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CAPITAL CONNECTIONS
Economic Supplement

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GDP, Manufacturing Indicate Economic Expansion

The U.S. economy (as measured by GDP) expanded in the fourth quarter at a 1.4-percent annual rate, considered to be the fastest in a year. Meanwhile, Chicago-area manufacturing pulled out of an 18-month slump in February by posting an index reading of 53.1—well above the index threshold of 50, which suggests the economic contraction may have ended. A reading above 50 indicates expansion, and the last time the mark rose that high was July 2000.

The revised 1.4-percent increase in gross domestic product for the three months ended December 31 and was the fastest since a 1.9-percent growth rate was posted in the fourth quarter of 2000. The rate beat a 0.2-percent pace that was predicted by forecasters in January.

According to Wall Street analysts, the economic growth report and the manufacturing index add to evidence the economy is rebounding from what may prove to be the mildest recession since World War II. This news has led to a decline in Treasury bonds as some investors switched to corporate debt.

According to the National Bureau of Economic Research, however, the economy fell into recession in March. NBER is a private, non-profit group that charts economic growth and contractions. The group uses a broader definition of recession than the "two consecutive quarters of declining GDP" often cited by economists. In no recession since World War II has the economy contracted for only one quarter.

Economic Growth on Track to Rebound

According to a recent report by economists at Lehman Brothers, GDP is expected to expand as high as 2.5 percent in the first quarter and 2 percent in the second quarter of 2002. The same report predicted the U.S. unemployment rate may rise to 6.1 percent for the first quarter of this year and climb further to 6.3 percent in Q2. The unemployment rate was 5.6 percent in January.

Meanwhile, the overnight bank-lending rate remains at 1.75 percent, where it has been since January 30 when the Federal Reserve Open Market Committee last met. Analysts on Wall Street anticipate the Fed will keep the targeted federal funds rate low since inflation remains muted and manageable for now—a trend expected to continue throughout the calendar year. The FOMC, which sets the overnight rate, is next scheduled to meet March 19.

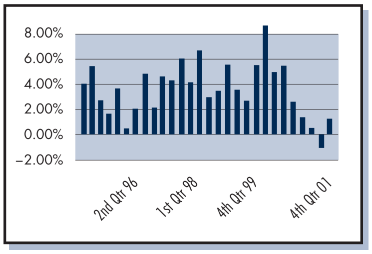
Key Interest Rates

On March 1, 2002

FEDERAL FUNDS RATE	3-MONTH LIBOR	BANK PRIME RATE
1.75%	1.90125%	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 February 28, 2002*

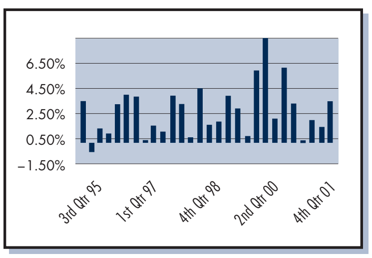


- The U.S. economy expanded in the fourth quarter at a 1.4-percent annual rate, which is the fastest in a year, according to the Commerce Department.
- The revised increase in GDP for the last three months of 2001 compared with a 0.2-percent pace estimated in January and was the fastest since posting 1.9 percent in the fourth quarter of 2000.

GDP INFLATION MEASURES

- The GDP price deflator, a broad measure of inflation tied to the GDP report, dropped at a –0.3-percent pace in the fourth quarter.
- The personal consumption expenditure (PCE) price index rose at a 0.7-percent annual pace in the fourth quarter, up from -0.2 percent reported for the third quarter.

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



- According to the Wall Street Journal, for the first time in a generation, American workers became significantly more productive in the past year even as the economy itself was sinking.
- Non-farm labor productivity, a gauge of how much an employee produces for every hour worked, rose at an annual rate of 3.5 percent in the fourth quarter, compared with a revised 1.5-percent posting in Q3, according to the Labor Department.
- The aggressive corporate cost-cutting that accelerated after September 11 appears to have helped companies be more productive, though at the expense of more than a million jobs and many work-hours.

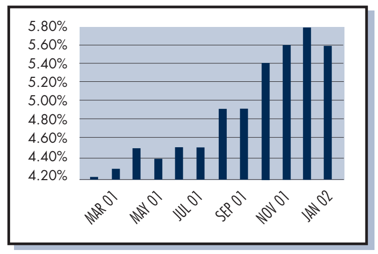
TRADE DEFICIT *On February 21, 2002*

The Commerce Department reported that the U.S. trade deficit continued to narrow to $25.3 billion in December—compared to $28.5 billion in November. Petroleum costs have been at their lowest cost mark in two and a half years during the same period, which further helped narrow the deficit.

