

## **Prefatory Note**

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

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## **Part 2**

March 14, 2007

# **CURRENT ECONOMIC AND FINANCIAL CONDITIONS**

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## **Recent Developments**

March 14, 2007

## **Recent Developments**

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## **Domestic Nonfinancial Developments**

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## Domestic Nonfinancial Developments

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Economic activity appears to be expanding at a modest pace this quarter. Output continues to be damped by declining construction activity as homebuilders attempt to reduce their inventories of unsold homes. In addition, business investment has softened considerably over the past several months, with weakness especially noticeable for equipment used in the construction and motor vehicle industries. Manufacturing output also has been held down by developments in these two industries and by emerging signs of softness in the production of business equipment. But there have been favorable developments as well. Demand for housing appears to have stabilized, at least for the time being, and inventories of light motor vehicles have declined close to the levels desired by firms. Moreover, consumer spending has increased appreciably since late last year, and labor demand continues to expand—albeit less rapidly than the average pace last year. Total PCE inflation has decelerated over the past year because of declining energy prices, but the most recent twelve-month change in core PCE prices to January was slightly higher than at the same time last year.

### Labor Market Developments

Labor demand appears to have moderated at the beginning of the year. Private nonfarm payroll employment increased at an average pace of 95,000 per month in the first two months of the year, about 70,000 below the average in the second half of 2006.<sup>1</sup> In February, private nonfarm payroll employment increased only 58,000, as severe winter weather likely contributed to a 62,000 decline in construction employment. Elsewhere, manufacturing employment fell again last month, but employment in services-producing sectors increased 129,000. Although employment in goods-producing industries has decelerated noticeably since the first half of last year, employment gains in services-producing sectors have remained strong.

In February, the average workweek of production or nonsupervisory workers on private nonfarm payrolls ticked down 0.1 hour, to 33.7 hours, likely held down by bad weather; indeed, in the household survey the number of individuals who reported working part time because of bad weather spiked up last month. The decline in the workweek pushed aggregate hours down 0.3 percent in February, and the February level of hours stood 0.1 percent below the fourth-quarter average.

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<sup>1</sup> The January employment report included the annual benchmark revision to the payroll survey. The benchmark revision added 68,000 to the average monthly change in nonfarm payroll employment from April 2005 to March 2006, raising it to 237,000. From April 2006 to December 2006, the average monthly change in nonfarm payroll employment was revised up 22,000, to 168,000.

**Changes in Employment**

(Thousands of employees; seasonally adjusted)

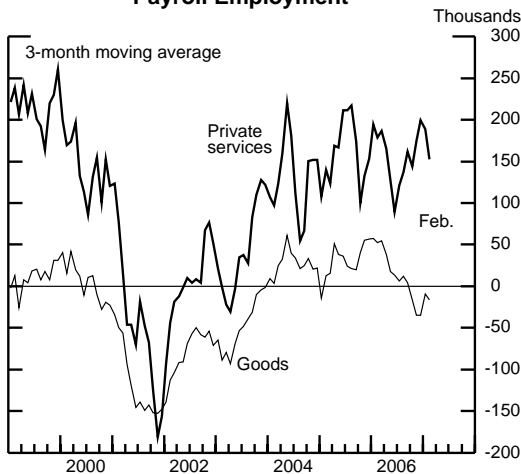
Measure and sector	2006	2006				2007	
		Q2	Q3	Q4	Dec.	Jan.	Feb.
	Average monthly change				Monthly change		
Nonfarm payroll employment (establishment survey)	189	124	202	177	226	146	97
Private	169	103	166	164	218	131	58
Natural resources and mining	5	5	3	4	6	0	5
Manufacturing	-7	9	-11	-25	-12	-2	-14
Construction	11	0	11	-14	1	28	-62
Wholesale trade	11	8	9	12	20	-5	6
Retail trade	-3	-27	-2	11	-4	25	7
Transportation and utilities	9	10	8	11	8	6	1
Information	2	-3	1	7	16	1	13
Financial activities	16	11	20	10	16	4	8
Professional and business services	42	36	32	52	66	26	29
Temporary help services	-1	1	-4	6	10	3	-12
Nonbusiness services <sup>1</sup>	83	55	94	96	100	48	66
Total government	20	21	36	13	8	15	39
Total employment (household survey)	262	235	173	340	303	31	-38
Memo:							
Aggregate hours of private production workers (percent change) <sup>2</sup>	2.5	3.1	1.4	2.0	.6	-.2	-.3
Average workweek (hours) <sup>3</sup>	33.8	33.9	33.8	33.9	33.9	33.8	33.7
Manufacturing (hours)	41.1	41.2	41.3	41.1	41.0	40.8	40.8

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

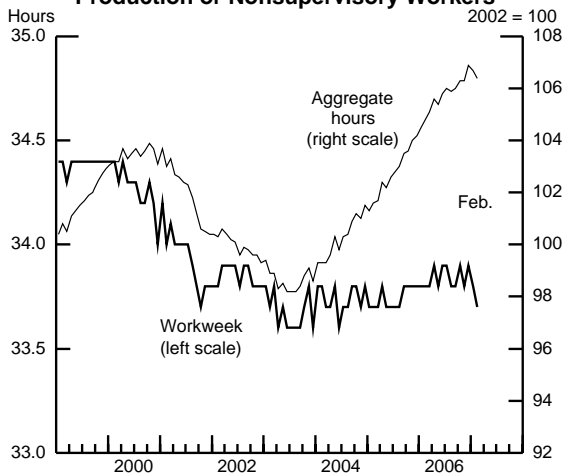
2. Establishment survey. Annual data are percent changes from Q4 to Q4. Quarterly data are percent changes from preceding quarter at an annual rate. Monthly data are percent changes from preceding month.

3. Establishment survey.

**Changes in Private Payroll Employment**



**Aggregate Hours and Workweek of Production or Nonsupervisory Workers**

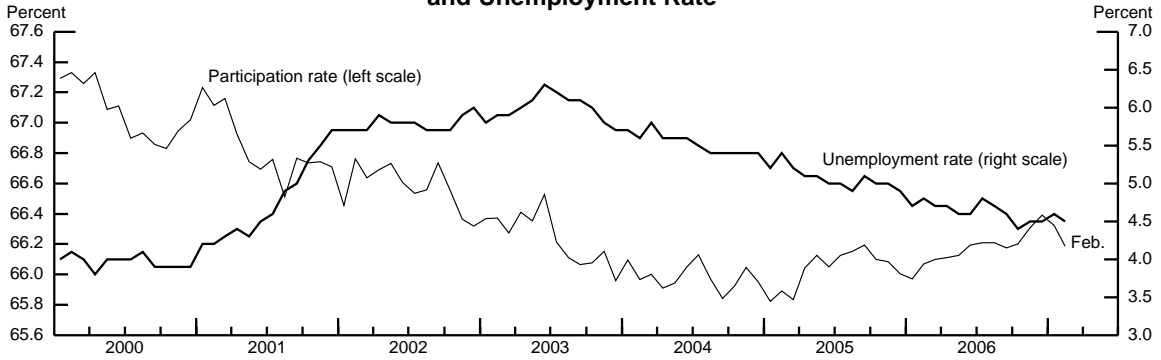


**Selected Unemployment and Labor Force Participation Rates**

(Percent; seasonally adjusted)

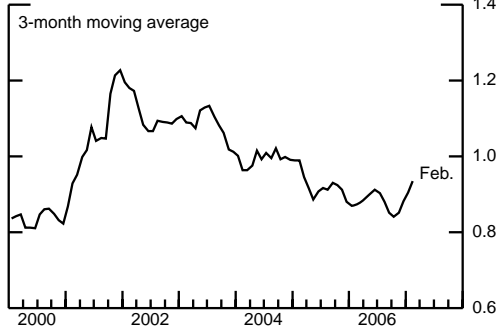
Rate and group	2006	2006				2007	
		Q2	Q3	Q4	Dec.	Jan.	Feb.
<i>Civilian unemployment rate</i>							
Total	4.6	4.7	4.7	4.5	4.5	4.6	4.5
Teenagers	15.4	14.8	16.1	15.1	15.2	15.0	14.9
20-24 years old	8.2	8.1	8.3	8.3	7.9	8.1	7.4
Men, 25 years and older	3.5	3.6	3.5	3.3	3.5	3.6	3.7
Women, 25 years and older	3.7	3.8	3.8	3.5	3.5	3.6	3.5
<i>Labor force participation rate</i>							
Total	66.2	66.1	66.2	66.3	66.4	66.3	66.2
Teenagers	43.6	43.8	43.5	43.4	43.4	42.8	42.2
20-24 years old	74.6	74.3	74.9	75.0	75.4	75.2	74.8
Men, 25 years and older	75.5	75.5	75.4	75.7	75.8	75.7	75.7
Women, 25 years and older	59.6	59.5	59.9	59.8	59.7	59.7	59.6

**Labor Force Participation Rate and Unemployment Rate**



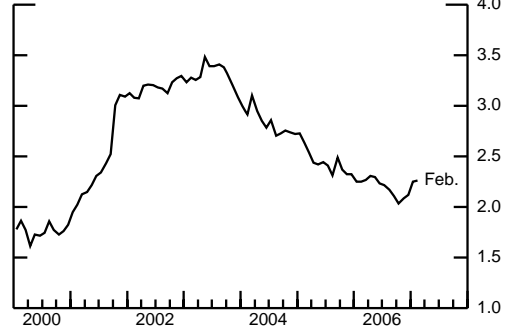
**Job Losers Unemployed Less Than 5 Weeks**

(as a percentage of household employment)



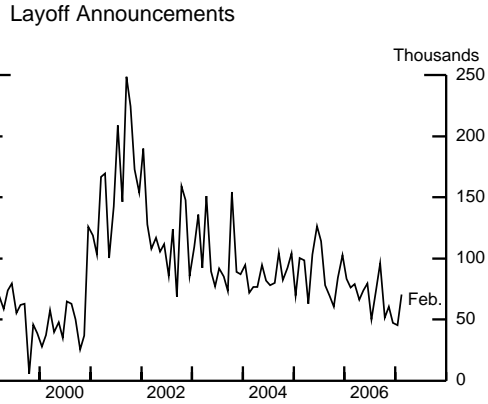
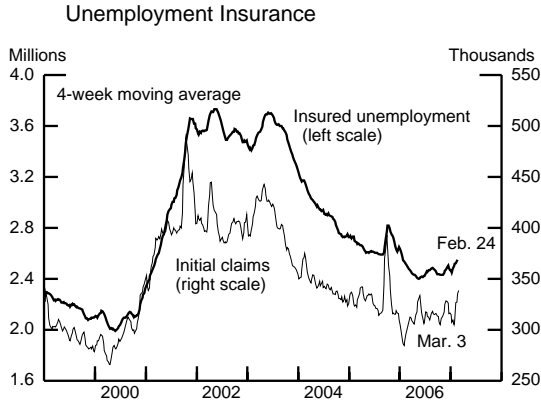
**Unemployed Job Losers**

(as a percent of the labor force)



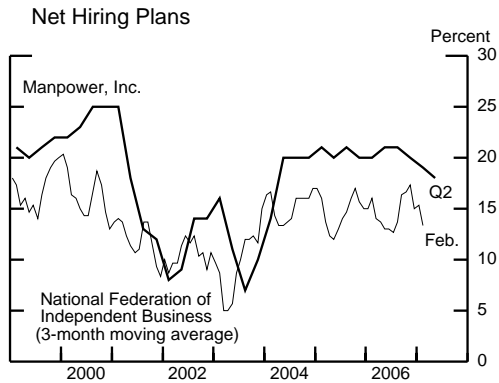
## Labor Market Indicators

### Layoffs

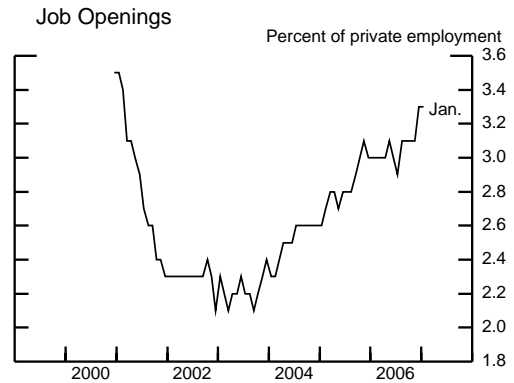


Note. Seasonally adjusted by FRB staff.  
Source. Challenger, Gray, and Christmas, Inc.

### Hiring

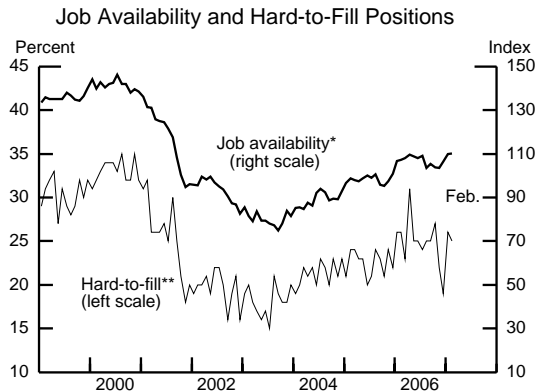


Note. Percent planning an increase in employment minus percent planning a reduction.



Source. Job Openings and Labor Turnover Survey.

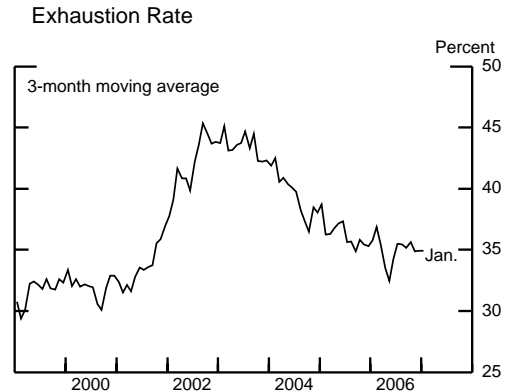
### Labor Market Tightness



\*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 1 "hard-to-fill" job opening.

Source. For job availability, Conference Board; for hard-to-fill, National Federation of Independent Business.



Note. The exhaustion rate is calculated as the number of individuals who were receiving unemployment insurance benefits but reached the end of their potential eligibility expressed as a percent of all individuals who began receiving such benefits 6 months earlier.



In the household survey, the unemployment rate edged down 0.1 percentage point in February to 4.5 percent—equal to the average level in the fourth quarter—and the labor force participation rate declined 0.1 percentage point, to 66.2 percent—a bit below the average level in the fourth quarter. Consistent with the apparent moderation in payroll employment, the number of job losers unemployed for less than 5 weeks as a percent of employment—a proxy for the layoff rate—has risen somewhat in recent months, and, as a result, the total number of unemployed job losers has also crept up.

Other indicators of labor demand have been mixed. The four-week moving average of initial claims for unemployment insurance has moved up recently and stood at 339,000 in the week ending March 3, slightly above the high end of the range seen over the past year. In addition, layoff announcements, as measured by Challenger, Gray, and Christmas, increased in February, although the level remained relatively low. Moreover, firms' hiring plans—as measured by Manpower and the National Federation of Independent Businesses (NFIB)—have edged down recently. In contrast, job openings, as reported by the Bureau of Labor Statistics, remained at a high level through the end of January.

Measures of labor market tightness have changed relatively little, on net, recently. According to the NFIB, 25 percent of firms reported that they had a hard-to-fill position in February, a share about equal to the average level in the second half of last year. Although the Conference Board survey of consumers indicates that jobs have become a bit easier to find in recent months, the number of individuals who remain on unemployment insurance rolls until their benefits expire (the exhaustion rate) has changed little of late.

The staff estimates that productivity in the nonfarm business sector rose at an annual rate of 1.7 percent in the fourth quarter. Over the past four quarters, output per hour increased 1.5 percent by our estimate— $\frac{1}{2}$  percentage point below the pace recorded during the preceding four quarters.<sup>2</sup>

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<sup>2</sup> These estimates reflect the BLS's recent incorporation of the benchmark revision to nonfarm payroll employment into its estimates of nonfarm business productivity. The benchmark revision resulted in downward revisions to productivity growth of about  $\frac{1}{2}$  percentage point over the four quarters of 2005 and  $\frac{1}{4}$  percentage point over the four quarters of 2006.

### Output per Hour

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

Sector	2004:Q4 to 2005:Q4	2005:Q4 to 2006:Q4	2006			
			Q1	Q2	Q3	Q4
Nonfarm business						
All persons	2.1	1.5 <sup>1</sup>	3.5	1.2	-.5	1.7 <sup>1</sup>
All employees <sup>2</sup>	1.6	1.7 <sup>1</sup>	4.5	.9	-.2	1.4 <sup>1</sup>
Nonfinancial corporations <sup>3</sup>	1.8	n.a.	10.4	-4.4	4.1	n.a.

1. Staff estimates.

2. Assumes that the growth rate of hours of non-employees equals the growth rate of hours of employees.

3. All corporations doing business in the United States except banks, stock and commodity brokers, and finance and insurance companies. The sector accounts for about two-thirds of business employment. Nonfinancial corporate output is calculated as an income-side measure.

### Industrial Production

After a decline of ½ percent in January, the available data suggest that total industrial production (IP) rose solidly in February, in part because of transitory factors. Production last month was boosted by a temporary surge in output at utilities, reflecting the sizable swing in temperatures from a moderately warm January to a cold February, and by a bounceback in motor vehicle assemblies from a steep decline in January. Manufacturing output outside motor vehicles and parts appears to have risen moderately in February after having fallen in January and in the fourth quarter of last year. Capacity utilization in manufacturing, which stood 0.2 percentage point below its 1972-2006 average in January, likely rose in February, but remained a good bit below its recent peak in August of last year.<sup>3</sup>

Production cutbacks at motor vehicle manufacturers and in upstream industries related to construction and motor vehicles account for a substantial share of the weakness in IP during the past six months. More recently, however, the softness has spread to some areas of business equipment and to some areas of non-auto consumer goods. Meanwhile,

<sup>3</sup> The initial estimates of industrial capacity for 2007 were published last month. Total industrial capacity is projected to rise 2.1 percent in 2007 after having expanded 2.4 percent in 2006. Manufacturing capacity, which is estimated to increase 2.4 percent this year, is also likely to decelerate relative to 2006. Motor vehicle assembly plants at Ford and GM that are currently idled or slated to be idled have been removed from our capacity estimates and account for the slower rise in capacity this year. Excluding motor vehicles and parts, manufacturing capacity is estimated to increase slightly faster in 2007 than in 2006. Mining capacity is projected to increase 0.7 percent in 2007, about the same as in 2006, while capacity at utilities is expected to increase 1.3 percent, rising more slowly than last year.

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

Component	Proportion 2006 (percent)	2006 <sup>1</sup>	2006		2006		2007
			Q3	Q4	Nov.	Dec.	Jan.
			Annual rate		Monthly rate		
<b>Total</b>	<b>100.0</b>	<b>3.7</b>	<b>4.0</b>	<b>-8</b>	<b>-1</b>	<b>.5</b>	<b>-5</b>
Previous	100.0	3.7	4.0	-5	-1	.4	...
Manufacturing	81.8	3.4	4.4	-1.7	-1	.8	-7
Ex. motor veh. and parts	76.3	3.9	5.5	-1.5	-3	.8	-4
Ex. high-tech industries	71.4	2.5	4.0	-3.3	-4	.7	-5
Mining	8.6	7.9	.6	2.5	-2	1.4	-1.2
Utilities	9.6	2.3	4.6	4.2	-5	-2.7	2.3
<i>Selected industries</i>							
High technology	4.8	24.7	27.3	25.3	.9	1.4	1.7
Computers	1.2	12.9	2.3	27.9	2.0	2.8	2.0
Communications equipment	1.1	13.9	6.6	6.3	.8	.6	2.4
Semiconductors <sup>2</sup>	2.6	35.1	51.3	32.2	.4	1.2	1.2
Motor vehicles and parts	5.5	-3.7	-9.8	-3.9	3.5	1.8	-6.0
<i>Market groups excluding energy and selected industries</i>							
Consumer goods	20.9	1.5	2.7	.7	-1	.1	-5
Durables	4.0	-2.0	1.5	-8.0	-7	1.0	-5
Nondurables	16.9	2.4	3.0	2.9	.1	-1	-5
Business equipment	7.8	10.2	13.0	4.1	.5	2.5	-1.6
Defense and space equipment	1.7	2.0	5.5	-3.5	-1.2	.3	1.2
Construction supplies	4.5	-2.3	-1.0	-9.5	-1.0	1.8	-1.1
Business supplies	7.9	1.0	-.3	-1.8	.0	.3	-5
Materials	26.1	2.4	2.3	-6.8	-1.0	.6	-8
Durables	14.5	2.3	2.3	-8.5	-1.2	.6	-7
Nondurables	11.6	2.5	2.3	-4.6	-6	.7	-8

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

2. Includes related electronic components.

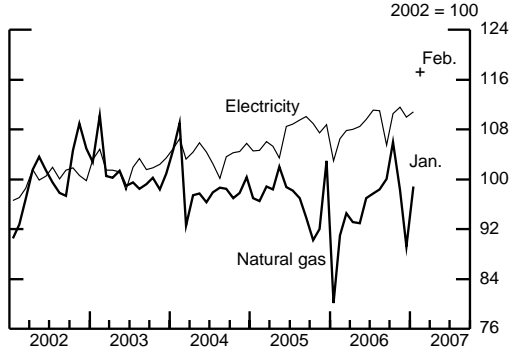
... Not applicable.

**Capacity Utilization**  
(Percent of capacity)

Sector	1972- 2006 average	1994- 95 high	2001- 02 low	2006				2007
				Q2	Q3	Q4	Dec.	Jan.
<b>Total industry</b>	<b>81.0</b>	<b>85.1</b>	<b>73.6</b>	<b>82.0</b>	<b>82.3</b>	<b>81.7</b>	<b>81.8</b>	<b>81.2</b>
Manufacturing	79.8	84.6	71.6	80.6	80.9	80.1	80.4	79.6
Ex. motor veh. and parts	79.9	84.3	71.4	80.8	81.4	80.5	80.7	80.2
Mining	87.4	88.9	84.8	91.0	90.9	91.2	91.9	90.8
Utilities	86.7	93.7	83.8	85.9	86.4	86.7	84.8	86.6
<i>Stage-of-process groups</i>								
Crude	86.5	89.5	82.0	88.8	89.4	89.1	89.4	88.5
Primary and semifinished	82.2	88.2	74.6	83.9	84.1	82.8	82.5	82.4
Finished	77.8	80.5	70.0	77.6	77.9	78.1	78.6	77.6

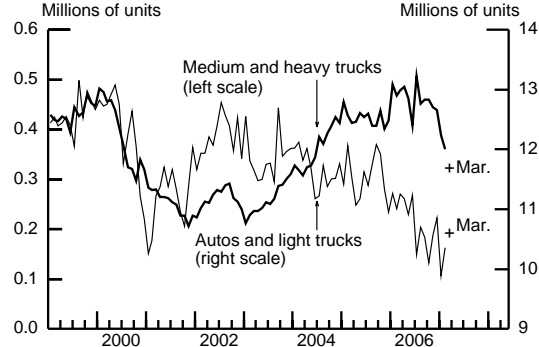
### Indicators of Industrial Activity

Utilities Output



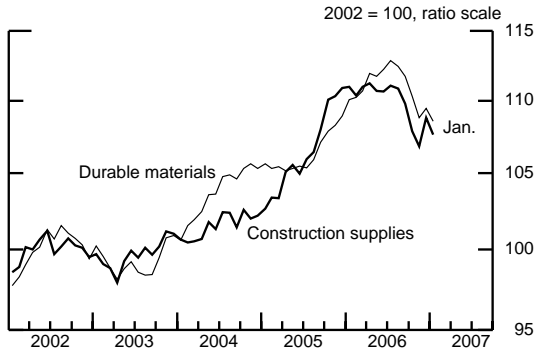
Note. February value for electricity generation is based on weekly data.

Motor Vehicle Assemblies



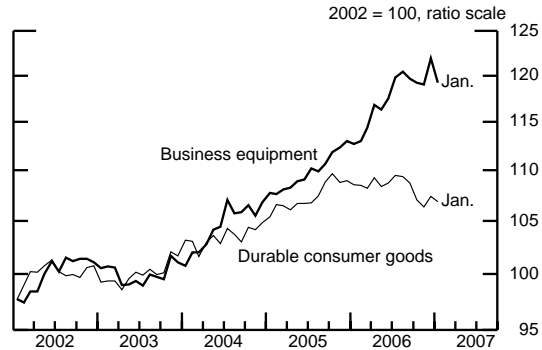
Note. March values are based on latest industry schedules.

IP: Construction Supplies and Durable Materials



Note. Data exclude motor vehicle parts, high-tech, and aircraft parts industries.

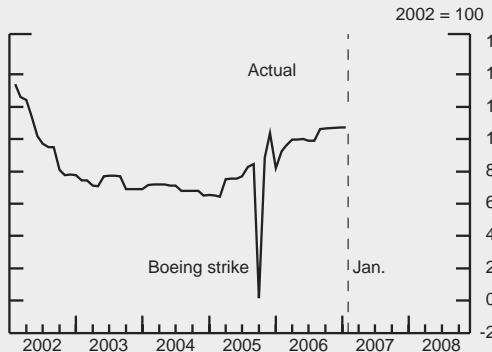
IP: Equipment and Consumer Goods



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

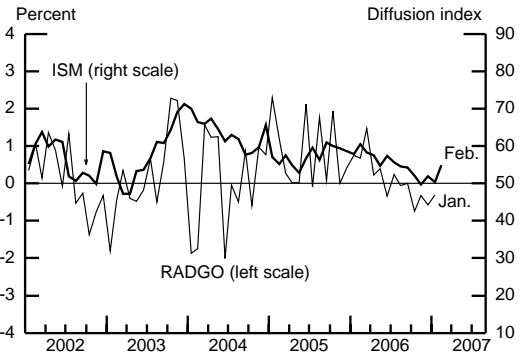
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Boeing Commercial Aircraft Completions: Actual



Note. 1998 price-weighted index. Actual completions equal deliveries plus the change in the stock of finished aircraft.

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.

the output of commercial aircraft and of high-tech products has continued to boost IP, though by less than it had in the middle of 2006.

The assembly rate for light motor vehicles—after having dropped to an annual rate of 9.9 million units in January—rose to a rate of 10.4 million units in February. This rebound brought the February pace of assemblies only back to the average rate over the second half of 2006—a period during which producers had sharply curtailed output. Such low assembly rates have enabled automakers to continue to reduce dealer inventories relative to sales, which at the end of February stood at an estimated 65 days, roughly their preferred level. Assemblies of medium and heavy trucks declined further in February after having plunged about 20 percent in January, reflecting payback for last year’s surge in demand ahead of EPA’s tightening of engine regulations at the beginning of this year. Overall motor vehicle assemblies are scheduled to rise somewhat in March and then rise sharply in the second quarter.

Output in high-technology industries appears to have increased at a solid pace in February after four months in which production rose at a moderate rate. Semiconductor production picked up in February after having decelerated around the turn of the year across a wide variety of chip types. Although inventories had risen relative to sales for a broad group of chipmakers in the fourth quarter (the latest available data), a large share of that increase likely reflected stockbuilding in anticipation of the new Windows Vista operating system. Thus, if Vista sales unfold as producers expect, the inventory situation is unlikely to hold back chip production significantly in coming months.

In the computer sector, weekly data from the market-tracking firm NPD suggest that retail PC sales have surged since the January 31 release of Windows Vista.<sup>4</sup> The output of computers for business use has been boosted by rapid production gains for high-end servers, but demand for small servers has been relatively tepid. Communications equipment output jumped in January after having slowed in the fourth quarter. The guidance for 2007 in recent quarterly reports for the major telecommunications service

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<sup>4</sup> Early reports suggest that the mix of PC demand has shifted to higher-end machines in conjunction with the release of Vista. At the same time, NPD reports that unit sales of the stand-alone version of Vista were 60 percent lower in the week after its release, compared with sales of Windows XP in the week after its initial release in 2001. The jump in PC sales in the past few weeks, combined with the lackluster box sales of Vista, likely reflects the demands on computer processing power by the new operating system; these demands apparently are inducing a larger share of consumers to purchase a new computer than did Windows XP.

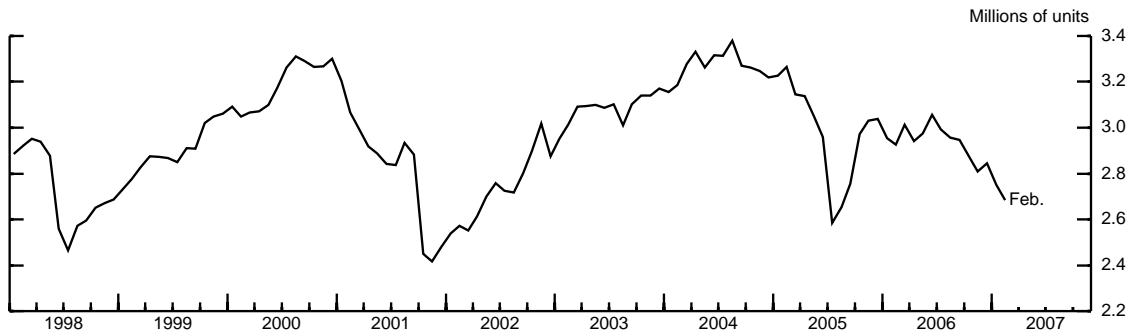
**Production of Domestic Light Vehicles**  
(Millions of units at an annual rate except as noted)

Item	2006		2007					
	Q3	Q4	Q1	Q2	Jan.	Feb.	Mar.	Apr.
U.S. production <sup>1</sup>	10.5	10.5	10.3	11.0	9.9	10.4	10.6	11.1
Autos	4.3	4.4	4.0	4.2	4.1	3.9	3.9	4.1
Light trucks	6.2	6.1	6.3	6.8	5.8	6.5	6.7	7.0
Days' supply <sup>2</sup>	70	70	n.a.	n.a.	66	65	n.a.	n.a.
Autos	54	60	n.a.	n.a.	61	62	n.a.	n.a.
Light trucks	82	77	n.a.	n.a.	70	66	n.a.	n.a.
Inventories <sup>3</sup>	2.95	2.84	n.a.	n.a.	2.75	2.68	n.a.	n.a.
Autos	.95	1.03	n.a.	n.a.	1.03	1.02	n.a.	n.a.
Light trucks	1.99	1.81	n.a.	n.a.	1.72	1.66	n.a.	n.a.
Memo: U.S. production, total motor vehicles <sup>4</sup>	11.0	11.0	10.6	11.3	10.3	10.7	10.9	11.4

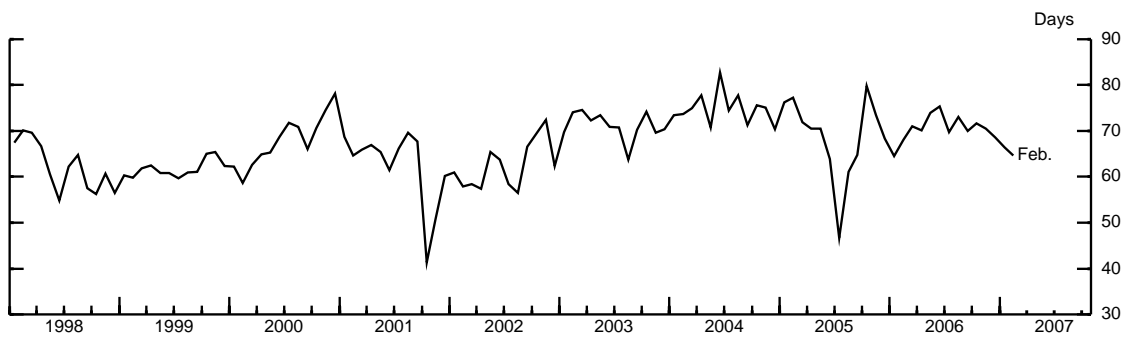
Note. FRB seasonals. Components may not sum to totals because of rounding.

1. Production rates for the first and second quarters reflect the latest industry schedules.
  2. Quarterly values are calculated with end-of-period stocks and average reported sales.
  3. End-of-period stocks.
  4. Includes medium and heavy trucks.
- n.a. Not available.

**Inventories of Light Vehicles**

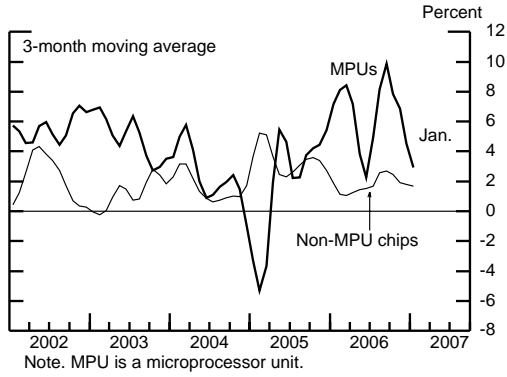


**Days' Supply of Light Vehicles**

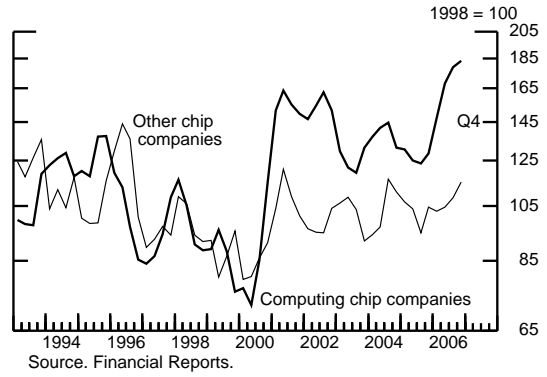


## Indicators of High-Tech Manufacturing Activity

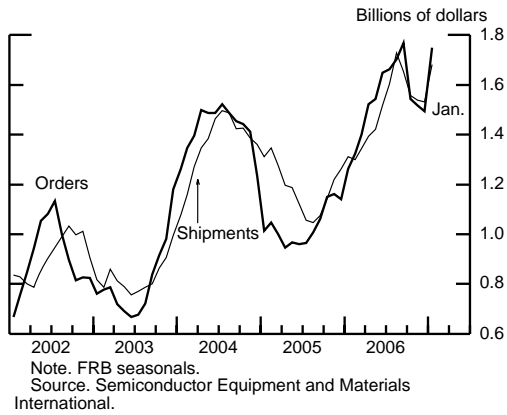
Rate of Change in Semiconductor Industrial Production



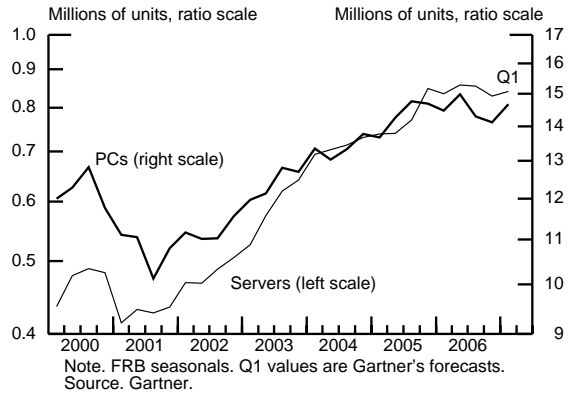
Day's Supply at Major Semiconductor Companies



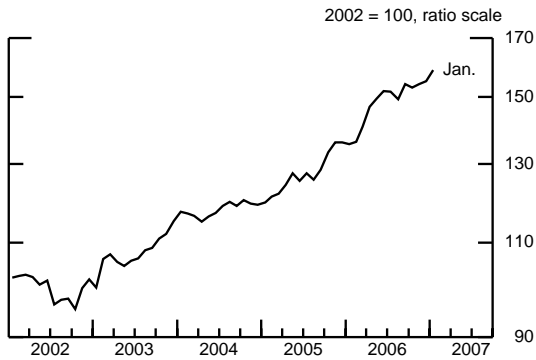
Bookings and Billings for Semiconductor Equipment



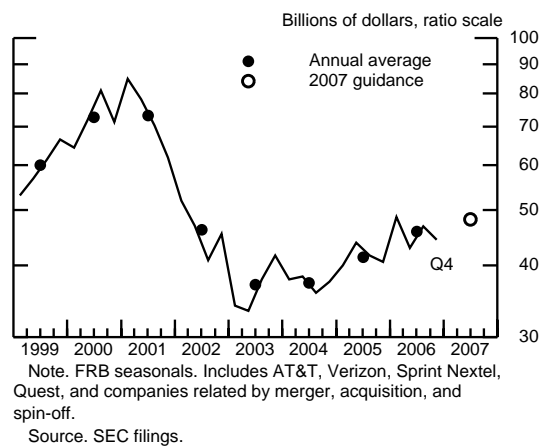
U.S. Personal Computer and Server Sales



IP: Communications Equipment



Capital Expenditures by Selected Telecommunications Service Providers



providers (TSPs) points to continued capital spending gains this year, although somewhat smaller than those in the past two years.

Outside of energy, high-tech, and motor vehicles and parts, industrial production fell sharply in the fourth quarter and appears to have fallen further, on balance, in the first two months of 2007. In addition to the significantly reduced demand from industries related to homebuilding and motor vehicles, output also has been damped by attempts to bring down elevated inventories in some upstream sectors such as wood products, non-metallic mineral products, and fabricated metal products. Moreover, the weakness appears to have seeped into the production of business equipment, such as industrial equipment and machine tools, as well as the production of non-auto consumer durables, such as furniture and appliances. However, with inventories of cars and light trucks now in better balance and assemblies scheduled to rise in the second quarter, the drag on the output of industries upstream to motor vehicles should begin to diminish.

Near-term indicators of manufacturing activity are generally favorable. For example, the diffusion index for new orders from the Institute for Supply Management (ISM) increased in February to a level consistent with moderate gains in manufacturing output; the new orders indexes from the regional Federal Reserve surveys also turned up, on balance, in February. In contrast, the three-month moving average of the staff's series on real adjusted durable goods orders fell  $\frac{1}{4}$  percent in January; excluding high-tech industries, the measure fell  $\frac{3}{4}$  percent, its sixth consecutive monthly decline.

### **Light Motor Vehicles**

Although sales of light motor vehicles declined 200,000 units (annual rate) in February to a 16.5 million unit rate, this pace was still somewhat above that set in the fourth quarter of last year. Auto sales more than accounted for February's decline,

. In contrast, sales of light trucks ticked up last month; the increase was concentrated at General Motors and Ford and helped the Big Three automakers boost their domestic market share for the first time since October of last year.

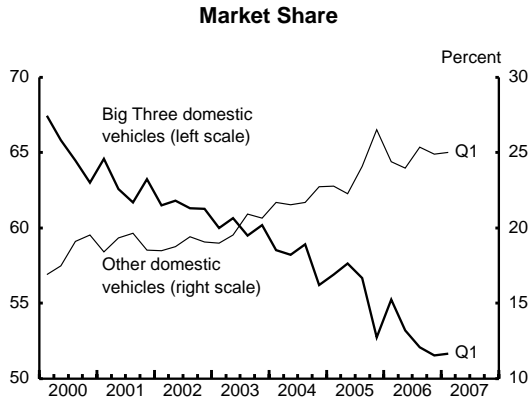
Although both the Reuters/University of Michigan index of car-buying attitudes and the Conference Board measure of new car purchase plans edged down in February, they remain within the ranges seen in recent months. And, so far this month, sales by the major transplants suggest that total purchases of light motor vehicles in March will be close to February's pace. Accordingly, with demand well maintained, manufacturers'



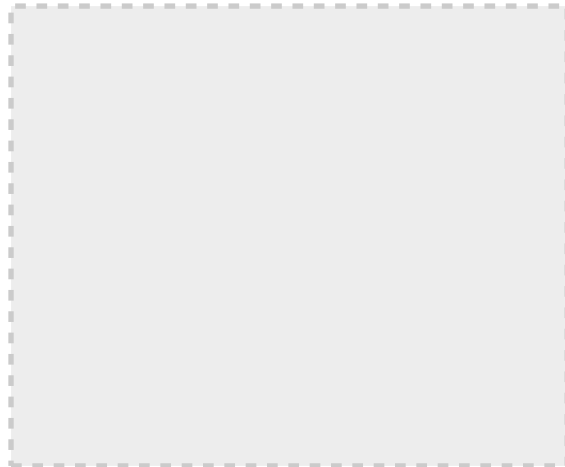
**Sales of Light Vehicles**  
(Millions of units at an annual rate; FRB seasonals)

Category	2006	2006				2007	
		Q2	Q3	Q4	Dec.	Jan.	Feb.
Total	16.5	16.3	16.6	16.3	16.7	16.7	16.5
Autos	7.8	7.8	7.9	7.6	8.1	7.7	7.4
Light trucks	8.7	8.5	8.7	8.7	8.6	9.0	9.1
North American <sup>1</sup>	12.8	12.6	12.8	12.4	12.7	12.7	12.7
Autos	5.4	5.4	5.4	5.2	5.6	5.2	5.1
Light trucks	7.4	7.1	7.4	7.2	7.2	7.5	7.7
Foreign-produced	3.7	3.7	3.7	3.8	4.0	4.0	3.8
Autos	2.3	2.4	2.5	2.4	2.5	2.5	2.4
Light trucks	1.3	1.3	1.3	1.5	1.4	1.5	1.4
Memo: Big Three domestic market share (percent) <sup>2</sup>	53.7	53.9	52.8	52.3	51.2	51.2	53.4

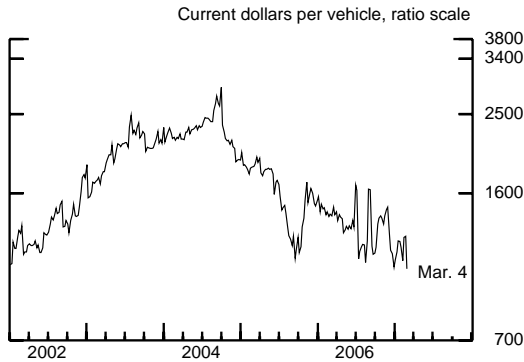
Note. Components may not sum to totals because of rounding.  
 1. Excludes some vehicles produced in Canada that are classified as imports by the industry.  
 2. Domestic market share excludes sales of foreign brands affiliated with the Big Three.



