Outlook and Fourth Quarter 2010 Review

The economy is showing signs of a stronger recovery after approximately a year and a half of recession followed by another year and a half of an unusually weak recovery. The Bureau of Economic Analysis revised estimate of real GDP growth for the first quarter was 2.8% following a 2.6% real growth in the third quarter of 2010. Inventory depletion was a key drag on GDP growth in the fourth quarter of 2010, but this should give an extra boost to first quarter growth. The falling value of the dollar and improved global economies helped stimulate U.S. exports. Further improvement of the export sector of the economy depends on the continued global economic recovery. The economy must grow consistently above 3% to generate enough jobs to bring down unemployment in a meaningful way. While many economists are predicting a self-sustaining recovery in 2011, recent shocks to global political stability and energy prices threaten that recovery.

The unemployment rate remains high at 9% with little promise for dramatic reduction in 2011. The labor force participation rate is at an historic low, making it more difficult to reduce the unemployment rate when discouraged workers finally re-enter the labor market. Core inflation remains low at this point and excess capacity suggests that demand-pull inflation is not on the horizon. Nevertheless, energy prices are rising along with overall commodity prices, setting a stage for cost-push inflation pressures that could materialize, much like the inflation of the 1980s. Concerns over inflation are building but the Fed is not likely to implement an exit strategy from quantitative easing as long as the economy remains sluggish. Quantitative easing has not had the desired effect of bringing the 10-year maturity rates down. This is a critical objective in monetary easing, since mortgage and other long term investment decisions are most directly linked to the 10-year maturity segment. Another round of quantitative easing (QE3) is not out of the question if inflation pressures subside.

Analysts will likely pull back from earlier estimates of a 3.5% growth rate in the second half of 2011, given recent shocks to oil prices and global political stability. A big factor affecting the path of future energy prices will be the ability of Saudi Arabia to offset oil disruptions occurring with other countries in the Middle East. For the near future, the markets will play a tug of war between optimism for an economic recovery and fear over inflation linked to world political instability. The uncertainty of sovereign debt conditions is another wild card.

Survey of Professional Forecasters – Upbeat Forecasts

The outlook for the U.S. economy is generally upbeat in the most recent *Survey of Professional Forecasters* released on February 11, 2011. The survey, based on forecasts of 43 professional forecasters, provides a consensus forecast of 3.6 percent real GDP growth for the first quarter of 2011. The revised forecast is well above the prior forecast of 2.4%. Forecasters also provided a more optimistic view of unemployment compared to prior surveys. For example, the average annual unemployment rate is projected to be 9.1 percent in 2011 followed by 8.5 percent in 2012 and 7.8 percent in 2013. Nonfarm payrolls are expected to grow by 129,100 jobs per month in the first quarter of 2011 with continued improvement throughout the year. A summary of the consensus forecasts for GDP and employment by quarter in 2011 appear in Table 1 below.

Table 1. Survey of Professional Forecasters - GDP and Employment

	Real GDP (%)		**Unemployment Rate (%)**		**Payrolls* (000s/month)**	
	Previous	Current	Previous	Current	Previous	Current
I Q 2011	2.4	3.6	9.5	9.3	104.2	129.1
II Q 2011	2.7	3.5	9.4	9.2	144.3	188.3
III Q 2011	3.3	3.1	9.2	9.0	139.8	201.1
IV Q 2011	2.9	3.4	9.0	8.8	170.6	213.1

**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.*
Source: Survey of Professional Forecasters, Philadelphia Federal Reserve Bank

Professional forecasters provided upward revisions of short term inflation but there was little change in long term inflation forecasts in the most recent survey. The current consensus forecast for CPI inflation is 2.5 percent compared to a 1.6 percent forecast in the prior survey. The forecasters also predict a higher current-quarter headline PCE inflation of 2.0 percent, compared to a 1.5 percent rate in the prior survey. These estimates may well increase when the full impact of the Middle East transition in governments take place. Forecasts for quarterly inflation rates appear in Table 2.

