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Economic Evaluation Group, Inc. Presents Monthly Economic Update for April, 2007

Quote of the month. “You cannot build character and courage by taking away a man’s initiative and independence.” – Abraham Lincoln

The month in brief. By the end of March, the markets had recovered from the shock wave in the subprime mortgage sector and comments of former Federal Reserve Chairman Alan Greenspan, who had earlier publicly put the odds of a U.S. recession at one in three. By March 30 the Dow Jones had recovered almost 300 points from the 416-point plunge of February 27. In the bond market, spreads between 2-year and 10-year treasuries were at their widest since last summer.

The Federal Reserve made no rate cut, but shifted its policy to allow for the possibility of a rate hike, as Fed Chairman Ben Bernanke explained that the Fed was “looking for a bit more flexibility.” Consumer spending maintained the slowing economy in the face of the real estate downturn, the mortgage meltdown and rising oil and gas prices.

Domestic economic health. Fed Chairman Bernanke told Congress in March that he did not expect a recession to occur, but the economy remained sluggish, with most economists predicting a 2-3% growth rate for the quarter.

A drop in jobless claims affirmed the health of the job market, but the crumbling real estate sector, the severity of the mortgage crisis, and frail business

investment all contributed to the volatility of the stock market.

Global economic health. In the eyes of International Monetary Fund chief Rodrigo de Rato, the world economy was still poised for 5% growth, with China, India, Japan and the European markets as drivers. Still, some economists are concerned about China’s 10% growth rate.

Four major central banks will face monetary policy decisions in April (Royal Bank of Australia, Bank of England, Bank of Canada, and the European Central Bank) and all are expected to leave current interest rates alone.

World financial markets. After months of advances, European and Asian markets healthily rebounded from the late February plunge as March began, and rode capably through fears about the financial troubles of America’s subprime lenders. But there is still some global apprehension over the state of the American real estate market, the jump in oil prices and the decline in U.S. consumer confidence. The consistently exciting CSI 300 – the Chinese index that fatefully plunged 9.2% on February 27 – actually rallied to five consecutive record closes late in the month.

Commodities markets. The slump from late February’s global selloff was quickly countered on the commodities front.

Oil prices surged during the second half of March, climbing above \$66 per barrel at month's end on the New York Mercantile Exchange. Iran's capture of British sailors and marines, and the kidnapping of foreigners by Nigerian militants, added to geopolitical tensions for a spike in oil and gasoline prices (over \$3 along the American coasts).

Natural gas prices rose to \$7.73 by the end of the month. Gold prices climbed above \$660 per ounce in late March, helped by the rising energy prices.

Housing & interest rates. The biggest story was the deterioration of the sub-prime mortgage sector: lenders such as New Century, Fremont General, Ameriquet, and First Franklin fell hard and faced bankruptcy or buyout.

But in the prime mortgage market, rates were still very low and Fannie Mae and Freddie Mac continued to provide liquidity so borrowers could access mortgages at decent terms. At the end of March, 30-year FRMs were averaging 6.16%, 15-year FRMs 5.86%, and 5-year ARMs 5.88%.

The second biggest story was the glut of housing inventory. In March, we found out that the inventory of homes for sale rose 6% in February, while new housing construction dipped 3.9%. Federal Reserve Chairman Ben Bernanke and Treasury Secretary Henry Paulson did not see spillover from these woes into other economic sectors, both characterizing the threat as "contained."

April outlook. Are we seeing a soft landing in progress, or strong indications of recession? Will consumer spending hold up under pressure from the housing slump and rising oil and gas prices? (Oil prices appear poised to sit above \$60 for the majority of the month.) An interest rate cut may not come for many months.

The bright side is that April is earnings season, and generally a good month for the markets, with the three major indexes usually gaining 1-2%. Many earnings reports will be published this month, hopefully with few disappointments for the markets.

The big days ahead for market watchers: April 6 (latest unemployment data), April 17 (latest housing starts data), April 25 (latest new home sales data), and April 27 (1Q advance GDP data).

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