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

September 14, 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

On August 29, Hurricane Katrina struck the Gulf Coast. Clearly, the economic dislocation in that region has been enormous. For example, press reports indicate that an unprecedented number of initial claims for unemployment insurance have been filed in the Gulf states. Anecdotal information and the very few hard statistical indicators of macroeconomic conditions outside the Gulf states have been mixed but do not point to a significant curtailment in overall activity at least thus far. Automobile industry analysts expect sales to fall in September, but the anticipated drop is probably just a further undoing of the discount-induced surge in July. Reports from chain stores do not point to any sharp break in sales since the storm. In addition, a substantial dose of fiscal stimulus, some of which will have an immediate effect, has been appropriated.

Before the storm, economic activity appeared to have been on a solid trajectory. The August labor market report showed another moderate increase in payroll employment, and other indicators suggested further gains in production and sales over the July-August period. Housing activity remained strong through the summer. Consumer spending seems to have exhibited considerable vigor in the face of rapidly rising energy prices. Business investment, however, appeared to have lost a bit of steam, as orders and shipments were again on the soft side in July. Core price inflation remained in check through July. However, consumer energy costs had risen dramatically even before Hurricane Katrina hit; they rose further in the wake of the storm and have retraced only a portion of that rise.

Labor Market Developments

Labor demand continued to expand at a moderate pace through mid-August.[1] Private nonfarm payrolls rose 154,000 last month, and the level of employment in July was revised up slightly. The average increase over the three months ending in August was 174,000, a rate on par with the gains seen since the fourth quarter of last year. Employment increases were widespread among industries last month, with construction posting a noticeable advance. Among the weaker performers, hiring at wholesalers and providers of temporary help services was quite modest, while manufacturing jobs continued to trend down. The average workweek of production or nonsupervisory workers was unchanged in August, at 33.7 hours, and aggregate hours in this category rose 0.1 percent, to a level ½ percent (not an annual rate) above the average level in the second quarter.

The unemployment rate edged down to 4.9 percent in August, its lowest level since August 2001, and the labor force participation rate edged up further, to 66.2 percent. The

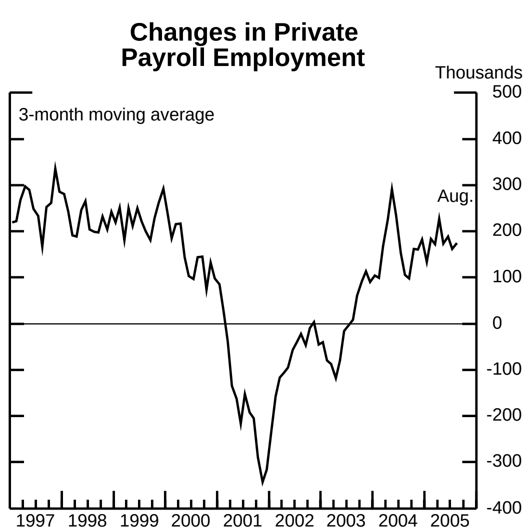
[1] Because Hurricane Katrina reached the Gulf Coast two weeks after the reference week for the August employment report, the August figures were not affected. In 2004, 1.8 million persons were on nonfarm payrolls in the counties in Alabama, Louisiana, and Mississippi that were hit the hardest by the storm, equal to a bit less than 1½ percent of total employment. This area also accounts for about 1½ percent of the nation's housing units, 1½ percent of retail sales, and nearly 2 percent of manufacturers' shipments.

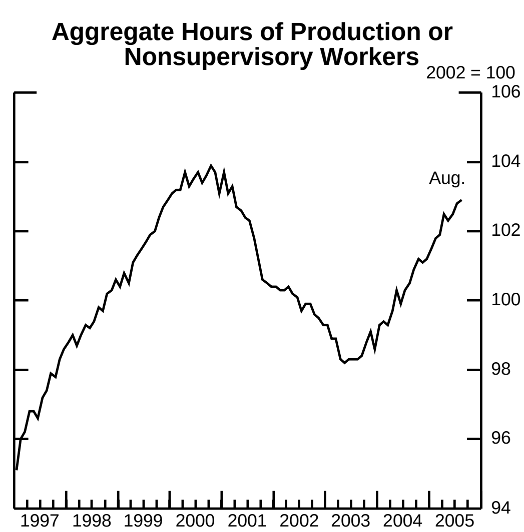
Changes in Employment

(Thousands of employees; seasonally adjusted)

Measure and sector	2004	2004 Q4	2005 Q1	2005 Q2	2005 June	2005 July	2005 Aug.
	Average monthly change				Monthly change		
Nonfarm payroll employment (establishment survey)	183	190	182	198	175	242	169
Private	171	182	172	188	169	200	154
Previous	171	182	172	186	164	181	...
Manufacturing	3	-6	-6	-13	-25	-6	-14
Construction	23	29	24	24	17	7	25
Wholesale trade	7	4	6	7	3	8	8
Retail trade	13	13	17	23	11	58	12
Transportation and utilities	9	5	18	8	-2	6	0
Information	-2	0	2	4	0	-1	3
Financial activities	12	15	13	14	19	19	15
Professional and business services	45	53	41	37	55	42	29
Temporary help services	15	14	9	8	12	3	7
Nonbusiness services[1]	59	67	51	83	87	65	75
Total government	12	8	10	10	6	42	15
Total employment (household survey)	146	210	115	379	163	438	373
Memo:							
Aggregate hours of private production workers (percent change)[2]	2.4	2.4	2.3	2.8	.2	.3	.1
Average workweek (hours)[3]	33.7	33.7	33.7	33.7	33.7	33.7	33.7
Manufacturing (hours)	40.8	40.6	40.6	40.4	40.4	40.5	40.5

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.

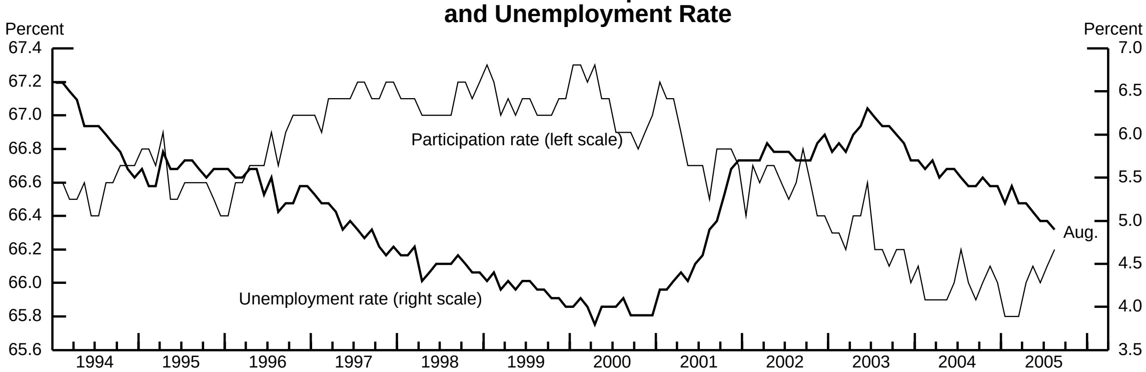




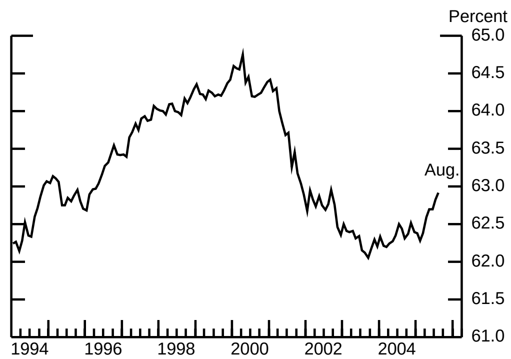
Selected Unemployment and Labor Force Participation Rates
(Percent; seasonally adjusted)

Rate and group	2004	2004 Q4	2005 Q1	2005 Q2	2005 June	2005 July	2005 Aug.
Civilian unemployment rate							
Total	5.5	5.4	5.3	5.1	5.0	5.0	4.9
Teenagers	17.0	17.1	16.9	17.3	16.4	16.1	16.5
20-24 years old	9.4	9.3	9.5	8.8	8.8	8.3	8.9
Men, 25 years and older	4.4	4.3	4.1	3.8	3.7	3.8	3.6
Women, 25 years and older	4.4	4.2	4.1	4.2	4.2	4.3	4.0
Labor force participation rate							
Total	66.0	66.0	65.8	66.0	66.0	66.1	66.2
Teenagers	43.8	44.1	43.5	43.9	43.9	43.8	44.1
20-24 years old	75.0	75.3	74.4	74.3	74.8	74.7	74.5
Men, 25 years and older	75.3	75.3	75.2	75.5	75.5	75.5	75.7
Women, 25 years and older	59.3	59.2	59.1	59.2	59.2	59.5	59.4

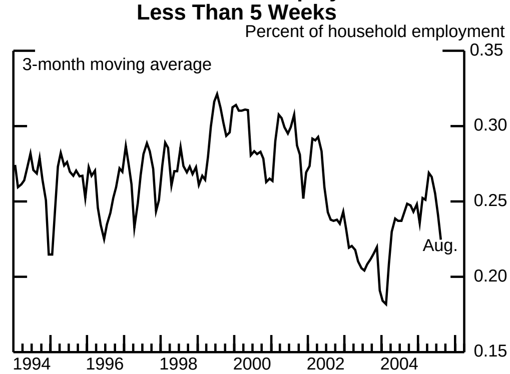
Labor Force Participation Rate and Unemployment Rate



Employment-Population Ratio

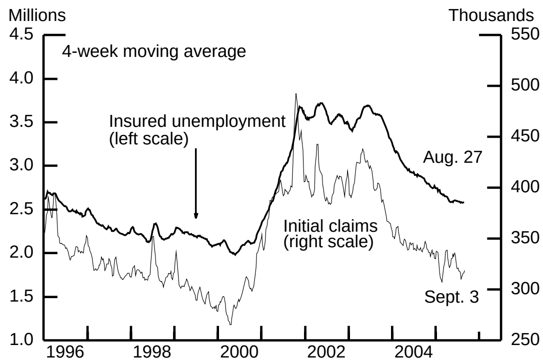


Job Leavers Unemployed Less Than 5 Weeks

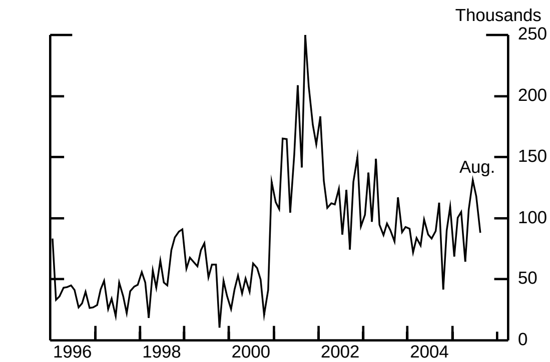


Labor Market Indicators

Unemployment Insurance

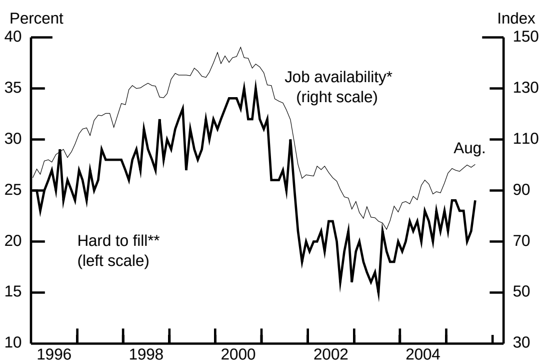


Layoff Announcements



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

Labor Market Tightness

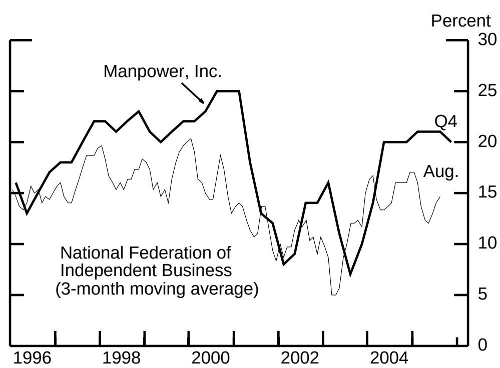


*Proportion of households believing jobs are plentiful, minus the proportion believing jobs are hard to get, plus 100.
**Percent of small businesses surveyed with at least one "hard to fill" job opening.
Source. For job availability, Conference Board; for hard to fill, National Federation of Independent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

Job Openings and Help Wanted Index

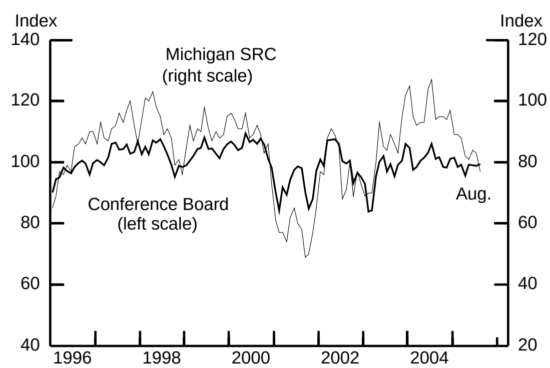
Source. For job openings, Job Openings and Labor Turnover Survey; for help wanted index, Conference Board.

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.

higher participation rate and lower unemployment rate combined to raise the employment-population ratio to 62.9 percent—the highest reading in three years. All told, these figures suggest that some slack remains in the labor market, but that it continues to diminish gradually.

The first reading on initial claims for unemployment insurance in the post-Katrina period showed that filings were nearly unchanged in the week ending September 3. The Bureau of Labor Statistics estimates that about 10,000 individuals reported disaster-related claims in that week, both in the hurricane-affected states and in neighboring states housing evacuees. However, despite these filings, Louisiana and Mississippi reported low numbers of claims, likely because claims offices were closed and because individuals were evacuating and unable to file.

The August readings for other labor market indicators were mixed but generally consistent with a gradual improvement in current labor market conditions; they contained no signs of widespread tightness. On the one hand, layoff announcements fell back in August to their lowest level since April after having jumped in early summer. Likewise, the share of firms reporting to the National Federation of Independent Businesses that they had a hard-to-fill position moved up last month to its highest level since February, although it remained well below the elevated levels seen in the late 1990s. On the other hand, the job opening rate (as measured by the Job Openings and Labor Turnover Survey) has not changed much this year after having risen appreciably in 2004, while the Help Wanted Index has remained at the low levels that have been evident throughout the expansion. Alternative measures of households' perceptions of job prospects are also sending conflicting signals: While the Conference Board's measure of job availability has edged up in recent months, the downward movement of late in the number of job leavers in the household survey who had been unemployed less than five weeks as a percentage of household employment suggests that workers have become less willing to leave a job before finding another.

Among the more forward-looking indicators, the hiring plans of small businesses popped up in August, although the three-month moving average remained below the levels around the start of the year. At the same time, net hiring plans of participants in the Manpower survey remained at the positive level that has been reported since the middle of 2004. Household expectations of the labor market as measured by the Conference Board have been flat since May, while the recent results from the Michigan Survey point to some deterioration.

Industrial Production

Total industrial production eked out a gain of 0.1 percent in August even though Hurricane Katrina sharply curtailed production in the Gulf Coast region during the last three days of the month. Manufacturing output climbed 0.3 percent, mainly because of higher production of motor vehicles and parts. The output of mines decreased 0.6 percent, and the output of utilities fell 0.5 percent.

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

Component	Proportion 2004 (percent)	2004[1]	2005		2005		
			Q1	Q2	June	July	Aug.
			Annual rate		Monthly rate		
Total	**100.0**	**4.3**	**3.6**	**1.5**	**.8**	**.1**	**.1**
Previous	100.0	4.3	3.6	1.4	.8	.1	...
Manufacturing	81.9	5.1	4.0	1.0	.3	.1	.3
Ex. motor veh. and parts	74.7	5.3	4.1	1.5	.1	.3	.0
Ex. high-tech industries	70.2	4.4	2.6	.8	.1	.2	-.1
Mining	8.3	-2.0	8.4	3.3	.5	-1.0	-.6
Utilities	9.8	2.7	-3.2	4.3	4.9	.7	-.5
Selected industries							
High technology	4.5	18.7	29.4	13.0	.9	2.3	1.5
Computers	1.0	6.9	14.9	12.7	.9	.9	1.0
Communications equipment	1.2	9.6	23.6	6.9	.0	2.3	.7
Semiconductors[2]	2.3	29.9	39.1	16.3	1.4	2.8	2.0
Motor vehicles and parts	7.2	2.9	2.7	-4.9	2.6	-1.9	3.7
Market groups excluding energy and selected industries							
Consumer goods	22.0	3.7	2.3	1.4	.1	-.3	-.4
Durables	4.3	1.3	.2	-4.2	-.4	-.3	.5
Nondurables	17.7	4.3	2.9	2.7	.2	-.3	-.6
Business equipment	7.7	9.3	6.7	10.4	.3	1.8	-.6
Defense and space equipment	1.9	6.1	9.3	17.5	1.1	1.6	1.5
Construction supplies	4.3	3.8	4.3	2.1	-.8	.6	.7
Business supplies	8.1	3.2	5.1	1.1	-.3	-.2	-.1
Materials	25.2	3.9	.4	-3.9	-.1	.2	.0
Durables	13.9	4.6	.0	-3.8	.1	.1	.9
Nondurables	11.3	2.9	.9	-3.9	-.3	.3	-1.0

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	2005			
				Q4	Q1	Q2	July	Aug.
Total industry	**81.0**	**70.8**	**78.6**	**78.8**	**79.3**	**79.4**	**79.8**	**79.8**
Manufacturing	79.8	68.5	77.2	77.6	78.1	78.1	78.3	78.4
High-tech industries	78.3	74.1	74.3	69.8	71.8	71.7	72.6	72.8
Excluding high-tech industries	79.9	68.2	77.3	78.5	79.0	79.0	79.1	79.3
Mining	87.1	78.6	83.5	85.6	87.5	88.4	87.8	87.4
Utilities	86.8	77.7	84.2	85.4	84.4	85.1	88.4	87.8

Although the exact magnitude of the effect of the hurricane on total IP is difficult to determine, we estimate that the change in total IP in August was likely reduced about 0.3 percentage point. So far in September, the disruptions in the Gulf region have continued to restrain IP significantly, although many of the affected industries have already made substantial progress toward recovery. In particular, whereas more than 95 percent of Gulf Coast oil production and about 90 percent of Gulf Coast natural gas extraction were shut down on August 30, the Department of the Interior's Minerals Management Service estimates that only 56 percent of crude oil production and 37 percent of natural gas extraction in the Gulf remained shut-in as of September 13. In addition, the Department of Energy reports that the number of shut-down refineries has fallen from nine immediately after the storm to five currently, and the number that were operating at reduced rates has fallen sharply as well. Nonetheless, utilization rates in the petroleum refining industry were high before the hurricane hit; thus, the industry's ability to make up lost production will be limited even after all refineries are again fully operational.

Outside the energy sector, Katrina has restrained production in basic chemicals, shipbuilding, food processing, fertilizer, pulp and papermills, nonferrous foundries, and fabricated structural steel; all of these industries have a sizable share of factory shipments that originate in the affected area. Although flooding, power outages, and damaged infrastructure continue to impair the ability of some plants to ramp up production, others have restored production nearly to pre-hurricane levels.[2]

Elsewhere, motor vehicle production rebounded 400,000 units in August to an annual rate of 12.2 million units, and industry schedules suggest that assemblies will continue at about that pace in September. Accordingly, the production of motor vehicles and parts directly contributed about ¼ percentage point to the change in total IP in August and will likely be a neutral influence in September. Inventories of light vehicles were little changed in August after having fallen sharply in July and were equivalent to sixty-one days' supply at the end of the month when evaluated at the August sales pace. Initial assembly plans for the fourth quarter call for production to total an annual rate of 12.1 million units.

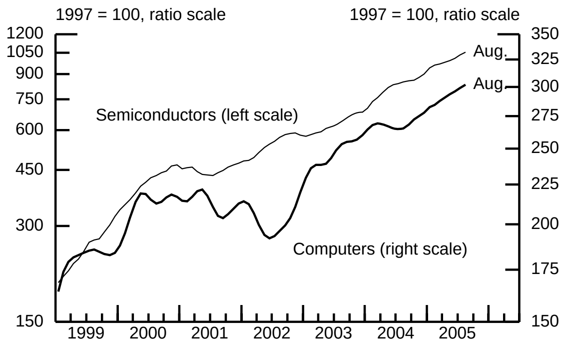
The IP index for commercial aircraft rose further in August after posting robust gains throughout most of this year. However, Boeing's machinists union initiated a strike on September 2 that led the company to cease production of all commercial aircraft.[3] Industry analysts anticipate that it will continue for more than a month.

[2] For example, according to Chemical Market Associates, Inc. (CMAI) all ten chlorine production facilities in the affected region—representing about 27 percent of domestic capacity—are now producing, whereas six of the ten were offline on September 6.

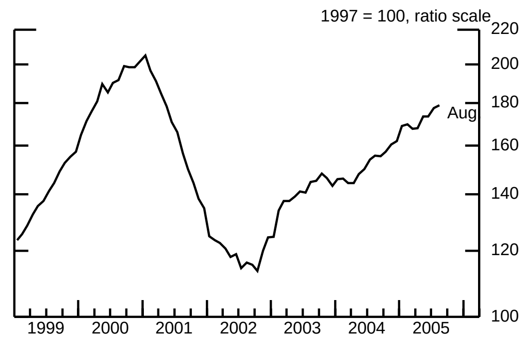
[3] Output in the commercial aircraft industry, of which Boeing represents more than 90 percent, currently accounts for 0.8 percent of total industrial production.

Indicators of High-Tech Manufacturing Activity

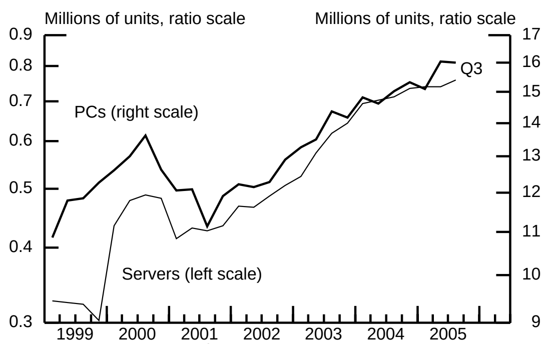
IP: Computers and Semiconductors



IP: Communications Equipment

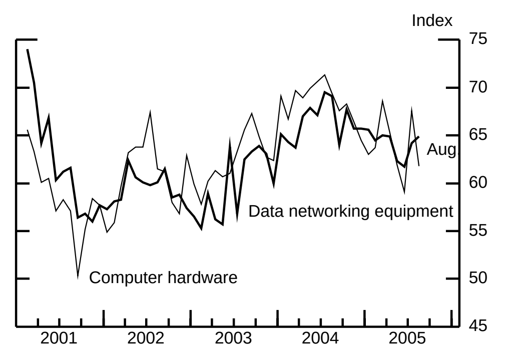


U.S. Personal Computer and Server Sales



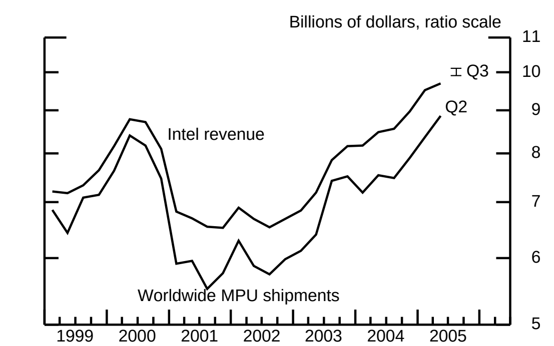
Note. FRB seasonals.
Source. Gartner.

CIO Magazine Future Spending
Diffusion Indexes



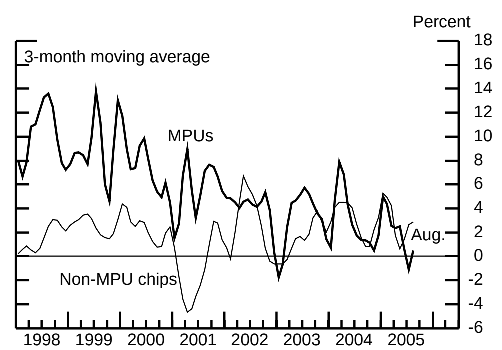
Note. The diffusion index equals the percentage of respondents planning to increase future spending plus one-half the percentage of respondents planning to leave future spending unchanged.
Source. CIO Magazine.

Microprocessor Unit (MPU) Shipments
and Intel Revenue



Note. Q3 is the range of Intel's guidance as of September 8, 2005. FRB seasonals.
Source. Intel and Semiconductor Industry Association.

Rate of Change in Semiconductor
Industrial Production



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

Item	2004	2005 H1	2005 Q3	2005 Q4	2005 July	2005 Aug.	2005 Sept.
U.S. production[1]	11.7	11.5	11.7	11.7	11.4	11.8	11.9
Autos	4.3	4.3	4.3	4.1	4.3	4.3	4.2
Light trucks	7.4	7.2	7.4	7.7	7.0	7.5	7.7
Days' supply[2]	74	68	n.a.	n.a.	47	61	n.a.
Autos	59	53	n.a.	n.a.	45	47	n.a.
Light trucks	83	77	n.a.	n.a.	47	72	n.a.
Inventories[3]	3.22	2.96	n.a.	n.a.	2.58	2.65	n.a.
Autos	1.02	.93	n.a.	n.a.	.85	.85	n.a.
Light trucks	2.20	2.03	n.a.	n.a.	1.73	1.80	n.a.
Memo: U.S. production, total motor vehicles[4]	12.0	11.9	12.1	12.1	11.8	12.2	12.3

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

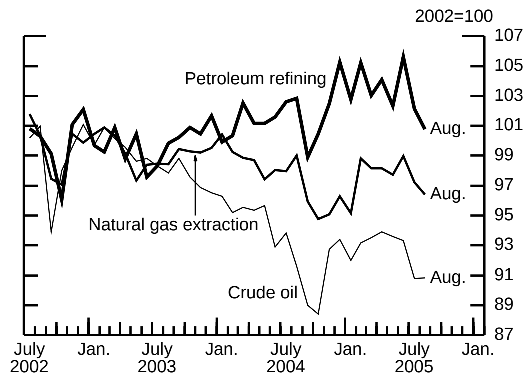
In the high-tech sector, the pace of production has picked up somewhat in recent months after having slowed in the second quarter. In August, high-tech output moved up 1.5 percent after an increase of 2.3 percent in July. The recent acceleration has been driven by communications equipment and semiconductors. Production gains for computers continue to average about 1 percent per month, well below the average pace in the latter half of the 1990s.

Industry reports paint a favorable picture of the near-term prospects for communications equipment and semiconductors. Our contact at Cisco was decidedly upbeat about business conditions in the near term, citing continued strong replacement demand. In addition, the *CIO Magazine* diffusion index of future spending for data networking equipment moved up again in August (although the index for future spending on computer hardware fell back after having spurted up in July). As for semiconductors, Intel's mid-quarter update to its revenue guidance for the third quarter is consistent with the accelerating production of microprocessors and flash memory. However, in the computer industry, the latest outlook from Gartner suggests that unit sales of personal computers have slowed in the third quarter.

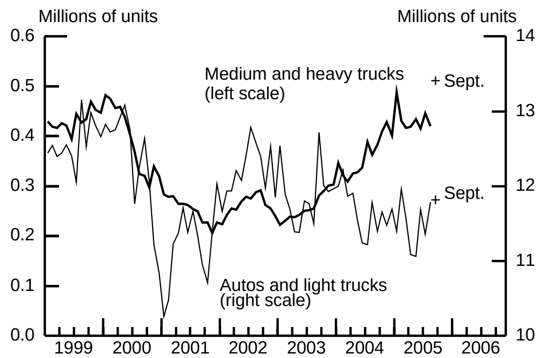
Outside of transportation, high-tech, and energy, production was uneven in August. The output of defense and space equipment continued to trend upward. In contrast, the production of consumer goods decreased 0.4 percent in August, a decline driven by a

Indicators of Manufacturing Activity

Energy IP

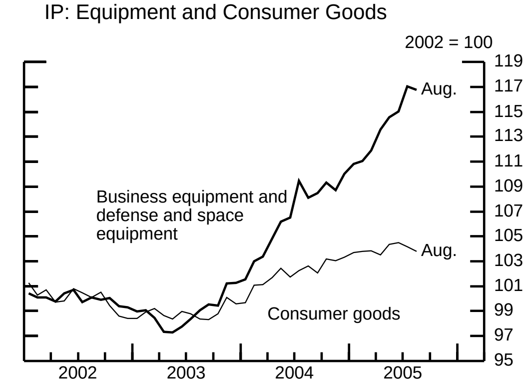


Motor Vehicle Assemblies



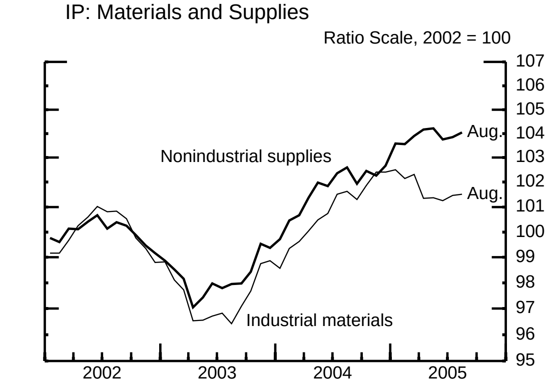
Note. September values are based on latest industry schedules.

IP: Equipment and Consumer Goods



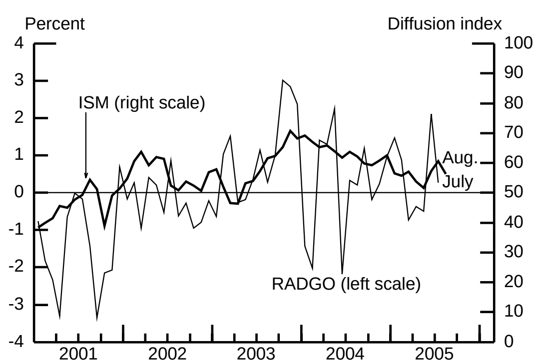
Note. Data exclude energy, motor vehicles and parts, and high-tech industries.

