.9 billion in January (revised). The narrowing of the deficit reflected a steep decline in imports, which more than offset a sizable decline in exports. The value of exports of goods and services fell 2.2 percent, following a 1.2 percent increase in January. The lion's share of the February decline was in exports of capital goods. Within capital goods, exports of aircraft, high-tech goods, and other capital goods all moved lower. There were smaller declines in exports of industrial supplies (particularly fuels), consumer goods, and services. Automotive exports rose in February after falling in January.

#### Trade in Goods and Services

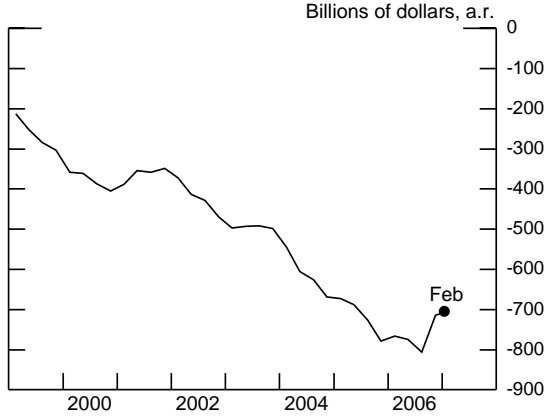
	2006	Annual rate			Monthly rate		
		2006		2007	2006		2007
		Q3	Q4	Q1 <sup>e</sup>	Dec.	Jan.	Feb.
Percent change							
<i>Nominal BOP</i>							
Exports	12.8	11.7	9.7	2.9	.4	1.2	-2.2
Imports	5.0	13.6	-9.7	.1	2.1	-6	-1.7
<i>Real NIPA</i>							
Exports	9.4	6.8	10.6	-1.2	...	...	...
Imports	3.3	5.6	-2.6	2.3	...	...	...
Billions of dollars							
<i>Nominal BOP</i>							
Net exports	-765.3	-805.6	-714.4	-703.9	-61.5	-58.9	-58.4
Goods, net	-836.0	-875.6	-791.8	-777.8	-68.1	-65.2	-64.5
Services, net	70.7	70.0	77.4	74.0	6.6	6.3	6.0

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

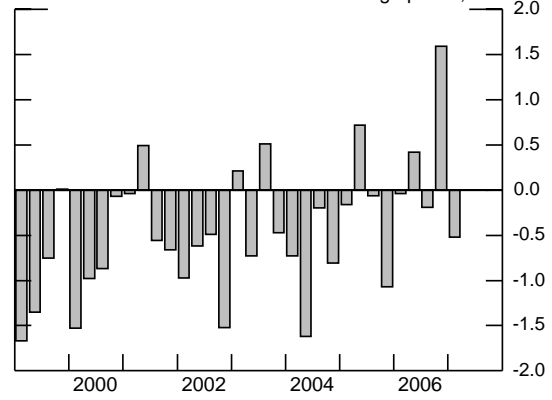
The average value of exports in January and February increased 2.9 percent (a.r.) from the fourth quarter. Strong exports of consumer goods pulled up the growth rate, while exports of services, industrial supplies, capital goods, and automotive products were all close to their fourth-quarter levels. In the advance NIPA release for the first quarter, real exports of goods and services were reported to have fallen at an annual rate of 1.2 percent.

### U.S. International Trade in Goods and Services (Quarterly)

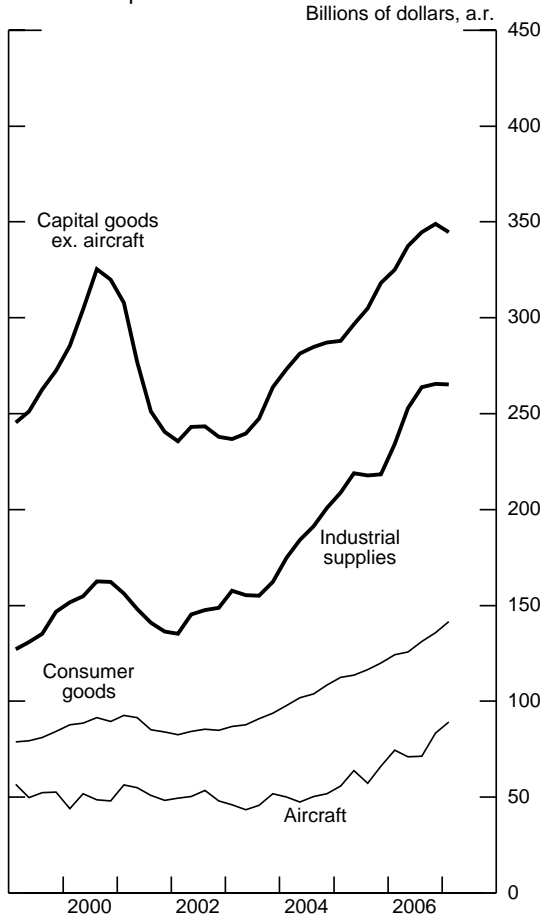
Trade Balance



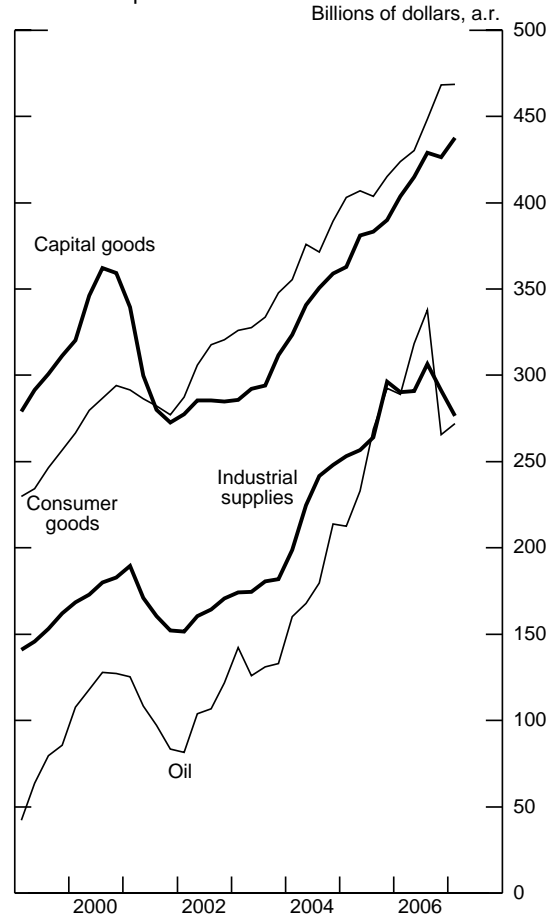
Contribution of Net Exports to Real GDP Growth



Selected Exports



Selected Imports



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

	Levels				Change <sup>1</sup>			
	2006	2007	2007		2006	2007	2007	
	Q4	Q1 <sup>e</sup>	Jan.	Feb.	Q4	Q1 <sup>e</sup>	Jan.	Feb.
<b>Exports of G&amp;S</b>	<b>1493.9</b>	<b>1504.7</b>	<b>1521.4</b>	<b>1488.0</b>	<b>34.1</b>	<b>10.8</b>	<b>17.9</b>	<b>-33.5</b>
Goods exports	1066.5	1077.0	1092.6	1061.3	21.4	10.5	20.1	-31.3
Gold	9.0	7.3	7.3	7.4	-.6	-1.7	-2.3	.1
Other goods	1057.5	1069.7	1085.3	1054.0	22.0	12.2	22.4	-31.4
Capital goods	432.2	433.8	446.7	420.8	16.3	1.5	12.6	-25.9
Aircraft & parts	83.4	89.2	92.1	86.2	12.1	5.8	8.2	-5.9
Computers & accessories	48.2	47.0	48.9	45.0	.9	-1.2	2.8	-3.9
Semiconductors	50.3	49.1	50.2	48.0	-3.3	-1.2	1.8	-2.2
Other capital goods	250.3	248.5	255.5	241.6	6.6	-1.8	-.1	-13.9
Automotive	108.9	108.8	106.8	110.8	-2.0	-.1	-7.6	4.0
Ind. supplies (ex. ag., gold)	265.5	265.2	268.7	261.7	1.6	-.3	7.1	-6.9
Consumer goods	135.8	141.6	143.6	139.5	4.6	5.8	6.2	-4.1
Agricultural	74.7	79.5	79.2	79.8	-.5	4.8	2.9	.6
All other goods	40.5	40.9	40.4	41.4	2.0	.4	7.6	1.0
Services exports	427.4	427.7	428.8	426.6	12.7	.3	-2.2	-2.2
<b>Imports of G&amp;S</b>	<b>2208.3</b>	<b>2208.6</b>	<b>2227.9</b>	<b>2189.2</b>	<b>-57.1</b>	<b>.3</b>	<b>-13.0</b>	<b>-38.7</b>
Goods imports	1858.3	1854.8	1874.6	1835.0	-62.4	-3.5	-14.5	-39.6
Oil	265.5	271.0	293.4	248.7	-72.1	5.6	14.9	-44.7
Gold	5.1	4.2	4.6	3.9	-.4	-.9	-.6	-.7
Other goods	1587.7	1579.5	1576.6	1582.4	10.1	-8.1	-28.8	5.8
Capital goods	426.3	437.6	440.3	434.9	-2.7	11.3	15.2	-5.4
Aircraft & parts	31.0	32.5	32.9	32.1	3.5	1.5	.2	-.7
Computers & accessories	100.8	110.3	112.9	107.8	-3.5	9.5	14.7	-5.1
Semiconductors	27.0	27.4	27.5	27.4	-1.5	.4	.9	-.1
Other capital goods	267.5	267.4	267.1	267.6	-1.3	-.1	-.6	.5
Automotive	258.2	252.5	252.9	252.1	5.1	-5.7	-19.5	-.8
Ind. supplies (ex. oil, gold)	291.1	276.5	277.0	276.0	-15.5	-14.6	-10.1	-1.0
Consumer goods	468.4	468.7	462.1	475.2	19.8	.3	-15.1	13.1
Foods, feeds, bev.	77.1	79.1	78.9	79.3	1.0	2.0	1.6	.4
All other goods	66.5	65.1	65.3	64.9	2.3	-1.4	-.9	-.4
Services imports	350.0	353.8	353.3	354.2	5.3	3.8	1.5	.9
<i>Memo:</i>								
Oil quantity (mb/d)	13.09	13.93	15.02	12.83	-.76	.83	1.34	-2.19
Oil import price (\$/bbl)	55.55	53.27	53.49	53.05	-11.21	-2.26	-2.25	-.44

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

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

The value of imported goods and services fell 1.7 percent in February, after falling 0.6 percent in January. Oil imports plunged, reflecting declines in both prices and quantities. Imports of industrial supplies, capital goods, and automotive products also fell. These declines were partially offset by a sizable increase in imports of consumer goods.

The average value of imports in January and February was flat relative to the fourth quarter. Imports of capital goods, services, and petroleum were all above their fourth-quarter levels, but these increases were offset by lower imports of industrial supplies and automotive products. In the advance NIPA release for the first quarter, real imports of goods and services were reported to have increased 2.3 percent at an annual rate.

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

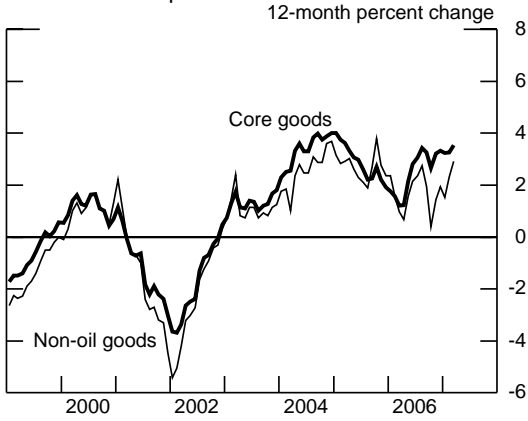
**Non-oil imports.** In March, import prices for both non-oil goods and core goods rose 0.3 percent. Prices for imported material-intensive goods rose 0.7 percent, in large part reflecting higher prices for imported metals. Prices for imported finished goods were up almost 0.2 percent in March. Within finished goods, consumer goods experienced the largest price increase, rising 0.2 percent. Outside of core imports, the price for imported natural gas rose 4.7 percent in March. Prices for imported computers and semiconductors fell 0.8 and 0.1 percent, respectively.

In the first quarter, as reported in the advance NIPA release, import prices increased 1.3 percent at an annual rate, as lower prices for imported oil, computers, and semiconductors tempered higher prices for imported services, natural gas, and core goods. Prices of imported core goods increased 2.8 percent, largely on account of higher prices for material-intensive goods.

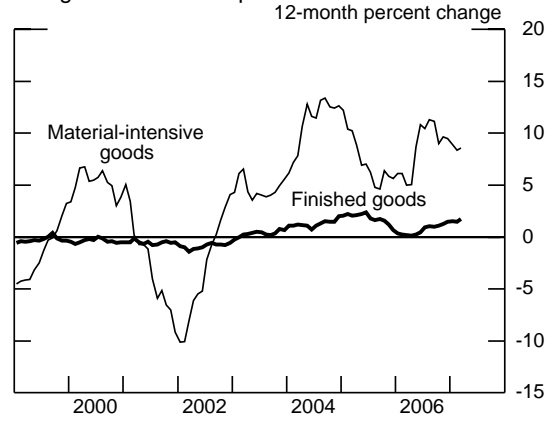
**Oil.** The BLS price index of imported oil rose 9 percent in March, following little change in February. The spot price of West Texas Intermediate (WTI) crude oil increased to a similar extent over the two months, but the timing differed; spot WTI rose 9 percent in February and 2 percent in March. In April, the spot price averaged about \$64 per barrel, up about \$3.50 per barrel from the March average, and it closed at \$64.41 per barrel on May 1. The rise in oil prices since February reflects OPEC production restraint, production problems in Iraq and Nigeria, and increased concern about a possible disruption of exports from Iran. Strong oil demand in the United States, owing in part to below-normal temperatures in February and early March, has also supported oil prices.

