Although the United States has run current account deficits since 1990, those deficits have recently assumed extraordinary proportions. Between 2004:Q4 and 2005:Q3, the U.S. external deficit has averaged 6.4 percent of GDP. A current account deficit is the difference between a country’s imports of goods and services and the sum of its exports and net factor payments. Although other macroeconomic factors affect exchange rates (e.g., differential interest and growth rates), many economists have suggested that, in the presence of large current account deficits, the dollar will depreciate. As the dollar depreciates, the dollar price of foreign goods and services increases, while the price abroad (in foreign currency) of U.S. goods and services declines. As a result, U.S. households and firms buy fewer imported goods, while foreign households and firms purchase more U.S. goods. Therefore a depreciating dollar ought to bring the current account back toward neutral.1

The chart shows that over the period 2002-04 the real effective value of the U.S. dollar has depreciated at an average pace of 4.7 percent per annum. This tendency reversed in 2005; the real value of the dollar appreciated by 3.6 percent last year. Many commentators have expressed concerns about the incompatibility between the dollar U-turn and the current account deficit, predicting dollar depreciation in 2006. Why has the dollar appreciated despite the very large U.S. current account deficit? One factor is that, over the period 2004-05, the monetary authorities of a number of developing countries—mostly in Asia—purchased 269 billion in U.S. dollar securities. China alone has seen its U.S. dollar reserves grow by $167 billion, to exceed $800 billion.2

These Asian governments oppose an uncontrolled dollar depreciation for two reasons: (i) Their huge dollar-denominated reserves expose them to enormous losses if the dollar depreciates significantly. A 20 percent dollar depreciation, for example, would reduce Chinese reserves by an amount between 2 and 9 percent of the Chinese GDP and reduce Singapore’s reserves by between 18 and 25 percent of its GDP. (ii) Uncontrolled growth of foreign reserves can also cause an excessive expansion of domestic liquidity, which poses inflation risks.

As a result, many U.S. trading partners have resisted the weakening dollar and welcomed 2005 as a break to an unsustainable trend. A number of Asian countries still need to implement institutional reforms to prepare them for domestically driven growth and end their dependence on export surpluses supported by weak currencies. In July 2005, China took a step in this direction by revaluing the renminbi’s parity with the dollar by 2.1 percent and simultaneously switching from a dollar peg to a managed floating regime in which the parity is determined with reference to a basket of currencies. The Chinese are implementing other structural reforms to increase the efficiency of currency markets and to enable all firms to hedge currency risks. This seems to herald further reforms that might re-establish more symmetry in international trade relationships. If developing Asian economies will persist on the reforming path, in the long-run the dollar may not have to bear the entire burden of much needed adjustments in international current accounts.

—Massimo Guidolin

2 Source: International Monetary Fund.
Conventions used in this publication:

1. Charts and tables contain data that were current through January 2006. Unless otherwise indicated, data are quarterly.

2. The percent change refers to the percent change from the same period in the previous year. For example, the percent change in $x$ between quarter $t-4$ and the current quarter $t$ is: \[ \left( \frac{x_t}{x_{t-4}} - 1 \right) \times 100. \]

3. All data with significant seasonal patterns are adjusted accordingly.

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Research Department
Federal Reserve Bank of St. Louis
411 Locust St.
St. Louis, MO 63102

Please keep in mind that we must make some difficult choices with respect to the material we include.

Thank you in advance for your help in making *International Economic Trends* a great publication.

Sincerely,
Christopher J. Neely
Editor, *International Economic Trends*
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### Long-Term Interest Rates
Percent

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<td>4.65</td>
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</tbody>
</table>
Canada

Real GDP
Percent change from year ago

Consumer Price Index
Percent change from year ago

Unemployment Rate
Percent

Hourly Earnings
Percent change from year ago*

Current Account Balance
Percent of GDP

* Hourly earnings are seasonally adjusted.
Hourly Earnings and Output per Worker

Percent change from year ago

Hourly Earnings*

Output per Worker

Labor Force Indicators

Percent change from year ago

Employment (left scale)

Unemployment Rate (right scale)