IP: Materials and Supplies



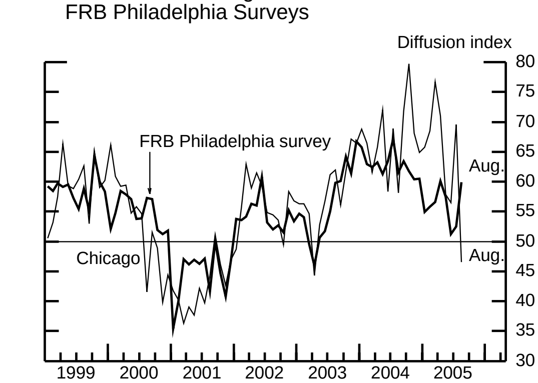
Note. Excluding energy, motor vehicles and parts, and high-tech industries.

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.

New Orders: Chicago and FRB Philadelphia Surveys



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

drop in the production of nondurable consumer goods; a dropback in the production of farm machinery, which had spiked in July, pulled down the index for business equipment. Among upstream market groups, the output of construction supplies rose 0.7 percent in August. The output of materials designated for further processing in the industrial sector was unchanged in August and has moved down, on balance, from its year-ago level. Within this group, however, the production of iron and steel jumped 4.3 percent in August after having been restrained earlier in the year while steel service centers worked off excess inventories.

The forward-looking indicators of industrial activity were mixed in August but generally remained consistent with modest near-term gains. The Institute for Supply Management's new orders diffusion index decreased in August but remained above 50 for the twenty-eighth consecutive month. Although the new orders diffusion index from the Chicago Purchasing Managers survey plunged in August, the Philadelphia Fed's new-orders diffusion index moved up solidly, and most other regional indexes continue to point to near-term production increases. The three-month moving average of the staff's series on real adjusted durable goods orders ticked up in July.

Motor Vehicles

Sales of light vehicles fell to an annual rate of 16.7 million units in August—well below the near-record pace of 20.7 million units in July but roughly in line with the average pace for the first half of the year. According to confidential data, a jump in fleet sales helped to support total sales in August in the face of a steep plunge in retail sales, which covers both consumer purchases and leases. The weakness in the retail segment may have reflected in part the limited availability of some GM models as well as the payback that typically follows a surge in sales. The automakers have informed us on a confidential basis that they expect light vehicle sales to fall in a range of 15¼ million to 16½ million units in September.

Although the employee discounts were initially scheduled to expire at the end of July, they have been extended a few times and are now set to expire on October 3 (September 30 at GM). GM has added its 2006 model-year large SUVs and full-sized pickups to the promotion, although the cash-back incentives offered on these models are smaller than those on the 2005 models.[4] Ford had included some 2006 models in its employee-discount program in July and August but limited the promotion to 2005 models in September. Employee pricing at Chrysler applies only to 2005 models. The manufacturers have continued to partially offset the employee discounts by scaling back their cash rebates and reduced-rate financing offers. Indeed, the average value of

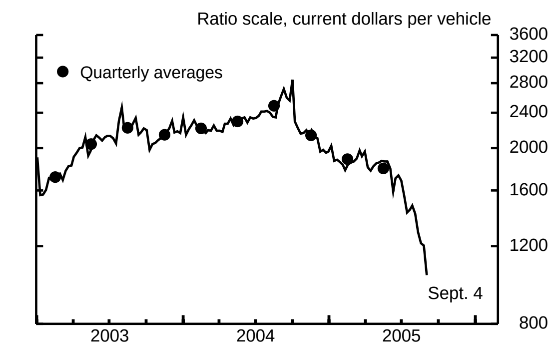
[4]Both GM and Ford have been struggling to shore up the sales of large and mid-sized SUVs, which have been slipping all year as a result of not only high gasoline prices but also the aging line-up of the companies' models in this market segment. GM plans to redesign some of its large SUVs and pickups over the winter shutdown and to debut its 2007 models in early 2006. Even with the redesigns, recent statements by GM officials indicate that the automaker is scaling back its outlook for SUV sales in the coming years.

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

Category	2004	2004	2005				
		Q4	Q1	Q2	June	July	Aug.
Total	16.9	17.1	16.5	17.2	17.8	20.7	16.7
Autos	7.5	7.7	7.5	7.6	7.5	8.1	7.7
Light trucks	9.4	9.4	9.0	9.6	10.3	12.6	8.9
North American[1]	13.5	13.5	13.2	13.7	14.3	17.0	13.2
Autos	5.4	5.4	5.4	5.4	5.2	5.7	5.5
Light trucks	8.1	8.1	7.8	8.3	9.1	11.3	7.7
Foreign-produced	3.4	3.6	3.3	3.5	3.5	3.7	3.4
Autos	2.1	2.3	2.1	2.2	2.2	2.3	2.2
Light trucks	1.2	1.3	1.2	1.3	1.3	1.3	1.2
Memo: Big Three domestic market share (percent)[2]	58.7	57.0	57.7	58.4	61.0	61.6	54.8

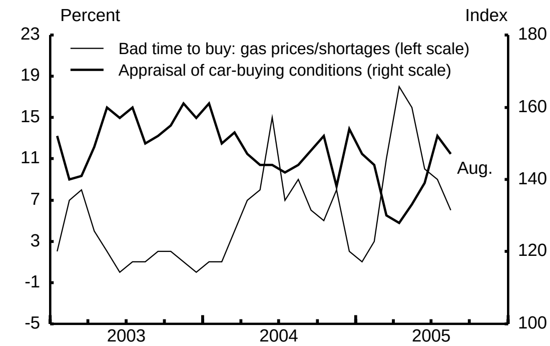
Note. Components may not sum to totals because of rounding. Data on sales of trucks and imported autos for the most recent month are preliminary and subject to revision.
1. Excludes some vehicles produced in Canada that are classified as imports by the industry.
2. Domestic market share excludes sales of foreign brands affiliated with the Big Three.

Average Value of Incentives on Light Vehicles

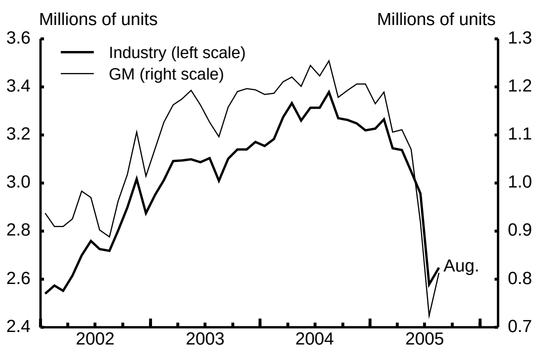


Note. Weighted average of customer cash rebate and interest rate reduction. Data are seasonally adjusted.
Source. J.D. Power and Associates.

Michigan Survey Index of Car-Buying Attitudes

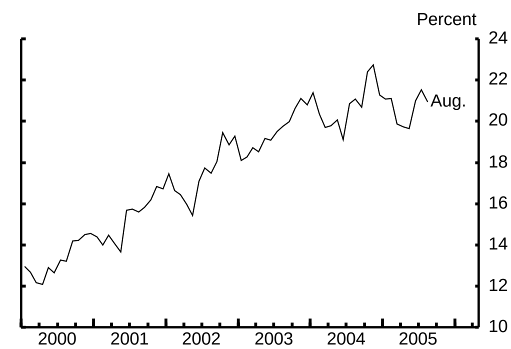


Inventories of Light Vehicles



Note. FRB seasonals. Monthly totals.

Market Share of Large and Mid-sized SUVs



Note. FRB seasonals.

incentives per light vehicle sold, which excludes the employee-discount programs, fell $242 in August and stood nearly $600 below the levels that prevailed in the first half of the year. Nevertheless, according to the Michigan Survey for August (which was released on August 26), consumers continued to perceive that car prices are low and that car-buying conditions are favorable. Surprisingly, only 8 percent of respondents at the time of the August survey cited high gasoline prices as a reason not to buy a car, compared with a high of 18 percent in April.

Consumer Spending

Real consumer spending rose briskly during the summer, the result of the surge in purchases of motor vehicles and moderate increases in spending on other goods and services. The combination of strong overall spending growth and tepid gains in real income has put downward pressure on the saving rate in recent months, and, according to the published data, it fell to negative 0.6 percent in July.[5]

In the retail control category of goods—which excludes sales by auto dealers and building material and supply stores—nominal spending rose 1 percent in August. Factoring in our projection for consumer prices, we estimate that real spending on PCE goods excluding autos and trucks jumped nearly 1½ percent in June, was up a little in July, and rose 0.2 percent in August. Real outlays for services rose 0.4 percent in June and 0.2 percent in July (the latest available data).

Real disposable income was unchanged in July after having risen at an annual rate of just 2 percent in the second quarter. The increase in nominal wages and salaries in July outpaced the rise in prices, but other components of income declined sharply in real terms. Moreover, steep increases in energy prices will continue to damp real income gains in August and September. The ratio of household wealth to income continued to inch up in the second quarter because of an increase in stock prices and another jump in home prices. The August reports on consumer sentiment from the Michigan Survey and the Conference Board—which were completed before the hurricane struck the Gulf Coast—moved in opposite directions, but the levels of both series were consistent with solid increases in spending.

Housing

Residential construction continued at a robust pace through midyear. Starts of new single-family homes in July were at an annual rate of 1.71 million units, slightly above their average level in the first half of the year, while new permit issuance and the backlog of unused permits were at record levels. In the multifamily sector, starts dipped to an annual rate of 331,000 units, but permits remained strong.

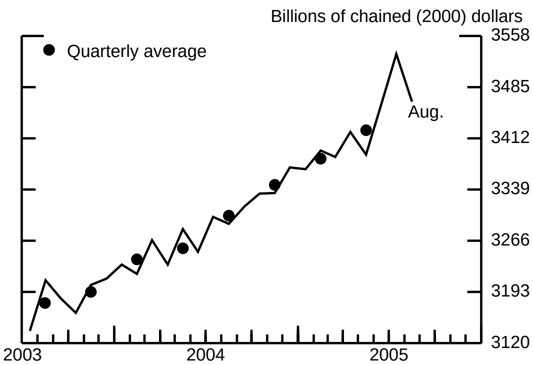
[5] The BEA has apparently assumed that the share of new truck purchases going to consumers fell in July even though fleet, retail, and lease data suggest that the consumers' share likely increased. Combining this with our expectation of an upward revision to spending based on the retail sales report, we estimate that the saving rate fell to negative 1 percent in July.

Retail and Food Services Sales
(Percent change from preceding period; seasonally adjusted current dollars)

Category	2004 Q4	2005 Q1	2005 Q2	2005 June	2005 July	2005 Aug.
	Annual rate			Monthly rate		
Total sales	9.9	6.0	10.8	1.9	1.8	-2.1
Retail control[1]	10.5	7.3	9.0	1.1	.5	1.0
Previous estimate	10.5	7.3	8.8	.9	.4	...
Ex. sales at gasoline stations	7.9	7.0	7.1	.8	.0	.5
GAF	6.7	7.3	6.3	.9	-.2	.3
Memo: Real PCE goods ex. autos and trucks[2]	6.3	6.5	4.5	1.4	.1	.2

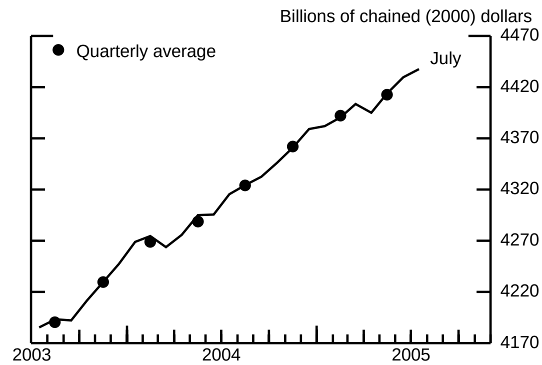
1. Total sales less outlays at building material and supply stores and automobile and other motor vehicle dealers.
2. Q2, June, and July are staff estimates. August is a staff forecast.
... Not applicable.

Real PCE Goods

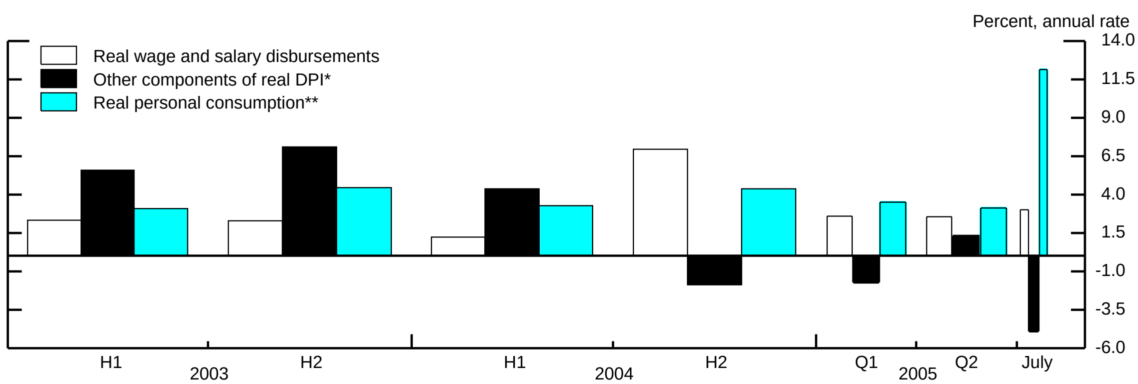


Note. June, July, and 2005:Q2 are staff estimates; August is a staff forecast.

Real PCE Services



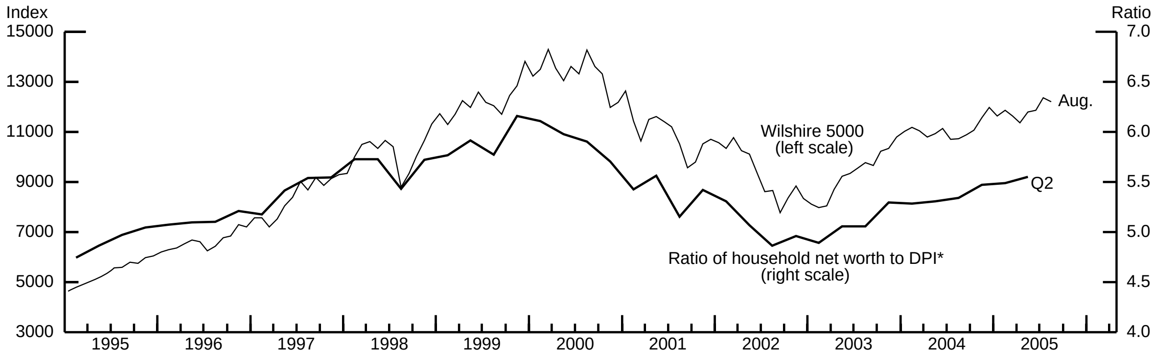
Change in Real Wages and Salaries, Other Real DPI, and Real Personal Consumption



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

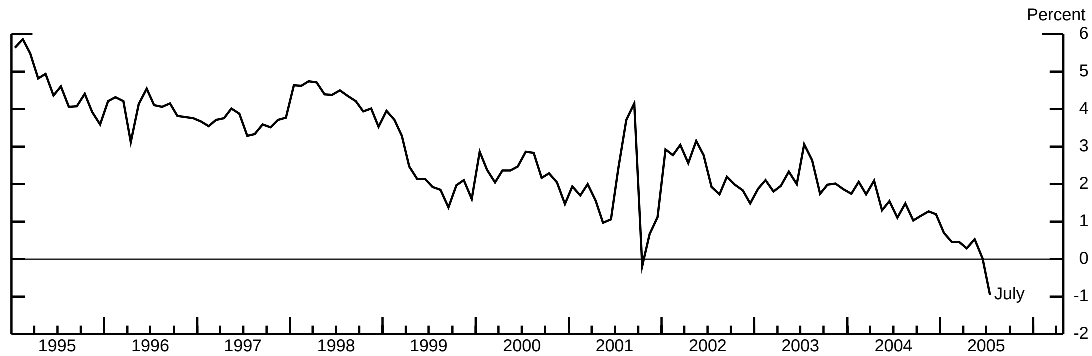
Household Indicators

Household Net Worth and Wilshire 5000



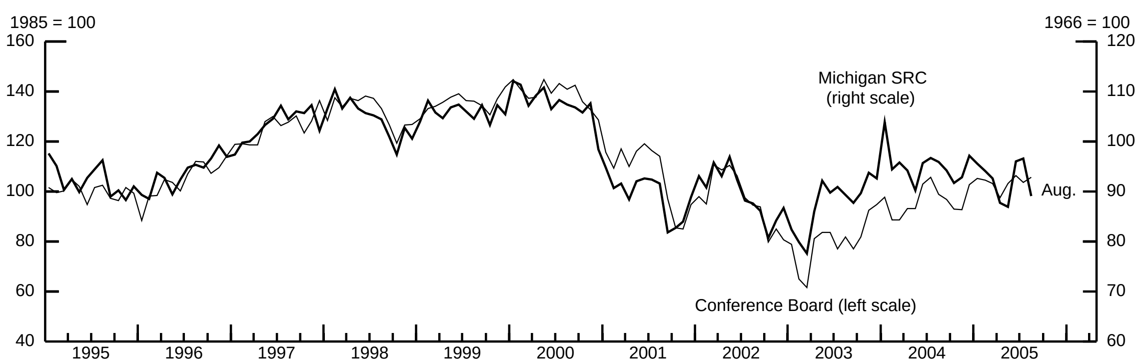
* Value for 2004:Q4 excludes the effect on income of the one-time Microsoft dividend in December. Value for 2005:Q2 is a staff estimate.

Personal Saving Rate



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

Consumer Confidence

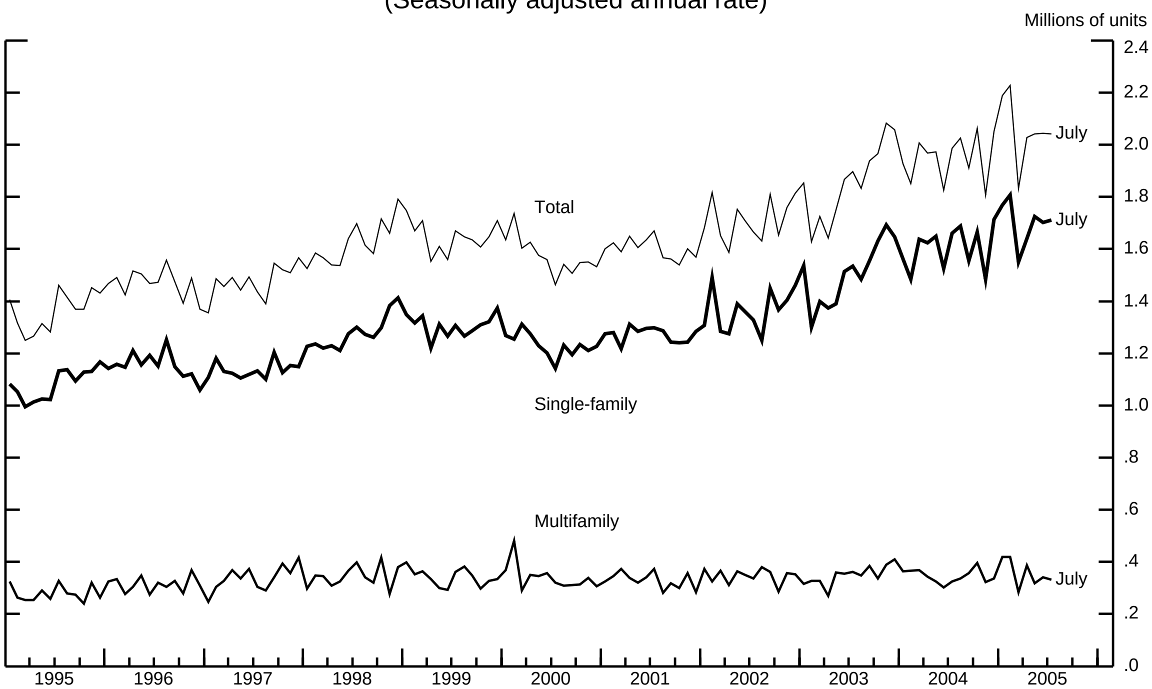


Private Housing Activity
(Millions of units; seasonally adjusted annual rate except where noted)

Sector	2004	2005				
		Q1	Q2	May	June	July
All units						
Starts	1.96	2.08	2.04	2.04	2.05	2.04
Permits	2.05	2.08	2.11	2.06	2.13	2.17
Single-family units						
Starts	1.61	1.71	1.69	1.72	1.70	1.71
Permits	1.60	1.60	1.64	1.63	1.65	1.69
Adjusted permits[1]	1.64	1.63	1.67	1.66	1.68	1.72
Permit backlog[2]	.150	.150	.161	.153	.161	.162
New home sales	1.20	1.25	1.30	1.30	1.32	1.41
Existing home sales	5.96	5.98	6.30	6.22	6.39	6.24
Multifamily units						
Starts	.35	.37	.35	.32	.34	.33
Permits	.46	.48	.47	.43	.48	.48
Permit backlog[2]	.075	.068	.060	.062	.060	.062
Mobile homes						
Shipments	.131	.137	.128	.127	.127	.125
Condos and Co-ops						
Existing home sales	.82	.85	.93	.92	.96	.92

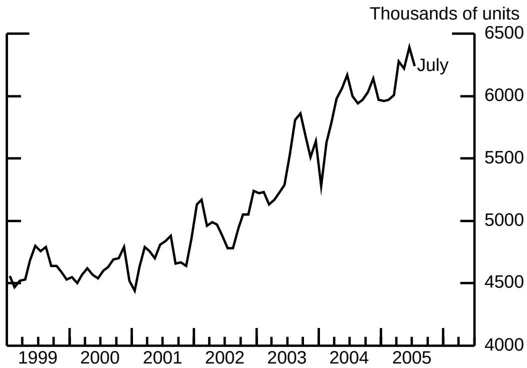
1. Adjusted permits equal permit issuance plus total starts outside of permit-issuing areas.
2. Number outstanding at end of period. Seasonally adjusted by Board staff. Excludes permits that have been canceled, abandoned, expired, or revoked. Not at an annual rate.

Private Housing Starts
(Seasonally adjusted annual rate)



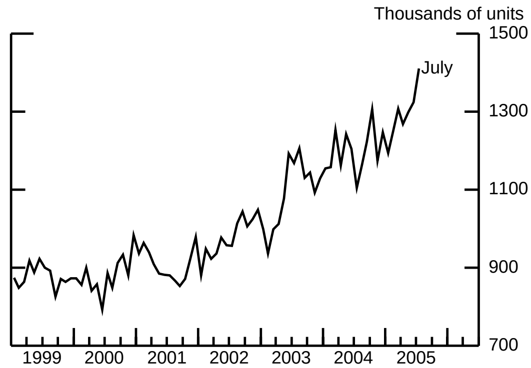
Indicators of Single-Family Housing

Existing Home Sales



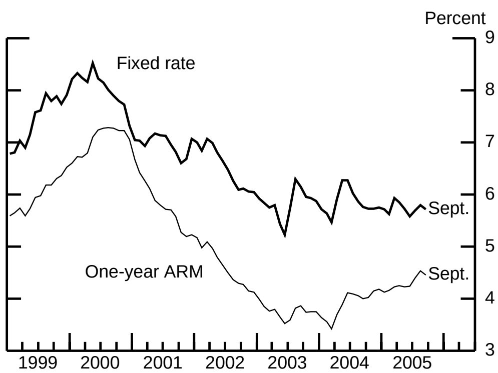
Source. National Association of Realtors.

New Home Sales



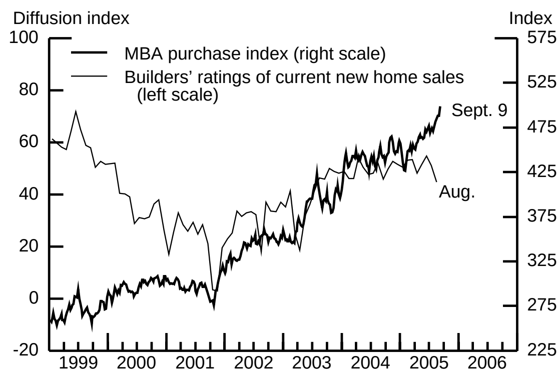
Source. Census Bureau.

Mortgage Rates



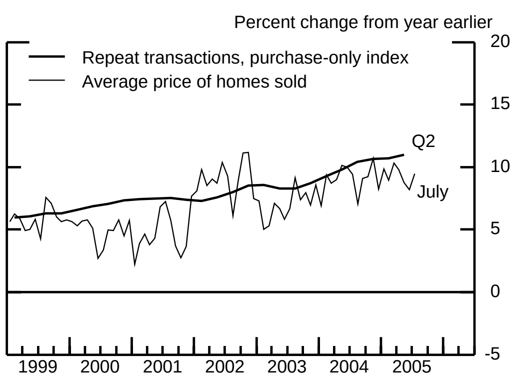
Note. The September readings are based on data through Sept. 7.
Source. Freddie Mac.

Homebuying Indicators



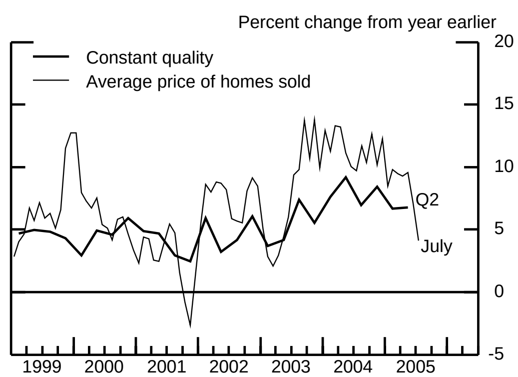
Note. MBA index is a 4-week moving average. Builders' ratings are seasonally adjusted by Board staff.
Source. Mortgage Bankers Association and National Association of Home Builders.

Prices of Existing Homes



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

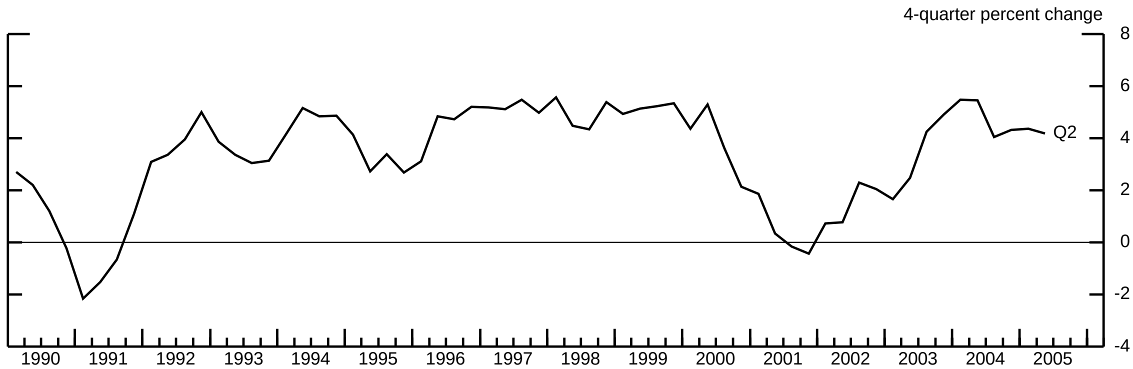
Prices of New Homes



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

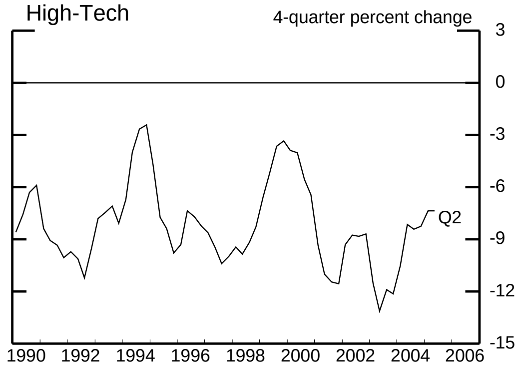
Equipment and Software Investment Fundamentals

Real Business Output

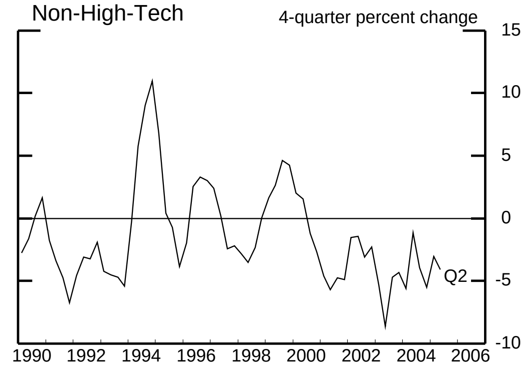


User Cost of Capital

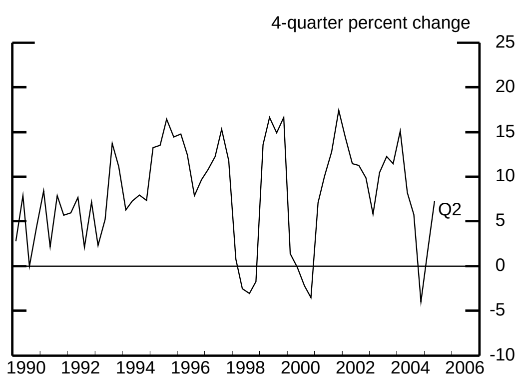
High-Tech



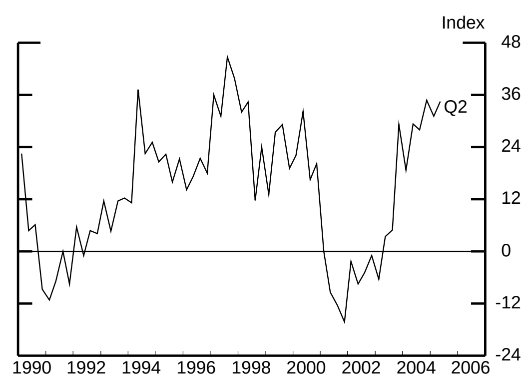
Non-High-Tech



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.

