Prefatory Note

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

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Class III FOMC - Internal (FR)

Part 2

August 4, 2005

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

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

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Domestic Nonfinancial Developments

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Overview

Led by strong growth in final sales, economic activity expanded at a solid pace in the second quarter. In particular, net exports surged and residential investment posted another robust gain. Consumer spending and business investment rose at moderate rates last quarter. However, manufacturing output decelerated a good bit, and the pace of inventory investment dropped considerably. In the past few months, the labor market has continued to improve gradually. On average, payrolls have expanded a bit more rapidly than we estimate is necessary to absorb net new entrants into the workforce, and the unemployment rate has edged down to 5 percent. Meanwhile, core consumer price inflation has moderated in recent months.

Labor Market Developments

The labor market continues to make steady progress: Private payroll employment rose 144,000 in June, bringing the average gain for the first half of the year to 172,000 jobs per month, roughly on par with the average monthly increase last year. Hiring in the services industries and in construction remained strong in June, but manufacturing employment declined further. Aggregate hours of production workers rose at an annual rate of 2.8 percent in the second quarter, a bit faster than in the first quarter. More recently, the four-week moving average of initial claims for unemployment insurance has fallen to 317,000 in the week ending July 30, noticeably below the mid-June readings.

In the household survey, the unemployment rate edged down 0.1 percentage point in June, to 5.0 percent, and the labor force participation rate dropped back 0.1 percentage point, to 66.0 percent. The unemployment rate currently stands about where it was in mid-1997, when we judge the labor market to have been roughly in equilibrium. Several other indicators are also approximately in line with their 1997 average levels. The share of persons working part-time for economic reasons, the short-term quit rate—which provides a measure of workers' perceptions of the relative abundance of alternative employment—new hiring plans (as measured by the Manpower survey), and the rate of insured unemployment have all moved back to the favorable levels of eight years ago.

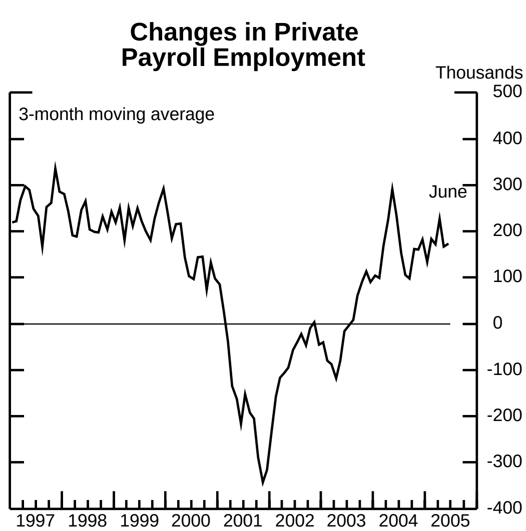
However, other indicators of labor market conditions are a bit weaker than their 1997 levels. According to the National Federation of Independent Business survey, the fraction of firms with a position described as hard-to-fill remains visibly below where it was eight years ago, an indication that smaller firms face few shortages of workers. Households' perceptions of job availability are also below the average level in 1997. In addition, many job seekers continue to experience long periods of job search. Despite

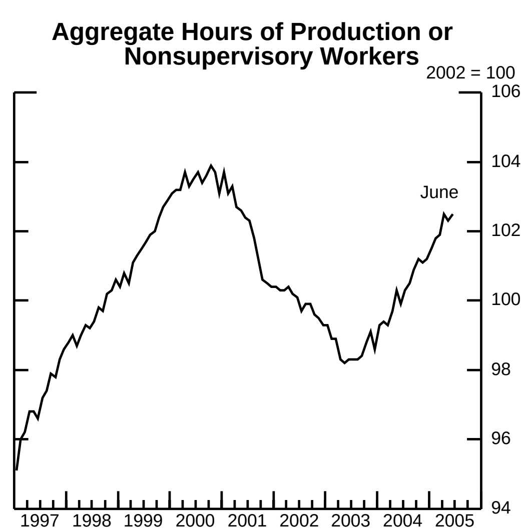
Changes in Employment

(Thousands of employees; seasonally adjusted)

Measure and sector	2004	2004 Q4	2005 Q1	2005 Q2	2005 Apr.	2005 May	2005 June
	Average monthly change				Monthly change		
Nonfarm payroll employment (establishment survey)	183	190	182	181	292	104	146
Private	171	182	172	173	278	97	144
Previous	171	182	172	...	261	73	...
Manufacturing	3	-6	-6	-15	-15	-6	-24
Construction	23	29	24	26	48	12	18
Wholesale trade	7	4	6	5	6	9	1
Retail trade	13	13	17	15	29	15	2
Transportation and utilities	9	5	18	10	20	10	1
Information	-2	0	2	6	18	-2	2
Financial activities	12	15	13	12	15	4	16
Professional and business services	45	53	41	38	47	10	56
Temporary help services	15	14	9	8	15	-1	9
Nonbusiness services[1]	59	67	51	74	107	43	71
Total government	12	8	10	8	14	7	2
Total employment (household survey)	146	210	115	379	598	376	163
Memo:							
Aggregate hours of private production workers (percent change)[2]	2.4	2.4	2.3	2.8	.6	-.2	.2
Average workweek (hours)[3]	33.7	33.7	33.7	33.7	33.8	33.7	33.7
Manufacturing (hours)	40.8	40.6	40.6	40.4	40.5	40.4	40.4

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



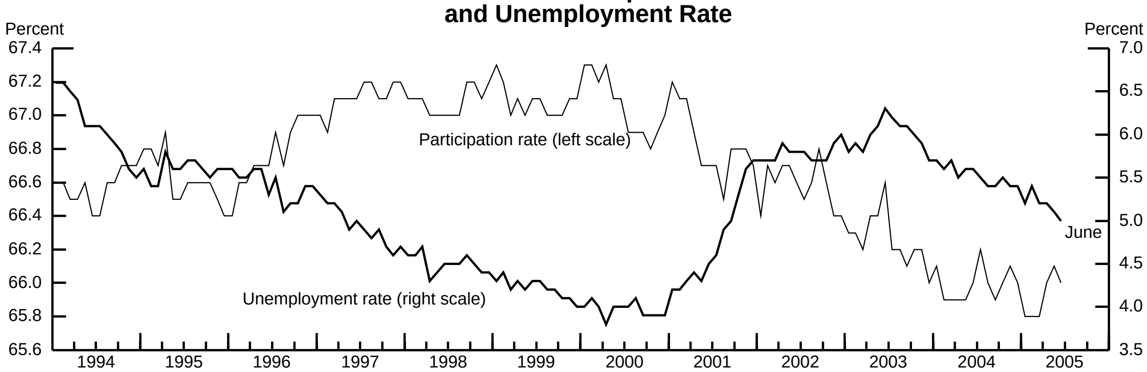


Selected Unemployment and Labor Force Participation Rates

(Percent; seasonally adjusted)

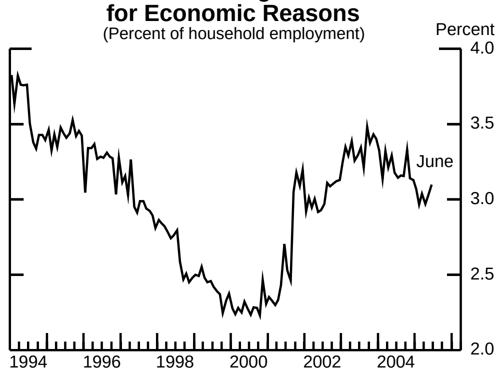
Rate and group	2004	2004 Q4	2005 Q1	2005 Q2	2005 Apr.	2005 May	2005 June
Civilian unemployment rate							
Total	5.5	5.4	5.3	5.1	5.2	5.1	5.0
Teenagers	17.0	17.1	16.9	17.3	17.7	17.9	16.4
20-24 years old	9.4	9.3	9.5	8.8	8.9	8.8	8.8
Men, 25 years and older	4.4	4.3	4.1	3.8	3.8	3.8	3.7
Women, 25 years and older	4.4	4.2	4.1	4.2	4.2	4.1	4.2
Labor force participation rate							
Total	66.0	66.0	65.8	66.0	66.0	66.1	66.0
Teenagers	43.8	44.1	43.5	43.9	43.8	44.0	43.9
20-24 years old	75.0	75.3	74.4	74.3	74.0	74.3	74.8
Men, 25 years and older	75.3	75.3	75.2	75.5	75.5	75.6	75.5
Women, 25 years and older	59.3	59.2	59.1	59.2	59.3	59.3	59.2

Labor Force Participation Rate and Unemployment Rate



Persons Working Part-Time for Economic Reasons

(Percent of household employment)

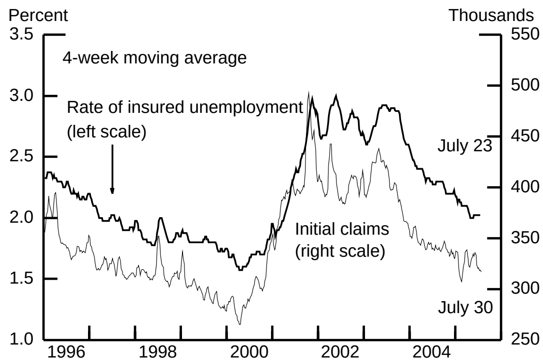


Short-Term Quit Rate

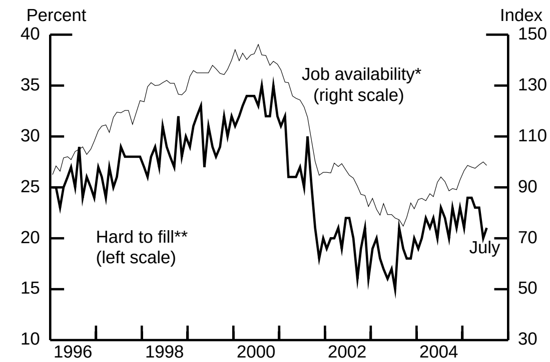
(Unemployed less than 5 weeks)

Labor Market Indicators

Unemployment Insurance

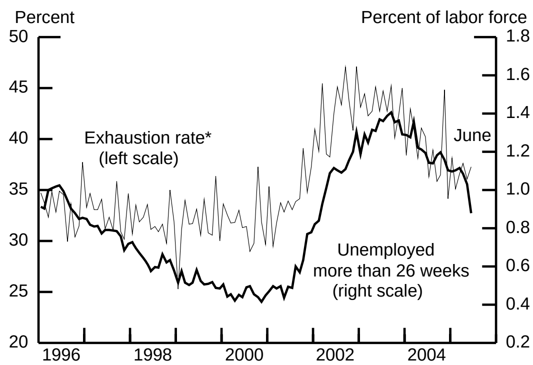


Labor Market Tightness



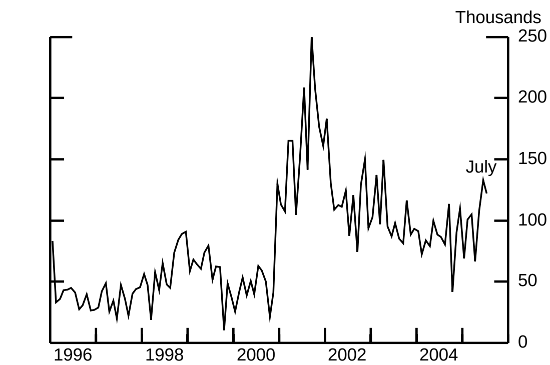
*Proportion of households believing jobs are plentiful, minus the proportion believing jobs are hard to get, plus 100.
**Percent of small businesses surveyed with at least one "hard to fill" job opening.
Source. For job availability, Conference Board; for hard to fill, National Federation of Independent Business.

Exhaustion Rate and Long-Term Unemployed



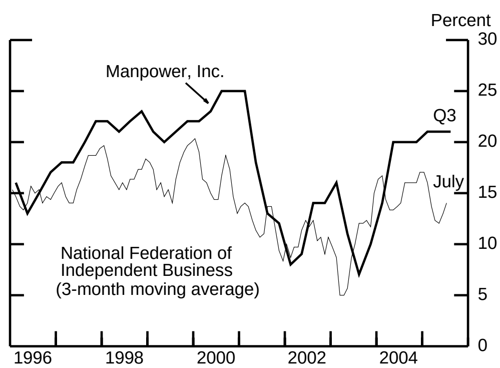
*Note. Seasonally adjusted by FRB staff. Exhaustion rate is number of individuals who exhausted benefits without finding a job, expressed as a share of individuals who began receiving benefits six months earlier.

Layoff Announcements



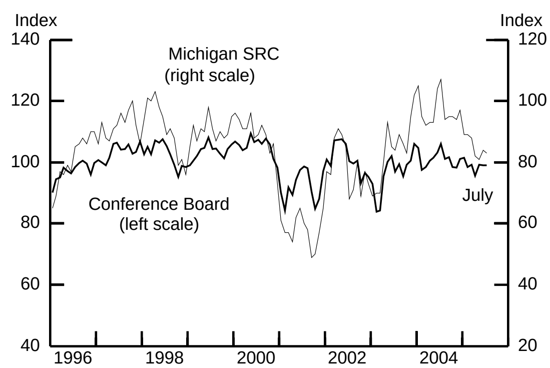
Note. Seasonally adjusted by FRB staff.
Source. Challenger, Gray, and Christmas, Inc.

Net Hiring Plans



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

Expected Labor Market Conditions



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

dropping lately, long-term unemployment is still high, and the exhaustion rate—the proportion of workers leaving the unemployment insurance (UI) rolls after having used their entire period of eligibility (usually twenty-six weeks)—remains somewhat elevated. Finally, the number of monthly layoff announcements, which should move down as labor market conditions improve, has not yet reached the low levels of the mid-1990s. On balance, these indicators suggest that the unemployment rate may be understating, if only a little, the amount of slack that remains in the labor market.

Based on the latest National Income and Product Accounts (NIPA) data, we now estimate that productivity in the nonfarm business sector increased at an annual rate of 3¼ percent in the first quarter and 2 percent in the second quarter. Over the four quarters ending in the second quarter of 2005, productivity rose an estimated 2¼ percent, a considerable step-down from the comparable period four quarters earlier.

Labor Output per Hour
(Percent change from preceding period at an annual rate;
seasonally adjusted)

Sector	2003	2004	2004	2005		2003:Q2 to 2004:Q2	2004:Q2 to 2005:Q2
			Q4	Q1	Q2		
Nonfarm business							
All persons	5.0	2.6	2.4	3.3	1.9	4.3	2.2
All employees[1]	5.5	2.5	2.1	3.7	1.8	4.2	2.6
Nonfinancial corporations[2]	4.4	4.7	8.5	3.6	1.6	3.2	5.2

Note. Annual changes are from fourth quarter of preceding year to fourth quarter of year shown. Data are staff estimates. Output in the nonfarm business sector was published as part of the annual revision to the national income and product accounts. However, output for the second quarter of 2005 and hours for the fourth quarter of 2004 and the first and second quarters of 2005 are staff estimates. Before 2004:Q4, the level of hours is published data.
1. Assumes that the growth rate of hours of non-employees equals the growth rate of hours of employees.
2. All corporations doing business in the United States except banks, stock and commodity brokers, and finance and insurance companies. The sector accounts for about two-thirds of business employment.

Industrial Production

Industrial production climbed 0.9 percent in June, led by a weather-related jump of 5.3 percent in the output of utilities. Manufacturing production advanced at a solid pace in both May and June. However, these gains followed small declines in the preceding two months. As a result, factory production rose at an annual rate of only 1½ percent in the second quarter, partly reflecting a slowing pace of inventory investment. Still, indicators for July suggest that the improved pace of activity in the late spring continued last month.

Selected Components of Industrial Production

(Percent change from preceding comparable period)

Component	Proportion 2004 (percent)	2004[1]	2005 Q1	2005 Q2	2005 Apr.	2005 May	2005 June
			Annual rate		Monthly rate		
Total	**100.0**	**4.3**	**3.6**	**2.1**	**-.3**	**.3**	**.9**
Previous	100.0	4.3	3.5	...	-.3	.4	...
Manufacturing	81.9	5.1	4.0	1.5	-.1	.5	.4
Ex. motor veh. and parts	74.7	5.3	4.1	2.0	.0	.5	.1
Ex. high-tech industries	70.2	4.4	2.6	1.3	-.1	.4	.1
Mining	8.3	-2.0	8.4	4.3	.0	.2	.4
Utilities	9.8	2.7	-3.2	6.0	-2.1	-.5	5.3
Selected industries							
High technology	4.5	18.7	29.4	12.8	.9	1.8	.2
Computers	1.0	6.9	14.9	15.2	1.3	1.3	1.2
Communications equipment	1.2	9.6	23.6	6.9	.2	4.1	-1.6
Semiconductors[2]	2.3	29.9	39.1	14.8	1.1	1.0	.8
Motor vehicles and parts	7.2	2.9	2.7	-4.3	-1.6	.4	2.9
Market groups excluding energy and selected industries							
Consumer goods	22.0	3.7	2.3	1.7	-.2	.7	.3
Durables	4.3	1.3	.2	-2.7	-.9	.3	.6
Nondurables	17.7	4.3	2.9	2.8	-.1	.8	.2
Business equipment	7.7	9.3	6.7	9.7	1.3	.7	.3
Defense and space equipment	1.9	6.1	9.3	16.9	1.9	.8	1.5
Construction supplies	4.3	3.8	4.3	2.9	.5	.1	-.4
Business supplies	8.1	3.2	5.1	2.1	.2	.3	.0
Materials	25.2	3.9	.4	-3.3	-.8	.1	-.3
Durables	13.9	4.6	.0	-4.3	-.9	.1	-.5
Nondurables	11.3	2.9	.9	-2.1	-.6	.0	.0

1. From fourth quarter of preceding year to fourth quarter of year shown.
2. Includes related electronic components.
... Not applicable.

Capacity Utilization

(Percent of capacity)

Sector	1972-2004 average	1982 low	1990-91 low	2004 Q4	2005 Q1	2005 Q2	2005 May	2005 June
Total industry	**81.0**	**70.8**	**78.6**	**78.8**	**79.3**	**79.5**	**79.4**	**80.0**
Manufacturing	79.8	68.5	77.2	77.6	78.1	78.2	78.2	78.4
High-tech industries	78.3	74.1	74.3	69.8	71.8	71.7	72.0	71.4
Excluding high-tech industries	79.9	68.2	77.3	78.5	79.0	79.1	79.1	79.3
Mining	87.1	78.6	83.5	85.6	87.5	88.6	88.6	89.0
Utilities	86.8	77.7	84.2	85.4	84.4	85.4	83.8	88.2

The second-quarter deceleration in manufacturing production was due, in part, to a contraction in motor vehicle output, as both medium and heavy truck assemblies and light vehicle production moved lower. Light vehicle assemblies fell to an annual rate of 11.1 million units in April and May—well below their first-quarter pace—as producers worked off elevated light truck inventories. In June, assemblies rebounded to a rate of 11.7 million units, and they are estimated to have remained at that rate in July. For the third quarter as a whole, manufacturers' schedules call for light vehicle production at an annual rate of 11.8 million units.

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

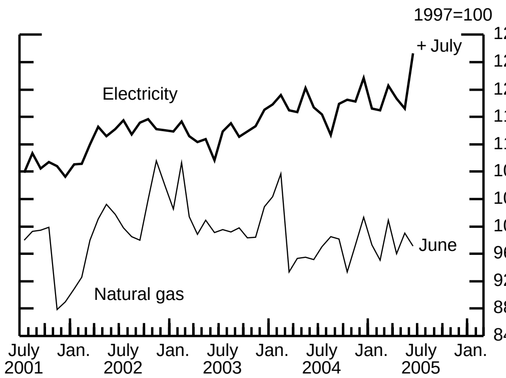
Item	2004	2005					
		Q1	Q2	Q3	May	June	July
U.S. production[1]	11.7	11.6	11.3	11.8	11.1	11.7	11.7
Autos	4.3	4.4	4.2	4.2	4.1	4.4	4.3
Light trucks	7.4	7.2	7.1	7.6	6.9	7.3	7.4
Days' supply[2]	74	73	66	n.a.	71	63	48
Autos	59	57	53	n.a.	53	54	47
Light trucks	83	85	75	n.a.	83	69	49
Inventories[3]	3.22	3.15	2.96	n.a.	3.05	2.96	2.66
Autos	1.02	.99	.93	n.a.	.92	.93	.88
Light trucks	2.20	2.15	2.03	n.a.	2.12	2.03	1.78
Memo: U.S. production, total motor vehicles[4]	12.0	12.1	11.7	12.1	11.5	12.1	12.2

Note. Components may not sum to totals because of rounding.
1. Production rates for July and the third quarter reflect the latest schedules from Ward's Communications.
2. Quarterly values are calculated with end-of-period stocks and average reported sales. July data are estimated.
3. End-of-period stocks. July data are estimated.
4. Includes medium and heavy trucks.
n.a. Not available.

In the high-tech sector, the pace of production growth has been only lukewarm of late. In June, the output of high-technology products edged up 0.2 percent, the smallest increase since December 2003 and well below the longer-run (1972–2004) average monthly gain of 1.6 percent (not at an annual rate). For the second quarter as a whole, the output of communications equipment posted a moderate increase, and computer production rose at an annual rate of 15 percent—a relatively modest gain by the standards of that sector but well above the meager 2004 increase. Nonetheless, anecdotal evidence on high-tech production has been positive. Recent industry reports point to strengthening business demand for communications equipment, which bodes well for domestic production because U.S. manufacturers specialize more in products geared toward business use. In

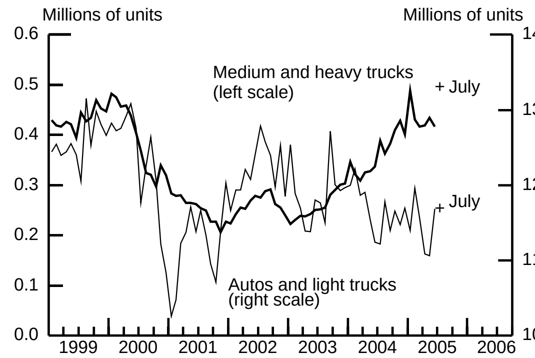
Indicators of Manufacturing Activity

Utilities Output



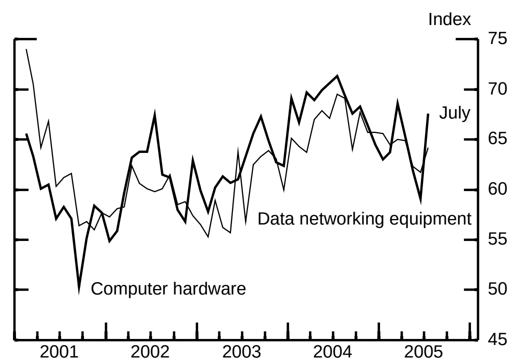
Note. July value for electricity generation is based on weekly data.

Motor Vehicle Assemblies



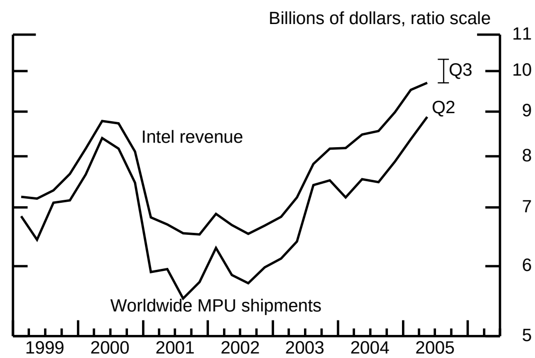
Note. July values are based on latest industry schedules.

CIO Magazine Future Spending
Diffusion Indexes



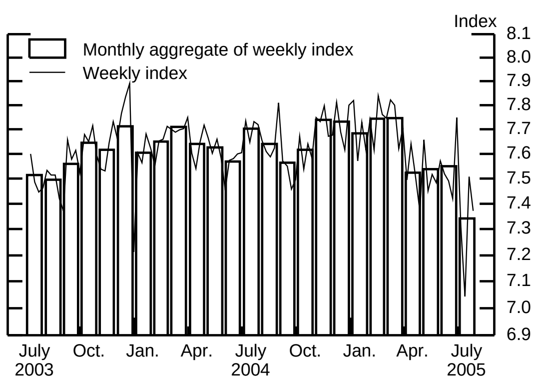
Note. The diffusion index equals the percentage of respondents planning to increase future spending plus one-half the percentage of respondents planning to leave future spending unchanged.
Source. CIO Magazine.

Microprocessor Unit (MPU) Shipments
and Intel Revenue



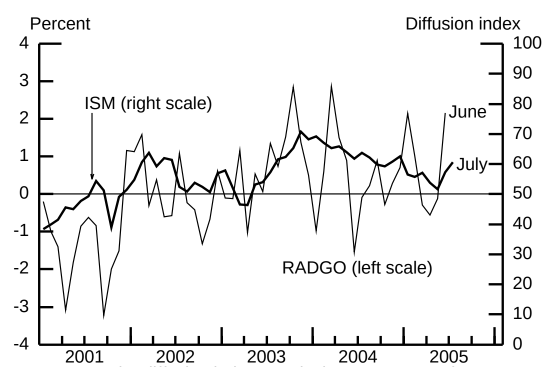
Note. Q3 is the range of Intel's guidance as of July 19, 2005. FRB seasonals.
Source. Intel and Semiconductor Industry Association.

Weekly Production Index Excluding Motor
Vehicles and Electricity Generation



Note. One index point equals 1 percent of 1997 total industrial output.

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



Note. The diffusion index equals the percentage of respondents reporting greater levels of new orders plus one-half the percentage of respondents reporting that new orders were unchanged. RADGO is a 3-month moving average.

addition, the *CIO Magazine* diffusion indexes of future spending plans for data networking equipment and computer hardware popped up in July.

Upstream from computers and communications equipment, the production of semiconductors has been sluggish. Output increased just 0.8 percent in June, capping a sharp deceleration for the second quarter as a whole. Going forward, Intel’s third-quarter guidance is consistent with accelerating production of microprocessors and flash memory, which make up almost one-fourth of industry semiconductor production. Moreover, the increased usage of the latest generation of semiconductor chips (such as dual-core microprocessors) may boost production in coming months.[1]

Elsewhere, industrial production showed mixed results in the second quarter. The index for business equipment rose at a annual rate of 9.7 percent, and the index for defense and space equipment shot up at a rate of nearly 17 percent. In contrast, the output of consumer goods slowed to a 1.7 percent gain, and the output of business and construction supplies rose more modestly than in the first quarter. Materials output, which accounts for about one-fourth of total industrial production, declined at an annual rate of 3.3 percent in the second quarter; drops in the production of paper and steel—industries in which inventories remain elevated relative to consumption—more than accounted for the decline.

The available weekly output data suggest uneven production growth in July. Total motor vehicle assemblies edged up, electricity generation increased a little further after an enormous rise in June, and lumber production appears to have rebounded from its drop in June. However, the output of crude oil was held down by the recent hurricane activity in the Gulf of Mexico. Among the forward-looking indicators, the staff’s series on real adjusted durable goods orders rose markedly in June, and the Institute for Supply Management’s new orders diffusion index moved higher in July. The regional indexes such as the Empire State Survey and the Philadelphia Business Outlook Survey also improved in July. Taken together, these series are consistent with solid near-term gains in manufacturing output.

[1] Dual-core microprocessors, which have started to appear in personal computers, permit users to engage simultaneously in two computationally intensive activities such as burning compact discs and manipulating digital photos and videos.

Motor Vehicles

After dipping in the first quarter, sales of light vehicles rebounded in the second quarter to an annual rate of 17.2 million units. In July, sales of light vehicles surged further to 20.6 million units. The jump in July sales reflected the extension of General Motors' (GM) employee-discount program and the introduction of similar programs by Ford and Chrysler.[2] These programs have proven to be immensely popular even though the Big Three automakers seem to have offset some of the cost of the new programs by cutting back on incentives that traditionally have been used to fuel sales.[3] Industry contacts suggest that customers may be responding positively to the programs' fixed, "no haggle" pricing. According to the Michigan Survey, the July sales increase—which was concentrated in light trucks—may also have benefited to some extent from diminished concerns about gasoline prices. Overall, the Michigan index of car-buying conditions jumped in July to its most favorable level since last December.

Reflecting the elevated pace of sales, inventories of light vehicles fell in June and are estimated to have declined again in July to their lowest level since early 2002.[4] Inventories appear to be particularly lean at GM, which reported that—excluding periods affected by strikes—its stock of light vehicles may be at the lowest level since 1975.

Consumer Spending

After having posted sizable gains in the second half of last year, real consumer spending expanded at a more moderate pace in the first half of this year. Excluding the wide swings in motor vehicles purchases, consumer outlays rose at an annual rate of more than 4 percent in the first quarter before decelerating to a 3 percent pace in the second. The moderation was consistent with the temperate fundamentals underlying consumption in the first half. More recently, both stock prices and consumer confidence have moved up from their levels earlier this year.

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[2] In early June, GM introduced its employee-discount program, which allowed the general public to purchase vehicles at the same prices as those offered to GM employees. Chrysler and Ford followed with similar programs in July. GM and Chrysler consumers can also take advantage of cash rebates or reduced-rate financing. In the Ford program, the employee-discount price is in lieu of cash rebates or reduced-rate financing. In June and July all three promotions covered most 2005 model-year vehicles. GM and Ford have extended their programs through September 6. Chrysler has reported plans to continue its program until its stock of 2005 model-year vehicles is exhausted.

[3] J.D. Power and Associates reports that the value of incentives fell sharply in June and again in July. The employee price programs represent a price cut and are not captured in these incentive series, which include only cash rebates and reduced-rate financing.

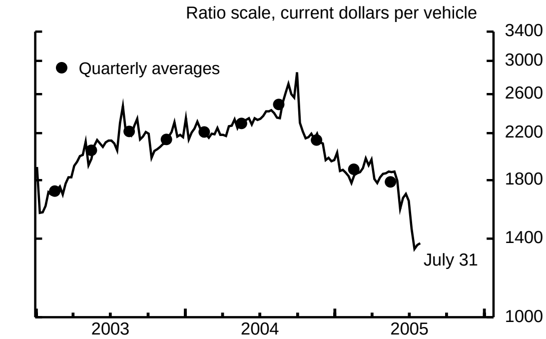
[4] Estimates of light vehicle inventories in July are based on actual reported sales and estimated light vehicle production from Ward's Communications.

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

Category	2004	2004 Q4	2005 Q1	2005 Q2	2005 May	2005 June	2005 July
Total	16.9	17.1	16.5	17.2	16.6	17.8	20.6
Autos	7.5	7.7	7.5	7.6	7.5	7.5	8.1
Light trucks	9.4	9.4	9.0	9.6	9.1	10.3	12.6
North American[1]	13.5	13.5	13.2	13.7	13.2	14.3	17.0
Autos	5.4	5.4	5.4	5.4	5.3	5.2	5.7
Light trucks	8.1	8.1	7.8	8.3	7.9	9.1	11.2
Foreign-produced	3.4	3.6	3.3	3.5	3.4	3.5	3.7
Autos	2.1	2.3	2.1	2.2	2.2	2.2	2.4
Light trucks	1.2	1.3	1.2	1.3	1.2	1.3	1.3
Memo: Big Three market share (percent)	58.7	57.0	57.7	58.4	57.5	61.0	61.5

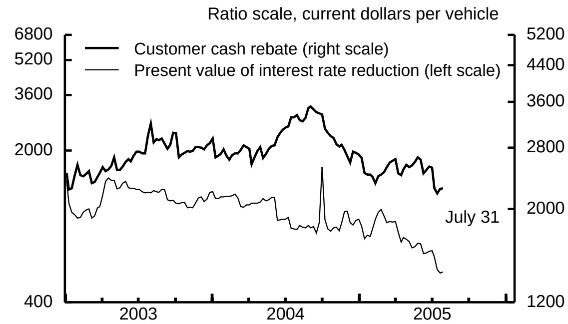
Note. Components may not sum to totals because of rounding. Data on sales of trucks and imported autos for the most recent month are preliminary and subject to revision.
1. Excludes some vehicles produced in Canada that are classified as imports by the industry.

Average Value of Incentives on Light Vehicles



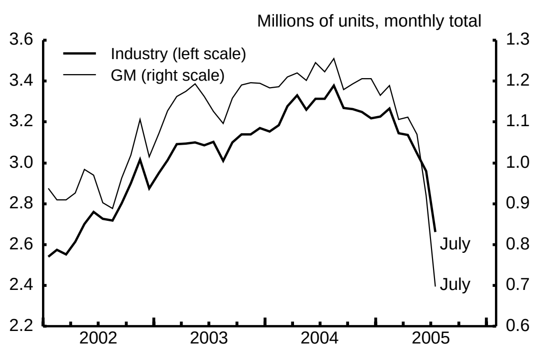
Note. Weighted average of customer cash rebate and interest rate reduction. Data are seasonally adjusted.
Source. J.D. Power and Associates.

