

Prefatory Note

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Part 2

September 12, 2007

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

September 12, 2007

Recent Developments

Domestic Nonfinancial Developments

Domestic Nonfinancial Developments

The incoming nonfinancial economic data, most of which pertain to the period before the recent turbulence in financial markets, suggest that economic activity advanced at a moderate pace early in the third quarter. Notably, retail sales and orders and shipments of capital goods posted solid gains in July. However, residential investment weakened further even before the recent disruptions in mortgage markets. In addition, private payrolls posted only a small gain in August, and manufacturing production appears to have slowed. Meanwhile, core inflation, although having risen a bit from the unusually low rates of increase in the spring, remained moderate through July.

Labor Market Developments

Private nonfarm payroll employment rose only 24,000 in August, and the levels of employment in June and July were revised down. As a result, private-sector hiring now appears to have decelerated further over the summer: Increases averaged about 70,000 per month over the three months ending in August, compared with gains near 120,000 per month in the first five months of this year and gains of about 165,000 per month in the second half of 2006.¹

The weakness in job gains last month was spread fairly widely across industries. Employment in residential construction and manufacturing posted noticeable declines; employment in wholesale trade and transportation was little changed; and hiring at business services was well below recent trends.² With payroll employment up modestly and the workweek flat, aggregate hours of private production or nonsupervisory workers in August held steady at a level 0.2 percent (not at an annual rate) above their second-quarter level.

However, in contrast to August's weak employment report, other indicators do not suggest any marked slowdown in labor market conditions. Indicators of layoffs—initial claims for unemployment insurance, the short-term job losers rate from the household survey, and the announcements of downsizing plans as measured by Challenger, Gray, and Christmas, Inc.—moved up in August but remained no higher than readings of earlier

¹ A preliminary estimate of the benchmark revision to employment for March 2007 is scheduled to be announced in October. The revision could change the deceleration that is currently registered in the employment data.

² Because the establishment survey measures employment for the week including the 12th of the month, the August data likely do not reflect much of the effect of the recent turmoil in financial markets. Employment in industries most closely identified with real estate lending—real estate credit as well as mortgage and nonmortgage loan brokers—was flat for a year after the housing market began to soften in late 2005 and has fallen substantially since then. Data for these industries are available only through July.

Changes in Employment

(Thousands of employees; seasonally adjusted)

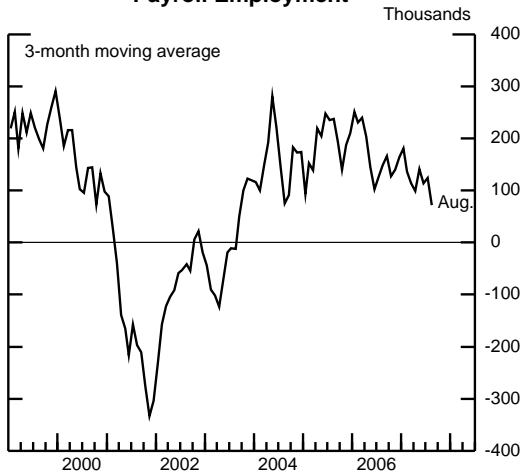
Measure and sector	2006		2007				
	2006	Q4	Q1	Q2	June	July	Aug.
	Average monthly change				Monthly change		
Nonfarm payroll employment (establishment survey)	189	177	142	126	69	68	-4
Private	169	164	115	114	71	120	24
Natural resources and mining	5	4	3	2	3	5	4
Manufacturing	-7	-25	-14	-13	-19	-1	-46
Construction	11	-14	3	-9	6	-14	-22
Wholesale trade	11	12	2	15	17	9	3
Retail trade	-3	11	27	-7	-11	5	13
Transportation and utilities	9	11	2	1	1	7	-3
Information	2	7	4	2	-4	-4	-7
Financial activities	16	10	2	5	-4	24	0
Professional and business services	42	52	14	17	-7	25	6
Temporary help services	-1	6	-7	-11	-15	-5	-13
Nonbusiness services ¹	83	96	71	100	90	64	77
Total government	20	13	28	12	-2	-52	-28
Total employment (household survey)	262	340	109	-38	197	-30	-316
Memo:							
Aggregate hours of private production workers (percent change) ²	2.5	2.0	1.1	2.1	.4	-.1	.0
Average workweek (hours) ³	33.8	33.9	33.8	33.8	33.9	33.8	33.8
Manufacturing (hours)	41.1	41.1	41.0	41.2	41.4	41.3	41.3

1. Nonbusiness services comprises education and health, leisure and hospitality, and "other."

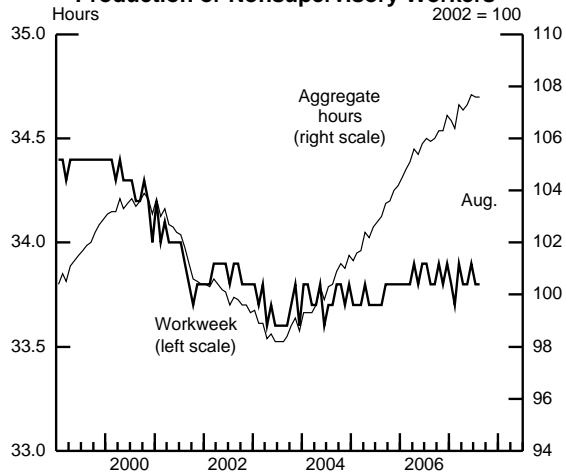
2. Establishment survey. Annual data are percent changes from Q4 to Q4. Quarterly data are percent changes from preceding quarter at an annual rate. Monthly data are percent changes from preceding month.

3. Establishment survey.

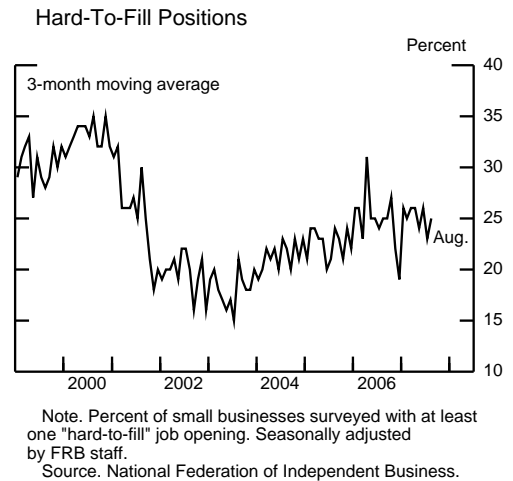
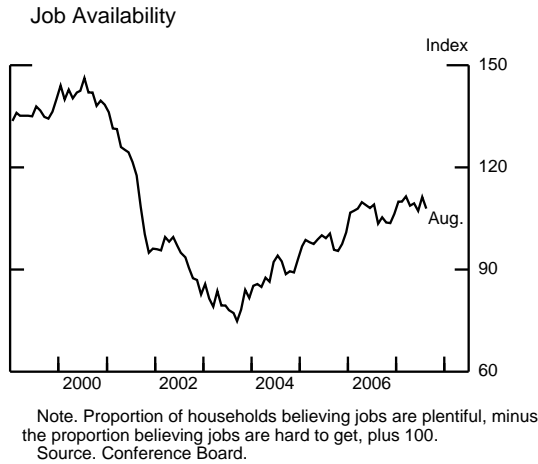
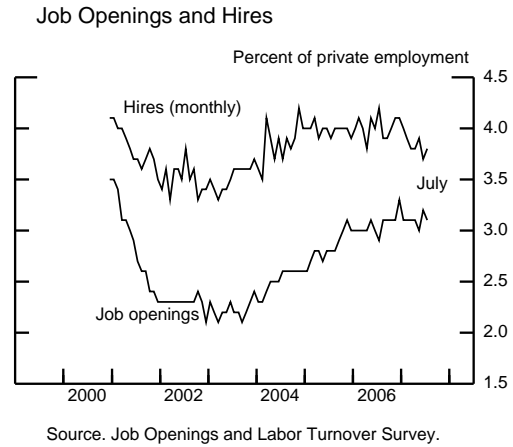
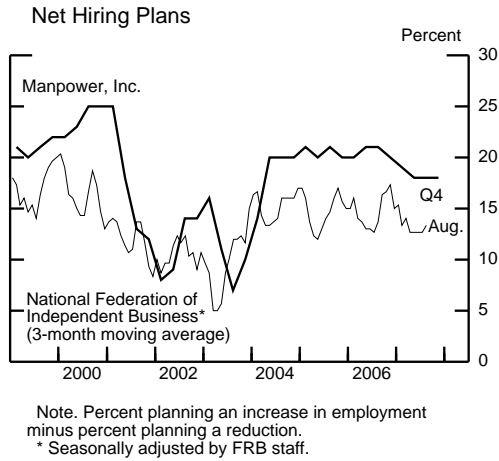
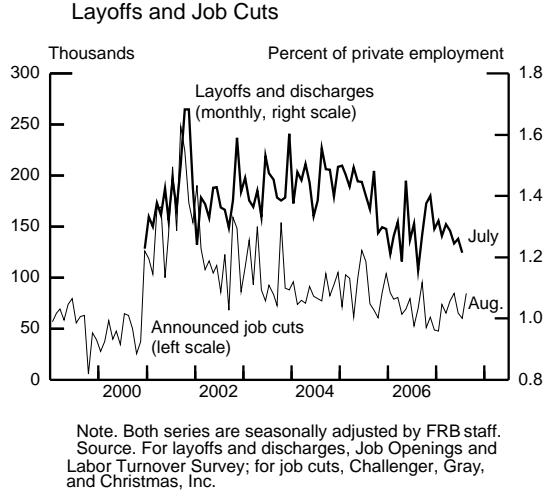
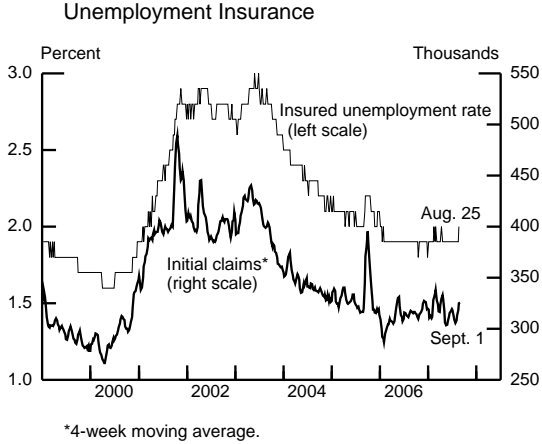
Changes in Private Payroll Employment



Aggregate Hours and Workweek of Production or Nonsupervisory Workers



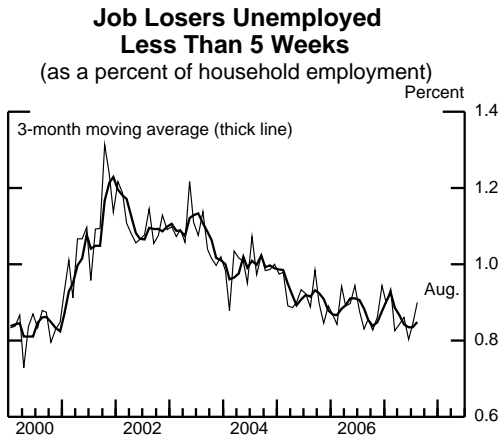
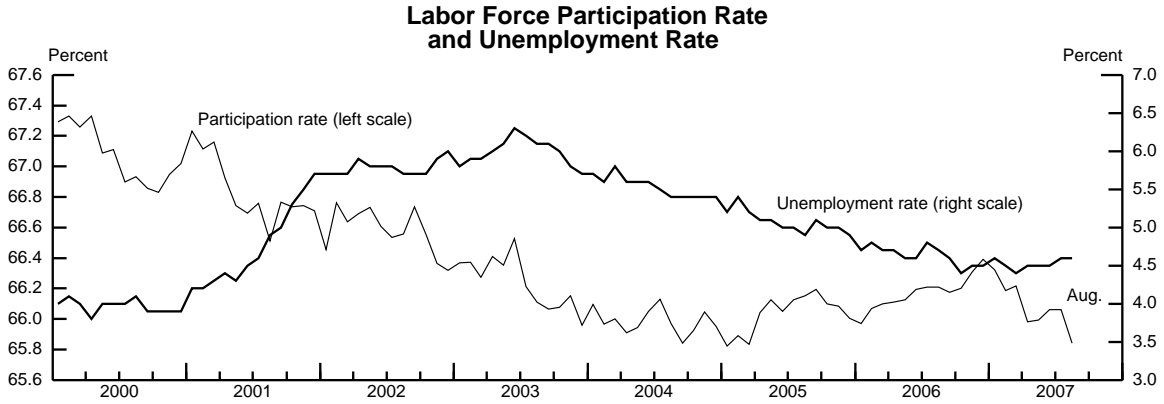
Labor Market Indicators



Selected Unemployment and Labor Force Participation Rates

(Percent; seasonally adjusted)

Rate and group	2006	2007					
		Q4	Q1	Q2	June	July	Aug.
<i>Civilian unemployment rate</i>							
Total	4.6	4.5	4.5	4.5	4.5	4.6	4.6
Teenagers	15.4	15.1	14.8	15.6	15.8	15.2	16.1
20-24 years old	8.2	8.3	7.7	7.7	8.0	8.5	8.3
Men, 25 years and older	3.5	3.3	3.6	3.5	3.4	3.6	3.6
Women, 25 years and older	3.7	3.5	3.5	3.5	3.6	3.7	3.7
<i>Labor force participation rate</i>							
Total	66.2	66.3	66.2	66.0	66.1	66.1	65.8
Teenagers	43.6	43.4	42.2	41.5	41.8	41.2	39.7
20-24 years old	74.6	75.0	75.1	74.2	74.5	74.6	74.0
Men, 25 years and older	75.5	75.7	75.7	75.6	75.5	75.6	75.5
Women, 25 years and older	59.6	59.8	59.6	59.6	59.7	59.8	59.8



this year. Indicators of hiring—hiring plans in surveys by the National Federation of Independent Business (NFIB) and Manpower—were little changed so far this quarter. Auxiliary indicators of labor market tightness—the insured unemployment rate and survey measures from the NFIB and the Conference Board—also suggest little change.

In the household survey, the unemployment rate held steady at 4.6 percent in August, 0.1 percentage point above its second-quarter level and equal to its 2006 average. The labor force participation rate dropped back to 65.8 percent—a decline that occurred, according to the Bureau of Labor Statistics, because the relatively late survey reference week captured more of the outflow from summer jobs than usual. Apart from a few months last fall and winter, the labor force participation rate has hovered between 66.0 percent and 66.2 percent for more than two years.

Productivity in the nonfarm business sector rose at an annual rate of 2.6 percent in the second quarter after a 0.7 percent rate of increase in the first quarter. Even including this acceleration, labor productivity in this sector rose only 0.9 percent over the four quarters ending in 2007:Q2, $\frac{3}{4}$ percentage point less than in the comparable period four quarters earlier.

Output per Hour

(Percent change from preceding period at an annual rate; seasonally adjusted)

Sector	2005:Q2 to 2006:Q2	2006:Q2 to 2007:Q2	2006		2007	
			Q3	Q4	Q1	Q2
Nonfarm business						
All persons	1.5	.9	-1.6	1.8	.7	2.6
All employees ¹	1.2	.9	-1.4	1.5	.2	3.1
Nonfinancial corporations ²	.5	2.1	3.1	1.3	.7	3.5

1. Assumes that the growth rate of hours of non-employees equals the growth rate of hours of employees.
2. All corporations doing business in the United States except banks, stock and commodity brokers, and finance and insurance companies. The sector accounts for about two-thirds of business employment. Nonfinancial corporate output is calculated as an income-side measure.

Industrial Production

Industrial production for August will be published on Friday. The information currently in hand suggests that total industrial production (IP) was boosted in August by a weather-related surge in electricity generation. Meanwhile, production in the manufacturing sector appears to have slowed following widespread gains in the preceding two months. Manufacturing IP rose 0.6 percent in June and July, supported by solid gains in exports

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

Component	Proportion 2006 (percent)	2006 ¹	2007		2007		
			Q1	Q2	May	June	July
			Annual rate		Monthly rate		
Total	100.0	3.5	1.1	3.3	-.2	.6	.3
Previous	100.0	3.5	1.1	2.9	-.1	.5	...
Manufacturing	81.9	3.4	.8	3.9	-.1	.6	.6
Ex. motor veh. and parts	76.3	3.9	1.4	3.3	.0	.5	.5
Ex. high-tech industries	71.5	2.5	.9	2.6	-.1	.5	.4
Mining	8.6	8.0	-4.8	1.1	.1	.4	.7
Utilities	9.6	.3	8.7	-.2	-1.6	.1	-2.1
<i>Selected industries</i>							
Energy	20.5	4.0	4.8	-.7	-.2	.2	-.6
High technology	4.8	24.6	9.2	13.8	.7	1.2	1.5
Computers	1.2	12.1	32.8	38.3	4.1	.8	.8
Communications equipment	1.1	14.8	27.7	6.8	-1.0	1.5	1.0
Semiconductors ²	2.6	34.8	-6.9	5.5	-.4	1.3	2.1
Motor vehicles and parts	5.5	-3.8	-7.5	13.2	-.5	2.4	2.6
<i>Total ex. selected industries</i>	69.1	2.4	.1	3.0	-.3	.5	.3
Consumer goods	20.9	1.8	1.0	1.8	-.6	.8	.3
Durables	4.0	-1.9	-3.6	4.0	-.2	1.1	-.2
Nondurables	16.9	2.7	2.1	1.2	-.7	.8	.4
Business equipment	7.8	10.2	-3.3	4.4	.2	.1	.8
Defense and space equipment	1.7	2.0	-2.2	-2.6	.3	.7	.5
Construction supplies	4.5	-2.2	-3.0	4.9	.4	1.2	-.1
Business supplies	7.9	1.0	.0	1.3	-.3	.3	.2
Materials	26.1	2.3	1.1	3.9	-.2	.2	.4
Durables	14.5	2.0	1.3	5.4	.1	.2	.4
Nondurables	11.6	2.6	1.0	2.0	-.6	.3	.4

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- 2006 average	1994- 95 high	2001- 02 low	2006	2007			
				Q4	Q1	Q2	June	July
Total industry	81.0	85.1	73.6	81.5	81.3	81.6	81.8	81.9
Manufacturing	79.8	84.6	71.6	80.1	79.8	80.2	80.4	80.7
Ex. motor veh. and parts	79.9	84.3	71.4	80.5	80.3	80.4	80.5	80.7
Mining	87.4	88.9	84.8	91.3	90.0	90.2	90.4	91.0
Utilities	86.7	93.7	83.8	85.0	86.4	86.0	85.5	83.6
<i>Stage-of-process groups</i>								
Crude	86.5	89.5	82.0	89.1	88.7	89.4	89.5	90.0
Primary and semifinished	82.2	88.2	74.6	82.3	82.2	82.2	82.2	82.1
Finished	77.8	80.5	70.0	78.2	78.0	78.6	78.8	79.1

and a diminishing drag from inventories; the advances in output in those months were fairly widespread. Looking forward, although available indicators of manufacturing activity have been generally positive, scheduled cuts in motor vehicle production and continued weakness in residential construction should prove to be a material drag on manufacturing IP in the coming months. As of July, capacity utilization in manufacturing stood 0.9 percentage point above its 1972-2006 average.

Light motor vehicle production has maintained an average pace a bit below 11 million units since June, a noticeable step-up from the low levels of production seen near the turn of the year, when automakers cut production to bring their inventories back in line with sales. However, because sales have softened, on average, this summer, inventories of light vehicles are again somewhat elevated; days' supply for domestic light vehicles stood at 69 at the end of August, a fair bit above the standard industry target of about 65. As a result, industry schedules for September have been pared back to 10.9 million units. Moreover, initial assembly plans for the fourth quarter call for production to drop to 10.2 million units, as automakers expect sales to remain tepid through the end of the year. These schedules are preliminary and frequently revised. Nonetheless, if realized, the substantial pullback in motor vehicle production could subtract up to 1 percentage point from the annual rate of change in total IP in the fourth quarter.

Output in the high-technology sector increased 1.5 percent in July and thus continued the modest acceleration of the preceding few months. The output of communications equipment rose solidly in both June and July, in part because of robust enterprise demand for voice and data networking equipment. In addition, recent industry anecdotes suggest that capital expenditures by telecommunications service providers, which had been running a bit on the soft side, will pick up in the second half of the year. The acceleration in production of communications equipment was partly offset by a deceleration in computer production, which slowed to a monthly growth rate of 0.8 percent in June and July after an average monthly rate of 3 percent in the first five months of the year. Gartner's projections for the third quarter show a decline in unit sales of personal computers (PCs) as the boost from the retail release of Microsoft Vista unwinds.

Production in most categories of semiconductors rose in June and July after a period of uneven gains earlier this year. The principal constraints on output appear to be diminishing: Semiconductor inventories are now at more comfortable levels, and industry anecdotes point to rising chip demand at manufacturers of PCs, cell phones, and consumer electronics. In particular, Intel recently revised up significantly its third-quarter revenue guidance to reflect stronger-than-expected demand. Nevertheless, gains

Production of Domestic Light Vehicles
(Millions of units at an annual rate except as noted)

Item	2007							
	Q1	Q2	Q3	Q4	June	July	Aug.	Sept.
U.S. production ¹	10.2	10.8	10.9	10.2	11.0	11.1	10.7	10.9
Autos	4.0	3.9	3.9	3.6	4.1	4.1	3.9	3.7
Light trucks	6.3	6.9	7.0	6.6	7.0	7.0	6.8	7.2
Days' supply ²	65	67	n.a.	n.a.	69	76	69	n.a.
Autos	60	55	n.a.	n.a.	56	65	61	n.a.
Light trucks	69	75	n.a.	n.a.	80	84	74	n.a.
Inventories ³	2.67	2.67	n.a.	n.a.	2.67	2.87	2.85	n.a.
Autos	1.00	.95	n.a.	n.a.	.95	1.04	1.02	n.a.
Light trucks	1.67	1.72	n.a.	n.a.	1.72	1.83	1.83	n.a.
Memo: U.S. production, total motor vehicles ⁴	10.6	11.1	11.2	10.5	11.3	11.4	10.9	11.2

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

1. Production rates in September and the third and fourth quarters reflect the latest industry schedules.

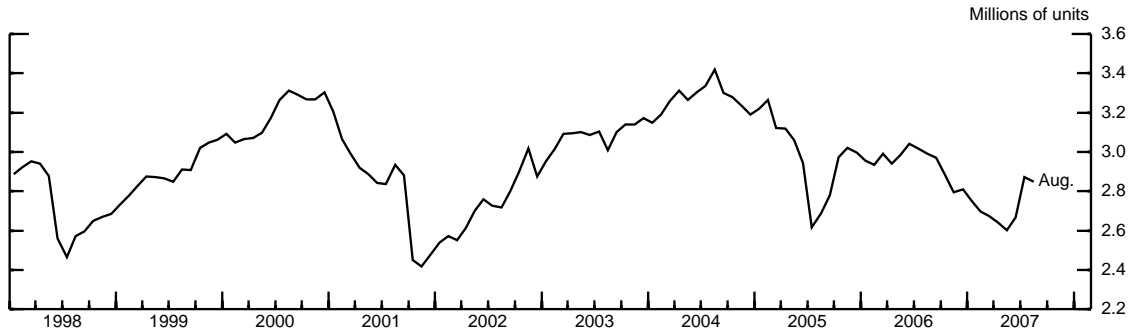
2. Quarterly values are calculated with end-of-period stocks and average reported sales.

3. End-of-period stocks.

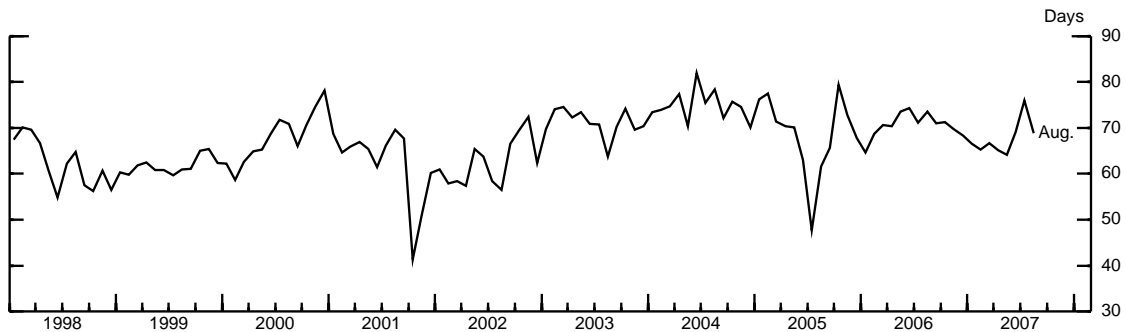
4. Includes medium and heavy trucks.

n.a. Not available.

Inventories of Light Vehicles

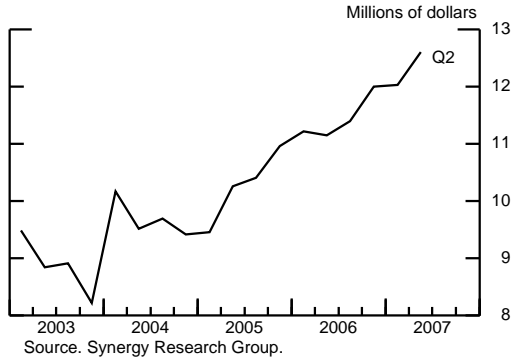


Days' Supply of Light Vehicles

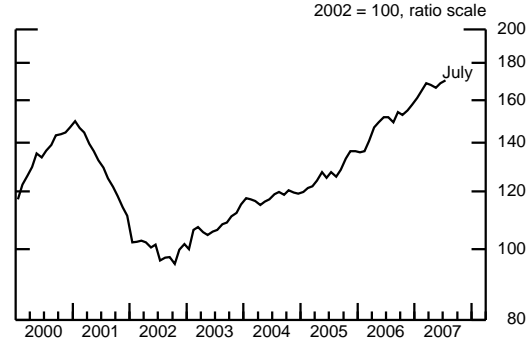


Indicators of High-Tech Manufacturing Activity

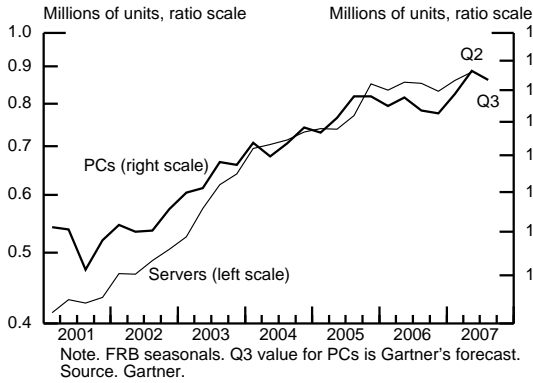
Enterprise Spending on Voice and Data Networking Equipment



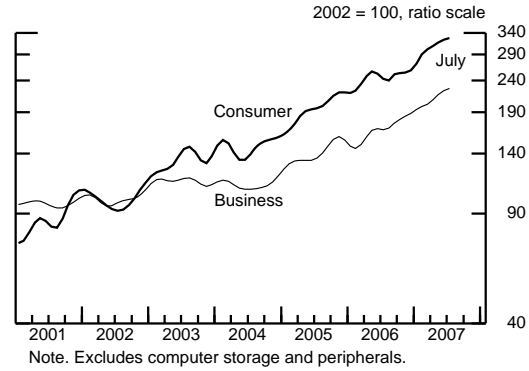
IP: Communications Equipment



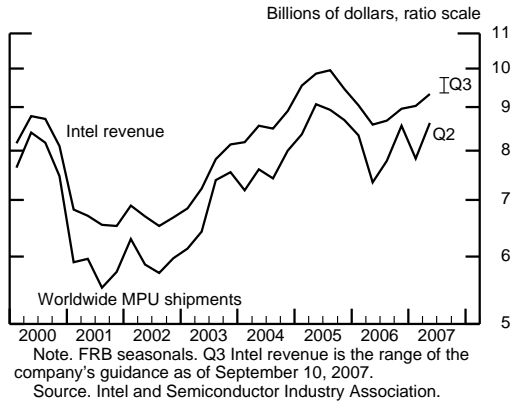
U.S. Personal Computer and Server Sales



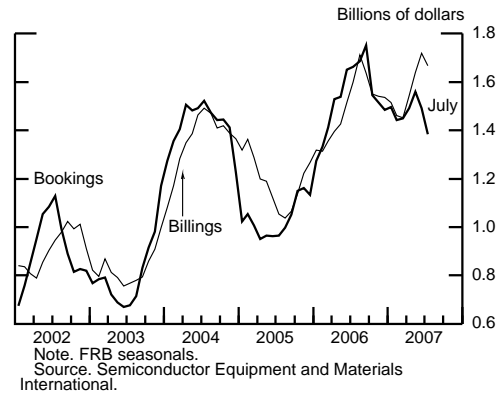
IP: Business and Consumer Computers



MPU Shipments and Intel Revenue

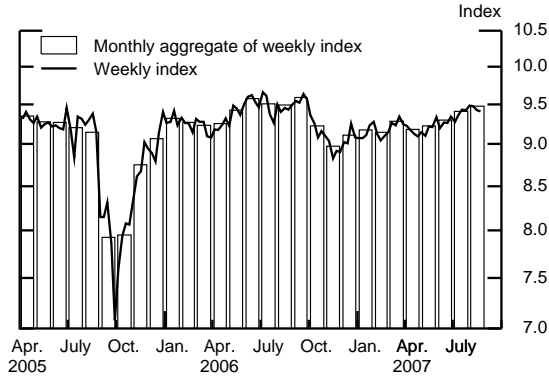


Bookings and Billings for Semiconductor Equipment

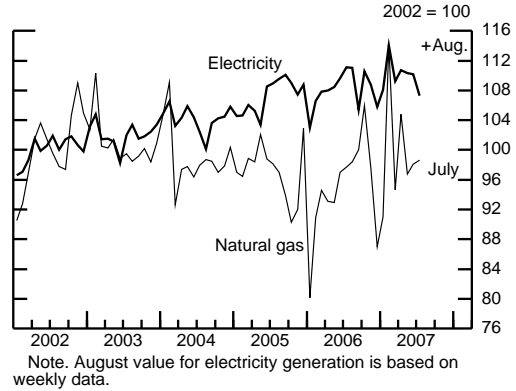


Indicators of Industrial Activity

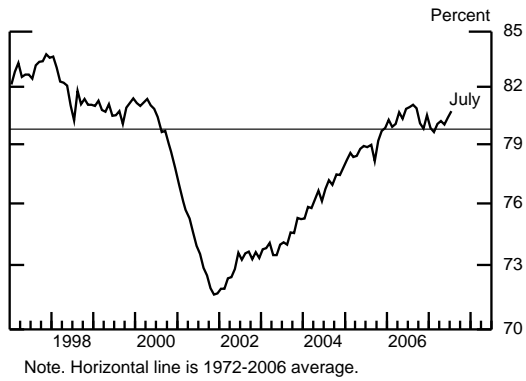
Weekly Production Index excluding Motor Vehicles and Electricity Generation



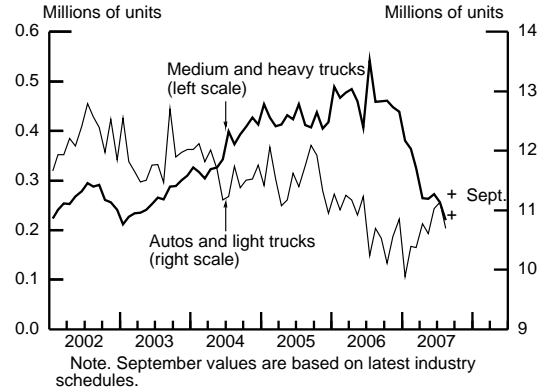
Utilities Output



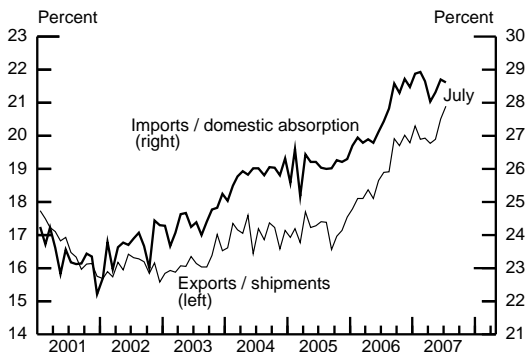
Manufacturing Capacity Utilization



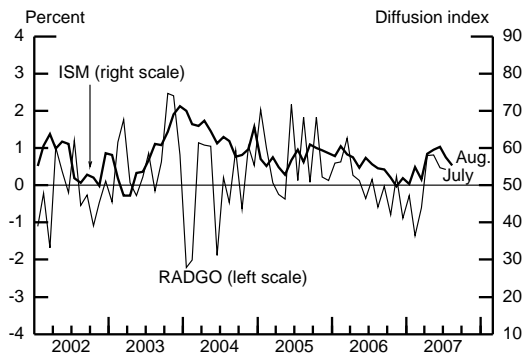
Motor Vehicle Assemblies



Trade Shares



New Orders: ISM Survey and Change in Real Adjusted Durable Goods Orders (RADGO)



in semiconductor production during the next few months are unlikely to be as strong as they were last year. Looking further ahead, the Semiconductor Equipment and Materials International book-to-bill ratio dropped in July to its lowest level since May of 2005, a sign that chip manufacturers are slowing their pace of capacity expansion.

On balance, production among the major market groups outside of motor vehicles and parts, energy, and high technology rose 0.3 percent in July after an increase of 0.5 percent in June. The output of consumer goods increased for the second consecutive month, as a rise in consumer nondurables offset declines in consumer durables such as household appliances, carpeting, and furniture. Production of business equipment popped up in July, on the strength of further advances in commercial aircraft and a rebound in the output of farm machinery, which had declined sharply in June. The output of construction supplies edged down in July after four months of production increases that appeared to be driven by gains associated with nonresidential construction. The output of industrial materials moved up 0.4 percent in July, and gains were recorded in both durable and nondurable materials.

The preliminary indicators of manufacturing activity in August, such as production worker hours and some physical product data, point to a slowdown in production after the strong gains in June and July. In coming months, the direct and upstream effects of scheduled reductions in motor vehicle production and the ongoing contraction in residential construction will likely be a drag on IP. That said, other indicators of near-term manufacturing activity have been generally positive. The August reading on the diffusion index for new orders, as reported by the Institute for Supply Management (ISM), remained at a level consistent with moderate output gains in the coming months, and the three-month moving average of the change in real adjusted durable goods orders showed a modest increase in July. Moreover, according to the staff's flow of goods inventory system, inventories in manufacturing outside of motor vehicles and parts appear well aligned with demand. Finally, domestic production continues to benefit from robust foreign demand. The export share of manufactured products—defined as the ratio of nominal exports to nominal shipments—moved up further in July from an already elevated level in June, and the export orders index from the ISM edged up further in August.

Motor Vehicles

Sales of light vehicles bounced back to an annual rate of 16.2 million units in August after having plunged earlier in the summer. The rebound in sales was concentrated at the

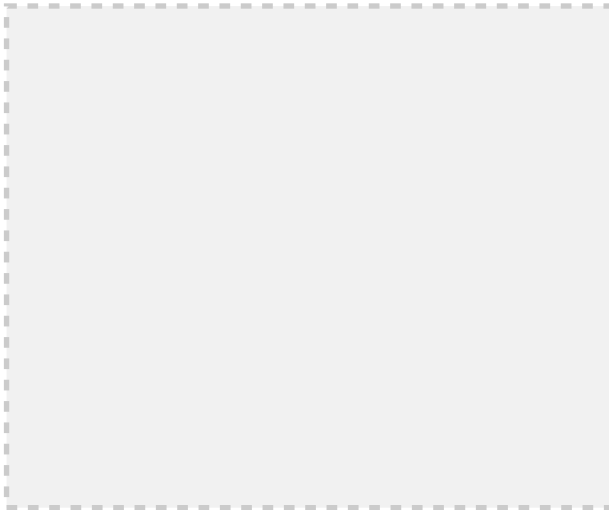
Sales of Light Vehicles
(Millions of units at an annual rate; FRB seasonals)

Category	2006	2006	2007				
		Q4	Q1	Q2	June	July	Aug.
Total	16.5	16.3	16.4	16.0	15.6	15.2	16.2
Autos	7.8	7.6	7.6	7.7	7.6	7.2	7.4
Light trucks	8.7	8.7	8.9	8.4	8.0	8.0	8.9
North American ¹	12.8	12.5	12.6	12.3	11.9	11.6	12.7
Autos	5.4	5.2	5.1	5.3	5.2	4.9	5.1
Light trucks	7.4	7.2	7.4	7.0	6.6	6.7	7.6
Foreign-produced	3.7	3.8	3.9	3.8	3.8	3.6	3.5
Autos	2.3	2.4	2.4	2.4	2.4	2.3	2.2
Light trucks	1.3	1.4	1.4	1.4	1.4	1.3	1.3
Memo: Detroit Three domestic market share (percent) ²	53.7	52.3	52.1	51.8	50.1	48.3	51.9

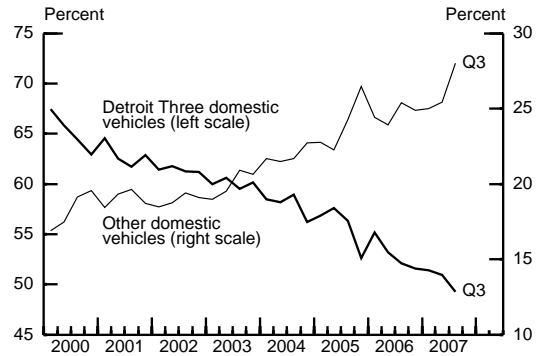
Note. Components may not sum to totals because of rounding.

1. Excludes some vehicles produced in Canada that are classified as imports by the industry.
2. Domestic market share excludes sales of foreign brands affiliated with the Detroit Three.

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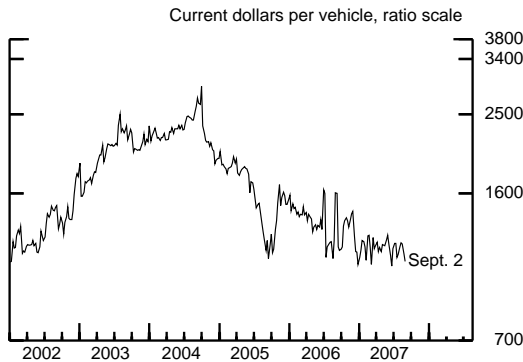


Market Share



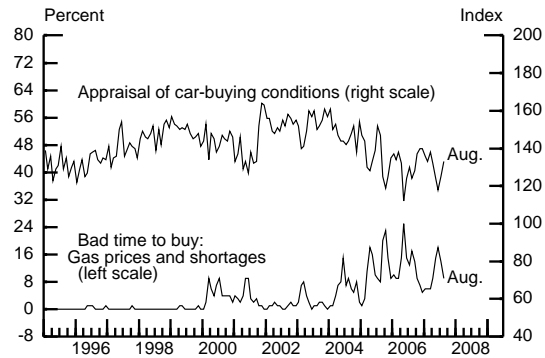
Note. The third-quarter averages are calculated using July and August values.

Average Value of Incentives on Light Vehicles



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

Car-Buying Attitudes



Source. Reuters/University of Michigan Survey.

Detroit Three automakers, which introduced some targeted incentive programs over the course of the month that likely brought back some customers who had postponed their vehicle purchases while waiting for better deals.³ Vehicle sales in August may also have been boosted by the recent declines in gasoline prices after the steep run-up in preceding months.

Even with the upturn in August, sales have averaged 15.9 million units at an annual rate since the end of the first quarter, down from the robust rate that prevailed at the turn of the year. The more moderate sales pace seems consistent with recent indicators of demand. Consumers' perceptions of car-buying conditions in the Reuters/University of Michigan survey continued to recover in August from the dip in June. However, sentiment in August was still less buoyant than during the first quarter of 2007, as consumers expressed dissatisfaction with vehicle prices and remained anxious about gasoline prices. High gasoline prices continue to depress the demand for larger vehicles such as sport-utility vehicles and full-size pickup trucks. The slowdown in residential construction also is reported to be damping sales of heavier-duty full-size pickup trucks, as a sizable portion of these sales are made to workers in construction-related industries. Given that weakness in housing activity is likely to persist well into next year, sales of these vehicles could remain at low levels for an extended period. Because this segment of the market is dominated by the domestic producers, the domestic market share of the Detroit Three receded further, on balance, in July and August, from its level in the second quarter. Meanwhile, sales by transplant firms have trended up this year, and data from the major Japanese automakers indicate that sales in early September were higher than in August.