**Prices of U.S. Imports and Exports**

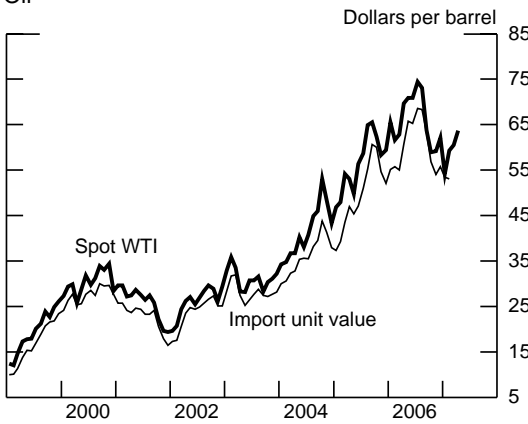
**Merchandise Imports**



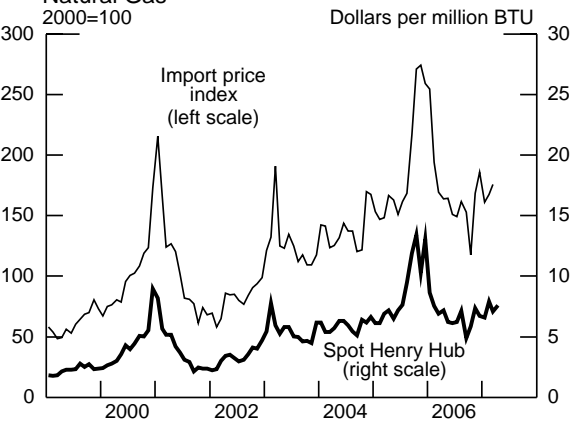
**Categories of Core Imports**



**Oil**



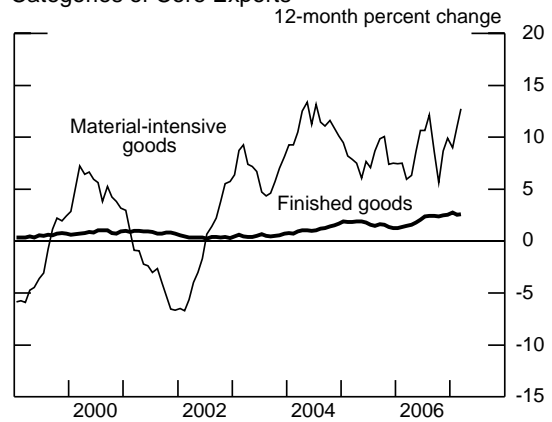
**Natural Gas**



**Merchandise Exports**



**Categories of Core Exports**



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

	Annual rate			Monthly rate		
	2006		2007	2007		
	Q3	Q4	Q1	Jan.	Feb.	Mar.
	----- BLS prices -----					
<b>Merchandise imports</b>	4.2	-11.9	1.5	-1.1	.1	1.7
Oil	7.0	-51.9	-5.5	-6.6	.6	9.0
Non-oil	3.4	1.8	2.8	-.1	.1	.3
Core goods <sup>1</sup>	4.2	1.9	3.4	.3	.1	.3
Finished goods	2.5	1.2	1.9	.2	.1	.2
Cap. goods ex. comp. & semi.	2.9	1.2	2.7	.6	-.1	.1
Automotive products	1.4	.8	.6	.0	.2	.1
Consumer goods	3.0	1.5	2.0	.2	.0	.2
Material-intensive goods	9.7	3.6	6.6	.7	-.1	.7
Foods, feeds, beverages	8.5	6.5	9.6	1.5	.2	-.1
Industrial supplies ex. fuels	10.0	1.8	4.1	.5	-.3	.8
Computers	-5.2	-2.5	-8.3	-1.1	-1.1	-.8
Semiconductors	3.2	2.2	-4.9	-.6	-.4	-.1
Natural gas	-12.5	7.6	30.5	-13.2	4.0	4.7
<b>Merchandise exports</b>	5.2	.4	7.0	.4	.7	.7
Core goods <sup>2</sup>	6.6	.8	8.6	.6	.8	.8
Finished goods	2.5	1.9	3.4	.7	-.0	.1
Cap. goods ex. comp. & semi.	2.4	3.0	4.0	.7	.0	.2
Automotive products	1.5	.9	1.7	.2	.1	.1
Consumer goods	3.0	.3	3.5	.9	-.1	.0
Material-intensive goods	12.7	-.7	16.9	.6	2.1	2.0
Agricultural products	18.8	20.9	28.2	.7	2.8	2.1
Industrial supplies ex. ag.	11.3	-5.7	14.0	.5	2.0	1.9
Computers	-3.1	-3.4	-12.2	-1.7	-.7	-.8
Semiconductors	-10.8	-3.3	-3.3	-.4	.0	-.7
	----- NIPA prices -----					
<b>Chain price index</b>						
Imports of goods & services	5.4	-8.6	1.3	...	...	...
Non-oil merchandise	3.3	1.0	2.3	...	...	...
Core goods <sup>1</sup>	4.3	1.2	2.8	...	...	...
Exports of goods & services	4.5	-.9	3.6	...	...	...
Total merchandise	5.3	.0	3.9	...	...	...
Core goods <sup>2</sup>	5.8	.3	5.9	...	...	...

1. Excludes computers, semiconductors, and natural gas.

2. Excludes computers and semiconductors.

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

**Exports.** In March, export prices for core goods rose 0.8 percent, the same rate of increase as in February. Prices for exported nonagricultural industrial supplies rose 1.9 percent, owing to higher prices for exported metals, chemicals, and fuels. Prices for agricultural products also shot up in March, with higher prices for corn, vegetables, meat, and wheat all contributing to the increase. Prices for finished goods were little changed in March for the second consecutive month, after rising robustly in January.

In the advance NIPA release for the first quarter, exports prices climbed 3.6 percent at an annual rate, as higher prices for exports of core goods and services more than offset steep declines in prices of exported computers and semiconductors. Core export prices increased 5.9 percent, boosted by a sharp increase in prices for exports of industrial supplies and agricultural goods.

#### **U.S. International Financial Transactions**

Foreign official flows into the United States (line 1 of the Summary of U.S. International Transactions table) moved up noticeably in the first three months of the year, continuing the upward trend that began in early 2005. Most of these inflows came from countries other than the G10 and OPEC (line 1c),

The chart on Foreign Official Financial Flows provides a broader perspective on these data. The G-10 countries have fluctuated between small inflows to and outflows from the United States in recent months, with the trend remaining a modest net outflow. Although inflows attributed to OPEC countries have tapered off in recent months, the June 2006 survey data on foreign holdings of U.S. securities indicate that inflows from OPEC have been stronger than recorded in these monthly data. Securities acquired by OPEC through financial centers are assigned to those financial centers in the Treasury International Capital data, but often can be reclassified with aid of the survey data. Inflows from countries other than the G-10 and OPEC have been growing over the past few years, with quite strong inflows in recent months.

Private foreign net purchases of U.S. securities (line 4 of the table and the top panels of the chart on Private Securities Flows) in the first quarter of this year are near the pace recorded in 2006. Demand for Treasuries (line 4a) and equities (line 4d) strengthened from an already healthy level set in the fourth quarter, with purchases of Treasuries in March exceeding all those registered in 2006. However, purchases of corporate bonds

(line 4c) moderated a tad and private foreigners sold agencies (line 4b), on net. Most transactions took place through the financial centers of the United Kingdom and the Cayman Islands.

U.S. acquisitions of foreign securities (line 5 of the table and the bottom panels of the chart on Private Securities Flows) remained strong in the first quarter of this year. Net acquisitions of bonds (line 5a) jumped up in March, pulling the quarter up in line with the pace recorded in 2006 and in line with new issuance by foreign firms. Purchases of foreign stocks (line 5b), although slowing slightly from the strong pace set in the fourth quarter, remained elevated.

Flows recorded by the banking sector (line 3) tend to be volatile. They recorded net inflows for 2006 as a whole, and a modest outflow for the first quarter of this year.



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

	2005	2006	2006			2007		
			Q2	Q3	Q4	Q1	Feb	Mar
<b>Official financial flows</b>	<b>213.6</b>	<b>310.8</b>	<b>81.4</b>	<b>81.1</b>	<b>70.3</b>	<b>117.7</b>	<b>50.2</b>	<b>30.4</b>
1. Change in foreign official assets in the U.S. (increase, +)	199.5	308.4	82.0	80.1	68.9	117.8	50.3	30.5
a. G-10 countries + ECB	-21.3	-33.2	-16.8	-5.2	-4.3	-4.8	-5.9	0.2
b. OPEC	7.5	33.2	16.5	12.1	-7.8	9.9	-0.9	3.6
c. All other countries	213.4	308.4	82.3	73.1	81.0	112.6	57.1	26.6
2. Change in U.S. official reserve assets (decrease, +)	14.1	2.4	-0.6	1.0	1.4	-0.1	-0.1	-0.1
<b>Private financial flows</b>	<b>571.9</b>	<b>408.3</b>	<b>72.2</b>	<b>148.6</b>	<b>94.3</b>	<b>n.a.</b>	<b>...</b>	<b>...</b>
<b>Banks</b>								
3. Change in net foreign positions of banking offices in the U.S. <sup>1</sup>	15.4	107.6	-3.6	55.0	6.2	-5.5	31.6	-27.6
<b>Securities<sup>2</sup></b>								
4. Foreign net purchases (+) of U.S. securities	616.7	695.2	169.3	153.3	172.3	190.0	36.2	79.3
a. Treasury securities	178.1	34.6	16.0	-8.9	29.2	56.6	11.7	35.3
b. Agency bonds	72.3	97.2	27.6	26.6	2.0	-15.7	-19.9	-3.9
c. Corporate and municipal bonds	274.3	414.6	105.7	99.7	112.4	99.0	31.1	34.4
d. Corporate stocks <sup>3</sup>	92.0	148.7	20.0	35.9	28.7	50.1	13.2	13.5
5. U.S. net acquisitions (-) of foreign securities	-197.0	-284.5	-58.5	-53.8	-114.9	-84.9	-21.5	-42.0
a. Bonds	-53.1	-147.8	-35.3	-44.4	-53.6	-43.4	-5.1	-32.8
b. Stock purchases	-139.9	-120.0	-20.9	-9.3	-50.9	-39.8	-16.4	-9.2
c. Stock swaps <sup>3</sup>	-4.0	-16.8	-2.4	0.0	-10.4	-1.8	0.0	0.0
<b>Other flows (quarterly data, s.a.)</b>								
6. U.S. direct investment (-) abroad	-9.1	-248.9	-47.4	-65.4	-74.2	n.a.	...	...
7. Foreign direct investment in the U.S.	109.8	183.6	46.8	61.6	29.4	n.a.	...	...
8. Foreign acquisitions of U.S. currency	19.4	12.6	1.1	1.1	8.4	n.a.	...	...
9. Other (inflow, +) <sup>4</sup>	16.7	-57.1	-35.6	-3.3	67.1	n.a.	...	...
<b>U.S. current account balance (s.a.)</b>	<b>-791.5</b>	<b>-856.7</b>	<b>-217.7</b>	<b>-229.4</b>	<b>-195.8</b>	<b>n.a.</b>	<b>...</b>	<b>...</b>
<b>Capital account balance (s.a.)<sup>5</sup></b>	<b>-4.4</b>	<b>-3.9</b>	<b>-1.0</b>	<b>-0.6</b>	<b>-0.6</b>	<b>n.a.</b>	<b>...</b>	<b>...</b>
<b>Statistical discrepancy (s.a.)</b>	<b>10.4</b>	<b>141.4</b>	<b>65.1</b>	<b>0.2</b>	<b>31.8</b>	<b>n.a.</b>	<b>...</b>	<b>...</b>

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 non-market means such as mergers and reincorporations.

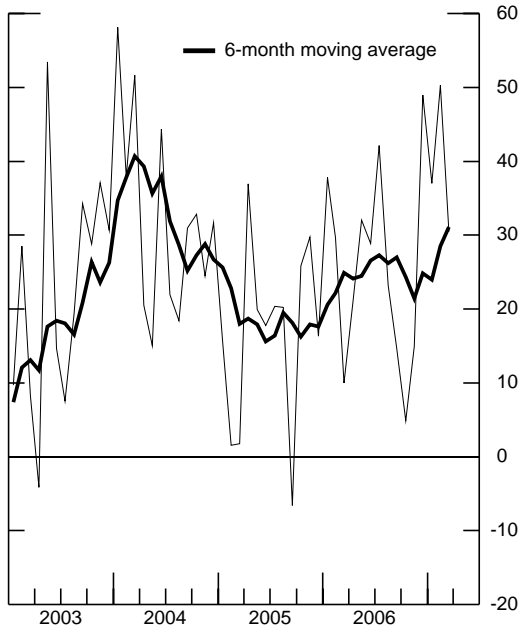
4. Transactions by nonbanking concerns and other banking and official transactions not shown elsewhere plus amounts resulting from adjustments made by the Department of Commerce and revisions in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.

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

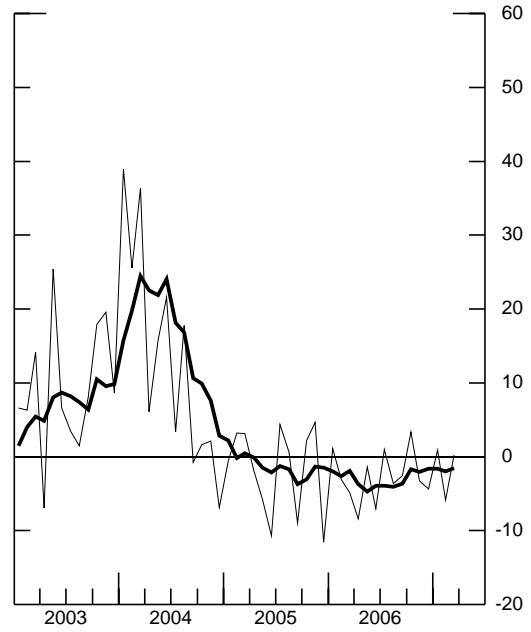
n.a. Not available. ... Not applicable.

**Foreign Official Financial Flows Through March 2007 (increase, +)**  
 (\$ Billions, monthly, not seasonally adjusted)

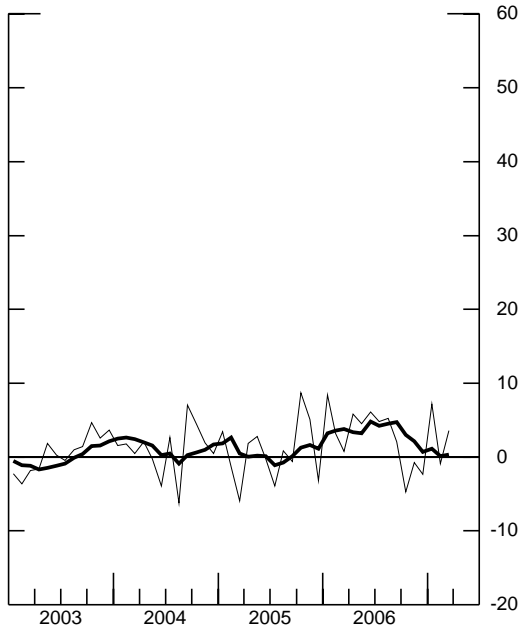
Total



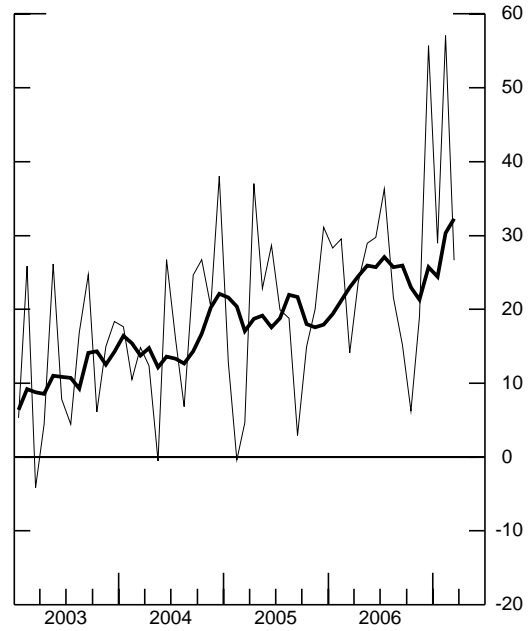
G-10 + ECB



OPEC



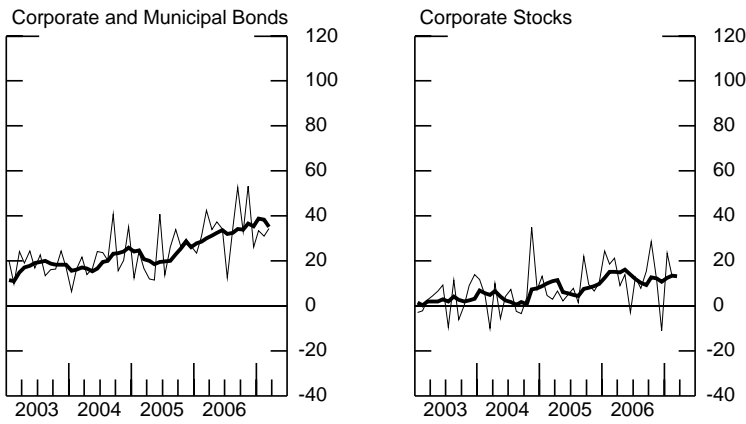
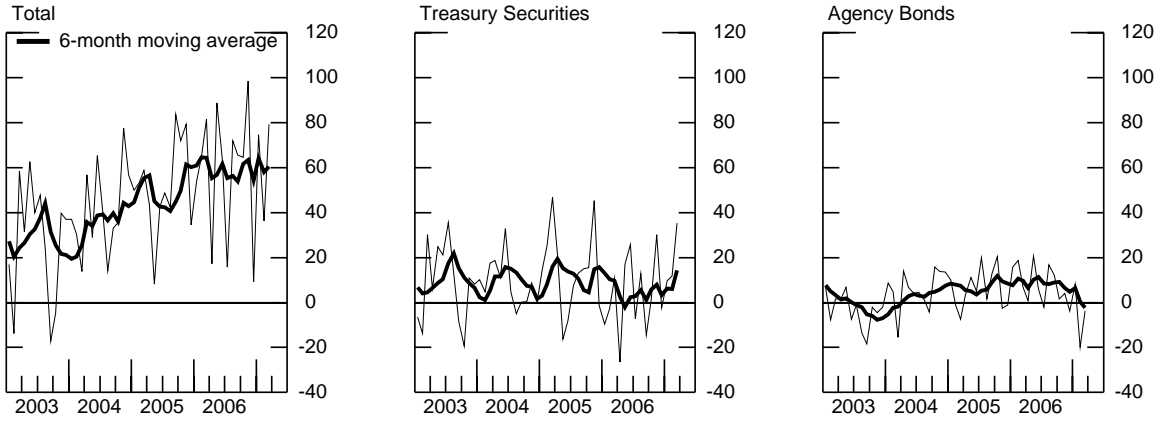
All other countries



