



*The*  
President's  
Report *to the*  
Board *of*  
Directors

November 2, 2012

## CURRENT ECONOMIC DEVELOPMENTS - November 2, 2012

Data released since your last Directors' meeting show that the economy accelerated in the third quarter, but likely not by enough to significantly reduce unemployment or stem the threats posed by the ongoing fiscal and financial concerns both here and in Europe. Resilient consumers and the burgeoning recovery in the housing market have brightened the outlook, but support from manufacturing and business investment has declined. In all, growth is unlikely to improve much further over the rest of the year.

In October, nonfarm payrolls posted another solid increase and job gains for the previous two months were revised higher. However, the unemployment rate ticked up one-tenth of a percentage point from the three-year low seen in September. Initial claims for unemployment insurance eased a bit in October, but remain above their pre-recession levels.

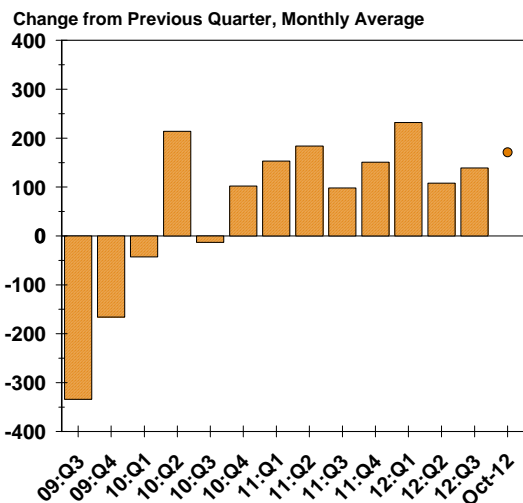
The growth in real GDP in the third quarter primarily reflected positive contributions from personal consumption expenditures, federal government spending, and residential fixed investment. Those effects were partly offset by negative contributions from exports, nonresidential fixed investment, and private inventory investment.

Also in October, consumer attitudes improved towards both current economic conditions and the short-term outlook. The ISM index increased slightly in October, but continued to signal only a small expansion in the manufacturing sector.

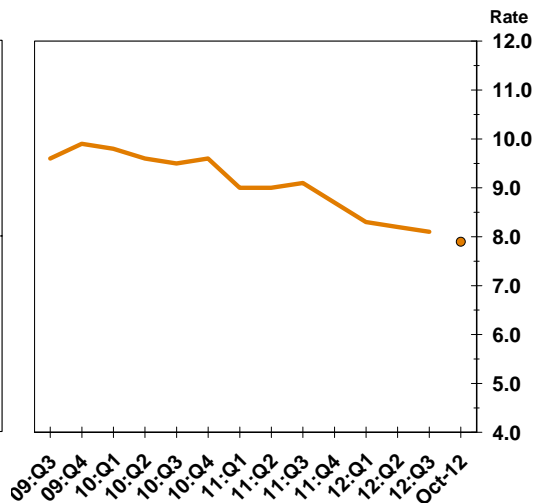
Total consumer inflation decelerated further in the third quarter, as did the core index. Unit labor costs also fell in the third quarter and total compensation costs, as measured by the ECI, slowed. Oil prices fell steadily through October, and their average for the month dropped from those of the previous two months.

Nonfarm payrolls added 171,000 jobs in October, and job gains for the previous two months were revised upward by a total of 84,000 jobs. Despite the better-than-expected payroll gains, the unemployment rate rose one-tenth of a percentage point to 7.9% in October. The uptick in the unemployment rate was due primarily to a moderate increase in the size of the labor force, which outpaced a smaller gain in civilian employment.

