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Economic Evaluation Group, Inc. Presents Monthly Economic Update for April, 2008

Quote of the month. “The secret of joy in work is contained in one word – excellence. To know how to do something well is to enjoy it.” – Pearl S. Buck

The month in brief. Financially, March 2008 will be remembered for two major news items: the embarrassing, troubling collapse of Bear Stearns Cos., and the surprising, encouraging tactics of the Federal Reserve to rev up the markets.

Rumors had circulated for weeks that Bear Stearns would bite the dust; its shares dropped 20% between February 26 and March 6, and its cool began to crack. On March 16, JP Morgan Chase bought the 85-year-old investment banking giant for dimes on the dollar with help from the Fed.¹ (You may recall the liquidity problems Bear Stearns had last summer after two of its hedge funds had to be rescued.) On March 11, the Fed announced that it would temporarily loan struggling banks and brokerages as much as \$200 billion in Treasuries, through an auction program that would essentially result in the swap of Treasury securities for mortgage-backed securities and bundled mortgage debt.² The Fed also made another deep cut to the benchmark interest rate on March 18, bringing it down .75% to 2.25%.³

Domestic economic health. At the start of March, we got the news that the economy had posted a net job loss for the second straight month: after shedding 17,000 jobs in January, payrolls shrunk by 63,000 jobs in February. (That stumped dozens of economists polled by Bloomberg.com; their median

forecast anticipated a gain of 23,000 jobs.)⁴ February retail sales were down 0.6%, according to the Commerce Department.⁵ Consumer prices were flat for the month, after rising 0.3% in January; energy prices dropped 0.5% in February.⁶ As March wrapped up, the Commerce Department informed us that consumer spending rose only a paltry 0.1% in February (the smallest monthly advance in more than a year).⁷ The Reuters/University of Michigan index of consumer sentiment dipped to 69.5 in March, another low-water mark and a low unseen since 1992.⁷

Marketwise, the first third of March was the worst: the Dow dropped below 12,000 on March 7 for the first time since January, and the S&P 500 bottomed out that day at 1,293.37, a low unseen since September 2006.⁸ But when the Fed pledged to ramp up its lending to troubled banks and securities firms on March 11, the DJIA had its best trading day in five years, a robust 3.6% one-day gain of 416.66.² More seesawing followed as the Dow responded to the March 18 rate cut (+420), a March 19 commodities selloff (-293), and a March 20 rally (+262) as investors responded to a commodities price drop and a respected analyst’s assessment of a “once-in-a-lifetime” chance to buy financial stocks.⁹

Global economic health. As goes the U.S., so goes the world – to a point. Things were not going so well in the Eurozone. In late March, EU Economic and Monetary Commissioner Joaquin Almunia spoke of “sound economic fundamentals” but also admitted that “strong headwinds” were holding back EU

economies. Data showed Eurozone growth declining from 2.6% in 3Q 2007 to 2.2% in 4Q 2007, and the European Commission was forecasting 1.8% growth across 2008.¹⁰ On March 31, the EU reported March Eurozone inflation of 3.5%, a 0.2% rise from February, plus declining economic sentiment in a key survey.¹¹

Inflation was rising in key Asian economies. Data showed India's inflation rate at a 14-month high (6.68%) at mid-March.¹² The People's Bank of China was contending with the highest inflation rate in 12 years – 8.7% as of the end of February.¹³

World financial markets. While March was a depressing month on Wall Street, the major overseas indexes had it worse. Much worse. Major indexes ended March poorly with anticipation of further trouble in the U.S. banking sector. On March 31, the Hang Seng index was down 6.1% on the month.¹⁴ The Nikkei 225, the Hang Seng, and Australia's S&P/ASX 200 index were not only down for the month but down 16-18% for the first quarter.¹⁵

In Europe, the FTSE 100 lost 3.1% in March.¹⁶ Other major indexes went deeper into the red to make first-quarter losses truly painful – the FTSE 100, DJ Euro Stoxx 50, CAC 40 and DAX lost 13-20% in 1Q 2008.¹⁵

Commodities markets. As many analysts predicted and/or feared, March brought us \$1,000 gold and \$110 oil ... and in late March, a spoiler of a week, as the commodities markets had their worst week in 52 years (no, that is not a typo) as an effect of the Federal Reserve's pledge to loan money to both securities firms and banks and the dollar rallying. The Reuters/Jefferies CRB Index dropped 8.3% during the week of March 17-21.¹⁷ Gold prices were at \$1,033.90 an ounce on March 17, and oil at \$111.80 a barrel on March 18.¹⁷ In the last full trading week of March, gold prices recovered nearly 2% and silver prices more than 6%.¹⁸ Oil prices ended March at \$101.58 a barrel, and gold prices at \$916.20 an ounce.¹⁹

Housing & interest rates. At the end of the month, there was a hint of hope: the National Association of Realtors announced that sales of existing homes actually rose 2.9% in February.²⁰

Aside from that, the news was hardly cheery. New home sales had fallen 1.8% for February, according to Commerce Department data.²¹ A Fed report stated that for the first time since 1945, homeowner debt

exceeded homeowner equity. Moody's Economy.com predicted 10% of U.S. homeowners having 0% or negative equity at the end of March.²² We found out from RealtyTrac that the year-over-year rate of foreclosure-related filings had increased 59.8% from February 2007 to February 2008; nationally, the number of REO properties had jumped 110% from a year before.²³

Mortgage rates took a notable drop in mid-March, an effect of the Fed's actions. The rates on 30-year FRMs dropped to 5.87% from 6.13% during the week ending March 21, edging downward to 5.85% by March 28.²⁴

Major indexes. It was a month of severe mood swings – what else is new? – but also a relatively level month for the DJIA, NASDAQ and S&P 500 compared to February. The NASDAQ even gained ground.

% Change	1-Month	Y-T-D
DJIA	-0.03	-7.55
NASDAQ	+0.33	-14.07
S&P 500	-0.60	-9.92

Source: CNNMoney.com, USAToday.com, 3/31/08^{25, 26}
Indices cannot be invested into directly.

April outlook. When will the upturn begin? Have we seen the worst of the downturn? Investors might be gently encouraged on two fronts: one, by Treasury Secretary Henry Paulson's March 31 proposal to vastly overhaul the regulation of the financial sector – which one former Commodity Futures Trading Commission official called “a dream come true for Wall Street”²⁷ – and two, by possible interest rate cuts by the Bank of England and the European Central Bank, even in the face of rising inflation, which would mean the Fed isn't alone in trying to stem the fallout from the credit crunch.²⁸ Some analysts think that coming indicators might not be as bad as feared, i.e., that the future negatives will be a bit less negative ... but the consensus seems to be that there are still months to go before a full recovery. Perhaps earnings season will help.

And now, the important dates on the April economic calendar: the latest ISM index (4/1), February factory orders (4/2), March wages and unemployment (4/4), February pending home sales and the March 18 FOMC minutes (4/8), February wholesale inventories (4/9),

April consumer sentiment (4/11), February retail sales and business inventories (4/14), March CPI and core CPI (4/16), March housing starts, building permits and industrial production (4/16), March leading indicators and the April Philadelphia Fed index (4/17),

March existing home sales (4/23), March durable goods orders and new home sales (4/24), the Conference Board's April survey of consumer confidence (4/29), and advance 1Q GDP plus a new FOMC policy statement (4/30).

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