

WEEKLY ECONOMIC COMMENTARY - WEEK OF APRIL 4, 2008

FINANCIAL INDICATORS				
INTEREST RATES	April 4	Week Ago	Month Ago	Year Ago
3-month Treasury bill	1.37%	1.34%	1.44%	5.03%
6-month Treasury bill	1.52	1.48	1.54	5.09
3-month LIBOR	2.73	2.70	2.94	5.35
2-year Treasury note	1.82	1.66	1.52	4.72
5-year Treasury note	2.61	2.52	2.44	4.65
10-year Treasury note	3.47	3.45	3.55	4.76
30-year Treasury bond	4.31	4.33	4.56	4.92
Tax-Exempt Revenue Bonds (Triple-A)				
5-Year	3.12	3.04	3.29	3.71
10-Year	4.06	4.05	4.07	3.99
30-Year	5.19	5.19	5.18	4.51
30-year fixed mortgage rate				
	5.88	5.85	6.03	6.17
15-year fixed mortgage rate				
	5.42	5.34	5.47	5.87
1-year adjustable rate				
	5.19	5.24	4.94	5.44
STOCK MARKET				
Dow Jones Industrial	12609.42	12216.40	11893.69	12560.20
S&P 500	1370.40	1315.22	1293.37	1443.76
NASDAQ	2370.98	2261.18	2212.49	2471.34
Commodities				
Gold (\$ per troy ounce)	913.12	936.50	974.20	679.40
Oil (\$ per barrel) - Crude Futures (NYMEX)	106.16	105.41	105.50	68.24
ECONOMIC INDICATOR (Latest Month/Quarter)				
	Current Month/Qtr	Previous Month/Qtr	Two-Months/ Qtrs Ago	Average-Past 6 Months or Qtrs.
ISM Manufacturing Index (March)	48.6	48.3	50.7	49.4
ISM Nonmanufacturing Index (March)	49.6	49.3	44.6	50.4
Nonfarm Payrolls (March) - change in 000s	-80.0	-76.0	-76.0	1.5
Unemployment Rate (March) - Percent	5.1	4.8	4.9	4.9

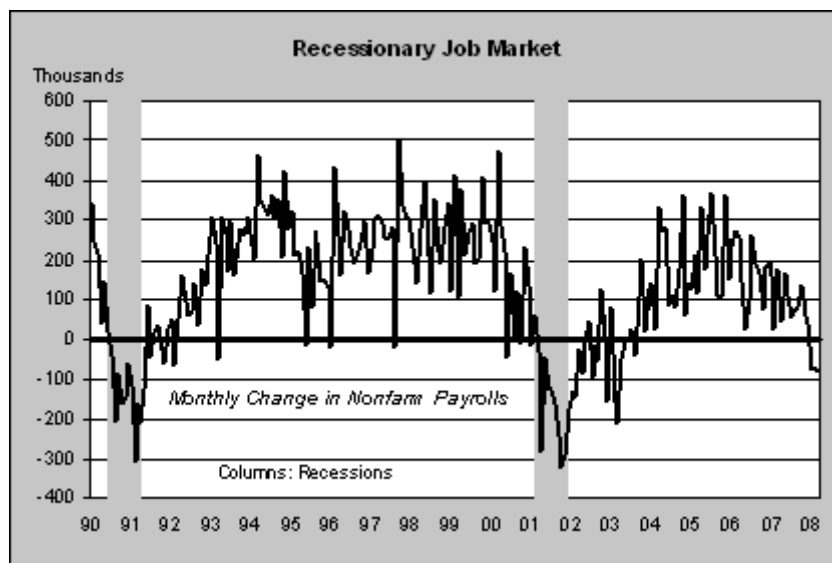
Policy makers are generally loath to mention the "R" word except in an historical context. For Washington denizens, the reason is obvious: no politician worth his or her salt wants to admit that they had any responsibility for a recession, particularly in an election year. For Federal Reserve officials, the reason is somewhat more altruistic, but just as deceiving. The Fed knows that public psychology can influence economic activity, and its assessment of conditions has a big impact on the mood of households and businesses. Hence, if the Fed admits that a recession is underway, it runs the risk of aggravating the downturn by discouraging consumers and businesses from spending and hiring.

But the current Fed can hardly duck the obvious, especially since consumer sentiment is already in the dumps, businesses are cutting back investment spending as well as slashing payrolls, and a perplexed public is trying to understand the reasons why a housing-related credit crunch has so abruptly brought the economy to its knees. With his back to the wall Fed chairman Bernanke really has no choice but to fess up, and in his testimony before Congress this week, he forlornly admitted that the U.S. may indeed contract over the first half of the year. To be sure, that's not the same as saying outright that the economy is either in, or even heading towards, a recession. But Bernanke came as close as any Fed official can in acknowledging the obvious.