Inflation

Percent change from year ago

Consumer Price Index

Producer Price Index

Government Debt and Budget Balance

Percent of GDP, annual data

Debt (right scale)

Budget Balance (left scale)
Reserve Money
Percent change from year ago

Monetary Aggregates
Percent change from year ago

Interest Rates
Percent

Stock Exchange Index - Toronto Stock Exchange
2000 = 100
Euro Area

International Economic Trends

Real GDP
Percent change from year ago

Employment
Percent change from year ago

Consumer Price Index
Percent change from year ago

Unemployment Rate
Percent

Hourly Earnings
Percent change from year ago*

Current Account Balance
Percent of GDP

* Hourly earnings are seasonally adjusted.
M1
Percent change from year ago
18
15
12
9
6
3
0
2001 2002 2003 2004 2005

Interest Rates
Percent
5
4
3
2
1
0
2001 2002 2003 2004 2005

M3
Percent change from year ago
10
8
6
4
2
2001 2002 2003 2004 2005

Exchange Rate and Inflation Differential
Euro/US$
1.184
1.084
0.984
0.884
0.784
0.684
2001 2002 2003 2004 2005

Stock Exchange Index - Dow Jones EURO STOXX™
2000 = 100
90
80
70
60
50
40
2001 2002 2003 2004 2005

Real Effective Exchange Rate
Index 2000 = 100
125
120
115
110
105
100
2001 2002 2003 2004 2005
* EUROSTAT has recently changed how it calculates GDP. Data are currently available back to 1995 but will soon be revised back to 1991.
Hourly Earnings and Output per Worker
Percent change from year ago

-2 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28 29 30
8 6 4 2 0

Hourly Earnings*
Output per Worker**

* Hourly earnings are seasonally adjusted. ** EUROSTAT is currently revising output data. Output per worker data are available only back to 1995.

Labor Force Indicators
Percent change from year ago

-2 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28 29 30
-2 -1 0 1 2 3

Employment (left scale)
Unemployment Rate (right scale)

Inflation
Percent change from year ago

-3 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28 29 30
-3 -2 -1 0 1 2 3

Consumer Price Index
Producer Price Index

Government Debt and Budget Balance
Percent of GDP, annual data

-6 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25 26 27 28 29 30
-6 -4 -2 0 2

Debt (right scale)
Budget Balance (left scale)
Real GDP
Percent change from year ago

Employment
Percent change from year ago

Consumer Price Index
Percent change from year ago

Unemployment Rate
Percent

Hourly Earnings
Percent change from year ago*

Current Account Balance
Percent of GDP

* Hourly earnings are seasonally adjusted.
### GDP
Percent change from year ago

![GDP Chart]

### Industrial Production
Percent change from year ago

![Industrial Production Chart]

### Retail Sales
Percent change from year ago

![Retail Sales Chart]

### Capacity Utilization
Percent

![Capacity Utilization Chart]
Hourly Earnings and Output per Worker
Percent change from year ago

* Hourly earnings are seasonally adjusted.

Labor Force Indicators
Percent change from year ago

Inflation
Percent change from year ago

Government Debt and Budget Balance
Percent of GDP, annual data
**Real GDP**
Percent change from year ago

<table>
<thead>
<tr>
<th>Year</th>
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**Employment**
Percent change from year ago

<table>
<thead>
<tr>
<th>Year</th>
<th>2001</th>
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<th>2003</th>
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<td>-3</td>
<td>0</td>
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**Consumer Price Index**
Percent change from year ago

<table>
<thead>
<tr>
<th>Year</th>
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**Unemployment Rate**
Percent

<table>
<thead>
<tr>
<th>Year</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
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<td>4</td>
<td>5</td>
<td>6</td>
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**Hourly Earnings**
Percent change from year ago*

<table>
<thead>
<tr>
<th>Year</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
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<td>Earnings</td>
<td>2</td>
<td>1</td>
<td>0</td>
<td>1</td>
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**Current Account Balance**
Percent of GDP

<table>
<thead>
<tr>
<th>Year</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
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<th>2005</th>
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* Hourly earnings are seasonally adjusted.
Hourly Earnings and Output per Worker
Percent change from year ago

* Hourly earnings are seasonally adjusted.

