

WEEK IN  
REVIEW

January 28 – February 1, 2008

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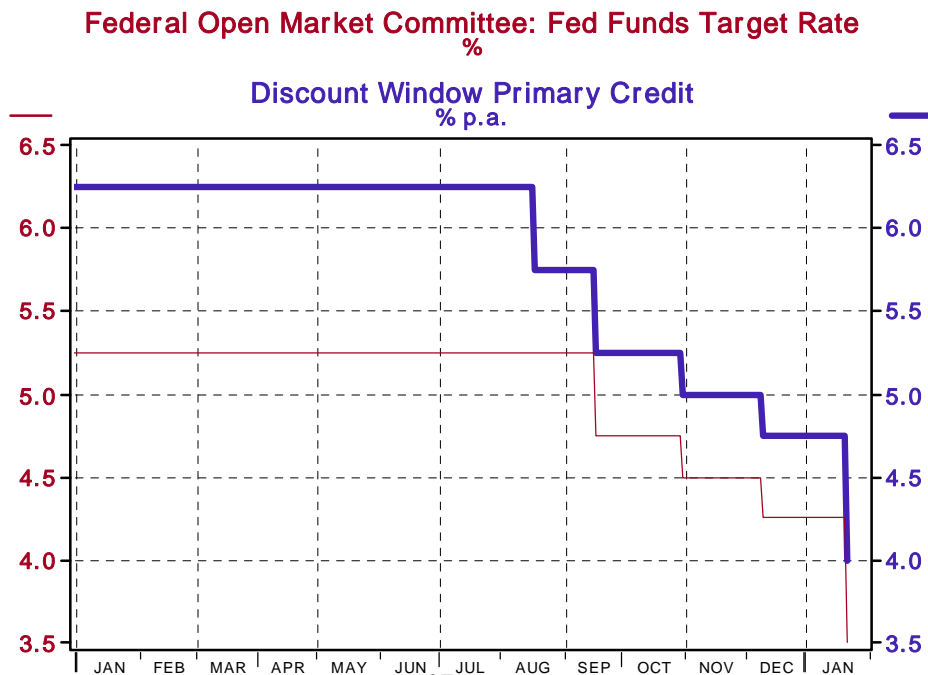
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**Central Bank Policies**

The past week has been another week of rapid changes in financial markets. In a surprise inter-meeting move, the FOMC lowered the federal funds rate and discount rate 75 bps to 3.50% and 4.00%, respectively, on January 22, 2008.

