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August 8, 2003

# CURRENT ECONOMIC AND FINANCIAL CONDITIONS

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## **Supplemental Notes**

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

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## Supplemental Notes

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### The Domestic Nonfinancial Economy

#### Labor Productivity and Costs

Output per hour of all persons in the nonfarm business sector is estimated to have increased at an annual rate of 5.7 percent in the second quarter; that figure is based on the BEA's advance estimate that output of the nonfarm business sector (excluding the rental value of owner-occupied housing) rose at an annual rate of 3.4 percent last quarter while hours of all persons declined at a 2.2 percent rate.<sup>1</sup> Productivity is now shown to have risen at a 2.1 percent rate in 2003:Q1.

With Thursday's report, the BEA revised the historical productivity and cost series to incorporate new estimates of hours worked. Those new estimates folded in the recent benchmark and methodological revisions to hours from the establishment survey, revised estimates of data from the household survey that adjust for the 2000 Census population controls, and new survey-based adjustments to convert hours paid to hours worked.

Taken together, the changes to the data on hours worked had little effect on the previously published estimates of productivity and costs for the period before 2001. That is, the newly reported level of hours in 2000 is little changed from the earlier estimate. However, hours are now reported to have declined much more sharply in 2001 than previously estimated. That revision can be traced largely to the methodological revisions that were made to data from the establishment survey data—specifically, the introduction of sample-based estimates and the conversion to the North American Industrial Classification System. As a result, output per hour in the nonfarm business sector is now reported to have risen 3.2 percent over the four quarters of 2001 compared with the 1.9 percent rise shown earlier. Since then, hours are now estimated to have declined a bit more than previously reported, boosting the rate of productivity increase by roughly 0.3 percentage point over the period from 2001:Q4 to 2003:Q1 to an average of 4 percent.

Taken by themselves, the revised estimates of hours currently imply little change in the staff's view of the rate of increase in potential real GDP in recent years. Although productivity has increased faster, on average, than previously reported, hours worked have declined more steeply. Our initial review of the new data suggests that we would leave the level of potential output at the end of 2003 unchanged from that assumed in the August Greenbook.

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1. Based on our current estimate of second-quarter real GDP, we expect a small upward revision to the rate of increase in nonfarm business output and, thus, that productivity increased at an annual rate of 6.2 percent.

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The release also reported current and revised estimates of compensation per hour. In addition to the revised estimates of hours, the hourly compensation figures were revised to reflect updated data on worker compensation from the National Income and Product Accounts as a result of the BEA folding in more current information on payrolls from the quarterly unemployment insurance tax records. Hourly compensation is estimated to have risen at an annual rate of 3.5 percent in the second quarter of 2003 after having increased at a 4.1 percent rate in the first quarter. Nonetheless, the year-over-year change in hourly compensation last quarter was 2.8 percent, little different than the year-over-year changes reported for 2001 and 2002.

August 8, 2003

**Compensation, Productivity and Unit Labor Costs**  
**Nonfarm Private Business Sector**  
 (Percent change at an annual rate)