Labor Market: Unemployment Slowing

Economists predicting monthly unemployment numbers are forecasting a posting of 5.8 percent in February—lower than the more widely expected quarterly figure of 6.1 percent. 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 in December was 5.8 percent. Economists expect hiring to begin again later this spring as demand goes up and inventories hit rock bottom. The February unemployment report is due March 8.

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.
- Retailers created the most jobs since April, while factories lost the fewest jobs since September.

EMPLOYMENT COST INDEX *On January 31, 2002*

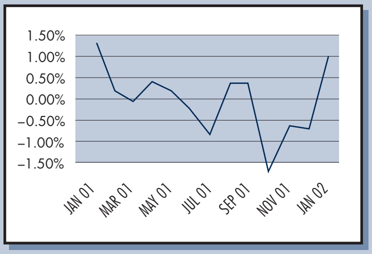
- The employment cost index, the government's best measure of how workers are compensated, rose 0.9 percent in Q4 of 2001 after a 1.0-percent increase in the third quarter.
- Wages and salaries increased 0.8 percent during the final quarter of 2001, identical to the change in the third quarter. At the 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: Slight Increases, Mostly Benign

Both top inflation measures showed signs of a slight increase during the month of January, mainly due to higher costs for food, energy and medical care—according to government figures. Overall, inflation continues to remain muted and manageable for now—a trend expected to continue throughout the calendar year. With no serious signs of inflation creeping into the current economy, the Fed should allow the overnight bank rate to stay pegged at 1.75 percent. Lower prices make it easier for Federal

Reserve policymakers to leave the benchmark overnight bank lending rate at its current 40-year low.

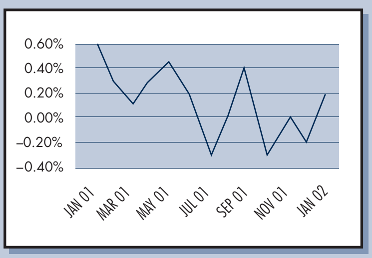
PRODUCER PRICE INDEX *On February 15, 2002*



• Prices paid to U.S. factories, farmers and other producers increased in January after declining in the previous two months—a posting anticipated by many financial economists. Even so, the soft economy and price competition, as well as a strong dollar, are putting a cap on the ability of producers to consider raising prices.

• The 0.1-percent increase in the producer price index, which was in line with the median economic forecasts, followed a 0.7-percent decline in December and a 0.6-percent drop in November, the Labor Department said. Excluding food and energy, wholesale prices fell 0.1 percent after a 0.2-percent rise.

CONSUMER PRICE INDEX *On February 20, 2002*



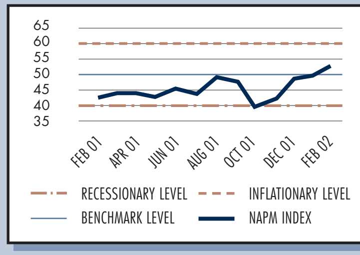
• U.S. consumer prices rose in January for the first time in four months. The expected 0.2-percent increase in the consumer price index followed a revised 0.1-percent drop in the prior two months and reflects the median of 43 forecasters in a Bloomberg News Survey.

• The consumer price index, the most widely followed gauge of U.S. inflation, rose 0.2 percent during the month, the Labor Department said. That followed a 0.1-percent decline in December. Excluding volatile food and energy costs, the index rose 0.2 percent.

Industrial Sector: Rebound Evident

U.S. industrial production declined in January less than at any time in the past seven months—a sign 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 2001, the last time production rose. The report follows other signs that the manufacturing free-fall may be over. The National Association of Purchasing Management index rose to 53.1, well above its expansionary threshold of 50, which has not happened since July 2000.

NATIONAL ASSOCIATION OF PURCHASING MANAGERS INDEX *On February 28, 2002*



• The manufacturing index, known NAPM, rocketed to 53.1 in February from a revised 45.1 in January.

• A month after the September 11 terrorist attacks, the index fell to 39.8, the lowest since February 1991. Readings below 50 signal a contraction in the economy, while a reading above 50 indicates an expansionary phase. The last time the index had a reading above 50 was July 2000.

• The manufacturing report further added to evidence that the economy is rebounding from what may prove to be a historically mild economic contraction.

• Industrial production (2/15), which measures the physical volume of output of the nation's factories, mines and utilities, dropped 0.1 percent in January after falling 0.3 percent in December, according to The Federal Reserve.