Average Value of Incentives on Light Vehicles with Incentives



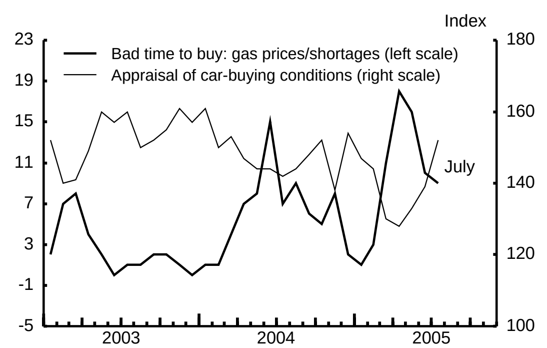
Source. J.D. Power and Associates.

Inventories of Light Vehicles



Note. FRB seasonals. July data are forecasted.

Michigan Survey Index of Car-Buying Attitudes

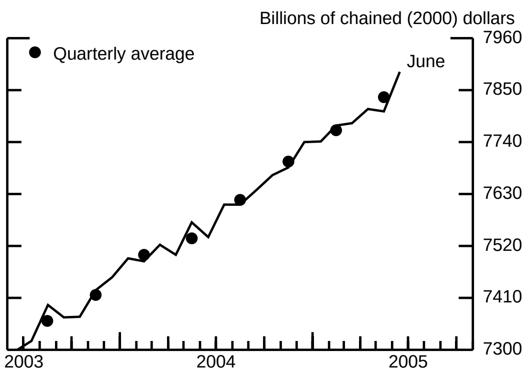


Real Personal Consumption Expenditures
(Percent change from the preceding period)

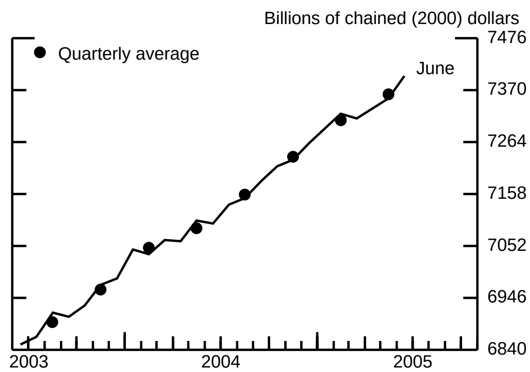
	2004		2005				
	H1	H2	Q1	Q2	Apr.	May	June
	Annual rate				Monthly rate		
Total real PCE[1]	3.3	4.4	3.5	3.6	.4	-.1	1.1
Durable goods[1]	2.4	8.1	2.6	11.3	1.6	-3.1	5.4
Motor vehicles[1]	-2.7	7.5	-8.0	16.7	2.2	-6.2	9.7
Excluding motor vehicles	6.7	8.6	12.0	7.1	1.2	-.5	2.0
Nondurable goods	4.6	4.7	5.3	3.3	.8	.3	.9
Energy	-.5	2.0	9.5	-3.2	-.2	1.9	-1.7
Other	5.2	5.0	4.8	4.1	.9	.0	1.2
Services	2.8	3.5	2.8	2.3	-.1	.4	.3
Energy	-3.1	10.8	1.3	3.2	-3.5	1.6	1.7
Other	3.1	3.2	2.8	2.3	.1	.3	.3

1. Values for 2005:Q2 and June are staff estimates.

Real PCE*

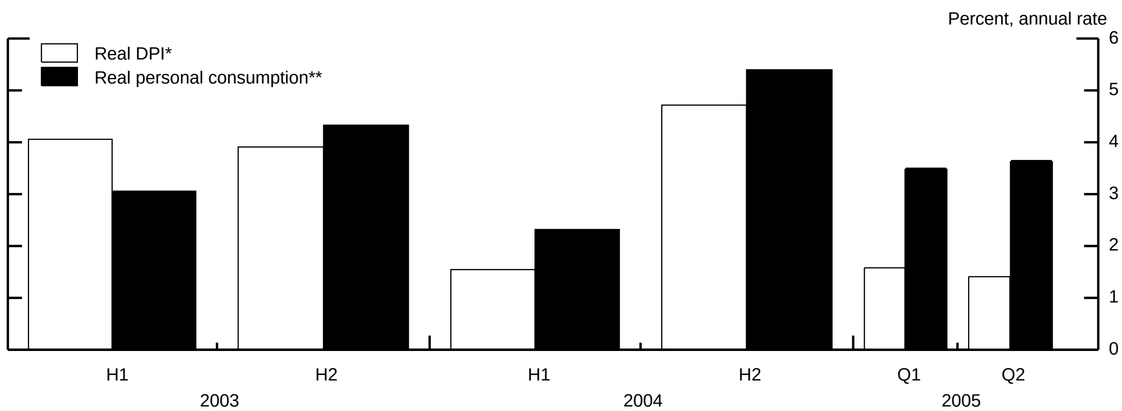


Real PCE Excluding Motor Vehicles



* Values for 2005:Q2 and June are staff estimates.

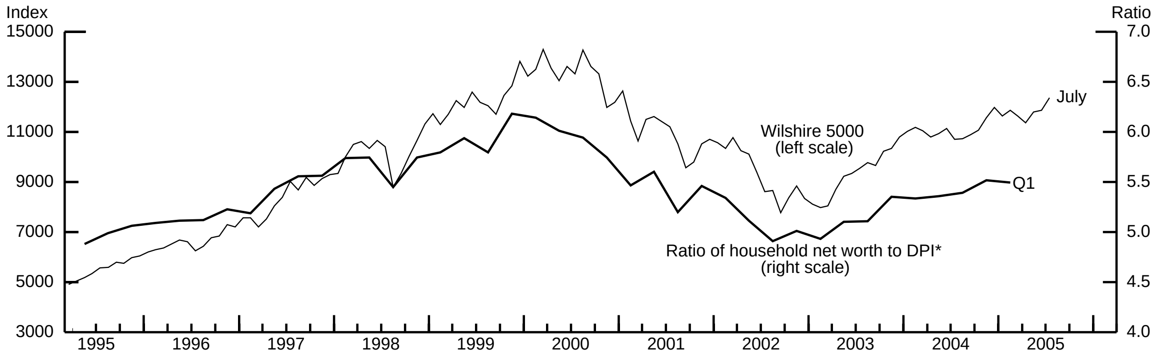
Changes in Real DPI and Real PCE



* Values for 2004:H2 and 2005:Q1 exclude the effect on income of the one-time Microsoft dividend in December.
** Value for 2005:Q2 is a staff estimate.

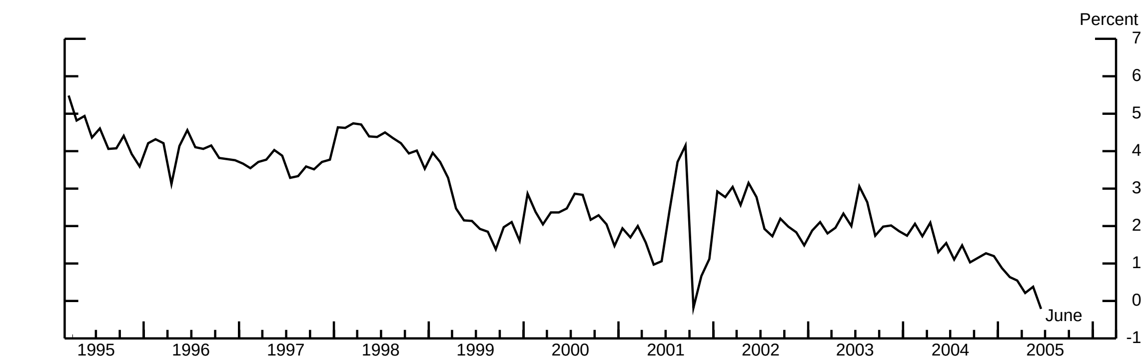
Household Indicators

Household Net Worth and Wilshire 5000



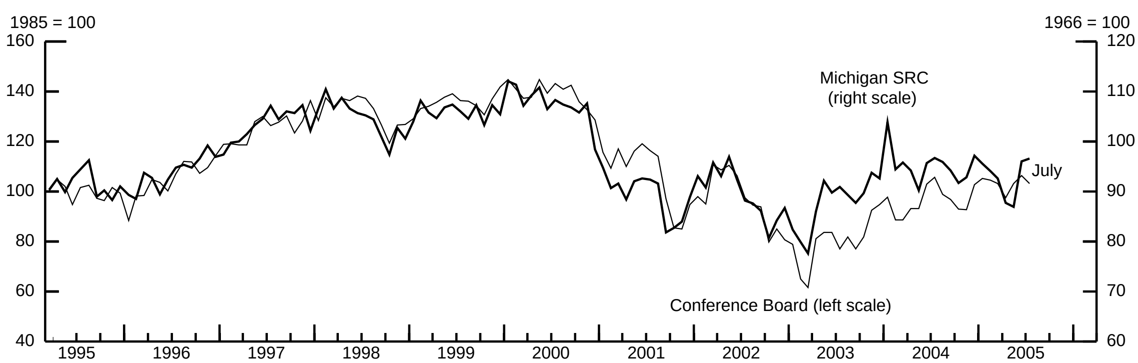
* Value for 2004:Q4 excludes the effect on income of the one-time Microsoft dividend in December.

Personal Saving Rate



Notes. Value for December 2004 excludes the effect on income of the one-time Microsoft dividend in that month.
Value for June 2005 is a staff estimate.

Consumer Confidence



The monthly pattern of consumer spending was uneven in the second quarter. After increasing solidly in April, total real personal consumption expenditures edged down in May and then jumped 1.1 percent in June.[5] Sales of cars and trucks rose sharply in June, and outlays for a broad range of other goods also surged, putting spending on a strong trajectory going into the current quarter. Expenditures on services expanded at a solid pace again in June as unseasonably warm weather boosted electricity usage.

Going forward, the most recent indicators suggest that spending in July rose at a good clip. Purchases of motor vehicles climbed to a dizzying pace, and sales at the largest chain stores are reported to have been brisk. In addition, the July readings of consumer sentiment from both the Michigan Survey and the Conference Board remained at levels consistent with healthy spending gains.

Real disposable personal income rose 0.5 percent in June but moved up at an annual rate of just 1.4 percent for the second quarter as a whole. Although nominal wages and salaries posted a moderate rise last quarter, real income was held back by the jump in energy prices. With increases in spending outpacing gains in disposable personal income in recent months, the personal saving rate is estimated to have fallen to close to zero last quarter. Household wealth appears to have increased roughly in line with income in the first half of the year, leaving the wealth-to-income ratio nearly unchanged. Movements in stock prices since June should have a more favorable effect on consumer demand.

Housing

Activity in the residential construction sector has remained quite robust. New single-family homes were started at an annual rate of 1.67 million units in June, well above last year's pace and only a little below the average rate over the first half of this year. After having dipped in May, starts of multifamily units rebounded to an annual rate of 337,000 units in June. The permits data for both sectors suggest that residential construction will remain solid in the near term. Permit issuance for single-family homes—after adjusting for activity in areas where they are not required—rose to 1.68 million units in June. Moreover, the backlog of unused permits for single-family units increased substantially.

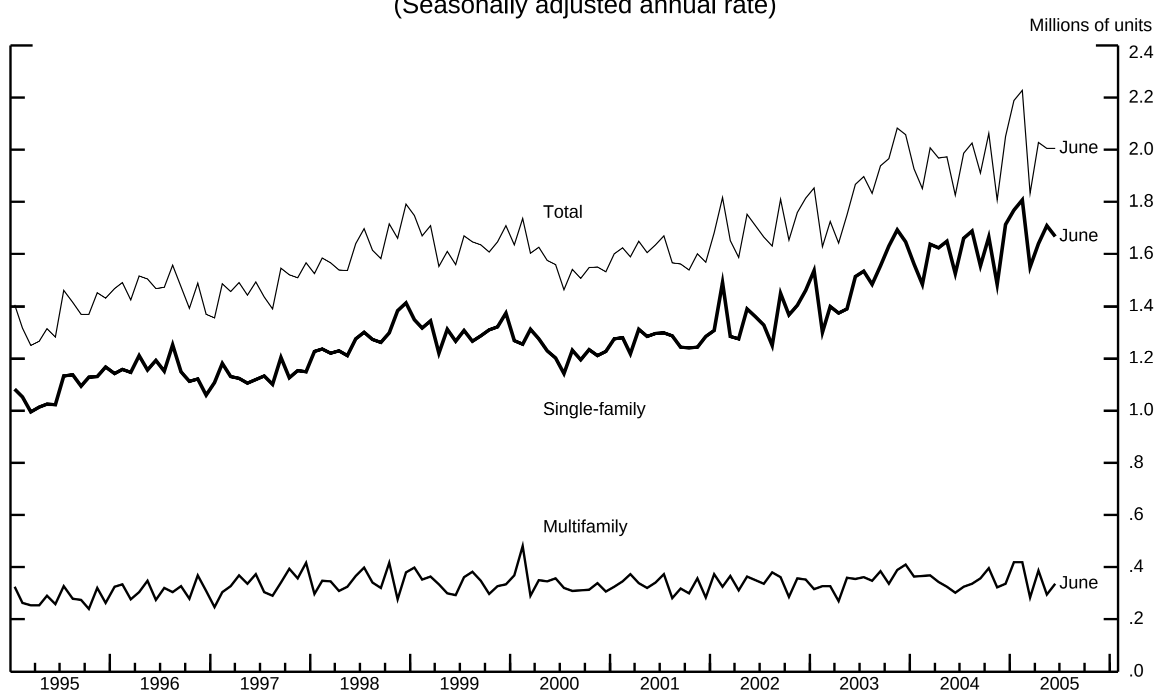
[5] The BEA estimates that real PCE rose 0.8 percent in June. Because registration data are not yet available, this estimate includes the BEA's assumption about the share of motor vehicles sold to consumers rather than to businesses. Based on our discussions with automakers, we believe this assumption is too low and does not adequately reflect the popularity of GM's employee-discount program with consumers. The alternative assumption that we have used boosts PCE growth in the second quarter but has an offsetting effect on the growth rate of business investment.

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

Sector	2004	2005 Q1	2005 Q2	2005 Apr.	2005 May	2005 June
All units						
Starts	1.96	2.08	2.01	2.03	2.00	2.00
Permits	2.05	2.08	2.11	2.15	2.06	2.13
Single-family units						
Starts	1.61	1.71	1.67	1.64	1.71	1.67
Permits	1.60	1.60	1.64	1.64	1.63	1.65
Adjusted permits[1]	1.64	1.63	1.67	1.67	1.66	1.68
Permit backlog[2]	.151	.150	.165	.155	.154	.165
New home sales	1.20	1.25	1.33	1.28	1.32	1.37
Existing home sales	5.96	5.98	6.29	6.28	6.22	6.37
Multifamily units						
Starts	.35	.37	.34	.39	.30	.34
Permits	.46	.48	.47	.51	.43	.48
Permit backlog[2]	.075	.068	.062	.064	.063	.062
Mobile homes						
Shipments	.131	.137	.128	.129	.127	.128
Condos and Co-ops						
Existing home sales	.82	.85	.93	.90	.92	.96

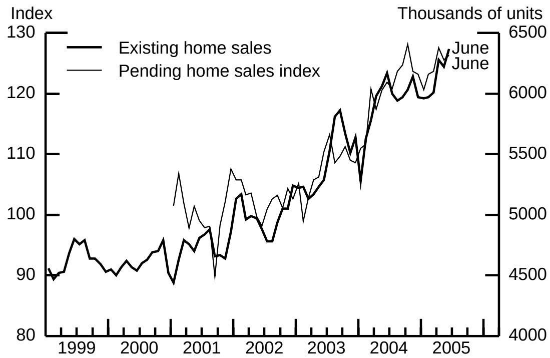
1. Adjusted permits equal permit issuance plus total starts outside of permit-issuing areas.
2. Number outstanding at end of period. Seasonally adjusted by Board staff. Excludes permits that have been canceled, abandoned, expired, or revoked. Not at an annual rate.

Private Housing Starts
(Seasonally adjusted annual rate)



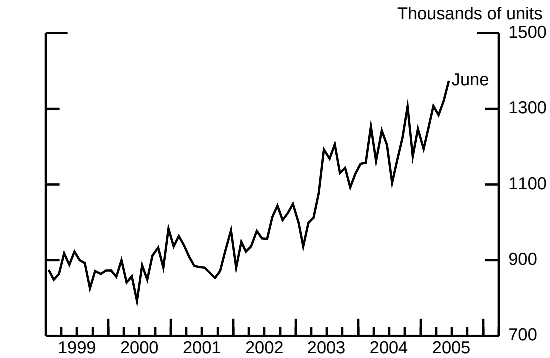
Indicators of Single-Family Housing

Existing Home Sales



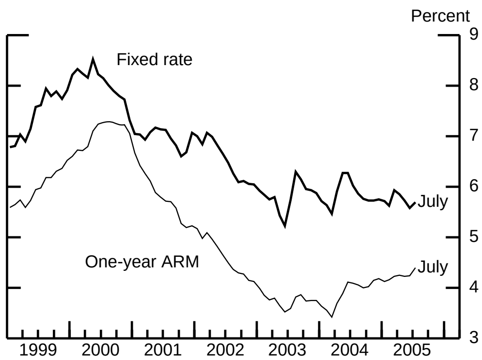
Source. National Association of Realtors.

New Home Sales



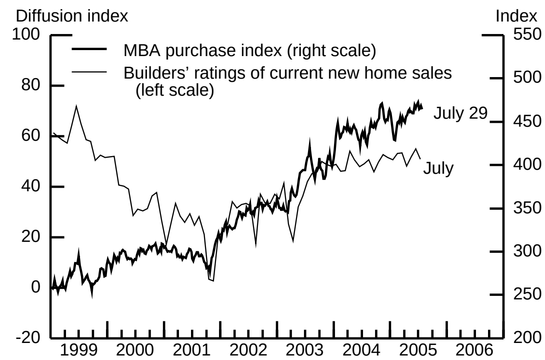
Source. Census Bureau.

Mortgage Rates



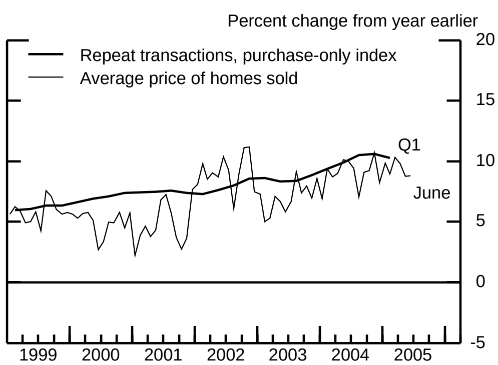
Note. The July readings are based on data through July 27.
Source. Freddie Mac.

Homebuying Indicators



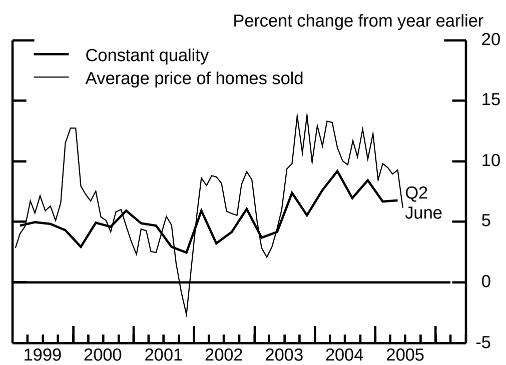
Note. MBA index is a 4-week moving average. Builders' ratings are seasonally adjusted by Board staff.
Source. Mortgage Bankers Association and National Association of Home Builders.

Prices of Existing Homes



Source. For repeat transactions, OFHEO; for average price, National Association of Realtors.

Prices of New Homes



Note. Average price of homes sold is a 3-month moving average.
Source. Census Bureau.

Home sales remained strong in June. Sales of single-family existing homes rose 2½ percent in June to an annual rate of 6.37 million units, well above last year's average level. New home sales also continued to increase briskly, jumping 4 percent in June to an annual rate of 1.37 million units. Housing demand continues to receive a boost from low long-term mortgage rates. Rates on thirty-year fixed-rate mortgages stood at about 5.8 percent in early August. However, rates for one-year adjustable-rate mortgages have continued to move up gradually—increasing roughly 40 basis points so far this year. Available indicators suggest that home sales will continue at a good clip in July. The pending home sales index—which provides advance information about existing home sales in the near term—edged up in June, and the four-week moving average of mortgage applications for purchase remained in an elevated range.

Prices of existing homes have continued to climb sharply, while the rate of price appreciation for new homes has shown some signs of moderating. The average sales price of existing homes in June was 9½ percent higher than that of a year earlier, about the same pace of appreciation as twelve months ago. In the new-home market, the constant-quality price index—which controls for changes in the geographic composition of sales, home size, and a few other readily measurable attributes—was up 6¾ percent in the second quarter from the level of a year earlier, down somewhat from the 9¼ percent increase four quarters earlier. Recent sales of new-home sales have been more heavily weighted toward houses priced below the median, and, as a result, the average price of new homes has decelerated noticeably more than the constant-quality index.

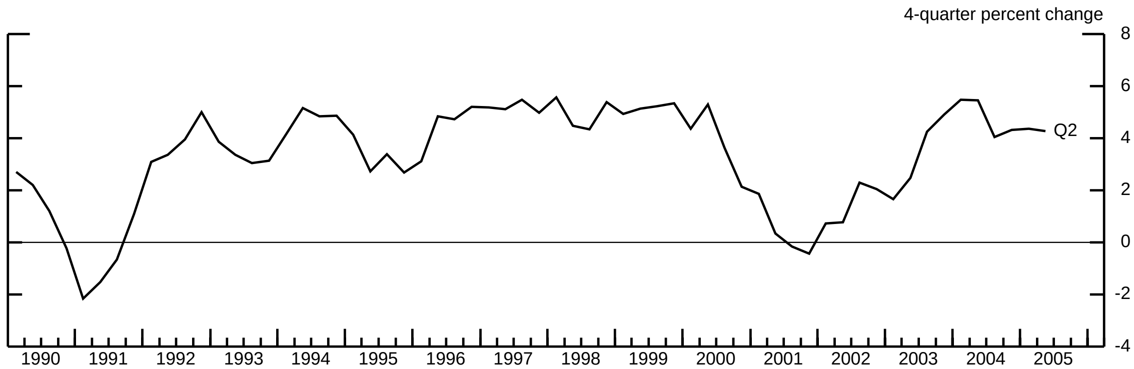
Equipment and Software

Business spending on equipment and software has been expanding at solid, if unspectacular, rates. We now estimate that real outlays on equipment and software increased at an annual rate of 8 percent in the second quarter, about the same as the first-quarter pace. Although outlays for transportation equipment shot up last quarter, spending growth outside of this volatile category was markedly slower than earlier in the year. Nonetheless, fundamentals remain conducive to gains in capital spending: Business output continues to expand, financing conditions remain favorable, and although increases in corporate cash flow have tapered off over the past year, many firms still are holding ample stockpiles of liquid assets. Moreover, according to survey evidence, businesses are optimistic about the near-term outlook.

In the high-tech sector, real business spending slowed to an annual rate of 15 percent in the second quarter from the 26 percent pace in the first quarter, despite another

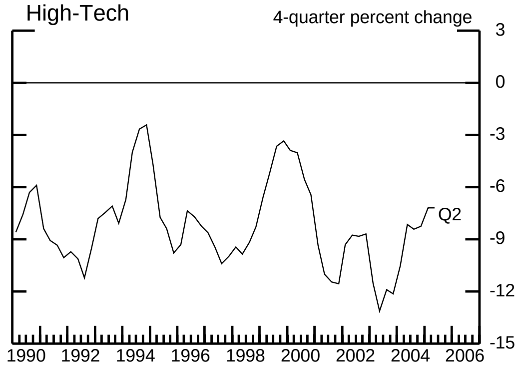
Equipment and Software Investment Fundamentals

Real Business Output

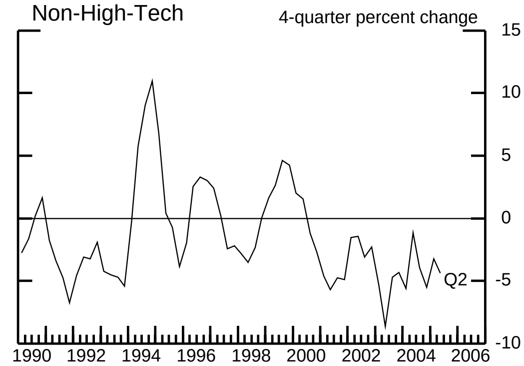


User Cost of Capital

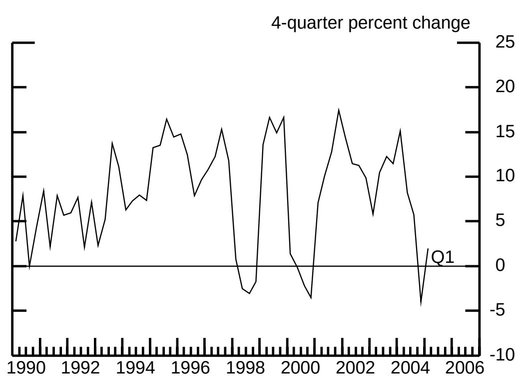
High-Tech



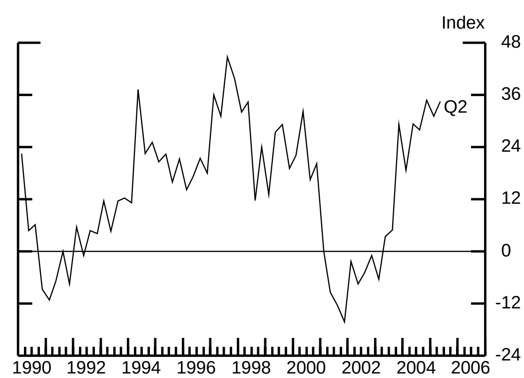
Non-High-Tech



Real Corporate Cash Flow



NABE Capital Spending Diffusion Index



Note. The diffusion index equals the percentage of respondents planning to increase spending minus the percentage of respondents planning to reduce spending.
Source. NABE Industry Survey.

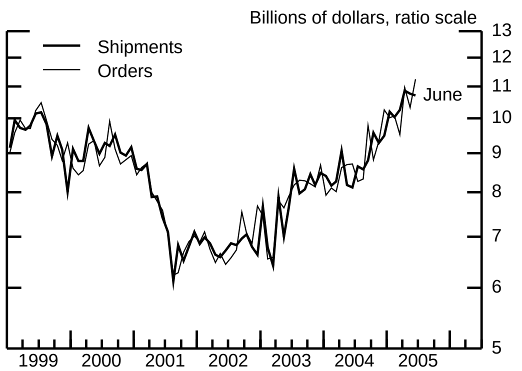
Orders and Shipments of Nondefense Capital Goods

(Percent change; seasonally adjusted current dollars)

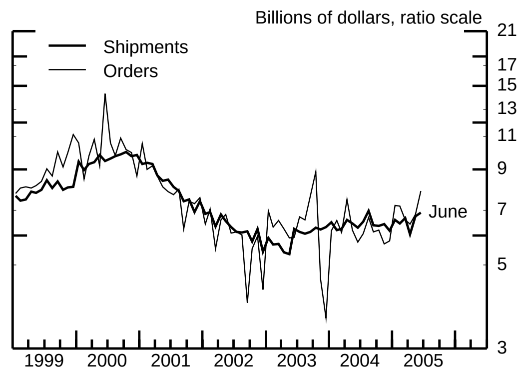
Indicators	2005 Q1	2005 Q2	2005 Apr.	2005 May	2005 June
	Annual rate		Monthly rate		
Shipments	12.8	9.9	2.3	.3	.0
Excluding aircraft	14.0	5.0	1.5	1.2	-.4
Computers and peripherals	33.9	26.9	6.0	-.9	-.5
Communications equipment	16.2	-.4	-9.3	11.4	2.4
All other categories	10.0	1.5	2.0	.5	-.8
Orders	7.6	56.3	4.0	16.1	-1.8
Excluding aircraft	21.8	2.8	1.7	-.7	3.9
Computers and peripherals	18.0	45.8	15.2	-5.8	8.8
Communications equipment	99.3	2.0	-2.8	6.3	15.4
All other categories	14.9	-4.3	-.3	-.5	1.3
Memo:					
Shipments of complete aircraft[1]	23.9	n.a.	34.4	28.2	n.a.

1. From Census Bureau, Current Industrial Reports; billions of dollars, annual rate.
n.a. Not available.

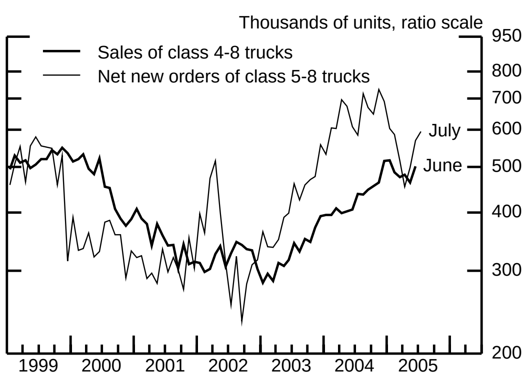
Computers and Peripherals



Communications Equipment

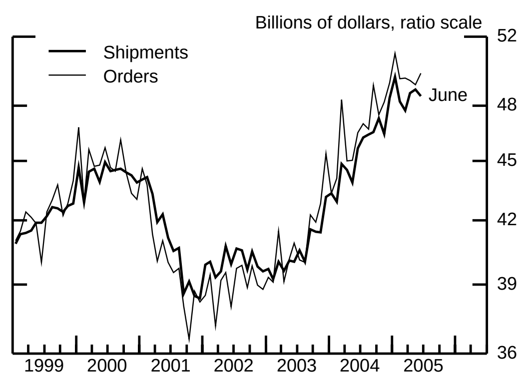


Medium and Heavy Trucks



Note. Annual rate, FRB seasonals.
Source. For class 4-8 trucks, Ward's Communications; for class 5-8 trucks, ACT Research.

Other Equipment



appreciable increase in real outlays for computers and peripherals last quarter. Spending on communications equipment rose at a subdued pace in the second quarter following a large first-quarter gain. Similarly, increases in software spending stepped down substantially last quarter. However, revenue guidance from major software vendors bodes well for future spending in this category.

Real outlays on transportation equipment jumped in the second quarter. Real business purchases of light vehicles soared, led by increased demand for high-end light trucks. In contrast, real spending for medium and heavy trucks was little changed last quarter. Still, new orders for medium and heavy rigs shot up in June and rose further in July. Elsewhere in the transportation sector, real business outlays for aircraft increased in the second quarter—albeit from their lowest level in a decade—and domestic orders of aircraft picked up in May and June for the first time in a year.

Investment spending on non-high-tech, non transportation equipment declined at an annual rate of 3 percent in the second quarter, with the downturn concentrated in the machinery category. Nonetheless, new orders outstripped shipments again in June, and the backlog of unfilled orders rose for the seventeenth consecutive month. Furthermore, the positive July readings on orders and shipments from the surveys of manufacturers by the ISM and the Philadelphia and New York Reserve Banks point to near-term gains in this sector.

Nonresidential Construction

Although conditions in nonresidential property markets seem to be firming a bit, spending on nonresidential construction remains at low levels. The vacancy rate for industrial buildings began heading down early last year, but even so, outlays on manufacturing structures have fallen in the past couple of months and have been roughly flat since the end of last year. Spending in other categories has also been uninspiring over the past few quarters. Outlays for commercial buildings have been about flat even though retail vacancy rates continue to be low. Office construction remains at a depressed level despite a downward-trending vacancy rate, while outlays in the “other” category have been edging down for some time. In the drilling and mining sector, expenditures resumed an upward trajectory in the second quarter.

