Prefatory Note

The attached document represents the most complete and accurate version available based on original copies culled from the files of the FOMC Secretariat at the Board of Governors of the Federal Reserve System. This electronic document was created through a comprehensive digitization process which included identifying the best-preserved paper copies, scanning those copies,[1] and then making the scanned versions text-searchable.[2] Though a stringent quality assurance process was employed, some imperfections may remain.

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.

---

[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 5/20/2009.

Confidential (FR) Class III FOMC

Part 2

October 22, 2003

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

October 22, 2003

Recent Developments

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

Domestic Nonfinancial Developments

Domestic Nonfinancial Developments

Overview

The pace of the economic expansion appears to have picked up substantially. Consumer spending and the demand for housing were quite strong in the third quarter, and business outlays for capital equipment appear to have accelerated. Meanwhile, activity in the labor market seems to be leveling out, and industrial production has firmed in recent months. Core consumer prices have risen somewhat faster over the past several months than they did earlier in the year; even so, the twelve-month change in core CPI prices was only 1.2 percent in September, a full percentage point less than the increase during the preceding year.

Labor Market Developments

The labor market appears to be stabilizing. Total nonfarm payrolls rose 57,000 in September, and the July and August declines in employment now are estimated to have been smaller than previously reported.[1] The average workweek of production or nonsupervisory workers held steady last month at August's upward-revised level of 33.7 hours. Aggregate hours of production workers were unchanged in September, although hours for the third quarter as a whole were nearly 1 percent (annual rate) below those for the second quarter.[2]

Private payroll employment climbed 72,000 in September, the first increase since January. The largest gain was in professional and business services, which added 66,000 jobs in September—half of them at temporary help supply firms. Employment also increased in most other major industries in September. Key exceptions were manufacturing and the related wholesale trade industry, although even in these sectors, the pace of job loss (29,000 and 5,000 respectively) was somewhat slower than in previous months. Government employment fell 15,000 in September as a large cutback in local education more than offset gains at the federal and state level and elsewhere in local government.

In the household survey, the unemployment rate in September was unchanged at 6.1 percent, and the labor force participation rate ticked down further, to 66.1 percent. The number of job losers unemployed less than five weeks as a percent of household employment moved down for the fourth month in a row, but the number of individuals unemployed more than twenty-six weeks as a

---

1. The Bureau of Labor Statistics' preliminary estimate of the benchmark revision to the level of payroll employment in March 2003 is a downward revision of 145,000, or 0.1 percent—small relative to the average absolute revision of 0.3 percent over the preceding ten years.

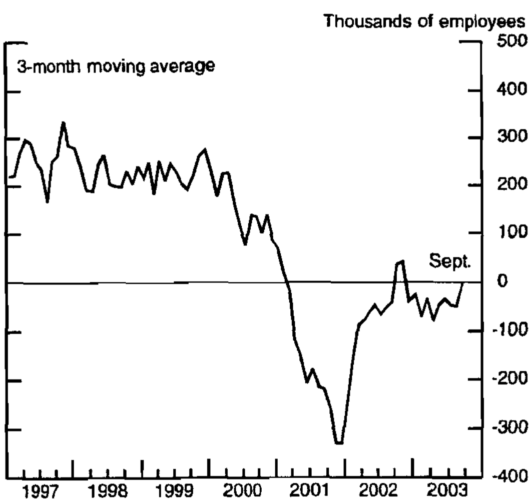
2. However, because of a sharp rise in hours of the self-employed, total hours of all persons in the nonfarm business sector will likely show an increase in the third quarter.

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

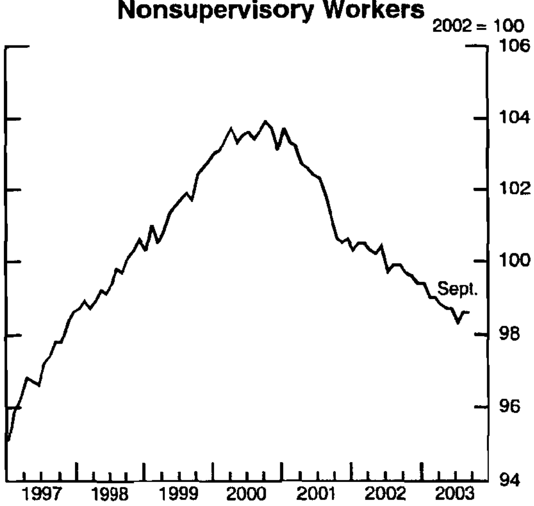
	2002	2003 H1	2003 Q3	2003 July	2003 Aug.	2003 Sept.
	-Average	monthly	change-			
Nonfarm payroll employment[1]	-39	-49	-14	-57	-41	57
Private	-55	-36	-2	-39	-39	72
Previous	*-55*	*-36*	*n.a.*	*-56*	*-67*	*n.a.*
Manufacturing	-57	-55	-45	-61	-46	-29
Construction	-4	12	12	4	19	14
Wholesale trade	-7	-6	-8	-11	-9	-5
Retail trade	-6	-7	2	-6	1	10
Transportation and utilities	-4	-11	-0	-10	-2	12
Information	-14	-11	-8	-7	-14	-4
Financial activities	5	14	6	9	-2	10
Professional and business services	-10	6	39	57	-5	66
Temporary help services	1	8	23	19	18	33
Non-business services[2]	45	23	3	-11	21	0
Total government	16	-13	-12	-18	-2	-15
Total employment (household survey)	31	217	-55	-260	147	-52
Memo:						
Aggregate hours of private production workers (percent change)[1,3]	-1.0	-1.7	-0.9	-0.4	0.3	0.0
Average workweek (hours)[1]	33.9	33.7	33.7	33.6	33.7	33.7
Manufacturing (hours)	40.5	40.3	40.2	40.1	40.2	40.4

Note. Average change from final month of preceding period to final month of period indicated.
1. Survey of establishments.
2. Non-business services comprises education and health, leisure and hospitality, and "other."
3. Annual data are percent changes from Q4 to Q4. Quarterly data are percent changes from preceding quarter at an annual rate. Semiannual data are percent changes from Q4 to Q2. Monthly data are percent changes from preceding month.
n.a. Not available.

Private Payroll Employment Growth



Aggregate Hours of Production or Nonsupervisory Workers

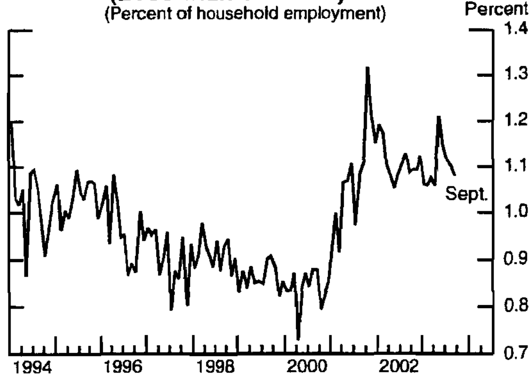


SELECTED UNEMPLOYMENT AND LABOR FORCE PARTICIPATION RATES
(Percent; based on seasonally adjusted data)

	2002	2003 Q1	2003 Q2	2003 Q3	2003 July	2003 Aug.	2003 Sept.
Civilian unemployment rate (16 years and older)	5.8	5.8	6.2	6.1	6.2	6.1	6.1
Teenagers	16.5	17.2	18.6	17.5	18.4	16.6	17.6
20-24 years old	9.7	9.2	10.4	10.5	10.3	10.3	10.9
Men, 25 years and older	4.7	4.9	5.3	5.2	5.2	5.3	5.0
Women, 25 years and older	4.6	4.4	4.6	4.7	4.7	4.6	4.8
Labor force participation rate	66.6	66.3	66.4	66.2	66.2	66.2	66.1
Teenagers	47.4	45.2	45.1	44.2	44.3	44.3	43.9
20-24 years old	76.4	75.5	75.9	75.5	75.4	75.3	75.7
Men, 25 years and older	75.9	75.3	75.6	75.5	75.4	75.5	75.4
Women, 25 years and older	59.4	59.6	59.8	59.5	59.6	59.6	59.2

Labor Force Participation Rate and Unemployment Rate

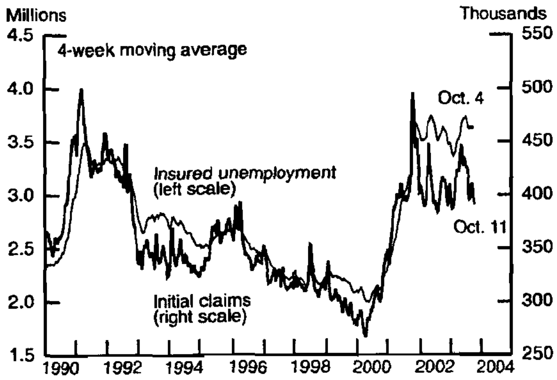
Job Losers (Less than 5 weeks)
(Percent of household employment)



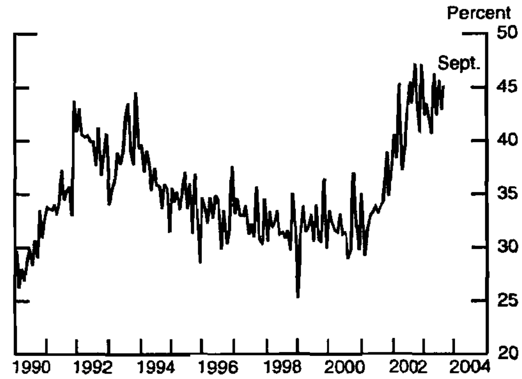
Long-term Unemployed (More than 26 weeks)
(Percent of labor force)

Labor Market Indicators

Unemployment Insurance

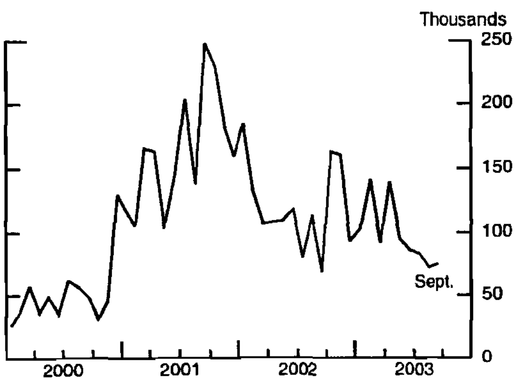


Exhaustion Rate



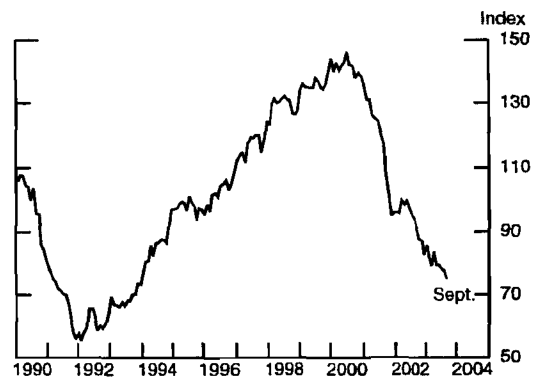
Note. Seasonally adjusted by FRB staff. Exhaustion rate is the number of individuals who exhausted their benefits without finding a job, expressed as a share of the individuals who began receiving benefits six months earlier.

Layoff Announcements



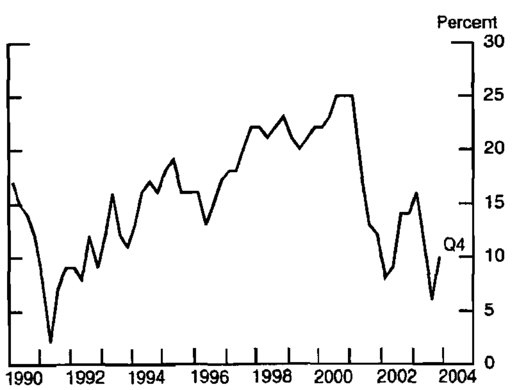
Note. Seasonally adjusted by FRB staff.
Source. Challenger, Gray and Christmas, Inc.

Current Labor Market Conditions



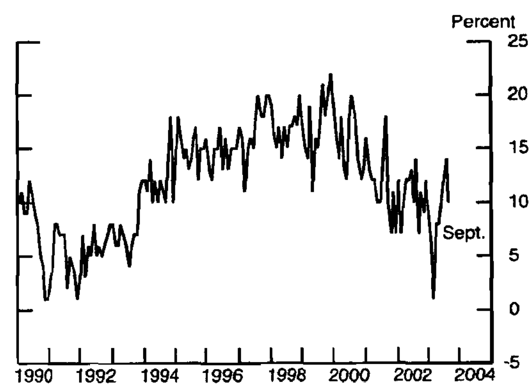
Note. The proportion of households believing jobs are plentiful, minus the proportion believing jobs are hard to get, plus 100.
Source. Conference Board.

Net Hiring Strength



Note. Percent planning an increase in employment minus percent planning a reduction.
Source. Manpower, Inc.

Small Business Hiring Plans



Note. Percent planning an increase in employment minus percent planning a reduction.
Source. National Federation of Independent Businesses.

percent of the labor force edged up. These figures suggest that layoffs are continuing to subside but that hiring remains depressed.

This interpretation of the labor market is reinforced by other data. The four-week moving average of initial claims for unemployment insurance has declined a bit recently, reaching 391,000 in the week ending October 11. Similarly, layoff announcements, as tracked by the outplacement firm Challenger, Gray, and Christmas, Inc., remain well below the level in the first half of the year. However, the four-week moving average of insured unemployment has changed little since early August, and the proportion of unemployment insurance recipients who exhausted their benefits remained elevated in September. Moreover, household perceptions of job availability, as reported in the Conference Board survey, deteriorated further in September and now stand at their lowest level since December 1993.

In contrast, a large fraction of firms participating in the Manpower survey declared plans to boost hiring in the fourth quarter, although the net margin remains well below its first-quarter level.[3] And, despite a downtick in September, the third-quarter average of the volatile survey on small business hiring plans, reported by the National Federation of Independent Businesses, is near the upper end of the range of the past few years.

Industrial Production

Conditions in the industrial sector have improved somewhat in recent months. Industrial production posted a noticeable increase of 0.4 percent in September. Although much of the strength in output last month reflected a jump in motor vehicle assemblies, manufacturing output excluding motor vehicles and parts still moved up 0.2 percent.[4] For the third quarter as a whole, industrial production expanded at an annual rate of 3.3 percent, and capacity utilization turned up after having reached a twenty-year low in the second quarter. Production gains have apparently become more widespread across industries in the third quarter, as the diffusion index of three-month percent changes in IP has now registered above 50 three months in a row.

Increased production of high-tech goods contributed 1.3 percentage points to the overall change in IP in the third quarter. In particular, the production of semiconductors advanced at an annual rate of more than 50 percent, the fastest quarterly increase in this category since the second quarter of 2000. The recent

3. Manpower participants reported the fourth-quarter hiring plans as of the third quarter. In terms of their usefulness in predicting employment changes, we believe these reported plans actually pertain to the remainder of the third quarter following the survey and to October.

4. According to our industry contacts, production in a few industries, such as motor vehicles and steel, was briefly affected by Hurricane Isabel; nonetheless, most of the lost production appears to have been made up within the month.

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

Component	Proportion 2002 (percent)	2002[1]	2003[2]		2003[3]		
			Q2	Q3	July	Aug.	Sept.
Total	**100.0**	**1.4**	**-3.7**	**3.3**	**.8**	**-.1**	**.4**
Previous	100.0	1.4	-3.8	...	.7	.1	...
Manufacturing	84.6	1.0	-2.9	2.9	.5	-.3	.7
Ex. motor veh. and parts	77.5	.1	-2.0	1.3	.3	-.1	.2
Ex. high-tech industries	72.2	-.5	-3.0	-.3	.2	-.4	.1
Mining	6.0	-1.9	-.1	3.1	.0	.4	.0
Utilities	9.3	7.7	-13.2	7.1	3.5	1.8	-2.2
Selected industries							
High technology	5.3	7.1	13.3	25.6	2.1	2.9	1.5
Computers	1.2	19.9	18.4	20.5	1.7	2.0	2.0
Communications equipment	1.7	-16.6	-3.0	-4.7	-1.1	1.0	-1.7
Semiconductors[4]	2.4	19.8	22.4	52.6	4.4	4.6	3.1
Motor vehicles and parts	7.1	10.9	-11.7	21.6	3.2	-1.9	6.6
Market groups excluding energy and selected industries							
Consumer goods	22.5	-1.3	-.7	-2.5	-.4	-.5	.0
Durables	3.5	.5	-3.2	-.5	.1	.2	-.5
Nondurables	19.0	-1.6	-.3	-2.9	-.5	-.7	.1
Business equipment	7.2	-6.0	-3.6	3.0	.2	.4	.0
Defense and space equipment	1.9	4.9	6.3	8.2	.2	.8	1.0
Construction supplies	6.7	.8	-2.3	.5	.1	.3	-.1
Business supplies	7.5	.3	-4.7	-.7	-.1	-.6	.3
Materials	25.5	.9	-5.2	-.2	.6	-.6	.2
Durables	13.6	.6	-6.1	1.6	.9	-.6	.0
Nondurables	11.9	1.3	-4.2	-2.1	.2	-.7	.3

1. Fourth-quarter to fourth-quarter change.
2. Annual rate.
3. Monthly rate.
4. Includes related electronic components.
... Not applicable.

Capacity Utilization
(Percent of capacity)

Sector	1972-2002 average	1982 low	1990-91 low	2003				
				Q1	Q2	Q3	Aug.	Sept.
Total industry	**81.3**	**70.8**	**78.6**	**75.2**	**74.2**	**74.6**	**74.5**	**74.7**
Manufacturing	80.2	68.6	77.2	73.2	72.5	72.9	72.7	73.1
High-tech industries	79.3	75.6	74.6	62.1	62.6	64.6	64.9	65.3
Excluding high-tech industries	80.2	68.1	77.3	74.7	74.0	74.2	73.9	74.4
Mining	86.9	78.6	83.3	84.4	84.3	84.9	85.0	84.9
Utilities	86.7	77.2	84.2	86.9	82.9	83.4	84.5	82.4

acceleration has been concentrated in high-value microprocessors. Elsewhere in the high-tech sector, the third-quarter increase in computer production, at an annual rate of just over 20 percent, was about even with the average gain in the first half of the year. A pickup in demand for mobile computing equipment accounted for much of the strength in overall PC shipments. In contrast, the output of communications equipment, which has continued to founder, fell at an annual rate of nearly 5 percent.

Forward-looking indicators for the high-tech sector have been, on balance, positive: Intel's latest revenue projections are consistent with another noticeable rise in semiconductor production in the fourth quarter. The latest projections by Gartner call for PC shipments to rise modestly in the fourth quarter, although shipments of servers are expected to decrease. New orders for communications equipment have stabilized, and a diffusion index of future spending on data-networking equipment (such as routers, switches, and hubs), compiled by *CIO Magazine,* moved up in August and September. However, anecdotal reports from our business contacts indicate that industry conditions are still mixed. In addition, days' supply for communications equipment, as measured by the staff's flow-of-goods system, remains elevated, a factor that may hinder production for a while longer.

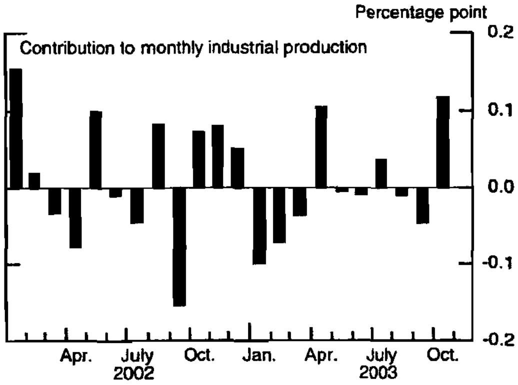
In the energy sector, electricity generation pulled back in September, when temperatures returned to more normal levels after an unusually hot July and August. In contrast, the production of manufactured energy goods and oil and gas extraction posted solid gains—the result, in part, of a response to the sharp rise in energy prices over the same period.

Among the various IP market groups excluding energy, high-tech, and motor vehicles and parts, most categories registered output gains in September. Production of consumer nondurable goods edged up after having fallen in the previous two months, as did the output of business supplies. Production of business equipment was held down, in part, by continued declines in the output of commercial aircraft; Boeing recently announced further reductions in its planned assemblies, a move that suggests that the level of production in this category will remain tepid through early next year. The production of defense and space equipment registered another outsized gain in September. Construction supplies dropped back, but for the quarter as a whole, output in this category was up a bit from the average level recorded in the second quarter.

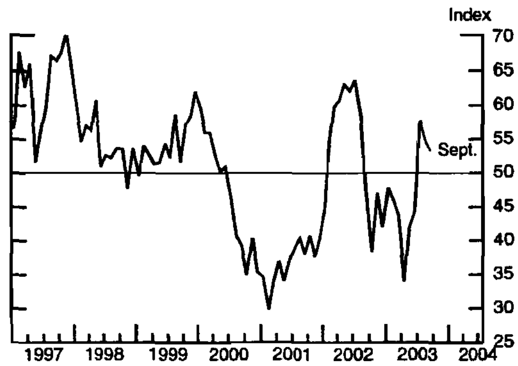
The forward-looking indicators of near-term production suggest that the recent expansion in activity in the industrial sector will continue in coming months. For example, the ISM index of new orders moved up in September to its highest level in nine months, and the index of order backlogs was at its highest level in more than a year. The various diffusion indexes of new orders published by the

Indicators of Manufacturing Activity

Weekly Physical Product Data Except
Electricity Generation and Motor Vehicles

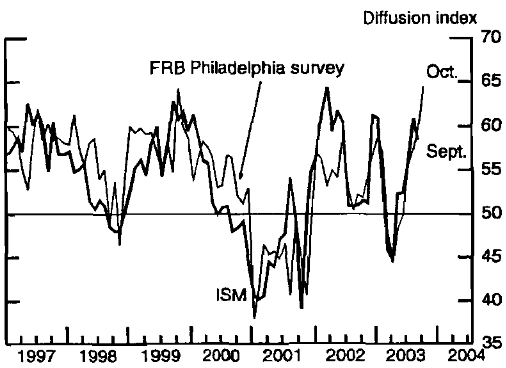


Industrial Production Diffusion Index



Note. The diffusion index equals the percentage of series that increased over three months plus one-half the percentage that were unchanged.

New Orders: ISM and
FRB Philadelphia Surveys



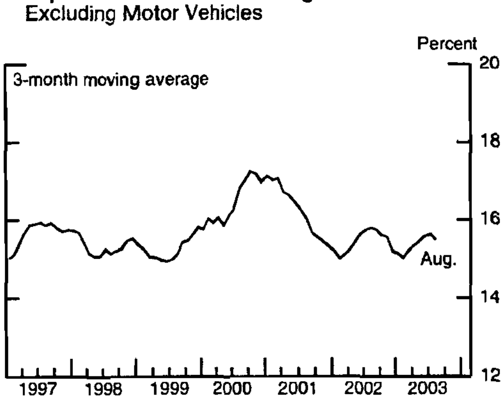
Note. The diffusion index equals the percentage of respondents reporting greater levels of new orders, plus one-half the percentage of respondents reporting that new orders were unchanged.

Boeing Commercial Aircraft Completions

Note. 1998 price-weighted index. Actual completions equal deliveries plus the change in the stock of finished aircraft. Data through September are actual completions;

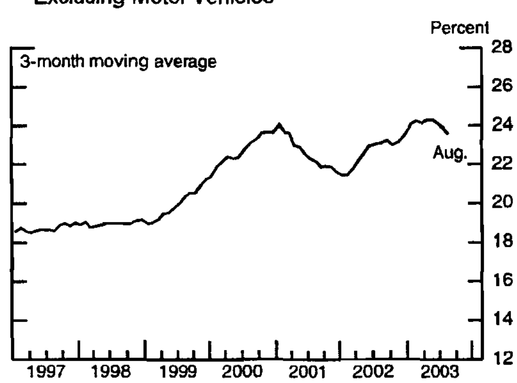
Content partially redacted.

Export Share of Manufacturing
Excluding Motor Vehicles



Note. The export share is the ratio of the value of exports to the value of domestic shipments.
Source. Census Bureau.

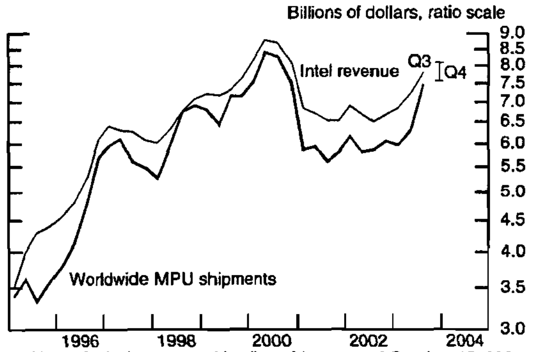
Import Share of Manufacturing
Excluding Motor Vehicles



Note. The import share is the ratio of the value of imports to the value of domestic shipments plus net imports.
Source. Census Bureau.

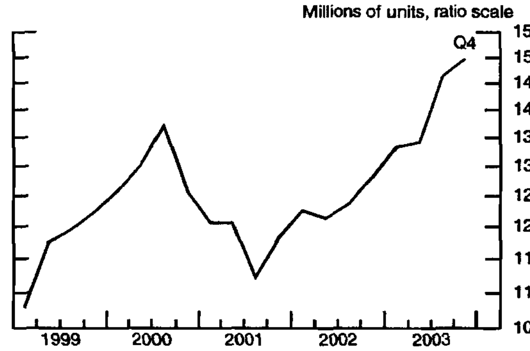
Indicators of High-Tech Manufacturing Activity

Microprocessor Unit (MPU) Shipments and Intel Revenue



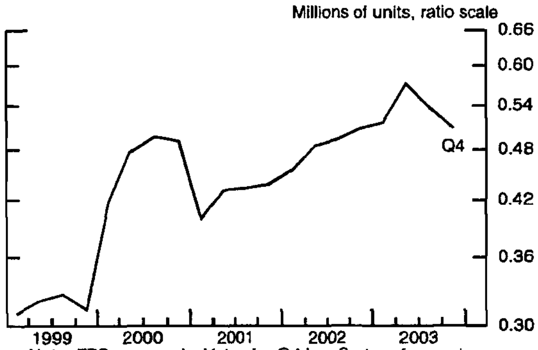
Note. Q4 is the range of Intel's guidance as of October 15, 2003.
Source. Intel and Semiconductor Industry Association.

U.S. Personal Computer Shipments



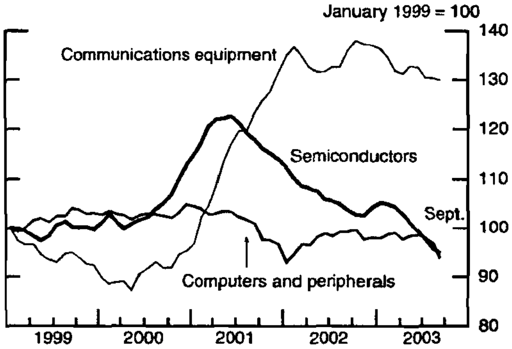
Note. FRB seasonals. Value for Q4 is a Gartner forecast.
Source. Gartner.

U.S. Server Shipments



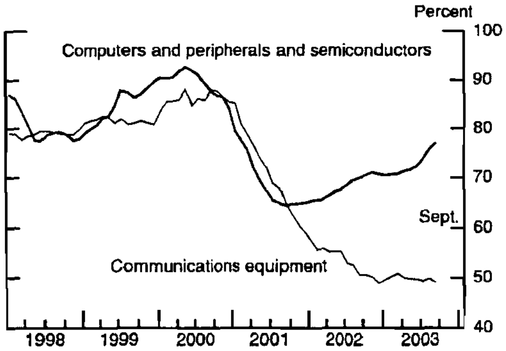
Note. FRB seasonals. Value for Q4 is a Gartner forecast.
Source. Gartner.

Days' Supply of Computers and Peripherals, Communications Equipment, and Semiconductors

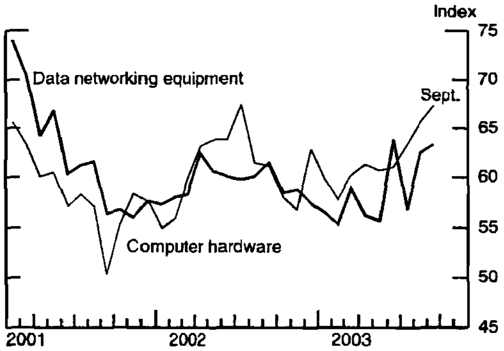


Source. Board staff's flow-of-goods system.

High-Tech Capacity Utilization Rates



CIO Magazine Future Spending Diffusion Index



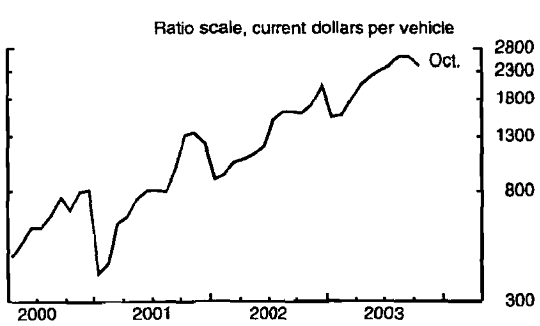
Note. The diffusion index equals the percentage of respondents planning to increase future spending plus one-half the percentage of respondents planning to leave future spending unchanged. The average number of respondents per month from February 2001 to September 2003 was 273.
Source. CIO Magazine.

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

		2003			2003		
	2002	Q1	Q2	Q3	July	Aug.	Sept.
Total	16.7	15.8	16.2	17.5	17.2	18.9	16.6
Autos	8.1	7.7	7.4	7.9	7.8	8.2	7.5
Light trucks	8.6	8.1	8.8	9.7	9.4	10.6	9.0
North American[1]	13.5	12.5	12.9	14.2	13.9	15.4	13.2
Autos	5.9	5.5	5.4	5.8	5.8	6.1	5.4
Light trucks	7.6	6.9	7.5	8.4	8.1	9.3	7.8
Foreign-produced	3.3	3.4	3.3	3.4	3.3	3.5	3.3
Autos	2.2	2.2	2.0	2.1	2.0	2.2	2.1
Light trucks	1.1	1.2	1.3	1.3	1.3	1.4	1.2
Memo:							
Medium and heavy trucks	.40	.37	.39	.45	.45	.44	.45

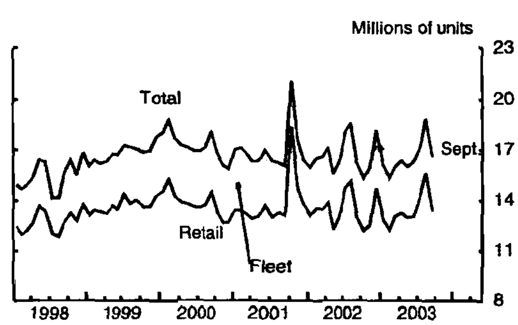
Note. Components may not sum to totals because of rounding. Data on sales of trucks and imported autos for the most recent month are preliminary and subject to revision.
1. Excludes some vehicles produced in Canada that are classified as imports by the industry.

Average Value of Incentives on Light Vehicles



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

Fleet and Retail Sales of Light Vehicles



Note. Annual rate. FRB seasonals.

Michigan Survey Index of Car-Buying Attitudes

Note. Data are preliminary.

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

Component	Proportion, 2003: H1 (percent)	2003				
		Q1	Q2	June	July	Aug.
Total orders	**100.0**	**0.7**	**-0.2**	**2.5**	**1.6**	**-1.1**
Adjusted orders[1]	75.0	0.6	-0.8	1.5	1.7	-2.4
Computers	4.0	-4.7	13.4	3.4	3.5	-1.9
Communication equipment	4.0	25.6	-8.9	0.4	13.4	-4.5
Other capital goods	24.0	2.0	0.3	1.9	-1.9	-0.3
Other[2]	43.0	-1.4	-2.0	1.2	2.5	-3.3
MEMO						
Real adjusted orders	...	1.0	-0.5	1.7	1.8	-2.2
Excluding high tech	...	0.2	-1.2	1.8	1.0	-2.6

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.

regional Federal Reserve Banks, some of which are available through October, have been similarly upbeat. Furthermore, although the staff's series for real adjusted durable goods orders declined in August, a three-month moving average of this volatile series suggests that, on balance, orders have improved modestly over the past few months. On the downside, data on import and export shares indicate that the net trade position for manufacturing outside of motor vehicles has shown little improvement as yet in response to the decline in the exchange value of the dollar since early 2002.

Motor Vehicles

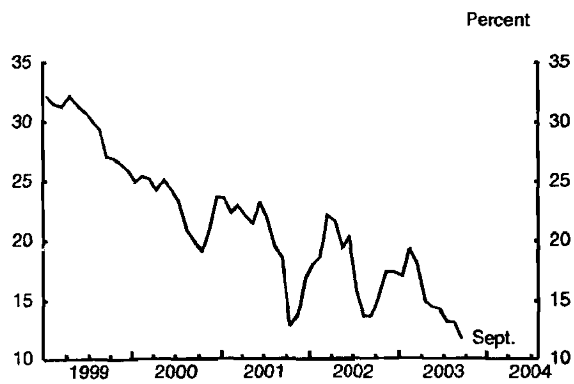
After having surged in August, sales of autos and light trucks receded to an annual rate of 16.6 million units in September. For the third quarter as a whole, sales of light vehicles averaged 17.5 million units (annual rate), up 1-1/2 million units from the average sales pace over the first half the year. During the summer, consumer demand for vehicles probably was boosted by the sharp increase in sales incentives in July and August. The tax cuts that became effective at mid-year may also have played a role. Incentives fell back a bit in September and slid still further in early October. Nevertheless, according to the Michigan survey, consumer car-buying attitudes moved back up in early October to a very positive level. In contrast, business demand for light vehicle

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

Item	2002	2003			2003			
	Q4	Q1	Q2	Q3	June	July	Aug.	Sept.
U.S. production	12.4	12.4	11.7	12.3	11.9	12.2	11.8	13.0
Autos	4.9	4.7	4.4	4.6	4.5	4.5	4.3	4.9
Trucks	7.5	7.7	7.3	7.7	7.4	7.7	7.4	8.0
Days' supply[1]	63	74	70	62	70	65	55	67
Inventories[2]	2.73	3.01	2.96	2.88	2.96	2.95	2.76	2.88

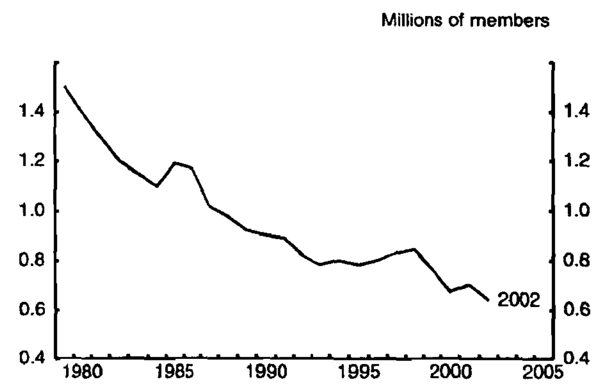
NOTE. Components may not sum to totals because of rounding.
1. Quarterly values calculated with end-of-period stocks and average reported sales; excludes medium and heavy trucks (classes 3-8).
2. End-of-period stocks; excludes medium and heavy trucks.