• Capacity utilization (2/15), which measures the extent to which capital stock in the production of goods is being used in the economy, fell slightly in January to 74.2 percent. Capacity utilization was measured at 74.4 percent in December.

• Orders for durable goods (2/27), items that are expected to last at least three years, rose in January by 2.6 percent after rising 0.9 percent in December.

• Factory orders (2/5) rose 1.2 percent in December for goods other than military hardware, following a revised 4.3-percent decrease in November, according to the Commerce Department.

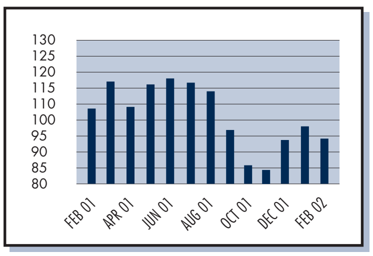
• Construction spending (3/1) rose 1.5 percent in January to an annual rate of $876.7 billion, according to the Commerce Department. The increase followed a revised 0.5-percent rise in December.

Housing: Record Numbers Posted

Sections of the housing market remained strong entering the New Year as existing home sales hit record levels while construction and building permit numbers remained strong. Economists attribute the strength to unseasonably warm weather and continued low interest rates. Also, housing values have seen solid appreciation, while the stock market remains unstable. Meanwhile, new homes fell hard in January, which is a huge contrast to the positive existing home numbers. This suggests housing will be hard pressed to repeat last year's record performance.

- Housing starts (2/19) rose 6.3 percent to an annual rate of 1.68 million new homes. Analysts were looking for a 1.6 million rate in January. That's up from the 1.57 million rate in December. Warm weather and low interest rates continued to play a major role in the higher numbers.
- Building permits (2/19), an indication of future home building activity, rose 3.1 percent to a 1.71 million rate in January. That easily tops analysts' forecasts of 1.6 million.
- Sales of existing family homes (2/25) jumped a record 16.2 percent to an annual rate of 6.04 million units in January, also a record high. Economists surveyed were expecting just 5.2 million units.
- New home sales (2/27) plunged 14.8 percent in January in their biggest decline in eight years. New homes were sold at a seasonally adjusted rate of 823,000 last month, down from a revised 966,000 pace in December.

Consumer Sector: Confidence Remains Sturdy



Consumer confidence in the U.S economy fell in February from a five-month high, reflecting less optimism about employment and income. The index dropped to 94.1 after rising to a revised 97.8 in January. Consumers' assessments of present conditions and their outlook for the next six months declined. The level of confidence still remains high enough to underpin spending, which may boost business for retailers.

Analysts had expected a reading of 97, but were disappointed by the actual numbers. The economy's imminent rebound will be more moderate than the recoveries from previous recessions, and the decline in confidence this month is one of the reasons for the subdued upturn. This decline in confidence shows that consumers are a little more cautious, but there are no signs panic is developing.

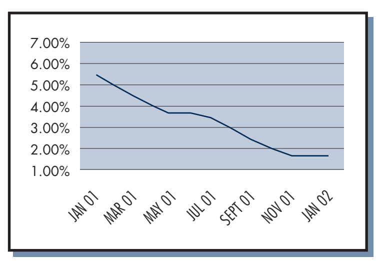
- Personal income (3/1) rose another 0.4 percent in January after rising 0.4 percent in December. This equaled the largest increase in six months. Analysts had expected a 0.1 percent increase in incomes this month.
- Personal consumption (spending) (3/1) data showed that shoppers are doing their part to help boost the economy. Consumer spending rose at a 6-percent annual rate in the fourth quarter of 2001, the fastest pace in almost two years.
- Retail sales (2/13) increased 1.2 percent during the month of January, which was better than the 0.4-percent increase analysts had expected. This rise in sales was the largest one-month gain in almost two years, a sign that consumers are supporting the economy as it recovers from recession.

Looking Ahead: Overall Outlook Positive

Several positive trends are starting to show signs of economic recovery for the U.S. domestic economy: inflation will continue to improve in the coming months; the unemployment rate and the capacity utilization rate are in deflationary territory; capacity utilization is well below competition from importers; the dollar remains strong, ensuring aggressive competition from importers; and early signs point to another strong productivity number during the first quarter.

