

## **Prefatory Note**

The attached document represents the most complete and accurate version available based on original files from the FOMC Secretariat at the Board of Governors of the Federal Reserve System.

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## **Part 2**

January 21, 2004

# **CURRENT ECONOMIC AND FINANCIAL CONDITIONS**

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## **Recent Developments**

January 21, 2004

## **Recent Developments**

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## **Domestic Nonfinancial Developments**

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## Domestic Nonfinancial Developments

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### Overview

The economy appears to have expanded at a robust pace again last quarter. The fundamentals for consumer spending are quite positive, and activity in the residential construction sector continues to be extremely strong. On the business side, outlays for equipment and software likely posted moderate gains in the fourth quarter, and firms appear to have accumulated inventories for the first time in three quarters. Moreover, conditions in the industrial sector have brightened considerably since the last Greenbook. Despite the strong pace of economic activity, the labor market is improving only slowly, with private payroll employment showing a small acceleration in the fourth quarter. Core consumer price inflation has continued to slow in the last few months, and inflation expectations have remained subdued. The twelve-month change in the core CPI was only 1.1 percent last year, about 3/4 percentage point less than the increase in 2002.

### Labor Market Developments

The December employment report suggested that the labor market has not gained as much momentum as previously appeared to be the case. Private nonfarm payrolls rose only 5,000 in December, and their level in November was revised down 35,000. The average monthly increase in employment in the fourth quarter is now estimated to have been just 44,000, a clear improvement over the average monthly loss of 36,000 during the first half of last year, but still a fairly weak recovery.

Manufacturing payrolls continued to shrink in December at about the same pace as in the previous few months. In addition, holiday-related hiring in retail trade was below average; however, employment in this industry will likely bounce back this month because the lower rate of seasonal hiring implies fewer seasonal layoffs as well. Elsewhere, job gains were recorded in December in construction, education and health services, and professional and business services. Within business services, employment at temporary help firms rose 30,000, continuing the strong performance in this category since last spring.

Average weekly hours of production or nonsupervisory workers dropped 0.2 hour to 33.7 hours in December, reversing the gains of the previous two months. Aggregate hours fell 0.6 percent last month but increased at an annual rate of 2.2 percent for the fourth quarter as a whole, the first quarterly increase since the fourth quarter of 2000.

In the household survey, the unemployment rate fell 0.2 percentage point in December, to 5.7 percent, and was down more than 1/2 percentage point from

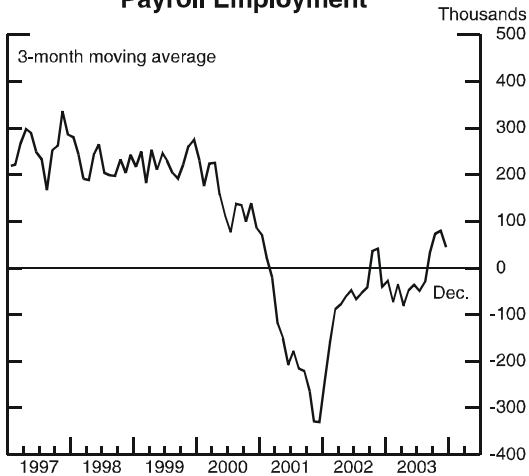
**Changes in Employment**

(Thousands of employees; seasonally adjusted)

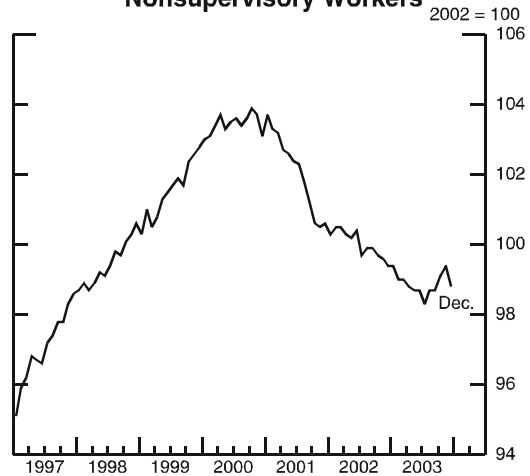
| Measure and sector  | 2003                   |      |      |                |      |      |
|---|------------------------|------|------|----------------|------|------|
|   | H1                     | Q3   | Q4   | Oct.           | Nov. | Dec. |
|   | Average monthly change |      |      | Monthly change |      |      |
| Nonfarm payroll employment (establishment survey)                           | -49                    | 26   | 48   | 100            | 43   | 1    |
| Private   | -36                    | 32   | 44   | 83             | 44   | 5    |
| Previous  | -36                    | 32   | ...  | 112            | 50   | ...  |
| Manufacturing   | -55                    | -40  | -23  | -17            | -26  | -26  |
| Construction  | 12                     | 14   | 11   | 4              | 14   | 14   |
| Wholesale trade   | -6                     | -6   | 5    | 0              | 2    | 12   |
| Retail trade  | -7                     | 8    | -19  | 9              | -28  | -38  |
| Transportation and utilities  | -11                    | 1    | -0   | 4              | 5    | -9   |
| Information   | -11                    | -5   | 0    | -4             | -1   | 5    |
| Financial activities  | 14                     | 5    | -11  | -15            | -7   | -12  |
| Professional and business services  | 6                      | 34   | 39   | 35             | 37   | 45   |
| Temporary help services   | 8                      | 18   | 21   | 11             | 23   | 30   |
| Nonbusiness services <sup>1</sup>   | 23                     | 25   | 42   | 66             | 47   | 14   |
| Total government  | -13                    | -7   | 4    | 17             | -1   | -4   |
| Total employment (household survey)   | 202                    | -10  | 278  | 451            | 438  | -54  |
| Memo:   |                        |      |      |                |      |      |
| Aggregate hours of private production workers (percent change) <sup>2</sup> | -1.7                   | -0.7 | 2.2  | 0.4            | 0.3  | -0.6 |
| Average workweek (hours) <sup>3</sup>                                       | 33.7                   | 33.7 | 33.8 | 33.8           | 33.9 | 33.7 |
| Manufacturing (hours)   | 40.3                   | 40.3 | 40.7 | 40.6           | 40.8 | 40.7 |

1. Nonbusiness services comprises education and health, leisure and hospitality, and "other."
  2. Establishment survey. Semiannual data are percent changes from Q4 to Q2. Quarterly data are percent changes from preceding quarter at an annual rate. Monthly data are percent changes from preceding month.
  3. Establishment survey.
- ... Not applicable.

**Changes in Private Payroll Employment**



**Aggregate Hours of Production or Nonsupervisory Workers**



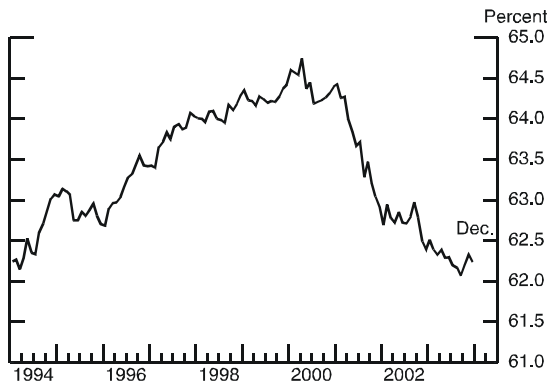
**Selected Unemployment and Labor Force Participation Rates**  
(Percent; seasonally adjusted)

| Rate and group                        | 2002 | 2003 | 2003 |      |      |      |      |
|---------------------------------------|------|------|------|------|------|------|------|
|                                       |      |      | Q3   | Q4   | Oct. | Nov. | Dec. |
| <i>Civilian unemployment rate</i>     |      |      |      |      |      |      |      |
| 16 years and older                    | 5.8  | 6.0  | 6.1  | 5.9  | 6.0  | 5.9  | 5.7  |
| Teenagers                             | 16.5 | 17.4 | 17.5 | 16.3 | 17.1 | 15.7 | 16.1 |
| 20-24 years old                       | 9.7  | 10.0 | 10.4 | 10.0 | 10.1 | 10.4 | 9.6  |
| Men, 25 years and older               | 4.7  | 5.1  | 5.1  | 4.9  | 5.0  | 5.0  | 4.7  |
| Women, 25 years and older             | 4.6  | 4.6  | 4.7  | 4.6  | 4.7  | 4.6  | 4.6  |
| <i>Labor force participation rate</i> |      |      |      |      |      |      |      |
| Total                                 | 66.6 | 66.2 | 66.2 | 66.1 | 66.2 | 66.2 | 66.0 |
| Teenagers                             | 47.4 | 44.5 | 44.2 | 43.6 | 43.7 | 43.8 | 43.2 |
| 20-24 years old                       | 76.4 | 75.4 | 75.5 | 74.9 | 75.2 | 75.0 | 74.5 |
| Men, 25 years and older               | 75.9 | 75.5 | 75.5 | 75.6 | 75.5 | 75.6 | 75.6 |
| Women, 25 years and older             | 59.4 | 59.6 | 59.5 | 59.4 | 59.5 | 59.5 | 59.3 |

**Labor Force Participation Rate and Unemployment Rate**

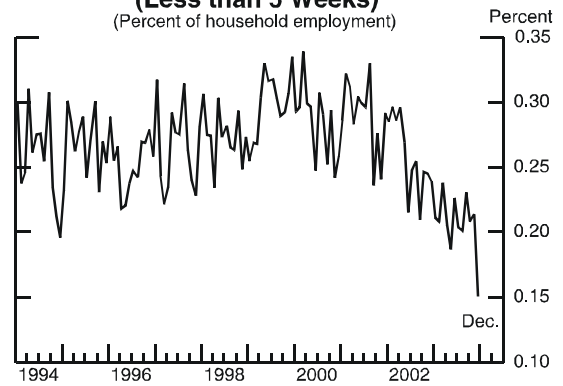


**Employment-Population Ratio**



**Short-term Quit Rate (Less than 5 Weeks)**

(Percent of household employment)



last summer.<sup>1</sup> These movements in the unemployment rate seem at odds with the message conveyed by the payroll data. However, as suggested by the extended decline in the labor force participation rate, a partial explanation for the paradox could be that marginal workers are staying out of the labor force in reaction to poor hiring prospects in greater numbers than has historically been the case. Indeed, the employment-population ratio—which captures the net effects of movements in labor force participation and unemployment—has changed little, on balance, since the summer after having dropped considerably between early 2001 and the first half of last year. Another indication that employed workers still view job opportunities as very limited is the short-term quit rate (the number of individuals who chose to leave their previous job and have been unemployed less than five weeks as a percent of household employment), which fell sharply in December and has trended downward, on balance, since 2001.

In the weeks following the reference week for the December employment report, initial claims for unemployment insurance continued to drift down, suggesting improved job growth in January. For the week ending January 10, the four-week moving average of initial claims stood at 347,000, the lowest level since February 2001. The four-week moving average of insured unemployment fell to 3.23 million for the week ending January 3, its lowest level since September 2001.<sup>2</sup> Although the claims data suggest that job losses have tapered off, new hiring apparently remains sluggish. In December, the proportion of unemployment insurance recipients who exhausted their benefits before finding a job stood near last year's high average level.

Other indicators of labor market conditions have been mixed. Survey data from the National Federation of Independent Businesses (NFIB) indicate that hiring plans of small firms rose sharply in December. The latest readings from Manpower Inc.'s survey of firms' hiring plans and the Conference Board's help wanted index—both of which tend to be less volatile than the NFIB measure—improved, though by much less than the NFIB survey. The Conference Board reported that households' assessments of current labor market conditions worsened a bit in December, though they are still better than they were last

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1. With December's employment report, the BLS released revised seasonal factors for series pertaining to the labor force going back to 1999. Resulting revisions to the unemployment rate were small.

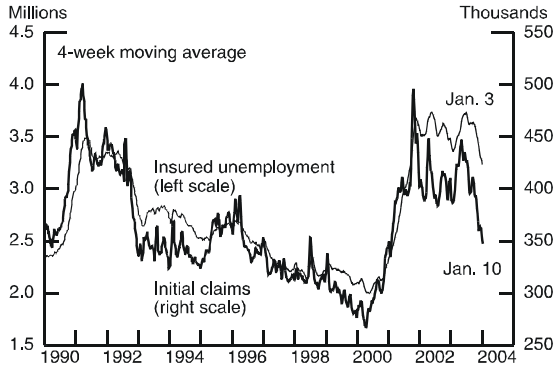
Prior to the December report, the BLS estimated seasonal factors twice a year. Beginning with the December report, new seasonal factors will be estimated every month and applied to the current month's data, though revisions to historical data will occur only once a year.

2. In the week ending December 27, 792,000 persons filed continuing claims under the Temporary Emergency Unemployment Compensation (TEUC) program. Current law does not allow individuals to enroll in the TEUC program after December 27. However, individuals who were already enrolled in the program as of that week will continue to receive benefits until their eligibility expires.

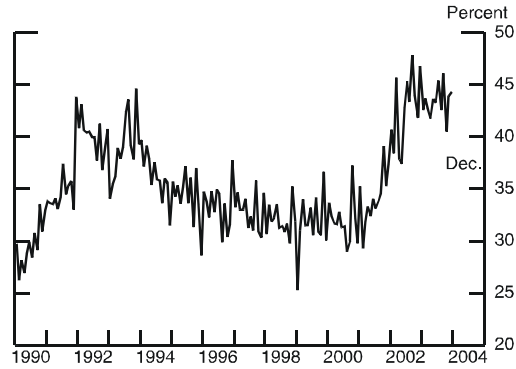


**Labor Market Indicators**

**Unemployment Insurance**

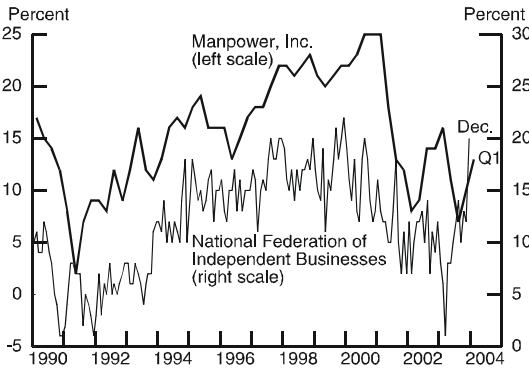


**Exhaustion Rate**



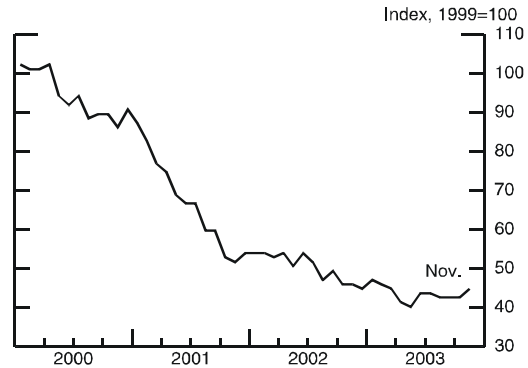
Note. Seasonally adjusted by FRB staff. Exhaustion rate is number of individuals who exhausted benefits without finding a job, expressed as a share of individuals who began receiving benefits six months earlier.

**Net Hiring Strength**



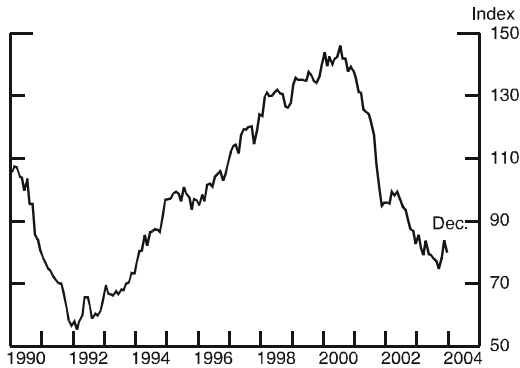
Note. Percent planning an increase in employment minus percent planning a reduction.

**Help Wanted Index**



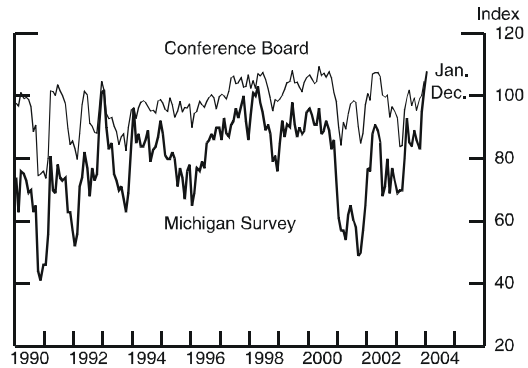
Source. Conference Board.

**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.

**Expected Labor Market Conditions**



Note. The proportion of households expecting labor market conditions to improve, minus the proportion expecting conditions to worsen, plus 100.

summer. In contrast, optimism about future labor market conditions increased significantly in the latest readings from both the Conference Board and Michigan surveys.

### **Industrial Production**

The pace of expansion in the industrial sector picked up in the fourth quarter. Total IP rose at an annual rate of 6.2 percent, the largest increase since the second quarter of 2000. Manufacturing production jumped 6.6 percent on gains that were widespread across both industry and market groups. After having surged in the third quarter, the output of motor vehicles and parts moved up at about the same rate as overall manufacturing in the fourth quarter. Output at mines increased at a 3 percent rate, while output at utilities rose at a 5-1/2 percent rate, led by another solid increase in electricity generation that mirrored the strengthening in the manufacturing sector.

High-tech industries accounted for nearly 30 percent of the increase in total IP in the fourth quarter. Semiconductor production has continued to chalk up significant gains, led by increases in the output of chips. Recent revenue guidance from Intel for the current quarter is consistent with another increase in semiconductor production, albeit at a slower pace than in the fourth quarter. Capacity utilization at chipmakers moved above 90 percent last quarter, and recent data on semiconductor equipment orders suggest that demand for the equipment needed to expand capacity has rebounded. Elsewhere in high tech, computer production stepped up from an average monthly change of 2 percent in the third quarter to 2-1/2 percent in the fourth quarter. IP for communications equipment more than retraced a dip in the third quarter and ended 2003 more than 8 percent above its level a year earlier.

Outside of energy, motor vehicles and parts, and high tech, production at all stages of processing posted gains in the fourth quarter. The output of finished products, led by solid increases in business equipment and consumer durables, moved up at an annual rate of 3.5 percent after having edged up 0.6 percent in the previous quarter. Production at the earlier stages of processing, primary and semifinished production, has been on an upward trend since the middle of 2003. These broad-based gains stand in contrast to the first half of 2002, when a similar increase in production at the primary and semifinished stages was not supported by a pickup in the output of finished goods. Widespread increases pushed the November diffusion index of three-month percent changes in IP to its highest level since 1987, and even though the index ticked down in December, it was above 50 for a sixth consecutive month.

Although total IP rose just 0.1 percent in December following an average monthly gain of 0.7 percent in the previous three months, the forward-looking indicators of near-term production suggest that industrial activity will continue to strengthen. In particular, the Institute for Supply Management's (ISM) index

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

| Component   | Proportion<br>2002<br>(percent) | 2003 <sup>1</sup> | 2003        |            | 2003         |            |           |
|---|---------------------------------|-------------------|-------------|------------|--------------|------------|-----------|
|   |                                 |                   | Q3          | Q4         | Oct.         | Nov.       | Dec.      |
|   |                                 |                   | Annual rate |            | Monthly rate |            |           |
| <b>Total</b>  | <b>100.0</b>                    | <b>1.6</b>        | <b>3.8</b>  | <b>6.2</b> | <b>.4</b>    | <b>1.0</b> | <b>.1</b> |
| Previous  | 100.0                           | ...               | 3.8         | ...        | .4           | .9         | ...       |
| Manufacturing   | 83.5                            | 2.0               | 3.7         | 6.6        | .2           | 1.0        | .3        |
| Ex. motor veh. and parts                                      | 76.8                            | 1.8               | 2.4         | 6.6        | .5           | 1.1        | .2        |
| Ex. high-tech industries                                      | 71.6                            | .4                | .4          | 4.7        | .3           | 1.0        | .1        |
| Mining  | 6.8                             | .8                | 1.0         | 3.0        | .2           | .6         | .0        |
| Utilities   | 9.8                             | -4                | 6.8         | 5.5        | 1.9          | 1.4        | -1.4      |
| <i>Selected industries</i>                                    |                                 |                   |             |            |              |            |           |
| High technology   | 5.2                             | 23.4              | 33.3        | 33.6       | 2.9          | 2.4        | 1.9       |
| Computers   | 1.3                             | 15.1              | 20.2        | 31.5       | 2.4          | 2.5        | 2.6       |
| Communications equipment                                      | 1.4                             | 8.2               | -6.7        | 12.3       | 3.3          | 1.2        | -2.2      |
| Semiconductors <sup>2</sup>                                   | 2.5                             | 36.8              | 69.5        | 46.6       | 3.0          | 2.9        | 3.6       |
| Motor vehicles and parts                                      | 6.7                             | 3.3               | 19.3        | 6.8        | -2.4         | .0         | .6        |
| <i>Market groups excluding energy and selected industries</i> |                                 |                   |             |            |              |            |           |
| Consumer goods  | 22.9                            | .1                | -1.5        | 3.0        | .4           | 1.0        | -2        |
| Durables  | 4.4                             | .6                | 2.0         | 5.6        | .8           | 1.3        | .1        |
| Nondurables   | 18.6                            | -1                | -2.3        | 2.4        | .3           | 1.0        | -2        |
| Business equipment  | 7.5                             | .9                | 4.3         | 5.1        | -.8          | 2.1        | -.1       |
| Defense and space equipment                                   | 1.8                             | 5.4               | 7.0         | 2.8        | .0           | -.1        | .1        |
| Construction supplies   | 4.3                             | 1.0               | 4.9         | 7.6        | .8           | 1.0        | .0        |
| Business supplies   | 8.5                             | .5                | -9          | 3.2        | .3           | .7         | -.1       |
| Materials   | 25.3                            | .0                | .1          | 7.4        | .6           | 1.2        | .4        |
| Durables  | 14.0                            | .3                | .8          | 9.8        | 1.1          | 1.2        | .5        |
| Nondurables   | 11.3                            | -.3               | -.7         | 4.6        | -.1          | 1.1        | .2        |

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

2. Includes related electronic components.

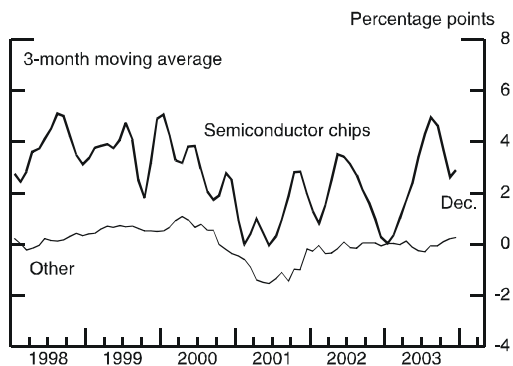
... Not applicable.

**Capacity Utilization**  
(Percent of capacity)

| Sector                         | 1972-<br>2002<br>average | 1982<br>low | 1990-<br>91<br>low | 2003        |             |             |             |             |
|--------------------------------|--------------------------|-------------|--------------------|-------------|-------------|-------------|-------------|-------------|
|                                |                          |             |                    | Q2          | Q3          | Q4          | Nov.        | Dec.        |
| <b>Total industry</b>          | <b>81.3</b>              | <b>70.9</b> | <b>78.6</b>        | <b>74.1</b> | <b>74.6</b> | <b>75.6</b> | <b>75.8</b> | <b>75.8</b> |
| Manufacturing                  | 80.2                     | 68.7        | 77.2               | 72.7        | 73.2        | 74.2        | 74.4        | 74.5        |
| High-tech industries           | 79.2                     | 75.4        | 74.5               | 62.0        | 65.0        | 68.1        | 68.2        | 68.9        |
| Excluding high-tech industries | 80.2                     | 68.2        | 77.3               | 73.9        | 74.3        | 75.2        | 75.4        | 75.5        |
| Mining                         | 86.9                     | 78.6        | 83.4               | 84.7        | 85.0        | 85.7        | 85.9        | 85.9        |
| Utilities                      | 87.0                     | 77.6        | 84.1               | 82.4        | 82.9        | 83.2        | 84.0        | 82.6        |

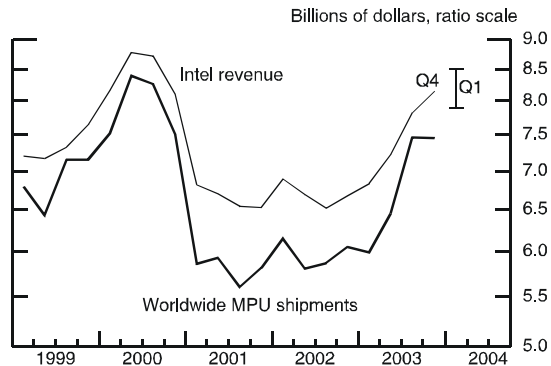
## Indicators of High-Tech Manufacturing Activity

Contribution to the Rate of Change in Semiconductor Industrial Production



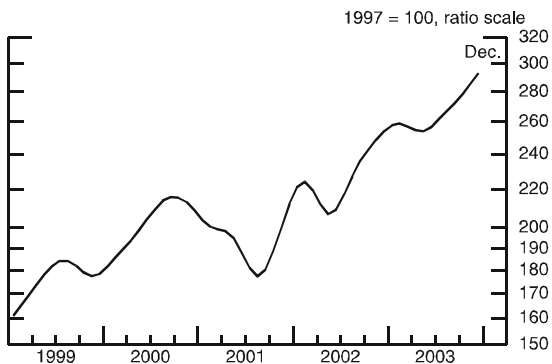
Note. Other includes related electronic components, such as printed circuit boards.

Microprocessor Unit (MPU) Shipments and Intel Revenue

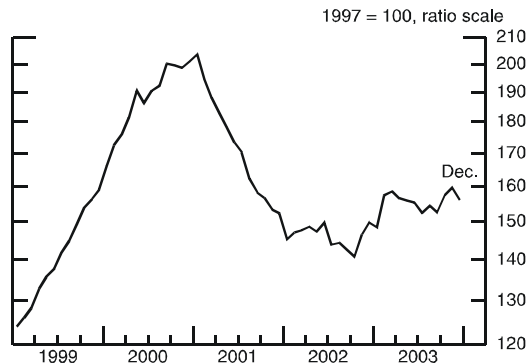


Note. Q1 is the range of Intel's guidance as of January 14, 2004. Source. Intel and Semiconductor Industry Association.

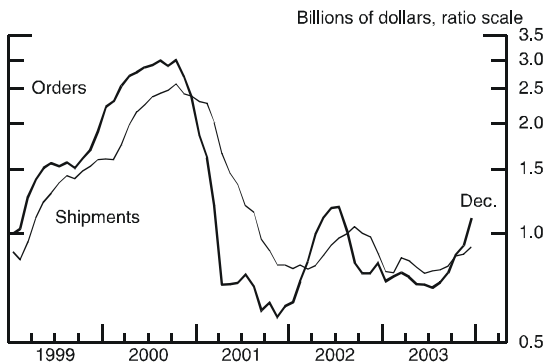
Computer and Peripheral Equipment Industrial Production



Communication Equipment Industrial Production

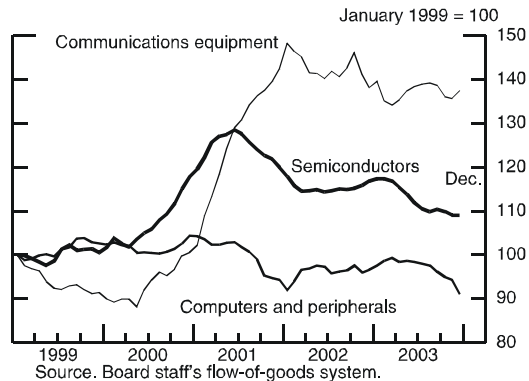


Semiconductor Manufacturing Equipment Orders and Shipments



Source. Semiconductor Equipment and Materials International.

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



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

of new orders jumped to a near-record level of 77.6 in December. More recently, the Philadelphia Fed's new orders index for January ticked down but remained at a high level. The three-month moving average of the staff's series for real adjusted durable goods orders rose 1.5 percent in November. Announced manufacturing layoffs declined for a second month in December, and announcements so far in January are on track to fall further. Weekly data for January point to a noticeable pickup in motor vehicle assemblies. Outside of motor vehicles, the available weekly production data suggest that the weekly industrial aggregate will contribute about 0.1 percentage point to the change in total IP.

**New Orders for Durable Goods**

(Percent change from preceding period except as noted; seasonally adjusted)

| Component                    | Proportion,<br>2003: H1<br>(percent) | 2003        |             |              |            |             |
|------------------------------|--------------------------------------|-------------|-------------|--------------|------------|-------------|
|                              |                                      | Q2          | Q3          | Sept.        | Oct.       | Nov.        |
|                              |                                      | Annual rate |             | Monthly rate |            |             |
| <b>Total orders</b>          | <b>100.0</b>                         | <b>-8</b>   | <b>17.1</b> | <b>2.2</b>   | <b>3.9</b> | <b>-2.5</b> |
| Adjusted orders <sup>1</sup> | 75.0                                 | -3.3        | 16.8        | 3.8          | 3.2        | -2.3        |
| Computers and peripherals    | 4.0                                  | 65.1        | 26.6        | -.2          | -.8        | -.3         |
| Communication equipment      | 4.0                                  | -31.2       | 80.8        | 15.6         | 16.3       | -41.1       |
| Other capital goods          | 24.0                                 | 1.0         | 7.6         | 5.7          | -.8        | 1.5         |
| Other <sup>2</sup>           | 43.0                                 | -7.9        | 16.6        | 2.2          | 4.5        | -.3         |
| Memo:                        |                                      |             |             |              |            |             |
| Real adjusted orders         | ...                                  | -1.6        | 17.8        | 3.8          | 3.1        | -2.4        |
| Excluding high tech          | ...                                  | -4.3        | 11.0        | 3.4          | 2.2        | .1          |

1. Orders excluding defense capital goods, nondefense aircraft, and motor vehicle parts.

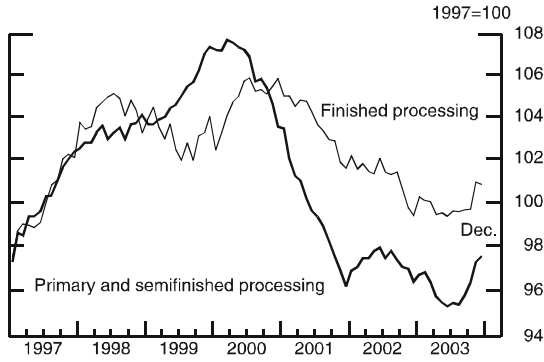
2. Primary metals; most fabricated metals; most stone, clay, and glass products; household appliances; scientific instruments; and miscellaneous durable goods.

... Not applicable.

In the ISM's Semiannual Economic Forecast that was released in December, the number of manufacturing purchasing managers who indicated that their companies plan to increase capital expenditures in 2004 exceeded the number that indicated a planned decrease; a diffusion index of these responses correlates well with annual changes in manufacturing investment. Coupled with the low factory operating rate, this diffusion index suggests that manufacturing investment in 2004 will increase modestly after having fallen in the previous three years. Such an increase would be consistent with a capacity gain of around 1-3/4 percent, a bit higher than the annual gains of about 1 percent recorded in the past two years, but still well below the average increase of 3-1/4 percent that prevailed from 1972 to 2001.

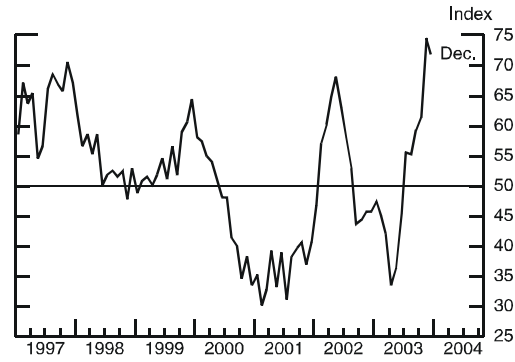
## Indicators of Manufacturing Activity

IP by Stage of Processing



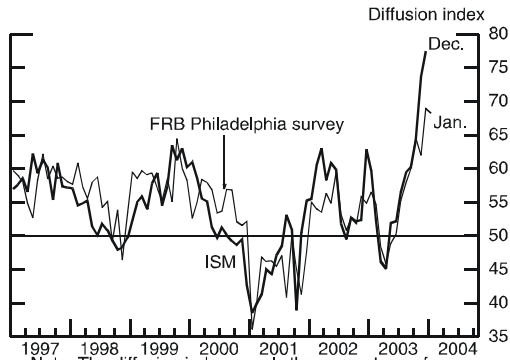
Note. Excludes energy, motor vehicles and parts, and high technology.

Industrial Production Diffusion Index



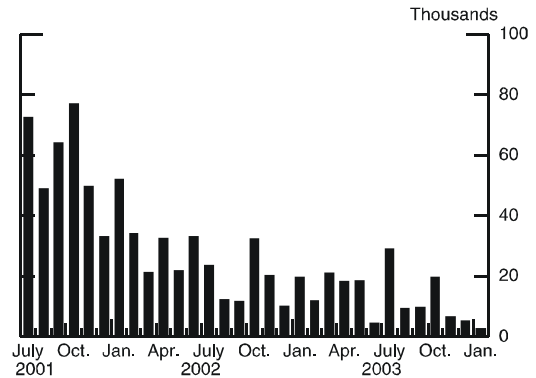
Note. The diffusion index equals the percentage of series that increased over three months plus one-half the percentage that were unchanged.

New Orders: ISM and FRB Philadelphia Surveys



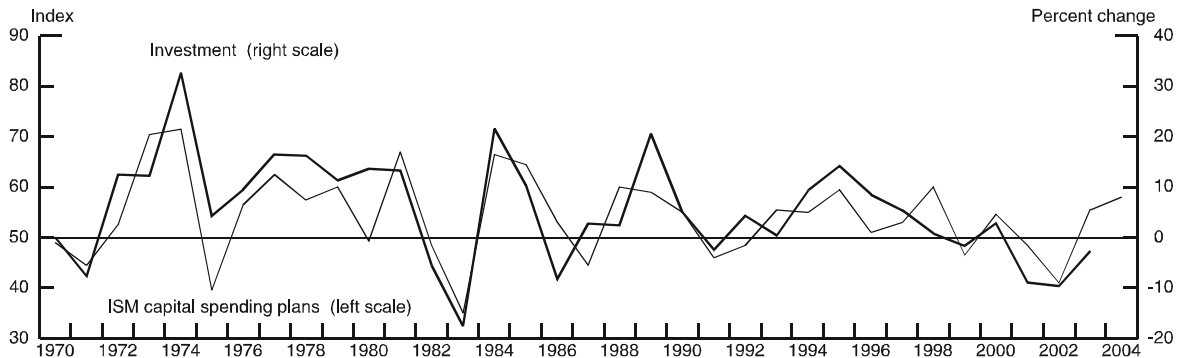
Note. The diffusion index equals the percentage of respondents reporting greater levels of new orders, plus one-half the percentage of respondents reporting that new orders were unchanged.

Announced Manufacturing Layoffs



Note. Data are through January 20, 2004. Staff seasonals. Source. Compiled by staff from news reports.

Manufacturing Investment



Note. Manufacturing investment data are from the Annual Survey of Manufacturers; figures for 2002 and 2003 are staff estimates. The ISM series is a diffusion index that equals the percentage of respondents reporting plans to increase investment plus one-half the percentage reporting no plans to change investment.

**Motor Vehicles**

Light-vehicle sales jumped in December to an annual rate of 18 million units, more than a million units above November's sales pace. Although the step-up in sales was likely spurred, in part, by the high level of incentives on new model-year vehicles, much of the increase likely reflected robust underlying consumer demand.<sup>5</sup> For the fourth quarter as a whole, sales averaged 16.8 million units, down sharply from the torrid third-quarter pace, but well above the average rate recorded in the first half of last year.

While estimates of the average incentive per vehicle crept up slightly in December, the average figure masks the fact that discounts increasingly were placed on new, more desirable, model-year vehicles. The Big Three firms, in particular, offered heavy promotions on their 2004 model-year vehicles and, in turn, increased their market share in December almost 4 percentage points from that in November. Not surprisingly, car-buying attitudes—as measured in the Michigan Survey—remained at a high level in January. Early this month, our industry contacts reported that they are seeing some payback from the unusually strong sales in December, and their projections for January as a whole ranged between 16.2 and 16.5 million units (excluding medium and heavy trucks). Incentives dropped noticeably early in the month, as the automakers apparently made efforts to back off from the large discounts offered in the fourth quarter.

With production at a robust annual rate of 12.2 million units in the fourth quarter, light-vehicle inventories ended the year up noticeably from the level at the end of the third quarter. Days' supply averaged 69 days in the fourth quarter, a bit above the manufacturers' targeted range. Despite the elevated level of inventories, the automakers' latest production plans call for a further increase in assemblies in the first quarter, to 12.5 million units.

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5. Of the increase of 1.2 million units in light motor vehicle sales from November to December, we estimate that roughly 800,000 units were attributable to the retail sector.

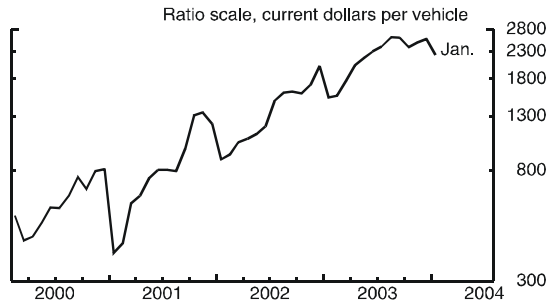
**Sales of Automobiles and Light Trucks**  
(Millions of units at an annual rate, FRB seasonals)

| Category                         | 2003 | 2003 |      |      | 2003 |      |      |
|----------------------------------|------|------|------|------|------|------|------|
|                                  |      | Q2   | Q3   | Q4   | Oct. | Nov. | Dec. |
| Total                            | 16.6 | 16.3 | 17.6 | 16.8 | 15.6 | 16.8 | 18.0 |
| Autos                            | 7.6  | 7.4  | 7.9  | 7.5  | 7.0  | 7.8  | 7.8  |
| Light trucks                     | 9.0  | 8.9  | 9.8  | 9.3  | 8.6  | 9.0  | 10.2 |
| North American <sup>1</sup>      | 13.3 | 13.0 | 14.3 | 13.6 | 12.5 | 13.4 | 14.8 |
| Autos                            | 5.5  | 5.4  | 5.8  | 5.5  | 5.1  | 5.6  | 5.8  |
| Light trucks                     | 7.8  | 7.6  | 8.5  | 8.1  | 7.5  | 7.9  | 9.0  |
| Foreign-produced                 | 3.3  | 3.3  | 3.4  | 3.2  | 3.1  | 3.4  | 3.2  |
| Autos                            | 2.1  | 2.0  | 2.1  | 2.0  | 1.9  | 2.2  | 2.0  |
| Light trucks                     | 1.2  | 1.3  | 1.3  | 1.2  | 1.1  | 1.2  | 1.2  |
| Memo:<br>Medium and heavy trucks | .33  | .31  | .34  | .37  | .34  | .37  | .41  |

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.

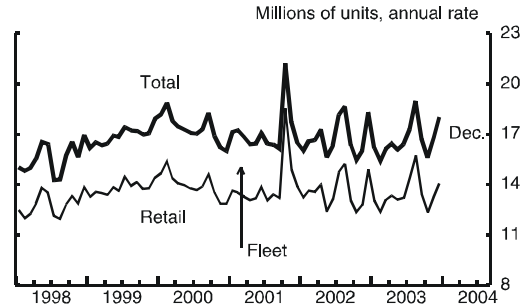
1. Excludes some vehicles produced in Canada that are classified as imports by the industry.

**Average Value of Incentives on Light Vehicles**



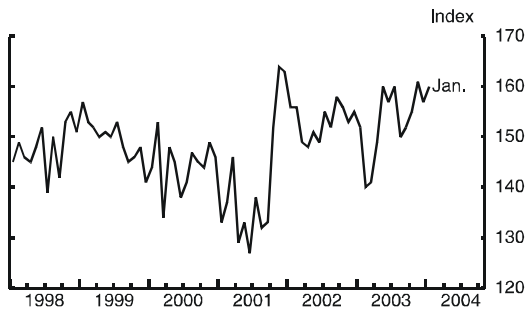
Note. Weighted average of customer cash rebate and interest rate reduction. Data are seasonally adjusted. Source: J.D. Power and Associates.