### Nonfarm Payroll Employment

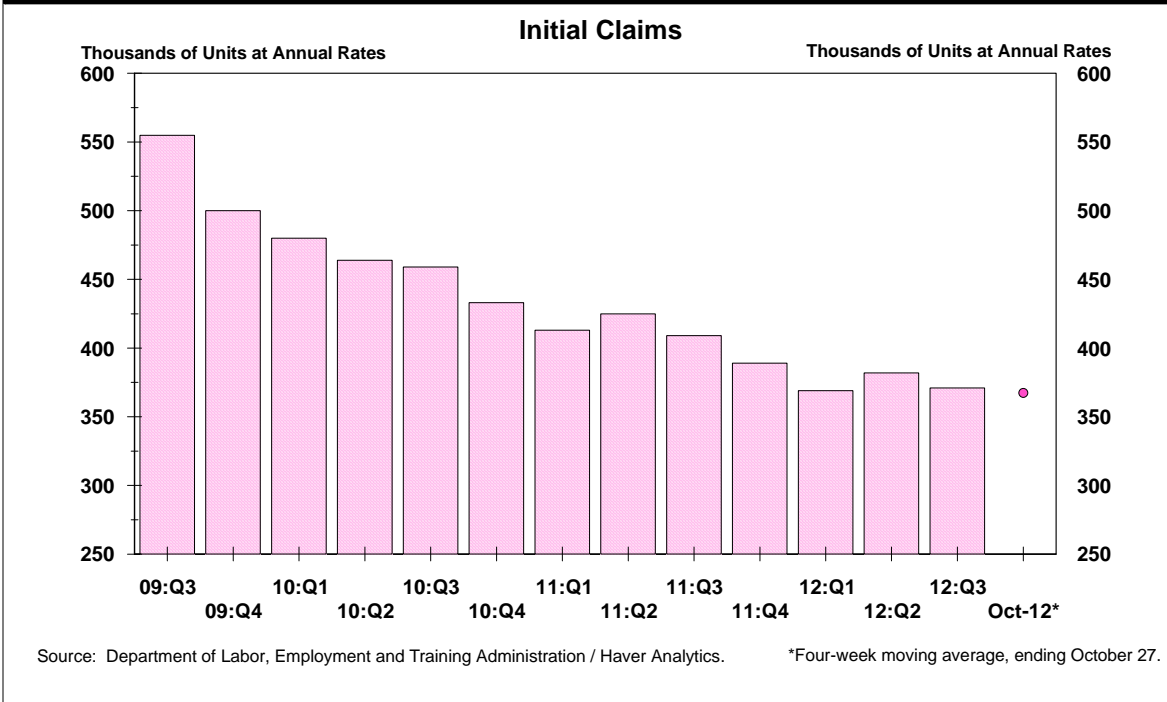


### Unemployment Rate

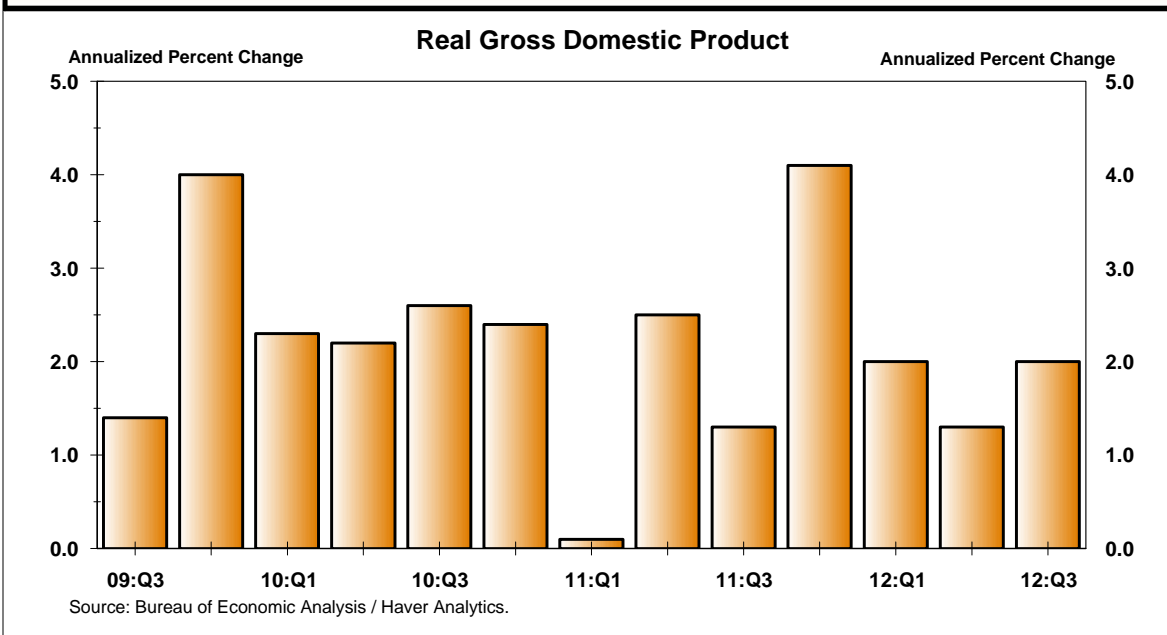


Source: Bureau of Labor Statistics / Haver Analytics.

Initial claims for unemployment insurance came down some in the third quarter and eased a bit more in October, but overall remain at a level consistent with little improvement in unemployment. Weekly claims averaged roughly 315,000 in the two years preceding the recession.

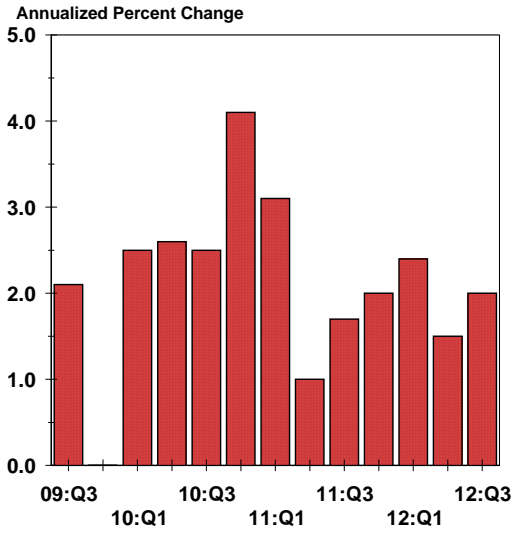


Real GDP growth accelerated in the third quarter. The higher rate was due primarily to an upturn in federal government spending, a downturn in imports, an acceleration in PCE, a smaller decrease in private inventory investment, an acceleration in residential fixed investment, and a smaller decrease in state and local government spending that were partly offset by downturns in exports and in nonresidential fixed investment.

