

## **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

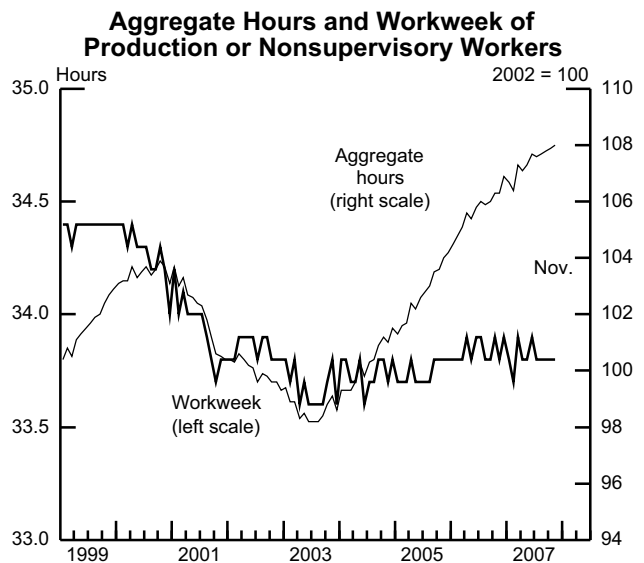
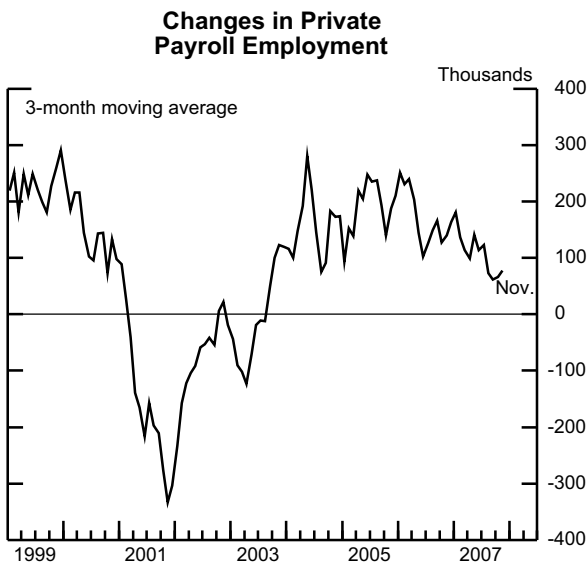
(Thousands of employees; seasonally adjusted)

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."

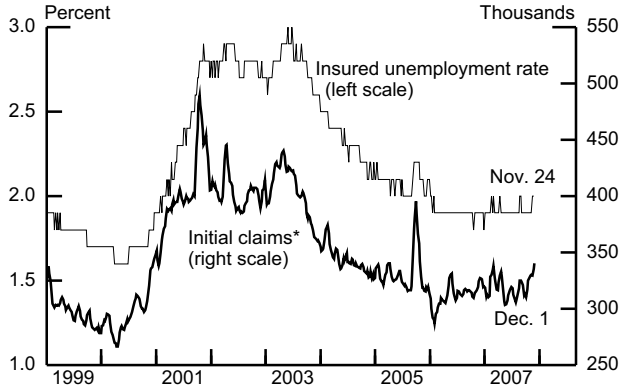
2. Establishment survey. Annual data are percent changes from Q4 to Q4. Quarterly data are percent changes from preceding quarter at an annual rate. Monthly data are percent changes from preceding month.

3. Establishment survey.



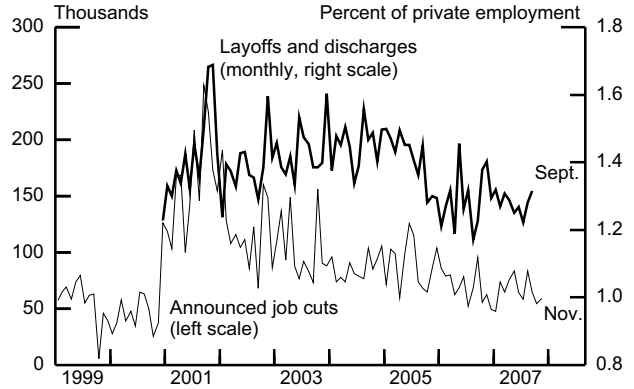
# Labor Market Indicators

### Unemployment Insurance



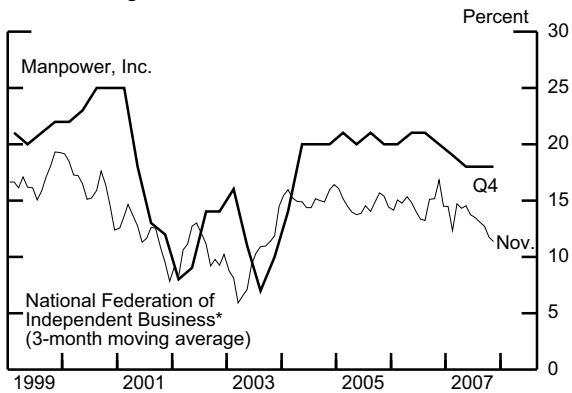
\*4-week moving average.

