WEEKLY ECONOMIC COMMENTARY -- WEEK OF APRIL 11, 2008

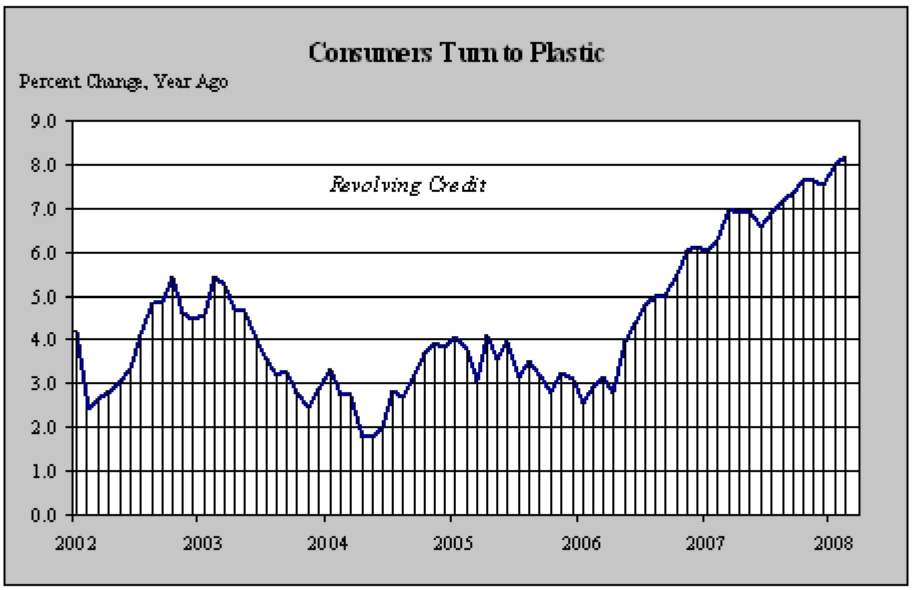
FINANCIAL INDICATORS				
INTEREST RATES	April 11	Week Ago	Month Ago	Year Ago
3-month Treasury bill	1.19%	1.37%	1.16%	5.00%
6-month Treasury bill	1.39	1.52	1.30	5.08
3-month LIBOR	2.71	2.73	2.76	5.36
2-year Treasury note	1.75	1.82	1.45	4.76
5-year Treasury note	2.57	2.61	2.37	4.69
10-year Treasury note	3.47	3.47	3.43	4.76
30-year Treasury bond	4.30	4.31	4.36	4.93
Tax-Exempt Revenue Bonds (Triple-A)				
5-Year	3.15	3.12	3.10	3.75
10-Year	4.03	4.06	4.02	4.04
30-Year	5.05	5.19	4.03	4.56
30-year fixed mortgage rate	5.88	5.88	6.13	6.22
15-year fixed mortgage rate	5.42	5.42	5.60	5.90
1-year adjustable rate	5.18	5.19	5.14	5.47
STOCK MARKET				
Dow Jones Industrials	12325.42	12609.42	11951.09	12612.13
S&P 500	1332.83	1370.40	1218.14	1452.85
NASDAQ	2290.24	2370.98	2212.49	2491.24
Commodities				
Gold ($ per troy ounce)	927.00	913.12	999.50	689.90
Oil ($ per barrel) - Crude Futures (NYMerc)	110.32	106.16	110.05	68.63
ECONOMIC INDICATOR (Latest Month/Quarter)		Previous Month/Qtr	Two-Months/ Qtrs Ago	Average-Past 6 Months or Qtrs.
Consumer Credit (February) - mlns of $s	5159	10290	2155	8812
Trade Deficit (February) - mlns of $s	62321	58959	57856	59346
Consumer Sentiment (April) - Index	93.2	69.5	70.8	72.2

Given the sparse number of economic reports this week, the "recession watch" has been put on the shelf, at least temporarily. To be sure, that didn't stop pundits from speculating over the prospective depth and duration of the presumed economic downturn now underway. Nor is it likely that the data respite swayed the majority opinion away from thinking that the economy might somehow avert the eleventh recession of the post World War 11 era. According to a Wall Street Journal poll taken April 4-7, economists by a 3-to-1 margin believe that the nosedive still has a ways to go, although they disagree over the major risks to the economy that lie ahead.

At the core of the debate is the extent to which the ongoing credit crisis and the housing crunch - the two major downside risks to the outlook - will impact consumer-spending decisions. The major reason that the last two recessions were relatively short and shallow is that households were resilient; indeed, during the 2001 recession, consumer spending did not even skip a beat despite the enormous wealth destruction associated with the unprecedented collapse in stock prices. Buoyed by sharp interest-rate reductions and a housing boom that greatly inflated home equity values, real consumer spending remained on a positive growth track that extended for a record 54 consecutive quarters. Although income growth lagged relative to the pace of past expansions, households compensated by drawing down savings and tapping into a swollen reservoir of credit that was easily accessible and cheap.