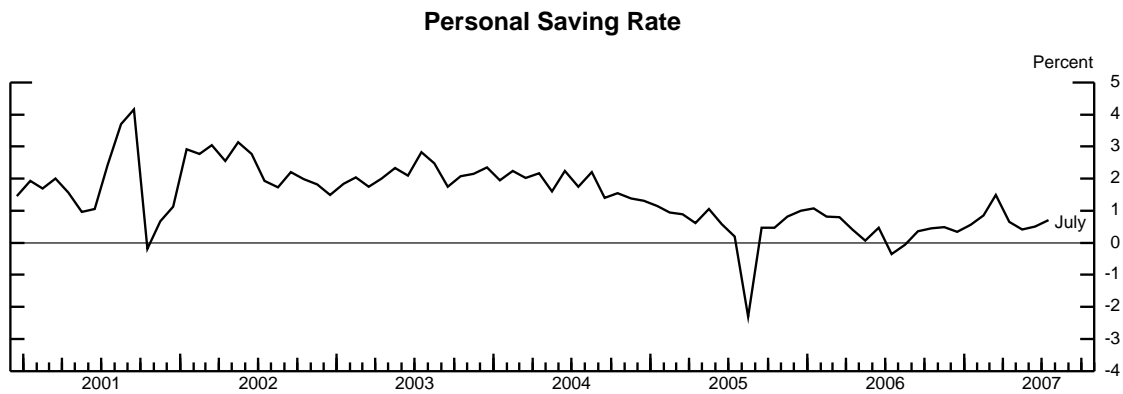
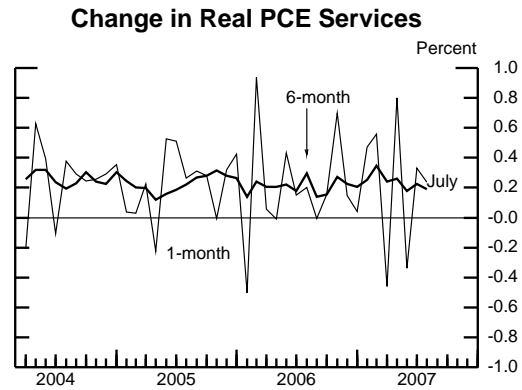
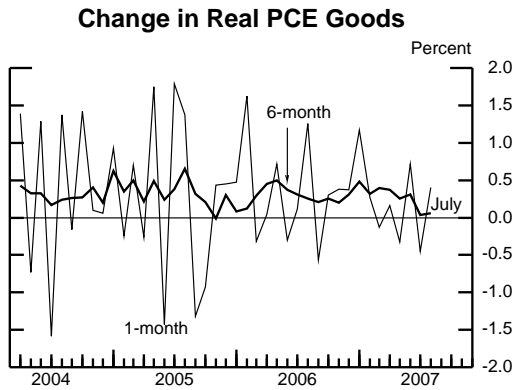
Consumer Spending

Consumer spending appears to have strengthened early this summer from its subdued second-quarter pace. Although auto sales were weak in July, real outlays for other goods rose briskly. At the same time, spending on services was up moderately despite a drop in outlays for energy services associated with relatively cool weather in the eastern part of the country. In August, warmer weather likely caused an increase in energy usage, and vehicle sales stepped up.

³ The average value of incentives used per light vehicle sale, as measured by J.D. Power and Associates, held steady in August. The incentive programs made available in that month were judiciously aimed at slow-selling vehicle lines, primarily pickup trucks, and did not escalate into an industrywide event sufficiently large to be reflected in this measure of incentives.

Real Personal Consumption Expenditures
(Percent change from the preceding period)

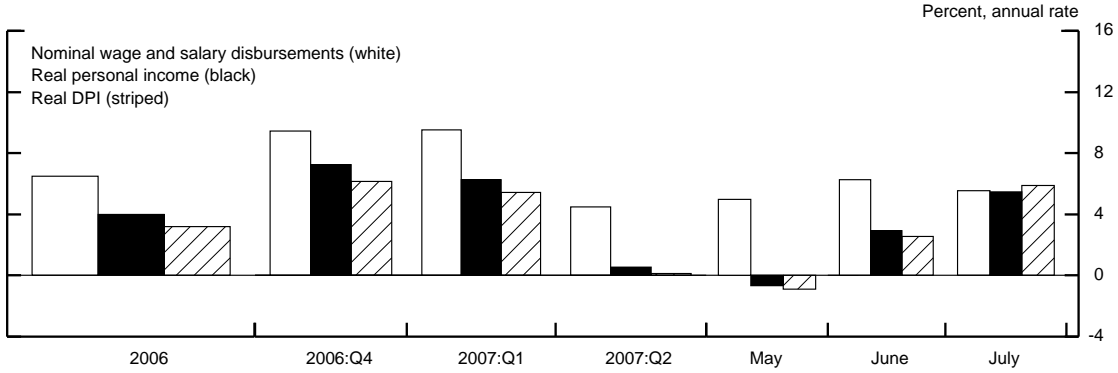
Category	2006		2007				
	H1	H2	Q1	Q2	May	June	July
	Annual rate			Monthly rate			
Total real PCE	3.1	2.9	3.7	1.4	.1	.0	.3
Durable goods	4.5	4.0	8.8	1.7	1.8	-1.8	.5
Motor vehicles	-4.7	2.1	11.3	-2.8	1.7	-3.8	.3
Excluding motor vehicles	11.6	5.3	7.1	5.1	2.0	-.4	.6
Nondurable goods	4.0	3.2	3.0	-.3	.3	.1	.4
Energy	1.1	-.4	2.4	-3.4	-1.9	.5	.8
Other	4.4	3.8	3.1	.1	.6	.0	.3
Services	2.4	2.6	3.1	2.3	-.3	.3	.2
Energy	-12.5	9.0	1.6	1.0	-12.1	2.6	-1.1
Other	3.1	2.4	3.2	2.3	.2	.2	.3
Memo: Real PCE goods ex. motor vehicles	5.3	3.5	4.0	.4	.6	-.1	.4



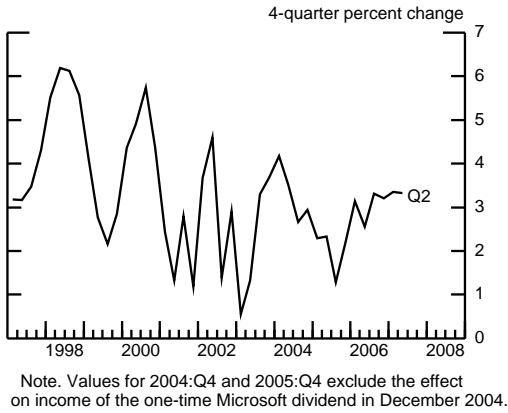
Note. Value for December 2004 excludes the effect on income of the one-time Microsoft dividend in that month.

Fundamentals of Household Spending

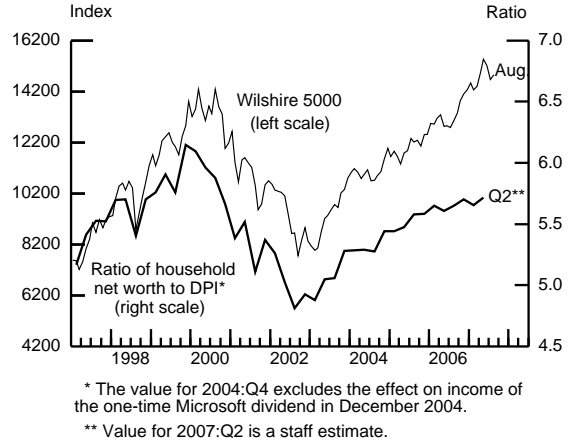
Changes in Nominal Wages and Salaries, Real Personal Income, and Real DPI



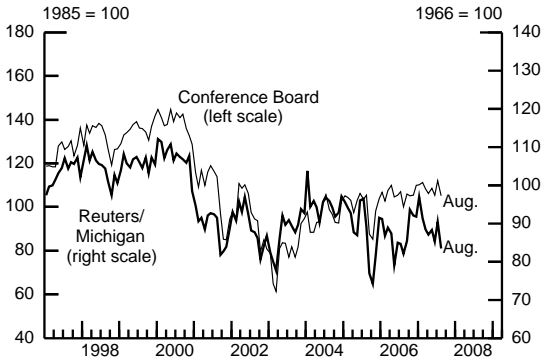
Change in Real DPI



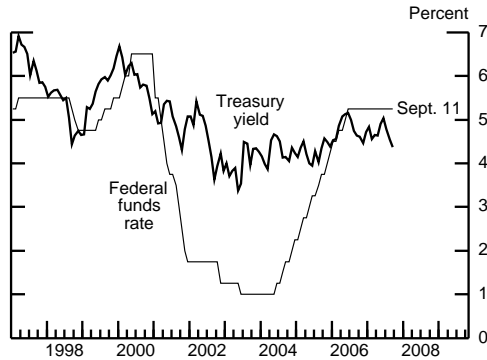
Household Net Worth and Wilshire 5000



Consumer Confidence



Federal Funds Rate and 10-Year Treasury Yield



Private Housing Activity

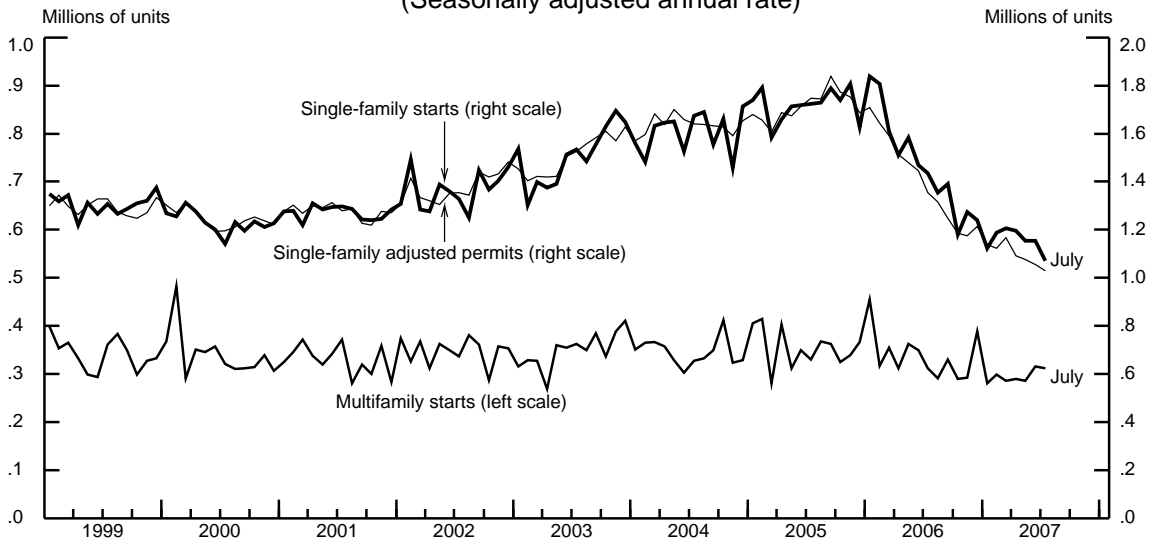
(Millions of units, seasonally adjusted; annual rate except as noted)

Sector	2006	2007				
		Q1	Q2	May	June	July
<i>All units</i>						
Starts	1.80	1.46	1.47	1.44	1.47	1.38
Permits	1.84	1.56	1.46	1.52	1.41	1.39
<i>Single-family units</i>						
Starts	1.47	1.17	1.17	1.16	1.15	1.07
Permits	1.38	1.12	1.05	1.06	1.02	1.01
Adjusted permits ¹	1.41	1.14	1.07	1.08	1.06	1.03
Permit backlog ²	.133	.133	.116	.126	.116	.116
New homes						
Sales	1.05	.85	.88	.88	.85	.87
Months' supply ³	6.36	7.64	7.41	7.37	7.63	7.35
Existing homes						
Sales	5.68	5.63	5.15	5.19	5.02	5.00
Months' supply ³	6.36	7.10	8.34	8.40	8.55	8.81
<i>Multifamily units</i>						
Starts	.336	.288	.297	.285	.316	.311
Permits	.461	.440	.411	.457	.394	.381
Permit backlog ²	.062	.076	.080	.082	.080	.079
<i>Mobile homes</i>						
Shipments	.117	.094	.099	.098	.101	.099
<i>Condos and co-ops</i>						
Existing home sales	.801	.790	.767	.790	.740	.750

1. Adjusted permits equal permit issuance plus total starts outside of permit-issuing areas.
2. Number outstanding at end of period. Excludes permits that have expired or have been canceled, abandoned, or revoked. Not at an annual rate.
3. At current sales rate; expressed as the ratio of seasonally adjusted inventories to seasonally adjusted sales. Quarterly and annual figures are averages of monthly figures.

Private Housing Starts and Permits

(Seasonally adjusted annual rate)



Note. Adjusted permits equal permit issuance plus total starts outside of permit-issuing areas.

Real disposable personal income (DPI) increased at an annual rate of 2¾ percent, on average, over the first half of this year despite the sharp increase in energy prices. More recently, estimates for July by the Bureau of Economic Analysis (BEA) show a ½ percent increase (not at an annual rate) in real DPI, as wages and salaries posted a strong gain and energy prices came down.⁴ The personal saving rate fell back in the second quarter after jumping in the first quarter on the strength of large bonuses. Smoothing through these fluctuations, the saving rate has been on a gradual upward trend over the past year. July's small increase continued this trajectory and brought the saving rate to ¾ percent, about 1 percentage point higher than its year-earlier level.

Despite the robust income gains of late, household wealth is likely providing a diminishing impetus to the pace of spending. The ratio of wealth to income flattened out in the first half of this year, as a deceleration in house prices appears to have largely offset a further rise in stock market wealth. Thus far in the third quarter, the ratio of wealth to income has likely fallen, reflecting recent declines in stock market wealth and an apparent further deceleration in house prices.

Readings on consumer sentiment from both the Reuters/Michigan and Conference Board surveys turned down in August, thereby reversing their July gains. The August level of sentiment was below the level that would normally be associated with the prevailing values of other indicators (such as inflation, labor market developments, and stock prices), an indication that sentiment may have been affected by concerns about the recent turmoil in financial markets.⁵ Taking a somewhat longer perspective, the Michigan measure has been drifting down since the start of the year, although the Conference Board survey remains in the range it has tracked since early 2006.

Housing

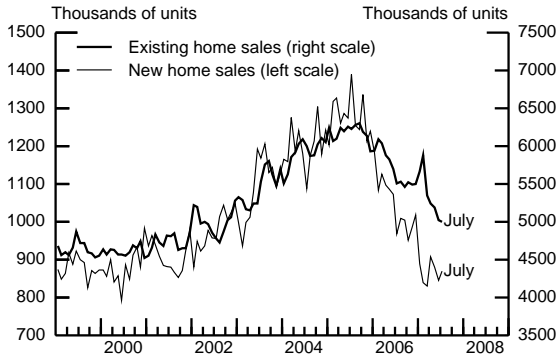
The housing sector remains exceptionally weak. Home sales have moved down considerably this year: Sales of new and existing single-family homes in July were down

⁴ The BEA revised down its estimate of the rise in income in the first quarter but revised up its estimate for the second quarter; on net, real DPI is now estimated to have risen a little faster than previously reported.

⁵ An alternative reading on these concerns is provided by a special survey conducted August 16-19 by the International Council of Shopping Centers, which asked respondents whether "the recent global financial problems have or might affect their spending habits." The results of this survey are a bit hard to gauge given its one-off nature, but they suggest that the spending plans of the respondents were not materially affected by the situation of financial markets as of the survey date. Only 13 percent of respondents indicated that they were aware of the situation and were having second thoughts about making major or discretionary purchases.

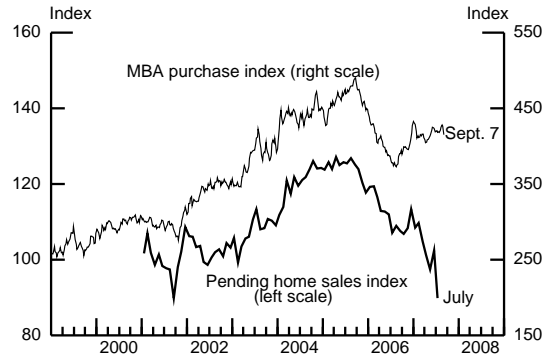
Indicators of Single-Family Housing

Home Sales



Source. For existing homes, National Association of Realtors; for new homes, Census Bureau.

Homebuying Indicators



Note. Purchase index is a 4-week moving average and is seasonally adjusted by FRB staff.
Source. For pending home sales, National Association of Realtors; for purchase index, Mortgage Bankers Assoc.

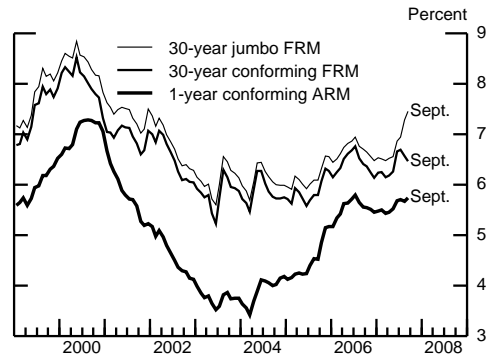
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New Home Sales Months' Supply



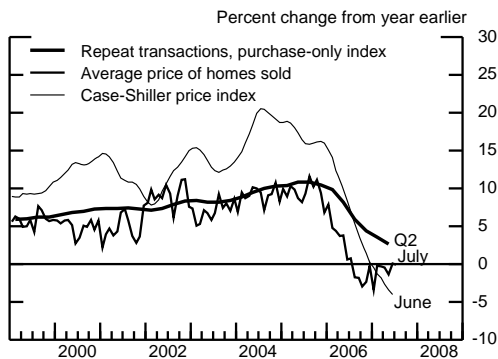
Note. Months' supply is calculated using the 3-month moving average of sales.
Source. for months' supply, Census Bureau.

Mortgage Rates



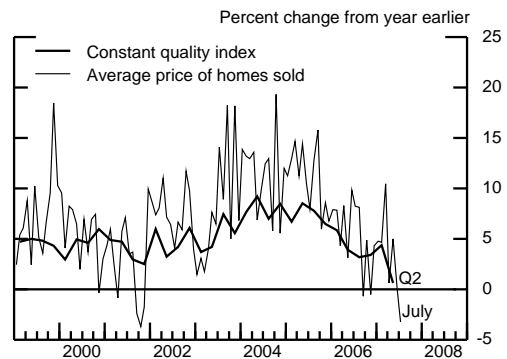
Note. Sept. readings are for data through Sept. 5, 2007.
Source. Conforming rates are from Freddie Mac. The jumbo rate is the sum of the 30-year conforming FRM rate and the jumbo conforming spread from bankrate.com.

Prices of Existing Homes



Note. The Case-Shiller price index is the 10-city index.
Source. For repeat transactions, OFHEO; for average price, National Association of Realtors; for Case-Shiller, Chicago Mercantile Exchange.

Prices of New Homes



Note. Average price values have been adjusted by Board staff to take into account new sampling procedures adopted in 2005.
Source. Census Bureau.

12 percent and 9 percent, respectively, from their averages over the second half of last year. Demand this year has been restrained by deteriorating conditions in the subprime mortgage market and by a net increase since early May of 30 basis points in rates for thirty-year fixed-rate conforming mortgages. Recently, the availability of financing to borrowers in the nonconforming mortgage markets appears to have been crimped even further. Nonprime mortgage originations (which include both subprime and alt-A categories) slowed to a trickle in July and August; spreads between rates for prime nonconforming (jumbo) and conforming thirty-year fixed-rate mortgages jumped to about 1 percentage point in August after having held steady near ¼ percentage point since 2001; and lenders have apparently adopted tighter lending standards for these loans.

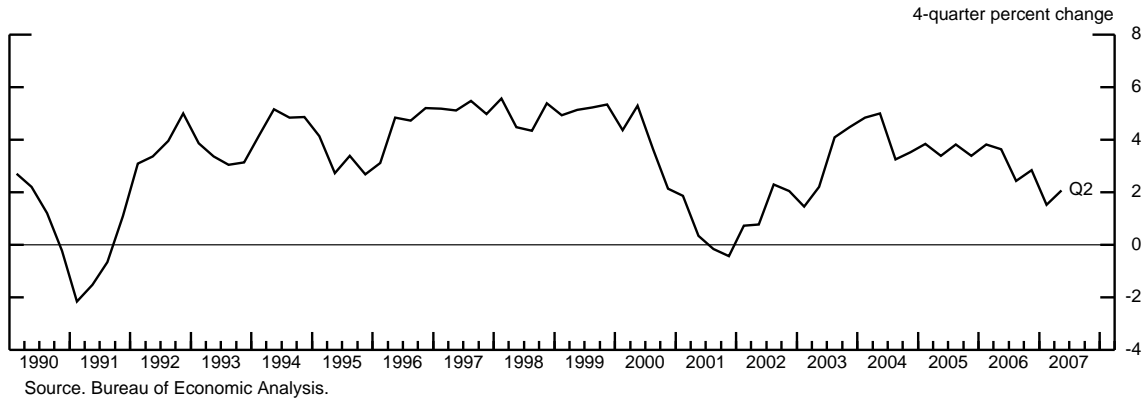
Most forward-looking indicators of housing demand point to a further deterioration in sales in the near term. The index of pending home sales agreements—which tends to lead existing home sales by one to two months—tumbled 12 percent in July. Although this drop followed an increase of 5 percent in June, July’s reading is 17 percent below the level seen in the second half of last year. The Reuters/Michigan index of homebuyer sentiment—which often anticipates substantial movements in home sales—dropped significantly in August and now shows a four-month decline that is comparable with the one seen when sales began to fall from their peak in the late summer of 2005. Anecdotal reports from homebuilders suggest that sales of new homes fell appreciably in August and that a lack of confidence in the housing market would likely restrain demand considerably for the rest of the year. The four-week moving average of the mortgage purchase index dropped back noticeably in early September but still stands well above its level in mid-April. The net increase in this index since late spring may be somewhat misleading because of distortions related to recent developments in nonprime mortgage markets.⁶

Single-family housing starts slid 7¼ percent to an annual rate of 1.07 million units in July—their lowest reading since 1996—and adjusted single-family permit issuance continued on a downward trajectory. Although single-family housing starts have come down more than 40 percent from their peak, they have lagged behind the collapse in demand. As a result, the months’ supply of new homes has risen considerably, on

⁶ Among other things, the mortgage purchase index does not sample applications taken by mortgage brokers, who issue the overwhelming majority of nonprime loans. Therefore, the index may not adequately reflect the dramatic falloff in new credit to this portion of the market. In addition, the index measures mortgage applications rather than approvals; because mortgage lending standards have become tighter this year for many borrowers, a smaller proportion of mortgage applications are likely to have been approved, and some borrowers may have applied to a larger number of lenders for a given loan.

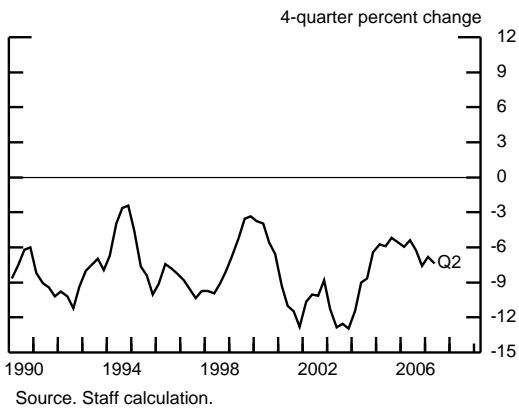
Fundamentals of Equipment and Software Investment

Real Business Output

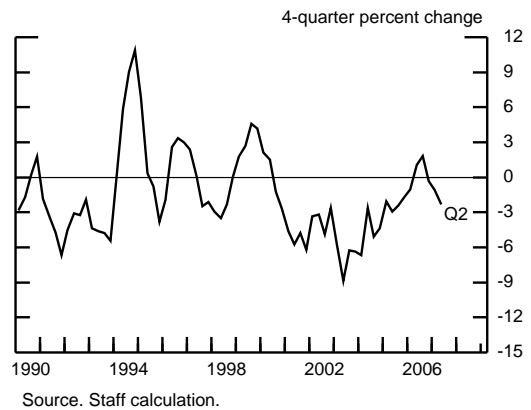


User Cost of Capital

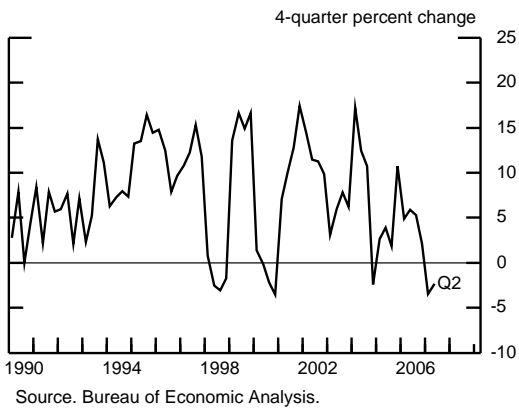
High-Tech



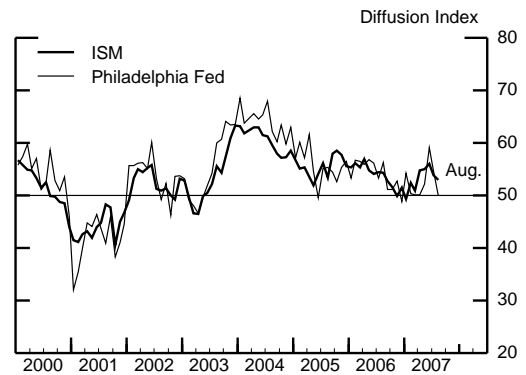
Non-High-Tech



Real Corporate Cash Flow



Surveys of Business Conditions



balance, this year, and in July it stood about 60 percent above the upper bound of the fairly tight range it had occupied between 1997 and the summer of 2005.

. In the multifamily sector, starts were at an annual rate of 311,000 units in July, in line with readings thus far this year and at the low end of the fairly narrow range seen since 1997.

House prices have continued to decelerate. The second-quarter reading of the purchase-only version of the repeat-sales price index calculated by the Office of Federal Housing Enterprise Oversight (OFHEO) was 2.6 percent higher than it was a year earlier, a considerably smaller gain than the 8.2 percent increase posted over the preceding four-quarter period. The ten-city version of the Case-Shiller repeat-price index has decelerated even more noticeably and shows an outright decline of 4 percent in the twelve months ending in June.⁷ The average price of existing homes sold—which is available on a more timely basis than are these other measures but is not quality adjusted—was about unchanged in July relative to twelve months earlier. The constant quality price index for new homes—which adjusts for the geographic composition of sales, square footage, and other readily measurable attributes—was just 0.6 percent higher in the second quarter than four quarters earlier but down from the 3.9 percent appreciation posted in the preceding year.⁸

Equipment and Software

We currently estimate that real spending on equipment and software (E&S) increased at an annual rate of 4 percent in the second quarter, moving back up after two weak quarters. Smoothing through that period of softness and the subsequent rebound, spending gains have been modest on average since the middle of 2006 after a period of

⁷ Unlike the OFHEO index, which captures only sales backed by conforming mortgage loans, the Case-Shiller index reflects all arms-length sales transactions in the included cities—Boston, Chicago, Denver, Las Vegas, Los Angeles, Miami, New York, San Diego, San Francisco, and Washington, DC.

⁸ Even these quality-adjusted readings on new-home price appreciation may be overstated because builders reportedly have stepped up their use of non-price incentives—such as including optional upgrades at no cost, granting more-favorable mortgage terms, and paying closing costs—over the past year to bolster sales and unload inventory.

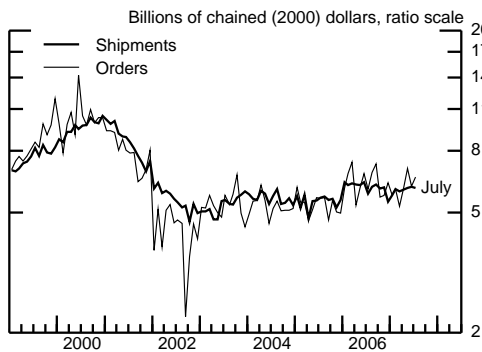
Orders and Shipments of Nondefense Capital Goods

(Percent change; seasonally adjusted current dollars)

Category	2007				
	Q1	Q2	May	June	July
	Annual rate		Monthly rate		
Shipments	-8.8	9.7	.7	-.5	1.2
Excluding aircraft	-11.1	9.6	.7	-.8	.4
Computers and peripherals	16.2	11.9	12.5	-7.6	-7.4
Communications equipment	2.4	12.6	1.0	.8	-1.0
All other categories	-14.7	9.0	-.5	-.2	1.4
Orders	-18.5	34.2	-6.8	6.3	5.4
Excluding aircraft	-16.2	13.0	-1.5	-.2	1.7
Computers and peripherals	13.2	7.5	15.3	-4.5	-4.6
Communications equipment	-13.0	64.2	16.4	-12.8	7.0
All other categories	-19.0	9.6	-4.8	1.8	1.9
Memo: Shipments of complete aircraft ¹	46.2	40.2	38.7	44.5	42.5

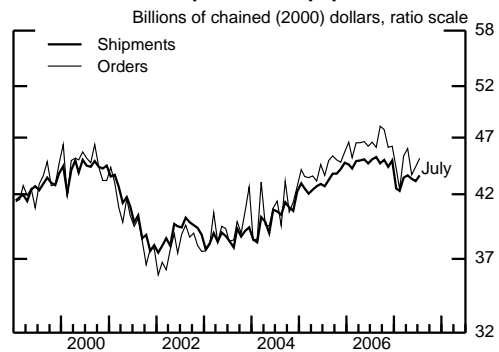
1. From Census Bureau, Current Industrial Reports; billions of dollars, annual rate.

Communications Equipment



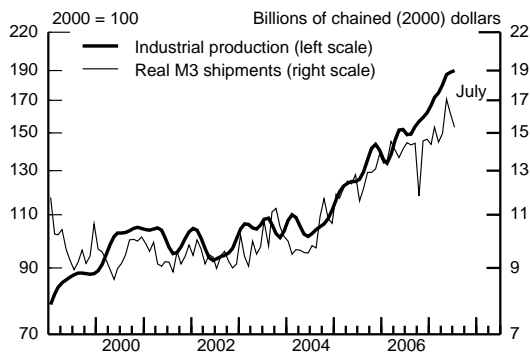
Note. Shipments and orders are deflated by a price index that is derived from the BEA's quality-adjusted price indexes and uses the PPI for communications equipment for monthly interpolation.

Non-High-Tech, Nontransportation Equipment



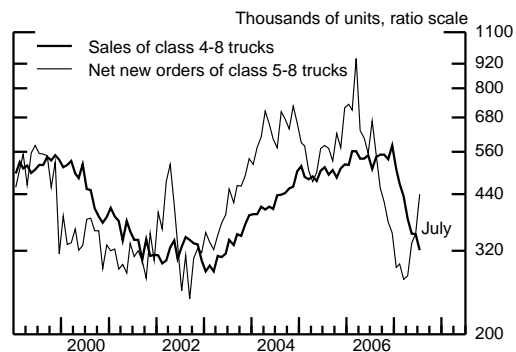
Note. Shipments and orders are deflated by the staff price indexes for the individual equipment types included in this category. Indexes are derived from the BEA's quality-adjusted price indexes.

Computers and Peripherals



Note. Ratio scales. Shipments are deflated by the staff price index for computers and peripheral equipment, which is derived from the BEA's quality-adjusted price indexes.

Medium and Heavy Trucks



Note. Annual rate, FRB seasonals. Source. For sales, Ward's Communications; for orders, ACT Research.

more-rapid expansion. The available data so far for the third quarter point to further moderate spending increases.

The slowdown in the average rate of increase in business outlays on E&S over the past few quarters likely reflects the gradual deceleration in business output since early last year. Although corporate cash reserves have shrunk over the past two quarters, they remain at high levels, and the user cost of capital goods has continued to decline. More recently, however, the turmoil in financial markets has raised financing costs for lower-grade borrowers and may be clouding the environment for business decisionmaking more generally. Surveys of business conditions—such as those conducted by the ISM, the Philadelphia Fed, and the NFIB—are some of the very few indicators timely enough to have been influenced by recent financial events. These measures suggest that increases in business activity were somewhat slower in August than in the second quarter. The August NFIB survey on loan availability showed some modest deterioration in current and expected credit conditions.

Real outlays on high-tech E&S expanded at an annual rate of about 9 percent in the second quarter on the heels of an even larger gain in the first quarter. More recently, July's data on computer industrial production and shipments point to solid increases, on net, early in the third quarter. Shipments of communications equipment dipped somewhat in July, but orders remained above shipments, suggesting that additional gains should be in the offing. The strength in communications spending seen so far this year seems to be centered outside of telecommunications service providers (TSPs) because it reflects gains mainly in items that are not usually purchased by these companies. By contrast, the capital expenditures guidance for TSPs called for a more moderate level of spending this year, and industry anecdotes suggest that expenditures in the first half of the year were even a bit below the industry's expectations.

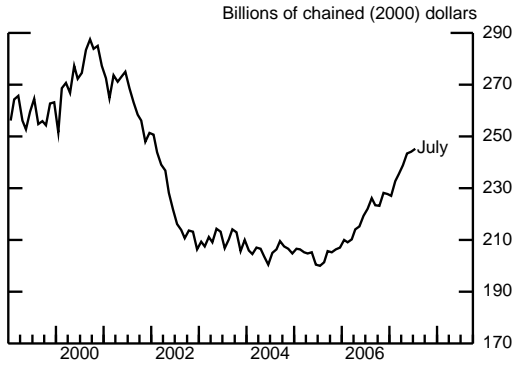
Real business outlays on transportation equipment dropped at an annual rate of nearly 25 percent in the second quarter, and data for July and August do not point to a rebound in the current quarter. Indicators of business-sector spending for motor vehicles have been mixed in recent months.

sales of medium and heavy trucks fell in July, continuing a downward trajectory that began soon after the introduction of more-stringent regulations on truck engines at the beginning of the year. However, new orders for medium and heavy trucks increased in June and July, signaling that the sales slump may be coming to an end. That said, the outlook for spending on these trucks remains uncertain; freight shipping volumes have been weak in recent months, which our industry contacts largely attribute to the

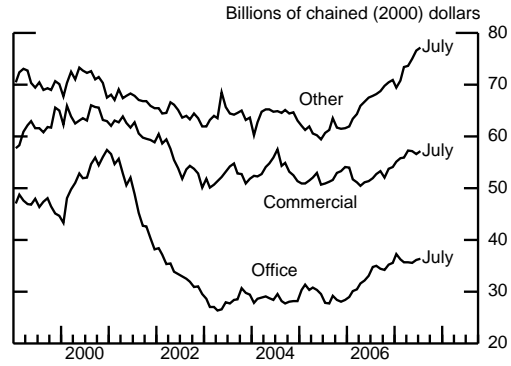
Nonresidential Construction and Indicators

(All spending series are seasonally adjusted at an annual rate; nominal CPIP deflated by BEA prices through Q1 and by staff projection thereafter)

Total Structures

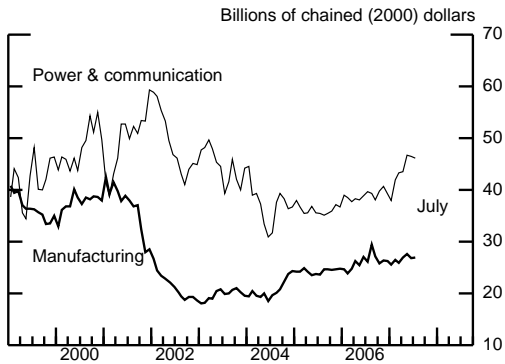


Office, Commercial, and Other

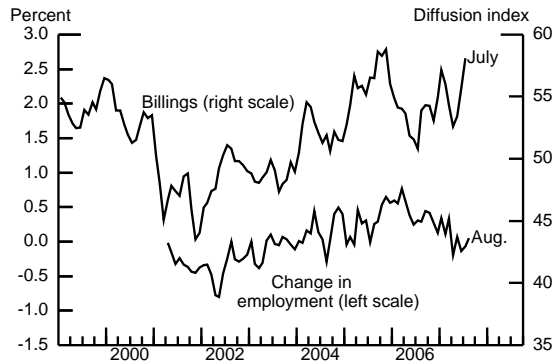


Note. Other includes religious, educational, lodging, amusement and recreation, transportation, and health-care facilities.

Manufacturing and Power & Communication

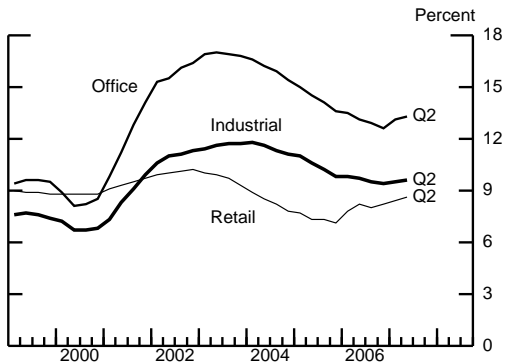


Architectural Billings and Nonresidential Construction Employment



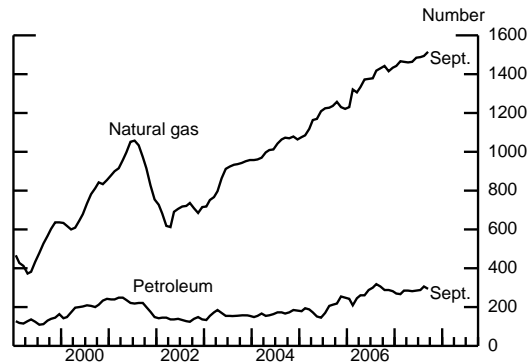
Note. Both series are 3-month moving averages. Employment includes industrial, commercial, and specialty trade construction. Source. For billings, American Institute of Architects; for employment, Bureau of Labor Statistics.

Vacancy Rates



Note. Industrial space includes both manufacturing structures and warehouses. Source. Torto Wheaton Research.

Drilling Rigs in Operation



Note. The September readings are based on data through September 7, 2007. Source. DOE/Baker Hughes.

slowdown in residential construction. Aircraft spending remained at a high level in the second quarter after a surge in the first quarter, but aircraft shipments in July and information on Boeing's deliveries suggest that domestic spending on aircraft is retreating somewhat in the third quarter.

Real business investment in equipment other than high-tech and transportation bounced back strikingly in the second quarter, increasing at an annual rate of more than 11 percent after three consecutive quarterly declines. However, the level of spending in the second quarter remained somewhat below its level a year earlier. In July, imports of this broad category rose more than exports, and orders and shipments registered a robust increase, pointing to solid increases in business investment in the third quarter. In particular, shipments of industrial machinery rebounded in July after two months of declines. Moreover, after having plummeted earlier in the year, shipments of construction machinery continued to recover, apparently because of increased demand from nonresidential construction and from abroad.

Nonresidential Construction

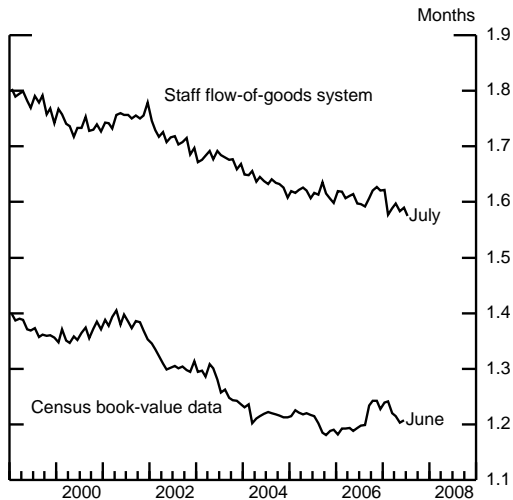
We currently estimate that real spending on construction of nonresidential buildings increased at an annual rate of close to 20 percent in the second quarter. Data for the third quarter are limited, but the nonfinancial fundamentals remain generally solid. Vacancy rates in this sector are lower than their averages of the past five years despite having edged up in recent quarters. Furthermore, the three-month moving average of the architectural billings index—which is well correlated to spending six months hence—was at a high level in July, pointing to strong gains into early next year. However, this rosy outlook is tempered by the recent turmoil in credit markets. Spreads on BBB-rated commercial-mortgage-backed securities (CMBS) have risen 94 basis points since early August. Although CMBS do not generally include construction loans, the higher cost of secondary market financing may put downward pressure on prices of existing commercial real estate, thereby discouraging new construction projects.

Nonfarm Inventory Investment
(Billions of dollars; seasonally adjusted annual rate)

Measure and sector	2006	2007				
	Q4	Q1	Q2	May	June	July
<i>Real inventory investment (chained 2000 dollars)</i>						
Total nonfarm business	13.6	-5.8	-1.4^e	n.a.	n.a.	n.a.
Motor vehicles	-16.8	-14.7	-10.2	n.a.	n.a.	n.a.
Nonfarm ex. motor vehicles	30.4	8.9	8.9 ^e	n.a.	n.a.	n.a.
Manufacturing and trade ex. wholesale and retail motor vehicles and parts						
Manufacturing	-1.8	-5.0	-3.9	-3.8	-7.5 ^e	n.a.
Wholesale trade ex. motor vehicles & parts	5.3	4.3	6.4	-.8	1.9	n.a.
Retail trade ex. motor vehicles & parts	11.3	1.8	8.5	20.6	3.0	n.a.
<i>Book-value inventory investment (current dollars)</i>						
Manufacturing and trade ex. wholesale and retail motor vehicles and parts	39.4	33.9	60.3	69.6	33.9	n.a.
Manufacturing	7.3	4.8	21.6	24.7	13.7	10.0
Wholesale trade ex. motor vehicles & parts	17.5	22.0	20.6	16.6	10.3	19.3
Retail trade ex. motor vehicles & parts	14.6	7.2	18.0	28.3	9.9	n.a.

