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August 9, 2002

# CURRENT ECONOMIC AND FINANCIAL CONDITIONS

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## **Supplemental Notes**

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

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## Supplemental Notes

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### The Domestic Nonfinancial Economy

#### Productivity and Costs

Output per hour in the nonfarm business sector increased at an annual rate of 1.1 percent in the second quarter, reflecting a 0.5 percent gain in output and a 0.7 percent decline in the hours worked of all persons. Productivity is estimated to have advanced 4.7 percent over the four quarters ending in the second quarter, up sharply from the 0.2 percent increase over the previous four quarters. After incorporating more recent data on both output and hours, we currently expect that the second-quarter increase in productivity will be revised up to 1.4 percent.<sup>1</sup>

As noted in Part 2 of the Greenbook, this report incorporated the annual revisions to the National Income and Product Accounts, the annual benchmark and other revisions to employment, and updated seasonal factors for hours. The resulting revisions were largely in line with our expectations.

Compensation per hour in the nonfarm business sector rose at an annual rate of 3.6 percent in the second quarter, after an upward-revised 3.6 percent increase in the first quarter. Unit labor costs in the second quarter of this year rose at a 2.4 percent rate, following a 4.6 percent rate of decline in the first quarter. The productivity and cost measure of hourly compensation has decelerated sharply over the last two years—to just 2.4 percent over the four quarters ending in the second quarter of this year from a peak of almost 8 percent in the third quarter of 2000. We believe that part of that slowing can be attributed to a falloff in stock-option exercises.

#### Producer Prices

The producer price index for finished goods declined 0.2 percent in July. Excluding food and energy, the finished goods PPI fell 0.3 percent, leaving the core PPI 0.2 percent below its level a year earlier; last July's twelve-month increase was 1.6 percent.

Prices of wholesale foods ticked down 0.1 percent last month, as large price swings for several categories of foodstuffs were offsetting. The PPI for energy also was little changed again in July. Gasoline prices rose 2.2 percent, following June's 1 percent rise, while prices for fuel oil jumped 6 percent, offsetting a similar-sized drop in the previous month. In contrast, prices for natural gas and electricity both moved lower. In all, wholesale energy prices

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1. The published estimates were based on output data as of the advance estimate of real GDP and did not incorporate the revisions to hours that were included in the labor market report for July.

**Labor Productivity and Costs**  
(Based on seasonally adjusted data)

Item	2000 <sup>1</sup>	2001 <sup>1</sup>	2001		2002		2001:Q2 to 2002:Q2
			Q3	Q4	Q1	Q2 <sup>P</sup>	
<b>Output per hour</b>							
Total business	2.4	1.9	1.8	7.6	8.3	1.4	4.7
Nonfarm business	2.1	1.9	2.1	7.3	8.6	1.1	4.7
Manufacturing	2.9	1.3	2.9	3.8	9.7	4.9	5.3
Nonfinancial corporations <sup>2</sup>	1.8	3.3	3.2	10.8	5.1	n.a.	n.a.
<b>Compensation per hour</b>							
Total business	7.3	1.5	0.9	1.4	3.8	3.9	2.5
Nonfarm business	7.2	1.4	1.0	1.5	3.6	3.6	2.4
Manufacturing	5.9	2.1	1.0	2.9	6.9	3.0	3.4
Nonfinancial corporations <sup>2</sup>	7.3	1.4	2.5	2.7	4.1	n.a.	n.a.
<b>Unit labor costs</b>							
Total business	4.9	-0.4	-0.9	-5.8	-4.2	2.4	-2.2
Nonfarm business	4.9	-0.5	-1.1	-5.4	-4.6	2.4	-2.2
Manufacturing	2.9	0.8	-1.9	-0.9	-2.6	-1.8	-1.8
Nonfinancial corporations <sup>2</sup>	5.4	-1.8	-0.7	-7.3	-0.9	n.a.	n.a.

NOTE: Percent change from preceding period at compound annual rate.

1. Changes are from fourth quarter of preceding year to fourth quarter of year shown.

2. The nonfinancial corporate sector includes all corporations doing business in the United States with the exception of banks, stock and commodity brokers, finance and insurance companies; the sector accounts for about two-thirds of business employment.

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declined 5-1/4 percent over the year ending in July, compared with a year-earlier decline of 1-3/4 percent.

