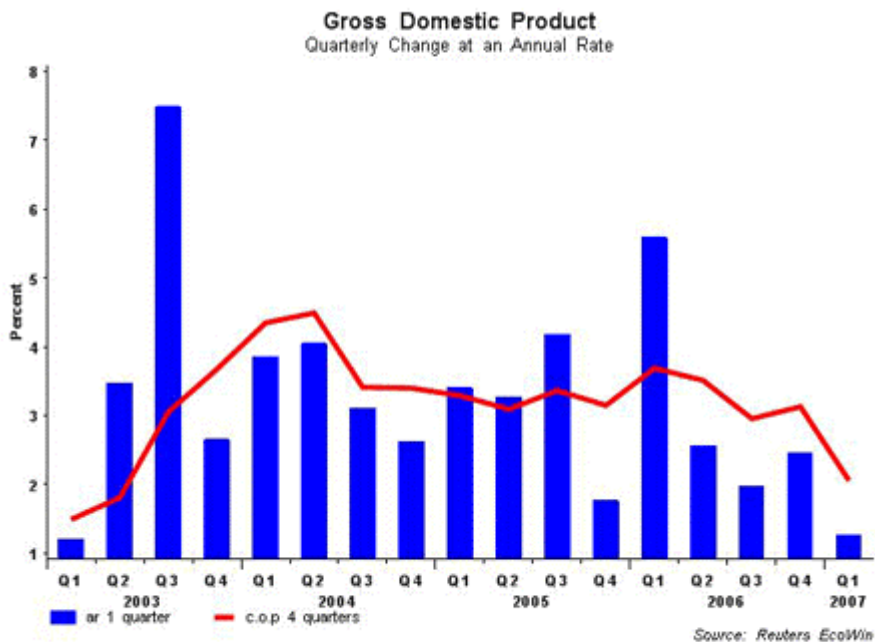


State of the Economy

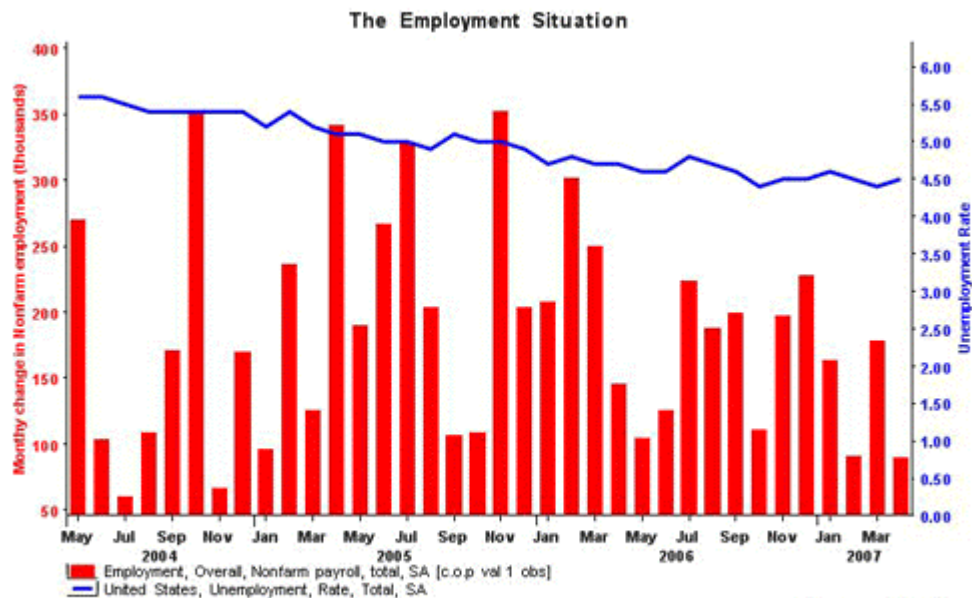
Recent Performance of the Overall Economy (GDP)

- According to the Commerce Department's advanced report, the economy grew at an annual rate of just 1.3 percent in the first quarter of 2007 (See chart below.) This is the slowest quarterly pace in four years.
- A continuing downturn in residential investment, which fell at an annual rate of 17 percent in the first quarter, coupled with a reduction in business inventories and a surprising drop in exports, was responsible for the slow pace of economic growth.
- The decline in housing was offset by strong 3.8 percent growth in consumer spending and a modest 2 percent increase in business investment.
- Over the most-recent four quarters, the GDP has increased 2.1 percent. This is the slowest 4-quarter pace since early 2003.



