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[1] In some cases, original copies needed to be photocopied before being scanned into electronic format. All scanned images were deskewed (to remove the effects of printer- and scanner-introduced tilting) and lightly cleaned (to remove dark spots caused by staple holes, hole punches, and other blemishes caused after initial printing).

[2] A two-step process was used. An advanced optimal character recognition computer program (OCR) first created electronic text from the document image. Where the OCR results were inconclusive, staff checked and corrected the text as necessary. Please note that the numbers and text in charts and tables were not reliably recognized by the OCR process and were not checked or corrected by staff.

Confidential (FR) Class III FOMC

Part 2

August 16, 2001

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Recent Developments

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

Confidential (FR) Class III FOMC

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Domestic Nonfinancial Developments

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Overview

The economy appears to have reached midsummer with only slight forward momentum. The news from the tech sector can only be characterized as bleak, and business investment more generally is in a deep slump. In many manufacturing industries, shipments remain soft, and sharp production cutbacks have not yet succeeded in bringing inventory-shipments ratios down to comfortable levels. However, household expenditures on consumption items and residential investment continue to hold up reasonably well. With energy prices having turned down and core inflation well behaved, overall consumer price inflation has eased a bit in recent months after a mild uptick earlier in the year. Indicators of wage inflation are sending somewhat mixed signals but, on balance, seem also to have moderated lately.

Real GDP

According to the advance estimate prepared by the Bureau of Economic Analysis (BEA), real GDP increased at an annual rate of 0.7 percent in the second quarter. However, new data on inventory investment and construction expenditures came in weaker than the BEA had assumed in the advance estimate. We estimate that the change in real GDP will be marked down to an annual rate of 0.2 percent. *Unless otherwise indicated, the discussion of second-quarter activity in this section of the Greenbook incorporates our expected revisions to GDP and related measures.*

Real GDP and Selected Components
(Percent change, annual rate, except as noted)

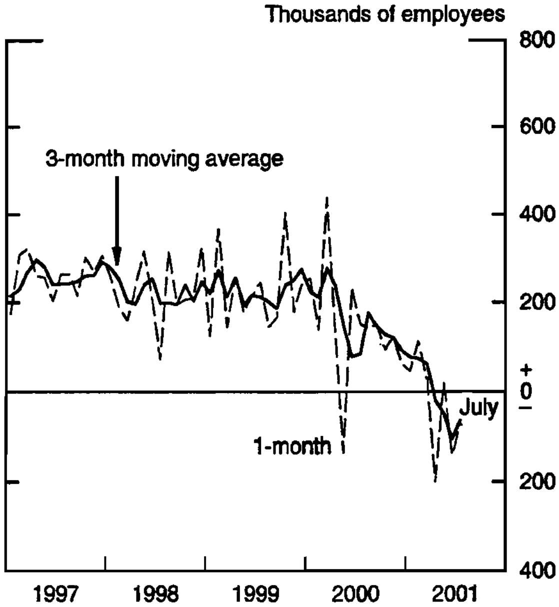
Measure	2001:Q1	2001:Q2 BEA advance estimate	2001:Q2 Staff estimate
Real GDP	**1.3**	**.7**	**.2**
Final sales	4.0	.7	.6
Consumption	3.0	2.1	2.1
Business fixed investment	-.2	-13.6	-13.4
Residential investment	8.5	7.4	4.5
Government	5.3	5.5	5.4
Inventory investment *(level, billions of chained 1996 dollars)*	-27.1	-26.9	-37.2

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

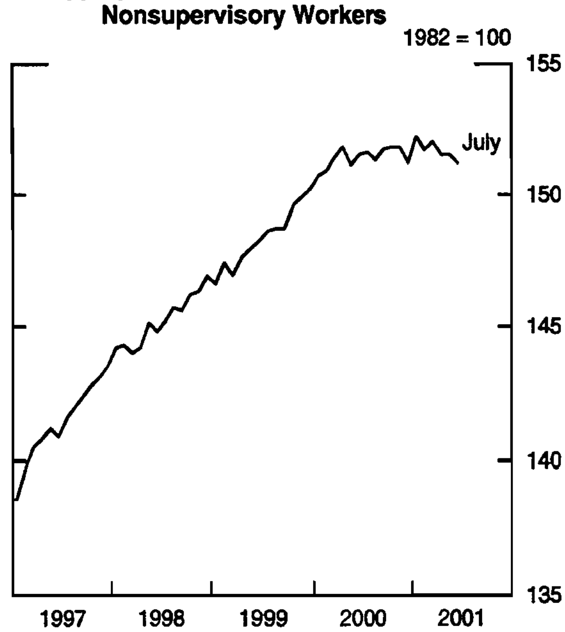
	2000 H1	2000 H2	2001 Q1	2001 Q2	2001 May	2001 June	2001 July
	--Average monthly change--						
Nonfarm payroll employment[1]	267	66	96	-72	41	-93	-42
Previous	*267*	*66*	*96*	*-90*	*8*	*-114*	
Private	178	121	63	-107	18	-138	-73
Mining	1	1	3	3	4	1	1
Manufacturing	5	-29	-78	-117	-130	-113	-49
Construction	16	21	46	-21	29	-14	1
Transportation and utilities	13	16	6	-4	11	-16	-4
Retail trade	31	21	17	38	16	24	6
Wholesale trade	9	8	-1	-15	-15	-16	0
Finance, insurance, real estate	-7	7	12	4	18	-13	-5
Services	110	76	57	5	85	9	-23
Help supply services	15	-19	-37	-44	-4	-38	-42
Total government	90	-54	32	35	23	45	31
Total employment (household survey)	114	109	-19	-283	-251	-171	447
Nonagricultural	116	115	19	-227	-252	27	397
Memo:							
Aggregate hours of private production workers (percent change)[1,2]	2.1	0.2	1.0	-1.5	0.0	-0.2	-0.1
Average workweek (hours)[1]	34.5	34.3	34.3	34.2	34.2	34.2	34.2
Manufacturing (hours)	41.8	41.3	41.0	40.8	40.7	40.7	40.8

Note. Average change from final month of preceding period to final month of period indicated.
1. Survey of establishments.
2. 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.

Private Payroll Employment Growth
(Strike-adjusted data)



Aggregate Hours of Production or Nonsupervisory Workers



Employment and Labor Productivity

Labor demand continued to weaken around midyear. Private nonfarm employment fell in three of the past four months, with net job losses totaling nearly 400,000 over that period; the drop in July was 73,000, led by further declines in manufacturing and in help supply services. Against that backdrop, we are discounting the recent flatness of the unemployment rate as a sign that labor market conditions have stabilized.

Manufacturing employment fell 49,000 in July, after average monthly declines of 115,000 in the second quarter. Almost all the job losses in July occurred in industrial machinery and electrical equipment; these industries, parts of which are involved in the production of computers, telecommunications equipment, and semiconductors, have accounted for 40 percent of factory job losses since the beginning of the year. Employment in help supply services, which is closely linked to manufacturing, has declined 80,000 over the past two months. Industry contacts cited weak demand among both traditional manufacturing and high-tech firms as having contributed to the decline.

Outside of manufacturing and help supply services, labor demand remained quite weak in recent months, with most industries experiencing little or no employment growth. The services industry excluding help supply added only 19,000 jobs last month, and the average monthly gain of 41,000 since the start of the second quarter was the smallest four-month average since 1992. Elsewhere, employment in retail trade rose only 6,000 in July, while employment in the construction industry and in the finance, insurance, and real estate industry, which had expanded throughout the first part of the year, experienced net employment declines in June and July.

Aggregate hours of production or nonsupervisory workers on private nonfarm payrolls inched down 0.1 percent in July after having dipped 0.2 percent in June; these cutbacks raise the prospect of a second consecutive quarterly decline in aggregate labor input. The recent declines have been primarily due to falling employment; the workweek has held steady at 34.2 hours since April.

In the household survey, the unemployment rate stood at 4.5 percent in July, 0.6 percentage point above the low of 3.9 percent reached in September and October but unchanged since April. Given the declines in payroll employment over the past several months, the absence of a further rise in the jobless rate is somewhat puzzling, although such discrepancies are not unprecedented. Nonetheless, the data from the payroll survey suggest a further rise in joblessness in coming months.

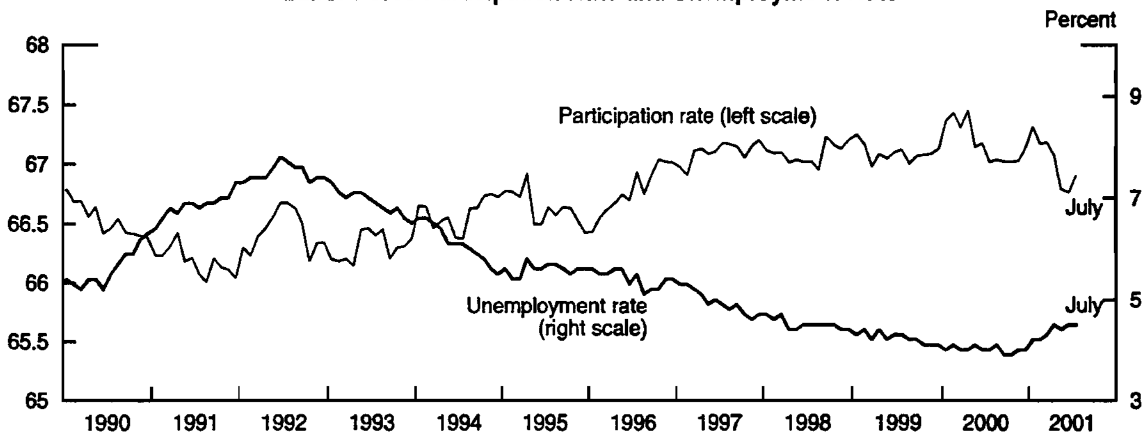
According to estimates from the BLS, an average of 370,000 initial claims for unemployment insurance were filed in the four weeks ended August 11—40,000

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

	1999	2000	2001 Q1	2001 Q2	2001 May	2001 June	2001 July
Civilian unemployment rate (16 years and older)	4.2	4.0	4.2	4.5	4.4	4.5	4.5
Teenagers	13.9	13.1	13.7	14.0	13.6	14.3	14.8
20-24 years old	7.5	7.1	7.4	8.1	7.9	8.2	7.5
Men, 25 years and older	3.0	2.8	3.1	3.4	3.3	3.4	3.5
Women, 25 years and older	3.3	3.2	3.3	3.4	3.4	3.5	3.4
Labor force participation rate	67.1	67.2	67.2	66.9	66.8	66.8	66.9
Teenagers	52.0	52.2	51.3	49.7	48.6	50.5	50.0
20-24 years old	77.6	77.9	78.2	76.6	76.3	76.2	76.7
Men, 25 years and older	76.1	76.0	75.9	75.9	75.9	75.8	75.8
Women, 25 years and older	59.5	59.7	59.9	59.6	59.7	59.5	59.7
Memo:							
Potential worker rate[1]	7.2	6.9	7.1	7.4	7.3	7.5	7.4

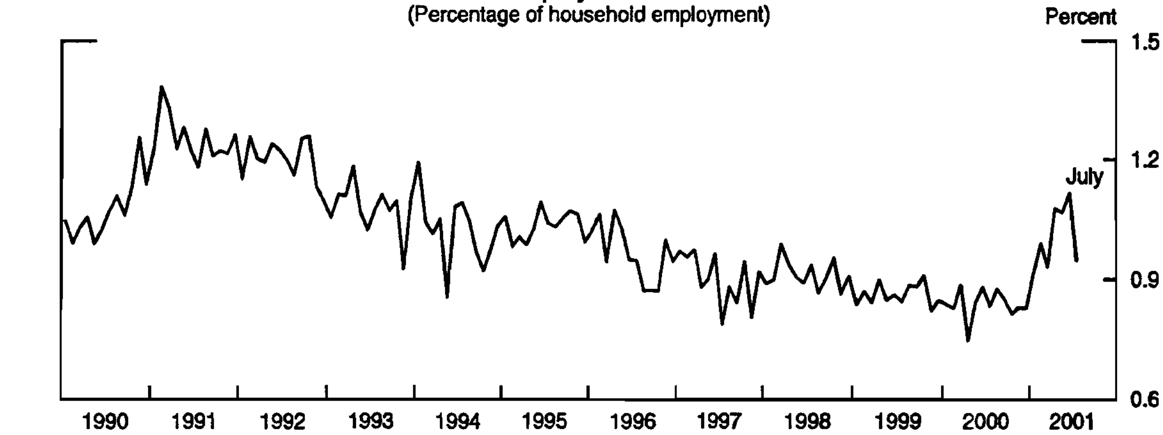
1. The potential worker rate equals the number of civilian unemployed plus those who are not in the labor force and want a job as a percentage of the civilian labor force plus those who are not in the labor force and want a job.

Labor Force Participation Rate and Unemployment Rate



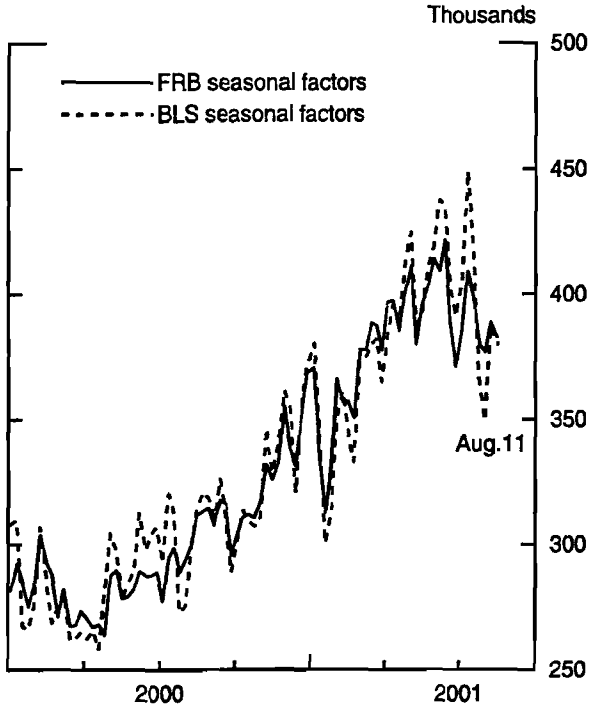
Job Losers Unemployed Less than 5 Weeks

(Percentage of household employment)

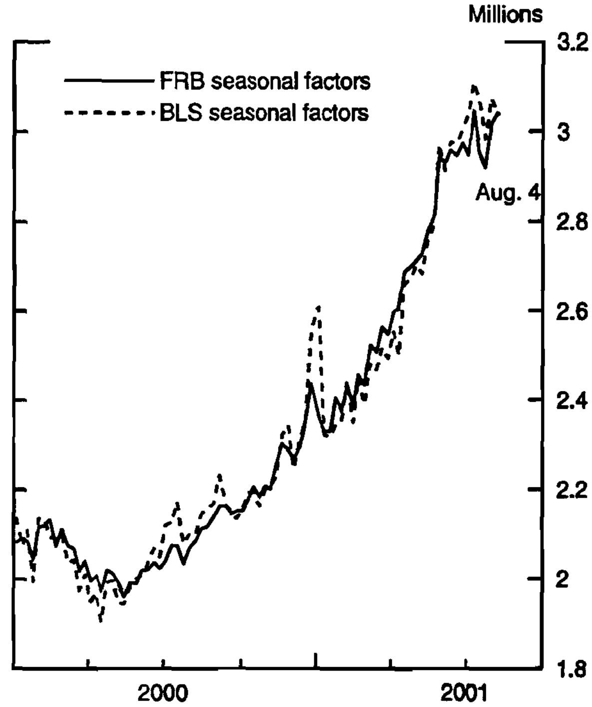


Labor Market Indicators

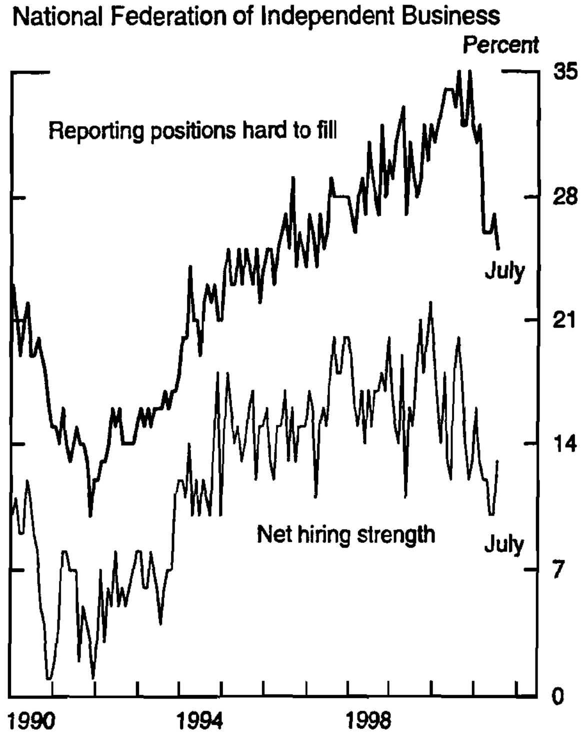
Initial Claims



Insured Unemployment

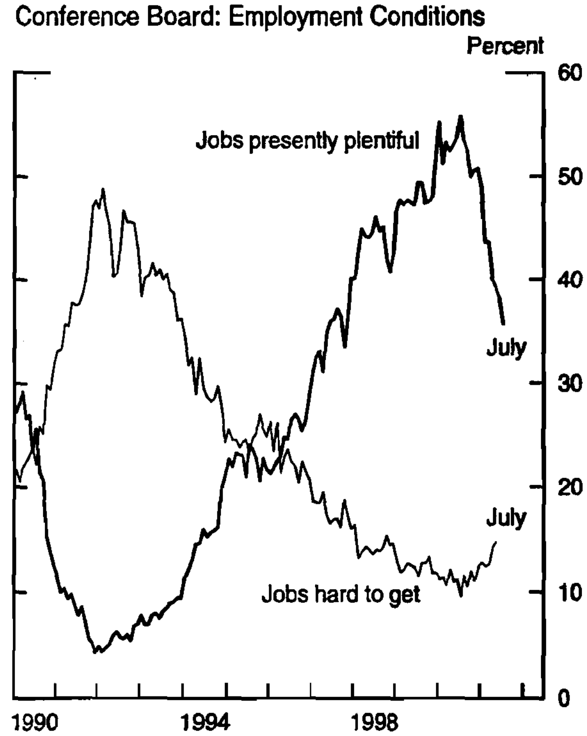


National Federation of Independent Business



Note. Percentage planning an increase in employment minus percentage planning a reduction.

Conference Board: Employment Conditions

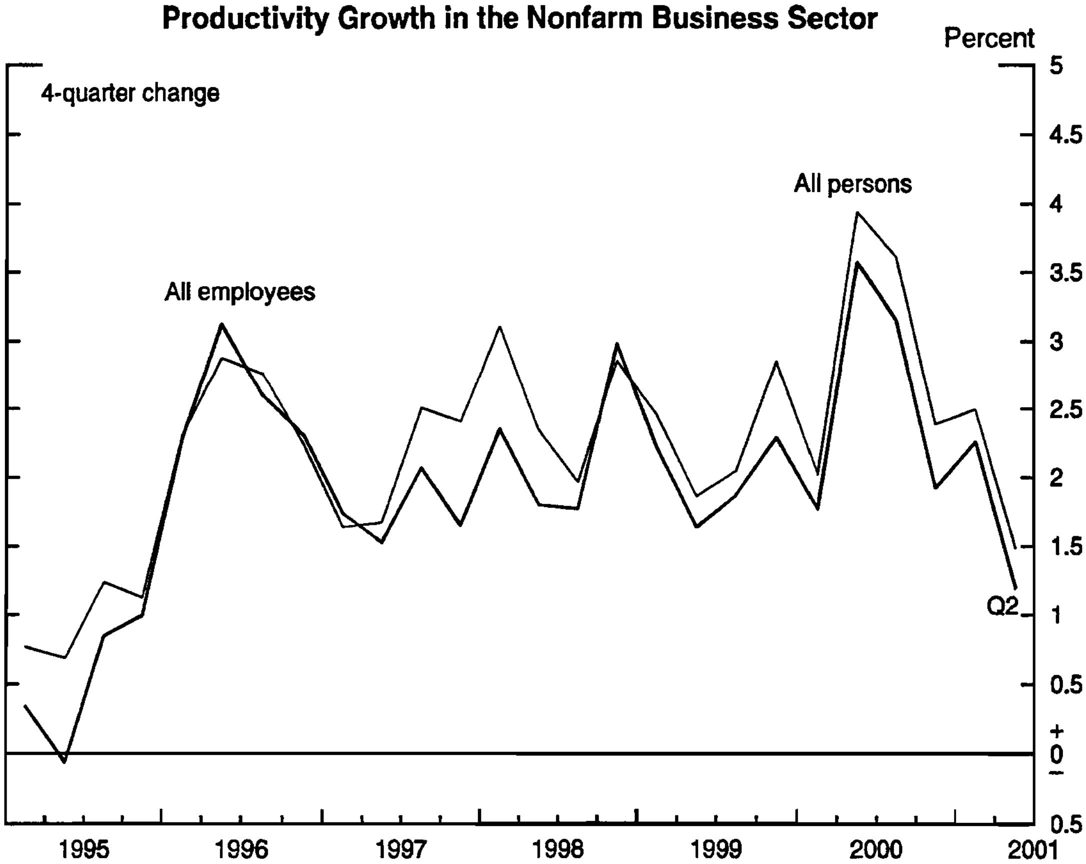


Labor Output Per Hour
(Percent change from preceding period at compound annual rate;
based on seasonally adjusted data)

Sector	1999[1]	2000[1]	2000		2001	
			Q3	Q4	Q1	Q2
Nonfarm business	2.8	2.3	1.4	2.3	.1	1.9
Nonfarm business (employees)	2.3	1.9	1.0	1.6	.9	1.2
Nonfinancial corporations[2]	2.9	4.2	4.0	1.6	.6	n.a.

1. Changes are from fourth quarter of preceding year to fourth quarter of year shown.
2. The nonfinancial corporate sector includes all corporations doing business in the United States with the exception of banks, stock and commodity brokers, and finance and insurance companies; the sector accounts for about two-thirds of business employment.

Productivity Growth in the Nonfarm Business Sector



Note. Staff estimate for 2001:Q2.

per week fewer than in late June. However, as often happens in the summer, recent movements in weekly unemployment insurance claims were significantly affected by temporary plant closings in the motor vehicle and textile industries that vary in their timing from year to year. This year, on a published basis, initial claims shot up in early July and then tumbled later in the month. To better account for shifts in the timing of these summer shutdowns, the Board staff has developed alternative seasonal factors for the claims data.[1] The resulting seasonally adjusted series is less volatile than the published series; it shows about a flat level of claims, on net, since late June. Both sets of seasonal factors show levels of claims in the latest week that are about 80,000 above the average for 2000. Also, using the Board's alternative seasonal adjustment procedures, the level of insured unemployment rose approximately 600,000 between late January and late June and has crept up since then.

Other labor market indicators have been broadly consistent with sluggish labor demand, but, for the most part, these did not worsen significantly in July. According to the National Federation of Independent Business (NFIB), small firms, on net, continued to report sharply lower hiring plans compared with last year, although hiring plans did turn up in July. From the household perspective, the Conference Board reported that the gap between those reporting that jobs were plentiful and those reporting that jobs were hard to get, which narrowed by 20 percentage points over the past year, was little changed in July. Nevertheless, other measures portrayed a labor market that was still moderately tight. According to the NFIB, more than a quarter of small firms report having at least one position that has been hard to fill. This measure, which dropped significantly from July of last year through March, has been roughly unchanged since; the latest reading was similar to those seen in 1997, when the unemployment rate was a touch below 5 percent.

The staff estimates that productivity in the nonfarm business sector increased at an annual rate of almost 2 percent in the second quarter of 2001 after little change in the first quarter.[2] Recent quarterly movements in productivity have been heavily influenced by fluctuations in hours of self-employed workers, which are developed from data collected in the household survey. Measured using the hours of employees, which make up 90 percent of the hours of all workers, output per hour increased at annual rates of almost 1 percent in the first

1. Compared with those used by the BLS, the seasonal adjustment procedures developed by the Board staff use a locally weighted regression technique that better accounts for shifts over time in the seasonal pattern of weekly claims.

2. The latest Productivity and Cost release also included revised productivity estimates for 1996:Q1 to 2001:Q1. These estimates reflected the annual revisions to the NIPA, the benchmark revisions to the Current Employment Statistics that were released on June 1, and revised seasonal factors. On balance, productivity was revised down over this period. The appendix describes these revisions in more detail.

SELECTED COMPONENTS OF INDUSTRIAL PRODUCTION
(Percent change from preceding comparable period)

	Proportion 2000	2000 Q4	2001 Q1	2001 Q2	2001 May	2001 June	2001 July
		----Annual rate-----			--Monthly rate---		
Total	100.0	-.9	-6.8	-4.2	-.3	-.9	-.1
Previous		-.9	-6.8	-5.6	-.5	-.7	
Manufacturing	87.8	-1.6	-7.9	-4.8	-.2	-1.0	.0
Ex. motor veh. and parts	82.1	.1	-6.6	-7.0	-.5	-1.0	-.3
Ex. high-tech industries	72.7	-2.8	-6.7	-5.4	-.4	-.9	-.1
Mining	6.3	-1.5	6.0	7.1	.3	-.7	-.6
Utilities	5.9	9.3	-3.4	-8.2	-1.6	1.0	-.5
Selected industries							
High technology	9.4	25.2	-6.1	-19.6	-1.7	-1.6	-2.4
Computers	2.7	24.8	-3.5	-8.7	-.9	-.6	-.8
Communication equipment	2.0	30.2	-1.7	-17.5	-2.5	-1.3	-3.9
Semiconductors[1]	4.7	23.3	-9.6	-26.4	-1.7	-2.5	-2.7
Motor vehicles and parts	5.7	-23.6	-27.2	36.7	4.5	-1.2	4.7
Aircraft and parts	2.2	5.1	-5.6	-2.5	-1.3	-.5	-.5
Market groups, excluding energy and selected industries							
Consumer goods	22.5	-1.7	-.1	-1.4	.2	-.5	-.1
Durables	3.5	-5.0	-5.0	-4.0	-.1	-.3	-.9
Nondurables	19.0	-1.0	.8	-1.0	.2	-.5	.1
Business equipment	8.4	4.0	-7.6	-13.2	-1.0	-2.4	-.1
Construction supplies	6.1	-4.7	-3.1	-3.0	-.2	-.4	-.2
Business supplies	7.1	.1	-12.1	-10.6	-.6	-.4	-.5
Materials	24.2	-7.3	-11.4	-6.0	-.6	-1.2	.0
Durables	15.9	-7.1	-9.4	-4.1	-.2	-1.0	.2
Nondurables	8.3	-7.7	-15.1	-9.5	-1.3	-1.5	-.3

1. Includes related electronic components.

CAPACITY UTILIZATION
(Percent of capacity)

	1967-2000 Avg.	1988-89 High	1990-91 Low	2000 Q4	2001 Q1	2001 Q2	2001 June	2001 July
Manufacturing	81.1	85.7	76.6	80.3	77.9	76.4	75.7	75.6
High-tech industries	80.4	81.9	72.4	85.1	77.3	69.5	67.5	65.1
Excluding high-tech	81.2	86.1	76.8	79.5	77.6	76.9	76.4	76.6

quarter and 1-1/4 percent in the second quarter. Nevertheless, on either basis, productivity has slowed appreciably over the past year. In the four quarters ended in 2001:Q2, productivity measured using hours of all persons increased only 1-1/2 percent, compared with an increase of 4 percent in the four quarters ended in 2000:Q2. Similarly, the output per hour of employees increased 1-1/4 percent in the four quarters ended in 2001:Q2, compared with 3-1/2 percent in the preceding four quarters. For both measures, the magnitude of the deceleration in productivity over the past year, given the slowdown in output, is roughly in line with historical experience.

Industrial Production and Inventories

Industrial production. Total industrial production edged down 0.1 percent in July after larger drops in the previous three months. Motor vehicle assemblies rose 370,000 units, to an annual rate of 12.1 million units, in July. However, the production of high-tech goods fell 2-1/2 percent—the biggest one-month decline since October 1989. Aside from motor vehicles and high-tech equipment, manufacturing production ticked down 0.1 percent last month; whether that flatness represents the start of a bottoming out in the non-high-tech sector is not clear, given the many other indicators that are still soft. The output at mines and

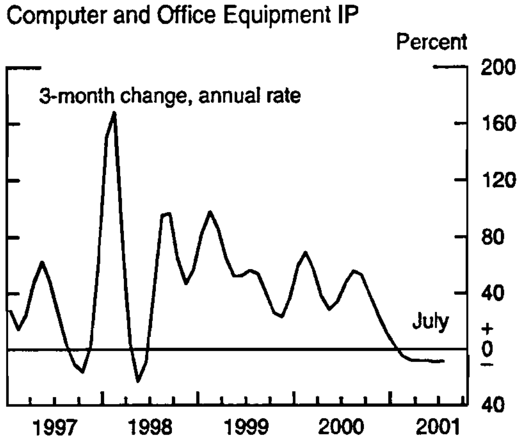
New Orders for Durable Goods
(Percent change from preceding period; seasonally adjusted)

Component	Share, 2001:H1	2001				
		Q1	Q2	Apr.	May	June
Total orders	**100.0**	**-7.0**	**-2.0**	**-5.7**	**2.8**	**-1.7**
Adjusted orders[1]	73.0	-5.6	-3.9	-5.0	3.1	-1.0
Computers	5.0	-8.9	-13.6	-6.9	-6.2	-3.5
Communications equipment	4.0	-10.1	-25.8	-6.8	-15.7	-12.9
Semiconductors and related devices	4.0	-19.2	-16.6	-40.3	34.6	4.0
Other capital goods	20.0	3.0	.0	8.3	-1.6	-1.5
Other[2]	40.0	-6.9	-.9	-7.0	6.5	.1
Memo:						
Real adjusted orders	...	-4.1	-3.0	-4.7	3.2	-.9
Excluding high tech	...	-3.6	-1.9	-2.5	2.3	-1.2

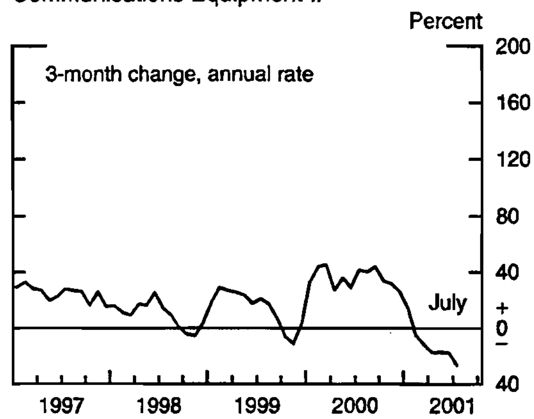
1. Orders excluding defense capital goods, nondefense aircraft, and motor vehicle parts.
2. Includes primary metals, most fabricated metals, most stone, clay, and glass products, household appliances, scientific instruments, and miscellaneous durable goods.
... Not applicable.

Measures of Activity in High-Tech Industry

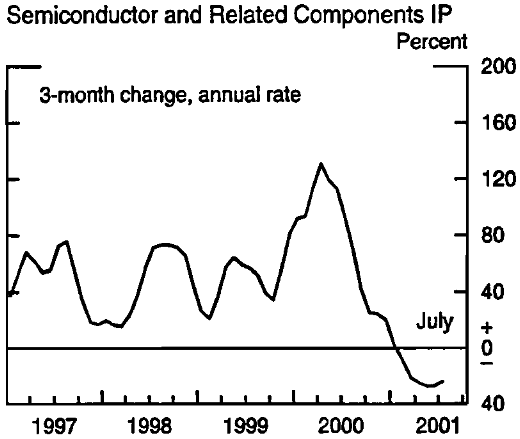
Computer and Office Equipment IP



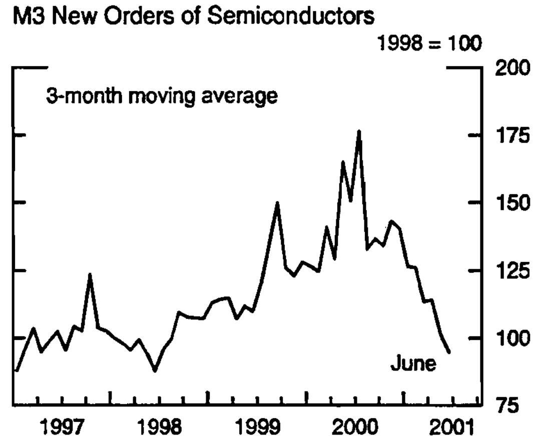
Communications Equipment IP



Semiconductor and Related Components IP

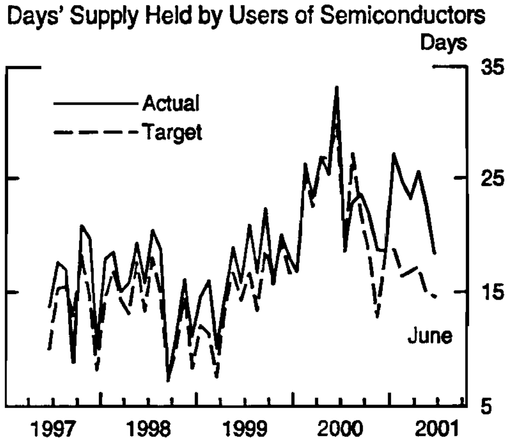


M3 New Orders of Semiconductors



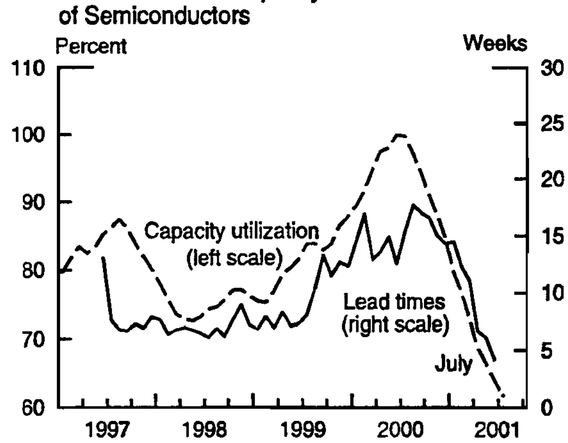
Note. Includes related components.

Days' Supply Held by Users of Semiconductors



Source. Dataquest survey of large semiconductor buyers.

Lead Times and Capacity Utilization of Semiconductors



Source. Dataquest survey of large semiconductor buyers.

utilities decreased moderately again. For manufacturing as a whole, the factory operating rate slipped to 75.6 percent in July, 6 percentage points lower than a year ago, when it stood at about its long-term average. In July, high-tech industries were operating about 15 percentage points below the long-run average capacity utilization rate, while outside of the high-tech sector the gap was around 4-1/2 percentage points.

High-tech. Conditions in the high-tech sector remain quite weak. In July, production of semiconductors dropped 2-3/4 percent, about the same rate of decline as in the previous three months. Moreover, Dataquest's latest survey of large semiconductor buyers indicated that chip demand is likely to remain subdued and that actual days' supply rose a little further above target in July. Meanwhile, analysts have pushed back their forecasts for a turnaround in the semiconductor industry until the end of the year. Downstream, the production of computers slipped 3/4 percent in July and decreased 9 percent over the previous twelve months. Sales were abysmal in the first half of 2001, particularly for personal computers, despite an ongoing price war among major manufacturers. The output of communications equipment makers tumbled nearly 4 percent in July; since the end of last year, production has plunged at an annual rate of nearly 19 percent. According to recent earnings announcements, several producers of communications equipment expect revenues to decline further in the third quarter and orders—which plummeted in June—to remain low. In addition, since the last Greenbook, several high-tech equipment manufacturers have announced sizable layoffs.[5]

Motor vehicles. In the motor vehicle sector, the July increase in assemblies came in the face of some renewed slippage in demand. Sales of new light vehicles for the month were at an annual rate of 16.3 million units, down from 17.1 million units in June. The decline in July occurred despite the continuation of many of the sales incentives that were initiated in the previous month and, according to industry analysts <u>on a confidential basis</u>, an advance in fleet sales. The automakers often use fleet sales to help smooth production, but with fleet purchases having been kept elevated for some time now, a retrenchment could be in the offing. With regard to retail demand, we expect automakers to keep using generous incentive programs to try to offset some of the negative influence of sluggish income growth and a subdued stock market, although the power of such incentives to draw in customers may be waning.

5. The announced layoffs were 7,000 for JDS Uniphase, 6,000 for Hewlett-Packard, 15,000 to 20,000 for Lucent, and 2,500 for Alcatel. In the case of the first three firms, these layoffs are for worldwide operations. JDS Uniphase is a Canadian firm with U.S. operations; H-P and Lucent are based in the United States. Alcatel is a French firm, but the 2,500 layoffs apply to work in the United States, including the closing of a plant in North Carolina.

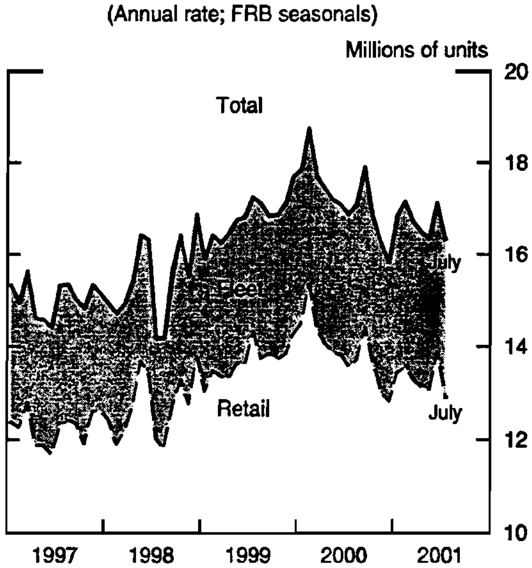
SALES OF AUTOMOBILES AND LIGHT TRUCKS
(Millions of units at an annual rate, FRB seasonals)

			2001		2001		
	1999	2000	Q1	Q2	May	June	July
Total[1]	16.8	17.2	16.9	16.6	16.3	17.1	16.3
Autos	8.7	8.8	8.6	8.4	8.3	8.4	8.1
Light trucks	8.1	8.4	8.3	8.2	8.0	8.7	8.2
North American[2]	14.3	14.4	14.0	13.6	13.4	14.1	13.3
Autos	7.0	6.8	6.6	6.3	6.3	6.4	6.1
Big Three	4.9	4.7	4.5	4.1	4.1	4.2	3.8
Transplants	2.1	2.2	2.1	2.2	2.3	2.2	2.3
Light trucks	7.3	7.5	7.4	7.3	7.1	7.7	7.2
Big Three	6.6	6.6	6.3	6.2	6.1	6.6	6.2
Transplants	.8	1.0	1.0	1.0	1.0	1.1	1.1
Foreign-produced	2.5	2.9	2.9	3.0	2.9	3.0	3.0
Autos	1.7	2.0	2.0	2.1	2.0	2.1	2.0
Light trucks	.8	.8	.9	1.0	.9	1.0	1.0
Memo:							
Total, as reported	16.8	17.2	16.9	16.6	16.3	17.1	16.3

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

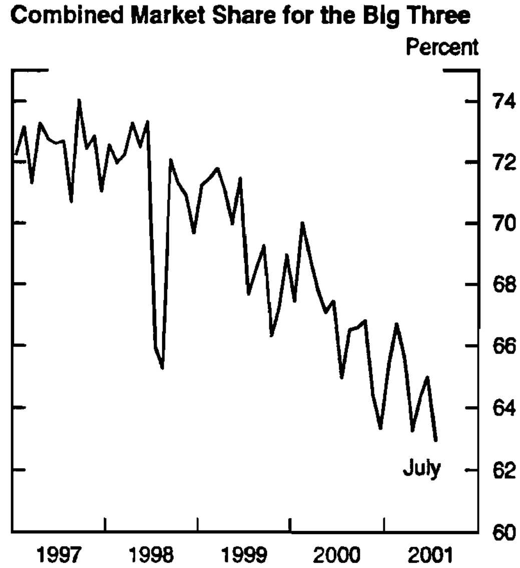
1. Excludes the estimated effect of automakers' changes in reporting periods.
2. Excludes some vehicles produced in Canada that are classified as imports by the industry.

Fleet and Retail Sales of Light Vehicles
(Annual rate; FRB seasonals)



Note. Staff estimates based on confidential data.

Combined Market Share for the Big Three



Inventories of automobiles are, if anything, on the lean side. For light trucks, however, the combination of a dropback in sales and a spurt in assemblies in July pushed the days' supply above the comfortable range of 65 to 70 days. Despite these developments, manufacturers have revised up scheduled truck production in August and September from already high levels. If third-quarter assemblies of these vehicles come in as scheduled and sales ease further (as we expect), a steep cutback in production seems likely to ensue.

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

Item	2001			2001				
	Q1	Q2	Q3[1]	May	June	July	Aug.[1]	Sept.[1]
U.S. production	10.9	11.7	12.1	11.8	11.7	12.1	12.2	12.0
Autos	5.0	5.1	5.0	5.1	5.1	4.9	5.1	5.0
Trucks	6.0	6.6	7.1	6.7	6.6	7.2	7.1	7.0
Days' supply[2]	62.4	62.0	n.a.	63.5	60.1	63.9	n.a.	n.a.
Autos	50.9	49.3	n.a.	50.3	49.0	49.7	n.a.	n.a.
Light trucks[3]	72.8	73.0	n.a.	75.4	69.2	75.8	n.a.	n.a.
Inventories[4]	2.84	2.75	n.a.	2.78	2.75	2.80	n.a.	n.a.

Note. Components may not sum to totals because of rounding.
1. Production rates reflect manufacturers' schedules for Q3.
2. Quarterly average calculated using end-of-period stocks and average reported sales.
3. Excludes medium and heavy (classes 3-8) trucks.
4. End-of-period stocks; excludes medium and heavy (class 3-8) trucks.
n.a. Not available.

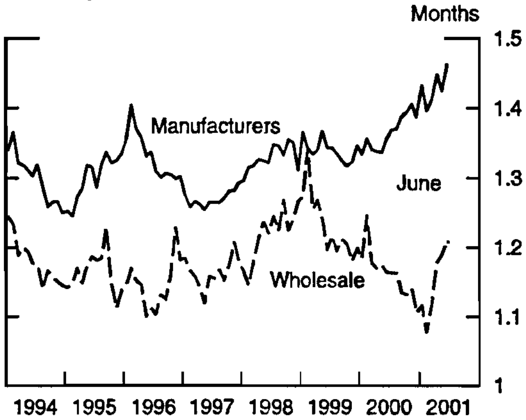
Other manufacturing. Outside of the motor vehicle and high-tech industries, production cutbacks this year have been widespread, and the diffusion index of three-month percent changes in IP—at 32.2 percent—remained in July at a level typically associated with recessions. The recent cutbacks in industrial materials and business supplies have been less severe than the earlier declines, on average, while business equipment production has been dropping off at a more pronounced rate.

