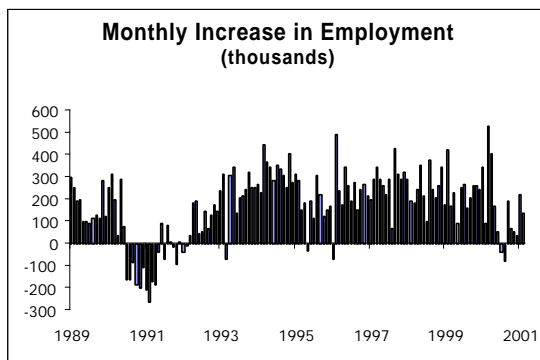


ECONOMIC SNAPSHOT

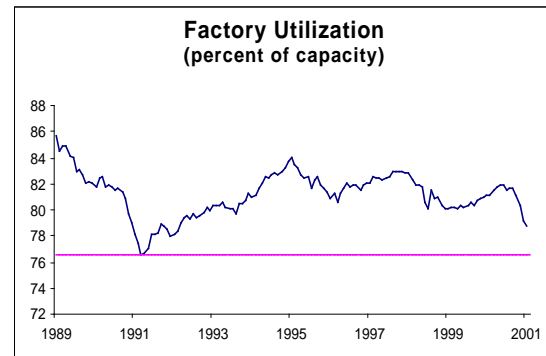
A stronger-than-anticipated report on employment in February confirms that the economy continues to grow and has not entered a recession. The unemployment rate remained steady at 4.2 percent as 135,000 jobs were added to payrolls nationwide. Coupled with reports of buoyant home sales, a bounce-back in consumer spending, and rising business orders for capital goods, the latest employment numbers show no evidence that a recession is underway. Job growth remains in positive territory, unlike during the recession of 1990-91 (see chart).



With recession fears receding, the Federal Reserve is now unlikely to embark on the course of aggressive interest-rate cuts that investors had anticipated. This shift of investor perceptions abruptly halted a brief stock-market rally earlier this month. At its meeting this week, the Fed likely will lower its federal funds target by 50 basis points (to 5 percent), with a larger cut now highly unlikely. In fact, the risk may well be that the Fed moves by less than expected, which would trigger a sharp sell-off of stocks.

Manufacturing sector continues to struggle. Despite the improved outlook for the overall economy, the manufacturing sector continues to contract, shedding

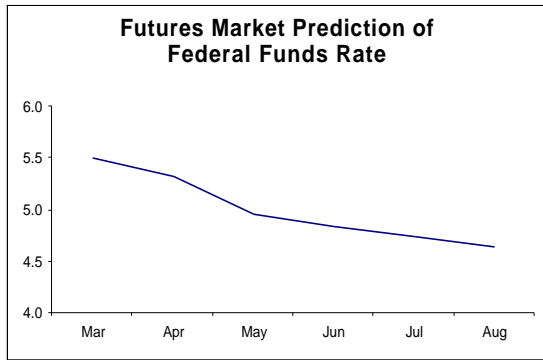
94,000 jobs last month. So far this year, job loss in manufacturing has exceeded the loss during all of last year as the downturn has accelerated. Factory output has declined since September and idle capacity is now approaching levels last seen during the 1990-91 recession (see chart).



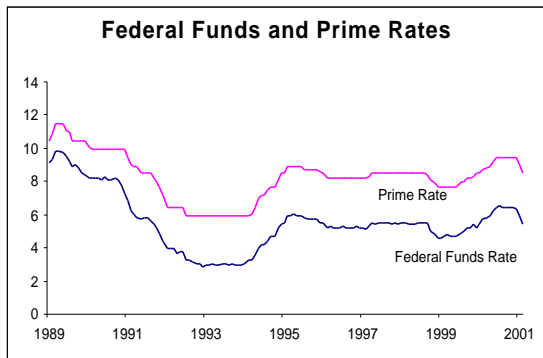
This extreme weakness in manufacturing and the ongoing decline in consumer confidence about the future will keep the Fed on a path that reduces interest rates through the summer. Although the economy has dodged the recession bullet, its growth remains well below the potential of the "New Economy." Accordingly, the Fed will continue to lower interest rates over the next several months, albeit somewhat less quickly and in smaller steps than seemed likely just a few weeks ago.

How low will rates go? The futures market provides a simple way to predict the future level of the federal funds rate (which is the rate at which banks lend to each other overnight). Contracts for federal funds are traded on the major commodity exchanges and the prices of these contracts can be used to assess investors' perceptions. These contracts foresee an easing by the Fed to a

rate of about 4.5 percent by late summer (see chart).



Because long-term bond and mortgage rates have already priced in this expected easing, these rates are not likely to fall by as much as the federal funds rate. The decline in the federal funds rate, however, will lower the prime lending rate of banks one-for-one because the prime rate is set at a fixed margin above the federal funds rate (see chart). With many home equity lines and

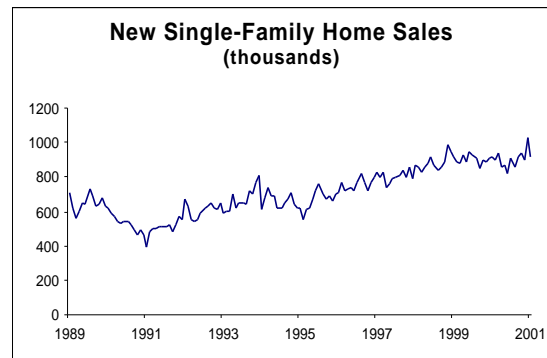


some credit cards pegged to the prime rate, the decline in the federal funds rate thus will benefit homeowners and consumers.

Housing sector remains a bright spot.

Mortgage refinancing has jumped upward in recent weeks, reflecting the bottoming-out of mortgage rates. This refinancing should help cushion any drop-off in consumer spending by putting cash in homeowners' pockets. Likewise, the surprisingly strong pace of home sales and housing starts, even during the usually weak winter season, is

providing important support to the economy (see chart). Overall, the good news on the housing front implies that consumer



spending likely will remain firm, and manage to carry the economy through its current slowdown and into accelerating growth later this year.