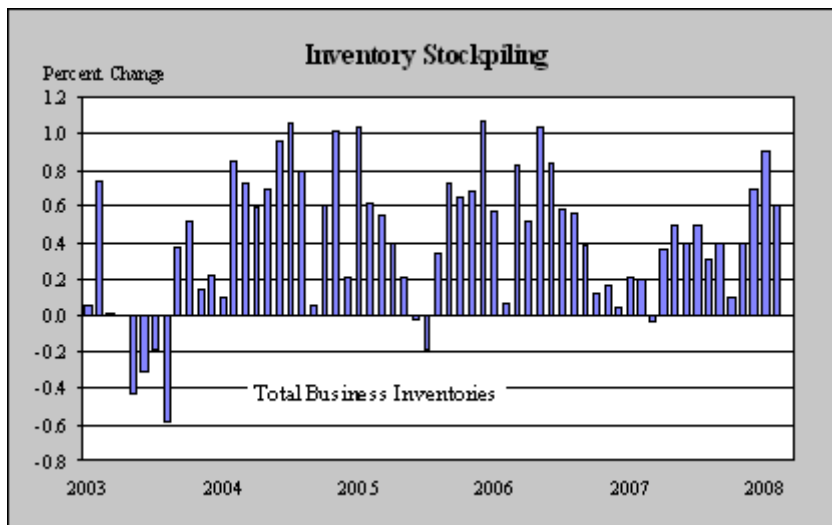


WEEKLY ECONOMIC COMMENTARY -- WEEK OF APRIL 18, 2008

FINANCIAL INDICATORS				
INTEREST RATES	April 18	Week Ago	Month Ago	Year Ago
3-month Treasury bill	1.36%	1.19%	0.61%	4.97%
6-month Treasury bill	1.66	1.39	1.19	5.04
3-month LIBOR	2.91	2.71	2.61	5.36
2-year Treasury note	2.14	1.75	1.59	4.65
5-year Treasury note	2.91	2.57	2.37	4.57
10-year Treasury note	3.72	3.47	3.33	4.67
30-year Treasury bond	4.51	4.30	4.17	4.85
Tax-Exempt Revenue Bonds (Triple-A)				
5-Year	3.10	3.15	3.04	3.74
10-Year	3.94	4.03	4.05	4.03
30-Year	4.90	5.05	5.16	4.55
30-year fixed mortgage rate				
	5.88	5.88	5.87	6.17
15-year fixed mortgage rate				
	5.40	5.42	5.27	5.89
1-year adjustable rate				
	5.10	5.18	5.15	5.45
STOCK MARKET				
Dow Jones Industrial	12849.36	12325.42	12361.32	12961.98
S&P 500	1390.33	1332.83	2258.11	1484.35
NASDAQ	2402.97	2290.24	1329.51	2526.39
Commodities				
Gold (\$ per troy ounce)	915.20	927.00	920.00	695.80
Oil (\$ per barrel) - Crude Futures (NYMEX)	116.77	110.32	101.84	63.38
ECONOMIC INDICATOR (Latest Month/Quarter)				
		Previous Month/Qtr	Two-Months/ Qtrs Ago	Average-Past 6 Months or Qtrs.
Retail Sales (March) - % change	0.2	-0.4	0.4	0.4
Consumer Price Index (March) - % change	0.3	0.0	0.4	0.4
Core CPI (March) - % change	0.2	0.0	0.3	0.2
Housing Starts (March) - 000s of units	947	1075	1083	1093
Building Permits (March) - 000s of units	927	984	1061	1064
Industrial Production (March) - % change	0.3	-0.7	0.1	0.0
Business Inventories (February) - % change	0.6	0.9	0.7	0.5

When the first quarter GDP numbers are released on April 30, it will probably show that the economy changed by a fraction of a percent on either side of zero during the period. Simply put, the figures on the economy's performance will not be decisive enough to quell the debate over whether the U.S. has technically slipped into a recession. Nonetheless the unofficial jury is clearly leaning towards that verdict. If the economy posted a positive growth rate in the January-March period, it will almost certainly register on the negative side of the ledger in the second quarter.