Note. The first quarter averages are calculated using January and February values.

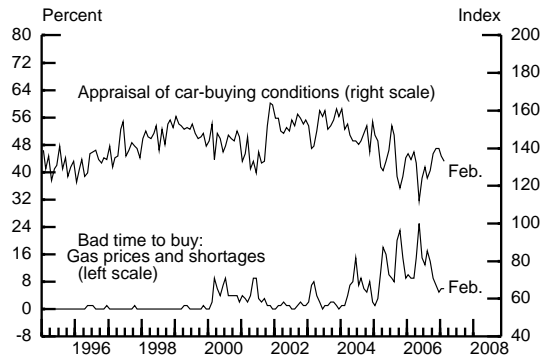


**Average Value of Incentives on Light Vehicles**



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

**Car-Buying Attitudes**



Source. Reuters/University of Michigan Survey.

pricing incentives seem likely to hold at a relatively low level in March, as they did in January and February.

### **Consumer Spending**

Real PCE appears on track to rise at a robust pace in the first quarter. In part, the recent strength of spending reflected January's jump in sales of light motor vehicles as well as a weather-related surge in spending on energy services. Outside of these areas, the pace of real spending has moderated since the turn of the year. In particular, nominal outlays for goods in the retail control group of stores, which excludes purchases at outlets selling motor vehicles and building materials and supplies, were about unchanged in February following a modest increase in January. After factoring in our projection for consumer prices, we estimate that real PCE control was down a touch, on net, over the first two months of the year after brisk gains in the previous four months. In contrast, real spending on non-energy services was solid in January, the most recent month for which data are available, boosted by robust outlays for medical services.

The determinants of consumer spending have been mixed. On the basis of unemployment insurance tax records, the Bureau of Economic Analysis (BEA) now estimates that real disposable personal income (DPI) rose at an annual rate of 3¼ percent in the third quarter of last year, about 1 percentage point below its earlier estimate. The BEA estimates that real DPI picked up in the fourth quarter and then jumped in January. A number of special factors, such as the annual pay raise to federal civilian and military personnel and cost-of-living adjustments to Social Security benefits and other transfer programs, resulted in a step-up in the level of DPI in January that is expected to persist. In addition, the BEA estimated that bonus payments and stock option exercises were unusually large; with this temporary boost to income, the saving rate rose ¼ percentage point to negative 1¼ percent in January. The latest readings on consumer sentiment have been generally favorable, and consumer spending has continued to draw support from the increases in household wealth that have occurred over the past two years. However, the boost to consumer spending from wealth has likely been muted to some extent by the lagged effects of the upward trend in borrowing costs over the past few years. In addition, the recent downturn in equity prices along with indications of slower home price appreciation point to a modest decline in the wealth-income ratio for the household sector this quarter.

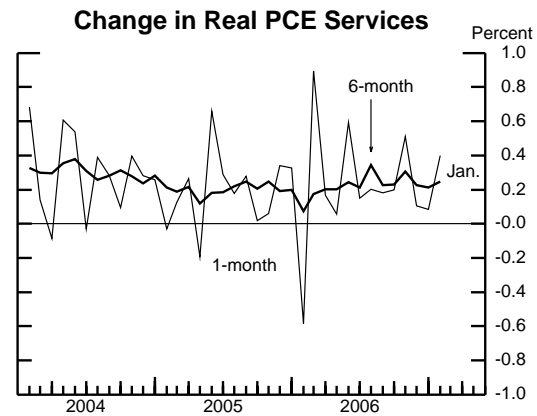
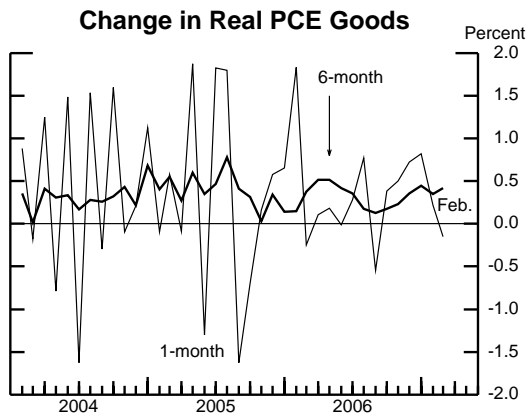
**Retail and Food Services Sales**

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

Category	2006				2007	
	Q2	Q3	Q4	Dec.	Jan.	Feb.
	Annual rate			Monthly rate		
Total sales	3.1	3.7	.3	1.2	.0	.1
Retail control <sup>1</sup>	7.8	3.7	-.7	1.3	.2	.0
Ex. sales at gasoline stations	4.6	5.6	4.7	.9	.3	-.2
Memo:						
Real PCE control <sup>2</sup>	1.0	1.9	7.0	.8	.0	-.2

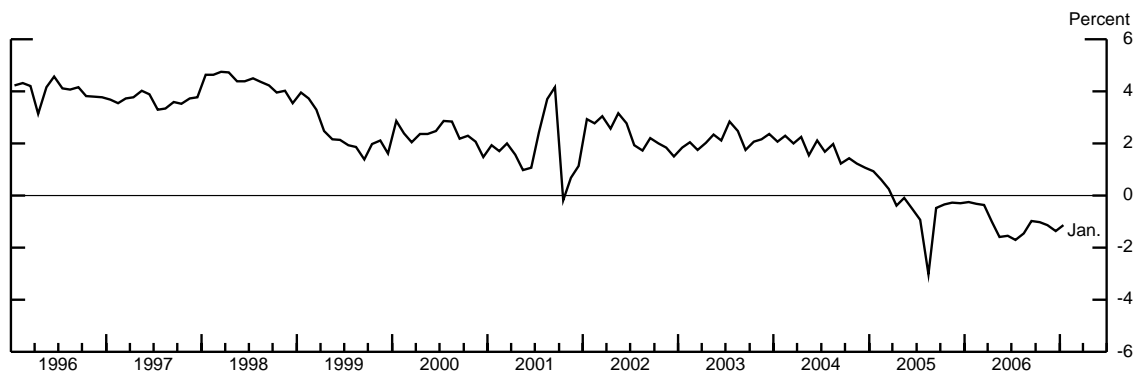
1. Total sales less outlays at building material and supply stores and automobile and other motor vehicle dealers.

2. Total goods spending excluding autos and trucks. The values for December and January are staff estimates. The value for February is a staff forecast.



Note. Values for December and January are staff estimates. Value for February is a staff forecast.

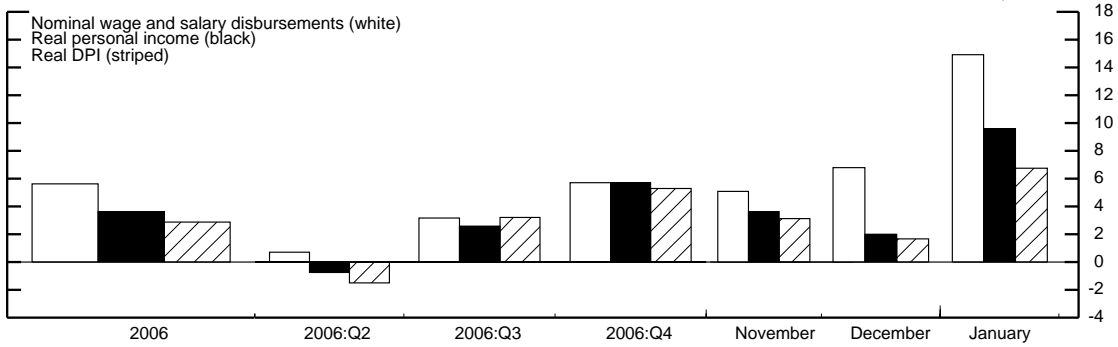
**Personal Saving Rate**



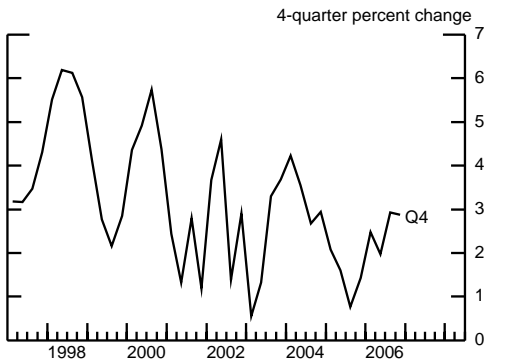
Note. Value for December 2004 excludes the effect on income of the special Microsoft dividend in that month.

## Fundamentals of Household Spending

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

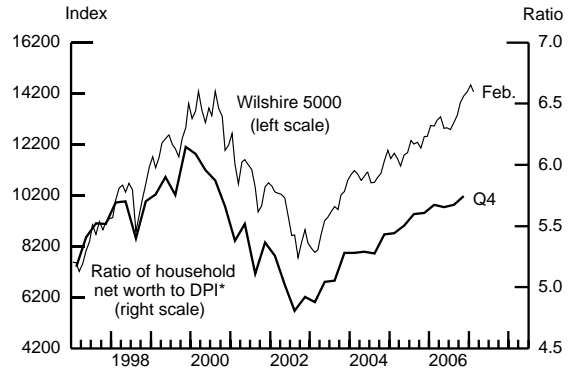


Change in Real DPI



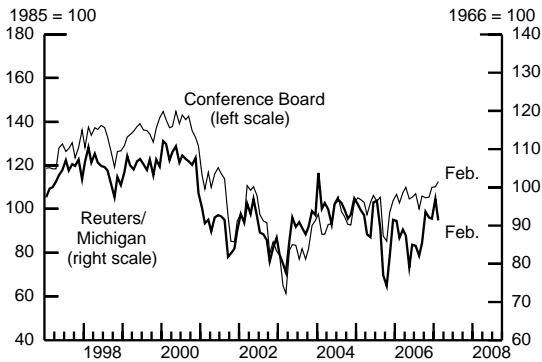
Note. Values for 2004:Q4 and 2005:Q4 exclude the effect on income of the one-time Microsoft dividend in December 2004.

Household Net Worth and Wilshire 5000

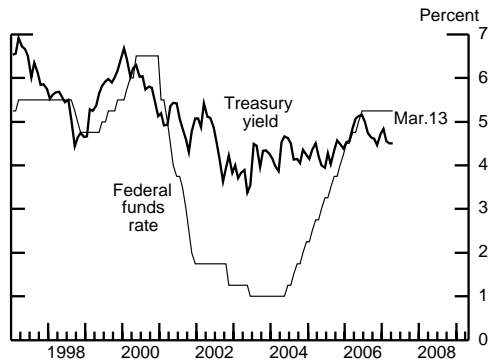


\* The value for 2004:Q4 excludes the effect on income of the one-time Microsoft dividend in December 2004.

Consumer Confidence



Federal Funds Rate and 10-Year Treasury Yield



**Housing**

Although data through January suggest that housing demand has stabilized since last summer, construction of new homes continued to decline as builders have tried to work off an elevated level of inventories. In addition, an apparent tightening of standards for nonprime borrowers in recent weeks will likely restrain home sales.

Single-family housing starts tumbled 11 percent in January while starts in the much smaller multifamily sector dropped 25 percent. These January declines followed weather-related spikes in activity in December, when unseasonably warm weather likely allowed homebuilders to begin some construction projects earlier than planned. However, adjusted permit issuance in the single-family sector—a more reliable indicator of the underlying pace of construction activity—also moved down 6 percent in January, leaving the level of permits 5 percent below the fourth-quarter average.

In contrast to construction, home sales have changed little, on net, in recent months. In January, sales of existing single-family homes rose 3½ percent to an annual rate of 5.7 million units, their first noticeable increase since February 2006.<sup>5</sup> And although sales of new homes fell in January, this drop followed a surge in December; smoothing through these swings, the average pace of new home sales in December and January was in line with the pace since mid-2006.

A number of other indicators are also consistent with relatively stable home sales through February. The index of pending home sales—a predictor of future sales of existing homes—has changed little since July after having fallen sharply over the preceding twelve months; the four-week moving average of the index of mortgage purchase applications stopped trending down around the same time. In addition, the Reuters/University of Michigan index of homebuying sentiment has risen a fair bit since September. These improved conditions are, in part, the result of a decline in mortgage rates: Despite an uptick in rates during the first two months of the year, the average rate for thirty-year fixed-rate mortgages is currently about 60 basis points below the level of last July. Average rates for one-year adjustable-rate mortgages are about 30 basis points lower. However, rising delinquencies among nonprime borrowers and related financial

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<sup>5</sup> New home sales are recorded at signing, while existing home sales are recorded when they close. Because of the typical lag between signing and closing, January's increase in existing home sales may be related to December's favorable weather. However, weather patterns and existing home sales have no statistically reliable relationship.

**Private Housing Activity**

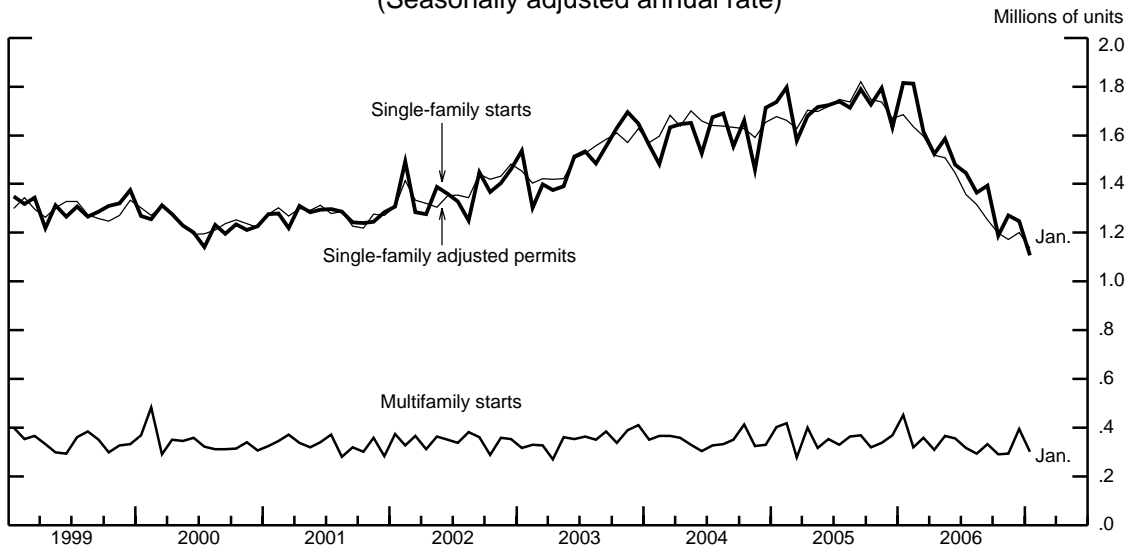
(Millions of units, seasonally adjusted; annual rate except as noted)

Sector	2006	2006				2007
		Q3	Q4	Nov.	Dec.	Jan.
<i>All units</i>						
Starts	1.80	1.71	1.56	1.57	1.64	1.41
Permits	1.84	1.71	1.56	1.51	1.61	1.57
<i>Single-family units</i>						
Starts	1.47	1.40	1.24	1.27	1.25	1.11
Permits	1.38	1.28	1.17	1.15	1.17	1.12
Adjusted permits <sup>1</sup>	1.41	1.31	1.19	1.17	1.20	1.14
Permit backlog <sup>2</sup>	.133	.137	.133	.137	.133	.137
New homes						
Sales	1.06	1.01	1.04	1.03	1.12	.94
Months' supply <sup>3</sup>	6.26	6.76	6.31	6.32	5.74	6.86
Existing homes						
Sales	5.68	5.50	5.50	5.49	5.50	5.69
Months' supply <sup>3</sup>	6.36	6.89	6.92	6.93	6.85	6.99
<i>Multifamily units</i>						
Starts	.336	.313	.327	.294	.395	.300
Permits	.457	.433	.394	.363	.445	.447
Permit backlog <sup>2</sup>	.062	.067	.062	.066	.062	.064
<i>Mobile homes</i>						
Shipments	.117	.107	.097	.096	.097	.094
<i>Condos and co-ops</i>						
Existing home sales	.801	.789	.759	.756	.768	.767

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

**Private Housing Starts and Permits**

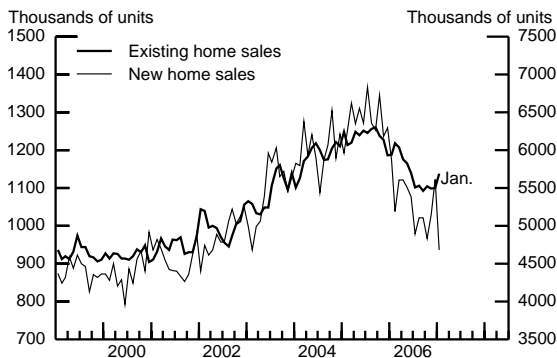
(Seasonally adjusted annual rate)



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

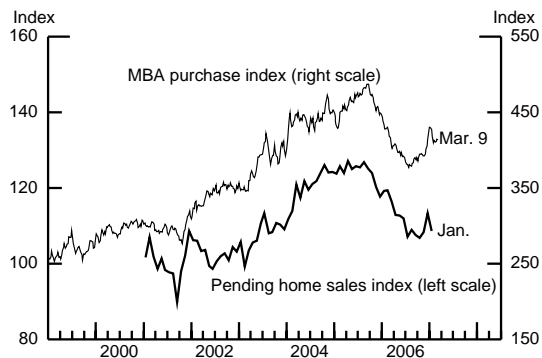
## Indicators of Single-Family Housing

### Home Sales



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

### Homebuying Indicators



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

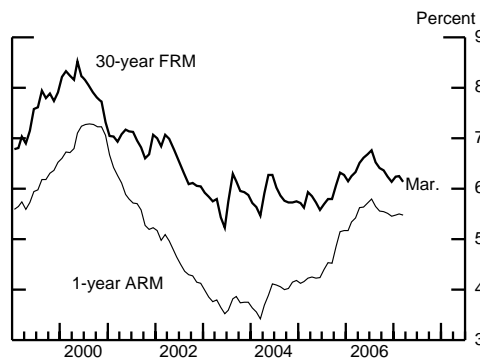
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### New Home Sales Months' Supply



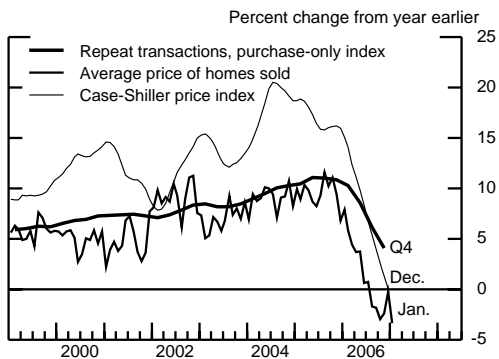
Note. supply is calculated using the 3-month moving average of sales.  
Source. ; for months' supply, Census Bureau.

### Mortgage Rates



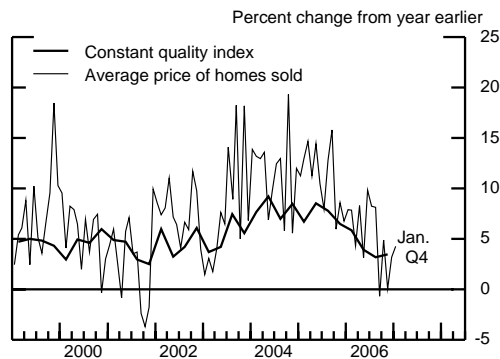
Note. The March readings are based on data through March 7, 2007.  
Source. Freddie Mac.

### Prices of Existing Homes



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

### Prices of New Homes



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

difficulties for nonprime lenders in recent weeks have led to tighter lending standards in this sector, which will likely act as a drag on home sales going forward.

The continued cuts in new residential construction in recent months appear to have begun to make a dent in builders' excess inventory of unsold new homes. Still, months' supply in January was about 30 percent above the high end of the relatively narrow range it occupied from 1997 to 2005.

.<sup>6</sup>

House-price appreciation has slowed markedly in recent quarters, with some measures showing outright declines recently. The purchase-only version of the price index for existing homes calculated by the Office of Federal Housing Enterprise Oversight (OFHEO) increased 4.1 percent over the four quarters of 2006, continuing the deceleration that began in mid-2005. The Case-Shiller home-price index—which uses a methodology similar to that for the OFHEO index but covers only ten large U.S. cities—was flat in the year ending in December. Meanwhile, the average price of existing homes sold (which is available on a more timely basis than the other price measures) moved down in January to a level that was 3 percent below that of a year earlier. However, because this measure does not adjust for changes in the average characteristics of homes sold, these declines might reflect a shift in the composition of sales away from higher-end homes. For new homes, the average price on a constant-quality basis was 3½ percent above year-earlier levels in the fourth quarter, a slower rate of increase than in the preceding three years. These figures may understate the actual deceleration in the cost to purchasers because homebuilders may have stepped up their use of a variety of non-price measures—such as granting more-favorable mortgage terms, paying closing costs, and including optional upgrades at no cost—to bolster sales and unload inventory.

### **Equipment and Software**

Real spending on equipment and software has weakened of late. In the fourth quarter, spending declined at an annual rate of 3½ percent, and in January, nominal orders and shipments of nondefense capital goods excluding aircraft posted widespread declines. Although much of the recent weakness has stemmed from the transportation equipment category, business investment in capital goods outside of transportation and high-tech has



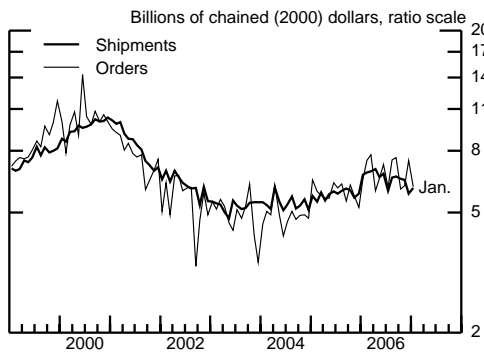
**Orders and Shipments of Nondefense Capital Goods**

(Percent change; seasonally adjusted current dollars)

Category	2006				2007
	Q3	Q4	Nov.	Dec.	Jan.
	Annual rate		Monthly rate		
Shipments	9.9	-4.0	1.8	-.7	-1.5
Excluding aircraft	6.9	-4.0	2.1	-.6	-2.8
Computers and peripherals	25.6	-36.0	35.8	-2.8	-2.7
Communications equipment	-21.7	-7.4	-.6	-10.0	4.9
All other categories	8.3	1.3	-.8	.6	-3.5
Orders	27.2	5.3	-.3	10.8	-20.2
Excluding aircraft	14.6	-4.2	-1.0	4.0	-6.3
Computers and peripherals	24.3	-31.1	36.8	-3.4	-5.0
Communications equipment	35.7	-26.3	2.6	20.9	-17.9
All other categories	11.4	2.4	-4.7	3.3	-5.2
Memo: Shipments of complete aircraft <sup>1</sup>	34.8	33.2	34.2	31.0	43.1

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

**Communications Equipment**



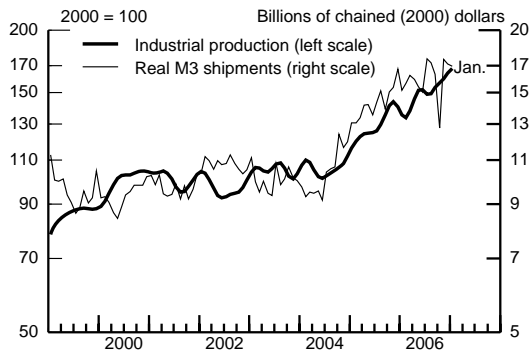
Note. Shipments and orders are deflated by a price index that is derived from the BEA's quality-adjusted price indexes and uses the PPI for communications equipment for monthly interpolation.

**Non-High-Tech, Nontransportation Equipment**



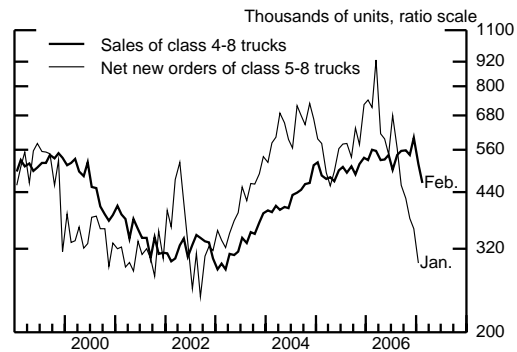
Note. Shipments and orders are deflated by the staff price indexes for the individual equipment types included in this category. Indexes are derived from the BEA's quality-adjusted price indexes.

**Computers and Peripherals**



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

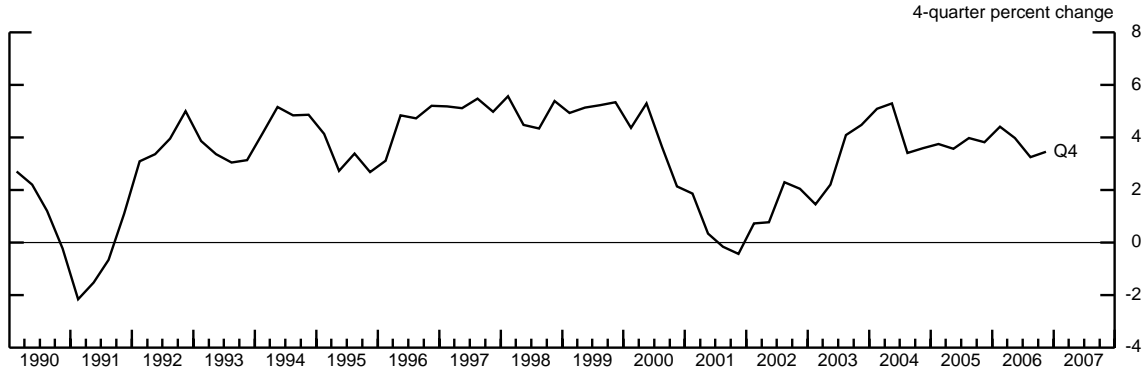
**Medium and Heavy Trucks**



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

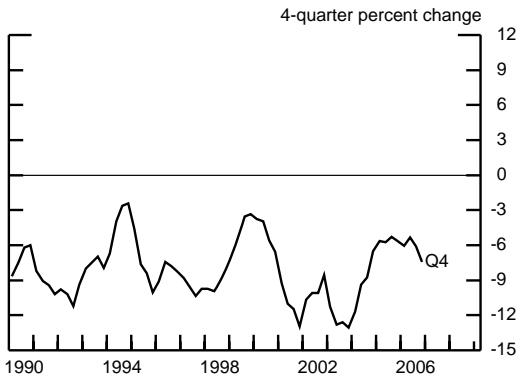
## Fundamentals of Equipment and Software Investment

Real Business Output

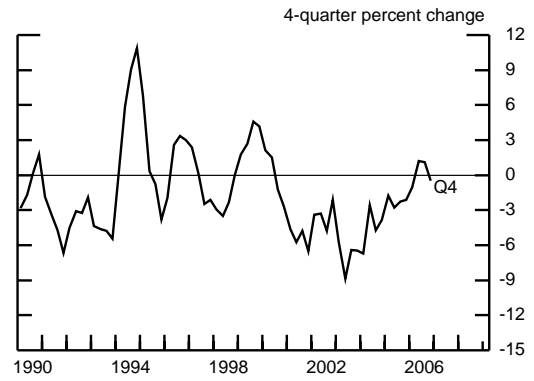


### User Cost of Capital

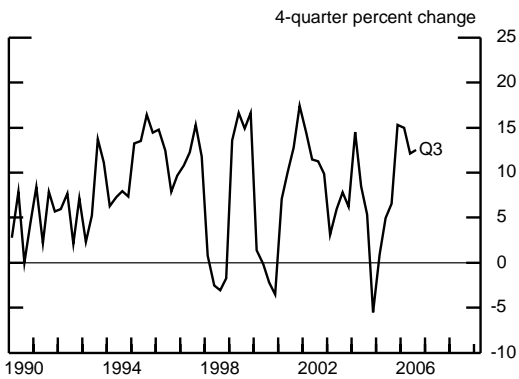
High-Tech



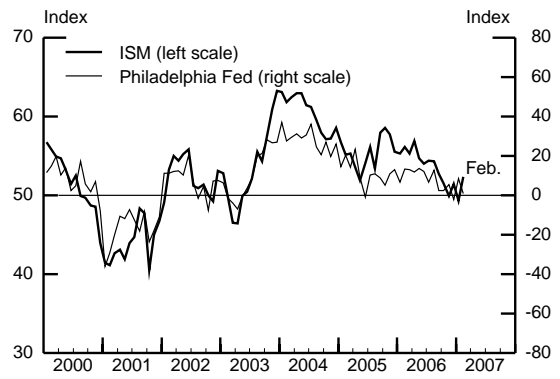
Non-High-Tech



Real Corporate Cash Flow



Business Conditions



Source. Manufacturing ISM Report on Business;  
Philadelphia Fed Business Outlook Survey.

also softened considerably. The slowdown in equipment and software spending has exceeded that suggested by its fundamental determinants. In particular, although the modest deceleration of business output in the second half of last year and the deterioration in many surveys of business conditions are consistent with some slowing in spending growth, ongoing declines in the user cost for high-tech capital goods and the ample cash reserves held by firms remain supportive of investment.

Business outlays on transportation equipment fell noticeably in the fourth quarter. In the first two months of this quarter, business purchases of light vehicles have remained low, compared with the levels seen in recent years, and new orders and deliveries of medium and heavy trucks (classes 4 to 8) have plunged in recent months.<sup>7</sup> In contrast, data on shipments of domestic aircraft in January and February suggest that business purchases of aircraft will rebound in the current quarter after declines in the past three quarters.

Real spending on high-tech equipment and software was subpar last quarter, but available data for the current quarter point to a more solid increase. Although computer shipments fell in January, imports surged, suggesting rising domestic purchases. In addition, as noted earlier, computer sales appear to have picked up markedly in February with the retail release of Windows Vista. Real outlays on communications equipment fell recently after rapid gains early last year, but spending growth is expected to resume fairly soon: TSPs provided guidance on capital expenditures for 2007 consistent with continued spending growth.<sup>8</sup>

Real spending on equipment other than high-tech and transportation dropped 5 percent in the fourth quarter of last year, and new orders and shipments at domestic manufacturers declined sharply in January, pointing to another decline in the first quarter. Orders and shipments of capital goods that are heavily used by the construction and motor vehicle industries (such as construction equipment and metalworking machinery) have been weak since the middle of last year and accounted for an outsized share of January's declines. However, in the latest readings, the weakness has not been confined to just these types of equipment: Categories such as industrial equipment; electromedical, measuring and controlling devices; and other electrical equipment have softened as well. On the bright side, the backlog of unfilled orders at manufacturers of nondefense capital goods other

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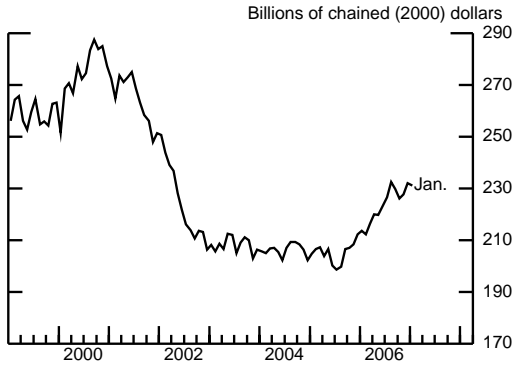
<sup>7</sup> As mentioned earlier, the steep drop in truck demand reflects payback for last year's surge of truck purchases ahead of new EPA regulations on emissions for diesel truck engines that went into effect in January.

<sup>8</sup> TSPs account for about one-fourth of total spending in this category.

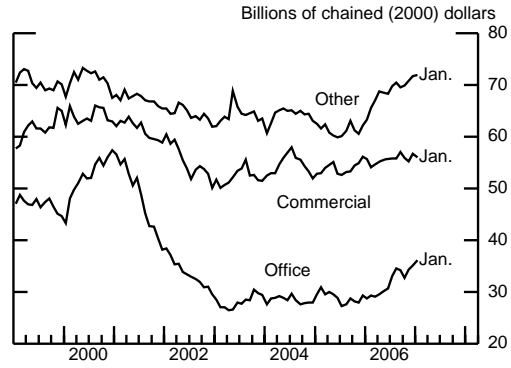
### Nonresidential Construction and Indicators

(All spending series are seasonally adjusted at an annual rate; nominal CPIP deflated by BEA prices through Q3 and by staff projection thereafter)

Total Structures

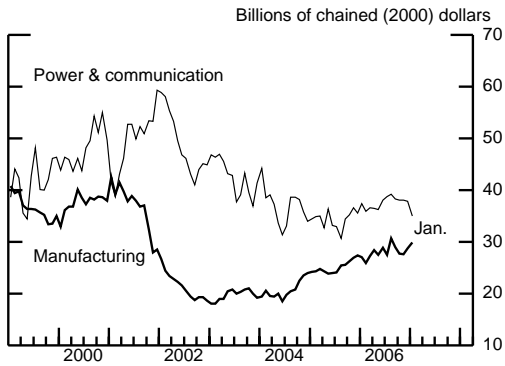


Office, Commercial, and Other

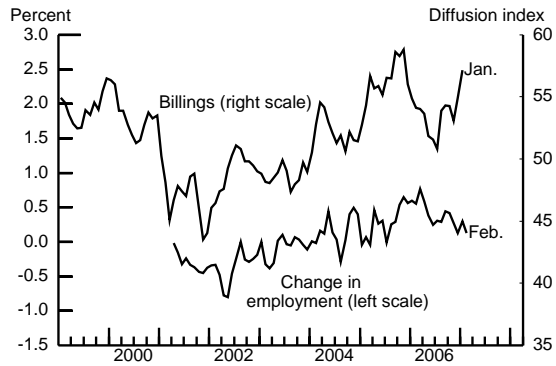


Note. Other includes religious, educational, lodging, amusement and recreation, transportation, and health-care facilities.

Manufacturing and Power & Communication

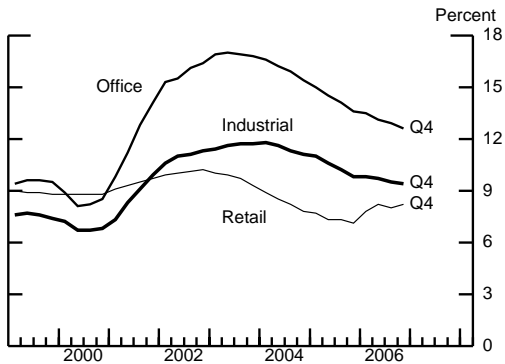


Architectural Billings and Nonresidential Construction Employment



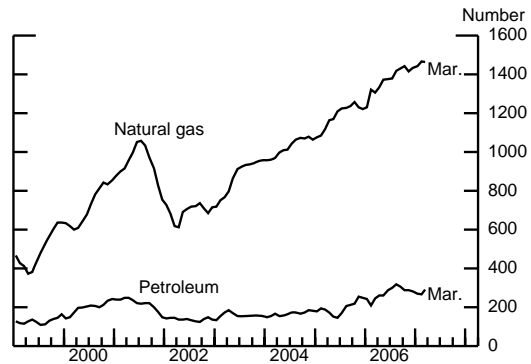
Note. Both series are 3-month moving averages. Employment includes industrial, commercial, and specialty trade construction. Source. For billings, American Institute of Architects; for employment, Bureau of Labor Statistics.

Vacancy Rates



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

Drilling Rigs in Operation



Note. The March readings are based on data through March 9, 2007. Source. DOE/Baker Hughes.

than transportation and high-tech continued to increase in January, and the overall ISM manufacturing index, which we find helpful as a near-term leading indicator of spending for this type of equipment, moved up in February.

### **Nonresidential Construction**

Activity in the nonresidential construction sector has moderated in recent months after having expanded at a brisk pace since late 2005. However, the fundamentals in this sector remain solid and point to an improvement in the near term. Vacancy rates in the industrial and office categories have moved down steadily over the past few years. In the retail sector, the vacancy rate moved sideways in the fourth quarter after having moved up in the first half of the year; nevertheless, its level was still well below its peak from a few years ago.<sup>9</sup> Furthermore, the architectural billings index—which is correlated with changes in nonresidential construction about six months hence—has rebounded in recent months.

Drilling and mining activity also decelerated in the second half of 2006 after having risen at an annual rate of nearly 15 percent in the first half. Moreover, during the first two months of 2007, the total number of drilling rigs in operation was flat. This deceleration may partly reflect the net decline in energy prices in the second half of last year.

### **Business Inventories**

Real nonfarm inventory investment excluding motor vehicles increased at an annual rate of \$39 billion in the fourth quarter of last year, a slower pace of accumulation than in the previous two quarters. The latest book-value data for manufacturing and trade excluding motor vehicles in January suggest that this slower pace of stockbuilding has continued into the current quarter. Even so, businesses appear to have only partially addressed the inventory imbalances that have arisen recently. The January book-value ratio of inventories to sales for manufacturing and trade (excluding motor vehicles) remained around the elevated level reached last September. In addition, information from the staff's flow-of-goods inventory system suggests that—excluding motor vehicles and parts—months' supply rose in January after having moved down in November and December. In particular, months' supply rose in January for construction supplies, materials, and business equipment but decreased for consumer goods. Moreover,

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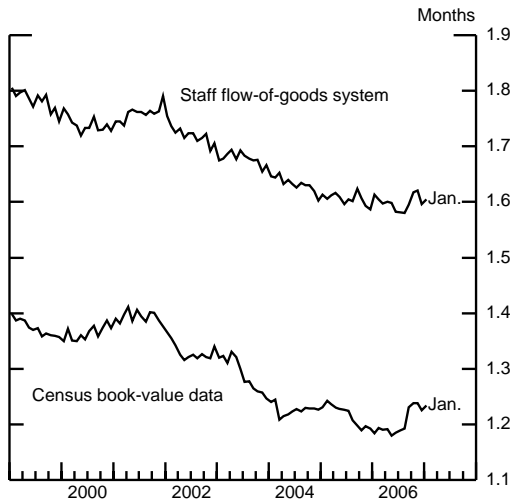
<sup>9</sup> Starting with this Greenbook, we have begun tracking vacancy rates using data supplied by Torto-Wheaton Research. This database provides a broader and more-representative sample than the data provided by the National Council of Real Estate Investment Fiduciaries or Costar, the two sources we used previously.

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

Measure and sector	2006					2007
	Q2	Q3	Q4	Nov.	Dec.	Jan.
<i>Real inventory investment (chained 2000 dollars)</i>						
<b>Total nonfarm business</b>	<b>52.2</b>	<b>53.3</b>	<b>15.6<sup>e</sup></b>	<b>n.a.</b>	<b>n.a.</b>	<b>n.a.</b>
Motor vehicles	3.0	-.8	-23.4 <sup>e</sup>	n.a.	n.a.	n.a.
Nonfarm ex. motor vehicles	49.2	54.2	39.0 <sup>e</sup>	n.a.	n.a.	n.a.
<b>Manufacturing and trade ex. wholesale and retail motor vehicles and parts</b>						
<b>Manufacturing</b>	<b>11.0</b>	<b>10.1</b>	<b>8.1<sup>e</sup></b>	<b>4.0<sup>e</sup></b>	<b>10.0<sup>e</sup></b>	<b>n.a.</b>
Wholesale trade ex. motor vehicles & parts	18.4	25.7	6.3 <sup>e</sup>	25.3 <sup>e</sup>	-19.7 <sup>e</sup>	n.a.
Retail trade ex. motor vehicles & parts	6.9	9.4	10.0 <sup>e</sup>	5.0 <sup>e</sup>	13.8 <sup>e</sup>	n.a.
<i>Book-value inventory investment (current dollars)</i>						
<b>Manufacturing and trade ex. wholesale and retail motor vehicles and parts</b>	<b>109.1</b>	<b>91.9</b>	<b>46.2</b>	<b>67.6</b>	<b>28.5</b>	<b>11.4</b>
Manufacturing	48.3	37.2	14.4	10.9	13.5	-10.4
Wholesale trade ex. motor vehicles & parts	43.2	40.8	18.9	50.0	-8.9	20.1
Retail trade ex. motor vehicles & parts	17.5	13.9	12.9	6.6	23.9	1.7

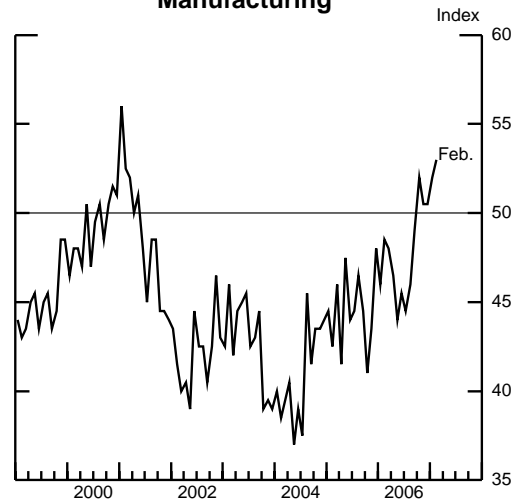
<sup>e</sup> Staff estimate of real inventory investment based on revised book-value data.  
n.a. Not available.  
Source. For real inventory investment, BEA; for book-value data, Census Bureau.