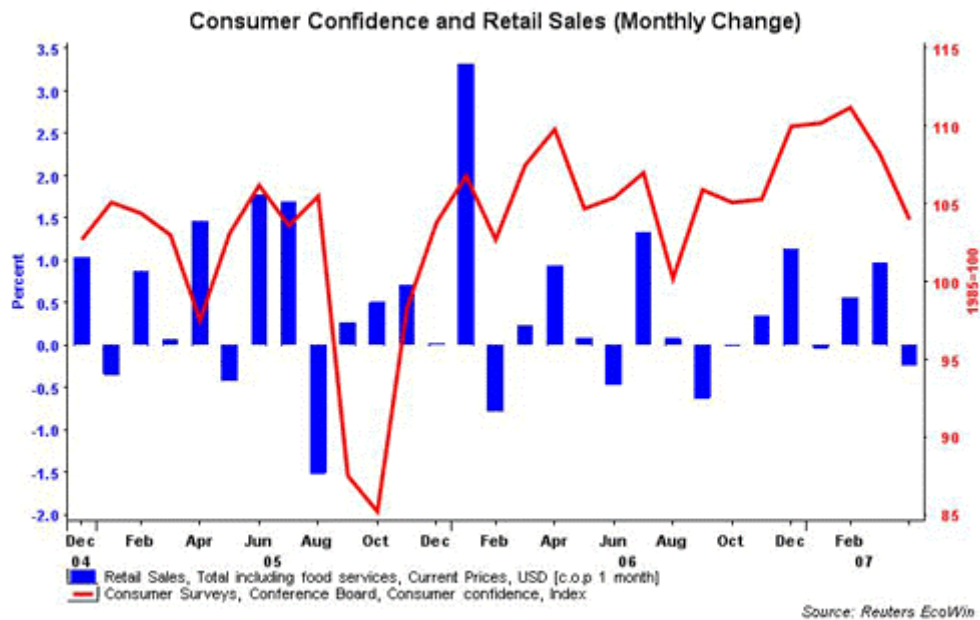
The Employment Situation

- Following a solid gain of 177,000 in March, the economy added just 88,000 in April. As a result, the unemployment rate edged up to 4.5 percent from 4.4 percent in March (see chart).
- Employment in goods-producing sectors fell by 28,000 in April, the sixth decline in the past ten months. Manufacturing employment fell by 19,000 while construction employment fell by 11,000.
- During the three months ending in April, the economy added an average of just 118,000 new jobs per-month, the slowest pace in more than two years.
- Over the past 12 months, real (inflation-adjusted) average private sector hourly earnings increased by 1.3 percent.
- The economy created 2.3 million net new jobs in 2006. This marks the third consecutive year 2 million+ jobs being created. After peaking at 6.3 percent in June of 2003, the unemployment rate now stands at 4.5 percent.



Consumer Confidence and Retail Sales

- Consumer confidence fell for a second-consecutive month in April to an 8-month low (see Chart below). The 25 percent rise in gasoline prices since February is a concern of consumers.
- The Commerce Department reported that retail sales fell by 0.2 percent in April. Due to a number of factors including strong demand, supply disruptions due to refinery outages, and a rise in oil prices, gasoline prices increased by 11 percent in April. This curtailed consumer spending in other areas. In fact, excluding spending at gasoline stations, retail sales fell by 0.4 percent in April, which was the largest monthly decline in 10 months.



Capital Goods Orders

- New orders for non-defense capital goods (excluding the volatile aircraft sector) have slowed significantly recently. After increasing 11 out of the prior 12 months, the three-month change core capital goods orders* declined each of the most recent five months (November through March.) The last time this occurred was in the latter half of 2001. Over the 3 months ending in March, new orders were down 4.1 percent.