Share of Motor Vehicle Leases in Total Sales



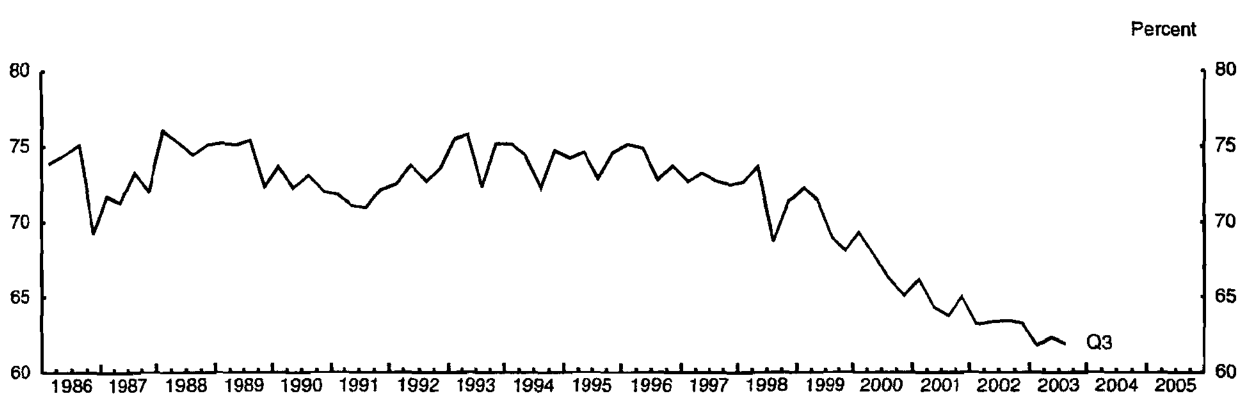
Source. J.D. Power and Associates.

UAW Membership



Source. UAW year-end financial reports. Includes active and retired.

Domestic Market Share of Big Three



fleets edged lower in the third quarter, to 3.1 million units, a sales rate a bit below the average in 2002.[5]

Total motor vehicle production jumped sharply to an annual rate of 13 million units in September. For the third quarter as a whole, production was at a 12.3 million unit rate, up from 11.7 million units in the second quarter. The supply of light vehicles held in inventory averaged sixty-two days in the third quarter, down from averages of well over seventy days during the first half of the year. The industry currently expects sales in the fourth quarter to average below their high third-quarter pace, and production is scheduled to drop back to an 11.9 million unit pace.

The UAW union recently ratified four-year agreements with the Big Three and parts suppliers Delphi and Visteon.[6] According to industry reports, a key objective for the UAW was to make the Big Three more competitive and preserve union jobs, and in pursuit of this objective, the union was prepared to make some concessions on compensation and plant closings. The membership of the UAW has fallen from its 1979 peak of 1.5 million to less than 640,000 in 2002.[7]

Under the new contracts, workers immediately receive a $3,000 signing bonus and will get another bonus equal to 3 percent of their wages in the second year. They will receive a 2 percent base-wage increase in the third year and a 3 percent increase in the fourth year.[8] The UAW estimates that union members will see their base wages, including COLAs, rise an average of 2-3/4 percent in each year of the agreement.[9] Retirement benefits were little changed, as was the health care package, which is provided free of charge to employees. For the Big Three, the costs per vehicle of providing health and retirement benefits to their

5. In the NIPA, vehicles leased to consumers are captured in business spending rather than in PCE. In recent years, the Big Three have favored incentive programs that encourage consumers to purchase their vehicles rather than lease them. In the 1990s, the Big Three supported vehicle sales with lucrative lease deals, which later turned out to be unprofitable. According to data from J. D. Power and Associates through September of this year, the share of leases in motor vehicle sales has averaged about 12 percent, down from an average of almost 30 percent in 2000.

6. The UAW's official name is the United Automobile, Aerospace and Agricultural Implement Workers of America.

7. In recent years, the UAW has been able to offset its steep losses in manufacturing to a small extent by successfully organizing some employees in the service sector.

8. Workers will continue to receive a cost-of-living adjustment (COLA) every three months, but the amount of the COLA will be reduced by 2 cents each quarter. In the 1999 agreement, workers received a 3 percent base-wage increase in each year of the agreement in addition to the COLA. They also received a $1,350 signing bonus.

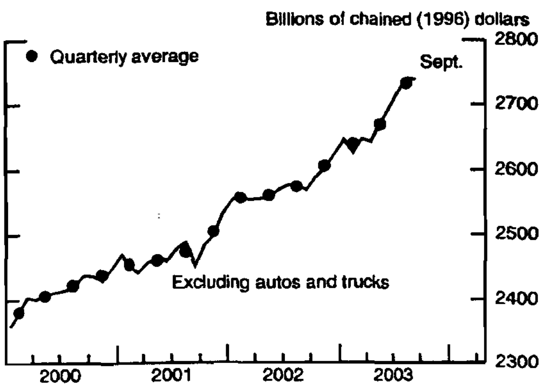
9. The UAW reports that an average union-represented assembler earns $25.60 an hour and has an average annual salary of $70,200 per year.

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

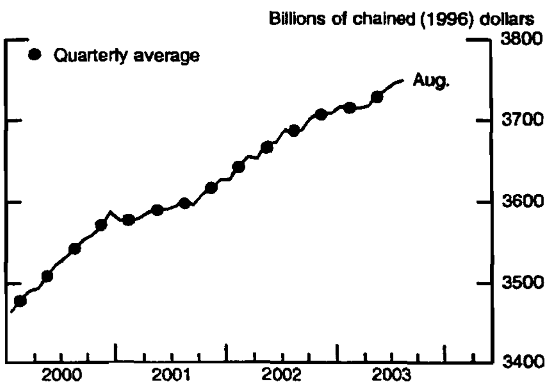
Category	2003 Q1	Q2	Q3	July	Aug.	Sept.
Total sales	1.4	1.4	2.9	1.4	1.2	-.2
Previous estimate	...	...	2.4	1.3	.6	...
Retail control[1]	1.9	.1	2.7	1.0	1.3	.1
Previous estimate	...	...	2.0	.9	.8	...
GAF[2]	.2	1.3	3.2	1.2	1.0	.2
Gasoline stations	7.6	-6.4	3.6	1.8	3.5	.3
Food services	2.3	2.3	2.3	.4	2.0	-1.4
Other retailers[3]	1.9	.1	2.2	.9	.8	.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.

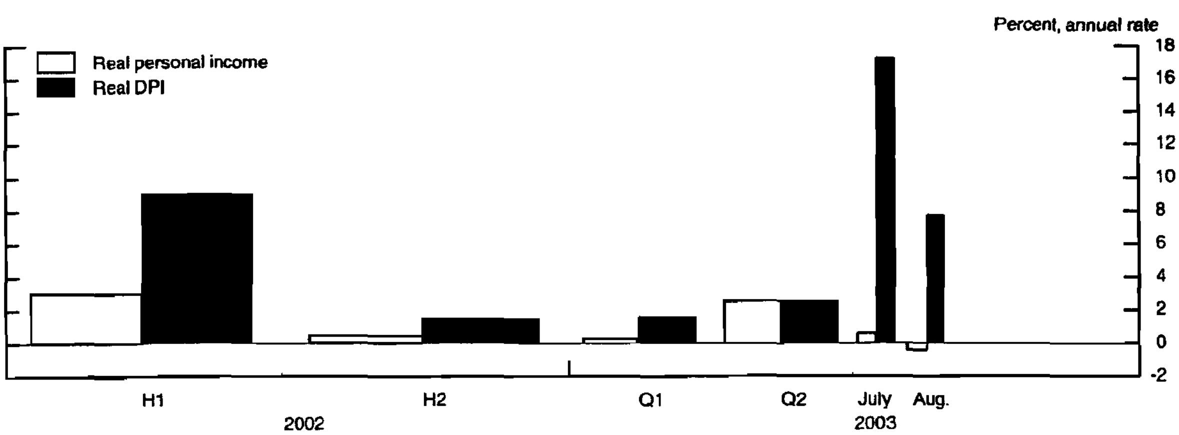
Real PCE Goods



Real PCE Services



Change in Real Personal Income and Real DPI



employees currently outstrip the same costs of other domestic auto producers by wide margins.[10]

Consumer Spending

Real personal consumption expenditures appear to have fallen back in September after having surged in July and August.[11] This pattern largely reflects a swing in consumer purchases of motor vehicles, which reversed their July-August run-up last month. However, apart from motor vehicles, outlays also rose at a solid pace in August and appear to have declined only slightly in September. Spending has been supported of late by the sizable boost to disposable personal income from the recently enacted tax cuts as well as by levels of wealth and confidence that are considerably above their values earlier this year.

In September, nominal sales in the retail control group of stores, which excludes automotive dealers and building materials and supply stores, ticked up 0.1 percent after having posted a robust 1.3 percent in August. Factoring in the effect of rising gasoline prices, we estimate that real retail control fell 0.1 percent in September after having jumped 0.8 percent in August. For the third quarter as a whole, real retail control skyrocketed at an annual rate of 9.8 percent.

Real outlays for services rose modestly in August, the most recent month for which official estimates are available. The increase was driven by a rise in spending for energy services. Expenditures for other services, which continued to advance at a lackluster pace, were held back, in part, by continued weakness in travel and recreation spending.

Real disposable income advanced 0.6 percent (at a monthly rate) in August after having jumped 1.3 percent in July, with both increases reflecting sizable reductions in tax payments. Real pre-tax income was essentially unchanged in both months.

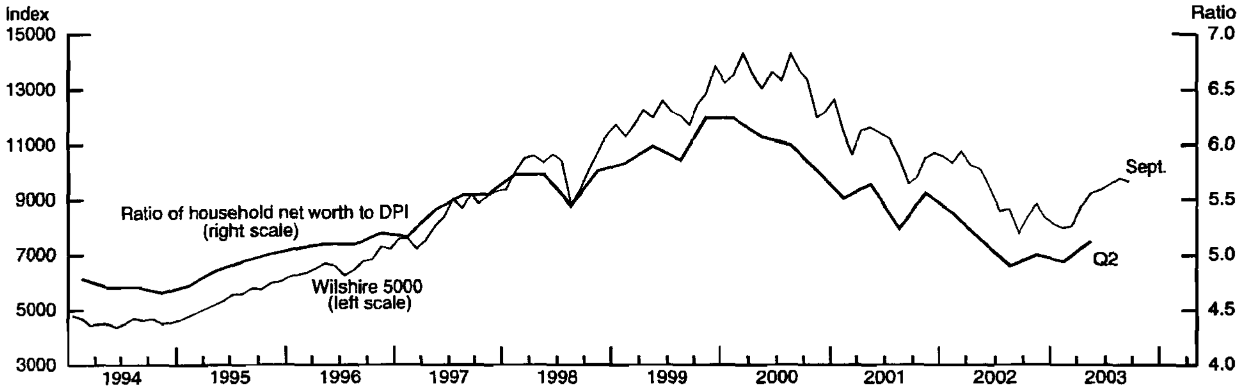
The early October rise in the Michigan Survey Research Center's index of consumer sentiment just offset the decline in September. The Conference Board measure of consumer sentiment also fell some in September. These measures of confidence have changed little, on balance, in recent months and stand well above their March lows.

10. For example, Prudential Securities estimates that GM spends $1,360 per vehicle on health and retirement benefits, Ford spends $734, and Chrysler $631; the comparable figures for Toyota and Honda are $180 and $107, respectively.

11. The September decrease does not appear to be attributable to Hurricane Isabel, which likely had negligible effects on aggregate consumer spending.

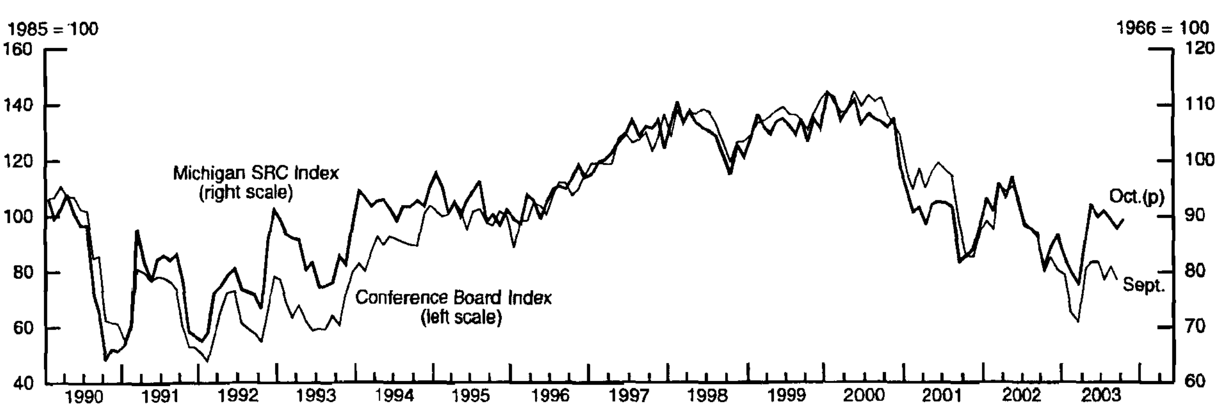
Household Indicators

Household Net Worth and Wilshire 5000



Personal Saving Rate

Consumer Confidence



Housing Markets

Housing construction and sales remained very strong in August and September even though mortgage rates were above the extremely low levels briefly reached at the beginning of the summer. In the single-family sector, new homes were started at an annual rate of 1.52 million units in September, only slightly below the blistering pace seen in June and July.[12] Permit issuance—adjusted for activity in areas where permits are not required—was roughly in line with starts in September, and the backlog of unused permits moved up, suggesting that starts will remain robust in coming months.

Sales of existing homes spiked to an annual rate of 6.47 million units in August, the fastest pace on record. In addition, sales of new homes moved back up in August to a level only a bit below June's record-setting rate. Taken together, these figures imply that commissions paid to real-estate brokers—a component of residential spending—were robust in the third quarter.

Between June and August, the rate on fixed-rate mortgages moved up more than 100 basis points, while the rate on one-year adjustable rate mortgages (ARMs) increased only 30 basis points. As a result, the share of new mortgage originations going to ARMs rose sharply in August, to 20 percent. This shift may have tempered the effect of rising rates on housing activity.

In the multifamily sector, starts rose to an annual rate of 368,000 units in September, the highest pace since August 2002. The ratio of permits to starts was well below its historical level, suggesting that multifamily starts will be reduced in coming months.

Recent indicators signal a robust pace of housing activity going into the fourth quarter. Since August, rates on both fixed- and adjustable-rate mortgages have reversed part of the run-up of earlier in the summer. Consumer sentiment toward homebuying, as measured by the Michigan Survey, improved noticeably in early October to a level just a bit below its recent high in May. In addition, the Mortgage Bankers Association's index of mortgage applications for the purchase of a home (as opposed to refinancing) moved down only slightly in the middle of October from its recent high.

The most recent data on house prices show that the median price for existing homes sold in August was 9-3/4 percent higher than during August 2002, up from a 5-1/4 percent increase during the preceding twelve months. In contrast, the repeat-sales price index for existing homes, which partially adjusts for shifts

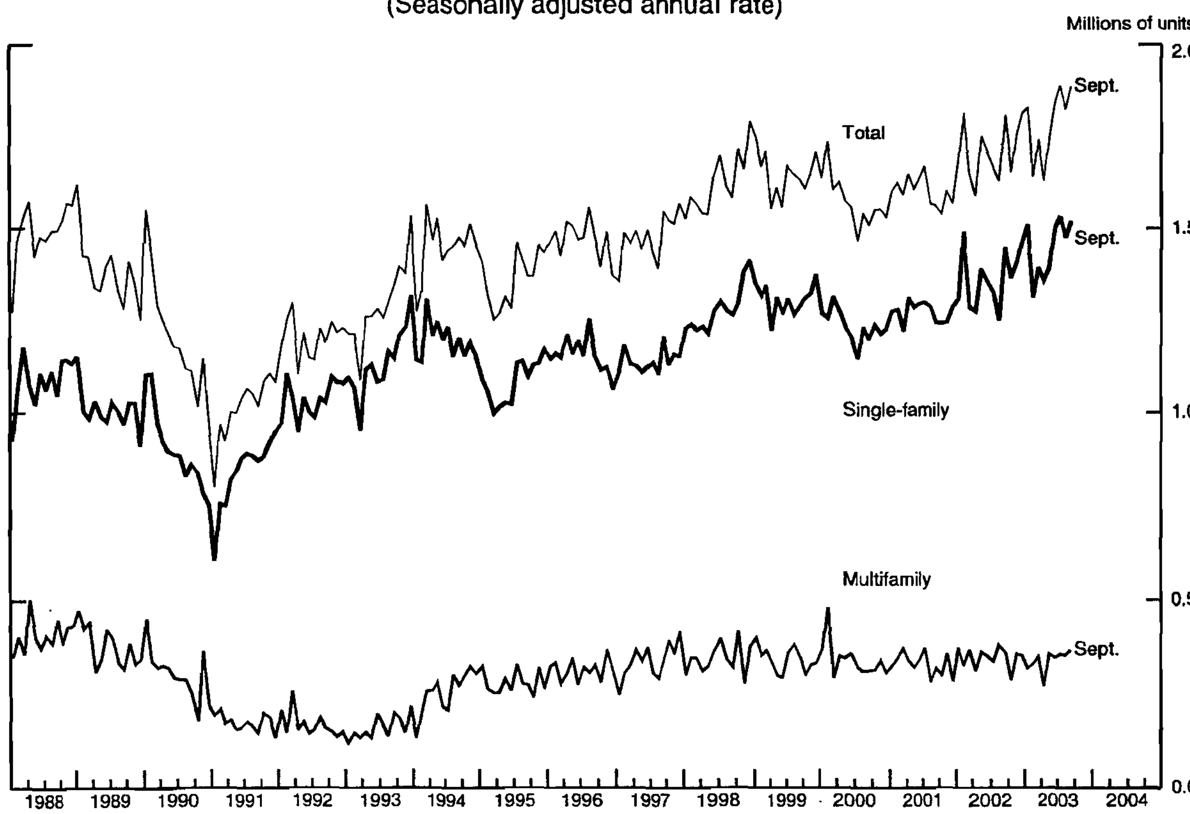
12. Hurricane Isabel appears to have had little effect on housing starts in September. In addition, using the aftermath of the significantly more destructive Hurricane Andrew as a guide, we expect that replacement and repair spending in the wake of Isabel will have only a minor effect on overall construction outlays.

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

Sector	2002	2003 Q1	2003 Q2	2003 Q3p	2003 July[r]	2003 Aug.[r]	2003 Sept.[p]
All units							
Starts	1.70	1.74	1.74	1.87	1.89	1.83	1.89
Permits	1.75	1.75	1.78	1.85	1.80	1.90	1.86
Single-family units							
Starts	1.36	1.41	1.42	1.51	1.53	1.47	1.52
Permits	1.33	1.35	1.37	1.46	1.43	1.48	1.47
Adjusted permits[1]	1.38	1.39	1.40	1.51	1.48	1.52	1.53
New home sales	0.97	0.98	1.09	n.a.	1.11	1.15	n.a.
Existing home sales	5.57	5.87	5.83	n.a.	6.13	6.47	n.a.
Multifamily units							
Starts	0.35	0.33	0.32	0.36	0.36	0.35	0.37
Permits	0.42	0.41	0.41	0.39	0.37	0.42	0.39
Mobile homes							
Shipments	0.17	0.14	0.13	0.13	0.14	0.13	n.a.

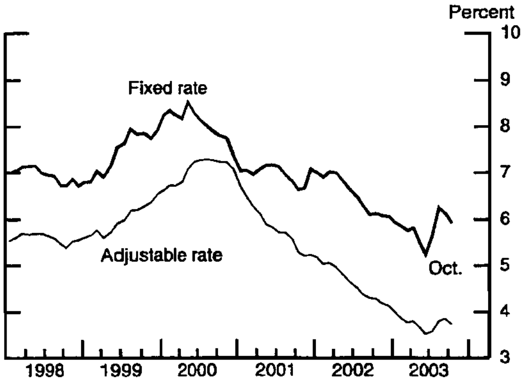
1. Adjusted permits equal permit issuance plus total starts outside of permit-issuing areas.
p Preliminary. r Revised. n.a. Not available.

Private Housing Starts
(Seasonally adjusted annual rate)



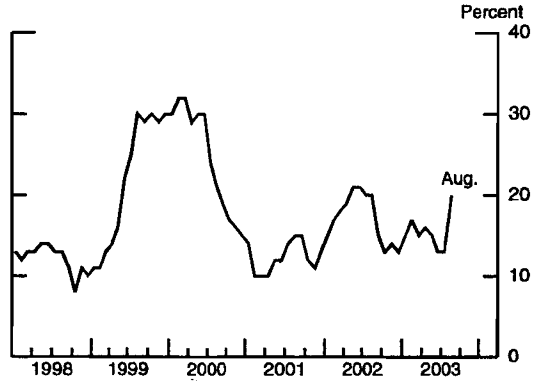
Indicators of Single-Family Housing

Mortgage Rates



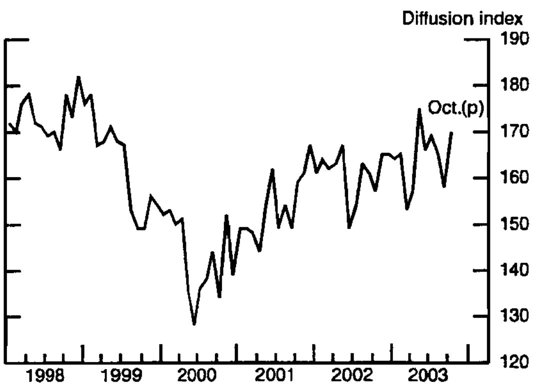
Note. The October reading is based on data through October 17.
Source. Freddie Mac.

ARM Share of Originations



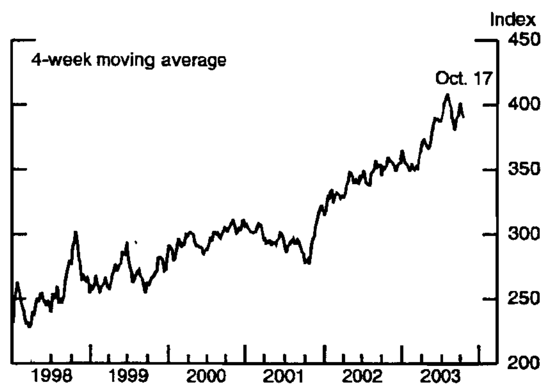
Source. Federal Housing Finance Board.

Perceived Homebuying Conditions



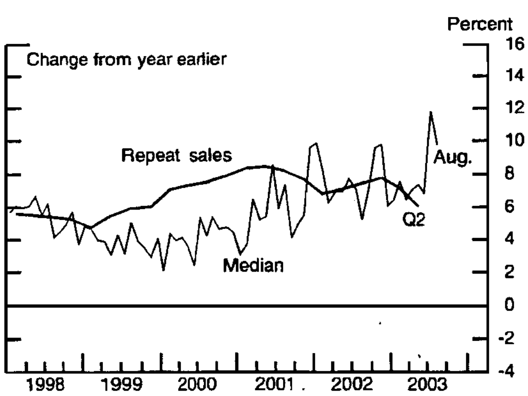
Source. Michigan Survey, not seasonally adjusted.

MBA Index of Purchase Applications



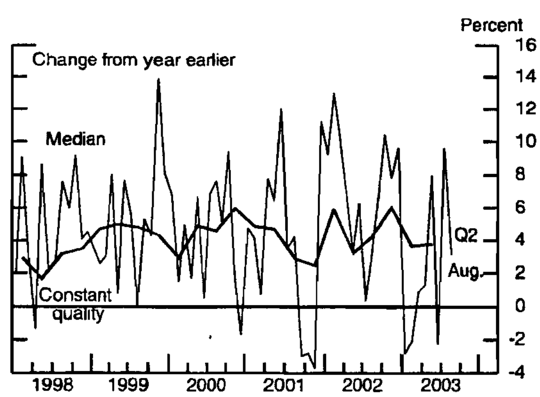
Source. Mortgage Bankers' Association.

Prices of Existing Homes



Source. National Association of Realtors and Freddie Mac.

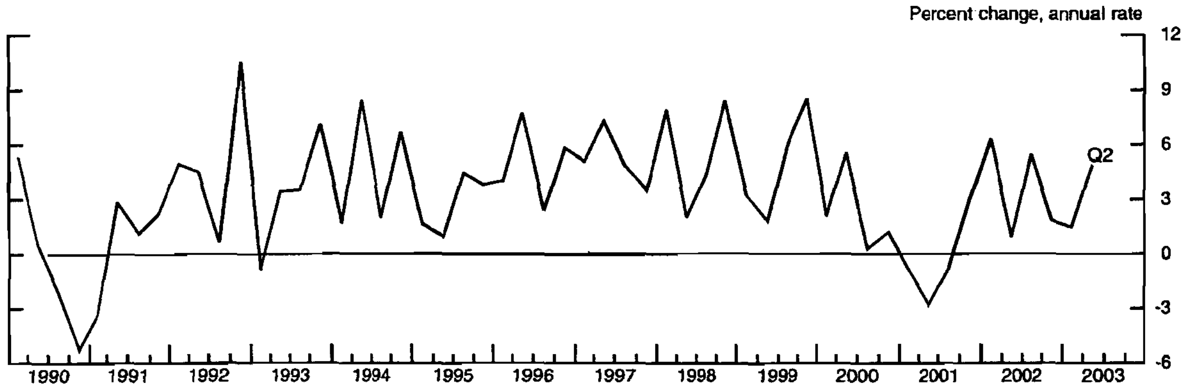
Prices of New Homes



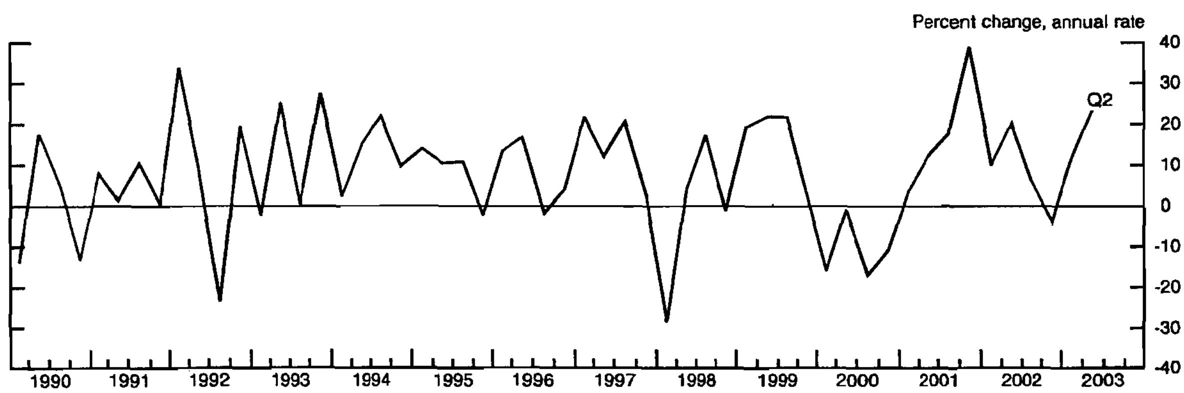
Source. Census Bureau.

Equipment and Software Investment Fundamentals

Real Business Output

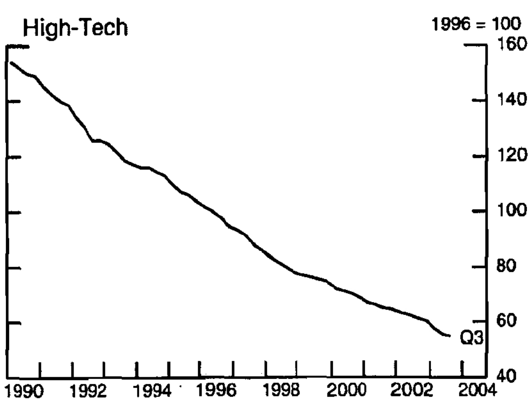


Real Corporate Cash Flow

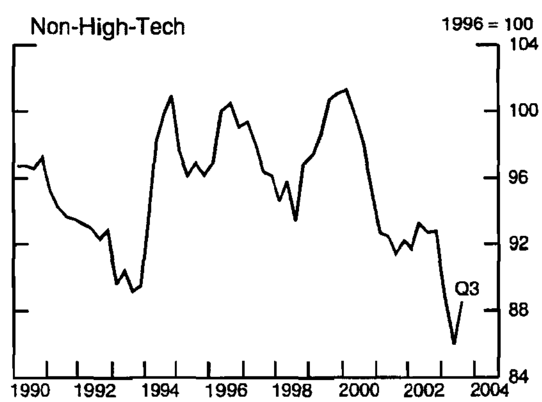


User Cost of Capital*

High-Tech



Non-High-Tech



*Excludes the effects of the partial expensing tax incentive.

in the composition of homes sold, has shown a marked deceleration since early 2001. This suggests that the acceleration of the unadjusted figures reflects compositional shifts rather than a genuine acceleration in house values. The median price of new homes sold in August was up about 3 percent from the previous August, the same increase as recorded during the year-earlier period. Quality-adjusted new home prices rose 3-3/4 percent during the year ending in the second quarter, compared with a 3-1/4 percent increase during the preceding year.

Equipment and Software

Real outlays for equipment and software in the third quarter appear to have advanced faster than the 8-1/4 percent annual rate recorded in the second quarter. Business purchases of motor vehicles moved up a good bit in the third quarter, while aircraft expenditures declined. The apparently strong third-quarter increases in spending aside from that on transportation equipment are consistent with the continued gains in business output and corporate cash flow as well as the low user cost of capital.

In the high-tech sector, nominal shipments of computing equipment dropped 10 percent (monthly rate) in August—not quite enough to reverse the July increase—and shipments of communications equipment receded a bit. But with prices for these goods falling, total real high-tech spending likely posted a sizable gain in the third quarter as a whole. Outside of the high-tech sector, shipments weakened in August, with small declines in most subcategories; still, a solid showing in July put this category on track for a moderate third-quarter increase. Looking forward, new orders for computers and peripherals have moved up in line with shipments, and bookings for communications equipment appear to have stabilized, albeit at a low level. While new orders apart from high-tech edged down in August, they have increased, on balance, since the beginning of the year—a development that suggests ongoing spending gains in this category.

Outlays in the transportation sector appear to have risen in the third quarter, spurred importantly by stronger sales of medium and heavy (class 8) trucks. Part of the increase in business demand for these vehicles over the past two quarters likely reflects the effects of partial expensing. In addition, sales of heavy trucks this year have been supported by a string of incentive programs from manufacturers; the removal of incentives in July likely contributed to the subsequent softening in orders for these vehicles. Meanwhile, domestic shipments and imports of aircraft moved down significantly in August from elevated levels in July.

Nonresidential Construction

Spending on nonresidential construction appears to be bottoming out. After having fallen 25 percent from October 2000 to August 2002, nominal outlays

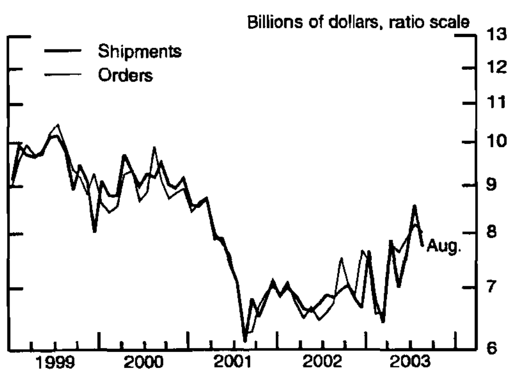
Orders and Shipments of Nondefense Capital Goods

(Percent change from preceding period; seasonally adjusted current dollars)

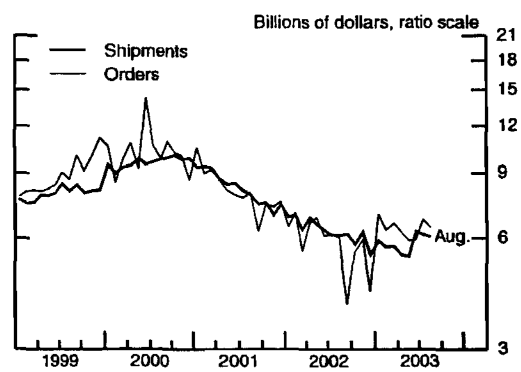
Indicators	2003 Q1	2003 Q2	2003 June	2003 July	2003 Aug.
	Annual rate		Monthly rate		
Shipments	-5.1	5.7	3.8	2.2	-3.1
Excluding aircraft	-1.9	5.6	2.8	2.5	-2.5
Computers and peripherals	7.6	35.8	9.1	12.5	-9.9
Communications equipment	-3.5	-6.5	16.4	-1.8	-1.2
All other categories	-3.2	2.7	-.1	1.3	-1.1
Orders	1.1	12.9	3.6	1.5	-2.3
Excluding aircraft	14.6	3.2	1.9	.5	-1.1
Computers and peripherals	-17.5	65.1	3.4	3.5	-1.9
Communications equipment	148.9	-31.2	.4	13.4	-4.5
All other categories	8.2	1.0	1.9	-1.9	-.3
Memo					
Shipments of complete aircraft[1]	29.5	25.8	33.5	33.8	25.7

1. From Census Bureau, Current Industrial Reports; billions of dollars, annual rate.

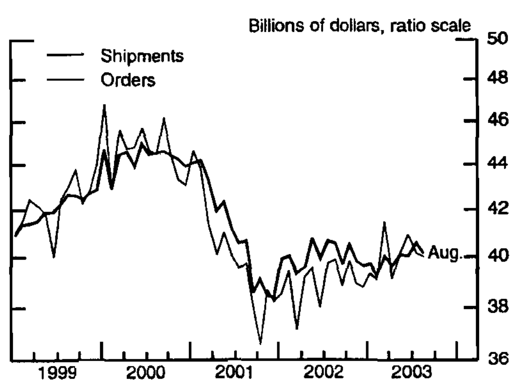
Computers and Peripherals



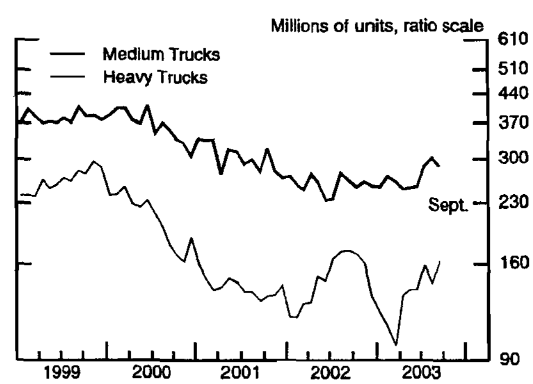
Communications Equipment



Other Equipment



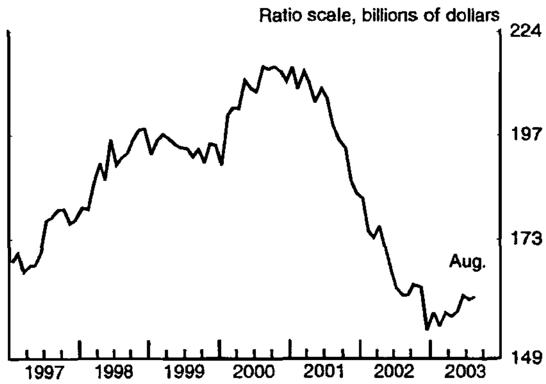
Sales of Medium and Heavy Trucks



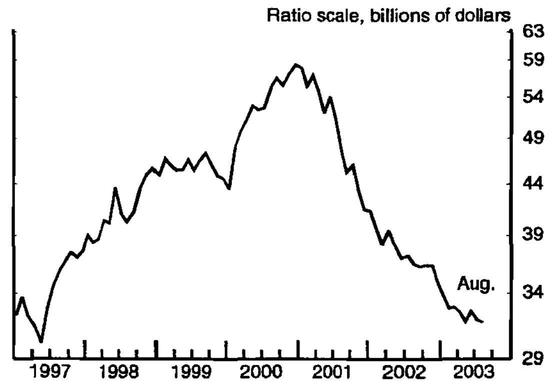
Note. Annual rate, FRB Seasonals.
Source. Ward's Communications.