**Fleet and Retail Sales of Light Vehicles**

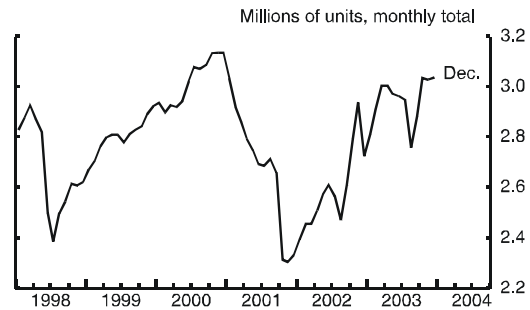


Note. FRB seasonals.

**Michigan Survey Index of Car-Buying Attitudes**



**Inventories of Light Vehicles**



Note. FRB seasonals.



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

| Item                      | 2003 | 2003 |      | 2004            | 2003 |      |      |
|---------------------------|------|------|------|-----------------|------|------|------|
|                           |      | Q3   | Q4   | Q1 <sup>1</sup> | Oct. | Nov. | Dec. |
| U.S. production           | 12.3 | 12.3 | 12.2 | 12.5            | 12.2 | 12.1 | 12.2 |
| Autos                     | 4.5  | 4.6  | 4.4  | 4.7             | 4.5  | 4.4  | 4.3  |
| Trucks                    | 7.6  | 7.7  | 7.8  | 7.8             | 7.7  | 7.7  | 7.8  |
| Days' supply <sup>2</sup> | 70   | 62   | 69   | n.a.            | 74   | 69   | 63   |
| Inventories <sup>3</sup>  | 3.04 | 2.88 | 3.04 | n.a.            | 3.04 | 3.03 | 3.04 |

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

1. Production rates for the first quarter reflect the latest schedules from Ward's Communications.

2. Quarterly values calculated with end-of-period stocks and average reported sales; excludes medium and heavy trucks.

3. End-of-period stocks; excludes medium and heavy trucks.

n.a. Not available

### Consumer Spending

Consumer spending appears to have increased at a solid pace at the end of 2003. Although December figures on outlays for services are not yet available, the data on retail sales and sales of light vehicles are consistent with an increase in real personal consumption expenditures in the fourth quarter at an annual rate of roughly 3 percent. Although personal income gains likely slowed last month owing to the drop in hours worked, the gradual improvement in labor market conditions, recent stock market gains, and upbeat readings on consumer confidence suggest that the momentum in household spending should be sustained going forward.

Nominal spending in the retail control category of goods—which excludes auto dealers and building material and supply stores—increased 0.7 percent in November and 0.2 percent in December; after accounting for price changes, we estimate that real spending in this category rose 1.0 percent in November and was flat in December. Real expenditures on services climbed 0.3 percent in November after having increased 0.1 percent in the previous month.

Real disposable personal income advanced smartly in November, with sizable gains in private wages and salaries and proprietors' income. The personal saving rate was 1.8 percent in November, below its level last summer when the advance rebates of the child tax credit were flowing to households but about equal to the revised level at the end of 2002.

In December, both the Michigan Survey Research Center's index of consumer sentiment and the Conference Board's index of consumer confidence stood well

**Retail and Food Services Sales**

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

| Category                     | 2003 |     |     |      |      |      |
|------------------------------|------|-----|-----|------|------|------|
|                              | H1   | Q3  | Q4  | Oct. | Nov. | Dec. |
| Total sales                  | 2.9  | 2.8 | 1.1 | .0   | 1.2  | .5   |
| Previous estimate            | ...  | ... | .5  | .0   | .9   | ...  |
| Retail control <sup>1</sup>  | 2.1  | 2.6 | 1.2 | .3   | .7   | .2   |
| Previous estimate            | ...  | ... | .9  | .2   | .4   | ...  |
| GAF <sup>2</sup>             | 1.5  | 3.1 | .7  | .0   | .4   | .3   |
| Gasoline stations            | 1.3  | 3.4 | .4  | -2.1 | 2.0  | -.4  |
| Food services                | 4.7  | 2.3 | 2.9 | 2.5  | 1.2  | .4   |
| Other retailers <sup>3</sup> | 2.0  | 2.2 | 1.4 | .4   | .5   | .1   |

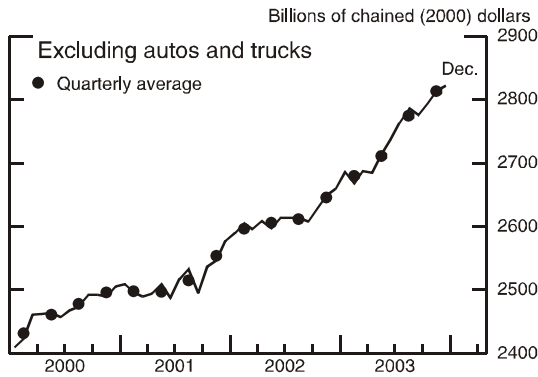
1. Total retail trade and food services less sales at building material and supply stores and automobile and other motor vehicle dealers.

2. Furniture and home furnishing stores; electronics and home appliance stores; clothing and accessories stores; sporting goods, hobby, book, and music stores; and general merchandise stores.

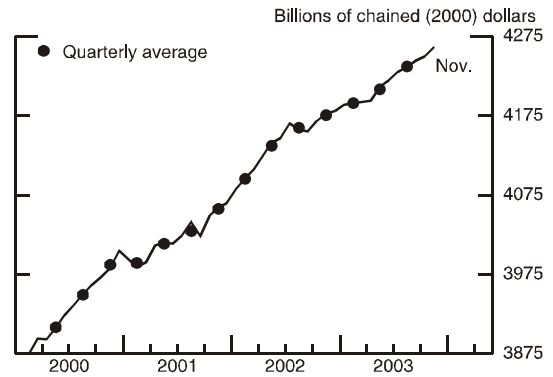
3. Health and personal care stores, food and beverage stores, electronic shopping and mail order houses, and miscellaneous other retailers.

... Not applicable.

**Real PCE Goods**

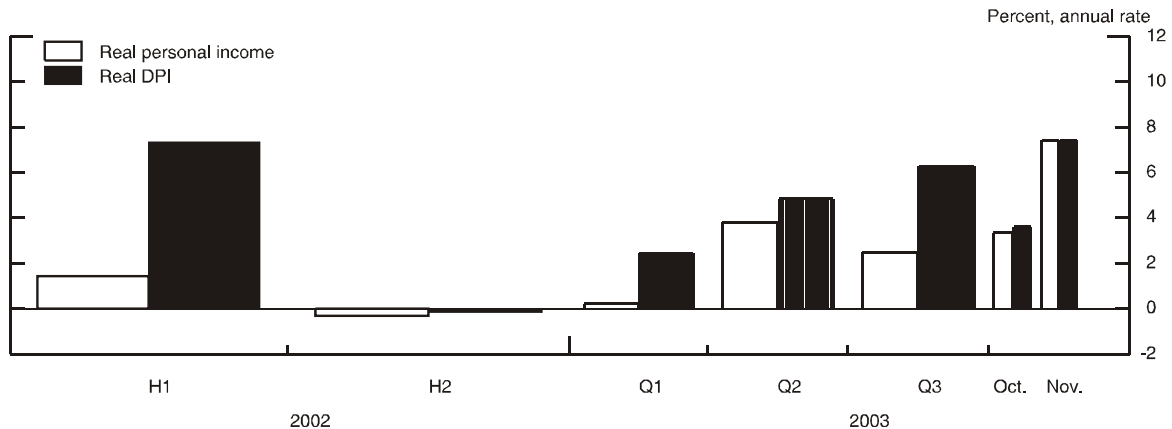


**Real PCE Services**



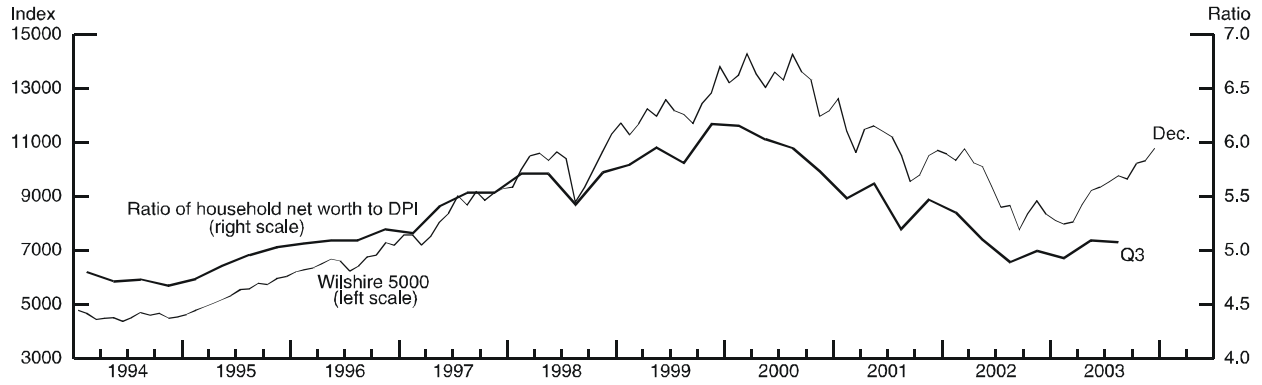
Note. Data for 2003:Q4 are a staff estimate.

**Change in Real Personal Income and Real DPI**



### Household Indicators

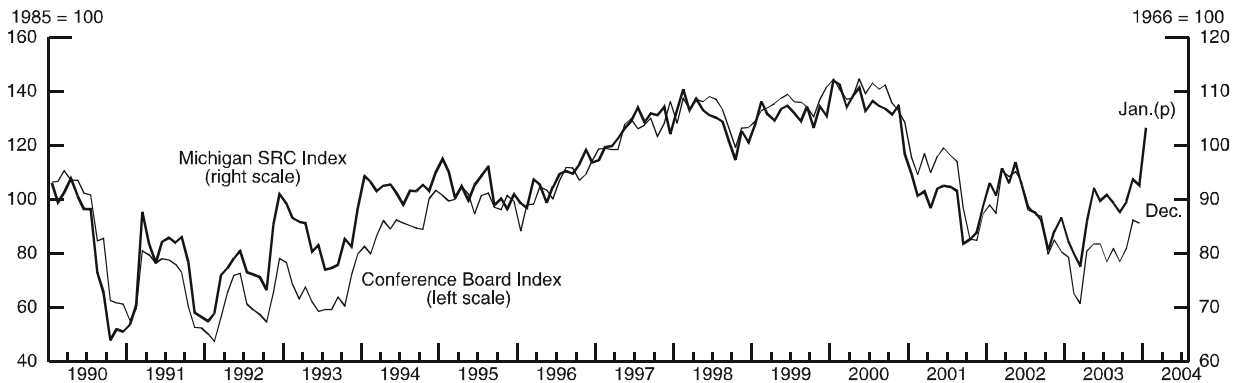
#### Household Net Worth and Wilshire 5000



#### Personal Saving Rate



#### Consumer Confidence



above their average readings last year, and the preliminary Michigan report for January surged to its highest level since November 2000. The recent upturn reflected significant improvements in consumers' assessments of both current and expected economic conditions.

### **Housing Markets**

Activity in housing markets remains very robust. In December, single-family starts edged down only a bit from the stunning rate they had reached in November, to an annual rate of 1.66 million units. New permit issuance (adjusted for activity in areas where permits are not required) moved up briskly to its highest level in more than twenty-five years, which narrowed noticeably the gap that had emerged between permits and starts. Although starts are likely to move closer in line with permits over the coming months, the high level of permits and the low level of mortgage rates suggest that single-family construction will remain quite elevated. In the multifamily sector, starts moved up to an annual rate of 424,000 units in December, its highest level in almost four years, despite high and rising vacancy rates through the third quarter of last year.

New home sales declined in November for the third consecutive month, though the 1.08 million-unit annual rate was well above most previous readings. Similarly, existing home sales have fallen back from September's high, but the level in November was still noticeably higher than average sales in the first half of 2003.

Other indicators also suggest that housing demand will be well maintained in the near term. The four-week moving average of purchase applications from the Mortgage Bankers Association and attitudes toward homebuying in the Michigan survey have both remained at relatively high levels. Rates on fixed-rate mortgages have edged down during the past few months and are now less than half a percentage point above the historical low recorded last June. Meanwhile, rates on adjustable-rate mortgages have flattened out near last year's low average level.

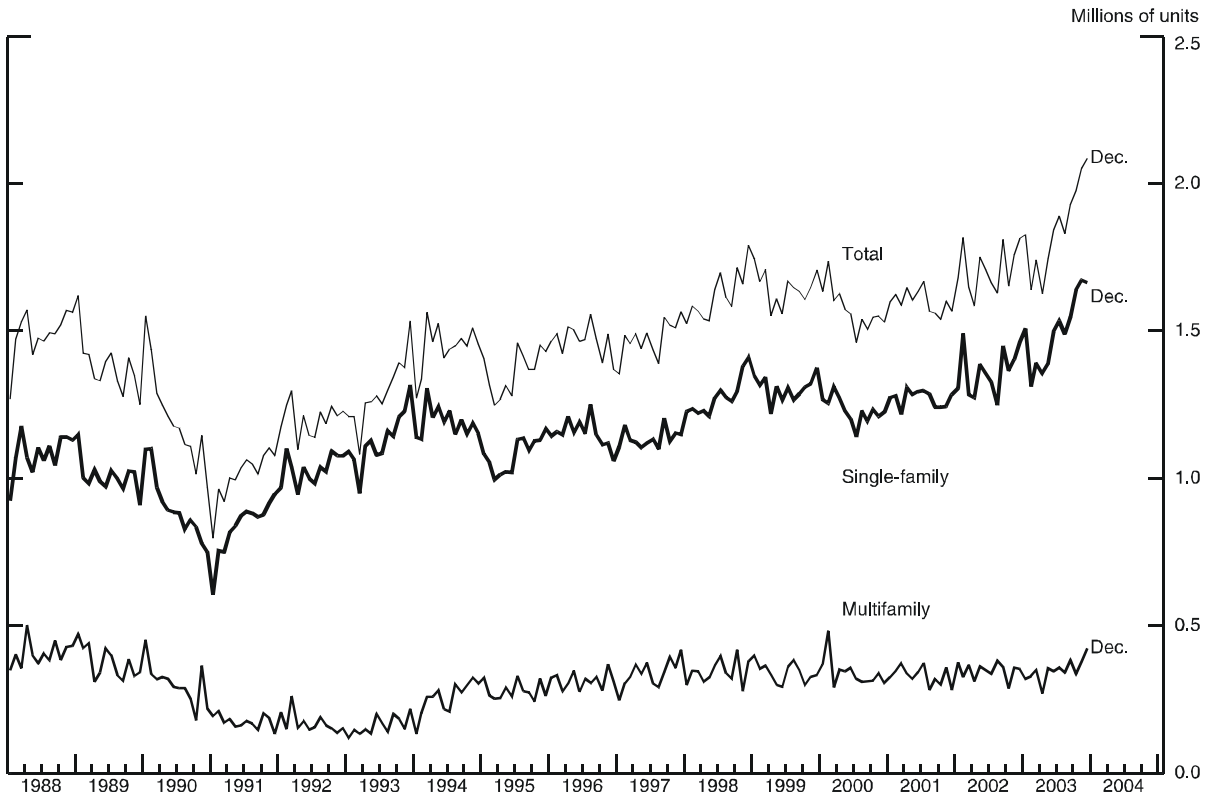
Prices of new homes continued to rise briskly through November. The median price was 15-1/2 percent higher than twelve months earlier, its largest increase in more than fifteen years. In the much larger market for existing homes, the twelve-month change in the median price slowed in November to 6 percent. Neither of these price measures adjusts for shifts in the characteristics of homes sold. The constant-quality price index for new homes, which controls for changes in geographic composition, home size, and other amenities, accelerated 3 percentage points to a 7-1/4 percent rate of increase over the year ending in the third quarter of 2003 (the latest available data). The repeat-sales price index for existing homes, which holds constant some of the

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

| Sector                        | 2003 | 2003 |      |      |      |      |      |
|-------------------------------|------|------|------|------|------|------|------|
|                               |      | Q2   | Q3   | Q4   | Oct. | Nov. | Dec. |
| <i>All units</i>              |      |      |      |      |      |      |      |
| Starts                        | 1.85 | 1.74 | 1.88 | 2.04 | 1.98 | 2.05 | 2.09 |
| Permits                       | 1.86 | 1.78 | 1.86 | 1.92 | 1.98 | 1.86 | 1.92 |
| <i>Single-family units</i>    |      |      |      |      |      |      |      |
| Starts                        | 1.50 | 1.42 | 1.52 | 1.66 | 1.64 | 1.67 | 1.66 |
| Permits                       | 1.44 | 1.37 | 1.47 | 1.51 | 1.54 | 1.47 | 1.51 |
| Adjusted permits <sup>1</sup> | 1.47 | 1.40 | 1.51 | 1.57 | 1.58 | 1.53 | 1.60 |
| New home sales                | n.a. | 1.10 | 1.16 | n.a. | 1.11 | 1.08 | n.a. |
| Existing home sales           | n.a. | 5.83 | 6.42 | n.a. | 6.35 | 6.06 | n.a. |
| <i>Multifamily units</i>      |      |      |      |      |      |      |      |
| Starts                        | 0.35 | 0.32 | 0.36 | 0.38 | 0.34 | 0.38 | 0.42 |
| Permits                       | 0.42 | 0.41 | 0.39 | 0.41 | 0.44 | 0.39 | 0.41 |
| <i>Mobile homes</i>           |      |      |      |      |      |      |      |
| Shipments                     | n.a. | 0.13 | 0.13 | n.a. | 0.13 | 0.13 | n.a. |

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

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



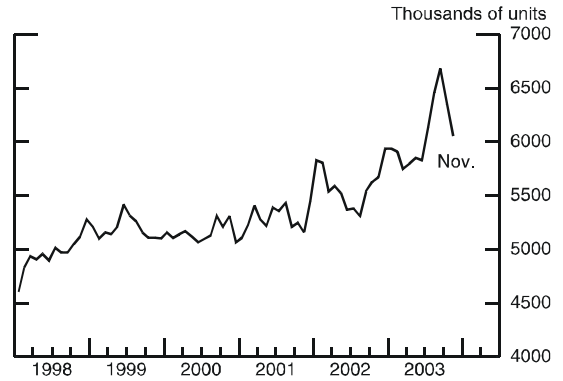
## Indicators of Single-Family Housing

New Home Sales



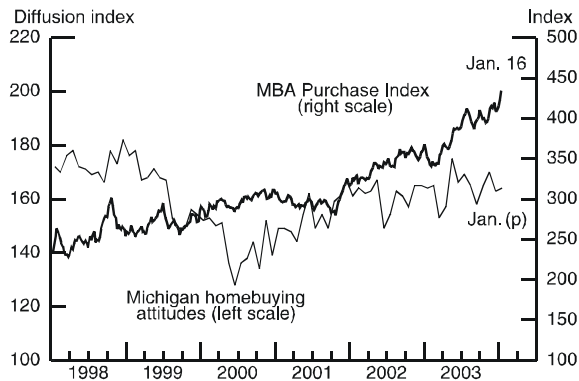
Source. Census Bureau.

Existing Home Sales



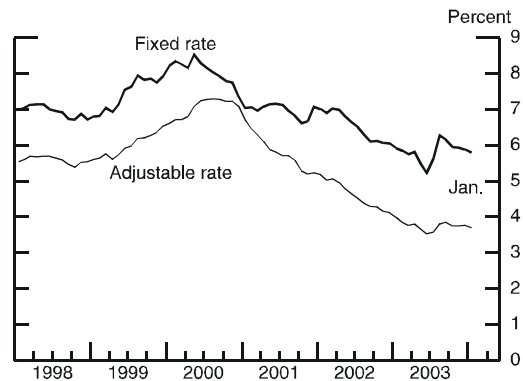
Source. National Association of Realtors.

Homebuying Indicators



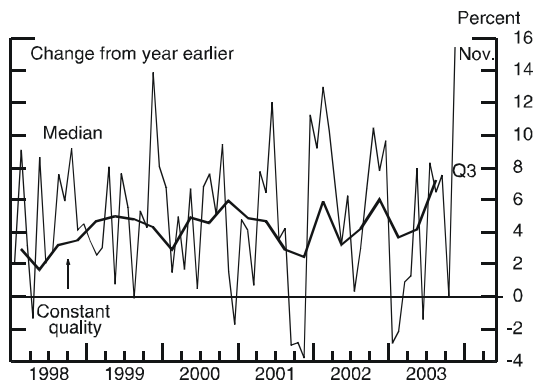
Note. MBA index is a 4-week moving average. Michigan Survey data are not seasonally adjusted.  
Source. Mortgage Bankers Association and Michigan Survey.

Mortgage Rates



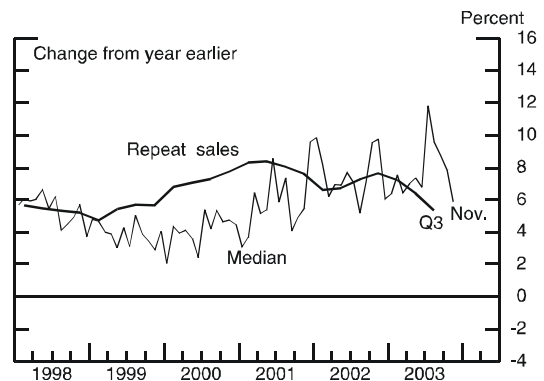
Note. The Jan. reading is based on data through Jan. 16.  
Source. Freddie Mac.

Prices of New Homes



Source. Census Bureau.

Prices of Existing Homes



Source. National Association of Realtors and Freddie Mac.

compositional shifts that can affect the median price, was 5-1/2 percent higher in the third quarter than a year earlier, its smallest four-quarter change since early 1999.

### **Equipment and Software**

Business outlays for equipment and software seem to be recovering from the poor performance of the past several years. Spending in the second half of last year likely received a significant boost from sharp gains in business output and corporate cash flow as well as the low level of the user cost of capital. In the transportation sector, business purchases of new motor vehicles and aircraft both appear to have strengthened. Elsewhere, spending on capital goods likely advanced at a moderate rate in the fourth quarter after having moved up appreciably in third quarter.

In the high-tech sector, nominal shipments of computing equipment dropped 2.4 percent in November (not at an annual rate), partially reversing the previous month's run-up. Nonetheless, given the ongoing decline in computer prices, real outlays for computing equipment appear to have posted another sizable increase in the fourth quarter. Nominal shipments of communications equipment fell slightly in November, and orders dropped precipitously after having registered large increases in the previous two months. Smoothing through the volatility of these series, real spending on communications equipment seems to have hit a lull in the fourth quarter after three quarters of double-digit growth. Real business purchases of software are likely to have increased a good bit in the fourth quarter, according to revenue reports now available from some of the major software vendors.

Increases in nominal shipments of civilian aircraft and parts in October and November suggest that business spending on aircraft rebounded noticeably in the fourth quarter, although investment in this category still lingers far below the levels that prevailed before the downturn. Elsewhere in transportation, fleet sales of light vehicles jumped in the fourth quarter to an annual rate of 3.6 million units, more than 400,000 units above the average pace of sales in the third quarter.<sup>6</sup> Sales of medium and heavy trucks also rose in the fourth quarter and reached their highest level since early 2001. In a sign of continued improvement in truck demand, net new orders for medium and heavy trucks surged in December.

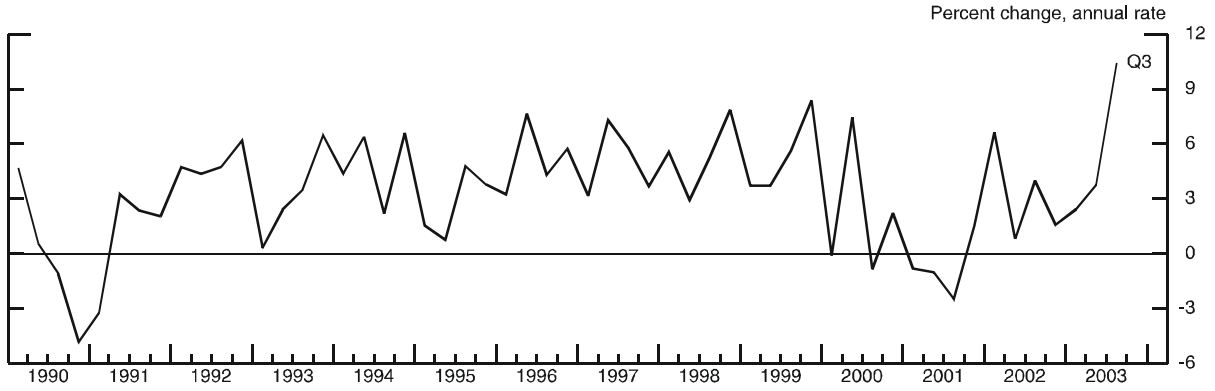
Outside of high-tech and transportation, nominal shipments were nearly unchanged in November after having edged down in October. However, new

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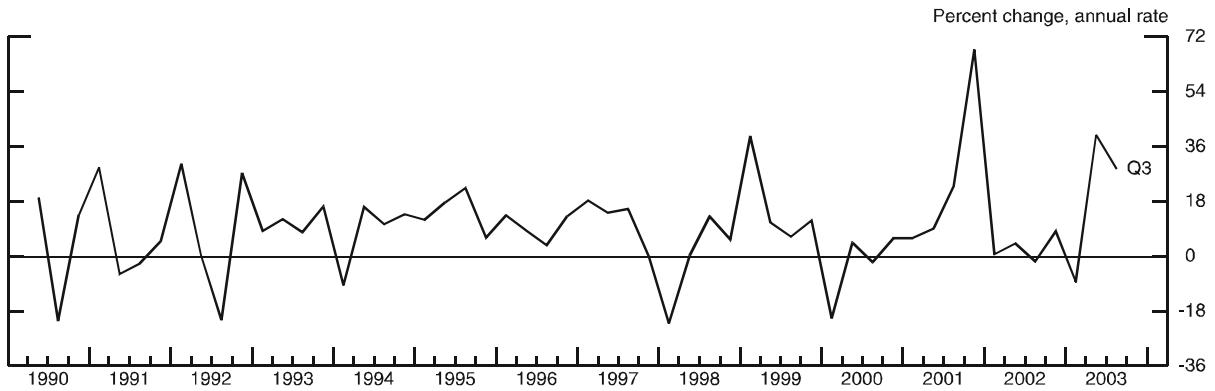
6. General Motors accounted for most of December's increase in fleet sales. Our contact there reported that their sales to rental car companies and to other businesses rose in December.

## Equipment and Software Investment Fundamentals

Real Business Output

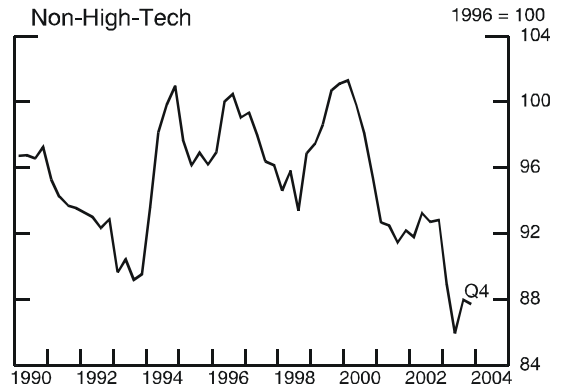
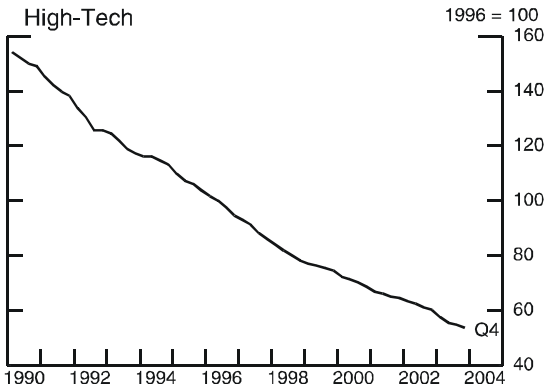


Real Corporate Cash Flow



### User Cost of Capital

(Excludes the effects of the partial expensing tax incentive)



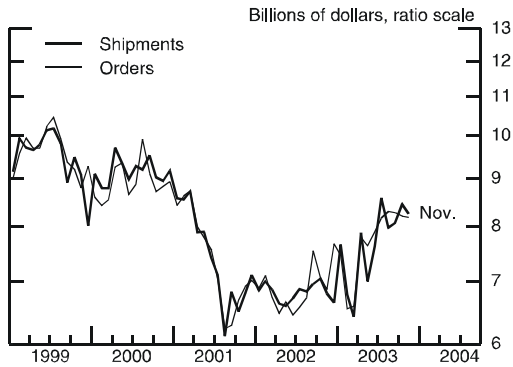


**Orders and Shipments of Nondefense Capital Goods**  
(Percent change; seasonally adjusted current dollars)

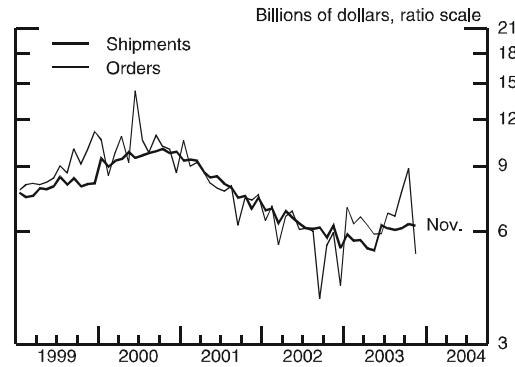
| Indicators   | 2003        |      |              |      |       |
|--|-------------|------|--------------|------|-------|
|  | Q2          | Q3   | Sept.        | Oct. | Nov.  |
|  | Annual rate |      | Monthly rate |      |       |
| Shipments  | 5.7         | 16.4 | 3.5          | .3   | .3    |
| Excluding aircraft                                   | 5.6         | 15.6 | 3.1          | .8   | -.6   |
| Computers and peripherals                            | 35.8        | 43.5 | 1.3          | 4.6  | -2.4  |
| Communications equipment                             | -6.5        | 35.2 | .9           | 2.8  | -1.3  |
| All other categories                                 | 2.7         | 8.4  | 3.8          | -.3  | -.1   |
| Orders   | 12.9        | 17.9 | 5.2          | 2.4  | -5.7  |
| Excluding aircraft                                   | 3.2         | 17.1 | 6.0          | 1.4  | -5.1  |
| Computers and peripherals                            | 65.1        | 26.6 | -.2          | -.8  | -.3   |
| Communications equipment                             | -31.2       | 80.8 | 15.6         | 16.3 | -41.1 |
| All other categories                                 | 1.0         | 7.6  | 5.7          | -.8  | 1.5   |
| Memo:<br>Shipments of complete aircraft <sup>1</sup> | 25.8        | 28.0 | 24.5         | 27.8 | 34.6  |

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

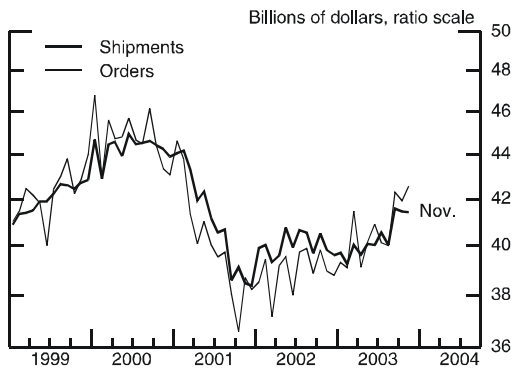
**Computers and Peripherals**



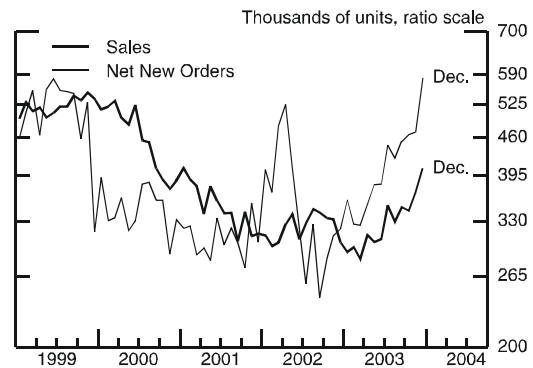
**Communications Equipment**



**Other Equipment**



**Medium and Heavy Trucks**



Note. Annual rate, FRB seasonals.

Source. Ward's Communications and ACT Research Co.

orders rose 1.5 percent in November, and the uptrend in orders since the beginning of last year points to further gains in spending in this category.

### **Nonresidential Construction**

After holding roughly steady, on balance, in the first half of 2003, real spending on private nonresidential construction appears to have slipped further in both the third and fourth quarters. In the commercial and health care sector and the manufacturing sector, which together account for roughly half of total investment in nonresidential structures, average nominal outlays in October and November were about unchanged from the previous quarter.<sup>7</sup> However, spending on other types of structures was down, on balance, over the same period. Expenditures for drilling and mining likely rose in the fourth quarter, owing to a continued increase in natural gas drilling activity.

Recent indicators of market conditions in the office sector suggest little improvement: Rents in the third quarter (the latest available data) were down a bit from their level a year earlier, and property values were little changed. The vacancy rate edged down but remained at a high level in the fourth quarter. For other commercial buildings, the indicators are mixed: Rents for retail structures and warehouses have been flat or have fallen further through the first three quarters of 2003; nonetheless, the value of retail and wholesale properties increased considerably, perhaps reflecting an improved outlook for future rents.

### **Inventories**

The book value of manufacturing and trade inventories excluding motor vehicles increased significantly in November for the third month in a row. Stocks at manufacturers were down a little, on average, in October and November, but nonauto wholesalers and retailers accumulated inventories at a brisk pace. Strong increases in sales, however, kept book-value inventory-sales ratios at or near their recent lows.

More recently, the Board staff's flow-of-goods system indicated that the days' supply of inventories edged down for a second month in December. The only industries that appeared to have elevated days' supply levels were paper and communications equipment.

### **Federal Government**

Higher defense spending as well as the revenue loss associated with the Jobs and Growth Tax Relief Reconciliation Act continued to put upward pressure on the federal unified budget deficit. Adjusted for shifts in the timing of outlays, the federal government recorded a cumulative \$60 billion deficit in

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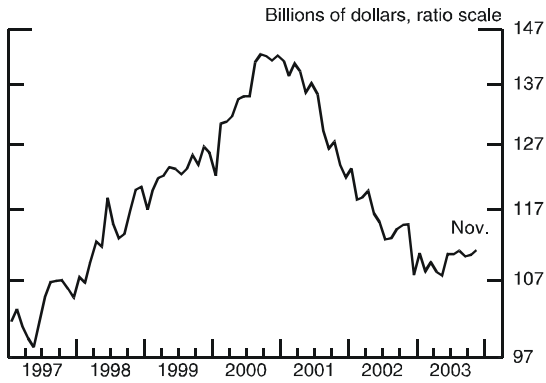
7. Commercial and health care—one of the new categories adopted by the BEA as part of the comprehensive revision—includes both office buildings and other commercial structures.

### Nonresidential Construction

Total Structures



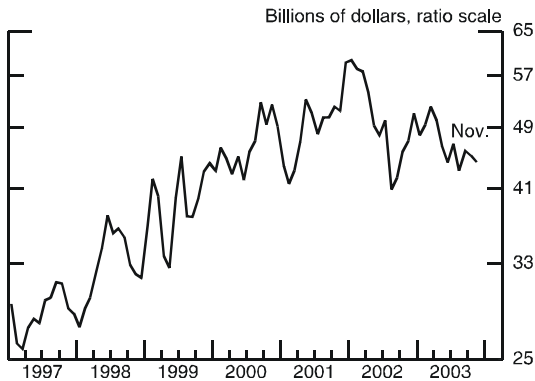
Commercial and Health Care



Manufacturing



Power and Communication



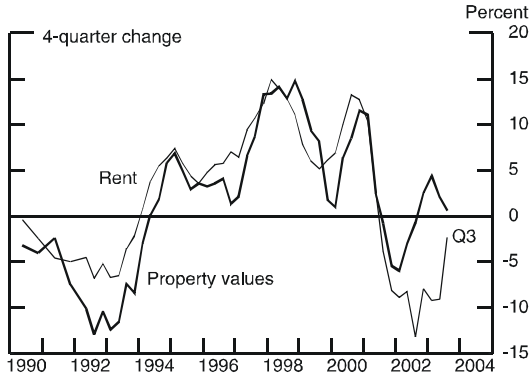
Other



**Indicators of Nonresidential Construction**

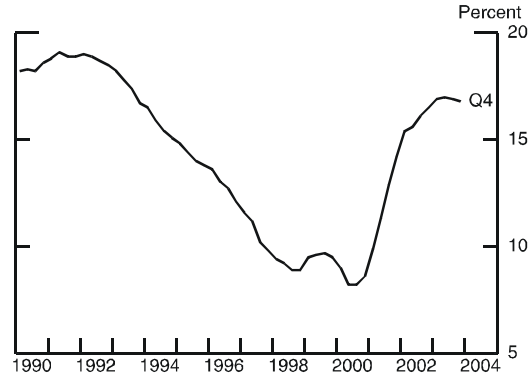
**Office Buildings**

**Property Values and Rent**



Source. National Real Estate Index.

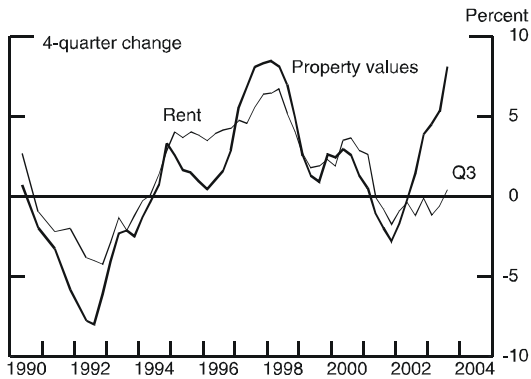
**Vacancy Rate**



Source. Torto Wheaton Research.

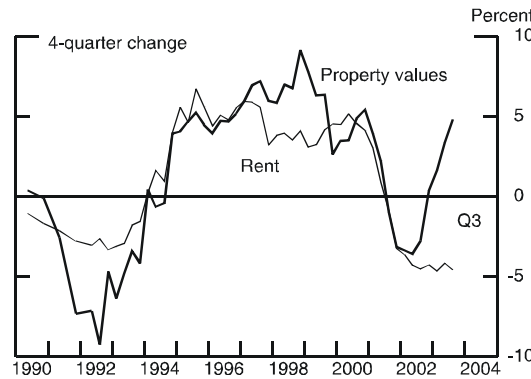
**Other Commercial Buildings**

**Retail Property Values and Rent**



Source. National Real Estate Index.

**Warehouse Property Values and Rent**



Source. National Real Estate Index.