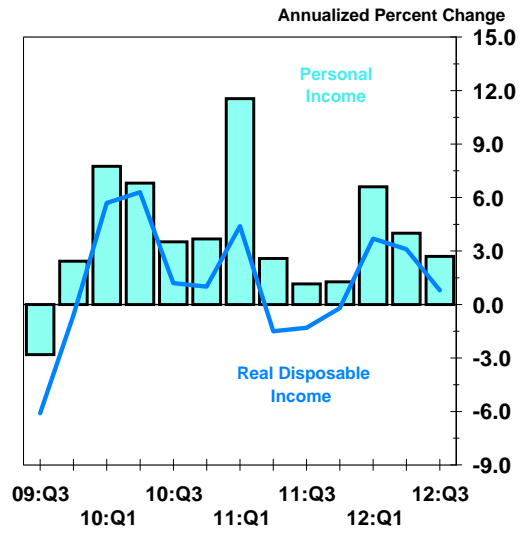


Real consumption accelerated in the third quarter, and was a primary contributor to the increase in third quarter GDP. The strong consumption occurred despite only a small increase in real incomes, which was well below the growth rates seen in the first two quarters of the year. Growth in nominal incomes also decelerated in the third quarter.

### Real Consumption



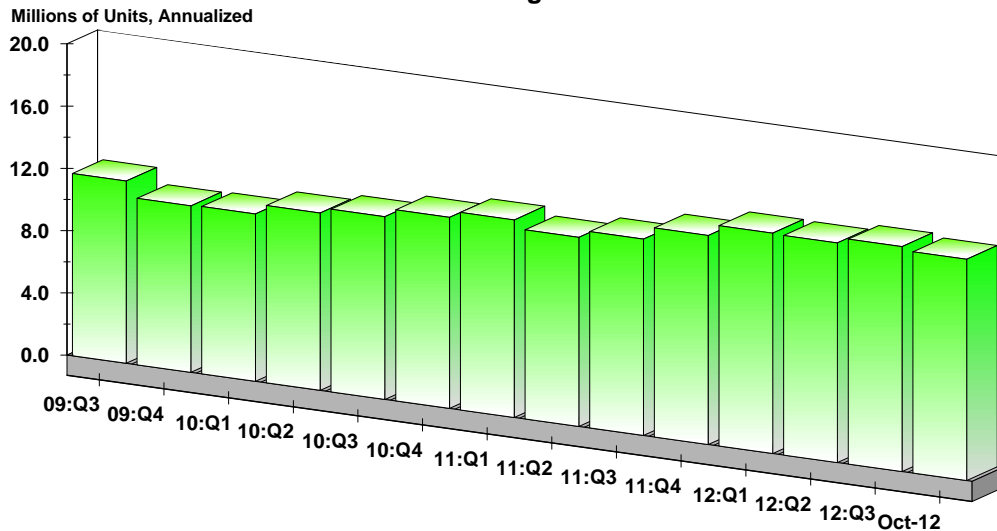
### Personal Income



Source: Bureau of Economic Analysis / Haver Analytics.

Total lightweight vehicle sales fell in October to below their third quarter average. The lower-than-expected sales were primarily due to weaker domestic vehicle sales, as Hurricane Sandy likely accounted for a portion of the decrease. Additionally, the drop in truck sales outpaced the decrease in auto sales.

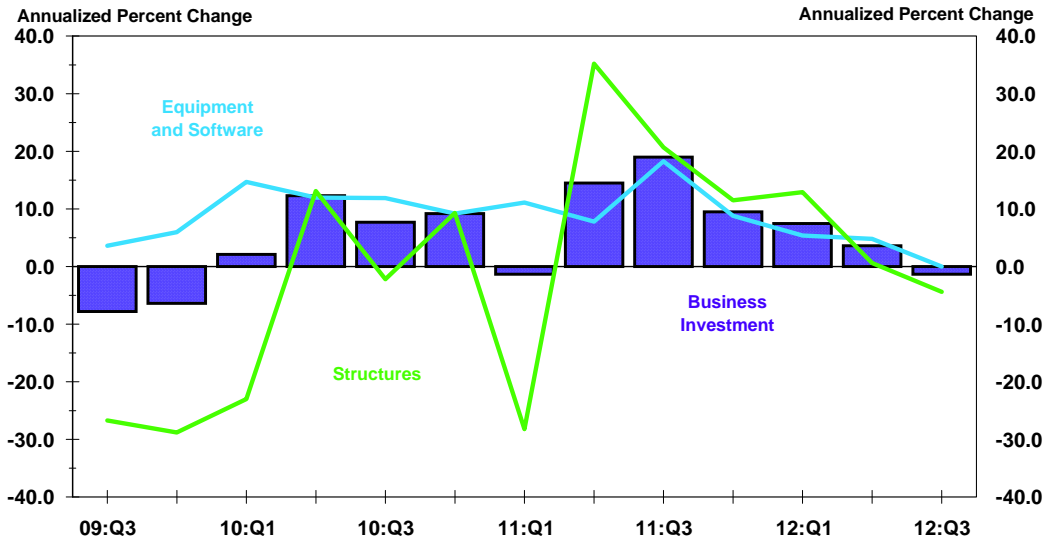
### Total Auto and Light Truck Sales



Source: Bureau of Economic Analysis / Haver Analytics / Edmunds.com / N.Y Times.