Nonresidential Construction
(Staff translation of CPIP data into traditional NIPA categories; seasonally adjusted annual rate)

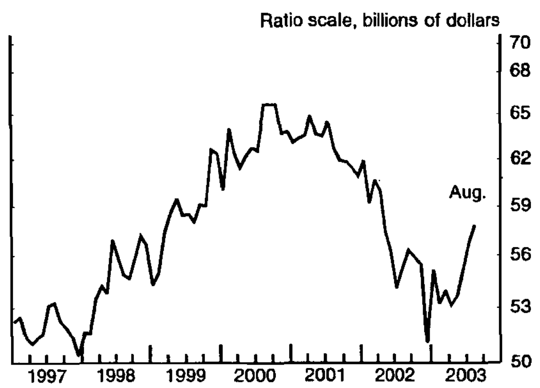
Total Building



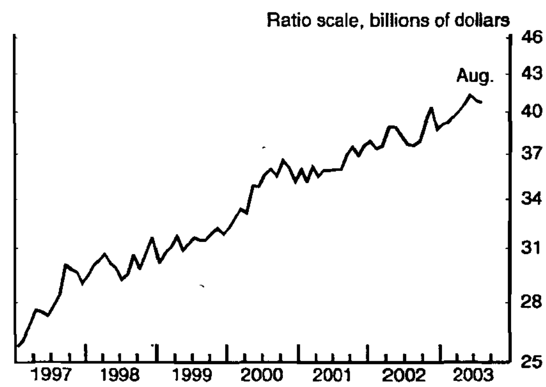
Office



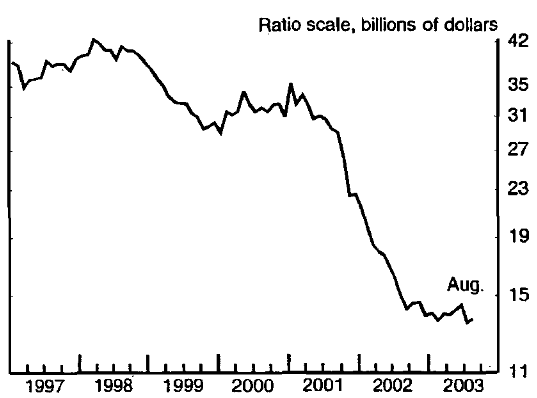
Other Commercial



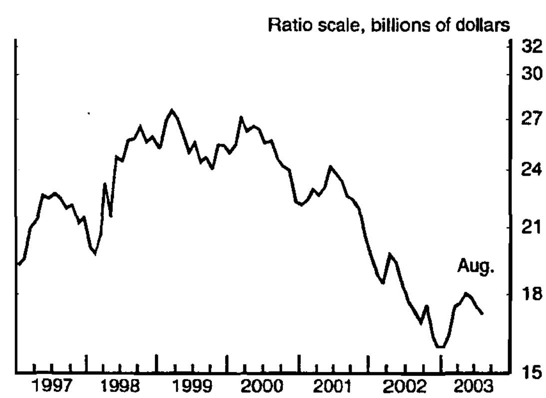
Institutional



Industrial



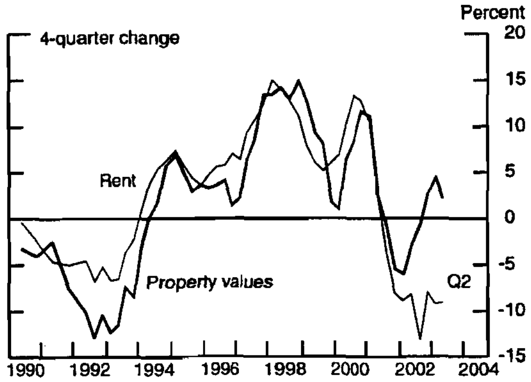
Lodging and Miscellaneous



Indicators of Nonresidential Construction

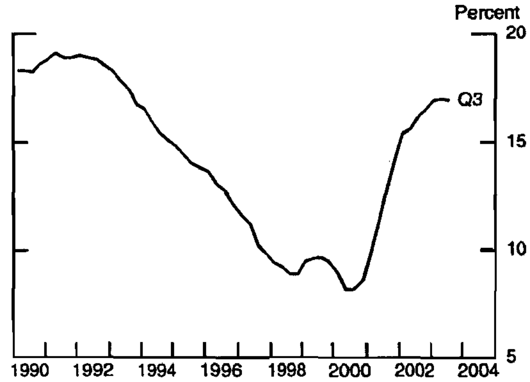
Office Buildings

Property Values and Rent



Source. National Real Estate Index.

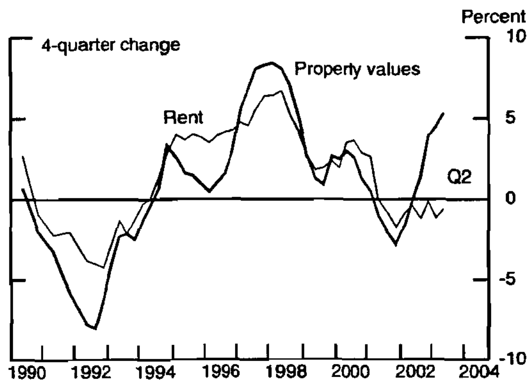
Vacancy Rate



Source. Torto Wheaton Research.

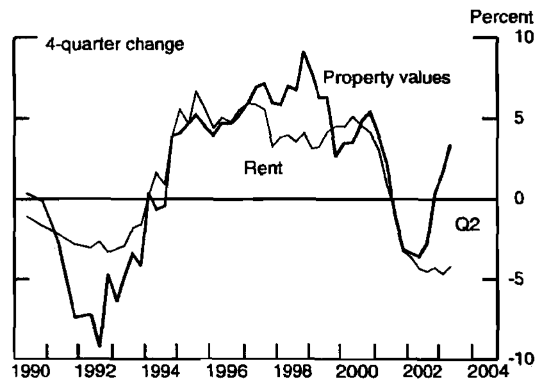
Other Commercial Buildings

Retail Property Values and Rent



Source. National Real Estate Index.

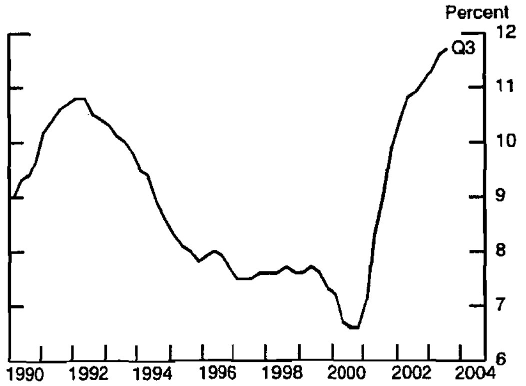
Warehouse Property Values and Rent



Source. National Real Estate Index.

Industrial Buildings

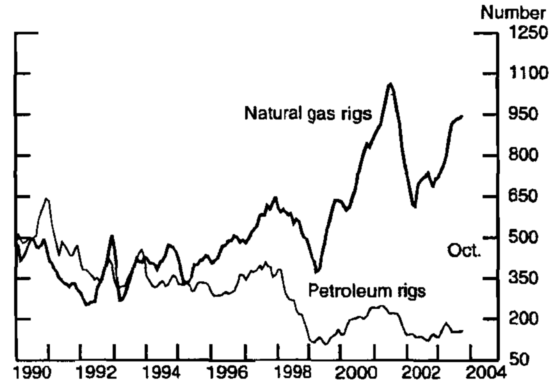
Vacancy Rate



Source. Torto Wheaton Research.

Drilling Activity

Rigs in Operation



Note. August values are averages through October 17.
Source. DOE/Baker Hughes.

for the construction of privately owned buildings were about flat, on net, during the twelve months ending in August. However, there are few signs so far of a sustained pickup in this sector.[13]

The recent sideways pattern of overall construction spending masks the disparate performance of its principal components. Nominal spending on office space continued to decline in August; office rents fell again in the second quarter, and although vacancy rates edged down slightly in the third quarter, they remained at a very high level. In contrast, outlays for the construction of other commercial buildings (such as those for retail and wholesale establishments) have moved higher in recent months despite falling rents through at least the second quarter.[14] Spending on private institutional buildings (such as schools, churches, and hospitals) has continued its strong uptrend.

Among the smaller subsectors of nonresidential construction, spending on industrial buildings continued to be very weak in August, and vacancy rates moved up again in the third quarter. Outlays for hotels and motels also remained depressed in August, although anecdotes suggest that spending in this sector may be reaching a trough. The increase in drilling and mining activity through October implies that outlays for drilling and mining structures are likely to increase further this fall, albeit at a slower pace than seen in the second quarter.

Business Inventories
The book value of manufacturing and trade inventories excluding motor vehicles dropped in August after having edged down in July. Manufacturers ran off stocks at a fairly rapid clip in both months, while wholesalers and retailers, excluding motor vehicles and parts dealers, recorded small declines in stocks in August after accumulations in July. Generally small changes in shipments and sales in the July-August period have kept book-value inventory-sales ratios about flat.

Days' supply for total IP in the flow-of-goods system edged up in September but remained below the average level recorded in the second quarter. Excluding motor vehicles and parts, the inventory-consumption ratio edged down to a record low. Among the various industries, only paper, communications

---

13. Again, with the aftermath of Hurricane Andrew as a guide, we do not expect that reconstruction following Hurricane Isabel will make a significant contribution to overall nonresidential construction spending. Indeed, a portion of the repair work may be classified as an intermediate good (like repairs to business equipment) and therefore would not be reflected in the spending figures.

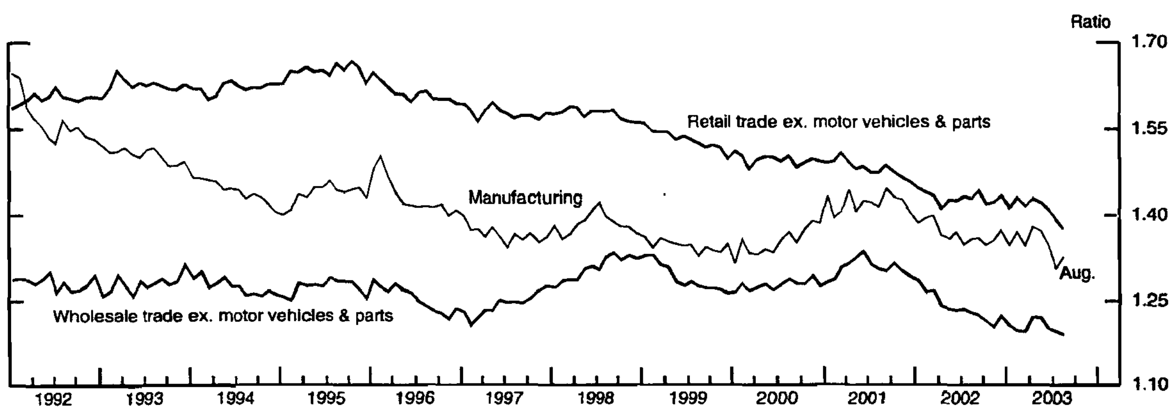
14. Prices for office and other commercial buildings moved higher in the second quarter despite declines in rents, perhaps because favorable financing conditions helped reduce the cost of owning a building. Still, weak rents could threaten recovery in these sectors.

Changes in Manufacturing and Trade Inventories

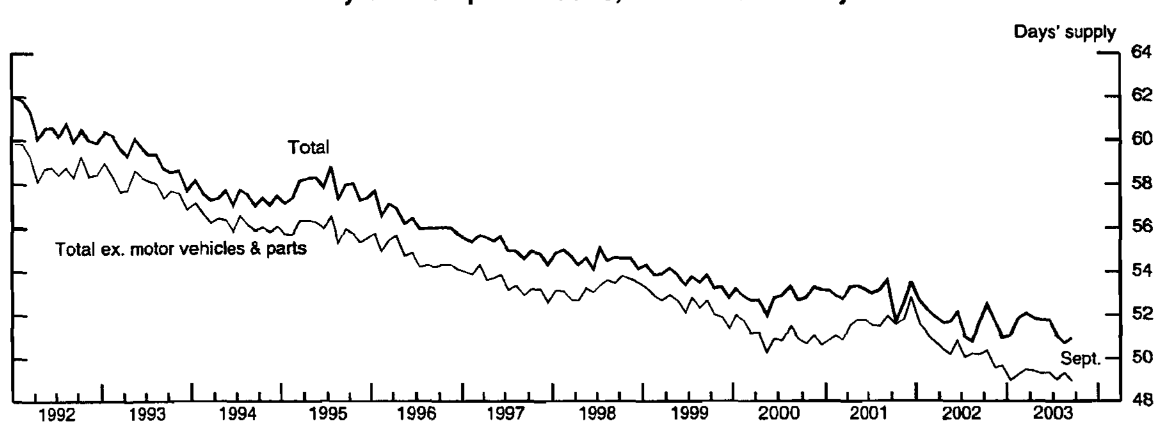
(Billions of dollars, seasonally adjusted book value, annual rate)

Sector	2002 Q4	2003 Q1	2003 Q2	2003 June	2003 July	2003 Aug.
Manufacturing and trade	43.7	55.7	-11.8	5.0	-26.4	-59.1
Ex. wholesale and retail motor vehicles & parts	15.1	23.4	-21.3	-11.0	-7.6	-17.3
Manufacturing	2.4	4.0	-10.1	-16.6	-22.8	-12.7
Ex. aircraft	1.5	5.0	-7.7	-8.5	-14.1	-12.3
Wholesale trade	7.6	8.4	-8.1	-.5	1.7	-5.7
Motor vehicles & parts	3.4	1.5	1.1	4.9	-7.4	-5.0
Ex. motor vehicles & parts	4.2	6.8	-9.2	-5.4	9.1	-.7
Retail trade	33.8	43.4	6.4	22.1	-5.3	-40.7
Motor vehicles & parts	25.3	30.8	8.4	11.1	-11.4	-36.8
Ex. motor vehicles & parts	8.5	12.6	-2.0	11.0	6.1	-3.9

Book-Value Inventories Relative to Shipments and Sales



Inventory-Consumption Ratios, Flow-of-Goods System



equipment, and, to a lesser degree, electrical equipment appear to have elevated inventory-consumption ratios.

Federal Government Sector

Spending resulting from the U.S. presence in Iraq and income tax cuts enacted under the Jobs and Growth Tax Relief Reconciliation Act continue to put upward pressure on the federal unified budget deficit. The deficit for fiscal 2003 was $374 billion, up substantially from the deficit of $158 billion recorded in the previous year. Limited progress is being made on the budget for fiscal 2004, and the federal government is operating on a continuing resolution that provides funding through the end of October.

Federal receipts, totaled over August and September, fell almost 4 percent from their corresponding year-earlier level owing to the effects of the tax legislation enacted in late May. The decline in individual income and payroll taxes over the two months reflects the new withholding tables, reduced quarterly declarations, and the two waves of child-credit refund checks that were mailed out in early August. On balance, corporate receipts edged up over the two-month period relative to a year earlier despite provisions of the tax legislation that both delayed about $5 billion of September payments to October 1 and held down taxes by allowing partial expensing of certain investments.

Outlays, adjusted for financial transactions and payment-timing shifts, rose about 8 percent in the August-September period from the year-earlier level. Apart from interest payments, which fell, increases were widespread, led by a sizable rise in both defense and Medicaid outlays.

On the legislative front, only three of the thirteen regular appropriations bills for fiscal 2004 have been enacted into law. The House and Senate have passed supplemental appropriations bills to fund activities in Iraq and Afghanistan. The House-passed bill provides $66 billion for added defense spending and $21 billion in aid for reconstruction. The Senate version is similar, but it converts a portion of the aid to Iraq into a loan.

State and Local Government Sector

Indicators of spending by state and local governments have been mixed so far in the third quarter. As of September, employment had fallen in almost every month since its high last February, with a cumulative drop of more than 100,000. The cutbacks have been spread nearly equally between state governments and local governments and between education and non-educational functions. Until September, the local education sector had not shown much deterioration in employment. But September was the start of the 2003-04 academic year in most school districts, and last month's employment decline probably reflected more recent budget decisions to cut education spending by many governments that had previously hoped to spare education. Meanwhile,

Federal Government Outlays and Receipts
(Unified basis; billions of dollars)

Function or source	September 2002	September 2003	September Percent change	12 months ending in September 2002	12 months ending in September 2003	12 months ending in September Percent change
Outlays	150.3	165.3	10.0	2,011.0	2,156.5	7.2
Financial transactions[1]	-0.4	-0.0	...	-1.0	-1.3	...
Payment timing[2]	-12.2	-13.1	...	-0.9	-0.8	...
Adjusted outlays	162.9	178.4	9.5	2,013.0	2,158.7	7.2
Receipts	192.7	191.6	-0.5	1,853.2	1,782.7	-3.8
Payment timing	0.0	0.0	...	26.0	0.0	...
Adjusted receipts	192.7	191.6	-0.5	1,827.2	1,782.7	-2.4
Surplus/deficit(-)	42.4	26.4	...	-157.8	-373.8	...
	Selected components of adjusted outlays and receipts					
Adjusted outlays	162.9	178.4	9.5	2,013.0	2,158.7	7.2
Net interest	5.6	4.9	-12.9	171.2	154.7	-9.6
Non-interest	157.2	173.4	10.3	1,841.8	2,004.0	8.8
National defense	32.2	38.5	19.7	347.7	404.7	16.4
Social security	38.4	39.9	4.0	456.4	474.7	4.0
Medicare	19.7	22.4	13.4	231.3	249.6	7.9
Medicaid	12.9	13.7	6.5	147.5	160.7	8.9
Income security	23.1	23.8	3.1	309.5	335.0	8.2
Agriculture	0.7	1.2	56.5	24.3	24.1	-0.9
Other	30.2	34.0	12.3	325.1	355.2	9.3
Adjusted receipts	192.7	191.6	-0.5	1,827.2	1,782.7	-2.4
Individual income and payroll taxes	148.2	144.9	-2.2	1,518.8	1,464.3	-3.6
Withheld + FICA	106.5	105.8	-0.7	1,377.1	1,368.8	-0.6
Nonwithheld + SECA	45.9	43.5	-5.2	321.1	289.0	-10.0
Refunds (-)	4.2	4.4	3.2	179.4	193.4	7.9
Corporate	30.8	30.3	-1.5	125.0	131.8	5.4
Gross	35.3	34.5	-2.4	188.4	194.5	3.2
Refunds (-)	4.5	4.1	-8.5	63.4	62.7	-1.0
Other	13.7	16.4	19.7	183.4	186.6	1.8
Adjusted surplus/deficit(-)	29.8	13.3	...	-185.8	-376.0	...

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

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

2. A shift in payment timing occurs when the first of the month falls on a weekend or holiday, or when the first 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.

construction spending ticked up in August after having risen during most of the spring and summer months, and the average level in July and August stood 1.8 percent above the average seen in the second quarter.

State legislatures are currently not considering fiscal issues, and lawmakers in most states appear to be taking a break from addressing the budgetary pressures that were pervasive last spring. Many seem to be hoping that a stronger underlying economy will bring receipts and spending into better alignment this year. Most states begin their next legislative sessions in January.

Prices and Labor Costs

Boosted by a run-up in gasoline prices, the consumer price index rose 0.3 percent in September. A sharp increase in energy prices over the preceding year pushed up the September twelve-month change in the CPI to 2.3 percent, compared with 1.5 percent a year earlier.

Excluding food and energy, the CPI increased 0.1 percent in September after a similar increase in August. Core consumer prices have risen somewhat faster over the past several months than they did earlier in the year when core inflation was depressed by a number of transitory factors. As of September, the twelve-month change in the core CPI stood at 1.2 percent, well below the 2.2 percent increase recorded during the comparable period a year earlier. The index for core goods fell again last month and was 2.4 percent below its level a year earlier, the largest twelve-month decline in more than fifty years. Core services prices rose 0.2 percent last month after a similar increase in August. Faced with continuing budget problems, many states raised university tuition sharply for the current school year and thereby pushed up the CPI for education services during the summer. Even so, prices of non-energy services as a whole decelerated 0.9 percentage point over the twelve months ending in September.

Core PCE prices edged up 0.1 percent in August. Over the twelve months ending in August, core PCE prices increased 1.3 percent; the rise was 1.7 percent during the comparable year-earlier period. The 0.4 percentage point deceleration in core PCE inflation between the two periods is noticeably less than the 1.0 percentage point deceleration in the core CPI over the same period. The difference between the two inflation measures is attributable in part to an appreciable acceleration in the prices of PCE items that are not included in the CPI and for which no market-based prices exist. The market-based component of the core PCE price index decelerated 3/4 percentage point over the twelve months ending in August, to a 0.7 percent rate of increase. The core portion of the chained CPI, like PCE prices, uses a superlative aggregation formula to account for substitution by consumers in response to changes in relative prices; core chained CPI also rose 0.7 percent over the twelve months ending in September, down 1.0 percentage point from the previous twelve-month period.

Measures of Inflation
(Percent)

Measures	12-month change		3-month change		2003	
	Sept. 2002	Sept. 2003[1]	June 2003	Sept. 2003[1]	Aug.	Sept.[1]
			Annual rate		Monthly rate	
CPI						
Total	**1.5**	**2.3**	**-.7**	**3.1**	**.3**	**.3**
Food	1.3	2.4	2.7	2.5	.3	.2
Energy	-4.8	14.7	-24.5	27.8	2.7	3.0
Ex. food and energy	**2.2**	**1.2**	**1.0**	**1.5**	**.1**	**.1**
Ex. tobacco	2.2	1.3	1.1	1.4	.1	.1
Core commodities	-1.1	-2.4	-3.1	-2.3	-.1	-.4
Core services	3.6	2.7	2.9	2.9	.2	.2
Current-methods total	1.5	2.3	-.7	3.1	.3	.3
Ex. food and energy	2.3	1.2	1.0	1.5	.1	.1
Ex. tobacco	2.2	1.2	1.1	1.4	.1	.1
Chained CPI (NSA)[2]	1.2	1.8	--	--	--	--
Ex. food and energy[2]	1.7	.7	--	--	--	--
PCE Prices						
Total	**2.1**	**2.0**	**-.2**	**2.9**	**.3**	**.2**
Food	1.5	2.2	2.6	2.1	.3	.2
Energy	-5.4	15.5	-27.0	29.5	2.8	3.2
Ex. food and energy	**2.7**	**1.2**	**1.2**	**1.7**	**.1**	**.1**
Ex. tobacco	2.6	1.3	1.3	1.7	.1	.1
Core commodities	-1.1	-2.4	-2.7	-1.2	-.1	-.2
Core services	4.3	2.8	2.9	3.0	.2	.2
Core market-based	1.4	.6	.4	1.7	.1	.0
Core nonmarket-based	7.4	3.5	4.3	1.9	.1	.2
PPI						
Total finished goods	**-1.8**	**3.5**	**-5.9**	**3.4**	**.4**	**.3**
Food	-2.9	6.6	5.1	6.8	.7	1.2
Energy	-6.3	12.9	-27.8	6.5	1.2	.1
Ex. food and energy	**-.3**	**.1**	**-2.4**	**1.3**	**.1**	**.0**
Ex. tobacco	-.5	.6	-2.2	1.4	.1	.0
Core consumer goods	.1	-.1	-3.0	1.3	.1	.1
Capital equipment	-.9	.6	-1.7	1.4	.1	-.1
Intermediate materials	-.6	3.7	-9.9	2.1	.5	-.1
Ex. food and energy	.5	1.7	-.9	.9	.1	.1
Crude materials	3.1	22.3	-36.4	-4.1	-1.4	3.4
Ex. food and energy	8.6	11.1	-9.4	30.7	3.7	2.3

1. PCE prices in September are staff estimates.
2. Higher frequency figures are not shown for data that are not seasonally adjusted.

Consumer energy prices moved up 3.0 percent in September on the heels of a gain of 2.7 percent in August. These increases reflected low inventories of gasoline in August and a gasoline pipeline breakdown in Phoenix, which pushed wholesale and retail gasoline prices sharply higher through late August. Gasoline inventories moved up to normal levels in September, and markups reverted to their historical values by the first week of October; nonetheless, the arithmetic of monthly averaging led to a large increase in the gasoline CPI in September and implies a substantial decline in the gasoline CPI for October.

Earlier in the year, extremely tight inventories of natural gas and heating oil heightened concerns about possible shortfalls in the coming winter heating season. However, supplies of natural gas have since risen to normal levels because of both higher production and temperate weather. Total distillate fuel oil inventories have also returned to normal levels in recent months, but the heating oil component of distillate inventories remains below normal, especially in New England, the big consuming region for heating oil.

The CPI for food rose 0.2 percent in September, with pronounced increases for prices of beef and pork. Livestock prices have been pushed up by a ban on imports of live cattle from Canada, where a case of mad cow disease was identified this past spring.

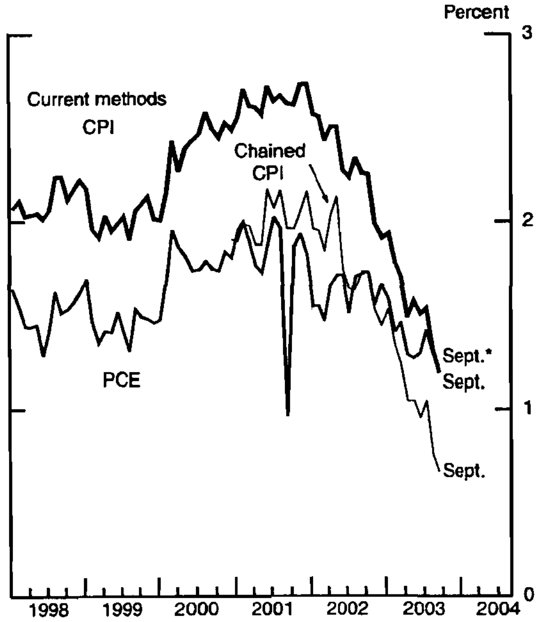
The PPI for capital equipment edged down in September but was still 0.6 percent above its level of a year earlier. Prices for core intermediate materials rose 0.1 percent and were up 1.7 percent from a year earlier—an acceleration relative to the previous twelve-month period that, to a large extent, reflects sizable price increases for energy-intensive products. The major indexes of spot commodity prices have moved higher since the September Greenbook. The Journal of Commerce industrial price index has increased 5.8 percent, in part because of a pickup in prices for metals, crude oil, cotton, and plywood. The Commodity Research Bureau's spot industrial commodity price index, which excludes energy and forest products, has increased 9.2 percent.

Like consumer price inflation, most broad measures of total price inflation have been boosted over the past year by accelerating energy prices, while broad measures of core price inflation have generally moved a bit lower. In particular, the four-quarter change in the GDP price index excluding food and energy was 1.3 percent in the second quarter, 0.2 percentage point below the pace recorded a year earlier.

According to the Michigan Survey, median year-ahead expected inflation fell back in early October to 2.4 percent, close to the average for the second and third quarters. Median expected consumer price inflation over the next five to ten years ticked up, to 2.8 percent, remaining in the narrow range that has

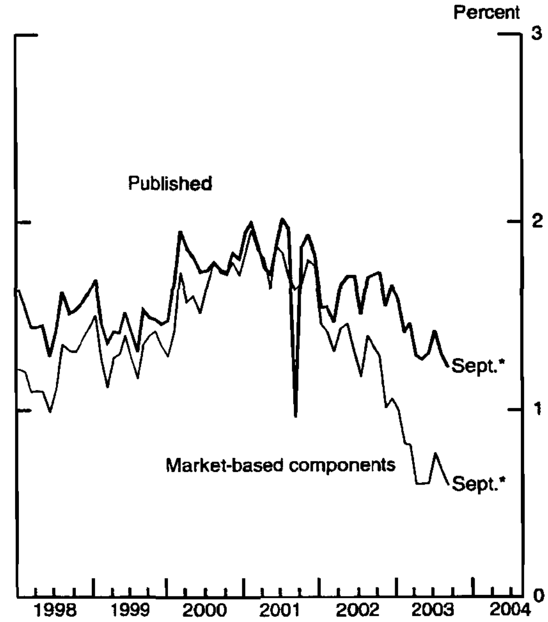
Core Consumer Price Inflation
(12-month change except where noted)

CPI and PCE excluding Food and Energy



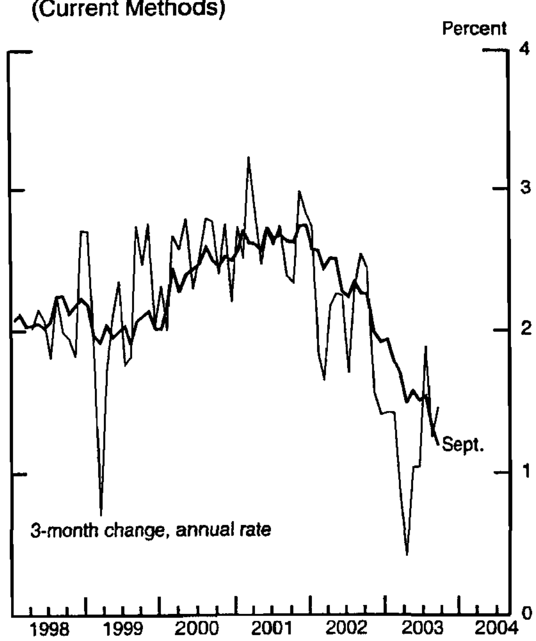
* PCE for September is staff estimate.

PCE excluding Food and Energy

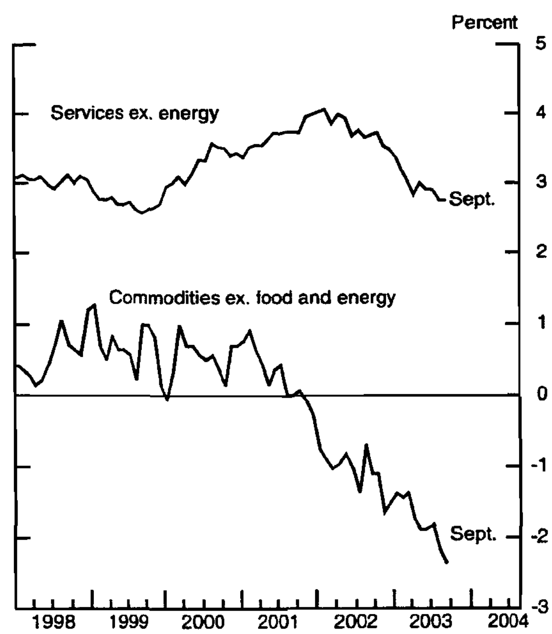


* Staff estimate.

CPI excluding Food and Energy (Current Methods)



CPI Services and Commodities



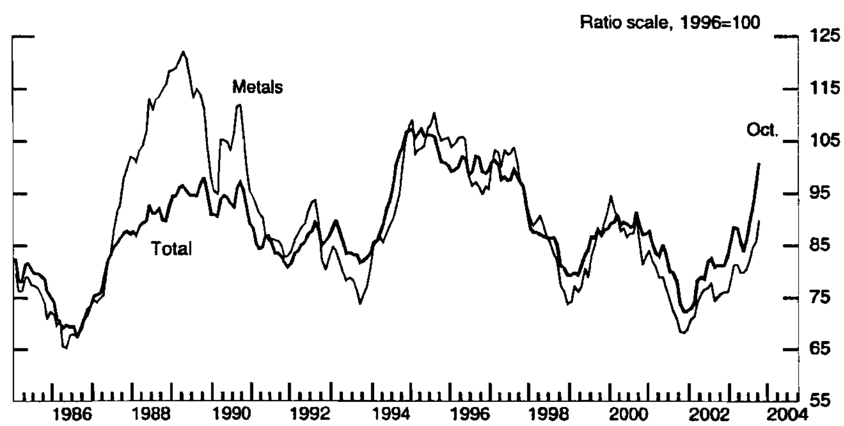
Spot Prices of Selected Commodities
(Percent change except as noted)

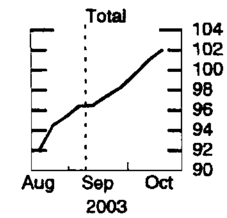
Commodity	Current price (dollars)	2001[1]	2002[1]	12/31/02 to 9/9/03[2]	9/9/03 to 10/21/03[2]	Memo: 52-week change to 10/21/03
Metals						
Copper (lb.)	0.910	-22.0	2.8	17.8	5.8	24.7
Steel scrap (ton)	130.667	-17.7	49.2	32.6	1.6	26.9
Aluminum, London (lb.)	0.680	-14.3	0.7	5.5	5.7	13.1
Precious metals						
Gold (oz.)	378.200	1.2	24.7	10.9	-1.1	21.0
Silver (oz.)	5.100	-3.5	3.0	9.7	-2.9	15.1
Forest products[3]						
Lumber (m. bdft.)	293.000	25.0	-13.0	73.0	-15.3	48.0
Plywood (m. sqft.)	550.000	3.2	-0.3	79.9	5.8	82.1
Petroleum						
Crude oil (barrel)	29.590	-16.3	65.8	-13.9	7.5	11.3
Gasoline (gal.)	0.884	-28.0	54.6	12.3	-7.0	10.6
Fuel oil (gal.)	0.831	-42.6	57.4	-13.0	10.4	11.0
Livestock						
Steers (cwt.)	108.990	-19.7	12.9	16.5	29.8	65.2
Hogs (cwt.)	36.000	-9.9	-18.9	31.7	-8.9	28.6
Broilers (lb.)	0.627	3.7	7.4	4.6	0.1	29.2
U.S. farm crops						
Corn (bu.)	2.025	-4.1	19.2	0.9	-12.5	-15.6
Wheat (bu.)	3.600	-8.9	30.4	-14.8	1.7	-29.3
Soybeans (bu.)	7.120	-13.4	35.6	9.1	16.4	34.7
Cotton (lb.)	0.705	-45.7	53.8	12.6	30.8	75.0
Other foodstuffs						
Coffee (lb.)	0.525	-35.3	1.1	32.6	-11.0	8.2
Memo						
JOC Industrials	102.000	-17.1	16.2	14.9	5.8	25.9
JOC Metals	90.900	-17.0	9.5	12.9	6.2	19.3
CRB Futures	244.790	-16.3	23.0	4.2	0.2	7.5
CRB Spot Industrials	294.730	-14.6	14.4	8.6	9.2	22.4

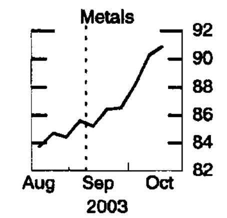
1. Changes are from the last week of the preceding year to the last week of the year indicated.
2. 9/9/03 is the Tuesday immediately preceding publication of the September Greenbook.
3. Prices shown apply to the Friday before the date indicated.

