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RECENT ECONOMIC DEVELOPMENTS

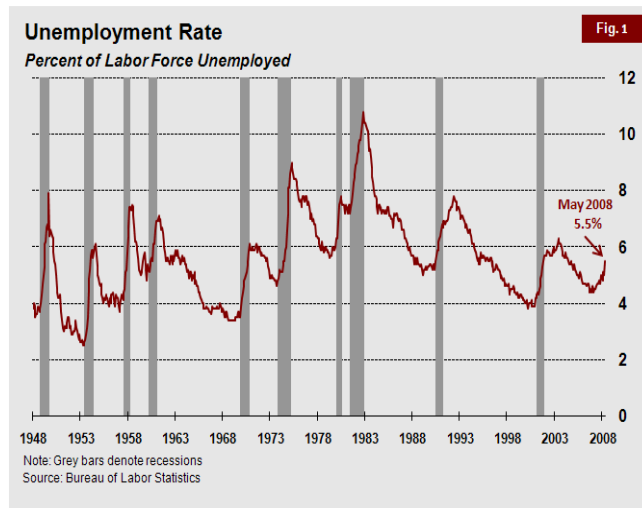
JUNE 17, 2008

SLUGGISH LABOR MARKETS; INFLATION FEARS

The unemployment rate jumped to 5.5% in May, from 5.0% in April, and payroll employment declined for the fifth consecutive month, raising concerns that the economy has slipped into a recession. However, despite a significant drag from continued adjustments in housing markets, growth in the inflation-adjusted (real) gross domestic product (GDP) was 0.9% in the 1st quarter, up from 0.6% in the 4th quarter of 2007. Moreover, private forecasters see positive, though sluggish, growth throughout this year and a return to more trend-like growth of around 3.0% by the end of 2009. To combat the recent slowdown in growth and financial market strains, the Federal Reserve (Fed) has lowered short-term interest rates significantly and is supplying ample liquidity to financial markets. The low rates and liquidity infusions, along with recent sharp increases in energy, food, and other commodity prices, could lead to higher future inflation. In light of rising risks of higher inflation, many expect that the Fed will end its recent campaign of cutting short-term interest rates at its policymaking meeting later this month. At its most recent meeting in late April, the Fed cut its target overnight interest rate to 2.00%, from 2.25%. That rate cut followed a sequence of larger cuts earlier this year as well as a variety of unusual financial-crisis-management actions (e.g., establishment of a Term Auction Facility and a Term Securities Lending Facility, and partnering with JPMorgan Chase & Co. in an acquisition of Bear Stearns).

Highlights

- The *unemployment rate* rose to 5.5% in May, from 5.0% in April (Fig. 1).
- Non-farm *payroll employment* declined by 49,000 in May, the 5th consecutive monthly decline (Fig. 2, next page).
- *GDP* growth was revised up to 0.9% in the 1st quarter, from an earlier estimate of 0.6% (Fig. 3, next page).
- *Consumer price inflation* remains low by historical standards, but recent sharp increases in prices of oil and other commodities present significant risks of higher future inflation and inflation expectations (Fig. 4, next page).
- The *Fed* cut its target overnight interest rate by $\frac{1}{4}$ of a percent to 2.0% at its April policymaking meeting. Expectations are that the Fed, fearing inflation, will end its rate cutting campaign at its meeting later this month, despite sluggish economic activity and continued adjustments in the housing and financial markets.



Unemployment Rises to 5.5%; Five Consecutive Months of Payroll Job Declines

The *unemployment rate* rose to 5.5% in May, from 5.0% in April and a near-term low of 4.4% in March 2007 (Fig. 1). *Payroll employment* fell by 49,000 jobs in May (Fig. 2, next page). There has been a decline of 324,000 payroll jobs over the past five consecutive months with payroll job declines. Reflecting adjustments in the housing sector, employment in the construction industry declined by 34,000 in May and has declined by 475,000 jobs since its recent peak in September 2006; two-thirds of the 475,000 decline in construction jobs has occurred in the past seven months.

GDP Growth in the 1st Quarter Revised Up to 0.9%

GDP growth was revised up to a 0.9% annualized rate in the 1st quarter, up from an earlier estimate of 0.6% and up from 0.6% growth in the 4th quarter of 2007 (Fig. 3, next page). Growth in the 1st quarter primarily reflected consumer spending (up 1.0%, compared with an increase of 2.3% in the 4th quarter), exports (up 2.8%), federal government spending (up 4.4%), and the change in inventory investment (which added 0.21 percentage point to the 1st-quarter change in real GDP). Partly offsetting those positive contributions to growth was a decline in residential investment (down 25.5%). Residential investment has declined for nine consecutive quarters, reducing growth over that period by an average 0.91 percentage point. Over the same period, export growth has added an average 0.90 percentage point to GDP growth. Real GDP has grown for 26 straight quarters, with growth averaging 2.7%.

Inflation Fears

Inflation in core measures of consumer prices, which exclude often-volatile energy and food prices, remains low by historical standards. Inflation in the core consumer price index (CPI), for example, was 2.3% on a year-over-year basis in May and has averaged 2.4% this year. Inflation in the all-inclusive CPI, however, was 4.1% in May, the same as the average for the year and up significantly from a 2.9% average last year. Much of the increase can be attributed to rapid increase in energy prices; year-over-year inflation in the energy component of the CPI has averaged 17.9% in the first five months of this year. Oil prices have risen sharply; year-over-year growth in the price of a barrel of West Texas Intermediate crude has averaged over 75% in the first five months of this year and the per-barrel price level has risen above \$130 in recent weeks. Gasoline prices have risen above \$4 a gallon, on average, nationwide. Growth in food prices and other commodity prices has also been rapid in recent months.