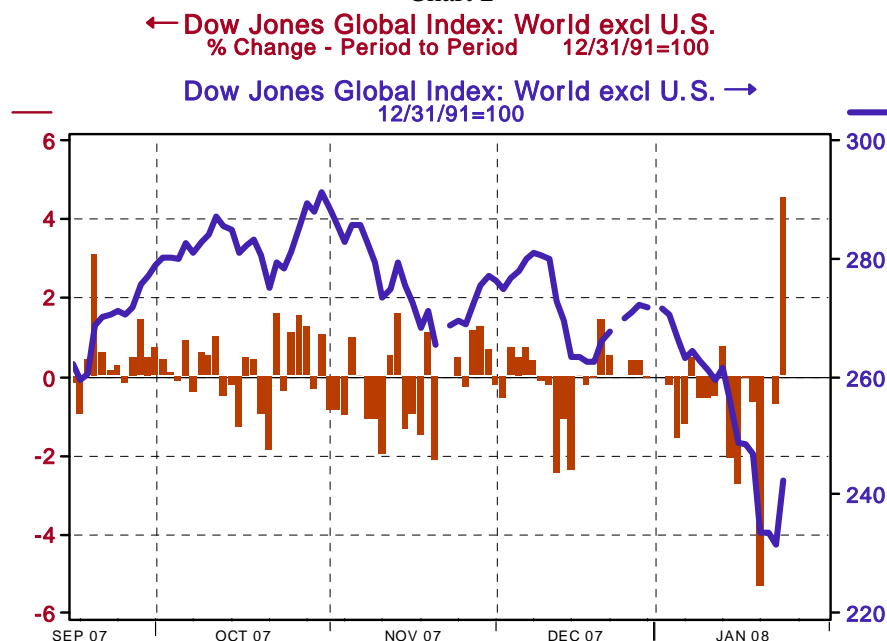
Chart 1



Source: Federal Reserve Board /Haver Analytics

The statement noted that (1) “weakening economic outlook and increasing downside risks to growth,” (2) “deepening of the housing contraction”, and (3) “some softening of labor markets” were reasons for the easing of monetary policy. The statement did not mention equity markets explicitly but cited that “broader financial market conditions have continued to deteriorate and credit has tightened further for some businesses and households.” The U.S. markets were closed on January 21, the sharp drop in global equity prices of January 21 continued into January 22, and the futures markets in the U.S. were pointing to a likely sharp decline in equity prices before markets opened in the U.S. The unexpected significant declines in equity prices appear to have played a role in the surprise action of the FOMC. The impact from the unwinding of positions at Societe Generale on equity markets remains unclear.

Chart 2



Source: Wall Street Journal /Haver Analytics

**Table 1 Change in Equity Prices**

	World ex U.S. Dow Jones Index	S&P 500	Dow Jones 30 industrials
Peak	291.11	1565.15	14164.53
Dec. 31, 2007	271.84	1468.36	13264.82
Jan. 22, 2008*	233.56	1310.91	11991.13
Jan. 23, 2008	231.73	1338.60	12270.17
Jan. 24, 2008	242.31	1352.07	12378.61
YTD Change on 1/22/08*	-14.08%	-10.72%	-9.60%
Change from Peak on 1/22/08*	-19.77%	-16.24%	-15.34%
YTD Change on 1/24/08	-10.86%	-7.92%	-6.68%
Change from Peak on 1/24/08	-16.8%	-13.6%	-12.6%

\* - As of 2:00PM CT. The Dow Jones World ex US index peaked on October 31, 2007 and the S&P 500 and Dow Jones 30 peaked on October 9, 2007.

The voting record for the cut in the federal funds rate shows that the new rotating schedule for voting Fed Presidents of the FOMC was not in place at the meeting on January 22. Among the 2007 voting members of the FOMC, President Poole of the Federal Reserve Bank of St. Louis dissented and would have preferred to cut at the January 29-30 FOMC meeting.

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Governor Mishkin was absent and did not vote. Fed President Hoenig, a reputed hawk, voted in favor of a cut in the federal funds rate. Bernanke, Timothy F. Geithner, Charles L. Evans, Donald L. Kohn, Kevin Warsh, Randall S. Kroszner, and Eric S. Rosengren were the other members of the FOMC in favor of lowering the funds rate. The Federal Reserve Banks of Chicago and Minneapolis requested the 75 bps cut in the discount rate.

Further easing of monetary policy is on the table, but the magnitude and timing is less clear. We suspect policy discussions at the January 29-30 will be quite contentious given that President Poole dissented. Two new members of the FOMC -- Presidents Fisher and Plosser -- are classified as hawks. In addition, a fiscal policy stimulus package is under active consideration. There could be a preference to wait until the March 18 FOMC meeting to assess the impact of the monetary and fiscal policy easing put in place. The futures market has priced a 50 bps cut for the January 30 meeting, although the odds are smaller today compared with the movements soon after the surprise move on January 22. We maintain that the most likely case is for the Fed to hold at the January 30 FOMC meeting, with a small risk of a cut in the federal funds rate.

The policy statement indicated that the inflation concern was downgraded a few notches. In today's statement, the FOMC noted that it *"expects inflation to moderate in coming quarters, but it will be necessary to continue to monitor inflation developments carefully."* By contrast, the December 11 statement ran as follows: *"Readings on core inflation have improved modestly this year, but elevated energy and commodity prices, among other factors, may put upward pressure on inflation. In this context, the Committee judges that some inflation risks remain, and it will continue to monitor inflation developments carefully."*

The main conclusion from these actions is that the FOMC was already on a course of easing monetary policy to address the significant weakness of the U.S. economy and it perceived a significant market correction as an additional destabilizing force that is unnecessary at this juncture. From table 1 it is reasonable to conclude that equity markets responded in the desired direction. If history is a guide, the Fed has made similar moves on other occasions of crisis. The actions taken with regard to Long Term Capital Management issue and the easing put in place after the October 19, 1987 crash in equity prices are recent examples. Fiscal policy measures to stimulate economic activity were enacted in 2001 when households received \$300 - \$600 rebates. Therefore, the policy actions being put in place now are not setting a precedent.