Home sales also remained elevated through July. New home sales climbed 6½ percent to an annual rate of 1.41 million units. Although inventories of new homes for sale have risen this year, the months' supply (evaluated at July's sales pace) was still below the readings in the first half of the year and well short of historical norms. Sales of existing single-family homes slipped 2½ percent in July from the record-setting level in June, but they remained at a lofty annual rate of 6.24 million units. Inventories of existing homes moved up further and equaled 4.6 months' supply at July's pace—at the high end of recent readings but a good bit below the historical average.

Demand for housing continues to be supported by low long-term mortgage rates—the thirty-year fixed rate is still hovering around 5¾ percent, as it has since late last year. Rates for one-year adjustable-rate mortgages have increased roughly 30 basis points so far this year but have stayed well below their levels of a few years ago. Most near-term indicators of sales activity—such as the index of mortgage applications for purchase through early September and the July pending home sales index—remained at high levels. In contrast, the index of builders' ratings for new home sales slipped noticeably in August and was at the lower end of readings registered over recent years; however, this index has not tracked home sales or construction very closely in the past six years.

Prices of existing homes continued to increase rapidly during the first half of 2005, while the rate of price appreciation for new homes moderated somewhat. The purchase-only version of the OFHEO price index, which controls for differences in quality by tracking repeat sales of the same houses over time, was 11 percent higher in the second quarter than it had been a year earlier. The constant-quality price index for new homes—which controls for changes in the geographic composition of sales, home size, and other readily measurable attributes—was up 6¾ percent in the second quarter from its year-ago level, at the lower end of the range of the past year and a half. The average price of new homes decelerated markedly over the summer; some of the slowing was likely the result of a compositional shift.

Equipment and Software

Although real outlays for equipment and software posted a solid gain in the second quarter, business spending does not appear to have had much forward momentum at midyear. The softness in shipments and orders in July implies a less rosy near-term outlook than seemed likely a month ago, even though the fundamentals still appear quite positive. In particular, business output continues to expand at a rapid clip, financing conditions remain favorable, and firms still hold large stocks of liquid assets. Furthermore, for the most part, anecdotal reports and business surveys provide ongoing evidence of business optimism, although concerns about energy-related costs are increasing (as reported in the latest reading of the ISM survey).

In the high-tech sector, nominal shipments of computers edged up 0.5 percent in July after two months of declines. Although falling prices imply that real purchases continue to rise, the increase in real outlays on computers and peripherals this quarter is likely to fall far short of the nearly 40 percent annual rate that was registered, on average, in the

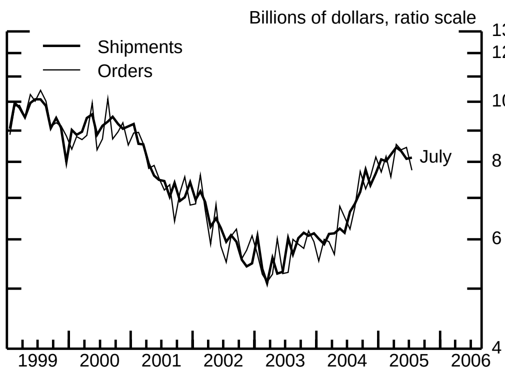
Orders and Shipments of Nondefense Capital Goods

(Percent change; seasonally adjusted current dollars)

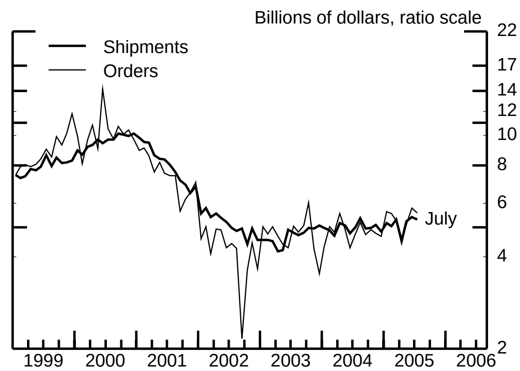
Indicators	2005 Q1	Q2	May	June	July
	Annual rate		Monthly rate		
Shipments	13.0	8.2	.7	.0	-.7
Excluding aircraft	15.6	1.3	1.9	-.2	-.5
Computers and peripherals	30.2	9.3	-1.5	-2.8	.5
Communications equipment	16.7	-8.5	15.9	3.6	-1.9
All other categories	13.2	1.0	1.2	-.2	-.5
Orders	5.9	66.1	18.7	-2.2	-7.5
Excluding aircraft	20.5	2.2	-.5	4.9	-4.1
Computers and peripherals	8.8	36.8	-2.0	.9	-8.2
Communications equipment	71.1	-20.5	11.3	12.9	-3.7
All other categories	18.0	.0	-1.4	4.7	-3.4
Memo:					
Shipments of complete aircraft[1]	23.9	30.2	28.2	27.9	26.8

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

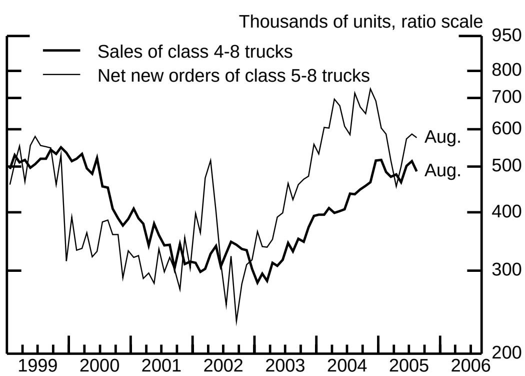
Computers and Peripherals



Communications Equipment

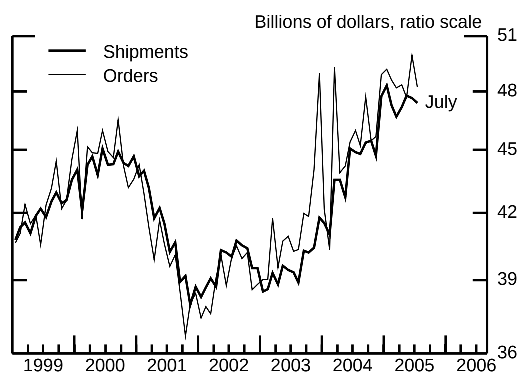


Medium and Heavy Trucks



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

Other Equipment



first half of the year. In contrast, orders and shipments of communications equipment have been running at reasonably high levels since May and point to a sizable gain in real outlays in this category in the current quarter.

In the transportation sector, business spending on new motor vehicles was brisk over the summer. Fleet sales rose sharply in August, in part perhaps because the manufacturers accelerated some deliveries to businesses in the face of soft retail demand. Sales of medium and heavy trucks were robust in July and August after having weakened a bit earlier in the year, and new orders for these vehicles stayed high. Demand for trucks is likely to remain elevated into 2006, as some customers will likely try to buy ahead of the new EPA regulations on truck engines that will take effect in January 2007. Elsewhere, business spending on aircraft continued to be restrained by excess capacity in the U.S. airline industry and stratospheric fuel costs.

Investment spending on non-high-tech, nontransportation equipment edged down in the second quarter, and the incoming data suggest that the softness persisted into the summer. Nominal shipments in this broad category fell 0.5 percent in July after having been essentially flat over the preceding few months, and orders decreased in July as well. Some of this softness appears to be related to the second-quarter slowdown in the manufacturing sector—the primary customer for this type of equipment. However, order backlogs have continued to rise, suggesting that shipments should turn back up in coming months.

Nonresidential Construction

Conditions in nonresidential property markets have improved incrementally this year, but real spending on nonresidential structures has yet to gain traction. The vacancy rate for office buildings drifted down during the two years ending in the second quarter of 2005, but construction in this sector was about flat through July. Real spending on commercial buildings has also been moving sideways despite the continued low vacancy rate in this sector. In addition, real construction outlays in the manufacturing sector have been sluggish recently after having increased late last year.

Outlays on drilling and mining structures moved up sharply in the second quarter. The number of rigs drilling for natural gas continued to climb over the summer and, according to initial estimates from Baker Hughes, remained high through early September. After some weakness last spring, the number of rigs drilling for crude oil also rose over the summer and is estimated to have held fairly steady post-Katrina. The Baker Hughes data, however, consider rigs to be operating unless they are officially confirmed to be lost or significantly damaged; thus, they may not yet fully reflect hurricane-related disruptions.

Business Inventories

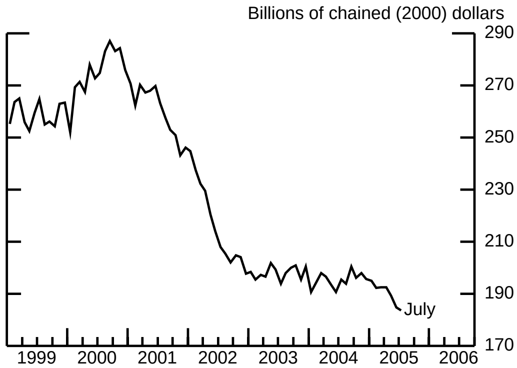
Investment in real nonfarm inventories excluding motor vehicles slowed markedly in the second quarter, and partial data suggest that real stockbuilding remained subdued in July. The book value of manufacturing stocks rose at an annual rate of $28 billion in July, compared with an increase of just $1 billion in the second quarter. However, much of the

Nonresidential Construction and Indicators

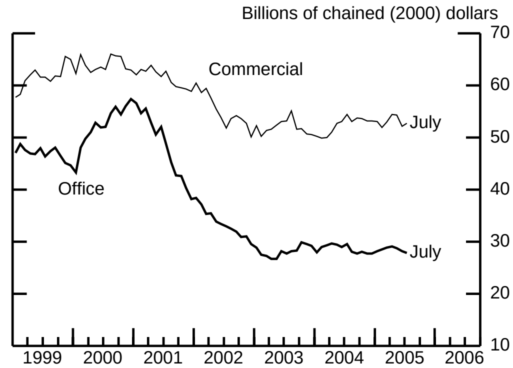
Real Construction

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

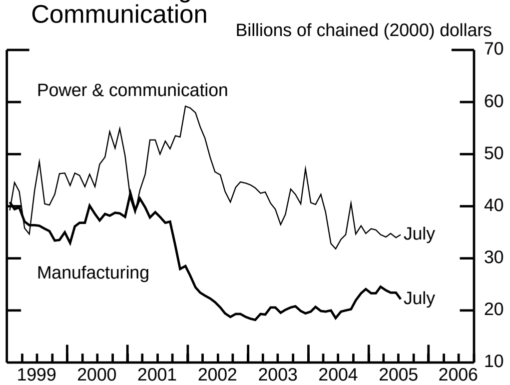
Total Structures



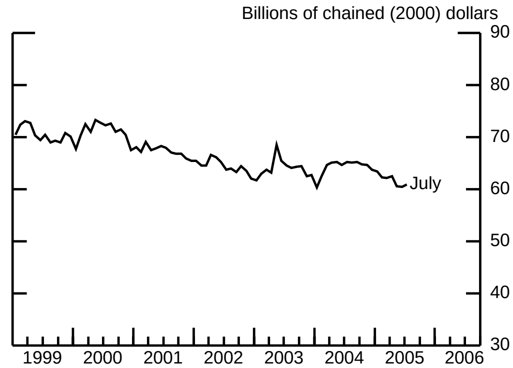
Office and Commercial



Manufacturing and Power & Communication



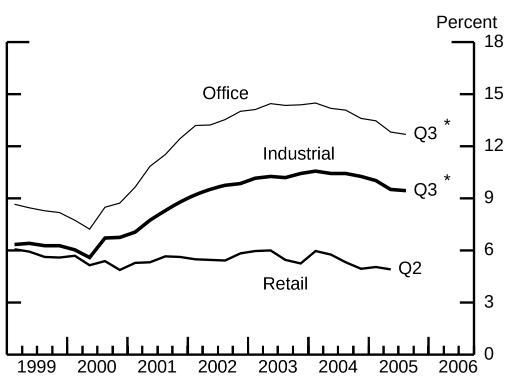
Other



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

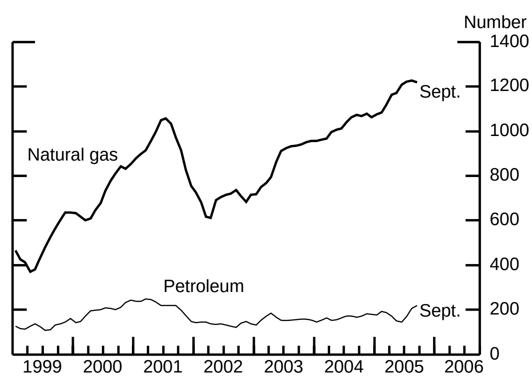
Indicators

Vacancy Rates



Source. For office and industrial, CoStar Property Professional; for retail, National Council of Real Estate Investment Fiduciaries.
* Estimates based on data through Sept. 9.

Drilling Rigs in Operation



Note. Sept. values are averages through Sept. 9.
Source. DOE/Baker Hughes.

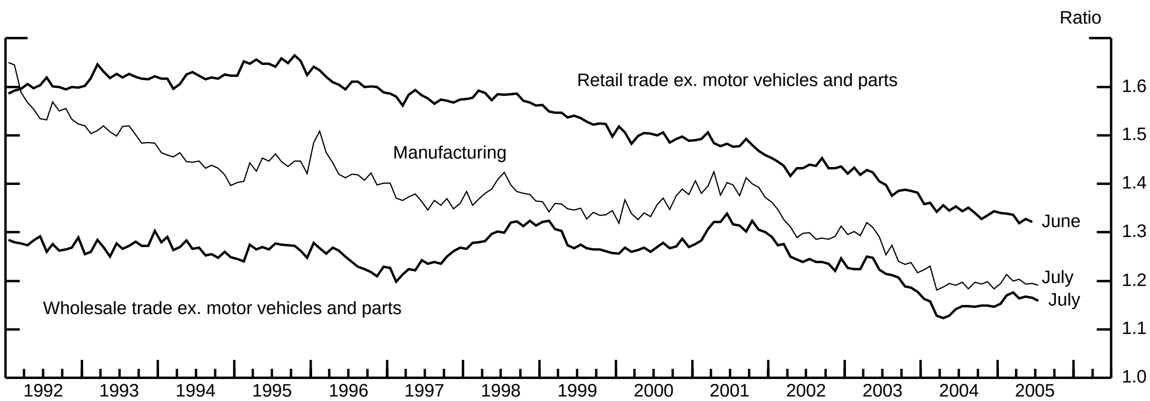
Changes in Manufacturing and Trade Inventories

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

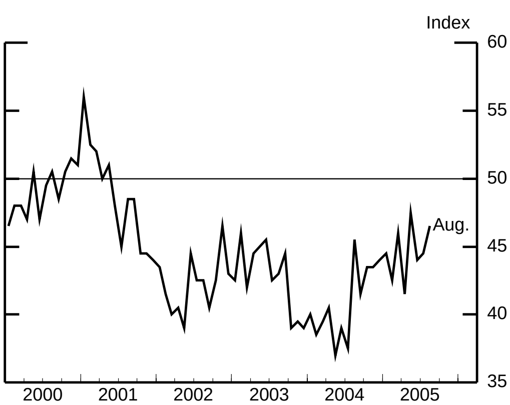
Sector	2005 Q1	2005 Q2	2005 May	2005 June	2005 July
Manufacturing and trade	88.6	21.1	21.7	1.5	n.a.
Ex. wholesale and retail motor vehicles and parts	92.0	31.9	28.7	33.5	n.a.
Manufacturing	42.6	.9	-5.6	3.5	27.8
Ex. aircraft	38.1	4.0	-10.2	8.8	16.8
Wholesale trade	30.5	20.2	13.7	18.9	-3.6
Motor vehicles and parts	-1.1	7.9	5.4	12.3	.8
Ex. motor vehicles and parts	31.6	12.4	8.3	6.6	-4.4
Retail trade	15.5	-.1	13.7	-20.9	n.a.
Motor vehicles and parts	-2.3	-18.8	-12.3	-44.3	n.a.
Ex. motor vehicles and parts	17.7	18.7	26.0	23.4	n.a.

n.a. Not available.

Book-Value Inventories Relative to Shipments and Sales

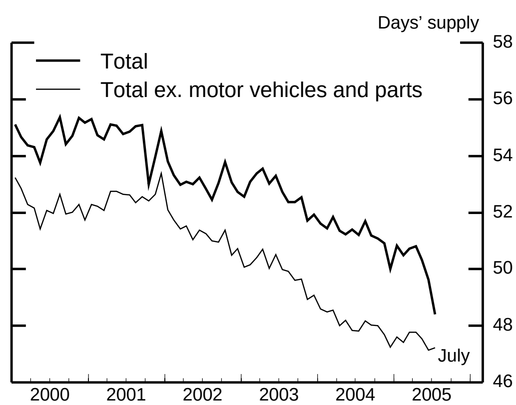


ISM Customer Inventories: Manufacturing



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

Inventory-Consumption Ratios, Flow-of-Goods System



Federal Government Outlays and Receipts

(Unified basis; billions of dollars except as noted)

Function or source	July-August 2004	July-August 2005	July-August Percent change	12 months ending in August 2004	12 months ending in August 2005	12 months ending in August Percent change
Outlays	382.4	400.3	4.7	2278.1	2437.0	7.0
Financial transactions[1]	-.7	-.8	...	-2.2	-.9	...
Payment timing[2]	.1	.0	...	-13.2	.1	...
Adjusted outlays	383.1	401.0	4.7	2293.5	2437.8	6.3
Receipts	272.1	297.5	9.3	1864.1	2109.1	13.1
Payment timing	.0	.0	...	.0	.0	...
Adjusted receipts	272.1	297.5	9.3	1864.1	2109.1	13.1
Surplus or deficit (-)	-110.3	-102.8	...	-414.1	-328.0	...
Selected components of adjusted outlays and receipts						
Adjusted outlays	383.1	401.0	4.7	2293.5	2437.8	6.3
Net interest	31.3	33.0	5.4	160.7	178.5	11.1
Non-interest	351.8	368.0	4.6	2132.9	2259.4	5.9
National defense	78.8	83.5	5.9	453.6	484.2	6.7
Social Security	83.2	87.9	5.7	494.1	520.9	5.4
Medicare	47.0	51.0	8.6	268.3	292.4	9.0
Medicaid	27.2	28.7	5.7	175.1	181.8	3.8
Income security	47.7	48.8	2.3	335.9	343.9	2.4
Agriculture	1.4	1.8	32.2	19.0	26.8	41.1
Other	66.5	66.3	-.4	386.9	409.4	5.8
Adjusted receipts	272.1	297.5	9.3	1864.1	2109.1	13.1
Individual income and payroll taxes	229.2	251.4	9.7	1489.7	1658.0	11.3
Withheld + FICA	225.6	245.3	8.7	1392.5	1481.2	6.4
Nonwithheld + SECA	10.4	12.5	20.8	285.2	355.1	24.5
Less: Refunds	6.8	6.5	-4.9	188.0	180.4	-4.1
Corporate	6.7	9.9	47.2	177.4	250.1	40.9
Gross	10.2	14.1	38.3	219.5	280.7	27.9
Less: Refunds	3.5	4.2	20.9	42.1	30.6	-27.3
Other	36.2	36.2	.0	196.9	201.0	2.1
Adjusted surplus or deficit (-)	-110.9	-103.5	...	-429.5	-328.8	...

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.

July increase was in the petroleum sector and was likely related to the run-up in oil prices. In the wholesale trade sector excluding motor vehicles, inventories fell $4 billion at an annual rate in July after having posted a $12 billion gain in the second quarter.

The slower rate of inventory investment that emerged in the spring and appears to have continued into the summer suggests that firms have substantially completed the stockbuilding that seemed warranted in light of the low ratios of inventories to sales that prevailed earlier. Survey results from the ISM for August are supportive of that view. Information from the staff's flow-of-goods inventory system for July also indicates that—with the exceptions of paper and, to a lesser degree, food—inventories were well aligned with consumption.

Federal Government Sector

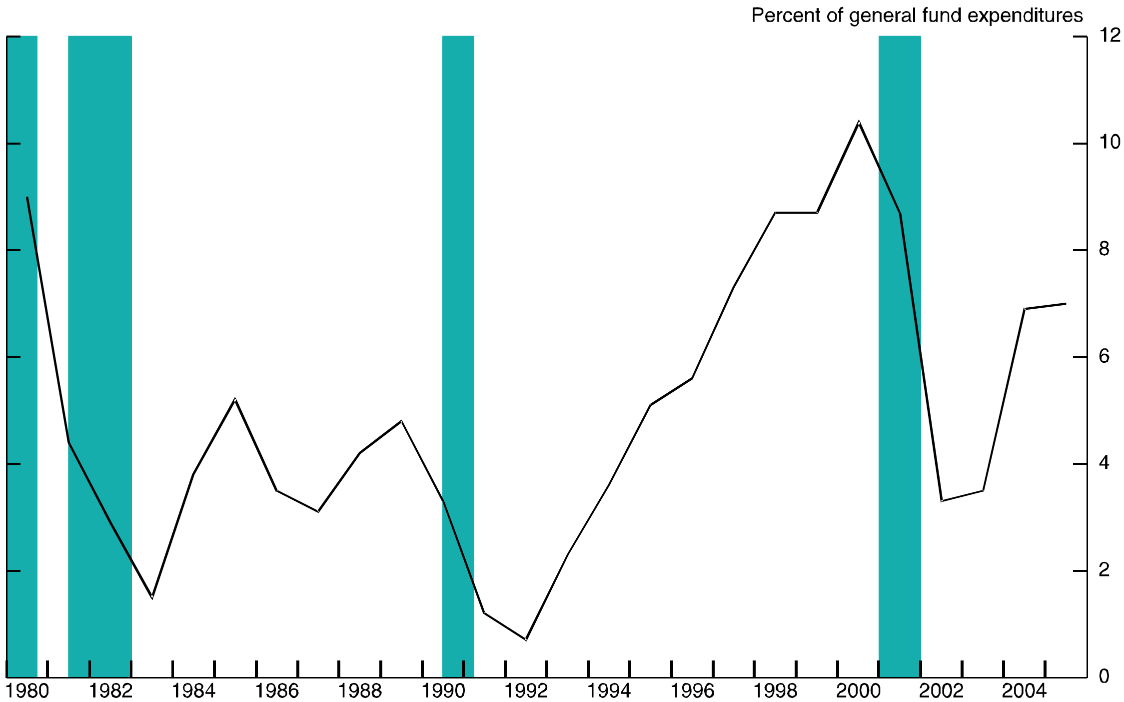
The *Monthly Treasury Statements* for July and August were broadly consistent with the summer budget projections from the Congressional Budget Office (CBO) and the Office of Management and Budget (OMB); these projections indicated that the unified deficit for fiscal 2005 would be in the area of $330 billion to $335 billion. The President has signed into law two bills containing a combined $62 billion for hurricane relief. These emergency appropriations are not expected to have much effect on the deficit in fiscal 2005, which ends on September 30, but will add significantly to the deficit in 2006.

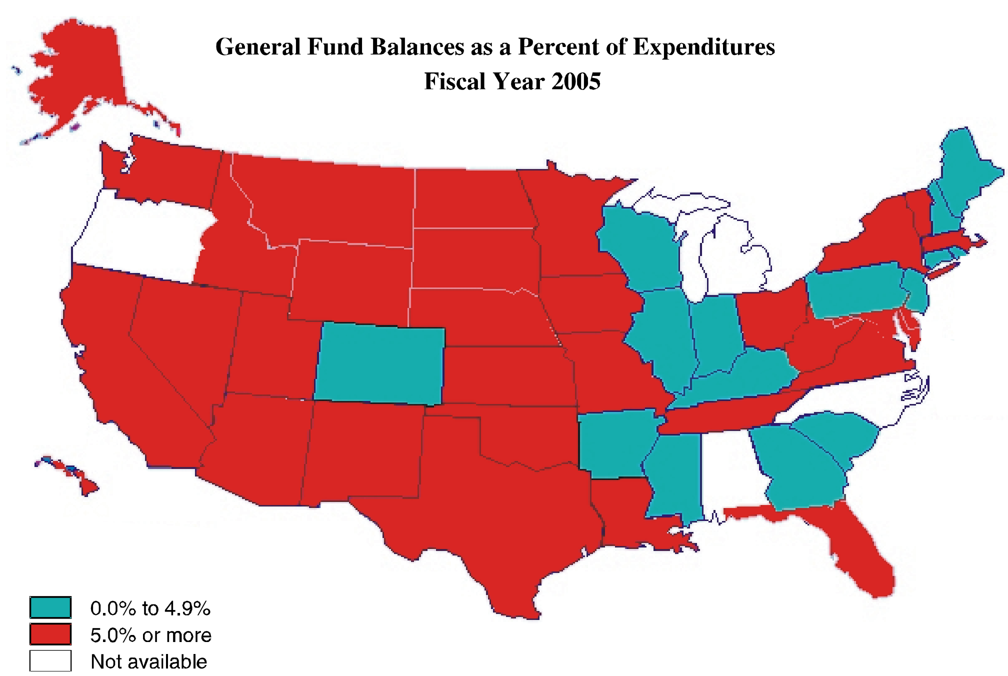
In the July-August period, unified federal tax receipts were about 9 percent above their year-earlier level. Most of this increase reflects growth in wages and salaries and the associated bracket creep. Outlays in the July-August period were roughly 5 percent above their year-earlier level, with especially large increases for Medicare and agriculture. Defense spending was 6 percent above its year-earlier level, about in line with its recent trend.

The CBO released its midyear budget update on August 15. As expected, the CBO revised down its estimate of the baseline deficit for fiscal 2005. Although the CBO projected larger baseline deficits over fiscal 2006-15 in August than it did in March, the revision largely reflected the incorporation of the supplemental appropriations enacted during the spring and the statutory requirement that the CBO extrapolate forward that additional spending. Otherwise, the CBO's outlook for the baseline budget over the next few years was a little better than it had appeared in March, while the underlying budget picture for subsequent years was little changed. The petering out of the near-term improvement in the budget reflected the CBO's assessment that the recent positive tax surprise was largely the result of transitory factors.

In early September, the President signed an emergency supplemental appropriation of $10.5 billion to aid victims of Hurricane Katrina. A few days later, a second bill totaling $52 billion in aid was enacted. In terms of regular appropriations for fiscal 2006, the President has signed only two of the twelve standard appropriations bills; however, the Congress has made considerable progress on the remaining bills, suggesting that their enactment will not likely drag on long in the new fiscal year.

State General Fund Ending Balances
(Fiscal years)





Source. State Budget and Tax Actions 2005: Preliminary Report, National Conference of State Legislatures, August 17, 2005.

Changes in CBO's Baseline Projections since March 2005
(Billions of dollars, fiscal years)

Item	2005	2006	2007	2008	2009	2010	Total, 2006-10	Total, 2006-15
March budget deficit	**-365**	**-298**	**-268**	**-246**	**-219**	**-201**	**-1232**	**-980**
Changes								
Legislative	**-34**	**-80**	**-94**	**-103**	**-110**	**-118**	**-506**	**-1219**
Revenues	0	0	-2	-2	-2	-2	-9	-18
Outlays[1]	34	80	93	101	108	116	497	1202
Economic	**25**	**21**	**11**	**3**	**2**	**3**	**40**	**35**
Revenues	28	21	11	8	10	13	62	132
Outlays[1]	3	0	0	5	8	10	23	97
Technical	**42**	**43**	**27**	**12**	**5**	**0**	**87**	**54**
Revenues	56	48	30	12	6	0	95	65
Outlays[1]	14	4	3	0	0	1	8	10
Total effect on deficit	**33**	**-16**	**-56**	**-89**	**-103**	**-116**	**-379**	**-1130**
August budget deficit	**-331**	**-314**	**-324**	**-335**	**-321**	**-317**	**-1612**	**-2110**

Note. Negative numbers indicate an increase in the deficit.
1. Includes net interest payments.

State and Local Government Sector

Indicators of state and local activity have been mixed in recent months. After having climbed for four months, nominal construction put-in-place fell in June and July to a level 1 percent below the second-quarter average. Much of the weakness was in the education and highway components, each of which accounts for almost 30 percent of the sector's construction. Meanwhile, state and local employment rose 16,000 in August after a 42,000 gain in July.

The National Conference of State Legislatures has released its annual report on the fiscal status of state governments.[6] Roughly two-thirds of the states reported that their general fund balances plus rainy day funds at the end of fiscal 2005 were equal to more than 5 percent of general fund expenditures—the level that many analysts view as sufficient when evaluating a state's fiscal condition. These results are a good deal better than the states had anticipated a year earlier when they first formulated their 2005 budgets. Much of the improvement was the result of higher revenues than originally projected. Some states used the unanticipated revenues for supplemental appropriations, and some deposited them into their rainy day funds or left them in their general funds.

[6] Data were collected from forty-six states for fiscal 2005, which ended on June 30 in most states.