Business Inventories

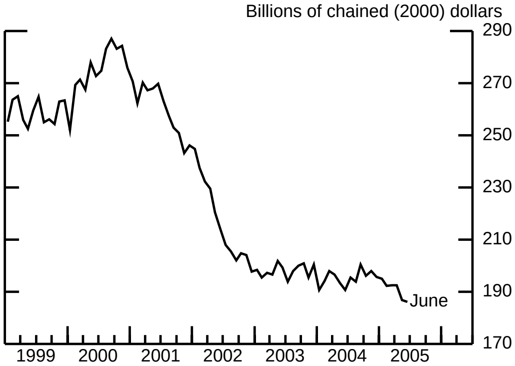
With June data for manufacturing inventory investment in hand, we now estimate that real nonfarm inventories edged down slightly in the second quarter after having increased

Nonresidential Construction and Indicators

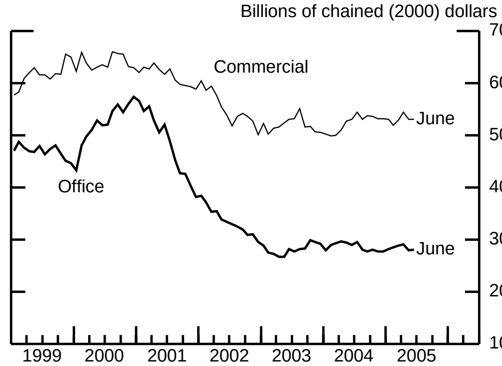
Real Construction

(Seasonally adjusted, annual rate; nominal CPIP deflated by BEA prices through Q1 and by staff projection thereafter)

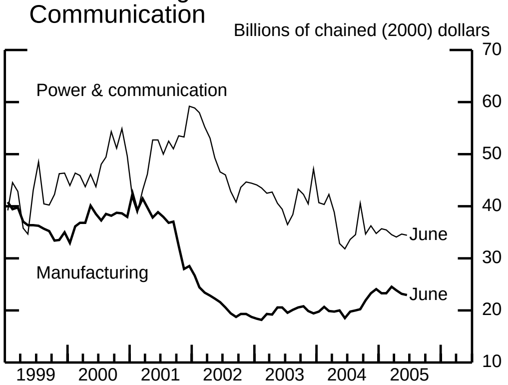
Total Structures



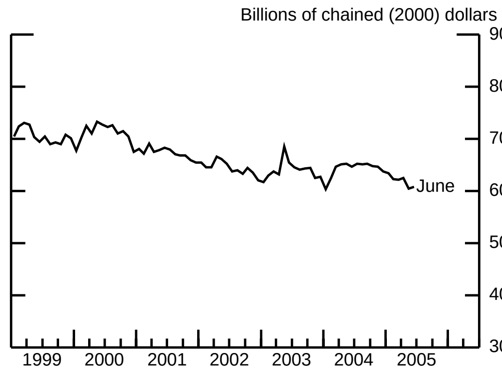
Office and Commercial



Manufacturing and Power & Communication



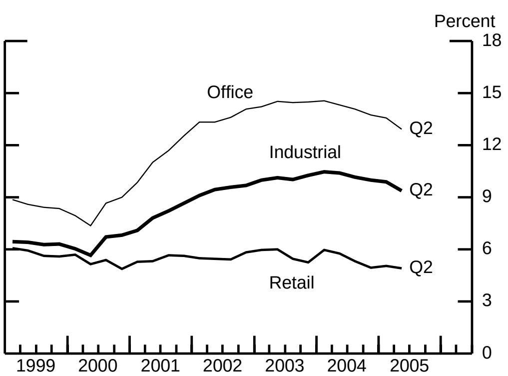
Other



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

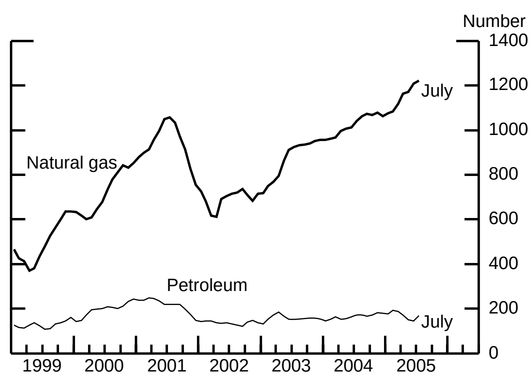
Indicators

Vacancy Rates



Source. Office and industrial, CoStar Property Professional; retail, National Council of Real Estate Investment Fiduciaries.

Drilling Rigs in Operation



Note. July values are averages through July 29.
Source. DOE/Baker Hughes.

at a rate of $62 billion in the first quarter. This sharp swing in the pace of real inventory investment is estimated to have subtracted 2¼ percentage points from the change in real GDP in the second quarter. While stronger-than-expected sales of light vehicles in the second quarter contributed to the drop in inventory investment, the step-down may also suggest that efforts that businesses undertook to rebuild stocks during 2004 and early 2005 are largely complete. Indeed, by the end of the second quarter, except for a few sectors with sizable overhangs (such as steel and paper), businesses seemed reasonably content with inventory levels. This view is apparent in recent surveys, which suggest that an increasing number of firms are satisfied with both their own and their customers' inventory positions.

Data from the staff's flow-of-goods inventory system are roughly consistent with the NIPA data. Inventories declined in May and June, and days' supply edged down for a third straight month. Inventories appear elevated relative to consumption only for paper and, to a lesser degree, for food and for steel held by metal service centers.

Federal Government Sector

The federal budget picture has improved markedly in recent months as a result of exceptional strength in receipts. Indeed, although outlays have continued to rise at the relatively rapid pace of the past few years, the deficit in the unified budget narrowed to about $336 billion over the twelve months ending in June, roughly $100 billion less than the twelve-month deficit over the preceding twelve-month period.

In June, federal tax receipts were nearly 10 percent above their year-earlier level. Individual nonwithheld taxes, which are mainly quarterly declarations for tax liability in 2005, continued to soar, as did corporate income taxes. The surge in corporate receipts this year has likely been driven by strong growth in economic profits as well as by the expiration of the bonus depreciation provision at the end of 2004.

Outlays in June were 9 percent above their year-earlier level and reflected sizable increases in net interest payments, Medicare spending, and defense expenditures. Data from Daily Treasury Statements for payments to defense vendors in July are consistent with further gains in real defense outlays this quarter.

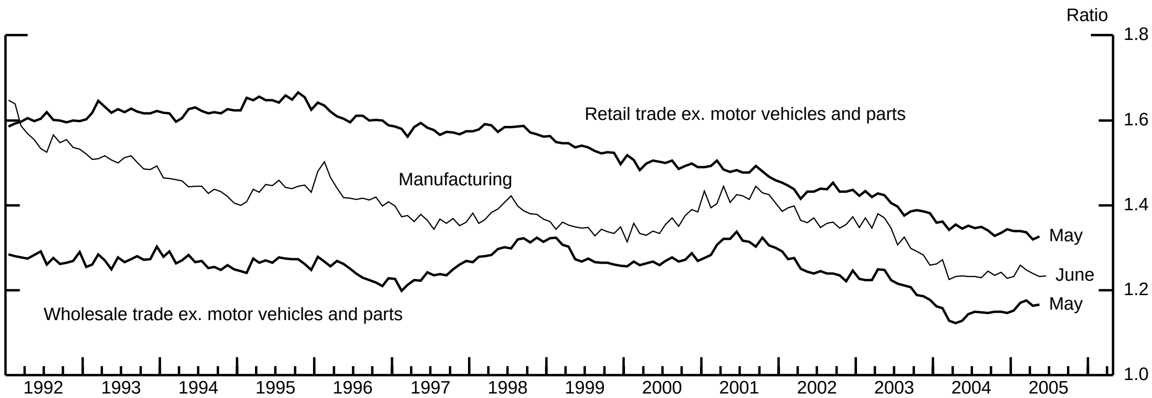
According to the *Mid-Session Review*, the Administration now estimates that the budget deficit will come in at $333 billion in fiscal 2005, nearly $100 billion less than had been anticipated in February. The Administration has also lowered its projections for

Changes in Nonfarm Inventories
(Billions of chained (2000) dollars; annual rate)

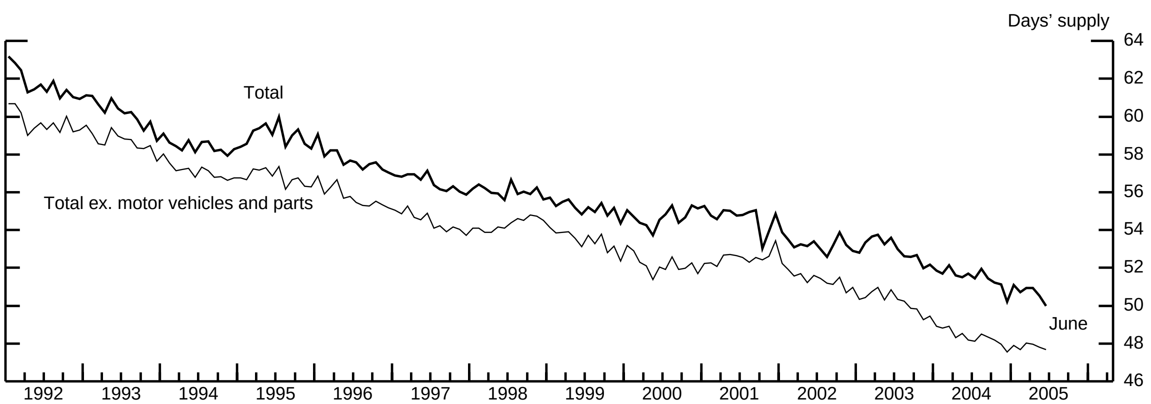
Sector	2004 Q3	2004 Q4	2005 Q1	2005 Q2*
Nonfarm inventory investment	43.7	50.8	61.8	-1.3
Excluding finished motor vehicles and parts	51.0	60.4	66.5	25.2
Manufacturing	5.6	2.3	24.1	-7.3
Merchant wholesalers	27.7	29.6	18.5	9.9
Retail trade	6.8	20.3	11.5	11.0

* Staff estimate.

Book-Value Inventories Relative to Shipments and Sales

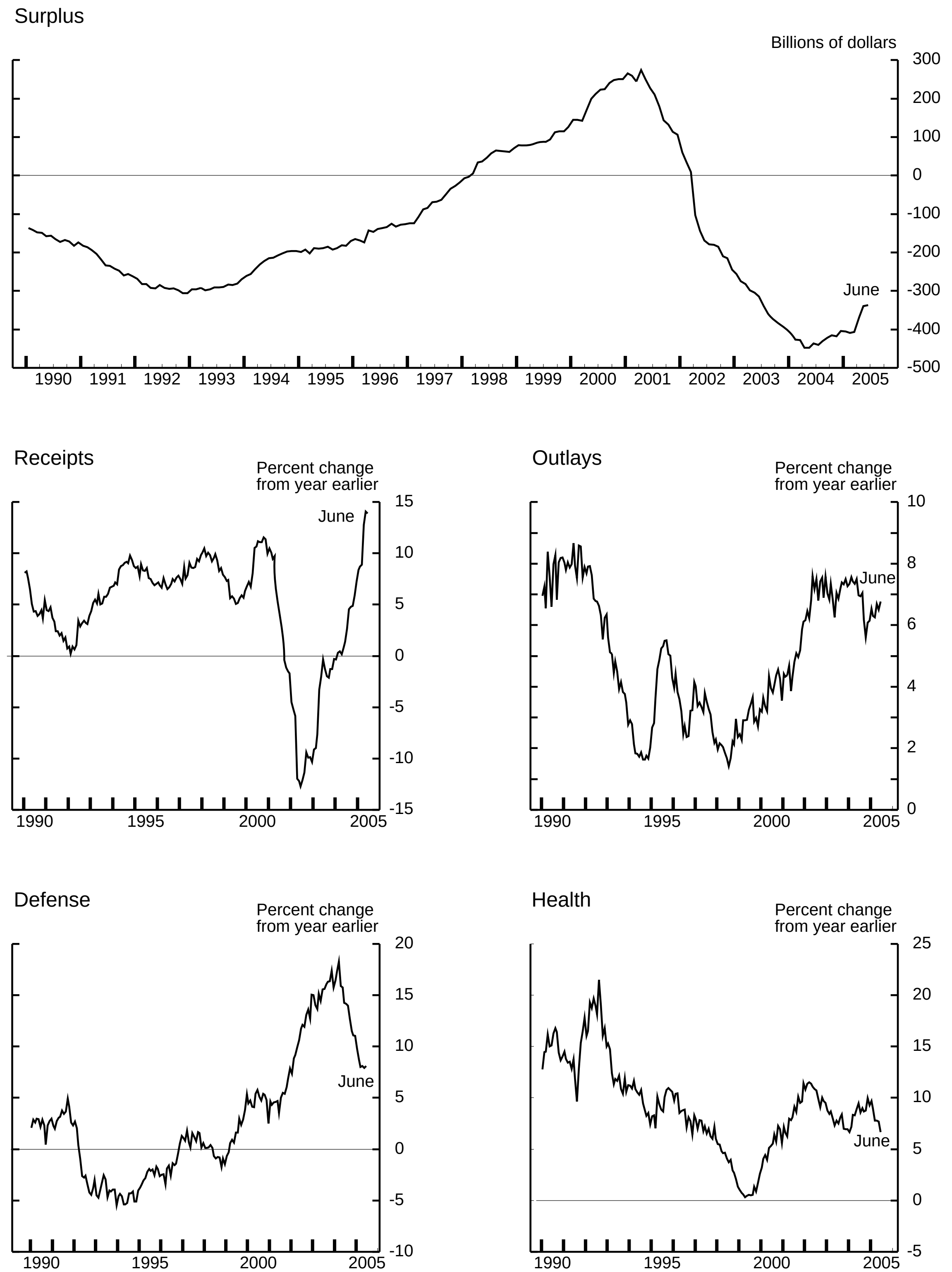


Inventory-Consumption Ratios, Flow-of-Goods System



Federal Sector Developments

(Unified budget, adjusted for payment-timing shifts; 12-month moving sum)



Note. Surplus, outlays, and defense data exclude Defense Cooperation Account and deposit insurance. Health data include Medicaid and Medicare outlays.

Federal Government Outlays and Receipts

(Unified basis; billions of dollars except as noted)

Function or source	June 2004	June 2005	June Percent change	12 months ending in June 2004	12 months ending in June 2005	12 months ending in June Percent change
Outlays	195.3	212.4	8.8	2264.3	2419.1	6.8
Financial transactions[1]	.2	.1	...	-1.6	-.9	...
Payment timing[2]	.0	.0	...	-.4	.2	...
Adjusted outlays	195.1	212.3	8.8	2266.3	2419.9	6.8
Receipts	214.4	234.8	9.5	1829.7	2083.7	13.9
Payment timing	.0	.0	...	.0	.0	...
Adjusted receipts	214.4	234.8	9.5	1829.7	2083.7	13.9
Surplus or deficit (-)	19.1	22.4	...	-434.6	-335.5	...
Selected components of adjusted outlays and receipts						
Adjusted outlays	195.1	212.3	8.8	2266.3	2419.9	6.8
Net interest	13.0	16.9	30.1	155.6	176.8	13.6
Non-interest	182.1	195.4	7.3	2110.8	2243.1	6.3
National defense	39.3	42.8	8.9	443.7	479.6	8.1
Social Security	44.4	47.8	7.8	490.3	516.1	5.3
Medicare	24.5	26.8	9.6	262.9	288.4	9.7
Medicaid	18.0	18.0	-.2	176.6	180.2	2.1
Income security	21.4	22.0	2.5	338.2	342.8	1.4
Agriculture	.5	.7	...	20.1	26.4	31.0
Other	34.0	37.2	9.7	379.0	409.6	8.1
Adjusted receipts	214.4	234.8	9.5	1829.7	2083.7	13.9
Individual income and payroll taxes	155.0	163.7	5.7	1462.4	1635.8	11.9
Withheld + FICA	120.1	121.5	1.2	1379.4	1461.5	5.9
Nonwithheld + SECA	37.7	45.2	19.9	284.9	352.9	23.9
Less: Refunds	2.8	3.0	7.7	201.9	180.7	-10.5
Corporate	44.3	56.5	27.5	174.6	246.9	41.4
Gross	46.4	57.7	24.4	218.5	276.8	26.7
Less: Refunds	2.1	1.3	-40.0	43.9	29.9	-31.9
Other	15.1	14.6	-3.3	192.7	201.0	4.3
Adjusted surplus or deficit (-)	19.3	22.5	...	-436.6	-336.2	...

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

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

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

... Not applicable.

Source. Monthly Treasury Statement.

subsequent years and expects the deficit to fall below $200 billion by 2008. One reason for the downward revision to the longer-run deficit projection is that the Administration assumes that much of the surprising strength in tax collections this spring will be permanent; in addition, it has revised up the projected path for the tax base. In contrast, changes to policy assumptions—in particular, the inclusion of a defense supplemental for fiscal 2006 and the phase-in of Social Security personal accounts starting in 2009—tend to boost the deficit. Similarly, the Congressional Budget Office has reduced its projection for the 2005 deficit to the neighborhood of $325 billion; it will release updated budget projections in mid-August.

Changes to the Administration's Budget Outlook Since February

(Billions of dollars, fiscal years)

Item	2005	2006	2007	2008	2009	2010
February deficit projection	427	390	312	251	233	207
Policy revisions						
Social Security personal accounts	0	0	0	0	22	54
Global war on terrorism	0	37	10	2	1	0
Associated interest and other policy	1	1	1	2	3	5
Technical and economic revisions						
Receipts (–, higher)	-87	-95	-84	-81	-77	-73
Non-interest outlays	-13	14	13	15	12	13
Interest outlays	5	-7	-19	-27	-32	-37
Mid-Session Review deficit	333	341	233	162	162	170

Before leaving on August recess, Congress passed several pieces of legislation. These include an energy bill that provides tax incentives to the energy sector over the next decade. In addition, after ten temporary extensions of the surface transportation law that had expired two years ago, Congress approved a six-year highway and mass transit reauthorization bill. The fiscal effects of these two bills are quite similar to what had been assumed in the President's budget.

State and Local Government Sector

We now estimate that real spending on consumption and gross investment by state and local governments rose at an annual rate of 3¼ percent in the second quarter after an upward revised increase of 1½ percent in the first quarter. The rate of increase in real spending also was revised up in 2004. In the second quarter, much of the increase was in construction expenditures; spending on consumption items rose at a rate of a bit less than 1 percent in real terms last quarter, similar to the average pace over the preceding year.[6]

The pickup in aggregate spending by the sector is consistent with reports of strengthening fiscal positions among the states. Income and sales tax collections apparently were quite robust this spring, and many states seem to have ended fiscal 2005 (which closed on June 30 in all but four states) with higher balances in their operating accounts than they had anticipated a few months earlier.

Prices

The news about recent inflation developments has been favorable.[7] The PCE price index was flat in June for a second consecutive month, bringing the increase for the past three months to 1.9 percent (annual rate), 1.5 percentage points below the rate of the preceding three months. Although a deceleration in energy price inflation contributed significantly to this moderation, increases in the core PCE price index have also slowed markedly in the past couple of months.

PCE prices for energy fell 0.6 percent in June after a 2.4 percent decline in May. Over the twelve months ending in June, the price index for energy rose 7.6 percent, a considerable slowdown compared with the 18 percent increase posted twelve months earlier. Crude oil prices have rebounded substantially since mid-June, and survey data point to sharp price increases for gasoline in July.

The food component of the PCE price index was unchanged in June for a second consecutive month. Prices of fruits and vegetables reversed earlier run-ups—which had reflected very tight supplies during the transition from the winter harvest to the spring

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[6] The second-quarter estimate for the growth in real spending by state and local governments is ¾ percentage point higher than the BEA's advance estimate. The revision is based on monthly construction data, which became available after the NIPA release.

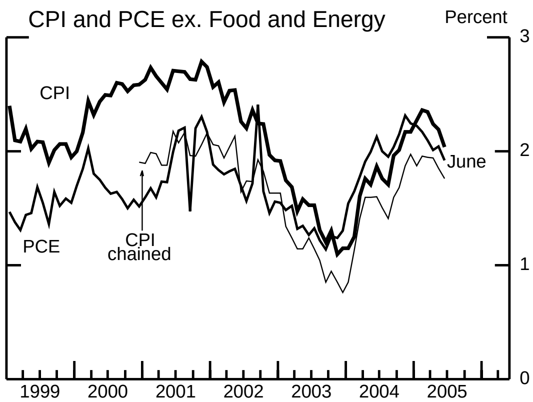
[7] Although core PCE price inflation over the four quarters of 2004 was revised up 0.6 percentage point to 2.2 percent in the NIPA annual revision, the revision largely occurred in nonmarket components, which have decelerated considerably in the first half of 2005. Market-based core PCE prices were little revised. See the appendix for more detail on the effect of the NIPA annual revision.

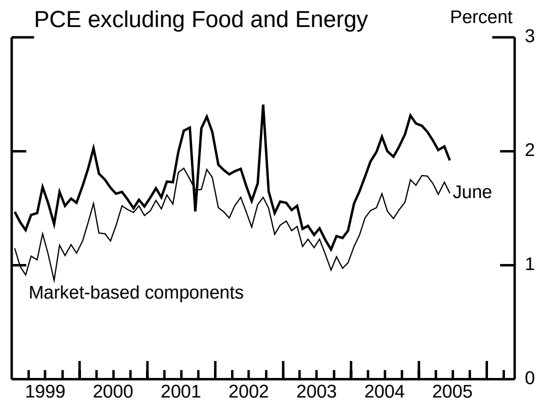
Measures of Inflation
(Percent)

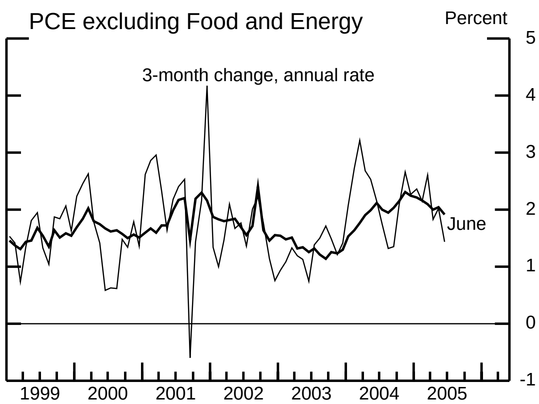
Measures	12-month change		3-month change		1-month change	
			Annual rate		Monthly rate	
	June 2004	June 2005	Mar. 2005	June 2005	May 2005	June 2005
CPI						
Total	**3.3**	**2.5**	**4.3**	**1.9**	**-.1**	**.0**
Food	3.7	2.2	1.3	3.4	.1	.1
Energy	17.0	7.3	21.1	7.5	-2.0	-.5
Ex. food and energy	**1.9**	**2.0**	**3.3**	**1.2**	**.1**	**.1**
Core goods	-1.0	.4	1.1	-.3	.2	-.2
Core services	3.0	2.7	4.0	1.7	.1	.2
Chained CPI (n.s.a.) [1]	2.8	2.2	...	...	...	...
Ex. food and energy [1]	1.6	1.8	...	...	...	...
PCE prices						
Total	**3.0**	**2.2**	**3.4**	**1.9**	**.0**	**.0**
Food	3.2	2.1	1.1	2.9	.0	.0
Energy	18.2	7.6	22.3	6.6	-2.4	-.6
Ex. food and energy	**2.1**	**1.9**	**2.6**	**1.4**	**.2**	**.0**
Core goods	-.5	-.1	1.7	-1.0	.2	-.3
Core services	3.2	2.8	3.0	2.5	.2	.2
Core market-based	1.6	1.6	2.6	1.4	.2	.0
Core non-market-based	4.5	3.2	2.9	1.8	.1	.0
PPI						
Total finished goods	**4.0**	**3.6**	**5.1**	**-.3**	**-.6**	**.0**
Food	6.7	.1	2.6	-5.0	-.3	-1.1
Energy	9.1	13.2	15.9	1.6	-3.5	2.0
Ex. food and energy	**1.7**	**2.2**	**3.4**	**1.0**	**.1**	**-.1**
Core consumer goods	1.8	2.3	4.0	1.2	.1	-.1
Capital equipment	1.6	2.1	2.8	.3	.1	-.2
Intermediate materials	7.0	6.2	7.8	.8	-.7	.1
Ex. food and energy	5.6	4.9	6.5	-1.3	-.3	-.2
Crude materials	19.4	1.7	4.1	-10.4	-2.0	-3.3
Ex. food and energy	20.5	5.2	-17.9	-25.4	-3.6	-4.3

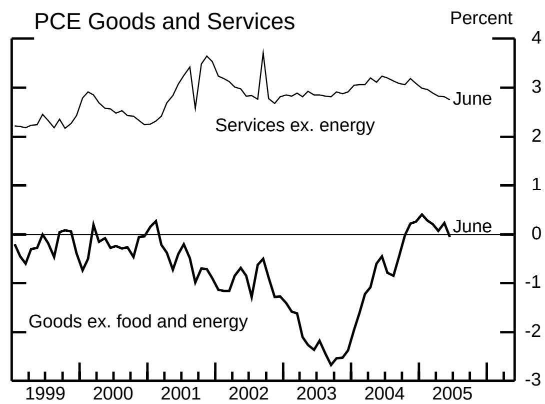
1. Higher-frequency figures are not applicable for data that are not seasonally adjusted.
... Not applicable.

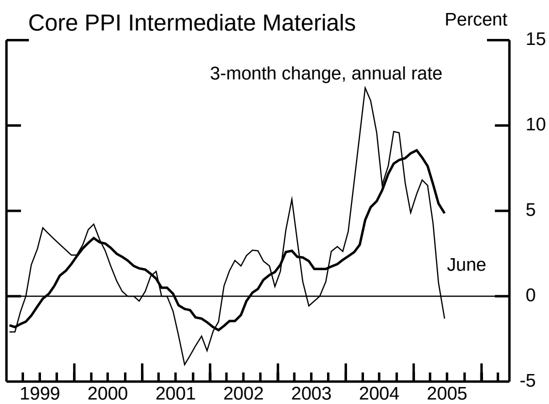
Measures of Price Inflation
(12-month change except as noted)

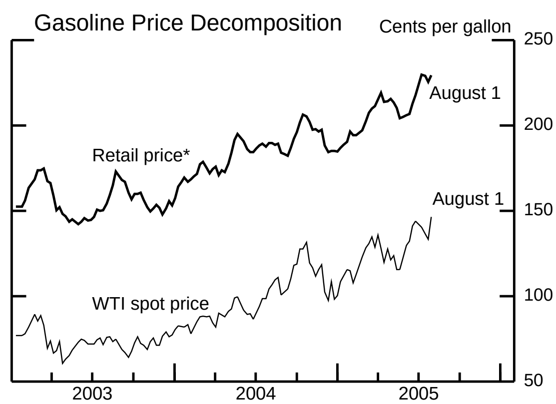












* Average of all grades reported by the Department of Energy, seasonally adjusted by FRB staff.

harvest—and these price declines offset price increases in other food categories. During the twelve months ending in June, food prices rose 2.1 percent, about 1 percentage point less than during the preceding year. More recently, wholesale meat prices fell substantially after a judicial ruling on July 15 that allowed the resumption of imports of young Canadian cattle into the United States; this change will likely help restrain retail consumer food prices by a small amount in the months ahead.

Excluding food and energy, the PCE price index rose at an annual rate of 1½ percent in the three months ending in June after having posted significantly larger increases earlier in the year. Much of the recent slowdown has been in core goods prices, which had been pushed up noticeably by higher prices for imports, energy, and core intermediate materials last year. Prices of core services have also decelerated recently, though much less than the slowing in goods prices. The market-based components of core PCE inflation also have moderated of late, rising at an annual rate of 1½ percent in the three months ending in June, down from a 2½ percent rate during the preceding three months. During the twelve months ending in June, overall core PCE prices rose just under 2 percent, a shade less than the upward-revised increase of one year earlier.

Most broader measures of inflation have decelerated a bit during the past year. In the four quarters ending last quarter, GDP prices decelerated about ½ percentage point from the year-earlier pace. Excluding food and energy items, GDP price inflation has been about steady near 2½ percent as a slowdown in investment price inflation about offset faster price increases for government purchases.

Survey measures of inflation expectations have been mixed in recent months. After having hovered around 3¼ percent from March through June, median year-ahead inflation expectations as measured by the Michigan Survey moved down to 3 percent in July. By contrast, median five- to ten-year inflation expectations ticked up a tenth in July to 2.9 percent but still remained in the narrow range observed over the past few years.

At earlier stages of processing, the producer price index for core intermediate materials fell 0.2 percent in June after declining 0.3 percent in May. During the three months ending in June, core intermediate materials declined at an annual rate of 1¼ percent—a striking turnaround from the 6½ percent rate of increase that was posted in the first three months of this year. Outside of energy, commodity prices have also been relatively subdued lately. Although the Journal of Commerce industrials index, which includes a substantial energy component, has edged up recently, the Commodity Research Bureau

Broad Measures of Inflation

(Percent change, Q2 to Q2)

Measure	2002	2003	2004	2005
Product prices				
GDP price index	1.6	2.0	2.8	2.4
Less food and energy	2.1	1.8	2.5	2.4
Nonfarm business chain price index	1.0	1.2	2.2	2.3
Expenditure prices				
Gross domestic purchases price index	1.4	2.1	3.0	2.8
Less food and energy	1.9	1.7	2.5	2.3
PCE price index	1.2	1.8	2.7	2.5
Less food and energy	1.8	1.3	2.0	2.0
PCE price index, market-based components	.9	1.7	2.5	2.4
Less food and energy	1.5	1.2	1.5	1.7
CPI	1.3	2.2	2.8	2.9
Less food and energy	2.4	1.5	1.8	2.2
Chained CPI	1.0	1.9	2.5	2.5
Less food and energy	1.9	1.2	1.6	1.8
Median CPI	3.6	2.2	2.5	2.3
Trimmed mean CPI	2.2	1.9	2.1	2.2

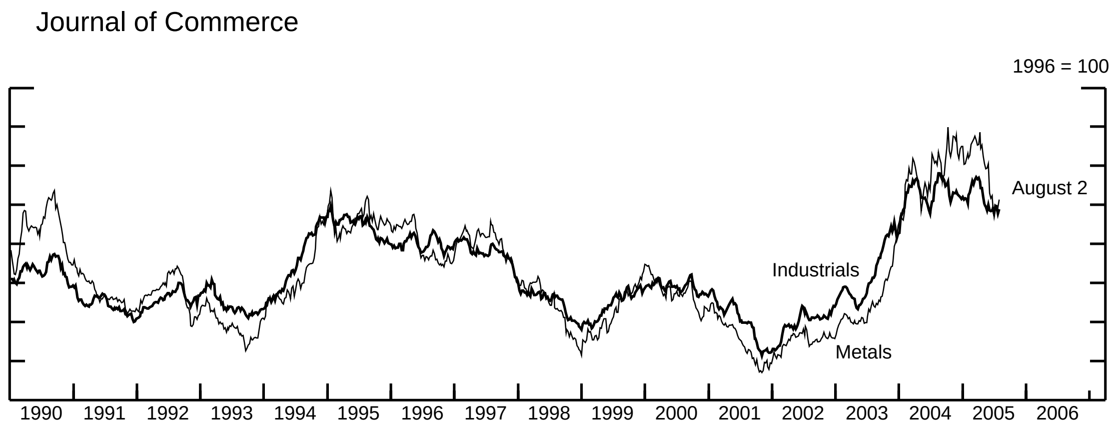
Surveys of Inflation Expectations

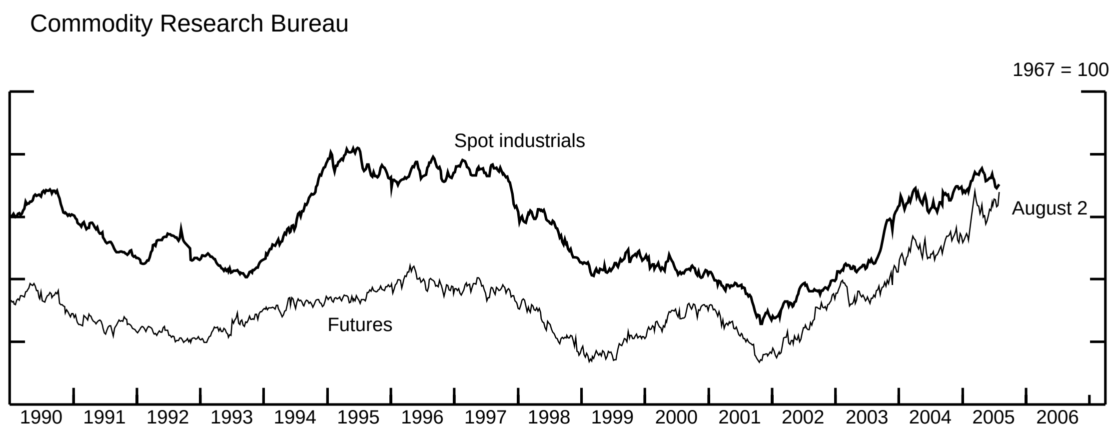
(Percent)

Period	Actual CPI inflation [1]	University of Michigan				Professional forecasters (10-year) [4]
		1 year [2]		5 to 10 years [3]		
		Mean	Median	Mean	Median	
2003:Q3	2.2	2.8	2.3	3.1	2.7	2.5
Q4	1.9	3.0	2.6	3.1	2.8	2.5
2004:Q1	1.8	3.1	2.7	3.4	2.9	2.5
Q2	2.9	4.0	3.3	3.3	2.8	2.5
Q3	2.7	3.3	2.9	3.1	2.8	2.5
Q4	3.3	3.4	3.0	3.1	2.8	2.5
2005:Q1	3.0	3.6	3.0	3.2	2.8	2.5
Q2	2.9	3.9	3.2	3.3	2.9	2.5
2005:Jan.	3.0	3.5	2.9	3.2	2.7	...
Feb.	3.0	3.3	2.9	3.1	2.8	...
Mar.	3.1	4.0	3.2	3.3	2.9	2.5
Apr.	3.5	4.0	3.3	3.4	3.0	...
May	2.8	3.8	3.2	3.5	2.9	...
June	2.5	4.0	3.2	3.1	2.8	2.5
July	n.a.	3.6	3.0	3.3	2.9	...

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

Commodity Price Indexes





Note. The Journal of Commerce industrial price index is based almost entirely on industrial commodities, with a small weight given to energy commodities. The Commodity Research Bureau (CRB) spot industrials index consists entirely of industrial commodities, excluding energy. The CRB futures index gives about a 60 percent weight to food commodities and splits the remaining weight roughly equally among energy commodities, industrial commodities, and precious metals. Copyright for Journal of Commerce data is held by CIBCR, 1994.

