



RECENT ECONOMIC DEVELOPMENTS

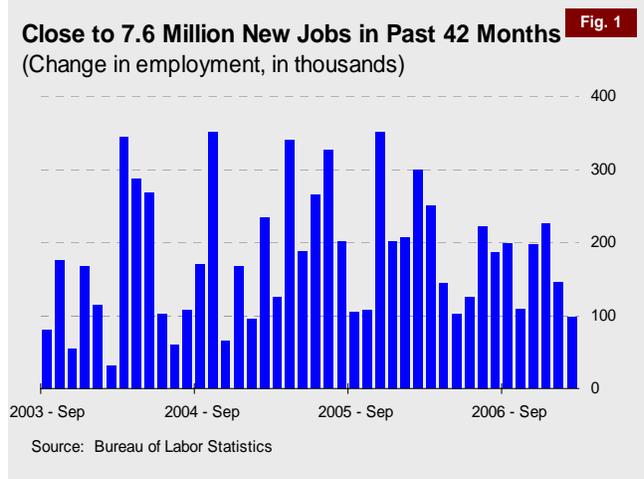
MARCH 13, 2007

PICKUP IN GROWTH EXPECTED DESPITE FINANCIAL JITTERS

Following a 9% decline in Shanghai’s stock market, equity valuations tumbled in the U.S. and across Europe and Asia on Tuesday, February 27, though analysts lack an identifiable single trigger. The recent volatility in financial markets appears to have had little effect on expectations about the pace of economic growth this year. Private forecasters continue to see somewhat below-trend growth in the near term but a return to more trend-like growth of around 3.0% by year’s end. Annualized growth in the inflation-adjusted (real) gross domestic product (GDP) was 2.2% in the 4th quarter of 2006 and has averaged 3.0% over the past 21 consecutive quarters of expansion. Employment has also expanded; close to 7.6 million new payroll jobs have been created in the past 42 months of consecutive job gains. February’s unemployment rate was a low 4.5% of the labor force.

Highlights

- Job gains continue; 97,000 new payroll jobs were created in February. Payrolls are up by close to 7.6 million new jobs in the past 42 consecutive months with job gains (Fig. 1).
- The unemployment rate edged down to 4.5% in February, well below the recent peak of 6.3% in June 2003 (Fig. 2, next page).
- Real GDP growth was revised down to an annualized 2.2 % in the 4th quarter from an earlier estimate of 3.5% (Fig. 3, next page).
- The housing market continues to cool: existing home sales fell by 4.3% in January on a year-over-year basis; new home sales fell by 20.1% (Fig. 4, next page). The subprime mortgage market has shown signs of considerable strain.



Close to 7.6 Million New Jobs in 42 Months; Unemployment Rate Edges Down to 4.5%

Payroll employment increased by 97,000 new jobs in February, the 42nd consecutive month with job gains (Fig. 1). Close to 7.6 million new jobs were added to payrolls in that period. Over the year ending in February, payroll employment grew by 2 million. During the past year, payroll job gains have averaged a healthy 167,000 per month. The *unemployment rate* edged down to 4.5% in February and has ranged from 4.4% to 4.6% for the last six months, well below the near-term peak of 6.3% in June 2003 (Fig. 2, next page).

GDP Growth Revised to 2.2% in the 4th Quarter

GDP growth was revised down to 2.2% for the 4th quarter, primarily reflecting downward revisions to private inventory investment and to consumer spending, as well as an upward revision to imports. Real GDP increased at a robust 3.3% rate *in 2006* (from the 4th quarter of 2005 to the 4th quarter of 2006), up from a rate of increase of 3.2% in 2005. Real GDP has grown for 21 consecutive quarters, with growth averaging a robust 3.0% over that period. The *Blue Chip* consensus of private forecasters sees a gradual acceleration in growth, rising to 3.1% by the end of 2007 (Fig. 3, next page).

Jitters in Financial Markets

Following a 9% loss in Shanghai's stock market, equity valuations tumbled in the U.S. and across Europe and Asia on Tuesday, February 27 ("grey Tuesday"). Analysts lack an identifiable single trigger for the pullback in global markets. On grey Tuesday, the *Dow Jones Industrial Average* fell by 3.3%, the *NASDAQ* by 3.9%, and the *Standard and Poor's 500* by 3.5%. Testifying before the House Budget Committee on February 28, Fed Chairman Bernanke remarked that "financial markets seem to be working well" and that: "My view is that taking all the new data into account, that there is really no material change in our expectations for the U.S. economy since I last reported to Congress a couple weeks ago."