Measures of Consumer Price Inflation
(Percent)

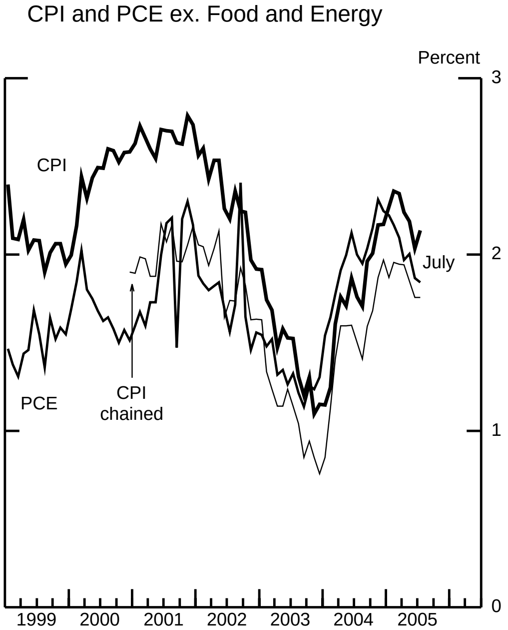
Measures	12-month change		3-month change		1-month change	
			Annual rate		Monthly rate	
	July 2004	July 2005	Apr. 2005	July 2005	June 2005	July 2005
CPI						
Total	**3.0**	**3.2**	**6.2**	**1.9**	**.0**	**.5**
Food	4.0	2.1	3.7	1.5	.1	.2
Energy	14.3	14.2	51.2	4.7	-.5	3.8
Ex. food and energy	**1.8**	**2.1**	**2.6**	**1.6**	**.1**	**.1**
Core commodities	-1.2	.5	-.3	-1.1	-.2	-.3
Core services	3.0	2.8	3.8	2.4	.2	.3
Chained CPI (n.s.a.) [1]	2.6	2.6	...	...	...	...
Ex. food and energy [1]	1.5	1.8	...	...	...	...
PCE prices						
Total	**2.8**	**2.5**	**4.4**	**1.3**	**.0**	**.3**
Food	3.4	2.0	3.8	.9	.0	.2
Energy	15.1	14.8	54.8	3.9	-.6	4.0
Ex. food and energy	**2.0**	**1.8**	**1.7**	**1.2**	**.0**	**.1**
Core commodities	-.8	-.1	-.2	-1.9	-.3	-.3
Core services	3.2	2.7	2.5	2.6	.2	.2
Core market-based	1.5	1.6	1.5	1.3	.0	.0
Core non-market-based	4.5	3.0	2.7	1.0	.0	.1

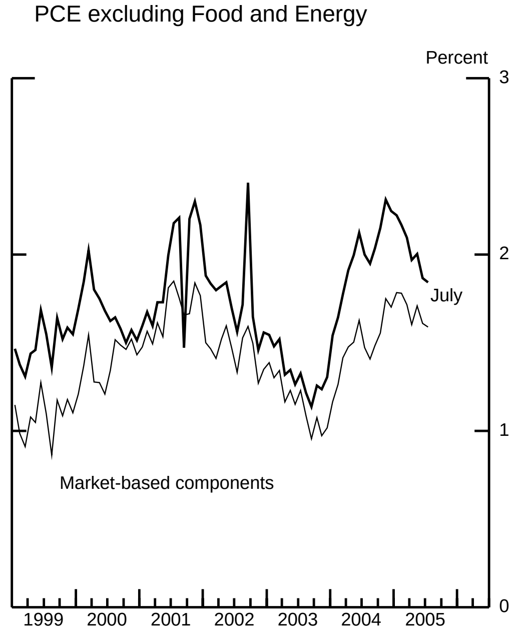
1. Higher-frequency figures are not applicable for data that are not seasonally adjusted.
... Not applicable.

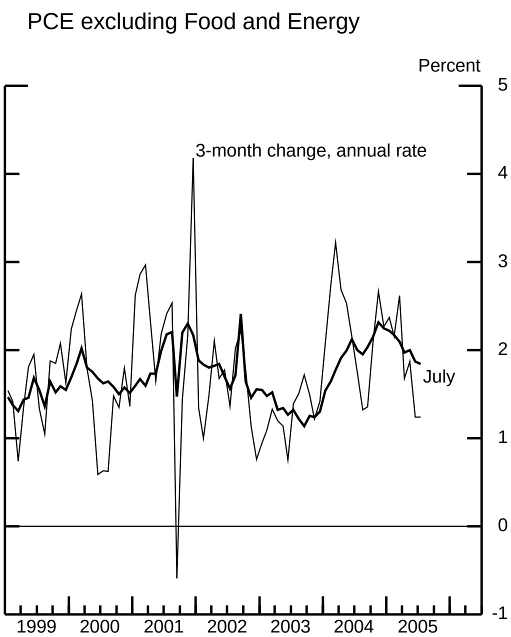
Measures of Producer Price Inflation
(Percent)

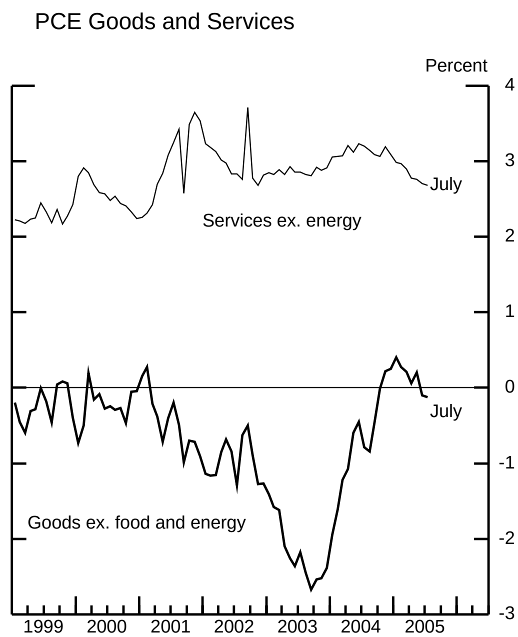
Measures	12-month change		3-month change		1-month change	
			Annual rate		Monthly rate	
	Aug. 2004	Aug. 2005	May 2005	Aug. 2005	July 2005	Aug. 2005
PPI						
Total finished goods	**3.3**	**5.1**	**2.6**	**6.7**	**1.0**	**.6**
Food	4.0	1.2	1.0	-6.5	-.3	-.3
Energy	9.8	19.2	5.8	48.4	4.4	3.7
Ex. food and energy	**1.5**	**2.4**	**2.1**	**1.3**	**.4**	**.0**
Core consumer goods	1.5	2.6	2.0	1.0	.4	-.1
Capital equipment	1.4	2.2	2.5	.8	.5	-.1
Intermediate materials	8.0	6.1	4.4	7.4	1.0	.7
Ex. food and energy	7.2	3.2	.8	-1.3	-.1	-.1
Crude materials	23.5	11.3	20.3	24.2	6.7	2.3
Ex. food and energy	32.3	-.2	-9.2	13.4	3.1	4.6

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



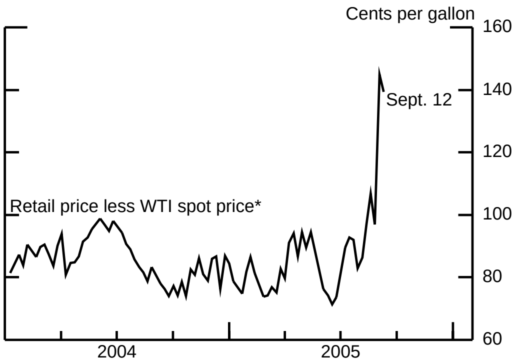






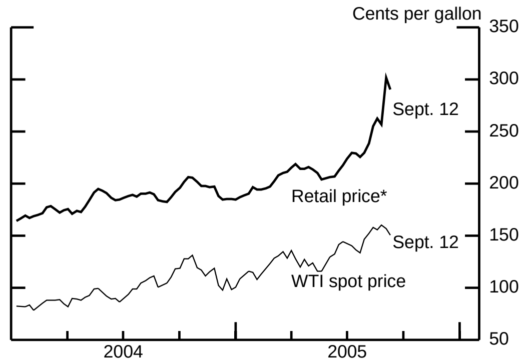
Energy Prices and Inventories
(Data from Energy Information Administration except as noted)

Total Gasoline Margin



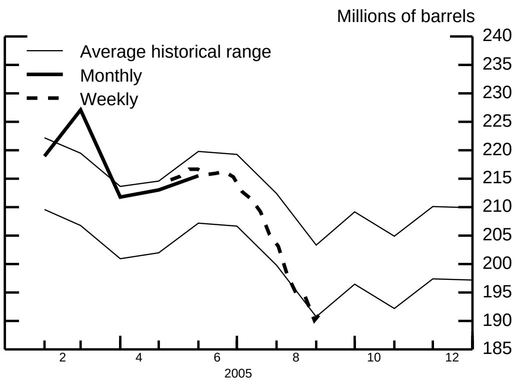
* Regular grade seasonally adjusted by FRB staff, less West Texas intermediate spot price.

Gasoline Price Decomposition



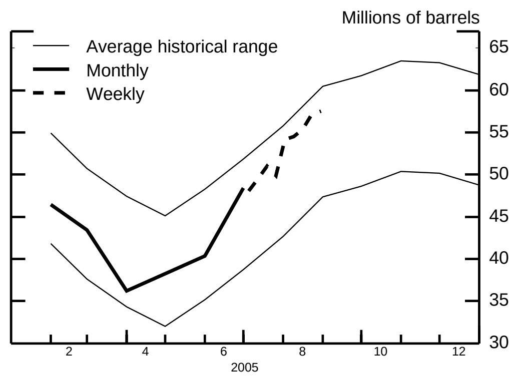
* Regular grade seasonally adjusted by FRB staff.

Gasoline Inventories



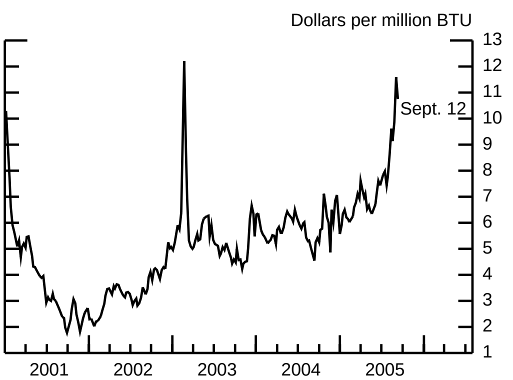
Note. Average historical range calculated by Energy Information Administration.

Heating Oil Inventories



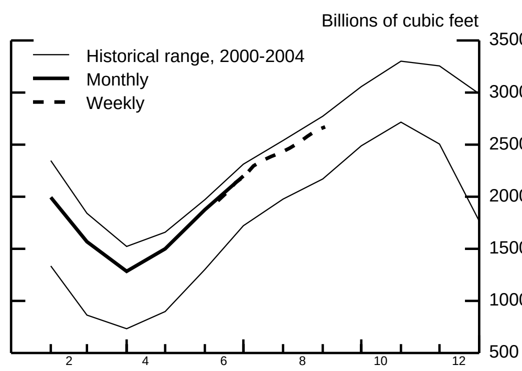
Note. Historical range calculated by FRB staff.

Natural Gas Prices



Note. Spot price, Henry Hub.

Natural Gas Inventories



Note. Historical range calculated by FRB staff.

Prices

Core consumer price inflation has remained moderate, with the core PCE price index up 0.1 percent in July and just 1.2 percent at an annual rate over the three months ending in July. However, a surge in energy prices has pushed up overall consumer price inflation considerably. PCE energy prices jumped 4.0 percent in July, and survey evidence on gasoline prices points to enormous increases over the August–September period. Over the twelve months ending in July, overall PCE prices rose 2.5 percent, and the year-over-year change is likely to rise going forward.

The PCE price index for energy rose 15 percent during the year ending in July, nearly the same as the increase posted over the year ending in July 2004. Energy prices were on track for a further large increase in August even prior to Hurricane Katrina. Gasoline prices were rising especially rapidly, reflecting both the ongoing rise in crude oil prices and a sharp run-up in margins that came about as a fire at one refinery and the closing of others for maintenance cut production and led to a sharp drawdown in inventories. Gasoline prices rose further in the wake of the hurricane; indeed, the Oil Price Information Service reports that retail regular gasoline prices peaked on September 2 at \$3.04 per gallon—44 cents higher than on August 26 (before Katrina struck). They have since declined about 11 cents per gallon, and although gasoline inventories have fallen to historically low levels, pressure on prices should ease a bit further in coming weeks as more domestic production is restored and additional imports of gasoline arrive. Nevertheless, survey data in hand suggest that the gasoline component of the CPI will have risen 8 percent in August and is likely to rise at roughly twice that rate in September. Futures quotes, which have dropped since peaking on September 1, point to declines in gasoline prices in November and December—but, seasonally adjusted, gasoline margins are not expected to return to their pre-hurricane levels.

Natural gas prices have also moved up sharply in recent weeks as some industrial users have substituted away from refined products and as production has been restrained by damage to facilities in the Gulf of Mexico. In contrast to the situation for gasoline, inventories of natural gas were at comfortable levels prior to the hurricane and remain sufficient for the time being, and onshore natural gas pipelines in the path of Katrina appear to have survived with little damage. However, a significant amount of natural gas production remains offline, and several natural gas processing plants in Louisiana are still shut down. Recent natural gas futures prices suggest that production losses may keep natural gas prices high through the coming winter.

The food component of the PCE price index rose 0.2 percent in July after having shown no change for the two preceding months. During the twelve months ending in July, food prices rose 2 percent, well below their increase during the preceding year. Expanding production of meats and poultry contributed to this slowdown, and increased supplies should continue to restrain increases in consumer food prices in the months ahead. Although growing conditions appeared mediocre earlier this year, recent field surveys of this year’s corn and soybean crops have been positive. Prices dipped a little in the

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	2.4
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	1.9
PCE price index, market-based components	.9	1.7	2.5	2.4
Less food and energy	1.5	1.2	1.5	1.6
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: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
Q3	n.a.	n.a.	n.a.	n.a.	n.a.	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	3.2	3.6	3.0	3.3	2.9	...
Aug.	n.a.	3.7	3.1	3.3	2.8	...

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.

immediate aftermath of the hurricane, but the declines were mostly retraced when it became clear that crop exporting facilities were relatively undamaged.

Excluding food and energy, the PCE price index rose 0.1 percent in July after having been unchanged in June. For the three months ending in July, core PCE prices rose at an annual rate of 1¼ percent, ½ percentage point less than the increase in the preceding three months. While inflation in core services has been fairly stable of late, price increases for core goods have slowed. This slowdown partly reflected a sizable drop in motor vehicle prices caused by the employee-discount pricing programs among the Big Three automakers. The discounts are expected to be removed around the end of September, which should be reflected in the PCE price index in October and November. During the twelve months ending in July, overall core PCE prices rose 1¾ percent, a touch below their pace a year earlier.

As measured by the Michigan Survey, short-run inflation expectations edged up to 3.1 percent in August but remained a shade below the levels of last spring. Median long-run inflation expectations inched back down to 2.8 percent in August—a level near the center of the narrow range observed over the past few years.

At earlier stages of processing, commodity prices have been mixed since the August Greenbook, with prices of metals and energy-related commodities increasing significantly but with prices of other commodities mostly declining. Steel scrap prices have risen 63 percent in the past month and a half, back to the elevated levels seen during 2004; according to trade reports, this increase reflects a slower flow of scrap steel into dealers' yards as well as a pickup in export demand along the U.S. East and (prior to the hurricane) Gulf coasts. The Journal of Commerce index of industrial commodities prices, which includes a substantial energy component, has jumped nearly 11 percent in recent weeks, while the Commodity Research Bureau spot industrials index, which excludes energy items, has increased only 1¼ percent. The considerable increases in prices for metal and energy commodities have not yet shown through to intermediate goods. In the producer price index, core intermediate materials edged down 0.1 percent in August, continuing the declines seen in each of the three previous months. Over the past twelve months, core intermediate prices have risen 3¼ percent, a good bit less than the increase over the preceding year.

Labor Costs

The staff estimates that compensation per hour in the nonfarm business sector increased at an annual rate of 4½ percent in the second quarter. Nonetheless, because of the faster increases reported during the preceding three quarters, the year-over-year increase in hourly compensation stood at 6½ percent in the second quarter, and the rise in unit labor costs was 4¼ percent—both mark a significant step-up from the pace of a year earlier. Contributing to that acceleration was the 10 percent (annual rate) surge in hourly compensation in the final quarter of last year. Part of the end-of-year jump was apparently the result of a temporary burst of bonuses and stock option exercises. However, the recent estimate of compensation for the first quarter, which reflects the

Selected Commodity Price Indexes
(Percent change)

Index	2004 [1]	12/28/04 to 8/2/05 [2]	8/2/05 [2] to 9/13/05	52-week change to 9/13/05
JOC industrials	8.7	-2.3	10.9	3.4
JOC metals	19.4	-10.9	10.3	4.9
CRB spot industrials	5.0	.7	1.2	3.2
CRB spot foodstuffs	2.7	-1.5	-1.4	-9.2
CRB futures	11.1	12.6	-.7	16.2

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

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

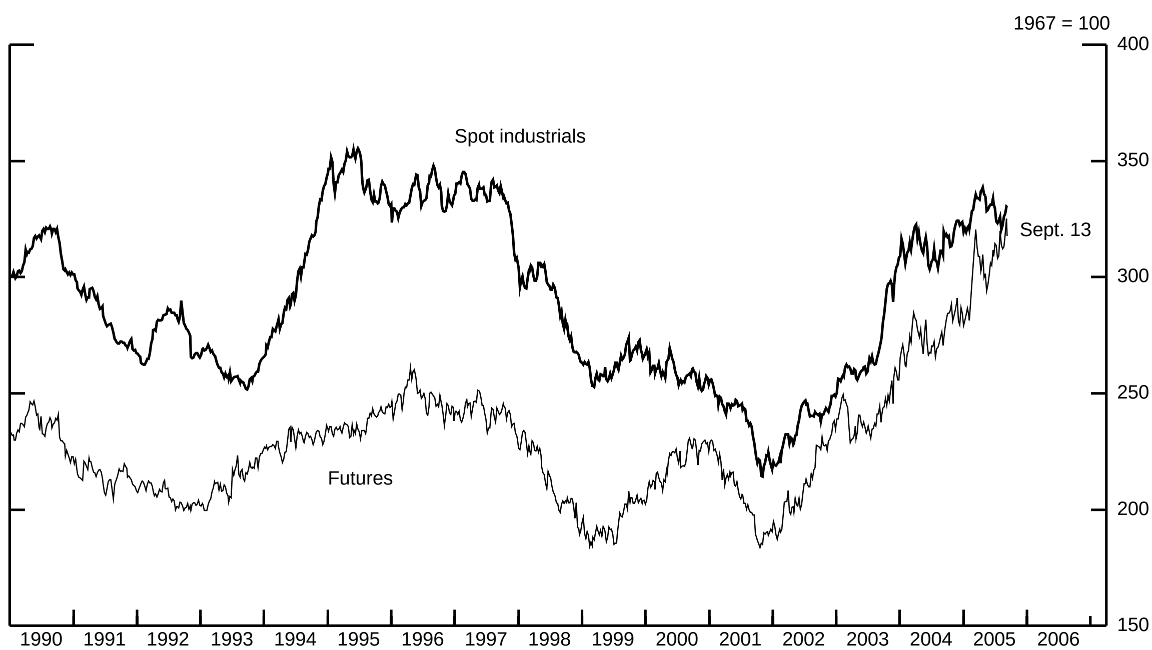
Commodity	2004 [1]	12/28/04 to 8/2/05 [2]	8/2/05 [2] to 9/13/05	52-week change to 9/13/05
Metals				
Copper (lb.)	48.3	10.2	.0	33.0
Steel scrap (ton)	33.7	-33.3	62.8	15.4
Aluminum, London (lb.)	n.a.	n.a.	-1.1	9.1
Precious metals				
Gold (oz.)	6.5	-2.8	3.3	9.9
Silver (oz.)	17.8	3.1	-4.3	10.5
Forest products [3]				
Lumber (m. bdft.)	16.6	-4.2	.6	-27.8
Plywood (m. sqft.)	3.8	-14.6	37.1	-13.5
Petroleum				
Crude oil (barrel)	n.a.	n.a.	2.2	48.0
Gasoline (gal.)	5.6	66.0	17.2	56.0
Fuel oil (gal.)	31.5	37.8	7.5	46.3
Livestock				
Steers (cwt.)	19.5	-10.4	4.5	1.6
Hogs (cwt.)	33.8	2.1	-1.0	-9.9
Broilers (lb.)	4.1	6.5	1.2	12.6
Farm crops				
Corn (bu.)	-18.2	10.7	-17.3	-12.3
Wheat (bu.)	1.1	-6.4	7.9	3.8
Soybeans (bu.)	-29.1	26.4	-19.2	2.4
Cotton (lb.)	-37.7	12.4	-3.4	-4.6
Other foodstuffs				
Coffee (lb.)	n.a.	n.a.	-13.8	22.2

1. From the last week of the preceding year to the last week of the year indicated.
2. August 2, 2005, is the Tuesday preceding publication of the August Greenbook.
3. Prices shown apply to the Friday before the date indicated.
n.a. Not available.

Commodity Price Indexes

Journal of Commerce

Commodity Research Bureau



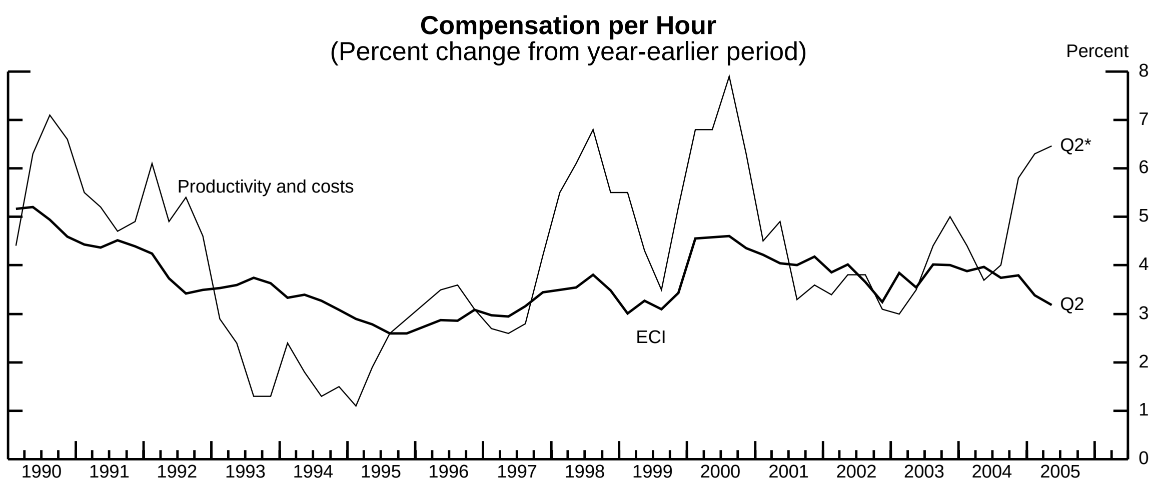
Note. The Journal of Commerce industrial price index is based almost entirely on industrial commodities, with a small weight given to energy commodities. The Commodity Research Bureau (CRB) spot industrials index consists entirely of industrial commodities, excluding energy. The CRB futures index gives 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.

Nonfarm Business Sector 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[e]	2004 Q3	2004 Q4	2005 Q1	2005 Q2[e]
Compensation per hour	3.7	6.5	6.1	10.2	5.5	4.4
Unit labor costs	-.4	4.3	4.7	7.6	2.2	2.6

e Staff estimate.



* Value for Q2 is a staff estimate.

newly available employer unemployment insurance tax records, suggests that more of the surge could be permanent than we had earlier reckoned.

Other gauges of labor costs do not show a comparable pickup. In particular, the Employment Cost Index (ECI) rose at an annual rate of only 2½ percent in the first half of the year. The twelve-month change in ECI compensation, which excludes stock options, was 3¼ percent in June—down from 4 percent a year earlier. Over the past twelve months, average hourly earnings rose 2¾ percent, just ½ percentage point more than the increase posted over the preceding twelve months.

Domestic Financial Developments

Selected Financial Market Quotations

(One-day quotes in percent except as noted)

Instrument	2004 June 28	2004 Dec. 31	2005 Aug. 8	2005 Sept. 13	Change to Sept. 13 from selected dates (percentage points) 2004 June 28	2004 Dec. 31	2005 Aug. 8
Short-term							
FOMC intended federal funds rate	1.00	2.25	3.25	3.50	2.50	1.25	.25
Treasury bills[1]							
3-month	1.36	2.18	3.47	3.40	2.04	1.22	-.07
6-month	1.74	2.52	3.70	3.65	1.91	1.13	-.05
Commercial paper (A1/P1 rates)[2]							
1-month	1.28	2.29	3.49	3.65	2.37	1.36	.16
3-month	1.45	2.28	3.65	3.76	2.31	1.48	.11
Large negotiable CDs[1]							
3-month	1.53	2.50	3.73	3.84	2.31	1.34	.11
6-month	1.82	2.72	3.96	3.98	2.16	1.26	.02
Eurodollar deposits[3]							
1-month	1.29	2.32	3.51	3.70	2.41	1.38	.19
3-month	1.51	2.49	3.70	3.81	2.30	1.32	.11
Bank prime rate	4.00	5.25	6.25	6.50	2.50	1.25	.25
Intermediate- and long-term							
U.S. Treasury[4]							
2-year	2.88	3.08	4.19	3.89	1.01	.81	-.30
5-year	3.97	3.63	4.28	3.94	-.03	.31	-.34
10-year	4.90	4.34	4.49	4.22	-.68	-.12	-.27
U.S. Treasury indexed notes							
5-year	1.56	1.03	1.82	1.35	-.21	.32	-.47
10-year	2.25	1.65	2.01	1.68	-.57	.03	-.33
Municipal general obligations (Bond Buyer)[5]	5.01	4.49	4.38	4.26	-.75	-.23	-.12
Private instruments							
10-year swap	5.21	4.65	4.85	4.54	-.67	-.11	-.31
10-year FNMA[6]	5.30	4.61	4.68	4.47	-.83	-.14	-.21
10-year AA[7]	5.59	4.98	5.18	4.92	-.67	-.06	-.26
10-year BBB[7]	6.18	5.38	5.68	5.47	-.71	.09	-.21
5-year high yield[7]	8.30	7.34	7.84	7.81	-.49	.47	-.03
Home mortgages (FHLMC survey rate)[8]							
30-year fixed	6.21	5.77	5.89	5.71	-.50	-.06	-.18
1-year adjustable	4.19	4.10	4.57	4.45	.26	.35	-.12

Stock exchange index	Record high Level	Record high Date	2004 Dec. 31	2005 Aug. 8	2005 Sept. 13	Change to Sept. 13 from selected dates (percent) Record high	2004 Dec. 31	2005 Aug. 8
Dow Jones Industrial	11,723	1-14-00	10,783	10,537	10,597	-9.60	-1.72	.57
S&P 500 Composite	1,527	3-24-00	1,212	1,223	1,231	-19.40	1.59	.66
Nasdaq	5,049	3-10-00	2,175	2,164	2,172	-56.98	-.17	.34
Russell 2000	689	8-2-05	652	660	673	-2.23	3.31	2.05
Wilshire 5000	14,752	3-24-00	11,971	12,213	12,322	-16.47	2.93	.89

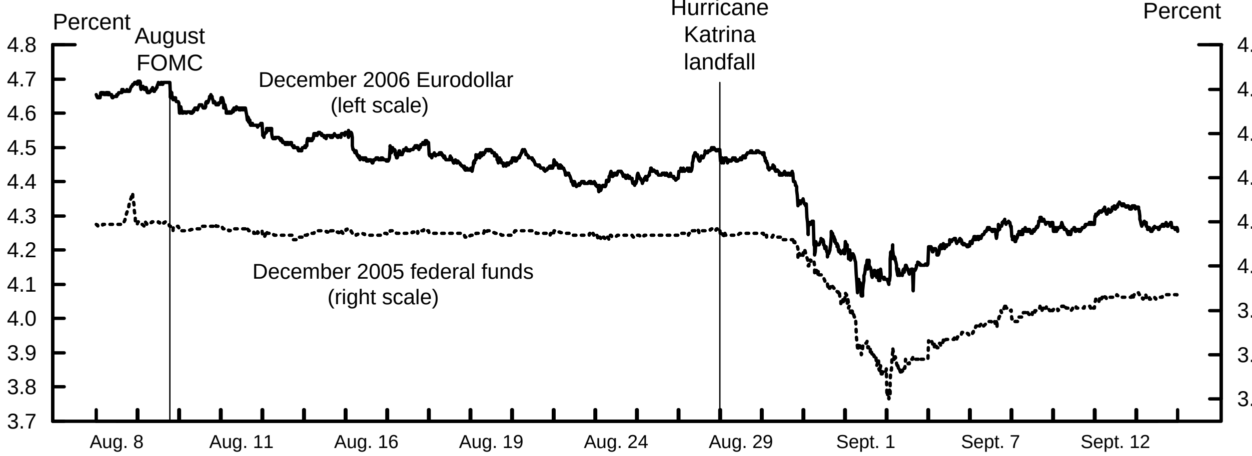
1. Secondary market.
2. Financial commercial paper.
3. Bid rates for Eurodollar deposits collected around 9:30 a.m. eastern time.
4. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
5. Most recent Thursday quote.
6. Constant-maturity yields estimated from Fannie Mae domestic noncallable coupon securities.
7. Derived from smoothed corporate yield curves estimated using Merrill Lynch bond data.
8. Home-mortgage data for September 13, 2005, is from September 8, 2005.

NOTES:

June 28, 2004, is the day before the most recent policy tightening began.
August 8, 2005, is the day before the most recent FOMC meeting.

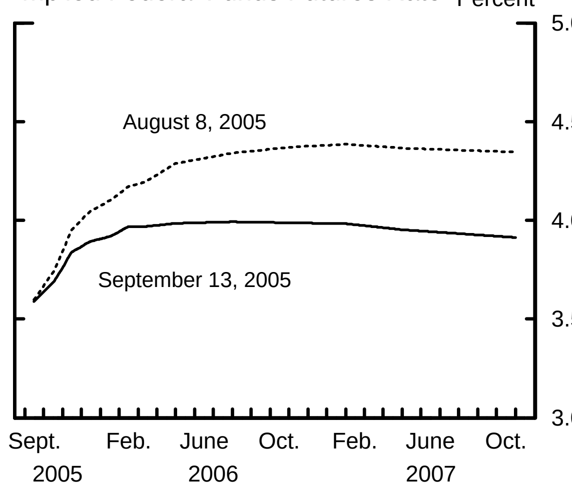
Policy Expectations and Treasury Yields

Futures Contract Rates



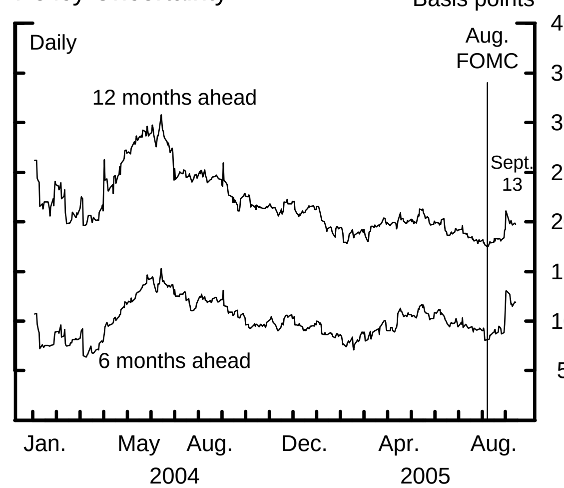
Note. 5-minute intervals.