Table 2. Survey of Professional Forecasters - Short Term Inflation Forecasts

	Headline CPI (%)		**Core CPI (%)**		**Headline PCE* (%)**		**Core PCE (%)**	
	Previous	Current	Previous	Current	Previous	Current	Previous	Current
I Q 2011	1.6	2.5	1.1	1.0	1.5	2.0	1.1	1.0
II Q 2011	1.3	1.3	1.3	1.2	1.2	1.3	1.1	1.3
III Q 2011	1.8	1.8	1.3	1.3	1.4	1.5	1.2	1.3
IV Q 2011	1.8	1.8	1.5	1.4	1.6	1.5	1.3	1.4

Source: Survey of Professional Forecasters, Philadelphia Federal Reserve Bank

Measured on a fourth-quarter over fourth-quarter basis, headline CPI inflation is expected to average 1.7 percent in 2011 and 2.0 percent in 2012, which is only slightly higher than the forecast of 1.6 percent and 1.9 percent in the last survey. Forecasters expect fourth-quarter over fourth-quarter headline PCE inflation to average 1.6 percent in 2011, up from 1.4 percent in the last survey and 1.8 percent in 2012, unchanged from the previous estimate. Forecasts for annual inflation rates are in Table 3 below.

Table 3. Survey of Professional Forecasters – Annual Inflation Averages

	Headline CPI (%)		Core CPI (%)		Headline PCE* (%)		Core PCE	
	Previous	Current	Previous	Current	Previous	Current	Previous	Current
2011	1.6	1.7	1.3	1.3	1.4	1.6	1.2	1.3
2012	1.9	2.0	1.7	1.7	1.8	1.8	1.6	1.6
2013	N.A.	2.1	N.A.	1.9	N.A.	1.9	N.A.	1.7

Source: Survey of Professional Forecasters, Philadelphia Federal Reserve Bank

The Livingston Survey – Less Upbeat Forecasts

The *Livingston Survey*, sponsored by the Philadelphia Federal Reserve Bank, provides an alternative set of economic forecasts. The 33 participants in the December Livingston Survey see more modest output growth through 2011 than the consensus found in the *Survey of Professional Forecasters*. The Livingston forecasters, who are surveyed twice a year, project that the economy's output (real GDP) will rise at an annual rate of only 2.5 percent (annual rate) in the first half of 2011, followed by growth of 2.9 percent (annual rate) in the second half of 2011.

The Livingston panelists also expect to see a slower recovery in the labor market than the forecasters in the Survey of Professional forecasters, with the unemployment rate at 9.4 percent in June 2011. The unemployment rate is then expected to fall slightly lower, to 9.2 percent in December 2011.

The Livingston forecasters' projections for inflation are in line with the Survey of Professional Forecasters. In both 2010 and 2011, consumer prices (CPI) are expected to rise at an annual rate of 1.6 percent. These forecasts are 0.2 and 0.1 percentage point lower than the forecasts from the survey of six months ago. Consumer price inflation is expected to average 2.0 percent in 2012.

The Fed is Optimistic – But not Ready to End Treasury Purchases

The Fed forecasts provided in Table 4 show more optimism than forecasts from either the *Survey of Professional Forecasters* or the *Livingston Survey*. Minutes from the January Federal Open

Market Committee meeting and the revisions to the Federal Reserve's central tendency forecast both suggest that the Fed expects a stronger recovery in 2011. Nevertheless, there is no suggestion that the Fed will execute an exit strategy from quantitative easing in the near future. The Fed is likely to complete its QE2 repurchase program as planned, especially since the intended drop in the mid-range maturity Treasuries has not yet taken place as expected.

Table 4. Revisions in the Federal Open Market Committee Forecasts

	FOMC Meeting	2011	2012	2013	Longer Run
Change in Real GDP					
	Jan-11	3.4 to 3.9	3.5 to 4.4	3.7 to 4.6	2.5 to 2.8
	Nov-10	3.0 to 3.6	3.6 to 4.5	3.5 to 4.6	2.5 to 2.8
Unemployment Rate					
	Jan-11	8.8 to 9.0	7.6 to 8.1	6.8 to 7.2	5.0 to 6.0
	Nov-10	8.9 to 9.1	7.7 to 8.2	6.9 to 7.4	5.0 to 6.0
PCE Inflation					
	Jan-11	1.3 to 1.7	1.0 to 1.09	1.2 to 2.0	1.7 to 2.0
	Nov-10	1.1 to 1.7	1.1 to 1.8	1.2 to 2.0	1.6 to 2.0
PCE Core Inflation					
	Jan-11	1.0 to 1.3	1.0 to 1.5	1.1 to 2.0	
	Nov-10	.9 to 1.6	1.0 to 1.6	1.1 to 2.0	

