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CAPITAL CONNECTIONS
Economic Supplement

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Fed Keeps Rate Low to Let Recovery Gain Momentum

The benchmark U.S. lending rate remains at a 40-year low, making it easier for consumers to buy cars and houses, and for companies to invest. Central bankers voted unanimously to keep the overnight bank-lending rate at 1.75 percent, when they met last on May 7, 2002.

The Fed's policy-setting Open Market Committee indicated at the time that the economy is just getting back on its feet after a recession that started in March of last year. It was the third time in a row the Fed has held rates steady after 11 reductions in 2001.

The FOMC used almost identical language after its last two meetings when it declined to raise the overnight rate, saying the economy needed more time to recover. In a statement announcing its May decision, the Fed stated that the prospect of growth through the next quarter was uncertain. Economists believe the Fed's statement suggests the first rate increase will not happen before the September FOMC meeting—leaving rates unchanged at the meetings in June and August. Investors began to reach a similar conclusion based on trading in federal funds futures contracts.

Economy Strengthens while Jobless Rate Climbs Higher

The U.S. economy may face a "jobless recovery" similar to the period following the 1990-91 recession when unemployment rose for more than a year after the economic rebound began, said Robert McTeer, president of the Federal Reserve Bank of Dallas. Unemployment may rise above April's 6 percent rate before it starts to decline, McTeer told the Montreal Economic Institute.

Companies have deferred hiring until a steady growth in profits is assured. The number of Americans collecting jobless benefits rose for a fifth straight week, at the end of May, to a 19-year high of 3.89 million. The unemployment rate probably rose to 6.1 percent this month, according to the median of 26 forecasts in a Bloomberg News survey.

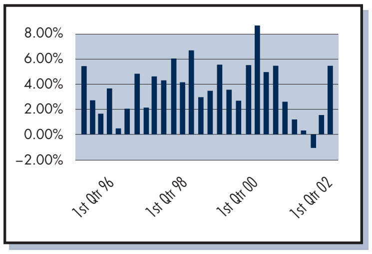
A 0.5 percent rise in the consumer price index for April was a "little disconcerting," according to McTeer, but that was only for one month and mostly energy related. Gains in worker productivity are likely to boost economic growth and corporate profits during the current recovery—holding inflation in check.

Key Interest Rates

On May 30, 2002

FEDERAL FUNDS RATE	3-MONTH LIBOR	BANK PRIME RATE
1.75%	1.8975%	4.75%

GROSS DOMESTIC PRODUCT *On May 24, 2002*

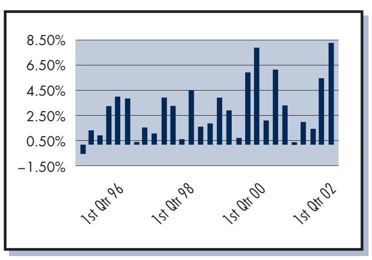


- The U.S. economy expanded at a 5.6 percent annual rate during the first quarter. That was less than previously estimated and may be followed by a slower pace of growth this year, according to a Bloomberg News report.
- The Commerce Department's revision of the GDP posting, from 5.8 percent reported a month ago, reflected less consumer and government spending and a larger decline in business investment than estimated.
- Since first-quarter growth was faster than the 1.7 percent pace in the final quarter of 2001, economists remain confident the economy is out of a 15-month recession.

GDP INFLATION MEASURES *On May 28, 2002*

- The personal consumption expenditure (PCE) price index rose at a slower-than-expected annual rate of 0.5 percent in April, following a 0.3 percent increase in March.
- According to Bloomberg News, the PCE report is the latest to suggest that consumers may provide less support to the economy as the year progresses.

U.S. PRODUCTIVITY *Due May 31, 2002*



- U.S. productivity grew during the first quarter at the fastest pace in almost two decades as companies kept payrolls lean while making goods in a recovering economy.
- The Labor Department's measure of how much an employee produces for every hour of work rose at a revised 8.4 percent annual rate from January to March 2002.
- While down from the 8.6 percent initially estimated, it was the fastest since mid-1983 and up from a 5.5 percent increase in the final three months of 2001.
- Companies reduced worker hours for the fourth straight quarter to boost productivity, which helps determine how fast the economy can expand without triggering inflation.