Business investment fell in the third quarter for the first time since 2011:Q1, as nonresidential structures decreased and equipment and software was unchanged.

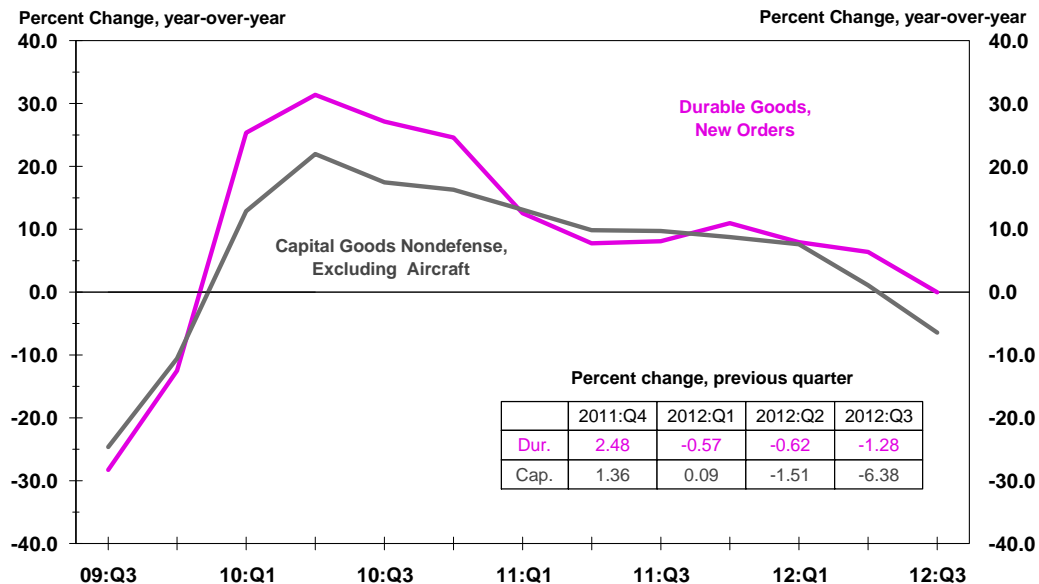
### Business Investment



Source: Bureau of Economic Analysis / Haver Analytics.

On a year-over-year basis, new orders for durable goods fell slightly in the third quarter, their first decline in nearly three years. Orders of nondefense capital goods, excluding aircraft, also decreased in the third quarter, suggesting future business investment will continue to slow.

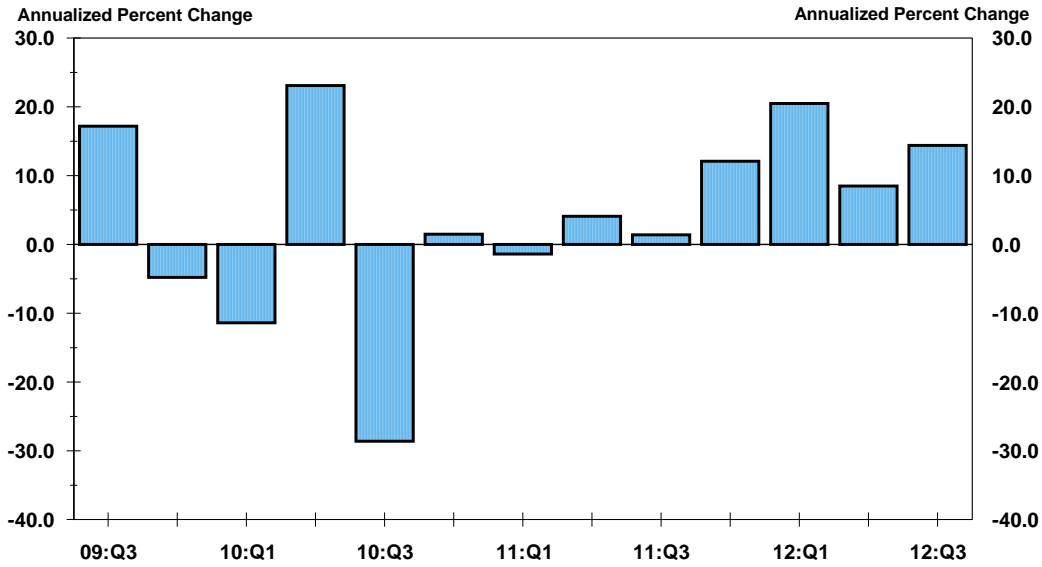
### Durable Goods Orders



Source: U.S. Census Bureau / Haver Analytics.

