

## **Prefatory Note**

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December 7, 2007

# CURRENT ECONOMIC AND FINANCIAL CONDITIONS

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## **Supplemental Notes**

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

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## Supplemental Notes

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### The Domestic Nonfinancial Economy

#### Labor Market Developments

Employment gains have stepped down in recent months, reflecting to a large extent the weakness in the housing market. Last month, private nonfarm payrolls rose 64,000, little different from the average rate over the three months ended in October, but down nearly 60,000 from the pace over the preceding three-month period. In November, residential construction shed 20,000 jobs—its fourth month of sizable declines—and employment in housing-related sectors such as finance, real estate, and building material and garden-supply retailers continued to trend down. Elsewhere, factory payrolls declined again, while employment in most service-producing industries continued to move up.

Because the average workweek of production or nonsupervisory workers has been unchanged, on balance, over the past year, the rise in aggregate hours has slowed in line with employment. In November, the index of aggregate weekly hours of production or nonsupervisory workers inched up to a level 0.3 percent above its third-quarter average (not at an annual rate).

Indicators from the household survey also point to some recent softening in the labor market.<sup>1</sup> After having increased 0.2 percentage point over the third quarter, the unemployment rate held steady at 4.7 percent for a third month in November. Although the labor force participation rate moved back up to 66.1 percent last month, it remains about  $\frac{1}{4}$  percentage point below its recent peak earlier this year.

Other indicators of labor market activity point to some further slowing of labor demand in coming months. The four-week moving average of initial claims for unemployment insurance continued to trend up, but remains in a range consistent with modest employment gains.<sup>2</sup> In addition, the index of expected unemployment change over the next twelve months in the Reuters/University of Michigan Survey of Consumers jumped in early December to its highest level since the aftermath of Hurricane Katrina in September 2005. Moreover, the National Federation of Independent Business reported that its index of net hiring plans continued to move down in November.

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<sup>1</sup> The reference week for the household survey was one week earlier in November than is typically the case to avoid data collection during Thanksgiving week. The effects of this change on the monthly estimates are unclear.

<sup>2</sup> We must interpret the recent claims figures with caution because seasonal adjustment of initial claims is particularly difficult around major holidays.

Average hourly earnings rose 0.5 percent in November following smaller increases in the previous two months. Over the twelve months ended in November, average hourly earnings rose 3.8 percent, off a bit from the 4.1 percent pace over the previous twelve months.

### **Consumer Sentiment**

The Reuters/University of Michigan index of consumer sentiment ticked down further in early December as a result of respondents more pessimistic views of the outlook for their personal finances and for business conditions in the year ahead. Households' assessment of current conditions turned up a touch reflecting more a favorable opinion of buying conditions for large household durables. Their appraisal of current buying conditions for cars slipped further, but, citing lower prices, their views of buying conditions for houses improved.

Respondents' median expectation for year-ahead inflation edged up further in December to 3.5 percent, and their median expectation for inflation over the next five to ten years moved up to 3.1 percent. Both readings are at the high end of the range of the past two years.

