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Part 2

December 5, 2001

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

December 5, 2001

Recent Developments

Domestic Nonfinancial Developments

Domestic Nonfinancial Developments

Overview

The incoming data have had a somewhat firmer tone in recent weeks than those available at the time of the last FOMC meeting, but economic activity still appears to be declining this quarter. The latest readings on initial claims and insured unemployment are consistent with a further drop in employment in November on the heels of a sharp contraction in October. The available data and reports from industry sources suggest another decline in factory production outside of motor vehicles in November. Sales of new motor vehicles have been phenomenal, but have been largely accommodated by a drawdown in dealer stocks. Other household and business spending appears to have recovered somewhat from the sharp falloff in September but, on balance, remains below the levels that prevailed last summer. Inflation has moved lower as the result of falling energy prices, and year-ahead inflation expectations have plunged in recent months.

Labor Market Developments

The labor market weakened dramatically in October; the unemployment rate jumped 1/2 percentage point, and private payroll employment dropped 439,000, the largest one-month decline since 1975. The workweek also decreased, and aggregate hours of production or nonsupervisory workers fell 0.7 percent.

Almost every major industry shed jobs in October. Manufacturers cut another 142,000 workers in October, bringing the loss over the preceding twelve months to more than 1.1 million jobs. However, in contrast to the pattern that held through August, industries outside of manufacturing accounted for the bulk of October's employment decline. Almost half of all the cuts in non-factory jobs occurred in travel- and tourism-related industries, in which demand fell abruptly in the aftermath of the September 11 terrorist attack.¹

More recently, the incoming data on claims for unemployment insurance are consistent with a further noticeable decline in employment in November—albeit not as sharp as occurred in October. The four-week moving average of initial claims stood at 454,000 for the week ended November 24; while that level was 50,000 below its peak of a month ago, it remained higher than the average from mid-June to mid-September, when private payrolls declined an

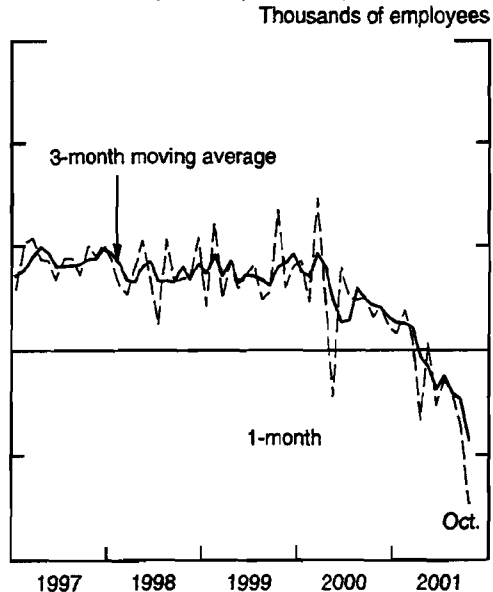
1. In its October release on mass layoffs, the BLS reported mass layoffs (those involving fifty or more unemployment insurance claims against a firm in one month) due to "non-natural disasters," a new reason code added to the survey to identify workers separated from a company as a direct or indirect result of an incident such as the September 11 attack. In the five-week period following September 11, the BLS estimates that 88,508 workers were affected by mass layoffs related to the events of September 11. More than 70 percent of the layoffs occurred in New York, California, Nevada, Illinois, Hawaii, or Texas, and 80 percent of the affected workers were employed in the air transport or hotel industries.

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

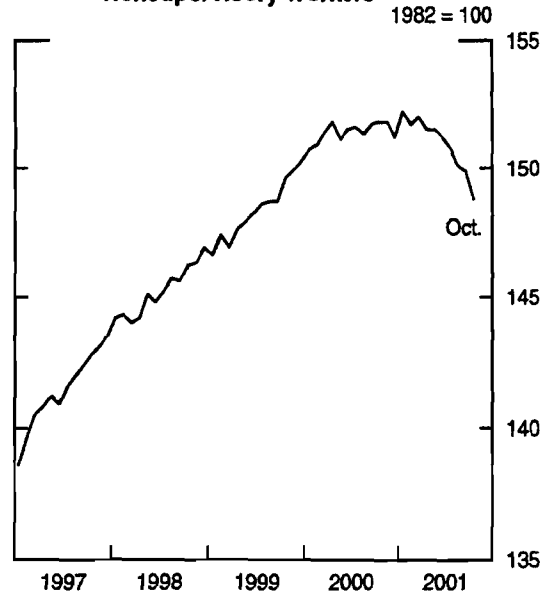
	2000		2001		2001		
	H1	H2	Q2	Q3	Aug.	Sept.	Oct.
	--Average monthly change--						
Nonfarm payroll employment ¹	267	66	-74	-83	-54	-213	-415
Previous	267	66	-74	-88	-84	-199	
Private	178	121	-113	-141	-127	-211	-439
Mining	1	1	3	1	2	-1	-2
Manufacturing	5	-29	-120	-105	-155	-90	-142
Construction	16	21	-22	-1	-6	1	-30
Transportation and utilities	13	16	-3	-19	-26	-20	-55
Retail trade	31	21	35	-13	-23	-61	-81
Wholesale trade	9	8	-15	-11	-7	-22	-23
Finance, insurance, real estate	-7	7	4	-1	5	5	5
Services	110	76	4	7	83	-23	-111
Help supply services	15	-19	-44	-17	-14	-2	-107
Total government	90	-54	39	58	73	-2	24
Total employment (household survey)	114	109	-283	83	-986	788	-619
Nonagricultural	116	115	-227	8	-1058	685	-599
Memo:							
Aggregate hours of private production							
workers (percent change) ^{1,2}	2.1	0.2	-1.5	-3.0	-0.5	-0.1	-0.7
Average workweek (hours) ¹	34.5	34.3	34.2	34.1	34.0	34.1	34.0
Manufacturing (hours)	41.8	41.3	40.8	40.7	40.7	40.6	40.4

Note. Average change from final month of preceding period to final month of period indicated.
 1. Survey of establishments.
 2. Semi-annual data are percent change from Q4 to Q2 and from Q2 to Q4 at an annual rate. Quarterly data are percent changes from preceding quarter at an annual rate. Monthly data are percent change from preceding month.

Private Payroll Employment Growth
(Strike-adjusted data)



Aggregate Hours of Production or Nonsupervisory Workers

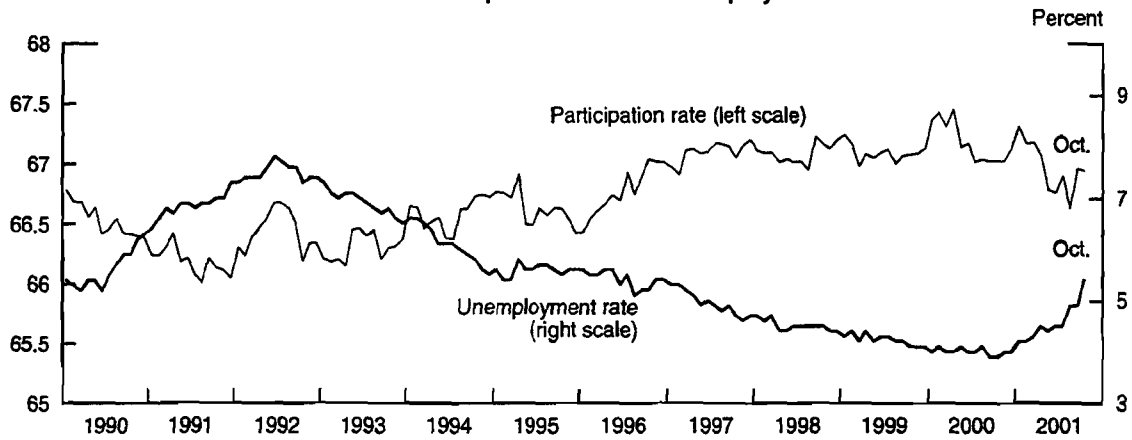


SELECTED UNEMPLOYMENT AND LABOR FORCE PARTICIPATION RATES
(Percent; based on seasonally adjusted data, as published)

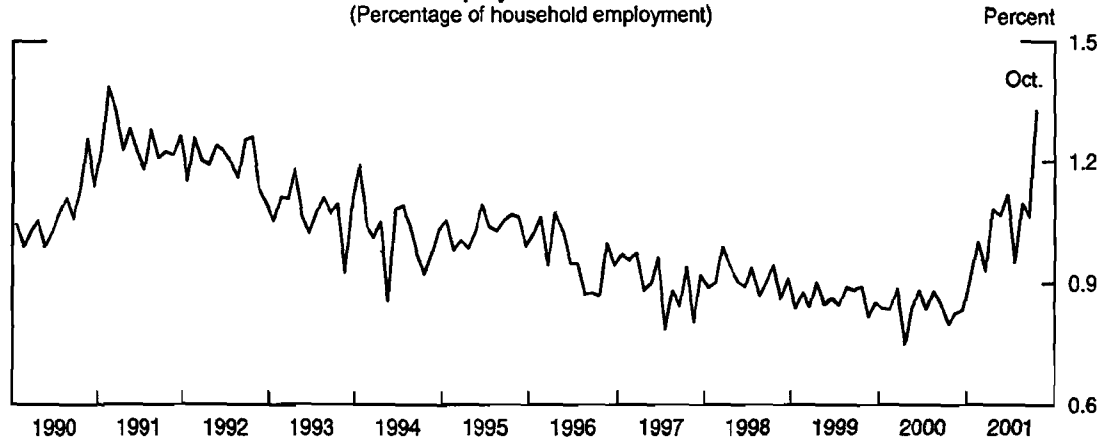
	1999	2000	2001			2001		
			Q1	Q2	Q3	Aug.	Sept.	Oct.
Civilian unemployment rate (16 years and older)	4.2	4.0	4.2	4.5	4.8	4.9	4.9	5.4
Teenagers	13.9	13.1	13.7	14.0	15.2	16.1	14.7	15.5
20-24 years old	7.5	7.1	7.4	8.1	8.4	9.0	8.5	9.5
Men, 25 years and older	3.0	2.8	3.1	3.4	3.6	3.7	3.7	4.2
Women, 25 years and older	3.3	3.2	3.3	3.4	3.7	3.7	3.9	4.3
Labor force participation rate	67.1	67.2	67.2	66.9	66.8	66.6	67.0	66.9
Teenagers	52.0	52.2	51.3	49.7	49.1	47.4	49.8	50.0
20-24 years old	77.6	77.9	78.2	76.6	77.0	76.8	77.6	77.0
Men, 25 years and older	76.1	76.0	75.9	75.9	75.9	75.8	75.9	76.0
Women, 25 years and older	59.5	59.7	59.9	59.6	59.7	59.6	59.7	59.6
Memo: Potential worker rate ¹	7.2	6.9	7.1	7.4	7.8	8.0	7.8	8.4

1. The potential worker rate equals the number of civilian unemployed plus those who are not in the labor force and want a job as a percentage of the civilian labor force plus those who are not in the labor force and want a job.

Labor Force Participation Rate and Unemployment Rate

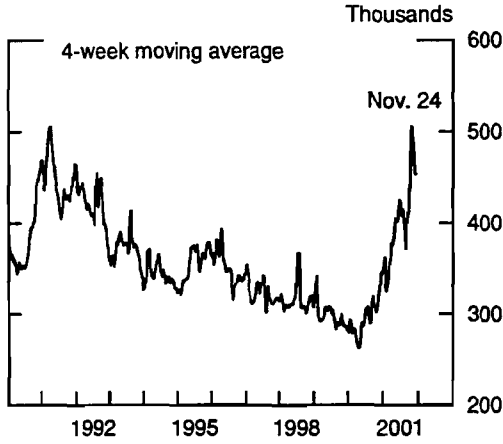


Job Losers Unemployed for Less Than 5 Weeks
(Percentage of household employment)

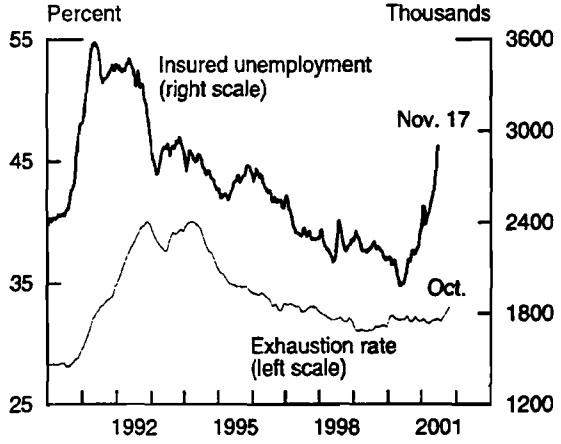


Labor Market Indicators

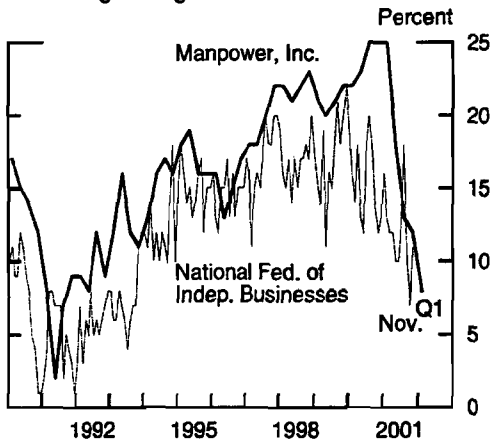
Initial Claims



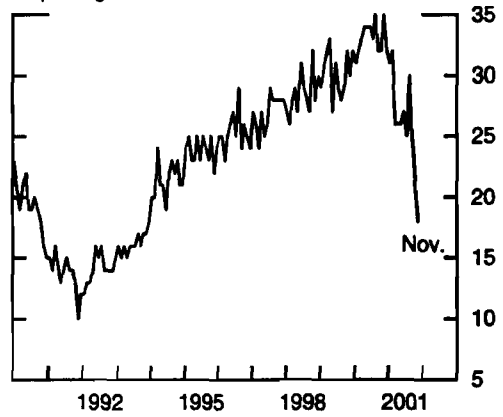
Insured Unemployment



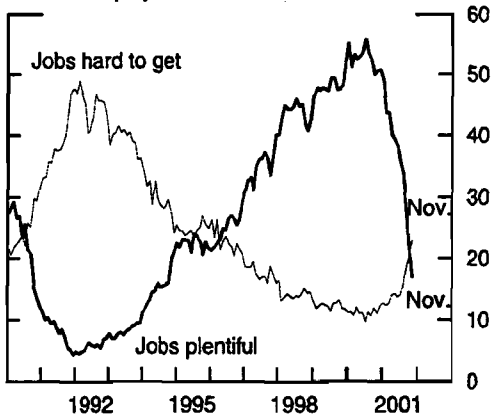
Net Hiring Strength



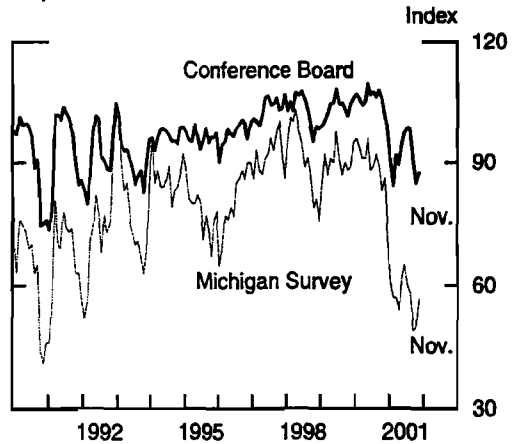
Nat. Fed. Of Independent Businesses: Reporting Positions Hard to Fill



Conference Board: Current Employment Conditions



Expected Conditions



average of 140,000 per month. Moreover, the four-week moving average of insured unemployment in mid-November was up substantially from a month earlier, suggesting that individuals already on the UI rolls are finding new jobs difficult to obtain. As further evidence of reduced job-finding prospects for the unemployed, the exhaustion rate—the fraction of insured unemployed who have exhausted their UI benefits—moved up in October after having been about flat in recent years.²

Other indicators of labor market conditions have either weakened further recently or continued to remain at relatively depressed levels. Manpower's index of net hiring intentions for the first quarter declined again and is approaching the trough reached in 1991.³ The National Federation of Independent Businesses' (NFIB) hiring index moved up in November, retracing the previous month's decline, but was still below its average level this summer; the NFIB also reported that the number of firms with hard-to-fill positions dropped to the lowest level since 1993. In the November Conference Board survey, households had a more negative assessment of current job availability than at any time since early 1996, while expectations about future employment prospects, as reported in the Michigan SRC and Conference Board surveys, remained near the average levels recorded during the 1990-91 recession, despite having improved somewhat in November.

The Bureau of Labor Statistics will release its advance estimate of productivity for the third quarter on December 6. Based on the NIPA data released on November 30 and the data on hours published to date, we estimate that output per hour in the nonfarm business sector increased at an annual rate of roughly 1-1/2 percent in the third quarter of 2001. Over the four quarters ended last quarter, we estimate that productivity rose 1.6 percent; although that rise is down considerably from the 3.6 percent pace recorded for the year-earlier period, it is still quite robust given the large deceleration in output over the past year.

2. More specifically, the exhaustion rate is the ratio of the twelve-month moving average of the number of insured unemployed who have exhausted their UI benefits to the twelve-month moving average of the number of unemployed first receiving benefits six months earlier. Regular unemployment insurance benefits are exhausted after 26 weeks in almost all states.

3. Although the Manpower survey asks employers about their intentions to change the size of their workforce for the upcoming three months, the index is more highly correlated with the current situation than employment one quarter ahead.

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

Component	Proportion, 2000	2001 ¹			2001 ²		
		Q1	Q2	Q3	Aug.	Sept.	Oct.
Total	100.0	-6.1	-5.9	-4.8	-4	-9	-1.2
Manufacturing	86.7	-7.1	-6.2	-5.0	-6	-1.0	-1.3
Ex. motor veh. and parts	80.2	-5.8	-8.7	-5.9	-4	-8	-1.0
Ex. high-tech industries	71.4	-4.8	-6.6	-4.0	-4	-8	-1.0
Mining	6.8	3.5	3.5	-3.5	.0	.1	-1.8
Utilities	6.5	-3.4	-10.7	-3.9	1.3	-1.0	.7
<i>Selected industries</i>							
High technology	8.9	-13.6	-25.9	-22.6	-7	-1.2	-9
Computers	2.0	-3.9	-16.3	-13.4	-5	-2.5	-5
Communication equipment	2.0	-16.8	-26.3	-28.8	-1.8	-2.9	-2.4
Semiconductors ³	4.9	-16.2	-29.8	-23.8	-4	.2	-4
Motor vehicles and parts	6.4	-23.1	33.6	6.4	-2.6	-3.6	-4.8
Aircraft and parts	2.4	1.1	-3.5	-15.7	-1.8	-1.9	-2.5
<i>Market groups excluding energy and selected industries</i>							
Consumer goods	21.8	-8	-1.0	-1.8	-7	-5	-4
Durables	3.5	-10.5	-4.8	-6.3	-2	-9	-1.9
Nondurables	18.3	1.1	-4	-1.1	-8	-5	-1
Business equipment	7.9	-5.1	-14.1	-13.2	-4	-2.0	-1.4
Construction supplies	6.4	-3.2	-1.1	-2.2	.4	.1	-2.2
Business supplies	7.0	-8.3	-15.4	-4.7	-9	-5	-9
Materials	24.1	-7.7	-8.3	-2.0	.2	-9	-1.4
Durables	16.3	-7.0	-5.8	-3.3	-2	-1.5	-1.7
Nondurables	7.8	-9.1	-13.3	.9	1.1	.2	-7

1. Annual rate.

2. Monthly rate.

3. Includes related electronic components.

Capacity Utilization
(Percent of capacity)

Sector	1967- 2000 average	1988- 89 high	1990- 91 low	2001			2001	
				Q1	Q2	Q3	Sept.	Oct.
Total industry	82.1	85.4	78.1	78.9	77.4	76.2	75.5	74.6
Manufacturing	81.1	85.7	76.6	77.2	75.6	74.4	73.7	72.8
High-tech industries	80.5	81.9	72.4	74.0	66.4	61.2	60.3	59.5
Excluding high-tech industries	81.1	86.1	76.8	77.5	76.7	76.1	75.4	74.4

Labor Output per Hour

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

Sector	1999 ¹	2000 ¹	2001		
			Q1	Q2	Q3 ²
Nonfarm businesses					
All persons ³	2.8	2.3	.1	2.2	1.5
All employees ⁴	2.3	1.9	.9	1.4	1.5
Nonfinancial corporations ⁵	2.9	4.2	.6	3.4	3.7

1. Changes are from the fourth quarter of the preceding year to the fourth quarter of the year shown.

2. Staff estimate.

3. Includes non-employees (published definition).

4. Assumes that the growth rate of hours of all persons equals the growth rate of hours of all employees.

5. The nonfinancial corporate sector consists of all corporations doing business in the United States with the exception of banks, stock and commodity brokers, and finance and insurance companies; the sector accounts for about two-thirds of business employment.

Industrial Production

Industrial production fell 1.2 percent in October following a 0.9 percent decline in September. In October, production declines occurred in most market groups and industries. Motor vehicle assemblies fell 1/2 million units (annual rate) for the third consecutive month, after having been at relatively elevated rates during the spring and early summer. Production of high-technology goods dropped again, and manufacturing output elsewhere continued to be restrained by weak demand for business equipment, by efforts to pare inventories, and by competition from abroad.⁴

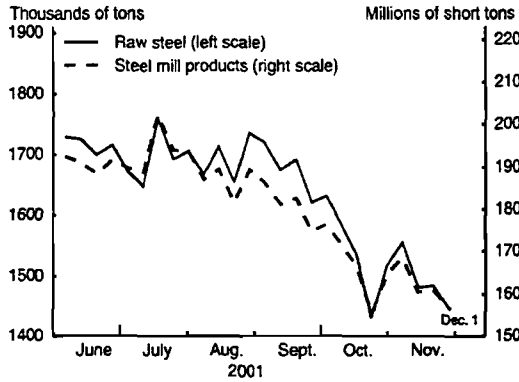
The factory operating rate fell again in October to 72.8 percent—lower than the 76.6 percent rate reached in the 1990-91 recession but still above the 69 percent of December 1982. The current downturn for the high-tech industry has been particularly severe: After having peaked in May 2000 at 88.8 percent, capacity utilization at high-tech plants sunk to 59.5 percent in October, even with a considerable slowdown in the expansion of capacity at those plants.

4. On November 27, the 2001 Annual Revision to Industrial Production and Capacity Utilization was released. Industrial output and capacity are now reported to have increased at a slower rate in 1999 and 2000. However, the overall picture portrayed by the updated data is unchanged. The rate of industrial capacity utilization is little revised at 76.2 percent in the third quarter of 2001, and the decline in industrial production since it peaked in the middle of last year is 7.0 percent, ½ percentage point more than previously estimated.

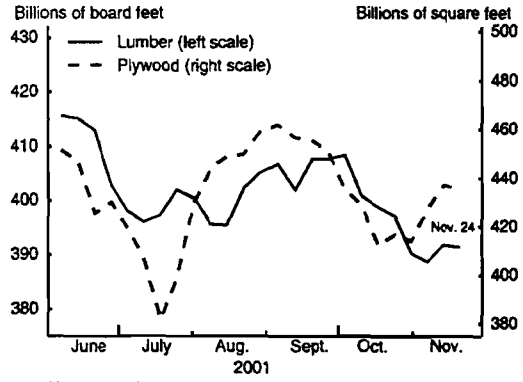
Indicators of Manufacturing Activity

Selected Weekly Production Series

Steel Products

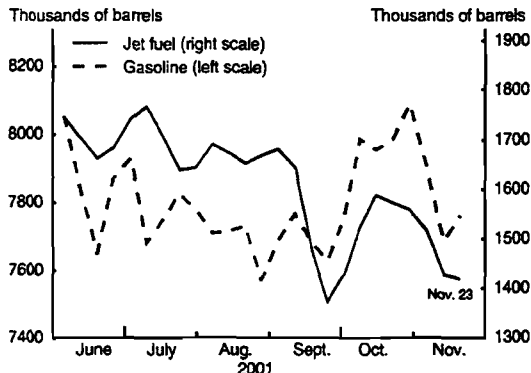


Wood Products



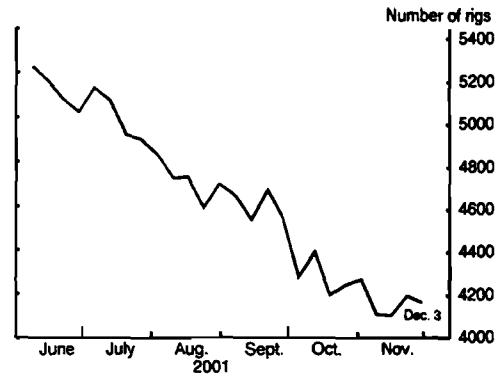
Note. 3-week moving average.

Fuel



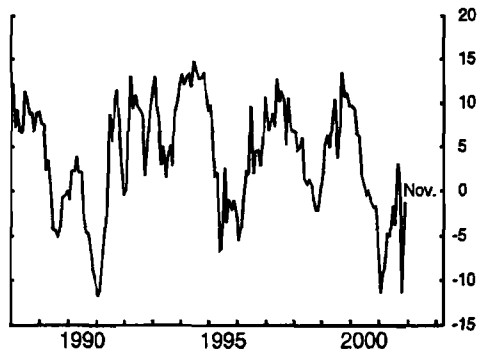
Note. 2-week moving average.

Rotary Oil and Gas Rigs in Operation



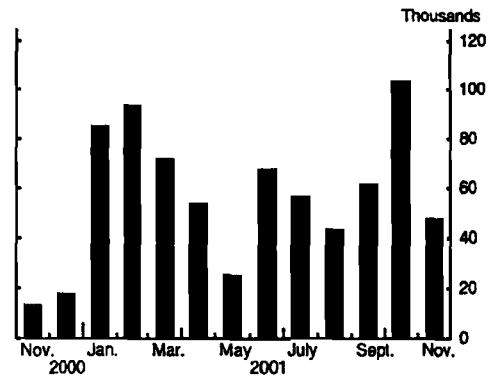
Other Indicators

NAPM New Orders Diffusion Index



Note. Diffusion index: half the quantity of the percentage of respondents reporting greater levels of new orders, less the percentage of respondents reporting lower levels of new orders.

Announced Manufacturing Layoffs



Note. Data are through December 2, 2001.
Source. Compiled by staff from news reports.

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

Item	2001		2002	2001			2002
	Q3	Q4 ¹	Q1 ¹	Oct.	Nov. ¹	Dec. ¹	Jan. ¹
U.S. production	11.6	11.3	11.5	10.7	11.6	11.5	12.2
Autos	4.7	4.8	5.0	4.4	4.8	5.1	5.1
Trucks	6.9	6.5	6.5	6.3	6.9	6.4	7.1
Days' supply ²							
Autos	49.1	n.a.	n.a.	30.3	35.5	n.a.	n.a.
Light trucks ³	74.0	n.a.	n.a.	47.0	52.9	n.a.	n.a.
Inventories ⁴	2.69	n.a.	n.a.	2.26	2.14	n.a.	n.a.

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

1. Production rates reflect Ward's Communications' latest estimates for November and schedules for December and the first quarter.
 2. Quarterly average calculated using end-of-period stocks and average reported sales.
 3. Excludes medium and heavy (classes 3-8) trucks.
 4. End-of-period stocks; excludes medium and heavy (class 3-8) trucks.
- n.a. Not available.

Despite having improved, most of the recent data on production, new orders, and other indicators still point to continued weakness in the industrial sector. One noticeable plus in November is the production of motor vehicles: Assemblies rose to about 11-1/2 million units (annual rate) in November, nearly 1 million units higher than in October. Nonetheless, dealer stocks are estimated to have declined more than 50,000 units (not at an annual rate) from the level at the end of the third quarter to the end of November and were at the lowest level since August 1991. Although anecdotal reports indicate that dealer inventories of 2001 model-year vehicles were liquidated quickly, no reports of shortages of 2002 vehicles have surfaced. Current schedules, as published by Ward's, suggest little change in the pace of assemblies in December and in the first quarter of next year from November's rate. However, because of the magnitude and timing of the drop in sales that likely will accompany the reduction in sales incentives, the balance of risks to scheduled motor vehicle production early next year is more heavily weighted on the downside.

Outside of motor vehicles, the available weekly production series are expected to make a negative contribution to the November change in total IP.⁵ The iron and steel industry is still reeling from low demand and intense import competition. Production of lumber continued to decline last month, although the output of plywood has stepped up some. Electricity generation was down in November, and production of jet fuel has remained well below its level before September 11, freeing up capacity that was used to build up stocks of gasoline. The number of oil and gas rigs in operation declined further in November, continuing the slide that has been evident since late spring after prices began to soften appreciably.

Some positive signs may have begun to emerge in the high-tech area. In the semiconductor industry, the rate of decline in production has lessened: Between August and October, the output of semiconductors and related devices fell at an average monthly rate of 0.2 percent, considerably less than the declines of 2 to 3 percent per month in the spring and early summer. According to staff estimates, inventories of semiconductors have been liquidated at a fast clip since May, and a survey of large buyers of semiconductors suggests that the gap between actual days' supply and target days' supply has narrowed from earlier this year. In the computer industry, the market for servers, which contracted sharply early this year, may be hitting bottom. Sun Microsystems (the second largest producer of servers) reported that sales have started to increase, and IBM (the largest producer of servers) indicated that business is not getting worse. In contrast, the outlook for the communications equipment industry still looks grim. Orders rose sharply in October, but to a level that was still below that of August. Moreover, inventories remain high, and equipment utilization rates at many telecom-service providers reportedly are quite low.

Other indicators of the manufacturing sector remain weak. For instance, although real adjusted orders turned up 6.2 percent in October, they had plunged more than 9 percent in September. In November, the National Association of Purchasing Management index of new orders bounced back, but still suggested that the sector was contracting. Announced manufacturing layoffs, which surged in the aftermath of September 11, were still relatively large at 50,000 in November.

5. Weekly production data are available for a variety of industries, including motor vehicles, lumber, plywood, raw steel, steel products, appliances, petroleum products, meat products, coal, drilling activity, and electricity generation. These weekly series make up about 15 percent of total industrial production.

New Orders for Durable Goods

(Percent change from preceding period; seasonally adjusted)

Component	Share, 2001:H1	2001				
		Q2	Q3	Aug.	Sept.	Oct.
Total orders	100.0	-2.3	-5.1	-.6	-9.2	12.8
Adjusted orders ¹	73.0	-4.2	-5.7	-.4	-9.8	5.9
Computers	5.0	-14.0	-19.4	-8.8	-7.1	18.4
Communications equipment	4.0	-26.3	-16.9	-.3	-40.6	61.6
Semiconductors and related devices	4.0	-19.4	-3.5	20.7	16.9	-17.2
Other capital goods	20.0	-2.8	-5.3	.3	-6.4	-.3
Other ²	40.0	.5	-3.4	-1.3	-11.8	8.0
Memo:						
Real adjusted orders	...	-3.4	-4.7	.0	-9.3	6.2
Excluding high tech	...	-1.3	-13.8	-.5	-9.8	4.7

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

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

... Not applicable.

Consumer Spending

The staff estimates that real PCE jumped 3 percent in October, as consumers responded to the zero-rate financing packages offered by the motor vehicle industry, and spending in other categories partially recovered from the step-down in September.⁶ Smoothing through the factors that boosted consumption growth temporarily in October, consumer spending appears to be moving up at a modest pace early in the fourth quarter.

Sales of light vehicles surged in October to an annual rate of more than 21 million units in response to aggressive sales incentives offered by automakers. In November, sales of light vehicles dropped back a bit from the blistering October pace, but remained at a robust 17.8 million units (annual rate)—still well above the third-quarter average of 16.1 million units. Although the initial round of incentives expired in mid-November, pared-back versions of

6. The BEA reported that real PCE increased 2.2 percent in October. In constructing that estimate, the BEA allocated a lower proportion of the sales of light motor vehicles to consumers than we believe—based on confidential information on deliveries to fleet companies—actually occurred. Using the staff estimate of the split in sales between households and businesses boosts our monthly estimate of real PCE to 3 percent; our forecast of business spending was adjusted accordingly, leaving no significant effect of the shift in assumed shares on our estimate of real GDP in the fourth quarter.

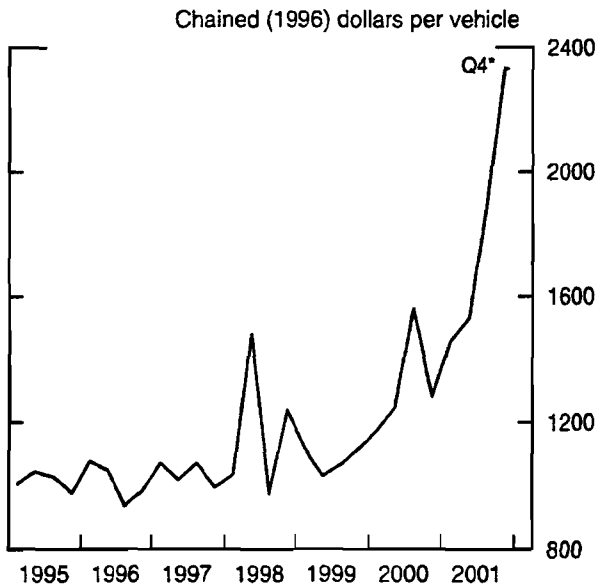
SALES OF AUTOMOBILES AND LIGHT TRUCKS
(Millions of units at an annual rate, FRB seasonals)

	1999	2000	2001		2001		
			Q2	Q3	Sept.	Oct.	Nov.
Total ¹	16.8	17.2	16.6	16.1	15.8	21.1	17.8
Autos	8.7	8.8	8.4	7.9	7.7	10.2	8.6
Light trucks	8.1	8.4	8.2	8.2	8.1	10.9	9.2
North American ²	14.3	14.4	13.6	13.1	12.9	17.6	14.5
Autos	7.0	6.8	6.3	5.9	5.7	7.8	6.3
Light trucks	7.3	7.5	7.3	7.3	7.1	9.8	8.2
Foreign-produced	2.5	2.9	3.0	3.0	2.9	3.6	3.3
Autos	1.7	2.0	2.1	2.0	1.9	2.4	2.3
Light trucks	.8	.8	1.0	1.0	.9	1.2	1.0
Memo:							
Total retail sales (confidential) ³	13.7	13.9	13.4	13.1	13.1	18.6	15.0

Note. Components may not sum to totals because of rounding. Data on sales of trucks and imported autos for the most recent month are preliminary and subject to revision.

