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IN THIS ISSUE

Economic Supplement Editor
Beth Ann Johnson
703-709-2018
email: bjohnson@nrucfc.org

Fed Holds Rates Steady—Sights Bumpy Road Ahead

The Federal Reserve held the benchmark interest rate—the federal funds rate—steady and took a step toward lowering it for a 12th time in two years by indicating that the risks of an economic slowdown outweigh the threat of inflation. Central bankers left the benchmark overnight bank lending rate at a 41-year low of 1.75 percent and indicated the economy's recovery from recession is less assured than it was just a few months ago.

The U.S. economy's recovery will be driven by inventory restocking, household spending and rising productivity. The recovery will be "bumpy" for a time, according to Chicago Federal Reserve Bank President Michael Moskow. The Fed's interest-rate policy is currently "very accommodative and it is intentionally that way to help the economy move forward and expand more rapidly. Nevertheless, the Fed cannot—and should not—try to smooth out every bump," Moskow said.

Fed funds futures, a barometer of expectations for the direction of interest rates, currently indicate that investors do not anticipate the central bank will lower rates in the coming months. The October fed funds futures market has an implied yield of 1.73 percent. The Fed next meets on September 24; it is widely expected that the Federal Reserve will leave rates unchanged at 1.75 percent and maintain a neutral policy outlook.

Economic Growth Expected to Improve Modestly

The U.S. economy grew at a weak 1.1 percent annual rate from April through June, but that is expected to be the weakest quarter of the year, according to government figures. Meanwhile, corporate profits—after taxes—grew less than in the first quarter.

The economy is expected to grow at a 2.6 percent annual pace in the current quarter and by a 3 percent rate in the final three months of the year, according to the latest Blue Chip Economic Indicators survey.

The same survey also projects that the economy will grow an overall 2.3 percent this year.

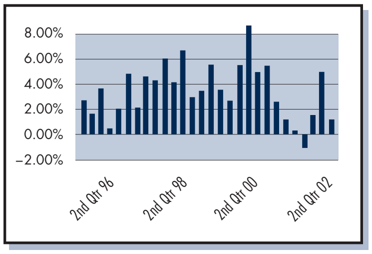
A better than expected rise in U.S. worker productivity in the second quarter has helped inflation remain subdued and may add to business expansion and investments going forward. Economists also expect slower economic growth to hold price pressure at bay. The U.S unemployment rate unexpectedly fell to 5.7 percent in August, the lowest it has been since March.

Key Interest Rates

On August 2, 2002

FEDERAL FUNDS RATE	3-MONTH LIBOR	BANK PRIME RATE
1.75%	1.80%	4.75%

GROSS DOMESTIC PRODUCT *On August 29, 2002*

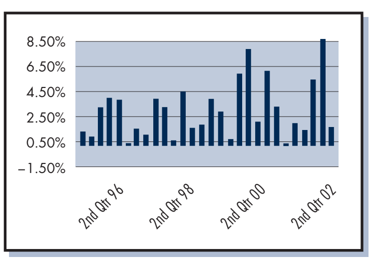


- The U.S. economy grew at a 1.1 percent annual rate from April through June, which may prove to be the weakest quarter of the year, government figures showed.
- The rate of increase in gross domestic product, the total value of all goods and services produced in the U.S., is the same as the Commerce Department expected last month.
- The economy expanded at a 5 percent rate in the first three months of 2002, when most economists say the recovery from recession began.

GDP INFLATION MEASURES *On August 29, 2002*

- The GDP price deflator rose at a 1.1 percent rate in the second quarter. That compares with a 1.2 percent pace of increase originally reported and a 1.3 percent rise in the first quarter.
- The relatively benign increase suggests inflation is under control, which helps growth because it boosts spending power.

U.S. PRODUCTIVITY *On August 5, 2002*

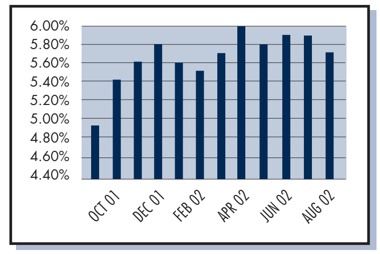


- The productivity of U.S. workers rose in the second quarter at a faster pace than previously reported, as output increased more than first estimated, a government report showed.
- The Labor Department's measure of how much work is performed by one person in an hour rose at a 1.5 percent annual pace from April to June, higher than the earlier estimate of a 1.1 percent surge in the first three months of the year.
- Economists had expected the government to report that productivity in the second quarter grew at a 1.1 percent annual rate, the same as previously reported, based on the median of 52 forecasts in a Bloomberg News survey.