Aggregate inventories. After a sizable liquidation in the first quarter, the overall pace of inventory decumulation was a bit more rapid in the second quarter. We now estimate that real nonfarm inventories decreased at an annual rate of around $35 billion in the second quarter, following a drop of $27 billion

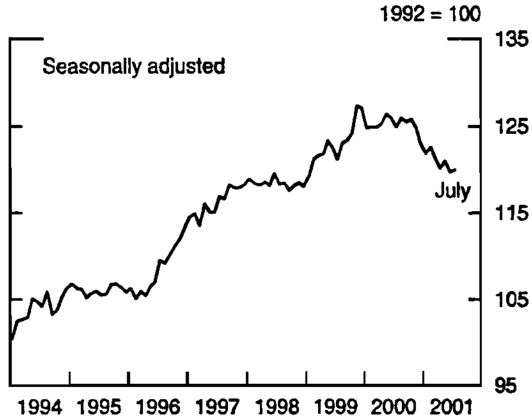
Inventory-Sales Ratios and Industrial Production in Selected Industries

Chemicals and Products

Inventory-Sales Ratio

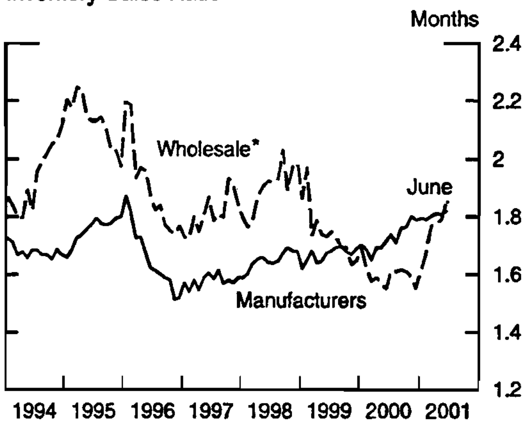


Industrial Production



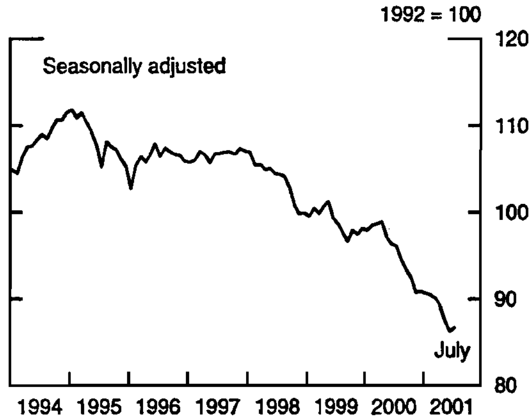
Textiles and Apparel

Inventory-Sales Ratio



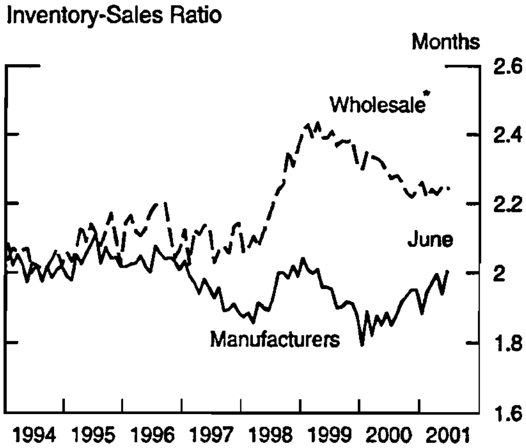
* Wholesale apparel, piece goods, and notions.

Industrial Production



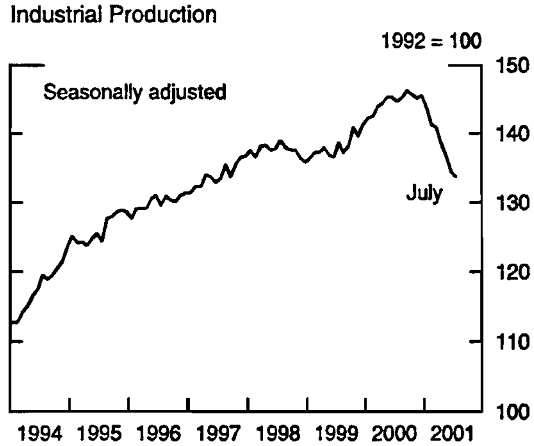
Machinery and Electrical Equipment Excluding High-Tech

Inventory-Sales Ratio



* Wholesale machinery, equipment, and supplies.

Industrial Production

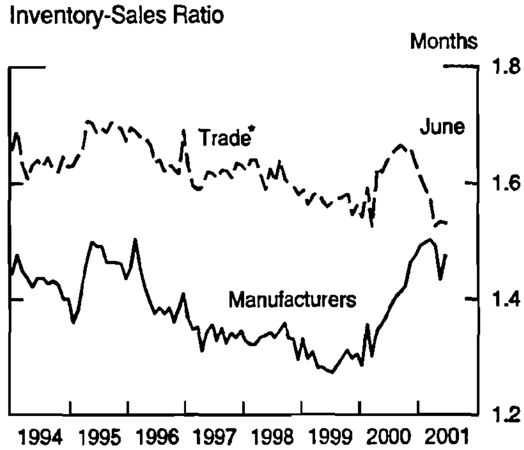


Note. Inventory-sales ratios calculated at book value.

Inventory-Sales Ratios and Industrial Production in Selected Industries

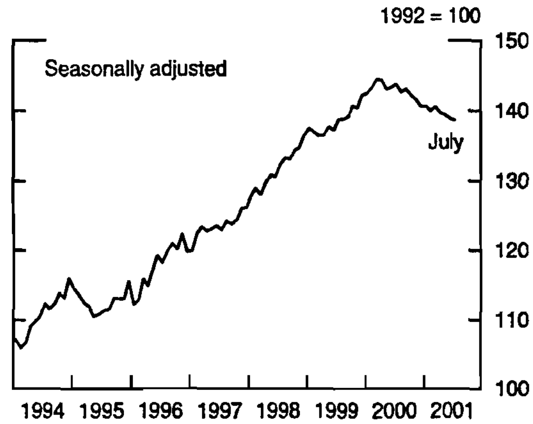
Construction Supplies

Inventory-Sales Ratio



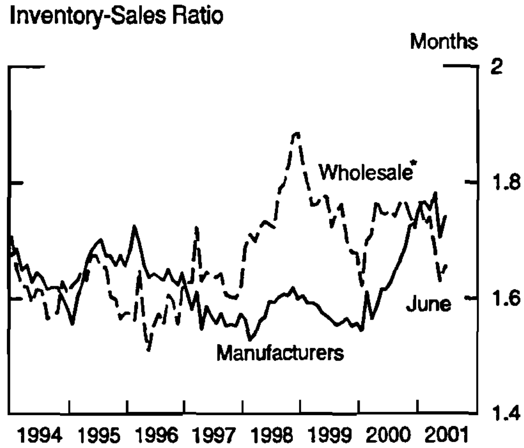
* Retail building materials group of stores and wholesale lumber and construction materials.

Industrial Production



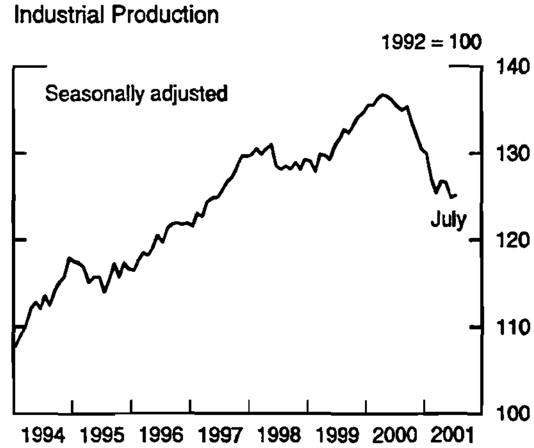
Primary and Fabricated Metals

Inventory-Sales Ratio



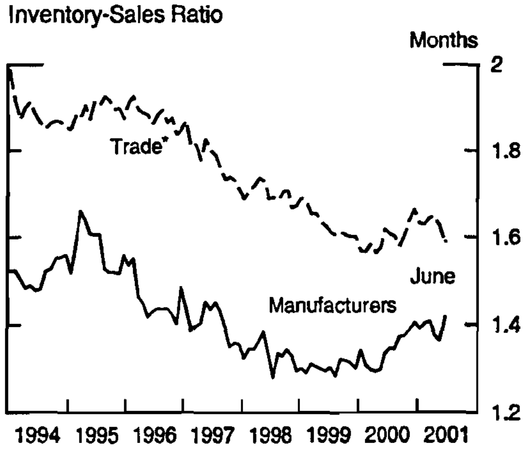
* Wholesale metals and minerals, excluding petroleum.

Industrial Production



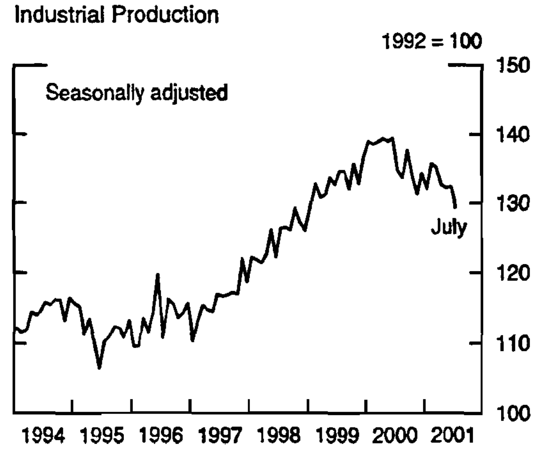
Furniture and Appliances

Inventory-Sales Ratio



* Retail furniture group of stores and wholesale furniture and home furnishings.

Industrial Production



Note. Inventory-sales ratios calculated at book value.

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

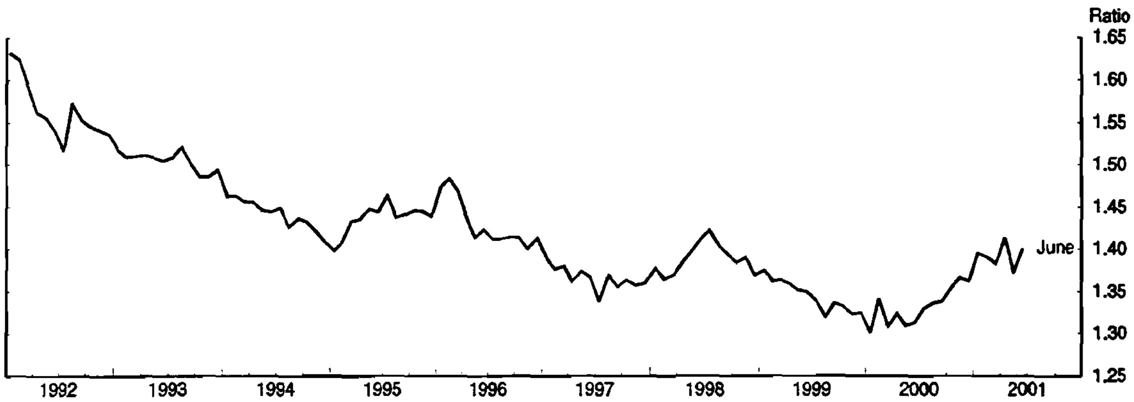
Category	2000	2001		2001		
	Q4	Q1	Q2	Apr.	May	June
Manufacturing and trade	45.7	-24.0	-35.5	-22.0	-22.2	-62.4
Less wholesale and retail motor vehicles	36.5	-10.0	-31.8	-17.0	-21.0	-57.5
Manufacturing	17.2	-11.9	-29.1	-11.0	-35.4	-40.9
Less aircraft	17.1	-10.1	-29.6	-13.0	-36.3	-39.6
Merchant wholesalers	9.4	-5.0	1.9	3.4	10.8	-8.4
Less motor vehicles	7.0	-2.4	5.5	6.4	16.8	-6.8
Retail trade	19.1	-7.2	-8.4	-14.4	2.3	-13.0
Automotive dealers	6.8	-11.5	-.2	-2.0	4.8	-3.3
Less automotive dealers	12.3	4.3	-8.2	-12.4	-2.5	-9.7

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

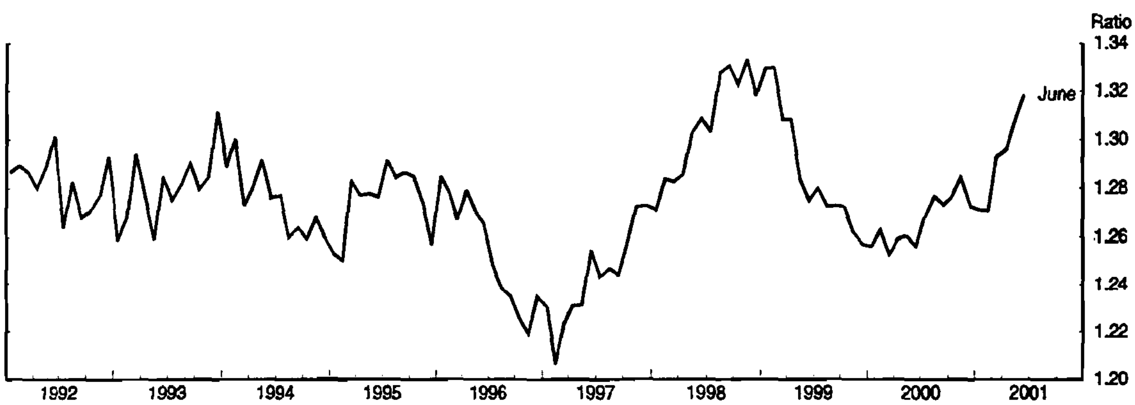
Category	2000	2001		2001		
	Q4	Q1	Q2	Apr.	May	June
Manufacturing and trade	1.42	1.43	1.43	1.44	1.42	1.43
Less wholesale and retail motor vehicles	1.37	1.39	1.40	1.40	1.38	1.40
Manufacturing	1.36	1.38	1.40	1.41	1.37	1.40
Primary metals	1.83	1.81	1.78	1.85	1.74	1.78
Steel	2.41	2.29	2.23	2.36	2.16	2.23
Machinery	2.04	2.05	2.10	2.08	2.02	2.10
Computers and electronics	1.25	1.41	1.55	1.51	1.55	1.55
Electrical equipment	1.37	1.41	1.40	1.43	1.40	1.40
Transportation equipment	1.50	1.43	1.40	1.54	1.39	1.40
Motor vehicles	.62	.59	.60	.63	.57	.60
Aircraft	4.33	3.90	3.48	4.44	3.79	3.48
Fabricated metals	1.67	1.72	1.71	1.74	1.68	1.71
Textiles	1.87	1.77	1.68	1.75	1.71	1.68
Paper	1.18	1.18	1.20	1.19	1.18	1.20
Chemicals	1.39	1.41	1.46	1.45	1.42	1.46
Petroleum	.67	.71	.72	.68	.66	.72
Rubber and plastics	1.25	1.25	1.24	1.26	1.23	1.24
Merchant wholesalers	1.30	1.31	1.33	1.31	1.32	1.33
Less motor vehicles	1.27	1.29	1.32	1.30	1.31	1.32
Durable goods	1.63	1.63	1.62	1.63	1.62	1.62
Nondurable goods	.95	.98	1.03	.98	1.02	1.03
Retail trade	1.62	1.60	1.56	1.57	1.57	1.56
Less automotive dealers	1.51	1.50	1.48	1.48	1.48	1.48
Automotive dealers	1.92	1.86	1.80	1.80	1.81	1.80
General merchandise	1.93	1.96	1.92	1.90	1.93	1.92
Apparel	2.47	2.43	2.44	2.39	2.42	2.44
Food	.84	.85	.86	.85	.85	.86

Inventory-Sales Ratios
(Seasonally adjusted book value)

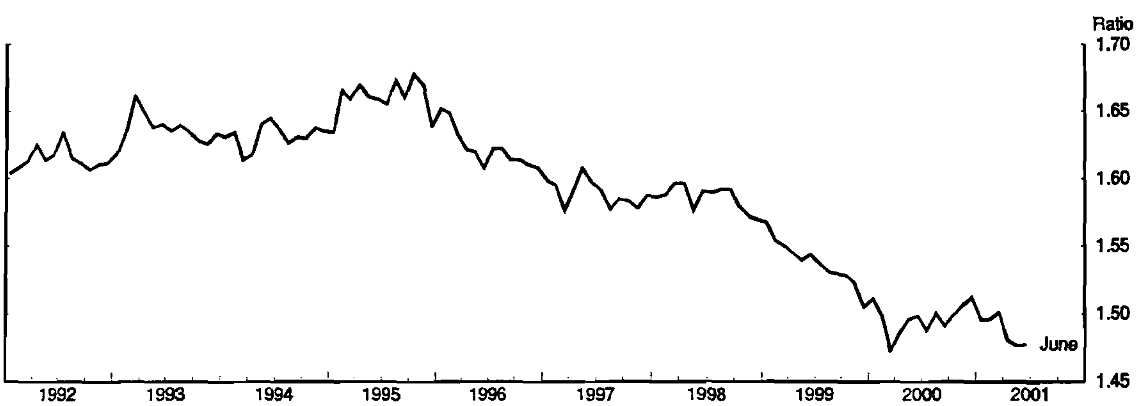
Manufacturing



Wholesale Trade Excluding Motor Vehicles



Retail Trade Excluding Motor Vehicles



RETAIL SALES
(Percent change; seasonally adjusted)

	2001		2001		
	Q1	Q2	May	June	July
Total retail trade and food services	1.3	1.3	.2	.0	.0
Previous estimate		1.5	.4	.2	
Retail control[1]	1.0	.6	.5	-.2	.2
Previous estimate		.6	.5	-.1	
Furniture and home furnishings	1.7	-.6	1.0	.2	.4
Electronics and appliances	-1.8	.5	.5	1.8	.7
Clothing and accessories	1.6	-1.9	-1.3	-.5	.9
Food and beverage stores	.9	.5	.7	.0	.2
General merchandise	1.0	.5	-1.2	.3	.9
Gasoline stations	-1.1	3.5	2.8	-3.6	-4.2
Health & personal care	2.7	1.5	1.4	.4	1.7
Nonstore retailers[2]	-1.5	-3.7	-.5	-.7	.2
Other retailers[3]	3.0	2.1	1.4	.1	1.0
Food services	2.6	.9	1.0	.7	1.0

1. Total retail trade and food services less sales at building material and supply stores and automobile and other motor vehicle dealers.
2. Includes electronic shopping and mail order houses.
3. Includes miscellaneous retailers and sporting goods, hobby, book and music stores.

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

		2001		2001	
	2000	Q1	Q2	May	June
	Q4/Q4	Annual rate		Monthly rate	
Total real PCE	4.2	3.0	2.1	.2	.2
Durable goods	5.3	10.6	6.0	.2	1.6
Motor vehicles	1.6	16.1	3.9	-.2	3.9
Excluding motor vehicles	8.1	6.7	7.5	.6	-.1
Nondurable goods	3.6	2.4	.4	.3	-.2
Services	4.3	1.8	2.2	.1	.1
Electricity and natural gas	12.2	-11.2	-11.4	-4.2	1.7
Transportation	2.6	1.0	-1.2	-.4	.1
Medical	3.0	2.9	3.3	.2	.2
Personal business	6.7	.9	4.6	.5	-.3
Brokerage services	20.4	-9.6	7.8	1.7	-4.3
Recreation	2.6	6.5	3.8	1.4	-.3
Other	4.1	2.3	2.4	.1	.1
Memo:					
Real disposable personal income	4.0	2.7	2.5	.1	.1
NIPA personal saving rate[1]	1.0	1.1	1.2	1.2	1.1
Previous estimate	-.1	-1.0		-1.1	

1. Data are in levels. Annual and quarterly values are averages over the period indicated.

in the first quarter.[6] As a result, the change in nonfarm inventory investment shaved more than 1/4 percentage point from the change in GDP last quarter, after having subtracted 2-1/2 percentage points from the first-quarter figure. Given our estimate that final sales inched up last quarter, the real inventory-sales ratio dropped a bit further.

We also estimate that, in real terms, manufacturers liquidated inventories at an annual rate of $24 billion last quarter, following a $15 billion drawdown in the first quarter. Much of the liquidation occurred at manufacturers of computers and electronic products; however, shipments by these producers also plunged in the second quarter, and the inventory-shipments ratio in this sector rose further from an already high level. Elsewhere in manufacturing, inventories and shipments fell roughly in tandem last quarter, and the inventory-sales ratio held steady. Nevertheless, stocks remained stubbornly high relative to shipments in a number of manufacturing sectors (metals, furniture, chemicals, and rubber and plastics), despite aggressive production cutbacks.

Real wholesale inventories (excluding motor vehicles) are estimated to have risen $4-1/2 billion (annual rate) last quarter, after little change in the first quarter. In book-value terms, non-auto distributors built stocks at an annual rate of $5-1/2 billion, as a large drawdown of stocks at durable goods wholesalers (particularly electrical goods jobbers) was more than offset by an accumulation at distributors of nondurable goods (especially drug wholesalers). Sales have been sluggish of late, and the ratio of inventories to sales moved sharply higher in the second quarter. This ratio has been rising, on balance, since early last year and is now approaching the high levels recorded in late 1998 and early 1999.

According to our estimates, real retail inventories (excluding motor vehicles) decreased $7-3/4 billion (annual rate) in the second quarter, following a slight accumulation in the first quarter. In book value terms, non-auto retailers liquidated stocks at an annual rate of $8.2 billion last quarter, reflecting moderate-sized liquidations spread among most of the major types of stores. In addition, for most categories of retail outlets, inventory-sales ratios edged lower in the second quarter.

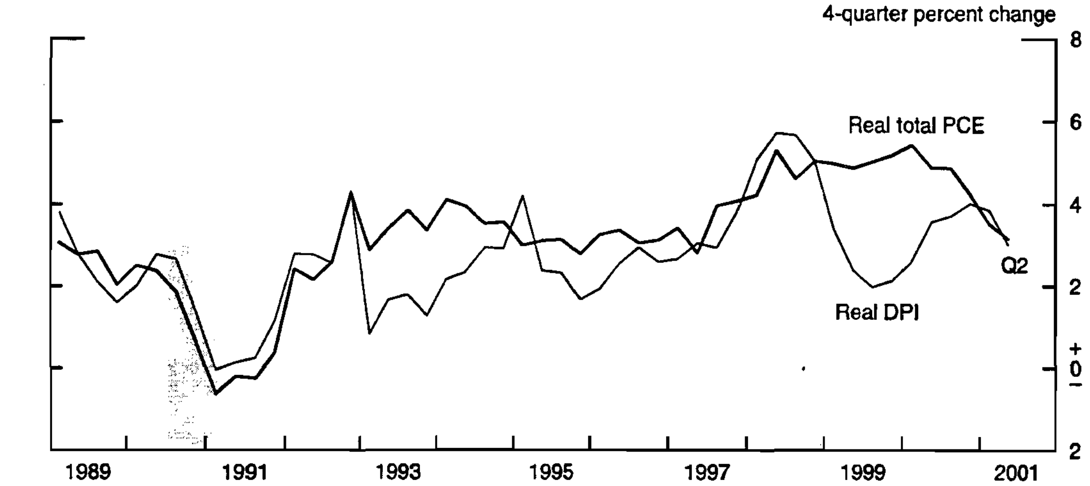
Consumer Spending and Personal Income

Real consumer spending slowed to an annual rate of 2-1/4 percent in the second quarter, but it may be poised for a somewhat faster rise in the third quarter. The underlying pace of income growth has slowed in recent quarters with the

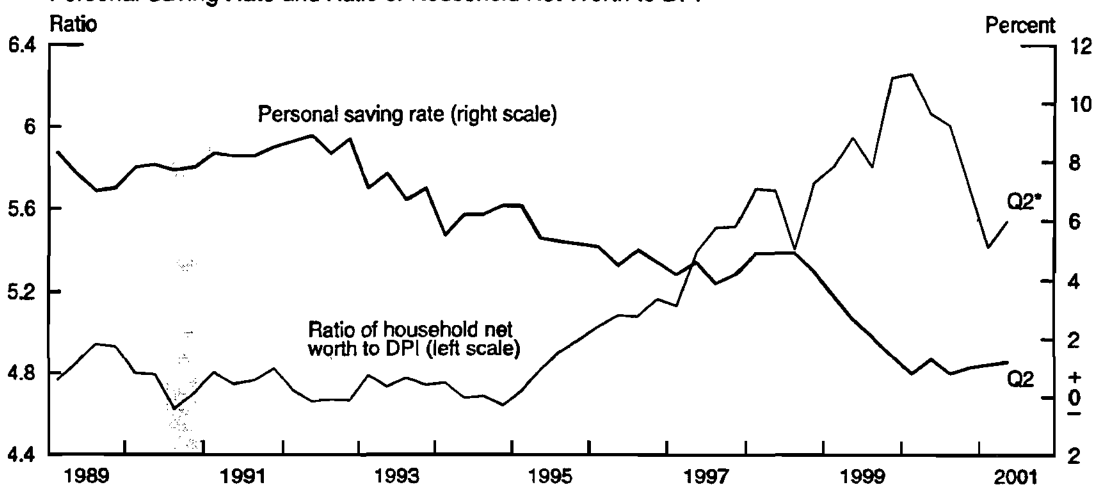
6. In book-value terms, manufacturing and trade inventory investment (excluding motor vehicles) in the second quarter was $15 billion lower, on balance, than the BEA had assumed in the advance NIPA estimate.

Household Indicators

Consumer Spending and Income

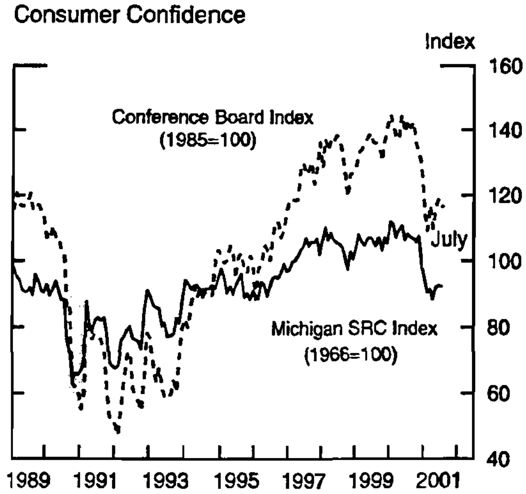


Personal Saving Rate and Ratio of Household Net Worth to DPI

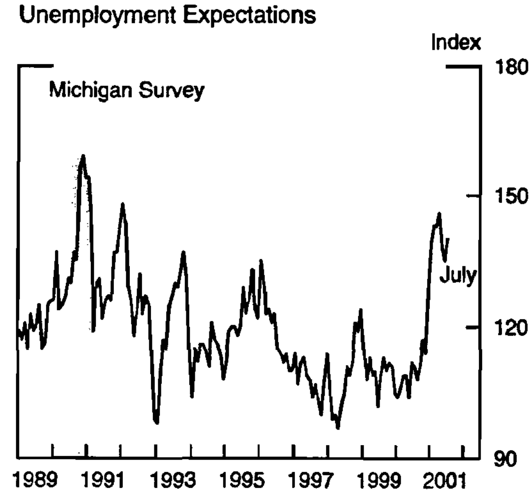


*Ratio of household net worth to DPI for the second quarter of 2001 is an estimate.

Consumer Confidence



Unemployment Expectations



softening in the labor market, but tax rebates will provide a substantial boost this quarter. Stock-market values have eroded further this year, shaving household balance sheets a bit more. Consumer confidence appears to have stabilized at moderately favorable levels in recent months, after having fallen precipitously around the turn of the year.

In July, nominal sales at stores in the retail control group rose 0.2 percent.[7] With the exception of gasoline stations, where lower retail prices led to a sizable drop in nominal sales, retailers reported widespread and robust gains.[8] All told, we estimate that real consumer outlays for goods (including motor vehicles and energy products) advanced 0.4 percent in July to a level 0.6 percent (not at an annual rate) above the second-quarter average.

Estimates of expenditures on services are available only through June; in the second quarter, real service outlays rose at an annual rate of 2-1/4 percent. Spending on services was held down in the second quarter by steep declines in outlays for electricity and natural gas, likely reflecting both cooler-than-average temperatures and cutbacks in purchases of energy services in response to the cumulative run-up in prices.[9] Outside of energy, outlays for services increased 2-3/4 percent last quarter.

Real disposable personal income increased 2-1/2 percent in the second quarter, after having risen 2-3/4 percent in the first quarter. The gains in income were similar to the rise in consumer spending over these two quarters, a markedly different situation from the pattern in recent years when a sizable run-up in household net worth led to increases in spending that outpaced income growth by a wide margin. After having climbed to an historical high in the first quarter of 2000, the ratio of net worth relative to income has moved lower, and the personal saving rate has edged up.[10] The labor market data for July suggest that wage and salary income probably posted a modest gain last month.

7. The retail control is calculated as total nominal retail and food services sales less retail sales at automobile and other motor vehicle dealerships and at building material and supply stores.

8. Physical product data from the Department of Energy indicate that real purchases of gasoline increased noticeably in July.

9. The PCE price index for natural gas and electricity jumped at an annual rate of nearly 36 percent in the first quarter. It declined at an annual rate of 1 percent in the second quarter. Over the past four quarters, it is up more than 15 percent.

10. In the annual revision to the NIPA, the personal saving rate was revised up substantially to show, on net, much less of a decline over the past three years than had been previously estimated. Before the revision, the saving rate in recent years had fallen by more than our estimates of the wealth effect would have indicated; the NIPA revision brought saving into better alignment with wealth.

Private Housing Activity

(Millions of units; seasonally adjusted annual rate)

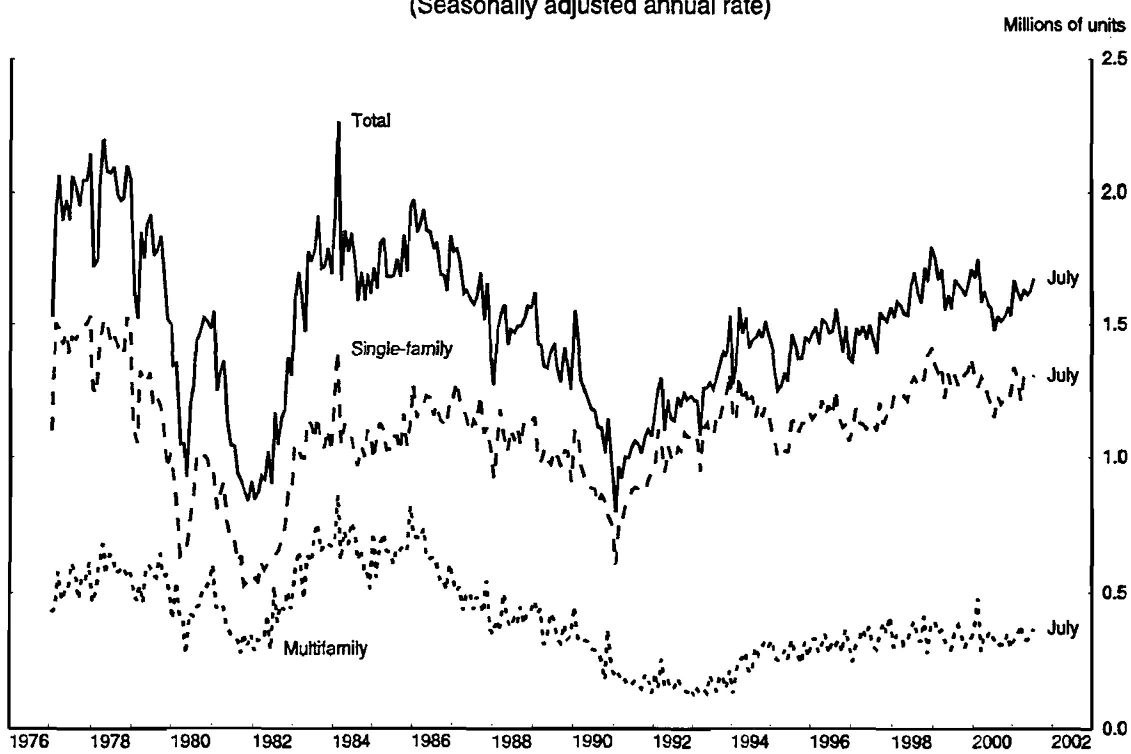
		2000	2001				
	2000	Q4	Q1	Q2[r]	May[r]	June[r]	July[p]
All units							
Starts	1.57	1.54	1.63	1.62	1.61	1.63	1.67
Permits	1.59	1.58	1.67	1.60	1.62	1.59	1.56
Single-family units							
Starts	1.23	1.22	1.28	1.29	1.29	1.29	1.30
Permits	1.20	1.20	1.24	1.22	1.21	1.23	1.20
Adjusted permits[1]	1.25	1.23	1.28	1.27	1.26	1.28	1.24
New home sales	0.88	0.94	0.95	0.91	0.91	0.92	n.a.
Existing home sales	5.11	5.10	5.27	5.30	5.36	5.33	n.a.
Multifamily units							
Starts	0.34	0.32	0.35	0.33	0.33	0.34	0.37
Permits	0.39	0.38	0.43	0.38	0.42	0.36	0.36
Mobile homes							
Shipments	0.25	0.20	0.17	0.19	0.19	0.20	n.a.

1. Adjusted permits equals permit issuance plus total starts outside of permit-issuing areas.

p Preliminary. r Revised. n.a. Not available.

Private Housing Starts

(Seasonally adjusted annual rate)



Consumer sentiment, as measured by both the Michigan Survey Research Center (SRC) and the Conference Board, was little changed in July, and both measures have fluctuated within very narrow ranges since early this year. The SRC index of the expected change in unemployment rose slightly in July; however, on balance, it has drifted lower since the early spring, suggesting that consumers' expectations of labor market conditions over the coming twelve months have improved somewhat from earlier in the year.

Housing Markets

Supported by low mortgage rates, single-family housing activity has held up well in recent months despite the softening economy.[11] Single-family starts in July rose to an annual rate of 1.30 million units, which is slightly above the high level in the second quarter. In contrast, adjusted permits fell in July to an annual rate of 1.24 million units. With single-family starts well above adjusted permits, the starts estimate likely overstates the underlying pace of single-family homebuilding last month.

Sales of new homes rose in June to 922,000 units (annual rate) and, with the stock of new homes for sale at a low 292,000 units, the months' supply stood at just 3.9 months. The pace of sales in the second quarter matched the average for the latter half of last year. Sales of existing homes edged down to 5.3 million units (annual rate) in June, but still were only slightly below the historical peak for this series.

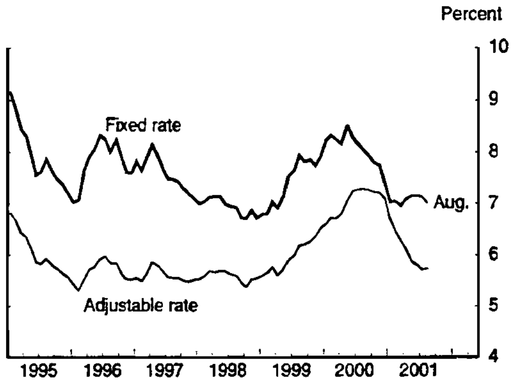
Other indicators of housing demand also show continued strength. The Michigan Survey's measure of households' perceptions of homebuying conditions has trended up since the middle of last year, though a decline in July partly reversed a jump in June. Also, the Mortgage Bankers' Association index of purchase applications for home mortgages remained near the top of its range through early August, and builders' rating of new home sales rose noticeably in August to its highest level since last November. Data from the Senior Loan Officers Opinion Survey for August indicate that the demand at commercial banks for new mortgages to purchase homes has remained robust.

Increases in house prices have moderated only a little so far this year. The constant-quality new home price index, which controls for differences over time in house size, geography, and several important structural characteristics, rose 3-3/4 percent over the four quarters ended in the second quarter, as compared

11. From April through July, the average rate on fixed-rate mortgages (FRMs) was unchanged, on balance, while the average rate on adjustable-rate mortgages (ARMs) fell 35 basis points. ARM financing lowers the initial out-of-pocket cost of home ownership and helps to support housing demand by buyers who are willing to assume the risk that mortgage rates may rise. The share of mortgage originations with adjustable rates has risen slightly from the recent low of 10 percent in March and April to 12 percent in May and June (latest data).

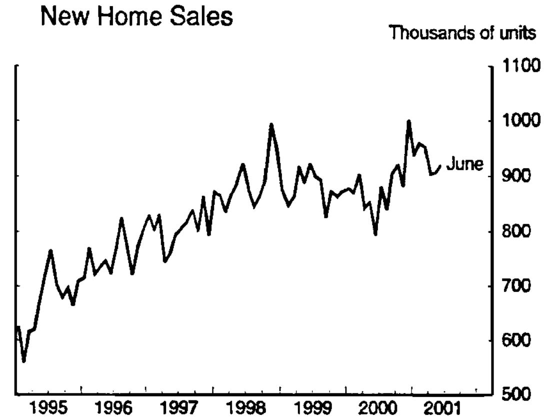
Indicators of Single-Family Housing

Mortgage Rates



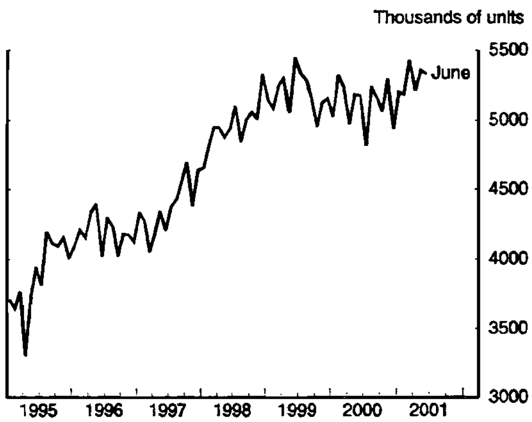
Note. The Aug. reading is based on data through Aug. 10.
Source. Freddie Mac.

New Home Sales



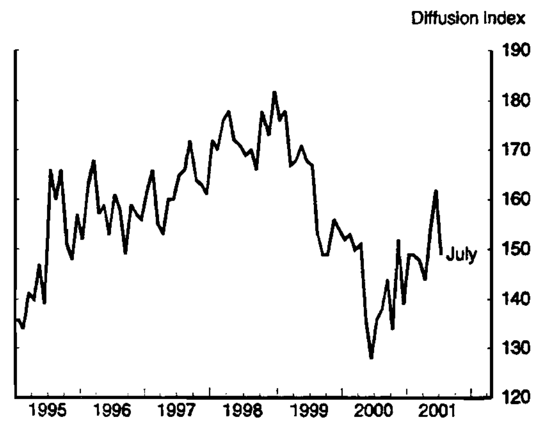
Source. Census Bureau.

Existing Home Sales



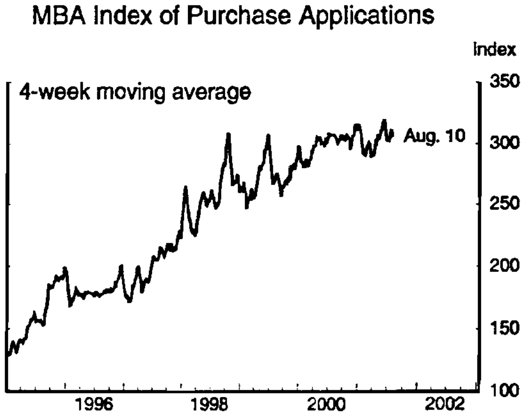
Source. National Association of Realtors.

Perceived Homebuying Conditions

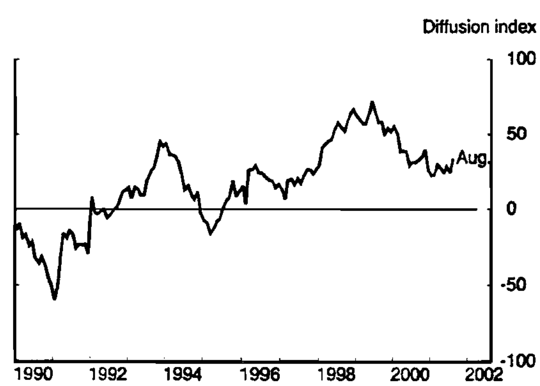


Source. Michigan Survey, not seasonally adjusted.

MBA Index of Purchase Applications



Builders' Rating of New Home Sales



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

with 5 percent in the previous year. The repeat-sales price index for existing homes, which also is relatively unaffected by compositional changes because it compares prices for the same housing units over time, increased 8-1/2 percent over the four quarters ended in the second quarter, only a percentage point less rapid than the first quarter's record-high pace.[12]

In the multifamily sector, starts increased to an annual rate of 368,000 units in July—the second highest reading in the past year and a half. However, starts were extraordinarily high relative to permits, which suggests that the underlying pace of construction is noticeably below the level reported in July. The vacancy rate for multifamily rental units was 8-3/4 percent in the second quarter—about the same relatively low rate as a year earlier.

Business Fixed Investment

Equipment and software. Business spending on equipment and software has continued to retreat at a rapid pace. Real outlays are estimated to have decreased at an annual rate of 14-1/2 percent in the second quarter, a much faster decline than in the preceding two quarters. The weakness in investment reflects sluggish growth in business output and a nosedive in corporate cash flow. Against these forces, a continued decline in the cost of capital has had only a small cushioning effect. We have no direct evidence on investment in the current quarter, but both the June data on orders and shipments of capital goods and numerous anecdotal reports point to another sizable drop in spending.

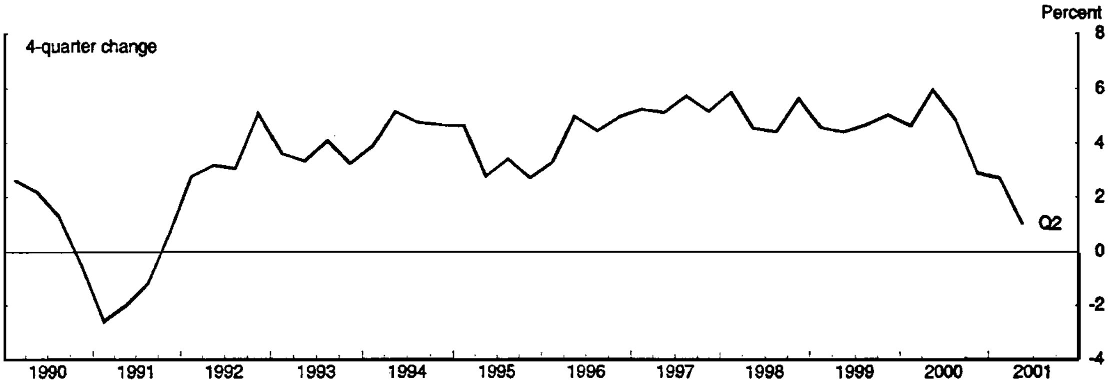
The situation in the high-tech sector remains grim. Real expenditures on computer hardware and software sank at an annual rate of 13-3/4 percent in the second quarter, the largest decline since 1982. Shipments of computing equipment fell 6-3/4 percent in June, implying a very weak trajectory heading into the third quarter, and several major computer hardware and software makers have reported that they expect the weakness to continue. Demand for communications equipment has been exceptionally weak of late. Real spending in this category plummeted at an annual rate of nearly 40 percent in both the first and second quarters, and outlays for communications equipment appear to be poised for another terrible performance in the third quarter: Bookings took another nosedive in June, and the level of new orders has now fallen back to where it stood in late 1996.