Commodity Price Measures

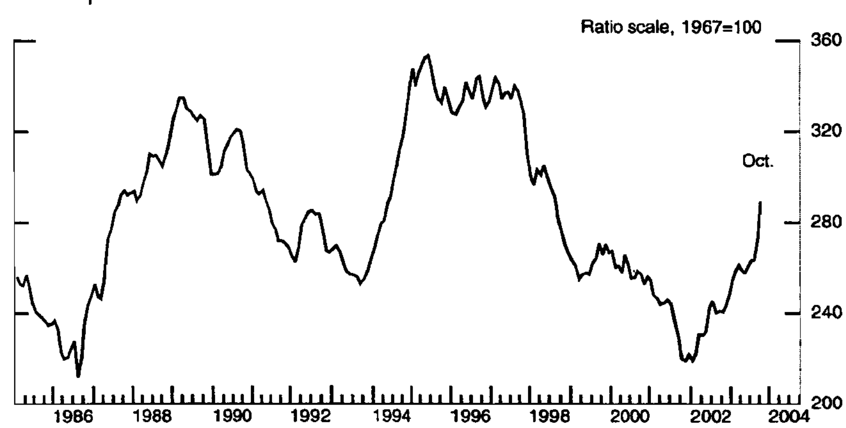
Journal of Commerce Index

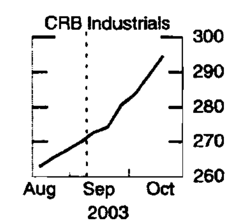




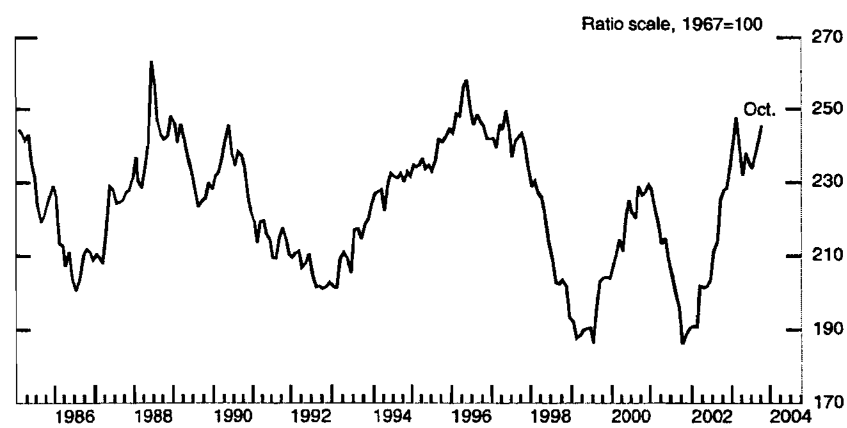


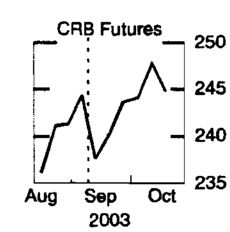
CRB Spot Industrials





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.

prevailed over the past two years. In September, the Philadelphia Fed published the most recent quarterly survey of professional forecasters' long-term inflation expectations, which remained unchanged at 2.5 percent.

We have received relatively little information about labor costs since the previous Greenbook. Average hourly earnings of production or nonsupervisory workers on private nonfarm payrolls edged down 0.1 percent in September, to a level 2.7 percent above a year earlier. That twelve-month increase was 0.2 percentage point less than during the previous twelve-month period and more than 1/2 percentage point below the pre-recession peak.

On benefits, the Survey of Employer-Sponsored Health Benefits conducted annually by the Kaiser Family Foundation and the Health Research and Educational Trust (HRET) showed that health insurance premiums increased nearly 14 percent, on average, between the spring of 2002 and the spring of 2003. The Kaiser/HRET survey also indicated that health insurance costs rose sharply for both employers and workers, with the share of premiums paid by covered workers holding virtually steady at 27 percent (for a family policy) in 2003. For 2004, premiums in the Federal Employees Health Benefits Program are expected to rise 10-1/2 percent, the fourth consecutive double-digit increase. Also, Towers Perrin has released some preliminary results from its survey for 2004, which show health insurance premiums increasing an average of 11 percent for active workers.

Broad Measures of Inflation
(4-quarter percent change)

Measure	Q2 2000	Q2 2001	Q2 2002	Q2 2003
Product prices				
GDP chain price index	2.1	2.5	1.1	1.5
Less food and energy	2.0	2.0	1.5	1.3
Nonfarm business chain price index [1]	1.8	2.0	.4	.9
Expenditure prices				
Gross domestic purchases chain price index	2.5	2.3	.9	1.7
Less food and energy	1.9	1.9	1.4	1.3
PCE chain price index	2.6	2.4	1.1	1.8
Less food and energy	1.8	1.8	1.7	1.3
PCE chain price index, market-based components	2.5	2.5	.8	1.3
Less food and energy	1.6	1.8	1.4	.6
CPI	3.3	3.4	1.3	2.2
Less food and energy	2.4	2.6	2.4	1.5
Chained CPI	n.a.	2.7	1.1	1.7
Less food and energy	n.a.	2.0	2.0	1.0
Median CPI	2.5	3.5	3.6	2.2
Trimmed mean CPI	2.4	2.8	2.2	1.9

1. Excluding housing.
n.a. Not available.

Surveys of Inflation Expectations
(Percent)

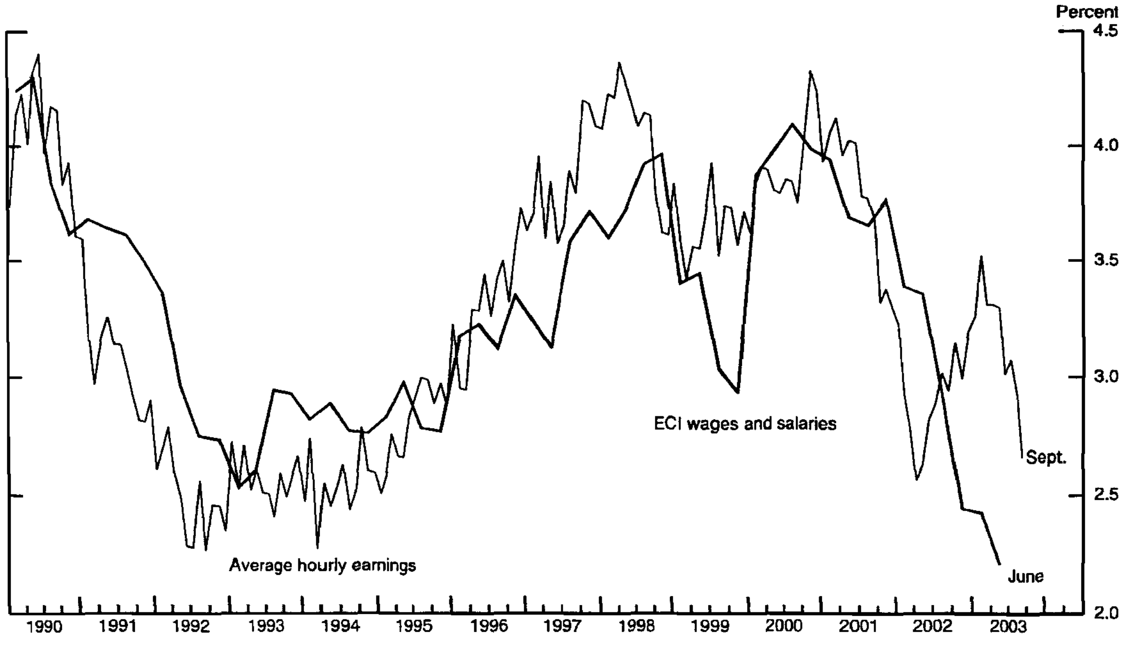
Period	Actual CPI inflation [1]	University of Michigan: 1 year [2] Mean	University of Michigan: 1 year [2] Median	University of Michigan: 5 to 10 years [3] Mean	University of Michigan: 5 to 10 years [3] Median	Professional forecasters (10-year) [4]
2001:Q4	1.9	1.5	1.1	3.1	2.8	2.6
2002:Q1	1.3	2.6	2.2	3.1	2.8	2.5
Q2	1.3	3.1	2.7	3.4	2.9	2.5
Q3	1.6	2.8	2.6	3.2	2.7	2.5
Q4	2.2	2.7	2.5	3.3	2.8	2.5
2003:Q1	2.9	3.2	2.8	3.0	2.7	2.5
Q2	2.1	2.6	2.2	3.1	2.7	2.5
Q3	2.2	2.8	2.3	3.1	2.7	2.5
2003:July	2.1	2.3	1.7	3.2	2.7	
Aug.	2.2	2.8	2.5	3.0	2.7	
Sept.	2.3	3.4	2.8	3.0	2.7	2.5
Oct.	n.a.	2.9	2.4	3.0	2.8	

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 average, during the next 12 months?
3. Responses to the question: By about what percent per year do you expect prices to go up, on average, during the next 5 to 10 years?
4. CPI projections compiled by the Federal Reserve Bank of Philadelphia.
n.a. Not available.

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

	12-month percent change			Percent change to Sept. 2003 from month indicated		Percent change	
	Sept. 2001	Sept. 2002	Sept. 2003	Mar. 2003	June 2003	Aug. 2003	Sept. 2003
	-Annual rate-					- Monthly rate-	
Total private nonfarm	3.7	2.9	2.7	2.1	1.8	0.2	-0.1
Manufacturing	3.5	3.2	3.0	2.6	3.1	0.4	0.3
Construction	2.4	3.4	2.0	2.0	1.3	0.2	0.2
Wholesale trade	2.6	1.2	2.1	2.2	1.6	0.2	0.1
Retail trade	3.7	3.5	2.0	2.2	2.0	0.2	0.0
Transportation and warehousing	2.0	2.6	3.3	1.6	1.2	-0.2	-0.1
Information	3.7	2.7	3.6	2.5	0.6	0.3	-0.8
Financial activities	3.9	4.6	5.3	5.9	2.4	0.1	-0.4
Professional and business services	5.2	2.6	2.0	0.2	0.0	0.1	-0.2
Education and health services	4.8	4.1	3.0	2.4	3.9	0.4	0.3
Leisure and hospitality	2.3	2.6	1.9	1.2	0.9	0.0	0.1
Other services	4.4	3.1	1.4	-0.3	0.6	0.1	0.1

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



Appendix

The Household and Payroll Measures of Employment

Each month, the Bureau of Labor Statistics (BLS) publishes two independent estimates of employment. The payroll employment measure is based on a survey of establishments conducted as part of the Current Employment Statistics program, and the household measure of employment is based on a survey of households called the Current Population Survey. The payroll survey estimates the number of employees on nonfarm payrolls based on a sample of about 400,000 establishments that account for about one-third of total nonfarm payroll employment. Each year, the payroll employment estimates are benchmarked to a near-universe count of payroll employment that is taken in March of the previous year from unemployment insurance tax records and other administrative data. In contrast, the household survey estimates the number of persons with a job by interviewing approximately 60,000 households. The household survey figures are inflated by monthly estimates of the population to generate estimates of national employment and unemployment. Although the raw household survey data are not revised, the population estimates used to inflate them are occasionally updated to incorporate new information from decennial censuses and new estimates of immigration.

The two measures differ importantly in concept. First, the payroll survey tallies jobs, whêreas the household survey counts the number of individuals with a job. Thus, a person who holds multiple jobs at different establishments would appear more than once in the payroll survey but only once in the household survey. In addition to covering wage and salary workers on nonfarm payrolls, the household survey's measure of employment includes unincorporated self-employed individuals, workers in private households, unpaid family workers, workers on unpaid absences, and farm employees, all of whom are excluded from the payroll records of nonfarm establishments. At the same time, the payroll survey includes wage and salary workers under the age of 16; these workers are excluded from the household survey.

The BLS has made major changes to both employment surveys over the past decade. Over the past several years, the payroll survey methodology has shifted from an archaic, quota-sampling procedure to a probability sample of establishments. In 1994, a major redesign of the household survey sharpened the clarity of its questions and improved the interviewing techniques used in the survey. In addition, the household survey adopted the North American Industrial Classification System (NAICS) for its industrial and occupational classifications in January 2003; the payroll survey estimates were converted to NAICS in June 2003. How such changes may have altered the comparability of the two measures of employment or their cyclical characteristics is not known.

Reconciling the Levels of the Two Employment Measures

Each month, the Board's staff adjusts household employment to the concept underlying the payroll survey insofar as the available data allow (table). We also incorporate estimates of the updates to the population controls over the historical period to which they apply.[1] Although these adjustments, on net, reduce the level of household employment and narrow the discrepancy in the levels of the reported series, the difference remains large (chart 1).

Over time, the discrepancy between the adjusted household measure and the payroll measure has had two components: one secular and one cyclical. The secular component has tended to expand as monthly household estimates progressively extend beyond the most recent update to Census population controls. Indeed, before the incorporation (in January 2003) of the new controls for the 2000 decennial Census and the annual update to the population estimates for immigration, the average monthly discrepancy was around 4.1 million. The updates to the population estimates eliminated about 60 percent of that gap.

Regarding cyclical behavior, the payroll series has historically been more pro-cyclical than the adjusted household series. In the past, the inability of the payroll survey to adequately capture births and deaths of establishments as they occurred contributed to its cyclical pattern during the periods between annual benchmarks. But even after benchmarking, it remained more pro-cyclical than the household measure, and researchers have not been fully able to explain why this is so. Among the possible explanations is an increase during periods of weak labor markets in work "off the books" of establishments, which might cushion the reported decline in household employment relative to the payroll measure. Another contributing factor may be related to the procedures for dealing with persons who do not respond to the household survey either because they refuse to participate or because the interviewers cannot reach them. Those procedures assume that the labor force characteristics of the nonrespondents are the same as those for persons in a similar demographic group who are interviewed. If those missed tend to be marginal workers who are less likely to be employed during weak labor markets and more likely to hold jobs when employment is expanding, the procedures would dampen the cyclicality of household employment. Finally, the expanded use of multiweek pay periods may result in workers appearing on the payrolls of more than one establishment, and thus as employed more than once in the payroll survey— particularly when hiring is robust and workers are changing jobs more often. Such job changers would be counted as employed at only one job in the household survey, which measures labor force activity during a single reference week during the month.

Another unresolved issue in reconciling the two employment measures is an apparent break in the level of the gap between the two series. That break seems to coincide with the introduction of the new household survey in 1994. Before 1994, the discrepancy between the adjusted household series and the payroll series tended to fluctuate widely but averaged close to zero; since then, the gap, while still seemingly cyclical, has been persistently negative—that is, the level of the adjusted household series has been below that of the payroll series.

1. The BLS typically does not revise its historical data to reflect updates to the population controls; this omission can result in a noticeable break in the official time series, as it did in January 2003.

Differences in Employment Changes Indicated by the Two Measures
More recently, attention has focused not on the levels of the two measures but on their divergent signals of the change in employment. For example, between the most recent recession trough (November 2001) and September 2003, the payroll survey showed a decline of roughly 1 million jobs, while the official household survey indicated a rise of 1 million; the increase in our adjusted household series was even larger—1-1/4 million.[2] That said, the labor market by either measure has been very weak during the past twenty-two months—with employment even somewhat weaker than during the recovery from the 1990-91 recession and much weaker than in earlier economic expansions (chart 2).

Two upcoming revisions to the series are likely to change those estimates, and whether they will, on net, narrow the difference between the two is unclear. First, the BLS recently reported that its preliminary tabulations of employment from first-quarter unemployment insurance tax records imply a downward revision of approximately 145,000 in the level of payroll employment for March 2003; those revisions are scheduled for release with the preliminary estimates for January 2004. Taken alone, that change would increase the discrepancy between the changes indicated by the two employment measures. However, at the same time, the household survey figures will be adjusted to new population controls that incorporate information on immigration in the period since 2000. Because we believe that immigration has slowed recently, we anticipate that the upcoming adjustment may lower the estimate of the population and of its future rate of change and, thus, result in a lower reported level of household employment. The magnitude of this change is uncertain, but assuming that it goes in the direction that we anticipate, it also would tend to reduce the recent increase in household employment over the period since the recession trough.

The Two Surveys as Economic Indicators
Each of the two surveys has strengths and weaknesses as an indicator of economic activity. The principal advantage of the household survey is that it provides a broader view of employment than does the payroll survey. However, measurement of many of the components of household survey employment that are missing from the payroll concept may be subject to greater nonsampling reporting error than the components that the two surveys have in common. In addition, unlike the payroll estimates, the monthly estimates from the household survey are not revised, and the sampling variation of the household survey is noticeable. The approximate standard error for the month-to-month change in household employment is 177,000.[3] By comparison, before its recent major redesign, the root mean squared error of the month-to-month change in payroll employment was about 65,000. Finally, as noted earlier, the household survey

2. Changes in employment over shorter periods also diverge widely. In September 2003, the adjusted household survey was down 847,000 from its year-earlier level while payroll employment was 427,000 lower—a difference of 420,00. In June, the adjusted household figures showed an *increase* of 780,000 from a year earlier while payroll employment was estimated to have fallen 480,000—a difference of more than 1 million.

3. Information on the statistical characteristics of the two surveys is routinely available in an appendix, "Explanatory Notes and Estimates of Error," to the monthly *Employment and Earnings* volume published by the BLS.

questionnaire was redesigned in 1994. Although researchers have developed a good understanding of how to bridge the old and new series, we do not know to what extent the cyclical properties of the household measures of labor market activity may have changed.

On balance, the Board's staff has found the payroll survey to be the more reliable indicator of current economic activity, although it also has a number of disadvantages as a current indicator. For example, the monthly revisions to the preliminary estimates of payroll employment have tended to be pro-cyclical. And, as noted earlier, before the recent redesign of the sample, preliminary payroll survey estimates were subject to large and systematic benchmark revisions. Before the changeover to the new sample, benchmark revisions to payroll employment were generally positively correlated with both the change in payroll employment and with whether it was accelerating or decelerating. They also tended to be positively serially correlated. Thus, the upcoming March 2003 adjustment of -145,000 is not necessarily surprising because payroll employment was declining, on balance, over the period from March 2002 to March 2003.[4] The recent statistical improvements in the payroll survey were, in part, intended to improve its ability to estimate employment between benchmarks; whether the redesign will, over time, alter these earlier systematic patterns is unclear.

We also found that benchmark revisions to the change in payroll employment were not correlated with changes in household employment when information on initial claims for unemployment insurance was used to control for the stage of the business cycle. In a recent report to the House Budget Committee, John Kitchen reports the opposite result.[5] However, because he did not control for the stage of the business cycle and included only early stages of recoveries in his sample, we believe that he may be picking up a spurious correlation in which the less-cyclically-sensitive household survey may be acting as a proxy for the stage of the cycle. He also did not adjust, as we do in our empirical work, for the discontinuities in the household survey when new population controls are introduced.

4. The March 2003 revision will be small by historical standards—0.1 percent compared with an average absolute revision of 0.3 percent over the preceding ten years.

5. John Kitchen, "A Note on the Observed Downward Bias in Real-Time Estimates of Payroll Jobs Growth in Early Expansions," U.S. House of Representatives, Committee on the Budget, August 2003 (mimeo.).

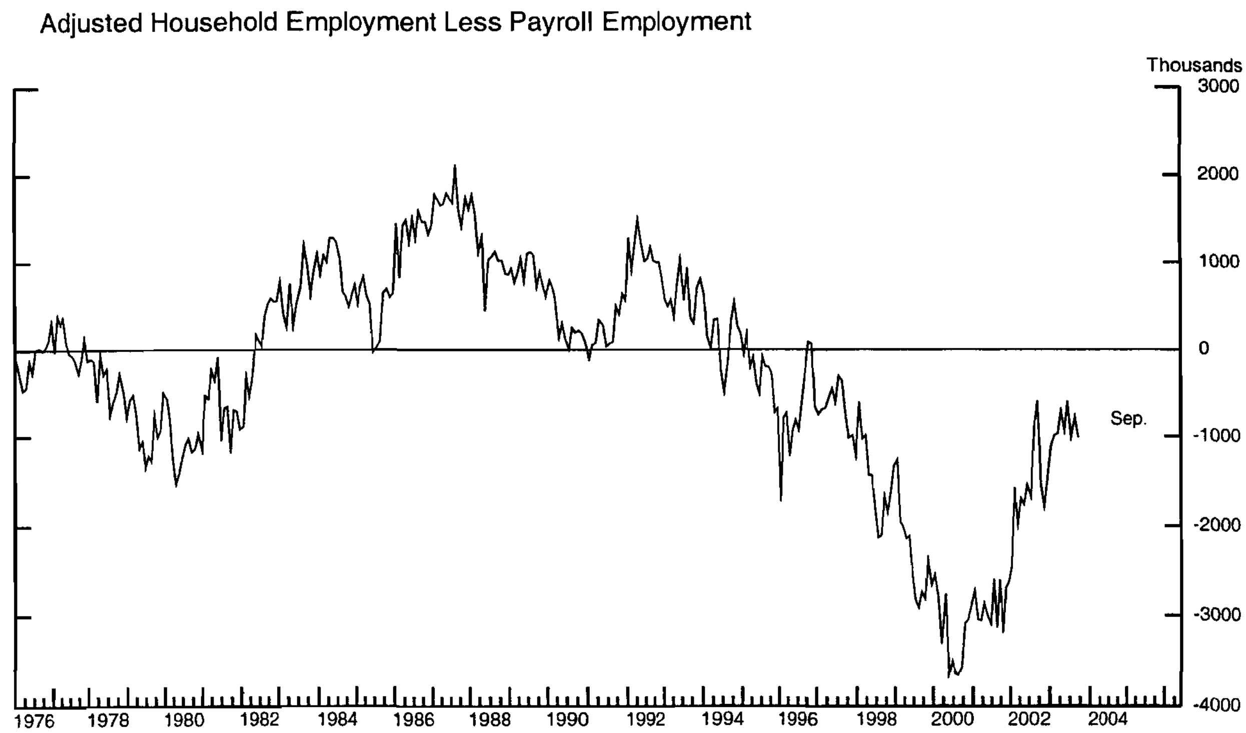
RECONCILIATION OF HOUSEHOLD AND PAYROLL EMPLOYMENT
(Seasonally adjusted, in thousands)

			Adjustments									Memo
			Less				Plus					
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
2001: Sept.	131,550	137,184	2,353	9,069	796	1,978	5,126	410	423	128,949	2,601	136,858
Oct.	131,198	136,714	2,366	9,022	878	2,042	4,792	383	421	128,003	3,195	136,370
Nov.	130,900	136,580	2,245	8,913	901	1,925	4,807	385	422	128,210	2,690	136,218
Dec.	130,661	136,447	2,297	8,955	942	1,914	4,894	392	409	128,033	2,628	136,067
2002: Jan.	130,578	136,189	2,380	8,714	879	1,775	4,892	391	406	128,131	2,447	135,791
Feb.	130,510	136,867	2,356	8,746	853	1,723	4,949	396	408	128,942	1,568	136,450
Mar.	130,481	136,578	2,349	8,702	832	1,947	4,942	395	411	128,496	1,985	136,143
Apr.	130,415	136,649	2,350	8,773	835	1,838	5,065	405	403	128,726	1,689	136,196
May	130,411	136,958	2,247	8,875	792	2,071	4,884	391	401	128,649	1,762	136,487
June	130,383	136,872	2,185	8,865	881	1,979	5,073	406	403	128,844	1,539	136,383
July	130,204	136,850	2,330	8,946	871	1,979	5,001	400	401	128,527	1,677	136,343
Aug.	130,224	137,282	2,178	9,015	848	1,685	4,970	398	400	129,324	900	136,757
Sept.	130,289	137,855	2,324	9,084	844	1,764	5,045	404	409	129,698	591	137,312
Oct.	130,408	137,549	2,493	9,117	894	1,928	4,953	396	408	128,875	1,533	136,988
Nov.	130,409	137,122	2,324	9,314	908	1,689	4,945	396	397	128,623	1,786	136,542
Dec.	130,198	137,037	2,352	9,290	810	1,840	5,174	414	393	128,726	1,472	136,439
2003: Jan.	130,356	137,536	2,314	9,444	748	1,733	5,145	412	389	129,243	1,113	137,536
Feb.	130,235	137,408	2,178	9,258	729	1,985	5,197	416	383	129,254	981	137,408
Mar.	130,084	137,348	2,227	9,181	778	1,845	5,026	402	370	129,115	969	137,348
Apr.	130,062	137,687	2,128	9,139	818	1,986	4,965	397	376	129,354	708	137,687
May	129,986	137,487	2,157	9,065	851	2,081	4,951	396	375	129,055	931	137,487
June	129,903	137,738	2,213	9,250	958	1,872	5,084	407	371	129,307	596	137,738
July	129,846	137,478	2,193	9,306	1,019	1,966	5,073	406	369	128,842	1,004	137,478
Aug.	129,805	137,625	2,348	9,538	975	1,769	5,238	419	378	129,029	776	137,625
Sept.	129,862	137,573	2,362	9,394	895	1,816	4,976	398	371	128,851	1,011	137,573
Memo: Change over the 12 months ending September 2003												
	-427	-282	38	310	51	52	-69	-6	-39	-847	420	261

(1) Nonfarm payroll employment.
(2) Household employment, corrected for updates to population.
(3) Agriculture.
(4) Self-employed.
(5) Unpaid family and private household.
(6) Unpaid absences.
(7) Multiple job holders who are nonfarm, nonprivate household, wage and salary workers on their secondary jobs.
(8) Estimate of jobs beyond secondary held by multiple job holders.
(9) Estimate of 15-year-old wage and salary workers.
(10) Adjusted household.
(11) Nonfarm payroll minus adjusted household.
(12) Household employment, as published.

Chart 1

Comparison of Household and Payroll Employment Measures



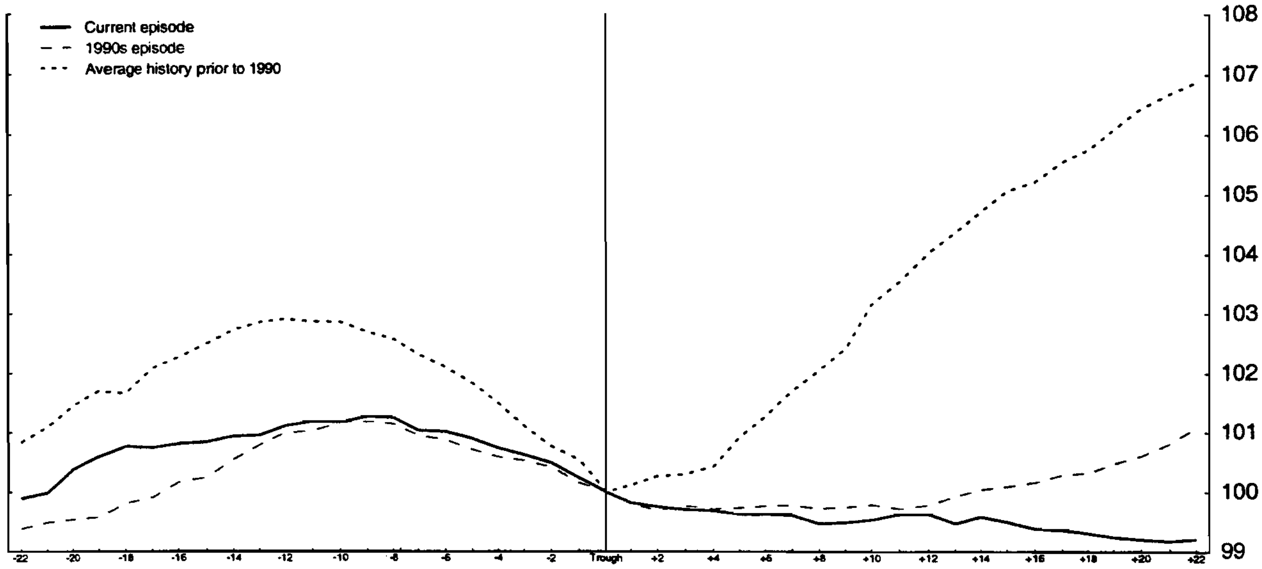
Note. Shaded bars are periods of recession.

Chart 2

Cyclical Comparisons of Payroll and Household Employment

Payroll Employment

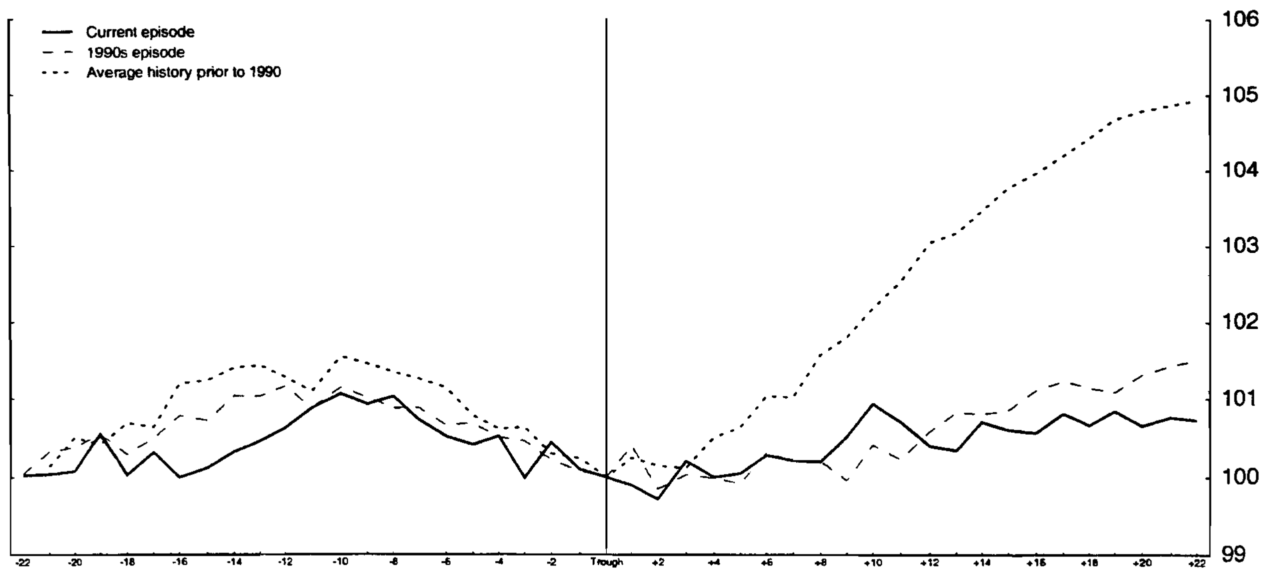
Index, trough = 100



Note. Current episode trough is 2001m11; historical troughs included are 1949m10, 1954m5, 1958m4, and 1961m2, 1970m2, 1975m3, 1980m7, 1982m11, and 1991m3.

Household Employment (Adjusted for Population Breaks)

Index, trough = 100



Note. Current episode trough is 2001m11; historical troughs included are 1949m10, 1954m5, 1958m4, and 1961m2, 1970m2, 1975m3, 1980m7, 1982m11, and 1991m3.

Domestic Financial Developments

Selected Financial Market Quotations

(One-day quotes in percent except as noted)

Instrument	2001	2003			Change to Oct. 21 from selected dates (percentage points)		
	Sept. 10	June 24	Sept. 15	Oct. 21	2001 Sept. 10	2003 June 24	2003 Sept. 15
Short-term							
FOMC intended federal funds rate	3.50	1.25	1.00	1.00	-2.50	-.25	.00
Treasury bills [1]							
3-month	3.19	0.81	0.94	0.91	-2.28	.10	-.03
6-month	3.13	0.82	1.01	1.02	-2.11	.20	.01
Commercial paper (A1/P1 rates)							
1-month	3.42	0.91	1.01	1.02	-2.40	.11	.01
3-month	3.24	0.88	1.03	1.04	-2.20	.16	.01
Large negotiable CDs [1]							
1-month	3.46	0.96	1.07	1.06	-2.40	.10	-.01
3-month	3.26	0.93	1.08	1.11	-2.15	.18	.03
6-month	3.24	0.92	1.12	1.16	-2.08	.24	.04
Eurodollar deposits [2]							
1-month	3.41	0.94	1.06	1.05	-2.36	.11	-.01
3-month	3.26	0.91	1.09	1.11	-2.15	.20	.02
Bank prime rate	6.50	4.25	4.00	4.00	-2.50	-.25	.00
Intermediate- and long-term							
U.S. Treasury [3]							
2-year	3.59	1.14	1.64	1.89	-1.70	.75	.25
10-year	5.14	3.46	4.45	4.54	-.60	1.08	.09
30-year	5.55	4.53	5.34	5.37	-.18	.84	.03
U.S. Treasury 10-year indexed note	3.28	1.70	2.17	2.13	-1.15	.43	-.04
Municipal revenue (Bond Buyer) [4]	5.25	4.89	5.32	5.34	.09	.45	.02
Private instruments							
10-year swap	5.62	3.67	4.73	4.76	-.86	1.09	.03
10-year FNMA [5]	5.68	3.84	4.84	4.89	-.79	1.05	.05
10-year AA [6]	6.30	4.13	5.14	5.19	-1.11	1.06	.05
10-year BBB [6]	7.11	5.16	5.99	5.98	-1.13	.82	-.01
High-yield [7]	12.72	9.03	9.02	8.51	-4.21	-.52	-.51
Home mortgages (FHLMC survey rate) [8]							
30-year fixed	6.89	5.21	6.16	6.05	-.84	.84	-.11
1-year adjustable	5.64	3.51	3.87	3.79	-1.85	.28	-.08

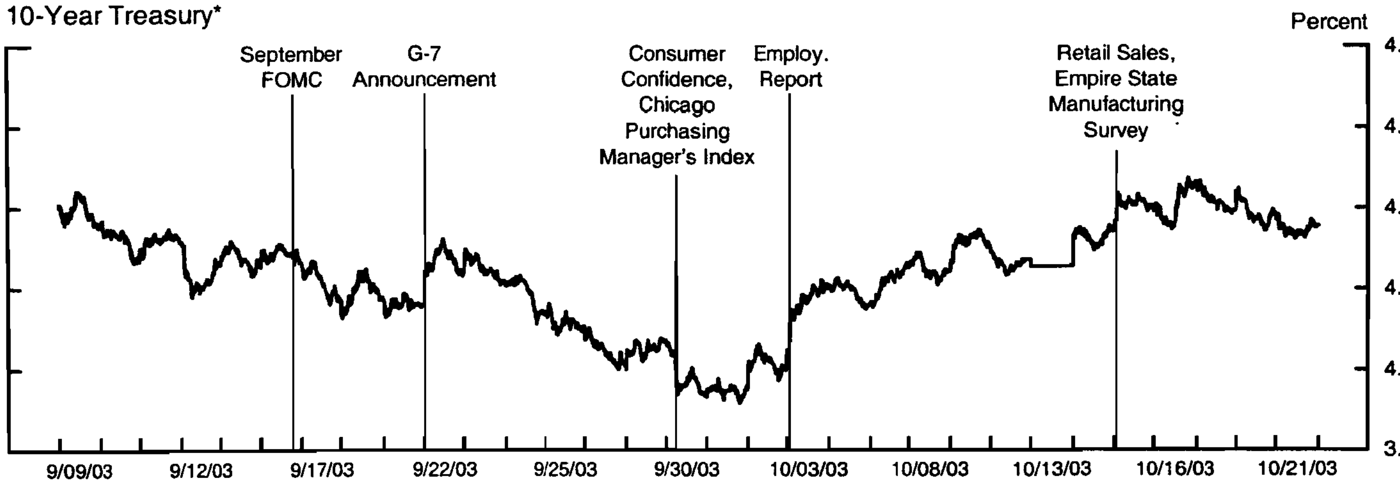
Stock exchange index	Record high		2003			Change to Oct. 21 from selected dates (percent)		
	Level	Date	June 24	Sept. 15	Oct. 21	Record high	2003 June 24	2003 Sept. 15
Dow-Jones Industrial	11,723	1-14-00	9,110	9,449	9,748	-16.85	7.00	3.16
S&P 500 Composite	1,527	3-24-00	983	1,015	1,046	-31.52	6.36	3.08
Nasdaq (OTC)	5,049	3-10-00	1,606	1,846	1,941	-61.56	20.88	5.16
Russell 2000	606	3-9-00	441	508	526	-13.30	19.20	3.52
Wilshire 5000	14,752	3-24-00	9,388	9,843	10,165	-31.09	8.27	3.27

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.