Implied Federal Funds Futures Rate



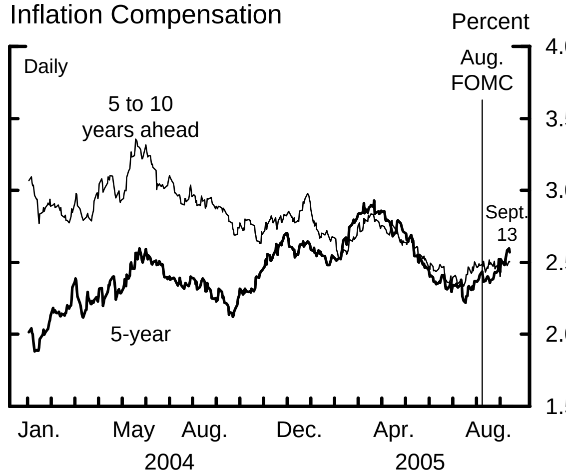
Note. Estimates from federal funds and Eurodollar futures, with an allowance for term premia and other adjustments.

Policy Uncertainty



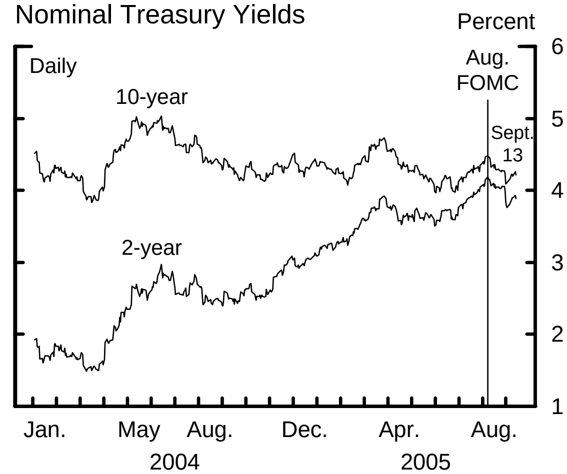
Note. Width of a 90 percent confidence interval for the federal funds rate computed from the term structures for both the expected federal funds rate and implied volatility.

Inflation Compensation



Note. Estimates based on smoothed nominal and inflation-indexed Treasury yield curves.

Nominal Treasury Yields



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

Domestic Financial Developments

Overview

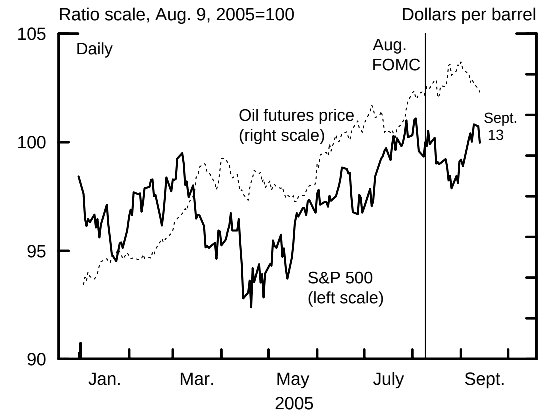
Over the intermeeting period, market interest rates dropped appreciably in response to Hurricane Katrina, rising energy prices, and some weaker-than-anticipated economic data. Futures quotes indicate that market participants now attach about a one-in-four chance to a pause in monetary tightening at the September meeting and have marked down the expected path of the federal funds rate thereafter. Nominal Treasury yields declined in line with these changed policy expectations. TIPS yields fell notably as well, and the configuration of yields implies a rise in inflation compensation for the next few years but no change further out. Stock prices edged higher, credit spreads on investment-grade corporate bonds were little changed, and spreads for lower-tier bonds widened modestly. Business debt continued to expand at a moderate pace in August. Household borrowing remained strong through the second quarter, as low interest rates and another large increase in house prices continued to support robust growth of mortgage debt.

Policy Expectations and Treasury Yields

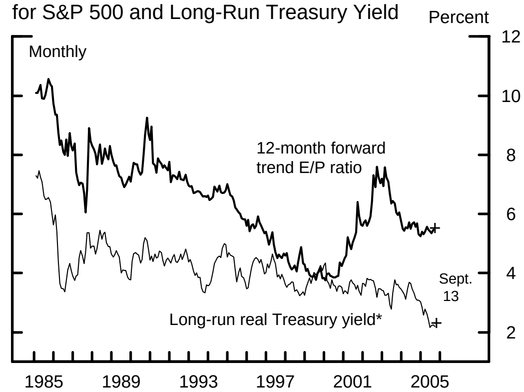
The decision by the FOMC to raise the target federal funds rate 25 basis points at the August meeting had been widely anticipated, as was the content of the accompanying statement. Early in the intermeeting period, policy expectations for next spring and beyond drifted down in response to incoming data that ran on the soft side of expectations and concerns about the effects of rising oil prices. The devastation from Hurricane Katrina and the associated spike in energy prices (especially for gasoline and other refined products) substantially reduced near- and longer-term policy expectations. Against the backdrop of these effects of Katrina, expectations were scaled back further after the release of the August FOMC minutes, as market participants reportedly focused on the Committee's view that "elevated energy prices were seen as likely to be a significant drag on consumption." More recently, the expected policy path has reversed some of the earlier decline, as the worst-case scenarios about damages to industrial infrastructure from Hurricane Katrina have not materialized, prices of oil and gasoline have fallen back, and speeches by Federal Reserve officials have mentioned the need for continued vigilance against inflation. Judging from federal funds futures, investors currently place about a one-in-four chance on a pause in monetary tightening at the September meeting and expect a federal funds rate slightly below 4 percent in the middle of next year—down 30 basis points since the August meeting—with virtually no additional tightening later. Uncertainty about the future path of policy rose significantly over this period, mainly after the hurricane.

Corporate Yields, Risk Spreads, and Stock Prices

S&P 500 and Oil Futures Price 24 Months Ahead

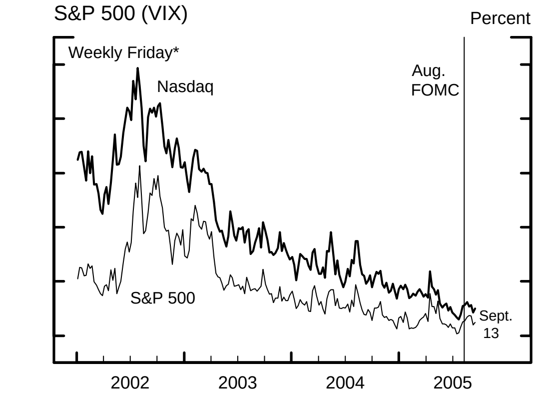


12-Month Forward Trend Earnings-Price Ratio for S&P 500 and Long-Run Treasury Yield



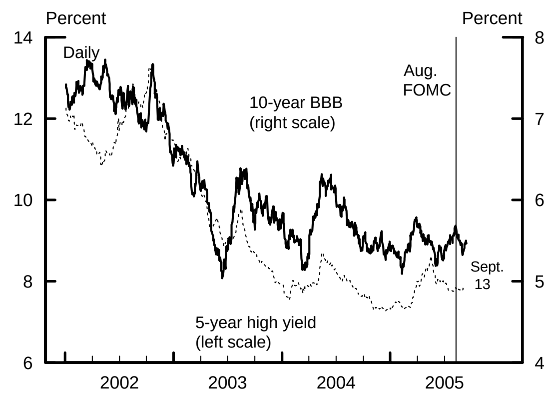
* Yield on synthetic Treasury perpetuity minus Philadelphia Fed 10-year expected inflation.
\+ Denotes the latest observation using daily interest rates and stock prices and latest earnings data from I/B/E/S.

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



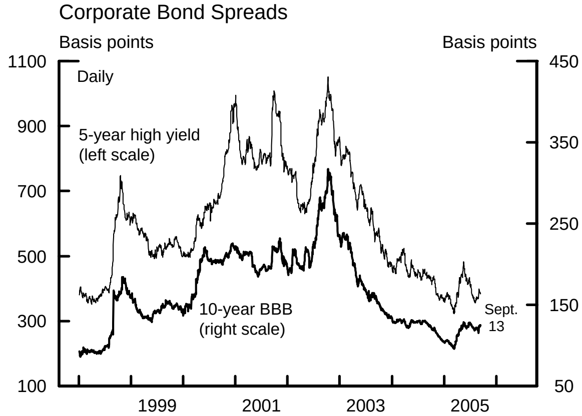
* Latest observation is for most recent business day.

Yields for BBB and High-Yield Corporate Bonds



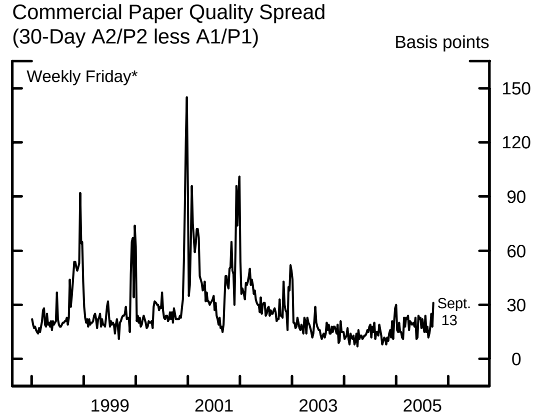
Note. Yields from smoothed yield curves based on Merrill Lynch bond data.

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.

Treasury yields fell 25 to 35 basis points over the intermeeting period, largely on the revision in policy expectations. Inflation compensation as derived from indexed nominal Treasury debt over the next five years rose slightly amid rising energy prices. However, inflation compensation over the subsequent five years was little changed.

Stock Prices and Corporate Interest Rates

Overall, the response of stock prices to economic data and hurricane-related news has been quite muted. Broad equity index levels were up a bit over the intermeeting period, apparently supported by lower interest rates, which helped offset concerns that rising energy prices might reduce economic growth. Shares of Allstate, an insurer with significant exposure to losses in the Gulf Coast states, fell about 10 percent, but a broader index of domestic property and casualty insurers was down only 2 percent. Implied volatilities on both the Nasdaq 100 and S&P 500 remained low, readings consistent with a low level of perceived macroeconomic risk in the near term. The trend-adjusted twelve-month forward earnings-price ratio, a measure of expected long-run real equity returns, remained near 5½ percent, where it has been hovering for several years. The spread between this measure and the real perpetuity Treasury yield—a rough gauge of the equity risk premium—widened a touch further.

Yields on investment-grade corporate bonds fell nearly as much as those on comparable-maturity Treasuries, and their spreads were up just a few basis points over the intermeeting period. Yields on speculative-grade bonds were little changed, implying a modest rise in credit spreads. Risk spreads on commercial paper remained low.

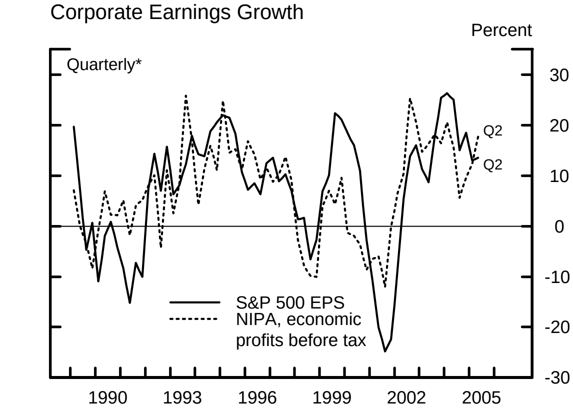
Corporate Earnings and Credit Quality

Aside from the notable disappointment of Wal-Mart's quarterly report, the final batch of second-quarter earnings reports—including those from many other retailers—brought predominantly good news to investors. With essentially complete data on second-quarter earnings in hand, earnings per share for the S&P 500 are estimated to have grown nearly 14 percent over the preceding year, a bit more than had been projected in the August Greenbook. The BEA's preliminary estimate of second-quarter corporate profits also came in on the high side of the staff's projection. Reflecting the positive second-quarter news, analysts' forecasts of year-ahead earnings for S&P 500 firms were revised up about 1 percent in mid-August. Upward revisions were notable for firms in the energy sector.

Credit quality of nonfinancial firms remained strong. Corporate balance sheets continued to show relatively high levels of liquid assets, even after some drawdown in those

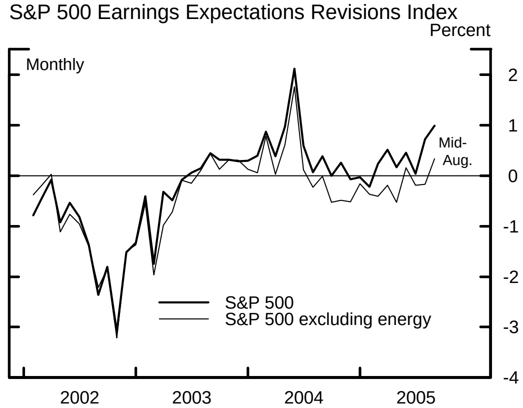
Corporate Earnings and Credit Quality

Corporate Earnings Growth



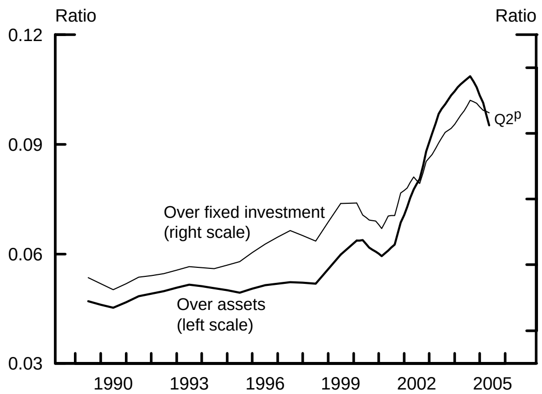
* Change from four quarters earlier.
Source. I/B/E/S for S&P 500 EPS.

S&P 500 Earnings Expectations Revisions Index



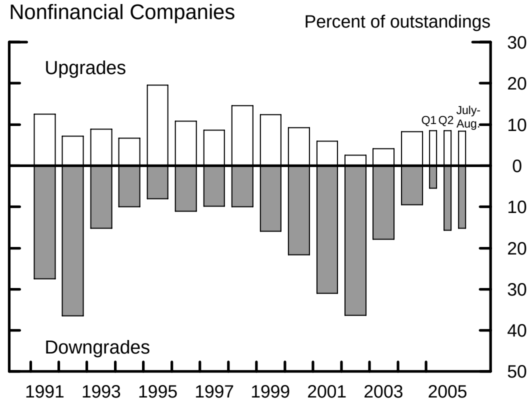
Note. Index is a weighted average of the percent change in the consensus forecasts of current-year and following-year EPS for constant sample.

Liquid Assets Held by Nonfinancial Corporations



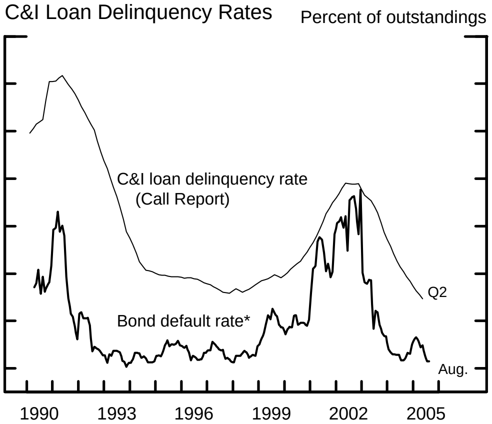
Note. Computstat data, annual through 1999 and quarterly thereafter; fixed investment is at an annual rate.
p Preliminary.

Bond Ratings Changes of Nonfinancial Companies



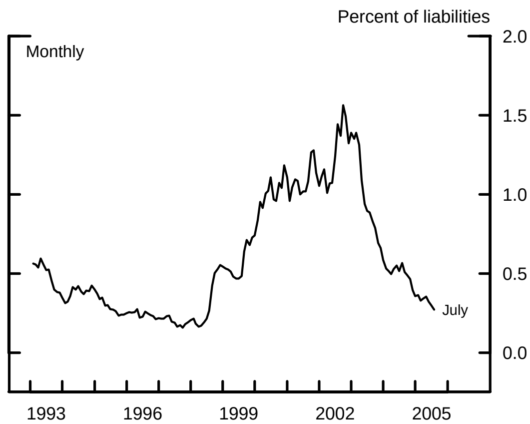
Note. Data are at an annual rate.
Source. Moody's Investors Service.

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. Moody's KMV.

Business Finance

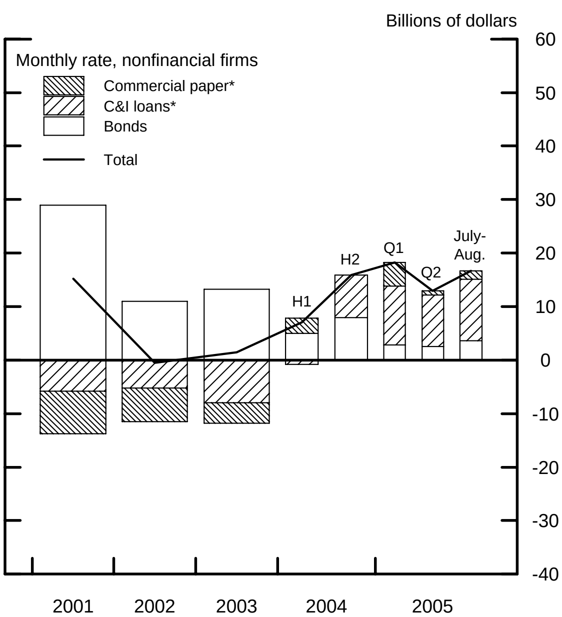
Gross Issuance of Securities by U.S. Corporations

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

Type of security	2002	2003	2004 H1	2004 H2	2005 Q1	2005 Q2	2005 July	2005 Aug.
Nonfinancial corporations								
Stocks[1]	5.2	3.7	5.7	4.9	4.4	3.2	1.9	6.2
Initial public offerings	.7	.4	.8	2.3	2.3	1.0	1.3	4.0
Seasoned offerings	4.4	3.2	4.9	2.6	2.1	2.1	.6	2.2
Bonds[2]	24.8	31.6	22.8	22.7	17.5	18.6	18.0	17.8
Investment grade	15.7	16.0	8.2	8.5	6.0	9.9	6.2	11.1
Speculative grade	4.8	11.3	10.5	8.5	7.7	4.7	7.1	5.6
Other (sold abroad/unrated)	4.2	4.3	4.1	5.7	3.9	4.0	4.7	1.1
Memo								
Net issuance of commercial paper[3]	-6.3	-3.8	2.8	-.1	4.5	.8	5.1	-2.1
Change in C&I loans at commercial banks[3,4]	-5.2	-7.9	-.8	8.0	10.9	9.7	18.3	4.6
Financial corporations								
Stocks[1]	4.0	6.9	8.3	5.1	5.4	5.2	2.9	5.4
Bonds[2]	87.0	111.1	131.1	147.6	162.5	172.0	150.0	165.4

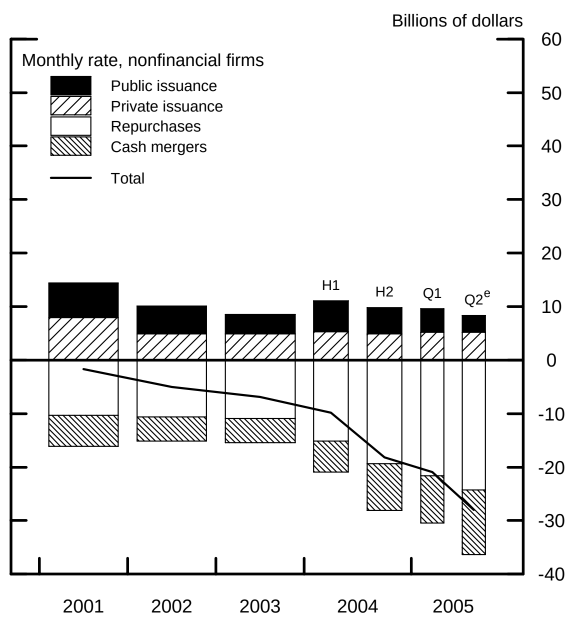
Note. Components may not sum to totals because of rounding.
1. Excludes private placements and equity-for-equity swaps that occur in restructurings.
2. Data include regular and 144a private placements. Bond totals reflect gross proceeds rather than par value of original discount bonds. Bonds are categorized 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.

Selected Components of Net Debt Financing



* Seasonally adjusted, period-end basis.

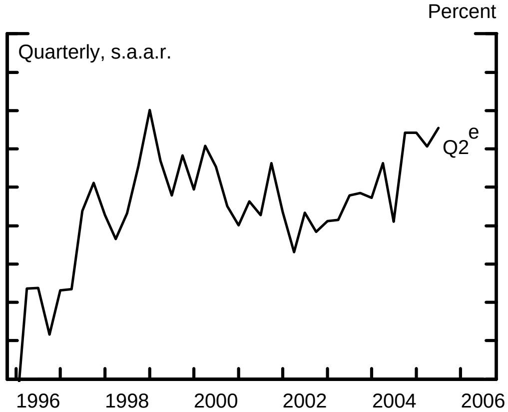
Components of Net Equity Issuance



e Staff estimate.

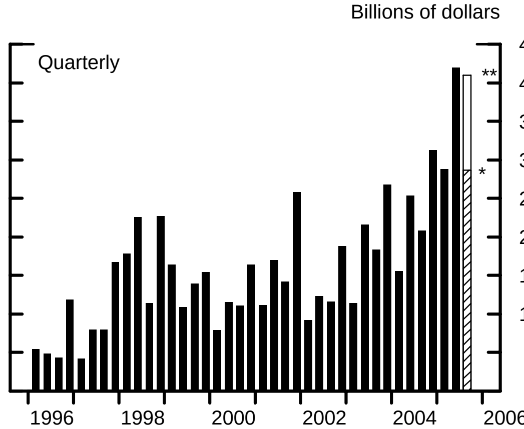
Commercial Real Estate

Growth of Commercial Mortgage Debt



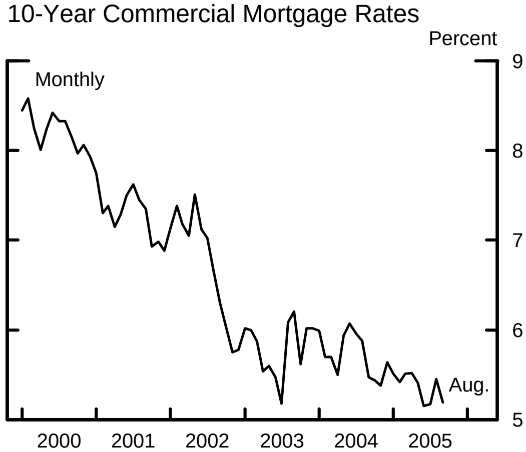
e Staff estimate.

Gross Issuance of CMBS



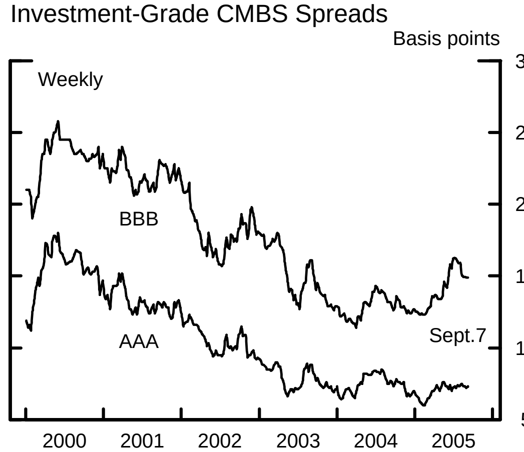
* Through September 9.
** Staff estimate for Q3.
Source. Commercial Mortgage Alert.

10-Year Commercial Mortgage Rates



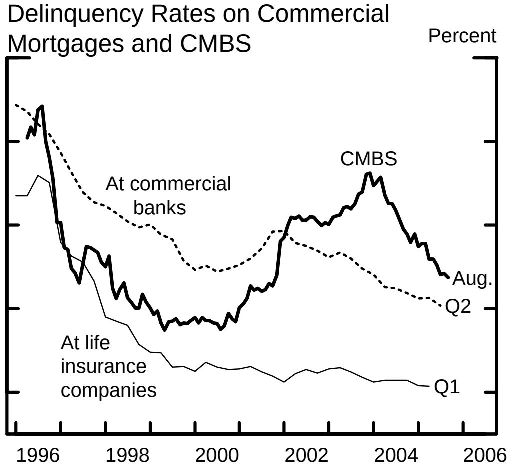
Source. Barron's/Levy.

Investment-Grade CMBS Spreads



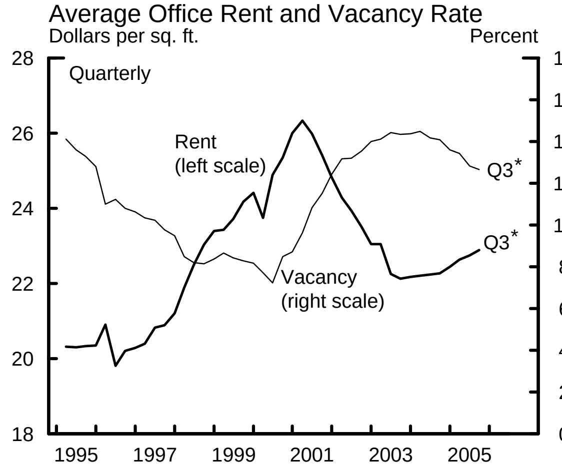
Note. Measured relative to the 10-year Treasury yield.
Source. Morgan Stanley.

Delinquency Rates on Commercial Mortgages and CMBS



Source. Call Report, ACLI, Morgan Stanley.

Average Office Rent and Vacancy Rate



Source. CoStar.
* Through September 7.

balances over the first half of the year. Downgrades of corporate debt outpaced upgrades in July and August, but the bulk of downgraded debt again came from the auto sector, as Moody's further lowered their ratings on Ford and GM debt. Both the realized six-month trailing bond default rate and the forecast of the aggregate year-ahead default rate based on KMV's model have dropped to very low levels. However, with two major airlines tottering on the brink of bankruptcy, a rise in the default rate seems likely.

Business Finance

Nonfinancial firms continued to issue bonds in August at the moderate pace of the past several months. Speculative-grade issues accounted for about one-third of the proceeds. However, substantial retirements have kept net bond issuance tepid so far in the third quarter. In contrast, bank loans continued to expand briskly during the first two months of this quarter and commercial paper rose somewhat as well, leaving net debt financing near the moderate pace seen over the past year.

After a sluggish July, gross public equity issuance picked up smartly in August, propelled by a surge in initial public offerings—twenty-two nonfinancial issues from a variety of industries—which were, by and large, enthusiastically received. New registrations continued apace, suggesting that IPO issuance will remain brisk this autumn so long as stock prices do not move lower. At the same time, secondary offerings remained scarce, likely reflecting the healthy state of corporate balance sheets.

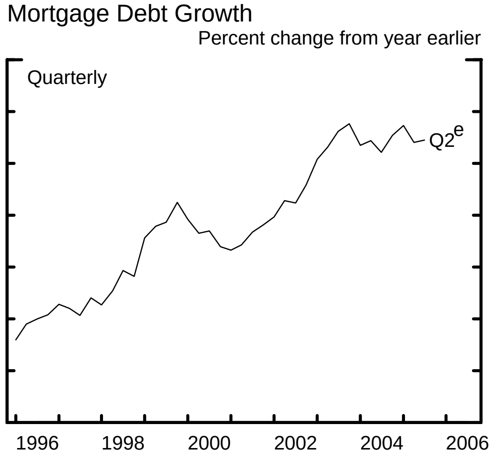
Equity retirements, bolstered by strong profits and ample cash positions, are estimated to have soared in the second quarter. Share repurchases are set to hit a record once again, while completions of cash-financed mergers also increased in the second quarter. Early indications are that retirements will continue to be elevated in the current quarter.

Commercial Real Estate

Commercial mortgage debt rose at an annual rate of nearly 14 percent in the second quarter, and recent issuance and the calendar of offerings of commercial-mortgage-backed securities (CMBS) suggest continued strength in the third quarter. Spreads on AAA-rated issues remain low, and, in recent weeks, spreads on BBB-rated issues have partly retraced the run-up that occurred earlier this year. While some analysts have expressed concern about lower underwriting standards and a thinner buffer from subordinated tranches, the underlying market fundamentals are solid. Delinquency rates on commercial mortgages and CMBS have continued to trend down, and data on vacancy rates and rents point to a further recovery in real estate market conditions.

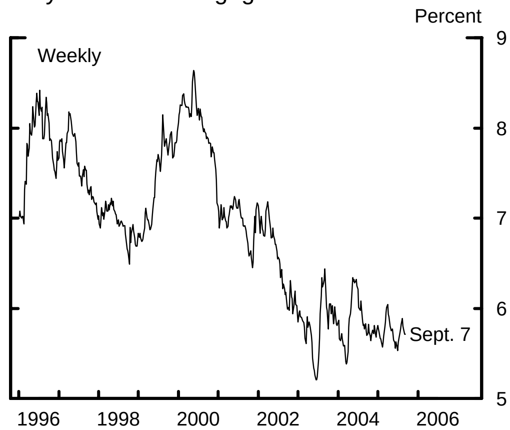
Household Liabilities

Mortgage Debt Growth



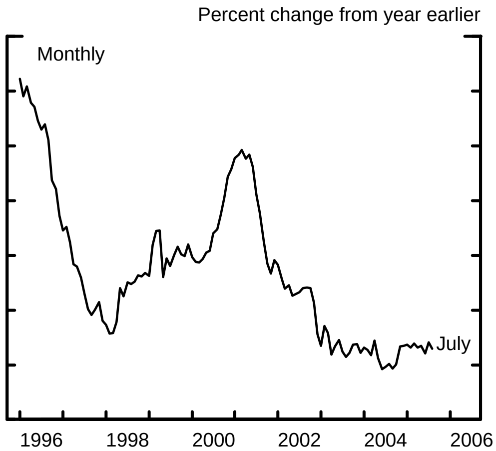
e Staff estimate.