Moreover, recent survey results offer little hope of an improvement in the high-tech sector in the latter part of the year. A Merrill Lynch survey of 65 chief

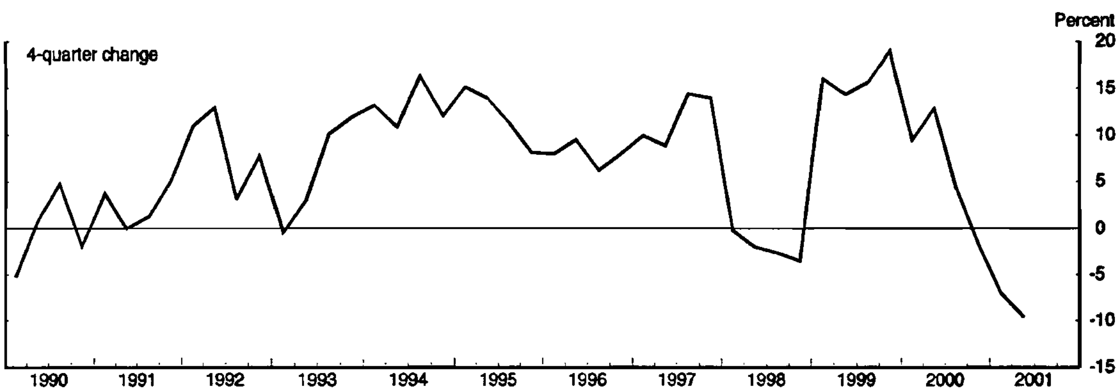
12. The series on repeat-sale home prices, which comes from Freddie Mac, dates back to 1987.

Equipment Investment Fundamentals

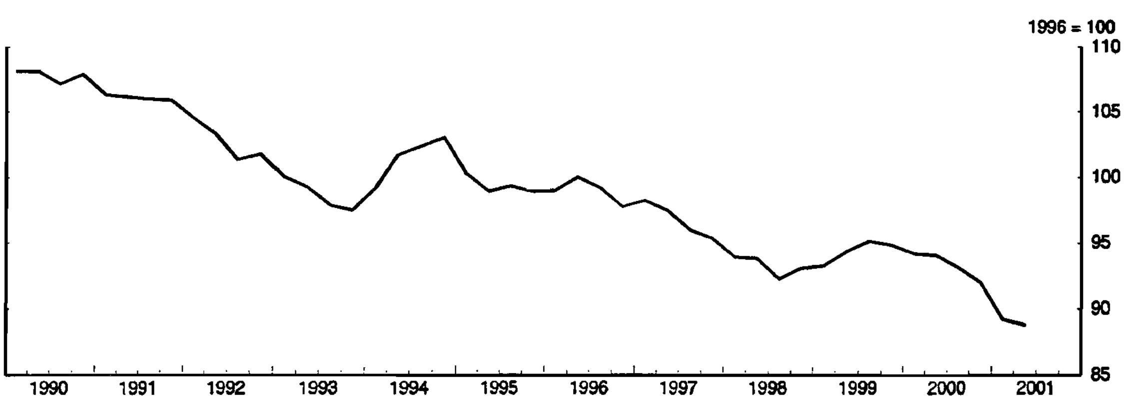
Business Output



Real Cash Flow



User Cost of Capital



Note. Equipment excluding high-tech and transportation.

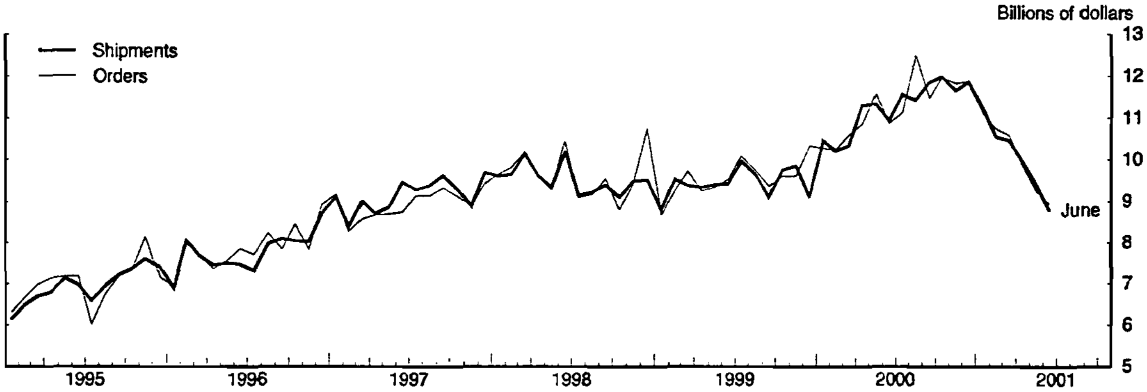
BUSINESS CAPITAL SPENDING INDICATORS
(Percent change from preceding comparable period; based on seasonally adjusted data, in current dollars)

	2001		2001		
	Q1	Q2	Apr.	May	June
Equipment and software					
Shipments of nondefense capital goods	-2.6	-5.4	-5.1	1.6	-2.3
Excluding aircraft	-3.0	-5.6	-3.4	-.4	-2.9
Computers and related equipment	-9.0	-12.8	-4.8	-5.5	-6.8
Communications equipment	-13.6	-12.4	-10.6	-3.3	1.1
All other categories	.7	-2.8	-1.9	1.1	-2.7
Shipments of complete aircraft	17.4	4.1	-2.5	17.0	3.8
Medium & heavy truck sales (units)	-1.5	-6.5	-12.4	13.3	-1.8
Orders for nondefense capital goods	-8.6	-6.7	-5.5	-1.3	-2.6
Excluding aircraft	-3.9	-7.4	-2.5	-1.1	-2.4
Computers and related equipment	-8.9	-13.6	-6.9	-6.2	-3.5
Communications equipment	-10.1	-25.8	-6.8	-15.7	-12.9
All other categories	-1.3	-2.6	-.7	2.5	-.7
Nonresidential structures					
Construction put in place, buildings	3.2	-5.3	-2.1	-6.5	.1
Office	-.6	-8.8	-4.4	-9.7	-.6
Other commercial	6.6	-4.2	-1.0	-8.0	.8
Institutional	2.0	-.7	-.8	1.2	-3.0
Industrial	7.5	-4.9	-.4	-9.7	5.3
Lodging and miscellaneous	.3	-6.6	-4.0	-1.7	-2.4
Rotary drilling rigs in use[1]	13.9	9.3	4.4	2.0	-1.3

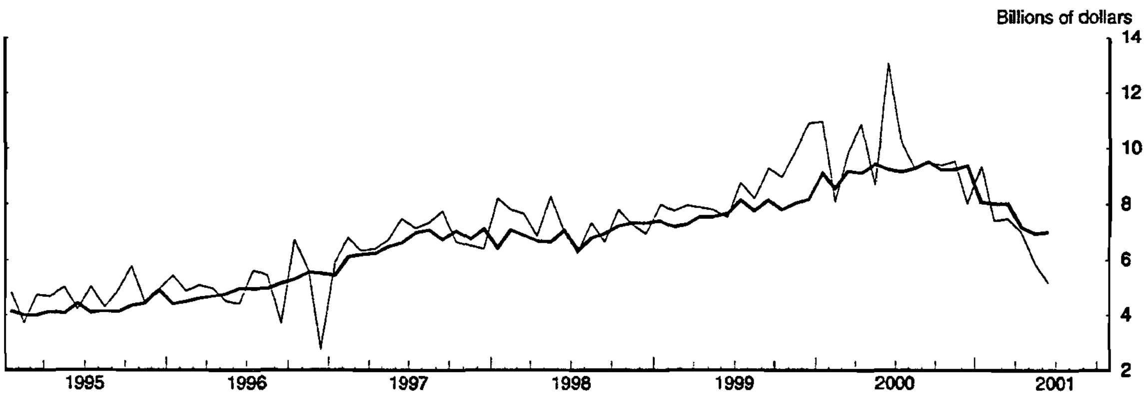
1. Percent change of number of rigs in use, seasonally adjusted.

Recent Data on Orders and Shipments

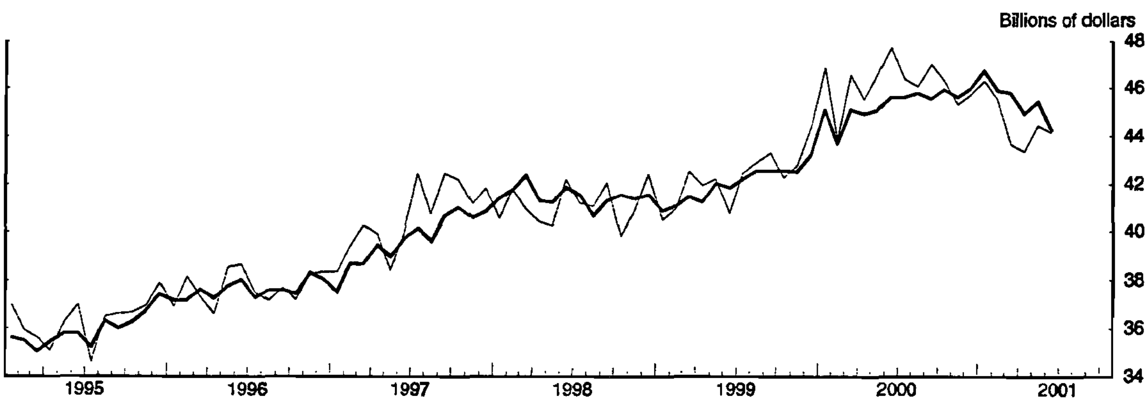
Computers and Related Equipment



Communications Equipment



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



financial officers and chief technology officers found that 72 percent believe that technology spending will be flat or down in the second half compared with a year ago; a Morgan Stanley poll reported that a majority of 225 tech buyers plan to cut or slow spending. These survey results are consistent with the downbeat reports from our own informal business contacts and with anecdotes in the Beige Book.

Business spending on aircraft has remained relatively unscathed so far this year. We estimate that real expenditures on aircraft advanced moderately in the second quarter as both Airbus and Boeing stepped up deliveries to domestic airlines. Deliveries to U.S. customers remained quite strong in July.

Real spending on equipment outside of the high-tech and transportation categories decreased at an annual rate of 12-1/2 percent in the second quarter. The weakness reflected sharply lower outlays on almost all types of machinery. The only notable exceptions were gains in expenditures on machinery that is typically purchased by the service industry, the mining sector (which includes oil and gas extraction), and the health care industry. Overall, spending on equipment and machinery (excluding high-tech and transportation) appears likely to continue to decline in coming months. New orders for this grouping dropped 2-1/2 percent in the second quarter (not at an annual rate), and the level of unfilled orders fell further.

Nonresidential construction. The weakness in the business sector is beginning to show through to spending on nonresidential structures. After having held up surprisingly well through the first quarter, outlays for nonresidential construction plunged at an annual rate of 13-1/2 percent in the second quarter, as expenditures for office, industrial, and lodging facilities all contracted sharply.[13]

Real spending for construction of office buildings plummeted in the second quarter, following a smaller decline in the preceding quarter. Demand, as measured by the net change in occupied space, contracted noticeably in the first

13. Our estimates for nonresidential structures reflect benchmark revisions to the construction-put-in-place data (extending as far back as 1993 in some cases) that were released after the NIPA report. Total nonresidential expenditures, in real terms, were revised down in 1999 and 2000 by $2 billion and $7 billion respectively. These revisions primarily reflected large reductions in the estimates for industrial structures owing to newly available source data. Also, the Census Bureau had been inappropriately including investment by independent power producers both in the public utilities and in the industrial structures components of private nonresidential structures. The benchmark revisions removed these expenditures from the industrial construction category.

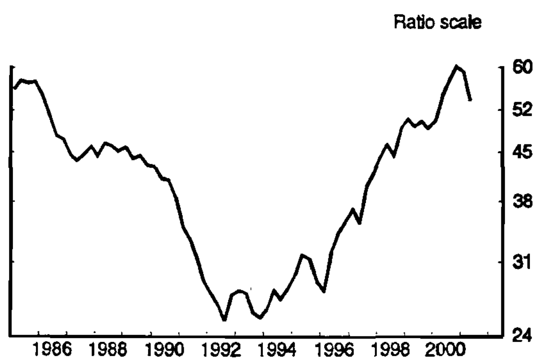
Real Investment in Nonresidential Structures

(Billions of 1996 dollars, chain weighted)

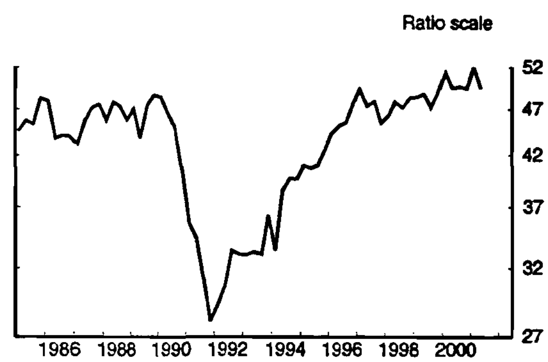
Buildings

Note. In addition to buildings, the nonresidential structures category includes outlays for drilling and mining, expenditures by utilities, and investment in miscellaneous private facilities such as streets, sewers, and parks.

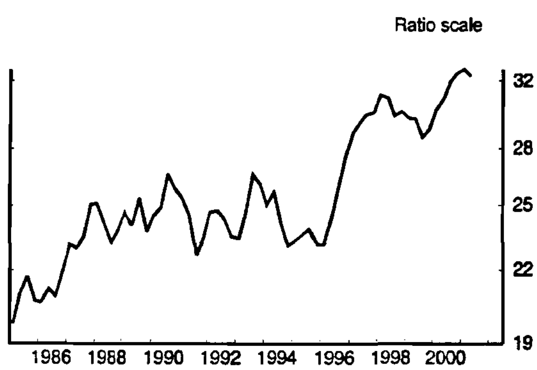
Office



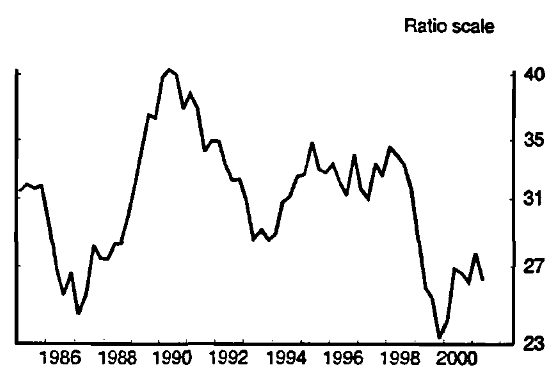
Other Commercial



Institutional



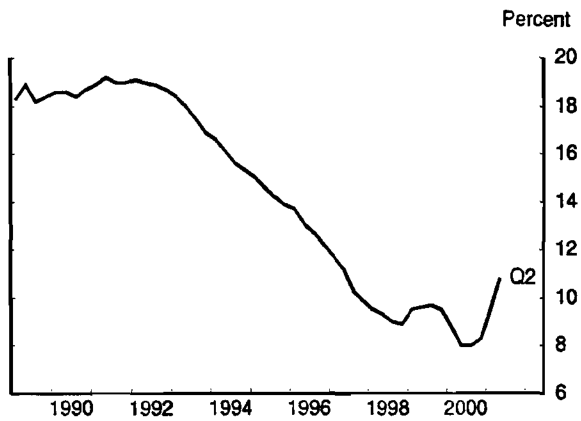
Industrial



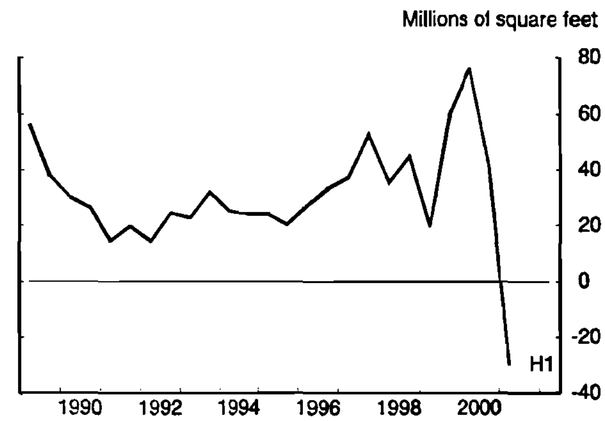
Commercial Real Estate Markets

Office Buildings

Vacancy Rate

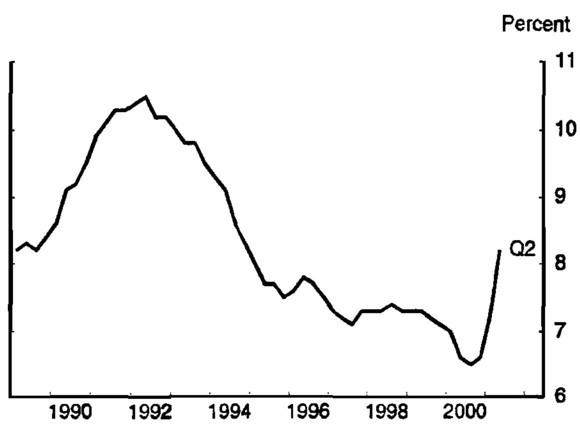


Change in Occupied Space

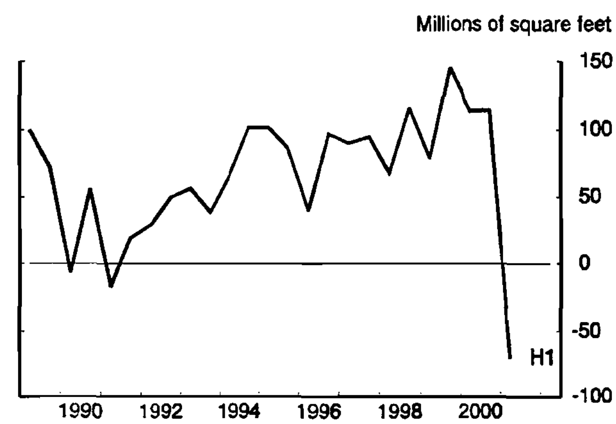


Industrial Buildings

Vacancy Rate



Change in Occupied Space



Source. Torto Wheaton Research. Estimates are based on data for more than 50 MSAs.

FEDERAL GOVERNMENT OUTLAYS AND RECEIPTS
(Unified basis; billions of dollars)

	June			12 months ending in Jun.		
	2000	2001	Percent change	2000	2001	Percent change
Outlays	159.0	171.0	7.6	1775.4	1843.7	3.8
Deposit insurance	-0.1	-0.1	...	-3.7	-1.9	...
Spectrum auction	0.0	0.0	...	-0.8	-1.2	...
Sale of major assets	0.0	0.0	...	0.0	0.0	...
Other	159.0	171.1	7.6	1779.9	1846.7	3.8
Receipts	214.9	202.9	-5.6	1982.0	2073.0	4.6
Surplus	55.9	31.9	...	206.6	229.3	11.0
	Outlays excluding deposit insurance, spectrum auction, and sale of major assets are adjusted for payment timing shifts[1]					
Outlays	147.7	159.2	7.8	1768.6	1846.1	4.4
National defense	27.1	26.8	-0.9	290.4	300.3	3.4
Net interest	17.5	15.9	-9.1	228.0	212.5	-6.8
Social security	38.2	39.5	3.4	403.3	426.9	5.8
Medicare	15.6	16.7	7.3	194.1	208.6	7.5
Medicaid	10.4	11.9	14.0	115.0	127.5	10.9
Other health	3.0	3.9	28.8	35.3	41.3	16.9
Income security	16.5	19.2	16.0	245.0	260.1	6.1
Agriculture	1.7	0.9	-46.1	32.1	31.8	-0.8
Other	17.8	24.5	37.8	225.3	237.1	5.2
Receipts	214.9	202.9	-5.6	1982.0	2073.0	4.6
Individual income and payroll taxes	160.1	159.4	-0.5	1584.6	1691.9	6.8
Withheld + FICA	113.8	113.3	-0.5	1334.7	1414.5	6.0
Nonwithheld + SECA	49.6	49.3	-0.4	384.2	422.2	9.9
Refunds (-)	3.2	3.3	1.1	134.3	144.9	7.9
Corporate	40.5	29.9	-26.1	201.5	190.9	-5.3
Gross	41.9	31.6	-24.7	229.3	226.9	-1.0
Refunds (-)	1.4	1.6	18.4	27.8	36.0	29.7
Other	14.2	13.6	-4.5	196.0	190.2	-2.9
Surplus	67.2	43.7	...	213.5	226.9	6.3

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

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

... Not applicable.

half of 2001, marking the first semiannual decline on record.[14] Moreover, the vacancy rate for office buildings has increased significantly over the past two quarters. The largest increases in office vacancy rates have been in high-technology centers, where earlier expectations of rapid expansion in operations had led some firms to lease office space and data centers in anticipation of future needs. With the technology sector now contracting, substantial amounts of such space have become available for subleasing.

Real outlays for industrial buildings declined at an annual rate of 20 percent in the second quarter, about reversing the rise posted in the first quarter. Moreover, demand for industrial space has dropped back sharply as well. The amount of occupied industrial space plunged during the first half of this year, and the vacancy rate for industrial buildings jumped up.[15] The weakening demand for industrial property has been widespread both in areas where high-technology manufacturing businesses are concentrated and where other types of manufacturers are located.

Spending for other commercial structures (which include retail space and warehouses) dropped at an annual rate of 18-1/2 percent in the second quarter, erasing a first-quarter increase, and outlays for lodging and other miscellaneous facilities fell another 25 percent. In addition, construction outlays by public utilities decreased at an annual rate of 8-1/2 percent last quarter: However, given the continuing need for expansion of power-generation capacity, the second-quarter drop is more likely a temporary pause rather than the beginning of a sustained downturn in activity. Elsewhere, on the positive side, expenditures for drilling and mining soared at an annual rate of 44 percent in the second quarter following a 68 percent surge in the first quarter.

Government Sector

Federal. The federal unified budget surplus has deteriorated recently, reflecting a significantly weaker trend in incoming receipts. On the legislative front, two small supplemental appropriations bills for fiscal 2001 were enacted, one for defense and one for agriculture subsidies.

Federal receipts in June were 5-1/2 percent lower than in June 2000. Gross corporate income tax collections plummeted 25 percent in June; this decline

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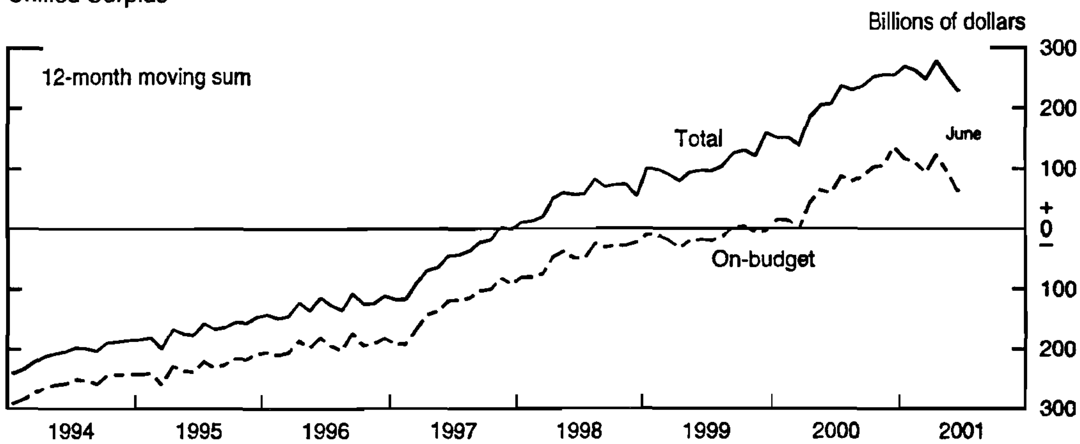
14. The available historical data for this series are semiannual and date back to the second half of 1988.

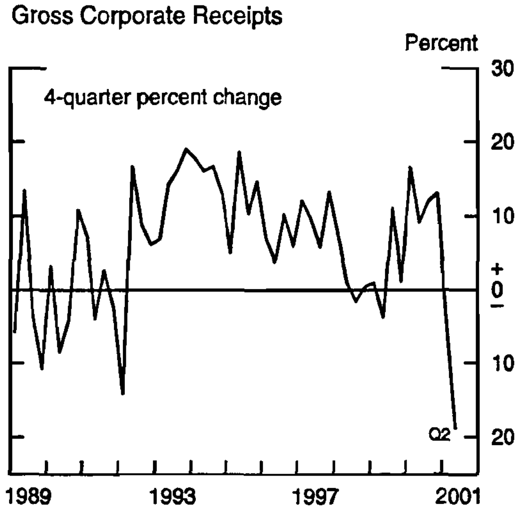
15. Over the first half of this year, vacancy rates for office buildings shot up in both downtown and suburban markets. In downtown areas, the vacancy rate in the second quarter was 8-1/2 percent, up from 6-3/4 percent in the fourth quarter of 2000. In suburban markets, the rise over this period was from 9-1/4 percent to 12 percent.

Federal Sector Developments

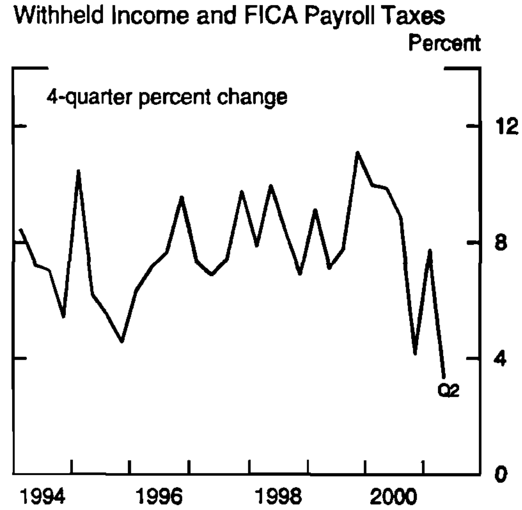
Unified Surplus



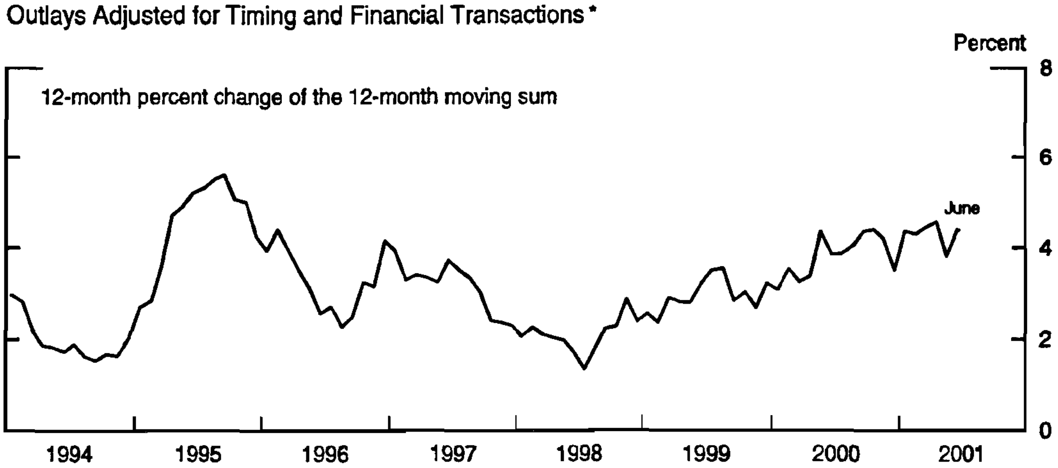
Gross Corporate Receipts



Withheld Income and FICA Payroll Taxes



Outlays Adjusted for Timing and Financial Transactions*



*Excludes deposit insurance and spectrum auctions.

largely reflected the second quarterly installment of estimated taxes on profits expected to be earned in 2001, and it followed an 11 percent drop in April (the deadline month for the first estimated payment).[16] Individual nonwithheld income and payroll taxes edged down in June (also a deadline month for quarterly estimated payments) relative to June 2000. This ended the string of robust double-digit increases seen in this category over the past six years. Compared with a year ago, withheld income and payroll taxes also edged down in June and for the second quarter were only 3 percent higher than last year.

Federal outlays soared in June, rising 7-1/2 percent above last year's level. In part, this increase owed to upward-revised estimates of the costs of loan programs, but it also reflected a pickup in Medicare spending that began this spring and rising payments of unemployment benefits.

Slumping receipts and the surge in outlays in June held the overall unified budget surplus to $32 billion, some $24 billion lower than last June. After having peaked at nearly $270 billion in the twelve months ended in January, the twelve-month surplus declined to $230 billion in June. In the third quarter, the surplus will be depressed further because of the disbursement of individual income tax rebate checks and the delay in corporate income tax payments, as provided in the 2001 Tax Act.[17]

Before the August recess, the Congress passed two supplemental appropriations bills for fiscal 2001. The defense bill provides $6-1/2 billion in spending, spread over several years, and the agriculture spending bill provides $5-1/2billion in emergency subsidies to be paid by the end of September. Work on the thirteen regular appropriations bills for fiscal 2002 has been uneventful thus far: The House has passed nine bills, and the Senate has passed five bills—all in line with the Budget Resolution and the administration's requests. That said, little progress has been made on the two key bills—Defense and Labor/HHS/Education—that are widely expected to determine whether overall appropriations stay within the budget outlines.

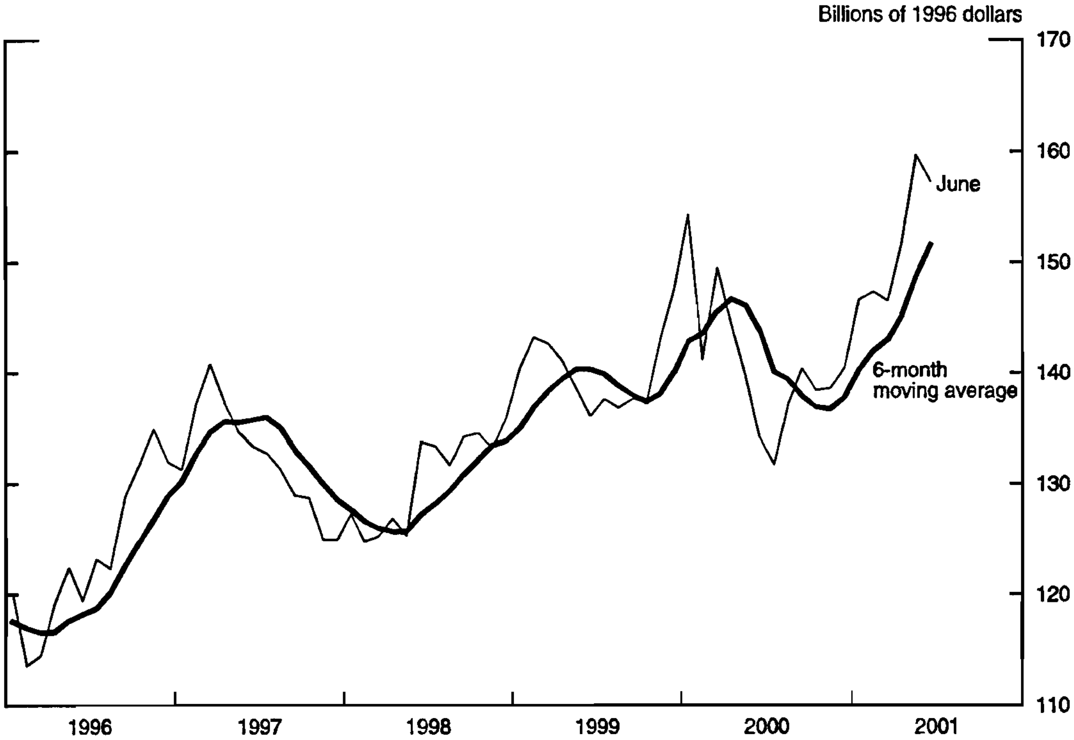
State and local. We estimate that real spending by state and local governments increased at an annual rate of 7-1/2 percent in the second quarter, following an

16. These tax payments appear consistent with the available data on corporate earnings (although they may also reflect developments in other elements of taxable income, such as capital gains realizations and bad-debt write-offs).

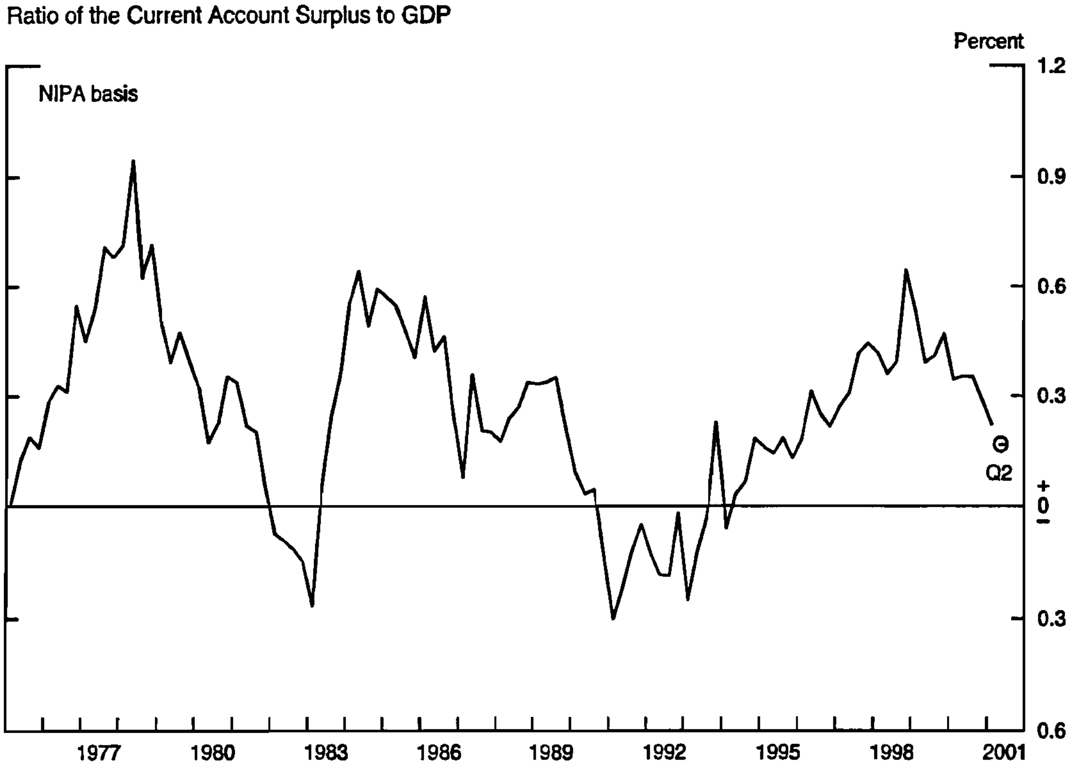
17. The Treasury has been mailing about $3-1/2 billion in rebate checks each week since July 20 and expects to complete the issuance by the end of September.

State and Local Governments

Total Construction Put in Place



Ratio of the Current Account Surplus to GDP



Note. The surplus excludes social insurance funds. 2001:Q2 is a staff estimate.

upward revised 6-1/2 percent advance in the first quarter.[18] The two-quarter gain reflects unusually large increases in most major spending categories. In terms of investment spending, capital expenditures by state and local governments had been inexplicably weak last year despite favorable fundamentals—notably, low interest rates and robust budget surpluses—and a continuing need to repair and expand existing infrastructure. However, spending surged in the first half of this year, bringing most components of state and local construction up to record high levels. Meanwhile, the rise in real compensation paid to state and local workers stepped up in the first half of the year, as increases in employment far exceeded the gains seen in 2000. Another large increase in employment was registered in July.

With the pace of spending by state and local governments up in the first half of this year and revenues rising more slowly than during 2000, the surplus of operating accounts (measured in relation to GDP) appears to have fallen in the second quarter to its lowest level since the end of 1995. Indeed, in recent fiscal surveys of both state and city governments, many officials have reported that their budget conditions have begun to tighten.[19] According to the National Conference of State Legislatures, states reported a decline in general fund balances (as a percentage of expenditures) in fiscal 2001 for the first time since fiscal 1992.[20] State tax revenue rose just 4.5 percent in fiscal 2001, roughly half the pace registered in the previous year. On the spending side, outlays for Medicaid jumped 14 percent in fiscal 2001, more than double the pace that had been budgeted. Furthermore, many states reported that they expect another decline in general fund balances in 2002, citing, among other reasons, the likelihood of relatively weak income and sales tax collections. A survey of cities from the National League of Cities conveyed a similar message: In fiscal 2001, officials in proportionately more cities than in any year since 1994 reported a reduction in their ability to meet financial obligations.[21]

Prices

Consumer price inflation has eased in recent months, as energy prices have turned down and increases in core consumer prices have subsided from their

18. Our second-quarter estimate takes account of the June construction-put-in-place data that were released after the NIPA report. Also, the surplus of operating accounts in the second quarter is a staff estimate because corporate profits and profits taxes are not yet available.

19. This year's survey of states reports expenditures and revenue for forty-six states; it excludes Massachusetts, New York, North Carolina, and Tennessee, whose fiscal 2002 budgets had not been adopted by time of the report's deadline. The city report is based on a sample survey of large and medium-sized cities and may include different cities from year to year.

20. The general fund balance is the surplus in the current year plus the cumulation of all prior years' surpluses; it is considered a barometer of the fiscal well-being of the state.

21. Each city was asked to answer the survey in terms of its own fiscal year, which corresponds to the calendar year for about 40 percent of cities. Another 40 percent end their fiscal years on June 30, and the timing for the fiscal year is mixed for the rest.

RECENT PRICE INDICATORS
(Percent)

	From 12 months earlier		2001		2001	
	July 2000	July 2001[1]	Q1	Q2	June	July[1]
			-Annual rate-		-Monthly rate-	
CPI						
Total	3.7	2.7	4.2	3.1	0.2	-0.3
Core	2.5	2.7	3.2	2.6	0.3	0.2
ex tobacco	2.3	2.6	3.1	2.4	0.3	0.1
Core commodities	0.4	0.4	1.1	-0.9	0.0	0.1
ex tobacco	-0.3	-0.2	0.8	-1.8	-0.0	-0.2
Core services	3.4	3.7	4.0	4.0	0.5	0.2
Current-methods	3.6	2.7	4.2	3.1	0.2	-0.3
Core	2.4	2.7	3.1	2.6	0.3	0.2
ex tobacco	2.3	2.6	3.1	2.4	0.3	0.1
PCE Prices						
Total	2.9	1.9	3.2	1.7	0.2	-0.2
Core	2.0	1.7	2.6	1.1	0.2	0.2
ex tobacco	1.9	1.6	2.5	1.0	0.2	0.1
Core commodities	-0.4	-0.6	0.3	-1.9	0.0	-0.0
ex tobacco	-1.0	-1.1	0.0	-2.7	-0.0	-0.3
Core services	3.0	2.7	3.5	2.5	0.3	0.2
Core market prices	1.8	1.7	2.4	1.1	0.2	0.2
Core nonmarket prices	3.0	1.7	3.3	1.4	0.3	0.2
PPI						
Total finished goods	4.3	1.5	5.3	1.0	-0.4	-0.9
Core	1.6	1.6	1.6	1.4	0.1	0.2
ex tobacco	1.2	0.9	0.4	0.7	0.1	0.2
Core consumer goods	1.7	2.1	2.5	2.0	0.0	0.1
ex tobacco	1.1	1.1	0.6	0.9	-0.0	0.2
Capital equipment	1.2	0.9	0.4	0.9	0.1	0.2
Core intermediate materials	2.8	-0.5	1.0	0.1	-0.3	-0.4
Core crude materials	7.5	-10.3	-7.5	-17.6	-0.2	-0.9

1. PCE Prices for July are staff estimates.

more rapid first-quarter pace. The core CPI moved up 0.2 percent in July and has increased 2.7 percent over the past twelve months. Although up 0.2 percentage point from its year-earlier reading, this twelve-month change has held steady so far this year. And revised data show the core PCE price index to have decelerated a little over the past year. The overall consumer price index moved down 0.3 percent in July, reflecting a drop in energy prices, and is up 2.7 percent over the past year.

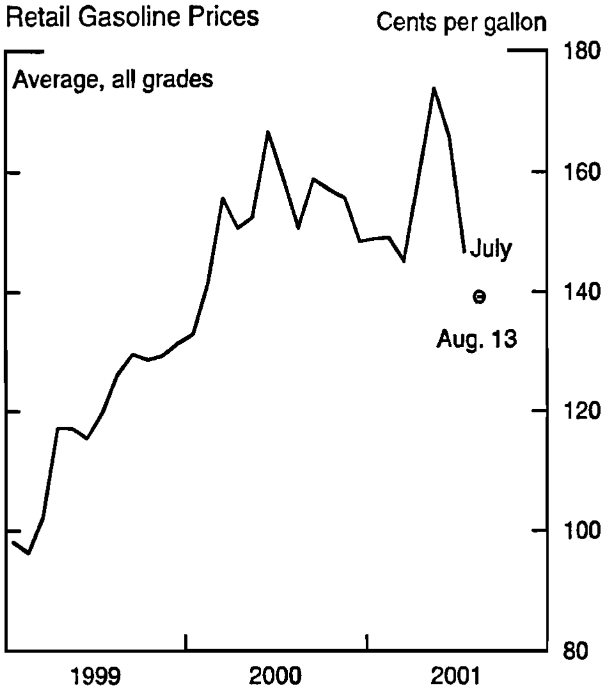
The CPI for energy fell 5.6 percent in July, bringing the twelve-month change down to nearly 2 percent. The July energy price decline reflected, most importantly, a sharp drop in gasoline prices.

Survey evidence indicates that retail gasoline prices began to move higher in the middle of this month. Still, with gasoline inventories having been rebuilt to normal levels, margins have declined about 25 cents per gallon since May. Natural gas inventories have also been rebuilt to levels a bit above seasonal norms, and prices continued to move lower in July. (Although Hurricane Barry cut into production of both crude oil and natural gas, the problem does not appear to have been severe.) Regarding electricity, markets in California have been surprisingly calm: Wholesale prices are low, and no blackouts have yet occurred this summer. Nonetheless, a further rate increase will probably be required to cover the $12.5 billion bond sale scheduled for October.

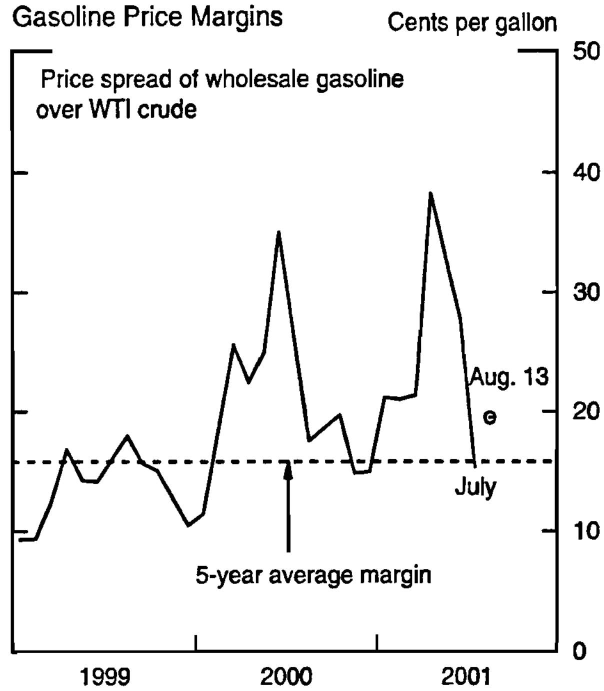
Consumer food prices rose 0.4 percent in June and 0.3 percent in July. Prices of fruits and vegetables flattened out in July after a larger-than-average rise in June, and the price index for meats, poultry, fish, and eggs slowed last month. Excluding these categories, food prices were up 0.4 percent in July, after having risen 0.3 percent in June. The twelve-month change in the index for all foods remained above 3 percent in July. Meats and dairy products, both of which have been affected by supply limitations, have shown particularly large increases on a year-to-year basis. Prices for these commodities, along with crop prices, are discussed in more detail in a later section on farm supply developments.