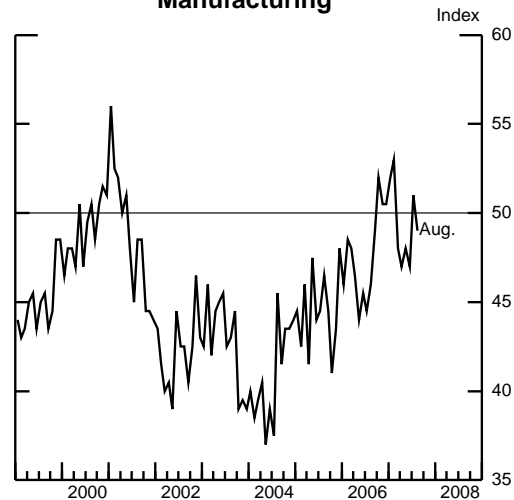
^e Staff estimate of real inventory investment based on revised book-value data.
n.a. Not available.
Source. For real inventory investment, BEA; for book-value data, Census Bureau.

Inventory Ratios ex. Motor Vehicles



Note. Flow-of-goods system covers total industry ex. motor vehicles and parts, and inventories are relative to consumption. Census data cover manufacturing and trade ex. motor vehicles and parts, and inventories are relative to sales.

ISM Customer Inventories: Manufacturing



Note. A number above 50 indicates inventories are "too high."

The BEA's preliminary estimate of activity in the drilling and mining sector jumped at an annual rate of 48 percent in the second quarter after a small decline in the first quarter. The second-quarter increase stands in contrast with incoming data for the number of rigs in operation, which registered only a small rise in the second quarter.⁹ Gains in the number of rigs in operation remained modest in July and August, suggesting that investment early in the third quarter has been little changed. Looking forward, anecdotes in the most recent Beige Book suggest that incentives for further expansion of natural gas drilling have been damped by recent price declines and persistently high inventories.

Business Inventories

Real nonfarm inventory investment excluding motor vehicles increased at a moderate annual rate of \$9 billion last quarter, the same as in the first quarter. Book-value data for the manufacturing and wholesale trade sectors point to a somewhat slower pace of inventory accumulation in July. The ratio of book-value inventories to sales in the manufacturing and trade sector, excluding motor vehicles, changed little in June after declining in previous months from the elevated levels seen in late 2006. Information from the staff's flow-of-goods inventory system suggests that the months' supply of goods excluding motor vehicles and parts edged down in July. Purchasing managers do not appear to see a problem with the level of their customers' inventories, as the ISM customers' inventories index moved back below 50 in August.

Federal Government Sector

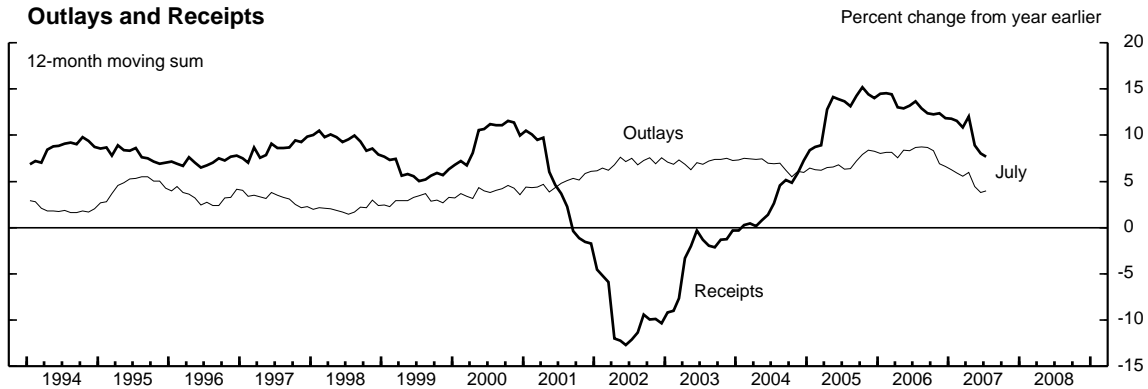
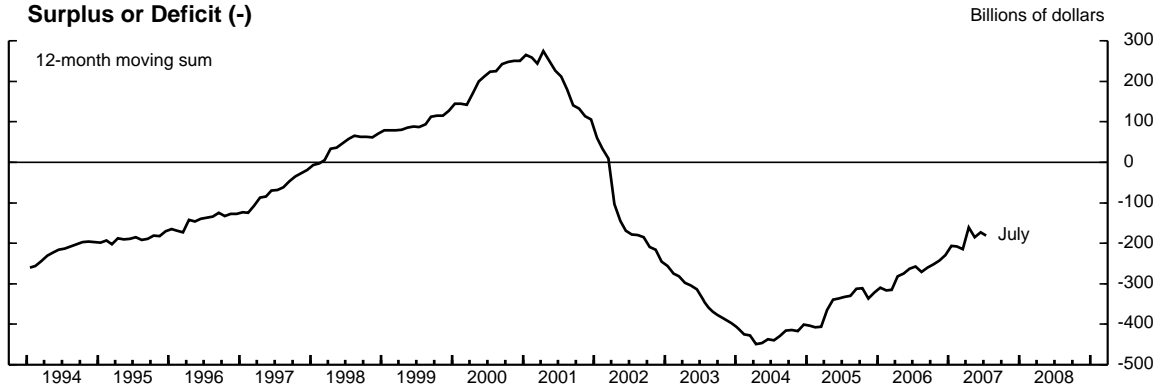
After having declined steadily in the past three years, the federal budget deficit has leveled off in recent months, as receipts have decelerated a bit more than outlays. For the twelve months ending in July 2007, the deficit (adjusted for payment-timing shifts and financial transaction) was \$180 billion, or approximately 1¼ percent of nominal GDP.¹⁰

Although receipts have been rising more slowly recently, revenues in July still were almost 7 percent above their year-earlier level. Individual income and payroll tax revenues, which made up the bulk of receipts in July, were a robust 8 percent above their

⁹ To form its quarterly judgmental estimates of real spending in this category, the BEA extrapolates the quantity of drilling forward by using proprietary data from the American Petroleum Institute (API) on footage drilled and estimated cost per foot, a second measure of footage drilled from the Department of Energy, and the number of drilling rigs in operation from Baker Hughes. The proprietary data from the API receive about 60 percent of the weight in this calculation and are not available to the staff.

¹⁰ The Congressional Budget Office released an update of its budget outlook on August 23 that projected the unadjusted deficit for fiscal 2007 to be \$158 billion, which is lower than its estimate of \$177 billion in March, primarily because of greater-than-expected receipts.

Federal Government Budget
(Unified basis; adjusted for payment-timing shifts and financial transactions; data from Monthly Treasury Statement)



Recent Federal Outlays and Receipts

(Billions of dollars except as noted)

Function or source	July			12 months ending in July		
	2006	2007	Percent change	2006	2007	Percent change
Outlays						
Outlays	208.4	226.0	8.4	2,634.3	2,739.3	4.0
Net interest	22.1	24.0	8.8	218.6	236.4	8.1
National defense	41.6	46.7	12.4	519.2	556.6	7.2
Major transfers ¹	109.5	118.4	8.1	1,412.2	1,499.5	6.2
Other	31.7	33.4	5.3	452.3	420.2	-7.1
Receipts						
Receipts	159.8	170.4	6.7	2,376.6	2,559.0	7.7
Individual income and payroll taxes	131.6	142.3	8.1	1,821.1	1,966.9	8.0
Corporate	10.1	9.6	-4.1	333.6	381.9	14.5
Other	18.1	18.5	2.3	221.9	210.2	-5.2
Surplus or deficit (-)						
Surplus or deficit (-)	-48.7	-55.5	...	-257.7	-180.3	...

1. Includes Social Security, Medicare, Medicaid, and income security programs.

... Not applicable.

level a year earlier. In contrast, corporate tax payments were a little below their year-earlier level. Data from Daily Treasury Statements indicate that individual income and payroll receipts continued to rise at a solid pace in August, but that corporate revenues remained below their level twelve months earlier.

Federal spending also has been slowing over the past year, but in July outlays rose briskly to a level more than 8 percent above their year-earlier level. In particular, defense spending in July was more than 12 percent higher than the level a year earlier. Nevertheless, federal spending cumulated over the twelve months ending in July was up only 4 percent from its level in the year-earlier period.

Since returning from its recess, the Congress has continued to work on the annual appropriations bills necessary to fund discretionary federal spending in fiscal 2008, which begins October 1. So far, the House has passed all of the twelve appropriations bills, but the Senate has only passed five, and none has been enacted. A continuing resolution will be needed to fund agencies covered by appropriations bills that have not been enacted by the start of the new fiscal year.

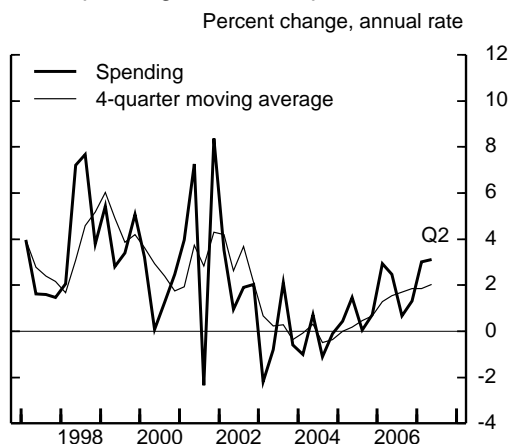
State and Local Government Sector

Taken at face value, the incoming data point to very weak state and local purchases in the third quarter. According to the most recent employment report, state and local employment fell 26,000 in August after having dropped 58,000 in July. Much of the recent weakness is in local education, where employment is reported to have fallen a cumulative 100,000 between May and August after having increased substantially between mid-2006 and the spring of this year. Given the usual volatility of these data in summer months—as well as their apparent inconsistency with other information on activity in the sector—we would not be surprised to see either significant upward revisions to the published data or a dramatic rebound in hiring in September. Meanwhile, real construction spending appears to have retained considerable vigor in July after having risen appreciably in the first half of the year.

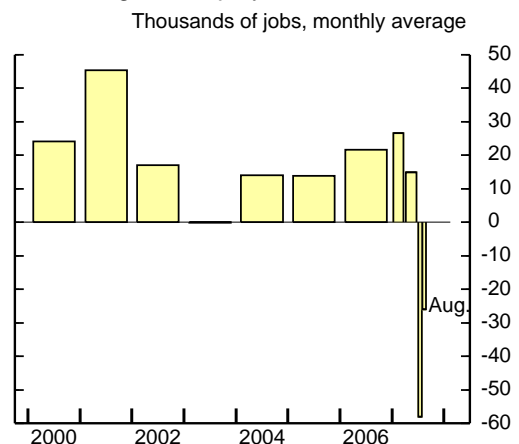
On the whole, state fiscal positions remain sound. The preliminary *State Budget & Tax Actions 2007* report from the National Conference of State Legislatures (NCSL) suggests that states in the aggregate experienced a hefty increase in general-fund spending in fiscal 2007 (which ended on June 30 in most states) but still finished the year with sizable

State and Local Indicators

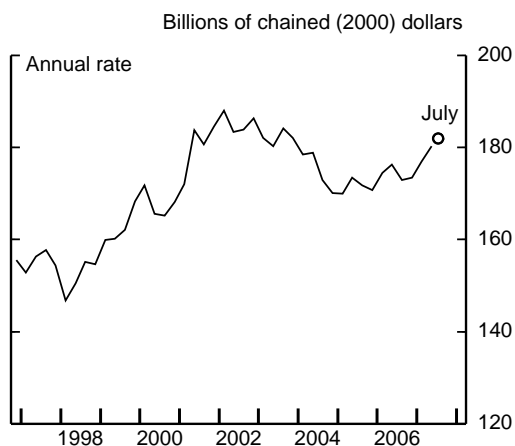
Real Spending on Consumption & Investment



Net Change in Employment

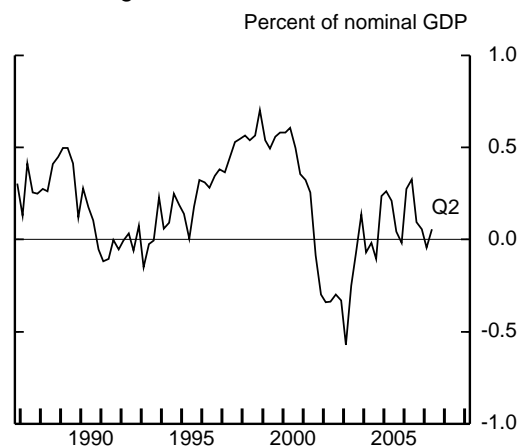


Real Construction

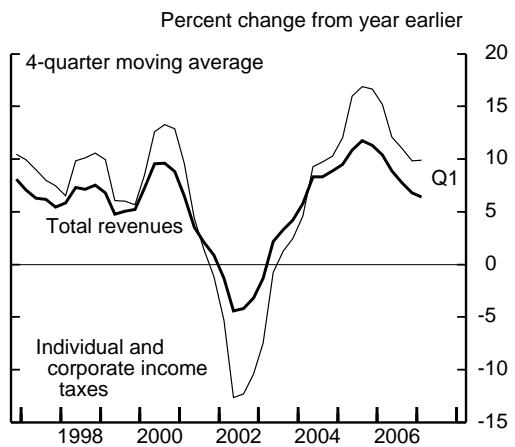


Note. Nominal CIPIP deflated by BEA prices through Q2 and by a staff projection thereafter.

Net Saving

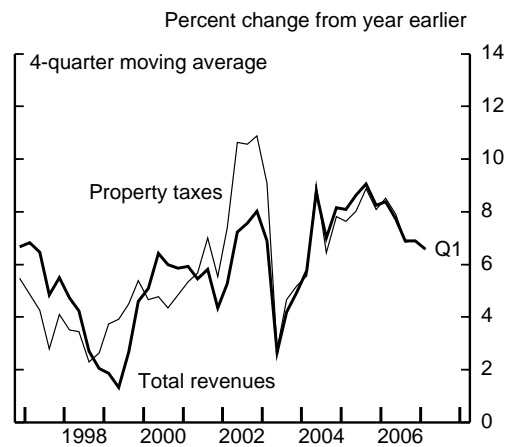


State Revenues



Source. Census Bureau.

Local Revenues



Source. Census Bureau.

balances in their reserve funds.¹¹ That said, current fiscal conditions do not have the luster that was evident a year ago, mainly because revenue inflows have tapered off after a period of outsized increases.¹² According to the NCSL, aggregate reserve balances at the end of fiscal 2007 were somewhat smaller than those at the end of fiscal 2006, and with spending slated to rise moderately in fiscal 2008 (and revenues expected to remain subdued), reserves may decline further over the coming year. Moreover, several states are concerned about budget prospects beyond the current fiscal year. For example, California adopted a budget in late August that is expected to be balanced for fiscal 2008; however, if current policies remain in place, the state is likely to face significant operating shortfalls in 2009 and 2010.

Prices

After rapid increases earlier this year, headline consumer price inflation was moderate in both June and July as energy prices fell. Over the twelve months ending in July, total PCE prices were up about 2 percent, down from the 3½ percent increase posted over the previous twelve months. Excluding food and energy, PCE inflation also has been moderate in recent months, although it has drifted up a touch from its very low rates this spring. Despite the recent volatility in energy prices, long-run inflation expectations have remained within the range that has prevailed during much of the past few years.

Core PCE prices rose 0.2 percent in June and 0.1 percent in July. Although quite modest, these increases were enough to cause the three-month change in core PCE prices to edge up to 1.6 percent in July from 1.1 percent in May. The latest three-month change was boosted by prices of apparel and housing services, both of which moved up after low readings in the spring. On a twelve-month-change basis, core PCE inflation has decelerated from 2.3 percent in July 2006 to 1.9 percent in July 2007. Step-downs in price inflation for prescriptions drugs, motor vehicles, and nonmarket services account for nearly all of the deceleration in core PCE prices. Although owners' equivalent rent decelerated over the past year, this change was largely offset by an acceleration in tenants' rent and lodging away from home; on balance, changes in the prices of housing

¹¹ The NCSL tabulation is based on information from the forty-five states that had fiscal 2008 budgets in place as of late July. It is missing information from California, Illinois, Michigan, North Carolina, and Wisconsin, which together account for more than one-fourth of state general-fund totals.

¹² According to unpublished preliminary estimates from the Rockefeller Institute, state tax collections increased 5 percent on a year-over-year basis in the second quarter of 2007 after having posted double-digit increases over the preceding three years. Personal income taxes rose 8 percent on a year-over-year basis in the second quarter, whereas sales taxes and corporate income taxes each rose about 2 percent.

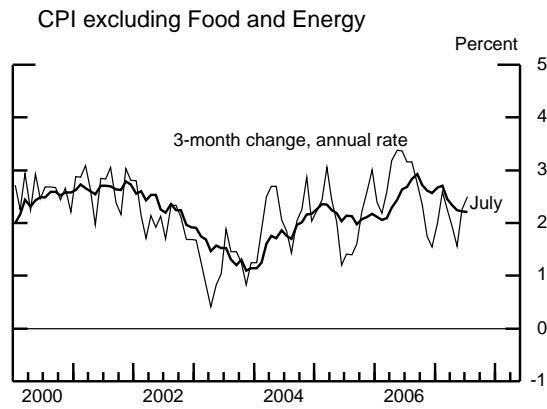
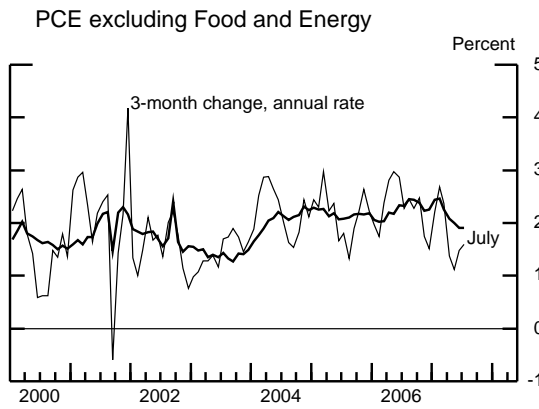
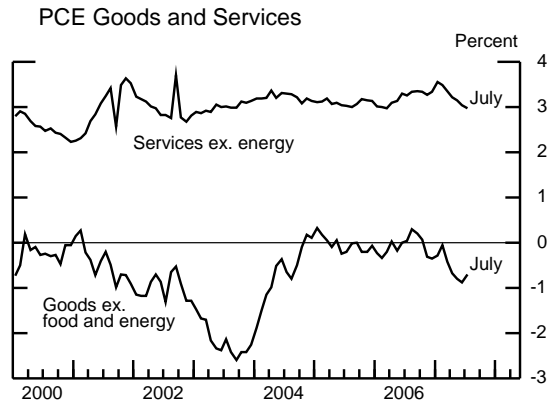
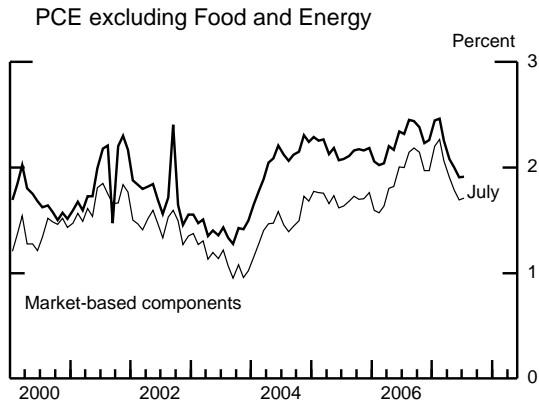
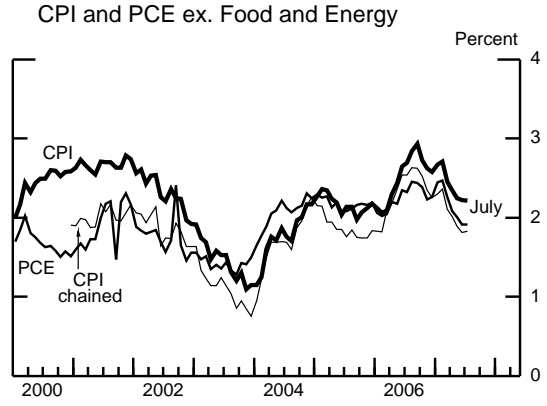
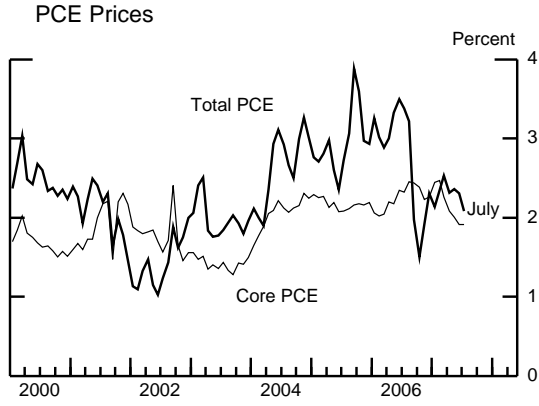
Price Measures
(Percent change)

Measures	12-month change		3-month change		1-month change	
	July 2006	July 2007	Annual rate		Monthly rate	
			Apr. 2007	July 2007	June 2007	July 2007
<i>CPI</i>						
Total	4.1	2.4	5.7	4.0	.2	.1
Food	2.2	4.2	6.1	4.4	.5	.3
Energy	20.5	1.0	43.3	16.0	-.5	-1.0
Ex. food and energy	2.7	2.2	1.9	2.5	.2	.2
Core goods	.5	-.6	-.5	-.1	-.1	.1
Core services	3.5	3.3	2.9	3.5	.3	.3
Shelter	3.6	3.7	2.6	3.9	.4	.3
Other services	3.4	2.9	2.9	3.4	.3	.3
Chained CPI (n.s.a.) ¹	3.5	2.1	...	...	...	...
Ex. food and energy ¹	2.5	1.8	...	...	...	...
<i>PCE prices</i>						
Total	3.4	2.1	4.1	2.9	.2	.1
Food and beverages	2.3	3.9	5.4	4.7	.5	.3
Energy	21.7	.6	46.3	16.3	-.6	-1.1
Ex. food and energy	2.3	1.9	1.4	1.6	.2	.1
Core goods	.0	-.7	-1.0	-.9	-.1	.1
Core services	3.3	3.0	2.4	2.6	.3	.2
Shelter	3.7	3.5	3.1	2.9	.3	.2
Other services	3.1	2.8	2.1	2.5	.3	.1
Core market-based	2.0	1.7	1.3	1.3	.1	.1
Core non-market-based	3.7	2.8	1.5	3.0	.3	.2
<i>PPI</i>						
Total finished goods	4.0	4.0	12.8	5.2	-.2	.6
Food	1.3	6.2	16.3	-4.2	-.8	-.1
Energy	16.7	6.6	48.5	24.1	-1.1	2.5
Ex. food and energy	.8	2.3	1.8	2.5	.3	.1
Core consumer goods	.7	2.4	1.9	3.1	.3	.2
Capital equipment	1.0	2.3	1.9	1.6	.3	.1
Intermediate materials	8.7	4.1	12.5	9.3	.5	.6
Ex. food and energy	7.9	2.4	5.7	4.4	.4	.2
Crude materials	6.2	13.1	60.8	15.1	.3	1.2
Ex. food and energy	36.3	8.9	49.5	-.1	-.2	.0

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

... Not applicable.

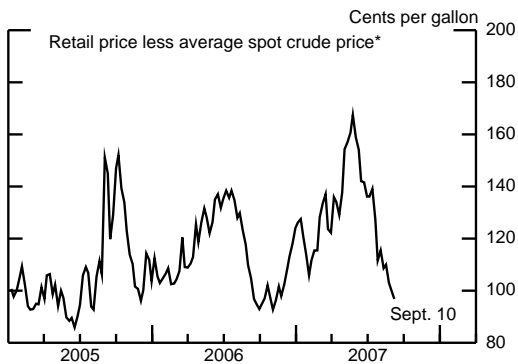
Consumer Prices (12-month change except as noted)



Energy Prices and Inventories

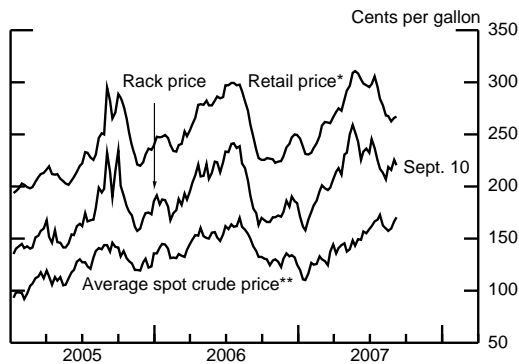
(Data from Energy Information Administration except as noted)

Total Gasoline Margin



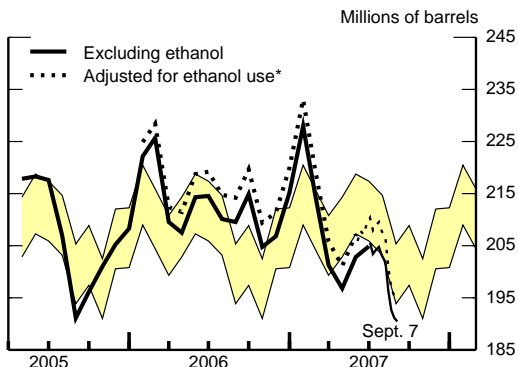
* Regular grade seasonally adjusted by FRB staff, less average spot crude price: 60% WTI, 40% Maya heavy crude.

Gasoline Price Decomposition



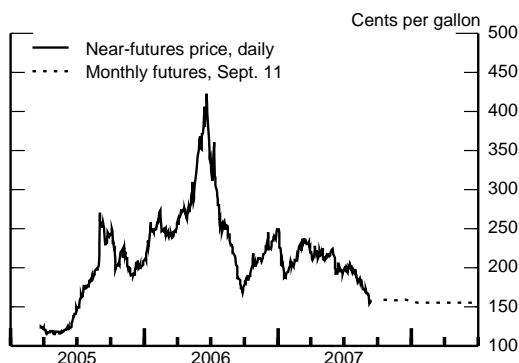
* Regular grade seasonally adjusted by FRB staff.
** 60% WTI, 40% Maya heavy crude.

Gasoline Inventories



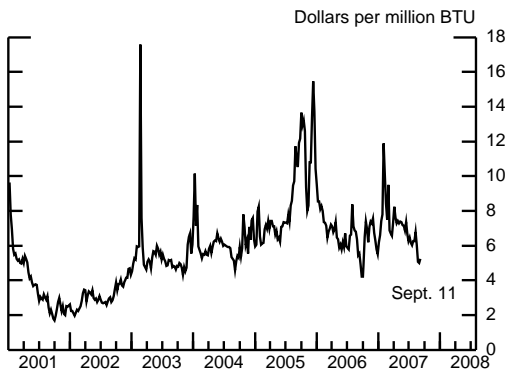
Note. Shaded region is average historical range as calculated by DOE. Monthly data through June 2007, weekly data thereafter, as indicated by line weights.
* Adjustment for approximate amount of fuel ethanol to be blended with RBOB component of inventories; estimated by FRB staff.

Ethanol Prices



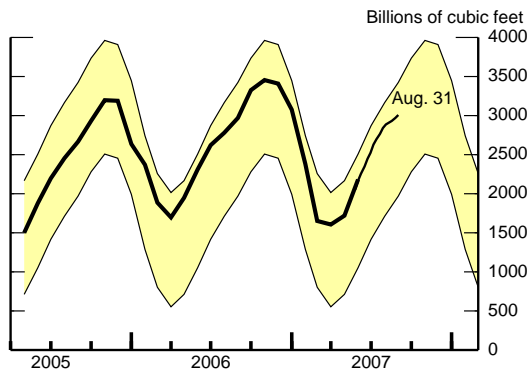
Source. Chicago Board of Trade.

Natural Gas Prices



Note. National average spot price.
Source. Bloomberg.

Natural Gas Inventories



Note. Shaded region is defined as 5-year average plus seasonal factors +/- 1 standard deviation. Monthly data through May 2007, weekly data thereafter, as indicated by line weights.

services were not an important contributor to the past year's deceleration in core PCE inflation.

Energy prices declined 1 percent in July after having fallen ½ percent in June. Gasoline prices moved down 1¾ percent in July and appear to have dropped even more in August, even though inventories remain near the low end of their normal range. These recent declines in gasoline prices have coincided with a sharp narrowing of the margin between retail gasoline prices and crude oil prices and their move to more-normal levels after reaching record highs in May. Despite some large swings, PCE energy prices as of July stood only ½ percent higher than their year-earlier level. In contrast, energy-price increases ranged from 14 percent to 22 percent in each of the preceding three years.

In July, food prices continued their string of sizable increases observed since January. Some of this year's increase reflects the difficulty of quickly expanding livestock herds and flocks, which had been pruned earlier in response to low prices, but a significant portion of the step-up appears to be a pass-through of high corn prices, which have been boosted by strong demand for ethanol. Corn prices have fallen back over the past few months, although the spot price remains about 40 percent higher than it was a year ago. Prices of some other grains, including wheat and soybeans, have surged as well, because output was reduced by adverse weather and a shift of acreage to corn production. Over the twelve months ending in July, the PCE price index for food and beverages has increased 4 percent, compared with a rise of 2¼ percent in the previous year. The acceleration has been most apparent for comestibles for which corn is a major input; for instance, beef prices in July were up 6½ percent from a year earlier, poultry prices were up nearly 8 percent, milk prices had jumped 18 percent, and egg prices had surged 34 percent. By contrast, for food in purchased meals—a relatively stable component of consumer price inflation for which labor is a much larger share of overall costs—prices were 3½ percent higher in July than a year earlier, an acceleration of only about ½ percentage point from the previous twelve months.

Measures of inflation expectations remain moderate. As measured by the Reuters/Michigan survey, the median expectation for year-ahead inflation declined to 3.2 percent in August—still 0.2 percentage point above its level at the turn of the year—and the median expectation over the next five to ten years fell to 2.9 percent, the low end of the range seen in the past couple of years. Readings on inflation expectations over the next ten years in the Survey of Professional Forecasters were mixed: CPI expectations were unchanged in August, at 2.4 percent, while PCE price expectations—used in the FRB/US model—edged up to 2.1 percent. Five-year inflation compensation derived

Broad Measures of Inflation
(Percent change, Q2 to Q2)

Measure	2004	2005	2006	2007
<i>Product prices</i>				
GDP price index	2.9	3.0	3.5	2.7
Less food and energy	2.7	3.1	3.3	2.5
Nonfarm business chain price index	2.2	3.2	3.5	2.0
<i>Expenditure prices</i>				
Gross domestic purchases price index	3.1	3.4	3.8	2.5
Less food and energy	2.7	3.0	3.1	2.3
PCE price index	2.8	2.6	3.3	2.3
Less food and energy	2.1	2.1	2.2	2.0
PCE price index, market-based components	2.4	2.4	3.2	2.2
Less food and energy	1.5	1.7	1.9	1.8
CPI	2.8	2.9	4.0	2.7
Less food and energy	1.8	2.2	2.4	2.3
Chained CPI	2.7	2.6	3.4	2.3
Less food and energy	1.7	1.9	2.4	1.9
Median CPI	2.4	2.3	2.9	3.2
Trimmed mean CPI	2.1	2.2	2.7	2.7
Trimmed mean PCE	2.3	2.3	2.7	2.4

Surveys of Inflation Expectations
(Percent)

Period	Actual CPI inflation ¹	Reuters/Michigan Survey				Professional forecasters (10 years) ⁴
		1 year ²		5 to 10 years ³		
		Mean	Median	Mean	Median	
2005:Q4	3.7	4.6	3.7	3.5	3.1	2.5
2006:Q1	3.6	3.7	3.0	3.3	2.9	2.5
Q2	4.0	4.5	3.5	3.6	3.1	2.5
Q3	3.3	4.0	3.4	3.3	3.0	2.5
Q4	1.9	3.5	3.0	3.5	3.0	2.5
2007:Q1	2.4	3.6	3.0	3.4	2.9	2.4
Q2	2.7	4.2	3.3	3.5	3.0	2.4
Q3	n.a.	n.a.	n.a.	n.a.	n.a.	2.4
Apr.	2.6	4.0	3.3	3.6	3.1	...
May	2.7	4.3	3.3	3.7	3.1	2.4
June	2.7	4.2	3.4	3.3	2.9	...
July	2.4	4.2	3.4	3.6	3.1	...
Aug.	n.a.	4.0	3.2	3.4	2.9	2.4

1. Percent change from the same period in the preceding year.

2. Responses to the question, By about what percent do you expect prices to go up, on average, during the next 12 months?

3. Responses to the question, By about what percent per year do you expect prices to go up, on average, during the next 5 to 10 years?

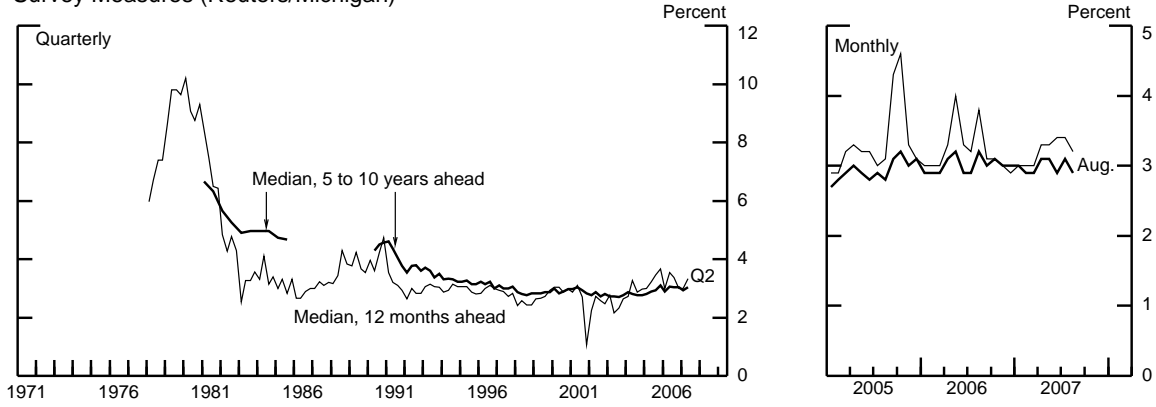
4. Quarterly CPI projections compiled by the Federal Reserve Bank of Philadelphia.

... Not applicable.

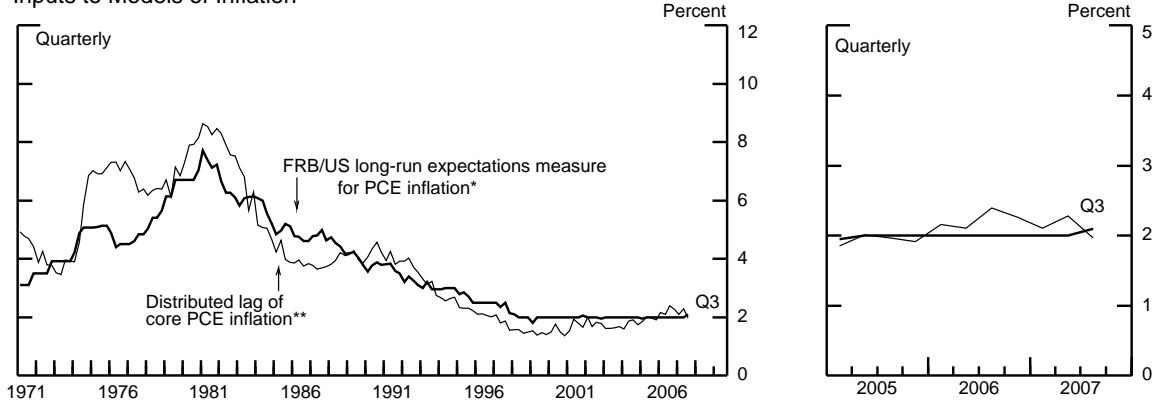
n.a. Not available.

Measures of Expected Inflation

Survey Measures (Reuters/Michigan)

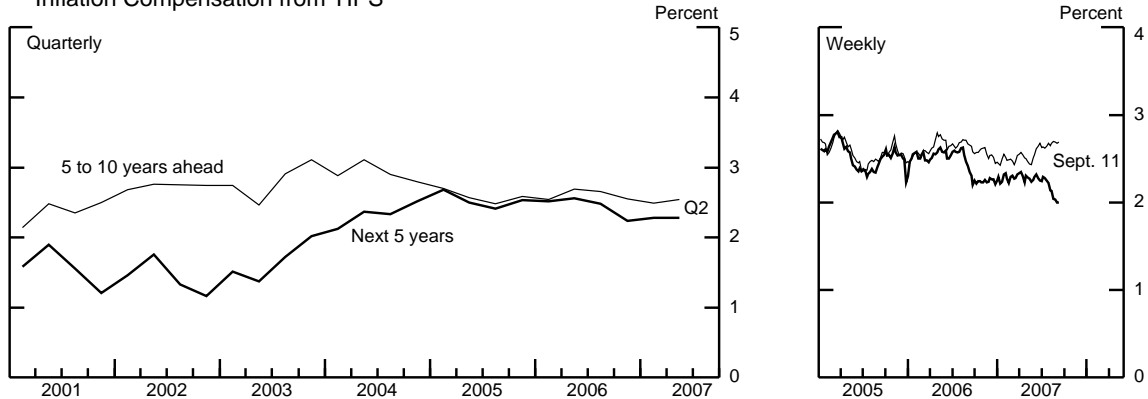


Inputs to Models of Inflation



*For 2007 forward, the median projection for PCE inflation over the next 10 years from the Survey of Professional Forecasters (SPF); for 1991 to 2006, the equivalent SPF projection for the CPI; for 1981 to 1991, a related survey for the CPI conducted by Richard Hoey; and for the period preceding 1981, a model-based estimate constructed by Board staff. The survey data before 2007 are adjusted down 0.5 percentage point to put the CPI projections approximately on a PCE basis.
 **Derived from one of the reduced-form Phillips curves used by Board staff.

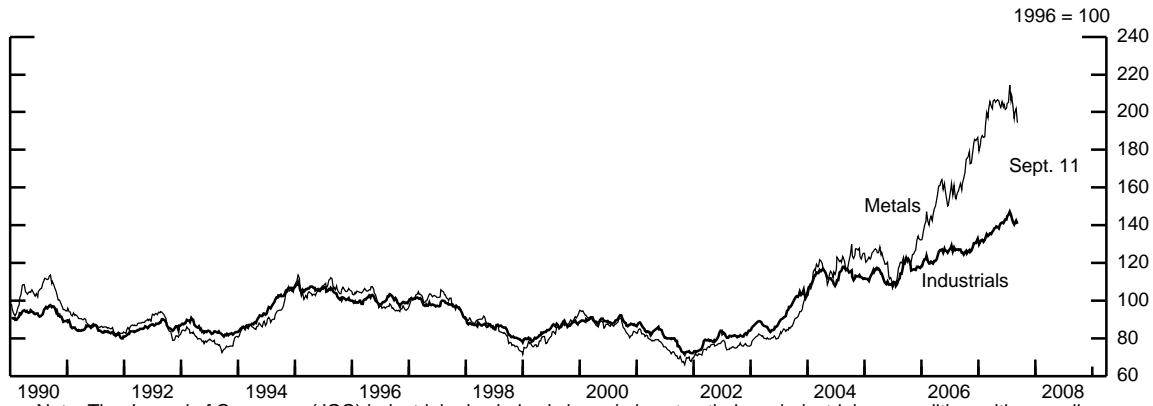
Inflation Compensation from TIPS



Note. Based on a comparison of an estimated TIPS yield curve with an estimated nominal off-the-run Treasury yield curve, with an adjustment for the indexation-lag effect.

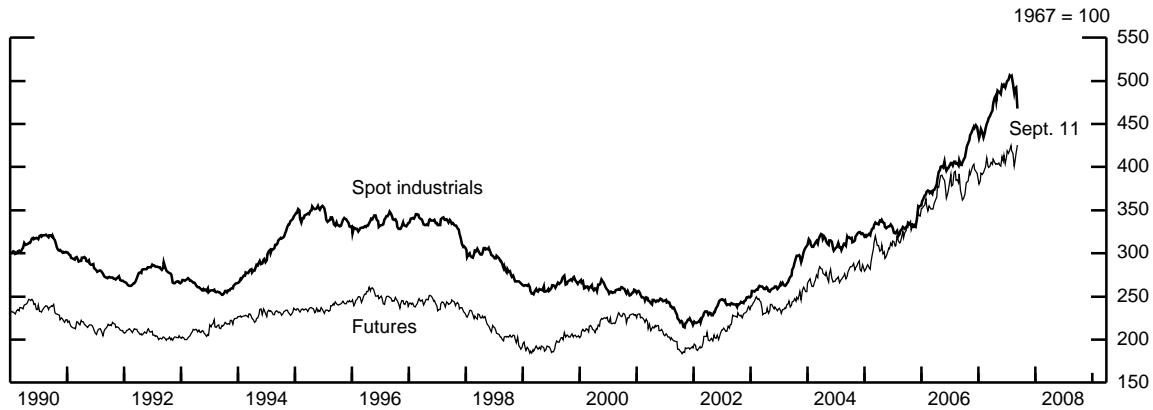
Commodity Price Indexes

Journal of Commerce



Note. The *Journal of Commerce* (JOC) industrial price index is based almost entirely on industrial commodities, with a small weight given to energy commodities. Copyright for *Journal of Commerce* data is held by CIBCR, 1994.

Commodity Research Bureau



Note. The Commodity Research Bureau (CRB) spot industrials 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.

Selected Commodity Price Indexes (Percent change)

Index	2006 ¹	12/19/06 to 7/31/07 ²	7/31/07 ² to 9/11/07	52-week change to 9/11/07
JOC industrials	11.0	11.6	-3.3	10.8
JOC metals	38.9	11.7	-5.8	19.8
CRB spot industrials	26.9	12.7	-7.4	16.3
CRB spot foodstuffs	13.0	19.3	.3	20.5
CRB futures	15.0	7.3	.2	14.0

1. From the last week of the preceding year to the last week of the year indicated.
2. July 31, 2007, is the Tuesday preceding publication of the August Greenbook.

from TIPS ticked down since the time of the August Greenbook, but forward inflation compensation over the subsequent five years is unchanged.

