Prefatory Note

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

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Confidential (FR) Class III FOMC

January 26, 2007

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Supplemental Notes

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

Contents

Supplemental Notes

The Domestic Nonfinancial Economy

Sales of New and Existing Homes

The data on sales of new and existing homes in December provide further evidence that housing demand is stabilizing. Sales of new homes climbed 4¾ percent in December to an annual rate of 1.12 million units following an upward-revised increase of 7½ percent in November. Much of December's increase was concentrated in the Midwest and may have been related to the unusually warm temperatures in that region in December. Total existing home sales ticked down ¾ percent in December to an annual rate of 6.2 million units. Sales of single-family homes slipped 1¼ percent to an annual rate of 5.4 million units, but remained within the fairly narrow range of readings seen since mid-summer. Sales of existing condos and co-ops were up 2 percent relative to their November reading.

The stock of new homes for sale ticked down for the fifth consecutive month in December after having peaked in July. Even so, these inventories amounted to 5¾ months' supply at December's higher sales pace, about 20 percent above the upper bound of the relatively tight range that this variable occupied between 1997 and 2005.[1] In the market for existing homes, the stock of single-family existing homes for sale ticked down in December and represented seven months' supply at December's sales pace—in line with the elevated readings seen throughout the second half of last year.

The average sales prices of both new and existing homes were unchanged in December relative to their levels twelve months earlier. On a constant-quality basis, new home prices in the fourth quarter were 3½ percent higher than their level four quarters earlier, down from the 6½ percent appreciation posted in the preceding four-quarter period. The most recent reading of the purchase-only version of the OFHEO price index, which partially controls for changes in the structural characteristics and amenities of homes sold, was up 6 percent in the third quarter relative to its level four quarters earlier.

Manufacturers' Shipments and Orders

Shipments of nondefense capital goods excluding aircraft declined 0.3 percent in December while new orders rose 2.4 percent, partially retracing the declines registered in

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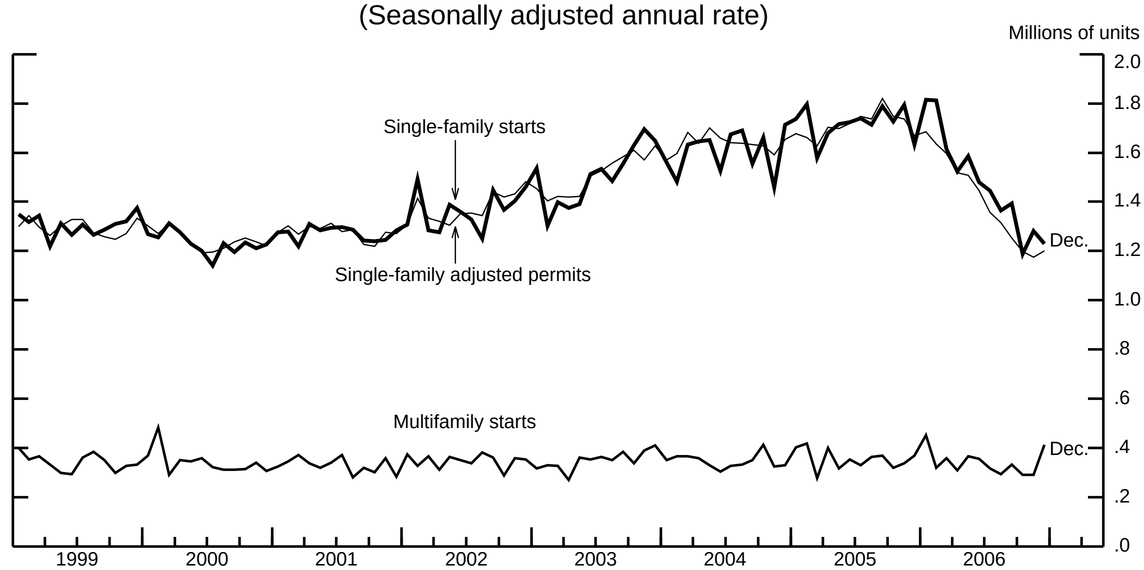
Private Housing Activity
(Millions of units, seasonally adjusted; annual rate except as noted)