30-year Fixed Mortgage Rate

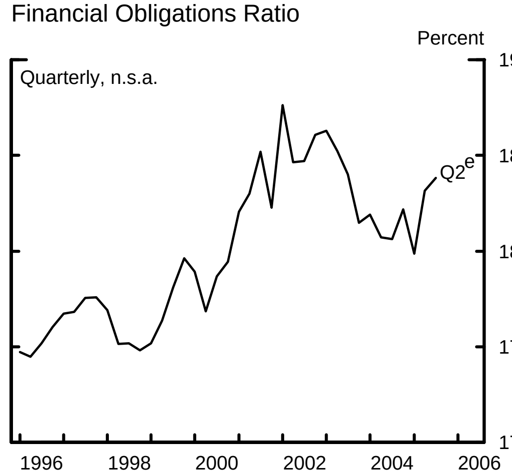


Source. Freddie Mac.

Consumer Credit Growth

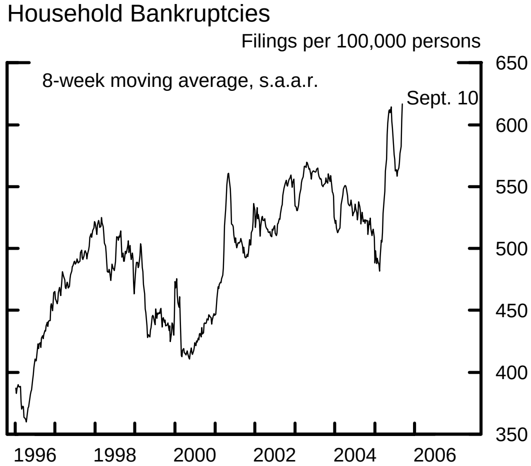


Financial Obligations Ratio



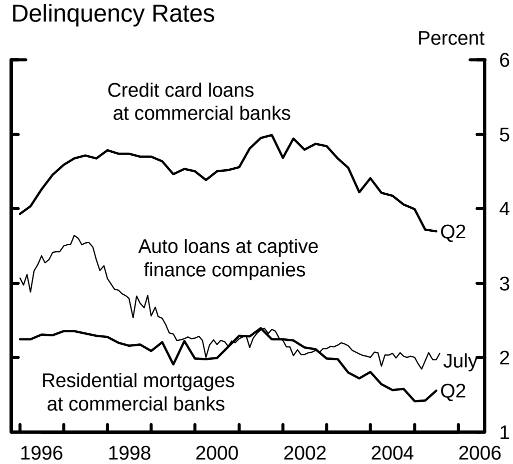
e Staff estimate.

Household Bankruptcies



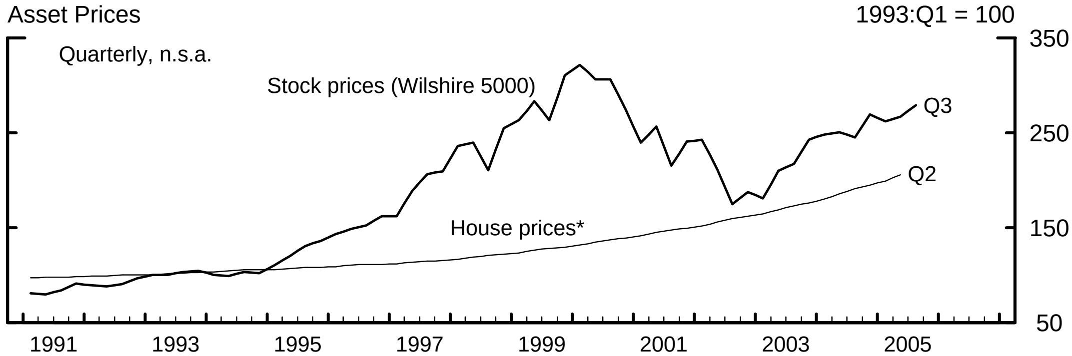
Source. Visa Bankruptcy Notification Service.

Delinquency Rates

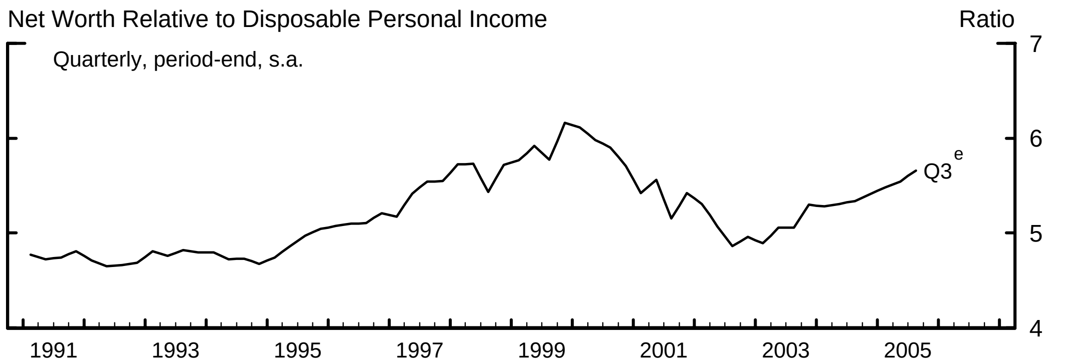


Source. Federal Reserve, Call Report.

Household Assets



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



e Staff estimate.

Net Flows into Long-Term Mutual Funds

(Billions of dollars, monthly rate)

Fund type	2003	2004 H1	2004 H2	2005 Q1	2005 Q2	2005 July	2005 Aug.[e]	Assets July
Total long-term funds	**18.0**	**20.0**	**15.0**	**22.3**	**13.9**	**18.9**	**15.3**	**6,563**
Equity funds	**12.7**	**19.7**	**9.9**	**15.8**	**8.7**	**10.1**	**5.2**	**4,670**
Domestic	10.7	13.7	4.8	5.2	3.1	5.4	-3.2	3,892
International	2.0	6.0	5.1	10.6	5.6	4.7	8.4	778
Hybrid funds	**2.7**	**4.1**	**3.0**	**4.5**	**2.3**	**1.5**	**1.7**	**556**
Bond funds	**2.6**	**-3.8**	**2.0**	**2.0**	**2.9**	**7.4**	**8.4**	**1,338**
High-yield	2.2	-2.1	0.5	-2.3	-1.0	0.3	-0.4	150
Other taxable	1.0	0.1	2.0	3.8	3.5	5.4	7.1	851
Municipals	-0.6	-1.9	-0.4	0.4	0.4	1.7	1.7	337

Note. Excludes reinvested dividends.

e Staff estimates based on confidential ICI weekly data.

Source. Investment Company Institute.

Treasury Financing

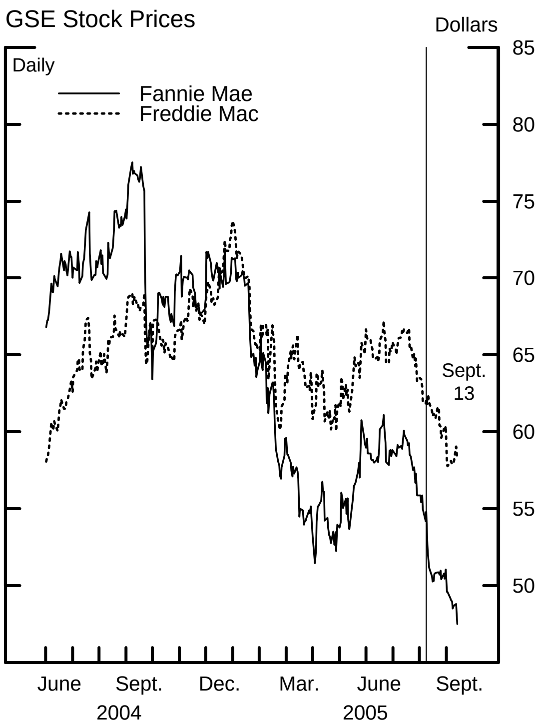
(Billions of dollars)

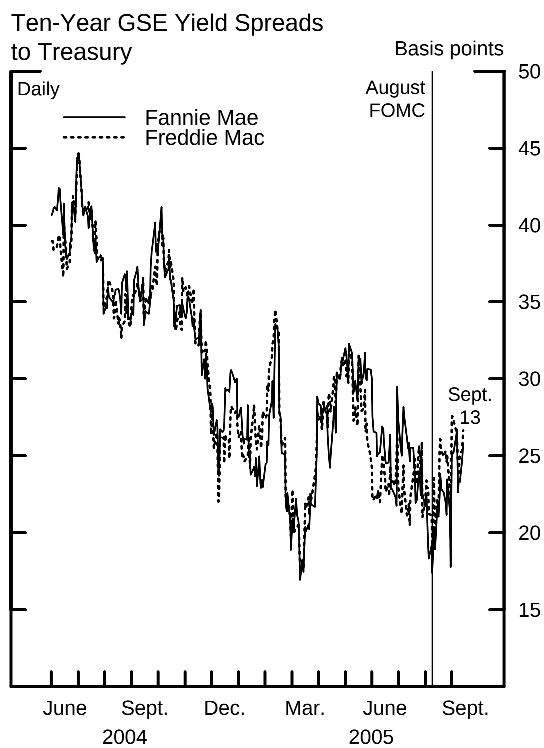
Item	2004 Q2	2004 Q3	2004 Q4	2005 Q1	2005 Q2	2005 July	2005 Aug.
Total surplus, deficit (–)	**-25.8**	**-85.7**	**-118.1**	**-176.6**	**44.8**	**-52.8**	**-50.0**
Means of financing deficit							
Net borrowing	40.7	83.4	102.1	164.7	-42.8	52.9	35.3
Nonmarketable	6.2	-5.2	2.4	20.8	35.9	6.1	7.0
Marketable	34.5	88.6	99.7	143.9	-78.7	46.8	28.3
Bills	-34.9	14.3	43.6	55.7	-135.8	18.8	11.0
Coupons	69.4	74.3	56.0	88.2	57.1	28.0	17.4
Decrease in cash balance	-23.3	8.3	11.7	2.2	-10.7	-7.8	32.4
Other[1]	8.4	-6.0	4.3	9.7	8.7	7.6	-17.7
Memo:							
Cash balance, end of period	44.6	36.3	24.7	22.4	33.2	41.0	8.6

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





Note. GSE yields based on senior unsecured debt.

Household Finance

Growth of household debt continued at a brisk pace in the second quarter, again led by a substantial rise in mortgage debt. Over the year ending in the second quarter, mortgage debt increased 13 percent, a rise fueled by low mortgage rates and rapid house price appreciation. Early and incomplete data indicate continued robust mortgage borrowing in the third quarter. The thirty-year fixed mortgage rate declined over the intermeeting period to 5.7 percent, near the middle of the range seen over the past year. In contrast to mortgage debt, consumer credit has continued to expand only moderately, with the July figure just 4½ percent above its year-earlier level. Growth of overall household debt outpaced that of disposable income in the second quarter and caused the financial obligations ratio to edge up.

Although bankruptcy filings have increased over the past few weeks, this upturn likely reflects the beginning of another surge in filings before mid-October, when the widely publicized bankruptcy reform legislation that was passed last spring takes effect. Other data point to improving household credit quality conditions, with most delinquency rates remaining low or falling.

Large increases in home prices continued to boost household wealth through the middle of this year. OFHEO's repeat-transactions house price index rose at an annual rate of 13½ percent in the second quarter. The strength in home price appreciation was distributed widely, with twenty-five states experiencing double-digit percentage increases on a year-over-year basis. The net rise in stock prices over the past couple of months suggests that net worth is continuing to grow relative to income in the current quarter. Net purchases of long-term mutual fund shares remained fairly brisk in August, with flows tilted toward international equity funds and high-grade bond funds.

Treasury and Agency Finance

Last month, the Congressional Budget Office lowered its estimate of the fiscal year 2005 federal budget deficit to about $331 billion from its March estimate of $365 billion. Much of the reduction reflected higher tax revenues. The estimates were released before Hurricane Katrina, however, which has thus far spurred more than $60 billion in appropriations.

Foreign official purchases of Treasuries do not appear to have changed substantially since China's currency revaluation in July. Indirect bidder participation in Treasury auctions, which investors often take as a proxy for investment demand from foreign official

State and Local Government Finance

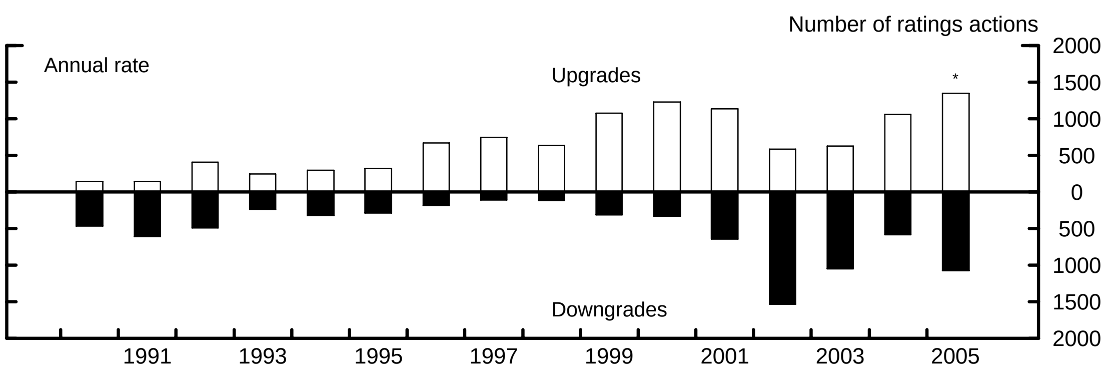
Gross Offerings of Municipal Securities

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

Type of security	2002	2003	2004	2005 Q1	2005 Q2	2005 July	2005 Aug.
Total	36.3	37.9	34.7	34.8	41.1	39.2	41.3
Long-term [1]	30.3	32.0	29.8	32.8	37.0	34.0	33.0
Refundings [2]	10.1	10.0	10.8	16.3	16.8	15.9	12.1
New capital	20.2	22.1	19.0	16.5	20.2	18.1	20.9
Short-term	6.0	5.8	4.9	2.1	4.1	5.2	8.3
Memo: Long-term taxable	1.7	3.5	2.0	1.5	2.4	3.3	2.2

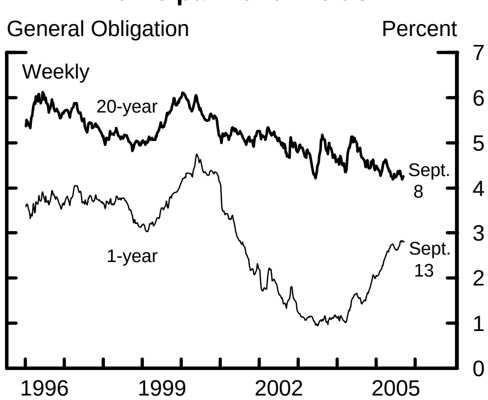
1. Includes issues for public and private purposes.
2. All issues that include any refunding bonds.

Ratings Changes



* Data through September 7 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.

Monetary Aggregates

(Based on seasonally adjusted data)

Aggregate or component	2003	2004	2005 Q1	2005 Q2	2005 July	2005 Aug. (p)	Level ($ billions), Aug. (p)
Aggregate	Percent change (annual rate)[1]						
1. M2[2]	5.5	5.2	4.0	1.7	1.5	5.0	6,551
2. M3[3]	4.8	5.8	5.5	5.9	3.3	12.2	9,875
Components of M2[4]							
3. Currency	5.9	5.5	3.7	2.7	.8	5.6	713
4. Liquid deposits[5]	14.1	10.1	3.5	-2.0	-1.7	4.0	4,203
5. Small time deposits	-9.3	-.4	14.6	21.9	17.8	17.6	929
6. Retail money market funds	-11.5	-11.9	-5.0	-1.3	.2	-6.2	698
Components of M3							
7. M3 minus M2[6]	3.4	7.0	8.8	14.7	7.0	26.8	3,324
8. Large time deposits, net[7]	4.3	20.9	34.1	24.8	-6.4	46.6	1,275
9. Institutional money market funds	-5.5	-5.6	-10.0	4.0	10.3	16.2	1,093
10. RPs	12.5	-.1	-16.9	9.3	20.2	23.4	518
11. Eurodollars	29.3	27.3	25.7	20.7	22.3	1.1	438
Memo							
12. Monetary base	5.9	5.6	3.7	2.7	1.0	3.9	775
	Average monthly change (billions of dollars)[8]						
Selected managed liabilities at commercial banks							
13. Large time deposits, gross	-1.5	14.9	25.9	18.6	-12.4	43.4	1,364
14. Net due to related foreign institutions	3.1	-10.8	13.1	-4.3	48.8	-31.5	71
15. U.S. government deposits at commercial banks	-.3	.2	2.0	2.7	-5.3	-0.2	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	July 2005	Aug. 2005	Level ($ billions), Aug. 2005
Total							
1. Adjusted[1]	**5.9**	**8.9**	**14.4**	**9.9**	**10.0**	**12.4**	**7,053**
2. Reported	5.6	8.4	12.3	9.6	7.9	12.2	7,196
Securities							
3. Adjusted[1]	8.6	6.5	23.0	6.2	10.6	2.1	1,861
4. Reported	7.2	5.1	15.1	5.2	3.1	2.1	2,004
5. Treasury and agency	8.9	4.9	20.7	-5.7	3.8	-3.2	1,175
6. Other[2]	4.9	5.5	6.5	22.4	2.1	9.7	829
Loans[3]							
7. Total	4.9	9.8	11.2	11.3	9.8	16.2	5,192
8. Business	-9.4	1.5	17.2	13.4	16.6	11.5	987
9. Real estate	11.1	13.9	13.3	13.6	20.5	14.6	2,803
10. Home equity	30.8	43.4	18.7	13.1	13.8	6.4	434
11. Other	8.8	9.8	12.4	13.6	21.7	16.0	2,368
12. Consumer	5.4	8.8	8.2	3.2	6.1	11.3	700
13. Adjusted[4]	5.8	6.0	6.0	-2.5	3.9	5.0	1,060
14. Other[5]	6.8	8.0	-1.3	8.1	-37.6	34.4	703

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.

institutions, was below average in the five-year Treasury note auction that occurred the day after the August FOMC meeting but substantially above average in auctions later in the intermeeting period. An alternative indicator of foreign official demand—the value of Treasury securities held in custody on behalf of foreign official institutions at the Federal Reserve Bank of New York—increased at about the pace seen earlier in the year.

Over the intermeeting period, the stock prices of Fannie Mae and Freddie Mac fell about 12 percent and 6 percent, respectively, partly because of announcements by Fannie Mae that it would miss deadlines for filing earnings results with the SEC and by Freddie Mac that its 2005 first-half earnings were down 60 percent from a year earlier. However, agency debt spreads rose only slightly over the intermeeting period.

State and Local Government Finance

In August, gross issuance of long-term municipal bonds to finance capital projects continued at a robust pace, while issuance for advance refunding edged down from the exceptional rate seen earlier this year. Short-term issuance of municipal bonds was bumped up in August by a single large deal. The credit quality of municipal bonds held steady, with rating upgrades on municipal bonds just outpacing downgrades so far this year. The ratio of municipal bond yields to those on comparable-maturity Treasuries, an alternative measure of credit quality, was little changed on net after Hurricane Katrina. The rating agencies have put about $9 billion in obligations from polities in the affected areas—a tiny fraction of the overall municipal market—on watch for possible downgrades as they wait for further information.

Money and Bank Credit

M2 growth picked up to a moderate 5 percent pace in August. Staff estimates suggest only a modest contribution to August growth from special factors, such as mortgage prepayments and foreign demand for U.S. dollars. So far, reporting difficulties resulting from Hurricane Katrina have made money stock data only slightly more prone to later revisions. Also, some temporary compositional changes may occur if affected households shift into cash, as has happened after past natural disasters. In the aggregate, though, effects on both data quality and the growth of major components of M2 seem to have been quite small.

Growth of bank credit surged to an annual rate of 12½ percent in August, with loans accounting for the bulk of the increase. Growth in mortgage loans to households was very strong, and consumer credit expanded moderately. Lending to businesses, through

C&I loans and commercial mortgages, remained robust. Loan growth in August was also boosted by a rebound in the volatile “other loans” component. As with M2, the hurricane may affect the accuracy of the bank credit data and bank credit growth going forward, but the effects are likely to be small in the aggregate.

Data from the August Survey of Terms of Business Lending (STBL) indicate that the average spread of rates on C&I loans over Eurodollar and swap yields adjusted for non-price loan characteristics rose 10 basis points from May, a gain driven mostly by an increase in the spread on high-risk loans and loans secured by collateral. The adjusted STBL results are broadly consistent with recent movements in spreads on BB-rated syndicated loan tranches at banks, which have also moved up from historical lows in recent months.

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 $57.9 billion in July from $59.5 billion in June (revised). The decline in the deficit reflected both an increase in exports and a reduction in imports.

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

	2004	Annual rate			Monthly rate		
		2004	2005		2005		
		Q4	Q1	Q2	May	June	July
Real NIPA[1]							
Net exports of G&S	-601.3	-634.1	-645.4	-611.2	...	...	...
Nominal BOP							
Net exports of G&S	-617.6	-676.9	-692.2	-693.3	-56.1	-59.5	-57.9
Goods, net	-665.4	-728.7	-745.3	-747.7	-60.8	-63.8	-62.6
Services, net	47.8	51.8	53.1	54.4	4.7	4.3	4.6

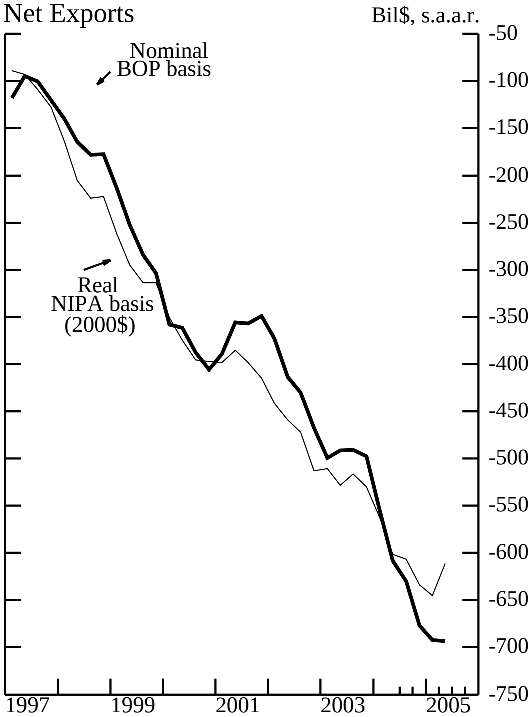
1. Billions of chained (2000) dollars.
Source. U.S. Department of Commerce, Bureaus of Economic Analysis and Census.
n.a. Not available. ... Not applicable.

In July, the value of exports of goods and services increased 0.4 percent following a 0.1 percent increase in June. The increase in July was largely driven by higher merchandise exports, as services exports remained almost unchanged. All major categories of merchandise posted modest gains in July, with agricultural goods providing the largest contribution. Within capital goods, strong exports of aircraft, semiconductors, and computers offset a decline in exports of other capital goods (particularly telecommunication products).

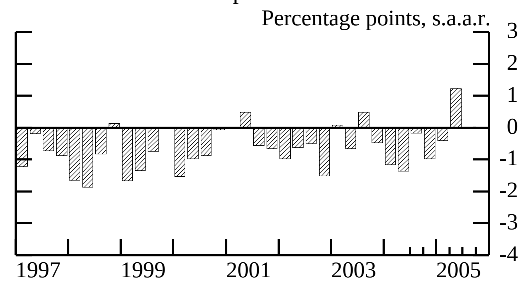
The value of imported goods and services decreased 0.7 percent in July, after a rise of 2.1 percent in June. The value of oil imports increased strongly in both months; in July, however, the increase was more than offset by a decline in imports of both services and non-oil goods. Within non-oil goods, a modest increase in imports of automotive products in July was more than offset by declines in imports of all other major categories. The decline in consumer goods in large part reflected a drop in the volatile pharmaceutical category. Within capital goods, the declines in July were widespread following equally widespread gains in June.

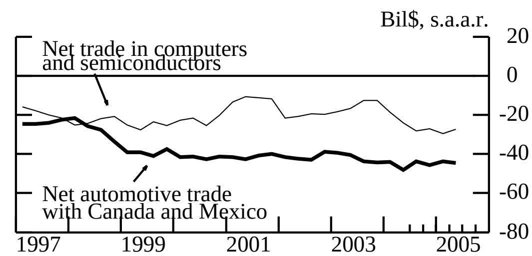
U.S. International Trade in Goods and Services

Net Exports

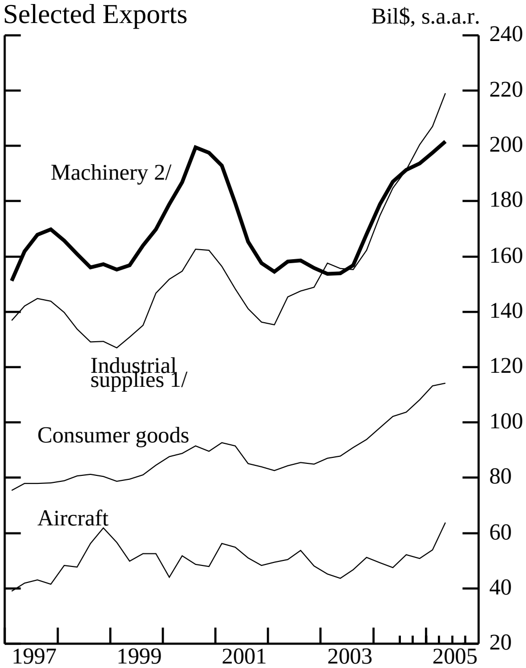


Contribution of Net Exports to Real GDP Growth



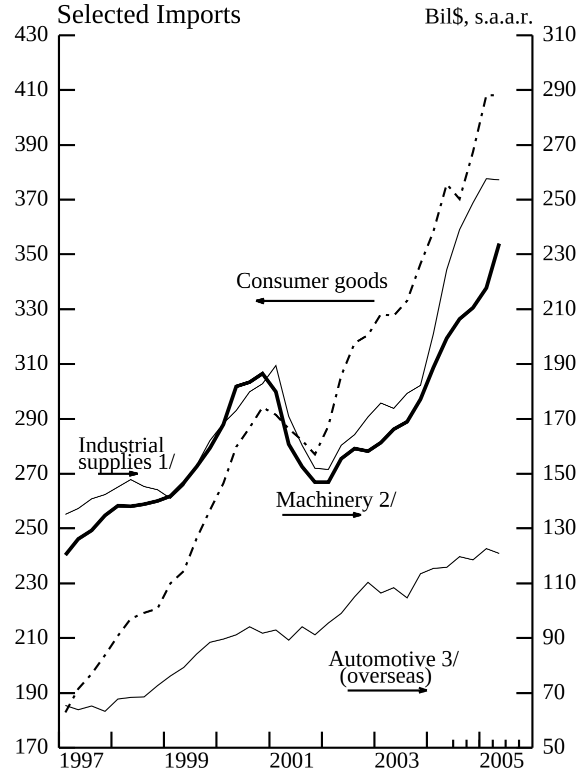


Selected Exports



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

Selected Imports



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

U.S. Exports and Imports of Goods and Services

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

	Levels				Change[1]			
	2005		2005		2005		2005	
	Q1	Q2	June	July	Q1	Q2	June	July
Exports of G&S	**1225.8**	**1269.1**	**1269.7**	**1274.9**	**30.2**	**43.4**	**0.9**	**5.2**
Goods exports	855.4	894.2	894.1	899.1	19.9	38.8	0.5	4.9
Gold	5.5	5.5	5.6	5.0	0.5	-0.0	0.2	-0.6
Other goods	849.8	888.7	888.5	894.1	19.3	38.8	0.3	5.5
Aircraft & parts	53.9	63.7	61.8	63.7	2.9	9.9	2.9	1.8
Computers & accessories	44.0	45.8	45.0	46.3	0.4	1.8	-1.4	1.4
Semiconductors	43.4	45.9	45.4	47.6	-2.6	2.4	-1.2	2.3
Other capital goods	200.4	205.2	209.4	206.0	3.7	4.8	6.3	-3.4
Automotive	94.8	93.9	94.0	95.5	1.1	-0.9	1.1	1.5
to Canada	51.4	51.4	52.2	51.1	-0.7	-0.0	2.2	-1.0
to Mexico	14.8	15.4	15.0	12.6	-1.4	0.6	-0.4	-2.4
to ROW	28.5	27.1	26.9	31.8	3.2	-1.4	-0.7	4.9
Agricultural	62.3	68.6	68.0	70.1	-0.3	6.3	-4.0	2.1
Ind supplies (ex. ag, gold)	207.0	219.0	217.6	218.2	6.5	12.0	-3.4	0.6
Consumer goods	113.2	114.1	114.2	114.8	5.0	0.9	-2.6	0.6
All other goods	30.8	32.5	33.3	31.8	2.6	1.6	0.1	-1.5
Services exports	370.4	375.0	375.6	375.8	10.4	4.6	0.5	0.3
Imports of G&S	**1918.0**	**1962.4**	**1983.6**	**1970.2**	**45.6**	**44.5**	**41.5**	**-13.5**
Goods imports	1600.7	1641.9	1660.1	1649.9	36.5	41.2	37.0	-10.2
Petroleum	211.7	229.6	237.8	248.1	-3.4	17.9	20.4	10.2
Gold	3.8	4.0	4.1	3.7	-1.0	0.2	-0.1	-0.4
Other goods	1385.1	1408.3	1418.2	1398.1	40.8	23.1	16.8	-20.1
Aircraft & parts	25.6	28.2	29.3	25.3	-2.1	2.6	2.2	-4.0
Computers & accessories	92.1	93.7	97.4	95.3	0.8	1.6	4.4	-2.0
Semiconductors	25.0	25.3	25.2	27.1	-0.6	0.4	0.4	1.8
Other capital goods	220.3	236.3	239.5	234.9	7.1	16.0	8.2	-4.6
Automotive	232.7	232.3	235.0	236.4	0.2	-0.4	-1.5	1.4
from Canada	69.4	65.7	66.3	67.9	-0.6	-3.6	0.2	1.6
from Mexico	40.6	45.6	45.4	33.7	-3.5	5.0	-0.9	-11.7
from ROW	122.7	121.0	123.4	134.9	4.3	-1.7	-0.8	11.5
Ind supplies (ex. oil, gold)	257.7	257.2	256.1	251.9	8.7	-0.5	4.6	-4.2
Consumer goods	408.1	408.1	410.1	400.9	20.7	-0.0	1.0	-9.2
Foods, feeds, bev.	66.3	67.3	67.6	67.3	2.0	1.0	-0.3	-0.3
All other goods	57.4	59.7	58.1	59.1	4.0	2.4	-2.3	1.0
Services imports	317.3	320.6	323.5	320.3	9.1	3.3	4.5	-3.2
Memo:								
Oil quantity (mb/d)	14.55	13.57	13.88	13.38	0.16	-0.98	0.71	-0.50
Oil import price ($/bbl)	39.89	46.28	46.91	50.76	-1.10	6.39	1.70	3.85

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

With the July trade data release, services exports and imports were revised for the January to June period. The revisions for services imports were fairly minor, whereas those for exports were more substantive. Compared with the previously published data, the value of services exports was revised down $5 billion at an annual rate in the first quarter and $12.5 billion in the second quarter.