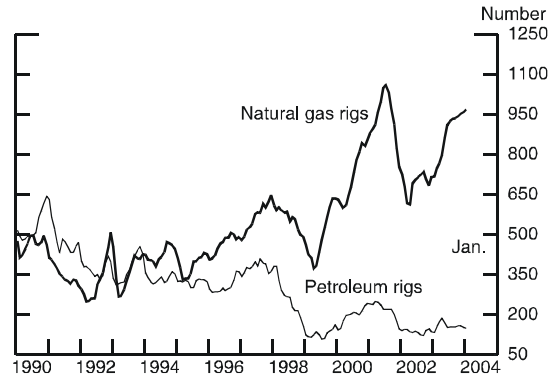
**Industrial Buildings**

**Manufacturing Capacity Utilization**



**Drilling Activity**

**Rigs in Operation**

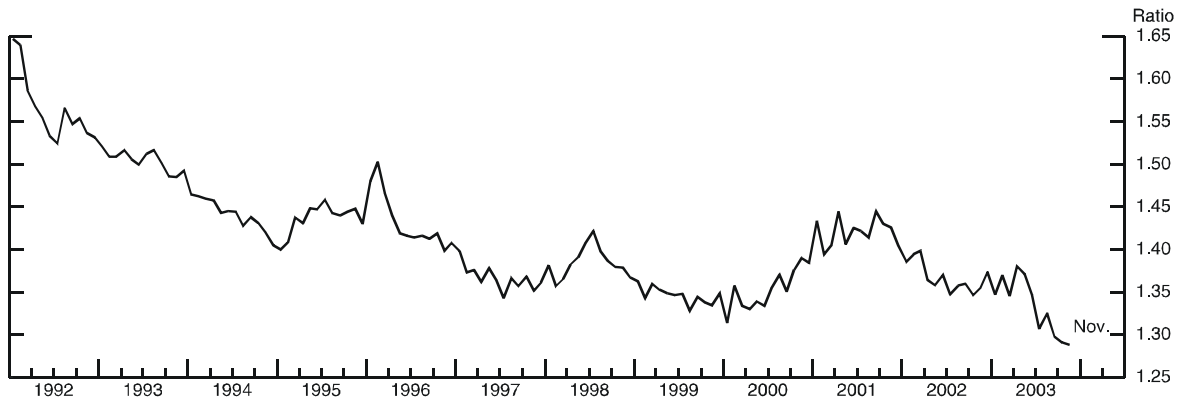


Note. January values are averages through January 16.  
Source. DOE/Baker Hughes.

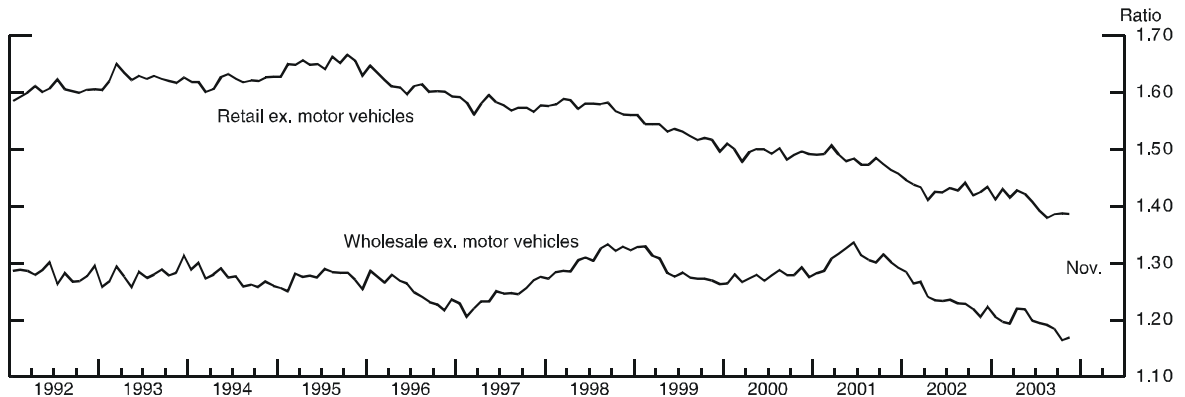
**Changes in Manufacturing and Trade Inventories**  
(Billions of dollars; seasonally adjusted book value; annual rate)

| Sector  | 2003  |       |       |      |      |
|---|-------|-------|-------|------|------|
|   | Q2    | Q3    | Sept. | Oct. | Nov. |
| Manufacturing and trade<br>Ex. wholesale and retail<br>motor vehicles & parts | -11.8 | -8.1  | 57.0  | 59.7 | 49.5 |
| Manufacturing<br>Ex. aircraft   | -10.1 | -17.5 | -16.1 | 4.6  | -9.3 |
| Wholesale trade<br>Motor vehicles & parts<br>Ex. motor vehicles & parts       | -8.1  | 3.1   | 11.7  | 18.4 | 18.2 |
| Retail trade<br>Motor vehicles & parts<br>Ex. motor vehicles & parts          | 6.4   | 6.3   | 61.4  | 36.7 | 40.6 |
|   | -2.0  | 13.0  | 30.1  | 9.5  | 17.9 |

**Inventories Relative to Shipments: Manufacturing**



**Inventories Relative to Sales: Trade**



November and December, up about \$16 billion from the same period a year earlier.

Adjusted outlays were almost \$20 billion higher than in the same period a year earlier. Defense spending in November and December was up sharply from year-earlier levels; however, in spite of the large boost in defense appropriations for fiscal year 2004, the level of defense spending in recent months is not much higher than in the second quarter of last year. Meanwhile, outlays for Medicare and income security were only slightly higher, and net interest and agriculture expenditures were lower than a year earlier.

Adjusted receipts in November and December were up less than 1 percent from a year earlier. Individual income and payroll taxes were little changed, and corporate tax payments were up only modestly from the same period a year earlier. The weak growth in tax receipts largely reflected the individual income tax cuts and corporate expensing provisions passed last spring.

The Congress has not yet passed seven of thirteen appropriations bills, and operations are being funded through a continuing resolution that expires on January 31. An omnibus bill will likely be passed shortly.

### **State and Local Governments**

Recent monthly indicators suggest that real state and local spending rose in the fourth quarter. After a prolonged period of weakness, employment in the sector increased in each of the three months in the quarter. Meanwhile, government spending on construction increased steadily for eight consecutive months, and the October-November average stood nearly 4-1/2 percent above the average level in the fourth quarter of 2002. Highway construction, in particular, has moved up noticeably in recent months.

The pickup in spending coincides with several reports released late last year that indicate that state finances are improving. Sources noted that growth in state revenues has moved up relative to a year ago, and fewer states are facing significant fiscal difficulties. Nonetheless, numerous states, including California, New Jersey, and New York, will likely have to address budget shortfalls for fiscal year 2005. Legislatures in 44 states will be holding sessions this year, with the majority beginning in January. Relative to the early 1990s, when tax hikes figured prominently in states' budget balancing strategies, the level of anti-tax sentiment now appears to be higher; states appear to be more focused on spending cuts and borrowing in order to bring budgets into alignment.

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

| Function or source  | November-December |       |                | 12 months ending in December |        |                |
|---|-------------------|-------|----------------|------------------------------|--------|----------------|
|   | 2002              | 2003  | Percent change | 2002                         | 2003   | Percent change |
| Outlays   | 356.9             | 364.1 | 2.0            | 2044.9                       | 2190.2 | 7.1            |
| Financial transactions <sup>1</sup>                         | -.8               | -.5   | ...            | -2.2                         | -.9    | ...            |
| Payment timing <sup>2</sup>                                 | 11.4              | .0    | ...            | .7                           | .6     | ...            |
| Adjusted outlays  | 346.3             | 364.5 | 5.3            | 2046.4                       | 2190.6 | 7.0            |
| Receipts  | 302.8             | 304.9 | .7             | 1814.3                       | 1795.5 | -1.0           |
| Payment timing <sup>3</sup>                                 | .0                | .0    | ...            | 13.0                         | .0     | ...            |
| Adjusted receipts   | 302.8             | 304.9 | .7             | 1801.3                       | 1795.5 | -3             |
| Surplus or deficit (-)                                      | -54.1             | -59.1 | ...            | -230.6                       | -394.7 | ...            |
| <i>Selected components of adjusted outlays and receipts</i> |                   |       |                |                              |        |                |
| Adjusted outlays  | 346.3             | 364.5 | 5.3            | 2046.4                       | 2190.6 | 7.0            |
| Net interest  | 28.3              | 27.7  | -2.2           | 168.2                        | 153.5  | -8.7           |
| Non-interest  | 317.9             | 336.8 | 5.9            | 1878.2                       | 2037.1 | 8.5            |
| National defense  | 64.4              | 73.0  | 13.3           | 361.2                        | 418.0  | 15.7           |
| Social security   | 77.3              | 80.1  | 3.6            | 462.1                        | 479.1  | 3.7            |
| Medicare  | 40.1              | 42.3  | 5.5            | 238.9                        | 251.7  | 5.4            |
| Medicaid  | 25.0              | 27.8  | 11.2           | 150.3                        | 164.6  | 9.5            |
| Income security   | 50.0              | 51.0  | 2.0            | 320.5                        | 335.7  | 4.7            |
| Agriculture   | 8.2               | 6.5   | -21.1          | 22.3                         | 25.1   | 12.3           |
| Other   | 52.9              | 56.1  | 6.0            | 322.8                        | 363.0  | 12.4           |
| Adjusted receipts   | 302.8             | 304.9 | .7             | 1801.3                       | 1795.5 | -3             |
| Individual income and payroll taxes                         | 237.5             | 236.8 | -.3            | 1499.7                       | 1464.7 | -2.3           |
| Withheld + FICA   | 238.4             | 236.3 | -.9            | 1361.6                       | 1368.6 | .5             |
| Nonwithheld + SECA  | 8.7               | 9.1   | 4.5            | 319.6                        | 289.2  | -9.5           |
| Less: Refunds   | 9.6               | 8.5   | -11.0          | 181.5                        | 193.1  | 6.3            |
| Corporate   | 37.5              | 39.5  | 5.4            | 119.3                        | 142.0  | 19.0           |
| Gross   | 46.2              | 47.1  | 2.0            | 186.5                        | 201.4  | 8.0            |
| Less: Refunds   | 8.7               | 7.6   | -12.7          | 67.2                         | 59.4   | -11.5          |
| Other   | 27.8              | 28.6  | 3.0            | 182.2                        | 188.8  | 3.6            |
| Adjusted surplus or deficit (-)                             | -43.5             | -59.6 | ...            | -245.1                       | -395.1 | ...            |

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

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

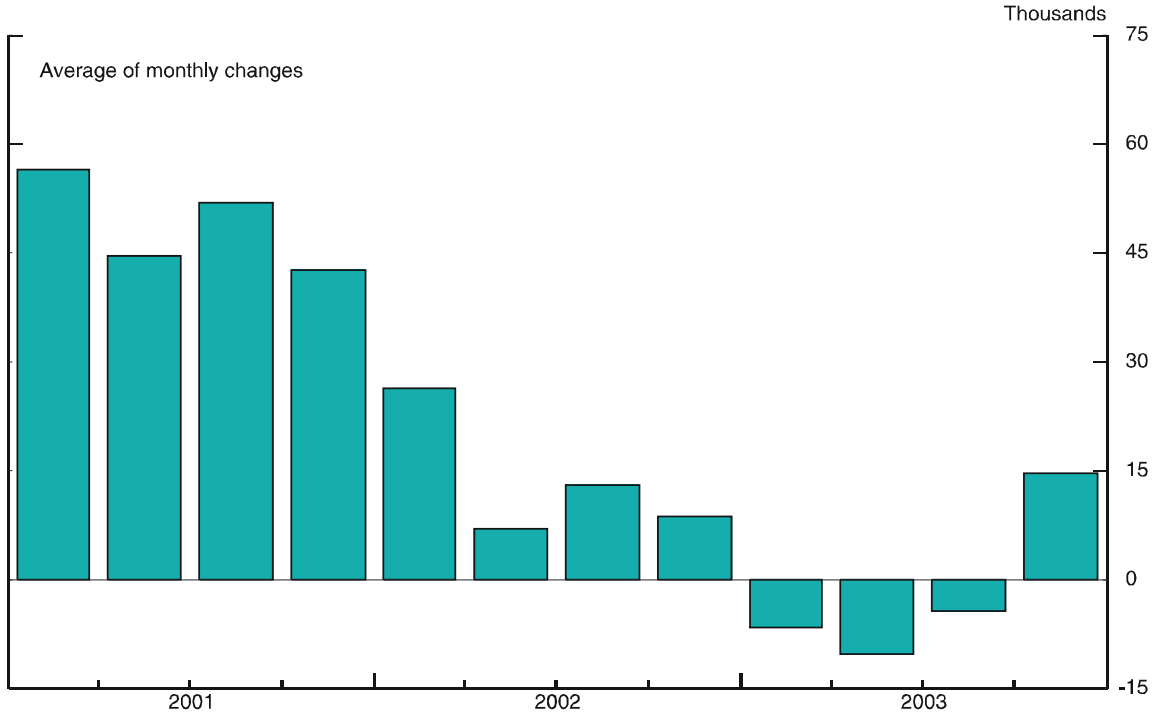
2. A shift in payment timing occurs when the first of the month falls on a weekend or holiday, or when the first three days of a month are nonworking days. Outlays for defense, social security, Medicare, income security, and "other" have been adjusted to account for these shifts.

3. Under the 2001 and 2003 tax acts, there were several shifts in the deadlines for payment of personal and corporate income taxes and excise taxes.

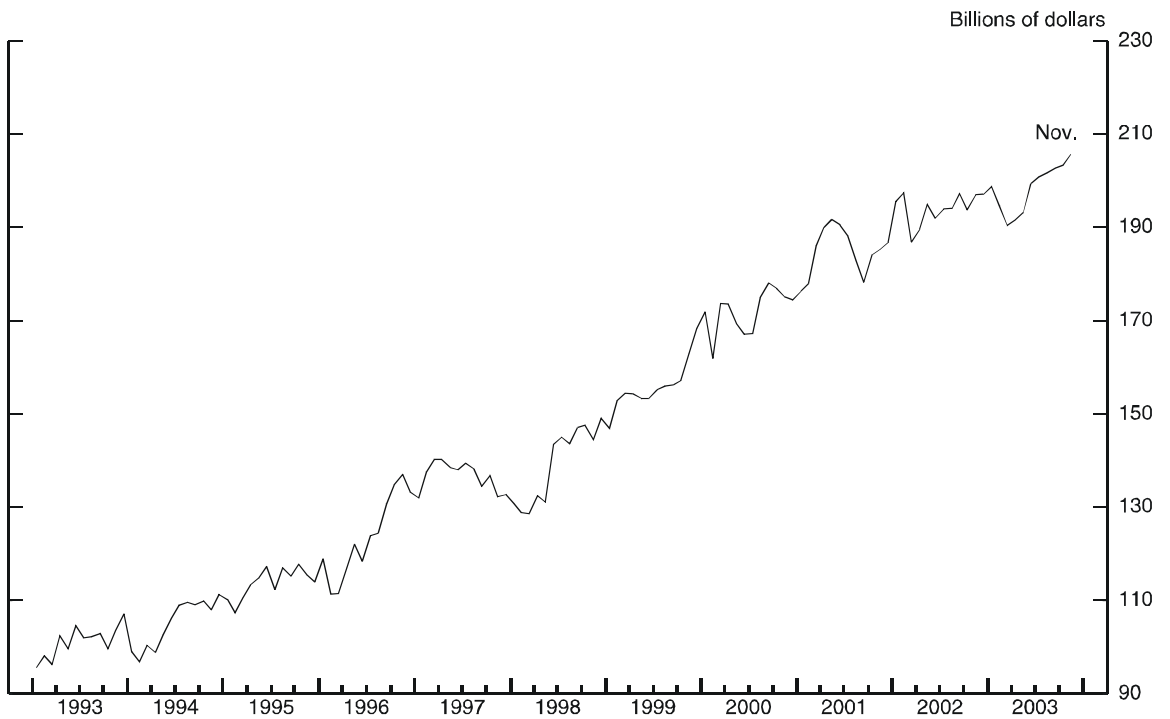
... Not applicable.

### State and Local Employment and Construction

Employment



Construction Put in Place





**Prices and Labor Costs**

Prices of consumer goods and services other than food and energy continued to decelerate through the end of last year. Overall consumer prices were flat, on balance, during the past three months, as a small increase in core prices and a large rise in food prices were offset by a noticeable drop in energy prices. Over the twelve months ending in December, the CPI was up 1.9 percent, 1/2 percentage point below the rate recorded in 2002. The core CPI decelerated a sharper 3/4 percentage point over the same period.

Consumer energy prices rose 0.2 percent in December after having dropped 3.0 percent in the previous month; natural gas prices turned up, and gasoline prices only edged down following larger declines in the two previous months. Survey data for the first half of January point to a large increase in the CPI for gasoline this month. In early January, an Arctic cold wave in New England led to a sharp runup in spot prices for natural gas; however, spot prices have since retreated, on balance, to slightly above the average level in December, and natural gas inventories were reported to have remained at comfortable levels. At the retail level, natural gas prices are likely to rise further in January as the earlier jumps in spot prices are passed through.

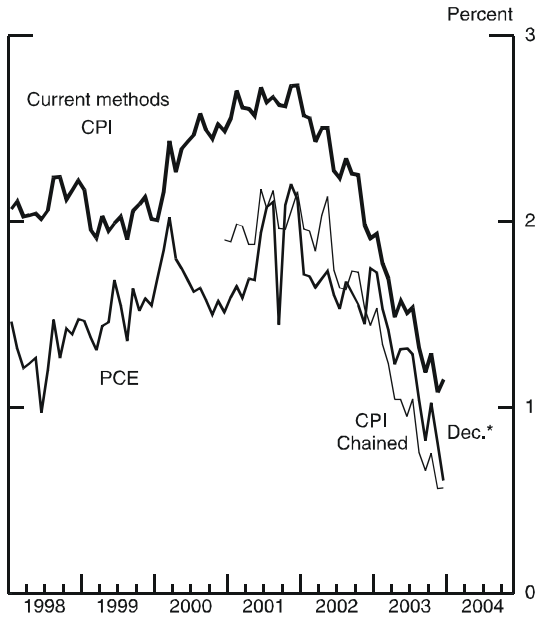
The CPI for food rose 0.6 percent in December, about in line with the average monthly gain in the previous two months. Much of December's increase reflected a further surge in the price of beef that occurred prior to the discovery of mad cow disease in domestic herds late last month. Since the mad cow announcement on December 23, live cattle prices have fallen by almost 20 percent, and a portion of this decline should show through early this year to consumer prices for beef. Overall food prices jumped 3.6 percent last year, a pickup of about 2 percentage points from the preceding year. The acceleration reflected broad-based increases in both domestic and foreign demand, as well as some delays in ramping up supplies to meet the higher prices.

Excluding food and energy, the CPI edged up 0.1 percent in December after having posted a similar decline in November. The twelve-month change in core consumer prices was 1.1 percent, compared with an increase of 1.9 percent in 2002. The slowdown last year was widespread: Core goods prices dropped 2.5 percent, compared with a decline of 1.5 percent in the previous twelve months, while prices of core services rose 2.6 percent in 2003, a deceleration of 0.8 percentage point.

Core PCE prices were unchanged in November (the latest available data) and are estimated to have risen 0.1 percent last month. Over the twelve months ending in November, core PCE prices increased 0.8 percent, compared with a 1.5 percent rise in the previous twelve months. The step down in core PCE inflation was a bit less than the deceleration in the core CPI. In contrast to many times in the past when the difference in behavior could be explained by prices of

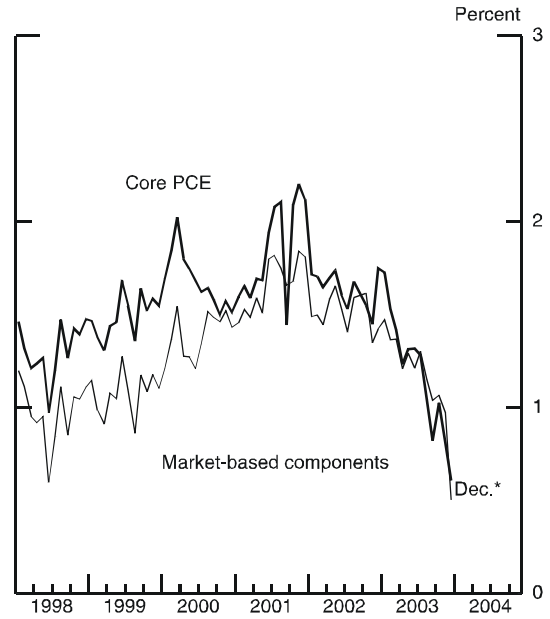
**Core Consumer Price Inflation**  
(12-month change except where noted)

CPI and PCE excluding Food and Energy



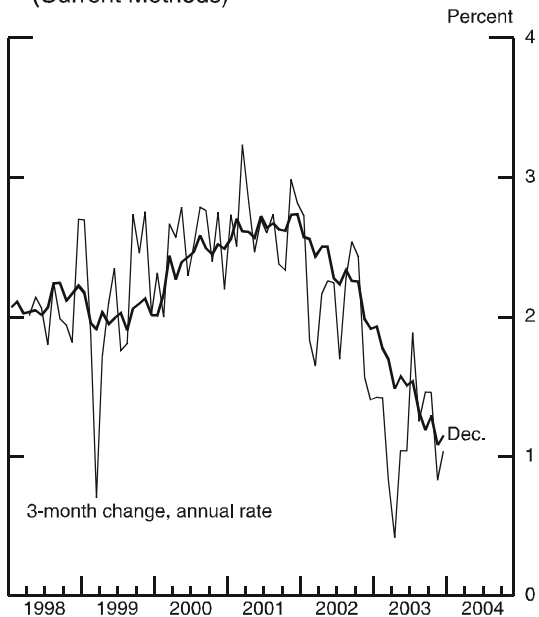
\* PCE for December is a staff estimate.

PCE excluding Food and Energy

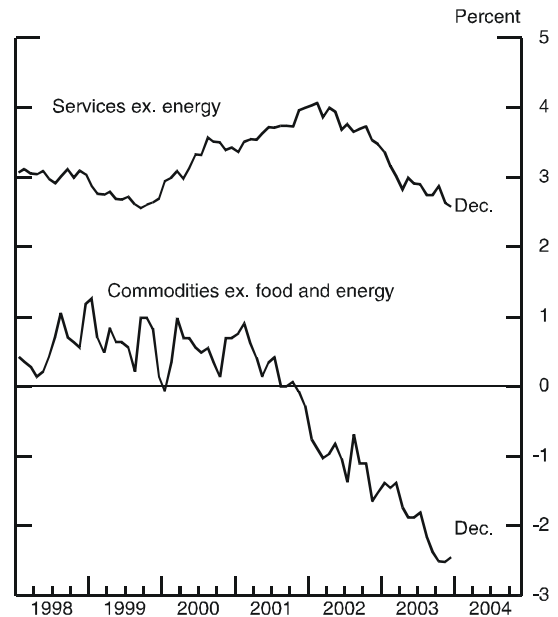


\* Staff estimate.

CPI excluding Food and Energy  
(Current Methods)



CPI Services and Commodities



**Measures of Inflation**  
(Percent)

| Measures                          | 12-month change |                           | 3-month change |                           | 1-month change |                           |
|-----------------------------------|-----------------|---------------------------|----------------|---------------------------|----------------|---------------------------|
|                                   | Dec.<br>2002    | Dec.<br>2003 <sup>1</sup> | Annual rate    |                           | Monthly rate   |                           |
|                                   |                 |                           | Sept.<br>2003  | Dec.<br>2003 <sup>1</sup> | Nov.<br>2003   | Dec.<br>2003 <sup>1</sup> |
| <i>CPI</i>                        |                 |                           |                |                           |                |                           |
| <b>Total</b>                      | <b>2.4</b>      | <b>1.9</b>                | <b>3.1</b>     | <b>.0</b>                 | <b>-.2</b>     | <b>.2</b>                 |
| Food                              | 1.5             | 3.6                       | 2.5            | 6.6                       | .4             | .6                        |
| Energy                            | 10.7            | 6.9                       | 27.8           | -23.8                     | -3.0           | .2                        |
| <b>Ex. food and energy</b>        | <b>1.9</b>      | <b>1.1</b>                | <b>1.5</b>     | <b>1.0</b>                | <b>-.1</b>     | <b>.1</b>                 |
| Ex. tobacco                       | 1.9             | 1.1                       | 1.4            | 1.0                       | -.1            | .1                        |
| Core commodities                  | -1.5            | -2.5                      | -2.3           | -2.8                      | -.4            | -.1                       |
| Core services                     | 3.4             | 2.6                       | 2.9            | 2.7                       | .0             | .2                        |
| Current-methods total             | 2.4             | 1.9                       | 3.1            | .0                        | -.2            | .2                        |
| Ex. food and energy               | 1.9             | 1.1                       | 1.5            | 1.0                       | -.1            | .1                        |
| Ex. tobacco                       | 1.8             | 1.2                       | 1.4            | 1.0                       | -.1            | .1                        |
| Chained CPI (n.s.a.) <sup>2</sup> | 2.0             | 1.4                       | ...            | ...                       | ...            | ...                       |
| Ex. food and energy <sup>2</sup>  | 1.4             | .6                        | ...            | ...                       | ...            | ...                       |
| <i>PCE Prices</i>                 |                 |                           |                |                           |                |                           |
| <b>Total</b>                      | <b>2.1</b>      | <b>1.2</b>                | <b>1.9</b>     | <b>.1</b>                 | <b>-.1</b>     | <b>.2</b>                 |
| Food                              | 1.5             | 3.0                       | 2.0            | 5.4                       | .3             | .6                        |
| Energy                            | 11.3            | 6.9                       | 30.2           | -23.9                     | -3.0           | .2                        |
| <b>Ex. food and energy</b>        | <b>1.8</b>      | <b>.6</b>                 | <b>.4</b>      | <b>.8</b>                 | <b>.0</b>      | <b>.1</b>                 |
| Ex. tobacco                       | 1.6             | .6                        | .4             | .8                        | .0             | .1                        |
| Core commodities                  | -1.7            | -2.2                      | -1.2           | -2.1                      | -.3            | -.1                       |
| Core services                     | 3.2             | 1.8                       | 1.1            | 2.1                       | .1             | .2                        |
| Core market-based                 | 1.4             | n.a.                      | 1.6            | n.a.                      | -.1            | n.a.                      |
| Core non-market-based             | 3.3             | n.a.                      | -5.3           | n.a.                      | .1             | n.a.                      |
| <i>PPI</i>                        |                 |                           |                |                           |                |                           |
| <b>Total finished goods</b>       | <b>1.2</b>      | <b>4.0</b>                | <b>3.7</b>     | <b>3.1</b>                | <b>-.3</b>     | <b>.3</b>                 |
| Food                              | -.6             | 7.7                       | 6.8            | 8.7                       | -.3            | .2                        |
| Energy                            | 12.3            | 11.5                      | 8.2            | 2.0                       | -1.2           | 1.8                       |
| <b>Ex. food and energy</b>        | <b>-.5</b>      | <b>1.0</b>                | <b>1.3</b>     | <b>1.3</b>                | <b>-.1</b>     | <b>-.1</b>                |
| Ex. tobacco                       | -.3             | 1.1                       | 1.4            | 1.2                       | -.1            | -.1                       |
| Core consumer goods               | -.5             | 1.0                       | 1.0            | 1.8                       | .0             | -.1                       |
| Capital equipment                 | -.6             | .9                        | 1.7            | 1.2                       | -.1            | -.1                       |
| Intermediate materials            | 3.2             | 3.9                       | 1.8            | 2.7                       | -.2            | .5                        |
| Ex. food and energy               | 1.5             | 2.1                       | .9             | 2.6                       | .2             | .1                        |
| Crude materials                   | 24.7            | 18.5                      | -3.2           | 21.1                      | .2             | 2.0                       |
| Ex. food and energy               | 12.6            | 20.8                      | 27.8           | 52.5                      | 4.3            | 3.4                       |

1. PCE prices in December are staff estimates.

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

... Not applicable.

n.a. Not available.

PCE items not included in the CPI and for which no market-based prices exist, the most recent discrepancy is centered in the market-based components. The BEA's new measure of the market-based component of core PCE prices decelerated 0.3 percentage point over the year ending in November, noticeably less than the core CPI or core PCE prices. Relative to the CPI, the smaller deceleration in core market-based PCE prices reflects a number of factors, but differences in the contributions of medical and housing services prices appear to account for much of the gap.<sup>8</sup>

The PPI for capital equipment edged down 0.1 percent in December but was up 0.9 percent over the twelve months of 2003, a noticeable pickup from the 0.6 percent decline in the preceding year. The acceleration last year owed to swings in the indexes for cars and light trucks, which increased in 2003 after having fallen in the previous two years. Prices at earlier stages of processing have been increasing at rates that are broadly consistent with the pickup in industrial activity as well as with rising prices for both petroleum products and non-energy imports. The PPI for core intermediate materials increased 0.1 percent in December and 2.1 percent for 2003 as a whole, an acceleration of about 3/4 percentage point from the preceding year.

Commodity prices have continued to move up at a brisk pace since the last Greenbook. The Journal of Commerce industrial price index has increased nearly 4 percent and is up almost 25 percent from a year ago. Among the various commodities in this index, a surge in the prices of metals and petroleum since the December Greenbook was partly offset by a sizable decline in plywood prices. The Commodity Research Bureau's price index for spot industrial commodities, which excludes forest products and energy, has risen about 7 percent since the last Greenbook and is also up nearly 25 percent relative to its level a year ago.

Broad measures of overall inflation picked up over the year ending in the third quarter of 2003, owing in large part to a surge in energy prices: The GDP price index rose 1.7 percent, compared with a 1.4 percent increase over the preceding four quarters. Excluding food and energy, the price index for GDP rose 1.3 percent over the same period, a half percentage point less than in the preceding year.

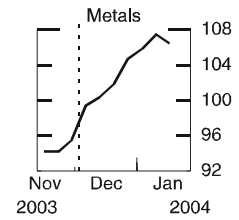
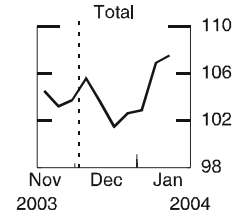
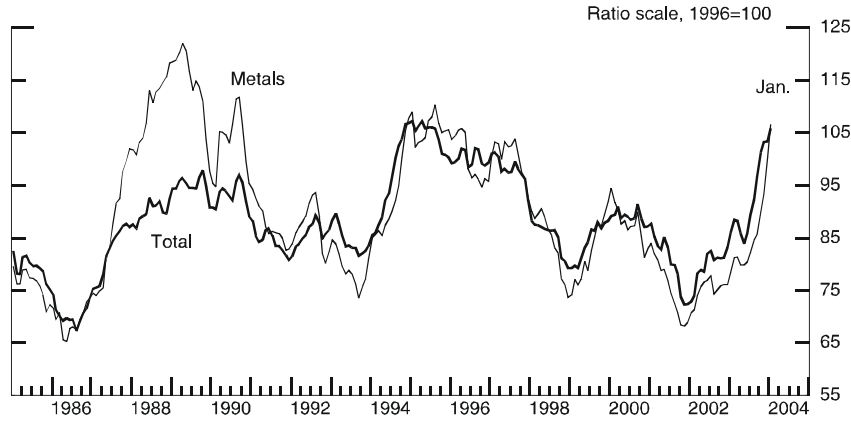
Median year-ahead expected inflation, as measured by the Michigan survey, was little changed at 2.7 percent in early January. Median expected consumer price inflation over the next five to ten years ticked up early this year, to 2.9 percent,

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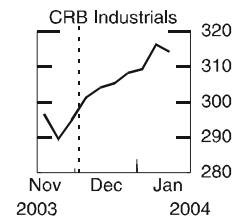
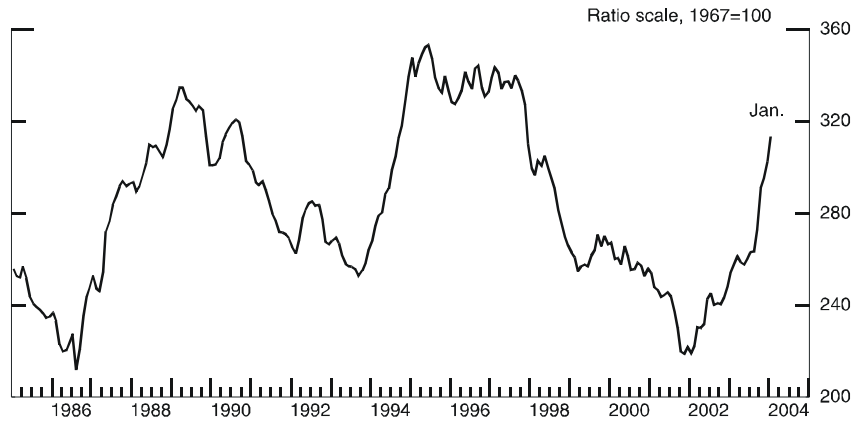
8. PCE medical services prices, which are based on PPIs rather than CPIs, and which have a much larger weight in PCE than in the CPI, have accelerated, while the CPI for medical services has decelerated over the past year. In addition, the deceleration in the price of housing services, while similar for both indexes, has a much smaller weight in PCE than in the CPI.

## Commodity Price Measures

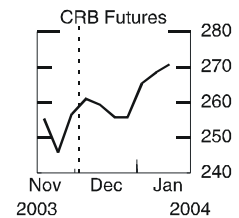
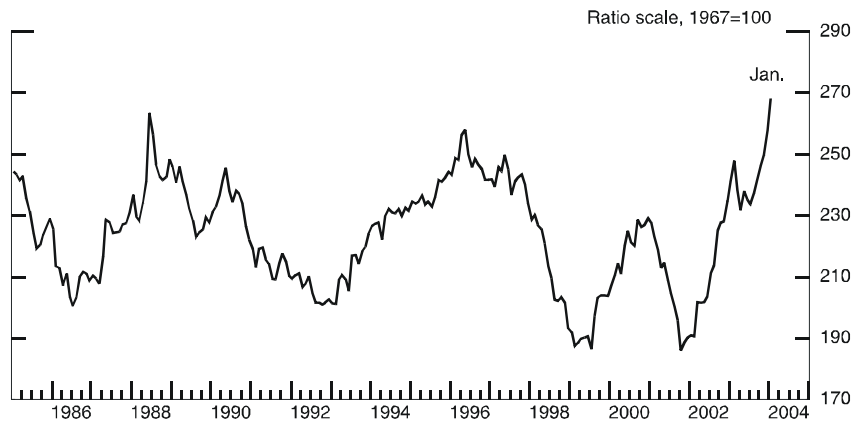
Journal of Commerce Index



CRB Spot Industrials



CRB Futures



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

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

| Commodity                           | Current price (dollars) | 2001 <sup>1</sup> | 2002 <sup>1</sup> | 12/31/02 to 12/2/03 <sup>2</sup> | 12/2/03 <sup>2</sup> to 1/20/04 | Memo: 52-week change to 1/20/04 |
|-------------------------------------|-------------------------|-------------------|-------------------|----------------------------------|---------------------------------|---------------------------------|
| <i>Metals</i>                       |                         |                   |                   |                                  |                                 |                                 |
| Copper (lb.)                        | 1.130                   | -22.0             | 2.8               | 31.5                             | 17.7                            | 43.0                            |
| Steel scrap (ton)                   | 179.667                 | -17.7             | 49.2              | 51.4                             | 22.4                            | 66.9                            |
| Aluminum, London (lb.)              | .727                    | -14.3             | .7                | 14.8                             | 3.9                             | 15.8                            |
| <i>Precious metals</i>              |                         |                   |                   |                                  |                                 |                                 |
| Gold (oz.)                          | 409.250                 | 1.2               | 24.7              | 16.4                             | 2.0                             | 15.7                            |
| Silver (oz.)                        | 6.355                   | -3.5              | 3.0               | 14.8                             | 15.5                            | 32.0                            |
| <i>Forest products</i> <sup>3</sup> |                         |                   |                   |                                  |                                 |                                 |
| Lumber (m. bdft.)                   | 323.000                 | 25.0              | -13.0             | 55.0                             | 4.2                             | 56.0                            |
| Plywood (m. sqft.)                  | 410.000                 | 3.2               | -3                | 88.6                             | -24.8                           | 38.5                            |
| <i>Petroleum</i>                    |                         |                   |                   |                                  |                                 |                                 |
| Crude oil (barrel)                  | 32.180                  | -16.3             | 65.8              | -9.0                             | 10.6                            | .5                              |
| Gasoline (gal.)                     | 1.013                   | -28.0             | 54.6              | .9                               | 18.6                            | 17.3                            |
| Fuel oil (gal.)                     | 1.011                   | -42.6             | 57.4              | -1.2                             | 18.3                            | 13.4                            |
| <i>Livestock</i>                    |                         |                   |                   |                                  |                                 |                                 |
| Steers (cwt.)                       | 79.020                  | -19.7             | 12.9              | 37.9                             | -20.5                           | .0                              |
| Hogs (cwt.)                         | 40.000                  | -9.9              | -18.9             | 18.3                             | 12.7                            | 14.3                            |
| Broilers (lb.)                      | .744                    | 3.7               | 7.4               | 7.8                              | 15.4                            | 29.2                            |
| <i>Farm crops</i>                   |                         |                   |                   |                                  |                                 |                                 |
| Corn (bu.)                          | 2.570                   | -4.1              | 19.2              | 3.1                              | 8.7                             | 14.7                            |
| Wheat (bu.)                         | 4.338                   | -8.9              | 30.4              | 5.1                              | -.6                             | 8.3                             |
| Soybeans (bu.)                      | 8.160                   | -13.4             | 35.6              | 35.9                             | 7.2                             | 48.9                            |
| Cotton (lb.)                        | .693                    | -45.7             | 53.8              | 38.8                             | 4.4                             | 45.1                            |
| <i>Other foodstuffs</i>             |                         |                   |                   |                                  |                                 |                                 |
| Coffee (lb.)                        | .608                    | -35.3             | 1.1               | 24.2                             | 10.0                            | 22.1                            |
| <i>Memo:</i>                        |                         |                   |                   |                                  |                                 |                                 |
| JOC Industrials                     | 107.500                 | -17.1             | 16.2              | 23.6                             | 3.7                             | 24.1                            |
| JOC Metals                          | 106.400                 | -17.0             | 9.5               | 26.0                             | 11.4                            | 34.3                            |
| CRB Futures                         | 270.770                 | -16.3             | 23.0              | 9.5                              | 5.5                             | 11.8                            |
| CRB Spot Industrials                | 314.300                 | -14.6             | 14.4              | 18.6                             | 6.6                             | 22.7                            |

1. Changes are from the last week of the preceding year to the last week of the year indicated.

2. Dec. 2, 2003, is the day preceding publication of the December Greenbook.

3. Prices shown apply to the Friday before the date indicated.

**Broad Measures of Inflation**  
(Percent change, Q3 to Q3)

| Measure  | 2000 | 2001 | 2002 | 2003 |
|--|------|------|------|------|
| <i>Product prices</i>                          |      |      |      |      |
| GDP chain price index                          | 2.3  | 2.4  | 1.4  | 1.7  |
| Less food and energy                           | 2.1  | 2.1  | 1.8  | 1.3  |
| Nonfarm business chain price index             | 2.0  | 1.8  | .9   | 1.3  |
| <i>Expenditure prices</i>                      |      |      |      |      |
| Gross domestic purchases chain price index     | 2.5  | 1.9  | 1.4  | 1.8  |
| Less food and energy                           | 1.9  | 1.9  | 1.6  | 1.3  |
| PCE chain price index                          | 2.4  | 2.0  | 1.5  | 1.7  |
| Less food and energy                           | 1.6  | 1.9  | 1.8  | 1.0  |
| PCE chain price index, market-based components | 2.4  | 1.9  | 1.2  | 1.9  |
| Less food and energy                           | 1.4  | 1.7  | 1.6  | 1.2  |
| CPI  | 3.5  | 2.7  | 1.6  | 2.2  |
| Less food and energy                           | 2.5  | 2.7  | 2.3  | 1.3  |
| Chained CPI                                    | n.a. | 2.1  | 1.2  | 1.7  |
| Less food and energy                           | n.a. | 2.1  | 1.7  | .8   |
| Median CPI                                     | 2.8  | 3.7  | 3.3  | 2.0  |
| Trimmed mean CPI                               | 2.6  | 2.7  | 2.1  | 1.9  |

n.a. Not available.

