

Economic Trends

November 2007

(Covering October 14, 2006–November 8, 2007)

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08.20.07

by Mark S. Sniderman

Air supply... Financial markets of all kinds have been unusually volatile in the past few months. In just the last couple of weeks, investors were buffeted by three different price movements: Oil prices soared, gold prices surged, and the dollar continued its protracted slide. Investors showed their uneasiness about the future by pushing stock prices steeply lower.

In the summer, price volatility was most evident in the stock prices of home builders and mortgage lenders, and in the markets for asset-backed commercial paper and collateralized debt obligations. More recently, as a broader range of financial companies reported sizeable losses on assets in their portfolios, investors began to reassess their forecasts and anticipate slower economic growth in the next several quarters. If commercial and investment banks are forced to trim their risk exposure and shore up their capital positions, might they not scale back their extension of credit, their provision of backup lines, and their willingness to make markets in risky securities? Could such a retreat precipitate a credit crunch severe enough to slow the economic expansion?

Credit crunches are periods in which borrowers have trouble obtaining credit from banks and capital markets at a given interest rate. Some borrowers might be able to obtain credit on more restrictive terms than those that prevailed before the crunch; others might be unable to obtain credit at any price. Crunches typically come about when lenders suddenly revise their opinions about risk or do not have enough capital to add more assets to their balance sheets. Restrictive monetary policy can also induce a credit crunch by limiting reserves to the banking system.

Credit crunches can pose serious risks to economic expansions because the rationing of credit will probably make some investment projects infeasible, and could even squeeze highly leveraged borrowers to the point of business failure. The resulting decline in production and employment, if it were to spread throughout the economy, could contribute to a recession. This possibility has taught monetary policymakers to be wary of imposing restrictive monetary policies and credit controls during periods of credit market fragility.

Indeed, since August, when signs of financial market distress emerged, the Federal Open Market Committee has dropped its federal funds rate target by 75 basis points and reduced the spread between the funds rate and the primary credit borrowing rate by 50 basis points. These actions were designed, at a minimum, to avoid an inadvertently restrictive policy at a time when lenders were becoming more cautious.

The Federal Reserve's Senior Loan Officer Opinion Survey provides one gauge of credit market tightness and puts it into some perspective over time. From the latest survey, we learned that nearly 20 percent of the respondents reported tightening standards for commercial and industrial loans to medium- and large-sized companies during the third quarter. Nearly 40 percent of them reported increasing the spread of loan rates over their bank's cost of funds. Senior lenders reported that their restraint was focused primarily on commercial real estate and consumer installment lending. Importantly, however, the tightening is a recent development; similar surveys conducted earlier this year found scant evidence of it. It is too soon to tell how long it will persist or how severe it might be.

There is little evidence, from the latest survey at least, of a widespread curtailment of credit. How telling that source of information will prove to be is unclear because various other financial institutions now play key roles in the credit-extension process. If they are retrenching at a faster pace than commercial banking organizations, we might see more credit market restraint than the survey suggests. At the same time, if the survey began to show a commer-

cial bank retreat and nonbank financial firms stepped up their credit market activities, we might experience only a modest credit adjustment.

Daniel Webster once remarked that “Credit is the vital air of the system of modern commerce.”* Soon enough, we will know what is in the air.

Inflation and Prices

September Price Statistics

11.07.07

by Michael F. Bryan and Brent Meyer

September Price Statistics

	Percent change, last					2006 avg.
	1mo. ^a	3mo. ^a	6mo. ^a	12mo.	5yr. ^a	
Consumer Price Index						
All items	3.2	1.0	3.1	2.8	2.9	2.6
Less food and energy	2.7	2.5	2.4	2.1	2.0	2.6
Median ^b	3.0	2.5	2.5	2.8	2.5	3.1
16% trimmed mean ^b	2.9	2.0	2.2	2.3	2.3	2.7
Producer Price Index						
Finished goods	14.7	1.5	3.7	4.4	3.7	1.6
Less food and energy	0.7	1.5	2.0	2.0	1.6	2.1

The Consumer Price Index (CPI) rose at a 3.4 percent annualized rate in September, after falling 1.7 percent in August, pushing the 12-month growth rate from 2.0 percent to 2.8 percent. Although oil prices exerted a considerable influence on the monthly CPI report, general upward pressure was evident across the consumer’s market basket. The rise in the core CPI, the median CPI, and the 16 percent trimmed-mean CPI, at 2.7 percent, 3 percent, and 2.9 percent, respectively, were all above their 3-, 6-, and 12-month averages.

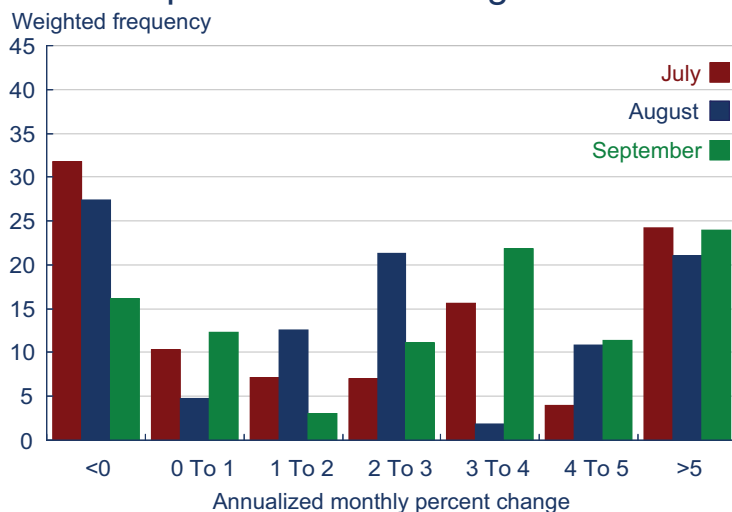
A look at the distribution of the price changes in CPI components bears this observation out. Over the past three months, the percentage of CPI components showing outright price declines has fallen steadily, from about 32 percent to 16 percent of the consumer’s market basket, while the share showing price increases of 3 percent or more has grown from about 42 percent to 57 percent.

a. Annualized.
 b. Calculated by the Federal Reserve Bank of Cleveland.
 Sources: U.S. Department of Labor, Bureau of Labor Statistics; and Federal Reserve Bank of Cleveland.

In its October 31 statement, the Federal Open Market Committee reiterated its concern that “some inflation risks remain” and noted that “recent increases in energy and commodity prices, among other factors, may put renewed upward pressure on inflation.” “In this context,” said the FOMC, “some inflation risks remain, and [the committee] will continue to monitor inflation developments carefully.”

Readings from the Producer Price Index (PPI), which is subject to somewhat larger monthly fluctuations than the CPI, spiked 14.7 percent at an annualized rate in September, taking back most of August’s 15.3 percent decrease. However, the PPI excluding food and energy only increased 0.7

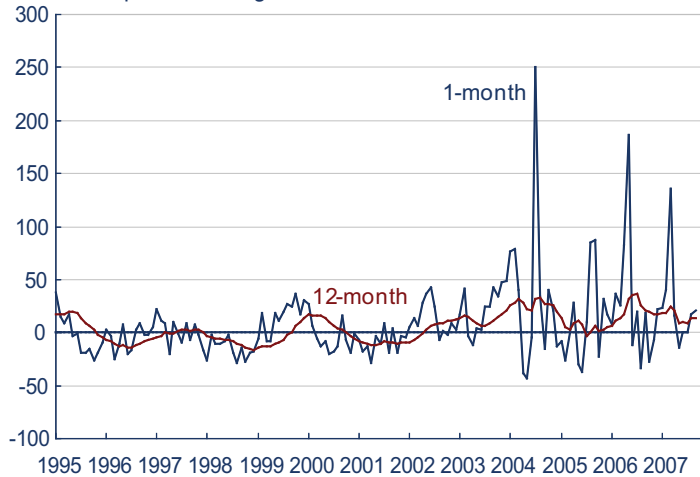
CPI Component Price-Change Distributions



Sources: U.S. Department of Labor, Bureau of Labor Statistics.

Core Crude PPI*

Annualized percent change

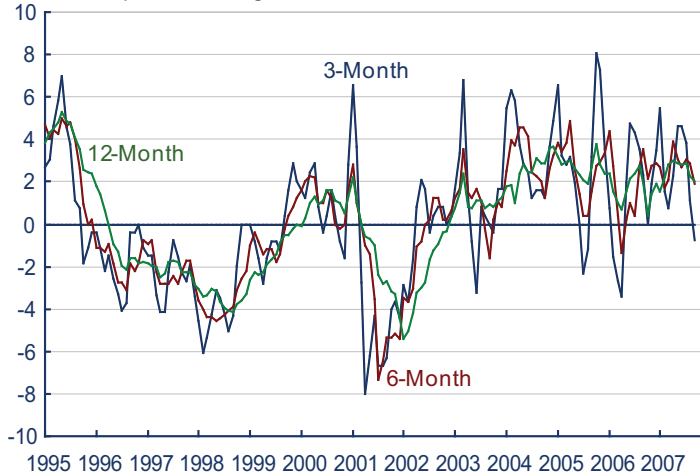


*Core crude PPI includes all crude nonfood materials in the PPI, excluding energy.

Source: Bureau of Labor Statistics

Non-Oil Import Price Index

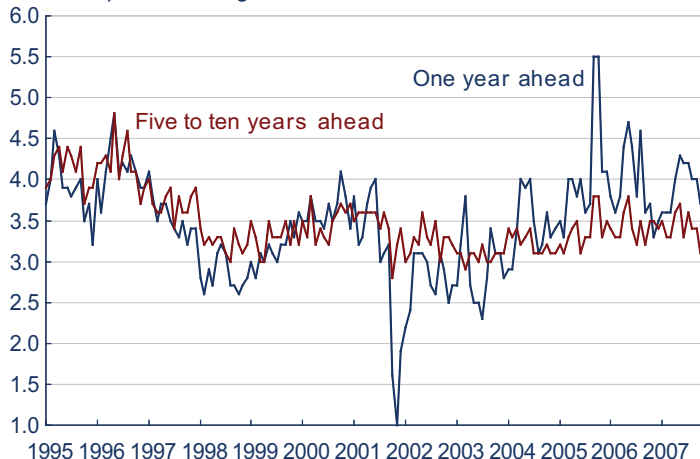
Annualized percent change



Source: Bureau of Labor Statistics

Household Inflation Expectations*

12-month percent change



*Mean expected change as measured by the University Of Michigan's *Survey of Consumers*.

Source: University of Michigan.

percent, after rising 2.3 percent last month. Nevertheless, we've seen a variety of significant price hikes for crude materials other than energy over much of the year, and that pattern seems to have continued into the third quarter. Crude foodstuffs were up a little more than 12 percent over the June-to-September period, as were nonfood and nonenergy materials costs.

Among the potential contributors to a worsening inflation outlook is the continued decline in the dollar vis-à-vis foreign currencies. As the value of the dollar declines, some upward pressure on import prices seems inevitable. How much, and how persistent these price pressures might be, is unknown, and depends, among other things, on how retailer and foreign margins adjust to the falloff in U.S. demand for foreign goods. To date, however, the so called "pass through" of the declining dollar to import prices has been difficult to see in the data with non-oil import costs trending rather steadily at about 2 percent annually.

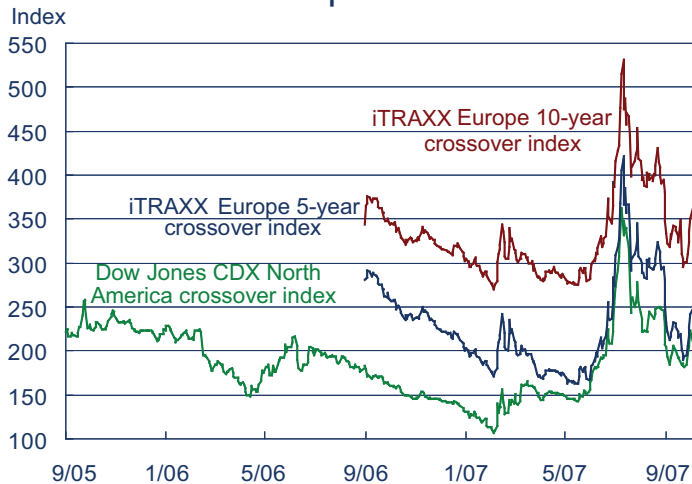
If inflation risks have heightened recently, the change hasn't been reflected in the survey data on inflationary expectations. Household inflation expectations, both short and longer run, have been falling since May, according to the University of Michigan's *Survey of Consumers*. Expected average short-run inflation (for the year ahead) fell from 4 percent to 3.5 percent in October. Longer-term expectations (5 to 10 years out), which had been holding just above the 10-year average of 3.4 percent since April, dropped to 3 percent during the month.

Financial Markets: Settling but Cautious

11.07.07

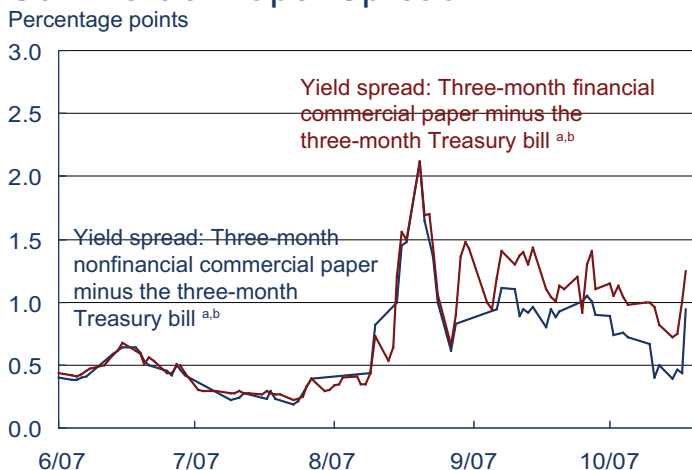
by John Carlson and Sarah Wakefield

Credit Default Swaps



Source: Bloomberg Financial Services.

Commercial Paper Spread



a. All yields are from constant-maturity series.
 b. Financial commercial paper is issued by financial firms for companies and nonfinancial commercial paper is issued by companies.
 Source: Federal Reserve Board

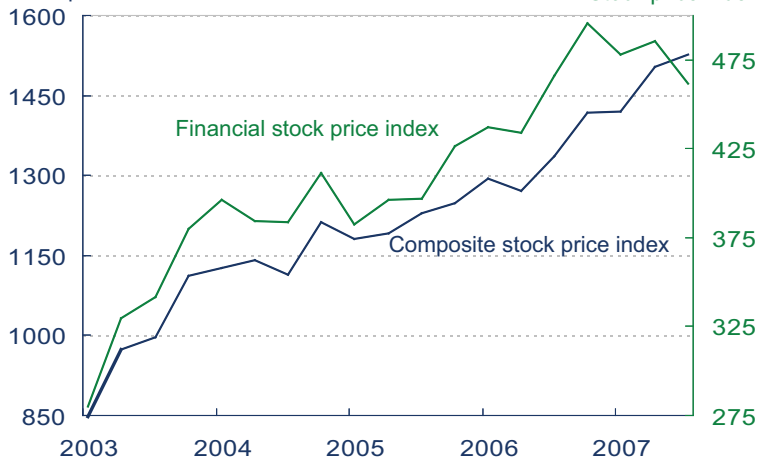
Credit markets have settled a great deal since late summer, when it became starkly apparent that subprime mortgages were much riskier than had been previously thought. The value of a broad array of assets fell dramatically, as market participants reassessed the price they were willing to pay for risky assets more generally. Rates paid on credit default swaps—indicators of the market’s appetite for risk—jumped sharply in August but have declined substantially in recent weeks, suggesting that markets have become more comfortable with taking on some risk.