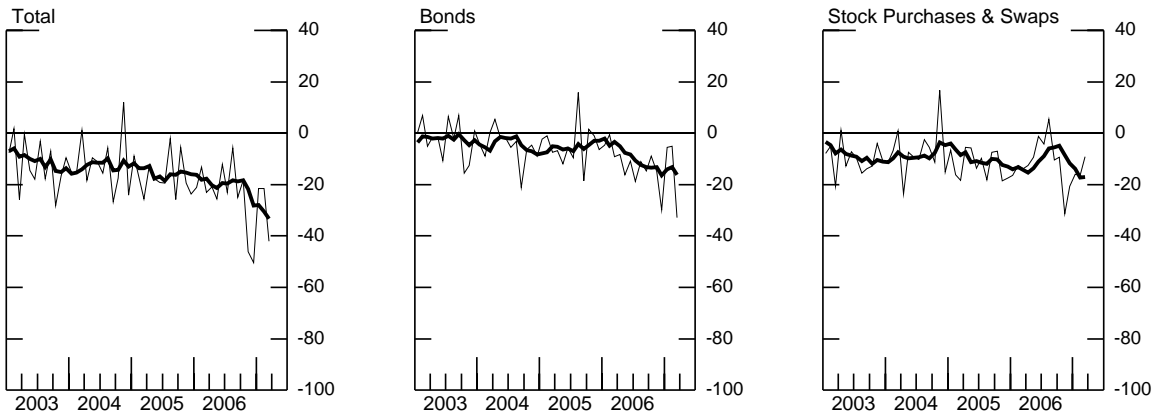
**Private Securities Flows Through March 2007**

(\$ Billions, monthly, not seasonally adjusted)

**Foreign Net Purchases (+) of U.S. Securities**



**U.S. Net Acquisitions (-) of Foreign Securities**



## Foreign Financial Markets

The trade-weighted index of the exchange value of the dollar against the major foreign currencies fell 2 percent over the intermeeting period, with the dollar depreciating against all currencies in the index except against the yen. On a bilateral basis, the dollar depreciated about 4 percent against the Canadian dollar and 2 percent against the euro and sterling, but it appreciated 2 percent against the Japanese yen. Much of the yen's depreciation against the dollar occurred in early April, reportedly on the re-establishment of yen-funded carry trades after the beginning of the new Japanese fiscal year. The appreciation of the euro, the Canadian dollar, and sterling over the intermeeting period was in part due to economic data releases in Europe and Canada that exceeded market expectations. In particular, German employment growth in February, French GDP growth for the fourth quarter of 2006, U.K. and Canadian consumer price inflation in February and March, and Canadian employment growth in March were higher than had been expected. Governor King was required to write an open letter to the Chancellor of the Exchequer because 12-month inflation rose to 3.1 percent in March, more than one percentage point higher than the Bank of England's target. The letter had to explain what the Bank of England would do to redress this situation.

Over the intermeeting period, headline equity indexes rose 3 to 7 percent on net in the euro area, United Kingdom, Canada, and United States, but they were little changed in Japan. Market participants attributed the increases in Europe and North America to better than expected economic data and quarterly earnings reports. Japan's lagging stock index performance was linked to indications that inflation and activity are not expected to accelerate.

There were no monetary policy changes in major foreign industrial countries over the intermeeting period. Inflation compensation, as implied by the difference between long-term nominal yields and yields on inflation-indexed notes, were little changed. Option-implied volatilities on both the dollar-yen and dollar-euro exchange rates declined over the intermeeting period. The euro-dollar implied volatility remains at very low levels, and the dollar-yen implied volatility retraced previous upswings, possibly signaling an end to the late-February/early-March "flight to quality" episode. Realized volatility of stock market indexes and ten-year government bonds in Japan, Europe, and the United States was little changed over the intermeeting period.

Towards the end of the intermeeting period, the Turkish lira depreciated 7 percent over two days and the Istanbul headline equity index declined 4 percent on growing tensions over the Islamist AK Party's presidential candidate, Abdullah Gul. On Saturday, April 28, the Turkish military released a statement warning the AK Party government that it would protect the secular state; the secular opposition requested an annulment of Friday's first-round parliamentary vote, and approximately 700,000 civilians demonstrated against the ruling party on Sunday April 29. On May 1, Turkey's Constitutional Court issued a ruling in favor of the opposition by stating that a quorum was not achieved in the first presidential vote on Friday. On May 2, the likelihood of an escalation of the political crisis decreased further after Prime Minister Erdogan announced his intention to call early parliamentary elections and to change the constitution so the president is elected directly by popular vote. Since May 1 the lira has appreciated about 1 percent, the Istanbul headline index has increased almost 2 percent, and Turkey's EMBI+ spread narrowed 4 bps to 205 bps. Other emerging market currencies, exchange indices and the EMBI+ spread were relatively stable over this episode, showing no signs of spillovers so far.

The dollar depreciated about 2 percent against the Brazilian *real*, 1-1/3 percent against the Mexican peso, about 1 percent against the Korean won and only 0.4 percent against the renminbi over the intermeeting period. The overall EMBI+ spread declined 16 basis points, on balance. The Mexican and Brazilian EMBI+ spreads narrowed 18 and 33 basis points, respectively, while the Argentina EMBI+ spread rose 55 basis points on news that April's inflation data will not reflect the actual rise in consumer prices because of government alterations to the index. Latin American and emerging Asia equity indexes rose 6 to 10 percent, and the Shanghai Composite index soared 25 percent. The outsized equity index gain in China coincided with the report of higher than expected GDP growth data in 2007 Q1. The People's Bank of China raised the deposits to required reserves ratio twice by 50 basis points over the intermeeting period to 11 percent, and it raised the benchmark one-year lending and deposit rates by 27 basis points.

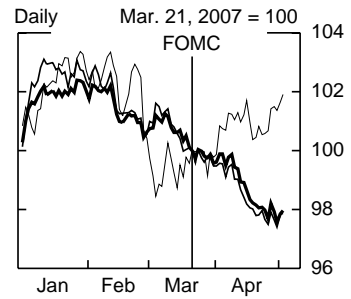
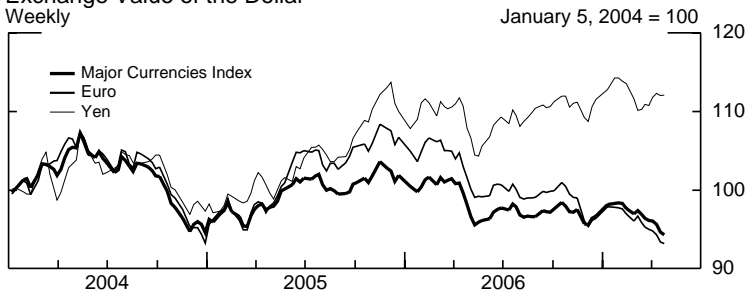
. The Desk did not intervene during the period for the accounts of the System or the Treasury.

**Exchange Value of the Dollar and Stock Market Indexes**

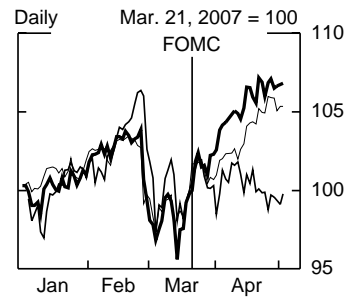
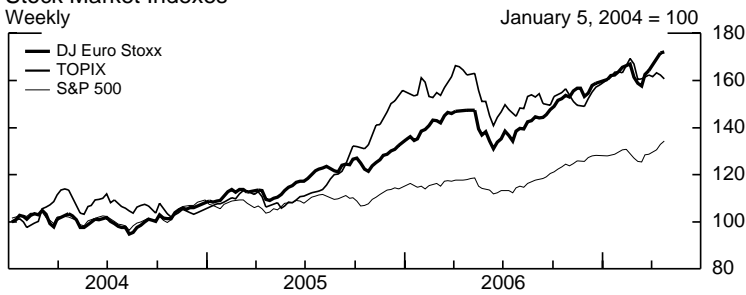
	Latest	Percent change since March FOMC
<i>Exchange rates*</i>		
Euro (\$/euro)	1.3593	-2.2
Yen (¥/\$)	120.1	1.9
Sterling (\$/£)	1.9907	-2.0
Canadian dollar (C\$/\\$)	1.1085	-4.3
<i>Nominal dollar indexes*</i>		
Broad index	104.8	-1.4
Major currencies index	79.2	-2.0
OITP index	131.4	-0.8
<i>Stock market indexes</i>		
DJ Euro Stoxx	427.0	6.8
TOPIX	1704.2	-0.2
FTSE 100	6447.5	3.0
S&P 500	1486.6	5.4

\* Positive percent change denotes appreciation of U.S. dollar.

**Exchange Value of the Dollar**  
Weekly



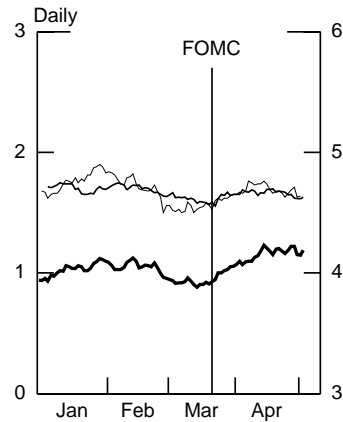
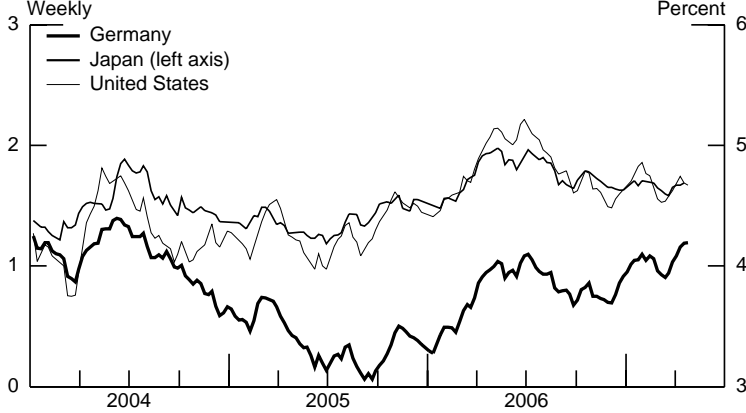
**Stock Market Indexes**  
Weekly



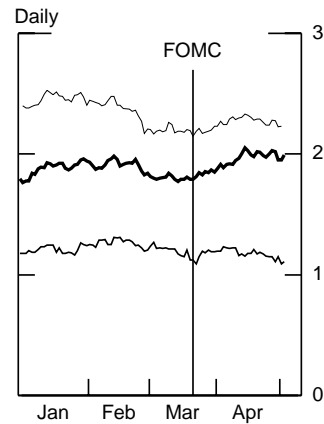
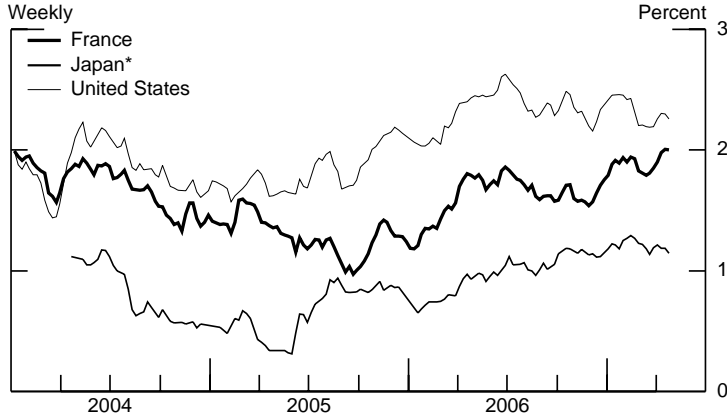
**Industrial Countries: Nominal and Real Interest Rates**

	3-month LIBOR		10-year nominal		10-year indexed		Percent
	Latest	Change since March FOMC	Latest	Change since March FOMC	Latest	Change since March FOMC	
Germany	4.02	0.13	4.19	0.26	2.06	0.21	
Japan	0.67	-0.05	1.63	0.04	1.11	-0.01	
United Kingdom	5.73	0.17	5.08	0.25	1.97	0.26	
Canada	4.28	0.01	4.18	0.09	...	...	
United States	5.36	0.01	4.64	0.08	2.23	0.04	

**Nominal 10-Year Government Bond Yields**



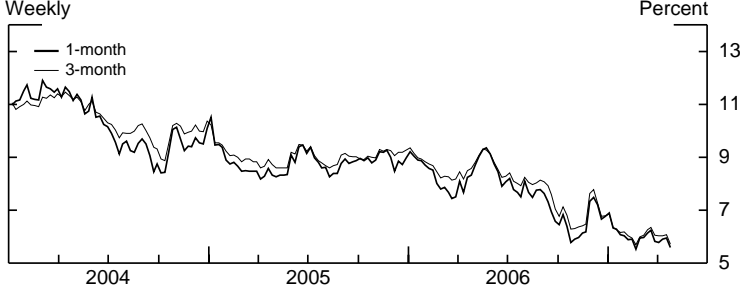
**Inflation-Indexed 10-Year Government Bond Yields**



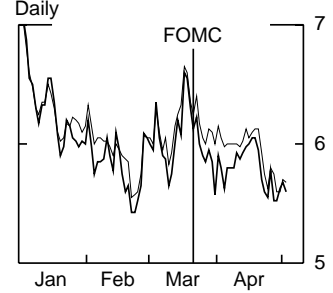
\*Japan first issued inflation-indexed debt in March 2004.

**Measures of Market Volatility**

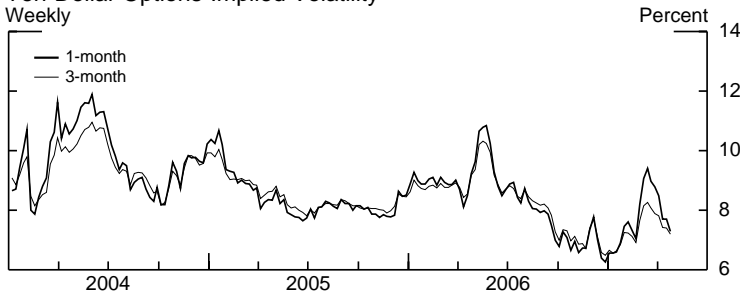
**Dollar-Euro Options-Implied Volatility\***  
Weekly



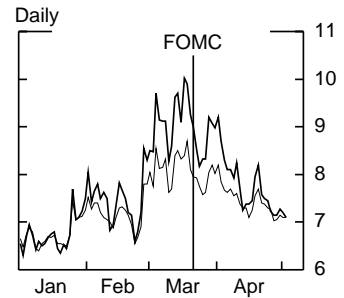
\*Derived from at-the-money options.



