



MONTHLY MARKET MONITOR

WEDNESDAY, NOVEMBER 21, 2007

MMM 11-07

SHARON L. STARK, 202.906.6567
 BARBARA F. BUCKLEY 202.906.6286
 OFFICE OF THE SENIOR DEPUTY DIRECTOR



Current Interest Rates

	11/19/2007 Yield	10/31/2007 Yield	YTD BP Change
Short-term			
Federal Funds Target	4.50%	4.50%	-75
Prime Rate	7.50%	7.50%	-75
Libor (3-mo.)	4.98%	4.89%	-38
3-mo. T-bill	3.36%	3.91%	-164
6-mo. T-bill	3.49%	4.07%	-159
2yr T-note	3.17%	3.95%	-164
Longer-term			
5yr T-note	3.55%	4.17%	-114
10yr T-note	4.08%	4.47%	-63
30yr Bond	4.48%	4.75%	-33

Source: BLOOMBERG L.P. as of 11/19/07 4:42 p.m.

Interest Rate Swap Spreads

	11/19/2007 BP Change	10/31/2007 BP Change	YTD BP Change
2yr	97	64	61
5yr	89	65	49
10yr	78	64	30
30yr	69	60	19

Source: BLOOMBERG L.P. as of 11/19/07 4:42 p.m.

EVENTS

November 20, 2007, OTS 3Q Press Conference – *Tentative*

December 3, 2007, OTS National Housing Forum, National Press Club, Washington, DC – *Invitation Only*

MARKET COMMENTARY

News of third quarter markdowns in asset prices, followed by projections for potentially more value deterioration, caused credit spreads to widen significantly in the past month. Interest rate swap spreads, as shown on the preceding page, rose across the maturity curve, with the greatest increase evidenced by a 33 basis point jump in 2-year swap spreads. Uncertainty and fear appear to be the drivers in the financial markets, as the downturn in mortgage asset prices has spread to equity values. The NASDAQ Composite Index fell by 9.46% and the S&P 500 Index is down 7.56% from a month ago due to analysts' disappointment in earnings projections and investor preference for more stable investments.¹ Risk aversion is the strategy du jour by most market participants, which has driven Treasury security yields to the lowest levels this year. While the percentage of subprime loans outstanding, relative to all mortgage loans, is approximately 13%, the impact of the decline in value appears to be spreading. The layering of risks within an asset class has, in many instances, had the effect of magnifying and expanding the risk exposure to levels currently unknown. It is this uncertainty in the financial markets that continues to leave financial managers skittish and less willing to extend credit to those other than Prime borrowers.

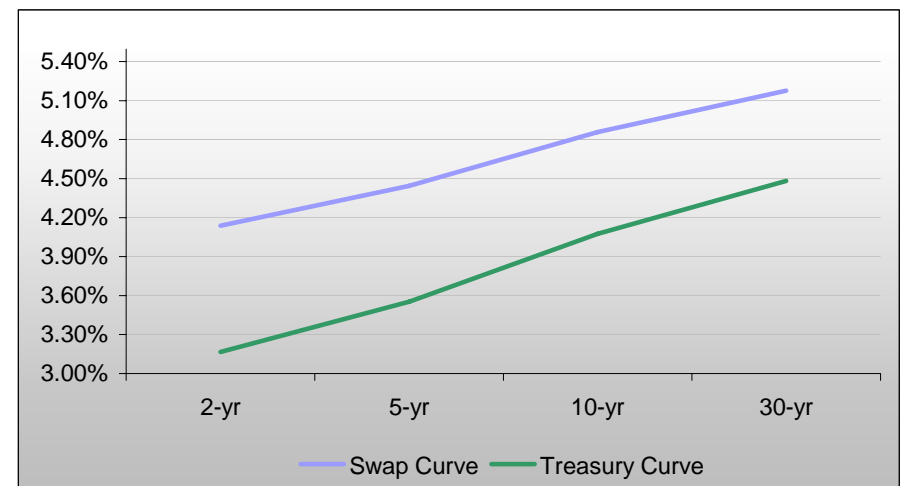
Short-term funding conditions suffered another outbreak of risk aversion. In the previous month's report, we noted some improvement in repo rates for non-Agency mortgage collateral. This proved to be short-lived as one-month repo rates for AAA rated private label mortgage securities rose to Libor +42 basis points (bps) or (5.20%), plus a 10% haircut. Agency one-month repo rates are at approximately 4.90%, or Libor +13bps, plus a 5% haircut for liquidity risk.² Note that the absolute rate for Agency repo has fallen due to the overall drop in interest rates, but the premium over Libor and haircut for liquidity are

¹ Bloomberg Financial Markets, November 19, 2007; 1:22 pm EDT.
² LIBOR is the London interbank offering rate. The one-month LIBOR is at 4.78% as of November 20, 2007. The 5% haircut refers to the price discount applied to the market value of the collateral to account for liquidity risk.

higher than the previous month. The 10% haircut for non-Agency repo remains unchanged from the last month, but the spread over Libor rose markedly. These rates are approximate, and volatile. Nonetheless, one may conclude that liquidity conditions remain vulnerable to adverse events.

As we approach the holidays, trading volume will fall and prices may be more opaque. Year-end market valuations are expected to occur in mid-December, causing some volatility in prices and perhaps, more news stories on the "lack of price transparency." Non-Agency mortgage assets, whether whole loans or securitizations, are difficult to value under normal market conditions, making the next month a greater challenge for thrifts. The Federal Open Market Committee also meets again in December, and speculation on what action the policy makers may or may not take will influence market conditions as well. The continued downturn in housing activity and impact on funding costs and sources will be the focus of U.S. financial institutions over the coming months. The ongoing attention to liquidity has prompted some thrifts to be proactive in securing future funding; an activity that may serve the industry well if we encounter future spontaneous liquidity shortfalls.