Price increases for goods at earlier stages of processing have slowed recently. The PPI for core intermediate materials increased 0.2 percent in July, to a level only 2½ percent above its level a year earlier; the modest rise was considerably less than the 8 percent increase over the preceding twelve months, as prices for most energy-intensive products have decelerated over the past year. Since the August Greenbook, commodity prices have dropped, even though they remain considerably higher than their year-earlier levels. The *Journal of Commerce* index of industrial materials has fallen ¾ percent since the August Greenbook, and the Commodity Research Bureau's index of industrial spot prices has dropped 7½ percent.

Labor Costs

Compensation per hour in the nonfarm business sector rose at an annual rate of 4 percent in the second quarter after having increased at an upward-revised rate of 6 percent in the first quarter. The increase over the past four quarters—5¾ percent—is noticeably above the increase in the preceding four quarters and also well above the increase seen in the employment cost index (ECI) over the same period.¹³ Combined with the deceleration in output per hour, the compensation data imply that unit labor costs have continued to accelerate, with the change over the four quarters ending in 2007:Q2 at 5 percent. As a result, the markup of nonfarm business prices over unit labor costs has fallen back from its peak at the end of last year, although it remains above its long-run average.

More recently, average hourly earnings of production or nonsupervisory workers increased 0.3 percent in both July and August, putting the twelve-month change in this measure of wages at 3.9 percent, only a little below the change for the twelve months ending in August 2006.

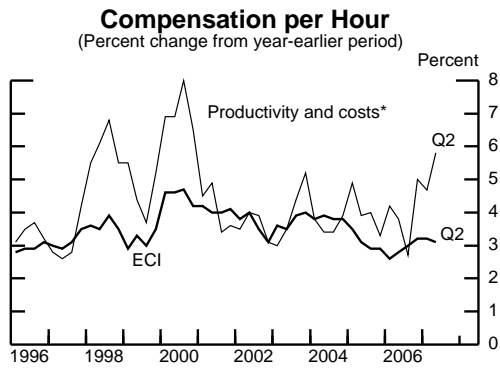
¹³ In the preliminary GDP release, the BEA revised downward its estimate of bonuses that accrued in the fourth quarter. However, because the BEA will not revise its fourth-quarter NIPA estimates until the next annual revision, the published levels of compensation per hour and unit labor costs for the fourth quarter of 2006 and onward will be overstated. As a result, the current four-quarter changes in these series are overstated by 0.4 percentage point.

Hourly Compensation and Unit Labor Costs

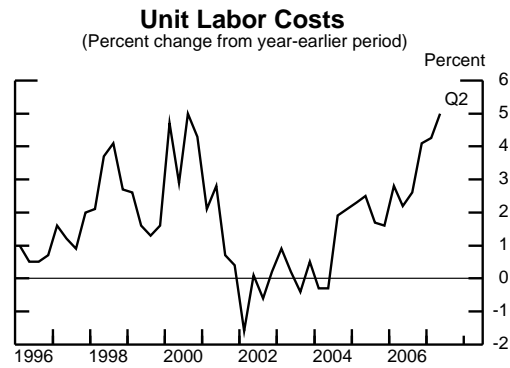
(Percent change from preceding period at compound annual rate; based on seasonally adjusted data)

Category	2005:Q2 to 2006:Q2	2006:Q2 to 2007:Q2 ^e	2006		2007	
			Q3	Q4	Q1	Q2 ^e
<i>Compensation per hour</i> Nonfarm business	3.8	5.8	1.3	12.2	5.9	4.1
<i>Unit labor costs</i> Nonfarm business	2.2	5.0	2.9	10.3	5.2	1.8

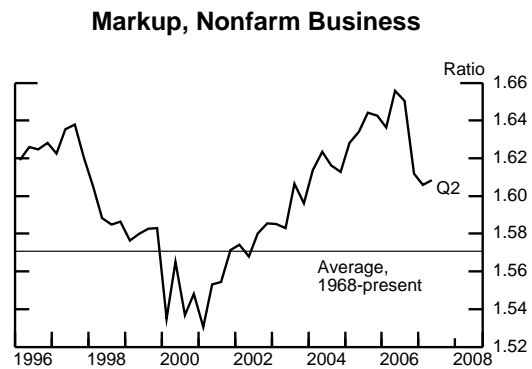
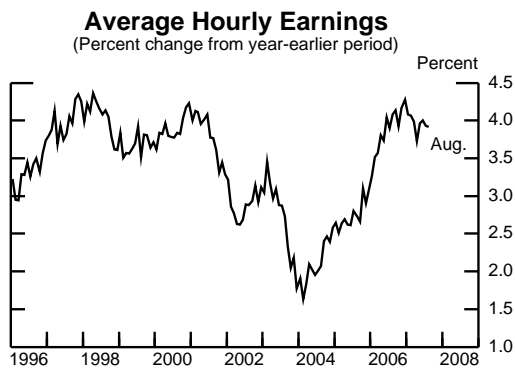
e Staff estimate.



* Value for 2007:Q2 is a staff estimate.



Note. Value for 2007:Q2 is a staff estimate.



Note. The markup is the ratio of output price to unit labor costs. Value for 2007:Q2 is a staff estimate.

Domestic Financial Developments

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

Instrument	2004	2006	2007		Change to Sept. 11 from selected dates (percentage points)		
	June 28	June 29	Aug. 6	Sept. 11	2004 June 28	2006 June 29	2007 Aug. 6
<i>Short-term</i>							
FOMC intended federal funds rate	1.00	5.25	5.25	5.25	4.25	.00	.00
Treasury bills ¹							
3-month	1.36	4.88	4.74	4.00	2.64	-.88	-.74
6-month	1.74	5.06	4.72	4.11	2.37	-.95	-.61
Commercial paper (A1/P1 rates) ²							
1-month	1.28	5.27	5.26	5.31	4.03	.04	.05
3-month	1.45	5.37	5.29	5.48	4.03	.11	.19
Large negotiable CDs ¹							
3-month	1.53	5.47	5.34	5.72	4.19	.25	.38
6-month	1.82	5.59	5.27	5.51	3.69	-.08	.24
Eurodollar deposits ³							
1-month	1.29	5.33	5.33	5.85	4.56	.52	.52
3-month	1.51	5.49	5.35	5.85	4.34	.36	.50
Bank prime rate	4.00	8.25	8.25	8.25	4.25	.00	.00
<i>Intermediate- and long-term</i>							
U.S. Treasury ⁴							
2-year	2.88	5.26	4.49	4.00	1.12	-1.26	-.49
5-year	3.97	5.15	4.52	4.05	.08	-1.10	-.47
10-year	4.90	5.28	4.82	4.48	-.42	-.80	-.34
U.S. Treasury indexed notes ⁵							
5-year	1.60	2.51	2.43	2.00	.40	-.51	-.43
10-year	2.26	2.61	2.48	2.13	-.13	-.48	-.35
Municipal general obligations (Bond Buyer) ⁶	5.01	4.71	4.51	4.57	-.44	-.14	.06
Private instruments							
10-year swap	5.21	5.81	5.44	5.00	-.21	-.81	-.44
10-year FNMA ⁷	5.38	5.59	5.34	4.92	-.46	-.67	-.42
10-year AA ⁸	5.60	6.20	6.12	5.96	.36	-.24	-.16
10-year BBB ⁸	6.25	6.74	6.57	6.35	.10	-.39	-.22
10-year high yield ⁸	8.41	8.74	9.21	8.98	.57	.24	-.23
Home mortgages (FHLMC survey rate) ⁹							
30-year fixed	6.21	6.78	6.59	6.46	.25	-.32	-.13
1-year adjustable	4.19	5.82	5.65	5.74	1.55	-.08	.09

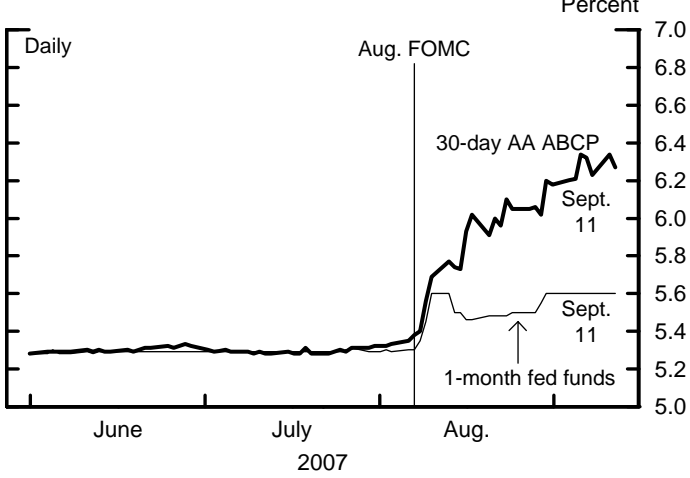
Stock exchange index	Record high		2006	2007		Change to Sept. 11 from selected dates (percent)		
	Level	Date	June 29	Aug. 6	Sept. 11	Record high	2006 June 29	2007 Aug. 6
Dow Jones Industrial	14,000	7-19-07	11,191	13,469	13,308	-4.94	18.92	-1.19
S&P 500 Composite	1,553	7-19-07	1,273	1,468	1,471	-5.25	15.60	.26
Nasdaq	5,049	3-10-00	2,174	2,547	2,597	-48.55	19.46	1.97
Russell 2000	856	7-13-07	714	766	782	-8.59	9.51	2.07
Wilshire 5000	15,701	7-13-07	12,846	14,723	14,809	-5.68	15.29	.59

1. Secondary market.
2. Financial commercial paper.
3. Bid rates for Eurodollar deposits collected around 9:30 a.m. eastern time.
4. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
5. Derived from a smoothed Treasury yield curve estimated using all outstanding securities and adjusted for the carry effect.
6. Most recent Thursday quote.
7. Constant-maturity yields estimated from Fannie Mae domestic noncallable coupon securities.
8. Derived from smoothed corporate yield curves estimated using Merrill Lynch bond data.
9. Home mortgage rates for September 11, 2007, are for the week ending September 6, 2007.

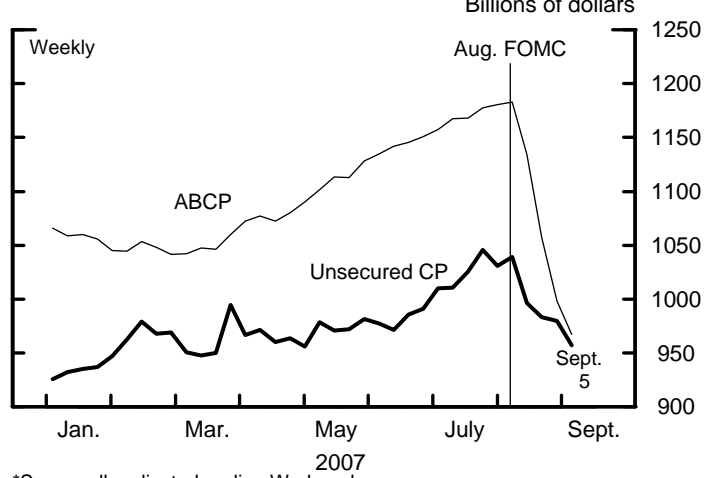
NOTES:
June 28, 2004, is the day before the most recent policy tightening began.
June 29, 2006, is the day the most recent policy tightening ended.
August 6, 2007, is the day before the most recent FOMC announcement.

III-C-1
Short-Term Funding and Interbank Markets

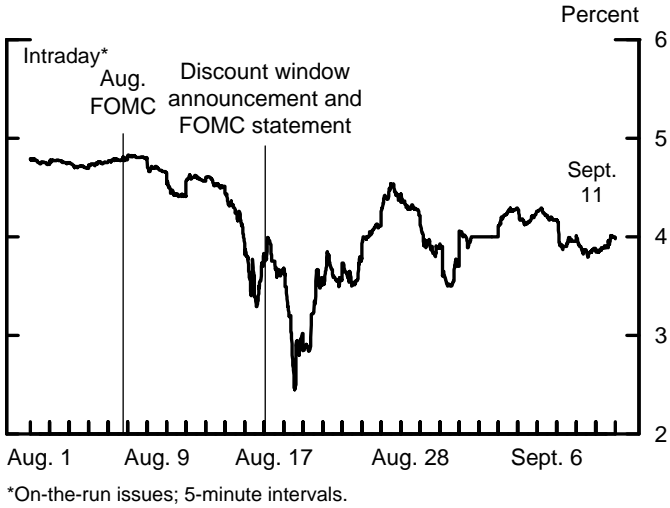
Term Fed Funds and Commercial Paper Rates



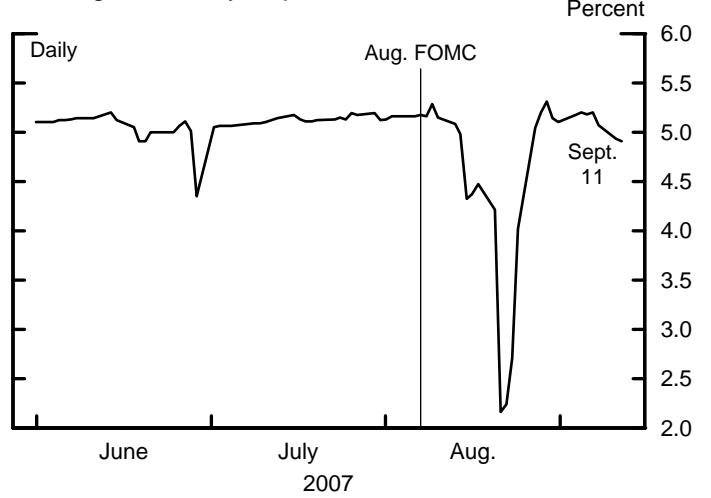
Commercial Paper Outstandings*



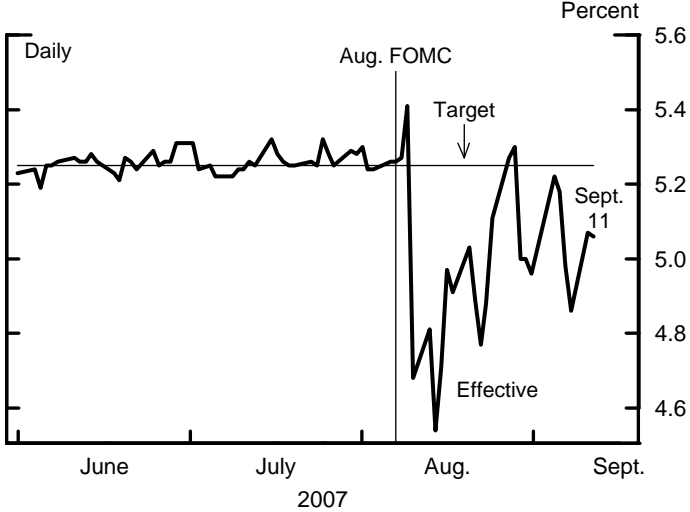
3-Month Treasury Bill Rate



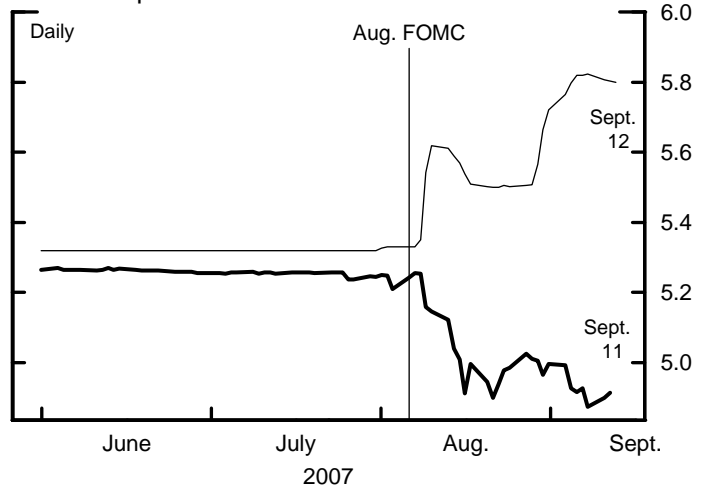
Overnight Treasury Repo Rate for General Collateral



Federal Funds Rates



1-Month Libor and 1-Month Overnight Index Swaps



Domestic Financial Developments

Overview

Amid heightened unease about exposure to subprime mortgages and about structured credit products more generally, conditions in short-term funding markets deteriorated significantly after the August 7 FOMC meeting. Rates jumped on both asset-backed commercial paper (ABCP) and unsecured commercial paper from lower-rated issuers, and the outstanding amount of paper contracted sharply. Increased desire for liquidity put upward pressure on interbank lending rates and resulted in impaired functioning in term interbank funding markets. In response, the Federal Reserve took several measures to support liquidity. These actions and announcements seemed to improve conditions in overnight markets, but considerable stress has remained in the commercial paper and term funding markets.

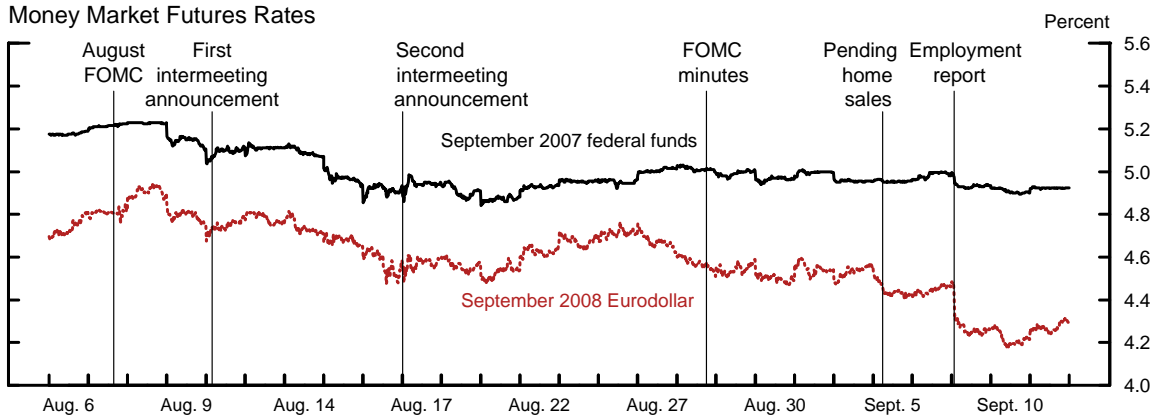
Investors significantly marked down their expected path for the federal funds rate and now appear virtually certain that the FOMC will ease policy at this meeting. Largely reflecting the change in policy expectations, two-year nominal Treasury yields declined about 50 basis points since the August 7 FOMC meeting, and ten-year yields decreased about 35 basis points. In corporate securities markets, yields on investment-grade and speculative-grade bonds declined—albeit somewhat less than Treasury yields—and equity prices were volatile but about unchanged on balance. In the household sector, securitization of nonconforming mortgages remained very limited and credit conditions tightened further for borrowers seeking those types of loans.

Money Market Functioning

Days after the August 7 FOMC meeting, U.S. and European commercial paper markets came under severe pressure after a large foreign bank suspended redemptions at some high-yield money funds it sponsored that held relatively large positions in ABCP. As yields on ABCP spiked, investors sought the relative safety of short-term Treasury securities and yields on three-month Treasury bills dropped sharply. Functioning in the bill market was notably impaired at times, with reports of exceptionally high bid-ask spreads. In the repo market, the demand for Treasury collateral increased sharply, particularly in the bill segment, and overnight repo rates for general collateral fell far below the federal funds rate. Unsecured bank funding markets also showed signs of stress, including volatile overnight interbank lending rates, elevated term interbank rates, and illiquidity in term funding markets.

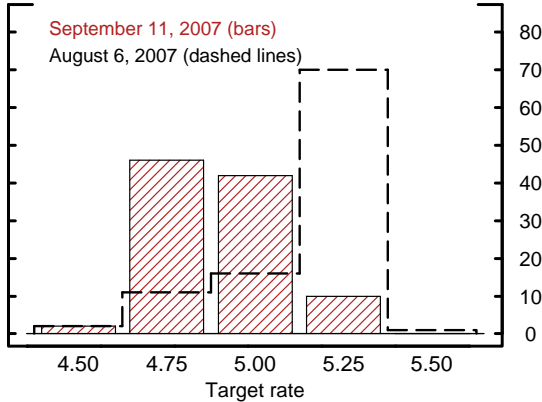
The Federal Reserve responded to strained conditions in short-term markets in a number of ways. On August 9 and 10, the Trading Desk provided significant levels of balances

Policy Expectations and Treasury Yields



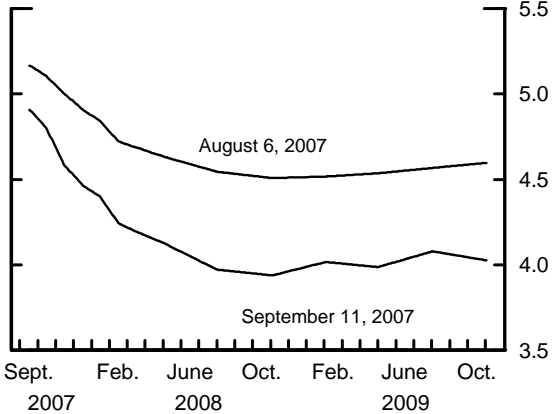
Note. 5-minute intervals. 8:00 a.m. to 4:00 p.m. No adjustments for term premiums.

Probability Density for Target Federal Funds Rate after the September Meeting



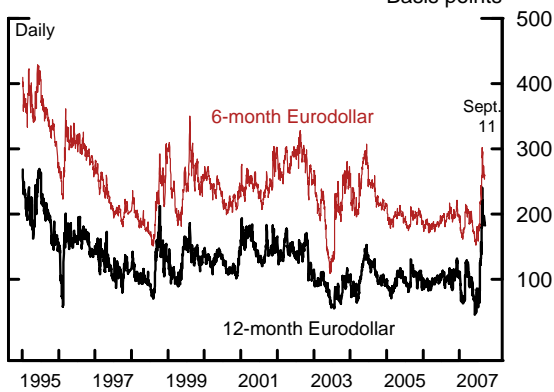
Note. Derived from binary options on target federal funds rate without term premium adjustment.

Expected Federal Funds Rates

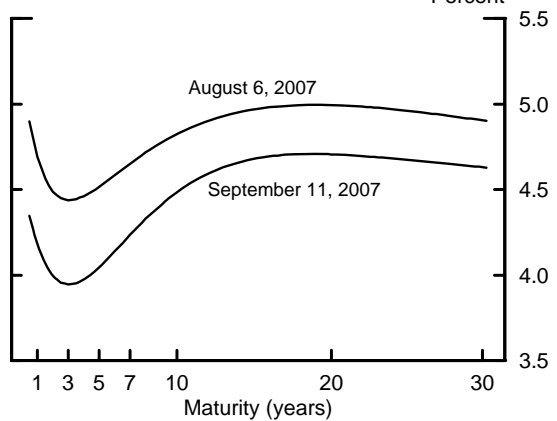


Note. Estimates from federal funds and Eurodollar futures.

Implied Volatility of Interest Rates



Treasury Yield Curve



Note. Smoothed yield curve estimated from off-the-run Treasury securities.

to the banking sector, and on August 10, the Federal Reserve announced that it would “provide reserves as necessary through open market operations to promote trading in the federal funds market” and noted that “the discount window is available as a source of funding.” On August 17, the FOMC issued a statement noting that financial market conditions had deteriorated and that “tighter credit conditions and increased uncertainty have the potential to restrain economic growth going forward.” That day, the Federal Reserve temporarily reduced the primary credit rate 50 basis points and announced changes in practices to allow the provision of term primary credit to large as well as small depository institutions. Later, the Federal Reserve clarified the acceptability of some ABCP as collateral for discount window borrowing, and, to help ease pressures in the bill market, the Trading Desk announced a temporary reduction—from 100 basis points to 50 basis points—in the minimum fee for borrowing securities from the SOMA Securities Lending Facility.

These actions by the Federal Reserve reportedly helped improve conditions in the Treasury bill market and in overnight funding markets. For example, the spread between the federal funds rate and the corresponding Treasury general collateral rate has returned to more normal levels. Although the level of the effective federal funds rate has remained somewhat below the target rate, trading liquidity in the overnight federal funds market has appeared ample, with record levels of brokered volumes. In contrast to overnight money markets, liquidity in term funding markets has remained poor and term premiums in short-dated securities have been quite elevated. In addition, the spread between one-month libor and overnight index swaps has stayed exceptionally wide, suggesting a persistent reluctance among banks to commit term funds.¹

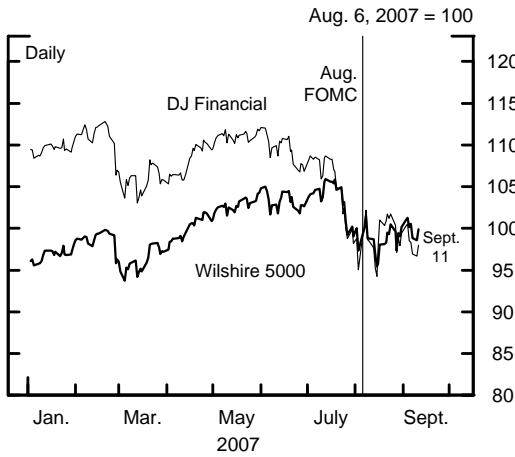
Interest Rates and Policy Expectations

Over the intermeeting period, ongoing developments in short-term credit markets and a few key data releases drove down the expected path for the federal funds rate. The FOMC’s decision at its August 7 meeting to leave the target federal funds rate unchanged at 5¼ percent, the accompanying statement, and the subsequent release of the minutes were all about in line with market expectations, and reactions in financial markets were muted. Neither the August 10 nor the August 17 statements by the Federal Reserve

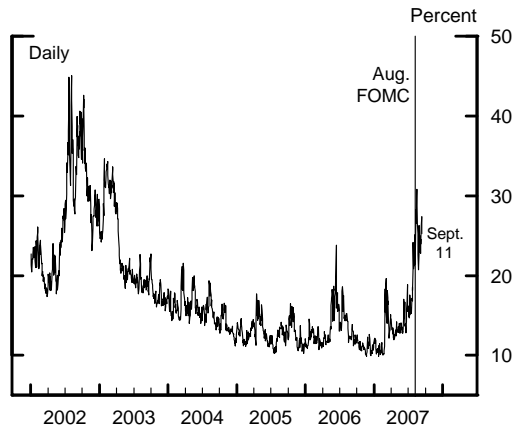
¹ An overnight index swap (OIS) is a fixed/floating interest rate swap, with the floating leg tied to an index of daily overnight rates, such as federal funds. Two parties exchange at maturity, based on the agreed notional amount, the difference between interest accrued at the fixed rate and interest accrued through geometric averaging of the floating or index rate. OIS contracts are used to hedge or to speculate on movements in overnight interest rates in all major currencies.

Corporate Yields, Risk Spreads, and Stock Prices

Selected Stock Price Indexes



Implied Volatility on S&P 500 (VIX)

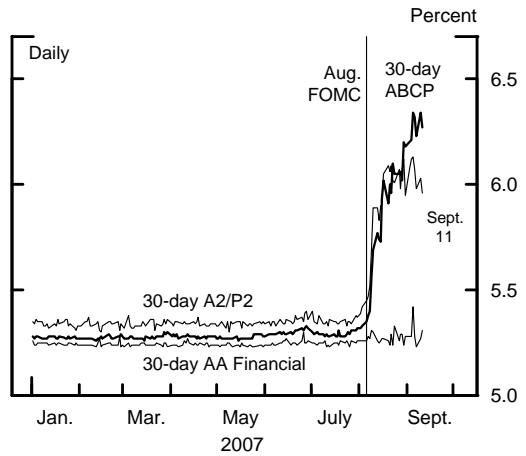


Ratio of Trend Earnings to Price for S&P 500 and Long-Run Treasury Yield



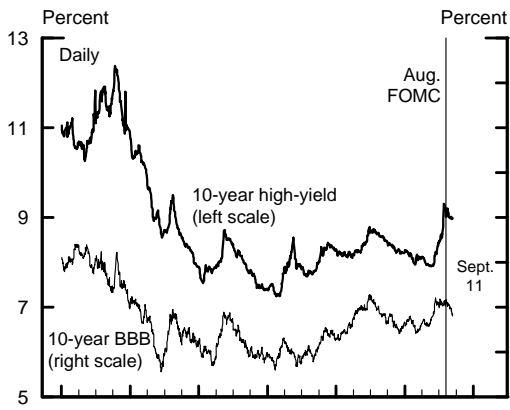
+ Denotes the latest observation using daily interest rates and stock prices and latest earnings data from I/B/E/S.
* Trend earnings are estimated using analysts' forecasts of year-ahead earnings from I/B/E/S.

Commercial Paper Yields



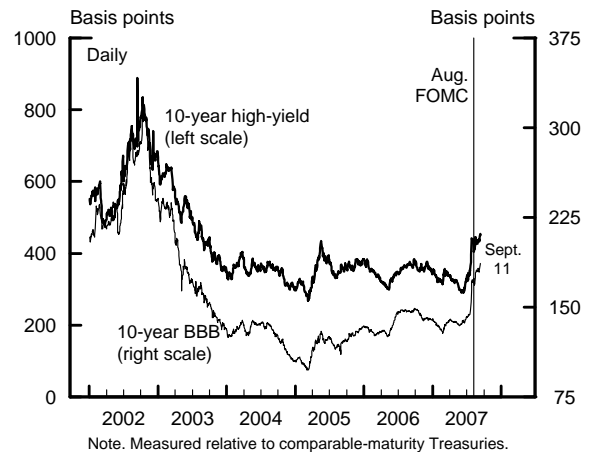
Note. Yields are for 1-month paper.

Corporate Bond Yields



Note. Yields from smoothed yield curves based on Merrill Lynch bond data.

Corporate Bond Spreads



Note. Measured relative to comparable-maturity Treasuries.

elicited large changes in interest rates. More recently, weaker-than-expected reports on housing activity and employment appeared to solidify market expectations for an easing of policy at the September meeting. Binary options on the target federal funds rate after the upcoming meeting suggest that investors now assign roughly even odds to 50 and 25 basis point reductions in the target funds rate at the upcoming meeting. The Desk's survey of primary dealers suggests similar expectations for the policy decision, and many dealers report that they expect the Committee's statement to indicate that downside risks to growth are the predominant policy concern.

Looking further ahead, futures market quotes imply that the expected federal funds rate at the end of 2008 is now about 4 percent, roughly 50 basis points lower than at the time of the August FOMC meeting. The distribution of the expected federal funds derived from options widened considerably since early August, and Eurodollar-implied volatilities six and twelve months ahead hit multiyear highs in mid-August. In line with this rise in volatility, several indicators suggest that term premiums along the Eurodollar curve jumped over the intermeeting period.

Two-year nominal Treasury yields declined about 50 basis points, on net, since August 6, as investors marked down the expected path of monetary policy. Five- and ten-year nominal Treasury yields declined about 50 and 35 basis points respectively. Quotes on TIPS suggest that almost all of the decreases in these yields can be attributed to real yields. Thus, implied inflation compensation over the next five years and five to ten years ahead were both about unchanged.

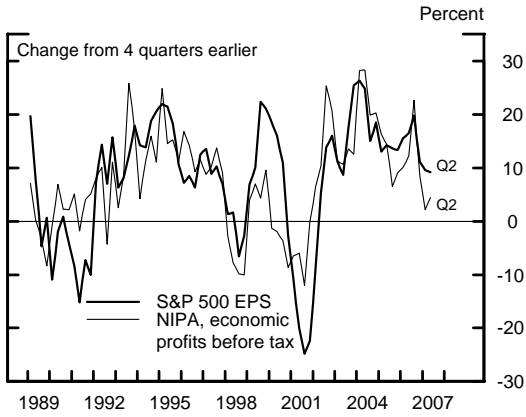
Stock Prices, Corporate Yields, and Risk Spreads

Broad equity price indexes were volatile over the intermeeting period, but the net changes were small. After reaching a peak in mid-August, options-implied volatility retreated, though it remained well above its range for most of the past several years. The spread between the twelve-month forward trend earnings-price ratio for S&P 500 firms and a real long-run Treasury yield—a rough gauge of the equity risk premium—opened up a bit more over the intermeeting period after having widened in late July and early August.

Conditions in the commercial paper market deteriorated markedly over the intermeeting period. The difficulties were triggered by apprehension about potential losses associated with mortgage-related assets in ABCP programs, but they then spread to other ABCP programs and to lower-rated unsecured commercial paper programs as well. ABCP spreads soared to record levels, and some conduits, particularly those holding mortgage

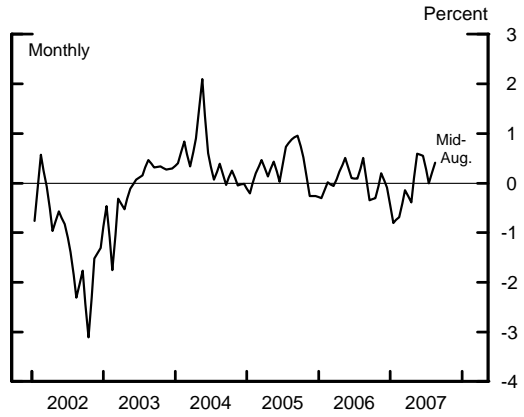
Corporate Earnings and Credit Quality

Corporate Earnings Growth



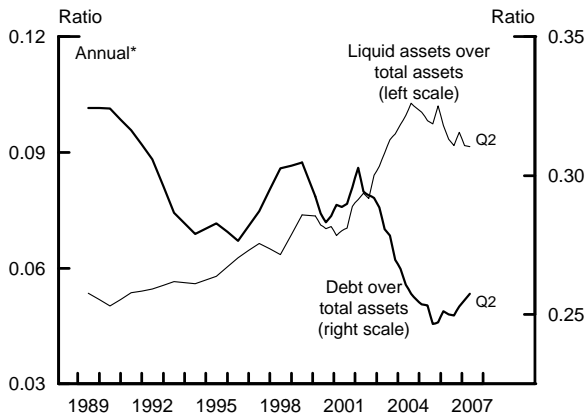
Source: I/B/E/S for S&P 500 earnings per share.

Revisions to Expected S&P 500 Earnings



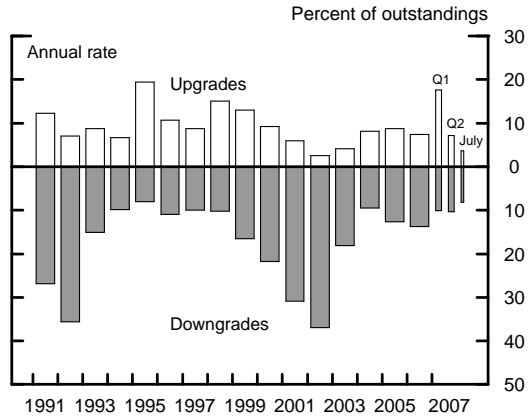
Note. Index is a weighted average of the percent change in the consensus forecasts of current-year and following-year EPS for a constant sample.

Financial Ratios for Nonfinancial Corporations



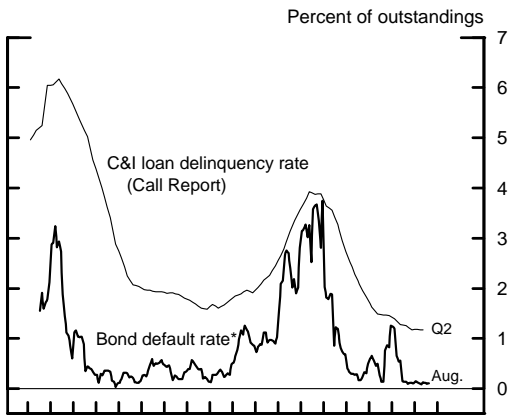
* Data are quarterly starting in 2000:Q1.
Source. Calculated with Compustat data.

Bond Ratings Changes of Nonfinancial Companies



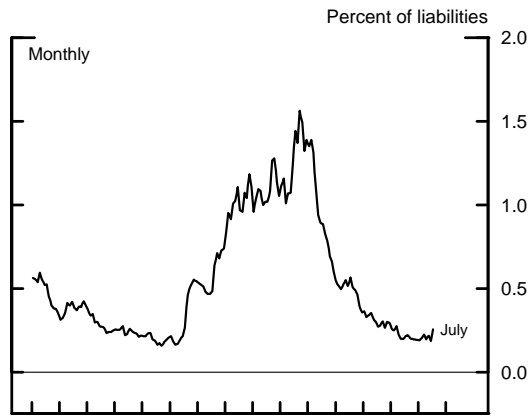
Source. Calculated with data from Moody's Investors Service.

Selected Default and Delinquency Rates



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

Expected Year-Ahead Defaults



Note. Firm-level estimates of default weighted by firm liabilities as a percent of total liabilities, excluding defaulted firms.
Source. Moody's KMV.

assets, were unable to roll over maturing paper. These developments led several programs to draw on backup lines, extend the maturity of their paper, or even to default. On a seasonally adjusted basis, total ABCP outstanding has dropped nearly 20 percent since the August 7 FOMC meeting.

Yields on investment-grade and speculative-grade corporate bonds fell a little less than those on comparable-maturity Treasuries, leaving their spreads slightly above the already higher levels prevailing at the time of the August 7 FOMC meeting. Both investment-grade and speculative-grade bond spreads are near their highest levels in four years, although they are still far below the peaks seen in mid-2002.

Corporate Earnings and Credit Quality

Both the NIPA measures and S&P earnings per share point to further increases in profits in the second quarter, although the pace was more moderate than it was a year ago. Revisions to analysts' year-ahead expected earnings per share for the S&P 500 were slightly positive through mid-August. Since then, however, expectations have likely deteriorated after a number of financial firms warned that credit market losses would hold down their profits in the near term. Among financial firms, profit expectations for investment banks were marked down further as analysts factored in a drop-off in fees from reduced leveraged buyout activity.

Over the intermeeting period, the available measures of corporate credit quality remained strong, but they generally reflect conditions before the onset of financial turmoil. In the second quarter, the liquidity of nonfinancial corporate balance sheets stayed high by historical standards, while leverage rose slightly from low levels. Rating downgrades on corporate bonds continued to be modest in July, and the six-month trailing bond default rate remained near zero through August. KMV's aggregate year-ahead expected default rate also stayed near record lows in July.

Business Finance

After having been tepid in July, gross bond issuance by investment-grade nonfinancial corporations rebounded strongly last month, whereas speculative-grade issuance increased only a touch. Speculative-grade bond deals and leveraged loans slated to finance LBOs have continued to be delayed or restructured. Outstanding nonfinancial commercial paper dipped in August, although the contraction was small in comparison with that for ABCP. C&I lending surged in August, reportedly as some banks funded

Business Finance

Gross Issuance of Securities by U.S. Corporations

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

Type of security	2003	2004	2005	2006	2007			
					Q1	Q2	July	Aug. ^p
<i>Nonfinancial corporations</i>								
Stocks ¹	3.7	5.4	4.6	4.7	5.9	5.1	2.8	1.6
Initial public offerings	.4	1.6	1.7	1.8	1.3	2.0	1.3	1.5
Seasoned offerings	3.3	3.8	2.8	2.9	4.6	3.1	1.5	.1
Bonds ²	31.6	22.7	19.1	29.8	32.8	43.1	13.1	31.5
Investment grade	15.9	8.2	8.4	13.0	13.0	15.5	9.1	26.9
Speculative grade	11.3	9.7	6.4	8.0	13.0	17.8	2.2	4.0
Other (sold abroad/unrated)	4.3	4.9	4.3	8.8	6.8	9.8	1.8	.6
<i>Memo</i>								
Net issuance of commercial paper ³	-3.4	1.5	-4	3.9	-.1	2.6	1.4	-5.8
Change in C&I loans at commercial banks ^{3,4}	-7.7	3.2	10.0	12.9	8.6	14.4	17.6	46.0
<i>Financial corporations</i>								
Stocks ¹	6.6	6.9	5.0	5.3	8.7	9.9	3.1	.1
Bonds ²	111.1	139.3	176.3	187.7	208.9	205.1	117.8	105.5

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

1. Excludes private placements and equity-for-equity swaps that occur in restructurings.

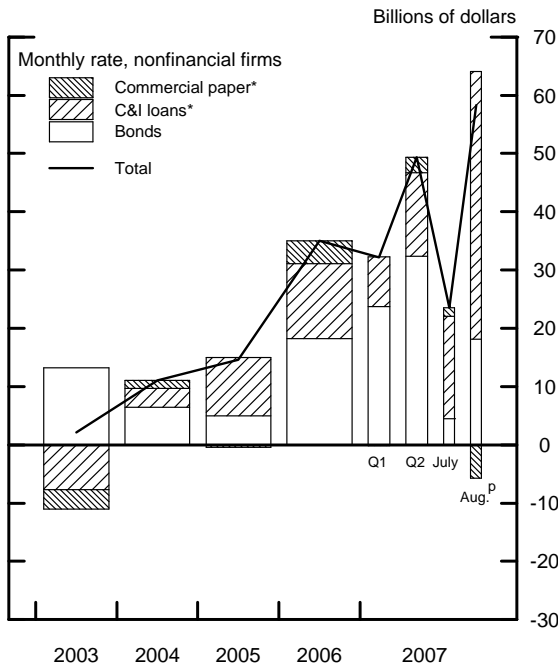
2. Data include regular and 144a private placements. Bond totals reflect gross proceeds rather than par value of original discount bonds. Bonds are categorized according to Moody's bond ratings or to Standard & Poor's if unrated by Moody's.