**Surveys of Inflation Expectations**  
(Percent)

| Period    | Actual<br>CPI<br>inflation <sup>1</sup> | University of Michigan |        |                            |        | Professional<br>forecasters<br>(10-year) <sup>4</sup> |
|-----------|---|------------------------|--------|----------------------------|--------|---|
|           |   | 1 year <sup>2</sup>    |        | 5 to 10 years <sup>3</sup> |        |   |
|           |   | Mean                   | Median | Mean                       | Median |   |
| 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   |
| Q4        | 1.9                                     | 3.0                    | 2.6    | 3.1                        | 2.8    | 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.      | 2.0                                     | 3.1                    | 2.6    | 3.1                        | 2.8    | ...   |
| Nov.      | 1.8                                     | 3.1                    | 2.7    | 3.1                        | 2.7    | ...   |
| Dec.      | 1.9                                     | 2.8                    | 2.6    | 3.1                        | 2.8    | 2.5   |
| 2004:Jan. | n.a.                                    | 2.9                    | 2.7    | 3.4                        | 2.9    | ...   |

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 twelve months?

3. Responses to the question: By about what percent per year do you expect prices to go up, on average, during the next five to ten years?

4. Quarterly CPI projections compiled by the Federal Reserve Bank of Philadelphia.

n.a. Not available.

... Not applicable.

and moved toward the upper end of the narrow range that has prevailed over the past few years.

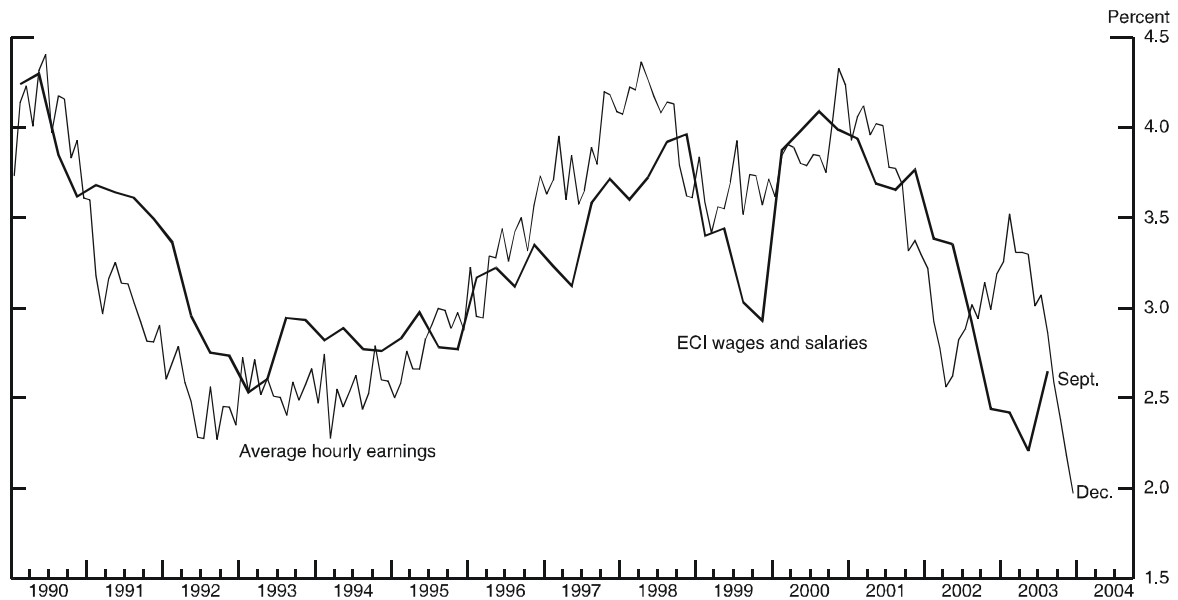
Since the last Greenbook, we have received little new information regarding labor costs. Average hourly earnings of production or nonsupervisory workers on private nonfarm payrolls rose 0.2 percent in December after having edged up 0.1 percent in November. Over the twelve months of 2003, average hourly earnings increased 2.0 percent, down from the 3-1/4 percent rate recorded in both 2001 and 2002.



**Average Hourly Earnings of  
Production or Nonsupervisory Workers**  
(Percent change; seasonally adjusted data)

| Industry                               | 12-month change |              |              | 3-month change |              | 1-month change |              |
|--|-----------------|--------------|--------------|----------------|--------------|----------------|--------------|
|  | Dec.<br>2001    | Dec.<br>2002 | Dec.<br>2003 | Annual rate    |              | Monthly rate   |              |
|  |                 |              |              | Sept.<br>2003  | Dec.<br>2003 | Nov.<br>2003   | Dec.<br>2003 |
| Total private nonfarm                  | 3.3             | 3.2          | 2.0          | 1.6            | 1.6          | .1             | .2           |
| Manufacturing                          | 3.6             | 3.5          | 2.3          | 2.8            | 1.8          | .1             | .3           |
| Construction                           | 2.5             | 3.4          | 1.5          | 1.3            | 1.7          | .3             | .1           |
| Trade, transportation and<br>utilities | 2.4             | 2.4          | 1.8          | .8             | 2.2          | .1             | .1           |
| Financial activities                   | 3.8             | 4.6          | 3.8          | 1.9            | -1.4         | -.3            | .1           |
| Professional and<br>business services  | 4.0             | 3.2          | 1.4          | .5             | 2.1          | .2             | .1           |
| Education and<br>health services       | 4.8             | 4.0          | 2.1          | 2.3            | 2.0          | .1             | .1           |
| Leisure and hospitality                | 2.2             | 3.4          | 1.0          | .5             | 2.8          | .1             | .5           |

**Labor Costs  
Production or Nonsupervisory Workers**  
(12-month change)



## Appendix

### Comprehensive Revision of the National Income and Product Accounts

On December 10 the Bureau of Economic Analysis released a comprehensive revision of the national income and product accounts (NIPA) for the period from 1929 through the second quarter of 2003; on December 23 the BEA released the “final” NIPA estimate for the third quarter of 2003.<sup>1</sup> In a comprehensive revision—which occurs every four or five years—the BEA modifies concepts (the definition of components), adjusts methods of measurement (the approach to measuring components), and updates source data (the data used to implement the measurement methods). The revision announced in December did not feature any revolutionary changes in measurement methods comparable to the 1996 introduction of chain weighting, or major conceptual change like the 1999 redefinition of software as a final investment good, but it did introduce several important improvements of each type.

The key conceptual revisions included changes to the measurement of property and casualty insurance services, which had previously been based on premiums earned less actual payouts. In the revision, the BEA added insurers’ expected investment income from the portion of reserves that belong to policyholders. Moreover, the BEA replaced current payouts with a measure of “normal” payouts (calculated as a moving average of past payouts); this change somewhat reduced the volatility of nominal GDP and PCE, as well as of GDP and PCE price inflation, around catastrophes such as Hurricane Andrew (1992) and the 2001 terrorist attacks.

The BEA also changed the measurement of imputed bank services by recognizing that borrowers as well as depositors benefit from banks’ financial intermediation. Previously, the BEA had assumed that the entire difference between what banks earn from loans and what they pay out on deposits represented implicit services provided to depositors. By shifting a substantial share of banking services from depositors to borrowers—and thus effectively from households to businesses, for whom such services are an intermediate input—this change reduced the level of nominal GDP by about \$90 billion in 2001, but it did not significantly affect the rates of change of real GDP or PCE.

Among the BEA’s revisions to measurement were improved methods for estimating corporate profits before tax data become available and for estimating PCE hotel and motel services, improvements to residences, price indexes for business structures and software, and net transactions and dealer margins for used motor vehicles. In addition, the BEA incorporated the 1997 benchmark input-output accounts and source data that have become available since the most recent annual revision in July 2002.

Finally, for purposes of presentation, the reference year for chain-type quantity and price indexes and for chain-dollar estimates was updated from 1996 to 2000. This rebasing has no effect on rates of change.

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1. The year 1929 is the earliest for which NIPA estimates are available. Some revised series have not yet been released, notably, complete data on motor vehicles and capital stocks.

**Real GDP**

The average rate of change in real GDP, whether measured over the past several years or over longer historical periods, was hardly changed by this revision. The average annual rate of increase in real GDP from 1929 to 2002 was unrevised at 3.4 percent, and the basic pattern of previous business cycles was preserved. In the latest recession, real GDP is now estimated to have declined at an average annual rate of 0.7 percent over the first three quarters of 2001 (for a cumulative decline of 0.5 percent), versus the earlier estimate of 0.8 percent (for a cumulative decline of 0.6 percent).<sup>2</sup> Between the trough and the second quarter of 2003, GDP increased at an average annual rate of 2.6 percent; the earlier estimate was 2.7 percent. The longer-run rates of change of most components of GDP were also little revised, with the notable exception of spending at both the federal and state and local government levels, for which the change in recent years was revised down a fair bit.

**Prices**

Revisions to core PCE prices were fairly small despite several important methodological changes to the index. The revisions to the measurement of banking services noted above significantly reduced the share of these services in PCE and, hence, the share of imputed bank service charges in the PCE price index. In addition, the smoothed measure of payouts now used to compute the net cost of property and casualty insurance attenuated—but did not eliminate—the swing in PCE prices induced by the September 11 terrorist attacks.<sup>3</sup>

The BEA's new index of market-based core PCE inflation (available since 1997) differs significantly from the series that the Board staff had put together earlier. The new BEA series indicates that market-based core PCE prices decelerated a cumulative 0.4 percentage point over the course of the eight quarters ending in 2003:Q2, whereas the Board staff's pre-revision measure implied a 1.2 percentage point deceleration. Of the 0.8 percentage point difference between the BEA and Board staff series, 0.3 percentage point is attributable to revisions to the underlying data. An additional 0.2 percentage point reflects the BEA's inclusion of a large fraction of brokerage fees in the index; we had excluded brokerage fees from our estimates of the market-based

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2. The previous estimate of a small rise in real GDP in 2000:Q3 has been revised to a decline. But an upward revision in 2000:Q4 leaves the change in real GDP in the second half of 2000 essentially the same as previously reported.

3. The BEA's new methodology applies to property and casualty insurance but not life insurance. As a result, the terrorist attacks are now estimated to have reduced the net cost of insurance in PCE by \$10-1/2 billion in 2001:Q3, compared with the earlier assumption of \$18 billion.

measure.<sup>4</sup> The remaining difference is more difficult to explain, but it appears to result from the BEA's use of unpublished source data for its market-based series.<sup>5</sup>

Upward revisions to GDP prices, particularly in late 2001, flattened somewhat the path of GDP price inflation over the past couple of years. These revisions stemmed partly from upward revisions to government prices; in addition, the BEA's new methodology for estimating insurance prices reduces some of the measured deceleration in GDP prices over the four quarters ending in 2002:Q3.<sup>6</sup>

### **Income-Side Measures**

The comprehensive revision generated larger changes on the income side of the accounts. The BEA revised down its estimate of nominal wages and salaries for the 1989-2002 period but increased its estimate of employer contributions for pensions and health insurance starting in the mid-1990s; on balance, the level of compensation was revised up from 1997 on.<sup>7</sup> The BEA also revised its estimates of other components of personal income. All told, however, personal consumption was revised up more than was income and by enough to reduce the personal saving rate an average of 0.8 percentage point from 1992 through the first half of last year.

Economic profits as a share of GNP are higher than previously reported in each year since 1992, with an especially large upward revision in 2002. A good deal of the 2002 revision reflects the new methodology that the BEA introduced to estimate the effect of stock-option exercises on corporate profits before corporate tax data become available; this new method results in a lower estimate of stock-option exercises in that year.

Net saving by state and local governments excluding social insurance funds—roughly equal to the surplus in the operating accounts of these governments—now appears to have turned negative in the fourth quarter of 2001, a full year later than in the unrevised data. In addition, the average deficit over the period from the fourth quarter of 2001 through the third quarter of 2003 was revised down from an annual rate of \$41 billion to an annual rate of \$11 billion. These revisions primarily reflected new source data

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4. The BEA first began to use PPIs to measure certain types of brokerage fees in the 2002 annual revision to the NIPA; hence, starting in 1999, roughly half of this component of PCE was "market based." To maintain a historically consistent series, the Board staff continued to treat brokerage fees as part of nonmarket PCE for the post-1998 data.

5. In particular, the BEA's definition of market-based services includes premium payments for several types of insurance; published data show only net insurance costs, defined as premiums paid less benefits received. The BEA's staff has indicated that it plans to make the unpublished data available in the near future, which should permit us to better reconcile the published series with our earlier estimate.

6. Prior to the comprehensive revision, the BEA's insurance adjustments *boosted* GDP inflation by 1 percentage point in 2001:Q3, because the insurance-related reduction in measured PCE prices was more than offset by a reduction in measured prices of imported services (which raises GDP inflation). In the current data, the BEA's insurance adjustments *lower* GDP inflation in 2001:Q3 by 0.4 percentage point.

7. The *change* in compensation was revised down in 2002 owing primarily to a downward revision to wages and salaries attributable to more complete source data.

showing lower spending and higher property tax receipts; conceptual changes were minimal and had little effect.

The nominal statistical discrepancy, which measures the difference between GDP and gross domestic income, was revised up for most years since the late 1980s. The discrepancy is now more positive in the years from 1989 to 1997; it remains negative from 1998 through 2002 but now appears to be roughly zero in the first half of last year. Upward revisions to some components of PCE—stemming importantly from new methods for estimating sales of used motor vehicles and hotel and motel lodging services—raised the level of GDP but did not generate comparable revisions on the income side.

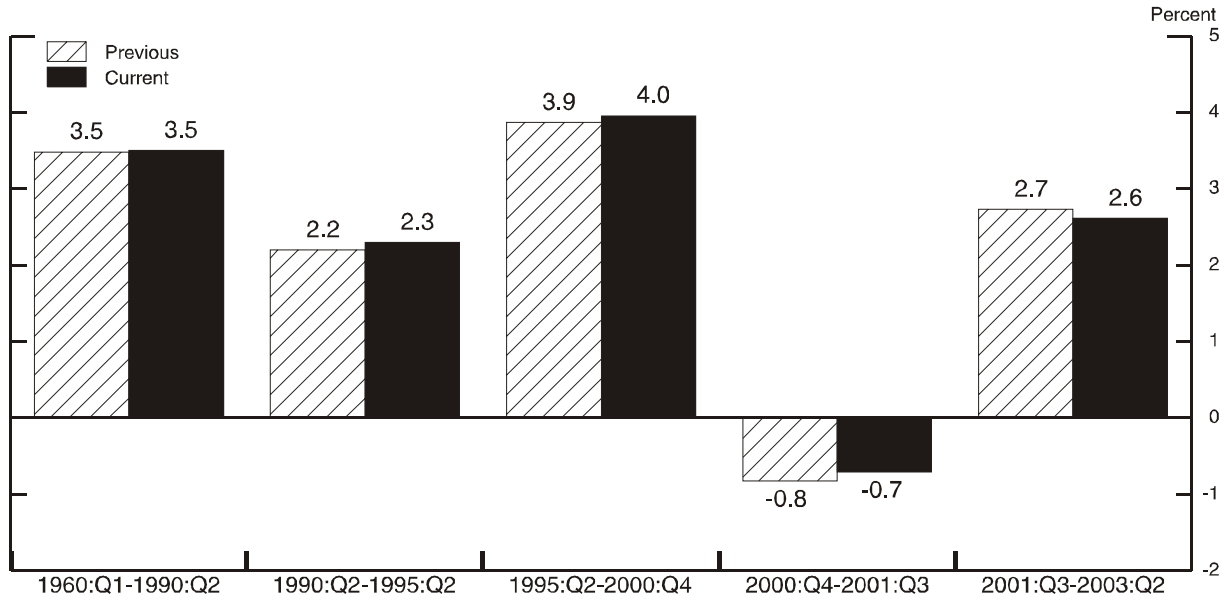
### **Productivity**

The Bureau of Labor Statistics has yet to publish figures on labor productivity that incorporate the NIPA revision, but the Board staff estimates that revisions to previously published productivity data for recent years will be small.<sup>8</sup> The cumulative increase in productivity between 1995 and the cyclical peak in 2001 will likely be revised up about 1 percentage point, while the subsequent cumulative change will likely be revised down by 0.6 percentage point. We expect the full historical revision to raise the level of productivity in the second quarter of 2003 by 0.3 percent.

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8. Publication of revised data through 2002 was scheduled for January 10 but has been delayed because of the lag in the availability of the new BEA estimates for output. As part of the comprehensive revision, the BEA changed its definition of the nonfarm business sector to match the definition used by the BLS. This change itself will have no effect on the published productivity figures, as the definition used by the BLS has not changed.

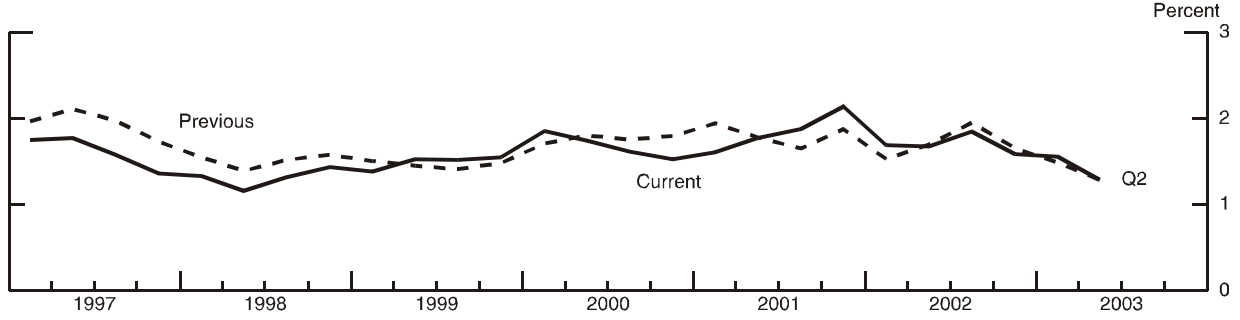
**Change in Real GDP**  
(Average annual percent change)



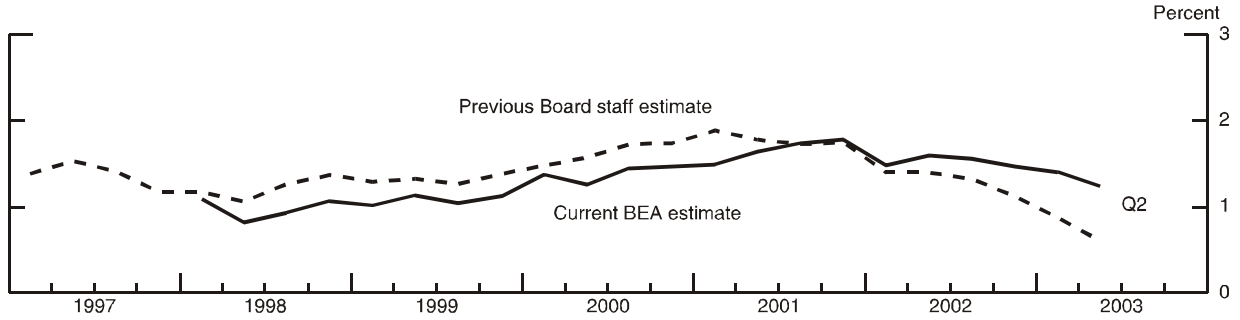
**Revisions to Growth of Real GDP and Selected Major Components**  
(Revisions in percentage points at an annual rate, current less previous)

|                                      | 1990:Q2-<br>1995:Q2 | 1995:Q2-<br>2000:Q4 | 2000:Q4-<br>2001:Q3 | 2001:Q3-<br>2003:Q2 |
|--------------------------------------|---------------------|---------------------|---------------------|---------------------|
| GDP                                  | .1                  | .1                  | .1                  | -.1                 |
| Consumer spending                    | .1                  | .3                  | -.2                 | .1                  |
| Business fixed investment            | .1                  | .1                  | -.1                 | -.6                 |
| Residential investment               | .6                  | -.1                 | .5                  | -.7                 |
| Government spending                  | .0                  | -.3                 | -1.0                | -.2                 |
| Memo:                                |                     |                     |                     |                     |
| Contribution of inventory investment | .0                  | .0                  | .4                  | .0                  |
| GDP price index                      | -.1                 | -.1                 | -.1                 | .4                  |

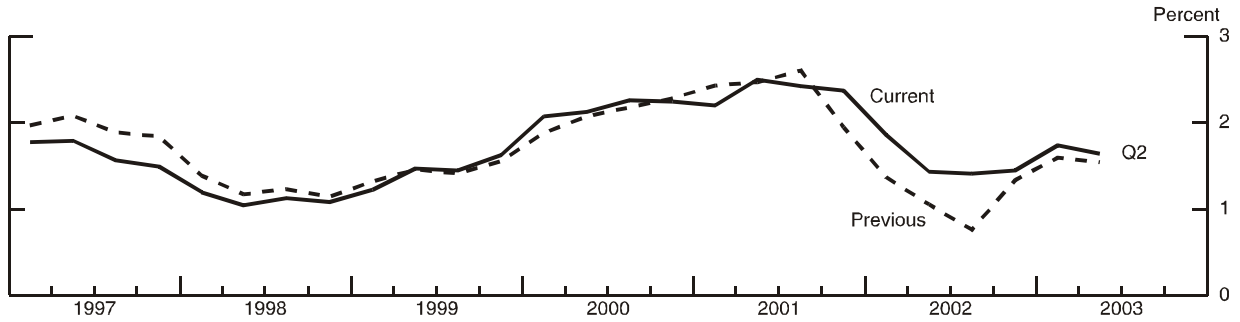
**Core PCE Price Index**  
(4-quarter percent change)



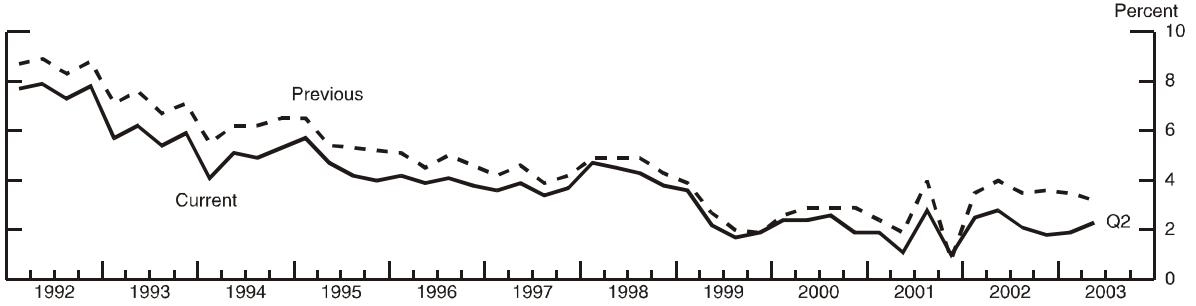
**Market-based Core PCE Price Measures**  
(4-quarter percent change)



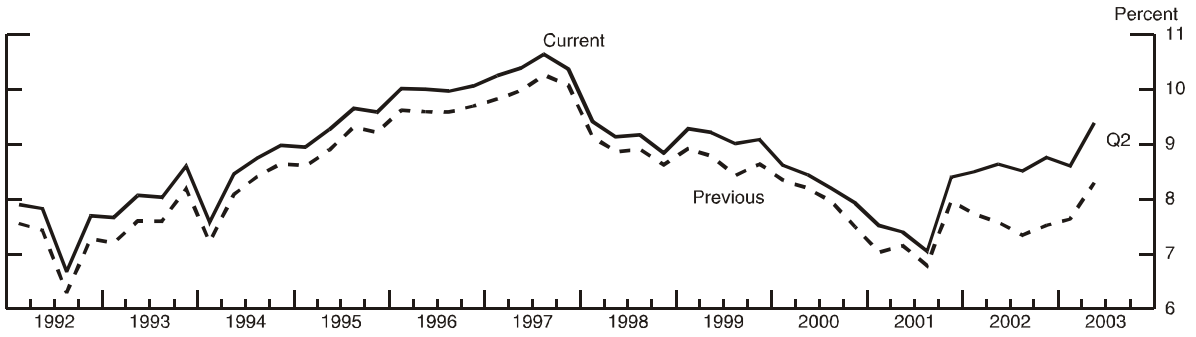
**GDP Price Index**  
(4-quarter percent change)



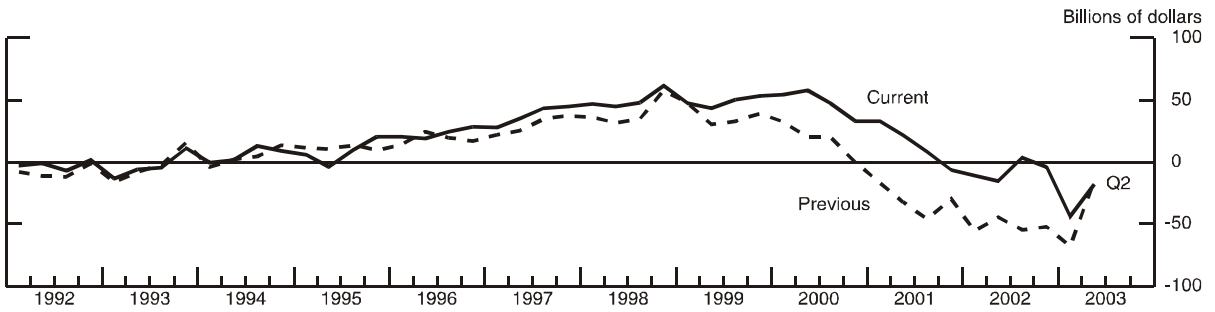
**Personal Saving Rate**  
(Percent of disposable personal income)



**Economic Profits as a Share of GNP**

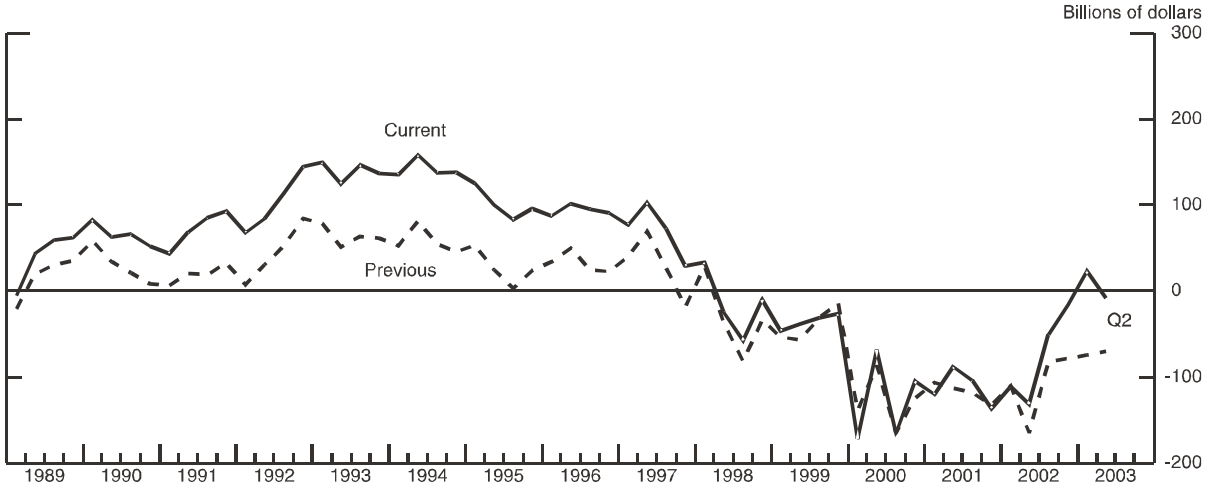


**Net Saving by State and Local Governments**  
Excluding Social Insurance Funds

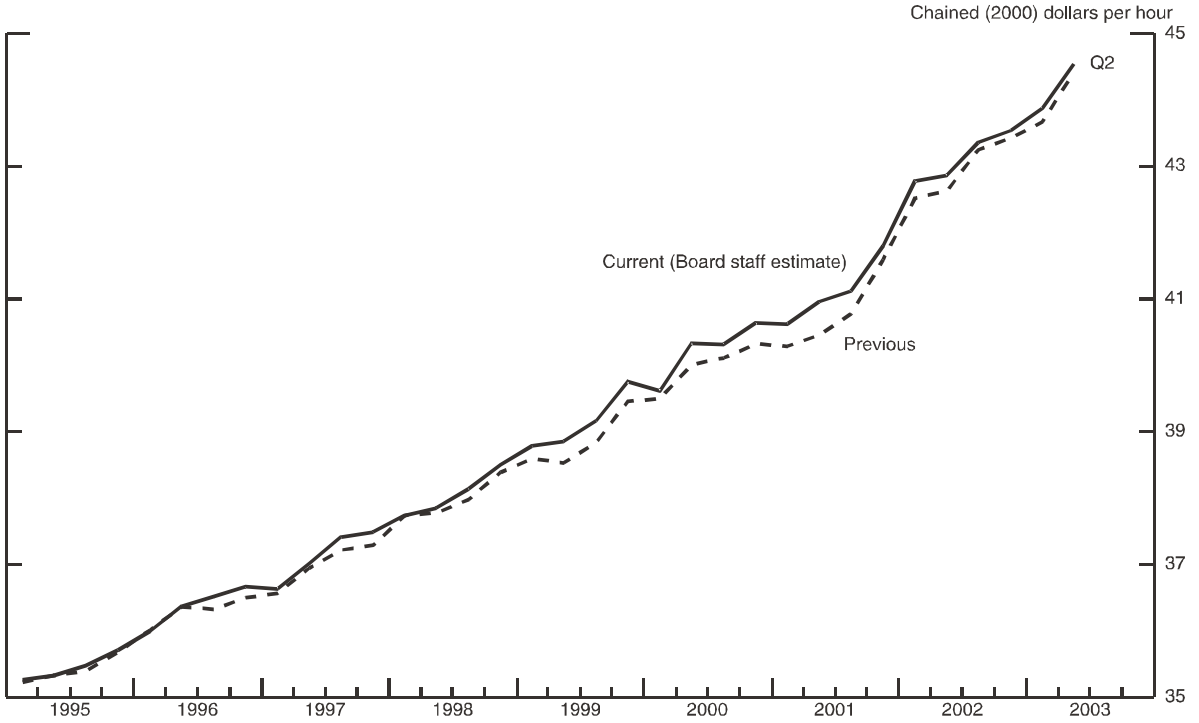




### Statistical Discrepancy



### Productivity in the Nonfarm Business Sector



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## **Domestic Financial Developments**

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

| Instrument                                      | 2002    | 2003    |        | 2004    | Change to Jan. 20 from selected dates (percentage points) |              |             |
|---|---------|---------|--------|---------|---|--------------|-------------|
|   | Dec. 31 | June 24 | Dec. 8 | Jan. 20 | 2002 Dec. 31  | 2003 June 24 | 2003 Dec. 8 |
| <i>Short-term</i>                               |         |         |        |         |   |              |             |
| FOMC intended federal funds rate                | 1.25    | 1.25    | 1.00   | 1.00    | -.25  | -.25         | .00         |
| Treasury bills <sup>1</sup>                     |         |         |        |         |   |              |             |
| 3-month   | 1.20    | 0.81    | 0.91   | 0.88    | -.32  | .07          | -.03        |
| 6-month   | 1.21    | 0.82    | 1.01   | 0.96    | -.25  | .14          | -.05        |
| Commercial paper (A1/P1 rates)                  |         |         |        |         |   |              |             |
| 1-month   | 1.28    | 0.91    | 1.02   | 0.97    | -.31  | .06          | -.05        |
| 3-month   | 1.36    | 0.88    | 1.04   | 1.00    | -.36  | .12          | -.04        |
| Large negotiable CDs <sup>1</sup>               |         |         |        |         |   |              |             |
| 1-month   | 1.34    | 0.96    | 1.10   | 1.03    | -.31  | .07          | -.07        |
| 3-month   | 1.31    | 0.93    | 1.10   | 1.05    | -.26  | .12          | -.05        |
| 6-month   | 1.32    | 0.92    | 1.17   | 1.11    | -.21  | .19          | -.06        |
| Eurodollar deposits <sup>2</sup>                |         |         |        |         |   |              |             |
| 1-month   | 1.30    | 0.94    | 1.08   | 1.03    | -.27  | .09          | -.05        |
| 3-month   | 1.30    | 0.91    | 1.08   | 1.04    | -.26  | .13          | -.04        |
| Bank prime rate                                 | 4.25    | 4.25    | 4.00   | 4.00    | -.25  | -.25         | .00         |
| <i>Intermediate- and long-term</i>              |         |         |        |         |   |              |             |
| U.S. Treasury <sup>3</sup>                      |         |         |        |         |   |              |             |
| 2-year  | 1.60    | 1.14    | 1.93   | 1.70    | .10   | .56          | -.23        |
| 10-year   | 4.09    | 3.46    | 4.44   | 4.20    | .11   | .74          | -.24        |
| 30-year   | 4.96    | 4.53    | 5.27   | 5.07    | .11   | .54          | -.20        |
| U.S. Treasury 10-year indexed note              | 2.32    | 1.70    | 1.96   | 1.84    | -.48  | .14          | -.12        |
| Municipal revenue (Bond Buyer) <sup>4</sup>     | 5.16    | 4.89    | 5.19   | 4.92    | -.24  | .03          | -.27        |
| Private instruments                             |         |         |        |         |   |              |             |
| 10-year swap                                    | 4.22    | 3.67    | 4.65   | 4.40    | .18   | .73          | -.25        |
| 10-year FNMA <sup>5</sup>                       | 4.49    | 3.84    | 4.75   | 4.50    | .01   | .66          | -.25        |
| 10-year AA <sup>6</sup>                         | 5.06    | 4.13    | 5.08   | 4.85    | -.21  | .72          | -.23        |
| 10-year BBB <sup>6</sup>                        | 6.45    | 5.16    | 5.78   | 5.49    | -.96  | .33          | -.29        |
| 5-year high yield <sup>6</sup>                  | 11.45   | 8.95    | 7.97   | 7.61    | -3.84   | -1.34        | -.36        |
| Home mortgages (FHLMC survey rate) <sup>7</sup> |         |         |        |         |   |              |             |
| 30-year fixed                                   | 5.93    | 5.21    | 6.02   | 5.66    | -.27  | .45          | -.36        |
| 1-year adjustable                               | 4.01    | 3.51    | 3.77   | 3.62    | -.39  | .11          | -.15        |

| Stock exchange index | Record high |         | 2003    |        | 2004    | Change to Jan. 20 from selected dates (percent) |              |             |
|----------------------|-------------|---------|---------|--------|---------|---|--------------|-------------|
|                      | Level       | Date    | June 24 | Dec. 8 | Jan. 20 | Record high                                     | 2003 June 24 | 2003 Dec. 8 |
| Dow-Jones Industrial | 11,723      | 1-14-00 | 9,110   | 9,965  | 10,529  | -10.19  | 15.57        | 5.65        |
| S&P 500 Composite    | 1,527       | 3-24-00 | 983     | 1,069  | 1,139   | -25.45  | 15.79        | 6.50        |
| Nasdaq (OTC)         | 5,049       | 3-10-00 | 1,606   | 1,949  | 2,148   | -57.45  | 33.78        | 10.22       |
| Russell 2000         | 606         | 3-9-00  | 441     | 543    | 598     | -1.34   | 35.63        | 10.12       |
| Wilshire 5000        | 14,752      | 3-24-00 | 9,388   | 10,425 | 11,131  | -24.54  | 18.57        | 6.77        |

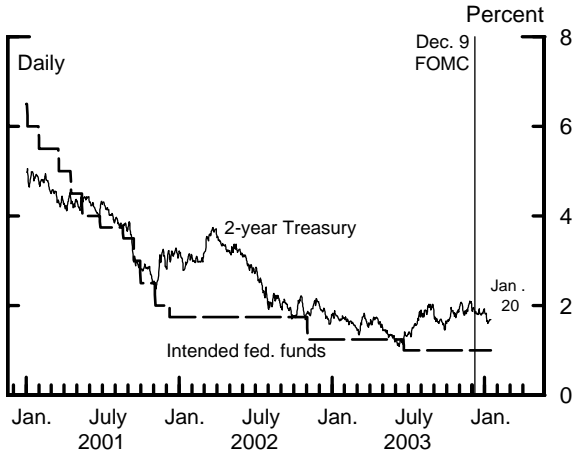
1. Secondary market.
2. Bid rates for eurodollar deposits collected around 9:30 a.m. Eastern time.
3. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
4. Most recent Thursday quote.
5. Constant maturity yields estimated from Fannie Mae domestic noncallable coupon securities.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

NOTES:

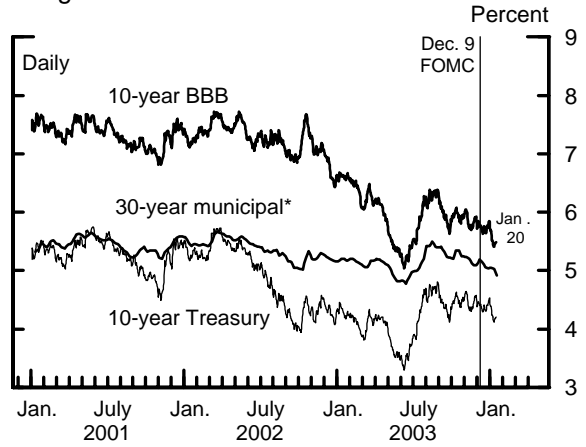
June 24, 2003, is the last day before the most recent policy easing.  
December 8, 2003, is the day before the most recent FOMC meeting.

# Interest Rates and Policy Expectations

Short-Term Interest Rates

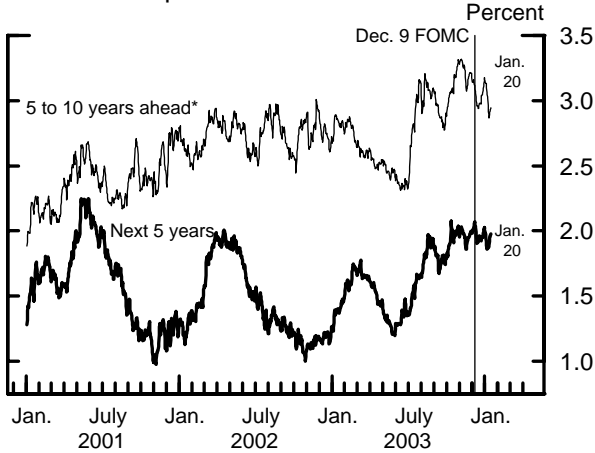


Long-Term Interest Rates



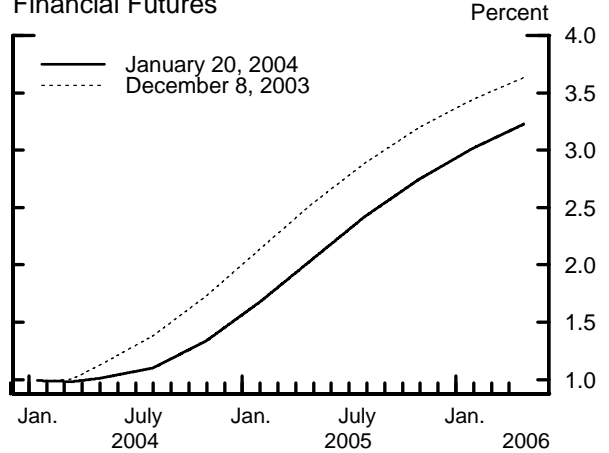
\*Bond Buyer Revenue, weekly Thursday frequency.

Inflation Compensation



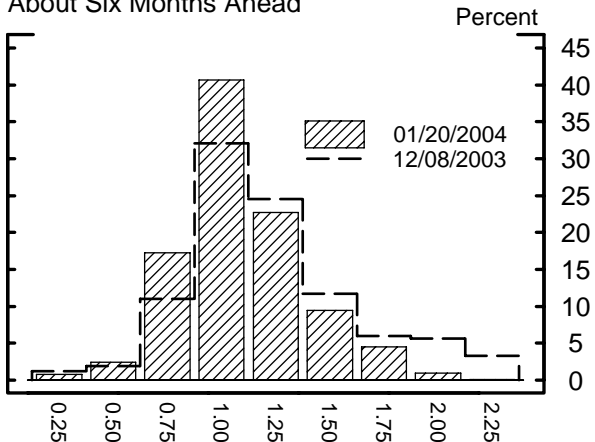
\*Estimates based upon smoothed nominal and inflation-indexed Treasury yield curves.

Expected Federal Funds Rate Estimated from Financial Futures



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

Implied Distribution of Federal Funds Rate About Six Months Ahead



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

Policy Uncertainty



Note. Width of a 90 percent confidence interval computed from the term structures for the expected federal funds rate and implied volatility.