TRADE DEFICIT *On August 29, 2002*

Imports rose by $77.9 billion in the second quarter, while exports rose by $30.3 billion. That left a trade deficit of $494.1 billion and subtracted 1.65 percentage points from growth. A trade deficit subtracts from GDP because it means Americans are satisfying demand by purchasing from abroad.

Labor Market: Unemployment Falls to 5.7%



The U.S unemployment rate unexpectedly fell to 5.7 percent in August, the lowest it has been since March. Companies added workers to their payroll for the fourth consecutive month, a sign that the majority of firings may be over. Payrolls increased by 39,000 last month, as jobs were added in health care, construction and the government. Surging consumer demand for cars and housing may help the economy grow twice as fast this quarter than it did in the second quarter of 2002. Companies are slowly adding to their workforce to help boost income growth. The unemployment rate was expected to rise to 6 percent.

EMPLOYMENT REPORT *On September 6, 2002*

- Average hourly earnings in August rose 0.3 percent, or 4 cents, following a 0.2 percent increase in July.
- Analysts were expecting payrolls to increase by 30,000 compared with the 39,000 reported. In July, employment grew a revised 67,000, about 10 times more than the government had initially estimated.

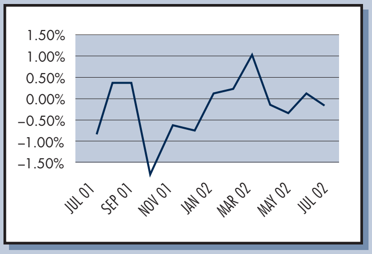
EMPLOYMENT COST INDEX *On July 25, 2002*

- The employment cost index, the government's best measure of how workers are compensated, rose 1.0 percent in the second quarter. This was faster than the 0.8 percent increase seen in the first quarter of 2002.
- Wages and salaries increased 1.0 percent during the second quarter of 2002, higher than the 0.8 percent rise seen in the first quarter.
- In the last 12 months, labor costs are 4 percent higher, compared with a 3.9 percent increase in the 12 months through June 2001.

Inflation: Under Control

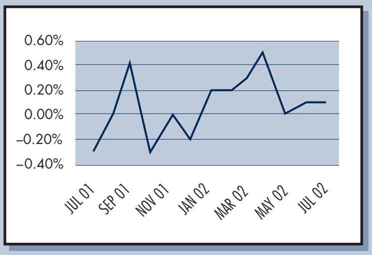
Once again July inflation numbers came in weaker than expected. Producer prices unexpectedly fell while consumer prices rose 0.1 percent, half of what economists were expecting. Economists agree that the slower economic growth we are experiencing will hold price pressure at bay. "We have an economic environment in which there's the virtual absence of price pressure," according to a senior economist at Morgan Stanley. With inflation tame, Federal Reserve policy makers are able to keep the benchmark interest rate at a four-decade low to ensure the economic recovery takes hold.

PRODUCER PRICE INDEX *On August 8, 2002*



- Producer prices fell 0.2% in July after a 0.1% increase in June. Economists were expecting a 0.1 percent rise in the index for July.
- The “core” index, which excludes the volatile food and energy sectors of the economy, declined 0.3 percent in July from the previous month. Analysts were expecting a 0.1 percent increase.
- The producer price index has fallen 1.1 percent for the twelve months that ended in July.

CONSUMER PRICE INDEX *On August 16, 2002*

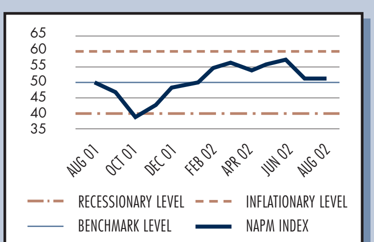


- Consumer prices rose 0.1 percent in July, matching June’s increase. Economists expected a 0.2 percent increase for July.
- Meanwhile, the “core” index, which excludes the volatile food and energy components, rose 0.2 percent in July. The index rose 0.1 percent in June. Wall Street had forecasted a 0.2 percent increase, matching expectations.
- Consumer prices are running at a 2.5 percent annual rate so far this year, compared with a 2.7 percent pace last year at this time.