The PPI for core consumer goods dropped 0.4 percent in July, following a 0.3 percent increase in June. Last month's decline in core consumer prices was led by a 1-1/2 percent drop in prices of cars and light trucks, which partly reflected an increase in buyer incentives. Car prices were down 3 percent from a year earlier, while light truck prices were down more than 4 percent. Elsewhere, apparel prices declined 0.4 percent, partly reversing June's 0.5 percent increase. Overall, the PPI for core consumer goods has decelerated 2 percentage points over the past year, and the July twelve-month increase in this series stood at 0.2 percent.

Prices for capital equipment fell 0.4 percent in July. In addition to the decline in car and light truck prices, July saw a decline of 1 percent in prices for communications equipment and a 3.8 percent drop in computer prices. With July's decline, computer prices have fallen 26 percent from a year earlier, compared with a decline of 21 percent over the preceding year.

At earlier stages of processing, prices for core intermediate goods rose 0.2 percent last month, but remain 0.3 percent lower than their year-earlier level. Prices for core crude materials rose 1.7 percent in July; these prices started to increase around the beginning of this year, and are now nearly 7 percent higher than they were a year earlier.

**Producer Price Indexes**  
(Percent)

	<u>From 12 months earlier</u>		<u>From 3 months earlier</u>		<u>2002</u>	
	July 2001	July 2002	April 2002	July 2002	June	July
Total finished goods	1.4	-1.1	4.1	-2.0	0.1	-0.2
Food	2.8	-1.3	-6.3	-0.6	0.1	-0.1
Energy	-1.7	-5.2	40.8	-8.6	0.0	0.1
Excluding food and energy	1.6	-0.2	0.5	-0.5	0.2	-0.3
Excluding tobacco	0.9	-0.5	-0.3	-0.6	0.2	-0.4
Core consumer goods	2.2	0.2	1.3	-0.5	0.3	-0.4
Excluding tobacco	1.1	-0.2	-0.1	-0.6	0.3	-0.4
Capital equipment	0.8	-0.8	-0.6	-1.1	0.1	-0.4
Intermediate materials	-0.2	-1.5	7.9	-0.6	0.2	0.2
Excluding food and energy	-0.5	-0.3	2.4	1.8	0.2	0.2
Crude materials	-7.3	-6.2	35.1	-5.5	-3.6	0.6
Excluding food and energy	-9.2	6.9	16.5	30.1	1.6	1.7

### Commercial Bank Credit

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

Type of credit	2001	Q1 2002	Q2 2002	May 2002	June 2002	July 2002	Level, July 2002 (\$ billions)
<b>Total</b>							
1. Adjusted <sup>1</sup>	4.2	1.1	5.2	9.4	5.5	6.6	5,418
2. Reported	5.1	-1.4	5.4	12.6	9.8	11.0	5,599
<i>Securities</i>							
3. Adjusted <sup>1</sup>	9.4	7.7	13.7	16.1	5.7	9.6	1,411
4. Reported	12.5	-2.1	13.7	27.4	21.2	25.0	1,591
5. Treasury & Agency	5.3	.7	24.2	30.8	16.8	10.9	907
6. Other <sup>2</sup>	23.0	-5.7	.2	22.6	27.3	44.2	684
<i>Loans<sup>3</sup></i>							
7. Total	2.5	-1.2	2.4	7.0	5.4	5.6	4,008
8. Business	-3.6	-6.1	-8.1	-5.7	-7.9	-15.0	988
9. Real estate	7.1	3.9	6.7	15.0	14.7	19.4	1,870
10. Home equity	19.9	25.6	39.6	50.2	41.5	44.7	192
11. Other	6.1	1.9	3.4	11.2	11.7	16.6	1,677
12. Consumer	3.8	4.9	4.8	5.9	-1.3	-4.4	567
13. Adjusted <sup>4</sup>	7.4	4.8	4.1	11.6	3.7	-2.5	919
14. Other <sup>5</sup>	-.1	-13.4	5.3	5.8	6.0	6.8	584

Note. All data are adjusted for breaks caused by reclassifications. Monthly levels are pro rata averages of weekly (Wednesday) levels. Quarterly levels (not shown) are simple averages of monthly levels. Annual levels (not shown) are levels for the fourth quarter. Growth rates are percentage changes in consecutive levels, annualized but not compounded. The conversion from a thrift to a commercial bank charter added approximately \$37 billion to the assets and liabilities of domestically chartered commercial banks in the week ending May 8, 2002.