## **Domestic Financial Developments**

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### **Overview**

Over the intermeeting period, equity prices staged a broad rally as investor expectations of corporate earnings continued to improve. Nonetheless, intermediate- and long-term interest rates declined, as mixed economic data and the release of the October FOMC minutes pushed down the expected path for the federal funds rate after the first quarter of this year. Demand for business credit remained subdued in the fourth quarter, and the growth of household debt appears to have slowed a bit.

### **Policy Expectations and Interest Rates**

The FOMC's statement following its December meeting—in particular, the shift to a near balance of the risks to inflation—prompted an initial rise in Treasury yields. Two days later, however, yields dropped after the release of the minutes of the October FOMC meeting, as market participants reportedly focused on the Committee's view that output growth might not “entirely eliminate currently large margins of unemployed labor and other resources until perhaps the latter part of 2005 or even later.” Over the subsequent weeks, yields edged up because of better-than-expected initial claims and ISM manufacturing survey data, but those effects were more than offset by a marked decline after the December employment report, which was much weaker than expected.

On balance since the December FOMC meeting, yields on Treasury coupon securities declined about 25 basis points. Yields on ten-year TIPS decreased less than comparable nominal Treasury yields, implying a decline in ten-year inflation compensation of about 10 basis points.

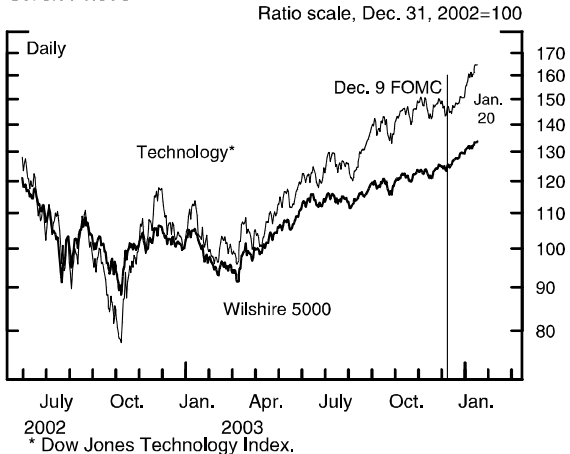
Judging from surveys and futures market quotes, investors see virtually no chance that the FOMC will change the target federal funds rate at the upcoming meeting. Further along the curve, implied rates on eurodollar futures contracts that expire in the middle of this year and beyond declined 25 to 50 basis points on balance over the intermeeting period, as market participants pushed back their expectations for the commencement of a monetary policy tightening. Futures quotes suggest that investors anticipate that policy tightening will begin in the second half of this year and will push the federal funds rate up about 50 basis points by year-end. Measures of uncertainty around the expected path for monetary policy have moved down since the last FOMC meeting.

### **Stock Prices and Corporate Risk Spreads**

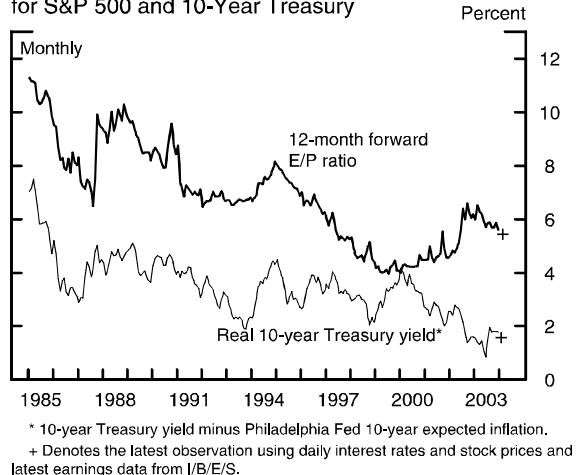
Broad equity price indexes climbed nearly 7 percent over the intermeeting period, reaching highs not seen since before September 11, 2001. Technology and small-cap shares outperformed the overall market, rising about 10 percent. Although the economic news was mixed, the outlook for earnings continued to

### Stock Prices and Corporate Risk Spreads

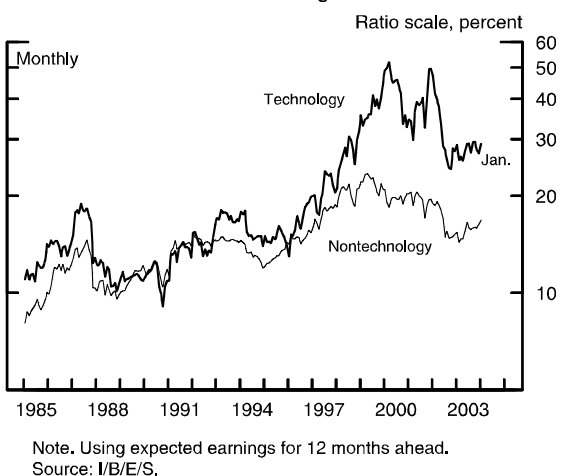
Stock Prices



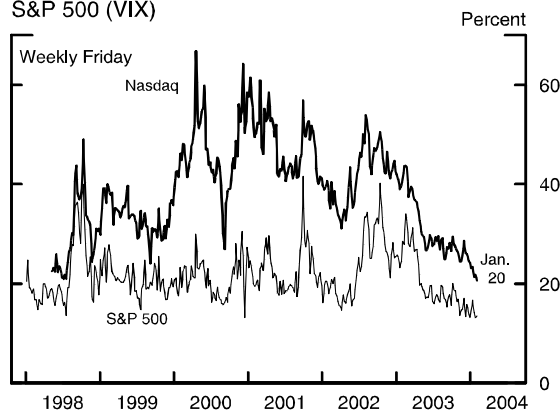
12-Month Forward Earnings-Price Ratio for S&P 500 and 10-Year Treasury



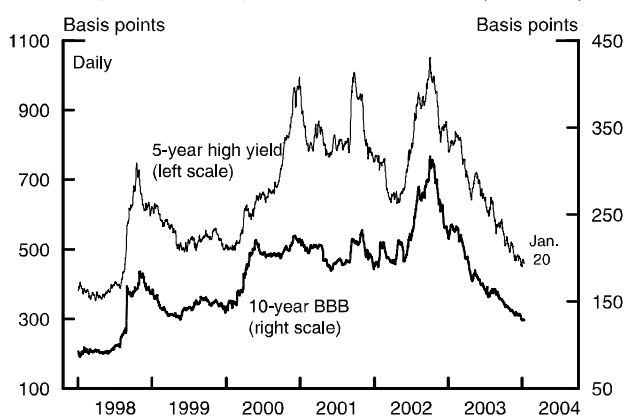
Selected S&P 500 Price-Earnings Ratios



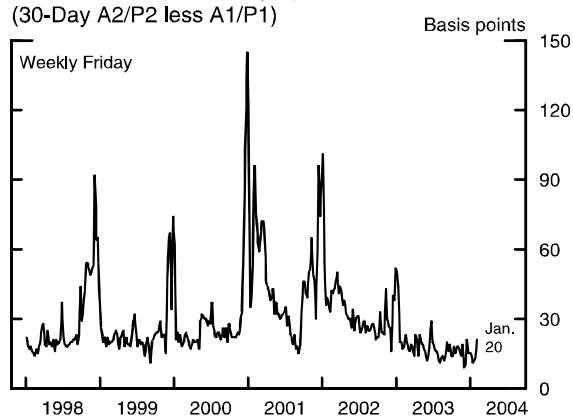
Implied Volatility on Nasdaq 100 (VXN) and S&P 500 (VIX)



Corporate Bond Spreads to Similar Maturity Treasury



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



improve, and market commentary pointed to that improvement as the source of the further rise in equity prices. The forward-earnings yield on the S&P 500 index edged down over the intermeeting period, but the gap over the real Treasury yield remained in the upper part of the range seen over the past two decades. The forward price-earnings ratio for technology companies in the S&P 500 has bounced around in recent months but continues to be somewhat elevated relative to its historical average, suggesting that investors expect the higher earnings growth at technology firms to be sustained. Implied volatility for the S&P 500 has remained low and that for the Nasdaq has moved down since the last FOMC meeting.

Risk spreads on upper-tier investment-grade corporate bonds have been about unchanged since the last FOMC meeting, while spreads on lower-tier investment-grade and speculative-grade bonds moved lower. Commercial paper risk spreads have stayed well below historical averages, and year-end pressures never materialized in this market, likely in part because issuers most subject to rollover risk exited the market as it continued to shrink last year.

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

Analysts' expectations for S&P 500 earnings per share for the fourth quarter of last year currently stand at 21 percent above their year-earlier level. As in the past couple of quarters, negative guidance has been largely absent, indicating that actual growth will come in even higher. Moreover, analysts have revised up their expectations for this year's earnings.

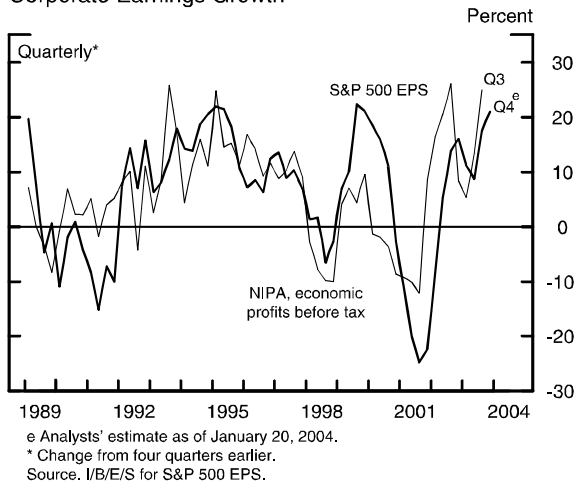
Corporate credit quality appears to have continued to improve. Bond downgrades moderated considerably in the second half of last year. Correspondingly, the realized bond default rate remained quite low at the end of the year, and the expected year-ahead default rate based on firm-specific measures from the KMV Corporation dropped further. Allegations of corporate fraud at Parmalat did not generate notable fallout in U.S. financial markets, in part because the company's debt is mostly euro-denominated and is not widely held by U.S. investors.

#### **Business Finance**

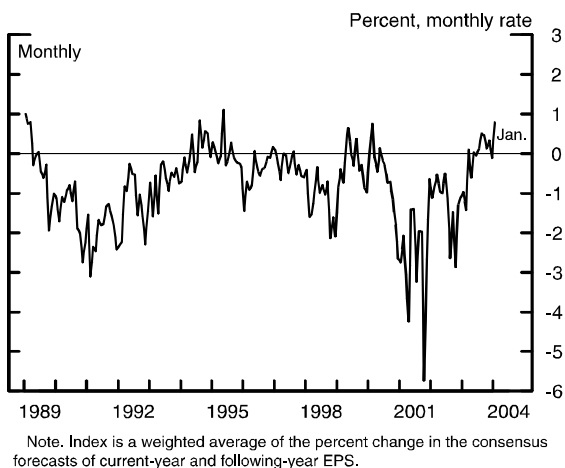
Gross bond issuance by nonfinancial firms held up in December, but retirements were sizable, leaving net bond issuance slightly negative. Commercial paper outstanding ran off sharply, partly reflecting the paring back of programs by some cash-laden retailers, and outstanding C&I loans also posted a substantial contraction (on a month-end basis). For the fourth quarter as a whole, the sum of these components of nonfinancial business financing moved further into negative territory, as firms relied on substantial cash cushions built up from profits and the proceeds from past borrowing to finance spending.

### Corporate Credit Quality and Earnings

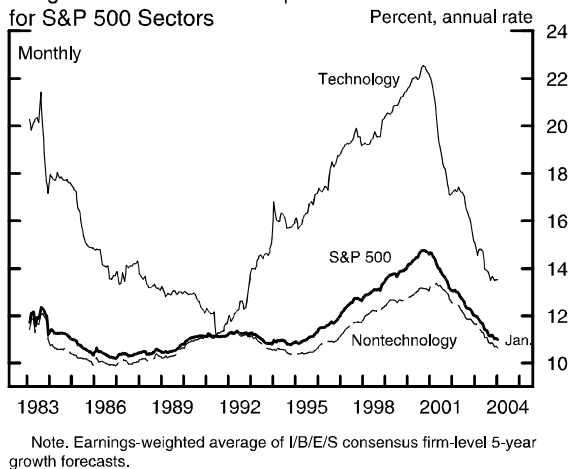
Corporate Earnings Growth



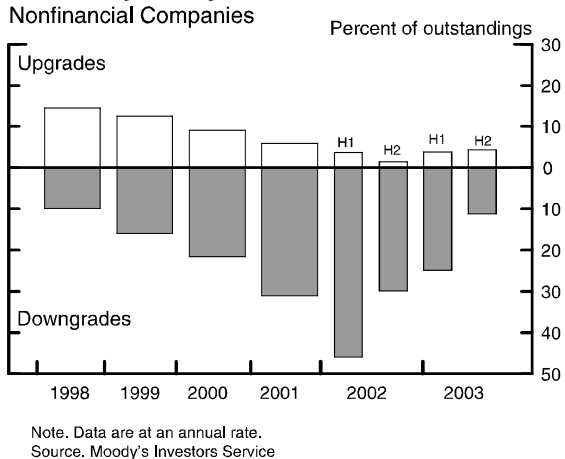
S&P 500 EPS Revisions Index



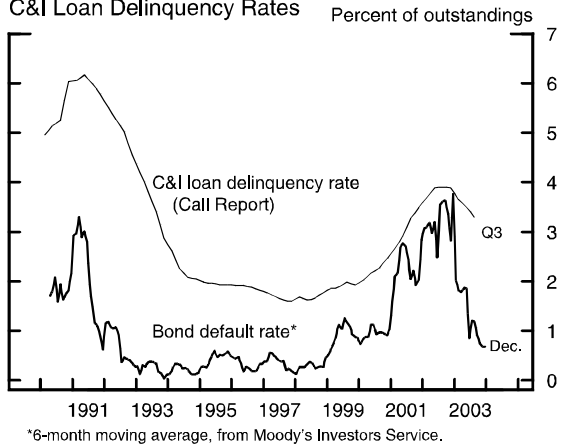
Long-Term EPS Growth Expectations for S&P 500 Sectors



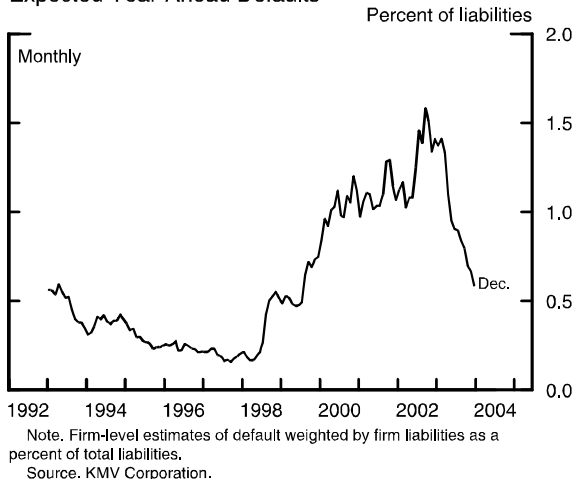
Bond Ratings Changes of Nonfinancial Companies



Bond Default and C&I Loan Delinquency Rates



Expected Year-Ahead Defaults





**Business Finance**

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

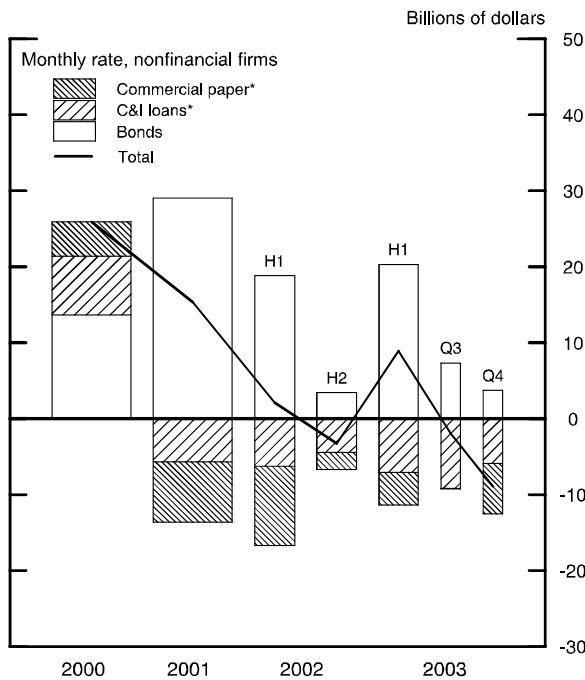
(Billions of dollars; monthly rates, not seasonally adjusted)

| Type of security                                       | 2000 | 2001 | 2002 | 2003  |       |       |       |
|--|------|------|------|-------|-------|-------|-------|
|  |      |      |      | H1    | Q3    | Q4    | Dec.  |
| <i>Nonfinancial corporations</i>                       |      |      |      |       |       |       |       |
| Stocks <sup>1</sup>                                    | 9.9  | 6.5  | 5.2  | 2.8   | 3.9   | 5.2   | 3.7   |
| Initial public offerings                               | 4.4  | 2.1  | 0.7  | 0.0   | 0.7   | 1.0   | 1.2   |
| Seasoned offerings                                     | 5.5  | 4.4  | 4.4  | 2.8   | 3.2   | 4.2   | 2.4   |
| Bonds  | 22.7 | 39.8 | 24.8 | 36.3  | 26.1  | 25.4  | 24.4  |
| Investment grade <sup>2</sup>                          | 13.2 | 27.5 | 15.7 | 20.0  | 10.3  | 13.0  | 11.5  |
| Speculative grade <sup>2</sup>                         | 4.7  | 8.9  | 4.8  | 11.5  | 12.2  | 10.0  | 11.0  |
| Other (sold abroad/unrated)                            | 4.9  | 3.4  | 4.2  | 4.9   | 3.7   | 2.4   | 1.9   |
| <i>Memo</i>  |      |      |      |       |       |       |       |
| Net issuance of commercial paper <sup>3</sup>          | 4.5  | -8.0 | -6.3 | -4.3  | -0.1  | -6.7  | -21.0 |
| Change in C&I loans at commercial banks <sup>3,4</sup> | 7.8  | -5.7 | -5.4 | -7.1  | -9.2  | -5.9  | -13.8 |
| <i>Financial corporations</i>                          |      |      |      |       |       |       |       |
| Stocks <sup>1</sup>                                    | 1.4  | 4.2  | 4.0  | 6.0   | 7.5   | 7.9   | 9.3   |
| Bonds <sup>5</sup>                                     | 57.8 | 80.2 | 87.0 | 106.3 | 102.7 | 109.7 | 99.1  |

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.

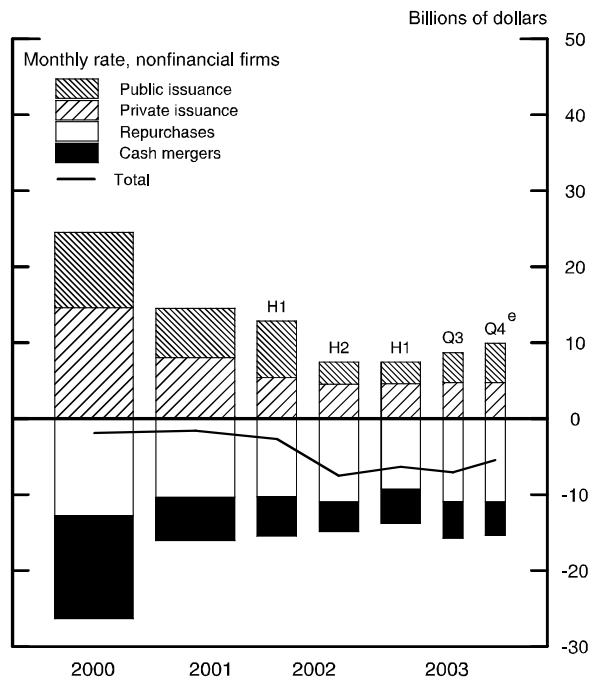
1. Excludes equity issues associated with equity-for-equity swaps that have occurred in restructurings.
2. Bonds sold in U.S. categorized according to Moody's bond ratings, or to Standard & Poor's if unrated by Moody's.
3. End-of-period basis, seasonally adjusted.
4. Adjusted for FIN 46 effects.
5. Excludes mortgage-backed and asset-backed bonds.

**Selected Components of Net Debt Financing**



\* Seasonally adjusted.

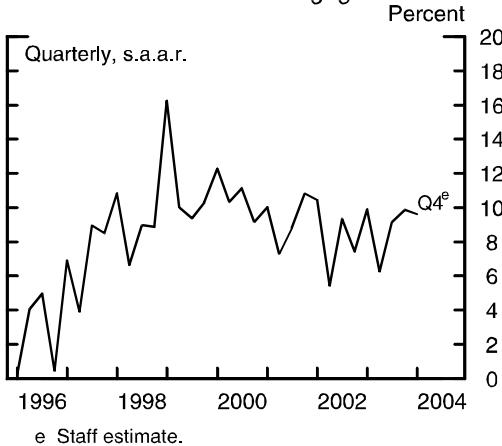
**Components of Net Equity Issuance**



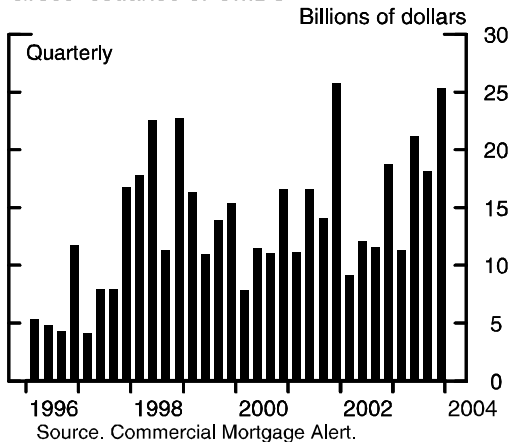
<sup>e</sup> Staff estimate.

**Commercial Real Estate**

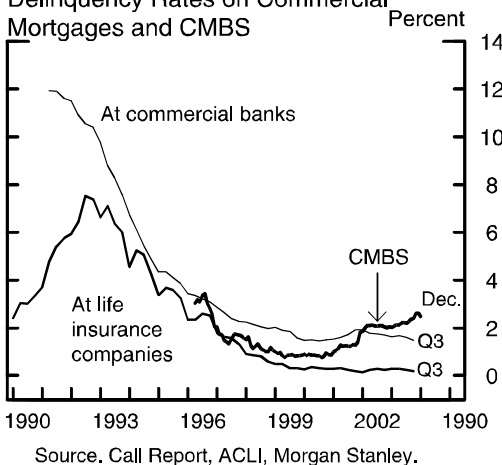
**Growth of Commercial Mortgage Debt**



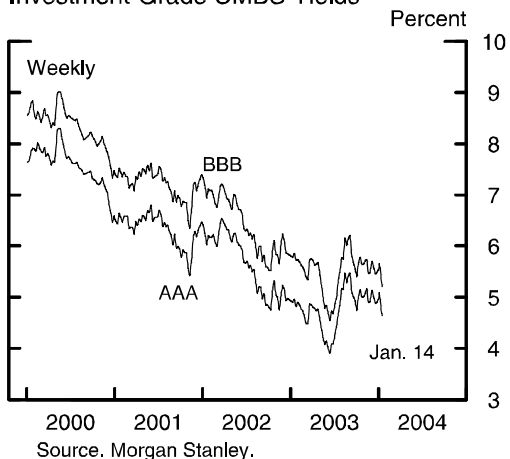
**Gross Issuance of CMBS**



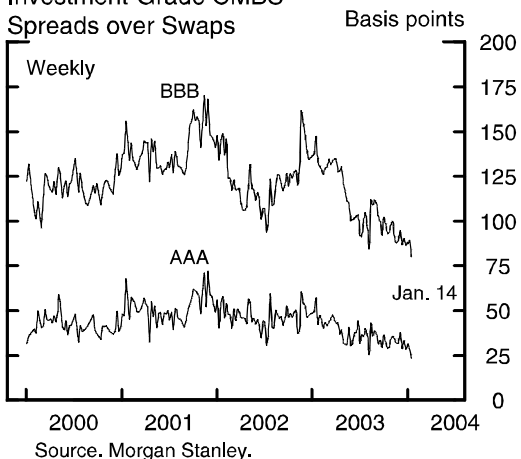
**Delinquency Rates on Commercial Mortgages and CMBS**



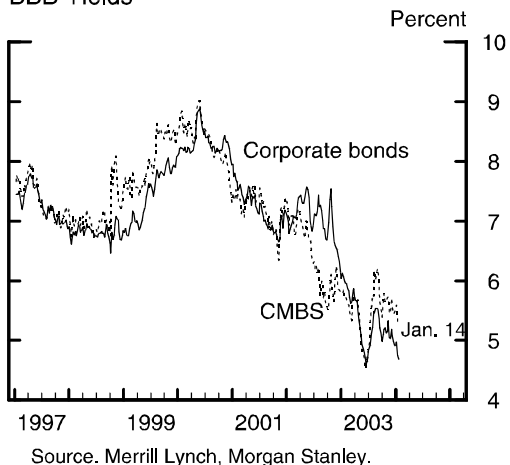
**Investment-Grade CMBS Yields**



**Investment-Grade CMBS Spreads over Swaps**



**BBB Yields**



Though overall demand for financing has been weak, credit conditions have been favorable, especially for riskier credits. Speculative-grade firms have raised substantial amounts in the bond market, accounting for about 40 percent of gross bond issuance in the past two quarters—considerably more than in recent years. In addition, the January Senior Loan Officer Opinion Survey indicated that banks, on net, had eased credit standards and some lending terms on C&I loans over the past three months.

Gross equity issuance by nonfinancial firms dropped back in December from a particularly robust November pace. The slowdown was concentrated in seasoned offerings, as the IPO market continued its gradual recovery last month. Equity retirements in the fourth quarter—from both repurchases and cash-financed mergers—appear to have maintained a pace similar to that seen earlier in the year. Share repurchases have remained strong despite the dividend tax cut last year, which may reflect the funding of stock options as well as some companies' ongoing preference for the flexibility of distributing cash through share repurchases rather than dividends. Overall, net equity issuance in the fourth quarter was a little less negative than it was earlier in the year.

### **Commercial Real Estate**

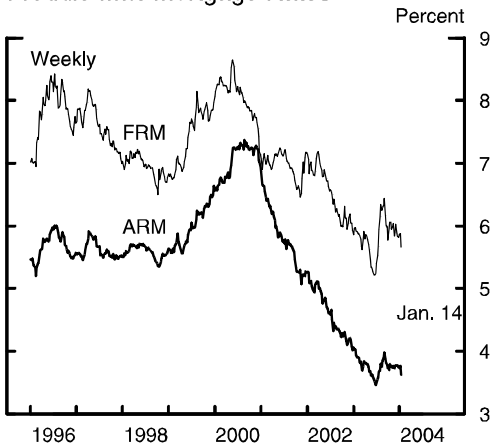
The growth of commercial mortgage debt likely remained strong in the fourth quarter, boosted by robust net issuance of CMBS. Although delinquency rates for commercial mortgages on the books of financial institutions remained low, overall CMBS delinquencies continued to rise, reaching a level last seen in 1996. According to the responses to the January Senior Loan Officer Opinion Survey, the differential trends in delinquency rates reflect the inclusion of higher-risk debt in the CMBS pools and the fact that securitized mortgages are more difficult to refinance. Despite the rising delinquency rate, CMBS yields declined notably in early January, leaving spreads over swaps down about 10 basis points over the intermeeting period. The spread between BBB-rated CMBS and BBB-rated corporate debt was narrowed slightly during that time.

### **Household Finance**

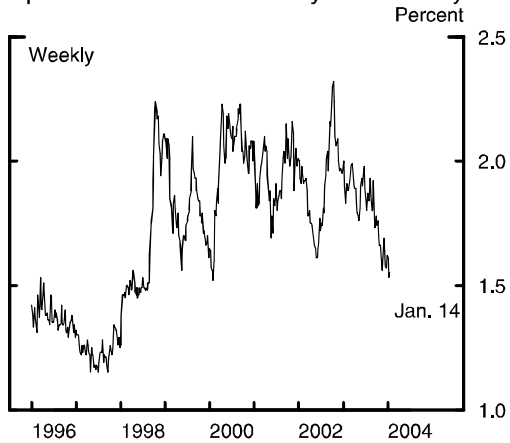
Interest rates on thirty-year fixed-rate home mortgages have fallen about 35 basis points since the last FOMC meeting, a bit more than longer-term Treasury yields. The decrease in rates will likely cause mortgage refinancing to pick up in January. Purchase volume has remained strong, and home mortgage debt is estimated to have grown at a robust 11-1/2 percent annual rate in the fourth quarter, just a shade below its third-quarter pace. Meanwhile, consumer credit is estimated to have grown at a 5 percent annual rate in the fourth quarter of last year, down slightly from its third-quarter pace of about 6 percent.

### Household Liabilities

Freddie Mac Mortgage Rates

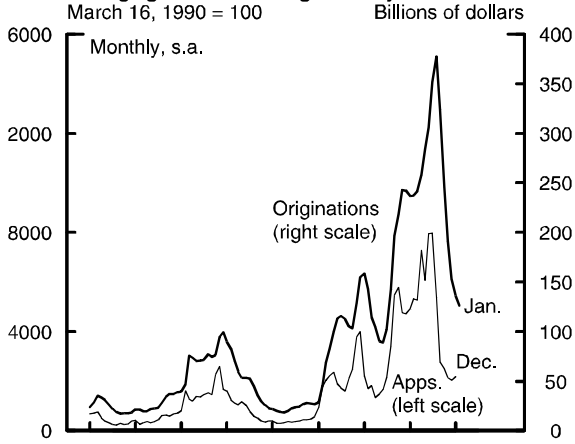


Spread of FRM Rate to 10-year Treasury



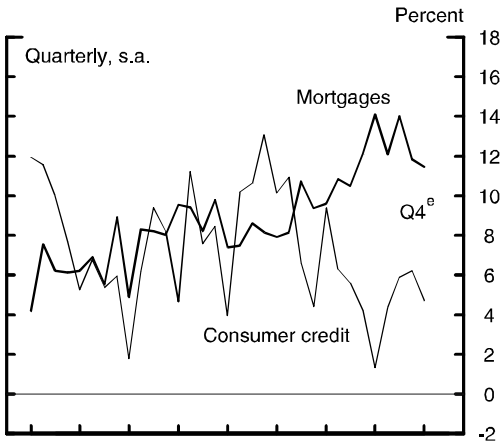
Mortgage Refinancing Activity

March 16, 1990 = 100



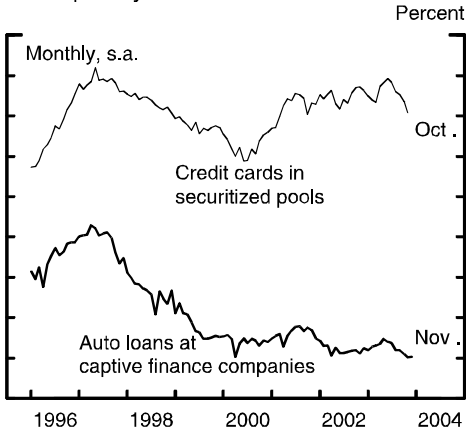
Source. Staff estimates.

Household Debt Growth



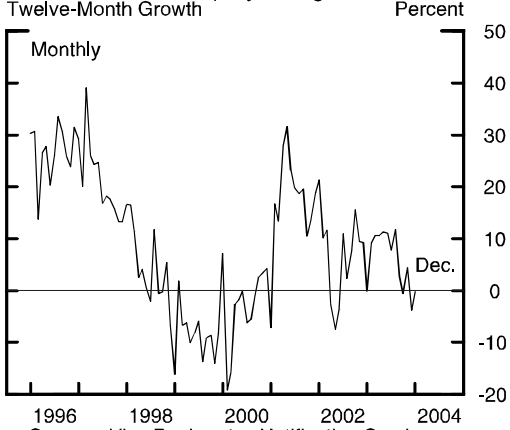
e Staff estimate.

Delinquency Rates



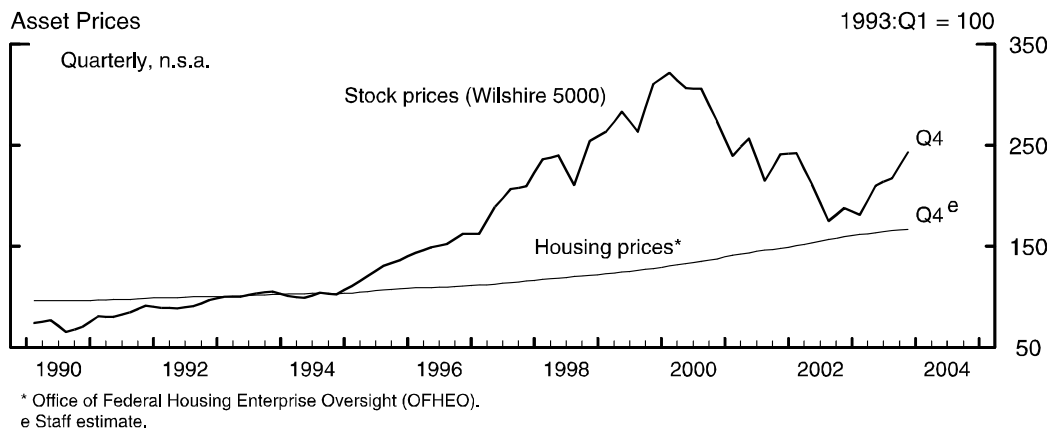
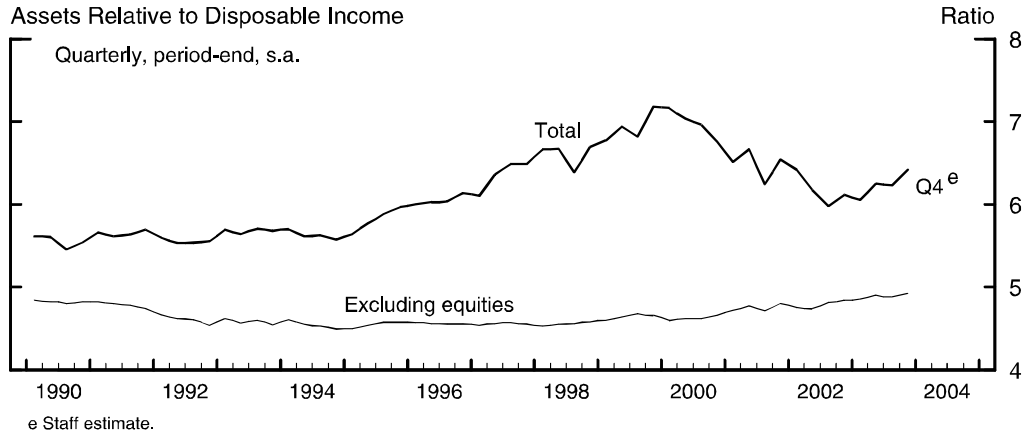
Source. Moody's, Federal Reserve.

Household Bankruptcy Filings



Source. Visa Bankruptcy Notification Service Statistics.

### Household Assets



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

|                              | 2001        | 2002        | 2003        |             |             |             | Assets<br>Nov. |                   |
|------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|----------------|-------------------|
|                              |             |             | H1          | Q3          | Oct.        | Nov.        |                | Dec. <sup>e</sup> |
| <b>Total long-term funds</b> | <b>10.8</b> | <b>10.2</b> | <b>19.1</b> | <b>14.5</b> | <b>28.1</b> | <b>15.4</b> | <b>26.3</b>    | <b>5,162</b>      |
| <b>Equity funds</b>          | <b>2.8</b>  | <b>-2.2</b> | <b>5.8</b>  | <b>20.7</b> | <b>25.3</b> | <b>14.9</b> | <b>19.3</b>    | <b>3,513</b>      |
| Domestic                     | 4.6         | -2.0        | 5.4         | 18.2        | 19.2        | 12.5        | 13.6           | 3,031             |
| International                | -1.8        | -0.2        | 0.5         | 2.5         | 6.1         | 2.5         | 5.7            | 482               |
| <b>Hybrid funds</b>          | <b>0.7</b>  | <b>0.7</b>  | <b>2.0</b>  | <b>3.5</b>  | <b>4.1</b>  | <b>3.0</b>  | <b>4.2</b>     | <b>416</b>        |
| <b>Bond funds</b>            | <b>7.3</b>  | <b>11.7</b> | <b>11.3</b> | <b>-9.8</b> | <b>-1.3</b> | <b>-2.5</b> | <b>2.8</b>     | <b>1,233</b>      |
| High-yield                   | 0.6         | 0.9         | 3.7         | -0.1        | 2.1         | 1.1         | 1.8            | 149               |
| Other taxable                | 5.7         | 9.5         | 7.1         | -7.5        | -2.4        | -2.5        | 1.8            | 750               |
| Municipals                   | 1.0         | 1.4         | 0.5         | -2.1        | -1.0        | -1.1        | -0.7           | 334               |

Note. Excludes reinvested dividends.

e Staff estimates based on confidential ICI weekly data.

Source. Investment Company Institute.

**State and Local Government Finance**

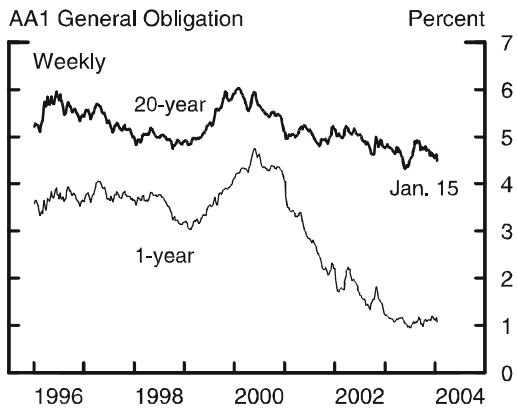
**Gross Offerings of Municipal Securities**

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

| Type of security        | 2000 | 2001 | 2002 | 2003 |      |      |      |
|-------------------------|------|------|------|------|------|------|------|
|                         |      |      |      | H1   | Q3   | Q4   | Dec. |
| Total                   | 17.9 | 29.0 | 36.3 | 40.6 | 34.7 | 35.0 | 34.8 |
| Long-term <sup>1</sup>  | 15.0 | 24.3 | 30.3 | 34.5 | 28.4 | 30.5 | 30.7 |
| Refundings <sup>2</sup> | 2.2  | 7.6  | 10.1 | 11.4 | 8.4  | 7.4  | 5.4  |
| New capital             | 12.9 | 16.7 | 20.2 | 23.1 | 20.0 | 23.1 | 25.3 |
| Short-term              | 2.8  | 4.7  | 6.0  | 6.1  | 6.3  | 4.5  | 4.1  |
| Memo: Long-term taxable | 0.7  | 1.4  | 1.7  | 3.9  | 2.6  | 3.6  | 4.4  |

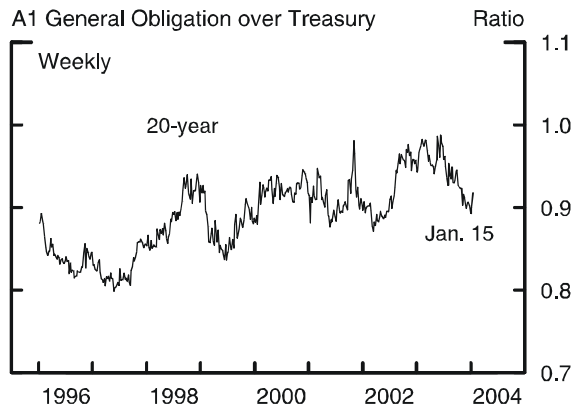
- 1. Includes issues for public and private purposes.
- 2. All issues that include any refunding bonds.

**Municipal Bond Yields**



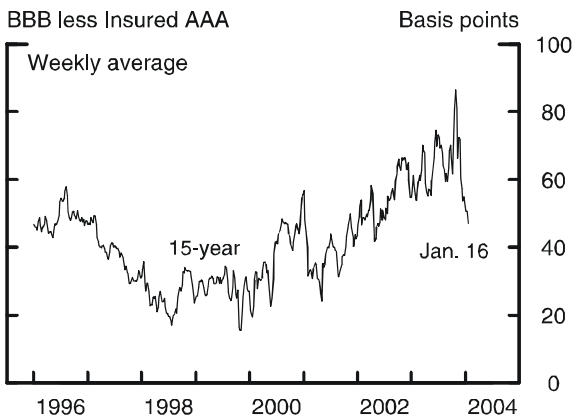
Source: Bloomberg.