Overseas, the **European Central Bank** (ECB) has maintained a hawkish stance. President Trichet noted that "in demanding times of significant market correction and turbulences, it is the responsibility of the central bank to solidly anchor inflation expectations to avoid additional volatility in already highly volatile markets." Trichet also indicated that the ECB will stick by its base case which has downside risks to the forecast already as part of the scenario. He mentioned that the ECB will be watching the real economy carefully to infer the inflationary implications.

The **Bank of Canada** lowered the policy rate 25 bps to 4.00% shortly after the Federal Reserve lowered its rate by 75 basis points on January 22. The **Bank of England** is widely expected to ease monetary policy at the February 6-7 meeting, bringing down the base rate to 5.25% from 5.50%. The **Bank of Japan** left the policy rate unchanged, as with their

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assessment of the economy. Given the recent developments in global financial markets, the Bank of Japan is probably on hold for several months.

## Existing Home Sales – December 2007

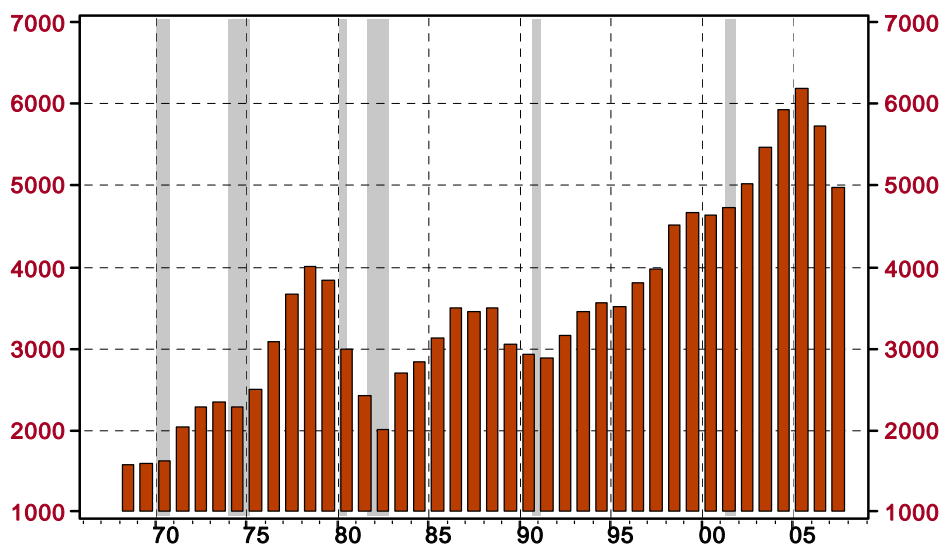
### First Annual Drop in Median Home Price on Record

Sales of all existing homes fell 2.2% to 4.89 million units in December. In 2007, sales of all existing homes dropped 12.8%. Sales of existing single-family homes declined 2.0% to an annual rate of 4.31 million units. In 2007, sales of existing single-family homes fell 13.0%, close to the drop recorded in 1989 and the largest annual decline since 1982. On a regional basis, sales of existing homes dropped in all regions of the nation, with the 19.5% drop in the West leading the group; sales of existing homes fell 12.8% in the South, 10.2% in the Midwest, and 8.3% in the Northeast.