Industrial Sector: Losing Momentum

As the economy continues to show signs of weakness, many economists point to lackluster business investment that is desperately needed for the economy’s recovery to be sustained. What little manufacturing that is taking place currently seems to come from consumer demand. Until businesses begin to invest, analysts do not expect to see robust manufacturing, which is a key driver for continued momentum.

THE INSTITUTE FOR SUPPLY MANAGEMENT’S FACTORY INDEX *On September 3, 2002*



- U.S. manufacturing stalled in August, as orders declined for the first time in nine months and production slowed, indicating that the economy’s recovery may be faltering.
- The Institute for Supply Management’s factory index held at 50.5 last month, less than expected and below the average 53.8 for the first seven months of this year.
- As of late, the only manufacturing growth occurring in the economy is coming from consumer demand. Economists and Federal Reserve policy makers say business investment is needed for the economy’s recovery to be sustained.
- Before the Institute’s report, the median of 48 forecasts in a Bloomberg News Survey was for a reading of 51.8. Even so, this month’s level of 50.5 was the seventh month the index has held above 50.0, the dividing line between expansion and contraction among manufacturers.
- Industrial Production (8/15), rose 0.2 percent in July, the slowest pace in three months, evidence that the economic recovery is faltering. Economists had expected no change in industrial production, based on the median of 60 forecasts in a Bloomberg News Survey, after a previously reported increase of 0.8 percent for June.
- Capacity Utilization (8/15), the amount of factory, mine and utility capacity in use, rose last month to 76.1 percent of capacity from 76 percent in June. Capacity utilization, while up, remains below the average 81.8 percent during the record economic expansion that occurred from March 1991 to March 2001.
- Orders for Durable Goods (8/27), rose more in July than at any time in the last nine months as demand increased for computers, cars and aircraft, government figures showed. Orders for big-ticket goods made to last at least three years surged 8.7 percent to $179.7 billion, the Commerce Department said. The increase was larger than expected and followed a revised 4.5 percent drop the previous month.
- Construction Spending (9/4), stalled in July, as companies reduced work on factories, offices and other nonresidential buildings, government figures showed. New construction in July was valued at $834.1 billion, the Commerce Department said. That followed a revised 1.7 percent decrease in June to $833.8 billion. Office vacancy rates have surged and the value of nonresidential buildings in July was the lowest since September 1996.
- Factory Orders (9/5), orders placed with U.S. factories rose more in July than at any time in the last nine months as demand increased for computers, cars and aircraft, government figures showed. Factory orders increased 4.7 percent last month to $327.6 billion following a revised 2.5 percent drop in June, the Commerce Department said. Excluding transportation equipment, orders rose 1.8 percent after a 1.8 decrease in June.

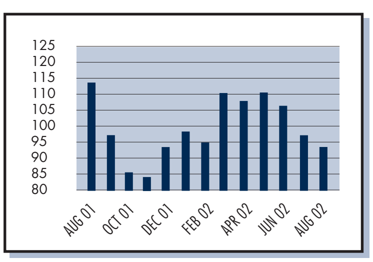
Housing: Expected to Remain Firm

The housing market continues to be the strength of the economy. Sales of existing and new homes both rose in July, as the housing market is poised to sell a record 6.36 million houses this year—surpassing the 6.21 million record in 2001. The strong housing market has been a major reason the economy is still showing signs of positive growth, as home sales often lead to purchases of furniture, appliances, and home improvement products.

Economists expect the housing market to remain strong, as there is no indication in the near term that mortgage rates will increase significantly. There is still concern that housing prices have been rising faster than is generally considered reasonable. Neverthereless, July's figures indicate that prices dropped slightly from June, indicating that home prices are leveling off.

- Housing Starts (8/16) fell for the second consecutive month, dropping 2.7 percent in July to a seasonally adjusted annual rate of 1.649 million units. Meanwhile, building permits fell 0.5 percent, indicating the housing market might cool off slightly in the near future.
- Sales of Existing Family Homes (8/26), which account for 85 percent of home purchases, rose in line with expectations in July, increasing 4.5 percent to a seasonally adjusted annual rate of 5.33 million units. July's increase helped somewhat offset June's large decrease.
- New Home Sales (8/26) rose to another record pace in July, increasing 6.7 percent to a seasonally adjusted annual rate of 1.017 million units. The increase in July was well above expectations and follows a revised 2.6 percent decrease in June. Economists are expecting new home sales to remain strong as long as mortgage rates remain near three decade lows.