**Municipal Bond Ratios**



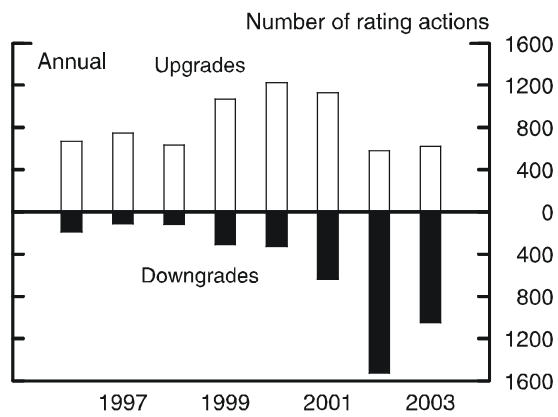
Source: Bond Buyer.

**Revenue Bond Spread**



Source: Bloomberg.

**Bond Rating Changes**



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

Household credit quality has been stable to improving over the fourth quarter. Seasonally adjusted delinquency rates on credit-card-backed securities declined in October, and those on auto loans remained low in November. Household bankruptcy filings stabilized over the fourth quarter, albeit at still-elevated levels.

Sizable stock price gains produced an increase in the ratio of household assets to disposable income in the fourth quarter. To date there has been little evidence that news of investigations into mutual fund trading practices has prompted a pullback by mutual fund investors. In December and the first half of January, households continued to pour money into long-term mutual funds.

#### **State and Local Government Finance**

Gross municipal bond issuance was robust in December, keeping fourth-quarter issuance about in line with the rapid third-quarter pace. New capital issuance was particularly strong last month, fueled by strong infrastructure demands and borrowing to cope with remaining fiscal pressures.

Yields on longer-term municipal bonds moved down about in line with Treasury yields over the intermeeting period. The revenue-bond credit spread fell further and is now at a level last seen in 2002. In addition, for last year as a whole, the net balance of upgrades to downgrades of municipal bonds improved noticeably.

#### **Treasury and Agency Finance**

The Treasury conducted its regularly scheduled auctions of two-, five-, and ten-year nominal securities and a ten-year inflation-indexed security over the intermeeting period. The results from the auctions were mixed. The five-year note auction met strong demand. However, the TIPS auction the next day—the largest since the inception of the program in 1997—was quite weak, with a stop-out rate an unusually wide 5 basis points above the when-issued rate.

On December 22, the Federal Reserve released a widely anticipated staff working paper that argued that Fannie Mae and Freddie Mac benefit greatly from an implied government subsidy but pass along little of that benefit to home buyers. Although the paper's findings received extensive coverage in the media, there was little immediate effect on GSE stock prices or yield spreads.

#### **Money and Bank Credit**

M2 fell at almost a 2 percent annual rate in December, the fourth consecutive monthly decline. The decline in M2 for the fourth quarter was also about

**Treasury Financing**  
(Billions of dollars)

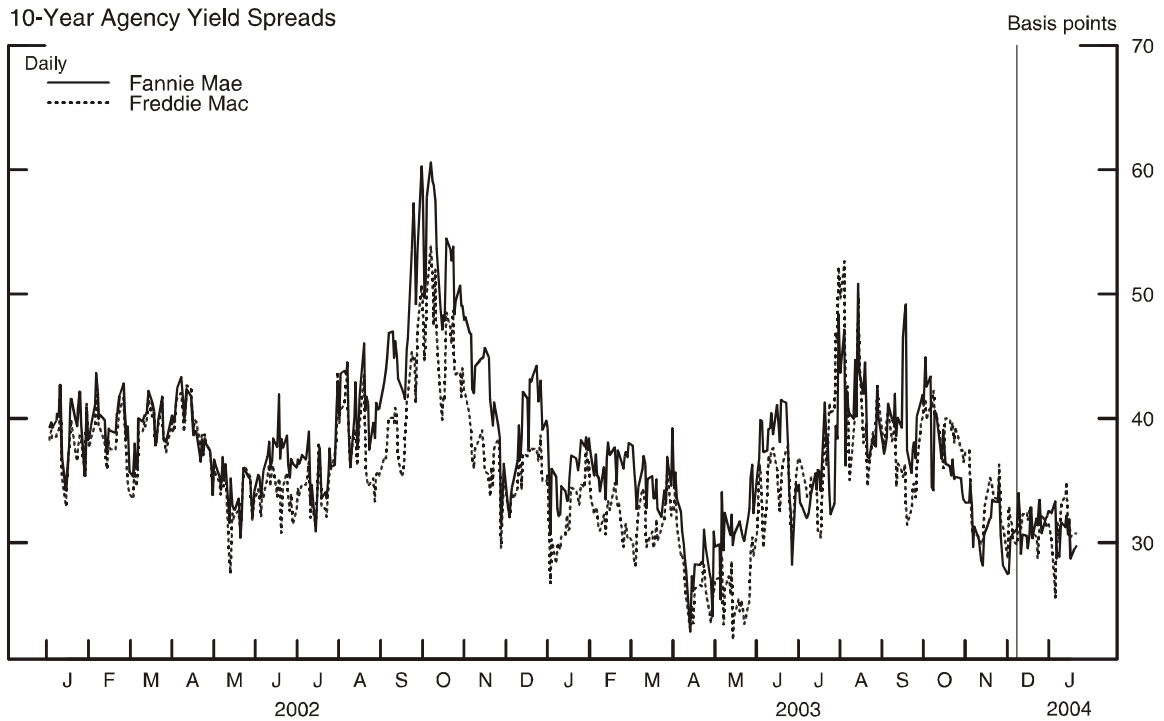
| Item                              | 2003          |              |               |               |              |              |
|-----------------------------------|---------------|--------------|---------------|---------------|--------------|--------------|
|                                   | Q1            | Q2           | Q3            | Q4            | Nov          | Dec.         |
| <b>Total surplus, deficit (-)</b> | <b>-144.9</b> | <b>-16.6</b> | <b>-104.5</b> | <b>-128.7</b> | <b>-43.0</b> | <b>-16.2</b> |
| Means of financing deficit        |               |              |               |               |              |              |
| Net borrowing                     | 63.5          | 106.3        | 107.6         | 118.6         | 43.2         | 10.7         |
| Nonmarketable                     | -50.5         | 45.9         | 31.4          | 6.6           | -0.1         | 0.0          |
| Marketable                        | 114.0         | 60.4         | 76.2          | 112.0         | 43.4         | 10.7         |
| Bills                             | 67.0          | -27.2        | -14.9         | 9.2           | 11.1         | -27.6        |
| Coupons <sup>1</sup>              | 47.0          | 87.6         | 91.1          | 102.8         | 32.2         | 38.4         |
| Debt buybacks                     | 0.0           | 0.0          | 0.0           | 0.0           | 0.0          | 0.0          |
| Decrease in cash balance          | 19.8          | -16.8        | -4.9          | 1.8           | 13.6         | -11.8        |
| Other <sup>2</sup>                | 61.6          | -73.0        | 1.9           | 8.3           | -13.8        | 17.2         |
| MEMO                              |               |              |               |               |              |              |
| Cash balance, end of period       | 13.3          | 30.0         | 35.0          | 33.2          | 21.4         | 33.2         |

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 line indicates December FOMC meeting.



### Monetary Aggregates

(Based on seasonally adjusted data\*, removing FIN 46 effects)

| Aggregate or component                                    | 2003<br>(p) | 2003  |           | 2003  |       |             | Level<br>(\$ billions)<br>Dec. 03<br>(p) |
|---|-------------|-------|-----------|-------|-------|-------------|--|
|   |             | Q3    | Q4<br>(p) | Oct.  | Nov.  | Dec.<br>(p) |  |
| <i>Aggregate</i>  |             |       |           |       |       |             |  |
| Percent change (annual rate) <sup>1</sup>                 |             |       |           |       |       |             |  |
| 1. M2 <sup>2</sup>  | 5.2         | 7.0   | -1.8      | -3.6  | -1.5  | -1.8        | 6,062                                    |
| 2. M3 <sup>3</sup>  | 4.8         | 9.1   | -2.4      | -4.8  | -2.8  | -3.4        | 8,831                                    |
| <i>Components of M2<sup>4</sup></i>                       |             |       |           |       |       |             |  |
| 3. Currency   | 6.0         | 4.2   | 6.4       | 7.7   | 5.7   | 4.9         | 664                                      |
| 4. Liquid deposits <sup>5</sup>                           | 13.8        | 16.7  | 3.8       | 3.9   | 3.4   | 2.6         | 3,778                                    |
| 5. Small time deposits                                    | -9.6        | -13.4 | -10.4     | -9.7  | -10.4 | -7.1        | 806                                      |
| 6. Retail money market funds                              | -11.5       | -9.6  | -23.5     | -39.0 | -21.0 | -21.8       | 807                                      |
| <i>Components of M3</i>                                   |             |       |           |       |       |             |  |
| 7. M3 minus M2 <sup>6</sup>                               | 3.9         | 13.6  | -3.8      | -7.2  | -5.7  | -7.0        | 2,768                                    |
| 8. Large time deposits, net <sup>7</sup>                  | 8.1         | 32.6  | 2.7       | -9.2  | 6.9   | 12.7        | 885                                      |
| 9. Institutional money market funds                       | -6.1        | 7.6   | -16.7     | -22.5 | -24.2 | -19.7       | 1,100                                    |
| 10. RPs   | 12.3        | -10.9 | 7.1       | 16.7  | 13.3  | -18.1       | 502                                      |
| 11. Eurodollars   | 25.2        | 30.0  | 10.9      | 19.5  | -3.8  | 2.6         | 282                                      |
| <i>Memo</i>   |             |       |           |       |       |             |  |
| 12. Monetary base   | 6.0         | 4.1   | 6.0       | 7.7   | 5.4   | 3.4         | 721                                      |
| Average monthly change (billions of dollars) <sup>8</sup> |             |       |           |       |       |             |  |
| <i>Selected managed liabilities at commercial banks</i>   |             |       |           |       |       |             |  |
| 13. Large time deposits, gross                            | 1.7         | 16.6  | -6.1      | -22.2 | -.5   | 12.8        | 1,026                                    |
| 14. Net due to related foreign institutions               | 3.1         | -1.3  | 9.4       | 34.0  | 11.0  | -31.1       | 144                                      |
| 15. U.S. government deposits at commercial banks          | -.3         | .8    | .4        | -1.3  | .6    | 3.0         | 19                                       |

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. Deposits reported due to FIN 46 have been removed.

4. Non-bank travelers checks not listed.

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

6. Sum of large time deposits, institutional money market funds, RP liabilities of depository institutions, and eurodollars held by U.S. addressees.

7. Net of holdings of depository institutions, money market funds, U.S. government, and foreign banks and official institutions. Deposits reported due to FIN 46 have been removed.

8. For the years shown, "average monthly change" is the Q4 to Q4 dollar change divided by 12. For the quarters shown, it is the quarter-to-quarter dollar change divided by 3.

p Preliminary.

\* These data also reflect the effects of the annual seasonal factor review.

### Commercial Bank Credit

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

| Type of credit                 | 2003       | Q3<br>2003  | Q3<br>2003 | Q4<br>2003 | Nov.<br>2003 | Dec.<br>2003 | Level,<br>Dec. 2003<br>(\$ billions) |
|--------------------------------|------------|-------------|------------|------------|--------------|--------------|--------------------------------------|
| <b>Total</b>                   |            |             |            |            |              |              |                                      |
| <b>1. Adjusted<sup>1</sup></b> | <b>5.9</b> | <b>11.6</b> | <b>4.6</b> | <b>-5</b>  | <b>9.4</b>   | <b>-4.5</b>  | <b>5,966</b>                         |
| 2. Reported                    | 5.6        | 11.7        | 2.5        | .0         | 7.9          | -2.3         | 6,159                                |
| <i>Securities</i>              |            |             |            |            |              |              |                                      |
| 3. Adjusted <sup>1</sup>       | 9.0        | 19.1        | -3.6       | 6.0        | 26.9         | -2.6         | 1,634                                |
| 4. Reported                    | 7.6        | 18.7        | -10.2      | 6.9        | 20.0         | 4.6          | 1,826                                |
| 5. Treasury and agency         | 8.6        | 29.2        | -15.3      | 2.7        | 22.6         | -.7          | 1,101                                |
| 6. Other <sup>2</sup>          | 6.1        | 2.7         | -2.1       | 13.4       | 15.8         | 12.6         | 726                                  |
| <i>Loans<sup>3</sup></i>       |            |             |            |            |              |              |                                      |
| 7. Total                       | 4.8        | 8.9         | 7.7        | -2.8       | 2.9          | -5.3         | 4,333                                |
| 8. Business                    | -8.8       | -7.0        | -13.9      | -9.6       | -4.5         | -5.3         | 877                                  |
| 9. Real estate                 | 11.0       | 11.6        | 18.4       | -1.8       | -8.3         | -1.2         | 2,216                                |
| 10. Home equity                | 30.8       | 28.1        | 24.1       | 30.9       | 35.2         | 32.9         | 281                                  |
| 11. Other                      | 8.7        | 9.6         | 17.6       | -5.9       | -14.2        | -6.0         | 1,935                                |
| 12. Consumer                   | 6.2        | 2.0         | 6.9        | 12.5       | 57.2         | 6.7          | 634                                  |
| 13. Adjusted <sup>4</sup>      | 6.1        | 5.2         | 3.3        | 8.6        | 35.9         | 1.7          | 997                                  |
| 14. Other <sup>5</sup>         | 4.7        | 32.5        | 4.5        | -11.5      | 1.2          | -31.8        | 606                                  |

Note. Data are adjusted to remove estimated effects of consolidation related to FIN 46 and 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.

1. Adjusted to remove effects of mark-to-market accounting rules (FIN 39 and FAS 115).

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

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

2 percent, the largest since the start of consistent data collection in 1959.<sup>1</sup> The drop in M2 in December reflected additional weakness in liquid deposits, as well as continued shrinkage in small time deposits and retail money market mutual funds. Households continued to shift into equity mutual funds and, in December, also moved into bond funds. The boost to liquid deposits earlier in the year owing to the effects of mortgage refinancing activity was substantially unwound during the fourth quarter. However, abstracting from special factors, underlying M2 growth last quarter appears weak.

Bank credit declined at a 4-1/2 percent annual rate in December, as securities and loans contracted. Business lending continued to fall in November and December, with weakness again concentrated at large domestic and foreign-related institutions. However, on net, respondents to the January Senior Loan Officer Survey noted a pickup in demand for business loans over the past three months and also indicated that they had experienced an increase in the number of inquiries from potential business borrowers during that time. Preliminary reports from a sample of bank holding companies indicate that the banking sector remained highly profitable in the fourth quarter of 2003 and that credit quality also continued to improve.

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1. These data incorporate the effects of the annual seasonal factor review and are confidential until their release, which is planned for January 29th.

## Appendix

### January 2004 Senior Loan Officer Opinion Survey

The January 2004 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 series of questions on commercial real estate lending; banks were asked about longer-term changes in terms on commercial real estate loans, the types of properties used to secure these loans, and commercial real estate loan securitizations. Responses were received from fifty-three domestic and twenty foreign banking institutions.

Moderate net fractions of both domestic banks and U.S. branches and agencies of foreign banks indicated that they had eased lending standards and several lending terms on C&I loans over the past three months. Lending standards on commercial real estate loans over the same period were little changed. After reporting declining demand for C&I loans for the past three years, domestic banks, on net, indicated in the January survey that loan demand from firms of all sizes had strengthened. By contrast, foreign institutions continued to report weaker C&I loan demand on net. Both domestic and foreign institutions reported stronger demand for commercial real estate loans, on net, over the past three months.

Small net fractions of domestic banks indicated that they had tightened some terms on credit card loans, but standards and terms on other household loans were reportedly unchanged. A sizable net percentage of banks experienced weaker demand for loans to purchase homes over the past three months, and a number of institutions indicated that demand for all types of consumer loans had declined over the same period.

#### **Lending to Businesses**

In the January survey, 17 percent of domestic banks, on net, reported that they had eased their lending standards on C&I loans for large and middle-market firms over the past three months, the largest reported net easing of credit policies since the third quarter of 1993. In addition, 12 percent of domestic banks, on net, indicated that they had eased standards on loans for small firms. Similarly, a moderate fraction of U.S. branches and agencies of foreign banks reported an easing of lending standards on C&I loans over the past three months.

In addition to easing their credit standards on C&I loans, commercial banks reported easing a number of terms on such loans over the past three months. On net, about 25 percent of domestic banks indicated that they had narrowed the spreads of loan rates over their cost of funds for large and middle-market borrowers, up from 14 percent in the October survey. Domestic banks also continued to trim spreads on business loans for small borrowers. About 15 percent of foreign institutions, on net, noted that they had narrowed spreads on C&I loans, compared with no change in the previous survey. For the first time since the fourth quarter of 1998, when the survey began collecting information on risk premiums, domestic banks, on net, reported that they had lowered the premiums charged on riskier loans to large and middle-market firms. Domestic and foreign institutions, on net, continued to report an easing of terms on credit lines, including increased maximum sizes of such lines and lower costs.

According to survey respondents, more-aggressive competition from other banks and nonbanks, as well as an improvement in the economic outlook, were the most important reasons behind their decisions to ease credit standards and terms on C&I loans over the past three months. More than 80 percent of the domestic banks, and more than 70 percent of the foreign institutions, that reported an easing of standards or terms in the January survey cited more-aggressive competition as at least a somewhat important reason for doing so. Indeed, 39 percent of domestic respondents indicated that this was a very important reason. About 75 percent of domestic institutions that eased their lending policies pointed to a more favorable economic outlook. Among domestic institutions that reported a tightening of standards and terms on C&I loans, a reduced tolerance for risk was the most frequently cited reason for having done so.

**C&I loan demand.** For the first time since early 2000, domestic survey respondents noted that the demand for C&I loans had strengthened. About 25 percent of domestic banks, on net, reported increased demand for C&I loans from small firms, and 11 percent, on net, reported stronger demand from large and middle-market firms. In the October survey, 2 percent of domestic banks, on net, indicated weaker loan demand from small firms, and 8 percent, on net, reported weaker demand from large and middle-market borrowers. The apparent turnaround in reported loan demand over the past three months was also reflected in a rising proportion of domestic respondents that experienced an increase in the number of inquiries from potential business borrowers: 37 percent of domestic institutions, on net, reported an increase in the number of inquiries in the January survey, up from 18 percent in October and 10 percent in the August survey. However, foreign institutions continued to report a deterioration in C&I loan demand.

According to domestic respondents, the most important reasons for the strengthening of loan demand over the past three months were increased customer investment in plant and equipment and increased customer needs to finance accounts receivable and inventories. Of the domestic banks that experienced a decline in demand, about two-thirds indicated that it was due in part to an increase in their customers' internally generated funds, and two-thirds also attributed the decline in part to a shift in their customers' borrowing to another bank or a nonbank credit source. Branches and agencies of foreign banks cited the same reasons as domestic banks for decreased C&I loan demand.

**Commercial real estate lending.** As in the previous survey, domestic banks, on net, reported essentially no change in their lending standards on commercial real estate loans in the January survey. On the demand side, more than 20 percent of domestic banks, on net, reported that the demand for commercial real estate loans had increased over the past three months, a turnaround from the October survey, when about 10 percent of domestic respondents, on net, reported weaker demand for such loans. More than one-fifth of foreign institutions, on net, also reported stronger demand for commercial real estate loans in the January survey, whereas they reported no net change in demand in the previous survey.

Special questions asked banks about changes in terms on commercial real estate loans over the past year. About 20 percent of domestic banks, on net, reported that they had increased the maximum size of the commercial real estate loans that they are willing to

extend, and 12 percent, on net, indicated that they are willing to provide longer maturities on these loans. Most other lending terms on commercial real estate loans were little changed, on net, in 2003. Among domestic institutions that eased lending terms, the most frequently cited reasons for doing so were more-aggressive competition from other commercial banks or nonbank lenders and an improvement in the condition of, or outlook for, the commercial real estate market.

In responses to a special question about what types of real estate secured nonfarm, nonresidential commercial real estate loans, domestic banks indicated that office buildings were used as collateral for about 30 percent of these loans, retail developments for about 20 percent, and industrial properties for nearly 15 percent. More than 40 percent of nonfarm, nonresidential commercial real estate loans held by foreign institutions were secured by office properties. In addition to retail properties, hotel and resort properties also figured prominently in the commercial real estate portfolios of U.S. branches and agencies of foreign banks.

The January survey also asked several questions about the securitization of commercial real estate loans. More than three-fourths of domestic and half of foreign respondents indicated that less than 5 percent of all commercial real estate loans that their bank originated over the past year had been securitized. However, two domestic banks—accounting for a tiny fraction of commercial real estate loans held by domestic respondents—and four foreign institutions reported that they had securitized more than one-half of the year's originations. Both foreign and domestic institutions noted that the credit quality of commercial real estate loans that they had securitized was comparable to the credit quality of loans that they had originated and held on their books. The vast majority of banks also indicated that they generally do not retain servicing rights or provide credit enhancements such as recourse on the commercial real estate loans they securitize.

Since mid-2002, delinquency rates on commercial real estate loans held by banks and life insurance companies have been stable or falling, while those on loans backing commercial-mortgage-backed securities (CMBS) have been rising. About 90 percent of domestic and about 60 percent of foreign respondents attributed the divergence in the delinquency rates to the tranching structures of CMBS facilities, which facilitate the inclusion of higher-risk mortgages in the CMBS pools; the second most frequently cited reason was that securitized mortgages are less likely to be refinanced than those held on banks' balance sheets. This reasoning is consistent with the May 2003 survey in which respondents indicated that the most important reason for the low delinquency rates on the commercial real estate loans they held was the ability of borrowers to refinance and lower their debt financing costs as interest rates declined.

### **Lending to Households**

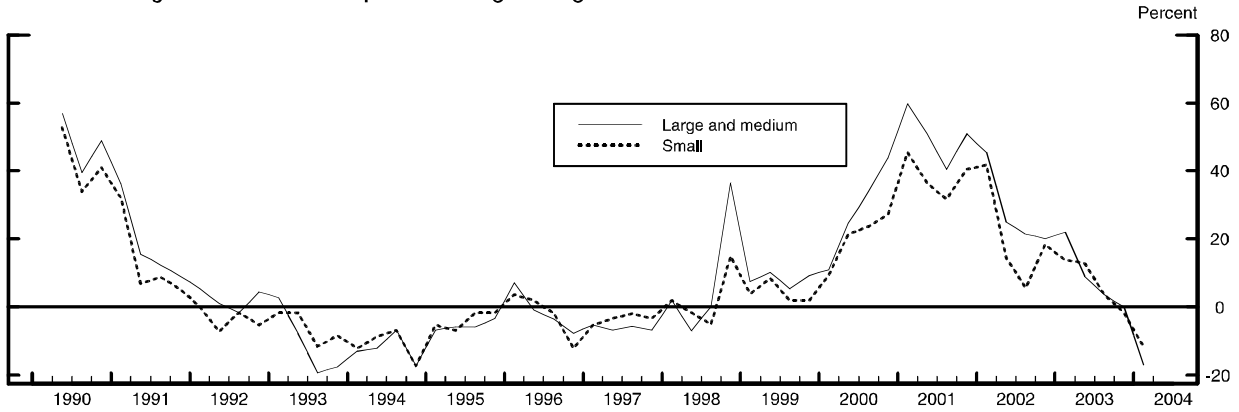
Credit demand from households reportedly weakened over the past three months. On net, more than one-third of domestic banks indicated that the demand for residential mortgage loans to purchase homes had deteriorated, a significantly greater share than in the October survey. However, respondents may find it difficult to separate mortgage originations used to buy homes from those used to refinance existing mortgages, and the pace of refinancing has slowed considerably since the middle of last year. About

15 percent of banks, on net, reported weaker demand for consumer loans of all types over the past three months, the largest net percentage reporting such weakening since the fourth quarter of 2001.

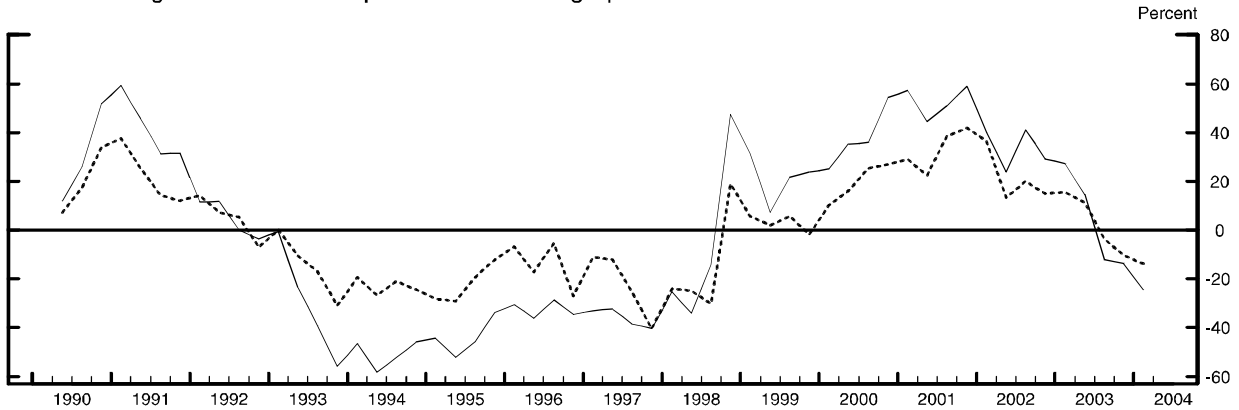
As for supply, respondents indicated that they had not changed their lending standards on residential mortgages, on net, and that their lending policies for credit card and other consumer loans were also largely unchanged. However, a moderate fraction of banks reported that they had decreased the extent to which credit card accounts are granted to customers who do not meet credit-scoring thresholds.

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

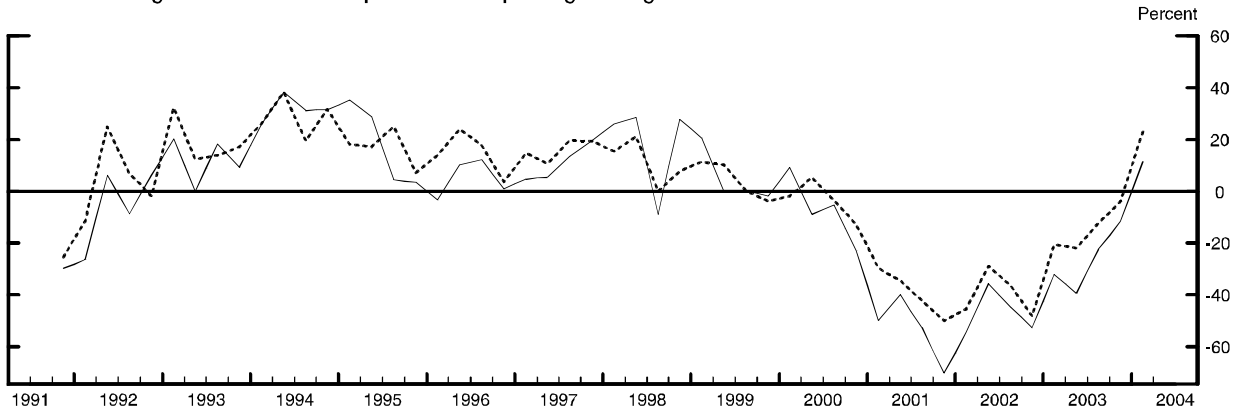
Net Percentage of Domestic Respondents Tightening Standards for C&I Loans



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



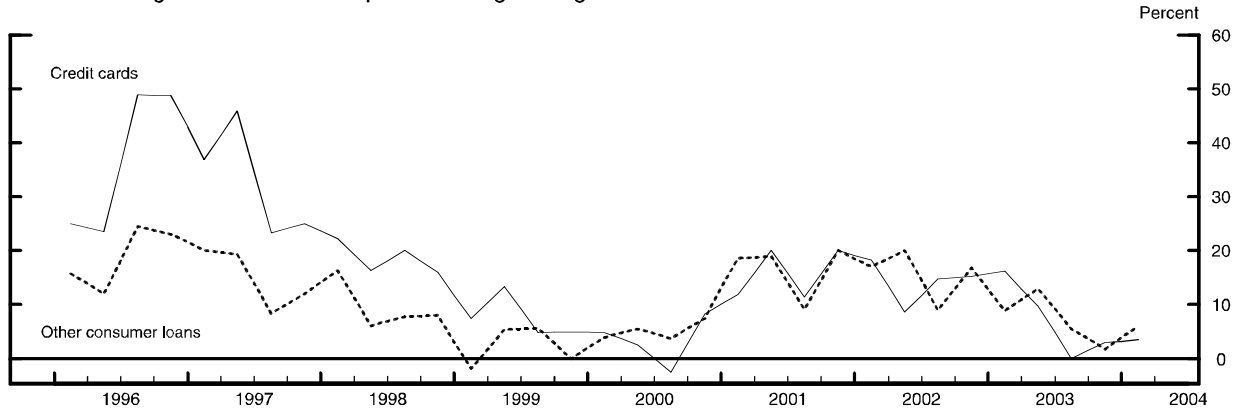
Net Percentage of Domestic Respondents Reporting Stronger Demand for C&I Loans



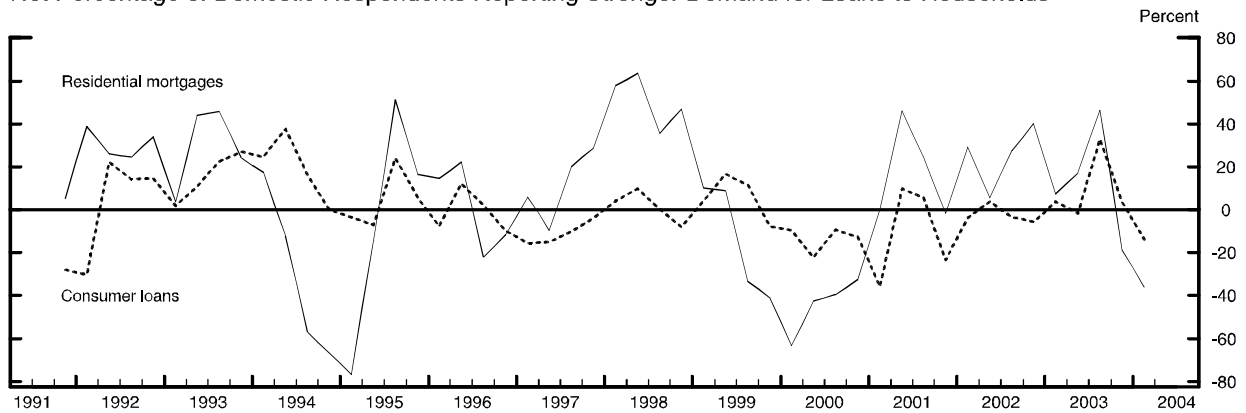


## Measures of Supply and Demand for Loans to Households

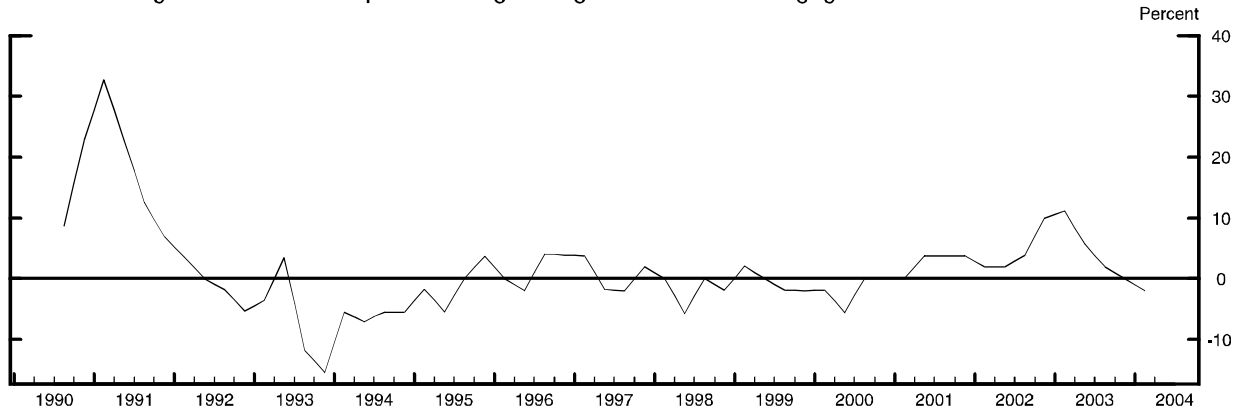
Net Percentage of Domestic Respondents Tightening Standards on Consumer Loans



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



Net Percentage of Domestic Respondents Tightening Standards for Mortgages to Individuals



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## **International Developments**

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## International Developments

### U.S. International Transactions

#### Trade in Goods and Services

The U.S. international trade deficit in November shrank to \$38 billion, its lowest level since about one year ago.

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

|                              | 2002   | Annual rate<br>2003 |        |                 | Monthly rate<br>2003 |       |       |
|------------------------------|--------|---------------------|--------|-----------------|----------------------|-------|-------|
|                              |        | Q2                  | Q3     | Q4 <sup>e</sup> | Sept.                | Oct.  | Nov.  |
| <i>Real NIPA<sup>1</sup></i> |        |                     |        |                 |                      |       |       |
| Net exports of G&S           | -470.6 | -526.0              | -505.2 | ...             | ...                  | ...   | ...   |
| <i>Nominal BOP</i>           |        |                     |        |                 |                      |       |       |
| Net exports of G&S           | -418.0 | -496.7              | -485.6 | -477.5          | -41.3                | -41.6 | -38.0 |
| Goods, net                   | -482.9 | -552.4              | -545.3 | -544.3          | -46.6                | -47.1 | -43.6 |
| Services, net                | 64.8   | 55.6                | 59.7   | 66.8            | 5.2                  | 5.5   | 5.6   |

1. Billions of chained (2000) 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 increased 2.9 percent in November, returning to a level not recorded since early 2001. The rise was driven by a sharp increase in capital goods exports, largely coming from the volatile category of aircraft. Exports of agricultural products and consumer goods also posted sizable increases. In contrast, exports of automotive products and industrial supplies declined. Services receipts rose 1.4 percent from October levels. At an annual rate, the average for October and November of the value of exported goods and services was 23 percent above the average for the third quarter. The increase was spread across all major categories, with notable increases in industrial supplies, aircraft, and other capital goods.

The value of imports of goods and services fell 0.8 percent in November, following two monthly increases; the level, however, remained above the September figure. About two-thirds of the decline resulted from a drop in the volume of imported oil. Imports of consumer goods and non-oil industrial supplies declined modestly, with little change in other categories. Services payments rose 1.5 percent from October levels. At an annual rate, the average for October and November of the value of imported goods and services was about 13 percent above the average for the third quarter, the largest such increase this year and more than twice the pace recorded in the third quarter. Double-digit increases were recorded for capital goods, automotive products, consumer goods, and food. Oil imports, on the other hand, declined.