## Changes in Employment

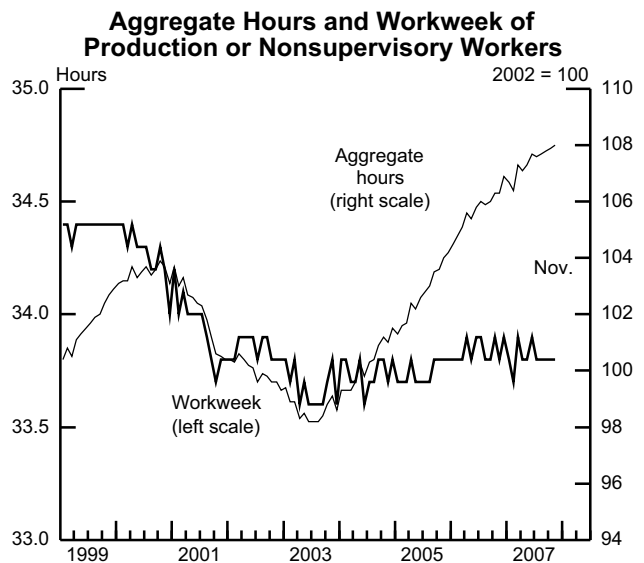
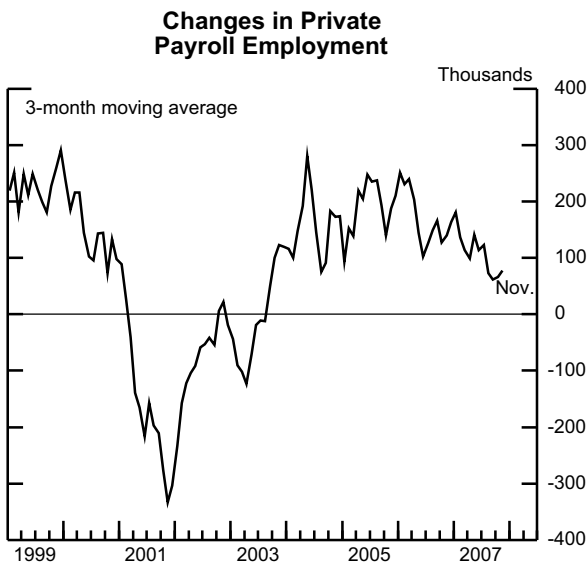
(Thousands of employees; seasonally adjusted)

| Measure and sector  | 2006 | 2007                   |      |      |                |      |      |
|---|------|------------------------|------|------|----------------|------|------|
|   |      | Q1                     | Q2   | Q3   | Sept.          | Oct. | Nov. |
|   |      | Average monthly change |      |      | Monthly change |      |      |
| Nonfarm payroll employment (establishment survey)                           | 189  | 142                    | 126  | 77   | 44             | 170  | 94   |
| Private   | 169  | 115                    | 114  | 61   | 37             | 132  | 64   |
| Natural resources and mining  | 5    | 3                      | 2    | 2    | 0              | 2    | 2    |
| Manufacturing   | -7   | -14                    | -13  | -21  | -15            | -15  | -11  |
| Construction  | 11   | 3                      | -9   | -23  | -25            | -9   | -24  |
| Wholesale trade   | 11   | 2                      | 15   | 9    | 11             | 14   | 5    |
| Retail trade  | -3   | 27                     | -7   | 0    | -3             | -15  | 24   |
| Transportation and utilities  | 9    | 2                      | 1    | 9    | 16             | 3    | 5    |
| Information   | 2    | 4                      | 2    | 0    | 6              | -2   | -6   |
| Financial activities  | 16   | 2                      | 5    | -7   | -24            | -2   | -20  |
| Professional and business services  | 42   | 14                     | 17   | 23   | 12             | 64   | 30   |
| Temporary help services   | -1   | -7                     | -11  | -9   | -17            | 28   | 11   |
| Nonbusiness services <sup>1</sup>   | 83   | 71                     | 100  | 70   | 59             | 91   | 59   |
| Total government  | 20   | 28                     | 12   | 15   | 7              | 38   | 30   |
| Total employment (household survey)   | 262  | 109                    | -38  | 39   | 463            | -250 | 696  |
| Memo:   |      |                        |      |      |                |      |      |
| Aggregate hours of private production workers (percent change) <sup>2</sup> | 2.5  | 1.1                    | 2.1  | 1.2  | .1             | .1   | .1   |
| Average workweek (hours) <sup>3</sup>                                       | 33.8 | 33.8                   | 33.8 | 33.8 | 33.8           | 33.8 | 33.8 |
| Manufacturing (hours)   | 41.1 | 41.0                   | 41.2 | 41.3 | 41.3           | 41.2 | 41.3 |

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

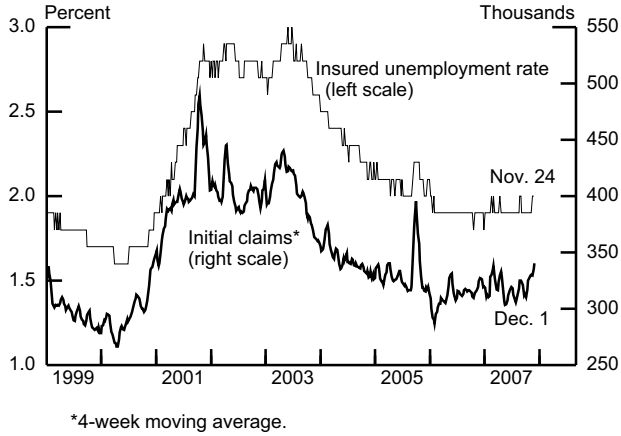
2. Establishment survey. Annual data are percent changes from Q4 to Q4. Quarterly data are percent changes from preceding quarter at an annual rate. Monthly data are percent changes from preceding month.