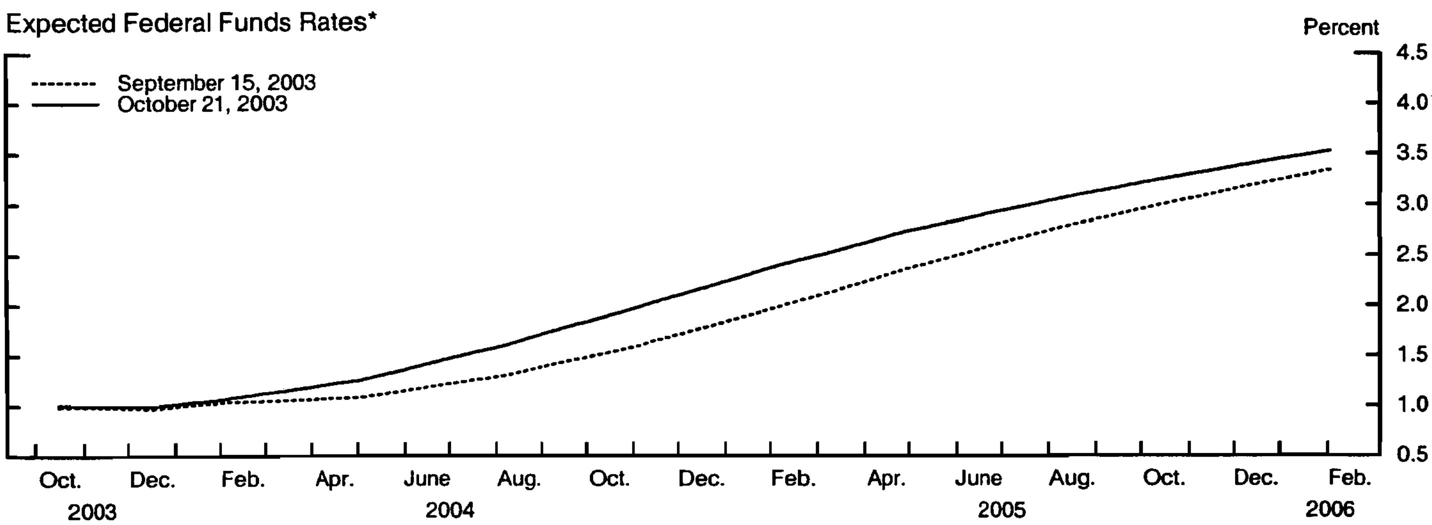
NOTES:

September 10, 2001 is the day before the terrorist attacks.
June 24, 2003 is the day before the most recent policy easing.
September 15, 2003 is the day before the most recent FOMC meeting.

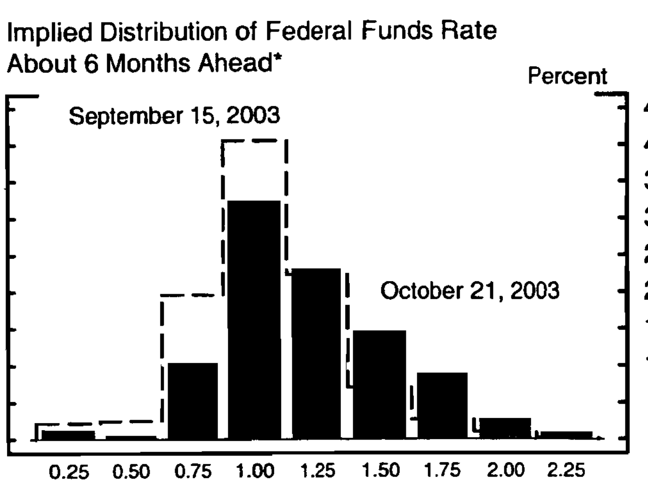
Interest Rates and Policy Expectations



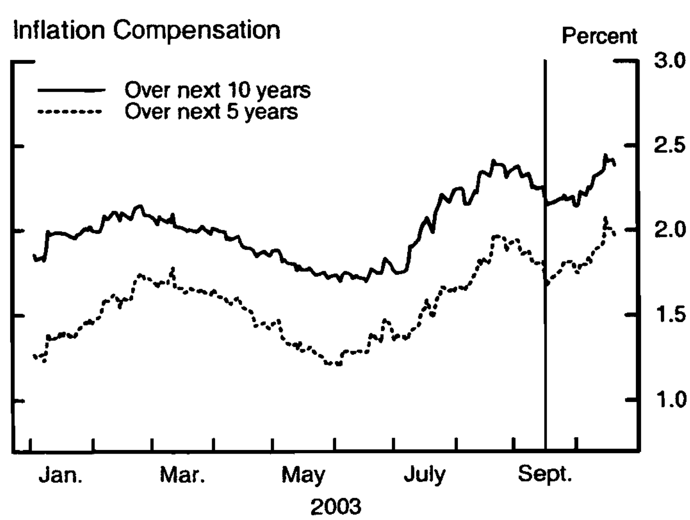
*On-the-run issue, 5-minute intervals.



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



*Based on the distribution of the three-month eurodollar rate five months ahead (adjusted for a risk premium), as implied by options on eurodollar futures contracts.



Note. Vertical line indicates September FOMC meeting.

Domestic Financial Developments

Overview

Generally favorable economic data and earnings news contributed to a more optimistic tone in financial markets over the intermeeting period. Investors marked up the expected path for policy, and Treasury and high-grade private yields rose. Signs of strengthening economic activity led to an appreciable narrowing of risk spreads, pushing down borrowing costs for many mid- to lower-tier corporate credits. In addition, equity prices were buoyed by third-quarter profits that generally beat analysts' expectations.

Corporate bond issuance stepped up in September, but the runoff of short-term debt continued, leaving overall business borrowing lackluster. Household borrowing has held up well despite a notable drop-off in mortgage refinancing activity. Federal borrowing has continued at a brisk pace, driven by elevated military expenditures and sluggish tax revenues. In addition, state and local governments continued to issue substantial amounts of debt to finance capital projects.

Policy Expectations and Treasury Yields

Investors marked up the expected path for policy substantially over the period, largely on a string of better-than-expected economic releases in October as well as on comments by Federal Reserve officials that led investors to anticipate an earlier onset of policy tightening. Current money market futures quotes suggest that market participants are confident that the FOMC will not change policy at its October meeting. Futures quotes further out on the curve imply that investors now place considerable odds on a quarter-point tightening by the middle of next year. Consistent with the upward revision in policy expectations, nominal Treasury coupon yields rose about 10 to 25 basis points. Market-based measures of inflation compensation increased about as much as nominal yields, although survey-based measures of inflation expectations were little changed.

Stock Prices and Corporate Yields

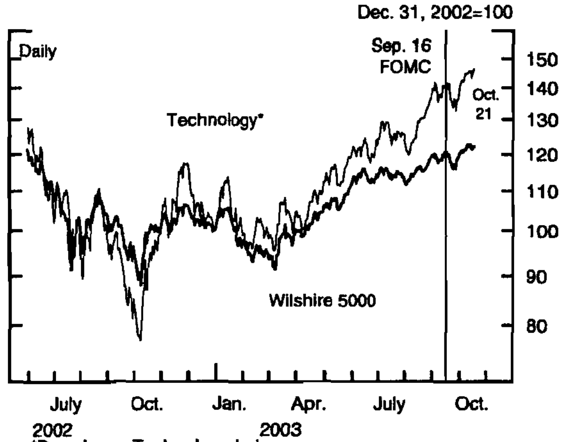
Broad equity price indexes rose about 3 percent over the intermeeting period, with many touching new highs for the year. Market volatility was low, and options prices indicated that investors expect volatility to remain subdued. Technology-sector stock prices outpaced the broader market, keeping the forward price-earnings ratio for this sector well above the P-E ratios for nontech firms. The forward-earnings yield on the entire S&P 500 continued to hover at about 5-3/4 percent, and its gap over the real Treasury yield remained steady as well. This measure of the equity premium falls squarely within its range prior to the run-up in stock prices in the late 1990s.

Yields on investment-grade corporate bonds rose slightly less than yields on longer-dated Treasuries, leaving risk spreads for these securities a touch lower.

10/22/03

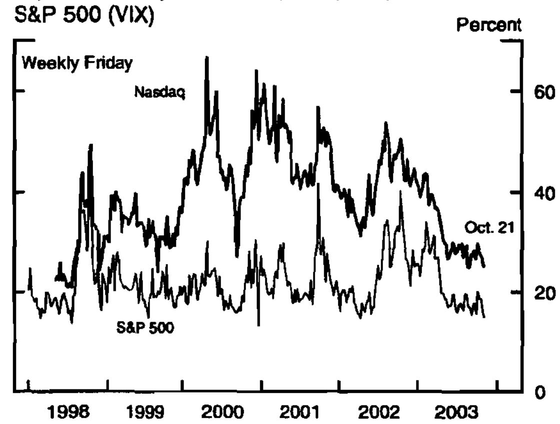
Stock Prices and Corporate Risk Spreads

Stock Prices

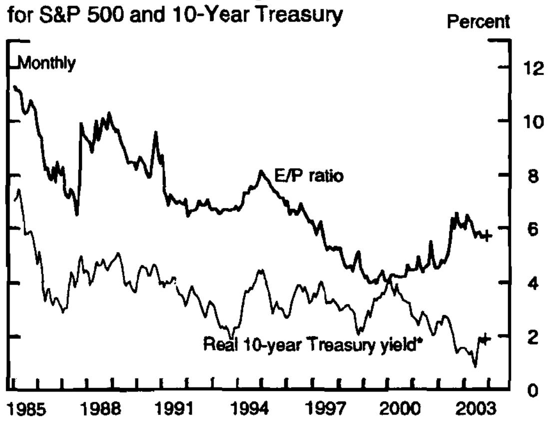


*Dow Jones Technology Index

Implied Volatility on Nasdaq 100 (VXN) and S&P 500 (VIX)

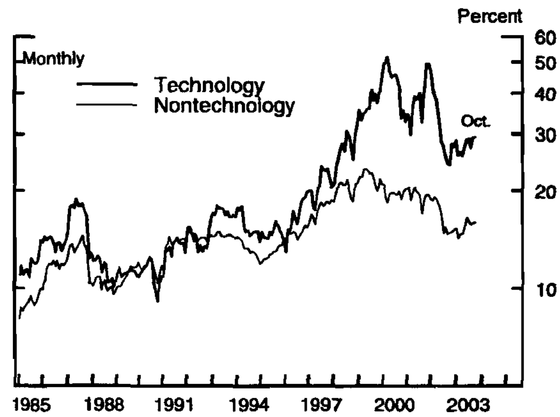


12-Month Forward Earnings-Price Ratio for S&P 500 and 10-Year Treasury



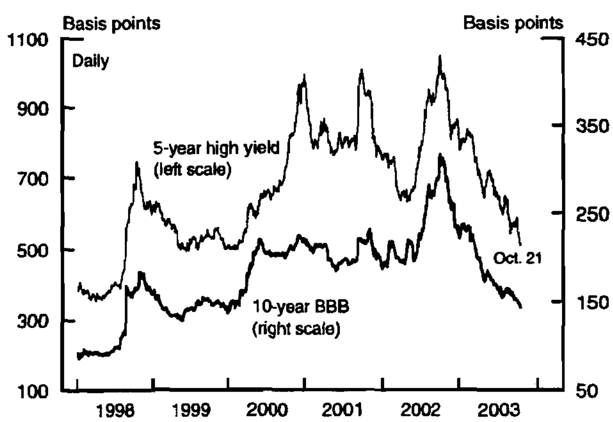
* 10-year Treasury yield minus Philadelphia Fed 10-year expected inflation.
+ Denotes the latest observation using daily interest rates and stock prices and latest earnings data from I/B/E/S.

Selected S&P 500 Price-Earnings Ratios*

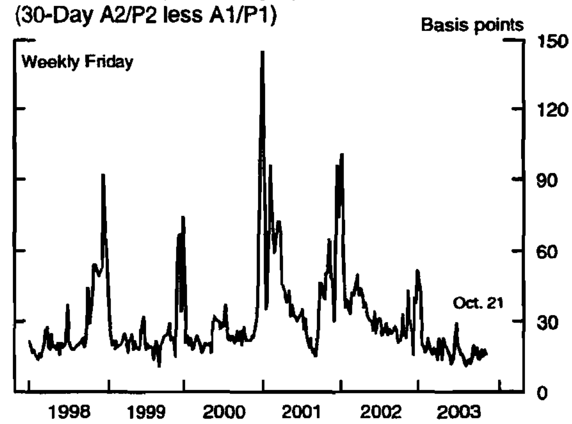


*Using expected earnings for twelve months ahead
Source: I/B/E/S.

Corporate Bond Spreads to Similar Maturity Treasury



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



Yields on speculative-grade bonds further extended their recent declines, slipping about another 50 basis points and significantly narrowing their spreads against Treasuries.

Corporate Earnings and Credit Quality
To date, reports on third-quarter S&P 500 earnings suggest that profits increased markedly, far surpassing analysts' already optimistic forecasts, on balance. Seasonally adjusted earnings per share are estimated to have jumped roughly 10 percent at a quarterly rate from the second quarter. Overall, guidance for the fourth quarter has also been favorable, even if somewhat cautious, and earnings forecasts for 2003 and 2004 inched higher in September and October.

On the basis of dividend announcements thus far, the annual indicated dividend per share of the S&P 500 has risen more than 10 percent since the end of 2002. Although some of the increases likely reflect a response to the dividend tax cut, the breadth of the advance may be a sign of the corporate sector's growing confidence in a sustained profit recovery. Announcements of new share repurchase programs also jumped in the third quarter, but are running a bit below the previous year's pace.

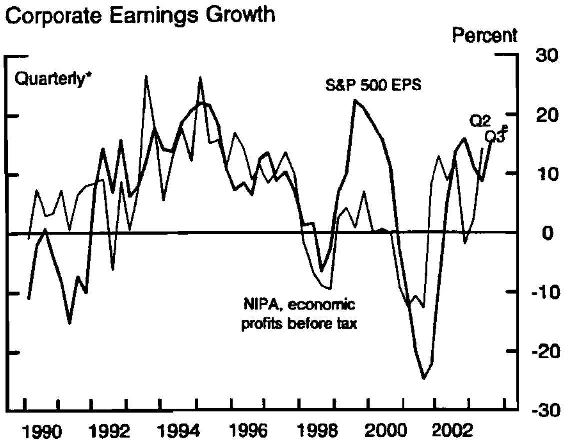
Bond rating downgrades of nonfinancial corporations remained modest in September and were almost matched by upgrades, a substantial improvement from the first half of this year. The trailing six-month bond default rate remained at around 1 percent. The forecast of aggregate year-ahead default probability, however, continued to fall as broad equity prices improved moderately and market volatility declined.

Business Finance
Bond issuance by nonfinancial corporations bounced back in September after a lull in July and August. The pickup was especially pronounced in the investment-grade sector, but speculative-grade issuance was also robust. With much of the proceeds from bond offerings earmarked to retire other debt, short- and intermediate-term credit once again was paid down, as reflected in the contractions in both commercial paper and C&I loans. However, the most recent Senior Loan Officer Opinion Survey on Bank Lending Practices indicated that this weakening in C&I loan demand may be diminishing. For the third quarter as a whole, total net debt financing appears to have run at a roughly zero rate as strong earnings and a buildup of cash assets from strong borrowing earlier this year may have reduced the demand for funds. However, data for the first half of October suggest that net debt financing has risen a bit.

Presumably supported by stock price increases this summer, gross issuance of public equity by nonfinancial firms totaled $6-1/2 billion in September, the

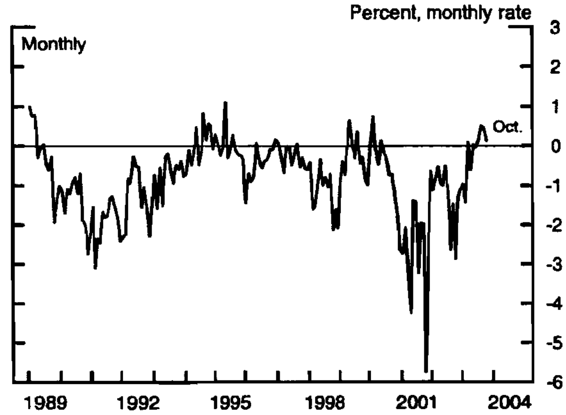
Corporate Credit Quality and Earnings

Corporate Earnings Growth



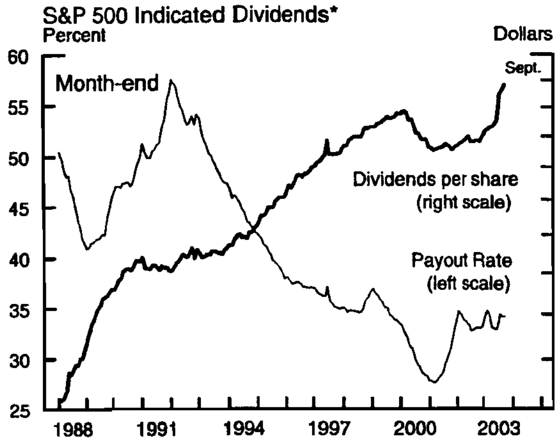
e Analysts' estimate as of August 29.
* Change from 4 quarters earlier.
Source. I/B/E/S for S&P 500 EPS.

S&P 500 EPS Revisions Index



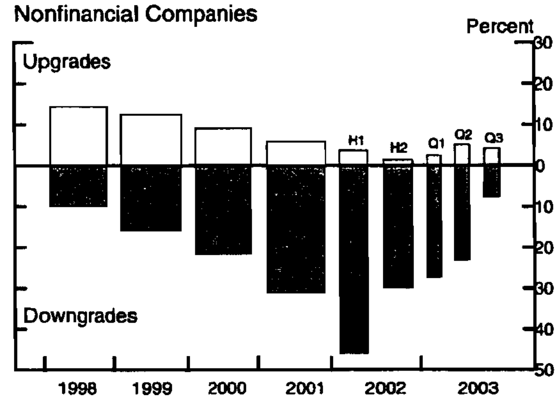
Note. Index is a weighted average of the percent change in the consensus forecasts of current-year and following-year EPS.

S&P 500 Indicated Dividends*



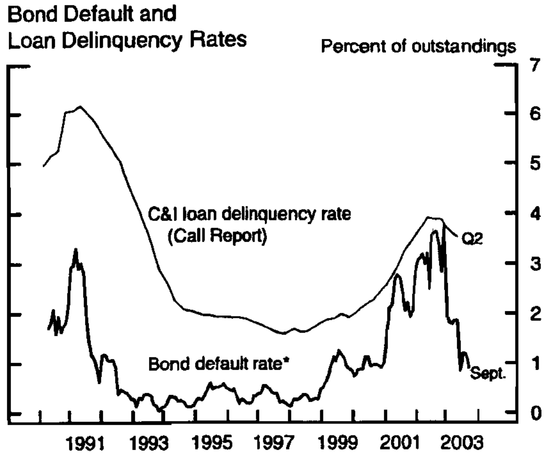
*Annual dividends per share based on firms'most recent announcements
Source: Standard & Poor

Ratings Changes of Nonfinancial Companies



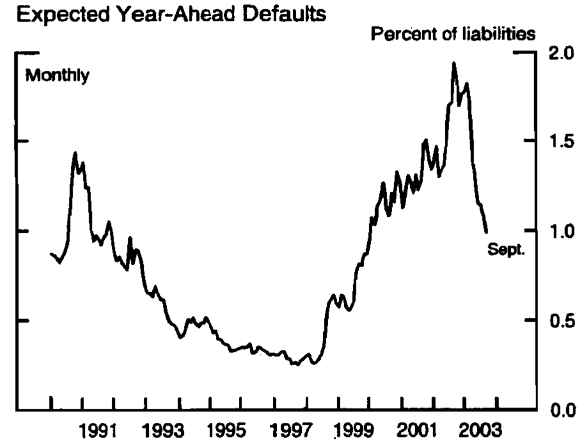
Note. Data are at an annual rate. Debt upgrades and downgrades as a percentage of par value of all bonds outstanding.
Source. Moody's Investors Service.

Bond Default and Loan Delinquency Rates



*6-month moving average, from Moody's Investors Service.

Expected Year-Ahead Defaults



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

Business Finance

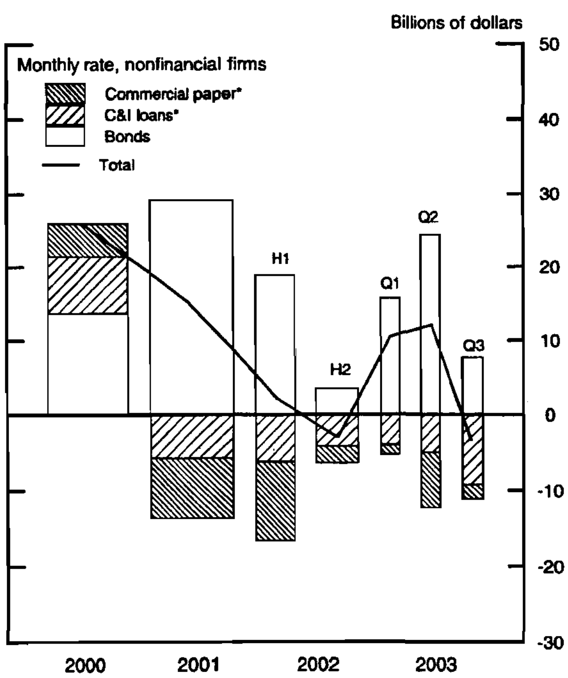
Gross Issuance of Securities by U.S. Corporations

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

Type of security	2000	2001	2002 H1	2002 H2	2003 H1	2003 July	2003 Aug.	2003 Sept.
Nonfinancial corporations								
Stocks [1]	9.9	6.5	7.4	2.9	2.8	3.3	2.0	6.6
Initial public offerings	4.4	2.1	1.2	0.3	0.0	1.0	0.0	1.1
Seasoned offerings	5.5	4.4	6.3	2.6	2.8	2.3	1.9	5.5
Bonds	22.7	39.8	31.7	17.8	36.3	28.4	17.6	32.3
Investment grade [2]	13.2	27.5	19.8	11.6	20.0	7.2	5.4	18.1
Speculative grade [2]	4.7	8.9	6.4	3.3	11.5	18.0	8.1	10.5
Other (sold abroad/unrated)	4.9	3.4	5.6	2.9	4.9	3.2	4.1	3.6
Memo								
Net issuance of commercial paper [3]	4.5	-8.0	-10.4	-2.2	-4.3	5.4	2.2	-7.8
Change in C&I loans at commercial banks [3]	7.8	-5.7	-6.2	-4.2	-7.5	11.7	-4.6	-19.3
Removing FIN 46 effects						*-6.5*	*-3.0*	*-18.2*
Financial corporations								
Stocks [1]	1.4	4.2	4.2	3.8	6.0	6.0	5.8	6.0
Bonds [4]	57.8	80.2	90.0	83.9	106.3	88.8	89.5	126.8

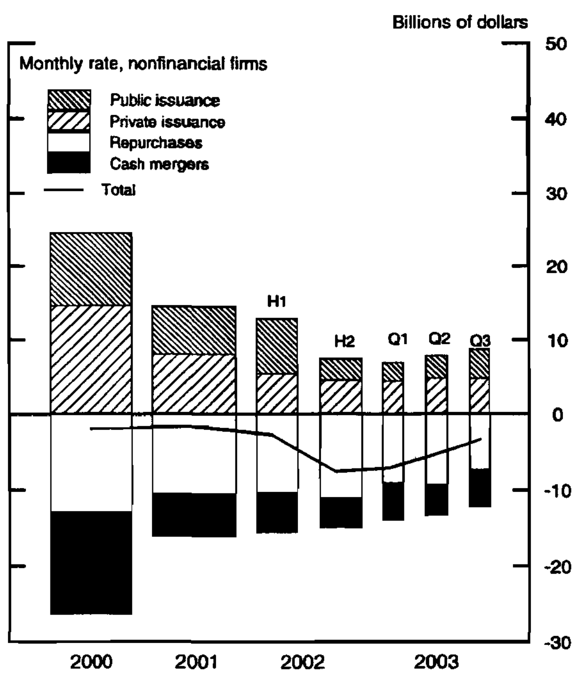
Note. Components may not sum to totals because of rounding. These data include bonds issued privately under Rule 144A. All other private placements are excluded. Total reflects gross proceeds rather than par value of original discount bonds.
1. Excludes equity issues associated with equity-for-equity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

Components of Net Debt Financing



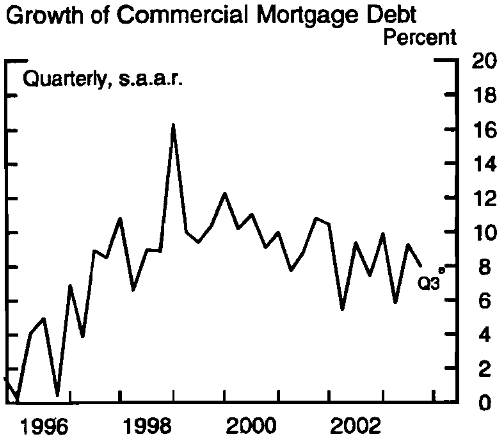
* Seasonally adjusted.
e Staff estimate.

Components of Net Equity Issuance



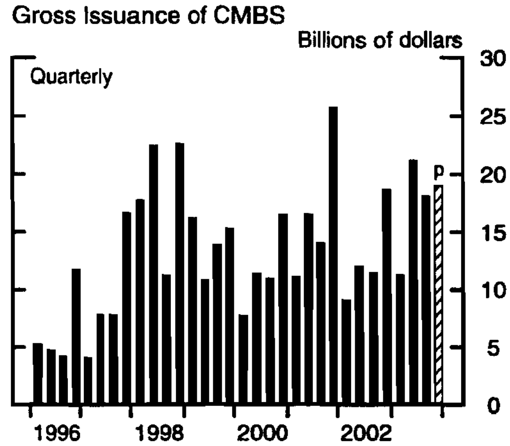
Commercial Real Estate

Growth of Commercial Mortgage Debt



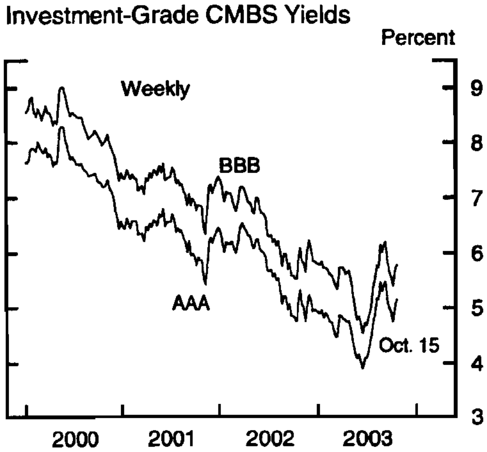
e Staff estimate.

Gross Issuance of CMBS



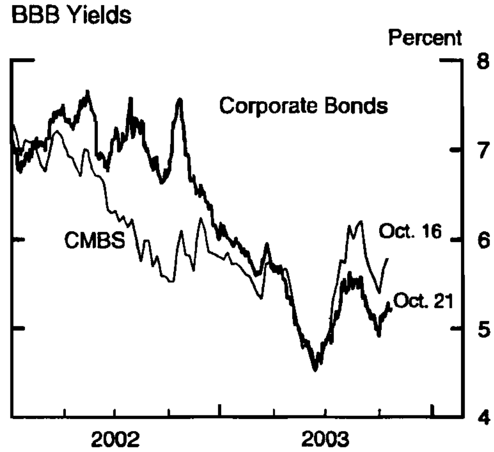
p Period to date at a quarterly rate.
Source. Commercial Mortgage Alert.

Investment-Grade CMBS Yields



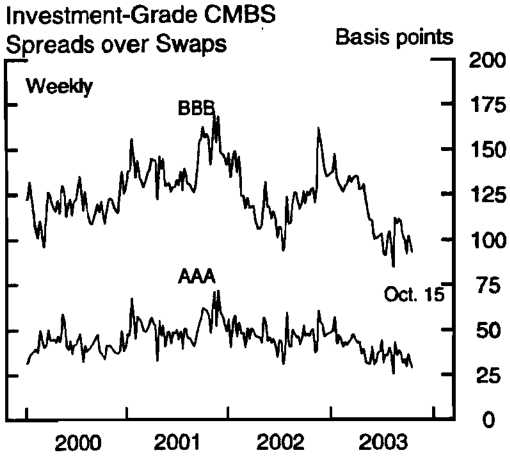
Source. Morgan Stanley.

BBB Yields



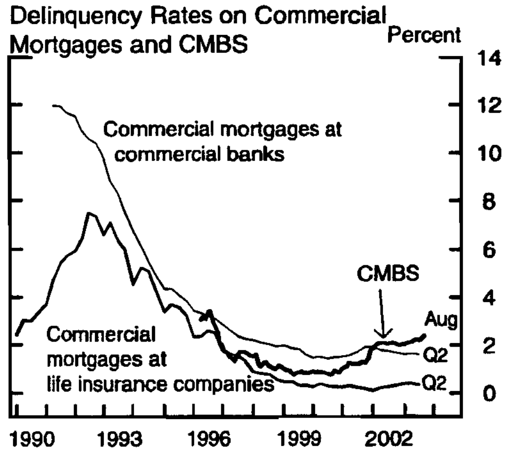
Source. Merrill Lynch, Morgan Stanley.

Investment-Grade CMBS Spreads over Swaps



Source. Morgan Stanley.

Delinquency Rates on Commercial Mortgages and CMBS



Source. Call Report, ACLI, Morgan Stanley.

strongest monthly showing in more than a year. IPOs increased, reflecting greater willingness of investors to fund risky ventures. Seasoned offerings were robust and came from a variety of industries, although apparently a large chunk of the proceeds was earmarked to pay down debt. Cash-financed mergers inched higher in the third quarter, and net equity issuance is estimated to have remained marginally negative.

Commercial Real Estate
Commercial mortgage debt expanded in the third quarter at an estimated 8 percent rate, down slightly from its second quarter pace. In the commercial-mortgage-backed securities (CMBS) market, rates fell slightly on net over the intermeeting period, and incoming data suggests a slight increase in CMBS issuance. CMBS credit spreads remain narrow, consistent with the low level of mortgage delinquency rates overall. However, BBB-rated CMBS continued to trade at a yield premium to BBB-rated corporate debt, reflecting some concern among investors about commercial real estate fundamentals and the rapid pace of CMBS issuance.

Household Finance
Interest rates on both adjustable-rate and thirty-year fixed-rate mortgages fell on net over the intermeeting period. However, the declines produced only an uptick in refinancing applications, as rates remain well above their lows in mid-June. With a slight rise in purchase originations offsetting some of the decline in refinancing activity, home mortgage debt growth is estimated to have slowed to a still-brisk 11 percent annual rate in the third quarter.

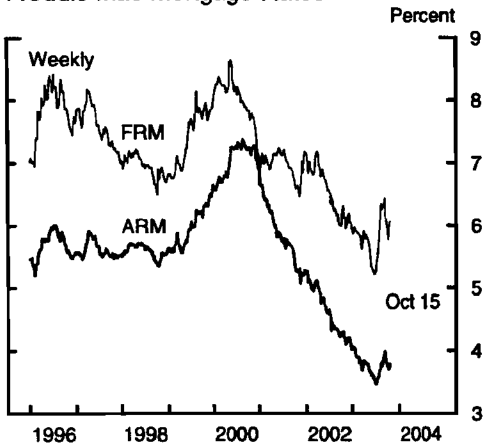
Consumer credit grew at an estimated annual rate of 5 percent in the third quarter, up slightly from the pace in the second quarter. This modest acceleration in consumer credit occurred even though some households may have used their tax rebates to pay down consumer debt.

Consumer credit quality appears to have improved slightly in recent months. Delinquency rates on consumer loans and home mortgages at commercial banks fell in the second quarter, and those on auto loans at the captive finance companies remained at low levels in August. Household bankruptcy filings are estimated to have remained stable in October, albeit at elevated levels.

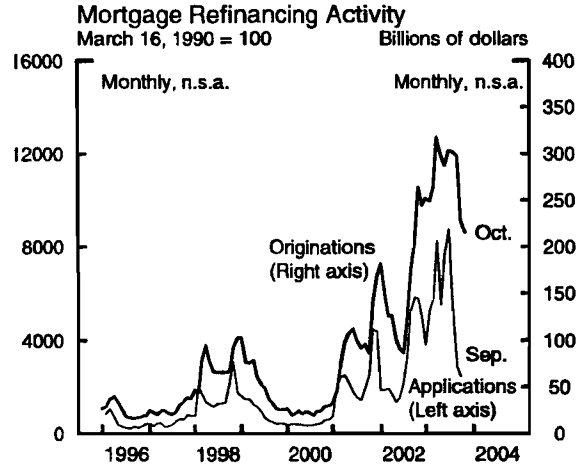
Although the growth of house prices is estimated to have moderated somewhat over the third quarter, sizable stock price gains produced a substantial increase in household net worth. At the same time, though, tax cuts boosted households' disposable income, so that the ratio of net worth to disposable income was about

Household Liabilities

Freddie Mac Mortgage Rates

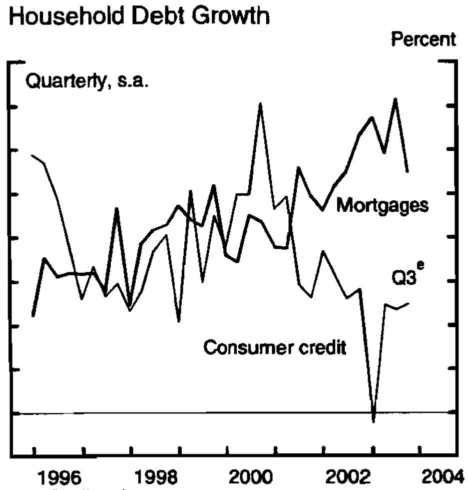


Mortgage Refinancing Activity



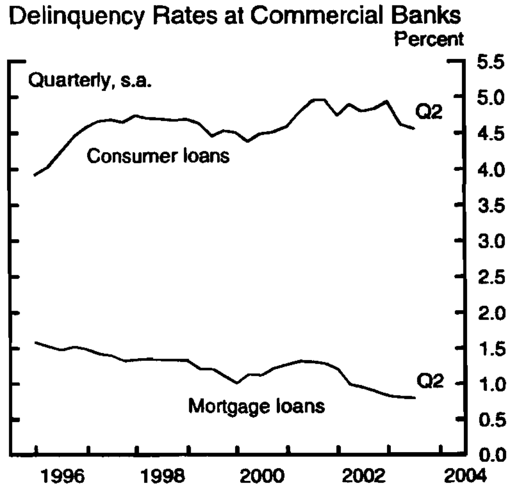
Source. Staff estimates.

Household Debt Growth



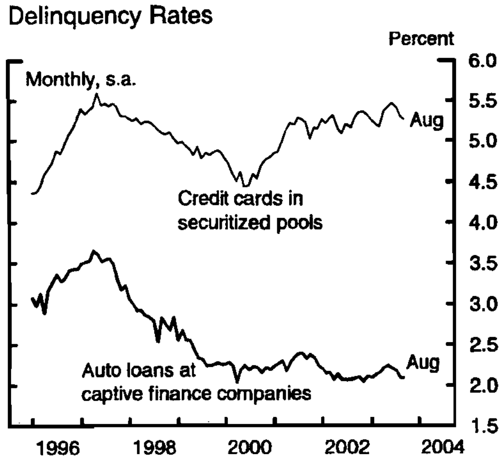
e Staff estimate.

Delinquency Rates at Commercial Banks



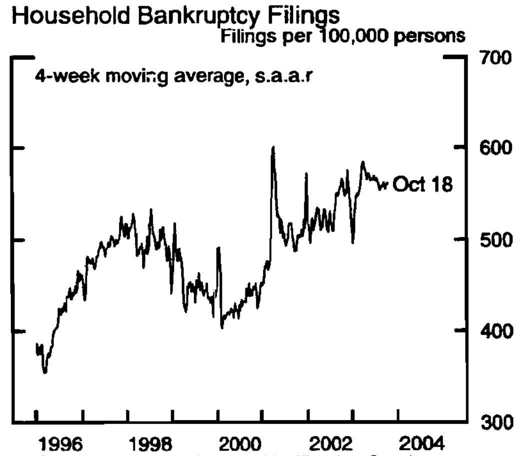
Source. Call Report.

Delinquency Rates



Source. Moody's, Federal Reserve.