Many of the subprime mortgages had been repackaged into new asset-backed securities called collateralized debt obligations (CDOs). The CDOs are essentially sliced into claims—called tranches—that are structured in such a way so as to have different levels of risk. Some of the “safer” tranches were financed through the issuance of asset-backed commercial paper. Unfortunately, even the safest slices of mortgage debt proved to be much riskier than originally thought. Spreads on commercial paper over safe Treasury issues of comparable maturities also jumped in August, as purchasers of commercial paper became reluctant to buy new paper as the old paper matured. Although the spreads may have declined, lenders remain cautious, and spreads have retraced some of their recent declines.

It is widely accepted that although credit markets have settled relative to last summer, the economy is far from being out of the woods. The problem is that no one really knows what the appropriate value of assets is now or how deep the subprime mess extends into financial market institutions and beyond. Over the last two weeks, for example, several major financial firms surprised market participants by writing down the value of mortgage-backed assets by a much greater amount than had been anticipated. Market participants are dubious about whether the write-downs are sufficient.

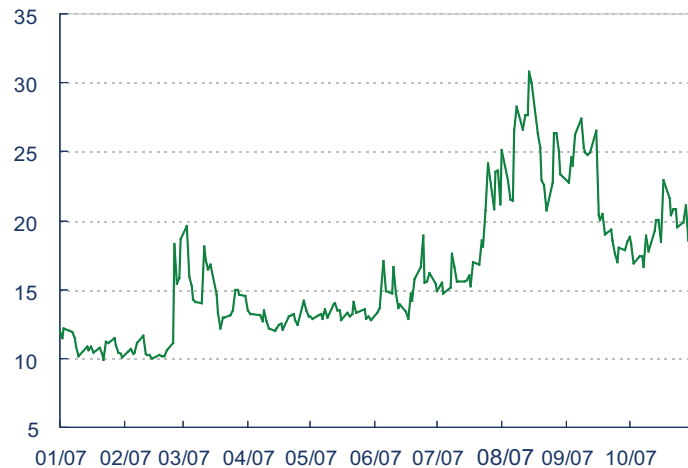
S&P 500

Stock price index



Sources: Wall Street Journal, Financial Times.

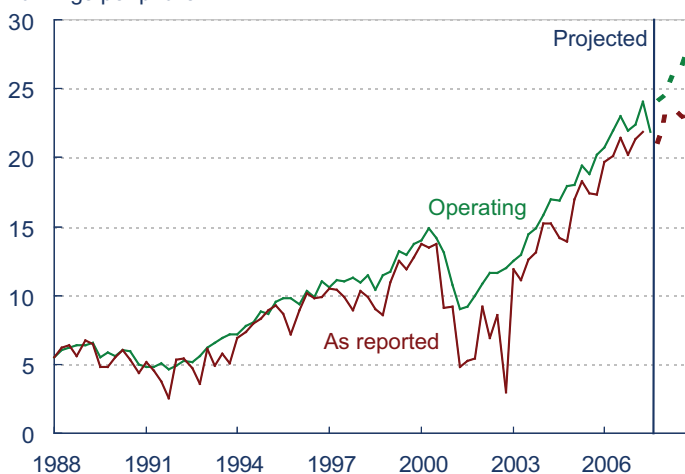
CBOE Market Volatility Index



Source: Wall Street Journal.

S&P 500

Earnings per share^a



a: Earnings after 2007:Q3 are projections provided by Standard and Poors.

Source: Standard and Poor's corporation.

Asset write-downs are charged against earnings.

Thus, profits in the financial sector have taken quite a hit. The recent decline in the Financial Stock Price Index reflects the charge to profits. Moreover, it appears as though the market anticipated some of the tough sledding faced by financial institutions. While the broad S&P 500 Index has increased around 6 percent year-to-date, the Financial Stock Price Index has fallen—beginning its descent in the spring.

The big question facing policymakers is whether the effects of the subprime mess will spill over to the economy more generally. To the extent that the S&P is forward-looking, the absence of further declines in the broad composite stock index since August suggests that the worst may be behind us. Notwithstanding the recent increase in stock market volatility, the gains in equity prices overall suggest that the nonfinancial sector remains robust.

Moreover, analysts predict that the operating profits of S&P 500 firms will grow at healthy rates over the next year or so. Operating earnings do not take into account special write-downs like those made by financial firms, so they tend to be higher than reported earnings.

Projections of operating earnings per share are “bottom-up” aggregates, meaning that they are share-weighted averages of analysts’ predictions of individual firm earnings. As-reported earnings projections, on the other hand, are top-down predictions made by equity strategists. The divergence between the two estimates clearly indicates that the strategists anticipate further write-downs next year although “as reported” earnings are still projected to grow for the broad index. These projections suggest that the effects of financial turmoil are not spreading beyond the financial sector.

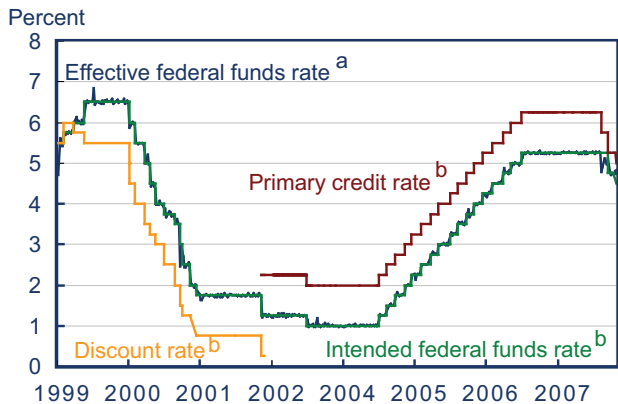
Policymakers are keenly aware that the financial market turmoil could be prolonged and are monitoring financial conditions carefully. If it appears as though financial conditions are worsening and beginning to clearly undermine the economic expansion, central banks can use monetary policy to offset the macroeconomic risk. However, as Federal Reserve Board Governor Frederick Mishkin said on Monday, central banks are “powerless” when it comes to “valuation risk.”

The Well-Anticipated Rate Cut

10.31.07

by John Carlson and Sarah Wakefield

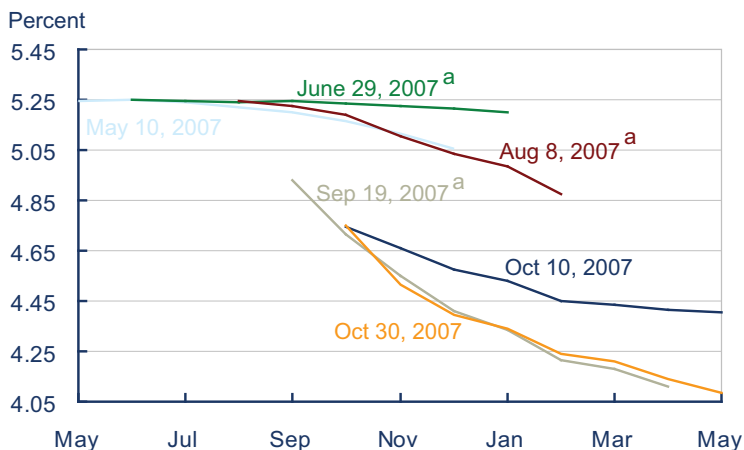
Reserve Market Rates



a. Weekly average of daily figures.
b. Daily observations.

SOURCES: Board of Governors of the Federal Reserve System, "Selected Interest Rates," Federal Reserve Statistical Releases, H. 15.

Implied Yields On Federal Funds Futures



a. One day after FOMC meeting.

SOURCE: Chicago Board of Trade and Bloomberg Financial Services.

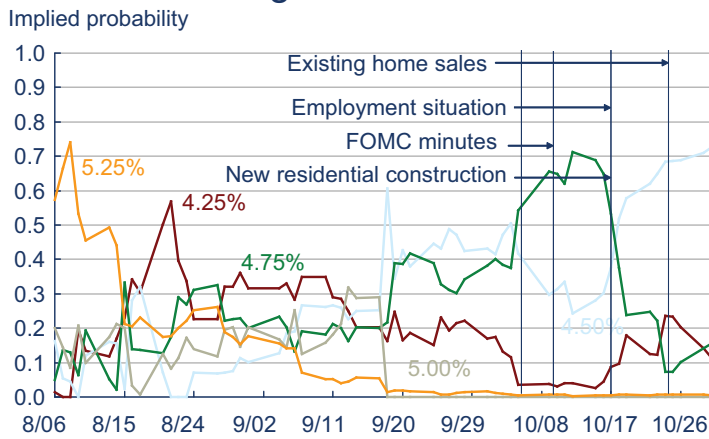
The Federal Open Market Committee voted today to lower the fed funds target 25 basis points to 4.50 percent. One FOMC member dissented. Voting against was Thomas M. Hoenig, who preferred no change. The rate reduction action followed a 50 basis point rate cut at the September meeting. In a related action, the Board of Governors unanimously approved a 25 basis point reduction in the Discount Rate to 5.0 percent. This action followed a 50 basis point reduction on August 17 and a 25 basis point reduction in September.

The Committee's statement emphasized that "Today's action, combined with policy action taken in September, should help forestall some of the adverse effects on the broader economy that might otherwise arise from the disruptions in financial markets and promote moderate growth over time." The statement recognized that "readings on core inflation had improved modestly this year, but recent increases in energy and commodity prices, among other factors, may put renewed upward pressure on inflation." The FOMC noted "that some inflation risks remain" and that the Committee "will continue to monitor inflation developments carefully."

Prices of futures and options on fed funds had indicated that market participants expected a rate cut of 25 basis points today. Before the meeting, the implied probability of a quarter-point cut was about 70 percent, based on options data. The odds of both a half-a-point cut and no change outcomes were both between 10 percent and 15 percent.

The period since the September 18 FOMC meeting has seen markets settle some relative to the previous intermeeting period. This was apparent in term libor rates. Libor, which stands for London Interbank Offered Rate, is the rate of interest at which banks offer to lend money to one another in the wholesale money markets in London. Because these interbank loans are not secured by collateral, rates on term lending rise relative to the fed funds

October Meeting Outcomes



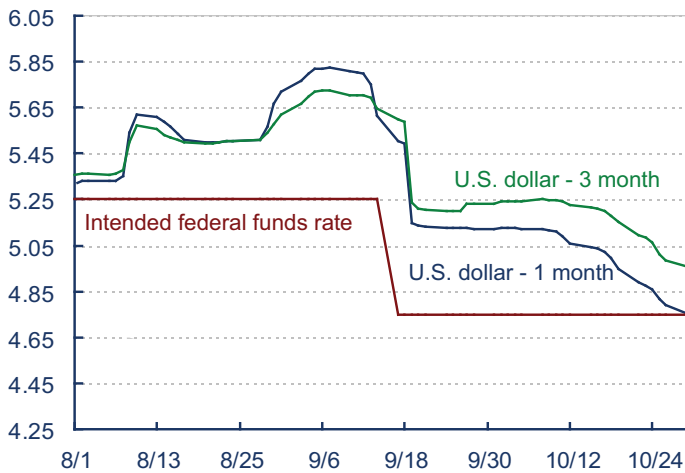
rate when markets become skittish. Since the last FOMC meeting, both one-month and three-month libor rates fell relative to the fed funds rate, indicating a greater willingness among banks to engage in unsecured lending. Though risk premiums appear to be lower, few participants believe that financial conditions are back to normal.

Moreover, the Trading Desk at the New York Fed held rates much closer to the intended rate than they had in the previous intermeeting period. This signaled that the Trading Desk faced more normal conditions in the market for overnight borrowing.

The settling of markets in the intermeeting period and a strong employment report initially led market participants to expect the Fed to hold rates steady at today's meeting. Such an expectation seemed to be confirmed by the FOMC meeting minutes that were released earlier in the month. In recent weeks, however, incoming data revealed that the housing market was even weaker than had been anticipated. The magnitude of the drop in residential housing investment amplified markets' fears that unchecked momentum in housing could spill over into other sectors, raising the risk of recession. Markets have come to expect another rate cut in December of at least 25 basis points.

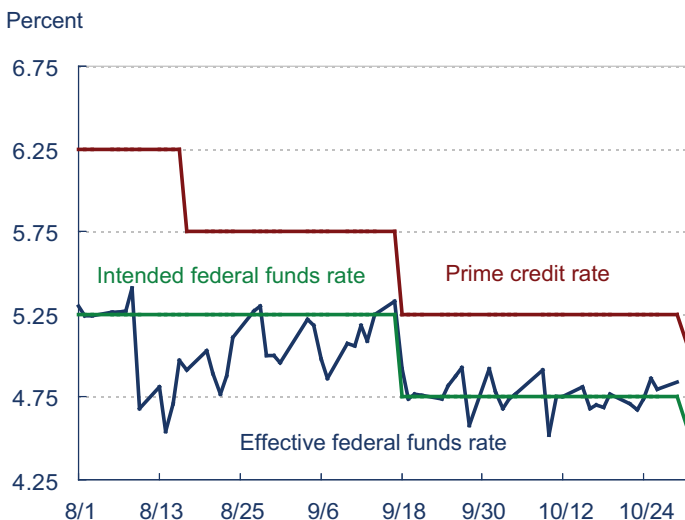
In its assessment of risks, the FOMC statement noted that the Committee "judges that, after this action, the upside risks to inflation roughly balance the downside risks to growth." The immediate reaction to the statement was largely negative. Equity prices fell, erasing gains on the day. Within minutes, however, market sentiment turned favorable and equity prices rose to new highs on the day. The Dow ended the day up 1 percent. Odds on another rate cut in December backed off to less than 50-50. The yield on 10-year Treasuries rose 9 basis points.

Libor Rates



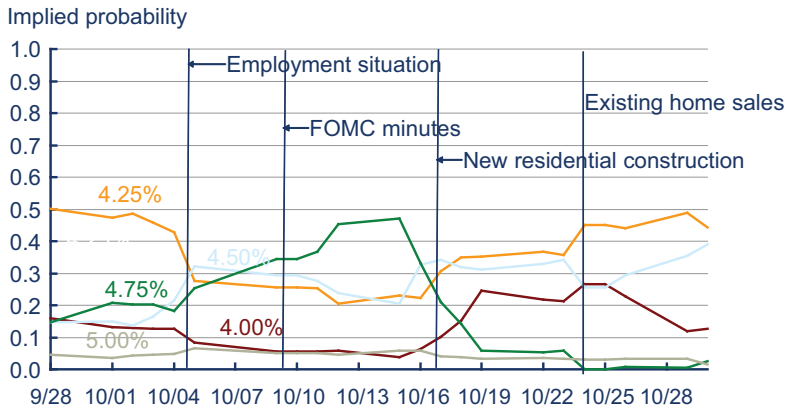
Source: Bloomberg Financial Services.