1. The automakers' changes in reporting periods have no effect on the figures shown.
2. Excludes some vehicles produced in Canada that are classified as imports by the industry.
3. Sales include consumer purchases and leases of light vehicles.

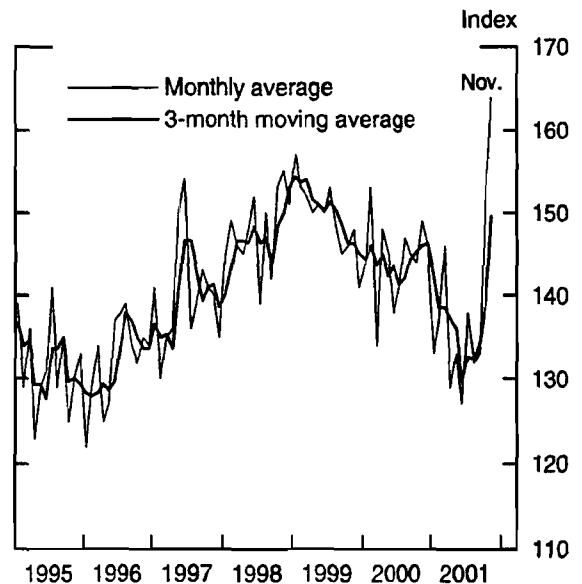
Marketing Incentives for Light Vehicles



Note. Nominal industry data from GM and deflated by total PCE deflator.

*Staff estimate.

Michigan Survey Index of Car-Buying Attitudes

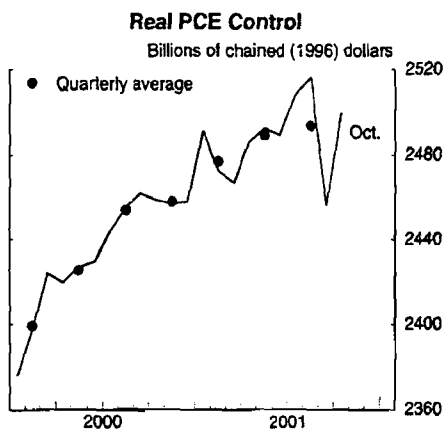


1995 1996 1997 1998 1999 2000 2001

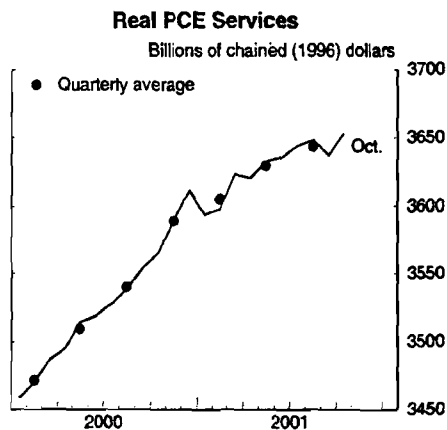
REAL PERSONAL CONSUMPTION EXPENDITURES
(Percent change from the preceding period unless otherwise noted)

	2001		2001		
	Q2	Q3	Aug.	Sept.	Oct.
	- Annual rate -		--- Monthly rate ---		
Total real PCE ¹	2.5	1.1	.2	-1.1	3.0
Durable goods ¹	7.0	.7	-.1	-2.9	20.4
Motor vehicles ¹	5.6	-.6	-.3	-2.8	43.5
Nondurable goods	.3	.5	.3	-2.0	1.2
Services	2.8	1.5	.1	-.3	.4
Electricity and natural gas	-13.8	.3	1.3	-5.4	1.0
Transportation	-.4	-3.5	.5	-4.4	1.6
Medical	4.6	3.7	.3	.4	.2
Recreation	1.0	-2.4	.3	-2.2	1.0
Housing	1.7	1.6	.2	-.2	.4
Memo:					
Real disposable personal income	2.4	12.5	1.9	-.6	-2.4
NIPA personal saving rate ²	1.1	3.8	4.2	4.6	.2

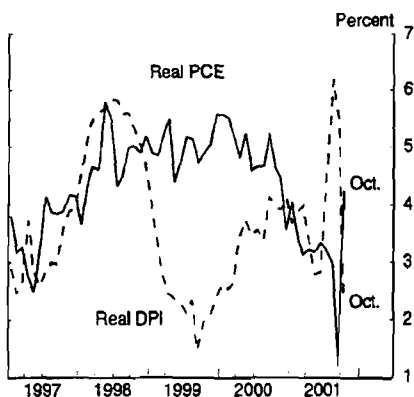
1. October data are staff estimates.
2. Data are in levels. Annual and quarterly values are averages over the period indicated.



Note. Real PCE for goods excluding autos and trucks.

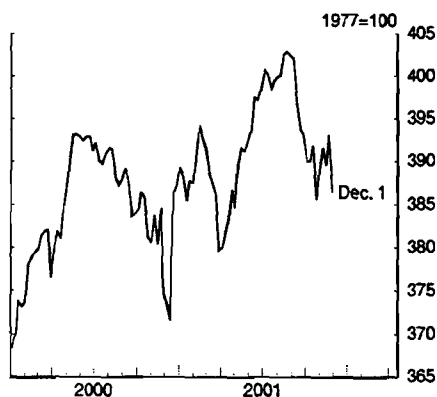


Real Consumer Spending and Income



Note. Real PCE in October is a staff estimate.

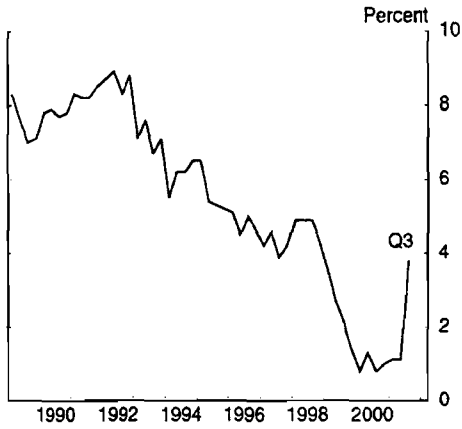
Weekly Chain Store Sales



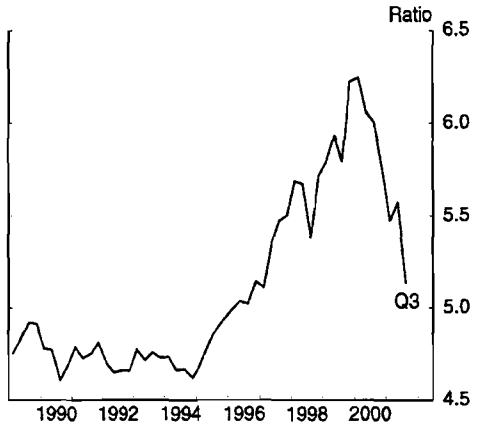
Source. Bank of Tokyo-Mitsubishi.

Household Indicators

Personal Saving Rate

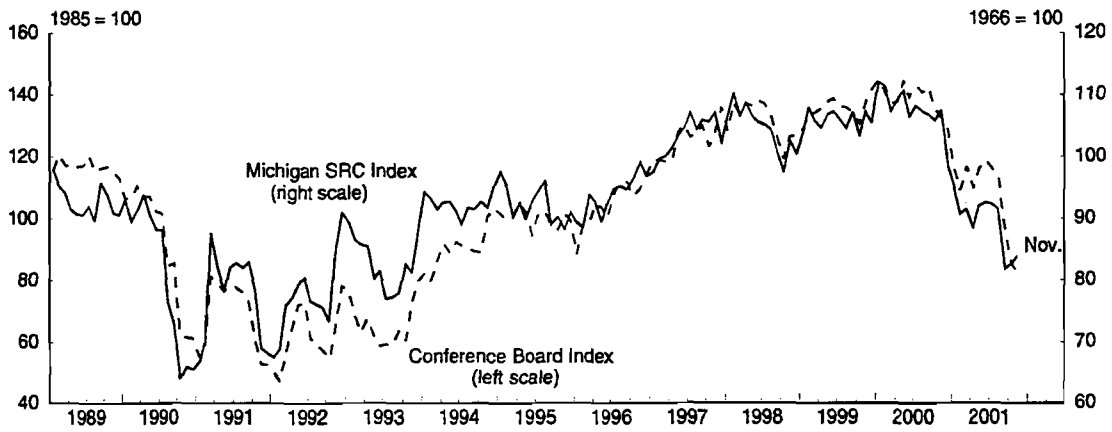


Ratio of Household Net Worth to DPI

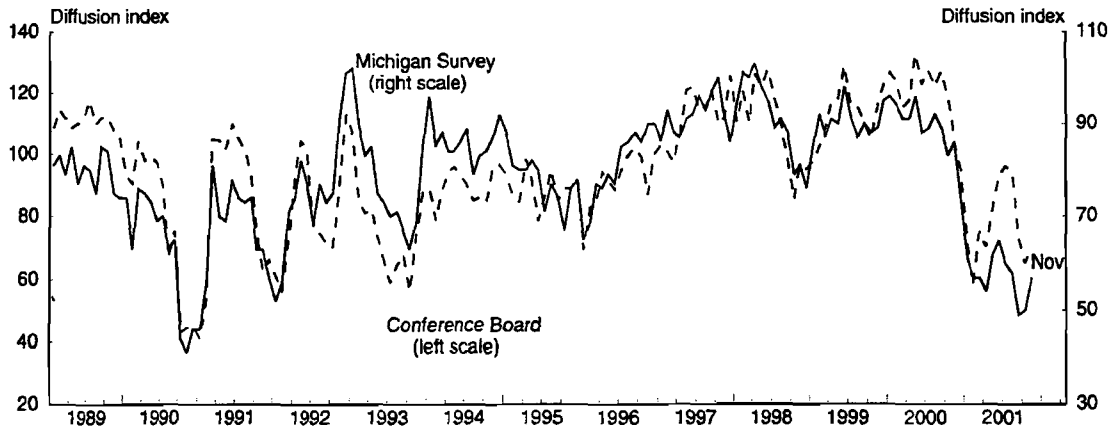


Note. 2001:Q3 is a staff estimate.

Consumer Confidence



Labor Market Expectations



Note. The diffusion indexes are scaled so that increases indicate improvements in expected labor market conditions.

these packages were extended and are likely to remain in place through early next year.⁷

Consumer spending on goods other than motor vehicles rebounded 1-3/4 percent in October to a level that, while still short of the August reading, was about 1/4 percent above the third-quarter average. The recovery in this category was led by a rise in spending on durable goods, which more than reversed the steep drop in September. In contrast, outlays for nondurable goods posted only a modest gain and remained below the August level. A pickup in outlays for consumer services in October was also noticeable. In part, the over-the-month increase was boosted by an some revival in spending on travel-related services, such as hotels and airlines, which had plunged in September. However, the upturn in spending in these areas was modest, leaving the October levels below their third-quarter averages. Spending on energy services also picked up slightly after a steep drop in September. More fundamentally, the uptrend in outlays for services not directly affected by the events of September 11—such as medical care and education—was fairly well maintained through October.

Available indicators for November point to a more lackluster pace of spending than in October. According to the Bank of Tokyo-Mitsubishi, chain store sales came in at or below retailers' admittedly modest plans last month. Generally mild temperatures (relative to seasonal norms) around the country probably led to a sizable drop in spending on energy services. Data from the Department of Energy indicate that real gasoline purchases moved up a little in November. The volume of stock-market transactions edged down last month, suggesting slightly lower outlays on investment counseling and brokerage fees. Finally, information from the airline industry is consistent with some additional recovery in this area.

On the income side, without the significant boost that had been provided through September from this summer's tax rebates and with the labor market having softened further, real disposable personal income dropped 2.4 percent in October. Indeed, the result would have been worse if not for some relief provided by the sharp decline in consumer energy prices that month. The recent pickup in equity values, if sustained, would raise the ratio of household net worth to disposable income to near the level registered early this year, albeit still down considerably from its peak in the spring of 2000.

After having dropped in September, indicators of consumer sentiment have been somewhat mixed. The Michigan Survey Research Center's (SRC) index of consumer sentiment edged higher for a second consecutive month in November

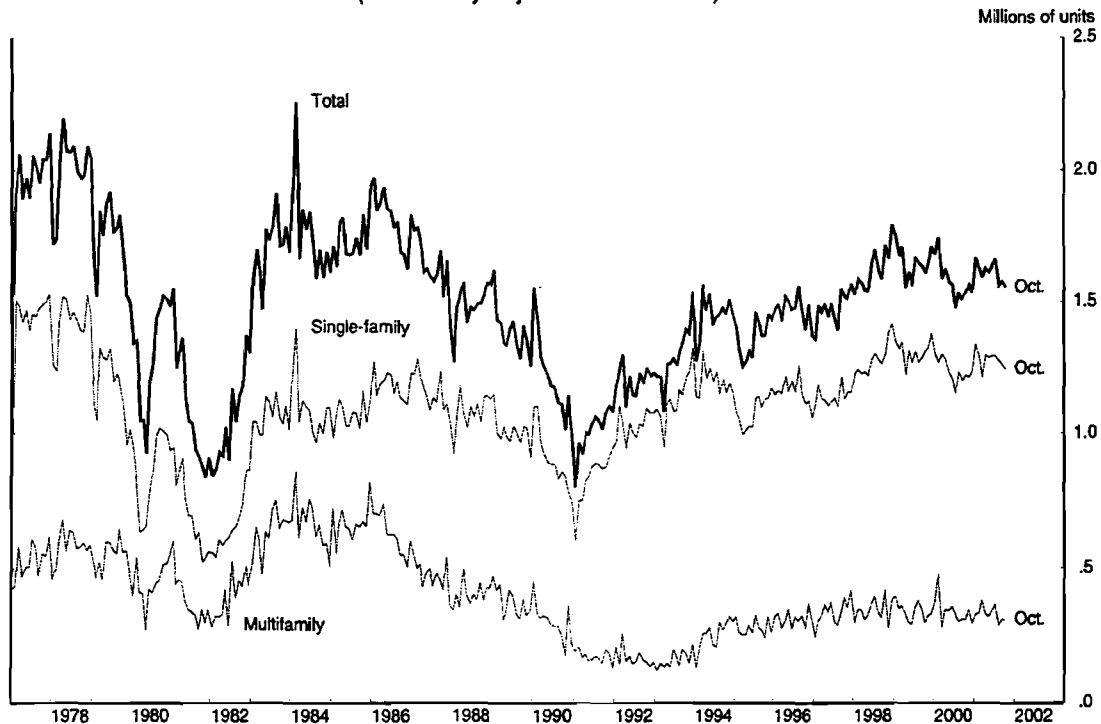
7. For example, GM announced that zero-interest financing will be available until January 2, but it is restricted to certain models. In addition, discounted financing for longer-term loans is now less favorable. Ford and DaimlerChrysler also have incentive programs scheduled to expire in early to mid-January.

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

	2000	2001					
		Q1	Q2	Q3 ^r	Aug. ^r	Sept. ^r	Oct. ^p
<i>All units</i>							
Starts	1.57	1.63	1.62	1.60	1.56	1.57	1.55
Permits	1.59	1.67	1.60	1.56	1.57	1.53	1.47
<i>Single-family units</i>							
Starts	1.23	1.28	1.29	1.27	1.27	1.26	1.24
Permits	1.20	1.24	1.22	1.20	1.21	1.16	1.14
Adjusted permits ¹	1.25	1.28	1.27	1.24	1.26	1.20	1.17
New home sales	.88	.95	.89	.88	.87	.88	.88
Existing home sales	5.11	5.27	5.30	5.21	5.54	4.90	5.17
<i>Multifamily units</i>							
Starts	.34	.35	.33	.32	.29	.32	.31
Permits	.39	.43	.38	.36	.36	.36	.33
<i>Mobile homes</i>							
Shipments	.25	.18	.19	.20	.20	.21	n.a.

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

Private Housing Starts
(Seasonally adjusted annual rate)



while the Conference Board's (CB) index of consumer confidence fell again. Monthly movements aside, the surveys seem to be well aligned when considered over a longer time span. For example, in November, both the CB and SRC measures were noticeably lower than in early summer, the time of their most recent peaks; both measures have also registered similar-sized declines over the past year or so, having fallen to below-average levels in November from their near-historical peaks in the fall of 2000.

Housing Markets

Although the level of homebuilding continued to moderate in October, it remained relatively high, supported by historically low mortgage rates.⁸ Starts of single-family homes declined 1-1/4 percent in October to an annual rate of 1.24 million units; although down from the pace of construction earlier this year, the latest reading was close to the average level in 2000 and off only modestly from the averages that prevailed in 1998 and 1999. One note of caution, however, is that adjusted permits for single-family construction decreased another 2-1/4 percent in October, after a 4-1/4 percent drop in September; given the pace of starts, the backlog of unused single-family permits held by builders came down further. Taken together, the latest readings on permits and backlogs suggest that the starts estimate for October somewhat overstates the strength of activity in the industry.⁹

Sales of new homes were essentially unchanged in October at an annual rate of 880,000 units and have held relatively steady since May. Sales of existing homes rebounded 5-1/2 percent to 5.2 million units in October; the rise reversed half of the sharp decline in September and likely reflected some closings that had been postponed after September 11.

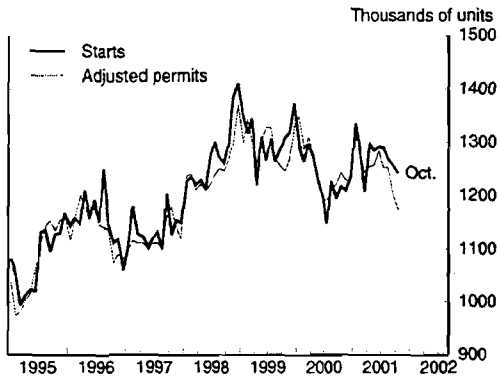
Recent indicators of housing demand in November have given somewhat inconsistent readings. For example, in November, the four-week moving average for the Mortgage Bankers Association index of purchase applications for home mortgages recovered a considerable part of its decline between June and late October. Similarly, by November, the Michigan survey's measure of households' attitudes toward home buying had largely retraced its third-quarter

8. In October, the average rate on fixed-rate mortgages (FRMs) declined to 6.60 percent, which is the lowest level to date for the Freddie Mac series, which begins in early 1971. The average rate on adjustable-rate mortgages declined in October to 5.26 percent, the lowest in 7-1/2 years. The FRM rate edged up to 6.68 percent in November and edged above 7 percent last week.

9. The monthly permits estimate is based on a sample that is nine times as large as the sample that underlies the starts estimate, and tests by Census show that the single-family permits series is subject to substantially lower statistical error than the series for single-family starts. Reflecting these differences, single-family starts typically adjust toward a better alignment with permits rather than the reverse. Empirically, the lagged deviation between starts and permits has significant predictive power for the change in starts but not for the change in permits.

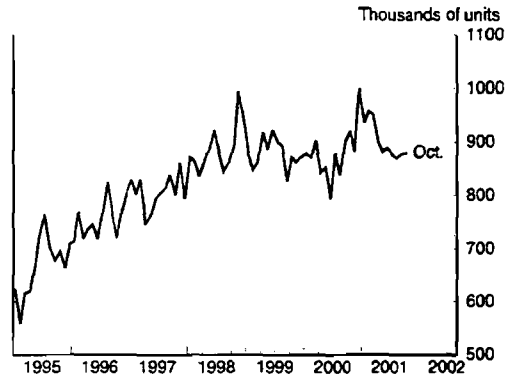
Indicators of Single-Family Housing

Starts and Adjusted Permits



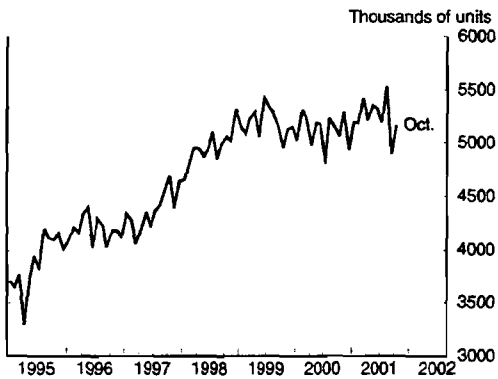
Note. Adjusted permits calculated by Board staff.
Source. Census Bureau.

New Home Sales



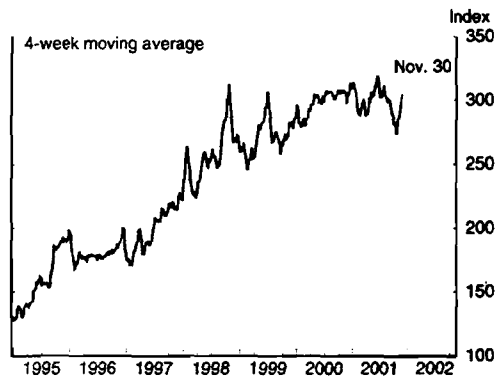
Source. Census Bureau.

Existing Home Sales

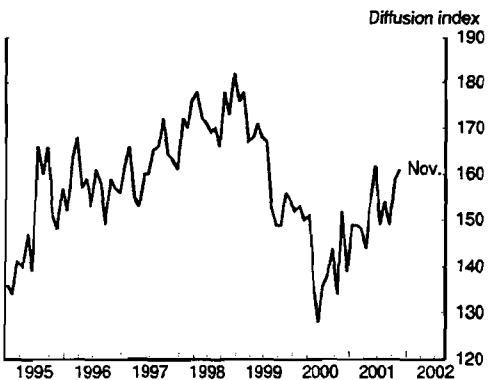


Source. National Association of Realtors.

MBA Index of Purchase Applications

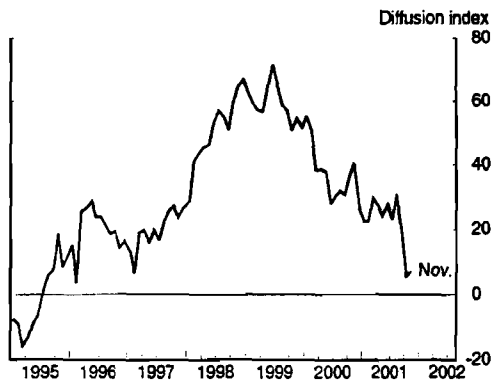


Perceived Homebuying Conditions



Source. Michigan Survey, not seasonally adjusted.

Builders' Rating of New Home Sales



Note. Created from NAHB data as the proportion of builders rating current sales as good minus those rating them as poor. Seasonally adjusted by FRB staff.

decline, and traffic of potential buyers in both new and existing homes has recovered considerably from the weak readings in September and October. In contrast, builders' ratings of new home sales—which have for some time been more pessimistic than actual sales—remained near a five-year low in November, and builders indicated a reduction in planned starts for the rest of this year and the first half of next year.¹⁰

In the multifamily sector, starts declined 1-1/2 percent in October to an annual rate of 310,000 units, which is toward the lower end of the range over the past two years. Even so, conditions in the market for multifamily rental units remain relatively favorable for construction. Over the year ending in the third quarter, the vacancy rate for multifamily rental units has held steady at a fairly low level, and with a twelve-month increase of 4.6 percent in October, the CPI for residential rent has been rising much more rapidly than overall consumer prices.

Business Fixed Investment

Equipment and software. Real outlays for equipment and software fell at an annual rate of 9.3 percent in the third quarter and appear headed for a somewhat larger decline this quarter. However, the latest data suggest that some of the steep decline in orders and shipments in September likely reflected a pause in activity after September 11, rather than additional underlying weakness.

New orders for nondefense capital goods excluding aircraft increased 6.5 percent in October after having declined 10 percent in September. Bookings for office and computing equipment were up more than 18 percent, and bookings for communications equipment were up nearly 62 percent. Total orders for high-tech equipment moved above their August levels but remained lower than in July. Outside of the high-tech sector, orders ticked down in the aggregate. However, in a number of categories, such as industrial machinery and metalworking machinery, orders advanced after steep falloffs in September.

Meanwhile, shipments of nondefense capital goods excluding aircraft moved up 1.4 percent in October on the heels of a 5 percent drop in the previous month. Most sectors recorded increases in October. Notably, shipments of office and computing equipment rose for the second straight month, after having declined sharply for most of the year. Overall, the level of shipments for nondefense capital goods (excluding aircraft) has been running above new orders since

10. In early November, the National Association of Home Builders asked 380 builders whether, in the aftermath of the September 11 attacks, they had made any change in their plans for housing starts for the fourth quarter of this year or for the first half of 2002. About one-fourth of them indicated having reduced the number of housing starts planned for the fourth quarter of this year and the first half of next year. In both periods, the median amount of the intended curtailment of starts was 20 percent. These results are roughly consistent with the results of similar survey questions that were asked in early October.

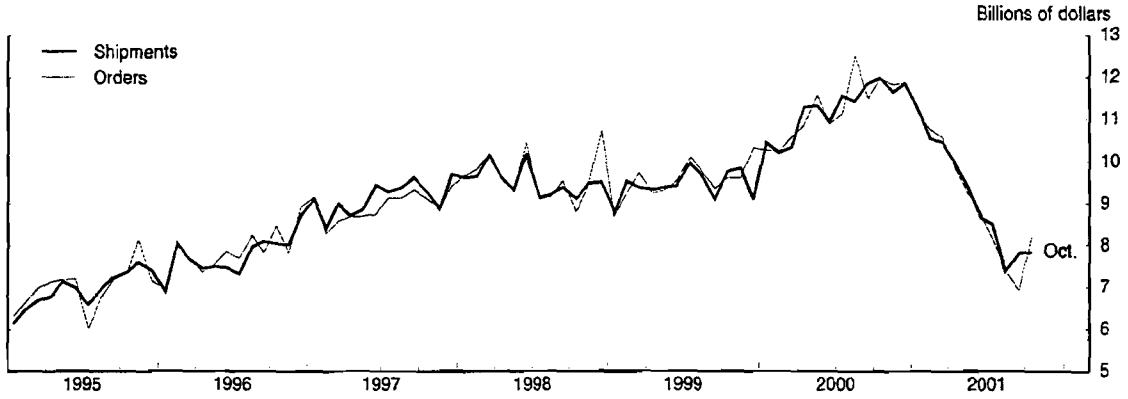
BUSINESS CAPITAL SPENDING INDICATORS
(Percent change from preceding comparable period;
based on seasonally adjusted data, in current dollars)

	2001		2001		
	Q2	Q3	Aug.	Sept.	Oct.
<u>Equipment and software</u>					
Shipments of nondefense capital goods	-5.6	-6.7	-2.6	-4.1	.9
Excluding aircraft	-5.8	-7.1	-2.3	-5.0	1.4
Computers and related equipment	-13.1	-15.4	-13.2	5.9	.3
Communications equipment	-12.8	-11.9	-2.5	-6.9	-2.3
All other categories	-2.8	-4.6	-.1	-6.5	2.1
Shipments of complete aircraft	3.8	6.5	-9.1	-17.6	n.a.
Medium & heavy truck sales (units)	-5.1	-6.2	.5	-6.9	18.4
Orders for nondefense capital goods	-7.1	-10.6	-.9	-13.1	7.4
Excluding aircraft	-7.7	-8.7	-1.1	-10.0	6.5
Computers and related equipment	-14.0	-19.4	-8.8	-7.1	18.4
Communications equipment	-26.3	-16.9	-.3	-40.6	61.6
All other categories	-2.8	-5.3	.3	-6.4	-.3
<u>Nonresidential structures</u>					
Construction put in place, buildings	-4.0	-5.4	-4.3	-2.8	1.8
Office	-7.0	-9.7	-7.1	-1.3	4.4
Other commercial	-2.8	-5.4	-1.7	-5.2	4.2
Institutional	-.1	-1.2	-.3	.1	5.4
Industrial	-4.3	-2.7	-8.2	-4.0	-9.2
Lodging and miscellaneous	-4.8	-5.2	-4.9	-2.8	-.6
Rotary drilling rigs in use ¹	9.3	-5.0	-4.6	-5.6	-7.9

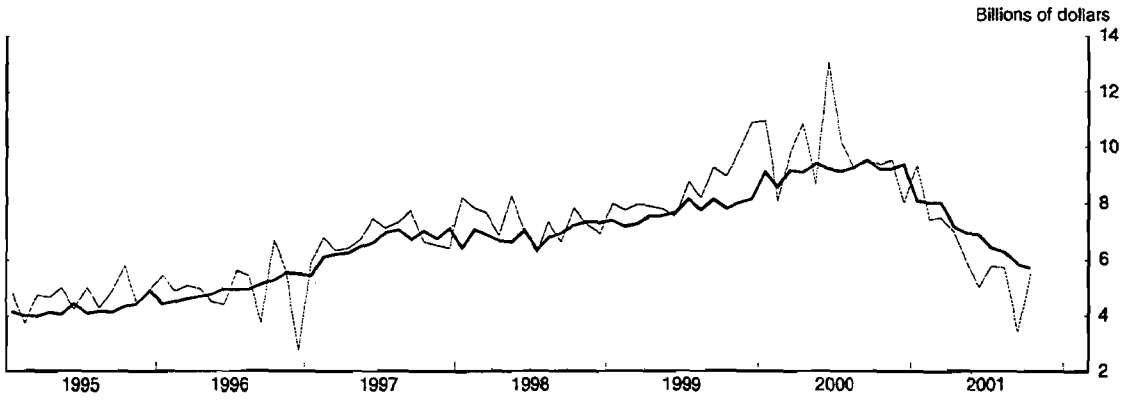
1. Percent change of number of rigs in use, seasonally adjusted.

Recent Data on Orders and Shipments

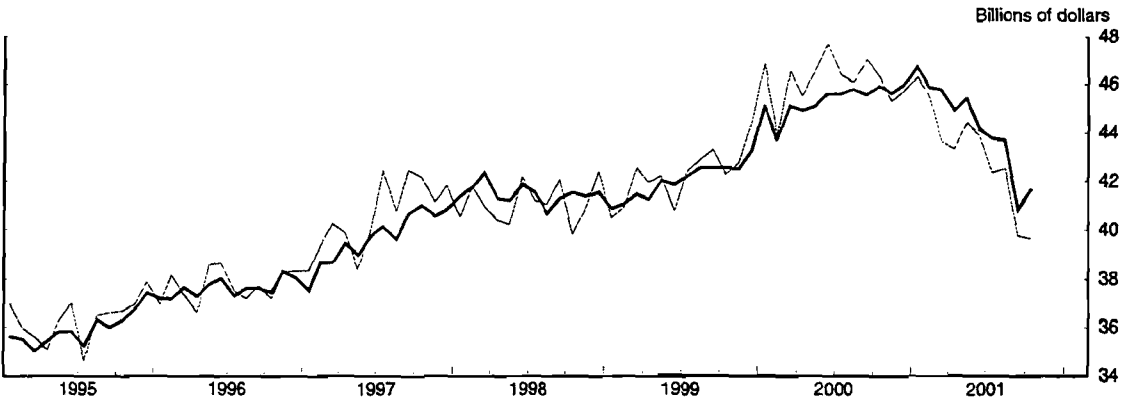
Computers and Related Equipment



Communications Equipment

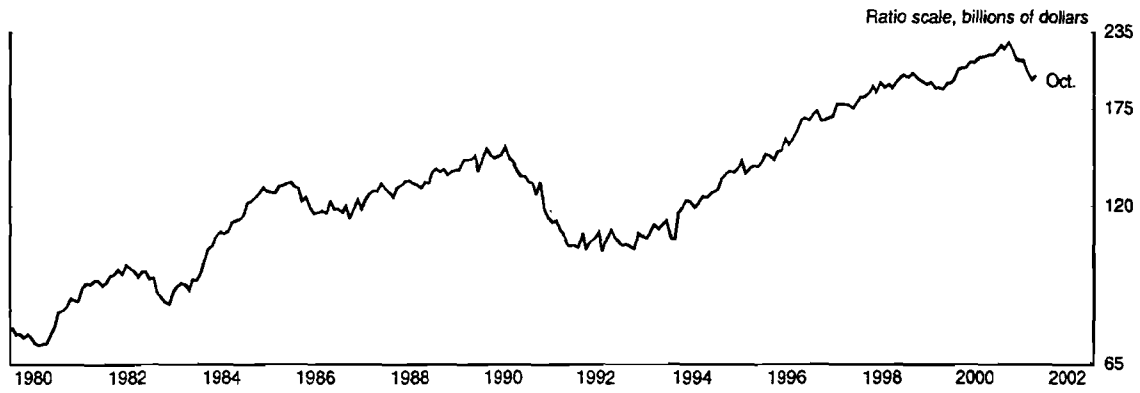


Other Equipment (Total Ex. Transportation, Computers, Communications)

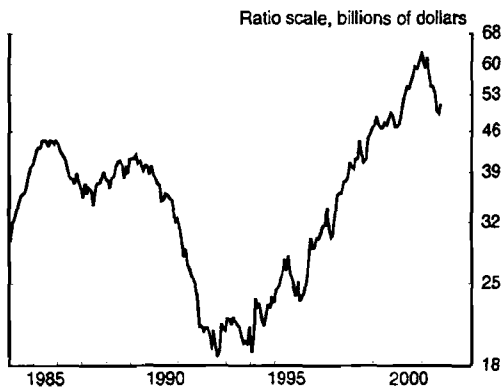


Nonresidential Construction (Seasonally adjusted, annual rate)

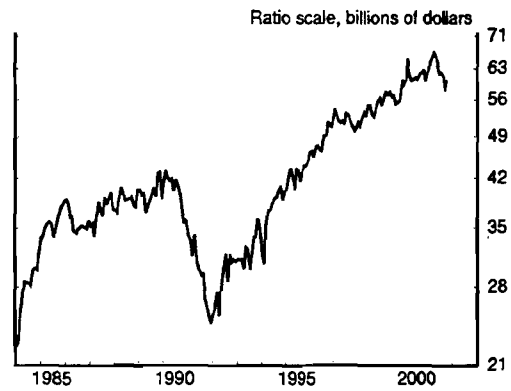
Total Building



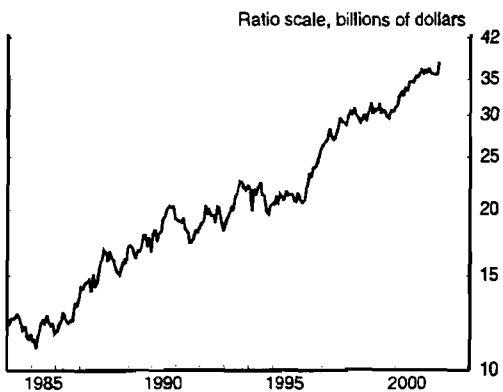
Office



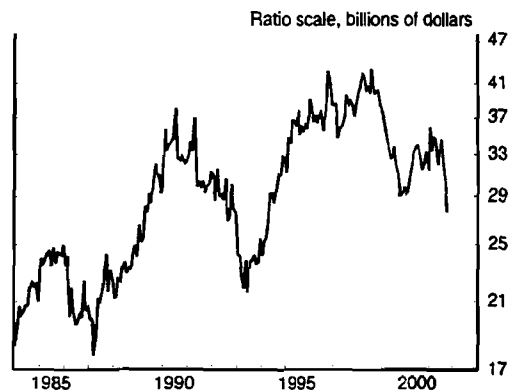
Other Commercial



Institutional



Industrial



January, and as a result, the backlog of unfilled orders has moved below its level of a year ago.