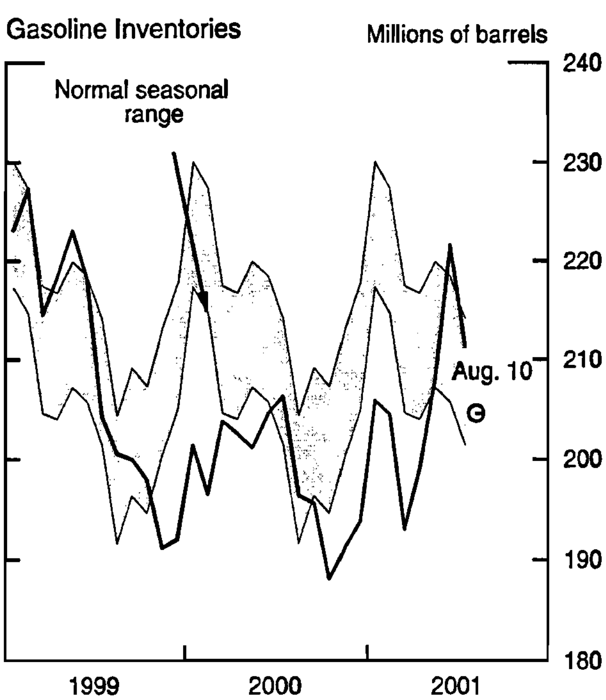
The modest increase in the CPI excluding food and energy items in July left the three-month change for this series at an annual rate of 2.4 percent, well below the spike that occurred early this year. The CPI for core commodities moved up 0.1 percent in July, as a jump in tobacco prices offset declines for apparel and many durable goods. Over the past twelve months, core goods prices have risen 0.4 percent—the same increase as in the previous twelve-month period. In contrast, prices for non-energy services have accelerated noticeably over the past year, and the index for these items rose 0.2 percent further in July. Over the twelve months ended in July, prices for non-energy services have risen 3.7 percent, about 1/4 percentage point more than in the previous twelve-month

Gasoline and Natural Gas Developments

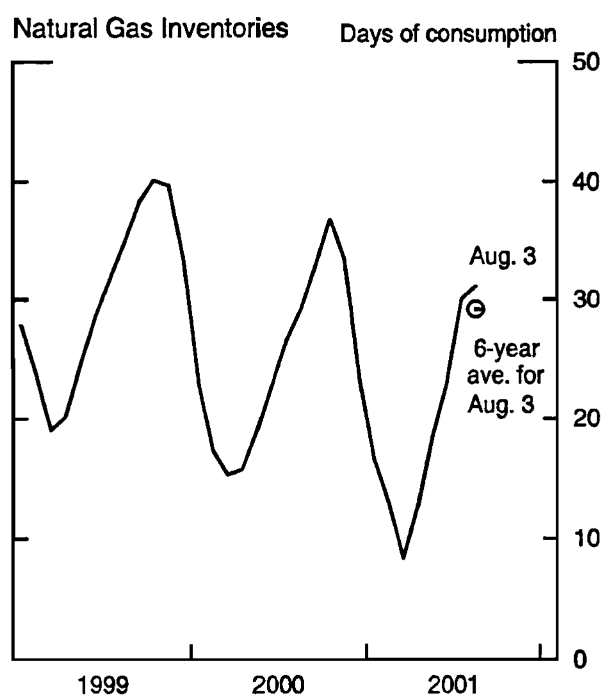


Note. Prices adjusted using CPI seasonal factors.





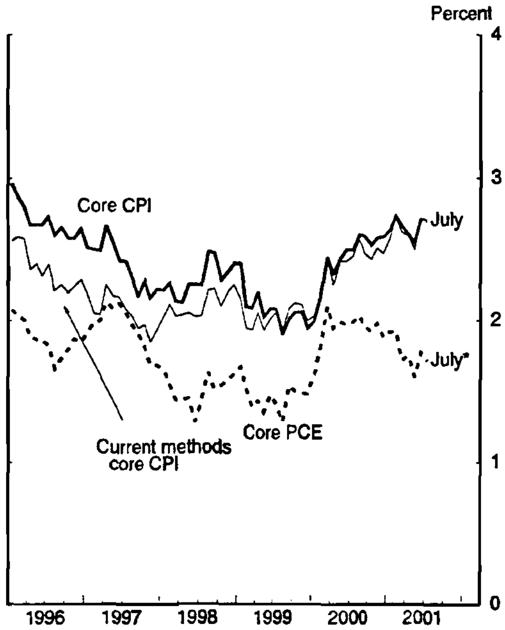
Source. U.S. Department of Energy.



Note. Working gas in storage divided by U.S. DOE projection of 2000/2001 average daily winter consumption.

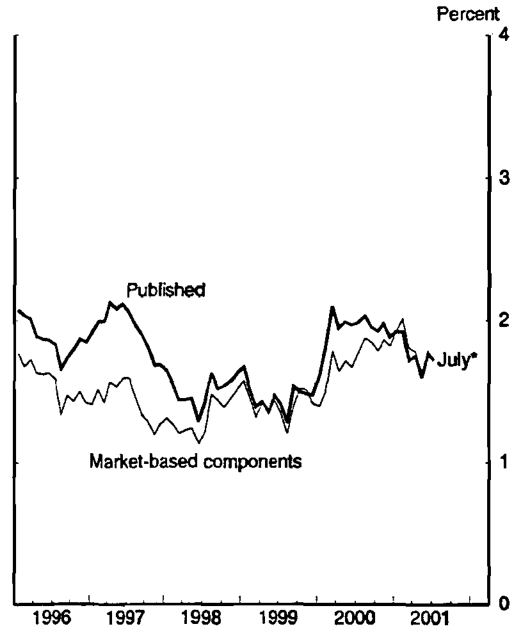
Measures of Core Consumer Price Inflation
(12-month change except as noted)

CPI and PCE Excluding Food and Energy



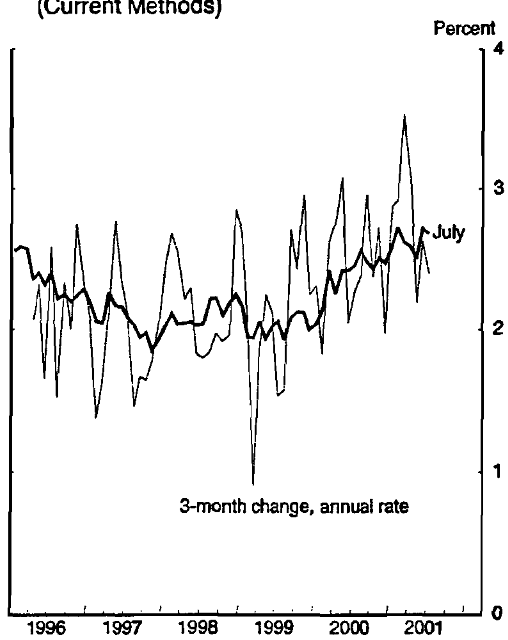
* Staff estimate

PCE Excluding Food and Energy

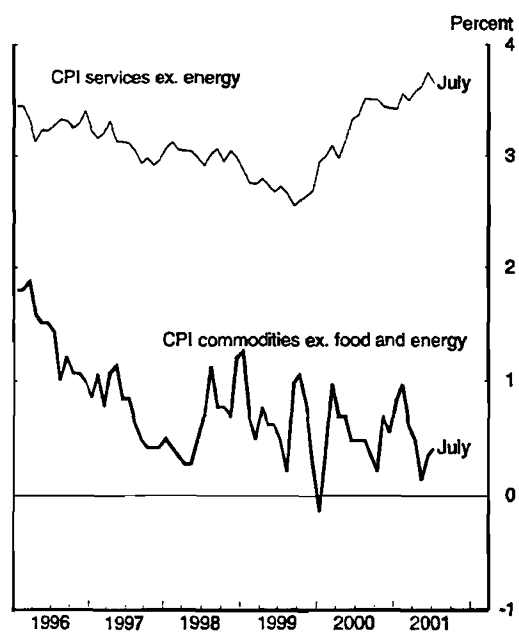


* Staff estimate

CPI Excluding Food and Energy
(Current Methods)



CPI Services and Commodities



BROAD MEASURES OF INFLATION
(4-quarter percent change)

	1998 Q2	1999 Q2	2000 Q2	2001 Q2
Product prices				
GDP chain price index	1.2	1.4	2.3	2.3
Less food and energy	1.3	1.4	2.2	1.8
Nonfarm business chain price index[1]	0.8	1.1	1.9	1.9
Expenditure prices				
Gross domestic purchases chain price index	0.8	1.4	2.6	2.1
Less food and energy	1.0	1.3	2.0	1.6
PCE chain price index	1.0	1.5	2.7	2.3
Less food and energy	1.4	1.4	2.0	1.7
PCE chain price index, market-based components	0.8	1.5	2.6	2.4
Less food and energy	1.2	1.4	1.7	1.7
CPI	1.6	2.1	3.3	3.4
Less food and energy	2.2	2.1	2.4	2.7
Current-methods CPI	1.3	2.0	3.3	3.4
Less food and energy	2.1	2.0	2.3	2.7
Median CPI	2.9	2.7	2.6	3.5
Trimmed mean CPI	2.0	1.7	2.5	3.0

1. Excluding housing.

SURVEYS OF (CPI) INFLATION EXPECTATIONS
(Percent)

	Actual inflation[1]	University of Michigan: 1 year		University of Michigan: 5 to 10 years		Professional forecasters (10-year)[4]
		Mean[2]	Median[2]	Mean[3]	Median[3]	
1999-Q3	2.3	3.1	2.7	3.4	2.9	2.5
Q4	2.6	3.5	2.9	3.3	2.9	2.5
2000-Q1	3.2	3.6	3.0	3.5	3.0	2.5
Q2	3.3	3.5	3.0	3.3	2.8	2.5
Q3	3.5	3.6	2.9	3.4	2.9	2.5
Q4	3.4	3.8	3.0	3.7	3.0	2.5
2001-Q1	3.4	3.4	2.9	3.6	3.0	2.5
Q2	3.4	3.9	3.1	3.6	3.0	2.5
2001-Jan.	3.7	3.8	3.0	3.5	2.9	
Feb.	3.5	3.2	2.8	3.6	3.0	
Mar.	2.9	3.3	2.8	3.6	3.0	2.5
Apr.	3.3	3.7	3.1	3.6	3.1	
May	3.6	3.9	3.2	3.6	3.0	
June	3.2	4.0	3.0	3.6	3.0	2.5
July		3.0	2.6	3.4	2.9	

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

period. The CPIs for owners' equivalent rent and for tenants' rent rose 0.3 percent and 0.4 percent, respectively, in July; these indexes have each accelerated 1 percentage point relative to the preceding year.

Core PCE prices have been rising notably less rapidly than the core CPI and, indeed, have decelerated a touch over the past year. In June, the twelve-month change in core PCE prices stood at 1.8 percent, down from 2 percent in the previous year according to revised NIPA data. (The information in the July CPI suggests that the twelve-month change in core PCE prices will edge down further to 1.7 percent in July.) Over the past year, the core PCE price index has increased about a percentage point less than the core CPI. The gap between increases in these two price measures has widened markedly since the first half of the 1990s, when the two registered, on average, the same rate of increase (measuring the core CPI according to the current-methods series).

Part of the difference between the two measures of core consumer prices is the result of the inclusion of a variety of items in the PCE measure that are outside the scope of the CPI. Many of these out-of-scope items do not have market prices; the BEA relies on a variety of sources and techniques to estimate these prices, and the resulting figures tend to be quite erratic. These non-market prices decelerated markedly over the past year and account for most of the small deceleration in the overall core component of the PCE price index. Inflation as measured by the market-based components of the core PCE index has been little changed over the past year.

Prices for capital goods as measured by the producer price index moved up 0.2 percent in July, leaving the twelve-month change at 0.9 percent, about 1/4 percentage point below the year-earlier increase. Prices for computers, which plummeted in the first quarter, have declined at a moderate pace in the past few months. In all, computer prices have declined 19 percent over the twelve months to July, a slightly more rapid pace than the decline over the previous year.

Turning to broader price indexes, the chain price index for gross domestic purchases excluding food and energy items rose 1.6 percent over the four quarters ended in 2001:Q2, down about 1/2 percentage point from the increase over the previous four quarters. With finished energy prices having decelerated modestly over this period, a similar easing is evident for overall gross domestic purchases prices. However, the increase in overall GDP prices over the past year, at 2.3 percent, was unchanged from the year-earlier figure, held up by a sharp increase in energy margins earlier this year that was not yet unwound by the second quarter.

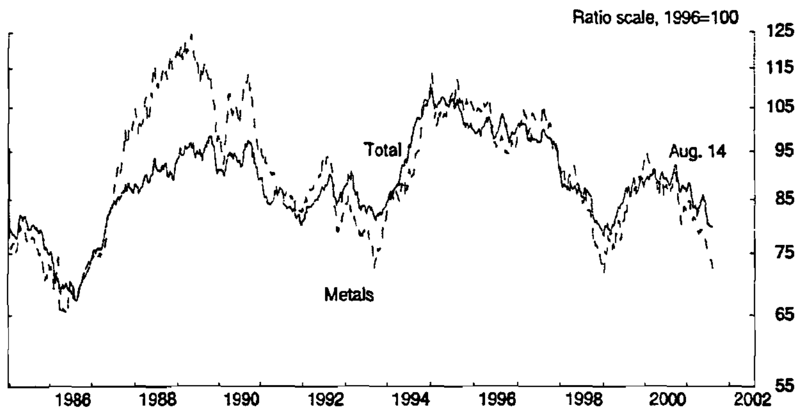
SPOT PRICES OF SELECTED COMMODITIES

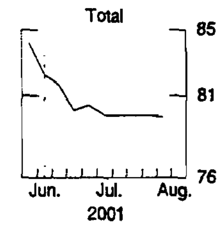
	Current price (dollars)	1999	2000	Dec. 26 to June 19[2]	June 19[2] to Aug. 14	Memo: Year earlier to date
		Percent change[1]				
Metals						
Copper (lb.)	0.690	26.1	3.4	-15.4	-10.4	-23.3
Steel scrap (ton)	80.000	61.5	-32.7	-0.4	1.7	-13.0
Aluminum, London (lb.)	0.611	27.7	-0.8	-5.9	-8.1	-12.1
Precious metals						
Gold (oz.)	274.500	-1.6	-5.7	-0.3	0.4	0.1
Silver (oz.)	4.220	5.5	-10.9	-4.9	-5.0	-13.9
Forest products[3]						
Lumber (m. bdft.)	308.000	8.3	-44.6	72.2	-0.6	40.0
Plywood (m. sqft.)	350.000	-3.2	-8.2	23.2	1.4	22.0
Petroleum						
Crude oil (barrel)	25.780	163.3	-13.0	19.2	-2.7	-13.6
Gasoline (gal.)	0.810	132.9	5.2	2.3	7.9	-5.3
Fuel oil (gal.)	0.744	140.7	34.4	-18.9	-3.4	-14.3
Livestock						
Steers (cwt.)	68.140	15.7	13.2	-5.5	-6.4	5.6
Hogs (cwt.)	52.250	194.0	7.1	41.1	-1.9	21.5
Broilers (lb.)	0.593	-4.0	-13.7	19.6	-0.3	20.0
U.S. farm crops						
Corn (bu.)	2.055	-10.2	10.1	-15.2	16.8	39.8
Wheat (bu.)	3.070	-17.4	31.9	-6.0	-6.3	11.1
Soybeans (bu.)	5.050	-17.6	10.8	-5.7	9.0	12.8
Cotton (lb.)	0.355	-20.9	27.0	-38.6	-1.7	-39.7
Other foodstuffs						
Coffee (lb.)	0.453	5.1	-43.1	-18.0	-18.8	-42.2
Memo:						
JOC Industrials	79.700	11.0	-1.5	-5.2	-3.2	-10.0
JOC Metals	71.900	26.3	-10.3	-8.4	-5.9	-17.6
CRB Futures	201.990	7.8	12.1	-8.9	-3.1	-7.6
CRB Spot	238.250	-0.1	-3.5	-4.7	-2.6	-6.5

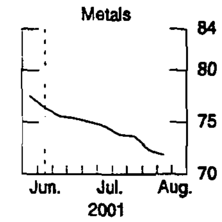
1. Changes, if not specified, are from the last week of the preceding year to the last week of the period indicated.
2. Week of the June Greenbook.
3. Reflects prices on the Friday before the date indicated.

Commodity Price Measures

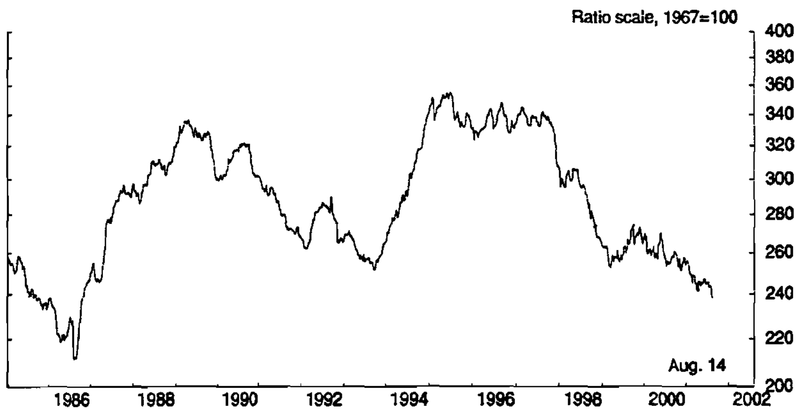
Journal of Commerce Index

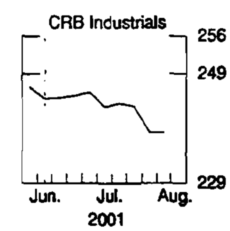




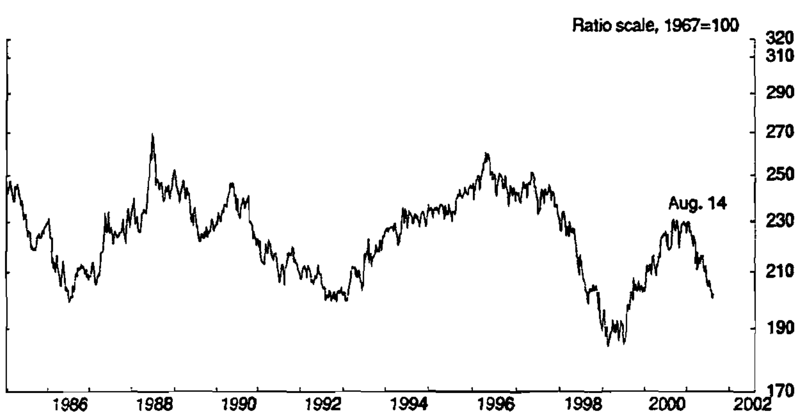


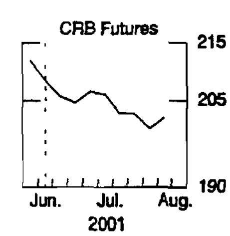
CRB Spot Industrials





CRB Futures





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

EMPLOYMENT COST INDEX OF HOURLY COMPENSATION
FOR PRIVATE INDUSTRY WORKERS

	2000			2001	
	June	Sept.	Dec.	Mar.	June
	-----Quarterly percent change------- (Compound annual rate)				
Total hourly compensation[1]	4.7	3.8	3.5	4.6	4.0
Wages and salaries	4.2	3.6	3.3	4.4	3.8
Benefit costs	5.1	5.0	4.4	5.9	3.8
By industry					
Construction	5.8	5.7	5.9	3.9	4.4
Manufacturing	4.2	3.9	2.2	4.6	3.2
Trans., comm., and public utilities	5.1	4.2	3.6	5.5	5.1
Wholesale trade	4.6	1.6	5.4	2.1	6.9
Retail trade	4.0	3.6	3.6	4.1	2.2
FIRE	2.9	5.6	1.3	5.8	4.1
Services	4.6	4.3	3.4	6.6	3.1
By occupation					
White collar	4.9	3.8	4.0	4.5	4.4
Blue collar	3.4	4.2	3.3	4.7	2.2
Service occupations	4.5	3.4	4.4	5.0	3.2
Memo:					
State and local governments	3.1	2.5	3.3	4.1	4.6
	-----Twelve-month percent change----				
Total hourly compensation	4.6	4.6	4.4	4.2	4.0
Excluding sales workers	4.4	4.6	4.4	4.4	4.2
Wages and salaries	4.1	4.1	3.9	3.8	3.8
Excluding sales workers	3.9	4.0	3.9	4.2	3.9
Benefit costs	5.7	6.0	5.6	5.0	4.8
By industry					
Construction	4.6	5.2	5.8	5.3	5.0
Manufacturing	4.7	4.6	4.0	3.6	3.5
Trans., comm., and public utilities	3.4	3.9	4.2	4.6	4.6
Wholesale trade	5.0	4.0	4.0	3.4	4.0
Retail trade	4.1	4.4	4.2	3.8	3.4
FIRE	5.0	5.1	5.0	3.9	4.2
Services	4.6	4.7	4.4	4.8	4.4
By occupation					
White collar	4.9	4.8	4.6	4.3	4.2
Sales	5.4	4.9	4.2	2.3	2.8
Nonsales	4.7	4.7	4.6	4.8	4.5
Blue collar	4.3	4.4	4.2	3.9	3.6
Service occupations	3.4	4.0	3.9	4.2	4.1
Memo:					
State and local governments	3.5	3.3	3.0	3.3	3.6

1. Seasonally adjusted by the BLS.

At earlier stages of processing, the producer price index for core intermediate materials edged down over the twelve months ended in July after having increased nearly 3 percent over the previous twelve months. And the PPI for core crude materials continued to move lower in July after dropping sharply earlier in the year. Indexes of industrial materials prices (such as the Commodity Research Bureau and *Journal of Commerce* commodity price indexes) also generally have moved down since the last Greenbook.

Inflation expectations from the Michigan survey have declined recently. The median expectation for inflation over the coming year dropped to 2.6 percent in July after having fluctuated around 3 percent during the first six months of the year. The mean of these expectations, which in contrast to the median had moved up notably during the second quarter, fell even more sharply than the median in July. However, over a five-to-ten year horizon, median expected inflation edged down just a tenth in July, to 2.9 percent, and has remained little changed over the past two years.

Labor Costs

Movements over the past couple of years in the two main indicators of labor costs—the ECI and nonfarm compensation per hour—have been difficult to reconcile. Nevertheless, both measures suggest that compensation gains might have crested and are now turning down.

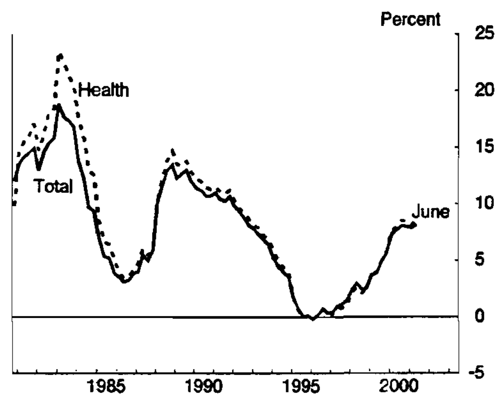
The ECI for hourly compensation in private industry rose 4 percent over the twelve months ended in June, down from a 4-1/2 percent increase over the preceding year. Some deceleration occurred both in wages and salaries and in benefits. Within the benefits component, the year-over-year increases for nonproduction bonuses, paid leave, and retirement and savings benefits were smaller.[22] In contrast, employer costs for workers' compensation accelerated noticeably over the past year, and health-insurance costs continued to rise rapidly.

Nonfarm compensation per hour (CPH) increased at an annual rate of 4-3/4 percent in the second quarter, after having risen at a 5 percent pace in 2001:Q1. Although these gains continued to outpace those measured in the ECI, they represent a sharp slowing from the extremely rapid rise in CPH now estimated to have occurred in 2000. These two measures of labor costs differ in a variety of ways, including the fact that nonfarm compensation per hour reflects changes in the industry and occupation mix of employment and changes in overtime hours worked, while the ECI is unaffected by such changes. But probably the more important difference between these two measures in recent

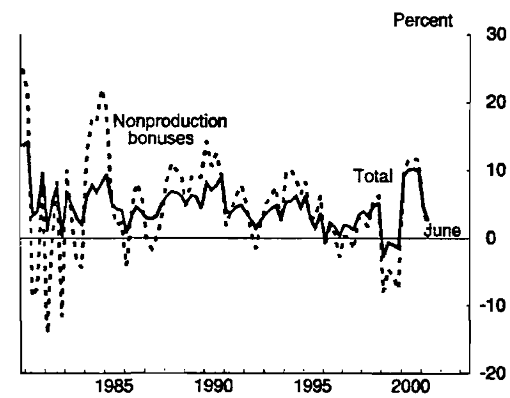
22. With the exception of health insurance, the benefits detail is unpublished and is provided to us by the BLS on a confidential basis.

Components of ECI Benefits Costs (CONFIDENTIAL)
(Private industry workers; 12-month change)

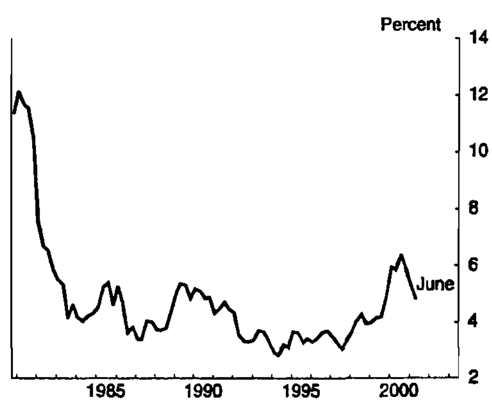
Insurance Costs



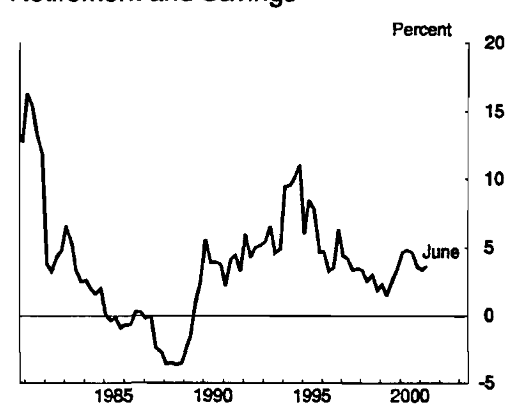
Supplemental Pay



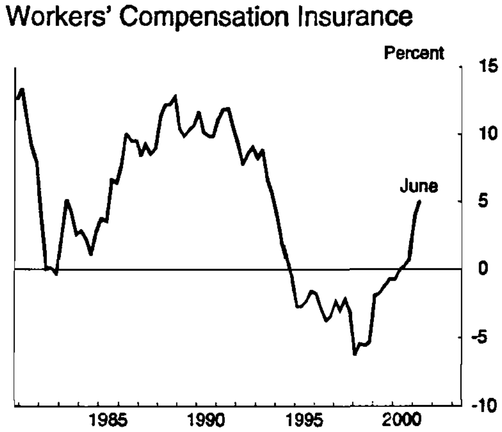
Paid Leave



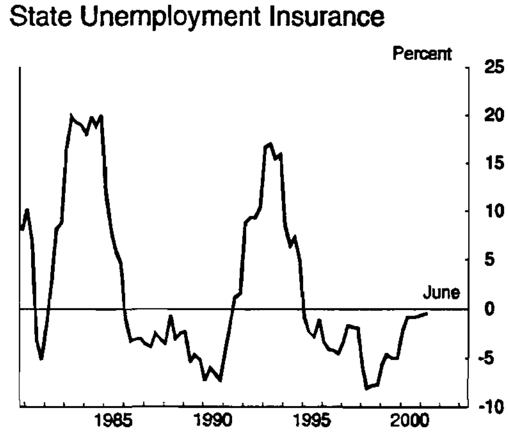
Retirement and Savings



Workers' Compensation Insurance



State Unemployment Insurance



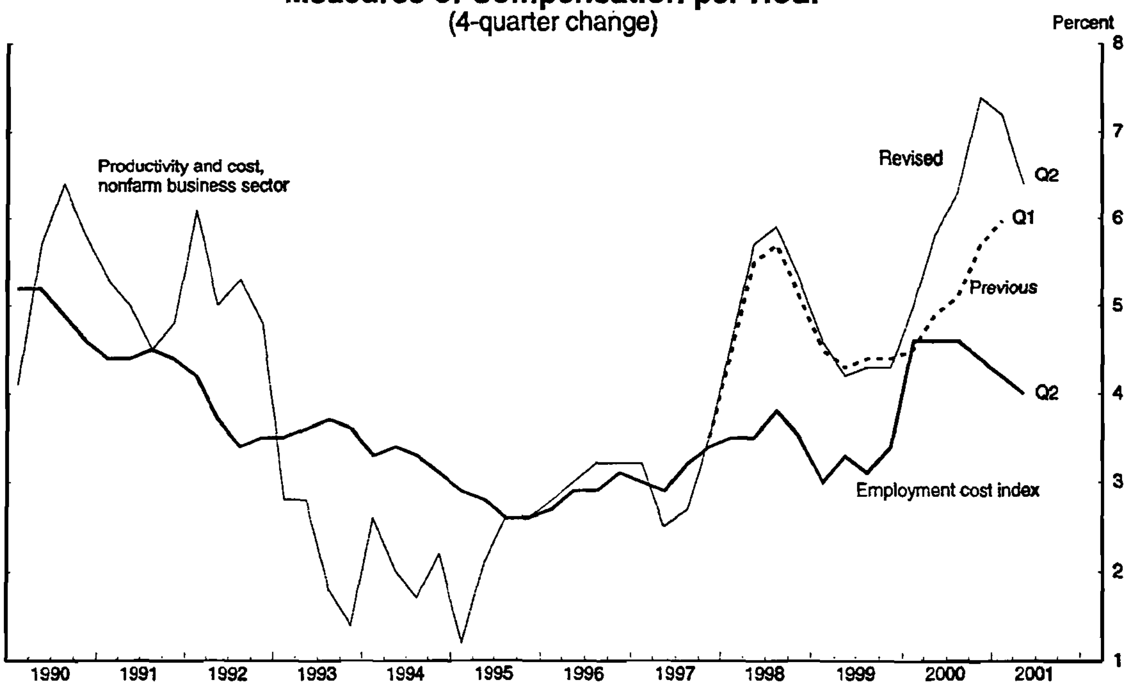
Note. Unpublished and confidential ECI benefits detail.

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

	1999	2000	2000 Q3	2000 Q4	2001 Q1	2001 Q2	2000:Q2 to 2001:Q2
Compensation per hour							
Total business	4.4	7.6	6.5	9.4	5.3	5.2	6.6
Nonfarm business	4.3	7.4	7.1	8.9	5.1	4.7	6.4
Nonfinancial corporations (1)	4.4	7.5	6.8	9.6	5.7	n.a.	n.a.
Unit labor costs							
Total business	1.4	4.8	5.5	6.3	5.3	2.4	4.8
Nonfarm business	1.5	5.0	5.6	6.4	5.0	2.1	4.8
Nonfinancial corporations (2)	1.5	3.2	2.7	7.9	5.0	n.a.	n.a.

1. Changes are from fourth quarter of preceding year to fourth quarter of year shown.
2. The nonfinancial corporate sector includes all corporations doing business in the United States with the exception of banks, stock and commodity brokers, finance and insurance companies; the sector accounts for about two-thirds of business employment.

Measures of Compensation per Hour
(4-quarter change)

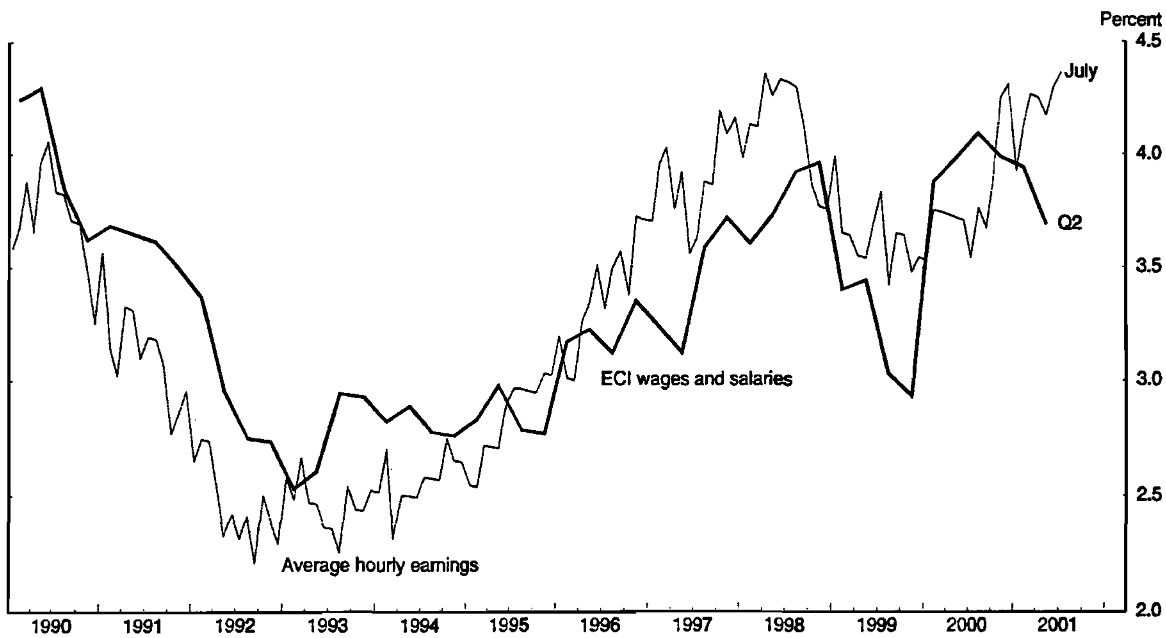


Source. Bureau of Labor Statistics.

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

	12-month percent change			Percent change to July 2001 from month indicated		Percent change	
	July 1999	July 2000	July 2001	Jan. 2001	Apr. 2001	June 2001	July 2001
	- - - - - - - - Annual rate- - - -				- - - - -	-Monthly rate-	
Total private nonfarm	3.8	3.5	4.4	4.6	4.0	0.5	0.3
Manufacturing	4.0	2.8	3.5	4.6	4.1	0.2	0.4
Construction	3.6	3.7	2.4	0.1	3.1	0.4	0.0
Transportation and public utilities	2.7	3.0	3.9	3.7	1.7	0.8	-0.5
Finance, insurance, and real estate	4.3	2.7	5.7	6.4	7.6	0.6	0.6
Retail trade	3.9	4.1	3.9	4.2	4.2	0.5	0.0
Wholesale trade	3.6	4.2	3.8	3.8	2.0	0.9	-0.1
Services	4.1	3.8	5.0	5.3	3.9	0.4	0.5

Average Hourly Earnings for Production or Nonsupervisory Workers
(12-month change)



years is that stock options granted as part of compensation are not directly incorporated in the ECI, while CPH includes the value of such options when they are exercised. Exercises have increased notably in recent years, which helps explain part of the faster increases in CPH than in the ECI since 1997, and we suspect that some of the sharp acceleration in CPH in 2000 reflects a pickup in option exercises as well.[23]

To the extent that firms can and do hedge against stock-option risk when the options are granted, employees' subsequent gains, *per se*, should not impose unexpected costs on the firm that would lead to pressure on prices. Rather, the value of the options at the time they are granted should be viewed as the increment to labor costs—though neither the ECI nor CPH attempts to measure the option value of these grants. Stock-option exercises look to have exceeded grants over the several years through 2000.

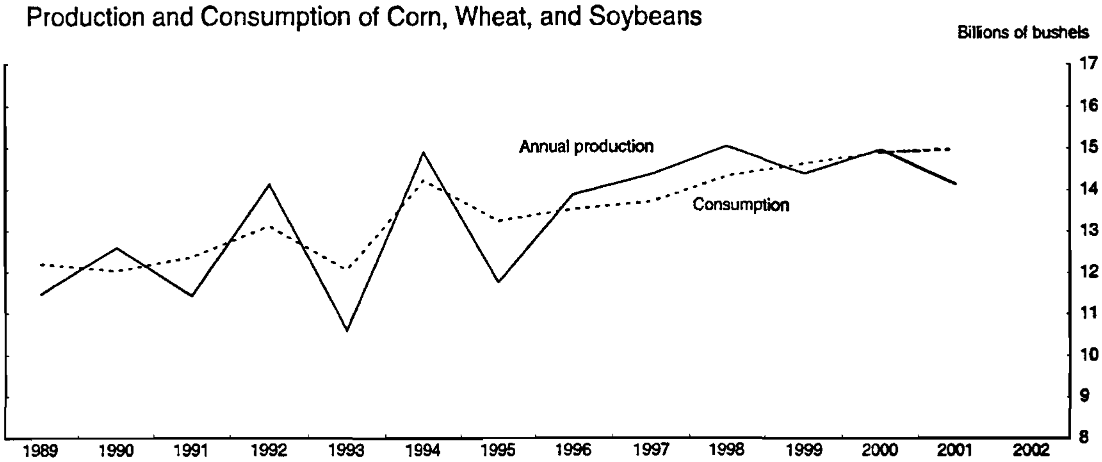
Combined with the downward revision to productivity, last year's upward revision to nonfarm compensation per hour implies that the CPH-based measure of unit labor costs surged 5 percent after having risen about 2 percent, on average, in 1998 and 1999. Taken at face value, the upward revision to unit labor costs, combined with the comparatively minor price revisions, would imply that firms' price-cost margins have a notably smaller cushion to absorb further cost increases than was evident in the pre-revision data. Because stock-option exercises appear to have exceeded grants through 1999—as well as, we think, in 2000—a more relevant measure of unit labor costs—one that includes the value of grants but not exercises—may have been increasing a little more slowly than the published hourly compensation data indicate. Or course, given the downward revision to productivity, even this adjustment would likely leave unit labor costs significantly higher on a revised basis than previously estimated.

The July employment report provided the first look at wage developments in the third quarter. Average hourly earnings of production or nonsupervisory workers increased 0.3 percent in July and were up 4.4 percent over the preceding twelve months. In contrast to the ECI for wages and salaries of workers in production and nonsupervisory occupations, average hourly earnings have not yet shown signs of deceleration. Although movements in these two

23. The Board staff constructed a series on option exercises from the annual reports of 150 companies since 1996. Unfortunately, the annual reports do not provide information on the average price at which these options were exercised, leaving a relatively wide range for the value of these option exercises given the wide range of stock-market prices during each year.

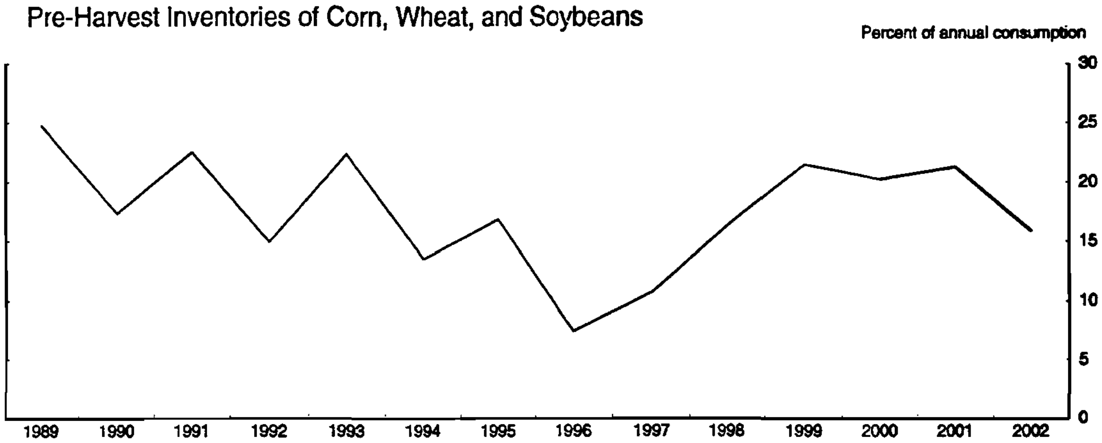
Crop Production, Inventories, and Prices

Production and Consumption of Corn, Wheat, and Soybeans



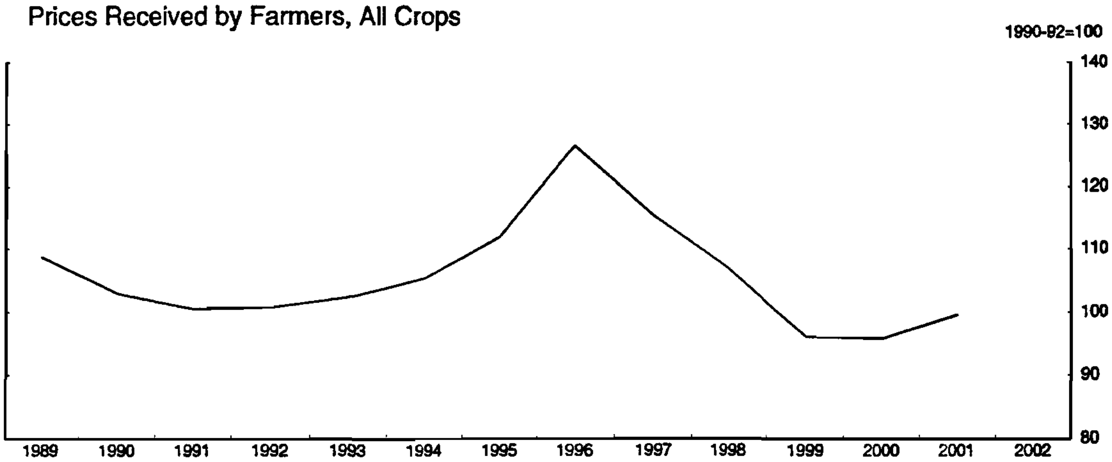
Note. 2001 data are USDA forecasts.

Pre-Harvest Inventories of Corn, Wheat, and Soybeans



Note. Stocks available at the start of the annual harvest, as a percent of consumption during the preceding marketing year.
Data for 2001 and 2002 are USDA forecasts.