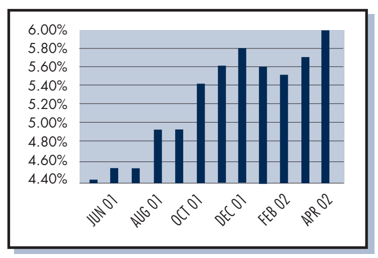
TRADE DEFICIT *On May 17, 2002*

The U.S. trade deficit unexpectedly narrowed in March as exports rose faster than imports and global demand for capital goods increased, signs of an improving global economy. The $31.6 billion excess in imports over exports of goods and services followed a $31.8 billion gap in February, according to the Commerce Department.

Labor Market: Unemployment Expected to Climb

The unemployment rate for May is expected to be 6.1 percent when it is released June 7, according to economists. The rate unexpectedly shot up to 6.0 percent in April, reiterating beliefs that the economic recovery remains fairly weak. Still, many economists project unemployment to climb even higher, claiming employment recovery usually lags behind an economic turnaround by several months. Employers are reluctant to add new jobs until they are sure a rebound is under way.

EMPLOYMENT REPORT *On May 3, 2002*



- Unemployment increased to 6 percent in April, the highest point in nearly eight years, even as U.S. companies added jobs for the first time in nine months.
- Economists are expecting a 6.1 percent unemployment rate for May, due out June 7.
- Analysts were expecting unemployment to come in at 5.8 percent in April with 60,000 new jobs created. The unemployment rate was 5.7 percent in March.

EMPLOYMENT COST INDEX *On April 25, 2002*

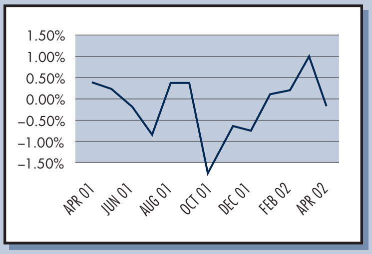
- The first-quarter employment cost index, the government's best measure of how workers are compensated, rose 0.8 percent in Q1 of this year. This was the slowest quarterly reading since the first quarter of 1999.
- Wages and salaries increased 1.0 percent during the final quarter of 2001, identical to the change in Q3.
- This could contain potentially good news for the broad economy as the lack of wage pressure provides relief for corporations, allowing executives to authorize more capital expenditure.

Inflation: More Mixed Results

Producer prices unexpectedly fell while consumer prices rose in April. Given the conflicting economic results, analysts often put more emphasis on the PPI index because it has proven to be a better signal of future economic activity than changes in the CPI.

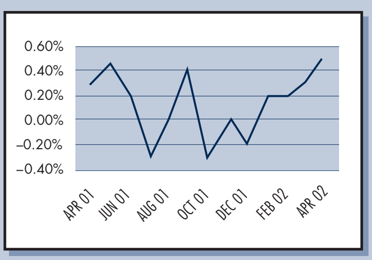
The subdued inflation outlook will hopefully allow the Fed to not be as aggressive in raising short-term interest rates. Inflation, for the most part, has been contained while productivity continues to be strong.

PRODUCER PRICE INDEX *On April 12, 2002*



- U.S. producer prices unexpectedly fell in April as food costs showed the biggest decline in almost three decades and sluggish consumer spending kept a lid on clothing and computer prices.
- The 0.2 percent drop in the index of prices paid to factories, farmers and other producers followed a 1 percent gain in March, the Labor Department said. Excluding food and energy, wholesale prices rose 0.1 percent, the 11th straight reading of that size or smaller.
- Economists had expected a 0.4 percent increase in producer prices, based on the median of 61 forecasts in a Bloomberg News survey. They had also projected a 0.1 percent gain in prices excluding food and energy.