Demand for commercial aircraft is expected to remain depressed. Airbus plans to revise down its production schedules in 2002 to 300 deliveries of planes, down from 320 planes in 2001. However, many analysts believe Airbus will be forced to cut production below 290 planes, and some estimates run as low as 250 planes. Boeing has not announced any further reductions for 2002 subsequent to the steep reductions that the company announced in October.

Business demand for motor vehicles has continued to weaken this quarter. With travel down sharply in recent months, some rental companies have announced their intention to reduce their stocks of vehicles. Although confidential data from automakers indicate that fleet sales rebounded in November from their sharp drop in October, average sales over the past two months were well below the 3 million-unit sales rate in the third quarter. Sales of medium and heavy trucks also popped up in October after having fallen sharply in September. Nevertheless, sales of these vehicles have declined for the past seven quarters, and part of the October jump probably reflects activity that was postponed in September.

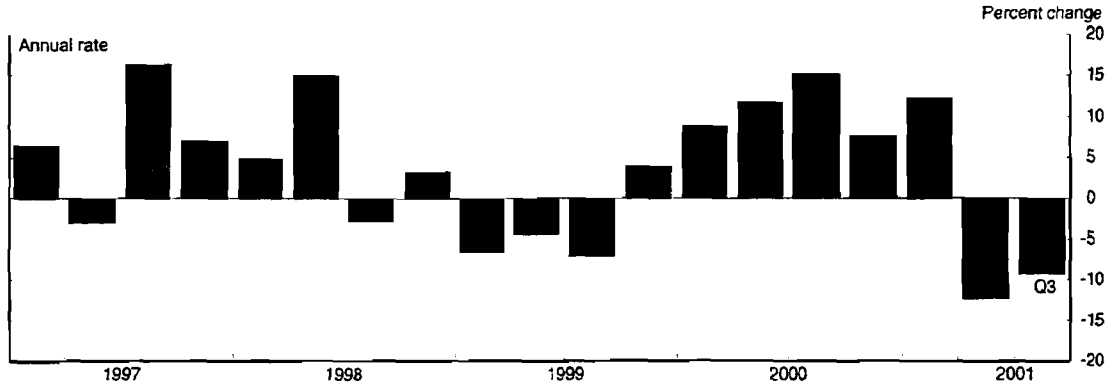
Nonresidential construction. Real outlays for the construction of nonresidential buildings increased 1.7 percent in October but were down more than 6 percent from the third-quarter average, following a 5.8 percent drop in the third quarter (not at annual rate).¹¹

For office buildings and other commercial structures, the declines in expenditures seen in the third quarter were partly reversed in October. Outlays for both types of structures rose 4.2 percent in real terms. According to updated estimates from CB Richard Ellis, a leading real estate brokerage, consulting, and information company, the vacancy rate for office buildings in downtown areas and in suburban locations jumped again in the third quarter, reaching 10.4 percent and 13 percent respectively. The latest vacancy rates, while up sharply from levels a year ago, are in a moderate range by historical standards.

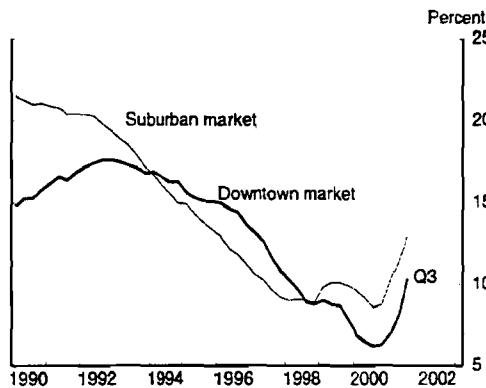
11. The staff estimates that real investment in nonresidential structures declined at an annual rate of 6.9 percent in the third quarter; this figure incorporates revisions to construction expenditures in August and September that were not reflected in the preliminary GDP estimate for investment in nonresidential structures, which was reported to have declined 9.3 percent at an annual rate. Third-quarter expenditures would have been weaker but for the long-term lease in July of the World Trade Center from the Port Authority of New York to two private companies. This transaction was treated by the BEA as a purchase of property by private nonresidential business. Excluding this special factor, private construction spending would have shown a decline at nearly a 21 percent rate last quarter. The boost to nonresidential investment spending from the asset sale was offset by a reduction in spending by state and local governments and therefore had no effect on GDP.

Nonresidential Structures

Real Nonresidential Investment

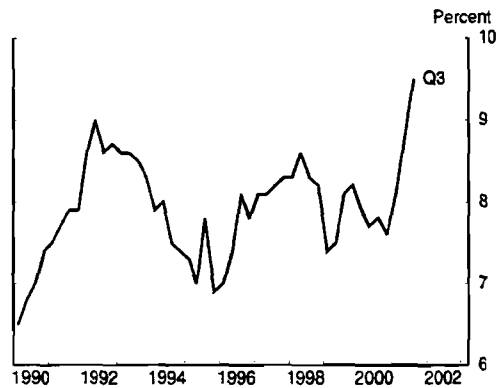


Office Vacancy Rate



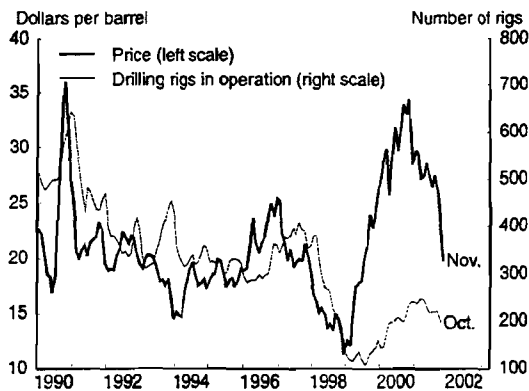
Source. CB Richard Ellis.

Industrial Vacancy Rate



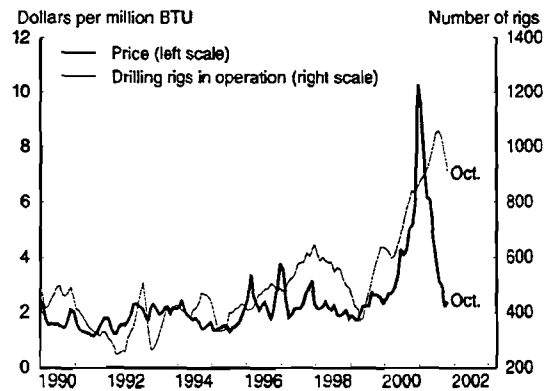
Source. CB Richard Ellis.

Petroleum Prices and Drilling Activity



Source. WTI spot price and DOE/Baker Hughes.

Natural Gas Prices and Drilling Activity



Source. Henry Hub spot price and DOE/Baker Hughes.

For industrial structures, real construction expenditures dropped 9.5 percent in October. According to CB Richard Ellis, the vacancy rate for industrial buildings increased to 9.5 percent in the third quarter, the highest on record (the series dates back to 1984).

Investment expenditures for drilling and mining declined at an annual rate of 5.2 percent in the third quarter (latest data) compared with a jump in the second quarter of nearly 34 percent. As noted earlier, the number of oil and gas drilling rigs in operation has edged down in recent months as prices have declined significantly.

Inventories

According to the preliminary GDP report, the real stock of nonfarm inventories declined at an annual rate of \$57 billion in the third quarter, which was nearly as large as the runoff in the first two quarters combined. Excluding motor vehicle inventories, which increased slightly last quarter, constant-dollar inventories fell at an annual rate of \$60 billion. Manufacturing shipments and wholesale and retail sales (excluding motor vehicles) in real terms declined in the third quarter as well; accordingly, the aggregate inventory-sales ratio only edged down from its second-quarter level.

The book value of manufacturers' inventories dropped at an annual rate of \$48.4 billion in September. Although inventories declined in nearly every durable and nondurable industry grouping in September, many stock-to-sales ratios nonetheless rose sharply further. Even in the few industries in which inventory-shipments ratios did move down, stocks remained quite high relative to shipments. More recent information indicates that inventories held by durable goods manufacturers, which constitute about two-thirds of the total manufacturing inventory stock, fell at an annual rate of \$15 billion in October. Inventory-shipments ratios moved down a bit from the high levels recorded in September in most durable goods categories.

The book value of wholesale inventories excluding motor vehicles decreased at an annual rate of \$12 billion in September. Stocks declined in most durable goods categories, although not by as much as sales. In most nondurable goods sectors, inventories fell or were little changed. However, because of robust stock-building by drug wholesalers, nondurable goods in aggregate recorded an increase in inventories, and the inventory-sales ratio increased for the second consecutive month.

The book value of retail inventories excluding motor vehicles declined at an annual rate of \$6 billion in September. Because non-auto retail sales fell 1.3 percent in September, the inventory-sales ratio jumped despite the liquidation in stocks.

CHANGES IN MANUFACTURING AND TRADE INVENTORIES
(Billions of dollars; annual rate except as noted;
based on seasonally adjusted Census book value)

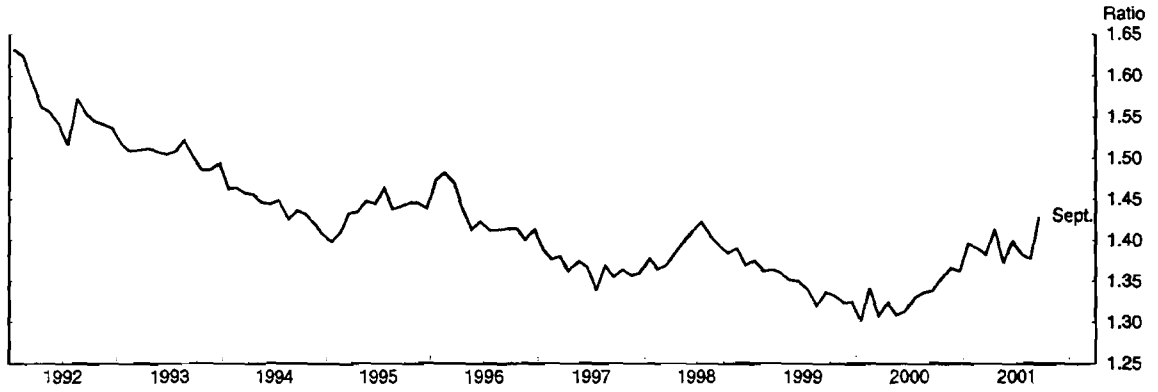
Category	2001			2001		
	Q1	Q2	Q3	Aug.	Sept.	Oct.
Manufacturing and trade	-24.0	-43.3	-56.7	-31.0	-66.9	n.a.
Less wholesale and retail motor vehicles	-10.0	-40.4	-61.5	-30.0	-66.4	n.a.
Manufacturing	-11.9	-34.4	-44.3	-41.3	-48.4	n.a.
Durables	-9.6	-25.2	-35.5	-30.6	-41.4	-15.2
Merchant wholesalers	-5.0	.2	-15.8	-8.5	-4.8	n.a.
Less motor vehicles	-2.4	3.3	-16.0	-3.2	-11.9	n.a.
Retail trade	-7.2	-9.0	3.4	18.9	-13.7	n.a.
Automotive dealers	-11.5	.3	4.5	4.3	-7.6	n.a.
Less automotive dealers	4.3	-9.3	-1.2	14.6	-6.1	n.a.

SELECTED INVENTORY-SALES RATIOS IN MANUFACTURING AND TRADE
(Months' supply, based on seasonally adjusted Census book value)

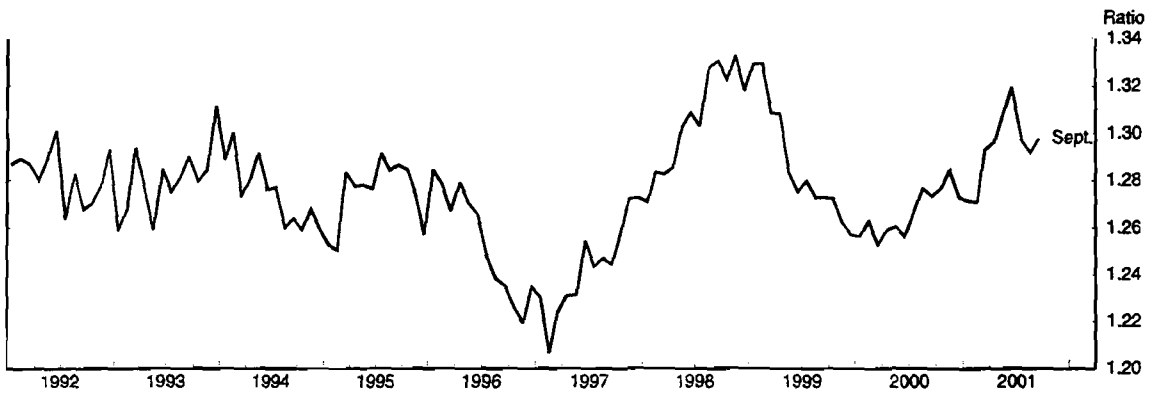
Category	2001			2001		
	Q1	Q2	Q3	Aug.	Sept.	Oct.
Manufacturing and trade	1.42	1.42	1.42	1.42	1.45	n.a.
Less wholesale and retail motor vehicles	1.38	1.38	1.38	1.38	1.41	n.a.
Manufacturing	1.38	1.38	1.38	1.38	1.43	n.a.
Durables	1.59	1.59	1.60	1.59	1.67	1.61
Nondurables	1.13	1.12	1.12	1.12	1.14	n.a.
Merchant wholesalers	1.30	1.32	1.31	1.30	1.32	n.a.
Less motor vehicles	1.28	1.31	1.29	1.29	1.30	n.a.
Durable goods	1.62	1.61	1.59	1.58	1.61	n.a.
Nondurable goods	.97	1.03	1.03	1.02	1.03	n.a.
Retail trade	1.59	1.56	1.57	1.56	1.59	n.a.
Less automotive dealers	1.50	1.47	1.48	1.47	1.49	n.a.
Automotive dealers	1.85	1.80	1.83	1.81	1.89	n.a.
General merchandise	1.94	1.92	1.91	1.92	1.92	n.a.
Apparel	2.41	2.41	2.44	2.40	2.55	n.a.
Food	.85	.86	.85	.85	.84	n.a.

Inventory-Sales Ratios
(Seasonally adjusted book value)

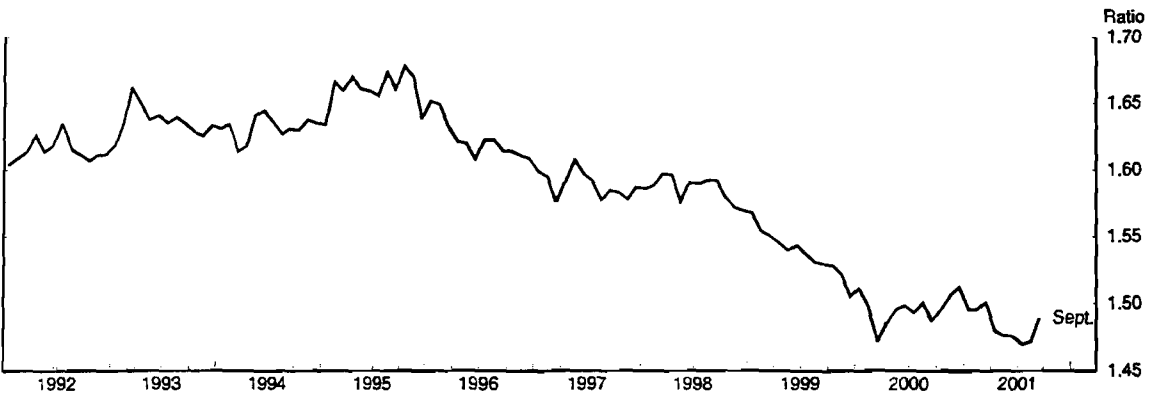
Manufacturing



Wholesale Trade Excluding Motor Vehicles



Retail Trade Excluding Motor Vehicles



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

Function or source	October			12 months ending in Oct.		
	2000	2001	Percent change	2000	2001	Percent change
Outlays	146.4	166.5	13.7	1,787.2	1,883.3	5.4
Deposit insurance	-0.1	-0.1	...	-3.4	-1.5	...
Spectrum auctions	0.0	0.0	...	-0.2	-1.0	...
Sale of major assets	0.0	0.0	...	0.0	0.0	...
Other	146.5	166.7	13.8	1,790.7	1,885.8	5.3
Receipts	135.1	157.2	16.3	2,039.1	2,012.3	-1.3
Surplus	-11.3	-9.4	...	251.9	129.0	-48.8
Outlays excluding deposit insurance, spectrum auction, and sale of major assets are adjusted for payment timing shifts ¹						
Outlays	153.4	166.7	8.6	1,790.5	1,882.9	5.2
National defense	24.1	26.4	9.5	291.5	309.7	6.2
Net interest	18.4	16.2	-12.2	222.9	203.8	-8.6
Social security	34.5	36.3	5.0	411.3	434.7	5.7
Medicare	17.2	17.2	-0.3	198.9	214.5	7.8
Medicaid	11.4	13.4	18.0	119.8	131.4	9.7
Other health	3.4	4.1	20.5	37.0	43.2	16.8
Income security	19.0	21.7	14.3	246.3	268.4	9.0
Agriculture	5.0	5.3	5.2	36.7	28.6	-22.1
Other	20.4	26.2	28.4	226.0	248.5	10.0
Receipts	135.1	157.2	16.3	2,039.1	2,012.3	-1.3
Individual income and payroll taxes	120.8	124.2	2.8	1,635.4	1,654.5	1.2
Withheld + FICA	112.9	116.2	2.9	1,374.9	1,417.2	3.1
Nonwithheld + SECA	9.0	10.1	11.7	394.4	420.5	6.6
Refunds (-)	1.1	2.0	83.3	133.9	183.2	36.8
Corporate	1.7	19.7	1,055.4	206.8	169.1	-18.2
Gross	7.1	30.1	323.6	235.6	209.8	-11.0
Refunds (-)	5.4	10.4	92.2	28.8	40.6	41.2
Other	12.6	13.2	4.6	196.9	188.6	-4.2
Surplus	-18.3	-9.5	...	248.7	129.3	-48.0

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

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

... Not applicable.

Government Sector

Federal. The federal government recorded a \$9 billion unified deficit during October 2001. Although this deficit is slightly smaller than the year-earlier figure (\$11 billion), the reduction is more than explained by special factors that boosted receipts to a level 16 percent above last October. In particular, the Economic Growth and Tax Relief Reconciliation Act of 2001 allowed corporations to shift about \$23 billion in estimated payments from September 15 to October 1, and an extra business day this October added roughly \$5 billion to receipts. Excluding these special factors, receipts this October were slightly below a year earlier, and the unified deficit would have been \$37 billion.

Adjusted for routine timing shifts, outlays were nearly 9 percent higher in October than they were twelve months earlier. While defense spending was up about 10 percent, an increase of this magnitude was expected before September 11, suggesting that the terrorism-related operations did not have a material effect on October outlays. Outlays for Medicaid and income security also rose briskly.

Stimulus Packages Proposed in the Congress for Fiscal 2002
(Billions of dollars)

Package element	House	Senate		
		Democrats	Republicans	Moderates
Total	102	67	100	75
Partial expensing	39	14	26	26
New rebate checks	14	14	0	14
UI / COBRA	2	21	15	18
Eliminate corporate AMT	25	0	9	0
Accelerate TRRA ¹	13	0	13	12
Payroll tax holiday	0	0	37	0
Other	9	18	0	5

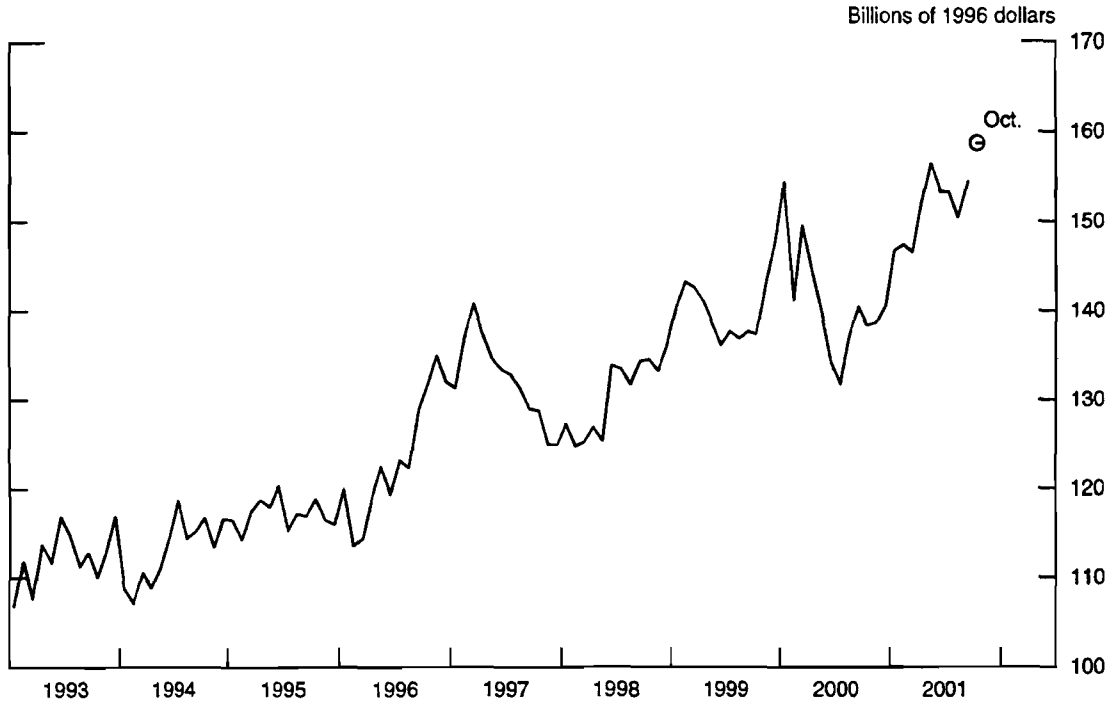
1. Economic Growth and Tax Relief Reconciliation Act of 2001.

The Congress has been grappling with several fiscal initiatives. President Bush signed a bill that federalizes approximately 28,000 airport security personnel at an annual budget cost of roughly \$2 billion.¹² This outlay will be financed by a ticket surcharge of up to \$10 per roundtrip.

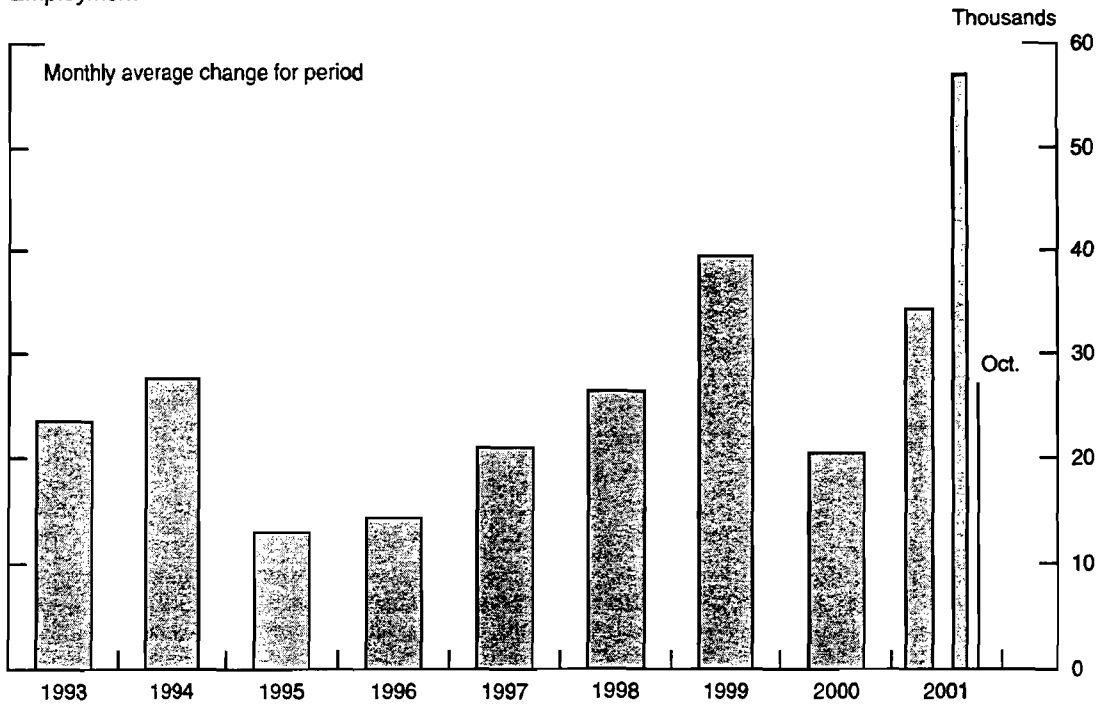
12. The bill stipulates that the federal takeover be phased in over the next year. Two years after the plan is fully phased in, airports may opt out of the federal system and re-hire private contractors.

State and Local Construction and Employment

Construction Put in Place



Employment



After the House passed a Republican fiscal stimulus package in October, a proposal developed by Democrats stalled in the Senate. Congressional leaders have agreed to a framework for negotiations designed to bridge the gaps between these two plans. A package developed by Senate moderates may form the basis for a compromise. This bipartisan plan includes investment incentives, new rebate checks, unemployment-related benefits, and accelerated implementation of the recently enacted tax cuts.

Completion of the regular fiscal 2002 appropriations process is still being held up by disputes over additional emergency spending. The House has attached \$20 billion to its fiscal 2002 defense spending bill. However, Senate Democrats want to increase emergency-related spending by somewhat more—about \$35 billion—and the Administration has threatened to veto those larger increases. As negotiations continue, the Congress has passed a continuing resolution that provides funding for programs without completed appropriations bills through December 15.

State and local governments. Although pressures on budgets are intensifying, state and local consumption and investment purchases continued at a robust pace in the early part of the fourth quarter.¹³ Real construction put-in-place jumped 2-3/4 percent (monthly rate) in October, to a level more than 13 percent above the level at the end of 2000. Meanwhile, hiring was well maintained in October; the addition of 27,000 jobs in October came on the heels of a rapid 57,000 average monthly rise in the third quarter.

Looking ahead, state governments continue to report that revenues have been coming in below expectations, and many are working out strategies that will allow them to finish the current fiscal year with their budgets in balance. Until recently, the proposed remedies focused on reducing planned expenditures, dipping into budget-stabilization (so-called rainy-day) funds, and funding some additional capital projects with debt rather than current receipts. More recently, however, several state governments have indicated a willingness to consider tax hikes or the postponement of tax reductions.

An October survey of city governments by the National League of Cities reported that many jurisdictions, faced with widening imbalances in their budgets, expect to draw down reserves and constrain the rise in expenditures. Many are concerned about the added costs of heightened public safety and security measures that have coincided with a slowdown in revenue collections. Nonetheless, only a few cities suggested that they would consider higher taxes or fees.

13. Note that in the fourth quarter, the change in state and local purchases, as measured in the NIPA, will be boosted as investment spending returns to the level recorded before the World Trade Center was transferred, as discussed earlier, to the private sector.

RECENT PRICE INDICATORS
(Percent)

	From 12 months earlier		From 3 months earlier		2001	
	Oct. 2000	Oct. 2001	July 2001	Oct. 2001	Sept.	Oct.
			-Annual rate-		-Monthly rate-	
<u>CPI</u>						
Total	3.4	2.1	1.4	0.5	0.4	-0.3
Food	2.4	3.4	4.3	3.3	0.2	0.5
Energy	15.9	-5.6	-13.6	-20.8	2.6	-6.3
Ex. food and energy	2.5	2.6	2.4	2.4	0.2	0.2
Ex. tobacco	2.5	2.5	2.1	2.6	0.1	0.2
Core commodities	0.2	0.0	-1.1	-0.5	0.3	-0.1
Ex. tobacco	-0.1	-0.5	-2.2	0.1	0.1	0.1
Core services	3.5	3.7	4.1	3.3	0.1	0.2
Current-methods total	3.4	2.1	1.4	0.5	0.4	-0.3
Ex. food and energy	2.4	2.6	2.4	2.4	0.2	0.2
Ex. tobacco	2.4	2.5	2.1	2.6	0.1	0.2
<u>PCE Prices</u>						
Total	2.6	1.5	0.8	0.6	-0.6	0.7
Food	2.5	3.3	3.9	3.4	0.1	0.4
Energy	16.0	-5.7	-14.3	-19.5	3.2	-6.5
Ex. food and energy	1.9	1.6	1.3	1.3	-0.9	1.2
Ex. tobacco	1.9	1.5	1.1	1.5	-1.0	1.2
Core commodities	-0.6	-0.8	-1.6	-1.2	0.3	-0.0
Ex. tobacco	-0.9	-1.2	-2.5	-0.7	0.0	0.1
Core services	3.0	2.6	2.6	2.5	-1.4	1.7
Core market-based	1.8	1.7	1.3	1.6	0.2	0.2
Core nonmarket-based	2.6	1.3	1.1	0.4	-6.2	6.4
<u>PPI</u>						
Total finished goods	3.7	-0.4	-5.2	-3.7	0.4	-1.6
Food	1.6	2.8	-3.9	2.6	0.2	-0.4
Energy	19.3	-9.5	-29.1	-21.3	0.9	-7.7
Ex. food and energy	1.2	0.8	1.6	-1.3	0.3	-0.5
Ex. tobacco	1.1	0.2	0.5	-1.4	0.3	-0.6
Core consumer goods	1.2	1.3	1.8	-0.5	0.4	-0.4
Ex. tobacco	1.1	0.4	0.0	-0.6	0.4	-0.5
Capital equipment	0.9	0.0	1.1	-2.5	0.1	-0.7
Intermediate materials	4.6	-2.4	-4.2	-7.2	0.1	-1.5
Ex. food and energy	2.1	-1.2	-2.3	-3.5	-0.1	-0.4
Crude materials	25.3	-25.0	-43.3	-47.4	-4.1	-9.1
Ex. food and energy	-0.5	-10.8	-8.5	-9.0	0.2	-1.7

Prices and Labor Costs

Prices.

With energy prices resuming their downward slide in October, the twelve-month change in the consumer price index slowed to 2.1 percent, down from a 3.4 percent increase over the preceding twelve months. October's reading was the lowest twelve-month change in more than two years. The CPI excluding food and energy has risen 2.6 percent since October 2000, up marginally from the change over the year-earlier period, while the twelve-month change in core PCE prices was 1.6 percent in October, down from 1.9 percent over the preceding twelve months.¹⁴ The deceleration in core PCE prices contrasts with the essentially flat pattern of core CPI inflation over the past year. The difference is largely due to the wider scope of the PCE series, which includes a number of categories with non-market-based prices (such as imputed bank service charges) that have decelerated sharply over the past year.

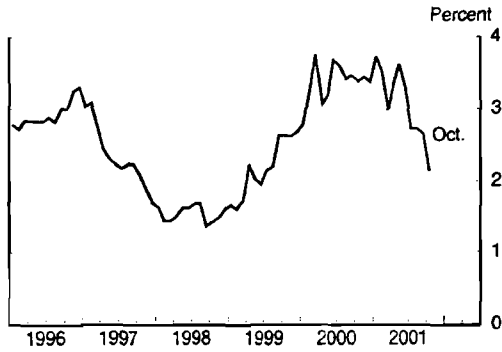
The CPI for energy fell sharply in October, reflecting large declines for prices of motor fuel, heating oil, and natural gas. Survey data indicate that gasoline and heating oil prices fell further in November. These declines partly reflect the roughly \$2.50 per barrel drop in spot prices of crude oil last month. In addition, energy inventories are generally in good shape. Gasoline stocks have remained on the high side of the seasonal norm, and margins have dropped back to more-normal levels. The winter heating season has begun in far better shape than a year ago: Inventories of both natural gas and heating oil are much higher than last year's levels. As a result, spot prices for natural gas in recent weeks have fallen back to levels last seen in late 1999. Retail electricity prices have begun to edge down in recent months, reflecting the lower cost of natural gas inputs.