3. End-of-period basis, seasonally adjusted.

4. Adjusted commercial bank credit data.

p Preliminary.

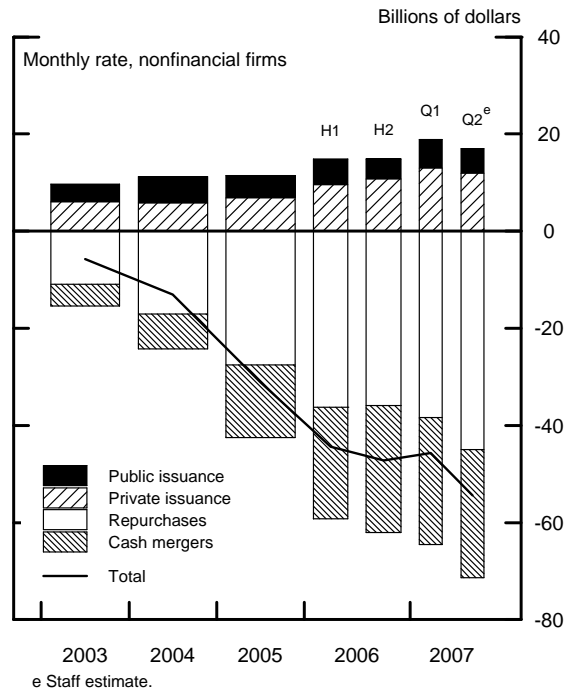
Selected Components of Net Debt Financing



* Seasonally adjusted, period-end basis.

p Preliminary.

Components of Net Equity Issuance



e Staff estimate.

leveraged loans that they had intended to syndicate to nonbank investors and perhaps as some firms substituted bank credit for commercial paper.

Gross public equity issuance by nonfinancial corporations slowed to a trickle in August; the drop probably reflected both seasonal weakness and the effects of recent volatility in equity markets. Equity retirements continued unabated in the second quarter, and early indications are that repurchases remained robust through August, as did equity retirements associated with cash-financed mergers and acquisitions. In contrast, announcements of new LBOs essentially came to a halt in August.

Commercial Real Estate

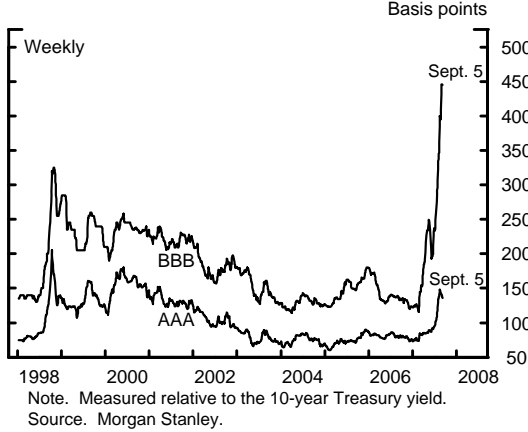
Over the intermeeting period, spreads of rates on investment-grade commercial-mortgage-backed securities (CMBS) over those on comparable-maturity Treasury securities widened substantially. The recent increase in CMBS spreads reflects both concerns among investors and rating agencies over the higher leverage on recently securitized commercial mortgages and greater concerns about structured finance products in general. The increase in CMBS spreads has reportedly caused interest rates on commercial mortgages originated for securitization to increase about 25 basis points.

In the second quarter, investor concerns about higher leverage led to an increase in the subordination rate—the share of the CMBS pool that must default before holders of a given tranche must absorb any losses—for newly securitized BBB-rated CMBS. According to measures of loan quality from rating agencies, most loans originated in the second quarter that were intended for securitization in the third quarter remained highly leveraged. There are signs of improving loan quality for mortgages intended for securitization—the share of newly originated commercial mortgages with loan-to-value ratios at or above 80 percent, an indicator of the future quality of loans in CMBS pools, has shown some improvement in recent months.

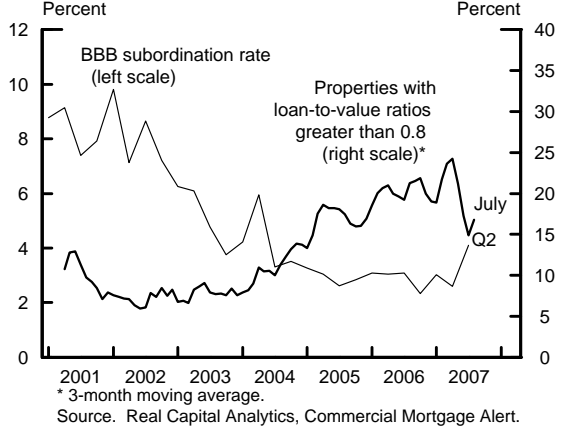
Commercial mortgage debt rose briskly in the second quarter, amid continued increases in the price of commercial real estate properties and the uptrend in leverage observed last spring. The elevated pace of borrowing appears to have carried into the third quarter, as a backlog of loans originated earlier this year has kept issuance of CMBS high. There are indications that higher borrowing costs and tighter underwriting standards may be beginning to hold down the volume of commercial real estate lending. These indicators include a notable increase in canceled sales contracts in July, slower growth of

Commercial Real Estate

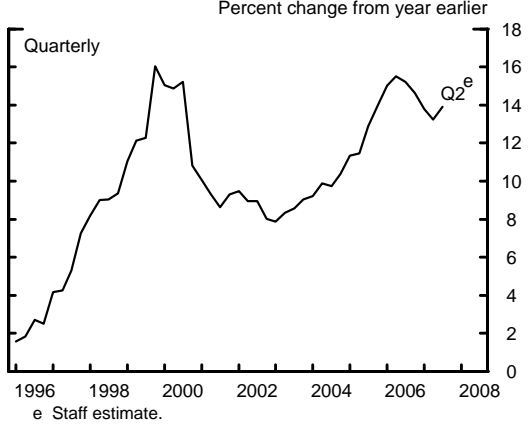
Investment-Grade CMBS Spreads



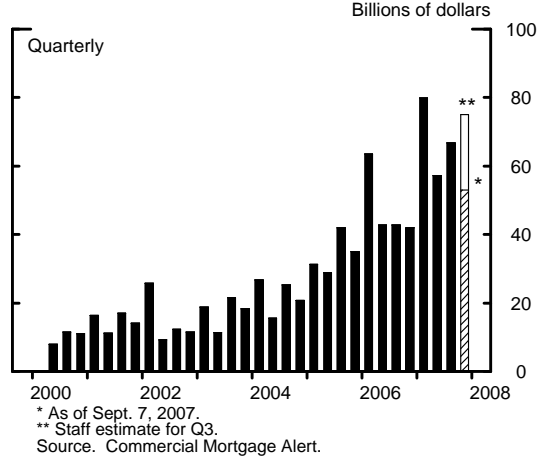
Leverage on Newly Securitized Mortgages



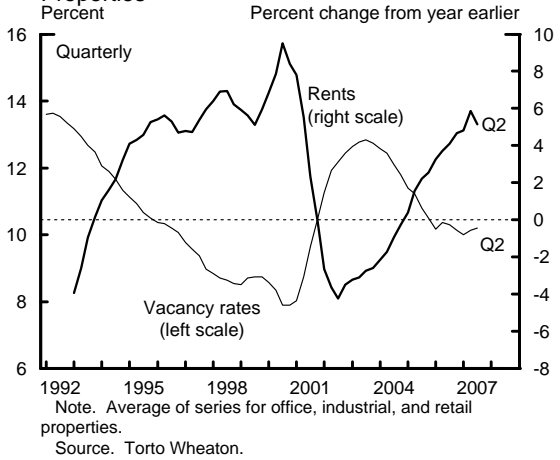
Commercial Mortgage Debt



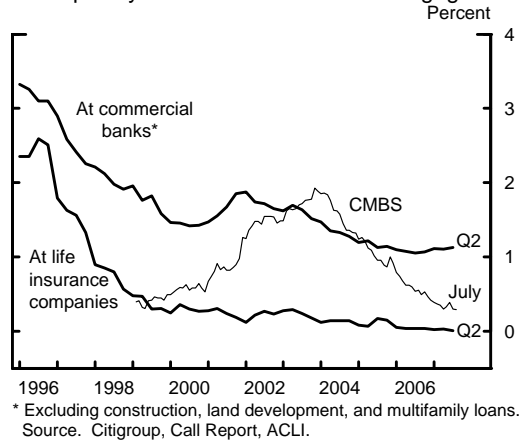
Gross Issuance of CMBS



Rents and Vacancy Rates on Commercial Properties

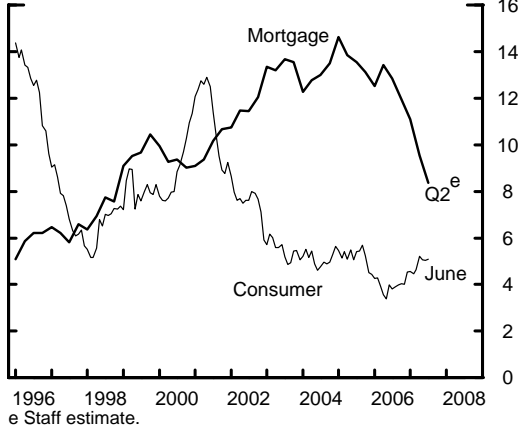


Delinquency Rates on Commercial Mortgages

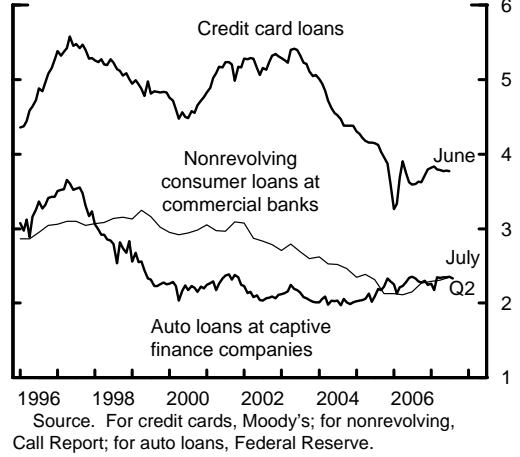


Household Liabilities

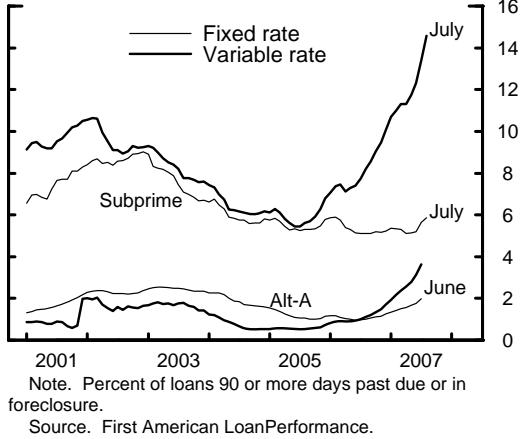
Mortgage Debt and Consumer Credit
Percent change from year earlier



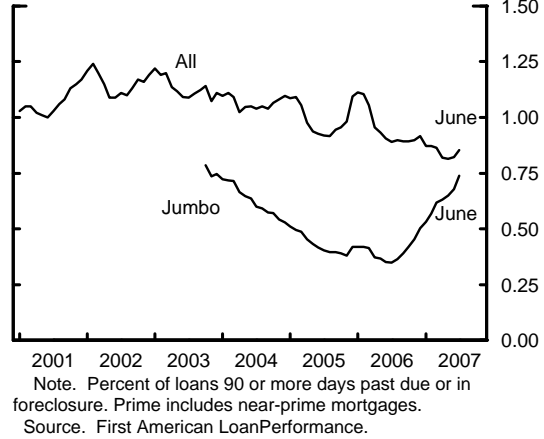
Delinquencies on Consumer Loans
Percent



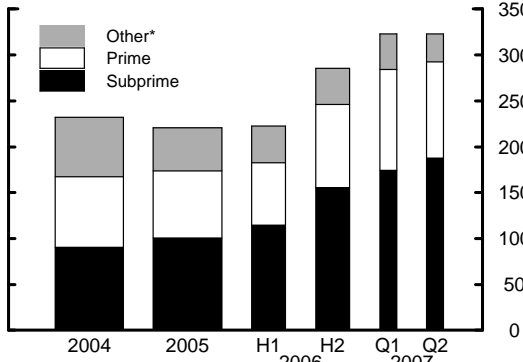
Delinquencies on Nonprime Mortgages
Percent of loans



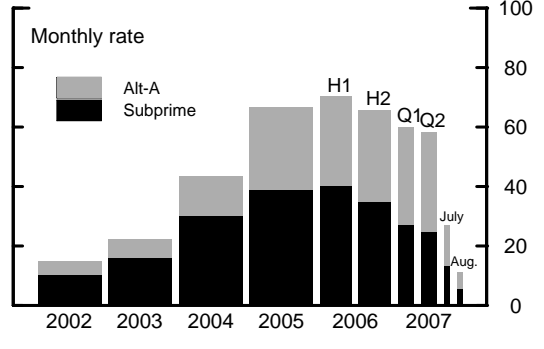
Delinquencies on Prime Mortgages
Percent of loans



Number of Foreclosures Started
Thousands, quarterly rate



Gross Issuance of Alt-A and Subprime MBS
Billions of dollars

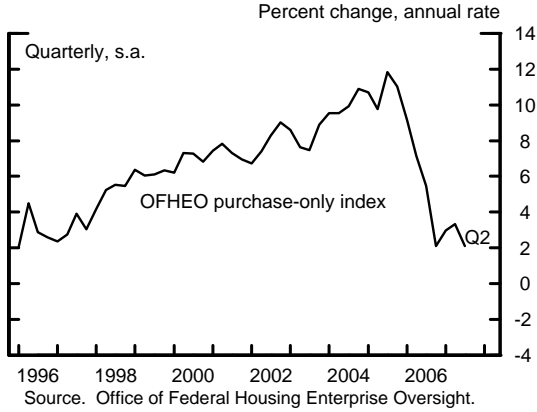


* Primarily FHA/VA but includes loans not elsewhere classified.
Source. Staff estimates based on data from the Mortgage Bankers Association.

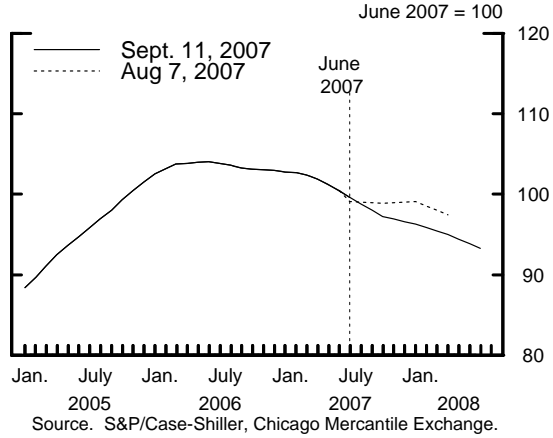
Source. Inside Mortgage Finance MBS database.

Household Assets

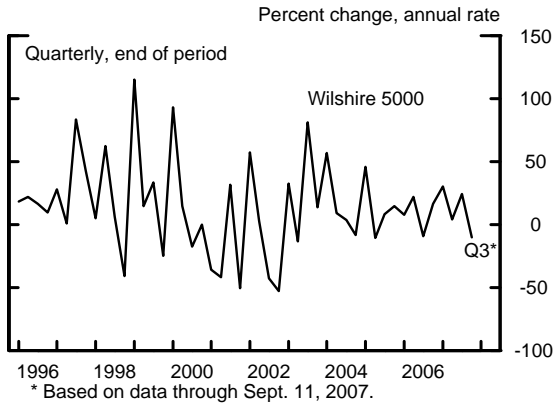
House Prices



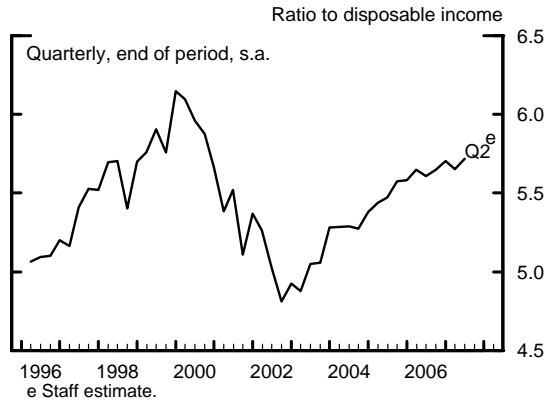
S&P/Case-Shiller House Price Futures



Stock Prices



Net Worth



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

Fund type	2006	2006	2007		2007		Assets July
		Q4	Q1	Q2	July	Aug. ^e	
Total long-term funds	18.9	21.6	39.5	24.2	16.3	-16.3	8,682
Equity funds	13.2	11.2	21.2	8.1	10.7	-14.8	6,391
Domestic	0.8	-0.9	6.5	-3.9	-4.1	-15.8	4,828
International	12.4	12.1	14.7	12.0	14.9	1.0	1,563
Hybrid funds	0.6	1.8	3.3	1.9	1.9	0.1	688
Bond funds	5.1	8.6	15.0	14.1	3.6	-1.6	1,603
High-yield	-0.2	0.5	0.7	-0.2	-1.7	-1.6	156
Other taxable	4.1	6.3	11.4	12.5	5.2	0.3	1,069
Municipals	1.3	1.8	2.9	1.8	0.2	-0.3	378
Money funds	27.4	52.7	18.2	39.1	45.4	174.0	2,604

Note. Excludes reinvested dividends.

e Staff estimate based on confidential weekly data.

Source: Investment Company Institute.

commercial mortgages extended by banks in July and August, and a lighter calendar of CMBS slated for issuance in the fourth quarter.

Nonetheless, fundamentals in the commercial real estate sector continue to be solid. In the second quarter, the vacancy rate on commercial properties remained low relative to its range earlier this decade, and commercial rents continued to post moderate gains. As a result, delinquency rates on most types of commercial real estate loans have remained low.

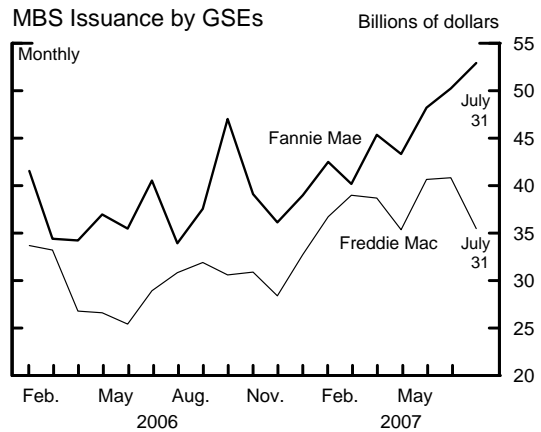
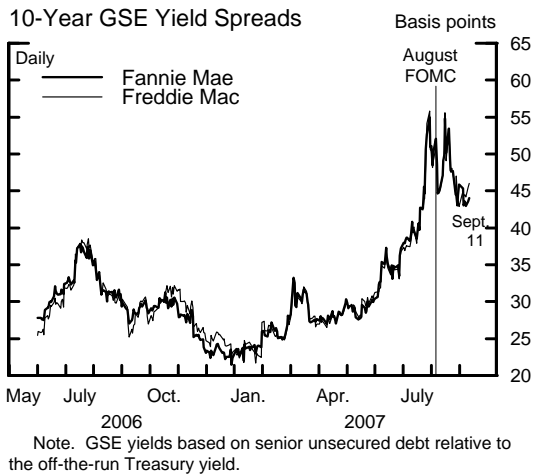
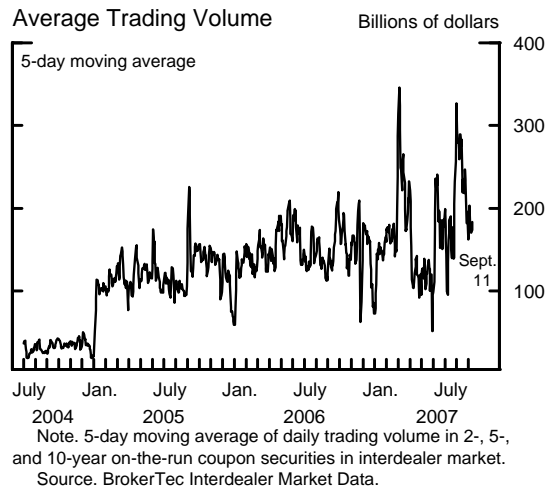
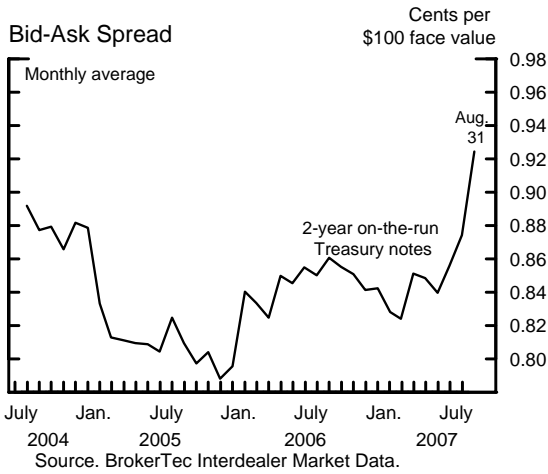
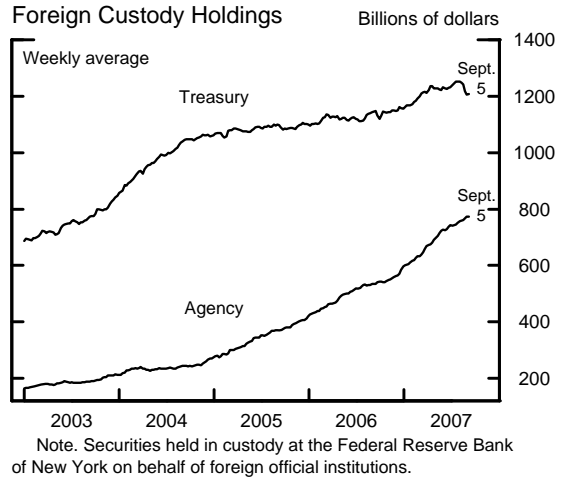
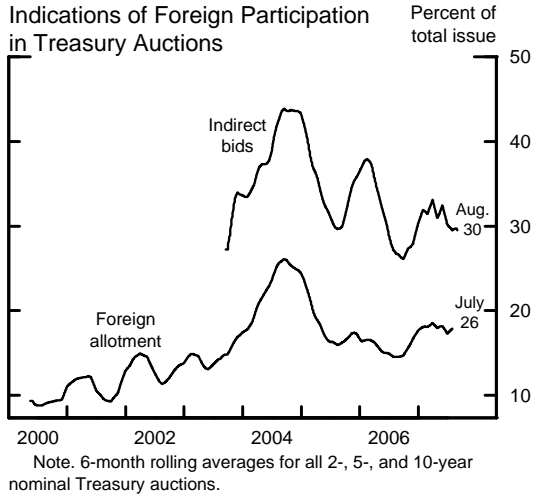
Household Finance

On a year-over-year basis, growth of home mortgage debt slowed again in the second quarter, a decrease broadly consistent with the lower pace of home sales and the sharp deceleration in home-price appreciation. Consumer credit continued to expand moderately through July.

Delinquency rates on most types of consumer loans have crept up in recent quarters, but the levels have generally remained in the lower portion of their historical ranges. In contrast, the performance of nonprime mortgages has deteriorated further. The delinquency rate on subprime variable-rate mortgages increased in July to a level well above the peak observed during the recession in 2001; the delinquency rate for variable-rate loans in alt-A pools, although much lower, has also increased noticeably. In the prime mortgage sector, the delinquency rate on the aggregate of all such loans remained low through June, even though the rate for the jumbo mortgages in this aggregate roughly doubled over the preceding year. Foreclosure starts remained at an elevated level in the second quarter, with a further increase among borrowers with subprime mortgages offsetting a decline for prime borrowers.

The available evidence suggests extremely limited securitization activity for the nonprime and jumbo mortgage markets in recent weeks. With their funding options constrained, lenders are reportedly offering prime jumbo mortgages with higher rates and more-selective terms and are holding the loans on their balance sheets. Meanwhile, the supply of credit to borrowers who qualify for conforming mortgage loans has been relatively unaffected by developments in other segments of the mortgage market. Issuance of agency-backed MBS was strong through July, particularly in comparison with the level seen in the subprime, alt-A, and jumbo markets.

Treasury and Agency Finance



The OFHEO index of prices for purchased homes rose at an annual rate of 2 percent in the second quarter, down from an upward-revised pace of 3¼ percent in the first quarter. According to the S&P/Case-Shiller index, home prices in ten of the largest metropolitan markets fell 4 percent for the year ending in July, and futures quotes on that index suggest that market participants expect some further decline in coming months.

The ratio of household net worth to disposable income ticked up in the second quarter, but the net decline in stock prices since the beginning of July should reduce net worth in the current quarter. Long-term mutual funds had sizable net outflows in August that may have signaled a decreased appetite for risk. In contrast, money market funds received near-record monthly inflows last month.

Treasury and Agency Finance

During the intermeeting period, the Treasury auctioned two-, five-, ten-, and thirty-year coupon securities. Demand at the auction for the two-year Treasury note was reportedly quite strong, and the bid-to-cover ratio was well above average. Bid-to-cover ratios at the other auctions were in their typical ranges. Indirect bidding, an indicator of foreign demand, was roughly in line with recent levels. Despite the recent financial market turmoil, the cash market for these securities generally functioned well, with fairly high trading volumes. However, heightened volatility in the secondary market for Treasury bills reportedly caused dealers to be reluctant to bid at some bill auctions, which resulted in very low bid-to-cover ratios.

Yield spreads on debt issued by government-sponsored enterprises (GSEs) spiked notably in mid-August but then receded. Net debt issuance by Fannie Mae and Freddie Mac has been light because of the portfolio caps imposed on these GSEs by their regulator.

State and Local Government Finance

Gross issuance of long-term municipal bonds for new capital projects and for advance refunding declined somewhat further in August amid a jump in the ratio of long-term municipal bond yields to those of comparable-maturity Treasury securities. Meanwhile, short-term issuance picked up in August—its typical seasonal pattern. The perceived credit quality of municipal bonds appeared to deteriorate somewhat in August, even as the number of ratings upgrades outpaced downgrades. The primary source of investors' concerns about credit quality was the possible exposure of municipal bond insurers to subprime mortgages, which contributed to the spike in the municipal bond yield ratio.

State and Local Government Finance

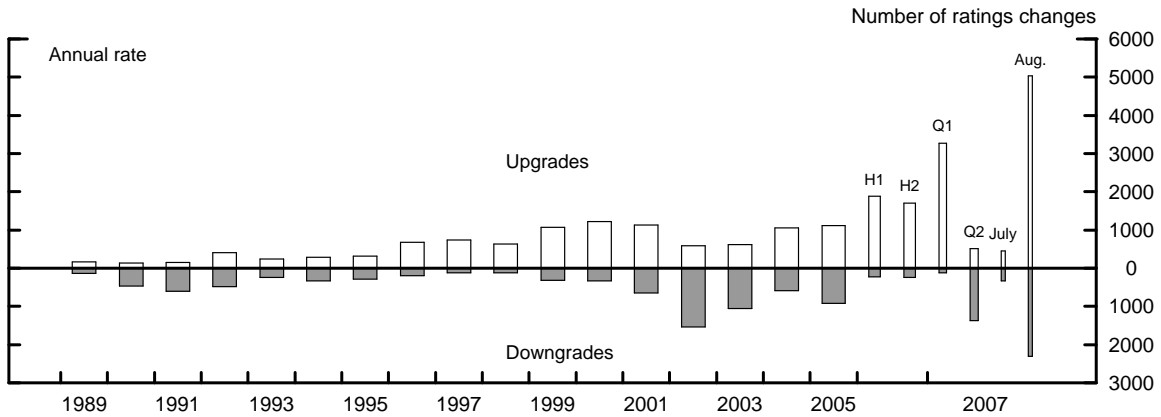
Gross Offerings of Municipal Securities

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

Type of security	2003	2004	2005	2006	2007			
					Q1	Q2	July	Aug.
Total	37.9	34.7	38.4	36.1	37.9	45.5	34.2	34.4
Long-term ¹	32.0	29.8	34.1	32.5	35.7	41.1	31.2	26.0
Refundings ²	10.0	10.8	15.6	10.6	17.7	14.9	8.0	6.8
New capital	22.1	19.0	18.6	21.9	18.0	26.2	23.2	19.3
Short-term	5.8	4.9	4.2	3.7	2.2	4.4	3.0	8.3
Memo: Long-term taxable	3.5	2.0	2.1	2.5	1.2	2.9	2.5	.9

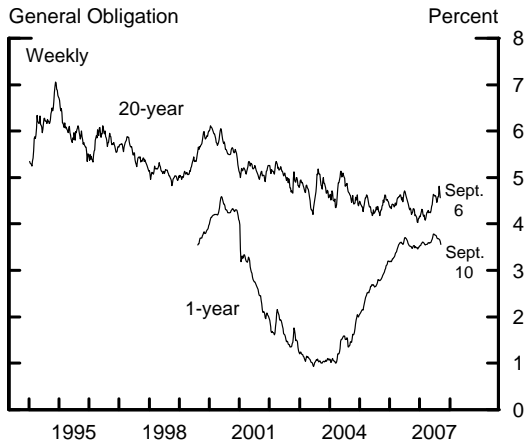
- 1. Includes issues for public and private purposes.
- 2. All issues that include any refunding bonds.

Ratings Changes



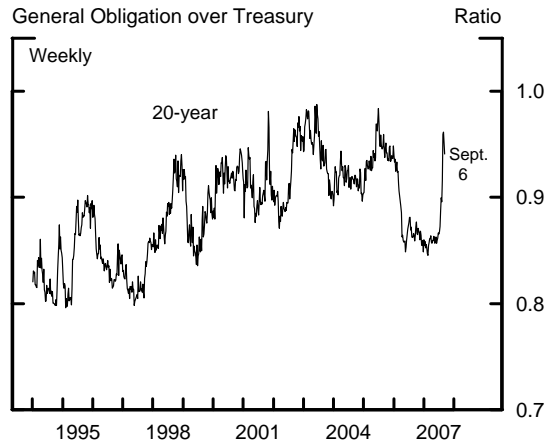
Source: S&P's Credit Week Municipal and Ratings Direct.

Municipal Bond Yields



Source: Municipal Market Advisors and Bond Buyer.

Municipal Bond Yield Ratio



Source: Bond Buyer.

M2 Monetary Aggregate
(Based on seasonally adjusted data)

Aggregate and components	Percent change (annual rate) ¹						Level (billions of dollars), Aug. (p)
	2005	2006	2007				
			Q1	Q2	July	Aug. (p)	
M2	4.1	4.9	7.1	6.7	4.2	10.7	7,334
Components ²							
Currency	3.5	3.6	1.7	2.1	5.1	.5	759
Liquid deposits ³	2.0	.8	6.6	7.0	1.5	8.9	4,475
Small time deposits	18.9	18.6	4.5	4.2	.3	2.0	1,179
Retail money market funds	-.2	13.0	18.9	13.1	22.6	40.3	915
Memo:							
Institutional money market funds	4.9	15.9	11.2	28.2	26.9	60.7	1,586
Monetary base	3.5	3.2	1.6	2.3	3.0	5.1	825

1. For years, Q4 to Q4; for quarters and months, calculated from corresponding average levels.

2. Nonbank traveler's checks are not listed.

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

p Preliminary.

Commercial Bank Credit

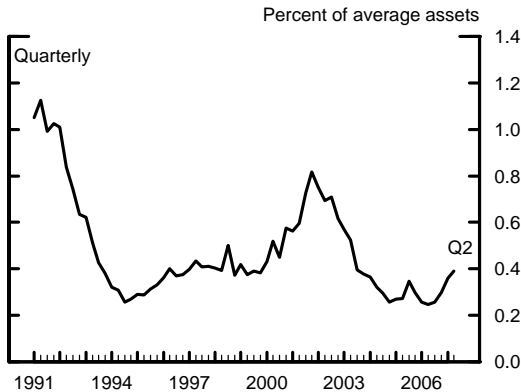
(Percent change, annual rate, except as noted; seasonally adjusted)

Type of credit	2005	2006	Q1 2007	Q2 2007	July 2007	Aug. 2007 ^e	Level ¹ Aug. 2007 ^e
Total	10.5	9.5	9.1	9.4	9.7	15.5	8,450
<i>Loans²</i>							
Total	11.6	10.7	9.9	9.4	9.5	18.1	6,349
To businesses							
Commercial and industrial	13.5	16.4	7.9	11.1	18.8	31.5	1,288
Commercial real estate	17.0	13.6	10.3	11.4	2.1	8.1	1,530
To households							
Residential real estate	11.9	7.2	9.5	6.4	5.1	.8	1,837
Revolving home equity	13.3	1.5	3.5	.1	5.8	8.9	462
Other	11.4	9.4	11.7	8.6	4.9	-2.0	1,375
Consumer	3.1	5.2	7.5	5.2	12.0	3.6	770
Originated ³	.7	6.4	8.1	2.2	15.6	8.7	1,161
Other ⁴	8.5	11.0	14.8	13.3	16.2	65.4	925
<i>Securities</i>							
Total	7.5	5.9	6.6	9.4	10.1	7.8	2,100
Treasury and agency	2.4	1.2	2.1	-6.8	8.5	-1.3	1,186
Other ⁵	17.5	13.7	13.3	33.3	12.1	19.8	914

Note. Yearly annual rates are Q4 to Q4; quarterly and monthly annual rates use corresponding average levels. Data have been adjusted to remove the effects of mark-to-market accounting rules (FIN 39 and FAS 115), the consolidation of certain variable interest entities (FIN 46), the adoption of fair value accounting (FAS 159), and the effects of sizable thrift-to-bank and bank-to-thrift structure activity in October 2006 and March 2007 respectively. Data also account for breaks caused by reclassifications.

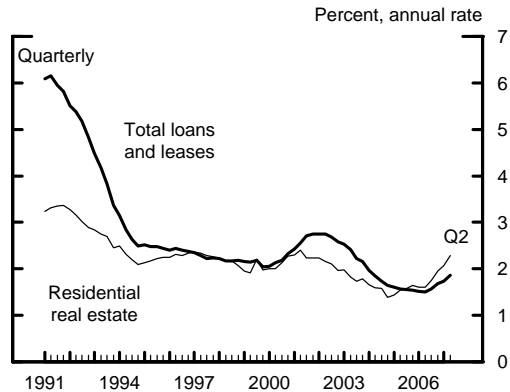
1. Billions of dollars. Pro rata averages of weekly (Wednesday) levels.
 2. Excludes interbank loans.
 3. Includes an estimate of outstanding loans securitized by commercial banks.
 4. Includes security loans and loans to farmers, state and local governments, and all others not elsewhere classified. Also includes lease financing receivables.
 5. 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.
- e Estimated.

Loan-Loss Provisioning



Source. Call Report.

Delinquency Rates on Loans



Source. Call Report.

Money and Bank Credit

M2 increased at an annual rate of about 10½ percent in August. The increase was led by a surge in liquid deposits and retail money funds as investors adjusted their portfolios in response to recent financial market turmoil. Small time deposits, which had been rather sluggish, showed some notable inflows during the last two weeks of August, as some depository institutions bid aggressively to obtain this source of funds.

Commercial bank credit is estimated to have risen sharply in August, as total loans expanded vigorously—mainly at large banks. In addition to the jump in C&I loans, “other” loans surged, in part because of short-term extensions to nonbanks and unplanned overdrafts. The sharp increase in unplanned overdrafts appears to be consistent with some banks having extended backup financing to commercial paper conduits.

Commercial real estate loans also expanded solidly last month, although the average pace over July and August was only about half that registered during the first half of the year. On the household side, banks’ holdings of loans backed by residential real estate were about flat in August, held down in part by some loan sales, but originations of consumer loans rose noticeably. Total securities held by banks increased moderately last month, partly because of a few large banks’ purchases of commercial paper.

According to the latest Call Report data, the profitability of the commercial banking industry held about steady at a high rate in the second quarter, with a further narrowing of banks’ net interest margin about offset by gains in non-interest income and reductions in non-interest expense. Banks’ rate of provisioning for loan losses moved higher for the third straight quarter, but the increase was smaller than in the previous two quarters. The delinquency rate on all loans and leases moved higher for the fourth straight quarter, pushed up by a further rise in delinquencies on both residential real estate loans and loans to finance the construction of residential properties.² However, delinquency rates on other major loan categories were little changed last quarter, and the overall delinquency rate on bank loans remained well below its long-run average level.

² In March 2007, banks began reporting new Call Report memorandum items on loans outstanding, charge-offs, and delinquencies that split construction and land development loans into “1-4 family residential construction loans,” “other construction loans,” and “all land development and other land loans.” According to these new data, the delinquency rate on the residential construction portion of construction and land development loans rose to 3.1 percent at the end of Q2 from 2.4 percent in Q1, whereas the delinquency rate on the remaining portion of such loans only increased about 10 basis points in Q2, to 1.8 percent.

International Developments

International Developments

U.S. International Transactions

Trade in Goods and Services

The U.S. international trade deficit narrowed to \$59.2 billion in July from \$59.4 billion in June (revised). The narrowing of the deficit reflected both higher exports and imports, but with exports increasing more than imports.

Trade in Goods and Services

	2006	Annual rate			Monthly rate		
		2006	2007		2007		
		Q4	Q1	Q2	May	June	July
Percent change							
<i>Nominal BOP</i>							
Exports	13.3	13.5	4.9	14.9	2.5	1.3	2.7
Imports	4.7	-7.3	3.8	10.1	2.3	.8	1.8
<i>Real NIPA</i>							
Exports	9.3	14.3	1.1	7.6	...	...	...
Imports	3.7	1.6	3.9	-3.2	...	...	...
Billions of dollars							
<i>Nominal BOP</i>							
Net exports	-758.5	-707.7	-710.3	-710.7	-59.6	-59.4	-59.2
Goods, net	-838.3	-801.4	-803.5	-816.9	-68.5	-68.4	-68.1
Services, net	79.7	93.6	93.1	106.1	8.9	9.0	8.9

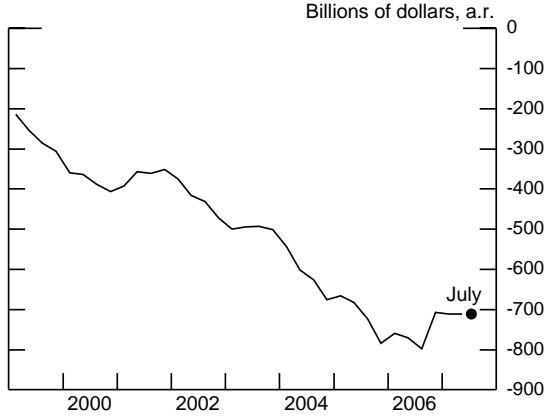
Source. U.S. Department of Commerce, Bureaus of Economic Analysis and Census.
n.a. Not available. ... Not applicable.

In July, the value of exports of goods and services increased 2.7 percent. Sharp increases in exports of both aircraft and automobiles contributed importantly to the overall gain. Exports of agricultural products and consumer goods were also strong. In contrast, exports of industrial supplies and semiconductors exhibited declines.

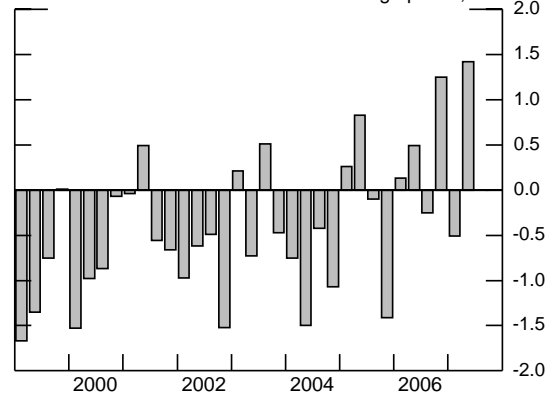
The value of exports in the second quarter increased 14.9 percent (a.r.), as exports increased briskly in June following strong growth in May. Exports of agricultural goods, automotive products, and industrial supplies exhibited particular strength in the second quarter. In contrast, exports of capital goods rose modestly, reflecting declines in aircraft and computers that partially offset strong growth in other capital goods. In the preliminary NIPA release, real exports of goods and services were reported to have risen 7.6 percent, with both exports of goods and services exhibiting strong growth.