3. Establishment survey.

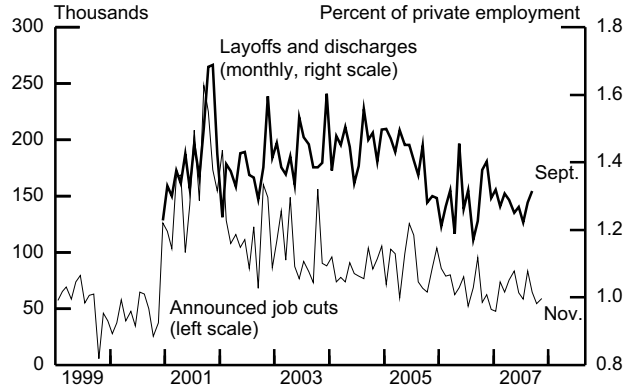


# Labor Market Indicators

### Unemployment Insurance

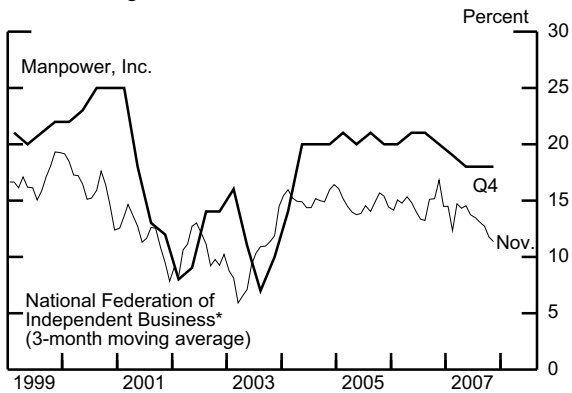


### Layoffs and Job Cuts



Note. Both series are seasonally adjusted by FRB staff.  
Source. For layoffs and discharges, Job Openings and Labor Turnover Survey; for job cuts, Challenger, Gray, and Christmas, Inc.

### Net Hiring Plans



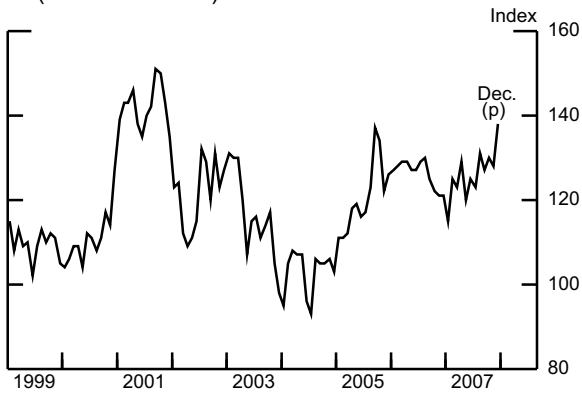
Note. Percent planning an increase in employment minus percent planning a reduction.  
\* Seasonally adjusted by FRB staff.

### Job Openings and Hires



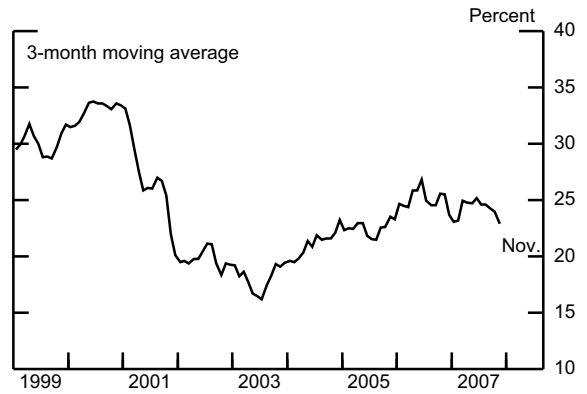
Source. Job Openings and Labor Turnover Survey.