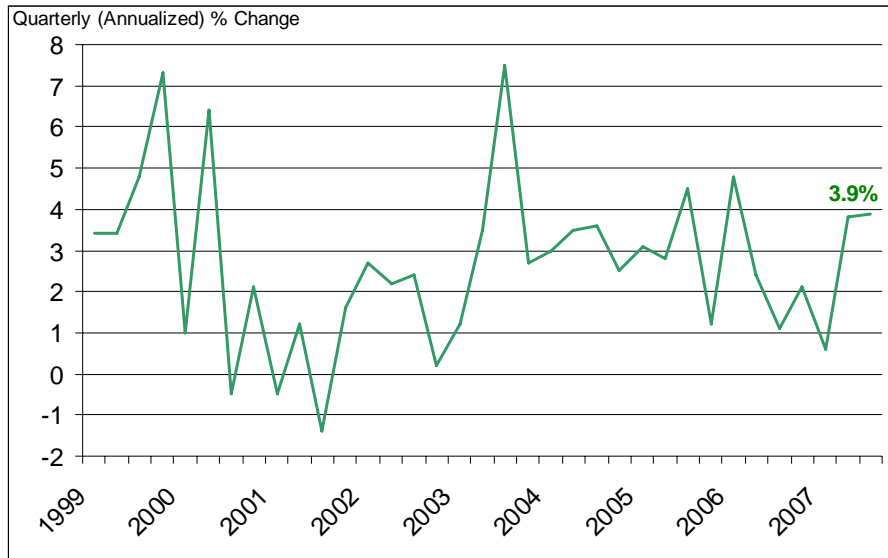
CURRENT TREASURY VS. SWAP CURVE (CHART 1)



Source: BLOOMBERG L.P. as of 11/19/07 4:42 p.m.

ECONOMIC CONDITIONS

GDP (GROSS DOMESTIC PRODUCT), SEPTEMBER 2007 (CHART 2)



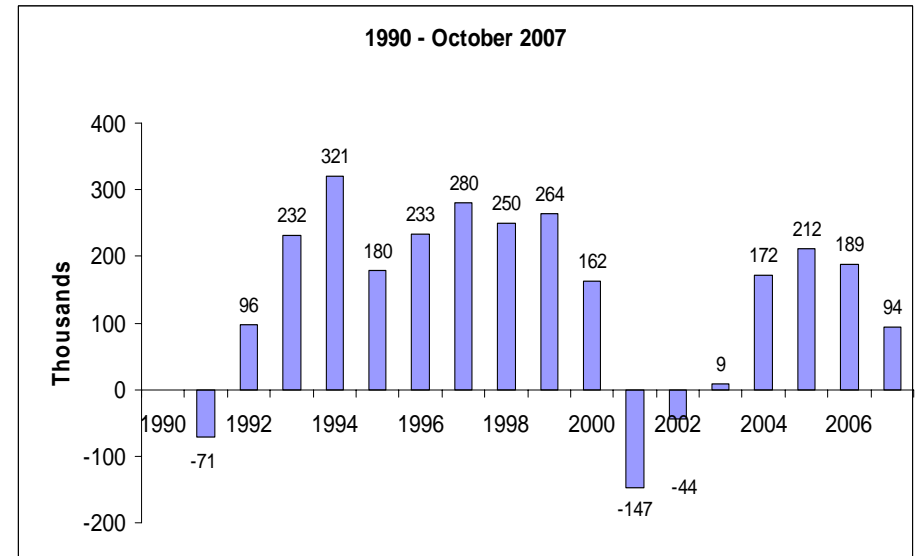
SOURCE: BLOOMBERG L.P.

U.S. GROSS DOMESTIC PRODUCT

Growth in the U.S. economy advanced a surprising 3.9% in the third quarter of the year, putting the year-over-year change in real GDP at 2.6% for the period. The gain was driven by continued growth in consumer spending, a narrowing trade deficit, and inventory restocking by domestic corporations. Residential investment plunged 20.1% in the three months ended in September, following an 11.8% and 16.3% decline in the second and first quarters, respectively. The contraction in housing subtracted 1.1% points from GDP in the third quarter, but was offset by the addition of 0.9% points from the net increase in real exports and 0.4% points from the \$15.7 billion increase in real inventories. Personal consumption expenditures, or consumer spending, rebounded from a 1.4% pace in the second quarter to 3.0% in the third period. The seemingly endless ability of the consumer to increase spending is puzzling; however, the absence of exogenous sources of cash such as low

rate financing, home equity, and stock portfolio gains, may test the resourcefulness of the U.S. consumer in the coming months.

YTD ANNUAL AVERAGE CHANGE IN NONFARM PAYROLLS (CHART 3)



SOURCE: BUREAU OF LABOR STATISTICS

EMPLOYMENT

The October payroll growth of 166,000 was higher than most analysts expected and puts the year-to-date average annual change in the job growth rate at 94,000 per month. This is significantly lower than the 189,000 and 212,000 averages in 2006 and 2005, respectively and partially reflects the influence of the euphoric housing market on employment in the previous years. The gains in nonfarm jobs were limited to the service industries of education and healthcare, leisure activities, and professional and business services in October. Manufacturing and construction payrolls continued to contract and are down for the twelve months ended in October. Average hourly earnings rose a scant 0.2% last month and 3.8% year-over-year, outpacing the inflation rate by nearly 1%, but decelerating from the advances of 4.0% a year ago.