Change in GDP and Inflation Projections are Fourth quarter to fourth quarter. Unemployment is the average for the year.
Source: Federal Reserve Central Tendency Forecasts

Analysts are looking for signs that the Fed will pull back from monetary easing. The reduction in the unemployment rate to 9% took place for reasons unrelated to economic strength. A decline in the labor force by 1.27 million since June 2009 was largely responsible for unemployment reductions this year. The Fed is more likely to target hiring strength, rather than the unemployment rate, as an indicator of a self-sustaining recovery. For example, in the past, the Fed waited until private employment gains averaged over 200,000 per month before raising interest rates. In the Survey of Professional Forecasters this rate of employment gains may not be reached until late in 2011 at the earliest.

The Fed is walking a dangerous line between stimulation and inflation that must be managed carefully. Expansionary growth of the money supply and improved bank liquidity are designed to stimulate a sluggish economy by easing interest rates. The irony is that the Fed's measures may actually lead to higher interest rates if inflation enters the system. The nominal interest rate is equal to the real rate plus a premium for expected inflation and a premium for credit risk. If inflation expectations rise, interest rates will rise, everything else equal. In this scenario the results of continued monetary expansion will be higher interest rates, not lower rates. Higher interest rates in this economic environment will not only affect private investment, but government financing of the expected large deficits will become very expensive. Service of the interest payments on the national debt will add to the overall debt burden significantly. This phenomenon would not only be a disaster for the federal governments but for state and local governments too.

Middle East Turmoil – How Serious are the Shocks?

While the key elements for a stronger recovery appears to be on track in 2011, shocks from global political instability along with concurrent rising oil prices may derail recovery in the U.S., as well as for the rest of the world.

Self Sustaining Recovery

While the economy appears to be on a path for recovery, unemployment remains too high. For a self sustaining recovery, without stimulus from either fiscal policy or the Fed, the economy needs to grow consistently above 3% to generate enough jobs to bring down unemployment. If external shocks moderate, all the preconditions are in place for an above-trend growth to begin in 2011.

Businesses are highly profitable in general with healthy balance sheets. Businesses are capable of creating new jobs if they see more certainty in taxes, employee benefit costs, and sales. The financial profiles of households are improving as deleveraging and low interest rates reduce debt service burdens. Delinquency rates on credit cards, auto loans and first mortgages are falling. Capitalization of banks and creditors has improved along with profitability, largely due to improving credit quality and wide lending margins.

While businesses and households have the ability to spend, a general lack of confidence in the future presents an obstacle to a more rapid recovery. Surveys show weak but improving sentiment, reflected by the financial market rebound and narrower credit spreads (risk premiums) in the bond market. The S&P 500 is up 85% from its low of two years ago and is within 15% of the all-time high it reached in late 2007, just before the financial panic. The University of Michigan survey of consumer confidence has reached a three year high. However, too many threats to global economic recovery and government budgets remain for a sense of comfort.

Labor Costs are Down but Employment Gains will be Difficult

U.S. unit labor costs have fallen more over the past two years than during any period since record-keeping began after World War II. Labor costs in the U.S. are back to where they were five years ago, while overseas labor markets have tightened. China and India no longer have such obvious advantages over the U.S., particularly for higher-value activities. This trend has been aided by a weaker U.S. dollar, which has fallen over 10% in the last decade relative to emerging economies to include China. There is more room for declines in the value of the dollar relative to China, Brazil, and other emerging-market currencies. Overall, U.S. products and production should be more competitive with imports.

Job creation could get a boost for new start-ups. Financing a new business is still tough, but underwriting standards for small businesses are improving, according to the Fed's survey of loan officers. The improved stock market might help stimulate venture capital and private equity firms to take more chances on start-ups, since the public market offers a more attractive exit strategy.