### Reuters/Michigan Expected Unemployment Change (next 12 months)



Note. The fraction of households expecting unemployment to rise, minus the fraction expecting unemployment to fall, plus 100.  
p Preliminary.

### Hard-To-Fill Positions



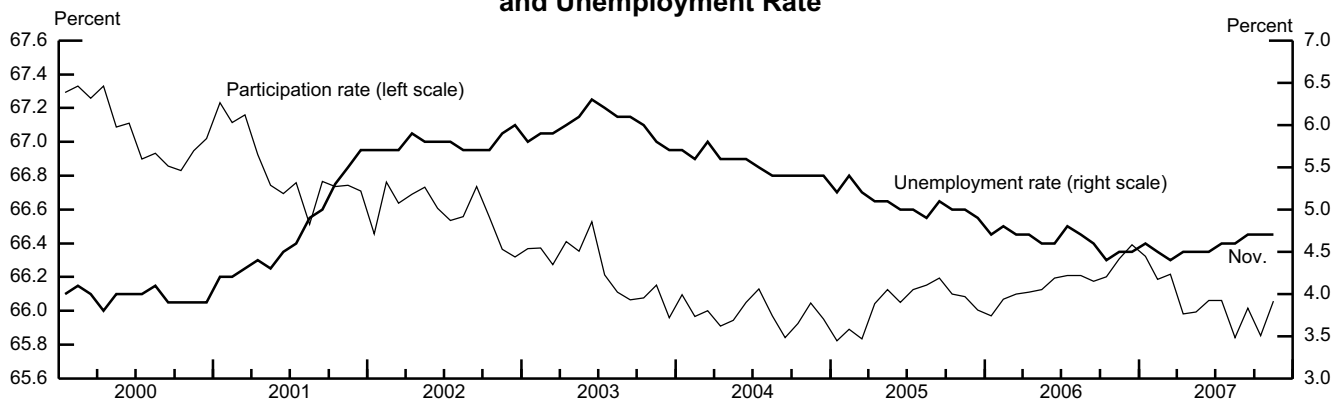
Note. Percent of small businesses surveyed with at least one "hard-to-fill" job opening. Seasonally adjusted by FRB staff.  
Source. National Federation of Independent Business.

## Selected Unemployment and Labor Force Participation Rates

(Percent; seasonally adjusted)

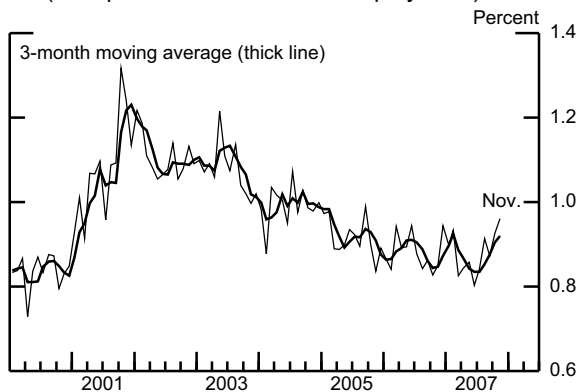
| Rate and group                        | 2006 | 2007 |      |      |       |      |      |
|---------------------------------------|------|------|------|------|-------|------|------|
|                                       |      | Q1   | Q2   | Q3   | Sept. | Oct. | Nov. |
| <i>Civilian unemployment rate</i>     |      |      |      |      |       |      |      |
| Total                                 | 4.6  | 4.5  | 4.5  | 4.7  | 4.7   | 4.7  | 4.7  |
| Teenagers                             | 15.4 | 14.8 | 15.6 | 15.7 | 16.0  | 15.6 | 16.3 |
| 20-24 years old                       | 8.2  | 7.7  | 7.7  | 8.5  | 8.9   | 8.5  | 8.1  |
| Men, 25 years and older               | 3.5  | 3.6  | 3.5  | 3.6  | 3.6   | 3.7  | 3.6  |
| Women, 25 years and older             | 3.7  | 3.5  | 3.5  | 3.7  | 3.6   | 3.7  | 3.8  |
| <i>Labor force participation rate</i> |      |      |      |      |       |      |      |
| Total                                 | 66.2 | 66.2 | 66.0 | 66.0 | 66.0  | 65.9 | 66.1 |
| Teenagers                             | 43.6 | 42.2 | 41.5 | 40.7 | 41.2  | 41.1 | 40.8 |
| 20-24 years old                       | 74.6 | 75.1 | 74.2 | 74.5 | 75.0  | 74.0 | 74.5 |
| Men, 25 years and older               | 75.5 | 75.7 | 75.6 | 75.5 | 75.5  | 75.3 | 75.6 |
| Women, 25 years and older             | 59.6 | 59.6 | 59.6 | 59.8 | 59.8  | 59.6 | 59.8 |