Chart 4

### Existing 1-Family Home Sales: United States

SAAR, Thous

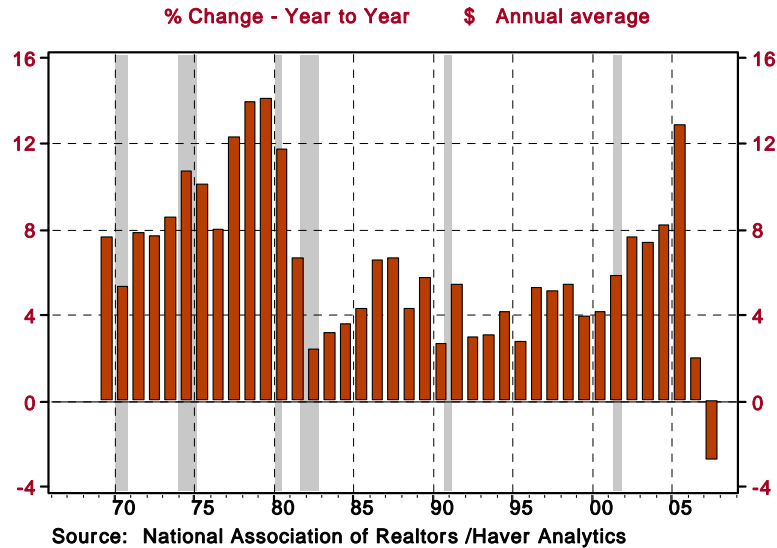


Source: National Association of Realtors /Haver Analytics

The median price of an existing single-family home declined 0.4% to 206,550 in December. On an annual basis, the median price of an existing single-family home has fallen 2.8% in 2007, the first decline in the median price of an existing single-family home since record keeping began for this series in 1968.

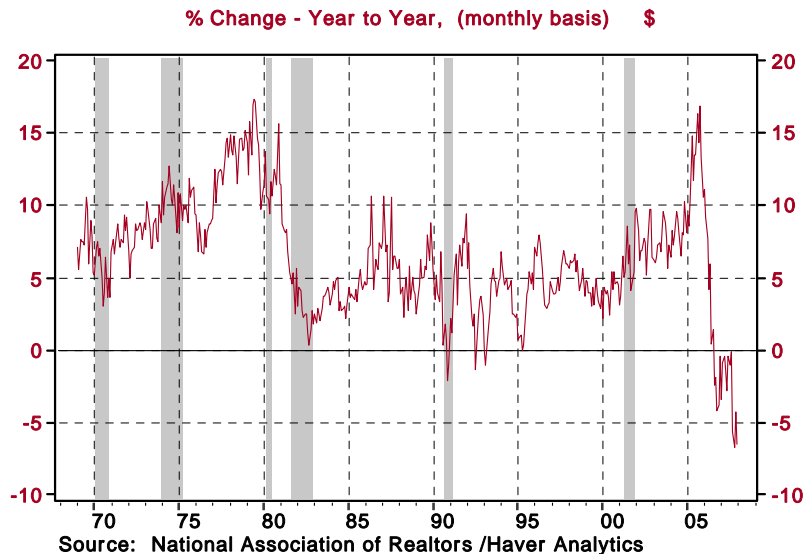
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Chart 5  
**NAR Median Sales Price: Existing 1-Family Homes, United States**



On a year-to-year basis, the median price of an existing single-family home fell 6.5% in December, the second largest drop on record, with the 6.7% year-to-year drop in October 2007 holding the record for the largest decline (see chart 6).

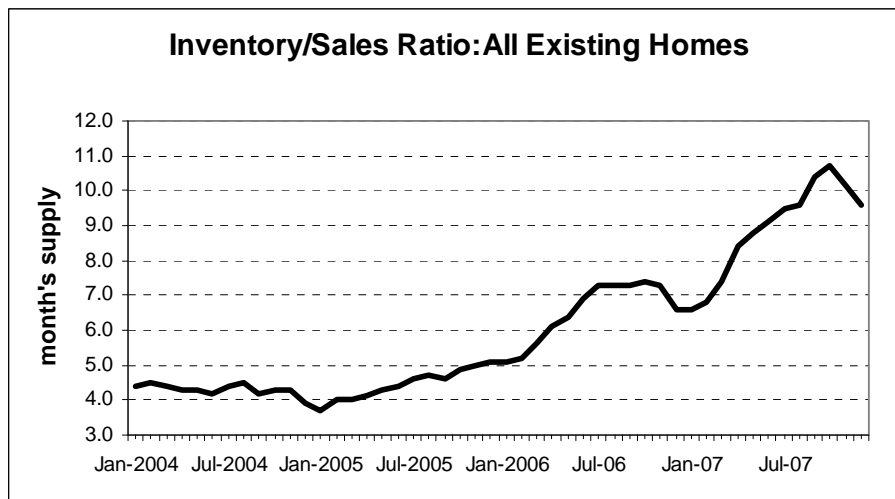
Chart 6  
**NAR Median Sales Price: Existing 1-Family Homes, United States**