Prices of Internationally Traded Goods

Non-oil imports. In August, the prices of U.S. imports of non-oil goods and core goods were both flat. A small increase in the price index for non-oil industrial supplies was offset by small declines in the price indexes for most other categories of imports. Following an increase of 0.4 percent in July, prices of non-oil industrial supplies climbed an additional 0.2 percent in August, with the increases in both months primarily the result of higher natural gas prices. Consumer goods prices fell 0.2 percent, with the decline widespread across consumption categories. The prices of imported capital goods (excluding computers and semiconductors) fell 0.1 percent. In August, prices for computers were flat, whereas prices of semiconductors increased 0.5 percent.

The average level of core import prices in July and August was 0.75 percent at an annual rate below the second quarter average, as prices in all sub-categories posted declines with the exception of automotive products. The main contributors to the overall price decline were foods and non-oil industrial supplies, which fell 6¼ percent and 1¼ percent, respectively.

Oil. The BLS price of imported oil rose 7.1 percent in August. The spot price of West Texas Intermediate (WTI) crude oil rose 10.7 percent that month to average $65 per barrel. The spot price climbed above $60 per barrel in the last week of July and continued climbing throughout the month to peak at $69.82 per barrel on August 30, in the immediate aftermath of Hurricane Katrina. Before Katrina, the increase in the spot price reflected supply disruptions in the Gulf of Mexico, the North Sea, India, Ecuador, and Africa, as well as heightened concerns about supplies from the Middle East. Since its peak, the spot price has edged back down to close at $63.12 on September 13, as reduced crude oil demand due to shuttered refineries and releases from strategic reserves have placed downward pressure on prices.

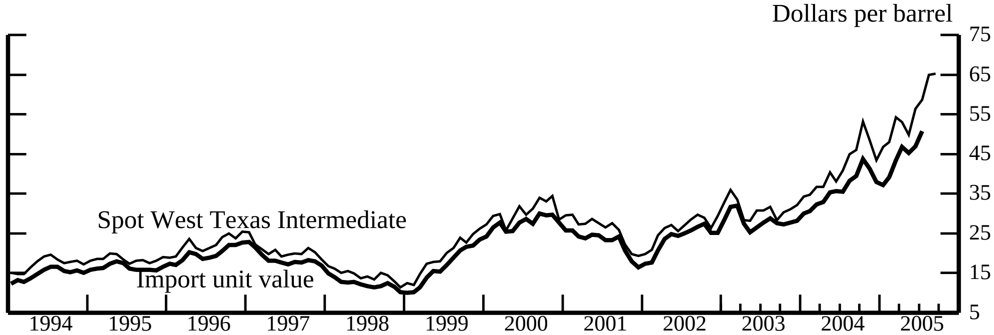
Prices of U.S. Imports and Exports

(Percentage change from previous period)

	Annual rate			Monthly rate		
	2005			2005		
	Q1	Q2	Q3e	June	July	Aug.
	---------------------- BLS prices ---------------------					
Merchandise imports	3.3	10.5	8.2	1.2	0.8	1.3
Oil	-1.6	69.1	70.5	8.6	6.1	7.1
Non-oil	4.2	1.7	-1.6	-0.2	-0.2	0.0
Core goods*	5.1	2.0	-0.8	-0.2	0.0	0.0
Cap. goods ex comp & semi	5.3	2.0	-0.5	0.0	-0.1	-0.1
Automotive products	0.4	0.5	0.3	0.1	0.0	0.0
Consumer goods	4.7	0.0	-1.1	0.0	-0.2	-0.2
Foods, feeds, beverages	9.2	7.3	-6.2	-1.2	-0.7	-0.1
Industrial supplies ex oil	8.5	6.6	-1.3	-0.7	0.4	0.2
Computers	-6.6	-4.9	-9.8	-0.3	-2.2	0.0
Semiconductors	-1.1	-2.0	-4.0	0.0	-1.2	0.5
Merchandise exports	4.9	3.2	-0.3	-0.1	0.1	-0.1
Core goods*	6.0	4.2	0.8	-0.1	0.3	0.1
Cap. goods ex comp & semi	3.9	1.7	0.3	0.0	0.0	0.1
Automotive products	1.4	0.8	0.5	0.0	0.1	0.0
Consumer goods	2.4	0.3	-0.8	-0.2	0.0	0.0
Agricultural products	3.6	18.8	3.9	1.1	-0.1	-0.6
Industrial supples ex ag	12.9	6.2	0.9	-0.5	0.8	0.3
Computers	-7.8	-7.5	-8.2	-0.5	-2.1	0.9
Semiconductors	-1.4	-3.3	-11.0	0.4	-1.2	-3.9
Chain price index	--------------------- NIPA prices ---------------------					
Imports of goods & services	2.9	8.0	n.a	...	...	...
Non-oil merchandise	3.7	1.5	n.a	...	...	...
Core goods*	4.6	2.1	n.a	...	...	...
Exports of goods & services	4.6	3.7	n.a	...	...	...
Total merchandise	4.5	2.9	n.a	...	...	...
Core goods*	6.1	3.8	n.a	...	...	...

*/ Excludes computers and semiconductors.
e/ Average of two months.
n.a. Not available. ... Not applicable.

Oil Prices



Exports. In August, the price index of U.S. exports of total goods fell 0.1 percent, whereas the prices of core goods increased 0.1 percent. The increase in core export prices was primarily driven by a 0.3 percent increase in the prices of non-agricultural industrial supplies, which more than offset a 0.6 percent fall in the prices of agricultural exports. The rise in the core index was also supported by a 0.1 increase in the prices of capital goods (excluding computers and semiconductors). The price indexes for automotive products and consumer goods were unchanged. In August, the prices of semiconductors fell 3.9 percent, whereas the prices of computers rose 0.9 percent.

The average level of prices in July and August was 0.75 percent at an annual rate above the second quarter average, as a decline in consumer goods prices was more than offset by higher prices in all other sub-categories. The main contributors to the overall price increase were agricultural and industrial supplies prices, which climbed 4 percent and 1 percent, respectively.

U.S. International Financial Transactions

Net private foreign purchases of U.S. securities were relatively weak in the second quarter, but rebounded in July (line 4 of the Summary of U.S. International Transactions table). A large part of the July upswing is attributed to private foreigners' net purchases of Treasury securities, after net sales in June (line 4a). In addition, private foreign net purchases of agency bonds, which had been weak throughout the first half of this year, were near a record level in July (line 4b). Private foreign net purchases of corporate bonds (line 4c) were robust in the second quarter and remained strong in July, while net purchases of corporate stocks (line 4d) moved up slightly in July from their subdued pace of the second quarter.

Foreign official inflows (line 1) were strong in both the second quarter and in July after a subdued first quarter, with strong inflows from countries outside of the G10 and OPEC. China has accounted for the bulk of official inflows to date this year, and Norway, which actively manages its oil fund, has contributed significantly to the monthly swings in these flows. Partial and confidential data on custody accounts at FRBNY suggest further sizable foreign official inflows in August, but these inflows stalled in the first weeks of September.

U.S. acquisitions of foreign securities (line 5) picked up a bit in the second quarter and in July. Net purchases of foreign stocks (line 5b) slowed from their first-quarter pace, but U.S. purchases of foreign bonds (line 5a) moved up from early in the year. Given the ongoing review of the TIC data on net transactions in foreign bonds, however, it is difficult to know how much of the recent increase in bond flows reflects larger purchases and how much reflects more complete reporting.

The volatile banking sector (line 3) registered a modest inflow in July. For the year to date, the banking sector has recorded a net outflow of $37 billion.

Summary of U.S. International Transactions

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

	2003	2004	2004		2005			
			Q3	Q4	Q1	Q2	Jun.	Jul.
Official financial flows	**269.0**	**398.1**	**76.1**	**95.2**	**31.3**	**81.3**	**21.1**	**23.3**
1. Change in foreign official assets in the U.S. (increase, +)	267.5	395.3	75.7	94.6	25.9	82.1	21.2	21.7
a. G-10 countries + ECB	111.4	161.7	20.4	-3.1	5.5	-18.2	-10.5	4.0
b. OPEC	5.9	12.1	3.5	6.8	-3.9	4.6	.1	-4.5
c. All other countries	150.2	221.5	51.8	90.8	24.3	95.6	31.7	22.1
2. Change in U.S. official reserve assets (decrease, +)	1.5	2.8	.4	.7	5.3	-.8	-.1	1.7
Private financial flows	**291.7**	**186.5**	**40.6**	**73.7**	**134.1**	**n.a.**	**...**	**...**
Banks								
3. Change in net foreign positions of banking offices in the U.S. [1]	64.7	-23.2	-16.6	-4.8	-7.6	-55.3	-48.4	26.3
Securities [2]								
4. Foreign net purchases of U.S. securities (+)	338.1	505.6	88.1	170.3	157.2	95.4	30.4	65.1
a. Treasury securities	115.2	121.9	1.0	10.0	76.3	5.5	-20.2	15.9
b. Agency bonds	-38.3	66.0	.5	43.2	.8	4.3	.5	18.4
c. Corporate and municipal bonds	223.9	255.9	84.9	71.2	58.2	77.1	47.4	20.4
d. Corporate stocks [3]	37.2	61.8	1.7	45.8	21.9	8.5	2.7	10.4
5. U.S. net acquisitions (-) of foreign securities	-159.5	-106.0	-38.6	-17.8	-38.7	-40.1	-14.8	-15.7
a. Bonds	-40.8	-22.0	-21.6	-8.1	1.4	-17.8	-1.9	-5.8
b. Stock purchases	-101.2	-96.2	-16.4	-35.2	-38.0	-22.3	-12.9	-9.9
c. Stock swaps [3]	-17.4	12.2	-.6	25.5	-2.1	.0	.0	.0
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-140.6	-252.0	-41.2	-100.0	-32.2	n.a.	...	...
7. Foreign direct investment in the U.S.	67.1	106.8	35.7	31.6	28.8	n.a.	...	...
8. Foreign holdings of U.S. currency	16.6	14.8	2.6	5.3	1.1	n.a.	...	...
9. Other (inflow, +) [4]	105.2	-59.6	10.7	-10.9	25.7	n.a.	...	...
U.S. current account balance (s.a.)	**-519.7**	**-668.1**	**-167.0**	**-188.4**	**-195.1**	**n.a.**	**...**	**...**
Capital account balance (s.a.) [5]	**-3.2**	**-1.6**	**-.4**	**-.5**	**-4.5**	**n.a.**	**...**	**...**
Statistical discrepancy (s.a.)	**-37.8**	**85.1**	**50.7**	**19.9**	**34.1**	**n.a.**	**...**	**...**

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

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

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

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

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

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

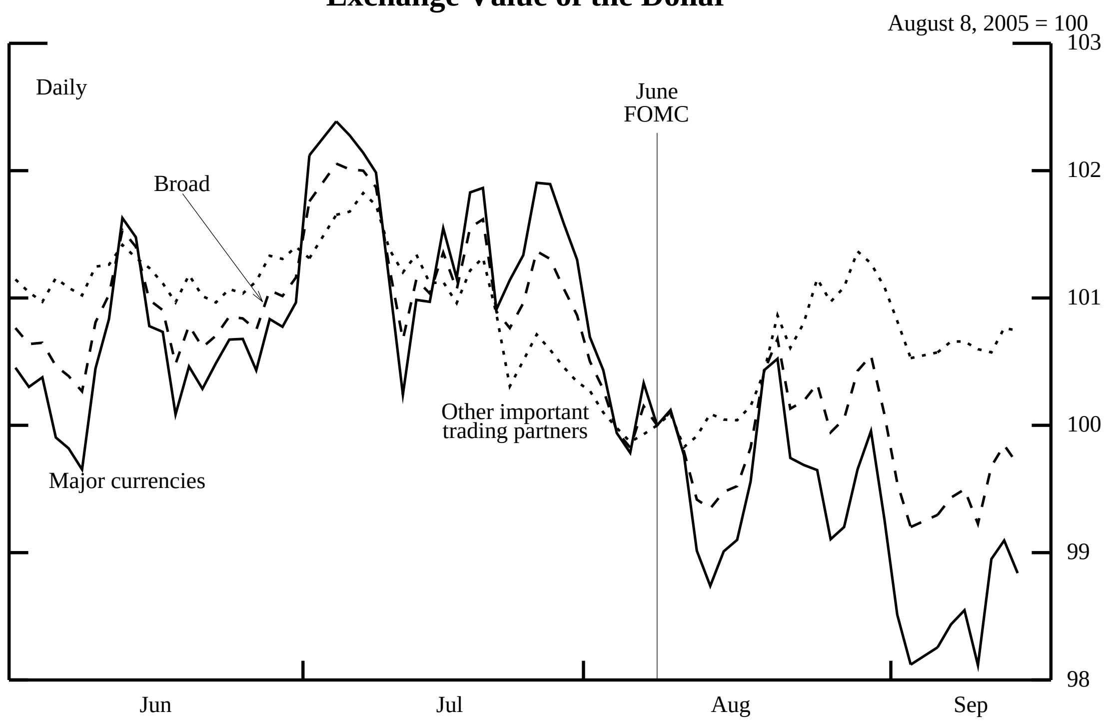
n.a. Not available. ... Not applicable.

Year to date, private foreign inflows into U.S. securities are a robust $318 billion – a pace running slightly ahead of last year's record private inflows. However, foreign official inflows so far this year are only $136 billion, well below the record inflows of the last two years. Taken together, foreign official and private inflows are running below last year's level. In addition, U.S. acquisitions of foreign securities have been running at a pace above that of last year. Offsetting these reductions in net portfolio inflows is a smaller net direct investment outflow in the first quarter relative to the sizable net outflows recorded last year. Second quarter direct investment data will be published September 16 and discussed in the Supplement.

Foreign Financial Markets

The major currencies index of the dollar declined 1¼ percent on net over the intermeeting period. Much of this decline occurred in late August, when short- and long-term dollar-denominated interest rates generally fell more than those of other major industrial economies. Energy prices rose sharply in late August and early September following the landfall of Hurricane Katrina, but reversed some or all of these increases late in the intermeeting period. Major equity indexes rose modestly across the globe over the period, driven by some better-than-expected earnings reports, the continued declines in global interest rates, and the declines in energy prices towards the end for the intermeeting period.

Exchange Value of the Dollar



The dollar appreciated ½ percent on balance against the euro, but depreciated 2½ percent against the Canadian dollar and sterling and ¾ percent versus the yen. The dollar depreciated broadly in late August, as market participants re-adjusted their relative growth and interest rate expectations of the United States versus those of other major economies following the release of U.S. manufacturing sector data that were weaker than had been expected.

Financial Indicators in Major Industrial Countries

Country	Three-month rate Sep. 14 (Percent)	Three-month rate Percentage point change	Ten-year yield Sep. 14 (Percent)	Ten-year yield Percentage point change	Equities percent change
Canada	2.86	.16	3.84	-.18	2.36
Japan	.05	.00	1.36	-.04	8.79
Euro area	2.14	.00	3.09	-.27	.66
United Kingdom	4.46	.00	4.18	-.21	-.14
Switzerland	.72	.00	1.79	-.24	1.69
Australia	5.63	.01	5.15	-.22	2.27
United States	3.84	.11	4.13	-.29	.90
Memo: Weighted-average foreign	1.99	.04	3.31	-.20	n.a.

NOTE. Change is from August 8/9 to September 14 (10 a.m. EDT).
n.a. Not available.

Short-term Canadian dollar interest rates rose 16 basis points during the intermeeting period. On September 7 the Bank of Canada raised its policy rate by 25 basis points, to 2.75 percent, in its first monetary policy adjustment in nearly a year. Yields implied by sterling interest rate futures currently show that the market is pricing in the likelihood of an additional 25-basis-point cut by the Bank of England by early next year, but the staff forecast projects that the Bank of England's policy will remain steady through 2007. Three-month euro interest rates were unchanged on net; statements by European Central Bank President Trichet during the period highlighted inflation risks, but were interpreted as indicating that the current stance of monetary policy was appropriate in the near term. Ten-year sovereign yields were little changed in Japan but fell about 25 basis points in the euro area, largely in line with the drop in the benchmark Treasury yield. Headline equity indexes rose about 9 percent in Japan but were nearly unchanged in Europe. The outperformance of Japanese equities was led by the banking sector, following several positive earnings reports and signs that banking profitability was in a sustained period of improvement.

Financial Indicators in Latin America, Asia, and Russia

Economy	Currency/ US dollar: Sep. 14	Currency/ US dollar: Percent change	Short-term interest rates[1]: Sep.13/14 (Percent)	Short-term interest rates[1]: Percentage point change	Dollar-denominated bond spread[2]: Sep.13/14 (Percent)	Dollar-denominated bond spread[2]: Percentage point change	Equity prices: Percent change
Mexico	10.78	1.36	9.10	-.50	1.31	-.17	3.61
Brazil	2.33	.62	20.31	.83	3.88	.01	8.90
Argentina[3]	2.92	1.57	6.13	-.12	4.13	.13	6.38
Chile	536.50	-1.71	3.66	.00	.56	.03	-1.48
China	8.09	-.19	n.a.	n.a.	.61	-.05	5.62
Korea	1025.40	1.12	n.a.	n.a.	...	...	6.46
Taiwan	32.77	2.53	1.51	.01	...	...	-3.63
Singapore	1.68	1.47	2.19	.19	...	...	-1.50
Hong Kong	7.76	-.16	3.63	.17	...	...	.26
Malaysia	3.77	.53	2.88	.03	.50	-.09	-3.20
Thailand	40.89	-.61	3.65	.70	n.a.	n.a.	5.32
Indonesia	9970.00	1.96	12.85	3.94	1.47	.41	-8.96
Philippines	55.90	.13	7.63	1.25	4.14	-.03	-3.78
Russia	28.29	-.45	n.a.	n.a.	1.11	-.26	9.87

NOTE. Change is from August 8/9 to September 13/14.

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, market participants continued to focus on the evolution of China's new exchange rate regime. Since the 2.1 percent revaluation of the renminbi against the dollar on July 21, there have been only minimal daily fluctuations of the renminbi against the dollar. Given this fact, there are only limited signs that the new renminbi management is based on minimizing changes in a trade-weighted index of the renminbi. Market participants have reduced their expectations for additional renminbi appreciation against the dollar, and 12-month NDF prices currently indicate only about 3 percent further renminbi appreciation.

On net over the period, the dollar appreciated about 2½ percent against the Taiwan dollar, 2 percent against the Indonesian rupiah, and 1 percent against the Korean won. A few emerging Asian equity indexes also declined on balance as market participants focused on these countries' dependence on imported energy. The Indonesian rupiah depreciated sharply early during the period, but recovered somewhat following a series of central bank monetary policy tightening measures designed to counter market concerns over the unsustainability of domestic energy price subsidies.

The dollar appreciated 1½ percent against the Mexican peso and ½ percent against the Brazilian *real*. Brazilian asset prices continued to be buffeted by market concerns over political corruption allegations regarding the Lula administration. Equity prices rose about 4 percent in Mexico and almost 9 percent in Brazil. Market participants pointed to higher global commodity prices as supporting these indexes, especially Mexican share prices. Mexico and Brazil's EMBI+ spreads were little changed on balance.

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 countries rose on average in the second quarter, but performance across the different economies was mixed. Japanese real GDP growth remained robust but moderated from exceptional performance in the first quarter as firms corrected rising inventory positions and household consumption returned toward more sustainable rates of growth. German real GDP was stagnant while French real GDP rose only tepidly in the wake of a reversal in final domestic demand, leading overall growth in the euro area to slow. Real GDP growth in the United Kingdom improved slightly, although private consumption remained subdued. Canadian real GDP picked up strongly as net exports rose after several quarters of decline.

Rising energy prices have recently caused some increase in consumer price inflation, but inflation remains generally well contained despite this. Mild deflation persists in Japan. In the euro area, core inflation remained at its lowest rate since early 2001, but energy prices have kept headline inflation slightly above the ECB's target ceiling of 2 percent. The inflation rate in the United Kingdom moved above the Bank of England's 2 percent target in July, driven by rising costs for services. Headline inflation in Canada also picked up in July, but core inflation remains moderate.

In **Japan**, real GDP grew 3.3 percent at an annual rate in the second quarter. Gross fixed investment rose 10.9 percent and private consumption rose 2.4 percent, but the rise in final demand was partly offset by a negative contribution from inventories as firms began to rein in inventory levels that had built up over the previous six months. Net exports made a larger-than-expected positive contribution to GDP growth following three quarters of negative contribution, perhaps partly driven by the rise in the dollar relative to the yen over the first half of the year; exports rose 12.1 percent, while imports rose 6 percent.

Monthly indicators point to a weak start to the third quarter. Real workers' household spending fell 4.2 percent and retail sales fell 2.2 percent in July, led by sharp declines in monthly automobile sales. Industrial production fell 1.1 percent in July, although a survey of Japanese firms projects gains in August and September. The purchasing manager's index (PMI) for manufacturing fell to 53.8 in August to mark the first decline since December. The nominal trade surplus fell in July as increases in oil and other commodity prices sent imports higher, although in real terms exports held steady while imports declined.

Japanese labor markets continue to gradually improve. The unemployment rate edged back up to 4.4 percent in July from its seven-year low of 4.2 percent in June, but this was due to a rise in labor force participation. Nominal wages were up 0.3 percent from a year ago in July, marking the fourth consecutive month of wage inflation on a year-over-year basis.

Nationwide core consumer prices (which exclude fresh food but include energy) fell 0.2 percent in July from a year ago. The GDP deflator fell 0.7 percent below its year-ago level in the second quarter. Monetary policy was unchanged. The balance of reserve accounts again fell temporarily below the Bank of Japan's floor of ¥30 trillion, for three days in early August, but has since returned to within the Bank's target range of ¥30-35 trillion. The BOJ continues to state that it will maintain its policy of quantitative easing until deflation ends.

The Liberal Democratic Party (LDP) scored a major victory in the September 11 elections for the Lower House of Parliament, winning its first outright majority in 15 years. Prime Minister Koizumi is expected to reintroduce his bills to privatize the postal savings system later this month. Although the bills were defeated by the Upper House in August, the electoral victory for Koizumi and his allies within the LDP is expected to ensure that the bills will now pass both houses of Parliament by the end of the year.

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

Component	2003[1]	2004[1]	2004		2005	
			Q3	Q4	Q1	Q2
GDP	**2.2**	**.9**	**-.5**	**.5**	**5.8**	**3.3**
Total domestic demand	1.3	.7	.2	.7	6.3	2.5
Consumption	1.0	.3	-.1	-1.2	4.9	2.4
Private investment	8.9	1.3	1.6	1.8	9.4	10.9
Public investment	-12.5	-11.8	-7.3	-1.8	-3.5	-9.9
Government consumption	.9	3.0	1.2	2.6	2.7	1.0
Inventories[2]	-.3	.4	.0	.7	1.3	-.7
Exports	10.6	10.8	2.6	6.3	-.3	12.1
Imports	2.8	10.4	9.4	8.9	2.7	6.0
Net exports[2]	.9	.3	-.6	-.1	-.3	.9

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

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

Indicator	2004	2005					
	Q4	Q1	Q2	May	June	July	Aug.
Industrial production[1]	-.9	1.8	-.4	-2.8	1.6	-1.2	n.a.
All-industries index	-.1	1.3	.3	-1.6	1.3	n.a.	n.a.
Housing starts	-3.9	3.3	-2.1	5.9	1.4	9.2	n.a.
Machinery orders[2]	5.7	.8	.8	-6.7	11.1	-4.3	n.a.
Machinery shipments[3]	-.8	-.4	2.4	-3.6	3.2	-1.5	n.a.
New car registrations	.2	-2.6	1.2	-.3	4.5	-6.6	1.6
Unemployment rate[4]	4.6	4.6	4.3	4.4	4.2	4.4	n.a.
Job offers ratio[5]	.90	.91	.95	.94	.96	.97	n.a.
Business sentiment[6]	1.0	-2.0	1.0	…	…	…	…
CPI (core, Tokyo area)[7]	-.3	-.5	-.4	-.4	-.4	-.4	-.3
Wholesale prices[7]	2.0	1.3	1.7	1.8	1.4	1.5	1.7

1. Mining and manufacturing.
2. Private sector, excluding ships and electric power.
3. Excluding orders for ships and from electric power companies.
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.

Real GDP growth in the **euro area** slowed to 1.2 percent in the second quarter after being revised downward 0.5 percentage point to 1.4 percent in the first quarter. The slowdown in the second quarter was mainly the result of a dip in private consumption, which shrank for the first time in more than three years, by 0.1 percent. The contribution of final domestic demand remained positive, however, as rising investment and public expenditures more than offset the fall in consumption. After providing considerable stimulus to growth in the first quarter, the external sector contributed only 0.2 percentage points to second-quarter GDP growth, as exports rose only marginally faster than imports. Inventories increased by a large amount, adding 0.7 percentage points to overall growth.

Indicators for the current quarter suggest that the pace of economic activity is picking up. In July, industrial production grew at a robust pace in Germany, although it fell unexpectedly in France. Industrial orders have improved in recent months, with euro-area orders up 3.7 percent in June and German orders also up 3.7 percent in July. Euro-area retail sales dipped a bit in July, however, indicating that households’ demand has remained weak.

Euro-area economic sentiment improved in August for the third consecutive month, recording the highest reading since February. The euro-area manufacturing PMI remained above the 50 threshold for growth in August after posting a considerable gain in July. The PMI for the services sector remained near the 53 mark, where it has been for much of the year. In Germany, the IFO index of manufacturing sentiment edged down in August but remained well-above the second-quarter level.

Labor market conditions continued to show some improvement, with the euro-area unemployment rate edging down to 8.6 percent in July. In spite of the surge in energy prices, twelve-month consumer price inflation fell to 2.1 percent in August. Core inflation, excluding energy and unprocessed food, has fallen since the start of the year and was unchanged at 1.4 percent in July.

Euro-Area Real GDP
(Percent change from previous period, except as noted, s.a.a.r.)

Component	2003[1]	2004[1]	2004		2005	
			Q3	Q4	Q1	Q2
GDP	**.9**	**1.5**	**1.0**	**.7**	**1.5**	**1.2**
Total domestic demand	1.6	1.9	2.8	2.1	.4	1.0
Consumption	.7	1.9	.8	3.3	.7	-.3
Investment	1.0	1.1	2.0	1.6	-.6	1.0
Government consumption	1.4	.6	1.6	-1.1	1.9	1.4
Inventories[2]	.7	.5	1.6	.1	-.2	.7
Exports	1.0	6.1	5.1	2.0	-2.6	8.6
Imports	2.8	7.4	10.2	5.7	-5.4	8.6
Net exports[2]	-.6	-.3	-1.7	-1.3	1.1	.2
Memo:						
GDP of selected countries						
France	1.4	2.1	.3	2.6	1.6	.5
Germany	.2	.5	-.3	-.3	3.0	.0
Italy	.0	.8	1.6	-1.6	-2.1	2.7

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

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

Indicator	2004	2005					
	Q4	Q1	Q2	May	June	July	Aug.
Industrial production[1]	-.2	.0	.4	-.4	.3	n.a.	n.a.
Retail sales volume[2]	.1	.7	-.3	1.2	.0	-.5	n.a.
Unemployment rate[3]	8.8	8.8	8.7	8.7	8.7	8.6	n.a.
Consumer confidence[4]	-13.0	-13.3	-14.3	-15.0	-15.0	-15.0	-15.0
Industrial confidence[4]	-3.3	-6.3	-10.0	-11.0	-10.0	-8.0	-8.0
Manufacturing orders, Germany	1.7	-.3	.8	2.3	2.3	3.7	n.a.
CPI[5]	2.3	2.0	2.0	2.0	2.1	2.2	2.1
Producer prices[5]	3.8	4.1	3.9	3.5	4.0	4.0	n.a.
M3[5]	6.6	6.5	7.6	7.3	7.6	7.9	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 1.9 percent in the second quarter, revised up from a preliminary estimate of 1.5 percent. A rise in expenditures on durable goods led consumption to grow 0.9 percent, slightly better than its first quarter pace. Fixed investment rose 6.2 percent and net exports contributed 2.2 percentage points to growth, but real GDP was held down by a negative contribution from inventories.

Early indicators for the third quarter point to continued moderate growth. After falling throughout the second quarter, business confidence rebounded strongly in July and remained in positive territory in August. The PMI for manufacturing squeaked above the 50 mark in August, while the PMI for services remained near its 2005 average of 55.

Month-to-month house price growth continues to be just slightly positive. According to the Nationwide Building Society index of house prices, the twelve-month change of house prices was 2.4 percent in August. Household net borrowing for house purchase remained stable in August at £11.6 billion.

Inflationary pressures have increased recently. The twelve-month rate of consumer price inflation surpassed the Bank of England’s 2 percent target in July and continued to accelerate to 2.4 percent in August. Twelve-month inflation excluding energy fell one tenth of a percentage point to 1.8 percent in August. The labor market in the United

Kingdom remains tight, as the unemployment rate continues to be near record lows. The twelve-month growth rate of unit labor costs rose from 2.8 to 4.1 percent in July.

