

Prefatory Note

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October 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

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Supplemental Notes

The Domestic Nonfinancial Economy

Sales and Prices of New Homes

Sales of new homes rose 4¾ percent in September to an annual rate of 770,000 units, but from an August figure that was revised down nearly 8 percent to an annual rate of 735,000 units. In addition, sales in June and July were both marked down to annual rates of about 800,000 units. These sales figures were generally in line with our expectations, given that initial estimates of new home sales have been revised down systematically over the past two years.¹ As for prices, the incoming data provide solid evidence to support anecdotal reports that builders are now resorting to aggressive price cuts to entice reluctant buyers.

The inventory of new homes for sale edged down for the seventh consecutive month in September and is now about 9 percent below the all-time high reached in July of last year. Even so, these inventories still amounted to 8¼ months' supply at September's sales pace—up from about 6½ months late in 2006 and about twice what we view as the builders' desired target.

The constant-quality price index for new homes was down ¾ percent relative to its level four quarters earlier. This was the first outright four-quarter decline in this index since 1992 and only the fifth such decline since 1964. Average new-home prices—which are not quality adjusted—were down 2¾ percent in September relative to twelve months earlier, their third-consecutive twelve-month decline.

Consumer Sentiment

After having been unchanged in September, the Reuters/University of Michigan index of consumer sentiment fell to 80.9 in October. The decrease was slightly larger than had been reported in the preliminary estimate released in the middle of the month, implying that sentiment fell a bit further in the second half of the month. Since July, the level of sentiment has fallen below what would seem to be consistent with the news on inflation, the labor market and, until recently, the stock market; the decline may well reflect households' continued concerns regarding financial turmoil and unfavorable

¹ Since the beginning of 2006, the Census has revised down its initial estimates of new home sales by an average of about 6 percent.

developments in housing markets. The “expected conditions” component of the overall index decreased significantly between September and October while the “current conditions” component was unchanged. Nonetheless, both indexes are down noticeably from their mid-year highs. Among those items not included in the overall sentiment index, consumers’ expectations about the change in unemployment over the next twelve months worsened a little in October. Consumers’ appraisals of buying conditions for cars also softened, as respondents reported less favorable pricing and credit conditions. However, consumers’ appraisals of buying conditions for houses strengthened in October, largely because of an increase in number of households noting that prices were low.

Among households, the median of expected inflation over the next twelve months remained unchanged at 3.1 percent in October, and the median of expected inflation over the next five to ten years ticked down to 2.8 percent, the lowest level in two years.

Orders and Shipments of Durable Goods

Shipments of nondefense capital goods excluding aircraft rose 1.0 percent in September, on the heels of an upward-revised increase of 1.8 percent in August; new orders were up 0.4 percent. Within the high-tech category, orders and shipments of computers and peripherals posted a robust gain in September and were revised up significantly in August. Orders and shipments of communications equipment also rose in September. Outside of the high-tech sector, shipments increased at a solid rate last month on top of upward revisions to August, while orders were flat.

The three-month moving average of the staff’s constructed series on real adjusted durable goods orders increased in September for the sixth month in a row. This series—which strips out nondefense aircraft, defense capital goods, and industries for which reported orders actually equal shipments—is an indicator of near-term industrial production.