**Inventory Ratios ex. Motor Vehicles**



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

**ISM Customer Inventories: Manufacturing**



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

purchasing managers at manufacturing firms, on net, continue to view their customers' inventory levels as too high.

### **Federal Government Sector**

The federal unified budget deficit narrowed further in the early part of this year as receipts continued to post unusually strong gains. Relative to a year earlier, receipts in January and February rose 11 percent. Collections of withheld individual income and payroll taxes increased 11 percent—a noticeably faster pace than in the preceding twelve months, and nonwithheld individual income and payroll taxes jumped 16 percent. These estimated nonwithheld payments primarily reflect the fourth quarterly payment on 2006 tax liability; the strength in these quarterly payments suggests that tax liabilities have continued to rise faster than personal income, as measured by the NIPA.<sup>10</sup> Outlays in January and February increased 4 percent compared with the year-earlier period. Outlays growth has stepped down in recent months, in part because of a return to more-normal levels of disaster assistance spending and in part because of a slowing in the rate of growth of defense spending. On a NIPA basis, the January and February data are consistent with little change in real defense spending this quarter relative to last.

The Administration released its proposed budget for fiscal 2008 on February 5. The Administration expects the fiscal 2007 budget deficit to total \$244 billion, little changed from last year; the fiscal 2008 deficit is projected to be \$239 billion if the Administration's policies are enacted.<sup>11</sup> The key near-term policy proposals include increased defense spending—for both the global war on terror and other defense operations—and a one-year extension of alternative minimum tax relief for individuals. The Administration proposes to balance the budget by 2012 through cutting real outlays on discretionary programs over the next five years.<sup>12</sup>

In mid-February, the Congress passed a continuing resolution to fund government operations through the remainder of the fiscal year. With the new legislation, the

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<sup>10</sup> Detailed data allowing us to identify the sources of the pick-up in 2006 tax liabilities are not yet available. However, data for prior years point to a number of potential sources, including outsized capital gains realizations, which are not included in personal income, and shifts in the income distribution toward those in higher tax brackets.

<sup>11</sup> According to the CBO's preliminary analysis, if the President's policies are enacted, the budget deficit would be \$214 billion in fiscal 2007 and \$226 billion in fiscal 2008.

<sup>12</sup> The budget proposes to boost real defense outlays 10 percent from fiscal 2006 to fiscal 2008. In subsequent years, however, the budget projects declines in real defense outlays because of reduced funding for the global war on terror, so that by 2012 real spending is 8 percent lower than it was in fiscal 2006. Real nondefense outlays are projected to fall 15 percent over the next five years.

## Federal Government Outlays and Receipts

(Unified basis; billions of dollars except as noted)

Function or source	January-February			12 months ending in February		
	2006	2007	Percent change	2006	2007	Percent change
Outlays	441.1	462.6	4.9	2550.5	2680.7	5.1
Financial transactions <sup>1</sup>	-.4	-.4	...	-1.3	-14.1	...
Payment timing <sup>2</sup>	-12.4	-9.3	...	-.2	-6.1	...
Adjusted outlays	453.9	472.3	4.1	2552.0	2700.9	5.8
Receipts	342.9	380.9	11.1	2236.1	2488.0	11.3
Payment timing	.0	.0	...	.0	-6.0	...
Adjusted receipts	342.9	380.9	11.1	2236.1	2494.0	11.5
Surplus or deficit (-)	-98.3	-81.8	...	-314.4	-192.7	...
<i>Selected components of adjusted outlays and receipts</i>						
Adjusted outlays	453.9	472.3	4.1	2552.0	2700.9	5.8
Net interest	32.9	38.9	18.2	201.1	227.7	13.2
Non-interest	421.0	433.4	2.9	2350.9	2473.2	5.2
National defense	82.3	87.4	6.1	502.3	544.6	8.4
Social Security	92.1	96.8	5.1	535.3	567.5	6.0
Medicare	57.4	59.4	3.5	308.6	359.3	16.4
Medicaid	27.2	31.5	15.9	183.0	183.8	.4
Income security	82.2	89.1	8.4	348.0	361.4	3.8
Agriculture	5.8	4.5	...	30.7	25.7	-16.2
Other	74.0	64.7	-12.6	443.0	430.9	-2.7
Adjusted receipts	342.9	380.9	11.1	2236.1	2494.0	11.5
Individual income and payroll taxes	297.5	335.4	12.8	1727.0	1904.5	10.3
Withheld + FICA	283.2	313.0	10.5	1533.0	1641.9	7.1
Nonwithheld + SECA	62.8	73.0	16.3	375.2	450.6	20.1
Less: Refunds	48.5	50.5	4.2	181.3	192.4	6.2
Corporate	13.6	15.1	10.5	299.8	373.5	24.6
Gross	19.3	20.7	6.9	329.0	399.0	21.3
Less: Refunds	5.7	5.6	-1.6	29.2	25.5	-12.7
Other	31.8	30.4	-4.3	209.3	216.0	3.2
Adjusted surplus or deficit (-)	-111.0	-91.4	...	-315.8	-206.9	...

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 3 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. In addition, defense outlays for retiree health care have been converted from an annual to a monthly basis.

... Not applicable.

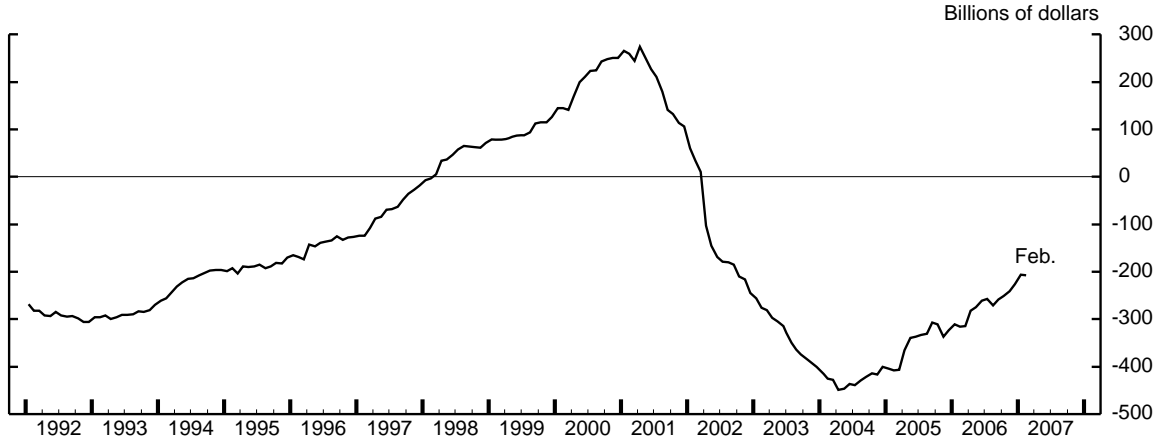
Source. Monthly Treasury Statement.



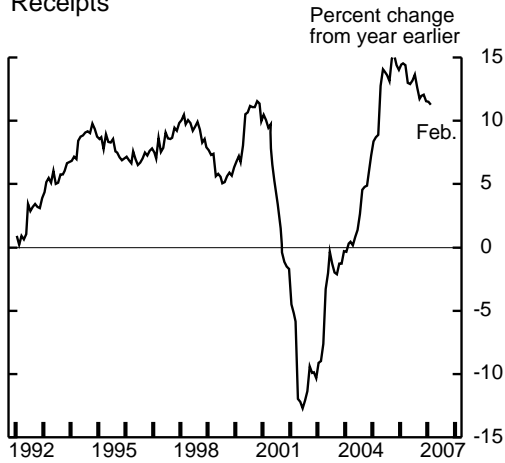
### Federal Unified Budget

(Adjusted for payment-timing shifts; all panels based on 12-month moving sum)

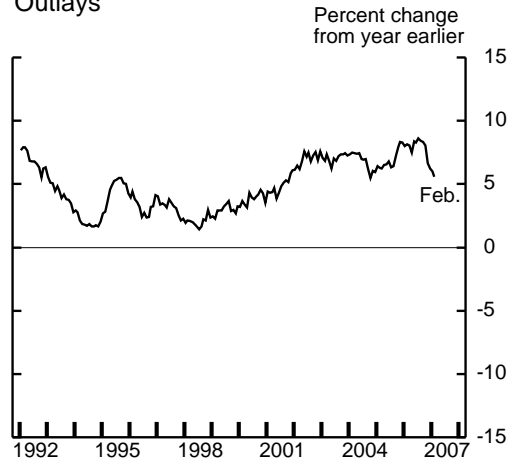
#### Surplus



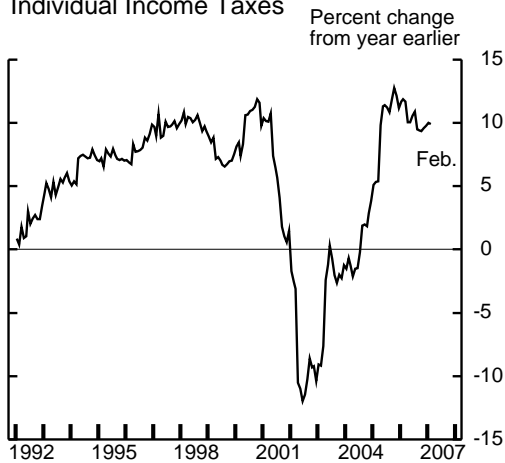
#### Receipts



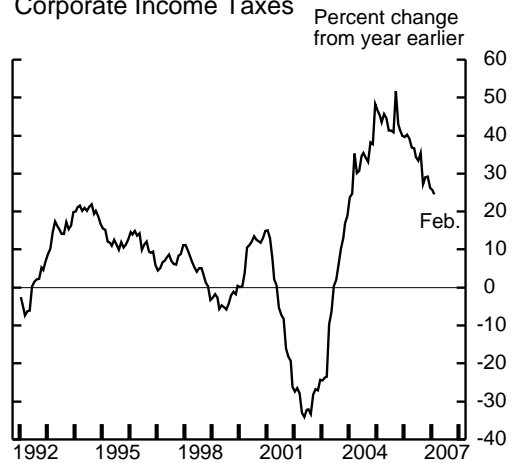
#### Outlays



#### Individual Income Taxes



#### Corporate Income Taxes



Note. Surplus and outlays data exclude Defense Cooperation Account and deposit insurance.

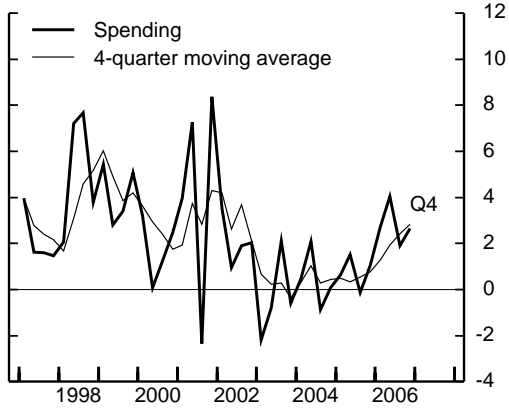
### Administration Budget Projections and Economic Assumptions

Item	2007	2008	2009	2010	2011	2012	
<b>Budget projections (fiscal years)</b>	Billions of dollars						
	Receipts	2540	2662	2798	2955	3104	3307
	Outlays	2784	2902	2985	3049	3157	3246
	Surplus	-244	-239	-187	-94	-54	61
	Percent of GDP						
	Receipts	18.5	18.3	18.3	18.3	18.3	18.6
	Outlays	20.2	20.0	19.5	18.9	18.6	18.3
	Surplus	-1.8	-1.6	-1.2	-0.6	-0.3	0.3
	<b>Economic assumptions (calendar years)</b>	Percent change, fourth quarter to fourth quarter					
		Real GDP	2.9	3.1	3.1	3.0	3.0
GDP price index		2.5	2.3	2.2	2.1	2.0	2.0
CPI-U		2.6	2.6	2.5	2.4	2.3	2.3
Percent, annual average							
Unemployment rate		4.6	4.8	4.8	4.8	4.8	4.8
Treasury yields							
3-month	4.7	4.6	4.4	4.2	4.1	4.1	
10-year	5.0	5.1	5.2	5.3	5.3	5.3	

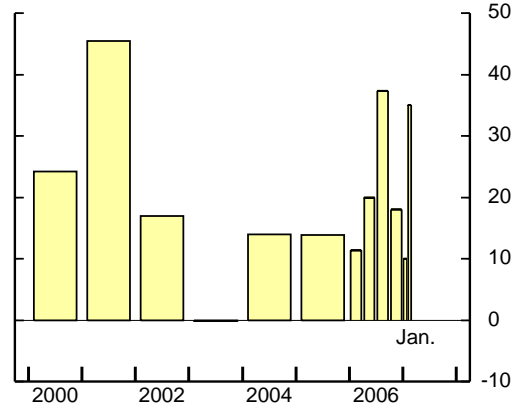
Source. Office of Management and Budget, *Budget of the United States Government: Fiscal Year 2008* (February 2007).

**State and Local Indicators**

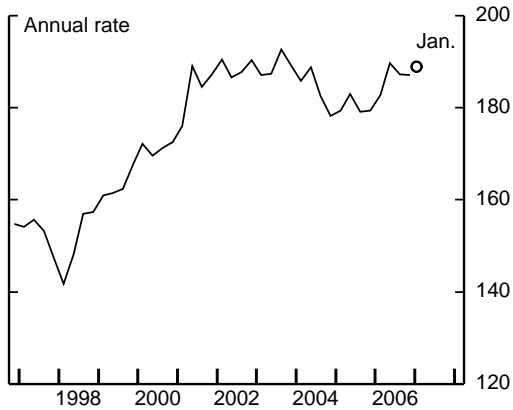
**Real Spending on Consumption & Investment**  
Percent change, annual rate



**Net Change in Employment**  
Thousands of jobs, monthly average

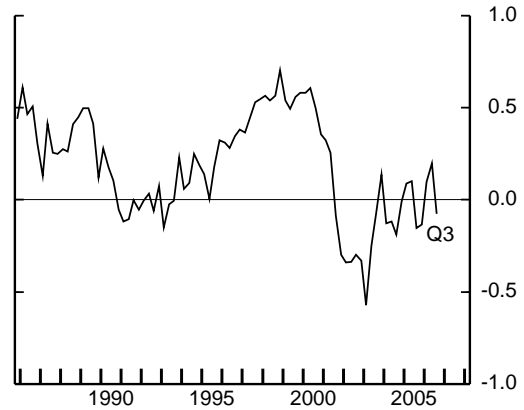


**Real Construction**  
Billions of chained (2000) dollars

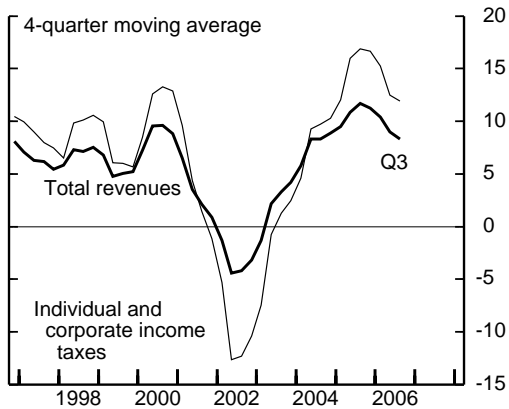


Note. Nominal CPIP deflated by BEA prices through Q4 and by staff projection thereafter.

**Net Saving**  
Percent of nominal GDP

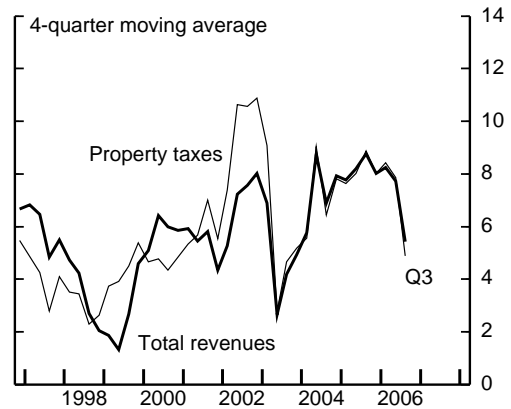


**State Revenues**  
Percent change from year earlier



Source. Census Bureau.

**Local Revenues**  
Percent change from year earlier



Source. Census Bureau.

Congressional Budget Office (CBO) expects that nondefense discretionary spending will be about unchanged in fiscal 2007 as declines in hurricane-related outlays are offset by increases elsewhere. The Congress is now considering the Administration's request for \$100 billion of additional defense funding for fiscal 2007.

### **State and Local Government Sector**

Recent data suggest that real purchases by state and local governments are rising solidly. Employment gains so far this quarter have been similar to the relatively strong gains in 2006: Employment rose 23,000, on average, in January and February, compared with an average monthly increase of 21,000 in 2006. In contrast, recent data on construction suggest a pause in the strong growth experienced in 2006. In January, the level of nominal outlays for construction was 2 percent above its fourth-quarter average (not at an annual rate). However, because prices for construction-related materials have been rising rapidly of late, much of this increase likely reflects higher costs.

State governments continue to report favorable fiscal conditions, and these conditions now appear to be leading policymakers to increase spending. According to the National Conference of State Legislatures (NCSL), state government revenues rose 7¾ percent in fiscal year 2006 (the fiscal year ends on June 30 for most states), 5 percentage points faster than states' projections at the start of the fiscal year. The NCSL reports that more than half the states bolstered their reserve funds with some of this unexpected revenue, but most spent at least a portion of it as well. Spending on capital projects was reported to be particularly prevalent, which is consistent with the 2006 surge in state and local investment spending estimated in the NIPA. The favorable fiscal climate also appears to be spurring increased spending this year; on average, fiscal year 2007 budgets anticipate that general fund spending will increase 2 percentage points faster than was expected at the same point in last year's budget cycle.

### **Prices**

The total PCE price index rose 0.2 percent in January, as a decline in energy prices partly offset a 0.7 percent jump in food prices and an increase of 0.3 percent in the core index. On a twelve-month-change basis, PCE price inflation was 2 percent, down 1.2 percentage points from a year earlier; a deceleration in energy prices more than accounted for the reduction in overall PCE inflation over this period.

January's rise of 0.3 percent in core PCE prices followed two consecutive monthly increases of 0.1 percent. Core PCE inflation was held down in November and December

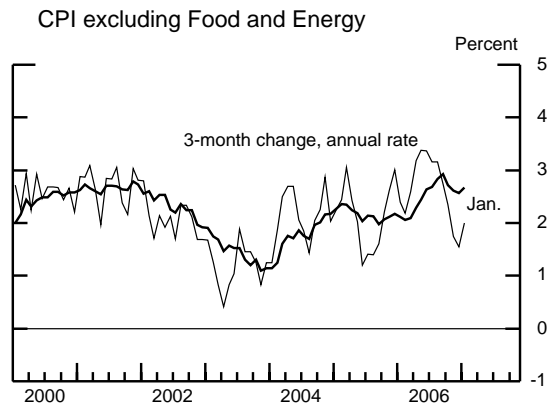
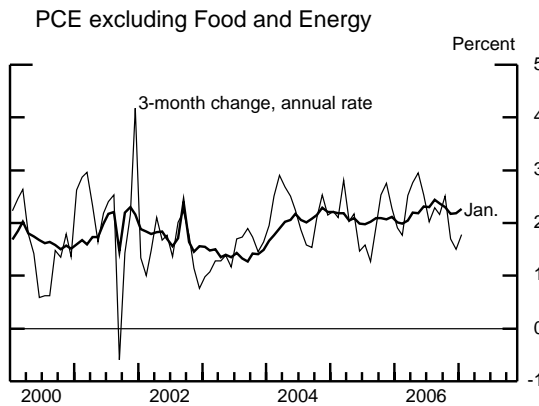
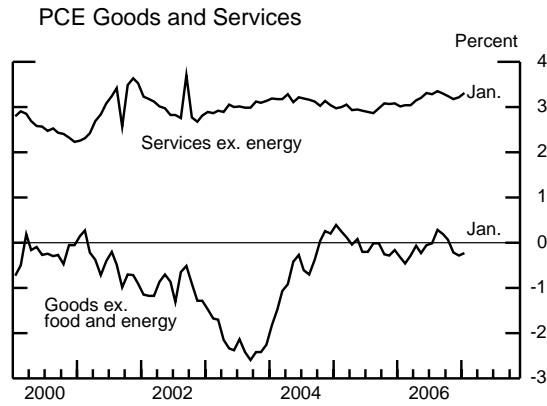
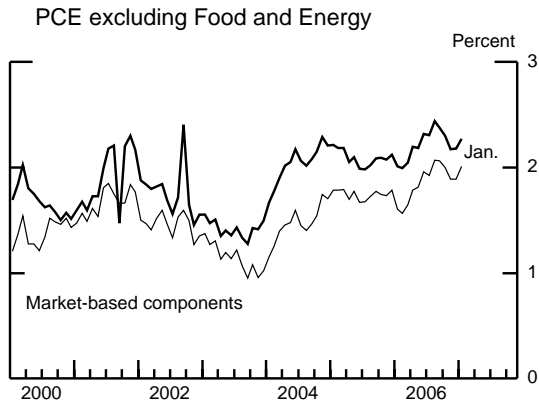
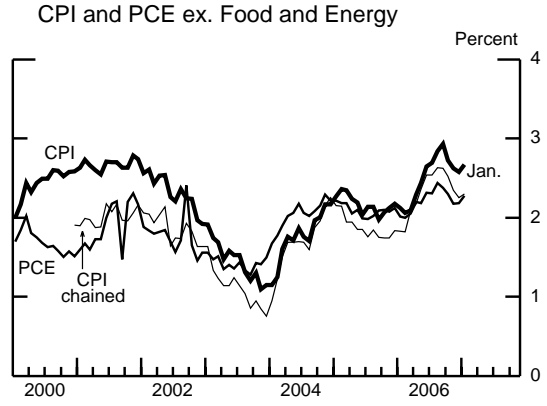
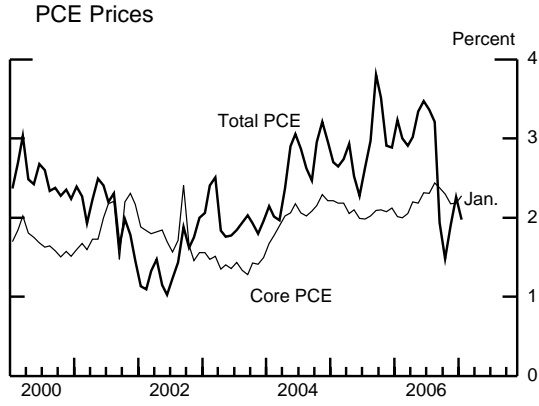
**Price Measures**  
(Percent change)

Measures	12-month change		3-month change		1-month change	
	Jan. 2006	Jan. 2007	Annual rate		Monthly rate	
			Oct. 2006	Jan. 2007	Dec. 2007	Jan. 2007
<i>CPI</i>						
<b>Total</b>	<b>4.0</b>	<b>2.1</b>	<b>-2.7</b>	<b>2.7</b>	<b>.4</b>	<b>.2</b>
Food	2.6	2.4	3.7	2.4	.0	.7
Energy	24.8	-3.1	-43.1	10.1	4.2	-1.5
<b>Ex. food and energy</b>	<b>2.1</b>	<b>2.7</b>	<b>2.3</b>	<b>2.0</b>	<b>.1</b>	<b>.3</b>
Core goods	.1	-.2	-.6	-1.4	.0	.1
Core services	2.9	3.8	3.6	3.4	.2	.3
Shelter	2.7	4.4	3.8	4.4	.4	.3
Other services	3.3	3.1	3.1	2.4	.1	.3
Chained CPI (n.s.a.) <sup>1</sup>	3.4	1.9	...	...	...	...
Ex. food and energy <sup>1</sup>	1.8	2.3	...	...	...	...
<i>PCE prices</i>						
<b>Total</b>	<b>3.2</b>	<b>2.0</b>	<b>-1.1</b>	<b>2.3</b>	<b>.3</b>	<b>.2</b>
Food and beverages	2.5	2.4	3.2	2.3	.0	.7
Energy	24.4	-2.8	-44.7	10.1	4.4	-1.6
<b>Ex. food and energy</b>	<b>2.0</b>	<b>2.3</b>	<b>2.5</b>	<b>1.8</b>	<b>.1</b>	<b>.3</b>
Core goods	-.3	-.2	.5	-.9	-.1	.2
Core services	3.0	3.3	3.4	2.9	.2	.3
Shelter	2.7	4.4	3.8	3.9	.3	.3
Other services	3.1	2.9	3.3	2.5	.2	.3
Core market-based	1.6	2.0	2.1	1.6	.1	.2
Core non-market-based	3.9	3.4	4.2	2.8	.2	.4
<i>PPI</i>						
<b>Total finished goods</b>	<b>5.6</b>	<b>.2</b>	<b>-9.6</b>	<b>8.7</b>	<b>.9</b>	<b>-.6</b>
Food	1.9	2.7	3.6	11.1	1.5	1.1
Energy	25.2	-7.3	-40.5	14.2	2.2	-4.6
<b>Ex. food and energy</b>	<b>1.3</b>	<b>1.8</b>	<b>-.5</b>	<b>6.2</b>	<b>.2</b>	<b>.2</b>
Core consumer goods	1.3	1.5	-.7	5.7	.1	.2
Capital equipment	1.2	2.3	-.5	7.0	.1	.2
Intermediate materials	9.2	.9	-7.3	2.0	.5	-.7
Ex. food and energy	4.9	3.8	2.2	-1.4	.0	.0
Crude materials	22.1	-8.0	-38.5	53.6	2.8	-6.3
Ex. food and energy	6.3	17.8	-17.3	10.5	.5	1.6

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

... Not applicable.

### Consumer Prices (12-month change except as noted)



by unusually low rates of increase for nonmarket PCE prices and by a dip in goods price inflation. Over the twelve months ending in January, core PCE prices accelerated 0.3 percentage point, to a rate of increase of 2.3 percent; similarly, market-based core PCE inflation picked up 0.4 percentage point over this period, to a 2 percent rate. The increase in both of these measures of core consumer price inflation over the past year was driven importantly by a sharp acceleration in shelter costs.

The energy component of the PCE price index fell 1.6 percent in January; over the past twelve months, energy prices have declined nearly 3 percent, compared with a year-earlier increase of more than 24 percent. The drop in energy prices in January was broad-based: Prices for gasoline and motor oil, heating fuel, and natural gas all declined about 3 percent. In contrast, electricity prices rose 2 percent, apparently reflecting periodic rate adjustments in some areas. Through late January, falling crude oil costs helped hold down prices for petroleum-based energy products, while warmer-than-usual weather this winter allowed inventories of petroleum products and natural gas to move above their seasonal norms. However, demand during the recent spell of extremely cold weather pared these inventories back toward more-normal levels, and crude costs have moved higher of late. Although available survey data point to little change in consumer energy prices in February, these prices appear headed for a large increase in March.

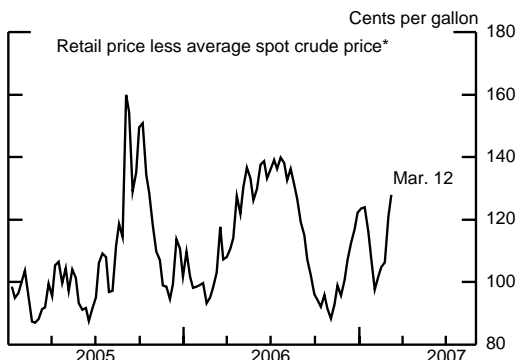
The PCE price index for food and beverages rose 0.7 percent in January after having been about unchanged in the preceding two months. While prices increased for most categories of foodstuffs, the rise in fruit and vegetable prices was particularly pronounced, largely because of the effects of cold weather in the western part of the country. Food prices were also boosted by the pass-through of earlier sharp increases in spot prices for grain and livestock. In recent weeks, low inventories and adverse weather forecasts for the coming season have caused spot and futures prices for corn to rise. As corn prices have moved higher and unusually cold weather has stressed animals, producers have been slaughtering animals at lower weights; the reduction in output from lower average weights has raised prices for beef and pork.

Broader measures of inflation moved lower in 2006, led by a sharp deceleration in energy prices. Despite the small increase in core PCE price inflation, the price index for GDP less food and energy decelerated, reflecting slower rates of increase in the prices for other components of final demand, especially construction.

## Energy Prices and Inventories

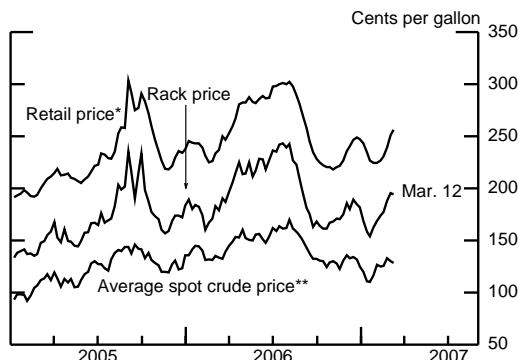
(Data from Energy Information Administration except as noted)

**Total Gasoline Margin**



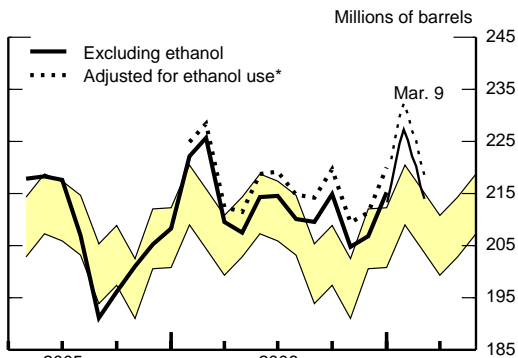
\* Regular grade seasonally adjusted by FRB staff, less average spot crude price: 60% WTI, 40% Maya heavy crude.

**Gasoline Price Decomposition**



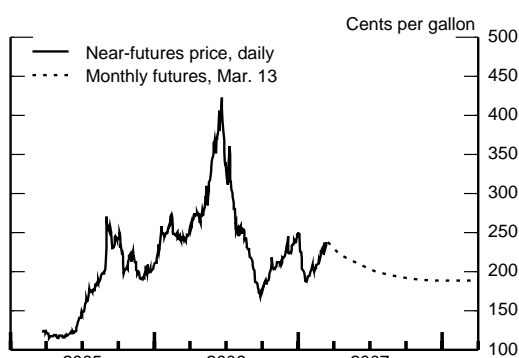
\* Regular grade seasonally adjusted by FRB staff.  
 \*\* 60% WTI, 40% Maya heavy crude.

**Gasoline Inventories**



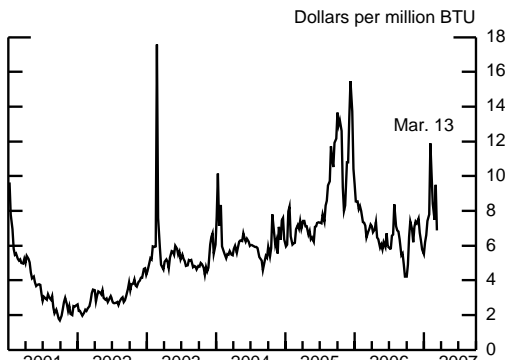
Note. Shaded region is average historical range as calculated by DOE. Monthly data through December 2006, weekly data thereafter, as indicated by line weights.  
 \* Adjustment for approximate amount of fuel ethanol to be blended with RBOB component of inventories; estimated by FRB staff.

**Ethanol Prices**



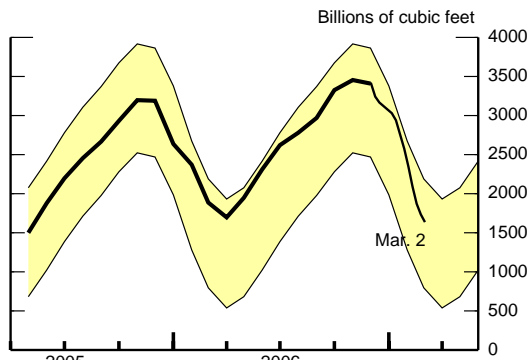
Source: Chicago Board of Trade.

**Natural Gas Prices**



Note. National average spot price.  
 Source: Bloomberg.

**Natural Gas Inventories**

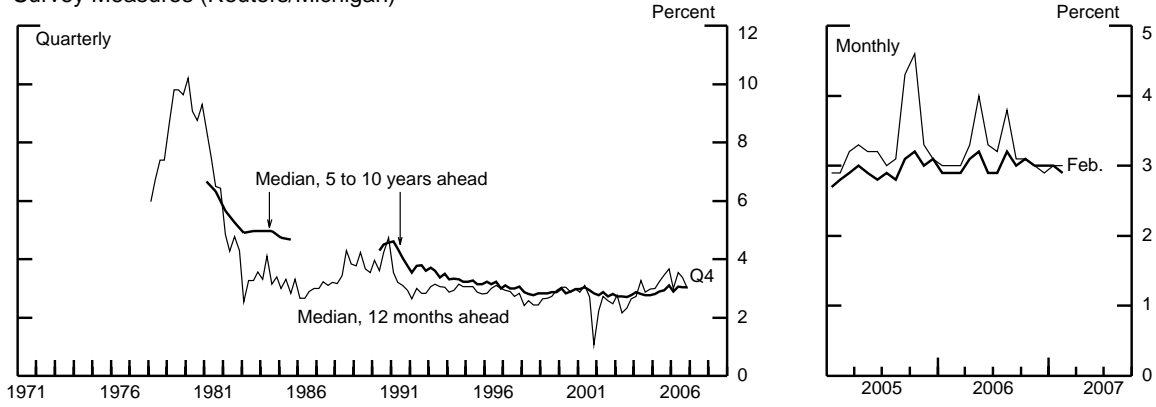


Note. Shaded region is historical range for 2000 to 2004 as calculated by FRB staff. Monthly data through November 2006, weekly data thereafter, as indicated by line weights.

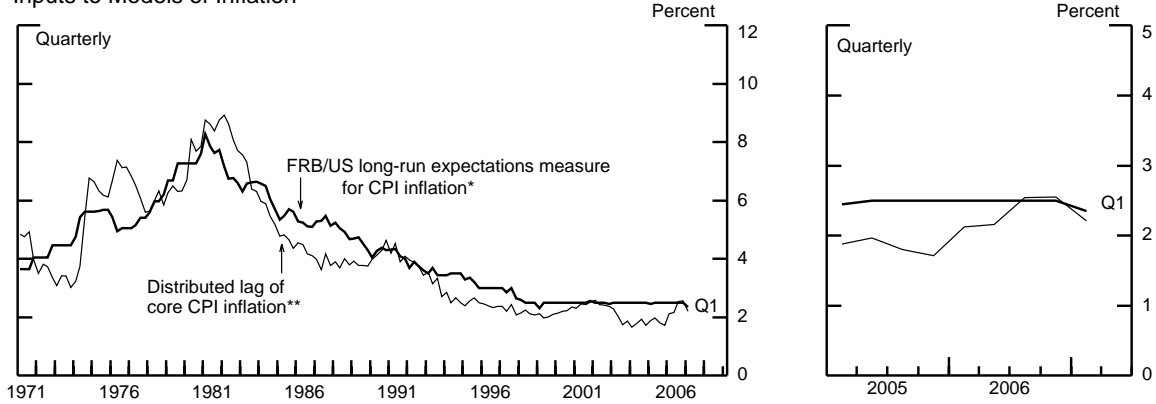


## Measures of Expected Inflation

Survey Measures (Reuters/Michigan)

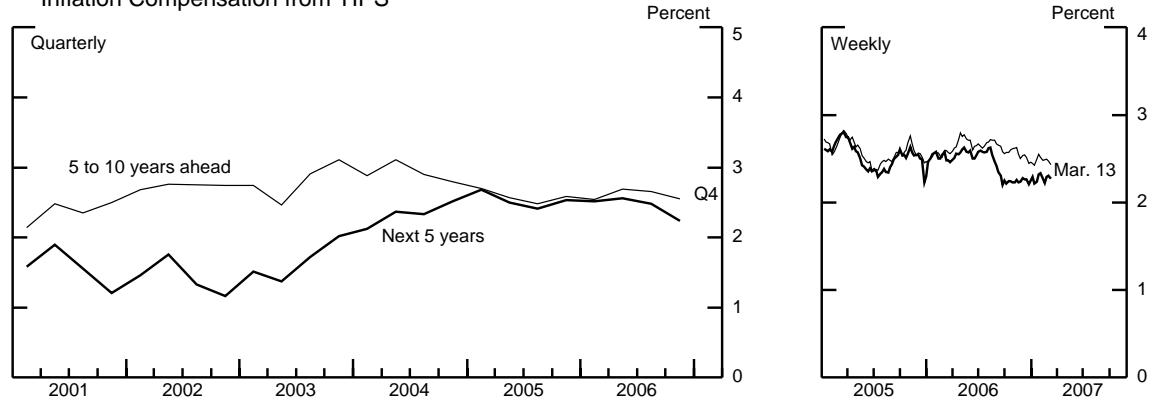


Inputs to Models of Inflation



\* For 1991 forward, the median projection for CPI inflation over the next 10 years from the Survey of Professional Forecasters; for 1981 to 1991, a related survey conducted by Richard Hoey; and for the period preceding 1981, a model-based estimate constructed by Board staff.  
 \*\* Derived from one of the reduced-form Phillips curves used by Board staff.

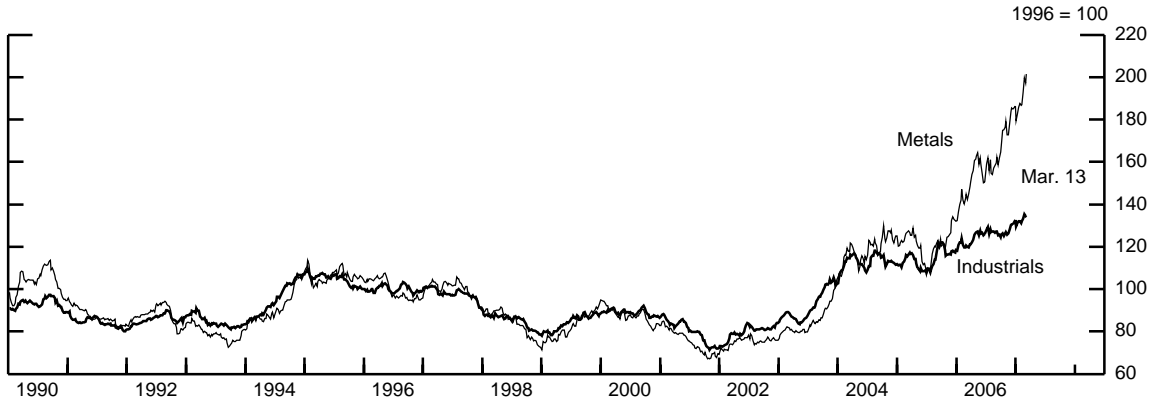
Inflation Compensation from TIPS



Note. Based on a comparison of an estimated TIPS yield curve with an estimated nominal off-the-run Treasury yield curve, with an adjustment for the indexation-lag effect since March 2004.

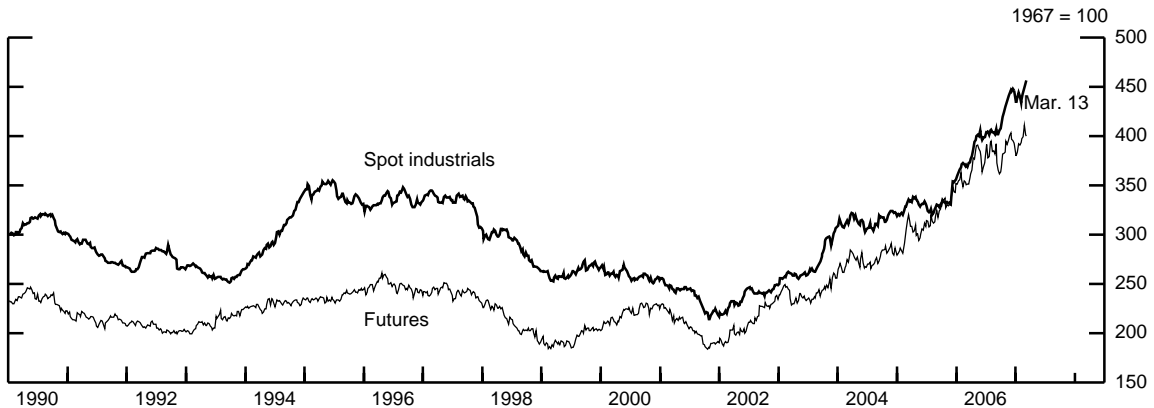
## Commodity Price Indexes

### Journal of Commerce



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

### Commodity Research Bureau



Note. The Commodity Research Bureau (CRB) spot industrials index consists entirely of industrial commodities, excluding energy. The CRB futures index gives about a 60 percent weight to food commodities and splits the remaining weight roughly equally among energy commodities, industrial commodities, and precious metals.

