Prefatory Note

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

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[1] In some cases, original copies needed to be photocopied before being scanned into electronic format. All scanned images were deskewed (to remove the effects of printer- and scanner-introduced tilting) and lightly cleaned (to remove dark spots caused by staple holes, hole punches, and other blemishes caused after initial printing).

[2] A two-step process was used. An advanced optical character recognition computer program (OCR) first created electronic text from the document image. Where the OCR results were inconclusive, staff checked and corrected the text as necessary. Please note that the numbers and text in charts and tables were not reliably recognized by the OCR process and were not checked or corrected by staff.

Content last modified 6/05/2009.

Confidential (FR) Class III FOMC

Part 2

September 18, 2002

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

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

Confidential (FR) Class III FOMC

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Domestic Nonfinancial Developments

Domestic Nonfinancial Developments

Overview

The data that have become available since the August Greenbook show significant crosscurrents in the economy. The continuing boost from large incentives pushed motor vehicle sales even higher in August, and consumer spending on other goods also posted solid gains in July and August. Housing starts remained at a high level through July. Shipments of nondefense capital goods rose briskly in July, although anecdotal reports have not been as upbeat as the recent data. In contrast to the spending data, readings on the labor market suggest that conditions remained tepid in August, and industrial production edged down. Meanwhile, core inflation stayed low during the summer.

Labor Market

The labor market has yet to gain significant forward momentum. In August, private nonfarm payrolls were flat; aggregate hours, which recovered only partially from July's large decline, remained below the second-quarter average. The unemployment rate moved down 0.2 percentage point, to 5.7 percent in August—a decline that does not accord with other information we have received recently on labor market conditions. Indeed, initial claims for unemployment insurance have risen in the past few weeks, and the recent level of claims suggests that employment growth probably remained quite weak in early September.

Manufacturing employment declined 68,000 in August—the largest drop in this category since the winter. However, that drop may overstate the weakness in factory hiring because employment in the help-supply sector, which provides many of its workers to manufacturing firms, rose 51,000. Employment in retail trade also declined last month, by 55,000. Services outside of help supply added 49,000 jobs, after making similar gains in the previous several months, and construction posted its largest employment advance in more than a year. Nonfarm payroll employment was also boosted by the addition of 41,000 jobs in federal and in state and local government. Of the new federal jobs, 16,000 were airport security jobs created by the Transportation Security Administration.[1]

A 0.3 percent gain in aggregate hours of production or nonsupervisory workers in August only partly reversed the 0.7 percent drop in July. Average weekly hours ticked up 0.1 hour, but the workweek of 34.1 hours stands below its level in the spring.

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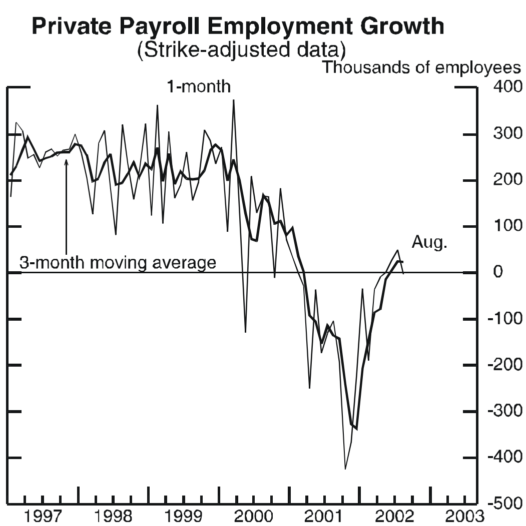
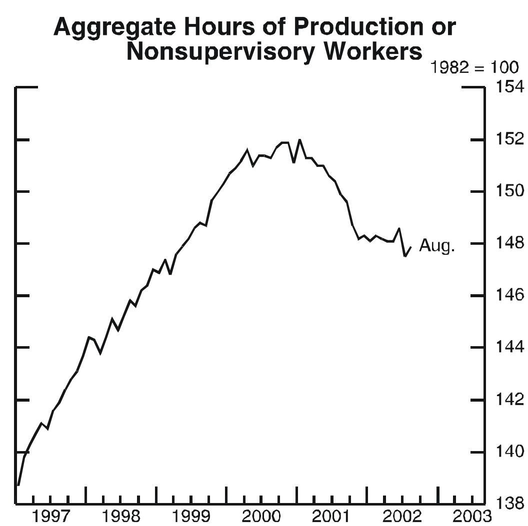
1. Eventually, all airport security workers will be federal employees; attaining that goal entails a shift of employees from the private to the public sector. However, in any given month, an increase in federal airport security employment may not be completely offset by a decrease in private employment. In August, employment in the detective, guard, and armored car services industry (which includes private-sector airport security workers) declined 9,000.

CHANGES IN EMPLOYMENT
(Thousands of employees; based on seasonally adjusted data)

	2000	2001	2002 Q1	2002 Q2	2002 June	2002 July	2002 Aug.
	--Average monthly change--						
Nonfarm payroll employment[1]	159	-119	-63	12	34	67	39
Previous	*159*	*-119*	*-63*	*22*	*66*	*6*	
Private	138	-158	-88	7	29	47	-2
Mining	1	1	-2	-2	-3	-4	1
Manufacturing	-11	-109	-80	-22	-14	-7	-68
Construction	8	-3	-14	-15	8	-30	34
Transportation and utilities	17	-23	-14	-8	-3	-7	-13
Retail trade	32	-15	5	-8	-19	33	-55
Wholesale trade	-7	-16	-7	0	0	-2	-8
Finance, insurance, real estate	5	10	-3	-2	1	4	7
Services	92	-2	27	63	59	60	100
Help supply services	-0	-54	4	36	14	-30	51
Total government	22	39	25	5	5	20	41
Total employment (household survey)	115	-153	-54	53	-364	-8	429
Nonagricultural	119	-154	-14	58	-378	-179	523
Memo:							
Aggregate hours of private production workers (percent change)[1,2]	1.1	-2.1	-0.5	0.2	0.3	-0.7	0.3
Average workweek (hours)[1]	34.4	34.2	34.2	34.2	34.3	34.0	34.1
Manufacturing (hours)	41.6	40.7	40.8	41.0	41.1	40.7	40.8

Note. Average change from final month of preceding period to final month of period indicated.
1. Survey of establishments.
2. 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.

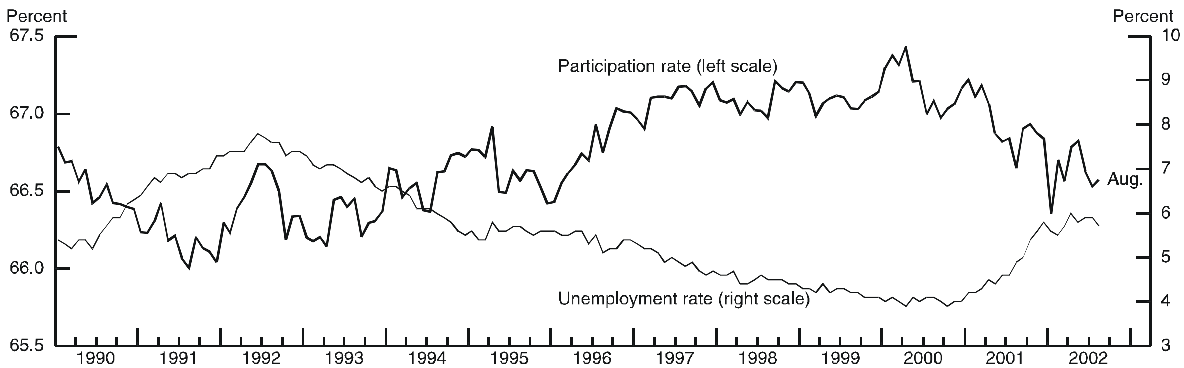




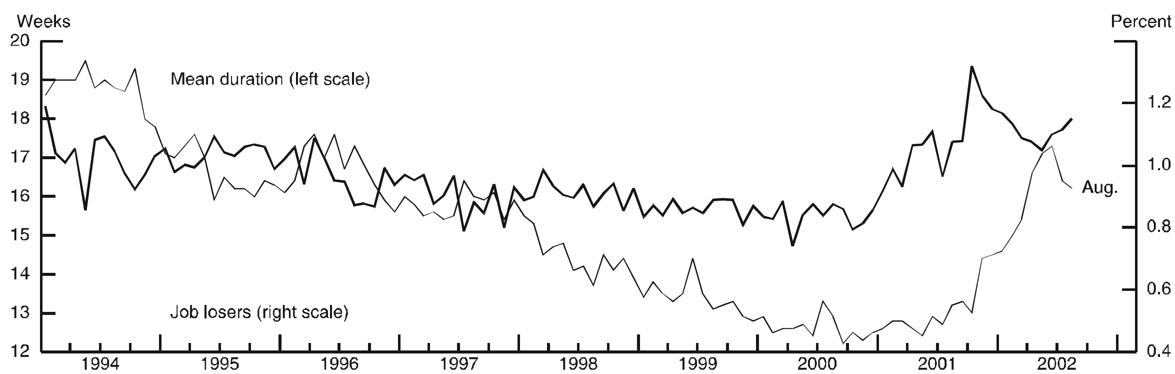
SELECTED UNEMPLOYMENT AND LABOR FORCE PARTICIPATION RATES
(Percent; based on seasonally adjusted data, as published)

	2000	2001	2002 Q1	2002 Q2	2002 June	2002 July	2002 Aug.
Civilian unemployment rate (16 years and older)	4.0	4.8	5.6	5.9	5.9	5.9	5.7
Teenagers	13.0	14.7	16.0	17.1	17.6	17.7	17.2
20-24 years old	7.1	8.3	9.8	9.4	9.3	9.5	9.6
Men, 25 years and older	2.8	3.6	4.5	4.9	4.9	4.7	4.6
Women, 25 years and older	3.2	3.7	4.4	4.8	4.6	4.6	4.5
Labor force participation rate	67.2	66.9	66.5	66.7	66.6	66.5	66.6
Teenagers	52.2	49.9	48.2	47.7	47.6	47.1	47.1
20-24 years old	77.9	77.2	76.3	76.7	76.5	76.4	77.0
Men, 25 years and older	76.0	75.9	75.6	75.9	75.9	75.7	75.9
Women, 25 years and older	59.7	59.7	59.6	59.6	59.4	59.4	59.6

Labor Force Participation Rate and Unemployment Rate



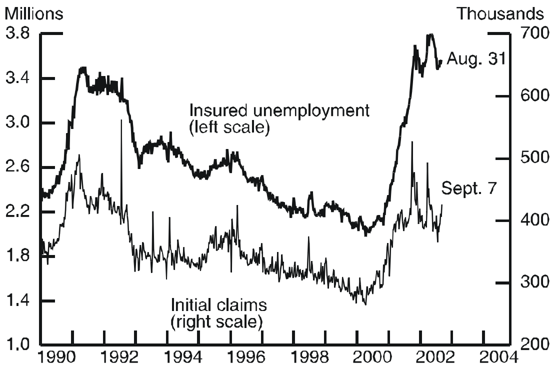
Job Losers Unemployed for Less Than 5 Weeks and Duration of Unemployment



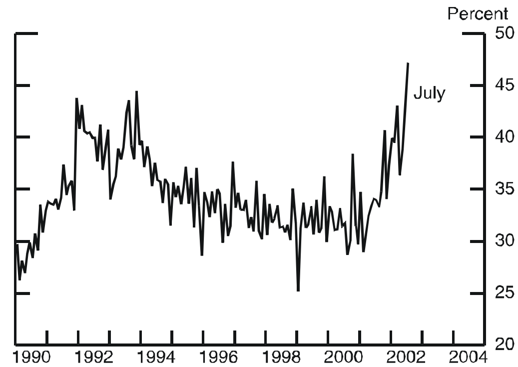
Note. Job losers unemployed for less than five weeks measured as a percentage of household employment.

Labor Market Indicators

Unemployment Insurance

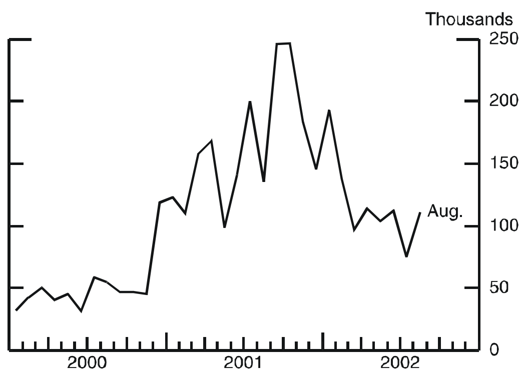


Exhaustion Rate



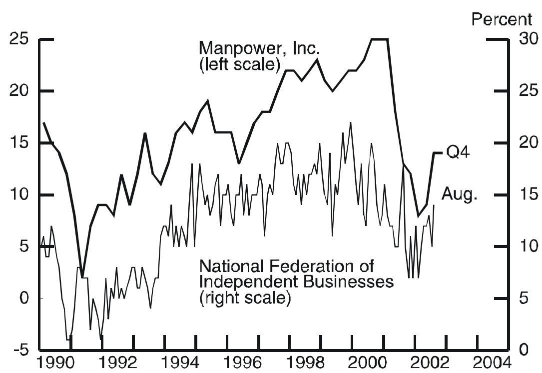
Note. Seasonally adjusted by FRB staff. Exhaustion rate is the number of individuals who exhausted their benefits without finding a job, expressed as a share of the individuals who began receiving benefits six months earlier.

Layoff Announcements



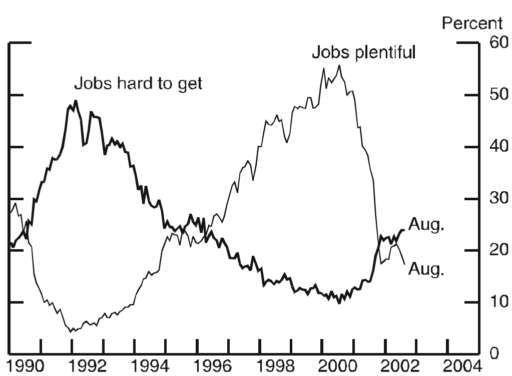
Note. Seasonally adjusted by FRB staff.
Source. Challenger, Gray and Christmas, Inc.

Net Hiring Strength



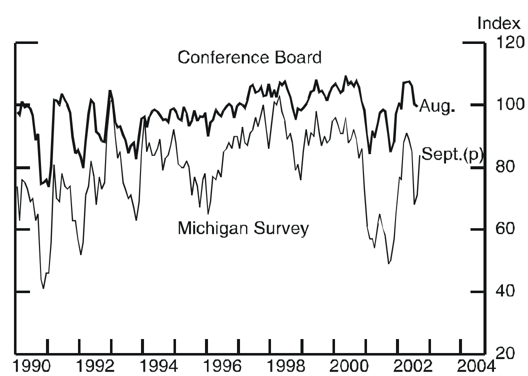
Note. Percent planning an increase in employment minus percent planning a reduction.

Current Employment Conditions



Source. Conference Board.

Expected Employment Conditions



Note. The proportion of households expecting unemployment to fall, minus the proportion expecting it to rise, plus 100.
p. Preliminary.

The household survey showed the unemployment rate declining 0.2 percentage point in August to 5.7 percent. A broader measure of joblessness, which includes individuals who are out of the labor force but want a job as well as those who are unemployed, also fell a bit in August.[2] The unemployment rate is little changed from its level in December 2001, even though nonfarm payroll employment has declined, on balance, this year. We believe that this unusual combination may have occurred because some workers who were pulled into the work force during the late 1990s by strong demand and tight labor markets may have formed only a marginal attachment to the labor force, and therefore did not report themselves as unemployed after losing their jobs, but instead moved directly out of the labor force. Indeed, the labor force participation rate has fallen from 66.8 percent to 66.6 percent since December of last year.

Moreover, the reported decline in the unemployment rate is not consistent with the weakness suggested by many other labor market indicators. For example, the four-week moving average of initial claims for unemployment insurance has moved up 20,000 since the August survey week, to 410,000—a level consistent with little, if any, net increase in employment in September. The four-week moving average of insured unemployment stood at 3.54 million in the week ended August 31, up 20,000 from the August survey week. The exhaustion rate (the number of individuals who exhausted their benefits without finding a job, expressed as a share of the individuals who began receiving unemployment benefits six months earlier) increased to 47.2 percent in July (seasonally adjusted by the FRB staff), a level similar to the peak in 1993.

Layoff announcements edged up in August, reversing their July decline, and participants in the Manpower Survey reported no change in their hiring plans in the fourth quarter. However, respondents to the National Federation of Independent Businesses (NFIB) survey became more upbeat, reporting the highest level of net hiring expectations since August 2001. Consumers' views of the labor market also appear to be mixed. In the Conference Board's August survey, the proportion of households reporting jobs plentiful ticked down for the third month in a row, to its lowest level in this business cycle. The proportion of August respondents finding jobs hard to get was unchanged from July, remaining at the highest level in this cycle. In addition, these respondents reported slightly lower employment expectations in August than in July. On the other hand, respondents to the preliminary Michigan survey for September reported improved expectations following the recent lows of July and August.

2. We generally place more weight on the data from the establishment survey, which are gleaned from company records, than on the data from the household survey, which are based on self-reporting by individuals. According to the BLS, the standard error of the one-month change in the unemployment rate is 0.1 percentage point.

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

Component	Proportion 2001	2001[1]	2002[2] Q1	2002[2] Q2	2002[3] June	2002[3] July	2002[3] Aug.
Total	**100.0**	**-5.9**	**2.6**	**4.1**	**.6**	**.4**	**-.3**
Previous	100.0	-5.9	2.6	4.4	.7	.2	
Manufacturing	86.7	-6.1	3.0	3.6	.6	.3	-.1
Ex. motor veh. and parts	80.4	-6.6	1.6	2.4	.3	.0	.0
Ex. high-tech industries	73.8	-5.5	-.2	1.1	.2	.0	-.1
Mining	6.2	-2.4	-9.1	-3.3	1.1	-.5	.8
Utilities	7.1	-6.1	8.3	16.7	1.0	2.4	-2.5
Selected industries							
High technology	6.6	-15.6	23.7	18.5	.9	.2	1.6
Computers	1.5	-8.2	36.1	4.9	-.6	.0	.8
Communication equipment	1.5	-24.4	-19.1	-5.1	.7	-4.4	-1.1
Semiconductors[4]	3.5	-14.9	39.0	34.4	1.5	1.8	2.7
Motor vehicles and parts	6.3	-.4	22.7	18.4	3.9	3.9	-1.4
Aircraft and parts	2.6	-11.6	-30.7	-31.6	-2.5	-2.9	-1.4
Market groups excluding energy and selected industries							
Consumer goods	24.0	-1.6	1.3	-1.7	.5	-.1	-.3
Durables	3.5	-8.0	6.8	5.6	-.9	-.1	-1.1
Nondurables	20.6	-.5	.5	-2.9	.8	-.1	-.2
Business equipment	7.9	-10.8	-4.6	.3	.5	-.6	.7
Defense and space equipment	2.0	.2	2.8	4.5	.6	.7	.9
Construction supplies	6.6	-3.8	8.7	5.3	.5	-1.4	.6
Business supplies	7.1	-8.4	-4.9	1.0	-.2	.4	-.1
Materials	23.9	-6.9	.7	6.2	.2	.3	-.2
Durables	16.3	-7.3	-.3	4.0	.3	.2	-.3
Nondurables	7.6	-6.1	2.6	10.8	-.1	.6	.0

1. Fourth-quarter to fourth-quarter change.
2. Annual rate.
3. Monthly rate.
4. Includes related electronic components.

Capacity Utilization
(Percent of capacity)

Sector	1967-2001 average	1982 low	1990-91 low	2001 Q4	2002 Q1	2002 Q2	2002 July	2002 Aug.
Total industry	**81.9**	**71.1**	**78.1**	**74.7**	**75.0**	**75.6**	**76.2**	**76.0**
Manufacturing	80.9	69.0	76.6	73.1	73.5	74.0	74.5	74.4
High-tech industries	80.0	77.3	72.4	60.7	62.9	64.2	63.9	64.3
Excluding high-tech industries	81.0	68.0	76.8	74.7	74.9	75.4	76.0	75.8
Mining	87.6	80.3	87.0	87.6	85.3	84.6	84.8	85.4
Utilities	87.6	75.9	83.4	83.6	84.3	86.7	88.8	86.3

We now estimate that second-quarter productivity growth in the nonfarm business sector was 1.7 percent at an annual rate, a bit faster than the BLS estimated in its preliminary release. Over the four quarters ended in 2002:Q2, productivity is estimated to have advanced 4.9 percent, following a 0.2 percent rise over the preceding four-quarter period. Output per hour in the nonfinancial corporate sector is estimated to have increased at an annual rate of 5.0 percent in the second quarter. Over the four quarters ended in 2002:Q2, this measure of productivity advanced 6.0 percent, up from the 0.4 percent rise posted in the previous four quarters.

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

Sector	1999[1]	2000[1]	2001[1]	2001		2002	
				Q3	Q4	Q1	Q2
Nonfarm businesses							
All persons[2]	3.0	2.1	1.9	2.1	7.3	8.6	1.7[3]
All employees	2.4	1.7	2.0	2.0	7.6	7.3	1.6[3]
Nonfinancial corporations[4]	1.8	1.8	3.3	3.2	10.8	5.1	5.0

1. Change is from fourth quarter of the preceding year to fourth quarter of the year shown.
2. Includes non-employees (published definition).
3. Staff estimates.
4. The nonfinancial corporate sector consists of all corporations doing business in the United States with the exception of banks, stock and commodity brokers, and finance and insurance companies. The sector accounts for about two-thirds of business employment.

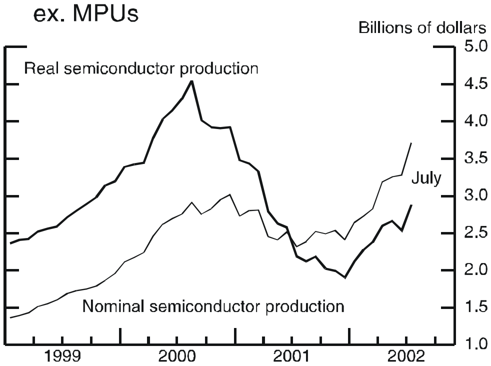
Industrial Production

Output in the industrial sector declined 0.3 percent in August, following an upward revised gain of 0.4 percent in July. Motor vehicle assemblies decreased last month, and electricity generation fell back after a heat-related run-up in July. Manufacturing production excluding motor vehicles was flat for a second month, after sizable increases in the first half of the year. The factory operating rate slipped to 74.4 percent in August, 1-1/2 percentage points above its recent low in December 2001, but still 6-1/2 percentage points below its 1967 to 2001 average.

The August decline in motor vehicle assemblies directly shaved 0.1 percent off total IP. Fourth-quarter schedules call for production at an annual rate of 12.5 million units—high by historical standards but still 1/2 million units lower than third-quarter schedules. If realized, the resulting decline in the value-added of the motor vehicle and parts industry would directly reduce growth of total

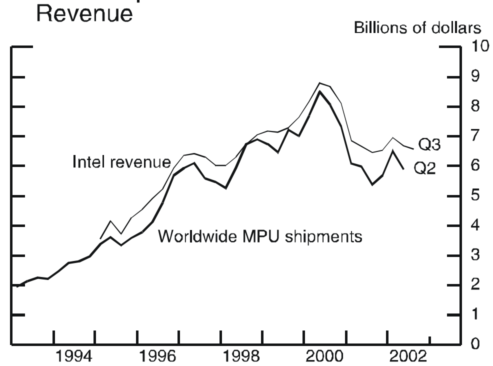
Indicators of High-Tech Manufacturing Activity

Semiconductor Production ex. MPUs



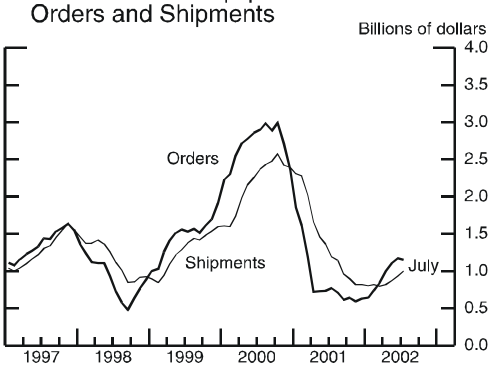
Source. Semiconductor Industry Association and FRB staff estimates.

MPU Shipments and Intel Revenue



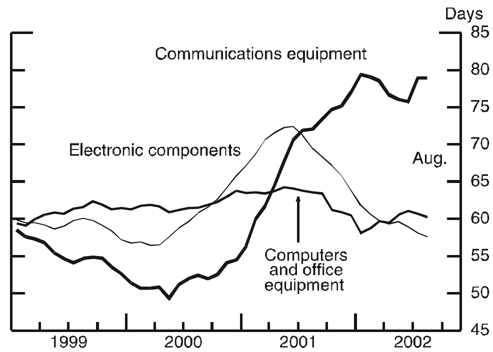
Note. Q3 is the midpoint of Intel's guidance as of September 5, 2002.
Source. Intel and Semiconductor Industry Association.

Semiconductor Equipment Orders and Shipments



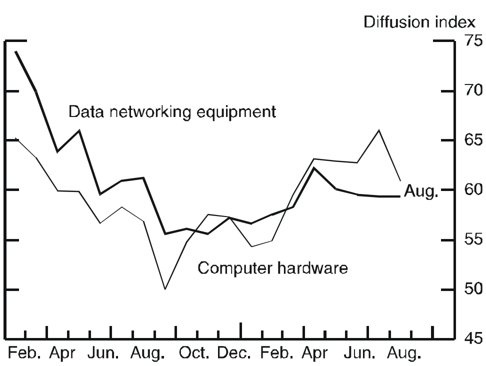
Source. Semiconductor Equipment and Materials International.

Days' Supply



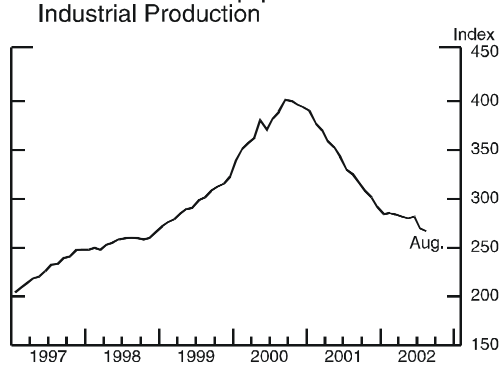
Source. FRB staff's flow-of-goods system.

High-Tech Spending Plans



Note. The diffusion index equals 50 plus half the percentage of respondents planning to increase future spending, less the percentage of respondents planning to reduce future spending. The average number of respondents per month from February 2001 to August 2002 was 262.
Source. *CIO Magazine.*

Communication Equipment Industrial Production



industrial output in the fourth quarter by around 3/4 percentage point at an annual rate.

Output in the high-tech sector rose 1.6 percent in August after a small increase in July. Semiconductor production was boosted in August by sharp gains in the production of semiconductors other than microprocessors (MPUs). The Semiconductor Industry Association attributes the non-MPU strength to demand for consumer products such as DVD players, video games, and digital cameras. The production of MPUs has lagged behind the output of other chips because of relatively weak demand from computer manufacturers: U.S. computer production increased in August for the first time since March, though by only a modest 0.8 percent. Intel, which makes about 80 percent of the MPUs produced worldwide, recently marked down its forecast for third-quarter revenue a touch and noted that the outlook for personal computers and notebooks is a little weaker than it had previously anticipated. Last month's *CIO Magazine* survey of information officers showed that buying plans for computer hardware and related items have been scaled back since the previous survey in July, but they are still consistent with near-term increases in the level of outlays. The production of communications equipment fell 1.1 percent in August after a 4.4 percent plunge in July. Despite persistent production cuts over the past two years, stocks of communications equipment remained high relative to the recent pace of sales.

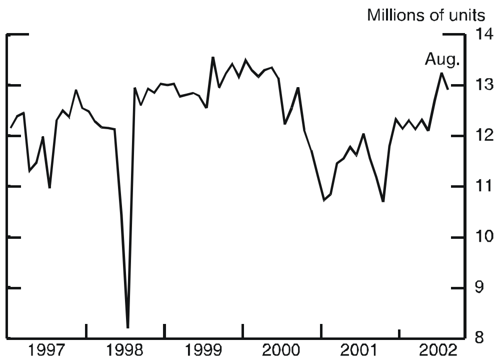
Aircraft production contracted 1.4 percent in August because of another decline in the output of commercial aircraft. Since its recent peak in November 2000, the production of commercial aircraft has been cut in half.

. Beyond that cut, however, the information provided by the company suggests that prospective declines in production will be relatively small.

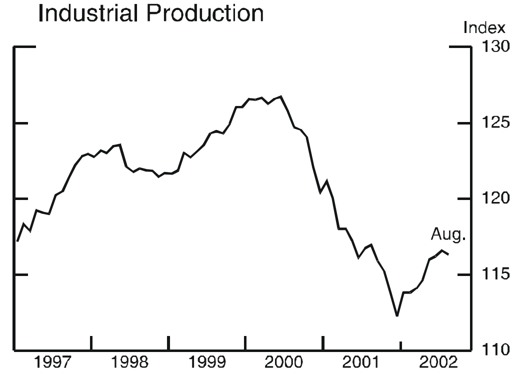
Production changes across the rest of the industrial sector have been mixed. The output of business equipment other than transportation and high-tech bounced back from a decrease in July, and the output of construction supplies moved up. However, the production of business supplies and industrial materials declined. The output of consumer goods aside from motor vehicles and high-tech dropped 0.3 percent in August, pushed down by a drop in the production of furniture and appliances and by a decrease in the output of nondurables. Data from the staff's flow-of-goods system imply that, relative to sales, stocks of consumer goods excluding motor vehicles had already moved down from uncomfortable levels, suggesting that the recent softness in consumer goods production has not stemmed from an inventory overhang. More broadly, according to the flow-of-goods

Indicators of Manufacturing Activity

Motor Vehicle Assemblies

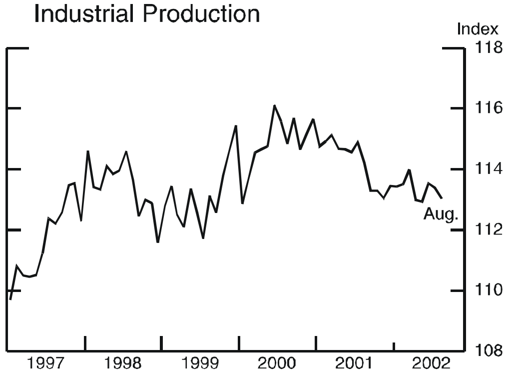


Other Materials Industrial Production



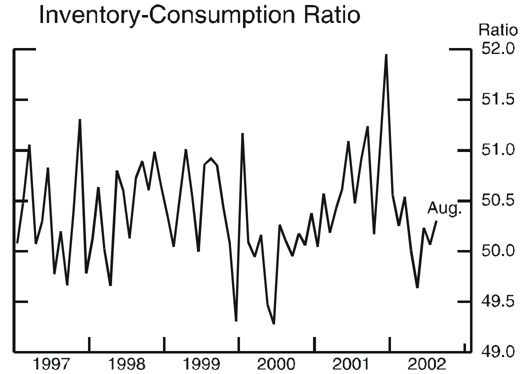
Note. Excludes motor vehicles and aircraft parts, high-tech materials, and energy materials.

Other Consumer Goods Industrial Production



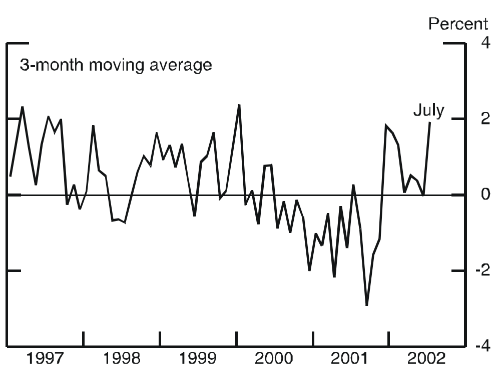
Note. Excludes motor vehicles and parts, computers, and energy products.

Consumer Goods Inventory-Consumption Ratio



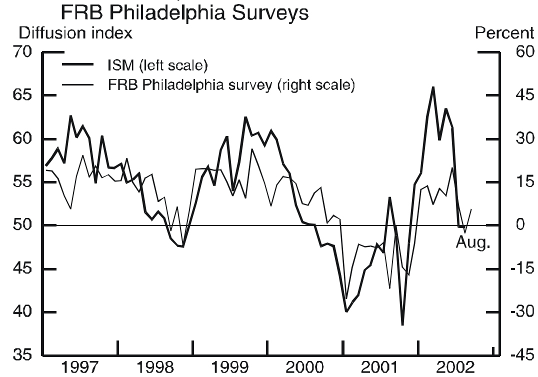
Note. Excludes motor vehicles.
Source. FRB staff's flow-of-goods system.

Real Adjusted Durable Goods Orders



Note. Excludes semiconductors.

New Orders, ISM and FRB Philadelphia Surveys



Note. The ISM index equals 50 plus half the difference between the percentage of respondents reporting greater levels versus lower levels of new orders. The FRB Business Outlook Survey is the difference between the percentage of respondents reporting greater levels versus lower levels of new orders.

system, inventories do not appear to be high, and indeed, purchasing managers continue to report that their customers' inventories are too low.

Indicators of near-term manufacturing activity have been mixed. Real adjusted durable goods orders surged in July and pushed up the three-month average by 1.9 percent. In contrast, the new orders index from the Institute for Supply Management slipped a little further in August to 49.7, after having declined 10 percentage points in July. Several regional diffusion indexes of orders also stepped down over the summer.