But that string of record consumer-spending increases is on the cusp of ending, if not in the quarter just ended then most likely in the current quarter. With two months of data in tow, real consumption for the first quarter is on track for a miniscule gain of half percentage point or less, a gain that could easily be wiped out by a downturn in March. Preliminary readings on chain store and auto sales indicate that consumer spending may well have declined last month. Whether or not that materializes remains to be seen, but there is little question that the props to spending are weakening dramatically. As reported last week, private-sector employers slashed payrolls for the fourth consecutive month in March, the jobless rate jumped from 4.8 percent to 5.1 percent, and average weekly earnings fell.

With the personal savings rate hovering near zero and households owing more against their homes that they have in equity, consumers have few alternatives left to sustain purchasing power. One resource that is still being relied on is the credit card, which will only reinforce the budget squeeze as an ever-larger fraction of paychecks must be earmarked for repayments. In February, for example, the revolving portion of consumer installment debt - mostly credit cards - increased by a sizeable $4.9 billion, lifting the total outstanding to 8.2 percent above the year-earlier level. That's the highest annual pace since the depths of the 2001 recession in August of that year.



True, the upsurge in credit-card borrowing partly reflects a shift from home-equity borrowing, which is becoming more difficult to obtain due to falling home values that are cutting into housing equity and tighter lending standards by banks. But that should not obscure the greater financial stress that households are experiencing. According to credit card issuers, their card-carrying customers are increasingly borrowing to finance spending on essentials, such as food, gasoline and medicine. That's a far cry from the highly discretionary purchases that households were funding when they were aggressively borrowing against home equity during the halcyon period of soaring real-estate values. What's more, the cost of credit-card borrowing is considerably higher than that for mortgage or home-equity loans, which have the additional advantage of being tax deductible.

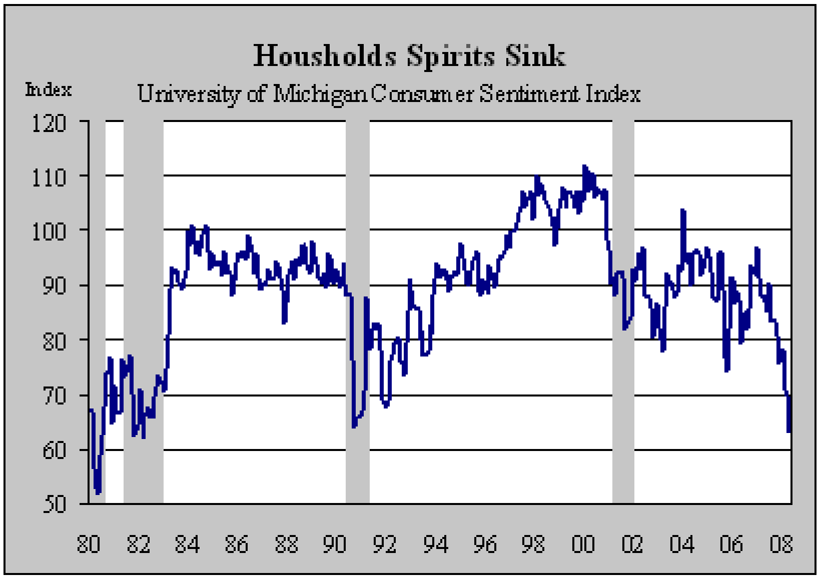
Not surprisingly, with the job market deteriorating and impairing income prospects, more and more borrowers are falling behind on their payments. According to the American Bankers Association, late payments on consumer loans, including credit cards, soared to the highest level since 1991 in the fourth quarter. In response, lenders are scaling back credit-card limits and issuing far fewer preauthorized cards to new customers, something that will only reinforce the credit squeeze facing households and further limit their spending options. It is a time-honored axiom that credit is the lifeblood that nourishes economic growth, and the narrowing of the credit spigot since the mortgage-market meltdown and housing collapse gained traction early last year is arguably the main catalyst sending the economy into its current tailspin.

At the same time, the depth and duration of the recession will hinge importantly on the ability of policy makers to return the credit markets to a reasonably healthy state, restoring the flow of funds to creditworthy households and businesses. Fortunately, there are signs that the worst of the financial crisis may be behind us. The Federal Reserve's unprecedented efforts to provide liquidity to bank and nonbank institutions, easing the balance sheet logjam created by moribund mortgage securities and opening its lending window much wider to a broader spectrum of institutions, have lifted some of the restraints choking off the flow of credit. Banks are lending to each other again, as reflected by the narrowing in the Libor/ federal funds rate spread and investors are dipping their toes into the pool of riskier securities, erasing some of the extreme widening out of quality yield spreads since the turn of the year.

Still, the risk of the adverse feedback loop remains a distinct threat in the minds of the Fed and private forecasters. As the recession spurs the unemployment rate to higher levels, as it inevitably will, and household balance sheets are further impaired by declining housing wealth, as most certainly will occur, the rising trend in loan defaults will continue, creating more financial strains on lenders. Fearing another wave of higher loan write-offs, lenders could then become even stingier about making new loan commitments, which would reinforce the weakening in the economy. Should this adverse feedback loop gain momentum, it would grease the skids of the economy's downward path, portending a much deeper recession than currently expected.