Reserve Market Rates



Source: Board Of Governors Of The Federal Reserve System, "Selected Interest Rates," Federal Reserve Statistical Released, H. 15.

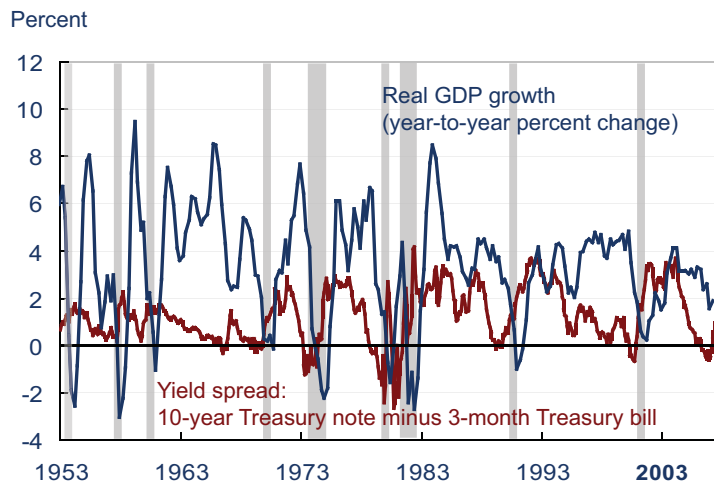
December Meeting Outcomes with January Options



Money, Financial Markets, and Monetary Policy

What Is the Yield Curve Telling Us?

Yield Spread and Real GDP Growth*



*Shaded bars indicate recessions.

Sources: U.S. Department of Commerce, Bureau of Economic Analysis; and Board of Governors of the Federal Reserve System.

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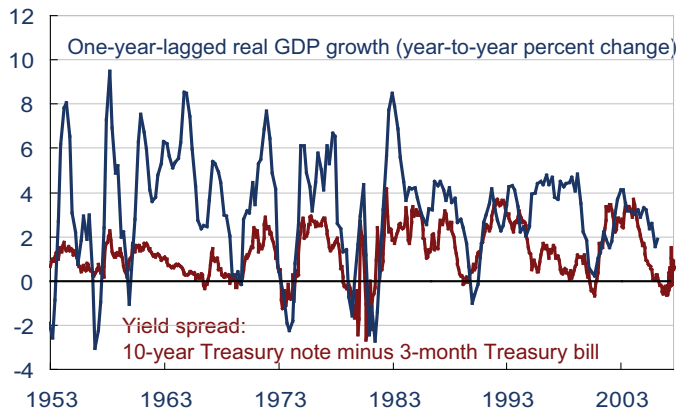
by Joseph G. Haubrich and Katie Corcoran

Since last month, longer-term interest rates have increased with little movement in short rates, increasing the slope of the yield curve. One reason for noting this is that the slope of the yield curve has achieved some notoriety as a simple forecaster of economic growth. The rule of thumb is that an inverted yield curve (short rates above long rates) indicates a recession in about a year, and yield curve inversions have preceded each of the last six recessions (as defined by the NBER). Very flat yield curves preceded the previous two, and there have been two notable false positives: an inversion in late 1966 and a very flat curve in late 1998. More generally, though, a flat curve indicates weak growth, and conversely, a steep curve indicates strong growth. One measure of slope, the spread between 10-year bonds and 3-month T-bills, bears out this relation, particularly when real GDP growth is lagged a year to line up growth with the spread that predicts it.

The yield curve had been giving a rather pessimistic view of economic growth for a while now, but with the increasingly steep curve, this is turning around. The spread remains robustly positive, with the 10-year rate at 4.67 percent and the 3-month rate at 4.00 percent (both for the week ending October 12). Standing at 67 basis points, the spread is up from September's 38 basis points and well above August's -4 basis points. Projecting forward using

Yield Spread and Lagged Real GDP Growth

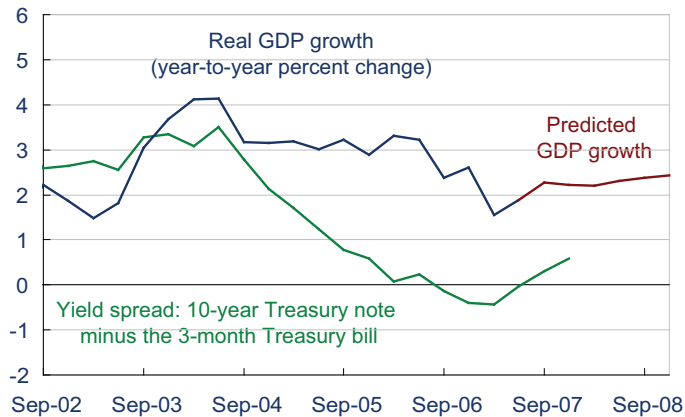
Percent



Sources: U.S. Department of Commerce, Bureau of Economic Analysis; and Board of Governors of the Federal Reserve System.

Predicted GDP Growth and the Yield Spread

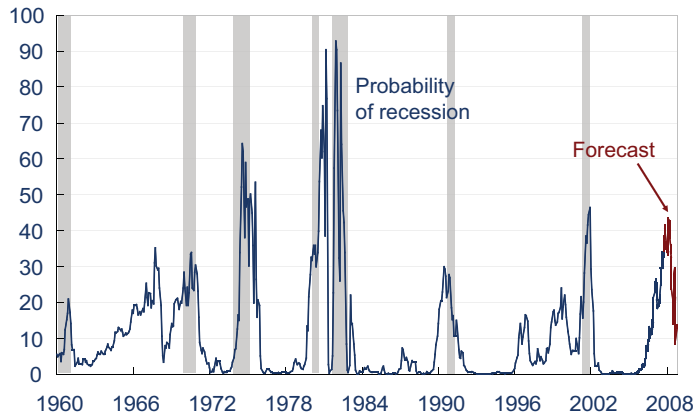
Percent



Sources: U.S. Department of Commerce, Bureau of Economic Analysis; the Board of Governors of the Federal Reserve System; and authors' calculations.

Probability of Recession Based on the Yield Spread*

Percent



*Estimated using probit model. Shaded bars indicate recessions.

Sources: U.S. Department of Commerce, Bureau of Economic Analysis; Board of Governors of the Federal Reserve System; and authors' calculations.

past values of the spread and GDP growth suggests that real GDP will grow at about a 2.4 percent rate over the next year. This is broadly in the range of other forecasts, if a bit on the low side.

While such an approach predicts when growth is above or below average, it does not do so well in predicting the actual number, especially in the case of recessions. Thus, it is sometimes preferable to focus on using the yield curve to predict a discrete event: whether or not the economy is in recession. Looking at that relationship, the expected chance of a recession in the next year is 14 percent, down from September's 17 percent and August's 28 percent.

Perhaps the decreasing probability of a recession seems strange in the midst of recent financial concerns, but one aspect of those concerns has been a flight to quality, which has lowered Treasury yields, and a reduction in both the federal funds target rate and the discount rate by the Federal Reserve, which tends to steepen the yield curve.

Our 14 percent chance is below the 26.2 percent calculated by James Hamilton over at Econbrowser (though to be fair, we are calculating different events: our number gives a probability that the economy will be in recession over the next year; Econbrowser looks at the probability that the first quarter of 2007 was in a recession).

Of course, it might not be advisable to take this number quite so literally, for two reasons. First, this probability is itself subject to error, as is the case with all statistical estimates. Second, other researchers have postulated that the underlying determinants of the yield spread today are materially different from the determinants that generated yield spreads during prior decades. Differences could arise from changes in international capital flows and inflation expectations, for example. The bottom line is that yield curves contain important information for business cycle analysis, but, like other indicators, should be interpreted with caution.

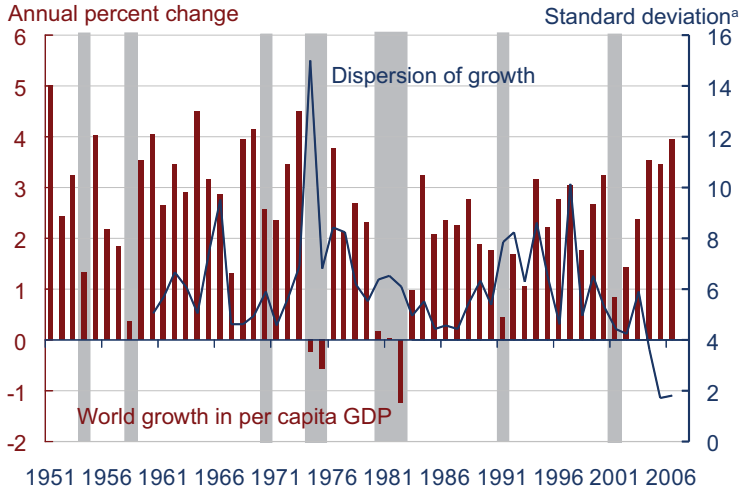
For more detail on these and other issues related to using the yield curve to predict recessions, see the *Commentary* "Does the Yield Curve Signal Recession?"

Is It the Best of Times or the Worst?

11.07.07

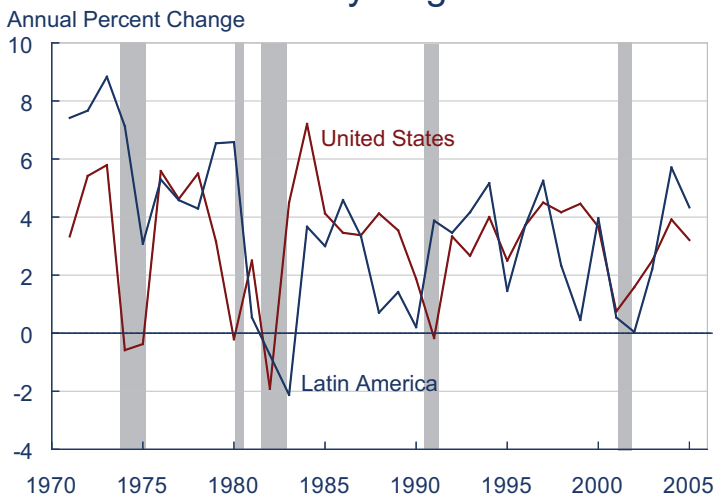
By Owen F. Humpage and Michael Shenk

World Growth



Note: Shaded bars indicate U.S. recessions.
 a. Standard deviation of detrended GDP growth across countries.
 Source: International Monetary Fund, World Economic Outlook, October 2007.

Real GDP Growth by Region



Note: Shaded bars indicate U.S. recessions.
 Source: International Monetary Fund, World Economic Outlook, April 2007.

The continuing implosion of the U.S. housing market has caused many forecasters to trim their economic-growth estimates for this year and next. Although none is openly using the R-word, most expect a period of substandard growth extending at least through the first half of 2008. The great uncertainty in the economic outlook is the extent to which housing-related woes and the associated financial-market turmoil might impact other sectors, notably business investment and consumer spending.

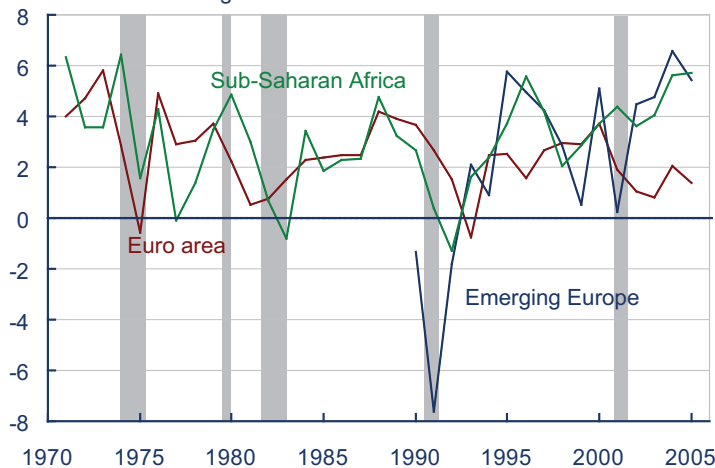
August's roiling of global financial markets highlighted another aspect of the U.S. housing-market meltdown: the fact that growing international trade and cross-border financial flows have made the world's economies more interdependent. More than ever before, events in one country can spill over into others.

Over the past year, in two editions of its *World Economic Outlook*,^{1,2} the International Monetary Fund (IMF) has explored how closer economic ties among nations have changed global business cycles. This article summarizes some of the key points made in those very interesting articles.

As worrisome as the current housing and financial-market turmoil may be, it comes during a time of phenomenal worldwide economic activity. The pace of economic growth is the highest in 30 years, and the extent to which countries across the globe are sharing in the prosperity, as measured by the low dispersion in growth rates, seems unprecedented. The volatility of the growth—both across the globe and within most countries—has been moderating since at least the early 1980s, so much so that economists have dubbed the phenomenon “the Great Moderation.” In most countries and regions of the globe, according to the IMF analysis, economic expansions appear to be lengthening, while recessions are getting shorter and milder. Latin America and Japan are notable exceptions. Deep

Real GDP Growth by Region

Annual Percent Change

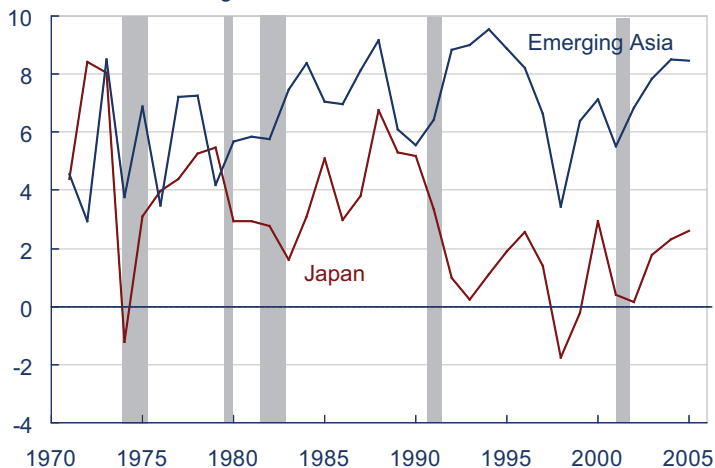


Note: Shaded bars indicate U.S. recessions.

Source: International Monetary Fund, World Economic Outlook, April 2007.

Real GDP Growth by Region

Annual Percent Change



Note: Shaded bars indicate U.S. recessions.

Source: International Monetary Fund, World Economic Outlook, April 2007.

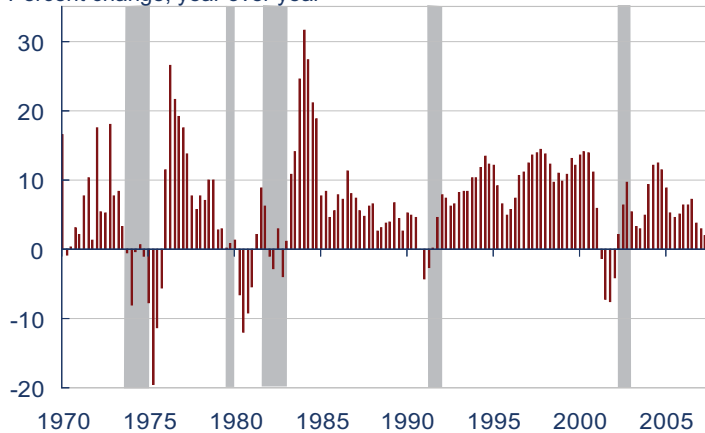
recessions—those resulting in an output loss of at least 3 percent—seem a thing of the past in most large developed countries, including Japan, as well as in China and India.