New Orders for Durable Goods
(Percent change from preceding period except as noted; seasonally adjusted)

Component	Share, 2001: H1 (percent)	2002 Q1	Q2	May	June	July
Total orders	**100.0**	**1.5**	**-.4**	**.4**	**-4.5**	**9.2**
Adjusted orders[1]	71.0	2.6	.5	-.2	-4.9	10.8
Computers	4.0	-1.4	-5.0	3.5	-9.7	13.8
Communication equipment	3.0	6.3	-3.3	-2.8	-18.2	11.6
Other capital goods	23.0	.8	2.4	.5	-4.1	7.7
Other[2]	37.0	3.9	.3	-.8	-3.7	12.3
MEMO						
Real adjusted orders	. . .	3.0	.9	-.2	-4.8	11.2
Excluding high tech	. . .	2.9	.8	-.4	-5.0	11.4

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

Motor Vehicles
Sales of light vehicles have been extremely strong during the past two months. Automakers brought back zero percent financing and boosted cash incentives in early July; light vehicle sales jumped 1.8 million units that month to an annual rate of 18.1 million units. In August, sales rose further to an 18.6 million unit pace. Although most of the increase in July and August was in retail sales to consumers, fleet sales to businesses also moved up over this period.

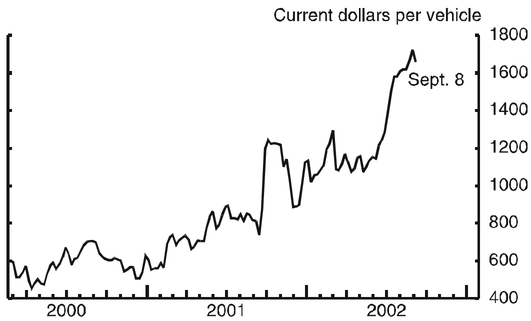
Industry sources indicated confidentially earlier this month that they were expecting light vehicle sales in September of about 17-1/2 million units—down

Sales of Automobiles and Light Trucks
(Millions of units at an annual rate, FRB seasonals)

			2002		2002		
	2000	2001	Q1	Q2	June	July	Aug.
Total	17.2	17.0	16.3	16.3	16.3	18.1	18.6
Autos	8.8	8.4	7.9	8.1	8.0	8.8	8.7
Light trucks	8.4	8.6	8.4	8.3	8.3	9.3	9.9
North American[1]	14.4	14.0	13.0	13.1	13.0	14.6	15.4
Autos	6.8	6.3	5.7	5.9	5.8	6.5	6.6
Light trucks	7.5	7.6	7.4	7.2	7.2	8.1	8.8
Foreign-produced	2.9	3.1	3.3	3.2	3.2	3.4	3.2
Autos	2.0	2.1	2.2	2.2	2.2	2.3	2.2
Light trucks	.8	1.0	1.1	1.0	1.1	1.2	1.0
Memo:							
Medium and heavy trucks	.6	.4	.4	.4	.4	.4	.4

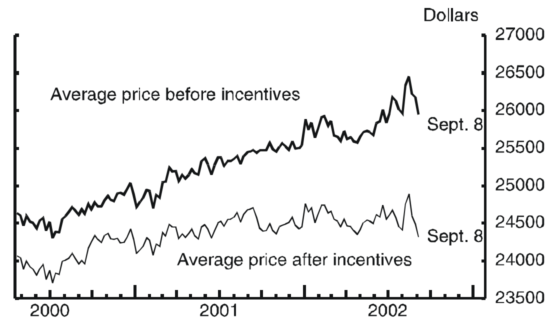
Note. Components may not sum to totals because of rounding. Data on sales of trucks and imported autos for the most recent month are preliminary and subject to revision.
1. Excludes some vehicles produced in Canada that are classified as imports by the industry.

Marketing Incentives for Light Vehicles



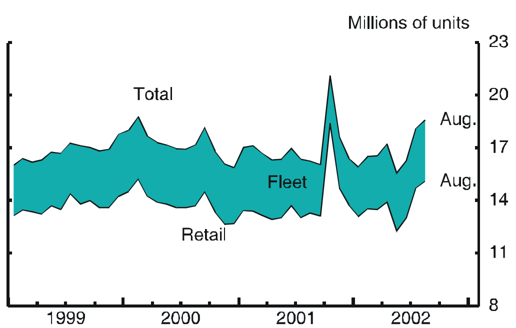
Note. Data not seasonally adjusted.
Source. J.D. Power and Associates.

Average Price Before and After Incentives



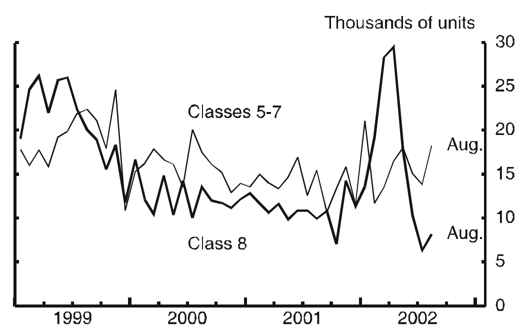
Note. Seasonally adjusted data.
Source. J.D. Power and Associates.

Fleet and Retail Sales of Light Vehicles



Note. Annual rate; FRB seasonals.
Source. Staff estimates based on confidential data.

Net New Orders for Medium and Heavy Trucks



Note. Monthly rate; FRB seasonals.

a little from the August level owing, in part, to some trimming of incentive programs.[5] In early September, GM announced new incentives that were less generous on balance than those available in July and August, but the company did include zero-rate financing on 36-month loans for the purchase of 2003 model-year vehicles. In response, Ford and Chrysler announced programs similar to GM's.[6]

The current round of incentives provides an offset to announced price increases for new model-year vehicles. Chrysler and Ford have announced that average prices for their 2003 vehicles will be up 0.5 percent and 0.4 percent, respectively, relative to comparably equipped 2002 vehicles.[7] GM has not announced an average figure. Consumers apparently have not noticed any deterioration in the pricing environment: Car-buying attitudes improved in the preliminary September Michigan Survey, to the highest level since last December.

With sales of light vehicles running ahead of manufacturers' expectations in July and August, inventories of light vehicles are apparently below desired levels. Inventories declined 130,000 units in August to 2.5 million, while supply dropped to about 51 days when evaluated at last month's elevated sales pace, and to about 54 days when evaluated at the average sales pace over the past twelve months; both figures are well below the industry target of around 63 days. Nevertheless, manufacturers have scheduled a step-down in production to an annual rate of 12.5 million units in September and a continuation at that level in the fourth quarter. These schedules suggest that producers anticipate some softening in sales in coming months.

Domestic fourth-quarter production could be disrupted severely if the Canadian Auto Workers (CAW) union strikes Ford or Chrysler. On September 17, the CAW reached a tentative agreement on a new contract with GM, and the union will use this contract as the pattern agreement for upcoming negotiations with the

5. The recent history of these projections suggests that the early-month forecasts have a standard error of 1 million units.

6. GM's previous program expired on September 3. In its new program, consumers may receive zero percent financing for up to three years on model year 2002 or 2003 cars; reduced-rate financing is available for longer maturities. Cash rebates of up to $1,500 are also available in lieu of reduced-rate financing. In the program that just expired, only model-year 2002 vehicles were eligible, but zero percent financing was available for up to five years, and cash rebates of up to $5,000 were offered. GM's program expires on October 31, while Ford's and Chrysler's current programs expire on September 30.

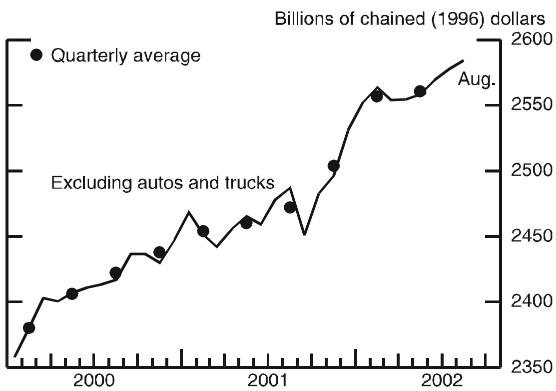
7. These figures translate into an average increase of about $125 per vehicle for Chrysler and $120 for Ford.

Total Retail and Food Services Sales
(Percent change; seasonally adjusted)

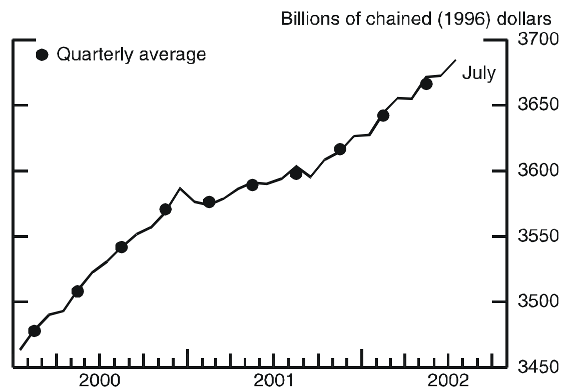
Expenditure	2002 Q1	Q2	June	July	Aug.
Total sales	-.6	1.1	1.4	1.1	.8
Previous estimate	...	.9	1.4	1.2	...
Retail control[1]	1.8	.9	.4	.2	.3
Previous estimate	...	.9	.6	.4	...
GAF[2]	2.1	.3	.8	-.3	.7
Gasoline stations	.9	5.7	-1.1	2.8	-.8
Food services	3.4	.7	.6	-1.0	.1
Other retailers[3]	1.2	.5	.2	.5	.4

1. Total retail trade and food services less sales at building material and supply stores and automobile and other motor vehicle dealers.
2. Furniture and home furnishing stores, electronics and home appliance stores, clothing and accessories stores, sporting goods, hobby, book and music stores, and general merchandise stores.
3. Health and personal care stores, food and beverage stores, electronic shopping and mail order houses, and miscellaneous other retailers.
... Not applicable.

Real PCE Goods

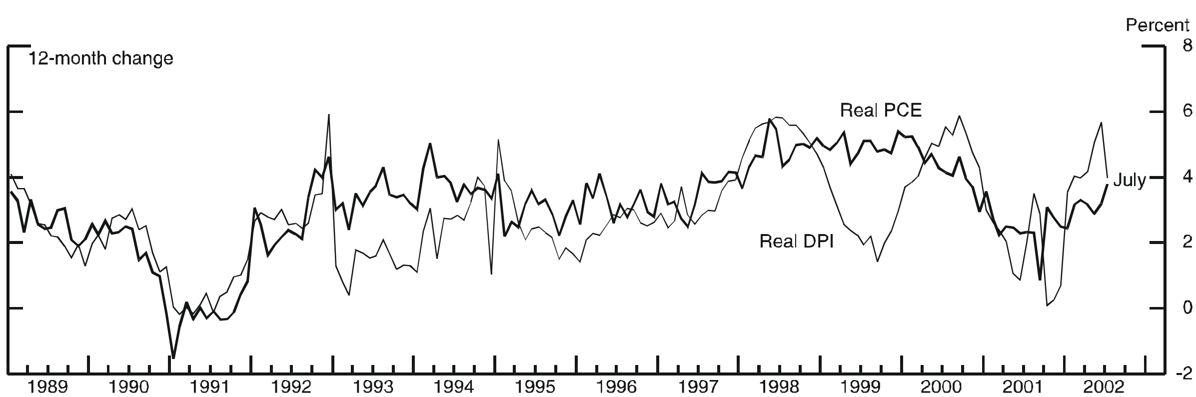


Real PCE Services



Note. June to August are staff estimates.

Real Consumer Spending and Income



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

Item	2002			2002			
	Q1	Q2	Q3[1]	June	July	Aug.	Sept.[1]
U.S. production	12.2	12.4	12.9	12.7	13.2	12.9	12.5
Autos	5.2	5.2	5.2	5.3	5.4	5.1	5.2
Trucks	7.0	7.2	7.6	7.4	7.8	7.8	7.3
Total days' supply[2]	57.5	62.7	n.a.	63.1	55.7	50.6	n.a.
Inventories[3]	2.44	2.68	n.a.	2.68	2.66	2.53	n.a.

Note. Components may not sum to totals because of rounding.
1. Production rates reflect Ward's Communications' latest estimates for Q3 and September.
2. Quarterly average calculated using end-of-period stocks and average reported sales.
3. End-of-period stocks; excludes medium and heavy trucks (classes 3-8).
n.a. Not available.

other automakers. Job security is the most important issue, and negotiations with Ford may prove difficult; Ford has announced plans to shut an Ontario truck plant and to lay off between 1,000 and 1,500 workers (roughly 10 percent of Ford's unionized workforce in Canada). A strike against Ford in Canada would quickly shut down the company's assembly and parts plants in the United States. The last strike by the CAW was in 1996, when the union clashed with GM over outsourcing.

Consumer Spending

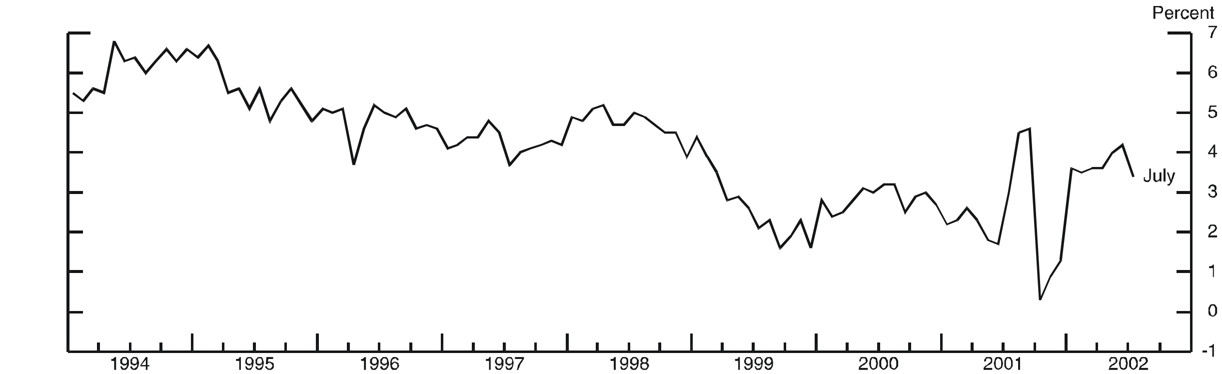
Consumer spending on goods aside from motor vehicles appears to be increasing at a moderate pace in the third quarter. In August, nominal retail sales in the so-called control category of stores, which excludes sales at motor vehicle dealers and building supply outlets, rose 0.3 percent.[8] Spending moved up noticeably at furniture and home furnishing stores and at general merchandise outlets but declined at electronic and appliance stores and at clothing and accessory outlets. We estimate that real PCE for the control items advanced 0.2 percent in August after slightly larger increases in the preceding two months.

Outlays on services rose 0.3 percent in July (the most recent available data); the gain was led by a surge in estimated expenditures on brokerage and investment

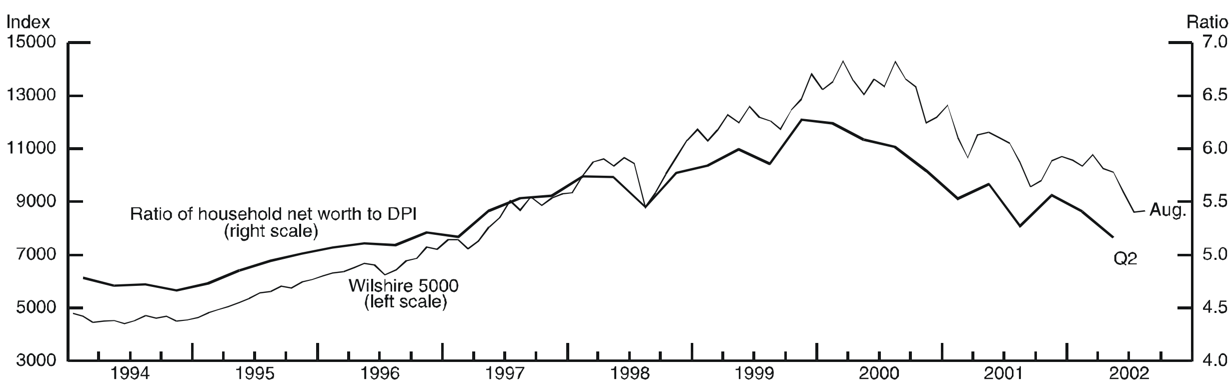
8. The increase in nominal retail control was revised down 0.2 percentage point in both June and July.

Household Indicators

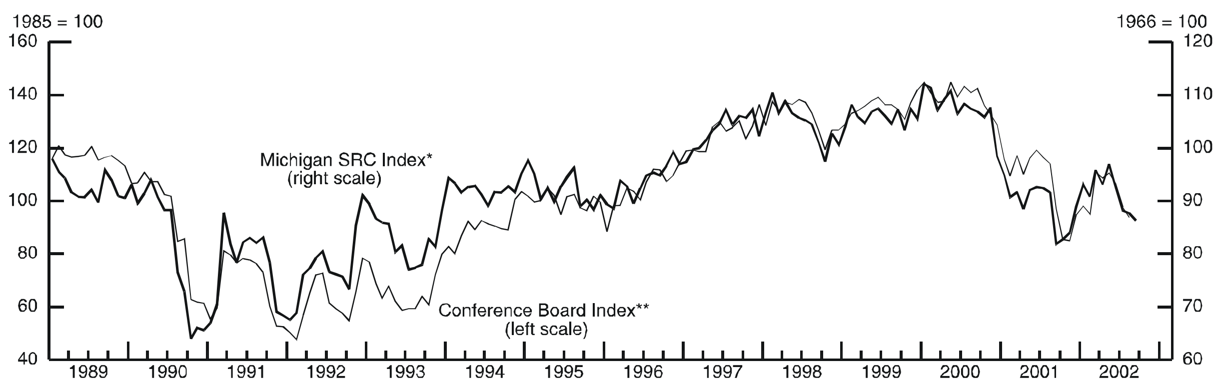
Personal Saving Rate



Household Net Worth and Wilshire 5000



Consumer Confidence



*Through September (Preliminary)
**Through August

counseling. However, the jump in brokerage spending was likely reversed in August given that month's drop in trading volumes. Outlays on energy services were little changed in July, and weather data for August suggest that electricity demand declined last month.

Real disposable personal income was about unchanged in July, and the latest employment report points to little gain in the wage and salary component of household income for August. However, gains in real disposable income over a longer period remain sizable; they have been boosted in part by the decline in income tax payments associated with last year's tax legislation and a reduction in capital gains realizations owing to the weak stock market. The twelve-month change in real DPI in July was 4 percent.

With income roughly unchanged in July, the considerable rise in spending led to a 0.8 percentage point decline in the saving rate, to 3.4 percent. Still, the saving rate remains near the high end of the range seen in the past three years, a pattern consistent with the sharp decline in household wealth. In the second quarter, the ratio of household net worth to disposable personal income fell to its lowest level since 1996, and the stock market's decline since the end of the second quarter has likely further reduced this ratio.

Both the Michigan Survey Research Center's index of consumer sentiment and the Conference Board's index of consumer expectations edged down in August, and the Michigan index ticked down further in early September. Both measures are now close to the levels seen last December and close to their averages over the past twenty years.

Housing Market

Housing activity remained robust in early summer, though a bit less so than during the spring. In the single-family sector, the pace of starts declined about 2-1/4 percent in July to an annual rate of 1.32 million units. Issuance of permits to build new single-family homes—adjusted for starts that occurred in areas where permits are not required—was only a touch below the pace of starts; the permits figure is consistent with little change in starts for the remainder of the current quarter. In the multifamily sector, new homes were started at an annual rate of 328,000 units in July, a pace just a bit below the average recorded during the past year and a half.

Mortgage rates have fallen during the past several months, with the average rate on a thirty-year fixed-rate mortgage standing at 6.18 percent in mid-September, and the average initial rate on a thirty-year adjustable-rate mortgage at 4.32 percent. Consumers' rating of homebuying conditions in the Michigan Survey and the Mortgage Bankers Association's index of mortgage application volume both remained elevated in early September, a pattern suggesting that low

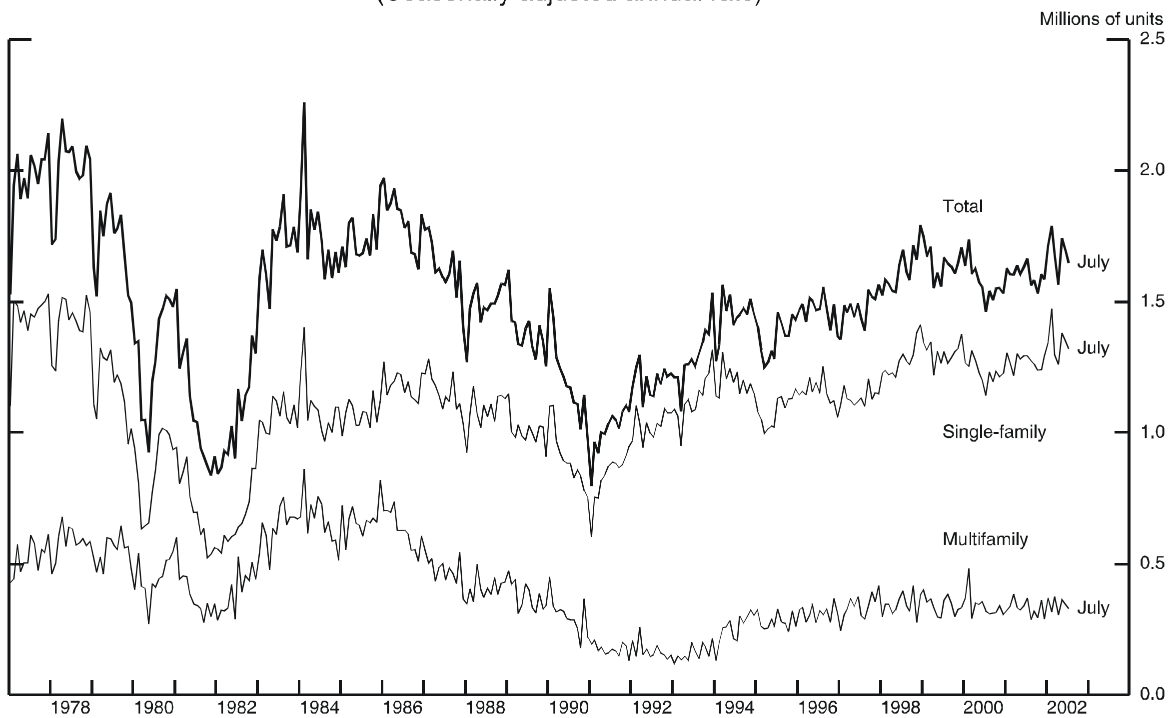
Private Housing Activity
(Millions of units; seasonally adjusted annual rate)

		2001	2002				
	2001	Q4	Q1	Q2[r]	May [r]	June[r]	July[p]
All units							
Starts	1.60	1.57	1.73	1.67	1.74	1.70	1.65
Permits	1.64	1.64	1.69	1.67	1.68	1.71	1.70
Single-family units							
Starts	1.27	1.26	1.37	1.33	1.38	1.35	1.32
Permits	1.24	1.23	1.31	1.27	1.27	1.29	1.28
Adjusted permits[1]	1.28	1.26	1.34	1.31	1.30	1.34	1.30
New home sales	0.91	0.93	0.91	0.95	0.98	0.95	1.02
Existing home sales	5.30	5.24	5.78	5.54	5.74	5.10	5.33
Multifamily units							
Starts	0.33	0.32	0.35	0.34	0.36	0.34	0.33
Permits	0.40	0.41	0.39	0.40	0.41	0.41	0.42
Mobile homes							
Shipments	0.19	0.20	0.18	0.18	0.18	0.17	0.17

1. Adjusted permits equals permit issuance plus total starts outside of permit-issuing areas.

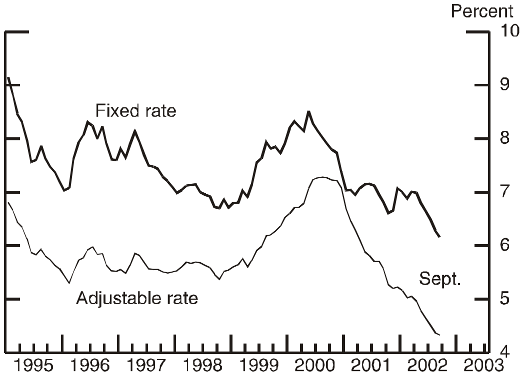
p Preliminary. r Revised. n.a. Not available.

Private Housing Starts
(Seasonally adjusted annual rate)



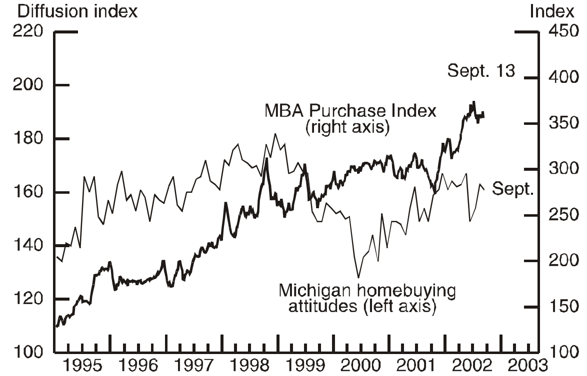
Indicators of Single-Family Housing

Mortgage Rates



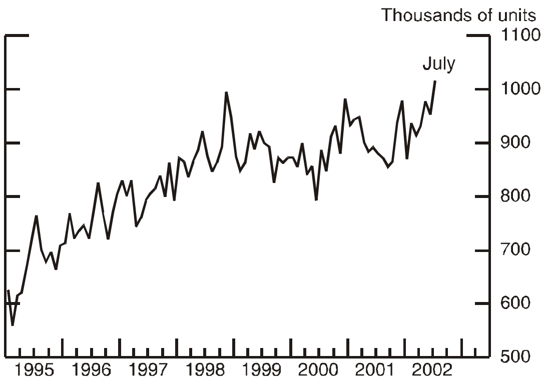
Note. Sept. figure is based on data through Sept. 13.
Source. Freddie Mac.

Homebuying Indicators



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

New Home Sales



Source. Census Bureau.

Existing Home Sales

*National Association of Realtors.

House Prices

National Prices
4-quarter percent change

Measure	2000:Q2	2001:Q2	2002:Q2
New			
Median	2.8	9.7	1.9
Constant quality	4.9	4.7	2.8
Existing			
Median	3.4	6.4	7.5
Repeat sales	7.8	8.9	6.5

Sources. Census Bureau, National Association of Realtors, and Office of Federal Housing Enterprise Oversight.

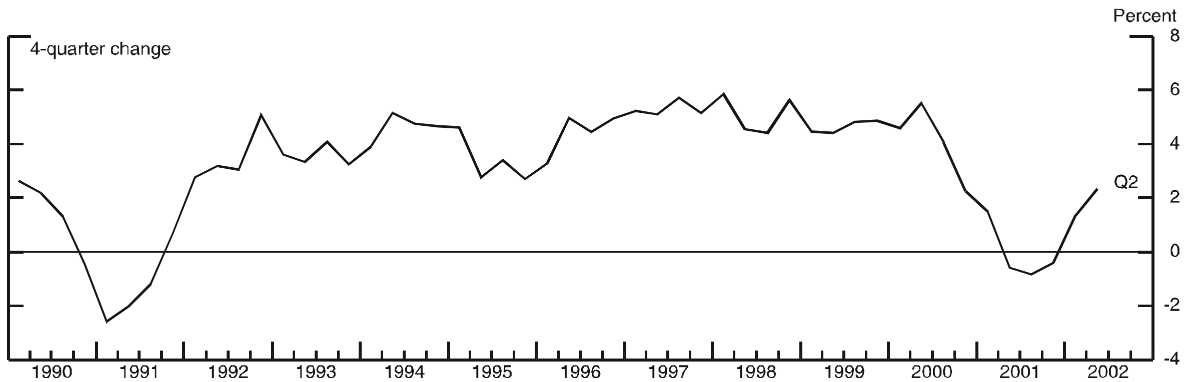
Metro-Area Repeat-Sales Prices
4-quarter percent change

City	2000:Q2	2001:Q2	2002:Q2
Austin	14.4	11.9	.1
Boston	16.7	12.7	10.4
Minneapolis	13.0	11.4	10.4
New York	15.0	11.6	11.1
San Francisco	25.4	13.8	.3
Washington, D.C.	10.0	11.3	11.4

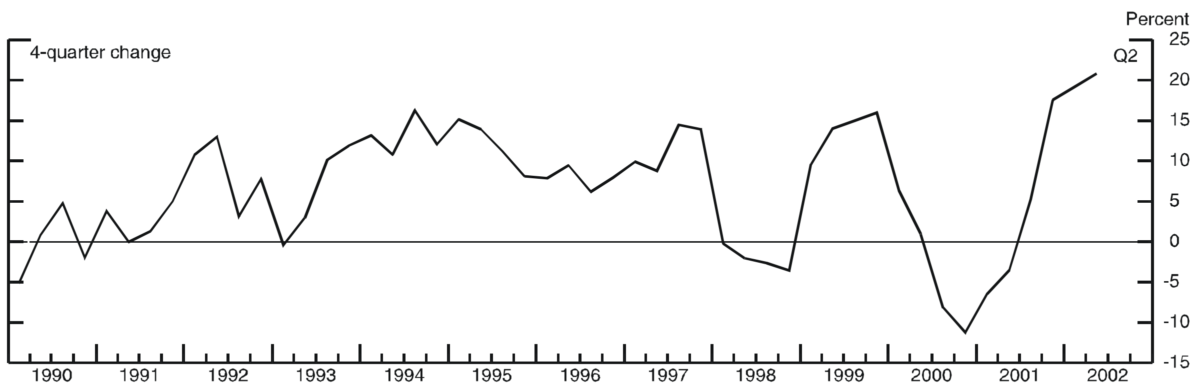
Source. Office of Federal Housing Enterprise Oversight.

Equipment Investment Fundamentals

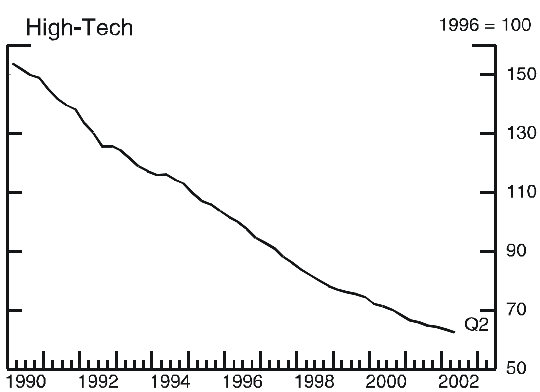
Business Output

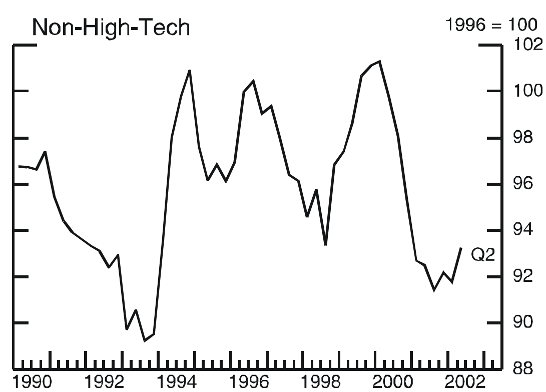


Real Cash Flow



User Cost of Capital*





*Excludes the effects of the partial-expensing tax incentive.

mortgage rates have continued to support housing activity despite stagnant employment and declining household wealth.

Sales of new homes rose 6-3/4 percent in July to an annual rate of just over 1.0 million units, a record high, and the inventory of unsold homes remained low. Sales of existing homes, as published by the National Association of Realtors (NAR), increased 4-1/2 percent in July to an annual rate of 5.33 million units; the gain partly offset June's 11 percent drop. However, this large swing mainly reflected NAR's seasonal adjustment procedures and is not apparent in the estimate produced with the Board staff's seasonal factors which, unlike those of the NAR, include an adjustment for the number of business days each month.[9] July's sales pace—which was about the same using either set of seasonal factors—was below the record highs seen earlier this year and back in line with the average pace of the past four years.

Although house prices continued to move up through the second quarter, some indicators suggest that the pace of increase has slowed recently. The four-quarter rise in the median purchase price of new homes was about 2 percent last quarter, down from the 9-3/4 percent increase registered during the previous year. A deceleration in prices also is evident using the Census Bureau's quality-adjusted measure—from a 4-3/4 percent gain during the four quarters ending in 2001:Q2 to a 2-3/4 percent increase over the most recent four quarters. The repeat-sales index for existing homes—which controls for some of the changes in the composition of homes sold that can affect the median price—has also decelerated about 2 percentage points, to a 6-1/2 percent pace. In contrast, the median purchase price of existing homes has shown no sign of deceleration. It was up 7-1/2 percent last quarter from a year earlier, compared with a 6-1/2 percent increase over the previous year.

The repeat-sales price index has decelerated in most, but not all, metropolitan areas. The most dramatic change has been in the San Francisco Bay area; in San Francisco itself, prices increased almost 15 percent in 2001 but have held about steady in 2002. Many other metropolitan areas (such as Boston and Minneapolis) have experienced a mild deceleration in prices, but some areas (including New York and Washington) have not.

