Outlook and Market Review – Fourth Quarter 2012

The U.S. economy is still far behind a typical recovery. In the revised estimate, the economy grew by a miniscule 0.1% in the fourth quarter of 2012. Consumers contributed 1.5% growth to GDP, but were drowned out by reduced government spending and a continued slide of the international trade account. Neither of these drags on growth is likely to improve much in 2013. GDP growth for all of 2012 was only 2.2%, following a 1.8% growth rate in 2011. Since the start of 2010, growth has averaged 2.2 percent, which is especially dismal given the historic depth of the starting point. As we approach the fourth anniversary of economic recovery this summer, we have a $1 trillion gap between what the economy is producing and potential GDP. That gap represents lost jobs and lost wealth that is abnormal during a recovery. A few years of GDP growth of at least 3 percent to 5 percent will be needed just to get back on a normal track. Unfortunately, even optimistic students of the economy are not predicting GDP growth that high in the near future. Job growth is improving and the housing sector is rebounding, but there are significant drags that remain from the massive federal debt overhang (discussed in prior Outlooks). The payroll tax cut expired on Jan. 1 and some combination of higher taxes and spending reduction is inevitable. Automatic spending cuts are in place unless Congress and the President work out a feasible plan. The consensus across a variety of professional forecasts is in line with 2.2% to 2.5% growth in 2013 and 2014, if there are no other major shocks.

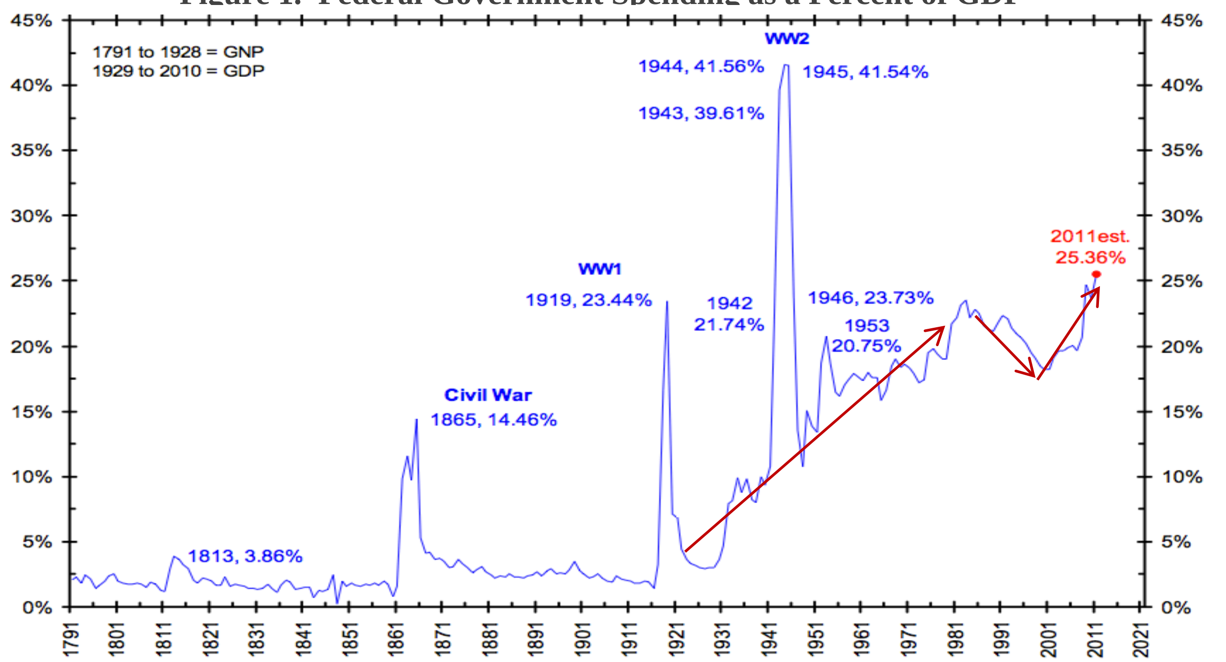
The official unemployment rate is 7.7% with an estimated 18% underemployment rate. The economy is adding jobs at an improved rate of around 160,000 per month, but this rate of expansion of the market is hardly keeping pace with population and productivity growth. Inflation remains moderate with the CPI and PCE indexes growing at less than the 2% target of the Fed. While specific price spikes in energy and food are likely, overall inflation pressures remain low, allowing the Fed to stay on a course of easy money in line with announced intentions. Ten-year bond yields continue to hover around 2% and are likely to remain there for the remainder of the year. Outflows from the bond market to the stock market are largely being offset by inflows of international capital, due to a stronger and relatively more secure dollar.

Big Picture – The Government and Foreign Trade Drag on Recovery

The recession began five years ago and was officially “over” three years ago. In normal times the private sector would be poised to expand enough to overcome government slowdowns in spending. But we do not live in normal times. The business sector is facing uncertainty both at home and abroad, consumers are adjusting to current and future tax increases, higher health care and energy costs are attacking household budgets, and wages are nearly stagnant. The federal government's fiscal mess is forcing it to tighten the budget or face potential credit rating downgrades that have hit other countries, most recently the U.K.

The federal government sector, now approximately 25% of the economy, is likely to grow more slowly as the drag of unsustainable deficits weighs down on policymakers. *Figure 1* below illustrates the growing role of government spending in the GDP over time. Both entitlements and service on debt components of federal budget spending are set for healthy growth leaving either a crowding out of discretionary components like defense or significant increases in taxes to make up the difference. The 2012 elections left political chaos with support for increased spending and higher taxes from one side and a commitment to keep taxes and spending in check on the other side. The only outcome so far is an overall higher tax increase of about $600 billion without significant entitlement or tax code reform overall. The most likely scenario is for existing spending and tax imbalances to continue until a clearer political consensus takes place in 2014 or 2016. Campaigning for those elections is more likely than passing a solution for entitlement and tax reform along the lines of the Simpson Bowles proposal.