Private-sector payroll growth is expected to improve from approximately 1.25 million net new jobs in 2010 to more than 2 million in 2011. The expected payroll cuts at state and local governments due to fiscal problems will be the principal drag on the job market. On balance, it is unlikely that unemployment will fall below 9% for an extended period in 2011. Even with private sector job growth the unemployment rate will not decline much because the labor force will grow as workers re-enter the job market. The size of the labor force has been unchanged for the past three years and participation is near a twenty five year low.

The events surrounding the recession have probably increased the threshold for full employment to an unemployment rate close to 6%, compared to a 4.5% to 5% full-employment rate expectation prior to the recession. Job openings are likely to take longer to fill now, since many of the unemployed have been out of the market for a prolonged period resulting in less relevant skills and marketability. Mobility of workers to new locations to find jobs are also less likely since homeowners tend to be underwater with mortgages and are not able to move to new jobs.

U.S. Credit Markets Back to Normal …But only for Some

Credit markets have improved since 2008 and 2009 reflected by U.S. corporate bond spreads. While borrowing costs have not come down for all firms, corporate borrowing costs for top-rated firms are at about the same level experienced in the January 2003 and December 2007 period. Top-rated firms survived the recession and now that the worst has passed, investors are more confident that these firms will cover debt obligations. Credit market conditions for lesser-rated corporations are not quite back to normal, but borrowing costs should improve as the economy grows above the 3% rate. Banks currently face higher borrowing costs than pre-recession levels with option-adjusted spreads of about 100 basis points higher. Factors contributing to the elevated bank risk premiums include Europe's sovereign debt crisis concerns and continued foreclosures.

Summary of Recent Data Releases

GDP- Growth Remains too Low to Make Inroads on Unemployment

- Real GDP grew 2.8% at an annualized pace in the fourth quarter of 2010 improving from the 2.6% pace in the third quarter. The key drag on growth in the quarter came from private inventories, subtracting 3.7 percentage points. However, the drag in the fourth quarter suggests that the first quarter of 2010 will receive an added boost as inventories are replaced. Consumer spending, investment, and trade were all positives for growth in the fourth quarter. Growth in GDP and its components by quarter since 2009 appears in Table 5.

Table 5. GDP and Components by Quarter since 2009

Annualized % Change	**IV 2010**	**III 2010**	**II 2010**	**I 2010**	**IV 2009**	**III 2009**	**II 2009**	**I 2009**
Real GDP	2.8*	2.6	1.7	3.7	5.0	1.6	-0.7	-4.9
Consumption	2.9*	1.7	1.5	1.3	0.7	1.4	-1.1	-0.3
Fixed investment	**0.6***	0.2	2.1	0.4	-0.1	0.1	-1.3	-5.7
Fixed residential investment	0.1*	-0.8	0.6	-0.3	0.0	0.3	-0.5	-1.2
Fixed nonresidential investment	0.4*	0.9	1.5	0.7	-0.1	-0.1	-0.7	-4.5
Inventories	**-3.7***	1.6	0.8	2.6	2.8	1.1	-1.0	-1.1
Net exports	3.4*	-1.7	-3.5	-0.3	1.9	-1.4	1.5	2.9
Government	**-0.3***	0.8	0.8	-0.3	-0.3	0.3	1.2	-0.6

*The downward revision came from an upward revision to imports—higher imports reduce GDP—and downward revisions to state and local government and consumer spending. These were somewhat offset by an upward revision to exports.
Source: *Bureau of Economic Analysis*

- Real GDP has now increased for six straight quarters. On a year-ago basis, real GDP rose 2.8% in the fourth quarter.

- The average growth rate across the four quarters of 2010, real GDP rose 2.9%. This is the first calendar year increase since 2007 and the largest since 2005.

- Demand from consumers and business was extremely strong. Final sales of domestic product—GDP minus the change in inventories—grew 7.1% annualized in the fourth quarter. This is the largest quarterly gain since 1984, when the economy was coming out of the downturn of the early 1980s.

- Sales of durable goods rose more than 22% annualized.