Sector	2006	2006 Q2	Q3	Q4	Oct.	Nov.	Dec.
All units							
Starts	1.80	1.87	1.71	1.56	1.48	1.57	1.64
Permits	1.84	1.93	1.71	1.56	1.55	1.51	1.61
Single-family units							
Starts	1.46	1.53	1.40	1.23	1.19	1.28	1.23
Permits	1.38	1.46	1.28	1.17	1.18	1.15	1.17
Adjusted permits[1]	1.41	1.49	1.31	1.19	1.20	1.17	1.20
Permit backlog[2]	.131	.156	.137	.131	.142	.137	.131
New homes							
Sales	1.06	1.10	1.01	1.06	1.00	1.07	1.12
Months' supply[3]	6.23	6.17	6.76	6.17	6.67	6.08	5.75
Existing homes							
Sales	5.68	5.86	5.48	5.49	5.51	5.51	5.44
Months' supply[3]	6.38	6.12	7.02	6.98	7.03	6.92	7.00
Multifamily units							
Starts	.337	.343	.313	.331	.291	.290	.412
Permits	.457	.466	.433	.394	.372	.363	.445
Permit backlog[2]	.062	.068	.067	.062	.066	.065	.062
Mobile homes							
Shipments	n.a.	.122	.107	n.a.	.098	.096	n.a.
Condos and co-ops							
Existing home sales	.803	.828	.796	.757	.734	.761	.777

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

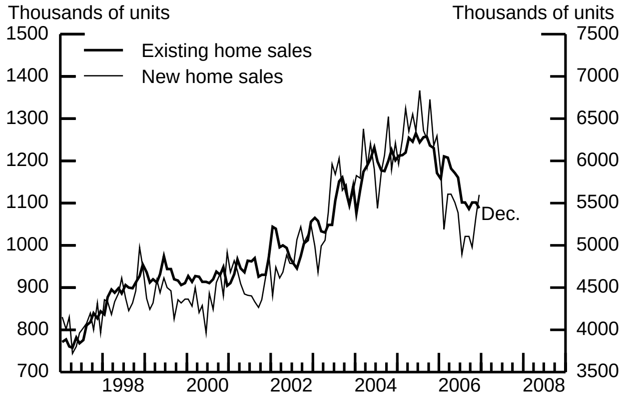
Private Housing Starts and Permits
(Seasonally adjusted annual rate)



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

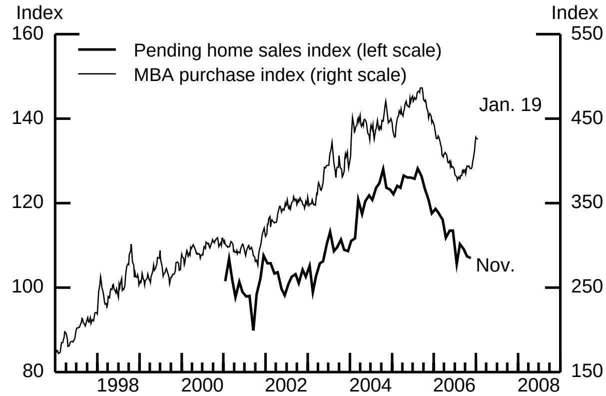
Indicators of Single-Family Housing

Home Sales



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

Homebuying Indicators



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

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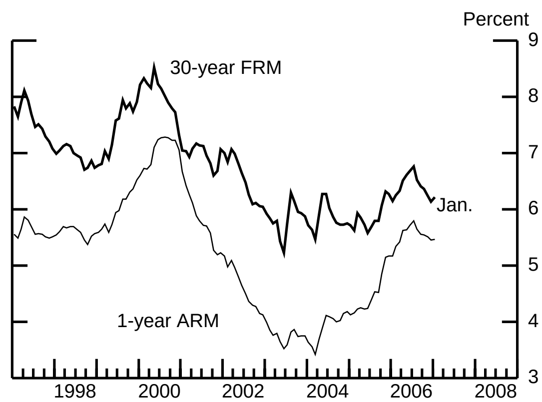
New Home Sales
Months' Supply

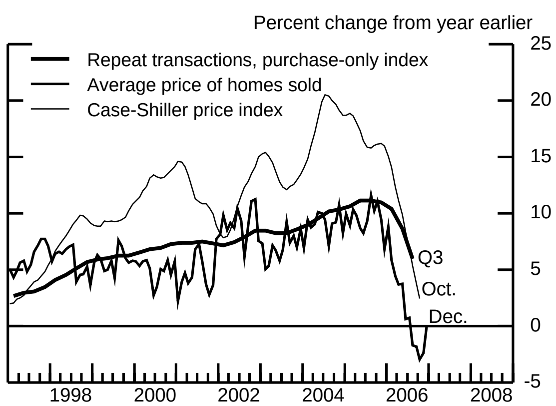
Note. . Months' supply is calculated using the 3-month moving average of sales.
Source. ; for months' supply, Census Bureau.