Selected Commodity Price Indexes
(Percent change)

Index	2004[1]	12/28/04 to 6/21/05[2]	6/21/05[2] to 8/2/05	52-week change to 8/2/05
JOC industrials	8.7	-2.6	.3	-5.9
JOC metals	19.4	-10.1	-.8	-8.1
CRB spot industrials	5.0	3.2	-2.4	6.3
CRB spot foodstuffs	2.7	1.5	-3.0	-6.2
CRB futures	11.1	9.6	2.7	18.8

1. From the last week of the preceding year to the last week of the year indicated.
2. June 21, 2005, is the Tuesday preceding publication of the June Greenbook.

spot industrials index, which excludes energy items, has fallen 2.4 percent. Nonetheless, both measures of commodity prices have remained at an elevated level since the end of 2003.

Labor Costs

Over the three months ending in June, the Employment Cost Index (ECI) for hourly compensation in private industry rose at an annual rate of just 2½ percent, a second consecutive reading of meager compensation gains. As of the end of June, the twelve-month increase in the ECI was 3¼ percent, ¾ percentage point less than in the comparable period twelve months earlier.

Over the twelve months ending in June, the wages and salaries component of the ECI rose 2½ percent, roughly the same increase as over the previous year. However, benefit costs rose 5 percent during the twelve months ending in June, a slowdown of almost 2½ percentage points relative to the rate of the preceding year. Much of the slowdown in benefit costs was due to smaller increases in contributions to retirement and saving programs; many companies likely have benefited from the rebound in equity prices over the past two years and therefore have less need to make up for earlier losses sustained by their defined-benefit pension plans. In addition, increases in costs for health insurance, which had slowed to the 7 percent to 8 percent range in recent quarters, eased further in the June report, and the twelve-month change stood at 6¼ percent, well below the double-digit increases of a few years ago.

Using the most recent NIPA data, the staff estimates that compensation per hour in the nonfarm business sector increased at an annual rate of 3½ percent in the second quarter. This pace is down sharply from increases of 10 percent and 7 percent, respectively, in the preceding two quarters, when a year-end burst of bonuses and exercises of stock options apparently pushed up this measure of compensation considerably. Unit labor costs are estimated to have risen at a 1½ percent rate in the second quarter, far below the outsized increases posted in recent quarters.

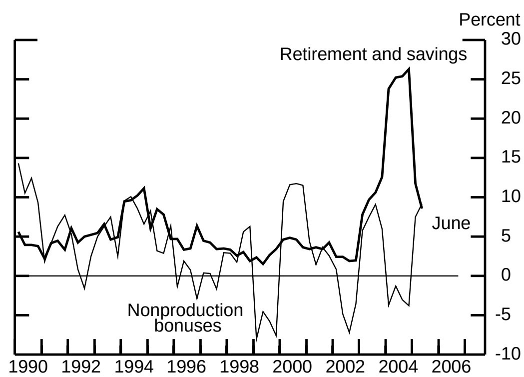
Change in Employment Cost Index of Hourly Compensation for Private-Industry Workers

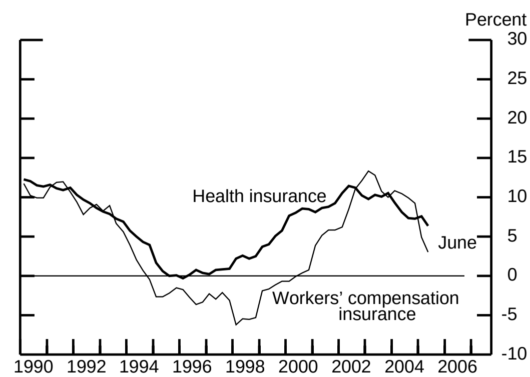
Index	2004 June	2004 Sept.	2004 Dec.	2005 Mar.	2005 June
	Quarterly change (compound annual rate)[1]				
Total hourly compensation	**3.8**	**4.0**	**3.2**	**2.5**	**2.5**
Wages and salaries	2.5	3.0	1.7	2.4	2.4
Benefits	6.9	5.5	6.7	4.3	3.2
	12-month change				
Total hourly compensation	**4.0**	**3.7**	**3.8**	**3.4**	**3.2**
Wages and salaries	2.6	2.6	2.4	2.4	2.4
Benefits	7.3	6.8	6.9	5.8	4.9

1. Seasonally adjusted by the BLS except June.

Employment Cost Index
(Private-industry workers; 12-month change)

ECI Benefits Costs (confidential)
(Private-industry workers; 12-month change)





Hourly Compensation and Unit Labor Costs

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

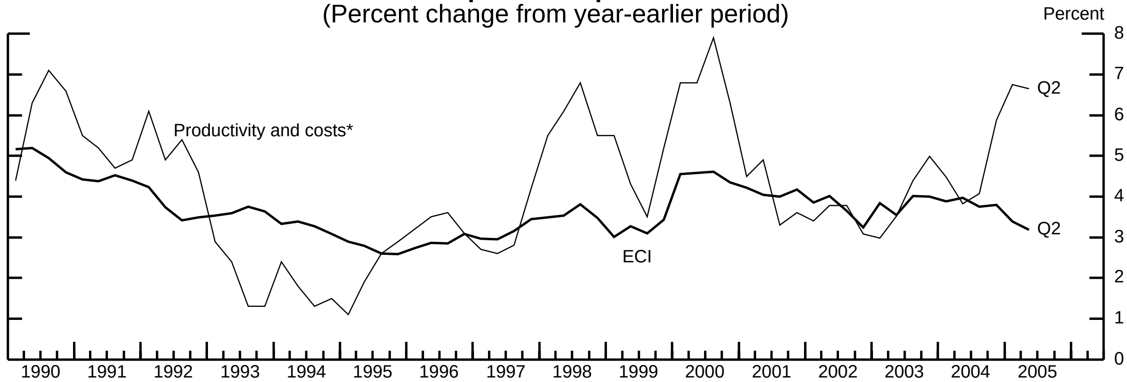
Category	2003:Q2 to 2004:Q2	2004:Q2 to 2005:Q2	2004		2005	
			Q3	Q4	Q1	Q2
Compensation per hour						
Nonfarm business	3.8	6.7	6.2	10.1	7.0	3.4
Nonfinancial corporations [1]	3.2	6.6	6.4	10.6	7.3	2.5
Unit labor costs						
Nonfarm business	-.4	4.3	4.8	7.5	3.6	1.4
Nonfinancial corporations [1]	.0	1.3	-1.0	1.9	3.5	.8

Note. Staff estimates. Output and compensation are derived from the annual revision to the national income and product accounts. However, output and compensation for the second quarter of 2005 and hours for the fourth quarter of 2004 and the first and second quarters of 2005 are staff estimates. Before the fourth quarter of 2004, the level of hours is published data.

1. All corporations doing business in the United States except banks, stock and commodity brokers, and finance and insurance companies. The sector accounts for about two-thirds of business employment.

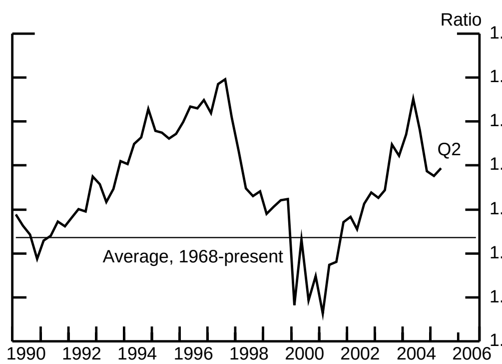
Compensation per Hour

(Percent change from year-earlier period)



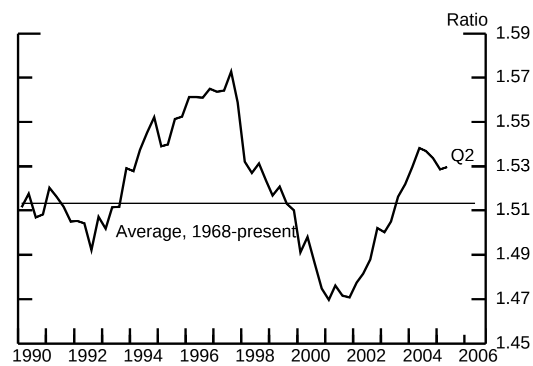
* Staff estimate.

Markup, Nonfarm Business



Note. Ratio of output price to unit labor costs.
Staff estimate.

Markup, Nonfinancial Corporations



Note. Ratio of output price to unit labor costs.
Staff estimate.

Appendix

Annual Revision of the National Income and Product Accounts

The annual revision of the national income and product accounts (NIPA), released on July 29, affected data back to the beginning of 2002. The revision allowed the Bureau of Economic Analysis (BEA) to incorporate more-comprehensive source data, including data from tax records and economic surveys, and to make methodological changes. Although this year's revision mainly reflected the incorporation of new source data, BEA also made two noteworthy changes to their methods. First, it began using the Census Bureau's Quarterly Services Survey as the source for data on investment in computer software and for several components of PCE services.[1] Second, it improved its estimates of the price of implicit services of commercial banks.[2]

On a four-quarter change basis, real GDP growth was revised down 0.4 percentage point in both 2002 and 2003 and 0.1 percentage point in 2004. Much of the downward revision was concentrated in personal consumption expenditures and investment in equipment and software. The downward revision to the change in real PCE was primarily due to updated information from two Census Bureau surveys: The Service Annual Survey and the American Housing Survey. The largest source of downward revision to the change in real E&S was shipments data on high-tech equipment from the Census Bureau's Annual Survey of Manufactures. In the nonfarm business sector, we estimate that the four-quarter change in real output per hour will be revised down 0.6 percentage point in 2002, 0.5 percentage point in 2003, and 0.2 percentage point in 2004.

The BEA also revised its price indexes. The average change in the GDP price index was revised up 0.2 percentage point per year from the fourth quarter of 2001 to the fourth quarter of 2004. Core PCE inflation was also revised up about 0.2 percentage point per year during the same period, with most of the upward revision occurring in 2004. Most of the revision to core PCE inflation was due to changes in two nonmarket pieces: medical insurance and implicit services of financial institutions other than commercial banks. The index for core market-based PCE prices was little revised.

On the income side of the accounts, the growth rate of gross domestic income was revised down in each of the open years and in the first quarter of this year. The revisions to gross domestic income were, on average, larger than those to GDP, and in the first quarter of 2005, the revised statistical discrepancy was closer to zero than previously reported. The growth rate of real disposable personal income was, on balance, revised down, mainly in 2004 and the first quarter of

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[1] These components are telephone services, cable television, Internet service providers, legal services, other transportation services, and refuse collection.

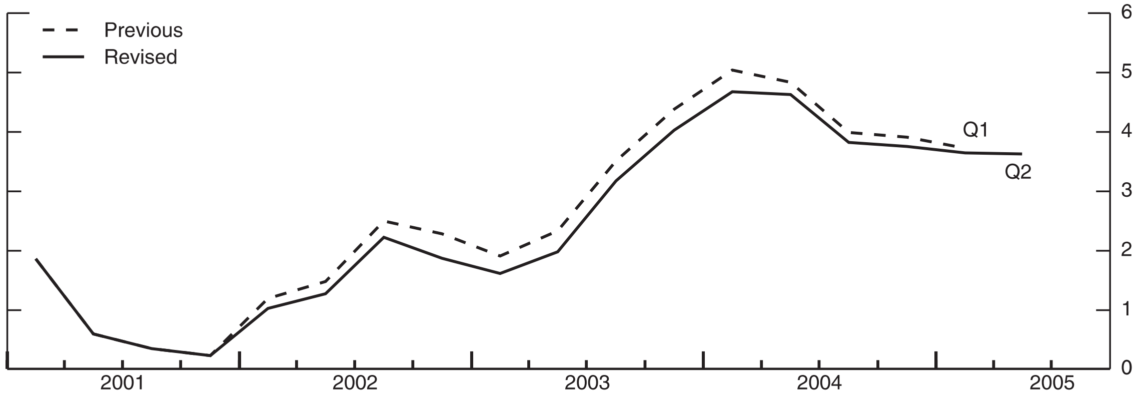
[2] This change in methodology resulted in a much smoother pattern for prices and nominal spending for implicit services of commercial banks but did not have a large net effect on these series.

2005. Because personal outlays were revised down even more in 2002 and 2003 (largely because of downward–revised personal consumption expenditures), the personal saving rate was revised up 0.6 percentage point in the fourth quarter of 2002 and 0.7 percentage point in the fourth quarter of 2003. However, the personal saving rate was revised up only 0.1 percentage point in the fourth quarter of 2004, and it was revised down 0.2 percentage point in the first quarter of this year.

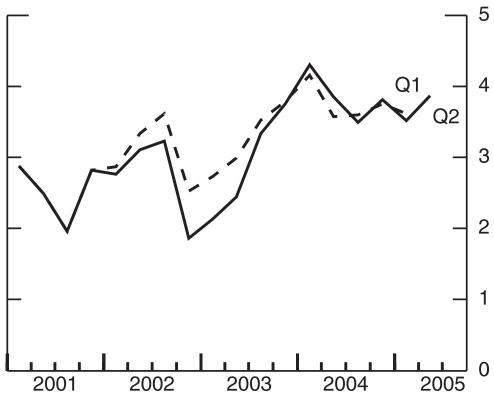
Corporate economic profits were revised up in 2002 and most of 2003 (in large part to reflect new data from the Internal Revenue Service). However, profits were revised down in 2004, principally because the BEA made a special adjustment to account for the apparent increase in stock-option exercises in late 2004. The BEA used footnotes from corporations' financial statements to make its estimate of the effect of these exercises.

Annual Revision to the NIPA
(4-quarter percent change)

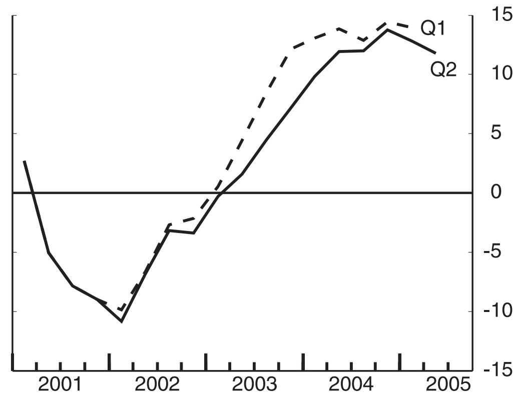
Real GDP



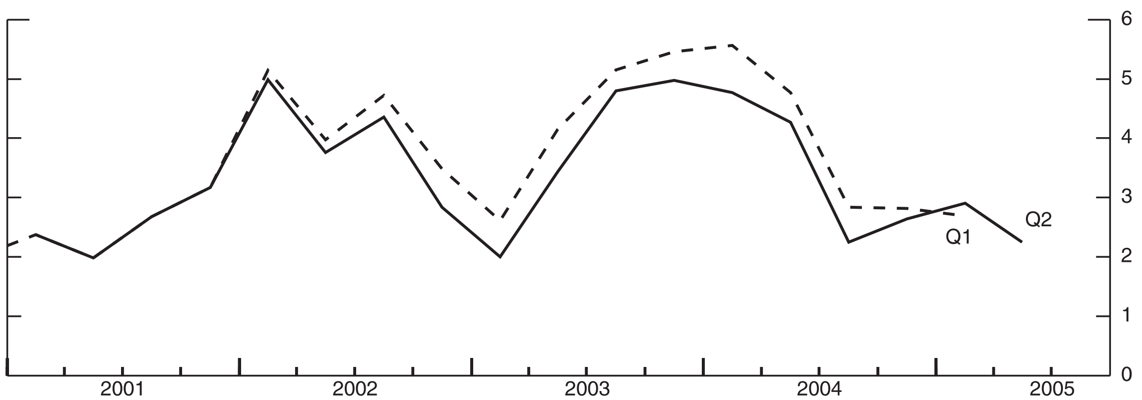
Real Personal Consumption Expenditures



Real Equipment and Software



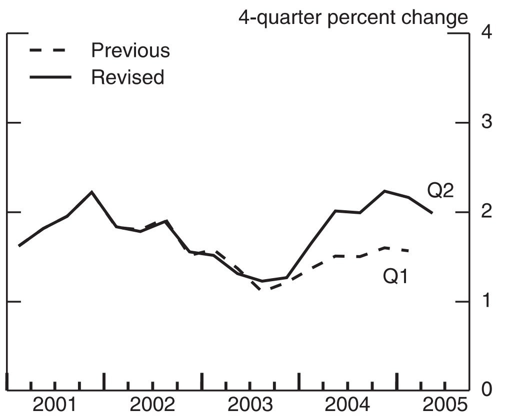
Nonfarm Business Output per Hour*



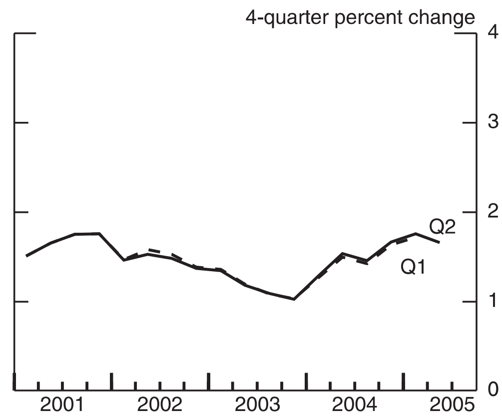
*Staff estimates.

Annual Revision to the NIPA (Continued)

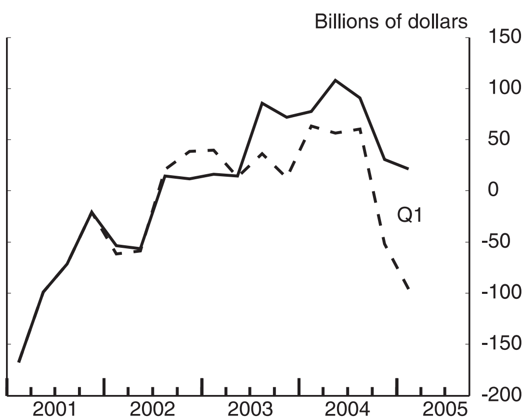
Core PCE Prices



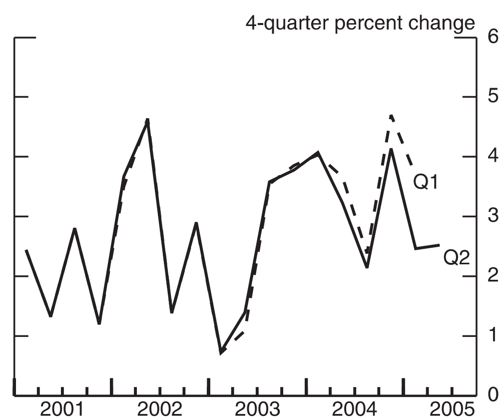
Market-Based Core PCE Prices



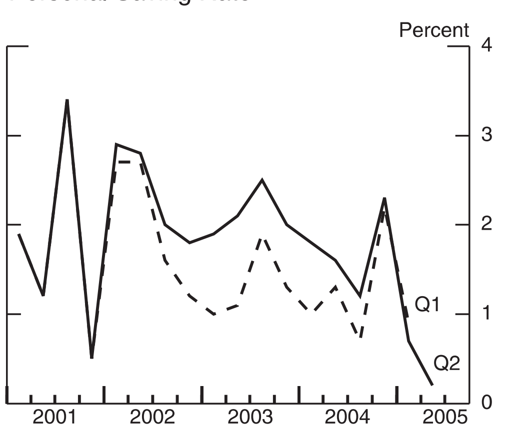
Statistical Discrepancy



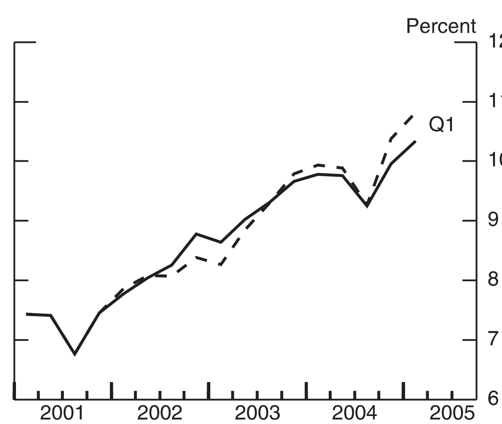
Real DPI



Personal Saving Rate



Profits as a Share of GNP



Note. Excluding Federal Reserve Banks.

Domestic Financial Developments

Selected Financial Market Quotations

(One-day quotes in percent except as noted)

Instrument	2004 June 28	2004 Dec. 31	2005 June 29	2005 Aug. 3	Change to Aug. 3 from selected dates (percentage points): 2004 June 28	2004 Dec. 31	2005 June 29
Short-term							
FOMC intended federal funds rate	1.00	2.25	3.00	3.25	2.25	1.00	.25
Treasury bills[1]							
3-month	1.36	2.18	3.06	3.38	2.02	1.20	.32
6-month	1.74	2.52	3.23	3.60	1.86	1.08	.37
Commercial paper (A1/P1 rates)[2]							
1-month	1.28	2.29	3.22	3.45	2.17	1.16	.23
3-month	1.45	2.28	3.34	3.62	2.17	1.34	.28
Large negotiable CDs[1]							
3-month	1.53	2.50	3.47	3.70	2.17	1.20	.23
6-month	1.82	2.72	3.65	3.91	2.09	1.19	.26
Eurodollar deposits[3]							
1-month	1.29	2.32	3.28	3.50	2.21	1.18	.22
3-month	1.51	2.49	3.44	3.68	2.17	1.19	.24
Bank prime rate	4.00	5.25	6.00	6.25	2.25	1.00	.25
Intermediate- and long-term							
U.S. Treasury[4]							
2-year	2.88	3.08	3.67	4.06	1.18	.98	.39
5-year	3.97	3.63	3.76	4.13	.16	.50	.37
10-year	4.90	4.34	4.06	4.37	-.53	.03	.31
U.S. Treasury indexed notes							
5-year	1.56	1.03	1.41	1.73	.17	.70	.32
10-year	2.25	1.65	1.69	1.94	-.31	.29	.25
Municipal revenue (Bond Buyer)[5]	5.37	5.04	4.76	4.86	-.51	-.18	.10
Private instruments							
10-year swap	5.21	4.65	4.35	4.75	-.46	.10	.40
10-year FNMA[6]	5.30	4.61	4.28	4.58	-.72	-.03	.30
10-year AA[7]	5.59	4.98	4.76	5.06	-.53	.08	.30
10-year BBB[7]	6.18	5.38	5.34	5.56	-.62	.18	.22
5-year high yield[7]	8.30	7.34	7.97	7.76	-.54	.42	-.21
Home mortgages (FHLMC survey rate)							
30-year fixed	6.21	5.77	5.53	5.82	-.39	.05	.29
1-year adjustable	4.19	4.10	4.24	4.47	.28	.37	.23

Stock exchange index	Record high: Level	Record high: Date	2004 Dec. 31	2005 June 29	2005 Aug. 3	Change to Aug. 3 from selected dates (percent): Record high	2004 Dec. 31	2005 June 29
Dow Jones Industrial	11,723	1-14-00	10,783	10,374	10,698	-8.75	-.79	3.11
S&P 500 Composite	1,527	3-24-00	1,212	1,200	1,245	-18.49	2.73	3.77
Nasdaq	5,049	3-10-00	2,175	2,069	2,217	-56.09	1.90	7.15
Russell 2000	689	8-2-05	652	643	683	-.75	4.88	6.32
Wilshire 5000	14,752	3-24-00	11,971	11,947	12,466	-15.50	4.13	4.34

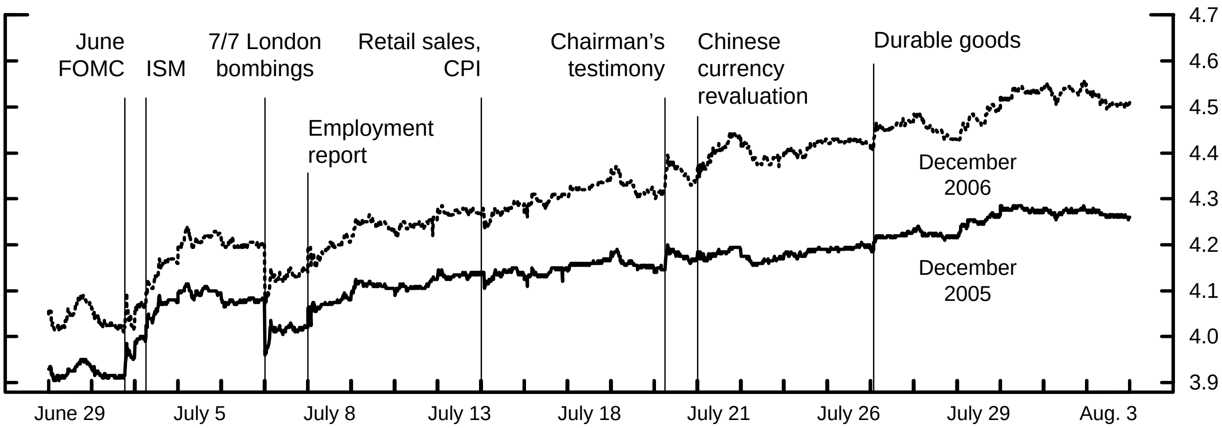
1. Secondary market.
2. Financial commercial paper.
3. Bid rates for Eurodollar deposits collected around 9:30 a.m. eastern time.
4. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
5. Most recent Thursday quote.
6. Constant-maturity yields estimated from Fannie Mae domestic noncallable coupon securities.
7. Derived from smoothed corporate yield curves estimated using Merrill Lynch bond data.

NOTES:

June 28, 2004, is the day before the most recent policy tightening began.
June 29, 2005, is the day before the most recent FOMC announcement.

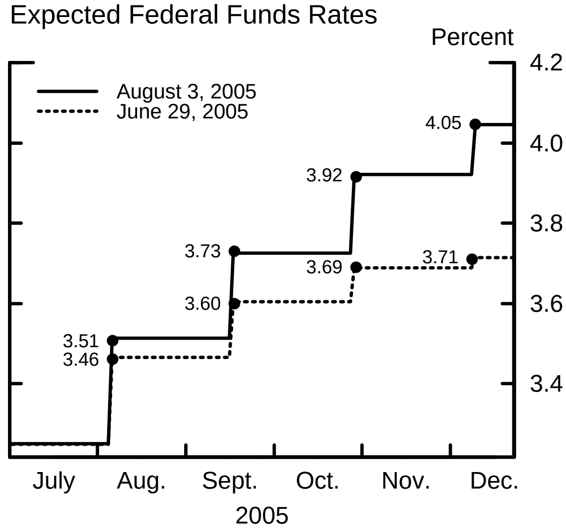
Policy Expectations and Treasury Yields

Eurodollar Futures



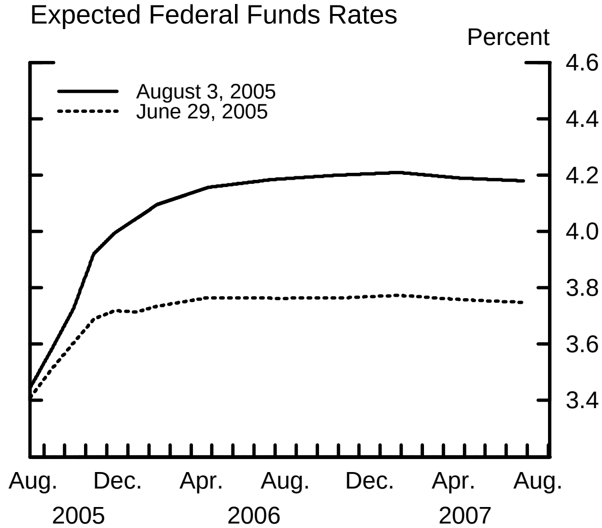
Note. 5-minute intervals.

Expected Federal Funds Rates



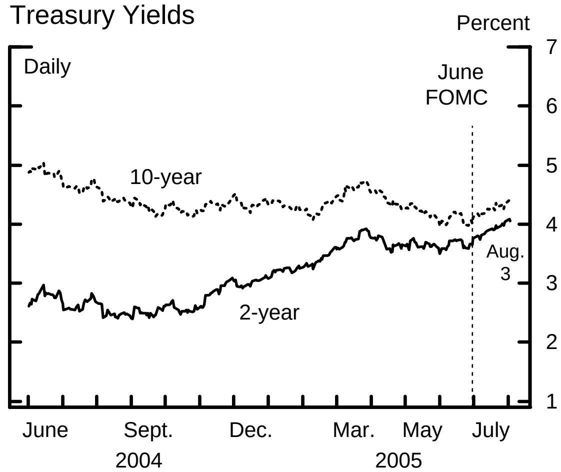
Note. Estimates assume a 1.0 basis point per month term premium and zero probability of intermeeting moves.

Expected Federal Funds Rates



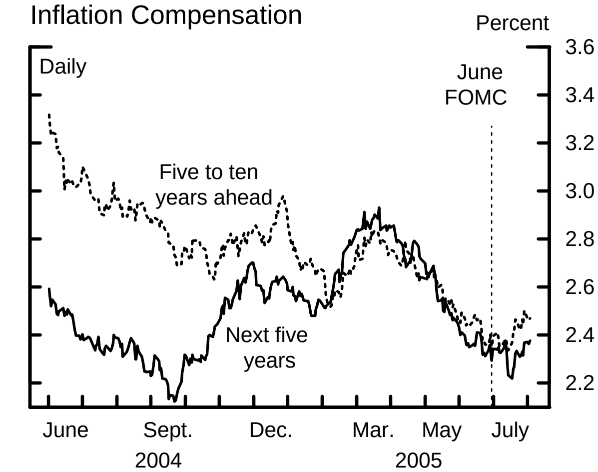
Note. Estimates from federal funds and Eurodollar futures, with an allowance for term premia and other adjustments.

Treasury Yields



Note. Estimates from smoothed Treasury yield curve based on off-the-run securities.

Inflation Compensation



Note. Estimates based on nominal and inflation-indexed Treasury yields.

Domestic Financial Developments

Overview

Developments in financial markets over the intermeeting period suggest that investors have become more confident of prospects for solid economic growth. Market participants are now virtually certain of a quarter-point increase in the target federal funds rate at the upcoming FOMC meeting, and they have marked up the expected path of policy thereafter. Yields on nominal Treasury coupon securities rose substantially, primarily reflecting higher real yields; inflation compensation based on TIPS yields was about unchanged. Favorable corporate earnings reports for the second quarter lifted stock prices, credit spreads on speculative-grade bonds narrowed considerably, and measures of corporate credit quality remained strong. Business debt expanded at a moderate pace in the second quarter and in July, and early indicators suggest that household debt growth likely eased in the second quarter from the first quarter's brisk pace.

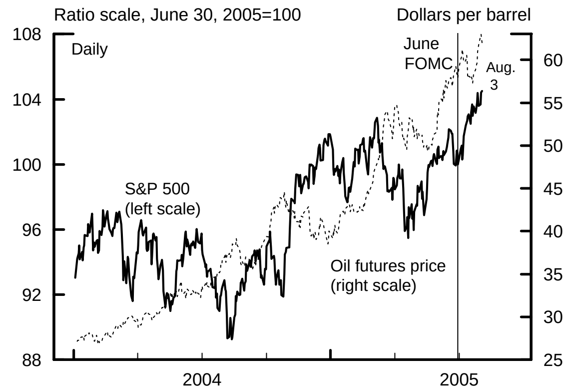
Policy Expectations and Treasury Yields

The FOMC's decision at its June meeting to raise the target federal funds rate 25 basis points and the accompanying statement were about in line with investors' expectations and prompted only a limited market reaction. Subsequent economic data releases and corporate earnings reports supporting an outlook for strong economic growth led market participants to raise their expected path for the federal funds rate. On net over the intermeeting period, the expected policy path shifted up about 35 basis points, to a touch above 4 percent by year-end 2005, and up roughly 45 basis points, to nearly 4¼ percent, by the end of next year. Surveys suggest that investors are certain of a quarter-point hike in the target federal funds rate at the August meeting and believe that the FOMC will make only modest changes to the accompanying policy statement.

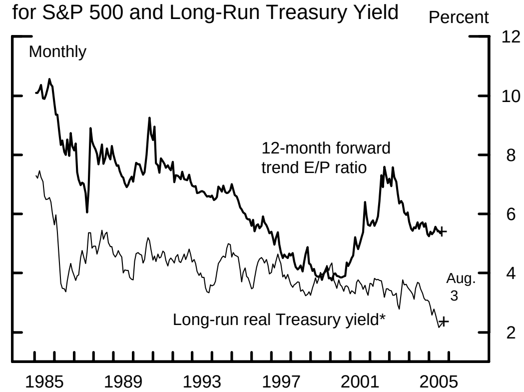
Yields on nominal Treasury securities at two- and ten-year maturities have risen about 40 basis points and 30 basis points, respectively, since the June FOMC meeting, which is consistent with changes in policy expectations. The July 7 terrorist attacks in London prompted a transitory safe-haven rally in the Treasury market, but yields returned to pre-attack levels the next day. Yields rose on July 21 after the Chinese government unexpectedly announced a revaluation of the yuan, although much of the increase was reversed over the following days on indications that further revaluations would not be forthcoming in the near term. Inflation-indexed Treasury yields moved up about in line with nominal yields over the intermeeting period, leaving inflation compensation little changed on net.