Prices Received by Farmers, All Crops



Note. Datapoint for 2001 is the Jan.-July average.

series are similar over long spans of time, over shorter periods significant differences can emerge.[24]

Agricultural Developments

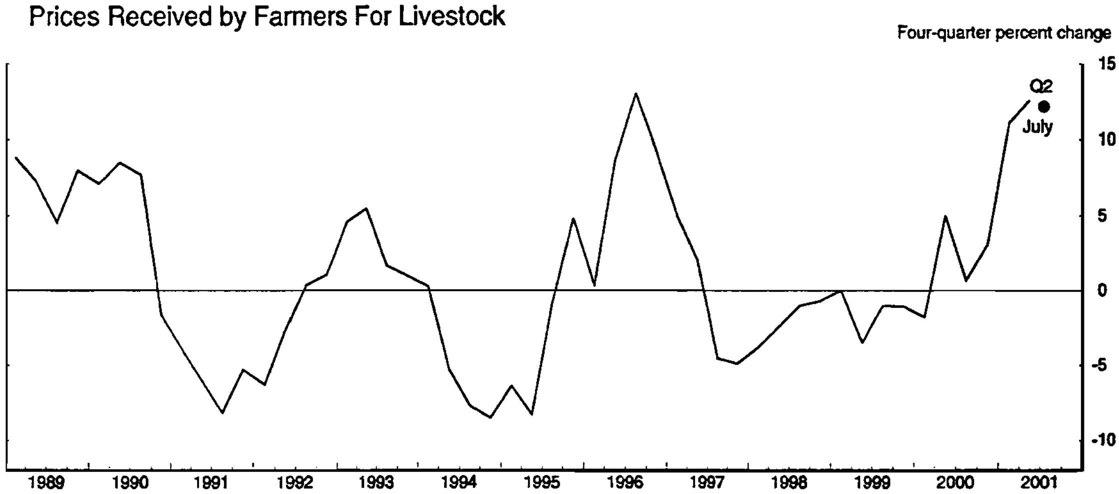
The Department of Agriculture's August crop report provided the first detailed look at how the fall harvest for 2001 is likely to shape up. On the basis of August 1 conditions, aggregate output of the three major field crops—corn, wheat, and soybeans—is expected to decline somewhat from last year's level, which was almost a record high. Cool, damp weather during the spring and hot, dry weather in some regions in midsummer have combined to trim acreage a bit and to pull yields a little below earlier forecasts. The USDA is predicting that aggregate consumption of these crops over the coming year will exceed this year's production. Consequently, inventories are expected to drop back somewhat from the high levels of the past three years. Prices of crops have turned up with the prospective tightening of stocks, but, having fallen substantially in the latter part of the 1990s, these prices remain to the low side of the average over the past decade.

The prices received for livestock have also been rising this year, and the second-quarter average of prices received by farmers for these products was almost 13 percent above the level of the previous year. This price rise seems to have been driven to a considerable degree by cutbacks in supply. Production of meat has trailed year-earlier levels in recent quarters; output of milk also has fallen. The USDA is forecasting that supplies of livestock products, overall, will be gradually picking up in coming quarters. Traders in futures markets apparently concur, as futures prices for livestock show about a third of the rise of livestock prices over the past year (2000:Q2 to 2001:Q2) will be reversed over the next four quarters, with declines for hogs and milk more than offsetting a small year-to-year price rise for cattle.

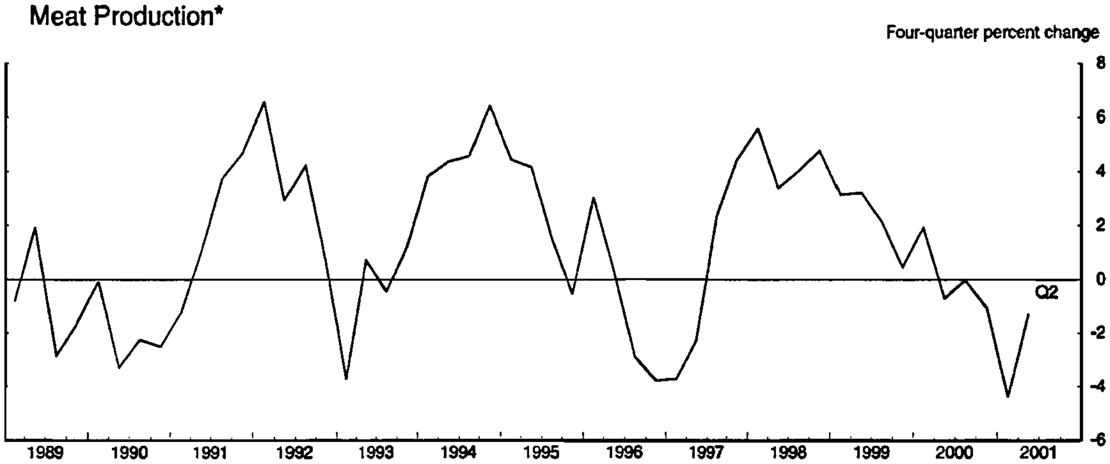
24. An alternative weighting of average hourly earnings that is similar to the fixed-weighted ECI suggests that weighting differences cannot explain much of the discrepancy between the two series.

Livestock Production and Prices

Prices Received by Farmers For Livestock

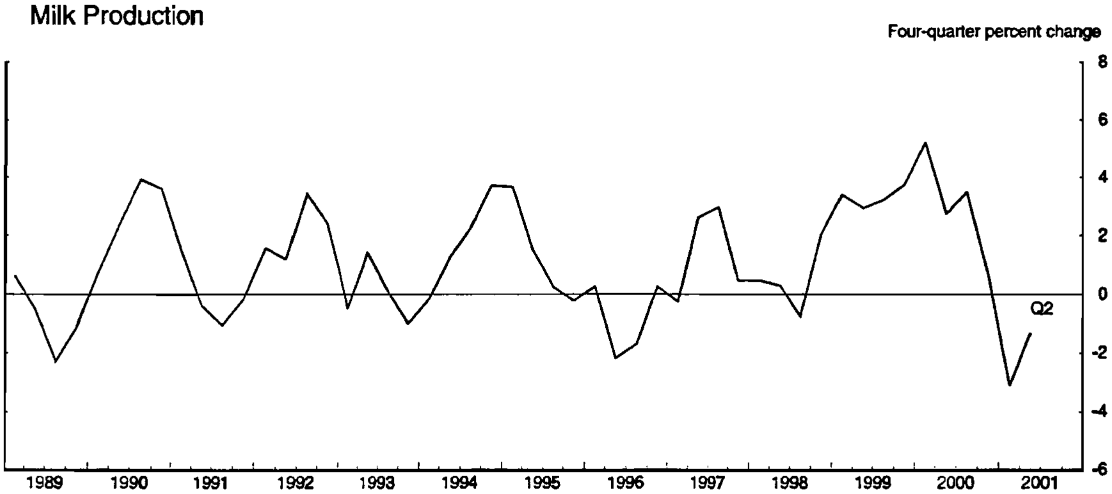


Meat Production*



*Includes beef, veal, pork, and lamb; excludes poultry.

Milk Production



Appendix

Annual Revision to the National Income and Product Accounts

On July 27, the BEA published its regular annual revision to the national income and product accounts. The revision, which extended back to 1998, incorporated more comprehensive source data, including annual Census Bureau surveys of businesses and of state and local governments, new information from the OMB and USDA, updated international transactions accounts, unemployment insurance records, and business tax returns. In addition, the BEA made several methodological changes, including conversion to the North American Industrial Classification System (NAICS) for estimating some components of GDP, adoption of a new FRB price index that reflects quality improvements in local area networks for estimating real investment in communications equipment, and incorporation of new source data for estimating investment in prepackaged and custom software.

Revisions to GDP and Its Components

From the fourth quarter of 1997 to the first quarter of this year, the average annual rate of growth in real GDP was revised down 0.3 percentage point, to 3.8 percent. On a fourth-quarter to fourth-quarter basis, growth was revised up 0.2 percentage point in 1998, and down 0.6 percentage point in both 1999 and 2000. The growth rate in the first quarter of 2001 was revised up 0.1 percentage point, to 1.3 percent.

About half of the downward revision to real GDP over the three-year period reflected a slower estimated rate of growth in business investment in software, owing to new source data from the Census Bureau's annual surveys of service-producing firms.[1] In addition, personal consumption expenditures are shown in the revised data as having increased at a slightly less robust average pace—4.7 percent over the past three years compared with 4.9 percent in the previous estimates. In contrast, the revised data showed a considerably stronger pace of residential investment.

Income-Side Developments

The level of gross domestic income was revised down in the first quarter of 2001, but by less than GDP. Thus, the previously large gap between these measures (the statistical discrepancy) widened further.

Shifts in the composition of income were sizable. Labor compensation was revised up considerably, largely on the basis of wage and salary data from unemployment insurance records (as the BEA had announced earlier in the spring), while corporate profits were revised down on the basis of information from tax returns. In the first quarter of this year, economic profits excluding Federal Reserve banks amounted to 7.5 percent of gross national product, down from a previous estimate of 8.2 percent. The higher level of wage and salary disbursements showed through to higher personal income (despite a fair-sized downward revision to personal interest income).

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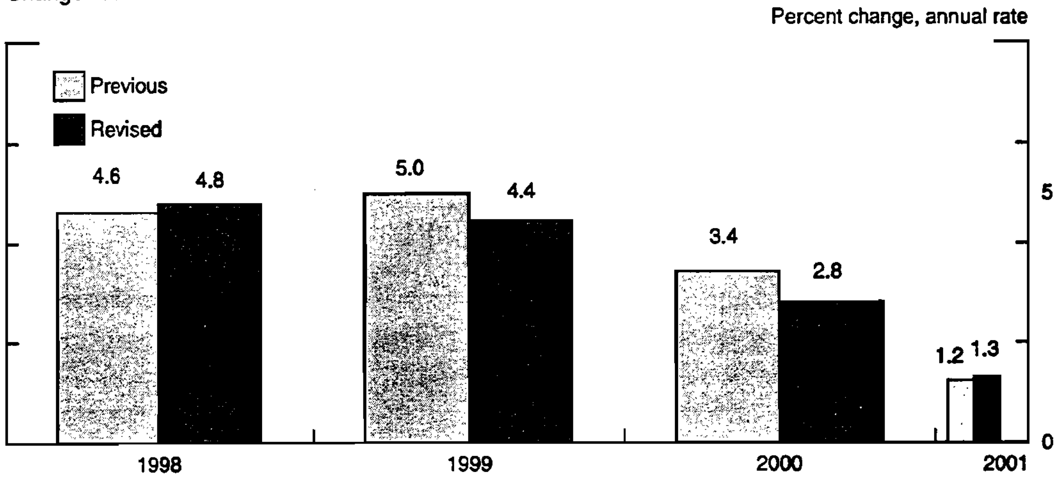
1. To guard against such large revisions in the future, the BEA has begun using data on receipts from software company reports to the Securities and Exchange Commission and trade-source data on monthly retail sales of business software to extrapolate the quarterly software estimates. Previously, the BEA had based its extrapolation procedures on compensation data for firms providing computer programming services and producing prepackaged software.

Annual Revision to National Income and Product Accounts

Change in Real GDP*

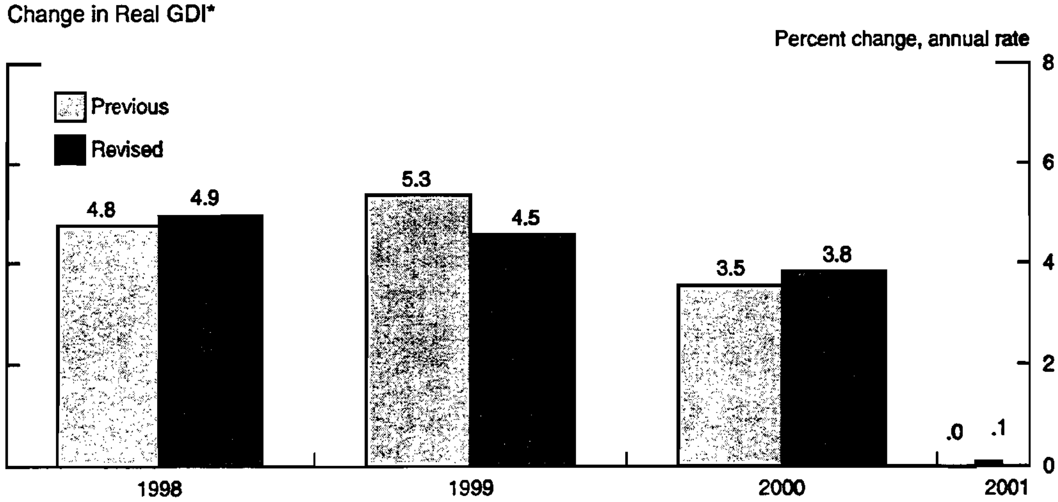


* Annual changes are Q4 to Q4.

Real GDP and Related Items
(Annualized percent change from 1997:Q4 to 2001:Q1)

	Previous estimate	Revised estimate
1. Gross domestic product	4.1	3.8
2. Final sales	4.4	4.1
3. PCE	4.9	4.7
4. Business fixed investment	10.4	8.7
5. Residential investment	3.4	4.3
6. Federal spending	1.7	1.4
7. State and local spending	3.6	3.6
Memo:		
8. Nonfarm business output (less housing)	4.7	4.3
9. Gross domestic income	4.2	4.1

Change in Real GDI*

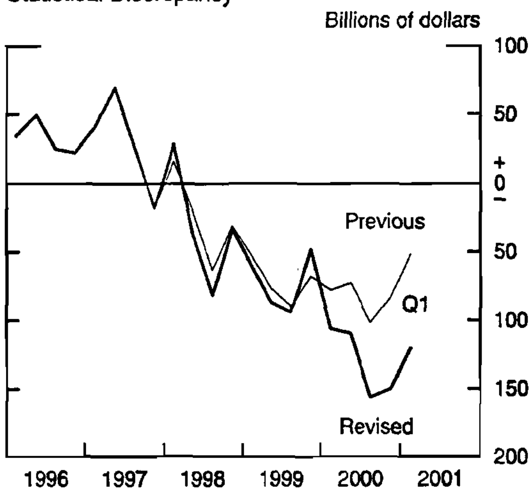


* Annual changes are Q4 to Q4.

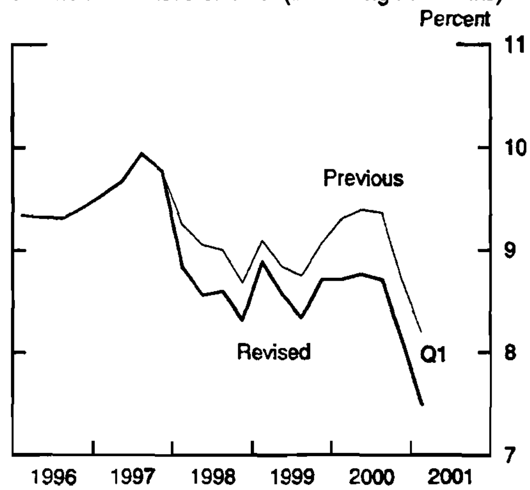
Annual Revision to National Income and Product Accounts

(Continued)

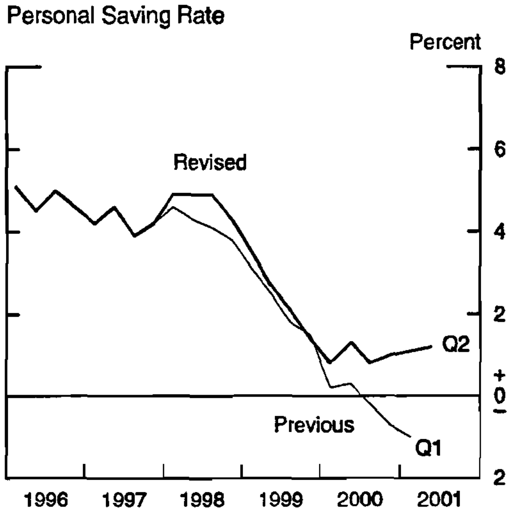
Statistical Discrepancy



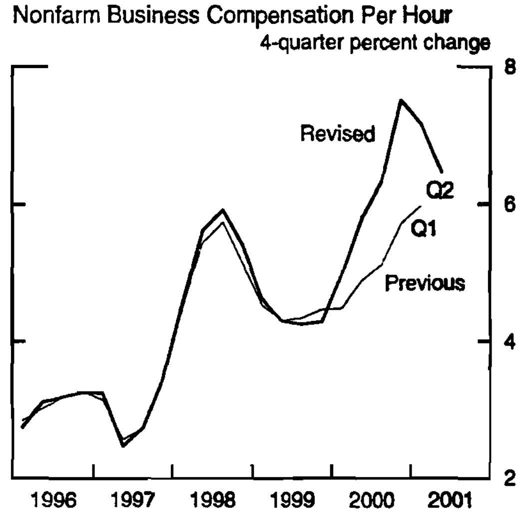
Profits as a Share of GNP (Excluding FR Banks)



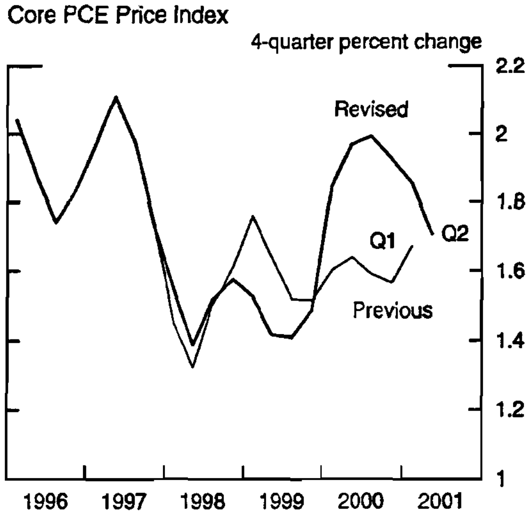
Personal Saving Rate



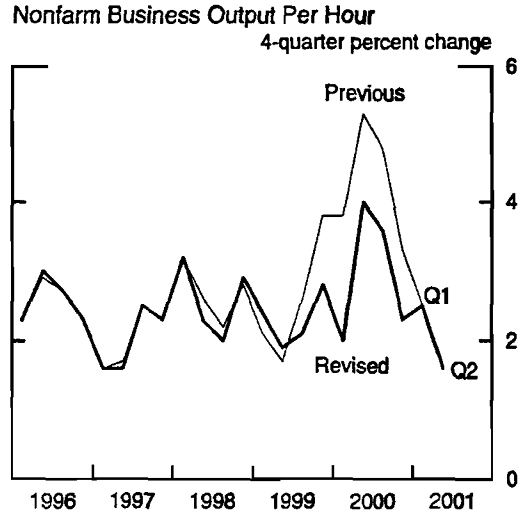
Nonfarm Business Compensation Per Hour



Core PCE Price Index



Nonfarm Business Output Per Hour



Disposable income was also revised up, and, with the downward revision to PCE, the personal saving rate in the first quarter of 2001 was measured to be 1.1 percent—2.1 percentage points above the previous estimate.

Compensation and Prices

Nonfarm business compensation per hour is now estimated to have increased faster, on net, over the revision period, reflecting a substantially more rapid rise in hourly compensation in 2000 than had been previously estimated. Meanwhile, four-quarter percent changes in core PCE prices were essentially unrevised in 1998 and 1999 but were revised up 0.3 percentage point in 2000. Last year, the upward revisions were concentrated in the non-market-based components of PCE prices, especially brokerage services.

The BLS's Annual Revisions to Productivity

On August 7, the BLS released updated estimates of productivity, which incorporated the new GDP data as well as the annual benchmark revision to the payroll employment survey released in June. According to the new figures, output per hour in the nonfarm business sector rose at an annual rate of 2-1/2 percent between the fourth quarter of 1997 and the first quarter of this year, about 1/2 percentage point slower than previously shown. Most of the downward revision reflected slower output growth in 1999 and 2000. Still, the revised data indicate a considerably faster pace of productivity growth in the past three years compared with the 1-1/2 percent growth rate experienced, on average, between 1974 and 1994.

Domestic Financial Developments

Selected Financial Market Quotations

(One-day quotes in percent except as noted)

Instrument	2000	2001			Change to Aug. 15 from selected dates (percentage points)		
	June 26	July 17	June 26	Aug. 15	2000 June 26	2001 July 17	2001 June 26
Short-term							
FOMC intended federal funds rate	6.50	3.75	4.00	3.75	-2.75	.00	-.25
Treasury bills [1]							
3-month	5.66	3.53	3.38	3.35	-2.31	-.18	-.03
6-month	5.94	3.48	3.38	3.31	-2.63	-.17	-.07
Commercial paper							
1-month	6.56	3.71	3.64	3.55	-3.01	-.16	-.09
3-month	6.56	3.59	3.52	3.44	-3.12	-.15	-.08
Large negotiable CDs [1]							
1-month	6.64	3.75	3.68	3.56	-3.08	-.19	-.12
3-month	6.73	3.67	3.61	3.47	-3.26	-.20	-.14
6-month	6.89	3.71	3.61	3.48	-3.41	-.23	-.13
Eurodollar deposits [2]							
1-month	6.63	3.75	3.65	3.52	-3.11	-.23	-.13
3-month	6.69	3.67	3.60	3.44	-3.25	-.23	-.16
Bank prime rate	9.50	6.75	7.00	6.75	-2.75	.00	-.25
Intermediate- and long-term							
U.S. Treasury [3]							
2-year	6.54	4.16	4.09	3.85	-2.69	-.31	-.24
10-year	6.35	5.43	5.46	5.29	-1.06	-.14	-.17
30-year	6.22	5.76	5.80	5.64	-.58	-.12	-.16
U.S. Treasury 10-year indexed note	4.08	3.42	3.29	3.32	-.76	-.10	.03
Municipal revenue (Bond Buyer) [4]	5.99	5.52	5.52	5.35	-.64	-.17	-.17
Private instruments							
10-year swap	7.38	6.04	6.02	5.82	-1.56	-.22	-.20
10-year FNMA	7.15	5.96	5.97	5.78	-1.37	-.18	-.19
10-year AA [5]	7.60	6.55	6.55	6.41	-1.19	-.14	-.14
10-year BBB [5]	8.49	7.44	7.37	7.18	-1.31	-.26	-.19
High yield [6]	11.97	12.76	13.10	12.43	.46	-.33	-.67
Home mortgages (FHLMC survey rate) [7]							
30-year fixed	8.14	7.21	7.11	7.00	-1.14	-.21	-.11
1-year adjustable	7.22	5.79	5.74	5.70	-1.52	-.09	-.04

Stock exchange index	Record high		2001			Change to Aug. 15 from selected dates (percent)		
	Level	Date	July 17	June 26	Aug. 15	Record high	2001 July 17	2001 June 26
Dow-Jones Industrial	11,723	1-14-00	10,606	10,472	10,346	-11.75	-2.46	-1.21
S&P 500 Composite	1,527	3-24-00	1,214	1,217	1,178	-22.88	-3.00	-3.18
Nasdaq (OTC)	5,049	3-10-00	2,067	2,065	1,919	-61.99	-7.18	-7.06
Russell 2000	606	3-9-00	491	491	479	-20.98	-2.37	-2.42
Wilshire 5000	14,752	3-24-00	11,261	11,254	10,911	-26.04	-3.11	-3.05

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

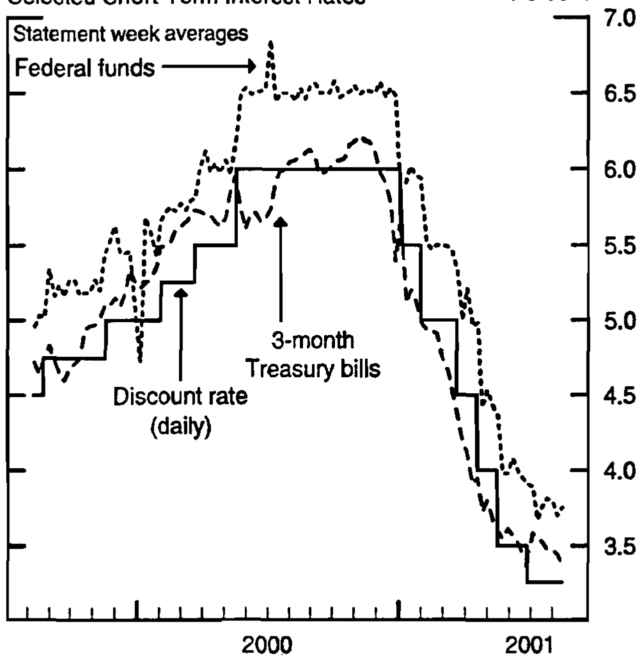
NOTES:

June 26, 2000 is the day before the FOMC meeting that ended the most recent period of policy tightening.
July 17, 2001 is the day before the most recent Monetary Policy Report Testimony(House).
June 26, 2001 is the day before the most recent FOMC action.

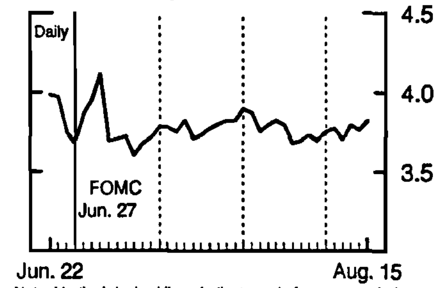
BA:DAM

Selected Interest Rates

Selected Short-Term Interest Rates

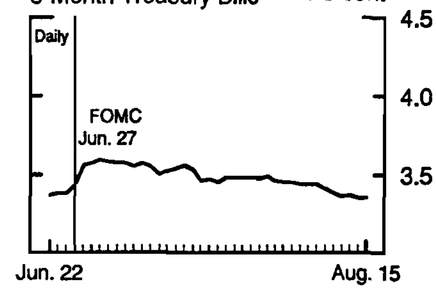


Federal Funds

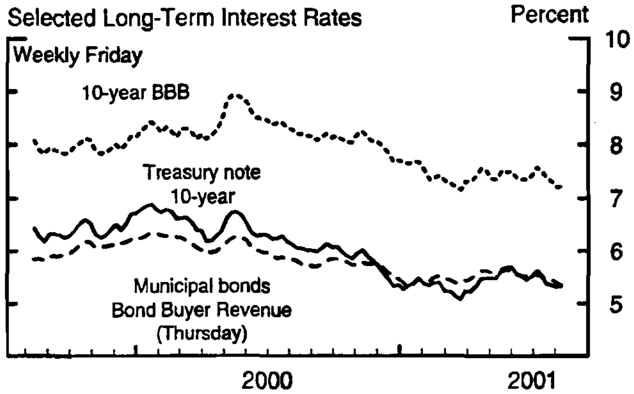


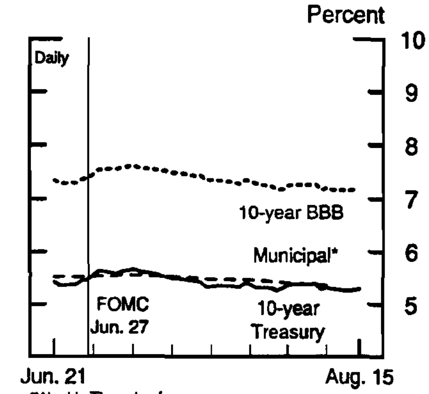
Note. Vertical dashed lines indicate end of reserve period.

3-Month Treasury Bills



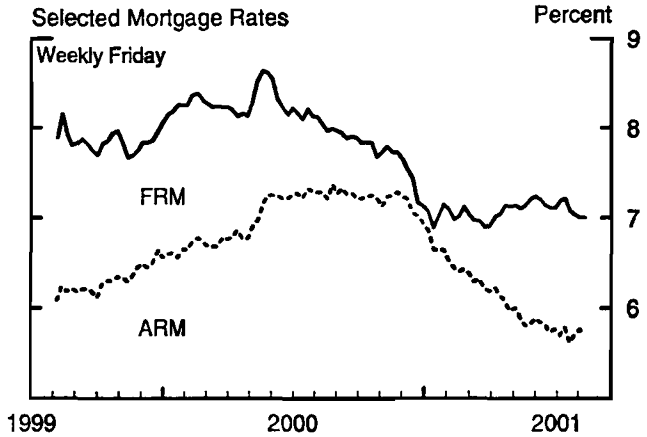
Selected Long-Term Interest Rates

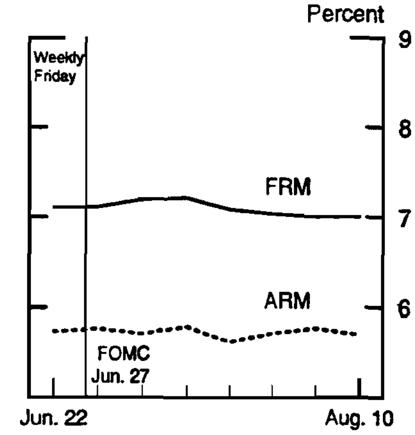




*Weekly Thursday frequency.

Selected Mortgage Rates





Domestic Financial Developments

Policy Expectations, Interest Rates, and Stock Prices
Market participants built in a higher path for the federal funds rate immediately following the June FOMC meeting, but then proceeded to move it lower. Futures quotes increased initially in response to the smaller-than-expected quarter-point easing and the release of the minutes from the May meeting that noted a growing concern among some Committee members about the risks of inflation. However, this increase was more than rolled back by the generally weak cast to news on the economy and the Chairman's monetary policy testimony in mid-July, which many viewed to be emphasizing downside risks to the economy.

On net, the expected path of the funds rate has shifted down about 10 basis points a few months out to as much as 50 basis points in 2002. Current futures market quotes suggest that investors are confident of a quarter-point easing at the August meeting and place some odds on a larger move. Moreover, the trough in the expected funds rate has been lowered and pushed out from the fourth quarter of this year to early next year, suggesting a more pessimistic assessment of the prospects that the recovery in economic growth will take hold in coming months.

Weak second-quarter corporate earnings and the sizable downward revisions to analysts' earnings projections for the second half of this year weighed on equity markets over the period. Broad stock market indexes were down about 3 percent, with technology shares pulling the Nasdaq down about 7 percent.

The less sanguine economic outlook spurred declines in Treasury coupon yields, with the fall most pronounced at shorter maturities. Investment-grade bond yields fell about in line with comparable Treasury yields, leaving risk spreads little changed on balance. Major speculative-grade bond indexes posted larger declines, but some of those declines are due to changes in the composition of the indexes.[1]

Business borrowing appears to have remained weak in July, as firms have greatly restrained spending programs in the current economic environment and lenders have remained cautious. In the most recent survey of bank lending practices, a substantial fraction of bank loan officers reported that they continued to tighten standards and terms on loans to businesses over the past three months though less than in previous surveys.

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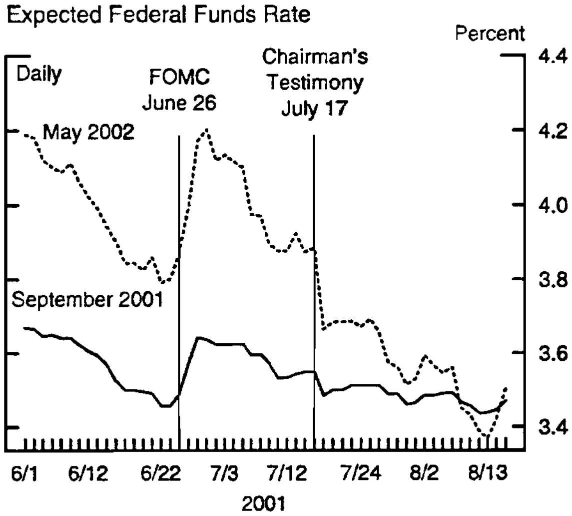
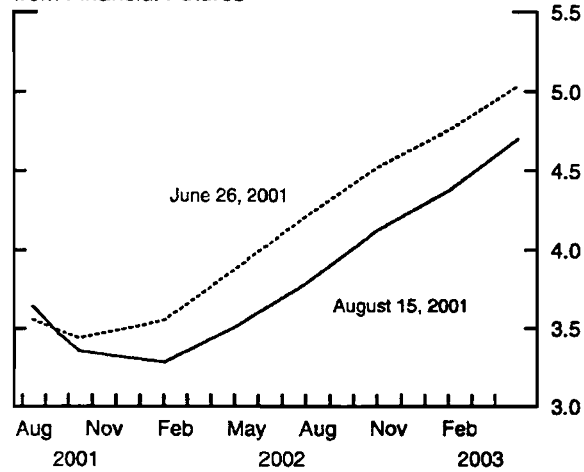
1. About 50 of the 67 basis point decline in the ML175 index is due to a change in the composition of bonds in the index. In particular, a number of newly issued bonds that carried lower risk premiums were added to the index.

Policy Expectations, Interest Rates, and Stock Prices

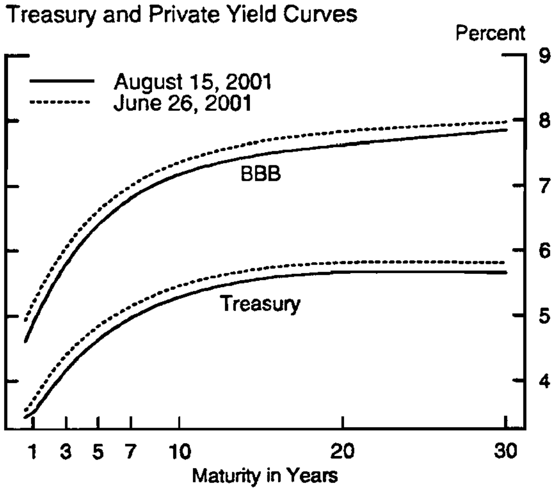
Expected Federal Funds Rate



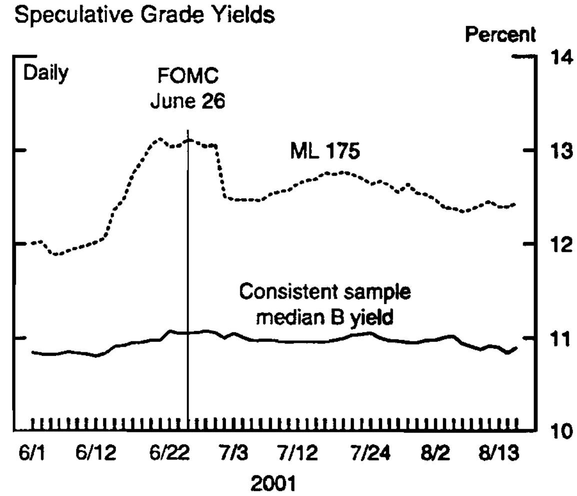
Expected Federal Funds Rate Estimated from Financial Futures



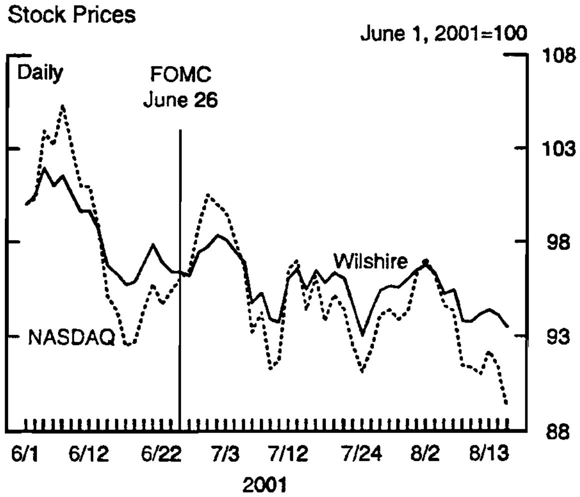
Treasury and Private Yield Curves



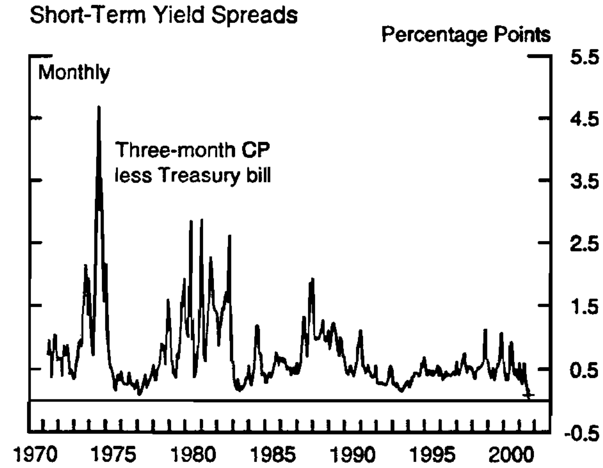
Speculative Grade Yields



Stock Prices



Short-Term Yield Spreads



+ Represents 8/15/2001

Both mortgage borrowing and consumer credit growth slowed in the second quarter. Although the household debt-service burden ticked down in the second quarter, it remains close to its mid-1980s peak, suggesting that households continue to feel payment strains.

Business Finance

Reports from the vast majority of S&P 500 firms indicate that second-quarter operating earnings per share fell about 21 percent from the year-earlier level, the largest decline in more than a decade.[2] However, the stock market remained fairly resilient in the face of the weak earnings reports, which appear to have been largely anticipated by market participants. While equity analysts continue to expect earnings to recover in the second half, they have revised down substantially the extent of the projected rebound. Looking further ahead, expectations for five-year earnings growth rates have also been marked down, most notably for technology firms.

With share prices languishing, funds raised in public equity markets by domestic nonfinancial firms—which had jumped in June—plummeted in July to the lowest monthly total so far this year. Issuance thus far in August has been minimal, and market sentiment toward new public issues by technology firms remains very cool. Moreover, venture capital financing fell further in the second quarter and is down about 60 percent from the level in the fourth quarter of last year.

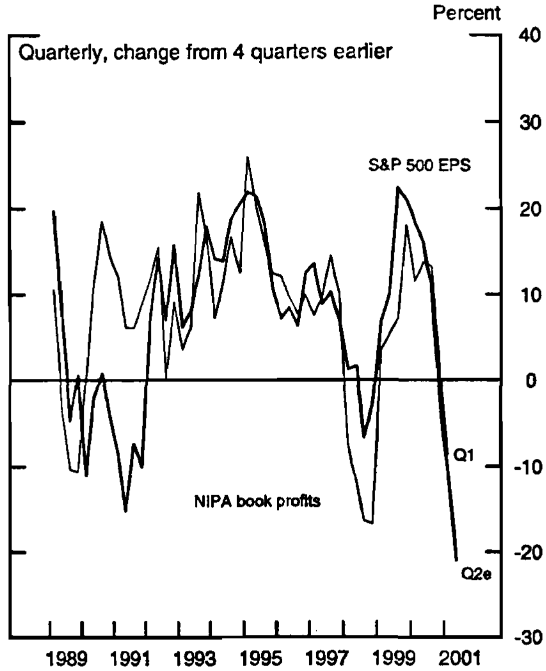
At the same time, equity retirements by domestic corporations have continued to moderate. Announcements of share repurchase programs fell in the second quarter to the slowest pace since 1994, and announcements continued to be few and far between in July, as firms apparently have been trying to conserve cash. Retirements from domestic cash-financed mergers fell in the second quarter to just over one-third of the rate recorded last year and slackened further in July. Merger announcements have also thinned.

The volume of borrowing by nonfinancial firms has dropped off appreciably over the past couple of months. This slowdown appears to reflect both weakness in capital expenditures and the reduced level of cash-financed merger activity. Bond issuance by nonfinancial corporations, which posted a record high of $67 billion in May, slowed to an average of $29 billion in June and July, only partly owing to a lessening in the pace of debt restructuring from earlier in the year when corporations took advantage of attractive rates to issue long-term debt and pay down bank loans and commercial paper. C&I loans declined

2. This figure for operating earnings excludes most one-time charges. The second quarter saw a significant number of large charges for restructuring and write-downs of goodwill that led to some outsized "top-line" losses.

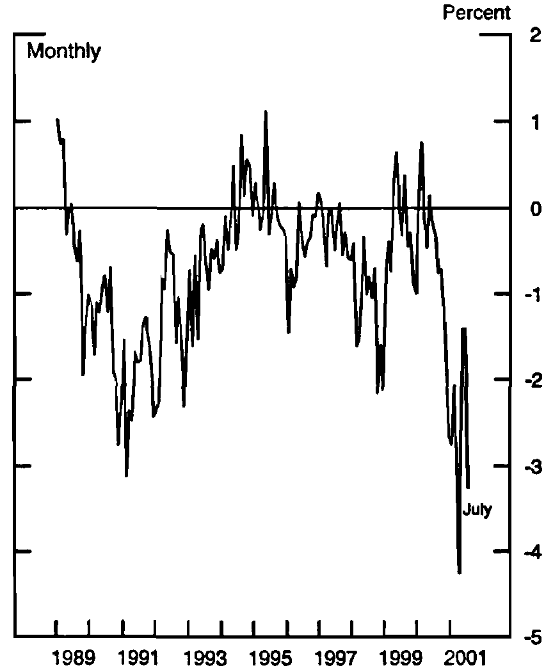
Earnings and Stock Valuations

After-Tax Corporate Earnings

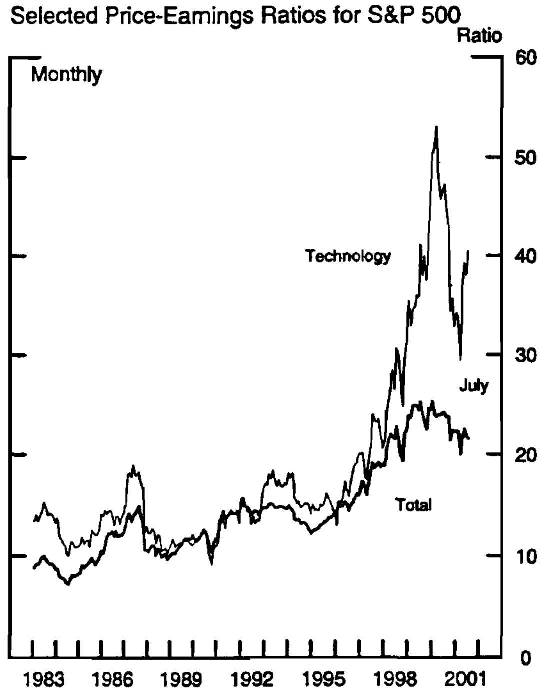


e Staff estimate.

Revisions to S&P 500 Year-ahead Earnings

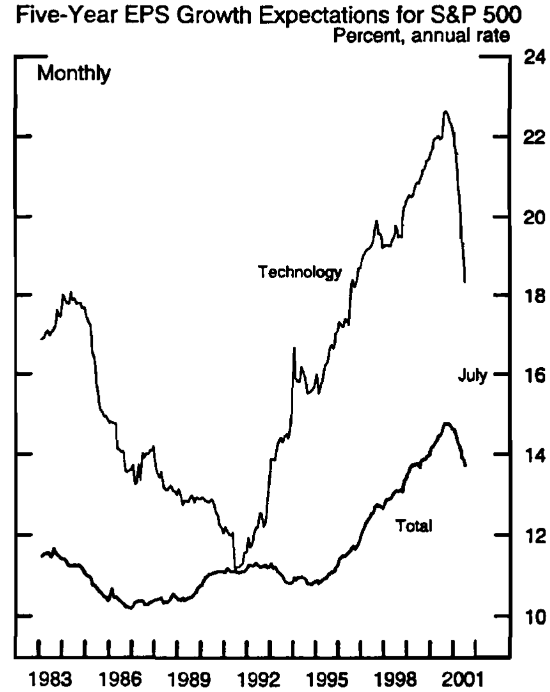


Selected Price-Earnings Ratios for S&P 500



Note. Using expected earnings for 12 months ahead.
Source. I/B/E/S.