Residential investment posted another solid gain in the third quarter and has now increased in each of the last six quarters.

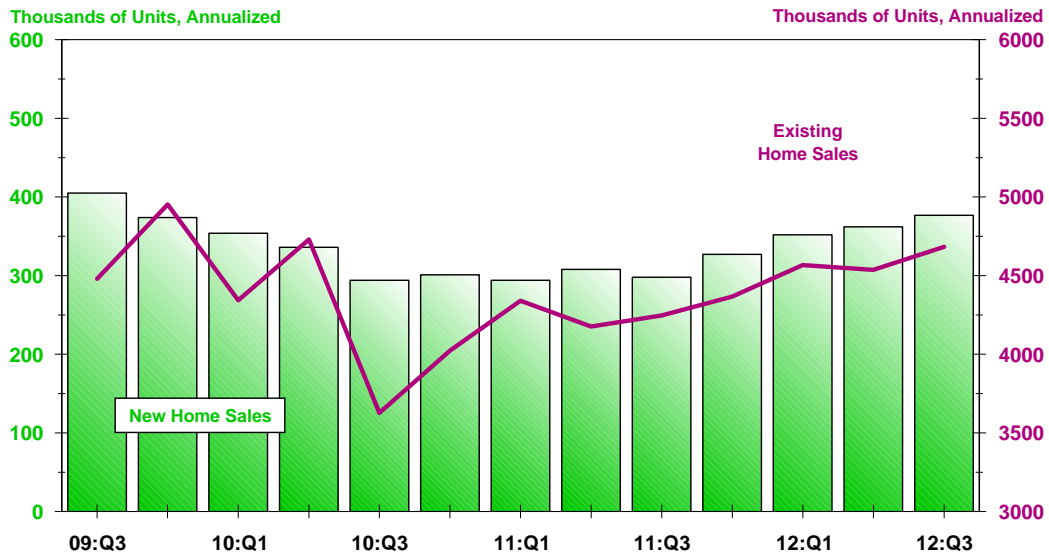
### Residential Investment



Source: U.S. Census Bureau / Haver Analytics.

The housing market continued to improve in the third quarter. New home sales rose for the fourth consecutive quarter to reach their highest level in three years. Existing home sales also increased in the third quarter, more than offsetting the small dip seen in the second quarter.

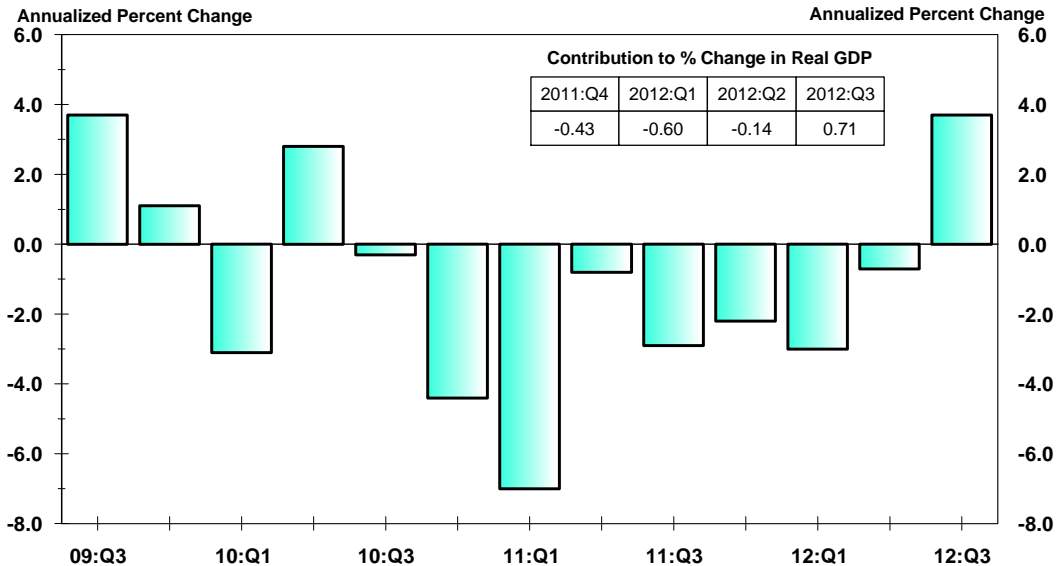
### New and Existing Home Sales



Source: U.S. Census Bureau / Haver Analytics.

Government spending jumped in the third quarter, following two straight years of quarterly declines. The improvement was due to an unexpected increase in federal defense spending, which is likely to be temporary.