### Labor Force Participation Rate and Unemployment Rate



### Job Losers Unemployed Less Than 5 Weeks

(as a percent of household employment)



### Unemployed Due to Job Loss

(as a percent of the labor force)





**Reuters/University of Michigan Survey of Consumers**  
**Indexes of consumer sentiment**  
 (Not seasonally adjusted)

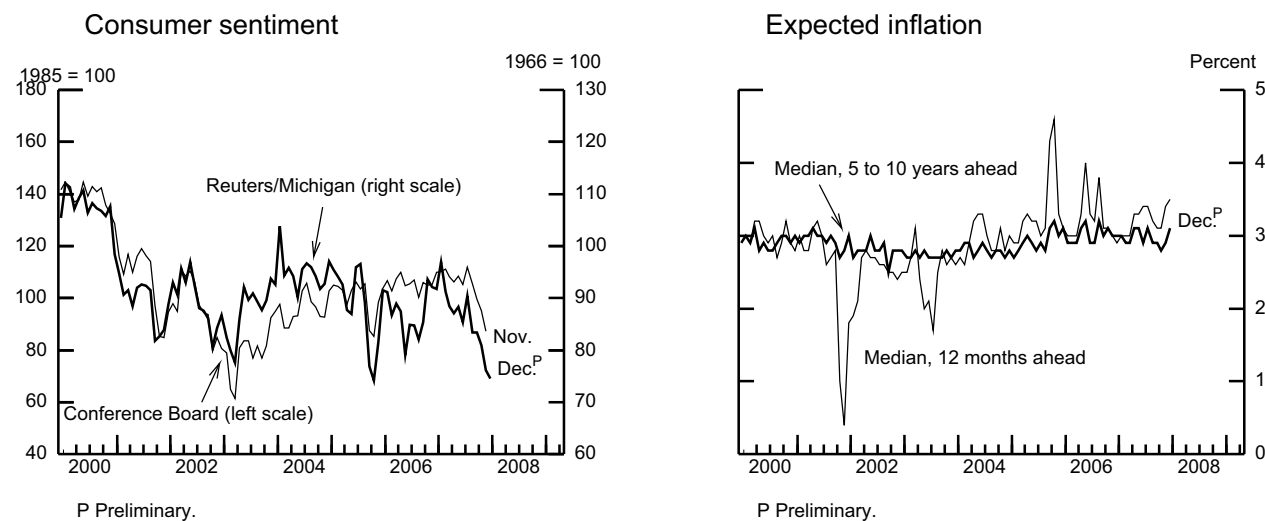
| Category  | 2007  |       |       |      |       |      |      |                   |
|---|-------|-------|-------|------|-------|------|------|-------------------|
|   | May   | June  | July  | Aug. | Sept. | Oct. | Nov. | Dec. <sup>P</sup> |
| Composite of current and expected conditions <sup>1</sup> | 88.3  | 85.3  | 90.4  | 83.4 | 83.4  | 80.9 | 76.1 | 74.5              |
| Current conditions <sup>1</sup>                           | 105.1 | 101.9 | 104.5 | 98.4 | 97.9  | 97.6 | 91.5 | 92.1              |
| Expected conditions <sup>1</sup>                          | 77.6  | 74.7  | 81.5  | 73.7 | 74.1  | 70.1 | 66.2 | 63.2              |
| Personal financial situation                              |       |       |       |      |       |      |      |                   |
| Now compared with 12 months ago <sup>2</sup>              | 113   | 110   | 115   | 103  | 109   | 111  | 101  | 98                |
| Expected in 12 months <sup>2</sup>                        | 125   | 117   | 125   | 120  | 119   | 119  | 115  | 111               |
| Expected business conditions                              |       |       |       |      |       |      |      |                   |
| Next 12 months <sup>2</sup>                               | 97    | 94    | 105   | 87   | 82    | 78   | 73   | 65                |
| Next 5 years <sup>2</sup>                                 | 89    | 88    | 96    | 88   | 96    | 84   | 76   | 76                |
| Appraisal of buying conditions                            |       |       |       |      |       |      |      |                   |
| Cars  | 124   | 118   | 125   | 133  | 139   | 128  | 117  | 115               |
| Large household appliances <sup>2</sup>                   | 160   | 154   | 156   | 152  | 144   | 142  | 136  | 140               |
| Houses  | 135   | 131   | 129   | 118  | 123   | 131  | 122  | 134               |
| Expected unemployment change - next 12 months             | 120   | 125   | 123   | 131  | 127   | 130  | 128  | 138               |
| Prob. household will lose a job - next 5 years            | 19    | 23    | 21    | 24   | 21    | 21   | 19   | 22                |
| Expected inflation - next 12 months                       |       |       |       |      |       |      |      |                   |
| Mean  | 4.3   | 4.2   | 4.2   | 4.0  | 4.0   | 3.7  | 4.3  | 4.5               |
| Median  | 3.3   | 3.4   | 3.4   | 3.2  | 3.1   | 3.1  | 3.4  | 3.5               |
| Expected inflation - next 5 to 10 years                   |       |       |       |      |       |      |      |                   |
| Mean  | 3.7   | 3.3   | 3.6   | 3.4  | 3.4   | 3.1  | 3.4  | 3.6               |
| Median  | 3.1   | 2.9   | 3.1   | 2.9  | 2.9   | 2.8  | 2.9  | 3.1               |

