



# CAPITAL CONNECTIONS

## Economic Supplement

### IN THIS ISSUE

Key Indicators	
Economic Measures .....	1
Labor Market .....	2
Inflation .....	3
Industrial Sector .....	3
Housing Market .....	4
Consumer Market .....	4
Looking Ahead .....	4
Eye on the Fed .....	5
Treasury Focus, Rates .....	5
Streetwatch .....	5
Futures Market .....	6

Economic Supplement Editor  
Beth Ann Johnson  
703-709-2018  
email: [bjohnson@nrucfc.org](mailto:bjohnson@nrucfc.org)

### Recession Fears Ease; Fed Stands Firm

Central bankers kept the overnight bank-lending rate at 1.75 percent on January 30. An official statement released by the Fed stated “signs that weakness in demand is abating and economic activity is beginning to firm have become more prevalent.” Analysts on Wall Street believe the Fed is poised to keep the targeted federal funds rate low given that inflation remains benign and risks for the economy are still weighted toward weakness. A full economic recovery is still at least a full quarter away. The Federal Open Market Committee, which sets the bank-lending rate, is next scheduled to meet March 19.

The U.S. economy unexpectedly grew at a 0.2-percent annual rate in the fourth quarter of 2001 as consumer and government spending surged, a sign the recession that started last March may have run its course. The expansion was contrary to economists’ expectations of a 1.1-percent contraction in the last quarter, based on the median of 57 forecasts in a Bloomberg News Survey. The U.S. economy shrank at a 1.3-percent pace in the third quarter, according to the Commerce Department.

### Economic Growth: Recovery in Q2 of 2002

The improved tone of the economy is evident, and the aggressive inventory cuts of the past year have created room for at least some increase in production. With this in mind, leading economists at Lehman Brothers on Wall Street have raised their Q1 GDP forecast from flat to 1 percent and expect unemployment to creep higher but not rise to more than 6.3 percent for the year.

GDP is expected to expand at a 2-percent rate in the second quarter and rise as high as 3 percent in the third quarter of this year. The U.S. unemployment rate fell unexpectedly to 5.6 percent in January. Economists were expecting unemployment to continue creeping higher to 5.9 percent for the month. Still, layoffs previously slated for the year will most likely materialize in the coming months and are widely expected to push the unemployment rate higher in the coming months. Personal spending grew at a 5.4-percent annual pace in the fourth quarter. That was the fastest increase since the first quarter of 2000, and it followed a 1-percent rate of increase in the previous three months. Consumers spent more on durable goods than at any time in the last 15 years, according to an article from Bloomberg.

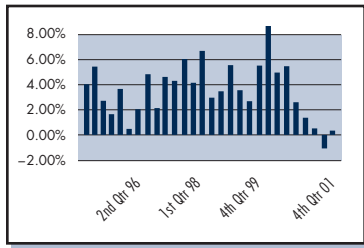
### Key Interest Rates

*On February 1, 2002*

FEDERAL FUNDS RATE	3-MONTH LIBOR	BANK PRIME RATE
1.75%	1.92%	4.75%

For a more in-depth picture of what’s happening in the U.S. economy, visit the RTFC Web site for additional charts and data. Look for the Economic Supplement In-Depth in the “Information & Publications” section of the Web site under “Publications.”

## GROSS DOMESTIC PRODUCT *On January 30, 2002*



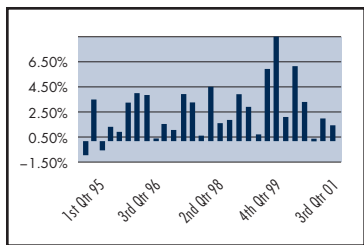
- GDP, the total value of all goods and services produced in the nation, dropped at a 1.3-percent pace in the third quarter, according to the Commerce Department.

- The U.S. economy unexpectedly expanded at a 0.2-percent annual rate in Q4 of 2001 as consumer and government spending surged.
- Analysts expected the economy to shrink at a 1.1-percent annual rate in the fourth quarter.