The Domestic Financial Economy

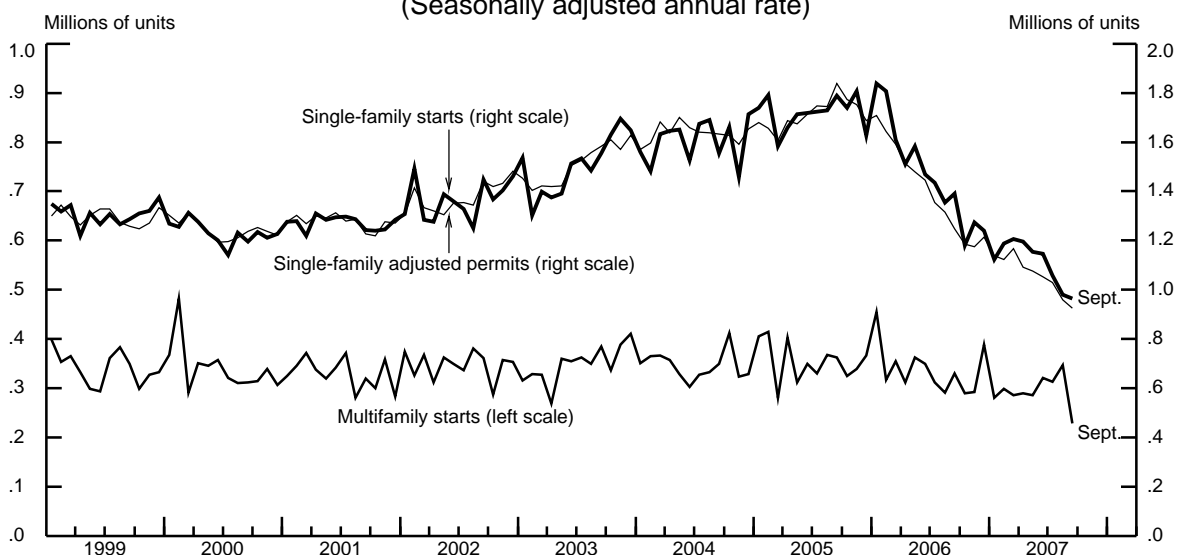
Private Housing Activity

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

Sector	2006	2007					
		Q1	Q2	Q3	July	Aug.	Sept.
<i>All units</i>							
Starts	1.80	1.46	1.46	1.30	1.37	1.33	1.19
Permits	1.84	1.56	1.46	1.32	1.39	1.32	1.26
<i>Single-family units</i>							
Starts	1.47	1.17	1.17	1.00	1.06	.98	.96
Permits	1.38	1.12	1.05	.94	1.01	.93	.88
Adjusted permits ¹	1.41	1.14	1.07	.97	1.03	.96	.92
Permit backlog ²	.133	.132	.116	.112	.115	.115	.112
<i>New homes</i>							
Sales	1.05	.85	.86	.77	.80	.74	.77
Months' supply ³	6.36	7.64	7.65	8.30	8.08	8.67	8.15
<i>Existing homes</i>							
Sales	5.68	5.63	5.15	4.72	5.00	4.79	4.38
Months' supply ³	6.35	7.12	8.34	9.26	8.75	8.95	10.07
<i>Multifamily units</i>							
Starts	.336	.288	.298	.296	.313	.347	.228
Permits	.461	.440	.411	.384	.381	.388	.384
Permit backlog ²	.062	.076	.081	.076	.081	.077	.076
<i>Mobile homes</i>							
Shipments	.117	.094	.099	n.a.	.099	.097	n.a.
<i>Condos and co-ops</i>							
Existing home sales	.801	.790	.767	.700	.750	.690	.660

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.

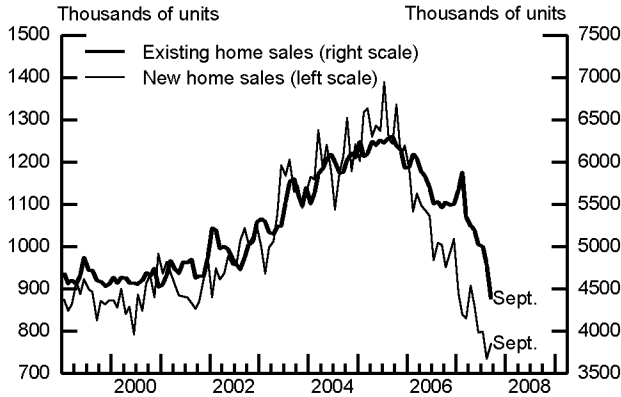
Private Housing Starts and Permits (Seasonally adjusted annual rate)



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



Source. For pending home sales, National Association of Realtors.