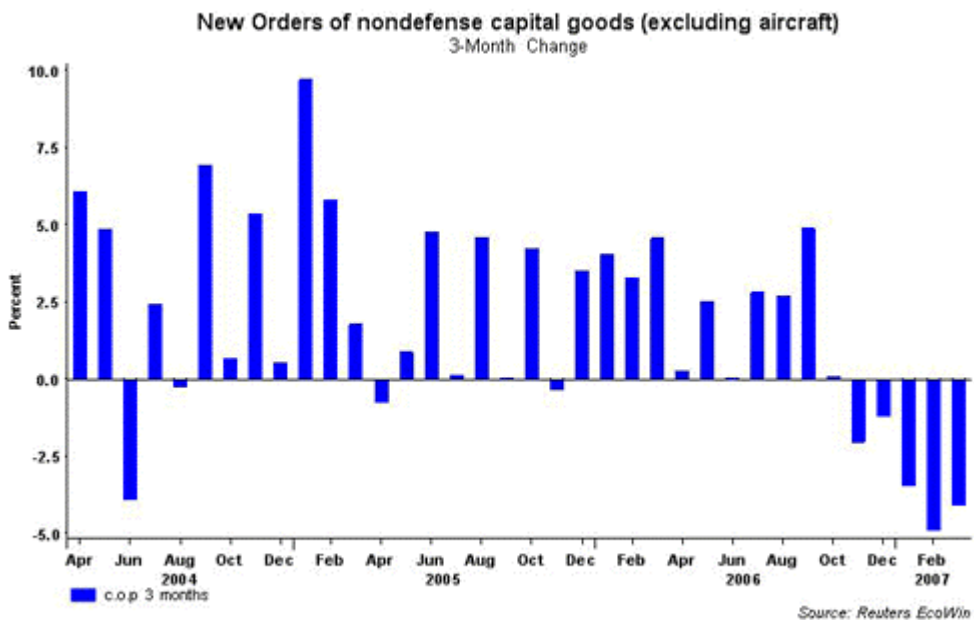
In the 3-months ending in March:

- New orders for machinery declined 4.8 percent.
- New orders for computers and electronic products declined 4.8 percent.
- New orders for nondefense communications equipment declined 11 percent.

- New orders for motor vehicles and parts declined 6.6 percent.

This is an indication that the sluggish growth in business investment in the first quarter will likely continue into the second quarter of 2007.

*the 3-month change smoothes out some of the innate volatility of big-ticket orders.



Housing

- The housing market continues to be weak. The closely-watched National Association of Homebuilders (NAHB) housing market index bottomed out in September. As of April, the index is marginally above the September low. (See chart.) This indicates that the downturn in housing will continue to be a drag on the economy at least through the first half of the year.

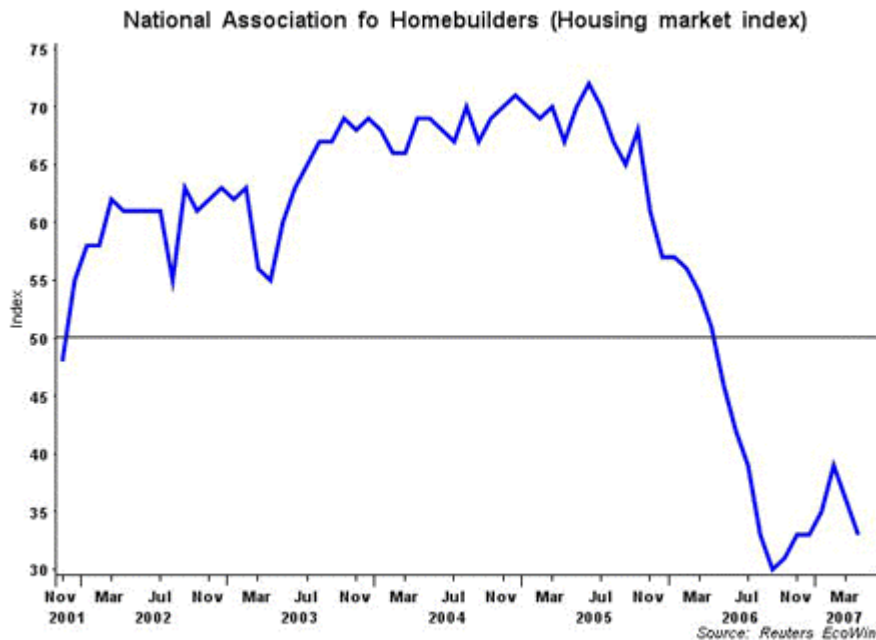
- The downturn began last November. After averaging 69 over the prior 2 years (where a level over 50 indicates growth), the NAHB Index dropped below 50 in May and fell to 30 in September -- the

lowest level since February 1991. The index climbed to a level of 40 in February and then fell back to a level of 33 in April.