The consumer price index for food rose 0.5 percent in October, bringing the twelve-month change to 3.4 percent—1.0 percentage point higher than a year earlier. However, the USDA's index of prices received by farmers has declined sharply over the past few months after having posted a series of increases earlier this year, and this week's futures quotes suggest that farm prices will continue to decline moderately next year. These developments are likely to slow the increases in retail food prices over the coming months.

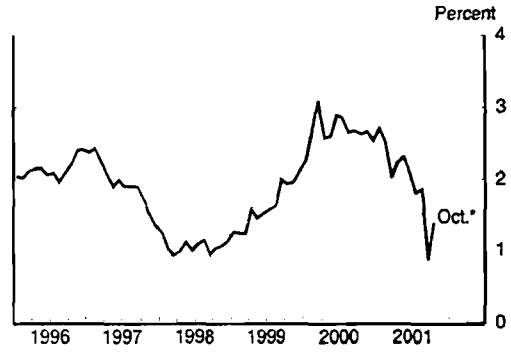
14. Core PCE prices jumped 1.2 percent in October, more than reversing the decline in September that was caused by the BEA's treatment of insurance payments; the twelve-month change in October was no longer affected. These insurance adjustments affected the third-quarter GDP chain-type price index, which increased 2.2 percent according to the preliminary GDP release. As we reported previously, this measure of price inflation was boosted approximately 0.9 percentage point in the third quarter by the BEA's treatment of insurance payments, while PCE chain-type price inflation was reduced 1.1 percentage points. The BEA adjusted nominal imports of insurance services in a manner that reduced the import price deflator, and this adjustment had a larger effect on GDP prices than did the associated downward adjustment to PCE prices.

Measures of Consumer Price Inflation
(12-month change except as noted)

Total CPI

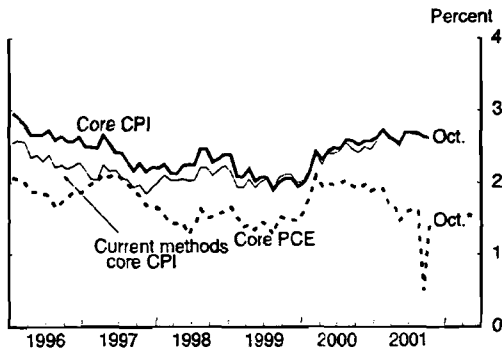


Total PCE



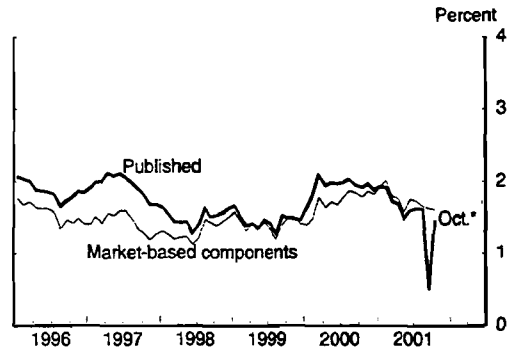
* Staff estimate

CPI and PCE Excluding Food and Energy



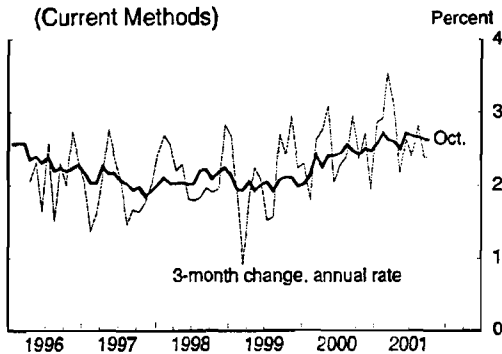
* Staff estimate

PCE Excluding Food and Energy

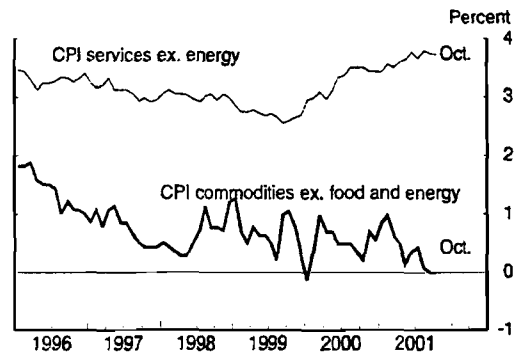


* Staff estimate

CPI Excluding Food and Energy
(Current Methods)



CPI Services and Commodities



In October, the CPI excluding food and energy rose 0.2 percent for the fourth consecutive month. Prices of commodities excluding food and energy edged down in October after having risen 0.3 percent in September. The recent changes have been influenced importantly by changes in tobacco prices; excluding tobacco, the index for core commodities edged up 0.1 percent in both September and October.¹⁵ Over the year ending in October, prices of core commodities excluding tobacco declined 1/2 percent.

Prices for non-energy services increased 0.2 percent in October after having risen 0.1 percent in September. The increases in September and October were held down by large declines in prices for airfares and for lodging away from home. Although these categories tend to be volatile, the recent softness is consistent with anecdotal reports of weakness in tourism and travel. In contrast, the CPIs for both owners' equivalent rent and tenants' rent advanced 0.4 percent. Compared with October 2000, the twelve-month changes in these two indexes have accelerated 1 percentage point and 1/2 percentage point, respectively, to 4.2 percent and 4.5 percent.

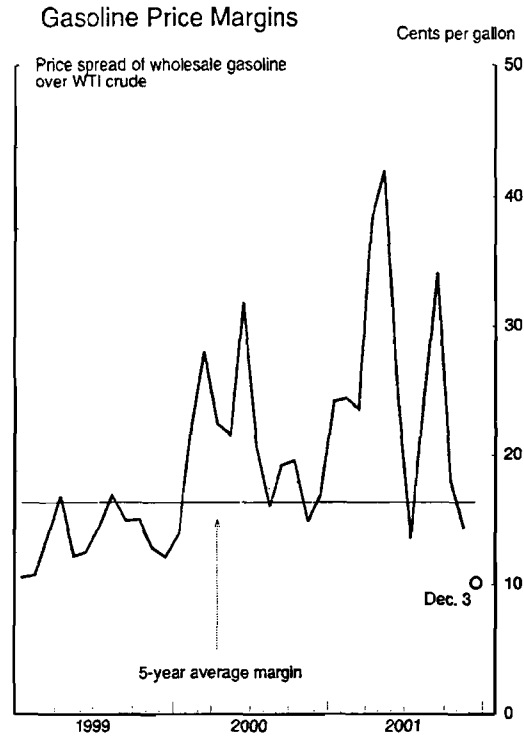
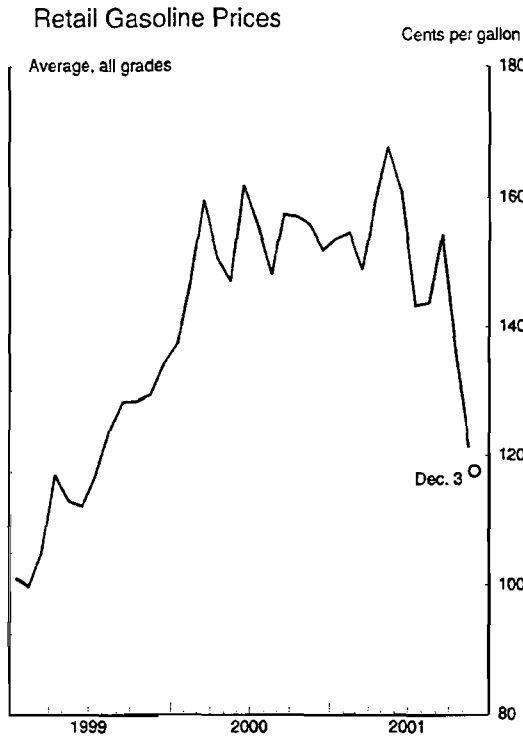
Prices for capital goods, as measured by the PPI, fell 0.7 percent in October. This decline—the largest monthly drop in more than forty years—was mainly the result of falling prices for motor vehicles. Unlike the CPI, the PPI takes financing incentives into account when measuring producer prices for motor vehicles. Prices for communications equipment continued their recent slide in October, falling 0.6 percent. Computer prices are reported to have risen slightly in October, but this increase follows two large monthly declines. Over the past three months, computer prices have plunged at an annual rate of more than 40 percent.

Recent price changes at earlier stages of processing have been mixed. The producer price index for core intermediate materials fell 0.4 percent in October. Over the twelve months ending in October, this index declined 1.2 percent, compared with a 2.1 percent rise over the preceding twelve months. The PPI for core crude materials dropped 11 percent over the year through mid-October. However, indexes of industrial materials prices have turned up over the past month. The CRB spot industrial price index is up 4 percent since the time of the last Greenbook; the Journal of Commerce index, which has been held down by the decline in energy prices, increased 1 percent over this period.

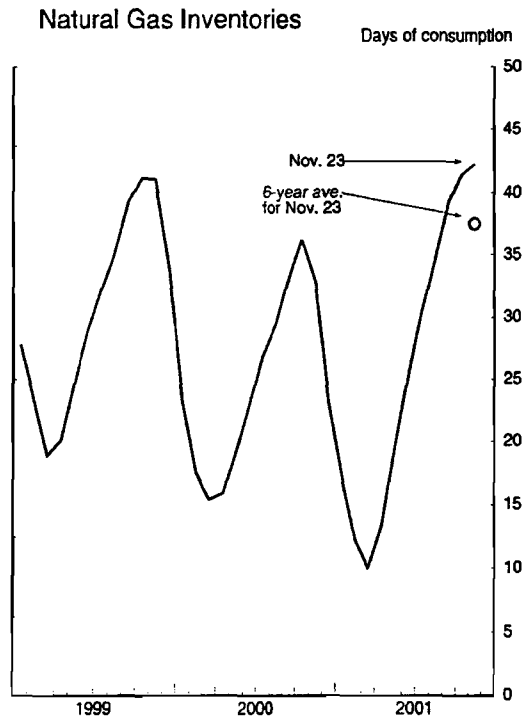
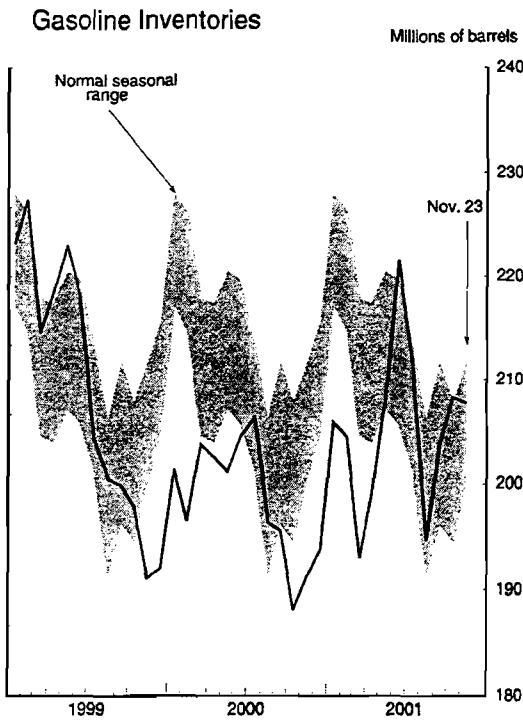
Near-term inflation expectations, as measured by the University of Michigan survey, moved down further in November after a surprisingly large drop in October. The latest survey put the median expectation for inflation in the coming year at 0.4 percent, down from 2.8 percent in September and 1 percent

15. The CPI does not include auto financing charges and, thus, has not been affected by the recent round of aggressive incentives. Indeed, reported consumer prices for new motor vehicles rose a touch in October.

Gasoline and Natural Gas Developments



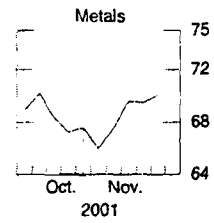
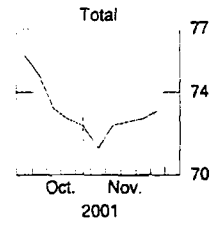
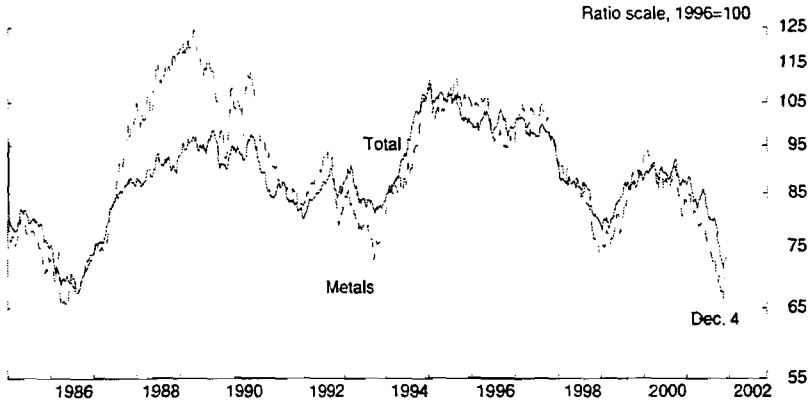
Note. Prices adjusted with CPI seasonal factors.



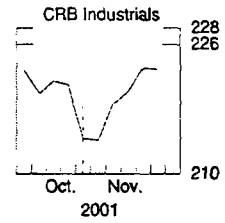
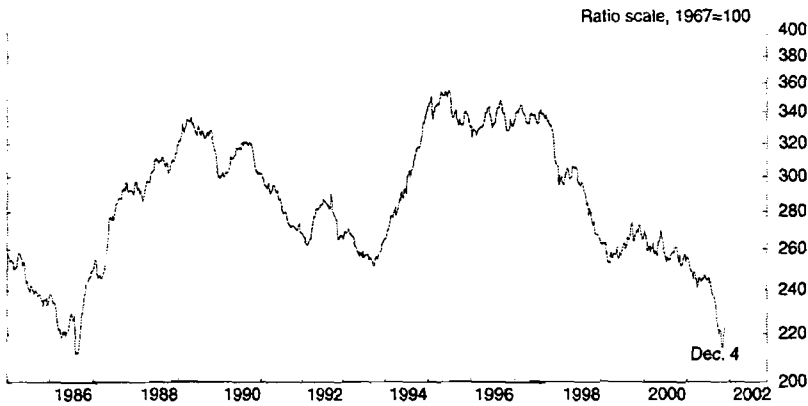
Note. Working gas in storage divided by U.S. D.O.E. projection of 2001/2002 average daily winter consumption.

Commodity Price Measures

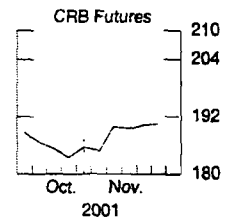
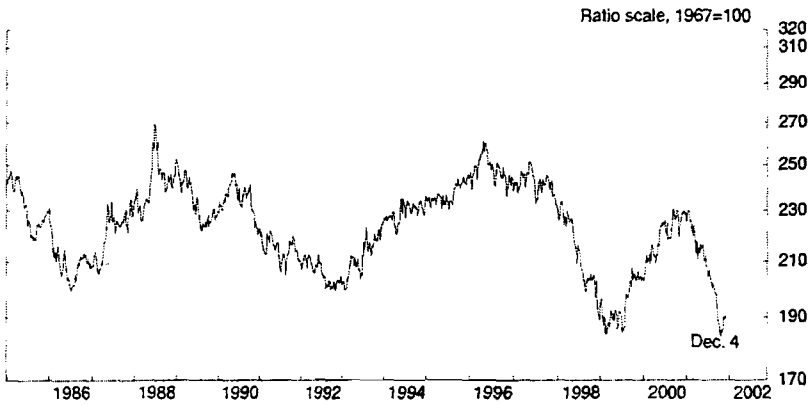
Journal of Commerce Index



CRB Spot Industrials



CRB Futures



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

SPOT PRICES OF SELECTED COMMODITIES

	Current price (dollars)	-----Percent change ¹ -----				Memo: Year earlier to date
		1999	2000	Dec. 26 to Oct. 30 ²	Oct. 30 ² to Dec. 04	
Metals						
Copper (lb.)	0.740	26.1	3.4	-26.4	10.4	-17.8
Steel scrap (ton)	65.000	61.5	-32.7	-7.6	-11.0	-15.9
Aluminum, London (lb.)	0.622	27.7	-0.8	-18.5	8.0	-8.8
Precious metals						
Gold (oz.)	276.600	-1.6	-5.7	2.3	-1.4	2.1
Silver (oz.)	4.190	5.5	-10.9	-8.7	-1.8	-11.4
Forest products³						
Lumber (m. bdft.)	213.000	8.3	-44.6	13.9	3.9	1.4
Plywood (m. sqft.)	295.000	-3.2	-8.2	0.0	5.4	-3.3
Petroleum						
Crude oil (barrel)	19.170	163.3	-13.0	-8.5	-5.8	-33.1
Gasoline (gal.)	0.522	132.9	5.2	-25.1	-5.2	-30.0
Fuel oil (gal.)	0.518	140.7	34.4	-35.3	-15.7	-48.4
Livestock						
Steers (cwt.)	65.830	15.7	13.2	-15.8	1.5	-9.8
Hogs (cwt.)	32.500	194.0	7.1	-2.0	-12.2	-18.0
Broilers (lb.)	0.513	-4.0	-13.7	11.5	-7.4	-6.0
U.S. farm crops						
Corn (bu.)	2.000	-10.2	10.1	-11.6	9.0	1.5
Wheat (bu.)	3.275	-17.4	31.9	-1.6	-4.5	-4.2
Soybeans (bu.)	4.350	-17.6	10.8	-16.2	5.6	-10.3
Cotton (lb.)	0.325	-20.9	27.0	-55.1	23.4	-48.2
Other foodstuffs						
Coffee (lb.)	0.405	5.1	-43.1	-46.0	10.2	-41.3
Memo:						
JOC Industrials	73.100	11.0	-1.5	-16.6	1.0	-16.4
JOC Metals	70.100	26.3	-10.3	-18.9	3.7	-14.0
CRB Futures	190.480	7.8	12.1	-18.9	2.6	-17.0
CRB Spot Industrials	223.000	-0.1	-3.5	-16.5	4.0	-12.3

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

in October—the largest two-month decline in the history of the series, which began in 1978. Inflation expectations fell almost as sharply in late 1981, but that episode occurred during a period of ongoing disinflation that followed double-digit inflation rates; by contrast, the recent declines occurred suddenly, after a long period of relatively stable inflation expectations. The underlying survey data show that the drop in the median expectation was largely the result of a big increase in the fraction of respondents who are expecting inflation to be either zero or negative over the next year.¹⁶ In contrast to the plunge in the year-ahead expectations, longer-term inflation expectations have moved down only a little in recent months.

Labor costs. We have received little new information on labor costs since the last Greenbook. Based on the GDP release, we expect that compensation per hour in the nonfarm business sector increased at an annual rate of 3.8 percent in the third quarter. For the fourth quarter, the only figures we have in hand are average hourly earnings of production or nonsupervisory workers, which edged up 0.1 percent in October. Since October 2000, this measure of wages has increased 4.1 percent, a touch above the year-earlier reading. Nevertheless, average hourly earnings have decelerated in recent months, increasing at an annual rate of 3.7 percent over the three months ending in October. Concerning benefits, anecdotal reports continue to point to further sizable increases in employers' health insurance costs. For example, a recent Towers Perrin survey reported an average increase of 13 percent in health care premiums for active employees for 2002.

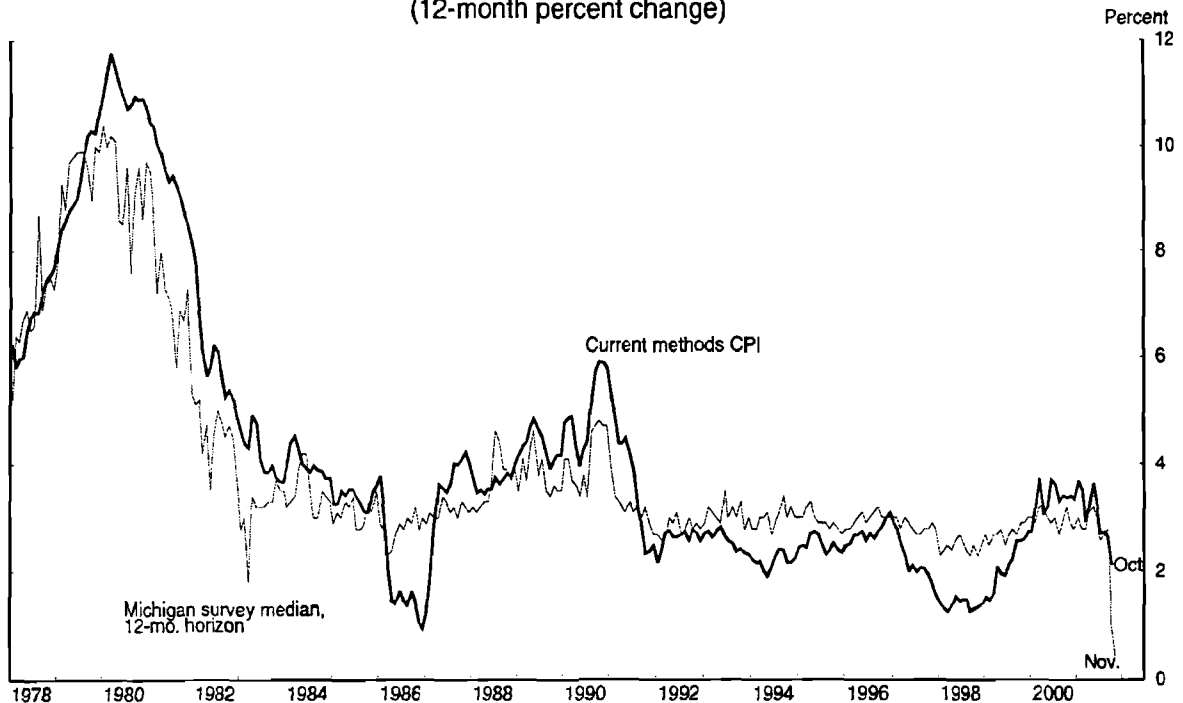
16. In fact, 53 percent of Michigan survey respondents reported that they expect prices to stay the same or go down over the next year. The reported median inflation series has remained positive, however, because the SRC interpolates integer responses when calculating this series. For example, respondents who expect prices to be flat are distributed evenly between -0.5 percent and 0.5 percent.

SURVEYS OF (CPI) INFLATION EXPECTATIONS
(Percent)

	Actual inflation ¹	University of Michigan				Professional forecasters (10-year) ⁴
		1 year		5 to 10 years		
		Mean ²	Median ²	Mean ³	Median ³	
1999-Q4	2.6	3.5	2.9	3.3	2.9	2.5
2000-Q1	3.2	3.6	3.0	3.5	3.0	2.5
Q2	3.3	3.5	3.0	3.3	2.8	2.5
Q3	3.5	3.6	2.9	3.4	2.9	2.5
Q4	3.4	3.8	3.0	3.7	3.0	2.5
2001-Q1	3.4	3.4	2.9	3.6	3.0	2.5
Q2	3.4	3.9	3.1	3.6	3.0	2.5
Q3	2.7	3.1	2.7	3.5	2.9	2.5
July	2.7	3.0	2.6	3.4	2.9	
Aug.	2.7	3.1	2.7	3.6	3.0	
Sept.	2.6	3.2	2.8	3.4	2.9	2.5
Oct.	2.1	1.6	1.0	2.8	2.7	
Nov.		1.0	0.4	3.2	2.8	

1. CPI; percent change from the same period in the preceding year.
2. Responses to the question: By about what percent do you expect prices to go up, on the average, during the next 12 months?
3. Responses to the question: By about what percent per year do you expect prices to go up, on the average, during the next 5 to 10 years?
4. Compiled by the Federal Reserve Bank of Philadelphia.

Actual and Expected Inflation
(12-month percent change)



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

	1999 ¹	2000 ¹	2000		2001		2000:Q3 to 2001:Q3
			Q4	Q1	Q2	Q3	
<u>Compensation per hour</u>							
Total business	4.4	7.6	9.4	5.3	5.3	4.1	6.0
Nonfarm business	4.3	7.4	8.9	5.1	4.8	4.5	5.8
Nonfinancial corporations ²	4.4	7.5	9.6	5.7	6.2	n.a.	n.a.
<u>Unit labor costs</u>							
Total business	1.4	4.8	6.3	5.3	3.0	1.9	4.1
Nonfarm business	1.5	5.0	6.4	5.0	2.6	1.8	3.9
Nonfinancial corporations ²	1.5	3.2	7.9	5.0	2.7	n.a.	n.a.

1. Changes are from fourth quarter of preceding year to fourth quarter of year shown.

2. The nonfinancial corporate sector includes all corporations doing business in the United States with the exception of banks, stock and commodity brokers, finance and insurance companies; the sector accounts for about two-thirds of business employment.

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

	12-month percent change			Percent change to Oct. 2001 from month indicated		Percent change	
	Oct. 1999	Oct. 2000	Oct. 2001	Apr. 2001	July 2001	Sept. 2001	Oct. 2001
	- - - - - Annual rate - - - - -					- Monthly rate -	
Total private nonfarm	3.6	3.9	4.1	3.7	3.7	.3	.1
Manufacturing	3.6	3.5	3.3	4.1	4.4	.2	.4
Construction	3.6	3.8	2.1	2.7	2.9	.1	.2
Transportation and public utilities	2.6	3.8	4.6	4.8	6.3	.5	.6
Finance, insurance, and real estate	3.4	3.1	5.1	4.3	1.5	.1	-.2
Retail trade	4.0	4.2	3.6	3.5	2.9	-.1	.5
Wholesale trade	3.6	4.1	3.1	1.3	.0	1.1	-.9
Services	4.1	3.9	5.2	4.5	5.3	.4	.2

Domestic Financial Developments

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

Instrument	2000		2001			Change to Dec. 4 from selected dates (percentage points)		
	June 26	Sept. 10	Nov. 5	Dec. 4	2000 June 26	2001 Sept. 10	2001 Nov. 5	
<i>Short-term</i>								
FOMC intended federal funds rate	6.50	3.50	2.50	2.00	-4.50	-1.50	-.50	
<i>Treasury bills</i> ¹								
3-month	5.66	3.19	1.97	1.71	-3.95	-1.48	-.26	
6-month	5.94	3.13	1.91	1.76	-4.18	-1.37	-.15	
<i>Commercial paper</i>								
1-month	6.56	3.42	2.11	1.96	-4.60	-1.46	-.15	
3-month	6.56	3.24	2.04	1.84	-4.72	-1.40	-.20	
<i>Large negotiable CDs</i> ¹								
1-month	6.64	3.46	2.14	2.02	-4.62	-1.44	-.12	
3-month	6.73	3.26	2.06	1.88	-4.85	-1.38	-.18	
6-month	6.89	3.24	2.02	1.90	-4.99	-1.34	-.12	
<i>Eurodollar deposits</i> ²								
1-month	6.63	3.41	2.11	2.01	-4.62	-1.40	-.10	
3-month	6.69	3.26	2.08	1.92	-4.77	-1.34	-.16	
Bank prime rate	9.50	6.50	5.50	5.00	-4.50	-1.50	-.50	
<i>Intermediate- and long-term</i>								
<i>U.S. Treasury</i> ³								
2-year	6.54	3.59	2.52	2.82	-3.72	-.77	.30	
10-year	6.35	5.14	4.62	5.02	-1.33	-.12	.40	
30-year	6.22	5.55	5.09	5.47	-.75	-.08	.38	
U.S. Treasury 10-year indexed note	4.09	3.26	2.99	3.38	-.71	.12	.39	
Municipal revenue (Bond Buyer) ⁴	5.99	5.25	5.23	5.40	-.59	.15	.17	
<i>Private instruments</i>								
10-year swap	7.38	5.62	5.00	5.35	-2.03	-.27	.35	
10-year FNMA	7.15	5.64	4.89	5.36	-1.79	-.28	.47	
10-year AA ⁵	7.60	6.30	5.89	6.13	-1.47	-.17	.24	
10-year BBB ⁵	8.49	7.08	6.93	7.00	-1.49	-.08	.07	
High yield ⁶	11.97	12.86	13.55	12.47	.50	-.39	-1.08	
<i>Home mortgages (FHLMC survey rate)</i> ⁷								
30-year fixed	8.14	6.89	6.56	7.02	-1.12	.13	.46	
1-year adjustable	7.22	5.64	5.26	5.22	-2.00	-.42	-.04	

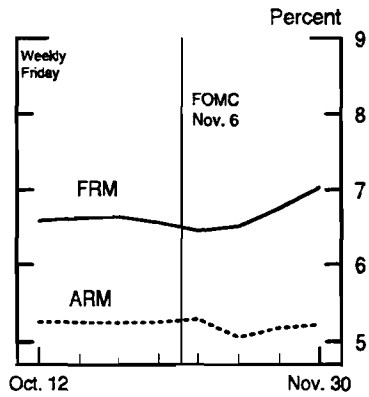
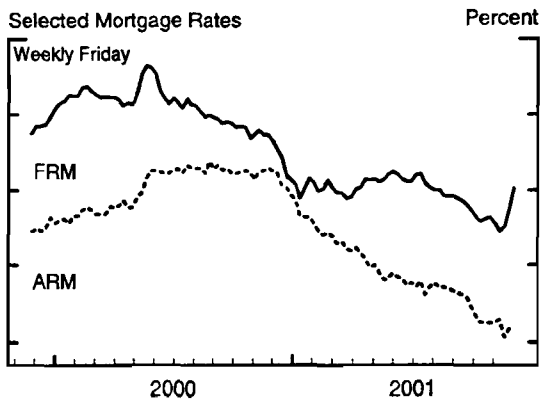
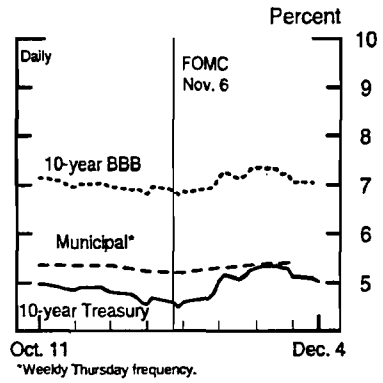
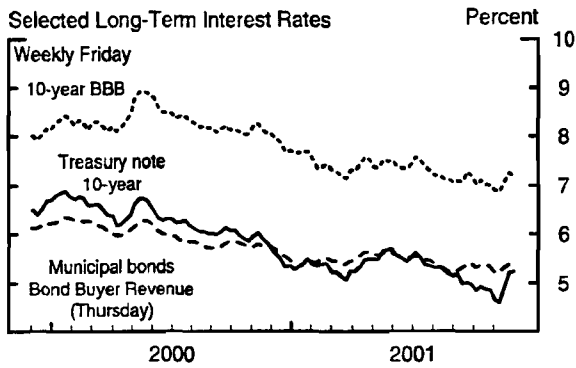
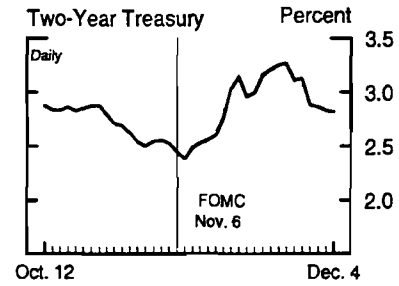
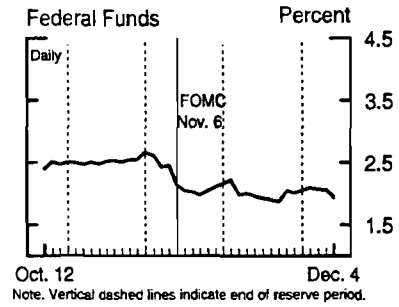
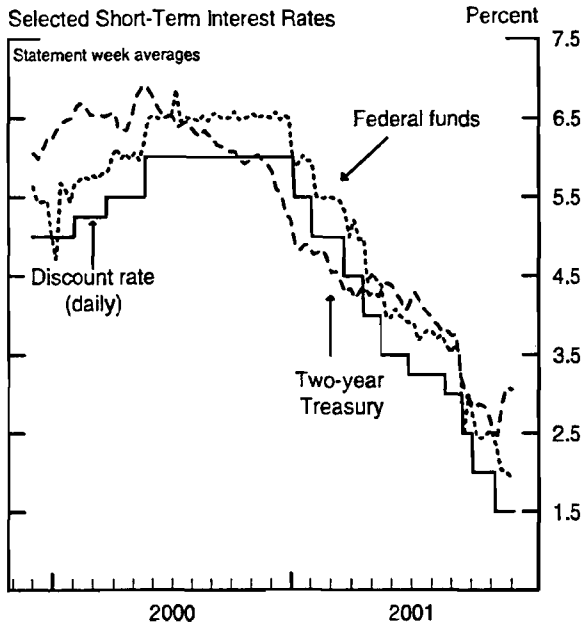
Stock exchange index	Record high		2001			Change to Dec. 4 from selected dates (percent)		
	Level	Date	Sept. 10	Nov. 5	Dec. 4	Record high	2001 Sept. 10	2001 Nov. 5
Dow-Jones Industrial	11,723	1-14-00	9,606	9,441	9,894	-15.60	3.00	4.80
S&P 500 Composite	1,527	3-24-00	1,093	1,103	1,145	-25.05	4.78	3.80
Nasdaq (OTC)	5,049	3-10-00	1,695	1,794	1,963	-61.12	15.79	9.45
Russell 2000	606	3-9-00	441	438	468	-22.81	6.15	6.93
Wilshire 5000	14,752	3-24-00	10,104	10,157	10,595	-28.18	4.85	4.31

1. Secondary market.
2. Bid rates for Eurodollar deposits collected around 9:30 a.m. Eastern time.
3. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
4. Most recent Thursday quote.
5. Derived from smoothed corporate yield curves estimated using Merrill Lynch bond data.
6. Merrill Lynch 175 high-yield bond index composite.
7. For week ending Friday previous to date shown.

NOTES:

June 26, 2000 is the day before the FOMC meeting that ended the most recent period of policy tightening.
September 10, 2001 is the day before the terrorist attacks.
November 5, 2001 is the day before the most recent FOMC meeting.