Labor Force Indicators
Percent change from year ago

Inflation
Percent change from year ago

Government Debt and Budget Balance
Percent of GDP, annual data
International Trade - Goods and Services
Percent of GDP

Current Account Balance
Percent of GDP

Foreign Exchange Reserves
Billions of US$

Stock Exchange Index - CDAX
2000 = 100
Real GDP
Percent change from year ago

Employment
Percent change from year ago

Consumer Price Index
Percent change from year ago

Unemployment Rate
Percent

Hourly Earnings
Percent change from year ago*

Current Account Balance
Percent of GDP

* Hourly earnings are seasonally adjusted.
Hourly Earnings and Output per Worker
Percent change from year ago

* Hourly earnings are seasonally adjusted.

Labor Force Indicators
Percent change from year ago

Inflation
Percent change from year ago

Government Debt and Budget Balance
Percent of GDP, annual data

Research Division
Federal Reserve Bank of St. Louis
Real GDP
Percent change from year ago

Employment
Percent change from year ago

Consumer Price Index
Percent change from year ago

Unemployment Rate
Percent

Monthly Earnings
Percent change from year ago*

Current Account Balance
Percent of GDP

* Monthly earnings are seasonally adjusted.
**Monthly Earnings and Output per Worker**

Percent change from year ago

- Monthly Earnings*
- Output per Worker

* Monthly earnings are seasonally adjusted.

**Labor Force Indicators**

Percent change from year ago  

- Employment (left scale)
- Unemployment Rate (right scale)

**Inflation**

Percent change from year ago

- Consumer Price Index
- Producer Price Index

**Government Debt and Budget Balance**

Percent of GDP, annual data

- Budget Balance (left scale)
- Gross Debt (right scale)
International Economic Trends Japan

International Trade - Goods and Services
Percent of GDP

Exports
Imports

Current Account Balance
Percent of GDP

Foreign Exchange Reserves
Billions of US$

Real Effective Exchange Rate
Index 2000 = 100
### Adjusted Monetary Base
Percent change from year ago

![Graph showing Adjusted Monetary Base](image)

### Monetary Aggregates
Percent change from year ago

![Graph showing Monetary Aggregates](image)

M1

M2

### Interest Rates
Percent

![Graph showing Interest Rates](image)

3-Month CDs

10-Year Government Bonds

### Stock Exchange Index - Tokyo Stock Exchange
2000 = 100

![Graph showing Stock Exchange Index](image)
### Real GDP
Percent change from year ago

![Real GDP chart](chart)

### Employment
Percent change from year ago

![Employment chart](chart)

### Consumer Price Index
Percent change from year ago

![Consumer Price Index chart](chart)

### Unemployment Rate
Percent

![Unemployment Rate chart](chart)

### Weekly Earnings
Percent change from year ago*

![Weekly Earnings chart](chart)

### Current Account Balance
Percent of GDP

![Current Account Balance chart](chart)

* Weekly earnings are seasonally adjusted.
**Weekly Earnings and Output per Worker**

Percent change from year ago

*Weekly earnings are seasonally adjusted.*

**Labor Force Indicators**

Percent change from year ago

**Inflation**

Percent change from year ago

**Government Debt and Budget Balance**

Percent of GDP, annual data

*The series has been revised by the OECD from unconsolidated to consolidated debt at market prices.*
United Kingdom

International Economic Trends

M0
Percent change from year ago

Monetary Aggregates
Percent change from year ago

Interest Rates
Percent

Stock Exchange Index - Financial Times Stock Exchange
2000 = 100
Real GDP
Percent change from year ago

Employment
Percent change from year ago

Consumer Price Index
Percent change from year ago

Unemployment Rate
Percent

Hourly Earnings
Percent change from year ago*

Current Account Balance
Percent of GDP

* Hourly earnings are seasonally adjusted.
GDP
Percent change from year ago

Industrial Production
Percent change from year ago

Retail Sales
Percent change from year ago

*Data prior to 1993 may not be strictly comparable with later figures (see Notes).

Capacity Utilization
Percent

Nominal
Real
Hourly Earnings and Output per Worker

Percent change from year ago

* Hourly earnings are seasonally adjusted.