## GDP INFLATION MEASURES

- The GDP price deflator, a broad measure of inflation tied to the GDP report, dropped at a -0.1 percent pace in the fourth quarter, falling at the same level previously reported for the third quarter.
- The personal consumption expenditure (PCE) price index rose at a 1.3-percent annual pace in the fourth quarter, down from the 1.6 percent reported for the third quarter.

## U.S. PRODUCTIVITY *On February 6, 2002*



- Productivity, a gauge of how much an employee produces for every hour worked, rose at a revised 1.5-percent annual rate in the third quarter, compared with the initial 2.7 percent reported, according to

the Labor Department. Productivity grew at a 2.1-percent pace in the second quarter.

- Fourth quarter productivity results will be announced on February 6. Analysts on Wall Street are expecting productivity to bounce as high as 3 percent for the fourth quarter of last year.
- U.S. worker productivity in the third quarter of 2001 grew at a slower-than-expected pace, reflecting the worst three months of economic contraction since the 1990-91 recession.

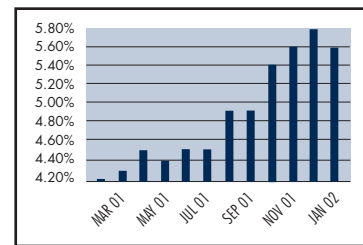
## TRADE DEFICIT *On January 18, 2002*

The Commerce Dept reported that the U.S. trade deficit continued to narrow to \$27.9 billion in November (compared to \$29.3 billion in October) as companies purchased fewer barrels of imported petroleum in anticipation of a prolonged recession. During the same period, petroleum costs were at their lowest price in two and a half years, which further helped narrow the deficit.

## Labor Market: On the Rebound?

The U.S. unemployment rate fell to 5.6 percent in January—surprising economists who were expecting a rise to 5.9 percent for the month. The jobless rate was 5.8 percent in December. This helps point to signs the recession is ending and recovery is in prospect. Economists expect hiring to begin again later this spring as demand goes up and inventories hit rock bottom. Analysts, however, are cautious about reading too much into a single month's data release. Often, the rate can change due to seasonal movements in the market; it generally takes several months to start a consistent trend.

## EMPLOYMENT REPORT *On February 1, 2002*



- Unemployment unexpectedly fell to 5.6 percent in January from 5.8 percent in December. It is the first decrease since May of last year.
- Payrolls declined by 89,000 jobs last month,

the fewest jobs in six months. December's payroll declined by 130,000.

- Analysts had projected the unemployment rate to rise to 5.9 percent and the market to shed 50,000 jobs. Retailers created the most jobs since April, while factories lost the fewest jobs since September.

## EMPLOYMENT COST INDEX *On January 31, 2002*

- The employment cost index, the government's best measure of how workers are compensated, rose 0.9 percent in Q4 of 2001 after a 1.0-percent increase in the third quarter.
- Wages and salaries increased 0.8 percent during the final quarter of 2001, identical to the change in the third quarter. At the same time, benefit costs rose 1.2 percent in Q4.
- The sluggish economy and rising unemployment have helped contain labor costs—a trend that, most likely, will continue going forward.

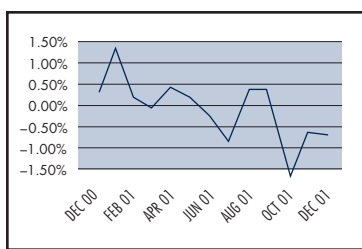
## Inflation Indices Decline in December

Both inflation measures decreased in the month of December, mainly due to lower costs for energy. Plummeting energy prices were mainly responsible for dragging down the CPI.

For example, energy prices, which account for about one-12th of the CPI index, fell 3.2 percent in December after falling 4.4 percent in November. Gasoline prices fell 6.0 percent after dropping 10.1 percent the previous month. Similar results were reported in the PPI index released earlier in the month.

Additionally, most CPI sectors saw price drops in December, especially food, apparel and transportation. With inflation tame, there's no urgency for Fed policymakers to raise the overnight bank lending rate—now at a 40-year low of 1.75 percent—as the economy starts to recover.

