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CAPITAL CONNECTIONS
Economic Supplement

IN THIS ISSUE

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Weak Job Growth May Keep Fed at Bay

According to many Wall Street analysts, Federal Reserve policymakers are not likely to start raising interest rates for several more months after April's jump in the jobless rate to a seven-and-a-half-year high of 6 percent suggests the U.S. economic recovery most likely will be slow. The economy has added jobs in only one month since July, raising concerns about the fragility of the rebound.

Fed Chair Alan Greenspan and his fellow central bankers meet on May 7 and are expected to keep the overnight bank lending rate at a 40-year low of 1.75 percent, where it has been since December, following 11 consecutive reductions in 2001. That is the assessment of all 54 economists in a recent Bloomberg News survey.

The biggest bond trading firms on Wall Street also expect no rate change at the Fed's June 25-26 meeting. The implied yield on the July federal funds futures market has fallen to 1.80 percent from a recent high of 2.23 percent on April 1, implying that investors, too, are postponing their expectations for a tightening in monetary policy by the Fed any time soon.

Other Signs Continue to Indicate Economic Recovery

The U.S. economy fell into recession in March 2001, and all signs indicate a recovery began late last year. Gross domestic product expanded at a 5.8-percent annual rate in the first quarter of 2002, the fastest in more than two years. Manufacturing has increased for three consecutive months. Consumer confidence has mostly risen from historical lows after the September 11 terrorist attacks. In fact, home sales set a record this year. The consumer price index, the most widely followed gauge of U.S. inflation, increased by only 0.3 percent in March, a sign that inflation is benign and in check, according to the Labor Department.

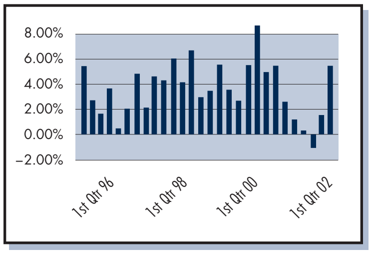
During the same period, productivity gains surged as companies squeezed additional work from their existing personnel rather than hiring new staff. That helped reduce labor costs, taking the pressure off companies to raise prices as they coped with falling demand during the recession. Until demand fully picks up from consumers and businesses, and companies start hiring again, Greenspan and other central bankers have said they do not expect the economy to be completely back on its feet.

Key Interest Rates

On May 3, 2002

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

GROSS DOMESTIC PRODUCT *On April 26, 2002*

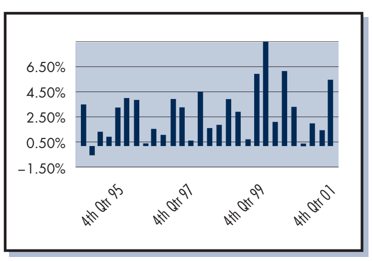


- The U.S. economy grew in the first quarter at the fastest rate in more than two years—providing strong evidence that the recession that began in March of 2001 has ended.
- GDP, the total of all goods and services produced domestically, rose at a 5.8-percent annual rate in the first quarter of 2001, according to the Commerce Department. That was faster than expected and the most dramatic one-time increase since the fourth quarter gains of 1999.
- The increase was greater than the 5-percent rate predicted by analysts. It followed the 1.7-percent pace logged in the fourth quarter of last year.

GDP INFLATION MEASURES *On April 26, 2002*

- Inflation remains benign. The personal consumption expenditure (PCE) price index—a measure of inflation watched by the Fed and tied to spending—rose at a 0.6-percent annual rate in the first quarter of this year, following a slightly better 0.8-percent rise in Q4 of 2001.
- This Q1 PCE index was 0.6 percent higher than it was in the first quarter of 2001, which is the smallest year-over-year increase since the fourth quarter of 1961.