### Selected Commodity Price Indexes (Percent change)

Index	2006 <sup>1</sup>	12/19/06 to 1/23/07 <sup>2</sup>	1/23/07 <sup>2</sup> to 3/13/07	52-week change to 3/13/07
JOC industrials	11.0	1.1	2.0	12.3
JOC metals	38.9	.5	8.4	41.5
CRB spot industrials	26.9	-.9	2.8	23.8
CRB spot foodstuffs	13.0	3.6	4.5	22.7
CRB futures	15.0	-.7	1.9	13.9

1. From the last week of the preceding year to the last week of the year indicated.

2. January 23, 2007, is the Tuesday preceding publication of the January Greenbook.

**Broad Measures of Inflation**  
(Percent change, Q4 to Q4)

Measure	2003	2004	2005	2006
<i>Product prices</i>				
GDP price index	2.2	3.2	3.1	2.5
Less food and energy	1.9	3.1	3.0	2.6
Nonfarm business chain price index	1.2	3.2	3.2	1.9
<i>Expenditure prices</i>				
Gross domestic purchases price index	2.2	3.7	3.6	2.3
Less food and energy	1.9	3.0	2.8	2.6
PCE price index	1.9	3.0	3.1	1.9
Less food and energy	1.4	2.2	2.1	2.2
PCE price index, market-based components	1.6	2.7	3.0	1.6
Less food and energy	1.0	1.7	1.8	1.9
CPI	1.9	3.4	3.7	1.9
Less food and energy	1.2	2.1	2.1	2.7
Chained CPI	1.7	3.1	3.2	1.8
Less food and energy	.8	2.1	1.8	2.4
Median CPI	2.0	2.3	2.4	3.6
Trimmed mean CPI	1.7	2.3	2.5	2.7
Trimmed mean PCE	1.7	2.3	2.4	2.4

**Surveys of Inflation Expectations**  
(Percent)

Period	Actual CPI inflation <sup>1</sup>	Reuters/University of Michigan Index				Professional forecasters (10 years) <sup>4</sup>
		1 year <sup>2</sup>		5 to 10 years <sup>3</sup>		
		Mean	Median	Mean	Median	
2005:Q2	2.9	3.9	3.2	3.3	2.9	2.5
Q3	3.8	4.3	3.5	3.5	2.9	2.5
Q4	3.7	4.6	3.7	3.5	3.1	2.5
2006:Q1	3.6	3.7	3.0	3.3	2.9	2.5
Q2	4.0	4.5	3.5	3.6	3.1	2.5
Q3	3.3	4.0	3.4	3.3	3.0	2.5
Q4	1.9	3.5	3.0	3.5	3.0	2.5
2007:Q1	n.a.	n.a.	n.a.	n.a.	n.a.	2.4
Oct.	1.3	3.7	3.1	3.5	3.1	...
Nov.	2.0	3.3	3.0	3.5	3.0	2.5
Dec.	2.5	3.5	2.9	3.4	3.0	...
2007:Jan.	2.1	3.6	3.0	3.5	3.0	...
Feb.	n.a.	3.6	3.0	3.3	2.9	2.4

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

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

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

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

... Not applicable.

n.a. Not available.

Survey measures of inflation expectations were little changed in February. As measured by the Reuters/University of Michigan index, the median expectation for year-ahead inflation remained at 3 percent last month. The median five- to ten-year expectation edged down to 2.9 percent and is ¼ percentage point lower than its recent peak last August. Ten-year-ahead expected CPI inflation from the Survey of Professional Forecasters (SPF) also edged down 0.1 percentage point last month after having held steady at 2.5 percent for the past five years and after having averaged 2.5 percent in every year since 1998.<sup>13</sup>

At earlier stages of processing, the producer price index (PPI) for core intermediate goods was unchanged in January for the second month in a row. The twelve-month change in this index was 3.8 percent in January, down about 1 percentage point from a year ago. Part of the slowdown in price inflation for intermediate goods can be traced to a deceleration in the prices for many energy-intensive materials that occurred in response to the sharp slowing in energy prices over this period.

Commodity prices have moved higher in recent weeks. The Commodity Research Bureau's spot index of industrial materials is up 2.8 percent since the January Greenbook, while the *Journal of Commerce* index of industrial materials has risen 2 percent; both commodity price indexes have been boosted by a jump in metals prices.

### **Labor Costs**

Labor costs have accelerated over the past year, although the extent of the increase in compensation inflation differs across measures and is further obscured by special factors that temporarily boosted NIPA estimates of wage and salary accruals in the fourth quarter.

Over the three months ending in December, the employment cost index (ECI) for hourly compensation of private industry workers rose at an annual rate of 3.2 percent. The ECI also increased 3.2 percent over the twelve months of 2006 as a whole, 0.3 percentage

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<sup>13</sup> The downtick in the SPF expectations measure was surprising enough that the research department at the Federal Reserve Bank of Philadelphia (which conducts the SPF) examined how individual forecasters' responses contributed to the change. The researchers indicated that although a fraction of the revision could have resulted from changes to the composition of the panel of forecasters, "changing views on the long-run inflation outlook among those participants who submitted projections in both surveys accounts for some of the downward revision." (Note, however, that there were also additions made to the inflation questions asked in the survey: For the first time, quarterly *core* CPI and quarterly top-line and core PCE forecasts were solicited, as were forecasts for *long-run* top-line PCE price inflation.)

point faster than the rise in 2005. The wage and salary component of the ECI rose 3.2 percent in 2006, up 0.7 percentage point from the previous year. In contrast, benefit costs slowed over this period, as indicated by December's twelve-month change of 3.1 percent, down nearly 1 percentage point from the increase in 2005. Although increases in pension costs and some components of benefits that are closely related to movements in wage rates—namely, Social Security and paid leave—picked up in 2006, increases in a number of other benefits costs were slower, with nonproduction bonuses posting a particularly sharp deceleration.

In line with the Productivity and Costs (P&C) release, we estimate that hourly compensation in the nonfarm business sector jumped at an annual rate of 8.2 percent in the fourth quarter of 2006 after a downward-revised increase of 0.6 percent in the third quarter. On a four-quarter basis, compensation per hour rose 4.9 percent over 2006, up 1.2 percentage points from the preceding year.<sup>14</sup> The fourth-quarter increase reflected the BEA's assumption that bonus payments and stock option exercises added \$50 billion (annual rate) to wage and salary accruals, on which the P&C hourly compensation estimate is based.<sup>15</sup>

Average hourly earnings rose 0.2 percent in January and 0.4 percent in February. These increases left the change in average hourly earnings over the twelve months ending in February at 4.1 percent, up 0.6 percentage point from a year ago.

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<sup>14</sup> The downward revision to 2006:Q3 P&C hourly compensation growth—which was previously estimated to have risen at an annual rate of 3.1 percent—mainly stems from the incorporation of third-quarter state UI tax data into the BEA's compensation estimates. In addition, the BLS incorporated the annual benchmark revision to the establishment survey data into its P&C estimates. This resulted in revisions to hours (and hence hourly compensation) back to 2002 and lowered the Q4-to-Q4 change in hourly compensation growth 0.2 percentage point in 2006 and 0.4 percentage point in 2005 (revisions to earlier years were much smaller).

<sup>15</sup> News stories indicate that bonus payments by Wall Street firms surged to record levels at the turn of the year. These payments were made—and show up as wage and salary *disbursements*—in early 2007. (Note that the BEA will not have actual source data for 2007:Q1 wage and salary disbursements until the preliminary estimate of 2007:Q2 GDP is prepared in August.) However, the BEA assumed that these bonuses represented remuneration for productive activity in 2006:Q4 and therefore imputed them to that period's compensation bill.

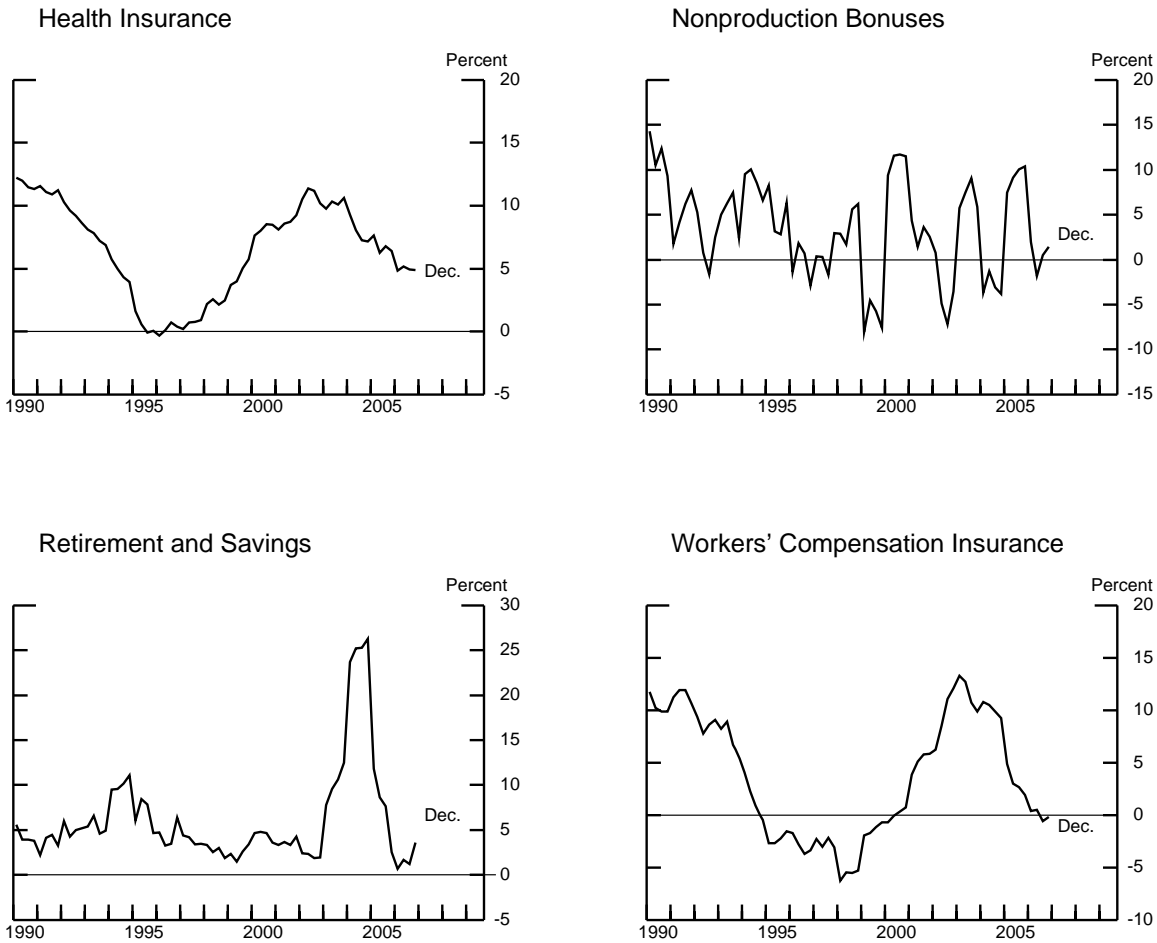
In addition, note that an increase in bonus payments of this sort would in principle show up in the benefits component of the ECI in the first quarter of 2007. (In contrast, the ECI excludes stock option exercises entirely.)

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

Measure	2005	2006			
	Dec.	Mar.	June	Sept.	Dec.
	Quarterly change (compound annual rate) <sup>1</sup>				
<b>Total hourly compensation</b>	<b>2.8</b>	<b>2.4</b>	<b>3.2</b>	<b>3.6</b>	<b>3.2</b>
Wages and salaries	2.8	2.8	3.6	3.2	2.8
Benefits	3.3	1.6	2.8	4.0	4.0
	12-month change				
<b>Total hourly compensation</b>	<b>2.9</b>	<b>2.6</b>	<b>2.8</b>	<b>3.0</b>	<b>3.2</b>
Wages and salaries	2.5	2.4	2.8	3.0	3.2
Benefits	4.0	3.0	2.7	2.8	3.1

1. Seasonally adjusted by the Bureau of Labor Statistics.

**Change in ECI Benefits (confidential)**  
(Private-industry workers; 12-month change)

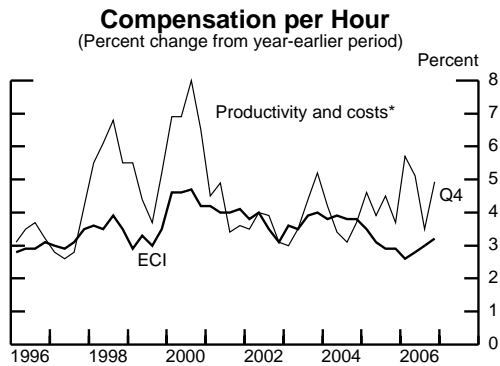


### Hourly Compensation and Unit Labor Costs

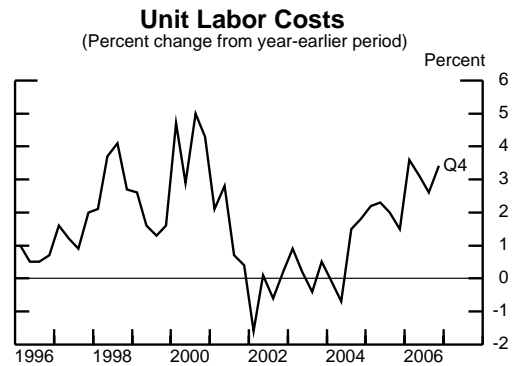
(Percent change from preceding period at compound annual rate; based on seasonally adjusted data)

Category	2004:Q4 to 2005:Q4	2005:Q4 to 2006:Q4 <sup>e</sup>	2006			
			Q1	Q2	Q3	Q4 <sup>e</sup>
<i>Compensation per hour</i> Nonfarm business	3.7	4.9	12.9	-1.4	.6	8.2
<i>Unit labor costs</i> Nonfarm business	1.5	3.4	9.1	-2.5	1.1	6.5

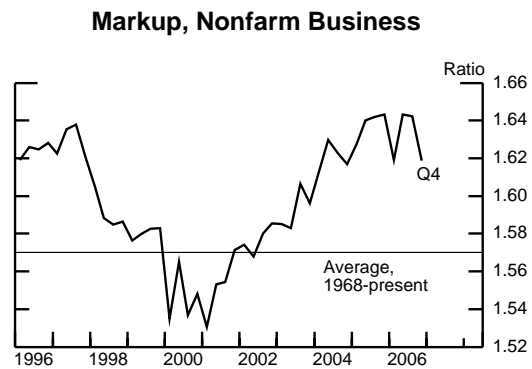
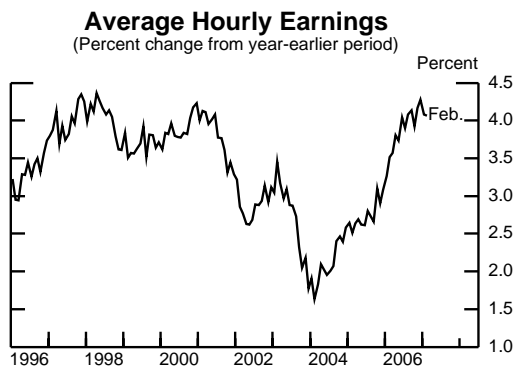
e Staff estimate.



\* Value for 2006:Q4 is a staff estimate.



Note. Value for 2006:Q4 is a staff estimate.



Note. The markup is the ratio of output price to unit labor costs. Value for 2006:Q4 is a staff estimate.

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## **Domestic Financial Developments**

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

Instrument	2004	2006	2007		Change to Mar. 13 from selected dates (percentage points)		
	June 28	June 29	Jan. 30	Mar. 13	2004 June 28	2006 June 29	2007 Jan. 30
<i>Short-term</i>							
FOMC intended federal funds rate	1.00	5.25	5.25	5.25	4.25	.00	.00
Treasury bills <sup>1</sup>							
3-month	1.36	4.88	5.00	4.94	3.58	.06	-.06
6-month	1.74	5.06	4.98	4.89	3.15	-.17	-.09
Commercial paper (A1/P1 rates) <sup>2</sup>							
1-month	1.28	5.27	5.25	5.25	3.97	-.02	.00
3-month	1.45	5.37	5.24	5.24	3.79	-.13	.00
Large negotiable CDs <sup>1</sup>							
3-month	1.53	5.47	5.32	5.30	3.77	-.17	-.02
6-month	1.82	5.59	5.35	5.28	3.46	-.31	-.07
Eurodollar deposits <sup>3</sup>							
1-month	1.29	5.33	5.32	5.32	4.03	-.01	.00
3-month	1.51	5.49	5.36	5.34	3.83	-.15	-.02
Bank prime rate	4.00	8.25	8.25	8.25	4.25	.00	.00
<i>Intermediate- and long-term</i>							
U.S. Treasury <sup>4</sup>							
2-year	2.88	5.26	4.98	4.56	1.68	-.70	-.42
5-year	3.97	5.15	4.85	4.40	.43	-.75	-.45
10-year	4.90	5.28	4.95	4.59	-.31	-.69	-.36
U.S. Treasury indexed notes							
5-year	1.56	2.49	2.46	2.01	.45	-.48	-.45
10-year	2.25	2.61	2.48	2.18	-.07	-.43	-.30
Municipal general obligations (Bond Buyer) <sup>5</sup>	5.01	4.71	4.32	4.08	-.93	-.63	-.24
Private instruments							
10-year swap	5.21	5.81	5.40	5.08	-.13	-.73	-.32
10-year FNMA <sup>6</sup>	5.38	5.59	5.20	4.89	-.49	-.70	-.31
10-year AA <sup>7</sup>	5.60	6.20	5.76	5.48	-.12	-.72	-.28
10-year BBB <sup>7</sup>	6.25	6.74	6.29	5.95	-.30	-.79	-.34
10-year high yield <sup>7</sup>	8.41	8.74	8.19	8.10	-.31	-.64	-.09
Home mortgages (FHLMC survey rate) <sup>8</sup>							
30-year fixed	6.21	6.78	6.34	6.14	-.07	-.64	-.20
1-year adjustable	4.19	5.82	5.54	5.47	1.28	-.35	-.07

Stock exchange index	Record high		2006	2007		Change to Mar. 13 from selected dates (percent)		
	Level	Date	June 29	Jan. 30	Mar. 13	Record high	2006 June 29	2007 Jan. 30
Dow Jones Industrial	12,787	2-20-07	11,191	12,523	12,076	-5.56	7.91	-3.57
S&P 500 Composite	1,527	3-24-00	1,273	1,429	1,378	-9.79	8.26	-3.56
Nasdaq	5,049	3-10-00	2,174	2,449	2,351	-53.44	8.10	-4.01
Russell 2000	829	2-22-07	714	798	769	-7.27	7.67	-3.62
Wilshire 5000	14,797	2-20-07	12,846	14,439	13,966	-5.61	8.72	-3.27

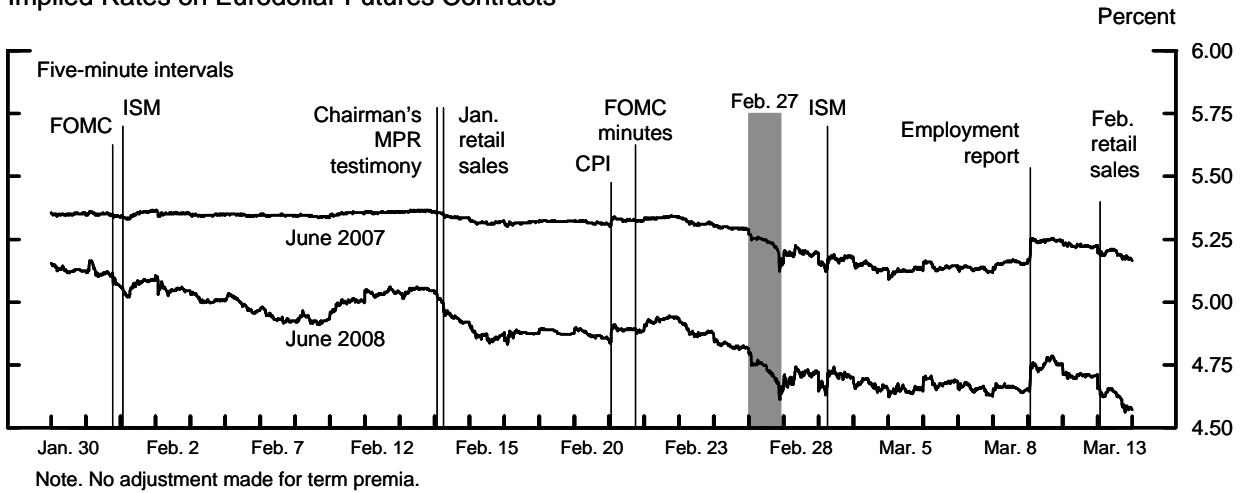
1. Secondary market.
2. Financial commercial paper.
3. Bid rates for Eurodollar deposits collected around 9:30 a.m. eastern time.
4. Derived from a smoothed Treasury yield curve estimated using off-the-run securities.
5. Most recent Thursday quote.
6. Constant-maturity yields estimated from Fannie Mae domestic noncallable coupon securities.
7. Derived from smoothed corporate yield curves estimated using Merrill Lynch bond data.
8. Home mortgage rates for March 13, 2007, are for the week ending March 8, 2007.

NOTES:

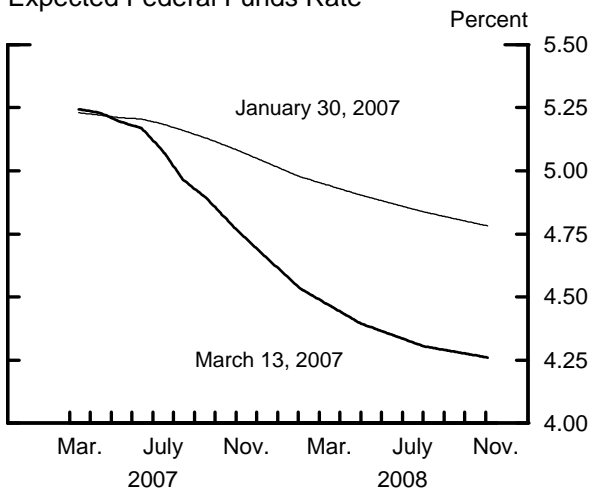
June 28, 2004, is the day before the most recent policy tightening began.  
June 29, 2006, is the day the most recent policy tightening ended.  
January 30, 2007, is the day before the most recent FOMC announcement.

### Policy Expectations and Treasury Yields

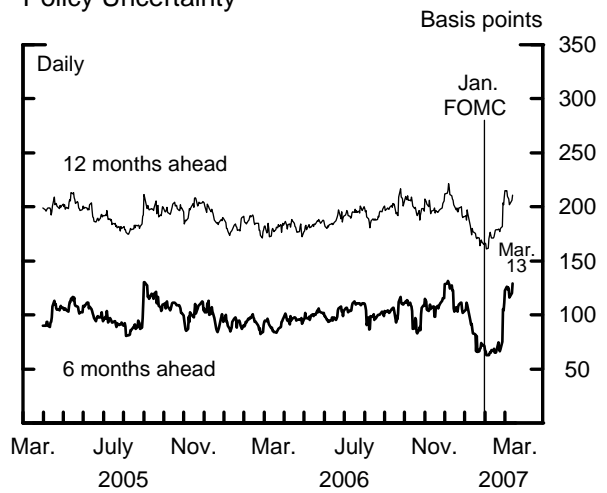
Implied Rates on Eurodollar Futures Contracts



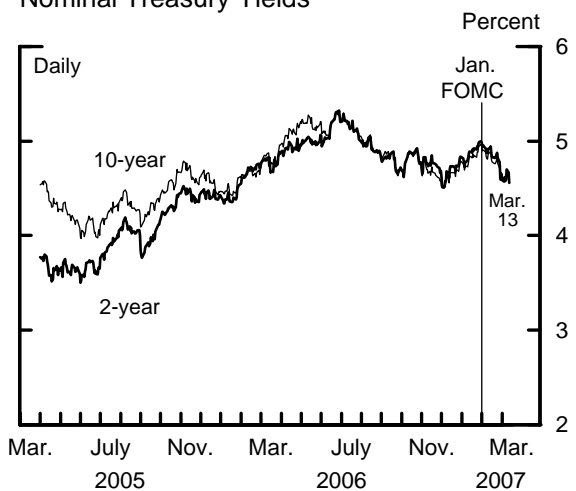
Expected Federal Funds Rate



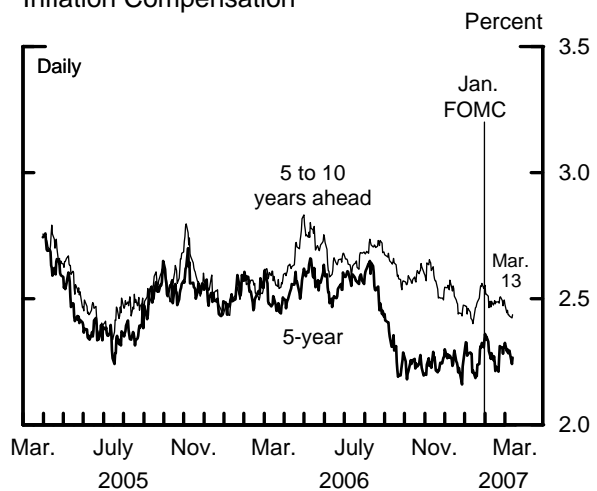
Policy Uncertainty



Nominal Treasury Yields



Inflation Compensation



## Domestic Financial Developments

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### Overview

Financial markets were especially turbulent at times over the intermeeting period as investors apparently became less confident about the underlying strength of the U.S. economic expansion and somewhat less willing to hold risky assets. Although market participants were steady in their conviction that the FOMC will keep policy unchanged at the upcoming meeting, they marked down their predicted path for monetary policy later this year and next. Nominal Treasury yields moved lower across the curve. Yields on Treasury inflation-protected securities (TIPS) also declined, and inflation compensation edged lower except in the very near term. Yields on investment-grade corporate bonds fell about as much as those on comparable-maturity Treasury securities, but those on speculative-grade bonds fell somewhat less, leaving risk spreads wider. Equity markets ended the period with fairly sizable losses. Overall household and business credit quality remained favorable, although the subprime mortgage sector has deteriorated notably.

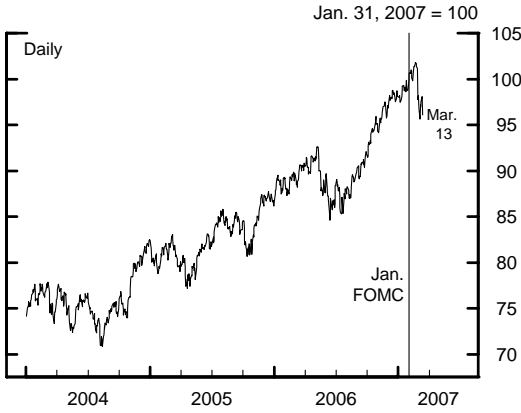
### Policy Expectations and Interest Rates

Market participants largely anticipated the FOMC's policy decision at the January meeting, but yields edged lower, as some investors reportedly interpreted the discussion of inflation prospects in the statement as somewhat more optimistic than they had anticipated. The Monetary Policy Report to the Congress and the Chairman's accompanying testimony also prompted a modest decline in short-term interest rates, as investors focused on the Chairman's remark that "inflation pressures are beginning to diminish" and on the downwardly revised central tendencies of the FOMC's projections for real GDP growth. Policy expectations for the upcoming meeting changed little during the intermeeting period, as investors continued to expect the Committee to keep policy on hold. However, at longer horizons, the expected path for monetary policy moved down, on balance, with the most visible shift accompanying the sharp market moves at the end of February. The mixed economic data released over the intermeeting period had only a modest net effect on policy expectations, but concerns that problems in the subprime mortgage sector might weigh on economic activity may have contributed to the downward shift. Investors now see about a 40 percent chance of at least 25 basis points of easing by June, and they also expect a cumulative reduction of roughly 100 basis points in the target rate by the end of 2008, about 50 basis points more than before the January meeting.

Investors became markedly more uncertain about the path for monetary policy. Implied volatilities inferred from options on Eurodollar futures moved up in late February from near historical lows and stayed near those more moderate levels thereafter. In addition,

### Corporate Yields, Risk Spreads, and Stock Prices

Wilshire 5000

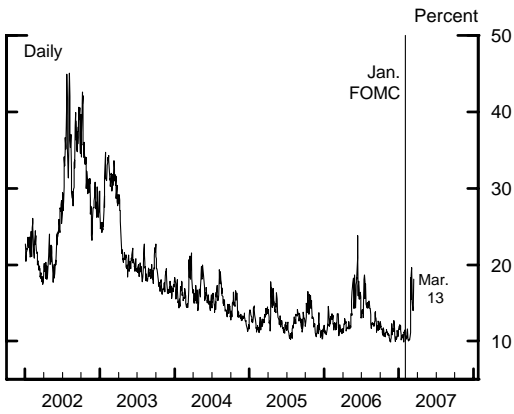


Ratio of Trend Earnings to Price for S&P 500 and Long-Run Treasury Yield

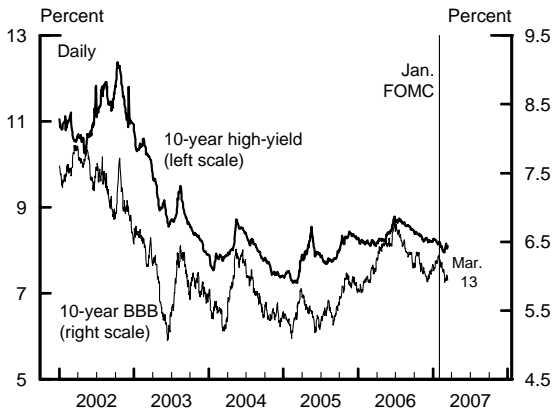


+ Denotes the latest observation using daily interest rates and stock prices and latest earnings data from I/B/E/S.  
 \* Trend earnings are estimated using analyst forecast of year-ahead earnings from I/B/E/S.

Implied Volatility on S&P 500 (VIX)

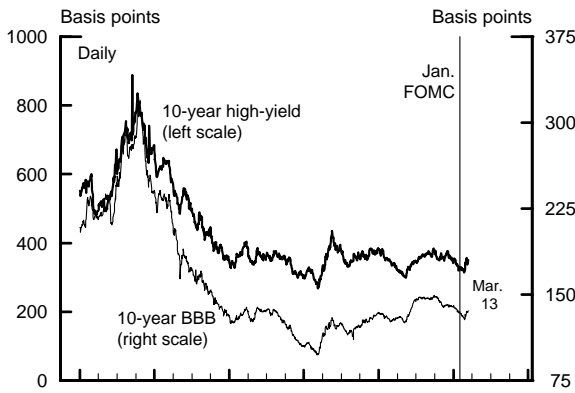


Corporate Bond Yields



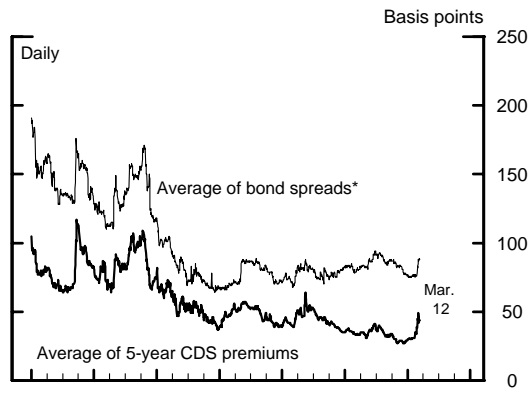
Note. Yields from smoothed yield curves based on Merrill Lynch bond data.

Corporate Bond Spreads



Note. Measured relative to comparable-maturity Treasuries.

Investment Bank Bond Spreads and CDS



Source. Merrill Lynch and Markit.

\* Spreads are measured relative to comparable-maturity Treasuries and are for bonds with 3-7 years in remaining maturity for Merrill Lynch, Bear Stearns, Goldman Sachs, and Lehman Brothers.

the options-implied distributions of funds rates between three and twelve months ahead are now considerably more skewed toward lower interest rates.

Two- and ten-year nominal Treasury yields decreased about 40 and 35 basis points, respectively, over the intermeeting period. Movements at the short end of the curve were generally consistent with the downwardly revised policy outlook, and the apparent shift toward less risky assets by investors may have depressed yields further out the term structure. Indeed, movements in Treasury yields closely tracked the ups and downs in the stock market, particularly during the periods of heightened financial market volatility. Real yields also declined, albeit by less than nominal rates, generally leaving TIPS-based inflation compensation slightly lower despite a rise in oil prices.

### **Stock Prices and Corporate Interest Rates**

Stock prices drifted up early in the intermeeting period, as earnings reports continued to be solid. However, equity markets plunged on February 27 and declined further on balance over the period, reflecting some pullback from risk as well as increased concerns about the economic outlook and the condition of some subprime lenders. On net, broad stock price indexes are down 3 percent to 4 percent since the last FOMC meeting. The spread between the twelve-month forward trend earnings-price ratio for S&P 500 firms and a real long-run Treasury yield—a rough gauge of the equity risk premium—widened somewhat but remained within its range of the past few years. Implied volatility on the S&P 500 index shot up on February 27 from very low levels and stayed somewhat elevated.

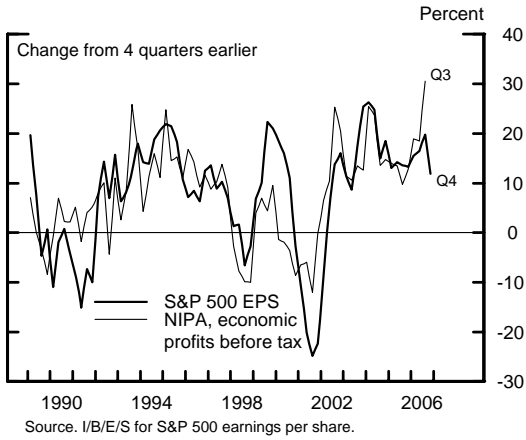
On net over the intermeeting period, yields on investment-grade corporate bonds fell about in line with those on comparable-maturity Treasury securities, leaving their spreads little changed at low levels. Bond spreads and CDS premiums for several investment banks that may be exposed directly to the subprime mortgage market widened some but are within the range of the past couple of years. Spreads on speculative-grade bonds widened about 25 basis points, mostly since late February, but remained low. Liquidity in corporate bond markets, as measured by trading volume and estimated bid-ask spreads, remained ample during the recent turbulence. Trading volume in the CDS market also reportedly stayed strong. Spreads on commercial paper were low and stable.

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

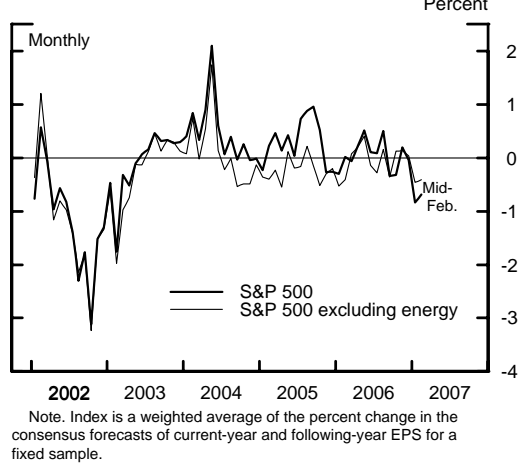
Operating earnings per share for S&P 500 firms increased about 12 percent over the year ending in the fourth quarter, a deceleration from the remarkably strong pace earlier in

### Corporate Earnings and Credit Quality

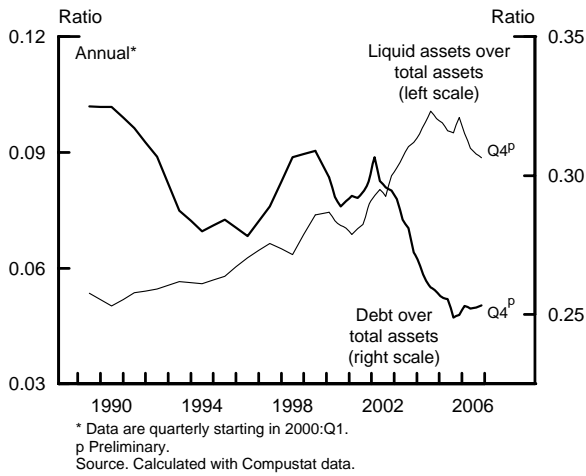
Corporate Earnings Growth



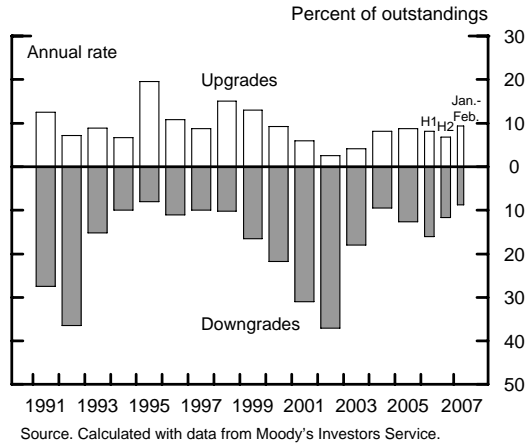
Revisions to Expected S&P 500 Earnings



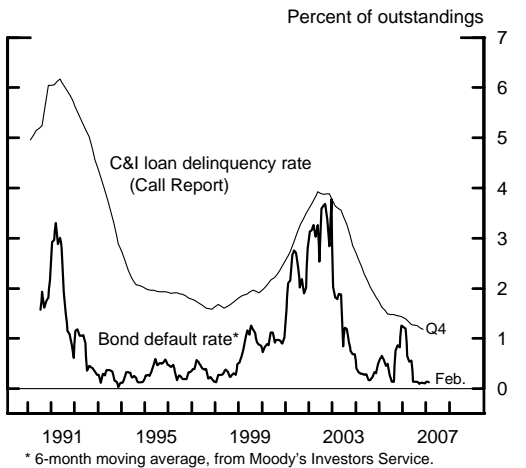
Financial Ratios for Nonfinancial Corporations



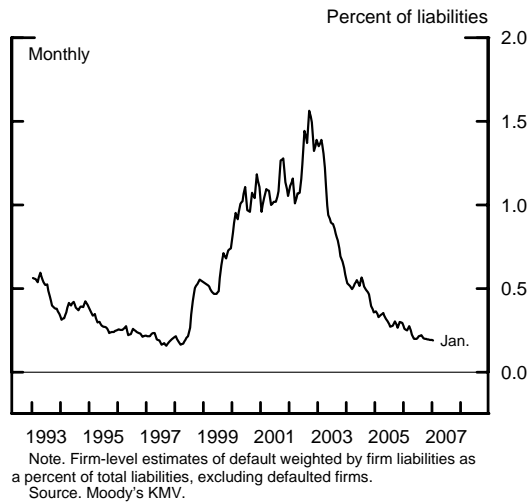
Bond Ratings Changes of Nonfinancial Companies



Selected Default and Delinquency Rates



Expected Year-Ahead Defaults



## Business Finance

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

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

Type of security	2003	2004	2005	2006			2007
				H1	Q3	Q4	Q1 <sup>p</sup>
<i>Nonfinancial corporations</i>							
Stocks <sup>1</sup>	3.7	5.4	4.6	5.2	2.6	5.6	3.6
Initial public offerings	.4	1.6	1.7	1.9	.7	2.7	1.7
Seasoned offerings	3.3	3.8	2.8	3.3	1.9	2.9	1.9
Bonds <sup>2</sup>	31.6	22.7	19.1	30.3	20.7	38.3	22.8
Investment grade	15.9	8.2	8.4	14.4	10.5	12.7	10.0
Speculative grade	11.3	9.7	6.4	8.4	4.8	10.4	8.3
Other (sold abroad/unrated)	4.3	4.9	4.3	7.6	5.5	15.3	4.5
<i>Memo</i>							
Net issuance of commercial paper <sup>3</sup>	-3.4	1.5	-.4	3.4	-1.2	9.9	-2.1
Change in C&I loans at commercial banks <sup>3,4,5</sup>	-7.7	3.2	9.9	14.5	14.5	6.6	9.9
<i>Financial corporations</i>							
Stocks <sup>1</sup>	6.6	6.9	5.0	4.4	5.0	7.3	8.0
Bonds <sup>2</sup>	111.1	139.3	176.3	190.2	175.1	195.4	154.0

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.

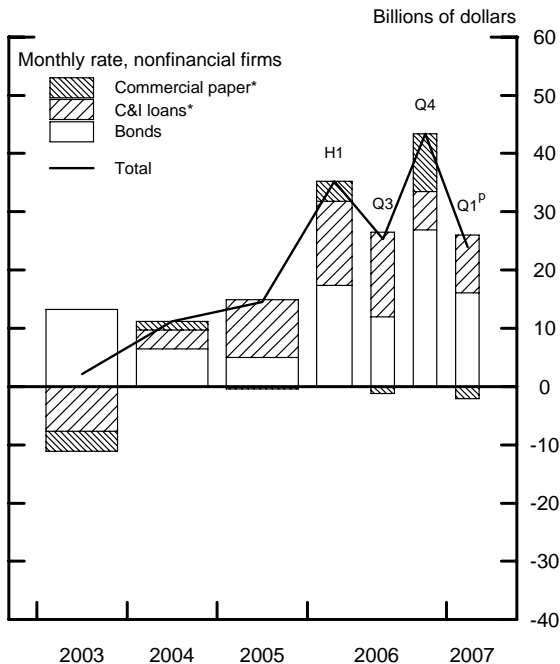
3. End-of-period basis, seasonally adjusted.

4. Adjusted for FIN 46 effects.

5. Adjusted to remove the effects of a consolidation of a sizable amount of thrift assets onto a commercial bank's books in October 2006.