Selected Interest Rates



Domestic Financial Developments

Overview

Data released over the intermeeting period, though mixed, were on balance stronger than expected and were read by market participants as providing some assurance that economic activity would turn up next year sufficiently for monetary policy to start to tighten substantially. The steepening trajectory of policy expectations and reduced concerns about the economy and credit risk, which were reinforced by developments in Afghanistan, prompted a run-up in Treasury yields, a rise in stock prices, and a narrowing of credit spreads. Nonfinancial corporations once again issued a considerable volume of long-term debt, including some offerings by speculative-grade firms. The Treasury also was a heavy borrower, as tax receipts flagged and spending surged. Household borrowing remained robust, supported mainly by elevated mortgage borrowing, but also by loans arising from a surge in light vehicle sales.

Policy Expectations, Interest Rates, and Equity Prices

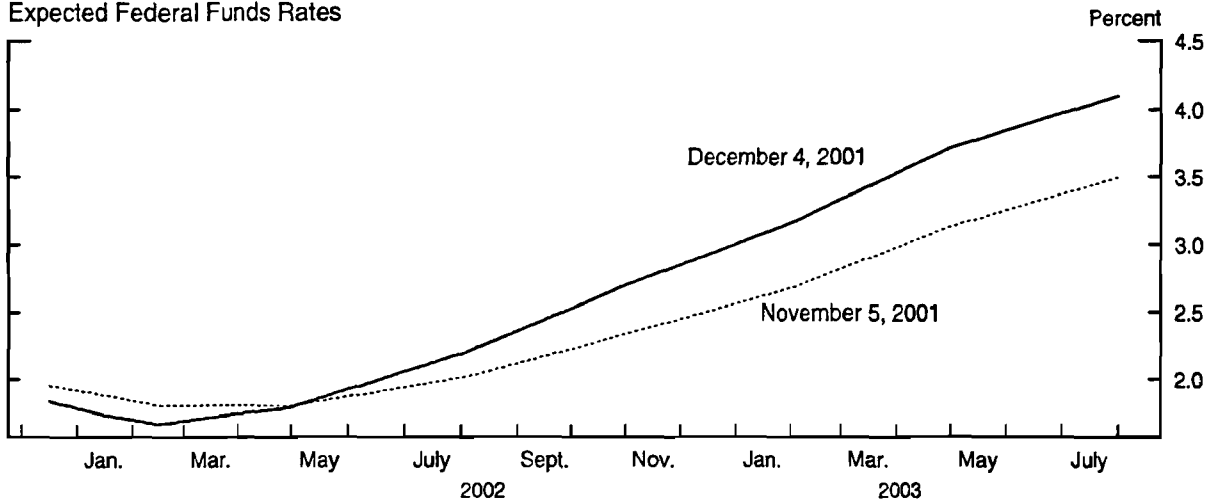
Rates on federal funds futures contracts imply that investors are virtually certain of a further quarter-point easing at the December meeting and now expect that the funds rate next year will rise more than they had anticipated at the time of the last FOMC meeting. Judging from implied volatility derived from options on interest rate futures, however, it also seems that investors' sense of uncertainty about this outlook, and the associated steeper path for monetary policy, remains quite elevated relative to recent years.

The more upbeat view of economic prospects and the associated firmer expected trajectory for monetary policy boosted Treasury coupon yields 30 to 40 basis points over the intermeeting period. Market participants cited military successes in Afghanistan as contributing to some unwinding of safe-haven demands. Moreover, a small part of the rise in Treasury yields probably owed to some reduction of the scarcity premiums that had been built into those yields immediately following the Treasury's announcement on October 31 of the suspension of the thirty-year security. Yields on Treasury inflation-indexed securities rose nearly as much as nominal yields, as inflation compensation remained subdued. Investment-grade corporate yields rose as well, but to a lesser extent than Treasuries. Junk bond yields actually fell appreciably, pulling risk spreads on these securities well below their levels on September 11.

Broad equity indexes gained about 4 percent over the intermeeting period, and the Nasdaq rose 9-1/2 percent. These advances occurred even though equity analysts continued to revise down their forecasts of S&P 500 earnings for the year ahead and over longer horizons. The combination of rising stock prices and downward revisions to the earnings outlook imply that equity valuations again are very rich by historical standards.

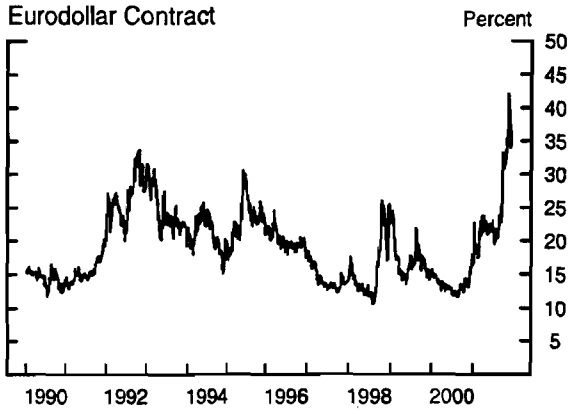
Policy Expectations and Interest Rates

Expected Federal Funds Rates

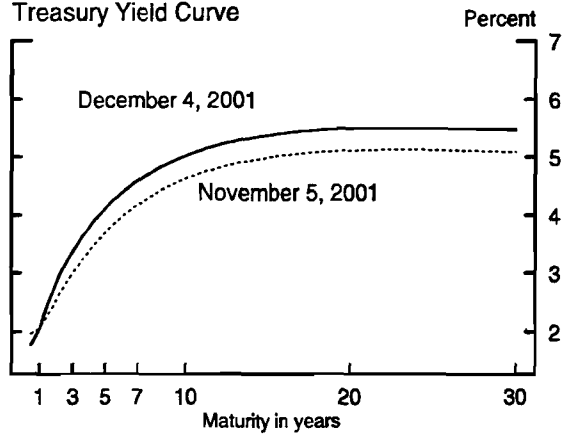


Note. Estimates from federal funds and eurodollar futures with an allowance for term premia and other adjustments.

Implied Volatility on Twelve Month Ahead Eurodollar Contract

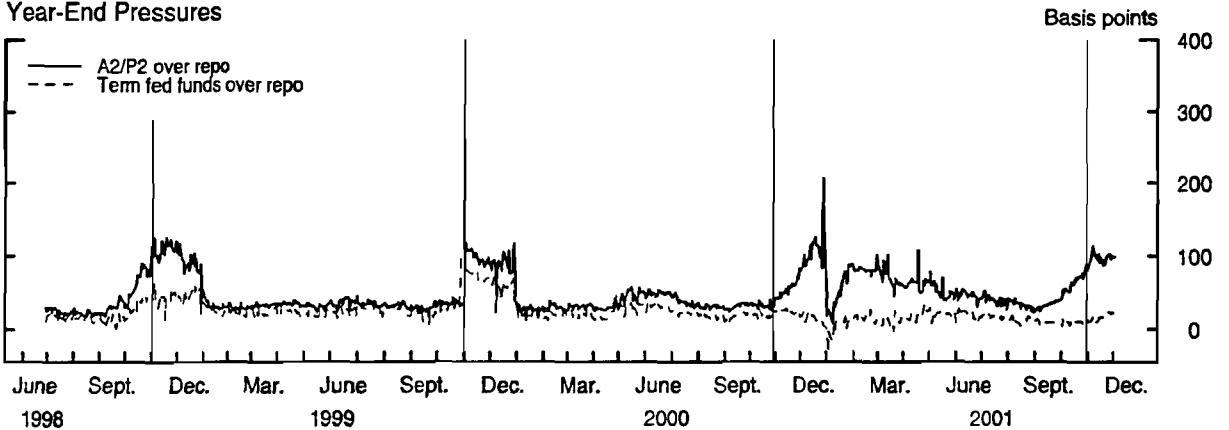


Treasury Yield Curve



Note. Smoothed yield curve estimated from off-the-run Treasury coupon securities. Yields shown are those on notional par Treasury securities with semi-annual coupons.

Year-End Pressures



Note. Spreads shown are those over the two-month RP rate for the two-month A2/P2 rate and the two-month term fed funds rate. Vertical lines represent first day on which the rates shown cross year-end.

Business Finance

Rising share prices encouraged a moderate pickup in gross equity issuance from the depressed third-quarter level. Recent issues have been concentrated in the energy and health care sectors. The number of firms scheduled to go public in the near future stayed at a low level relative to past years.

The level of bond rates remained attractive for investment-grade firms, which floated \$43 billion of bonds in November, exceeding October's rapid pace. Many investment-grade firms continued to use bond proceeds to pay down short-term obligations, to refinance higher-coupon debt, and to build cash positions.

Although high-yield bond spreads fell more than a percentage point over the intermeeting period, they remain at elevated levels similar to those of the early 1990s. Currently, these spreads appear to be more closely aligned with their historical relationships to fundamentals, such as expected defaults, than in the wake of the terrorist attacks. While issuance in this market has been somewhat subdued, firms that are able to tell a convincing story about profitability reportedly can still receive financing.

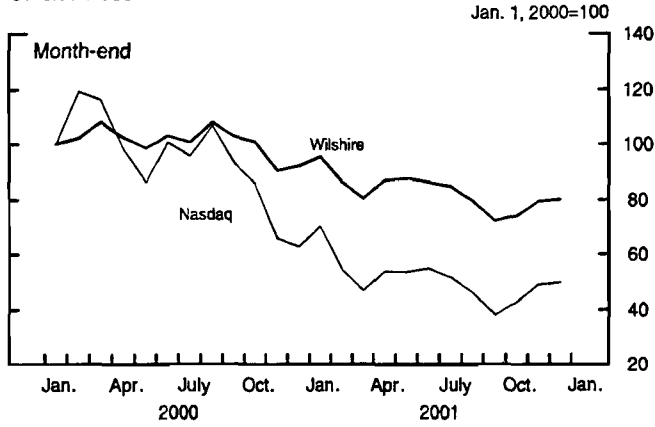
Evidently, corporate bond market participants are looking beyond the recent news showing a continued erosion in corporate credit quality. The twelve-month trailing average of junk bond defaults rose to a record 14 percent in October, up from 13 percent in September. Expected default frequencies in the year ahead remained very elevated, and ratings downgrades were widespread. Significantly, AT&T was downgraded one notch to A3/A- by both Moody's and S&P's at the end of October, an action that affected some \$53 billion of outstanding debt. Enron filed for bankruptcy in early December after its debt had been downgraded six notches to junk. With liabilities reportedly greater than \$20 billion, it is the largest bankruptcy filing to date.

Credit spreads for A2/P2 commercial paper issuers narrowed over most of the intermeeting period, but then moved up sharply as Enron's downgrades made investors more skittish about holding paper over year-end. Prior to Enron, year-end premiums for A2/P2 issuers had been running a bit higher than at the same time last year. While top-tier (A1/P1) firms face little in the way of year-end premiums, they continued to shrink their paper programs over the intermeeting period. In November, total domestic nonfinancial commercial paper outstanding fell another \$2-1/2 billion, leaving outstandings down about \$100 billion, or 30 percent, this year.

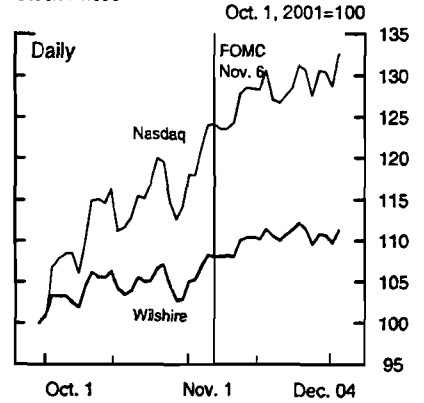
In contrast to the nonfinancial segment of the market, asset-backed commercial paper has grown rapidly all year. Anecdotal reports indicate that firms are making more intensive use of these conduits to liquefy assets and build cash positions going into year-end. Notably, the financing arms of Ford and GMAC,

Stock Prices and Corporate Risk Spreads

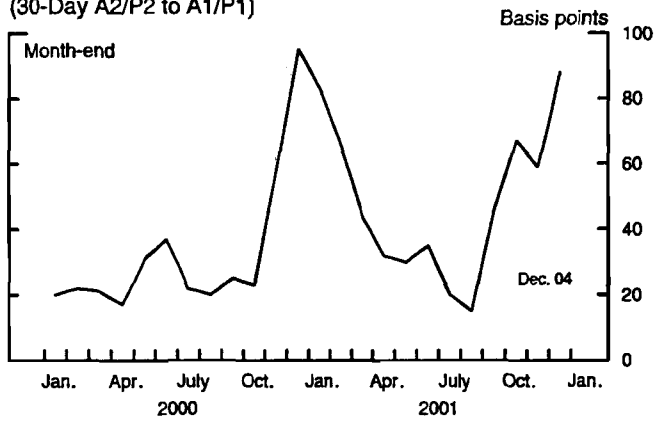
Stock Prices



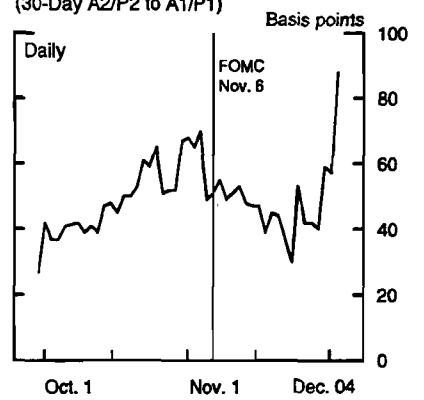
Stock Prices



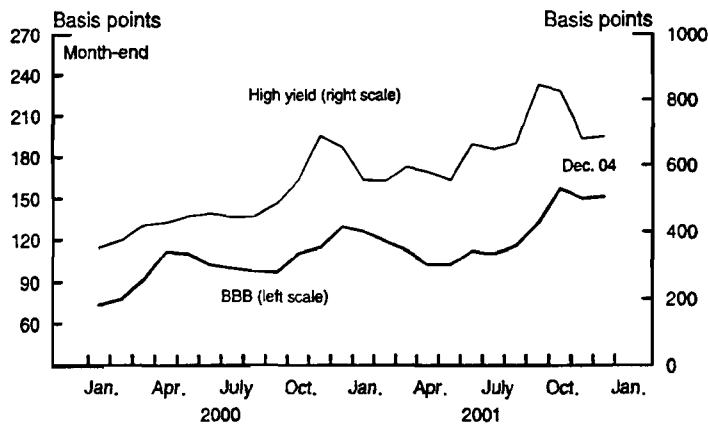
Commercial Paper Rate Spread
(30-Day A2/P2 to A1/P1)



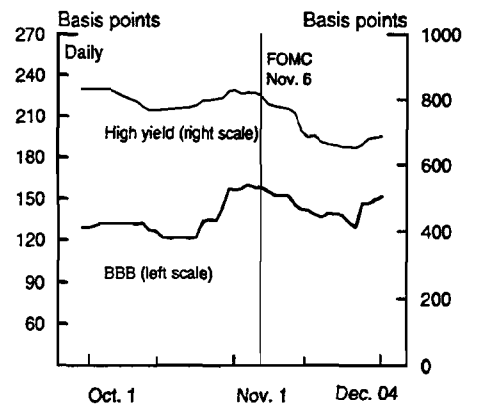
Commercial Paper Rate Spread
(30-Day A2/P2 to A1/P1)



Corporate Risk Spreads to 10-Year AAA Yield



Corporate Risk Spreads to 10-Year AAA Yield



Gross Issuance of Securities by U.S. Corporations

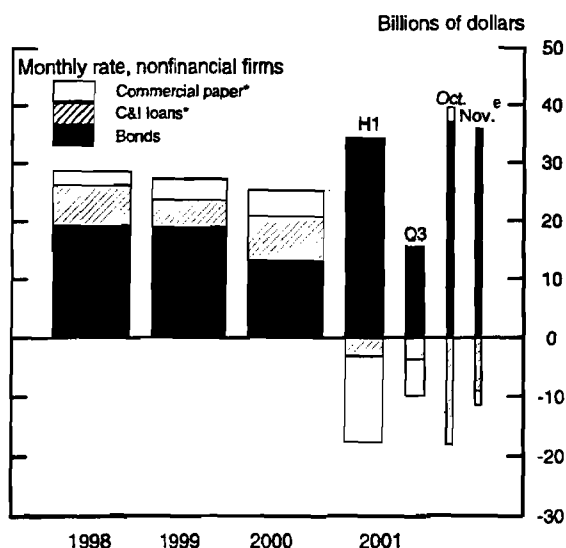
(Billions of dollars; monthly rates, not seasonally adjusted)

Type of security	1998	1999	2000		2001		Oct.	Nov. ^e
			H1	H2	H1	Q3		
All U.S. corporations	94.0	89.4	80.0	77.0	123.6	93.5	137.2	105.4
Stocks ¹	10.6	11.0	14.1	8.4	10.5	7.3	11.8	11.4
Bonds	83.5	78.4	65.9	68.6	113.1	86.2	125.4	94.0
<i>Nonfinancial corporations</i>								
Stocks ¹	6.2	9.2	12.4	7.3	7.5	3.3	4.2	6.7
Initial public offerings	2.2	4.2	5.7	3.1	3.2	1.0	.5	.6
Seasoned offerings	4.0	5.0	6.7	4.2	4.2	2.3	3.7	6.1
Bonds ²	25.6	24.5	21.3	19.1	43.2	26.4	45.0	50.0
Investment grade ³	14.1	13.9	11.5	12.4	28.9	20.9	36.9	43.0
Speculative grade ³	10.2	7.5	5.4	3.7	11.9	3.8	7.6	6.5
Other (sold abroad/unrated)	1.3	3.1	4.4	3.1	2.4	1.7	.6	.5
<i>Financial corporations</i>								
Stocks ¹	4.4	1.8	1.6	1.1	3.0	4.0	7.6	4.7
Bonds	57.8	53.9	44.7	49.5	69.9	59.7	80.4	49.0
<i>Memo</i>								
Net issuance of commercial paper, nonfinancial corporations ⁴	2.3	3.6	6.4	2.7	-14.5	-6.2	2.6	-2.4
Change in C&I loans at commercial banks ⁴	7.0	4.7	10.4	4.7	-3.0	-3.6	-18.3	-9.0

Note. Components may not sum to totals because of rounding. These data include speculative-grade bonds issued privately under Rule 144A. All other private placements are excluded. Total reflects gross proceeds rather than par value of original discount bonds.

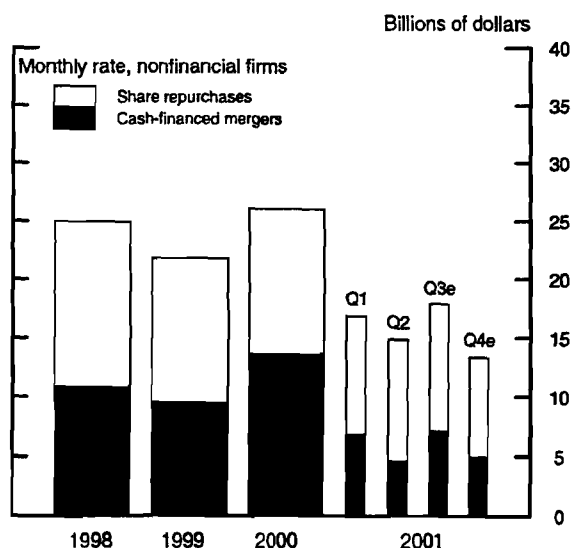
1. Excludes equity issues associated with equity-for-equity swaps that have occurred in restructurings.
2. Excludes mortgage-backed and asset-backed bonds.
3. Bonds sold in U.S. categorized according to Moody's bond ratings, or to Standard Poor's if unrated by Moody's.
4. End-of-period basis, seasonally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

Components of Net Debt Financing



* Seasonally adjusted.
e Staff estimate.

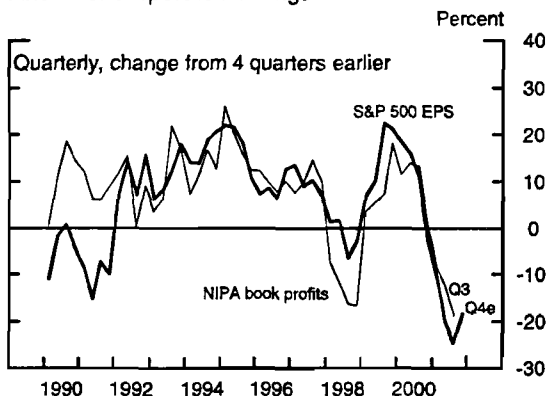
Equity Retirements



e Staff estimate.

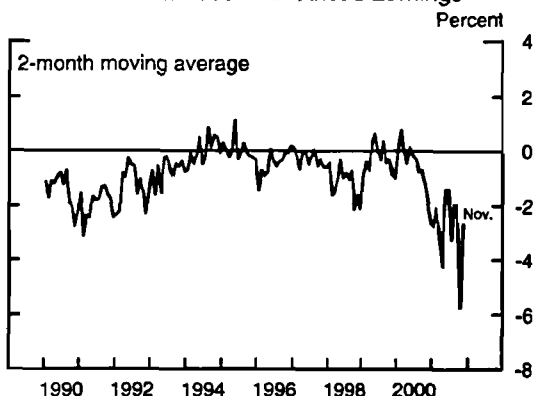
Corporate Earnings and Credit Quality

After-Tax Corporate Earnings



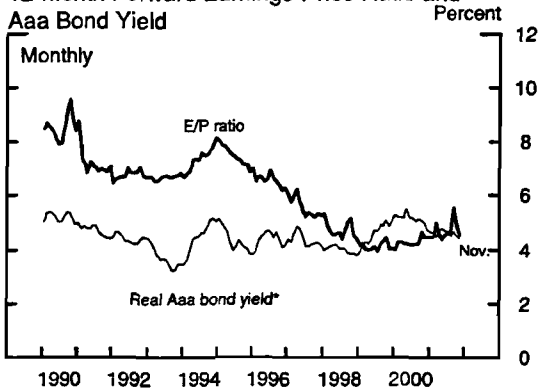
e Staff estimate.
Source: I/B/E/S.

Revisions to S&P 500 Year-Ahead Earnings



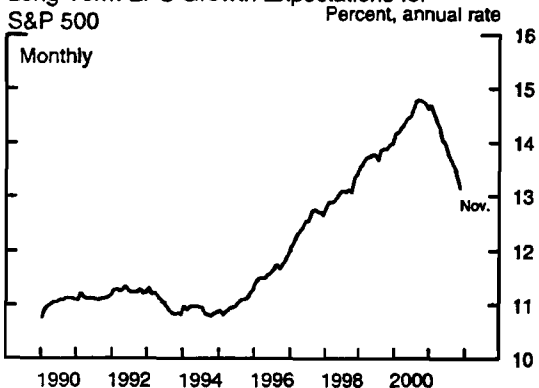
Source: I/B/E/S.

12-Month Forward Earnings-Price Ratio and Aaa Bond Yield



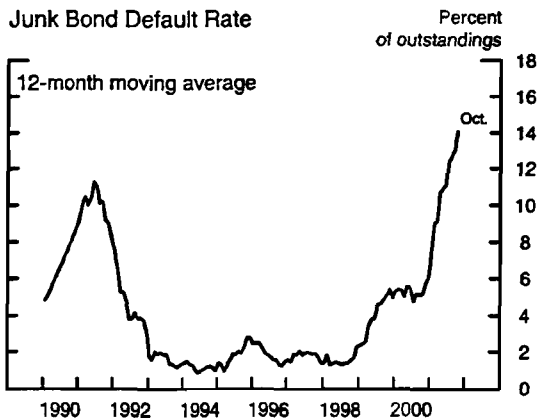
*Aaa bond yield less Philadelphia Fed 10-year expected inflation.

Long-Term EPS Growth Expectations for S&P 500



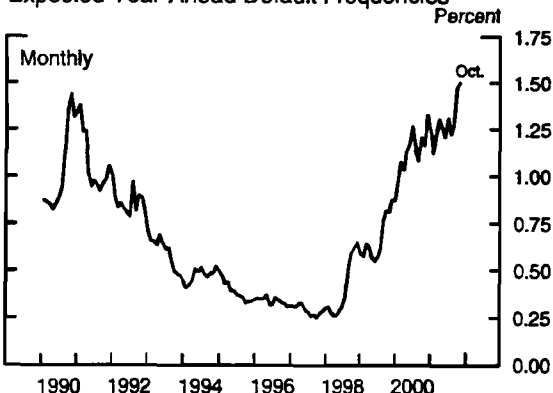
Note. Earnings-weighted average of I/B/E/S consensus firm-level 5-year growth forecasts.

Junk Bond Default Rate



Source: Moody's.

Expected Year-Ahead Default Frequencies



Source: KMV Corp.
Note. Weighted average of firm-level estimates.

both recently downgraded to tier-2 status in the CP market, have apparently ramped up their asset-backed commercial paper (which remains tier-1 rated) as well as some longer-term asset-backed funding, in part to finance light vehicle receivables acquired through sales-incentives programs.

Commercial Real Estate

The growth of commercial mortgage debt—including debt securitized through CMBS issues—appears to be slowing somewhat in the current quarter from the rapid third-quarter pace. Although vacancy rates have risen, delinquency rates on commercial mortgages at commercial banks are up only a bit, and they remain at low levels. Credit spreads in the CMBS market were little changed over the intermeeting period.

Household Finance

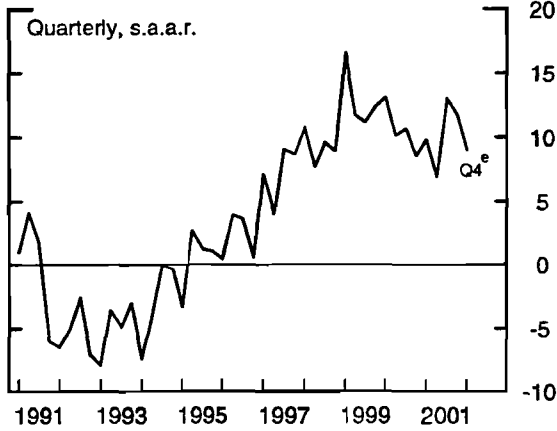
Fixed-rate residential mortgage rates hit a low in the second week of November, with the thirty-year fixed-rate mortgage averaging 6.45 percent. Low rates boosted the Mortgage Bankers Association (MBA) refinancing index and also reversed the recent downward trend of the MBA purchase index. More recently, rates have climbed back closer to 7 percent, responding to the rise in longer-term Treasury yields. Overall, residential mortgage growth in the fourth quarter is estimated to be a little weaker than in the third quarter, while aggressive automotive financing incentives appear to be supporting consumer credit growth this quarter. As a result, the household debt-service burden likely will move back up to the level recorded in the first half of the year, after having temporarily fallen in the third quarter when the distribution of the income tax rebate boosted income.

On balance, the latest readings on household credit quality show a little further deterioration over the third quarter. While the delinquency rate on home mortgages on the books of commercial banks came down slightly, the MBA delinquency rate ticked up, and the delinquency rates for subprime borrowers, measured by the Mortgage Information Corporation, moved up substantially. Movements in credit card delinquency rates in the third quarter were mixed, with the rate on pools of securitized receivables falling slightly and that on credit card debt held at commercial banks inching up. Personal bankruptcy filing rates also moved up slightly in November.

The ratio of household assets to disposable income is likely to rebound some in the fourth quarter, given recent stock market gains. Flows into domestic bond funds strengthened in October and appear to have continued in November. The flow of assets out of equity funds stopped in October, and data for November suggest a rebound, perhaps an indication of some reversal in household sentiment toward risk. A fair amount of caution persists, however, as the equity share of new contributions to 401(k) pension plans declined in October, and

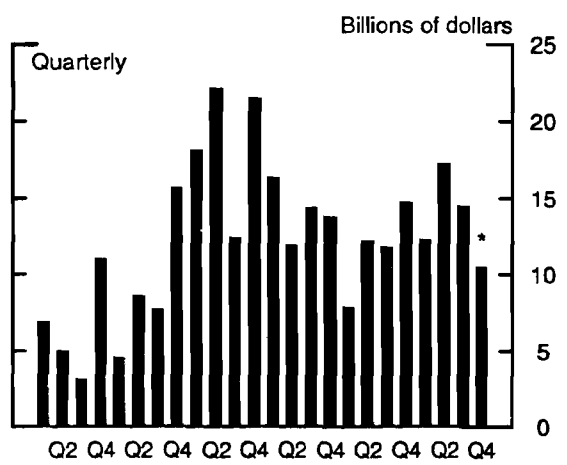
Commercial Real Estate

Growth of Commercial Mortgage Debt
Percent



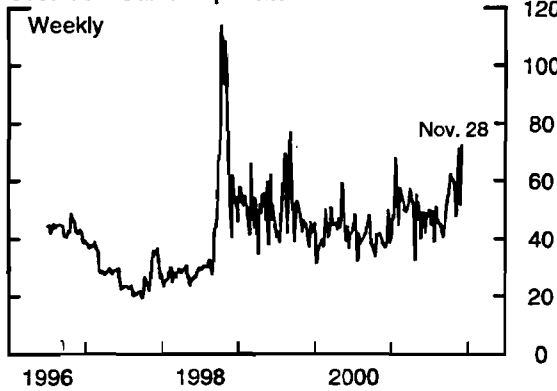
e. Staff estimate.

Total CMBS Gross Issuance
Billions of dollars



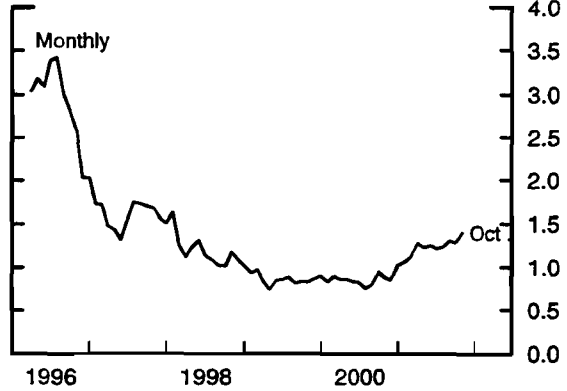
Q2 Q4 Q2 Q4 Q2 Q4 Q2 Q4 Q2 Q4 Q2 Q4
1996 1997 1998 1999 2000 2001
* Period to November 20, 2001.
Source. Commercial Mortgage Alert.

CMBS Spreads (AAA Tranches)
over 10-Year Swap Rate
Basis points



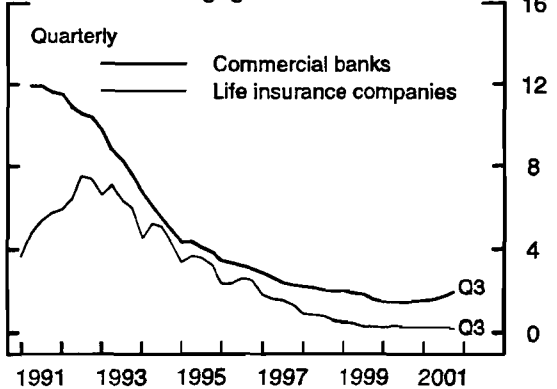
Source. Morgan Stanley.

CMBS Delinquency Rate
Percent



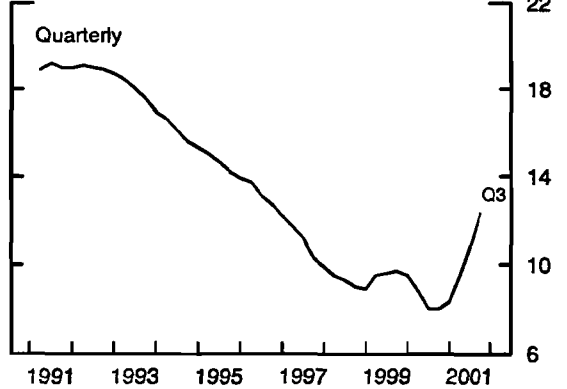
Source. Morgan Stanley.

Delinquency Rates on
Commercial Mortgages
Percent



Source. ACLI, Call Report.

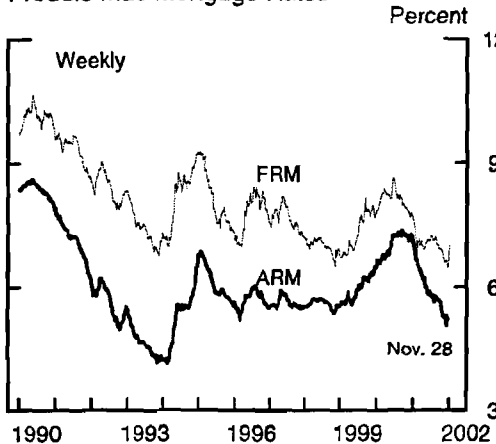
Office Vacancy Rate
Percent



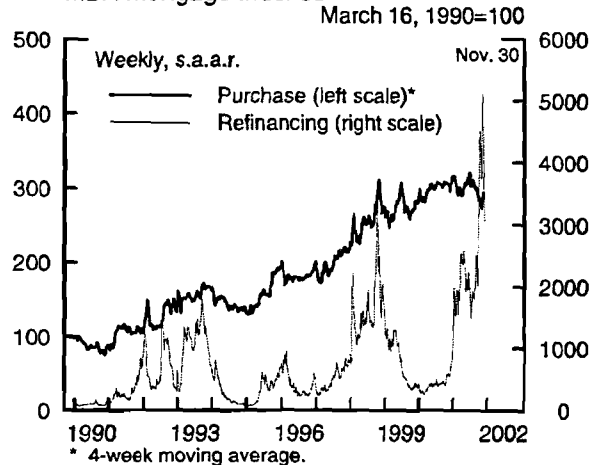
Source. Torto Wheaton Research.