Labor Force Indicators

Percent change from year ago

Inflation

Percent change from year ago

Government Debt and Budget Balance

Percent of GDP, annual data
International Economic Trends

United States

International Trade - Goods and Services
Percent of GDP

Current Account Balance
Percent of GDP

Foreign Exchange Reserves
Billions of US$

Real Effective Exchange Rate
Index 2000 = 100
Notes

**Euro-Area Data:** On January 1, 2001, the euro area was enlarged to include Greece as its 12th member country. Historical euro area series for capacity utilization, the consumer price index, current account balance, earnings, employment, government debt and budget balance, gross domestic product (GDP), industrial production, merchandise trade, the producer price index, and unemployment include Greece. The series for interest rates, monetary aggregates, the real effective exchange rate, retail sales, and the stock exchange index incorporate Greece starting in January 2001.

Euro-area interest rates prior to December 1998 are calculated on the basis of national government yields weighted by GDP. Starting in 1999, short-term rates are euro interbank offered rates. Long-term rates are calculated on the basis of national government bond yields weighted by the nominal outstanding amounts of government bonds in each maturity band.

The euro/dollar exchange rate used in the chart on page 12 is a synthetic rate prior to January 1999. This is constructed by calculating a weighted average of the exchange rates of the euro-area countries, excluding Greece and Luxembourg, against the dollar. The weights are based on 1997 GDP shares.

**German Data:** As a result of reunification, data for all of Germany are now incorporated in the statistical series. The starting periods for unified German data are listed below. Care should be exercised when interpreting the data around these break periods.

- Third quarter 1990: current account balance, international trade, and unemployment.
- First quarter 1991: consumer price index, GDP, industrial production, output per worker.
- First quarter 1993: stock exchange index.
- Third quarter 1993: employment.

**Capacity Utilization** covers the manufacturing sector for Canada, France, Japan, the United Kingdom, the United States, and the euro area; manufacturing excluding food, beverage, and tobacco for Germany; and mining and manufacturing for Italy.

**Consumer Price Index** is for all items. The current index is based on goods and services consumed by all individuals for Canada; all multi-person households excluding those mainly engaged in agriculture, forestry, and fisheries for Japan; all households except pensioners dependent on state pension and high income households for the United Kingdom; and all urban households for the United States. Data for the euro area, France, Germany, and Italy are based on the harmonized index of consumer prices.

**Current Account Balance** is the sum of merchandise and service exports and income receipts on domestic assets abroad minus the sum of merchandise and service imports and income payments from foreign assets in the domestic economy plus net unilateral transfers.

**Earnings** are based on hourly earnings in manufacturing for Canada, Germany, the United States, and the euro area; hourly earnings in manufacturing excluding construction for France, hourly earnings in industry for Italy; monthly earnings in manufacturing for Japan; and weekly earnings in manufacturing for the United Kingdom.

The **Exchange Rate** for all countries except the United States is expressed as units of local currency per U.S. dollar. For the United States the trade-weighted exchange rate, TWEX, is used. This is a weighted average of the exchange value of the U.S. dollar relative to the major international currencies—the euro, Canadian dollar, Japanese yen, British pound, Swiss franc, Australian dollar, and Swedish kronor. Prior to 1999, the currencies of the euro-area countries (with the exception of Greece) are used instead of the euro.

**Real Effective Exchange Rate** uses normalized unit labor costs in manufacturing. The weighting scheme used to construct the rates, for all except the euro area, is based on disaggregated data for trade among 21 industrial countries in manufactured goods for 2000. For the euro area the weights relate to the trade of the euro area with the other countries. The weights reflect the relative importance of a country’s trading partners in its direct bilateral trade relations and competition in third markets. Normalized unit labor costs in manufacturing are calculated by dividing an index of actual hourly compensation per worker by a five-year moving average index of output per man-hour.

**Employment** data refer to civilian employment for Canada, Germany, Italy, Japan, and the United States; industrial employment for France; and total employment for the euro area and the United Kingdom.

**Foreign Exchange Reserve** data are end of period. The dollar value of reserves may fluctuate as a result of changes in reserve holdings and/or changes in the value of the currencies held vis-à-vis the U.S. dollar.