CONSUMER PRICE INDEX *On May 15, 2002*



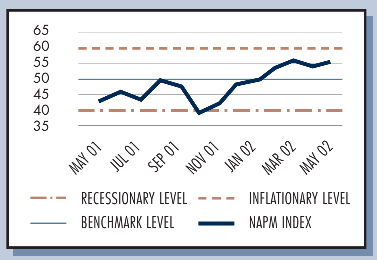
- U.S. consumer prices rose more in April than at any time in the last 11 months, reflecting higher energy costs and the biggest jump in tobacco in more than two years, government figures showed.
- Economists surveyed by Bloomberg News expected a 0.4 percent April increase in the CPI. The increase was the largest since a 0.5 percent rise in May 2001.
- Excluding the surge in tobacco prices, the core rate rose 0.2 percent, suggesting inflation is tame.
- So far this year, the CPI is running at a 3.8 percent annual pace, compared with a 3.5 percent rate in the same period last year. Core inflation is running at a 2.4 percent rate increase, down from 3.0 percent during the first four months of last year.

Industrial Sector: Manufacturing Expands Rapidly

Last month's manufacturing index, the Institute for Supply Management's factory index, was the highest in more than two years and, for the fourth straight period, greater than 50 at 55.7—indicating ongoing expansion. The group's measures of new orders and production rose, and factories reported the strongest demand for exports since May 2000.

Consumer spending has helped factories rebound from an 18-month slump that started in August 2000. One reason for a continued rise in demand is new homes sales, which may have their second-best year in 2002. Spending on residential construction in the United States rose to a record in April, according to the Commerce Department.

THE INSTITUTE FOR SUPPLY MANAGEMENT'S FACTORY INDEX *On June 1, 2002*



- U.S. manufacturing grew in May at the fastest pace in more that two years, as increases in production and orders at home and overseas buttressed the economy's recovery from recession.
- The Institute for Supply Management's factory index rose to 55.7 in May from 53.9 in April—beating analyst's expectations.
- Analysts had expected an index reading of 54.7, based on the median of 60 forecasts in a Bloomberg News survey.
- Last month's index was the highest in more than two years and the fourth straight time it was larger than 50, which indicates expansion.
- Industrial production (5/15), rose by 0.4 percent in April—marking four straight months of gains. The numbers were bolstered by a jump in auto manufacturing. Vehicle discounts helped limit a rise in consumer prices, suggesting inflation currently does not threaten the economy's rebound.
- Capacity utilization (5/15), which measures the extent to which capital stock in the production of goods is being used in the economy, rose in April to 75.5 percent—the highest posting in seven months. Capacity utilization was measured at a revised 75.3 percent in March.

- Orders for durable goods (5/23), big-ticket items such as cars, appliances and other goods meant to last three years or longer, increased by 1.1 percent in April. The gain was double what economists had expected and followed a 0.2 percent rise in March, according to the Commerce Department.
- Factory orders (5/31): Orders at U.S. factories rose for a fifth straight month in April, and orders in the industrial Midwest in particular suggest even faster growth for the manufacturing sector. Higher demand for automobiles, machinery, steel and clothing contributed to a 1.2 percent increase in April, following a 1 percent increase in March.
- Construction spending (6/3) rose by 0.2 percent during April—from a 1.2 percent drop in March. The numbers were boosted by record outlays on housing that may keep supporting the economic recovery in 2002. The increase brought the total value of work on projects such as houses, highways and factories to an annual rate of $871.9 billion, according to the Commerce Department.

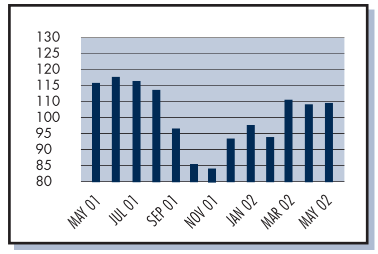
Housing: Historically High Despite Drop

The housing market remains resilient throughout this slow and sluggish, albeit, recovering economy. Both new and existing home sales rose in April, halting a short declining period this spring. A big drop in sales could cause serious problems for the economy, lowering consumer confidence and home values. Economists think it is unavoidable, however, that sales will level off this summer—bringing them more in line with typical numbers.