Equipment and Software

On balance, business spending on equipment and software appears to be advancing at a solid clip in the third quarter, buoyed by an increase in motor

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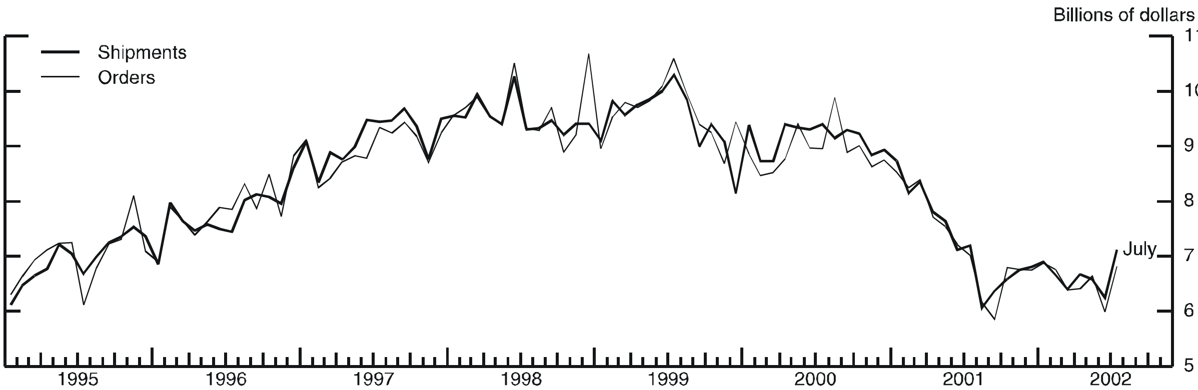
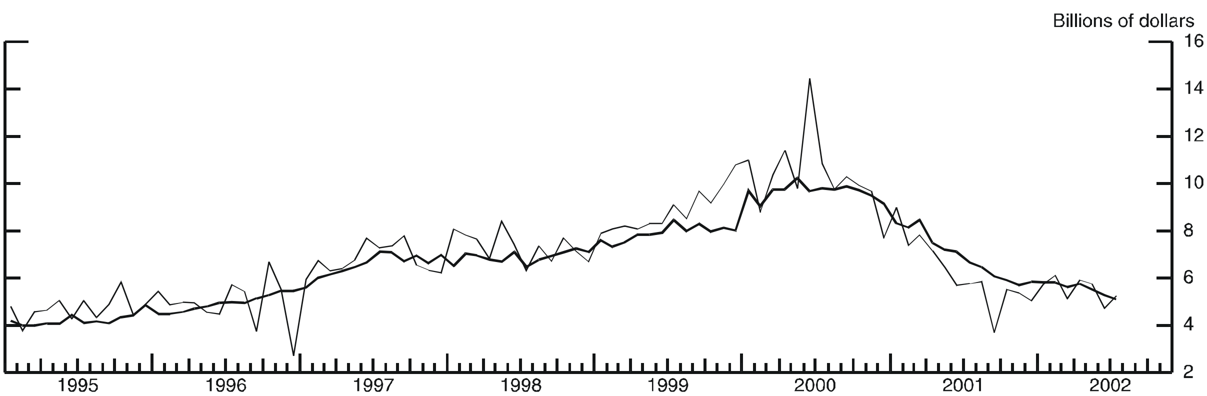
9. The NAR seasonal factor exaggerated the decline in sales in June because it did not take account of the fact that June had five weekends instead of the usual four. With fewer business days, one would expect fewer house-purchase closings.

Recent Data on Orders and Shipments

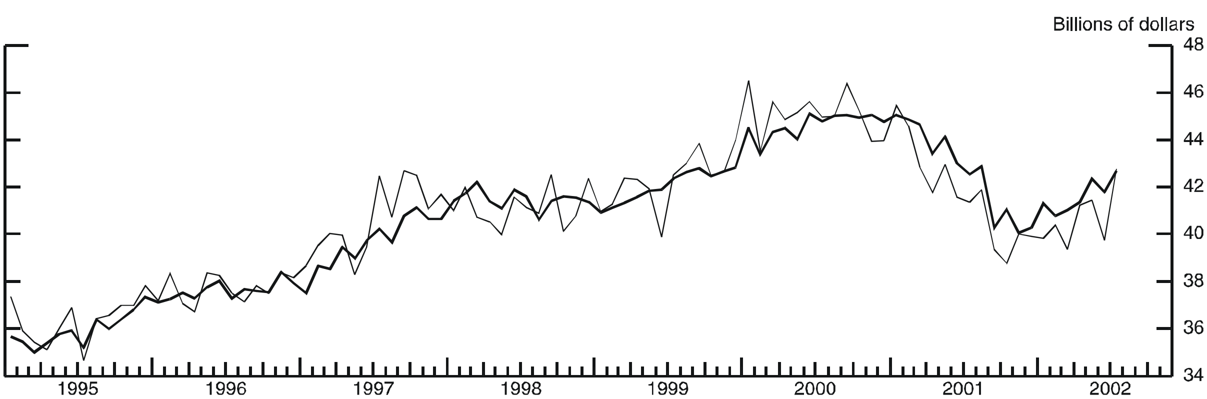
Computers and Peripherals



Communications Equipment



Other Equipment (Total Ex. Transportation, Computers, Communications)



vehicle purchases and a stabilization in aircraft expenditures that followed large declines earlier in the year. Excluding the volatile transportation sector, however, outlays seem to be expanding at a moderate pace, as in the first half of the year. Business output growth, rising corporate cash flow, and the user cost of capital are likely providing some impetus to investment, but anecdotal reports suggest that firms are hesitant to ramp up capital expenditures substantially.

Business spending on aircraft looks poised to move up a bit in the third quarter, but such a move would reverse only a small portion of the considerable decline recorded in the second quarter. The recent low levels of aircraft expenditures reflect the sizable drop in air traffic owing to the recession and the terrorist attacks, factors that are only now being fully reflected in the purchase of new airplanes.

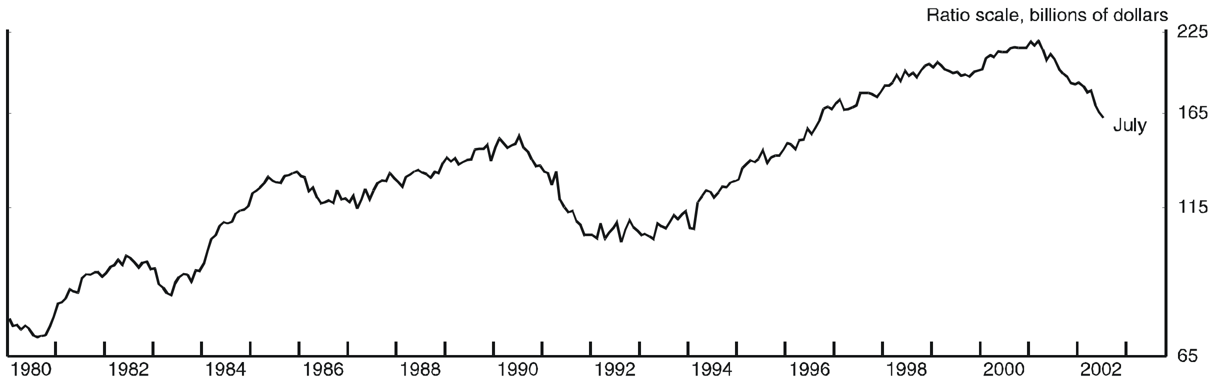
Business demand for motor vehicles has firmed recently, but near-term prospects vary greatly by class of vehicle. Fleet sales of light vehicles increased in each of the past three months, and the level of fleet sales in August was the highest since March 2001. Sales of medium and heavy trucks increased in both July and August. For heavy trucks, the recent pickup in sales reflects businesses' desire to take delivery in advance of new EPA regulations for class 8 trucks that go into effect in October. Sales are likely to be much weaker in the near future, as net orders for heavy trucks have fallen sharply since May.[10] In contrast, orders for medium trucks (classes 5 to 7) have gradually moved higher this year, and they rose again in August.

Nominal shipments of computing equipment surged 13.9 percent in July (not at an annual rate) after a sharp decline in the second quarter. However, several major computer manufacturers have reported that they are expecting fairly flat nominal sales for the quarter as a whole. This anecdotal evidence—along with the extreme volatility of the shipment series—suggests that the July gain is likely to be at least partially reversed in August and September. Still, with computer prices apparently falling more rapidly than in the second quarter, the available data suggest that real computer expenditures will probably pick up this quarter. Software spending, which we estimate to have risen at an annual rate of 11.5 percent in the second quarter, tends to move roughly in line with hardware expenditures and thus seems likely to increase again in the current quarter.

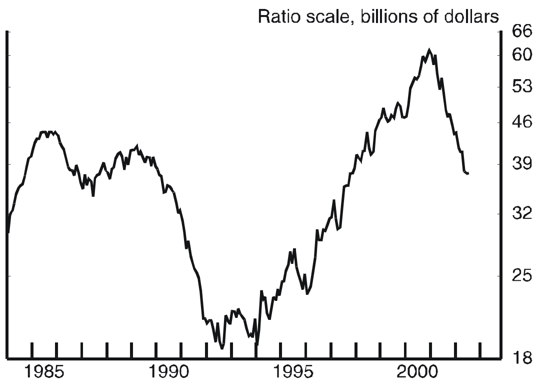
10. The trucking industry remains in the doldrums. Consolidated Freightways Corporation, the nation's third-largest long-distance freight hauler, filed for bankruptcy on September 3. Disruptions due to the closing are expected to be small, according to press reports, because of excess capacity in the industry.

Nonresidential Construction
(Seasonally adjusted, annual rate)

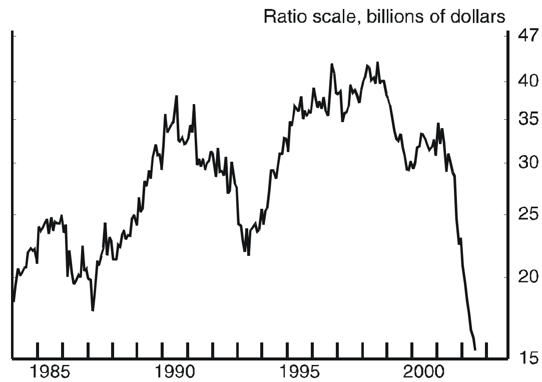
Total Building



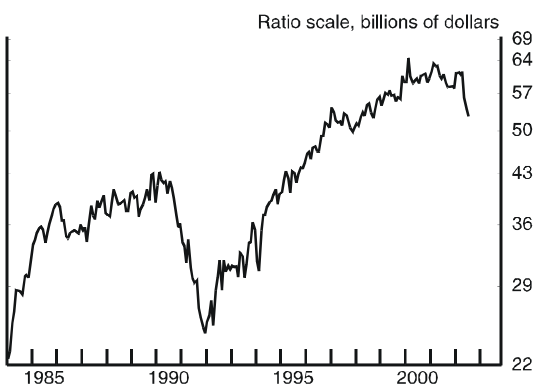
Office



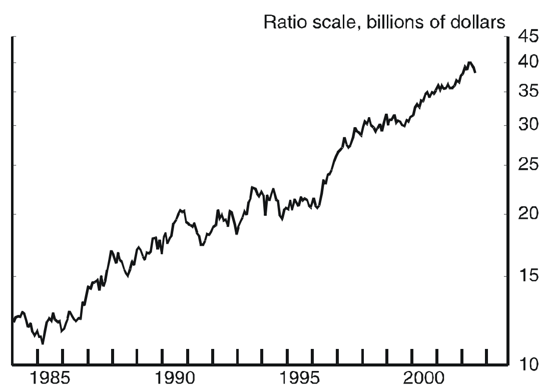
Industrial



Other Commercial



Institutional



EQUIPMENT AND SOFTWARE SPENDING INDICATORS
(Percent change from preceding comparable period;
based on seasonally adjusted data, in current dollars)

	2002		2002		
	Q1	Q2	May	June	July
	-Annual rate-		--Monthly rate--		
Shipments of nondefense capital goods	.3	-1.9	.7	-2.2	3.7
Excluding aircraft	3.3	3.2	1.2	-2.1	3.0
Computers and peripherals	-4.0	-8.8	-1.4	-5.0	13.9
Communications equipment	-5.0	-14.8	-4.0	-4.6	-3.2
All other categories	5.8	8.0	2.4	-1.3	2.2
Shipments of complete aircraft	-27.9	-43.5	-25.0	14.6	22.5
Medium & heavy truck sales (units)	-35.7	16.3	2.2	-8.6	6.2
Orders for nondefense capital goods	9.9	-6.3	3.6	-9.6	14.3
Excluding aircraft	4.3	3.3	.5	-6.3	8.8
Computers and peripherals	-5.5	-18.5	3.5	-9.7	13.8
Communications equipment	27.9	-12.4	-2.8	-18.2	11.6
All other categories	3.1	9.9	.5	-4.1	7.7

In contrast, the near-term outlook for real spending on communications equipment continues to be grim. Shipments of communications equipment fell 3.2 percent in July after a large drop in the second quarter. Bookings increased 11.6 percent in July but are down more than 50 percent since mid-2000. According to statements by manufacturers of communications equipment, telecommunications service providers are still slashing capital expenditures—particularly for equipment not used in their wireless segments.

Apart from the high-tech and transportation sectors, nominal shipments rose 2.2 percent in July after a 1.3 percent decline in June. The level of orders moved above shipments for the first time since early last year, and the backlog of unfilled orders edged up. Shipments of construction machinery and of measuring and controlling devices (a grouping that includes MRIs, volt meters, air conditioning controls, and watches) have been especially strong of late. Real business spending in these categories expanded at a rapid pace in the second quarter, and the most recent shipments data suggest ongoing gains.

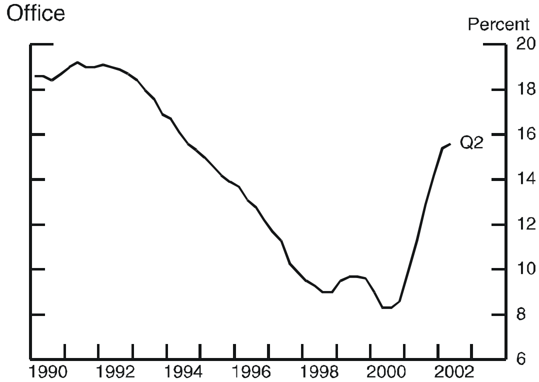
Nonresidential Construction

A decline in nominal spending for construction of nonresidential buildings in July extended the downward trend that began in early 2001. Spending moved lower in every major category except office buildings. In the industrial sector, outlays

Indicators of Nonresidential Construction

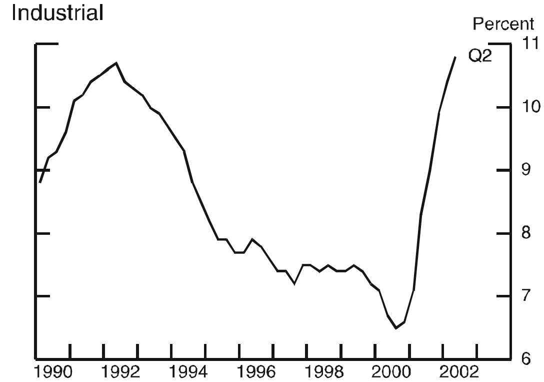
Vacancy Rates

Office



Source. Torto Wheaton Research.

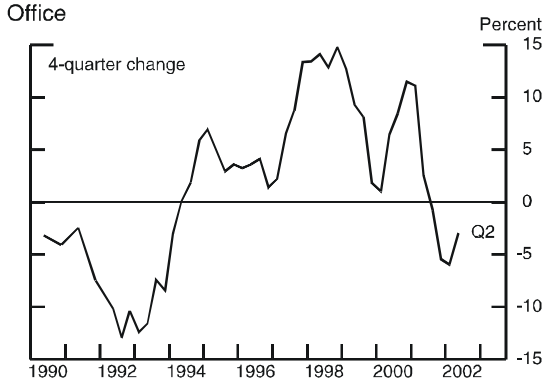
Industrial



Source. Torto Wheaton Research.

Property Values

Office



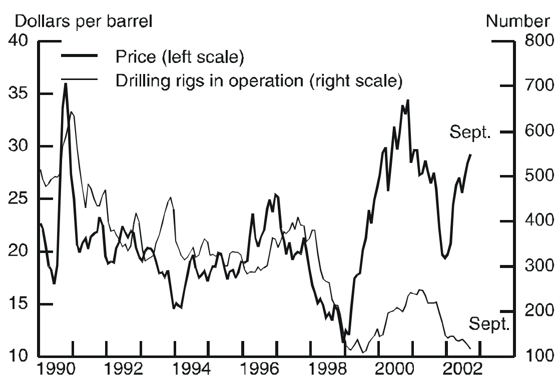
Source. National Real Estate Index.

Retail and Warehouse

Source. National Real Estate Index.

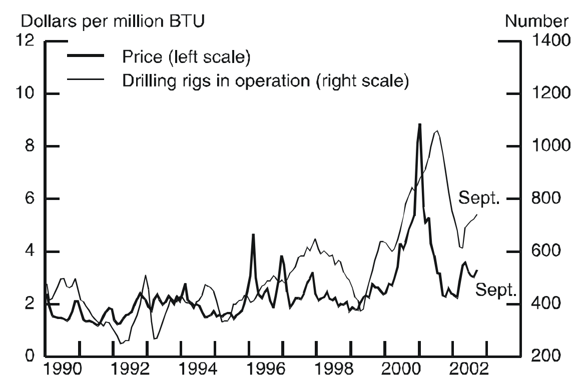
Drilling Activity

Petroleum Prices and Drilling



Note. September values are averages through September 13th.
Source. WTI spot price and DOE/Baker Hughes.

Natural Gas Prices and Drilling



Note. September values are averages through September 13th.
Source. Henry Hub spot price and DOE/Baker Hughes.

dropped 4-1/4 percent in July and now stand at the lowest level in twenty-five years. Spending in the other commercial sector—which includes retail and wholesale space—has dropped sharply during the past several months after having shown resilience through all of 2001 and part of 2002; July's level was almost 15 percent below that of the first quarter. In contrast, outlays for utilities and other private construction rose about 8 percent in July after a 2-3/4 percent increase in June.[11]

Other indicators also suggest that the deterioration of conditions in the office sector may be easing a bit. Although vacancy rates in this sector moved up again last quarter, from 15.4 percent to 15.6 percent, the increase was the smallest in almost two years. In addition, office property values fell less on a year-over-year basis than they have in almost a year. In contrast, the weakening in the industrial sector showed no signs of abating in the second quarter, with the vacancy rate moving up significantly further to nearly 11 percent. Property values in the warehouse sector fell again last quarter, but retail property values were about unchanged.

The number of natural gas drilling rigs in operation rose sharply through mid-September, a gain more than offsetting the slight decline in the number of petroleum rigs in operation. These data suggest that spending on the construction of drilling structures has increased so far this quarter.

Business Inventories

The book value of manufacturing and trade inventories excluding motor vehicles increased at an annual rate of $28.6 billion in July, the second straight monthly gain following declines in every month since February 2001. But gains in sales and shipments further drove down the inventory-sales ratio in July to a very low level.

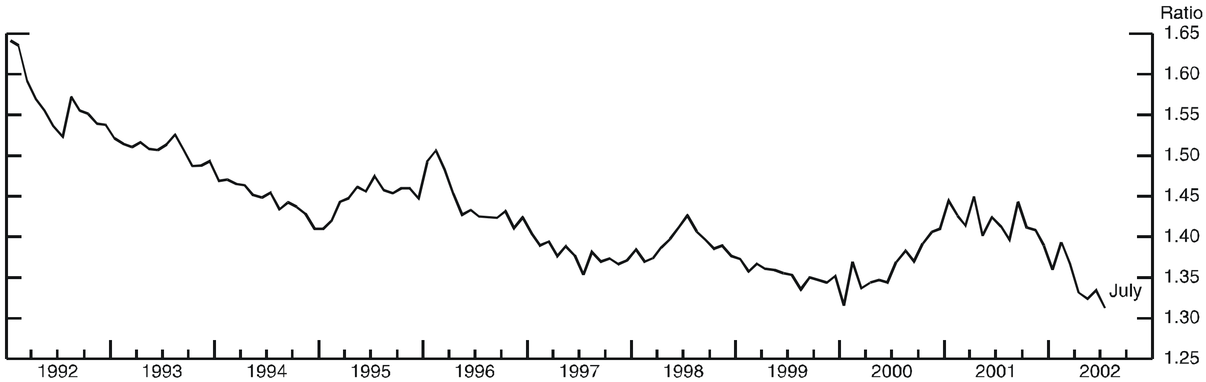
Manufacturers' inventories decreased at an annual rate of $5.0 billion in book-value terms in July after a drop of $12.8 billion in the second quarter. The decline resulted from a sizable liquidation at producers of transportation equipment and likely reflected a large drawdown of inventories held in the early stage of processing in the aircraft industry. Excluding the volatile aircraft sector, inventories rose in July as manufacturers of chemicals, petroleum products, and rubber and plastics accumulated inventories on a book-value basis—a gain that perhaps partly reflected higher prices for inputs into those goods.

11. According to confidential data from the Census Bureau, almost all of July's increase in spending in this sector resulted from a sharp rise in outlays by electric power utilities. Spending in this subsector now stands at about the same level seen early last spring; we have no good explanation for May's and June's weak figures.

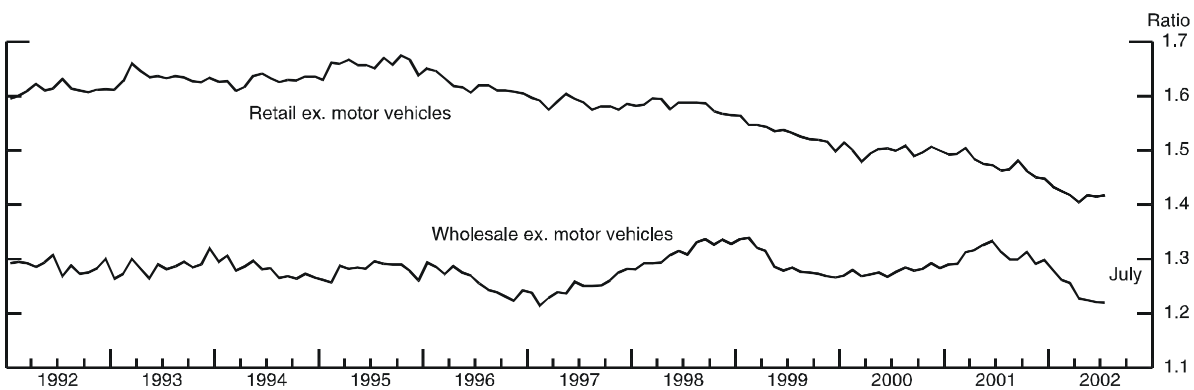
Changes in Manufacturing and Trade Inventories
(Billions of dollars, seasonally adjusted book value, annual rate)

Category	2001 Q4	2002 Q1	2002 Q2	2002 May	2002 June	2002 July
Manufacturing and trade	-143.8	-26.7	12.6	32.0	35.1	60.3
Less wholesale and retail motor vehicles	-90.6	-45.1	-11.5	-11.9	15.8	28.6
Manufacturing	-51.5	-30.9	-12.8	-18.7	-4.3	-5.0
Less aircraft	-48.0	-25.4	-10.7	-19.2	-4.6	1.7
Merchant wholesalers	-31.4	-17.1	-5.6	-1.4	15.1	21.7
Less motor vehicles	-28.6	-13.3	-7.7	-8.4	11.4	18.1
Retail trade	-60.9	21.3	31.0	52.0	24.3	43.6
Automotive dealers	-50.3	22.1	22.0	36.8	15.6	28.1
Less automotive dealers	-10.6	-0.8	9.0	15.2	8.8	15.5

Inventories Relative to Shipments: Manufacturing



Inventories Relative to Sales: Trade



A rise of $18.1 billion (annual rate) in the book value of wholesale inventories (excluding motor vehicles) in July followed a $7.7 billion pace of liquidation in the second quarter. The bulk of the accumulation reflected stockbuilding at distributors of farm products, machinery, and miscellaneous nondurables—a category that includes farm supplies, books, flowers, tobacco, and paint. Most other categories registered small inventory changes.

Retailers (excluding automotive dealers) accrued inventory stocks at an annual rate of $15.5 billion in July after having built inventories at a $9.0 billion pace in the second quarter. An accumulation at general merchandisers accounted for more than half of the July buildup. The ratio of inventories to sales ticked up—especially at stores carrying furniture, electronics, and appliances—but remains at a fairly low level.

Federal Government

The Federal budget continues to deteriorate, albeit at a slower pace than earlier this year. A supplemental spending bill for fiscal 2002 was enacted in August, but little progress has been made on appropriations for fiscal 2003. The Congressional Budget Office's mid-year update of the budget outlook indicated that the budget will move back to balance over the next five years under the baseline assumption that no new spending initiatives or tax cuts are enacted.

Over the twelve months ending in July, the budget recorded a deficit of $192 billion, compared with a surplus of $227 billion over the previous twelve months. This swing of more than $400 billion reflects the slowdown in economic activity, policy actions, and an unusually sharp deterioration in personal tax receipts relative to income.

Total receipts in July 2002 were 5 percent above the year-earlier level. However, receipts had been held down in July 2001 by the issuance of refund checks. Abstracting from those checks as well as from calendar-related variation, July receipts declined on a year-over-year basis, in part because of the lower withholding schedules embodied in last year's tax act. In recent months, withheld taxes have been a bit softer than we would have expected given the new tax law and the BEA's estimates for wages and salaries. Net corporate income tax collections over the twelve months ending in July were 32 percent below their level in the previous twelve months, compared with a 4 percent increase in economic profits shown in the NIPA data for the year ending 2002:Q2 compared with the year ending 2001:Q2. This difference partly reflects the partial expensing provision and other tax law changes enacted in March. Daily Treasury data indicate that corporate collections rebounded sharply in September.

Federal government outlays in July were 11 percent above their year-earlier level (adjusted for regular shifts in payment timing). Over the twelve months ending in

Federal Government Outlays and Receipts

(Unified basis; billions of dollars)

Function or source	July 2001	July 2002	July Percent change	12 months ending in July 2001	12 months ending in July 2002	12 months ending in July Percent change
Outlays	125.0	163.6	30.8	1,840.4	2,009.0	9.2
Deposit insurance	0.0	-0.3	...	-2.1	-0.3	...
Spectrum auctions	-12.4	0.0	...	-13.4	12.4	...
Sale of major assets	0.0	0.0	...	0.0	0.0	...
Other	137.4	163.9	19.3	1,855.9	1,996.9	7.6
Receipts	127.8	134.4	5.1	2,067.5	1,817.1	-12.1
Surplus	2.8	-29.2	...	227.1	-191.9	...
	Outlays excluding deposit insurance, spectrum auction, and sale of major assets are adjusted for payment timing shifts[1]					
Outlays	147.4	163.9	11.2	1,855.9	1,994.3	7.5
Net interest	17.3	15.0	-13.2	212.1	176.2	-17.0
Non-interest	130.1	148.9	14.5	1,643.7	1,818.1	10.6
National defense	24.7	29.2	18.3	303.2	340.2	12.2
Social security	37.1	38.1	2.6	429.7	452.1	5.2
Medicare	18.7	20.8	11.3	211.0	228.1	8.1
Medicaid	10.6	12.6	18.6	128.8	145.2	12.8
Other health	3.5	4.1	17.5	41.7	47.7	14.4
Income security	19.8	25.2	27.8	262.2	302.0	15.2
Agriculture	0.2	0.1	-61.3	31.6	28.0	-11.1
Other	15.6	18.8	21.0	235.6	274.7	16.6
Receipts	127.8	134.4	5.1	2,067.5	1,817.1	-12.1
Individual income and payroll taxes	109.7	115.0	4.9	1,687.6	1,502.3	-11.0
Withheld + FICA	114.3	113.5	-0.7	1,417.1	1,377.2	-2.8
Nonwithheld + SECA	5.6	5.0	-9.9	423.2	331.4	-21.7
Refunds (-)	10.2	3.5	-65.4	152.8	206.3	35.0
Corporate	2.7	1.7	-38.2	188.6	128.2	-32.0
Gross	5.0	6.8	35.9	225.3	187.0	-17.0
Refunds (-)	2.3	5.2	122.0	36.8	58.9	60.0
Other	15.4	17.7	14.7	191.4	186.6	-2.5
Surplus	-19.5	-29.5	...	211.6	-177.2	...

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

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

... Not applicable.

CBO BUDGET PROJECTIONS AND ECONOMIC ASSUMPTIONS

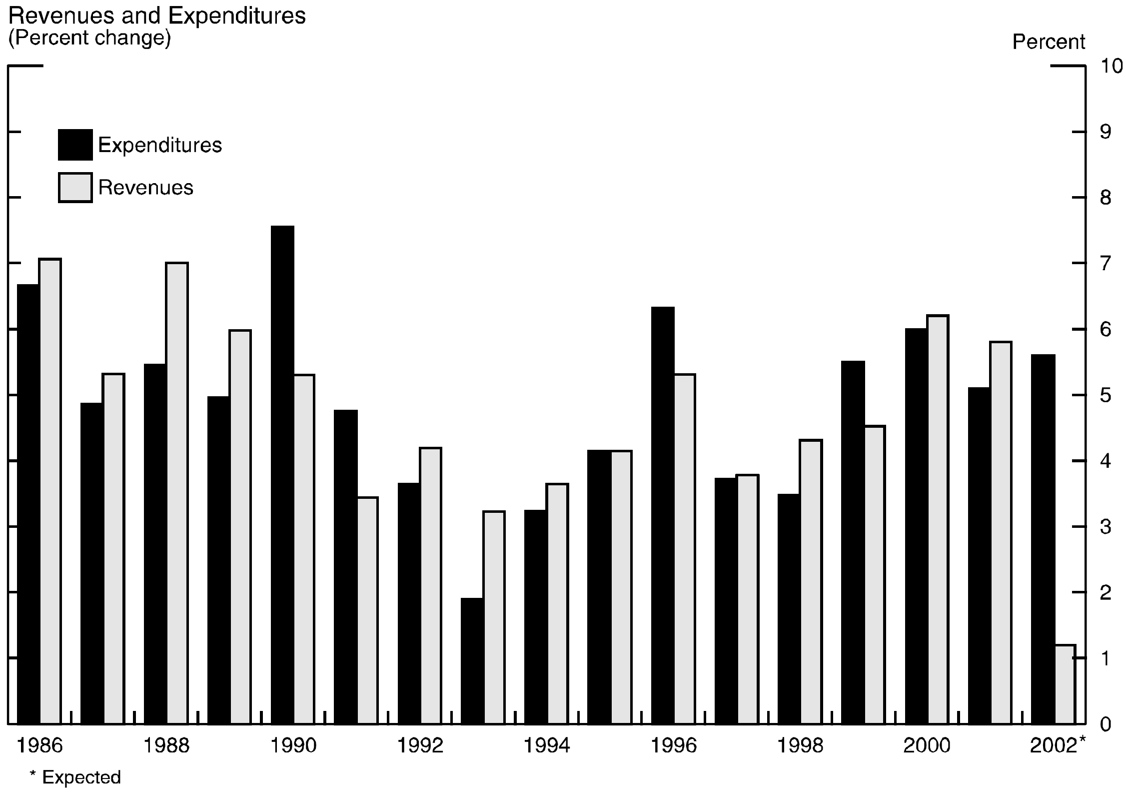
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Budget projections under current policies[1] (fiscal years)											
	Billions of dollars										
Total surplus	-157	-145	-111	-39	15	52	88	133	177	323	522
On-budget	-314	-315	-299	-246	-209	-190	-174	-147	-122	4	185
Off-budget	157	170	188	207	224	242	262	280	299	319	337
Economic assumptions (calendar years)											
	Percent change, year over year										
Nominal GDP	3.4	4.6	5.2	5.2	5.3	5.4	5.4	5.3	5.3	5.2	5.2
Real GDP	2.3	3.0	3.3	3.1	3.2	3.2	3.2	3.2	3.1	3.1	3.0
CPI-U	1.6	2.9	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
	Percent, annual average										
Unemployment rate	5.9	5.9	5.5	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2
Treasury yields											
Three-month	1.7	3.0	4.8	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9
Ten-year	5.0	5.5	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8

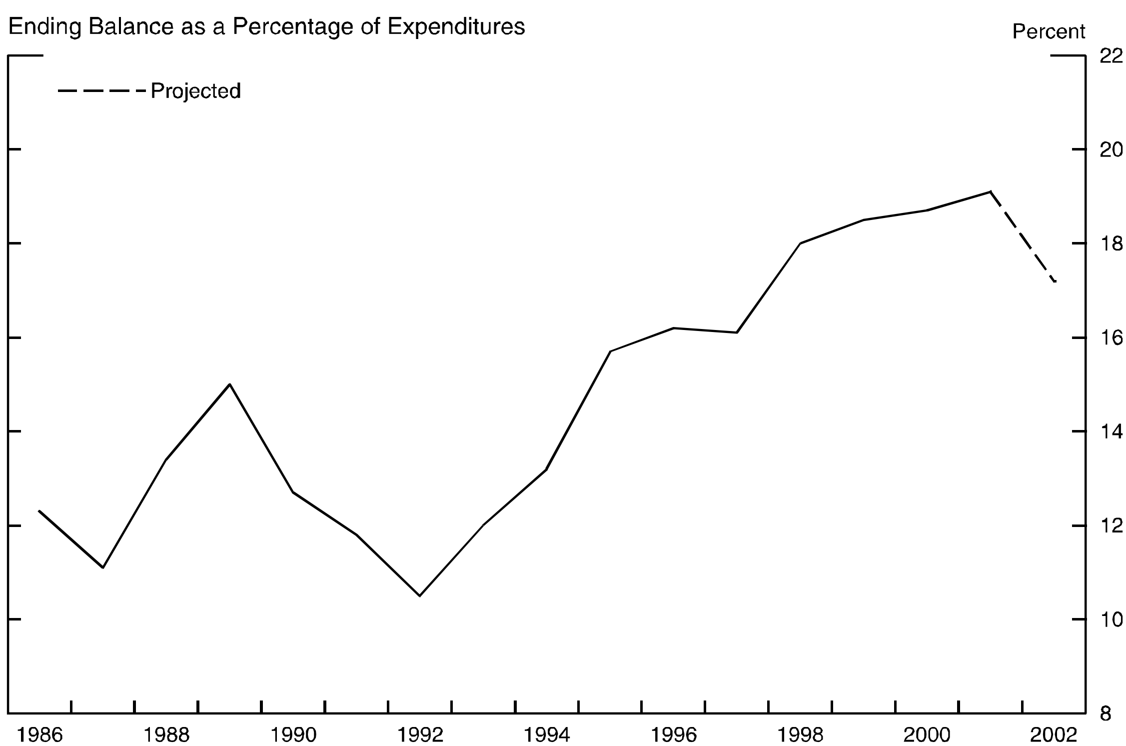
1. The on-budget surplus excludes the social security surplus and the Postal Service (which are off-budget). The current policies baseline assumes that budget authority for discretionary spending grows at the rate of inflation after 2002 and no new mandatory spending or tax legislation is enacted. Baseline includes the budget effects of the economic stimulus legislation enacted in March 2002 and supplemental appropriations enacted in January 2002 and August 2002.