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

Component	2003[1]	2004[1]	2004		2005	
			Q3	Q4	Q1	Q2
GDP	**3.1**	**2.7**	**1.4**	**2.2**	**1.5**	**1.9**
Total domestic demand	3.2	3.0	2.4	3.1	.9	-.4
Consumption	2.4	3.8	2.3	2.2	.5	.9
Investment	-.8	3.8	6.2	-.8	1.0	6.2
Government consumption	6.1	1.1	.6	1.5	2.8	1.6
Inventories[2]	.6	-.2	-.2	1.3	.1	-2.7
Exports	3.7	4.8	1.5	4.3	-3.4	24.5
Imports	4.0	5.8	4.9	7.2	-4.8	12.6
Net exports[2]	-.2	-.5	-1.0	-1.0	.6	2.2

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

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

Indicator	2004	2005					
	Q4	Q1	Q2	May	June	July	Aug.
Industrial production	.1	-.9	.0	.2	-.2	-.3	n.a.
Retail sales volume[1]	.1	.1	.4	-.2	1.2	-.3	n.a.
Unemployment rate[2]							
Claims-based	2.7	2.6	2.7	2.7	2.8	2.8	2.8
Labor force survey[3]	4.7	4.7	4.7	…	…	….	…
Business confidence[4]	4.3	12.7	-.3	-1.0	-5.0	6.0	3.0
Consumer confidence[5]	-.7	1.0	-2.0	-3.0	-3.0	-1.0	-2.0
Consumer prices[6]	1.4	1.7	1.9	1.9	2.0	2.3	2.4
Producer input prices[7]	6.8	10.5	9.8	7.4	11.9	14.1	12.9
Average earnings[7]	4.3	4.5	4.1	4.1	4.1	n.a.	n.a

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

Activity in **Canada** accelerated in the second quarter. Real GDP grew 3.2 percent following downwardly-revised growth of 2.1 percent in the first quarter. The stronger-than-expected outcome masked the reversal of a recent pattern of high growth in domestic demand coupled with soft net external demand. Final domestic demand growth slowed from its first-quarter surge, as consumption rose 2.4 percent and business investment advanced 4.2 percent. Exports edged up moderately, while imports, following four straight quarters of strong gains, fell 3.5 percent, causing net exports to contribute 1.8 percentage points to growth.

Early indicators for the third quarter suggest continued strength. The composite index of leading indicators continued its recent string of solid advances in July. After surprisingly strong growth throughout the year, housing starts, despite a decline in August, remain elevated. Moderate job gains continued in July and August, with the unemployment rate holding near a 30-year low of 6.8 percent. The real merchandise trade balance expanded in July, with volumes in most export categories up from the previous month and most import categories recording declines.

In July, the twelve-month rate of consumer price inflation moved up to 2 percent**,** largely due to upward pressure from gas prices. The twelve-month rate of core inflation, excluding the eight most volatile components, slipped to 1.5 percent. In response to the higher headline inflation, the Bank of Canada raised its policy rate 25 basis points to 2.75 percent in September.

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

Component	2003[1]	2004[1]	2004		2005	
			Q3	Q4	Q1	Q2
GDP	**1.7**	**3.3**	**3.5**	**2.1**	**2.1**	**3.2**
Total domestic demand	3.9	5.1	9.7	6.2	3.4	1.5
Consumption	2.7	3.9	3.5	3.8	6.7	2.4
Investment	8.5	5.4	6.3	7.5	7.5	4.2
Government consumption	2.7	2.5	2.0	2.1	3.6	3.1
Inventories[2]	.0	1.2	5.5	1.9	-2.6	-1.4
Exports	.1	3.0	-2.8	-3.1	5.5	.8
Imports	5.7	8.3	12.4	8.3	11.0	-3.5
Net exports[2]	-2.1	-1.9	-5.8	-4.5	-2.1	1.8

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

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

Indicator	2004	2005					
	Q4	Q1	Q2	May	June	July	Aug.
GDP by industry	.5	.6	.7	.3	.2	n.a.	n.a.
Industrial production	-.1	-.1	.1	.8	-.3	n.a.	n.a.
New manufacturing orders	-.9	3.0	-1.7	-.7	.4	n.a.	n.a.
Retail sales	.9	2.3	1.1	-1.1	1.0	n.a.	n.a.
Employment	.4	.1	.4	.2	.1	.0	.2
Unemployment rate[1]	7.1	7.0	6.8	6.8	6.7	6.8	6.8
Consumer prices[2]	2.3	2.1	1.9	1.6	1.7	2.0	n.a.
Core consumer prices[2,3]	1.6	1.7	1.6	1.6	1.5	1.4	n.a.
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).

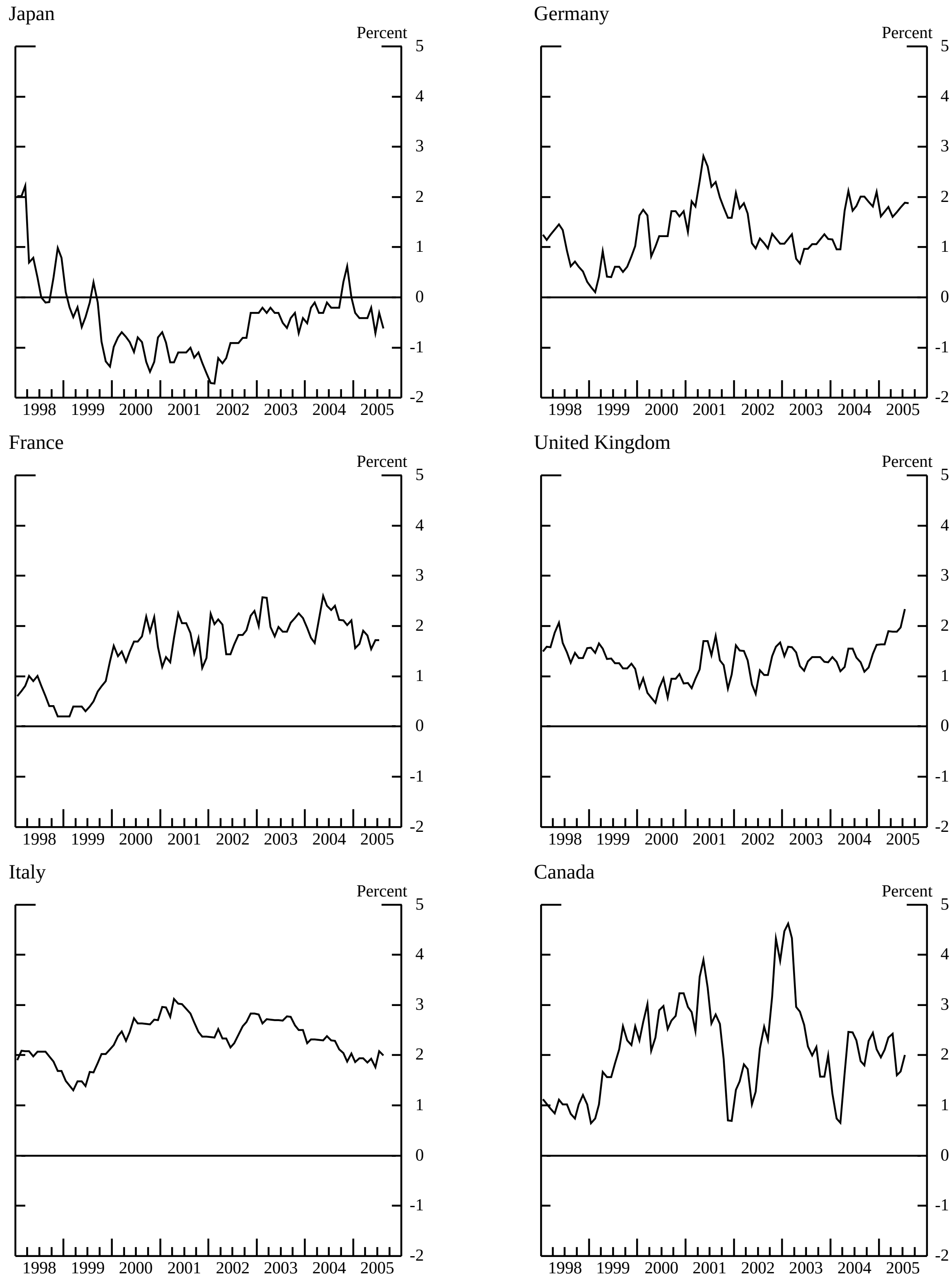
n.a. Not available. . . . Not applicable.

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

Country and balance	2004	2005				
	Q4	Q1	Q2	May	June	July
Japan						
Trade	105.0	102.3	76.7	76.1	74.3	64.8
Current account	173.8	171.3	160.1	162.2	165.9	146.6
Euro area						
Trade	60.4	74.3	60.9	64.2	49.9	n.a.
Current account	43.9	15.7	1.6	28.9	-36.5	n.a.
Germany						
Trade	192.7	214.9	200.8	190.2	213.2	189.0
Current account	86.3	144.2	108.9	72.5	159.3	151.9
France						
Trade	-28.5	-29.2	-24.5	-14.1	-19.2	-38.6
Current account	-16.9	-31.7	-37.8	-32.5	-3.0	n.a.
Italy						
Trade	-8.5	-7.8	-6.1	-3.9	-4.4	n.a.
Current account	-24.4	-33.8	-36.0	-34.7	-31.1	n.a.
United Kingdom						
Trade	-115.3	-112.6	-107.0	-113.6	-90.9	-106.6
Current account	-30.6	-44.0	n.a.	...	...	...
Canada						
Trade	47.3	41.2	44.5	39.3	47.2	57.1
Current account	17.3	11.0	15.0	...	...	...

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

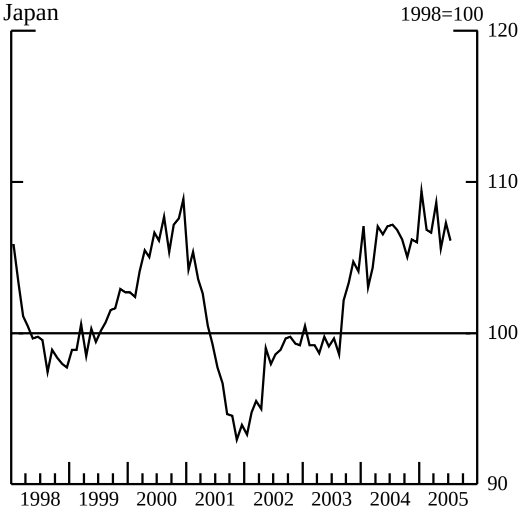
Consumer Price Inflation in Selected Industrial Countries
(12-month change)



Industrial Production in Selected Industrial Countries

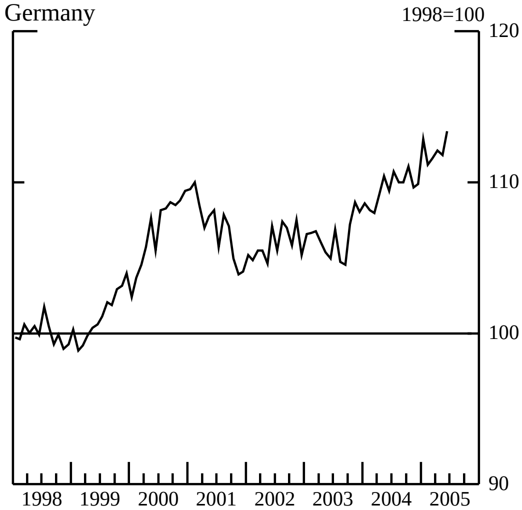
Japan

1998=100

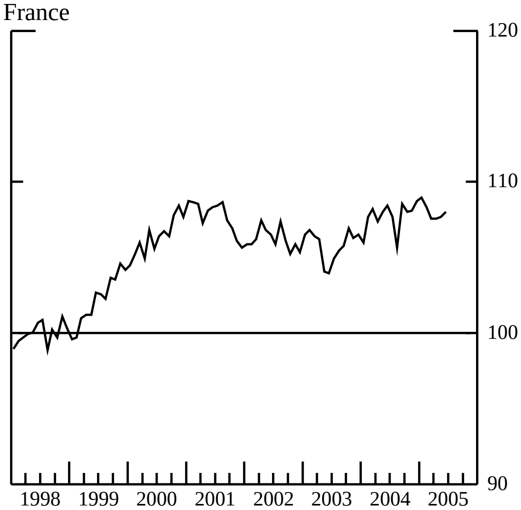


Germany

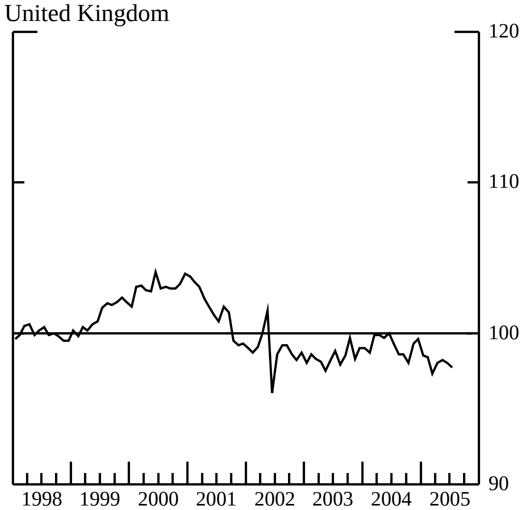
1998=100



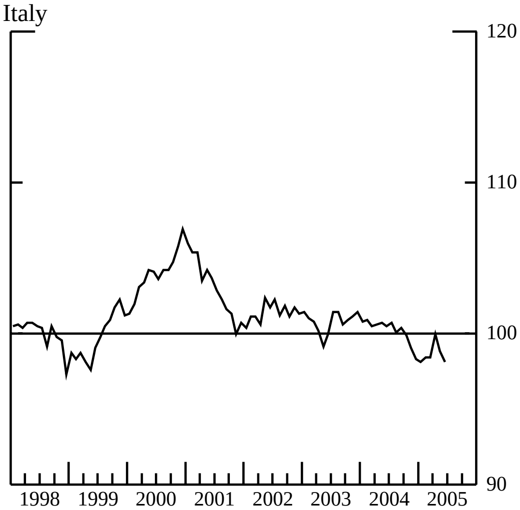
France



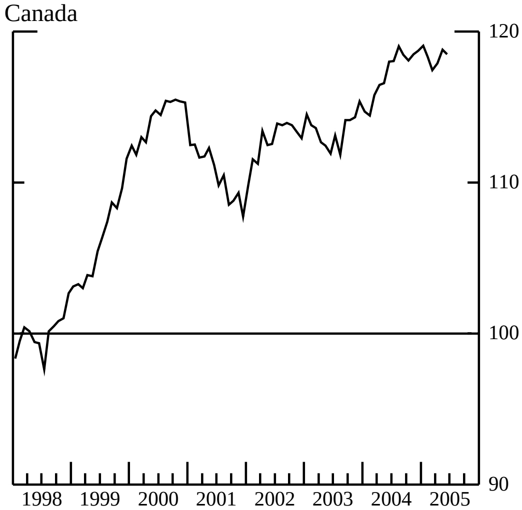
United Kingdom



Italy



Canada



Economic Situation in Other Countries

Second-quarter growth in the emerging market economies picked up on average after slowing in the first quarter, although there was considerable variation across countries. More recently, performance has remained mixed. In Asia, a second-quarter slowdown in China was more than offset by a rebound in Singapore and Thailand and by a Disneyland-related surge in activity in Hong Kong. Growth was also solid in Korea and India. In Latin America, Mexican real GDP declined, while growth in Brazil was surprisingly strong. Data releases for July have been mixed in emerging market economies. The rise in international oil prices has contributed to an increase in inflation, but the impact has varied widely, reflecting in part varying degrees of oil intensity and controls on domestic fuels prices.

Recent data from **China** point to growth at a more moderate pace than over the past several years, mainly as a result of slowing investment, which declined in July for the first time this year. Imports also fell in July before snapping back in August. The average rate of industrial production growth over the past several months is about half of last year's pace. The PMI came down in August, although it remained in expansionary territory. On the other hand, in July and August, retail sales continued to grow at a double-digit pace and exports continued to soar. For 2005 through August, the trade surplus was about $70 billion, more than double the surplus for all of 2004. Consumer price inflation moved down in August as food price inflation fell to below 1 percent. The authorities have been raising domestic prices of fuels, but to date those hikes have lagged increases in world prices of fuels.

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

Indicator	2003	2004	2005				
			Q1	Q2	June	July	Aug.
Real GDP[1]	10.0	9.5	12.7	5.0	…	…	…
Industrial production	18.9	14.4	4.1	4.3	1.1	.6	1.2
Consumer prices[2]	3.2	2.6	2.8	1.7	1.6	1.7	1.2
Trade balance[3]	25.5	32.1	90.9	109.0	125.1	137.6	109.2

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.

Second quarter real GDP grew an astounding 12½ percent (a.r.) in **Hong Kong**, driven by a surge in activity related to preparations for the opening of Disneyland. July exports and imports both fell from their very high June levels, and the resulting trade deficit was little changed from the previous month. Consumer price inflation inched up in July.

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

Indicator	2003	2004	2005				
			Q1	Q2	May	June	July
Real GDP[1]	4.5	6.9	5.7	12.6	…	…	…
Unemployment rate[2]	7.9	6.9	6.1	5.7	5.7	5.7	5.7
Consumer prices[3]	-1.9	.2	.3	.9	.9	1.2	1.3
Trade balance[4]	-8.5	-12.0	-9.4	-9.1	-12.9	-6.7	-6.8

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.

Taiwanese real GDP grew about 3¼ percent in the second quarter. Exports made the largest contribution to overall growth, but personal consumption and investment spending were both up. Industrial production fell sharply in July, reversing part of June's large gain, but the output of high-tech components rose. The average trade surplus over July and August was little changed from its second-quarter level. Consumer price inflation jumped in August due to higher fuels prices and typhoon-related increases in food prices.

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

Indicator	2003	2004	2005				
			Q1	Q2	June	July	Aug.
Real GDP[1]	5.8	3.2	2.6	3.3	…	…	…
Unemployment rate[2]	5.0	4.5	4.2	4.2	4.2	4.2	n.a.
Industrial production	7.1	9.8	-.2	1.3	2.9	-1.8	n.a.
Consumer prices[3]	-.1	1.6	1.6	2.1	2.4	2.4	3.6
Trade balance[4]	16.9	6.1	2.8	3.1	3.5	6.2	-1.3
Current account[5]	29.3	18.6	17.6	6.9	…	…	…

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

Recent indicators for **Korea** have remained positive. Revised data for second-quarter GDP growth confirmed the preliminary estimate of 5 percent. Industrial production rose 1.3 percent in July following a strong performance in June. Recent sales and confidence surveys are holding at high levels. Exports remained elevated, and the trade surplus rose despite strong oil imports. Consumer price inflation decelerated further in August, although the fuel component registered sizeable gains. Housing prices in selected areas rose sharply, prompting the government in August to announce hikes in property and capital gains taxes and measures aimed at increasing housing supply.

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

Indicator	2003	2004	2005				
			Q1	Q2	June	July	Aug.
Real GDP[1]	4.2	3.0	1.5	5.0	…	…	…
Industrial production	4.9	10.2	1.1	.5	2.3	1.3	n.a.
Unemployment rate[2]	3.6	3.7	3.7	3.7	3.8	3.8	n.a.
Consumer prices[3]	3.4	3.0	3.1	3.0	2.7	2.5	2.0
Trade balance[4]	22.0	38.2	43.1	27.7	35.9	39.8	n.a.
Current account[5]	11.9	27.6	23.8	11.0	27.5	16.4	n.a.

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

In the ASEAN region, performance varied in the second quarter. Real GDP rebounded in Singapore and Thailand from first-quarter declines and accelerated in the Philippines, but stagnated in Indonesia and Malaysia following strong first-quarter growth. Domestic factors contributed to the divergent performance, including a resurgence of output in Singapore's volatile biomedical sector and, in Thailand, a recovery from the tsunami and a drought. More recently, July industrial production was down in Thailand and Singapore from the very strong second quarter, and fell in Malaysia as well. In July, Indonesia, Malaysia, and Singapore continued to record high trade surpluses, while Thailand reversed a string of large deficits as a result of plummeting imports. With the exception of Singapore, consumer price inflation continued to be elevated, reflecting the higher price of oil, and in some countries, a reduction in fuel subsidies and higher food prices.

Since the last Greenbook, monetary policies have been tightened in Thailand and Indonesia. On September 8, Thailand's central bank raised its policy rate 50 basis points to 3.25 percent. Indonesia's central bank tightened policy in late August and early September in response to strong downward pressures on the rupiah and stock prices, which raised the prospect that the country may be entering a financial crisis. Analysts have been concerned about rising inflation, a weaker-than-expected Q2 GDP, and the fiscal burden from fuel subsidies, given Indonesia's high level of public debt. Since late August, the Indonesian central bank's target for the one-month interest rate has risen from 8.75 percent to 10 percent, which has helped stabilize asset prices, and the government has given indications that fuel subsidies will be reduced in coming months.

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

Indicator	2003	2004	2005				
			Q1	Q2	May	June	July
Real GDP[1]							
Indonesia	5.0	6.5	5.4	.6	…	…	…
Malaysia	6.6	5.7	9.9	.0	…	…	…
Philippines	4.6	5.4	3.1	5.5	…	…	…
Singapore	5.5	6.5	-4.6	18.0	…	…	…
Thailand	7.6	5.5	-2.8	7.9	…	…	…
Industrial production[2]							
Indonesia[3]	3.9	4.0	4.1	n.a.	-9.4	n.a.	n.a.
Malaysia	9.3	11.3	1.4	.0	-2.8	3.5	-3.4
Philippines	.0	1.0	-3.5	5.3	1.3	-4.4	n.a.
Singapore	3.0	13.9	-7.7	8.0	-4.5	9.5	-2.3
Thailand	13.9	11.1	-1.1	3.1	1.2	2.5	-.8

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	May	June	July
Indonesia	28.5	25.1	27.5	20.7	26.0	17.6	23.2
Malaysia	21.4	21.2	27.5	26.3	22.0	26.7	21.9
Philippines	-4.2	-4.4	-1.6	-4.4	-2.6	-7.6	n.a.
Singapore	16.2	16.1	14.9	15.7	17.4	17.4	17.4
Thailand	3.8	1.7	-12.3	-20.6	-20.9	-25.2	2.3

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	June	July	Aug.
Indonesia	5.2	6.4	7.8	7.6	7.4	7.8	8.3
Malaysia	1.2	2.1	2.4	3.0	3.2	3.0	3.7
Philippines	3.9	8.6	8.5	8.2	7.6	7.1	7.2
Singapore	.7	1.3	.3	.1	-.2	.1	n.a.
Thailand	1.8	2.9	2.8	3.7	3.8	5.3	5.6

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

In **India**, incoming data point to continued robust growth. Industrial production was up 3½ percent in the second quarter before a weather-related decline in July, and indicators of consumer demand are strong. Twelve-month consumer price inflation turned up in July, however, and the government raised gasoline and diesel prices by 7 percent in early September, the second such increase this year. The relatively slow rate of pass-through of oil prices has resulted in losses at India's state-owned oil companies and reduced government revenues. Rising oil prices are also boosting imports.

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

Indicator	2003	2004	2005				
			Q1	Q2	June	July	Aug.
Real GDP[1]	11.0	6.4	6.4	n.a.	…	…	…
Industrial production	6.6	8.5	.8	3.4	1.8	-2.8	n.a.
Consumer prices[2]	3.7	3.8	4.2	4.0	3.3	4.1	n.a.
Wholesale prices[2]	5.8	6.7	5.3	5.3	4.3	4.1	3.2
Trade balance[3]	-13.7	-21.7	-35.9	-41.9	-51.8	-31.9	-38.2
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 weaker-than-expected pace of expansion in economic activity. Real GDP fell 1.7 percent (a.r.) in the second quarter. The slowdown was concentrated in manufacturing, particularly the auto sector, reflecting weak U.S demand for Mexican manufactures. In addition, high real interest rates appear to have begun to weigh on domestic demand. There was also an unexpected decline in agricultural production. July industrial production and export performance were weaker than expected.

Aggressive monetary policy tightening by the Bank of Mexico (BOM) from early 2004 to March 2005 appears to have been effective in reducing inflation. Twelve-month consumer price inflation was 3.9 percent in August, down from the 5.3 percent registered at the end of last year and within the upper limit of the target range of 2 to 4 percent. Furthermore, twelve-month core inflation has continued to trend down, to 3.3 percent in August. High international oil prices have not passed through to domestic inflation because of controls on fuels prices. The slowing economy and improved inflation prospects led the BOM to begin easing policy in late August. The rate on 28-day peso-denominated bills, a widely used measure of the monetary policy stance, has fallen from 9.6 in early August to 9.4 in early September.

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

Indicator	2003	2004	2005				
			Q1	Q2	June	July	Aug.
Real GDP[1]	2.1	4.8	.7	-1.7	…	…	…
Overall economic activity	1.4	4.1	.3	-.1	-1.2	n.a.	n.a.
Industrial production	-.2	3.5	.0	-.2	-1.4	.2	n.a.
Unemployment rate[2]	3.2	3.7	3.8	4.0	3.8	3.5	n.a.
Consumer prices[3]	4.0	5.2	4.4	4.5	4.4	4.5	3.9
Trade balance[4]	-5.8	-8.8	-11.8	-5.2	-3.4	-9.8	n.a.
Imports[4]	170.5	196.8	211.2	213.5	214.3	217.3	n.a.
Exports[4]	164.8	188.0	199.4	208.3	210.9	207.5	n.a.
Current account[5]	-8.6	-7.3	-10.1	-.1	…	…	…

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**, real GDP was up 5¾ percent in the second quarter, following a weak first quarter. Growth was led by a 20 percent jump in investment, which did not quite reverse the previous two successive quarters of sharp declines. Private consumption was up 3¾ percent, supported by recovering real incomes and a rapid expansion of consumer credit, despite extremely high nominal and real interest rates. On the production side, the extractive sector soared 75 percent (a.r.), reflecting rapid increases in output of petroleum and other commodities, while manufacturing output jumped nearly 8 percent. July industrial production, however, plummeted 2½ percent and the decline was broadly based. Consumer price inflation was only 0.2 percent in August, bringing twelve-month inflation down to 6 percent. The fall in inflation reflects in part a decline in food prices and the continued pass-through from the appreciation of the *real* earlier this year. In addition, government-controlled Petrobras had not changed domestic prices of gasoline and diesel fuel in 2005 until September 9, when the company raised prices of gasoline and diesel fuel at its refinery gates by about 15 percent.

In mid-August, the central bank kept its policy rate on hold for the third straight month. The monetary policy committee's minutes, however, removed language suggesting that interest rates would remain at current rates for a "sufficiently long time" to contain inflation, raising expectations that the policy rate will be cut at the mid-September meeting. Political scandals that involve members of Lula's party and administration have continued to dominate the congressional agenda, dashing hopes of progress on economic reforms before the October 2006 presidential election.

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

Indicator	2003	2004	2005				
			Q1	Q2	June	July	Aug.
Real GDP[1]	.9	4.7	1.5	5.8	...	...	...
Industrial production	.1	8.3	-.2	2.0	2.0	-2.5	n.a.
Unemployment rate[2]	12.3	11.5	10.6	9.8	9.2	9.2	n.a.
Consumer prices[3]	9.3	7.6	7.4	7.8	7.3	6.6	6.0
Trade balance[4]	24.8	33.7	39.8	44.8	44.2	57.9	39.9
Current account[5]	4.2	11.7	10.8	10.3	15.0	31.1	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.

In **Argentina**, the pace of the economic recovery from the 2001-02 financial crisis appears to have accelerated in the second quarter, after a slowdown in the first quarter. Although industrial production growth slowed in the second quarter, the monthly index of economic activity, which has closely tracked real GDP growth in recent years, jumped 7 percent, up from 4¾ percent in the first quarter. Twelve-month consumer price inflation has moved up this year, reaching almost 10 percent in August, well above the central bank's informal target range of 5-8 percent for the end of 2005. The central bank has continued to intervene to stem upward pressures on the peso.

In mid-August, an IMF mission to Buenos Aires was cancelled shortly before it was scheduled to take place. Indications are that the mission will occur after the October Congressional elections to give time for the Argentine Congress to pass a 2006 budget. The Fund has been pressing for tighter fiscal and monetary policies, more progress on banking and utility sector reforms, and a normalization of relations with holdout creditors.

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

Indicator	2003	2004	2005				
			Q1	Q2	June	July	Aug.
Real GDP[1]	11.8	9.1	2.1	n.a.	…	…	…
Industrial production	16.2	10.7	2.0	1.2	-.5	.1	n.a.
Unemployment rate[2]	17.3	13.6	13.0	n.a.	…	…	…
Consumer prices[3]	3.7	6.1	8.2	8.8	9.0	9.6	9.7
Trade balance[4]	15.7	12.1	9.7	12.4	6.3	14.8	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**, real GDP soared 23 percent (a.r.) in the second quarter according to staff estimates, reflecting a 30 percent increase in non-petroleum activity. Activity was boosted by expansionary policies that have been supported by the high price of oil. Petroleum sector activity was up a relatively tepid 3 percent. The oil sector's Q2 performance is consistent with anecdotal evidence that oil production and investment have been constrained by the Chavez government's hostile approach to private investors, by management problems at the government oil firm, PdVSA, and by the government's transfer of PdVSA profits to social development funds.

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

Indicator	2003	2004	2005				
			Q1	Q2	June	July	Aug.
Real GDP[1]	6.6	12.1	19.4	23.0	…	…	…
Unemployment rate[2]	18.0	15.1	13.3	11.9	11.5	n.a.	n.a.
Consumer prices[3]	27.1	19.2	17.0	16.3	15.9	15.3	14.9
Non-oil trade balance[4]	-5.5	-10.5	-14.5	-16.1	n.a.	n.a.	n.a.
Trade balance[4]	16.5	21.4	28.4	29.3	n.a.	n.a.	n.a.
Current account[5]	11.4	13.8	18.6	23.3	…	…	…

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.

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