Household Liabilities

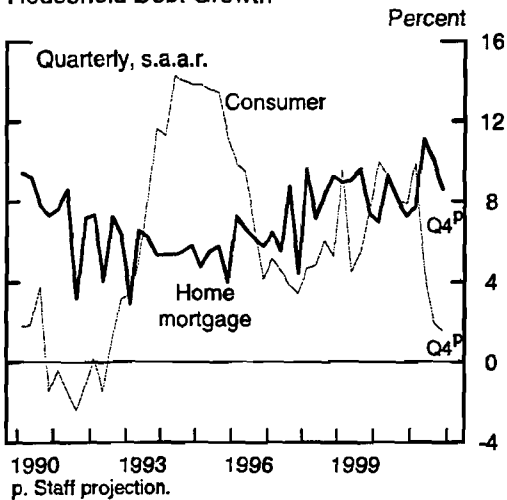
Freddie Mac Mortgage Rates



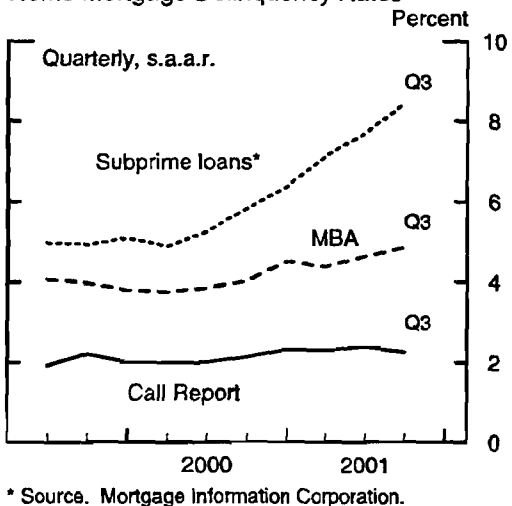
MBA Mortgage Indexes



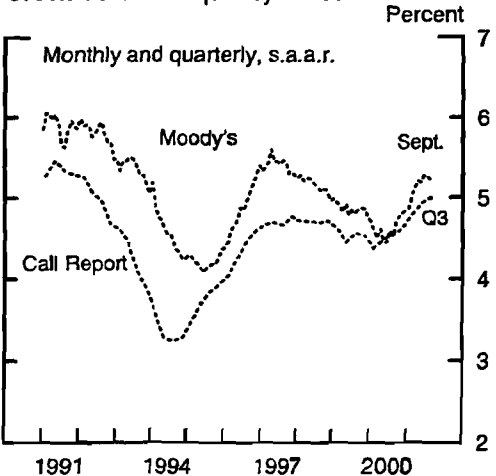
Household Debt Growth



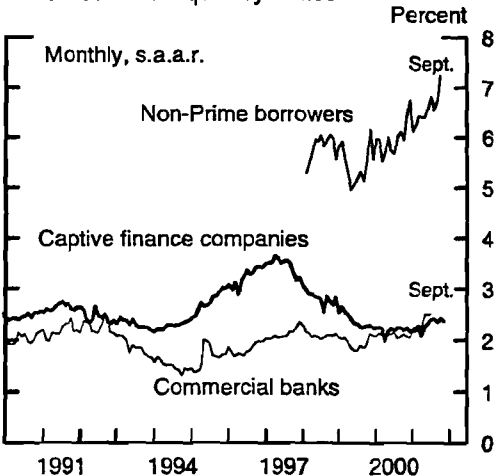
Home Mortgage Delinquency Rates



Credit Card Delinquency Rates



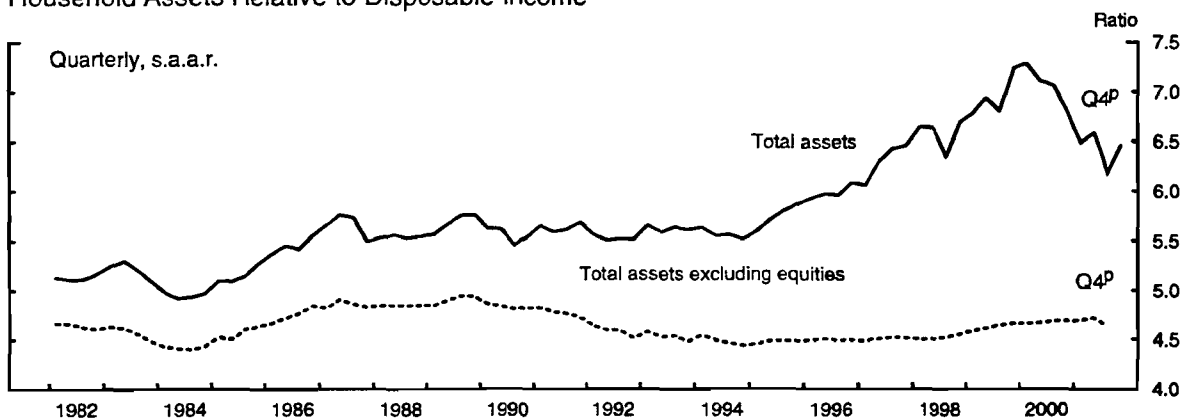
Auto Loan Delinquency Rates



Source. Federal Reserve, American Bankers Association.

Household Assets

Household Assets Relative to Disposable Income



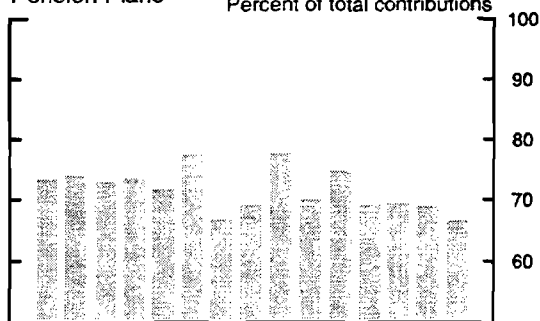
p. Staff projection.

Net Flows into Long-Term Mutual Funds
(Excluding reinvested dividends; billions of dollars, monthly rates)

	1999	2000	2001				Assets
			Q3	Sept.	Oct.	Nov. ^e	Oct.
Total long-term funds	14.2	18.4	-0.6	-23.0	15.8	16.0	4,376
Equity funds	15.7	25.1	-11.6	-29.4	0.8	6.9	3,111
Domestic	14.8	21.2	-8.3	-26.7	5.0	7.0	2,710
Capital appreciation	13.5	25.5	-8.3	-20.6	1.2	5.0	1,613
Total return	1.4	-4.3	-0.0	-6.1	3.8	2.0	1,098
International	0.9	3.9	-3.3	-2.7	-4.2	-0.1	401
Hybrid funds	-1.0	-2.6	-0.2	-1.3	1.6	1.3	330
Bond funds	-0.5	-4.0	11.3	7.7	13.5	7.8	935
International	-0.2	-0.2	-0.1	-0.2	-0.2	-0.1	20
High-yield	-0.2	-1.0	-0.3	-2.0	0.6	2.8	90
Other taxable	1.0	-1.6	10.0	10.1	11.1	4.5	523
Municipals	-1.0	-1.2	1.7	-0.3	2.0	0.6	301

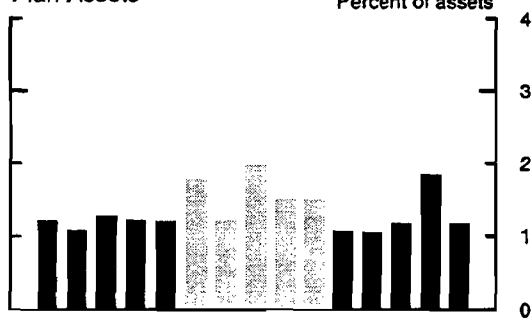
e. Staff estimates based on confidential ICI weekly data.
Source. Investment Company Institute (ICI).

Equity Allocation of New Contributions to 401(k) Pension Plans



Aug. Oct. Dec. Feb. Apr. June Aug. Oct.
2000 2001
Note. Consists of equity mutual funds and company stock.
Source. Hewitt Associates.

Transfers Among Existing 401(k) Pension Plan Assets



Aug. Oct. Dec. Feb. Apr. June Aug. Oct.
2000 2001
Note. Shading indicates predominant direction of transfers: dark bars indicate transfers toward fixed income investments, light bars indicate transfers toward equity.
Source. Hewitt Associates.

most of the transfers within existing pension funds were directed toward fixed-income investments.

Treasury and Agency Finance

The Treasury's net borrowing in marketable debt so far in the fourth quarter is well above its announced target of \$31 billion. To meet financing needs, the Treasury stepped up gross weekly bill offerings to \$55 billion in late November, the highest level ever. Part of the increase reflects the use of the four-week bill to meet seasonal fluctuations in the Treasury's financing needs that, in past years, were financed instead through cash management bills.

After the Treasury's October 31 announcement of the suspension of issuance of thirty-year bonds, bid-ask spreads on outstanding bonds initially widened considerably amid the sharp price movements that followed the announcement. While those spreads have since narrowed as the market has digested the news, liquidity in the bond sector nevertheless reportedly remains below the level that prevailed prior to the Treasury's announcement.

The settlement process in the Treasury market seems to be operating more smoothly. The volume of fails-to-deliver, which surged in September and early October, has dropped off sharply, although it remains above the levels seen in recent years. The increment may partly reflect the low levels of Treasury repo rates, which have limited the costs of failing to deliver Treasury securities.

Despite the Treasury's cancellation of the thirty-year bond, neither Freddie Mac nor Fannie Mae has indicated that it intends to step up issuance of thirty-year bonds to fill the void. Heavy prepayments on mortgage-backed securities prompted by low interest rates have apparently led to more cautious issuance of longer-term debt. The past strategy of issuing long-term debt and then taking positions in the swap market to pay a floating rate and receive a fixed-rate to shorten the duration of their liabilities is no longer viable because yields on long-term agency debt have been above long-term swap rates for some time now.

State and Local Government Finance

Gross offerings of long-term municipal bonds in November were large, though below the exceptional pace in October, as low interest rates continue to provide a boost to issuance.

Although the credit quality of most state and local governments remains high, signs of weakness have emerged. Many states have reported that revenues are failing to meet projections, with some indicating that they expect to dip into their reserve funds to make up for lower-than-expected revenues. In line with these reports, broad measures suggest that the credit quality of municipal bond issuers may be topping out. The pace of net credit-rating upgrades has slowed,

Treasury and Agency Finance

Treasury Financing (Billions of dollars)

Item	2001					
	Q1	Q2	Q3	Sep.	Oct.	Nov.(e)
Total surplus, deficit (-)	-22.5	193.7	-41.9	35.2	-9.4	n.a.
Means of financing deficit						
Net borrowing	23.7	-157.4	68.6	2.0	-3.7	68.4
Nonmarketable	6.0	6.2	-5.7	-0.3	5.8	-1.0
Marketable	17.7	-163.6	74.4	2.3	-9.5	69.4
Bills	65.0	-92.1	114.8	2.3	1.3	77.1
Coupons ¹	-39.3	-62.3	-32.6	0	-8.3	-5.9
Debt buybacks	-8.0	-9.2	-7.7	0	-2.5	-1.7
Decrease in cash balance	-7.2	-15.4	-5	-37.9	16.6	-2.9
Other ²	6.0	-20.9	-26.2	.6	-3.5	n.a.
MEMO						
Cash balance, end of period	28.3	43.7	44.2	44.2	27.6	30.5

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

1. Does not include Treasury debt buybacks.

2. Direct loan financing, accrued items, checks issued less checks paid, and other transactions.

e. Estimated.

n.a. Not available.

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

Agency	2001					
	Q1	Q2	Q3	Sep.	Oct.	Nov.
FHLBs	8.4	-7.7	19.2	15.3	3.7	n.a.
Freddie Mac	34.4	35.4	37.7	18.8	5.9	n.a.
Fannie Mae	23.9	35.7	24.7	9.0	-8	n.a.
Farm Credit Banks	0	2.2	.1	.1	0	n.a.
Sallie Mae	1.9	.4	1.7	-1.0	n.a.	n.a.
MEMO						
<i>Outstanding noncallable reference and benchmark securities</i>						
Notes and bonds	351.2	384.1	411.5	411.5	426.5	440.9
Bills	270.0	278.0	288.5	288.5	296.5	287.0
Total	621.2	662.1	700.0	700.0	723.0	727.9

NOTE. Excludes mortgage pass-through securities issued by Fannie Mae and Freddie Mac.

e. Estimated

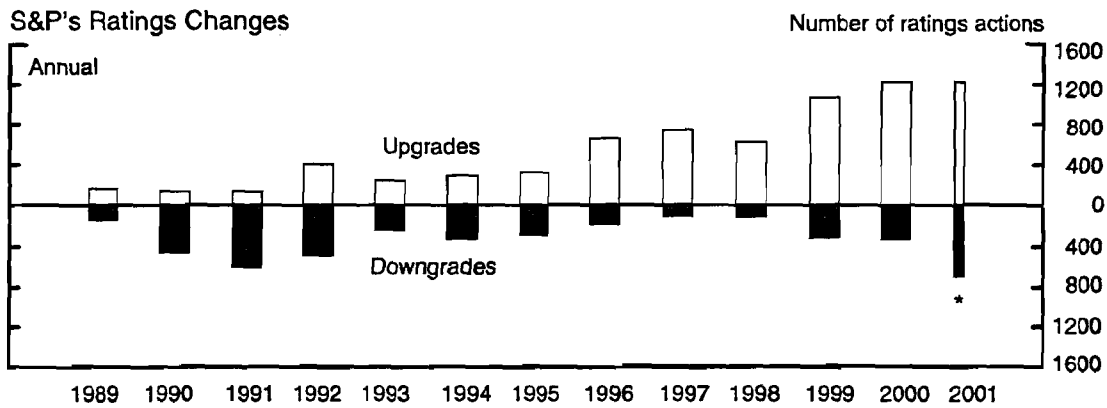
n.a. Not available

State and Local Government Finance

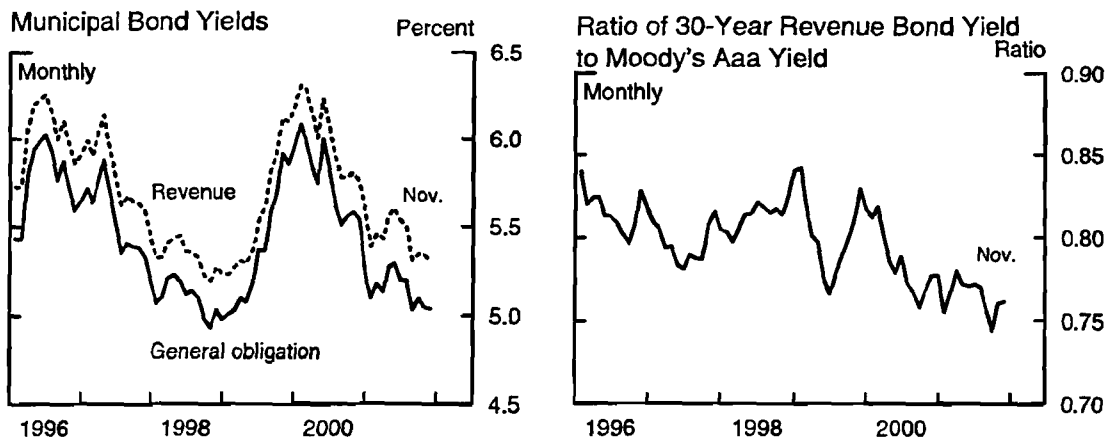
Gross Offerings of Municipal Securities (Billions of dollars; monthly rates, not seasonally adjusted)

	1999	2000	2001				
			H1	Q3	Sept.	Oct.	Nov. ^e
Long-term ¹	18.0	15.0	21.4	17.8	13.2	30.4	23.5
Refundings ²	4.5	2.2	6.4	5.0	3.0	9.2	7.0
New capital	13.5	12.9	15.0	12.9	10.1	21.2	16.5
Short-term	2.7	2.8	3.7	5.9	8.5	6.6	3.0
Total tax-exempt	20.6	17.9	25.0	23.8	21.7	37.1	26.0
Total taxable	1.1	0.7	1.2	0.7	0.7	1.2	1.6

- 1. Includes issues for public and private purposes.
- 2. All issues that include any refunding bonds.
- e. Staff estimate based on data through Nov. 30.



Source. S&P's Credit Week Municipal.
* Data through Nov. 15 at an annual rate.



Note. Average of weekly data.

Note. Average of weekly data.

Monetary Aggregates
(Based on seasonally adjusted data)

Aggregate or component	2000	2001					Level (bil. \$) Oct. 01
		Q2	Q3	Sep.	Oct.	Nov. (p)	
<i>Aggregate</i>		Percent change (annual rate) ¹					
1. M2 ²	6.2	10.4	10.5	25.2	0.0	8.3	5398.3
2. M3	9.3	15.0	9.4	23.6	11.5	15.5	7908.3
<i>Selected components</i>							
3. Currency	4.2	6.0	11.7	11.5	7.4	7.6	571.3
4. Liquid deposits ³	3.2	17.2	20.0	44.0	-3.0	19.2	2796.8
5. Small time deposits	9.5	-4.1	-9.5	-8.9	-13.2	-17.5	994.9
6. Retail money market funds	12.2	11.2	5.6	17.3	18.1	4.1	1027.3
7. M3 minus M2 ⁴	17.2	25.3	7.1	20.1	36.7	31.1	2509.9
8. Large time deposits, net ⁵	13.6	0.7	-1.6	5.5	20.1	12.9	825.0
9. Institution-only money market mutual funds	24.0	54.9	21.0	52.9	76.7	29.3	1108.2
10. RPs	11.7	21.0	-9.7	-40.8	-11.1	65.0	354.7
11. Eurodollars	17.9	8.1	6.6	27.9	-12.3	52.9	222.1
<i>Memo</i>							
12. M1	-1.7	5.4	13.8	54.0	-37.8	-0.9	1157.0
13. Sweep-adjusted M1 ⁶	1.6	6.5	12.1	40.8	-18.4	1.1	1606.6
14. Demand deposits	-10.9	-4.2	23.0	177.5	-114.7	-11.8	326.4
15. Other checkable deposits	-0.8	16.5	6.4	0.0	-29.4	-5.3	251.2
16. Savings deposits	6.7	20.9	21.3	29.7	18.5	26.6	2219.2
17. Monetary base	1.4	5.4	14.7	47.3	-19.2	2.8	629.5
		Average monthly change (billions of dollars) ⁷					
<i>Selected managed liabilities at commercial banks</i>							
18. Large time deposits, gross	8.7	1.3	-4.0	-0.7	18.2	13.9	961.5
19. Net due to related foreign institutions	1.3	-10.3	-3.0	-24.2	4.4	-24.7	174.2
20. U.S. government deposits at commercial banks	-1.4	-2.4	5.3	-39.4	20.9	-26.6	40.6

1. For the years shown, Q4 to Q4 percent change. For the quarters shown, based on quarterly averages.

2. Sum of M1, retail money market funds, saving deposits, and small time deposits.

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

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

5. Net of holdings of depository institutions, money market mutual funds, U.S. government and foreign banks and official institutions.

6. Sweep figures used to adjust these series are the estimated national total of transaction account balances initially swept into MMDAs owing to the introduction of new sweep programs on the basis of monthly averages of daily data.

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

p--Preliminary

and the ratio of thirty-year revenue bond yields to Moody's Aaa yield rose slightly over the intermeeting period. Significant problems continue to plague California and New York. In late November, Moody's downgraded California from Aa3 to A1, citing both declining tax revenues and the protracted electricity crisis. Moody's also downgraded the general obligation debt of New York City in November, based on high estimates of the clean-up costs from the terrorist attacks.

Money and Bank Credit

M2 was flat in October, apparently reflecting a substantial unwinding of distortions generated by the September 11 terrorist attacks; preliminary data for November indicate somewhat slower growth than the rapid pace for the year as a whole. In the face of continued impetus from past reductions in the opportunity cost of M2, the deceleration likely reflects weak nominal income and perhaps a bit of continued payback from September.

Over recent months, patterns of M2 growth have been driven mainly by liquid deposits and retail money funds. Liquid deposits increased sharply following the September 11 attacks, owing to involuntary asset accumulation from payment systems disruptions and to safe-haven demands. Through October, retail money fund growth remained quite strong, as households were initially leery of equity markets following the attacks. As the outlook improved and equity markets rallied, some of this preference for safety apparently has waned, leaving November retail money fund growth moderate.

After declining in October, bank credit picked up moderately in November, based on preliminary data. However, business loans in November continued to contract, in part reflecting the sluggish economy, but also a substitution toward longer-term financing. Loans to the household sector continue to be robust.

Although bank asset quality has deteriorated generally, most delinquency and charge-off rates are still substantially below the rates observed during the 1990-91 recession. Looking forward, recent Call Report data suggest that banks expect further erosion of credit quality and, possibly, higher charge-offs, as indicated by the relatively high rate of loan-loss provisioning.

Commercial Bank Credit

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

Type of credit	2000	Q2 2001	Q3 2001	Sept. 2001	Oct. 2001	Nov.P 2001	Level, Nov. 2001 ^P (\$ billions)
Total							
1. Adjusted ¹	9.4	2.7	1.8	13.2	-7.3	4.8	5,224
2. Reported	10.0	3.2	2.3	15.3	-6.0	7.6	5,408
<i>Securities</i>							
3. Adjusted ¹	1.8	4.1	11.5	7.6	15.3	9.8	1,297
4. Reported	4.6	6.1	12.4	15.9	17.6	19.9	1,480
5. Treasury & Agency	-2.3	-3.3	10.5	15.9	24.5	15.8	824
6. Other ²	16.9	18.7	14.8	16.0	9.0	24.8	656
<i>Loans³</i>							
7. Total	12.0	2.2	-1.2	15.0	-14.5	3.1	3,927
8. Business	9.0	-4.4	-9.6	3.6	-18.5	-13.4	1,037
9. Real estate	14.1	6.3	3.0	4.0	8.5	8.4	1,740
10. Home equity	27.2	12.5	13.3	21.5	29.6	19.8	148
11. Other	13.1	5.7	2.1	2.4	6.6	7.4	1,592
12. Consumer	10.5	3.8	-2.5	-2	6.4	14.4	555
13. Adjusted ⁴	7.3	5.1	1.7	1.2	12.2	18.9	896
14. Other ⁵	13.4	1.6	3.2	81.0	-87.7	6.3	595

Note. All data are adjusted for breaks caused by reclassifications. Monthly levels are pro rata averages of weekly (Wednesday) levels. Quarterly levels (not shown) are simple averages of monthly levels. Annual levels (not shown) are levels for the fourth quarter. Growth rates are percentage changes in consecutive levels, annualized but not compounded.

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

2. Includes securities of corporations, state and local governments, and foreign governments and any trading account assets that are not Treasury or Agency securities.

3. Excludes interbank loans.

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

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

p Preliminary.

International Developments

International Developments

U.S. International Transactions

Trade in Goods and Services

The U.S. trade deficit in goods and services dropped sharply to a little less than \$19 billion in September from \$27 billion in August. However, the decline was entirely the result of the recording of estimated future payments by foreign insurers related to the events of September 11, which reduced reported service imports by \$11 billion. Net of this effect, the trade deficit widened by about \$2 billion in September, as exports fell 8½ percent while imports excluding the insurance payment were down 4 percent.

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

	2000	Annual rate 2001			Monthly rate 2001		
		Q1	Q2	Q3	July	Aug.	Sept.
<i>Real NIPA¹</i>							
Net exports of G&S	-399.1	-404.5	-406.7	-408.1	...	...	...
<i>Nominal BOP</i>							
Net exports of G&S	-375.7	-380.1	-355.2	-299.9	-29.2	-27.1	-18.7
Goods, net	-452.2	-450.1	-430.6	-423.3	-35.8	-34.1	-35.9
Services, net	76.5	70.0	75.4	123.4	6.7	7.0	17.2

1. Billions of chained (1996) dollars.

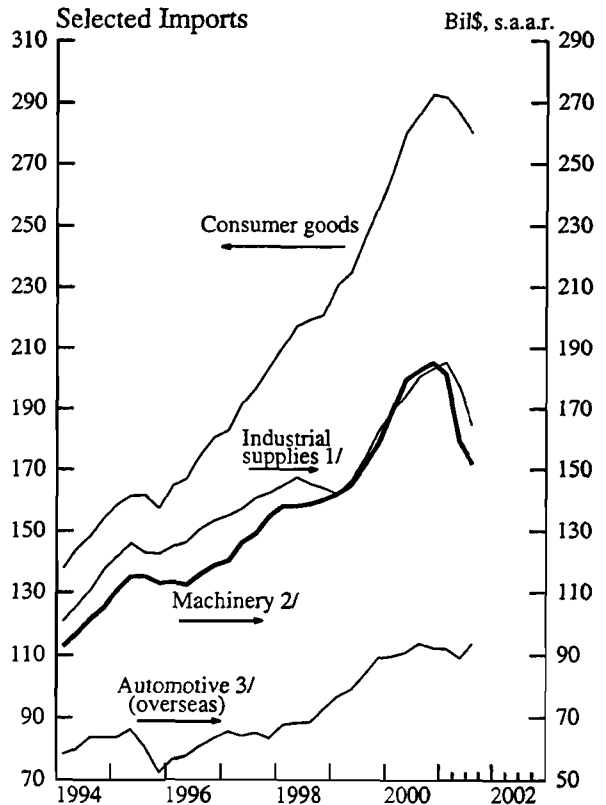
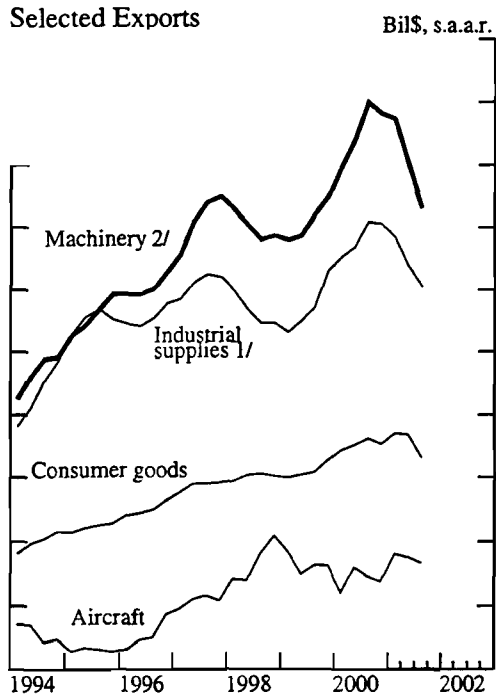
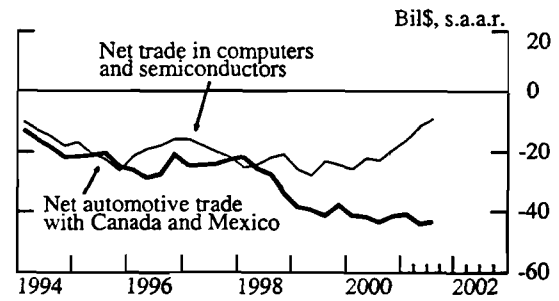
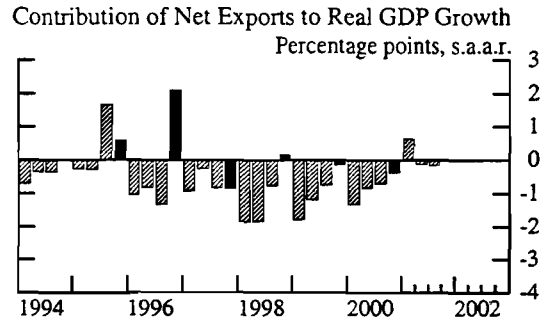
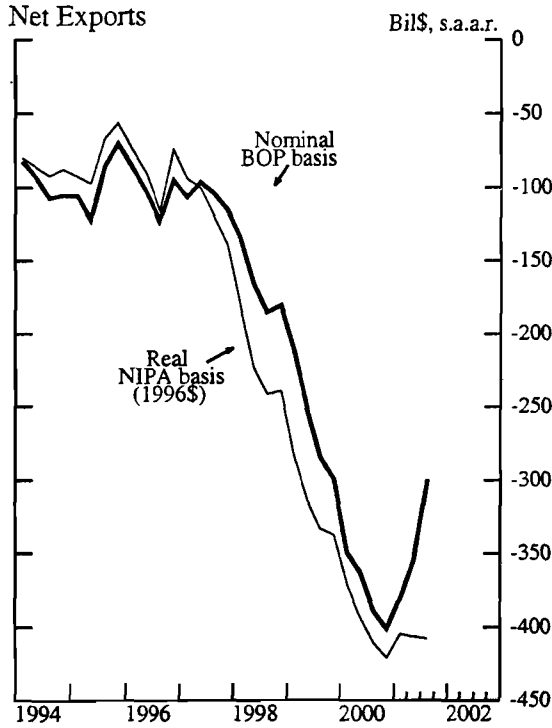
Source: U.S. Department of Commerce, Bureau of Economic Analysis and Census.

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

The events of September 11 had several distinct impacts on trade. Both exports and imports of services, particularly passenger fares and other travel expenditures, were down significantly in September. Goods trade also fell as a result of temporary disruptions after the 11th and weakening activity both at home and abroad. Declines in exports in September were widespread among categories, with a particularly sharp drop in capital goods. Decreases were also recorded in almost all major categories of imports, with the notable exception of consumer goods, which rose slightly.

For the third quarter as a whole the deficit was \$300 billion (s.a.a.r.), down from \$355 billion in the second quarter. About three-quarters of this reduction (\$44 billion annualized) resulted from the September insurance payment described above.

U.S. International Trade in Goods and Services



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

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

U.S. Exports and Imports of Goods and Services

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

	Levels				Amount Change ¹			
	2001		2001		2001		2001	
	Q2	Q3	Aug.	Sept.	Q2	Q3	Aug.	Sept.
Exports of G&S	1042.1	981.6	1014.2	927.5	-34.2	-60.5	11.0	-86.6
Goods exports	743.5	695.1	714.4	666.6	-36.3	-48.4	10.1	-47.7
Gold	7.6	2.4	2.6	1.6	0.9	-5.2	-0.5	-1.0
Other goods	735.9	692.7	711.8	665.1	-37.2	-43.1	10.6	-46.8
Aircraft & parts	55.1	53.1	54.3	50.9	-0.9	-2.0	0.3	-3.5
Computers	48.6	44.6	45.0	42.8	-7.4	-4.0	-0.9	-2.2
Semiconductors	46.5	38.9	38.5	37.0	-11.5	-7.5	-2.8	-1.5
Other capital gds	182.7	168.2	171.2	158.7	-14.6	-14.5	-3.4	-12.6
Automotive	76.3	77.3	80.2	76.9	4.5	1.0	5.5	-3.3
to Canada	42.2	40.3	42.2	38.6	4.7	-2.0	2.1	-3.5
to Mexico	15.9	15.6	17.5	16.5	-0.3	-0.3	4.6	-1.0
to ROW	18.2	21.4	20.5	21.8	0.2	3.2	-1.2	1.2
Agricultural	53.9	54.8	58.2	52.5	-0.6	1.0	4.4	-5.7
Ind supplies (ex. ag)	147.6	140.7	145.5	136.5	-9.1	-6.9	5.5	-9.1
Consumer goods	93.6	86.0	86.2	82.6	-0.5	-7.6	-3.0	-3.7
All other goods	31.7	29.2	32.7	27.4	2.8	-2.5	12.3	-5.3
Services exports	298.7	286.5	299.8	260.9	2.1	-12.2	0.9	-38.9
Imports of G&S	1397.3	1281.5	1339.4	1151.8	-59.1	-115.8	-13.7	-187.6
Goods imports	1174.1	1118.4	1123.3	1097.7	-55.8	-55.7	-11.0	-25.6
Petroleum	114.3	102.0	102.8	100.6	-3.0	-12.2	0.3	-2.2
Gold	6.5	2.2	2.3	2.3	0.4	-4.3	0.4	-0.0
Other goods	1053.3	1014.2	1018.1	994.7	-53.2	-39.1	-11.7	-23.4
Aircraft & parts	31.1	31.3	31.5	28.6	0.0	0.2	-2.3	-2.9
Computers	75.9	67.9	68.1	63.7	-9.8	-7.9	-4.0	-4.4
Semiconductors	30.8	24.7	24.3	25.1	-13.5	-6.1	-0.4	0.8
Other capital gds	162.1	154.2	157.3	152.4	-22.6	-7.9	4.3	-4.8
Automotive	191.3	193.0	197.6	190.2	4.3	1.8	6.2	-7.3
from Canada	61.0	59.0	62.5	54.9	5.0	-2.0	2.9	-7.6
from Mexico	41.1	40.2	42.5	40.3	2.5	-0.9	4.6	-2.2
from ROW	89.1	93.8	92.5	95.0	-3.1	4.7	-1.3	2.5
Ind supplies	177.3	164.6	163.2	157.5	-8.2	-12.7	-10.0	-5.7
Consumer goods	286.3	280.1	279.2	279.7	-5.4	-6.2	-2.2	0.5
Foods, feeds, bev.	45.7	47.9	47.2	47.8	-0.1	2.2	-1.6	0.7
All other goods	52.9	50.4	49.9	49.7	2.0	-2.5	-1.7	-0.2
Services imports	223.2	163.1	216.2	54.2	-3.4	-60.2	-2.7	-162.0
<i>Memo:</i>								
Oil quantity (mb/d)	12.92	11.88	12.11	11.43	0.12	-1.04	0.01	-0.68
Oil import price (\$/bbl)	24.22	23.52	23.26	24.11	-0.86	-0.70	0.05	0.85

1. Change from previous quarter or month.

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

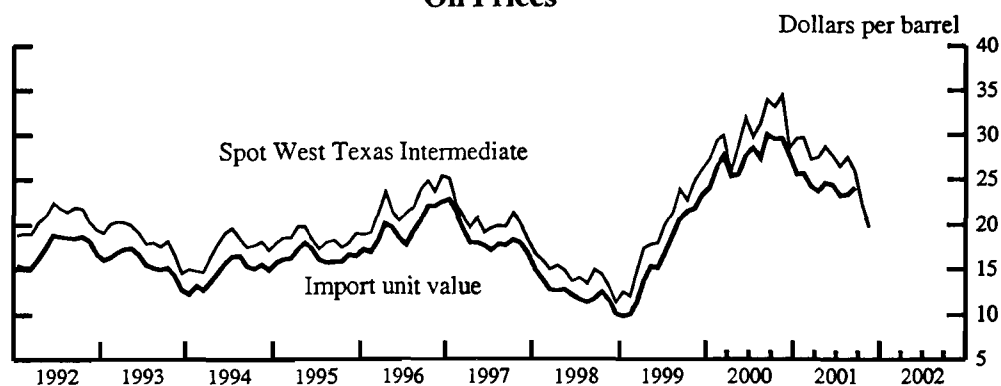
Prices of U.S. Imports and Exports
(Percentage change from previous period)

	Annual rates			Monthly rates		
	2001			2001		
	Q1	Q2	Q3	Aug.	Sept.	Oct.
	----- BLS prices (1995 weights)-----					
Merchandise imports	-5.3	-6.9	-7.2	-0.1	0.1	-2.4
Oil	-44.8	-10.9	-11.6	1.8	1.2	-15.7
Non-oil	2.4	-6.4	-6.3	-0.4	-0.1	-0.4
Core goods*	3.1	-6.1	-6.2	-0.4	0.0	-0.4
Cap. goods ex comp & semi	-0.3	-0.6	-1.1	-0.2	0.2	0.1
Automotive products	-0.1	-1.0	-0.5	-0.1	0.3	0.2
Consumer goods	0.6	-1.2	-1.1	0.0	-0.1	-0.1
Foods, feeds, beverages	0.1	-8.8	-7.2	0.1	0.5	-0.3
Industrial supplies ex oil	12.4	-18.1	-20.8	-1.7	-0.1	-2.6
Computers	-4.3	-12.6	-13.3	-0.4	-2.1	-0.9
Semiconductors	-3.7	-6.2	-1.1	0.0	-0.5	0.3
Merchandise exports	-0.3	-2.1	-2.8	-0.2	0.1	-0.7
Core goods*	-0.1	-1.7	-2.1	-0.2	0.1	-0.6
Cap. goods ex comp & semi	2.4	1.3	-0.4	-0.2	0.0	-0.1
Automotive products	0.5	0.5	0.0	0.0	0.0	0.1
Consumer goods	-0.7	-1.0	0.7	0.0	0.3	0.0
Agricultural products	2.9	-2.9	6.1	1.1	-0.3	-1.7
Industrial supplies ex ag	-4.1	-6.3	-10.9	-0.7	0.4	-1.6
Computers	-2.4	-4.9	-8.1	-1.1	0.0	0.0
Semiconductors	-2.9	-7.1	-7.0	0.3	0.0	-4.8
	---Prices in the NIPA accounts (1996 weights)---					
Chain price index						
Imports of goods & services	-3.0	-6.0	-17.0	...	...	...
Non-oil merchandise	1.4	-5.6	-6.5	...	...	...
Core goods*	2.2	-5.0	-6.0	...	...	...
Exports of goods & services	-0.1	-1.0	-1.8	...	...	...
Total merchandise	-0.4	-1.5	-2.2	...	...	...
Core goods*	-0.0	-1.0	-1.5	...	...	...