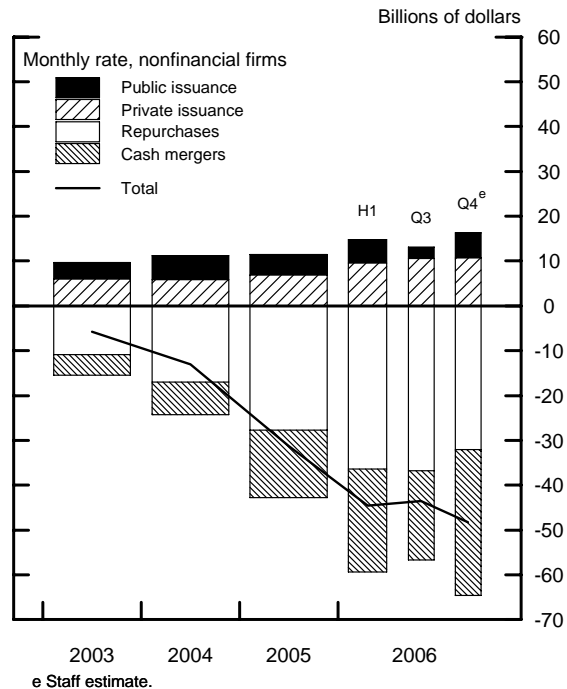
p Preliminary.

#### Selected Components of Net Debt Financing



\* Seasonally adjusted, period-end basis.  
p Preliminary.

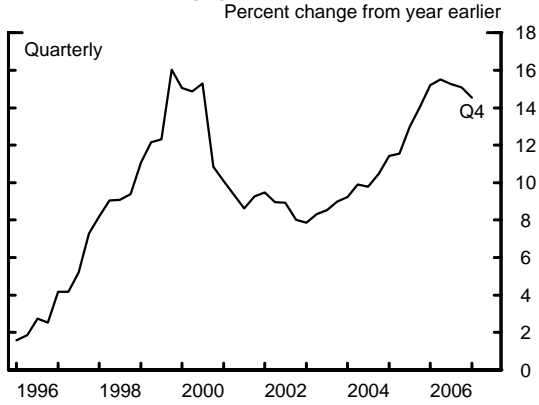
#### Components of Net Equity Issuance



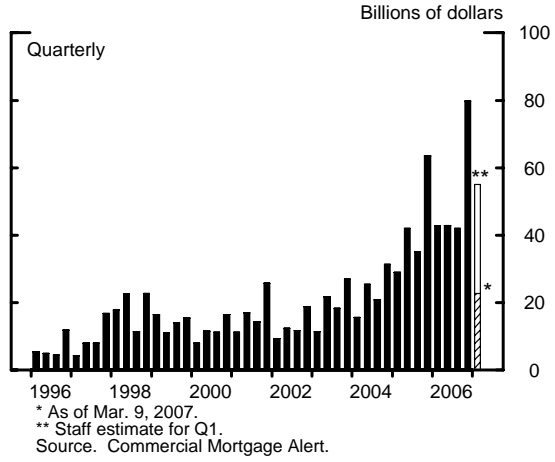
e Staff estimate.

### Commercial Real Estate

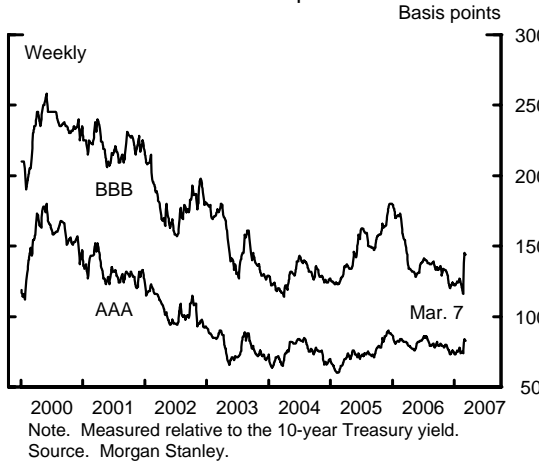
Commercial Mortgage Debt



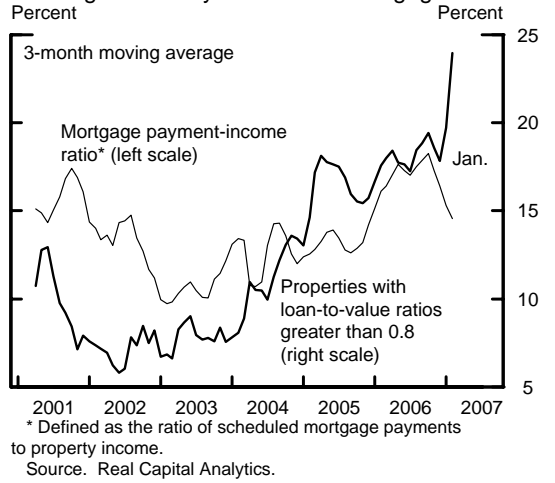
Gross Issuance of CMBS



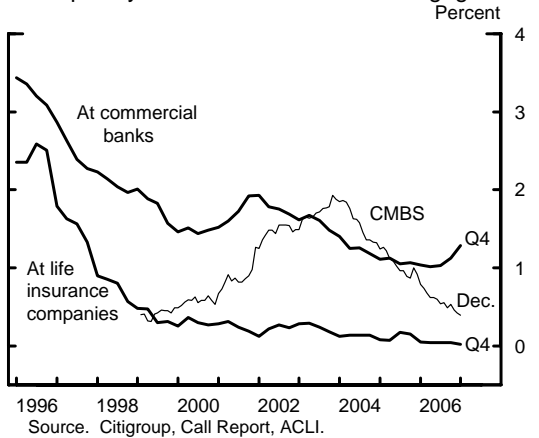
Investment-Grade CMBS Spreads



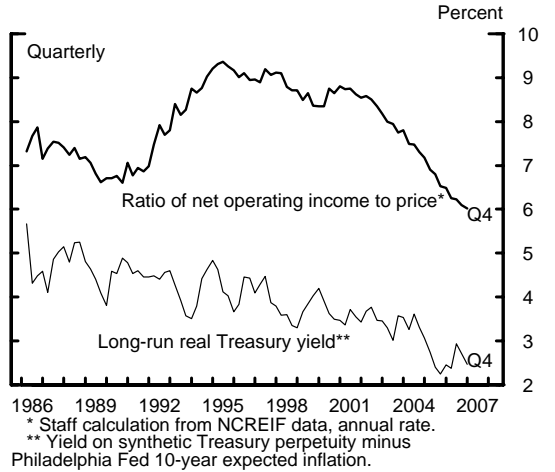
Leverage on Newly Securitized Mortgages



Delinquency Rates on Commercial Mortgages



Commercial Real Estate Valuation





2006. Revisions to year-ahead earnings expectations remained moderately negative; about half of the decline was attributable to the energy sector. Investment banks reporting quarterly data ending in February generally posted large gains in earnings.

Indicators of the credit quality of nonfinancial firms have stayed strong. Data in hand for the fourth quarter of 2006 indicate that corporate cash holdings relative to assets continued to recede but remained high and that the ratio of debt to total assets stayed low. In the first two months of the year, the volume of bond upgrades slightly outpaced that of downgrades. The realized six-month trailing bond default rate stayed near zero in February, and the delinquency rate on C&I loans in the fourth quarter was the lowest in more than a decade. The January forecast of the aggregate year-ahead default rate from KMV was the lowest since 1998, although the measure for February could tick up because stock market volatility is a key input into KMV's model.

### **Business Finance**

Gross bond issuance by nonfinancial firms has been solid this quarter, and a notable fraction of the proceeds has been used to refinance existing debt. In addition, as has been the case in the past few quarters, issuance of speculative-grade bonds has been boosted by strong merger and acquisition financing. Bond issuance has been strong in early March despite recent market turbulence. C&I loans have continued to expand moderately; lenders appear to have remained accommodative despite the recent volatility. In contrast, commercial paper outstanding has declined, in part because some firms paid down what appeared to be bridge financing for acquisitions. Overall, net debt financing is estimated to have moderated in the first quarter from the rapid fourth-quarter pace, although it remains reasonably robust.

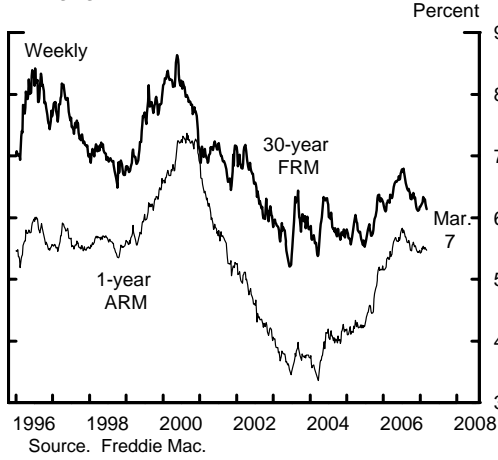
Gross public equity issuance, both seasoned offerings and IPOs, has also moderated this quarter, with the slowdown emerging before the recent volatility in equity markets. Data for the fourth quarter indicate that private equity issuance proceeded apace and was fueled by strong leveraged buyout activity. Still, gross equity issuance continued to be dwarfed by the extraordinary pace of equity retirements. Boosted by strong profits and ample cash on corporate balance sheets, retirements from cash-financed mergers and acquisitions reached a new record high in the fourth quarter.

### **Commercial Real Estate**

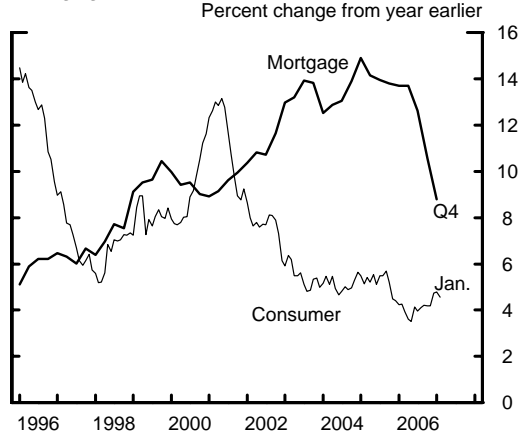
Commercial mortgage borrowing increased appreciably again in the fourth quarter, and the calendar of scheduled commercial-mortgage-backed securities (CMBS) offerings

### Household Liabilities

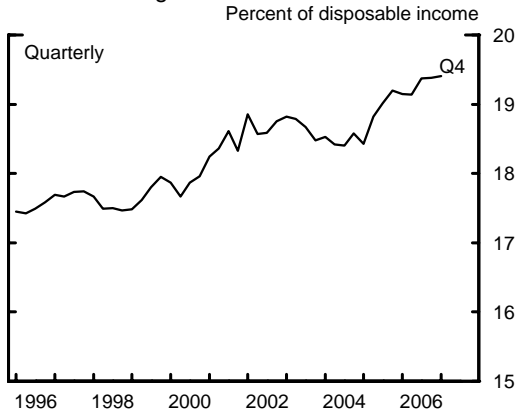
Mortgage Rates



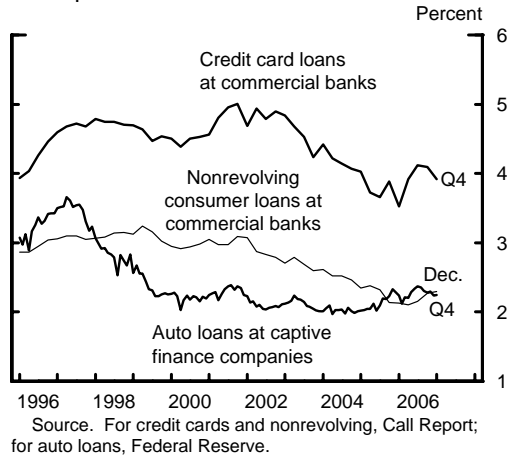
Mortgage Debt and Consumer Credit



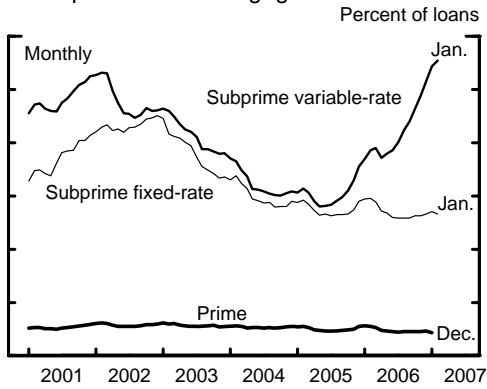
Financial Obligations Ratio



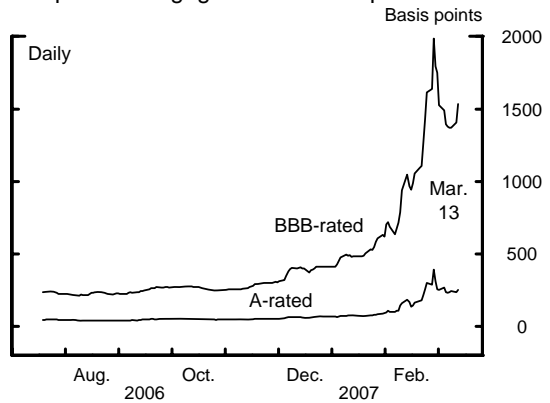
Delinquencies on Consumer Loans



Delinquencies on Mortgages



Subprime Mortgage CDS Index Spreads



suggests that issuance will be strong in the current quarter. Spreads on investment-grade CMBS widened in late February to their highest level since early 2006, as investors reportedly reacted to the increased volatility in equity and subprime mortgage markets.

The rapid growth of commercial mortgage debt in recent years has been associated with rising leverage on new mortgages. The percentage of newly securitized mortgages with loan-to-value ratios greater than 80 percent has increased substantially over the past year, and the ratio of scheduled mortgage payments to property income for these mortgages is in the upper part of the range seen in the past few years. As yet, however, delinquency rates on CMBS and commercial mortgages held by life insurance companies remain low. The delinquency rate on commercial mortgages held by commercial banks has risen in recent quarters, but the rise appears to be driven mainly by construction and land development loans, many of which are tied to residential real estate projects.

Further large increases in commercial property prices in the fourth quarter led to another decline in the ratio of net operating income to property prices. The spread of this ratio over the real perpetuity Treasury yield, a rough measure of the risk premium on commercial real estate assets, remains in the lower part of the range observed over the past decade.

### **Household Finance**

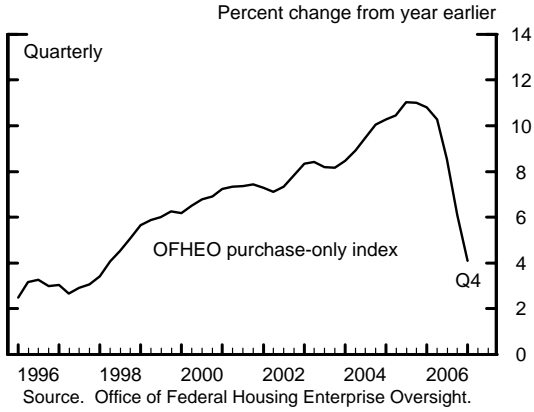
Interest rates available to prime borrowers on both thirty-year fixed-rate and one-year adjustable-rate mortgages decreased slightly over the intermeeting period. As origination volumes and house-price growth slowed, mortgage debt decelerated substantially further in the fourth quarter. Growth of consumer credit remained moderate through January.

Although the financial obligations ratio was at its historical high in the fourth quarter, readings on household credit quality continued to be favorable on the whole. Delinquency rates on consumer loans and prime mortgages, which account for the vast majority of total household debt, remained low, as did delinquency rates on subprime fixed-rate mortgages.

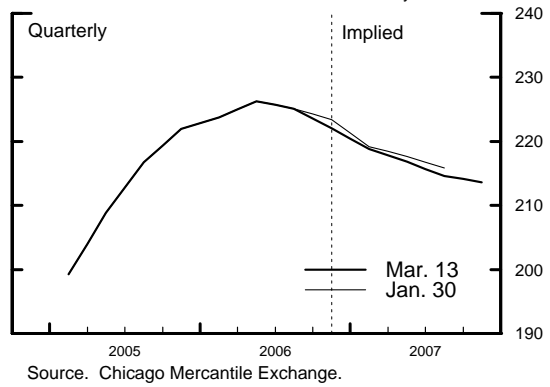
Delinquency rates on subprime variable-rate mortgages have continued to climb, however. Some borrowers apparently have had difficulty coping with large upward adjustments to their contract rates against a backdrop of flatter house prices. Moreover, an evident loosening of underwriting standards has meant that subprime loans originated in 2006 are going delinquent at a considerably faster pace than other recent vintages.

### Household Assets

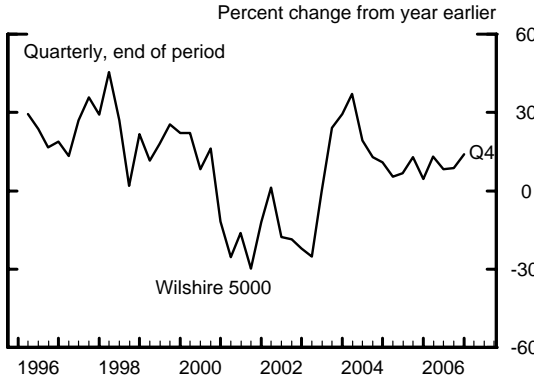
House Prices



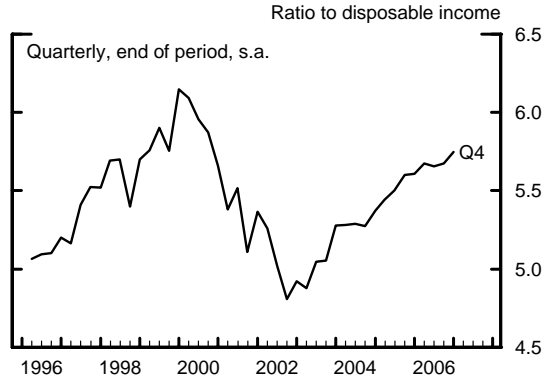
House-Price Path Implied by Futures on S&P/Case-Shiller 10-City Index



Stock Prices



Net Worth



### Net Flows into Long-Term Mutual Funds

(Billions of dollars, monthly rate)

Fund type	2004	2005	2006	2006		2007		Assets Jan.
				Q3	Q4	Jan.	Feb. <sup>e</sup>	
<b>Total long-term funds</b>	<b>17.5</b>	<b>16.0</b>	<b>19.0</b>	<b>9.2</b>	<b>21.6</b>	<b>46.9</b>	<b>48.4</b>	<b>8,212</b>
<b>Equity funds</b>	<b>14.8</b>	<b>11.3</b>	<b>13.3</b>	<b>4.1</b>	<b>11.2</b>	<b>28.3</b>	<b>27.9</b>	<b>6,039</b>
Domestic	9.3	2.5	0.9	-3.6	-0.9	7.2	10.8	4,690
International	5.6	8.7	12.4	7.7	12.1	21.1	17.1	1,349
<b>Hybrid funds</b>	<b>3.6</b>	<b>2.1</b>	<b>0.6</b>	<b>0.3</b>	<b>1.8</b>	<b>3.4</b>	<b>3.3</b>	<b>663</b>
<b>Bond funds</b>	<b>-0.9</b>	<b>2.6</b>	<b>5.0</b>	<b>4.8</b>	<b>8.6</b>	<b>15.2</b>	<b>17.2</b>	<b>1,510</b>
High-yield	-0.8	-1.3	-0.2	0.4	0.5	0.9	1.2	159
Other taxable	1.0	3.5	4.0	3.3	6.3	11.5	13.1	985
Municipals	-1.1	0.4	1.3	1.0	1.8	2.8	2.9	366

Note. Excludes reinvested dividends.

e Staff estimate based on confidential weekly data.

Source. Investment Company Institute.

Lenders have increasingly had to repurchase loans previously securitized because of so-called “early payment defaults,” and investors have reportedly stepped up their scrutiny of loans going into securitizations. As a result of these developments, a number of monoline subprime lenders have shut their doors. Spreads on CDS indexes for pools of subprime mortgages originated last year continued to climb, on net, over the intermeeting period. The bank supervisory agencies have issued for comment expanded guidance for some types of subprime mortgage lending.

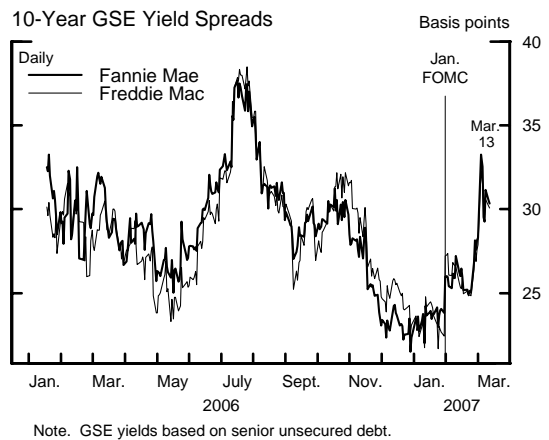
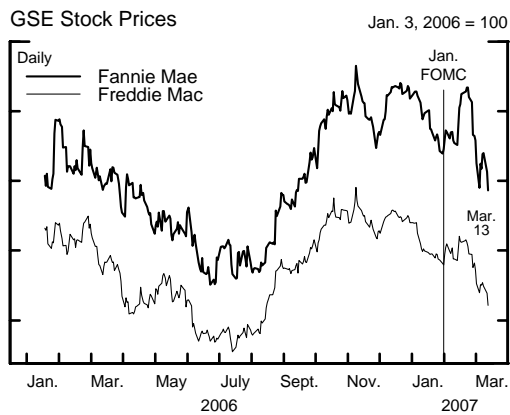
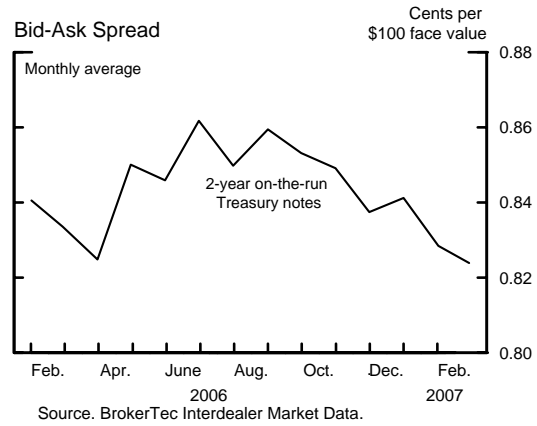
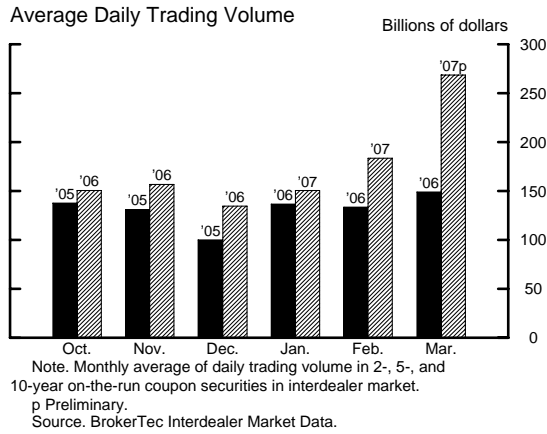
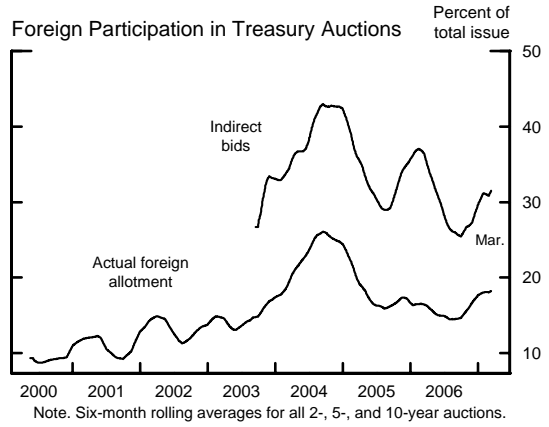
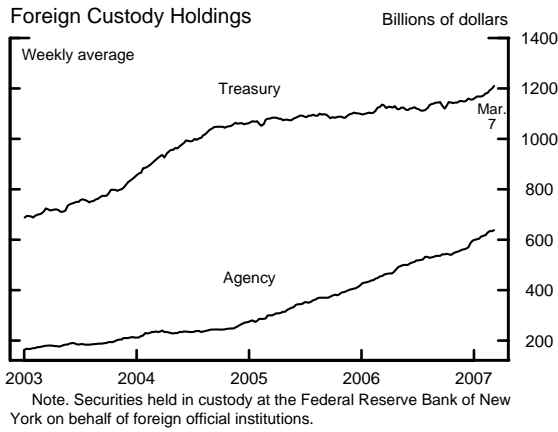
Home-price appreciation as measured by the four-quarter change in the OFHEO purchase-only index slowed further in the fourth quarter. The modest downward trajectory for expected home prices in ten of the largest metropolitan markets over the next few quarters, derived from futures quotes on the S&P/Case-Shiller home-price index, was largely unchanged over the intermeeting period. Notwithstanding the small increases in home prices, the ratio of household net worth to disposable personal income rose notably in the fourth quarter owing to the rise in stock prices. Net inflows to long-term mutual funds approached record levels in January and February, propelled by strong inflows to world equity funds and bond funds. Domestic equity funds also attracted substantial net new cash after several quarters of net outflows. However, equity funds had net outflows in the first week of March, suggesting that investors were put off by the market turbulence that began in late February.

### **Treasury and Agency Finance**

Over the intermeeting period, the Treasury auctioned securities across the maturity spectrum, and demand was reportedly strong amid some reduction in auction sizes. As part of its midquarter refunding statement, the Treasury announced that it is considering eliminating the three-year note from its auction calendar and that it will announce its decision at the May refunding after April tax receipts have been evaluated. Various indicators suggest that foreign demand for nominal Treasury securities held steady: Foreign custody holdings of Treasury securities at the Federal Reserve Bank of New York increased somewhat, and the six-month rolling average of the proportion of two-, five-, and ten-year note auctions awarded to foreign investors stayed relatively high. News that China plans to manage a part of its international reserves more aggressively than in the past had little effect on Treasury yields.

The market for Treasury securities functioned well despite the recent heightened financial market volatility. The combined volume of trading in two-, five-, and ten-year on-the-run Treasury notes estimated from BrokerTec data reached a record high during the week of

Treasury and Agency Financing



## State and Local Government Finance

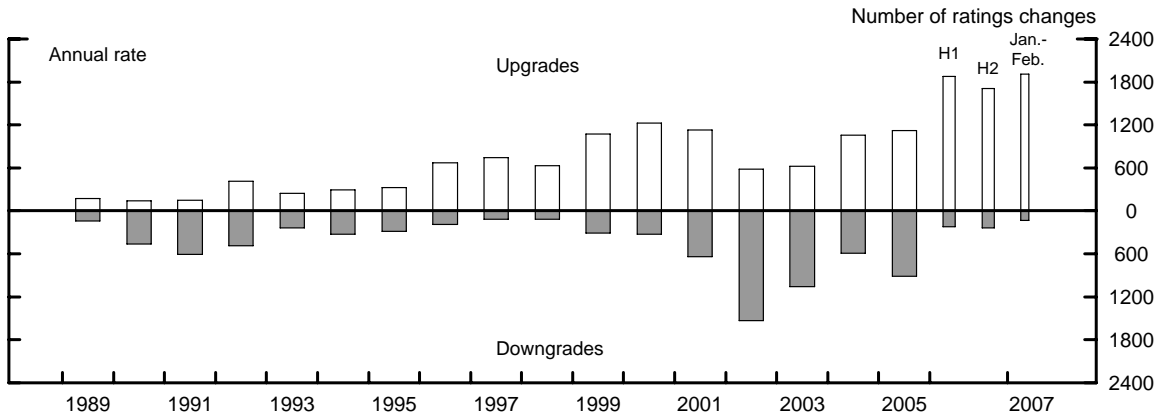
### Gross Offerings of Municipal Securities

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

Type of security	2003	2004	2005	2006			2007
				H1	Q3	Q4	Q1 <sup>p</sup>
Total	37.9	34.7	38.4	32.9	34.6	44.1	36.5
Long-term <sup>1</sup>	32.0	29.8	34.1	30.0	29.1	40.6	34.6
Refundings <sup>2</sup>	10.0	10.8	15.5	9.7	8.0	14.6	15.0
New capital	22.1	19.0	18.7	20.3	21.1	26.0	19.6
Short-term	5.8	4.9	4.2	2.8	5.5	3.5	1.9
Memo: Long-term taxable	3.5	2.0	2.1	2.8	2.7	1.8	1.0

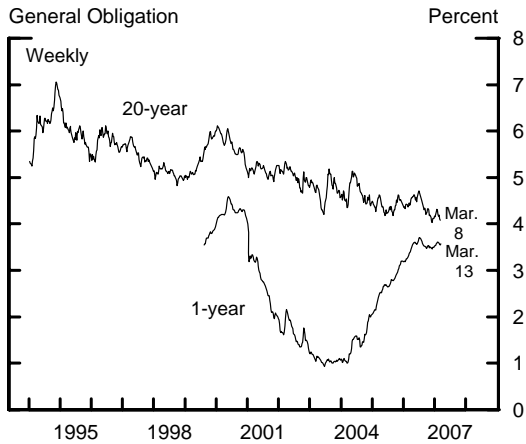
- 1. Includes issues for public and private purposes.
- 2. All issues that include any refunding bonds.
- p Based on preliminary data through March 8, 2007.

### Ratings Changes



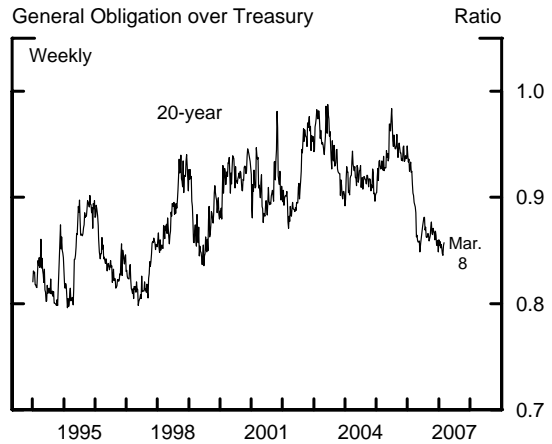
Source. S&P's Credit Week Municipal and Ratings Direct.

### Municipal Bond Yields



Source. Municipal Market Advisors and Bond Buyer.

### Municipal Bond Yield Ratio



Source. Bond Buyer.

**M2 Monetary Aggregate**  
(Based on seasonally adjusted data)

Aggregate and components	Percent change (annual rate) <sup>1</sup>						Level
	2005	2006	2006		2007		(billions of dollars),
			Q3	Q4	Jan.	Feb.	Feb.
						(p)	(p)
M2	4.1	5.0	4.2	6.8	10.3	5.3	7,112
Components <sup>2</sup>							
Currency	3.6	3.6	1.1	3.1	1.1	-1.0	750
Liquid deposits <sup>3</sup>	2.0	.6	-1.2	2.7	10.6	4.0	4,349
Small time deposits	18.7	19.7	20.2	17.7	6.7	8.7	1,179
Retail money market funds	-.2	12.9	15.7	17.4	22.4	12.5	827
Memo:							
Institutional money market funds	4.9	15.7	17.2	20.9	-3.6	8.5	1,339
Monetary base	3.5	3.1	.7	2.5	1.4	-2.0	812

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

2. Nonbank traveler's checks are not listed.

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

p Preliminary.



February 27. Trading appears to have been orderly: Bid-ask spreads remained within normal ranges, and market participants characterized liquidity as normal.

The stock prices of Fannie Mae and Freddie Mac decreased a touch more than the broad equity indexes over the intermeeting period, and yield spreads on agency debt over comparable-maturity Treasuries widened somewhat on net. Congressman Barney Frank, chairman of the House Financial Services Committee, has introduced legislation on government-sponsored enterprises (GSEs) that somewhat strengthens the GSEs' safety and soundness regulation but falls short of the reforms supported by the Federal Reserve Board. The House will hold hearings on the Frank bill over the next few weeks, and a vote on the bill is likely in April. A substantial majority in the House is expected to support the bill. However, to date, there seems to have been little action in the Senate regarding GSE legislation.

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

The pace of gross issuance of long-term municipal bonds has been solid thus far in the first quarter, although it has not reached the outsized fourth-quarter pace. Advance refunding issuance increased a bit, but new capital issuance slowed notably. In view of the sizable bond capacities approved in a number of states in the November elections, the slowdown is likely to be only temporary. Issuance of short-term municipal bonds continued to be modest. The credit quality of municipal bonds remained solid, and the number of bonds with rating upgrades continued to far outpace the number with downgrades over the intermeeting period.

### **Money and Bank Credit**

M2 expanded at an annual rate of about 5¼ percent in February, down from a more than 10 percent pace in January. The slowdown in February was led by a moderation in the rate of growth of liquid deposits, the largest component of M2, after outsized gains in January. Decelerations this year in small time deposits and retail money market funds likely owe to a narrowing of the spread between the rates paid on these and alternative assets. Currency contracted a bit in February, a development that reflected a further softening of foreign demand.

Growth of commercial bank credit is estimated to have picked up notably in the first two months of the year from the sluggish pace of the fourth quarter. The acceleration was largely the result of an increase in banks' purchases of securities and faster growth in banks' holdings of real estate loans. Loan price data from the Survey of Terms of

**Commercial Bank Credit**

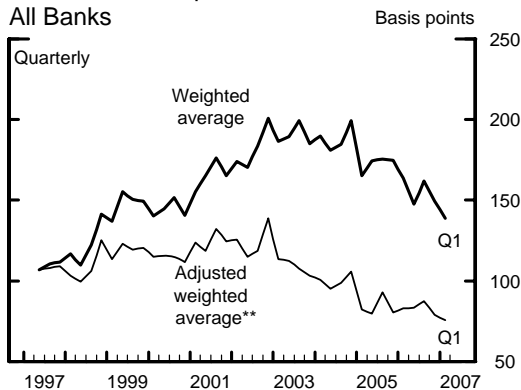
(Percent change, annual rate, except as noted; seasonally adjusted)

Type of credit	2005	H1 2006	Q3 2006	Q4 2006*	Jan. 2007	Feb. 2007 <sup>p</sup>	Level, <sup>1</sup> Feb. 2007* <sup>p</sup>
Total <sup>2</sup>	10.5	11.9	9.1	3.0	5.9	10.0	7,979
<i>Loans<sup>3</sup></i>							
Total	11.6	11.6	10.8	6.3	6.9	9.4	5,994
To businesses							
Commercial and industrial	13.1	16.3	20.2	9.7	3.7	6.6	1,177
Commercial real estate	17.1	15.6	13.6	7.1	7.4	13.5	1,459
To households							
Residential real estate	12.0	7.7	7.3	2.2	4.9	5.7	1,765
Revolving home equity	13.3	.1	3.9	1.3	3.7	-6.3	453
Consumer	3.1	6.7	6.5	.3	11.8	-.6	742
Originated <sup>4</sup>	.7	7.4	5.1	4.8	10.2	1.8	1,138
Other <sup>5</sup>	8.6	12.0	4.5	14.3	10.7	23.2	851
<i>Securities</i>							
Adjusted <sup>2</sup>	7.6	12.7	4.4	-6.5	2.8	11.7	1,985
Reported	5.4	13.3	3.9	-6.0	-5.2	9.5	2,136
Treasury and agency	.0	8.3	6.1	-3.5	2.4	3.2	1,200
Other <sup>6</sup>	13.5	20.0	1.5	2.7	-14.3	17.0	965

Note. Yearly annual rates are Q4 to Q4; quarterly and monthly annual rates use corresponding average levels. Data are adjusted to remove estimated effects of consolidation related to FIN 46 and for breaks caused by reclassifications.

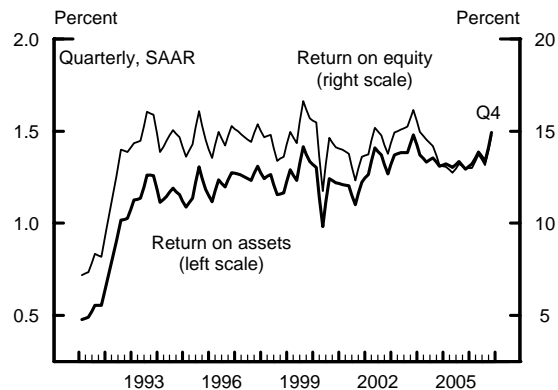
1. Billions of dollars. Pro rata averages of weekly (Wednesday) levels.
  2. Adjusted to remove effects of mark-to-market accounting rules (FIN 39 and FAS 115).
  3. Excludes interbank loans.
  4. Includes an estimate of outstanding loans securitized by commercial banks.
  5. Includes security loans and loans to farmers, state and local governments, and all others not elsewhere classified. Also includes lease financing receivables.
  6. 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.
- \* Adjusted to remove the effects of a consolidation of a sizable volume of thrift assets onto a commercial bank's books in October 2006.  
p Preliminary.

**C&I Loan Rate Spreads\***



\* Spread over banks' estimated cost of funds.  
\*\* Adjusted for changes in nonprice loan characteristics.  
Source. Survey of Terms of Business Lending.

**Bank Profitability**



Source. Call Report.

Business Lending conducted during the week of February 5 indicate that the average spread of C&I loan rates over banks' cost of funds, adjusted for changes in nonprice loan characteristics, edged down further in the first quarter. The decline mainly occurred at domestic banks. At these institutions, spreads on higher-risk loans not made under previous commitment—a category of loans that reflects the most recent pricing trends for risky credits—are at levels not seen since the first half of 1998. Reportedly, the reaction in the U.S. syndicated loan market to the recent turbulence in financial markets was generally muted.

According to the latest Call Report data, profitability in the commercial banking sector improved further in the fourth quarter of 2006. Supported by growth in all income components, the industry return on assets rose to its highest level in many years, while the return on equity also increased notably. Credit quality remained excellent, as charge-off rates on all loans and leases remained very low by historical standards, although delinquency rates edged up from low levels in the second half of the year.

Last Page of Domestic Financial Developments

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## **International Developments**

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## International Developments

### U.S. International Transactions

#### Trade in Goods and Services

The U.S. international trade deficit narrowed considerably to \$714.4 billion (annual rate) in the fourth quarter, as a 9.7 percent increase in the value of exports was coupled with a 9.7 percent decrease in the value of imports. Exports of aircraft and services rose robustly, even as exports of automotive products fell back from their elevated third-quarter level and exports of semiconductors declined for the second consecutive quarter. The decline in imports primarily reflected a fall in both the volume and price of imported oil. In addition, imports of non-oil industrial supplies and capital goods declined, more than offsetting a strong increase in imports of consumer goods and a smaller increase in imports of automotive products.