Stock Prices, Corporate Yields, and Risk Spreads

S&P 500 and Oil Futures Price 24 Months Ahead

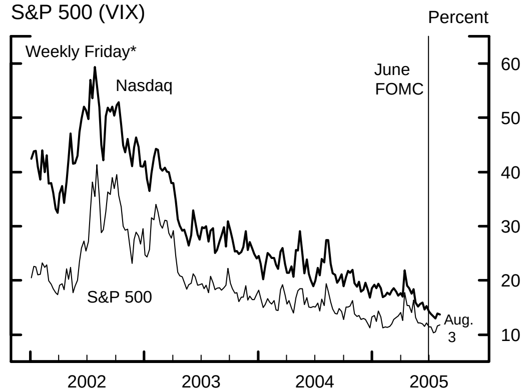


12-Month Forward Trend Earnings-Price Ratio for S&P 500 and Long-Run Treasury Yield



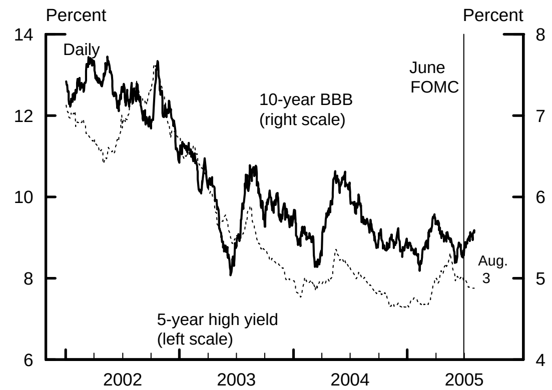
* Yield on synthetic Treasury perpetuity minus Philadelphia Fed 10-year expected inflation.
+ Denotes the latest observation using daily interest rates and stock prices and latest earnings data from I/B/E/S.

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



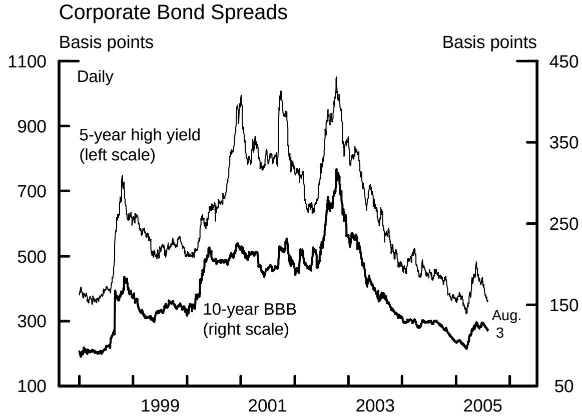
* Latest observation is for most recent business day.

Yields for BBB and High-Yield Corporate Bonds



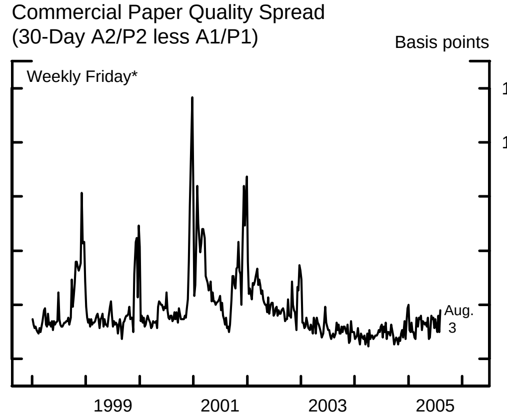
Note. Yields from smoothed yield curves based on Merrill Lynch bond data.

Corporate Bond Spreads



Note: Measured relative to comparable-maturity Treasuries.

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



* Latest observation is for most recent business day.

Stock Prices and Corporate Interest Rates

Corporate earnings reports that generally beat forecasts and the largely positive economic news lifted stock prices over the intermeeting period, with major equity indexes rising 3 to 7¼ percent. The trend-adjusted twelve-month forward earnings-price ratio was little changed at around 5½ percent and remains in the narrow range registered since early 2004. The spread between this measure and the real perpetuity Treasury yield—a rough gauge of the equity risk premium—held steady over the intermeeting period at a level above its average over the past two decades. Implied volatilities on both the Nasdaq 100 and S&P 500 remained at historically low levels.

Spreads on BBB-rated bonds were down about 10 basis points. Speculative-grade bond yields declined, and their credit spreads narrowed nearly 60 basis points. Currently, these spreads are only about 40 basis points above the very low levels touched earlier this year. Quality spreads on commercial paper remained low.

Corporate Earnings and Credit Quality

Reports from about 400 of the S&P 500 firms indicate that second-quarter earnings per share likely increased about 13 percent from four quarters earlier, and gains were registered broadly across sectors. That increase implies a 3 percent advance from the first quarter to the second quarter (seasonally adjusted quarterly rate). Analysts' forecasts of year-ahead earnings for the S&P 500 firms were revised upward between mid-June and mid-July; the increase mainly reflected positive revisions to forecasts for energy firms. Excluding these firms, revisions were, on balance, a touch negative and about in the range seen since mid-2004.

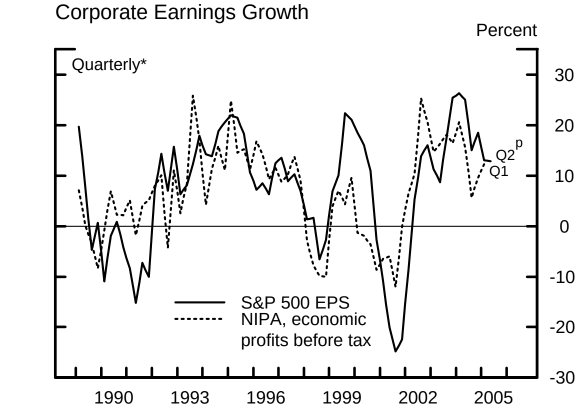
Overall, the financial position of nonfinancial firms continues to be strong, with firms still holding large stocks of liquid assets. The dollar volume of corporate bonds that were downgraded increased in the second quarter, largely reflecting the downgrades of General Motors and Ford debt; among other firms, ratings upgrades about kept pace with downgrades. In June, both the realized six-month trailing default rate on bonds and the expected year-ahead default rate based on KMV's firm-level estimates remained low.

Business Finance

Gross bond issuance by nonfinancial firms rebounded in June and July from the lackluster figures posted in April and May, but hefty retirements have left net bond issuance only slightly positive in the past couple of months. Short-term borrowing in July was robust: Commercial paper outstanding rebounded after large quarter-end

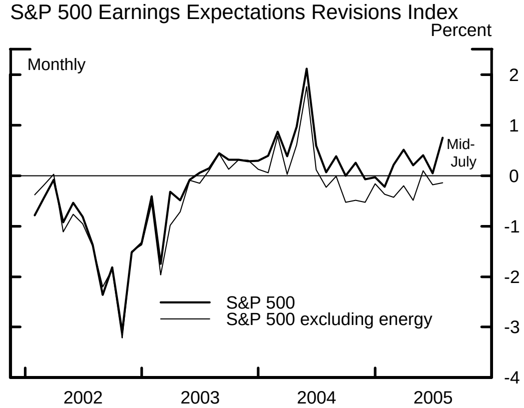
Corporate Earnings and Credit Quality

Corporate Earnings Growth



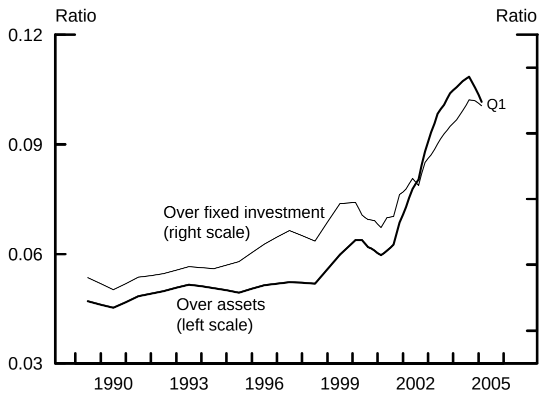
* Change from four quarters earlier.
Source. I/B/E/S for S&P 500 EPS.

S&P 500 Earnings Expectations Revisions Index



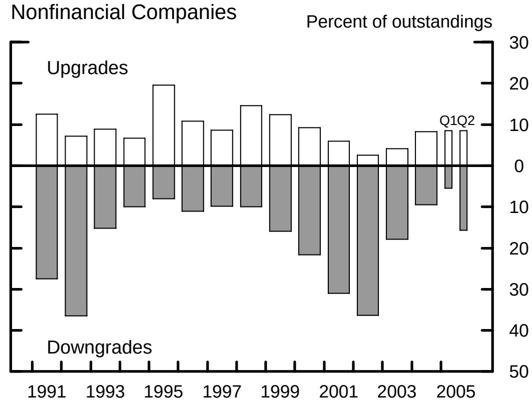
Note. Index is a weighted average of the percent change in the consensus forecasts of current-year and following-year EPS for constant sample.

Liquid Assets Held by Nonfinancial Corporations



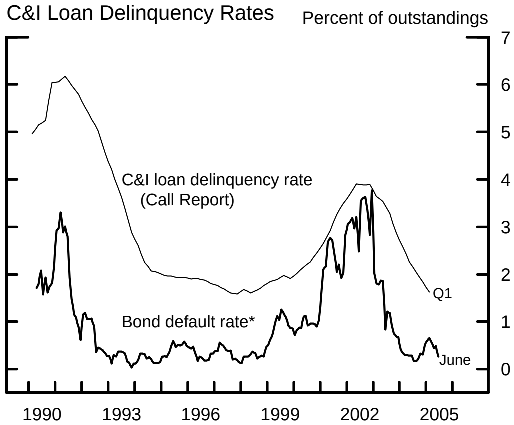
Note. Computstat data, annual through 1999 and quarterly thereafter; fixed investment is at an annual rate.

Bond Ratings Changes of Nonfinancial Companies



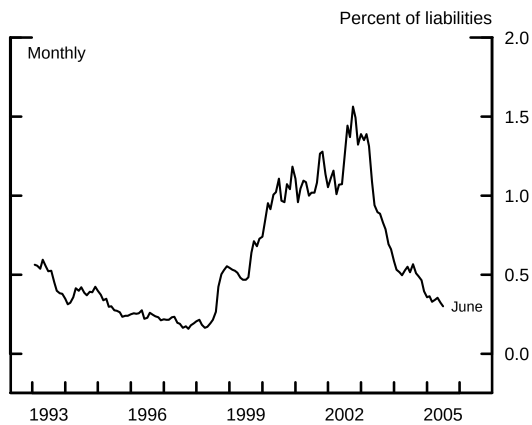
Note. Data are at an annual rate.
Source. Moody's Investors Service.

Bond Defaults and C&I Loan Delinquency Rates



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

Expected Year-Ahead Defaults



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

Business Finance

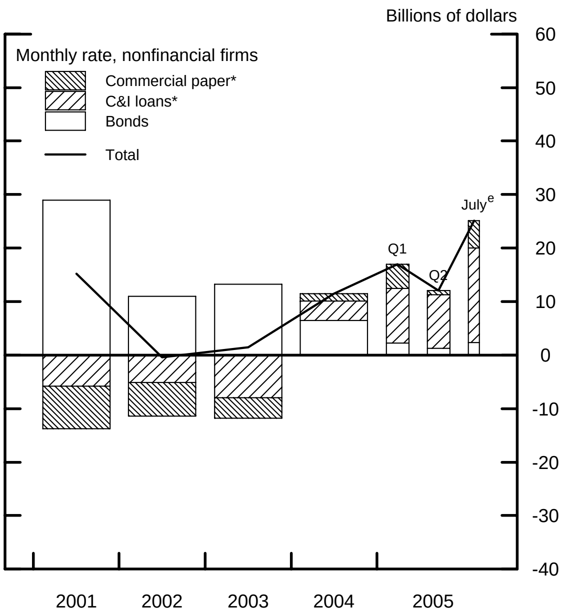
Gross Issuance of Securities by U.S. Corporations

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

Type of security	2001	2002	2003	2004	2005 Q1	2005 Q2	2005 June	2005 July[e]
Nonfinancial corporations								
Stocks[1]	6.5	5.2	3.7	5.3	4.4	3.2	4.4	1.9
Initial public offerings	2.1	.7	.4	1.6	2.3	1.0	1.5	1.3
Seasoned offerings	4.4	4.4	3.2	3.8	2.1	2.1	2.9	.5
Bonds[2]	39.8	24.8	31.6	22.8	16.9	17.3	30.8	18.1
Investment grade	27.5	15.7	16.0	8.3	6.0	9.5	15.6	6.2
Speculative grade	8.9	4.8	11.3	9.5	7.7	4.7	7.9	7.1
Other (sold abroad/unrated)	3.4	4.2	4.3	4.9	3.2	3.1	7.3	4.8
Memo								
Net issuance of commercial paper[3]	-8.0	-6.3	-3.8	1.4	4.5	.8	-17.4	5.2
Change in C&I loans at commercial banks[3,4]	-5.8	-5.1	-7.9	3.6	10.3	10.0	.8	17.7
Financial corporations								
Stocks[1]	4.2	4.0	6.9	6.7	5.4	5.2	9.5	2.9
Bonds[2]	80.2	87.0	111.1	139.4	162.1	171.9	220.6	127.6

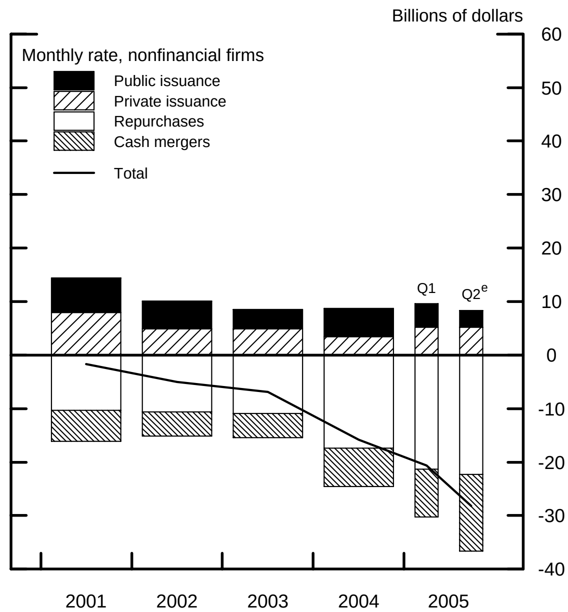
Note. Components may not sum to totals because of rounding.
1. Excludes private placements and equity-for-equity swaps that occur in restructurings.
2. Data include regular and 144a private placements. Bond totals reflect gross proceeds rather than par value of original discount bonds. Bonds are categorized according to Moody's bond ratings, or to Standard & Poor's if unrated by Moody's.
3. End-of-period basis, seasonally adjusted.
4. Adjusted for FIN 46 effects.
e Staff estimate.

Selected Components of Net Debt Financing



* Seasonally adjusted, period-end basis.
e Staff estimate.

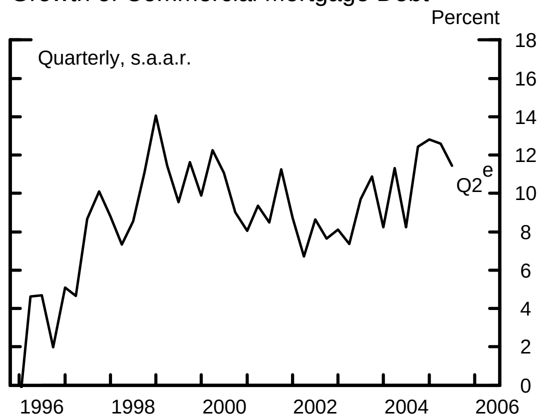
Components of Net Equity Issuance



e Staff estimate.

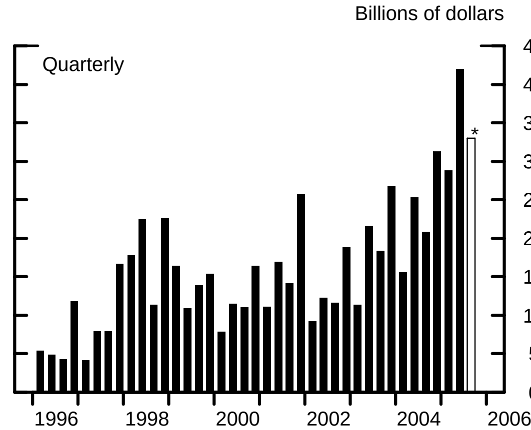
Commercial Real Estate

Growth of Commercial Mortgage Debt



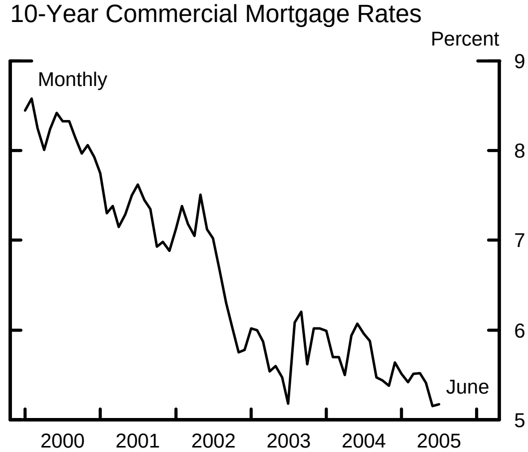
e Staff estimate.

Gross Issuance of CMBS



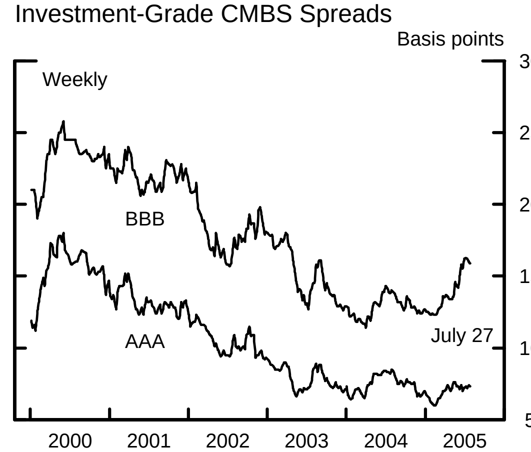
* Staff estimate for Q3.
Source. Commercial Mortgage Alert.

10-Year Commercial Mortgage Rates



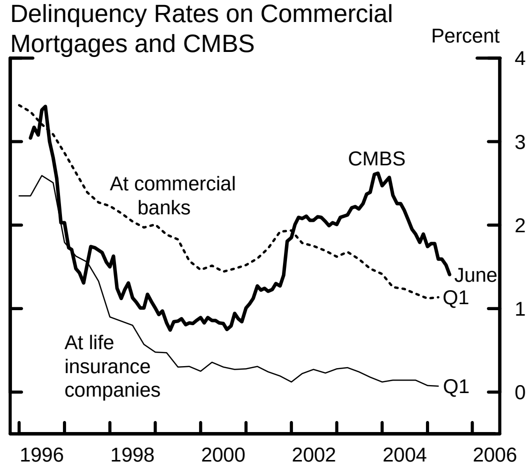
Source. Barron's/Levy.

Investment-Grade CMBS Spreads



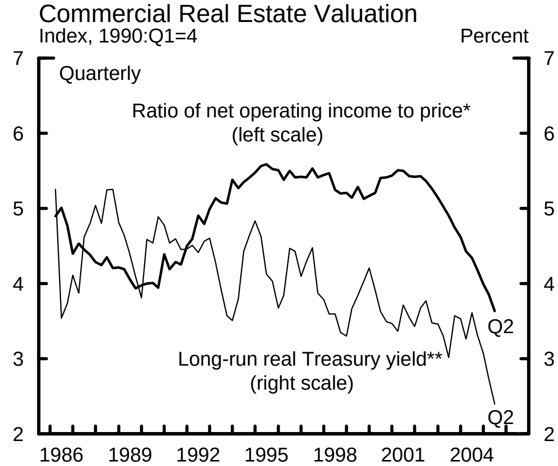
Note. Measured relative to the 10-year Treasury yield.
Source. Morgan Stanley.

Delinquency Rates on Commercial Mortgages and CMBS



Source. Call Report, ACLI, Morgan Stanley.

Commercial Real Estate Valuation



* Staff calculation from NCREIF data.
** Yield on synthetic Treasury perpetuity minus Philadelphia Fed 10-year expected inflation.

paydowns that had damped second-quarter growth, and bank loans to businesses advanced briskly. According to the July Senior Loan Officer Opinion Survey on Bank Lending Practices, U.S. banks, on net, eased standards further on C&I loans over the past three months even as demand for loans continued to firm. On balance, net business borrowing through bank loans, commercial paper, and bonds in July stepped up from the moderate pace recorded in the first two quarters of this year.

Gross public equity issuance was sluggish in the second quarter and remained so in July, although new registrations with the Securities and Exchange Commission suggest a pickup in IPOs in coming months. The outsized first-quarter figures for equity retirements appear to have been surpassed in the second quarter, as strong profits and large cash positions continued to bolster cash-financed mergers and share repurchases. Hence, net equity issuance probably dropped even further into negative territory last quarter.

Commercial Real Estate

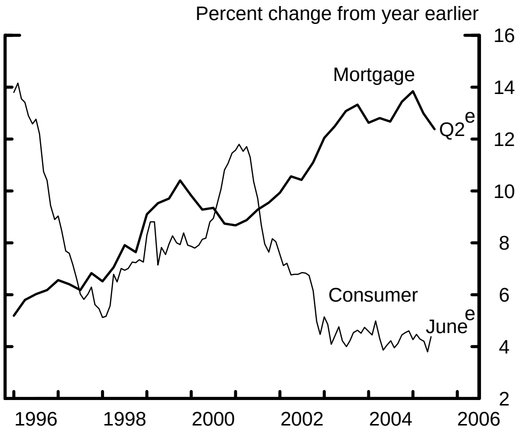
Growth of commercial mortgage debt likely maintained a double-digit pace in the second quarter, as the issuance of commercial-mortgage-backed securities (CMBS) set a record; the calendar of offerings suggests another large volume in the current quarter. Spreads on BBB-rated CMBS widened in the second quarter and in July and were likely pressured higher by the heavy issuance. Delinquency rates on CMBS declined further in June. The ratio of net operating income to property prices, an indicator of the rate of return on commercial real estate, edged down further in the second quarter. Even so, the spread of this ratio over the real perpetuity Treasury yield, a rough proxy for the risk premium on commercial real estate assets, widened somewhat in the second quarter but remained in the lower part of the range observed over the past decade.

Household Finance

Household debt is estimated to have expanded briskly in the second quarter but a bit less rapidly than earlier this year. Mortgage debt growth likely eased a bit in the second quarter because of increases in mortgage rates and—based on prices of existing homes—a possibly reduced pace of home price appreciation. Since the last FOMC meeting, rates on thirty-year fixed-rate mortgages have risen about in line with ten-year Treasury yields. Boosted by stronger retail sales in June, consumer credit growth appears to have picked up from the tepid pace recorded in April and May.

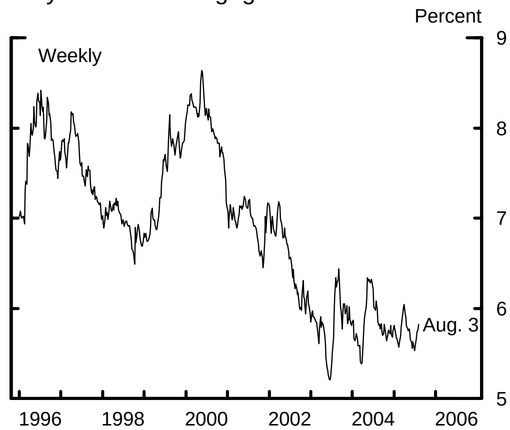
Household Liabilities

Debt Growth



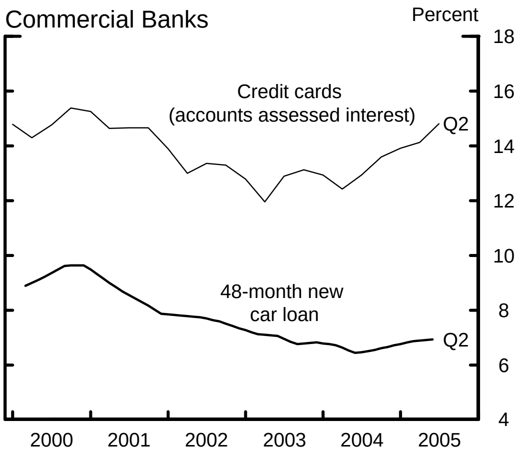
e Staff estimate.

30-year Fixed Mortgage Rate



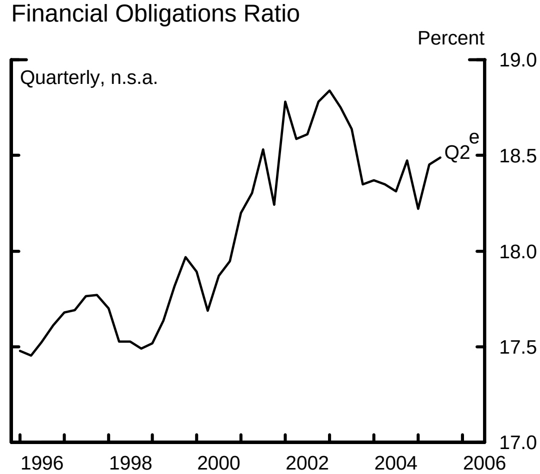
Source. Freddie Mac.

Consumer Loan Interest Rates at Commercial Banks



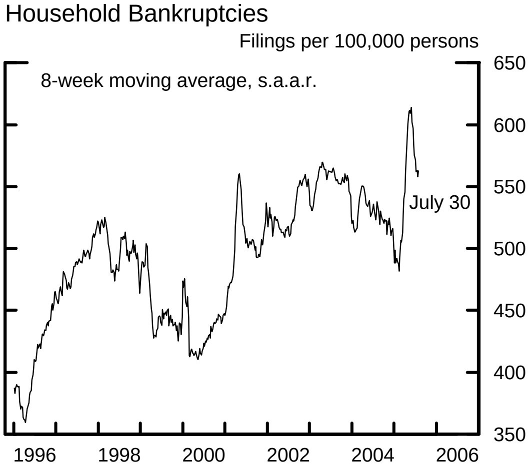
Source. Federal Reserve.

Financial Obligations Ratio



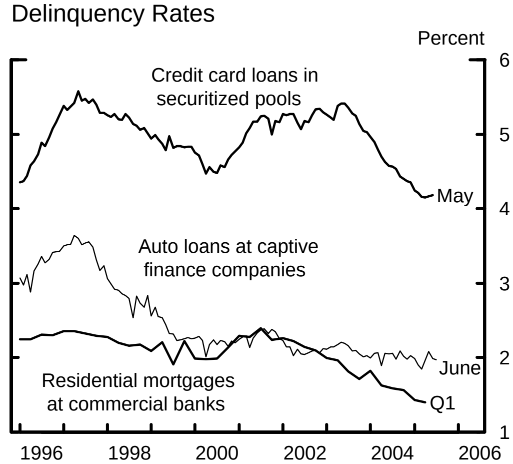
e Staff estimate.

Household Bankruptcies



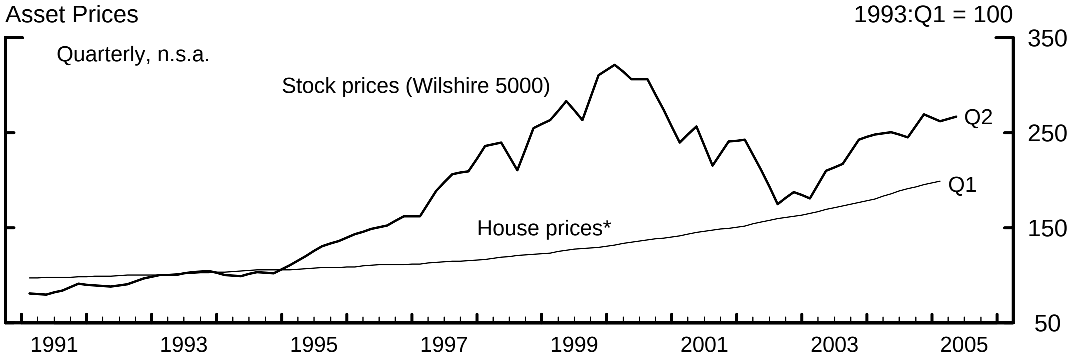
Source. Visa Bankruptcy Notification Service.

Delinquency Rates

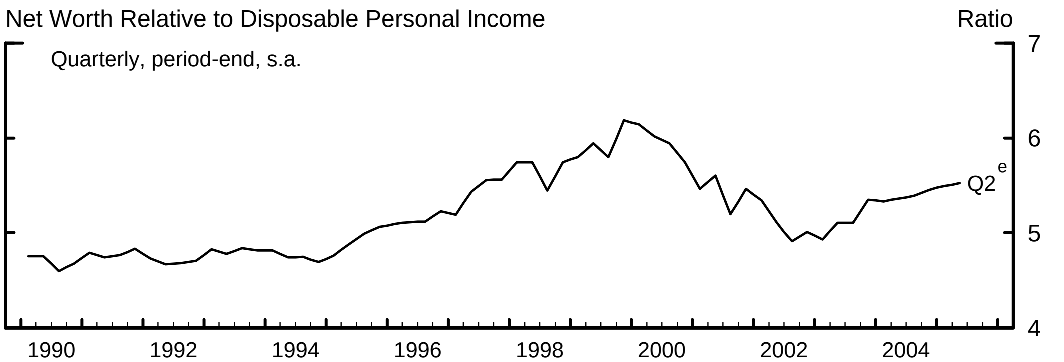


Source. Moody's, Federal Reserve, Call Report.

Household Assets



* Source. Office of Federal Housing Enterprise Oversight (OFHEO); repeat-sales purchase-only index.



e Staff estimate.

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

Fund type	2003	2004		2005				Assets
		H1	H2	Q1	Q2	June	July[e]	June
Total long-term funds	**18.0**	**20.0**	**15.0**	**22.3**	**13.9**	**12.2**	**18.3**	**6,349**
Equity funds	**12.7**	**19.7**	**9.9**	**15.8**	**8.7**	**6.1**	**7.8**	**4,470**
Domestic	10.7	13.7	4.8	5.2	3.1	1.7	2.4	3,728
International	2.0	6.0	5.1	10.6	5.6	4.4	5.3	742
Hybrid funds	**2.7**	**4.1**	**3.0**	**4.5**	**2.3**	**2.1**	**0.9**	**545**
Bond funds	**2.6**	**-3.8**	**2.0**	**2.0**	**2.9**	**4.0**	**9.6**	**1,334**
High-yield	2.2	-2.1	0.5	-2.3	-1.0	0.0	0.6	148
Other taxable	1.0	0.1	2.0	3.8	3.5	2.9	7.0	850
Municipals	-0.6	-1.9	-0.4	0.4	0.4	1.1	2.0	337

Note. Excludes reinvested dividends.

e Staff estimates based on confidential ICI weekly data.

Source. Investment Company Institute.

Treasury Financing

(Billions of dollars)

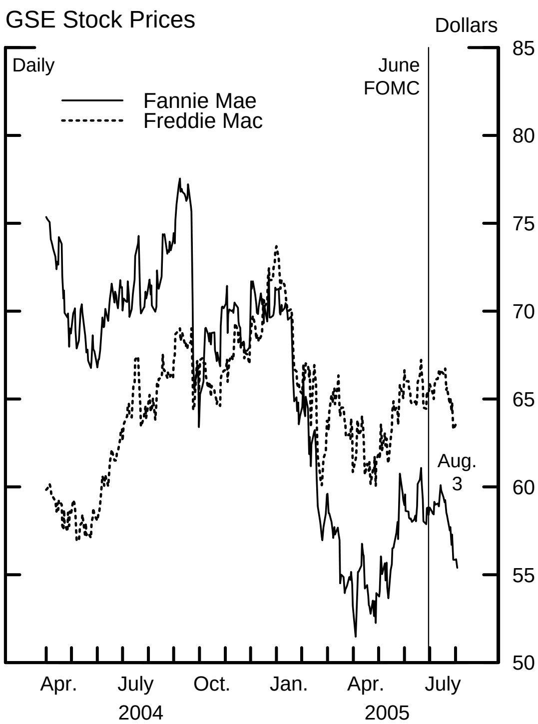
Item	2004			2005			
	Q2	Q3	Q4	Q1	Apr.	May	June
Total surplus, deficit (–)	**-25.8**	**-85.7**	**-118.1**	**-176.6**	**57.7**	**-35.3**	**22.4**
Means of financing deficit							
Net borrowing	40.7	83.4	102.1	164.7	-21.8	-8.4	-12.6
Nonmarketable	6.2	-5.2	2.4	20.8	13.0	14.5	8.4
Marketable	34.5	88.6	99.7	143.9	-34.8	-22.9	-21.0
Bills	-34.9	14.3	43.6	55.7	-67.8	-30.1	-37.9
Coupons	69.4	74.3	56.0	88.2	33.0	7.2	17.0
Decrease in cash balance	-23.3	8.3	11.7	2.2	-53.9	59.8	-16.6
Other[1]	8.4	-6.0	4.3	9.7	18.0	-16.1	6.8
Memo:							
Cash balance, end of period	44.6	36.3	24.7	22.4	76.4	16.6	33.2

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

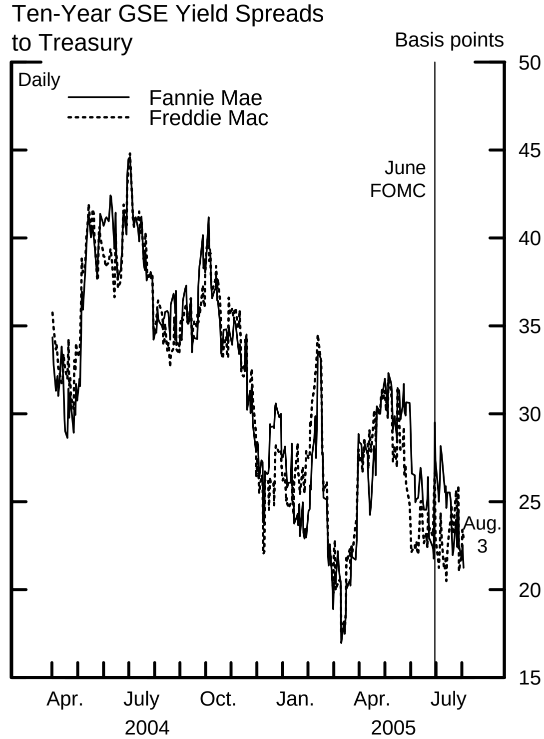
1. Direct loan financing, accrued items, checks issued less checks paid, and other transactions.