Note. Figures on financial, business, and buying conditions are the percent reporting 'good times' (or 'better') minus the percent reporting 'bad times' (or 'worse'), plus 100. Expected change in unemployment is the fraction expecting unemployment to rise minus the fraction expecting unemployment to fall, plus 100.

P Preliminary.

1. Feb. 1966 = 100.

2. Indicates the question is one of the five equally-weighted components of the index of sentiment.



## Commercial Bank Credit

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

| Type of credit            | 2004 | 2005 | H1<br>2006 | Q3<br>2006 | Oct.<br>2006* | Nov.<br>2006*c | Level, <sup>1</sup><br>Nov. 2006*c |
|---------------------------|------|------|------------|------------|---------------|----------------|------------------------------------|
| Total <sup>2</sup>        | 8.9  | 10.5 | 11.9       | 7.7        | .0            | 6.0            | 7,794                              |
| <i>Loans<sup>3</sup></i>  |      |      |            |            |               |                |                                    |
| Total                     | 9.7  | 11.6 | 11.7       | 10.0       | 3.5           | 5.3            | 5,835                              |
| To businesses             |      |      |            |            |               |                |                                    |
| Commercial and industrial | 1.2  | 13.2 | 16.4       | 18.9       | 9.1           | 4.6            | 1,162                              |
| Commercial real estate    | 11.7 | 17.1 | 15.6       | 12.9       | 2.2           | 6.9            | 1,408                              |
| To households             |      |      |            |            |               |                |                                    |
| Residential real estate   | 15.6 | 12.0 | 7.7        | 7.0        | 6.5           | -1.9           | 1,726                              |
| Revolving home equity     | 43.8 | 13.3 | .1         | 3.2        | .3            | 4.3            | 449                                |
| Consumer                  | 8.8  | 3.1  | 6.7        | 5.8        | -10.9         | 9.5            | 725                                |
| Originated <sup>4</sup>   | 6.0  | .5   | 7.1        | 5.5        | -1.6          | 9.6            | 1,113                              |
| Other <sup>5</sup>        | 7.4  | 8.4  | 12.0       | 3.0        | 4.8           | 15.8           | 814                                |
| <i>Securities</i>         |      |      |            |            |               |                |                                    |
| Adjusted <sup>2</sup>     | 6.6  | 7.6  | 12.8       | 1.1        | -10.6         | 8.1            | 1,960                              |
| Reported                  | 5.2  | 5.3  | 13.0       | 2.1        | -12.4         | 10.6           | 2,124                              |
| Treasury and agency       | 4.9  | .0   | 8.3        | 4.2        | -27.5         | -2.0           | 1,171                              |
| Other <sup>6</sup>        | 5.7  | 13.3 | 19.4       | -6         | 7.0           | 26.5           | 953                                |