U.S. PRODUCTIVITY *Due May 7, 2002*

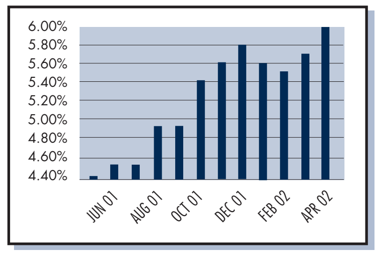


- According to a recent Bloomberg News survey of economists, productivity in the U.S. most likely rose at a 7-percent annual rate in the first quarter of the year.
- Economists further believe that productivity raced ahead at the fastest pace in two years, making it easier for businesses to boost profits and fuel the economy's rebound, while keeping inflation in check.
- Non-farm labor productivity, a measure of how much work an employee performs in an hour, rose at a 5.2-percent annual rate in the fourth quarter.
- Productivity figures for the first quarter of 2002 will be released on May 7.

TRADE DEFICIT *On April 17, 2002*

The Commerce Department reported that the U.S. trade deficit grew in February to its widest in 10 months, as a recovering economy fueled demand for imported automobiles, televisions and business equipment. February's $31.5-billion trade gap was larger than expected and 11.6 percent wider than the $28.2-billion shortfall in January.

Labor Market: Unemployment Jumps



Unemployment unexpectedly shot up to 6.0 percent in April, reinforcing beliefs that the economic recovery remains fairly weak. The April mark is 0.3 percent higher from March's 5.7 percent reading. Although 43,000 jobs were added last month, it was not enough to satisfy the number of people looking for jobs.

Many economists predict unemployment will rise to even higher levels since 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. This is the highest U.S. unemployment rate since August 1994.

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.
- Payrolls increased by 43,000 jobs last month, which wasn't enough to offset the 565,000 people entering the workforce in April.
- The April number outpaced analysts' predictions that unemployment would come in at 5.8 percent with 60,000 new jobs created.

EMPLOYMENT COST INDEX *On April 25, 2002*

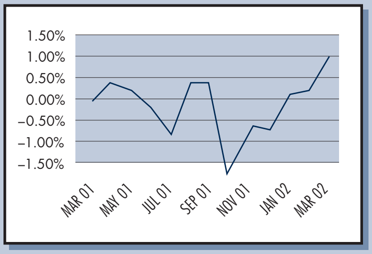
- The employment cost index, the government's best measure of how workers are compensated, rose 0.8 percent in the first quarter. This was the slowest quarterly reading since the first quarter of 1999.
- Wages and salaries increased 1.0 percent during the final quarter of 2001, identical to the change recorded in the third quarter.

- This could contain potentially good news for the broad economy as the lack of wage pressure provides relief for corporations, which, in turn, allows for more capital expenditure.

Inflation: Rising Energy Costs Push Inflation Indices Moderately Higher

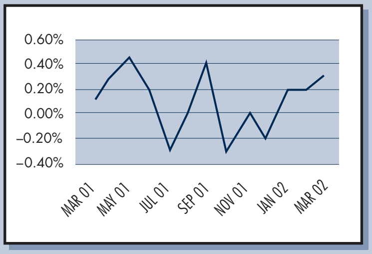
The PPI/CPI indexes both jumped in the month of March due to higher energy costs. The 5.5-percent increase in energy costs, lead by gasoline price surges of 21.3 percent, helped push March producer prices higher. Higher energy costs had the same effect on the CPI index. Even so, the overall inflation picture continues to look quite benign. Tame inflation, which reflects increased worker productivity, competition from foreign producers and the effects of last year's recession, helps explain why Federal Reserve policymakers may hold off on raising interest rates when they meet in May and June.

PRODUCER PRICE INDEX *On April 12, 2002*



- Prices paid to U.S. factories, farmers and other producers rose more in March than at any time in the past 14 months as energy costs soared. The 1-percent jump in the Producer Price Index followed a 0.2-percent gain in February, the Labor Department said.
- Last month's rise was the biggest since a 1.1-percent gain in January 2001. Excluding food and energy, wholesale prices rose 0.1 percent, after showing no change the prior month.
- So far this year, producer prices are running at a 5.6-percent annual rate, compared with a 4.3-percent pace in the same three months last year.
- The core PPI is running at a 0.3-percent annual rate, compared with a 1.3-percent pace in the same period of 2001.

