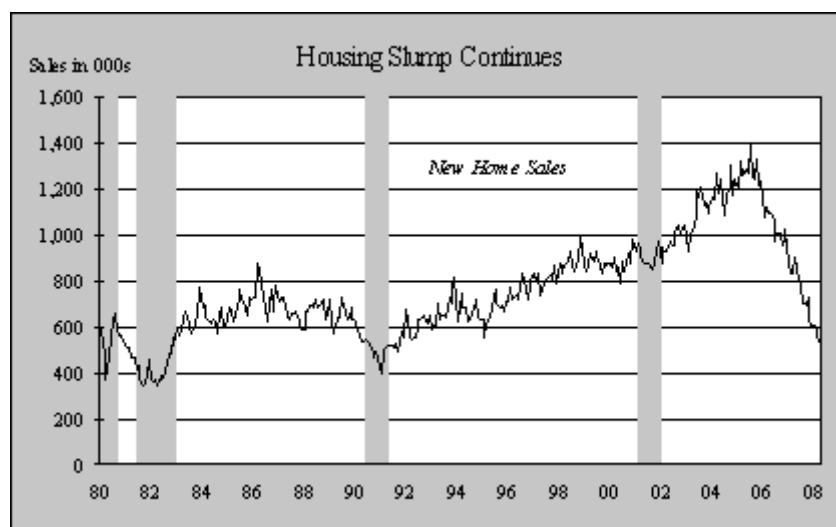


WEEKLY ECONOMIC COMMENTARY -- WEEK OF APRIL 25, 2008

FINANCIAL INDICATORS				
INTEREST RATES	April 25	Week Ago	Month Ago	Year Ago
3-month Treasury bill	1.37%	1.36%	1.34%	4.92%
6-month Treasury bill	1.71	1.66	1.48	5.02
3-month LIBOR	2.91	2.91	2.70	5.36
2-year Treasury note	2.42	2.14	1.66	4.66
5-year Treasury note	3.18	2.91	2.52	4.58
10-year Treasury note	3.87	3.72	3.45	4.69
30-year Treasury bond	4.59	4.51	4.33	4.88
Tax-Exempt Revenue Bonds (Triple-A)				
5-Year	3.12	3.10	3.04	3.76
10-Year	3.93	3.94	4.05	4.01
30-Year	4.88	4.90	5.19	4.49
30-year fixed mortgage rate				
	6.03	5.88	5.85	6.16
15-year fixed mortgage rate				
	5.62	5.40	5.34	5.87
1-year adjustable rate				
	5.29	5.10	5.24	5.43
STOCK MARKET				
Dow Jones Industrials	12891.86	12849.36	12216.40	13120.94
S&P 500	1397.84	1390.33	1315.22	1494.07
NASDAQ	2422.93	2402.97	2261.18	2557.21
Commodities				
Gold (\$ per troy ounce)	889.70	915.20	936.50	684.70
Oil (\$ per barrel) - Crude Futures (NYMEX)	118.58	116.77	105.41	68.41
ECONOMIC INDICATOR (Latest Month/Quarter)				
		Previous Month/Qtr	Two-Months/ Qtrs Ago	Average-Past 6 Months or Qtrs.
New Home Sales (March) - 000s of units	526	575	607	612
Median Sales Price (New Homes)	\$227,600	\$244,200	\$232,900	\$235,967
Existing Home Sales (March) - 000s of units	4930	5030	4890	4953
Durable Goods Orders (March) - % change	-0.3	-0.9	-4.4	-0.2

In assessing the housing market, we're reminded of a famous line in the third "Godfather" movie, to wit: "Just when I thought I was out... they pull me back in". What brings this analogy to mind is the murderous dive in the latest batch of housing data, which trumped any slim hope that the residential meltdown was nearing an end. True, the hope had tenuous support to begin with, and only a minority of industry analysts actually clung to it. Still, the optimists believed that the time-honored dynamic of falling home prices and lower mortgage rates would start to work its magic on demand, bringing more home buyers back into the market.