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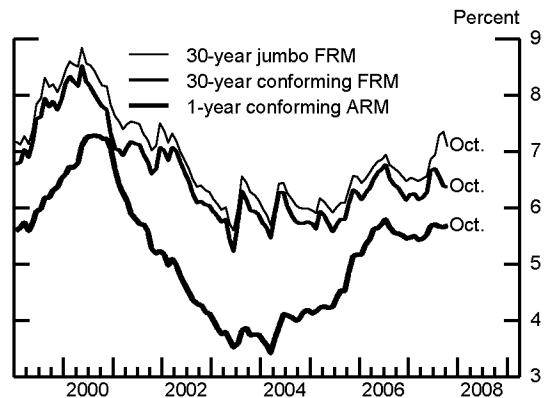
New Home Sales Months' Supply



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

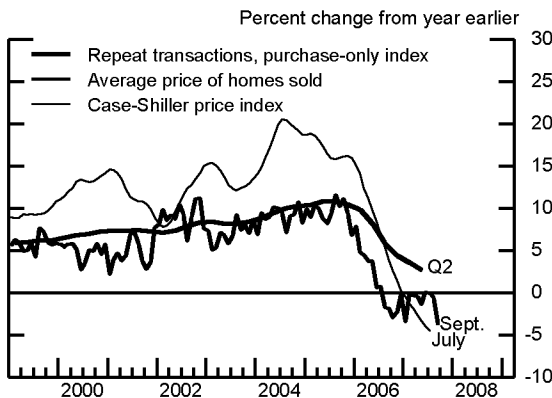
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Mortgage Rates



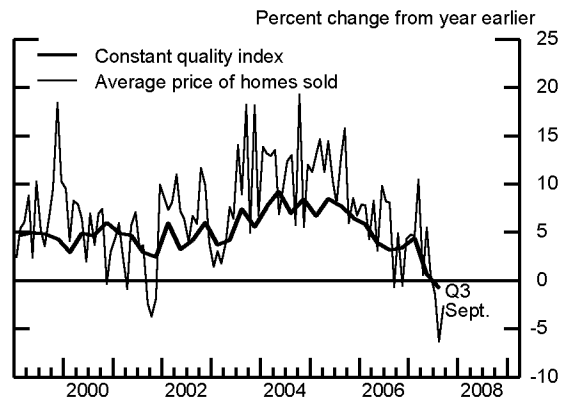
Note. The Oct. readings are for data through Oct. 24, 2007. Source. Conforming rates are from Freddie Mac. The jumbo rate is the sum of the 30-year conforming FRM rate and the jumbo conforming spread from bankrate.com.

Prices of Existing Homes



Note. The Case-Shiller price index is the 10-city index. 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.

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

Category	2007									
	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct. ^P	Oct. ^F	
Composite of current and expected conditions ¹	88.4	87.1	88.3	85.3	90.4	83.4	83.4	82.0	80.9	
Current conditions ¹	103.5	104.6	105.1	101.9	104.5	98.4	97.9	98.2	97.6	
Expected conditions ¹	78.7	75.9	77.6	74.7	81.5	73.7	74.1	71.6	70.1	
Personal financial situation										
Now compared with 12 months ago ²	111	119	113	110	115	103	109	111	111	
Expected in 12 months ²	126	127	125	117	125	120	119	116	119	
Expected business conditions										
Next 12 months ²	95	87	97	94	105	87	82	84	78	
Next 5 years ²	94	90	89	88	96	88	96	86	84	
Appraisal of buying conditions										
Cars	138	132	124	118	125	133	139	133	128	
Large household appliances ²	157	152	160	154	156	152	144	143	142	
Houses	137	138	135	131	129	118	123	134	131	
Expected unemployment change - next 12 months	123	129	120	125	123	131	127	133	130	
Prob. household will lose a job - next 5 years	22	18	19	23	21	24	21	21	21	
Expected inflation - next 12 months										
Mean	3.6	4.0	4.3	4.2	4.2	4.0	4.0	3.5	3.7	
Median	3.0	3.3	3.3	3.4	3.4	3.2	3.1	3.0	3.1	
Expected inflation - next 5 to 10 years										
Mean	3.3	3.6	3.7	3.3	3.6	3.4	3.4	3.0	3.1	
Median	2.9	3.1	3.1	2.9	3.1	2.9	2.9	2.8	2.8	

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.