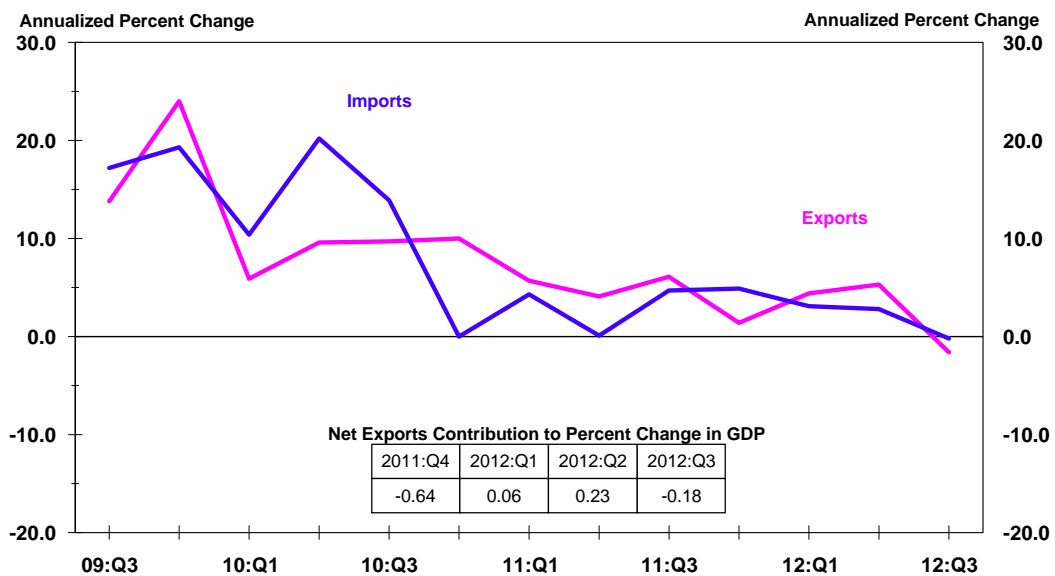
### Government Spending



Source: Bureau of Economic Analysis / Haver Analytics.

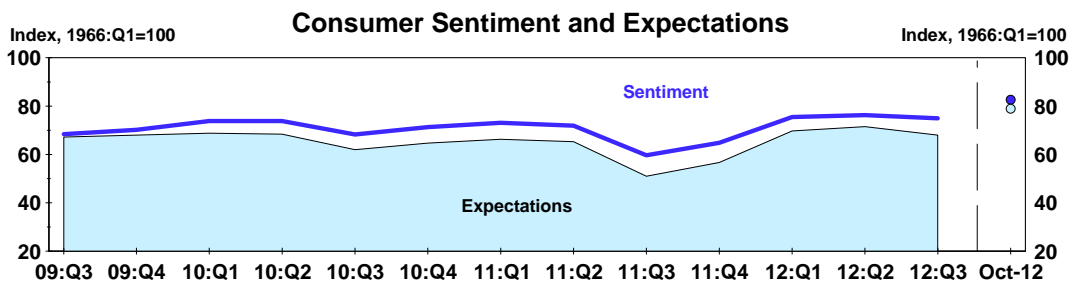
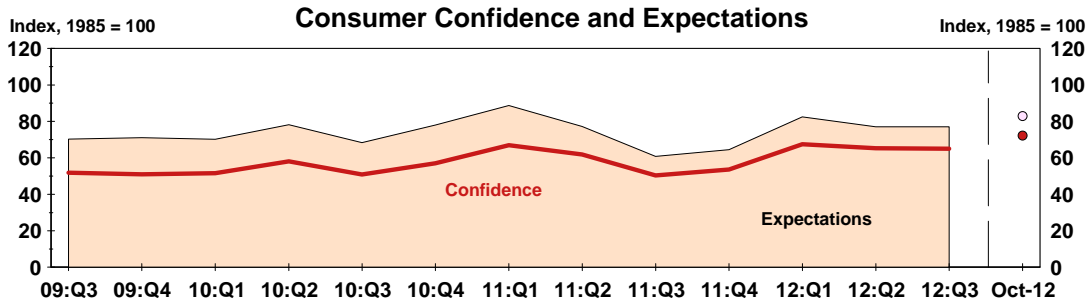
Exports fell in the third quarter, more than offsetting a smaller decrease in import growth, which resulted in a slight drag on GDP from net exports.