*/ Excludes computers and semiconductors.

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

Oil Prices



Imports of goods and services net of the insurance payment were down about 20 percent at an annual rate. Declines were widespread among regions and categories, with the largest reductions in capital goods and industrial supplies (oil and non-oil). Imports of consumer goods and of services were down by smaller amounts.

Exports of goods and services were down about 20 percent at an annual rate for the quarter, as a moderate decline in the July-August period preceded the sharper drop in September. The third-quarter falloff in goods exports, which was somewhat less in dollar terms than the fall in imports, was also widespread, with steep declines for the second consecutive quarter in both capital goods and industrial supplies. Exports of consumer goods, which have generally held up better than other categories this year, also fell sharply in the third quarter, while service exports were reduced by the curtailment of foreign travel. In contrast, automotive trade, both exports and imports, rose in the third quarter.

Prices of Internationally Traded Goods

Oil. Following the September terrorist attacks, spot oil prices fell sharply amid concerns about weak world oil demand resulting from prospects for reduced economic activity and lower jet fuel consumption. For the third quarter on average, the price of imported oil fell 17 percent at an annual rate, marginally faster than in the second quarter but much less than in the first quarter. In October, the price of imported oil dropped 15.7 percent, the largest decline since 1991, and the spot price of West Texas Intermediate moved lower again in November following OPEC's decision not to cut production unless several non-OPEC countries limit production as well. It is not yet clear what impact Russia's recent decision to restrain oil exports will have on the market. The spot price of WTI has recently been trading near \$20 per barrel.

Non-oil imports. The average price of imported non-oil goods fell in October, the ninth consecutive month in which the index either fell or was unchanged. The price index for core goods also dropped, led by a continued downturn in prices for industrial supplies and materials (particularly natural gas, nonferrous metals, and lumber). In contrast, there were small increases in prices of automotive products and imported capital equipment (excluding computers and semiconductors), for the second consecutive month. For the third quarter, the average price of core goods fell just over 6 percent at an annual rate, about the same rate of decline as in the second quarter. The decline was again led by decreases in prices of imported industrial supplies, with smaller price declines recorded in all other major trade categories.

Exports. Prices of U.S. goods exports (total and core) fell sharply in October following small increases in September. The October decline was the largest

since January 1998, and marked a resumption of the downward trend that has been evident since the beginning of this year. Prices of both industrial supplies and agricultural exports showed particularly sharp declines in October. In the third quarter, the price of exported core goods declined 2.1 percent at an annual rate, a bit steeper fall than in the second quarter. Although the price of exported industrial supplies fell more sharply than in the second quarter, this was partly offset by an increase in the price of agricultural exports, which had fallen in the second quarter.

U.S. International Financial Transactions

Foreign official assets held in the United States (line 1 of the Summary of U.S. International Transactions Table) increased \$17 billion in the third quarter. Increases recorded for the BIS (\$8 billion) and for Brazil, China, and Taiwan (\$3 billion) more than offset sizable declines in the reserves of Germany (\$6 billion) and Venezuela (\$5 billion). Partial data from FRBNY indicate that as of mid-November foreign official holdings increased \$13 billion since the end of September. This increase was overwhelmingly due to a further rise in Japan's holdings (\$11 billion), stemming from intervention activity late in the third quarter.

Foreign private net purchases of U.S. securities (line 4) fell substantially in the third quarter. Foreign sales of Treasury issues (line 4a) accelerated; however, the largest declines in net purchases came in U.S. corporate bonds and stocks (lines 4c and 4d). The falloff was particularly sharp in September and likely came in the wake of the terrorist attacks; however, our data do not provide information on the timing of September market activity. In that month, purchases of agencies and corporate bonds trailed down and foreigners resumed selling U.S. Treasury securities. In sharp contrast to previous periods, foreigners also sold \$10 billion of U.S. equities in September—the first monthly sales recorded since September 1998. Although the sales were widespread, they loomed largest in the financial centers in Europe (\$5 billion) and the Caribbean (\$4 billion). For the quarter, foreign demand for U.S. agency bonds (line 4b) remained strong, and net purchases of agencies are on track to exceed last year's total.

The reduced inflows owing to smaller net foreign purchases of U.S. securities in the third quarter (\$50 billion) were more than offset by a downward swing in U.S. purchases of foreign securities as U.S. net purchases of \$44 billion in the second quarter turned to sales of \$21 billion in the third. Net sales of foreign bonds, amounting to \$25 billion (line 5a), were offset in small part by net acquisitions of foreign stock, including stock swaps. U.S. residents have been selling foreign bonds since March, but these sales accelerated markedly during the third quarter and remained concentrated in European financial centers. U.S.

residents also sold net \$5 billion of foreign stock in September (line 5c) in contrast to steady net purchases since the end of last year.

Data on U.S. international securities transactions for October, together with any revisions to earlier months, are expected in early December and will be included in the Greenbook Supplement. These data may give some indication of whether the falloff in foreign demand for U.S. securities in September was a short-lived reaction to events or a signal of change in investor sentiment.

Net outflows of \$15 billion were recorded in the banking sector (line 3); these largely arose from transactions with unaffiliated foreign banks.

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

	1999	2000	2000	2001				
			Q4	Q1	Q2	Q3	Aug.	Sept.
Official financial flows	55.0	39.3	-5.4	4.8	-21.3	13.1	-6.3	9.6
1. Change in foreign official assets in the U.S. (increase, +)	46.4	39.6	-4.0	4.6	-20.0	16.7	-6.1	12.7
a. G-10 countries	49.7	12.3	-.8	-5.5	-6.1	-5.6	-4.4	1.6
b. OPEC countries	2.0	10.7	.6	.8	-2.1	-4.7	-1.9	-3.7
c. All other countries	-5.3	16.6	-3.8	9.2	-11.7	27.0	-.2	14.8
2. Change in U.S. official reserve assets (decrease, +)	8.6	-.3	-1.4	.2	-1.3	-3.6	-0.2	-3.1
Private financial flows	321.7	404.0	119.1	98.7	146.0	n.a.	...	...
Banks								
3. Change in net foreign positions of banking offices in the U.S. ¹	-12.4	-6.8	13.3	-79.3	29.5	-14.6	20.1	-38.0
Securities²								
4. Foreign net purchases of U.S. securities (+)	333.2	435.7	117.8	148.4	125.8	75.2	44.2	2.3
a. Treasury securities	-19.9	-52.4	-10.1	.6	-8.5	-9.2	5.3	-4.0
b. Agency bonds	71.9	111.9	38.3	38.8	29.4	33.1	13.3	6.3
c. Corporate and municipal bonds	158.8	182.1	50.8	68.9	70.4	36.8	12.5	9.9
d. Corporate stocks ³	122.4	194.0	38.8	40.7	34.5	14.5	13.2	-9.9
5. U.S. net acquisitions (-) of foreign securities	-112.9	-101.1	-17.8	-27.1	-43.5	20.8	4.7	15.0
a. Bonds	-5.7	-4.1	3.3	-2.0	8.8	25.4	9.4	10.3
b. Stock purchases	15.6	-13.1	3.6	-22.6	-18.1	-2.7	-2.9	4.7
c. Stock swaps ³	-122.9	-84.0	-24.7	-2.6	-34.2	-1.8	-1.8	.0
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-155.4	-152.4	-39.1	-40.9	-35.6	n.a.	...	...
7. Foreign direct investment in U.S.	301.0	287.7	84.7	52.5	67.2	n.a.	...	...
8. Foreign holdings of U.S. currency	22.4	1.1	6.2	2.3	2.8	n.a.	...	...
9. Other (inflow, +) ⁴	-54.2	-59.9	-46.0	41.3	.3	n.a.	...	...
U.S. current account balance (s.a.)	-324.4	-444.7	-116.3	-111.8	-106.5	n.a.	...	...
Capital account balance (s.a.)⁵	-3.5	.7	.2	.2	.2	n.a.	...	...
Statistical discrepancy (s.a.)	-48.8	.7	2.4	8.1	-18.4	n.a.	...	...

NOTE. The sum of official and private financial flows, the current account balance, the capital account balance, and the statistical discrepancy is zero. Details may not sum to totals because of rounding.

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

2. Includes commissions on securities transactions and excludes adjustments BEA makes to account for incomplete coverage; therefore does not match exactly the data on U.S. international transactions published by the Department of Commerce.

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

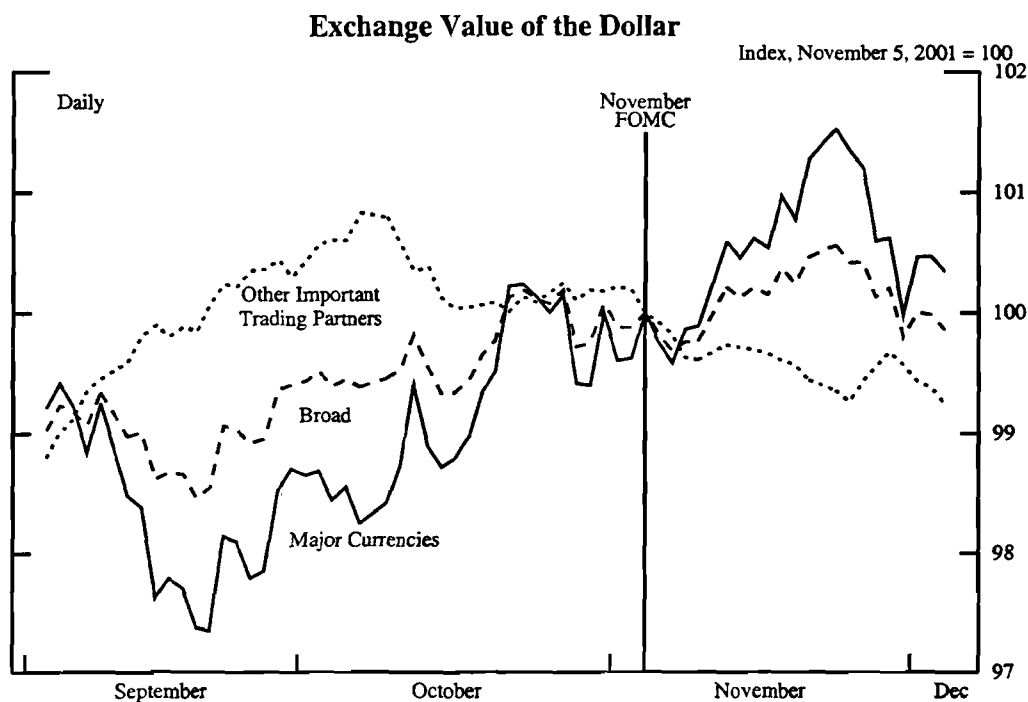
4. Transactions by nonbanking concerns and other banking and official transactions not shown elsewhere plus amounts resulting from adjustments made by the Department of Commerce and revisions in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business

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

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

Foreign Exchange Markets

On balance, the trade-weighted index of the dollar's exchange value against other major currencies rose 0.3 percent over the intermeeting period. The dollar appreciated during the first half of the period largely in reaction to data releases supporting some optimism about prospects for economic activity in the United States, particularly relative to other foreign industrial economies. In addition, positive developments in the Afghanistan war, which prompted expectations that the U.S. military engagement may end sooner than had been anticipated, also seemed to support the dollar. The dollar subsequently retraced most of its gains as market participants reassessed their outlook for the U.S. economy following the release of weaker-than-expected data on consumer confidence and initial jobless claims in the United States.



The index of the dollar's value against our other important trading partners, in contrast, fell 0.75 percent over the intermeeting period, led by an appreciation of the Brazilian *real* and Korean won. The appreciation of the *real* occurred despite an increasingly precarious situation in Argentina, as the government there attempts to restructure most of \$132 billion of sovereign debt and to avoid a threatening collapse of its financial system and/or of the currency peg to the dollar. The appreciation of the *real* occurred as market participants appeared to be optimistic that Argentina's problems will not spill over into other Latin American economies.

On net, the dollar appreciated 0.4 percent versus the euro, and 2.4 percent versus sterling. The European Central Bank and Bank of England lowered their policy rates by a larger-than-expected 50 basis points early in the period. The dollar was also supported against the euro by weak economic data on confidence and GDP in the euro area, and against sterling by speculation about U.K. entry into the European Monetary Union.

Late in the intermeeting period, the Bank of Canada lowered its policy rate 50 basis points, in line with expectations. The U.S. dollar depreciated a net 1.5 percent over the period against the Canadian dollar, which rebounded from record lows. The dollar appreciated 2.0 percent against the yen during the intermeeting period. Comments from Japanese officials that led to speculation about possible intervention weighed on the yen, as did reports that the Bank of Japan may be considering purchasing foreign bonds.

Financial Indicators in Major Industrial Countries

Country	Three-month rate		Ten-year yield		Equities
	Dec. 5 (Percent)	Percentage Point Change	Dec. 5 (Percent)	Percentage Point Change	Percent Change
Canada	2.14	-.31	5.24	.27	6.36
Japan	.03	.00	1.38	.07	-.64
Euro area	3.35	-.14	4.61	.30	5.06
United Kingdom	3.93	-.10	4.72	.28	2.22
Switzerland	1.85	.00	3.27	.32	4.03
Australia	4.30	.06	5.56	.38	3.86
United States	1.88	-.18	4.72	.41	4.81
Memo: Weighted-average foreign	2.08	-.14	4.39	.24	n.a.

NOTE. Change is from November 5 to December 5 (10 a.m. EDT).
n.a. Not available.

Long-dated bond yields in most industrial economies increased dramatically following the positive events in Afghanistan, but by less than in the United States. On balance, 10-year sovereign yields in most foreign industrial countries outside Japan rose about 30 basis points over the period. The yield on Japanese government bonds rose 7 basis points; both Moody's and Standard and Poor's downgraded Japan's sovereign credit rating. Yields implied by euro and sterling

interest rate futures contracts maturing in the last three quarters of 2002 also increased, ending 30 to 60 basis points higher on net over the period

Much of the gain in bond yields came as market participants appeared to unwind risk-averse bond positions in favor of higher yielding stocks. On net, broad equity indexes rose 2 to 5 percent in Europe, and about 4 and 6 percent in Australia and Canada, respectively, while the Japanese broad index declined 0.6 percent. Technology-related stocks in Germany, Japan, and the United Kingdom significantly outperformed broader indexes in the latter half of the period.

Concerns over Argentina did not appear to weigh on other emerging markets, as equity indexes increased, and dollar-denominated bond spreads over Treasuries fell, in most emerging market economies over the intermeeting period. The largest increases in emerging market equity prices occurred in Korea, Singapore, and Taiwan, which were all up over 15 percent, led by gains in technology shares. In Latin America, equity indexes in Brazil, Chile, and Mexico rose 5 to 8 percent, and sovereign bond yield spreads over Treasuries narrowed 40 to 240 basis points. Currencies of several emerging market economies appreciated against the dollar. The Chilean peso and Brazilian *real* rose 5 and 6 percent, respectively, and the Korean won rose 2.7 percent, against the dollar.

Financial market movements in Argentina reflected deepening concerns over the government's ability to avoid default on \$132 billion in public debt. Early in the period the government announced that it would conduct an exchange of a large portion of its sovereign debt. Even with the near-term debt service relief that the exchange is intended to provide, the government is likely to miss the fiscal targets that are preconditions for disbursement in December of \$1.3 billion in IMF Funds. Without the IMF disbursement, the government will be hard pressed to make upcoming debt payments of \$2 billion in December. In response to a surge in deposit withdrawals at the end of the period, the government imposed restrictions on the size of bank deposit withdrawals and transfers of funds out of the country. Reflecting the effect of interest rate caps imposed by the government, one-month interbank interest rates fell 73 percentage points over the period, but overnight rates soared as banks sought to meet liquidity demands. Interest rates implied by one-month non-deliverable forward contracts also soared, reaching over 250 percent (a.r.) during the period. The yield spread

of Argentina's sovereign debt over Treasuries rose more than 1400¹ basis points over the period and Argentina's equity index fell over 9 percent.

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

Financial Indicators in Latin America, Asia, and Russia

Economy	Currency/ US dollar		Short-term Interest rates ¹		Dollar-denominated bond spread ²		Equity prices
	Dec. 5	Percent Change	Dec.4/5 (Percent)	Percentage Point Change	Dec.4/5 (Percent)	Percentage Point Change	Percent Change
Mexico	9.21	-.18	6.42	-1.02	3.32	-.66	5.58
Brazil	2.44	-5.97	19.10	.00	8.90	-2.44	8.47
Argentina	1.01	1.04	11.50	-73.50	*38.98	*14.63	-9.44
Chile	675.50	-4.99	6.42	.00	2.50	-.43	5.07
China	8.28	.00	n.a.	n.a.	1.49	.07	3.91
Korea	1260.90	-2.71	4.15	-.05	1.12	-.38	22.56
Taiwan	34.36	-.55	2.57	-.27	...	...	20.68
Singapore	1.83	.71	1.00	.38	...	...	16.05
Hong Kong	7.80	-.01	1.95	-.01	...	...	11.96
Malaysia	3.80	-.01	2.90	.00	1.55	-.11	10.15
Thailand	43.93	-1.70	3.00	.25	3.73	.69	11.29
Indonesia	10465.00	-3.99	17.78	-.01	5.01	-.25	.73
Philippines	51.90	.19	10.38	-1.50	5.47	-1.32	12.48
Russia	29.95	.84	n.a.	n.a.	7.15	-2.02	10.82

NOTE. Change is from November 5 to December 4/5.

1. One month interbank interest rate, except Chile: 30-day deposit rate; Korea: 1-week call rate. No reliable short-term interest rates exist for China or Russia.

2. Spread over similar maturity U.S. Treasury security yield. Mexico, Brazil, Argentina, Korea, the Philippines and Russia: EMBI+ yield. Chile and China: Global bond yield. Malaysia: Eurobond yield. Thailand and Indonesia: Yankee bond yield. Taiwan, Singapore, and Hong Kong do not have outstanding sovereign bonds denominated in dollars.

* Based on the Argentine sub-component of J.P. Morgan's EMBI+ index; 640 basis points of this increase is due to a break in the series that resulted when J.P. Morgan re-weighted the index to account for Argentina's debt exchange.

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

1. Based on the Argentine sub-component of J.P. Morgan's EMBI+ index; 640 basis points of this increase is due to a break in the series that resulted when J.P. Morgan re-weighted the index to account for Argentina's debt exchange.

Developments in Foreign Industrial Countries

The latest GDP data confirm that activity in foreign industrial countries was weak in the third quarter. Indicators suggest further deterioration in the current quarter, as business confidence collapsed in September and showed little improvement in October and November. In Japan, output likely registered another sharp decline in the third quarter, and industry indicators weakened further in October. Activity also declined slightly in Canada. Real GDP barely expanded in the euro area in the third quarter, and confidence indicators fell sharply in October and a bit more in November. Growth was better sustained in the United Kingdom but incoming data point to a slower rate of expansion this quarter.

Inflation continued to decline, primarily reflecting lower oil prices. The twelve-month rate of consumer price inflation in October declined to less than 2 percent in Canada, while retail price inflation in the United Kingdom remained below the Bank of England's 2½ percent target. The preliminary November estimate shows that euro-area inflation retreated to just above the European Central Bank's (ECB) 2 percent ceiling. Deflation continued in Japan.

Several central banks eased monetary policy further in November, acknowledging the improved outlook for inflation and citing concerns about the weaker outlook for activity. On November 8, the ECB and the Bank of England each cut official interest rates 50 basis points, and the Bank of Canada announced a 50 basis point cut on November 27. Banks' reserves held at the Bank of Japan remain at elevated levels.

Indicators for **Japan** suggest that the economy continued to deteriorate in recent months. Industrial production plunged nearly 3 percent in September and slid a bit further in October. The broader all-industry index declined nearly 1 percent in September. Machinery orders plummeted 13 percent in September and shipments of machinery dropped slightly in October. Private consumption also appears to be weakening, with household expenditures down about ¾ percent and new passenger car registrations essentially flat in the third quarter. Residential and non-residential building starts fell for the second consecutive month in October.

Conditions in the labor market also worsened. The unemployment rate rose to a record 5.4 percent in October, with employment down 2 percent from its recent peak in November of last year. The job-offers-to-applicants ratio fell to 0.55, its lowest level since April last year. Prices have continued to decline. Core consumer goods prices in the Tokyo area (which exclude fresh food but include energy) were down 1 percent in November from a year earlier. Deflation in

wholesale prices for domestic goods has intensified as the impact of the earlier run-up in energy prices has faded.

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

Indicator	2001						
	Q1	Q2	Q3	Aug.	Sep.	Oct.	Nov.
Industrial production ¹	-3.6	-4.1	-4.3	.8	-2.9	-.3	n.a.
All-industry index	.9	-2.0	-1.8	-.2	-.8	n.a.	n.a.
Housing starts	-4.0	-2.9	5.4	-.4	-3.4	-3.0	n.a.
Machinery orders ²	-7.0	1.1	-5.7	8.7	-13.2	n.a.	n.a.
Machinery shipments	-4.6	-7.2	-5.3	1.2	-5.7	-.2	n.a.
New car registrations	2.6	1.7	-.3	9.6	-13.7	n.a.	n.a.
Unemployment rate ³	4.8	4.9	5.1	5.0	5.3	5.4	n.a.
Job offers ratio ⁴	.63	.61	.59	.59	.57	.55	n.a.
Business sentiment ⁵	-22	-27	-36	...	...	...	...
CPI (Core, Tokyo area) ⁶	-1.4	-1.3	-1.2	-1.2	-1.2	-1.0	-1.0
Wholesale prices ⁶	-.5	-.7	-1.0	-1.0	-1.1	-1.1	n.a.

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

The merchandise trade surplus (customs clearance basis) widened a little in the third quarter, as a 6 percent (s.a.) drop in imports, largely reflecting weakening domestic demand, outpaced a 4 percent decline in exports. In October, the merchandise trade surplus narrowed as imports rose 9 percent while exports were flat.

The BOJ's official policy is to maintain the level of the outstanding balance of banks' deposits held at the central bank "at above ¥6 trillion." Since mid October, the balance has averaged about ¥9 trillion, but spiked to ¥14 trillion at the end of November in response to concerns over Japanese money market funds associated with Enron's financial difficulties.

In mid November, the Diet passed a supplementary budget of ¥3 trillion (\$25 billion) for FY2001 (April 2001-March 2002). The “real-water” content of the package is estimated to be about ¥1 trillion (0.2 percent of GDP). Most of the real-water spending is on structural reform measures, with relatively little on traditional public works. The budget sets aside about ¥500 billion for labor-market programs, such as increased public employment and extended job training schemes. The budget also designates funds to deal with the recent outbreak of “mad cow” disease in Japan and to implement anti-terrorism measures. Financing the supplementary budget will bring total new debt issuance to ¥30 trillion for FY2001, an amount Prime Minister Koizumi has pledged not to exceed. Soon after the Diet passed the first supplementary budget, the government announced that it would begin deliberation over a second supplementary budget of ¥4 trillion that would be financed by proceeds from the past sale of the government-owned telecommunications corporation. The “real-water” content of the prospective package is expected to be about ¥2.5 trillion, although the contents of the package are still unknown. Even with the addition of this supplementary spending, fiscal policy will be somewhat contractionary in the latter half of this fiscal year.

In the **euro area**, real GDP data confirm that activity remained weak in the third quarter, growing only 0.4 percent (s.a.a.r.) as consumption spending slowed and fixed investment fell for the fourth consecutive quarter. A sizable inventory draw-down subtracted 1.9 percentage points from growth. Net exports added 1.9 percentage points to growth, as a large decline in imports more than offset weakness in exports. In Germany, real GDP fell 0.6 percent, following a slight decline in the second quarter. This is the first time since 1993 that German GDP has contracted for two consecutive quarters. Real GDP also declined in the Netherlands. In France, however, growth picked up to a 1.9 percent rate, supported by robust consumer spending.

Incoming indicators are consistent with a contraction in euro-area activity in the current quarter. The volume of German industry orders plunged 4.1 percent in September from the previous month with both domestic and foreign orders weak. After falling sharply in October to the lowest value in its four-year history, the purchasing managers index (PMI) for the euro-area manufacturing sector improved slightly in November, but still signaled contraction in the manufacturing sector for the eighth consecutive month. Service sector PMIs for October and November are also consistent with contracting activity. Euro-area economic sentiment sank in October and slipped a bit further in November to its lowest level since 1997. Confidence declined in all sectors. In the industrial survey, there has been a notable deterioration in production expectations and in orders; levels of stocks appear to remain high. In the consumer survey, the

Euro-Area Real GDP¹						
(Percent change from previous period, except as noted, s.a.a.r.)						
Component	1999 ²	2000 ²	2000	2001		
			Q4	Q1	Q2	Q3
GDP	3.6	2.8	2.4	2.1	.3	.4
Total domestic demand	3.5	2.2	1.8	.3	1.1	-1.6
Consumption	3.0	1.9	.7	3.4	2.1	.9
Investment	5.9	2.9	-1.4	-1.3	-1.9	-1.0
Government consumption	2.5	1.7	3.0	2.3	1.5	.4
Inventories ³	-.0	.1	1.1	-1.7	.0	-1.9
Exports	9.9	12.0	9.8	-.7	-.8	-2.3
Imports	9.8	10.6	8.6	-5.3	1.3	-7.6
Net exports ³	.2	.7	.6	1.7	-.8	1.9
<i>Memo:</i>						
France	3.7	3.2	3.5	1.8	.9	1.9
Germany	3.0	2.5	.6	1.6	-.1	-.6
Italy	2.9	2.6	3.5	3.4	-.2	.8

1. Includes Greece as of 2001 Q1.

2. Q4/Q4.

3. Percentage point contribution to GDP growth, s.a.a.r.

outlook for the general economic situation and for unemployment showed the greatest deterioration.

Labor market data for the euro area as a whole have yet to show much deterioration, as the harmonized unemployment rate edged up to 8.4 percent in September and remained at that rate in October. National statistics show more pronounced increases in the French and German unemployment rates.

According to the preliminary estimate, the twelve-month rate of euro-area consumer price inflation moved down to 2.1 percent in November, just above the ECB's 2 percent target ceiling. Core consumer price inflation (which excludes food, energy, alcohol and tobacco) edged up to 2.3 percent in October on a twelve-month basis, but producer price inflation, which peaked at 6.6 percent for the twelve months ending in October of last year, has moved down steadily this year.

Euro-Area Economic Indicators¹							
(Percent change from previous period except as noted, s.a.)							
Indicator	2001						
	Q1	Q2	Q3	Aug.	Sep.	Oct.	Nov.
Industrial production ²	-3	-8	-3	1.5	-.5	n.a.	n.a.
Retail sales volume	.5	.1	.6	.2	.3	n.a.	n.a.
Unemployment rate ³	8.4	8.4	8.4	8.3	8.4	8.4	n.a.
Consumer confidence ⁴	1.0	-1.7	-7.7	-8.0	-9.0	-10.0	-12.0
Industrial confidence ⁵	1.0	-5.3	-10.0	-10.0	-11.0	-16.0	-18.0
Mfg. orders, Germany	-2.7	-1.6	-2.7	.8	-4.1	n.a.	n.a.
CPI ⁶	2.5	3.1	2.7	2.7	2.5	2.4	2.1
Producer prices ⁶	4.8	3.9	1.7	1.9	.9	-.3	n.a.
M3 ⁶	3.7	5.5	6.9	6.0	6.9	7.4	n.a.

1. Euro-area indicators include Greece only from January 2001.

2. Excludes construction.

3. Euro-area standardized to ILO definition. Includes Eurostat estimates in some cases.

4. Diffusion index based on European Commission surveys in individual countries; Averages of responses to questions on financial situation, general economic situation, and purchasing attitudes.

5. Diffusion index based on European Commission surveys in individual countries; Averages of responses to questions on production expectations, orders, and stocks.

6. Eurostat harmonized definition, 12-month percent change.

n.a. Not available.

On November 8, the ECB reduced its policy interest rates by 50 basis points, bringing the minimum bid rate for the refinancing tender to 3.25 percent. ECB President Duisenberg noted that the ECB's current assessment is that inflation will fall "well below" the 2 percent limit early next year and will stay there. The ECB has cut its policy rates 150 basis points this year.

In its autumn forecast, the European Commission noted that, with activity in the euro area significantly weaker than anticipated earlier this year, most countries will miss their Stability and Growth Pact targets this year and next, in some cases by more than a percentage point of GDP. The Commission expects that the euro area will record a deficit of 1.1 percent of GDP for 2001, and the deficit is expected to grow to 1.4 percent in 2002. The deficit in Germany is projected to be the largest, reaching 2.7 percent of GDP in 2002, well above the deficit of

1.2 percent of GDP expected last spring and close to the Stability and Growth Pact limit of 3 percent.

Preparations for the changeover to euro-denominated currency notes and coins on January 1 have moved into final stages. As of the end of October, more than 13 billion euro banknotes had been produced, enough to replace the existing stock of national banknotes and to provide most of the additional 5 billion banknotes for a desired “logistical contingency” stock. Delivery of currency notes and coins to euro-area banks began in September. Most retail establishments began to receive euro notes and coins in early December. The general public can obtain “starter kits” of coins in mid December; euro notes will be available from most ATMs in euro-area countries starting January 1. EU Commission polls indicate the percentage of euro-area residents who consider themselves “well informed” about the changeover process has risen steadily in recent months to 68 percent in October, while those unaware of the changeover date has fallen to 6 percent.

Real GDP growth in the **United Kingdom** rose slightly from 1.8 percent (s.a.a.r.) in the second quarter to 2 percent in the third quarter. Total domestic demand grew 1.5 percent. Consumption expenditures remained robust but fixed investment fell 11.7 percent. Inventories made a negligible contribution to growth. Net exports subtracted 0.5 percentage point from growth, as both imports and exports continued to contract.

Indicators for the fourth quarter suggest that growth is slowing. In November, consumer confidence rebounded somewhat but remained lower than in September. Retail sales fell 0.1 percent (s.a.) in October, and retail sales surveys for November suggest that although sales growth picked up, it did not return to its previous robust rate. Although service sector growth has been robust in recent quarters, the latest service sector surveys are consistent with growth slowing in the fourth quarter. In November, the outlook for expected future production in the manufacturing sector remained very pessimistic.

Notwithstanding the recent slowing in activity, labor market conditions remain tight. The official claims-based unemployment rate rose slightly to 3.2 percent in October, while the labor force survey measure of the unemployment rate remained at 5.1 percent for the three months centered in August. Both unemployment rates are at near-record lows.

The twelve-month rate of retail price inflation (excluding mortgage interest payments) remained at 2.3 percent in October, below the Bank of England’s official target of 2.5 percent. Average earnings growth in September was at the

4.5 percent rate (from a year earlier) that the Bank of England believes to be compatible with its inflation target.