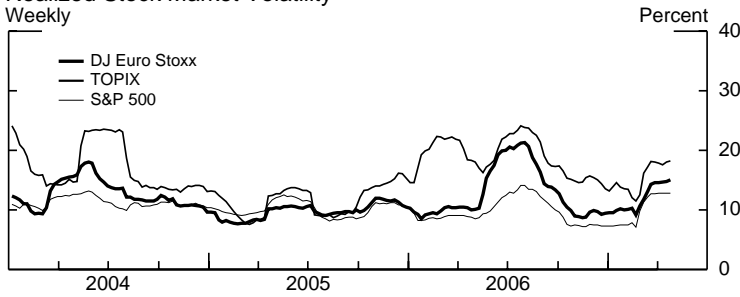
**Yen-Dollar Options-Implied Volatility\***  
Weekly



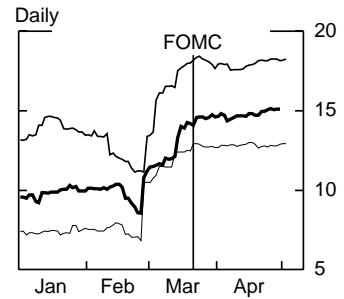
\*Derived from at-the-money options.



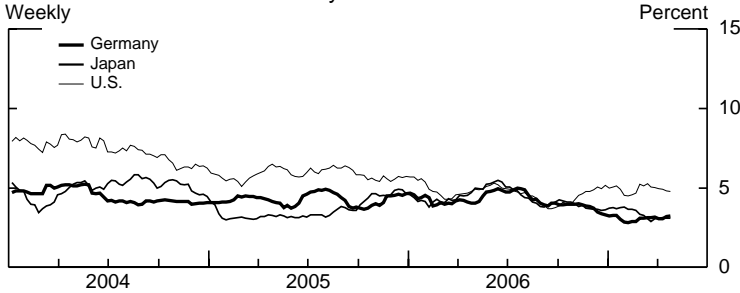
**Realized Stock Market Volatility\***  
Weekly



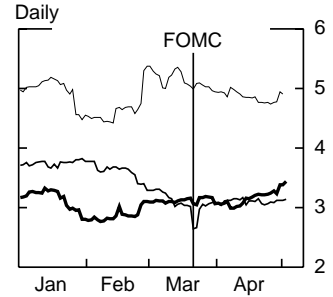
\*Annualized standard deviation of 60-day window of daily returns.



**Realized 10-Year Bond Volatility\***  
Weekly



\*Annualized standard deviation of 60-day window of daily returns.



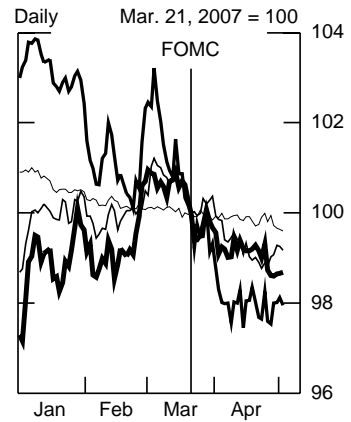
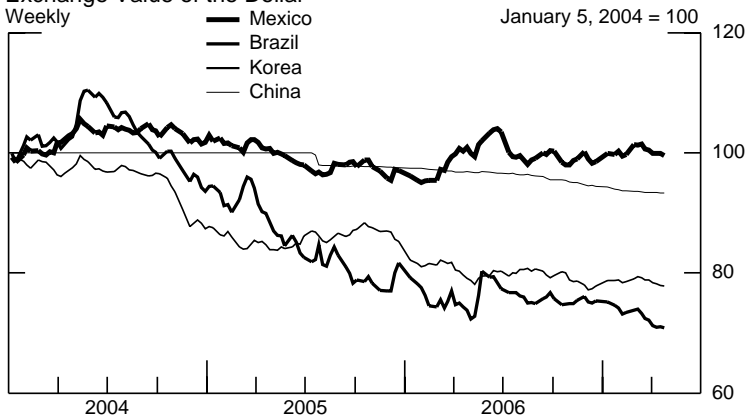


**Emerging Markets: Exchange Rates and Stock Market Indexes**

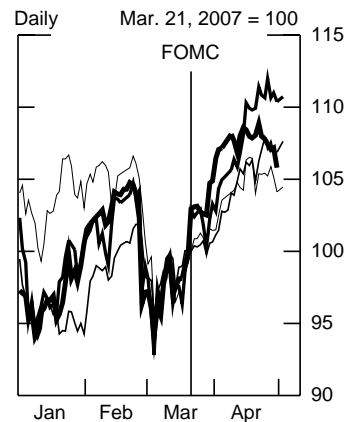
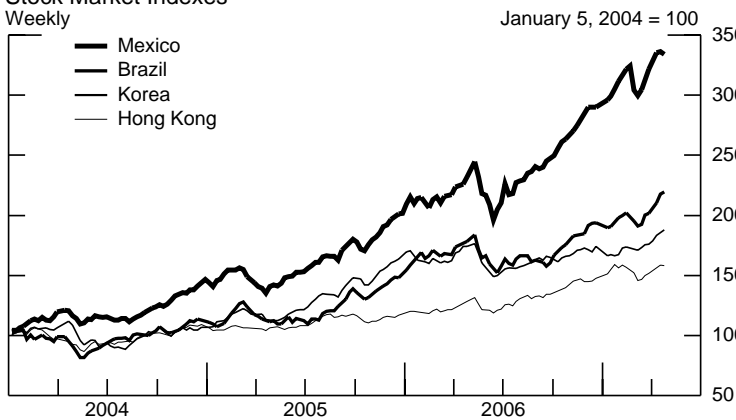
	Exchange value of the dollar		Stock market index	
	Latest	Percent change since March FOMC*	Latest	Percent change since March FOMC
Mexico	10.9340	-1.3	28997	5.8
Brazil	2.0295	-2.1	49108	10.7
Venezuela	2144.60	0.0	43363	-10.4
China	7.7039	-0.4	3841	25.6
Hong Kong	7.8222	0.1	20388	4.5
Korea	929.9	-0.8	1553	7.7
Taiwan	33.33	0.7	7903	1.9
Singapore	1.5259	0.2	930	9.4
Thailand	32.75	2.7	705	5.4

\* Positive percent change denotes appreciation of U.S. dollar.

**Exchange Value of the Dollar**  
Weekly



**Stock Market Indexes**  
Weekly



**Emerging Markets: Short-Term Interest Rates and Dollar-Denominated Bond Spreads**

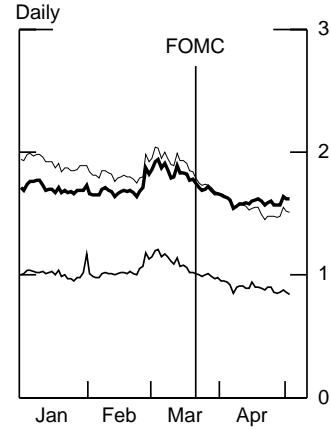
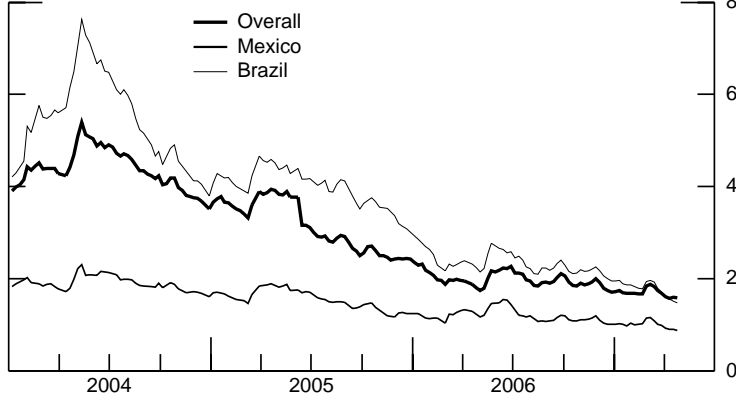
	Short-term interest rates*		Dollar-denominated bond spreads**		Percent
	Latest	Change since March FOMC	Latest	Change since March FOMC	
Mexico	7.30	0.22	0.84	-0.18	
Brazil	12.20	-0.35	1.51	-0.33	
Argentina	9.06	-0.31	2.73	0.55	
China	...	...	0.54	-0.01	
Korea	5.00	0.35	...	...	
Taiwan	1.93	0.07	...	...	
Singapore	3.50	0.00	...	...	
Hong Kong	4.19	0.05	...	...	

\*One month interest rate except 1-week rate for Korea. No reliable short-term interest rate exists for China.

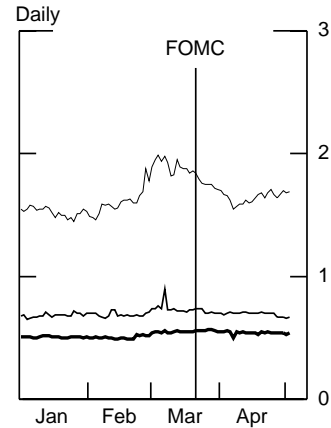
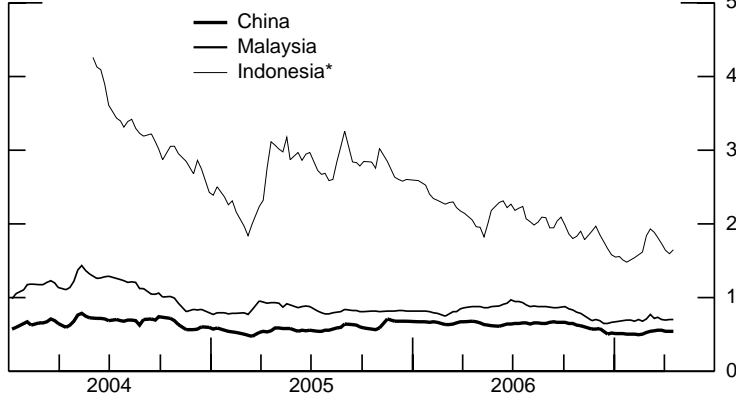
\*\*EMBI+ or EMBI Global Spreads over similar-maturity U.S. Treasuries.

... Korea, Taiwan, Singapore, and Hong Kong have no outstanding dollar-denominated sovereign bonds.

**EMBI+ Spreads**  
Weekly



**EMBI Global Spreads**  
Weekly



\*Begins May 2004.

## **Developments in Advanced Foreign Economies**

The advanced foreign economies appear to be growing at a steady rate. Canadian growth seems to have rebounded from a disappointing fourth quarter. Renewed household demand in Japan points toward further strong growth in the first quarter, while investment demand seems to be underpinning growth in the United Kingdom. Although euro-area exports have slowed from the rapid pace set in the fourth quarter and the hike in the German value added tax appears to have had a noticeable impact on purchases of consumer durables at the start of the year, overall economic conditions remain quite good.

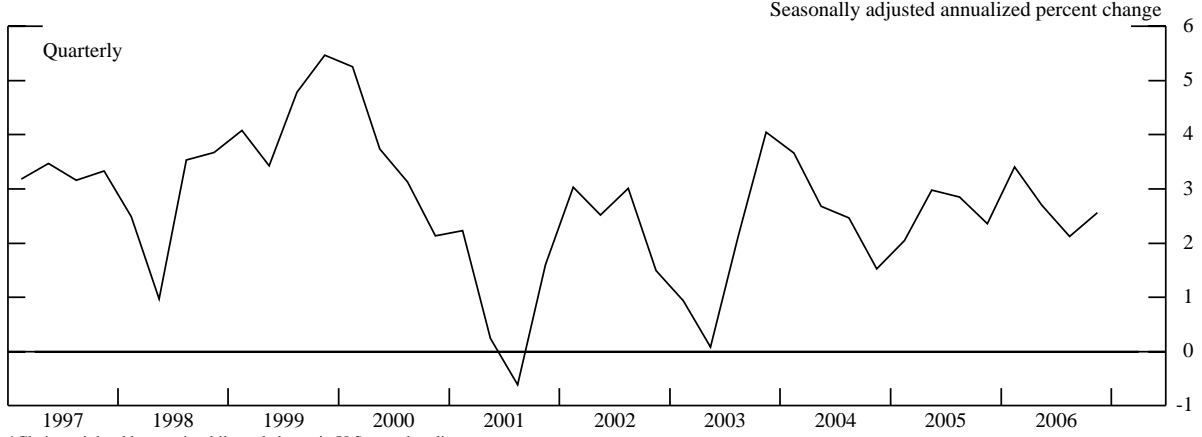
The inflation picture has been much more mixed by comparison. Inflation in the euro area has remained steady at just below 2 percent since the end of last year, but inflation in the United Kingdom rose more than 1 percentage point above the Bank of England's target for the first time since that Bank was granted independence while in Canada twelve-month inflation jumped 90 basis points to over 2 percent. In stark contrast, consumer prices fell back into deflation in Japan, and there are indications that a return to positive rates of inflation may be several months off. Central bank officials held their policy rates constant in the intervening period, although markets expect each of the four major foreign central banks to raise rates later this year.

**Japanese** consumer prices returned to deflation in February after ten months of positive twelve-month inflation rates. As of March, the headline CPI had declined 0.1 percent from a year ago and the core (which excludes fresh food only) CPI declined 0.3 percent. Rising food and energy prices caused the Tokyo headline CPI to increase over the month of April, but consumer prices excluding fresh food and energy were unchanged, indicating that a return to positive nationwide inflation may not occur for several months. There appears to be little inflationary impulse from wages despite a strong labor market; nominal wages fell 1.8 percent in February compared with a year earlier. In more positive news, it was reported that average land prices rose last year for the first time since 1990. Residential land prices rose 0.1 percent and commercial land prices rose 2.3 percent.

Measures of activity in the first-quarter are encouraging. Real expenditures by households and retail sales both rose over the first quarter, indicating that some of the strength in household demand witnessed in the fourth quarter has carried over into the

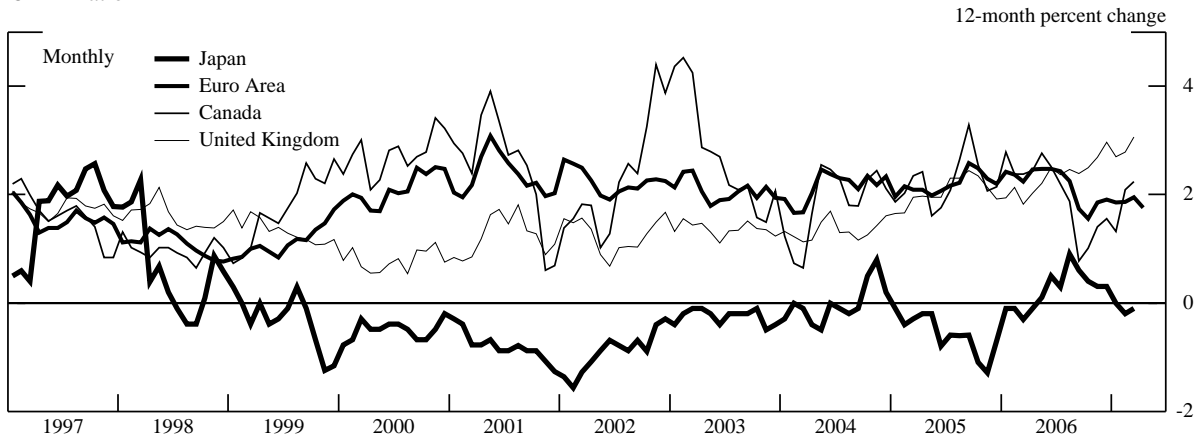
**Advanced Foreign Economies**

Average Real GDP\*

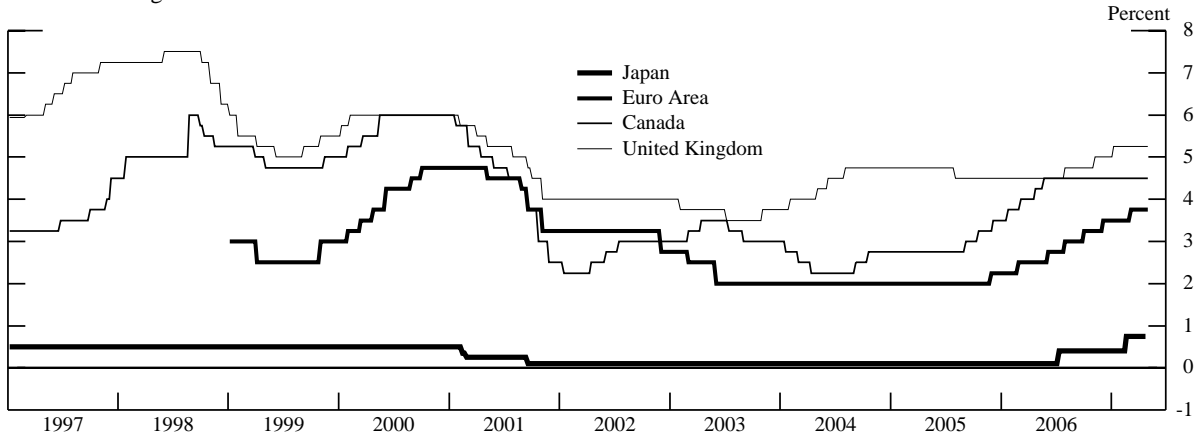


\*Chain weighted by moving bilateral shares in U.S. merchandise exports.