The inventory of unsold existing homes fell to a 9.6-month supply from 10.1-month supply in November. The high level of inventories suggests that additional price declines in 2008 are likely. Unlike the market of new homes, sellers of existing homes can remove signs and postpone sales, which is probably what is occurring.

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Chart 7



### Jobless Claims

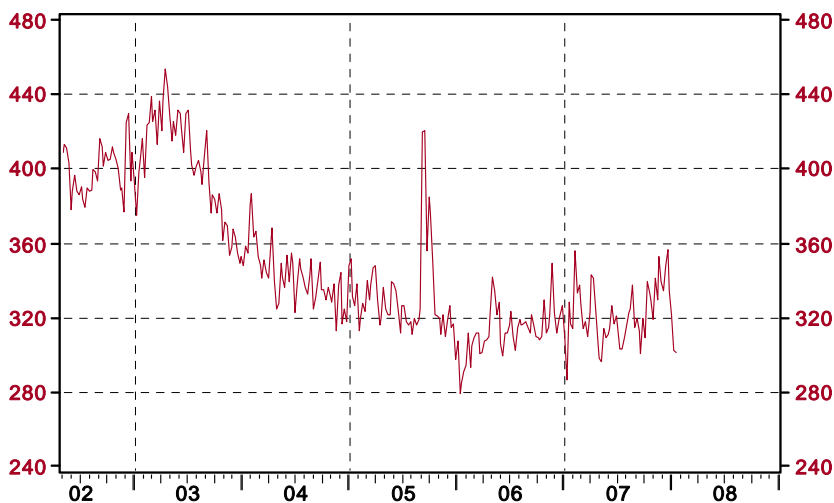
#### Initial Jobless Claims Stall, Underlying Trend of Continuing Claims Closer to Reality

Initial jobless claims declined 1,000 to 301,000 during the week ended January 19. Initial jobless claims are down 56,000 from the week ended January 14. This downward trend is sending signals that are contrary to the message from all other labor market reports.

Chart 8

#### Unemployment Insurance: Initial Claims, State Programs

SA, Thous



Source: Department of Labor /Haver Analytics

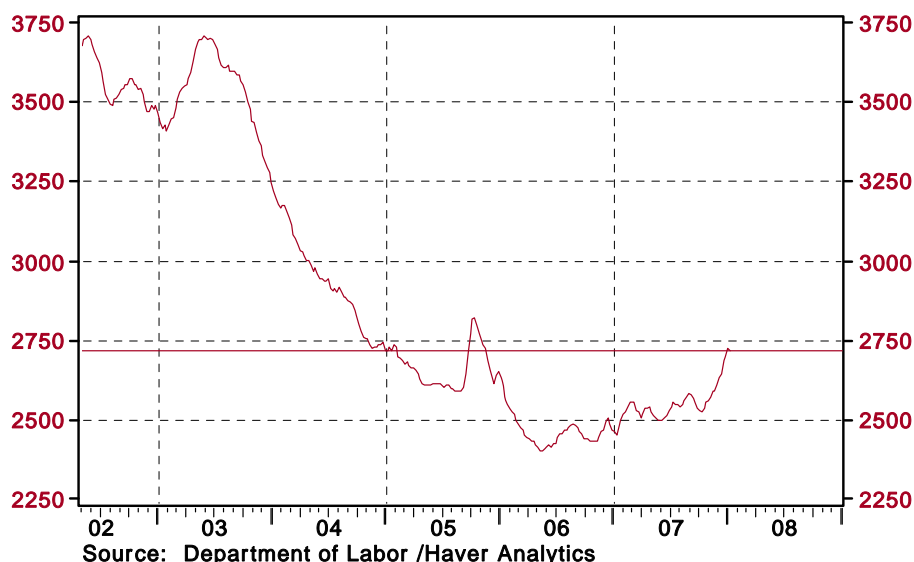
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The upward trend of continuing claims is consistent with messages from other labor market data. Although during the week ended January 12, continuing claims fell 75,000 to 2.672 million, the four-week moving average is at the highest level since late-2005 (see chart 9). The insured unemployment rate (2.0%) has switched between 2.0% and 2.1% in the last four weeks.