Source. Congressional Budget Office, The Budget and Economic Outlook: An Update (August 2002).

City Fiscal Conditions

(Fiscal Years)





Source. National League of Cities.

July, outlays adjusted for timing shifts were 7-1/2 percent higher than a year earlier, as noninterest outlays rose more than 10 percent—the fastest rate of increase in a decade. This increase has been propelled by double-digit gains in defense and nondefense discretionary spending as well as by surging expenditures for health programs including Medicaid and Medicare.

In August, President Bush signed into law a $24 billion supplemental appropriations bill for fiscal 2002. The bill included an additional $5 billion in budget authority that was contingent upon the President agreeing to the emergency designation made by the Congress; the President did not agree to this designation, preferring to fund some of the affected programs out of regular fiscal 2003 appropriations. Progress on fiscal 2003 appropriations bills has been hampered by the lack of a congressional budget resolution and disagreement about the overall level of appropriations. Thus, the Congress likely will need to enact a continuing resolution to provide temporary spending authority for many programs when the fiscal year begins October 1. Indeed, as has been the case frequently in recent years, the appropriations process may extend well into the fall. The possibility of a lame-duck session after the elections has already been mentioned by the Senate leadership.

The Congressional Budget Office's mid-year update of the budget outlook indicated that the budget will record a deficit of $157 billion in fiscal 2002 and a similar deficit in 2003 if no new spending initiatives or tax cuts are enacted. The baseline deficit projection includes the effects of the supplemental appropriations bill enacted in August, but the resulting level of discretionary spending for fiscal 2003 and beyond is still a bit below the Administration's request. The baseline budget is projected to move back into surplus by 2006. The CBO's budget projections were based on an economic forecast that envisioned the economy growing about 3 percent on average during the next five years and the unemployment rate falling to 5.2 percent (the CBO's estimate of the NAIRU) by 2005.

State and Local Governments

State and local government employment increased about 20,000 in both July and August. Employment at state universities and colleges was flat, whereas it averaged an increase of 6,000 per month during the same months in 2000 and 2001, suggesting that these public institutions have felt the effects of state budget cuts this summer. In contrast, hiring was quite strong at public elementary and secondary schools, probably because of continuing enrollment increases and greater availability of teachers and support staff. Construction spending rose 1-1/2 percent (monthly rate) in July.

While most state budgets have eroded over the past year, the fiscal condition of many cities has remained quite strong. According to the National League of

RECENT PRICE INDICATORS
(Percent)

	From 12 months earlier		From 3 months earlier		2002	
	Aug. 2001	Aug. 2002[1]	May 2002	Aug. 2002[1]	July	Aug.[1]
			-Annual rate-		-Monthly rate-	
CPI						
Total	2.7	1.8	3.4	2.2	0.1	0.3
Food	3.1	1.2	0.0	0.5	0.2	-0.1
Energy	2.8	-2.8	34.4	4.0	0.4	0.6
Ex. food and energy	2.7	2.4	2.1	2.1	0.2	0.3
Ex. tobacco	2.6	2.2	2.2	1.8	0.2	0.3
Core commodities	0.1	-0.7	-1.4	-0.3	-0.1	0.2
Core services	3.8	3.7	3.4	3.4	0.3	0.4
Current-methods total	2.7	1.8	3.4	2.2	0.1	0.3
Ex. food and energy	2.7	2.4	2.1	2.1	0.2	0.3
Ex. tobacco	2.6	2.2	2.2	1.8	0.2	0.3
Chained CPI (NSA)	2.1	1.3	--	--	--	--
Ex. food and energy	1.9	1.7	--	--	--	--
PCE Prices						
Total	2.1	1.4	2.4	2.0	0.2	0.2
Food	3.0	1.4	-0.2	1.0	0.2	-0.0
Energy	1.8	-3.0	36.2	4.7	0.5	0.6
Ex. food and energy	2.0	1.7	1.3	2.0	0.1	0.3
Ex. tobacco	1.9	1.5	1.3	1.7	0.1	0.2
Core commodities	-0.8	-1.0	-1.2	-0.9	-0.2	0.2
Core services	3.2	2.8	2.4	3.3	0.3	0.3
Core market-based	1.7	1.4	1.1	1.5	0.1	0.3
Core nonmarket-based	2.8	2.6	2.1	3.8	0.4	0.3
PPI						
Total finished goods	2.0	-1.6	1.5	-0.3	-0.2	0.0
Food	3.9	-2.4	-10.0	-1.1	-0.1	-0.4
Energy	0.7	-5.8	28.1	4.6	0.1	1.0
Ex. food and energy	1.5	-0.3	0.0	-1.1	-0.3	-0.1
Ex. tobacco	0.9	-0.6	-0.8	-1.2	-0.4	-0.1
Core consumer goods	2.0	0.1	1.0	-0.8	-0.4	-0.1
Capital equipment	0.8	-1.0	-1.1	-1.4	-0.4	-0.1
Intermediate materials	-0.2	-0.9	6.5	3.2	0.2	0.4
Ex. food and energy	-0.8	0.4	2.4	3.3	0.2	0.4
Crude materials	-4.5	-4.2	51.5	-5.7	0.6	1.6
Ex. food and energy	-9.3	9.2	25.6	15.3	1.7	0.4

1. PCE prices in August are staff estimates.

Cities' most recent annual survey, property tax collections have held up well in recent years, and they are expected to rise another 6 percent during fiscal 2002.[12] Property taxes are the mainstay of most cities' budgets, accounting for nearly 30 percent of cities' own-source revenue. However, a fair number of cities depend to a significant extent on income and sales taxes; these revenues came in below expectations at the end of calendar 2001 and the beginning of 2002, and they were projected to increase only about 1 percent for fiscal 2002 as a whole. As a result, the rise in overall tax receipts was projected to be significantly smaller than in the previous fiscal year. With general fund expenditures expected to move up substantially, ending balances measured as a share of expenditures were projected to decline a little from their record high in fiscal 2001.

Prices

Price inflation edged up in August, but the average inflation rate during the past several months remained below the pace seen last year. Through the August readings, the twelve-month rate of increase in both the CPI and the PCE price index was about 3/4 percentage point less than its year-earlier reading.[13] Although much of the past year's slowdown in inflation has occurred in the volatile food and energy sectors, core inflation has eased as well.

Consumer energy prices rose 0.6 percent in August, following an increase of 0.4 percent in July. In August, the price of natural gas fell further, but prices for fuel oil, gasoline, and electricity increased. Much of the rise in gasoline prices this summer reflected the pass-through of increases in crude oil prices from their mid-June trough; these increases now cumulate to about $5 per barrel. However, gasoline inventories are plentiful, and from mid-July through mid-September, refiners apparently have been forced to squeeze their margins rather than fully pass along the increases in crude oil cost. Although the CPI for natural gas has been declining all summer, spot prices have turned up a bit since mid-August as a surplus of natural gas inventories diminished slightly. The recent erosion of this inventory glut may reflect, in part, the protracted drought along the eastern seaboard and in some western states, which has forced some utilities that typically depend on hydroelectric generation to turn to higher-cost coal and natural gas.

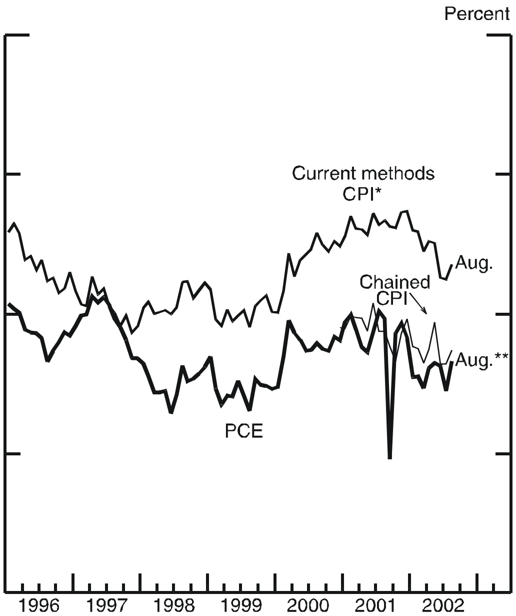
Prices for consumer foods fell 0.1 percent in August. Although a drought this summer in many agricultural regions has boosted crop prices considerably, it also

12. The National League of Cities began collecting city fiscal data in the mid-1980s. The recent survey was conducted in March and April. For about 40 percent of cities, the fiscal year corresponds to the calendar year; for another 40 percent, the fiscal year ends on June 30; among the remaining 20 percent of cities, most end their fiscal year September 30.

13. The PCE price index for August will be released on September 30; the statements in the text refer to estimates by the Board staff based on published CPI and PPI data.

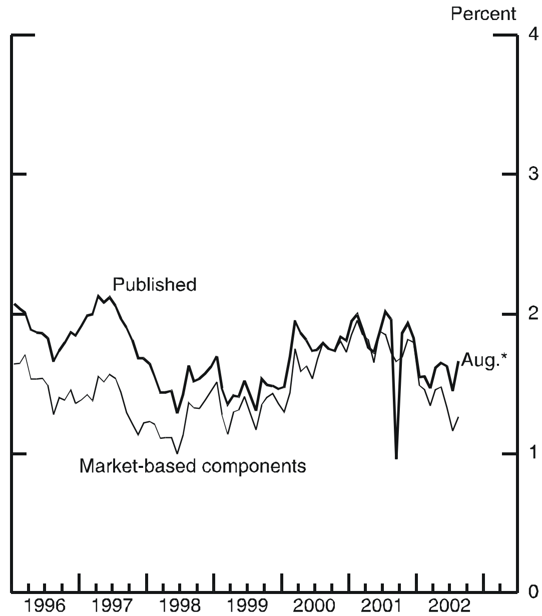
Measures of Core Consumer Price Inflation
(12-month change)

CPI and PCE excluding Food and Energy



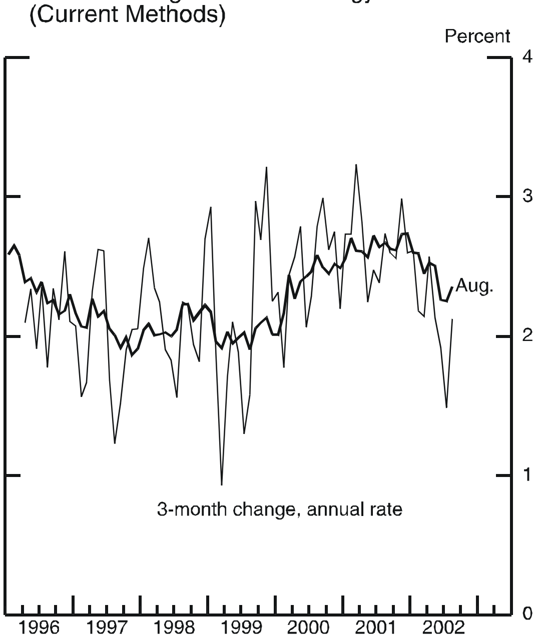
* Reproduced, along with 3-month change, in lower left panel.
** Staff estimate

PCE excluding Food and Energy

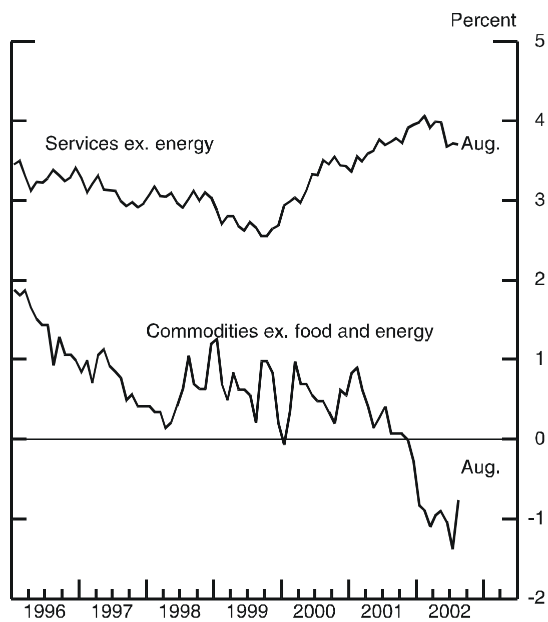


* Staff estimate

CPI excluding Food and Energy
(Current Methods)



CPI Services and Commodities



has contributed to a selloff of livestock that has pushed down prices for meat and poultry. Over the twelve months ended in August, consumer food prices rose 1.2 percent; they were up 3.1 percent in the previous twelve-month period.

Consumer prices for items other than food and energy rose 0.3 percent in August; on a twelve-month basis, core consumer prices were up 2.4 percent through August, compared with 2.7 percent in the preceding twelve months. The deceleration in the core CPI has been most pronounced for goods prices, which fell 0.7 percent in the twelve months ended in August after an increase of 0.1 percent in the preceding year. By contrast, prices of non-energy services rose 3.7 percent in the twelve months ended in August, quite close to the 3.8 percent increase one year earlier.

On the basis of the Board staff's translation of published price data, we estimate that the PCE price index for items other than food and energy rose 1.7 percent during the twelve months ended in August, a deceleration from the 2.0 percent gain in the previous year. The slowdown in core PCE inflation was apparent both for commodities (which through August slowed 0.2 percentage point relative to one year earlier) and for services (which slowed 0.4 percentage point). The deceleration in core PCE prices also is evident for the market-based components of the index, which rose 1.4 percent in the twelve months ended in August versus an increase of 1.7 percent the preceding year, and for the part of core PCE for which market-based prices are not available, which is estimated to have risen 2.6 percent in the year ended in August and 2.8 percent in the previous year.

The BLS has begun to publish a new index called the chained CPI or C-CPI-U, which it constructs with a so-called "superlative" aggregation formula. This new method of summarizing the data on consumer prices for specific items takes account of changes in the mix of purchases by consumers in response to changes in relative prices.[14] According to this measure, prices rose 1.3 percent in the twelve months ended in August, compared with an increase of 2.1 percent in the preceding year. Excluding food and energy, the chained CPI increased 1.7 percent in the twelve months ended in August, down 0.2 percentage point from one year earlier. These increases in the chained core CPI are similar in magnitude to the corresponding increases in the core PCE price index, which suggests that a substantial part of the difference between the PCE and official CPI measures of inflation in recent years may have arisen from the fixed-weight character of the latter index. Although the chained CPI and the PCE price index

14. By contrast, the official CPI uses a Laspeyres formula, which tends to overstate increases in prices by not factoring in consumers' moves to lower-cost items when relative prices change. In the official index, the market-basket weights are now scheduled to be updated every two years. The chained CPI is available only after 1999, and it is not seasonally adjusted.

BROAD MEASURES OF INFLATION
(4-quarter percent change)

	1999 Q2	2000 Q2	2001 Q2	2002 Q2
Product prices				
GDP chain price index	1.5	2.1	2.5	1.0
Less food and energy	-3.7	2.0	2.0	1.4
Nonfarm business chain price index[1]	1.1	1.8	2.0	0.4
Expenditure prices				
Gross domestic purchases chain price index	1.4	2.5	2.3	0.9
Less food and energy	-5.7	1.9	1.9	1.4
PCE chain price index	1.6	2.6	2.4	1.1
Less food and energy	1.4	1.8	1.8	1.6
PCE chain price index, market-based components	1.5	2.6	2.5	0.8
Less food and energy	1.3	1.6	1.8	1.4
CPI	2.1	3.3	3.4	1.3
Less food and energy	2.1	2.4	2.6	2.5
Current-methods CPI	2.0	3.3	3.4	1.3
Less food and energy	2.0	2.3	2.7	2.4
Median CPI	2.7	2.5	3.7	3.6
Trimmed mean CPI	1.7	2.4	2.9	2.2

1. Excluding housing.

SURVEYS OF (CPI) INFLATION EXPECTATIONS
(Percent)

	Actual inflation[1]	University of Michigan: 1 year, Mean[2]	1 year, Median[2]	5 to 10 years, Mean[3]	5 to 10 years, Median[3]	Professional forecasters (10-year)[4]
2000-Q4	3.4	3.8	3.0	3.7	3.0	2.5
2001-Q1	3.4	3.4	2.9	3.6	3.0	2.5
Q2	3.4	3.9	3.1	3.6	3.0	2.5
Q3	2.7	3.1	2.7	3.5	2.9	2.5
Q4	1.9	1.5	1.1	3.1	2.8	2.6
2002-Q1	1.3	2.6	2.2	3.1	2.8	2.5
Q2	1.3	3.1	2.7	3.4	2.9	2.5
Q3		2.8	2.6	3.2	2.7	2.5
Apr.	1.6	3.1	2.8	3.2	2.8	
May	1.2	3.1	2.7	3.6	3.0	
June	1.1	3.0	2.7	3.3	2.8	2.5
July	1.5	2.7	2.6	3.2	2.8	
Aug.	1.8	2.6	2.6	3.5	2.9	
Sept.		3.2	2.6	3.0	2.5	2.5

1. CPI; percent change from the same period in the preceding year.
2. Responses to the question: By about what percent do you expect prices to go up, on the 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 the average, during the next 5 to 10 years?
4. Compiled by the Federal Reserve Bank of Philadelphia.

show smaller increases over the past couple of years than does the official CPI, all three price measures show similar-sized decelerations.

Survey measures of expected inflation show less decline than measures of actual inflation. According to the Michigan survey for the first part of September, median one-year-ahead inflation expectations were 2.6 percent; this figure puts the third-quarter estimate of inflation expectations also at 2.6 percent, which is very close to the reading for the third quarter of last year. Longer-term inflation expectations also were little changed through the summer—with median five-to-ten year expectations holding between 2-3/4 percent and 3 percent, a range that has prevailed for several years—but the preliminary reading for September ticked down below this range.

Commodity prices have moved up a little, on balance, since the last Greenbook, and prices for most commodities stand well above the lows that were established late last year. An August gain of 0.4 percent in the PPI for intermediate materials excluding food and energy brought the twelve-month change to 0.4 percent, a noticeable pickup relative to the decline of 0.8 percent in the preceding twelve-month period. Prices for core crude materials rose further in August; this series now has increased 9.2 percent over the past twelve months and has thus reversed the previous year's decline of more than 9 percent. Recent increases in prices for most metals and crude oil have helped reverse some of the July decline in the *Journal of Commerce* industrial price index. The CRB futures index, which has risen more than 8 percent since early August, has been boosted by drought-related increases for many crops. Crop conditions seem to have stabilized because of substantial rainfall in recent weeks in the major growing areas, and most forecasters now point to about a 7 percent drop this year in the output of corn and a similar decline in soybean production.

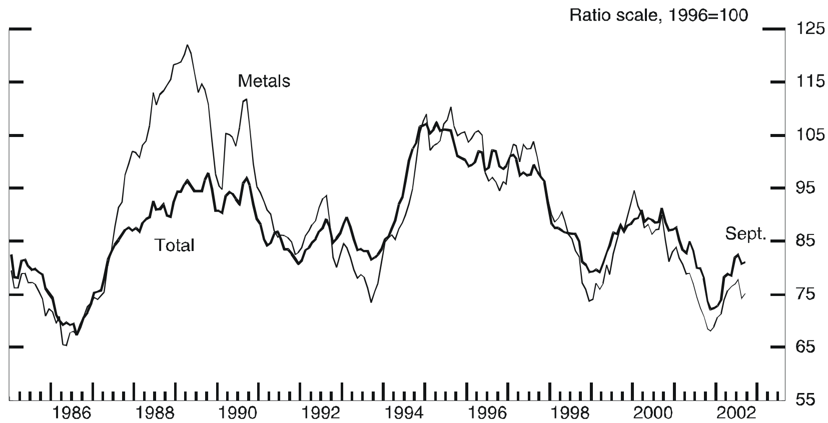
Labor Costs

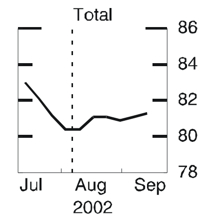
Average hourly earnings for production or nonsupervisory workers rose 0.3 percent in August after a 0.2 percent gain in July. Higher unemployment and lower consumer price inflation have contributed to a sharp deceleration in this measure of labor costs; average hourly earnings increased 3.1 percent over the twelve months ended in August and 4.1 percent over the preceding twelve-month period.

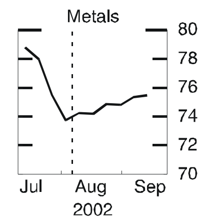
The latest available data on broader measures of compensation are for the second quarter. A second-quarter gain of 3.7 percent (annual rate) for compensation per hour in the nonfarm business sector boosted the four-quarter change to about 2-1/2 percent. This measure of labor costs has accelerated over the past couple of quarters despite the pronounced deceleration in average hourly earnings; the difference likely reflects the dissipation of the drag associated with the declining exercise of stock options during much of 2001 as equity prices slumped. The

Commodity Price Measures

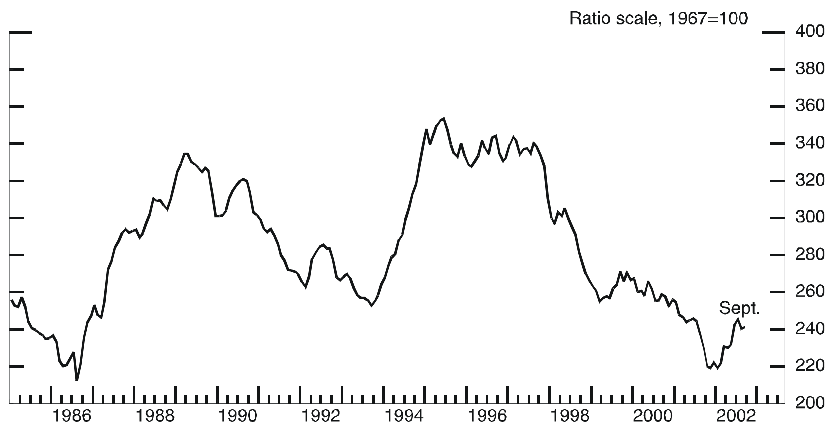
Journal of Commerce Index

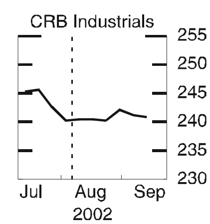




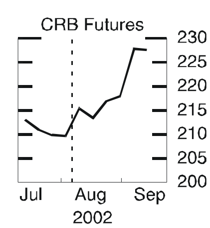


CRB Spot Industrials





CRB Futures



Note. Larger panels show monthly average of weekly data through last available week. Smaller panels show weekly data, Tuesdays. Vertical lines on small panels indicate week of last Greenbook. The Journal of Commerce index is based almost entirely on industrial commodities, with a small weight given to energy commodities, and the Commodity Research Board (CRB) spot price index consists entirely of industrial commodities, excluding energy. The CRB futures index gives about a 60 percent weight to food commodities and splits the remaining weight roughly equally among energy commodities, industrial commodities, and precious metals. Copyright for Journal of Commerce data is held by CIBCR, 1994.

SPOT PRICES OF SELECTED COMMODITIES

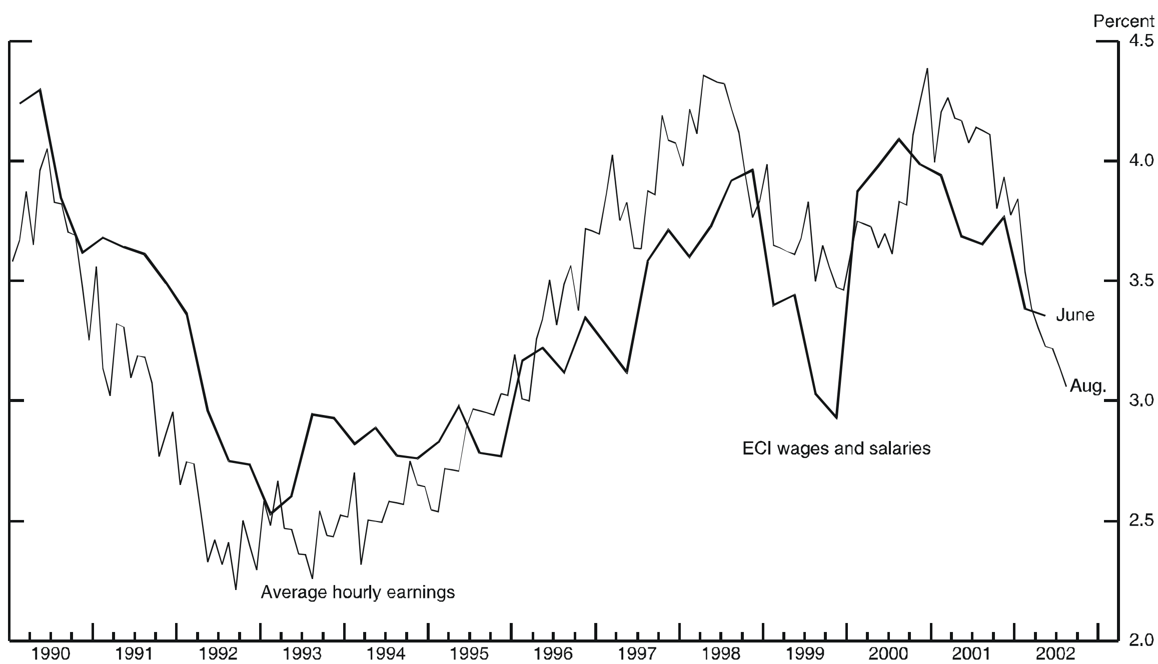
	Current price (dollars)	Percent change[1] 2000	2001	Dec. 25 to Aug. 06[2]	Aug. 06[2] to Sept. 17	Memo: Year earlier to date
Metals						
Copper (lb.)	0.720	5.7	-22.0	0.0	1.4	4.3
Steel scrap (ton)	103.667	-32.7	-17.7	56.4	2.0	30.7
Aluminum, London (lb.)	0.594	1.9	-14.3	-4.0	2.2	-3.1
Precious metals						
Gold (oz.)	315.900	-4.7	1.2	10.2	3.3	9.2
Silver (oz.)	4.590	-11.2	-3.5	3.1	-1.2	3.6
Forest products[3]						
Lumber (m. bdft.)	204.000	-41.5	25.0	4.9	-13.6	-30.8
Plywood (m. sqft.)	298.000	-4.9	3.2	6.2	-2.9	-9.7
Petroleum						
Crude oil (barrel)	27.700	-1.1	-16.3	38.0	7.8	2.5
Gasoline (gal.)	0.755	7.6	-28.0	47.7	-3.3	-9.7
Fuel oil (gal.)	0.759	24.6	-42.6	21.0	15.1	-1.0
Livestock						
Steers (cwt.)	65.220	9.9	-19.7	0.7	4.7	-6.2
Hogs (cwt.)	28.500	10.2	-9.9	2.9	-18.6	-38.7
Broilers (lb.)	0.542	-13.9	3.7	1.3	3.7	-13.9
U.S. farm crops						
Corn (bu.)	2.615	11.4	-4.1	20.4	9.2	35.5
Wheat (bu.)	5.025	31.4	-8.9	31.3	20.6	60.3
Soybeans (bu.)	5.670	13.1	-13.4	29.8	2.6	24.1
Cotton (lb.)	0.373	31.4	-45.7	22.6	-4.5	14.8
Other foodstuffs						
Coffee (lb.)	0.493	-47.8	-35.3	-6.8	20.1	10.7
Memo:						
JOC Industrials	81.300	-0.1	-17.1	11.7	1.1	3.7
JOC Metals	75.500	-9.3	-17.0	6.6	2.3	6.6
CRB Futures	227.530	12.0	-16.3	9.4	8.5	15.0
CRB Spot Industrials	240.900	-2.7	-14.6	9.5	0.3	5.3

1. Changes, if not specified, are from the last week of the preceding year to the last week of the period indicated.
2. Week of the August Greenbook.
3. Reflects prices on the Friday before the date indicated.

AVERAGE HOURLY EARNINGS
(Percent change; based on seasonally adjusted data)

	12-month percent change			Percent change to Aug 2002 from month indicated		Percent change	
	Aug. 2000	Aug. 2001	Aug. 2002	Feb. 2002	May 2002	July 2002	Aug. 2002
	- - - - - - - - Annual rate- - - -					-Monthly rate-	
Total private nonfarm	3.8	4.1	3.1	2.8	3.3	0.2	0.3
Manufacturing	3.1	3.3	2.9	2.3	1.8	-0.2	0.4
Construction	4.2	2.3	2.8	2.3	2.6	0.3	0.1
Transportation and public utilities	3.2	3.4	3.2	2.2	0.9	-0.2	0.1
Finance, insurance, and real estate	4.0	4.3	3.2	3.9	5.6	0.6	0.2
Retail trade	3.9	3.1	3.0	3.3	3.7	-0.1	0.3
Wholesale trade	4.2	3.9	2.6	1.4	4.5	0.0	0.9
Services	4.2	5.5	3.7	3.5	3.7	0.5	0.2

Average Hourly Earnings for Production or Nonsupervisory Workers
(12-month change)



LABOR COSTS
(Percent change, annual rate; based on seasonally adjusted data)

	2000[1]	2001[1]	2001 Q3	2001 Q4	2002 Q1	2002 Q2	2001:Q2 to 2002:Q2
<u>Compensation per hour</u>							
Total business	7.3	1.5	0.9	1.4	3.8	4.0	2.5
Nonfarm business	7.2	1.4	1.0	1.5	3.6	3.7	2.4
Nonfinancial corporations[2]	7.3	1.4	2.5	2.7	4.1	4.2	3.4
<u>Unit labor costs</u>							
Total business	4.9	-0.4	-0.9	-5.8	-4.2	2.3	-2.2
Nonfarm business	4.9	-0.5	-1.1	-5.4	-4.6	2.1	-2.3
Nonfinancial corporations[2]	5.4	-1.8	-0.7	-7.3	-0.9	-0.8	-2.5

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.

recent quarterly readings are roughly in line with those of the employment cost index, which does not include the exercise of stock options and has decelerated gradually since 2000.

On the benefits side, health insurance premiums in the Federal Employees Health Benefits Program will rise an average 11 percent in 2003, the third consecutive double-digit increase. The Annual Employer Benefits Survey conducted by the Kaiser Family Foundation and the Health Research and Educational Trust showed that health insurance premiums for family plans are increasing 12-3/4 percent in 2002, similar to the increases in health benefit costs recorded by the ECI so far this year. The Kaiser survey also indicated that health insurance costs were increasing for both employers and workers, with the share of premiums paid by covered workers holding steady at 27 percent for 2002, identical to the survey results for the preceding two years.