**Government Budget Balance** is the difference between general government current receipts and total outlays. Total outlays consist of current expenditures and net capital expenditures. **Government Debt** incorporates all financial liabilities of the general government sector. The general government sector consolidates the accounts of the central, state, local, and social security sectors.

**Cumulative Inflation Differential** is the cumulative change in the foreign consumer price index (CPI) over the change in the U.S. CPI, in percentage terms. The base period for the cumulative rate of change is taken to be the first period of the chart. For example, if the base period is 1999:Q3, then the cumulative inflation differential for Japan for 2003:Q3 is as follows:

\[
\text{inflation differential} = 100 \left( \frac{P_{2003Q3}^J}{P_{1999Q3}^J} - \frac{P_{2003Q3}^{US}}{P_{1999Q3}^{US}} \right)
\]

where \(P_{2003Q3}^J\) is the Japanese CPI in the third quarter of 2003. For the U.S. chart on page 41, foreign CPI is calculated as the weighted average of the CPIs of countries whose currencies are used in the major currency trade-weighted exchange rate index. Starting in 1999, the euro-area harmonized consumer price index is used for the euro area. Prior to 1999, the price levels for the individual euro area countries (excluding Greece and Luxembourg) are used. The cumulative inflation differential is shown because the theory of purchasing power parity states that exchange rate changes should be systematically positively related to this variable.

**Industrial Production** measures the change in the volume of output in the mining, manufacturing, oil, electricity, gas, and water industries.

The **Short-Term Interest Rate** table on page 4 uses the relevant 3-month interest rate shown in the country pages.

The **Long-Term Interest Rate** table on page 4 uses the government bond rate. The government bond rate is a composite of yields on federal government bonds with maturities of more than 10 years for the United States; 10-year benchmark bonds for France; 7- to 15-year public sector bonds for Germany; 15- to 20-year government bonds through 1990 and 10-year government bonds starting in 1991 for Italy; and 10-year government bonds for Canada, the euro area, Japan, and the United Kingdom.

The **Reserve Money** table on page 4 refers to the adjusted monetary base for Japan and the United States; reserve money for Canada; and M0 for the United Kingdom. **Reserve Money** is currency in circulation, deposits of the deposit money banks, and demand deposits of other residents (with the exception of the central government) with the monetary authority.

**Adjusted Monetary Base**

Japan: currency in circulation and current deposits at the Bank of Japan.

United States: the sum of currency in circulation outside Federal Reserve banks and the U.S. Treasury, deposits of depository financial institutions at Federal Reserve banks, and an adjustment for the effects of changes in statutory reserve requirements on the quantity of base money held by depositories.

**M0**


**M1**

Canada: currency in circulation and chartered bank net demand deposits.

Japan: cash, currency in circulation, and deposit money.

Euro area: currency in circulation and overnight deposits.
Notes and Sources

International Economic Trends

MZM
United States: currency in circulation, travelers’ checks, total publicly-held checkable deposits minus cash items in the process of collection and Federal Reserve float, savings deposits, shares in retail money market mutual funds (funds with initial investments of less than $50,000), net of retirement accounts, and institutional money market mutual funds.

M2
Canada: M1 plus all checkable notice deposits and personal term deposits. United Kingdom: currency in circulation and sterling retail deposits with the U.K. banks and building societies. United States: M2 less institutional money market mutual funds plus small denomination (less than $100,000) time deposits.

M2 + CDs
Japan: M1 plus private deposits, public deposits less demand deposits, and certificates of deposit.

M3
Euro area: M1 plus deposits with a maturity up to 2 years, deposits redeemable at notice up to 3 months, repurchase agreements, money market funds, and debt securities up to 2 years.

M4
United Kingdom: M2 plus wholesale deposits with the U.K. banks and building societies.

Output Per Worker is the ratio of real GDP to employment.

Producer Price Index covers manufacturing for Canada and the United Kingdom; and total industry for Japan and the United States. Data for the euro area, France, Germany, and Italy are based on the harmonized index of total industry excluding construction.