### 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



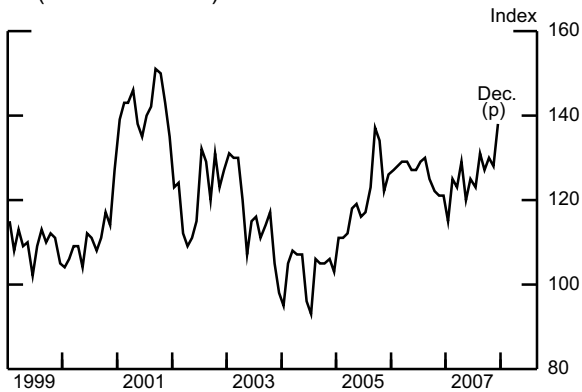
Note. Percent planning an increase in employment minus percent planning a reduction.  
\* Seasonally adjusted by FRB staff.

### 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



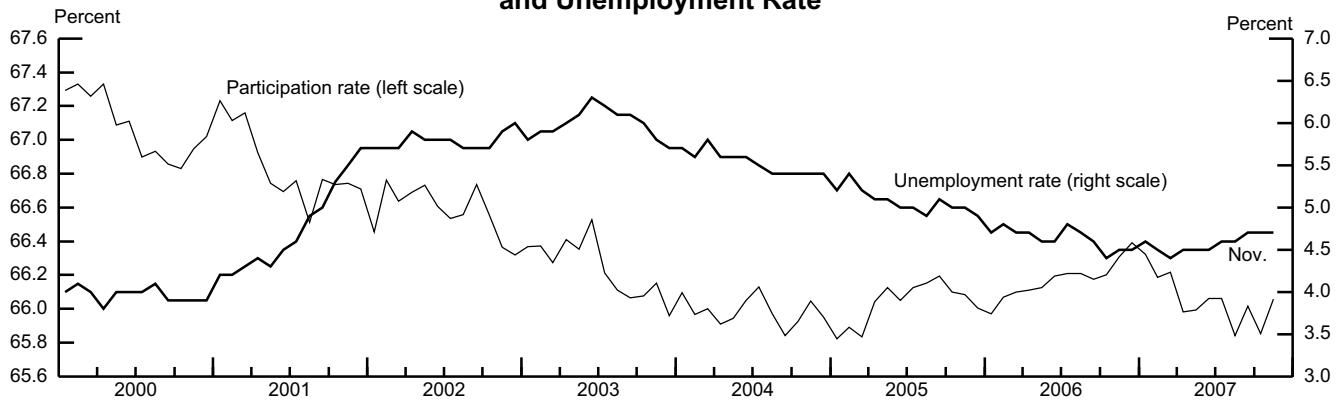
Note. Percent of small businesses surveyed with at least one "hard-to-fill" job opening. Seasonally adjusted by FRB staff.  
Source. National Federation of Independent Business.

## Selected Unemployment and Labor Force Participation Rates

(Percent; seasonally adjusted)

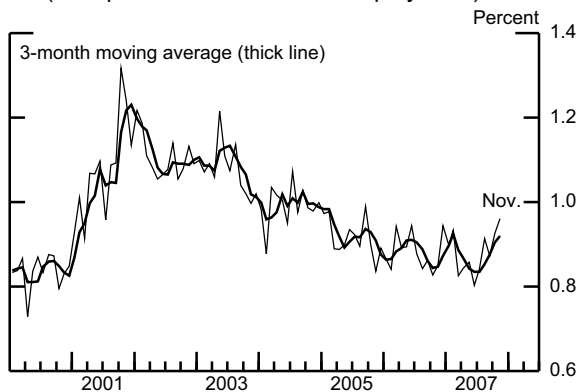
Rate and group	2006	2007					
		Q1	Q2	Q3	Sept.	Oct.	Nov.
<i>Civilian unemployment rate</i>							
Total	4.6	4.5	4.5	4.7	4.7	4.7	4.7
Teenagers	15.4	14.8	15.6	15.7	16.0	15.6	16.3
20-24 years old	8.2	7.7	7.7	8.5	8.9	8.5	8.1
Men, 25 years and older	3.5	3.6	3.5	3.6	3.6	3.7	3.6
Women, 25 years and older	3.7	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)