- A separate report by the Commerce Department on monthly housing starts and permits offers some evidence that the housing downturn, while ongoing, may be moderating.

New building permits have increased two times in the past 12 months. Both increases have taken place in the past 4 months.

New housing starts have increased six times in the past 12 months. Four of these six increases have taken place in the past 5 months.

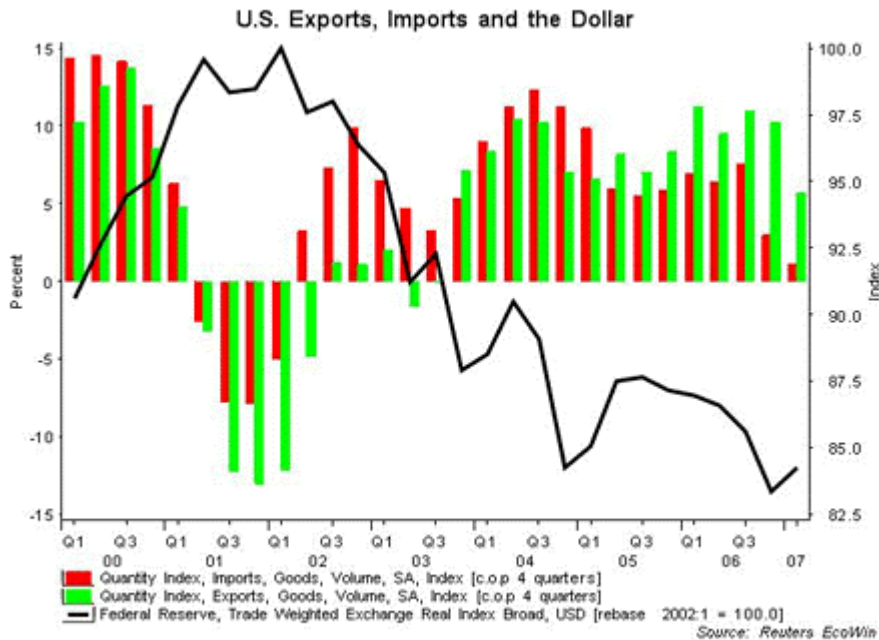


International Trade

- Since the first quarter of 2002, the dollar has fallen by more than 16 percent against other currencies. This has made U.S. exports more competitive globally. And while the U.S. economy has downshifted into low gear over the past six months, economic growth in Europe, Latin America and Asia has picked. This combination has resulted in

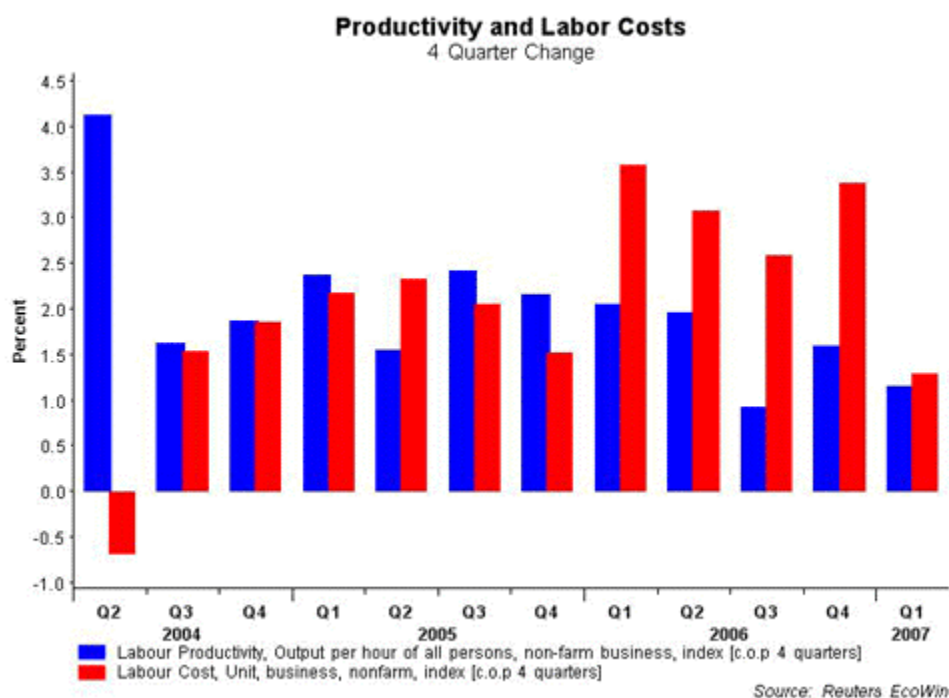
solid export growth and a slowdown in imports.