Domestic Financial Developments

Selected Financial Market Quotations

(One-day quotes in percent except as noted)

Instrument	2000 June 26	2001 Sept. 10	2002 Aug. 12	2002 Sept. 17	Change to Sept. 17 from selected dates (percentage points) 2000 June 26	2001 Sept. 10	2002 Aug. 12
Short-term							
FOMC intended federal funds rate	6.50	3.50	1.75	1.75	-4.75	-1.75	.00
Treasury bills [1]							
3-month	5.66	3.19	1.65	1.67	-3.99	-1.52	.02
6-month	5.94	3.13	1.60	1.65	-4.29	-1.48	.05
Commercial paper (A1/P1 rates)							
1-month	6.56	3.42	1.70	1.73	-4.83	-1.69	.03
3-month	6.56	3.24	1.67	1.75	-4.81	-1.49	.08
Large negotiable CDs [1]							
1-month	6.64	3.46	1.74	1.78	-4.86	-1.68	.04
3-month	6.73	3.26	1.70	1.78	-4.95	-1.48	.08
6-month	6.89	3.24	1.70	1.78	-5.11	-1.46	.08
Eurodollar deposits [2]							
1-month	6.63	3.41	1.72	1.77	-4.86	-1.64	.05
3-month	6.69	3.26	1.68	1.77	-4.92	-1.49	.09
Bank prime rate	9.50	6.50	4.75	4.75	-4.75	-1.75	.00
Intermediate- and long-term							
U.S. Treasury [3]							
2-year	6.54	3.59	2.07	2.04	-4.50	-1.55	-.03
10-year	6.35	5.14	4.49	4.15	-2.20	-.99	-.34
30-year	6.22	5.55	5.24	4.94	-1.28	-.61	-.30
U.S. Treasury 10-year indexed note	4.09	3.26	2.48	2.26	-1.83	-1.00	-.22
Municipal revenue (Bond Buyer) [4]	5.99	5.25	5.36	5.15	-.84	-.10	-.21
Private instruments							
10-year swap	7.38	5.62	4.76	4.43	-2.95	-1.19	-.33
10-year FNMA	7.15	5.64	4.81	4.42	-2.73	-1.22	-.39
10-year AA [5]	7.64	6.30	5.79	5.46	-2.18	-.84	-.33
10-year BBB [5]	8.40	7.11	7.23	6.82	-1.58	-.29	-.41
High yield [6]	12.30	12.72	13.51	12.99	.69	.27	-.52
Home mortgages (FHLMC survey rate) [7]							
30-year fixed	8.14	6.89	6.31	6.18	-1.96	-.71	-.13
1-year adjustable	7.22	5.64	4.37	4.32	-2.90	-1.32	-.05

Stock exchange index	Record high Level	Record high Date	2001 Sept. 10	2002 Aug. 12	2002 Sept. 17	Change to Sept. 17 from selected dates (percent) Record high	2001 Sept. 10	2002 Aug. 12
Dow-Jones Industrial	11,723	1-14-00	9,606	8,689	8,208	-29.99	-14.55	-5.54
S&P 500 Composite	1,527	3-24-00	1,093	904	874	-42.81	-20.05	-3.35
Nasdaq (OTC)	5,049	3-10-00	1,695	1,307	1,260	-75.04	-25.68	-3.59
Russell 2000	606	3-9-00	441	389	379	-37.42	-13.94	-2.38
Wilshire 5000	14,752	3-24-00	10,104	8,537	8,283	-43.85	-18.03	-2.98

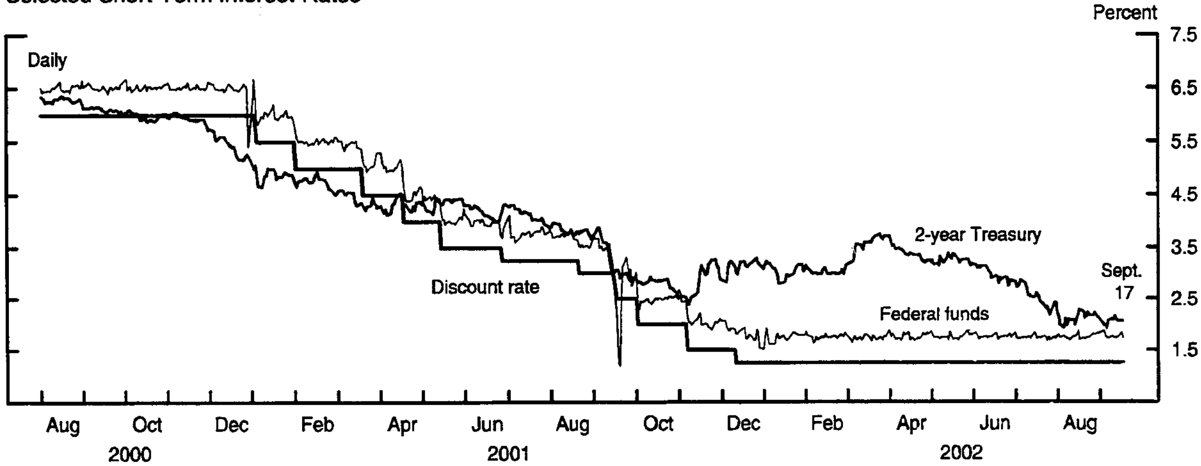
1. Secondary market.
2. Bid rates for Eurodollar deposits collected around 9:30 a.m. Eastern time.
3. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
4. Most recent Thursday quote.
5. Derived from smoothed corporate yield curves estimated using Merrill Lynch bond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

NOTES:

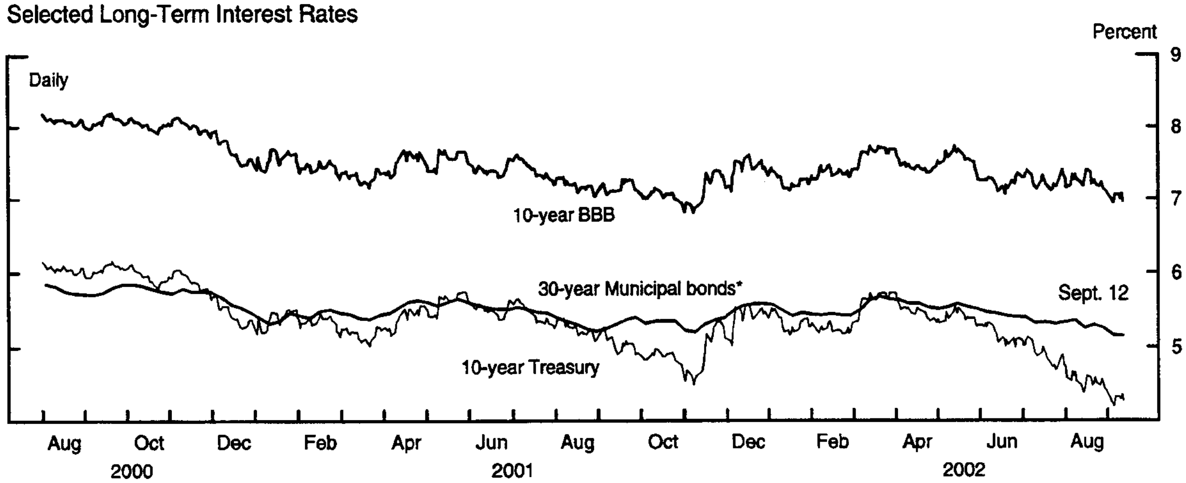
June 26, 2000, is the day before the FOMC meeting that ended the most recent period of policy tightening.
September 10, 2001, is the day before the terrorist attacks.
August 12, 2002, is the day before the announcement after the most recent FOMC meeting.

Selected Interest Rates

Selected Short-Term Interest Rates

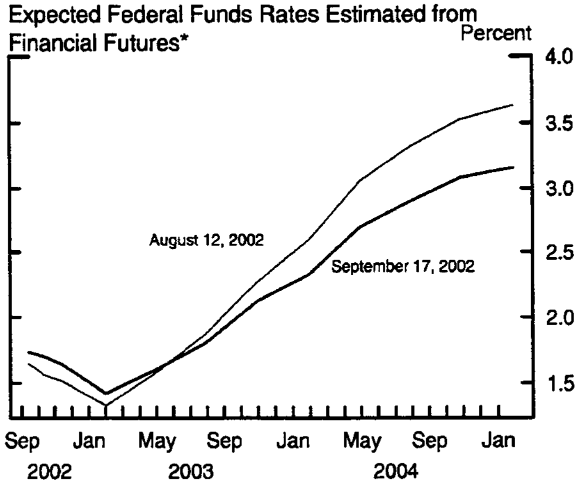


Selected Long-Term Interest Rates



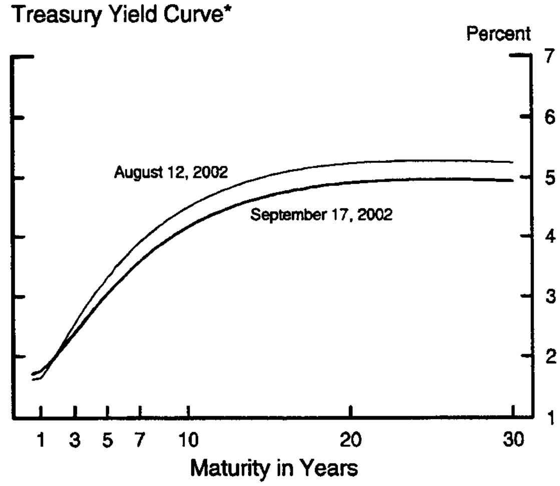
*Bond Buyer Revenue, weekly Thursday frequency.

Expected Federal Funds Rates Estimated from Financial Futures*



*Estimates from federal funds and eurodollar futures rates with an allowance for term premia and other adjustments.

Treasury Yield Curve*



*Smoothed yield curve estimated using off-the-run Treasury coupon securities. Yields shown are those on notional par Treasury securities with semi-annual payments.

Domestic Financial Developments

Overview

The uneventful passing of the August 14 deadline to certify financial statements provided some assurance to investors, and for a time, investor anxieties appeared to ebb somewhat. However, subsequent news suggesting a softer economy and heightened tensions with Iraq weighed on stock prices and boosted demand for Treasury securities. On balance, equity prices declined somewhat since the August FOMC meeting, while share price volatility remained at relatively high levels. Yields on Treasuries and investment-grade corporate securities fell about 35 basis points, while yields on speculative-grade bonds fell even more. Although market participants marked up the expected path of the federal funds rate in the near term in response to the wording of the FOMC announcement and comments by Federal Reserve officials, some odds on easing by year-end remain.

Nonfinancial businesses evidently paid down debt on net in August but seem to have resumed borrowing in September, albeit in meager volume. By contrast, household borrowing appears to have been well maintained recently, getting a boost from stronger motor vehicle sales and low mortgage rates. Meanwhile, Treasury and state and local government debt has continued to expand fairly briskly.

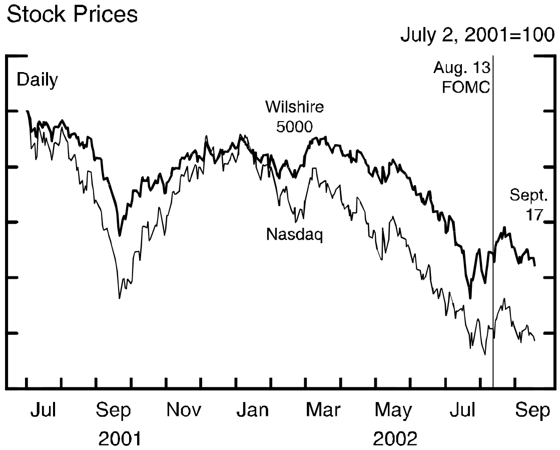
Policy Expectations, Stock Prices, and Interest Rates

The FOMC's decision at the August meeting--to leave the intended federal funds rate unchanged and to assess the risks as weighted toward economic weakness rather than balanced--elicited a noticeable drop in equity prices and Treasury coupon yields immediately after the announcement. Market participants evidently viewed the change and accompanying statement as foretelling a weaker economic outlook. Over the intermeeting period, the expected near-term path of the federal funds rate ticked higher as statements by a variety of Federal Reserve officials apparently led financial market participants to the view that less monetary policy ease likely would be forthcoming. Rates on federal funds futures contracts indicate that investors currently see only a slight chance of a policy easing at the upcoming meeting. In addition, none of the primary dealers surveyed recently expect a change in the stance of policy at this meeting, although a small minority anticipate significant easing--in the neighborhood of 1/2 to 3/4 percentage point--by year-end. At longer horizons, investors saw the softer economic news as implying less policy tightening was in store, and they marked down the path for the federal funds rate expected after early next year.

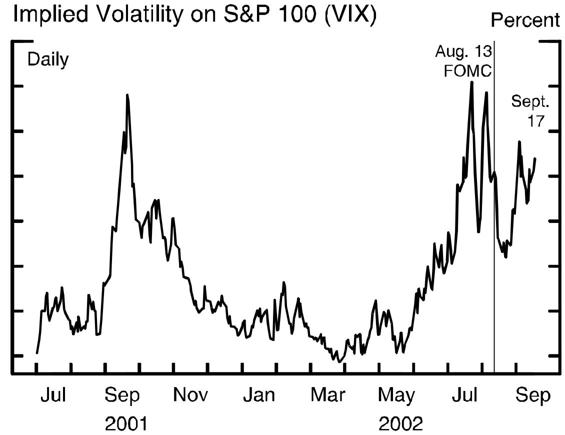
Broad equity indexes fell some on balance from the last FOMC meeting. Early in the period equity prices rose considerably, boosted in part by the relatively uneventful passing of the SEC's August 14 deadline for officers of large companies to certify corporate financial statements. More recently, however, equity prices have reversed course on concerns about the pace of economic growth, the less sanguine outlook for corporate profits, and the possibility of

Stock Prices and Corporate Risk Spreads

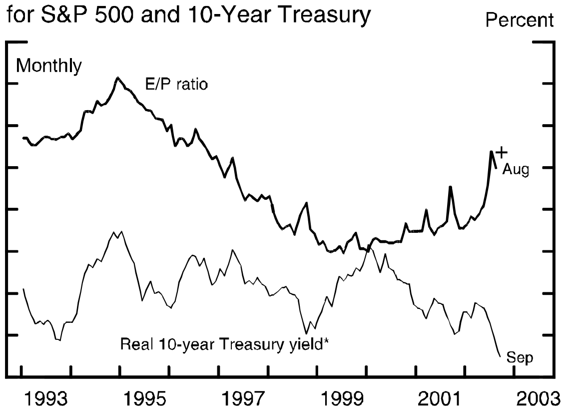
Stock Prices



Implied Volatility on S&P 100 (VIX)



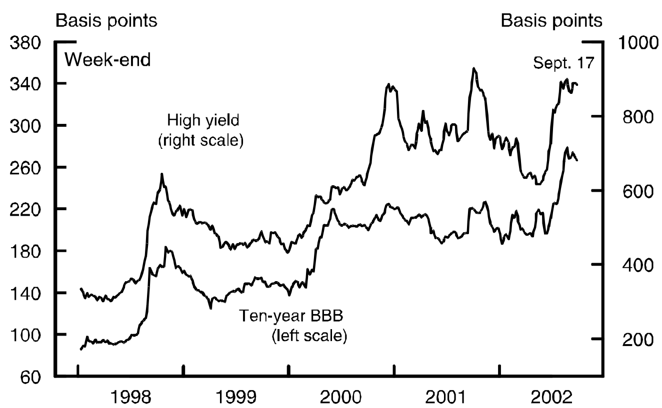
12-Month Forward Earnings-Price Ratio for S&P 500 and 10-Year Treasury



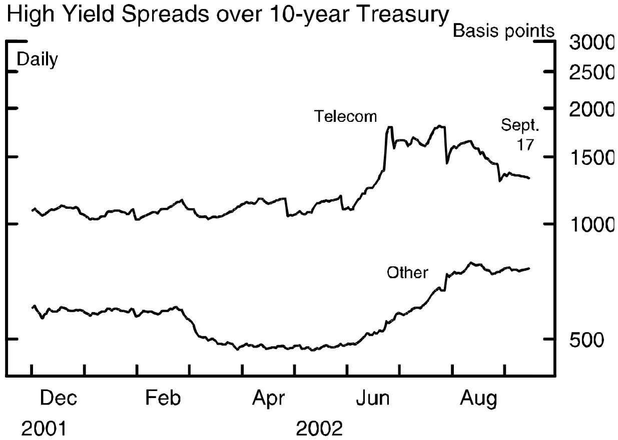
* 10-year Treasury yield minus Philadelphia Fed 10-year expected inflation.

\+ Denotes the latest observation using daily prices and latest earnings data from I/B/E/S.

Lower-Tier Risk Spreads to 10-Year Treasury

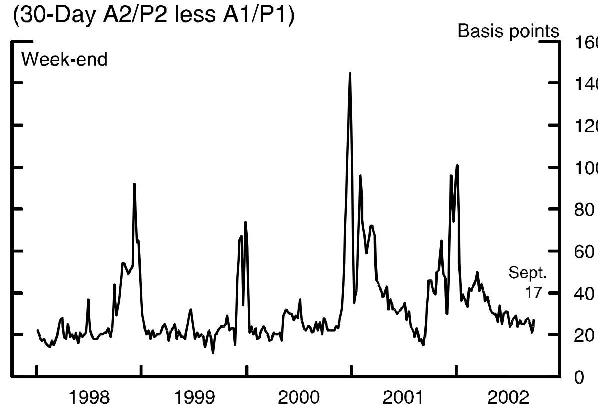


High Yield Spreads over 10-year Treasury



Note: Indexes constructed from Merrill Lynch database using bonds in the ML Master II index. Rebalanced on the last day of each month, which can lead to outsized changes at month-end.

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



military action against Iraq. The implied volatility of equity prices remains elevated, indicating that investors continue to perceive significant risks going forward. The forward earnings-price ratio for the S&P 500 remained just above 6 percent, but its spread over the real Treasury yield has risen to levels not seen since the early 1990s.

With the outlook for monetary policy a little less accommodative in the near term, shorter-maturity Treasury yields edged up over the intermeeting period. In contrast, intermediate- and long-term Treasury yields notably declined as incoming data were viewed as suggesting a softer outlook for the economy. Repeating the pattern of the past year or so, Treasury coupon yields largely moved in the same direction as equity prices, rising on net early in the intermeeting period before turning down in recent weeks. At the ten-year maturity, yields on Treasury inflation-indexed debt fell a bit less than yields on nominal Treasury securities, leaving measures of inflation compensation slightly lower. Movements in Treasury yields were substantial at times; perhaps the seasonally thin trading conditions typical of summer's end exacerbated the impact of market developments.

Investor sentiment about the corporate bond market seemed to improve after August 14th. However, the renewed appeal of corporate bonds was evidently tempered by the perceived weaker tone of economic data. Yields on higher-rated investment-grade corporate bonds largely tracked those on Treasuries of comparable maturities, leaving risk spreads on these securities about unchanged on balance. In contrast, yields on BBB-rated and below-investment-grade bonds declined by more than those on comparable Treasuries, and for nearly all industry sectors. Even so, risk spreads on those weaker credits remained exceptionally wide, in keeping with the anticipation of a continued high level of defaults and low recovery rates going forward. Risk spreads for commercial paper were about unchanged over the intermeeting period, remaining around typical levels.

Business Finance

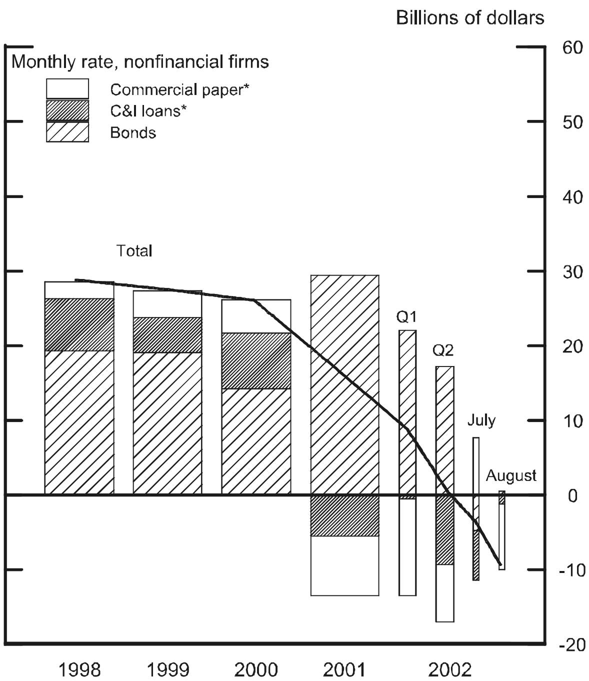
The major components of net debt financing by businesses--bonds, commercial paper, and bank loans--contracted further on balance in August. Despite a resumption of bond issuance by investment-grade nonfinancial corporations after August 14, issuance remained fairly weak last month, and hefty retirements held net bond issuance near zero. Moreover, the volume of outstanding commercial paper contracted once again in August as a number of firms reportedly used the proceeds from bond issuance to pay down paper. Firms did not borrow on net from banks either, as C&I loans were about unchanged, though this is in contrast to the considerable contraction seen over the past several months. Available data for September suggest that net debt financing has picked up, but only slightly.

Gross Issuance of Securities by U.S. Corporations
(Billions of dollars; monthly rates, not seasonally adjusted)

Type of security	1999	2000	2001 H1	2001 H2	2002 Q1	2002 Q2	2002 July	2002 Aug.
Nonfinancial corporations								
Stocks [1]	9.2	9.9	7.5	5.5	6.2	8.7	1.8	0.5
Initial public offerings	4.2	4.4	3.2	1.0	1.0	1.4	0.4	0.0
Seasoned offerings	5.0	5.5	4.2	4.5	5.2	7.3	1.4	0.5
Bonds [2]	24.5	20.2	43.1	31.2	31.0	26.9	7.5	14.5
Investment grade [3]	13.9	11.9	28.9	24.0	18.3	18.4	4.9	12.0
Speculative grade [3]	7.5	4.5	11.9	5.8	6.6	6.1	1.4	1.2
Other (sold abroad/unrated)	3.1	3.7	2.4	1.4	6.1	2.4	1.2	1.3
Memo								
Net issuance of commercial paper [4]	3.6	4.5	-14.5	-1.5	-13.0	-7.7	7.7	-8.8
Change in C&I loans at commercial banks [4]	4.7	7.4	-2.9	-8.1	-0.5	-9.3	-6.6	-1.2
Financial corporations								
Stocks [1]	1.8	1.4	3.0	5.5	5.1	3.3	2.5	3.1
Bonds	53.9	47.1	69.9	64.7	73.6	78.5	46.2	61.4

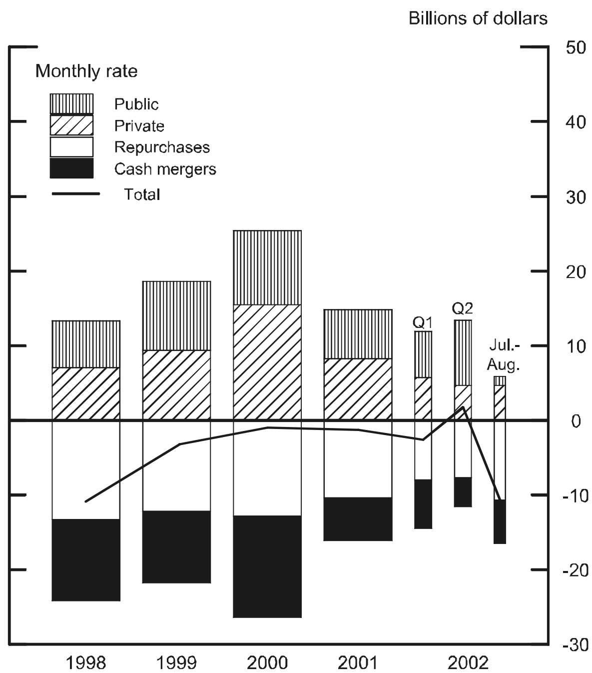
Note. Components may not sum to totals because of rounding. These data include speculative-grade bonds issued privately under Rule 144A. All other private placements are excluded. Total reflects gross proceeds rather than par value of original discount bonds.
1. Excludes equity issues associated with equity-for-equity swaps that have occurred in restructurings.
2. Excludes mortgage-backed and asset-backed bonds.
3. Bonds sold in U.S. categorized according to Moody's bond ratings, or to Standard & Poor's if unrated by Moody's.
4. End-of-period basis, seasonally adjusted.
e Staff estimate.

Components of Net Debt Financing



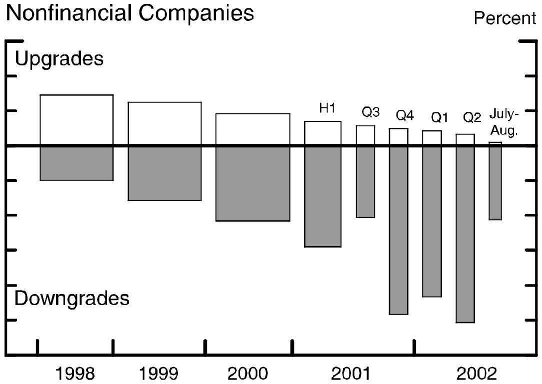
* Seasonally adjusted.

Net Equity Issuance



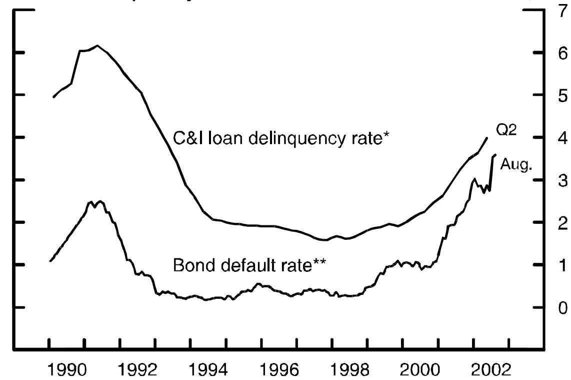
Corporate Credit Quality and Earnings

Ratings Changes Nonfinancial Companies



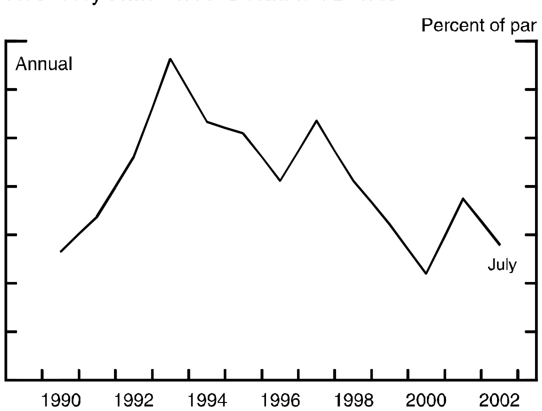
Note. Data are at an annual rate. Debt upgrades (downgrades) as a percentage of par value of all bonds outstanding.
Source. Moody's Investors Service.

Bond Default and Loan Delinquency Rates



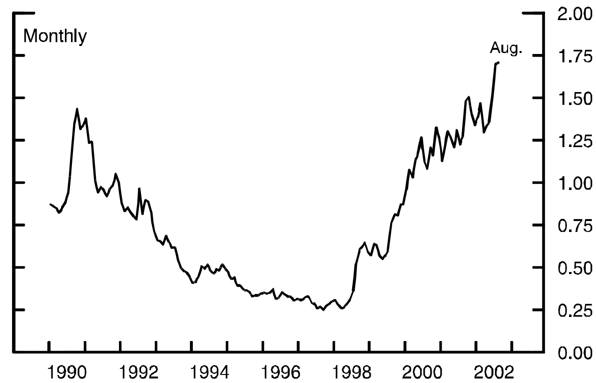
*Source. Call Report.
**Moving average (12-month), from Moody's Investors Service.

Recovery Rate on All Defaulted Bonds



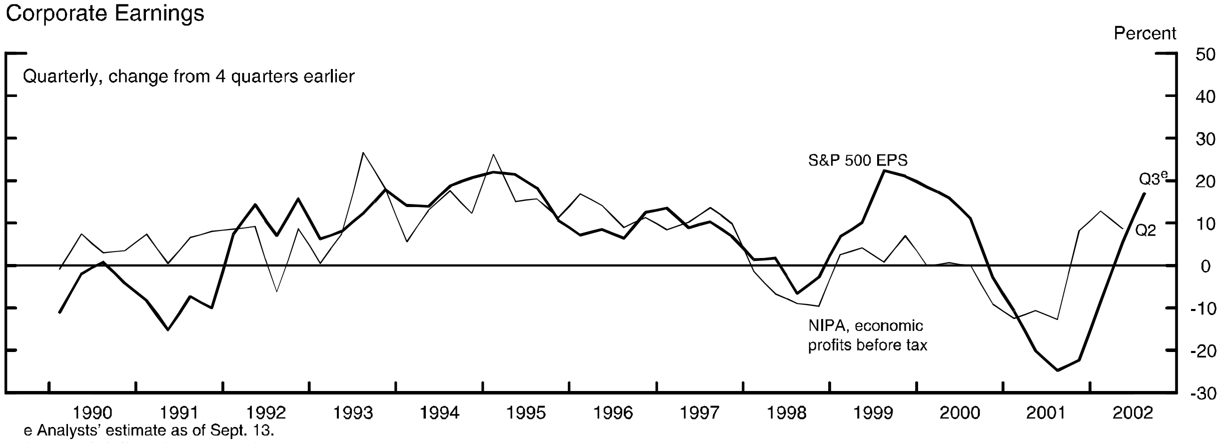
Source. Moody's Investors Service. Weighted-average market price at default for all bonds.

Expected Year-Ahead Defaults



Note. Firm-level estimates of default weighted by firm liabilities as a percent of total liabilities.
Source. KMV Corp.

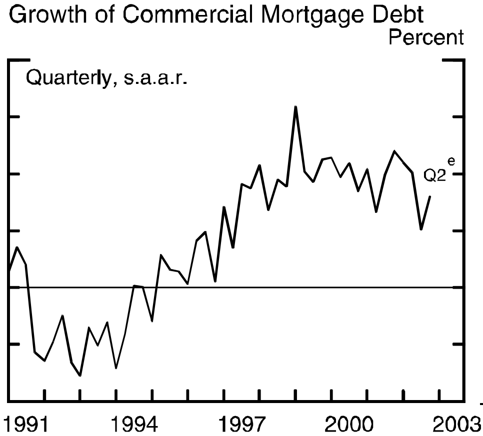
Corporate Earnings



e Analysts' estimate as of Sept. 13.
Source. I/B/E/S for S&P 500 EPS.

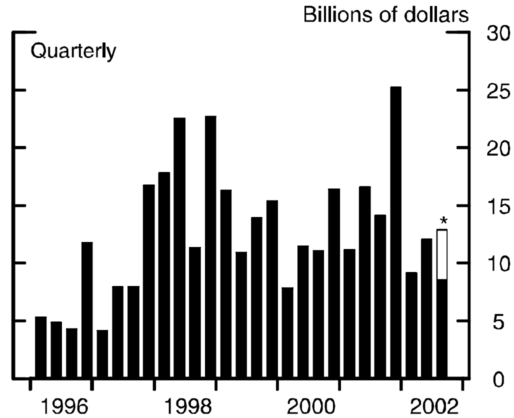
Commercial Real Estate

Growth of Commercial Mortgage Debt



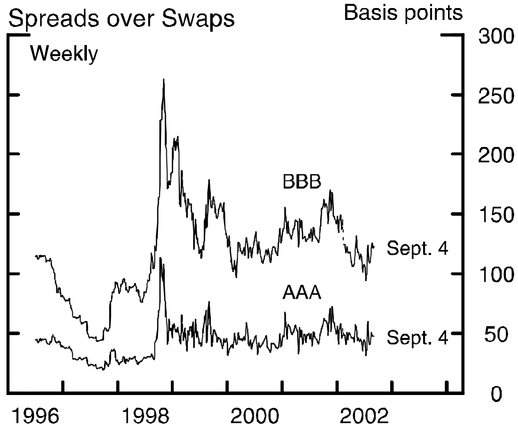
e Staff estimate.

Total CMBS Gross Issuance



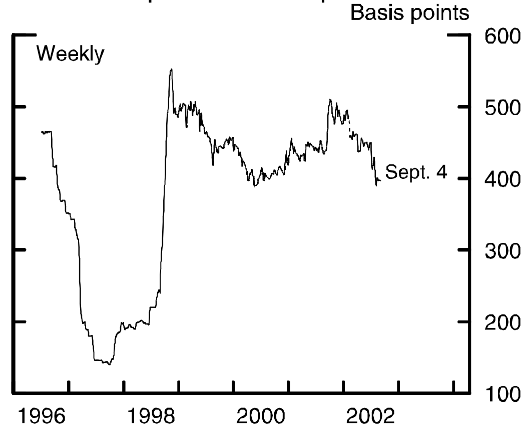
* Estimate assumes actual July and August pace (shown in black) continues for September.
Source. Commercial Mortgage Alert.

Investment-Grade CMBS Spreads over Swaps



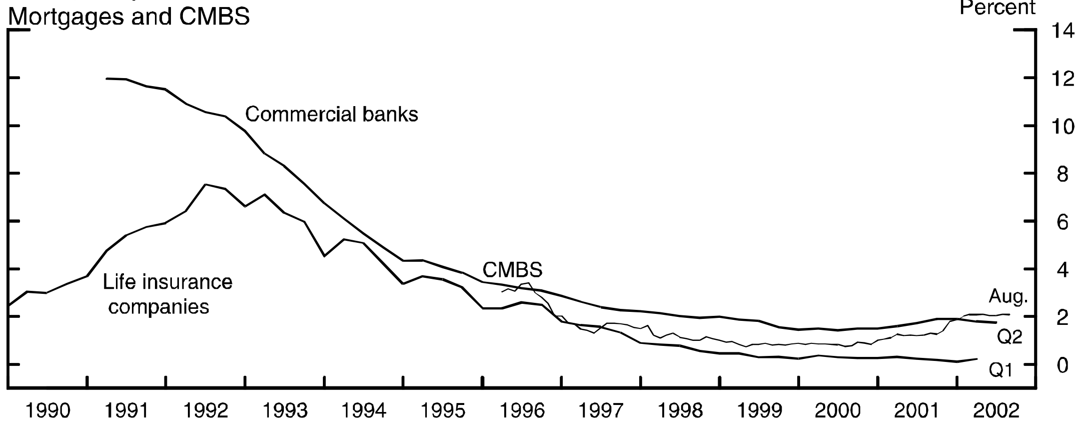
Note. Yield indexes were rebalanced on Feb. 1, 2002.
Source. Morgan Stanley.

BB CMBS Spread over Swap



Note. Yield indexes were rebalanced on Feb. 1, 2002.
Source. Morgan Stanley.

Delinquency Rates on Commercial Mortgages and CMBS



Source. Call Report, ACLI, Morgan Stanley.

Gross public equity issuance receded again in August: Seasoned equity offerings fell to near zero, and there were no IPOs last month--for only the second time since 1975. Currently only a few IPO deals are in the pipeline for the remainder of September, as widely publicized investigations into the IPO allocation process at investment banks likely have damped such activity. Venture capital investments fell again in the second quarter, and the sluggish pace of new capital committed suggests a pickup is not around the corner. Equity retirements are estimated to have risen in July as announcements of share buyback programs rose after stock prices plummeted. Announcements remained elevated in August but have fallen back somewhat to date in September. Meanwhile, cash-financed merger activity has been scant, and few new deals have been announced recently.