U.K. Real GDP

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

Component	1999 ¹	2000	2000	2001		
			Q4	Q1	Q2	Q3
GDP	2.7	2.4	2.0	2.6	1.8	2.0
Total domestic demand	3.6	2.9	2.1	3.6	1.7	1.5
Consumption	4.8	3.5	3.3	4.0	5.2	5.2
Investment	.6	7.7	15.2	-12.2	8.5	-11.7
Government consumption	2.3	.8	-2.9	4.0	3.0	2.8
Inventories ²	.0	-.9	-2.2	2.9	-3.9	-.0
Exports	8.6	10.3	10.7	5.2	-9.4	-13.7
Imports	10.4	10.4	9.6	6.2	-8.2	-10.8
Net exports ²	-1.0	-.6	-.2	-.7	-.0	-.5

1. Q4/Q4.

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

On November 8, the Monetary Policy Committee (MPC) of the Bank of England cut the official repo rate 50 basis points to 4 percent. The MPC has cut interest rates 200 basis points so far this year. In its statement, the MPC cited a deeper and longer global slowdown than previously expected and concerns about weakness in business and consumer confidence as reasons for its easing action.

U.K. Economic Indicators

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

Indicator	2001						
	Q1	Q2	Q3	Aug.	Sep.	Oct.	Nov.
Industrial production	-0.6	-1.1	-0.6	.7	-1.1	n.a.	n.a.
Retail sales	1.6	1.7	1.5	.7	.3	-0.1	n.a.
Unemployment rate ¹							
Claims-based	3.3	3.2	3.1	3.1	3.1	3.2	n.a.
Labor force survey ²	5.1	5.0	n.a.	5.1	n.a.	n.a.	n.a.
Business confidence ³	8.7	-0.7	-6.0	-13.0	-8.0	-23.0	-21.0
Retail prices ⁴	1.9	2.3	2.4	2.6	2.3	2.3	n.a.
Producer input prices ⁵	4.9	4.4	-3.4	-3.1	-6.2	-9.0	n.a.
Average earnings ⁵	5.0	4.7	4.4	4.3	4.5	n.a.	n.a.

1. Percent.

2. Three-month average centered on month shown.

3. Percentage of firms expecting output to increase in the next four months less percentage expecting output to decrease.

4. Excluding mortgage interest payments. Percent change from year earlier.

5. Percent change from year earlier.

n.a. Not available.

In **Canada**, economic activity slowed considerably going into the fourth quarter. In the third quarter, real GDP fell 0.8 percent (s.a.a.r.) following an upwardly-revised 0.6 percent gain in the second quarter. Net exports subtracted 0.3 percentage point from growth as both exports and imports declined. Consumption spending fell for the first time since the fourth quarter of 1995. In September, retail sales declined 1.7 percent from the previous month, as auto sales plunged 3.3 percent and non-auto retail activity fell 1.1 percent, but auto sales recovered in October and November with the introduction of financing incentives. Manufacturing shipments fell 2.5 percent in September, with particular weakness in the aerospace and petroleum sectors. While the decline in September manufacturing activity partially reflects the impact of September 11-related disruptions in cross-border traffic, a 1.4 percent fall in new orders for the month indicates a more prolonged weakness. Housing has exhibited a degree of resilience not seen in other sectors of the economy, with October starts increasing 12.7 percent (s.a.a.r.). Employment was essentially flat in October while the unemployment rate increased slightly as a consequence of labor force growth.

Canadian Real GDP						
(Percent change from previous period, except as noted, s.a.a.r.)						
Component	1999 ¹	2000 ¹	2000	2001		
			Q4	Q1	Q2	Q3
GDP	5.1	3.5	1.6	1.7	.6	-8
Total domestic demand	5.4	2.7	-1.4	.6	2.2	-1.1
Consumption	4.2	3.3	1.2	3.6	.6	-3
Investment	8.8	3.7	-1.7	-.4	3.1	5.4
Government consumption	2.7	2.3	3.5	2.8	4.7	1.6
Inventories ²	.6	-.4	-2.3	-1.9	.3	-2.1
Exports	8.7	4.3	-.1	-5.4	-4.2	-7.7
Imports	10.4	2.1	-9.1	-9.3	-1.3	-7.8
Net exports ²	-.2	1.1	3.8	1.4	-1.4	-.3

1. Q4/Q4.

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

The twelve-month rate of consumer price inflation declined considerably to 1.9 percent in October, slightly below the midpoint of the Bank of Canada's 1 to 3 percent target range. The drop was primarily the product of lower energy prices, though other prices decelerated a bit as well. On November 27, the Bank lowered its policy rate 50 basis points to 2.25 percent, bringing the cumulative reduction for this year to 350 basis points. The Bank stated that the cut was meant to support the growth of domestic demand, and was consistent with maintaining CPI inflation within the target range.

Canadian Economic Indicators

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

Indicator	2001						
	Q1	Q2	Q3	July	Aug.	Sep.	Oct.
GDP at basic prices	-0	.2	-.4	-.1	.0	-.8	n.a
Industrial production	-1.8	-.1	-2.3	-.4	-.2	-2.1	n.a
New mfg. orders	-5.4	1.2	-2.9	1.1	-1.0	-1.4	n.a
Retail sales	1.3	2.1	-.9	-.3	.0	-1.7	n.a
Employment	.2	.3	-.1	-.1	-.1	.1	.0
Unemployment rate ¹	6.9	7.0	7.1	7.0	7.2	7.2	7.3
Consumer prices ²	2.8	3.6	2.7	2.6	2.8	2.6	1.9
Consumer attitudes ³	110.0	113.1	108.0	...	...	...	...
Business confidence ³	117.5	131.6	93.0	...	...	...	...

1. Percent.

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

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

3. Level of index, 1991 = 100.

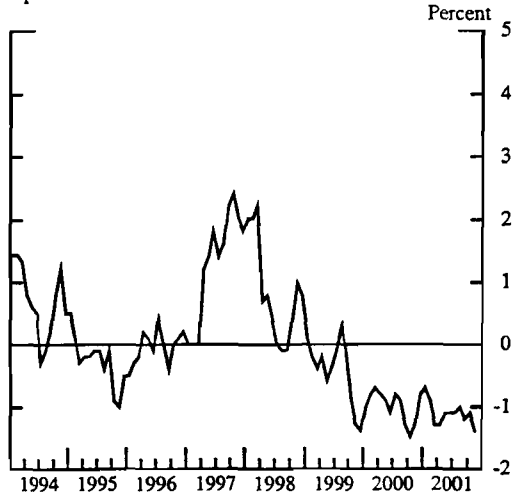
External Balances (Billions of U.S. dollars, s.a.a.r.)							
Country and balance	2001						
	Q1	Q2	Q3	July	Aug.	Sep.	Oct.
<i>Japan</i>							
Trade	67.6	50.3	55.6	32.1	62.5	72.1	37.4
Current account	101.9	67.0	97.7	84.7	85.9	122.4	n.a.
<i>Euro area</i>							
Trade ¹	11.4	49.2	62.1	90.4	54.7	41.3	n.a.
Current account ¹	-39.5	-39.9	-3.7	-42.4	45.4	-14.2	n.a.
<i>Germany</i>							
Trade	73.5	66.3	88.1	76.6	108.4	79.4	n.a.
Current account	-3.6	-8.0	-.7	-31.3	35.6	-6.4	n.a.
<i>France</i>							
Trade	.0	.1	.9	-.7	2.9	0.4	n.a.
Current account	4.0	1.5	5.6	6.3	7.3	3.2	n.a.
<i>Italy</i>							
Trade	8.9	6.5	-1.5	-16.2	.6	10.9	n.a.
Current account ¹	-7.7	-5.4	6.7	37.2	-6.3	-10.7	n.a.
<i>United Kingdom</i>							
Trade	-45.7	-52.3	-46.4	-41.3	-58.4	-39.5	n.a.
Current Account	-9.2	-22.1	n.a.	...	...	...	...
<i>Canada</i>							
Trade	55.8	44.0	33.1	32.6	30.5	36.1	n.a.
Current Account	35.6	23.4	14.3	...	...	...	...

1. Not seasonally adjusted.

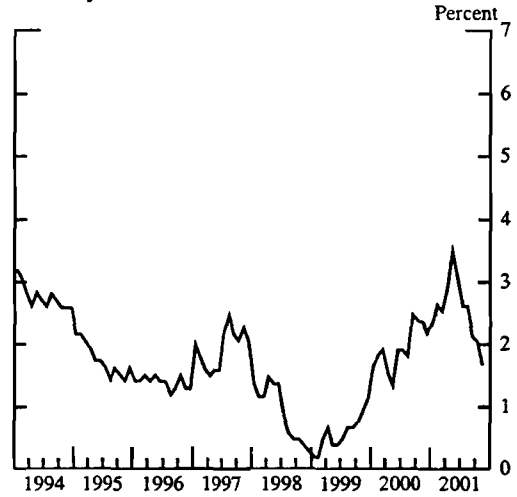
n.a. Not available. ... Not applicable.

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

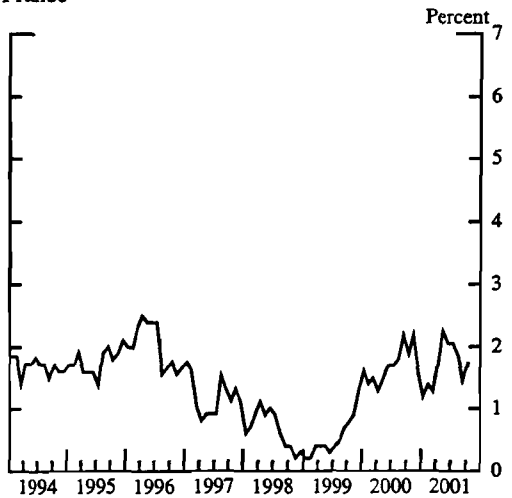
Japan



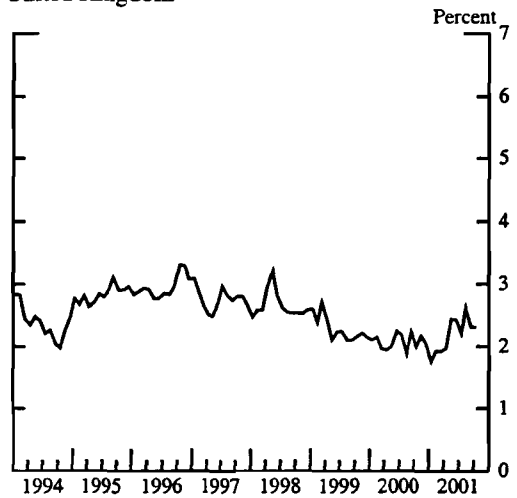
Germany



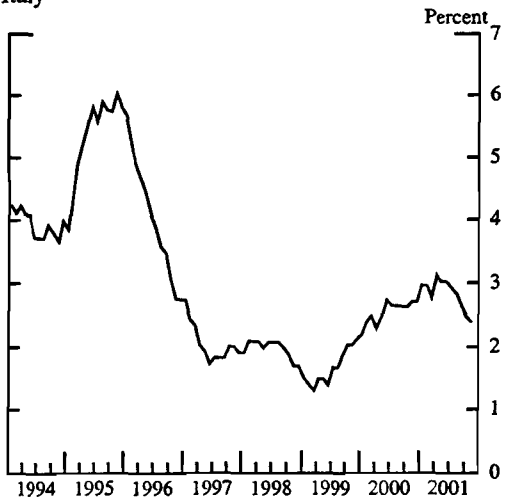
France



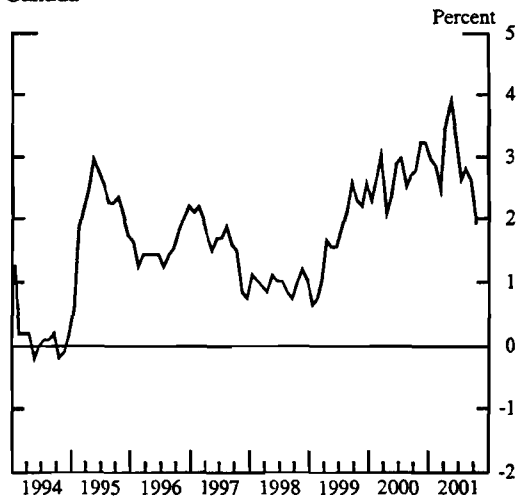
United Kingdom



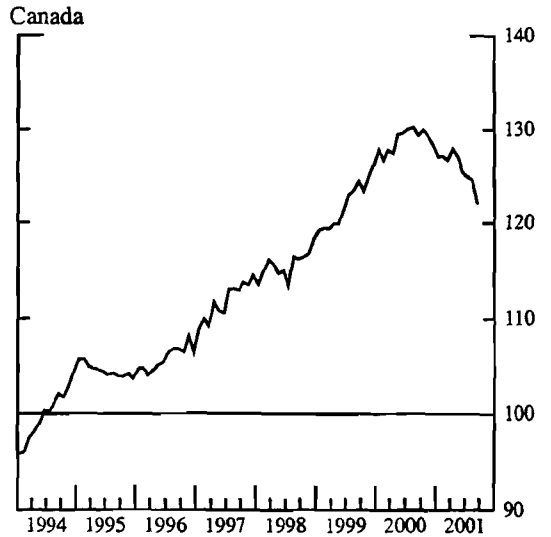
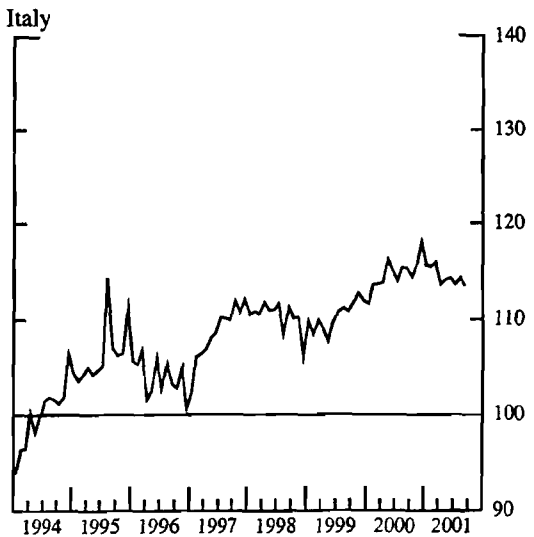
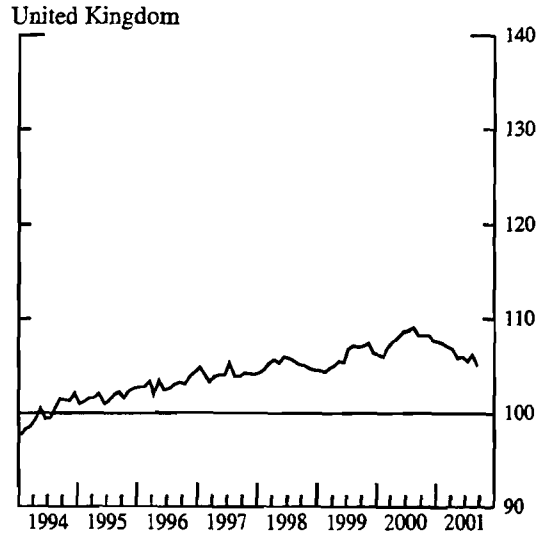
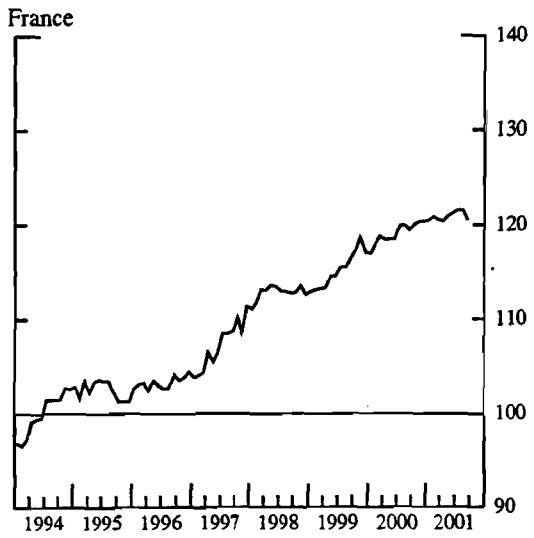
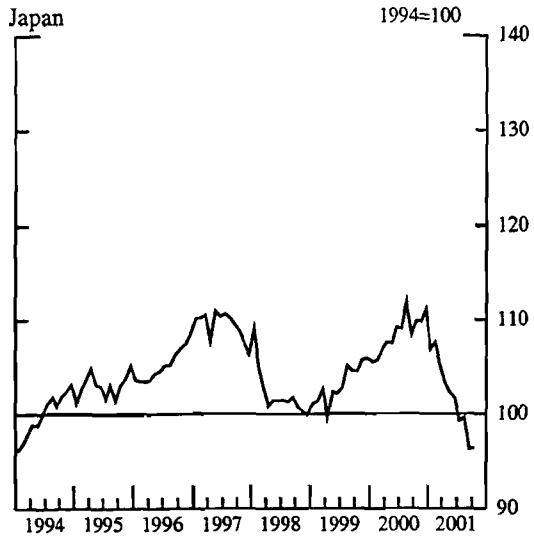
Italy



Canada



Industrial Production in Selected Industrial Countries



Economic Situation in Other Countries

Economic conditions in the major developing countries remain weak; however, signs have emerged that the worst may be over in some of the Asian economies that have been hardest hit by a slowdown in the high-tech sector. Singapore and Taiwan both reported sizeable increases in industrial production in October following difficulties in September, and Malaysia and Hong Kong recorded slightly positive GDP growth in the third quarter. In Latin America, recent data indicate that the global economic slowdown and ongoing Argentine financial troubles continue to hinder growth in the region. External demand remains subdued in all of the economies, and inflationary pressures are generally limited.

The situation in **Argentina** has worsened further since the last Greenbook, resulting in increased intensity of the financial turmoil in that country. Economic activity continues to contract. Industrial production fell 1.4 percent in October after a 3.8 percent decline in the third quarter. Construction, sales, and confidence indicators for October are all down significantly on a twelve-month basis. Prices in October were down 1.7 percent from a year earlier. October's trade balance was again positive, as exports rose slightly and imports fell over 30 percent from last year. Tax revenues posted another double digit decline in November from a year earlier and the government now projects a deficit of \$7.1 billion for 2001—exceeding the IMF deficit target by \$600 million. Private analysts expect the figure to be even larger.

Falling tax revenues have led to serious cash-flow problems for the Argentine government, which has taken several steps to address its funding needs. To reduce outlays, the federal government has signed agreements with the provinces to cut transfers in exchange for assistance in restructuring provincial debt. The government also announced a controversial two-part debt exchange of almost all of its publicly held debt to lessen debt servicing costs. The first part of the exchange targets local investors, including Argentine banks, pensions, and individuals and is scheduled for completion in early December. Preliminary results, reflecting primarily domestic institutional investors, have the government exchanging \$50 billion in federal and provincial debt for new instruments with lower interest rates and, in some cases, longer maturities. This is anticipated to lower interest and amortization costs \$6 billion in 2002. The exchange with international investors is expected in the first quarter of 2002. To meet immediate funding needs, the Argentine government borrowed upward of \$1 billion from the central bank in November.

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

Indicator	1999	2000	2001				
			Q2	Q3	Aug.	Sept.	Oct.
Real GDP ¹	-6	-2.4	1.1	n.a.	...	...	...
Industrial production	-5.8	-1.8	-1.7	-3.8	-2.7	-4	-1.4
Unemployment rate ²	13.8	15.1	16.4	...	...	...	n.a.
Consumer prices ³	-1.8	-.7	-.1	-1.1	-1.2	-1.1	-1.7
Trade balance ⁴	-.8	2.6	4.6	9.5	9.4	11.1	10.6
Current account ⁵	-12.0	-9.0	-4.0	n.a.	...	...	...

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

2. Percent, n.s.a. Data are released for May and October only. Figures for Q2 reflect data for May.

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

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

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

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

These actions proved insufficient to boost confidence; by the end of November spreads on sovereign debt were at record levels and bank depositors were panicking. After losing several billion dollars in deposits and central bank reserves in the last three days of November, the president issued several decrees on December 1 designed to restrict deposit and reserve outflows. The measures include a weekly limit on cash withdrawals from personal bank accounts, a prohibition on lending in pesos and a restriction that peso interest rates not exceed dollar rates, and strict controls on transfers of funds abroad (except for operations related to international trade). Spreads on Argentine sovereign debt have been extremely high and have risen steadily over the intermeeting period.

In **Mexico**, the economy continued to suffer from weak external demand and adverse confidence effects associated with the slowdown in the United States. Real GDP contracted about 1 percent in the third quarter, marking the fourth consecutive quarter of falling output. Indicators from the current quarter do not generally show any signs of a turnaround; exports remained depressed and the unemployment rate rose significantly in October, and business confidence remained low in November—although it recovered somewhat from the very weak September and October readings. The twelve-month inflation rate in October remained comfortably below the government's year-end target of 6½ percent.

In mid-November, the Mexican government proposed a budget that sets a fiscal deficit target of 0.65 percent of GDP for 2002, about the same as the deficit currently projected for this year. The government has chosen to keep fiscal policy tight, although with the government's assumptions about next year's oil prices already suspect, there has been some discussion in congress of possibly increasing the budget deficit target to one percent of GDP. Additionally, the proposed expenditure cuts are more severe than originally planned because the government is no longer assuming any lift to revenues through the passage of tax reform. In this year's proposed budget, the government is also reporting a projected public sector borrowing requirement (PSBR), which estimates the increase in public sector total net indebtedness, including net new lending by the development banks to the private sector. The PSBR projected for 2002 is 3.2 percent of GDP, about the same as in 2001. The budget is currently under debate in congress.

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

Indicator	1999	2000	2001				
			Q2	Q3	Aug.	Sept.	Oct.
Real GDP ¹	5.5	5.2	-1.0	-0.9	...	...	...
Overall economic activity	3.8	6.7	-0.4	-0.1	-0.2	.1	n.a.
Industrial production	4.4	6.3	-1.0	-0.3	-0.5	.3	n.a.
Unemployment rate ²	2.5	2.2	2.3	2.4	2.3	2.4	2.9
Consumer prices ³	12.3	9.0	6.9	6.0	5.9	6.1	5.9
Trade balance ⁴	-5.6	-8.0	-8.4	-9.2	-8.7	-8.6	-9.7
Imports ⁴	142.0	174.5	170.3	166.3	165.5	165.7	164.9
Exports ⁴	136.4	166.5	162.0	157.1	156.7	157.1	155.2
Current account ⁵	-14.0	-18.1	-13.8	-12.6	...	...	...

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

2. Percent; counts as unemployed those working one hour a week or less.

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

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

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

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

In **Brazil**, data releases since the last Greenbook have continued to point to weaker economic activity. Real GDP inched up 0.2 percent in the third quarter, as a large increase in agricultural output outweighed declines in other sectors of the economy. The unemployment rate jumped up in October. The consumer confidence index held steady in early November, but was down nearly

25 percent from its peak in March. Despite the weak economy, inflation rose in October, surpassing 7 percent on a twelve-month basis, reflecting mostly a rise in government-controlled prices and the pass-through of earlier depreciation of the *real* to domestic prices. This result is above the 6 percent ceiling of the government's inflation target range for 2001 (on a December-over-December basis). Weak domestic demand has contributed to an improvement in the trade balance since the second quarter.

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

Indicator	1999	2000	2001				
			Q2	Q3	Aug.	Sept.	Oct.
Real GDP ¹	4.0	4.3	.1	.2	...	...	...
Industrial production	-.7	6.6	-3.5	-1.8	.2	-.3	n.a.
Unemployment rate ²	7.6	7.1	6.2	6.1	6.1	6.3	6.8
Consumer prices ³	8.9	6.0	7.0	6.6	6.3	6.4	7.2
Trade balance ⁴	-1.3	-.7	-3.7	6.2	11.1	6.0	7.9
Current account ⁵	-25.4	-24.6	-27.4	-16.3	-13.7	-10.8	29.2

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

2. Percent. "Open" unemployment rate.

3. Percent change from year-earlier period, except annual figures, which are Dec./Dec. Price index is IPC-A.

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

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

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

Data on the **Venezuelan** economy point to weaker growth in economic activity, in line with falling oil prices. Third-quarter GDP rose 1.3 percent—well below the almost 6 percent average for 2000 and the current account fell 50 percent from the second quarter, to \$3.2 billion. Output growth primarily reflected massive public expenditure, particularly in construction. Large government outlays combined with declining oil revenues are generating sizable fiscal imbalances, and the deficit for next year is projected at 3 to 4 percent of GDP. Consumer price inflation ticked up to 12.7 percent on a twelve-month basis in November. The president recently signed laws that act to increase state control over Venezuelan industry, including a new Hydrocarbons Law that reverses Venezuela's seven-year trend of opening its oil sector to foreign firms. The laws are expected to reduce domestic and international investment, and the Venezuelan business community is organizing a work stoppage on December 10 in protest.

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

Indicator	1999	2000	2001				
			Q2	Q3	Sept.	Oct.	Nov.
Real GDP ¹	-4.1	5.7	1.0	1.3	...	...	...
Unemployment rate ²	15.2	13.4	13.6	13.1	13.5	n.a.	n.a.
Consumer prices ³	20.0	13.4	12.4	12.7	12.3	12.3	12.7
Non-oil trade balance ⁴	-9.1	-10.8	-11.9	n.a.	n.a.	n.a.	n.a.
Trade balance ⁴	7.6	18.0	11.8	n.a.	n.a.	n.a.	n.a.
Current account ⁵	3.7	13.4	6.4	3.2	...	...	...

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

2. Percent, n.s.a.

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

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

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

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

In **Korea**, real GDP increased strongly in the third quarter, boosted by a further increase in consumption, a slower rate of inventory reduction, and a surge in construction spending. In contrast, both exports and investment in facilities and equipment continued to decline. However, the third-quarter growth figure appears to overstate the underlying strength of activity, being supported by several temporary factors. Most important, the "Full Moon" holidays fell in October this year, rather than in September as they normally do, giving the third quarter three more working days than normal. Even taking account of this distortion, however, recent data on balance tend to confirm the resiliency of activity in recent quarters in the face of the slump in export demand.

Domestic demand this year has been supported by macroeconomic stimulus. The central bank has lowered its policy rate by a total of 125 basis points, tax rates have been reduced, and expenditures have been increased. In early November, the parliament approved 1.6 trillion won (\$1.3 billion) of additional spending. Combined with the 5 trillion won of supplemental budget expenditures approved in September, this provides spending stimulus amounting to 1-1/4 percent of GDP.

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

Indicator	1999	2000	2001				
			Q2	Q3	Sept.	Oct.	Nov.
Real GDP ¹	13.8	5.2	1.8	5.1	...	...	...
Industrial production	24.1	17.0	-1.5	1.6	2.9	-1.5	n.a.
Unemployment rate ²	6.3	4.1	3.7	3.5	3.3	3.5	n.a.
Consumer prices ³	1.3	3.1	5.3	4.3	3.2	3.5	3.4
Trade balance ⁴	28.4	16.9	16.6	11.9	11.7	7.6	n.a.
Current account ⁵	24.5	11.4	14.7	3.8	8.5	4.1	n.a.

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

2. Percent.

3. Percent change from year earlier, except annual changes, which are Dec./Dec.

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

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

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

While growth in the ASEAN region has declined markedly during the recent slowdown, data released since the last Greenbook indicate that economic activity may have bottomed out in some of the countries. Industrial production in Singapore surged in October, although electronics output continued to fall. Malaysia, a high-tech producer that was hammered in the second quarter, managed to squeak out 1 percent growth in the third quarter, in part owing to the government's large fiscal stimulus package. The Philippines has continued to perform reasonably well despite the global economic slowdown and surpassed market expectations with 2.7 percent growth in the third quarter, owing mainly to increased agriculture and service sector output. On the down side, real GDP in the third quarter fell slightly in Indonesia, another country that had been relatively insulated from the global slowdown up to this point.

Slow growth in the region has translated into low inflation, with each of the countries in the region registering stable or lower year-on-year inflation in October. For the most part, trade balances improved in the third quarter, as imports fell more sharply than exports. With the exception of Singapore, however, all of the countries in the region are on pace to post smaller trade surpluses this year than last year.

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

Indicator and country	1999	2000	2001				
			Q2	Q3	Aug.	Sept.	Oct.
<i>Real GDP¹</i>							
Indonesia	6.4	5.7	6.2	-1.0	...	...	...
Malaysia	11.5	6.4	-8.5	1.0	...	...	...
Philippines	5.1	3.9	6.4	2.7	...	...	...
Singapore	8.0	11.0	-9.7	-11.1	...	...	...
Thailand	6.4	3.1	.6	n.a.	...	...	...
<i>Industrial production²</i>							
Indonesia ³	-9	11.6	3.1	-1.9	-2.2	-0.4	n.a.
Malaysia	9.1	19.1	-5.3	1.1	0.8	-1.8	n.a.
Philippines	3.6	14.9	-9	3.4	14.7	-8.5	n.a.
Singapore	13.9	15.3	-6.2	-8.5	-2.4	-5.1	6.9
Thailand	12.5	3.2	-2	.3	1.8	.3	1.6

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

2. Annual figures are annual averages.

3. Staff estimate.

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

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

Country	1999	2000	2001				
			Q2	Q3	Aug.	Sept.	Oct.
Indonesia	24.7	28.6	22.3	27.4	30.1	25.1	29.8
Malaysia	19.1	16.0	13.9	15.0	14.5	14.6	13.1
Philippines	4.3	6.7	-1.3	-.1	-1.0	.2	n.a.
Singapore	3.6	3.3	6.0	4.8	8.0	1.6	2.0
Thailand	9.3	5.5	3.2	3.7	10.5	2.0	1.6

n.a. Not available.

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

Country	1999 ¹	2000 ¹	2001				
			Q2	Q3	Sept.	Oct.	Nov.
Indonesia	2.0	9.3	11.1	12.8	13.0	12.5	12.9
Malaysia	2.5	1.3	1.6	1.4	1.4	.9	n.a.
Philippines	4.3	6.6	6.7	6.4	6.1	5.4	n.a.
Singapore	.9	2.1	1.7	.8	.5	.2	n.a.
Thailand	.7	1.3	2.5	1.6	1.4	1.4	1.0

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

In **China**, recent indicators suggest that growth remains relatively strong. Industrial production moderated slightly in October, but retail sales were up from their September level, increasing by a robust 10.5 percent from a year earlier. The stronger than expected consumer demand pushed consumer prices slightly higher in October. Fixed asset investment by state-owned enterprises was up just 13 percent in October over the same month last year, down from the 20 percent increases registered earlier in the year. Exports declined for the first time since May, but imports dropped even more sharply, their second consecutive monthly decline, and the trade surplus widened markedly. Indicators of current and future foreign direct investment were down in October, but they have been relatively volatile in recent months owing to divergent pull and push factors; entry into the WTO has drawn foreign investment into China while the global economic slowdown has reduced the supply of foreign funds.

After a recent meeting of China's top policymakers, the government announced that it will implement stimulative measures to ensure that real GDP growth does not fall below 7 percent next year. The government is expected to issue 180 billion yuan in bonds next year, equivalent to 1.8 percent of GDP, just slightly higher than the amount this year.

Chinese Economic Indicators

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

Indicator	1999	2000	2001				
			Q2	Q3	Aug.	Sept.	Oct.
Real GDP ¹	4.1	8.0	7.5	6.9	...	...	...
Industrial production ²	8.0	11.4	10.6	8.5	8.1	9.5	8.8
Consumer prices ²	-1.0	1.5	1.6	.8	1.0	-1	.2
Trade balance ³	29.2	24.1	21.1	8.3	-8.4	14.9	30.6

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

2. Percent change from year earlier. Annual figures are year over year.

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

... Not applicable.

In **Hong Kong**, data received since the last FOMC meeting were mixed. Following a dismal second quarter, real GDP was up 1.6 percent in the third quarter, but other recent indicators were more negative. The unemployment rate increased to 5.5 percent in the August-to-October period, the highest level since early last year. The volume of retail sales was down nearly 2 percent in September from the previous month. Exports and imports both decreased by more than 6 percent in October. Consumer prices fell 1.2 percent over the twelve months ended October.

Hong Kong Economic Indicators

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

Indicator	1999	2000	2001				
			Q2	Q3	Aug.	Sept.	Oct.
Real GDP ¹	9.3	6.6	-5.5	1.6	...	...	...
Unemployment rate ²	6.3	5.1	4.5	5.3	4.9	5.3	5.5
Consumer prices ³	-4.0	-2.1	-1.3	-1.0	-1.1	-1.1	-1.2
Trade balance ⁴	-5.6	-11.0	-11.5	-14.0	-12.8	-13.4	-9.9

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

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

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

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

... Not applicable.

Indicators released over the past month suggest that the **Taiwanese** economy may have bottomed out. Despite a small increase in unemployment, industrial production rose 8.3 percent in October, almost exactly offsetting the large September decline. Exports and imports both increased by more than 20 percent from September, though they still remain well below levels recorded at the same time last year. The Council of Economic Planning and Development's index of leading indicators rose 2.5 percent from the previous month in October. This index has now risen for four out of the last five months, after declining in September. Consumer prices were up in October from year earlier levels after typhoons in Taiwan boosted food prices. Declines in other price measures, however, underlined weakness in the economy.

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

Indicator	1999	2000	2001				
			Q2	Q3	Aug.	Sept.	Oct.
Real GDP ¹	6.5	3.8	-10.1	-3.1	...	...	...
Unemployment rate ²	2.9	3.0	4.3	4.9	4.8	5.1	5.2
Industrial production	7.7	7.4	-2.9	-1.6	5.5	-8.0	8.3
Consumer prices ³	.1	1.7	.0	.0	.4	-.5	1.0
Trade balance ⁴	10.9	8.3	13.7	11.8	18.1	9.5	16.4
Current account ⁵	8.4	8.9	13.6	17.9	...	...	...

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

2. Percent.

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

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

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

... Not applicable.