### U.S. Exports and Imports of Goods and Services

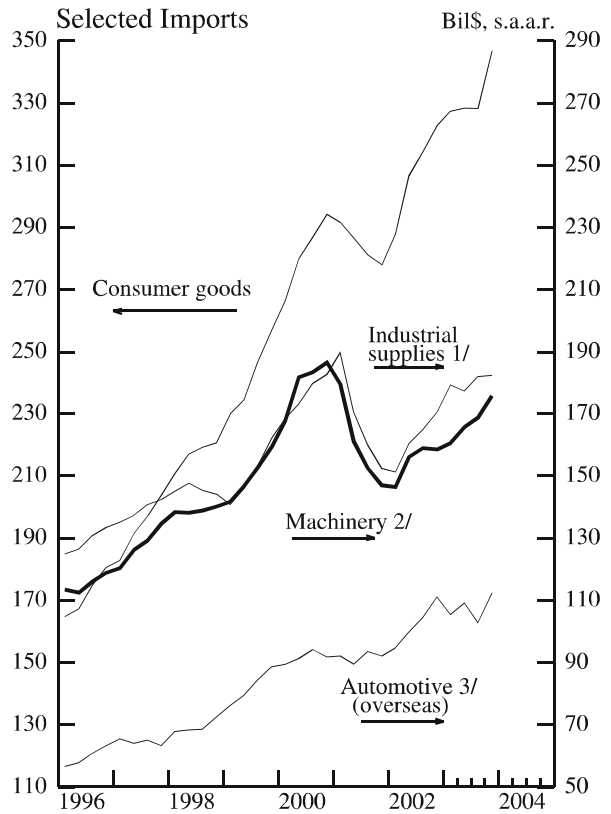
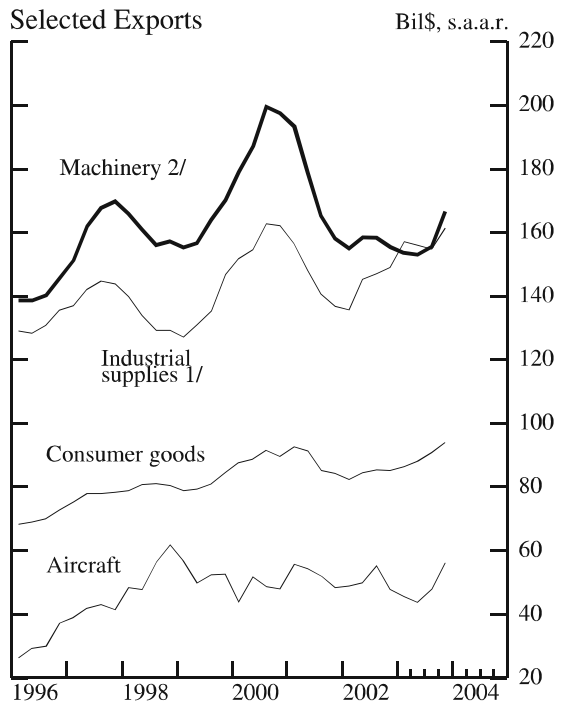
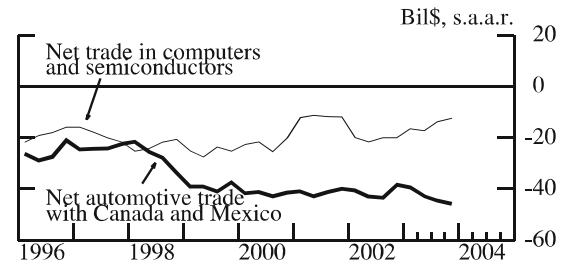
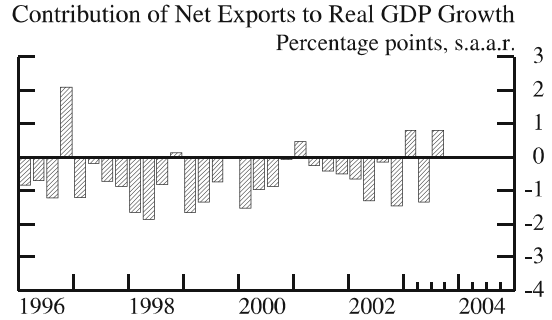
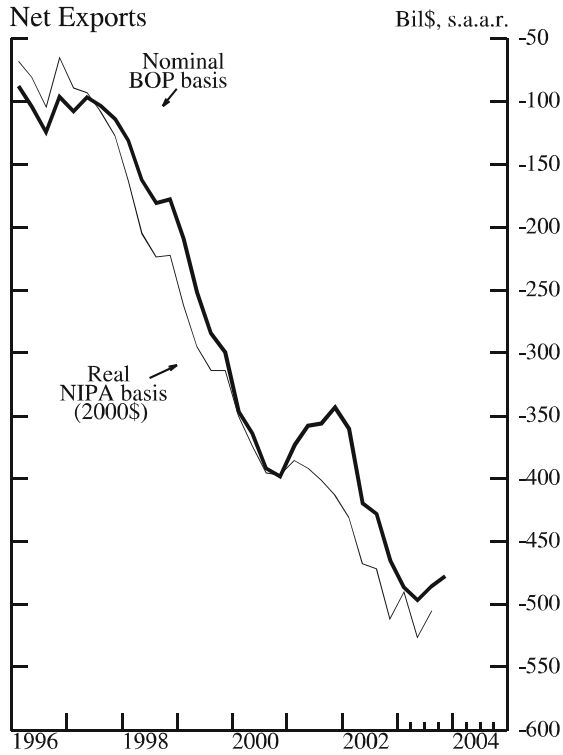
(Billions of dollars, s.a.a.r., BOP basis)

|                              | Levels        |                 |               |               | Amount Change <sup>1</sup> |                 |             |              |
|------------------------------|---------------|-----------------|---------------|---------------|----------------------------|-----------------|-------------|--------------|
|                              | 2003          |                 | 2003          |               | 2003                       |                 | 2003        |              |
|                              | Q3            | Q4 <sup>e</sup> | Oct.          | Nov.          | Q3                         | Q4 <sup>e</sup> | Oct.        | Nov.         |
| <b>Exports of G&amp;S</b>    | <b>1018.2</b> | <b>1072.3</b>   | <b>1057.1</b> | <b>1087.6</b> | <b>28.2</b>                | <b>54.1</b>     | <b>28.5</b> | <b>30.5</b>  |
| Goods exports                | 710.9         | 752.7           | 739.7         | 765.8         | 14.0                       | 41.8            | 23.2        | 26.1         |
| Gold                         | 5.3           | 4.7             | 4.9           | 4.5           | -0.3                       | -0.6            | -0.2        | -0.5         |
| Other goods                  | 705.6         | 748.1           | 734.8         | 761.3         | 14.2                       | 103.0           | 23.4        | 26.6         |
| Aircraft & parts             | 47.8          | 56.1            | 47.8          | 64.5          | 4.0                        | 8.4             | 2.2         | 16.7         |
| Computers & accessories      | 40.8          | 42.9            | 42.8          | 43.0          | 3.5                        | 2.1             | 0.6         | 0.2          |
| Semiconductors               | 46.9          | 48.7            | 48.5          | 48.8          | 1.6                        | 1.8             | 0.4         | 0.3          |
| Other capital goods          | 158.2         | 169.8           | 168.3         | 171.3         | 2.4                        | 11.6            | 7.8         | 3.0          |
| Automotive                   | 78.7          | 81.5            | 83.1          | 79.8          | -1.1                       | 2.8             | 2.2         | -3.3         |
| to Canada                    | 43.0          | 46.9            | 46.6          | 47.3          | -2.2                       | 3.9             | 0.7         | 0.7          |
| to Mexico                    | 13.4          | 14.4            | 15.3          | 13.5          | -1.0                       | 1.0             | 0.5         | -1.9         |
| to ROW                       | 22.2          | 20.2            | 21.2          | 19.1          | 2.1                        | -2.1            | 0.9         | -2.1         |
| Agricultural                 | 60.6          | 65.1            | 62.0          | 68.1          | 3.1                        | 4.4             | 4.1         | 6.2          |
| Ind supplies (ex. ag, gold)  | 154.7         | 161.3           | 162.4         | 160.2         | -1.3                       | 6.5             | 7.1         | -2.2         |
| Consumer goods               | 90.9          | 93.9            | 90.6          | 97.2          | 2.7                        | 3.0             | -2.0        | 6.6          |
| All other goods              | 27.1          | 28.8            | 29.3          | 28.4          | -0.9                       | 1.7             | 9.3         | -0.9         |
| Services exports             | 307.2         | 319.6           | 317.4         | 321.8         | 14.3                       | 12.3            | 5.2         | 4.5          |
| <b>Imports of G&amp;S</b>    | <b>1503.8</b> | <b>1549.8</b>   | <b>1556.0</b> | <b>1543.7</b> | <b>17.2</b>                | <b>46.0</b>     | <b>31.3</b> | <b>-12.3</b> |
| Goods imports                | 1256.2        | 1297.1          | 1305.1        | 1289.1        | 6.9                        | 40.8            | 29.7        | -16.0        |
| Petroleum                    | 137.1         | 128.1           | 132.4         | 123.9         | 6.6                        | -9.0            | -1.9        | -8.4         |
| Gold                         | 4.1           | 4.0             | 4.0           | 4.0           | -0.0                       | -0.0            | -0.3        | -0.0         |
| Other goods                  | 1115.0        | 1164.9          | 1168.7        | 1161.1        | 0.3                        | 49.8            | 31.9        | -7.6         |
| Aircraft & parts             | 23.0          | 25.3            | 24.4          | 26.1          | -0.7                       | 2.3             | 1.4         | 1.8          |
| Computers & accessories      | 76.6          | 79.8            | 80.0          | 79.7          | 1.5                        | 3.2             | 0.9         | -0.3         |
| Semiconductors               | 24.8          | 24.2            | 24.4          | 24.1          | 0.2                        | -0.6            | -1.0        | -0.3         |
| Other capital goods          | 170.8         | 177.7           | 177.1         | 178.4         | 2.5                        | 6.9             | 0.9         | 1.3          |
| Automotive                   | 203.8         | 219.5           | 220.1         | 218.9         | -7.8                       | 15.7            | 11.2        | -1.2         |
| from Canada                  | 60.2          | 63.5            | 65.5          | 61.5          | 0.7                        | 3.2             | 2.5         | -4.0         |
| from Mexico                  | 40.8          | 43.6            | 46.1          | 41.1          | -2.1                       | 2.9             | 3.4         | -5.0         |
| from ROW                     | 102.8         | 112.4           | 108.5         | 116.3         | -6.4                       | 9.6             | 5.3         | 7.8          |
| Ind supplies (ex. oil, gold) | 182.0         | 182.3           | 185.7         | 178.8         | 4.7                        | 0.2             | 0.3         | -6.9         |
| Consumer goods               | 328.1         | 346.7           | 348.0         | 345.3         | -0.2                       | 18.6            | 17.3        | -2.7         |
| Foods, feeds, bev.           | 55.6          | 57.9            | 57.5          | 58.4          | 0.6                        | 2.3             | 0.0         | 0.9          |
| All other goods              | 50.2          | 51.5            | 51.6          | 51.3          | -0.5                       | 1.2             | 1.0         | -0.2         |
| Services imports             | 247.6         | 252.8           | 250.9         | 254.7         | 10.3                       | 5.2             | 1.6         | 3.8          |
| <i>Memo:</i>                 |               |                 |               |               |                            |                 |             |              |
| Oil quantity (mb/d)          | 13.40         | 12.76           | 13.27         | 12.25         | -0.10                      | -0.63           | -0.06       | -1.02        |
| Oil import price (\$/bbl)    | 28.04         | 27.50           | 27.30         | 27.69         | 1.58                       | -0.54           | -0.27       | 0.39         |

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

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

## U.S. International Trade in Goods and Services



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

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

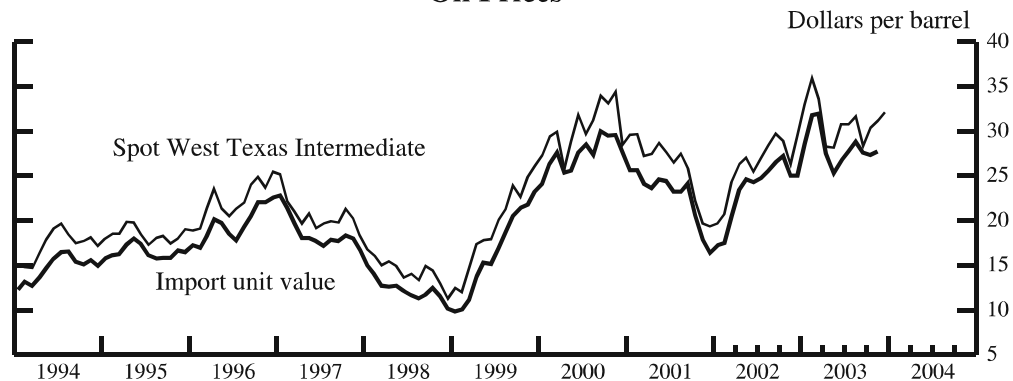
**Prices of U.S. Imports and Exports**  
(Percentage change from previous period)

|                             | Annual rates                                     |       |      | Monthly rates |      |      |
|-----------------------------|--|-------|------|---------------|------|------|
|                             | 2003   |       |      | 2003          |      |      |
|                             | Q2   | Q3    | Q4   | Oct.          | Nov. | Dec. |
|                             | ----- BLS prices (2000 weights)-----             |       |      |               |      |      |
| <b>Merchandise imports</b>  | -9.2   | 3.0   | 0.7  | 0.1           | 0.5  | 0.2  |
| Oil                         | -54.6  | 27.2  | 0.4  | 1.5           | 2.1  | 1.8  |
| Non-oil                     | -1.0   | 0.4   | 0.7  | -0.1          | 0.2  | 0.1  |
| Core goods*                 | -0.5   | 0.9   | 1.5  | 0.0           | 0.3  | 0.2  |
| Cap. goods ex comp & semi   | 1.7  | 1.1   | 0.3  | 0.0           | 0.4  | 0.2  |
| Automotive products         | 0.5  | 0.0   | 2.5  | 0.7           | 0.0  | 0.0  |
| Consumer goods              | 0.1  | 0.0   | 0.1  | -0.1          | 0.3  | 0.0  |
| Foods, feeds, beverages     | -1.0   | 0.1   | 4.1  | 0.2           | 0.5  | 0.7  |
| Industrial supplies ex oil  | -5.1   | 2.7   | 5.0  | -0.2          | 0.7  | 0.8  |
| Computers                   | -5.5   | -7.6  | -9.8 | -2.2          | -0.3 | -0.3 |
| Semiconductors              | -1.0   | 5.3   | -2.6 | -0.4          | 0.0  | -1.8 |
| <b>Merchandise exports</b>  | 0.9  | -0.3  | 3.9  | 0.3           | 0.5  | 0.2  |
| Core goods*                 | 1.6  | 0.9   | 5.2  | 0.5           | 0.5  | 0.2  |
| Cap. goods ex comp & semi   | 0.1  | 1.2   | 0.5  | 0.0           | 0.1  | 0.1  |
| Automotive products         | 0.1  | 0.9   | 0.3  | 0.1           | 0.0  | -0.1 |
| Consumer goods              | 0.5  | 0.1   | 2.0  | 0.4           | 0.2  | 0.1  |
| Agricultural products       | 6.1  | 6.1   | 39.8 | 2.4           | 3.9  | 0.7  |
| Industrial supplies ex ag   | 3.4  | 0.1   | 4.9  | 0.6           | 0.3  | 0.6  |
| Computers                   | -0.6   | -3.3  | 1.2  | 0.1           | 0.2  | 0.9  |
| Semiconductors              | -6.3   | -12.8 | -8.1 | -1.3          | -0.1 | -0.3 |
| <b>Chain price index</b>    | ---Prices in the NIPA accounts (2000 weights)--- |       |      |               |      |      |
| Imports of goods & services | -4.1   | 2.7   | n.a. | ...           | ...  | ...  |
| Non-oil merchandise         | -0.8   | 0.2   | n.a. | ...           | ...  | ...  |
| Core goods*                 | -0.3   | 0.6   | n.a. | ...           | ...  | ...  |
| Exports of goods & services | 0.8  | 1.6   | n.a. | ...           | ...  | ...  |
| Total merchandise           | 0.8  | 1.6   | n.a. | ...           | ...  | ...  |
| Core goods*                 | 2.4  | 1.1   | n.a. | ...           | ...  | ...  |

\* / Excludes computers and semiconductors.

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

**Oil Prices**



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**Prices of Internationally Traded Goods**

**Non-oil imports.** In December, the prices of U.S. imports of non-oil goods and of core goods rose 0.1 and 0.2 percent, respectively. Within core goods, the largest price increase, 0.8 percent, was for industrial supplies, reflecting higher prices for metals. Prices for foods, feed and beverages rose 0.7 percent, the fourth consecutive monthly increase. Prices of capital goods (excluding computers and semiconductors) increased 0.2 percent. Prices for automotive products and consumer goods were unchanged in December. The prices of U.S. imports of computers and semiconductors continued to decline in December. For the fourth quarter overall, the prices for imported core goods rose at an annual rate of 1½ percent, following an increase of 1 percent in the third quarter.

**Oil.** The BLS price of imported oil rose 1.8 percent in December. The spot price of West Texas Intermediate (WTI) crude oil was also higher in December, averaging \$32.10 per barrel, up around ¾ percent from November. The spot price has averaged \$34.30 per barrel thus far in January and closed at \$35.78 per barrel on January 20. Oil prices have increased since early December owing in part to declining oil inventories (particularly in the United States), recent cold weather, and an increase in natural gas prices. Strong economic activity, a decline in the exchange value of the dollar, and a slow recovery of oil exports from Iraq, where a lack of security remains a problem, are also keeping upward pressure on oil prices.

**Exports.** In December, the prices of U.S. exports of total goods and of core goods both increased 0.2 percent. For the fourth consecutive month, prices of agricultural products increased, rising 0.7 percent, owing to price increases for feedstuff, soybeans, and wheat. Prices for exported industrial supplies rose 0.6 percent, reflecting higher prices for metals and fuel oil. For both consumer goods and capital goods (excluding computers and semiconductors), prices edged up, whereas prices for automotive products fell slightly. Following a revised 0.2 percent increase in November, the prices of exported computers rose another 0.9 percent. In December, prices for semiconductors fell 0.3 percent. For the fourth quarter, the prices of exported core goods rose at an annual rate of 5¼ percent, after an increase of 1 percent in the third quarter.

**U.S. Current Account through 2003:Q3**

The U.S. current account deficit was \$540.2 billion (s.a.a.r.) in the third quarter of 2003, down from \$557.6 billion in the second quarter (revised). The deficits in goods and services trade and in other income and transfers shrank modestly, and the surplus in investment income increased slightly.

The deficit on goods and services narrowed \$11.5 billion (s.a.a.r.) in the third quarter, as exports rose more than imports. The increase in the value of

imported goods (2.3 percent a.r.) was almost entirely accounted for by an increase in the value of petroleum imports, which stemmed from higher import prices. Imports of services increased 18.7 percent (a.r.). The value of exported goods rose 8.8 percent, and the value of exported services moved up 21.2 percent. The increases in both exports and imports of services largely reflected a rebound in travel, though most other categories also showed increases.

The surplus on net investment income increased in the third quarter to \$15.3 billion (s.a.a.r.), with income receipts on U.S.-owned assets abroad increasing more than income payments on foreign-owned assets in the United States. The increase in receipts owed primarily to an increase in direct investment. The increase in payments was almost entirely accounted for by increases in “other” payments.

Net unilateral transfers to foreigners declined slightly to \$65.3 billion (s.a.a.r.), from \$67.8 billion (s.a.a.r.) in the second quarter.

### U.S. Current Account

(Billions of dollars, seasonally adjusted annual rate)

| Period           | Goods and services, net | Investment income, net | Other income and transfers, net | Current account balance |
|------------------|-------------------------|------------------------|---------------------------------|-------------------------|
| <i>Annual</i>    |                         |                        |                                 |                         |
| 2001             | -357.8                  | 15.7                   | -51.6                           | -393.7                  |
| 2002             | -418.0                  | 1.3                    | -64.1                           | -480.9                  |
| <i>Quarterly</i> |                         |                        |                                 |                         |
| 2002:Q4          | -464.5                  | 17.2                   | -67.1                           | -514.3                  |
| 2003:Q1          | -486.5                  | 6.3                    | -74.6                           | -554.8                  |
| Q2               | -496.7                  | 12.1                   | -73.0                           | -557.6                  |
| Q3               | -485.3                  | 15.3                   | -70.2                           | -540.2                  |
| <i>Change</i>    |                         |                        |                                 |                         |
| Q4-Q3            | -36.5                   | 19.1                   | -6.1                            | -23.4                   |
| Q1-Q4            | -22.1                   | -11.0                  | -7.5                            | -40.5                   |
| Q2-Q1            | -10.2                   | 5.9                    | 1.6                             | -2.7                    |
| Q3-Q2            | 11.5                    | 3.1                    | 2.8                             | 17.4                    |

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

### U.S. International Financial Transactions

Private foreign demand for U.S. securities (line 4 of the Summary of U.S. International Transactions table) rebounded strongly in November after substantial weakness in September and October. The \$50 billion in private foreigners' purchases of U.S. securities in the month was the most since May;



demand for Treasury securities and equities rebounded and inflows into corporate bonds, which were strong throughout the year, surged. Foreign official inflows (line 1) continued to be quite strong, amounting to \$24 billion. In November, U.S. investors on balance sold foreign securities (line 5) for the first time since June, as sales of foreign equities exceeded modest purchases of foreign bonds. In all, net private inflows through securities (line 4 plus line 5) and foreign official inflows combined to total \$78 billion in November, the largest monthly amount since May.

The robust foreign official inflows of \$24 billion in November owed primarily to Japanese exchange market intervention. Evidence from Federal Reserve Bank of New York custody accounts suggests even larger official inflows in December and January; over the six-week period from end-November through mid-January, custody holdings increased \$62 billion. More than half of this increase owed to further Japanese accumulation, but holdings by China and Russia also increased substantially.

U.S. investors' modest net sales of foreign securities in November owed primarily to net sales of equities through the United Kingdom, the euro area, and, reversing a recent trend, Taiwanese equities. At the same time, U.S. investors purchased a substantial amount of Hong Kong bonds (owing to a record dollar-denominated bond issuance) and continued to purchase Japanese equities (bringing year-to-date purchases of Japanese equities to \$32 billion). Private foreign investment in U.S. securities in November came primarily from Europe and financial centers in the Caribbean; in addition, private investors from Asia purchased a substantial amount of U.S. debt securities in the month.

Through November, year-to-date foreign net private purchases of U.S. securities totaled \$322 billion, somewhat below the record pace of 2002, and net U.S. purchases of foreign securities totaled \$58 billion, a relatively modest amount but a large swing from the net sales in 2002. The modest slowdown in private inflows into U.S. securities and the resumption of U.S. purchases of foreign securities imply that U.S. net private portfolio inflows through securities slowed to \$264 billion through November, a pace that is well below the previous year's record of \$422 billion. Foreign official inflows picked up the slack, totaling a record \$181 billion through November, double the robust inflows of 2002.

The highly volatile banking sector (line 3) saw sizeable net inflows of \$51 billion in October and \$41 billion in November.

Third-quarter balance of payments data were released in mid-December. Net outflows of direct investment, modest in the first half of the year, increased in the third quarter, as U.S. direct investment abroad (line 6) continued at its elevated pace and foreign direct investment in the United States (line 7) slowed.

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The slowing in foreign direct investment in the United States owed entirely to a shift in inter-company debt (from a U.S. affiliate to its foreign parent) that was partially offset by increases in equity investment and retained earnings. Through the first three quarters, net direct investment outflows (line 6 plus line 7) amounted to \$37 billion, following \$98 billion in net outflows in 2002.

The statistical discrepancy was positive \$12.5 billion in the third quarter, implying that the current account deficit slightly exceed reported net financial inflows. Data for the first two months of the fourth quarter—incomplete and subject to revision—suggest that the fourth quarter discrepancy will be negative; recorded net financial inflows (the sum of lines 1 - 5) for October and November total \$174 billion, far greater than recent quarterly current account deficits.

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

|  | 2001          | 2002          | 2002          |               | 2003          |               |             | Oct         | Nov |
|--|---------------|---------------|---------------|---------------|---------------|---------------|-------------|-------------|-----|
|  |               |               | Q4            | Q1            | Q2            | Q3            |             |             |     |
| <b>Official financial flows</b>  | <b>-5</b>     | <b>87.8</b>   | <b>25.5</b>   | <b>41.0</b>   | <b>56.0</b>   | <b>42.4</b>   | <b>16.9</b> | <b>24.3</b> |     |
| 1. Change in foreign official assets in the U.S. (increase, +)                 | 4.4           | 91.5          | 26.3          | 40.9          | 56.2          | 43.0          | 16.4        | 24.3        |     |
| a. G-10 countries  | -8.4          | 30.7          | 6.0           | 27.7          | 24.5          | 16.1          | 19.1        | 18.6        |     |
| b. OPEC countries  | -3.1          | -7.5          | .7            | -7.6          | 1.1           | 2.1           | 4.0         | 2.8         |     |
| c. All other countries   | 15.9          | 68.2          | 19.7          | 20.8          | 30.6          | 24.9          | -6.7        | 2.9         |     |
| 2. Change in U.S. official reserve assets (decrease, +)                        | -4.9          | -3.7          | -.8           | .1            | -.2           | -.6           | .5          | .0          |     |
| <b>Private financial flows</b>   | <b>416.1</b>  | <b>440.2</b>  | <b>127.0</b>  | <b>99.7</b>   | <b>94.0</b>   | <b>80.9</b>   | <b>...</b>  | <b>...</b>  |     |
| <b>Banks</b>   |               |               |               |               |               |               |             |             |     |
| 3. Change in net foreign positions of banking offices in the U.S. <sup>1</sup> | -6.2          | 147.0         | 33.9          | -12.7         | -19.4         | 22.8          | 50.6        | 40.8        |     |
| <b>Securities<sup>2</sup></b>  |               |               |               |               |               |               |             |             |     |
| 4. Foreign net purchases of U.S. securities (+)                                | 398.1         | 407.9         | 86.1          | 66.5          | 142.5         | 61.6          | 1.7         | 49.8        |     |
| a. Treasury securities   | -7.4          | 110.7         | 17.4          | 11.3          | 55.5          | 51.0          | -10.9       | 15.8        |     |
| b. Agency bonds  | 81.8          | 78.1          | 15.5          | -2.3          | -1.6          | -44.4         | -5.3        | -2.4        |     |
| c. Corporate and municipal bonds   | 201.8         | 160.3         | 39.9          | 59.6          | 67.3          | 57.6          | 18.9        | 27.4        |     |
| d. Corporate stocks <sup>3</sup>   | 121.8         | 58.8          | 13.3          | -2.1          | 21.3          | -2.7          | -1.0        | 8.9         |     |
| 5. U.S. net acquisitions (-) of foreign securities                             | -85.1         | 15.5          | -5.3          | -27.5         | 9.0           | -29.0         | -14.4       | 4.0         |     |
| a. Bonds   | 24.6          | 33.5          | 7.6           | 7.2           | 26.0          | 1.3           | -5.1        | -3.7        |     |
| b. Stock purchases   | -62.7         | -14.8         | -12.9         | -20.1         | -17.0         | -30.3         | -9.2        | 7.7         |     |
| c. Stock swaps <sup>3</sup>  | -47.0         | -3.2          | .0            | -14.7         | .0            | .0            | .0          | .0          |     |
| <b>Other flows (quarterly data, s.a.)</b>                                      |               |               |               |               |               |               |             |             |     |
| 6. U.S. direct investment (-) abroad   | -120.0        | -137.8        | -31.7         | -34.4         | -29.9         | -37.5         | ...         | ...         |     |
| 7. Foreign direct investment in U.S.   | 151.6         | 39.6          | 15.3          | 34.4          | 22.4          | 8.1           | ...         | ...         |     |
| 8. Foreign holdings of U.S. currency   | 23.8          | 21.5          | 7.2           | 4.9           | 1.5           | 2.8           | ...         | ...         |     |
| 9. Other (inflow, +) <sup>4</sup>  | 53.9          | -53.6         | 21.5          | 68.5          | -32.1         | 52.1          | ...         | ...         |     |
| <b>U.S. current account balance (s.a.)</b>                                     | <b>-393.7</b> | <b>-480.9</b> | <b>-128.6</b> | <b>-138.7</b> | <b>-139.4</b> | <b>-135.0</b> | <b>...</b>  | <b>...</b>  |     |
| <b>Capital account balance (s.a.)<sup>5</sup></b>                              | <b>-1.1</b>   | <b>-1.3</b>   | <b>-.4</b>    | <b>-.4</b>    | <b>-1.6</b>   | <b>-.8</b>    | <b>...</b>  | <b>...</b>  |     |
| <b>Statistical discrepancy (s.a.)</b>  | <b>-20.8</b>  | <b>-45.8</b>  | <b>-23.6</b>  | <b>-1.6</b>   | <b>-9.1</b>   | <b>12.5</b>   | <b>...</b>  | <b>...</b>  |     |

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

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

2. Includes commissions on securities transactions and therefore does not match exactly the data on U.S. international transactions published by the Department of Commerce.

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

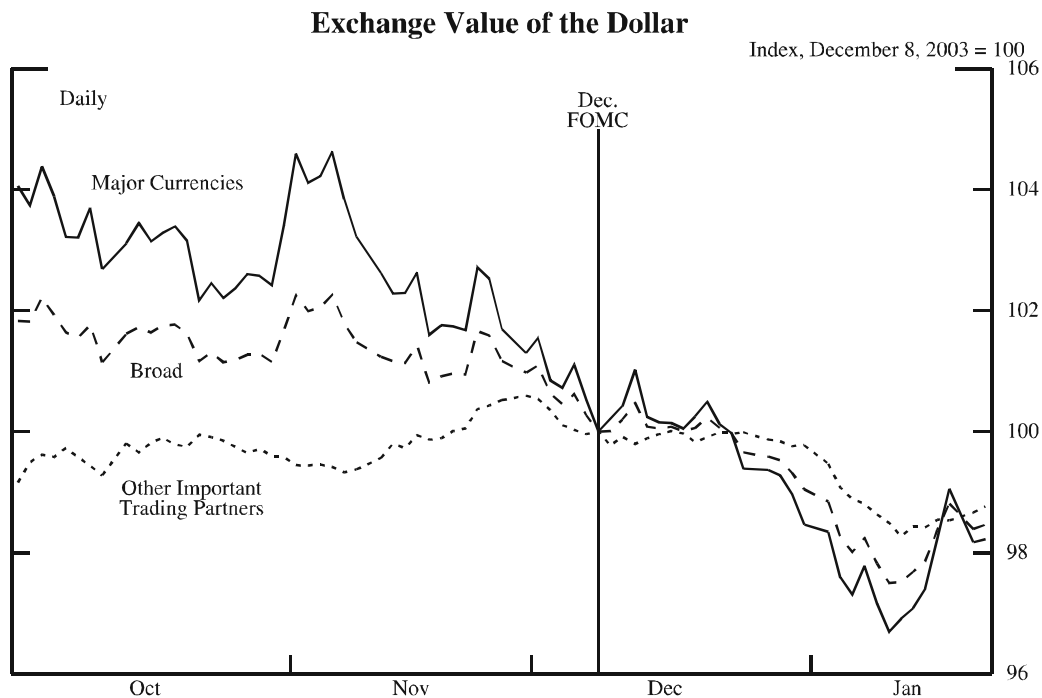
4. Transactions by nonbanking concerns and other banking and official transactions not shown elsewhere plus amounts resulting from adjustments made by the Department of Commerce and revisions in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business

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

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

## Foreign Financial Markets

The major currencies index of the dollar's exchange value has declined about 1¾ percent since the December FOMC meeting, led by a 5¼ percent depreciation of the dollar against sterling and a 3 percent depreciation against the euro. During the period, the dollar reached an all-time low against the euro (a 7-year low versus the implied Deutsch mark), and fell to levels not seen since 1992 against sterling. Against the Swiss franc, the dollar lost nearly 2 percent, while, on balance, the dollar was little changed against the Canadian dollar and the yen.



Ongoing concerns over investor willingness to finance the U.S. current account deficit at current exchange rates were again a primary factor exerting pressure on the dollar. After declining modestly in the first few weeks of the period, the dollar's rate of depreciation picked up in the second half of December as the U.S. government raised the terror alert level and announced a confirmed case of "mad cow disease" (Bovine Spongiform Encephalopathy) in the United States. The dollar registered further sharp losses against all major foreign currencies in the first weeks of the new year as U.S. employment data disappointed markets and official commentary suggested that, with inflation currently contained in the United States, U.S. monetary authorities are unlikely to adjust interest rates in response to recent currency movements. Late in the period, the dollar retraced much of its losses against major foreign currencies following stronger-than-expected U.S. consumer confidence data and as statements by numerous euro-

area officials prompted speculation that European authorities might soon intervene in currency markets or adjust interest rates to offset the effects of the euro's recent "brutal" appreciation.

The dollar was little changed against the yen on balance over the period. There was little market reaction to the Bank of Japan's decision to raise its target range for reserves on January 20. The Bank of Japan intervened in currency markets frequently during the period, purchasing an exceptionally large quantity of dollars on behalf of the Ministry of Finance. The amount of dollars purchased daily by the BoJ soared during the first full week of the new year, as market participants described the dollar-yen market as largely one-sided, with the Bank of Japan taking the buy side of a large number of dollar transactions. In mid-January, the MoF exhausted its formal budgetary authority to borrow yen for intervention purposes and drew ¥5 trillion from its ¥10 trillion foreign exchange swap facility with the Bank of Japan in order to be able to continue its operations. This swap facility was set up formally in the second half of December. It is set to expire once the Diet approves on the government's request for a supplemental budget, which contains a provision to raise the MoF's intervention-related borrowing authority by ¥21 trillion for the remainder of the 2003/2004 fiscal year and another ¥40 trillion thereafter.

The policy setting bodies of the European Central Bank and Bank of England left their respective policy rates unchanged at meetings in early January. While there was little immediate market reaction to the widely anticipated ECB decision, market expectations for the path of short-term euro interest rates have, on balance, shifted down 10 to 35 basis points over the period and now reflect a greater likelihood that the ECB will lower rates or postpone future rate increases. In addition to market expectations that the euro's appreciation may affect the interest rate decisions of the ECB, moderately disappointing data on economic confidence and surveys of purchasing managers in the euro area contributed somewhat to the decline in euro futures rates.

Expectations for the path of interest rates in the United Kingdom have also shifted back since the last FOMC meeting. Sterling futures rates declined in response to lower-than-expected U.K. inflation data as well as the BoE decision to leave rates unchanged at its January meeting—suggesting that a near-term rate increase that had been previously priced into markets may now be a bit less likely. Although economic data from Canada during the period were generally positive, Canadian interest rates fell in anticipation of the Bank of Canada's decision to cut its policy rate on January 20<sup>th</sup>. As had generally been expected, the BoC cited the negative effects of the strength of the Canadian dollar on export growth in its statement. After depreciating against the Canadian dollar for much of the period, the dollar reversed these losses in the weeks surrounding

the BoC decision and following news of a much-smaller-than-expected Canadian trade surplus.

### Financial Indicators in Major Industrial Countries

| Country                              | Three-month rate     |                               | Ten-year yield       |                               | Equities          |
|--------------------------------------|----------------------|-------------------------------|----------------------|-------------------------------|-------------------|
|                                      | Jan. 21<br>(Percent) | Percentage<br>Point<br>Change | Jan. 21<br>(Percent) | Percentage<br>Point<br>Change | Percent<br>Change |
| Canada                               | 2.39                 | -.33                          | 4.53                 | -.28                          | 7.53              |
| Japan                                | .08                  | .00                           | 1.34                 | -.02                          | 7.54              |
| Euro area                            | 2.08                 | -.08                          | 4.16                 | -.18                          | 6.92              |
| United Kingdom                       | 3.94                 | .01                           | 4.76                 | -.16                          | 3.58              |
| Switzerland                          | .16                  | -.02                          | 2.66                 | .01                           | 6.16              |
| Australia                            | 5.56                 | .10                           | 5.66                 | -.03                          | 2.93              |
| United States                        | 1.05                 | -.05                          | 4.06                 | -.23                          | 6.21              |
| Memo:<br>Weighted-average<br>foreign | 1.79                 | -.12                          | 4.04                 | -.18                          | n.a.              |

NOTE. Change is from December 8 to January 21 (10 a.m. EDT).  
n.a. Not available.

Yields on long-term euro-area and U.K. government debt declined 15 to 20 basis points on net, in line with the decline in U.S. Treasury yields, while Canadian long-term yields declined somewhat more. Country-specific economic data had only marginal influence on most foreign industrial economy bond markets, as the largest declines in yields came amid sharp drops in Treasury yields in response to U.S. news, and the U.S. December employment report in particular.

Major global equity markets saw strong net gains over the intermeeting period on optimism about the global recovery. Euro-area and Canadian equity markets registered gains of 7 and 8 percent, respectively, while the broad U.K. index gained about 4 percent on net. Shares of automobile corporations, which are typically more sensitive to currency moves, underperformed in European markets relative to their U.S. counterparts and broader European equity indexes. The broad Japanese equity index gained about 8 percent over the period, led by gains in the real estate and shipping industry. Japanese banking shares registered gains of about 6 percent.

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**Financial Indicators in Latin America, Asia, and Russia**


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| Economy     | Currency/<br>US dollar |                   | Short-term<br>Interest rates <sup>1</sup> |                               | Dollar-denominated<br>bond spread <sup>2</sup> |                               | Equity<br>prices  |
|-------------|------------------------|-------------------|---|-------------------------------|--|-------------------------------|-------------------|
|             | Jan. 21                | Percent<br>Change | Jan.20/21<br>(Percent)                    | Percentage<br>Point<br>Change | Jan.20/21<br>(Percent)                         | Percentage<br>Point<br>Change | Percent<br>Change |
| Mexico      | 10.93                  | -2.78             | 4.68                                      | -1.17                         | 1.82   | -.22                          | 9.77              |
| Brazil      | 2.84                   | -3.48             | 15.60                                     | -.79                          | 4.32   | -.52                          | 11.84             |
| Argentina   | 2.89                   | -3.43             | n.a.                                      | n.a.                          | 57.73  | -2.13                         | 23.63             |
| Chile       | 563.00                 | -7.13             | 1.94                                      | -.73                          | .85  | .02                           | -1.69             |
| China       | 8.28                   | .00               | n.a.                                      | n.a.                          | .43  | .06                           | 11.40             |
| Korea       | 1188.00                | .08               | 4.07                                      | -.02                          | ...  | ...                           | 9.76              |
| Taiwan      | 33.60                  | -1.32             | 1.18                                      | -.01                          | ...  | ...                           | 7.23              |
| Singapore   | 1.70                   | -.68              | .75                                       | .13                           | ...  | ...                           | 8.82              |
| Hong Kong   | 7.77                   | .03               | .06                                       | -.10                          | ...  | ...                           | 12.92             |
| Malaysia    | 3.80                   | -.01              | 3.00                                      | .00                           | .77  | .06                           | 5.18              |
| Thailand    | 39.03                  | -2.18             | 1.28                                      | -.03                          | .66  | .13                           | 15.41             |
| Indonesia   | 8400.00                | -1.08             | 8.35                                      | -.26                          | 2.09   | -.71                          | 19.84             |
| Philippines | 55.50                  | .29               | 6.25                                      | -1.00                         | 4.31   | -.10                          | 15.63             |
| Russia      | 28.77                  | -2.64             | n.a.                                      | n.a.                          | 2.37   | -.18                          | 12.33             |

NOTE. Change is from December 8 to January 20/21.

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.

Financial market conditions in emerging market economies have generally improved since the December FOMC. Many currencies in the index of the dollar's value against the currencies of our other important trading partners have gained, with the Mexican peso and Brazilian *real* up 3 and 3½ percent, respectively, against the dollar, and the Taiwan dollar up 1¼ percent. Equity markets in emerging Asian economies have seen gains on the order of 5 to 20 percent, supported by continued improvement in exports and in the face of a so far limited re-emergence of SARS. Major Latin America equity markets made similar gains as investors either assessed that the level of risk had decreased in light of the ongoing global economic recovery or their appetite for risk increased. Potentially also contributing to equity gains in Brazil and Mexico, monetary conditions eased over the period in these economies, with short-term rates now about 120 and 80 basis points lower, respectively. As had generally

been expected, the central bank of Brazil lowered its policy rate 100 basis points on December 17.

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



## Developments in Foreign Industrial Countries

Recent data indicate that the pickup in economic activity in the major foreign industrial countries continued in the fourth quarter. Japanese exports, machinery orders, and industrial production rose strongly. Despite the euro's appreciation, euro-area manufacturing data exhibited increasing strength, particularly in Germany. Data releases in the United Kingdom have generally been mixed, but business and retail sales indicators in December point to a maintained expansion. Canadian employment and sales data were strong in the fourth quarter, with the housing sector continuing to make a significant contribution to growth.

Consumer price inflation has been low and stable. Twelve-month core inflation in Canada remained at 1.8 percent, and twelve-month consumer price inflation in the euro area rose marginally to 2.1 percent, slightly above the ECB's 2 percent ceiling. The twelve month change in the Bank of England's new targeted measure of inflation, the consumer prices index, was 1.3 percent in November. Mild deflation continued in Japan.

The Bank of Japan and the Bank of Canada both eased monetary policy at the end of the period. The Bank of Japan raised its target for the balance of current accounts held at the bank by roughly 10 percent in a move it said was aimed at ensuring an economic recovery and reaffirming its determination to eliminate deflation. Citing recent appreciation of the Canadian dollar and its impact on growth, the Bank of Canada decreased the targeted overnight rate by 25 basis points to 2.5 percent.

In **Japan**, indicators suggest that the economy expanded strongly in the fourth quarter. Real exports surged in October and November, boosted by buoyant growth in emerging Asia, while imports rose somewhat. Industrial production for October and November was on average up about 3½ percent from the third-quarter average. The broader all-industries index rose ¾ percent in October. Core machinery orders, a leading indicator of business fixed investment, were on average up 10 percent in October and November from the third-quarter average. However, private consumption remained sluggish. Household expenditures in October and November were only slightly above the third-quarter average, while new car registrations fell 2 percent during the fourth quarter.

The Bank of Japan's Tankan index of business conditions rose in December, with the level of the aggregate diffusion index for business sentiment among firms of all sizes and across all industries increasing to -15 from -21 in

September. However, survey respondents projected a slight decline in the index, to -17, for March. The improvement in the aggregate index in December was broadly based, with increases for both manufacturers and nonmanufacturers across nearly all firm sizes.

### Japanese Economic Indicators

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

| Indicator                           | 2003 |      |      |       |      |      |      |
|-------------------------------------|------|------|------|-------|------|------|------|
|                                     | Q2   | Q3   | Q4   | Sept. | Oct. | Nov. | Dec. |
| Industrial production <sup>1</sup>  | -.7  | 1.3  | n.a. | 3.8   | 1.0  | 1.0  | n.a. |
| All-industries index                | .0   | .0   | n.a. | 2.1   | .8   | n.a. | n.a. |
| Housing starts                      | 4.3  | -6.9 | n.a. | 6.3   | 6.8  | -7.9 | n.a. |
| Machinery orders <sup>2</sup>       | 3.4  | -2.9 | n.a. | -1.6  | 17.4 | -7.8 | n.a. |
| Machinery shipments <sup>3</sup>    | 1.5  | 2.2  | n.a. | 2.3   | 4.8  | -.9  | n.a. |
| New car registrations               | -5.9 | 2.6  | -2.0 | 4.0   | -1.6 | -5.5 | 1.5  |
| Unemployment rate <sup>4</sup>      | 5.4  | 5.2  | n.a. | 5.1   | 5.2  | 5.2  | n.a. |
| Job offers ratio <sup>5</sup>       | .61  | .64  | n.a. | .66   | .70  | .74  | n.a. |
| Business sentiment <sup>6</sup>     | -26  | -21  | -15  | ...   | ...  | ...  | ...  |
| CPI (Core, Tokyo area) <sup>7</sup> | -.4  | -.3  | -.1  | -.3   | -.1  | -.2  | -.1  |
| Wholesale prices <sup>7</sup>       | -1.0 | -.7  | -.4  | -.5   | -.5  | -.5  | -.1  |

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.

Labor market conditions remained soft, although there are signs of improvement. In November, the unemployment rate was unchanged at 5.2 percent. Encouragingly, the job-offers-to-applicants ratio, a leading indicator of employment, jumped to its highest level in over six years. Core consumer goods prices in the Tokyo area (which exclude fresh food but include energy) were unchanged in December from the previous month but were down 0.1 percent from a year earlier. Deflation at the wholesale price level eased significantly in December, in part reflecting a jump in food prices.