The Fed Remains on Hold

The *Fed* kept its *target for overnight interest rates* at 5¼% at its January 31 meeting, the fifth consecutive policymaking meeting with no change in the target rate. Between June 2004 and late June 2006, the Fed had raised its target from 1% to 5¼% with 17 consecutive quarter-point increases. Despite those actions, long-term interest rates remain low. In its January policy statement, the Fed identified that "some tentative signs of stabilization have appeared in the housing market." The Fed is expected to keep its overnight-interest-rate target at 5¼% following its policymaking meeting on March 20 and 21.

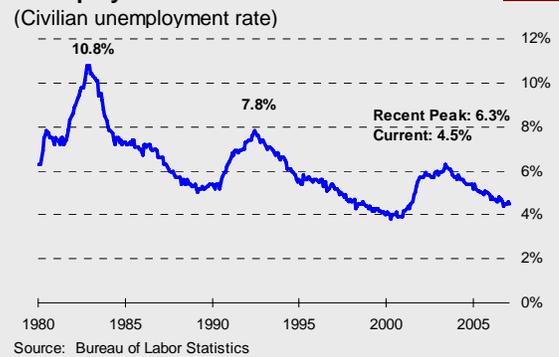
The Housing Sector Continues to Cool

Existing home sales were down 4.3% in January and have fallen for 14 straight months on a year-over-year basis. *New home sales* were down 20.1% in January and have fallen for 13 straight months. *House-price appreciation* has also slowed and *housing starts and permits* have declined for 10 straight months through January. Home sales have fallen from the rapid pace of the summer of 2005, but levels of sales remain strong, supported by still-low mortgage rates.

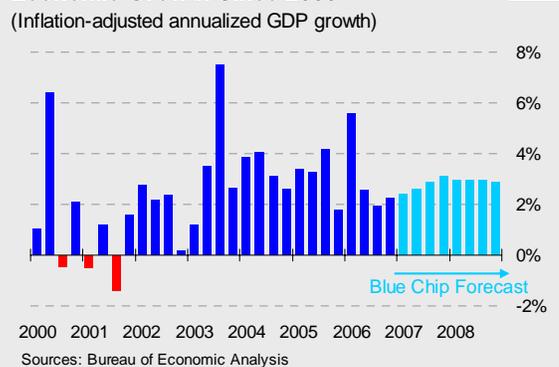
Subprime Mortgage Market Fallout

The market for "subprime" mortgages—home loans to those with poor credit histories—has witnessed rising default rates, causing a number of lending companies to close. New subprime loans in 2006 represented around 20% of the total mortgage market, up from 5% in 2001. There is little evidence to suggest a significant risk that the subprime difficulties will spill over and lead to a more general "credit crunch" in which even creditworthy borrowers find it significantly more costly to obtain loans.

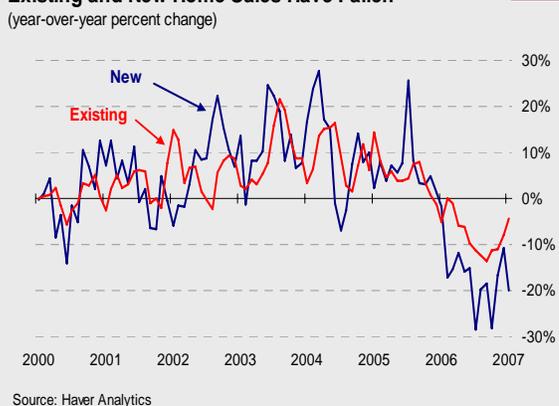
Unemployment Rate Below Previous Peaks Fig. 2



Economic Growth Since 2000 Fig. 3



Existing and New Home Sales Have Fallen Fig. 4



Upcoming Indicators

Inflation – The Consumer Price Index for February is scheduled for release on *March 16*.

Federal Reserve – The Fed's next policy meeting is scheduled for *March 20 and 21*.

GDP – The "final" estimate of GDP for the 4th quarter is scheduled for release on *March 29*.

Employment – The Bureau of Labor Statistics reports March's employment situation on *April 6*.