- Over the most recent four quarters (through the first quarter of 2007), U.S. goods exports increased by 5.7 percent. This is more than 5-times faster than the 1.1 percent rise in goods imports over the past year (see Chart).



Productivity and Labor Costs

- Productivity growth has been slowing recently. Over the four quarters through the first quarter of 2007, overall nonfarm business productivity increased by 1.1 percent, less than half the average annual increase generated over the past decade.(see chart.)
- At the same time, unit labor costs (ULCs) – the foundation for underlying inflationary trends – have accelerated. In 2006, ULCs rose by 3.4 percent – the fastest pace in six years. More recently, the pace of ULCs slowed to 0.6 percent growth in the first quarter of 2007. As a result, ULCs have risen by a more-restrained 1.3 percent over the year ending in the first quarter of 2007.



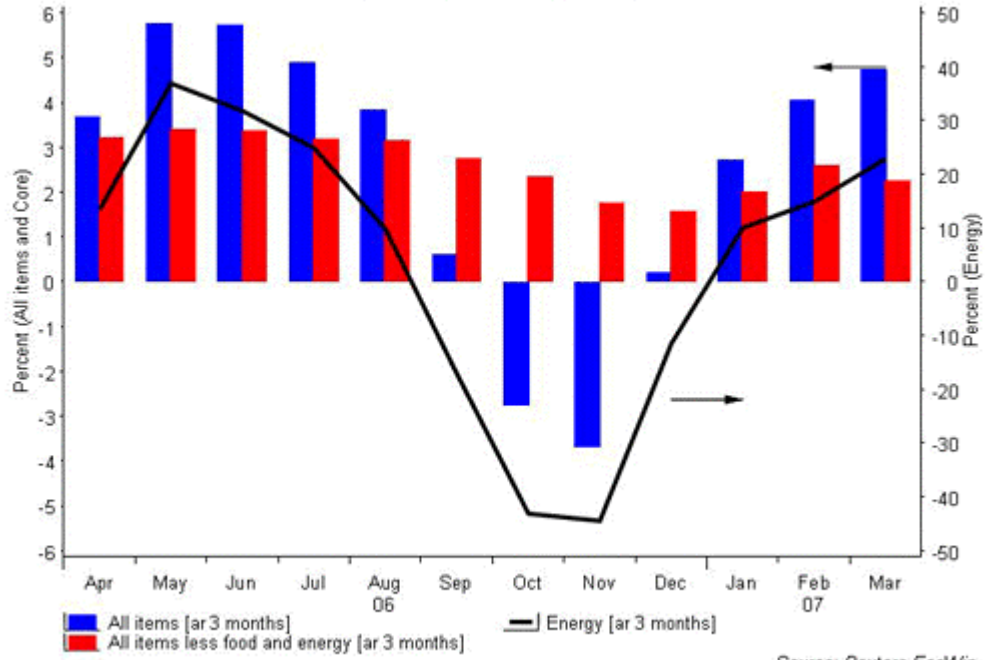
Inflation

Over the most-recent 3 months (through March), consumer energy prices have increased at an annual rate 23 percent. As a result, overall inflation has accelerated, increasing at an annual rate of 4.7 percent during the three months ending in March.

In addition, one of the consequences of the falling dollar has been a rise in import prices. During the period of 1996 through 2001, when the dollar was appreciating in value, the price of non-petroleum imports fell at an average annual rate of 1.9 percent. Since 2002 imports have increased at an average annual rate of 1.9 percent.

To date, these increases have not yet spilled into an acceleration in inflation in the rest of the economy, evidenced by the fact that core consumer prices (which exclude volatile energy and food components) increased at an annual rate of just 2.3 percent in the first quarter.

Consumer Prices (CPI)



Source: Reuters EcoWin