On January 20, the Bank of Japan raised its target range for the outstanding balance of bank accounts held at the BOJ to ¥30-35 trillion from its previous range of ¥27-32 trillion. In an accompanying statement, the Bank noted that "Japan's economy is recovering gradually" but cited several concerns, including continued structural problems, declining consumer prices, and developments in foreign exchange markets.

The Cabinet recently approved the budget for FY2004 (April 2004-March 2005). Expenditures will rise 0.4 percent (about 0.1 percent of GDP) relative to last year's initial budget, reflecting swelling social security and debt servicing costs. Many other spending programs were cut. Tax revenues are projected to be roughly unchanged. As a result, the budget will require a small increase in new bond issuance for FY2004 to ¥36.6 trillion.

In the **euro area**, recent data suggest that real GDP continued to strengthen in the fourth quarter. Industrial production surged in October, and German production in October and November rose on average almost 2½ percent above its third quarter level. The euro-area purchasing managers index (PMI) for manufacturing remained above 50 (the threshold indicating expansion). The increase in the German PMI for manufacturing was particularly strong. In addition, the volume of German manufacturing orders in October and November was nearly 4 percent over the third-quarter average. Trade data in October and November suggest a mild decline in exports and a slight increase in imports from third-quarter levels. However, foreign orders for German manufacturing goods rose in November, indicating that the drag from the rise of the euro has not fully offset the stimulus from an increase in foreign demand.

Twelve-month consumer price inflation remained above the ECB's 2 percent ceiling in December. Sharp increases in food prices put considerable upward pressure on headline inflation. The sharp appreciation of the euro has helped to offset the recent increase in dollar-denominated oil prices. Core inflation, excluding energy and unprocessed food, has hovered between 1.8 percent and 2 percent for most of 2003.

| <b>Euro-Area Economic Indicators</b>                        |       |       |       |       |       |       |       |
|---|-------|-------|-------|-------|-------|-------|-------|
| (Percent change from previous period except as noted, s.a.) |       |       |       |       |       |       |       |
| Indicator   | 2003  |       |       |       |       |       |       |
|   | Q2    | Q3    | Q4    | Sept. | Oct.  | Nov.  | Dec.  |
| Industrial production <sup>1</sup>                          | -.3   | .6    | n.a.  | -.4   | 1.4   | .1    | n.a.  |
| Retail sales volume <sup>2</sup>                            | -.2   | -.4   | n.a.  | .1    | .5    | n.a.  | n.a.  |
| Unemployment rate <sup>3</sup>                              | 8.8   | 8.8   | n.a.  | 8.8   | 8.8   | 8.8   | n.a.  |
| Consumer confidence <sup>4</sup>                            | -19.3 | -17.3 | -16.3 | -17.0 | -17.0 | -16.0 | -16.0 |
| Industrial confidence <sup>4</sup>                          | -12.0 | -11.3 | -7.3  | -9.0  | -8.0  | -6.0  | -8.0  |
| Mfg. orders, Germany  | -1.8  | 1.5   | n.a.  | 1.9   | 2.3   | .4    | n.a.  |
| CPI <sup>5</sup>  | 1.9   | 2.0   | 2.1   | 2.2   | 2.0   | 2.2   | 2.1   |
| Producer prices <sup>5</sup>                                | 1.4   | 1.2   | n.a.  | 1.1   | .9    | 1.4   | n.a.  |
| M3 <sup>5</sup>   | 8.4   | 7.5   | n.a.  | 7.5   | 8.1   | 7.4   | 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.

On balance, data for the fourth quarter suggest continued expansion in the **United Kingdom**. In November consumer confidence ticked down and industrial production more than retraced its October spurt. In December, however, the manufacturing PMI climbed to a four-year high and business confidence strengthened. Although the services PMI fell back in December and retail sales growth slowed in November, the trends in both series remained robust, and one of the leading surveys of retail sales suggested substantial December sales growth.

Private surveys suggested that the twelve-month rate of inflation in housing prices picked up in December to around 16 percent, but the government's experimental index showed a rate just below 10 percent for the twelve months ending in November. Household net mortgage and consumer borrowing remained elevated in November.

The labor market continued to be tight, as both the official claims-based and the labor force survey measures of the unemployment rate remained near 28-year lows.

### U.K. Economic Indicators

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

| Indicator                          | 2003 |      |      |      |      |      |      |
|------------------------------------|------|------|------|------|------|------|------|
|                                    | Q2   | Q3   | Q4   | Sep. | Oct. | Nov. | Dec. |
| Industrial production              | .3   | -.1  | n.a. | .2   | .7   | -1.0 | n.a. |
| Retail sales volume <sup>1</sup>   | 1.5  | 1.2  | n.a. | .7   | .6   | .1   | n.a. |
| Unemployment rate <sup>2</sup>     |      |      |      |      |      |      |      |
| Claims-based                       | 3.1  | 3.1  | 3.0  | 3.1  | 3.0  | 3.0  | 3.0  |
| Labor force survey <sup>3</sup>    | 5.0  | 5.0  | n.a. | 5.0  | 4.9  | n.a. | n.a. |
| Business confidence <sup>4</sup>   | -6.3 | -3.3 | 0    | -3.0 | -4.0 | -2.0 | 5.0  |
| Consumer confidence <sup>5</sup>   | -6.7 | -5.0 | n.a. | -3.0 | -3.0 | -4.0 | n.a. |
| Consumer prices <sup>6</sup>       | 1.3  | 1.4  | 1.3  | 1.4  | 1.4  | 1.3  | 1.3  |
| Producer input prices <sup>7</sup> | -.5  | 1.2  | 2.8  | .8   | 2.3  | 4.3  | 1.8  |
| Average earnings <sup>7</sup>      | 3.0  | 3.6  | n.a. | 3.7  | 3.7  | 3.2  | 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 12 months.

6. As of this Greenbook, this table will report the consumer prices index (CPI) rather than the retail price index excluding mortgage interest payments (RPIX). Percent change from year earlier.

7. Percent change from year earlier.

n.a. Not available.

On December 10, Chancellor of the Exchequer Gordon Brown confirmed that the Bank of England would adopt a 2 percent target for the twelve-month growth rate of the consumer prices index (previously called the harmonized index of consumer prices) effective immediately. The CPI target replaced the 2½ percent target for the retail price index excluding mortgage interest payments (RPIX). The twelve-month CPI rate stayed at 1.3 percent in December, remaining below the target. RPIX rose 2.6 percent in the twelve months ending in December. The Chancellor also revised upward his projections for Public Sector Net Borrowing (PSNB) to £37 billion for 2003-04

(around 2½ percent of GDP) and £31 billion for 2004-05. The government kept its real GDP growth forecasts for 2004 and 2005 at 3 to 3½ percent.

In **Canada**, employment increased 0.3 percent in December, marking the fourth consecutive month of robust job gains and pushing the unemployment rate down to 7.4 percent. Employment growth has been assisted by strength in the housing sector, as both the construction and real estate service industries have contributed significantly to the increase in jobs. Housing starts eased only slightly in the fourth quarter from the third quarter's 13-year high.

Other indicators for the fourth quarter have also been positive. Real GDP by industry in October was 0.7 percent above its third-quarter average, as the retail and wholesale sectors both grew briskly. October's increase in retail sales came despite a drop in domestic motor vehicle sales that extended through the quarter, with sales near a five-year low in December. The composite leading indicator continued to move up in December, capping the largest quarterly increase in the indicator since early 2002. However trade data in November were weaker than expected as the strong Canadian dollar weighed on export growth.

In November, the twelve-month rate of headline CPI inflation remained at 1.6 percent. Twelve-month core inflation, excluding food, energy, and indirect taxes, remained at 1.8 percent for the third consecutive month. On January 20, the Bank of Canada decreased the targeted overnight rate (its key policy rate) 25 basis points, to 2.50 percent. The Bank motivated the cut by citing the recent rapid appreciation of the Canadian dollar, and its impact on Canadian growth, as well as a subdued outlook for inflation and the existence of excess capacity in Canadian economy.

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**Canadian Economic Indicators**

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

| Indicator                           | 2003  |       |      |       |      |      |      |
|-------------------------------------|-------|-------|------|-------|------|------|------|
|                                     | Q2    | Q3    | Q4   | Sept. | Oct. | Nov. | Dec. |
| GDP by industry                     | .0    | .4    | n.a. | 1.0   | .2   | n.a. | n.a. |
| Industrial production               | -1.7  | .0    | n.a. | 2.0   | .3   | n.a. | n.a. |
| New mfg. orders                     | -4.6  | 1.0   | n.a. | 7.6   | -3.2 | n.a. | n.a. |
| Retail sales                        | -.1   | 1.0   | n.a. | -1.0  | .2   | n.a. | n.a. |
| Employment                          | .1    | .1    | .9   | .3    | .4   | .3   | .3   |
| Unemployment rate <sup>1</sup>      | 7.7   | 7.9   | 7.5  | 8.0   | 7.6  | 7.5  | 7.4  |
| Consumer prices <sup>2</sup>        | 2.8   | 2.1   | n.a. | 2.2   | 1.6  | 1.6  | n.a. |
| Core Consumer Prices <sup>2,3</sup> | 2.4   | 1.7   | n.a. | 1.8   | 1.8  | 1.8  | n.a. |
| Consumer attitudes <sup>4</sup>     | 116.2 | 122.0 | n.a. | ...   | ...  | ...  | ...  |
| Business confidence <sup>4</sup>    | 109.9 | 127.2 | 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.

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

| Country<br>and balance       | 2003  |       |       |       |       |       |
|------------------------------|-------|-------|-------|-------|-------|-------|
|                              | Q1    | Q2    | Q3    | Sept. | Oct.  | Nov.  |
| <i>Japan</i>                 |       |       |       |       |       |       |
| Trade                        | 73.3  | 77.2  | 90.1  | 102.9 | 113.6 | 112.1 |
| Current account              | 117.3 | 133.6 | 149.1 | 156.8 | 160.2 | 162.9 |
| <i>Euro area</i>             |       |       |       |       |       |       |
| Trade <sup>1</sup>           | 30.5  | 69.3  | 133.7 | 124.3 | 136.7 | 69.9  |
| Current account <sup>1</sup> | 11.1  | -29.4 | 74.2  | 129.8 | 113.9 | n.a.  |
| <i>Germany</i>               |       |       |       |       |       |       |
| Trade                        | 126.7 | 139.5 | 173.9 | 190.4 | 140.1 | 136.9 |
| Current account <sup>1</sup> | 41.9  | 39.2  | 58.2  | 127.2 | 105.4 | 87.1  |
| <i>France</i>                |       |       |       |       |       |       |
| Trade                        | .3    | .1    | 1.1   | 1.4   | .6    | .9    |
| Current account              | 3.5   | .6    | 3.1   | 3.3   | -3.1  | n.a.  |
| <i>Italy</i>                 |       |       |       |       |       |       |
| Trade                        | -1.0  | -2.8  | 2.5   | 7.4   | 17.2  | n.a.  |
| Current account <sup>1</sup> | -30.2 | -42.3 | 8.0   | -3.0  | 20.7  | n.a.  |
| <i>United Kingdom</i>        |       |       |       |       |       |       |
| Trade                        | -71.1 | -72.6 | -75.1 | -90.6 | -85.6 | -89.4 |
| Current Account              | -17.1 | -50.3 | -52.1 | ...   | ...   | ...   |
| <i>Canada</i>                |       |       |       |       |       |       |
| Trade                        | 42.5  | 38.9  | 44.3  | 49.9  | 46.8  | 39.5  |
| Current Account              | 18.7  | 14.5  | 21.2  | ...   | ...   | ...   |

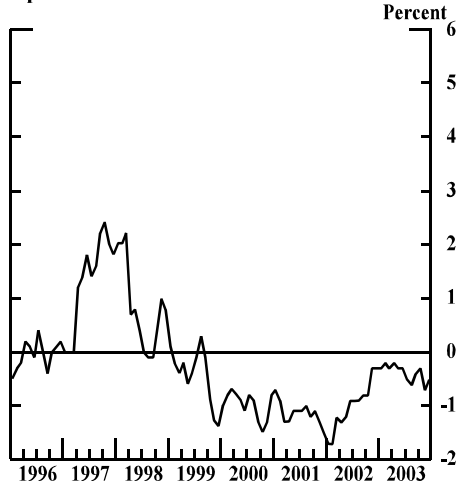
1. Not seasonally adjusted.

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

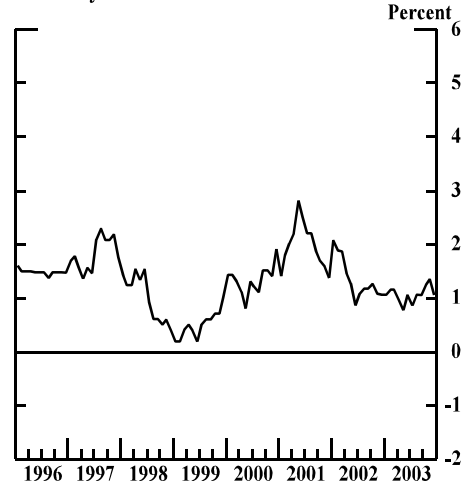


**Consumer Price Inflation in Selected Industrial Countries**  
(12-month change)

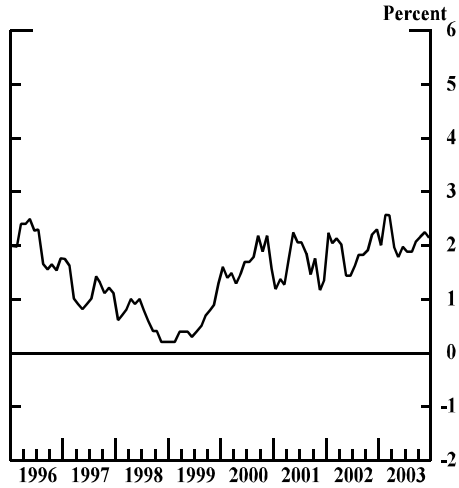
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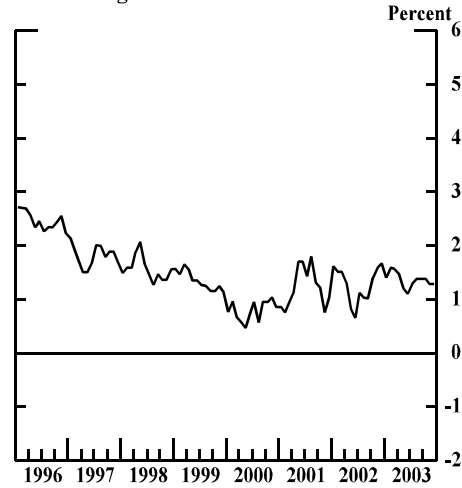
**Germany**



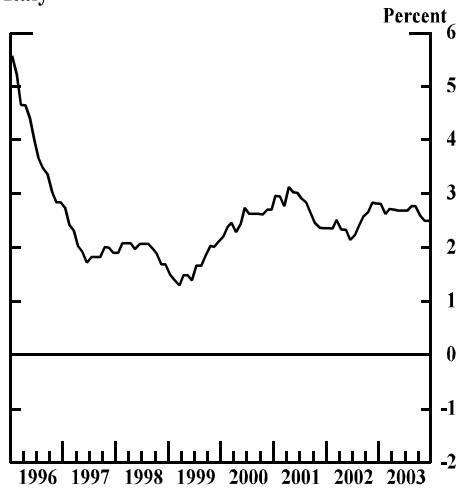
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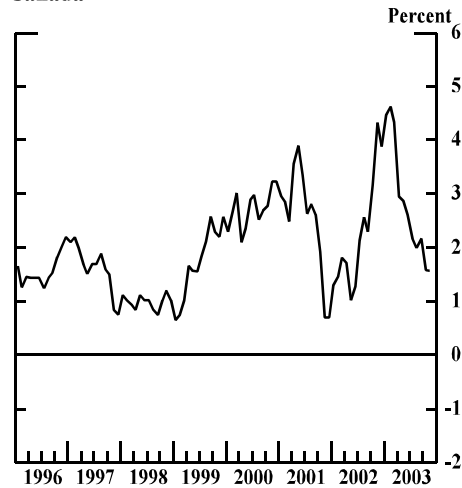
**United Kingdom**



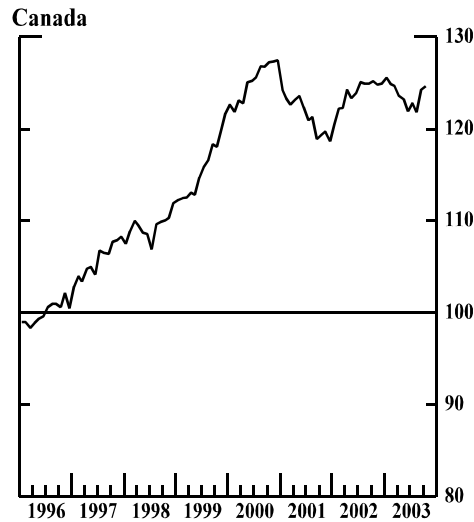
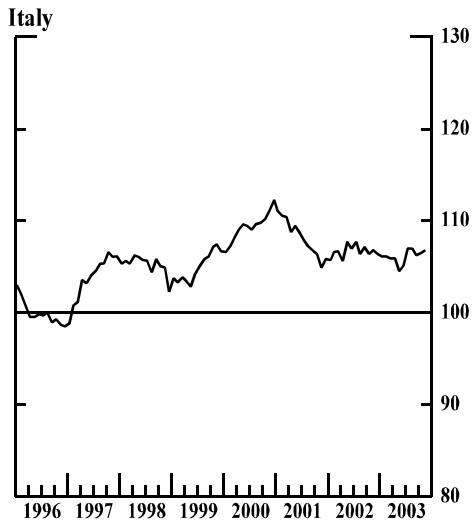
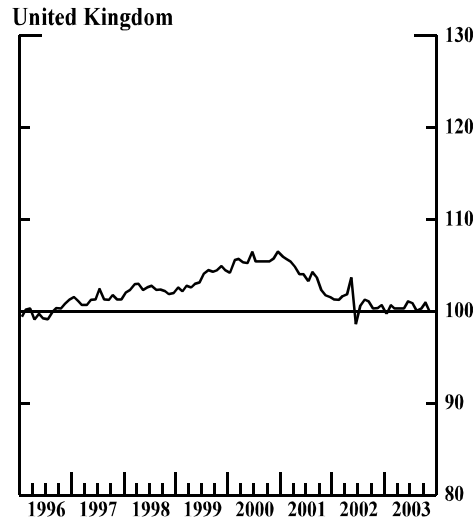
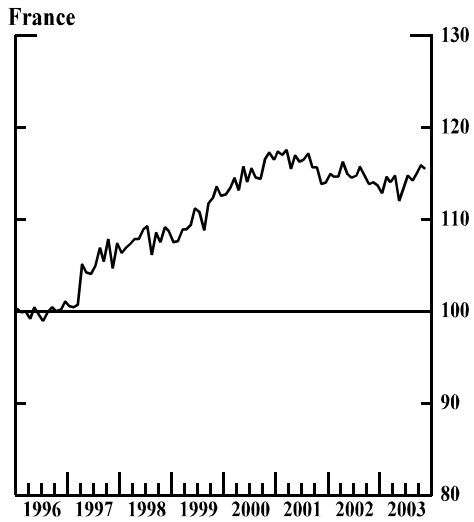
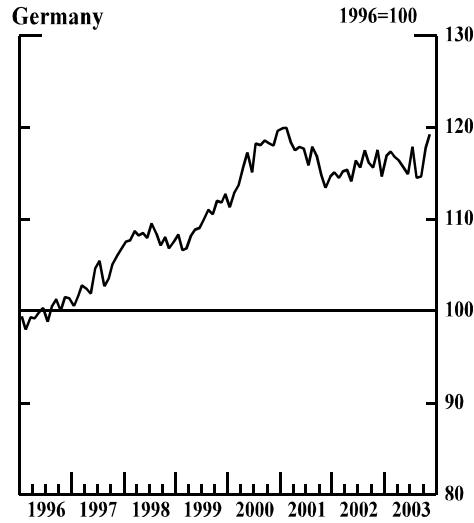
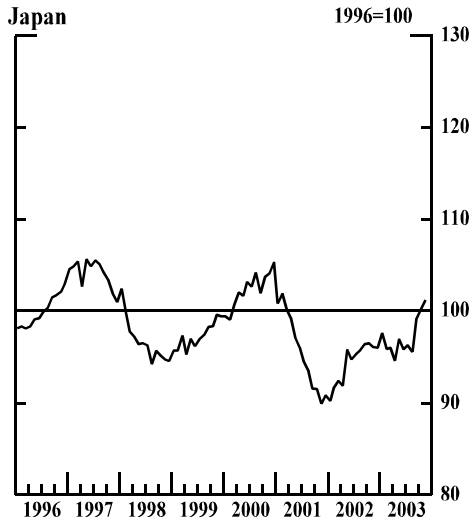
**Italy**



**Canada**



**Industrial Production in Selected Industrial Countries**



## Economic Situation in Other Countries

Recent data releases in developing Asia suggest that the rebound in growth has continued, although generally at a slower pace than in the third quarter. In Latin America, incoming data indicate a continuation of the economic recoveries in Argentina and Brazil, and there appear to be some signs of revival in Mexico's industrial sector. Inflation has remained subdued in most of the developing world.

Incoming data from the **Chinese** economy continue to point to a robust pace of expansion. Real GDP grew 7.9 percent in the fourth quarter, boosted by investment and exports, and third-quarter real GDP was revised upward (the first time China has ever released revised quarterly GDP figures). Exports were boosted in December by a change in government policy that will reduce tax rebates to exporters starting in January. The strong showing of exports in December enhanced the trade surplus for 2003 as a whole. Overall, the 2003 surplus narrowed a bit from 2002. The handful of SARS cases that emerged in early January give some cause of concern about a possible recurrence of the epidemic. Deflation has become less of a concern recently; continued increases in food prices have helped boost twelve-month inflation to 3 percent in November.

### Chinese Economic Indicators

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

| Indicator                          | 2002 | 2003 | 2003 |      |      |      |       |
|------------------------------------|------|------|------|------|------|------|-------|
|                                    |      |      | Q3   | Q4   | Oct. | Nov. | Dec.  |
| Real GDP <sup>1</sup>              | 8.0  | 9.9  | 19.6 | 7.9  | ...  | ...  | ...   |
| Industrial production <sup>2</sup> | 11.8 | 16.6 | 16.6 | 17.7 | 17.2 | 17.9 | 18.1  |
| Consumer prices <sup>2</sup>       | -.4  | n.a. | .8   | n.a. | 1.8  | 3.0  | n.a.  |
| Trade balance <sup>3</sup>         | 30.3 | 25.4 | 7.0  | 50.5 | -1.5 | 42.7 | 110.2 |

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.

In early January, the Chinese government revealed that at the end of 2003 it had infused \$45 billion of its foreign exchange reserves as fresh capital into two of its four large state banks. Around mid-December, the People's Bank of China increased the maximum interest rate that commercial banks and urban credit cooperatives can charge on loans. This is generally seen as a step toward

liberalization of interest rates and is intended to move the banks away from lending at a loss to state-owned enterprises and toward more profitable lending to the private sector. Although these steps are in the right direction, analysts emphasize that much more needs to be done to prepare Chinese banks to open up fully to foreign competition, which China has committed to do by the end of 2006 as part of its WTO accession.

Data releases since the last Greenbook suggest that the **Hong Kong** economy has continued to grow, but not at the skyrocketing-pace of the third quarter, when the economy bounced back from the impact of SARS. The growth of retail sales appeared to slow in November, but the unemployment rate continued to fall. Tourist arrivals reached a new record high in October and roughly stayed at that elevated level in November. The property sector has also continued to show signs of revival. Both exports and imports expanded in November, with total trade—a good indicator of economic activity for Hong Kong’s entrepot economy—rising about 5 percent from the previous month. With growth in imports outpacing that in exports, however, the trade deficit widened considerably in November. Twelve-month consumer price inflation remained negative in November, but the rate of deflation continued to slow.

### Hong Kong Economic Indicators

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

| Indicator                      | 2002 | 2003 | 2003 |      |       |       |      |
|--------------------------------|------|------|------|------|-------|-------|------|
|                                |      |      | Q3   | Q4   | Oct.  | Nov.  | Dec. |
| Real GDP <sup>1</sup>          | 5.2  | n.a. | 28.2 | n.a. | ...   | ...   | ...  |
| Unemployment rate <sup>2</sup> | 7.3  | 7.9  | 8.3  | 7.3  | 8.0   | 7.5   | 7.3  |
| Consumer prices <sup>3</sup>   | -1.6 | -1.8 | -3.7 | -2.3 | -2.6  | -2.4  | -1.8 |
| Trade balance <sup>4</sup>     | -7.7 | n.a. | -8.4 | n.a. | -13.0 | -19.8 | 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.

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

In **Taiwan**, economic activity has remained buoyant. Industrial production was up strongly in the fourth quarter. Driven by high-tech output, production reached new record highs in the quarter. The unemployment rate continued to decline in November. Exports, particularly in the high-tech sector, continued to expand, rising nearly 6 percent in the fourth quarter. But with imports surging a surprising 15 percent in the quarter, there was a considerable narrowing of the trade surplus. Export orders remained sturdy, posting a gain of about 13 percent

in November from their year-earlier levels. Consumer price inflation remained negative in the closing months of 2003, contributing to slight deflation for the year as a whole.

### Taiwan Economic Indicators

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

| Indicator                      | 2002 | 2003 | 2003 |      |      |      |      |
|--------------------------------|------|------|------|------|------|------|------|
|                                |      |      | Q3   | Q4   | Oct. | Nov. | Dec. |
| Real GDP <sup>1</sup>          | 4.3  | n.a. | 25.1 | n.a. | ...  | ...  | ...  |
| Unemployment rate <sup>2</sup> | 5.2  | n.a. | 5.0  | n.a. | 4.8  | 4.7  | n.a. |
| Industrial production          | 6.4  | 5.5  | 7.1  | 3.5  | .7   | .4   | 4.2  |
| Consumer prices <sup>3</sup>   | .8   | -.1  | -.6  | -.2  | -.1  | -.5  | -.1  |
| Trade balance <sup>4</sup>     | 18.1 | 17.0 | 20.0 | 9.2  | 14.9 | 8.9  | 3.9  |
| Current account <sup>5</sup>   | 25.7 | n.a. | 27.7 | 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.

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

Data releases since the last Greenbook show that strong exports, mainly high-tech products and automobiles, have continued to be the main contributor to growth in **Korea**, whereas consumption and investment remain weak. Industrial production declined slightly in November but remained 5 percent above the average level in the third quarter. Wholesale and retail trade and equipment investment decreased in November, and the unemployment rate declined to 3.5 percent in December. Bolstered by strong exports, the trade surplus widened further in November, and consumer and business sentiment continued to improve in December. Twelve-month consumer price inflation was unchanged at 3.4 percent in December.

On January 8, the Bank of Korea announced a target range of 2.5 to 3.5 percent for the average rate of core inflation for the three-year period 2004-2006. The liquidity problems faced by credit card companies re-emerged early in the new year, with LG Card, the largest credit card company in Korea, halting cash advances on January 8. The firm's large private and state-owned creditors subsequently announced that they would provide a 5 trillion won (4.2 billion dollar) bailout package to the firm.

### Korean Economic Indicators

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

| Indicator                      | 2002 | 2003 | 2003 |      |      |      |      |
|--------------------------------|------|------|------|------|------|------|------|
|                                |      |      | Q3   | Q4   | Oct. | Nov. | Dec. |
| Real GDP <sup>1</sup>          | 7.0  | n.a. | 4.7  | n.a. | ...  | ...  | ...  |
| Industrial production          | 8.3  | n.a. | .9   | n.a. | 2.4  | -.3  | n.a. |
| Unemployment rate <sup>2</sup> | 3.1  | 3.4  | 3.5  | 3.6  | 3.7  | 3.7  | 3.5  |
| Consumer prices <sup>3</sup>   | 3.8  | 3.4  | 3.2  | 3.5  | 3.8  | 3.4  | 3.4  |
| Trade balance <sup>4</sup>     | 14.8 | n.a. | 30.8 | n.a. | 31.2 | 37.6 | n.a. |
| Current account <sup>5</sup>   | 5.4  | n.a. | 16.0 | n.a. | 29.8 | 35.4 | 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.

Although Thailand's GDP release added to other indications of robust growth in the third quarter, more recent indicators from the **ASEAN** region have painted a moderation of activity. Singapore's industrial production contracted in November, largely due to the volatile pharmaceutical sector, but high-tech production remained strong. After positive performance in October, industrial production in Malaysia and Thailand softened in November. In general, trade surpluses were large across the region in November as imports fell more than exports. In December, Singapore's trade surplus almost doubled as rising imports were outpaced by surging exports. Inflation in the ASEAN countries remained low, with Indonesia substantially reducing inflation over the course of 2003.

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

| Indicator and country                    | 2001  | 2002 | 2003 |      |       |      |       |
|--|-------|------|------|------|-------|------|-------|
|  |       |      | Q2   | Q3   | Sept. | Oct. | Nov.  |
| <i>Real GDP<sup>1</sup></i>              |       |      |      |      |       |      |       |
| Indonesia                                | 1.7   | 3.8  | 6.6  | 6.7  | ...   | ...  | ...   |
| Malaysia                                 | -9    | 5.3  | 7.2  | 8.4  | ...   | ...  | ...   |
| Philippines                              | 3.6   | 5.8  | 3.2  | 7.0  | ...   | ...  | ...   |
| Singapore                                | -6.0  | 3.0  | -9.8 | 17.3 | ...   | ...  | ...   |
| Thailand                                 | 2.4   | 6.1  | 3.6  | 8.4  | ...   | ...  | ...   |
| <i>Industrial production<sup>2</sup></i> |       |      |      |      |       |      |       |
| Indonesia <sup>3</sup>                   | .7    | -1.1 | -2.5 | .8   | -5    | 1.4  | -3.0  |
| Malaysia                                 | -4.1  | 4.6  | 4.3  | 1.8  | 1.3   | 2.1  | .1    |
| Philippines                              | -5.7  | -6.1 | 1.7  | -1.4 | -5.3  | -1.9 | n.a.  |
| Singapore                                | -11.6 | 8.5  | -4.8 | 6.3  | -12.3 | 16.8 | -10.3 |
| Thailand                                 | 1.3   | 8.5  | 3.4  | -7   | 4.6   | 2.8  | -3.3  |

1. Annual rate. Annual figures are Q4/Q4.

2. Annual figures are annual averages.

3. Staff estimate.

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

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

| Country     | 2002 | 2003 | 2003 |      |      |      |      |
|-------------|------|------|------|------|------|------|------|
|             |      |      | Q3   | Q4   | Oct. | Nov. | Dec. |
| Indonesia   | 25.9 | n.a. | 27.1 | n.a. | 25.4 | 31.7 | n.a. |
| Malaysia    | 13.5 | n.a. | 19.9 | n.a. | 18.1 | 18.6 | n.a. |
| Philippines | -.2  | n.a. | -4   | n.a. | -.9  | -8.3 | n.a. |
| Singapore   | 8.7  | 16.2 | 18.7 | 17.2 | 13.8 | 13.0 | 24.9 |
| Thailand    | 3.4  | n.a. | 3.7  | n.a. | .9   | 7.1  | n.a. |

n.a. Not available.

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

| Country     | 2002 <sup>1</sup> | 2003 <sup>1</sup> | 2003 |      |      |      |      |
|-------------|-------------------|-------------------|------|------|------|------|------|
|             |                   |                   | Q3   | Q4   | Oct. | Nov. | Dec. |
| Indonesia   | 10.0              | 5.1               | 6.1  | 5.5  | 6.2  | 5.3  | 5.1  |
| Malaysia    | 1.7               | 1.2               | 1.0  | 1.2  | 1.3  | 1.1  | 1.2  |
| Philippines | 2.6               | 3.1               | 3.1  | 3.2  | 3.1  | 3.3  | 3.1  |
| Singapore   | .4                | n.a.              | .5   | n.a. | .6   | .6   | n.a. |
| Thailand    | 1.6               | 1.8               | 1.9  | 1.6  | 1.2  | 1.8  | 1.8  |

1. December/December.

n.a. Not available

In **Mexico**, there have been some recent signs of a revival in the industrial sector. Average industrial production over October and November was about 1¼ percent higher than in the third quarter, and manufacturing output was up about 1¾ percent over the same period. Exports, which are heavily weighted toward manufacturing, rose at a monthly rate of over 2 percent in each of the two months of October and November, also suggestive of improving conditions in the manufacturing sector. However, overall economic activity (a monthly proxy for real GDP) remained lackluster, posting only a modest ¼ percent gain in October. Despite some acceleration of consumer prices at the end of last year, inflation remains under control; twelve-month inflation came in at 4 percent in December, exactly at the upper bound of the Bank of Mexico's 2-4 percent target range.

In late December, the Mexican congress approved an austere government budget for this year which calls for the total public sector deficit to fall from 0.6 percent of GDP in 2003 to 0.3 percent of GDP in 2004. Because President Fox's tax reform proposals to boost government revenues were rejected by the congress, the newly approved budget entails more restraint in government spending than was originally envisaged by the administration. However, the macroeconomic assumptions underlying the budget projections are fairly conservative, especially for oil prices, creating some possibility of windfall revenues if oil prices remain high.



### Mexican Economic Indicators

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

| Indicator                      | 2002  | 2003 | 2003  |      |       |       |      |
|--------------------------------|-------|------|-------|------|-------|-------|------|
|                                |       |      | Q3    | Q4   | Oct.  | Nov.  | Dec. |
| Real GDP <sup>1</sup>          | 2.0   | n.a. | -1.4  | n.a. | ...   | ...   | ...  |
| Overall economic activity      | .9    | n.a. | -.1   | n.a. | .2    | n.a.  | n.a. |
| Industrial production          | -.1   | n.a. | -1.1  | n.a. | 1.5   | .8    | n.a. |
| Unemployment rate <sup>2</sup> | 2.7   | n.a. | 3.6   | n.a. | 3.6   | 4.0   | n.a. |
| Consumer prices <sup>3</sup>   | 5.7   | 4.0  | 4.1   | 4.0  | 4.0   | 4.0   | 4.0  |
| Trade balance <sup>4</sup>     | -7.9  | n.a. | -6.5  | n.a. | -3.6  | -4.3  | n.a. |
| Imports <sup>4</sup>           | 168.7 | n.a. | 170.4 | n.a. | 172.5 | 176.7 | n.a. |
| Exports <sup>4</sup>           | 160.8 | n.a. | 163.9 | n.a. | 168.9 | 172.3 | n.a. |
| Current account <sup>5</sup>   | -14.0 | n.a. | -8.6  | 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 generally paint a picture of continued economic recovery. Industrial production rose in November and was up 7½ percent from its recent trough in mid-2002. The growth of capital goods production was particularly strong, providing additional evidence of recovery in investment. Private consumption has been the slowest component of demand to show recovery, but domestic auto sales did rise sharply in the fourth quarter. Unemployment remains high. Brazil continued to record strong export growth, reflecting in part higher commodity prices and in part the response to the country's improved international competitiveness in recent years.

Prompted by the continued favorable inflation trends and still-weak private consumption, the central bank reduced its overnight interest rate by 100 basis points in mid-December to 16½ percent. This rate is well below the 26½ percent rate that prevailed in June of last year. Average 12-month-ahead expected inflation from the central bank's survey has remained at 6 percent in recent months. Responding to favorable financial conditions, the Brazilian government retired \$13 billion in dollar-linked instruments issued domestically in the second half of 2002.

### Brazilian Economic Indicators

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

| Indicator                      | 2002 | 2003 | 2003 |      |      |      |      |
|--------------------------------|------|------|------|------|------|------|------|
|                                |      |      | Q3   | Q4   | Oct. | Nov. | Dec. |
| Real GDP <sup>1</sup>          | 3.7  | n.a. | 1.6  | n.a. | ...  | ...  | ...  |
| Industrial production          | 2.4  | n.a. | 1.9  | n.a. | -.3  | .8   | n.a. |
| Unemployment rate <sup>2</sup> | 12.5 | n.a. | 13.0 | n.a. | 13.4 | 13.1 | n.a. |
| Consumer prices <sup>3</sup>   | 12.5 | 9.3  | 15.2 | 11.4 | 14.0 | 11.0 | 9.3  |
| Trade balance <sup>4</sup>     | 13.1 | 24.8 | 26.8 | 28.2 | 27.0 | 26.0 | 31.6 |
| Current account <sup>5</sup>   | -7.7 | n.a. | 13.2 | n.a. | 1.0  | -1.6 | 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**, recent data releases confirm that the economic recovery continues. Real GDP rose 11.7 percent at an annual rate in the third quarter, on the back of strong agricultural exports and rising consumer demand, although it remains below pre-crisis levels. Industrial production was up 3.7 percent in November. Twelve-month consumer price inflation remained low in December, at 3.8 percent. The Argentine peso, which appreciated 15 percent in 2003, has strengthened about 2 percent since the beginning of the year. Tax revenues have also improved. Argentina has met all of the quantitative criteria of its IMF program and has made some advances in structural reforms. The country, however, is lagging behind in its bank recapitalization efforts and has yet to show that it is pursuing debt restructuring negotiations with private creditors in good faith. The Argentine government's proposal of a 75 percent reduction in principal presented last September received a negative reaction from bondholders. In early December, a counteroffer calling for a maximum 35 percent reduction in principal was presented by a group of bondholders, but the Argentine government has insisted on its original plan.

### Argentine Economic Indicators

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

| Indicator                      | 2002  | 2003 | 2003 |      |      |      |      |
|--------------------------------|-------|------|------|------|------|------|------|
|                                |       |      | Q3   | Q4   | Oct. | Nov. | Dec. |
| Real GDP <sup>1</sup>          | -3.3  | n.a. | 11.7 | n.a. | ...  | ...  | ...  |
| Industrial production          | -10.7 | n.a. | 2.3  | n.a. | 3.6  | 3.7  | n.a. |
| Unemployment rate <sup>2</sup> | 20.4  | n.a. | n.a. | n.a. | ...  | ...  | ...  |
| Consumer prices <sup>3</sup>   | 41.4  | 3.8  | 5.1  | 3.8  | 4.0  | 3.7  | 3.8  |
| Trade balance <sup>4</sup>     | 16.7  | n.a. | 15.1 | n.a. | 15.9 | 15.6 | n.a. |
| Current account <sup>5</sup>   | 9.6   | n.a. | 5.8  | 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**, indications are that economic activity continued to recover in the fourth quarter, but the economy remains weak. Industrial production rose in October, but stood 20 percent below its recent peak in 2001. Oil production is still believed to be about 10 percent below the levels prevailing before the devastating December 2002 general strike. Inflation ended the year at 27 percent, despite the fixed exchange rate in effect since February 2003 and the weakness of the economy. President Chavez, facing mounting pressure to hold a recall referendum later this year, has been pressuring the central bank to transfer a portion of its international reserves to the government for development projects.

### Venezuelan Economic Indicators

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

| Indicator                          | 2002  | 2003 | 2003 |      |      |      |      |
|------------------------------------|-------|------|------|------|------|------|------|
|                                    |       |      | Q3   | Q4   | Oct. | Nov. | Dec. |
| Real GDP <sup>1</sup>              | -16.7 | n.a. | 31.8 | n.a. | ...  | ...  | ...  |
| Unemployment rate <sup>2</sup>     | 16.0  | n.a. | 17.6 | n.a. | 16.8 | 17.7 | n.a. |
| Consumer prices <sup>3</sup>       | 31.2  | 27.1 | 29.5 | 26.3 | 25.7 | 26.1 | 27.1 |
| Non-oil trade balance <sup>4</sup> | -8.5  | n.a. | 16.0 | n.a. | ...  | ...  | ...  |
| Trade balance <sup>4</sup>         | 13.0  | n.a. | 36.7 | n.a. | ...  | ...  | ...  |
| Current account <sup>5</sup>       | 7.4   | n.a. | 11.1 | 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.

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

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