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

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

1. Billions of dollars. Pro rata averages of weekly (Wednesday) levels.

2. Adjusted to remove effects of mark-to-market accounting rules (FIN 39 and FAS 115).

3. Excludes interbank loans.

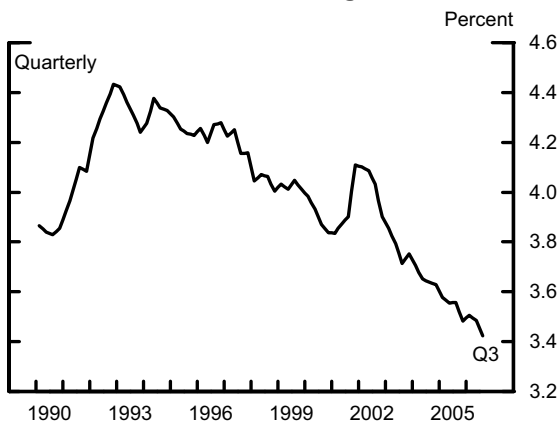
4. Includes an estimate of outstanding loans securitized by commercial banks.

5. Includes security loans and loans to farmers, state and local governments, and all others not elsewhere classified. Also includes lease financing receivables.

6. Includes private mortgage-backed securities, securities of corporations, state and local governments, foreign governments, and any trading account assets that are not Treasury or agency securities, including revaluation gains on derivative contracts.

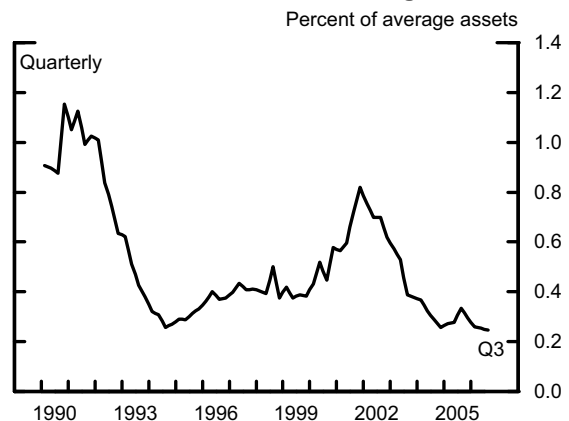
c Estimated.

### Net Interest Margin



Note. Net interest margin is net interest income divided by average interest-earning assets.  
Source. Call Report.

### Loan-Loss Provisioning



Source. Call Report.