- Investment in equipment and software, nonresidential structures, and residential structures all increased. Businesses are confident and are using their profits to invest.

- The trade deficit narrowed as imports fell and exports grew. Net exports added 3.4 percentage points to growth in the quarter; lower imports added 2.4 percentage points, while stronger exports added 1 percentage point.

Inflation- Demand Remains too Weak for Widespread Inflation

- There are no indications of inflation any time soon. With the unemployment rate still above 9% and slack prevalent throughout the economy, it is very difficult for firms to raise prices. The Federal Reserve will wrap up its quantitative easing program as expected in the middle of the year. The central bank will not increase the fed funds rate until early 2012, after the unemployment rate moves decisively lower.

- Consumer prices measured using the personal consumption expenditure price index rose 1.8% annualized in the fourth quarter; prices rose 0.8% in the third quarter.

- The Federal Reserve's preferred inflation measure, the core PCE deflator, which excludes food and energy prices, was up just 0.4% annualized in the fourth quarter, down slightly from 0.5% inflation in the previous quarter.

- Inflation is a growing concern as hopes for stabilization in global agriculture prices fade. The supply-demand balances for soy, corn and wheat look very tight. Agricultural prices make up a relatively large share of the consumer basket in emerging markets, likely pushing headline inflation rates up in coming months. Expectations of monetary tightening in these countries will put upward pressure on regional debt yields.

- A summary of different inflation measures over the past three months is provided in Table 6. All key measures, other than the producer price index for finished goods, signal rates of inflation well below the Fed's target limit of 2.5% annually.

Table 6. Alternative Inflation Measures over the past Three Months

Index – Month over Month % Change	**Jan. 11 2011**	**Dec. 10 2010**	**Nov.10 2010**	**3-month Moving Average**
Personal Consumption Expenditure (PCE)	na	0.3	0.1	0.1
Core Personal Consumption Expenditure (PCE)*	na	0.0	0.1	0.0
Consumer Price Index (CPI)	0.4	0.4	0.1	0.2
Core Consumer Price Index (CPI)*	0.2	0.1	0.1	0.0
Producer Price Index – finished goods (PPI)	0.8	0.9	0.7	0.5
Core Producer Price Index – finished goods (PPI)*	0.5	0.2	0.1	0.0

**Core inflation excludes food and energy prices.*
Source: Bureau of Economic Analysis

- Beyond energy and food, inflation has been contained. The core CPI has risen only 1.5% since the recovery began.

- A strengthening recovery is restoring some pricing power. The producer price index for finished goods is showing continued growth.

- The Treasury sold $9 billion in 30-year TIPS, yielding 2.9%, up from 1.8% at a similar auction in August. The TIPS yield is inflation protected and reflects a "real rate" of interest.

- Consumer expectations of inflation are considerably higher than the CPI and PCE recorded rates and are higher than analyst expectations. Table 7 below illustrates the longer run inflation expectations of consumers.

Table 7. Expected Inflation – University of Michigan Consumer Sentiment Survey

	Feb 11	Jan 11	Dec 10	Nov 10	Oct 10	Sep 10	Aug 10	Jul 10
1-yr (%)	3.4	3.4	3.0	3.0	2.7	2.2	2.7	2.7
5-yr (%)	2.9	2.9	2.8	2.8	2.8	2.7	2.8	2.9

Source: *University of Michigan*

Labor Markets – Discouraged Workers keep Unemployment Rate Low

- A brief overview of key labor market data appears in Table 8. The current unemployment rate of 9% is deceptive since the key factor leading to the decline from 9.4% was a decline in the labor participation rate.

- The weak labor market has kept wage growth low and weekly hours worked, for those who are employed, actually declined in January.

Table 8. Labor Markets and Employment

	Feb. 11 2011	Jan. 11 2011	Dec. 10 2010	Nov.10 2010	3-month Moving Average
Initial Unemployment Claims (thousands)	397.5	427.4	414.3	431.5	466.9
Unemployment Rate (%)	na	9.0	9.4	9.8	9.6
Aggregate Weekly Hours (month over month %)	na	-0.3	0.1	0.1	0.1
Wages and Salaries (month over month %)	na	na	0.3	0.1	0.3

Source: Bureau of Economic Analysis
All series are seasonally adjusted

Housing – Where is the Bottom?