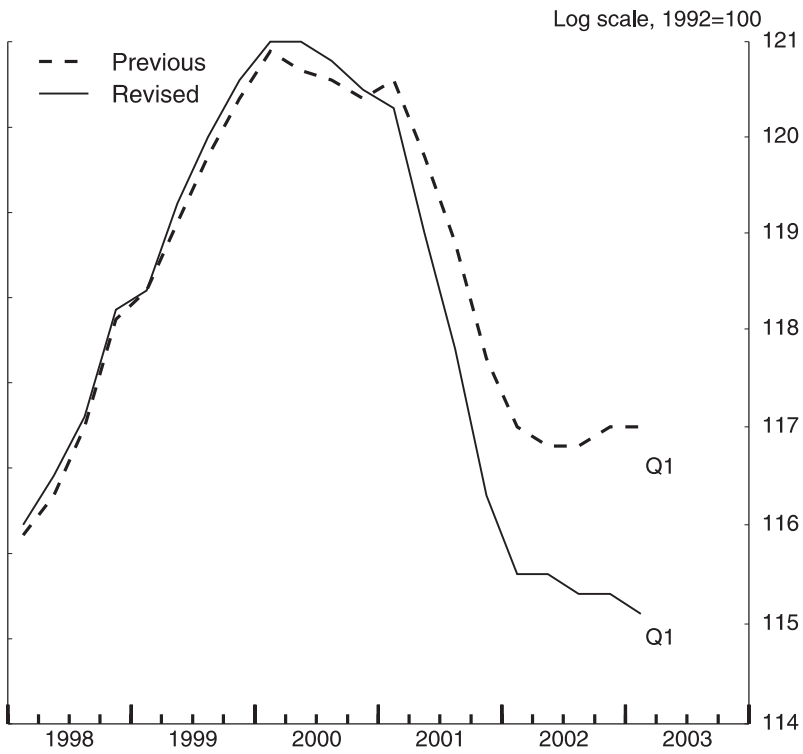
Period	Compensation per hour		Productivity		Unit labor costs	
	From year earlier <sup>1</sup>	From previous period	From year earlier <sup>1</sup>	From previous period	From year earlier <sup>1</sup>	From previous period
1994	2.1		1.1		1.0	
1995	2.7		1.1		1.5	
1996	3.2		2.3		.9	
1997	3.4		2.2		1.2	
1998	5.3		2.9		2.3	
1999	4.2		2.8		1.4	
2000	7.2		2.2		4.9	
2001	2.7		3.2		-.5	
2002	2.8		4.4		-1.6	
1999: H2		4.6		4.9		-.4
2000: H1		8.4		2.8		5.3
H2		6.0		1.6		4.5
2001: H1		3.1		.7		2.6
H2		2.2		5.7		-3.4
2002: H1		3.8		5.0		-1.2
H2		1.8		3.8		-1.9
2003: H1		3.8		4.0		-.2
2000: Q2	6.5	1.9	3.9	5.7	2.5	-3.6
Q3	7.8	8.8	3.2	.8	4.5	7.9
Q4	7.2	3.3	2.2	2.2	4.9	1.1
2001: Q1	4.5	4.3	2.0	-.4	2.5	4.7
Q2	4.6	2.0	1.1	1.6	3.5	.3
Q3	3.0	2.4	1.7	3.4	1.3	-.9
Q4	2.7	2.1	3.2	8.3	-.5	-5.7
2002: Q1	2.5	3.7	5.6	9.3	-2.9	-5.2
Q2	3.0	3.9	5.4	1.0	-2.3	2.9
Q3	2.9	2.0	6.1	5.9	-3.0	-3.7
Q4	2.8	1.6	4.4	1.7	-1.6	-.1
2003: Q1	2.9	4.1	2.6	2.1	.2	2.0
Q2	2.8	3.5	3.8	5.7	-1.0	-2.1

Note. Based on seasonally adjusted data.

1. Annual observations are the change from fourth quarter to fourth quarter. Half year changes are from Q2 to Q4 and from Q4 to Q2 at an annual rate.