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

| Instrument  | 2006    |          | 2007    |        | Change to Dec. 6 from selected dates (percentage points) |               |              |
|---|---------|----------|---------|--------|--|---------------|--------------|
|   | June 29 | Sept. 17 | Oct. 30 | Dec. 6 | 2006 June 29   | 2007 Sept. 17 | 2007 Oct. 30 |
| <i>Short-term</i>                                       |         |          |         |        |  |               |              |
| FOMC intended federal funds rate                        | 5.25    | 5.25     | 4.75    | 4.50   | -.75   | -.75          | -.25         |
| Treasury bills <sup>1</sup>                             |         |          |         |        |  |               |              |
| 3-month   | 4.88    | 4.05     | 3.86    | 3.02   | -1.86  | -1.03         | -.84         |
| 6-month   | 5.06    | 4.15     | 3.92    | 3.18   | -1.88  | -.97          | -.74         |
| Commercial paper (A1/P1 rates) <sup>2</sup>             |         |          |         |        |  |               |              |
| 1-month   | 5.27    | 5.23     | 4.56    | 4.86   | -.41   | -.37          | .30          |
| 3-month   | 5.37    | 5.25     | 4.65    | 4.86   | -.51   | -.39          | .21          |
| Large negotiable CDs <sup>1</sup>                       |         |          |         |        |  |               |              |
| 3-month   | 5.47    | 5.52     | 4.78    | 5.17   | -.30   | -.35          | .39          |
| 6-month   | 5.59    | 5.36     | 4.73    | 4.92   | -.67   | -.44          | .19          |
| Eurodollar deposits <sup>3</sup>                        |         |          |         |        |  |               |              |
| 1-month   | 5.33    | 5.55     | 4.75    | 5.50   | .17  | -.05          | .75          |
| 3-month   | 5.49    | 5.60     | 4.85    | 5.30   | -.19   | -.30          | .45          |
| Bank prime rate   | 8.25    | 8.25     | 7.75    | 7.50   | -.75   | -.75          | -.25         |
| <i>Intermediate- and long-term</i>                      |         |          |         |        |  |               |              |
| U.S. Treasury <sup>4</sup>                              |         |          |         |        |  |               |              |
| 2-year  | 5.26    | 4.12     | 3.84    | 3.03   | -2.23  | -1.09         | -.81         |
| 5-year  | 5.15    | 4.18     | 4.02    | 3.41   | -1.74  | -.77          | -.61         |
| 10-year   | 5.28    | 4.58     | 4.51    | 4.20   | -1.08  | -.38          | -.31         |
| U.S. Treasury indexed notes <sup>5</sup>                |         |          |         |        |  |               |              |
| 5-year  | 2.51    | 2.04     | 1.83    | 1.28   | -1.23  | -.76          | -.55         |
| 10-year   | 2.61    | 2.15     | 2.05    | 1.83   | -.78   | -.32          | -.22         |
| Municipal general obligations (Bond Buyer) <sup>6</sup> | 4.71    | 4.46     | 4.33    | 4.38   | -.33   | -.08          | .05          |
| Private instruments                                     |         |          |         |        |  |               |              |
| 10-year swap  | 5.81    | 5.17     | 5.03    | 4.65   | -1.16  | -.52          | -.38         |
| 10-year FNMA <sup>7</sup>                               | 5.59    | 5.01     | 4.90    | 4.65   | -.94   | -.36          | -.25         |
| 10-year AA <sup>8</sup>                                 | 6.20    | 6.05     | 5.86    | 5.95   | -.25   | -.10          | .09          |
| 10-year BBB <sup>8</sup>                                | 6.74    | 6.46     | 6.26    | 6.41   | -.33   | -.05          | .15          |
| 10-year high yield <sup>8</sup>                         | 8.74    | 8.95     | 8.67    | 9.27   | .53  | .32           | .60          |
| Home mortgages (FHLMC survey rate)                      |         |          |         |        |  |               |              |
| 30-year fixed   | 6.78    | 6.34     | 6.26    | 5.96   | -.82   | -.38          | -.30         |
| 1-year adjustable                                       | 5.82    | 5.65     | 5.57    | 5.46   | -.36   | -.19          | -.11         |

| Stock exchange index | Record high |         | 2007     |         |        | Change to Dec. 6 from selected dates (percent) |               |              |
|----------------------|-------------|---------|----------|---------|--------|--|---------------|--------------|
|                      | Level       | Date    | Sept. 17 | Oct. 30 | Dec. 6 | Record high                                    | 2007 Sept. 17 | 2007 Oct. 30 |
| Dow Jones Industrial | 14,165      | 10-9-07 | 13,403   | 13,792  | 13,620 | -3.85  | 1.62          | -1.25        |
| S&P 500 Composite    | 1,565       | 10-9-07 | 1,477    | 1,531   | 1,507  | -3.69  | 2.08          | -1.55        |
| Nasdaq               | 5,049       | 3-10-00 | 2,582    | 2,817   | 2,709  | -46.34   | 4.93          | -3.82        |
| Russell 2000         | 856         | 7-13-07 | 776      | 816     | 787    | -8.04  | 1.44          | -3.58        |
| Wilshire 5000        | 15,807      | 10-9-07 | 14,839   | 15,482  | 15,203 | -3.82  | 2.45          | -1.80        |

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

NOTES:

June 29, 2006, is the day the most recent policy tightening ended.  
September 17, 2007, is the day before the most recent policy easing began.  
October 30, 2007, is the day before the most recent FOMC announcement.