Figure 1. Federal Government Spending as a Percent of GDP



The Fed has made and is continuing to make massive commitments to expansionary policies with a plan of 85 billion dollars a month in bond repurchases. Roughly half of this is targeted to mortgage backed bonds to support housing. Inflation remains low overall in traditional measures, but there is a growing concern that traditional measures do not fully capture the inflation “misery” felt by households who spend an inordinate part of their budgets on energy and food. The December Federal Open Market Committee (FOMC) minutes showed concern over the continuation of quantitative easing. The document detailed how some Fed officials would like to end the program by the end of 2013. Just the mention of that possibility sent interest rates higher by 3/8% by the close of business on that day. While Fed Chair Bernanke continues to commit to an easy money policy into 2015, there is speculation on when the Fed will exit the bond market. This fear will be enhanced by data that shows an improving economy. In general, interest rates tend to "rise like a rocket and fall like a feather." The volatility seen in the first month of 2013 is likely to continue. While rates are expected to remain low, it may be a bumpy ride.

The private sector is showing life, but there are limits to growth with unemployment and underemployment at historic levels. Uncertainty about taxes, regulation, environmental initiatives, global market strength, political direction, international trade relations, and dysfunctional government all hold back long run investment and consumer optimism. The aging of baby boomers coupled with the high and growing costs of healthcare is a known problem that has not and is not likely to be managed effectively. The Affordable Healthcare Act increased demand for healthcare with no provision or incentive for increasing the supply of healthcare. Even Nobel Lauriat Paul Krugman, a leading proponent of the plan, now admits there will certainly be "death panels" and higher taxes on middle income taxpayers to make it work.

Most analysts believe that the net result of the sequestration will lower GDP slowly in 2013 with a total drag of less than .5%. The White House, the Federal Reserve, and independent economists largely view underlying economic factors as being "on the right track," but with painfully slow improvement. Bright spots in the economy like housing and autos are finally responding to extraordinarily low interest rates, suggesting that chronic problems in long term durable good spending are abating. The private sector is generating positive growth, although it is difficult to see enough strength to push growth in GDP much above 2% under current conditions.

Housing is Bouncing Back – Affordability Should Support Growth

Each month the National Association of Realtors (NAR) releases their Housing Affordability Index. The index measures affordability of a home based on typical family income. The index is based on the assumption that the borrower has a 20% down payment and a housing ratio not to exceed 25% of gross income. The index assumes a typical home at the national and regional levels based on the most recent monthly price and income data. An index of 100 is defined as the point where a median-income household has enough income to qualify for the purchase of a median-priced existing single-family home. Low housing prices and low mortgage rates have resulted in a higher index over time. According to NAR, the housing affordability index reached a record high of 194 in 2012. The typical family now earns 194% of the income necessary to purchase the typical house. Even with rising housing prices coupled with rising interest rates in 2013, the NAR projects the housing affordability index will average 160 during 2013.

Overbuilding of housing during 2000-2006 has been partially offset by "under-building" relative to demographic trends since then. Even with adjustments for the low household formation in recent years, there now appears to be a low inventory of housing. An upswing in building took place in the final months of 2012 and should continue into 2013. For the year that ended in

November, the number of residential construction jobs actually fell by 5,000 in 2012. Growth in 2013 is likely to boost hiring in housing construction to offset job loss last year.

Housing inventory normally falls in the winter months and improves in the spring, but this winter has seen a larger than normal decline. While signs of an improvement in the market are building, there are significant obstacles that remain. For example, there are still 10.7 million borrowers who owe more on their mortgages than their homes are worth. An additional 2.3 million have less than five percent equity in their homes. Those homeowners cannot sell without having to pay into their mortgages. First-time home buyers are still purchasing at an unusually low rate due to tighter credit standards.

Household Debt is Back to Normal Levels

Household debt grew to unsustainable levels during the boom years with an expansion of credit card bills, student loans, and home mortgages. A stronger foundation for an improved recovery is now taking shape with a return to a more normal level of debt. The ratio of household debt to GDP has now fallen from a peak of 98 percent at the start of 2009, back to the 81 percent condition of 2003. The cost of servicing household debt is at a record low due to the prolonged policy of low interest rates. At the end of 2012, the ratio of household debt servicing costs to after-tax personal income was down to 10.6 percent. Household balance sheets are now much stronger with the additional boost of higher stock prices and improved housing prices.

State and Local Governments Should be Less of a Drag

State and local governments have been persistent drags on the economy due to a wide range of state and municipality budget problems. State and local governments have cut spending and jobs. From 2000 to 2008, state and local governments added an average of 226,000 jobs a year, but an average of 154,000 jobs a year have been lost since 2008. States are struggling to manage budgets with lower tax revenues and higher spending on social welfare needs. There should be some improvement in 2013, as many states have made significant adjustments already and major budget-cutting issues are bottoming out. State and local government will not drive growth, but they should be less of a drag.

Forecasters' Expectations for the U.S. Economy

Blue Chip Economic Forecasters

One of the more optimistic short run forecasts for GDP growth is produced by the Blue Chip Economic Forecasters. The consensus from a panel of professional forecasters calls for GDP picking up to a 2.7 percent annual rate by the end of this year and 3.0 percent by the end of 2014. That pace is expected to pull the unemployment rate down to 7.5 percent by the end of this year and to 7.0 percent by the end of next year. If this scenario plays out, it will be well into 2015 at the earliest before the Fed reaches its 6.5 percent jobless rate target and begins to pull back monetary expansion. At some point, likely to be in the second part of 2015 or later, the economy must be weaned from the Fed's liquidity pump that has kept the economy propped up during the "recovery."