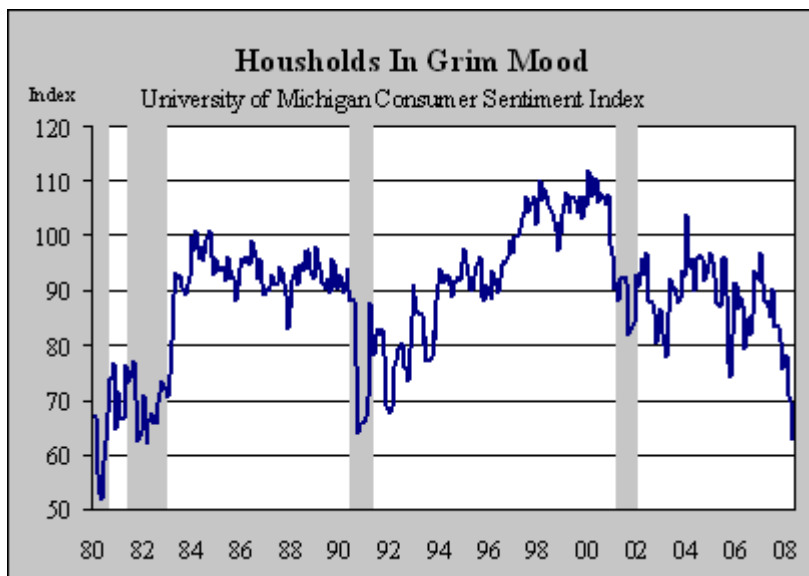
But even as the affordability index compiled by the National Association of Realtors is close to the highest level in more than a decade, people aren't buying. Their resistance, in turn, may inspire the pessimists to counter with another well-known axiom, namely that "you can lead a horse to water, but you can't make it drink". That line of action, or inaction, was strikingly revealed in March, when, according to the Commerce Department, sales of new homes plunged by another 8.5 percent to the lowest level since October 1991. The drop was far greater than expected and, at March's annual sales rate of 526 thousand, it would take 11 months to clear the market of unsold homes. That dwarfs the usual supply, which normally equals around four months of sales.



If there is any silver lining to the bulging supply overhang, it is that it entirely reflects declining sales, not a buildup in the absolute number of unsold homes. In fact, the physical inventory actually fell again in March for the seventh consecutive month. But if folks aren't buying, that's small comfort to builders, particularly since an outsize 40.1 percent of the unsold units are completed homes. Simply put, sellers are going to have to reduce prices considerably more than they already have in order to entice buyers into the market. In March, the median sales price plunged by 13.3 percent compared to its level of a year earlier. How severe is that? Not since July 1970 have prices suffered as large a year-over-year drop. Nor are conditions any better in the market for existing homes, where both sales and prices are also plummeting.

Making matters worse, surging foreclosures - which according to a Friday NY Times report has reached into one of the most gilded of luxury markets, Greenwich Connecticut, the home of hedge fund managers and the like - and the dwindling availability of jumbo loans portend significantly more downward pressure on prices. Just where this downward spiral ends nobody knows, but virtually everyone agrees that the overall economy will not recover from what is arguably the eleventh recession of the postwar era until the housing market bottoms out. The latest data strongly suggest that bottom is not yet in sight. That means construction spending is poised for more cutbacks in the months ahead and household wealth will suffer further damage as home values continue to shrink.

Indeed, declining property values along with an array of other negative influences are taking a toll on consumer confidence, further darkening the outlook. In its second and final survey for April, the Reuters/University of Michigan pollsters revealed that household sentiment plunged to a 26-year low of 62.6 during the month, which is even lower than the initial reading of 63.2 released on April 11. The index consists of a current conditions as well as an expectations component, and both were revised down from the original report. Not surprisingly, the current conditions component, which reflects perceptions of whether it is a good time to make such big-ticket purchases as cars, took the biggest hit, coming in a full 7.2 points lower than the initial reading.



The reasons for the grimmer perceptions about the current environment are clear: households are being squeezed from all sides. Paychecks are getting slimmer thanks to a deteriorating labor market, which featured an 80 thousand loss of jobs in March, following declines of 76 thousand in each of the previous two months. Meanwhile, budgets are under growing stress from soaring fuel and food prices. Both have been increasing at a faster rate in recent months, and both show no sign of easing. As the peak driving season approaches, retail gasoline prices have increased nearly 20 percent since the beginning of the year, and the spike in food prices is encompassing the basic necessities, such as milk, cereal, eggs and medicine. Not surprisingly, consumer inflationary expectations are also edging higher. The University of Michigan analysts found that households expect the inflation rate to rise to 4.8 percent over the next year, up from an expectation of 4.3 percent in March and the highest since October 1990.