A hallmark of recent global prosperity is an improvement in monetary policy. Following the abysmal performance of the 1970s, monetary policy in most advanced countries has focused primarily—if not solely—on achieving and maintaining reasonable price stability. Governments gave their central banks more autonomy, and central banks improved the clarity of their operations. More recently, central banks in emerging and developing countries have been showing similar improvements in their monetary policies. Fiscal policies, which can have monetary implications, have likewise improved, becoming less volatile. Advances in countries' financial infrastructures also seem important. Financial development can aid investment by spreading risk and can help households smooth their expenditures across good and bad times. Much of the moderation in world output volatility reflects a reduction in the volatility of consumption spending, as the IMF shows.

While global business cycles may have become more docile, they haven't lost their bite. The world remains susceptible to economic developments in the United States; if anything, globalization has probably increased that vulnerability. The extent to which a U.S. economic slowdown spills over to the rest of the world depends, of course, on how hard the United States is hit. Historically, when the United States slips into recession, growth in other countries and regions of the world significantly slows, but usually most other economies do not likewise experience a recession. The extent of the economic moderation in any one country mainly depends on its trade and financial ties with the United States. Other industrialized countries, Latin America, and, to a lesser extent, Asia seem to bear the brunt of a contraction in U.S. economic activity. Over the past year or so, as its housing-sector problems have unfolded, the United States has avoided a recession, but the rate of U.S. economic growth has fallen below its potential pace. The IMF

Real Imports of Goods and Services

Percent change, year over year



Note: Shaded bars indicate U.S. recessions.

Source: Bureau of Economic Analysis

suggests that when this happens, the global effects are fairly negligible and limited to other industrialized countries.

These global spillovers depend on many mitigating circumstances, but generally they slosh through two conduits: trade ties and financial linkages. The first is straightforward. When U.S. economic activity contracts, U.S. imports fall. The IMF suggests that the relative importance of this conduit may be waning somewhat. Regional trade ties—transactions with nearby neighbors—are growing more rapidly for most countries than trade with the United States. Nevertheless, the United States offers a huge market and remains the export destination for nearly 20 percent of all internationally traded goods. In addition, the recent sharp and broad-based depreciation of the dollar is likely to ramp up any trade-related spillovers stemming from a weaker pace of U.S. economic growth.

Financial linkages, however, seem a much more important channel for the transmission of international shocks than trade ties, especially among the large developed countries. Claims on the United States represent a huge share of foreign portfolios, and, likewise, U.S. investors maintain substantial claims on foreigners. Prices of like financial instruments are highly correlated across global markets, and as the IMF reports, this correlation seems to increase in weak markets. When shocks occur in one segment of the global financial market, such as the commercial paper associated with subprime lending, they can quickly spill across a broader array of assets with similar risk profiles. Uncertainty and any associated flight to quality can dry up market liquidity and quickly affect real business investment and consumer spending across countries with strong financial linkages.

So we are left wondering: Is this the best of times or worst?

1. International Monetary Fund. April 2007. "Decoupling the Train? Spillovers and Cycles in the Global Economy," *World Economic Outlook*, pp. 121–160.

2. International Monetary Fund. October 2007. "The Changing Dynamics of the Global Business Cycle," *World Economic Outlook*, pp. 67–94.

The Employment Situation, October

11.14.07

By Yoonsoo Lee and Michael Shenk

Labor Market Conditions

	Average monthly change (thousands of employees, NAICS)				
	2004	2005	2006	Jan.–Oct. 2007	October 2007
Payroll employment	172	212	189	125	166
Goods-producing	28	32	9	-23	-24
Construction	26	35	11	-8	-5
Heavy and civil engineering	2	4	2	0	1
Residential ^a	9	11	-2	-6	-22
Nonresidential ^b	3	4	6	2	15
Manufacturing	0	-7	-7	-17	-21
Durable goods	8	2	0	-12	-13
Nondurable goods	-9	-9	-6	-4	-9
Service-providing	144	180	179	148	190
Retail trade	16	19	-3	3	-22
Financial activities ^c	8	14	16	1	2
PBS ^d	38	57	42	24	65
Temporary help services	11	18	-1	-6	20
Education and health services	33	36	41	49	43
Leisure and hospitality	25	23	38	32	56
Government	14	14	20	22	36
Local educational services	8	6	11	10	35
		Average for period (percent)			
Civilian unemployment rate	5.5	5.1	4.6	4.6	4.7

a. Includes construction of residential buildings and residential specialty trade contractors.

b. Includes construction of nonresidential buildings and nonresidential specialty trade contractors.

c. Financial activities include the finance, insurance, and real estate sector and the rental and leasing sector.

d. PBS is professional business services (professional, scientific, and technical services, management of companies and enterprises, administrative and support, and waste management and remediation services).

Source: Bureau of Labor Statistics.

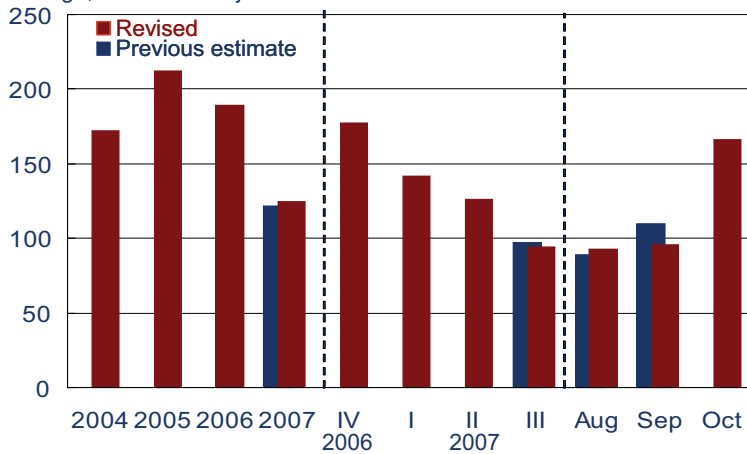
Nonfarm payrolls increased by 166,000 jobs in October. This is the largest gain since May and doubled market expectations of a gain of 83,000. The unemployment rate remained about the same at 4.7 percent, and the labor force participation rate was essentially unchanged (65.9 percent from 66.0 percent in September). The headline number in this report suggests that the labor market remains stronger than economists expected, calming fears about the ongoing decline in housing sectors and the turmoil in financial markets spilling over to other sectors. However, stronger-than-expected gains were not broadly observed across all sectors.

In fact, job gains in October were quite skewed, centering on service sectors, which repeats a recent pattern. Goods-producing sectors continued to show weakness, shedding 24,000 workers. The loss of 21,000 jobs in manufacturing puts the average change over the last three months at -28,000 jobs, the lowest three-month average since September 2003. Employment losses in durables (-12,000) are concentrated in transportation equipment (-7,400) and computer and electronic products (-4,300). Overall, the construction industry lost 5,000 jobs last month. Jobs in residential construction fell by 21,500, reflecting a sharp decline in the housing sector. Nonresidential construction remained resilient, adding 15,000 jobs in October.

The gain in overall employment reflected a 130,000 increase in private payrolls and a 36,000 gain in government payrolls. Most of the gains in government are from local educational services (35,000), a sector that went through significant revisions in recent months (see August and September employment situations). In August, the BLS originally reported a 32,000 loss in local educational services. This number, after two revisions in September and October, now stands at a 54,000 gain. As the BLS catches up on unusual seasonal changes around the start of the school year, the gains in September and October are very likely to be revised again.

Average Nonfarm Employment Change

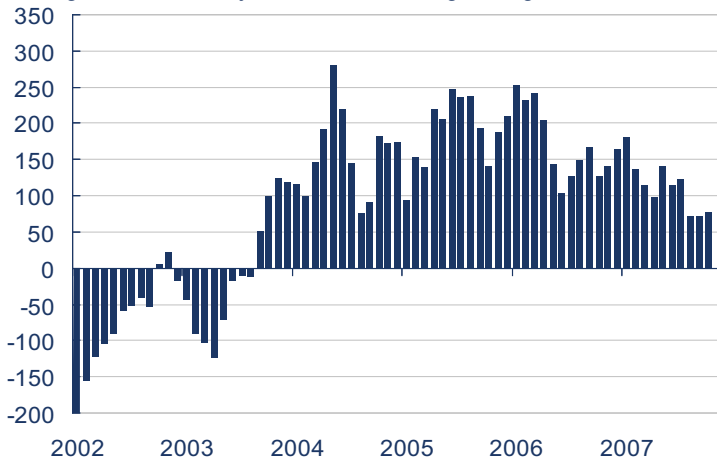
Change, thousands of jobs



Source: Bureau of Labor Statistics

Private Sector Employment Growth

Change, thousands of jobs: 3-month moving average



Source: Bureau of Labor Statistics

The private service sector continued to add jobs at a slightly faster rate. The three-month moving average of employment growth in the sector accelerated slightly (120,000 as of October), although this pace was lower than earlier this year. Employment gains were quite strong in Professional Business Services (65,000 gains, up from 23,000 in September). Education and Health Services added 43,000 jobs in October, but the gains in September in this sector were revised down from 44,000 to 29,000. Leisure and Hospitality also continued to add jobs (56,000) in October, along with 15,000 additional gains in September due to the revision. However, such strength in the service sector is not broadly observed. Retail Trade continued to lose jobs during the month (-22,000). Recent turmoil in the mortgage market has been a major issue in the financial markets. While lenders (credit intermediation and related service) cut 5,000 jobs, employment in financial sectors did not change much.

Overall, this month's report suggests that the labor market remains stronger than most were expecting. However, it is worth noting that monthly numbers are volatile and subject to revision. In last month's report, the Bureau of Labor Statistics (BLS) revised away the 4,000 job loss originally reported in August, raising that estimate to a gain of 89,000. Although this report's revisions to September (-14,000) and August's (4,000) employment numbers are relatively small, payroll gains in September and October are subject to revision in the next report. Excluding volatile government series, the three-month moving average of private payroll growth remains at the low end of the range it has been in since 2004. In a positive sign, temporary help employment, which is often used as a leading indicator of the overall labor market, grew by 20,000 after successive declines in recent months. However, softness in goods-producing sectors remains a concern for the economy.

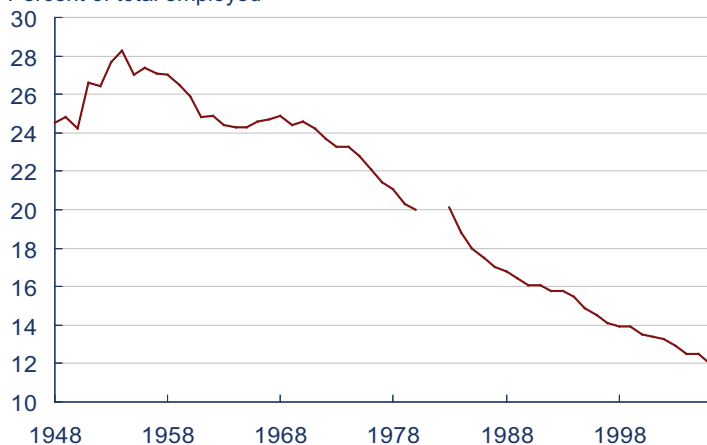
Union Membership

11.09.07

By Yoonsoo Lee and Beth Mowry

Union Membership Rates

Percent of total employed



a. Data after 1982 includes employee association membership

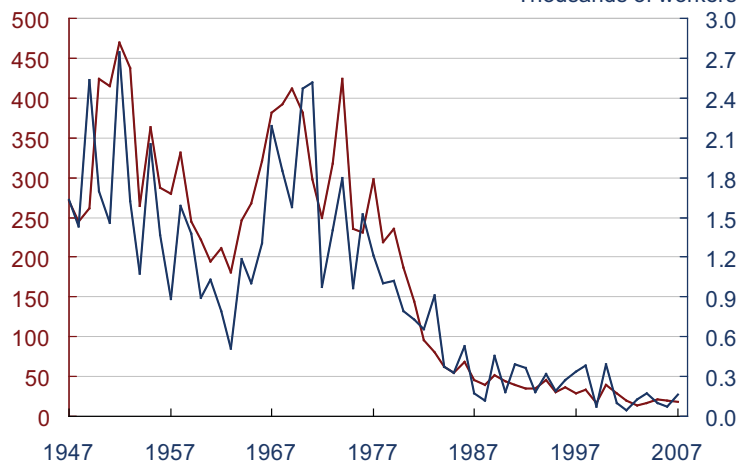
b. No data available 1981-1982

Source: Bureau of Labor Statistics

Work Stoppages

Number of strikes

Thousands of workers

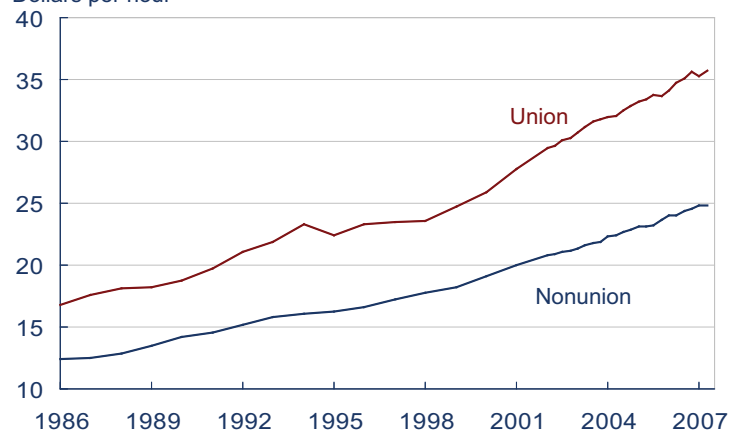


a. 2007 data is annualized data from the first three quarters

Source: Bureau of Labor Statistics

Employer Costs: Total Compensation

Dollars per hour



a. Data is in constant dollars

Source: Bureau of Labor Statistics

After the National Labor Relations Act became law in 1935, organized labor unions experienced growing popularity and began to exercise their rights to collectively bargain and take part in strikes. The Act was a spin-off of President Roosevelt’s New Deal, which was aimed at supporting prices and stimulating recovery from the Great Depression. Union membership increased steadily until 1954, at which point more than a quarter of all workers were unionized (17 million out of 60 million, or 28.3 percent). But since that peak, union membership has declined and stands at an all-time low of 12 percent (as of 2006).