The unemployment rate held steady at 4.7%, but tends to be a volatile indicator as workers drop in and out of the pool of available individuals seeking employment.

Real consumer spending advanced at a healthy 3.2% year-over-year pace in September. Purchases of durable goods and services led the increase as the shopping spree continues. Those who doubt the reliance of the consumer have been proven wrong throughout recent economic cycles and many analysts continue to anticipate a strong showing by the consumer during this downdraft in housing.

Inflation

Inflation pressures climbed higher in the past month led by a surge in food and energy prices. Core inflation remained tame with a 2.2% annualized increase in the CPI, sans food and energy, while the core PCE deflator held firm at a 1.8% pace. However, the overall inflation rate of 3.5% in October, was a marked increase from the 2.8% reported the previous month, fueled by a 14.5% twelve month gain in energy prices coupled with a 4.4% increase in the price for food. Retail gasoline prices are 23% higher from a year ago and are likely to spike in November due to the recent run-up in oil prices. As oil prices rise, natural gas prices have abated with prices stabilizing, and perhaps offering some relief to homeowners this winter that use this as a source to heat homes.

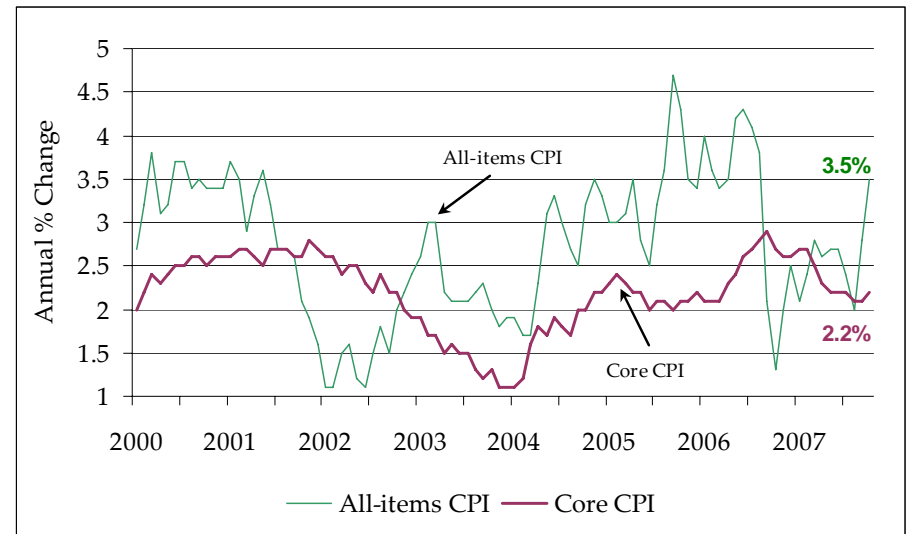
Unit labor costs remain elevated on a year-over-year basis at 4.3% in the third quarter, but have decelerated from a 5.1% pace in the previous quarter. Compensation per hour rose by 6.7% over the past year; however, productivity gains have helped to keep net costs tame. If economic growth slows, unit labor costs will likely accelerate as wages generally lag the overall economy. As a result, labor costs pose an additional threat to higher inflation.

SUMMARY

Economic conditions have held steady since our last report, with the continued decline in residential investment offset by strong consumer

spending, a shrinking trade deficit, and buildup of inventories. Inflation pressures have also accelerated, adding another element of risk to economic growth. **We are in the midst of a significant price adjustment in U.S. assets, driven by home prices with second round effects on equity values and prices for short-term credit.** As with any adjustment, there will be those that experience a greater share of adverse impacts. If the consumer is one of the groups negatively impacted, the decline in economic output could be severe, as inventory investment will likely shrink in the face of less demand and housing conditions remain distressed. The weaker dollar will continue to support growth in exports and output, but not likely enough to offset a downturn in consumer expenditures and slowing inventory growth. Rising consumer prices may also damp spending and further reduce output. The performance of these factors will be crucial to overall GDP growth in the next two quarters, and in turn, will likely pose challenges to earnings in the thrift industry.

CPI (CONSUMER PRICE INDEX), OCTOBER 2007 (CHART 4)



SOURCE: THE BUREAU OF ECONOMIC ANALYSIS

HOUSING

Housing conditions in the United States worsened in the third quarter as sales volume fell, home prices deteriorated, and delinquency and foreclosure activity rose. Several mortgage lenders have fled the business in 2007, while those that remain have reduced staff and tightened underwriting standards. As a result, it has become more difficult for homeowners to refinance an adjustable rate mortgage approaching a rate reset, or for a new buyer to purchase a home. The impact of this confluence of events is a decline in overall residential investment in the U.S. the past six consecutive quarters.

Home sales remain a drag on overall housing activity with existing home sales falling by 8.00% in September to 5.04 million units. According to the National Association of Realtors, both single- and multi-family properties experienced a drop in purchases for the month, resulting in a 19.1% decline in home sales over the last twelve months, the fastest rate of decline since the late 1980s. The supply of homes available for purchase rose to 4.4 million units or 10.5 months of sales at the current selling rate. Single-family home stockpiles are at 10.2 months of sales, the highest level since February 1988.