- Factory orders (3/6) will be up 2.1 percent in January. The manufacturing sector is showing signs of recovery, and economists expect the factory order figures to continue to trend higher in the coming months.
- Employment report (3/8). The key economic statistic of the week will likely be Friday's employment report, which should show an increase in hiring.
- FOMC Meeting (3/19). Most analysts expect the Fed to hold firm at the current level of 1.75 percent during its next FOMC meeting. Accounting and credit quality concerns have created a great deal of volatility in the financial markets, which has overshadowed very favorable macroeconomic news. The futures market trading does not indicate a Fed tightening until the mid-summer months.

Eye on the Fed



The Fed left the benchmark U.S. interest rate unchanged at its last meeting on January 30, saying the economy is beginning to recover from the recession that started last month. The Fed said the U.S. economy is "close to a turning point" and should begin growing at a slower pace than after previous recessions.

The economic rebound is expected to be subdued, and the economy will likely grow at a 2.5-percent to 3-percent annual growth rate in 2002. The Fed's outlook for 2002 suggests to investors that central bankers will keep interest rates low for some time in order to help consumers and businesses to borrow, aiding in the rebound.

In keeping the lending rate unchanged, Fed Chair Alan Greenspan commented that "even a subdued recovery beginning soon would constitute a truly remarkable performance for the American economy."

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

The yields on U.S. Treasuries remained relatively unchanged since the beginning of February, but yields did move slightly during the month. The largest move in Treasuries occurred in early March when a bigger-than-expected surge in manufacturing heightened speculation the Fed will raise interest rates by mid-year. This news caused Treasuries to have their largest decrease in five weeks—sending yields 10 basis points higher across the curve. Investors sold government debt to fund purchases of higher-yielding bonds of companies such as AT&T Corp. and Ford Motor Co. They are betting those securities will outperform Treasuries as an economic recovery bolsters corporate earnings.

Treasury Rates

MATURITY	SPOT RATES ON 2/1/2002	SPOT RATES ON 3/1/2002	SPREAD DIFFERENTIALS
2-Year	3.04%	3.01%	–3 Bp
5-Year	4.40%	4.21%	–19 Bp
10-Year	5.05%	4.89%	–16 Bp
30-Year	5.44%	5.43%	–1 Bp

MARKET MOVERS IN FEBRUARY

- Treasury yields fell slightly in late February as investors fled the equity market for safer U.S. government securities. Investors fled equities due to concerns over much-publicized accounting irregularities that loomed over the market. LIBOR rates remained stable, falling only 1 basis point over the week.
- Treasury yields rose in mid-February as economic data and comments by the Fed pointed to higher rates by year-end. The Fed stated that "the economy turns much more quickly in many respects today, and I would suggest that policy, too, needs to be prepared to be more nimble than has been the case in the past."
- Treasury yields fell across the curve in early February as a "flight to quality" overtook the Treasury markets. Investors fled to safer government securities as the S&P 500 posted its biggest weekly loss since September.

Streetwatch: Wall Street Firms Forecast

Wall Street firms believe the economy will start to turn around in the second quarter of 2002 as many market indicators are starting to show signs of an economic 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 to around 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 it is expected that a tightening bias will be adopted throughout the remainder of the year.

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Interest Rate Forecasts as Predicted by the Futures Market

On March 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%	3.01%	4.21%	4.89%	5.43%
Jun 02	1.84%	3.70%	4.69%	5.34%	5.87%
Sep 02	2.24%	3.90%	4.93%	5.48%	5.94%
Dec 02	2.28%	4.03%	4.97%	5.50%	6.01%

Energy Price Forecasts as Predicted by the Futures Market

On March 1, 2002

PERIOD	CRUDE OIL	HEATING OIL	HENRY HUB NATURAL GAS	PROPANE GAS	CINERGY ELECTRICITY	ENTERGY ELECTRICITY	PJM ELECTRICITY
Mar 02	21.90	.5887	2.359	.3425	N/A	N/A	N/A
Apr 02	21.95	.5895	2.416	.3425	N/A	N/A	N/A
May 02	21.79	.5910	2.479	.3450	N/A	N/A	N/A
Jun 02	21.67	.5945	2.537	.3450	N/A	N/A	N/A
Jul 02	21.61	.6010	2.592	.3475	N/A	N/A	N/A
Aug 02	21.56	.6090	2.607	.3475	N/A	N/A	N/A

Stock Market Forecasts as Predicted by the Futures Market

On March 1, 2002

PERIOD	DOW JONES IND. AVG	NASDAQ 100	S&P
Current	10,362	1,796	1,129
Mar 02	10,360	1,426	1,132
Jun 02	10,330	1,374	1,111
Sep 02	10,143	1,371	1,126

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

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