In recent weeks, evidence that the nation was in the midst of its tenth postwar recession has been piling

up. This week, the list was punctuated by another - and, by far, the most important - indicator of the economy's health: employment. In March, the ranks of workers outside of the farm sector shrank by another 80 thousand, marking the third consecutive monthly decline. What's more, the declines over the previous two months were revised higher by 67 thousand, bringing the cumulative drop in nonfarm payrolls to 232 thousand during the first quarter. In the fourth quarter of last year, when the economy expanded by a skimpy 0.6 percent, businesses added 241 thousand workers to their payrolls. That's a swing of nearly half a million jobs, underscoring the dramatic upsurge in pessimism about the economy that shows up in virtually every recent poll of households.

As the chart shows, the meltdown in the job market traces a pattern that is remarkably similar to the opening stages of recent recessions. In terms of magnitude, the three-month decline is not quite as large as those registered during the first three months of the 1991-92 and 2001 recessions, but the current numbers are subject to revisions. If the adjustments to January and February are any indication, the final tabulations will likely show that the job market has deteriorated at least as sharply during the first quarter as it had in the opening phase of the last two recessions. That said, the current numbers are bad enough as they are, leaving no doubt that policy makers face a difficult challenge in coming months. Indeed, if not for an increase in government hiring, the situation would look even worse. Companies in the private sector reduced payrolls by 98 thousand in March and by 282 thousand in the first quarter compared to the overall drop of 232 thousand.

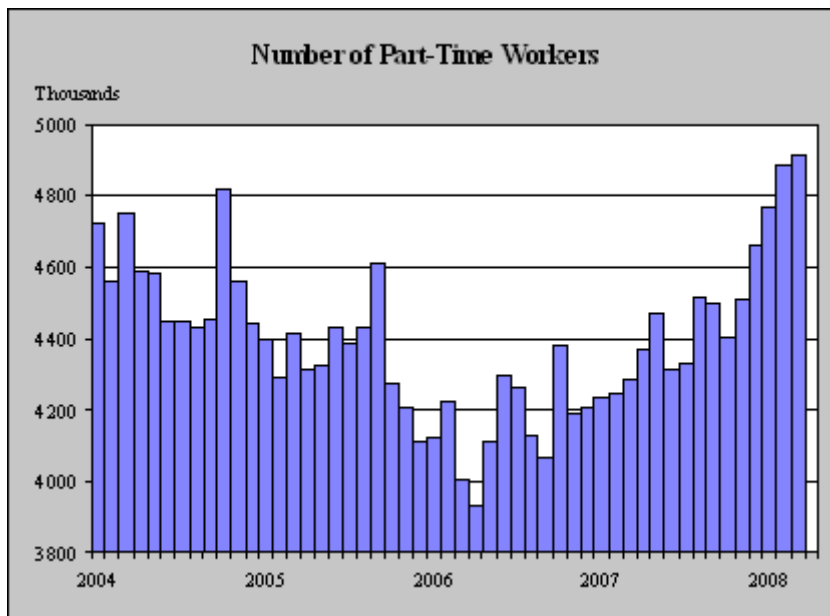


Not surprisingly, the two industries responsible for the largest payroll reductions are construction and manufacturing. In March, construction payrolls fell by 51 thousand following declines of 37 thousand and 39 thousand in the previous two months. It was the ninth consecutive month in which the ranks of unemployed hard hats swelled. However, it is no longer just the beleaguered residential builders that are laying off workers, which has been the case in every month since October 2006. In a clear sign that the housing woes have spread to the broader economy, workers on nonresidential projects are also being laid off in increasing numbers. In March, nonresidential construction payrolls were slashed by 20 thousand, marking the fifth consecutive monthly decline.

Likewise, the manufacturing sector is highlighted by the mounting problems in the automotive sector, where domestic car sales fell to the lowest level since August 1993 in March. Accordingly, auto factories reduced payrolls by 24 thousand last month, accounting for half of the 48 thousand drop in total manufacturing employment. True, a strike at auto parts maker American Axle, exaggerated the decline in autoworkers during the month, but the industry has been slashing workers for twelve

consecutive months. Since last March, nearly 100 thousand workers have fallen off the payrolls of companies that produce autos or parts. With job losses mounting and squeezing household incomes, it is hard to see much, if any, improvement in auto sales in the near future, portending more layoffs in a manufacturing sector that has been shrinking relentlessly in recent years.

No doubt, the headlines will emphasize the jump in the unemployment rate last month, which shot up to 5.1 percent from 4.8 percent in February. What's interesting about this number is that it is sensitive to changes in the size of the labor force. In February, the labor force shrank by 450 thousand workers, which kept the unemployment rate virtually unchanged, despite job losses during the month. When this pattern occurs during times of economic weakness, many analysts assert that the official jobless rate is being kept down by discouraged job-seekers leaving the labor force. However, in March, the labor force swelled by 410 thousand workers, much more than the number of workers who found jobs. Does this mean that discouraged workers are returning to the labor force because job prospects have improved? That's not likely in the current economic environment, particularly since surveys reveal that many more households believe jobs are becoming much harder to find. Indeed, if there is one component of the employment report that clearly shows the deterioration in job prospects, it is the surge in the number of people who are working part time because they could not find full time positions. In March, this number surged by 30 thousand to 4.91 million, the highest since February 2003.