Survey of Professional Forecasters

The panel of 39 economists in the Survey of Professional Forecasters expects real GDP to grow at an annual rate of 2.1 percent in the first quarter of 2013 and 2.3 percent in the second quarter. On an annual-average over annual-average basis, the forecasters see real GDP growing only 1.9 percent in 2013, well below the forecast of the Blue Chip Forecasters. The forecasters predict real GDP will grow 2.8 percent in 2014, 2.9 percent in 2015, and 3.0 percent in 2016. Forecasters predict that the unemployment rate will be an annual average of 7.7 percent in 2013, before falling to 7.2 percent in 2014, 6.7 percent in 2015, and 6.3 percent in 2016. These projections are below those of the last survey.

Forecasters are more optimistic about job growth. They revised upward their estimates of the growth in jobs in the next four quarters. Nonfarm payroll employment is expected to grow at 165,300 jobs per month this quarter and 154,200 jobs per month next quarter. Forecasters' projections for the annual-average level of nonfarm payroll employment suggest job gains at a monthly rate of 164,100 in 2013 and 176,800 in 2014. These annual-average estimates are computed as the year-to-year change in the annual-average level of nonfarm payroll employment, converted to a monthly rate.

Forecasts from the Survey of Professional Forecasters for real GDP, unemployment, and payrolls are summarized in *Table 1*. Upward revisions in the forecast are noted in green and downward revisions are shown in red. Overall, forecasters in the panel tended to be grouped together more than normal, suggesting a stronger consensus in the forecast. In the 45-year history of the Philadelphia Fed survey, the dispersion in economists' annual GDP forecasts was slimmer only in the 1994 and 1996 forecasts.

Table 1. Median Forecasts in Prior and Most Recent Forecasts (Annual Percentages)

	Real GDP (%)*		Unemployment Rate (%)		Payrolls (000s per month)	
Quarter	Previous	New	Previous	New	Previous	New
2013:Q1	1.7	**2.1**	7.9	**7.8**	127.4	**165.3**
2013:Q2	2.0	**2.3**	7.8	**7.7**	146.1	**154.2**
2013:Q3	2.7	**2.6**	7.8	**7.6**	170.2	**172.0**
2013:Q4	2.8	**2.5**	7.6	**7.5**	178.3	**180.4**
Annual						
2013	2.0	**1.9**	7.8	**7.7**	143.3	164.1
2014	2.7	2.8	7.4	**7.2**	N.A.	176.8
2015	2.9	2.9	6.9	**6.7**	N.A.	N.A.

The Survey of Professional Forecasters consensus calls for current-quarter headline CPI inflation to average 1.8 percent, lower than the last survey's estimate of 2.1 percent. The forecasters predict current-quarter headline PCE inflation of 1.4 percent, lower than the prediction of 1.8 percent from the survey of three months ago. The forecasters also see lower headline and core measures of CPI and PCE inflation during the next two years. Measured on a fourth-quarter over fourth-quarter basis, headline CPI inflation is expected to average 2.0 percent in 2013, down from 2.2 percent in the last survey, and 2.2 percent in 2014, down 0.1 percentage point from the previous estimate. Forecasters expect fourth-quarter over fourth-quarter headline PCE inflation to average 1.8 percent in 2013, down from 2.0 percent in the last survey, and 2.0 percent in 2014, down 0.2 percentage point from the previous estimate. The longer run inflation forecasts appear in *Table 2*.

Table 2. Median Short-Run and Long-Run Projections for Inflation (Annualized Percent)

	Headline CPI		Core CPI		Headline PCE		Core PCE	
	Previous	Current	Previous	Current	Previous	Current	Previous	Current
Quarterly								
2013:Q1	2.1	**1.8**	1.9	**1.8**	1.8	**1.4**	1.8	**1.4**
2013:Q2	2.2	**2.1**	2.0	2.0	2.0	**1.9**	1.9	**1.7**
2013:Q3	2.2	**2.1**	2.0	2.0	2.0	**1.9**	1.9	**1.8**
2013:Q4	2.3	**2.1**	2.0	2.0	2.1	**1.9**	1.9	**1.7**
2014:Q1	N.A.	**2.1**	N.A.	2.0	N.A.	**2.0**	N.A.	**1.8**
Annual (IV Q to IV Q)								
2013	2.2	**2.0**	2.0	**1.9**	2.0	**1.8**	1.9	**1.6**
2014	2.3	**2.2**	2.2	**2.1**	2.2	2.0	2.0	**1.9**
2015	N.A.	**2.3**	N.A.	**2.2**	N.A.	2.0	N.A.	**1.9**
Long Term Annual Averages								
2012-2016	2.28	N.A.	N.A.	N.A.	2.00	N.A.	N.A.	N.A.
2013-2017	N.A.	2.30	N.A.	N.A.	N.A.	2.00	N.A.	N.A.
2012-2021	2.30	N.A.	N.A.	N.A.	2.10	N.A.	N.A.	N.A.
2013-2022	N.A.	2.30	N.A.	N.A.	N.A.	2.00	N.A.	N.A.