CPI Inflation

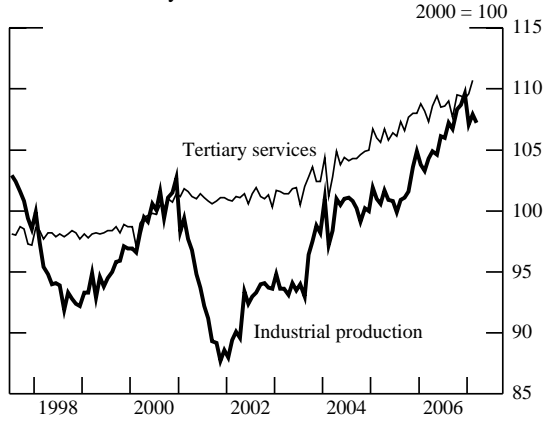


Official or Targeted Interest Rates

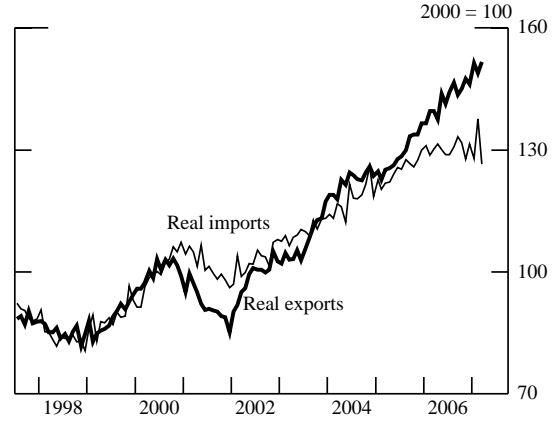


**Japan**

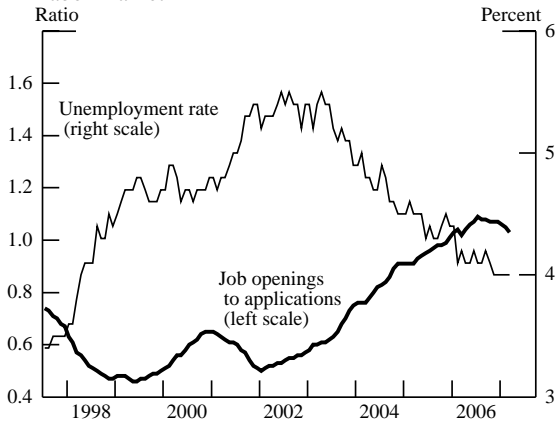
**Economic Activity**



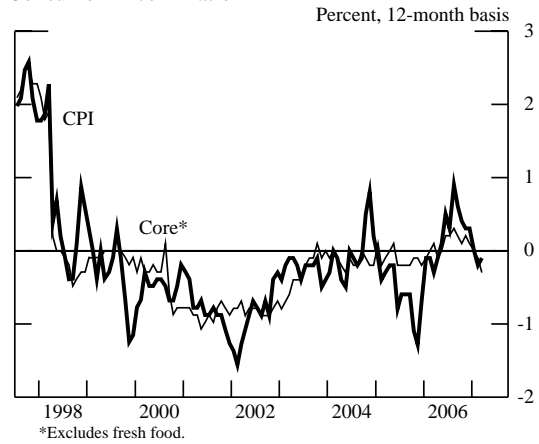
**Real Trade**



**Labor Market Ratio**



**Consumer Price Inflation**



**Economic Indicators**

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

Indicator	2006		2007		2006			2007		
	Q3	Q4	Q1	Dec.	Jan.	Feb.	Mar.	Jan.	Feb.	Mar.
Housing starts	-2.5	3.4	-4.6	-2.2	-3.6	-4.3	8.8			
Machinery orders <sup>1</sup>	-11.0	2.0	n.a.	-0.7	3.9	-5.2	n.a.			
Household expenditures	-2.0	1.6	1.0	-0.6	1.4	0.2	-0.8			
New car registrations	-3.8	-1.7	-1.1	-3.1	1.2	1.5	-3.9			
Business sentiment <sup>2</sup>	6.0	8.0	8.0	...	...	...	...			
Wholesale prices <sup>3</sup>	3.5	2.6	1.9	2.5	2.1	1.7	2.0			

1. Private sector, excluding ships and electric power.

2. Tankan survey, diffusion index. Level.

3. Percent change from year earlier, n.s.a.

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

current year. Household wealth rose a further 2.5 percent in the fourth quarter of last year, and both high levels of wealth and the strong labor market seem to be driving the resurgence in private consumption. The external sector also appears poised to contribute further to growth; the trade surplus rose to \$23.7 billion in the first quarter, its highest level in two years, spurred by the weak value of the yen and rising exports to Europe.

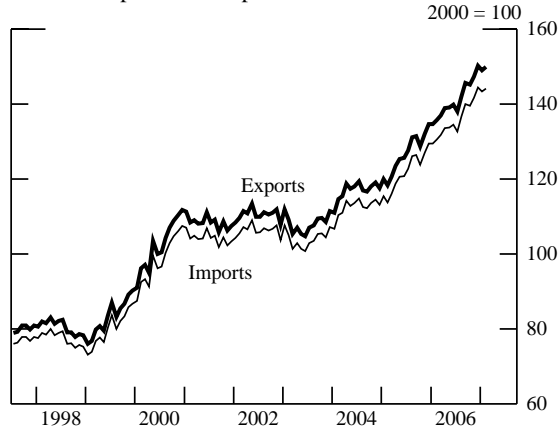
In contrast, core machinery orders fell in February, and shipments of investment goods and public works orders fell in both January and February, pointing to a potential cooling of investment and government spending after surprisingly strong growth in the fourth quarter. The Tankan diffusion index of business confidence remained steady in March, suggesting that the cooling of investment may only be temporary. Although the diffusion index for large manufacturers declined for the first time in a year, those firms nevertheless reported plans to boost spending on plant and equipment in fiscal 2007 by 2.9 percent, topping the amount reported a year ago for fiscal 2006, and they also indicated plans to further increase employment.

Incoming data suggest that external demand in the **euro area** has slowed after the surprising strength shown in the fourth quarter, when net exports accounted for most of GDP growth. Merchandise exports rose 1.3 percent on average over January and February from the fourth-quarter level, substantially less than the 4 percent quarterly growth rate registered in the three months to December. Furthermore, merchandise imports accelerated in the first two months of the year. In contrast, domestic economic conditions have improved in the intermeeting period. According to the European Commission, industrial confidence rose to record levels, and consumer confidence, buoyed by improving labor market prospects, rose to its highest level since mid-2001. The survey evidence has been confirmed by incoming production data for the first quarter. Euro-area industrial production averaged over January and February was 0.7 percent higher than the fourth-quarter level.

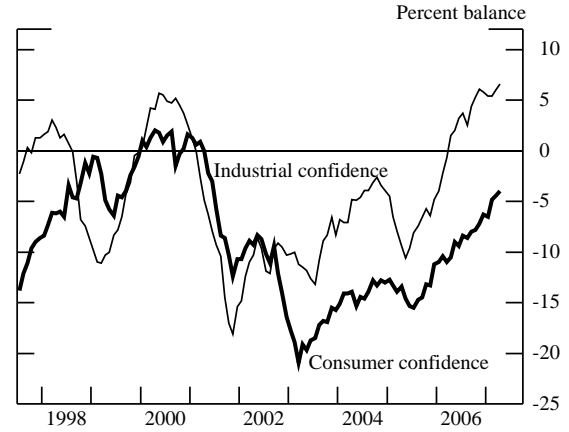
Germany's IFO bounced back in March and April, suggesting that economic activity is recovering quickly after a start-of-the-year moderation due to January's increase in the value-added tax. The effect of the VAT hike was mostly limited to the timing of German purchases of consumer durables, automobiles in particular: car registrations soared 14 percent in the fourth quarter and then plunged 22 percent in the first three months of 2007. For the euro area as a whole, retail sales rebounded in February after dropping in January and stand just slightly below the fourth-quarter level.

**Euro Area**

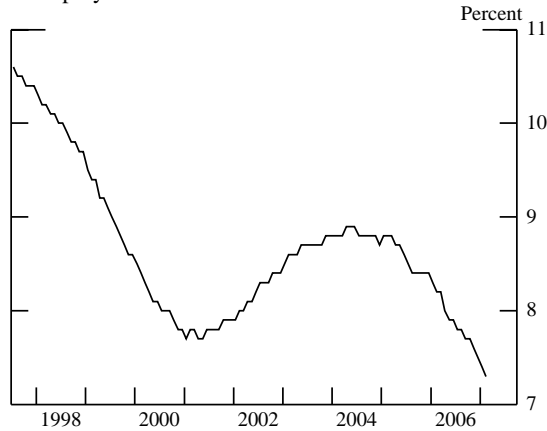
Nominal Exports and Imports



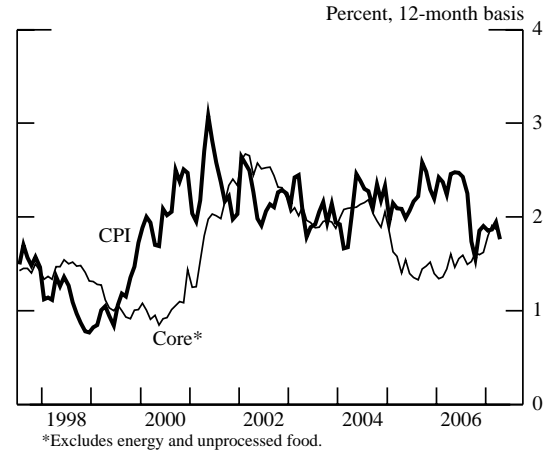
Economic Sentiment



Unemployment Rate



Consumer Price Inflation



**Economic Indicators**

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

Indicator	2006		2007	2006				2007		
	Q3	Q4	Q1	Dec.	Jan.	Feb.	Mar.			
Industrial production <sup>1</sup>	0.9	0.6	n.a.	1.2	-0.5	0.5	n.a.			
Retail sales volume <sup>2</sup>	0.6	0.4	n.a.	0.5	-0.8	0.3	n.a.			
New car registrations	-1.8	3.6	-2.2	1.1	-4.8	-0.7	4.5			
Employment	0.3	0.3	n.a.	...	...	...	...			
Producer prices <sup>3</sup>	5.4	4.1	n.a.	4.1	3.1	3.0	n.a.			
M3 <sup>3</sup>	8.4	9.8	10.9	9.8	9.9	10.0	10.9			

1. Excludes construction.

2. Excludes motor vehicles.

3. Eurostat harmonized definition. Percent change from year earlier, s.a.

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

The twelve-month rates of headline and core (excluding energy and unprocessed food) consumer price inflation have converged in recent months. The twelve-month rate of headline consumer price inflation edged down to 1.8 percent in April from 1.9 percent in March. While no details are available, the April slowdown is likely to be entirely attributable to base year effects. Although the euro-area unemployment rate declined to 7.2 percent in March, down more than a percentage point since the beginning of 2006, there is thus far little evidence that the improved labor market is causing significant wage pressure. Unit labor costs for the euro area fell over the second half of 2006, and ongoing negotiations in Germany suggest that wage growth will pick up only slightly from the modest pace registered over the past few years.

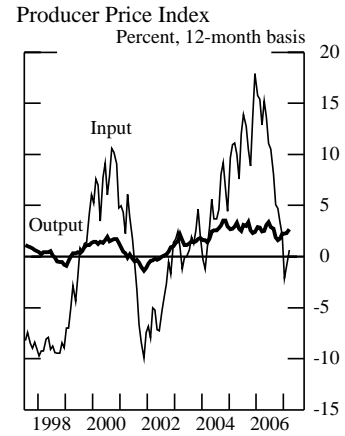
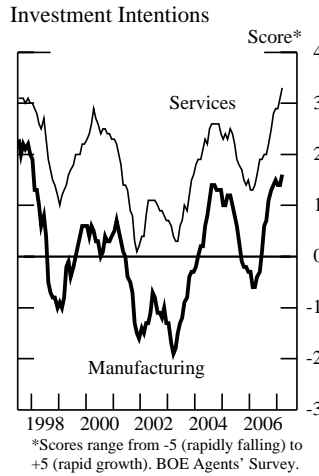
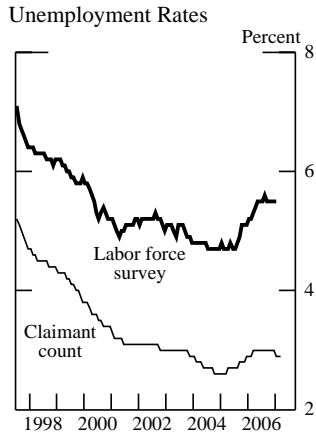
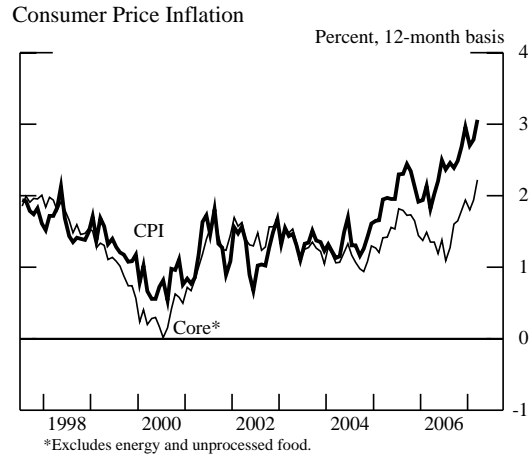
Headline inflation in the **United Kingdom** rose to 3.1 percent in March, its highest reading since inflation targeting was instituted in 1997. As mandated when inflation is more than a percentage point away from the official target of 2 percent, the Governor of the Bank of England wrote an open letter to the Chancellor of the Exchequer on April 16. In his letter, he indicated that around half of the pick up in inflation over the past year can be accounted for by unexpected sharp increases in domestic energy prices and a rise in food prices related to weather conditions. Although the Bank's central projection has inflation falling a little below target by the end of 2007, the Governor noted that capacity pressures had increased, and that monthly inflation has recently been volatile.