The S&P/Case-Shiller index is designed to measure the growth in home prices in various regions in the U.S. The National Home Price Index, published quarterly, is a broad market-weighted composite of single-family home price indices for nine census divisions in the country that is often referenced by press reports. **The index illustrated in Chart 6, is a monthly index measuring residential real estate values in 20 metropolitan regions and shows the average year-over-year price of a single-family home fell by 4.4% in August of 2007.** Like the Office of Federal Housing Enterprise Oversight's (OFHEO) House Price Index, the actual changes in the regions varies from a 5.7% increase in home prices in Seattle, Washington to a 10.1% drop in home values in Tampa, Florida. Unfortunately, both OFHEO and Case-Shiller believe the potential for future declines in house prices is high as the inventory of unsold homes remains elevated.

The performance of mortgage loans varies by loan type, borrower characteristics, and geographic location. The majority of home mortgages outstanding continue to be in the Prime fixed rate class at 61.5% of the market, followed by 15.2% in Prime ARM loans.³ Subprime ARM and fixed-rate borrowers comprise 7.4% and 6.6%, respectively, of mortgage loans outstanding. The remaining 9.4% of mortgages are held by FHA/VA borrowers.

LOAN PERFORMANCE

Delinquency and foreclosure rates are higher in all loan categories. Prime loan delinquencies, defined as 30, 60, and 90 day late payments, are approximately 95 basis points (bp) higher at 3.22% from 2.27%, than a year ago (as of September 2007) and are at their highest levels since 1999. Subprime loans experienced a much greater year-over-year gain in the delinquency rate of roughly 651 bps to 19.03% from 12.52%. The Alt-A category showed a similar trend, with late payments increasing by 317 bps to 12.58% from 9.41% in September 2006. **The subprime and Alt-A loan delinquency rates currently exceed that experienced in the recession of 2001 and are likely to continue the trend.** The fall and winter months of 2007 and 2008 will bring heavy ARM reset activity, according to data compiled by Credit Suisse Fixed Income Strategy group, and with it, an expected increase in payment stress on the borrower. The majority of the ARMs scheduled for rate resets fall in the subprime category, yet another sign of potential payment deterioration.

Foreclosure activity continues to accelerate, but remains below the recent stress period in 2000-2002. While the rate of foreclosure in prime loans is less than 0.50%, and is far from the peak pace of 0.80% observed in 2000, that of subprime and Alt-A have far exceeded the previous pace in 2000 and 2001. Subprime foreclosure activity rose by 0.54% from August to September 2007, compared to a 0.12% advance in Alt-A and 0.05% gain in Prime loan foreclosures. Our definition of foreclosure excludes bankruptcies, and may understate the actual number, but

³ Mortgage Bankers Association, October 2007.

nonetheless, is representative of activity in the industry. Absent a recession, it is unlikely that foreclosure levels in prime loans will exceed the 2000 highs; the other loan categories are likely headed for tougher times.

Adjustable rate loans comprise roughly 30% of mortgage debt outstanding and are experiencing the greatest amount of deterioration in payment performance. ARM delinquencies accelerated by 2.15% from a year ago September, while that of fixed rate loans is only 0.86% higher. Foreclosure rates among ARM loans is more than twice what it was a year ago, and continues to rise. We are currently in a period of heavy ARM resets, which are not likely to abate for at least another year. According to estimates by a Bank of America⁴ analyst, approximately \$515 billion of ARMs are scheduled to reset in 2007 followed by an additional \$680 billion in 2008. **Roughly \$400 billion or 78% of the planned ARM resets in 2007 are loans made to subprime borrowers, and 73% of those in 2008. Approximately 60% of those with ARMs that reset in the next twelve months have less than 15% equity in their homes.**⁵ Given the persistent increases in ARM loan delinquency rates, and the potential for a further decline in home values, the outlook for payment performance for this asset class is discouraging.

LOCATION, LOCATION, LOCATION

The location of the property financed also influences the performance of the mortgage loans. According the Realtytrac, Inc., the states of California, Florida, and Ohio accounted for approximately 44% of the third quarter foreclosures, with Nevada posting the highest default rate for the period. California foreclosure filings rose 36% from the second to third quarter of 2007, nearly four times the rate a year ago. Florida, which has a large percentage of investor home buyers that counted on rising home values, experienced a 50% advance in foreclosures in the quarter ended September 2007, double the pace last year. Michigan and

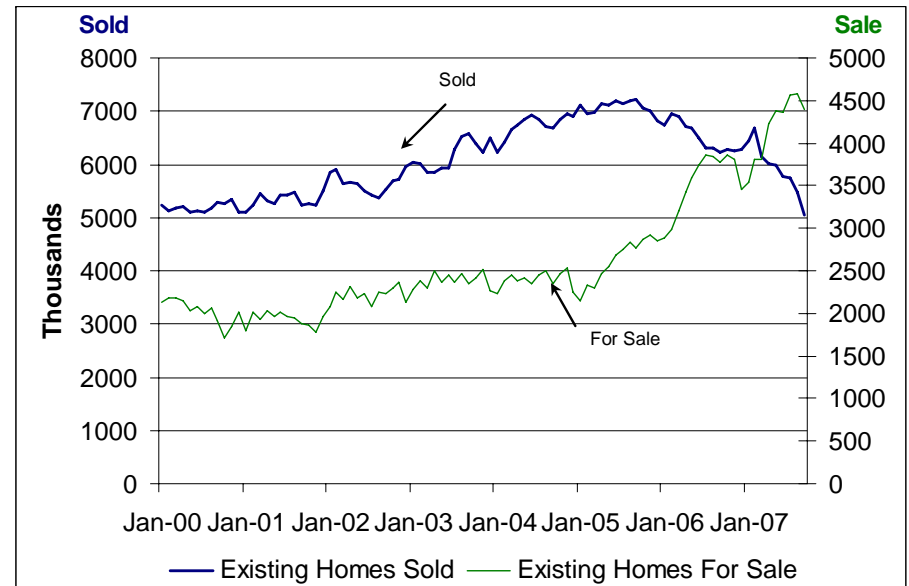
Ohio, with smaller volumes of foreclosures, reported a 66% and 28% increase in foreclosure activity, respectively, in the third quarter.