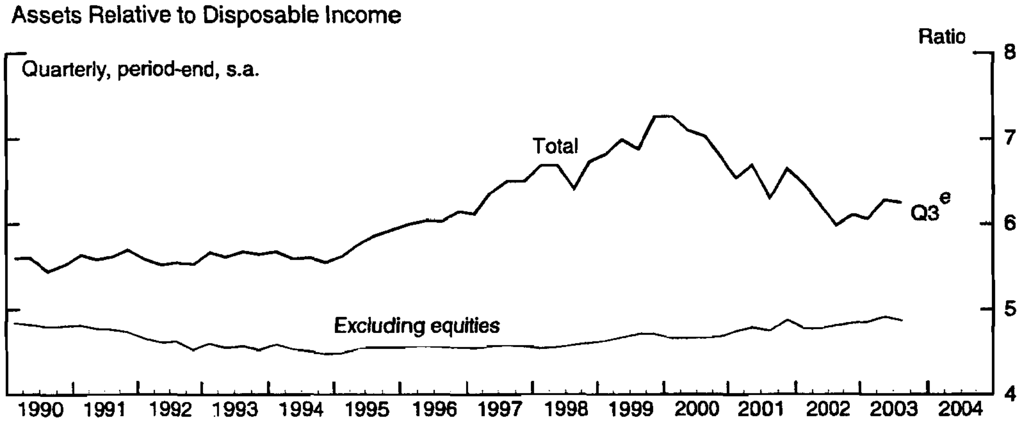
Household Bankruptcy Filings



Source. Visa Bankruptcy Notification Service Statistics.

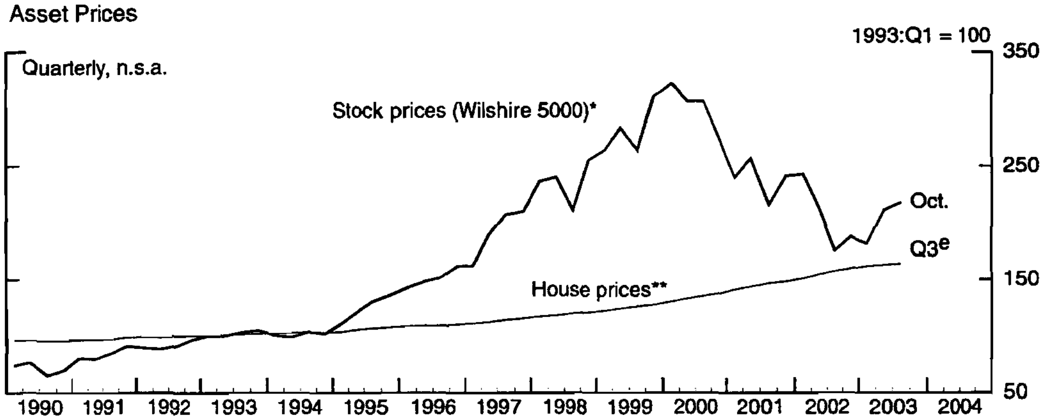
Household Assets

Assets Relative to Disposable Income



e Staff estimate.

Asset Prices



* Based on data through October 20.
** Office of Federal Housing Enterprise Oversight (OFHEO).
e Staff estimate.

Net Flows into Long-Term Mutual Funds

(Billions of dollars, monthly rate)

	2001	2002	2003 H1	2003 July	2003 Aug.	2003 Sept.	Assets Aug.
Total long-term funds	**10.8**	**10.3**	**19.1**	**14.1**	**13.6**	**18.3**	**4,828**
Equity funds	**2.8**	**-2.2**	**5.8**	**21.4**	**22.9**	**16.8**	**3,237**
Domestic	4.6	-2.0	5.4	19.0	18.1	16.9	2,807
International	-1.8	-0.2	0.5	2.4	4.8	-0.1	430
Hybrid funds	**0.7**	**0.7**	**2.0**	**3.5**	**3.3**	**3.6**	**382**
Bond funds	**7.3**	**11.7**	**11.3**	**-10.8**	**-12.6**	**-2.1**	**1,209**
High-yield	0.6	0.9	3.7	-1.7	0.6	1.3	138
Other taxable	5.7	9.5	7.1	-7.1	-10.4	-2.6	743
Municipals	1.0	1.4	0.5	-2.1	-2.8	-0.8	328

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

State and Local Government Finance

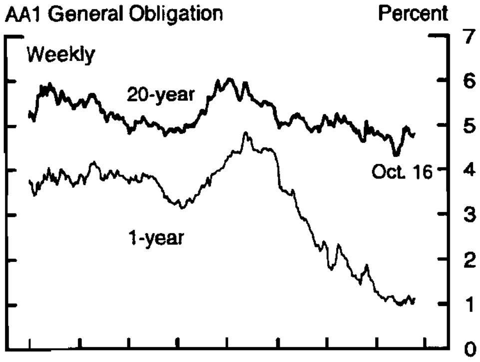
Gross Offerings of Municipal Securities

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

Type of security	2000	2001	2002	2003 H1	2003 Q3	2003 Sep.
Total	17.9	29.0	36.4	40.1	34.1	29.7
Long-term [1]	15.0	24.3	30.3	34.1	28.0	25.0
Refundings [2]	2.2	7.6	10.1	11.3	7.9	5.4
New capital	12.9	16.7	20.3	22.8	20.1	19.6
Short-term	2.8	4.7	6.0	6.0	6.2	4.7
Memo: Long-term taxable	0.7	1.4	1.7	3.9	2.5	4.2

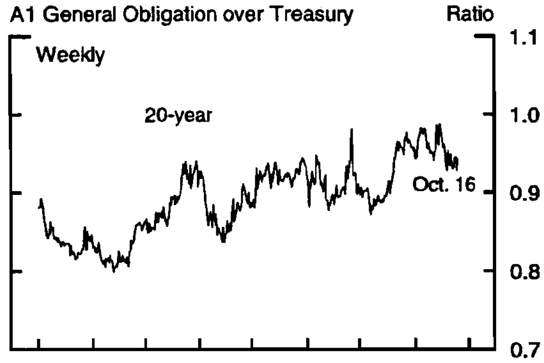
1. Includes issues for public and private purposes.
2. All issues that include any refunding bonds.

Municipal Bond Yields



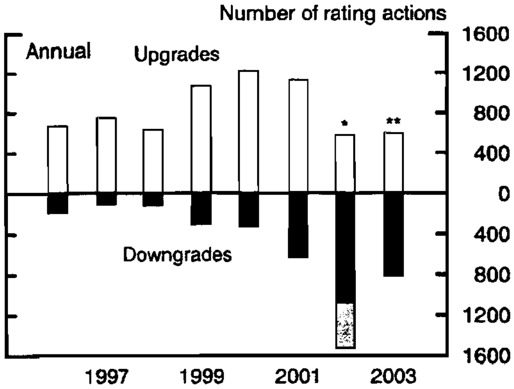
Source. Bloomberg.

Municipal Bond Ratios



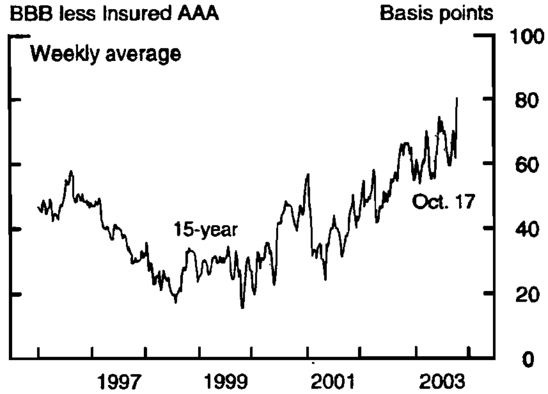
Source. Bond Buyer.

Bond Rating Changes



* Lightly shaded region shows a staff estimate of the number of downgrades related to downgrades of financial institutions that provided financial support for the bonds.
** Data through October 15 at an annual rate.
Source. S&P's Credit Week Municipal and Ratings Direct.

Revenue Bond Spread



Source. Bloomberg.

uunchanged in the third quarter. In September, households continued to shift assets out of corporate bond funds and into equity funds, although the flows into equity funds were not as large as they had been in August.

State and Local Government Finance

Gross municipal bond issuance has maintained a fairly robust pace in the third quarter, as municipalities continued to borrow for both short-term cash needs and long-term capital projects. However, the run-up in municipal yields in recent months has contributed to a dwindling volume of advance refunding issues.

Downgrades of municipal issues picked up a bit in recent weeks and included a five-notch downgrade to junk status of nearly $900 million in Pittsburgh general obligation bonds. Because the bonds are insured, prices were mostly unaffected, but the city has cancelled plans to issue new debt, and market reports suggested that this may be a sign of financing problems for other cities. More broadly, risk spreads for municipal revenue bonds, which have climbed of late, have hit a five-year high.

Treasury and Agency Finance

The Treasury borrowed less in the third quarter than it had projected at the August mid-quarter refunding, in part because of both a smaller-than-expected budget deficit over that period and a larger-than-projected drawdown of its cash balances.

The G-7 statement in mid-September raised some concerns that foreign official institutions would reduce their holdings of Treasury securities. However, such concerns were quieted after investors noted that indirect bidding at Treasury auctions, which includes bidding by the Federal Reserve Bank of New York on behalf of foreign monetary authorities, had not fallen off sharply.

The Congress continued to consider legislation that would affect the regulatory oversight of Fannie Mae and Freddie Mac, although it seems unlikely that such legislation will be passed this year. Share prices of the two GSEs rose and agency yield spreads narrowed a bit over the intermeeting period.

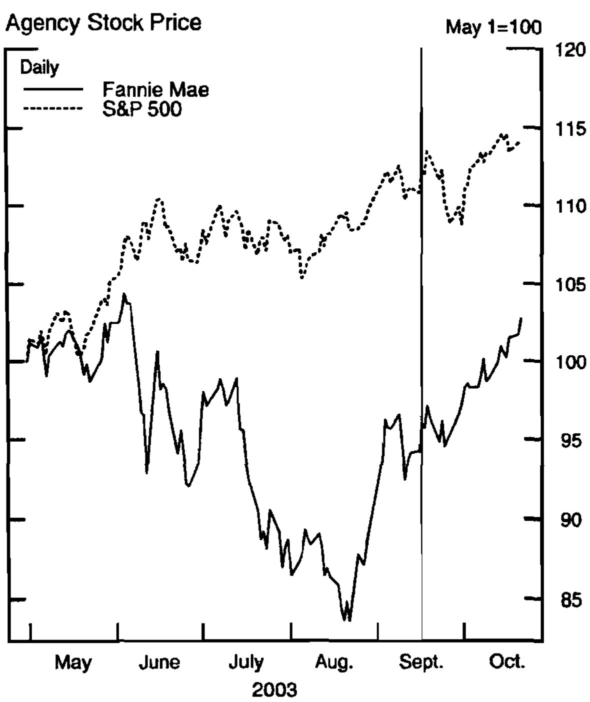
Several of the Federal Home Loan Banks announced notable losses over the intermeeting period, prompting the Administration and some members of the Congress to consider including these institutions under a new regulatory framework. Despite the losses, spreads of yields on Federal Home Loan Bank bonds over those on comparable Treasury securities moved up only a few basis points.

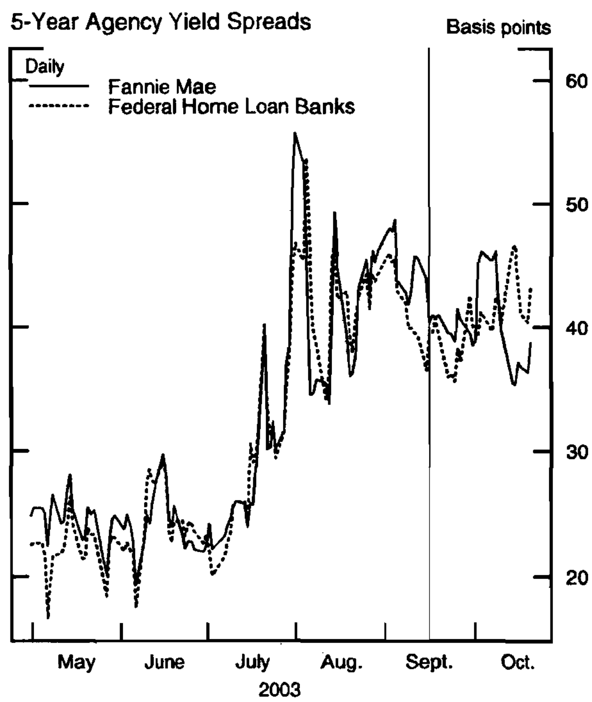
Treasury Financing
(Billions of dollars)

Item	2002 Q4	2003 Q1	2003 Q2	2003 Q3	2003 Sep.
Total surplus, deficit (−)	**-107.8**	**-144.9**	**-16.6**	**-104.5**	**26.4**
Means of financing deficit					
Net borrowing	96.9	63.5	106.3	107.6	-23.4
Nonmarketable	14.9	-50.5	45.9	31.4	-26.9
Marketable	82.0	114.0	60.4	76.2	3.5
Bills	20.0	67.0	-27.2	-14.9	-46.3
Coupons[1]	62.0	47.0	87.6	91.1	49.8
Debt buybacks	0.0	0.0	0.0	0.0	0.0
Decrease in cash balance	27.9	19.8	-16.8	-4.9	-29.5
Other[2]	-16.9	61.6	-73.0	1.8	26.6
MEMO					
Cash balance, end of period	33.0	13.3	30.0	35.0	35.0

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.

Agency Market Developments





Note. Vertical lines indicate September FOMC meeting.

Money and Bank Credit

M2 declined at about a 5 percent rate in September after having grown briskly in July and August. During previous months, M2 growth had been pushed up as funds related to MBS prepayments were temporarily placed in short-term deposit accounts. As the volume of refinancings diminished, this process was reversed and liquid deposits declined. M3 also declined in September, although not as quickly as M2.

Bank credit decreased at a 5.6 percent rate in September after having grown sluggishly during the two preceding months.[1] The ongoing reduction in banks' holdings of mortgage-backed securities has been a significant factor. C&I lending contracted more rapidly in September than in August, probably in part because of resurgent bond issuance. Weakness in C&I lending remained confined to large domestic banks and branches and agencies of foreign banks as business lending at small banks continued to expand.

1. Data on C&I loans presented in the Greenbook have been adjusted to remove the estimated effects of the adoption by some banks of Financial Accounting Standards Board (FASB) Interpretation 46 (FIN 46). This accounting change, which was issued in January, had originally required institutions to consolidate some variable interest entities into their balance sheets in the third quarter. During the intermeeting period, however, FASB announced that institutions could delay implementation of the new accounting treatment until the fourth quarter, reducing its effect for now.

Monetary Aggregates

(Based on seasonally adjusted data)

Aggregate or component	2002	2003 Q2	2003 Q3 (p)	2003 July	2003 Aug.	2003 Sep. (p)	Level ($ billions) Sep. 03 (p)
Aggregate	Percent change (annual rate)[1]						
1. M2[2]	6.8	8.4	8.6	9.7	8.1	-4.8	6,109
2. M3[3]	6.4	6.3	9.7	17.6	3.1	-3.2	8,900
2a. Removing FIN 46 effects [4]				*10.7*	*3.2*	*-3.2*	*8,875*
Components of M2 [5]							
3. Currency	8.2	6.0	2.7	-.6	5.6	7.0	653
4. Liquid deposits[6]	16.4	17.6	19.7	23.9	18.2	-2.6	3,768
5. Small time deposits	-9.0	-8.7	-14.6	-17.5	-16.7	-12.6	822
6. Retail money market funds	-6.0	-8.2	-9.4	-15.0	-9.0	-15.3	858
Components of M3							
7. M3 minus M2[7]	5.5	1.8	12.1	34.9	-7.6	.2	2,791
8. Large time deposits, net[8]	3.0	1.5	28.2	87.3	-1.1	-2.1	862
8a. Removing FIN 46 effects [4]				*12.8*	*-1.0*	*-2.5*	*813*
9. Institutional money market funds	2.2	-14.7	12.5	42.1	-19.6	6.1	1,171
10. RPs	20.6	27.8	-17.3	-57.9	-8.5	4.9	494
11. Eurodollars	7.0	32.0	18.5	26.9	26.7	-26.1	265
Memo							
12. Monetary base	7.2	5.9	4.1	.6	9.7	3.4	711
	Average monthly change (billions of dollars)[9]						
Selected managed liabilities at commercial banks							
13. Large time deposits, gross	1.8	-4.3	16.3	51.7	-2.2	-2.4	1,033
14. Net due to related foreign institutions	-3.2	-2.5	-1.3	16.6	-16.2	3.8	131
15. U.S. government deposits at commercial banks	-1.0	.7	1.2	.4	-7.4	7.0	18

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. Adjusted to remove estimated effects of consolidation related to FIN 46.
5. Non-bank travelers checks not listed.
6. Sum of demand deposits, other checkable deposits, and savings deposits.
7. Sum of large time deposits, institutional money market funds, RP liabilities of depository institutions, and eurodollars held by U.S. addressees.
8. Net of holdings of depository institutions, money market funds, U.S. government, and foreign banks and official institutions.
9. 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	2002	Q1 2003	Q2[7] 2003	July 2003	Aug. 2003	Sept. 2003	Level, Sept. 2003 ($ billions)
Total							
1. Adjusted[1]	**7.2**	**7.6**	**10.9**	**2.6**	**2.9**	**-5.6**	**5,950**
2. Reported	7.3	8.2	11.6	1.6	-3.1	-.1	6,187
Securities							
3. Adjusted[1]	13.6	13.2	17.7	-6.7	-9.2	-22.0	1,573
4. Reported	13.3	14.4	18.9	-30.4	-28.2	-.7	1,771
5. Treasury and agency	20.2	18.5	28.9	-37.1	-41.1	-18.5	1,061
6. Other[2]	4.3	8.2	3.6	-19.8	-7.7	27.0	710
Loans[3]							
7. Total	5.0	5.6	8.6	15.3	7.2	.1	4,416
7a. Removing FIN 46 effects[4]			*8.3*	*6.1*	*7.3*	*0.4*	
8. Business	-6.9	-5.4	-6.8	4.0	-10.2	-15.1	910
8a. Removing FIN 46 effects[4]			*-7.3*	*-15.7*	*-10.4*	*-14.2*	
9. Real estate	13.1	14.5	11.6	21.1	24.6	8.5	2,256
10. Home equity	36.6	28.1	28.1	20.1	20.2	25.1	258
11. Other	10.9	12.9	9.6	21.1	25.2	6.4	1,997
12. Consumer	5.5	2.8	-.1	1.0	1.4	10.1	602
13. Adjusted[5]	4.1	6.6	3.6	1.9	-4.1	1.8	961
14. Other[6]	1.6	-3.5	31.5	25.5	-20.1	-15.9	648
14a. Removing FIN 46 effects[4]			*30.6*	*-7.8*	*-20.8*	*-16.5*	

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.

Appendix

October 2003 Senior Loan Officer Opinion Survey

The October 2003 Senior Loan Officer Opinion Survey on Bank Lending Practices addressed changes in the supply of, and demand for, bank loans to businesses and households over the past three months. In addition, the survey contained a supplementary question on potential demand for commercial and industrial (C&I) loans, a series of questions on banks' participation in the secondary market for C&I loans, and a question on loans secured by real estate but used for purposes other than the acquisition or improvement of real estate. Responses were received from fifty-six domestic and twenty-one foreign banking institutions.

Almost all domestic banks and U.S. branches and agencies of foreign banks indicated that lending standards were about unchanged over the past three months for all types of loans. In addition, for the second consecutive survey, small net fractions of domestic banks reported easing spreads on C&I loans and on credit card loans. Banks that eased lending conditions on C&I loans frequently reported doing so in response to increased competition from nonbank lenders.

On the demand side, also for the second consecutive survey, the net fraction of banks that reported weaker demand for C&I loans declined, to less than 15 percent for borrowers of all sizes. Demand for commercial real estate loans at domestic banks weakened at about the same pace as in the previous survey (August 2003). Meanwhile, respondents indicated that demand for mortgage loans to purchase homes declined over the past three months, the first reported weakness in two years.[1] Demand for consumer loans, however, reportedly continued to strengthen, though at a less rapid pace than in August.

The large majority of domestic banks with assets of more than $20 billion and U.S. branches and agencies of foreign banks reported selling their adversely rated loans in the secondary loan market over the past two years. Domestic banks indicated that the most important reason for doing so was to reduce the level of risk in their C&I loan portfolios as a whole, while foreign institutions ranked reducing their exposure to individual borrowers highest. Investment banks and other nonbank financial institutions were reportedly the primary purchasers of adversely rated loans.

Lending to Businesses

In the October survey, domestic banks, on net, reported that lending standards on C&I loans for firms of all sizes were about unchanged. In contrast, a small percentage had tightened standards on those loans in the August survey. However, the largest domestic banks in the sample—those with assets of more than $20 billion—eased their lending standards, on net, over the past three months. A small net fraction of U.S. branches and

---

1. Although banks are asked to consider only new originations when answering this question, historically there has been fairly high correlation between responses to this question and the volume of mortgage refinancing.

agencies of foreign banks also eased lending standards, including one foreign bank that reported it had eased standards "considerably."

For the second consecutive survey, modest net fractions of domestic banks reported reducing the spreads of loan rates over the cost of funds for borrowers of all sizes. Domestic banks also reported easing terms on credit lines for larger borrowers, with 11 percent of respondents, on net, increasing the maximum size of credit lines and 5 percent, on net, reducing the cost of these lines. As with standards, the easing of terms generally occurred at the largest banks in the sample, while smaller banks continued to tighten most terms, on net. This movement reverses the pattern on surveys between the middle of 2000 and the end of 2002, in which the largest banks had been more likely than other banks to report tightening standards and terms. Foreign institutions, on net, reported no change in spreads on loans or in the cost or size of credit lines. As in August, however, moderate net fractions of domestic and foreign institutions increased the risk premiums charged on loans to their riskiest borrowers, and small fractions tightened collateral requirements.

Nearly 70 percent of the domestic banks that reported tightening standards and terms on C&I loans continued to report a reduced tolerance for risk as an important reason for doing so. Nearly 80 percent of the domestic and foreign banks that tightened lending standards or terms indicated that concern about the economic outlook was at least a somewhat important reason for tightening; but a similar percentage of the institutions that eased standards or terms cited an improved economic outlook as a reason for doing so. Moreover, although the percentages of banking institutions tightening standards and terms that cited concern about the economic outlook and industry-specific problems were higher than in August, they represented a much smaller number of banks because fewer institutions reported tightening standards and terms. Increased competition from other banks or nonbanks was cited by all of the foreign banks that eased lending conditions and about 80 percent of the domestic banks that did so.

The October survey indicates that the deterioration in demand from commercial borrowers has slowed and shows signs of stabilizing. Although 12 percent of domestic banks, on net, reported that demand for C&I loans from large and middle-market borrowers had weakened over the previous three months, that percentage is down significantly from the 22 percent that reported weaker loan demand in August and from the 40 percent that had reported weaker demand in April. In the current survey, only 4 percent of domestic banks, on net, reported weaker demand from small firms, whereas 12 percent, on net, had reported weaker demand in August. About 20 percent of domestic respondents and 35 percent of the largest banks, on net, indicated that inquiries from potential business borrowers had increased, up from only 10 percent and 20 percent, respectively, in August. U.S. branches and agencies of foreign banks reported no change in demand, on net, over the past three months, and 24 percent of these institutions, on net, indicated that the flow of inquiries from potential customers had picked up.

On net, banks continued to cite reduced investment in plant and equipment as the most important reason for weaker demand for C&I loans. A small net percentage of banks reported that demand for credit to finance inventories and accounts receivable had decreased. Several respondents said that demand for C&I loans had risen in part because borrowing had shifted to their bank from other credit sources; however, other domestic and foreign banks indicated that increased competition had reduced demand at their institutions. Demand for loans to finance mergers and acquisitions, which had previously been a frequently cited reason for weaker demand, was reported to have nearly stabilized, on net, in October.

The secondary market for C&I loans. Most of the domestic survey respondents with assets of more than $20 billion and nearly all of the U.S. branches and agencies of foreign banks indicated that they had sold adversely rated loans (those rated as special mention or classified as substandard, doubtful, or loss) in the secondary market at some time during the past two years. Almost 20 percent of the largest banks indicated that they sold more than 10 percent of those loans, while about 55 percent of all domestic banks that participated in the secondary market sold less than 5 percent of their adversely rated loans. Foreign institutions used the secondary market to reduce their exposure to these credits somewhat more aggressively: About one-third had sold more than 10 percent of their problem credits.

The most important reasons domestic banks gave for selling adversely rated loans were to trim the overall credit risk of their portfolio and to reduce exposure to particular firms. On average, domestic banks ranked the price that they obtained in the secondary market relative to their perception of the loan's value as a less important motive for selling than reducing credit risk. By contrast, foreign institutions on average ranked the attractiveness of the price as a close second to reducing exposure to particular firms.

Investment banks purchased about 50 percent of the adversely rated loans sold by domestic banks and more than 40 percent of those sold by U.S. branches and agencies of foreign banks. Nearly 25 percent of the adversely rated credits sold by domestic banks, and 30 percent of such loans at foreign banks, were bought by nonbank financial institutions, such as hedge funds and distressed debt funds, or other private investors. About 15 percent of the adversely rated loans sold by domestic banks reportedly went to other U.S. commercial banks, and about the same percentage of those loans sold by foreign banks were said to have been purchased by U.S. commercial banks. Among domestic banks that sold a significant share—more than 10 percent—of their adversely rated loans on the secondary market, purchasers were mainly investment banks, distressed-loan funds, or private venture groups.

Banks were also asked to indicate the shares of any loans (adversely rated or other) that they sold at specified ratios of the secondary market price to face value. As industry reports also indicate, the distressed market was very important for banking institutions that wanted to unload deteriorating credits. Domestic banks reported that, on average, almost 35 percent of loan sales were at 75 percent or less of face value and about 50 percent of the loans were sold for 85 percent or less. At foreign banks, the shares were 31 percent and 47 percent respectively. About 25 percent of the loans sold by domestic banks and 34 percent of the loans sold by foreign banks, on average, were sold at between 95 percent and 100 percent of par, and a small percentage of loans were sold above par.

A much smaller fraction of domestic banks—about 25 percent—reported that they had purchased loans in the secondary market, and those that did tended to purchase only loans that were trading above 90 percent of their face value. Foreign institutions were much more active purchasers of loans, though they too tended to buy only loans trading above 90 percent of face value.

Commercial real estate lending. Domestic banks reported that standards on commercial real estate loans were about unchanged, on net, over the past three months; the response ended a long period in which they had continuously tightened standards. One foreign bank reported easing standards on these loans. Demand for commercial real estate loans continued to erode at domestic banks, with 11 percent, on net, reporting a decline in demand in the October survey, about the same as in August, while at foreign institutions demand was unchanged. On net, 6 percent of domestic banks reported that there had been a slight increase over the past year in the volume of loans to commercial and industrial firms secured by real estate but used for purposes other than the acquisition or improvement of real estate. Thus, increases in such loans have apparently not contributed significantly to the decline in C&I loans over the same period, at least at respondent banks.

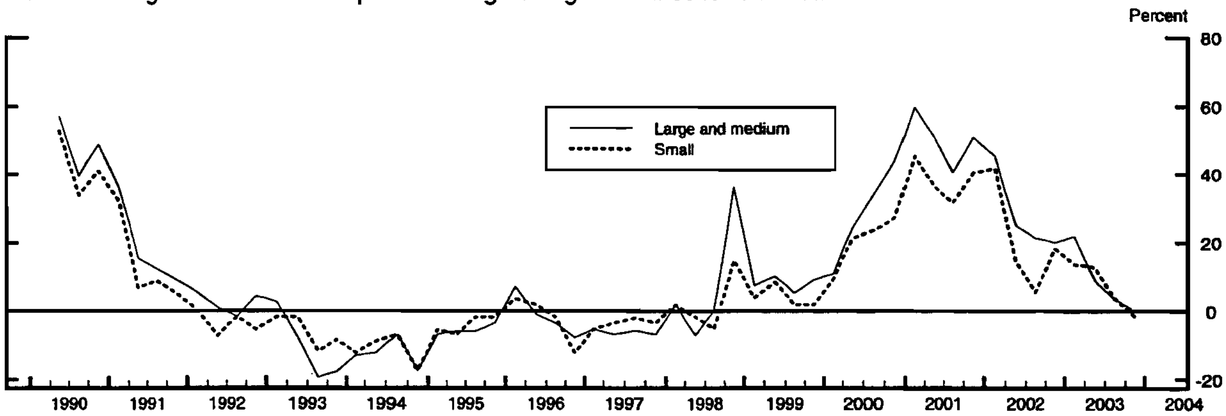
Lending to Households

Demand for mortgages to purchase homes reportedly weakened over the past three months. On net, 21 percent of domestic banks reported weaker demand for residential mortgage loans, whereas in August, 45 percent of banks had reported increased demand for mortgages. However, banks may find it hard to separate mortgage originations used to buy homes from those used to refinance existing mortgages. Concurrently, banks reported no change, on net, in lending standards on residential mortgages, little changed from the August survey.

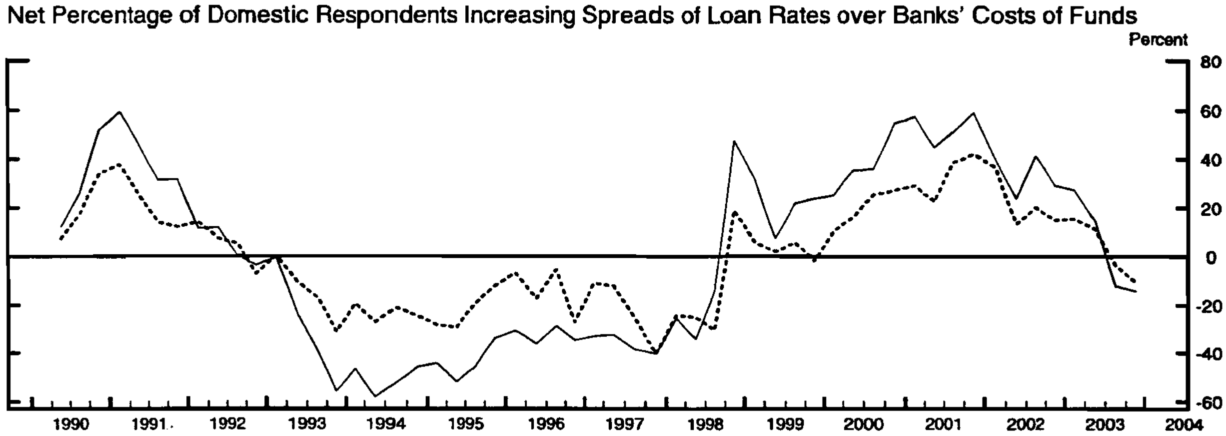
Fifteen percent of banks, on net, indicated that they were more willing to make consumer loans in the current survey, about the same share as in August. As is consistent with this report, only one bank tightened standards on credit card loans and, as had been the case in the past two surveys, a small net fraction of banks reported easing spreads on credit card loans. No banks tightened standards on other types of consumer loans, but about 8 percent reported increasing spreads on those loans. However, 10 percent of banks increased the minimum credit score required to obtain a credit card loan, and 4 percent did so for other types of consumer loans. In addition, about 20 percent of respondents indicated that they had reduced the extent to which they were willing to grant credit card loans to individuals who did not meet credit scoring thresholds, while 12 percent of domestic banks had done so for other types of consumer loans. About 4 percent of respondents, on net, indicated an increase in demand, compared with an unusually large 30 percent that had reported stronger demand in the August survey.

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

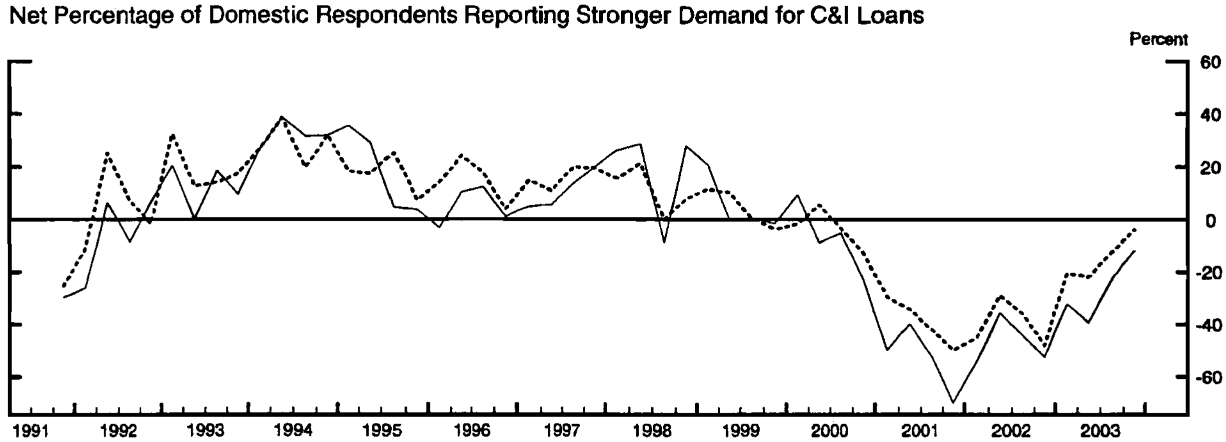
Net Percentage of Domestic Respondents Tightening Standards for C&I Loans



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

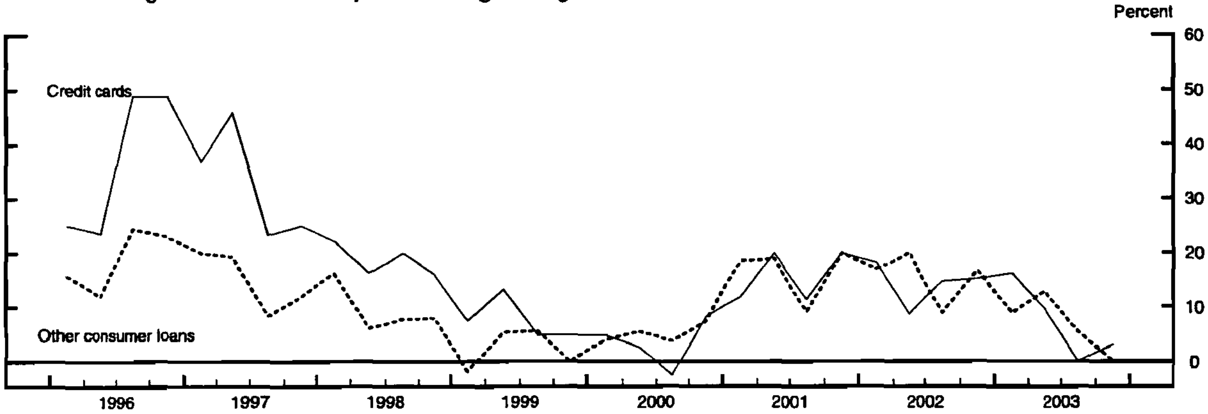


Net Percentage of Domestic Respondents Reporting Stronger Demand for C&I Loans

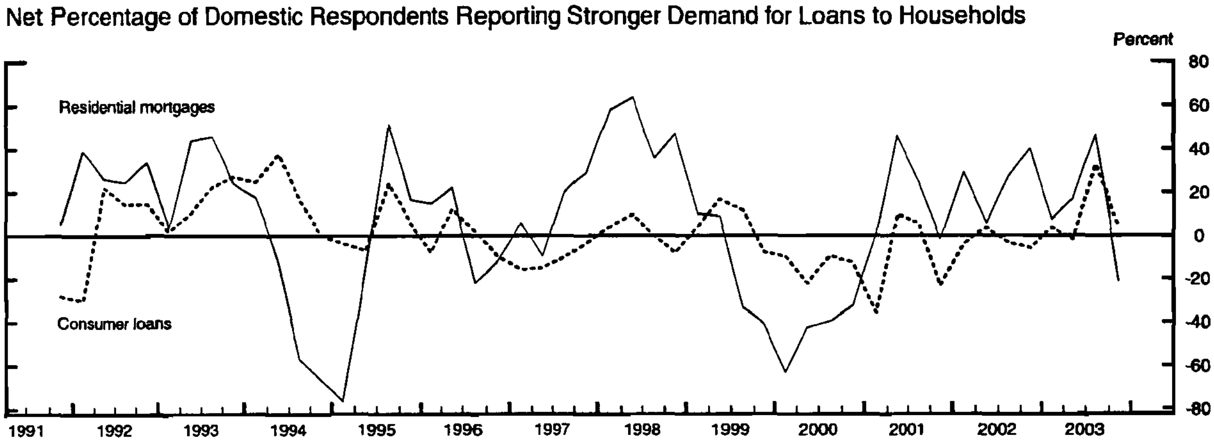


Measures of Supply and Demand for Loans to Households

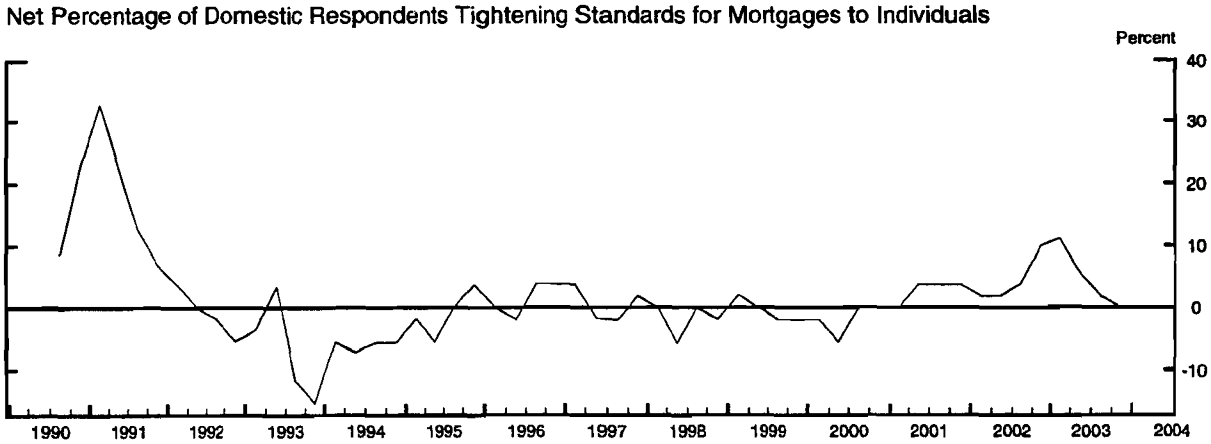
Net Percentage of Domestic Respondents Tightening Standards on Consumer Loans



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



Net Percentage of Domestic Respondents Tightening Standards for Mortgages to Individuals



International Developments

International Developments

U.S. International Transactions

Trade in Goods and Services

The U.S. international trade deficit in August was $39.2 billion, smaller than in any month since February and down from $40.0 billion in July (revised), as imports declined more than exports.