## Revisions to Hours and Productivity Nonfarm Business Sector

Hours

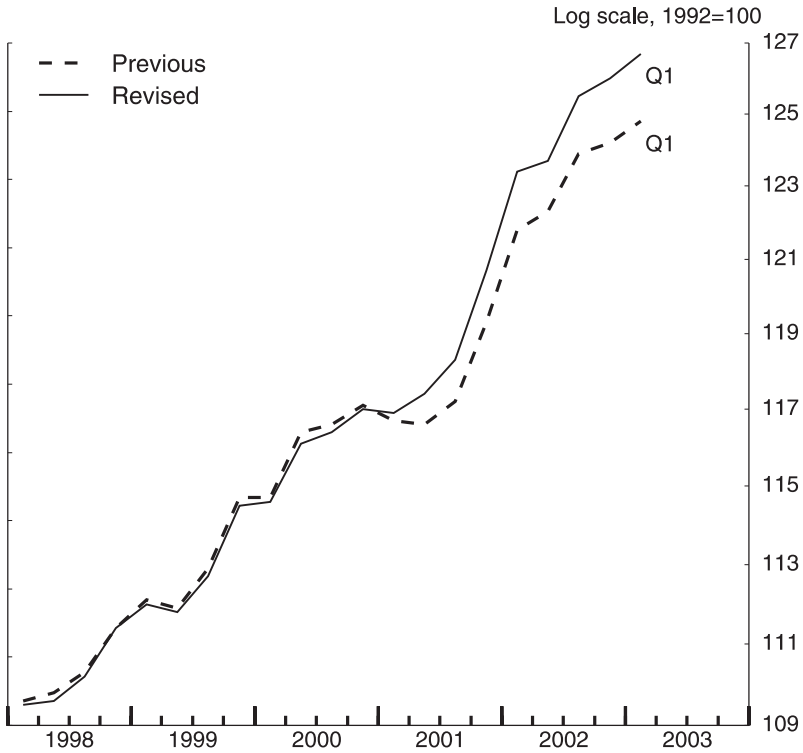


Hours

(Percent change, Q4 to Q4)

	Current	Previous
1998	2.6	2.6
1999	2.0	1.9
2000	-1.1	.0
2001	-3.5	-2.3
2002	-9.0	-6.0

Output per Hour



OPH

(Percent change, Q4 to Q4)

	Current	Previous
1998	2.9	2.9
1999	2.8	2.9
2000	2.2	2.1
2001	3.2	1.9
2002	4.4	4.2

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## The Domestic Financial Economy

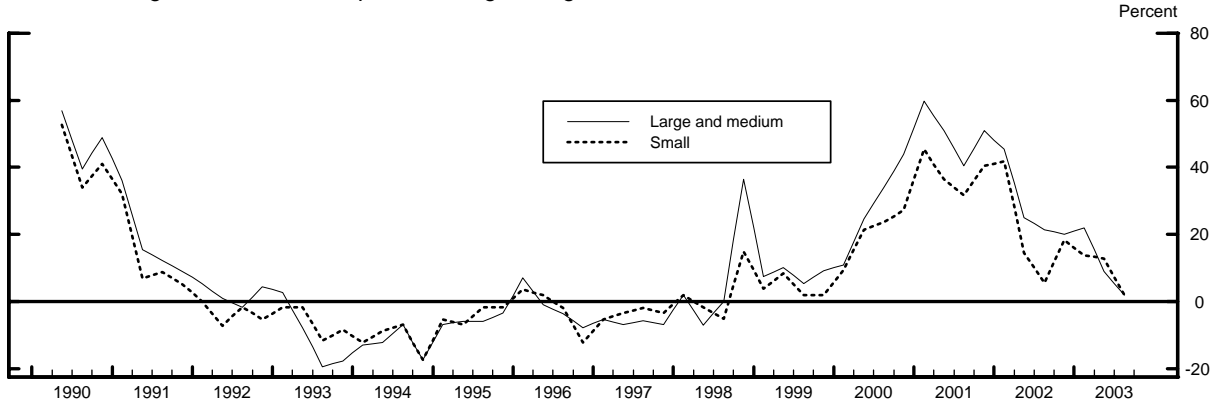
### **Senior Loan Officer Opinion Survey**

Attached is a set of tables reporting the results of the Senior Loan Officer Opinion Survey for August 2003.