GSE Market Developments

GSE Stock Prices



Ten-Year GSE Yield Spreads to Treasury



Note. GSE yields based on senior unsecured debt.

The ratio of financial obligations to disposable personal income is estimated to have ticked up in the second quarter. Bankruptcy filings have fallen somewhat in recent weeks, but they remain high, as many households evidently have been filing before the new bankruptcy law takes effect in October. Other indicators of household credit quality have held steady at favorable levels.

The small rise in stock prices in the second quarter points to a slight increase in the ratio of household net worth to disposable personal income. Net purchases of long-term mutual fund shares picked up in July from the second quarter pace, although net flows to domestic equity funds remained sluggish.

Treasury and Agency Finance

Consistent with the improvement in the federal budget in recent months, issuance of nominal Treasury securities has continued to decline, and the quantity of twenty-year TIPS auctioned in July was below market projections. Nonetheless, demand at auctions over the intermeeting period was lackluster, with bid-to-cover ratios in the lower half of recent ranges. The proportion of issues awarded to indirect bidders—a rough proxy for demand from foreign official institutions—averaged a bit above the levels reported earlier this year. An alternative indicator of foreign official demand, the value of Treasury securities held in custody at the Federal Reserve Bank of New York on behalf of foreign official institutions, increased over the intermeeting period at about the pace registered earlier in the year.

In the August mid-quarter refunding statement, the Treasury announced that it would reintroduce regular semi-annual issuance of a thirty-year nominal bond, with the auction calendar to be released in November. The decision had been widely anticipated and prompted little market reaction.

The stock prices of Fannie Mae and Freddie Mac declined 6 and 3 percent, respectively, amid investor concerns about legislation that would likely result in smaller GSE investment portfolios. Spreads of yields on GSE senior and subordinated unsecured debt over those on comparable Treasury securities were little changed.

State and Local Government Finance

In July, gross issuance of long-term municipal bonds to finance new capital projects exceeded the robust pace seen in the second quarter, and short-term issuance also edged up. Credit quality in this sector has shown modest improvement this year, as rating

State and Local Government Finance

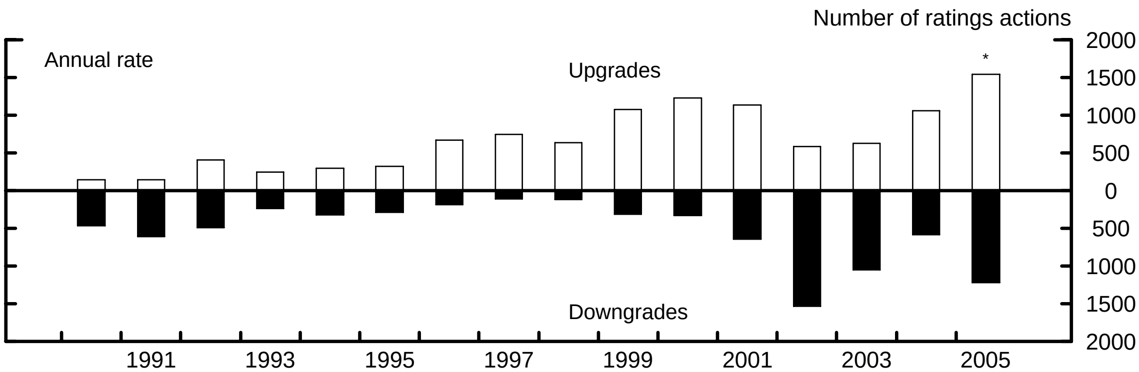
Gross Offerings of Municipal Securities

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

Type of security	2002	2003	2004	2005 Q1	2005 Q2	2005 July [e]
Total	36.3	37.9	34.7	34.8	41.1	39.0
Long-term [1]	30.3	32.0	29.8	32.7	37.0	34.0
Refundings [2]	10.1	10.0	10.8	16.3	16.1	11.0
New capital	20.2	22.1	19.0	16.4	20.9	23.0
Short-term	6.0	5.8	4.9	2.1	4.0	5.0
Memo: Long-term taxable	1.7	3.5	2.0	1.5	2.2	3.0

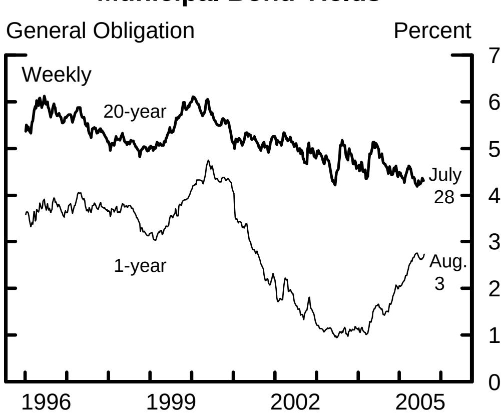
1. Includes issues for public and private purposes.
2. All issues that include any refunding bonds.
e Staff estimate based on preliminary data through July 28.

Ratings Changes



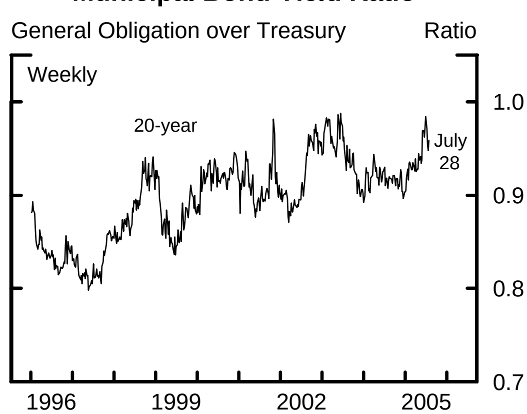
* Data through July 27 at an annual rate.
Source. S&P's Credit Week Municipal and Ratings Direct.

Municipal Bond Yields



Source. Bloomberg and Bond Buyer.

Municipal Bond Yield Ratio



Source. Bond Buyer.

upgrades on municipal bonds have outnumbered downgrades. Over the intermeeting period, the ratio of municipal bond yields to comparable-maturity Treasury yields ticked down.

Money and Bank Credit

M2 accelerated to an annual rate of 6 percent in June, an increase likely fueled by tax-related flows and prepayments associated with mortgage refinancing activity, but M2 slowed in July as these factors waned. Among the components of M2, small time deposits, whose rates of return adjust quickly to changes in market rates, continued to expand briskly in June and July, while liquid deposits and retail money funds were little changed, on balance. Overall, M2 has grown somewhat faster this year than would be predicted by its historical relationship with GDP and the opportunity cost of M2 assets; this growth perhaps has been boosted by the flattening of the yield curve.

Bank credit picked up a bit in July, after a deceleration in June that reflected a runoff in securities holdings. Real estate lending grew sharply last month, supported by robust activity in both the commercial and residential segments. Consumer loans picked up from a moderate pace, perhaps with a boost from strong automobile sales. C&I lending, which has been bolstered by leveraged buyouts and merger and acquisition activity in recent months, was strong again in July. By contrast, other loans, which are quite volatile, declined sharply in July after expanding in June.

Monetary Aggregates

(Based on seasonally adjusted data)

Aggregate or component	2003	2004	2005 Q1	2005 Q2	2005 June	2005 July (p)	Level ($ billions), July (p)
Aggregate	Percent change (annual rate)[1]						
1. M2[2]	5.4	5.2	3.7	1.7	6.0	1.3	6,510
2. M3[3]	4.8	5.8	5.2	5.4	9.8	2.3	9,743
Components of M2[4]							
3. Currency	5.9	5.5	3.7	2.7	4.9	.8	710
4. Liquid deposits[5]	14.0	10.1	3.4	-2.1	4.6	-2.1	4,177
5. Small time deposits	-9.4	-.3	13.3	22.1	22.4	18.0	914
6. Retail money market funds	-11.5	-11.8	-4.9	-1.2	-4.8	.5	702
Components of M3							
7. M3 minus M2[6]	3.6	7.1	8.4	13.3	17.5	4.3	3,234
8. Large time deposits, net[7]	4.3	20.8	34.7	22.0	25.8	-9.2	1,212
9. Institutional money market funds	-5.6	-5.7	-10.2	3.7	18.5	9.7	1,076
10. RPs	14.1	.8	-19.7	4.9	-17.0	15.1	506
11. Eurodollars	29.3	27.1	26.4	24.1	32.4	16.6	440
Memo							
12. Monetary base	5.9	5.6	3.6	2.7	5.1	.7	772
	Average monthly change (billions of dollars)[8]						
Selected managed liabilities at commercial banks							
13. Large time deposits, gross	-1.1	14.8	26.2	17.9	20.3	-12.9	1,317
14. Net due to related foreign institutions	3.1	-11.0	13.7	-4.4	-14.9	45.3	99
15. U.S. government deposits at commercial banks	-.3	.2	2.0	2.7	-15.2	-5.3	16

1. For the years shown, Q4-to-Q4 percent change. For the quarters shown, based on quarterly averages.
2. Sum of currency, liquid deposits (demand, other checkable, savings), small time deposits, retail money market funds, and nonbank traveler's checks.
3. Sum of M2, net large time deposits, institutional money market funds, RP liabilities of depository institutions, and Eurodollars held by U.S. addressees.
4. Nonbank traveler's checks not listed.
5. Sum of demand deposits, other checkable deposits, and savings deposits.
6. Sum of large time deposits, institutional money market funds, RP liabilities of depository institutions, and Eurodollars held by U.S. addressees.
7. Net of holdings of depository institutions, money market funds, U.S. government, and foreign banks and official institutions.
8. For the years shown, "average monthly change" is the Q4-to-Q4 dollar change divided by 12. For the quarters shown, it is the quarter-to-quarter dollar change divided by 3.

p Preliminary.

Commercial Bank Credit

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

Type of credit	2003	2004	Q1 2005	Q2 2005	June 2005	July[e] 2005	Level ($ billions), July 2005[e]
Total							
1. Adjusted[1]	**5.9**	**8.9**	**14.4**	**9.8**	**6.5**	**8.6**	**6,974**
2. Reported	5.6	8.4	12.4	9.6	7.4	6.7	7,115
Securities							
3. Adjusted[1]	8.6	6.5	23.0	5.7	-15.2	9.1	1,856
4. Reported	7.2	5.1	15.1	5.2	-10.3	2.1	1,998
5. Treasury and agency	8.9	5.0	20.7	-5.7	-27.5	3.5	1,178
6. Other[2]	4.9	5.4	6.5	22.4	14.9	.2	820
Loans[3]							
7. Total	4.9	9.8	11.4	11.3	14.5	8.5	5,117
8. Business	-9.4	1.5	16.9	13.0	6.6	17.6	978
9. Real estate	11.1	13.9	13.5	13.4	17.4	18.8	2,765
10. Home equity	30.8	43.4	18.7	13.2	9.3	11.2	431
11. Other	8.8	9.7	12.6	13.5	18.9	20.2	2,334
12. Consumer	5.4	8.8	8.2	3.3	4.9	8.7	695
13. Adjusted[4]	5.8	6.0	5.0	-2.5	2.9	5.6	1,054
14. Other[5]	6.8	7.9	-.9	9.2	23.9	-43.9	680

Note. Data are adjusted to remove estimated effects of consolidation related to FIN 46 and for breaks caused by reclassifications. Monthly levels are pro rata averages of weekly (Wednesday) levels. Quarterly levels (not shown) are simple averages of monthly levels. Annual levels (not shown) are levels for the fourth quarter. Growth rates are percentage changes in consecutive levels, annualized but not compounded.

1. Adjusted to remove effects of mark-to-market accounting rules (FIN 39 and FAS 115).
2. Includes private mortgage-backed securities, securities of corporations, state and local governments, foreign governments, and any trading account assets that are not Treasury or agency securities, including revaluation gains on derivative contracts.
3. Excludes interbank loans.
4. Includes an estimate of outstanding loans securitized by commercial banks.
5. Includes security loans and loans to farmers, state and local governments, and all others not elsewhere classified. Also includes lease financing receivables.

e Estimated.

Appendix

Senior Loan Officer Opinion Survey on Bank Lending Practices

The July 2005 Senior Loan Officer Opinion Survey on Bank Lending Practices addressed changes in the supply of, and demand for, bank loans to businesses and households over the past three months. The survey also queried banks about their current holdings and recent originations and securitizations of nontraditional mortgage products. This appendix is based on responses from fifty-four domestic banking institutions and twenty U.S. branches and agencies of foreign banks.

Domestic commercial banks reported a further easing of lending standards and terms for commercial and industrial (C&I) loans and commercial real estate loans over the past three months. At U.S. branches and agencies of foreign banks, in contrast, lending standards and terms for these types of loans were little changed over the same period. On net, domestic banks experienced stronger demand for C&I loans over the past three months, while foreign institutions indicated that demand for business loans was about unchanged. Both domestic and foreign institutions reported stronger demand for commercial real estate loans, on balance, and a few respondents, on net, reported having eased standards on such loans. A notable net fraction of domestic respondents reported stronger demand for loans to purchase homes over the past three months, while a small net percentage of banks also experienced a strengthening in demand for consumer loans. On net, credit standards for residential mortgages and consumer loans were about unchanged in the July survey, but a significant proportion of respondents indicated increased willingness to make consumer installment loans.

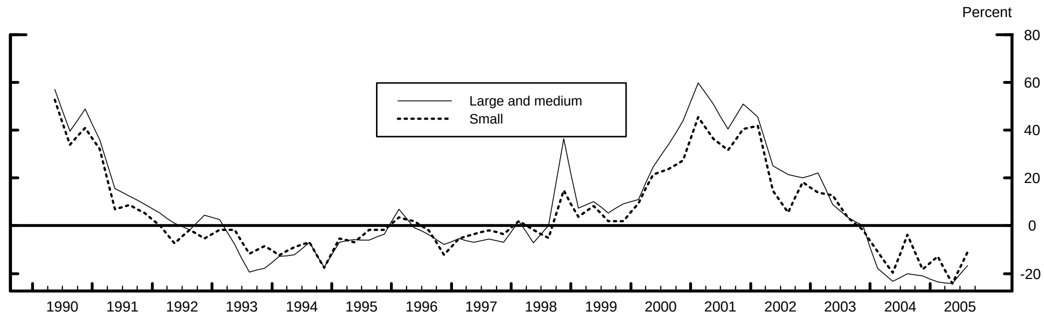
In response to a set of special questions on nontraditional mortgage products, domestic banks generally reported that such loans accounted for less than a quarter of their residential mortgage originations and of the mortgages on their books. More than one-half of respondents, however, noted that the share of mortgage originations accounted for by nontraditional mortgage products had been higher over the past twelve months than over the previous twelve-month period.

C&I Lending

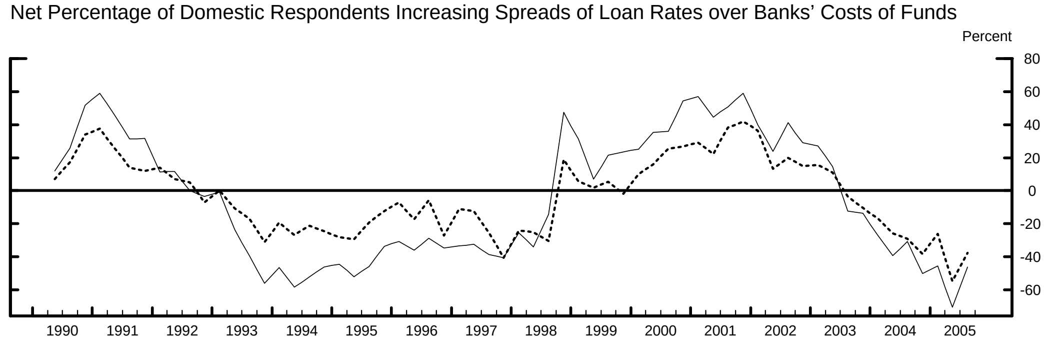
In the July survey, domestic banks reported a further net easing of standards and terms for C&I loans. About 15 percent of respondents, on net, reported having eased their credit standards for loans to large and middle-market firms over the past three months, a slightly lower net fraction than in recent surveys. On balance, 50 percent of domestic banks indicated that they had reduced the costs of credit lines for such firms in July, up from 40 percent in the April survey. About 45 percent—a somewhat smaller net percentage than in the previous survey—reported that they had narrowed spreads of

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

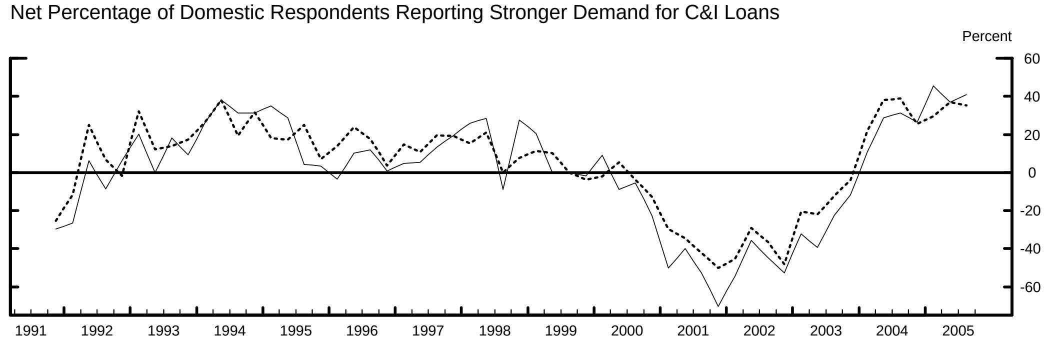
Net Percentage of Domestic Respondents Tightening Standards for C&I Loans



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

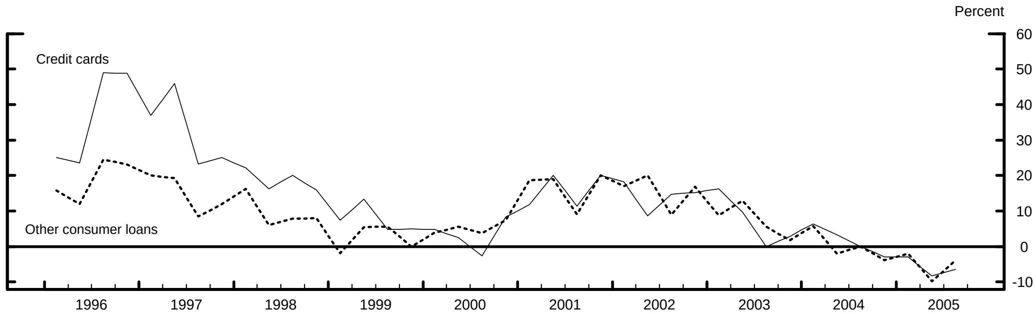


Net Percentage of Domestic Respondents Reporting Stronger Demand for C&I Loans

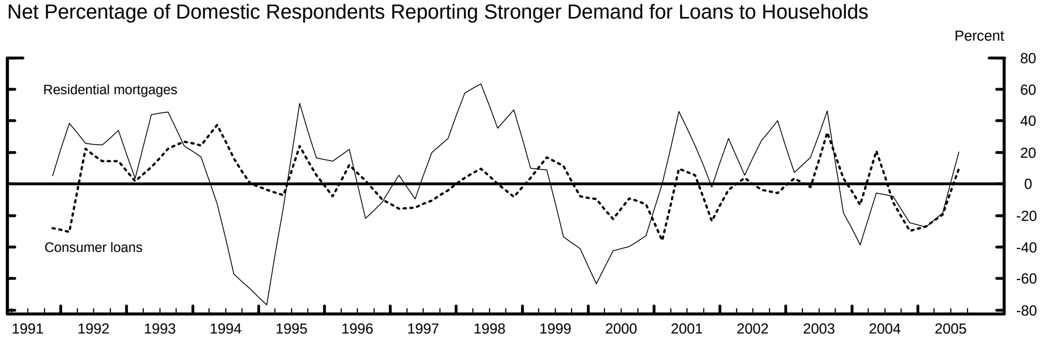


Measures of Supply and Demand for Loans to Households

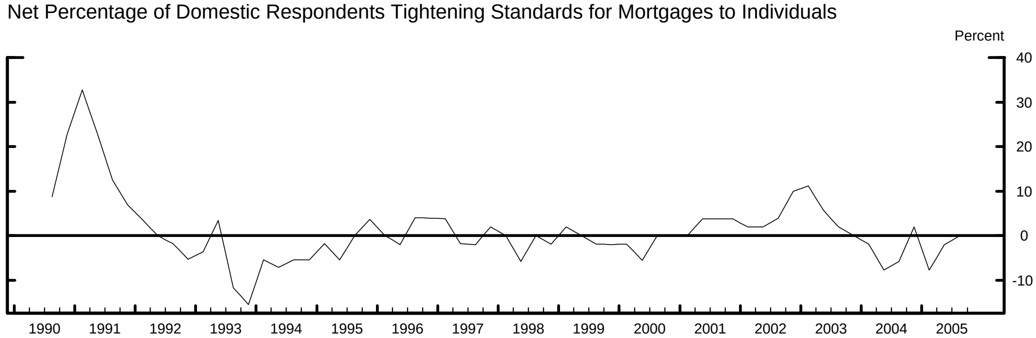
Net Percentage of Domestic Respondents Tightening Standards on Consumer Loans



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



Net Percentage of Domestic Respondents Tightening Standards for Mortgages to Individuals



loan rates over their cost of funds. Domestic respondents also reported having eased other lending terms over the past three months: About one-fourth of banks, on net, increased the maximum size and the maximum maturity of credit lines they are willing to extend to large and middle-market firms. In contrast, U.S. branches and agencies of foreign banks—customers of which are likely to be larger firms—indicated that their lending standards and terms for C&I loans were little changed over the past three months. For C&I loans to small firms, 11 percent of domestic banks, on net, noted that they had eased their lending standards—down from about 20 percent in April—and about one-third of respondents reported having trimmed spreads of loan rates over their cost of funds.

As in recent surveys, almost all domestic banks that reported having eased their lending standards and terms in the July survey cited more-aggressive competition from other banks or nonbank lenders as an important reason for having done so. Large fractions of those respondents also cited an increased tolerance for risk and a more favorable or less uncertain economic outlook as reasons for their move toward a less-stringent lending posture.

Demand for business loans reportedly strengthened over the past three months. Forty percent of domestic banks saw stronger demand for C&I loans from large and middle-market firms, on balance—about the same share as in the April survey. In contrast, foreign institutions reported that demand for C&I loans was about unchanged over the past three months. About one-third of domestic respondents also experienced stronger loan demand from small firms. As was the case in the April survey, a large majority of the domestic respondents that saw stronger loan demand pointed to borrowers' increased financing needs for accounts receivable and inventories as well as for investment in plant and equipment as having driven the rise in demand. A substantial fraction of domestic banks also pointed to a rise in merger and acquisition activity as having boosted demand for C&I loans. Regarding future business, 27 percent of domestic and 15 percent of foreign respondents, on net, indicated that inquiries from potential business borrowers had increased over the past three months, down from about 40 percent and 20 percent, respectively, in the April survey.

Commercial Real Estate Lending

On net, 13 percent of domestic banks reported an easing of lending standards on commercial real estate loans over the past three months, about half the fraction that did so in the April survey. All but one of the thirteen foreign branches and agencies active in commercial real estate lending reported unchanged standards on this type of loan. About one-fourth of domestic respondents, on net, experienced an increase in demand for commercial real estate loans over the past three months, about the same share as in the April survey. On net, 15 percent of foreign institutions indicated that demand for this type of loan had increased, down from one-third in April.

Households Lending

About one-fifth of domestic institutions reported in the July survey that they had become more willing to make consumer installment loans over the previous three months, a somewhat larger share than in April. However, standards and terms on credit card and non-credit-card consumer loans were reportedly little changed, on net, over the same period. A modest net fraction of banks reported stronger demand for consumer loans in the July survey.

Credit standards on residential mortgage loans were reportedly unchanged in the July survey. Demand for mortgages to purchase homes strengthened over the past three months: One-fifth of domestic respondents, on net, reporting stronger demand for such loans.

The July survey included a set of special questions on banks' current holdings and recent originations and securitizations of residential mortgages that could be categorized as nontraditional mortgage products. These products include—but are not limited to—adjustable-rate mortgages with multiple payment options, interest-only mortgages, and so-called "Alt-A" products, such as mortgages with limited income verification and mortgages secured by non-owner-occupied properties.[1]

About one-third of domestic respondents indicated that the share of residential mortgages on their books that could be classified as nontraditional mortgage products was less than 5 percent, and another third reported that the share of such products was between 5 percent and 15 percent. These shares are roughly similar if the responses are weighted by the respondent banks' dollar volumes of residential mortgages outstanding at the end of the first quarter. Only one bank indicated that nontraditional mortgage products accounted for more than one-half of residential mortgages on its books.

About one-third of domestic respondents reported that over the past twelve months the share of their residential mortgage originations that could be categorized as nontraditional products had been less than 5 percent. An additional 43 percent of respondents indicated that their share of nontraditional mortgage originations was between 5 percent and 25 percent over the same period. Banks reporting shares in this

[1] According to first-quarter Call Reports, the respondent banks accounted for about 60 percent of all residential real estate loans on the books of domestic commercial banks as of March 31, 2005.

range accounted for about 75 percent of all residential mortgages on the books of the survey respondents at the end of the first quarter.

More than half of respondent banks indicated that the share of nontraditional residential mortgage originations over the past twelve months was higher than it had been over the previous twelve-month period. Twelve percent of respondents noted that this share was substantially higher.

A large majority of respondents reported that their bank had securitized less than one-quarter of nontraditional mortgages originated over the past year. These institutions accounted for about one-half of the residential mortgages on all respondents' books. In contrast, three large banks—which accounted for almost 40 percent of the respondents' residential mortgages outstanding—indicated that the share of nontraditional mortgage originations that had been securitized exceeded 75 percent. On balance, a majority of the banks indicated that they were less likely to securitize nontraditional mortgage products than traditional mortgages. However, three large institutions—which accounted for more than 40 percent of the residential mortgages of the respondents—indicated that they were more likely to securitize nontraditional mortgage products.

Banks were also asked about the share of residential mortgages on their books used to finance purchases of second homes or homes for investment purposes. A substantial majority of banks indicated that this share was less than 10 percent. Most respondents also indicated that over the past year, the share of residential mortgage originations used to finance purchases of second homes or homes for investment purposes was less than 10 percent. One-fourth of the respondents noted that the share of originations accounted for by such loans was moderately higher over the past twelve months relative to the previous twelve-month period. Banks with larger mortgage portfolios were more likely to report an increase in this share.

Last Page of Financial Developments

International Developments

International Developments

U.S. International Transactions

Trade in Goods and Services

The U.S. international trade deficit narrowed to $55.4 billion in May from $56.9 billion in April (revised).

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

	2004	Annual rate			Monthly rate		
		2004	2005		2005		
		Q4	Q1	Q2[e]	Mar.	Apr.	May
Real NIPA[1]							
Net exports of G&S	-601.3	-634.1	-645.4	-601.3	...	...	...
Nominal BOP							
Net exports of G&S	-617.6	-676.9	-687.0	-673.5	-53.6	-56.9	-55.4
Goods, net	-665.4	-728.7	-745.3	-738.4	-58.9	-62.3	-60.8
Services, net	47.8	51.8	58.3	64.9	5.3	5.4	5.4

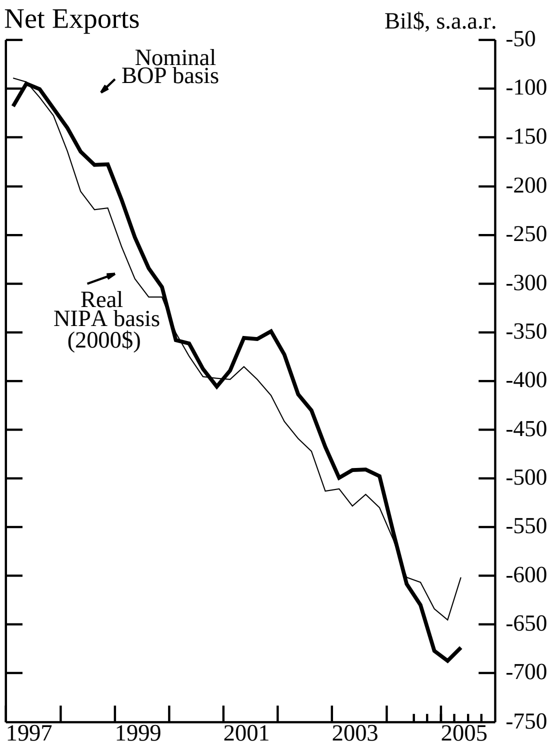
1. Billions of chained (2000) dollars.
e. BOP data are two months at an annual rate; NIPA data are BEA's advance estimate.
Source. U.S. Department of Commerce, Bureaus of Economic Analysis and Census.
n.a. Not available. ... Not applicable.

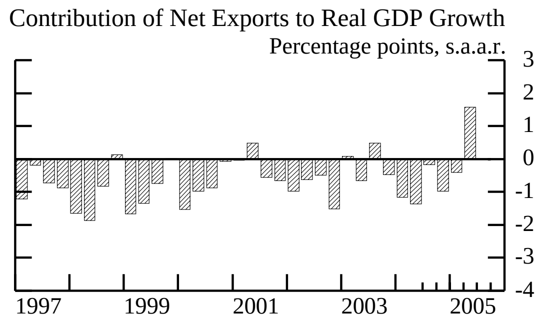
In May, the value of exports of goods and services increased slightly from April's strong level, as higher services exports were partly offset by a moderation in exports of goods. Within goods, exports of agricultural products and consumer goods both increased sharply, while exports of industrial supplies increased at a moderate pace. However, these gains were more than offset by weaker exports of both automotive products and capital equipment, as aircraft exports stepped down from April's elevated level.

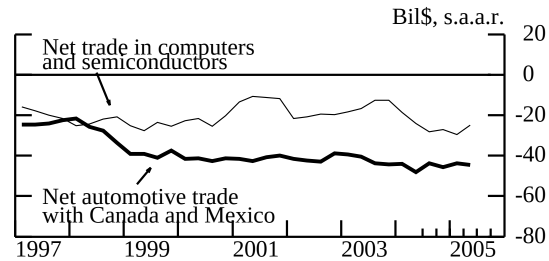
The average value of exports in April and May increased 17½ percent (a.r.) from the first quarter. Exports of capital goods showed the strongest gain, although exports of industrial supplies, agricultural goods, and services also moved up markedly relative to the first quarter.

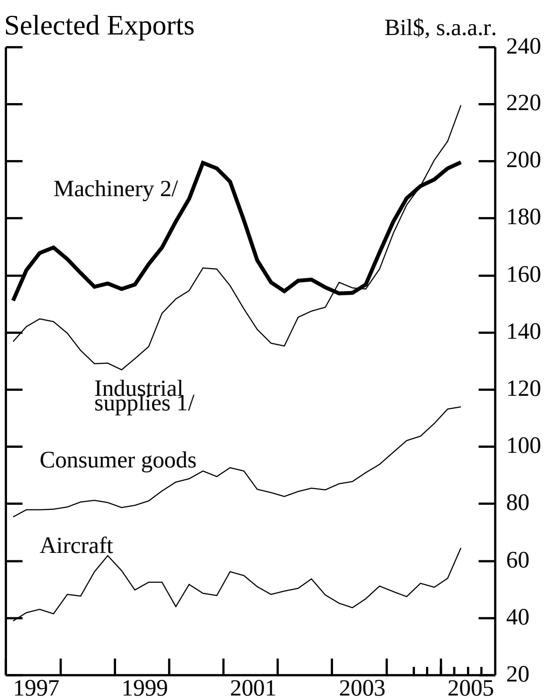
The value of imported goods and services decreased almost 1 percent in May, led by a sharp decline in the value of oil imports. Imports of non-oil goods also decreased, with both industrial supplies and capital goods exhibiting significant declines, more than offsetting a brisk increase in imports of automotive products and a modest gain in imports of consumer goods. Services imports increased moderately.