Consumer Sector: Falling Confidence Evident



Consumer confidence dropped in August to a nine-month low as a sluggish U.S. job market led Americans to scale back expectations for a speedy recovery. The Conference Board's index fell to 93.5 for July, from a revised 97.4 in July. Economists were expecting a reading of 97. The index has not been this low since a reading of 84.9 last November. Despite the recent declines, the Conference Board said there was no indication that consumers were about to stop spending altogether.

From a historical context, the August index is at a level that points "to a continued, but slow, economic expansion," the Conference Board said in their written release.

The group's Expectations Index, measuring what consumers expect the situation to be six months from now, fell to 94.5 from 96.1 last month. The Present Situation Index fell to 92 from a 99.4 reading in July.

- Personal Income (8/30) was unchanged in July after a 0.7% increase in June. Without increases in incomes, the strong consumer spending figures for the past couple of months will be difficult to sustain. Economists were expecting incomes to rise 0.3 percent.
- Personal Consumption (spending) (8/30) rose 1.0 percent in July following a 0.5% increase in June. Spending came in above Wall Street's expectations of a 0.8% increase. The increase in spending was the largest since October, and was largely a result of car buying due to zero-interest financing.
- Retail Sales (8/13) rose 1.2 percent during July, after a revised 1.4 percent gain in June. Analysts say consumers are becoming selective about their purchases, given low consumer confidence and weak stock prices. Excluding automobiles, sales rose only 0.2 percent in July. Economists were expecting retail sales to rise 1.2 percent.

Looking Ahead: Modest, Unsteady Growth

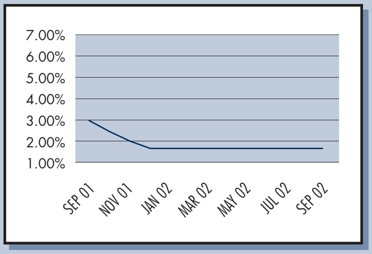
Strong consumer spending, especially due to strong auto sales, will most likely help the economy grow a solid 3.5% in the 3rd quarter. Wall Street is expecting consumer spending to be a strong 4.5% in the 3rd quarter. However, the corporate sector remains worried about the future, which will probably cause a drop-off in growth over the next two quarters to about 2.0%. Despite a stronger-than-expected employment report in August, corporate America is still reluctant to add jobs. Furthermore, inventory growth has slowed and new investment has been minimal or nil.
It appears that the economic indicators for the rest of the 3rd quarter will show positive signs of growth. Yet, because of corporate America's cautious state, the 3rd quarter's rebound will most likely not be sustainable.

Retail Sales (9/13) – The consensus outlook is for total retail sales to rise 0.5% in August and for non-auto sales growth to rise 0.1%. An increase in non-auto retail sales in August would mark the first occurrence of three consecutive monthly gains since early 2001. Sales might come in higher than expected due to positive technical factors.

FOMC Meeting (9/24) – The Fed is expected to leave the Federal Funds rate unchanged at 1.75%, especially after August's employment report was stronger than expected. Most likely the Fed will maintain its easing bias because the recent economic data has been mixed with regard to the economy's recovery.

Industrial Production (9/17) – Industrial production is expected to rise 0.2% in August after a similar increase in July, and capacity utilization is expected to increase to 76.2% from 76.1% in July.

Eye on the Fed



"U.S. interest rates are low enough to stimulate the economy and bolster consumer spending in a slow recovery from recession," said Cathy Minehan, president of the Federal Reserve Bank of Boston. "The recovery will proceed at the slow pace we're seeing for a while, with a gradual pickup in capital spending, and employment growth through the end of the year," she continued. The Fed expects the economy to grow at a pace of 3 percent or better in the first half of 2003, but they warned that there are several risks in their forecast and many of them are on the downside.

The Fed also feels that the housing market, which has helped bolster the economy during the recent recession, will remain strong in the upcoming months. The Fed believes that with mortgage rates as low as they are and no large commercial real estate problem that the housing market will continue to grow at a sustainable pace.