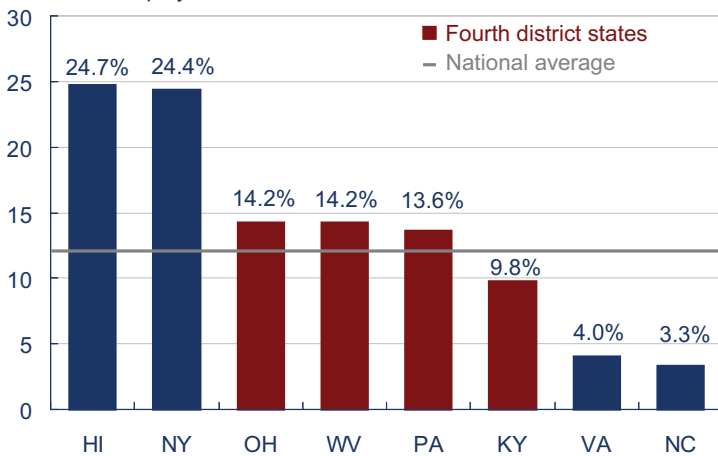
It is not just that union membership is growing more slowly than overall job growth; the number of union members has actually been declining. While the number of people employed has increased 14 percent over the last decade, the number of union members has dropped 5.6 percent. In 2006, out of the 128.2 million workers employed, 15.4 million were union members. Some economists attribute the decline in union membership to the labor force’s shift away from heavily-unionized industries such as manufacturing. Others argue that the demand for union representation has declined over time, as the public provision of social welfare benefits by the government has increasingly substituted for the benefits of union service.

The number of work stoppages has followed the same trend as union membership, declining sharply in the 1970s. In 2006, there were only 20 major work stoppages (involving 1,000 or more workers), compared to the 1970s, when more than 200 strikes occurred each year. The number of union members involved in each strike has declined as well: in the 1970s more than 1 million workers participated in strikes each year, whereas in 2006 the number had fallen to only 70,000.

On average, union workers and the members of similar employee organizations still earn higher

Union Membership Rates (2006)

Percent of employed



Note: HI and NY - states with the highest membership rates; VA and NC - states with the lowest membership rates

Source: Bureau of Labor Statistics

hourly compensation, including retirement and benefits. Average hourly compensation including benefits was \$35.69 for union members and \$24.79 for non-union members in the second quarter of 2007. In 2006, weekly wages and salaries for union members was \$833, compared to the \$642 for non-union workers.

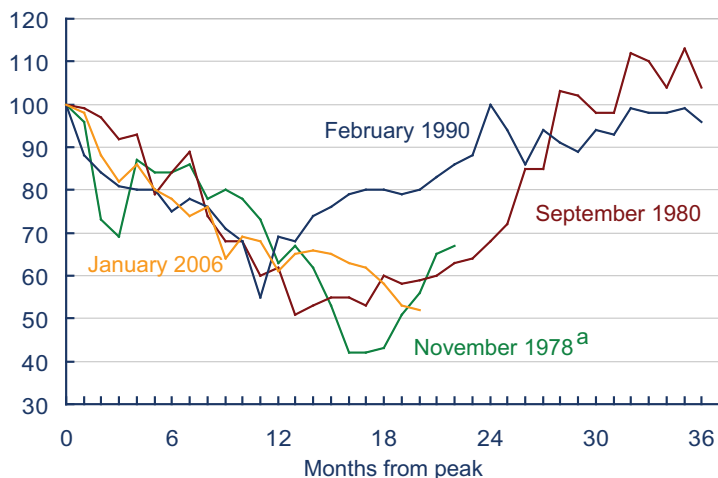
Rates of union membership widely vary across states. In 2006, 24.7 percent of workers in Hawaii belonged to unions or similar associations, while in North Carolina only 3.3 percent workers did—the lowest in the nation. Most of the Fourth District states slightly exceed the national average membership rate (12 percent). Ohio's 14.2 percent rate was above the nation's average and was a significant decline from its rate in 2000 of 17.4 percent. West Virginia, Pennsylvania, and Kentucky's union membership rates stand at 14.2 percent, 13.6 percent, and 9.8 percent, respectively.

Economic Activity and Labor

Housing Cycles

Single-Family Housing Starts

Index, peak = 100



a: The November 1978 cycle is truncated due to its intersection with the September 1980 cycle.

Source: Census

11.09.07

By Michael Shenk

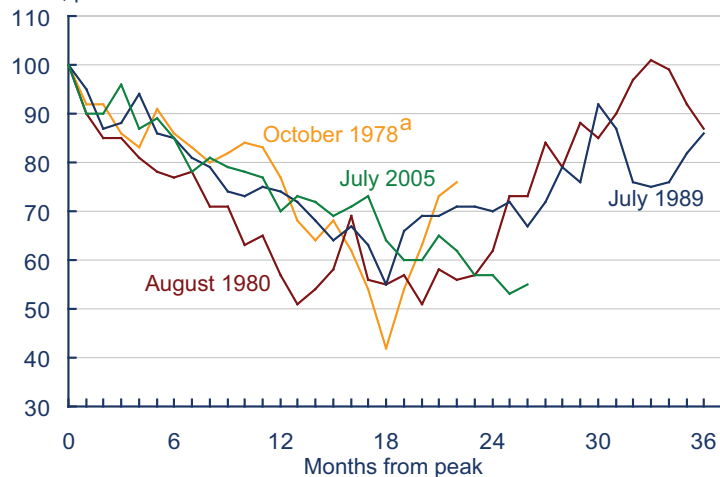
October's housing data, which predominately covers what happened in September, did little to change our picture of the housing market. A look at the recently released data shows that the downturn in housing continued through September. While this is not good news, some consolation can be had by comparing this downturn to others in the past. Looking at the last three housing slumps suggests this one is pretty typical. In fact, the current downturn actually compares favorably in some metrics. But then again, nothing indicates it is ending anytime soon.

To compare housing downturns across time in a meaningful way, it helps to look at various indicators of the market as indexes as opposed to raw numbers. By indexing the data of the different series to their respective peaks, we can get a clearer picture of the severity of each downturn over a given time frame.

During the four most recent downturns, single-family housing starts have fallen at fairly compara-

New Single-Family Home Sales

Index, peak = 100

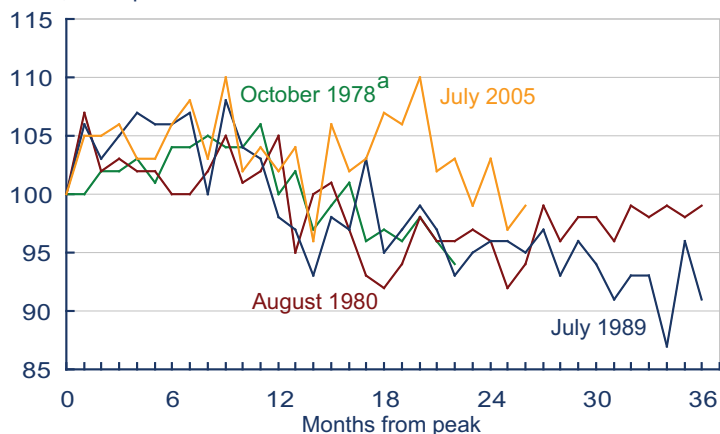


a: The October 1978 cycle is truncated due to its intersection with the August 1980 cycle.

Source: Census

Real Median Sales Price New Single-Family Homes

Index, sales peak = 100

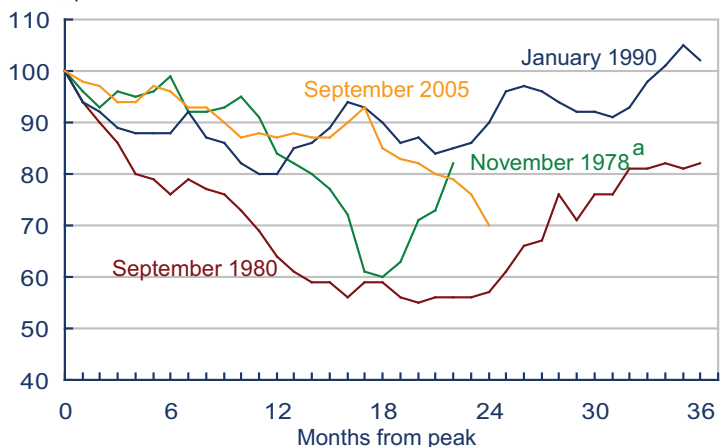


a: The October 1978 cycle is truncated due to its intersection with the August 1980 cycle.

Source: Census

Existing Single-Family Home Sales

Index, peak = 100



a: The November 1978 cycle is truncated due to its intersection with the September 1980 cycle.

Source: National Association of Realtors

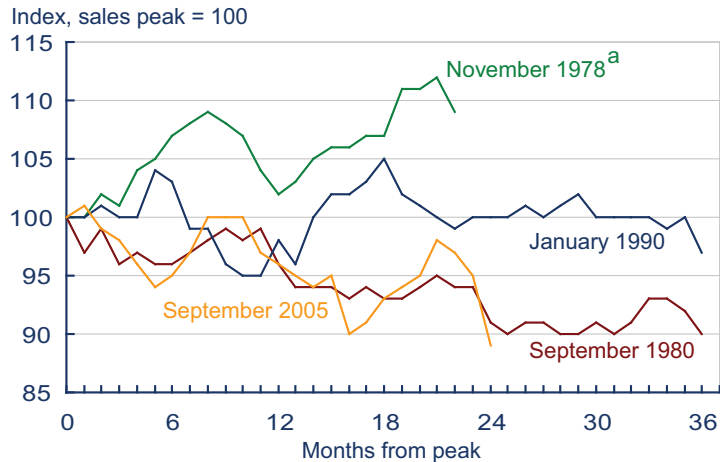
ble rates. With the exception of the housing slump beginning in 1990, which is noticeably shorter in terms of its effect on starts, the current position of housing starts is very close to what it was in each of the previous cycles. While the pace and size of the decline are very similar in all of these cases, the most recent downturn sticks out in terms of how long it has lasted. In none of the previous cycles had starts fallen consistently for more than a year and a half without a noticeable uptick.

As for new-single family home sales, their current decline appears to be pretty typical as well. This shouldn't be particularly surprising, assuming that there is a link between housing starts and new home sales. The current cycle does differ slightly in the pace of the sales decline, which was somewhat slower than the previous cycles through the first year and a half. And once again, around the 18-month mark, each of the previous cycles bottomed out, which has not yet happened in the current cycle.

The real median sales price for new single-family homes has historically been fairly flat throughout downturns in sales, with only a modest downward trend starting about 12 months after the peak in sales. Thus far, the current cycle does not seem to be an exception to this trend, but prices do appear to have been somewhat more resilient through the first 18 months of the cycle than in the past. The resiliency of prices may partially explain why previous cycles saw an uptick in sales around this time and the current cycle has not as of yet. (The median sales price of new homes may not necessarily reflect the actual cost of a new home. Sellers of new homes often can adjust the actual cost of the home by offering nonprice incentives or discounts that are not reflected in the sales price.)

The market for existing single-family homes, which is considerably larger than the market for new single-family homes, also appears to be behaving typically for a period of decline, although a bit more favorably than in previous slumps. Through the first 18 months of the current cycle, existing home sales were doing considerably better than all but the cycle beginning in 1990. (And that cycle would have had a much sharper downturn if data from

Real Median Sales Price, Existing Single-Family Homes



a: The November 1978 cycle is truncated due to its intersection with the September 1980 cycle.

Source: National Association of Realtors

December 1988 to June 1989 had been included, as there was a sharp decline in existing home sales during the period. The period was excluded, however, in order to keep the time periods consistent with the downturns in starts and new home sales.) As was the case with both housing starts and new home sales, sales of existing homes, which in previous cycles began to bottom out around the year and a half mark, have not shown any signs of reaching a trough in this cycle.

Perhaps responsible for the more modest decline in sales is the decline seen in the real median sales price of new homes. The current cycle's decline tracks the price movements of the cycle beginning in 1980 fairly closely. A notable difference between these two cycles is that the real price decline in the 1980 cycle was accompanied by a much steeper decline in sales. Still, the current decline in prices may be a little disconcerting for the typical homeowner, as homes generally make up a large portion of a household's wealth. It also may be a point of concern from a macroeconomic perspective if the price declines spill over into households' consumption decisions. Thus far, we have yet to see any signs that the consumer market is being affected by weakness in home prices.

So is this the worst housing slump in the last 30 years? Although it is too soon to tell, so far it is broadly similar to the ones we have seen before. Of course, there is one important difference we haven't yet mentioned: all three of the previous housing slumps were accompanied by recessions, while this one, so far, has not.

Third-Quarter GDP

11.01.07

By Brent Meyer

Real GDP and Components, Third-Quarter Advance Estimate

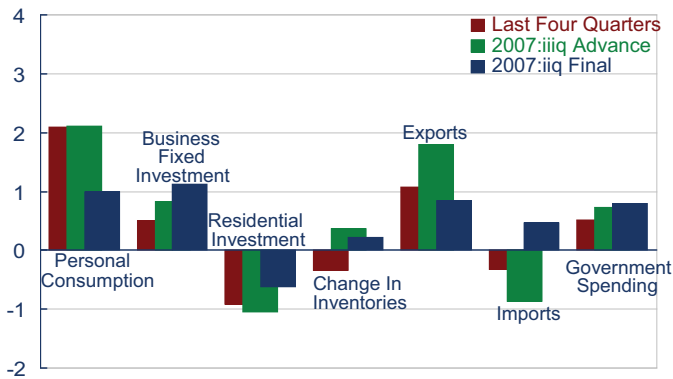
	Quarterly change (billions of 2000\$)	Annualized percent change, last	
		Quarter	Four quarters
Real GDP	110.6	3.9	2.6
Personal consumption	61.0	3.0	3.0
Durables	13.4	4.4	4.7
Nondurables	16.0	2.7	2.4
Services	32.9	2.9	3.0
Business fixed investment	26.1	7.9	4.8
Equipment	15.3	5.9	1.4
Structures	8.9	12.4	12.8
Residential investment	-26.8	-20.1	-16.4
Government spending	18.5	3.7	2.7
National defense	11.8	9.7	5.6
Net exports	27.7	—	—
Exports	52.7	16.2	9.6
Imports	25.0	5.2	2.0
Change in business inventories	9.9	—	—

Source: Bureau of Economic Analysis.

Real gross domestic product (GDP) increased at a 3.9 percent annualized rate in the third quarter of 2007, following a growth rate of 3.8 percent in the second quarter. Growth in personal consumption expenditures (PCE) accelerated in the third quarter, from 1.4 percent in the second quarter to 3.0 percent in the third. Also contributing to the rise in real GDP was an increase in exports, from 7.5 percent to 16.2 percent, driven by a 23.0 percent spike in goods exports. Imports rose from -2.7 percent to 5.2 percent. Gross private fixed investment was somewhat weaker in the third quarter, rising only 0.8 percent, as residential investment fell 20.1 percent and the growth rate in business fixed investment dropped from 11.0 percent in the second quarter to 7.9 percent in the third. However, investment in equipment and software rose 5.9 percent during the quarter, to its highest growth rate in six quarters. Of course, this information is from the advance report, which is based on incomplete data and, in some cases, trend assumptions, and is subject to further revisions.

Contribution to Percent Change in Real GDP

Percentage Points



Source: Bureau Of Economic Analysis

Personal consumption expenditures contributed 2.1 percentage points to the annualized percent change in real GDP during the third quarter, more than doubling the 1.0 percentage point contribution in the first quarter. Of the 2.1 percentage points contributed by PCE, services added 1.2 percentage points, while durable and nondurable goods contributed 0.4 percentage point and 0.6 percentage point, respectively. Exports, which usually contribute about 1.0 percentage point to GDP growth, added 1.8 points this quarter. Also, net exports added 0.9 percentage point, after a 0.9 percentage point subtraction by imports.