U.S. International Trade in Goods and Services

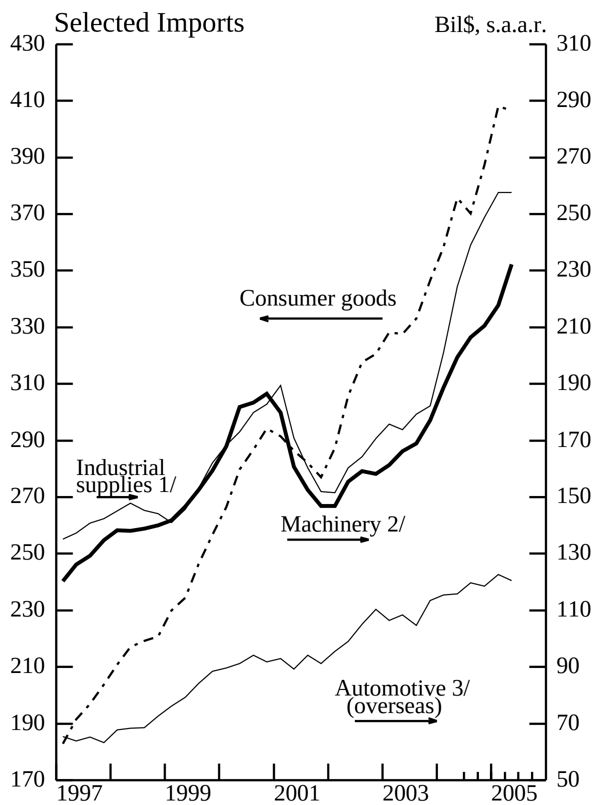








1. Excludes agriculture and gold.
2. Excludes computers and semiconductors.



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				Change[1]			
	2005		2005		2005		2005	
	Q1	Q2e	Apr.	May	Q1	Q2e	Apr.	May
Exports of G&S	**1230.8**	**1281.8**	**1280.9**	**1282.7**	**35.2**	**51.0**	**40.7**	**1.8**
Goods exports	855.4	894.3	894.6	894.0	19.9	39.0	36.3	-0.6
Gold	5.5	5.4	5.4	5.4	0.5	-0.1	-1.1	0.1
Other goods	849.8	888.9	889.3	888.6	19.3	101.4	37.4	-0.7
Aircraft & parts	53.9	64.7	70.5	58.9	2.9	10.8	12.3	-11.6
Computers & accessories	44.0	46.2	46.0	46.4	0.4	2.2	1.9	0.4
Semiconductors	43.4	46.1	45.8	46.5	-2.6	2.7	2.2	0.7
Other capital goods	200.4	203.1	203.2	202.9	3.7	2.6	2.6	-0.3
Automotive	94.8	93.8	94.7	92.9	1.1	-0.9	2.1	-1.8
to Canada	51.4	51.0	52.0	50.0	-0.7	-0.4	3.0	-2.1
to Mexico	14.8	15.6	15.9	15.4	-1.4	0.8	0.7	-0.5
to ROW	28.5	27.2	26.8	27.6	3.2	-1.3	-1.6	0.7
Agricultural	62.3	69.4	65.8	72.9	-0.3	7.1	2.4	7.1
Ind supplies (ex. ag, gold)	207.0	219.5	218.5	220.5	6.5	12.5	12.1	2.0
Consumer goods	113.2	114.1	111.5	116.7	5.0	0.9	-1.6	5.2
All other goods	30.8	32.1	33.3	30.8	2.6	1.2	14.8	-2.5
Services exports	375.4	387.5	386.2	388.7	15.3	12.1	4.4	2.4
Imports of G&S	**1917.8**	**1955.3**	**1963.7**	**1946.9**	**45.4**	**37.5**	**80.7**	**-16.8**
Goods imports	1600.7	1632.8	1642.4	1623.1	36.5	32.1	77.3	-19.4
Petroleum	211.7	225.5	233.4	217.7	-3.4	13.8	10.1	-15.7
Gold	3.8	4.0	3.9	4.2	-1.0	0.2	-0.2	0.3
Other goods	1385.1	1403.2	1405.1	1401.3	40.8	18.1	67.5	-3.9
Aircraft & parts	25.6	27.9	28.4	27.5	-2.1	2.3	2.2	-1.0
Computers & accessories	92.1	91.9	90.8	92.9	0.8	-0.2	0.4	2.1
Semiconductors	25.0	25.4	26.0	24.8	-0.6	0.4	1.5	-1.2
Other capital goods	220.3	234.6	238.1	231.1	7.1	14.3	23.6	-6.9
Automotive	232.7	231.7	225.4	237.9	0.2	-1.1	4.0	12.5
from Canada	69.4	65.5	65.0	66.0	-0.6	-3.9	2.1	1.1
from Mexico	40.6	45.7	45.1	46.3	-3.5	5.1	1.4	1.2
from ROW	122.7	120.4	115.3	125.5	4.3	-2.3	0.6	10.2
Ind supplies (ex. oil, gold)	257.7	257.7	264.1	251.2	8.7	-0.0	12.3	-12.9
Consumer goods	408.1	406.6	405.2	408.0	20.7	-1.6	19.6	2.8
Foods, feeds, bev.	66.3	67.0	66.3	67.7	2.0	0.7	0.7	1.4
All other goods	57.4	60.5	60.8	60.2	4.0	3.1	3.2	-0.6
Services imports	317.1	322.5	321.2	323.8	8.9	5.4	3.4	2.6
Memo:								
Oil quantity (mb/d)	14.55	13.42	13.66	13.18	0.16	-1.13	-0.45	-0.48
Oil import price ($/bbl)	39.89	45.99	46.77	45.20	-1.10	6.12	3.43	-1.57

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

On average, the value of imports in April and May increased 8 percent (a.r.) from the first quarter, as an increase in the value of oil imports and higher imports of capital goods more than offset lower imports of automotive products and consumer goods.

Prices of Internationally Traded Goods

Non-oil imports. In June, the prices of U.S. imports of non-oil goods and of core goods both fell 0.4 percent, marking the second consecutive month of falling prices. As in May, the main contribution to the price decline came from non-oil industrial supplies. After increasing briskly in March and April, the price index for non-oil industrial supplies fell 1.1 percent in May before declining another 1.1 percent in June, mainly on lower prices for natural gas and metals. Food prices fell 1.7 percent in June, reflecting lower vegetable prices. After large price increases earlier in the year, the finished goods categories had only small price movements in June. Prices for both automotive products and capital goods (excluding computers and semiconductors) were unchanged in June. The price index for consumer goods fell 0.1 percent. Prices for computers increased 0.1 percent in May, and prices for semiconductors fell 0.1 percent.

In the second quarter, NIPA core import prices rose 2.1 percent at an annual rate. The main contributors to the overall price increase were foods and non-oil industrial supplies, where large price increases in March and April were only partially undone in May and June. In the second quarter, the import price for capital goods (excluding computers and semiconductors) increased about 2 percent, a much slower rate of increase than in the first quarter. Automotive products and consumer goods saw only small price increases.

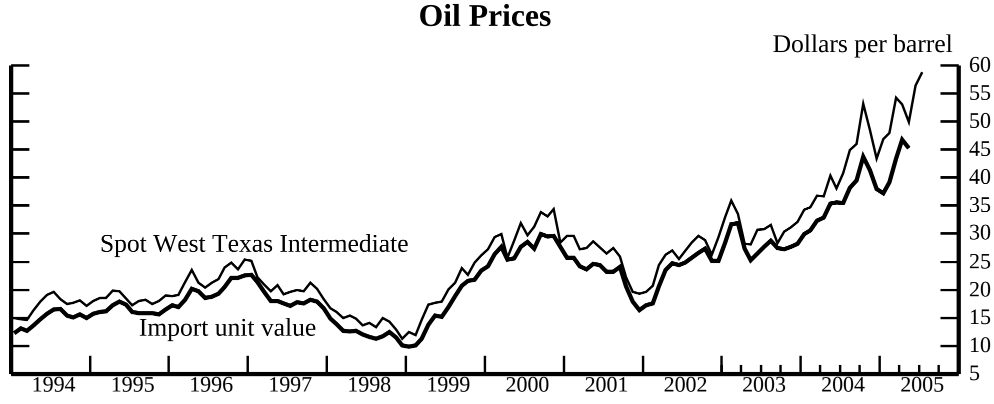
Oil. The BLS price of imported oil rose 7.6 percent in June. The spot price of West Texas Intermediate (WTI) crude oil rose more sharply in June, up 13 percent to average nearly $56.50 per barrel. The spot price rose late in May from about $50 per barrel to over $60 per barrel in late June as storms in the Gulf of Mexico threatened oil production and refining infrastructure. In July, the spot price averaged $58.70 per barrel and closed at $60.87 per barrel on August 3. This recent run-up owes, in part, to several production disruptions and delays as well as the death of King Fahd of Saudi Arabia. The prices of heavier grades of crude oil have also increased, but not to as great an extent as the price of WTI. In addition to ongoing concern about this hurricane season, oil prices remain elevated because of expected strong world oil demand going forward, concerns about future supplies from Iran, Iraq, Nigeria, Venezuela, and Russia, and limited spare production capacity in OPEC. The price of the far-dated futures contract (currently for delivery in December 2011) closed at $59.19 per barrel on August 3.

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

	Annual rate			Monthly rate		
	2004	2005		2005		
	Q4	Q1	Q2	Apr.	May	June
	BLS prices					
Merchandise imports	7.3	3.3	9.6	0.9	-1.0	1.0
Oil	35.3	-1.6	64.7	3.6	-4.8	7.6
Non-oil	3.2	4.2	1.4	0.4	-0.2	-0.4
Core goods*	4.1	5.1	2.2	0.5	-0.2	-0.4
Cap. goods ex comp & semi	2.6	5.3	2.0	0.3	0.1	0.0
Automotive products	2.4	0.4	0.8	0.2	0.0	0.0
Consumer goods	1.2	4.7	0.3	0.0	0.1	-0.1
Foods, feeds, beverages	10.7	9.2	6.9	-0.3	0.2	-1.7
Industrial supplies ex oil	11.1	8.5	5.7	1.9	-1.1	-1.1
Computers	-7.3	-6.6	-9.0	-1.3	-0.3	0.1
Semiconductors	-4.9	-1.1	-1.8	-0.5	-0.1	-0.1
Merchandise exports	3.6	4.9	3.3	0.5	-0.2	0.0
Core goods*	4.8	6.0	4.3	0.6	-0.2	0.0
Cap. goods ex comp & semi	3.3	3.9	1.9	0.3	0.0	0.1
Automotive products	1.2	1.4	0.9	0.0	0.1	0.1
Consumer goods	0.1	2.4	0.5	0.3	-0.1	-0.2
Agricultural products	-11.5	3.6	18.5	0.3	1.9	1.2
Industrial supples ex ag	17.2	12.9	5.7	1.5	-1.3	-0.6
Computers	-9.2	-7.8	-7.0	-1.0	-0.2	-0.4
Semiconductors	-1.7	-1.4	-3.1	-0.7	0.0	0.3
Chain price index	NIPA prices					
Imports of goods & services	6.8	2.9	8.8	...	...	...
Non-oil merchandise	2.9	3.7	1.4	...	...	...
Core goods*	3.9	4.6	2.1	...	...	...
Exports of goods & services	4.3	4.6	3.7	...	...	...
Total merchandise	3.8	4.5	3.1	...	...	...
Core goods*	4.9	6.1	4.0	...	...	...

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

Oil Prices



Exports. In June, the prices of U.S. exports of total goods and of core goods were unchanged from May. A 1.2 percent increase in prices for agricultural products offset a 0.6 percent fall in prices of non-agricultural industrial supplies and a 0.2 percent fall in the prices of exported consumer goods. Export prices for both capital goods and automotive products rose 0.1 percent. Prices of exported computers fell 0.4 percent, whereas prices for semiconductors increased 0.3 percent.

In the second quarter, prices of core exports (on a NIPA basis) rose 4 percent at an annual rate. Prices for agricultural products and non-agricultural industrial supplies increased briskly. Prices for capital goods (excluding computers and semiconductors) rose 1¾ percent. Prices for both automotive products and consumer goods increased only slightly.

U.S. International Financial Transactions

Net private foreign purchases of U.S. securities slowed for the fourth consecutive month in May (line 4 of the Summary of U.S. International Transactions table). Although, on net, private foreigners purchased agency bonds (line 4b) for the first time in four months, these purchases were more than offset by declines in private purchases of Treasury securities (line 4a) and corporate stocks (line 4d). Net purchases of corporate bonds (line 4c) remained fairly strong.

Foreign official inflows (line 1) also slowed in May, after a sizeable inflow in April. The easing is primarily attributed to countries other than the G10 and OPEC: Norway, which actively manages its oil fund, contributed significantly to this slowing. Inflows from China have remained relatively strong so far this year. Partial and confidential data on custody accounts at FRBNY indicate further sizable foreign official inflows in June and July.

U.S. acquisitions of foreign securities (line 5) continued at their recent pace in May. Net purchases of stocks (line 5b) moved back towards recent levels, while U.S. purchases of foreign bonds (line 5a) ticked up from April's level. However, it is difficult to know how much of this increase reflects larger purchases and how much reflects more complete reporting, given the effects of the ongoing review of the TIC data on net transactions in foreign bonds.

The volatile banking sector (line 3) registered a large net inflow in May, which more than offset the sizeable outflow in April. For the year to date, the banking sector has recorded a net outflow of less than $1 billion.

Summary of U.S. International Transactions

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

	2003	2004	2004 Q2	2004 Q3	2004 Q4	2005 Q1	2005 Apr.	2005 May
Official financial flows	**276.8**	**398.5**	**79.9**	**75.8**	**95.2**	**31.3**	**38.8**	**21.6**
1. Change in foreign official assets in the U.S. (increase, +)	275.3	395.7	78.8	75.3	94.6	25.9	39.0	22.1
a. G-10 countries	114.7	162.9	45.9	20.5	-.2	4.5	.1	-3.7
b. OPEC countries	6.1	12.0	-2.1	3.5	6.8	-3.9	1.8	2.7
c. All other countries	154.5	220.7	35.0	51.3	87.9	25.4	37.0	23.1
2. Change in U.S. official reserve assets (decrease, +)	1.5	2.8	1.1	.4	.7	5.3	-.2	-.6
Private financial flows	**283.8**	**186.1**	**91.1**	**40.9**	**73.7**	**134.1**	**...**	**...**
Banks								
3. Change in net foreign positions of banking offices in the U.S.[1]	64.7	-23.2	41.0	-16.6	-4.8	-8.3	-50.8	58.2
Securities[2]								
4. Foreign net purchases of U.S. securities (+)	335.6	490.0	151.4	88.4	170.3	155.5	34.1	30.0
a. Treasury securities	105.6	106.3	62.7	1.3	10.0	75.3	15.6	9.3
b. Agency bonds	-33.1	66.0	24.5	.5	43.2	.8	-1.3	5.8
c. Corporate and municipal bonds	225.0	255.9	55.2	84.9	71.2	57.7	14.4	14.9
d. Corporate stocks[3]	38.1	61.8	9.0	1.7	45.8	21.7	5.4	.0
5. U.S. net acquisitions (-) of foreign securities	-155.9	-106.0	-33.1	-38.6	-17.8	-38.7	-8.0	-12.3
a. Bonds	-41.1	-22.0	7.4	-21.6	-8.1	1.4	-5.3	-6.5
b. Stock purchases	-97.4	-96.2	-27.7	-16.4	-35.2	-38.0	-2.7	-5.8
c. Stock swaps[3]	-17.4	12.2	-12.7	-.6	25.5	-2.1	.0	.0
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-140.6	-252.0	-58.4	-41.2	-100.0	-32.2	...	...
7. Foreign direct investment in U.S.	67.1	106.8	31.0	35.7	31.6	28.8	...	...
8. Foreign holdings of U.S. currency	16.6	14.8	8.8	2.6	5.3	1.1	...	...
9. Other (inflow, +)[4]	96.3	-44.3	-49.6	10.7	-10.9	28.1	...	...
U.S. current account balance (s.a.)	**-519.7**	**-668.1**	**-166.6**	**-167.0**	**-188.4**	**-195.1**	**...**	**...**
Capital account balance (s.a.)[5]	**-3.2**	**-1.6**	**-0.4**	**-0.4**	**-0.5**	**-4.5**	**...**	**...**
Statistical discrepancy (s.a.)	**-37.8**	**85.1**	**-4.0**	**50.7**	**19.9**	**34.1**	**...**	**...**

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

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

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

3. Includes (4d) or represents (5c) stocks acquired through non-market means such as mergers and reincorporations.

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

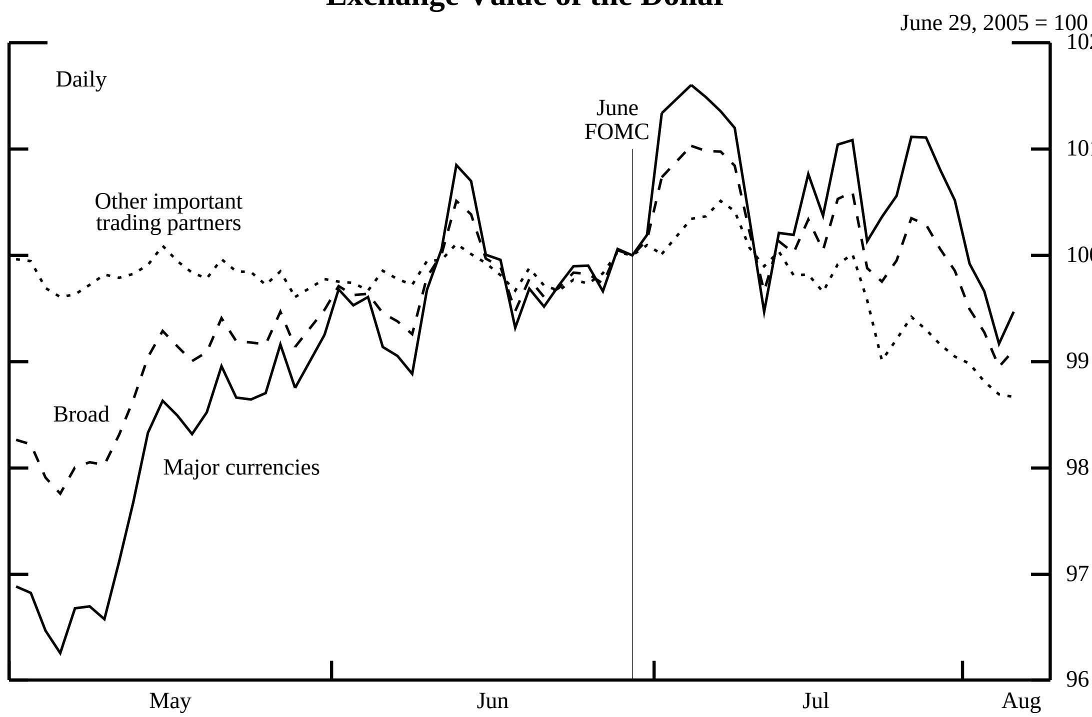
5. Consists of transactions in nonproduced nonfinancial assets and capital transfers.

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

Foreign Financial Markets

The trade-weighted major currencies index of the dollar declined slightly, 3/4 percent on net, over the intermeeting period. The dollar appreciated early in the period as short- and long-term dollar-denominated interest rates increased more than those of other industrial currencies, buoyed by data reinforcing the view that economic growth in the United States would likely continue to outpace that of Europe and Japan. However, the dollar later more than fully retraced these gains although interest rate differentials registered no further changes. Major equity indexes rose across the globe over the period, driven by a number of better-than-expected earnings reports. On July 21, China announced a major change to its exchange rate regime, including an immediate 2.1 percent appreciation of the renminbi versus the dollar. On a bilateral basis, the dollar depreciated 1-3/4 percent on balance against the euro and 3/4 percent versus the Canadian dollar. The dollar appreciated 1/2 percent versus the yen and 1 percent against sterling. Much of the dollar's movement versus sterling came in reaction to weaker-than-expected U.K. economic data and preceded the terrorist bombings in London on July 7.

Exchange Value of the Dollar



Financial Indicators in Major Industrial Countries

Country	Three-month rate: Aug. 4 (Percent)	Three-month rate: Percentage point change	Ten-year yield: Aug. 4 (Percent)	Ten-year yield: Percentage point change	Equities: percent change
Canada	2.66	.08	3.92	.12	5.68
Japan	.05	.00	1.38	.21	2.29
Euro area	2.13	.02	3.33	.18	4.34
United Kingdom	4.51	-.13	4.38	.18	3.95
Switzerland	.73	.04	2.01	.04	6.29
Australia	5.64	-.01	5.28	.18	2.30
United States	3.70	.54	4.29	.30	3.47
Memo: Weighted-average foreign	1.94	.02	3.38	.21	n.a.

NOTE. Change is from June 29/30 to August 4 (10 a.m. EDT).
n.a. Not available.

The three-month sterling spot interest rate declined 13 basis points over the intermeeting period. At the July 7 meeting of the Bank of England's Monetary Policy Committee, four of the nine members voted for a cut in the repo rate, and, at the August 4 meeting, the MPC lowered the Bank's repo rate by 25 basis points to 4.5 percent, citing a slowdown in the growth rates of household spending and business investment. Yields implied by sterling interest rate futures currently show that the market is assigning some probability to another 25-basis-point cut by the Bank of England by early next year. Three-month euro interest rates were little changed on net; statements by several European Central Bank officials during the period appeared to be tailored to quash market expectations of any monetary easing in the euro area in the near term. Ten-year sovereign yields rose about 20 basis points in Europe and Japan, less than the 30 basis-point increase in the benchmark Treasury yield. Japanese yields were boosted by press reports that some members of the Bank of Japan's Policy Board had expressed a belief that Japanese consumer prices would begin increasing by year's end. Headline equity indexes rose about 2 percent in Japan and about 4 percent in the euro area and the United Kingdom over the period. Stock prices were boosted by many stronger-than-expected earnings reports, particularly in the energy sector, which continued to be supported by rising crude oil prices.

Financial Indicators in Latin America, Asia, and Russia

Economy	Currency/ US dollar		Short-term interest rates[1]		Dollar-denominated bond spread[2]		Equity prices
	Aug. 4	Percent change	Aug.3/4 (Percent)	Percentage point change	Aug.3/4 (Percent)	Percentage point change	Percent change
Mexico	10.59	-1.66	9.60	.00	1.50	-.21	7.87
Brazil	2.32	-1.48	19.51	-.09	3.87	-.28	6.32
Argentina[3]	2.86	-.95	6.31	-.38	4.00	-4.66	9.73
Chile	558.00	-3.69	3.66	.12	.54	-.06	5.45
China	8.10	-2.10	n.a.	n.a.	.61	.08	2.00
Korea	1011.00	-2.27	3.37	-.01	...	...	10.24
Taiwan	31.83	.58	1.48	.08	...	...	3.27
Singapore	1.65	-1.98	1.94	-.06	...	...	6.17
Hong Kong	7.77	.02	3.41	.01	...	...	6.41
Malaysia	3.75	-1.26	2.85	.01	.52	-.01	6.41
Thailand	41.18	-.36	2.95	.30	.44	-.03	1.34
Indonesia	9735.00	-.52	8.85	.52	.98	.20	5.61
Philippines	55.80	.00	6.31	.81	4.20	-.14	2.79
Russia	28.46	-.59	n.a.	n.a.	1.30	-.32	13.40

NOTE. Change is from June 29/30 to August 3/4.
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.
3. J.P. Morgan re-structured Argentina's EMBI+ index in reaction to the recent debt exchange, prompting a drop in the Argentine EMBI+ spread from 66.07 to 9.10 percentage points on June 13.
n.a. Not available. ... Not applicable.

In emerging markets, the main event of the period was the long-awaited change in China's exchange rate regime, although the ultimate extent of the change remains uncertain. On July 21, the Chinese authorities announced that the renminbi would no longer be pegged to the dollar at a rate near 8.28 yuan per dollar. Instead, the authorities announced that they were moving to a "managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies." The exchange value of the renminbi against the dollar was moved immediately to 8.11 yuan per dollar, a revaluation of 2.1 percent. China's announcement raised some immediate speculation that the relatively small initial step could soon be followed by further exchange rate moves, but on July 26 the People's Bank of China issued a statement warning market participants not to expect additional substantial exchange rate moves in the near term. Since July 21, the exchange rate, heavily managed by official Chinese institutions, has registered only very small fluctuations near 8.11 yuan per dollar. The role of the currency basket in the management of the renminbi exchange rate, as well as the basket's composition, remains unclear for now.

China's announcement was immediately followed by sizable movements in the exchange rates of a number of Asian currencies against the dollar, but these movements were largely retraced in the ensuing days. Malaysia also ended its formal peg of the ringgit to the dollar soon after China's announcement. On net over the period, the dollar depreciated about 2 percent against the Korean won and the Singapore dollar, and about 1 percent versus the Malaysian ringgit. The dollar was little changed against the Thai baht and Taiwan dollar. Hong Kong did not change its exchange rate regime, and its currency only registered very small fluctuations against the U.S. dollar. Equity prices rose substantially in a number of Asian markets over the period, led by a 10 percent increase in Korea.

In Latin America, the dollar depreciated about 1-1/2 percent against the Mexican peso and the Brazilian *real*. Brazilian asset prices experienced much volatility early in the period on concerns that President Lula may become implicated in a growing bribes-for-votes scandal in Brazil's congress, but these concerns seemed to abate late in the period. On net, equity prices rose 6 percent in Brazil, 8 percent in Mexico, and 10 percent in Argentina. The Argentine sovereign yield spread over Treasuries declined sharply due to the issuance of new debt replacing old defaulted securities. Mexico's EMBI+ spread declined 21 basis points from an already very low level.

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

Developments in Foreign Industrial Countries

Growth in the foreign industrial economies appears to have turned down a bit in the second quarter, with the United Kingdom, Japan, and the euro area all showing evidence of slowing. Japanese industrial production fell slightly on average in the second quarter. The preliminary GDP estimate for the United Kingdom indicates growth of 1.5 percent in the second quarter, as the pace of expansion in the construction, service, and manufacturing sectors slowed from the first quarter rate. In the euro area, the external sector exerted a drag on growth, as the trade surplus through May was down relative to the first quarter. In contrast, Canadian real GDP seems to have accelerated slightly, according to monthly GDP estimates.

Consumer price inflation remained subdued overall. In the euro area, core inflation posted its slowest rate since early 2001 in June, but headline inflation moved up to 2.2 percent in July. In Canada, consumer prices continued rising at moderate rates. The inflation rate in the United Kingdom moved up to the Bank of England's 2 percent target in June. Mild deflation persisted in Japan.

In **Japan**, real workers' household spending fell 1.4 percent in June, while retail sales rose 0.1 percent, following a 1.4 percent decline in May. In the second quarter, retail sales grew more than 3 percent from a year ago, the fastest rate of growth since the mid-1990s. Tokyo department store sales were flat in June.

After falling 2.8 percent in May, industrial production increased by 1.5 percent in June. Investment indicators released since the last FOMC meeting were mixed. Core machinery orders fell 6.7 percent in May, but the Bank of Japan's July Tankan index of private capital investment plans for large firms in all industries projects expenditure growth of 9.4 percent in FY 2005, a substantial increase from the March survey. Overall, firms view business conditions as improving. The Tankan diffusion index of business conditions for firms of all sizes and industries bounced back in June to its December level, after dipping in March. The external sector continues to make negative contributions to growth: real exports of goods rose 1 percent in June while real imports of goods rose 4 percent.

Japanese labor markets continue to gradually improve. The unemployment rate declined to 4.2 percent in June, the lowest level since 1998 and employment rose 30,000 in the second quarter, slightly faster than the first-quarter pace. Total cash earnings (which include overtime pay and bonuses) rose 1.3 percent in June from one year ago, the biggest increase in two years. Nationwide core consumer prices (which exclude fresh food but include energy) fell 0.2 percent in June from a year ago.

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

Indicator	2004	2005					
	Q4	Q1	Q2	Apr.	May	June	July
Industrial production[1]	-.9	1.8	-.5	1.9	-2.8	1.5	n.a.
All-industries index	-.1	1.3	n.a.	1.7	-1.5	n.a.	n.a.
Housing starts	-3.9	3.3	-2.1	-2.4	5.9	1.4	n.a.
Machinery orders[2]	5.7	.8	n.a.	-1.0	-6.7	n.a.	n.a.
Machinery shipments[3]	-.8	-.4	2.4	4.5	-3.6	3.2	n.a.
New car registrations	.4	-2.7	1.4	.3	-.3	4.6	-6.5
Unemployment rate[4]	4.6	4.6	4.3	4.4	4.4	4.2	n.a.
Job offers ratio[5]	.90	.91	.95	.94	.94	.96	n.a.
Business sentiment[6]	1.0	-2.0	1.0	…	…	…	…
CPI (core, Tokyo area)[7]	-.3	-.5	-.4	-.5	-.4	-.4	-.4
Wholesale prices[7]	2.0	1.3	1.7	1.9	1.8	1.4	n.a.

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

Data for the **euro area** suggest that growth was weak in the second quarter. After providing considerable stimulus to growth in the first quarter, the external sector appears to have been a drag on growth in the second quarter; the euro area trade surplus was down in April and May relative to the first quarter, as imports grew faster than exports. Euro-area retail sales rebounded in May and June from a particularly weak showing in April, but retail sales for the second quarter as a whole were down 0.2 percent from the first quarter.

Euro-area industrial production declined 0.3 percent in May; however, recent improvement in business sentiment suggests that industrial activity may be picking up. Driven by a rise in industrial confidence, the European Commission's measure of euro-area economic sentiment turned up in June after falling in May to its lowest level in more than a year and a half. The euro-area manufacturing PMI moved back above the 50 threshold for growth in July for the first time since March. The PMI for the services sector remained around 53, near where it has been for much of the past year. The German IFO index of manufacturing sentiment continued on a positive trend and rose significantly in July.

Labor markets conditions showed some improvement, with the euro-area unemployment rate edging down to 8.8 percent in May and remaining there in June. In Germany, the national definition of the unemployment rate also moved slightly lower to 11.6 percent in July.

Euro-area twelve-month consumer price inflation rose to 2.2 percent in July, above the ECB ceiling. In contrast, core inflation, excluding energy and unprocessed food, slipped to 1.4 percent in June.

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

Indicator	2004	2005					
	Q4	Q1	Q2	Apr.	May	June	July
Industrial production[1]	-.2	.0	n.a.	.7	-.3	n.a.	n.a.
Retail sales volume[2]	.2	.7	-.2	-1.0	1.1	.4	n.a.
Unemployment rate[3]	8.8	8.8	8.7	8.8	8.7	8.7	n.a.
Consumer confidence[4]	-13.0	-13.3	-14.3	-13.0	-15.0	-15.0	-15.0
Industrial confidence[4]	-3.3	-6.3	-10.0	-9.0	-11.0	-10.0	-8.0
Manufacturing orders, Germany	1.7	-.4	.7	-2.6	2.7	2.4	n.a.
CPI[5]	2.3	2.0	2.0	2.1	2.0	2.1	2.2
Producer prices[5]	3.8	4.1	3.9	4.3	3.5	4.0	n.a.
M3[5]	6.6	6.5	7.5	6.8	7.3	7.5	n.a.

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

Real GDP in the **United Kingdom** rose 1.5 percent (a.r.) in the second quarter, according to the preliminary estimate. Service sector output grew 2.4 percent while total output from the production industries fell 1.6 percent; both were slower than their first-quarter paces. Output of the construction sector continued to slow, rising 1.6 percent compared with a rise of 2.6 percent in the first quarter and of 4.7 percent in the fourth quarter. Large revisions to GDP going back almost two years also changed the outlook for household balance sheets. The household savings rate is now thought to have hit a record low in 2004 as consumption was revised up and income was revised down in the first half of the year.

Early indicators for the third quarter indicate a slight improvement over second quarter activity. After falling throughout the second quarter, business confidence rebounded strongly in July. Consumer confidence also improved slightly in July. The purchasing managers' index for manufacturing in July retained most of June's strong gains, and the PMI for services edged higher in July.

U.K. Economic Indicators

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

Indicator	2004	2005					
	Q4	Q1	Q2	Apr.	May	June	July
Preliminary GDP*	2.3	1.5	1.5	. . .	. . .	. . .	. . .
Industrial production	.2	-.9	n.a.	.5	.1	n.a.	n.a.
Retail sales volume[1]	.1	.1	.6	.4	.0	1.4	n.a.
Unemployment rate[2]							
Claims-based	2.7	2.6	2.7	2.7	2.7	2.8	n.a.
Labor force survey[3]	4.7	4.7	n.a.	4.8	n.a.	n.a.	n.a.
Business confidence[4]	4.3	12.7	-.3	5.0	-1.0	-5.0	6.0
Consumer confidence[5]	-.7	1.0	-2.0	.0	-3.0	-3.0	-1.0
Consumer prices[6]	1.4	1.7	1.9	1.9	1.9	2.0	n.a.
Producer input prices[7]	6.8	10.5	9.8	10.1	7.4	12.1	n.a.
Average earnings[7]	4.3	4.5	n.a.	4.2	4.1	n.a.	n.a.