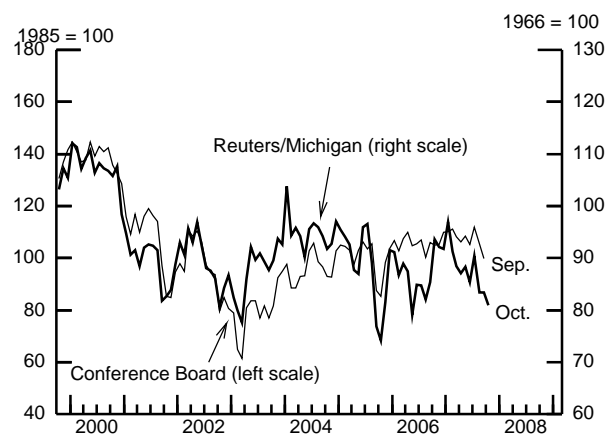
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F Final.

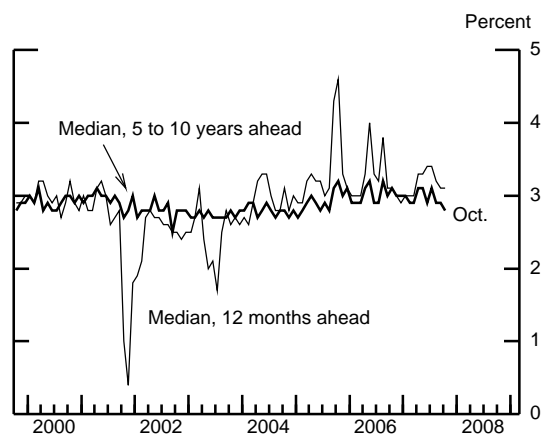
1. Feb. 1966 = 100.

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

Consumer sentiment



Expected inflation



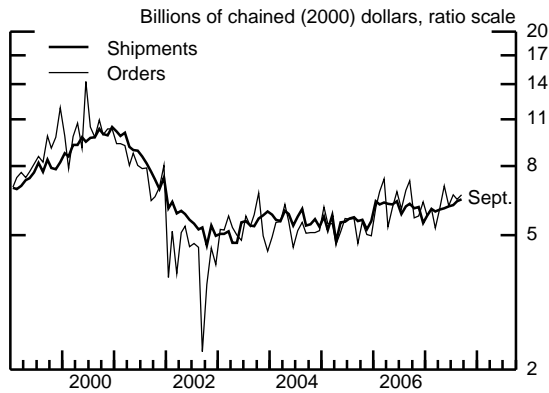
Orders and Shipments of Nondefense Capital Goods

(Percent change; seasonally adjusted current dollars)

Category	2007				
	Q2	Q3	July	Aug.	Sept.
	Annual rate		Monthly rate		
Shipments	9.7	8.3	1.0	1.6	.2
Excluding aircraft	9.6	5.0	.0	1.8	1.0
Computers and peripherals	11.9	-23.7	-15.1	16.2	2.2
Communications equipment	12.6	16.3	1.0	2.4	1.0
All other categories	9.0	7.4	1.5	.5	.9
Orders	34.2	-2.7	4.8	-12.2	4.4
Excluding aircraft	13.0	1.4	.9	-.1	.4
Computers and peripherals	7.5	-7.3	-12.1	14.4	1.1
Communications equipment	64.2	8.2	7.6	-3.0	3.2
All other categories	9.6	1.7	1.7	-1.2	.0
Memo:					
Shipments of complete aircraft ¹	40.2	n.a.	42.5	51.3	n.a.