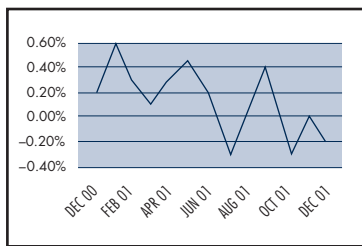
### PRODUCER PRICE INDEX *On January 13, 2002*



- Prices paid to U.S. factories, farmers and other producers declined in December for a third consecutive month, making 2001 the tamest year for wholesale inflation since 1986, according to government figures.

- The 0.7-percent decrease in the PPI was larger than expected and reflected declining costs for energy, autos and food. It followed a 0.6-percent decline in November, the Labor Department said. Excluding food and energy, prices unexpectedly fell 0.1 percent after a 0.2-percent rise.

### CONSUMER PRICE INDEX *On January 16, 2002*



U.S. consumer prices fell in December for the second time in three months, reflecting cheaper energy and clothing costs, according to the Labor Department.

The consumer price index, the most widely followed gauge of U.S. inflation, declined 0.2 percent during December. November saw no change, but a 0.3-percent drop in October was evident. Excluding the volatile food and energy sectors, the index rose 0.1 percent.

Consumer prices rose 1.6 percent last year, after rising 3.4 percent in 2000.

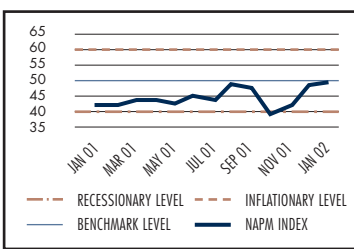
## Industrial Sector: Weakness Abates

U.S. industrial production declined in December less than at any time in six months—a sign that weakness in overall manufacturing may be finally bottoming out. According to the Federal Reserve, the 0.1-percent drop in production at factories, mines and utilities was the smallest drop since July, which was the last time production rose.

The report follows other signs that the manufacturing sector's freefall may have stopped. Factory workers are putting in longer hours and inventories have fallen to the lowest level in two years.

Meanwhile, manufacturing improved in January for the third straight month, a sign factories may soon recover from an 18-month slump.

### NATIONAL ASSOCIATION OF PURCHASING MANAGERS INDEX *On February 1, 2002*



- The manufacturing index, known as NAPM, increased to 48.2 in December, up from a revised 44.5 in November.

- A month after the September 11 terrorist attacks, the index fell to

39.8, the lowest numbers since February 1991. Readings below 50 signal a contraction, and the index has been below that level since July 2000.

- The manufacturing index averaged 43.9 a month in all of 2001, the lowest annual reading since an average of 38.5 in 1982, when the economy was in recession, and the third-worst since the index began in 1948.

- Industrial production (1/16)**, which measures the physical volume of output of the nation's factories, mines and utilities, fell 0.1 percent in December, following a revised 0.4-percent decrease in November, according to The Federal Reserve.

- Capacity utilization (1/16)**, which measures the extent to which capital stock in the production of goods is being used in the economy, fell very slightly in December to 74.4 percent. Capacity utilization was measured at 74.5 percent in November.

- Orders for durable goods (1/29)**, items that are expected to last at least three years, rose in December by 2 percent after dropping a revised 6 percent in November.

- **Factory orders (1/8)** rose 0.8 percent in November for goods other than military hardware, following a 2.9-percent rise in October, according to the Commerce Department.
- **Construction spending (2/1)** increased 0.2 percent during December to an annual rate of \$863.6 billion, according to the Commerce Department. The rise followed a revised 0.3-percent increase in November.

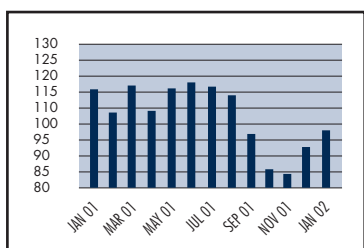
## Housing: Low Rates Keep Sector Strong

The housing market showed remarkable resilience throughout the 2001 recession. A record 5.25 million previously owned homes were sold last year. That was a 2.7-percent increase from the prior year. Likewise, housing construction had a remarkable year, rising 2.2 percent to 1.6 million units. New home sales also had a record year, rising to 900,000 units from 877,000 in 2000.

The extraordinary housing numbers this year can be attributed to the lowest average mortgage rate since 1971—about 6.97 percent, according to lender Freddie Mac.