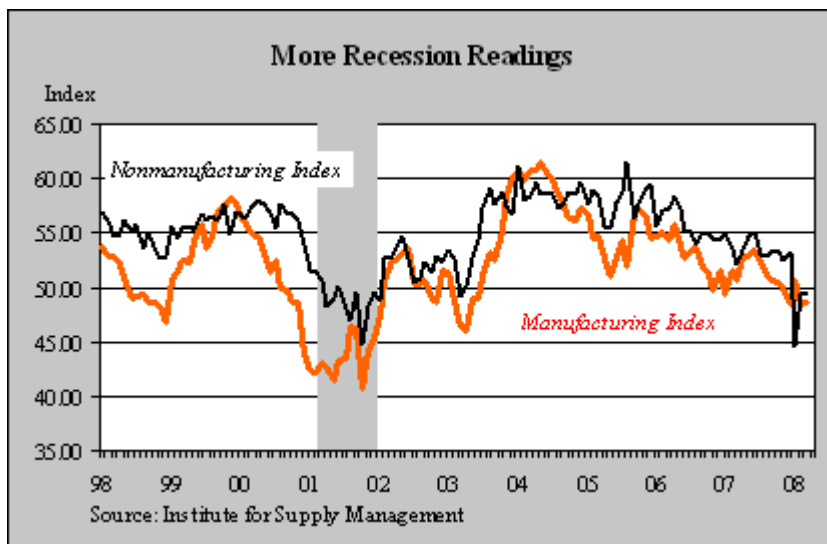


That said, a 5.1 percent unemployment rate is still historically low and only a tad above what is generally perceived to be a level consistent with full employment. Looked at from this perspective, the economy may still have enough firepower to expand, since roughly 95 percent of the workers in the labor force are pulling down paychecks. While there may be some validity to this perspective, it is not one that holds up to scrutiny. Despite the huge nearly offsetting swings in February and March, the labor force as a percent of the civilian population is hovering near the lowest level in two decades, meaning that an outsized fraction of the working-age population is not drawing a paycheck. A corollary to this observation is the fact that job creation (and income growth) during the latest expansion has been much less robust than has been the case in past cycles. If there is one positive aspect of this trend, it is that employers may not be burdened with bloated payrolls heading into the recession. If that's the case, it's quite possible that future layoffs may not be as large as they were in past recessions.

But the key takeaway from this analysis is that the relatively low 5.1 percent jobless rate (versus a 6.2

percent average over the past thirty years) does not mean the economy hasn't yet entered a recession. For one, the 2001 recession began when the unemployment rate was at an even lower 4.3 percent, before shooting up to 5.5 percent by the recession's end on the way to a peak of 6.3 percent during the first 18 months of the ensuing "jobless recovery". For another, the 5.1 percent rate represents an increase of 0.7 percentage points from its low of early last year. An increase of that magnitude has never occurred in the postwar period without the economy slipping into a recession. While this time "may be different" there is no compelling reason to believe that this statistical relationship has broken down.

Indeed, even prior to the dismal jobs report on Friday morning, the Institute for Supply Management (ISM) released its two measures of activity that described an economy in recession. Both its indices of manufacturing and service-sector activity remained below the 50 threshold, which demarcates expansion from contraction. The service-sector index has only been compiled for about a decade and, hence, just encompasses one recession. But it has now been below 50 for three consecutive months for the first time since the 2001 recession. It is also the first time that both indices had a reading of below 50 for at least two consecutive months since that downturn.



Simply put, the statistical evidence that the economy has fallen into a recession is powerful and getting stronger by the week. As noted earlier, Fed Chairman Bernanke in this week's testimony acknowledged the risk of an economic contraction, but nibbled around the edges rather than use the "R" word. The distinction is semantic, if there is a distinction at all. If the standard of two consecutive quarters of negative GDP growth is adopted, we will not know if a recession has indeed occurred for another nine months, when the NBER will have the necessary information to make that determination. That is not helpful. A more useful standard is the economy's ability to generate jobs and, as the latest Labor Department report clearly demonstrates, it is falling woefully short in that capacity.

This is no time for semantics. The economy has continued to deteriorate and the labor market continues to weaken. We suspect that the Fed will not let semantics interfere with what needs to be done to get the economy back onto a positive growth track. That implies further interest rate cuts and whatever intervention is necessary to restore confidence in the financial markets. Sadly, the housing and mortgage market distress that is at the core of the markets' turmoil is far from being resolved. The severity and duration of the recession will largely depend on when the housing crisis ends. Some recent indication that the widespread fall in home prices is beginning to entice buyers back into the market is a hopeful sign, but the distance between hope and reality remains exceptionally long.