The preliminary estimate of GDP growth in the first quarter was 2.6 percent, quite close to the pace in the fourth quarter. GDP components for the first quarter are not yet available, but whereas consumption showed signs of having softened, investment activities most likely continued at a brisk pace. Retail sales grew 0.4 percent in the first quarter, well below their average of 1.3 percent over the previous three quarters. However, the Bank of England's survey of U.K. private businesses suggests that investment intentions in the service sector are at their highest since the survey began in 1997. Moreover, investment intentions in the manufacturing sector were at their highest since January 1998 despite the recent appreciation of sterling.

The labor market showed signs of softening as both employment and the participation rate fell slightly over the three months to February compared to a quarter earlier. The claimant count and Labor Force Survey measures of the unemployment rate were both unchanged. Average earnings rose 5.1 percent in the twelve months to February, their largest increase in two years. However, growth in average earnings excluding bonuses



**United Kingdom**



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

Indicator	2006		2007	2007			
	Q3	Q4	Q1	Jan.	Feb.	Mar.	Apr.
Real GDP	2.7	2.7	2.6	...	...	...	...
PMI Services <sup>1</sup>	57.2	59.9	58.1	59.2	57.4	57.6	n.a.
Average earnings <sup>2</sup>	4.0	4.0	n.a.	4.7	5.1	n.a.	n.a.
Business confidence	13.0	8.3	20.3	12.0	28.0	21.0	18.0
Consumer confidence	-6.0	-4.9	-6.2	-7.4	-6.2	-5.1	-6.6
Trade balance <sup>3</sup>	-23.8	-23.4	n.a.	-7.8	-8.4	n.a.	n.a.

1. 50+ indicates expansion. 2. Percent change from year earlier.  
3. Level in billions of US Dollars.  
n.a. Not available. ... Not applicable.

was more modest, at 3.6 percent, and unit labor costs in the manufacturing sector fell over the same period, indicating that wage inflation has so far remained contained.

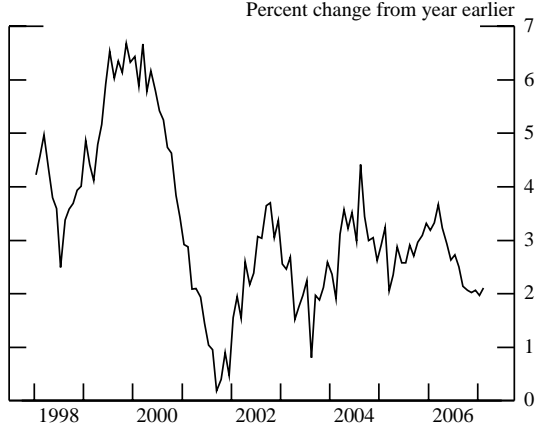
In **Canada**, the level of real GDP by industry averaged over January and February was 2.9 percent (a.r.) higher than in the fourth quarter. Goods-producing industries outpaced services, with the utilities and oil and gas extraction sectors leading the way. The average level of construction activity was also up compared to the fourth quarter. Services were held down by poor retail trade figures, consistent with a dip in real retail sales in both January and February. Overall business conditions remain strong. The Purchasing Managers Index and the composite index of leading indicators both rose sharply in the first quarter. The nominal merchandise trade balance averaged over January and February was up compared to the fourth quarter; in volume terms, average exports posted a healthy advance, while average imports declined about 1 percent.

The twelve-month rate of consumer price inflation rose sharply, hitting 2.2 percent in March. A surge in gasoline prices put upward pressure on consumer prices, as prices at the pump jumped nearly 13 percent between February and March and were up nearly 10 percent from a year earlier. The twelve-month rate of core inflation, which excludes the eight most volatile components and the effects of indirect taxes, ticked down to 2.3 percent in March despite continued upward pressure from housing costs. The twelve-month rate of new home price inflation remained elevated at 10 percent in February, down just slightly from previous months. House prices increases over the past year have been driven largely by the western provinces, especially the oil-producing province of Alberta, where twelve-month house price inflation is still 40 percent even after decelerating since the fall.

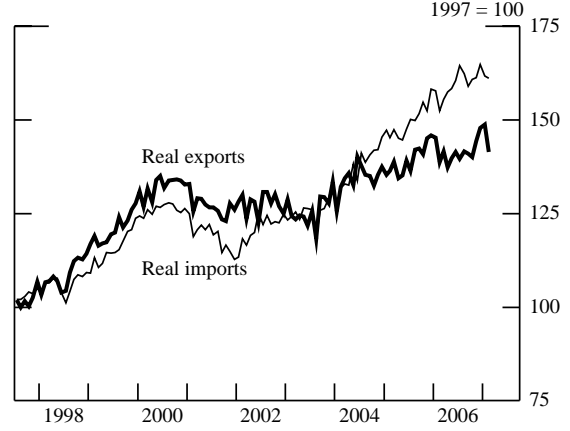
Employment continued to expand rapidly, growing 1 percent in the first quarter, the largest quarterly gain in nearly five years. Full-time employment growth has been especially strong, indicating that firms are confident that business conditions will remain buoyant for some time. The strong market has attracted more job seekers (the labor force rose 0.9 percent in the first quarter) and reduced the unemployment rate to a generational low. This may result in greater pressure on wages. Twelve-month wage growth of hourly manufacturing employees rose to 3 percent in January, although the wage growth for salaried employees remained steady at 2.4 percent.

**Canada**

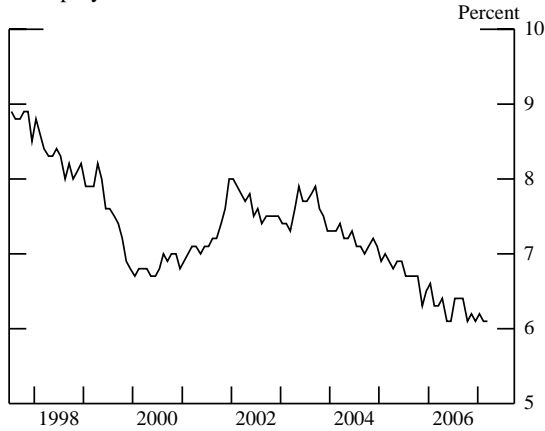
Real GDP by Industry



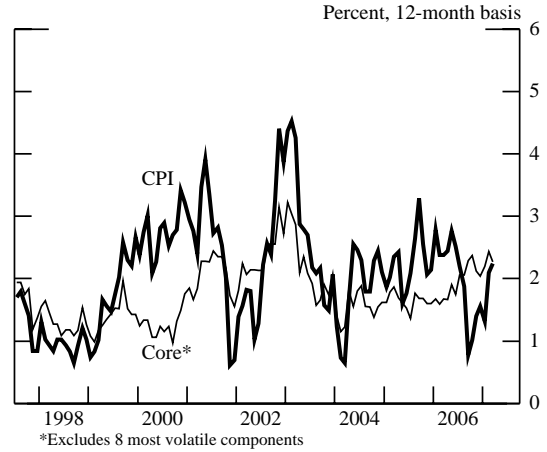
Real Trade



Unemployment Rate



Consumer Price Inflation



**Economic Indicators**

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

Indicator	2006		2007	2006	2007		
	Q3	Q4	Q1	Dec.	Jan.	Feb.	Mar.
Industrial production	-0.1	-1.1	n.a.	-0.1	0.0	1.3	n.a.
New manufacturing orders	0.8	1.0	n.a.	2.7	-2.1	1.9	n.a.
Retail sales	0.9	0.3	n.a.	2.0	-0.3	-0.7	n.a.
Employment	0.1	0.6	1.0	0.3	0.5	0.1	0.3
Consumer attitudes <sup>1</sup>	98.8	99.7	98.3	...	...	...	...
Business confidence <sup>1</sup>	135.6	148.1	139.9	...	...	...	...

1. 1991=100.  
n.a. Not available. ... Not applicable.

## **Economic Situation in Other Countries**

Economic activity in the emerging markets appears to have remained robust in the first quarter. In Asia, performance was supported by surging growth in China and continued strength, for the most part, elsewhere in the region. In Latin America, indicators point to further lackluster growth in Mexico and some weakening in Argentina, but in other countries, especially Brazil, conditions appear positive. Inflation has picked up in some countries, notably China and India, but appears generally well contained for the emerging market economies as a whole.

In **China**, activity accelerated significantly in the first quarter. Real GDP increased at a blistering pace of more than 13½ percent (a.r.) according to staff estimates, primarily supported by soaring investment and exports. Nominal growth of fixed asset investment picked up to 26 percent in the first quarter (four-quarter change) from just over 20 percent in the previous two quarters. The pace of investment is now back to the very high rate seen in the first half of 2006. A surge in exports in the first two months of the year led to a \$50 billion increase (a.r.) in the trade surplus in the first quarter, to \$264 billion (a.r.). The increase in exports was fairly broad-based and reflected the continued strength of global demand for Chinese goods, with some tentative indications that Europe and Latin America are accounting for a rising share of this demand. The surge in exports in January and February was in part due to an acceleration of shipments in anticipation of a curtailment of export rebates on the VAT for many goods. Indeed, export growth slumped in March when some of the export rebates were removed, narrowing the trade balance month-on-month.

Twelve-month consumer price inflation picked up a bit more in March, to about 3¼ percent. Much of the inflation stems from increases in food prices, which were up more than 7½ percent (twelve-month change) in March. Non-food price inflation remained in the neighborhood of 1 percent. Foreign exchange reserves surged \$140 billion in the first quarter to a level of more than \$1.2 trillion. At most, half of the surge can be accounted for by the change in the current account surplus and FDI inflows, suggesting that “hot money” inflows have picked up again. The increase in foreign currency reserves was mostly sterilized, and authorities raised benchmark interest rates in March by 27 basis points and continued to boost the required reserve ratio (by a total of 100 basis points in April). However, money growth remained above 17 percent year-over-year, still higher than desired by Chinese authorities.

**Chinese Economic Indicators**

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

Indicator	2005	2006	2006	2007			
			Q4	Q1	Jan.	Feb.	Mar.
Real GDP <sup>1</sup>	10.0	10.4	10.5	13.7	...	...	...
Industrial production	17.2	14.3	2.2	4.1	1.4	-3.6	11.2
Consumer prices <sup>2</sup>	1.6	2.8	2.1	2.8	2.1	3.0	3.2
Merch. trade balance <sup>3</sup>	102.0	177.4	214.8	264.0	217.3	470.3	104.4

1. Annual rate. Quarterly data estimated by staff from reported four-quarter growth rates. Annual data are Q4/Q4.

2. Percent change from year-earlier period, except annual data, which are Dec./Dec.

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

... Not applicable.

In **Hong Kong**, recent indicators for the first quarter suggest continued strength. The nominal merchandise trade deficit narrowed sharply. The expiration of export rebates in China may have contributed to the increase in Hong Kong's re-exports of Chinese goods this quarter. Separate data on the quantity of exports for January and February suggest that net exports may make a positive contribution to growth in the first quarter. Twelve-month inflation fell in February, reflecting a one-month holiday on public housing rent, but picked up again in March.

**Hong Kong Economic Indicators**

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

Indicator	2005	2006	2006	2007			
			Q4	Q1	Jan.	Feb.	Mar.
Real GDP <sup>1</sup>	7.8	6.9	5.3	n.a.	...	...	...
Unemployment rate <sup>2</sup>	5.7	4.8	4.4	4.3	4.4	4.3	4.3
Consumer prices <sup>3</sup>	1.4	2.3	2.1	1.7	2.5	.3	2.4
Merch. trade balance <sup>4</sup>	-10.5	-17.9	-22.8	-13.0	-25.4	-2.9	-10.6

1. Annual rate. Annual data are Q4/Q4.

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

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

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

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

In **Taiwan**, indicators point to some moderation. Industrial production fell again in the first quarter, with reductions in key sectors such as electronics and precision equipment. The merchandise trade surplus narrowed, and export orders for electronic products declined in the first quarter. After turning negative at the end of last year, four-quarter consumer price inflation picked up to 1 percent in the first quarter. In late March, the Taiwanese central bank raised its discount rate 12.5 basis points.

### Taiwan Economic Indicators

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

Indicator	2005	2006	2006	2007			
			Q4	Q1	Jan.	Feb.	Mar.
Real GDP <sup>1</sup>	6.4	4.0	4.6	n.a.	...	...	...
Unemployment rate <sup>2</sup>	4.1	3.9	3.9	3.9	3.9	3.9	3.9
Industrial production	4.6	5.0	-1.3	-1.1	.9	-3.6	4.6
Consumer prices <sup>3</sup>	2.2	.7	-.1	1.0	.3	1.7	.8
Merch. trade balance <sup>4</sup>	7.8	11.6	16.8	9.4	-2.7	14.1	16.9
Current account <sup>5</sup>	16.0	25.2	34.0	n.a.	...	...	...

1. Annual rate. Annual data are Q4/Q4.

2. Percent.

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

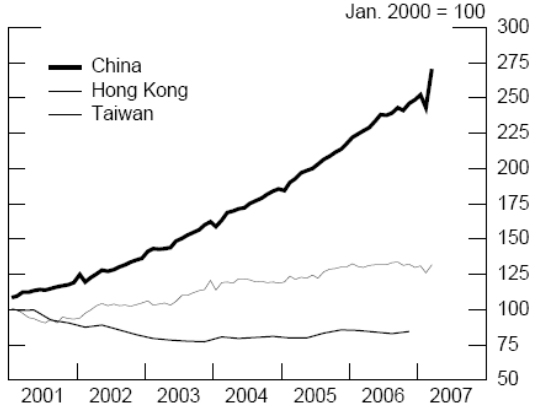
4. Billions of U.S. dollars, annual rate. Imports are c.i.f.

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

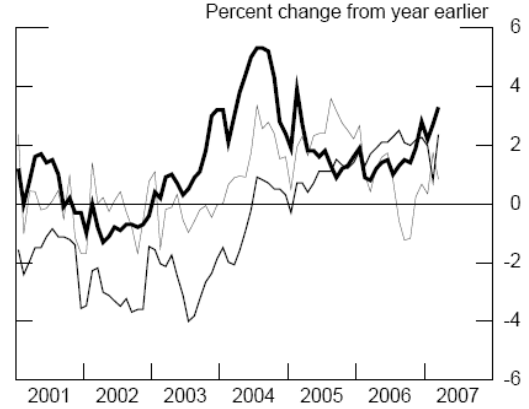
n.a. Not available. ... Not applicable.