Chart 9

**Continuing Claims: 4-Week Moving Average**

SA, Thous



**Highlights for Next Week – FOMC Meeting January 29 and 30**

1. **New Home Sales** [Jan. 28] – Sales of new homes are predicted to have dropped 5.0% in December to 645,000. Sales of new homes have declined 53.4% from their peak in July 2005. On a year-to-year basis, sales have dropped 35.2% from a year ago. **Consensus:** 645,000 vs. 647,000 million in November.
2. **Durable Goods Orders** [Jan. 29] – Durable goods orders are predicted to have risen in December (+0.4%) after a 0.1% increase in the prior month. In particular, orders of aircraft may have dropped and that of defense items risen, reversing the performance seen in November. **Consensus:** +1.6% vs. +0.1% in November
3. **Real GDP** [Jan. 30] – Real gross domestic product is expected to have risen 1.2% in the fourth quarter. Positive contributions from consumer spending, non-residential fixed investment, and exports are expected to be partly offset by a large drop in residential investment expenditures. **Consensus:** 1.2%

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4. **Personal Income and Spending** [Jan. 31] – The earnings and payroll numbers for December suggest a 0.3% increase in personal income. Auto sales posted a small increase in December, while non-auto retail sales were weak. Both of these suggest soft overall consumer spending (+0.1%). **Consensus:** Personal income +0.4%, consumer spending +0.1%
5. **Employment Situation** [Feb. 1] – Payroll employment in January is expected to show tepid gains (+25,000) after an 18,000 gain in December. Private sector payrolls fell 13,000 in the December, the first since June 2003. This report will be watched closely to evaluate the underlying fundamentals of the labor market. The jobless rate is predicted to have risen to 5.1%. **Consensus: Payrolls +58,000 vs. +18,000 in December, unemployment rate – 4.9%**
6. **ISM Manufacturing Survey** [Feb. 1] – The consensus for the manufacturing ISM composite index is 47.0, after a 47.7 reading in December. **Consensus: 50.3 from 50.8**

**Other reports** – Case-Shiller Price Index, Consumer Confidence Index [Jan. 29], Chicago Purchasing Managers' Index, Employment Cost Index [Jan. 31], Construction Spending and auto sales [Feb. 1].

## Key Interest Rates

	1/25/2008 14:23	1-wk. change, bps	4-wk. change, bps	1-yr. change, bps
3-month Libor	3.31	-58	-142	-205
2-year U.S. Treasury note yield	2.20	-16	-92	-279
10-year U.S. Treasury note yield	3.58	-8	-53	-130

## Global Economic Data

	Real GDP		CPI		Unemployment Rate		Central Bank Rate			
	SAAR, yoy %		NSA, yoy%		%	year-ago	%	year-ago		
United States	2.8	Q3-07	4.1	Nov-07	5.0	Dec-07	4.4	4.25	Nov-07	5.25
Euro-Area	2.7	Q3-07	3.1	Nov-07	7.2	Nov-07	7.9	4.00	Dec-07	3.50
Japan	2.0	Q3-07	0.7	Nov-07	3.8	Nov-07	4.0	0.50	Dec-07	0.25
UK	3.3	Q3-07	2.1	Nov-07	2.5	Dec-07	2.9	5.50	Dec-07	5.00
Australia	4.3	Q3-07	3.0	Q3-07	4.3	Dec-07	4.6	6.75	Dec-07	6.25
Canada	2.9	Q3-07	2.4	Nov-07	5.9	Dec-07	6.1	4.25	Dec-07	4.25
China	11.2	Q4-07	7.0	Nov-07	4.0	Q4-07	4.1	1.89	Dec-07	1.90
India	8.9	Q3-07	5.5	Nov-07	--	--	--	6.00	Dec-07	6.00
New Zealand	3.4	Q3-07	3.2	Q3-07	3.5	Q3-07	3.6	8.25	Dec-07	7.25
Norway	3.4	Q3-07	2.8	Nov-07	2.5	Q3-07	4.5	5.25	Dec-07	3.50
Singapore	8.9	Q3-07	4.4	Nov-07	1.7	Q3-07	2.6	0.98	Dec-07	3.32
South Korea	5.7	Q3-07	3.6	Dec-07	3.1	Dec-07	3.3	5.00	Dec-07	4.50
Sweden	2.6	Q3-07	3.5	Nov-07	5.6	Nov-07	6.4	4.00	Dec-07	3.00
Switzerland	2.8	Q3-07	2.0	Dec-07	2.6	Dec-07	3.1	2.76	Dec-07	2.10
Taiwan	7.0	Q3-07	3.2	Nov-07	4.0	Dec-07	3.9	3.38	Dec-07	2.75
Thailand	4.9	Q3-07	3.2	Dec-07	1.5	Nov-07	1.6	3.75	Dec-07	6.50