THE OUTLOOK AND IMPACT

The outlook for the U.S. housing market over the next twelve months remains troubling. Home construction is expected to continue to decline as falling sales and higher inventories discourage new building. Prices are likely to suffer further deterioration, with homes in areas with greater investor activity or declining employment and income growth, experiencing a larger loss of value. Finally, cautious lenders will maintain tight credit conditions in the home mortgage market, further delaying any improvement in housing demand.

The impact of the correction in the housing industry may result in an increase in loan loss reserves in OTS-supervised institutions and more pro-active strategies to secure the most reliable funding sources until the capital markets stabilize. These actions my serve the industry well as housing conditions slowly recover.

SUPPLY/DEMAND DYNAMICS IN HOUSING, SEPTEMBER 2007 (CHART 5)

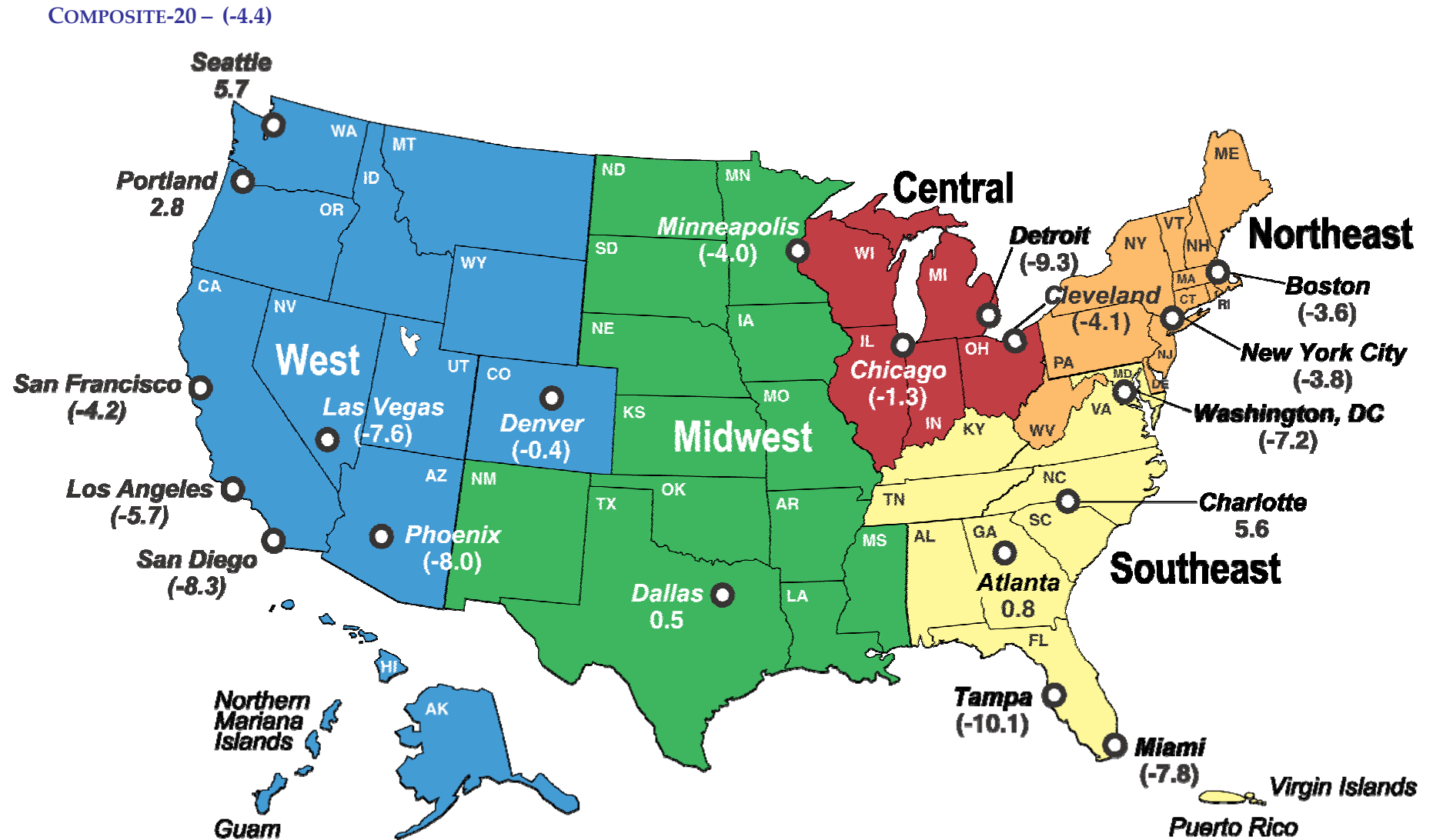


SOURCE: NATIONAL ASSOCIATION OF REALTORS

⁴ Analyst estimates as of August 26, 2007.