Measures of corporate credit quality deteriorated further in July and August. Moody's net downgrades of nonfinancial corporate debt again exceeded upgrades, though by a considerably narrower margin than in recent quarters. Downgrades continued to be concentrated in the telecom and energy sectors. Bond defaults totaled $36 billion in July and August, boosted by the titanic default of $26 billion of WorldCom debt, and the twelve-month moving average default rate stands at a record level. Recovery rates on defaulted bonds remain at historically low levels, particularly in the telecom sector. In addition, banks' Call Report data for the second quarter show that the delinquency rate on C&I loans edged up again, although it remains below the levels seen in the early 1990s.

Forward-looking measures of corporate credit quality also worsened a bit. The quantity of debt on Moody's Watchlist remained somewhat elevated in August, suggesting that additional net downgrades are likely in coming months, and KMV's estimate of expected year-ahead defaults surged in July and then edged up to a record level in August.

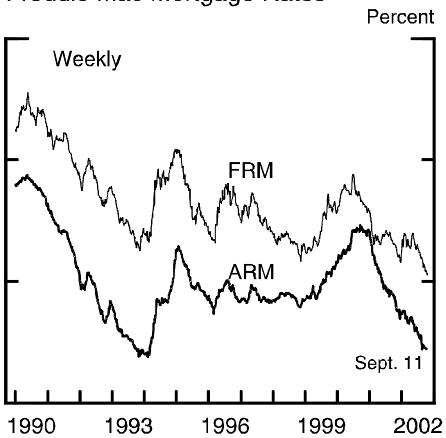
Earnings revisions by analysts since the last FOMC meeting have been scarce, but warnings are expected to pick up in coming days as the quarter-end approaches. Judging from the current estimate of growth in S&P 500-based earnings per share--at 18 percent above last year's level--equity analysts apparently still have a very optimistic view of third-quarter earnings.

Commercial Real Estate Finance

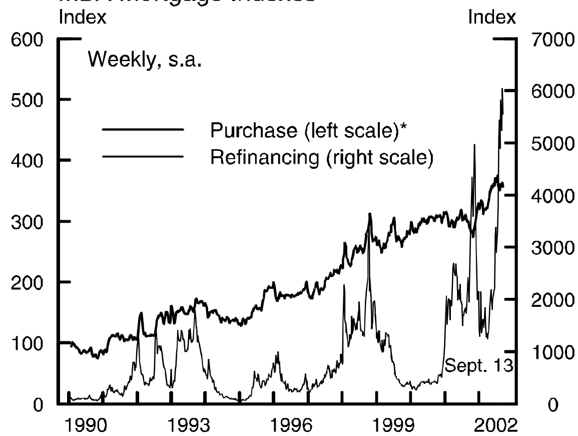
Commercial mortgage debt increased 8 percent at an annual rate in the second quarter, considerably faster than in the first quarter but still below last year's torrid pace. In the third quarter, however, growth likely has tapered off in keeping with the ongoing contraction in outlays on nonresidential structures. Nonetheless, issuance of commercial-mortgage-backed securities (CMBS) has been well maintained so far in the third quarter, and CMBS risk spreads remained in the lower part of their respective ranges over the past couple of years. These

Household Liabilities

Freddie Mac Mortgage Rates



MBA Mortgage Indexes

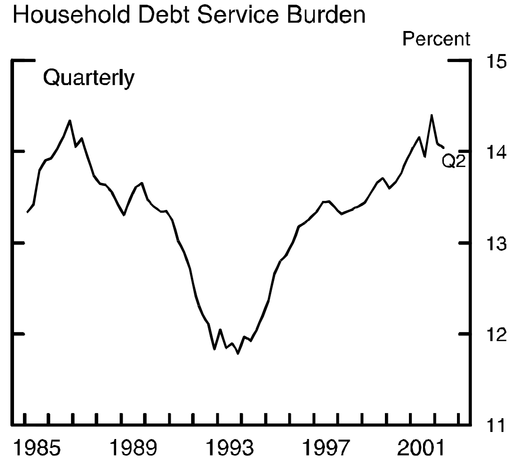


Note. March 16, 1990 = 100 before seasonal adj.
* 4-week moving average.

Household Debt Growth

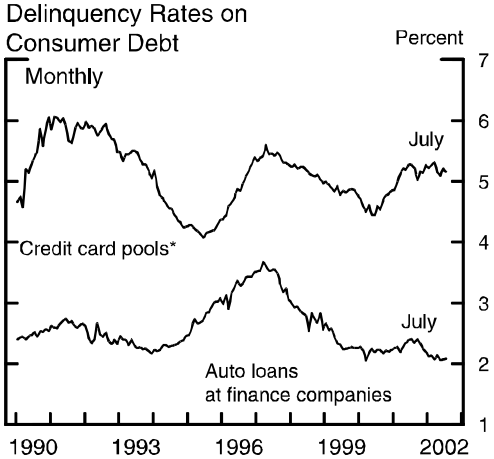
p Projection.

Household Debt Service Burden



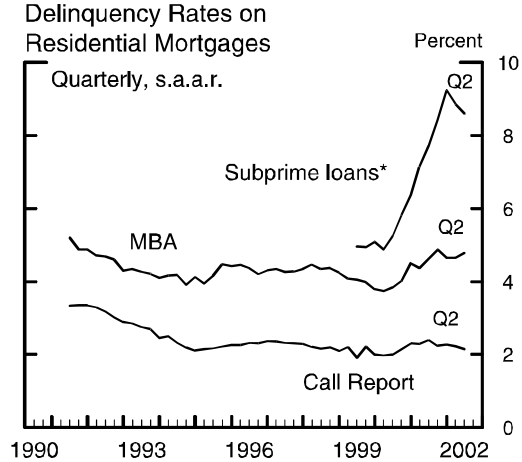
Note. Required debt payments relative to disposable personal income.

Delinquency Rates on Consumer Debt



* Securitized receivables (Moody's, seasonally adj.).

Delinquency Rates on Residential Mortgages



* Data from Loan Performance.

indicators do not suggest elevated concern about prospective defaults. Delinquency rates on commercial mortgages and CMBS also remained stable over the intermeeting period and well below those seen in the early 1990s.

Household Finance

The dip in home mortgage rates to historical lows during the intermeeting period prompted a record level of applications for mortgage refinancings and a high volume of mortgage purchase applications. Consistent with this activity, preliminary data point to a continued brisk expansion of residential mortgage debt in the third quarter, though probably a little slower than the 10-3/4 percent rate posted in the second quarter.

Available data indicate that consumer credit continued to grow strongly in the third quarter, boosted by motor-vehicle-related borrowing. A sharp drop in average interest rates on new car loans at auto finance companies in July reflected the effects of the latest round of zero-percent financing incentives.

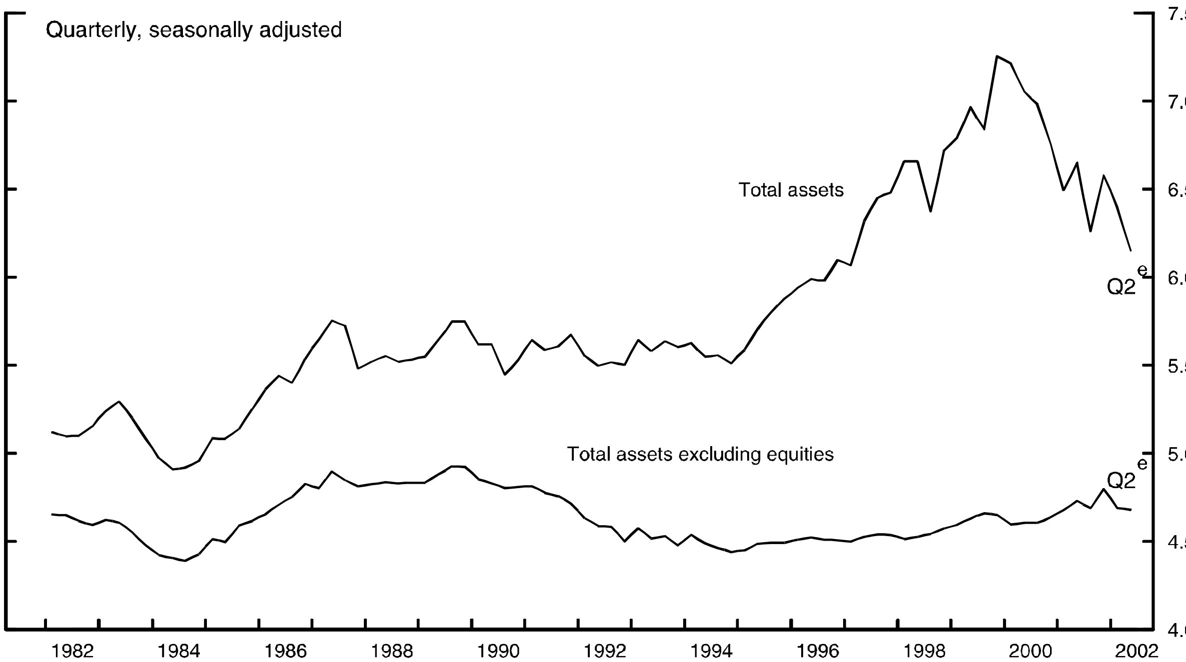
Overall household debt expanded at a rapid clip in the second quarter, keeping the debt-service burden near its historical peak. Both the debt-service burden and various measures of household credit quality have stayed within the ranges observed for a while. The delinquency rate on credit card pools edged down slightly in July but stayed in the neighborhood of recent experience, while the delinquency rate on auto loans at finance companies remained near historical lows through July. Call Report data for the second quarter show that the delinquency rates on credit card and other consumer loans at banks were little changed from their somewhat elevated levels in the first quarter (not shown). With regard to mortgage delinquencies, the series published by Mortgage Bankers Association ticked up in the second quarter owing mainly to the poor performance of FHA mortgages. In contrast, banks’ mortgage delinquencies edged down, likely reflecting the relatively small proportion of FHA mortgages held by banks.

The ratio of household net worth to disposable income, which fell steeply in the second quarter, was dragged down by the sharp declines in equity prices. With broad equity indexes having moved down further on balance since the end of June, this ratio has likely dropped again in the current quarter.

After withdrawing record amounts from equity mutual funds in July, households made only modest net withdrawals in August, and most of these came before the passing of the August 14 certification deadline. These withdrawals reflect a portfolio shift toward safer assets, as bond mutual funds posted substantial net inflows in both July and August, and these inflows were disproportionately directed toward government bond funds. Available data for early September suggest that modest net inflows to equity funds have likely resumed.

Household Assets

Relative to Disposable Income



e Staff estimate.

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

	2000	2001		2002				Assets
		H1	H2	Q1	Q2	July	Aug e	July
Total long-term funds	**18.5**	**15.1**	**6.5**	**30.3**	**11.8**	**-29.2**	**15.5**	**4,125**
Equity funds	**25.2**	**8.2**	**-2.7**	**18.4**	**-0.2**	**-52.6**	**-5.6**	**2,771**
Domestic	21.3	9.1	-0.0	17.1	-1.3	-49.0	-2.7	2,391
Capital appreciation	25.5	5.2	-2.2	9.4	-3.8	-34.0	-2.1	1,390
Total return	-4.3	3.9	2.2	7.7	2.5	-15.0	-0.6	1,001
International	3.9	-0.9	-2.7	1.3	1.1	-3.6	-2.9	380
Hybrid funds	**-2.6**	**1.0**	**0.5**	**2.6**	**1.7**	**-4.7**	**0.8**	**321**
Bond funds	**-4.0**	**5.9**	**8.7**	**9.3**	**10.2**	**28.1**	**20.4**	**1,033**
International	-0.2	0.0	-0.2	-0.0	0.1	0.3	0.1	20
High-yield	-1.0	0.9	0.3	1.8	-0.0	-1.7	1.8	89
Other taxable	-1.6	4.2	7.4	6.3	8.8	25.7	13.9	607
Municipals	-1.2	0.8	1.1	1.2	1.4	3.8	4.6	317

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

Treasury and Agency Finance

The Treasury borrowed $56 billion on net in August, up sharply from $36 billion in July. Most of the step-up occurred in the coupon sector, including sales of $27 billion in two-year notes that garnered a bid-to-cover ratio at the high end of the recent range. Fannie Mae and Freddie Mac paid down outstanding debt slightly in July, after raising $17 billion in the second quarter. Even so, spreads on agencies over comparable Treasuries have narrowed only a bit this year and were about unchanged over the intermeeting period. Fannie Mae's share price has fallen sharply in the past several weeks because of investors' concerns about its interest-rate-risk management practices.

State and Local Government Finance

Gross issuance of long-term municipal debt in August and September continued unabated from the rapid pace of recent months. Strong issuance for both new capital spending and advance-refunding was spurred by the further decline in yields on both revenue and general obligation bonds. Short-term issuance, often used to meet tax revenue shortfalls, also remained strong. The ratio of long-term municipal bond yields to Treasury yields rose notably over the intermeeting period, especially for revenue bonds. The rise likely reflects heavy municipal issuance, although it may also suggest some erosion in credit quality in this sector.

Money and Bank Credit

M2 growth moderated somewhat in August from July's torrid pace, and preliminary data for September indicate further slowing. Growth continued to be concentrated in liquid deposits, which were boosted by the historically low opportunity cost of holding such deposits, volatile equity prices, and a high volume of mortgage refinancing activity. The contraction in small time deposits probably persisted because of households' aversion to locking in the low rates available on these instruments. Retail money market mutual funds recorded small net outflows, perhaps reflecting an unwinding of July's safe haven flows. The unusually slow growth of currency likely indicates a moderation in both international and domestic demand.

Bank credit increased at a 15-1/2 percent annual rate in August, a pace more than double that in July. The strong gain partly reflected a surge in holdings of mortgage-backed securities. Banks also continued to extend large volumes of credit in the form of home equity loans and residential real estate loans.[1] The Survey of Terms of Business Lending conducted last month indicates that overall loan pricing conditions still reflect cautious lending by banks: The median spread of C&I loan rates over market interest rates on instruments of comparable maturity remained wide, and spreads on higher-risk loans declined only slightly from their lofty levels.

1. The very rapid expansion of consumer loans on the books of banks in August owed to the unwinding of several securitizations. Growth in consumer loans in August was 3-3/4 percent at an annual rate after adjusting for this effect.

Treasury and Agency Financing

Treasury Financing
(Billions of dollars)

Item	2001	2002				
	Q4	Q1	Q2	June	July	Aug.
Total surplus, deficit (−)	**-37.1**	**-96.6**	**15.6**	**29.1**	**-29.2**	**n.a.**
Means of financing deficit						
Net borrowing	59.5	50.8	21.1	31.6	36.1	56.3
Nonmarketable	10.5	-.7	6.0	25.3	-7.4	6.7
Marketable	49.0	51.5	15.1	6.3	43.5	49.6
Bills	73.3	23.1	-12.0	6.3	39.8	28.4
Coupons[1]	-15.8	28.4	31.1	.0	3.7	21.2
Debt buybacks	-8.5	.0	-4.0	.0	.0	.0
Decrease in cash balance	-8.1	38.3	-25.5	-31.3	-.2	13.3
Other[2]	-14.3	7.5	-11.2	-29.3	-6.8	n.a.
MEMO						
Cash balance, end of period	52.4	14.1	39.6	39.6	39.8	26.5

NOTE. Components may not sum to totals because of rounding.
1. Does not include Treasury debt buybacks.
2. Direct loan financing, accrued items, checks issued less checks paid, and other transactions.
n.a. Not available.

Net Borrowing of Government-Sponsored Enterprises
(Billions of dollars)

Agency	2001	2002				
	Q4	Q1	Q2	June	July	Aug.
FHLBs	9.4	2.1	17.3	2.9	8.2	n.a.
Freddie Mac	30.6	38.4	-2.1	.3	3.5	n.a.
Fannie Mae	36.5	6.3	19.2	7.0	-5.0	n.a.
Farm Credit Banks	.3	2.3	1.9	.7	.3	.4
MEMO						
Outstanding noncallable reference and benchmark securities						
Notes and bonds	449.9	483.9	498.3	498.3	515.5	514.0
Bills	292.0	285.8	257.3	257.3	276.8	266.8
Total	741.9	769.7	755.5	755.5	792.3	780.8

NOTE. Excludes mortgage pass-through securities issued by Fannie Mae and Freddie Mac.
n.a. Not available.

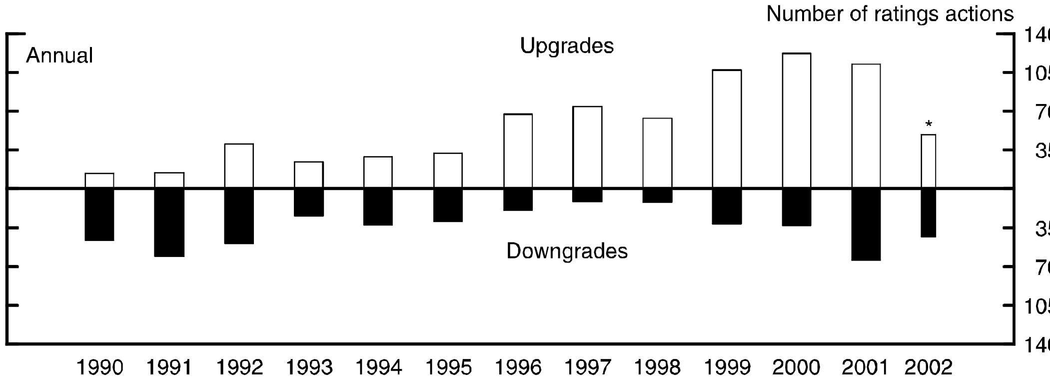
State and Local Government Finance

Gross Offerings of Municipal Securities
(Billions of dollars; monthly rate, not seasonally adjusted)

	1999	2000	2001	2002 Q1	2002 Q2	2002 Aug.	2002 Sept. [e]
Long-term [1]	18.0	15.0	22.5	21.5	30.8	28.9	31.3
Refundings [2]	4.5	2.2	6.5	6.6	10.3	9.5	9.9
New capital	13.5	12.9	16.0	14.9	20.5	19.4	21.4
Short-term	2.7	2.8	4.3	1.9	7.6	8.5	2.4
Total tax-exempt	20.6	17.9	26.9	23.4	38.4	37.4	33.7
Total taxable	1.1	0.7	1.1	1.0	1.2	1.1	0.3

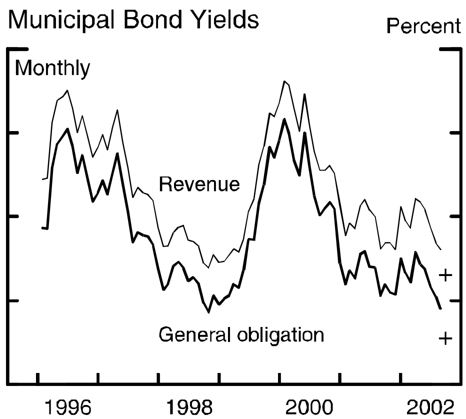
1. Includes issues for public and private purposes.
2. All issues that include any refunding bonds.
e Staff estimate based on preliminary data through September 12.

Bond Rating Changes



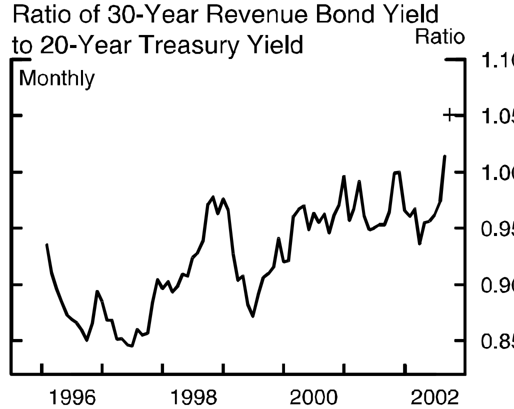
* Data through Sept. 4 at an annual rate.
Source. S&P's Credit Week Municipal and Ratings Direct.

Municipal Bond Yields



Note. Average of weekly data.
+ Last observation is for week of Sep. 12 .

Ratio of 30-Year Revenue Bond Yield to 20-Year Treasury Yield



Note. Average of weekly data.
+ Last observation is for week of Sep. 12 .

Monetary Aggregates

(Based on seasonally adjusted data)

Aggregate or component	2001	2002 Q1	2002 Q2	2002 Jun.	2002 Jul.	2002 Aug. (p)	Level (bil. $) Aug. 02 (p)
Aggregate	Percent change (annual rate)[1]						
1. M2[2]	10.3	5.8	3.4	7.4	12.9	9.4	5,685.6
2. M3[3]	12.8	5.0	3.5	6.3	8.3	10.4	8,310.6
Components of M2 [4]							
3. Currency	9.0	10.8	9.7	12.1	7.9	4.1	617.2
4. Liquid deposits[5]	17.9	17.4	10.3	11.7	16.4	19.0	3,176.4
5. Small time deposits	-4.9	-15.4	-8.3	-4.1	-6.6	-8.2	914.5
6. Retail money market funds	8.3	-9.4	-10.1	.9	23.1	-.7	969.2
Components of M3							
7. M3 minus M2[6]	18.5	3.5	3.9	4.2	-1.3	12.4	2,625.0
8. Large time deposits, net[7]	-2.9	4.0	8.4	-4.7	6.5	2.9	816.0
9. Institutional money market funds	51.1	-.3	2.8	10.7	-4.8	-1.5	1,190.1
10. RPs	1.5	9.5	-5.6	5.8	-3.5	79.5	397.3
11. Eurodollars	8.2	12.0	9.6	-1.1	-7.0	8.7	221.6
Memo							
12. Monetary base	8.5	9.1	8.1	11.2	8.5	4.2	671.1
	Average monthly change (billions of dollars)[8]						
Selected managed liabilities at commercial banks							
13. Large time deposits, gross	3.3	9.6	8.0	-8.8	-.3	-4.1	1,018.5
14. Net due to related foreign institutions	-6.5	-18.5	-3.2	-1.4	.0	.2	91.0
15. U.S. government deposits at commercial banks	1.5	1.1	-8.5	12.0	-4.3	35.1	49.7

1. For the years shown, Q4 to Q4 percent change. For the quarters shown, based on quarterly averages.
2. Sum of currency, liquid deposits (demand, other checkable, savings), small time deposits, retail money market funds, and non-bank travelers checks.
3. Sum of M2, net large time deposits, institutional money market funds, RP liabilities of depository institutions, and eurodollars held by U.S. addressees.
4. Non-bank travelers checks not listed.
5. Sum of demand deposits, other checkable deposits, and savings deposits.
6. Sum of large time deposits, institutional money funds, RP liabilities of depository institutions, and eurodollars held by U.S. addressees.
7. Net of holdings of depository institutions, money market mutual funds, U.S. government and foreign banks and official institutions.
8. For the years shown, "average monthly change" is the Q4 to Q4 dollar change divided by 12. For the quarters shown, it is the quarter-to-quarter dollar change divided by 3.
p Preliminary.

Commercial Bank Credit

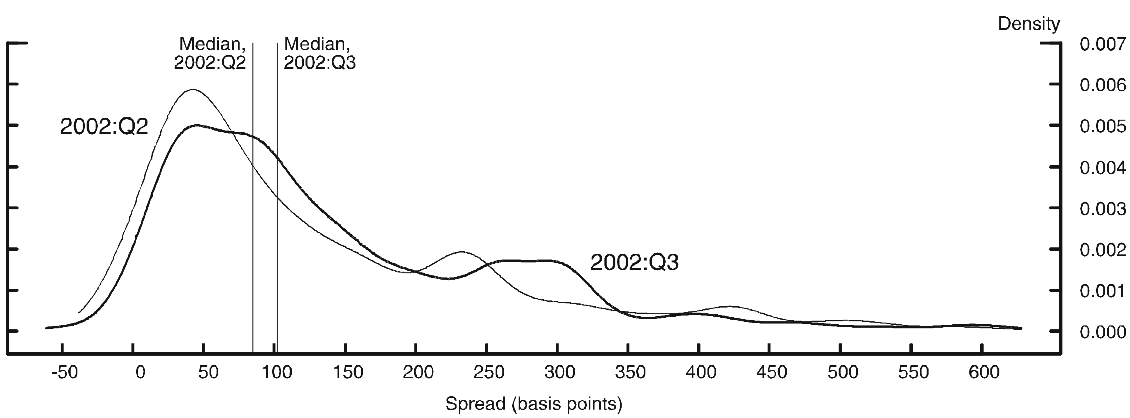
(Percent change, annual rate, except as noted; seasonally adjusted)

Type of credit	2001	Q1 2002	Q2 2002	June 2002	July 2002	Aug. 2002	Level, Aug. 2002 ($ billions)
Total							
1. Adjusted[1]	**4.2**	**1.0**	**5.1**	**5.2**	**5.6**	**15.5**	**5,482**
2. Reported	5.1	-1.5	5.4	9.6	10.1	17.6	5,676
Securities							
3. Adjusted[1]	9.5	7.9	13.5	4.3	5.4	21.8	1,432
4. Reported	12.6	-2.0	13.5	20.0	21.5	28.8	1,625
5. Treasury & Agency	6.8	1.3	22.3	17.0	10.6	37.2	946
6. Other[2]	21.1	-6.3	1.9	24.5	36.5	17.4	680
Loans[3]							
7. Total	2.5	-1.3	2.3	5.6	5.7	13.2	4,051
8. Business	-3.6	-6.6	-8.4	-7.5	-13.7	.2	987
9. Real estate	7.2	3.8	6.7	14.9	19.8	20.0	1,902
10. Home equity	19.9	25.6	39.6	41.5	44.0	30.0	197
11. Other	6.1	1.8	3.4	12.0	17.0	18.9	1,705
12. Consumer	3.8	5.3	5.1	-1.7	-6.5	21.8	577
13. Adjusted[4]	7.4	5.2	4.5	3.4	-3.8	3.8	923
14. Other[5]	-.3	-13.4	4.9	6.0	6.2	5.6	585

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.

Distribution of C&I Loan Rate Spreads



Note. Domestic banking institutions, nonprime-based loans. The spread is over the market interest rate on an instrument of comparable maturity.
Source. Federal Reserve Survey of Terms of Business Lending.

International Developments

International Developments

U.S. International Transactions

Trade in Goods and Services

The deficit in U.S. international trade in goods and services was $37.2 billion in June, $0.7 billion smaller than in May (revised). For the second quarter, the trade deficit was $445 billion at an annual rate, $65 billion larger than in the first quarter as a sharp rise in imports exceeded the jump in exports. NIPA real net exports weakened about $47 billion in the second quarter. The trade deficit for July, $34.6 billion, was released on Greenbook publication day; details will be provided in the Greenbook supplement.

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

	2001	Annual rate 2001	Annual rate 2002		Monthly rate 2002		
		Q4	Q1	Q2	Apr.	May	June
Real NIPA[1]							
Net exports of G&S	-415.9	-425.3	-446.6	-494.1	...	...	...
Nominal BOP							
Net exports of G&S	-358.3	-352.1	-379.4	-444.6	-36.1	-37.8	-37.2
Goods, net	-427.2	-402.7	-425.7	-490.6	-40.2	-41.7	-40.8
Services, net	68.9	50.5	46.3	46.0	4.0	3.9	3.6

1. Billions of chained (1996) dollars.
Source: U.S. Department of Commerce, Bureaus of Economic Analysis and Census.
n.a. Not available. ... Not applicable.

Exports of goods and services rose 1.7 percent in June, following a smaller increase in May. Exported goods jumped 2.0 percent, with the largest increase in the category of capital goods (especially semiconductors and aircraft). Exports of services rose only slightly. For the second quarter, the value of exported goods and services grew 17 percent at an annual rate. The largest increases were in exported machinery (especially semiconductors and other machinery), industrial supplies (particularly chemicals), and automotive products. Service receipts rose moderately, as receipts from foreigners traveling in the United States remained close to first quarter levels, while receipts from other private services rose.

Imports of goods and services in June were marginally higher than in May. The level of imported goods inched up from already high May levels, and service payments grew 2 percent (largely royalties and license fees). Increases in imported consumer goods, aircraft and industrial supplies were partly offset by declines in automotive products and oil (about half from a drop in price). For

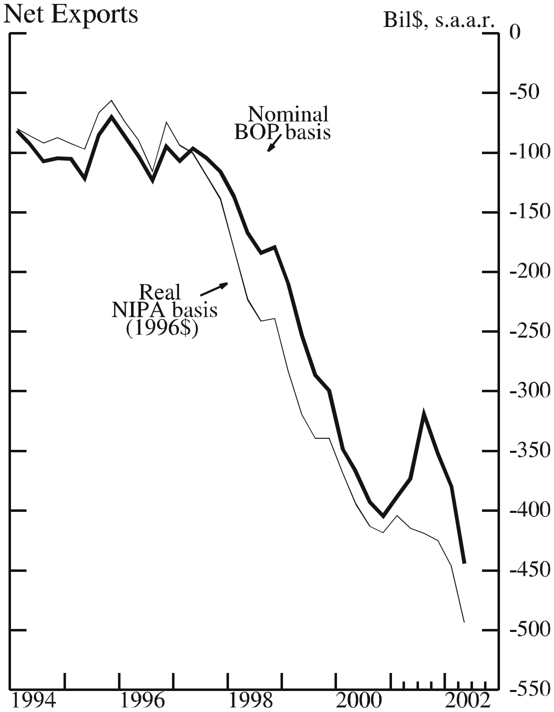
U.S. Exports and Imports of Goods and Services
(Billions of dollars, s.a.a.r., BOP basis)

	Levels				Amount Change[1]			
	2002		2002		2002		2002	
	Q1	Q2	May	June	Q1	Q2	May	June
Exports of G&S	**934.4**	**971.0**	**968.2**	**984.2**	**2.7**	**36.6**	**7.6**	**16.0**
Goods exports	658.6	690.7	687.9	702.0	-10.8	32.1	5.8	14.0
Gold	2.5	3.7	4.0	3.5	-0.3	1.1	0.6	-0.5
Other goods	656.1	687.0	683.9	698.4	-10.5	31.0	5.2	14.5
Aircraft & parts	49.4	50.2	48.2	53.3	1.3	0.8	-0.8	5.1
Computers	39.0	38.6	38.8	39.5	-2.8	-0.5	1.5	0.7
Semiconductors	39.5	43.9	43.3	46.0	1.3	4.4	1.0	2.7
Other capital gds	156.6	161.7	161.0	163.4	-4.2	5.1	0.2	2.4
Automotive	73.8	80.5	81.1	80.0	-0.4	6.6	0.9	-1.2
to Canada	41.4	44.1	44.0	44.4	1.4	2.7	0.1	0.4
to Mexico	14.4	17.2	18.1	16.6	-1.9	2.7	1.3	-1.5
to ROW	18.0	19.2	19.0	19.0	0.1	1.2	-0.5	-0.0
Agricultural	55.1	54.1	53.7	57.3	-0.7	-1.0	2.3	3.6
Ind supplies (ex. ag)	134.9	146.3	146.3	147.6	-1.9	11.4	1.2	1.4
Consumer goods	82.2	84.3	82.5	85.6	-2.3	2.1	-2.5	3.1
All other goods	25.5	27.5	29.1	25.8	-0.9	2.0	3.1	-3.2
Services exports	275.8	280.3	280.3	282.2	13.5	4.5	1.8	2.0
Imports of G&S	**1313.9**	**1415.6**	**1422.3**	**1430.2**	**30.0**	**101.7**	**28.1**	**7.8**
Goods imports	1084.3	1181.3	1188.3	1191.5	12.2	97.0	24.3	3.2
Petroleum	76.7	108.6	111.3	105.2	-4.3	32.0	2.1	-6.1
Gold	2.0	3.5	3.8	3.5	-0.4	1.5	0.7	-0.3
Other goods	1005.6	1069.2	1073.2	1082.7	16.9	63.6	21.6	9.6
Aircraft & parts	29.0	25.1	22.4	25.7	-3.5	-3.9	-4.8	3.2
Computers	75.6	76.6	76.7	76.2	7.2	1.0	-0.2	-0.6
Semiconductors	25.2	27.7	28.1	28.5	2.1	2.4	1.8	0.4
Other capital gds	147.5	159.7	161.7	162.0	-0.6	12.3	6.3	0.3
Automotive	190.4	207.1	211.8	205.5	2.9	16.7	7.7	-6.3
from Canada	58.2	61.2	61.8	60.2	2.5	3.0	0.2	-1.6
from Mexico	39.4	43.6	44.2	42.9	-0.8	4.3	0.4	-1.2
from ROW	92.9	102.3	105.8	102.4	1.2	9.4	7.1	-3.4
Ind supplies	152.8	163.0	162.2	165.1	0.5	10.2	0.6	2.8
Consumer goods	285.3	307.3	307.4	314.3	6.9	22.0	7.4	6.9
Foods, feeds, bev.	47.5	49.4	49.7	49.6	0.4	1.9	0.8	-0.1
All other goods	52.2	53.3	52.9	55.9	1.1	1.0	2.0	3.0
Services imports	229.6	234.3	234.0	238.7	17.8	4.8	3.7	4.6
Memo:								
Oil quantity (mb/d)	11.45	12.38	12.41	11.93	-0.62	0.93	-0.38	-0.48
Oil import price ($/bbl)	18.43	24.03	24.56	24.15	0.11	5.61	1.19	-0.41

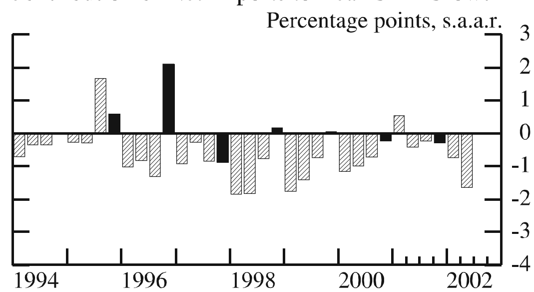
1. Change from previous quarter or month.
Source: U.S. Department of Commerce, Bureaus of Economic Analysis and Census.