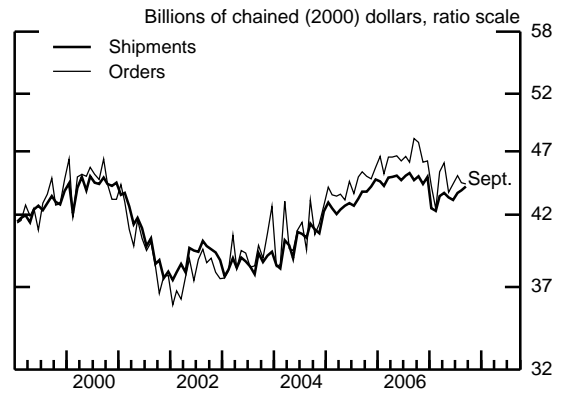
1. From Census Bureau, Current Industrial Reports; billions of dollars, annual rate.
n.a. Not available.

Communications Equipment



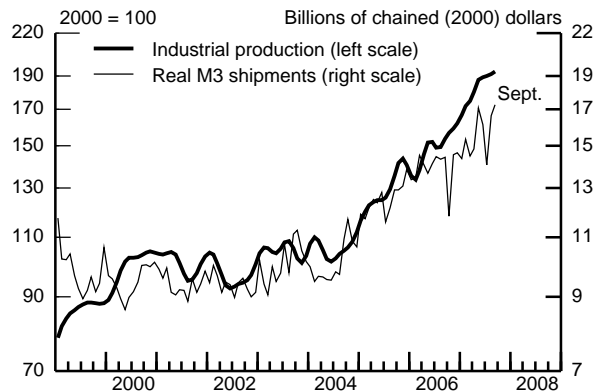
Note. Shipments and orders are deflated by a price index that is derived from the BEA's quality-adjusted price indexes and uses the PPI for communications equipment for monthly interpolation.

Non-High-Tech, Nontransportation Equipment



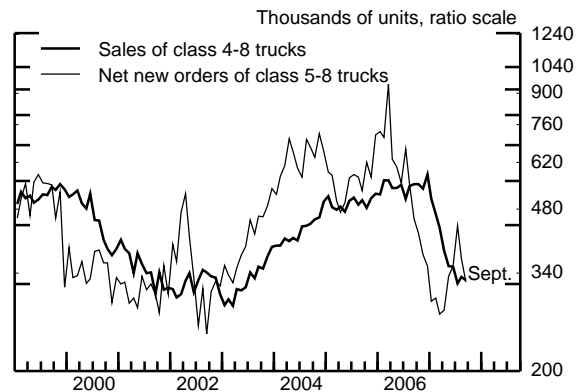
Note. Shipments and orders are deflated by the staff price indexes for the individual equipment types included in this category. Indexes are derived from the BEA's quality-adjusted price indexes.

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 sales, Ward's Communications; for orders, ACT Research.

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Selected Financial Market Quotations
(One-day quotes in percent except as noted)

Instrument	2004	2006	2007		Change to Oct. 25 from selected dates (percentage points)		
	June 28	June 29	Sept. 17	Oct. 25	2004 June 28	2006 June 29	2007 Sept. 17
<i>Short-term</i>							
FOMC intended federal funds rate	1.00	5.25	5.25	4.75	3.75	-.50	-.50
Treasury bills ¹							
3-month	1.36	4.88	4.05	3.84	2.48	-1.04	-.21
6-month	1.74	5.06	4.15	3.88	2.14	-1.18	-.27
Commercial paper (A1/P1 rates) ²							
1-month	1.28	5.27	5.23	4.71	3.43	-.56	-.52
3-month	1.45	5.37	5.25	4.74	3.29	-.63	-.51
Large negotiable CDs ¹							
3-month	1.53	5.47	5.52	4.85	3.32	-.62	-.67
6-month	1.82	5.59	5.36	4.74	2.92	-.85	-.62
Eurodollar deposits ³							
1-month	1.29	5.33	5.55	4.81	3.52	-.52	-.74
3-month	1.51	5.49	5.60	5.00	3.49	-.49	-.60
Bank prime rate	4.00	8.25	8.25	7.75	3.75	-.50	-.50
<i>Intermediate- and long-term</i>							
U.S. Treasury ⁴							
2-year	2.88	5.26	4.12	3.77	.89	-1.49	-.35
5-year	3.97	5.15	4.18	3.97	.00	-1.18	-.21
10-year	4.90	5.28	4.58	4.48	-.42	-.80	-.10
U.S. Treasury indexed notes ⁵							
5-year	1.60	2.51	2.04	1.77	.17	-.74	-.27
10-year	2.26	2.61	2.15	2.03	-.23	-.58	-.12
Municipal general obligations (Bond Buyer) ⁶	5.01	4.71	4.46	4.33	-.68	-.38	-.13
Private instruments							
10-year swap	5.21	5.81	5.17	4.98	-.23	-.83	-.19
10-year FNMA ⁷	5.38	5.59	5.01	4.88	-.50	-.71	-.13
10-year AA ⁸	5.60	6.20	6.05	5.86	.26	-.34	-.19
10-year BBB ⁸	6.25	6.74	6.46	6.23	-.02	-.51	-.23
10-year high yield ⁸	8.41	8.74	8.95	8.68	.27	-.06	-.27
Home mortgages (FHLMC survey rate)							
30-year fixed	6.21	6.78	6.34	6.33	.12	-.45	-.01
1-year adjustable	4.19	5.82	5.65	5.66	1.47	-.16	.01