Mortgage Rates



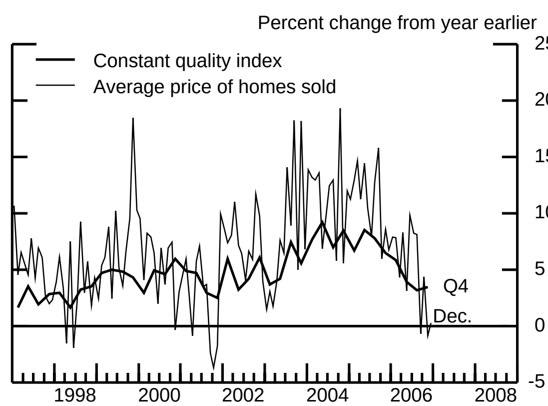
Note. The January readings are based on data through January 24, 2007.
Source. Freddie Mac.

Prices of Existing Homes



Source. For repeat transactions, OFHEO; for average price, National Association of Realtors; for Case-Shiller, Chicago Mercantile Exchange.

Prices of New Homes



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

October and November. For the fourth quarter as a whole, both shipments and orders declined significantly after having posted solid gains in the previous quarters.

The weakness in shipments last month was centered in the nondefense communications equipment category, in which shipments plunged 10.5 percent. However, this category is quite volatile, and the accompanying surge in new orders of more than 15 percent is encouraging. Orders and shipments of computer equipment revised up significantly in November, and shipments increased 1.3 percent in December, slightly offsetting the weak news on communications equipment. Outside of high-tech and transportation, shipments rebounded moderately from their November drop. Overall, the sluggishness in this category appears to have become fairly widespread.

The three-month moving average of the staff's constructed series on real adjusted durable goods orders stayed in negative territory for the third month in a row. This series—which strips out nondefense aircraft, defense capital goods, and industries for which reported orders actually equal shipments—has historically had some predictive power for industrial production.

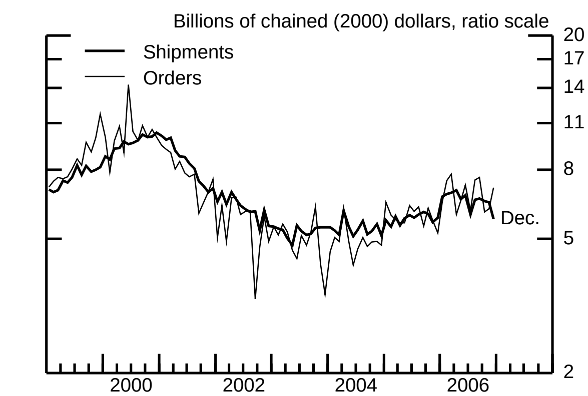
Orders and Shipments of Nondefense Capital Goods

(Percent change; seasonally adjusted current dollars)

Category	2006				
	Q3	Q4	Oct.	Nov.	Dec.
	Annual rate		Monthly rate		
Shipments	9.9	-3.6	-2.3	1.8	-.4
Excluding aircraft	6.9	-3.5	-1.5	2.1	-.3
Computers and peripherals	25.6	-32.0	-22.9	35.8	1.3
Communications equipment	-21.7	-8.2	-2.0	-.8	-10.5
All other categories	8.3	1.4	1.2	-.8	.6
Orders	27.2	3.0	-14.4	-.3	9.0
Excluding aircraft	14.6	-6.1	-4.0	-1.0	2.4
Computers and peripherals	24.3	-30.8	-23.7	36.8	-3.1
Communications equipment	35.7	-31.5	-21.3	2.5	15.4
All other categories	11.4	.6	.3	-4.7	1.9
Memo:					
Shipments of complete aircraft[1]	34.8	n.a.	34.4	34.2	n.a.