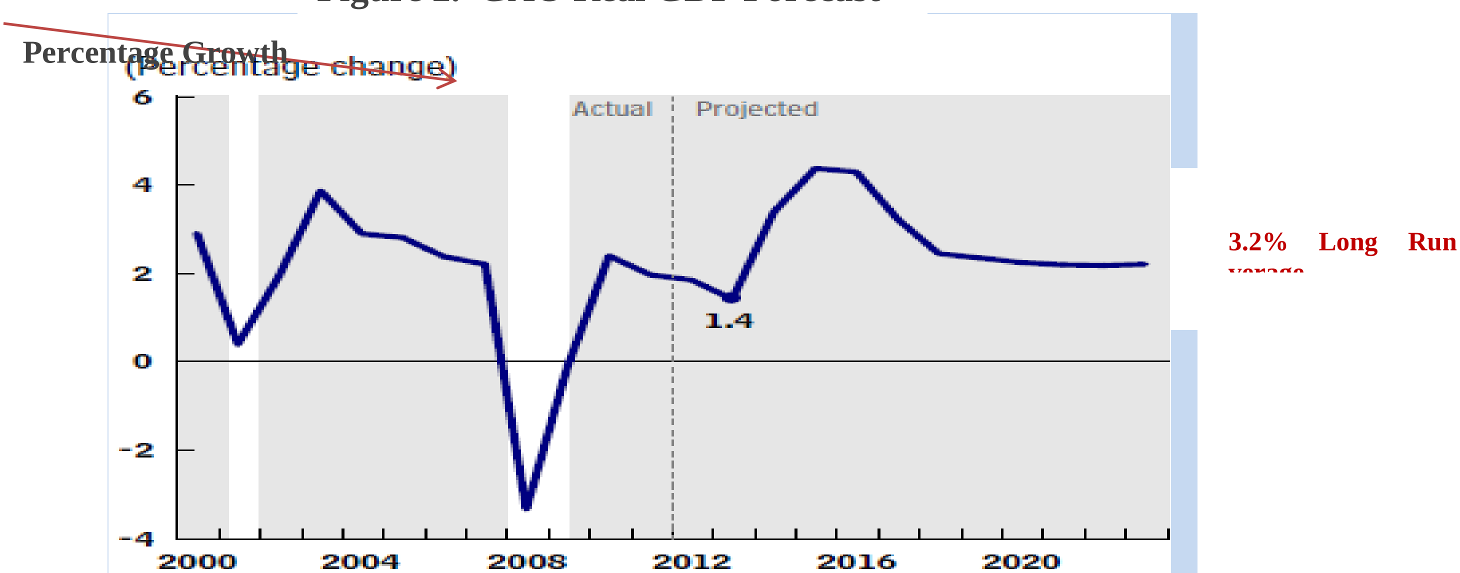
Over the next 10 years, 2013 to 2022, the forecasters expect headline CPI inflation to average 2.3 percent at an annual rate. The corresponding estimate for 10-year annual-average PCE inflation is 2.0 percent. Such low inflation forecasts go hand in hand with below normal long run GDP growth and above average unemployment in the overall economy. It will take at a long time period to transition to a stronger private sector without growing federal debt.

The CBO Forecasts - Assuming Existing Policies Remain in Place

The Congressional Budget Office's recently released economic projections and forecasts for U.S. budget deficits over the coming years. Like other forecasts, the CBO expects a slowdown in growth from prior projections. Much of this downward revision is linked to cuts in government spending and higher taxes that have been put in place by the Affordable Healthcare Act and recent deals on the fiscal cliff. The CBO expects fiscal contraction to trim 1.25 percentage points from growth this year and does not project offsetting stimulation of the private sector from existing policies.

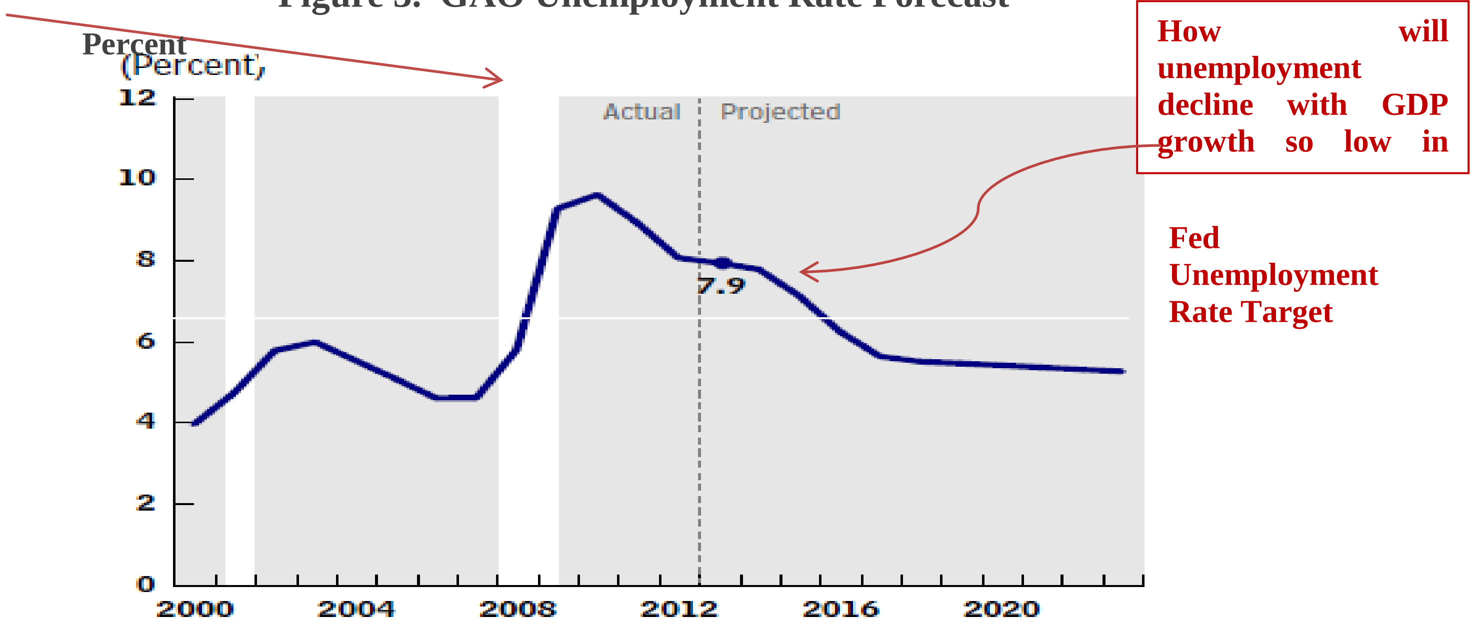
The GAO forecast a very low GDP growth rate of only 1.4% in 2013 and 2014. Even so, the GDP growth rate will exceed the long run average for only a few years and is then likely to fall below the 3.2% rate later in the decade. The GAO forecast of near term growth is lower than other forecasters, but a significantly higher rebound above 3% is projected in 2015 and 2016, just ahead of national elections. *Figure 2* below illustrates the GAO forecasts of Real GDP.