U.S. International Trade in Goods and Services (Quarterly)

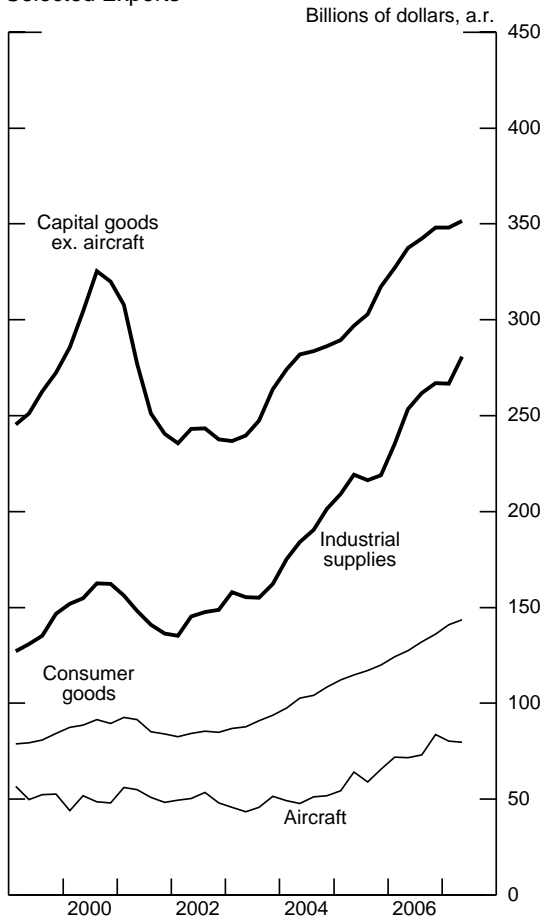
Trade Balance



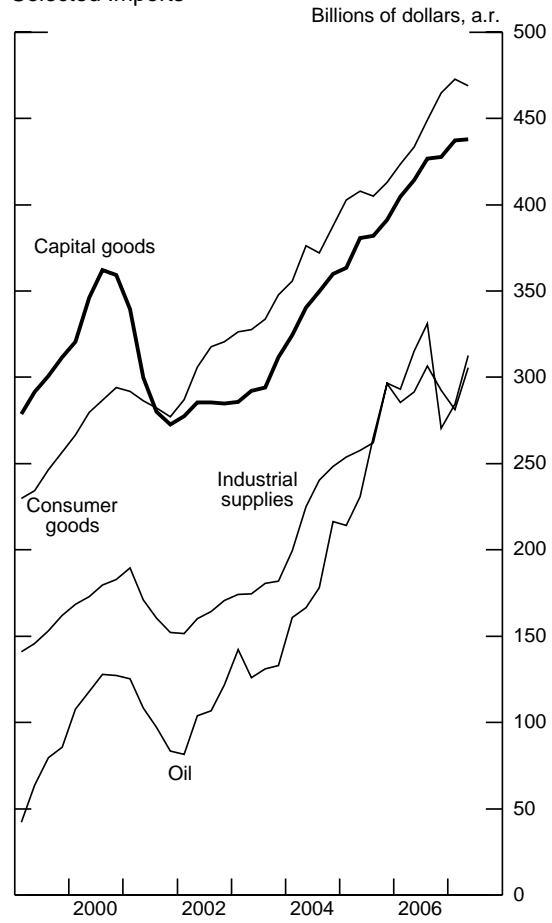
Contribution of Net Exports to Real GDP Growth



Selected Exports



Selected Imports



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

	Levels				Change ¹			
	2007		2007		2007		2007	
	Q1	Q2	June	July	Q1	Q2	June	July
Exports of G&S	1528.6	1582.8	1609.2	1652.2	18.1	54.1	19.9	43.0
Goods exports	1080.5	1117.4	1139.5	1181.3	14.5	36.9	18.2	41.8
Gold	10.6	16.5	17.7	12.0	1.6	5.9	3.8	-5.8
Other goods	1069.9	1100.9	1121.8	1169.4	13.0	31.0	14.4	47.5
Capital goods	428.1	431.2	439.6	462.7	-3.6	3.1	1.2	23.1
Aircraft & parts	80.4	79.5	82.9	97.6	-3.3	-.8	-.8	14.7
Computers & accessories	45.3	41.9	42.6	43.3	-2.6	-3.4	.0	.8
Semiconductors	50.2	49.8	52.0	48.2	-.6	-.4	2.5	-3.8
Other capital goods	252.2	260.0	262.2	273.6	2.9	7.8	-.5	11.5
Automotive	111.5	118.0	118.8	136.1	2.0	6.5	1.4	17.3
Ind. supplies (ex. ag., gold)	266.7	280.7	291.3	290.5	-.3	14.0	10.1	-.8
Consumer goods	140.9	143.5	142.4	148.3	4.9	2.6	-2.1	5.9
Agricultural	79.3	87.1	87.7	90.1	3.9	7.8	.5	2.3
All other goods	43.4	40.3	41.9	41.6	6.0	-3.1	13.3	-.3
Services exports	448.2	465.4	469.6	470.8	3.6	17.2	1.7	1.2
Imports of G&S	2238.9	2293.5	2322.3	2363.1	20.7	54.6	17.7	40.8
Goods imports	1883.9	1934.2	1960.2	1998.7	16.6	50.3	17.0	38.5
Oil	283.4	312.6	318.9	326.4	13.1	29.2	.1	7.5
Gold	7.8	9.8	5.5	12.5	2.7	1.9	-5.5	6.9
Other goods	1592.7	1611.9	1635.7	1659.8	.9	19.2	22.4	24.1
Capital goods	437.4	437.9	446.1	445.0	9.7	.4	7.0	-1.2
Aircraft & parts	32.8	34.3	37.8	33.7	2.2	1.5	5.7	-4.1
Computers & accessories	108.5	102.8	104.0	96.8	6.6	-5.7	1.5	-7.2
Semiconductors	27.0	26.0	25.6	25.2	-.2	-1.0	-.7	-.3
Other capital goods	269.2	274.8	278.7	289.2	1.2	5.6	.5	10.5
Automotive	253.4	252.3	258.0	271.2	-7.2	-1.1	11.9	13.2
Ind. supplies (ex. oil, gold)	281.2	305.5	310.8	314.1	-11.1	24.2	2.5	3.3
Consumer goods	473.0	468.8	470.9	476.1	8.2	-4.2	.2	5.3
Foods, feeds, bev.	80.1	80.3	80.8	83.2	3.2	.2	-.4	2.4
All other goods	67.5	67.1	69.2	70.3	-2.0	-.4	1.2	1.1
Services imports	355.0	359.3	362.2	364.4	4.1	4.3	.6	2.3
<i>Memo:</i>								
Oil quantity (mb/d)	14.32	13.41	13.28	12.87	1.01	-.91	-.25	-.41
Oil import price (\$/bbl)	54.33	63.82	65.72	69.42	-1.29	9.48	1.23	3.70

1. Change from previous quarter or month.

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

The value of imported goods and services rose 1.8 percent in July, boosted by a large increase in imports of automotive products. Higher imports of oil and capital goods excluding aircraft, computers, and semiconductors also contributed to the overall gain in imports. Imports of non-oil industrial supplies, consumer goods, and services all recorded moderate increases, whereas imports of aircraft, computers, and semiconductors declined.

In the second quarter, the value of imports rose 10.1 percent (a.r.), with imports growing only modestly in June following a large gain in May. The increase in the second quarter entirely reflects higher import prices, as real imports, according to the preliminary NIPA release, actually declined 3.2 percent. In particular, import prices for oil and other industrial supplies surged in the second quarter, driving up the nominal value of imports. In contrast, the value of imports of automotive products and consumer goods declined.

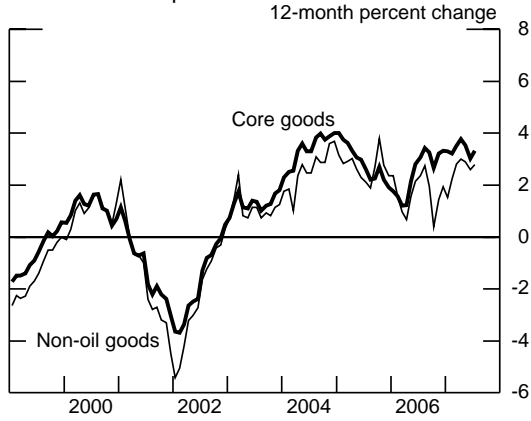
Prices of Internationally Traded Goods

Non-oil imports. In July, prices for U.S. imports of core goods rose 0.3 percent, after rising 0.1 percent in June. Material-intensive goods led the way after being flat in the previous month. Prices for imported food shot up in July, and prices for non-fuel industrial supplies moved up after a slight decline in June. The food price increase was almost entirely due to a sharp rebound in vegetable prices, which had plunged in the two previous months. Within non-fuel industrial supplies, prices in a number of categories fell in July, including prices for copper and aluminum, but a spike in prices for imported building materials more than offset those declines. Prices for imported finished goods rose 0.2 percent, with prices of capital goods accounting for most of the increase. Outside of core goods, prices for imported computers were flat, and prices for semiconductors fell modestly.

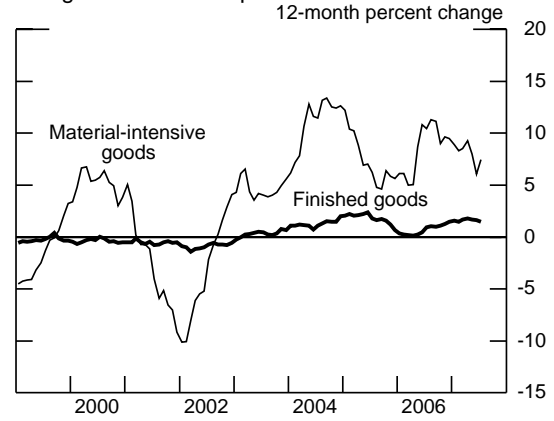
Oil. The BLS price index of imported oil rose 7 percent in July, following a 4½ percent increase in June. The spot price of West Texas Intermediate (WTI) crude oil increased about 9 percent in July. Moving into August, the spot price of WTI fell rapidly before retracing much of this decline late in the month and into early-September. Smoothing through these ups and downs, spot WTI averaged about \$72 per barrel in August, just \$2 per barrel lower than its July average. On September 11, OPEC announced that it will increase its production target by 500,000 barrels per day. Despite this news, the spot price of WTI rose to a record high of \$78.24 per barrel, reflecting skepticism among market participants that actual OPEC production will increase significantly.

Prices of U.S. Imports and Exports

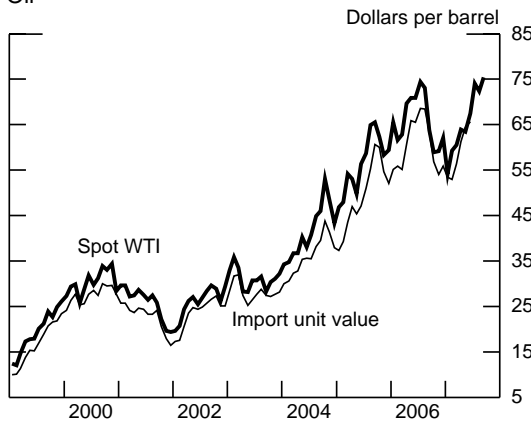
Merchandise Imports



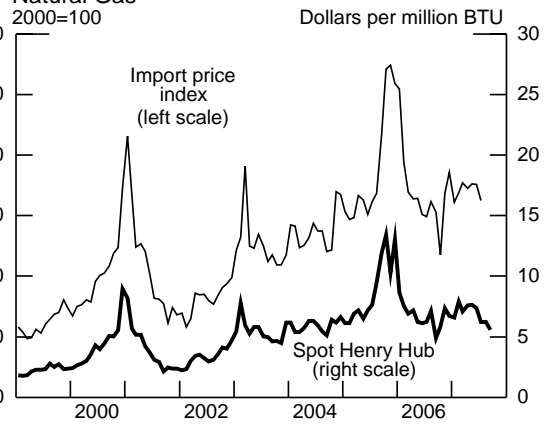
Categories of Core Imports



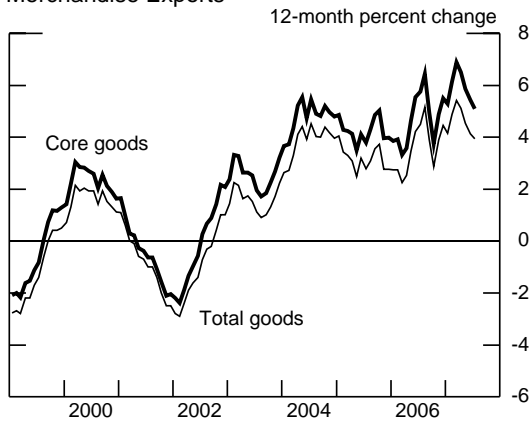
Oil



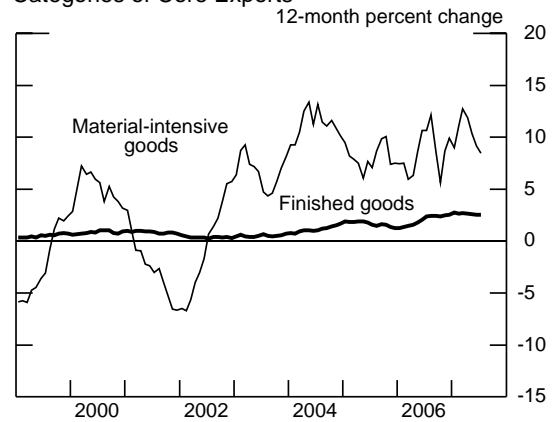
Natural Gas



Merchandise Exports



Categories of Core Exports



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

	Annual rate			Monthly rate		
	2006	2007		2007		
	Q4	Q1	Q2	May	June	July
	----- BLS prices -----					
Merchandise imports	-11.9	1.8	14.8	.9	.9	1.5
Oil	-51.9	-3.2	87.5	2.6	4.4	7.0
Non-oil	1.8	2.6	3.6	.6	.1	.2
Core goods ¹	1.9	3.4	4.3	.6	.1	.3
Finished goods	1.2	1.8	1.3	.1	.2	.2
Cap. goods ex. comp. & semi.	1.2	3.1	3.0	.3	.4	.4
Automotive products	.8	.3	.9	.1	.1	.1
Consumer goods	1.5	1.9	.4	.0	.1	.1
Material-intensive goods	3.6	6.4	11.5	1.6	-.0	.7
Foods, feeds, beverages	6.5	9.8	8.4	1.0	.2	1.6
Industrial supplies ex. fuels	1.8	3.8	12.2	1.8	-.1	.4
Computers	-2.5	-9.5	-7.5	-.3	-.3	.0
Semiconductors	2.2	-6.8	-20.0	-1.4	.0	-.4
Natural gas	7.6	33.6	14.1	2.1	-.2	-7.6
Merchandise exports	.4	7.2	5.7	.2	.3	.2
Core goods ²	.8	9.3	7.3	.2	.5	.2
Finished goods	1.9	3.6	2.5	.2	.1	.3
Cap. goods ex. comp. & semi.	3.0	4.4	2.7	.2	.2	.3
Automotive products	.9	1.7	.9	.0	.1	.1
Consumer goods	.3	3.4	3.2	.3	.1	.4
Material-intensive goods	-.7	17.0	13.7	.3	.8	.0
Agricultural products	20.9	27.8	7.2	.0	2.7	1.5
Industrial supplies ex. ag.	-5.7	14.1	15.2	.5	.3	-.5
Computers	-3.4	-12.8	-11.6	-.3	-.3	-.6
Semiconductors	-3.3	-.8	3.8	.0	.0	.1
	----- NIPA prices -----					
Chain price index						
Imports of goods & services	-9.4	1.0	11.8	...	...	...
Non-oil merchandise	1.2	2.1	2.5	...	...	...
Core goods ¹	1.3	2.7	3.4	...	...	...
Exports of goods & services	-.8	3.6	5.2	...	...	...
Total merchandise	.1	3.5	4.8	...	...	...
Core goods ²	.3	6.0	7.1	...	...	...

1. Excludes computers, semiconductors, and natural gas.

2. Excludes computers and semiconductors.

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

Exports. In July, prices for U.S. exports of core goods rose 0.2 percent, after rising 0.5 percent in June. Prices for material-intensive exports were flat in the month, as a jump in prices for agricultural products was offset by a fall in prices for nonagricultural industrial supplies. As in June, higher prices for meat and grain led the surge in prices for agricultural products. For nonagricultural industrial supplies, prices for iron and steel fell sharply and prices for aluminum also declined. Prices for exported finished goods rose 0.3 percent, with higher prices for exported consumer goods registering the largest increase. Prices for exported computers fell, whereas prices of exported semiconductors edged up.

U.S. International Financial Transactions

After recording very strong net purchases in the first half of the year, foreign private investors on net sold U.S. securities in July, the first outflow recorded in nearly four years (line 4 of the Summary of U.S. International Transactions table). Foreign demand was weak for all types of U.S. long-term debt securities, especially for corporate and municipal bonds (line 4c). For these bonds, foreign residents sold, on net, \$12 billion in July. This was the first such net sale since July 1993, and a sharp change from purchases of \$63 billion in May and \$15 billion in June (middle-left panel of the chart on Private Security Flows). Foreigners also sold, on net, agency bonds (line 4b), while their purchases of U.S. Treasury securities were close to zero (line 4a). The largest sale of U.S. Treasury bonds was recorded against the Cayman Islands;

. Large sales were also recorded against Japan, perhaps attributable to an unwinding of yen-carry trades. There were net purchases recorded against Europe. We note that the weakness in foreigners' acquisitions coincided with an unusually low issuance of U.S. corporate bonds during July and an increase in the number of downgrades of mortgage-backed securities. Foreign acquisitions of U.S. equities also slowed in July but remained robust at \$18 billion (line 4d).

Partially offsetting the sales of U.S. securities, the banking sector (line 3) posted an especially large net inflow of \$67 billion during July; a significant portion of this inflow owes to an increase in banks' own liabilities against the Cayman Islands. Further, half of the bank inflow reflects foreign purchases of short-term U.S. securities other than U.S. Treasury bills (which are included in line 4), including commercial paper (\$12 billion) and certificates of deposit (\$16 billion).

U.S. acquisitions of foreign securities totaled only \$7 billion in July (line 5 and the bottom panels of the chart on Private Security Flows), roughly 1/3 of the total recorded in June. Most of the weakening in July's acquisitions was recorded against the United Kingdom, which yields little conclusive information as to the ultimate destination of these flows as many non-U.K. securities trade on U.K. exchanges. The weakening of U.S. demand was most notable for foreign bonds (line 5a) and may just reflect the significant contraction in international bond issuance by foreigners.

Foreign official inflows picked up to \$44 billion in July (line 1 and top-left panel of the chart on Foreign Official Financial Flows).

. However, for the past year, the timing of official purchases of U.S. securities (line 1) has roughly coincided with increases in the custody accounts at the FRBNY.

Combining official flows with private banking and private security flows yields a net inflow in July of \$97 billion, above the pace of the second quarter.

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

	2005	2006	2006		2007			
			Q3	Q4	Q1	Q2	Jun	Jul
Official financial flows	272.0	443.6	109.6	85.9	145.3	73.8	31.9	44.1
1. Change in foreign official assets in the U.S. (increase, +)	257.9	441.2	108.6	84.5	145.4	73.8	32.0	44.2
a. G-10 countries + ECB	12.8	21.4	6.6	10.0	9.1	6.2	1.6	6.7
b. OPEC	14.0	45.2	13.1	-6.8	12.0	0.4	-1.4	-0.4
c. All other countries	231.1	374.6	88.9	81.2	124.3	67.2	31.9	37.9
2. Change in U.S. official reserve assets (decrease, +)	14.1	2.4	1.0	1.4	-0.1	0.0	-0.2	-0.1
Private financial flows	505.3	389.6	145.4	139.3	57.4	n.a.	...	...
Banks								
3. Change in net foreign positions of banking offices in the U.S. ¹	15.4	136.1	60.8	29.6	-23.7	6.8	-44.4	67.4
Securities²								
4. Foreign net purchases (+) of U.S. securities	573.9	533.3	117.6	149.4	157.4	206.0	56.6	-7.4
a. Treasury securities	133.7	-35.1	-15.9	22.5	45.5	-12.7	8.2	1.6
b. Agency bonds	37.0	17.1	0.3	-11.6	-33.2	15.0	6.5	-15.7
c. Corporate and municipal bonds	311.2	402.5	97.3	109.6	100.6	98.5	14.6	-11.7
d. Corporate stocks ³	92.0	148.8	35.9	28.8	44.4	105.1	27.2	18.4
5. U.S. net acquisitions (-) of foreign securities	-197.0	-290.4	-52.9	-118.4	-86.7	-81.9	-23.5	-7.2
a. Bonds	-53.1	-152.5	-44.8	-53.8	-42.9	-41.1	-8.9	0.2
b. Stock purchases	-139.9	-119.1	-8.0	-52.2	-39.6	-40.8	-14.6	-7.5
c. Stock swaps ³	-4.0	-18.8	0.0	-12.4	-4.2	0.0	0.0	0.0
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	7.7	-235.4	-49.0	-66.1	-75.5	n.a.	...	...
7. Foreign direct investment in the U.S.	109.0	180.6	43.0	45.6	23.5	n.a.	...	...
8. Net derivatives (inflow, +)	n.a.	28.8	15.1	-1.2	14.8	n.a.	...	...
9. Foreign acquisitions of U.S. currency	19.0	12.6	1.1	8.4	-1.6	n.a.	...	...
10. Other (inflow, +) ⁴	-22.6	24.0	9.6	92.0	49.3	n.a.	...	...
U.S. current account balance (s.a.)	-754.8	-811.5	-217.3	-187.9	-192.6	n.a.	...	...
Capital account balance (s.a.)⁵	-4.1	-3.9	-0.5	-0.6	-0.6	n.a.	...	...
Statistical discrepancy (s.a.)	-18.5	-17.8	-37.1	-36.6	-9.6	n.a.	...	...

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 non-market means such as mergers and reincorporations.

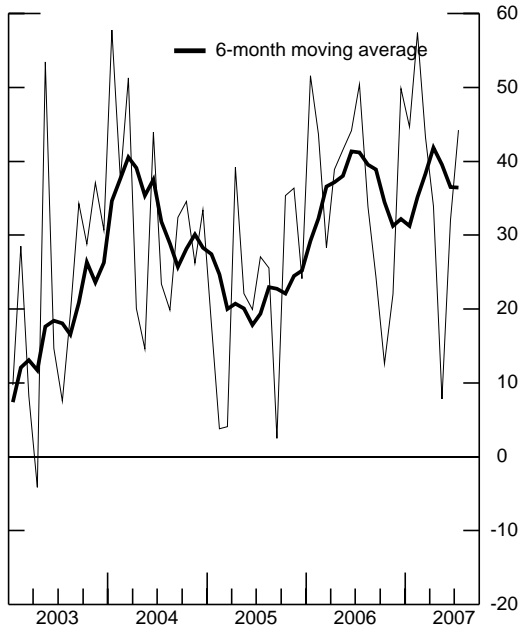
4. Transactions by nonbanking concerns and other banking and official transactions not shown elsewhere plus amounts resulting from adjustments made by the Department of Commerce and revisions in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.

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

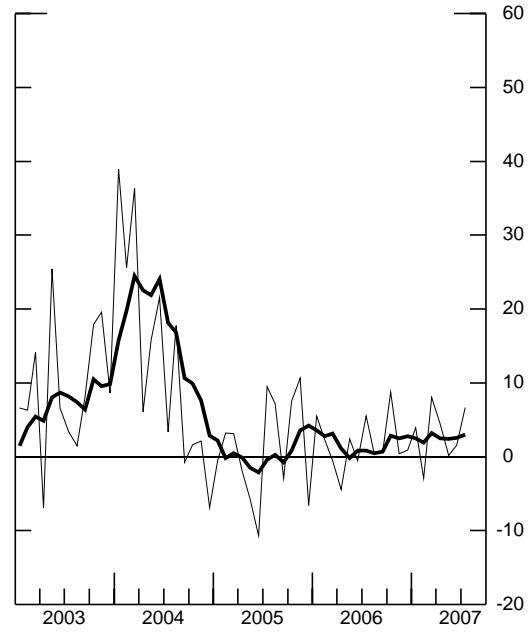
n.a. Not available. ... Not applicable.

Foreign Official Financial Flows Through July 2007 (increase, +)
 (\$ Billions, monthly, not seasonally adjusted)

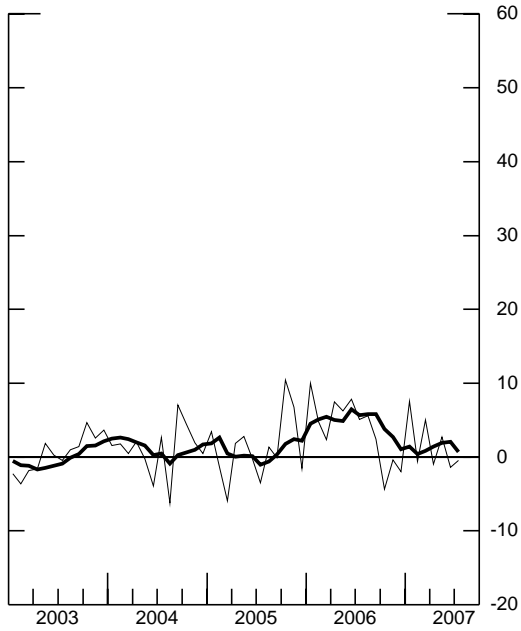
Total



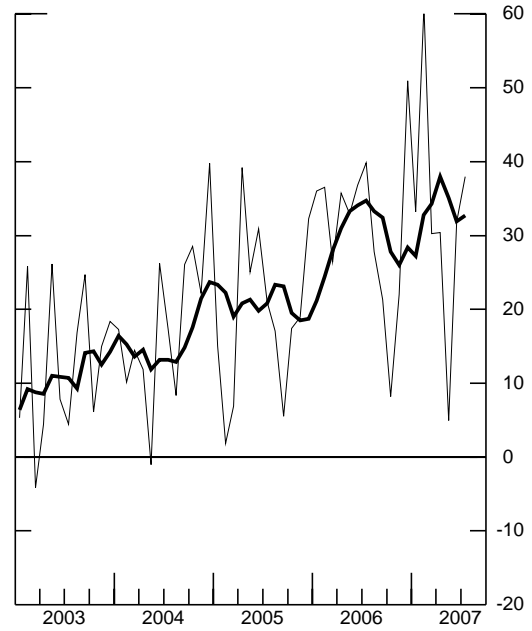
G-10 + ECB



OPEC



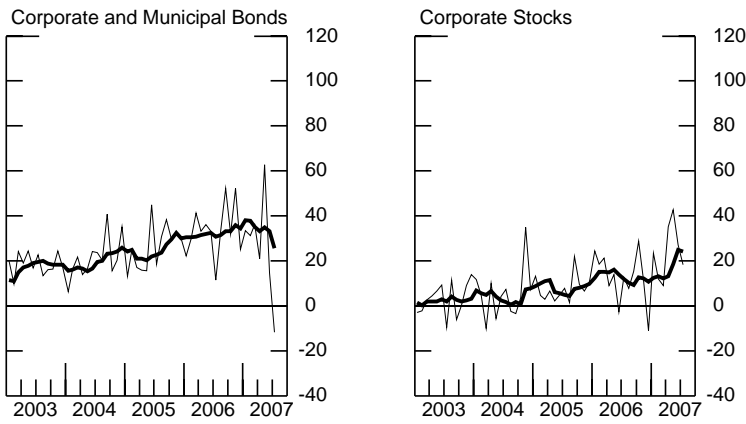
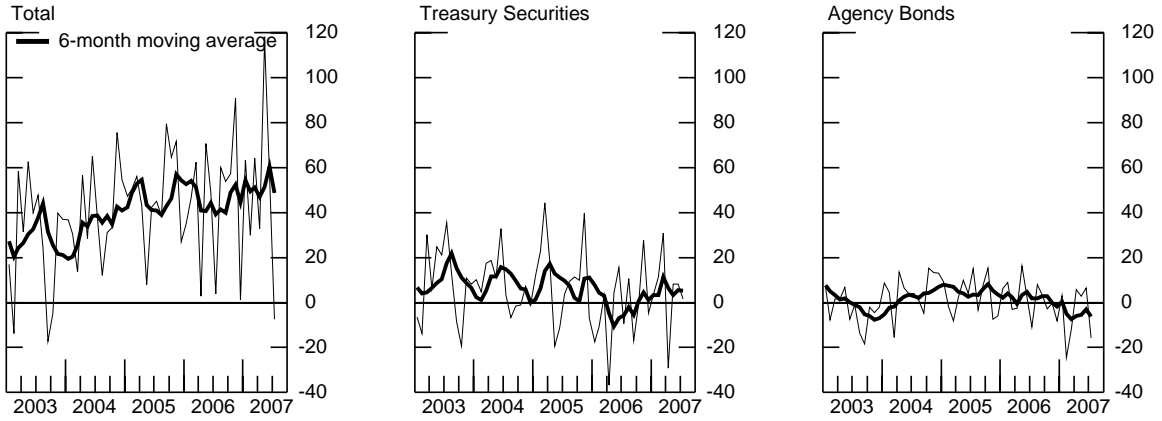
All other countries



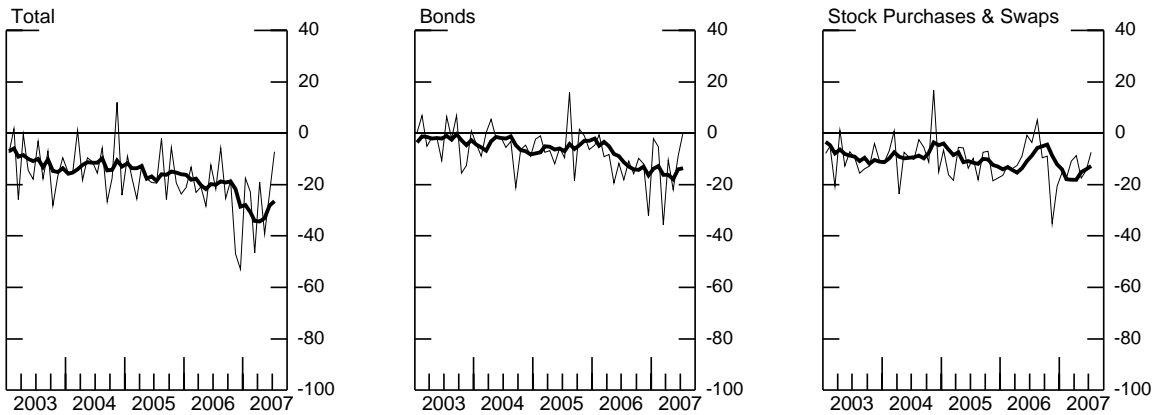
Private Securities Flows Through July 2007

(\$ Billions, monthly, not seasonally adjusted)

Foreign Net Purchases (+) of U.S. Securities



U.S. Net Acquisitions (-) of Foreign Securities



Foreign Financial Markets

At the time of the August FOMC meeting, several banks, including the German bank IKB Deutsche Industriebank, had begun to come under stress as they were called to extend credit to asset-backed commercial paper programs that they had sponsored and that had been used to fund purchases of U.S. mortgage-backed securities. Many banks increased their demand for liquidity on fears that there would be further draws on the credit lines that they had extended to commercial paper programs, placing pressure on overnight funding markets. Amid these fears, news on August 9 that the French bank BNP Paribas was restricting redemptions on three of its investment funds triggered a sharp market reaction, sending overnight rates well above central bank targets in most of the advanced foreign economies. The Federal Reserve, the European Central Bank, the Bank of Japan, the Bank of Canada, and the central banks of Australia, Norway, and Switzerland all conducted special market operations over the following week to inject liquidity into overnight funding markets.

Although central bank actions helped to partially stabilize overnight interest rates, concerns over liquidity led to funding difficulties in money markets at any but the shortest maturities. Premiums on 1- and 3-month interbank offer rates rose by as much as 60 basis points as financial institutions began to hoard the most liquid securities. These disruptions to domestic money markets also sharply impaired funding flows between money markets in the United States and Europe. According to market participants, bid-ask spreads in the foreign exchange swap market rose up to 20 times their normal levels on August 9 and 10 and volumes were about one tenth the normal amounts. European firms accustomed to accessing U.S. money markets for longer-term funding and using the foreign exchange swaps market to convert that funding back to euros may have experienced especially painful funding problems as a result. Term-money markets have yet to recover and premiums remain elevated, despite actions by the Federal Reserve and the European Central Bank to make longer-term funding available and decisions by the Bank of Canada and the Reserve Banks of Australia and of New Zealand to widen the set of securities that would be accepted as collateral.

Problems with asset-backed commercial paper (ABCP) have surfaced in almost all of the major markets. In Germany, in addition to IKB, Sachsen Landesbank was also unable to fund its ABCP conduit. The British special investment vehicle Cheyne Finance was forced to liquidate its assets and HBOS and Barclays both announced that they would expend funds to aid ABCP conduits that they had helped to establish. In Canada, a

conduit of the financial services company Coventree failed to roll its ABCP and numerous Canadian ABCP issuers requested to draw on their liquidity backstops. Commercial paper issuance slowed in most countries, particularly issuance of ABCP. Overall corporate bond issuance also fell markedly in the advanced foreign economies over July and August, and investment-grade corporate bond spreads have continued to rise modestly. Despite the continued financial turmoil, spreads on sub-investment grade credit default swaps have stabilized, though at high levels.

The trade-weighted exchange value of the dollar against its major trading partners has declined 1½ percent over the intervening period, but the dollar has appreciated a bit less than ⅓ percent against its other important trading partners. The yen has appreciated almost 3¾ percent against the dollar as heightened market volatility has encouraged the unwinding of carry trades, and the Australian and New Zealand dollars, popular targets of carry trade funds, have depreciated 2 and 7 percent respectively against the U.S. dollar. Major global equity markets fell sharply over the first half of August, but have since partially rebounded as the stream of headlines related to credit troubles has moderated. Financial and bank stocks were particularly hard hit, even in Japan, which is believed to have only limited exposure to the U.S. subprime-mortgage sector and has had only small losses related to it. Implied volatilities on the major equity indexes peaked in mid-August near levels last seen in 2002.

Emerging economy financial markets were affected by the turmoil in the advanced economies, with some illiquidity occurring in their foreign exchange and bond markets; however, investors appeared to discriminate among countries, and better performing economies have so far suffered fewer consequences. The exchange values of many emerging market currencies declined against the dollar and most emerging market stock indexes declined in mid-August at the height of market turmoil, but in most cases have since at least partially reversed. Although the Chinese renminbi depreciated against the dollar over the first half of August, it has since appreciated and is now ⅔ percent higher than at the time of the last FOMC meeting. The Chinese stock market has been largely unaffected by the recent turmoil, increasing 11 percent since the August FOMC meeting. The People's Bank of China raised benchmark interest rates at financial institutions for renminbi deposits and lending again on August 21, but this has had little effect on stock prices. In a move intended to help remove differences between on-shore and off-shore equity prices, the Chinese government announced that residents would be permitted to invest directly in Hong Kong-listed securities, but subsequently postponed the removal of controls.

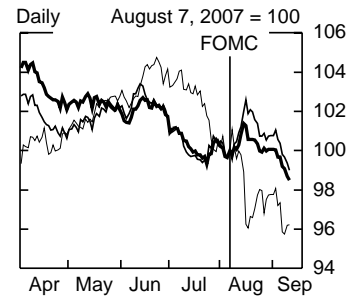
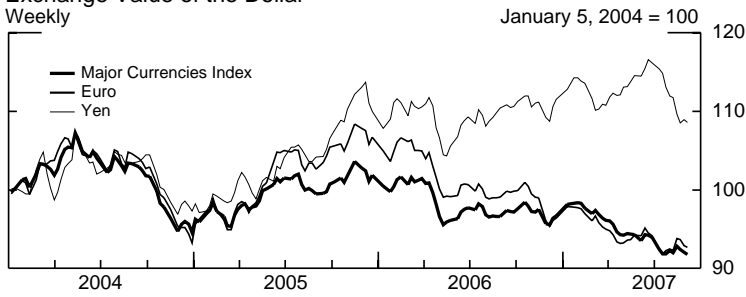
. The Desk did not intervene during the period for the accounts of the System or the Treasury. The Reserve Bank of Australia confirmed that it had intervened in currency markets on August 16 in what it said was an effort to restore liquidity to the foreign exchange market, but did not disclose the size of the operation or the currencies in which it had intervened.

Exchange Value of the Dollar and Stock Market Indexes

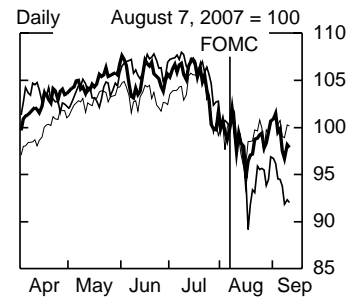
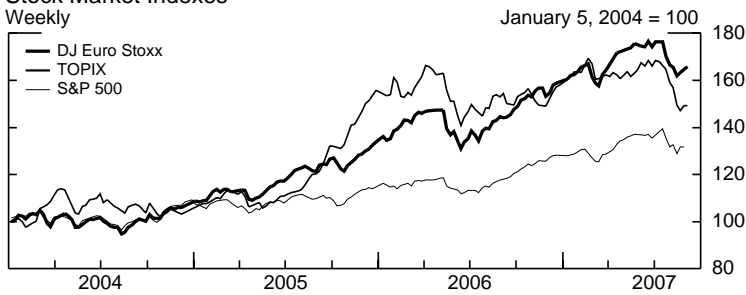
	Latest	Percent change since August FOMC
<i>Exchange rates*</i>		
Euro (\$/euro)	1.3886	-1.0
Yen (¥/\$)	114.0	-3.8
Sterling (\$/£)	2.0315	-0.6
Canadian dollar (C\$/\\$)	1.0413	-1.3
<i>Nominal dollar indexes*</i>		
Broad index	102.2	-0.6
Major currencies index	76.1	-1.5
OITP index	130.3	0.3
<i>Stock market indexes</i>		
DJ Euro Stoxx	402.8	-2.1
TOPIX	1528.3	-7.9
FTSE 100	6261.9	-0.7
S&P 500	1469.5	0.1

* Positive percent change denotes appreciation of U.S. dollar.

Exchange Value of the Dollar
Weekly



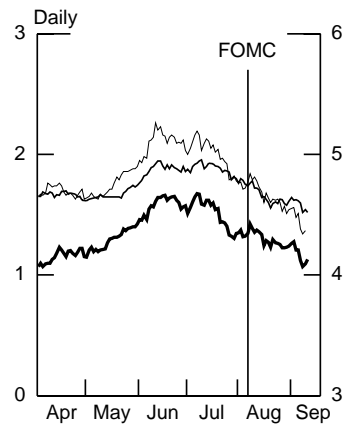
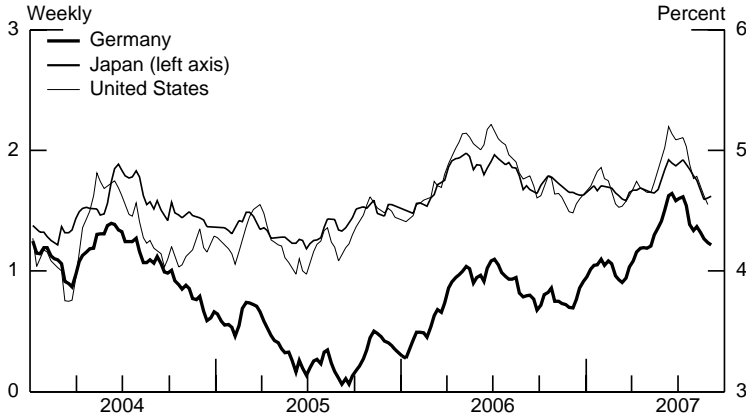
Stock Market Indexes
Weekly



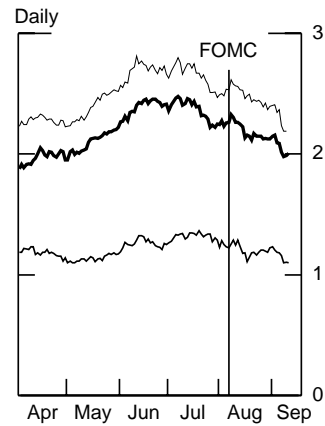
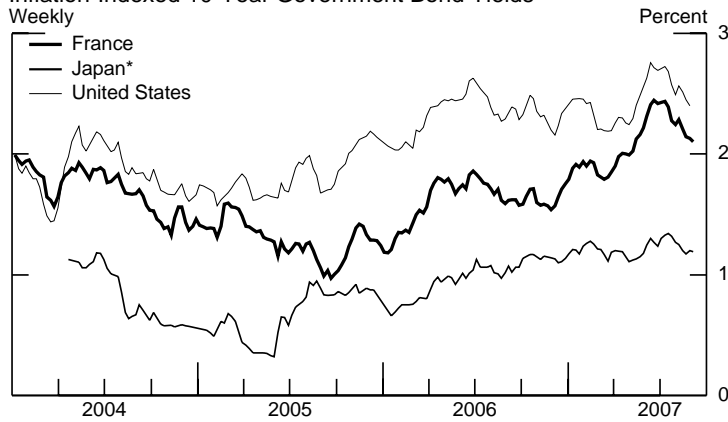
Industrial Countries: Nominal and Real Interest Rates

	3-month LIBOR		10-year nominal		10-year indexed		Percent
	Latest	Change since August FOMC	Latest	Change since August FOMC	Latest	Change since August FOMC	
Germany	4.74	0.41	4.13	-0.22	2.02	-0.27	
Japan	0.97	0.14	1.52	-0.22	1.10	-0.12	
United Kingdom	6.90	0.79	4.91	-0.30	1.73	-0.32	
Canada	5.34	0.65	4.32	-0.15	...	...
United States	5.70	0.35	4.37	-0.35	2.19	-0.35	

Nominal 10-Year Government Bond Yields



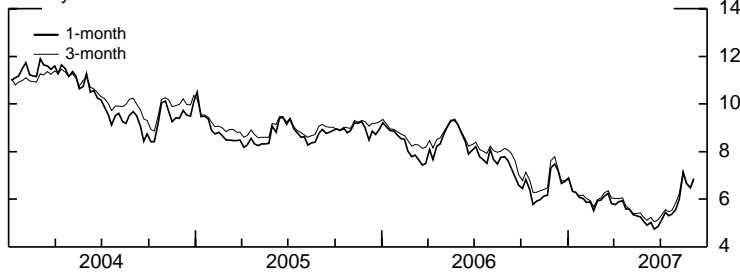
Inflation-Indexed 10-Year Government Bond Yields



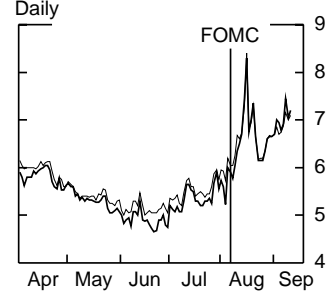
*Japan first issued inflation-indexed debt in March 2004.