Five-Year EPS Growth Expectations for S&P 500



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

Gross Issuance of Securities by U.S. Corporations

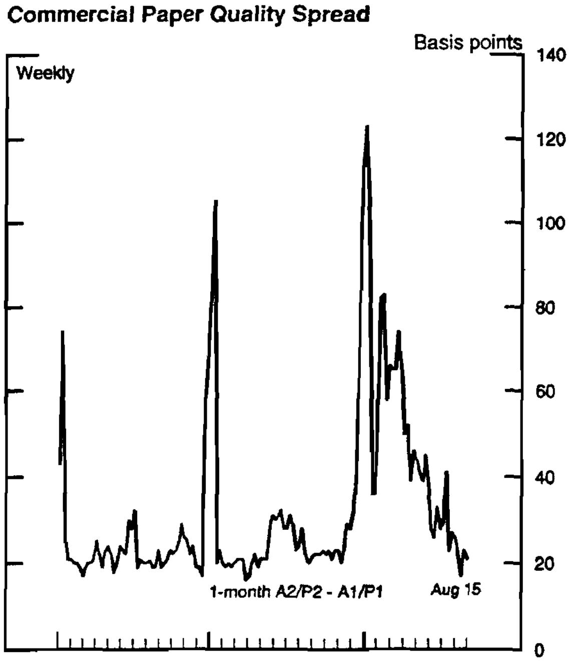
(Billions of dollars; monthly rates, not seasonally adjusted)

Type of security	1998	1999	2000		2001			
			H1	H2	Q1	Q2	June	July
All U.S. corporations	94.0	89.4	80.0	77.0	120.5	127.0	123.7	96.6
Stocks[1]	10.6	11.0	14.1	8.4	8.7	12.2	20.2	7.8
Bonds	83.5	78.4	65.9	68.6	111.7	114.8	103.5	88.8
Nonfinancial corporations								
Stocks[1]	6.2	9.2	12.4	7.3	5.5	9.4	16.6	3.9
Initial public offerings	2.2	4.2	5.7	3.1	1.7	4.7	9.8	2.3
Seasoned offerings	4.0	5.0	6.7	4.2	3.8	4.7	6.7	1.6
Bonds[2]	25.6	24.5	21.3	19.1	41.1	45.4	35.4	23.3
Investment grade[3]	14.1	13.9	11.5	12.4	28.5	29.5	19.7	14.1
Speculative grade[3]	10.2	7.5	5.4	3.7	10.2	13.4	13.1	4.0
Other (sold abroad/unrated)	1.3	3.1	4.4	3.1	2.4	2.4	2.6	5.2
Financial corporations								
Stocks[1]	4.4	1.8	1.6	1.1	3.2	2.8	3.7	3.9
Bonds	57.8	53.9	44.7	49.5	70.6	69.4	68.1	65.5
Memo								
Net issuance of commercial paper, nonfinancial corporations[4]	2.3	3.6	6.4	2.7	-17.3	-11.8	-23.1	-11.4
Change in C&I loans at commercial banks[4]	7.0	4.7	10.3	4.8	3.3	-9.4	-20.6	-2.9

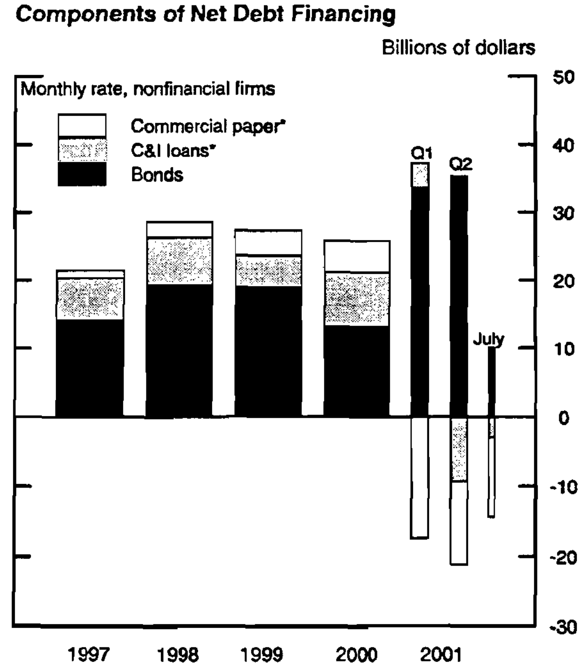
Note. Components may not sum to totals because of rounding. These data include speculative-grade bonds issued privately under Rule 144A. All other private placements are excluded. Total reflects gross proceeds rather than par value of original discount bonds.

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

Commercial Paper Quality Spread



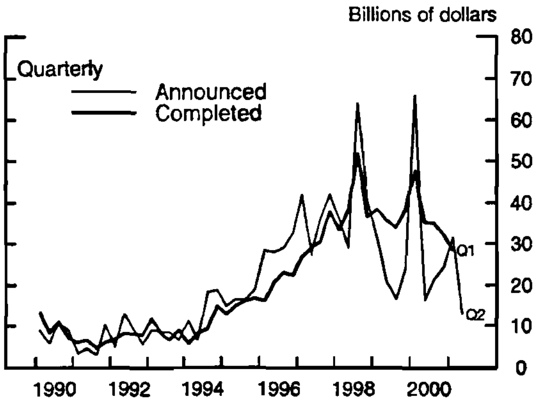
Components of Net Debt Financing



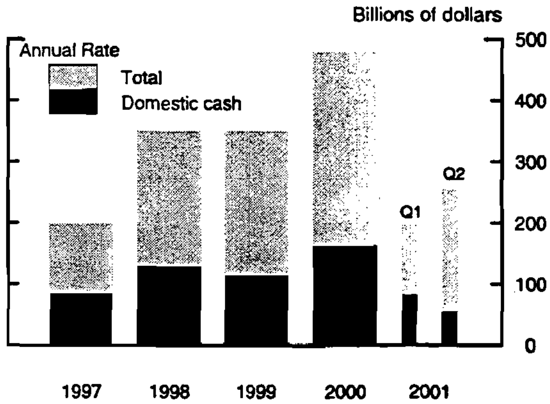
* Seasonally adjusted.

Corporate Finance Conditions

Share Repurchases

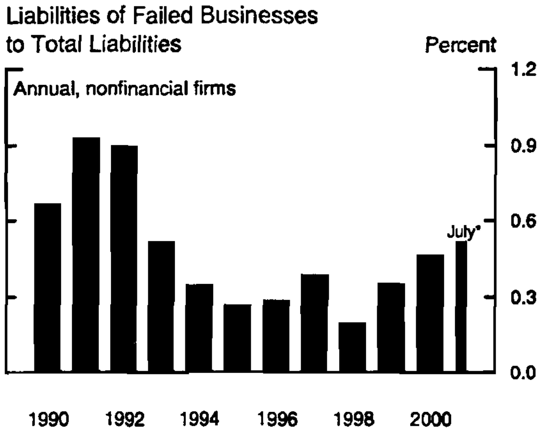


Merger Retirements from Domestic Takeovers



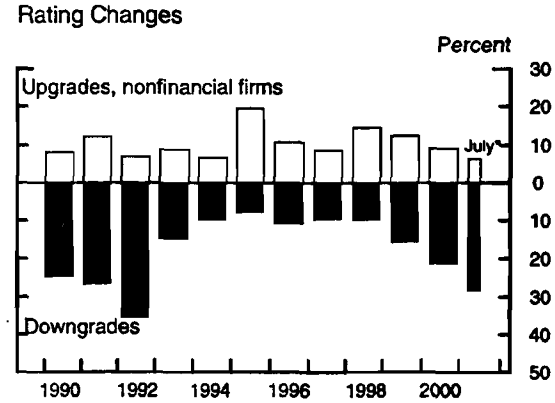
Source. Compustat & Securities Data Company.

Liabilities of Failed Businesses to Total Liabilities



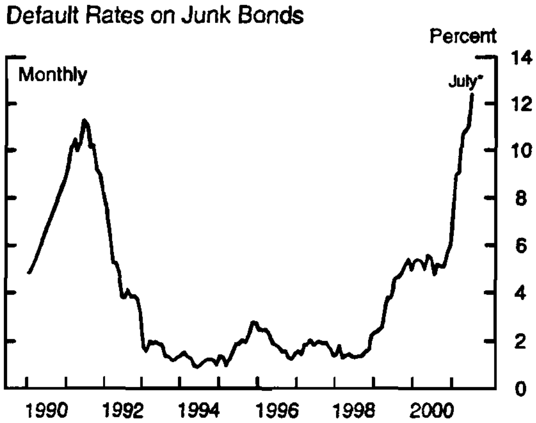
* 12-month trailing rate
Source. Dun & Bradstreet.

Rating Changes



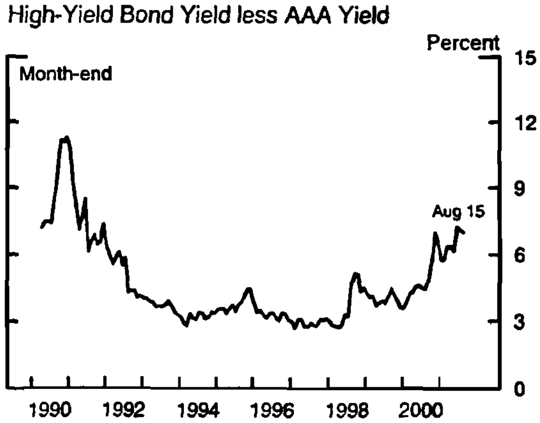
Note. Total debt upgrades (downgrades) as a percentage of par value of bonds outstanding.
*Year-to-date at an annual rate.
Source. Moody's.

Default Rates on Junk Bonds



*12-month trailing rate.
Source. Moody's.

High-Yield Bond Yield less AAA Yield



Source. Merrill Lynch.

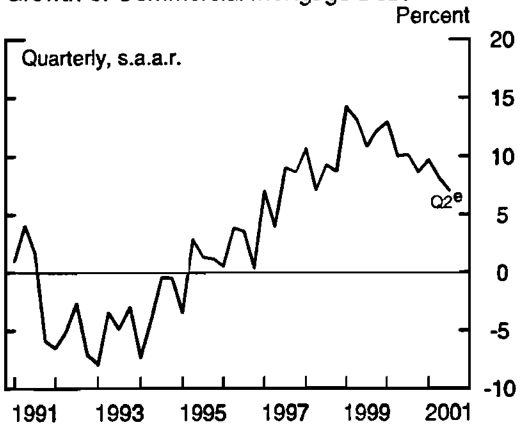
sharply in June and continued to contract at a somewhat slower pace in July. In this regard, about half of domestic banks in the August survey of lending practices reported weaker demand for C&I loans over the past three months. Domestic nonfinancial commercial paper outstanding continued to contract over both months, although the runoff slowed in July, and quality spreads have returned to a normal range, as a number of issuers that fell from favor have withdrawn from the market. Available data indicate that the major components of business borrowing, including bonds, bank loans, and commercial paper, continued to be weak in early August.

Incoming data suggest that corporate credit quality has continued to deteriorate, but probably at a slower rate than in prior months. Business failures slowed in June and July, albeit to a level that is still well above last year's pace. Debt downgrades continued to outpace upgrades in June and July, but by less than earlier in the year. Moody's downgraded, on net, an average of $20 billion per month in June and July, compared with an average net monthly downgrade of $57 billion over the first five months of the year. The default rate on junk bonds rose in July to over 12 percent and, based on recent forward-looking indicators, should remain near this elevated level in the year ahead. Junk bond spreads remain at a high level and are higher than predictions based on the historical relationship between spreads and expected default rates. Although bank loan officers surveyed in August continued to tighten terms and standards for business borrowers, the fraction that tightened fell relative to earlier in the year. Banks reporting tighter terms and standards cited a less favorable economic outlook as well as concern about rising defaults among below-investment-grade borrowers. Loan officers also noted a decidedly more stringent posture in their lending to firms in the high-tech sector.

Growth in commercial mortgage debt is estimated to have slowed to about a 7 percent pace in the second quarter. However, the market for commercial-mortgage-backed securities (CMBS) remains fairly strong, with relatively stable interest rate spreads and large volumes of issuance. At $17-1/4 billion, gross issuance in the second quarter was high relative to the past two or three years, and issuance for the third quarter to date is on track to match or surpass the second-quarter pace. On balance, available data indicate a modest deterioration in commercial real estate credit quality in the second quarter. While delinquency rates on commercial mortgages held by life insurance companies and those backing CMBS remained relatively low in the second quarter, office vacancy rates increased noticeably over the first half of 2001. Perhaps reflecting eroding prospects in this sector, more than 40 percent of domestic banks tightened standards on commercial real estate loans in the August loan officer survey, about the same as in the May survey.

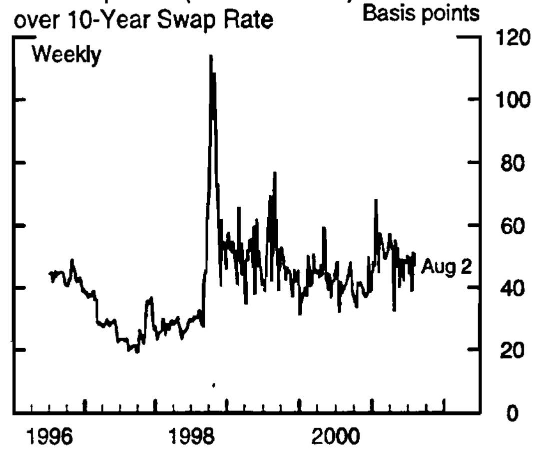
Commercial Real Estate

Growth of Commercial Mortgage Debt



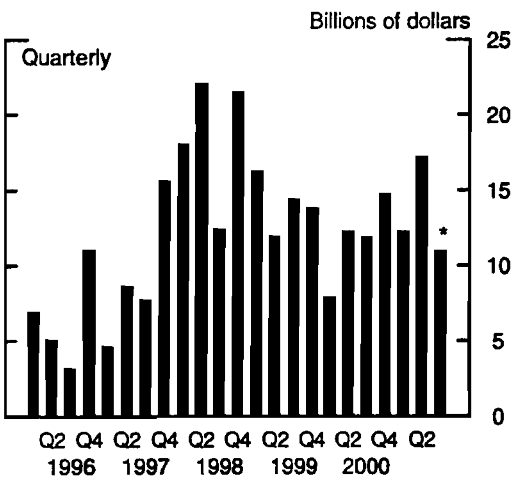
e. Staff estimate.

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



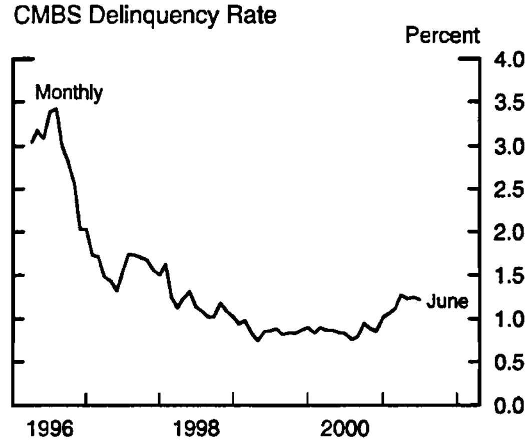
Source. Morgan Stanley.

Total CMBS Gross Issuance



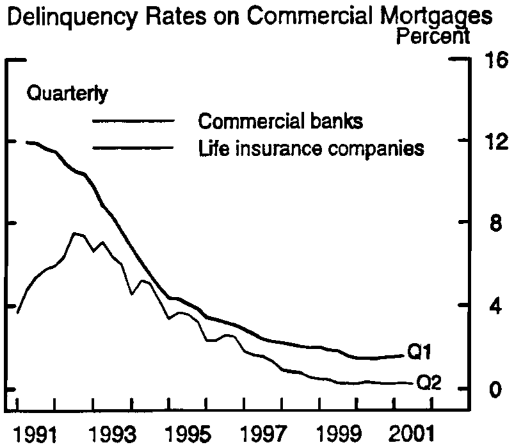
* Period to August 10, 2001.
Source. Commercial Mortgage Alert.

CMBS Delinquency Rate



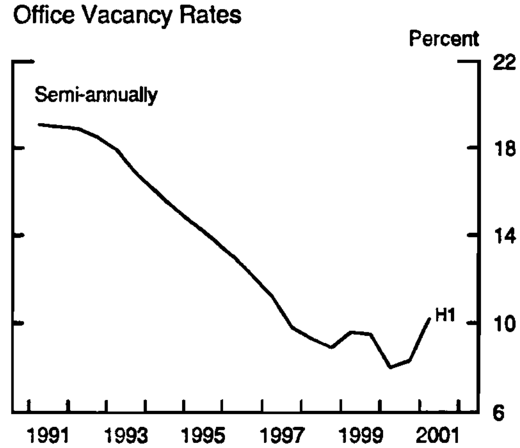
Source. Morgan Stanley.

Delinquency Rates on Commercial Mortgages



Source. ACLI, Call Report.

Office Vacancy Rates



Source. Torto Wheaton Research.

Household Finance

Rates on fixed-rate mortgages have edged down to just below 7 percent since the last FOMC meeting. Despite low mortgage rates and the tendency of homeowners to take some cash out when refinancing, mortgage debt growth in the second quarter looks to have been slower than in the first, as new residential construction cooled. Consumer credit growth also moderated in the second quarter, consistent with slower growth in household spending on durable goods. Survey evidence suggests that only a small percentage of domestic banks, on net, tightened terms or standards on household mortgage and consumer loans over the summer months. Total household debt is estimated to have increased at a 6 percent pace in the second quarter, down from nearly 8 percent recorded in the first quarter.

Slower household debt growth, combined with lower interest rates, contributed to a tick down in the debt-service burden in the second quarter.[3] Still, the debt-service burden remains relatively high, which appears to be taking its toll on household credit quality. The delinquency rate for credit cards in securitized pools reached a three-year high in June, while the delinquency rate for auto loans at captive finance companies edged up for the second month in a row.

The ratio of household assets to disposable income moved up slightly in the second quarter, owing mainly to higher stock market values. Households increased their net purchases of equity mutual funds in the second quarter, but net flows slackened toward the end of the quarter when the stock market turned down. Flows into equity mutual funds continued to weaken in July, while flows into domestic, investment-grade bond funds strengthened. The equity share of new contributions to 401(k) pension plans declined in June and July, and transfer activity waned, possibly reflecting investor uncertainty about the market.

Treasury Finance

The Treasury announced that it expects to borrow $51 billion in marketable debt in the third quarter, a sizable revision from the $57 billion paydown that it had expected as recently as the end of April. However, about a third of this increased borrowing merely reflects the shift of the corporate tax due date from September 15 to October 1, which will reduce fourth-quarter borrowing needs by an equal amount; the rest of the upward revision is attributable in roughly equal parts to the tax cut and to a shortfall in receipts relative to expectations.

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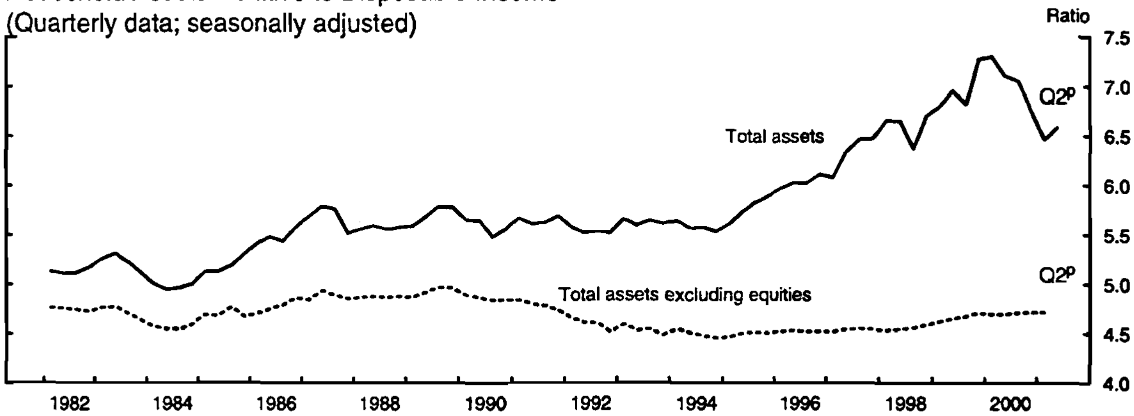
3. The upward revisions by BEA to disposable personal income pulled down the debt-service burden over the past three years, which now stands about 1/4 percentage point below its mid-1980s peak.

Household Assets

Household Assets Relative to Disposable Income
(Quarterly data; seasonally adjusted)



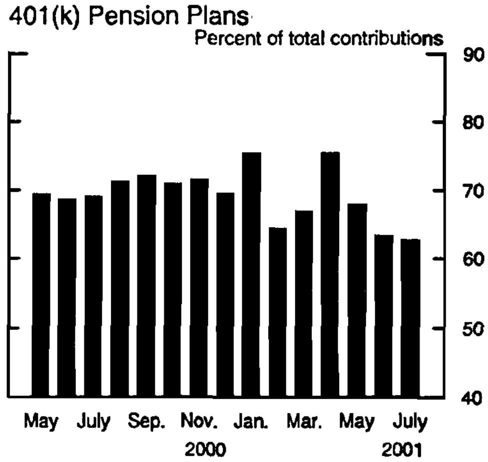
p. Staff projection.

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

	1999	2000	2001 Q1	2001 Q2	2001 June	2001 July[e]	Assets June
Total long-term funds	**14.2**	**18.4**	**9.6**	**20.8**	**14.7**	**11.7**	**4,888**
Equity funds	**15.7**	**25.1**	**0.5**	**16.0**	**10.6**	**-0.1**	**3,677**
Domestic	14.8	21.2	2.4	15.9	9.6	2.9	3,197
Capital appreciation	13.5	25.5	0.4	10.1	5.5	0.9	1,952
Total return	1.4	-4.3	1.9	5.8	4.0	2.0	1,245
International	0.9	3.9	-1.8	0.1	1.1	-3.0	480
Hybrid funds	**-1.0**	**-2.6**	**0.6**	**1.3**	**1.1**	**0.9**	**349**
Bond funds	**-0.5**	**-4.0**	**8.5**	**3.5**	**2.9**	**10.9**	**862**
International	-0.2	-0.2	0.1	-0.0	0.0	-0.1	20
High-yield	-0.2	-1.0	1.6	0.2	-1.6	1.0	95
Other taxable	1.0	-1.6	5.4	3.0	3.4	7.1	460
Municipals	-1.0	-1.2	1.4	0.4	1.2	2.9	287

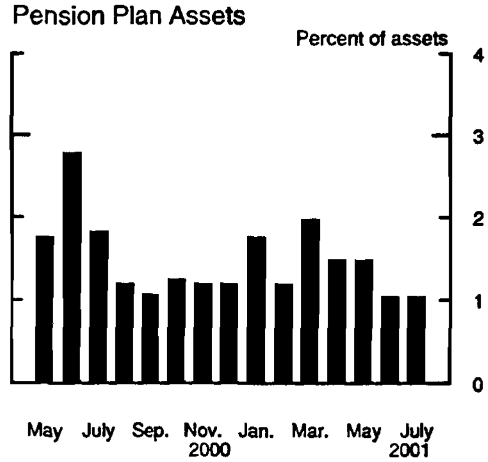
Source. Investment Company Institute (ICI).

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



Note. Includes equity mutual funds and company stock.
Source. Hewitt Associates.

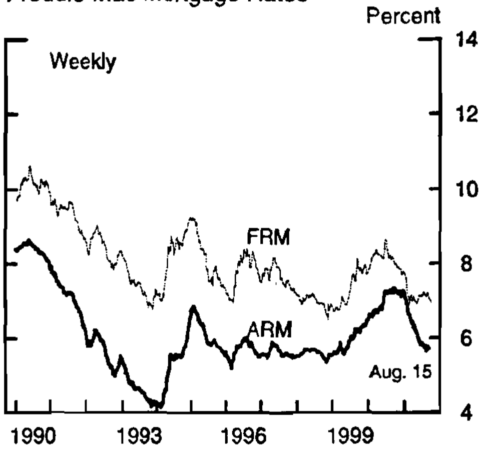
Transfers Among Existing 401(k) Pension Plan Assets



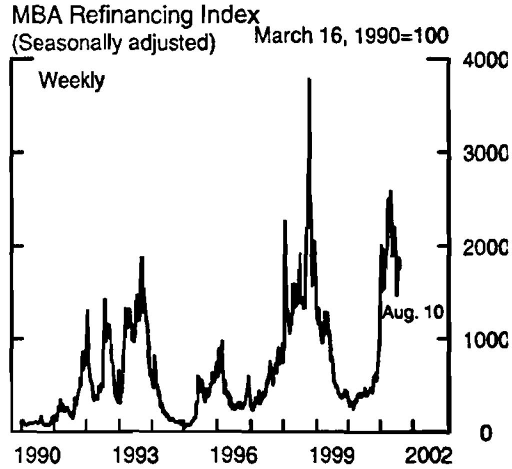
Note. Includes money market funds and GICs.
Source. Hewitt Associates.

Household Liabilities

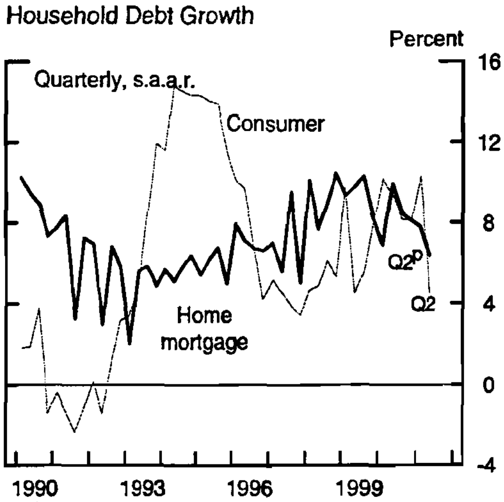
Freddie Mac Mortgage Rates



MBA Refinancing Index
(Seasonally adjusted)

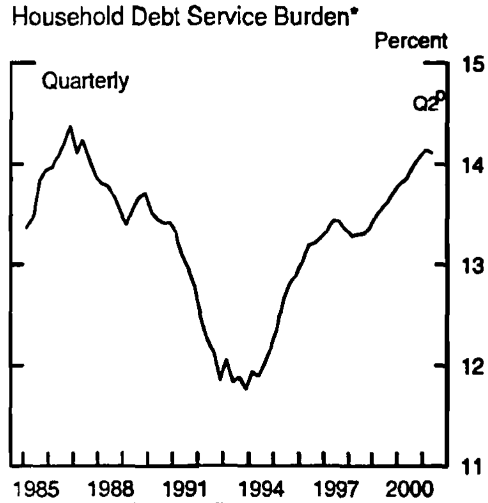


Household Debt Growth



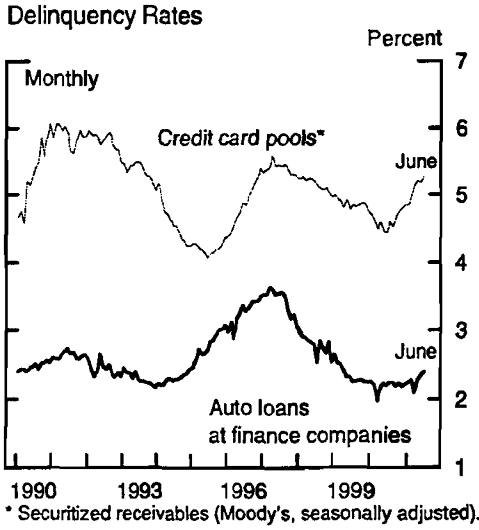
p. Staff projection.

Household Debt Service Burden*



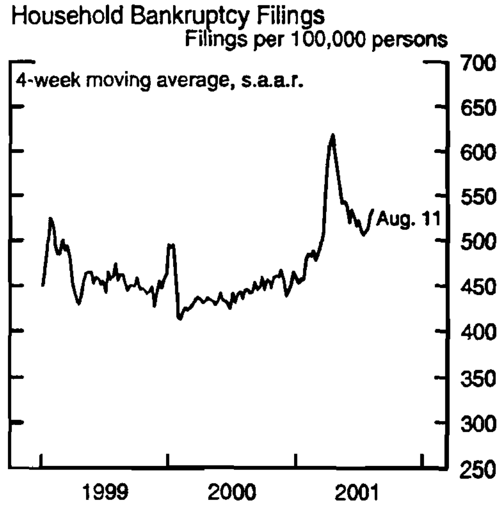
p. Staff projection. *Required debt payments relative to disposable personal income.

Delinquency Rates



* Securitized receivables (Moody's, seasonally adjusted).

Household Bankruptcy Filings



Treasury and Agency Finance

Treasury Financing
(Billions of dollars)

Item	2000	2001				
	Q4	Q1	Q2	May	June	July
Total surplus, deficit (-)	**-2.3**	**-22.5**	**193.7**	**-27.9**	**31.9**	**n.a.**
Means of financing deficit						
Net borrowing	-25.1	23.7	-157.4	-20.6	-1.2	-9.3
Nonmarketable	1.5	6.0	6.2	2.2	-1.0	-5.8
Marketable	-26.6	17.6	-163.6	-22.8	-.2	-3.5
Bills	30.4	65.0	-92.1	-.6	1.5	33.0
Coupons[1]	-48.2	-39.4	62.3	-19.7	0	-32.3
Debt buybacks	-8.7	-8.0	-9.2	-2.5	-1.7	-4.2
Decrease in cash balance	31.6	-7.2	-15.4	58.9	-37.4	20.3
Other[2]	-4.2	6.0	-20.9	-10.3	6.8	n.a.
MEMO						
Cash balance, end of period	21.1	28.3	43.7	6.3	43.7	23.1

NOTE. Components may not sum to totals because of rounding.
1. Does not include Treasury debt buybacks.
2. Direct loan financing, accrued items, checks issued less checks paid, and other transactions.
e. Estimated.
n.a. Not available.

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

Agency	2000	2001				
	Q4	Q1	Q2	May	June	July
FHLBs	13.8	8.4	n.a.	n.a.	n.a.	n.a.
Freddie Mac	20.0	34.4	35.4	12.0	6.3	n.a.
Fannie Mae	35.7	23.9	35.7	11.1	8.7	n.a.
Farm Credit Banks	3.1	0	2.2	.9	1.0	n.a.
Sallie Mae	3.0	1.9	.4	-.2	-.6	n.a.
MEMO						
Outstanding noncallable Reference and Benchmark Securities						
Notes and Bonds	313.1	351.2	384.1	377.1	384.1	393.3
Bills	235.0	270.0	278.0	284.5	278.0	292.0
Total	548.1	621.2	662.1	661.6	662.1	685.3

NOTE. Excludes mortgage pass-through securities issued by Fannie Mae and Freddie Mac.
n.a. Not available

The Treasury has begun to conduct weekly auctions of four-week bills, which are intended to help it better manage fluctuations in its cash balances and reduce its reliance on cash management bills. With the introduction of the four-week bill, weekly offerings of all bills reached nearly $40 billion—well above their historical range. The heavy supply, along with the prospect that issuance will remain elevated because of smaller surpluses, has apparently weighed on bill prices. Yield spreads on both three-month commercial paper and eurodollar deposits over the three-month Treasury bill have reached unusually low levels.

Agency and GSE Finance

Over the intermeeting period, Fannie Mae and Freddie Mac continued to issue sizable volumes of benchmark securities and to conduct limited buybacks of benchmark securities as a means of tailoring their liabilities to the duration of their asset portfolios. Yields on GSE benchmark notes and bonds, as well as comparable swap rates, fell by about the same amount as Treasury yields over the intermeeting period. At shorter maturities, the GSEs' bill programs did not seem to suffer much from the additional supplies associated with the Treasury's new four-week bill program.

State and Local Government Finance

Issuance of long-term tax-exempt securities totaled about $29 billion in June, including just over $9 billion of securities to refund outstanding debt. However, gross issuance of long-term bonds dropped in July, pulled down by a sharp decline in refunding activity. The pace of refundings has likely cooled because many governments have already taken advantage of the decline in long-term yields since the second half of last year.

The situation in California has improved of late, as energy prices edged down in early summer and remain lower than originally projected. California has been taken off watch lists by S&P and Moody's and is moving forward with its plan to issue a $12-1/2 billion bond later this year.

Money and Bank Credit

Growth of M2 slowed somewhat in July to an 8-1/2 percent pace after expanding at a 10-1/2 percent rate in the first half of the year. Liquid deposits and retail money funds continued to expand briskly while small time deposits ran off, reflecting the typical responses to declines in short-term interest rates. In addition, M2 may have been bolstered by increased foreign demand for U.S. currency as well as households' more cautious attitude toward investing in the stock market. The staff estimates that tax rebates, proceeding at $3-1/2 billion per week since the latter part of July, did not have much effect on M2 growth in July, but they are expected to add 2 to 4 percentage points to M2 growth in August and September.

State and Local Government Finance

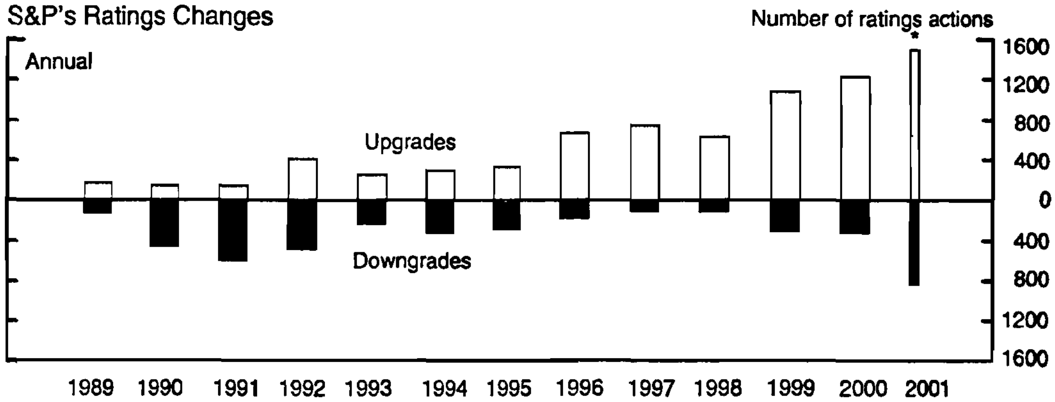
Gross Offerings of Municipal Securities

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

	1999	2000	2001 Q1	2001 Q2	2001 May	2001 June	2001 July
Long-term[1]	18.0	15.0	18.5	24.2	26.2	29.3	19.2
Refundings[2]	4.5	2.2	6.0	6.7	6.2	9.3	4.2
New capital	13.5	12.9	12.5	17.4	20.0	20.0	15.0
Short-term	2.7	2.8	2.6	4.7	2.0	10.6	2.4
Total tax-exempt	20.6	17.9	21.2	28.9	28.3	39.9	21.6
Total taxable	1.1	0.7	1.0	1.4	1.6	2.2	1.0

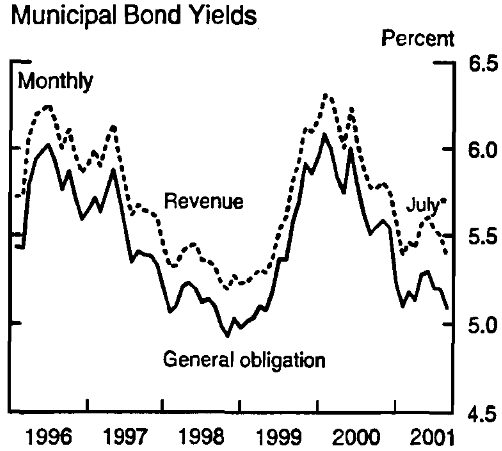
1. Includes issues for public and private purposes.
2. All issues that include any refunding bonds.
e. Staff estimate.

S&P's Ratings Changes



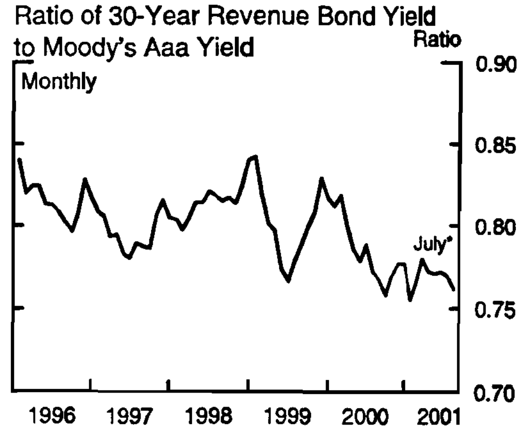
Source. S&P's Credit Week Municipal.
* Data through Aug. 9 at an annual rate.

Municipal Bond Yields



Note. Average of weekly data.
* Data through Aug. 9.

Ratio of 30-Year Revenue Bond Yield to Moody's Aaa Yield



Note. Average of weekly data.
* Data through Aug. 9.

Monetary Aggregates
(Based on seasonally adjusted data)

Aggregate or component	2000	2001 Q1	2001 Q2	2001 May	2001 June	2001 July (p)	Level (bil. $) Jul. 01 (p)
	Percent change (annual rate) [1]						
Aggregate							
1. M2[2]	6.2	10.7	10.2	5.2	9.6	8.5	5245.9
2. M3	9.3	12.6	14.1	14.0	13.1	6.8	7649.7
Selected components							
3. Currency	4.2	7.1	6.3	7.7	5.3	12.5	554.2
4. Liquid deposits[3]	3.2	12.1	17.2	14.7	17.4	14.6	2660.7
5. Small time deposits	9.5	3.8	-5.3	-3.7	-10.1	-14.8	1016.1
6. Retail money market funds	12.2	16.9	11.2	-11.8	12.1	14.0	1006.3
7. M3 minus M2[4]	17.1	16.9	23.0	33.7	20.7	3.1	2403.7
8. Large time deposits, net[5]	13.6	0.4	-1.2	11.2	3.4	-5.0	812.2
9. Institution-only money market mutual funds	23.9	49.8	54.8	67.2	44.1	8.1	1013.4
10. RPs	11.9	-7.2	21.1	10.2	4.4	-11.6	379.1
11. Eurodollars	17.9	3.1	-10.6	13.3	8.8	41.1	199.1
Memo							
12. M1	-1.7	5.1	5.5	-0.6	6.4	13.4	1136.0
13. Sweep-adjusted M1[6]	1.6	5.6	6.6	0.9	6.3	11.8	1566.4
14. Demand deposits	-10.9	-0.5	-3.8	-1.9	-6.1	9.7	313.3
15. Other checkable deposits	-0.8	8.4	16.2	-17.4	23.4	18.3	259.9
16. Savings deposits	6.7	14.7	20.7	21.4	20.3	14.8	2087.5
17. Monetary base	1.4	6.4	5.4	6.3	5.6	11.6	607.7
	Average monthly change (billions of dollars)[7]						
Selected managed liabilities at commercial banks							
18. Large time deposits, gross	8.7	7.3	1.2	4.7	3.4	-6.6	957.6
19. Net due to related foreign institutions	1.3	-5.4	-10.2	16.8	-22.5	7.3	192.0
20. U.S. government deposits at commercial banks	-1.4	1.1	-2.4	-2.7	-2.6	2.3	15.0

1. For the years shown, Q4 to Q4 precent change. For the quarters shown, based on quarterly averages.
2. Sum of M1, retail money market funds, saving deposits, and small time deposits.
3. Sum of demand deposits, other checkable deposits, and saving deposits.
4. Sum of large time deposits, institutional money funds, RP liabilities of depository institutions, and Eurodollars held by U.S. addressees.
5. Net of holdings of depository institutions, money market mutual funds, U.S. government and foreign banks and official institutions.
6. Sweep figures used to adjust these series are the estimated national total of transaction account balances initially swept into MMDAs owing to the introduction of new sweep programs on the basis of monthly averages of daily data.
7. For the years shown, "average monthly change" is the Q4 to Q4 dollar change divided by 12. For the quarters shown, it is the quarter-to-quarter dollar change, divided by 3.

p--Preliminary

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

Type of credit	2000	Q1 2001	Q2 2001	May 2001	June 2001	July 2001	Level, July 2001 ($ billions)
Total							
1. Adjusted[1]	**9.2**	**7.3**	**2.8**	**1.8**	**-2.7**	**1.6**	**5,182**
2. Reported	9.8	8.6	3.0	1.4	-1.4	-.8	5,312
Securities							
3. Adjusted[1]	1.8	3.9	5.1	7.7	3.2	16.0	1,254
4. Reported	4.3	9.4	5.6	5.8	7.9	5.1	1,384
5. Treasury & Agency	-2.4	-8.5	-4.0	4.1	-2.7	11.3	772
6. Other[2]	16.2	35.9	18.5	8.0	21.3	-2.5	613
Loans[3]							
7. Total	11.8	8.4	2.1	-.1	-4.6	-2.9	3,928
8. Business	9.0	6.9	-4.2	-3.3	-18.5	-11.0	1,069
9. Real estate	13.9	5.6	6.1	7.3	1.7	4.0	1,707
10. Home equity	26.2	23.0	13.1	11.4	9.5	13.8	141
11. Other	13.0	4.1	5.4	7.0	.9	3.2	1,565
12. Consumer	10.8	7.3	3.7	7.9	-4.8	-6.1	549
13. Adjusted[4]	7.9	9.3	5.5	5.6	1.9	.3	878
14. Other[5]	11.8	19.9	1.5	-21.6	3.6	-5.1	603

Note. All data are adjusted for breaks caused by reclassifications. Monthly levels are pro rata averages of weekly (Wednesday) levels. Quarterly levels (not shown) are simple averages of monthly levels. Annual levels (not shown) are levels for the fourth quarter. Growth rates are percentage changes in consecutive levels, annualized but not compounded. These data have been benchmarked to the December 1999 Call Report.

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

Bank credit edged up in July after a decline in June, as growth in securities more than offset the continued falloff in loans. Business loans, which have been declining since March, fell sharply in June and July. The growth of consumer loans and residential real estate loans in June and July was well below the pace in the first half of the year.

Appendix

Senior Loan Officer Opinion Survey on Bank Lending Practices

The August 2001 Senior Loan Officer Opinion Survey on Bank Lending Practices focused on changes in the supply of, and demand for, bank loans to businesses and households over the past three months. The survey included supplementary questions on the exposure of banks to firms in the high-technology sector and the degree to which credit standards and loan terms were tightened in that sector over the past year. Loan officers from fifty-seven large domestic banks and nineteen U.S. branches and agencies of foreign banks participated in the survey.

Although the number of domestic and foreign banking institutions that reported tightening standards and terms on commercial and industrial (C&I) loans over the past three months remained elevated, it was lower than earlier in the year. A significant fraction of domestic institutions also tightened standards for commercial real estate loans in the August survey. In general, banks that tightened standards and terms on C&I loans indicated that the most important reasons for tightening were a less favorable or more uncertain economic outlook and a worsening of industry-specific problems. Almost half of domestic banks, on net, reported weaker demand for C&I loans over the past three months, about the same proportion as in the May survey. A somewhat larger net fraction than in May reported that demand for commercial real estate loans had waned.

Domestic banks reported that only about 6 percent of C&I loans on their books were made to high-technology companies, indicating that their exposure to these firms is quite limited. By contrast, branches and agencies of foreign banks reported that loans to high-technology companies accounted for about 13 percent of their C&I loan portfolio. Domestic as well as foreign respondents noted that their tightening of credit standards and loan terms over the past year for tech firms was greater than that for similarly rated firms in other sectors (see the section below on lending to the high-tech sector for the definition of the sector used by the survey).