\* UK - Claimant Count Unemployment Rate  
\* Thailand - GDP Non-Seasonally Adjusted  
\* EA-13, UK, Sweden - Harmonized Unemployment

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## Historical US Economic Data

	Dec-07	Nov-07	Oct-07	Sep-07	Aug-07	Jul-07	Jun-07	May-07	Apr-07	Mar-07	Feb-07	Jan-07
Payroll Employment (000)	18	115	159	44	93	93	69	188	122	175	90	162
% Change, Year Ago *	1.0	1.1	1.2	1.1	1.3	1.3	1.4	1.5	1.4	1.4	1.5	1.6
Unemployment Rate (%)	5.0	4.7	4.8	4.7	4.7	4.7	4.6	4.5	4.5	4.4	4.5	4.6
Avg. Hourly Earnings (% Chg.)	0.4	0.4	0.2	0.2	0.3	0.3	0.5	0.4	0.2	0.3	0.4	0.2
% Change, Year Ago	3.7	3.8	3.7	3.9	3.9	3.9	4.0	4.0	3.7	4.0	4.1	4.1
PPI (% Chg.)	-0.1	3.2	0.1	1.0	-1.4	0.7	0.1	0.7	0.9	1.0	1.2	-0.6
% Change, Year Ago *	6.3	7.2	6.1	4.4	2.3	4.2	3.3	3.9	3.2	3.1	2.4	0.1
CPI (% Chg.)	0.3	0.8	0.3	0.3	-0.1	0.1	0.2	0.7	0.4	0.6	0.4	0.2
% Change, Year Ago *	4.1	4.3	3.5	2.8	2.0	2.4	2.7	2.7	2.6	2.8	2.4	2.1
ISM Diffusion Index (%)	47.7	50.8	50.9	52.0	52.9	53.8	56.0	55.0	54.7	50.9	52.3	49.3
Industrial Production (% Chg.)	0.0	0.3	-0.5	0.1	-0.1	0.6	0.5	-0.1	0.6	-0.1	0.8	-0.5
% Change, Year Ago	1.5	2.2	1.5	1.8	1.4	1.7	1.5	1.9	1.9	2.2	2.9	2.4
Capacity Utilization (%)	81.4	81.6	81.4	81.9	82.0	82.2	81.8	81.5	81.7	81.4	81.6	81.1
Nondefense Cap. Goods ex Aircraft												
- Orders (% Chg.)		-0.1	-3.0	1.4	0.1	0.9	-0.2	-1.5	2.0	4.6	-2.4	-4.4
% Change, Year Ago *		-2.4	-1.3	-4.6	-0.9	-0.7	-3.2	-1.6	2.9	-3.3	-3.0	-0.7
- Shipments (% Chg.)		0.2	-1.2	1.8	1.9	0.0	-0.8	0.7	0.9	1.6	0.6	-4.2
% Change, Year Ago *		1.6	3.2	0.8	0.0	-1.2	-1.6	-0.9	0.4	-2.3	-1.3	-1.8
Retail Sales (% Chg.)	-0.4	1.0	0.0	0.8	0.1	0.6	-0.8	1.6	-0.3	1.0	0.6	-0.2
% Change, Year Ago	3.2	6.5	6.3	2.7	4.0	3.6	3.5	5.6	2.8	4.3	3.8	4.1
Real Personal Consumption (% Chg.)		0.5	0.1	0.2	0.4	0.3	0.1	0.1	0.3	-0.2	0.3	0.4
% Change, Year Ago		3.0	2.7	3.2	3.2	2.5	2.9	2.9	3.0	3.0	3.2	3.4