Measures of Market Volatility

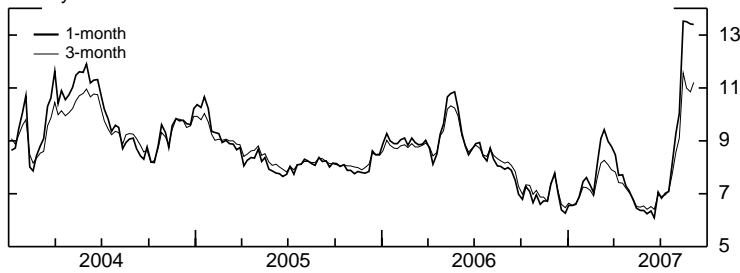
Dollar-Euro Options-Implied Volatility*
Weekly



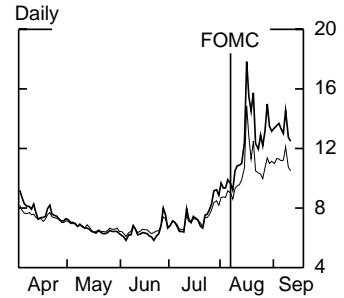
*Derived from at-the-money options.



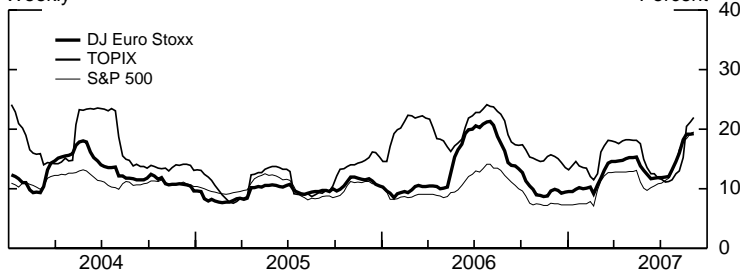
Yen-Dollar Options-Implied Volatility*
Weekly



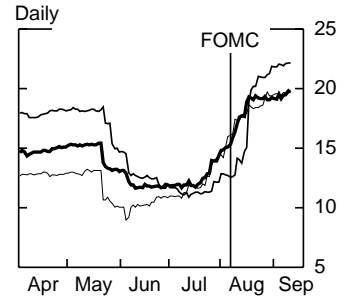
*Derived from at-the-money options.



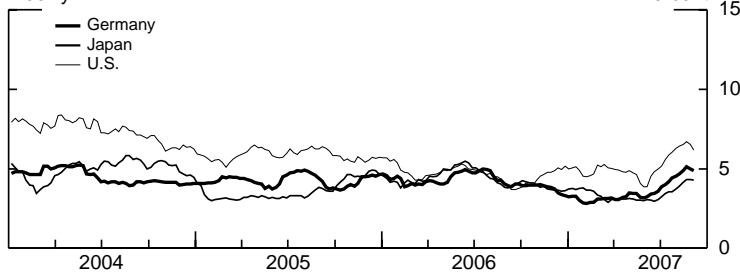
Realized Stock Market Volatility*
Weekly



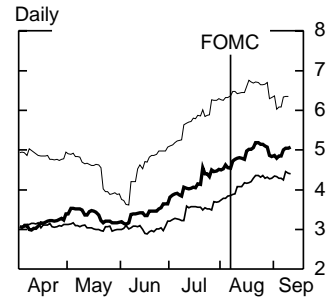
*Annualized standard deviation of 60-day window of daily returns.



Realized 10-Year Bond Volatility*
Weekly



*Annualized standard deviation of 60-day window of daily returns.

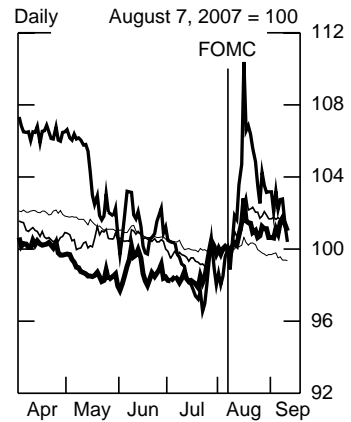
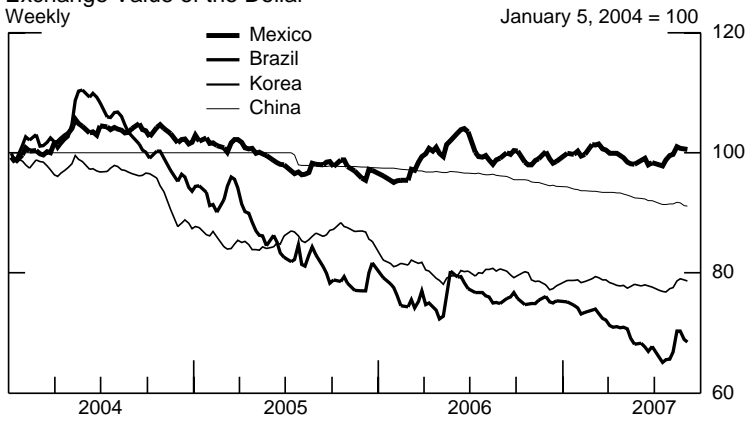


Emerging Markets: Exchange Rates and Stock Market Indexes

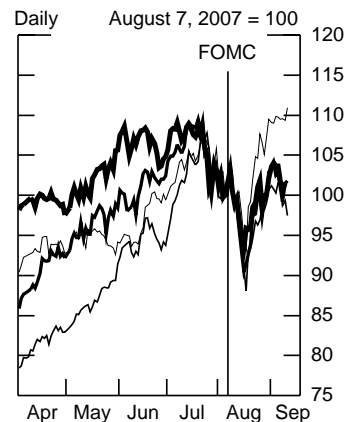
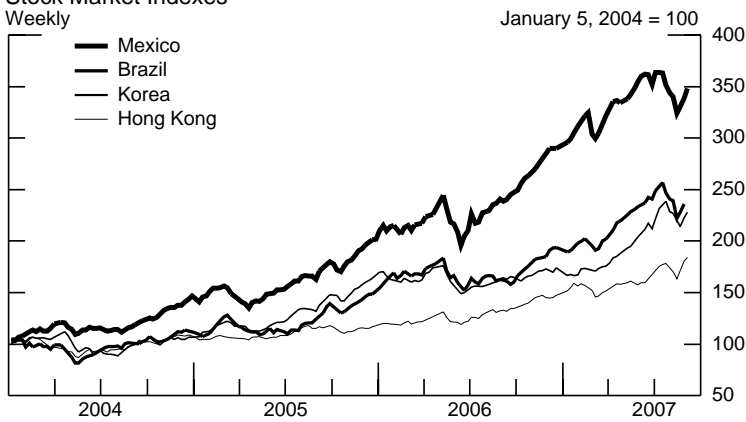
	Exchange value of the dollar		Stock market index	
	Latest	Percent change since August FOMC*	Latest	Percent change since August FOMC
Mexico	11.0710	1.0	30191	1.6
Brazil	1.9144	0.4	54054	1.8
Venezuela	2144.60	0.0	39292	-5.4
China	7.5216	-0.6	5173	11.2
Hong Kong	7.7883	-0.5	24310	11.0
Korea	932.7	1.1	1814	-2.5
Taiwan	33.06	0.5	9018	1.8
Singapore	1.5165	0.0	964	6.0
Thailand	32.10	6.2	802	-1.5

* Positive percent change denotes appreciation of U.S. dollar.

Exchange Value of the Dollar
Weekly



Stock Market Indexes
Weekly



Developments in Advanced Foreign Economies

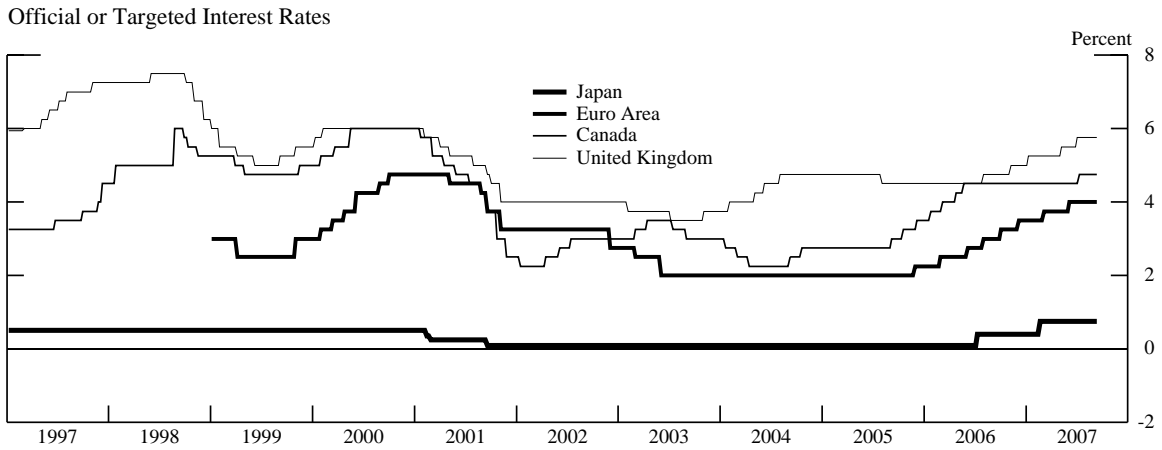
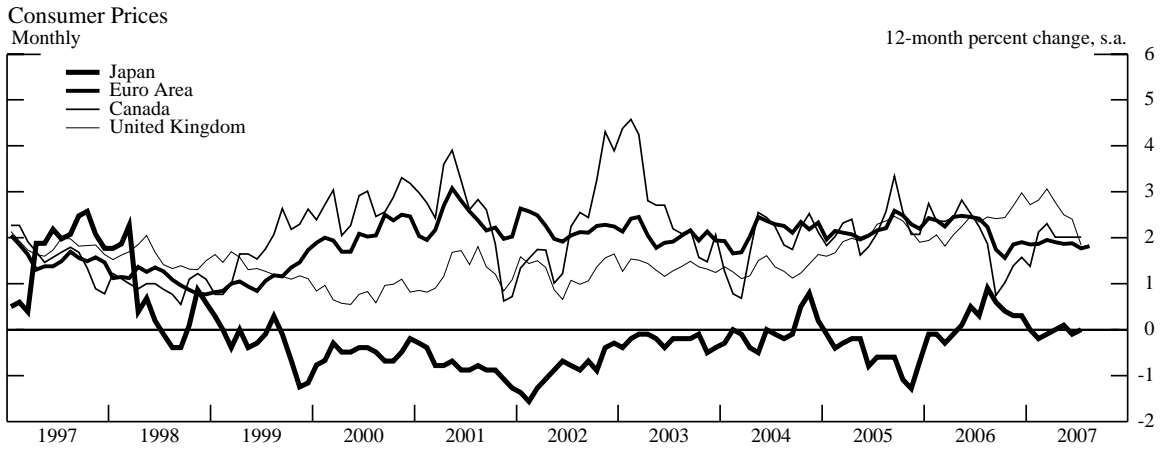
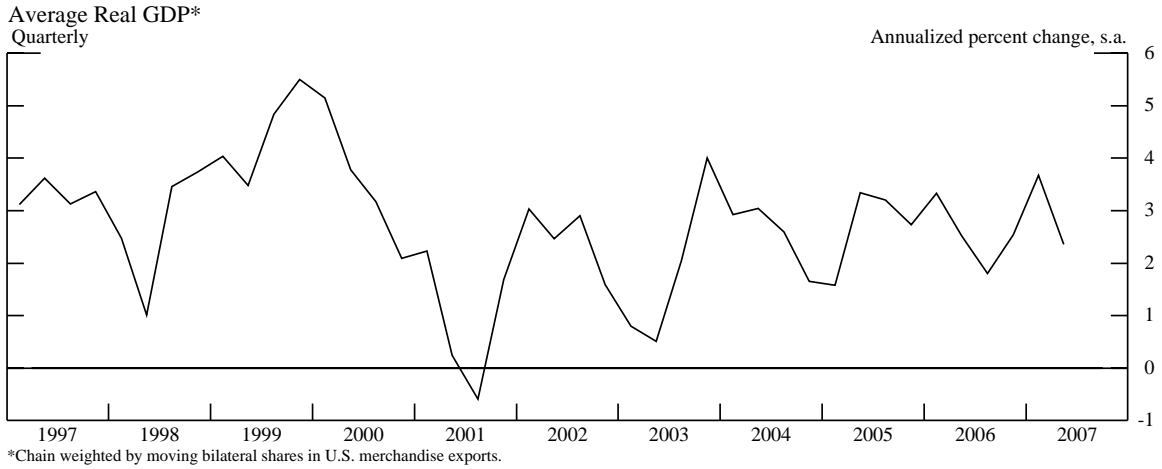
On average, economic indicators received since the August Greenbook have softened. Second-quarter GDP growth slowed in most advanced foreign economies, with the exception of the United Kingdom. The step-down was most pronounced in Japan, where GDP contracted 1.2 percent at an annual rate, but was also substantial in the euro area, where total domestic demand rose only about 0.5 percent (a.r.). Although growth edged down to 3.4 percent in Canada, data late in the quarter, including retail sales, indicated a more significant weakening in activity. This softness appears to have continued into the third quarter in some economies. In July, indicators in Europe generally have moderated on balance from their second-quarter levels; however those in Canada and Japan have slowed more notably. Most of the readings available on economic developments after August 9, when financial turmoil intensified, are measures of confidence. These measures dropped on average, but they are otherwise consistent with what was reported for July.

Headline inflation in most of the advanced foreign economies was close to 2 percent. Inflation rates held steady in Canada and the euro area, whereas in the United Kingdom the twelve-month rate dropped to 1.9 percent in July. In Japan, headline inflation was flat in July. No major central bank raised its policy rate during the intermeeting period, although as discussed above, most major central banks provided extra liquidity to overnight money markets in response to the recent turmoil in financial markets.

In **Japan**, real GDP contracted 1.2 percent in the second quarter, after two quarters of robust expansion. The declines in both public and private investment steepened markedly from the previous quarter. Also, consumption and export growth moved down noticeably, the latter bringing down the contribution from net exports substantially.

Recent indicators of economic activity suggest that the economy continues to show some weakness. Industrial production, industrial shipments, real household expenditures, and retail sales all fell in July. Temporary factors appear to have played a role, as an earthquake in northern Japan disrupted automobile production and bad weather weakened spending. However, the lackluster performance could also be more persistent since industrial production has now fallen in four of the last five months. Moreover, the continued decline in household earnings may also have contributed to weak consumer demand.

Advanced Foreign Economies



Japanese Real GDP

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

Component	2005 ¹	2006 ¹	2006		2007	
			Q3	Q4	Q1	Q2
GDP	2.8	2.5	-0.5	5.6	3.0	-1.2
Total domestic demand	2.0	2.0	-2.0	5.1	1.3	-1.3
Consumption	2.7	0.5	-3.7	4.3	3.4	1.0
Private investment	3.3	9.1	-0.2	11.7	-1.2	-6.2
Public investment	-0.1	-9.2	-18.4	15.7	-4.9	-9.9
Government consumption	0.7	1.4	2.2	0.3	-0.8	1.4
Inventories ²	-0.3	0.1	0.6	-0.3	-0.0	-0.4
Exports	10.1	6.3	9.1	3.5	14.2	3.1
Imports	4.2	2.7	-1.5	-0.3	3.6	2.4
Net Exports ²	0.9	0.6	1.5	0.6	1.6	0.2

1. Q4/Q4

2. Percentage point contribution to GDP growth.

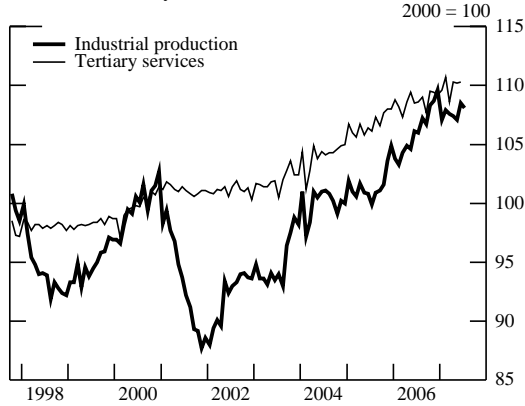
Notwithstanding the recent decline in output, the labor market continues to improve, with the unemployment rate falling to 3.6 percent in July, the best reading since February 1998. The job offers-to-applicants ratio (the number of officially posted job openings relative to the number of officially registered job seekers) remained flat at 1.07, close to a fifteen-year high. However, nominal wages continued to fall.

The nationwide core consumer price index (excluding fresh food only) fell 0.1 percent in July from a year earlier, the sixth consecutive month of decline, and the second-quarter GDP deflator fell 0.2 percent from a year ago. Meanwhile, the core CPI for Tokyo, a leading indicator of prices, remained unchanged from a year earlier in August.

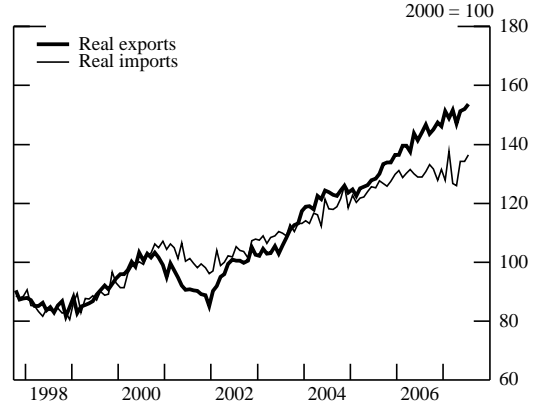
On September 12, Prime Minister Shinzo Abe resigned citing a lack of public trust that made it difficult to carry out government policies. His decision came as the Democratic Party of Japan opposed the passage of a law that would allow Japan to continue providing logistical support to U.S. led operations in Afghanistan. The ruling Liberal Democratic Party (LDP) announced that it will hold an election on September 19 to choose the successor to Prime Minister Abe. The LDP's secretary general, Taro Aso, and former finance minister, Sadakazu Tanigaki, are seen as possible contenders for the job.

Japan

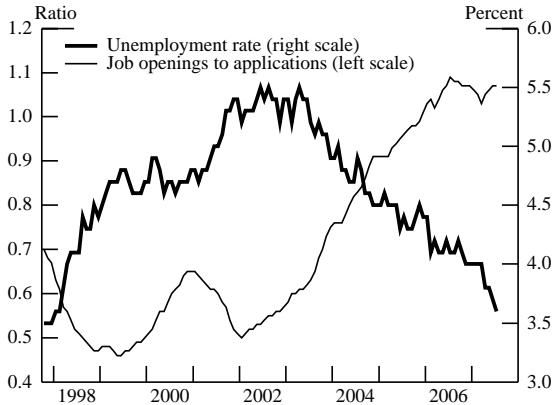
Economic Activity



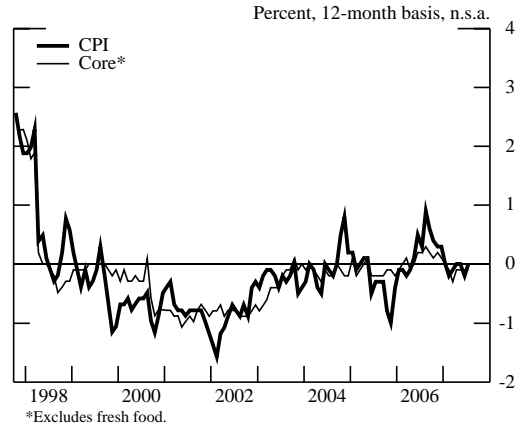
Real Trade



Labor Market



Consumer Price Inflation



Economic Indicators

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

Indicator	2006	2007		2007			
	Q4	Q1	Q2	May	June	July	Aug.
Housing starts	3.4	-4.6	1.2	-10.6	17.3	-30.1	n.a.
Machinery orders ¹	0.3	-0.7	-2.3	5.9	-10.4	17.0	n.a.
Household expenditures	1.6	1.0	-0.1	-0.2	-0.2	-1.2	n.a.
New car registrations	-2.1	-1.6	-2.5	1.0	-1.7	-2.6	11.5
Business sentiment ²	8.0	8.0	7.0	...	...	...	...
Wholesale prices ³	2.6	1.9	2.3	2.2	2.3	2.2	1.9

1. Private sector, excluding ships and electric power.

2. Tankan survey, diffusion index. Level.

3. Percent change from year earlier, n.s.a.

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

Euro-area GDP growth for the second quarter slowed to 1.4 percent at an annual rate, down from 2.9 percent in the previous quarter. The slowdown was widespread across the major euro-area countries and owed primarily to a decline in fixed investment following two quarters of strong growth. In addition, a drawdown of inventories subtracted ½ percentage point from GDP growth. In contrast, consumer spending rebounded after being flat in the first quarter as a result of the German VAT increase. Net exports contributed ¾ percentage point to GDP growth as export growth picked up.

Euro-Area Real GDP

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

Component	2005 ¹	2006 ¹	2006		2007	
			Q3	Q4	Q1	Q2
GDP	1.9	3.3	2.3	3.5	2.9	1.4
Total domestic demand	2.1	2.5	3.6	0.9	3.2	0.6
Consumption	1.3	2.1	2.0	1.9	0.0	2.0
Investment	4.1	5.9	3.0	7.1	8.1	-0.7
Government consumption	1.5	2.2	2.1	1.7	3.4	0.6
Inventories ²	0.1	-0.4	1.2	-1.9	0.7	-0.5
Exports	5.3	9.2	4.7	13.0	3.1	4.3
Imports	5.9	7.2	7.8	6.6	3.8	2.4
Net Exports ²	-0.2	0.9	-1.2	2.6	-0.3	0.8
Memo:						
GDP of selected countries						
France	1.4	2.1	0.3	1.5	2.2	1.3
Germany	1.6	3.9	3.0	4.0	2.2	1.0
Italy	0.7	2.8	1.2	4.6	1.1	0.5

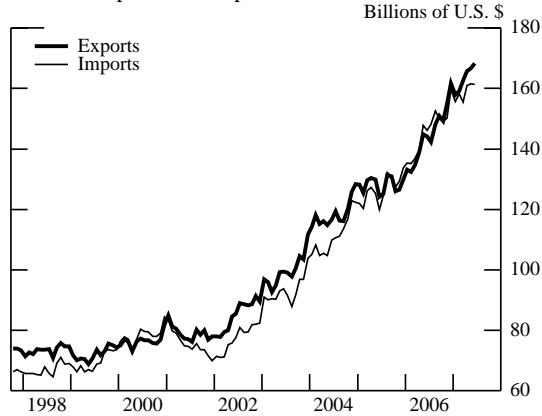
1. Q4/Q4

2. Percentage point contribution to GDP growth.

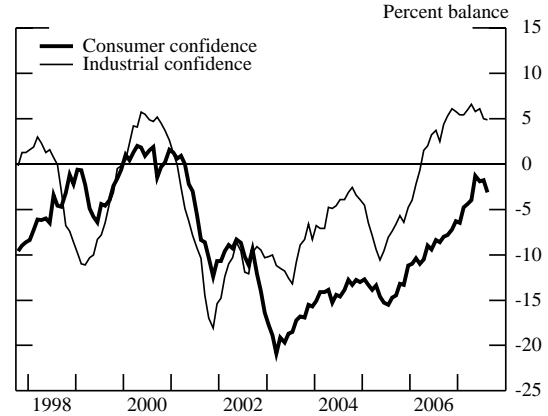
Other indicators of activity that had been relatively strong in the second quarter have moderated. German industrial production was almost unchanged in July. Euro-area manufacturing orders picked up sharply in June, though German orders plunged over 7 percent in July. The euro-area PMI for manufacturing declined from 54.9 in July to 54.3 in August but was still above the threshold for expansion. A number of business confidence measures, whose surveys include at least some responses after August 9, moved lower, including the European Commission survey of euro-area industrial confidence, the German IFO business climate index, and the ZEW survey of German financial market participants. The current conditions portions of these surveys

Euro Area

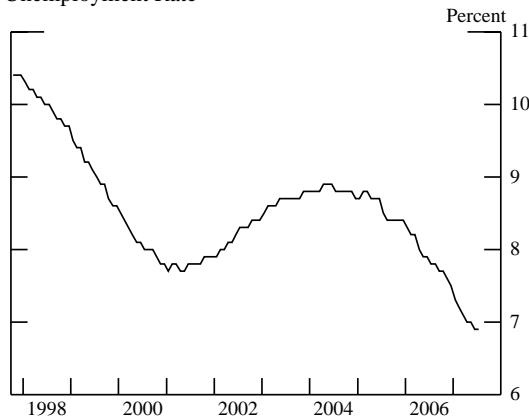
Nominal Exports and Imports



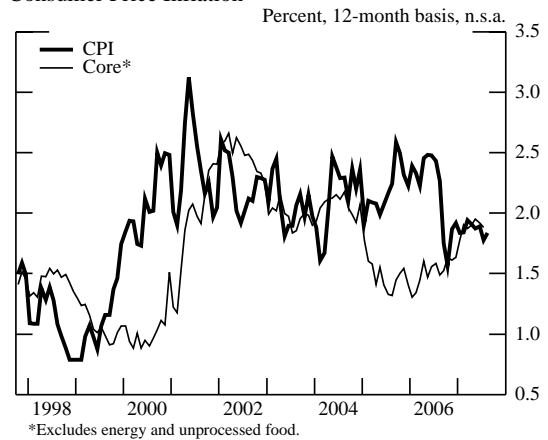
Economic Sentiment



Unemployment Rate



Consumer Price Inflation



Economic Indicators

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

Indicator	2006	2007		2007			
	Q4	Q1	Q2	Apr.	May	June	July
Industrial production ¹	0.7	0.9	0.4	-0.9	1.0	-0.0	0.5
Retail sales volume ²	0.3	0.0	0.1	-0.1	-0.8	0.6	0.1
New car registrations	3.5	-2.1	0.4	-5.4	4.3	1.4	n.a.
Employment	0.3	0.4	n.a.	...	...	...	...
Producer prices ³	4.1	3.0	2.4	2.5	2.4	2.3	1.8
M3 ³	9.9	11.0	10.9	10.3	10.6	10.9	11.7

1. Excludes construction.

2. Excludes motor vehicles.

3. Eurostat harmonized definition. Percent change from year earlier, s.a.

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

generally remained at a somewhat elevated level, even as the surveys of future prospects of activity weakened.

Retail sales in the euro area ticked up 0.1 percent in July, matching their rise in the second quarter. The euro-area unemployment rate continued at 6.9 percent in July; the unemployment rate has fallen about 1 percentage point over the past year. Other indicators collected after the financial disruptions intensified show more moderation. The service sector PMI edged down in August, but remained above its level in the second quarter. The European Commission survey of consumer sentiment declined fairly sharply in August, as consumers revised down their expectations of economic prospects. Nonetheless, consumer sentiment is still well above its long-run average.

Euro-area consumer prices inched up in August from the previous month, according to the preliminary estimate. The twelve-month increase in consumer prices was steady at 1.8 percent.

U.K. Real GDP

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

Component	2005 ¹	2006 ¹	2006		2007	
			Q3	Q4	Q1	Q2
GDP	1.8	3.1	2.8	3.3	2.8	3.4
Total domestic demand	1.0	3.5	0.3	2.6	2.8	3.8
Consumption	1.3	2.7	1.2	4.5	1.9	2.9
Investment	4.0	9.8	8.7	13.1	4.5	-4.3
Government consumption	2.5	1.9	1.3	1.8	2.2	3.2
Inventories ²	-1.0	-0.3	-1.9	-2.9	0.2	1.8
Exports	13.1	-1.1	-38.5	-1.4	-3.3	-4.0
Imports	9.1	0.1	-39.8	-3.0	-2.6	-1.7
Net Exports ²	0.7	-0.4	2.5	0.6	-0.1	-0.6

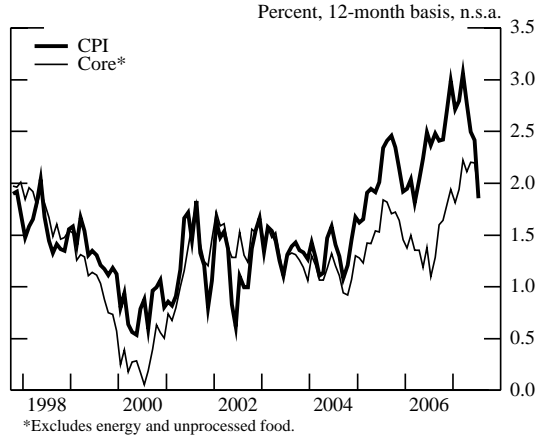
1. Q4/Q4

2. Percentage point contribution to GDP growth.

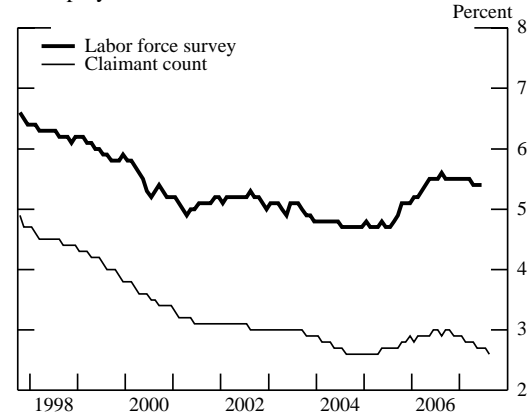
In the **United Kingdom**, real GDP growth increased to 3.4 percent in the second quarter. Private consumption grew 2.9 percent, up 1 percentage point from the first quarter. Higher inventories added 1.8 percentage points to output growth. Investment spending, which had been vigorous over the past two years, fell 4.3 percent. Business investment remained strong, however, expanding 3.2 percent, but government investment more than offset this as it returned to a moderate pace after an exceptionally strong first quarter.

United Kingdom

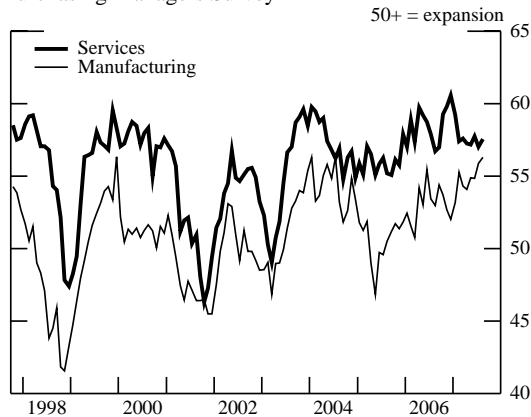
Consumer Price Inflation



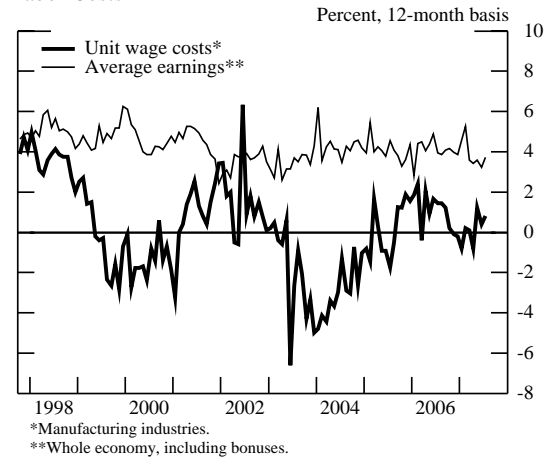
Unemployment Rates



Purchasing Managers Survey



Labor Costs



Economic Indicators

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

Indicator	2006	2007		2007			
	Q4	Q1	Q2	May	June	July	Aug.
Producer input prices ¹	3.6	-0.9	1.0	1.3	2.5	0.3	0.6
Industrial production	-0.1	-0.1	0.7	0.5	0.0	-0.1	n.a.
Business confidence ²	8.3	20.3	20.3	18.0	25.0	10.0	13.0
Consumer confidence ²	-4.9	-6.2	-4.2	-3.2	-2.9	-2.8	-2.1
Trade balance ³	-23.6	-23.7	-24.1	-7.8	-7.7	-9.0	n.a.
Current account ³	-27.7	-23.8	n.a.	...	...	...	...

1. Percent change from year earlier.

2. Percent balance. 3. Level in billions of US Dollars.

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

Recent data, including surveys that collected information partly after August 9, suggest that the economic expansion has continued at a moderate pace in the third quarter. Consumer confidence reached a two-year high in August, in part as households' expectations about their ability to save improved. Retailers reported that total sales rose about 4 percent in August from a year earlier. Business confidence firmed in August but, having plunged in July, remained well below its average over the first half of 2007. Among consumer services firms, optimism about the business situation tumbled in the third quarter. Nevertheless, the PMI for services stayed elevated in August, and the PMI for manufacturing and construction were at their highest levels since 1994 and 1998, respectively.

The claimant count measure of the unemployment rate edged down to 2.6 percent in August, matching a thirty-year low achieved in late 2004 and early 2005. The Labor Force Survey measure of the unemployment rate was unchanged at 5.4 percent in July. Average earnings including bonuses grew 3.8 percent in the twelve months to July, while unit wage costs in the manufacturing sector rose 0.8 percent over that period.

The twelve-month rate of consumer price inflation fell sharply in July, dipping to 1.9 percent. It was the first time since March 2006 that the headline inflation was below the Bank of England's target of 2 percent. Core inflation, which excludes energy and unprocessed food, also fell to 1.9 percent. Food products, household furniture, natural gas and electricity services made the largest contributions to the deceleration in inflation.

In **Canada**, real GDP growth edged down to a still-robust pace of 3.4 percent (a.r.) in the second quarter. Personal consumption expenditure rose 4.9 percent, fuelled by gains in income. After falling in the first quarter, business investment in machinery and equipment rebounded in the second quarter. Exports of goods and services increased 2.9 percent as exports of energy products surged. Exports of manufactured goods registered mixed results as automotive product exports plummeted and industrial goods and materials bounced back following a decline in the first quarter. Imports also increased rapidly, resulting in an overall negative net export contribution.

Canadian Real GDP

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

Component	2005 ¹	2006 ¹	2006		2007	
			Q3	Q4	Q1	Q2
GDP	3.2	1.9	1.3	1.5	3.9	3.4
Total domestic demand	4.1	3.3	2.5	-0.2	3.7	4.8
Consumption	3.8	4.5	5.1	3.7	3.4	4.9
Investment	9.8	4.9	3.3	4.3	1.6	4.1
Government consumption	2.6	3.1	1.5	3.0	2.4	2.6
Inventories ²	-0.7	-1.0	-1.5	-4.0	1.0	0.5
Exports	4.5	-0.9	2.6	2.7	0.8	2.9
Imports	7.1	3.0	6.2	-0.9	-0.4	6.4
Net Exports ²	-1.1	-1.6	-1.6	1.4	0.5	-1.5

1. Q4/Q4

2. Percentage point contribution to GDP growth.

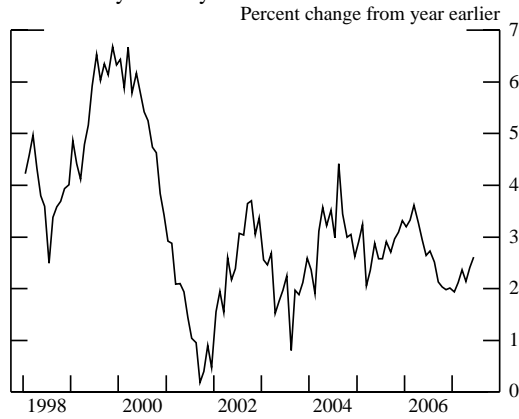
The second quarter ended on a weak note, and data for the third quarter are sparse. While consumer spending was strong in the second quarter, the trajectory coming into the third quarter is slower, as retail sales fell 0.6 percent in June. Real manufacturing shipments fell 1.7 percent in June suggesting continued weakness in business fixed investment, and the manufacturing PMI remains below its second-quarter level despite recovering some in August. After sliding 4 percent in both June and July, housing starts recovered 5 percent in August. The nominal surplus of merchandise trade narrowed further in July. Although real exports improved from a dip in June, real imports rose 4 percent.

In August, employment growth increased slightly from its subdued July pace. Unusually large increases in public-sector and education services accounted for most of the August increase. Education services had experienced a larger-than-normal decline in July. Despite the August pickup, employment gains are still well below the pace of the first half of 2007. The unemployment rate remained unchanged at its thirty-three-year low of 6 percent in August. Twelve-month wage inflation increased to 4 percent from 3.8 percent in July.

The twelve-month rate of consumer price inflation remained at 2.2 percent (n.s.a.) in July for the fourth consecutive month. Core inflation, which excludes the eight most volatile components and the effects of changes in indirect taxes, ticked down to 2.3 percent in July from 2.5 percent in June.

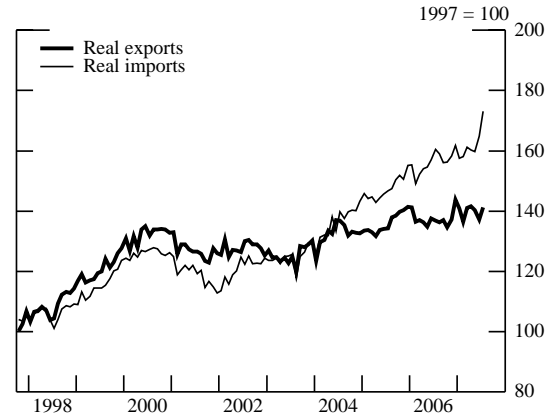
Canada

Real GDP by Industry*

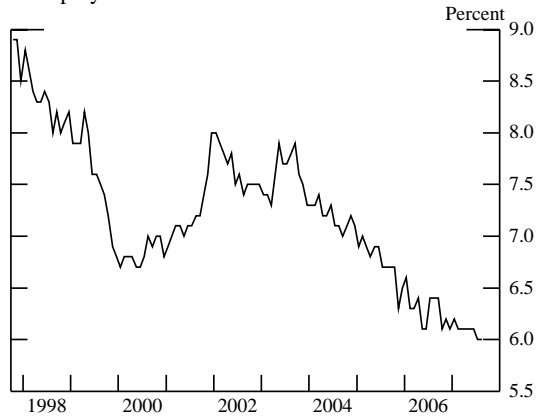


*Constructed from various Statistics Canada surveys and supplements the quarterly income and expenditure-based estimates.

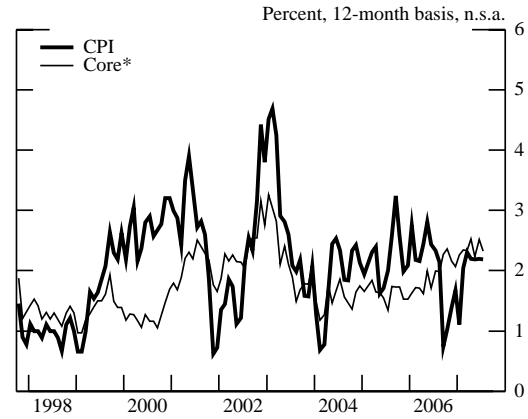
Real Trade



Unemployment Rate



Consumer Price Inflation



*Excludes 8 most volatile components and the effects of changes in indirect taxes.

Economic Indicators

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

Indicator	2006	2007		2007			
	Q4	Q1	Q2	May	June	July	Aug.
Industrial production	-1.2	0.8	0.4	-0.2	0.4	n.a.	n.a.
New manufacturing orders	1.5	0.7	-0.2	1.5	-1.9	n.a.	n.a.
Retail sales	0.7	1.1	2.6	2.3	-0.6	n.a.	n.a.
Employment	0.6	1.0	0.3	0.1	0.2	0.1	0.1
Consumer attitudes ¹	99.8	98.3	96.6	...	...	...	...
Business confidence ¹	108.1	102.1	106.7	...	...	...	...

1. 2002=100.

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

Economic Situation in Other Countries

Data through July, before the recent financial market volatility, suggest that economic activity in emerging market countries remained robust. Output in the Asian economies soared in the second quarter, with several countries posting at or near double-digit growth. In Latin America, Mexican and Venezuelan output rebounded sharply from earlier weakness. Chinese indicators for July point to only a modest slowing of output growth from its red-hot pace in the first half of this year. The scant August data received thus far provide little indication that the turmoil in financial markets has had a significant negative impact on real economic activity in emerging market economies. Data for the third quarter show some pickup in inflation, in part related to further increases in food prices.

In **China**, incoming data point to some moderation of economic activity in the third quarter. Industrial production fell in July on a seasonally-adjusted basis, and there was a significant deceleration of exports (s.a.) in July and August, which has contributed to a narrowing of the trade surplus. The slower export growth was expected, as its strength in prior months had reflected a pulling forward of shipments ahead of cuts in value-added tax rebates on many exports effective July 1. Fixed investment for the twelve months ending in July posted a strong increase of 26½ percent, but this was slightly lower than the pace seen in recent months.