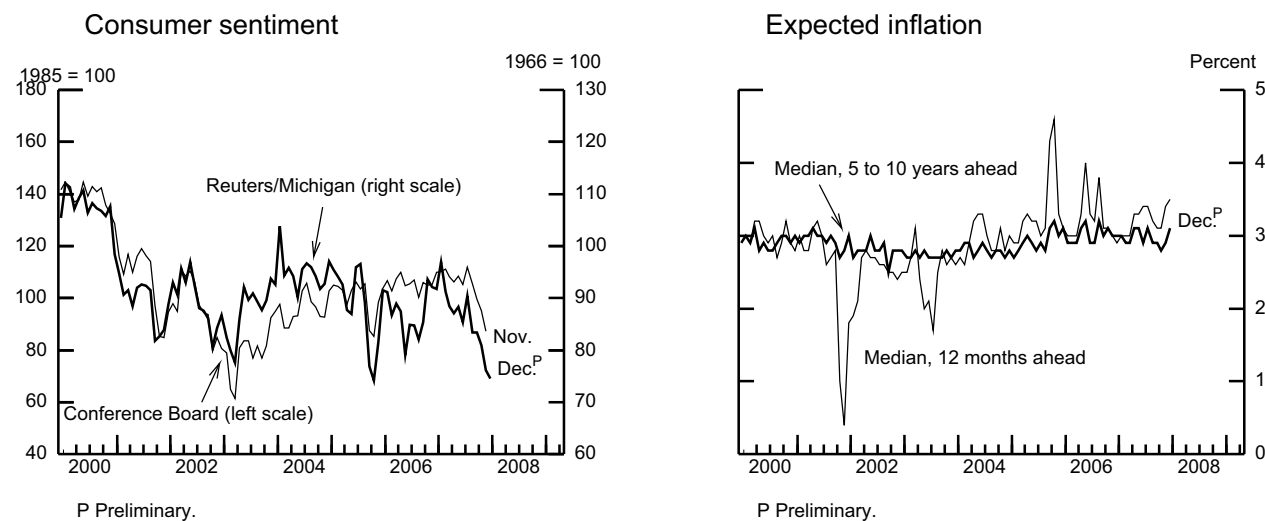
Category	2007							
	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec. <sup>P</sup>
Composite of current and expected conditions <sup>1</sup>	88.3	85.3	90.4	83.4	83.4	80.9	76.1	74.5
Current conditions <sup>1</sup>	105.1	101.9	104.5	98.4	97.9	97.6	91.5	92.1
Expected conditions <sup>1</sup>	77.6	74.7	81.5	73.7	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 2006	Q3 2006	Oct. 2006*	Nov. 2006*c	Level, <sup>1</sup> 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.

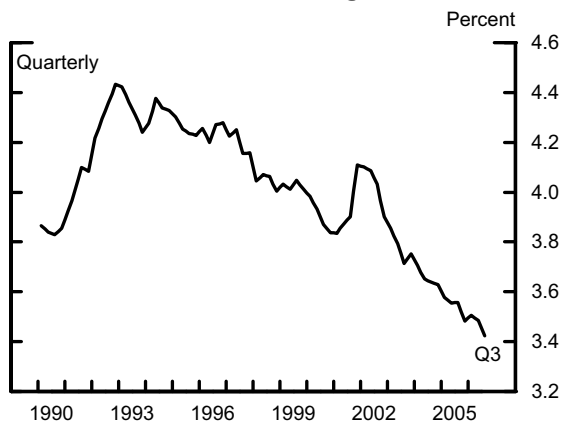
4. Includes an estimate of outstanding loans securitized by commercial banks.

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.

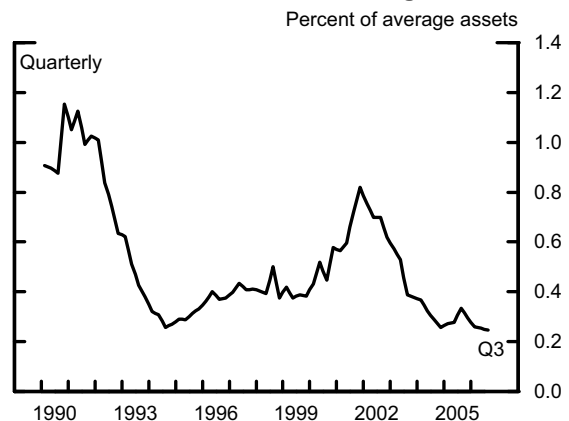
c Estimated.

### 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.