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

	2002	Annual rate 2003			Monthly rate 2003		
		Q1	Q2	Q3[e]	June	July	Aug.
Real NIPA[1]							
Net exports of G&S	-488.5	-510.3	-546.1	n.a.	...	...	...
Nominal BOP							
Net exports of G&S	-418.0	-486.5	-494.1	-475.4	-40.0	-40.0	-39.2
Goods, net	-482.9	-544.1	-552.4	-537.1	-45.1	-45.0	-44.5
Services, net	64.8	57.6	58.3	61.7	5.0	5.0	5.3

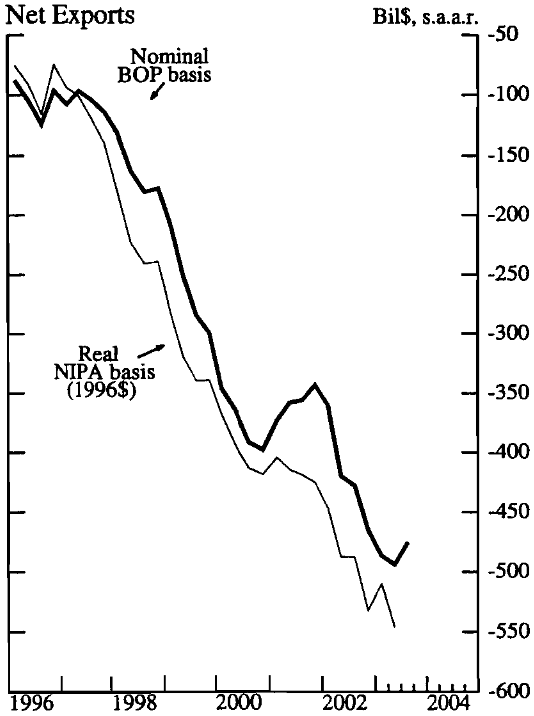
1. Billions of chained (1996) dollars.
e. BOP data are two months at an annual rate.
Source: U.S. Department of Commerce, Bureaus of Economic Analysis and Census.
n.a. Not available. ... Not applicable.

The value of exports of goods and services fell 2.7 percent in August, following three months of solid increases. The decline owed entirely to lower exports of goods; exported services rose 1.1 percent. Within goods, exports fell in most major trade categories. Particularly large declines occurred in agricultural products, aircraft, and automotive products, which reversed sizable increases in July. Despite the decline in August, the value of exported goods and services in July and August on average increased 11 percent at an annual rate from the second quarter level. About half of the increase owed to services, largely reflecting a rebound in travel-related activity. The remainder of the two-month increase was attributable primarily to higher exports of capital goods, particularly aircraft and computers, and agricultural products.

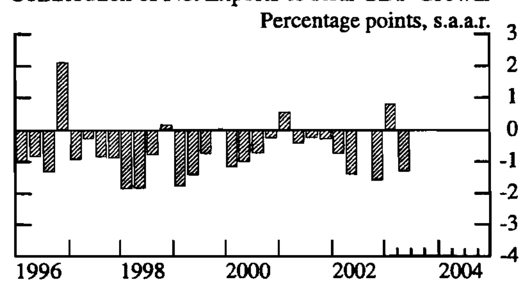
The value of imported goods and services fell 2.5 percent in August, reflecting lower imports of goods and unchanged imports of services. The monthly decline was largely driven by a 13 percent drop in imported automotive products. Smaller declines were recorded in aircraft, computers, and consumer goods. Imports of industrial supplies and machinery (other capital goods) increased moderately. For July and August combined, the value of imported goods and services increased at an annual rate of 2 percent from the second quarter level. Higher imports of services and oil (entirely from higher oil prices) more than offset lower imports of non-oil goods. The decline in imported non-oil goods resulted mainly from the drop in automotive imports.

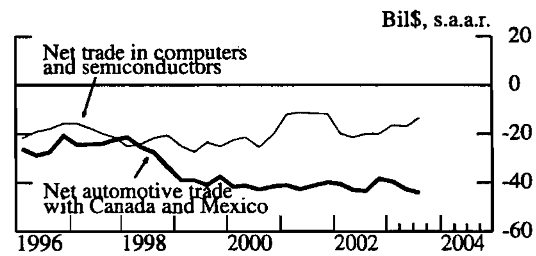
U.S. International Trade in Goods and Services

Net Exports

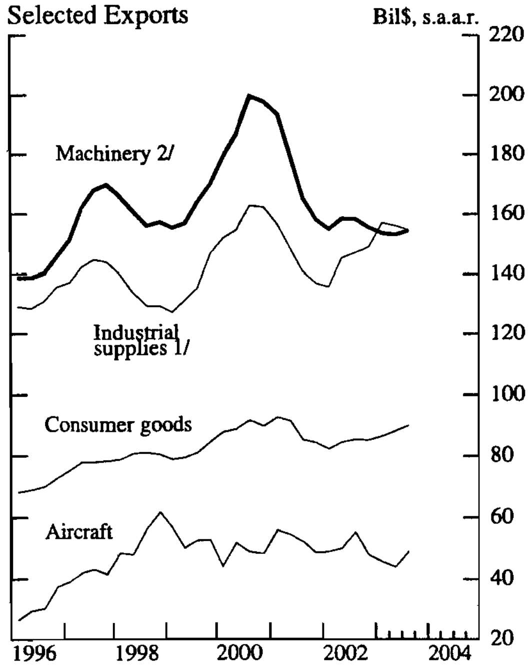


Contribution of Net Exports to Real GDP Growth



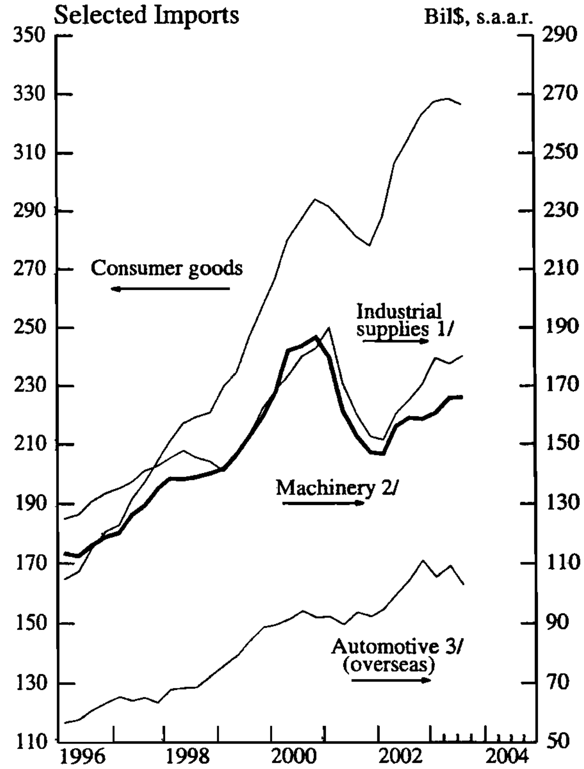


Selected Exports



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.

U.S. Exports and Imports of Goods and Services

(Billions of dollars, s.a.a.r., BOP basis)

	Levels				Amount Change[1]			
	2003		2003		2003		2003	
	Q2	Q3[e]	July	Aug.	Q2	Q3[e]	July	Aug.
Exports of G&S	**992.8**	**1018.2**	**1032.1**	**1004.3**	**3.3**	**25.4**	**18.6**	**-27.8**
Goods exports	697.0	708.6	724.2	693.0	3.6	11.6	13.2	-31.2
Gold	5.6	5.4	3.8	7.0	1.8	-0.2	-4.0	3.3
Other goods	691.4	703.2	720.5	686.0	1.8	69.3	17.1	-34.5
Aircraft & parts	43.8	48.9	52.6	45.1	-1.9	5.1	5.6	-7.5
Computers & accessories	37.2	40.0	40.8	39.3	-1.1	2.8	1.8	-1.4
Semiconductors	45.3	46.3	47.9	44.7	2.5	1.0	2.4	-3.2
Other capital goods	155.7	156.9	155.8	157.9	-0.5	1.2	-2.6	2.1
Automotive	79.8	77.5	81.7	73.4	-0.0	-2.2	3.1	-8.4
to Canada	45.2	41.6	45.6	37.6	-1.5	-3.6	1.3	-8.0
to Mexico	14.4	12.7	11.4	13.9	1.3	-1.8	-2.8	2.5
to ROW	20.2	23.2	24.6	21.8	0.1	3.1	4.6	-2.8
Agricultural	57.5	61.8	67.6	56.0	0.6	4.3	8.8	-11.6
Ind supplies (ex. ag, gold)	156.0	154.6	156.8	152.3	-1.1	-1.4	1.4	-4.5
Consumer goods	88.1	89.9	90.6	89.3	1.7	1.8	-1.7	-1.2
All other goods	28.0	27.3	26.7	27.8	1.7	-0.7	6.6	1.1
Services exports	295.8	309.6	307.9	311.3	-0.3	13.8	5.5	3.4
Imports of G&S	**1486.9**	**1493.7**	**1512.5**	**1474.8**	**10.9**	**6.8**	**18.6**	**-37.7**
Goods imports	1249.3	1245.8	1264.6	1226.9	11.9	-3.6	12.6	-37.7
Petroleum	130.5	138.4	139.5	137.2	-5.4	7.9	6.8	-2.3
Gold	4.1	3.9	2.5	5.3	1.7	-0.2	-3.2	2.8
Other goods	1114.7	1103.4	1122.5	1084.3	15.6	-11.3	9.1	-38.2
Aircraft & parts	23.7	22.7	24.6	20.8	0.2	-1.0	0.7	-3.9
Computers & accessories	75.2	75.4	76.7	74.1	2.0	0.3	1.8	-2.6
Semiconductors	24.6	24.4	24.6	24.2	0.1	-0.2	0.1	-0.4
Other capital goods	168.3	167.8	167.6	168.0	5.8	-0.5	-1.9	0.4
Automotive	211.6	201.5	215.6	187.4	7.0	-10.1	-3.2	-28.2
from Canada	59.6	58.9	63.5	54.3	0.4	-0.7	1.4	-9.2
from Mexico	42.8	39.8	37.0	42.5	2.7	-3.1	-6.3	5.5
from ROW	109.2	102.9	115.2	90.6	3.9	-6.3	1.7	-24.5
Ind supplies (ex. oil, gold)	177.3	180.0	179.1	180.9	-2.0	2.7	3.8	1.7
Consumer goods	328.3	326.4	327.5	325.3	0.9	-1.9	7.4	-2.2
Foods, feeds, bev.	55.0	54.8	55.0	54.5	0.7	-0.2	1.5	-0.5
All other goods	50.8	50.4	51.7	49.1	0.9	-0.3	-1.0	-2.6
Services imports	237.5	247.9	247.9	247.9	-1.0	10.4	5.9	0.0
Memo:								
Oil quantity (mb/d)	13.50	13.41	13.78	13.04	1.39	-0.09	0.15	-0.74
Oil import price ($/bbl)	26.46	28.27	27.72	28.81	-4.28	1.80	1.05	1.09

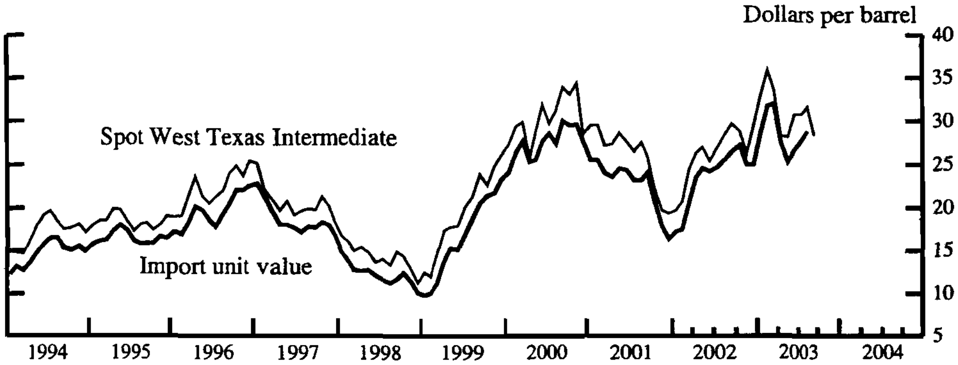
1. Change from previous quarter or month. e. Average of two months.
Source: U.S. Department of Commerce, Bureaus of Economic Analysis and Census.

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

	Annual rates			Monthly rates		
	2003			2003		
	Q1	Q2	Q3	July	Aug.	Sept.
	------------- BLS prices (2000 weights)-------------					
Merchandise imports	13.5	-9.2	3.2	0.5	0.1	-0.5
Oil	133.7	-54.6	29.7	5.1	2.4	-5.2
Non-oil	3.9	-1.0	0.7	0.1	-0.3	0.2
Core goods*	5.3	-0.5	1.1	0.2	-0.4	0.3
Cap. goods ex comp & semi	2.1	1.7	1.9	0.4	-0.2	-0.3
Automotive products	-0.4	0.5	0.0	0.0	0.0	-0.1
Consumer goods	-0.3	0.1	-0.1	-0.1	-0.1	0.0
Foods, feeds, beverages	7.1	-1.0	0.7	0.9	-0.2	0.6
Industrial supplies ex oil	25.3	-5.1	2.9	-0.2	-0.8	1.4
Computers	-5.7	-5.5	-7.8	-1.4	-0.1	-0.6
Semiconductors	-4.0	-1.0	5.8	1.7	-0.2	0.2
Merchandise exports	2.7	0.9	-0.3	-0.1	0.0	0.4
Core goods*	3.6	1.6	1.0	-0.2	0.1	0.5
Cap. goods ex comp & semi	0.9	0.1	0.9	0.1	0.0	0.0
Automotive products	0.7	0.1	0.9	0.2	0.0	0.0
Consumer goods	-0.1	0.5	0.3	0.0	-0.2	0.1
Agricultural products	0.2	6.1	6.4	0.0	-1.1	5.5
Industrial supples ex ag	12.4	3.4	0.3	-0.5	0.4	0.2
Computers	3.1	-0.6	-3.7	-0.1	-0.2	-0.5
Semiconductors	-5.8	-6.3	-12.1	0.2	0.0	-0.4
Chain price index	---Prices in the NIPA accounts (1996 weights)---					
Imports of goods & services	11.7	-3.9	n.a.	...	...	...
Non-oil merchandise	4.6	-0.6	n.a.	...	...	...
Core goods*	5.5	-0.3	n.a.	...	...	...
Exports of goods & services	3.9	0.8	n.a.	...	...	...
Total merchandise	3.4	1.6	n.a.	...	...	...
Core goods*	4.6	2.2	n.a.	...	...	...

*/ Excludes computers and semiconductors.
n.a. Not available. ... Not applicable.

Oil Prices



Prices of Internationally Traded Goods

Non-oil imports. In September, the prices of U.S. imports of non-oil goods and of core goods rose 0.2 and 0.3 percent, respectively, reversing similarly sized declines in August. Within core goods, the largest price changes were in industrial supplies and foods, feeds and beverages. Prices of imported foods, feeds and beverages rose 0.6 percent in September. The 1.4 percent increase in the price of industrial supplies was the result of higher prices for lumber and natural gas. In other major trade categories within core goods, only prices for capital goods excluding computers and semiconductors experienced a notable change, falling 0.3 percent. The prices of U.S. imports of computers continued to decline in September, but semiconductor prices edged higher. In the third quarter of 2003, the prices of imported core goods rose 1 percent at an annual rate. The largest contributions came from industrial supplies and capital goods excluding computers and semiconductors. Prices of computers fell 8 percent (a.r.), in the third quarter, whereas prices of semiconductors rose 6 percent (a.r.).

Oil. The BLS price of imported oil fell 5.2 percent in September, the first decrease in the price since May. The spot price of West Texas Intermediate (WTI) crude oil was also lower in September, averaging $28.29 per barrel, down more than 10 percent from August. However, the spot price began to rise at the end of September and has averaged nearly $31 per barrel thus far in October. The recent increase in the spot price reflects OPEC's decision in late September to reduce its production target by 900,000 barrels per day effective November 1. Prices also remain elevated owing in part to the slow return of Iraqi exports.

Exports. In September, the prices of U.S. exports of total goods and of core goods increased 0.4 and 0.5 percent, respectively. The rise was driven by a 5.5 percent increase in the price of agricultural products. Prices for exported industrial supplies rose 0.2 percent in September. In other major trade categories within core goods, prices were little changed. The prices of U.S. exports of computers and semiconductors both moved lower in September. In the third quarter, the prices of exported core goods rose at an annual rate of 1 percent. All of the major categories in core goods experienced price increases, but the largest rise came from agricultural products.

U.S. International Financial Transactions

Net foreign official inflows remained strong in August at $9 billion (line 1 of the Summary of U.S. International Transactions table) and were little changed from the inflows in July. Increases were largest for Asia, notably for Japan and Korea, and for Brazil. Through August, year-to-date foreign official inflows totaled

$112 billion. In September, foreign official assets held at the Federal Reserve Bank of New York increased a substantial $32 billion;

.

Private foreign purchases of U.S. securities (line 4) also continued to be very strong in August, sustaining the brisk pace set in the second quarter. Though nearly mirroring the previous month's total net purchases, the distribution of instruments changed. Foreign acquisitions of Treasury issues declined somewhat from the exceptionally high levels in July. There were small net sales of agency debt, and purchases of corporate bonds were lower, which may reflect a decline in new issuance for the month. In contrast, there was a marked increase in foreigners' purchases of U.S. equities. These amounted to $12 billion in August, up from net sales of $8 billion in July, and coincide with the uptick in the U.S. stock market in August. The net purchases of equities are mostly attributed to Europe and Canada.

Net U.S. purchases of foreign stocks (line 5b) surged to $15 billion during August, up from $6 billion in July. For the year through August, U.S. investors' purchases totaled $57 billion, more than double new foreign investment in U.S. stocks. U.S. investors' purchases in August were concentrated in Asia with Taiwan ($7 billion) and Japan ($5 billion) accounting for the largest inflows. U.S. investors continued their net sales of foreign bonds, but at a slower pace than in recent months.

The banking sector (line 3) saw net inflows of $11 billion, down from $47 billion in July. The August net flows reflected large interoffice outflows associated with repurchase activity in European markets that were more than offset by inflows in lending and deposits from the Caribbean centers. A number of large revisions have been made recently to the banking series to correct reporting errors and omissions. For the first half of this year banking transactions resulted in net outflows of $35 billion (revised from near zero).

Although merger and acquisition activity was slight, U.S. direct investment abroad (line 6) continued to expand at a rate near trend in the second quarter, owing in part to significant reinvested earnings. There are some signs of a pickup in merger activity and two acquisitions of foreign firms are pending for the third quarter. Foreign direct investment in the United States (line 7), buoyed by a large merger in the first quarter, fell back to the lower levels seen last year.

Summary of U.S. International Transactions

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

	2001	2002	2002		2003			
			Q3	Q4	Q1	Q2	July	Aug.
Official financial flows	**-.5**	**90.5**	**7.8**	**28.5**	**39.0**	**54.8**	**8.9**	**9.2**
1. Change in foreign official assets in the U.S. (increase, +)	4.4	94.2	9.2	29.3	39.0	55.0	8.7	9.2
a. G-10 countries	-8.4	30.7	2.1	6.0	26.9	25.2	6.0	1.6
b. OPEC countries	-3.1	-7.5	-1.3	.7	-7.5	1.1	-.3	.6
c. All other countries	15.9	70.9	8.4	22.7	19.5	28.7	3.0	7.0
2. Change in U.S. official reserve assets (decrease, +)	-4.9	-3.7	-1.4	-.8	.1	-.2	.3	-.1
Private financial flows	**416.1**	**437.5**	**163.4**	**124.1**	**101.6**	**93.8**	**...**	**...**
Banks								
3. Change in net foreign positions of banking offices in the U.S.[1]	-6.2	139.1	62.1	35.5	-32.4	-2.5	46.7	10.6
Securities[2]								
4. Foreign net purchases of U.S. securities (+)	398.1	403.5	105.1	82.9	68.5	144.3	50.7	51.5
a. Treasury securities	-7.4	106.4	58.1	14.2	13.4	57.4	32.0	24.2
b. Agency bonds	81.8	78.1	21.9	15.5	-2.3	-1.7	1.9	-1.2
c. Corporate and municipal bonds	201.8	160.3	17.2	39.8	59.5	67.3	24.6	16.9
d. Corporate stocks[3]	121.8	58.8	8.0	13.3	-2.1	21.2	-7.9	11.7
5. U.S. net acquisitions (-) of foreign securities	-85.1	15.5	21.4	-5.3	-27.5	9.0	-2.8	-13.4
a. Bonds	24.6	33.5	8.8	7.6	7.0	26.1	3.0	1.0
b. Stock purchases	-62.7	-14.8	14.0	-12.9	-19.9	-17.1	-5.8	-14.5
c. Stock swaps[3]	-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	-34.4	-32.0	...	...
7. Foreign direct investment in U.S.	151.6	39.6	14.2	15.3	34.4	12.1	...	...
8. Foreign holdings of U.S. currency	23.8	21.5	2.6	7.2	4.9	1.5	...	...
9. Other (inflow, +)[4]	53.9	-43.9	-10.4	20.2	88.2	-38.6	...	...
U.S. current account balance (s.a.)	**-393.7**	**-480.9**	**-122.7**	**-128.6**	**-138.7**	**-138.7**	**...**	**...**
Capital account balance (s.a.)[5]	**-1.1**	**-1.3**	**-.4**	**-.4**	**-.4**	**-.3**	**...**	**...**
Statistical discrepancy (s.a.)	**-20.8**	**-45.8**	**-48.1**	**-23.6**	**-1.6**	**-9.6**	**...**	**...**

NOTE: Data in lines 1 through 5 differ in timing and coverage from the balance of payments data published by The Department of Commerce. Details may not sum to totals because of rounding.

1. Changes in dollar-denominated positions of all depository institutions and bank holding companies plus certain transactions between broker-dealers and unaffiliated foreigners (particularly borrowing and lending under repurchase agreements). Includes changes in custody liabilities other than U.S. Treasury bills.

2. Includes commissions on securities transactions and 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

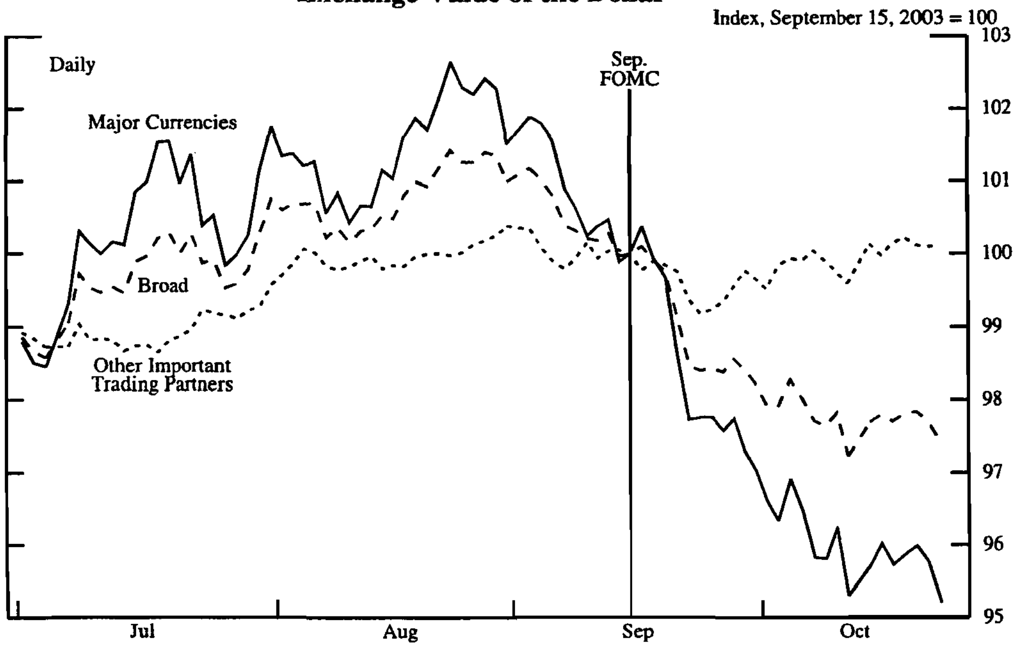
5. Consists of transactions in nonproduced nonfinancial assets and capital transfers.

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

Foreign Exchange Markets

The exchange value of the dollar, as measured by the major currencies index, fell 4¾ percent over the intermeeting period. The dollar's broad-based weakness versus other major currencies occurred despite several better-than-expected U.S. economic data releases, most notably the employment report for September. Although the dollar did move up following these releases, these gains proved short-lived.

Exchange Value of the Dollar



The negative market sentiment toward the dollar was reinforced on September 20 by the communiqué from the G-7 meeting in Dubai. For the first time in several years, the G-7 broached the subject of foreign exchange policy, with market participants paying particular attention to the phrase, "we emphasize that more flexibility in exchange rates is desirable for major countries or economic areas to promote smooth and widespread adjustments in the international financial system, based on market mechanisms." Based on their interpretation of the communiqué, market participants speculated that the G-7 may have called on Japanese monetary authorities to curtail their intervention activity. The dollar depreciated sharply against the yen following the release of the communiqué, as Japanese monetary authorities did indeed refrain from intervention until September 30, at which point the yen had already made most of its gains for the period. For the intermeeting period as a whole, the dollar depreciated 7 percent versus the yen. The Bank of Japan and the Japanese

Cabinet Office both upgraded their assessments of the Japanese economy and the Japanese stock market outperformed other major indexes.

The dollar depreciated 3¾ percent against the euro, as economic data releases signaled a pickup in euro-area economic activity. The U.S. dollar depreciated 4 and 5 percent relative to the Canadian and Australian dollars, respectively, as the continued rise in commodity prices amid expectations of a global recovery reportedly buoyed these currencies. The Canadian currency touched its highest level against the U.S. dollar since 1993. Questions about the Administration's resolve to maintain the "strong dollar" policy amid growing complaints from U.S. manufacturers about foreign competition appeared to play a role in the dollar's weakness over the period, as did concerns over the size of the U.S. fiscal and current account deficits.

Financial Indicators in Major Industrial Countries

	Three-month rate		Ten-year yield		Equities
Country	Oct. 22 (Percent)	Percentage Point Change	Oct. 22 (Percent)	Percentage Point Change	Percent Change
Canada	2.73	.04	4.84	.03	1.75
Japan	.08	.00	1.44	-.09	2.98
Euro area	2.15	.00	4.24	.07	-.56
United Kingdom	3.75	.16	4.93	.34	.63
Switzerland	.16	.01	2.62	-.06	-1.92
Australia	5.04	.08	5.65	.15	3.56
United States	1.11	.03	4.47	.19	2.10
Memo: Weighted-average foreign	1.83	.03	4.11	.04	n.a.

NOTE. Change is from September 15 to October 22 (10 a.m. EDT).
n.a. Not available.

Short-term interest rates moved little over the intermeeting period in the major industrial countries, as central banks kept policy interest rates unchanged. The Bank of Japan raised the upper limit of its target range for current account balances at the BOJ by ¥2 trillion to ¥32 trillion and clarified the conditions that would have to be met before it would end its quantitative easing policy.

Long-term rates in most industrial countries were little changed, on balance, except for the United Kingdom, where the yield on gilts rose 35 basis points. Futures markets priced in greater expectations of the Bank of England soon tightening monetary policy after BOE Governor King indicated that improved global economic activity might prompt action by the Monetary Policy Committee. Reinforcing these comments, minutes from the October MPC meeting showed that four of the nine MPC members had voted for a rate hike.

Despite the improved global economic outlook, equity prices in the industrial countries were mixed over the period. Japanese equities posted a modest 3 percent gain, outperforming shares on U.S. and European exchanges. Share prices for the Japanese banking sector jumped a heady 17 percent, as reported earnings by several key institutions came in well above market expectations. However, the strength of the yen against the dollar did weigh on the share prices of Japanese exporters, with the automobile sector subindex declining 7 percent.

Financial Indicators in Latin America, Asia, and Russia

	Currency/ US dollar		Short-term Interest rates[1]		Dollar-denominated bond spread[2]		Equity prices
Economy	Oct. 22	Percent Change	Oct.21/22 (Percent)	Percentage Point Change	Oct.21/22 (Percent)	Percentage Point Change	Percent Change
Mexico	11.20	2.05	4.93	.71	2.15	.03	2.69
Brazil	2.86	-1.07	19.40	-.25	6.16	-.45	12.38
Argentina	2.85	-1.21	n.a.	n.a.	54.87	6.79	17.37
Chile	641.70	-4.30	3.04	.00	.84	-3.08	13.02
China	8.28	-.01	n.a.	n.a.	.29	-2.25	.03
Korea	1181.00	.69	4.07	.05	...	...	3.41
Taiwan	33.85	-.82	1.12	-.06	...	...	7.44
Singapore	1.74	-1.18	.81	.06	...	...	12.53
Hong Kong	7.75	-.61	.22	-.84	...	...	11.33
Malaysia	3.80	-.01	3.00	.00	.70	-2.14	8.36
Thailand	39.94	-1.94	1.25	.00	.54	.07	6.75
Indonesia	8460.00	.00	8.79	-.11	2.72	.59	12.42
Philippines	55.15	.46	6.44	.13	4.02	.14	8.19
Russia	29.92	-2.50	n.a.	n.a.	2.35	-.16	8.25

NOTE. Change is from September 15 to October 21/22.

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.

Emerging markets stocks performed much better over the intermeeting period than those of industrial countries, as the anticipated global recovery reportedly helped foster an environment favoring riskier investments. Sentiment towards emerging markets was further enhanced after Moody's upgraded Russia's foreign-currency debt rating to investment grade status. Market participants added to positions in Brazil in hopes that Brazil will be the next country to have its debt rating upgraded. The yield spread of Brazil's dollar-denominated debt narrowed 50 basis points. Share prices on South American exchanges rose more than 12 percent.

Stocks in emerging Asia also performed well, with share prices gaining as much as 12 percent. Much attention was focused on China's exchange rate policy, with Bundesbank President Welteke stating that the section in the G-7 communiqué that called for flexibility in exchange rates pertained to countries in Asia. In addition, some Japanese officials commented that the call for flexibility was primarily directed at China. The amount of appreciation of the yuan versus the dollar priced in by twelve-month non-deliverable forward contracts rose by 1½ percentage points, to a total of 4 percent.

. The Desk did not intervene on behalf of the System or the Treasury during the period.

Developments in Foreign Industrial Countries

Available data for the third quarter generally suggest a moderate pace of growth in the major foreign industrial countries. In Japan, indicators of private investment and consumption were fairly flat following the second quarter's impressive gains, but the September Tankan recorded a broad-based increase in business sentiment. Euro-area surveys, particularly the purchasing managers' index (PMI) for manufacturing and industrial confidence, suggest that economic growth turned positive in the third quarter. In the United Kingdom, both the manufacturing and services PMIs hint at continued recovery. In Canada, data on GDP by industry, as well as on housing starts and employment, point to positive growth for the third quarter.

Twelve-month rates of consumer price inflation were little changed in recent months. Canadian headline inflation inched up to 2.2 percent in September. The U.K. inflation rate declined slightly, but remained above the 2½ percent target level. In the euro area, inflation held steady, just a bit above the ECB's 2 percent ceiling. In Japan, mild deflation continued.

In **Japan**, evidence for the third quarter suggests that growth continued at a moderate pace. For July and August on average, industrial production was up 0.2 percent from the second-quarter level. Indicators of consumer expenditures suggest only slight changes from second-quarter levels. New car registrations in the third quarter rose about 2 percent from the second-quarter average, while household expenditures in July and August on average were about flat compared to the second quarter. Core machinery orders, a leading indicator of business fixed investment, fell 1.7 percent in July and August on average relative to the second quarter. Non-residential building starts were about flat in July and August compared with the second quarter. Both real exports and imports rose in July and August, on average, from second-quarter levels, but imports grew more than exports.

Labor market conditions have generally been improving, but mild deflation continues. In August, the unemployment rate fell to its lowest rate since August 2001, down from a peak of 5.5 percent recorded early this year. The job-offers-to-applicants ratio, a leading indicator of employment, rose slightly. Core consumer goods prices in the Tokyo area (which exclude fresh food but include energy) fell 0.2 percent in September from the previous month, and were down 0.3 percent from a year earlier. Wholesale prices for domestic goods fell 0.5 percent in September from a year earlier.