Stock exchange index	Record high		2006	2007		Change to Oct. 25 from selected dates (percent)		
	Level	Date	June 29	Sept. 17	Oct. 25	Record high	2006 June 29	2007 Sept. 17
Dow Jones Industrial	14,165	10-9-07	11,191	13,403	13,672	-3.48	22.17	2.00
S&P 500 Composite	1,565	10-9-07	1,273	1,477	1,514	-3.24	18.98	2.56
Nasdaq	5,049	3-10-00	2,174	2,582	2,751	-45.51	26.51	6.55
Russell 2000	856	7-13-07	714	776	806	-5.80	12.85	3.91
Wilshire 5000	15,807	10-9-07	12,846	14,839	15,311	-3.14	19.19	3.18

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 28, 2004, is the day before the most recent policy tightening began.
June 29, 2006, is the day the most recent policy tightening ended.
September 17, 2007, is the day before the most recent FOMC announcement.

Commercial Bank Credit

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

Type of credit	2005	2006	H1 2007	Q3 2007	Aug. 2007	Sept. 2007	Oct. 2007 ^p	Level ¹ Oct. 2007 ^p
Total	10.5	9.7	9.2	12.1	17.0	16.1	6.7	8,646
<i>Loans²</i>								
Total	11.6	11.0	9.8	12.2	19.7	18.2	7.0	6,519
To businesses								
Commercial and industrial	13.5	16.4	9.6	24.0	31.5	44.3	38.3	1,379
Commercial real estate	17.1	13.9	11.3	7.7	8.1	8.2	1.2	1,554
To households								
Residential real estate	11.9	7.0	8.4	5.6	1.7	8.5	-.5	1,856
Revolving home equity	13.3	1.4	1.8	6.4	9.2	11.2	11.8	471
Other	11.4	9.2	10.7	5.3	-.8	7.6	-4.6	1,385
Consumer	3.1	5.9	6.3	10.5	3.9	11.6	-4.3	779
Originated ³	.7	6.9	5.1	10.2	9.0	9.3	.4	1,176
Other ⁴	8.3	12.2	13.4	18.8	74.5	23.1	-3.4	951
<i>Securities</i>								
Total	7.5	5.9	7.6	12.0	8.8	9.7	5.8	2,127
Treasury and agency	2.4	2.0	-4.5	4.6	-.2	-21.2	-40.7	1,125
Other ⁵	17.5	12.6	26.2	21.8	20.8	49.6	62.6	1,002

Note. Yearly annual rates are Q4 to Q4; quarterly and monthly annual rates use corresponding average levels. Data have been adjusted to remove the effects of mark-to-market accounting rules (FIN 39 and FAS 115), the consolidation of certain variable interest entities (FIN 46), the adoption of fair value accounting (FAS 159), and the effects of sizable thrift-to-bank and bank-to-thrift structure activity in October 2006, March 2007, and October 2007. Data also account for breaks caused by reclassifications.

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

2. Excludes interbank loans.

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

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

5. 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.

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