### Exports and Imports



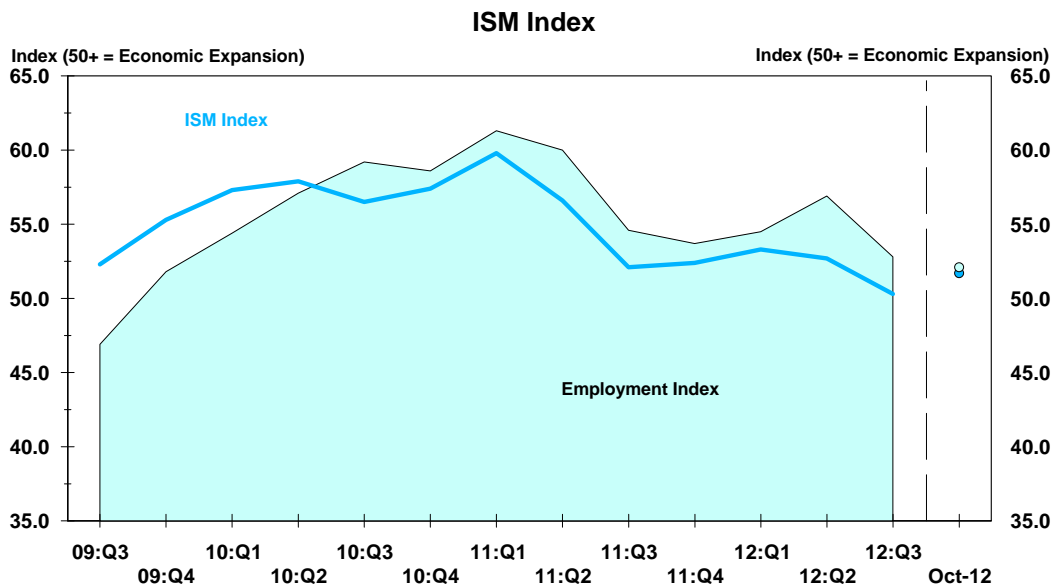
Source: Bureau of Economic Analysis / Haver Analytics.

Measures of consumer attitudes improved in October, after falling slightly in the third quarter, and are now at their highest levels since the recession. The optimism was widespread, with respondents expressing more favorable views on job prospects, personal finances, business conditions and overall economic expectations.



Source: The Conference Board (confidence) and University of Michigan (sentiment) / Haver Analytics.

The ISM manufacturing index improved a bit in October, after easing on average in the third quarter. While the index still signals slight expansion of the sector, growth has slowed somewhat since the beginning of the year. The employment index declined in October, falling slightly below its third quarter average.

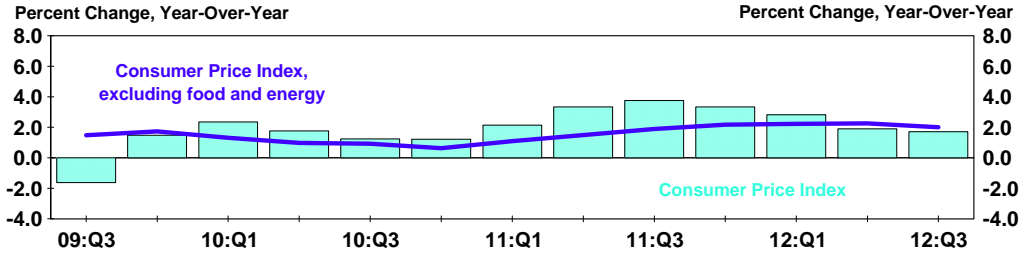


Source: Institute for Supply Management / Haver Analytics.

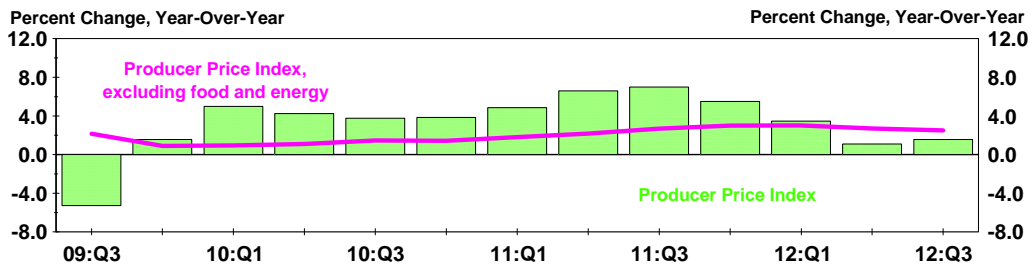


Total consumer prices continued to decelerate in the third quarter, as they had in each of the past three quarters, and core prices grew at their slowest rate in a year. Meanwhile, total producer prices accelerated in the third quarter for the first time since 2011:Q3, due mostly to rising fuel costs, as the core index continued to slow.

### Consumer Price Index



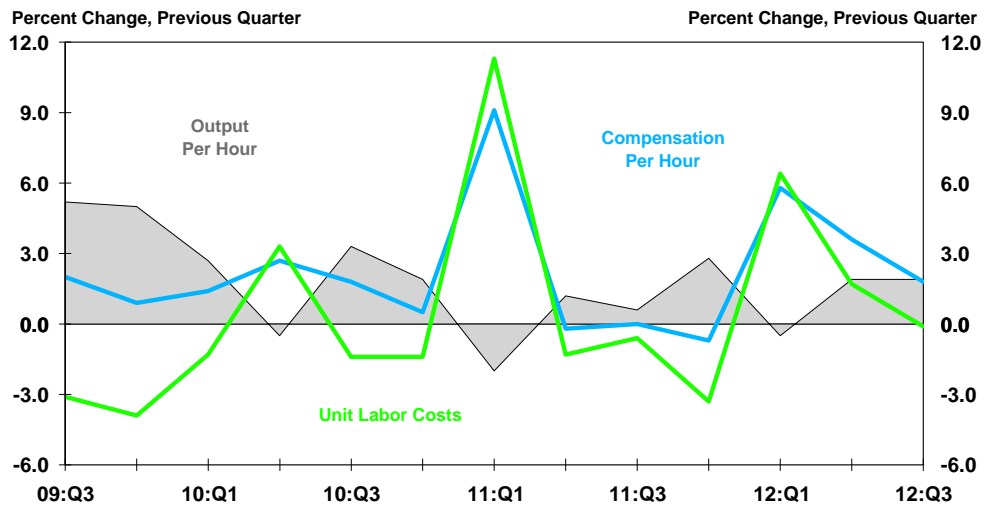
### Producer Price Index



Source: Bureau of Labor Statistics / Haver Analytics.