On a more positive note, the Bank of Japan's Tankan index of business conditions rose in September, with the level of the aggregate diffusion index for

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

Indicator	2003						
	Q1	Q2	Q3	Jun.	July	Aug.	Sept.
Industrial production[1]	.3	-.7	n.a.	-1.3	.5	-.7	n.a.
All-industries index	.7	.0	n.a.	.8	-1.5	n.a.	n.a.
Housing starts	.7	4.3	n.a.	8.7	-8.6	-8.5	n.a.
Machinery orders[2]	5.8	3.4	n.a.	2.4	-3.1	-4.3	n.a.
Machinery shipments[3]	.2	1.5	n.a.	-.9	-1.4	3.4	n.a.
New car registrations	1.3	-6.1	2.2	-6.0	1.2	-.0	5.0
Unemployment rate[4]	5.4	5.4	n.a.	5.3	5.3	5.1	n.a.
Job offers ratio[5]	.60	.61	n.a.	.61	.62	.63	n.a.
Business sentiment[6]	-26	-26	-21	...	...	...	...
CPI (Core, Tokyo area)[7]	-.7	-.4	-.3	-.4	-.4	-.3	-.3
Wholesale prices[7]	-.9	-1.0	-.7	-1.1	-.8	-.7	-.5

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

business sentiment increasing to -21 from -26 in June. This improvement was broadly based, with increases for both manufacturers and nonmanufacturers across nearly all firm sizes. Survey respondents project a further improvement in the index, to -19, for December. The closely watched index for large manufacturers entered positive territory for the first time since December 2000, increasing to 1 from -5 in June. For FY2003, firms generally expect increases in sales, profits, and investment.

On October 10, the Bank of Japan announced several measures intended to reinforce its commitment to a policy of quantitative easing. For one, the Bank increased the upper limit of its target range for the outstanding balance of reserve accounts held by private financial institutions at the BOJ to ¥32 trillion from ¥30 trillion. (The new target range is thus ¥27-32 trillion, as compared to ¥27-30 trillion previously.) It also announced that its policy of quantitative easing will not be lifted unless the core consumer price index registers inflation of zero percent or more (on a twelve-month basis) for a few months, and the Bank is convinced that the core CPI will not fall below zero percent soon thereafter. In addition, the BOJ will extend the maximum term of its repo operations from six months to one year.

Prime Minister Koizumi was reelected as Liberal Democratic Party (LDP) president on September 20, after which he reshuffled the Cabinet. Heizo Takenaka retained his posts as head of the Financial Services Agency and Minister of Economic and Fiscal Policy, despite strong calls for replacing him by several senior LDP lawmakers. Sadakazu Tanigaki was named Japan's new finance minister. On October 10, Koizumi dissolved the lower house of the Diet and called for a general election to be held on November 9.

In the **euro area**, recent data suggest that economic growth turned positive in the third quarter. In September, the euro-area PMI for manufacturing rose again, topping the 50 threshold and indicating expansion for the first time in seven months; industrial confidence also moved higher. Euro-area industrial production fell 0.4 percent in August, in part because of a greater than usual number of holidays in Germany. While this decline offset some of the gain made in July, the July-August average was 0.5 percent above the second-quarter average. German manufacturing orders were flat in August, but foreign orders rose about 2 percent, suggesting that the upturn in global growth is boosting the German manufacturing sector. German retail sales also picked up in August, while French retail sales declined. Along with the recent rise in the German PMI and fall in the French PMI, this raises the possibility that the under-performance of the German economy relative to the French economy over the past few years may not have continued in the third quarter.

Euro-area twelve-month consumer price inflation remained just above the ECB's 2 percent ceiling in September. Core inflation, excluding energy and unprocessed food, reversed its recent declines by moving back up to 2 percent. The heat wave this summer led to an increase in food price inflation, although energy price inflation declined in September.

In September, the French government announced measures to reduce its structural budget deficit by 0.7 percentage points of GDP in 2004. Its goal is to bring the deficit to 3.6 percent of GDP, down to the 4.0 percent projected for this year, but still above the 3 percent ceiling required by the Stability and Growth Pact (SGP). In October, the European Commission (EC) directed France to cut its deficit next year more than planned but gave it until 2005 to fully comply with the SGP. Specifically, the EC recommended that France reduce its structural

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

Indicator	2003						
	Q1	Q2	Q3	Jun.	Jul.	Aug.	Sept.
Industrial production[1]	.2	-.5	n.a.	-.0	1.0	-.4	n.a.
Retail sales volume[2]	.7	-.0	n.a.	.0	.1	n.a.	n.a.
Unemployment rate[3]	8.7	8.8	n.a.	8.8	8.8	8.8	n.a.
Consumer confidence[4]	-19.3	-19.3	-17.3	-19.0	-18.0	-17.0	-17.0
Industrial confidence[4]	-11.0	-12.0	-11.3	-12.0	-14.0	-11.0	-9.0
Mfg. orders, Germany	.3	-1.9	n.a.	2.2	-.2	.0	n.a.
CPI[5]	2.3	1.9	2.0	1.9	1.9	2.1	2.1
Producer prices[5]	2.4	1.5	n.a.	1.4	1.4	1.4	n.a.
M3[5]	8.0	8.4	n.a.	8.4	8.6	8.2	n.a.

1. Excludes construction.
2. Excludes motor vehicles.
3. Percent. Euro area standardized to ILO definition. Includes Eurostat estimates in some cases.
4. Diffusion index based on European Commission surveys in individual countries.
5. Eurostat harmonized definition. Percent change from year earlier.
n.a. Not available.

deficit by a whole percentage point in 2004. If the Council of Finance Ministers approves the EC recommendation and the French government does not change its budget accordingly, France could be forced to make a non-interest bearing deposit of just over 0.2 percent of its GDP. That deposit, which would be placed with the European Community, would be forfeited if the French government did not make sufficient progress on deficit reduction over the next two years.

In the **United Kingdom**, the Office of National Statistics recently released a considerably revised GDP series. A downward adjustment in 2002 mainly stemmed from higher imports. Newly released data on construction output contributed to a substantial upward revision to growth for the second quarter of 2003, from 1.4 percent to 2.4 percent. These revisions coincided with a switch to chain-weighted GDP, but the adjustments due to the change in methodology were relatively small.

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

Component	2001[1]	2002[1]	2002 Q3	2002 Q4	2003 Q1	2003 Q2
GDP	1.9	2.0	2.8	2.1	.7	2.4
Total domestic demand	2.9	3.3	3.1	5.8	-.2	2.0
Consumption	4.6	3.3	2.9	5.2	-.6	2.7
Investment	-1.8	4.8	.6	3.4	-2.8	5.1
Government consumption	4.2	.3	1.1	2.0	10.7	2.1
Inventories[2]	-.5	.4	.9	1.6	-1.3	-1.2
Exports	-2.9	-1.9	-3.8	-17.2	12.1	-9.9
Imports	.6	3.6	-1.9	-3.9	6.8	-9.7
Net exports[2]	-1.0	-1.6	-.5	-3.9	1.0	.4

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

On balance, data for the third quarter suggest continued recovery. Despite a considerable drop in manufacturing output in August, September's manufacturing PMI continued its upward trend and is consistent with further expansion. Business confidence ticked down in October. The British Chamber of Commerce's third-quarter survey showed a downturn in manufacturing sales and orders but a brisk pick-up in the service sector. In September, the services PMI climbed to its highest level since April 2000. Retail sales rose in August and the two leading surveys of retail sales edged up in September, while consumer confidence improved.

Although housing price inflation continued to decrease in September, it was still at a robust two-digit rate on a twelve-month basis. Consumer borrowing remains elevated. Net mortgage lending slowed in August, while consumer credit rose. Mortgage equity withdrawals fell slightly to 6 percent of net income in the second quarter.

The labor market continues to be tight as unemployment remains near a 28-year low. Employment rose 0.8 percent in the twelve months ending in July. The twelve-month rate of retail price inflation excluding mortgage interest payments (RPIX) inched down in September but remained above the Bank of England's 2½ percent target. The harmonized index of consumer prices (HICP) rose

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

Indicator	2003						
	Q1	Q2	Q3	Jul.	Aug.	Sept.	Oct.
Industrial production	-.3	.2	n.a.	-.1	-.8	n.a.	n.a.
Retail sales volume[1]	.0	1.5	n.a.	-.6	.2	n.a.	n.a.
Unemployment rate[2]							
Claims-based	3.1	3.1	3.1	3.1	3.1	3.1	n.a.
Labor force survey[3]	5.1	5.0	n.a.	5.0	n.a.	n.a.	n.a.
Business confidence[4]	-1.3	-6.3	-3.3	-4.0	-3.0	-3.0	-4.0
Consumer confidence[5]	-10.0	-6.7	-5.0	-6.0	-6.0	-3.0	n.a.
Retail prices[6]	2.9	2.9	2.9	2.9	2.9	2.8	n.a.
Producer input prices[7]	1.8	-.5	1.1	1.0	1.8	.4	n.a.
Average earnings[7]	3.5	3.0	n.a.	3.6	3.4	n.a.	n.a.

1. Excludes motor vehicles.
2. Percent
3. Three-month average centered on month shown.
4. Percentage of firms expecting output to increase in the next four months less percentage expecting output to decrease.
5. Average of the percentage balance from consumers' expectations of their financial situation, general economic situation, unemployment, and savings over the next 12months.
6. Excluding mortgage interest payments. Percent change from year earlier.
7. Percent change from year earlier.
n.a. Not available.

1.4 percent in the twelve months ending in September. Most of the difference between the RPIX and the HICP can be attributed to the exclusion of housing components in the latter.

On October 9, the Monetary Policy Committee voted 5 to 4 against raising rates 25 basis points, with both Mervyn King and Rachel Lomax, both of whom many had thought would be among the first to argue for higher rates, in the majority. The committee agreed that strength in the housing market suggested that consumption growth would not moderate as quickly as previously expected, but the minority contended that inflation would likely be above the target in two years time as a result, while the majority was concerned that "a premature rise in the repo rate might choke off the improvement in business conditions."

In **Canada**, real GDP by industry increased 7.2 percent (a.r.) in July, led by a strong performance in the auto sector. In August, however, manufacturing shipments decreased sharply, largely reflecting production disruptions associated with the Northeast power outage. The effects of the power outage were particularly evident in the motor vehicle sector, where July's gains were more than reversed, and in sharp declines in both exports and imports.

Employment rose slightly in the third quarter, as a large increase in September more than offset losses in July and August. Despite continued weakness in manufacturing employment, conditions in Canadian labor markets have improved of late benefitting from rising employment in the booming construction sector. Housing starts reached a thirteen-year high during the third quarter. Domestic demand has remained resilient in recent months, with preliminary estimates indicating that motor vehicle sales climbed in the third quarter to remain in the vicinity of the record-breaking levels of 2002.

Canadian Economic Indicators

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

Indicator	2003						
	Q1	Q2	Q3	Jun.	Jul.	Aug.	Sept.
GDP by industry	.8	-.1	n.a.	.1	.6	n.a.	n.a.
Industrial production	.1	-1.9	n.a.	-.8	1.1	n.a.	n.a.
New mfg. orders	1.5	-4.7	n.a.	1.9	2.3	-4.9	n.a.
Retail sales	1.8	-.1	n.a.	.3	1.0	.3	n.a.
Employment	.5	.1	.1	.3	-.1	-.1	.3
Unemployment rate[1]	7.4	7.7	7.9	7.7	7.8	8.0	8.0
Consumer prices[2]	4.5	2.8	2.1	2.6	2.2	2.0	2.2
Core Consumer Prices[2,3]	3.2	2.4	1.7	2.0	1.7	1.6	1.8
Consumer attitudes[4]	114.5	115.1	n.a.	...	...	...	...
Business confidence[4]	131.4	109.9	n.a.	...	...	...	...

1. Percent.
2. Percent change from year earlier, n.s.a.
3. Excluding food, energy, and indirect taxes.
4. Level of index, 1991 = 100.

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

In September, the twelve-month rate of headline CPI inflation rose slightly to 2.2 percent. Higher natural gas prices as well as a large increase in university tuition contributed to the rise. Twelve-month core inflation, excluding food, energy prices, and indirect taxes, edged up to 1.8 percent in September.

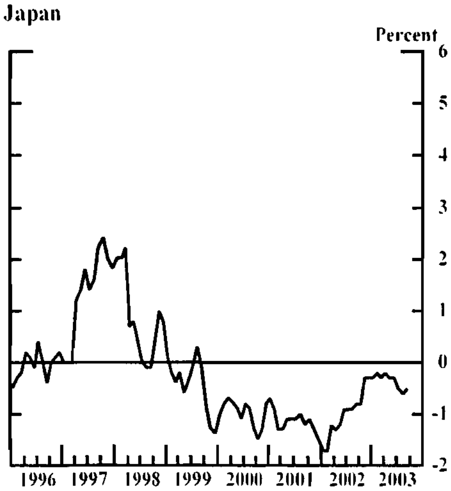
External Balances
(Billions of U.S. dollars, s.a.a.r.)

Country and balance	2002	2003				
	Q4	Q1	Q2	Jun.	Jul.	Aug.
Japan						
Trade	84.9	73.3	77.2	73.8	75.8	91.5
Current account	102.2	117.3	133.6	114.1	149.4	148.1
Euro area						
Trade[1]	103.4	31.3	70.3	102.0	182.0	86.8
Current account[1]	89.9	12.0	-22.4	39.2	16.4	n.a.
Germany						
Trade	129.1	125.7	139.1	140.4	170.3	163.8
Current account[1]	87.0	41.9	39.2	35.4	16.8	30.5
France						
Trade	1.1	.5	-.1	-.8	2.5	1.5
Current account	4.6	3.7	.6	2.5	.3	4.3
Italy						
Trade	5.3	.9	-3.9	-6.2	-2.1	-3.3
Current account[1]	-15.8	-30.2	-42.3	-61.3	28.2	-11.3
United Kingdom						
Trade	-83.3	-69.1	-71.1	-89.0	-58.5	-68.7
Current Account	-25.1	-14.9	-55.7	...	...	...
Canada						
Trade	34.7	43.4	42.7	41.6	41.6	44.9
Current Account	12.4	18.3	14.5	...	...	...

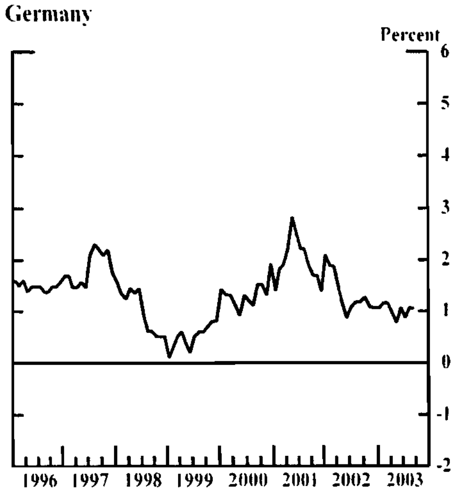
1. Not seasonally adjusted.
n.a. Not available. ... Not applicable.

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

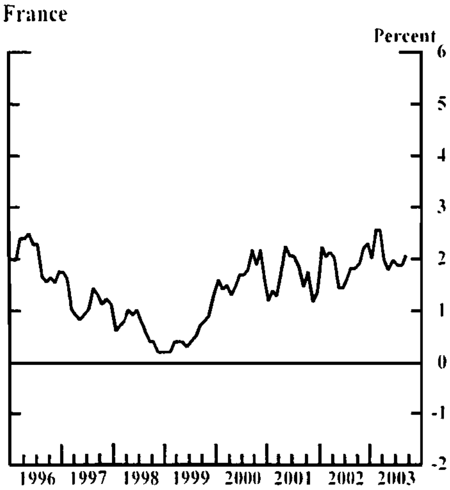
Japan



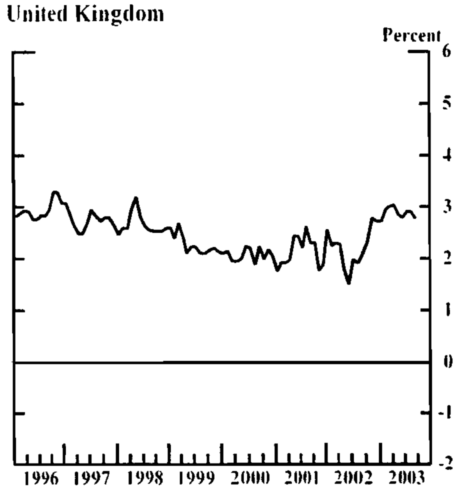
Germany



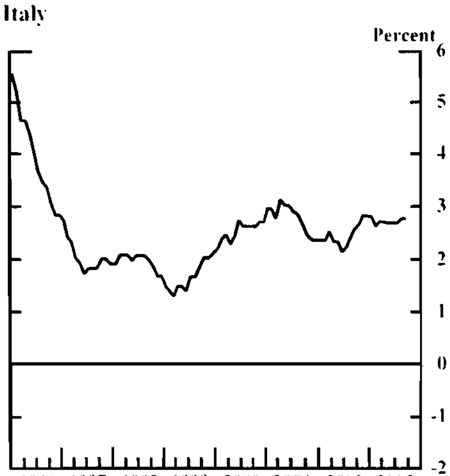
France



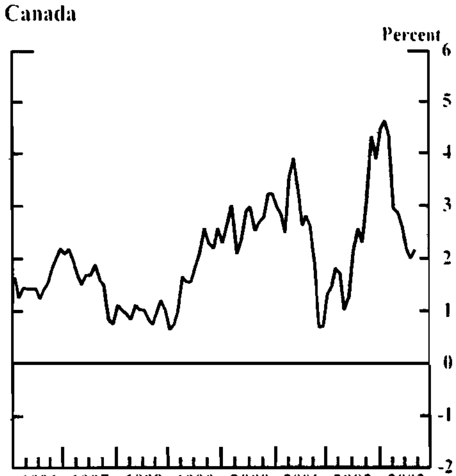
United Kingdom



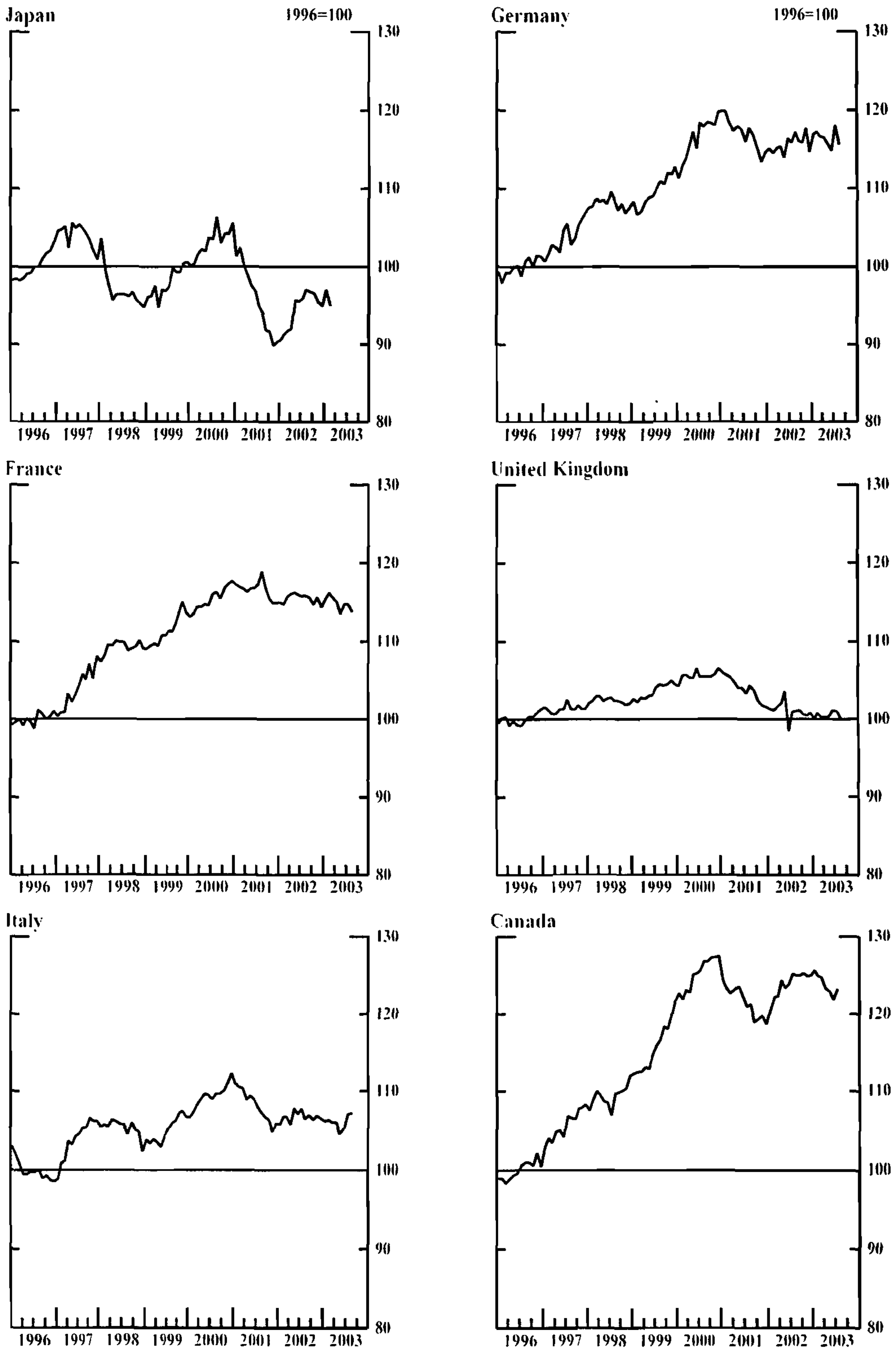
Italy



Canada



Industrial Production in Selected Industrial Countries



Economic Situation in Other Countries

The economies of emerging Asia appear to have recovered quickly from the economic effects of SARS. The Chinese economy, in particular, is racing ahead. In addition, indicators of high-tech production in the region have recently shown signs of a rapid expansion. In Latin America, the story is more uncertain. Recent indicators for Mexico have been mixed, although the Brazilian economy appears to have bottomed out and the economic recovery in Argentina has continued.

In general, inflation in the emerging market economies remains in check, with twelve-month consumer price inflation falling or staying put at already very low levels in most economies.

Chinese real GDP grew 17.5 percent in the third quarter, with growth boosted by strength in state-sector investment and exports. All indications are that China has completely recovered from the economic impact of SARS, with retail sales and tourism, in particular, having reached pre-SARS levels. Twelve-month consumer price inflation edged up again in September to just above 1 percent. Despite the low overall inflation figure, Chinese officials are concerned about possible overheating in some sectors and have made efforts to slow lending to those sectors. China's trade balance turned negative in September, as imports surged. Moreover, China's year-to-date trade surplus is considerably smaller than last year's surplus, and some analysts are forecasting that the trade balance will be close to zero for the year as a whole.

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

Indicator	2001	2002	2003				
			Q2	Q3	July	Aug.	Sept.
Real GDP[1]	7.5	8.0	-2.9	17.5	...	...	...
Industrial production[2]	8.9	11.8	15.1	16.6	16.5	17.1	16.3
Consumer prices[2]	-.3	-.4	.7	.8	.5	.9	1.1
Trade balance[3]	23.1	30.3	12.5	7.0	5.8	19.1	-3.7

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.
... Not applicable.

Despite the narrowing of the trade balance, attention has remained focused on China's exchange rate regime. Nondeliverable forward contracts point to appreciation of the renminbi exchange rate over the next twelve months. Chinese officials continue to insist, however, that no changes to the exchange rate regime will be made in the near future.

Economic conditions in **Hong Kong** are rapidly improving as the economic effects of SARS subside. Retail sales are now above and tourist arrivals are just below their pre-SARS levels. Moreover, the SARS-related climb in the unemployment rate appears to have begun to reverse itself. Even the property sector, which has been in a five-year slump, has recently shown some limited signs of improving, as recent changes in Chinese laws now allow some investment in the Hong Kong property market by Chinese companies. Although the trade balance slipped in August, total trade–a good indicator of economic activity for Hong Kong's entrepôt economy–remained near historical highs. Consumer prices continue to fall, although the rate of decline slowed somewhat in August.

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

Indicator	2001	2002	2003				
			Q2	Q3	July	Aug.	Sept.
Real GDP[1]	-1.3	5.2	-14.0	n.a.	...	...	...
Unemployment rate[2]	4.9	7.3	8.6	8.3	8.7	8.6	8.3
Consumer prices[3]	-3.7	-1.6	-2.5	n.a.	-4.0	-3.8	n.a.
Trade balance[4]	-11.4	-7.7	-6.8	n.a.	-2.6	-10.5	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.

Recent data for **Taiwan** have been encouraging. Production of high-tech goods soared in August, although this was largely offset by declines in other manufacturing sectors and construction. Export order books for electronics are at levels not seen since the high-tech bubble in 2000. Unemployment fell in the third quarter, after rising somewhat in the second quarter due to the effects of SARS. Both exports and imports rose at very rapid rates in September, with the net effect being a widening of the trade surplus. The renewed economic strength contributed to an easing of deflationary pressures, with consumer prices falling only slightly in September on a twelve-month basis.

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

Indicator	2001	2002	2003				
			Q2	Q3	July	Aug.	Sept.
Real GDP[1]	-1.9	4.3	-8.1	n.a.	...	...	...
Unemployment rate[2]	4.6	5.2	5.2	5.0	5.0	5.0	4.9
Industrial production	-7.3	6.4	-1.0	n.a.	5.0	.1	n.a.
Consumer prices[3]	-1.7	.8	-.1	-.6	-1.0	-.6	-.2
Trade balance[4]	15.6	18.1	16.2	20.0	20.0	18.8	21.3
Current account[5]	17.9	25.7	26.3	n.a.	...	...	...

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.

In **Korea**, indications are that the economy is recovering, although third-quarter output was damped by some adverse shocks. A series of labor strikes depressed industrial production in July, although it bounced back in August, and a typhoon in mid-September damaged some key infrastructure and hurt agricultural output. Even so, the unemployment rate has stabilized recently, after rising ½ percentage point earlier in the year. Retail sales were up in August, and business confidence indicators rose in September. In late September, the government confirmed that it would introduce a second supplementary budget this year to help pay for typhoon-related reconstruction. Twelve-month consumer price inflation inched up in September due to rising agricultural prices. The trade balance widened in August, as imports declined more than exports.

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

Indicator	2001	2002	2003				
			Q2	Q3	July	Aug.	Sept.
Real GDP[1]	4.2	7.0	-2.9	n.a.	...	...	...
Industrial production	.4	8.3	-.4	n.a.	-3.8	3.4	n.a.
Unemployment rate[2]	3.8	3.1	3.4	3.5	3.6	3.5	3.5
Consumer prices[3]	3.2	3.8	3.3	3.2	3.2	3.0	3.3
Trade balance[4]	13.5	14.2	19.3	n.a.	19.8	29.3	n.a.
Current account[5]	8.2	6.1	10.1	n.a.	5.1	16.7	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.

In general, the **ASEAN** economies appear to have recovered from the economic effects of SARS, with tourist arrivals and consumption indicators at or near pre-SARS levels. Real GDP in Thailand grew 3.5 percent in the SARS-affected second quarter, on the back of strong performances in the manufacturing and construction sectors. The recent behavior of industrial output in the region has been mixed. Production in Malaysia and Thailand contracted in August, but Singapore posted an impressive gain due to a surge in output in the pharmaceuticals industry. In addition, there are signs of strength in high-tech production in several of these countries. In August, trade balances improved slightly in Malaysia and the Philippines, while in Indonesia and Thailand surpluses shrank as exports fell more than imports. Singapore's trade surplus widened considerably in September due to surging exports. Inflation remained benign, with only Indonesia posting twelve-month consumer price inflation greater than 3 percent.

ASEAN Economic Indicators: Growth

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

Indicator and country	2001	2002	2003 Q1	2003 Q2	2003 June	2003 July	2003 Aug.
Real GDP[1]							
Indonesia	1.7	3.8	4.5	6.3	...	...	...
Malaysia	-.9	5.3	2.9	6.9	...	...	...
Philippines	3.6	5.7	-2.1	.3	...	...	...
Singapore	-6.0	3.0	1.4	-11.4	...	...	...
Thailand	2.2	6.4	5.4	3.5	...	...	...
Industrial production[2]							
Indonesia[3]	.7	-1.1	1.1	-2.5	-.9	4.2	n.a.
Malaysia	-4.1	4.6	2.1	4.3	-2.0	1.7	-1.8
Philippines	-5.7	-6.1	2.9	1.6	-8.4	9.8	n.a.
Singapore	-11.6	8.5	4.9	-5.3	1.8	-.6	17.8
Thailand	1.3	8.5	4.0	3.2	-2.1	1.8	-2.8

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	2001	2002	2003 Q2	2003 Q3	2003 July	2003 Aug.	2003 Sept.
Indonesia	25.4	25.9	29.2	n.a.	29.2	25.5	n.a.
Malaysia	14.2	13.5	20.8	n.a.	16.2	17.0	n.a.
Philippines	-.9	-.2	-1.2	n.a.	-1.9	-1.0	n.a.
Singapore	5.8	8.7	13.2	18.7	18.7	14.5	22.8
Thailand	2.5	3.4	5.8	n.a.	4.2	1.6	n.a.

n.a. Not available.

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

Country	2001[1]	2002[1]	2003 Q2	2003 Q3	2003 July	2003 Aug.	2003 Sept.
Indonesia	12.5	10.0	7.0	6.1	5.8	6.4	6.2
Malaysia	1.2	1.7	.9	1.0	1.0	1.0	1.1
Philippines	4.1	2.6	3.0	3.1	3.4	3.0	2.9
Singapore	-.6	.4	.2	n.a.	.3	.5	n.a.
Thailand	.8	1.6	1.8	1.9	1.8	2.2	1.7

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

In **Mexico**, supply-side indicators generally continued to point to some weakness in economic activity, although the monthly pattern provides some grounds for encouragement. An index of overall economic activity (a monthly proxy for real GDP) was about flat in July, but industrial production increased in August after three consecutive months of decline. Exports registered a small increase in August, and business confidence appears to be holding up. On the demand side, there are some tentative indications that consumption spending–a key component of the strong second-quarter GDP performance–may be losing some steam. Although retail sales held up in July, some consumer surveys showed a decline in confidence in August and September. Inflation has remained in check, with twelve-month consumer price increases recently coming in at the upper end of the government's 2-4 percent target range. Inflation expectations for year-end inflation currently stand at about 3.8 percent.

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

Indicator	2001	2002	2003				
			Q2	Q3	July	Aug.	Sept.
Real GDP[1]	-1.4	2.0	4.9	n.a.	...	...	...
Overall economic activity	-.1	.8	.4	n.a.	.0	n.a.	n.a.
Industrial production	-3.3	-.1	-.1	n.a.	-.2	.4	n.a.
Unemployment rate[2]	2.5	2.7	3.0	3.7	3.5	4.0	3.6
Consumer prices[3]	4.4	5.7	4.7	4.1	4.1	4.0	4.0
Trade balance[4]	-10.0	-7.9	-7.5	n.a.	-7.8	-7.1	n.a.
Imports[4]	168.4	168.7	168.4	n.a.	170.1	169.7	n.a.
Exports[4]	158.4	160.8	160.9	n.a.	162.3	162.6	n.a.
Current account[5]	-18.0	-14.0	-5.9	n.a.	...	...	...

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.

In **Brazil**, data releases since the last Greenbook suggest that the economy has bottomed out. Although unemployment climbed in recent months, industrial production rose 1.5 percent in August, the second consecutive monthly gain following a sharp decline in June. Production was strongest in the tradeable goods sectors, consistent with the view that external demand has continued to fuel growth. Month-to-month consumer price inflation rose in September, driven largely by an increase in government-regulated prices and gasoline prices. However, the average of one-year ahead inflation expectations are at 6.3 percent, well below current levels. Brazil has continued to register sizeable trade surpluses, leading to a small current account surplus.

Prompted by favorable inflation trends and the still weak economy, the central bank reduced its benchmark interest rate, the Selic, 200 basis points in late September. The Selic now stands at 20 percent, compared with 26.5 percent last June.

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

Indicator	2001	2002	2003				
			Q2	Q3	July	Aug.	Sept.
Real GDP[1]	-.9	3.2	-6.2	n.a.	...	...	...
Industrial production	1.6	2.5	-2.4	n.a.	.9	1.5	n.a.
Unemployment rate[2]	12.4	12.5	12.1	13.0	12.7	12.9	13.4
Consumer prices[3]	7.7	12.5	16.9	15.2	15.4	15.1	15.1
Trade balance[4]	2.7	13.1	23.6	26.8	22.8	26.4	31.3
Current account[5]	-23.2	-7.7	1.6	n.a.	8.9	14.6	n.a.

1. Annual rate. Annual figures are Q4/Q4.
2. Percent. Break in October 2001 as a result of change in methodology. Thus, 2001 is average for Q4 only.
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**, the economic recovery has continued. Real GDP rose 6.6 percent in the second quarter, and the average of July and August industrial production was more than 2 percent above its second quarter average. Consumer price inflation has continued to decline, with the twelve-month rate falling to 3.5 percent in September.

In mid-September, Argentina and the IMF agreed on a new three-year program. The final agreement does not include a timetable for utility tariff increases and does not explicitly require the government to compensate banks for the damage its crisis-management policies did to their balance sheets, conditions that the IMF had originally insisted would be necessary. The program sets a target for the primary surplus in 2004 of 3 percent of GDP, but it does not specify targets for the two subsequent years.

In late September, Argentina proposed a 75 percent reduction in the face value of more than $90 billion in defaulted debt owned by private bondholders. Under Argentina's complex plan, the country would offer investors a choice of three new bonds–discount bonds, par bonds, and capitalization bonds–in exchange for 152 existing issues denominated in seven currencies and issued in eight jurisdictions. Bondholders' reaction to the proposal has been largely negative.

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

Indicator	2001	2002	2003				
			Q2	Q3	July	Aug.	Sept.
Real GDP[1]	-10.3	-3.3	6.6	n.a.	...	...	...
Industrial production	-7.6	-10.6	.4	n.a.	1.3	1.8	n.a.
Unemployment rate[2]	18.1	20.4	16.4	n.a.	...	...	...
Consumer prices[3]	-1.4	41.0	14.5	5.2	7.3	4.9	3.5
Trade balance[4]	7.5	16.7	19.1	n.a.	18.5	15.5	n.a.
Current account[5]	-4.5	9.6	11.7	n.a.	...	...	...

1. Annual rate. Annual figures are Q4/Q4.
2. Percent, n.s.a. Data for Greater Buenos Aires. Data released semi-annually.
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 **Venezuela,** real GDP rebounded in the second quarter, but still remains 20 percent below its end-2001 level. Growth in the second quarter was led by a recovery in oil production, although non-oil production also experienced a sizeable increase. Oil production is still believed to be below the level prevailing before the general strike last December-January. Moreover, analysts have continued to express doubts about the sustainability of current production levels, given numerous technical problems following the dismissal by President Chavez of a large fraction of the employees of the government-owned oil firm early this year. Unemployment has remained high. Consumer price inflation fell in September, partly due to price controls and to the fixed exchange rate regime established last February. On a twelve-month basis, however, inflation remained above 25 percent. Stringent capital controls remain in place, but have been loosened somewhat. The official exchange rate is 1,600 bolivares per dollar, but the black market continued to price the bolivare at a significantly more depreciated exchange rate.

Venezuela's political outlook remains highly uncertain. The opposition continues to push for a national referendum that would "recall" President Chavez, but this does not appear likely to happen any time soon.

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

Indicator	2001	2002	2003				
			Q2	Q3	July	Aug.	Sept.
Real GDP[1]	.9	-16.7	87.5	n.a.	...	...	...
Unemployment rate[2]	13.4	16.0	18.4	n.a.	18.0	17.4	n.a.
Consumer prices[3]	12.3	31.2	34.2	29.5	31.8	30.4	26.5
Non-oil trade balance[4]	-12.2	-7.4	-2.4	n.a.	n.a.	n.a.	n.a.
Trade balance[4]	9.3	13.9	15.1	n.a.	n.a.	n.a.	n.a.
Current account[5]	3.9	7.7	9.4	n.a.	...	...	...

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.