Consumer prices continued to accelerate in July and August, with twelve-month increases of about 5½ and 6½ percent, respectively. As in recent months, the acceleration in prices can be explained entirely by a runup in prices of food. In addition to the hog-disease cycle, which is still playing out, floods in parts of China are also pushing up food prices. While non-food price inflation remains low, at less than 1 percent, concerns about food price increases spilling into non-food prices have intensified, as money growth has picked up significantly to 18½ percent for the twelve months ending in July. As expected, Chinese authorities undertook another round of monetary policy tightening in August, raising the benchmark one-year bank lending rate 18 basis points to 7.02 percent. The increase in inflation pushed real deposit rates further into negative territory. In response, the Chinese government raised the benchmark one-year deposit rate 27 basis points to 3.6 percent and the reserve requirement ratio 50 basis points to 12.5 percent.

In a small but important step toward capital account liberalization in late August, China's State Administration of Foreign Exchange announced a pilot program giving permission to some individual investors in China to make overseas investments in Hong Kong-listed securities. Under the program, such investments can be done only by opening an account with a Bank of China (BOC) branch that has an agency arrangement with BOC's Tianjin branch. If the program, which has yet to be implemented, becomes more widespread and investments are also allowed in other international markets, it has the potential to somewhat ease pressure on the renminbi to appreciate. Anticipation of investments from mainland China led to a rally in the H-shares (Chinese enterprises) index of Hong Kong's market.

Chinese Economic Indicators

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

Indicator	2005	2006	2007				
			Q1	Q2	Jun.	Jul.	Aug.
Real GDP ¹	10.0	10.4	14.2	14.7	...	...	...
Industrial production	17.2	14.3	4.1	8.1	6.0	-1.8	n.a.
Consumer prices ²	1.5	2.7	2.8	3.6	4.2	5.6	6.4
Merch. trade balance ³	102.0	177.5	249.4	280.6	309.8	261.4	249.9

1. Annual rate. Quarterly data estimated by staff from reported four-quarter growth rates. Annual data are Q4/Q4.

2. Percent change from year-earlier period, except annual data, which are Dec./Dec.

3. Billions of U.S. dollars, annual rate. Imports are c.i.f.
n.a. Not available. ... Not applicable.

In **Hong Kong**, real GDP jumped 8.2 percent in the second quarter following below-trend growth in the first quarter. Domestic demand surged, with private consumption and fixed investment both up sharply. The unemployment rate has continued to trend lower and in July fell to its lowest level since 1998. In addition, the volume of exports and imports in July grew 8 and 9 percent (relative to a year earlier), respectively.

Twelve-month inflation remained well under 2 percent in July as a result of a rent concession on public housing, which is scheduled to expire in October, but inflation has been trending upward over the past few months.

Hong Kong Economic Indicators

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

Indicator	2005	2006	2007				
			Q1	Q2	May	Jun.	Jul.
Real GDP ¹	7.8	7.2	2.4	8.2	...	...	...
Unemployment rate ²	5.7	4.8	4.3	4.2	4.3	4.2	4.1
Consumer prices ³	1.4	2.3	1.7	1.3	1.3	1.4	1.6
Merch. trade balance ⁴	-10.5	-17.9	-17.6	-18.8	-9.4	-35.1	-21.3

1. Annual rate. Annual data are Q4/Q4.

2. Percent. Monthly data are averages of the current and previous two months.

3. Percent change from year-earlier period, except annual data, which are Dec./Dec.

4. Billions of U.S. dollars, annual rate. Imports are c.i.f.

... Not applicable.

In **Taiwan**, output growth rebounded to 7.6 percent in the second quarter from a first-quarter trough. After contracting in the first quarter, industrial production jumped nearly 8 percent in the second quarter and surged in July. The unemployment rate remained at 3.9 percent in July, and the healthy labor market has helped support domestic consumption. In addition, trade data thus far in the third quarter have shown strong growth in exports, particularly in August. Although twelve-month consumer price inflation was near zero in the second quarter and July, prices rose 1.6 percent in August. Typhoons destroyed crops, which boosted food prices, and clothing prices increased.

Taiwan Economic Indicators

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

Indicator	2005	2006	2007				
			Q1	Q2	Jun.	Jul.	Aug.
Real GDP ¹	6.5	4.0	1.7	7.6	...	...	...
Unemployment rate ²	4.1	3.9	3.9	3.9	3.9	3.9	n.a.
Industrial production	4.6	5.0	-1.0	7.8	1.5	4.8	n.a.
Consumer prices ³	2.2	.7	1.0	.3	.1	-.3	1.6
Merch. trade balance ⁴	7.8	11.6	15.2	11.5	16.6	.5	30.4
Current account ⁵	16.0	24.7	34.6	19.9	...	...	...

1. Annual rate. Annual data are Q4/Q4.

2. Percent.

3. Percent change from year-earlier period, except annual data, which are Dec./Dec.

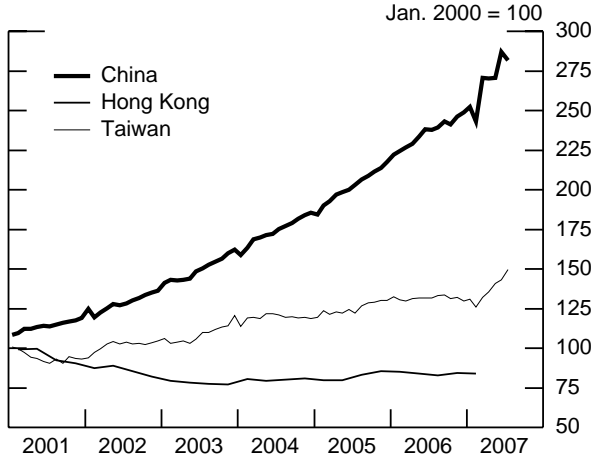
4. Billions of U.S. dollars, annual rate. Imports are c.i.f.

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

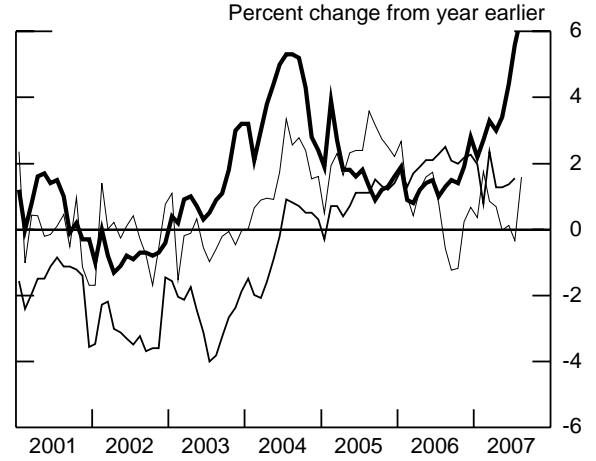
n.a. Not available. ... Not applicable.

China, Hong Kong, and Taiwan

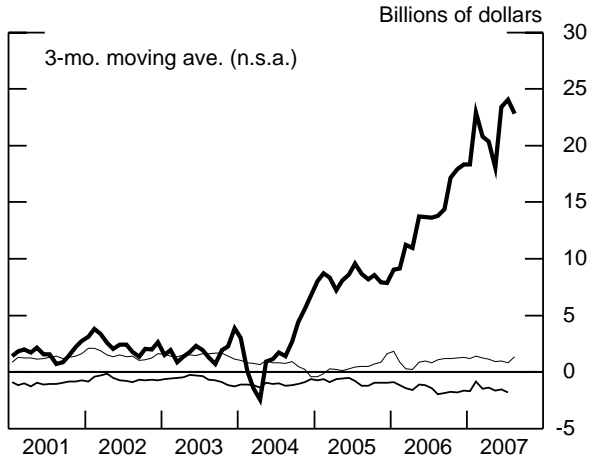
Industrial Production



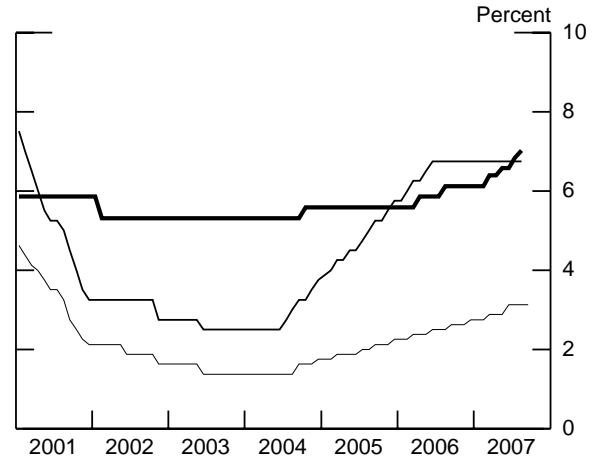
Consumer Prices



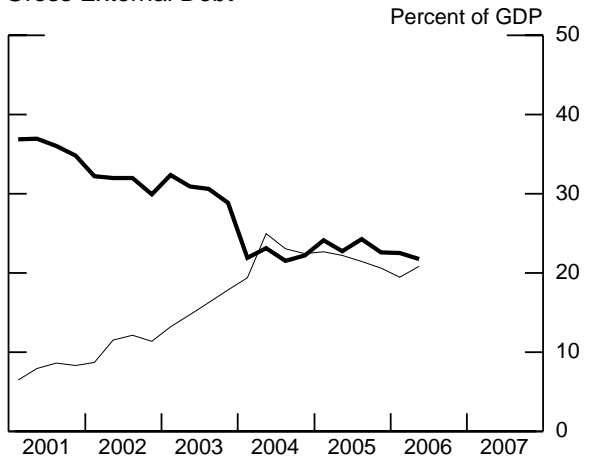
Merchandise Trade Balances



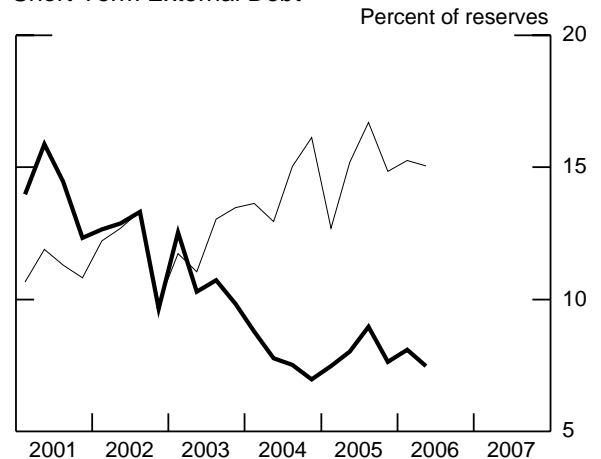
Benchmark Interest Rates



Gross External Debt



Short-Term External Debt



Major economic indicators for **Korea** have remained strong so far in the third quarter. Industrial production jumped 2.1 percent in July, supported by surging high-tech production. Korea's merchandise trade balance was sizable in July, and the current account balance recovered further. Trade indicators for August also show continued strength. In addition, July service activity and retail sales also strengthened. Despite the recent financial market turmoil, August measures of business and consumer confidence, remained elevated. Consumer price inflation dropped to 2 percent over the twelve months ended August, reflecting lower energy and food prices. Inflation has held at or below the lower bound of the Bank of Korea's 2.5 to 3.5 percent target range; however, sharp increases in lending by financial institutions led the Bank to tighten the target interest rate for the second consecutive month in August to 5 percent. The Bank of Korea held rates steady at its September meeting. Broad money growth slowed slightly to 10 percent in July.

Korean Economic Indicators

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

Indicator	2005	2006	2007				
			Q1	Q2	Jun.	Jul.	Aug.
Real GDP ¹	5.7	4.0	3.6	7.4	...	...	...
Industrial production	5.8	10.8	-6	4.4	1.9	2.1	n.a.
Unemployment rate ²	3.7	3.4	3.2	3.3	3.3	3.4	n.a.
Consumer prices ³	2.6	2.1	2.0	2.5	2.6	2.5	2.0
Merch. trade balance ⁴	32.7	29.2	29.5	25.2	30.7	27.5	n.a.
Current account ⁵	15.0	6.1	-6.6	.1	15.3	19.6	n.a.

1. Annual rate. Annual data are Q4/Q4.

2. Percent.

3. Percent change from year-earlier period, except annual data, which are Dec./Dec.

4. Billions of U.S. dollars, annual rate. Imports are c.i.f.

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

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

In **India**, output rose nearly 10 percent in the second quarter after a double-digit gain the quarter earlier. Agriculture and construction output fell back after previous sharp increases, but manufacturing production continued to surge and service sector output remained robust. The trade deficit, which had widened considerably in the second quarter, narrowed somewhat in July as imports shrank and exports expanded. FDI inflows soared in the second quarter; and while foreign investors withdrew from the stock market in early August, equity prices have almost recovered to their late July peak. Thus far in the third quarter, twelve-month inflation of both the CPI and the more closely watched wholesale price index have been below their second-quarter levels, in part

reflecting earlier administrative measures to lower prices of selected imported goods including fuels. In August, key domestic and foreign lenders in India announced that an Indian credit bureau to evaluate individual borrowers will be operational in November, and the Reserve Bank of India announced it would launch an electronic reporting platform for derivative products starting at the end of August.

Indian Economic Indicators

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

Indicator	2005	2006	2007				
			Q1	Q2	Jun.	Jul.	Aug.
Real GDP ¹	9.3	8.7	13.1	9.9	...	...	...
Industrial production	7.9	10.5	3.7	3.0	.1	n.a.	n.a.
Consumer prices ²	5.6	6.5	7.0	5.7	4.8	5.5	n.a.
Wholesale prices ²	4.4	5.7	6.4	5.4	4.5	4.4	3.9
Merch. trade balance ³	-43.9	-54.4	-60.8	-76.0	-84.5	-63.8	n.a.
Current account ⁴	-7.8	-9.4	10.3	n.a.	...	...	...

1. Annual rate. Annual data are Q4/Q4.

2. Percent change from year-earlier period, except annual data, which are Dec./Dec.

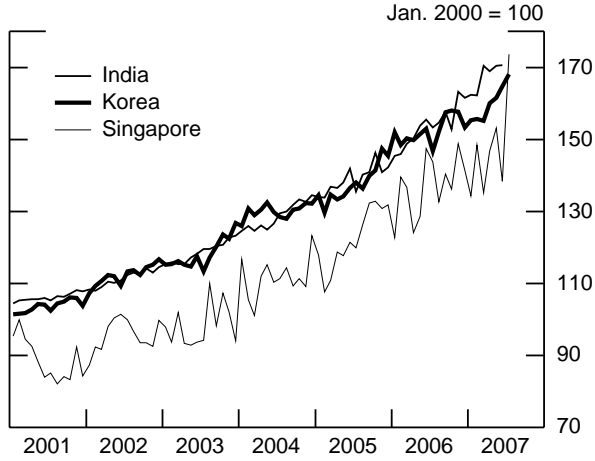
3. Billions of U.S. dollars, annual rate.

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

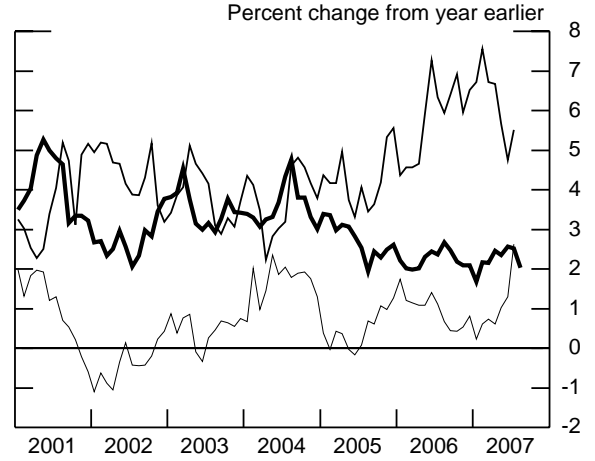
n.a. Not available. ... Not applicable.

India, Korea, and Singapore

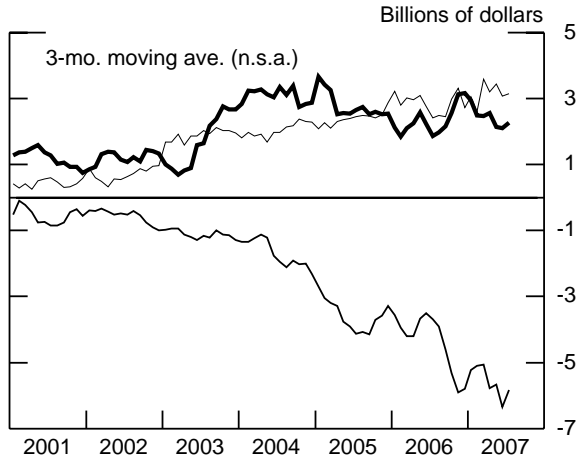
Industrial Production



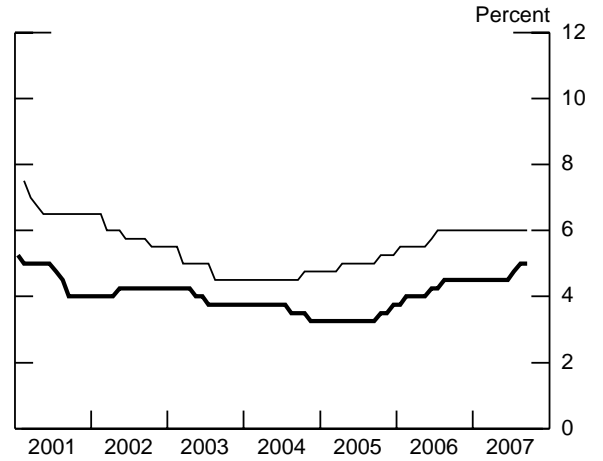
Consumer Prices



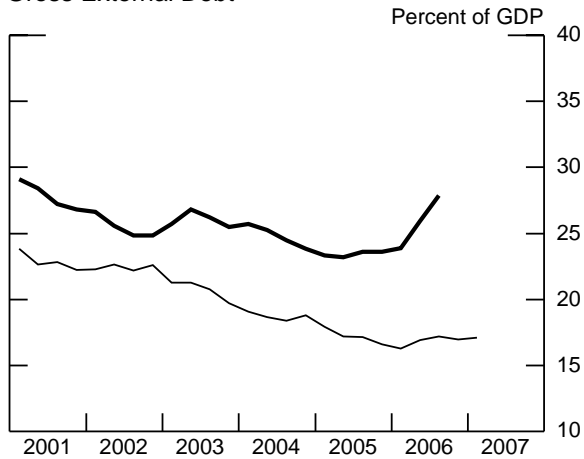
Merchandise Trade Balances



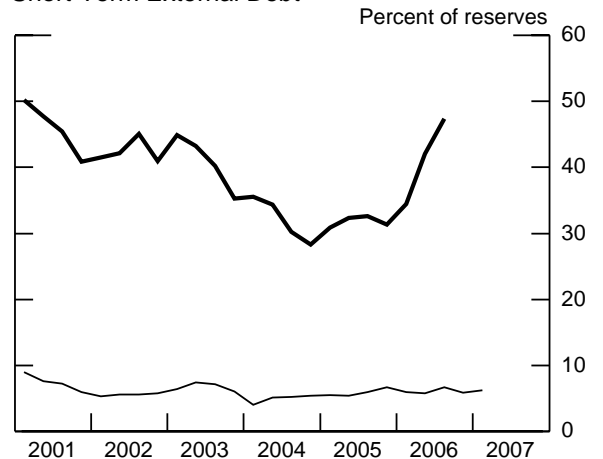
Benchmark Interest Rates



Gross External Debt



Short-Term External Debt



Across the ASEAN region, activity continued to expand at a strong pace in the second quarter. Real GDP soared over 14 percent in Singapore, buoyed by the volatile biomedical sector, and rose strongly elsewhere in the region as well. Growth was generally driven by domestic demand, notably private consumption. In July, industrial production in Singapore rose sharply following a large contraction the previous month, and Thailand followed the same pattern but with a much smaller swing. In Malaysia, industrial production contracted for the second consecutive month in July following strong growth in May. Trade balances in the region were generally strong except in Thailand, where the closure of plants for maintenance contributed to a pronounced narrowing of the surplus. Twelve-month consumer price inflation generally has risen in recent months across the region, owing mostly to higher food and/or energy prices. A two percentage-point increase in the goods and services tax in Singapore further boosted July inflation. In Thailand, however, the rapid appreciation of the baht and lackluster domestic demand continued to push inflation lower. On August 19, a majority of Thai voters approved a referendum on a new constitution. The adoption of the constitution sets the stage for general elections on December 23; a military government has been in power since the coup in September 2006.

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

Indicator	2005	2006	2007				
			Q1	Q2	May	Jun.	Jul.
<i>Real GDP¹</i>							
Indonesia	4.9	6.0	3.0	6.4	...	...	...
Malaysia	5.7	5.8	5.9	6.2	...	...	...
Philippines	5.6	5.5	10.6	7.1	...	...	...
Singapore	8.2	6.5	8.8	14.4	...	...	...
Thailand	4.3	4.2	4.9	5.2	...	...	...
<i>Industrial production²</i>							
Indonesia ³	1.3	-1.6	.3	2.2	-3.0	-2.2	n.a.
Malaysia	4.0	5.1	-2.3	3.1	4.1	-.1	-.6
Philippines	2.2	-9.9	-7.4	3.6	-.6	.8	n.a.
Singapore	9.5	11.9	-2.0	4.9	4.4	-9.6	25.5
Thailand	9.1	7.4	1.7	1.4	2.9	-1.0	1.5

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

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

Indicator	2005	2006	2007				
			Q1	Q2	May	Jun.	Jul.
Indonesia	28.0	39.7	43.1	40.6	38.4	39.6	42.7
Malaysia	26.4	29.5	24.3	28.5	31.0	34.2	32.2
Philippines	-6.2	-4.4	.9	-1.1	-.9	-4.9	n.a.
Singapore	29.6	33.1	42.9	36.9	31.8	33.7	47.5
Thailand	-8.5	2.2	16.2	13.0	14.4	18.1	2.6

n.a. Not available.

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

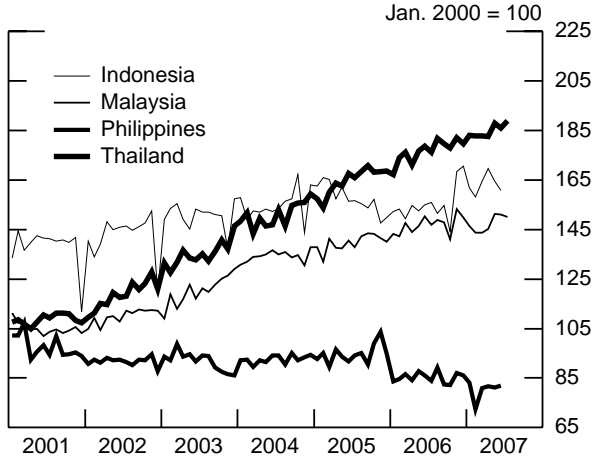
Indicator	2005 ¹	2006 ¹	2007				
			Q1	Q2	Jun.	Jul.	Aug.
Indonesia	17.0	6.7	6.3	6.0	5.7	6.0	6.6
Malaysia	3.3	3.1	2.6	1.5	1.4	1.6	n.a.
Philippines	6.7	4.3	2.9	2.4	2.3	2.6	2.4
Singapore	1.3	.8	.5	1.0	1.3	2.6	n.a.
Thailand	5.8	3.5	2.5	1.9	1.9	1.7	1.1

1. Dec./Dec.

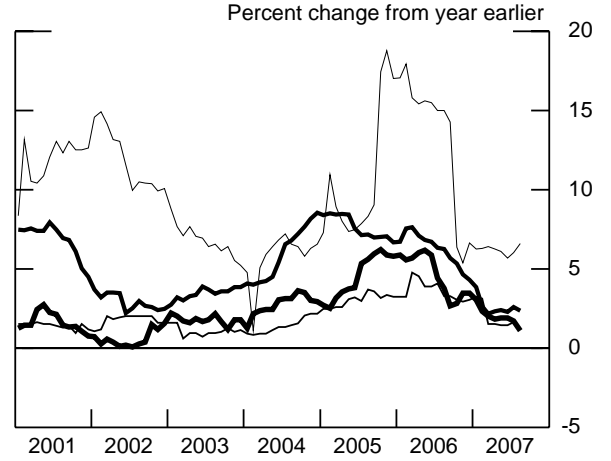
n.a. Not available.

ASEAN-4

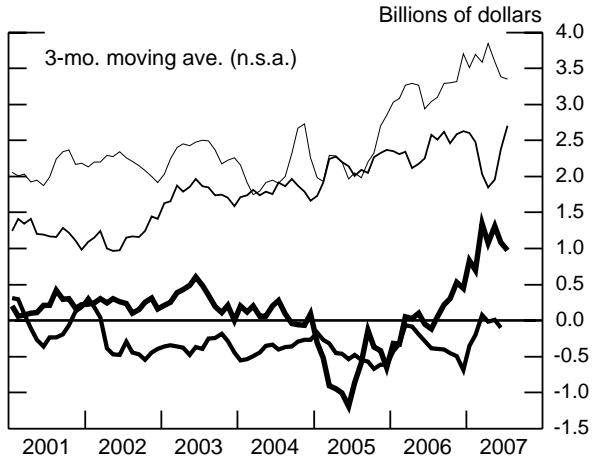
Industrial Production



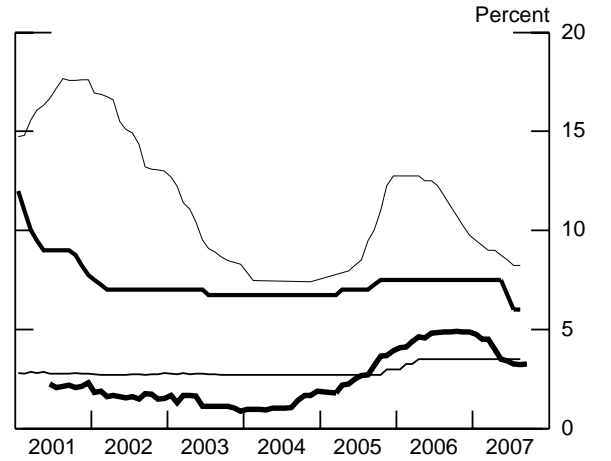
Consumer Prices



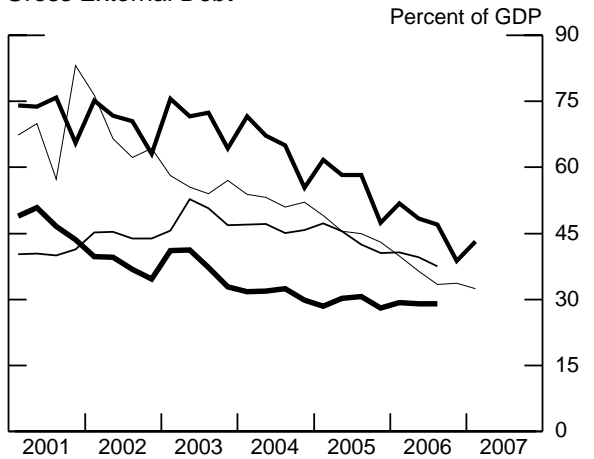
Merchandise Trade Balances



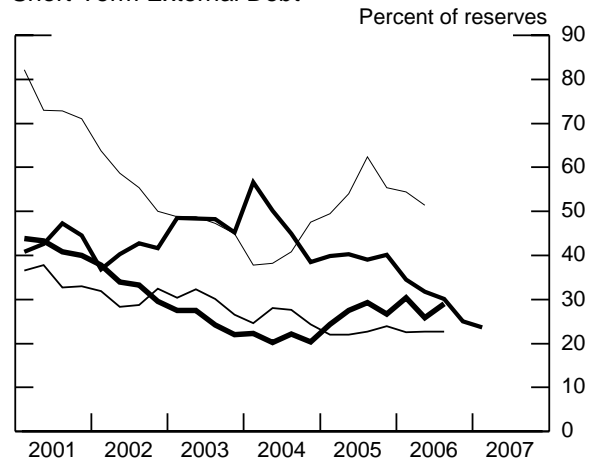
Benchmark Interest Rates



Gross External Debt



Short-Term External Debt



In **Mexico**, real GDP growth rebounded to 5.3 percent (s.a.a.r.) in the second quarter from the weak first quarter, mainly on the strength of agriculture and services, particularly transportation. Industrial production, which contracted in the first quarter, grew only 1.3 percent in the second as performance in the manufacturing sector remained subdued. Mexico's consumer confidence index rose in August to its highest level this year, but it is unclear the extent to which the timing of the survey allowed consumer's reaction to the recent financial market turmoil to be incorporated.

Twelve-month headline inflation continued to hover around 4 percent in July and August, driven by increases in agricultural prices. Twelve-month core inflation edged up to 3.9 percent. Headline inflation has remained around the upper limit of the Bank of Mexico's 2-to-4 percent target range for a year. Nonetheless, as it has since April, the central bank decided during its late-August meeting not to tighten monetary policy under the expectation that inflation will fall back within the target range soon. Once again, the central bank signaled a further tightening of policy might occur if inflation does not recede as expected.

Mexican Economic Indicators

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

Indicator	2005	2006	2007				
			Q1	Q2	Jun.	Jul.	Aug.
Real GDP ¹	2.5	4.3	1.2	5.3	...	...	...
Overall economic activity	3.1	4.9	.3	1.3	.3	n.a.	n.a.
Industrial production	2.1	5.0	-.9	1.3	.9	n.a.	n.a.
Unemployment rate ²	3.6	3.6	3.8	3.7	3.6	3.6	n.a.
Consumer prices ³	3.3	4.1	4.1	4.0	4.0	4.1	4.0
Merch. trade balance ⁴	-7.6	-6.1	-13.0	-14.8	-15.5	-12.2	n.a.
Merchandise imports ⁴	221.8	256.1	265.3	280.6	284.0	287.2	n.a.
Merchandise exports ⁴	214.2	250.0	252.3	265.8	268.5	275.0	n.a.
Current account ⁵	-4.8	-1.7	-10.8	-4.2	...	...	...

1. Annual rate. Annual data 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 data, 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**, second-quarter real GDP growth (data received too late to incorporate into the forecast and tables of Part 1) slowed to 3.2 percent, as a moderation in services growth more than offset a pickup in industrial production. In July, however, industrial

production fell 0.4 percent, weighed down by declines in production of capital and intermediate goods. The trade surplus has narrowed thus far in the third quarter. Imports in July and August grew 31 percent relative to the same period last year, while exports rose 7 percent. Inflation jumped in August, bringing twelve-month inflation to 4.3 percent, up from about 3 percent early this year. The rise in inflation reflects a rise in food prices, but other categories also saw increases.

On September 5, the central bank reduced its policy rate $\frac{1}{4}$ percentage point to 11.25 percent, down $8\frac{1}{2}$ percentage points since the current easing phase began in late 2005. The move marks a more gradual approach relative to the 50 basis-point reductions at the two previous meetings. The smaller cut appears to be in response to inflationary pressures from both soaring food prices and strong domestic demand.

Brazilian Economic Indicators

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

Indicator	2005	2006	2007				
			Q1	Q2	Jun.	Jul.	Aug.
Real GDP ¹	3.1	4.7	3.6	3.2	...	...	...
Industrial production	3.1	2.8	1.3	2.3	1.1	-.4	n.a.
Unemployment rate ²	9.8	10.0	9.7	9.6	9.6	9.4	n.a.
Consumer prices ³	5.7	3.3	3.1	3.4	3.8	3.9	4.3
Merch. trade balance ⁴	44.8	46.1	40.7	48.6	42.0	27.5	32.3
Current account ⁵	14.0	13.6	7.0	10.5	8.3	-8.6	n.a.

1. Annual rate. Annual data are Q4/Q4.

2. Percent.

3. Percent change from year-earlier period, except annual data, which are Dec./Dec.

Price index is IPCA.

4. Billions of U.S. dollars, annual rate.

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

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

In **Argentina**, the Index of Economic Activity (a monthly proxy of GDP) through June suggests that growth was strong in the second quarter. Argentine industrial production increased 1.5 percent in the second quarter, primarily due to growth in the motor vehicles sector. However, industrial production fell for the second consecutive month in July and the trade surplus narrowed. Twelve-month consumer price inflation remained elevated in July and August, partly reflecting a combined run-up in fiscal spending related to the October presidential election and an increase in food prices.

Argentine Economic Indicators

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

Indicator	2005	2006	2007				
			Q1	Q2	Jun.	Jul.	Aug.
Real GDP ¹	8.8	8.7	3.9	n.a.	...	...	...
Industrial production	8.0	8.5	.1	1.5	-.4	-2.0	n.a.
Unemployment rate ²	11.6	10.2	9.8	8.5	...	...	...
Consumer prices ³	12.1	9.7	9.4	8.9	8.8	8.7	8.7
Merch. trade balance ⁴	11.7	12.3	7.4	13.1	12.3	4.2	n.a.
Current account ⁵	5.7	8.0	3.4	n.a.	...	...	...

1. Annual rate. Annual data are Q4/Q4.

2. Percent; n.s.a.

3. Percent change from year-earlier period, except annual data, which are Dec./Dec.

4. Billions of U.S. dollars, annual rate.

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

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

In **Venezuela**, real GDP rose 9½ percent in the second quarter after declining in the first. Petroleum output partially rebounded from its 5 percent decline in the first quarter and rose by about 3 percent, while non-petroleum output rose 11 percent. Inflation continues to be extremely high, but edged down to around 16 percent in August on a twelve-month basis. In mid-August, the Chavez government unveiled a constitutional reform proposal that entails, among other things, the removal of presidential term limits and the central bank's legal autonomy. A referendum on the proposal is expected in December. In

Venezuelan Economic Indicators

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

Indicator	2005	2006	2007				
			Q1	Q2	Jun.	Jul.	Aug.
Real GDP ¹	10.9	11.8	-1.2	9.5	...	...	...
Unemployment rate ²	12.2	10.0	9.8	8.2	8.2	n.a.	n.a.
Consumer prices ³	14.4	17.0	19.1	19.5	19.4	17.2	15.9
Non-oil trade balance ⁴	-14.3	-22.7	-29.9	n.a.	...	...	...
Merch. trade balance ⁴	31.8	33.0	18.8	22.2	...	...	...
Current account ⁵	25.5	27.2	14.6	20.5	...	...	...

1. Annual rate. Annual data are Q4/Q4.

2. Percent.

3. Percent change from year-earlier period, except annual data, which are Dec./Dec.

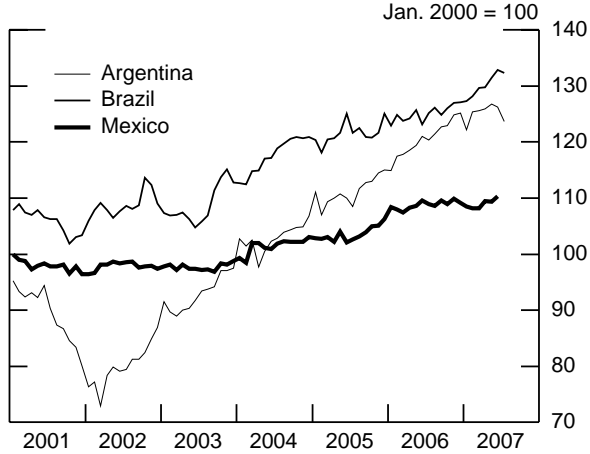
4. Billions of U.S. dollars, annual rate.

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

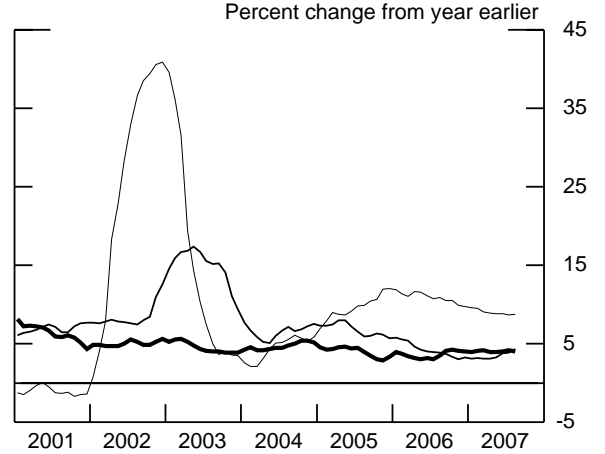
n.a. Not available. ... Not applicable.

Latin America

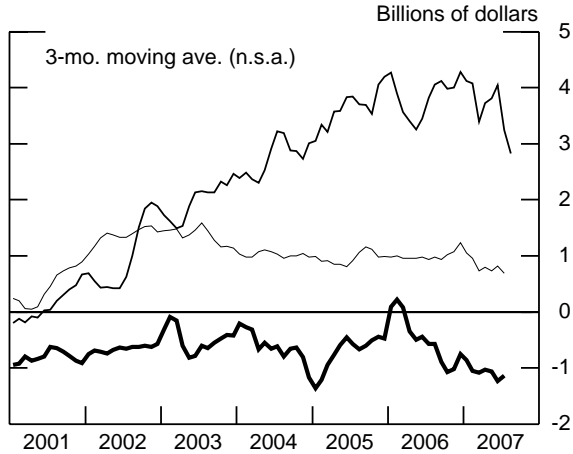
Industrial Production



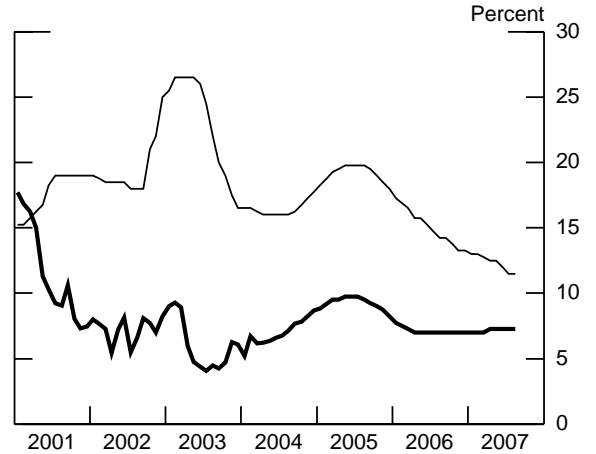
Consumer Prices



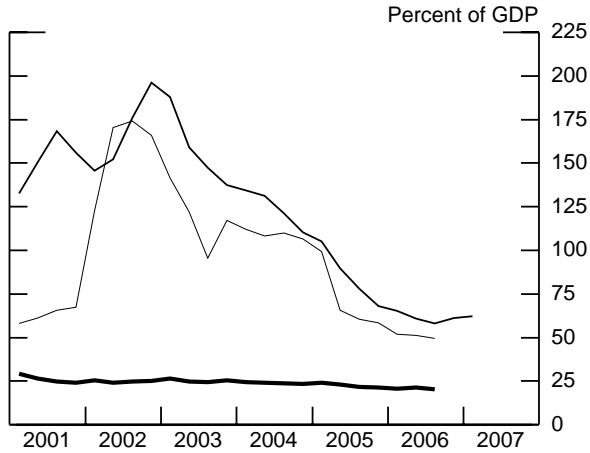
Merchandise Trade Balances



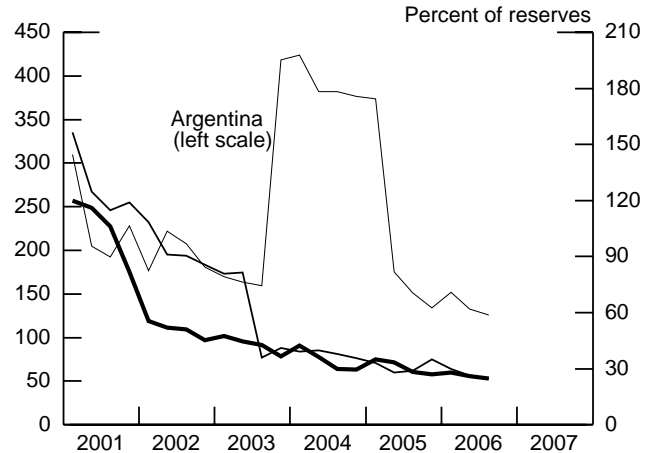
Benchmark Interest Rates



Gross External Debt



Short-Term External Debt



response to these developments and as global investors retreat from risk, the bolivar in the parallel market depreciated 20 percent in August. As of September 11, the bolivar had partially recovered to 4,800 VEN/dollar. (The official rate is 2,144 VEN/dollar.) In addition, the overnight interbank rate soared to 120 percent in early September, but declined to about 30 percent after the central bank opened its discount window.

In **Turkey**, industrial production was unchanged in the second quarter. Twelve-month consumer price inflation remained elevated at 7.4 percent in August, albeit below its level in the first half of the year. At its August meeting, the Central Bank of the Republic of Turkey decided to keep its short-term lending rate unchanged at 25.5 percent. The Central Bank suggested that aggregate demand conditions would continue to support the disinflation process. On August 28, Foreign Minister Abdullah Gul was formally elected the next President of Turkey.

Turkish Economic Indicators

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

Indicator	2005	2006	2007				
			Q1	Q2	Jun.	Jul.	Aug.
Real GDP ¹	7.4	6.1	6.9	3.9	...	...	...
Industrial production	5.4	5.9	.6	.1	-1.8	-.8	n.a.
Consumer prices ²	7.7	9.7	10.3	9.5	8.6	6.9	7.4
Merch. trade balance ³	-43.3	-53.8	-55.3	-60.7	-64.2	-70.7	n.a.
Current account ⁴	-22.6	-32.8	-37.2	-41.3	-39.8	n.a.	n.a.
Unemployment rate	10.2	9.8	9.7	n.a.	...	...	...

1. Percent change from year-earlier period. Annual data are annual averages.

2. Percent change from year-earlier period, except annual data, which are Dec./Dec.

3. Billions of U.S. dollars, annual rate. Imports are c.i.f.

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

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