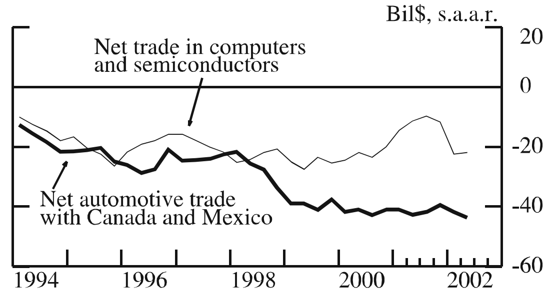
U.S. International Trade in Goods and Services

Net Exports

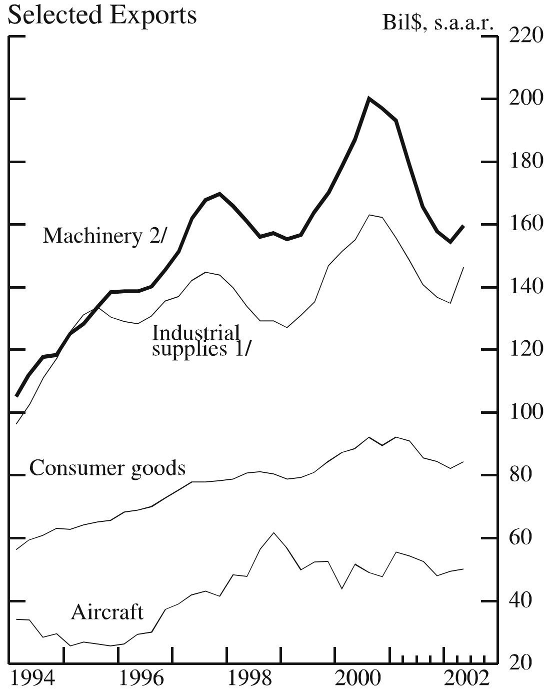


Contribution of Net Exports to Real GDP Growth



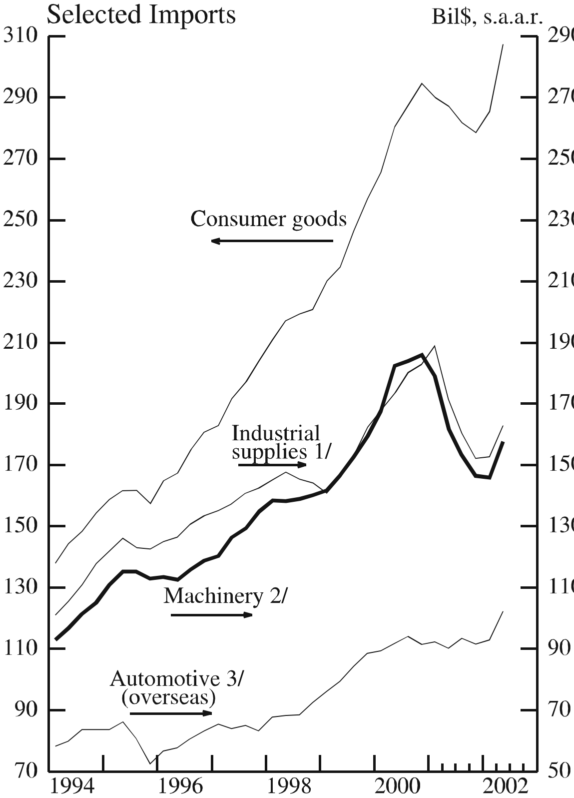


Selected Exports



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

Selected Imports



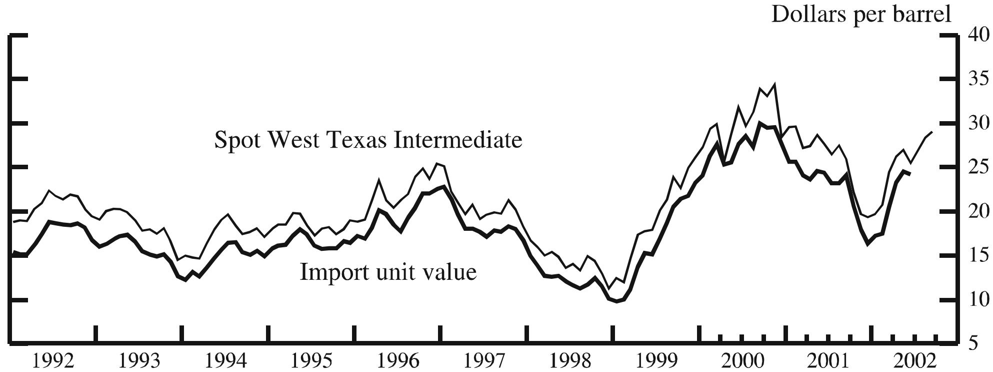
1. Excludes oil and gold.
2. Excludes computers and semiconductors.
3. Excludes Canada and Mexico.

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

	Annual rates			Monthly rates		
	2002			2002		
	Q1	Q2	Q3e	June	July	Aug.
	------------- BLS prices (2000 weights)-------------					
Merchandise imports	-2.0	10.2	1.6	-0.3	0.4	0.3
Oil	18.4	157.3	15.3	-3.5	4.3	2.1
Non-oil	-2.7	1.7	0.3	0.1	0.0	0.1
Core goods*	-2.4	1.8	1.2	0.2	0.1	0.2
Cap. goods ex comp & semi	-5.3	-1.9	1.8	0.3	0.1	0.4
Automotive products	-0.4	0.4	0.3	0.2	0.0	0.0
Consumer goods	-1.5	-1.2	0.3	-0.1	0.1	0.0
Foods, feeds, beverages	0.3	7.1	2.7	-1.0	0.8	0.2
Industrial supplies ex oil	-4.7	13.0	2.3	0.4	0.4	0.0
Computers	-2.7	-1.4	-3.5	-0.4	-0.5	-0.2
Semiconductors	-2.7	1.8	-6.5	-0.3	-1.5	0.0
Merchandise exports	-1.8	2.2	1.4	0.0	0.3	0.1
Core goods*	-1.3	3.4	3.1	0.3	0.4	0.2
Cap. goods ex comp & semi	0.9	0.7	-0.1	-0.1	0.0	0.0
Automotive products	1.3	0.1	0.1	0.0	-0.1	0.1
Consumer goods	-2.3	-0.9	1.0	0.1	0.1	0.1
Agricultural products	-2.6	2.3	18.7	1.2	2.6	1.9
Industrial supples ex ag	-3.6	10.8	6.3	0.7	1.1	-0.3
Computers	-4.5	-5.9	-7.8	-2.1	0.0	-0.4
Semiconductors	-8.1	-1.5	-9.5	-1.6	-1.3	0.0
Chain price index	---Prices in the NIPA accounts (1996 weights)---					
Imports of goods & services	-1.6	10.8	n.a.	...	...	...
Non-oil merchandise	-2.2	2.0	n.a.	...	...	...
Core goods*	-2.2	2.2	n.a.	...	...	...
Exports of goods & services	-0.8	2.8	n.a.	...	...	...
Total merchandise	-1.1	2.3	n.a.	...	...	...
Core goods*	-1.1	3.4	n.a.	...	...	...

*/ Excludes computers and semiconductors.
e/ Average of two months.
n.a. Not available. ... Not applicable.

Oil Prices



the second quarter, imports of goods and services surged 35 percent at an annual rate. Increases were recorded in all major trade categories other than aircraft. The largest increase was in imports of oil (largely price), while automotive products, consumer goods, machinery, and industrial supplies also recorded hefty gains. About one-third of the increase in imported machinery was in high-tech goods, the second quarterly gain. In addition, imports of basic industrial and service machinery rose for the first time in over a year. Payments by U.S. travelers abroad remained close to first quarter levels, while other private services increased.

Prices of Internationally Traded Goods

Non-oil imports. The price index of imported non-oil goods rose 0.1 percent in August, following no change in July. The price of core goods was up 0.2 percent; the price of computers was down 0.2 percent and the price of semiconductors remained unchanged. The component of core goods with the largest increase in August was the price index for capital goods. Prices in other major categories were little changed. In July and August, core goods prices rose 1¼ percent (a.r.) above the second-quarter level, following an increase of about 1¾ percent (a.r.) in the second quarter.

Oil. The BLS price of imported oil rose 2.1 percent in August after climbing a revised 4.3 percent in July. The BLS price of imported oil is up significantly since the beginning of the year, rising every month except June. The spot price of West Texas intermediate (WTI) crude oil has also risen on average since the beginning of the year and is currently around $29 per barrel, up from its average value near $19 per barrel in December. Factors putting upward pressure on crude oil prices are low exports from Iraq, the possibility of U.S. military intervention there, and tighter stock levels in the United States.

Exports. Prices of total U.S. goods exports rose 0.1 percent in August and the price of core goods rose 0.2 percent. The largest increase in August was in the price of agricultural exports, which rose 1.9 percent following an increase of 2.6 percent in July. Prices of industrial supplies and materials fell 0.3 percent, reversing the upward trend it has experienced most of this year, while prices in other major categories were generally little changed. The price of core goods in July and August on average was about 3 percent at an annual rate above the second-quarter level, which was up about 3½ percent from the first quarter.

U.S. Current Account through 2002:Q2

In 2002:Q2, the U.S. current account deficit increased to $520 billion at a seasonally adjusted annual rate (s.a.a.r.), $70 billion greater than the revised first quarter deficit. Increases in the deficit on goods and services and the deficit on income more than offset a decrease in net outflows for transfers.

For the second quarter, the deficit on goods and services increased $60.5 billion, s.a.a.r., with imports increasing faster than exports. Within exports, the categories with the largest increases were industrial supplies, capital goods, and automotive products. Within imports, the categories with the largest increases were petroleum and petroleum products, consumer goods, and automotive parts. The increase in petroleum and petroleum products was largely owing to higher prices. The $4.4 billion s.a.a.r increase in the services surplus in the second quarter was swamped by the $64.9 billion increase in the goods deficit. The deficit on investment income increased $21.2 billion, s.a.a.r., with direct investment payments increasing faster than receipts. The rapid growth in direct investment payments represents a further recovery from the very depressed levels recorded in the fourth quarter of 2001. The net outflow of other income and transfers decreased by $11.7 billion, s.a.a.r., reflecting a decrease in U.S. government grants.

The second-quarter release included revisions to first-quarter data. The current account deficit was virtually unchanged with a downward revision to the deficit on investment income offsetting a downward revision to the services surplus and a slight increase in the net outflow of transfers.

U.S. Current Account

(Billions of dollars, seasonally adjusted annual rate)

Period	Goods and services, net	Investment income, net	Other income and transfers, net	Current account balance
Annual				
2000	-378.7	27.7	-59.3	-410.3
2001	-358.3	20.5	-55.6	-393.4
Quarterly				
2001:Q3	-319.1	9.4	-55.6	-365.3
Q4	-352.1	32.4	-60.6	-380.3
2002:Q1	-382.0	2.7	-70.6	-449.8
Q2	-442.5	-18.5	-58.9	-519.8
Change				
Q3-Q2	54.2	-20.7	-1.8	31.6
Q4-Q3	-33.0	23.0	-5.0	-15.0
Q1-Q4	-29.9	-29.7	-9.9	-69.5
Q2-Q1	-60.5	-21.2	11.7	-70.0

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

U.S. International Financial Transactions

Net purchases of U.S. securities by private sector foreigners (line 4 of the Summary of U.S. International Transactions table) were again quite strong in July. After a slow start in January and February, the pace of foreign net purchases has increased substantially and is now approximately equal to last year's record pace. Net purchases of Treasuries ($30 billion, line 4a) were the highest in almost five years and well above the levels recorded in recent years, perhaps due in part to a flight to quality at a time of investor nervousness over corporate malfeasance. The largest increases were recorded for the United Kingdom ($11 billion), Japan ($9 billion), and the Cayman Islands ($7 billion). In contrast, net purchases of both agency (line 4b) and corporate debt securities (line 4c) were well below average, with purchases of corporate debt securities at their lowest level in over seven years, coinciding with a sharp reduction in new corporate debt issuance. Foreign net purchases of equities (line 4d) increased to $10 billion on unusually high trading volume.

U.S. private investors were substantial net sellers of foreign securities (line 5) in July. Sales of foreign bonds (line 5a) continued, but at a somewhat higher pace than in recent months. Net sales of foreign equities (line 5b) were the highest ever recorded for a single month, altering the recent trend of net purchases.

After rising significantly in June due in large part to Japanese intervention activity, foreign official reserves held in the United States rose modestly in July (line 1). Partial data from the Federal Reserve Bank of New York indicate that total foreign official reserves increased by $4 billion in August. Through July, foreign official inflows totaled $57 billion–a pace well above any recorded since 1996.

Recently released balance of payments data for the second quarter show that U.S. direct investment abroad (line 6) remained constant at $29 billion. Foreign direct investment in the United States (line 7) continued its downward trend and was only $1 billion in the quarter, reflecting both intercompany debt outflows and a further slowing of merger and acquisition activity.

The statistical discrepancy was positive $49 billion in the quarter, following a discrepancy of positive $25 billion in the first quarter. A positive statistical discrepancy indicates some combination of under-recorded net financial inflows or over-recorded net imports of goods and services.

Summary of U.S. International Transactions

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

	2000	2001	2001 Q3	2001 Q4	2002 Q1	2002 Q2	2002 June	2002 July
Official financial flows	**39.3**	**2.0**	**13.2**	**5.3**	**8.8**	**45.6**	**26.3**	**2.6**
1. Change in foreign official assets in the U.S. (increase, +)	39.6	6.9	16.8	5.5	8.4	47.5	29.1	2.9
a. G-10 countries	12.3	-7.9	-5.6	9.1	4.7	17.9	13.5	6.1
b. OPEC countries	10.7	-1.9	-4.8	4.2	-6.5	1.1	1.4	-0.1
c. All other countries	16.6	16.8	27.2	-7.8	10.2	28.5	14.2	-3.1
2. Change in U.S. official reserve assets (decrease, +)	-.3	-4.9	-3.6	-.2	.4	-1.8	-2.8	-.2
Private financial flows	**370.3**	**379.8**	**29.6**	**145.3**	**90.6**	**34.8**	**...**	**...**
Banks								
3. Change in net foreign positions of banking offices in the U.S.[1]	-6.7	7.3	-1.7	38.7	-2.3	–17.8	-30.0	-.6
Securities[2]								
4. Foreign net purchases of U.S. securities (+)	381.0	404.4	51.2	128.2	62.4	106.4	39.3	44.9
a. Treasury securities	-76.4	5.6	-14.2	28.3	-7.1	1.6	12.6	29.6
b. Agency bonds	96.5	86.4	19.4	28.1	2.8	32.4	3.3	3.4
c. Corporate and municipal bonds	165.7	201.7	33.1	38.3	43.3	60.3	19.3	2.4
d. Corporate stocks[3]	195.1	121.9	12.9	33.5	23.4	12.0	4.0	9.5
5. U.S. net acquisitions (-) of foreign securities	-126.6	-95.1	10.0	-26.2	2.0	-10.9	-1.6	18.3
a. Bonds	-23.3	12.3	21.0	-7.4	.6	9.5	4.5	6.5
b. Stock purchases	-22.9	-62.7	-9.3	-12.4	3.2	-20.3	-6.2	11.8
c. Stock swaps[3]	-80.4	-44.7	1.8	-6.4	-1.8	.0	.0	.0
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-178.3	-127.8	-41.7	-27.5	-29.3	-29.4	...	...
7. Foreign direct investment in U.S.	307.7	130.8	14.2	21.9	16.2	1.0	...	...
8. Foreign holdings of U.S. currency	1.1	23.8	8.2	10.5	4.5	7.2	...	...
9. Other (inflow, +)[4]	-7.9	36.4	- 10.5	-.1	25.3	-21.8	...	...
U.S. current account (s.a.)	**-410.3**	**-393.4**	**-91.3**	**-95.1**	**-112.5**	**-130.0**	**...**	**...**
Capital account balance (s.a.)[5]	**.8**	**.8**	**.2**	**.2**	**.2**	**.2**	**...**	**...**
Statistical discrepancy (s.a.)	**.0**	**10.7**	**48.3**	**-55.8**	**24.7**	**49.4**	**...**	**...**

NOTE: The sum of official and private financial flows, the current account balance, the capital account balance, and the statistical discrepancy is zero. 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 adjustments BEA makes to account for incomplete coverage, but excludes adjustments for commissions and therefore does not match exactly the data on U.S. international transactions published by the Department of Commerce.

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

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

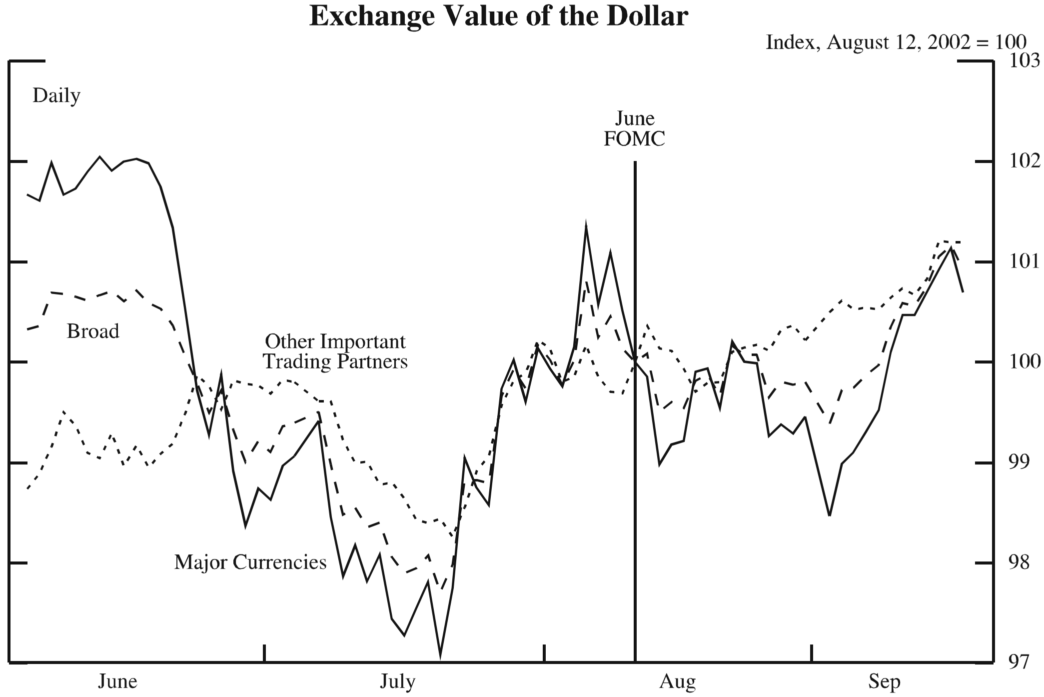
5. Consists of transactions in nonproduced nonfinancial assets and capital transfers.

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

Foreign Exchange Markets

Since the August meeting of the FOMC, the trade-weighted exchange value of the dollar against the major foreign currencies has appreciated about ¾ percent on balance. Although concerns about the timing and speed of recovery in the U.S. economy continued to be widespread during the intermeeting period, the effect of these concerns on the exchange value of the dollar appeared to be offset by reports showing that recovery in other industrial countries, particularly in Germany and Japan, would also likely be slow. Against individual currencies, the dollar was up slightly, on balance, over the period against the euro. The dollar appreciated about 2½ percent versus the Japanese yen and ¾ percent against the Canadian dollar but depreciated 1 percent vis-a-vis sterling.

Exchange Value of the Dollar



Equity prices in major industrial countries continued to be quite volatile during the intermeeting period and generally registered substantial losses. While U.S. equity indexes remained above the levels reached in July, European stock prices ended the period near the multi-year lows reached at that time. German stocks were hardest hit, falling 15 percent, with insurance share prices plunging 30 percent. Data casting fresh doubt on Japan's fledgling recovery pressured Japanese stock prices down, with the Nikkei index reaching its lowest level since the early 1980s during the period. This prompted calls by Japanese politicians for government intervention to support equity prices. On September 18, the Bank of Japan unexpectedly announced that it would consider measures to buy shares directly from banks, leading Japanese banking shares to quickly rebound on the day.

Financial Indicators in Major Industrial Countries

Country	Three-month rate: Sep. 18 (Percent)	Three-month rate: Percentage Point Change	Ten-year yield: Sep. 18 (Percent)	Ten-year yield: Percentage Point Change	Equities: Percent Change
Canada	2.96	.08	4.84	-.22	-3.15
Japan	.05	.00	1.23	-.03	-3.35
Euro area	3.31	-.03	4.32	-.21	-8.36
United Kingdom	3.91	.03	4.41	-.21	-6.60
Switzerland	.65	-.12	2.80	-.37	-7.25
Australia	5.06	.13	5.48	-.18	.61
United States	1.78	.08	3.84	-.38	-4.40
Memo: Weighted-average foreign	2.29	.02	4.07	-.20	n.a.

NOTE. Change is from August 12 to September 18 (10 a.m. EDT).
n.a. Not available.

Equity market volatility, concerns about global growth, and uncertainty about the situation in Iraq likely contributed to flows out of equity and into sovereign bonds, and ten-year benchmark bond yields ended the period down substantially in all major industrial countries. The yield on Japan's ten-year benchmark sovereign bond had fallen more than 20 basis points, to its lowest level since 1998, before rebounding after the announcement by the Bank of Japan on share purchases. Weak Japanese data, the upcoming end of the fiscal half-year, and unconfirmed reports that the Bank of Japan was considering increasing its outright purchases of government bonds, all appeared to weigh on the already low bond yield.

The European Central Bank, the Bank of Japan, and the Bank of England did not adjust their monetary policy stances during the period, in line with market expectations. The Bank of Canada had generally been expected to raise its target for the overnight rate on September 4, but left it at 2.75 percent, citing weaker prospects for growth in the United States and global financial market volatility. Three-month interest rates in major industrial countries registered only small net changes, reflecting the stability in policy rates.

Financial Indicators in Latin America, Asia, and Russia

Economy	Currency/ US dollar: Sep. 18	Currency/ US dollar: Percent Change	Short-term Interest rates[1]: Sep.17/18 (Percent)	Short-term Interest rates[1]: Percentage Point Change	Dollar-denominated bond spread[2]: Sep.17/18 (Percent)	Dollar-denominated bond spread[2]: Percentage Point Change	Equity prices: Percent Change
Mexico	10.02	1.75	6.74	.24	4.06	.04	2.61
Brazil	3.29	5.75	18.45	-.65	19.37	-3.15	-2.11
Argentina	3.61	-.28	70.00	.00	64.01	-6.07	3.10
Chile	730.00	4.06	2.80	-.49	3.81	.38	-3.84
China	8.27	-.12	n.a.	n.a.	1.78	-.04	-2.45
Korea	1203.00	.17	4.60	.00	n.a.	n.a.	1.22
Taiwan	34.59	2.58	2.23	.03	...	...	-7.61
Singapore	1.77	.74	1.25	.50	...	...	-6.12
Hong Kong	7.80	-.01	1.89	.22	...	...	-4.88
Malaysia	3.80	-.01	2.87	.00	2.03	.07	-6.47
Thailand	42.92	1.83	2.06	-.06	1.11	.37	-3.56
Indonesia	8990.00	1.64	14.24	-.84	3.51	-.94	-6.55
Philippines	52.22	1.10	5.63	-.75	5.09	.18	4.98
Russia	31.66	.27	n.a.	n.a.	6.06	.06	1.48

NOTE. Change is from August 12 to September 17/18.
1. One month interbank interest rate, except Chile: 30-day deposit rate; Korea: 1-week call rate. No reliable short-term interest rates exist for China or Russia.
2. Spread over similar maturity U.S. Treasury security yield. Mexico, Brazil, Argentina, Korea, the Philippines and Russia: EMBI+ yield. Chile and China: Global bond yield. Malaysia: Eurobond yield. Thailand and Indonesia: Yankee bond yield. Taiwan, Singapore, and Hong Kong do not have outstanding sovereign bonds denominated in dollars.
n.a. Not available. ... Not applicable.

In Latin America, the focus continued to be on Brazil and on the potential impact of a victory by an opposition party candidate in next month's presidential election. Although the Brazilian *real* depreciated 6 percent against the dollar on net over the period, Brazil's EMBI+ spread over Treasuries declined 300 basis points. Brazilian sovereign bond prices continued to react positively to the financial assistance package which was announced by the IMF on August 7, with approval on September 6. Although Argentina appeared no closer to finding solutions to its fiscal and banking crises, the peso, in very restricted trading, was little changed against the dollar, and Argentina's EMBI+ spread over Treasuries, though still extremely high, declined about 600 basis points. The Mexican peso depreciated over 1 percent against the dollar.

In emerging Asia, equity prices in Taiwan, Singapore, and Malaysia declined 6 to 8 percent over the period, amid concerns about the pace of the recovery in the technology sector. The New Taiwan dollar depreciated 2½ percent against the dollar. Korean financial markets outperformed the other technology exporting economies, as stock prices rose a bit and the Korean won appreciated slightly versus the dollar.

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

Developments in Foreign Industrial Countries

Data on second-quarter GDP for the major foreign industrial countries showed moderate growth, but the pace and sources of the expansion varied across countries. Canadian growth remained the most robust and continued to be supported by strength in consumption and investment. Growth in Japan, the euro area and the United Kingdom was slower and continued to depend on strong contributions from net exports, while investment spending declined further. Data released for the most recent months suggest that the pace of recovery remains relatively strong in Canada and is picking up in the United Kingdom but that growth is flattening out at low rates in Japan and the euro area.

Inflation rates generally moved higher, in part owing to higher energy prices. Twelve-month consumer price inflation rose to about 2 percent in the United Kingdom and to just above that in the euro area and Canada, whereas consumer prices continued to fall at nearly a 1 percent pace in Japan. Foreign central banks have not changed their policy interest rates since August, as financial-market volatility has contributed to uncertainty about growth prospects.

In **Japan**, real GDP rose 2.6 percent (s.a.a.r.) during the second quarter. The figure was based on a new computation method that gives greater weight to supply-side statistics. The rise was led by strong external demand; net exports added 1.6 percentage points to growth, with very rapid growth in exports outpacing a jump in imports. Private consumption edged up modestly, while residential investment declined. Business fixed investment fell much less than the roughly double-digit drops registered over the previous five quarters. Public investment fell 7 percent. Inventories made a slight positive contribution to growth, following a year of large negative contributions. Using the new methodology for computing GDP, growth in Q1 was revised down from 5.7 percent to about zero.

Indicators for the third quarter suggest that recovery may be flagging. Industrial production was about flat in July for the second consecutive month. Household expenditures were up only modestly in July compared with the second-quarter average. Recent data for business fixed investment have been mixed; core machinery orders rose 1.9 percent in July, following a 2.9 percent increase in June, but nonresidential building starts declined in July. Residential building starts rose from June to July, but were down 3 percent in July from their second-quarter average. Real exports rose only moderately in July from the second-quarter average, while imports jumped, sharply narrowing the trade surplus.

Labor market conditions remain unfavorable, with employment down 1.2 percent in July from year-earlier levels. The unemployment rate was stuck at

Japanese Real GDP
(Percent change from previous period, except as noted, s.a.a.r.)

Component	2000[1]	2001[1]	2001		2002	
			Q3	Q4	Q1	Q2
GDP	2.3	-1.5	-2.6	-2.8	-.0	2.6
Total domestic demand	2.2	-1.1	-2.4	-3.0	-2.0	1.0
Consumption	.3	1.6	-.4	.5	1.9	1.1
Private investment	11.0	-6.9	-8.6	-12.0	-7.6	-1.8
Public investment	-11.3	-3.5	3.1	-.7	-2.9	-7.4
Government consumption	4.1	3.0	2.2	3.0	1.1	2.2
Inventories[2]	.1	-.7	-.8	-1.2	-1.5	.8
Exports	9.7	-11.3	-12.1	-6.6	20.5	24.9
Imports	10.7	-9.0	-11.5	-8.9	-.2	10.8
Net exports[2]	.1	-.5	-.3	.1	1.9	1.6

1. Q4/Q4.
2. Percentage point contribution to GDP growth, s.a.a.r.

5.4 percent in July, only a touch below the record-high rate registered in December. The job-offers-to-applicants ratio, considered a key leading indicator of employment conditions, edged up in July. Core consumer goods prices in the Tokyo area (which exclude fresh food but include energy) increased 0.2 percent in August from the previous month, but were down 0.9 percent (n.s.a.) from a year earlier. Wholesale prices for domestic goods stayed roughly flat between February and August, but remained below year-earlier levels. The GDP deflator in the second quarter was 0.9 percent below its year-earlier level.

The Bank of Japan (BOJ) announced on September 18 that it is considering directly purchasing equity held by banks. The official statement was short on details, providing little information on the price, quantity, or timing of any such purchases. In a news conference held after the announcement, BOJ Governor Hayami remarked that the purchases would be made to help banks “reduce the impact of falling stocks” and to improve the stability of the Japanese financial system. Japanese banks currently own a substantial portion of Japanese equities and will be required to deduct losses on those holdings from their regulatory capital at the September 30 close of the fiscal half-year. The BOJ kept the guidelines for money market operations unchanged, with a goal of maintaining an outstanding balance of current accounts at the Bank of around ¥10 to

¥15 trillion. The BOJ announcement leaves unclear how its stock purchases would affect banks' current account balances at the BOJ.

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

Indicator	2001	2002					
	Q4	Q1	Q2	May	Jun.	Jul.	Aug.
Industrial production[1]	-3.4	.6	3.8	4.1	-.2	.1	n.a.
All-industry index	-.9	.6	.3	1.0	-.1	n.a.	n.a.
Housing starts	-2.5	.8	-.8	11.3	-13.1	3.1	n.a.
Machinery orders[2]	-7.5	-7.4	7.1	.2	2.9	1.9	n.a.
Machinery shipments	-4.7	3.6	6.6	8.7	-3.0	-1.5	n.a.
New car registrations	-5.5	1.9	5.3	4.9	-11.2	1.2	18.2
Unemployment rate[3]	5.4	5.3	5.3	5.4	5.4	5.4	n.a.
Job offers ratio[4]	.52	.51	.53	.53	.53	.54	n.a.
Business sentiment[5]	-40	-41	-32	...	...	...	...
CPI (Core, Tokyo area)[6]	-1.0	-.9	-1.1	-1.1	-1.0	-1.0	-.9
Wholesale prices[6]	-1.4	-1.4	-1.1	-1.2	-1.0	-1.2	-.9

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

On September 19 or 20, the government is expected to announce a package of stimulus measures. Likely components include measures to boost Japanese stock prices, policies to quicken disposal of banks' non-performing loans, and tax cuts in the range of ¥1 trillion to ¥2.5 trillion (0.2 to 0.5 percent of GDP). Earlier this month, the government announced that any future tax cuts are expected to be coupled with future tax increases or government spending cuts in order to maintain the medium-term revenue neutrality of tax reform. On the spending side, the government aims to keep next fiscal year's general expenditures equal to or below this fiscal year's figure of ¥47.5 trillion.

Euro-area real GDP rose 1.4 percent (s.a.a.r.) in the second quarter, the same pace as in the first quarter. Once again, growth was supported by positive contributions from net exports and inventory investment, although those contributions were about half as large as in the first quarter. Investment spending fell for the sixth consecutive quarter. Private consumption spending, however, rebounded in the second quarter as spending by German consumers recovered after having been cut sharply late last year.

Euro-Area Real GDP[1]
(Percent change from previous period, except as noted, s.a.a.r.)

Component	2000[2]	2001[2]	2001		2002	
			Q3	Q4	Q1	Q2
GDP	2.7	.4	.7	-1.2	1.4	1.4
Total domestic demand	2.2	1.9	-1.1	-.9	.2	.8
Consumption	1.8	1.6	.4	-.1	-.7	1.6
Investment	3.4	-2.5	-2.5	-3.6	-2.3	-3.2
Government consumption	2.2	1.4	1.2	1.5	3.1	1.5
Inventories[3]	-.0	-.7	-1.0	-.3	.5	.3
Exports	12.2	-3.3	-1.3	-6.6	.5	8.0
Imports	11.3	-4.9	-6.0	-6.4	-2.9	6.9
Net exports[3]	.5	.5	1.7	-.3	1.2	.6
Memo:						
France	3.8	.2	1.9	-2.0	2.1	2.0
Germany	1.9	.1	-.8	-1.2	1.1	1.1
Italy	2.6	.6	.3	-.9	.5	.9

1. Includes Greece as of 2001 Q1.
2. Q4/Q4.
3. Percentage point contribution to GDP growth, s.a.a.r.

Indicators for the third quarter suggest that growth is stuck at the relatively low first-half rate. Purchasing managers indexes (PMIs) for both manufacturing and services declined in July and August to just above the 50 level that is the threshold for indicating positive growth. In Germany, the largest and recently the most sluggish of the euro-area economies, industrial production and new manufacturing orders each declined about 1 percent in July, and retail sales fell more than 2 percent.

The twelve-month rate of euro-area consumer price inflation edged back above the ECB's target ceiling of 2 percent in August. Excluding food, energy, alcohol and tobacco, the twelve-month inflation rate remained at 2.4 percent in August, just below the six-year peak of 2.5 percent reached in May. Producer prices remain below year-earlier levels.