No doubt, the rise in near-term inflation expectations reflects surging gasoline and food prices, which are already hitting consumer pocketbooks even as they drive up the headline inflation rate. If gasoline prices recede in the months ahead, so too will both the overall inflation rate, which would bring down near-term expectations as well. Federal Reserve officials are aware of the volatile nature of these near-term trends, and usually do not respond to them. What the Fed is concerned with, however, is the trend in long-term inflation expectations, which has a more fundamental impact on wage and pricing behavior. Here, the trend is less worrisome, but may be on the verge of becoming problematic. In the final April survey, households expect the inflation rate to rise to 3.2 percent over the next 5-10 years, which is not overly alarming but up from 2.9 percent in March and the highest since August 2006.

It's almost a certainty that the edging up of inflation expectations will not short-circuit the Fed's efforts to jump-start growth by lowering interest rates at its policy-setting meeting next week. But it has tempered the aggressiveness behind the prospective easing moves. Until recently, the general consensus was that the next reduction would be 50 basis points, lowering the federal funds rate to 1.75 percent. However, the expectations priced into the futures markets as of Friday morning was for a cut of 25 basis points, and a slither of analysts believe that the Fed may actually stand pat. That seems to be too much of a dramatic shift in priorities for it to occur, particularly since the Fed has learned the hard way that surprising the markets with an unexpected move could have dramatic consequences.

Still, it would not be surprising if the Fed decided to implement a modest 25 basis point cut and suggest in its accompanying press statement that it will move to the sidelines for a while. That would appease some of the inflation hawks on the policy making committee - recall that two of them dissented from the 75 basis point cut at the March meeting - as well as others who are convinced the Fed is sowing the

seeds for an inflation flare-up later this year and in 2009. By cutting rates less now, the Fed also lessens the need to hastily rescind the rate cuts later when the economy starts to recover. Besides, there are many critics of further rate cuts who believe that lower rates will do little to help the economy, which is suffering more from a shortage of credit than the high cost of credit. In their view, the Fed should focus more on providing lenders with liquidity and help them build up capital, which would eventually promote the growth of credit to households and business.

Another reason that might enter the Fed's decision to scale back the easing process is the absence of new data indicating the economy is falling apart. True, the housing market is still on a steeply sliding slope, as the latest data attest. But the broader economy seems to be holding up fairly well, only gently sliding into a recession. The slide would steepen considerably if, and when, consumer spending goes into a tailspin. While that may well happen, so far the pullback by households, despite their abysmally low confidence level, has been gradual and confined largely to big-ticket items, like cars and housing-related goods and services. What's more, the rebate checks are in the mail and should start fattening bank accounts over the next several weeks. While most of these funds will be used to pay down debt and rebuild depleted savings, at least one-third of households, according to the University of Michigan survey, plan on spending the checks.

That alone should give the economy a nice boost, which will show up primarily in the third-quarter's GDP data. Recall that the 2003 rebate checks, which were considerably smaller than the ones now being mailed out, kicked up the growth rate to an astonishing 7.5 percent in the third quarter of that year and put the economy on a 3.2 percent average growth path over the next two and a half years. That's not likely to happen this time, given the powerful headwinds weighing against growth that didn't exist in 2003. Not only is the economy coping with a housing depression and soaring gas prices, it is operating in a weakening job market whereas job growth was on the verge of accelerating sharply in 2003. Hence, consumers felt more confident about spending their rebates then as they will in the months ahead.

Nonetheless, even the labor market - like the broader economy - is holding up better than it usually does in the early stages of a recession. Job losses have been tamer and the unemployment rate is still low by historical standards. True, the early readings on the job market may understate the weakness in labor conditions, which is common early in a recession for a variety of reasons. But the Fed has to be encouraged by the apparent resistance of companies to lay off workers, preferring instead to pare costs by cutting back on worker hours and granting slimmer pay raises. This dynamic shows up in the weekly claims for unemployment benefits. The trend is edging higher, as shown in the chart, around volatile weekly wiggles, but the overall level remains well below the usual peaks reached during recessions. That is small solace to people who can't find a job, or who must work for lower wages in part-time positions. However, for the Fed, it means that the floor under the economy has not cracked open and lessens the urgency for aggressive pump-priming measures. Hence, a cautious "wait-and-see" strategy may well be on the policy horizon.