Figure 2. GAO Real GDP Forecast



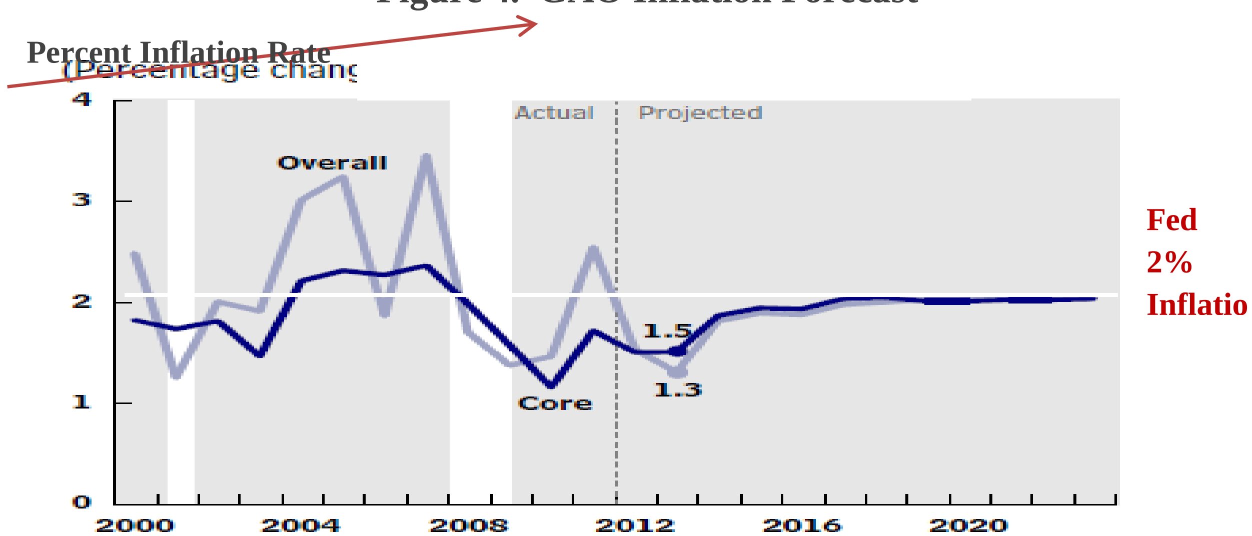
The GAO unemployment rate forecast appears in *Figure 3* below. The unemployment rate is expected to remain above the Fed's target of 6.5% until 2015, supporting the view that the Fed will maintain its current path of monetary stimulation to at least 2015. The unemployment forecast appears optimistic given the GAO's low GDP forecasts for 2013 and 2014.

Figure 3. GAO Unemployment Rate Forecast



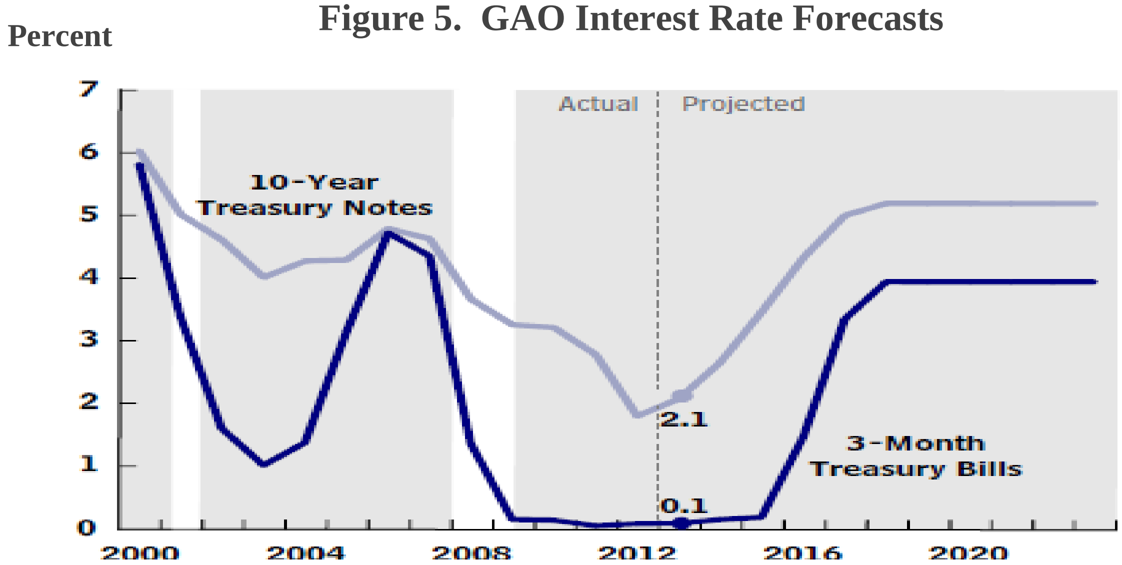
The GAO estimates of inflation match closely with the Fed's view that the 2% inflation target will be met easily until the target is hit sometime in late 2015 or early 2016 and then maintained. The GAO clearly believes the Fed will have room to maintain easy money policy to fulfill its mandate to lower unemployment without raising inflation. The GAO inflation forecast is shown in *Figure 4* below.

Figure 4. GAO Inflation Forecast



The GAO interest rate forecasts appear in *Figure 5* below. Rates are expected to move back to more normal levels in 2016 and beyond. Since the GAO expects inflation to remain low, the imbedded assumption must be that higher real rates will emerge as the Fed backs off expansionary policies prior to this period.