Meanwhile, housing starts fell significantly in April as expected, due to a correction in the stronger-than-expected winter numbers.

- Housing starts (5/16) fell 5.4 percent to a seasonally adjusted annual rate of 1.56 million units in April, the lowest level since October. Meanwhile, permits to build new units rose 0.3 percent, a promising indicator of future activity.
- Sales of existing family homes (5/28) surged 7 percent in April to a seasonally adjusted annual rate of 5.79 million units. That was the third-highest rate ever.
- New home sales (5/24) rose 1 percent to a seasonally adjusted annual rate of 915,000 units, showing continued resilience.

Consumer Sector: Confidence Rises, Spending Increases



Consumer confidence in the U.S. economy rose in May to their second-highest level since the September terrorist attacks, suggesting that spending will continue to drive the economy. The consumer confidence index increased to 109.8 this month from a revised 108.5 in April. May's reading is the highest since March 2002 and suggests that Americans are confident the economy will continue to improve. Economists had expected the index to rise to 110.0 this month, based on the median of 58 forecasts in a Bloomberg News survey.

The index, which tracks consumer expectations over the next six months, fell to 109.4 from 109.6 the previous month. The decrease in expectations suggests consumers do not believe the pace of economic growth will accelerate in the months ahead.

- Personal income (5/28) rose 0.3 percent in April after rising 0.5 percent in March. Consumers saved 2.8 percent of their disposable income in April after saving 3 percent in March.
- Personal consumption (spending) (5/28) data showed that shoppers are doing their part to help boost the economy. Consumer spending rose 0.5 percent in April following a 0.4 percent increase in March.
- Retail sales (5/14) increased 1.2 percent during the month of April, which was more than analysts had expected. Excluding volatile automobile sales, retail sales rose 1.0 percent in April compared with a 0.3 percent gain in March. Economists had expected the core rate to rise 0.7 percent.

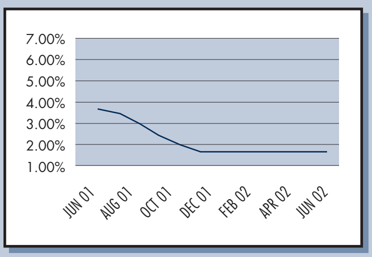
Looking Ahead: Continued Signs of Strength

Consumer spending, confidence, and personal income and consumption all indicate slight signs of improvement for the U.S. economy. The consumption outlook, however, continues to be mixed due to corporate cutbacks. Employment and wage growth will be weak, suggesting slow growth in income.

Several indicators with modest market-moving potential were released during the week of May 27 that continue to point toward sluggish economic growth during the upcoming summer months.

- Personal Income/Consumption (5/28) The consensus outlook is for income to rise 0.3 percent, just slightly below last month's 0.4 percent gain, and consumption to increase by 0.9 percent—its largest growth spurt since last October.
- Consumer Confidence (5/28) Confidence is expected to be slightly up in May from a forecasted 110 versus 108.8 in April. Negative news concerning potential terrorists attacks and the weak stock market continue to hurt consumer confidence.
- Factory Orders (5/31) Orders are expected to rise 1.0 percent in April, lead by further gains in non-durable goods orders.
- Chicago Purchasing Managers Index (5/31) PMI is expected to rise one point, to 56.0. The pace of manufacturing activity in the automobile-centered Chicago area has picked up slightly in May.
- FOMC Meeting (6/26) The Fed is expected to leave the Federal Funds rate unchanged at 1.75 percent with a neutral bias.

Eye on the Fed



The Fed is unlikely to raise interest rates until there are clear signs the recovery is in place. "The U.S, economy is growing at a slower pace than in the first quarter and unemployment may rise higher," said Robert McTeer, president of the Federal Reserve Bank of Dallas. "This means the Fed may wait quite some time before raising rates. The recovery that began in the fourth quarter of last year seems to be on track for now, but the momentum has weakened somewhat."

Since the economy continues to benefit from low inflation, the Fed is in no hurry to begin raising interest rates from their 40-year low. Productivity also grew in the first three months of 2002 at the fastest pace in almost two decades. Over the past six years, it has grown an average of 2.8 percent, almost double the rate of the preceding two decades.