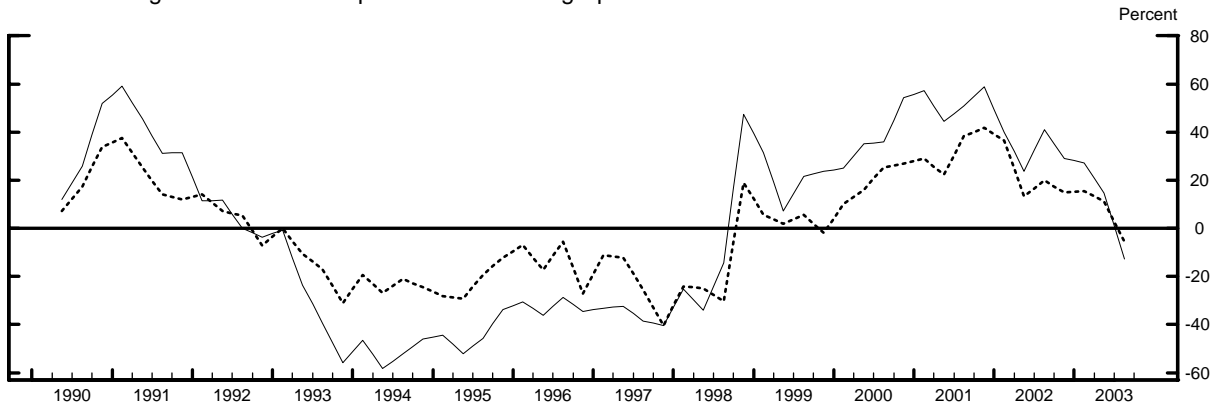


## Measures of Supply and Demand for C&I Loans, by Size of Firm Seeking Loan

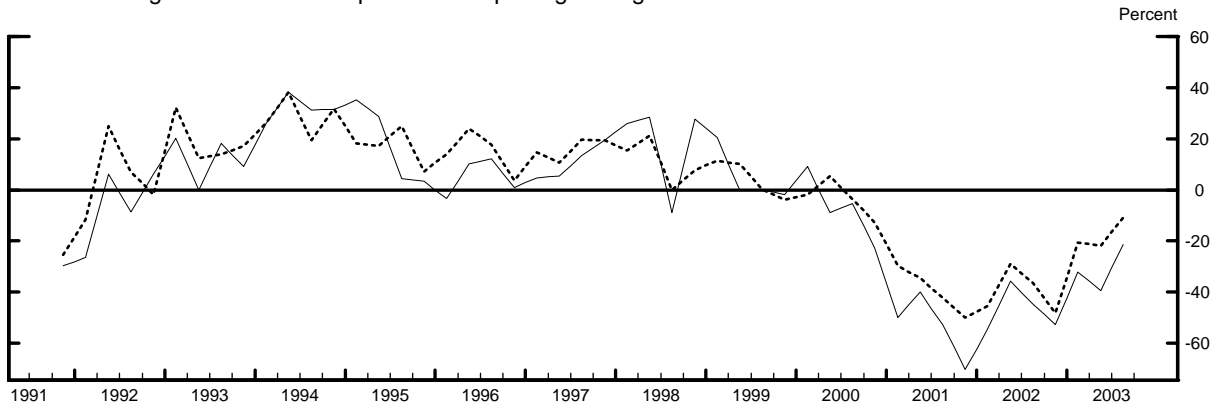
Net Percentage of Domestic Respondents Tightening Standards for C&I Loans