The Fed is Expected to End Its Rate Cutting Campaign

Despite sluggish economic growth, employment declines, higher unemployment, continuing declines in housing markets, and continuing strains in financial markets, markets expect that the Fed will leave its target overnight interest rate (the “*federal funds rate*”) unchanged at 2% at its policymaking meeting later this month. The Fed has cut its target rate significantly recently and has injected large amounts of liquidity into financial markets to combat stresses initiated by the sub-prime mortgage market meltdown. Many fear that the rate cuts and large liquidity infusions into the banking system could help fuel the risks of higher *inflation* already in place from recent increases in energy, food, and other commodity prices. Those price increases could eventually be passed through to increases in consumer prices more generally.

Housing Market Adjustments Continue

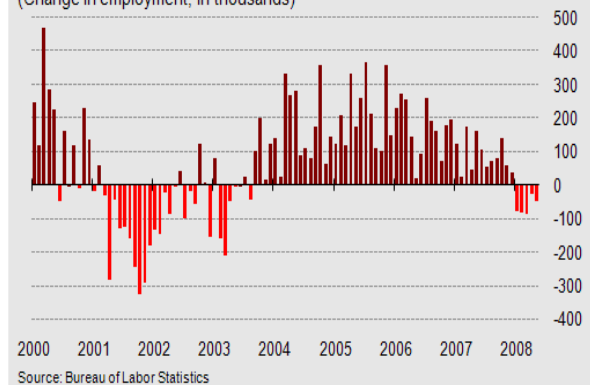
On a year-over-year basis, *existing and new home sales* have not risen since November of 2005. The inventory of unsold new homes remains elevated at around 11 months, well above the long-term average of 6 months. *Home price* appreciation, by all available measures, has also slowed from the high rates in 2005 with most measures recently showing declining home prices. *Mortgage delinquency and foreclosure rates* have risen markedly, especially for sub-prime adjustable-rate mortgages, since the beginning of 2006.

Mortgage Delinquencies and Foreclosures Continue to Rise

The Mortgage Bankers Association’s (MBA) *delinquency rate* measure (mortgages past due 30 days or more as a percent of total mortgages outstanding) for mortgage loans on 1-4 unit residential properties was 6.35% of all loans outstanding at the end of the 1st quarter, the highest recorded by the MBA since 1979. The percent of loans on which *foreclosure* actions were started during the 1st quarter was 0.99%, also the highest on record from the MBA’s mortgage survey since 1979. Foreclosure start rates were up on all mortgage types in the 1st quarter relative to a quarter earlier, but the rise in the overall foreclosure rate was largely driven by adjustable rate mortgages (ARMs). The percentage of all loans in the foreclosure process was 2.47% at the end of the 1st quarter. According to the MBA, California, Florida, Arizona, and Nevada combined represent large shares of recent foreclosure levels and increases in foreclosures.

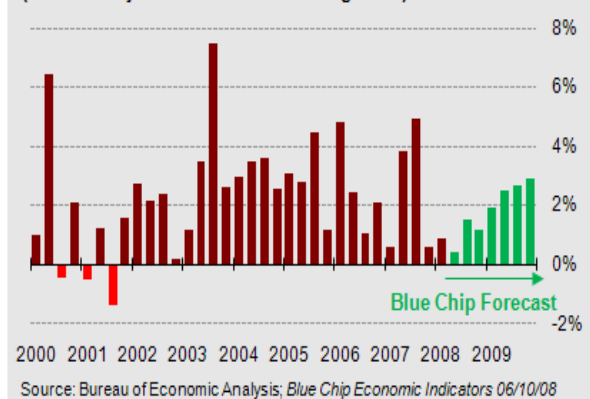
Payroll Employment Since 2000
(Change in employment, in thousands)

Fig. 2



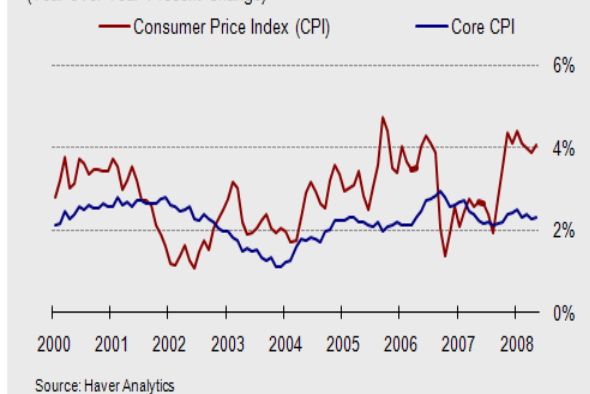
Economic Growth Since 2000
(Inflation-adjusted annualized GDP growth)

Fig. 3



Energy, Consumer, and Food Price Inflation
(Year-Over-Year Percent Change)

Fig. 4



Upcoming Indicators

Federal Reserve – The Fed’s next policy meeting is scheduled for June 24 and 25.

GDP – The final estimate of 1st quarter GDP growth arrives on June 26.

Employment – The Bureau of Labor Statistics reports June’s employment situation on July 3.

Inflation – The Consumer Price Index for June is scheduled for release on July 16.