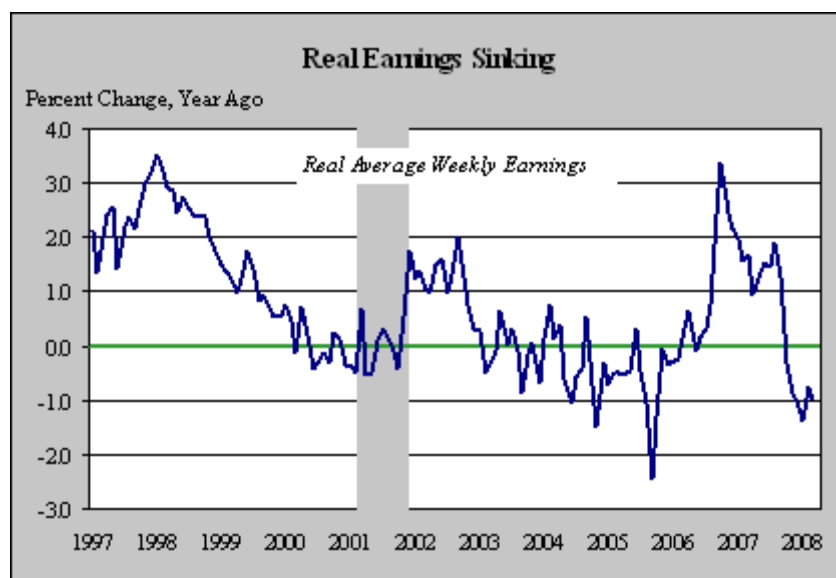
That's because the contractionary forces weighing on growth are all coalescing as the quarter draws to a close. Just about the only positive thrust is coming from net exports, which continue to benefit from the sinking dollar and solid demand from overseas. Another statistical lift might come from business spending on inventories, which increased sharply during the first two months of the quarter and is likely to jump further in March. But instead of a barometer of strength, the piling up of merchandise reflects weakening demands and, hence, is largely an involuntary buildup. If anything, businesses will make a concerted effort to reduce the inventory overhang in coming months, something that will deepen the contraction in GDP during the second quarter.



To be sure, there may have been some voluntary stockpiling taking place for two reasons. First, and perhaps the weaker rationale, is that there is a handful of optimists among business leaders who believe the economy will stage a solid recovery in the second half of the year; accordingly, having merchandise on the shelf to meet prospective demands is good business strategy. But the second reason is more compelling because it may partially explain the milder pace of job losses this year relative to the first few months of previous recessions. In essence, many companies are trying to retain their most senior and skilled workers as long as possible, resulting in higher output than otherwise and larger inventory stockpiles. Of course, this cannot be a long-lasting strategy if demand stays weak, as idle inventories are costly and eventually decimates the bottom line.

Indeed, while companies are retaining workers, they are edging towards the time when more layoffs become inevitable. In recent months, there has been a noticeable cutback in overtime and in hours worked as companies try to cope with slowing sales. Many employees have seen their workweek dwindle so much that they fall into the part-time category. In March, the number of people working part-time for economic reasons (either because they can't find full-time work or their workweek has been downsized) reached the highest level in more than a decade, exceeding the peak reached in the 2001 recession. Clearly, if conditions do not improve soon, these workers will be cut off entirely from payrolls, leading to a jump in the unemployment rate.

One thing is clear: whether through job losses or a reduced workweek, employee paychecks are being squeezed. Not only are wage increases slowing, they are not keeping up with inflation. Real weekly earnings for rank-and-file workers in March slid 1 percent below the year-earlier level, and were virtually unchanged from December 2001 -- the first year of the latest expansion. What this perspective brings into sharp focus is the huge role asset inflation played in supporting consumer spending during the six-year expansion. Paychecks simply did not provide the purchasing power needed keep up with expenditures, encouraging households to tap into their growing housing wealth, borrowing profusely against equity, and drawing down savings.



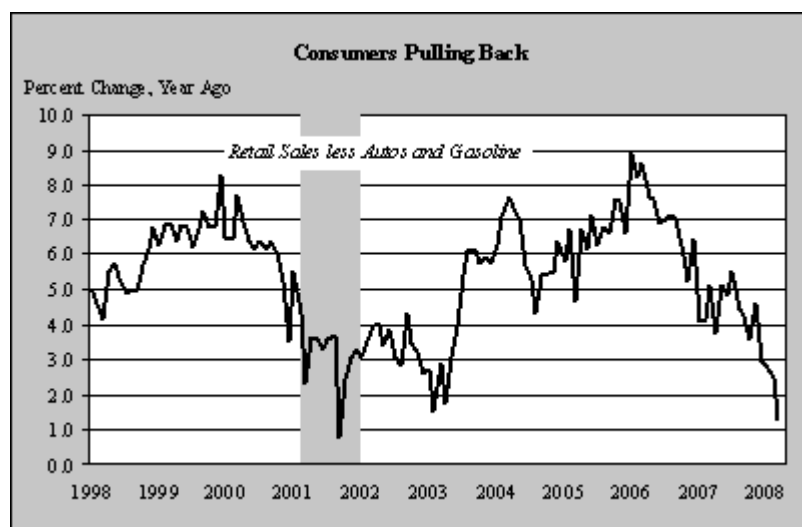
But with home prices now plummeting, that key wealth-building source is no longer available. And, with personal savings nonexistent, that reservoir of funds has all but dried up. So the question now is what will propel consumer spending going forward? Needless to say, the answer to that question will determine how severe and how long the presumed recession now underway will turn out to be. Clearly, whatever spending consumer does in the months ahead will be financed the old fashioned way - through earnings. And, the most likely course is that households will be putting aside more of their paychecks to rebuild savings, since wealth building via home-price appreciation is no longer a sure-fire path to a comfortable retirement nest egg. Put this all together, and the record-long string of 54 consecutive quarters of real consumer spending gains appears to be in peril.