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

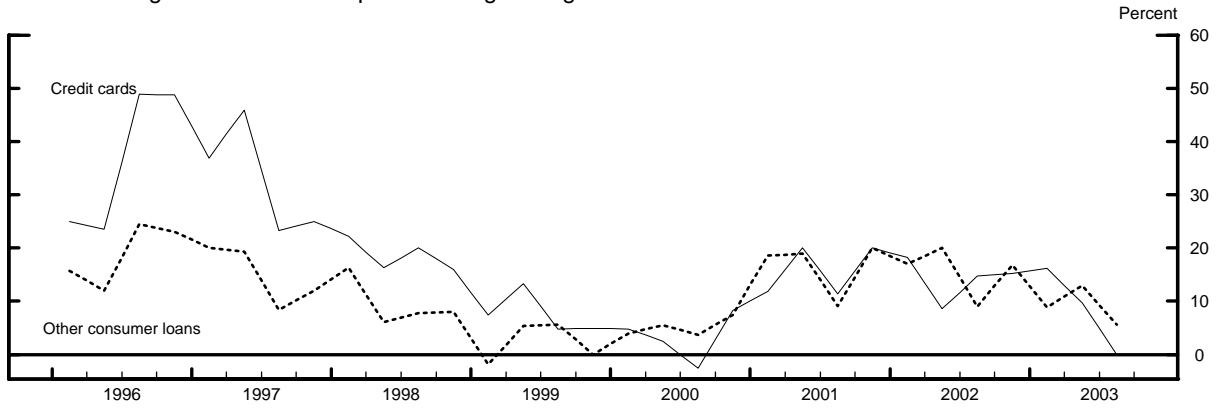


Net Percentage of Domestic Respondents Reporting Stronger Demand for C&I Loans

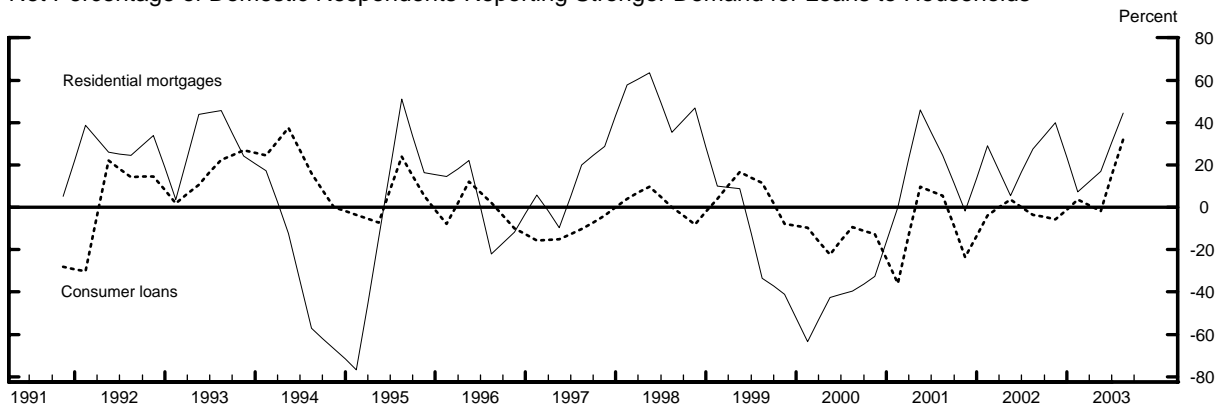


## Measures of Supply and Demand for Loans to Households

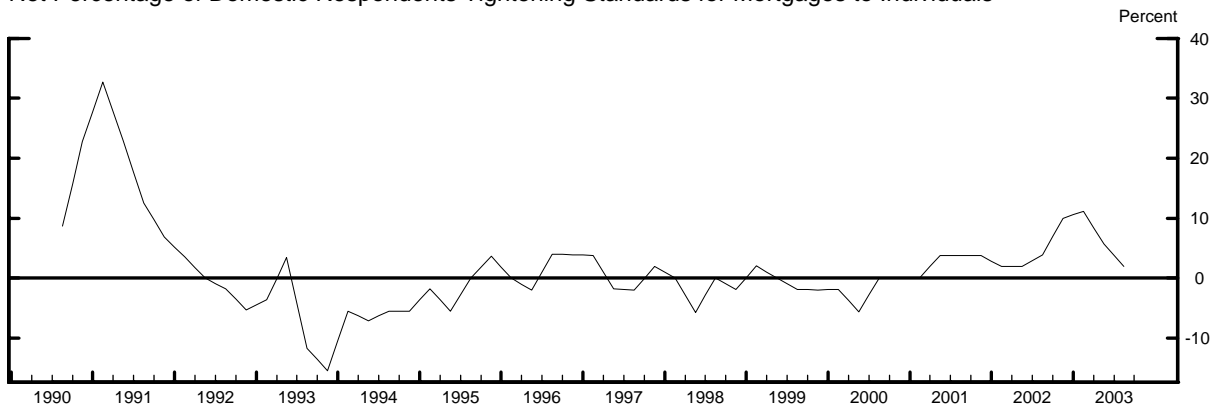
Net Percentage of Domestic Respondents Tightening Standards on Consumer Loans