⁵ "Rocky Terrain Ahead", The Economist, September 1, 2007.

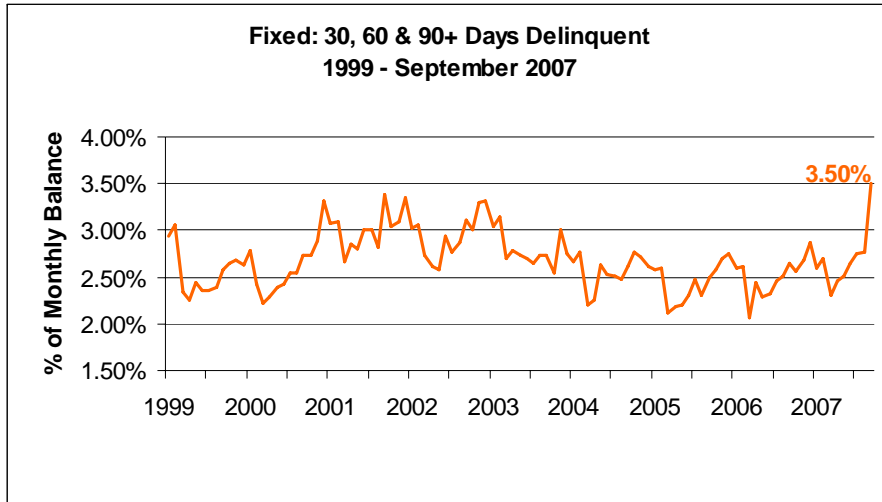
METROPOLITAN REGIONS IN THE S&P/CASE-SHILLER® HOME PRICE INDICES – YEAR-OVER-YEAR % CHANGE, AUGUST 2007 (CHART 6)



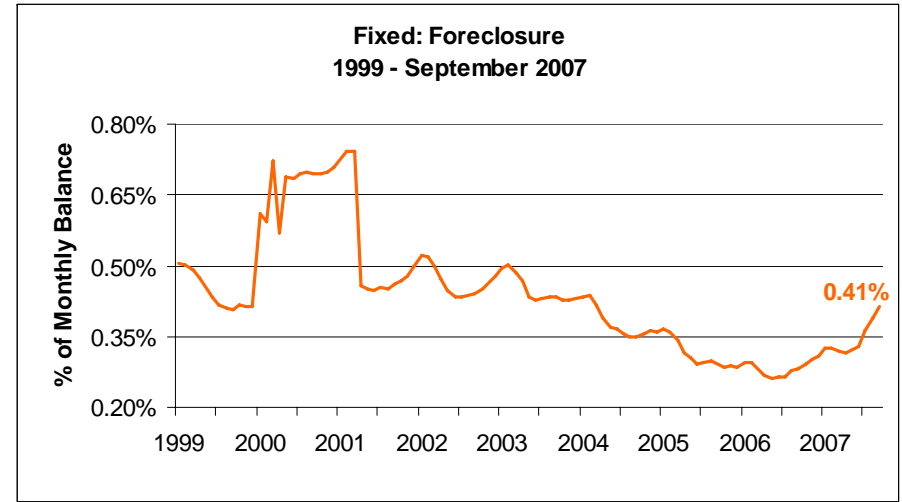
SOURCE: STANDARD & POORS, FISERV INC. AND MACROMARKTS LLC

NATIONAL DELINQUENCY & FORECLOSURE RATES: FIXED & ARM LOANS

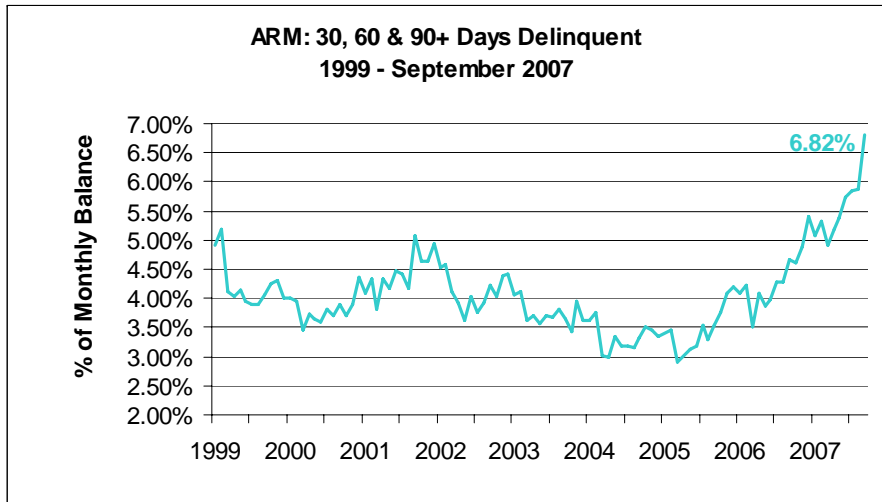
(CHART 7)