UPCOMING FOMC MEETINGS	WALL STREET EXPECTATIONS	FED OUTLOOK	FORECASTED FED FUNDS RATE
June 26, 2002	No Change	Neutral	1.75
August 13, 2002	No Change	Neutral	1.75
Sept. 24, 2002	+25	Tightening	2.00

Treasury Focus

The yields on U.S. Treasuries fell in May due to increasingly negative economic data led by the rise in the unemployment rate. The largest move in Treasuries occurred in early May when better-than-expected corporate profits were released. The yield curve steepened over the course of the month as short-term rates saw a decrease, while long-term rates saw a slight increase. The yields on the two-year note fell 5 basis points, while the yield on the 30-year note rose 4 basis points. Investors sold off stock and bought government securities as growing political tension initiated a flight to quality.

Treasury Rates

MATURITY	SPOT RATES ON 5/3/2002	SPOT RATES ON 5/30/2002	SPREAD DIFFERENTIALS
2-Year	3.23%	3.18%	–5 Bp
5-Year	4.40%	4.34%	–6 Bp
10-Year	5.10%	5.05%	–5 Bp
30-Year	5.58%	5.62%	+4 Bp

MARKET MOVERS IN MAY

- Treasury yields rose as the government sold more debt in the first week of May than in any other week since November 1995. The government debt was sold to finance the widening budget deficit. The yield on the benchmark five-year note rose 14 basis points over the week.
- Treasuries had their biggest weekly drop in almost two months in the second week of May. The drop was due to better-than-expected reports from corporations, as well as positive economic data. The yield on the benchmark two-year note increased 20 basis points, while the overall curve rose an average of 17 basis points.
- Treasury yields fell in the third week of May as the recent warnings by Vice President Dick Cheney about terrorist attacks caused a flight to quality into U.S. debt securities. Yields further fell due to the release of unemployment data that revealed the U.S. labor market lacks clear signs of improvement.

Streetwatch: Wall Street Firms Forecast

Wall Street firms believe the economy will start to turn around in the third quarter of 2002 as many market indicators are starting to show signs of an economic recovery. On average, they predict a 3.6 percent annual growth rate by Q3 of 2002. Unemployment is expected to rise to around 6.1 percent by mid-year before beginning to fall in Q4 of 2002. Treasury yields also are expected to continue climbing throughout the year as investors sell off bonds and put their money to work in the equity markets. Analysts predict the Fed will begin raising the fed funds rate by the third quarter of this year when they will adopt a tightening bias throughout the remainder of 2002.

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Interest Rate Forecasts as Predicted by the Futures Market

On May 30, 2002

PERIOD	30-DAY FED FUNDS	2-YEAR T-NOTE	5-YEAR T-NOTE	10-YEAR T-NOTE	30-YEAR T-NOTE
Current	1.75%	3.18%	4.34%	5.05%	5.62%
Jun 02	1.77%	3.44%	4.40%	5.15%	5.84%
Sep 02	1.94%	3.80%	4.70%	5.32%	5.91%
Dec 02	2.47%	3.90%	4.75%	5.50%	5.99%

Energy Price Forecasts as Predicted by the Futures Market

On May 30, 2002

PERIOD	CRUDE OIL	HEATING OIL	HENRY HUB NATURAL GAS	PROPANE GAS
May 02	25.76	.6590	3.505	.3800
Jun 02	25.87	.6655	3.557	.3950
Jul 02	25.78	.6735	3.582	.4000
Aug 02	25.61	.6810	3.612	.4050
Sep 02	25.44	.6880	3.867	.4100
Oct 02	25.27	.6935	4.099	.4050

Stock Market Forecasts as Predicted by the Futures Market

On May 30, 2002

PERIOD	DOW JONES IND. AVG	NASDAQ 100	S&P
Current	9,886	1,622	1,065
Jun 02	9,890	1,213	1,064
Sep 02	9,890	1,224	1,064
Dec 02	9,905	1,230	1,071

CFC's finance experts can answer your questions about specific economic information. Contact:

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