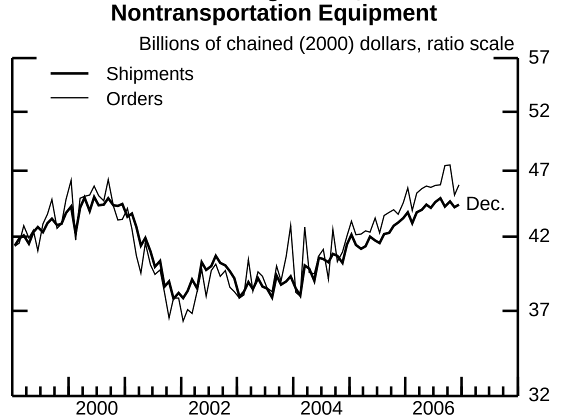
1. From Census Bureau, Current Industrial Reports; billions of dollars, annual rate.
n.a. Not available.

Communications Equipment



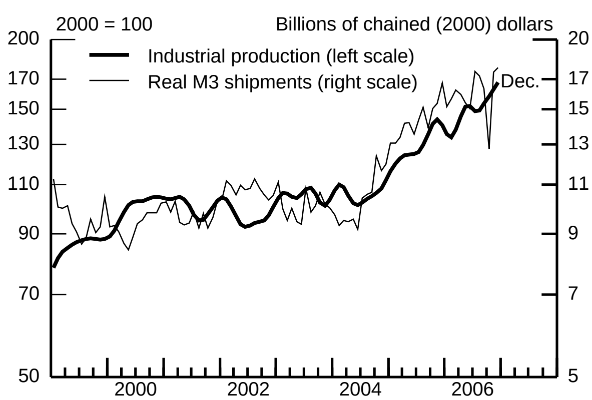
Note. Shipments and orders are deflated by a price index that is derived from the BEA's quality-adjusted price indexes and uses the PPI for communications equipment for monthly interpolation.

Non-High-Tech, Nontransportation Equipment



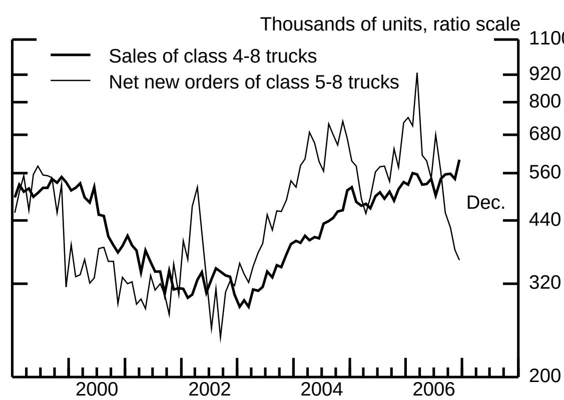
Note. Shipments and orders are deflated by the staff price indexes for the individual equipment types included in this category. Indexes are derived from the BEA's quality-adjusted price indexes.

Computers and Peripherals



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

Medium and Heavy Trucks



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

The Domestic Financial Economy

Commercial Bank Credit

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

Type of credit	2005	H1 2006	Q3 2006	Q4 2006*	Nov. 2006	Dec. 2006	Level,[1] Dec. 2006*
Total[2]	10.5	11.9	9.3	4.6	5.7	5.5	7,903
Loans[3]							
Total	11.6	11.6	10.8	6.2	5.4	9.8	5,909
To businesses							
Commercial and industrial	13.1	16.3	20.2	9.7	4.7	9.3	1,167
Commercial real estate	17.1	15.7	13.7	7.1	7.4	7.2	1,433
To households							
Residential real estate	12.0	7.7	7.3	1.6	-2.1	9.7	1,743
Revolving home equity	13.3	.1	3.9	1.3	4.3	7.2	453
Consumer	3.1	6.7	6.5	.3	8.6	11.4	734
Originated[4]	.7	7.4	5.1	4.5	9.0	9.9	1,124
Other[5]	8.5	12.0	4.6	14.8	16.1	13.6	832
Securities							
Adjusted[2]	7.6	12.6	4.8	-.1	6.5	-7.1	1,994
Reported	5.4	13.3	3.9	-3.4	9.4	1.6	2,144
Treasury and agency	.0	8.3	6.0	-4.0	-3.9	-14.2	1,192
Other[6]	13.5	20.0	1.6	9.1	26.1	21.3	981