- Sales of new homes dropped in January to 284,000, a decline of 12.6% from December. This drop follows December's strong gain, which remains in the double digits despite a 1% downward revision to December sales. New-home sales remain near a historic bottom. Averaged over the last six months, new-home sales are below 300,000 compared to 1.3 million in mid-2005 and the 880,000 for all of 2000.

- The decline in home sales combined with stable inventories of homes available for sale drove the months of inventory up to 7.9 from 7.0. The number of new homes available for sale remains lean, standing at 188,000 units, near the low of 181,000 hit in August 1967.

- The median new-house price increased compared with last year by nearly 6%. The median price is volatile, but has been trending up for the past year. Although builders are not selling many homes, low inventories are helping them avoid excessive price cuts. Data on new home sales since June of 2010 appear in Table 9.

Table 9. New Home Sales

	Jan 11 2011	Dec 10 2010	Nov 10 2010	Oct 10 2010	Sep 10 2010	Aug 10 2010	Jul 10 2010	Jun 10 2010
Months Supply on Market*	7.9	7.0	8.3	8.6	7.6	9.1	8.9	8.2
Median New Home Price ($000s)	233.9	237.2	221.1	207.5	227.6	232.1	211.2	219.0
% Change in Price	-1.4	7.3	6.5	-8.8	-2.0	9.9	-3.6	-3.1

**Millions seasonal annual adjusted*
Source: Census Bureau

- Tables 10 and 11 provide data on housing starts as well as existing home sales. The demand for housing picked up for the third consecutive month in January, according to the NAR's existing-home sales data. The 2.7% m/m gain brings home sales up to a pace of 5.36 million annualized units, the fastest it has been since May.

- Home sales have been gaining slightly recently, but the pace of sales remains slow. Months of inventory fell to 7.6, the lowest in more than a year. The median house price declined 3.7% y/y.

Table 10. Housing

	Feb. 11 2011	Jan. 11 2011	Dec. 10 2010	Nov.10 2010	3-month Moving Average
Housing Starts (millions)	na	0.60	0.52	0.55	0.58
Existing Home Sales (millions)	na	na	5.28	4.70	4.36
New Home Sales (millions)	na	na	0.33	0.28	0.29

Seasonally adjusted annual rates
Source: National Association of Realtors

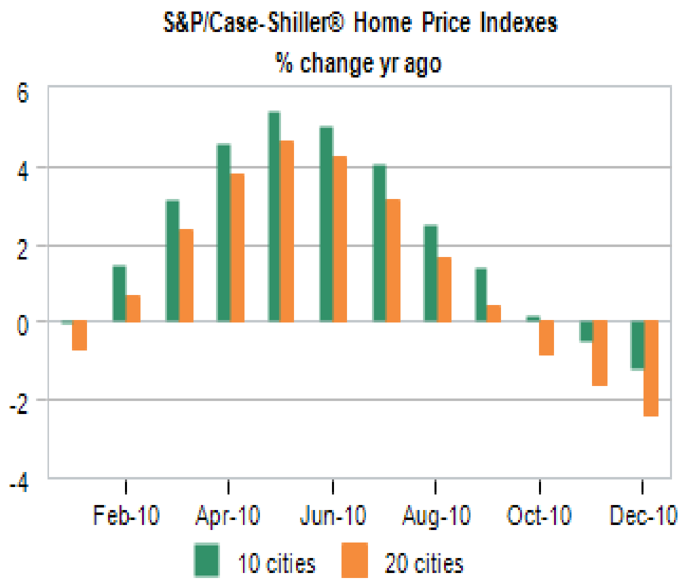
Table 11. Existing Home Sales

	Jan 11 2011	Dec 10 2010	Nov 10 2010	Oct 10 2010	Sep 10 2010	Aug 10 2010	Jul 10 2010	Jun 10 2010
Months Supply on Market*	7.6	8.2	9.6	10.6	10.9	11.7	12.5	8.9
Median New Home Price ($000s)	158.8	168.8	170.2	170.6	171.5	177.4	182.0	182.8

% Change from 1 yr. ago	-3.7	-1.0	0.1	-0.8	-2.5	0.1	0.4	0.6

**Millions seasonal annual adjusted*
Source: National Association of Realtors

- The S&P Case-Shiller Home Price Index in the figure below illustrates declining housing prices over the fourth quarter of 2010. The inability to establish a floor for housing prices is a significant weakness in the recovery.