**China, Hong Kong, and Taiwan**

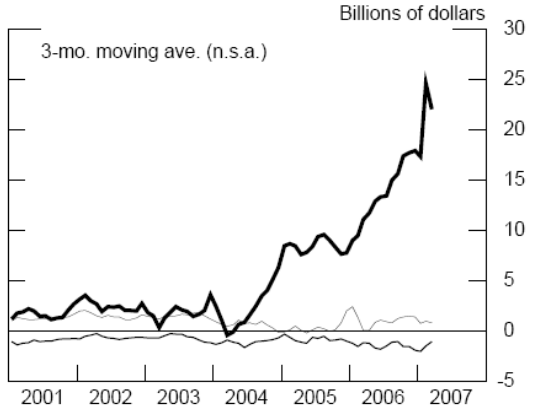
**Industrial Production**



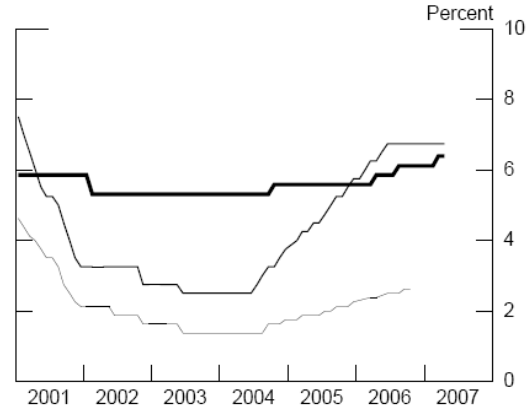
**Consumer Prices**



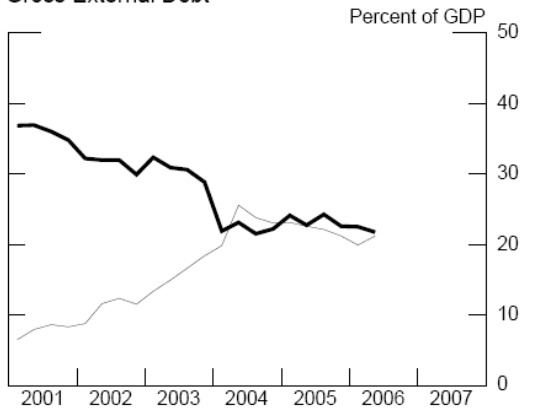
**Merchandise Trade Balances**



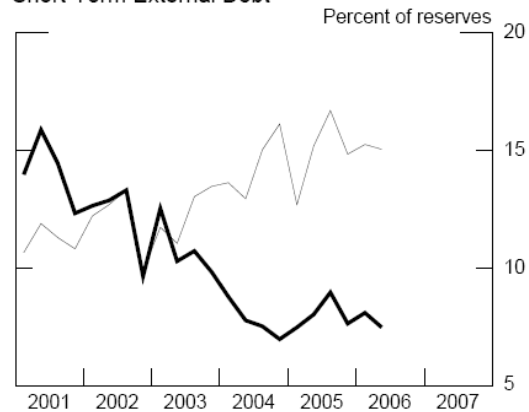
**Benchmark Interest Rates**



**Gross External Debt**



**Short-Term External Debt**



In **Korea**, first-quarter GDP growth was 3.6 percent, just a touch below that in the fourth quarter. Domestic demand showed considerable strength, with both private consumption and business investment rising sharply. Export growth was also robust but was outweighed by outsized gains in non-oil imports, especially capital goods. Strong imports of services helped generate a current account deficit in the first quarter. The most recent production and spending indicators suggest continued moderate gains in output. The unemployment rate edged down to 3.2 percent in the first quarter; and twelve-month consumer price inflation ticked up to 2.5 percent in April, but remains low relative to the Bank of Korea's 2.5 percent to 3.5 percent target range. In early April, Korean and U.S. negotiators concluded a bilateral free trade agreement. If ratified by the legislatures of both countries, market participants expect the agreement to help support Korean growth over the longer term.

### Korean Economic Indicators

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

Indicator	2005	2006	2006	2007			
			Q4	Q1	Feb.	Mar.	Apr.
Real GDP <sup>1</sup>	5.7	4.0	3.8	3.6	...	...	...
Industrial production	5.8	10.8	2.7	-6	.3	-.4	n.a.
Unemployment rate <sup>2</sup>	3.7	3.4	3.4	3.2	3.2	3.2	n.a.
Consumer prices <sup>3</sup>	2.6	2.1	2.1	2.0	2.2	2.2	2.5
Merch. trade balance <sup>4</sup>	32.7	29.2	37.9	30.1	38.5	33.6	n.a.
Current account <sup>5</sup>	15.0	6.1	24.6	-6.1	4.8	-17.9	n.a.

1. Annual rate. Annual data are Q4/Q4.

2. Percent.

3. Percent change from year-earlier period, except annual data, 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.

**Indian** economic indicators have remained robust. On average, industrial production was up nearly 2 percent in January and February from the previous quarter. The trade deficit narrowed in the first quarter as exports increased slightly and imports fell. Inflation remains a concern, with the most recent twelve-month changes of the closely watched wholesale price index and the CPI near or above 6 percent. At its April meeting, the Reserve Bank of India left interest rates unchanged, after tightening in earlier months, but announced its resolve to “condition policy and perceptions for inflation in the range of 4 to 4½ percent over the medium term” compared to its previous “comfort range” for wholesale price inflation of 5 to 5½ percent. The RBI also announced a series of measures to encourage capital outflows (e.g. raising the cap on overseas investment by



Indian companies) and discourage capital inflows (e.g. reducing interest rates on non-resident Indian deposits at Indian banks.)

### Indian Economic Indicators

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

Indicator	2005	2006	2006	2007			
			Q4	Q1	Jan.	Feb.	Mar.
Real GDP <sup>1</sup>	9.3	8.6	8.6	n.a.	...	...	...
Industrial production	7.9	10.5	1.8	n.a.	1.4	-5	n.a.
Consumer prices <sup>2</sup>	5.6	6.5	6.5	6.1	5.8	6.6	5.8
Wholesale prices <sup>2</sup>	4.4	5.7	5.6	6.4	6.4	6.3	6.5
Merch. trade balance <sup>3</sup>	-40.1	-52.5	-70.5	-64.3	-66.9	-69.3	-56.6
Current account <sup>4</sup>	-7.8	-9.1	-12.2	n.a.	...	...	...

1. Annual rate. Annual data are Q4/Q4.

2. Percent change from year-earlier period, except annual data, which are Dec./Dec.

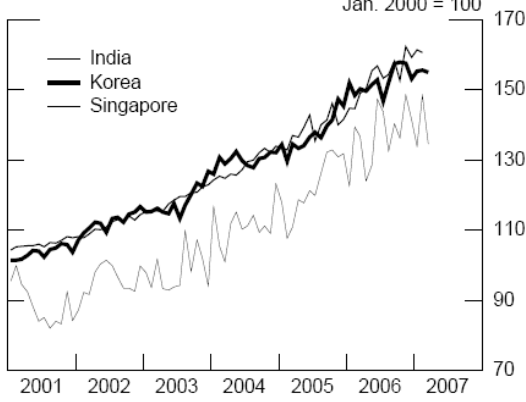
3. Billions of U.S. dollars, annual rate.

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

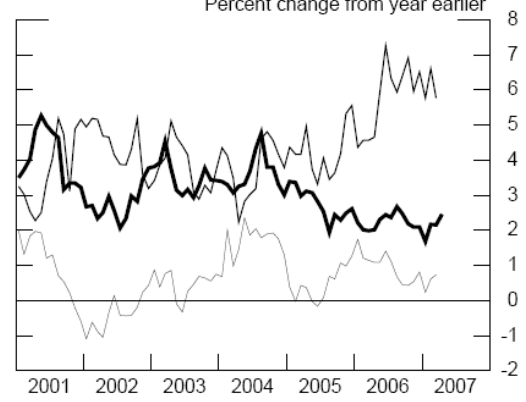
n.a. Not available. ... Not applicable.

### India, Korea, and Singapore

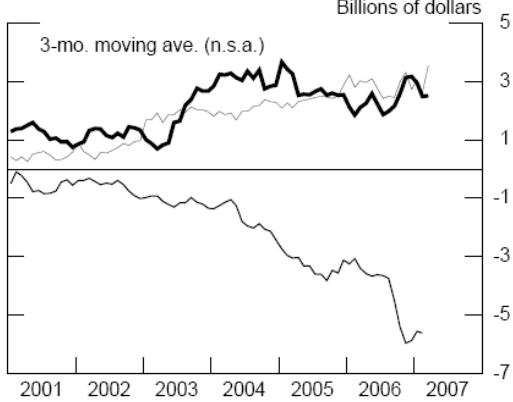
Industrial Production



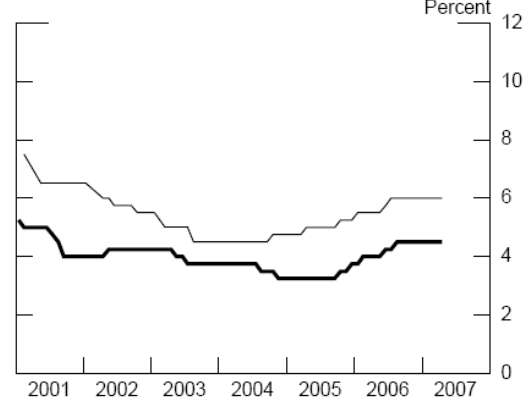
Consumer Prices



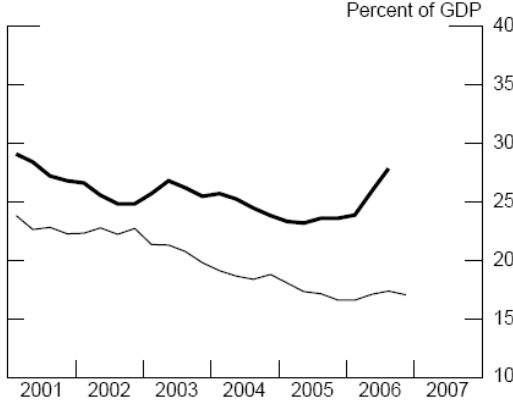
Merchandise Trade Balances



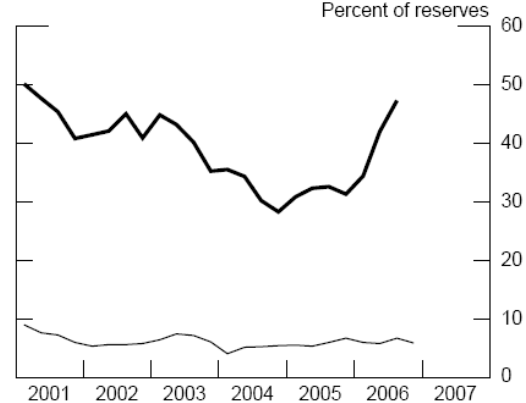
Benchmark Interest Rates



Gross External Debt



Short-Term External Debt



Economic indicators in the **ASEAN** region, on balance, suggest continued expansion in the first quarter. In Singapore, the advance unofficial estimate (not shown) indicates that first-quarter real GDP rose 7 percent, despite weaker industrial production, as domestic demand, notably construction and services, supported activity. Industrial production recovered in Thailand, but was generally down elsewhere in the region so far in the first quarter. On the other hand, regional trade balances have remained strong in recent months.

Outside of Indonesia and Singapore, twelve-month consumer price inflation across the region continued to decline, owing to more subdued energy price inflation, and in some countries, the unwinding of previous food prices increases and appreciation of the exchange rate. In the Philippines and Malaysia, in particular, inflation dipped as the effects of last year's VAT increase in the Philippines and the reduction in domestic fuel subsidies in Malaysia fell out of the calculations. Citing the moderation in inflation and the need to stimulate domestic demand, Bank of Thailand cut interest rates  $\frac{1}{2}$  percentage point in early April following two previous  $\frac{1}{4}$  percentage point cuts in January and February.

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

Indicator	2005	2006	2006	2007			
			Q4	Q1	Jan.	Feb.	Mar.
<i>Real GDP<sup>1</sup></i>							
Indonesia	4.9	6.0	7.1	n.a.	...	...	...
Malaysia	5.2	5.7	4.8	n.a.	...	...	...
Philippines	5.5	4.8	3.4	n.a.	...	...	...
Singapore	8.2	6.5	7.9	n.a.	...	...	...
Thailand	4.4	4.2	2.7	n.a.	...	...	...
<i>Industrial production<sup>2</sup></i>							
Indonesia <sup>3</sup>	1.3	-2.3	1.8	n.a.	-3.9	-8.3	n.a.
Malaysia	4.0	5.2	.0	n.a.	-2.3	-3.0	n.a.
Philippines	2.2	-9.9	.0	n.a.	-3.2	-8.9	n.a.
Singapore	9.5	11.9	2.3	-2.2	-5.3	10.8	-9.3
Thailand	9.1	7.4	.2	2.1	2.0	.2	.0

1. Annual rate. Annual data are Q4/Q4.

2. Annual data are annual averages.

3. Staff estimate.

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

**ASEAN Economic Indicators: Merchandise Trade Balance**  
(Billions of U.S. dollars, s.a.a.r.)

Indicator	2005	2006	2006	2007			
			Q4	Q1	Jan.	Feb.	Mar.
Indonesia	28.0	39.7	44.4	45.2	35.4	48.9	51.2
Malaysia	26.4	29.5	31.5	n.a.	26.9	29.6	n.a.
Philippines	-6.2	-4.5	-8.2	n.a.	5.6	-1.8	n.a.
Singapore	29.6	33.1	32.7	42.3	58.8	23.4	44.5
Thailand	-8.5	2.2	5.4	18.3	19.0	8.1	27.9

n.a. Not available.

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

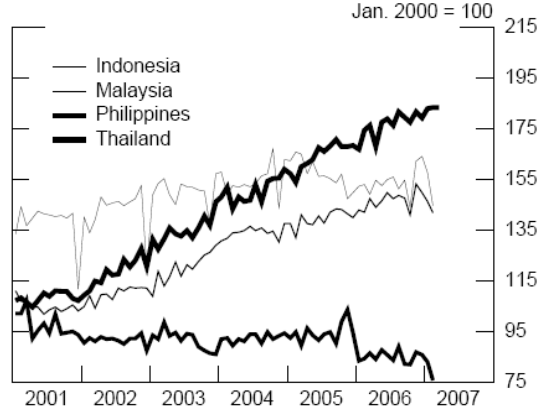
Indicator	2005 <sup>1</sup>	2006 <sup>1</sup>	2006	2007			
			Q4	Q1	Feb.	Mar.	Apr.
Indonesia	17.0	6.7	6.1	6.3	6.3	6.4	6.3
Malaysia	3.3	3.1	3.0	2.6	3.1	1.5	n.a.
Philippines	6.7	4.3	4.8	2.9	2.6	2.2	n.a.
Singapore	1.3	.8	.6	.5	.6	.7	n.a.
Thailand	5.8	3.5	3.3	2.5	2.3	2.0	1.8

1. Dec./Dec.

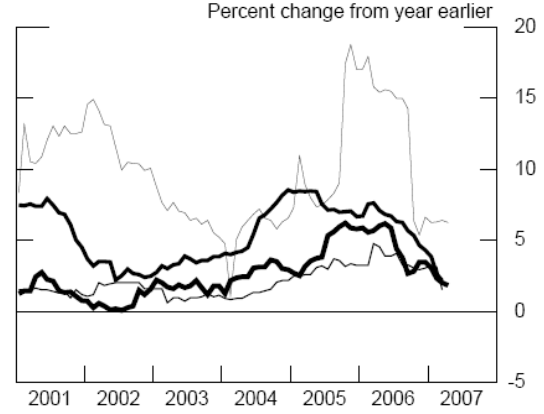
n.a. Not available.