1. Adjusted to remove effects of mark-to-market accounting rules (FIN 39 and FIN 115).
2. Includes private mortgage-backed securities, securities of corporations, state and local governments, and foreign governments and any trading account assets that are not Treasury or Agency securities, including revaluation gains on derivative contracts.
3. Excludes interbank loans.
4. Includes an estimate of outstanding loans securitized by commercial banks.
5. Includes security loans and loans to farmers, state and local governments, and all others not elsewhere classified. Also includes lease financing receivables.



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

Instrument	2000	2001	2002	2002	Change to Aug. 8 from selected dates (percentage points)		
	June 26	Sept. 10	June 25	Aug. 8	2000 June 26	2001 Sept. 10	2002 June 25
<i>Short-term</i>							
FOMC intended federal funds rate	6.50	3.50	1.75	1.75	-4.75	-1.75	.00
Treasury bills <sup>1</sup>							
3-month	5.66	3.19	1.70	1.59	-4.07	-1.60	-.11
6-month	5.94	3.13	1.77	1.56	-4.38	-1.57	-.21
Commercial paper (A1/P1 rates)							
1-month	6.56	3.42	1.75	1.69	-4.87	-1.73	-.06
3-month	6.56	3.24	1.74	1.65	-4.91	-1.59	-.09
Large negotiable CDs <sup>1</sup>							
1-month	6.64	3.46	1.80	1.73	-4.91	-1.73	-.07
3-month	6.73	3.26	1.81	1.69	-5.04	-1.57	-.12
6-month	6.89	3.24	1.89	1.67	-5.22	-1.57	-.22
Eurodollar deposits <sup>2</sup>							
1-month	6.63	3.41	1.78	1.72	-4.91	-1.69	-.06
3-month	6.69	3.26	1.81	1.67	-5.02	-1.59	-.14
Bank prime rate	9.50	6.50	4.75	4.75	-4.75	-1.75	.00
<i>Intermediate- and long-term</i>							
U.S. Treasury <sup>3</sup>							
2-year	6.54	3.59	2.89	2.08	-4.46	-1.51	-.81
10-year	6.35	5.14	5.11	4.66	-1.69	-.48	-.45
30-year	6.22	5.55	5.68	5.39	-.83	-.16	-.29
U.S. Treasury 10-year indexed note	4.09	3.26	3.12	2.61	-1.48	-.65	-.51
Municipal revenue (Bond Buyer) <sup>4</sup>	5.99	5.25	5.42	5.36	-.63	.11	-.06
Private instruments							
10-year swap	7.38	5.62	5.40	4.92	-2.46	-.70	-.48
10-year FNMA	7.15	5.64	5.39	4.97	-2.18	-.67	-.42
10-year AA <sup>5</sup>	7.64	6.30	6.15	5.97	-1.67	-.33	-.18
10-year BBB <sup>5</sup>	8.40	7.11	7.23	7.34	-1.06	.23	.11
High yield <sup>6</sup>	12.30	12.72	12.46	13.50	1.20	.78	1.04
Home mortgages (FHLMC survey rate) <sup>7</sup>							
30-year fixed	8.14	6.89	6.63	6.43	-1.71	-.46	-.20
1-year adjustable	7.22	5.64	4.60	4.45	-2.77	-1.19	-.15

Stock exchange index	Record high		2001	2002		Change to Aug. 8 from selected dates (percent)		
	Level	Date	Sept. 10	June 25	Aug. 8	Record high	2001 Sept. 10	2002 June 25
Dow-Jones Industrial	11,723	1-14-00	9,606	9,127	8,712	-25.68	-9.30	-4.54
S&P 500 Composite	1,527	3-24-00	1,093	976	905	-40.72	-17.12	-7.24
Nasdaq (OTC)	5,049	3-10-00	1,695	1,424	1,317	-73.92	-22.35	-7.55
Russell 2000	606	3-9-00	441	452	390	-35.68	-11.55	-13.84
Wilshire 5000	14,752	3-24-00	10,104	9,252	8,547	-42.06	-15.41	-7.61

1. Secondary market.
2. Bid rates for Eurodollar deposits collected around 9:30 a.m. Eastern time.
3. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
4. Most recent Thursday quote.
5. Derived from smoothed corporate yield curves estimated using Merrill Lynch bond data.
6. Merrill Lynch Master II high-yield bond.
7. For week ending Friday previous to date shown.

NOTES:

June 26, 2000, is the day before the FOMC meeting that ended the most recent period of policy tightening.  
 September 10, 2001, is the day before the terrorist attacks.  
 June 25, 2002, is the day before the announcement after the most recent FOMC meeting.