Productivity growth held steady during the third quarter, as increased output again outpaced a smaller gain in total hours. Total compensation growth slowed in the third quarter, while unit labor costs fell for the first time this year.

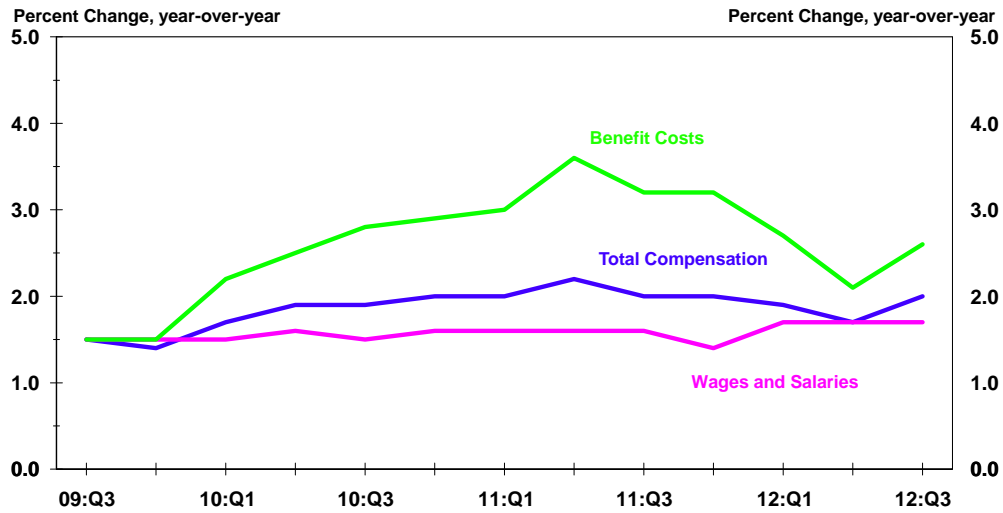
### Productivity and Costs



Source: Bureau of Labor Statistics / Haver Analytics.

Employment costs accelerated in the third quarter on a year-over-year basis, due to an acceleration in benefit costs, while wage and salary growth continued to hold steady.

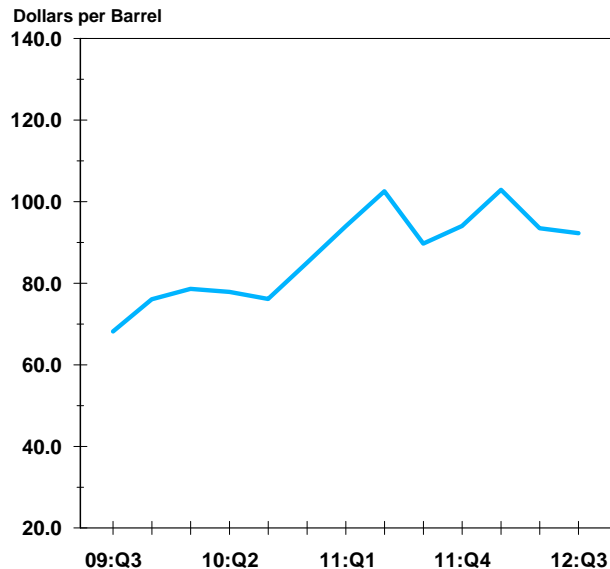
### Employment Cost Index



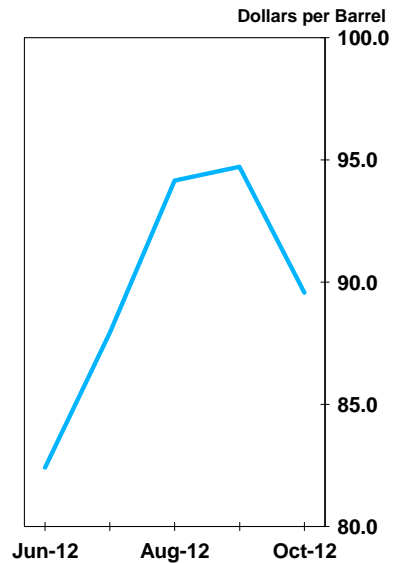
Source: Bureau of Labor Statistics / Haver Analytics.

On average, oil prices in October dropped from the levels seen in August and September. The daily closing prices fell consistently during the month, from around \$92 per barrel in early October to near \$86 by the end of the month.

### Domestic Spot Oil Price



### Past Five Months



Source: Wall Street Journal / Haver Analytics.

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