Figure 5. GAO Interest Rate Forecasts



Source for all GAO graphs: Congressional Budget Office

Summary of Recent Economic Data

Gross Domestic Product and Production – *GDP growth for 2013 is not likely to exceed the 2.2% growth rate of 2012. Most analysts believe the sequestration cuts, if allowed to stand, will slow growth later in 2013. In any event, it is looking like another slow growth year with the private sector building while the federal government is hamstrung by past spending excesses.*

- The first revision of fourth quarter 2012 GDP increased the estimate from -0.1% to a positive .1%. Analysts expected growth to be 1% to 1.25%. The key drags on growth were from a slowdown in the pace of inventory accumulation and a plunge in defense spending.

- Business investment in new equipment and software jumped 12.4 percent in the fourth quarter from the preceding three months, adding 9-tenths of a percent to the economy's overall expansion rate.

- Consumer spending – which accounts for roughly 70 percent of GDP – was up sharply in the fourth quarter, adding 1.5 percent to GDP. The recovering housing market added 3-tenths of a percent to growth.

- Durable goods orders in January were much stronger than expected, rising 4.6% compared to a 1.6% expected increase.

- Car sales jumped 16 percent in the fourth quarter of last year compared to the previous year, and are on pace for another annual sales increase. The prolonged sales downturn during the Great Recession left behind an aging fleet of cars and trucks that buyers are now replacing.

- Despite a lackluster holiday shopping season, overall retail sales in the last three months of the year were up 6 percent from a year ago.

- Manufacturers are also seeing a solid pickup in orders for new goods. Lower energy costs -- the result of an ongoing boom in natural gas production -- have helped them win bids against low-cost foreign competitors.

Employment and Labor Markets – *The economy added 236,000 jobs in February, reducing the unemployment rate to 7.7% from 7.9%. The labor market is slowly improving and wages are starting to move up slightly. Nevertheless, the economy is not likely to grow fast enough to move the unemployment rate down much.*

- Unemployment reduced to 7.7% from 7.9% in February. The unemployment rate peaked at 10% in October of 2009. The share of working age population with a job has been below 60% for almost four years.

- The Labor Department reported that 236,000 jobs were added to payrolls in February and there were 38,000 less jobs created in January than previously reported. This is the lowest unemployment rate since December of 2008.

- Job growth in 2012 averaged 181,000 a month, but not enough to significantly reduce unemployment. Economists say employment gains in excess of 250,000 a month over a sustained period are needed.

The data below discusses the January jobs report.

- All the job gains in January were in the private sector, where hiring was as broad-based as it was in December and declines in public sector employment remained moderate.

- Manufacturing employment advanced for a fourth straight month. Construction payrolls increased 28,000 in January, adding to December's healthy 30,000 gain. Construction jobs are expected to rise further as the housing market recovery gains momentum.

- Retail jobs increased by a solid 32,600 jobs in January, after rising 11,200 in December. Retail employment has now risen for seven straight months.

- Education and health payrolls added 25,000 jobs in January after a strong December.

- Government payrolls dropped by 9,000 in January after falling 6,000 in December. The pace is moderating as local government layoffs, outside education, subside. However, sequestration will likely lead to a significant slowdown in government hiring in 2013.

- Average hourly earnings rose four cents in January and were up 2.1 percent in the 12 months through January. Wages are slowly beginning to improve.

- The length of the workweek for the average worker was steady at 34.4 hours for a third straight month.

- Economists surveyed by Reuters had forecast the ADP National Employment Report would show a gain of 165,000 jobs. December's private payrolls were revised down to an increase of 185,000 from the previously reported 215,000.

- Small businesses with less than 50 employees did the most hiring this month, adding 115,000 jobs. But large businesses of more than 500 workers cut 2,000 jobs.

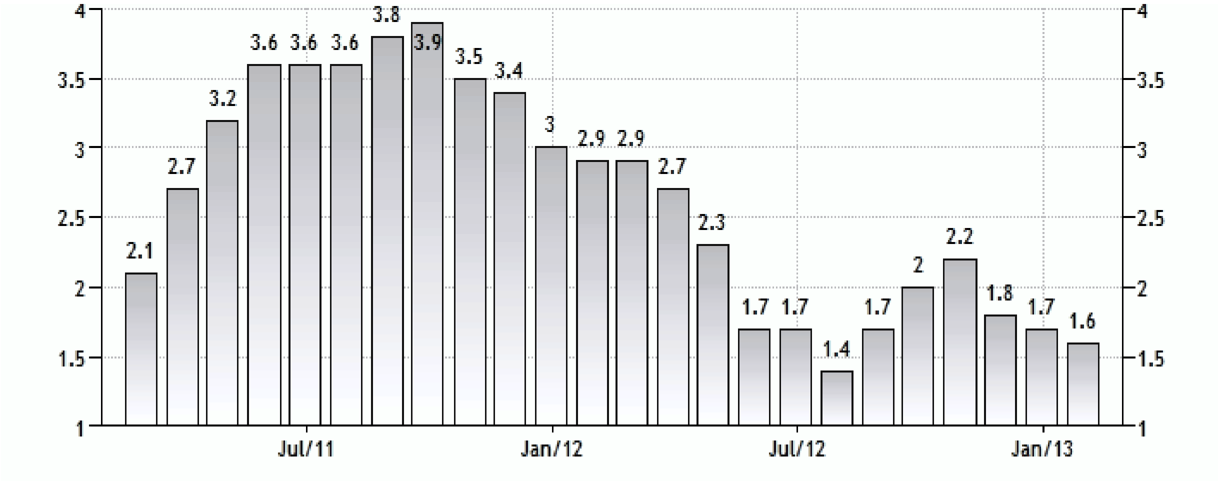
Inflation- *While prices are rising in the energy, housing, and stock markets there are not broad signs of inflation at the consumer or producer price level. Wage growth has also been flat since the recovery began. Nevertheless, the risk remains that the Fed's "exit strategy" will put another damper on the economy whenever it comes.*

- U.S. inflation eased over the past year and is off to a good start in 2013. The CPI increased at an annualized rate of only 1.6% in January of 2013. Historically, from 1914 until 2013, the United States Inflation Rate averaged 3.35 percent reaching an all-time high of 23.70 percent in June of 1920 and a record low of -15.80 percent in June of 1921.