**ASEAN-4**

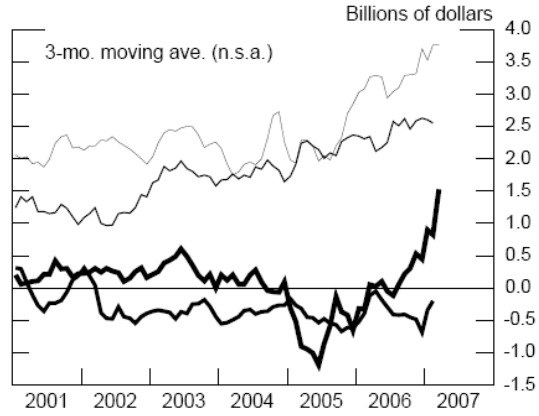
**Industrial Production**



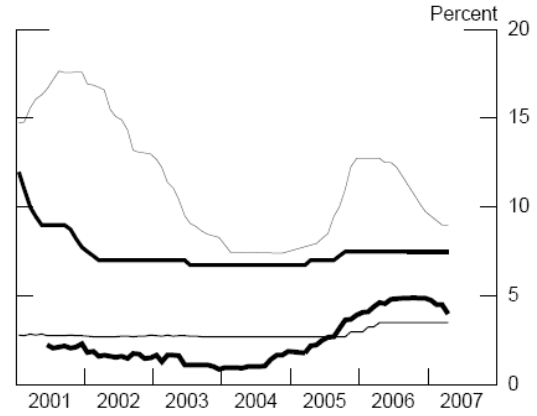
**Consumer Prices**



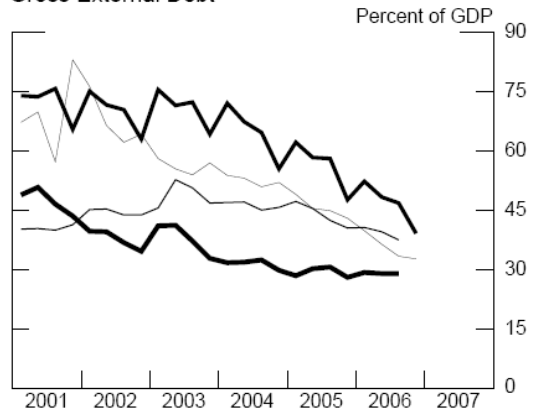
**Merchandise Trade Balances**



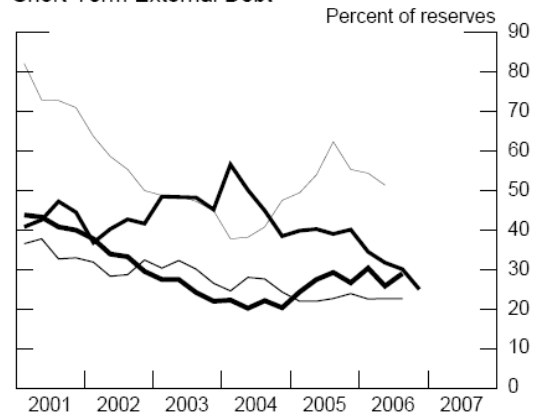
**Benchmark Interest Rates**



**Gross External Debt**



**Short-Term External Debt**



Recent indicators for **Mexico** point to further weakness in economic activity. Both industrial production and the overall index of economic activity fell in January, as soft performances in manufacturing, mining, and agriculture overwhelmed strength in the construction industry and the utilities sectors. In February, industrial production declined further as weakness continued in manufacturing, particularly automobiles, but also spread to construction, a previous source of strength.

Twelve-month headline inflation was 4.2 percent in March, the seventh consecutive month of inflation at or slightly above the upper limit of the central bank's 2 to 4 percent inflation target range. The Bank of Mexico (BOM) tightened policy in its late-April meeting, with the overnight lending rate rising  $\frac{1}{4}$  percentage point to 7.25 percent. The Bank cited the need to prevent previous food price increases from spreading to other sectors. Analysts had expected that the BOM would leave monetary policy unchanged, as incoming data from the first half of April suggested inflation was beginning to recede. This was the first time the BOM had tightened policy since March 2005.

### Mexican Economic Indicators

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

Indicator	2005	2006	2006	2007			
			Q4	Q1	Jan.	Feb.	Mar.
Real GDP <sup>1</sup>	2.5	4.3	1.9	n.a.	...	...	...
Overall economic activity	3.1	4.9	.7	n.a.	-.1	.2	n.a.
Industrial production	2.0	5.1	.1	n.a.	-.7	-.5	n.a.
Unemployment rate <sup>2</sup>	3.6	3.6	3.9	3.9	3.8	3.9	4.0
Consumer prices <sup>3</sup>	3.3	4.1	4.1	4.1	4.0	4.1	4.2
Merch. trade balance <sup>4</sup>	-7.6	-6.1	-8.5	-13.0	-16.7	-11.3	-10.9
Merchandise imports <sup>4</sup>	221.8	256.1	260.2	263.9	263.8	264.6	263.1
Merchandise exports <sup>4</sup>	214.2	250.0	251.7	250.9	247.1	253.3	252.2
Current account <sup>5</sup>	-4.8	-1.7	-8.6	n.a.	...	...	...

1. Annual rate. Annual data 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 data, which are Dec./Dec.

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

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

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

In **Brazil**, data released since the last Greenbook provided some signs that economic expansion in the first quarter continued. Industrial production in February did not recover fully from its January decline, but capital goods imports in March rose further. Retail sales in February were solid. Twelve-month inflation has been about 3 percent,

well below the 4½ percent mid-point of the target range for this year and next. On April 18, the central bank reduced its policy rate, the Selic Rate, ¼ percentage point to 12.5 percent, with three of the seven members having voted for a ½ percentage point decline.

In late March, the government released a benchmark revision of national income and product accounts. Real GDP growth from 2000 to 2005 was revised up ¾ percentage point per year. For 2006, the revision was 1 percentage point, bringing real GDP growth last year to 4.7 percent (Q4/Q4). On the production side, the major revision was an increase to services output. In terms of demand components, private consumption was revised up, but fixed investment was lowered a result of less investment in structures. The upward revision to GDP also lowered the net debt-GDP ratio to 45 percent from 50 percent previously.

### Brazilian Economic Indicators

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

Indicator	2005	2006	2006	2007			
			Q4	Q1	Feb.	Mar.	Apr.
Real GDP <sup>1</sup>	3.1	4.7	3.7	n.a.	...	...	...
Industrial production	3.1	2.8	.9	n.a.	.3	n.a.	n.a.
Unemployment rate <sup>2</sup>	9.8	10.0	9.6	9.7	9.7	9.5	n.a.
Consumer prices <sup>3</sup>	5.7	3.1	3.1	3.0	3.0	3.0	n.a.
Merch. trade balance <sup>4</sup>	44.8	46.1	50.8	40.4	43.7	33.1	56.9
Current account <sup>5</sup>	14.0	13.3	13.0	6.8	6.9	9.8	n.a.

1. Annual rate. Annual data are Q4/Q4.

2. Percent.

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

Price index is IPCA.

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 indicators for **Argentina** suggest economic growth moderated in the first quarter. Industrial production grew just 0.3 percent in Q1, a sharp deceleration from the previous quarter's performance. The index of economic activity, a monthly proxy of GDP, also indicates that output growth weakened through February. In addition, the merchandise trade surplus narrowed a bit in the first quarter. Labor market conditions, at least for the fourth quarter, appear favorable, with the unemployment rate (n.s.a.) dipping into the single digits for the first time since well before the crisis. Twelve-month inflation edged

down in March, reflecting more subdued increases in the prices for food, clothing, and education.

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

Indicator	2005	2006	2006	2007			
			Q4	Q1	Jan.	Feb.	Mar.
Real GDP <sup>1</sup>	8.9	8.6	7.5	n.a.	...	...	...
Industrial production	8.0	8.3	2.7	.3	-2.5	2.9	.2
Unemployment rate <sup>2</sup>	11.6	10.2	8.7	n.a.	...	...	...
Consumer prices <sup>3</sup>	12.2	9.8	10.1	9.4	9.6	9.6	9.1
Merch. trade balance <sup>4</sup>	11.7	12.3	13.1	7.3	5.7	9.2	8.8
Current account <sup>5</sup>	5.6	8.1	10.2	n.a.	...	...	...

1. Annual rate. Annual data are Q4/Q4.

2. Percent; n.s.a.

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

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

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

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

In **Venezuela**, the few available indicators for the first quarter suggest continued growth and high inflation. March auto sales were very strong and twelve-month CPI inflation was close to 20 percent in April. The Chavez government further increased its control over the oil sector in early May, when foreign oil companies ceded operational control of heavy-oil projects, as previously agreed. Companies must come to agreement with the government on the terms of the takeover by late June. The government has stated that some companies might not be compensated and any compensation will be at most the book value of the projects and not in cash. President Chavez also announced this week that Venezuela will withdraw its membership in the IMF and World Bank.

In April, the government petroleum company (PDVSA) issued \$7.5 billion of dollar-denominated bonds to local investors in exchange for bolivares. The sale was widely interpreted as an attempt to relieve some of the strong downward pressure on the bolivar. The bolivar has been pegged at about 2,150 per dollar since 2005 but, before the issue was announced, was trading in the parallel market at about 4,000 per dollar. The demand for bonds far exceeded the supply at the government's price, leading some investors to resell their bonds on the parallel market for dollars at a profit. (The parallel market exchange rate on May 1 stood at over 3,700 bolivares/dollar.)



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

Indicator	2005	2006	2006	2007			
			Q4	Q1	Feb.	Mar.	Apr.
Real GDP <sup>1</sup>	10.9	11.8	16.0	n.a.	...	...	...
Unemployment rate <sup>2</sup>	12.2	10.0	9.7	9.8	10.3	9.5	n.a.
Consumer prices <sup>3</sup>	14.4	17.0	16.1	19.1	20.4	18.5	19.4
Non-oil trade balance <sup>4</sup>	-16.3	-25.5	n.a.	n.a.	n.a.	n.a.	n.a.
Merch. trade balance <sup>4</sup>	31.8	33.0	n.a.	n.a.	n.a.	n.a.	n.a.
Current account <sup>5</sup>	25.5	27.2	17.0	n.a.	...	...	...

1. Annual rate. Annual data are Q4/Q4.

2. Percent.

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

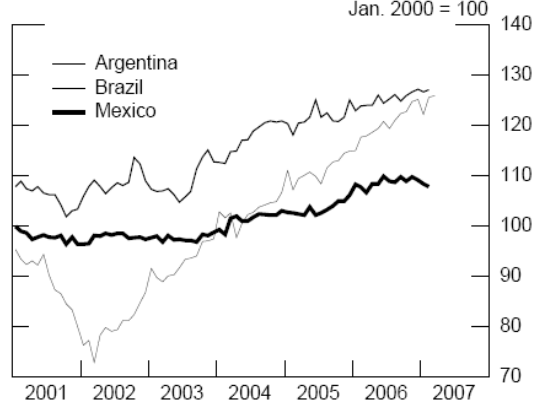
4. Billions of U.S. dollars, annual rate.

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

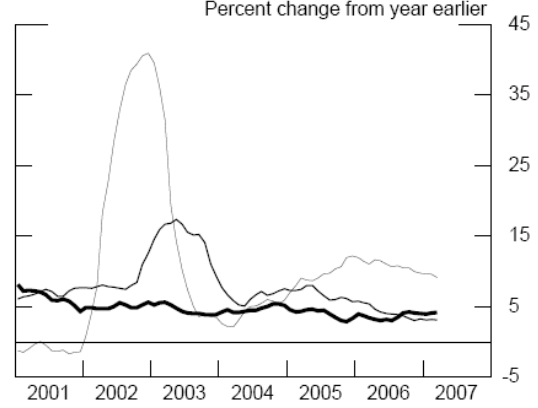
n.a. Not available. ... Not applicable.

Latin America

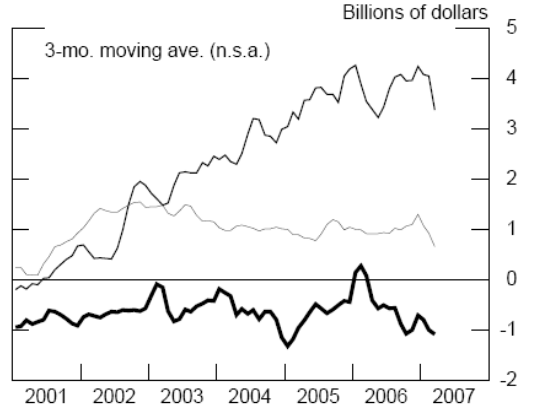
Industrial Production



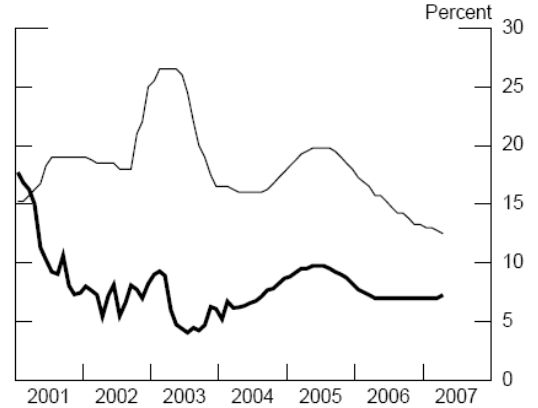
Consumer Prices



Merchandise Trade Balances



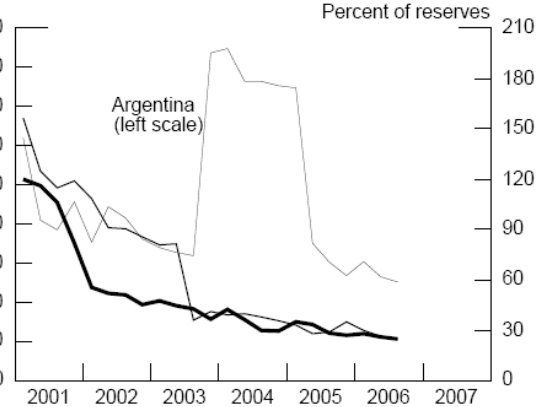
Benchmark Interest Rates



Gross External Debt



Short-Term External Debt



In **Turkey**, economic activity continued to moderate, with GDP rising 5.2 percent over the four quarters of last year, sustained by strong domestic demand. More recently, average industrial production in January and February rose 0.6 percent from the previous quarter. Large trade and current account deficits persisted in the first quarter. Despite real interest rates of over 10 percent, consumer price inflation has risen recently, driven by double-digit increases in food and energy prices.

Political tensions mounted between the Islamist and the secular parties at the start of the presidential election cycle. In late April, Prime Minister Erdogan, of the Islamist AK party, unexpectedly declined the Presidential nomination and named Foreign Minister Abdullah Gul, subject to parliamentary approval. Gul failed to garner the necessary two-thirds support, due to boycotts by the secular opposition. As a result, the Prime Minister has called for full parliamentary elections in late June. Separately, the Turkish military issued a statement warning the government to continue the secular tradition in governance. The EU responded negatively to military involvement in Turkey's domestic politics, but was supportive of early elections.

### Turkey Economic Indicators

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

Indicator	2005	2006	2006	2007			
			Q4	Q1	Jan.	Feb.	Mar.
Real GDP <sup>1</sup>	7.4	6.1	5.2	n.a.	...	...	...
Industrial production	5.4	5.9	3.0	n.a.	-7	6.3	n.a.
Consumer prices <sup>2</sup>	7.7	9.7	9.8	10.3	9.9	10.2	10.9
Merch. Trade balance <sup>3</sup>	-43.3	-52.7	-48.5	-53.7	-60.4	-54.6	-46.1
Current account <sup>4</sup>	-22.6	-31.6	-28.2	n.a.	-41.0	-30.7	n.a.
Unemployment rate	10.2	9.8	9.5	n.a.	...	...	...

1. Percent change from year-earlier period. Annual data are annual averages.

2. Percent change from year-earlier period, except annual data, which are Dec./Dec.

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

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

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

In **South Africa**, recent indicators point to continued growth. Average manufacturing production in January and February was up 1.3 percent from the fourth quarter. The current account deficit rose to 6.4 percent of GDP in 2006. In the first quarter, however, the merchandise trade deficit contracted, as purchases of foreign capital goods cooled and exports increased across all categories. Twelve-month consumer prices rose to 5.5 percent in March, nearing the ceiling of the South African Reserve Banks'

3 to 6 percent target range. A fuel price hike in March offset the effects of downward trending food prices.

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

Indicator	2005	2006	2006	2007			
			Q4	Q1	Jan.	Feb.	Mar.
Real GDP <sup>1</sup>	4.9	5.2	5.6	n.a.	...	...	...
Manuf. Production	3.6	4.8	1.9	n.a.	-.4	.3	n.a.
Mining Production	1.3	-1.3	5.1	n.a.	-5.1	3.0	n.a.
Consumer Prices <sup>2</sup>	3.9	4.6	5.0	5.2	5.3	4.9	5.5
Merch. trade Balance <sup>3</sup>	-2.9	-9.4	-13.2	-9.9	-15.8	-7.2	-6.8
Current Account <sup>4</sup>	-9.1	-16.3	-19.3	n.a.	...	...	...

1. Annual Rate. Annual data are Q4/Q4.

2. Percent change from year-earlier period for the CPIX, except annual data, which are Dec./Dec. CPIX excludes interest rates on mortgage bonds.

3. Billions of U.S. dollars, s.a.a.r.

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

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