Retail Sales are based on a volume index. The percent change in retail sales for the United States is based on the Standard Industrial Classification system through 1992 and the North American Industrial Classification System from 1993 on.

Stock Exchange Index refers to all share prices except for the United Kingdom, which excludes financial firms.

Unemployment Rate is the standardized unemployment rate. It is the percent-age of the civilian labor force that is unemployed. The unemployed are all persons of working age who are without work, readily available for work, and actively seeking work. The standardized rate may differ from the national unemployment rate calculations.

Sources

Abbreviations
Board of Governors of the Federal Reserve System (BOG)
Bureau of Economic Analysis, U.S. Department of Commerce (BEA)
International Monetary Fund, International Financial Statistics (IMF)
Organization for Economic Cooperation and Development, Economic Outlook (OECD1)
Main Economic Indicators (OECD2)
National Accounts Quarterly (OECD3)

Canada
Bank of Canada: M1 and M2.

BOG: exchange rate.
IMF: foreign exchange reserves, merchandise and service trade, real effective exchange rate, and reserve money.
OECD1: government debt and budget balance.
OECD2: capacity utilization, consumer price index, current account balance, GDP, hourly earnings, industrial production, interest rates, producer price index, retail sales, stock exchange index, and unemployment rate.
Statistics Canada: employment.

Euro Area
European Central Bank: current account balance and employment.
Eurostat: capacity utilization, consumer price index, GDP, interest rates, merchandise trade, producer price index, and retail sales.

Haver Analytics: synthetic euro exchange rate.
IMF: real effective exchange rate.
OECD1: government debt and budget balance.
OECD2: hourly earnings, industrial production, M1, M3, stock exchange index, and unemployment.

France
BOG: exchange rate.
Eurostat: capacity utilization, consumer price index, and producer price index.
IMF: foreign exchange reserves, merchandise and service trade, and real effective exchange rate.
Institut National de la Statistique et des Etudes Economiques: employment.
OECD1: government debt and budget balance.
OECD2: current account balance, GDP, hourly earnings, industrial production, retail sales, interest rates, stock exchange index, and unemployment.

Germany
BOG: exchange rate.
Bundesanstalt Fur Arbeit: employment.
Eurostat: capacity utilization, consumer price index, and producer price index.
IMF: foreign exchange reserves, merchandise and service trade, and real effective exchange rate.
OECD1: government debt and budget balance.
OECD2: current account balance, GDP, hourly earnings, industrial production, M1, M3, retail sales, interest rates, stock exchange index, and unemployment.

Italy
BOG: exchange rate.
Eurostat: capacity utilization, consumer price index, and producer price index.
IMF: foreign exchange reserves, merchandise and service trade, and real effective exchange rate.
Instituto Nazionale di Statistica: employment.
OECD1: government debt and budget balance.
OECD2: current account balance, GDP, hourly earnings, industrial production, long-term interest rates, retail sales, stock exchange index, and unemployment.

Japan
Bank of Japan: adjusted monetary base and long-term interest rate.
BOG: exchange rate.
IMF: foreign exchange reserves, merchandise and service trade, and real effective exchange rate.
OECD1: government debt and budget balance.
OECD2: capacity utilization, consumer price index, current account balance, employment, GDP, hourly earnings, industrial production, M1, M2, producer price index, retail sales, short-term interest rate, stock exchange index, and unemployment.

United Kingdom

BOG: exchange rate.
IMF: foreign exchange reserves, merchandise and service trade, and real effective exchange rate.
OECD1: government debt and budget balance.
OECD2: capacity utilization, consumer price index, current account balance, GDP, industrial production, interest rates, M4, producer price index, retail sales, stock exchange index, unemployment, and weekly earnings.
U.K. Office for National Statistics: employment and M0.

United States
BOG: capacity utilization, exchange rate, industrial production index, M2, and interest rates.
BEA: GDP, current account balance, merchandise and service trade, and retail sales.
BLS: employment, consumer price index, and producer price index.
Federal Reserve Bank of St. Louis: adjusted monetary base and MZM.
IMF: foreign exchange reserves and real effective exchange rate.
OECD1: government debt and budget balance.
OECD2: hourly earnings, stock exchange index, and unemployment.