That is certainly clear from the latest figures on retail sales. While total nominal sales surprised analysts by increasing 0.2 percent in March, the headline number is about the only positive aspect of the sales report. For one, if gasoline sales were stripped away, there would have been no gain at all to speak of. Sales at the fuel pump jumped 1.1 percent during the month, but this should surprise no one even remotely familiar with the surge in crude oil prices, which topped a record \$115 a barrel this week. On the retail level, the average price of unleaded regular gasoline jumped 7.1 percent in March, to \$3.25 a gallon. Since the demand for gasoline is relative inelastic in the short run, these higher prices leads to higher dollar sales, and that's exactly what happened. More of the same will undoubtedly take place in April, as pump prices continued to increase in response to the spike in crude oil prices.

In addition to gasoline, auto sales also increased in March, but that is at odds with the drop in unit sales reported by the industry for the month. So either the mix of sales changed in favor of more expensive vehicles, or the dollar figure will be revised down next month. We suspect the latter is more likely. Even so, by any measure of sales, the trend is undeniably weak. The nominal value of total retail sales has followed a saw-toothed pattern since last October, rising one month and declining the next, resulting in virtually no change over the six month period. After allowing for price increases, the average for the first quarter stands below the fourth quarter level, another sign that real consumer outlays will show a contraction in the GDP data at the end of the month.

Finally, as the chart shows, nominal retail sales less autos and gasoline are well into recession territory. In March, this grouping stood a skimpy 1.3 percent above the level of a year ago, a performance that just about matches the nadir reached during the 2001 recession. Looked at through this lens, the story is simple: rising prices of gasoline and food are sapping the ability of households to make discretionary

purchases, which are falling like a stone. Sales at building material and furniture stores, of course, are taking the biggest hit, but this is related more to the housing slump than to broader macro trends.



Other discretionary purchases, however, are suffering because of the squeeze on budgets coming from higher energy and food prices as well as ever-weakening paychecks. These include softer sales for clothing, particularly women's apparel, and a sharp falloff at general merchandise stores. The latter has been weak for a while, mostly due to sagging fortunes of Department stores. Lately, however, the weakness has spread to other general merchandise establishments, which include the so-called warehouse and club stores, which is another strong signal that the budgetary squeeze is reaching far down the income ladder. It was only a question of time before average families would have to rethink their plan to purchase one of the mainstays behind consumer spending - plasma TVs and other electronic gadgets. Well, it appears that time has come. In March sales at electronic stores fell after being flat in February. The March reading was the lowest since June 2007.

As noted at the outset, the forces of contraction are coalescing and forming a powerful downdraft on the economy heading into second quarter. There is little question that whatever the first-quarter's reading on the economy's performance will be, the second quarter will be considerably worse. The question now is whether the spring quarter will mark the most severe point of the recession, setting the stage for the second half recovery that the Federal Reserve is counting on. We suspect that it will, given the strong policy stimulus in the pipeline that has yet to work through the system. First and foremost, of course, is the tax rebates being mailed out in May, that will impart some uplift to activity in the third quarter, even if most of the rebate checks are used to pay for gasoline or pay down debts. Past experience shows that consumers put aside some of the windfall for discretionary purchases, as electronic purchases staged a hefty increase for a few months following the 2001 rebates even as the economy continued to struggle and the labor market remained soggy.

Then, of course, there is the considerable dose of monetary stimulus that has yet to work its full magic on the economy. The Fed has slashed interest rates by 300 basis points already, and another cut is baked in at the next two-day meeting on April 30/31. Until recently, the odds favored a 50 basis point reduction, but recent ominous inflation readings have heightened expectations of a smaller 25 basis point move. In addition to the rate-slashing campaign, the Fed has moved aggressively to shore up the balance sheets of banks and nonbanks alike, providing massive doses of liquidity through its discount window and holding auctions that in effect allow institutions to borrow Treasury securities using tainted mortgage securities as collateral. The key is to encourage banks and other institutions to increase lending to households and businesses, thus short-circuiting the credit crunch that is by far the biggest threat to

the economy. There are tentative signs that this strategy is working - even the CEOs of beleaguered investment banks this week asserted that the worst of the credit crisis is over -but time will tell. For the most part, Wall Street seems to subscribe to this more upbeat view, as the stock market staged its biggest rally in nearly five years this week. We understand that the stocks tend to be forward looking, but this is really cutting through a lot of dense fog, given the array of negative developments and powerful headwinds that are clouding the outlook.