Credit Markets and Yields –Credit Spreads Narrow

- Short term interest rates remain at historic lows but the 10-year yield has been rising, even with Fed quantitative easing. Credit spreads, measured as the difference between yields on risky bonds and non-risky bonds, have been falling. For example, the 1.62% spread for 10 year maturities of Corporate Aaa bonds over Treasury bonds in February was 2.11% in November.

- The yield curve is becoming steeper, reflected by a larger spread between 10 year and 2 year Treasury issues. Expectations for higher interest rates in the future (likely due to higher inflation expectations) explain the steeper slope. Table 12 provides a summary of key market yields and rates.

Table 12. Market Rates and Credit Spreads

	Feb. 11 2011	Jan. 11 2011	Dec. 10 2010	Nov.10 2010	3-month Moving Avg.
Fed Funds Target (%)	0.13	0.13	0.13	0.13	0.13

10-Year Treasury (%)	3.62	3.39	3.29	2.76	2.63
Aaa Spread Over 10YR Note (%)	1.62	1.65	1.72	2.11	1.94
Baa Spread Over 10YR Note (%)	2.56	2.69	2.81	3.16	3.05
Prime Rate (%)	3.25	3.25	3.25	3.25	3.25
Yield spread: (10yr - 2-yr) Treasury (%)	2.83	2.78	2.67	2.31	2.17

Sentiment and Confidence – Confidence is Improving but Remains Fragile

- The University of Michigan consumer sentiment index improved in February according to preliminary data. The gain was entirely due to an improvement in consumers' view of current conditions. Inflation expectations were unchanged, maintaining the large gain in near-term expectations in December.

- Consumer confidence took a small step forward in February. It remained in the high end of the range seen early in 2010, rather than at the lower levels seen from July through October.

- While the index gained from its final January reading, it is not on an upward trend. Economic drivers of confidence remain very mixed. Positive factors include the improved stock market since September, clearer near term tax policy, and a somewhat more optimistic view of the job market. Drags on confidence include higher gasoline prices, weak jobs gains, a large number of discouraged workers out of the labor force, and uncertainty over the impact of reforms in healthcare, financial markets, and the environment. The housing market continues to be a major drag on confidence, especially after the efforts of the federal homebuyer tax credit and quantitative easing have not prevented housing prices from falling again.

- Confidence remains an important ingredient for a full recovery. Businesses and households have an improved ability to spend but higher confidence will be needed to promote actual spending. Continued strength in the stock market, lower energy prices, and a stronger job market are all needed for a significant boost in confidence.

Table 12. University of Michigan Consumer Sentiment Survey (1966 QI = 100)

	Feb 11 2010	Jan 11 2010	Dec 10 2010	Nov 10 2010	Oct 10 2010	Sep 10 2010	Aug 10 2010	Jul 10 2010	Feb 11 2010
Index	75.1	74.2	74.5	71.6	67.7	68.2	68.9	67.8	75.1
Index Change	0.9	-0.3	2.9	3.9	-0.5	-0.7	1.1	-8.2	0.9

Source: University of Michigan

- The Conference Board index of leading indicators rose 0.1% in January. This is a smaller gain than expected but still suggests the recovery is well entrenched. The leading index was 5.25% higher on a year-ago basis.

- The drags on the leading index were the average workweek, jobless claims, building permits, and stock prices.

- The three-month annualized rate slowed to 8.2%. The six-month annualized rate decreased from 6.3% to 6.1%. These growth rates are consistent with the faster pace of recovery expected in the last half of 2011.

- The Conference Board consumer confidence index gained 7.2 points in January, to 60.6. This was only the second time the index exceeded 60 since 2008. The other came last May.

- The expectations component of the index gained 8 points to 80.3 while the present conditions component added 6.1 points to 31. The latter was the highest reading since November 2008.