- **Housing starts (1/17)** were down 3.4 percent in December at a seasonally adjusted annual rate of 1.57 million units. The decline primarily reflected a 26.5-percent drop in apartment construction while single-family homes rose 3.6 percent. Housing starts rose a revised 7.1 percent rate in November.
- **Building permits (1/17)** rose 3.6 percent to a seasonally adjusted pace of 1.65 million units, an indication of strong construction activity in the coming months.
- **Sales of existing family homes (1/25)** fell 0.8 percent in December from the previous month to a seasonally adjusted annual rate of 5.19 million. However, sales of existing homes for all of 2001 still hit a record high of 5.25 million homes—surpassing the previous record set in 1999.
- **New home sales (1/28)** spiked 5.7 percent in December to an annualized rate of 946,000 units in December. Economists predicted a slightly lower pace of 925,000 units. New homes account for 15 percent of all home sales.

## Consumer Sector: Confidence on the Rise



Consumer confidence in the U.S. economy rose to a five-month high amid optimism that a full economic recovery will begin by mid-year. The index rose to 97.3 in January after surging to 94.6 in December.

It seems Americans are once again willing to spend, which will help boost sales in the upcoming months. Analysts had expected a reading of 96 in the confidence index, based on the median of 42 forecasts in a Bloomberg survey.

General Motors and Ford said Americans are buying more cars and trucks in January than they had forecasted. Ford has stepped up production to 1.05 million vehicles in the first quarter, compared to 965,000 in the fourth quarter of 2001.

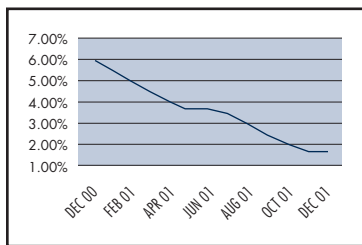
- **Personal income (1/31)** rose 0.4 percent in December after being unchanged in November. This was the first rise in income in four months, and it beat analysts' expectations of a 0.3-percent gain.
- **Personal consumption (spending) (1/31)** data showed that shoppers are doing their part to help boost the economy. Consumer spending rose at a 5.4-percent annual rate in the fourth quarter of 2001, the fastest pace in almost two years.
- **Retail sales (1/15)** decreased 0.1 percent during the month of December, which was better than the 1.3-percent decrease analysts had predicted. Sales in the final three months of 2001 were the best of any quarter in almost two years—a good sign the economy may soon emerge from the current recession.

## Looking Ahead: Positive Signs on Horizon

Early economic signs from leading economic indicators, as well as from an array of second-tier indicators, are mostly positive. Some examples:

1. The Philadelphia Fed survey of manufacturing activity jumped into positive territory, from a reading of -12.6 points in December to 14.7 points in January.
  2. The NAHB survey of homebuilders improved from an index reading of 55 in December to 61 in January.
  3. Initial jobless claims have been below the key 400,000 threshold for each of the first three weeks of January.
- **Non-farm productivity (2/6)**, a measure of output per hour worked, is expected to rise 3 percent in the fourth quarter, helped by suppressed price and wage inflation, following a 1.5-percent increase in the third quarter of last year.
  - **Factory orders (2/6)**. Given the rebound in durable goods orders that was last reported, analysts anticipate that factory orders will rise to 0.8 percent once the December numbers are published.
  - **Initial jobless claims (2/7)** are expected to slip by 5,000 to 385,000 jobs in the first week of February, according to Wall Street analysts.

## Eye on the Fed



The Fed left the benchmark U.S. interest rate unchanged at their January 30 meeting, saying that the economy is beginning to recover from the recession that started in January.

“Signs that weakness in demand is abating and economic activity is beginning to firm have become more prevalent,” the Fed said in a statement accompanying the decision.

Central bankers lowered the overnight rate 11 times by a total of 4.75 percent over the past year to send the rate to a 40-year low of 1.75 percent. Strong consumer confidence, better-than-expected retail sales, and a rise in GDP were all contributing factors to the Fed’s decision to leave rates unchanged. The Fed did warn that the economic rebound may falter—suggesting they are likely to leave rates low for some time to allow the recovery to take hold.