Personal Income (% Chg.)		0.4	0.2	0.5	0.5	0.6	0.4	0.4	-0.3	0.8	0.8	0.9
% Change, Year Ago		6.1	6.1	6.5	6.5	6.4	5.9	6.3	6.0	6.8	6.3	5.8
New Home Sales (SAAR, mn)		0.65	0.71	0.70	0.70	0.80	0.80	0.86	0.91	0.83	0.84	0.89
% Change, Year Ago *		-35.2	-25.7	-32.5	-31.8	-18.1	-25.5	-22.5	-17.0	-25.9	-22.7	-25.8
Existing Home Sales (SAAR, mn)	4.89	5.00	4.98	5.03	5.48	5.75	5.76	5.98	6.01	6.15	6.68	6.44
% Change, Year Ago *	-23.2	-17.8	-18.7	-22.5	-12.1	-6.1	-13.4	-10.1	-8.0	-12.6	-3.7	-3.2
Housing Starts (SAAR, mn)	1.01	1.17	1.27	1.18	1.35	1.37	1.47	1.44	1.49	1.49	1.49	1.40
% Change, Year Ago *	-38.8	-24.0	-11.9	-32.4	-17.4	-20.5	-19.0	-28.2	-15.5	-25.4	-28.9	-37.9
International Trade (Bils \$)		-63.1	-57.8	-57.1	-57.0	-59.1	-59.6	-59.9	-58.9	-62.7	-57.9	-57.0
	<b>Q4-07</b>	<b>Q3-07</b>	<b>Q2-07</b>	<b>Q1-07</b>	<b>Q4-06</b>	<b>Q3-06</b>	<b>Q2-06</b>	<b>Q1-06</b>	<b>Q4-05</b>	<b>Q3-05</b>	<b>Q2-05</b>	<b>Q1-05</b>
Real GDP, Chain Weighted, SAAR		4.9	3.8	0.6	2.1	1.1	2.4	4.8	1.2	4.5	2.8	3.1
% Change, Year Ago		2.8	1.9	1.5	2.6	2.4	3.2	3.3	2.9	3.2	3.0	3.2
Chain-Weighted Price Index, SAAR		1.0	2.6	4.2	1.7	2.4	3.5	3.4	3.5	3.5	2.6	3.9
% Change, Year Ago		2.4	2.7	2.9	2.7	3.2	3.5	3.2	3.4	3.3	3.0	3.3
Nominal GDP, SAAR		6.0	6.6	4.9	3.8	3.4	6.0	8.4	4.8	8.1	5.5	7.1
% Change, Year Ago		5.3	4.7	4.5	5.4	5.6	6.8	6.7	6.3	6.6	6.1	6.6
Employment Cost Index (%)		0.8	0.9	0.8	0.9	0.9	0.9	0.6	0.8	0.7	0.6	1.0
% Change, Year Ago		3.3	3.3	3.5	3.3	3.3	3.0	2.8	3.1	3.0	3.2	3.6
Productivity Nonfarm, SAAR		6.3	2.2	0.7	1.8	-1.6	0.8	2.5	-1.4	4.4	0.3	3.7
% Change, Year Ago		2.7	0.7	0.4	0.9	0.1	1.5	1.4	1.7	2.2	1.4	2.5
Unit Labor Costs, Nonfarm, SAAR		-2.0	-1.1	5.2	10.3	2.9	-1.0	4.6	4.1	1.3	1.2	-0.1
% Change, Year Ago		3.0	4.2	4.3	4.1	2.6	2.2	2.8	1.6	1.7	2.5	2.3

Source: Haver Analytics

\* NSA

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