Compared with the January and May surveys, smaller net fractions of domestic banks tightened standards and increased spreads over their cost of funds for all types of consumer loans over the past three months. According to the domestic respondents, demand for consumer loans was about unchanged in August. Nearly all domestic banks kept their standards for residential mortgage loans unchanged over the past three months. About one-fourth of the respondents, on net, noted that demand for residential mortgages had strengthened during the survey period, down from almost one-half in the May survey.

Lending to Businesses

Although banks again reported that they tightened standards on C&I loans over the past three months, the fractions of domestic and foreign respondents that reported doing so retreated for the second consecutive survey. The percentage of domestic banks that reported tightening their standards on loans to large and middle-market firms—which peaked at 60 percent in the January survey and decreased to about 50 percent in the May survey—fell to 40 percent in August. Lending standards on business loans to small firms followed a similar pattern: 32 percent of domestic banks reported tightening standards over the past three months, down from 36 percent in May and 45 percent in January. The fraction of U.S. branches and agencies of foreign banks that reported tightening standards for customers seeking C&I loans fell from two-thirds in May to one-half in the August survey.

In the August survey, the net fractions of domestic banks that reported tightening each of the loan terms listed in the survey were similar to the net fractions in May. More than half of the domestic respondents reported charging higher premiums on riskier loans to large and middle-market firms; as has been the case for several surveys, no bank reported lowering these premiums. More than half of the domestic banks, on net, indicated that they had increased spreads of loan rates over their cost of funds for large and middle-market firms over the past three months. Almost half, on net, also increased fees on credit lines for these borrowers. Somewhat smaller net fractions of domestic respondents tightened terms on C&I loans to small firms.

More than 60 percent of the U.S. branches and agencies of foreign banks reported charging higher premiums on riskier loans, and nearly the same fraction increased the fees associated with credit lines. More than half of the foreign institutions also noted that they had increased spreads and tightened loan covenants over the past three months.

Most of the domestic and foreign respondents that had tightened standards or terms on C&I loans over the previous three months continued to cite a less favorable or more uncertain economic outlook, a worsening of industry-specific problems, and a reduced tolerance for risk as the most important reasons for changing their lending policies. In responses that were consistent with the elevated default rate on junk bonds, 52 percent of domestic banks and 87 percent of foreign institutions that had tightened commercial lending policies also mentioned an increase in defaults by below-investment-grade borrowers as a contributing reason.

More than one-half of the domestic banks, on net, reported weaker demand for C&I loans from large and middle-market firms, up from 40 percent in May, and more than one-third, on net, reported decreased demand from small firms. Most of the domestic banks that reported weaker loan demand cited reduced customer needs to finance capital expenditures and mergers and acquisitions. About two-thirds of domestic banks also mentioned lower demand for inventory financing, a result that is consistent with the ongoing inventory correction. On net, 21 percent of foreign branches and agencies saw weaker loan demand over the past three months, compared with 10 percent, on net, in the May survey.

More than 40 percent of domestic banks tightened standards on commercial real estate loans over the past three months, about the same as in the May survey. One-fifth of foreign institutions that engage in commercial real estate lending also tightened standards in the current survey. On net, 32 percent of domestic and 10 percent of foreign institutions reported lower demand for commercial real estate loans over the past three months.

Lending to the High-Technology Sector

The current survey also included a series of special questions that addressed lending to high-technology firms over the past year. The survey defined the high-technology (or "tech") sector as consisting of the following five high-technology industries: (1) telecommunications service providers, (2) telecommunications equipment manufacturers, (3) internet commerce, (4) semiconductor manufacturers, and (5) computer hardware, software, and other high-tech industries.

Less than 6 percent, on average, of the volume of C&I loans on the books of domestic banks that responded to the questions was made to the firms in the high-technology sector; thus banks' exposures to this troubled sector appear to be limited.[1] More than one-third of these technology loans were made to telecommunications service providers, with the second highest area of concentration in the computer hardware, software, and other high-tech sectors group. Foreign institutions reported that about 13 percent of their outstanding C&I loans were accounted for by technology companies, of which telecommunications service providers represented about 40 percent.

Domestic and foreign institutions tightened credit standards for C&I loans to technology companies more aggressively than for loans outside the high-tech sector over the past year. The constriction of credit supply conditions was particularly severe for below-investment-grade high-tech firms: 25 percent of domestic banks reported that they had tightened standards somewhat more and 44 percent indicated that they had tightened standards considerably more for C&I loans to lower-rated tech borrowers relative to their non-tech counterparts. For foreign respondents, those fractions were 24 percent and 71 percent, respectively.

In addition, domestic and foreign banks reportedly tightened terms on loans to high-technology companies more aggressively than they had on loans to non-tech firms over the past year. About 50 percent of domestic banks indicated that they had increased price-related terms (such as fees and spreads) for investment-grade technology companies by more than they had for investment-grade non-tech firms. A greater number of domestic respondents, 72 percent, reported that they had toughened these terms for below-investment-grade tech firms relative to similarly rated firms in other sectors, a result consistent with the already elevated level of spreads and fees for below-investment-grade technology firms as of one year ago. This pattern of relative tightening was similar for non-price-related terms (such as loan covenants) at domestic banks and for both types of terms at branches and agencies of foreign banks.

Lending to Households

Over the past three months, domestic banks' credit standards for approving residential mortgage loans were largely unchanged. About one-fourth of the respondents, on net, reported that demand for residential mortgages increased over the past three months.

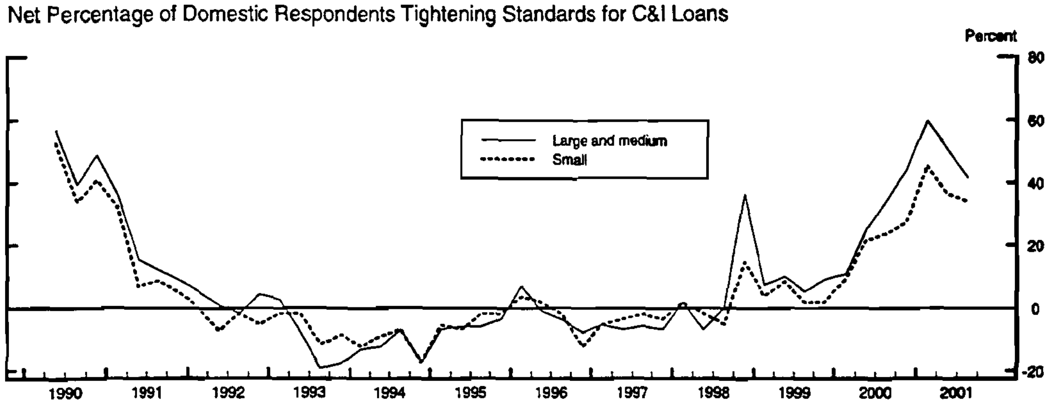
About 10 percent of domestic banks, on net, reported that they had tightened standards on credit card and other consumer loans over the survey period, down from 20 percent and 18 percent, respectively, in May. In addition, more than 10 percent of respondents increased the minimum required credit score for both categories of consumer loans. For consumer loans other than credit cards, 14 percent of domestic institutions, on net,

1. Two prominent large banks and one smaller bank declined to answer the question.

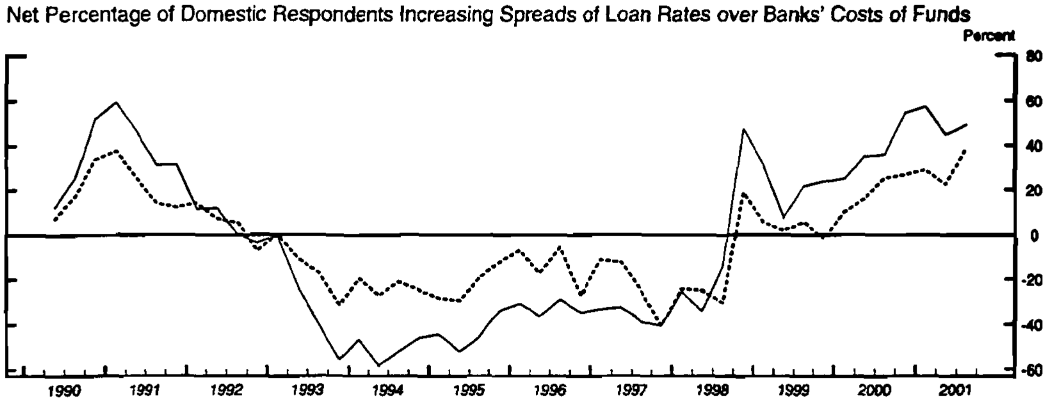
increased spreads over their cost of funds, down from about one-fourth in the previous survey, but only a few banks increased spreads on credit card loans in August. On net, 5 percent of banks reported stronger demand for consumer loans over the past three months.

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

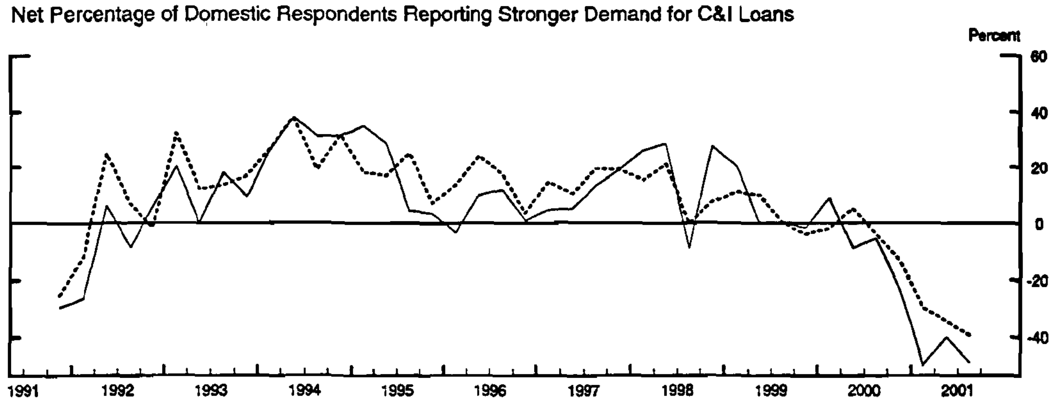
Net Percentage of Domestic Respondents Tightening Standards for C&I Loans



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

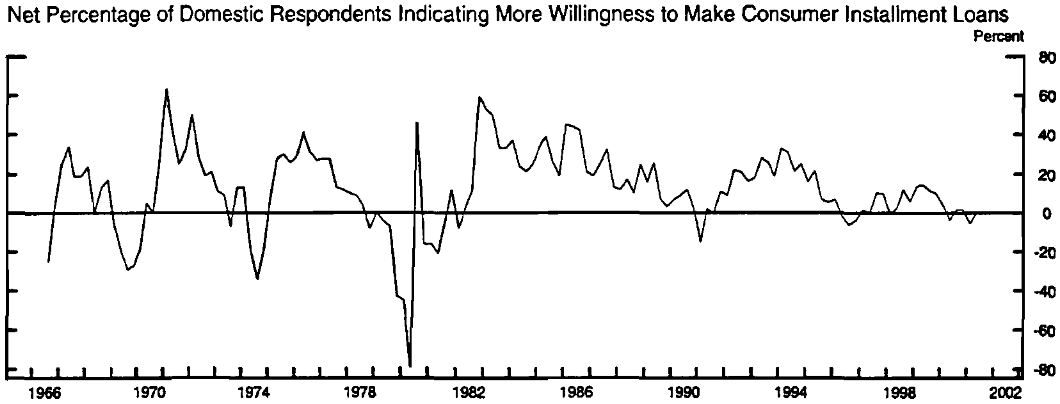


Net Percentage of Domestic Respondents Reporting Stronger Demand for C&I Loans

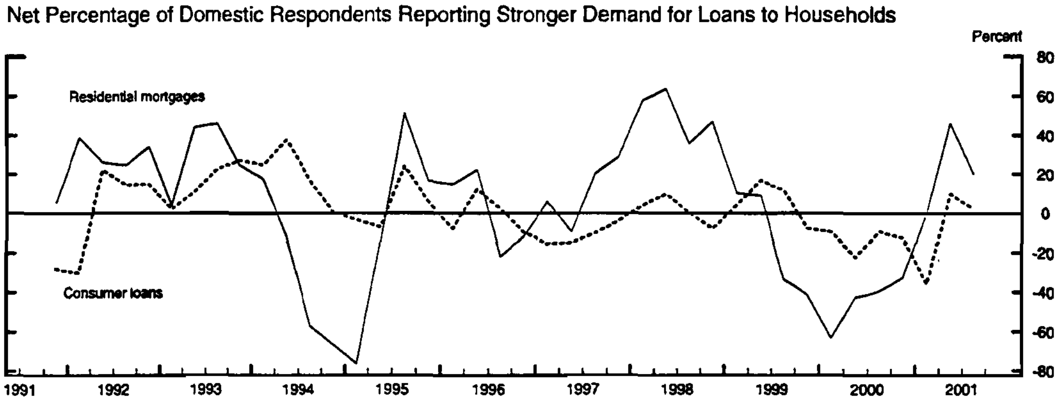


Measures of Supply and Demand for Loans to Households

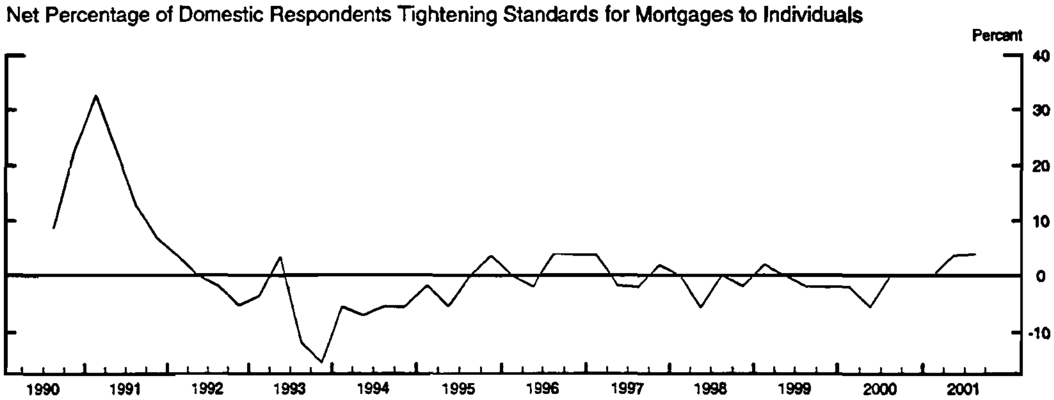
Net Percentage of Domestic Respondents Indicating More Willingness to Make Consumer Installment Loans



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



Net Percentage of Domestic Respondents Tightening Standards for Mortgages to Individuals



International Developments

International Developments

U.S. International Transactions

Trade in Goods and Services

The U.S. trade deficit in goods and services narrowed to $28.3 billion in May from $32.0 billion in April (revised). For April and May combined, the trade deficit was $362 billion at an annual rate, $18 billion smaller than in the first quarter.

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

	2000	Annual rate 2000 Q4	2001 Q1	2001 Q2e	Monthly rate 2001 Mar.	Apr.	May
Real NIPA[1]							
Net exports of G&S	-399.1	-421.1	-404.5	-407.4	...	...	...
Nominal BOP							
Net exports of G&S	-375.7	-401.2	-380.1	-362.0	-33.1	-32.0	-28.3
Goods, net	-452.2	-474.1	-450.1	-432.3	-38.8	-37.7	-34.4
Services, net	76.5	72.9	70.0	70.4	5.7	5.7	6.1

1. Billions of chained (1996) dollars.
e. BOP data are two months at an annual rate.
Source: U.S. Department of Commerce, Bureaus of Economic Analysis and Census.
n.a. Not available. ... Not applicable.

The value of exports increased about 1 percent in May, following sharp declines in both March and April. For April and May combined, the value of exports fell 11 percent at an annual rate from the first quarter level, following a smaller decrease in the first quarter. Almost all of the April-May decline was in exported capital goods (mainly computers, semiconductors, and other machinery) and industrial supplies. There were small increases in exports of automotive products to Canada and consumer goods.

The value of imports plummeted 2.4 percent in May, following a similarly sized decline in April. All major categories of imports fell, excluding oil, which was about unchanged. For April and May combined, the value of imports fell 13 percent at an annual rate from the first quarter level, roughly double the rate of decrease in the first quarter. While much of the decline was in computers, semiconductors, and other machinery, imports in nearly all other major trade categories decreased as well. Imports of automotive products, however, moved up somewhat, primarily from Canada and Mexico in response rising U.S. vehicle sales.

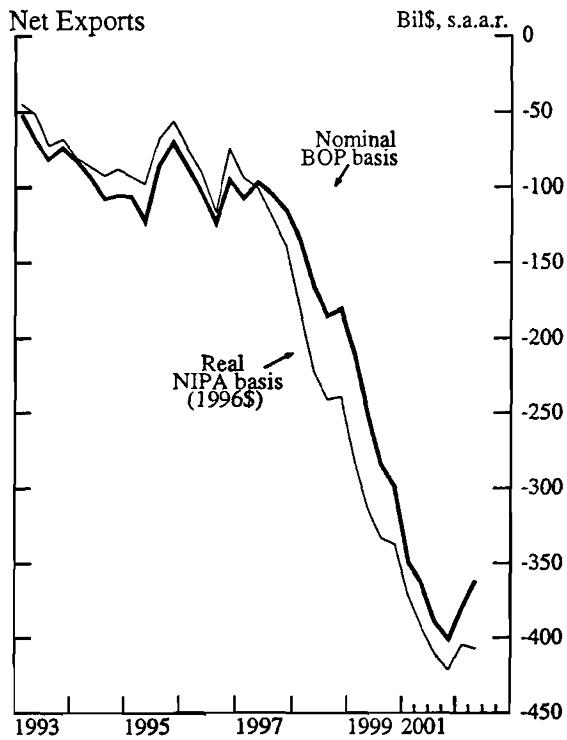
Data for U.S. trade in June will be released on August 17 and will be reported in the Greenbook supplement.

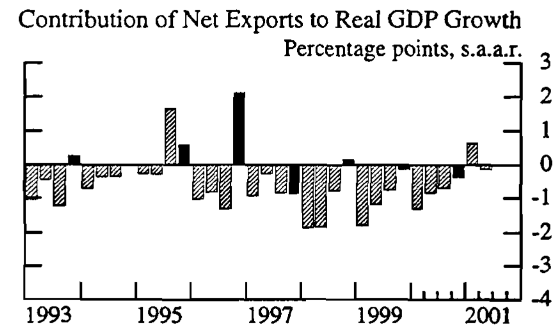
U.S. Exports and Imports of Goods and Services
(Billions of dollars, s.a.a.r., BOP basis)

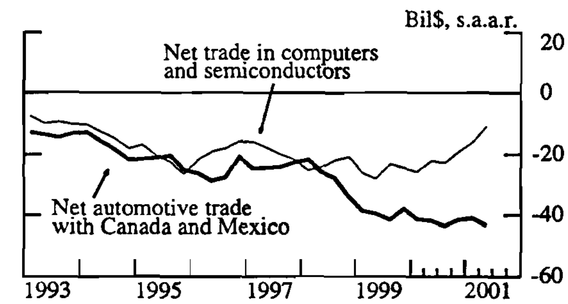
	Levels				Amount Change[1]			
	2001		2001		2001		2001	
	Q1	Q2[e]	Apr.	May	Q1	Q2[e]	Apr.	May
Exports of G&S	**1077.2**	**1048.0**	**1043.1**	**1052.8**	**-3.3**	**-29.2**	**-21.4**	**9.6**
Goods exports	779.8	750.0	746.0	753.9	-5.2	-29.8	-20.6	7.9
Gold	6.7	7.9	7.8	7.9	0.2	1.2	0.3	0.1
Other goods	773.1	742.1	738.2	746.0	-5.4	23.5	-20.8	7.8
Aircraft & parts	56.1	55.5	52.8	58.2	8.6	-0.5	-5.2	5.4
Computers	56.0	48.9	50.0	47.8	-1.2	-7.1	-4.1	-2.3
Semiconductors	58.0	48.9	48.6	49.1	-4.2	-9.1	-4.4	0.5
Other capital gds	197.3	183.6	183.5	183.7	-1.7	-13.7	-3.6	0.2
Automotive	71.8	74.7	73.3	76.0	-5.5	2.9	0.1	2.7
to Canada	37.5	41.3	41.3	41.3	-4.5	3.8	1.8	0.0
to Mexico	16.2	15.5	14.6	16.3	-0.9	-0.7	-3.0	1.7
to ROW	18.0	17.9	17.4	18.4	-0.0	-0.2	1.3	1.0
Agricultural	54.4	54.0	54.8	53.1	1.2	-0.5	-0.6	-1.7
Ind supplies (ex. ag)	156.7	149.3	149.7	149.0	-4.6	-7.3	-6.5	-0.7
Consumer goods	94.0	96.3	95.0	97.5	3.3	2.2	0.7	2.6
All other goods	28.9	31.0	30.5	31.6	-1.3	2.2	-2.6	1.1
Services exports	297.4	298.0	297.1	298.8	1.8	0.6	-0.9	1.7
Imports of G&S	**1457.3**	**1409.9**	**1427.1**	**1392.8**	**-24.4**	**-47.3**	**-34.4**	**-34.3**
Goods imports	1229.9	1182.3	1197.9	1166.7	-29.2	-47.5	-34.1	-31.2
Petroleum	117.2	115.2	114.9	115.4	-9.9	-2.1	4.8	0.5
Gold	6.1	6.7	5.6	7.8	-0.6	0.6	-0.5	2.2
Other goods	1106.5	1060.4	1077.4	1043.5	-18.7	-46.1	-38.3	-33.9
Aircraft & parts	31.0	30.8	30.5	31.0	0.4	-0.3	-6.4	0.5
Computers	85.7	77.5	79.5	75.4	-3.9	-8.2	-7.0	-4.1
Semiconductors	44.3	31.1	33.3	29.0	-4.7	-13.2	-6.8	-4.3
Other capital gds	184.6	164.2	168.0	160.4	-3.5	-20.4	-13.4	-7.7
Automotive	186.9	190.5	193.3	187.8	-6.1	3.6	7.8	-5.6
from Canada	56.1	60.3	60.8	59.8	-4.3	4.2	4.7	-1.0
from Mexico	38.7	39.9	38.7	41.0	-1.7	1.2	-5.2	2.3
from ROW	92.2	90.4	93.8	86.9	-0.1	-1.8	8.2	-6.9
Ind supplies	185.4	180.0	182.1	177.8	2.2	-5.5	-4.1	-4.3
Consumer goods	291.7	287.4	291.3	283.4	-0.9	-4.3	-13.9	-7.9
Foods, feeds, bev.	45.9	44.9	44.9	44.9	-0.5	-0.9	0.2	-0.0
All other goods	50.9	54.1	54.3	53.8	-1.8	3.2	5.3	-0.5
Services imports	227.4	227.6	229.2	226.1	4.7	0.2	-0.4	-3.1
Memo:								
Oil quantity (mb/d)	12.80	13.07	13.30	12.84	0.75	0.29	0.82	-0.46
Oil import price ($/bbl)	25.08	24.13	23.65	24.61	-3.81	-0.96	-0.50	0.96

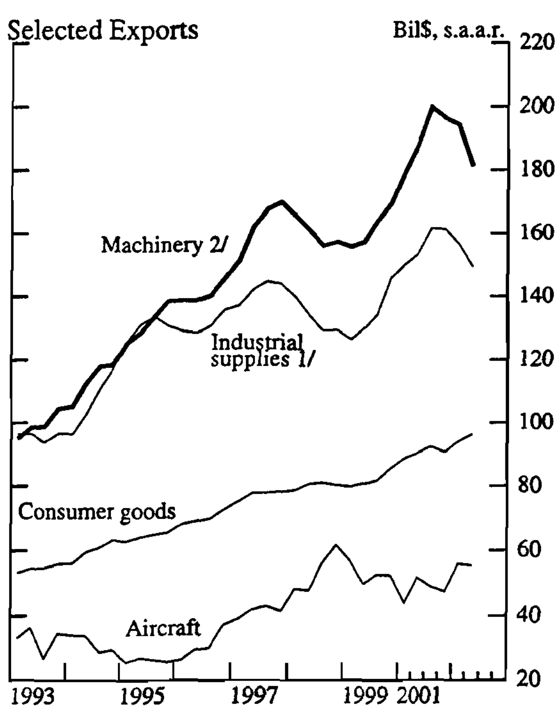
1. Change from previous quarter or month. e. Average of two months.
Source: U.S. Department of Commerce, Bureaus of Economic Analysis and Census.

U.S. International Trade in Goods and Services

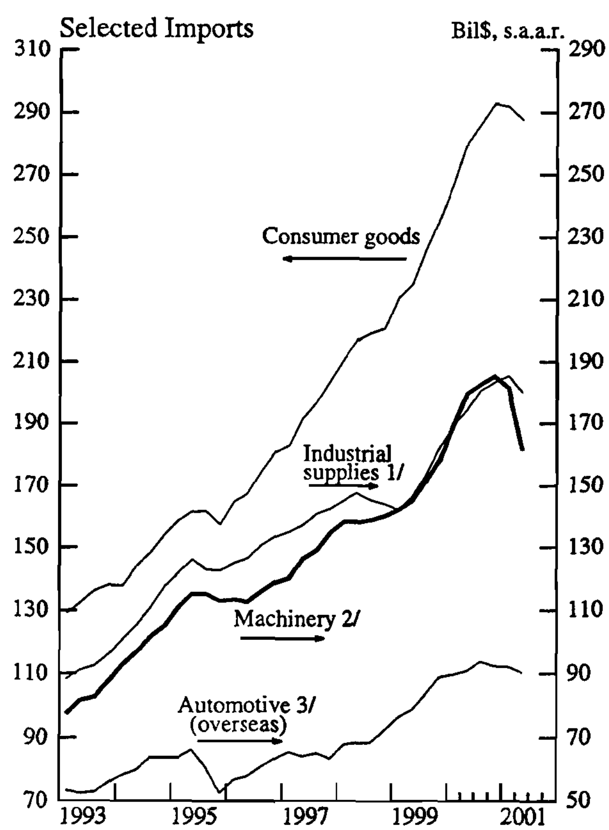








1. Excludes agriculture and gold.
2. Excludes computers and semiconductors.



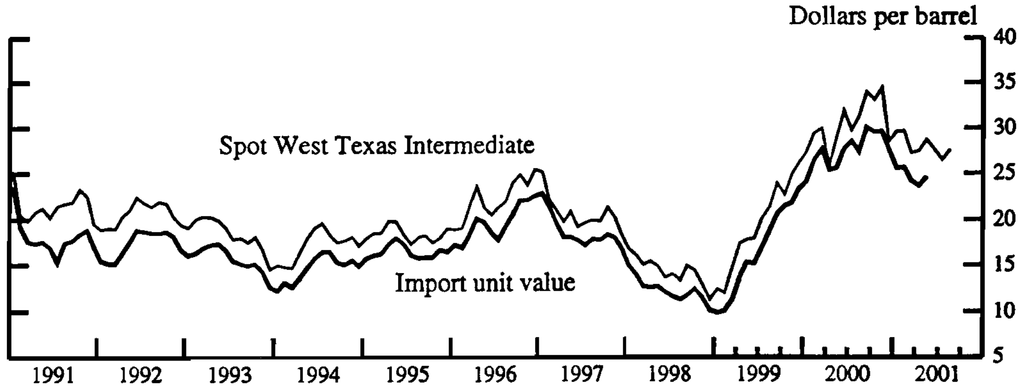
1. Excludes oil and gold.
2. Excludes computers and semiconductors.
3. Excludes Canada and Mexico.

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

	Annual rates			Monthly rates		
	2000	2001		2001		
	Q4	Q1	Q2	May	June	July
	------------- BLS prices (1995 weights)-------------					
Merchandise imports	0.8	-5.3	-6.9	0.3	-0.4	-1.6
Oil	5.0	-44.8	-10.6	4.7	-0.8	-6.1
Non-oil	0.3	2.4	-6.4	-0.3	-0.3	-1.0
Core goods*	0.8	3.1	-6.1	-0.3	-0.3	-1.0
Computers	-10.4	-4.3	-12.4	-0.2	-0.2	-2.0
Semiconductors	-0.2	-3.7	-6.2	-0.5	-0.6	0.5
Cap. goods ex comp & semi	-1.7	-0.3	-0.6	0.0	0.0	-0.1
Automotive products	0.0	-0.1	-0.9	-0.2	0.1	-0.2
Consumer goods	-1.0	0.6	-1.2	0.0	-0.2	-0.2
Foods, feeds, beverages	-2.9	0.1	-8.6	-0.2	-1.2	-1.4
Industrial supplies ex oil	6.9	12.4	-18.1	-1.0	-0.9	-3.6
Merchandise exports	0.7	-0.3	-1.9	-0.2	-0.2	-0.4
Core goods*	1.2	-0.1	-1.4	-0.1	-0.1	-0.4
Computers	-1.6	-2.4	-4.7	-1.1	-0.6	-0.5
Semiconductors	-3.1	-2.9	-7.1	-0.4	-0.9	-2.2
Cap. goods ex comp & semi	0.9	2.4	1.4	0.1	0.1	-0.2
Automotive products	0.0	0.5	0.5	0.0	0.0	0.0
Consumer goods	-0.8	-0.7	-0.9	-0.1	0.1	0.1
Agricultural products	12.4	2.9	-2.9	0.0	0.1	0.7
Industrial supples ex ag	-1.8	-4.1	-6.3	-0.7	-0.7	-1.6
Chain price index	---Prices in the NIPA accounts (1996 weights)---					
Imports of goods & services	0.4	-3.0	-5.3	...	...	...
Non-oil merchandise	0.4	1.4	-5.2	...	...	...
Core goods*	1.3	2.2	-4.4	...	...	...
Exports of goods & services	0.5	-0.1	-0.5	...	...	...
Total merchandise	0.4	-0.4	-1.2	...	...	...
Core goods*	1.1	-0.0	-0.7	...	...	...

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

Oil Prices



Prices of Internationally Traded Goods

Oil. The BLS price of imported oil dropped sharply in July, following declines in both the first and second quarters. After the United Nations postponed attempts to overhaul sanctions in early July, Iraq resumed oil exports, and the spot price of West Texas Intermediate fell below $25 per barrel. Other factors also put downward pressure on oil prices–increased levels of oil inventories and increasing signs of weak global demand. In response to these pressures, OPEC agreed in late July to cut production targets 1 million barrels per day beginning in September, and the spot price of WTI moved back up to near $28 per barrel.

Non-oil imports. Prices of imported non-oil (and core) goods dropped 1 percent (not an annual rate) in July. While prices of all major categories declined, the largest decrease was in industrial supplies. There was a sharp drop in the price of imported natural gas and smaller price declines for lumber, chemicals, unfinished metals, and paper. July was the sixth consecutive month of decline for prices of non-oil (and core) imports. In the second quarter, non-oil import prices (NIPA accounts) fell 5.2 percent at an annual rate (core goods by 4.4 percent), similarly led by declines in prices of imported industrial supplies.

Exports. Prices of U.S. goods exports (total and core) decreased 0.4 percent in July, the sixth consecutive monthly decline. Prices of computers and semiconductors dropped once again. The decline in prices of core goods was largely from industrial supplies (petroleum, chemicals, and metals) and other machinery. In the second quarter, prices of exported core goods (NIPA accounts) decreased marginally, 0.7 percent at an annual rate, as declines in prices of industrial supplies and agricultural products were offset by increases in prices of machinery.

U.S. International Financial Transactions

During the second quarter, foreign private net purchases of U.S. securities (line 4 of the Summary of U.S. International Transactions table) continued at an annual rate well above last year's record level. Net purchases of both corporate and agency bonds were very high in the second quarter. Foreign net acquisitions of corporate bonds, associated with a surge in corporate issuance in the first six months of the year, exceeded the record level set in the prior quarter. Net acquisitions of agency bonds, while slightly down from the first quarter, are still on pace to easily exceed last year's record net purchases. The slide in U.S. equity prices may finally be having some effect on foreign purchases, as foreign net acquisitions of equities fell in the second quarter and for the year are well below last year's level. Foreign holdings of Treasuries were essentially unchanged for the second consecutive quarter, altering the trend of fairly large net sales.

U.S. net acquisitions of foreign securities (line 5) were higher in the second quarter than in recent quarters, due in large part to stock swaps, with some $22 billion accounted for by the purchase of Voicestream Wireless by Deutsche Telekom in June. However, net acquisitions of foreign equities exclusive of stock swaps were also relatively high in the first two quarters of this year. U.S. investors appear to have reacquired their appetite for Japanese equities, purchasing $7 billion and $10 billion in the first two quarters, respectively, after being net sellers in 2000.

Measured foreign official assets held in the United States (line 1) fell by $33 billion in the quarter, with the largest decreases recorded by China ($19 billion) and Japan ($8 billion), while net gains were recorded by Argentina ($4 billion) and Russia ($3 billion). The Chinese official outflow is likely overstated, however: in the past many Chinese official inflows appear to have been recorded instead as private inflows in the transactions data[1], and Chinese private inflows for the quarter were measured at $13 billion – a huge sum relative to estimated private holdings. There were no reported foreign exchange market interventions by Japan. Partial data from the FRBNY show that between end-June and early-August total foreign official holdings were virtually unchanged and Japanese foreign official holdings fell an additional $4 billion.

The U.S. banking sector (line 3) recorded a modest net inflow of $6 billion in the second quarter. Of note are significant revisions to the first quarter banking sector data, where an originally-reported outflow of $108 billion that was used by the BEA to compute the first quarter balance of payments position has been reduced to an outflow of $51 billion.

1. The nearly-completed March 2000 benchmark survey of foreign holdings of U.S. long-term securities shows both that Chinese private holdings of U.S. securities were much lower than indicated by the transactions data and that Chinese official holdings were much higher. We suspect that securities purchased by government entities not classified as official (Ministry of Finance and Central Bank) are being transferred to the official sector in a manner that is not captured in the TIC reporting system.

Summary of U.S. International Transactions

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

	1999	2000	2000 Q3	2000 Q4	2001 Q1	2001 Q2	2001 May	2001 June
Official financial flows	**55.0**	**39.3**	**12.9**	**-5.4**	**4.7**	**-32.6**	**-21.2**	**-3.6**
1. Change in foreign official assets in the U.S. (increase, +)	46.4	39.6	13.2	-4.0	4.5	-31.3	-20.4	-3.1
a. G-10 countries	49.7	12.3	-4.2	-.8	-5.5	-6.7	-.9	-.4
b. OPEC countries	2.0	10.7	3.4	.6	.8	-2.1	-2.5	.0
c. All other countries	-5.3	16.7	14.0	-3.7	9.2	-22.5	-17.0	-2.8
2. Change in U.S. official reserve assets (decrease, +)	8.6	-.3	-.3	-1.4	.2	-1.3	-.8	-.5
Private financial flows	**321.7**	**404.0**	**101.5**	**119.1**	**75.8**	**n.a.**	**...**	**...**
Banks								
3. Change in net foreign positions of banking offices in the U.S.[1]	-12.4	-6.7	-8.4	9.9	-51.4	6.1	15.4	-5.4
Securities[2]								
4. Foreign net purchases of U.S. securities (+)	333.2	435.7	115.8	117.7	149.2	135.2	57.3	43.7
a. Treasury securities	-19.9	-52.4	-12.9	-10.1	.0	-1.6	3.7	-.5
b. Agency bonds	71.9	111.9	28.6	38.3	38.7	32.9	5.5	17.6
c. Corporate and municipal bonds	158.8	182.1	45.7	50.8	68.8	69.1	30.9	16.3
d. Corporate stocks[3]	122.4	194.0	54.4	38.8	41.7	34.8	17.2	10.3
5. U.S. net acquisitions (-) of foreign securities	-112.9	-101.1	-22.1	-17.8	-25.2	-44.5	-7.4	-32.6
a. Bonds	-5.7	-4.1	-9.0	3.3	-.9	8.8	2.3	1.0
b. Stock purchases	15.6	-13.1	-5.4	3.6	-21.7	-19.3	-8.1	-3.1
c. Stock swaps[3]	-122.9	-84.0	-7.7	-24.7	-2.6	-34.0	-1.6	-30.6
Other flows (quarterly data, s.a.)								
6. U.S. direct investment (-) abroad	-155.4	-152.4	-41.6	-39.1	-33.0	n.a.	...	...
7. Foreign direct investment in U.S.	301.0	287.7	76.0	84.7	41.6	n.a.	...	...
8. Foreign holdings of U.S. currency	22.4	1.1	.8	6.2	2.3	n.a.	...	...
9. Other (inflow, +)[4]	-54.2	-60.2	-19.0	-42.6	-7.7	n.a.	...	...
U.S. current account balance (s.a.)	**-324.4**	**-444.7**	**-115.3**	**-116.3**	**-109.6**	**n.a.**	**...**	**...**
Capital account balance (s.a.)[5]	**-3.5**	**.7**	**.2**	**.2**	**.2**	**n.a.**	**...**	**...**
Statistical discrepancy (s.a.)	**-48.8**	**.7**	**.7**	**2.4**	**28.8**	**n.a.**	**...**	**...**

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

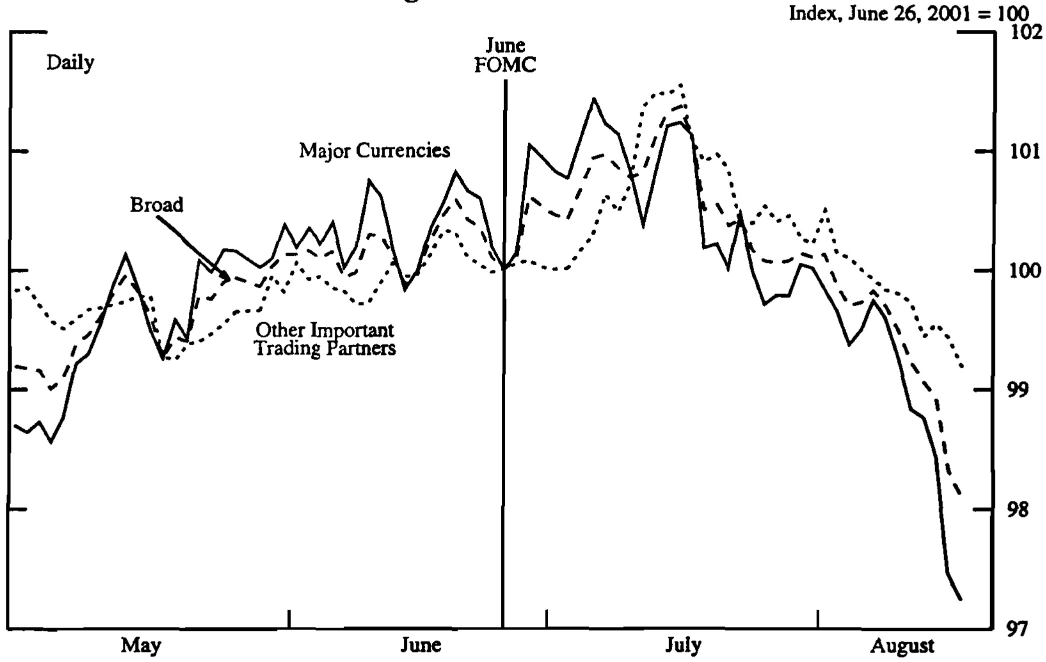
1. Changes in dollar-denominated positions of all depository institutions and bank holding companies plus certain transactions between broker-dealers and unaffiliated foreigners (particularly borrowing and lending under repurchase agreements). Includes changes in custody liabilities other than U.S. Treasury bills.
2. Includes commissions on securities transactions and excludes adjustments BEA makes to account for incomplete coverage; therefore does not match exactly the data on U.S. international transactions published by the Department of Commerce.
3. Includes (4d) or represents (5c) stocks acquired through mergers.
4. Transactions by nonbanking concerns and other banking and official transactions not shown elsewhere plus amounts resulting from adjustments made by the Department of Commerce and revisions in lines 1 through 5 since publication of the quarterly data in the Survey of Current Business
5. Consists of transactions in nonproduced nonfinancial assets and capital transfers.

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

Foreign Exchange Markets

On balance, the major currencies index of the trade-weighted exchange value of the dollar declined 2¾ percent over the intermeeting period, with much of this change occurring in recent days. Indications that the current period of slow-paced U.S. economic activity will continue longer than had previously been anticipated appeared to outweigh reports that economic activity is slowing in other industrial countries as well. The index of the dollar's value against the currencies of our other important trading partners declined fractionally over the intermeeting period.

Exchange Value of the Dollar



The dollar appreciated moderately against the euro in early July as market participants speculated that the European Central Bank, appearing constrained by relatively high inflation rates in the euro-area countries, would not ease its policy stance in the near term. Subsequent reports that inflationary pressures were easing somewhat in these countries helped renew speculation that the ECB, too, may decide to lower interest rates later this year. The advance estimate of U.S. second-quarter GDP growth apparently disappointed market participants and contributed to a change in market sentiment away from dollar-denominated assets. On balance, the dollar depreciated 5¾ percent against the euro over the period. While euro-denominated short-term interest rates and government bond yields declined slightly on net, euro-area share prices retreated 6 percent.

Financial Indicators in Major Industrial Countries

Country	Three-month rate Aug. 16 (Percent)	Three-month rate Percentage Point Change	Ten-year yield Aug. 16 (Percent)	Ten-year yield Percentage Point Change	Equities Percent Change
Canada	4.11	-.29	5.59	-.08	-1.40
Japan	.02	.00	1.30	.15	-11.28
Euro area	4.35	-.08	4.80	-.15	-6.07
United Kingdom	4.87	-.28	4.89	-.20	-2.38
Switzerland	3.13	-.03	3.28	-.06	-5.14
Australia	5.03	.05	5.84	.05	-2.86
United States	3.48	-.13	5.01	-.23	-2.43
Memo: Weighted-average foreign	3.12	-.14	4.58	-.06	n.a.

NOTE. Change is from June 26 to August 16.
n.a. Not available.

The dollar also depreciated 2 percent against sterling. The Bank of England surprised market participants by lowering its target policy interest rate on August 2, stating that its outlook for aggregate demand and output growth had become weaker than previously projected. The dollar appreciated about 1 percent against the Canadian dollar. The Bank of Canada, citing a slower pace of economic growth and reduced pressures on productive capacity and inflation, also eased its policy, lowering target rates 25 basis points on July 17. The move had been widely anticipated by market participants and elicited few market reactions. Largely reflecting the policy actions by the respective central banks, Canadian dollar and sterling short-term rates declined almost 30 basis points over the period.

The dollar strengthened against the yen during much of the intermeeting period, but depreciated abruptly late in the period, ending 3¼ percent weaker than at the June FOMC meeting. The comfortable victory of the LDP-led coalition in the Upper-House elections in late July appeared to strengthen Prime Minister Koizumi's mandate to introduce extensive structural changes to the Japanese economy. However, a worsening near-term outlook for Japanese economic activity–share prices dropped more than 11 percent on balance over the period-raised concerns that the Japanese government will need implement a supplemental budget and further worsen its fiscal imbalance (relative to earlier projections). This, in turn, contributed to a run-up of 15 basis points in the yield of the benchmark 10-year Japanese government bond; short-term rates remained near the zero-floor.