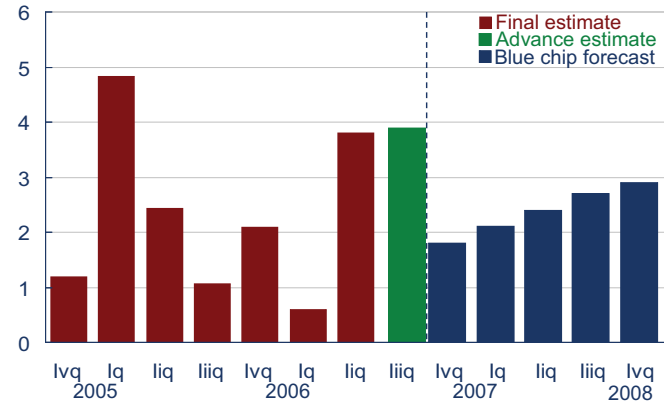
The so-called “housing slump” has continued for quite some time, but the level of residential investment is approaching the roughly \$450 billion average seen during the last recession. It stands at \$463.9 billion currently. Since its peak in the fourth quarter of 2005, residential investment has lost

\$143.3 billion. Over that same time period, business fixed investment has gained \$132.7 billion.

The near-term consensus growth forecast, as seen by the Blue Chip panel of economists, has GDP dipping down to a growth rate of 1.8 percent, but then rebounding to 2.9 percent by the end of 2008.

Real GDP Growth

Annualized quarterly percent change

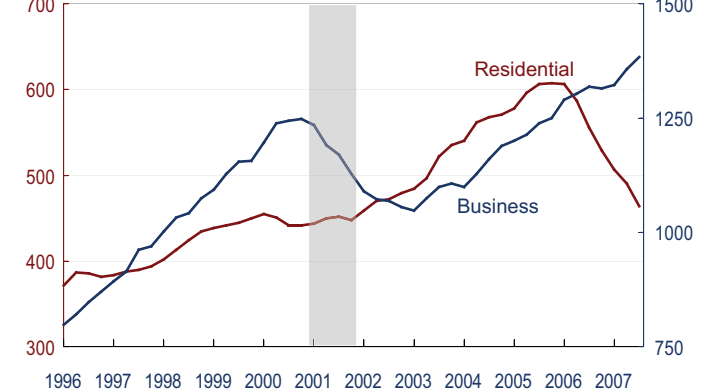


Source: Blue Chip Economic Indicators, October 2007; Bureau of Economic Analysis

Fixed Investment

Billions (Saar, chained 2000\$)

Billions (Saar, chained 2000\$)



Source: Bureau Of Economic Analysis

Economic Activity and Labor

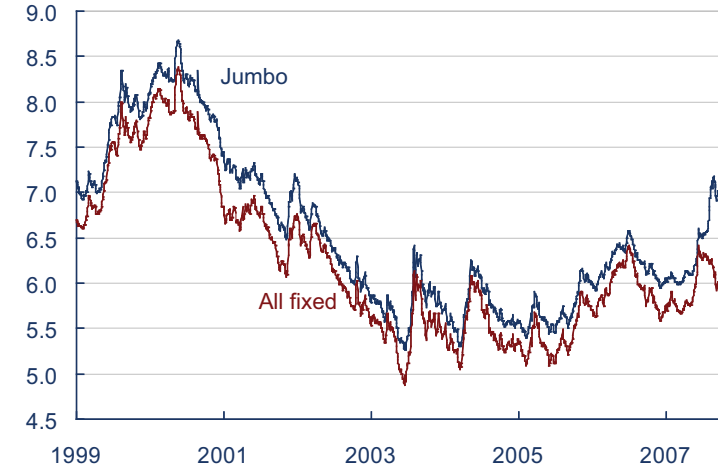
Jumbo Mortgages and Mortgage Market Conditions

10.29.07

By Andrea Pescatori and Michael Shenk

Fixed-Rate Mortgages

Percent



Source: Bloomberg

Mortgage markets can have a big effect on the economy more generally, as recent turmoil in financial markets—which began with turbulence in the mortgage industry—affirms. Conditions in mortgage markets are therefore followed closely. One interesting indicator of mortgage market conditions is the interest rate spread on jumbo mortgages.

Jumbo mortgages are loans too big to be purchased by Fannie Mae and Freddie Mac, the two largest secondary market lenders (together, they own or securitize more than 70 percent of the residential mortgage loans in the United States). Fannie and Freddie are permitted to buy only those loans that conform to a limit set by the Office of Housing Enterprise Oversight—\$417,000 for the continental United States since 2006 (higher for remaining states and territories). Loans above the conforming limits are usually purchased by financial institutions

Fixed-Mortgage Rate Spread: Jumbos minus Non-Jumbos

Percentage points



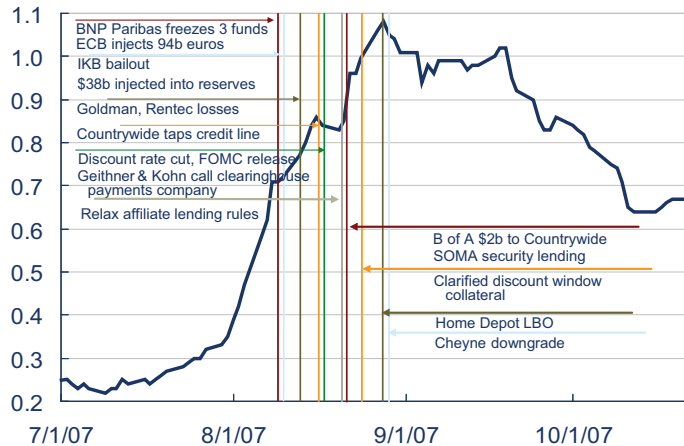
Source: Bloomberg

ranging from commercial banks to hedge funds, as well as Wall Street conduits that provide warehouse financing for mortgage lenders.

Jumbo mortgage loans pose a higher risk for lenders, and this risk is consistently reflected in the spread between the interest rates on jumbo mortgages and conventional mortgages, where the historical average is about 30 basis points. The risk reflected in this long-term average arises because it is harder to sell a luxury residence quickly for full price in the event of default. More generally, luxury homes are harder to price, and their prices are more vulnerable to market highs and lows; as a result, prices are more difficult to forecast. An increase in the volatility of housing prices could also increase the perceived risk associated with jumbo loans and hence, the spread.

Fixed Mortgage Rate Spread: Jumbo-Total

Percentage points



Source: Bloomberg

However, the spread between jumbo and conventional mortgage rates is affected by more than just the different sort of homes that belong to the jumbo pool. Interest rates on jumbo mortgages also reflect changes in the liquidity of the secondary market and the willingness of investors to buy its securities. Because Fannie Mae and Freddie Mac don't buy nonconforming loans, the secondary market for jumbo mortgages is generally less liquid than for conventional mortgages. In addition, the liquidity of the conventional secondary mortgage market is boosted by the implicit government guarantee investors believe the bonds issued by Fannie and Freddie enjoy. These bonds are perceived as having risk equivalent to government bonds (close to zero), because Fannie and Freddie are government-sponsored enterprises (GSEs), even though GSE securities are not, in fact, backed by the U.S. government. Consequently, the spread between interest rates on jumbo and conventional loans also measures the premium which must be paid to compensate investors for the lower liquidity of the secondary market's securities and should measure investors' appetites for jumbo mortgage-backed securities.

The trends in average interest rates for both jumbo and conventional mortgages are clearly determined by the broad macroeconomic factors that affect the overall economy. By plotting the difference (spread)

between the two rates, we isolate information about the premium paid for jumbo-based securities relative to conventional ones (note that our dataset includes loans called super jumbos, those that exceed \$650,000). This premium was pretty stable until the summer of 2007. In fact, the only notable spike before then was in the winter of 2001, just before a recession and in the aftermath of 9/11.

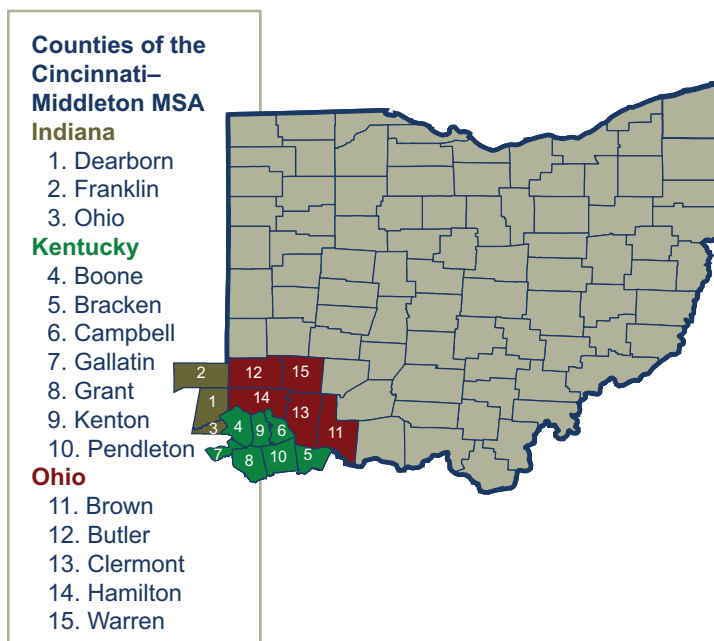
However, the biggest jump ever in the spread series happened only recently, in the summer of 2007. This jump is clearly associated with liquidity conditions in the secondary mortgage market: outside of Fannie Mae and Freddie Mac, buyers in the secondary market were finding it extremely difficult to resell mortgage-backed securities.

The premium on jumbo loans started to rise abruptly at the end of July, and by the end of August, it broke the 100 basis point threshold. The sharpest increase in the spread anticipated many August events, such as BNP Paribas freezing its three funds and the Cheyne downgrade.

The high volatility of the spread persisted until mid-September, when it began to slowly subside. At the moment, we still seem far from “normal” times, with a spread that is still about double the average seen over the last eight years.

Regional Activity

The Cincinnati Metropolitan Statistical Area



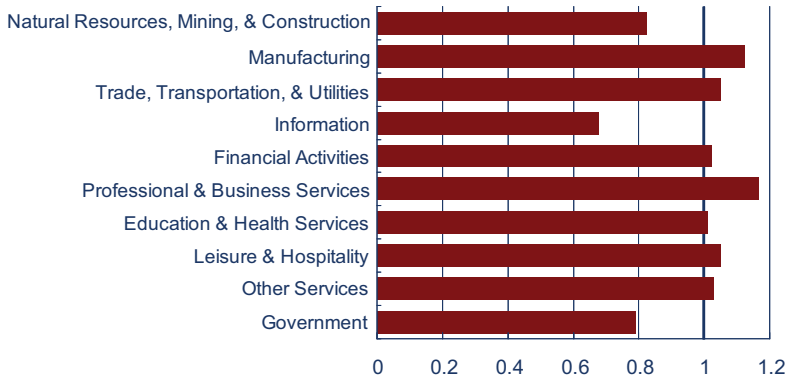
11.08.07

By Tim Dunne and Kyle Fee

The Cincinnati-Middleton Metropolitan Statistical Area (MSA) comprises fifteen counties in three states, including five counties in Ohio, seven counties in Kentucky, and three counties in Indiana. It is the twenty-fifth-largest MSA in the country, with a population of 2.1 million people in 2006.

Cincinnati’s distribution of employment across industries is quite similar to the nation’s as a whole, with a few important exceptions. Compared to the national economy, a greater share of Cincinnati’s workforce is employed in professional and business services and manufacturing, and a substantially smaller share is employed in the information and government sectors.

Location Quotients for Cincinnati-Middleton MSA and the U.S., 2006

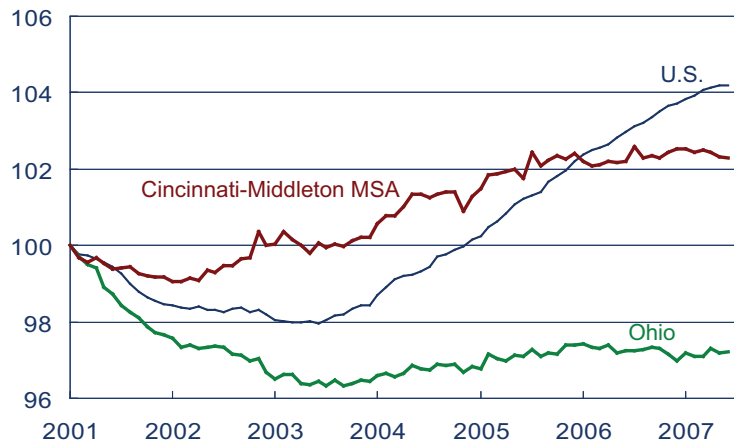


Note: A location quotient is the simple ratio of a given industry's employment share in one region to the industry's employment share in the nation. A location quotient of one indicates that the industry accounts for the same share of employment in the region and the nation.

Cincinnati's employment has grown less than the national average since the last business cycle peak in March 2001, but it has significantly outpaced overall state employment growth. During the 2002 recession, Cincinnati experienced less employment loss than the rest of the country as well as Ohio, and its employment rebounded relatively quickly. By the end of 2002, Cincinnati's employment had recovered to pre-recession levels, whereas U.S. and Ohio employment levels continued to fall well into 2003. However, since late 2005, Cincinnati's employment level has been relatively flat, as has Ohio's, while the nation's has continued to expand steadily.

Payroll Employment since March 2001

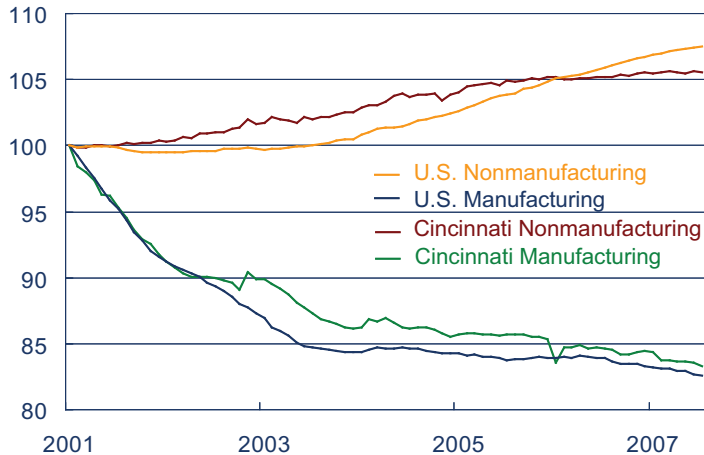
Index, March 2001 = 100



Looking at the changes across broad economic sectors, Cincinnati's weak employment growth relative to the nation's can be explained largely by weaker growth in the nonmanufacturing sector. Cincinnati's nonmanufacturing sector expanded about 2 percentage points more slowly than the nation's since late 2005. On the other hand, the pattern of growth in manufacturing employment was quite similar in Cincinnati and the country as a whole. The MSA's manufacturing employment showed a steep decline of 16.7 percent over the period, while the country's fell 17.4 percent.