#### Trade in Goods and Services

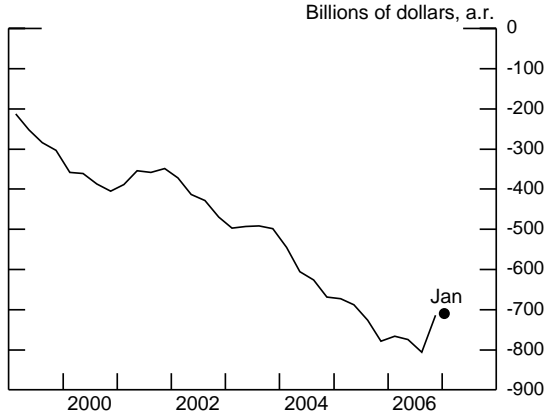
	2006	Annual rate			Monthly rate		
		2006			2006		2007
		Q2	Q3	Q4	Nov.	Dec.	Jan.
Percent change							
<i>Nominal BOP</i>							
Exports	10.4	14.1	11.7	9.7	1.0	.4	1.1
Imports	12.6	10.5	13.6	-9.7	.3	2.1	-.5
<i>Real NIPA</i>							
Exports	6.7	6.2	6.8	10.5	...	...	...
Imports	5.2	1.4	5.6	-2.2	...	...	...
Billions of dollars							
<i>Nominal BOP</i>							
Net exports	-765.3	-774.5	-805.6	-714.4	-58.2	-61.5	-59.1
Goods, net	-836.0	-843.5	-875.6	-791.8	-64.8	-68.1	-65.4
Services, net	70.7	69.0	70.0	77.4	6.6	6.6	6.3

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

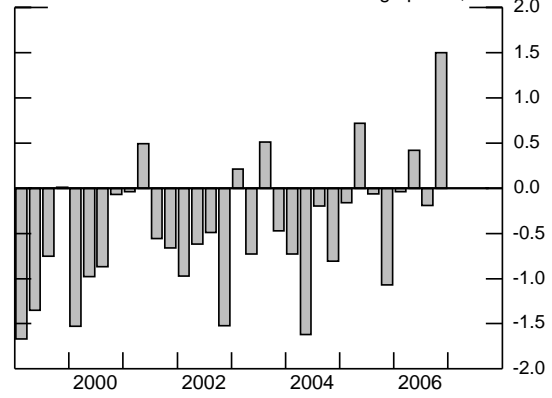
In January, the trade deficit narrowed to \$59.1 billion from \$61.5 billion in December (revised). The narrowing of the deficit reflected both higher exports and lower imports. The value of exports of goods and services increased 1.1 percent following a 0.4 percent increase in December. The January increase reflected a jump in the exports of goods, which more than offset a slight decline in exports of services. Within goods, exports

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

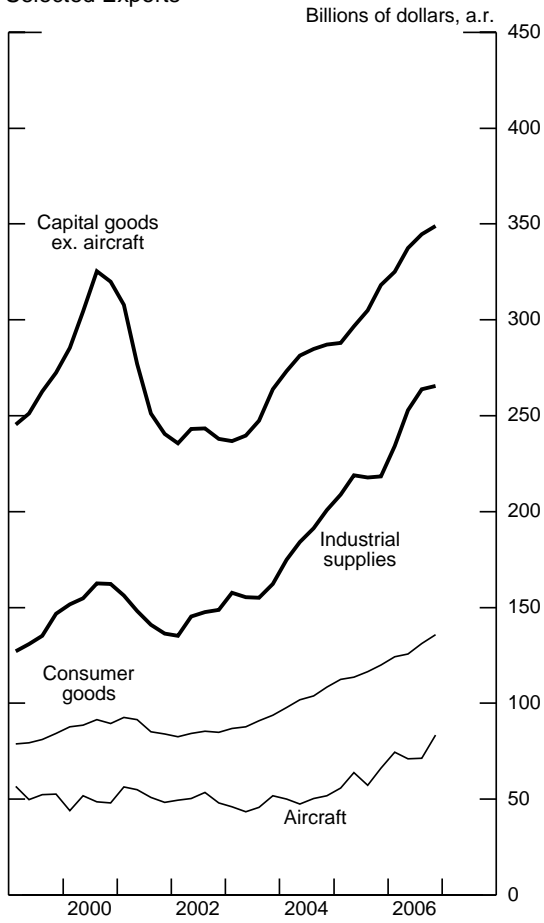
Trade Balance



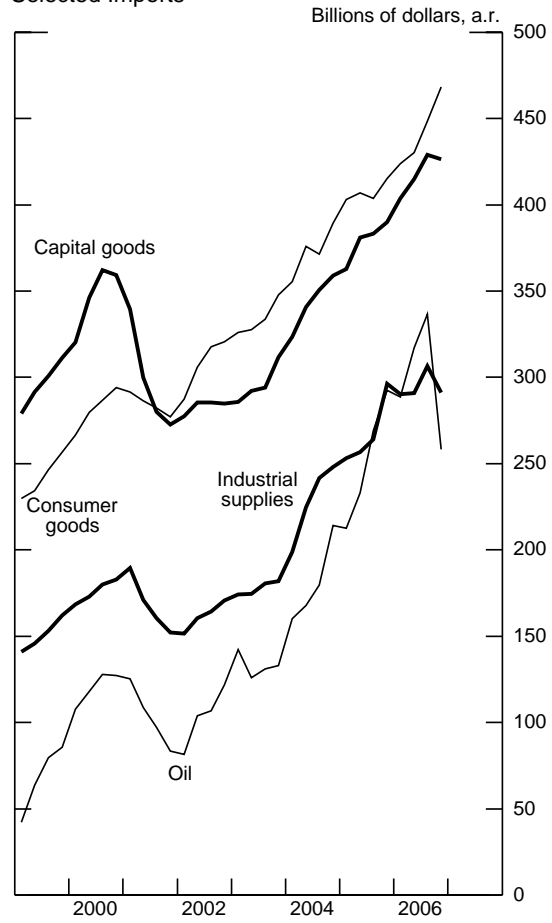
Contribution of Net Exports to Real GDP Growth



Selected Exports



Selected Imports



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

	Levels				Change <sup>1</sup>			
	2006		2006	2007	2006		2006	2007
	Q3	Q4	Dec.	Jan.	Q3	Q4	Dec.	Jan.
<b>Exports of G&amp;S</b>	<b>1459.8</b>	<b>1493.9</b>	<b>1503.5</b>	<b>1520.1</b>	<b>40.0</b>	<b>34.1</b>	<b>6.7</b>	<b>16.6</b>
Goods exports	1045.1	1066.5	1072.5	1090.2	36.9	21.4	4.4	17.7
Gold	9.6	9.0	9.5	7.3	.8	-.6	1.3	-2.3
Other goods	1035.5	1057.5	1063.0	1082.9	36.1	22.0	3.0	20.0
Capital goods	415.9	432.2	434.1	446.4	7.6	16.3	-1.3	12.3
Aircraft & parts	71.3	83.4	83.9	92.1	.3	12.1	-3.1	8.1
Computers & accessories	47.3	48.2	46.1	48.9	-.4	.9	-2.7	2.8
Semiconductors	53.6	50.3	48.4	50.1	-1.2	-3.3	-3.2	1.7
Other capital goods	243.7	250.3	255.6	255.3	9.0	6.6	7.7	-.3
Automotive	110.9	108.9	114.4	106.2	6.8	-2.0	6.3	-8.2
Ind. supplies (ex. ag., gold)	263.9	265.5	261.6	268.1	11.1	1.6	-4.2	6.5
Consumer goods	131.1	135.8	137.4	143.6	5.5	4.6	1.5	6.2
Agricultural	75.2	74.7	76.3	79.4	2.7	-.5	3.7	3.2
All other goods	38.5	40.5	39.2	39.2	2.4	2.0	-7.5	-.0
Services exports	414.7	427.4	431.0	429.9	3.1	12.7	2.4	-1.2
<b>Imports of G&amp;S</b>	<b>2265.4</b>	<b>2208.3</b>	<b>2240.9</b>	<b>2229.5</b>	<b>71.0</b>	<b>-57.1</b>	<b>45.6</b>	<b>-11.5</b>
Goods imports	1920.7	1858.3	1889.1	1875.4	69.0	-62.4	43.8	-13.8
Oil	337.5	265.5	278.5	293.5	19.5	-72.1	20.2	14.9
Gold	5.6	5.1	5.2	4.6	-.6	-.4	.4	-.6
Other goods	1577.6	1587.7	1605.4	1577.3	50.0	10.1	23.1	-28.1
Capital goods	429.1	426.3	425.1	440.3	14.3	-2.7	-3.8	15.1
Aircraft & parts	27.5	31.0	32.7	32.9	-.1	3.5	1.4	.2
Computers & accessories	104.3	100.8	98.2	112.9	3.0	-3.5	-5.6	14.8
Semiconductors	28.5	27.0	26.6	27.4	1.6	-1.5	-.4	.8
Other capital goods	268.8	267.5	267.7	267.0	9.8	-1.3	.7	-.7
Automotive	253.1	258.2	272.4	255.0	-4.6	5.1	18.8	-17.4
Ind. supplies (ex. oil, gold)	306.6	291.1	287.1	277.0	15.7	-15.5	-1.0	-10.1
Consumer goods	448.6	468.4	477.3	460.7	18.5	19.8	7.4	-16.5
Foods, feeds, bev.	76.1	77.1	77.3	79.0	3.2	1.0	.9	1.7
All other goods	64.2	66.5	66.3	65.4	2.9	2.3	.8	-.9
Services imports	344.7	350.0	351.8	354.1	2.1	5.3	1.8	2.3
<i>Memo:</i>								
Oil quantity (mb/d)	13.85	13.09	13.68	15.01	.23	-.76	.59	1.33
Oil import price (\$/bbl)	66.75	55.55	55.74	53.51	2.85	-11.21	1.72	-2.23

1. Change from previous quarter or month.

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

of capital goods moved up briskly, led by a particularly large jump in exports of aircraft and also supported by higher exports of computers and semiconductors. Exports of industrial supplies exhibited strong growth, boosted by a jump in exports of petroleum products, as did exports of consumer goods and agricultural products. In contrast, automotive exports fell back in January following a strong December.

The value of imported goods and services fell 0.5 percent in January following a 2.1 percent increase in December. In January, lower imports of non-oil goods more than offset higher imports of oil and services. The fall in imports of non-oil goods was led by large declines in imports of automotive products, which moved down from an elevated level in December, and consumer goods, which were held back by a decline in apparel imports. Imports of non-oil industrial supplies also declined. In contrast, imports of foods rose, and imports of capital goods climbed sharply, led by a jump in imports of computers.

### **Prices of Internationally Traded Goods**

**Non-oil imports.** In both January and February, import prices for non-oil goods fell 0.1 percent. In January, this figure was held down by natural gas prices, which fell more than 13 percent, but in February natural gas prices turned back up with the onset of colder weather. Import prices for core goods rose 0.3 percent in January but then fell 0.1 percent in February. Prices for imported capital goods (excluding computers and semiconductors) and nonfuel industrial supplies both fell in February after rising strongly in January. The February decline in industrial supplies was led by prices of imported metals, which fell sharply. Prices for finished goods fell slightly in February, after rising modestly in the two prior months.

The average level of core import prices in January and February was  $2\frac{3}{4}$  percent at an annual rate above the fourth-quarter average. Prices for a wide variety of goods accelerated in the first quarter, including capital goods (excluding computers and semiconductors), consumer goods, foods, and nonfuel industrial supplies. In addition, prices of imported computers continued to decline, and prices of imported semiconductors fell after a rare increase in the previous quarter.

**Oil.** The BLS price index of imported oil rose 2 percent in February, considerably less than the spot price of West Texas Intermediate (WTI) crude oil, which rose 9 percent in February and averaged around \$59 per barrel for the month. Thus far in March, the spot price has averaged more than \$60 per barrel, but has fallen over the past few days to close



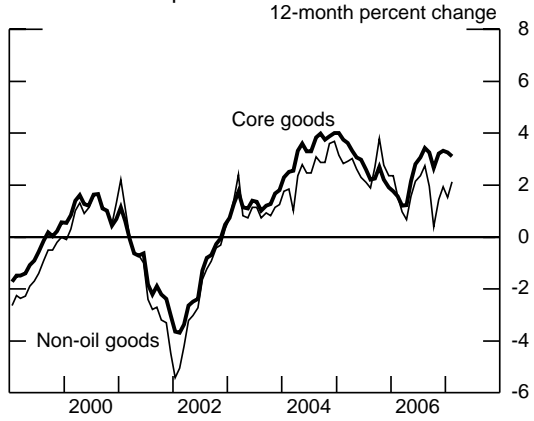
at \$57.94 per barrel on March 13. Despite the recent decline, oil prices remain above their average level in January. This rise in oil prices over the past two months reflects OPEC production restraint, a worsening of ongoing production problems in Iraq and Nigeria, and increased concern about a possible disruption of exports from Iran. Strong oil demand in the United States, owing in part to below-normal temperatures, has also supported oil prices.

**Exports.** In January and February, export prices for core goods rose 0.5 and 0.8 percent, respectively. Prices for material-intensive goods were held down in January by a large decline in the price of exported fuels and boosted in February as fuel prices bounced back. Prices for exported nonagricultural industrial supplies rose in both months, and prices for agricultural products shot up in February, primarily reflecting higher prices for corn and soybeans. Corn prices have risen as a result of higher demand for ethanol, while soybean prices have moved up as farmers have shifted acreage away from soybeans to corn. Prices for all major categories of finished goods moved up in January but were basically flat in February.

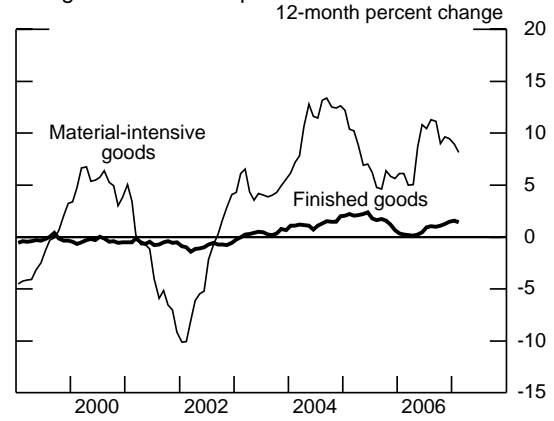
The average level of core export prices in January and February was about 6½ percent at an annual rate above the fourth-quarter average; prices for both finished and material-intensive goods accelerated in the first quarter. The acceleration was particularly pronounced for nonagricultural industrial supplies, which fell 5½ percent in the fourth quarter but jumped more than 9 percent on average so far in the first quarter.

**Prices of U.S. Imports and Exports**

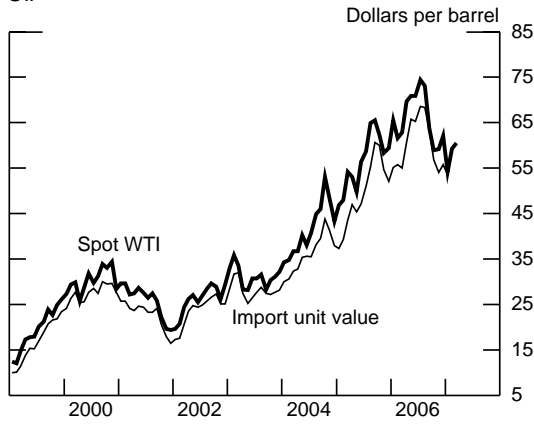
Merchandise Imports



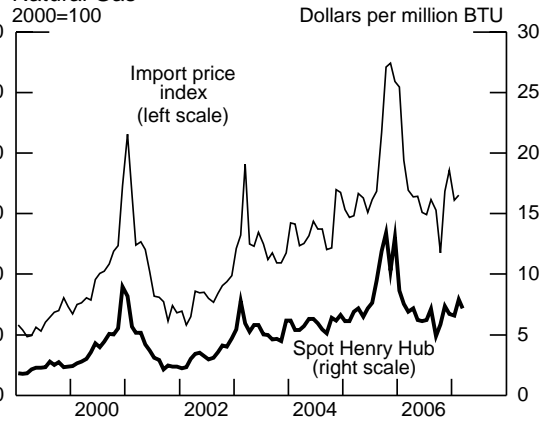
Categories of Core Imports



Oil



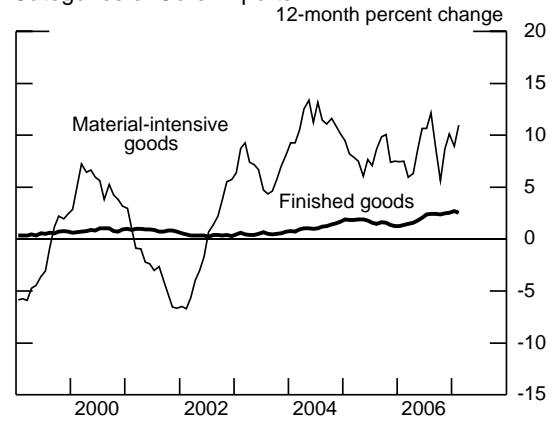
Natural Gas



Merchandise Exports



Categories of Core Exports



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

	Annual rate			Monthly rate		
	2006		2007	2006	2007	
	Q3	Q4	Q1 <sup>e</sup>	Dec.	Jan.	Feb.
	----- BLS prices -----					
<b>Merchandise imports</b>	4.2	-11.9	.5	1.1	-.9	.2
Oil	7.0	-51.7	-8.6	4.3	-5.3	2.0
Non-oil	3.4	1.8	2.0	.5	-.1	-.1
Core goods <sup>1</sup>	4.2	1.9	2.7	.3	.3	-.1
Finished goods	2.5	1.2	1.6	.2	.2	.0
Cap. goods ex. comp. & semi.	2.9	1.2	2.3	.2	.5	-.1
Automotive products	1.4	.8	.2	.0	.0	.1
Consumer goods	3.0	1.5	2.1	.3	.3	.0
Material-intensive goods	9.7	3.6	5.4	.7	.8	-.3
Foods, feeds, beverages	8.5	6.5	9.5	.8	1.5	.2
Industrial supplies ex. fuels	10.0	1.8	3.0	.5	.6	-.5
Computers	-5.2	-2.5	-7.2	-.2	-1.4	-.8
Semiconductors	3.2	2.4	-5.5	-.5	-.6	-1.1
Natural gas	-12.5	7.6	16.0	10.2	-13.2	2.5
<b>Merchandise exports</b>	5.2	.4	5.1	.6	.4	.7
Core goods <sup>2</sup>	6.6	.8	6.4	.7	.5	.8
Finished goods	2.5	1.9	3.1	.1	.6	.0
Cap. goods ex. comp. & semi.	2.4	3.0	3.3	.2	.6	.0
Automotive products	1.5	.9	1.5	.2	.2	.1
Consumer goods	3.0	.3	3.8	.1	.9	.0
Material-intensive goods	12.7	-.4	11.7	1.6	.3	2.2
Agricultural products	18.8	20.7	20.5	2.3	.6	2.3
Industrial supplies ex. ag.	11.3	-5.4	9.3	1.4	.2	2.1
Computers	-3.1	-3.4	-12.3	-.8	-2.1	-.7
Semiconductors	-10.8	-3.3	-3.2	-.1	-.6	-.1
	----- NIPA prices -----					
<b>Chain price index</b>						
Imports of goods & services	5.4	-8.6	...	...	...	...
Non-oil merchandise	3.3	1.1	...	...	...	...
Core goods <sup>1</sup>	4.3	1.3	...	...	...	...
Exports of goods & services	4.5	-.8	...	...	...	...
Total merchandise	5.3	.0	...	...	...	...
Core goods <sup>2</sup>	5.8	.3	...	...	...	...

1. Excludes computers, semiconductors, and natural gas.

2. Excludes computers and semiconductors.

e/ Average of two months.

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

**U.S. International Financial Transactions**

Foreign official flows into the United States (line 1 of the Summary of U.S. International Transactions table) surged in December after two relatively weak months of inflows, largely because of record inflows from countries other than the G10 and OPEC. For the year as a whole, foreign official inflows were up 50 percent from 2005, but were below the record \$385 billion inflows registered in 2004.

The chart on Foreign Official Financial Flows provides a broader perspective on these data. The G-10 countries have fluctuated between small inflows into and outflows from the United States in recent months, with the trend remaining a modest net outflow. OPEC countries have registered small inflows, on average, over the past year; January inflows were slightly above the recent trend. Inflows from countries other than the G-10 and OPEC have been growing over the past few years, with quite strong inflows in the past few months.

Private foreign net purchases of U.S. securities (line 4 of the table and the top panels of the chart on Private Securities Flows) slowed in December but for the year as a whole continued their upward trend. Purchases of corporate bonds (line 4c), despite moderating a bit in December, moved up sharply for the year as a whole relative to the level registered in 2005. Net purchases of Treasuries in 2006 were much more modest than those recorded in 2005, with net sales recorded in December. Private foreigners also sold agencies and corporate stocks (lines 4b and 4d, respectively) in December, though total purchases in 2006 were above their 2005 levels. In January, private foreign net purchases of U.S. securities bounced back from their December lull, as demand for corporate bonds remained strong, and transactions in Treasuries, agencies, and corporate stocks all switched back to net purchases. Most transactions were recorded against the financial centers of the United Kingdom and the Cayman Islands.

U.S. private acquisitions of foreign securities picked up noticeably near yearend (line 5 of the table and the bottom panels of the chart on Private Securities Flows), with the fourth quarter accounting for over 40 percent of the year's total. Bond purchases increased throughout the year and hit a record level in December. As a result, net bond purchases in 2006 were threefold those recorded in 2005. Purchases of stocks picked up in the final

two months of the year and helped to move 2006 net acquisitions up towards the level recorded in 2005. Equities acquired through stock swaps also increased in the fourth quarter. In January, U.S. private acquisitions slowed slightly from their recent trend, as stock purchases remained near their trend and net acquisitions of bonds moderated in line with lower new issuance of foreign bonds in the United States in the month.

Flows recorded by the banking sector (line 3) tend to be volatile. They recorded net inflows for 2006 as a whole, and a modest outflow in January.

Fourth-quarter balance of payments data (released on March 14) will be discussed in the Greenbook supplement.

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

	2005	2006	2006					2007	
			Q1	Q2	Q3	Q4	Dec	Jan	
<b>Official financial flows</b>	<b>214.7</b>	<b>304.0</b>	<b>75.1</b>	<b>77.8</b>	<b>80.2</b>	<b>70.9</b>	<b>50.6</b>	<b>38.8</b>	
1. Change in foreign official assets in the U.S. (increase, +)	200.6	301.6	74.6	78.3	79.2	69.5	50.4	38.8	
a. G-10 countries + ECB	-21.3	-36.5	-8.4	-18.7	-6.0	-3.4	-4.4	1.3	
b. OPEC	7.5	30.4	12.0	13.9	11.4	-6.9	-1.9	7.5	
c. All other countries	214.5	307.7	71.1	83.1	73.7	79.8	56.8	30.0	
2. Change in U.S. official reserve assets (decrease, +)	14.1	2.4	.5	-.6	1.0	1.4	.2	.0	
<b>Private financial flows</b>	<b>570.7</b>	<b>n.a.</b>	<b>96.4</b>	<b>75.4</b>	<b>96.2</b>	<b>n.a.</b>	<b>...</b>	<b>...</b>	
<b>Banks</b>									
3. Change in net foreign positions of banking offices in the U.S. <sup>1</sup>	15.4	103.1	.9	58.3	39.3	4.5	-28.7	-22.7	
<b>Securities<sup>2</sup></b>									
4. Foreign net purchases (+) of U.S. securities	611.3	715.3	198.2	176.2	157.3	183.6	11.9	75.8	
a. Treasury securities	178.1	39.0	-2.5	19.3	-7.4	29.5	-2.1	9.8	
b. Agency bonds	66.9	105.2	39.6	33.0	28.7	3.9	-3.7	9.1	
c. Corporate and municipal bonds	274.3	423.4	97.1	104.0	100.1	122.2	28.9	35.9	
d. Corporate stocks <sup>3</sup>	92.0	147.7	63.9	19.9	35.9	28.0	-11.1	21.1	
5. U.S. net acquisitions (-) of foreign securities	-197.0	-297.9	-57.5	-57.9	-52.6	-129.8	-50.2	-19.3	
a. Bonds	-53.1	-150.3	-14.7	-34.7	-43.5	-57.4	-30.3	-5.5	
b. Stock purchases	-139.9	-118.9	-38.8	-20.8	-9.2	-50.2	-20.0	-13.8	
c. Stock swaps <sup>3</sup>	-4.0	-28.7	-4.0	-2.4	.0	-22.3	.0	.0	
<b>Other flows (quarterly data, s.a.)</b>									
6. U.S. direct investment (-) abroad	-9.1	n.a.	-61.3	-46.8	-63.1	n.a.	...	...	
7. Foreign direct investment in the U.S.	109.8	n.a.	45.3	45.8	44.1	n.a.	...	...	
8. Foreign acquisitions of U.S. currency	19.4	n.a.	1.9	1.1	1.1	n.a.	...	...	
9. Other (inflow, +) <sup>4</sup>	20.9	n.a.	-31.2	-101.3	-30.0	n.a.	...	...	
<b>U.S. current account balance (s.a.)</b>	<b>-791.5</b>	<b>n.a.</b>	<b>-213.2</b>	<b>-217.1</b>	<b>-225.6</b>	<b>n.a.</b>	<b>...</b>	<b>...</b>	
<b>Capital account balance (s.a.)<sup>5</sup></b>	<b>-4.4</b>	<b>n.a.</b>	<b>-1.8</b>	<b>-1.0</b>	<b>-6</b>	<b>n.a.</b>	<b>...</b>	<b>...</b>	
<b>Statistical discrepancy (s.a.)</b>	<b>10.4</b>	<b>n.a.</b>	<b>43.4</b>	<b>64.9</b>	<b>49.7</b>	<b>n.a.</b>	<b>...</b>	<b>...</b>	

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

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

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

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

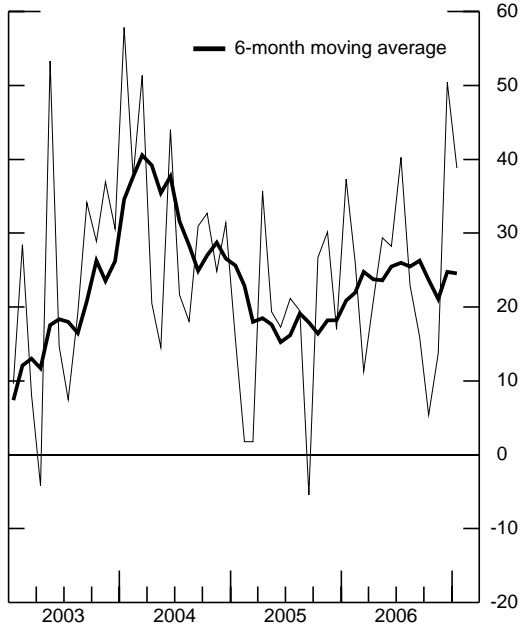
4. Transactions by nonbanking concerns and other banking and official transactions not shown elsewhere plus amounts resulting from adjustments made by the Department of Commerce and revisions in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business.

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

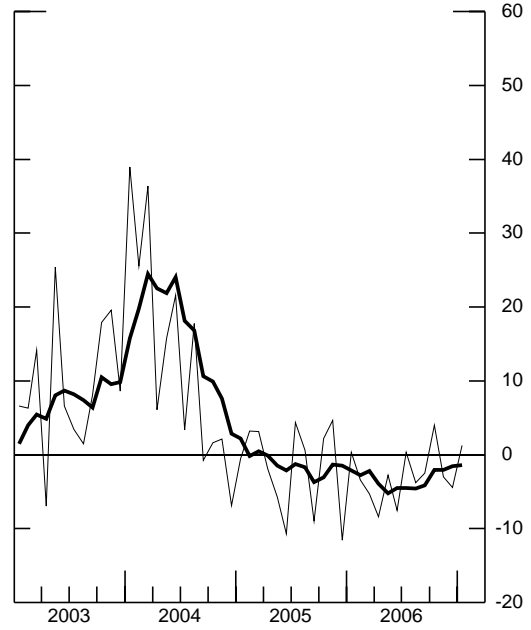
n.a. Not available. ... Not applicable.

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

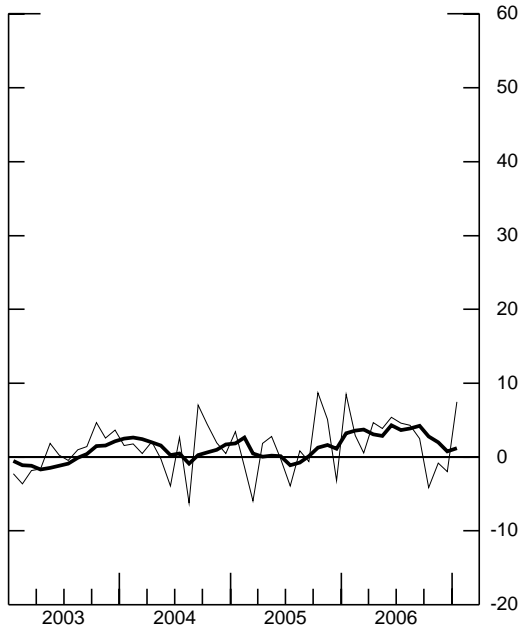
Total



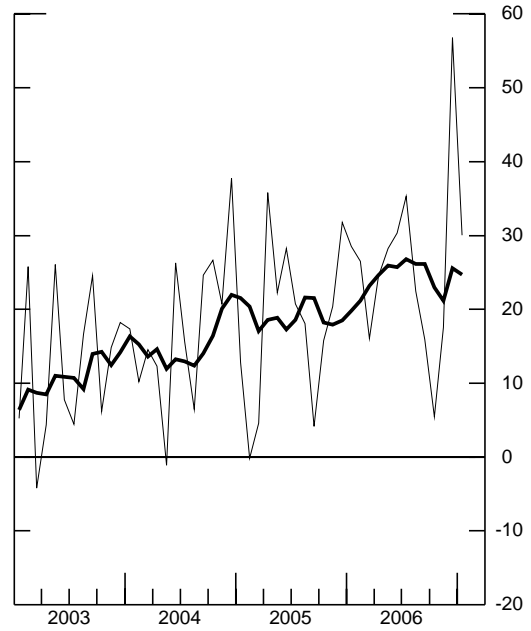
G-10 + ECB



OPEC



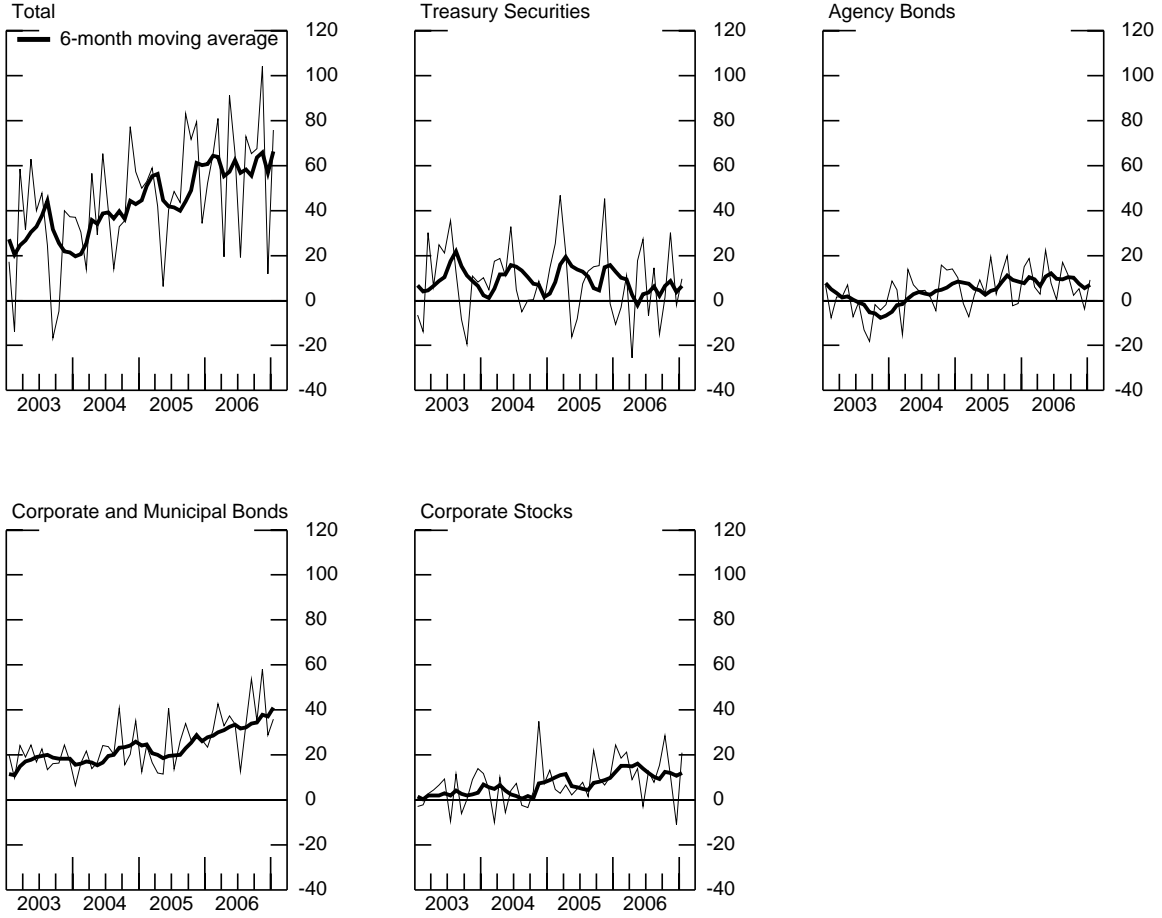
All other countries



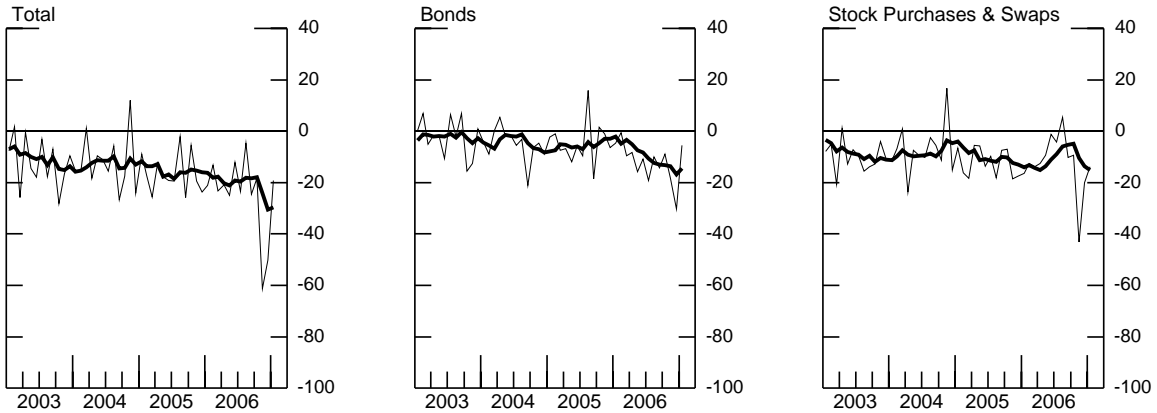
**Private Securities Flows Through January 2007**

(\$ Billions, monthly, not seasonally adjusted)

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



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





## Foreign Financial Markets

Over the intermeeting period, the major currencies index of the dollar's exchange value declined  $1\frac{1}{4}$  percent on net, likely reflecting concerns about some weaker-than-expected data releases in the United States. Beginning in late February, there were several days of heightened exchange rate volatility, sharp declines in global equity prices, and a widening of risk spreads on corporate and emerging market securities. This episode, which came amid reports that several U.S. subprime mortgage lenders were facing financial difficulties, was triggered in part by a 9 percent fall in Chinese equity prices on February 27. During the episode, international investors appeared to scale back risky positions financed in low interest rate currencies, particularly the Japanese yen and the Swiss franc. The unwinding of these "carry trades" seemed to be partially reversed late in the intermeeting period, as equity prices in most markets recovered some of their losses and exchange rate volatility declined. However, as this Greenbook was put to press, global equity prices were declining again amid growing concerns about the U.S. subprime mortgage sector. On a bilateral basis, the dollar depreciated  $3\frac{3}{4}$  percent versus the yen and  $2\frac{1}{4}$  percent against the Swiss franc on net over the intermeeting period. The dollar also depreciated  $1\frac{1}{2}$  percent against the euro and  $\frac{1}{2}$  percent versus the Canadian dollar, but it appreciated 2 percent versus sterling. Option-implied volatility on the dollar-yen exchange rate jumped up in late February from a near-record-low level and remained significantly above recent lows through the end of the period; euro-dollar option-implied volatility, in contrast, remained low.

Headline equity indexes in Europe ended the period down 2 to 5 percent on net, while Japanese stock prices declined about 3 percent. Equity indexes in industrial countries dropped 5 to 7 percent in late February and early March, but they rose on net before and after this episode of risk reduction. Three-month yen interest rates rose 19 basis points over the period, while euro interest rates rose 11 basis points; the Bank of Japan and the European Central Bank increased their respective policy rates 25 basis points. In contrast, three-month dollar and sterling interest rates declined slightly as market participants lowered the expected path of future monetary policy in the United States and the United Kingdom. Ten-year sovereign yields declined about 20 basis points in Europe and about 10 basis points in Japan, less than the drop of almost 40 basis points in the United States.

The dollar's trade-weighted exchange value against the currencies of our other important trading partners was little changed on balance over the intermeeting period, the result of

offsetting movements in various bilateral exchange rates. Several emerging-market currencies depreciated during the period of risk reduction in late February and early March, but most recovered late in the intermeeting period. On net, the dollar appreciated 1½ percent against the Mexican peso but depreciated 1 percent versus the Brazilian *real*. The dollar depreciated about ½ percent against the renminbi and was little changed on net against most currencies in emerging Asia. The dollar depreciated 5 percent versus the Thai baht; the Thai government announced the relaxation of some recently-imposed measures designed to slow capital inflows. Equity indexes in Latin America and emerging Asia experienced large swings over the intermeeting period. Most rose until late February, fell sharply (5 to 12 percent) during the episode of carry-trade unwinding, then rose again on net late in the period. Mexican and Brazilian indexes ended the period down 2 and 3 percent, respectively. In emerging Asia, Korea's main index rose 3½ percent on balance, but Hong Kong's dropped 6 percent. Chinese stock prices registered a net increase of 4 percent over the intermeeting period, notwithstanding their plunge in late February. Emerging market bond spreads rose over the period, with the EMBI+ index up 20 basis points on balance.

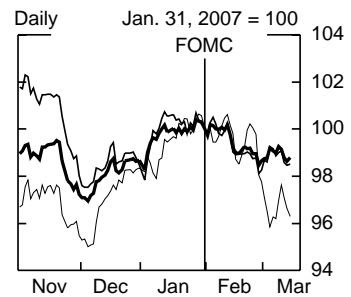
. The Desk did not intervene during the period for the accounts of the System or the Treasury.

### Exchange Value of the Dollar and Stock Market Indexes

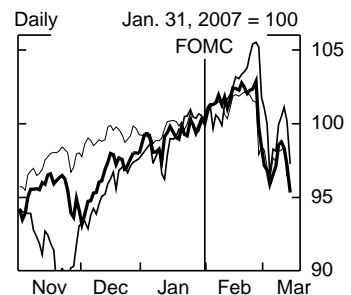
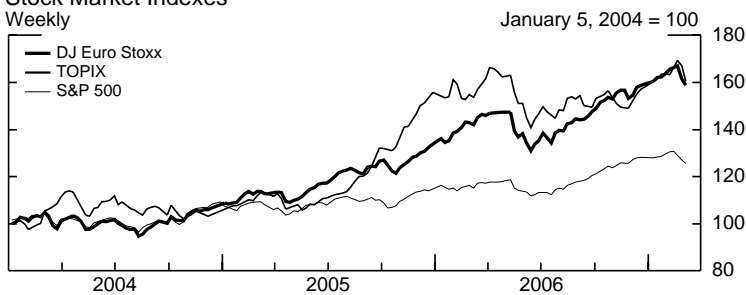
	Latest	Percent change since January FOMC
<i>Exchange rates*</i>		
Euro (\$/euro)	1.3193	-1.5
Yen (¥/\$)	116.5	-3.7
Sterling (\$/£)	1.9237	1.9
Canadian dollar (C\$/\\$)	1.1746	-0.4
<i>Nominal dollar indexes*</i>		
Broad index	107.1	-0.6
Major currencies index	81.5	-1.2
OITP index	133.3	-0.0
<i>Stock market indexes</i>		
DJ Euro Stoxx	384.8	-4.7
TOPIX	1674.9	-2.7
FTSE 100	6052.0	-2.4
S&P 500	1378.0	-3.6

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

Exchange Value of the Dollar  
Weekly



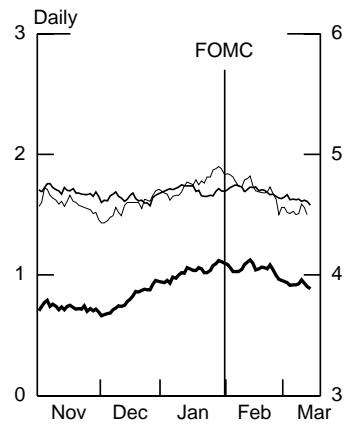
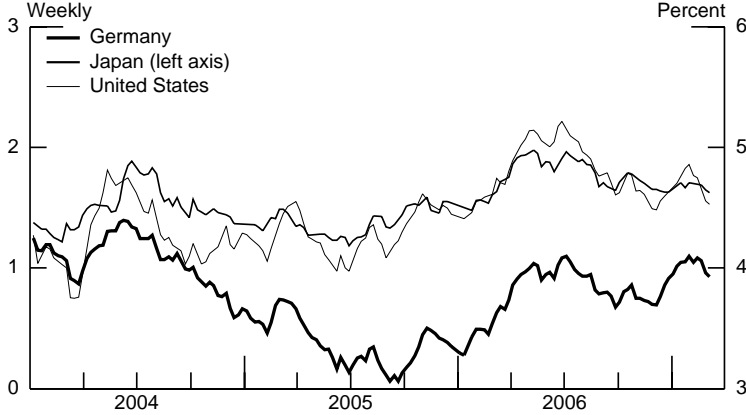
Stock Market Indexes  
Weekly



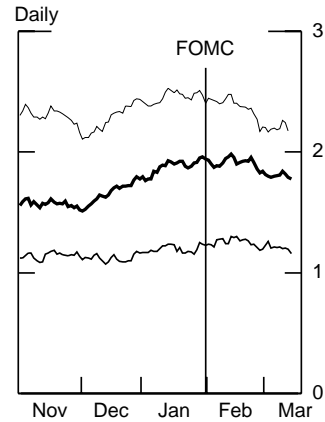
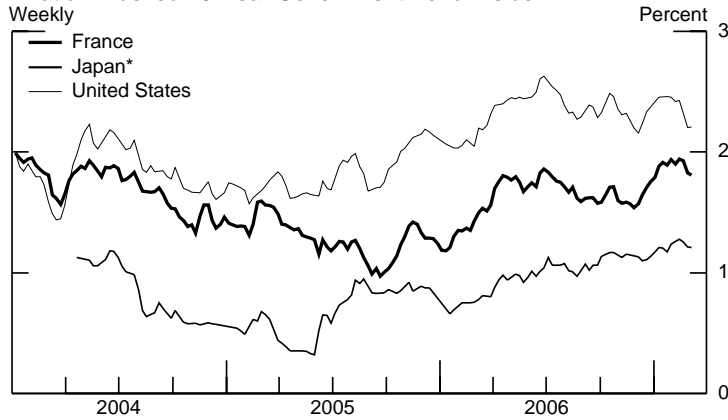
**Industrial Countries: Nominal and Real Interest Rates**

	3-month LIBOR		10-year nominal		10-year indexed		Percent
	Latest	Change since January FOMC	Latest	Change since January FOMC	Latest	Change since January FOMC	
Germany	3.90	0.11	3.89	-0.21	1.85	-0.17	
Japan	0.71	0.19	1.58	-0.12	1.16	-0.07	
United Kingdom	5.53	-0.06	4.74	-0.23	1.64	-0.25	
Canada	4.27	-0.01	3.99	-0.24	...	...	
United States	5.35	-0.01	4.50	-0.38	2.18	-0.30	

**Nominal 10-Year Government Bond Yields**



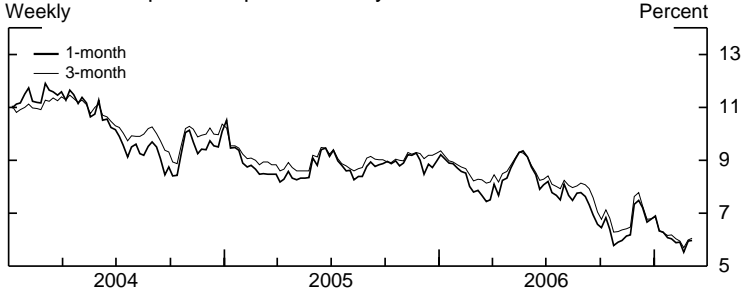
**Inflation-Indexed 10-Year Government Bond Yields**



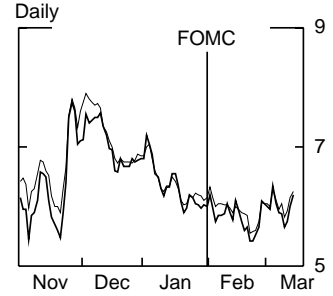
\*Japan first issued inflation-indexed debt in March 2004.