UPCOMING FOMC MEETINGS	WALL STREET EXPECTATIONS	FED OUTLOOK	FORECASTED FED FUNDS RATE
March 19, 2002	No Change	Neutral	1.75
May 7, 2002	No Change	Neutral	1.75
June 26, 2002	+25	Tightening	2.00

## Treasury Focus

Yields on U.S. Treasuries remained relatively unchanged since the beginning of January, but yields did move significantly during the month. At mid-month, Treasury yields on the shorter end of the curve were down as much as 45 basis points from the beginning of the month.

The decrease in yields was caused by the uncertainty surrounding whether the Fed was going to decrease rates for a 12th time in the past year when it met January 30. Once Greenspan announced that the Fed was confident the economy was showing early signs of recovery, the yields pushed back up in expectation that the Fed would leave rates unchanged at their next meeting.

With further Fed actions still remaining a mystery, Treasury yields will continue to be effected by economic data and Fed announcements.

## Treasury Rates

MATURITY	SPOT RATES ON 1/4/2002	SPOT RATES ON 2/1/2002	SPREAD DIFFERENTIALS
2-Year	3.08%	3.04%	-4Bp
5-Year	4.44%	4.40%	-4Bp
10-Year	5.11%	5.05%	-6Bp
30-Year	5.53%	5.44%	-9Bp

## MARKET MOVERS IN DECEMBER

- Treasury yields climbed higher across the yield curve in early January due to positive economic data, which suggested to investors that the economy might be in a recovery. Yields moved up by more than 10 basis points as investors sold Treasuries to buy corporate bonds and stocks, with expectations for higher corporate profits.
- Treasury yields plummeted in mid-January as investors realized the economy may be in the midst of a recovery, but a full recovery may take longer than originally expected. This point was driven home by Greenspan when he said there are “significant risks” the economic recovery may not endure.
- Treasury yields soared in late January as economic data remained strong. Treasuries saw their worst weekly loss since December as investors anticipated the Fed might raise interest rates as early as the second half of this year.

## Streetwatch: Wall Street Firms Forecast

Wall Street firms believe the economy will start to turn around in the second quarter of 2002 as multiple market indicators are starting to show signs of a recovery. On average, Wall Street firms predict a 2.0-percent annual growth rate by the second quarter of 2002.

Unemployment is expected to rise by close to 6 percent by mid-year before beginning to fall by the fourth quarter of 2002. Treasury yields are also expected to continue rising throughout the year as investors sell off bonds and put their money to work in the equity markets. Analysts also expect the Fed to 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.



RURAL TELEPHONE FINANCE COOPERATIVE  
 2201 Cooperative Way  
 Herndon, VA 20171

## Interest Rate Forecasts as Predicted by the Futures Market

On February 1, 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%	3.17%	4.45%	5.14%	5.57%
Mar 02	1.76%	3.52%	4.58%	5.19%	5.76%
Jun 02	1.92%	4.03%	4.86%	5.35%	5.85%
Sep 02	2.42%	4.16%	5.14%	5.57%	5.95%

## Energy Price Forecasts as Predicted by the Futures Market

On February 1, 2002

PERIOD	CRUDE OIL	HEATING OIL	HENRY HUB NATURAL GAS	PROPANE GAS	CINERGY ELECTRICITY	ENERGY ELECTRICITY	PJM ELECTRICITY
Mar 02	20.42	.5540	2.140	.2950	21.30	20.00	25.10
Apr 02	20.66	.5550	2.200	.2975	21.50	20.00	25.10
May 02	20.80	.5470	2.275	.3000	24.50	22.50	28.55
Jun 02	20.95	.5570	2.335	.3075	29.80	27.10	35.25
Jul 02	20.03	.5590	2.390	.3075	38.40	34.65	46.35
Aug 02	20.85	.5715	2.450	.3200	38.40	34.65	46.35

## Stock Market Forecasts as Predicted by the Futures Market

On February 1, 2002

PERIOD	DOW JONES IND. AVG	NASDAQ 100	S&P
Current	9,889	1,914	1,120
Mar 02	9,881	1,535	1,122
Jun 02	9,900	1,560	1,128
Sep 02	9,931	1,567	1,134

RTFC'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

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

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