Payroll Employment since March 2001

Index, March 2001 = 100

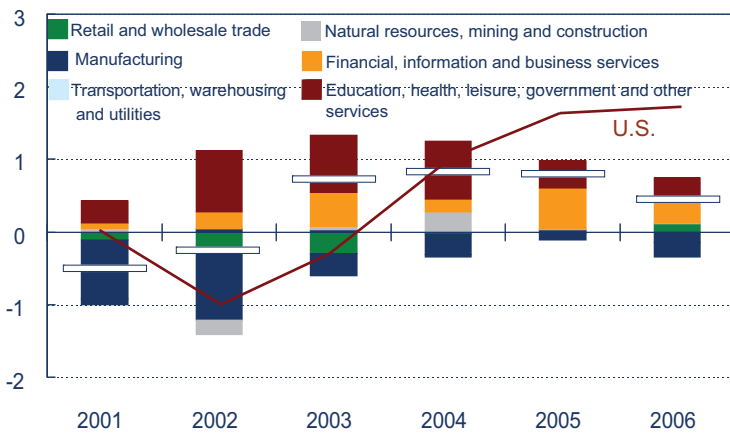


Breaking down employment growth into industry components provides a more detailed look at Cincinnati's labor market. Positive employment growth for the MSA was driven largely by two sectors of the economy—the education, health, leisure, government and other services sector, and the financial, information and business services sector. From 2001 to 2006, these sectors grew at average annual rates of 1.5 percent and 1.3 percent, respectively. Not surprisingly, Cincinnati's manufacturing sector acted as a drag on employment growth, showing declines in all six years.

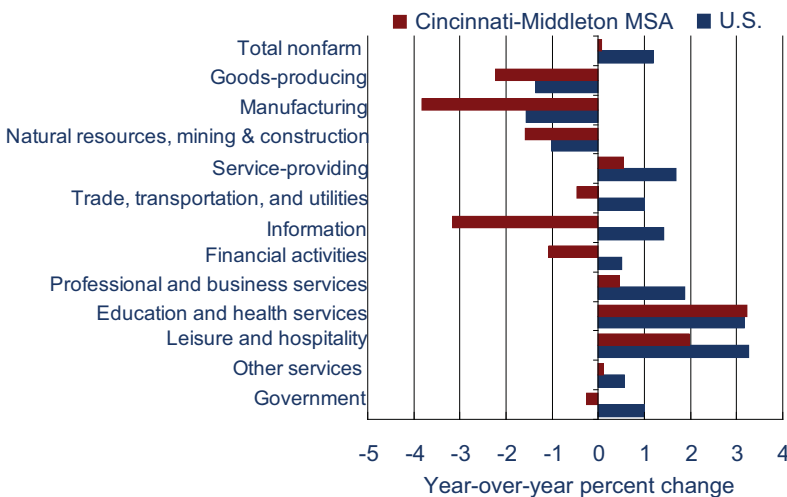
A year-over-year employment growth comparison provides a snapshot of the employment situation from September 2006 to September 2007. During this period, the nation's total employment increased 1.2 percent, whereas Cincinnati's total employment was essentially flat, rising only 0.1 percent. The MSA lost goods-producing jobs faster than the nation due to particularly sharp declines in manu-

Components of Employment Growth, Cincinnati-Middleton MSA

Percent change



Payroll Employment Growth, September 2006 - September 2007



facturing. Cincinnati's service sector added jobs at a much slower rate than the nation as a whole (0.5 percent versus 1.7 percent). This lack of job creation in the service sector has been at the heart of slow employment growth in some of Ohio's major cities. Cleveland (on the) Rocks, a recent Federal Reserve Bank of Cleveland Economic Commentary, looks at this issue in terms of Cleveland's employment growth.

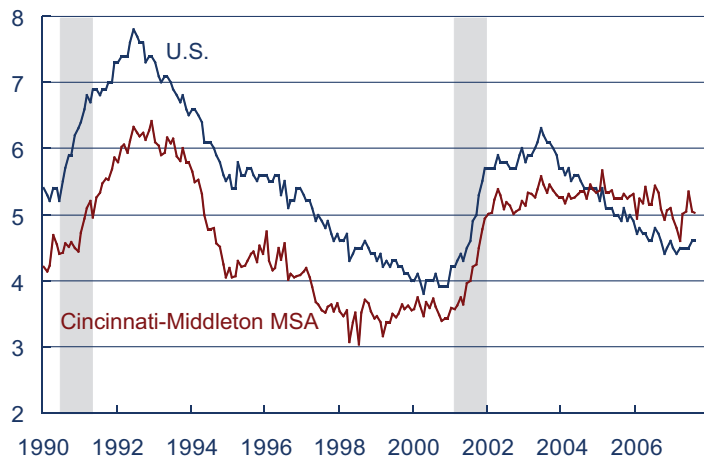
A look at unemployment rates over time reveals that unemployment levels in the Cincinnati area were below the U.S. average for quite a while—1990 until late 2004. (In fact, between 1997 and 2001, Cincinnati's unemployment rate was under 4 percent—a very low rate.) However, since the 2002 recession, the area's unemployment rate has generally hovered between 4.5 percent and 6 percent, and recently, they surpassed the nation's. In August 2007, the area's unemployment rate stood at 5.0 percent, 0.3 percent above the U.S. rate.

As with many other Midwestern MSAs, Cincinnati's population growth has lagged the nation's over the last several decades. While the MSA's population grew 24.5 percent from 1970 through 2006, this growth fell well short of the nation's 47 percent. Still, the Cincinnati metro area has grown much faster than the state of Ohio as a whole, where the population has grown only 7.7 percent over the last 36 years.

A look at income trends shows that Cincinnati's personal per capita income has tracked the U.S. rate closely over the last several decades. Compared to Ohio, Cincinnati's per capita personal income growth has been somewhat stronger than the state's, especially since the mid 1990s. In 2006, Cincinnati's per capita personal income was \$36,366—very close to the U.S. average (\$36,629) and higher than Ohio's (\$33,217).

Unemployment Rate

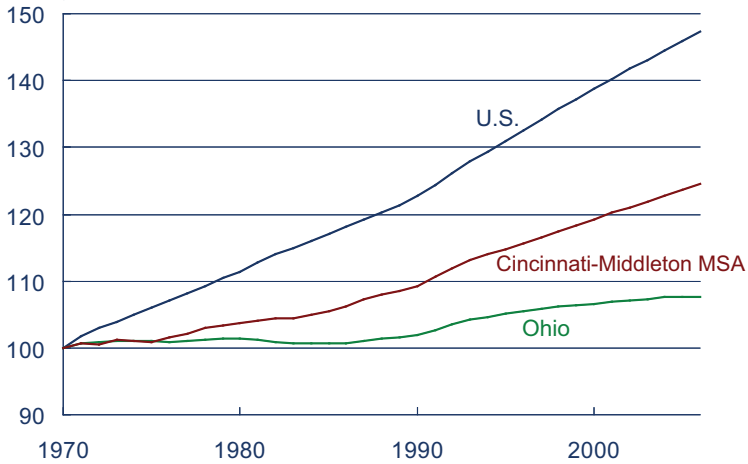
Percent



Note: Shaded bars indicate recessions.

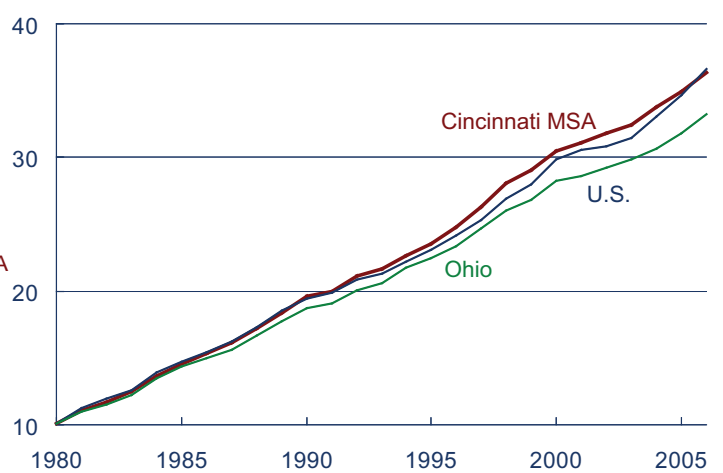
Population

Index, 1970 = 100



Per Capita Personal Income

Thousands of dollars



Regional Activity

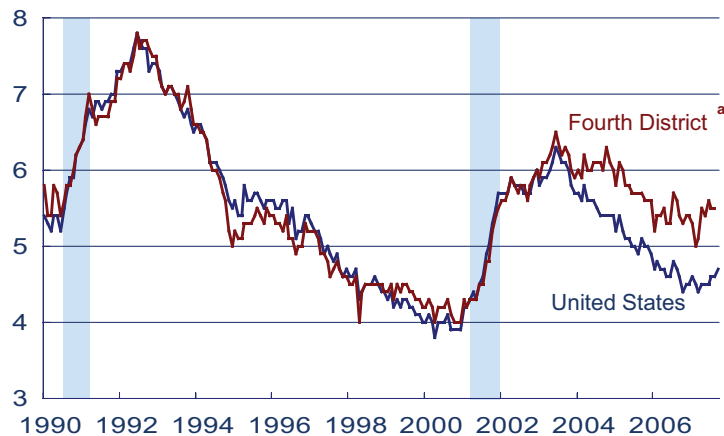
Fourth District Employment Conditions, August

10.29.07

by Tim Dunne and Kyle Fee

Unemployment Rates*

Percent



a. Seasonally adjusted using the Census Bureau's X-11 procedure.

* Shaded bars represent recessions. Some data reflect revised inputs, reestimation, and new statewide controls. For more information, see <http://www.bls.gov/lau/launews1.htm>.

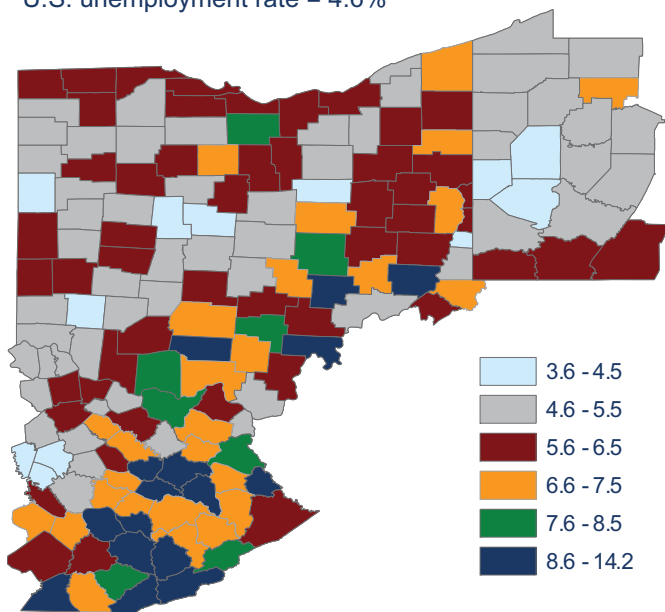
Source: U.S. Department of Labor, Bureau of Labor Statistics.

The district's unemployment rate remained at 5.5 percent for the month of August, exceeding the national rate by 0.9 percentage point. The district's rate has been higher than the national rate since early 2004. Since last year at this same time, the district's unemployment rate has decreased 0.1 percentage point, as has the national unemployment rate.

Of the 169 counties in the Fourth District, 17 had an unemployment rate below the national average in August and 152 had a higher one. Rural Appalachian counties continue to experience high levels of unemployment; Fourth District Kentucky is home to five counties with double-digit unemployment rates. Fourth District Pennsylvania had the lowest unemployment in the district in August at 4.7 percent, which was slightly higher than the national average. In contrast, Fourth District Kentucky (5.7 percent), Fourth District West Virginia (5.4 percent), and Ohio (5.7 percent) all had unemployment rates that were well above the national rate. Fourth District unemployment rates for the district's major metropolitan areas ranged from a low

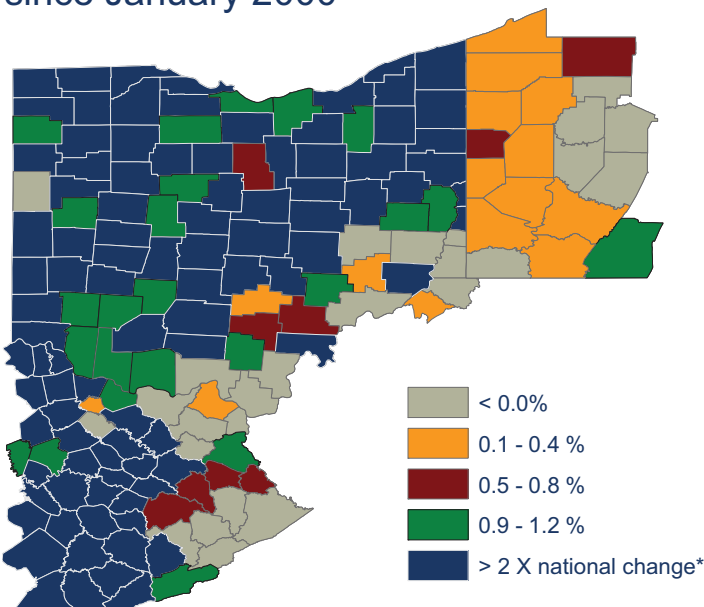
Unemployment Rates, August 2007*

U.S. unemployment rate = 4.6%



* Data are seasonally adjusted using the Census Bureau's X-11 procedure.
Source: U.S. Department of Labor, Bureau of Labor Statistics.

Changes in Unemployment Rates since January 2000



* Change in U.S. unemployment rate since January 2000 = 0.6%
Source: U.S. Department of Labor, Bureau of Labor Statistics.

of 4.4 percent in Lexington to a high of 6.1 percent in Cleveland.

Looking at the change in unemployment rates since January 2000, the Fourth District's rate has increased 1.3 percentage points (from 4.2 percent to 5.5 percent). The national unemployment rate increased 0.6 percentage point (from 4.0 percent) over the same period. Of the 169 counties in the Fourth District, 124 had changes in their unemployment rates which exceeded or equaled the change in the national rate, while 45 had less. In fact, 21 counties saw decreases in unemployment rates over the period. For the most part, the western part of the Fourth District saw greater increases in unemployment rates than did the eastern part.

Lexington is the only metropolitan area in the district where nonfarm employment grew faster than the national average over the past 12 months (Lexington: 2.0 percent; national average: 1.2 percent). Dayton, on the other hand, is the only major metro area where nonfarm employment decreased (-0.2 percent). Employment in goods-producing industries increased only in Akron (1.1 percent), while Cincinnati lost 2.2 percent of its goods-producing jobs. Nationally, employment in goods-producing industries declined 1.2 percent. Service-providing employment increased in seven of the eight major metropolitan areas, with Lexington posting the strongest growth by far (2.3 percent). Information services expanded strongly in Lexington (6.5 percent) and Toledo (4.9 percent) but contracted in Cincinnati (-3.2 percent) and Pittsburgh (-2.2 percent). Employment in professional and business services grew faster in Columbus (2.1 percent), Pittsburgh (1.6 percent), Toledo (2.6 percent), and Akron (2.3 percent) than in the nation as a whole (1.6 percent). All major Fourth District metropolitan areas posted job gains in the education and health services industry but only Cincinnati posted stronger growth than the nation (Cincinnati: 3.6 percent; nation: 3.4 percent).