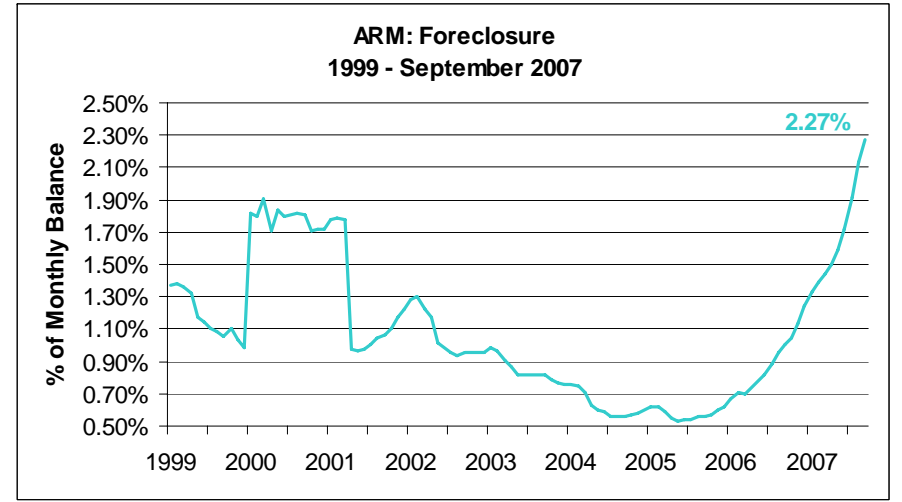
(CHART 8)



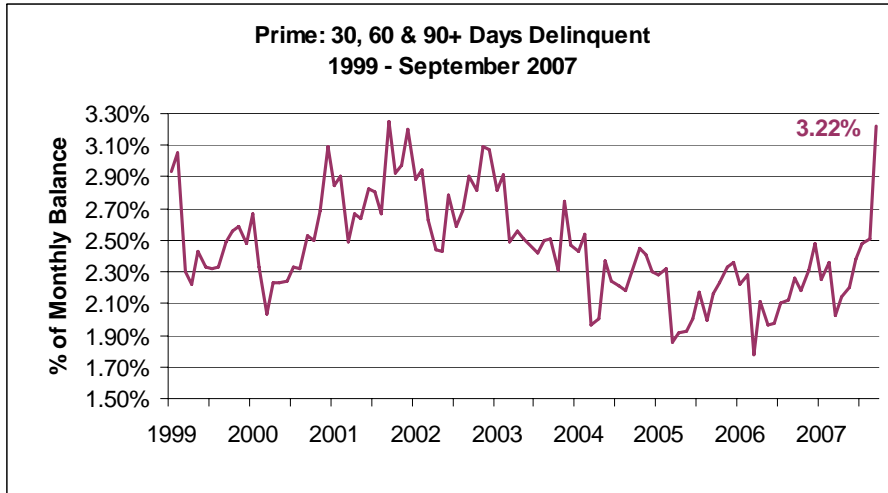
(CHART 9)



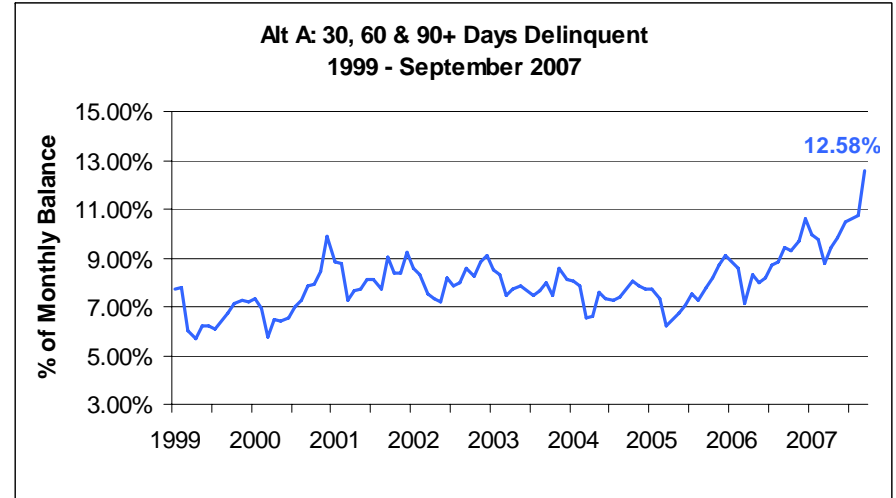
(CHART 10)



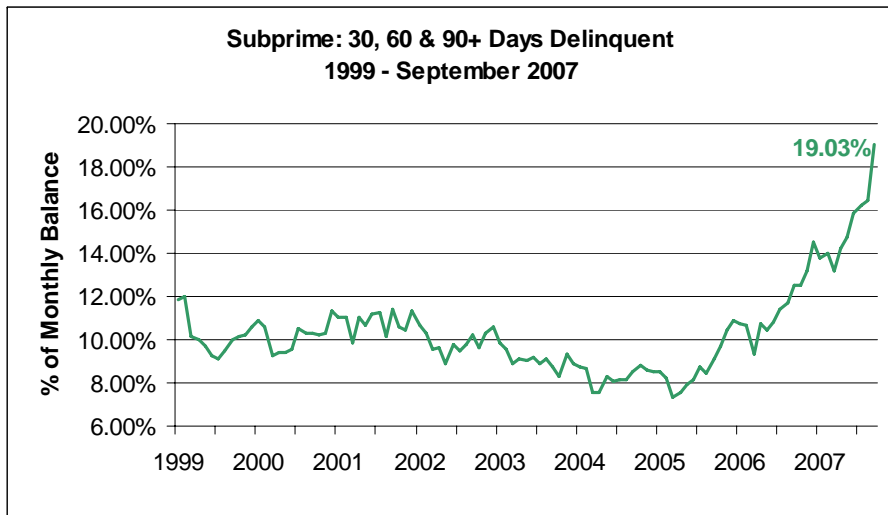
NATIONAL DELINQUENCY RATES: PRIME, ALT-A & SUBPRIME LOANS
 (CHART 11)