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



Net Percentage of Domestic Respondents Tightening Standards for Mortgages to Individuals



### Commercial Bank Credit

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

Type of credit	2002	Q1 2003	Q2 <sup>7</sup> 2003	May 2003	June <sup>7</sup> 2003	July <sup>p</sup> 2003	Level, July 2003 <sup>p</sup> (\$ billions)
<b>Total</b>							
<b>1. Adjusted<sup>1</sup></b>	<b>7.2</b>	<b>7.6</b>	<b>9.8</b>	<b>13.5</b>	<b>6.5</b>	<b>3.1</b>	<b>5,950</b>
2. Reported	7.3	8.2	10.9	19.8	10.7	7.7	6,218
<i>Securities</i>							
3. Adjusted <sup>1</sup>	13.9	13.2	16.1	17.6	8.3	-8.7	1,614
4. Reported	13.3	14.4	18.3	38.5	14.3	-29.6	1,811
5. Treasury and agency	20.1	18.5	29.2	34.1	17.1	-37.8	1,116
6. Other <sup>2</sup>	4.3	8.4	1.5	45.4	10.0	-16.2	695
<i>Loans<sup>3</sup></i>							
7. Total	5.0	5.6	7.8	11.9	9.2	23.7	4,407
7a. Removing FIN 46 effects <sup>4</sup>			7.4		5.9	7.5	
8. Business	-6.9	-5.1	-8.5	-13.9	-18.1	4.6	925
8a. Removing FIN 46 effects <sup>4</sup>			-9.0		-22.3	-16.7	
9. Real estate	13.1	14.4	11.7	13.2	12.9	20.6	2,194
10. Home equity	36.6	28.1	28.1	18.4	32.2	20.1	249
11. Other	10.9	12.7	9.7	12.5	10.5	20.6	1,945
12. Consumer	5.5	2.7	-1.4	8.2	9.6	.4	593
13. Adjusted <sup>5</sup>	4.1	6.6	2.9	12.7	5.8	2.1	961
14. Other <sup>6</sup>	1.5	-3.7	30.1	51.7	36.4	82.2	696
14a. Removing FIN 46 effects <sup>4</sup>			28.2		20.3	5.0	

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), as well as the estimated effects of consolidation related to FIN 46.

2. Includes private mortgage-backed securities, securities of corporations, state and local governments, foreign governments, and any trading account assets that are not Treasury or agency securities, including revaluation gains on derivative contracts.

3. Excludes interbank loans.

4. Adjusted to remove estimated effects of consolidation related to FIN 46.

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

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

7. Banks implemented FIN 46 on July 1, but because of the staff's standard interpolation procedure for weekly bank credit series, this change also affected the levels and growth rates of bank credit and various components in June.