Payroll Employment by Metropolitan Statistical Area

12-month percent change, August 2007

	Cleveland	Columbus	Cincinnati	Pittsburgh	Dayton	Toledo	Akron	Lexington	U.S.
Total nonfarm	0.0	0.6	0.0	0.3	-0.2	0.5	0.9	2.0	1.2
Goods-producing	-1.4	-1.4	-2.2	-1.1	-0.4	-0.3	1.4	-0.6	-1.2
Manufacturing	-2.2	-1.0	-1.3	-1.1	0.0	-0.4	1.1	-1.1	-1.4
Natural resources, mining, construction	1.3	-2.1	-4.1	-1.4	-1.9	0.0	2.5	0.8	-0.8
Service-providing	0.3	0.8	0.5	0.6	-0.2	0.7	0.8	2.3	1.7
Trade, transportation, utilities	0.0	0.1	-0.4	-0.3	-1.6	-1.1	0.3	-0.9	1.1
Information	0.0	-1.6	-3.2	-2.2	-0.9	4.9	0.0	6.5	1.0
Financial activities	-0.5	-1.5	-1.1	-0.9	1.5	1.5	-1.4	0.9	1.0
Professional and business services	-0.5	2.1	0.6	1.6	-0.9	2.6	2.3	-0.7	1.6
Education and health services	1.4	1.5	3.6	2.0	0.5	1.6	1.8	2.6	3.4
Leisure and hospitality	0.1	2.5	1.1	0.6	0.0	-0.6	-0.3	7.7	2.8
Other services	0.9	-1.3	1.2	-1.8	0.6	0.0	0.7	0.0	1.0
Government	1.1	1.1	-1.0	0.8	0.6	1.3	0.7	5.9	1.1
August unemployment rate (sa, percent)	6.1	4.7	5.0	4.7	5.7	6.0	5.0	4.4	4.6

Source: U.S. Department of Labor, Bureau of Labor Statistics.

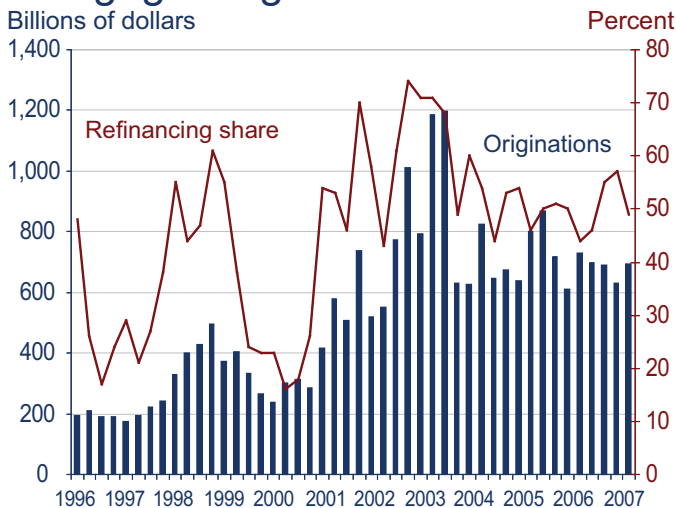
Banking and Financial Institutions

Mortgage Lending

11.09.07

by Ed Nosal and Saeed Zaman

Mortgage Originations



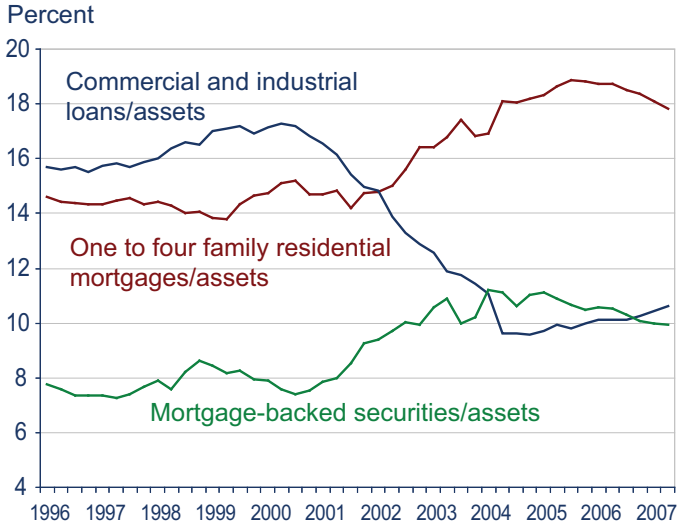
Source: Mortgage Bankers Association

Mortgage bankers originated \$631 billion of new mortgages in the first quarter of 2007 and \$694 billion in the second quarter, the lowest second-quarter increase since 2002. Relatively stable mortgage rates left little incentive for new refinancing, which constituted 49 percent of originations in the second quarter, a significant drop from their peak share of 74 percent in the fourth quarter of 2002.

The share of mortgage-related assets (mortgages and mortgage-backed securities) on banks' balance sheets has lessened in recent quarters but is still at historically high levels. Currently, mortgage-related assets make up 28 percent of commercial banks' assets.

Mortgage loan profitability, as approximated by the spread of the effective mortgage rate (interest plus fees) over savings banks' cost of funds, has been on the down swing since August 2006, after remaining stable for some time since the fall of 2003. Cur-

Mortgage and Commercial Lending by Commercial Banks

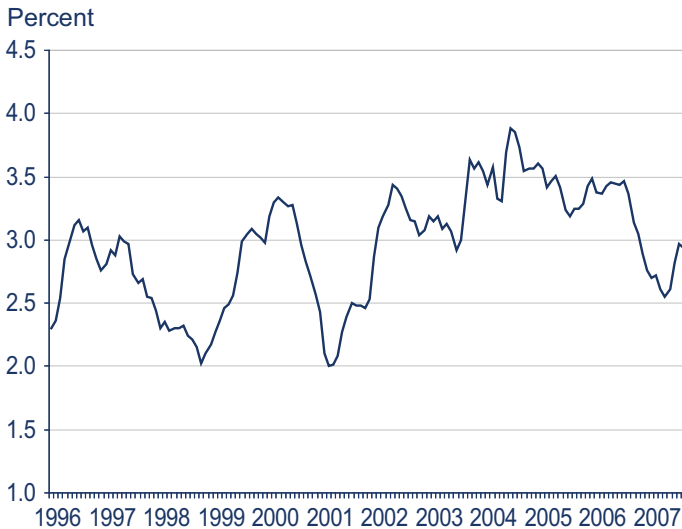


Source: Quarterly Bank Reports on Condition and Income

rently, the spread is at 2.94 percent. While the cost of funds has been increasing in step with the increase in the fed funds rate, banks did not fully pass the increasing costs on to their mortgage borrowers.

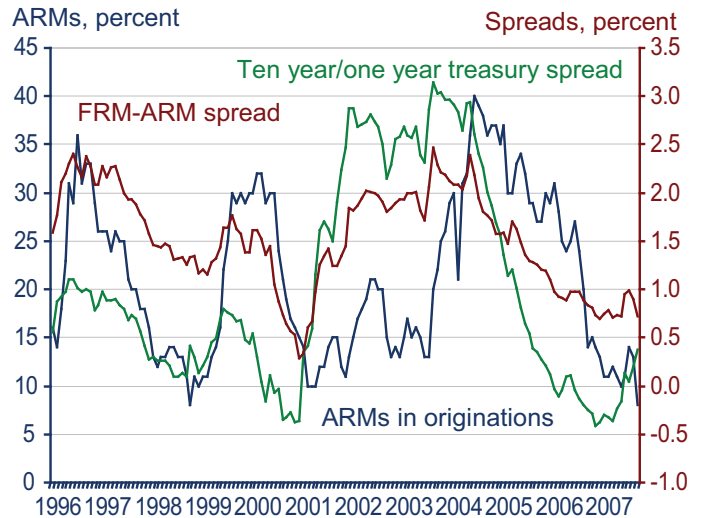
Since their peak in popularity, the share of adjustable-rate mortgages (ARMs) in total originations has decreased steadily from 40 percent in June 2004 to 8 percent in September 2007. ARMs depend on short-term rates, whereas fixed-rate mortgages (FRMs) depend on long-term rates. ARMs' drop in popularity over the years has resulted primarily from the rise in short-term rates and the decrease in the spread between fixed and adjustable mortgage rates. The other likely reason for their sharp decline in popularity in recent months is the blame ARMs are being assigned for the mortgage market turmoil.

Spread of the Effective Mortgage Rate Over Cost of Funds



Source: Federal Housing Finance Board

Adjustable-Rate Mortgages



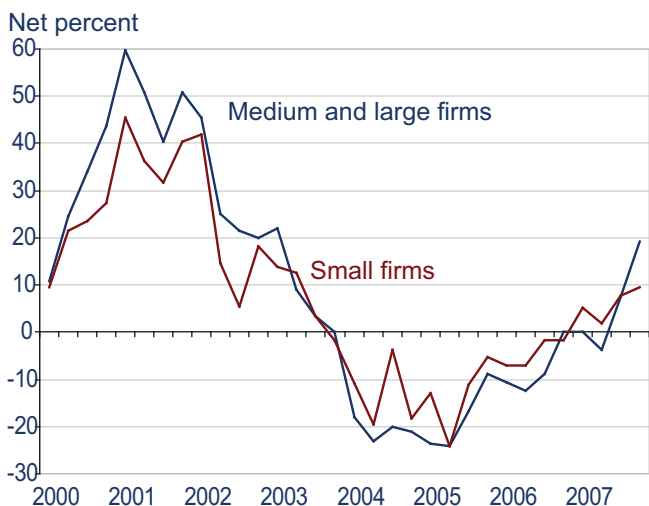
Source: US Department of the Treasury, Office of Thrift Supervision; Federal Housing Finance Board

Business Loan Markets

11.09.07

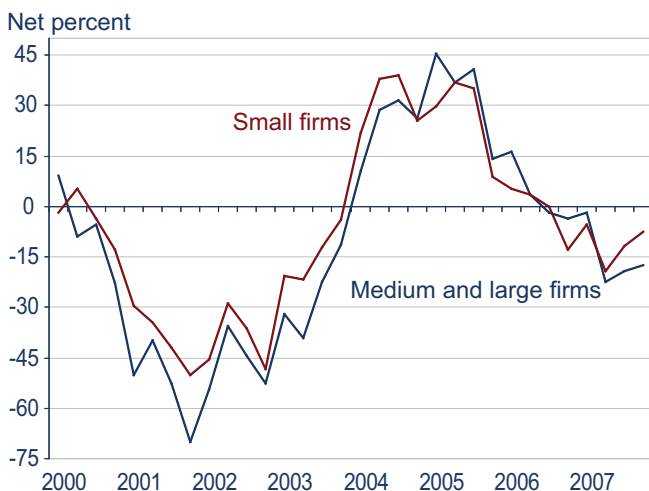
by Ed Nosal and Saeed Zaman

Domestic Banks Reporting Tighter Credit Standards



Source: Senior Loan Officer Opinion Survey on Bank Lending Practices, Board of Governors of the Federal Reserve System, October 2007.

Domestic Banks Reporting Stronger Demand



Source: Senior Loan Officer Opinion Survey on Bank Lending Practices, Board of Governors of the Federal Reserve System, October 2007

The Federal Reserve Board's October 2007 survey of senior loan officers (covering the months of August, September and October), found considerable tightening of standards for commercial and industrial loans. About one-fifth of domestic banks and one-third of foreign banks tightened standards for commercial and industrial loans to large and medium size firms, while the remaining fraction reported little change in lending standards in the period surveyed. The reasons cited for tightening included a less favorable economic outlook, a reduced tolerance for risk, and decreased liquidity in the secondary market. A large fraction of domestic and foreign banks increased the cost of credit lines and the premiums charged on loans to riskier borrowers. About a third of the banks surveyed raised lending spreads (loan rates over the cost of funds).

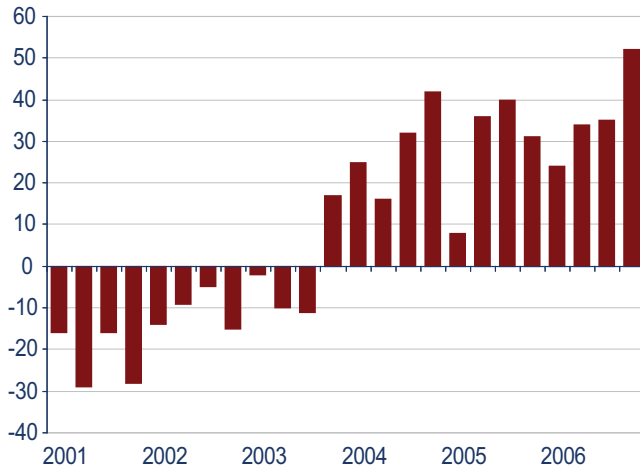
Demand for commercial and industrial loans has continued to weaken over the period surveyed, though the fraction of banks reporting weaker demand is smaller than the in previous survey. Those who reported weaker demand cited decreased investment in plants and equipment as the reason, while those who reported stronger demand cited difficulty in getting other forms of credit such as commercial paper, and increased activity in mergers and acquisitions.

Bank balance sheets have yet to reflect the decline in businesses' appetite for bank loans in the face of tightening credit standards. The \$52 billion increase in bank and thrift holdings of business loans in the second quarter of 2007 marks the thirteenth consecutive quarter of increases in bank and thrift holdings of commercial and industrial loans. The sharp reversal in the trend of quarterly declines in commercial and industrial loan balances on the books of FDIC-insured institutions prior to the second quarter of 2004 is still going strong.

The utilization rate of business loan commitments (drawdowns on prearranged credit lines extended

Quarterly Change In Commercial and Industrial Loans

Billions of dollars

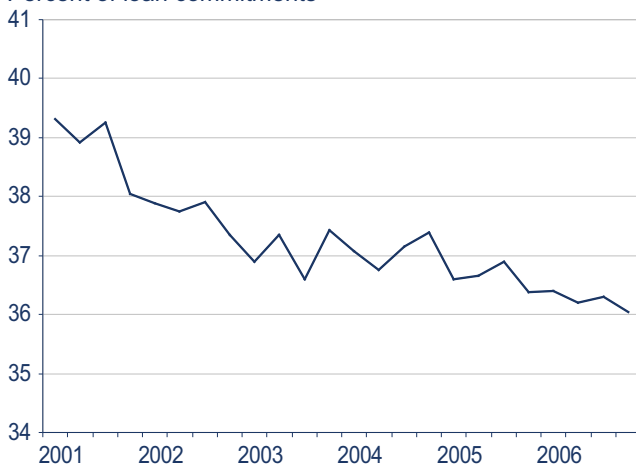


Source: Federal Deposit Insurance Corporation, Quarterly Banking Profile, Second Quarter 2007

by banks to commercial and industrial borrowers) held at 36.05 percent of total commitments. This could indicate the declining importance of bank credit to commercial borrowers as a result of easier access to capital markets, as well as lower demand.

Utilization Rate of Commercial and Industrial Loan Commitments

Percent of loan commitments



Source: Federal Deposit Insurance Corporation, Quarterly Banking Profile, Second Quarter 2007

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