CONSUMER PRICE INDEX *On March 15, 2002*



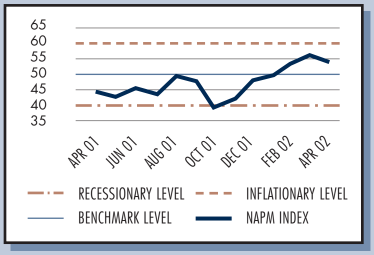
- The 0.3-percent March increase in the consumer price index, the most widely followed gauge of U.S. inflation, followed a 0.2-percent gain in February, the Labor Department said. Market analysts had expected the index to rise 0.5 percent.
- Excluding food and energy, the index rose 0.1 percent in March after rising 0.3 percent in February, a sign that inflation remains in check across most of the economy.
- Through the first quarter of this year, the CPI is running at a 3-percent annual pace, compared with a 3.5-percent rate in the same period last year.
- Core inflation is running at a 2.1-percent rate increase, down from 3.3 percent during the first three months of 2001.

Industrial Sector: Expanding, Though Not Without Exceptions

Industrial production in the U.S. economy rose in March at its fastest pace in 22 months, a sign manufacturing is adding to the economy's rebound from recession. Production at the nation's mines and utilities increased by 0.7 percent in March—the third straight consecutive gain—led by the biggest rise in manufacturing since March 2000.

In another report, the Institute for Supply Management's factory index, previously referred to as NAPM, expanded less than expected in April, suggesting the economy's rebound slowed after the strongest quarterly growth in two years. The overall drop in the index to 53.9 in April reflected slowdowns in orders and employment.

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



- The Institute for Supply Management's factory index slipped to 53.9 in April from a revised 55.6 in March. The index has been greater than 50—signaling economic growth—since February.
- Analysts had expected an index reading of 55, based on the median of 52 forecasts in a Bloomberg News survey.
- Industrial production (4/16), increased 0.7 percent in March after rising 0.3 percent in February, according to the Federal Reserve.
- Capacity utilization (4/16), which measures the extent to which capital stock in the production of goods is being used in the economy, rose in March to 75.4 percent, the highest level since August 2001. Capacity utilization was measured at a revised 74.9 percent in February.

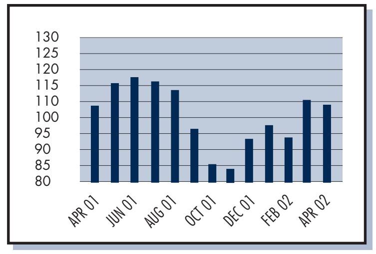
- Orders for durable goods (4/24) (big-ticket items such as cars, appliances and other goods meant to last three years or longer) fell by 0.6 percent in March after a revised 2.7-percent increase in February, according to the Commerce Department.
- Factory orders (4/2): The Commerce Department reported that factory orders unexpectedly fell in February by 0.1 percent to $323.77 billion, after rising a revised 1.1 percent in January. The drop was due to weak orders for non-durable goods such as food, paper products and chemicals.
- Construction spending (5/1) fell by 0.9 percent in April, which is considered to be a worse-than-expected performance, according to the Commerce Department. The decline was largely the result of a drop in public building projects. It also reflected some payback from the first two months of the year when warm weather boosted activity.

Housing: Historically High Despite Drop

Although housing numbers fell in March, they remained historically high—a sign the sector will continue to underpin the economic recovery. According to economists, the drop in sales last month reflects a correction from the strength enjoyed earlier in the quarter. Re-sales are likely to continue through 2002 at close to last year's record 5.3 million pace, according to analysts' expectations. Meanwhile, housing starts and construction also remained robust, although falling sharply in March from February's upwardly revised numbers.

