

May 9, 2002

Economic Model Update

Despite the slight dip in our Economic Model in the most recent month, recently released data confirms our view that the economy is staging a mild recovery from what turned out to be only a mild downturn. In retrospect, forecasts of a sharp, protracted slide in overall business activity following the 9/11 terrorist attacks were overblown.

First Quarter GDP increased sharply at a 5.8 percent rate, thanks in large part to a sharp drop-off in the rate of inventory liquidation as well as strong government spending at the federal and state levels and continued strength in consumption.

The dip in our Model is solely traceable to a fall in housing activity in March and a contraction engineered by the Fed in the growth of the nation's money supply, a development we forecast months ago. Additional pockets of weakness, including capital spending, will keep a lid on economic growth, which we forecast in the 3 ½ to 4 ½ percentage range for the balance of this year.

In the face of continued increases in the unemployment rate, which we expect to rise further in the next few months, the Fed reiterated the uncertainty facing the economy this week by stating the following:

The information that has become available since the last meeting of the Committee confirms that economic activity has been receiving considerable upward impetus from a marked swing in inventory investment. Nonetheless, the degree of the strengthening in final demand over coming quarters, an essential element in sustained economic expansion, is still uncertain.

Amid indications of the start of a mild recovery, and with virtually no signs of inflation, we now do not expect the Fed to raise the target Federal Funds rate until August at the earliest and probably not until their September meeting.