UPCOMING FOMC MEETINGS	WALL STREET EXPECTATIONS	FED OUTLOOK	FORECASTED FED FUNDS RATE
Sept. 24, 2002	No Change	Neutral	1.75
Nov. 6, 2002	No Change	Neutral	1.75
Dec. 10, 2002	No Change	Neutral	1.75

Treasury Focus

Treasury rates began to rise in early September after investors pared expectations that the Federal Reserve will lower interest rates to stimulate the economy. Recent economic indicators, such as a drop in the unemployment rate and a rise in worker productivity have been "satisfactory enough to dispel talk of an imminent rate cut."

The yield curve flattened over the course of the last month as long-term rates saw a larger decrease than did shorter-term securities. The yields on the two-year note fell 17 basis points, while the yield on the 30-year note fell 49 basis points. Investors continued to sell off stock and buy government securities in the continuing flight to quality.

Treasury Rates

MATURITY	SPOT RATES ON 8/2/2002	SPOT RATES ON 9/6/2002	SPREAD DIFFERENTIALS
2-Year	2.11%	1.94%	–17 Bp
5-Year	3.32%	2.93%	–39 Bp
10-Year	4.37%	3.92%	–45 Bp
30-Year	5.28%	4.79%	–49 Bp

MARKET MOVERS IN AUGUST

- There was a dramatic mid-month swing in interest rates driven by the FOMC rate decision, fluctuations in the equity markets, and disappointing economic reports. Yields on the short end of the U.S. Treasury curve ended the week 15-17 basis points higher, but not before hitting 40 year lows intra-week.
- In the third week of August, U.S. Treasuries rallied off of sliding equity markets. The week's Treasury rally was mitigated as the possibility of a Fed easing waned. The Fed suggested that the current Fed fund target rate might be low enough to support the recovery.
- The U.S. Treasury yield curve flattened in the last week of August as yields rallied more on the long end than the short. Yields resisted sliding further after an increase in durable goods orders as well as a rise in new and existing home sales.

Streetwatch: Wall Street Firms Forecast

Wall Street firms believe the economy will start to turn around in the second quarter of 2003 as the market struggles to gain a strong foothold for recovery. On average, Wall Street firms predict a 3.0 percent annual growth rate by the second quarter of 2003. Unemployment is expected to hover around 5.9 percent for the rest of the year before beginning to fall by the third quarter of 2003. Treasury yields are expected to start falling until investors believe that the recovery is in full swing.

Continuing uncertainty in equities and further fallout from the recent accounting scandals have left analysts with many variables to contemplate when making their forecasts. Inflation is also expected to remain under control even in the current low interest-rate environment.

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Interest Rate Forecasts as Predicted by the Futures Market

On September 6, 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%	1.94%	2.93%	3.92%	4.79%
Sep 02	1.73%	2.32%	3.20%	4.23%	5.19%
Dec 02	1.51%	2.47%	3.37%	4.38%	5.26%
Mar 03	1.51%	2.59%	3.52%	4.57%	5.30%

Energy Price Forecasts as Predicted by the Futures Market

On September 6, 2002

PERIOD	CRUDE OIL	HEATING OIL	HENRY HUB NATURAL GAS	PROPANE GAS
Oct 02	27.70	.7920	3.430	.4725
Nov 02	27.79	.8000	3.730	.4750
Dec 02	27.66	.8050	4.010	.4775
Jan 03	27.40	.8060	4.135	.4800
Feb 03	27.10	.7950	4.055	.4600
Mar 03	26.80	.7740	3.965	.4600

Stock Market Forecasts as Predicted by the Futures Market

On September 6, 2002

PERIOD	DOW JONES IND. AVG	NASDAQ 100	S&P
Current	8,425	1,294	894
Sep 02	8,420	922	894
Dec 02	8,405	927	895
Mar 03	8,289	901	882

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

JOHN F. SUTER
Assistant Treasurer, Long-Term Funding
suterj@nrucfc.org
Phone: 703-709-6748

MO G. SALEH
Derivatives Portfolio Manager
salehm@nrucfc.org
Phone: 703-709-6788

JOSH SILVERMAN
MTN Portfolio Manager
silverj@nrucfc.org
Phone: 703-709-6768

JASON W. FRENZ
Financial Analyst
frenzj@nrucfc.org
Phone: 703-709-6852

SCOTT W. EWING
Financial Analyst
ewings@nrucfc.org
Phone: 703-709-2070