- Housing starts (4/16) fell 7.8 percent to a seasonally adjusted annual rate of 1.646 million units in March, the largest monthly drop in two years. Starts of single-family homes fell 11.4 percent, while starts of apartments and condos rose 7.4 percent.
- Sales of existing family homes (4/25) dropped 8.3 percent in March to an annual pace of 5.4 million from a revised 5.89 million-unit sales rate in February. Re-sales had soared to a record 6.05 million pace in January.
- New home sales (4/24) fell 3.1 percent to 878,000, coming up 5,000 units short of economists' expectations. February's numbers, however, were revised upward to 906,000 units.

Consumer Sector: Confidence Falls Amid Resiliency



Consumer confidence declined during April as higher energy prices and a declining stock market damaged optimism about the state of the economy. The Conference Board's index dropped to 108.8 in April after posting 110.7 in March. Nevertheless, the decline was less than analysts had expected and confidence remains higher than in the several months following September 11. For this reason, consumers are likely to maintain a pace of spending that will help earnings at retailers grow and keep the economic recovery moving forward.

According to analysts, the drop in confidence may reflect U.S. concerns over the impact of fighting in the Middle East, and the effect it will have on energy supplies. The price of oil has already surged 25 percent above its March lows, and with continued uncertainty, this number could continue to rise.

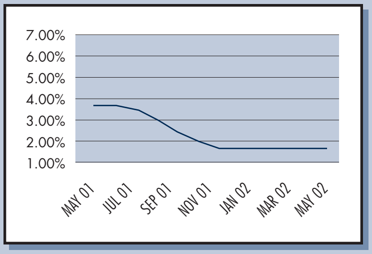
- Personal income (4/29) rose 0.4 percent in March after rising 0.6 percent in February. This was the smallest increase in incomes in three months. Analysts had expected a 0.5-percent increase this month.
- Personal consumption (spending) (4/29) data showed that shoppers are doing their part to help boost the economy. Consumer spending rose 0.4 percent in March following a 0.6-percent increase in February.
- Retail sales (4/12) increased 0.2 percent during the month of March, which was less than analysts had expected. The lower-than-expected gain is being attributed to shoppers spending more on gasoline and less on furniture, clothing and automobiles. Excluding purchases of gasoline, sales remained unchanged.

Looking Ahead: Continued Signs of Strength

Several indicators with market-moving potential released this week showed signs of continued growth. Employment, the purchasing managers' index, and consumer confidence statistics confirmed the economy's solid, though slower, upward trajectory. In addition, the Treasury will announce the terms of next week's quarterly refunding. With the budget balance worsening, the Treasury may signal increased auction sizes in the upcoming quarters for this year.

- Unit labor costs (5/7) for the first quarter are expected to be down by 3.5 percent compared to a reduction of 2.7 percent the in the fourth quarter of 2001.
- FOMC Meeting (5/7) The Fed is expected to leave the Federal Funds rate unchanged at 1.75 percent at its May and June meetings.
- Consumer credit (5/7) is expected to be slightly down in April as compared to March—to $6 billion from $7 billion.
- Producer price index (5/10), considered an important inflation measure, is expected to jump up by 0.4 percent for the month of April.

Eye on the Fed



Few signs of price pressures and a slower pace of spending help explain why the Fed is likely to leave the benchmark overnight bank lending rate at a 40-year low of 1.75 percent when it meets May 7. Central bankers have acknowledged that consumer demand is giving the economy less of a boost than expected, and they are willing to leave the rate unchanged in the near term to allow the economy to gather strength.

"As the recession gives way to recovery, consumer incentive to increase spending will no longer come from reduced interest rates and price discounts but instead from rising incomes and improving job opportunities," said Anthony Santomero, president of the Fed Bank of Philadelphia, explaining why the Fed is expecting a moderate recovery as consumers emerge from the mild recession with little pent-up demand and a fair amount of debt.