- In the United States, the most important categories in the unadjusted Consumer Price Index for All Urban Consumers are Shelter (31 percent of the total index) and Commodities other than food and energy (20 percent). Food accounts for 14 percent of the total index and Energy for 10 percent. Transportation Services constitute around 6 percent of the measure and Medical Care Services 5.5 percent. *Figure 6* below shows the annualized monthly CPI inflation rate from January 2011 to January 2013.

Figure 6. Annualized Rate of Inflation (Consumer Price Index)

Percent Change



- The Personal Consumption Expenditures Index (PCE) measure of inflation increased 1.32% in December of 2012, following a 1.44% increase in November. The year over year inflation rate based on the PCE is 2.42%. The long run average PCE inflation rate is 3.57%.

- The trimmed mean PCE inflation rate is an alternative measure of core inflation in the price index for Personal Consumption Expenditures (PCE). It is calculated by staff at the Dallas Fed, using data from the Bureau of Economic Analysis (BEA). The trimmed mean PCE inflation rate for January was an annualized 1.3 percent. According to the BEA, the overall PCE inflation rate for January was 0.2 percent, annualized, while the inflation rate for PCE excluding food and energy was 1.8 percent.

- *Table 3* below presents data on the trimmed mean PCE inflation rate and, for comparison, the overall PCE inflation and the inflation rate for PCE excluding food and energy.

Table 3. Personal Consumption Expenditure Inflation (Annualized Rates)

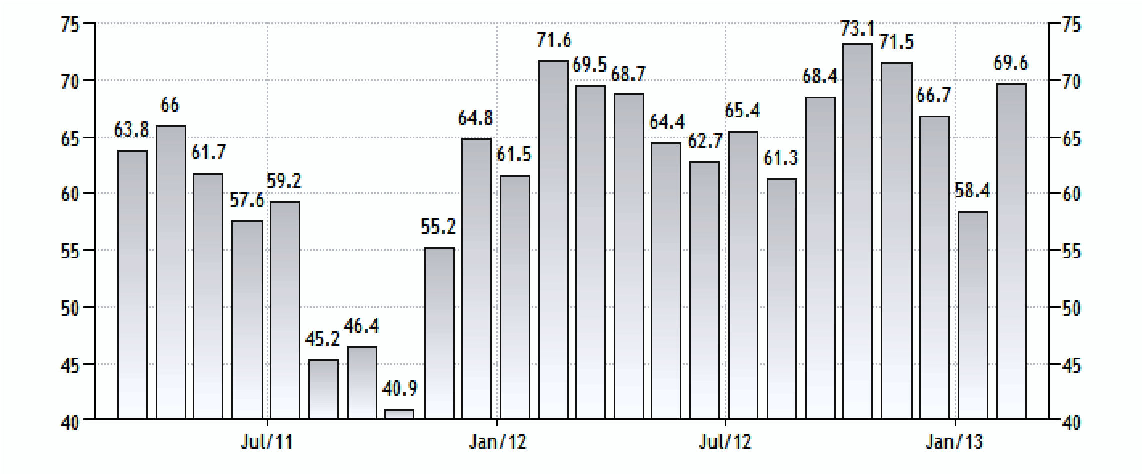
12-month PCE Inflation Rates

	Aug-12	Sep-12	Oct-12	Nov-12	Dec-12	Jan-13
PCE	1.4	1.6	1.8	1.5	1.4	1.2
PCE excluding food & energy	1.5	1.5	1.6	1.5	1.4	1.3
Trimmed mean PCE	1.7	1.8	1.7	1.7	1.6	1.5

Consumer Confidence – *Confidence is slipping and is now back to levels reached in 2011. It is unusual for confidence measures to slip right after a presidential election. Consumer confidence must remain strong to keep the private sector growing.*

- The Conference Board's Consumer Confidence Index increased to 69.60 in February from 58.40 in January of 2013. The Index from 1967 to 2013 averaged 92.86 reaching an all-time high of 144.70 in January of 2000 and a record low of 25.30 in February of 2009.

Figure 6 Consumer Confidence Index



- The Thomson Reuters/University of Michigan's preliminary reading on the overall consumer sentiment index in January came in at 71.3, down from 72.9. Consumer confidence dropped in January to its lowest level in more than a year as Americans were more pessimistic about the economic outlook and their financial prospects. The University of Michigan Consumer Sentiment final number for February came in at 77.6, up from the preliminary reading of 76.3 and the January final reading of 73.8. .

- The Conference Board's Consumers' views on the labor market were also weaker. The "jobs hard to get" index rose for the first time since September to 37.7, up from 36.1 the month before. The "jobs plentiful" index fell to 8.6 from 10.8.

Personal Income and Consumer Credit – *Personal income is off to a slow start in 2013 but consumer credit has been managed back to levels found prior to the recession. After-tax personal income will take a hit in 2013, but early signs suggest that consumers will maintain spending.*

- In January, Personal Income fell $505.5 billion, or 3.6 percent, and Disposable Personal Income (DPI) fell $491.4 billion, or 4.0 percent, according to the Bureau of Economic Analysis. Personal Consumption Expenditures (PCE) increased $18.2 billion, or 0.2 percent, in January. In December, Personal Income increased 2.6 percent, Disposable

Personal Income (DPI) increased 2.7 percent, and PCE increased 0.1 percent, based on revised estimates.

- Real Disposable Income fell 4.0 percent in January, in contrast to an increase of 2.7 percent in December. Real PCE increased 0.1 percent, the same increase as in December.