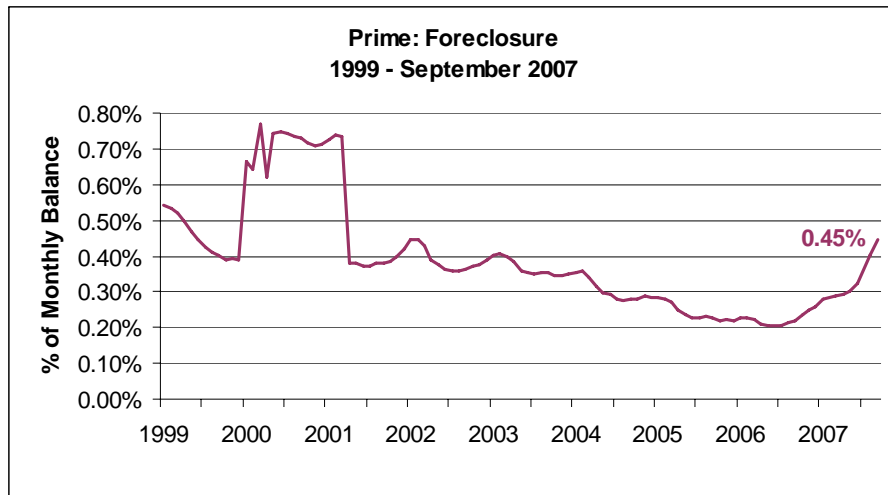
(CHART 12)



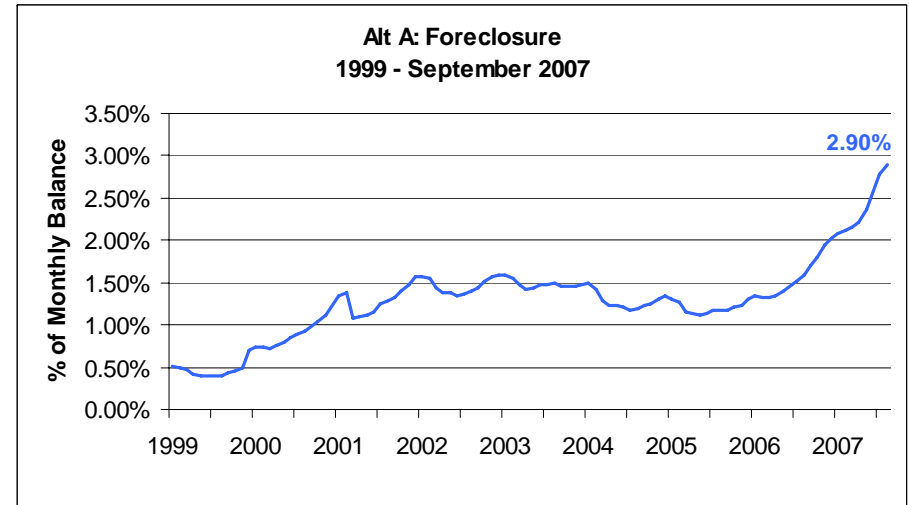
(CHART 13)



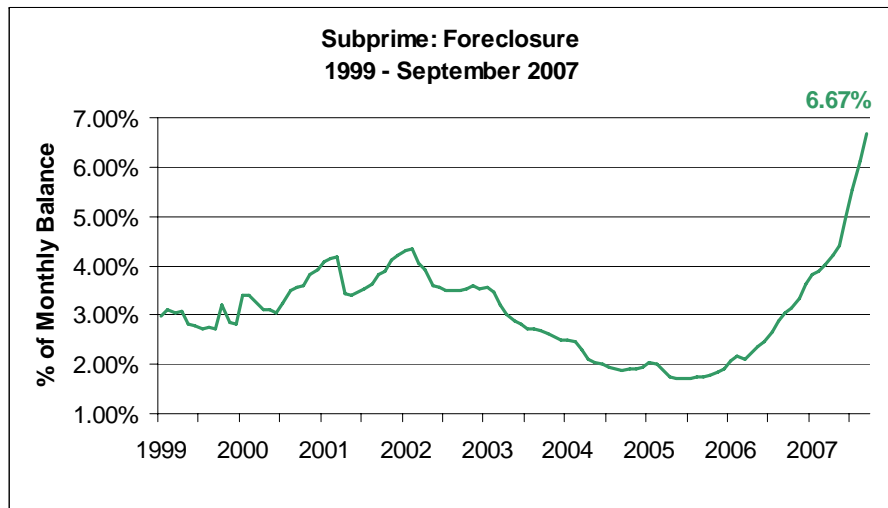
NATIONAL FORECLOSURE RATES: PRIME, ALT-A & SUBPRIME LOANS
(CHART 14)



(CHART 15)



(CHART 16)



SOURCE: CHARTS 7-16 LOANPERFORMANCE, A SUBSIDIARY OF FIRST AMERICAN REAL ESTATE SOLUTIONS (FARES)
NOTE: ALT A IS DEFINED AS ORIGINAL CREDIT SCORE 620-659 AND LTV AT ORIGINATION > 80%. ALL VARIATIONS OF DOCUMENTATION ARE INCLUDED. DATA FOLLOWS THE MBA DEFINITION OF DELINQUENCY.

The information contained herein has been prepared from sources believed to be reliable but is not guaranteed by the Office of Thrift Supervision or the Department of the Treasury and is not a complete summary or statement of all available data. The information analysis and opinions expressed herein are subject to change without notice.