* Annual rate.
1. Excludes motor vehicles.
2. Percent.
3. Three-month average centered on month shown.
4. Percentage of firms expecting output to increase in the next four months less percentage expecting output to decrease.
5. Average of the percentage balance from consumers' expectations of their financial situation, general economic situation, unemployment, and savings over the next 12 months.
6. Consumer prices index (CPI), percent change from year earlier.
7. Percent change from year earlier.

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

Month-to-month house price growth continues to be just a bit above zero on average. According to the Nationwide Building Society index of house prices, the twelve-month change of house prices was 2.7 percent in July. Household net borrowing for house purchase was stable in June at £11.5 billion.

Inflationary pressures seem to have picked up a bit recently. The twelve-month rate of consumer price inflation reached the Bank of England's 2 percent target in June. Twelve-month consumer price inflation excluding energy has risen considerably since early in the year, rising from 1.2 percent in January to 1.6 percent in June. Producer input price inflation has also risen, reaching 12 percent on a twelve-month basis in June.

In **Canada,** incoming data for the second quarter suggest continued improvement in economic activity. In May, GDP by industry advanced 3.6 percent (a.r.), led by expansions in the utilities, energy, and oil extraction sectors. Manufacturing activity also grew, although more slowly than overall output. Retail activity contracted in May, but this followed outsized gains during the first four months of the year.

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

Indicator	2004	2005					
	Q4	Q1	Q2	Mar.	April	May	June
GDP by industry	.5	.6	n.a.	-.1	.3	.3	n.a.
Industrial production	.0	-.1	n.a.	-.8	.4	.6	n.a.
New manufacturing orders	-.9	3.0	n.a.	-.4	.4	-.5	n.a.
Retail sales	.9	2.3	n.a.	-.3	1.3	-1.1	n.a.
Employment	.4	.1	.4	.0	.2	.2	.1
Unemployment rate[1]	7.1	7.0	6.8	6.9	6.8	6.8	6.7
Consumer prices[2]	2.3	2.1	1.9	2.3	2.4	1.6	1.7
Core consumer prices[2,3]	1.6	1.7	1.6	1.8	1.7	1.6	1.5
Consumer attitudes (1991 = 100)	123.3	123.4	122.2	…	…	…	…
Business confidence (1991 = 100)	139.8	135.9	139.2	…	…	…	…

1. Percent.
2. Percent change from year earlier, n.s.a.
3. Excluding the 8 most volatile components (fruits, vegetables, gasoline, fuel oil, natural gas, mortgage interest, intercity transportation, and tobacco).
n.a. Not available. . . . Not applicable.

Other indicators for the second quarter were mixed. Housing starts turned up again in June after a May lull; overall, though slowing a bit compared to 2004, the housing sector continued to see elevated activity in the first half of 2005. The composite index of leading indicators continued its recent solid advance in June. Retail sales turned down in May, following very strong advances the previous several months. The manufacturing sector, after a bit of a pickup on balance the previous few months, seemed to stall again in May, with shipments flat and new orders down.

The solid employment gains of the previous few months continued in June, with even the beleaguered manufacturing sector adding jobs. The unemployment rate edged down again, to 6.7 percent, matching a 30-year low also reached in mid-2000.

In June, the twelve-month rate of consumer price inflation was 1.7 percent, while the twelve-month rate of core inflation, excluding the eight most volatile components, came in at 1.5 percent.

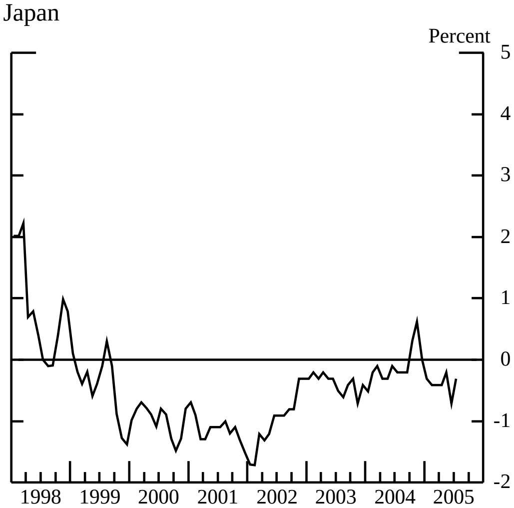
External Balances
(Billions of U.S. dollars, s.a.a.r.)

Country and balance	2004	2005				
	Q4	Q1	Q2	April	May	June
Japan						
Trade	105.3	102.1	79.0	81.9	78.6	76.6
Current account	173.8	171.3	n.a.	152.2	162.2	n.a.
Euro area						
Trade	57.7	73.7	n.a.	65.7	48.9	n.a.
Current account	43.9	15.7	n.a.	12.4	13.7	n.a.
Germany						
Trade	193.1	215.0	n.a.	196.9	185.3	n.a.
Current account	86.3	144.2	n.a.	94.9	67.4	n.a.
France						
Trade	-29.4	-31.0	n.a.	-45.6	-19.0	n.a.
Current account	-16.9	-31.7	n.a.	-78.0	-32.5	n.a.
Italy						
Trade	-8.6	-7.8	n.a.	-10.3	-4.6	n.a.
Current account	-24.4	-33.8	n.a.	-27.5	-34.7	n.a.
United Kingdom						
Trade	-115.3	-112.6	n.a.	-116.8	-110.5	n.a.
Current account	-30.6	-44.0	n.a.	...	...	...
Canada						
Trade	47.3	41.2	n.a.	47.7	38.2	n.a.
Current account	17.3	13.0	n.a.	...	...	...

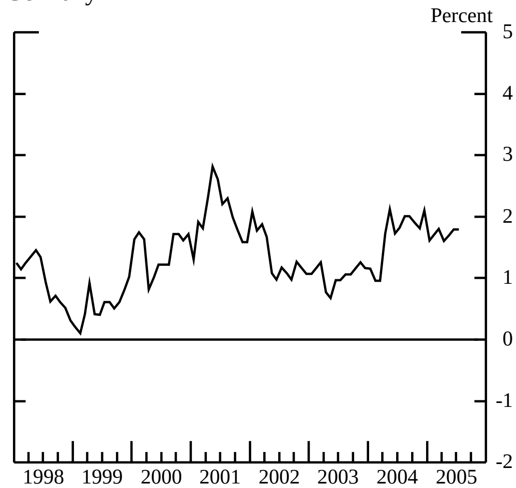
n.a. Not available. . . . Not applicable.

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

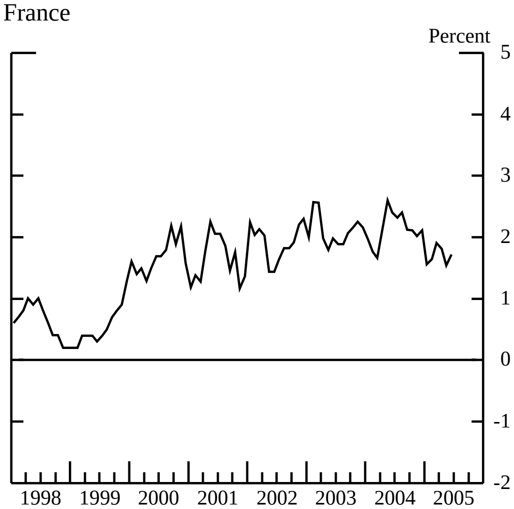
Japan



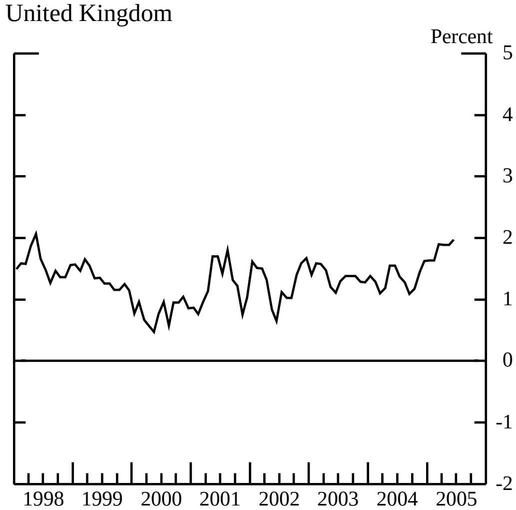
Germany



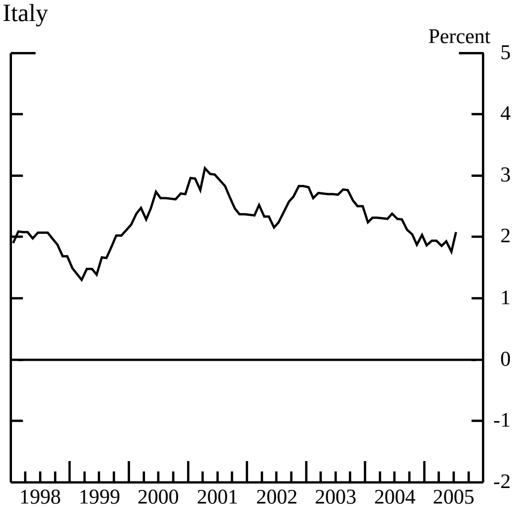
France



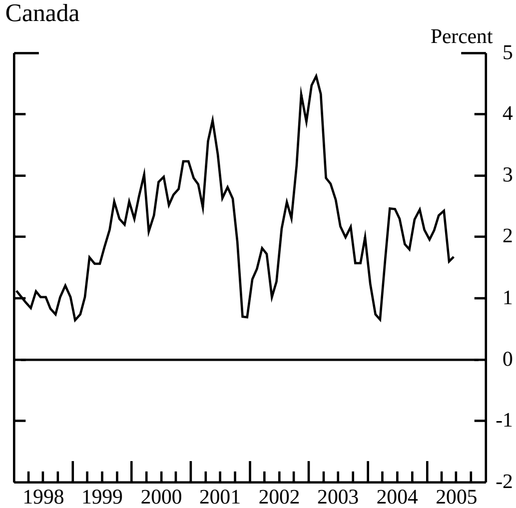
United Kingdom



Italy

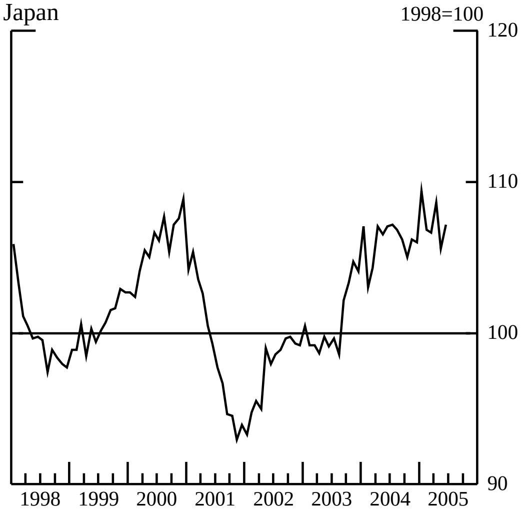


Canada

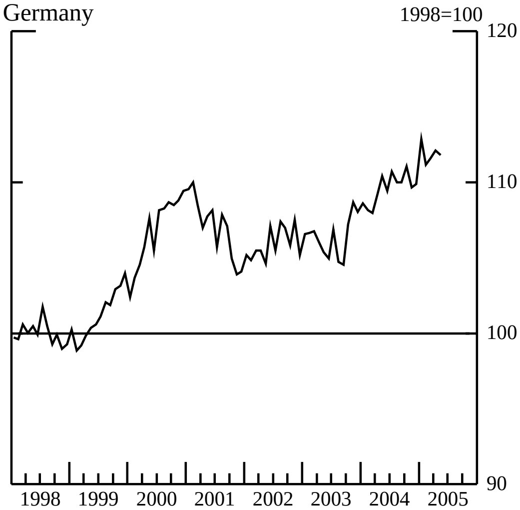


Industrial Production in Selected Industrial Countries

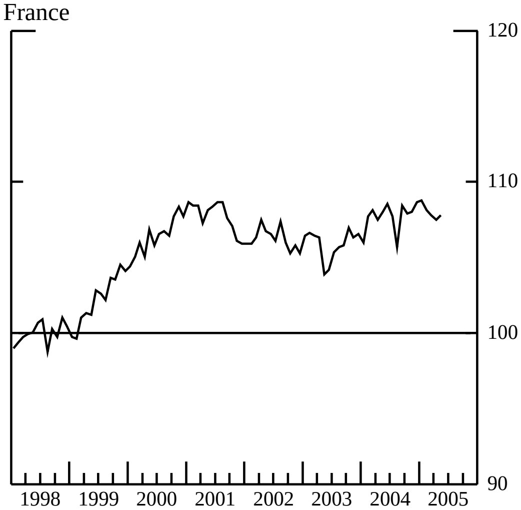
Japan 1998=100



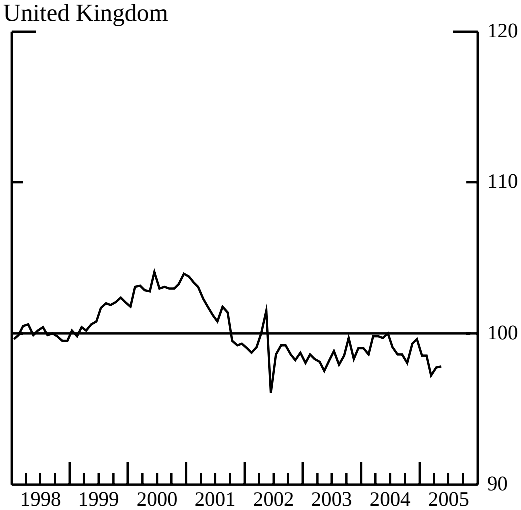
Germany 1998=100



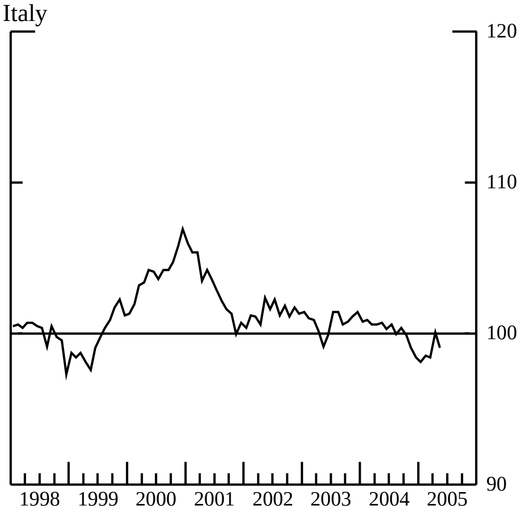
France



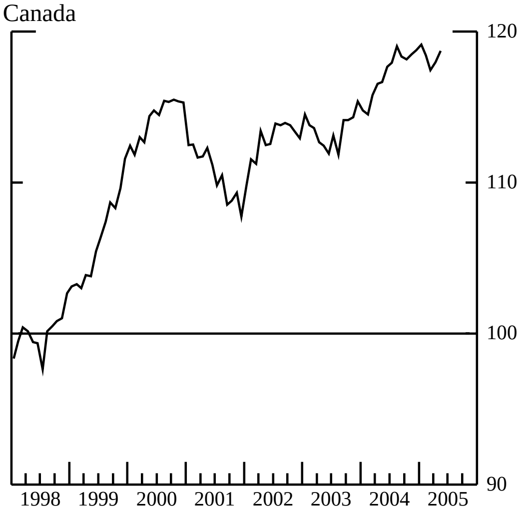
United Kingdom



Italy



Canada



Economic Situation in Other Countries

Indicators of economic activity across the developing economies have been mixed. In Asia, a slowdown in Chinese growth in the second quarter was offset by acceleration in Korea and a rebound in Singapore. In Latin America, growth continues at about its prior rate. With few exceptions, incoming inflation figures have surprised on the downside, perhaps reflecting little pass-through to date of higher crude oil prices into regulated domestic energy prices across the developing countries and tighter monetary policy in Latin America.

The staff estimates that real GDP growth in **China** slowed to 5 percent (s.a.a.r.) in the second quarter, based on the published four-quarter change of 9½ percent. The staff's GDP growth estimate is consistent with indicators for investment growth which were lower in the second quarter, after a spike in the first quarter. Export growth and consumer spending remained quite strong. With import growth slumping, the trade surplus soared, exceeding an annual rate of $100 billion in the second quarter. Four-quarter consumer price inflation was just 1.7 percent, almost half of its first-quarter pace, partially reflecting declines in food prices. Holdings of foreign exchange reserves exceeded $700 billion in June, but the pace of accumulation slowed from the first quarter. On July 22, China revalued the renminbi by about 2 percent against the dollar and announced it is moving to a managed float of the renminbi against an undisclosed basket of currencies. There has been considerable attention paid to bids by Chinese companies to purchase U.S. companies over the past few months. One of the most prominent bids, CNOOC's bid for Unocal, was dropped by CNOOC recently, citing U.S. political opposition.

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

Indicator	2003	2004	2005				
			Q1	Q2	Apr.	May	June
Real GDP[1]	10.0	9.5	12.7	5.0	...	...	...
Industrial production	18.6	14.5	3.0	6.1	2.5	.2	1.6
Consumer prices[2]	3.2	2.6	2.8	1.7	1.6	1.9	1.6
Trade balance[3]	25.5	32.1	91.0	109.3	91.7	110.7	125.4

1. Annual rate. Quarterly data estimated by staff from reported four-quarter growth rates. Annual data are Q4/Q4.
2. Percent change from year-earlier period, except annual data, which are Dec./Dec.
3. Billions of U.S. dollars, annual rate. Imports are c.i.f.
. . . Not applicable.

Recent economic news out of **Hong Kong** has been generally positive. In the second quarter, unemployment fell to 5.7 percent and trade volumes, a good indicator of growth in the entrepôt economy, rose to new highs. In part reflecting higher food prices, 12-month consumer price inflation increased to 1.2 percent in June, the highest reading since 1998.

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

Indicator	2003	2004	2005				
			Q1	Q2	Apr.	May	June
Real GDP[1]	4.5	6.8	6.1	n.a.	...	...	...
Unemployment rate[2]	7.9	6.9	6.1	5.7	5.9	5.7	5.7
Consumer prices[3]	-1.9	.2	.3	.9	.5	.9	1.2
Trade balance[4]	-8.5	-12.0	-9.4	-9.1	-7.6	-12.9	-6.7

1. Annual rate. Annual data are Q4/Q4.
2. Percent. Monthly data are averages of the current and previous two months.
3. Percent change from year-earlier period, except annual data, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate. Imports are c.i.f.
n.a. Not available. . . . Not applicable.

Indicators from **Taiwan** suggest that growth strengthened in the second quarter. Industrial production rose 1 percent, after dipping slightly in the first quarter, and the trade surplus widened a bit. Unemployment remained low. Four-quarter headline consumer price inflation moved up in the second quarter, but excluding food and energy it was about zero.

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

Indicator	2003	2004	2005				
			Q1	Q2	Apr.	May	June
Real GDP[1]	5.8	3.2	2.6	n.a.	…	…	…
Unemployment rate[2]	5.0	4.5	4.2	4.2	4.2	4.2	4.2
Industrial production	7.1	9.8	-.2	1.0	1.4	-1.2	2.3
Consumer prices[3]	-.1	1.6	1.6	2.1	1.6	2.3	2.4
Trade balance[4]	16.9	6.1	2.8	3.2	4.9	1.2	3.5
Current account[5]	29.3	18.7	16.7	n.a.	…	…	…

1. Annual rate. Annual data are Q4/Q4.
2. Percent.
3. Percent change from year-earlier period, except annual data, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate. Imports are c.i.f.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. . . . Not applicable.

Indicators for **Korea** have shown considerable strength since the June Greenbook. GDP growth jumped to 5 percent in the second quarter, due entirely to robust domestic demand. Following the GDP release, the Korean government announced that it was withdrawing plans to introduce a fiscal stimulus plan for later this year. Industrial production rose almost 2½ percent in June, boosted by strong consumer demand for durables. Recent sales and confidence surveys remained elevated. Signs of a stepdown in export growth are mounting, however. The current account surplus for the second quarter was less than half of that registered in the previous quarter. Consumer prices have decelerated in recent months and the unemployment rate ticked up in June.

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

Indicator	2003	2004	2005 Q1	2005 Q2	2005 May	2005 June	2005 July
Real GDP[1]	4.2	3.0	1.5	5.0	…	…	…
Industrial production	4.9	10.2	1.1	.5	.5	2.4	n.a.
Unemployment rate[2]	3.6	3.7	3.7	3.7	3.7	3.8	n.a.
Consumer prices[3]	3.4	3.0	3.1	3.0	3.1	2.7	2.5
Trade balance[4]	22.0	38.2	43.1	27.5	19.6	35.3	n.a.
Current account[5]	11.9	27.6	23.8	11.0	17.3	27.5	n.a.

1. Annual rate. Annual data are Q4/Q4.
2. Percent.
3. Percent change from year-earlier period, except annual data, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate. Imports are c.i.f.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. . . . Not applicable.

Incoming data from the **ASEAN** countries suggest that economic activity picked up in the second quarter. In Singapore, the unofficial advance estimate of second-quarter real GDP indicates a surge of over 12 percent. Elsewhere in the region, industrial production in recent months was up from the first-quarter level on average in Philippines and Thailand, but was down in Malaysia. Trade data show the ASEAN economies continue to run trade surpluses on average. The exceptions are the Philippines and Thailand. In Thailand, the trade deficit continued to widen because higher oil prices increased the nominal import bill.

Aside from Singapore, headline consumer price inflation remained elevated across the region, reflecting higher food and energy prices. Citing concerns over inflation, some countries have tightened monetary policy recently. In mid-July, the Philippine central bank increased the reserve requirement 2 percentage points, and the Thai central bank raised its key interest rate 25 basis points to 2.75 percent. In Indonesia, the central bank authorities introduced a new one-month target interest rate, initially set a bit higher than market-determined rates, in line with their simultaneous announcement of a "tight-biased" monetary policy for the remainder of the year.

In the Philippines, the political situation has deteriorated following allegations that President Arroyo was involved in electoral fraud. Partly reflecting the political situation, Moody's, Standard & Poor's, and Fitch downgraded their debt rating outlooks for the Philippines from stable to negative.

On July 22, Malaysia changed its seven-year-old exchange rate regime from a dollar peg to a managed float following China's exchange-rate announcement. The central bank statement indicated that the objective will be to maintain a stable currency around its "fair value" against a trade-weighted index of trading partners' currencies. Since the announcement and through the end of July, the ringgit has appreciated nearly 1.3 percent.

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

Indicator	2003	2004	2005				
			Q1	Q2	Apr.	May	June
Real GDP[1]							
Indonesia	5.0	6.5	6.0	n.a.	…	…	…
Malaysia	6.6	5.7	9.3	n.a.	…	…	…
Philippines	4.9	5.5	4.6	n.a.	…	…	…
Singapore	5.5	6.5	-5.5	n.a.	…	…	…
Thailand	7.6	5.5	-2.4	n.a.	…	…	…
Industrial production[2]							
Indonesia[3]	3.9	4.0	4.1	n.a.	3.6	-9.4	n.a.
Malaysia	9.3	11.3	1.4	n.a.	-.6	-3.1	n.a.
Philippines	.0	1.0	-3.5	n.a.	10.0	2.1	n.a.
Singapore	3.0	13.9	-7.8	7.7	13.0	-4.5	9.2
Thailand	13.9	11.1	-1.2	3.0	.1	1.2	2.0

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

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

Indicator	2003	2004	2005				
			Q1	Q2	Apr.	May	June
Indonesia	28.5	25.1	27.5	20.7	18.6	25.8	17.6
Malaysia	21.4	21.2	27.5	26.3	30.1	22.0	26.7
Philippines	-4.2	-4.4	1.0	n.a.	-.2	.0	n.a.
Singapore	16.2	16.1	14.9	15.9	12.3	17.4	18.0
Thailand	3.8	1.7	-12.3	-20.6	-15.7	-20.9	-25.2

n.a. Not available.

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

Indicator	2003[1]	2004[1]	2005				
			Q1	Q2	May	June	July
Indonesia	5.2	6.4	7.8	7.6	7.4	7.4	7.8
Malaysia	1.2	2.1	2.4	3.0	3.1	3.2	n.a.
Philippines	3.9	8.6	8.5	8.2	8.5	7.6	n.a.
Singapore	.7	1.3	.3	.1	.0	-.2	n.a.
Thailand	1.8	2.9	2.8	3.7	3.7	3.8	n.a.

1. Dec./Dec.
n.a. Not available.

In **India**, recent indicators have remained positive. GDP rose 6.4 percent in the first quarter, boosted by robust consumer demand, and average industrial production in the first two months of the second quarter was 2½ percent above the first-quarter level. Consumer prices decelerated throughout the second quarter, although the effect of the partial lifting of fuel subsidies in mid-June has yet to show through. The trade deficit continued to widen in the second quarter, reflecting surging imports.

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

Indicator	2003	2004	2005				
			Q1	Q2	Apr.	May	June
Real GDP[1]	11.0	6.4	6.4	n.a.	…	…	…
Industrial production	6.6	8.5	.5	n.a.	-.3	2.8	n.a.
Consumer prices[2]	3.7	3.8	4.2	4.0	5.0	3.8	3.3
Wholesale prices[2]	5.8	6.7	5.3	5.2	5.9	5.5	4.2
Trade balance[3]	-13.7	-21.7	-35.5	-44.0	-46.5	-33.6	-51.8
Current account[4]	6.9	-.8	.6	n.a.	…	…	…

1. Annual rate. Annual data are Q4/Q4.
2. Percent change from year-earlier period, except annual data, which are Dec./Dec.
3. Billions of U.S. dollars, annual rate.
4. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. . . . Not applicable.

In **Mexico**, recent data releases point to a moderate pickup in economic activity from a weak performance in the first quarter. Industrial production was held down in March and April by sluggish U.S. demand for Mexican manufacturing exports, but rose almost 1 percent at a monthly rate in May and was up 3 percent from a year ago. Similarly, the country's index of economic activity (a monthly proxy of real GDP) rose at a monthly rate of 0.8 percent in May and is up 3.4 percent from a year earlier, mainly on the back of solid performance in the services sector. In addition, data for retail sales and investment (not shown) suggest that domestic demand has remained relatively unaffected by high real interest rates.

Mexico's inflation outlook has improved in recent months. After tightening monetary policy a dozen times since early last year, the Bank of Mexico has not changed its policy over the last four months, in line with recent statements suggesting that its tightening cycle is over. The rate on 28-day peso-denominated bills has been stable at about 9.6 percent for the past month, up almost 5 percentage points since the tightening began. In June, twelve-month consumer inflation was 4.3 percent, down from the 5.2 percent registered last year, and within striking distance of the 4 percent upper limit of the central bank's target range. Core inflation was even lower at 3.4 percent in June and has continued trending down.

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

Indicator	2003	2004	2005				
			Q1	Q2	Apr.	May	June
Real GDP[1]	2.1	4.8	1.7	n.a.	…	…	…
Overall economic activity	1.4	4.0	.4	n.a.	.1	.8	n.a.
Industrial production	-.2	3.5	.2	n.a.	.5	.9	n.a.
Unemployment rate[2]	3.2	3.7	3.9	4.1	4.2	4.2	4.0
Consumer prices[3]	4.0	5.2	4.4	4.5	4.6	4.6	4.3
Trade balance[4]	-5.8	-8.8	-11.7	-4.5	-7.0	-4.2	-2.5
Imports[4]	170.5	196.8	211.3	213.2	211.5	214.2	213.9
Exports[4]	164.8	188.0	199.6	208.6	204.5	210.0	211.4
Current account[5]	-8.4	-7.3	-10.4	n.a	…	…	…

1. Annual rate. Annual data are Q4/Q4.
2. Percent; counts as unemployed those working one hour a week or less.
3. Percent change from year-earlier period, except annual data, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. . . . Not applicable.

In **Brazil**, data releases since the last Greenbook have been generally positive. Industrial production jumped in May, raising the April-May average 1¼ percent above its first-quarter level. Unemployment declined in May to below 10 percent and moved down further in June, partly reflecting exits from the workforce. With data available only through May, retail sales appear to have increased slightly in the second quarter. However, both consumer and business confidence declined in the second quarter. The external sector remains a bright spot, with nominal exports registering strong growth. Headline consumer prices were about unchanged in June, bringing down the twelve-month inflation rate to 7.3 percent. Part of this decline reflects a fall in food prices and the fact that Petrobras, the government oil firm, has not raised domestic prices of important fuels so far this year. However, taken together with a decrease in wholesale price inflation in May and June, it may signal that the sizeable appreciation of the *real* in recent months is finally passing through.

In June and July, the Brazilian central bank kept its policy rate, the Selic, on hold at 19¾ percent. In the minutes to the July meeting, the central bank expressed concern that core inflation measures remain too high to be compatible with the inflation target. Political scandals continue to make headlines, as members of the parties supporting President Lula have been accused of being bribed for their support for the administration's legislation. Although initially the impact appeared to be limited, it is now beginning to affect the President's popularity and financial markets.

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

Indicator	2003	2004	2005				
			Q1	Q2	May	June	July
Real GDP[1]	.8	4.6	1.3	n.a.	…	…	…
Industrial production	.1	8.3	-.2	n.a.	1.3	n.a.	n.a.
Unemployment rate[2]	12.3	11.5	10.6	9.8	9.8	9.2	n.a.
Consumer prices[3]	9.3	7.6	7.4	7.8	8.1	7.3	n.a.
Trade balance[4]	24.8	33.7	39.8	44.8	41.2	44.2	57.9
Current account[5]	4.2	11.7	10.8	10.3	7.4	15.0	n.a.

1. Annual rate. Annual data are Q4/Q4.
2. Percent; break in October 2001 as a result of change in methodology.
3. Percent change from year-earlier period, except annual data, which are Dec./Dec. Price index is IPC-A. Data are n.s.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.

The economic recovery in **Argentina** appears to be maturing. The unemployment rate has fallen relatively steadily to about half of its level at the peak of the crisis. In the first quarter, real GDP rose at an annual rate of just 2 percent as construction took a respite from its earlier heady pace of expansion. In the second quarter, industrial production rose 1.5 percent, about the same rate as in the first quarter, despite reports of energy shortages. Twelve-month consumer price inflation was over 9 percent in July, partly reflecting a jump in food prices earlier in the year. Inflation remains above the upper end of the central bank's unofficial target range of 5-8 percent for 2005, but under the government's unofficial upper bound of 10.5 percent.

Since the completion of the debt swap, Argentina has held several successful local auctions for long-term bonds. In face value terms, the government has placed $3 billion of inflation-indexed peso-denominated bonds. Foreign participation in these auctions has reportedly been significant. Subsequently, Argentina announced it will no longer auction inflation-indexed peso-denominated bonds, preferring instead dollar-denominated bonds. In the latest auction, dollar-denominated bonds with a face value of almost $0.5 billion were placed. Another $0.5 billion was sold to the Venezuelan government in an off-market transaction. However, Argentina's eventual access to international capital markets will largely depend on the outcome of ongoing negotiations with the IMF over a new program.

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

Indicator	2003	2004	2005				
			Q1	Q2	May	June	July
Real GDP[1]	11.8	9.1	2.1	n.a.	…	…	…
Industrial production	16.1	10.7	2.0	1.5	1.1	-.5	n.a.
Unemployment rate[2]	17.3	13.6	13.0	n.a.	…	…	…
Consumer prices[3]	3.7	6.1	8.2	8.8	8.6	9.0	9.6
Trade balance[4]	15.7	12.1	9.7	12.3	8.9	6.2	n.a.
Current account[5]	7.7	3.3	.0	n.a.	…	…	…

1. Annual rate. Annual data are Q4/Q4.
2. Percent; n.s.a.
3. Percent change from year-earlier period, except annual data, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. . . . Not applicable.

In **Venezuela**, preliminary estimates point to real GDP growth of 25 percent (a.r.) in the first quarter, supported by oil revenue-financed government spending. Inflation eased a bit in the second quarter, but remains high, boosted by the March devaluation of the bolivar as well as by expansionary fiscal policies. Oil production remains constrained by numerous problems at the government oil firm and the government's continued hostility toward private investors. In addition, profits from the state-owned firm are being used for social programs rather than maintenance and investment, raising concerns about future production. In July, President Chavez succeeded in amending the central bank law so that the state oil company is no longer obligated to sell its dollar inflows to the central bank. Moreover, the central bank was forced to make a one-time transfer of $6 billion out of its nearly $29 billion of international reserves to a new fund that can potentially be tapped to pay for imports, to invest in social or infrastructure projects with high import content, or to service external debt. Some portion of future oil revenues is also expected to be added to the fund, thus increasing Chavez's ability to fund social programs.

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

Indicator	2003	2004	2005				
			Q1	Q2	May	June	July
Real GDP[1]	6.6	12.1	24.7	n.a.	…	…	…
Unemployment rate[2]	18.0	15.1	13.3	11.9	12.6	11.5	n.a.
Consumer prices[3]	27.1	19.2	17.0	16.3	17.4	15.9	15.3
Non-oil trade balance[4]	-5.5	-10.5	-14.5	n.a.	n.a.	n.a.	n.a.
Trade balance[4]	16.5	21.4	28.1	n.a.	n.a.	n.a.	n.a.
Current account[5]	11.4	13.8	18.5	n.a.	…	…	…

1. Annual rate. Annual data are Q4/Q4.
2. Percent.
3. Percent change from year-earlier period, except annual data, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. . . . Not applicable.