Note. Yearly annual rates are Q4 to Q4; quarterly and monthly annual rates use corresponding average levels. Data are adjusted to remove estimated effects of consolidation related to FIN 46 and for breaks caused by reclassifications.
1. Billions of dollars. Pro rata averages of weekly (Wednesday) levels.
2. Adjusted to remove effects of mark-to-market accounting rules (FIN 39 and FAS 115).
3. Excludes interbank loans.
4. Includes an estimate of outstanding loans securitized by commercial banks.
5. Includes security loans and loans to farmers, state and local governments, and all others not elsewhere classified. Also includes lease financing receivables.
6. Includes private mortgage-backed securities, securities of corporations, state and local governments, foreign governments, and any trading account assets that are not Treasury or agency securities, including revaluation gains on derivative contracts.
* Adjusted to remove the effects of a consolidation of a sizable volume of thrift assets onto a commercial bank's books in October 2006.

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Selected Financial Market Quotations

(One-day quotes in percent except as noted)

Instrument	2004	2006		2007	Change to Jan. 25 from selected dates (percentage points)		
	June 28	June 29	Dec. 11	Jan. 25	2004 June 28	2006 June 29	2006 Dec. 11
Short-term							
FOMC intended federal funds rate	1.00	5.25	5.25	5.25	4.25	.00	.00
Treasury bills[1]							
3-month	1.36	4.88	4.81	5.01	3.65	.13	.20
6-month	1.74	5.06	4.88	4.98	3.24	-.08	.10
Commercial paper (A1/P1 rates)[2]							
1-month	1.28	5.27	5.25	5.25	3.97	-.02	.00
3-month	1.45	5.37	5.23	5.24	3.79	-.13	.01
Large negotiable CDs[1]							
3-month	1.53	5.47	5.31	5.32	3.79	-.15	.01
6-month	1.82	5.59	5.32	5.36	3.54	-.23	.04
Eurodollar deposits[3]							
1-month	1.29	5.33	5.35	5.32	4.03	-.01	-.03
3-month	1.51	5.49	5.35	5.36	3.85	-.13	.01
Bank prime rate	4.00	8.25	8.25	8.25	4.25	.00	.00
Intermediate- and long-term							
U.S. Treasury[4]							
2-year	2.88	5.26	4.66	4.98	2.10	-.28	.32
5-year	3.97	5.15	4.46	4.83	.86	-.32	.37
10-year	4.90	5.28	4.59	4.93	.03	-.35	.34
U.S. Treasury indexed notes							
5-year	1.56	2.49	2.20	2.49	.93	.00	.29
10-year	2.25	2.61	2.19	2.49	.24	-.12	.30
Municipal general obligations (Bond Buyer)[5]	5.01	4.71	4.03	4.32	-.69	-.39	.29
Private instruments							
10-year swap	5.21	5.81	5.01	5.33	.12	-.48	.32
10-year FNMA[6]	5.38	5.59	4.83	5.17	-.21	-.42	.34
10-year AA[7]	5.60	6.20	5.43	5.75	.15	-.45	.32
10-year BBB[7]	6.25	6.74	5.99	6.28	.03	-.46	.29
10-year high yield[7]	8.41	8.74	8.20	8.14	-.27	-.60	-.06
Home mortgages (FHLMC survey rate)							
30-year fixed	6.21	6.78	6.12	6.25	.04	-.53	.13
1-year adjustable	4.19	5.82	5.45	5.49	1.30	-.33	.04

Stock exchange index	Record high		2006		2007	Change to Jan. 25 from selected dates (percent)		
	Level	Date	June 29	Dec. 11	Jan. 25	Record high	2006 June 29	2006 Dec. 11
Dow Jones Industrial	12,622	1-24-07	11,191	12,328	12,503	-.94	11.72	1.41
S&P 500 Composite	1,527	3-24-00	1,273	1,413	1,424	-6.78	11.87	.77
Nasdaq	5,049	3-10-00	2,174	2,443	2,434	-51.78	11.95	-.35
Russell 2000	798	12-27-06	714	793	784	-1.70	9.78	-1.12
Wilshire 5000	14,752	3-24-00	12,846	14,248	14,359	-2.66	11.78	.78

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

NOTES:
June 28, 2004, is the day before the most recent policy tightening began.
June 29, 2006, is the day the most recent policy tightening ended.
December 11, 2006, is the day before the most recent FOMC announcement.