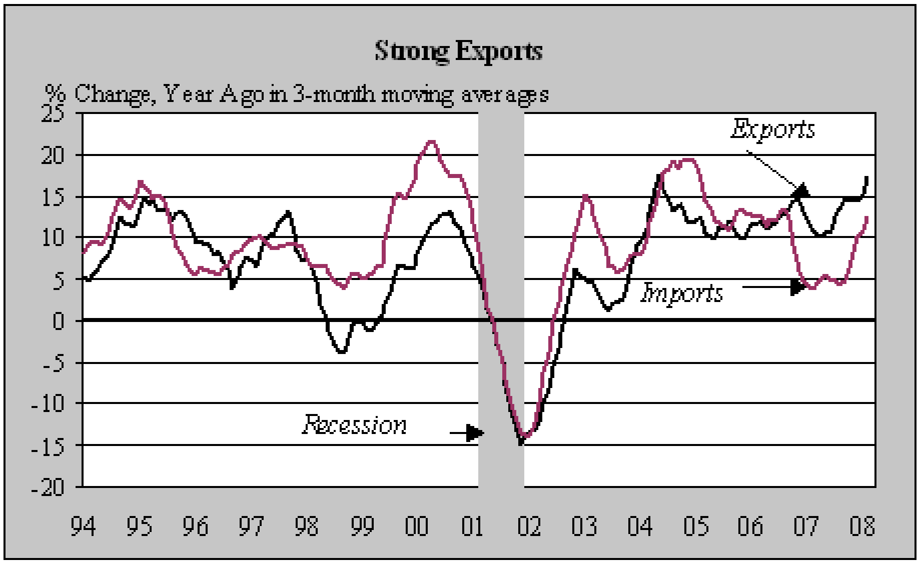
It remains to be seen if the Fed's efforts have short-circuited this adverse feedback loop. As noted above, some of the vital signs of market stress seem to be improving, and more remedial action is likely to come. The next policy meeting later this month will surely produce another rate cut, probably by a half-point, and additional reductions down the road seem likely. When all is said and done, the federal funds rate could wind up close to the 1 percent low reached in the aftermath of the 2001 recession, when the Fed believed the economy was threatened by deflation. This time, the deflation threat has been replaced by a credit crisis, which policy makers believe is just as scary and justifies measures that are at least as aggressive.

Assuming the Fed is able to mend the credit crisis before it spirals out of control, it still has the difficult task of limiting the fallout from the turmoil that has already taken place. That will not be easy, given how erratically the wheels under the economy are spinning. The first order of business will be to convince households that the apocalypse is not around the corner, a prospect that seems to have gripped the public's imagination. If there is any doubt that consumers are in a grim mood, it is only necessary to look at the latest sentiment survey taken by the University of Michigan. The widely followed poll, released early Friday morning, reveals that household spirits sank to its lowest level since March 1982 in the first half of April. Keep in mind that the 1981-82 recession was one of the most severe of the postwar period, topped only by the debilitating 1974-75 downturn.



As was the case during those two harsh downturns, households today are also fretting over spiraling oil prices, which was a key reason cited for their gloomy mood in April. Indeed, at current levels of crude quotes, the estimated cost of gasoline during the peak-driving season will siphon an additional $65 billion from disposable incomes. But the list of household misgivings includes a broad array of dispiriting forces, including the aforementioned credit crisis, the ongoing housing collapse and deteriorating job prospects. Needless to say, it is hard to be optimistic over the consumer spending outlook in coming months despite the lift expected from the tax rebate checks scheduled to be mailed out beginning in May.

What's more, one of the few bright spots shining through the clouds lost some luster this week, as the Commerce Department reported a surprising jump in the trade deficit in February. The unexpected $3.4 billion jump to $63.2 billion during the month lessens the positive thrust that the improvement in the real current account position would otherwise have on GDP during the first quarter, although it should still be slightly positive. We suspect that the spike in imports, which bloated the deficit, was somewhat of a fluke, reflecting intra-company activities between U.S. automakers and their Canadian-based assembly plants. On the plus side, U.S. exports continued to forge higher, increasing by 2 percent in February, the biggest monthly rise since last July. Exports now stand a hefty 20.8 percent above the level of a year ago, and should continue to provide a solid lift to the economy over the next quarter or two. That said, exports do not carry enough heft - accounting for 12 percent of GDP - to cushion the economic damage that a severe retrenchment in consumer spending would entail. Until a clearer picture of how that 70 percent component of total activity unfolds in coming months, policy makers and pundits will continue to speculate over the likely depth and duration of the recession.


Strong Exports
% Change, Year Ago in 3-month moving averages
Exports
Imports
Recession
25
20
15
10
5
0
-5
-10
-15
-20
94
95
96
97
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