UPCOMING FOMC MEETINGS	WALL STREET EXPECTATIONS	FED OUTLOOK	FORECASTED FED FUNDS RATE
May 7, 2002	No Change	Neutral	1.75
June 26, 2002	No Change	Neutral	1.75
August 13, 2002	+25	Tightening	2.00

Treasury Focus

The yields on U.S. Treasuries fell in March due to increasingly negative economic data that caught the market by surprise. The largest move in Treasuries occurred in early April when weak employment numbers were posted after a strong month of March.

The yield curve steepened over the course of the month as short-term rates saw a larger decrease than long-term rates. The yields on the two-year note fell 48 basis points, while the yield on the 30-year note fell 21 basis points. Investors began to sell off stock and buy government securities as growing political tension initiated a flight to quality.

Treasury Rates

MATURITY	SPOT RATES ON 3/29/2002	SPOT RATES ON 5/3/2002	SPREAD DIFFERENTIALS
2-Year	3.71%	3.23%	–48 Bp
5-Year	4.80%	4.40%	–40 Bp
10-Year	5.39%	5.10%	–29 Bp
30-Year	5.79%	5.58%	–21 Bp

MARKET MOVERS IN APRIL

- Treasury yields fell an average of 18 basis points in the first week of April due to Middle East tension, softer equities and surprising initial jobless claims data. Yields plunged as investor concern over the Middle East conflict may slow the U.S. economic recovery.
- The Treasury yields continued to fall in mid-April as mounting Middle East tension and disappointing economic data increased expectations that Fed policymakers may defer an interest rate hike. The yield on the two-year note reached a five-month low, while stock prices continued to fall.
- Treasury yields fell for the fourth week in five as consumer confidence and durable goods orders both posted weak numbers in the last week of April. As a result, investors drove the yield on the 10-year note to a seven-week low on the expectation that inflation would remain in check.

Streetwatch: Wall Street Firms Forecast

Wall Street firms believe the economy will turn around in the third quarter of 2002 as many market indicators are starting to show signs of an economic recovery. On average, Wall Street firms predict a 3.5-percent annual growth rate by Q3 of this year.

Analysts expect the unemployment rate, which is currently at 6 percent, to stabilize and then begin to fall by the fourth quarter of 2002. Treasury yields also are expected to continue rising throughout the year as investors sell off bonds and put their money to work in the equity markets. Analysts predict the Fed to raise the Fed funds rate by the third quarter, when policymakers will adopt a tightening bias throughout the remainder of the year.

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Interest Rate Forecasts as Predicted by the Futures Market

On May 3, 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%	3.23%	4.40%	5.10%	5.58%
Jun 02	1.78%	3.52%	4.58%	5.26%	5.83%
Sep 02	2.08%	3.65%	4.91%	5.44%	5.91%
Dec 02	2.60%	3.90%	4.97%	5.60%	6.00%

Energy Price Forecasts as Predicted by the Futures Market

On May 3, 2002

PERIOD	CRUDE OIL	HEATING OIL	HENRY HUB NATURAL GAS	PROPANE GAS
May 02	26.24	.6607	3.684	.4100
Jun 02	25.91	.6642	3.721	.4100
Jul 02	25.66	.6702	3.755	.4125
Aug 02	25.45	.6772	3.755	.4150
Sep 02	25.25	.6842	3.760	.4200
Oct 02	25.06	.6902	3.995	.4225

Stock Market Forecasts as Predicted by the Futures Market

On May 3, 2002

PERIOD	DOW JONES IND. AVG	NASDAQ 100	S&P
Current	9,983	1,615	1,071
Jun 02	9,980	1,201	1,072
Sep 02	10,068	1,216	1,071
Dec 02	10,115	1,243	1,089

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

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