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

Instrument	2000	2001	2003	2003	Change to Aug. 7 from selected dates (percentage points)		
	June 26	Sept. 10	June 24	Aug. 7	2000 June 26	2001 Sept. 10	2003 June 24
<i>Short-term</i>							
FOMC intended federal funds rate	6.50	3.50	1.25	1.00	-5.50	-2.50	-.25
Treasury bills <sup>1</sup>							
3-month	5.66	3.19	0.81	0.93	-4.73	-2.26	.12
6-month	5.94	3.13	0.82	1.02	-4.92	-2.11	.20
Commercial paper (A1/P1 rates)							
1-month	6.56	3.42	0.91	1.01	-5.55	-2.41	.10
3-month	6.56	3.24	0.88	1.03	-5.53	-2.21	.15
Large negotiable CDs <sup>1</sup>							
1-month	6.64	3.46	0.96	1.06	-5.58	-2.40	.10
3-month	6.73	3.26	0.93	1.08	-5.65	-2.18	.15
6-month	6.89	3.24	0.92	1.13	-5.76	-2.11	.21
Eurodollar deposits <sup>2</sup>							
1-month	6.63	3.41	0.94	1.05	-5.58	-2.36	.11
3-month	6.69	3.26	0.91	1.07	-5.62	-2.19	.16
Bank prime rate	9.50	6.50	4.25	4.00	-5.50	-2.50	-.25
<i>Intermediate- and long-term</i>							
U.S. Treasury <sup>3</sup>							
2-year	6.54	3.59	1.14	1.77	-4.77	-1.82	.63
10-year	6.35	5.14	3.46	4.47	-1.88	-.67	1.01
30-year	6.22	5.55	4.53	5.38	-.84	-.17	.85
U.S. Treasury 10-year indexed note	4.08	3.28	1.70	2.29	-1.79	-.99	.59
Municipal revenue (Bond Buyer) <sup>4</sup>	5.99	5.25	4.89	5.42	-.57	.17	.53
Private instruments							
10-year swap	7.38	5.62	3.67	4.75	-2.63	-.87	1.08
10-year FNMA <sup>5</sup>	7.19	5.68	3.84	4.88	-2.31	-.80	1.04
10-year AA <sup>6</sup>	7.64	6.30	4.13	5.17	-2.47	-1.13	1.04
10-year BBB <sup>6</sup>	8.40	7.11	5.16	6.09	-2.31	-1.02	.93
High-yield <sup>7</sup>	12.30	12.72	9.03	9.69	-2.61	-3.03	.66
Home mortgages (FHLMC survey rate) <sup>8</sup>							
30-year fixed	8.14	6.89	5.21	6.14	-2.00	-.75	.93
1-year adjustable	7.22	5.64	3.51	3.68	-3.54	-1.96	.17

Stock exchange index	Record high		2001	2003		Change to Aug. 7 from selected dates (percent)		
	Level	Date	Sept. 10	June 24	Aug. 7	Record high	2001 Sept. 10	2003 June 24
Dow-Jones Industrial	11,723	1-14-00	9,606	9,110	9,126	-22.15	-4.99	.18
S&P 500 Composite	1,527	3-24-00	1,093	983	974	-36.23	-10.84	-.95
Nasdaq (OTC)	5,049	3-10-00	1,695	1,606	1,652	-67.27	-2.55	2.90
Russell 2000	606	3-9-00	441	441	454	-25.14	2.96	2.92
Wilshire 5000	14,752	3-24-00	10,104	9,388	9,362	-36.53	-7.34	-.27

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. Constant maturity yields estimated from Fannie Mae domestic non-callable coupon securities.
6. Derived from smoothed corporate yield curves estimated using Merrill Lynch bond data.
7. Merrill Lynch Master II high-yield bond.
8. For week ending Friday previous to date shown.

NOTES:

June 26, 2000, is the day before the FOMC meeting that ended the most recent period of policy tightening.  
 September 10, 2001 is the day before the terrorist attacks.  
 June 21, 2003, is the day before the most recent FOMC meeting.

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## **International Developments**

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

Foreign official inflows (line 1 of the Summary of U.S. International Transactions table) slowed from the record \$50 billion in May to \$8 billion in June, owing primarily to a reduction in inflows from Japan, Russia, and Norway. Despite the slowdown in June, official inflows set a record for the second quarter. In July, official holdings at the Federal Reserve Bank of New York decreased, but this apparently owes to transfers to another U.S. custodian. Looking through these transfers, it appears that reserves increased modestly in July.

Private inflows into U.S. securities (line 4) also slowed from the May record—owing entirely to a shift from net purchases to net sales of agency bonds—but at \$54 billion remained at exceptionally high levels. Private foreign purchases of Treasury securities and corporate bonds continued at recent strong paces, while demand for U.S. equities picked up yet again. For the second quarter as a whole, private foreign purchases of U.S. securities set a record (\$164 billion), owing to record purchases of corporate bonds and the largest purchases of Treasury securities and equities since the fourth quarter of 1996 and the first quarter of 2002, respectively.

In June, U.S. investors sold foreign securities (line 5), as sales of foreign bonds exceeded purchases of foreign equities. For the second quarter as a whole, net sales of foreign bonds of \$21 billion more than offset foreign equity purchases of \$17 billion.