**Measures of Market Volatility**

**Dollar-Euro Options-Implied Volatility\***  
Weekly



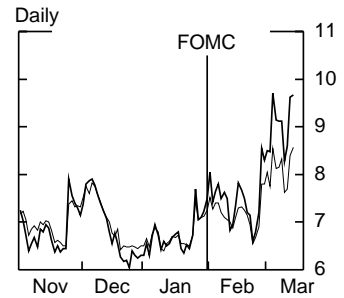
\*Derived from at-the-money options.



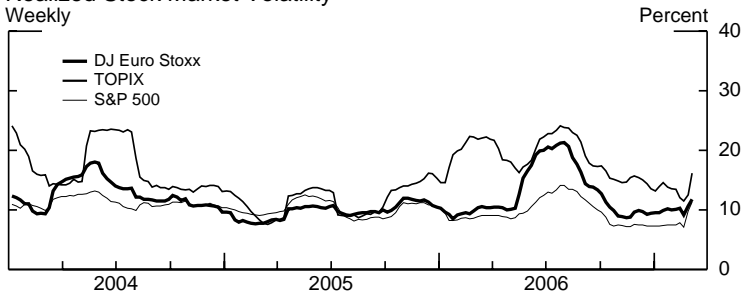
**Yen-Dollar Options-Implied Volatility\***  
Weekly



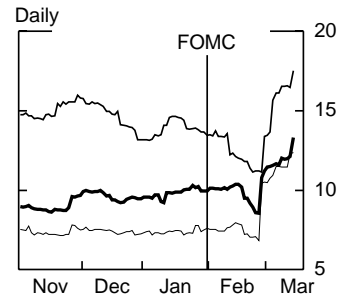
\*Derived from at-the-money options.



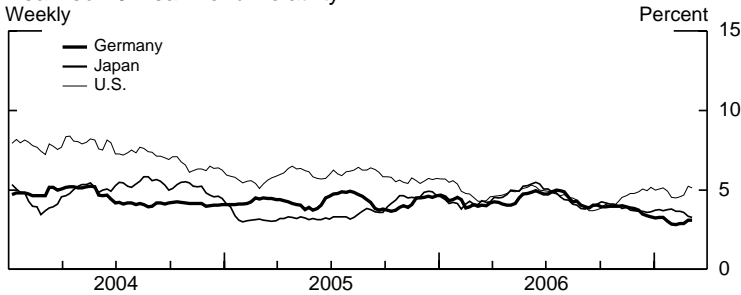
**Realized Stock Market Volatility\***  
Weekly



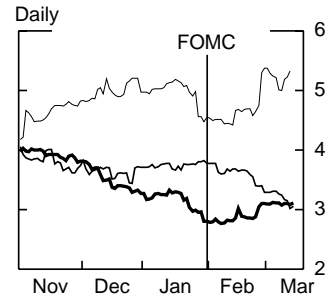
\*Annualized standard deviation of 60-day window of daily returns.



**Realized 10-Year Bond Volatility\***  
Weekly



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

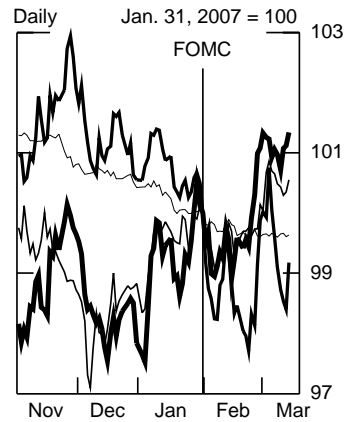
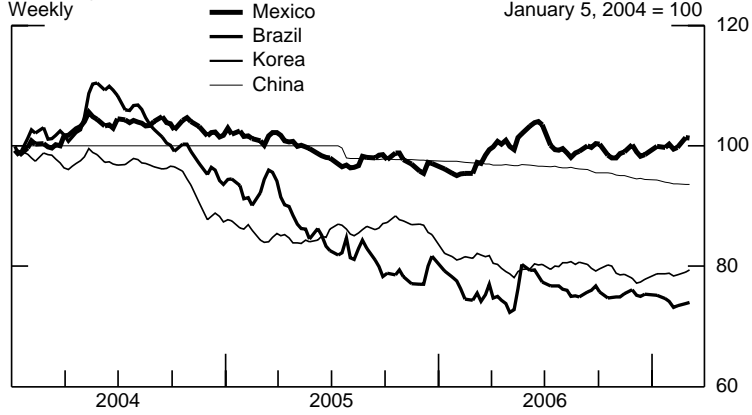


**Emerging Markets: Exchange Rates and Stock Market Indexes**

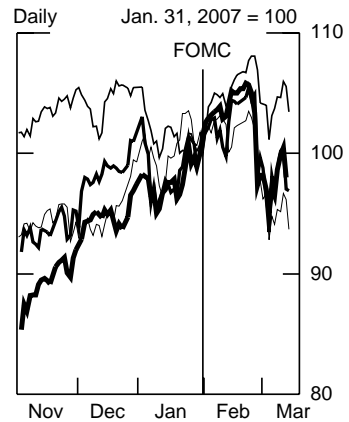
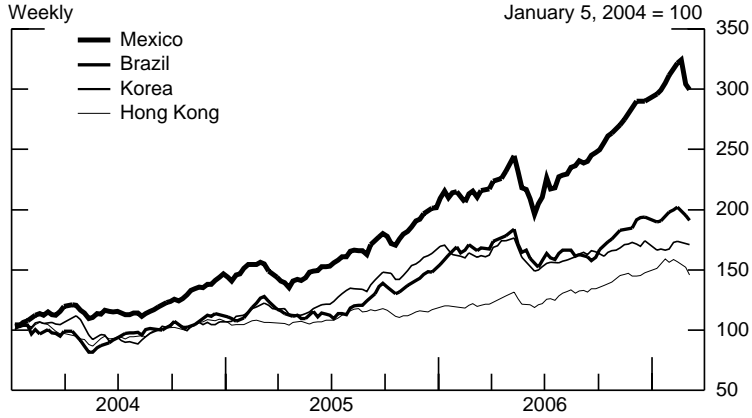
	Exchange value of the dollar		Stock market index	
	Latest	Percent change since January FOMC*	Latest	Percent change since January FOMC
Mexico	11.1860	1.3	26589	-2.0
Brazil	2.1050	-0.8	42674	-3.1
Venezuela	2144.60	0.0	50886	17.6
China	7.7430	-0.4	2906	4.3
Hong Kong	7.8148	0.1	18837	-6.3
Korea	946.2	0.6	1407	3.5
Taiwan	33.01	0.2	7570	-1.7
Singapore	1.5356	-0.0	817	-1.3
Thailand	32.90	-5.4	671	2.5

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

Exchange Value of the Dollar



Stock Market Indexes

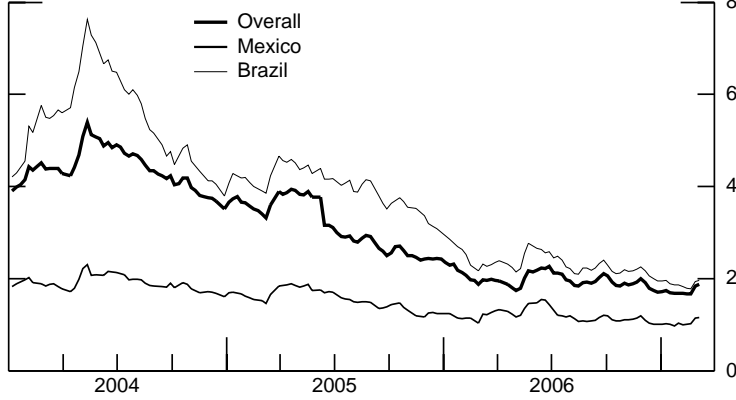


**Emerging Markets: Short-Term Interest Rates and Dollar-Denominated Bond Spreads**

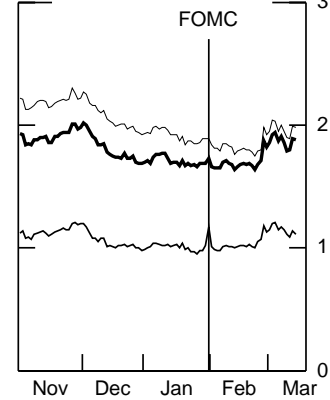
	Short-term interest rates*		Dollar-denominated bond spreads**	
	Latest	Change since January FOMC	Latest	Change since January FOMC
Mexico	7.10	0.04	1.11	0.09
Brazil	12.55	-0.61	1.98	0.09
Argentina	9.31	-0.25	2.28	0.43
China	...	...	0.54	0.04
Korea	4.65	-0.05	...	...
Taiwan	1.89	0.06	...	...
Singapore	3.50	0.00	...	...
Hong Kong	4.20	0.20	...	...

\*One month interest rate except 1-week rate for Korea. No reliable short-term interest rate exists for China.  
 \*\*EMBI+ or EMBI Global Spreads over similar-maturity U.S. Treasuries.  
 ... Korea, Taiwan, Singapore, and Hong Kong have no outstanding dollar-denominated sovereign bonds.

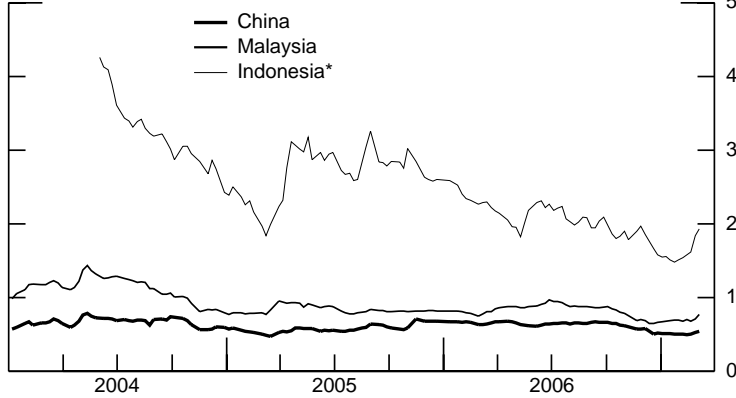
**EMBI+ Spreads**  
Weekly



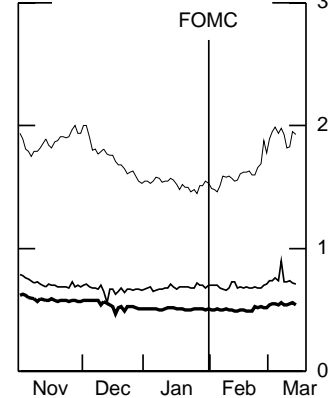
Daily



**EMBI Global Spreads**  
Weekly



Daily



\*Begins May 2004.

## Developments in Advanced Foreign Economies

Overall economic activity in the advanced foreign economies accelerated in the fourth quarter, supported by strong investment spending and firm exports. In Japan, private consumption rebounded strongly in the fourth quarter, while private investment and net exports continued to be important contributors to growth. The pace of economic expansion picked up in the euro area largely as a result of increases in investment spending and exports, with consumption growth remaining solid. Growth in the United Kingdom also firmed as a result of brisk investment spending and a rebound in consumption growth. In contrast, output in Canada decelerated in the fourth quarter following a sharp slowdown in inventory accumulation.

Inflationary pressures remain low in most foreign advanced economies in January and February, helped in part by lower energy prices at the start of the year. The Bank of Japan and the European Central Bank nevertheless decided to raise their policy rates  $\frac{1}{4}$  percentage point at their last meetings.

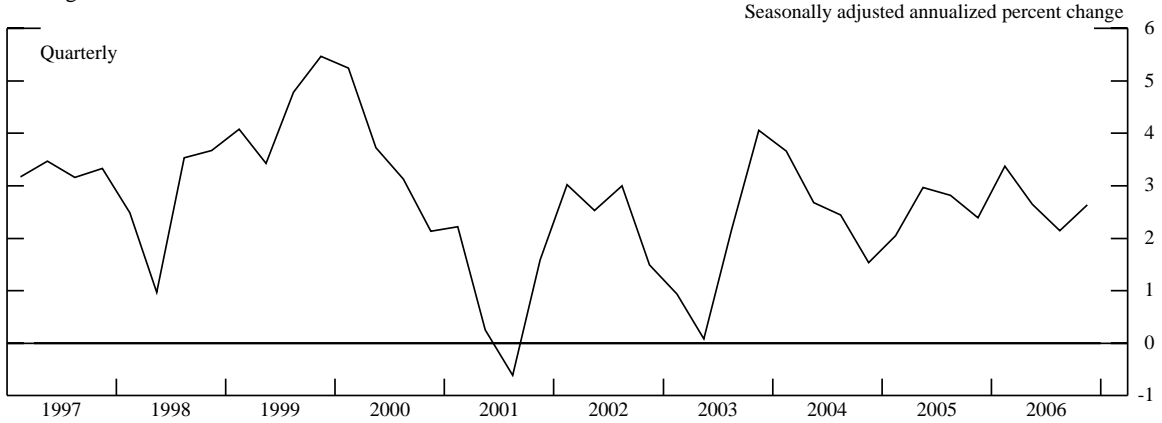
In **Japan**, real GDP grew 5.5 (s.a.a.r.) percent in the fourth quarter, rebounding from 0.5 percent growth in the third quarter. Household consumption grew 4.2 percent, offsetting a surprising 4.2 percent fall in the third quarter. Private investment continued to be strong, growing 12.5 percent, and net exports contributed 0.5 percentage points to growth, as exports rose and imports fell for the second quarter in a row. In contrast to the first three quarters of the year, the public sector contributed 0.6 percentage points to growth, as public investment grew 15.6 percent. However, public investment is likely to resume its decline.

Recent indicators suggest that consumption growth is firming and point to continued strength in net exports. Real expenditures by all households in January were 1.4 percent higher than a year earlier, the first such increase in more than a year. Moreover, retail sales also rose in January from December. The Bank of Japan's measure of the real trade surplus increased in January as real exports rose 1.8 percent while real imports contracted 5 percent. However, industrial production fell 1.5 percent in January, the biggest monthly decline in almost three years, and shipments of machinery also fell. Housing starts continued to slide, falling 3.6 percent in January.



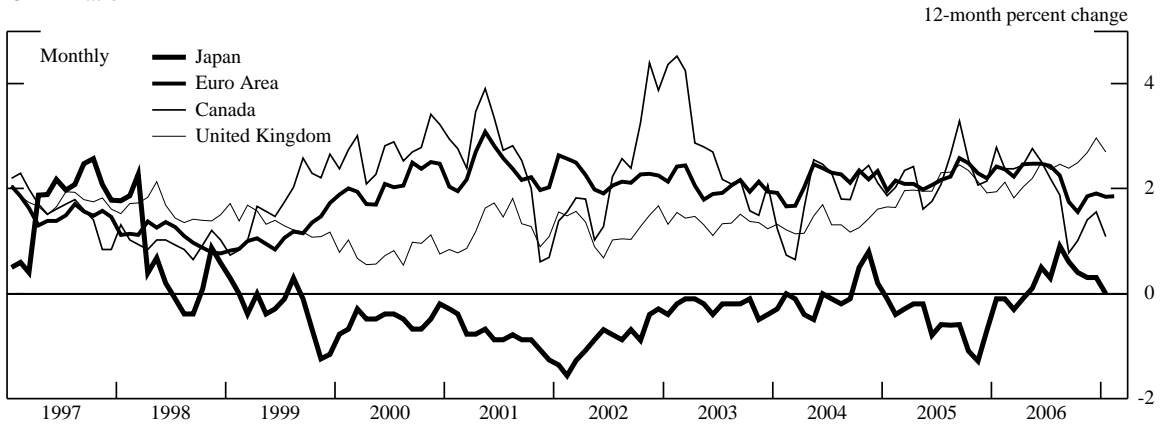
**Advanced Foreign Economies**

Average Real GDP\*

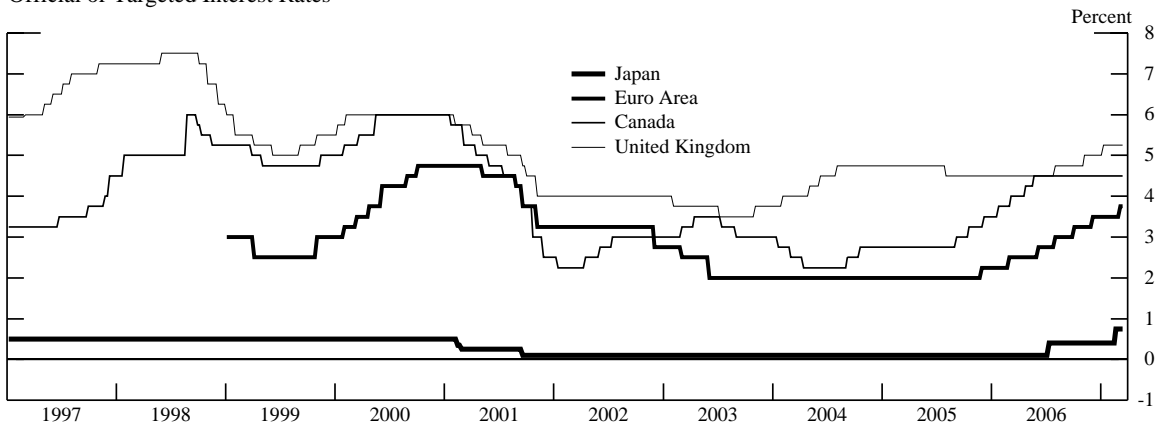


\*Chain weighted by moving bilateral shares in U.S. merchandise exports.

CPI Inflation



Official or Targeted Interest Rates



**Japanese Real GDP**

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

Component	2005 <sup>1</sup>	2006 <sup>1</sup>	2006			
			Q1	Q2	Q3	Q4
GDP	2.8	2.5	2.9	1.3	0.5	5.5
Total domestic demand	2.0	2.1	2.7	1.8	-1.2	5.1
Consumption	2.6	0.5	0.2	2.2	-4.2	4.2
Private investment	3.3	9.5	13.0	9.2	3.6	12.5
Public investment	-0.1	-9.2	-7.3	-22.6	-17.9	15.6
Government consumption	0.7	1.4	-0.7	3.0	2.7	0.5
Inventories <sup>2</sup>	-0.3	0.1	0.7	-0.6	0.9	-0.4
Exports	10.2	6.0	9.5	2.5	9.9	2.4
Imports	4.2	2.6	8.1	5.6	-1.9	-1.0
Net Exports <sup>2</sup>	0.9	0.6	0.5	-0.2	1.6	0.5

1. Q4/Q4

2. Percentage point contribution to GDP growth.

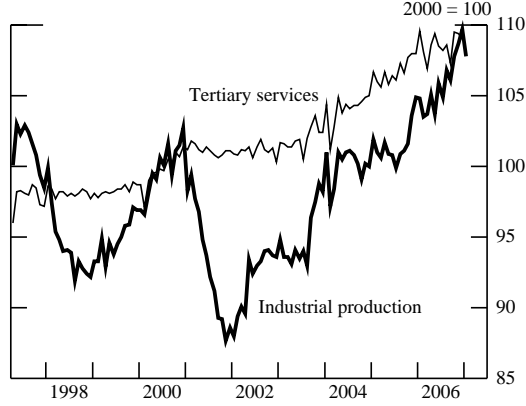
The unemployment rate held steady at 4 percent in January and the offers-to-applicants ratio (the number of officially posted job openings relative to the number of officially registered job seekers) fell a tad but remains at the elevated level of 1.06. Nevertheless, gross earnings, which include bonuses, were 1.4 percent lower than a year ago, the largest decline in more than two years.

Recent indicators point to weak inflationary pressures. The headline consumer price index was flat in January and was also unchanged from a year earlier. Core CPI inflation (excluding fresh food only) was 0.2 percent higher than a year earlier, while the twelve-month rate of wholesale price inflation continued to moderate in January. The GDP deflator fell 0.5 percent from a year ago in the fourth quarter.

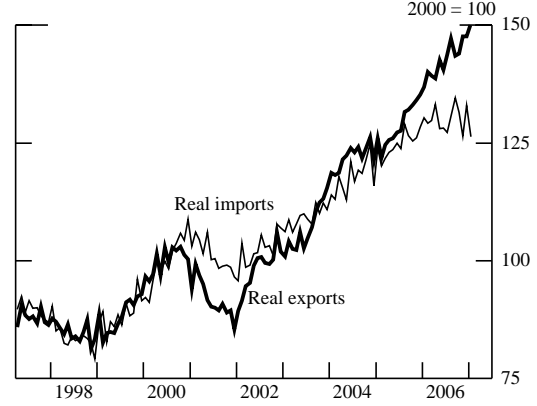
Despite the weak price data, the Bank of Japan raised its target for the overnight call rate 25 basis points to 0.5 percent in February. The Bank left its core economic assessment unchanged from January, repeating that a moderate economic expansion continues.

Japan

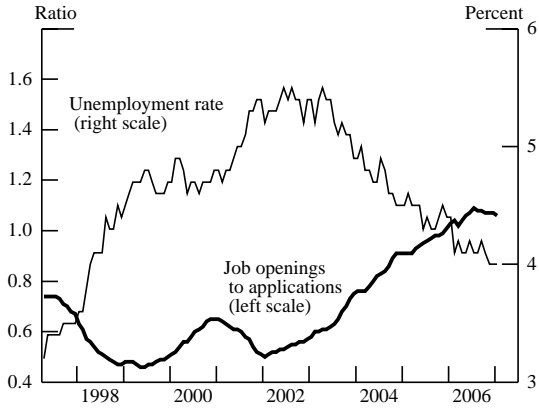
Economic Activity



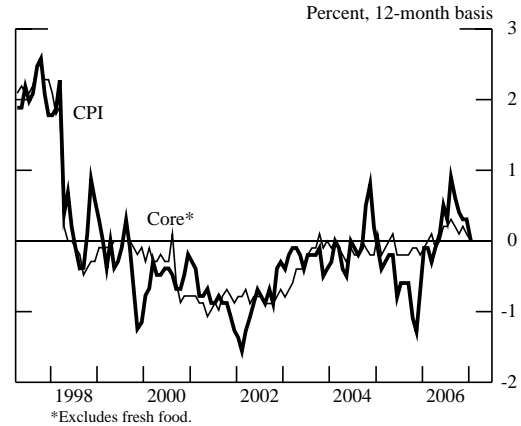
Real Trade



Labor Market



Consumer Price Inflation



**Economic Indicators**

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

Indicator	2006			2006		2007	
	Q2	Q3	Q4	Nov.	Dec.	Jan.	Feb.
Housing starts	2.0	-2.5	3.4	1.6	-2.2	-3.6	n.a.
Machinery orders <sup>1</sup>	8.9	-11.1	2.0	3.8	-0.7	3.9	n.a.
Machinery shipments <sup>1</sup>	3.6	1.7	2.5	2.0	-0.8	-0.8	n.a.
New car registrations	-3.7	-3.8	-1.7	0.3	-3.1	1.3	1.6
Business sentiment <sup>2</sup>	6.0	6.0	8.0	...	...	...	...
Wholesale prices <sup>3</sup>	3.1	3.5	2.7	2.7	2.5	2.2	1.8

1. Private sector, excluding ships and electric power.

2. Tankan survey, diffusion index. Level.

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

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

**Euro-Area Real GDP**

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

Component	2005 <sup>1</sup>	2006 <sup>1</sup>	2006			
			Q1	Q2	Q3	Q4
GDP	1.8	3.3	3.3	3.9	2.3	3.6
Total domestic demand	2.0	2.2	1.9	3.8	2.8	0.4
Consumption	1.2	2.1	2.3	1.3	2.8	2.2
Investment	3.2	4.8	3.4	8.6	2.3	4.9
Government consumption	1.6	2.5	5.7	0.1	2.5	2.0
Inventories <sup>2</sup>	0.3	-0.5	-1.2	1.3	0.1	-2.2
Exports	4.8	9.8	13.0	3.6	7.5	15.6
Imports	5.4	7.3	9.4	3.4	8.9	7.7
Net Exports <sup>2</sup>	-0.2	1.1	1.5	0.1	-0.5	3.2
Memo:						
GDP of selected countries						
France	1.0	2.2	2.0	4.3	0.0	2.6
Germany	1.7	3.7	3.4	4.8	3.2	3.5
Italy	0.7	2.8	3.1	2.4	1.2	4.7

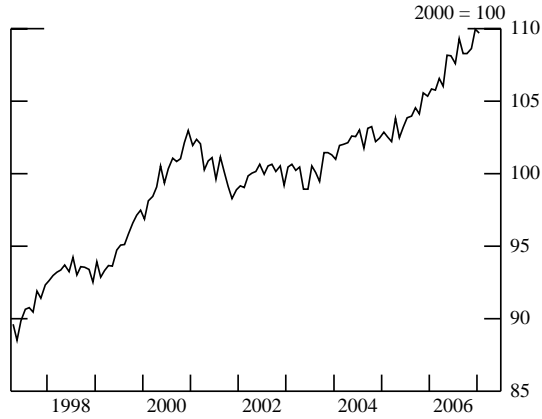
1. Q4/Q4

2. Percentage point contribution to GDP growth.

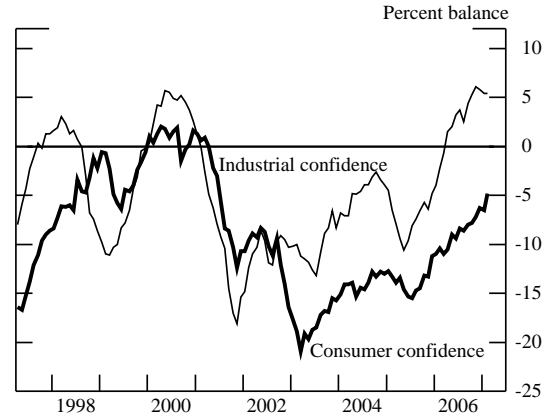
**Euro-area** GDP increased 3.6 percent (s.a.a.r.) in the fourth quarter, well up from its pace in the previous quarter. The growth rate of investment spending more than doubled from the third quarter to 4.9 percent. Exports surged 15.6 percent, and net exports contributed 3.2 percentage points to GDP growth, although this contribution was partly offset by a drawdown in inventories. Consumption remained solid, at 2.2 percent, a bit below the third-quarter pace in spite of any pull-ahead in spending coming from the January's hike in the German value-added tax. At the country level, Italy posted the biggest surprise, as its GDP growth surged to 4.7 percent, the best quarterly performance in eight years. All other major economies of the euro area also posted solid performances.

**Euro Area**

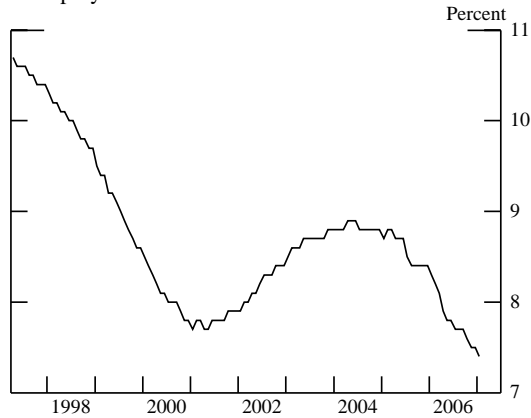
Industrial Production



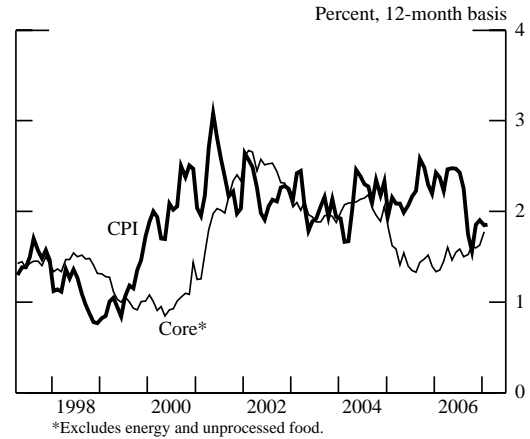
Economic Sentiment



Unemployment Rate



Consumer Price Inflation



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

Indicator	2006			2006		2007	
	Q2	Q3	Q4	Nov.	Dec.	Jan.	Feb.
Industrial production <sup>1</sup>	1.3	0.9	0.5	0.3	1.2	-0.1	n.a.
Retail sales volume <sup>2</sup>	0.4	0.6	0.2	0.6	0.3	-0.9	n.a.
Unemployment rate <sup>3</sup>	7.8	7.7	7.5	7.5	7.5	7.4	n.a.
CPI <sup>4</sup>	2.5	2.1	1.8	1.9	1.9	1.8	1.9
Producer prices <sup>4</sup>	5.8	5.4	4.1	4.3	4.1	3.0	n.a.
M3 <sup>4</sup>	8.4	8.5	9.8	9.3	9.8	n.a.	n.a.

1. Excludes construction.  
 2. Excludes motor vehicles.  
 3. Percent. Euro-area standardized to ILO definition. Includes Eurostat estimates in some cases.  
 4. Eurostat harmonized definition. Percent change from year earlier, s.a.  
 n.a. Not available. ... Not applicable.

Recent indicators for the euro area have generally remained robust. The European Commission indicator of economic sentiment bounced back in February from the dip posted in January. Consumer sentiment improved sharply, largely owing to better employment prospects. Confidence was unchanged in the industrial sector but fell in the construction sector. These developments, together with February's rebound of the purchasing managers' index (PMI) for manufacturing, suggest that euro-area industrial production continues to expand at a healthy pace. The PMI for the service sector fell in February, but its average in the first two months of the year remained above the fourth-quarter level. However, substantial declines in the production of energy and consumer durables led to a fall in euro-area industrial output in January.

Euro-area retail sales fell 0.9 percent in January from the previous month, more than offsetting sizable gains in November and December. That pattern of sales largely reflected German consumers' efforts to shift the timing of purchases to avoid the 3 percentage points rise in the value-added tax that occurred at the beginning of the year. In contrast, in France, household consumption of manufactured goods rose strongly in January for the second consecutive month.

There is no indication that January's plunge in German retail sales will derail the recovery of the euro-area largest economy. In February, Germany's IFO business climate index remained close to the all-time high posted in December. Furthermore, the German employment rose for the eleventh straight month in January and has gained almost 1.5 percent over the past year, even as the unemployment rate has fallen  $\frac{1}{2}$  percentage point since December. In January, the euro-area unemployment rate declined to 7.4 percent, down nearly a percentage point since the beginning of 2006, and the lowest rate since Eurostat began measuring it in 1993.

Euro-area consumer prices rose 0.3 percent in February from the previous month, according to a preliminary estimate. The twelve-month rate of inflation was steady at 1.9 percent. The inflation figures in the first two months of the year came in below most analysts' expectations; German prices did not rise as much as expected in response to the January hike in the value-added tax. In January, euro area core inflation (excluding energy and unprocessed food) in the euro area rose to 1.8 percent from the 1.6 percent rate recorded in the last three months of 2006. On March 8, the European Central Bank raised its key policy interest rate  $\frac{1}{4}$  percentage point to 3.75 percent. President Trichet said the ECB monetary policy "continues to be on the accommodative side," signaling that the tightening cycle is not yet over.

In the **United Kingdom**, recent economic data point to an increase in the pace of economic expansion supported by strong domestic demand. Real GDP growth firmed to 3.1 percent (a.r.) in the fourth quarter of 2006, as business investment expanded 10.4 percent, and private consumption grew 4.1 percent, rebounding from 1.8 percent in the third quarter. Net exports and inventories subtracted 0.8 and 0.9 percentage points from GDP growth, respectively.

### UK Real GDP

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

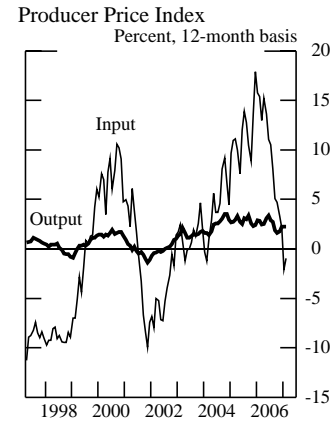
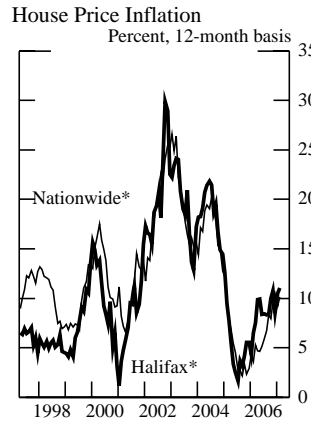
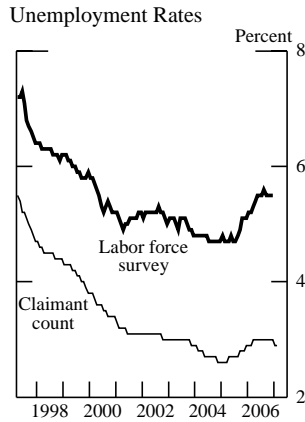
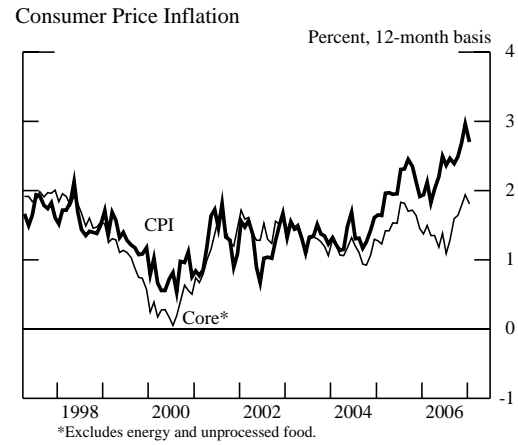
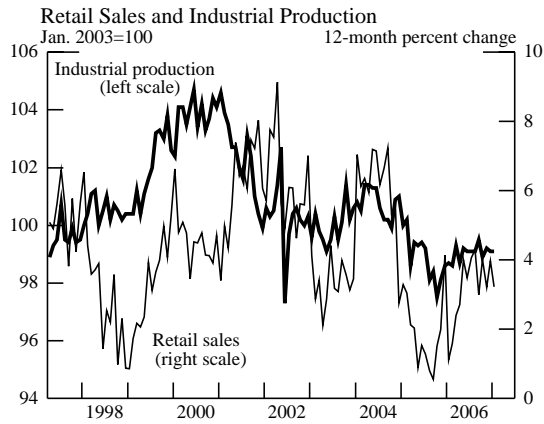
Component	2005 <sup>1</sup>	2006 <sup>1</sup>	2006			
			Q1	Q2	Q3	Q4
GDP	2.0	3.0	3.0	3.0	2.7	3.1
Total domestic demand	1.5	3.2	3.0	5.2	0.6	3.8
Consumption	1.1	2.8	1.5	3.9	1.8	4.1
Investment	5.5	7.2	6.8	3.6	7.9	10.4
Government consumption	3.2	1.5	0.2	1.8	2.6	1.5
Inventories <sup>2</sup>	-0.7	-0.1	1.0	1.3	-2.0	-0.8
Exports	11.6	-0.5	47.9	11.0	-37.9	-4.0
Imports	8.7	1.0	44.8	17.6	-38.3	-0.8
Net Exports <sup>2</sup>	0.4	-0.5	-0.5	-2.4	1.9	-0.9

1. Q4/Q4

2. Percentage point contribution to GDP growth.

Business confidence soared in February as the net balance of firms expecting production increases over the next four months jumped from 12 to 28 percent, its highest reading since May 1995. The PMI for manufacturing rose to 55.4 percent in February, its highest reading since July 2004. The PMI for services slid to 57.4 percent in February, but remained strong compared with previous history. Retail sales, on the other hand, contracted 1.8 percent in January following a 1.1 percent increase in December amid strong Christmas sales. Consumer confidence edged up in February after hitting a 45-month low in January. The claimant count of the unemployment rate was unchanged at 2.9 percent in February and the Labor Force Survey measure of the unemployment rate was similarly unchanged at 5.5 percent in December.

## United Kingdom



### Economic Indicators

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

Indicator	2006			2006		2007	
	Q2	Q3	Q4	Nov.	Dec.	Jan.	Feb.
Producer input prices <sup>1</sup>	13.3	8.0	3.6	3.7	2.5	-2.1	-1.1
Average earnings <sup>1</sup>	4.3	4.0	4.0	4.0	3.9	4.8	n.a.
Business confidence	12.0	13.0	8.3	5.0	11.0	12.0	28.0
Consumer confidence	-4.7	-6.0	-4.9	-5.3	-5.8	-7.4	-6.2
Trade balance <sup>2</sup>	-28.7	-23.8	-24.3	-8.1	-8.9	-7.4	n.a.
Current account <sup>2</sup>	-15.1	-17.7	n.a.	...	...	...	...

1. Percent change from year earlier.

2. Level in billions of US Dollars.

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



After reaching 3.0 percent in December, the twelve-month change in headline prices slid to 2.7 percent in January, brought down by falling energy prices, especially fuel for transportation. The decline in part reflects the fact that these prices were generally on the rise a year earlier. Average earnings including bonuses were 4.8 percent higher than a year earlier in January. Producer input prices fell 1.1 percent in the twelve-month period to February. House price inflation remained elevated at about 10 percent in February.

In Canada, real GDP grew only 1.4 percent (a.r.) in the fourth quarter, dragged down by slowdown in inventory accumulation. Exports contributed 2.2 percentage points to growth, their best showing of the year. Final domestic demand decelerated but remained firm, with personal consumption and business investment both growing solidly. Investment in residential structures edged up following a sharp third-quarter decline.

The few available indicators for the first quarter have been upbeat. Due in part to warm weather, housing starts popped up in January, with advances in both single-unit and multi-unit starts; February housing starts were cooler, but average housing starts in January and February were nonetheless a touch above their third-quarter average. The composite index of leading indicators recorded its largest advance in five years in January. The labor market also turned in another stellar performance in January and February, with total employment expanding more than it did during the entire fourth quarter, which itself was the second-largest gain in four years. Full-time employment growth, which has been especially strong in the past two years, continued to advance smartly. The unemployment rate returned to 6.1 percent in February, a generational low.

**Canadian Real GDP**

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

Component	2005 <sup>1</sup>	2006 <sup>1</sup>	2006			
			Q1	Q2	Q3	Q4
GDP	2.8	2.3	3.8	2.0	2.0	1.4
Total domestic demand	3.8	3.0	4.8	6.0	2.5	-1.3
Consumption	3.8	4.3	5.4	3.7	5.1	3.1
Investment	7.2	5.0	10.6	2.8	3.1	3.7
Government consumption	3.0	2.9	3.6	4.4	2.0	1.8
Inventories <sup>2</sup>	-0.6	-1.2	-1.3	2.3	-1.4	-4.4
Exports	4.5	0.5	-4.8	-1.3	3.5	4.8
Imports	6.9	2.8	-1.9	9.0	5.1	-0.6
Net Exports <sup>2</sup>	-0.9	-1.0	-1.2	-4.1	-0.7	2.2

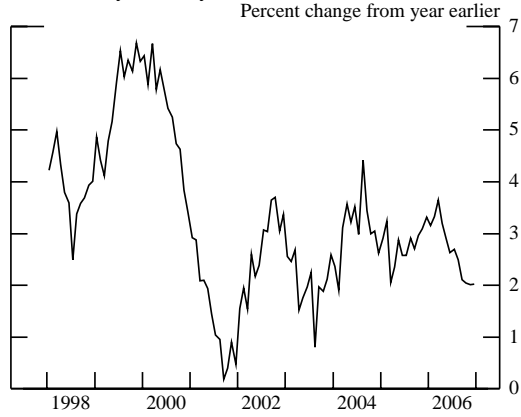
1. Q4/Q4

2. Percentage point contribution to GDP growth.

The twelve-month rate of consumer price inflation declined to 1.2 percent in January from 1.6 percent in December, pushed by falling gasoline prices. The twelve-month rate of core inflation, which excludes the eight most volatile components and the effects of indirect taxes, edged up to 2.1 percent in January from 2 percent in December. Even so, the upward pressure on the core index from homeowners' replacement costs continued to ease. The twelve-month rate of new home price inflation remained elevated at 10 percent in December, but was down slightly from the previous few months. Twelve-month house price inflation in the oil-producing province of Alberta, which leads the country with growth over 40 percent, has moved lower since the fall.