- Private wage and salary disbursements fell $44.8 billion in January, in contrast to an increase of $49.1 billion in December.

- For all of 2012 (from the 2011 annual level to the 2012 annual level) Personal Income increased 3.5 percent compared with an increase of 5.1 percent in 2011. Disposable Personal Income increased 3.3 percent, compared with an increase of 3.8 percent in 2011. PCE increased 3.7 percent, compared with an increase of 5.0 percent. Real DPI increased 1.5 percent in 2012, compared with an increase of 1.3 percent in 2011. Real PCE increased 1.9 percent, compared with an increase of 2.5 percent.

- After-tax income climbed 2.7 percent in December, the strongest since May 2008, while consumer spending rose 0.2 percent, just below the pace expected by analysts in a Reuters poll.

Housing – *Housing is improving both in terms of lower inventory and improved housing prices. Credit availability will remain a constraint, but Fed policies should help ease bank lending practices.*

- Total existing-home sales (completed transactions that include single-family homes, townhomes, condominiums and co-ops) increased 0.4 percent to a seasonally adjusted annual rate of 4.92 million in January from a downwardly revised 4.90 million in December. Total existing-home sales are 9.1 percent above the 4.51 million-unit pace in January 2012. Total existing-home sales rose 5.0 percent to a seasonally adjusted annual rate of 4.90 million in the fourth quarter from 4.66 million in the third quarter, and were 12.1 percent above the 4.37 million pace during the fourth quarter of 2011. Sales in the last quarter were at the highest level since the fourth quarter of 2009 when they reached 4.95 million.

- Total housing inventory at the end of January fell 4.9 percent to 1.74 million existing homes available for sale, which represents a 4.2-month supply at the current sales pace, down from 4.5 months in December. This is the lowest housing supply since April 2005, when it was also 4.2 months. Listed inventory is 25.3 percent below a year ago when there was a 6.2 month supply. Raw unsold inventory is at the lowest level since December 1999 when there were 1.71 million homes on the market.

- The national median existing single-family home price was $178,900 in the fourth quarter, up 10.0 percent from $162,600 in the fourth quarter of 2011. This is the strongest year-over-year price increase since the fourth quarter of 2005 when the median price jumped 13.6 percent. In the third quarter, the price rose 8.8 percent from a year earlier.

- At the end of the fourth quarter there were 1.82 million existing homes available for sale, which is 21.6 percent below the close of the fourth quarter of 2011 when 2.32 million homes were on the market. Unsold inventory is at the lowest level since January 2001 when there were 1.78 million homes for sale.

- According to Freddie Mac, the national commitment rate on a 30-year conventional fixed-rate mortgage averaged a record low 3.36 percent in the fourth quarter, down from 3.54 percent in the third quarter and 4.01 percent in the fourth quarter of 2011.

- NAR's national annual Housing Affordability Index rose to a record high 193.5 in 2012 from 186.4 in 2011. The Index is calculated on the relationship between median home price, median family income and average effective mortgage interest rate. The higher the index, the stronger household purchasing power. An index of 100 is defined as the point where a median-income household has exactly enough income to qualify for the purchase of a median-priced existing single-family home, assuming a 20 percent downpayment and 25 percent of gross income devoted to mortgage principal and interest payments. For first-time buyers making small downpayments, the affordability levels are relatively lower.

- The housing affordability index shows that the national median income of families was almost double the income needed to buy a median-priced home in 2012, so most buyers are able to stay well within their means.

Global Economy *Fears of a financial meltdown in Europe have faded. Last year's worries about a sharp slowdown in Asia have also eased for now.*

- Europe's economic and financial crisis is not over. The Euro-zone region contracted by a 2.3% annualized rate in the fourth quarter of 2012. Italy and Spain experienced sharp drops in real GDP. Even the Euro region's more prosperous northern countries weakened in the fourth quarter.

- GDP in Germany, Europe's largest economy, fell 2.3% at an annualized rate from the previous quarter, largely due to declining exports and investment. The fourth quarter slowdown in Germany may be the most problematic because of its relative economic size and because its economy had been relatively unscathed by the European debt crisis.

- French GDP declined at a 1.1% rate. France is reducing its forecast of 0.8% growth for 2013. The weak French economy and falling tax receipts are also derailing government plans to cut the budget deficit to 3% of GDP in 2013.

- Spanish GDP fell at a 2.8% annualized rate while Portugal and Greece reported even-deeper contractions. Italy's GDP fell at an annualized rate of 3.7% last quarter adding to concerns that the country's depressed economy could lead to political instability that reignites the Europe-wide debt crisis. While Spain and Italy are enacting growth-squelching spending cuts and tax hikes to rein in their budget deficits, they still stand to see their government debt burdens increase as their economies continue to shrink.

- The early 2013 outlook for many Euro countries does not suggest much improvement in GDP growth. The European Central Bank expected a recovery in the course of 2012,, but the worse-than-expected fourth-quarter contraction underscores how difficult a recovery may be. As the Euro bloc begins its fourth year of the debt crisis, there has been some financial market improvement linked to the ECB's pledge to do "whatever it takes" to preserve the Euro. But, more-stable markets haven't led to stronger business activity. There is concern that financial markets have become detached from the fundamentals of the economy. Concern mounts that poor economic conditions will mount political unrest in Spain and Italy that may destabilize the entire 17-country bloc.

- The United Kingdom was stripped of its Triple-A bond rating, which may well be the beginning of a larger downgrade of sovereign debt in troubled countries. Moody's Investors Service stripped the U.K. of its triple-A credit rating, predicting economic weakness will weigh on public finances for years to come. Moody's lowered the U.K.'s domestic and foreign-currency bond rating one notch to Aa1 and changed its outlook to stable. It is the first of the three major ratings firms to do so, though both Standard & Poor's Ratings Services and Fitch Ratings have the U.K. on negative outlooks.