Net capital flows through the banking sector (line 3) amounted to an outflow of \$22 billion in June, bringing second quarter net banking inflows to \$23 billion and year-to-date net flows to near zero.

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

	2001	2002	2002		2003			
			Q3	Q4	Q1	Q2	May	June
<b>Official financial flows</b>	<b>2.4</b>	<b>87.0</b>	<b>7.5</b>	<b>28.2</b>	<b>38.0</b>	<b>57.8</b>	<b>50.9</b>	<b>7.8</b>
1. Change in foreign official assets in the U.S. (increase, +)	7.3	90.7	8.9	29.0	38.0	57.6	51.0	7.8
a. G-10 countries	-7.9	30.2	1.8	6.0	26.7	28.1	24.8	4.7
b. OPEC countries	-1.2	-9.4	-1.4	.7	-7.5	1.1	2.0	.7
c. All other countries	16.4	69.8	8.4	22.4	18.8	28.4	24.2	2.4
2. Change in U.S. official reserve assets (decrease, +)	-4.9	-3.7	-1.4	-.8	.1	.2	.0	.0
<b>Private financial flows</b>	<b>413.2</b>	<b>441.0</b>	<b>163.7</b>	<b>124.4</b>	<b>74.7</b>	<b>n.a.</b>	<b>...</b>	<b>...</b>
Banks								
3. Change in net foreign positions of banking offices in the U.S. <sup>1</sup>	-5.9	98.7	65.7	52.6	-25.9	22.6	-8.0	-21.5
Securities <sup>2</sup>								
4. Foreign net purchases of U.S. securities (+)	398.1	398.1	104.9	81.4	70.8	164.4	72.3	53.6
a. Treasury securities	-7.4	101.8	57.9	13.6	14.5	61.5	24.2	26.6
b. Agency bonds	81.8	78.0	21.8	15.4	-2.1	14.3	15.5	-4.1
c. Corporate and municipal bonds	201.8	160.3	17.2	39.9	60.4	67.4	26.0	20.9
d. Corporate stocks <sup>3</sup>	121.8	58.1	8.0	12.6	-2.1	21.2	6.6	10.2
5. U.S. net acquisitions (-) of foreign securities	-85.1	15.3	21.4	-5.5	-27.3	3.6	1.3	4.5
a. Bonds	24.6	33.5	8.8	7.5	7.3	20.8	13.2	10.9
b. Stock purchases	-62.7	-14.9	14.0	-13.0	-19.9	-17.2	-11.9	-6.3
c. Stock swaps <sup>3</sup>	-47.0	-3.2	-1.4	.0	-14.7	.0	.0	.0
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-120.0	-137.8	-31.6	-31.7	-29.0	n.a.	...	...
7. Foreign direct investment in U.S.	151.6	39.6	14.2	15.3	25.8	n.a.	...	...
8. Foreign holdings of U.S. currency	23.8	21.5	2.6	7.2	4.9	n.a.	...	...
9. Other (inflow, +) <sup>4</sup>	50.8	5.5	-13.4	5.0	55.3	n.a.	...	...
<b>U.S. current account balance (s.a.)</b>	<b>-393.7</b>	<b>-480.9</b>	<b>-122.7</b>	<b>-128.6</b>	<b>-136.1</b>	<b>n.a.</b>	<b>...</b>	<b>...</b>
<b>Capital account balance (s.a.)<sup>5</sup></b>	<b>-1.1</b>	<b>-1.3</b>	<b>-.4</b>	<b>-.4</b>	<b>-.3</b>	<b>n.a.</b>	<b>...</b>	<b>...</b>
<b>Statistical discrepancy (s.a.)</b>	<b>-20.8</b>	<b>-45.8</b>	<b>-48.1</b>	<b>-23.6</b>	<b>23.7</b>	<b>n.a.</b>	<b>...</b>	<b>...</b>

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 commissions on securities transactions and excludes adjustments BEA makes to account for incomplete coverage; 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.