**Canada**

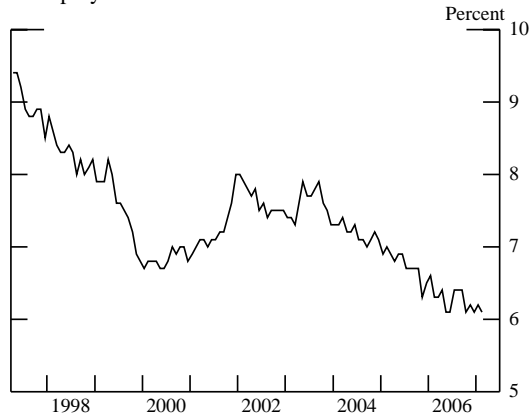
Real GDP by Industry



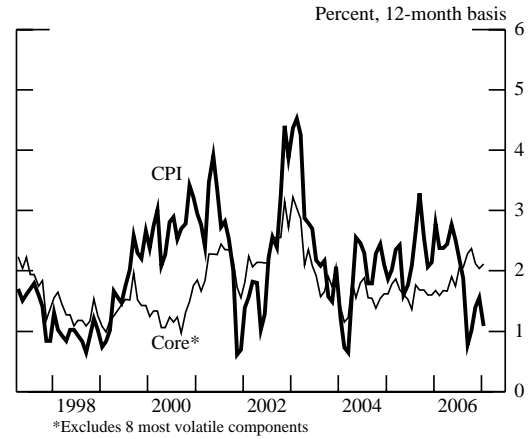
Real Trade



Unemployment Rate



Consumer Price Inflation



\*Excludes 8 most volatile components

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

Indicator	2006			2006		2007	
	Q2	Q3	Q4	Nov.	Dec.	Jan.	Feb.
Industrial production	-1.0	-0.1	-1.0	-0.0	-0.0	n.a.	n.a.
New manufacturing orders	-1.7	0.8	0.8	3.4	2.1	n.a.	n.a.
Retail sales	2.0	0.9	0.4	-0.3	2.1	n.a.	n.a.
Employment	0.7	0.1	0.6	0.1	0.3	0.5	0.1
Consumer attitudes <sup>1</sup>	122.0	121.2	122.6	...	...	...	...
Business confidence <sup>1</sup>	142.9	135.6	148.1	...	...	...	...

1. 1991=100.  
n.a. Not available. ... Not applicable.

## **Economic Situation in Other Countries**

Recent data from emerging Asian economies point to continued strength in economic activity, although there are signs of moderation in some countries. Growth picked up in China in the fourth quarter, but declined in some other emerging Asian economies such as Hong Kong, Taiwan, and Thailand. In Latin America, Mexican activity decelerated markedly in the fourth quarter, in part reflecting a decline in manufacturing exports to the United States. However, growth picked up in Brazil and, especially, Venezuela, and remained strong in Argentina. Inflationary pressures remain contained in most emerging market economies, although there have been some increases in China, Mexico, India and Venezuela. An acceleration of food prices largely accounts for the elevated inflation rates in China and Mexico.

In **China**, real GDP increased nearly 10 percent (a.r.) in the fourth quarter of last year, according to staff estimates. Although this is a significant pick-up from its third-quarter pace, it still left average growth for the second half of 2006 at about 8½ percent, considerably lower than the roaring 12-percent pace in the first half. Investment growth continued to moderate, slowing to about a 20-percent increase in the fourth quarter from its year-earlier level. But weakness in domestic sectors was offset by strength in exports. The nominal trade balance has continued to surprise on the upside this year, rising to a phenomenal \$344 billion (a.r.) on average in the first two months of this year. The increase is broad-based, with exports in several sectors (including electronics and machinery, clothing, furniture, and steel) posting sizable gains. After receding somewhat in January, twelve-month consumer price inflation picked up again in February, to 3 percent. Although interpretation of these monthly figures is complicated by the timing of the lunar calendar New Year holiday, food prices, which have been the source of the pickup in inflation in recent months, remain elevated. The acceleration in food prices reflects in part high grain prices resulting from greater demand for biofuel. Grain prices are a sensitive issue in China, and the authorities will likely take measures to stabilize them should the increases persist.

The plunge in the Chinese stock market at the end of February and the subsequent rebound did not appear to have any link to real economic fundamentals in China. The drop from a very high level resulting from last year's run up seemed to be triggered by reports of a greater clamp down on speculative activity in the market. Fueled by the trade surplus, international reserves continue to rise at a very fast clip, necessitating tightening actions – such as sterilization and increases in the banks' required reserve ratio (RRR) –

by Chinese authorities to manage the excess liquidity problem. However, this has been going on for some time; the most recent increase in the RRR of 50 basis points in mid-February was not a surprise and it was the fifth such increase since last June.

### Chinese Economic Indicators

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

Indicator	2005	2006	2006			2007	
			Q3	Q4	Dec.	Jan.	Feb.
Real GDP <sup>1</sup>	9.9	10.4	7.3	9.9	...	...	...
Industrial production	17.2	14.3	2.8	2.2	1.1	n.a.	n.a.
Consumer prices <sup>2</sup>	1.6	2.8	1.2	2.1	2.8	2.1	3.0
Merch. trade balance <sup>3</sup>	102.0	177.5	187.3	215.2	197.8	217.7	470.8

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

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

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

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

In **Hong Kong**, real GDP growth moderated in the fourth quarter, as an increase in the contribution of domestic demand to growth was more than offset by a decrease in the contribution from real net exports. The nominal merchandise trade deficit widened in January for the fifth consecutive month, suggesting the contribution of real net exports to growth will remain negative in the current quarter. However, the interpretation of the January figure is complicated by the timing of the lunar calendar holiday this year, which can make appropriate seasonal adjustment of the data difficult. Twelve-month inflation edged up in January, in part reflecting rising transport prices.

### Hong Kong Economic Indicators

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

Indicator	2005	2006	2006				2007
			Q3	Q4	Nov.	Dec.	Jan.
Real GDP <sup>1</sup>	7.8	6.9	10.8	5.3	...	...	...
Unemployment rate <sup>2</sup>	5.7	4.8	4.7	4.4	4.4	4.4	4.4
Consumer prices <sup>3</sup>	1.4	2.3	2.3	2.1	2.2	2.3	2.5
Merch. trade balance <sup>4</sup>	-10.5	-17.9	-12.7	-22.8	-22.4	-24.8	-25.4

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

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

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

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

... Not applicable.

In **Taiwan**, fourth-quarter output growth also moderated, largely reflecting contractions in investment and exports. Industrial production fell in the fourth quarter and registered only a minor increase in January, with reductions in important sectors such as electronics and precision equipment weighing on activity. Also in January, export orders for electronic products edged down for the fourth consecutive month. The merchandise trade balance was negative in January, but turned positive again in February. Again, the timing of lunar calendar New Year holiday makes interpretation of the monthly pattern difficult; the average trade balance for January and February combined was almost \$6 billion (a.r.). After falling a bit in January, twelve-month consumer price inflation picked up to 1.7 percent in February.

### Taiwan Economic Indicators

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

Indicator	2005	2006	2006			2007	
			Q3	Q4	Dec.	Jan.	Feb.
Real GDP <sup>1</sup>	6.4	4.0	7.2	4.6	...	...	...
Unemployment rate <sup>2</sup>	4.1	3.9	3.9	3.9	3.9	3.9	n.a.
Industrial production	4.6	5.0	.9	-1.3	-1.9	.1	n.a.
Consumer prices <sup>3</sup>	2.2	.7	-.3	-.1	.7	.3	1.7
Merch. trade balance <sup>4</sup>	7.8	11.6	15.1	16.8	24.0	-2.7	14.1
Current account <sup>5</sup>	16.0	25.2	25.1	34.0	...	...	...

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

2. Percent.

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

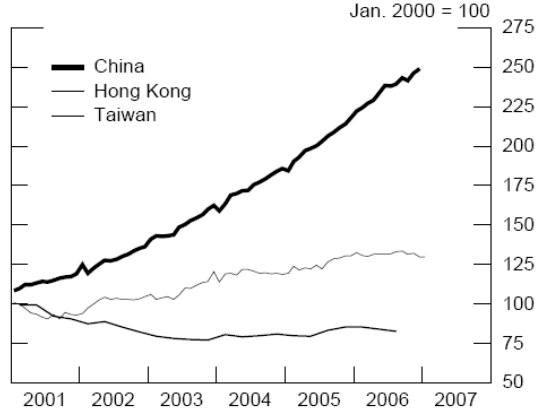
4. Billions of U.S. dollars, annual rate. Imports are c.i.f.

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

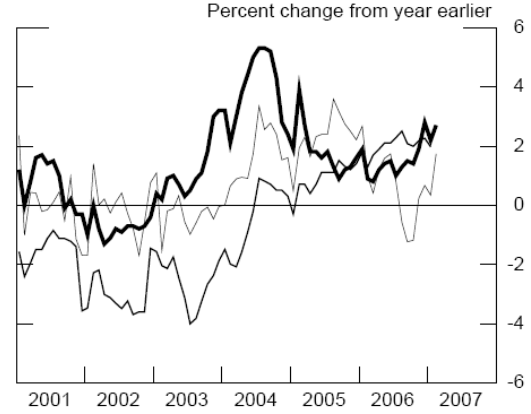
n.a. Not available. . . . Not applicable.

**China, Hong Kong, and Taiwan**

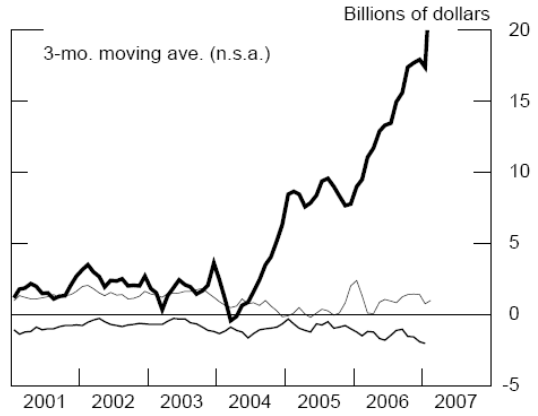
**Industrial Production**



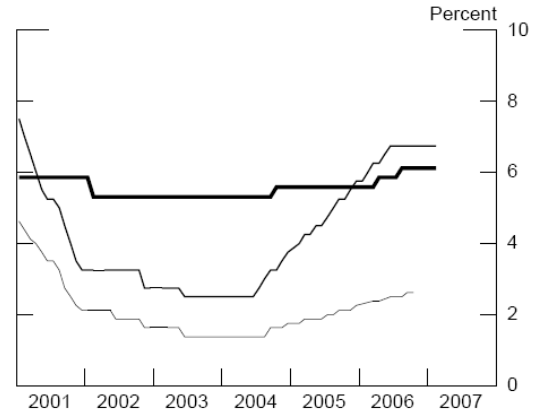
**Consumer Prices**



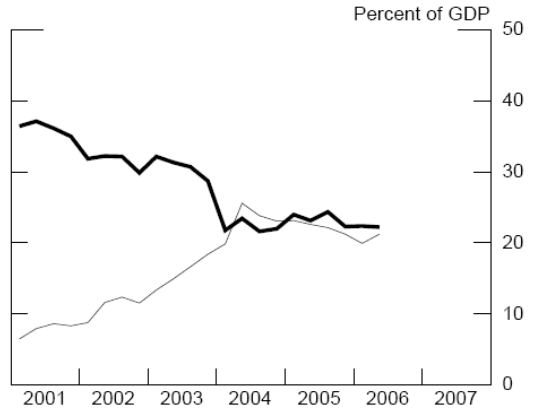
**Merchandise Trade Balances**



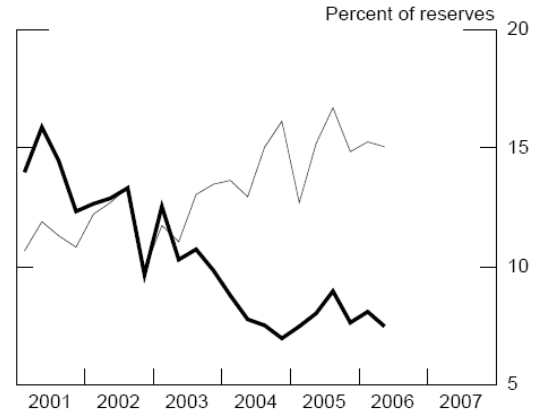
**Benchmark Interest Rates**



**Gross External Debt**



**Short-Term External Debt**



In **Korea**, incoming data since the last Greenbook have been mixed. Output growth slowed to 3.4 percent in the fourth quarter, held down by sluggish consumption and a significant drawdown in inventories. In January, industrial production only partially recovered from sizable declines in November and December. Concerns over the appreciating exchange rate and government measures to rein in the housing market have contributed to weakening consumer and business confidence, and retail sales and service sector output fell in January. Exports picked up in January, but a surge in imports and a large deficit in services led to a negative current account balance for the month. Twelve-month consumer price inflation remains below the Bank of Korea's target range of 2.5 to 3.5 percent.

### Korean Economic Indicators

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

Indicator	2005	2006	2006			2007	
			Q3	Q4	Dec.	Jan.	Feb.
Real GDP <sup>1</sup>	5.3	4.0	4.4	3.4	...	...	...
Industrial production	5.8	10.8	.5	2.7	-2.8	1.3	n.a.
Unemployment rate <sup>2</sup>	3.7	3.4	3.5	3.4	3.3	3.3	3.2
Consumer prices <sup>3</sup>	2.6	2.1	2.5	2.1	2.1	1.7	2.2
Merch. trade balance <sup>4</sup>	32.7	29.2	23.6	40.9	31.1	12.5	n.a.
Current account <sup>5</sup>	15.0	6.1	1.5	24.6	1.8	-6.1	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.

**Indian** economic indicators have remained robust. Real GDP rose 8.6 percent in the fourth quarter, with growth supported by continued strength in construction and services and by a rebound in agriculture after weakness in the previous two quarters. In January, industrial production rose almost 1 percent. Inflationary pressures appear to be mounting, however. Twelve-month inflation of the closely watched wholesale price index rose to 6.2 percent in January. In response, the government lowered fuel prices for consumers and reduced import duties on a number of products, including cement. Despite these measures, twelve-month wholesale price inflation edged up further in February, to 6.4 percent. Credit growth has also been soaring, and the Bank of India raised the cash reserve ratio for banks ½ percentage point to 6 percent.



**Indian Economic Indicators**

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

Indicator	2005	2006	2006			2007	
			Q3	Q4	Dec.	Jan.	Feb.
Real GDP <sup>1</sup>	9.3	8.6	8.7	8.6	...	...	...
Industrial production	7.9	10.4	.7	1.6	-1.5	.9	n.a.
Consumer prices <sup>2</sup>	5.6	5.6	6.2	6.1	5.6	5.8	n.a.
Wholesale prices <sup>2</sup>	4.4	5.7	5.1	5.6	5.7	6.2	6.4
Merch. trade balance <sup>3</sup>	-40.1	-54.6	-54.1	-73.6	-66.1	-66.9	n.a.
Current account <sup>4</sup>	-6.9	n.a.	-27.7	n.a.	...	...	...

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

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

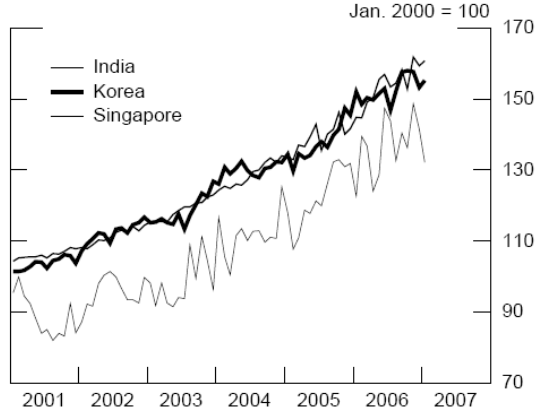
3. Billions of U.S. dollars, annual rate.

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

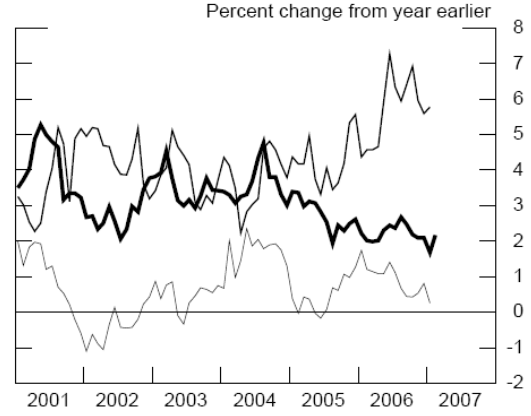
n.a. Not available. ... Not applicable.

### India, Korea, and Singapore

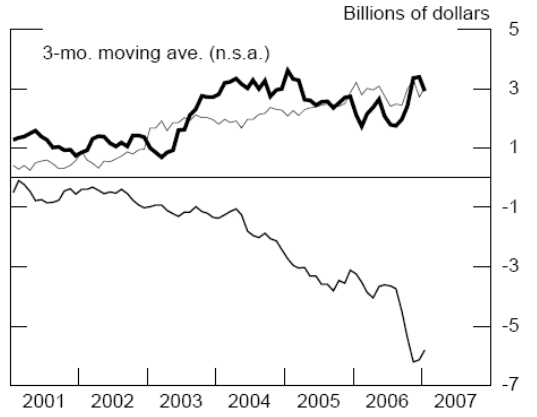
Industrial Production



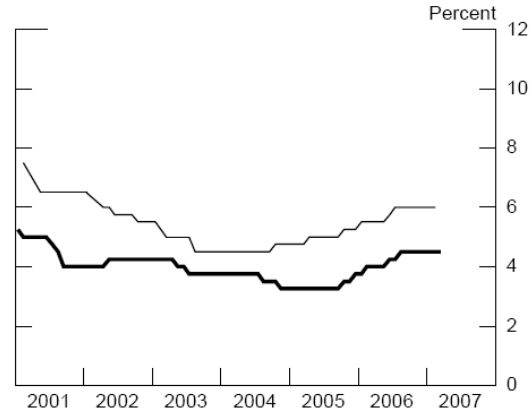
Consumer Prices



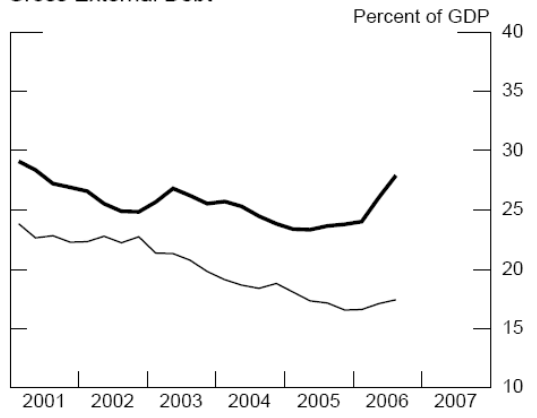
Merchandise Trade Balances



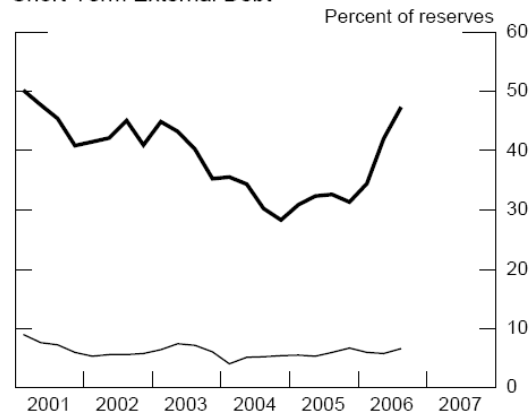
Benchmark Interest Rates



Gross External Debt



Short-Term External Debt



Economic activity in the **ASEAN** region continued to expand at a robust pace in the fourth quarter, although performance varied across the region. Real GDP rose solidly in Singapore, Indonesia, and Malaysia as domestic demand strengthened and nominal trade balances remained high, suggesting strong real net exports. In the Philippines, where the continued widening of the nominal trade deficit suggests that real net exports weakened, and in Thailand, where domestic demand was tepid, real GDP expanded at a more moderate pace. More recently, January industrial production was up slightly in Thailand, but down in Malaysia and Singapore.

Twelve-month consumer price inflation across the region continued to decline because of lower energy prices and, in some countries, exchange rate appreciation and the unwinding of previous food price increases. Citing the moderation in inflation and the need to stimulate domestic demand, the central banks of Indonesia and Thailand further loosened monetary policy. Specifically, Bank Indonesia cut interest rates by 25 basis points in early February and again in early March, and the Bank of Thailand lowered rates 25 basis points in late February.

The Bank of Thailand announced that, effective mid-March, capital controls instituted last December will be loosened further. In the Philippines, the central bank announced measures to liberalize capital outflows in an effort to stem currency appreciation; caps on foreign exchange purchases and outward investments by residents were raised. In early March, the central bank also approved a plan to repay in May the country's remaining Brady bond debt, estimated at \$126 million; this action was made possible by the country's improved fiscal position.

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

Indicator	2005	2006	2006				2007
			Q3	Q4	Nov.	Dec.	Jan.
<i>Real GDP<sup>1</sup></i>							
Indonesia	4.9	6.0	8.7	7.1	...	...	...
Malaysia	5.2	5.7	4.9	4.8	...	...	...
Philippines	5.5	4.8	3.1	3.4	...	...	...
Singapore	8.2	6.5	3.9	7.9	...	...	...
Thailand	4.4	4.2	5.7	2.7	...	...	...
<i>Industrial production<sup>2</sup></i>							
Indonesia <sup>3</sup>	1.3	1.8	.1	18.4	13.6	.0	n.a.
Malaysia	4.0	5.2	.8	.0	8.6	-2.2	-2.3
Philippines	2.2	-9.9	-1.0	.1	6.3	-1.4	n.a.
Singapore	9.5	11.6	4.1	2.3	9.2	-4.9	-6.5
Thailand	9.1	7.4	2.6	.1	2.2	-1.2	.2

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

2. Annual data are annual averages.

3. Staff estimate.

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

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

Indicator	2005	2006	2006				2007
			Q3	Q4	Nov.	Dec.	Jan.
Indonesia	28.0	39.7	39.5	44.1	40.6	50.2	35.5
Malaysia	26.4	29.5	31.5	31.5	31.6	35.3	23.2
Philippines	-6.2	-4.5	-4.9	-8.2	-7.2	-10.8	n.a.
Singapore	29.6	33.1	29.5	32.7	39.8	11.5	58.8
Thailand	-8.5	2.2	2.6	5.4	11.0	2.5	n.a.

n.a. Not available.

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

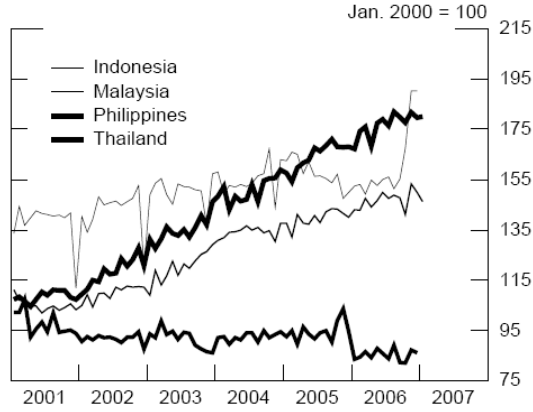
Indicator	2005 <sup>1</sup>	2006 <sup>1</sup>	2006			2007	
			Q3	Q4	Dec.	Jan.	Feb.
Indonesia	17.0	6.7	14.8	6.1	6.7	6.3	6.3
Malaysia	3.3	3.1	3.6	3.0	3.1	3.2	n.a.
Philippines	6.7	4.3	6.1	4.8	4.3	3.9	2.6
Singapore	1.3	.8	.7	.6	.8	.3	n.a.
Thailand	5.8	3.5	3.6	3.3	3.5	3.0	2.3

1. Dec./Dec.

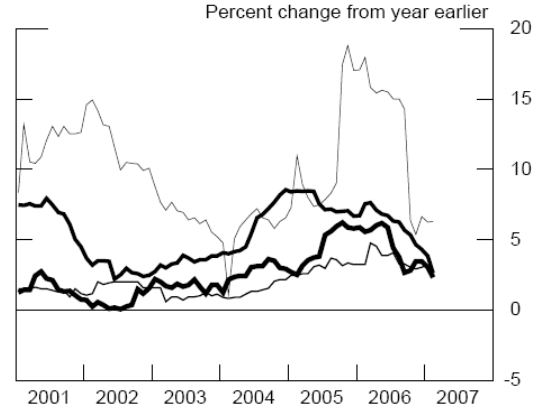
n.a. Not available.

**ASEAN-4**

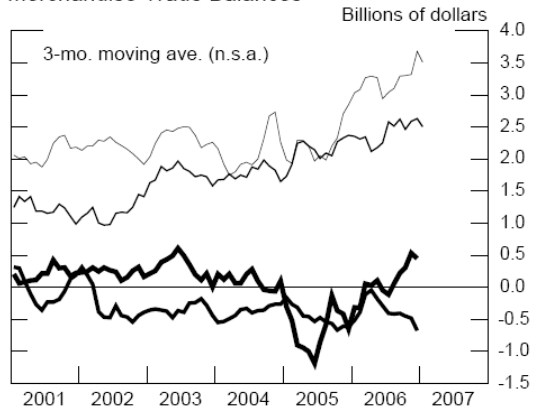
**Industrial Production**



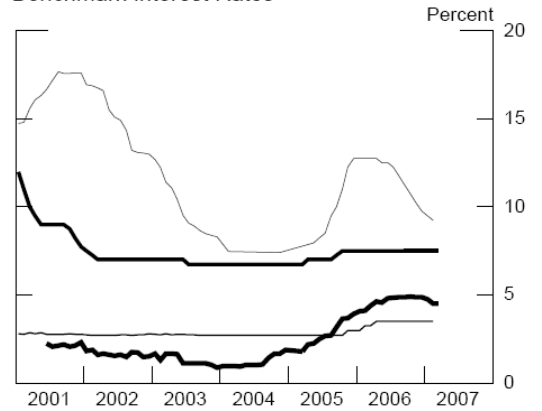
**Consumer Prices**



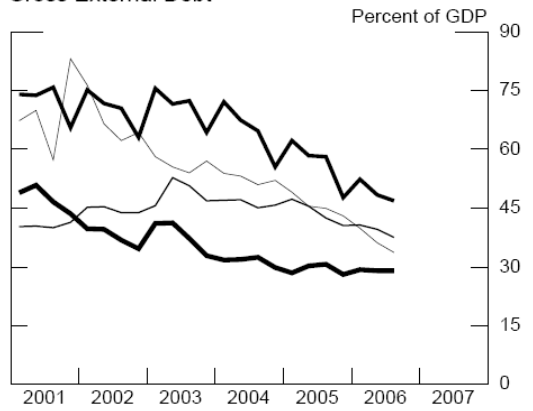
**Merchandise Trade Balances**



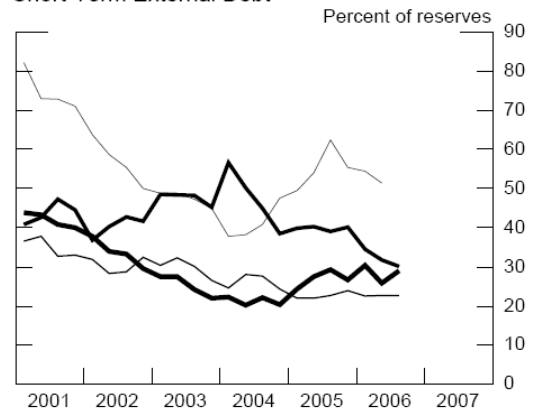
**Benchmark Interest Rates**



**Gross External Debt**



**Short-Term External Debt**



In **Mexico**, recent indicators point to a marked slowdown in the pace of economic activity. Real GDP growth fell to 1.9 percent (a.r.) in the fourth quarter. Weakness in the manufacturing and mining sectors offset solid performances in construction, services, and agriculture. Manufacturing exports to the United States declined, leading to a worsening of the trade balance in January. Twelve-month headline inflation was 4.1 percent in February, the sixth consecutive month of inflation at or above the upper limit of the central bank's 2 to 4 percent inflation target range. The elevated inflation rate largely reflected high prices for corn tortillas. Although the central bank left monetary policy unchanged during its late-February meeting, it warned of the need for policy tightening should inflation remain high.

### Mexican Economic Indicators

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

Indicator	2005	2006	2006			2007	
			Q3	Q4	Dec.	Jan.	Feb.
Real GDP <sup>1</sup>	2.5	4.3	2.7	1.9	...	...	...
Overall economic activity	3.1	4.9	.7	.7	.2	n.a.	n.a.
Industrial production	2.1	5.0	.3	.3	-.6	n.a.	n.a.
Unemployment rate <sup>2</sup>	3.6	3.6	3.7	3.9	3.9	3.8	n.a.
Consumer prices <sup>3</sup>	3.3	4.1	3.5	4.1	4.0	4.0	4.1
Merch. trade balance <sup>4</sup>	-7.6	-5.8	-9.9	-9.4	-8.5	-18.4	n.a.
Merchandise imports <sup>4</sup>	221.8	256.1	264.1	261.7	259.6	264.8	n.a.
Merchandise exports <sup>4</sup>	214.2	250.3	254.2	252.3	251.1	246.5	n.a.
Current account <sup>5</sup>	-4.8	-1.4	-4.6	-8.0	...	...	...

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 grew 4.4 percent (a.r.) in the fourth quarter, supported by strong private consumption and investment. Continuing the pattern over the past year, net exports made a negative contribution to growth, as real exports declined a little and imports rose substantially. In January, industrial output declined a bit and the unemployment rate edged up. Consumer price inflation remained at about 3 percent on a twelve-month basis.

In late January, the Lula government unveiled a package of measures aimed at spurring investment, the first big initiative since Lula began his second term earlier in the month. The package, which relies heavily on implicit and explicit subsidies to direct private investment to energy and other selected sectors, has received mostly tepid reviews from economists. In early March, the central bank lowered its target for the policy rate, the Selic rate, by 25 basis points, to 12¾ percent, bringing the cumulative decline in the rate to 700 basis points since the current easing phase began in September 2005.

### Brazilian Economic Indicators

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

Indicator	2005	2006	2006			2007	
			Q3	Q4	Dec.	Jan.	Feb.
Real GDP <sup>1</sup>	1.5	3.7	3.1	4.4	...	...	...
Industrial production	3.1	2.8	.7	.9	.3	-.3	n.a.
Unemployment rate <sup>2</sup>	9.8	10.4	10.5	9.6	9.5	9.7	n.a.
Consumer prices <sup>3</sup>	5.7	3.1	3.8	3.1	3.1	3.1	3.2
Merch. trade balance <sup>4</sup>	44.8	46.1	49.0	50.8	57.7	44.4	43.6
Current account <sup>5</sup>	14.2	13.5	29.9	13.0	4.7	3.9	n.a.

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

2. Percent.

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

Price index is IPCA.

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

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

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

In **Argentina**, the index of economic activity (a monthly proxy of GDP) through December suggests that output growth remained strong in the fourth quarter. Industrial production accelerated noticeably but fell back in January, largely reflecting the shutting down of motor vehicle plants for retooling. This retooling does not occur in the same month every year, complicating seasonal adjustment. Twelve-month inflation in January and February came in a bit lower than at the end of last year.



### Argentine Economic Indicators

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

Indicator	2005	2006	2006			2007	
			Q3	Q4	Dec.	Jan.	Feb.
Real GDP <sup>1</sup>	8.9	n.a.	10.9	n.a.	...	...	...
Industrial production	8.0	8.4	.8	2.5	.7	-2.5	n.a.
Unemployment rate <sup>2</sup>	11.6	n.a.	10.2	n.a.	...	...	...
Consumer prices <sup>3</sup>	12.2	9.8	10.6	10.1	9.8	9.6	9.6
Merch. trade balance <sup>4</sup>	11.7	12.4	11.4	13.3	18.7	5.7	n.a.
Current account <sup>5</sup>	5.4	n.a.	7.0	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.

**Venezuela** recorded its third straight year of double-digit growth, with real GDP soaring an estimated 22 percent (a.r.) in the fourth quarter. Profligate fiscal and monetary policies fueled overall growth over the past year, but activity stagnated in the energy sector even as oil revenues remained elevated. Inflation has become a major economic and political problem. Reported twelve-month consumer price inflation surpassed 20 percent in February and may understate actual inflation, as many food items that are in short supply because of price controls were excluded from the computation.

As expected, the Chavez-controlled congress approved the Enabling Law on January 31, giving Chavez broad powers for the next 18 months. Chavez introduced new measures to tackle inflation, reducing the VAT on certain items and threatening to nationalize grocery stores and distribution companies that do not comply with price controls. The nationalization of Electricidad de Caracas and CANTV (the nation's largest telecommunications company) is proceeding, and Chavez decreed the nationalization of the rest of the electricity companies. In February, Argentina and Venezuela issued a second dollar-denominated "bond of the south" for \$1.5 billion, split equally between the two countries. In early March, the government announced that the Bolivar will be replaced by the "Bolivar Fuerte" (Strong Bolivar) on January 1, 2008. The Bolivar Fuerte is equal to 1,000 Bolivares. The official exchange rate is 2,144 Bolivares per dollar, but the exchange rate in the parallel market was over 3,800 Bolivares per dollar in mid-March.

### Venezuelan Economic Indicators

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

Indicator	2005	2006	2006			2007	
			Q3	Q4	Dec.	Jan.	Feb.
Real GDP <sup>1</sup>	10.9	11.8	13.5	22.0	...	...	...
Unemployment rate <sup>2</sup>	12.2	10.0	10.0	8.7	8.7	11.1	n.a.
Consumer prices <sup>3</sup>	14.4	17.0	14.6	16.1	16.9	18.3	20.4
Non-oil trade balance <sup>4</sup>	-16.3	-25.5	-32.6	n.a.	n.a.	n.a.	n.a.
Merch. trade balance <sup>4</sup>	31.8	33.0	28.7	n.a.	n.a.	n.a.	n.a.
Current account <sup>5</sup>	25.5	27.2	29.5	17.0	...	...	...

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

2. Percent.

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

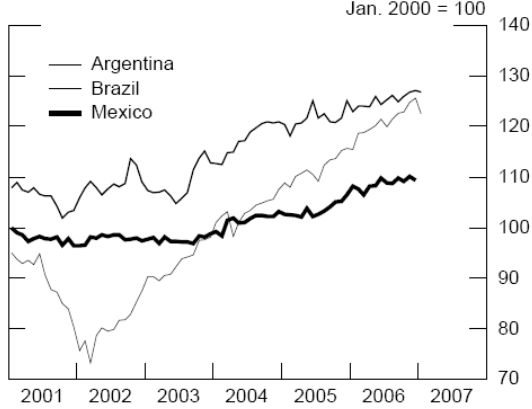
4. Billions of U.S. dollars, annual rate.

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

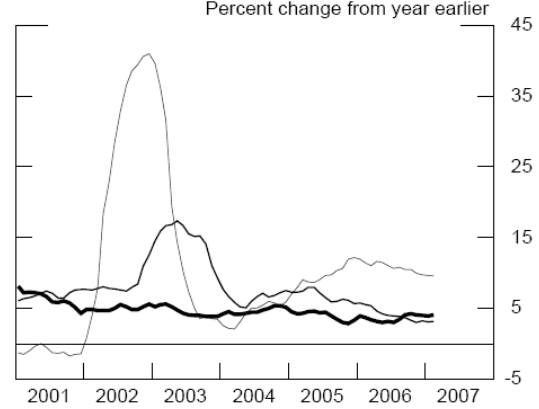
n.a. Not available. . . . Not applicable.

Latin America

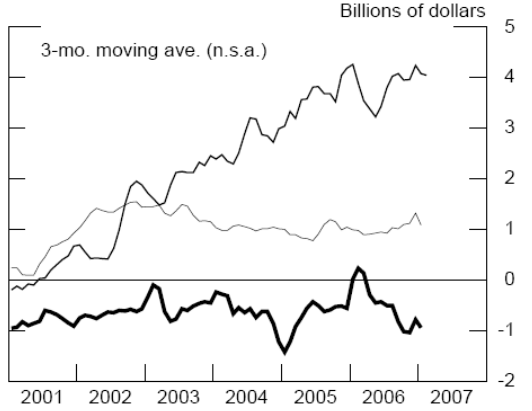
Industrial Production



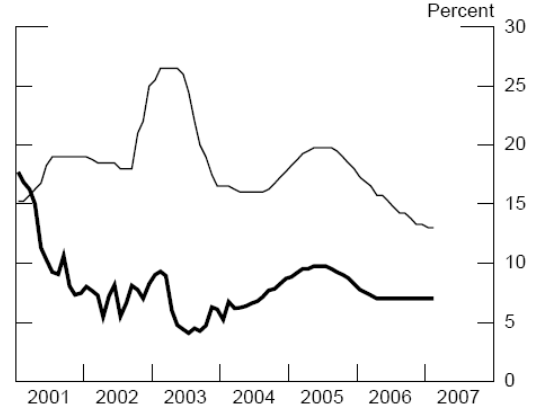
Consumer Prices



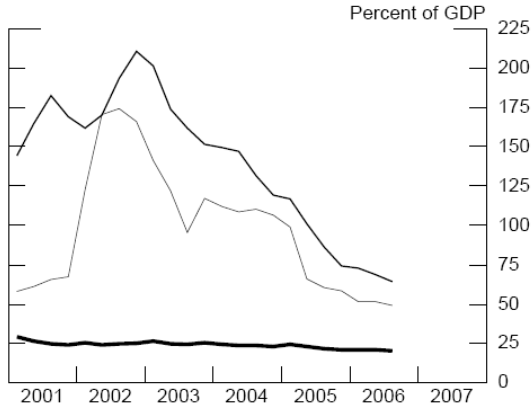
Merchandise Trade Balances



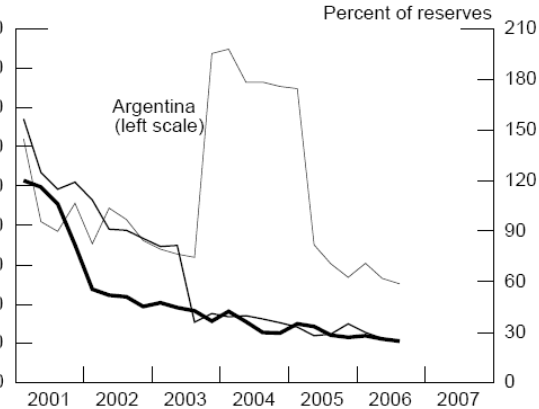
Benchmark Interest Rates



Gross External Debt



Short-Term External Debt



In **Turkey**, economic activity slowed toward the end of 2006. Although trade and current account deficits improved on falling energy and commodity prices, industrial production fell markedly in December. In January, the trade deficit widened again. Notwithstanding lower energy prices and sluggish growth, inflation remains a concern with consumer prices up more than 10 percent over the twelve months ended in February. Upcoming elections raise the possibility of expansionary fiscal policy, which, combined with generous public-sector wage increases, may fuel inflationary pressures further. EU accession talks appear to have stalled indefinitely, reflecting continued lack of progress in resolving issues related to Cyprus.

### Turkey Economic Indicators

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

Indicator	2005	2006	2006			2007	
			Q3	Q4	Dec.	Jan.	Feb.
Real GDP <sup>1</sup>	7.4	n.a.	3.4	n.a.	...	...	...
Industrial production	5.4	6.0	-1.8	2.8	-7.2	n.a.	n.a.
Consumer prices <sup>2</sup>	7.7	9.7	10.8	9.8	9.7	9.9	10.2
Merch. Trade balance <sup>3</sup>	-43.3	-51.8	-53.1	-48.0	-30.4	-47.9	n.a.
Current account <sup>4</sup>	-22.8	-31.9	-33.3	-24.0	.6	n.a.	n.a.
Unemployment rate	10.3	9.9	9.9	9.6	...	...	...

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

In **South Africa**, recent indicators point to a strengthening of growth. Real GDP increased 5.6 percent (a.r.) in the fourth quarter of last year, leading to a Q4/Q4 growth rate of more than 5 percent in 2006. Manufacturing production was up nearly 2 percent in December over the previous month. Twelve-month consumer price inflation in January crept up to 5.3 percent, after several months at 5 percent. The current account deficit continued to widen as merchandise imports outpaced merchandise exports, though both are growing at near-record rates.

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

Indicator	2005	2006	2006				2007
			Q3	Q4	Nov.	Dec.	Jan.
Real GDP <sup>1</sup>	4.9	5.2	4.5	5.6	...	...	...
Manuf. Production	3.6	4.9	1.4	2.1	1.2	1.9	-5
Mining Production	1.3	-1.0	.1	5.2	7.1	-2.4	-8.4
Consumer Prices <sup>2</sup>	3.9	4.6	5.0	5.0	5.0	5.0	5.3
Merch. trade Balance <sup>3</sup>	-2.9	-9.4	-7.1	-13.2	-12.8	-14.7	-15.8
Current Account <sup>4</sup>	-9.1	n.a.	-15.9	n.a.	...	...	...

1. Annual Rate. Annual data are Q4/Q4.

2. Percent change from year-earlier period for the CPIX, except annual data, which are Dec./Dec. CPIX excludes interest rates on mortgage bonds.

3. Billions of U.S. dollars, s.a.a.r.

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

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