Financial Indicators in Latin America, Asia, and Russia

	Currency/ US dollar		Short-term Interest rates[1]		Dollar-denominated bond spread[2]		Equity prices
Economy	Aug. 16	Percent Change	Aug.15/16 (Percent)	Percentage Point Change	Aug.15/16 (Percent)	Percentage Point Change	Percent Change
Mexico	9.07	.05	7.04	-1.96	3.90	.43	-1.46
Brazil	2.47	6.91	20.40	1.95	10.37	.80	-6.25
Argentina	1.00	.00	35.00	23.00	16.21	4.34	-21.10
Chile	691.70	10.99	7.44	2.16	2.48	-.30	6.04
China	8.28	.00	n.a.	n.a.	1.09	-.02	-14.06
Korea	1272.00	-2.23	4.70	-.60	2.16	.07	-1.32
Taiwan	34.47	.09	3.84	-.23	...	...	-2.04
Singapore	1.74	-4.21	2.44	.19	...	...	-3.52
Hong Kong	7.80	.00	3.42	-.14	...	...	-8.71
Malaysia	3.80	-.01	2.89	-.02	1.46	-.22	10.06
Thailand	44.55	-1.50	3.25	-1.50	3.38	.47	-.93
Indonesia	8725.00	-23.24	17.52	.85	7.67	.12	-.70
Philippines	50.90	-2.45	9.75	.13	6.06	.50	-7.53
Russia	29.35	.82	n.a.	n.a.	7.70	.51	-12.77

NOTE. Change is from June 26 to August 15/16.

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

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

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

Argentina's worsening economic crisis and the government's apparent inability to put its financing on a sustainable path led to a drastic increase in the yield spread of Argentine sovereign debt over U.S. Treasuries, an accelerated pace of withdrawal of currency from the Argentine banking system, a drop of almost 25 percent in share prices, and widespread pessimism about the country's ability to stave off a sovereign default and a collapse of its currency-board monetary regime. Late in the period, speculation that the IMF and other multilateral organizations may extend additional financial support to shore up foreign currency reserves led to a slight reduction in Argentine sovereign yield spreads.

Spillovers from Argentina's problems to other emerging markets over the period were largely limited to Brazil, which saw the exchange value of its currency fall 7 percent against the dollar and its EMBI+ spread widen 80 basis points. A new $15 billion standby agreement reached with the IMF on August 3 helped restore a measure of investor confidence and stabilize financial market prices in Brazil. Financial markets in Mexico were only slightly affected by the turmoil in Argentine financial markets. The earnings outlook for many companies located in East Asia suffered from the global slump in demand for high-tech sector products, and their share prices declined broadly. The removal from office of President Wahid of Indonesia in mid-July and the attendant non-violent resolution of long-simmering political uncertainty contributed to a 30 percent rally of the rupiah's exchange value against the dollar over the intermeeting period, but did not appear to provide a boost to prices of Indonesian financial assets.

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

Developments in Foreign Industrial Countries

Recent indicators for the foreign industrial economies suggest that activity weakened further in the second quarter. In Japan, incoming data are consistent with the economy having contracted in the second quarter, with a slump in domestic activity being exacerbated by slowing global demand. The deteriorating external environment has also contributed to further downward momentum in the euro area, where output in the manufacturing sector has fallen significantly in recent months, and in the United Kingdom, where real GDP is estimated to have grown only 1.2 percent (s.a.a.r.) in the second quarter. Growth also remains sluggish in Canada, although consumer confidence and industrial production both rebounded somewhat in the second quarter.

With oil prices down from last year's highs, consumer price inflation has begun to ease in recent months. The Canadian twelve-month rate of consumer price inflation dropped from 3.9 percent in May to 3.3 percent in June. In the euro area, the twelve-month rate of consumer price inflation moved down to 3 percent in June but still remained above the European Central Bank's 2 percent ceiling. Deflationary pressures in Japan have intensified recently, as the impact of higher oil prices there has begun to diminish.

With global growth slowing more than expected, the Bank of England surprised markets, lowering policy rates 25 basis points in August, and has now lowered rates 100 basis points since January. The Bank of Japan also surprised markets by voting to ease monetary policy in August, raising the target for banks' reserves held at the central bank and announcing an intention to increase their purchases of government bonds. The Bank of Canada lowered policy rates 25 basis points in July, bringing rates down a total of 150 basis points so far this year.

Recent indicators for **Japan** suggest that the economy contracted in the second quarter, after expanding slightly (according to recently revised data) in the first quarter. Industrial production dropped 3.9 percent in the second quarter, led by a steep decline in production of electrical machinery, a category that includes high-tech equipment. The broader all-industry index, a supply-side proxy for GDP, was nearly 2 percent below its first-quarter level on average in April and May. On the demand side, shipments of machinery also registered a sharp drop in the second quarter, while machinery orders, a leading indicator of business investment, tumbled in May and June, dragged down by a plunge in orders for electrical machinery. Both residential and nonresidential building starts fell in the second quarter. Household spending also weakened further, with household expenditures falling roughly 3 percent in the second quarter, and new passenger car registrations rising only modestly over the same period.

The job market continued to soften. Employment fell in June for the fourth consecutive month to a level about 1½ percent below its recent peak in November of last year, and the unemployment rate remained at 4.9 percent, a record high. The job-offers-to-applicants ratio remained unchanged at 0.61 in June, after declining steadily this year from its recent peak of 0.66 in December.

Prices continued to decline. Core consumer goods prices in the Tokyo area (which exclude fresh food but include energy) were down 0.9 percent in July from a year earlier. Deflation in wholesale prices for domestic goods has intensified, as the impact of the earlier run-up in energy prices has faded. Land prices also have continued to fall, with prices down 5 percent on average in January 2001 from a year earlier. This marked the tenth consecutive year of declining prices for both residential and commercial property.

The merchandise trade surplus (customs clearance basis) averaged $59 billion at an annual rate in the first six months of this year, about half the level in the same period in 2000. The declining trend in the surplus reflects the impact of higher oil prices as well as slowing global demand.

The Bank of Japan's closely-watched Tankan index of business conditions slipped further in June, with the deterioration largely concentrated in the manufacturing sector. Survey respondents also project a slight further decline in the index for September. Other indicators from the Tankan suggest that deflationary conditions are expected to persist. There was a decline in the number of firms that see "excess demand" for their products versus those that see "excess supply." Indicators of excessive inventory levels rose, and the number of firms that expect input and output prices to fall increased. Expectations for growth in sales and profits were downgraded significantly for this fiscal year. Capital investment is expected to fall about 6 percent in FY2001 after declining nearly 1 percent in FY2000.

On August 14, the Bank of Japan voted to ease monetary policy, raising its target for the outstanding balance of bank accounts held at the BOJ from 5 trillion yen to around 6 trillion yen. As part of this effort to ease policy, the BOJ will increase the monthly amount of outright purchases of long-term JGBs from the current 400 billion yen to 600 billion yen. The BOJ cited the worsening economy, which it blamed primarily on a fall in exports, in justifying this decision. The Bank also indicated that the easing measures are intended to provide maximum support for reform efforts that "have started to take place under the strong leadership of the government." This may be a reference to Prime Minister Koizumi's FY2002 budget guidelines, approved by the Cabinet on August 10, which call for steep cuts in public works and foreign aid expenditures. It is not clear, though, whether the intended cuts will in fact survive the budget process, which will not be completed until next April.

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

Indicator	2000	2001					
	Q4	Q1	Q2	Apr.	May	June	July
Industrial production	.4	-3.3	-3.9	-2.0	-1.0	-.7	n.a.
All-industry index	.4	.9	n.a.	-2.4	-.9	n.a.	n.a.
Housing starts	1.7	-4.0	-2.9	-5.8	5.6	-7.9	n.a.
Machinery orders[1]	1.3	-7.0	1.1	6.3	-2.1	-6.6	n.a.
Machinery shipments	1.4	-4.6	-7.2	-3.8	-1.4	-.2	n.a.
New car registrations	-.6	2.6	1.7	.1	5.5	.4	n.a.
Unemployment rate[2]	4.8	4.8	4.9	4.8	4.9	4.9	n.a.
Job offers ratio[3]	.65	.63	.61	.62	.61	.61	n.a.
Business sentiment[4]	-14	-22	-27	...	...	...	...
CPI (Core, Tokyo area)[5]	-.9	-1.0	-.9	-.9	-1.0	-.7	-.9
Wholesale prices[5]	-.1	-.4	-.7	-.7	-.6	-.7	-.8

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

In late July, Japan's ruling LDP secured its largest Upper House election win since 1992. Although Prime Minister Koizumi's overwhelming popularity was the driving force behind the LDP's successful showing, suggesting a strong popular mandate for reform, the actual prospects for reform are still unclear. With a stronger LDP there is a risk that the old guard will become more resistant to reform, particularly given continued deterioration in recent economic data. In addition, despite evidence of widespread public support for structural reform, it is not clear how deep that support will be if the reforms result in a significant rise in unemployment.

Recent data confirm that economic activity in the **euro area** slowed significantly in the second quarter and suggest continued weakness in the current quarter.

Industrial production declined in both April and May and was likely down roughly 1 percent (s.a.) in the second quarter overall, based on June data for Germany, Italy, the Netherlands, and Spain. The euro-area purchasing managers' surveys for the manufacturing sector moved down further in July, remaining below the threshold that indicates a contraction in manufacturing. Service sector purchasing managers' surveys edged up in July and continue to indicate expansion of activity, but at a slower pace than earlier this year. Euro-area industrial confidence declined further in July, largely reflecting more negative opinions on orders. Although consumer confidence remains above its long-run average, it has also declined for the last three months, largely reflecting increasing concerns over job prospects.

In its August monthly report, the Bundesbank reported that real GDP in Germany was likely to have remained unchanged in the second quarter, according to initial estimates. German manufacturing activity has been especially weak in the second quarter, as industrial production declined 2.1 percent (s.a.), the largest quarterly decline since 1993. In Italy, preliminary data indicate that real GDP fell 0.5 percent (s.a.a.r.) in the second quarter.

Labor market data for the euro area as a whole have yet to show much deterioration, as the harmonized unemployment rate has been unchanged at 8.3 percent from April through June. Based on national statistics, however, the French unemployment rate edged up to 8.8 percent in June. In Germany, the unemployment rate has been unchanged at 9.3 percent for the first half of this year, but the number of unemployed has increased over this period, reversing gains made in the second half of last year.

Consumer price data suggest that inflation is beginning to ease a bit in the euro area. Euro-area consumer prices rose 0.3 percent in June from the previous month and the twelve-month rate of consumer price inflation in the euro area moved down to 3.0 percent, but remained above the European Central Bank's 2 percent target ceiling for the thirteenth consecutive month. The twelve-month rate of core inflation (which excludes food, energy, alcohol and tobacco prices) was unchanged at 2.1 percent in June. Preliminary data for Germany, Italy, and France suggest that inflation moved down further in July. Producer price inflation also continues to ease; producer prices rose 3.5 percent in the euro area in the twelve months to June, the smallest increase since late 1999.

Euro-Area Economic Indicators[1]
(Percent change from previous period except as noted, s.a.)

Indicator	2000	2001					
	Q4	Q1	Q2	Apr.	May	June	July
Industrial production[2]	1.4	-.3	n.a.	-.7	-.1	n.a.	n.a.
Retail sales volume	.4	.6	n.a.	.5	-.1	n.a.	n.a.
Unemployment rate[3]	8.5	8.4	8.3	8.3	8.3	8.3	n.a.
Consumer confidence[4]	-2.7	-1.7	-3.7	-2.0	-4.0	-5.0	-7.0
Industrial confidence[5]	5.3	1.0	-5.3	-4.0	-5.0	-7.0	-9.0
Mfg. orders, Germany	2.2	-2.7	-2.0	-2.0	4.6	-2.5	n.a.
CPI[6,7]	2.7	2.5	3.1	2.9	3.4	3.0	n.a.
Producer prices[6,7]	6.1	4.7	3.9	4.4	3.9	3.5	n.a.
M3[8]	4.9	4.7	6.3	4.7	5.3	6.3	n.a.

1. Euro-area indicators do not include Greece prior to 2001 but do include Greece as of January.
2. Excludes construction.
3. Euro-area standardized to ILO definition. Includes Eurostat estimates in some cases.
4. Diffusion index based on European Commission surveys in individual countries; Averages of responses to questions on financial situation, general economic situation, and purchasing attitudes.
5. Diffusion index based on European Commission surveys in individual countries; Averages of responses to questions on production expectations, orders, and stocks.
6. Percent change from year earlier.
7. Eurostat harmonized definition.
8. Eurostat harmonized definition, n.s.a., 12-month percent change.

n.a. Not available.

Economic growth in the **United Kingdom** slowed further in the second quarter, as preliminary data indicated that real GDP growth rose only 1.2 percent (s.a.a.r.). Output from manufacturing industries fell again in the second quarter, while service sector growth slowed. However, retail sales continued to show strong gains.

Very limited indicators for the third quarter paint a mixed picture. Consumer confidence moved up in July to its highest level in over a year, and retail sales rose 0.6 percent (s.a.). Business confidence also increased in July, but the outlook for expected future production in the manufacturing sector remains pessimistic, and more recent surveys of the service sector are consistent with growth slowing in the third quarter.

Notwithstanding the recent slowing in activity, labor market conditions remain tight. The official claims-based unemployment rate remained at 3.2 percent in July, the lowest rate in 26 years, while the labor force survey measure of the unemployment rate remained at a record low of 5 percent for the three months centered in May. Average earnings growth in June ticked above the 4½ percent rate (from year earlier) that the Bank of England believes to be compatible with its inflation target, pushed up by mid-year bonuses. The twelve-month rate of retail price inflation (excluding mortgage interest payments) fell slightly in July.

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

Indicator	2000	2001					
	Q4	Q1	Q2	Apr.	May	June	July
Real GDP*	1.8	1.8	1.2	...	...	...	...
Industrial production	-.6	-.6	-1.1	-.3	-.9	.1	n.a.
Retail sales	1.3	1.6	1.6	.7	.7	-.1	.6
Unemployment rate[1]							
Claims-based	3.4	3.3	3.2	3.2	3.2	3.2	3.2
Labor force survey[2]	5.3	5.1	n.a.	4.9	5.0	n.a	n.a
Business confidence[3]	5.3	8.7	-.7	-2.0	-2.0	2.0	3.0
Retail prices[4]	2.1	1.9	2.3	2.0	2.4	2.4	2.2
Producer input prices[5]	9.9	4.9	4.4	6.8	4.2	2.4	-.3
Average earnings[5]	4.4	5.0	4.8	4.9	4.5	4.9	n.a

* preliminary
1. Percent.
2. Three-month average centered on month shown.
3. Percentage of firms expecting output to increase in the next four months less percentage expecting output to decrease.
4. Excluding mortgage interest payments. Percent change from year earlier.
5. Percent change from year earlier.
n.a. Not available. ... Not applicable.

At its August 2, 2001 meeting, the Monetary Policy Committee of the Bank of England voted to lower the official repo rate 25 basis points to 5 percent. The repo rate has been cut 100 basis points since the beginning of this year. In its August *Inflation Report*, the Bank indicated that the effects of the global slowdown and subdued investment should keep growth below trend through 2002.

In **Canada**, indicators for the second quarter suggest that economic growth has continued to slow. Real GDP at factor cost on average in April and May was 0.2 percent above the first quarter level, down from average quarterly growth of 0.9 percent in 2000. Growth of housing starts slowed in the second quarter and turned negative in July, suggesting that construction activity has cooled. Employment declined in June and July, and a slide in the help-wanted index suggests further weakening in labor market conditions. Concerns about employment prospects, however, do not appear to have seriously hurt household spending; retail sales have continued to grow at a solid pace. In addition, consumer confidence has shown some resilience, rebounding in the second quarter from a large decline in the first quarter. Similarly, surveys of investment plans show a rebound from the low levels seen earlier in the year.

The twelve-month rate of consumer price inflation dropped back to 3.3 percent in June as the influence of energy prices eased, but remained well above the ceiling of the Bank of Canada's 1 percent to 3 percent target range for the third consecutive month. The twelve-month core rate of inflation (which excludes food and energy prices) held steady at a more moderate 2.1 percent.

The Bank of Canada has lowered its policy rate, the Bank Rate, a total of 150 basis points this year, most recently by 25 basis points on July 17. The Bank Rate now stands at 4.5 percent. In its July 17 statement, the Bank indicated that the slower pace of economic growth in Canada has eased pressures on production capacity and should, along with a moderation in energy prices, contribute to a reduction in Canadian inflation in the second half of this year. The Bank's next policy announcement date is August 28.

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

Indicator	2000	2001					
	Q4	Q1	Q2	Apr.	May	June	July
GDP at factor cost	.4	.2	n.a.	.1	.3	n.a.	n.a.
Industrial production	-.2	-1.2	n.a.	.3	.2	n.a.	n.a.
New mfg. orders	.2	-5.1	n.a.	4.6	1.8	n.a.	n.a.
Retail sales	.1	1.3	n.a.	1.8	0.2	n.a.	n.a.
Employment	.7	.2	.3	.2	.1	-.1	-.1
Unemployment rate[1]	6.9	6.9	7.0	7.0	7.0	7.0	7.0
Consumer prices[2]	3.1	2.8	3.6	3.6	3.9	3.3	n.a.
Consumer attitudes[3]	114.2	109.4	113.5	...	...	...	...
Business confidence[4]	140.4	117.5	n.a.	...	...	...	...

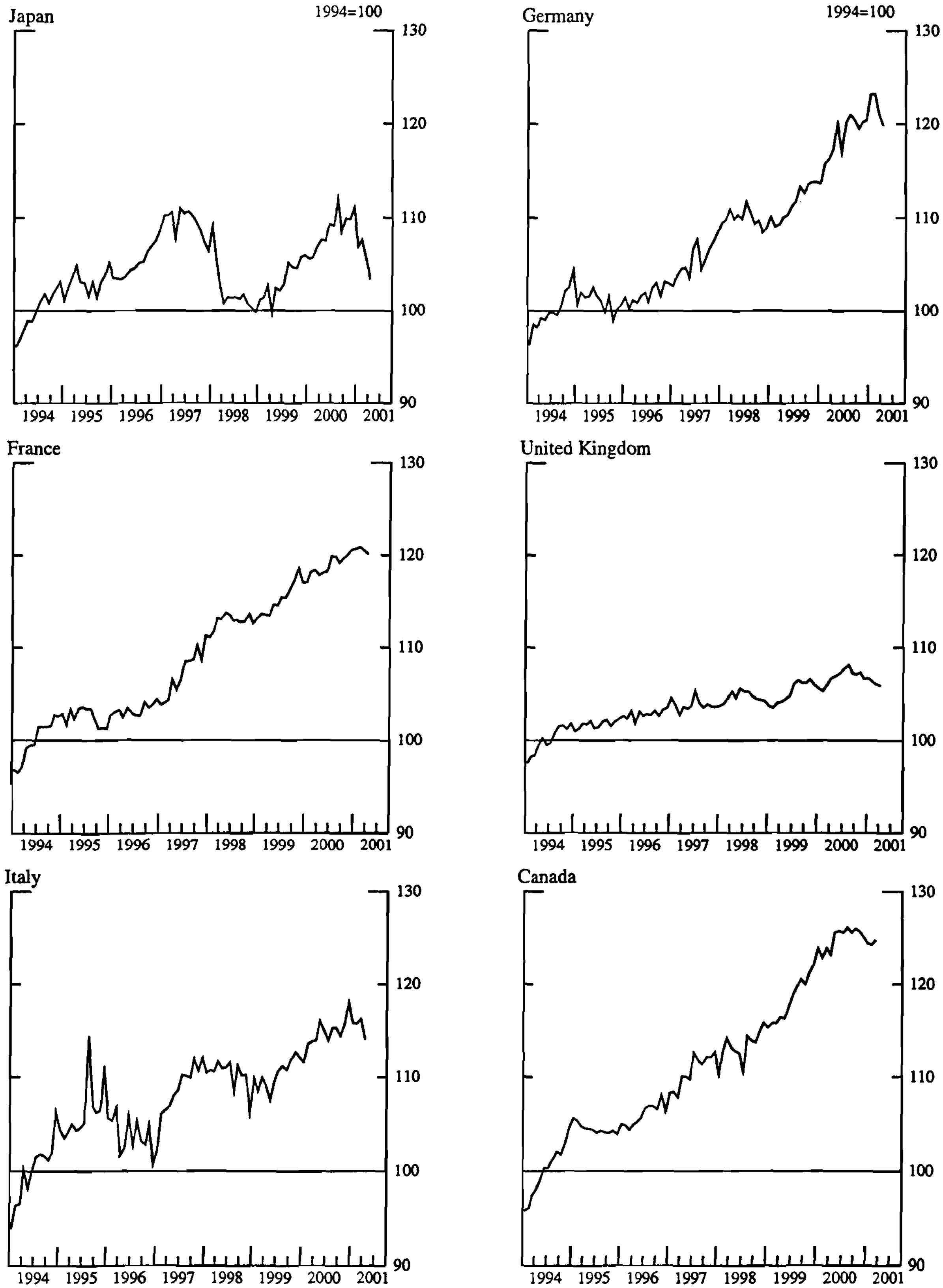
1. Percent.
2. Percent change from year earlier, n.s.a.
3. Level of index, 1991 = 100.
4. Level of index, 1977 = 100.
n.a. Not available. ... Not applicable.

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

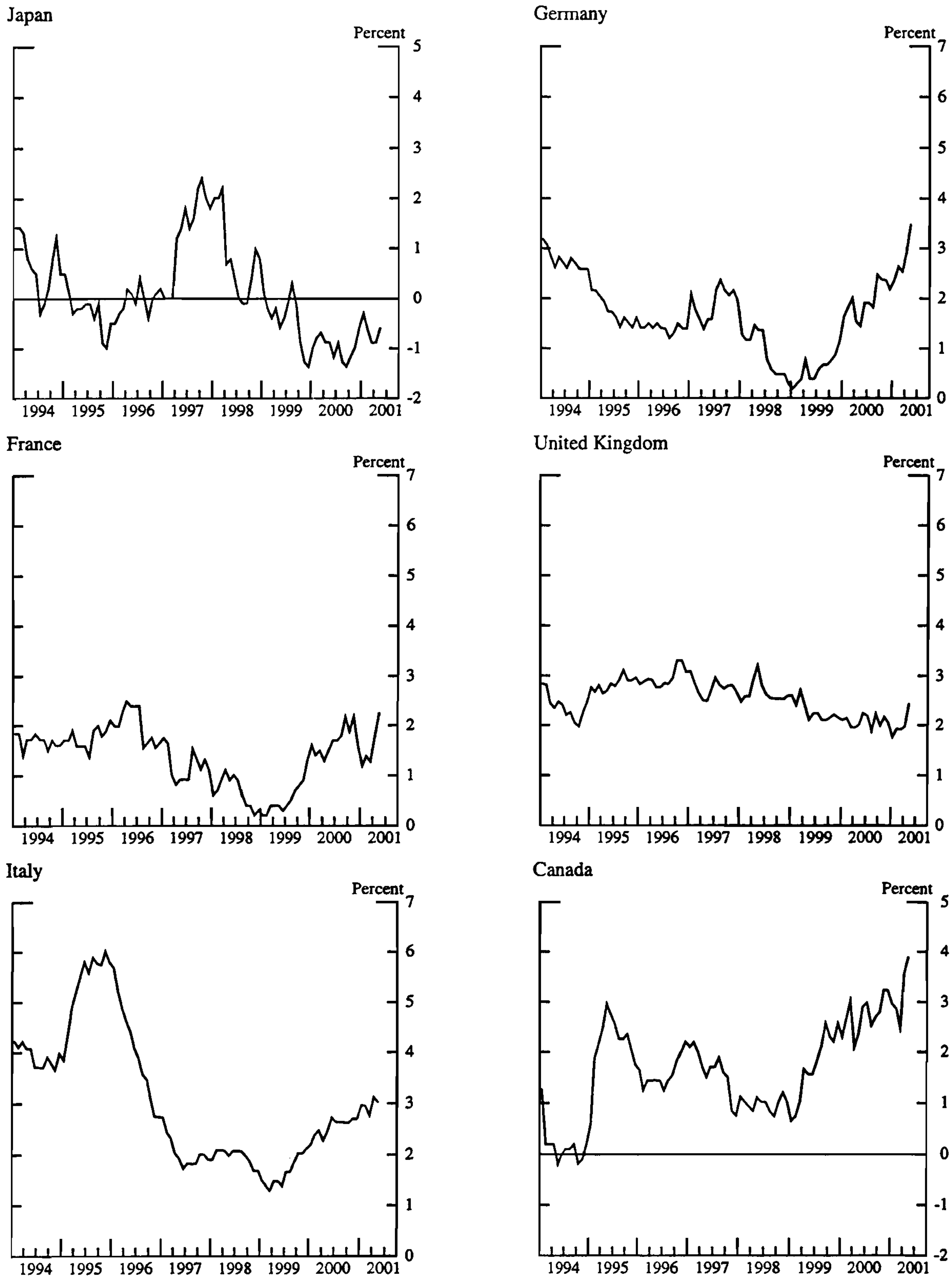
Country and balance	2000	2001				
	Q4	Q1	Q2	Apr.	May	June
Japan						
Trade	67.9	67.6	50.3	59.2	28.0	63.7
Current account	99.4	101.9	66.9	99.6	65.0.	36.2
Euro area						
Trade[1]	3.4	-15.5	n.a.	-7.5	17.8	n.a.
Current account[1]	-49.7	-23.5	n.a.	-35.3	-8.4	n.a.
Germany						
Trade	41.7	75.5	65.5	54.8	77.3	64.4
Current account	-32.4	-3.6	-7.5	21.3	1.6	-45.5
France						
Trade	-5.5	6.3	n.a.	-5.7	5.4	n.a.
Current account	2.1	4.0	n.a.	-.9	n.a.	n.a.
Italy						
Trade	.7	8.9	n.a.	11.8	5.3	n.a.
Current account[1]	-9.5	-7.7	n.a.	-6.1	-6.9	n.a.
United Kingdom						
Trade	-44.2	-43.4	n.a.	-48.1	-41.4	n.a.
Current Account	-21.4	-1.0	n.a.	...	...	...
Canada						
Trade	44.8	58.8	n.a.	53.1	54.2	n.a.
Current Account	22.4	33.3	n.a.	...	...	...

1. Not seasonally adjusted.
n.a. Not available. ... Not applicable.

Industrial Production in Selected Industrial Countries



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



Economic Situation in Other Countries

In the major developing countries, with a notable exception of China, the overall pace of economic growth continued to decline, reflecting sluggish external demand, and, in most countries, weak domestic demand. Recent data on real GDP, industrial production, and especially exports have shown slowing or outright declines in most countries. Inflation remains generally subdued. Financial and economic conditions in Argentina deteriorated further, but have generated only moderate spillovers to most other emerging markets.

Economic and financial conditions in **Argentina** have continued to deteriorate. Real GDP fell 0.8 percent in the first quarter (s.a.a.r.), and fourth-quarter real GDP was revised down significantly. More recent indicators were also weak. Industrial production, which had ticked up in April and May, more than retraced those gains in June. Auto sales plunged again in June, while retail sales indicators were mixed, and consumer confidence remained weak. Tax revenue fell almost 9 percent in June from the previous year, including a 22½ percent drop in the cyclically sensitive VAT revenues. The unemployment rate rose to 16.4 percent in May–a percentage point above the last reading in October, and consumer prices fell 1.1 percent over the twelve months ended June. The June trade surplus rose, reflecting flat exports and a sizable drop in imports.

The financial sector has been in turmoil over the past month and a half. In mid-June, spreads on sovereign debt, as measured by JP Morgan's EMBI+ index, were hovering just below 1000 basis points. However, political tensions between the provinces and federal government unsettled markets in late June and on July 10, yields at the bi-weekly auction of short-term government debt reached a four-year high of 14 percent. EMBI+ spreads for Argentina subsequently soared to nearly 1700 basis points and have generally remained above 1400 basis points since mid-July, despite two major policy initiatives intended to calm the markets. First, on July 11, the government announced a "zero deficit" policy–a major fiscal austerity plan calling for the budget to be balanced on a month-to-month basis. The plan calls for across-the-board cuts in most government expenditures, including wages and pensions, but excluding payments on debt and transfers to the provinces. The plan was approved by the legislature in late July, and salaries and pensions were cut 13 percent. Second, in early August, the government reached agreement with banks, pension funds, and mutual funds in Argentina to exchange most of the $4.3 billion in short-term debt maturing through the end of the year for longer-term debt, thus eliminating the need to hold biweekly public auctions aimed at rolling over short-term debt.

July saw an acceleration of private sector deposit withdrawals that has continued into August. Since early July, deposits have fallen over $9 billion (almost 11 percent), coupled with a sizable outflow in foreign reserves of over $5 billion (over 22 percent). These withdrawals are broad-based and have generated increased concerns about the stability of the banking system and the resources available to the government for maintaining the currency board.

As a result of these developments, the Argentine government has made a highly publicized plea for international financial assistance, calling for an additional $6-$9 billion in financial support from the IMF.

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

Indicator	1999	2000	2001				
			Q1	Q2	May	June	July
Real GDP[1]	-.6	-2.4	-.8	n.a.	...	...	...
Industrial production	-5.9	-1.9	-.3	-1.1	.1	-3.1	n.a.
Unemployment rate[2]	13.8	15.1	...	16.4	16.4	...	...
Consumer prices[3]	-1.8	-.7	-1.4	-.1	.2	-.3	-1.1
Trade balance[4]	-.8	2.6	3.4	4.6	2.7	7.8	n.a.
Current account[5]	-11.9	-8.9	-11.8	n.a.	...	...	...

1. Annual rate. Annual figures are Q4/Q4.
2. Percent, n.s.a. Data are released for May and October only. Figures for Q2 reflect data for May.
3. Percent change from year-earlier period, except annual figures, which are Dec./Dec.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. ... Not applicable.

In **Mexico**, real GDP declined 1 percent (s.a.a.r.) in the second quarter, the third consecutive quarterly decline. The fall in economic activity continues to reflect largely weak external demand. That said, in June, imports declined even more sharply than exports, leading to a sharp narrowing in the trade deficit. Twelve-month consumer price inflation has continued to decline, falling to 5.9 percent in July, below the year-end target of 6.5 percent.

With the very strong peso, inflation declining, and economic activity weakening, the Bank of Mexico (BOM) loosened monetary policy at the end of July, the second such easing since the end of May. Subsequently, at the August 7 auction of Treasury bills (Cetes), the yield on 28-day Cetes fell to 7.2 percent, a record low. In early August, the Mexican government issued abroad $1.5 billion in 30-year bonds at only 340 basis points above U.S. Treasuries. The government will use part of the proceeds from the swap to retire Brady bonds. Negotiations on fiscal reform measures have continued and are aimed in part at reducing Mexico's dependence on revenues from oil. A draft reform proposal is expected to be ready when Congress reconvenes in early September.

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

Indicator	1999	2000	2001				
			Q1	Q2	Apr.	May	June
Real GDP[1]	5.5	5.2	-1.4	-1.0	...	...	...
Industrial production	4.5	6.3	-1.5	...	-1.9	2.0	...
Unemployment rate[2]	2.5	2.2	2.3	2.4	2.2	2.6	2.3
Consumer prices[3]	12.3	9.0	7.5	6.9	7.1	7.0	6.6
Trade balance[4]	-5.6	-8.0	-9.0	-8.0	-8.4	-11.8	-3.9
Imports[4]	142.0	174.5	175.6	169.3	176.4	172.1	159.4
Exports[4]	136.4	166.5	166.7	161.3	167.9	160.4	155.5
Current account[5]	-13.7	-17.7	-17.6	...	...	...	...

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

In **Brazil**, real GDP declined nearly 4 percent (s.a.a.r.) in the second quarter, led by a nearly 11 percent decline in industrial output. The sharp drop in output reflects the effects of a series of interest rate hikes put in place since March and an electricity shortage. The weakening of the economy contributed to a narrowing in the trade balance in June. Inflation reached 7.5 percent on a year-over-year basis in July, up from its level earlier in the year and well above the central bank's mid-point target of 4 percent for December 2001. Inflationary pressures have been fueled by the depreciation of the *real* over the past few months.

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

Indicator	1999	2000	2001				
			Q1	Q2	May	June	July
Real GDP[1]	3.5	4.8	1.6	-3.9	...	...	n.a.
Industrial production	-.7	6.5	1.6	-3.6	-1.7	-1.1	n.a.
Unemployment rate[2]	7.6	7.1	5.7	6.2	6.5	6.2	n.a.
Consumer prices[3]	8.9	6.0	6.2	7.0	7.0	7.3	7.0
Trade balance[4]	-1.3	-.7	-.9	-3.2	-6.0	-.9	-1.3
Current account[5]	-25.4	-24.6	-26.2	-27.4	-28.1	-25.3	n.a.

1. Annual rate. Annual figures are Q4/Q4.
2. Percent. "Open" unemployment rate.
3. Percent change from year-earlier period, except annual figures, which are Dec./Dec. Price index is IPC-A.
4. Billions of U.S. dollars, annual rate.
5. Billions of U.S. dollars, n.s.a., annual rate.
n.a. Not available. ... Not applicable.

The Brazilian *real* and other Brazilian asset prices have been hit especially hard by the troubles in Argentina. In response, the Brazilian central bank and government have taken several major steps aimed at supporting the currency. In late June and mid-July, the central bank raised interest rates by a total of 225 basis points, to 19 percent. In June, the central bank sold over $1.3 billion to support the currency, and in early July, announced that it would sell up to $6 billion over the rest of the year ($50 million per day) to provide additional foreign currency to the private sector. In late June, the Brazilian government drew an additional $2 billion from its current IMF program and announced that it would not prepay $1.8 billion later this year, as it had previously indicated. Finally, in early August, the IMF announced that Brazil would obtain a new, mainly precautionary $15 billion IMF program to replace the current one, which expires on December 1. (Previously, the government had maintained that the program would not be renewed.) The program will run through the end of 2002. Upon IMF Executive Board approval of the program, which is expected in mid-September, $4.6 billion will be made available for Brazil. Under the program, the Brazilian government commits to tightening fiscal policies and to practicing monetary discipline.

Sparse **Venezuelan** data since the last FOMC meeting suggest a continued moderation from the rapid growth at the end of 2000. Aside from a few fast growing sectors such as communications, the non-oil industries continue to languish. The slowdown in inflation has stalled in recent months, with inflation rising to 13 percent on a twelve-month basis in July. Capital flight remains a concern, with about $1 billion leaving the country each month, according to June central bank estimates. In early August, the currency came under further downward pressure. The central bank responded by increasing some reserve requirements and restricting banks' access to foreign currency.

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

Indicator	1999	2000	2001				
			Q1	Q2	May	June	July
Real GDP[1]	-4.1	6.1	.6	n.a.	...	...	...
Unemployment rate[2]	15.2	13.4	14.2	n.a.	13.1	n.a.	n.a.
Consumer prices[3]	20.0	13.4	12.6	12.4	12.6	12.5	13.0
Non-oil trade balance[4]	-9.1	-10.8	-10.2	n.a.	...	...	...
Trade balance[4]	7.6	18.0	16.8	n.a.	...	...	...
Current account[5]	3.7	13.4	10.5	n.a.	...	...	...

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

In **Korea**, activity appears to have weakened further in recent months. Industrial production decreased for the third consecutive month in June, registering a decline from its year-earlier level for the first time in nearly two years. A further sharp drop in the production of semiconductors was again a key feature of the overall drop of industrial production. The index of business sentiment deteriorated noticeably in July, especially among export-oriented industries. Despite the pronounced recent weakness in the manufacturing sector, consumer spending appears to be holding up surprisingly well, and the forward-looking index of consumer confidence rose to its highest level in ten months in June.

In response to growing evidence of overall economic weakness, macroeconomic policy has started to move toward a more stimulative stance. In early July and again in early August, the Bank of Korea lowered its policy rate by 25 basis points, the second and third such reductions this year, bringing the rate down to

4.5 percent. The two most recent reductions were undertaken despite the inflation rate remaining above its 2 percent to 4 percent target range. In early August, the government announced that it would introduce a supplementary budget involving a modest amount of new spending and an accelerated schedule of previously announced public works projects.

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

Indicator	1999	2000	2001				
			Q1	Q2	May	June	July
Real GDP[1]	13.8	5.2	1.2	n.a.	...	...	...
Industrial production	24.1	17.0	.6	-1.5	-.1	-1.9	n.a.
Unemployment rate[2]	6.3	4.1	4.2	3.7	3.6	3.6	n.a.
Consumer prices[3]	1.3	3.1	4.2	5.3	5.5	5.3	5.1
Trade balance[4]	28.4	16.6	19.9	17.0	20.5	17.5	n.a.
Current account[5]	24.5	11.0	12.3	15.1	25.9	12.5	n.a.

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

Recent economic indicators in the **ASEAN** region generally indicate continued slowing in economic activity. In the second quarter, industrial production fell sharply in Malaysia and real GDP plummeted in Singapore, due to weak external demand for high-tech goods. Industrial output edged down in Thailand as well. In Indonesia, second quarter real GDP is estimated to have risen nearly 12 percent (s.a.a.r.) from the first quarter. All of the countries in the region have experienced falling exports in recent months. The decline is most noticeable in the region's electronics exporters but is also evident in the data for Thailand and Indonesia. Due to sharp declines in imports of intermediate goods, however, trade balances have not fallen as sharply. Inflation picked up in Thailand and Indonesia in the second quarter, fueled by currency depreciation, but inflation remained stable in the rest of the region. In response to weakness in their economies, Singapore, Malaysia, and Thailand have implemented fiscal stimulus packages.

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

Indicator and country	1999	2000	2001				
			Q1	Q2	Apr.	May	June
Real GDP[1]							
Indonesia	.5	4.4	4.3	12.1	...	...	...
Malaysia	11.0	6.3	5.6	...	...	...	...
Philippines	5.1	3.9	-2.1	...	...	...	...
Singapore	8.0	11.0	-10.8	-10.7	...	...	...
Thailand	6.7	3.0	-1.0	...	...	...	...
Industrial production[2]							
Indonesia[3]	-1.0	12.0	-.4	3.4	-3.2	4.5	.5
Malaysia	9.1	19.1	-3.4	-5.3	-2.2	-.1	-3.9
Philippines	3.6	14.3	-6.3	n.a.	-3.3	1.7	n.a.
Singapore	13.9	15.3	-9.2	-6.4	-2.0	.7	-11.3
Thailand	12.5	3.0	-1.9	-.9	.3	2.5	-3.7

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

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

Country	1999	2000	2001				
			Q1	Q2	Apr.	May	June
Indonesia	24.7	28.6	24.7	22.7	23.0	23.1	21.9
Malaysia	19.1	16.0	16.6	13.6	16.8	14.2	9.8
Philippines	4.3	6.7	6.3	n.a.	-3.1	-1.3	n.a.
Singapore	3.6	3.3	6.0	6.2	3.6	7.7	7.1
Thailand	9.3	5.5	-.3	n.a.	1.4	-.1	n.a.

n.a. Not available.

Some of the political problems that have been a source of uncertainty in the region have diminished recently. In Indonesia, Megawati Sukarnoputri became president after former-President Wahid was impeached in late July. The transfer of power was surprisingly peaceful, and financial markets have reacted favorably. The rupiah has appreciated against the dollar by about 20 percent. In Thailand, Prime Minister Thaksin was cleared of corruption charges that could have led to his removal from office, and in the Philippines, a cease-fire was signed with a separatist group that may put an end to a 30-year revolt in the southern islands.

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

Country	1999[1]	2000[1]	2001 Q1	2001 Q2	2001 May	2001 June	2001 July
Indonesia	2.0	9.3	9.3	11.1	10.8	12.1	13.0
Malaysia	2.5	1.3	1.7	1.7	1.7	1.7	n.a.
Philippines	4.3	6.6	6.8	6.6	6.5	6.7	6.8
Singapore	.9	2.1	1.7	1.7	1.9	1.2	n.a.
Thailand	.7	1.3	1.4	2.5	2.8	2.3	2.2

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

In **China**, recent indicators suggest that growth has moderated slightly from its rapid pace in the first quarter. Real GDP growth in the second quarter is estimated at 7.5 percent (s.a.a.r.), led by strong consumer demand. Investment was boosted by increased government spending on infrastructure and a pickup in inflows of foreign direct investment. Industrial output growth in July slowed somewhat from the twelve-month growth rates registered earlier this year. China has begun to feel the impact of the global economic slowdown, with exports falling nearly 7 percent (s.a.) in the second quarter. However, in June and July, exports rebounded slightly, although they remain at a lower level than in the first quarter. Partly reflecting the strength of domestic demand, the twelve-month inflation rate moved up to 1.6 percent in the second quarter, the highest rate in nearly four years.

In **Hong Kong**, data received since the last FOMC meeting point to continued sluggishness. For the second quarter as a whole, exports continued to slide on balance, falling to a level about 7 percent (s.a.) below their first-quarter average. The value of retail sales on average in April and May was nearly 3 percent (s.a.) below the first-quarter level. The unemployment rate remained unchanged at 4.6 percent (s.a.) in the April-June period. Deflation in Hong Kong eased slightly in June after heavy rains pushed food prices higher and the rate of decline in private housing rental prices lessened.

Chinese Economic Indicators

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

Indicator	1999	2000	2001				
			Q1	Q2	May	June	July
Real GDP[1]	4.1	8.0	8.1	7.5	...	...	...
Industrial production[2]	8.0	11.4	11.2	10.6	10.2	10.1	8.1
Consumer prices[2]	-1.0	1.5	.7	1.6	1.7	1.4	n.a.
Trade balance[3]	29.2	24.1	18.6	21.1	24.8	19.5	18.7

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

Hong Kong Economic Indicators

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

Indicator	1999	2000	2001				
			Q1	Q2	Apr.	May	June
Real GDP[1]	9.3	6.6	1.2	...	...	...	...
Unemployment rate[2]	6.1	5.0	4.6	4.6	4.6	4.6	4.6
Consumer prices[3]	-4.0	-2.1	-2.0	-1.3	-1.4	-1.5	-1.0
Trade balance[4]	-5.6	-11.0	-10.9	-11.5	-11.6	-10.8	-12.3

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

In **Taiwan**, recent indicators suggest that the economy has slipped into recession. June industrial production fell 2.4 percent (s.a.) and the unemployment rate rose to 4.6 percent (s.a.). In addition, exports have declined as exports of electronics and information technology products have sagged. Consumer prices increased slightly in July on a twelve-month basis, after two months of modest declines. To combat declining demand, Taiwan's central bank eased interest rates at the end of June, the seventh rate decline since December 2000.

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

Indicator	1999	2000	2001				
			Q1	Q2	May	June	July
Real GDP[1]	6.5	4.1	-2.7	...	...	...	...
Unemployment rate	2.9	3.0	3.8	4.4	4.2	4.6	n.a.
Industrial production[2]	7.7	7.4	-3.8	-2.9	1.4	-2.5	n.a.
Consumer prices[3]	.1	1.7	.6	.0	-.2	-.2	.1
Trade balance[4]	10.9	8.3	17.1	13.8	11.2	21.4	7.8
Current account[5]	8.4	8.9	15.8	...	...	...	...

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