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

Indicator	2001	2002					
	Q4	Q1	Q2	May	Jun.	Jul.	Aug.
Industrial production[1]	-1.8	.8	.1	.0	.5	n.a.	n.a.
Retail sales volume	.5	.2	-.3	.3	-.5	n.a.	n.a.
Unemployment rate[2]	8.1	8.1	8.3	8.3	8.3	8.3	n.a.
Consumer confidence[3]	-10.7	-9.7	-9.0	-8.0	-9.0	-10.0	n.a.
Industrial confidence[4]	-17.0	-13.0	-10.0	-9.0	-10.0	-10.0	n.a.
Mfg. orders, Germany	-.9	1.2	2.4	3.4	-3.3	-.9	n.a.
CPI[5]	2.1	2.6	2.1	2.0	1.8	1.9	2.1
Producer prices[5]	-.8	-.9	-.9	-1.0	-1.1	-.6	n.a.
M3[5]	8.1	7.2	7.1	7.7	7.1	7.1	n.a.

1. Excludes construction.
2. Percent. Euro-area standardized to ILO definition. Includes Eurostat estimates in some cases.
3. Diffusion index based on European Commission surveys in individual countries; Averages of responses to questions on financial situation, general economic situation, and purchasing attitudes.
4. Diffusion index based on European Commission surveys in individual countries; Averages of responses to questions on production expectations, orders, and stocks.
5. Eurostat harmonized definition. Percent change from year earlier.
n.a. Not available.

Slow growth has put pressure on euro-area government balances. The German government revealed that its deficit for the first half of 2002 was 3.5 percent. With tax revenues in the second half likely to be depressed by sluggish economic growth, and with an increase in government spending in response to the recent floods in eastern Germany, it appears increasingly likely that the German budget deficit will exceed the 3 percent Maastricht treaty limit this year. Germany should be able to escape sanctions by citing the exceptional circumstance of the floods and by emphasizing actions the government has taken to offset the budget impact in the medium term. In particular, the Schroeder government has proposed that scheduled individual income tax cuts will be postponed from 2003 to 2004 and corporate tax rates will be raised for one year in 2003.

In the **United Kingdom**, second-quarter real GDP rose 2.3 percent (s.a.a.r.) after two quarters of weak growth. The data were revised down substantially from preliminary estimates owing to a fall-off in production during the Queen's Golden Jubilee celebrations in June. Consumer spending rose briskly following a moderation of consumption growth in the first quarter. Gross fixed capital formation declined marginally, and inventories subtracted 1.4 percentage points from growth. Exports rose more sharply than imports, and net exports added 1.5 percentage points to growth.

U.K. Real GDP

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

Component	2000[1]	2001[1]	2001		2002	
			Q3	Q4	Q1	Q2
GDP	2.2	1.5	1.4	.4	.6	2.3
Total domestic demand	3.4	1.7	.7	3.0	3.2	1.1
Consumption	4.8	4.2	4.3	4.7	2.0	4.7
Investment	4.5	-6.7	-14.2	-.9	-5.6	-.2
Government consumption	1.3	3.9	4.8	7.9	8.1	-3.6
Inventories[2]	-.8	-.5	-.2	-1.3	1.5	-1.4
Exports	8.7	-4.6	-11.4	-6.3	-4.0	12.5
Imports	10.9	-2.8	-10.8	1.4	3.7	6.2
Net exports[2]	-1.2	-.5	.4	-2.7	-2.8	1.5

1. Q4/Q4.
2. Percentage point contribution to GDP growth, s.a.a.r.

As expected, industrial production bounced back substantially in July after plunging in June because of work stoppages related to the Golden Jubilee. Despite industrial production remaining about 1 percent below May's level, it is expected to result in a large "payback" effect to GDP in the third quarter.

Other indicators for the third quarter suggest a pick-up in growth in August after signs of a slowdown over the past several months. The manufacturing PMI recovered in August, indicating expansion again after July's contraction. Business confidence improved smartly in August continuing its climb from May's low. July's trade balance narrowed somewhat from June. Retail sales grew in July after two months of contraction. However, surveys for August retail sales are mixed. The services PMI increased in August, continuing to indicate expansion, whereas preliminary estimates of consumer confidence suggest little change in August from the month before.

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

Indicator	2001	2002					
	Q4	Q1	Q2	May	Jun.	Jul.	Aug.
Industrial production	-2.3	-1.2	.3	1.1	-4.3	3.4	n.a.
Retail sales volume	1.3	1.0	1.7	-.6	-.4	.4	n.a.
Unemployment rate[1]							
Claims-based	3.2	3.1	3.2	3.2	3.2	3.1	3.1
Labor force survey[2]	5.1	5.1	5.2	5.1	5.2	n.a.	n.a.
Business confidence[3]	-24.0	-3.3	8.0	4.0	6.0	9.0	16.0
Retail prices[4]	2.0	2.4	1.9	1.8	1.5	2.0	1.9
Producer input prices[5]	-8.2	-5.6	-5.9	-6.4	-6.9	-3.8	-2.2
Average earnings[5]	3.3	2.9	3.9	4.0	3.8	4.2	n.a.

1. Percent.
2. Three-month average centered on month shown.
3. Percentage of firms expecting output to increase in the next four months less percentage expecting output to decrease.
4. Excluding mortgage interest payments. Percent change from year earlier.
5. Percent change from year earlier.
... Not applicable.
n.a. Not available.

Data on the housing market are mixed, with widespread concern that Britain is experiencing a housing price bubble. The two leading surveys of housing prices continued to register twelve-month increases of around 20 percent in August. A new survey of housing prices (based on offer prices collected by real estate agents) indicated housing price growth slowed in August. In July, borrowing to finance the purchase of new homes bounced back to just above May's record high after dropping sharply in June.

Labor market conditions remain tight. The official claims-based unemployment rate remained at 3.1 percent in August, near a record low. Even so, the twelve-month rate of retail price inflation (excluding mortgage interest payments) remained below the Bank of England's 2½ percent target in August at 1.9 percent. The twelve-month growth rate of average earnings rose to 4.2 percent in July.

In **Canada**, real GDP increased 4.3 percent (s.a.a.r.) in the second quarter, following an upwardly revised 6.2 percent gain in the first quarter. Inventories contributed strongly to growth, as firms restocked following three quarters of sizable inventory drawdowns. Net exports subtracted from growth, as imports surged. Final domestic demand grew steadily at 3.7 percent, supported by continued strength in the home-building sector and a 20.6 percent surge in business investment in machinery and equipment. Monthly real GDP data by industry show some slowing of growth in recent months to 1.4 percent and 1.7 percent (s.a.a.r.) in June and July respectively.

Canadian Real GDP

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

Component	2000[1]	2001[1]	2001		2002	
			Q3	Q4	Q1	Q2
GDP	3.5	.8	-.5	2.9	6.2	4.3
Total domestic demand	2.6	-.3	-.7	-3.8	6.0	10.0
Consumption	3.4	2.2	-.3	4.1	2.8	3.0
Investment	3.6	-1.6	8.7	-13.9	8.7	7.8
Government consumption	3.4	2.1	1.9	.9	1.2	1.2
Inventories[2]	-.8	-1.6	-2.4	-3.4	2.2	5.7
Exports	4.7	-6.1	-7.0	-.6	5.4	1.8
Imports	2.2	-9.2	-7.0	-16.9	4.3	16.8
Net exports[2]	1.2	.9	-.3	6.6	.7	-4.9

1. Q4/Q4.
2. Percentage point contribution to GDP growth, s.a.a.r.

Other recent indicators suggest that the Canadian economy is continuing to grow at a steady rate. Manufacturing shipments jumped 12.6 percent (s.a.a.r) in July, led by the increased production of motor vehicles. New orders, however, fell during the month, as did the number of unfilled orders. Housing starts in July and August remain near the 12-year high reached early this year. Auto sales have also remained robust, with July's sales only slightly below the record numbers of late last year.

The unemployment rate decreased to 7.5 percent in August. Employment has grown 2.6 percent over the first eight months of 2002, the largest eight-month increase since 1994. Employment growth in the manufacturing and construction sectors has been particularly robust over the course of the year. The twelve-month rate of consumer price inflation in July rose to 2.1 percent from 1.3 percent in June, with most of the increase attributable to a rise in energy and cigarette prices, as well as higher automobile insurance premiums. The twelve-month rate of core price inflation, excluding food and energy prices, rose to 2.9 percent in July from 2.6 percent in June.

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

Indicator	2001	2002					
	Q4	Q1	Q2	May	Jun.	Jul.	Aug.
GDP by industry	.4	1.4	1.2	.1	.1	n.a.	n.a.
Industrial production	-1.1	2.4	1.7	-.6	-.1	n.a.	n.a.
New mfg. orders	-4.8	4.7	3.7	-.6	.0	-.5	n.a.
Retail sales	2.6	2.6	.8	-1.1	1.8	n.a.	n.a.
Employment	.1	.7	.9	.2	.4	.1	.4
Unemployment rate[1]	7.7	7.8	7.6	7.7	7.5	7.6	7.5
Consumer prices[2]	1.1	1.5	1.3	1.0	1.3	2.1	n.a.
Consumer attitudes[3]	114.7	125.0	125.5	...	...	...	...
Business confidence[3]	117.6	141.5	145.2	...	...	...	...

1. Percent.
2. Percent change from year earlier, n.s.a.
3. Level of index, 1991 = 100.
n.a. Not available. ... Not applicable.

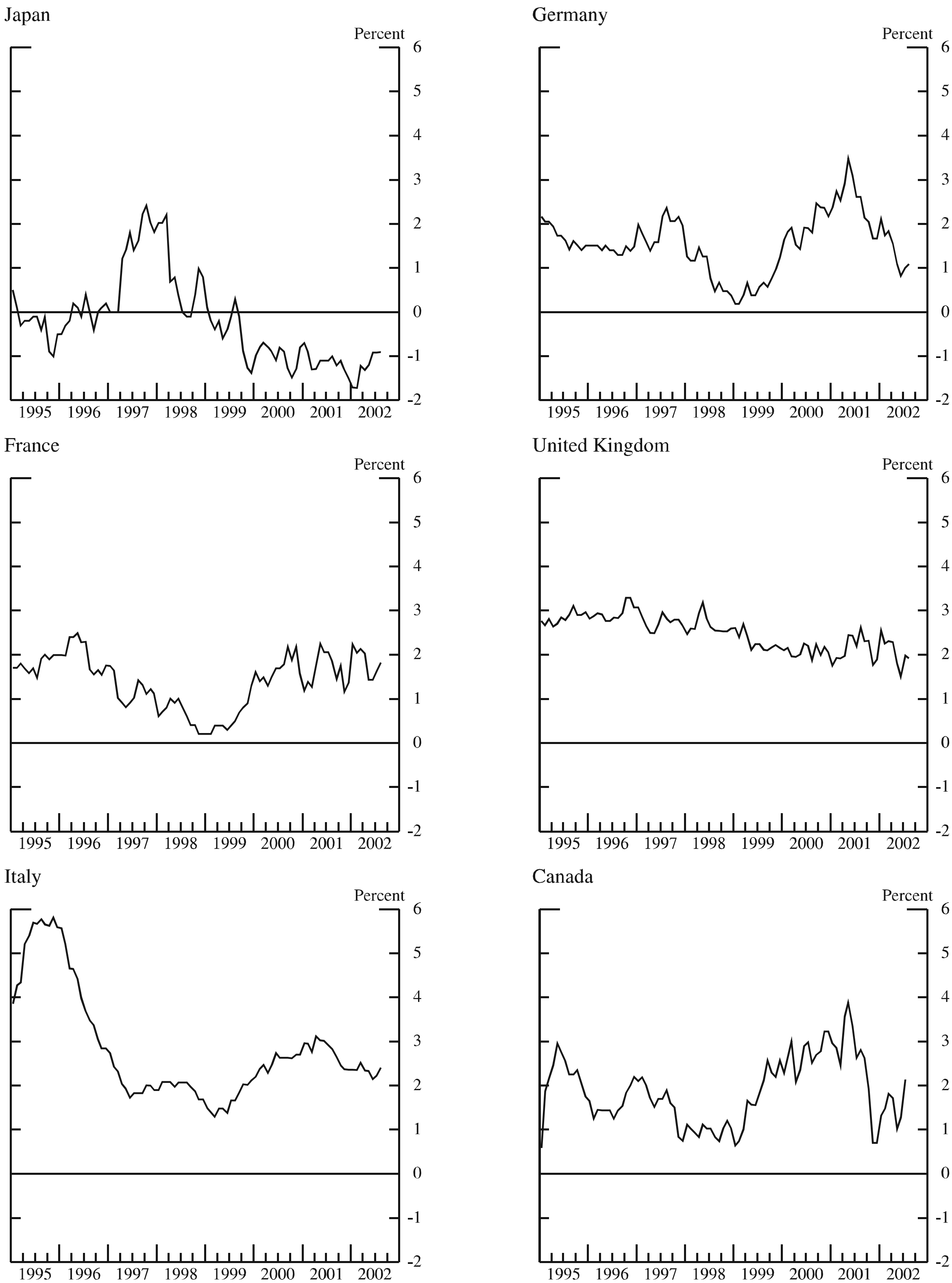
The Bank of Canada left its target for the overnight rate, its key policy rate, unchanged at 2.75 percent following its September 4 meeting date, citing concerns over growth prospects in the United States and other countries. The decision ended a string of rate hikes totaling 75 basis points, the most recent on July 16, that had reversed part of the cumulative reduction of 375 basis points that began in 2001. However, the Bank noted that the Canadian economy is approaching its production capacity and further rate hikes are likely to be necessary going forward.

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

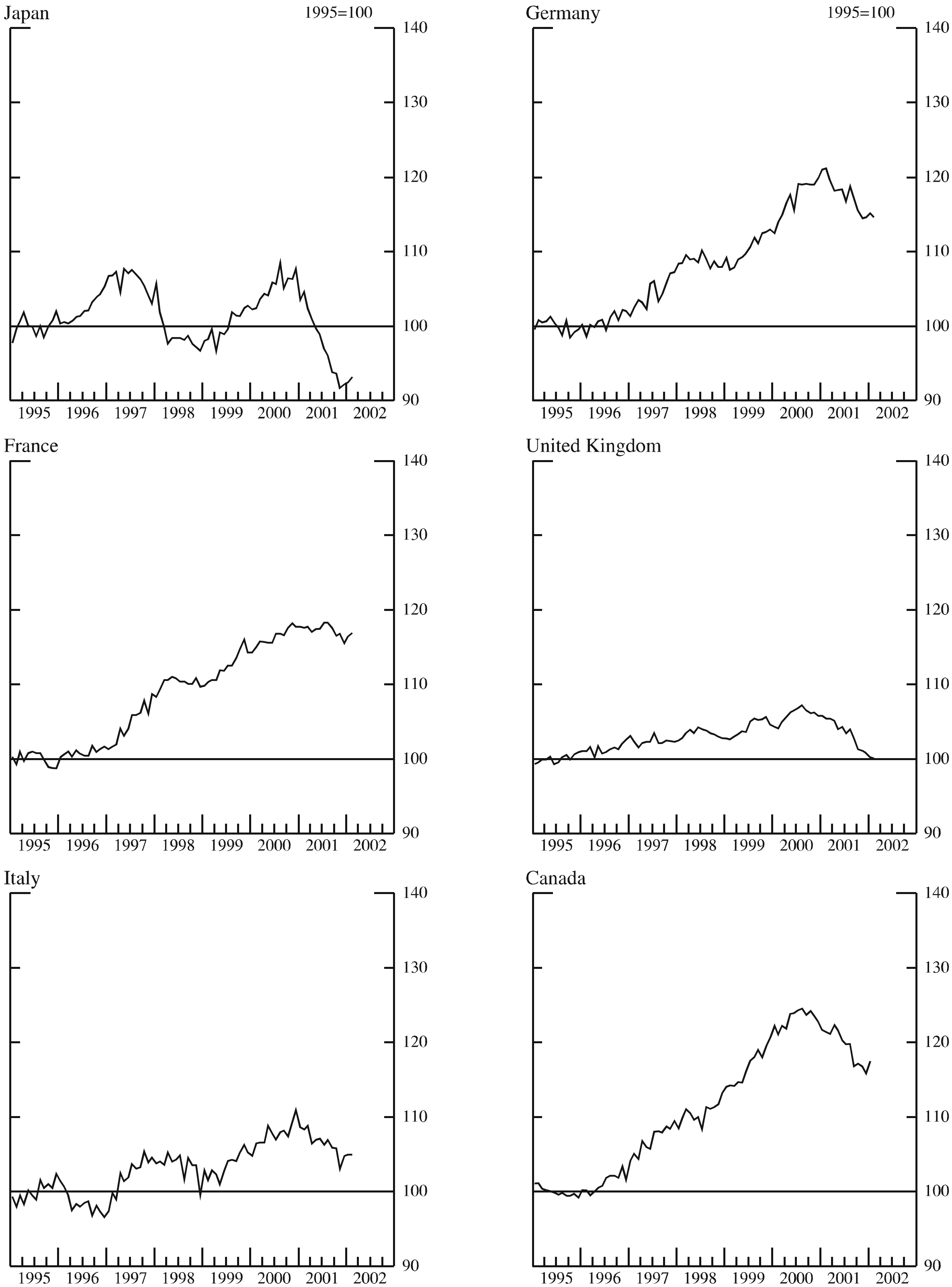
Country and balance	2001	2002				
	Q4	Q1	Q2	May	Jun.	Jul.
Japan						
Trade	45.9	72.4	86.1	86.1	101.2	68.5
Current account	98.5	117.5	120.6	121.5	133.9	128.7
Euro area						
Trade[1]	91.1	61.2	90.9	94.6	122.6	n.a.
Current account[1]	38.4	39.2	-5.3	1.1	44.7	n.a.
Germany						
Trade	91.3	112.6	107.8	113.3	111.3	126.4
Current account	25.5	36.9	43.7	42.8	46.1	5.7
France						
Trade	.8	1.1	1.9	2.6	1.4	4.3
Current account	4.1	3.6	4.0	5.0	6.7	n.a.
Italy						
Trade	15.3	5.6	9.6	13.5	8.3	n.a.
Current account[1]	7.5	-9.3	-13.9	-19.0	-7.6	n.a.
United Kingdom						
Trade	-48.4	-45.0	-38.2	-27.1	-50.2	-46.0
Current Account	-37.3	32.0	n.a.	...	...	...
Canada						
Trade	32.8	34.9	35.2	35.4	29.8	n.a.
Current Account	11.2	13.3	12.6	...	...	...

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

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



Industrial Production in Selected Industrial Countries



Economic Situation in Other Countries

Economic conditions in South America remain extremely fragile. No signs of recovery have emerged in Argentina and Venezuela. In Brazil, financial markets have stabilized somewhat over the intermeeting period, but the high level of uncertainty is taking a toll on economic activity. In contrast, growth in Mexico turned decidedly positive in the second quarter, led by strong exports. In emerging Asia, all countries experienced positive growth in the second quarter, and recent readings from economic indicators suggest that recovery has continued. With the notable exceptions of Argentina and Venezuela, inflation has generally remained under control.

In **Brazil**, real GDP growth in the second quarter slowed to 2.4 percent (s.a.a.r.), but was supported by strong agricultural output. Indicators for the third quarter have pointed to a weakening in activity, as the country's access to credit at home and abroad remains tightly constrained. Industrial output was flat in July, and unemployment edged above 8 percent. Twelve-month inflation ticked down in August to about 7½ percent, running above the 5½ percent upper limit of the government's inflation target range for 2002. The trade surplus has been increasing in recent months in response to the weakening economy, the depreciation of the *real*, and the easing of a customs strike.

During August, concerns rose over the lack of foreign credit for the Brazilian private sector, whose external obligations coming due in the next few months far exceed those of the government. These concerns prompted Finance Minister Malan and Central Bank President Fraga to meet with representatives of 16 major international banks in late August, resulting in a statement from the banks promising to maintain their "general level" of business to Brazil. The government has continued to shorten the maturity structure of its large domestic debt in an effort to contain the costs of refinancing that debt.

Observers remain concerned that opposition party presidential candidates, if elected in October, may not adhere to the conditions of a new $30 billion IMF loan for Brazil; the loan was approved by the Fund's executive board on September 6. About $5-6 billion will be released this year and the remainder next year, assuming that the new government (which will take office in January) adheres to fiscal and monetary discipline. Lula of the Workers Party continues to have a commanding lead in the opinion polls, but Serra, the candidate preferred by most market participants, has moved up in the polls since early September. The first round of the election will occur October 6; if no candidate wins a simple majority of the votes, a second round election between the two top contenders will be held October 27.

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

Indicator	2000	2001	2002				
			Q1	Q2	June	July	Aug.
Real GDP[1]	3.8	-.6	3.5	2.4	...	...	...
Industrial production	6.6	1.5	2.7	1.4	.9	.0	n.a.
Unemployment rate[2]	7.1	6.2	7.3	7.9	7.9	8.1	n.a.
Consumer prices[3]	6.0	7.7	7.6	7.8	7.7	7.6	7.3
Trade balance[4]	-.7	2.6	4.6	1.9	2.4	12.5	23.3
Current account[5]	-24.6	-23.2	-12.9	-20.4	-15.5	-6.6	n.a.

1. Annual rate. Annual figures are Q4/Q4.
2. Percent. “Open” unemployment rate.
3. Percent change from year-earlier period, except annual figures, which are Dec./Dec. Price index is IPC-A.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, n.s.a., annual rate.

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

In **Argentina**, economic indicators turned down again in July. Industrial production declined 2.4 percent, leaving output 13 percent below its level a year earlier and 25 percent below its 1998 peak. Sales and consumer confidence also declined in July. The extremely weak economy and suppressed utilities prices helped restrain consumer price inflation. The CPI rose 2.3 percent (s.a.) in August, bringing the twelve-month increase to over 36 percent, whereas the wholesale price index was up 108 percent on a twelve-month basis. Economic weakness and capital controls have led to an increase in the trade surplus; in July, on a twelve-month basis, exports were down 6 percent, but imports were down more than 50 percent.

Negotiations between the Argentine government and the IMF on a new stabilization program have remained at an impasse. The Argentine government submitted a letter of intent in mid-August, but the Fund voiced concerns about its inadequate monetary and fiscal framework and about the lack of a plan for returning the insolvent banking system to financial health. Developments in Argentina over the second half of August reinforced these concerns. First, congress approved several banking measures that extended protection for bank debtors. Second, rulings by the Supreme Court, which has been in conflict with the Duhalde government for months, continue to undermine efforts by the government to achieve fiscal balance and stabilize the banking system. Finally, reports indicate that various provinces will continue to issue their own quasi-monies to finance their fiscal deficits.

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

Indicator	2000	2001	2002				
			Q1	Q2	June	July	Aug.
Real GDP[1]	-1.9	-10.5	-21.8	n.a.	...	...	...
Industrial production	-1.8	-5.1	-3.4	-.8	1.5	-2.4	n.a.
Unemployment rate[2]	15.1	17.4	...	21.3	...	...	...
Consumer prices[3]	-.7	-1.5	4.2	23.3	28.4	32.9	36.5
Trade balance[4]	2.6	7.5	16.6	n.a.	16.2	16.8	n.a.
Current account[5]	-8.9	-4.6	6.0	n.a.	...	...	...

1. Annual rate. Annual figures are Q4/Q4.
2. Percent, n.s.a. Data are released for May and October only. Figures for Q2 reflect data for May.
3. Percent change from year-earlier period, except annual figures, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. ... Not applicable.

In **Mexico**, real GDP rose 4.7 percent (s.a.a.r.) in the second quarter following six consecutive quarters of output declines. The recovery in large part owes to a revival of external demand; on a seasonally-adjusted basis Mexican exports rose about 5 percent (not annualized) in the second quarter and a further 2 percent in July. The strength of exports also helped to narrow the current account deficit. However, industrial production was flat in July and this, together with a significant decline in business confidence in August, suggests that growth may have softened some from its second-quarter pace. In recent months, twelve-month CPI inflation has been a bit over the government's 4½ percent target for this year, reflecting in part the depreciation of the peso.

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

Indicator	2000	2001	2002				
			Q1	Q2	June	July	Aug.
Real GDP[1]	4.9	-1.5	-.0	4.7	...	...	...
Overall economic activity	6.5	-.2	.5	1.4	.2	n.a.	n.a.
Industrial production	6.0	-3.4	.6	1.4	-.3	0.0	n.a.
Unemployment rate[2]	2.2	2.5	2.7	2.7	2.6	2.9	n.a.
Consumer prices[3]	9.0	4.4	4.7	4.8	4.9	5.5	5.3
Trade balance[4]	-8.0	-10.0	-9.1	-8.2	-8.7	-7.4	n.a.
Imports[4]	174.5	168.4	164.2	170.4	170.4	172.4	n.a.
Exports[4]	166.5	158.4	155.1	162.2	161.7	165.1	n.a.
Current account[5]	-18.1	-17.9	-15.2	-12.0	...	....	...

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

The **Venezuelan** economy is mired in a deep recession. Output plunged over 22 percent (s.a.a.r.) in the second quarter. Declines were widespread, but particularly sizable in the oil, auto, and construction sectors. The second-quarter decline likely reflects the impact of April's attempted coup, but political tensions have remained high and there is little evidence of a subsequent pick-up in activity. The increase in oil prices over the past several months has proved insufficient to satisfy the government's hefty financing requirements, which are estimated by the government to be around 7 percent of GDP in 2002. So far this year, the government has had significant problems placing and rolling over domestic debt and has been unable to issue debt internationally. The bolivar has depreciated 7 percent since the last Greenbook and has fallen 45 percent since floating in mid-February. Consumer prices have risen 24 percent in the twelve months ended August.

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

Indicator	2000	2001	2002				
			Q1	Q2	June	July	Aug.
Real GDP[1]	5.7	.9	-15.3	-22.1	...	...	...
Unemployment rate[2]	13.4	13.3	15.5	15.8	16.2	n.a.	n.a.
Consumer prices[3]	13.4	12.3	14.6	18.9	19.6	22.0	24.2
Non-oil trade balance[4]	-10.3	-12.2	-11.1	n.a.	n.a.	n.a.	n.a.
Trade balance[4]	17.5	9.4	7.3	n.a.	n.a.	n.a.	n.a.
Current account[5]	13.4	4.1	.3	6.7	...	...	...

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

The **Korean** expansion, while still robust, showed some signs of moderating over the intermeeting period. Real GDP grew 5.6 percent (s.a.a.r.) in the second quarter, down from the faster pace in the first quarter; consumption and export growth were solid, but investment was weak. Industrial production in July rebounded only partially from its drop in June. (An election day holiday, labor strikes, and World Cup fever held down June’s figure.) In August, business sentiment improved, but remained below levels earlier this year, and consumer confidence slid for the second month in a row. Strong export growth in July was more than matched by a rise in imports, leading to a smaller trade surplus and virtually erasing the current account surplus. The unemployment rate has held steady at around 3 percent recently, and consumer price inflation through August remained well within the central bank’s 2 to 4 percent target range.

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

Indicator	2000	2001	2002				
			Q1	Q2	June	July	Aug.
Real GDP[1]	5.1	4.4	7.8	5.6	...	...	...
Industrial production	16.9	1.7	1.5	2.1	-3.6	1.9	n.a.
Unemployment rate[2]	4.1	3.7	3.0	3.1	3.0	3.0	3.1
Consumer prices[3]	2.8	3.2	2.5	2.7	2.6	2.1	2.4
Trade balance[4]	16.9	13.4	19.2	14.4	17.1	8.2	n.a.
Current account[5]	12.2	8.6	7.0	7.3	9.9	.3	n.a.

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

Since the last Greenbook, data from the **ASEAN** region show a further pick-up in growth. Both Singapore and Indonesia registered double-digit second-quarter growth rates, and the pace of expansion stepped up sharply in Malaysia and the Philippines as well. Some one-time factors, such as surges in agricultural output in Indonesia and the Philippines and a significant boost from government spending in Singapore, were at least partly responsible for the very strong performance.

Recent industrial production numbers have been encouraging, and the trade balances of the most export-dependent countries, Singapore and Malaysia, have been supported by rising exports. Trade performance has been mixed in the rest of the region, with rising imports roughly offsetting rising exports in Indonesia and the Philippines, and a surge in imports leading to a trade deficit for Thailand in July. Inflation has remained subdued in most of the region. Indonesia remains the outlier, with twelve-month inflation above 10 percent, but this is down from rates earlier this year.

ASEAN Economic Indicators: Growth

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

Indicator and country	2000	2001	2002				
			Q1	Q2	May	June	July
Real GDP[1]							
Indonesia	7.3	1.2	4.1	10.0	...	...	...
Malaysia	6.2	-.6	4.3	7.0	...	...	...
Philippines	3.7	3.9	-.2	9.7	...	...	...
Singapore	11.4	-6.4	8.1	13.6	...	...	...
Thailand	3.4	2.0	6.6	6.1	...	...	...
Industrial production[2]							
Indonesia[3]	11.6	.7	.4	-2.0	-1.3	1.0	n.a.
Malaysia	19.1	-4.1	2.1	2.4	.1	-1.7	4.1
Philippines	2.4	-6.6	5.3	5.4	-3.2	-3.1	n.a.
Singapore	15.3	-11.6	6.8	10.7	2.7	-2.2	0.0
Thailand	3.3	1.3	2.0	3.2	.4	-1.8	3.1

1. Annual rate. Annual figures are Q4/Q4.
2. Annual figures are annual averages.
3. Staff estimate.
n.a. Not available. ... Not applicable.

ASEAN Economic Indicators: Trade Balance

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

Country	2000	2001	2002				
			Q1	Q2	June	July	Aug.
Indonesia	28.6	25.4	26.7	28.3	28.9	26.2	n.a.
Malaysia	16.1	14.3	14.9	12.1	14.3	14.9	n.a.
Philippines	6.7	2.6	4.9	.8	.5	n.a.	n.a.
Singapore	3.3	5.8	6.2	5.8	4.8	13.2	11.8
Thailand	5.5	2.5	3.6	3.3	6.0	-3.5	n.a.

n.a. Not available.

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

Country	2000[1]	2001[1]	2002				
			Q1	Q2	June	July	Aug.
Indonesia	9.3	12.5	14.5	12.6	11.5	10.0	10.6
Malaysia	1.3	1.2	1.4	1.9	2.1	2.1	n.a.
Philippines	6.7	4.1	3.6	3.4	3.0	2.6	2.9
Singapore	2.1	-.6	-.8	-.4	.2	-.4	n.a.
Thailand	1.4	.8	.6	.2	.2	.1	.3

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

The **Chinese** economy has continued to grow at a rapid pace. The strong performance of the economy so far this year appears to have resulted mainly from surging investment and robust export growth. Nominal fixed investment rose 25 percent in the first half of the year over the same period a year earlier, reflecting strong public sector spending and inflows of foreign direct investment. Consumption, as measured by retail sales data, also appears to be holding up well. China continues to experience deflation, however, with consumer prices down nearly 1 percent from year-ago levels.

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

Indicator	2000	2001	2002				
			Q1	Q2	June	July	Aug.
Real GDP[1]	8.0	7.5	8.5	9.3	...	...	...
Industrial production[2]	11.4	8.9	8.2	12.5	12.4	12.8	12.7
Consumer prices[2]	1.5	-.3	-.6	-1.1	-.8	-.9	n.a.
Trade balance[3]	24.1	23.1	40.3	29.9	45.4	12.6	3.9

1. Annual rate. Quarterly data estimated by staff from reported four-quarter growth rates. Annual figures are Q4/Q4.
2. Percent change from year earlier. Annual figures are year over year.
3. Billions of U.S. dollars, annual rate. Imports are c.i.f.
n.a. Not available. ... Not applicable.

In **Hong Kong**, growth of real GDP edged up to 1.6 percent (s.a.a.r.) in the second quarter, but economic conditions remain weak. Consumption declined nearly 4 percent in the second quarter. Stagnant retail sales and weak consumer confidence in July suggest that a rebound in consumption is not imminent. Consumer prices continued to fall through July, and unemployment remained high through August. Hong Kong's trade deficit has widened in recent months, owing mainly to increased imports, many of which are destined for re-export. Hong Kong remains highly dependent on the external sector, though its role as an entrepot is being increasingly challenged by China's continuing integration into the world economy.

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

Indicator	2000	2001	2002				
			Q1	Q2	June	July	Aug.
Real GDP[1]	7.0	-1.4	0.8	1.6	...	...	...
Unemployment rate[2]	5.1	4.9	7.0	7.7	7.7	7.8	7.6
Consumer prices[3]	-2.1	-3.5	-2.6	-3.2	-3.4	-3.5	n.a.
Trade balance[4]	-11.0	-11.4	-4.5	-7.8	-10.6	-10.3	n.a.

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

Real economic activity in **Taiwan** increased only slightly in the second quarter, but the low rate of growth owed mainly to a negative arithmetic contribution from a surge in imports. Final domestic demand advanced 4 percent in the second quarter. Indicators for July have been mixed; exports moved down, but industrial production and foreign investment rose. Exports weakened a bit further in August, but a larger drop in imports led to a widening of the trade balance. Consumer prices in August retraced much of July's increase, as weather-related effects on food prices abated.

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

Indicator	2000	2001	2002				
			Q1	Q2	June	July	Aug.
Real GDP[1]	3.9	-1.6	6.2	.3	...	...	...
Unemployment rate[2]	3.0	4.6	5.3	5.2	5.2	5.0	n.a.
Industrial production	7.4	-7.3	3.8	6.0	-5.4	2.6	n.a.
Consumer prices[3]	1.7	-1.7	-.1	.0	.1	.4	-.3
Trade balance[4]	8.3	15.6	22.9	16.3	17.2	11.5	18.1
Current account[5]	8.9	18.9	29.1	24.3	...	...	...

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