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DAILY GLOBAL COMMENTARY

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The Long and Short of the Fannie Mae and Freddie Mac Rescue

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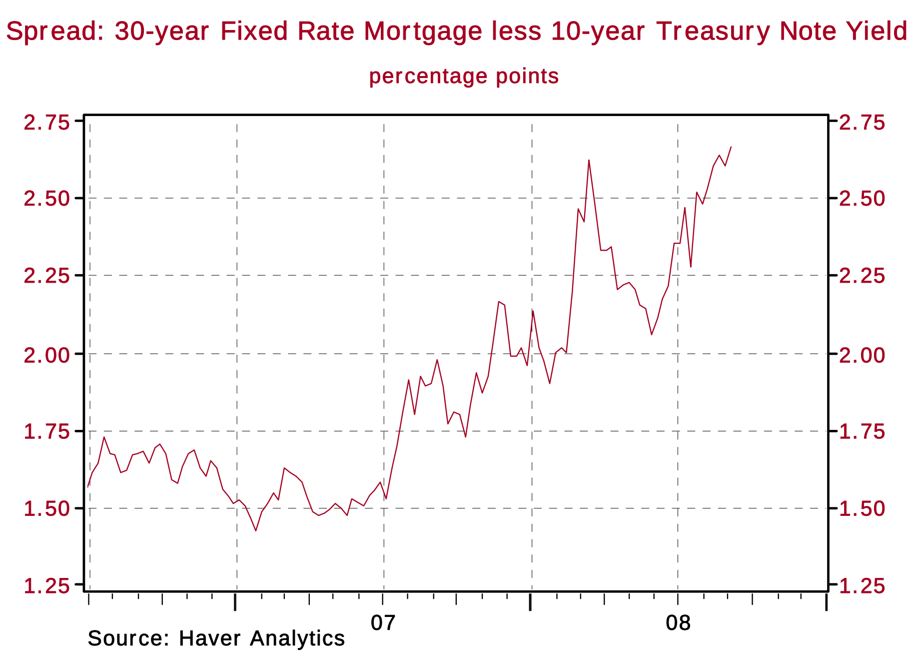
The U.S. Treasury's rescue of Fannie Mae and Freddie Mac over the weekend was only a matter of time. Financial market fragility looms large after a sharp cut in the federal funds rate, a fiscal stimulus package, and the myriad of programs to bring about stability in financial markets. The expectation is that the latest measure will foster stability in global financial markets. The $200 billion package is another type of fiscal stimulus to prevent a serious global financial market debacle. The long and short of this entire transaction is that it is an operation aimed at establishing market stability and improving housing market conditions in the short-run but at the same time it has raised the size of federal debt which will have an impact on interest rates in the long term that is not particularly desirable. The immediate impact is that infusion of funds to Fannie Mae and Freddie Mac should have a strong positive influence on the housing market. Mortgage rates have failed to follow the Fed's easing path (see chart 1) which has prevented a speedy adjustment in the housing market. The current elevated inventory situation of unsold homes points to additional price declines, while the weakness in labor market conditions suggest continued weakness in home sales. We will be watching mortgage rates closely in the next few weeks to gauge the success of this operation.

Chart 1



Financial market spreads is another aspect we will be watching to assess the impact of the latest action to bring about market stability. Charts 2-4 illustrate the status of market spreads as of September 5.

Chart 2

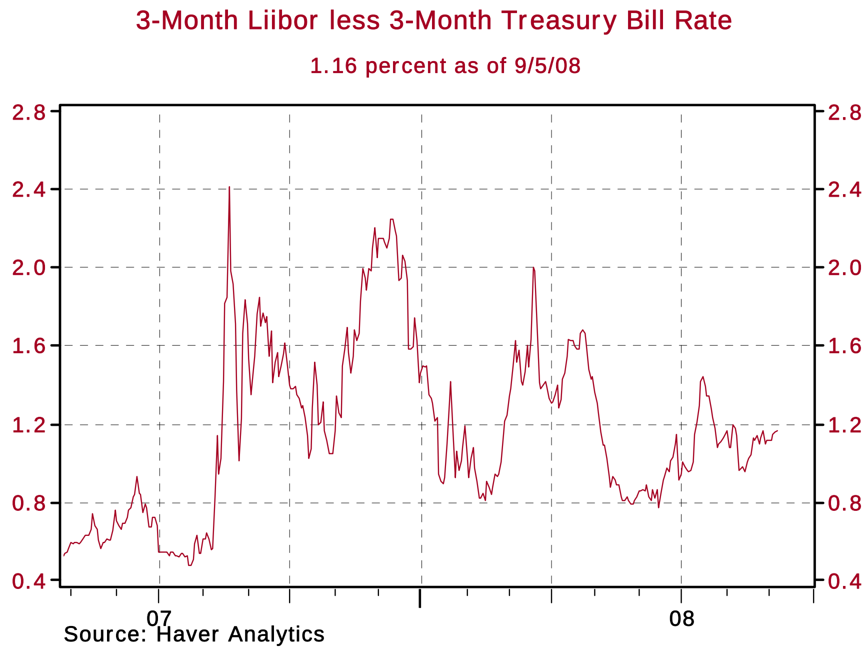


Chart 3

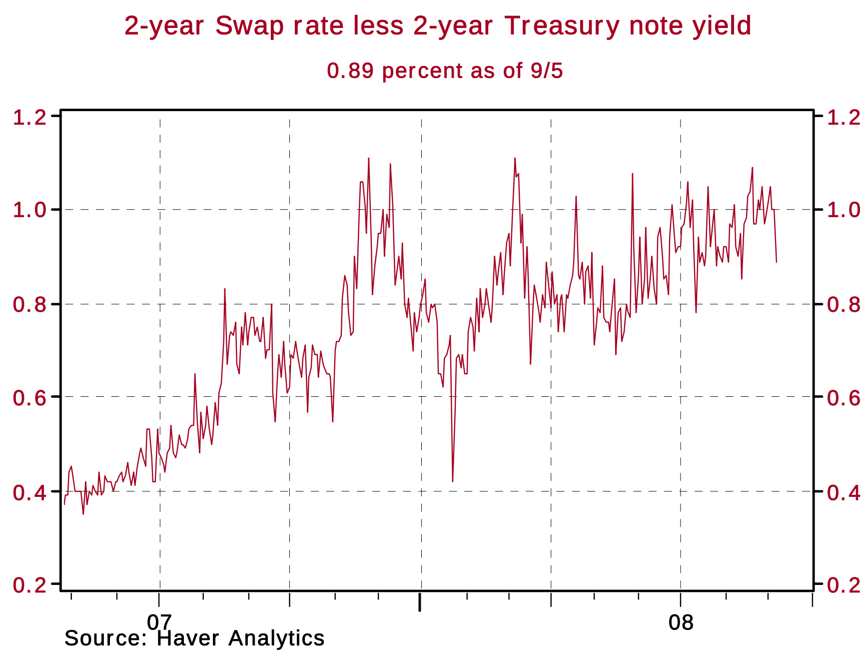
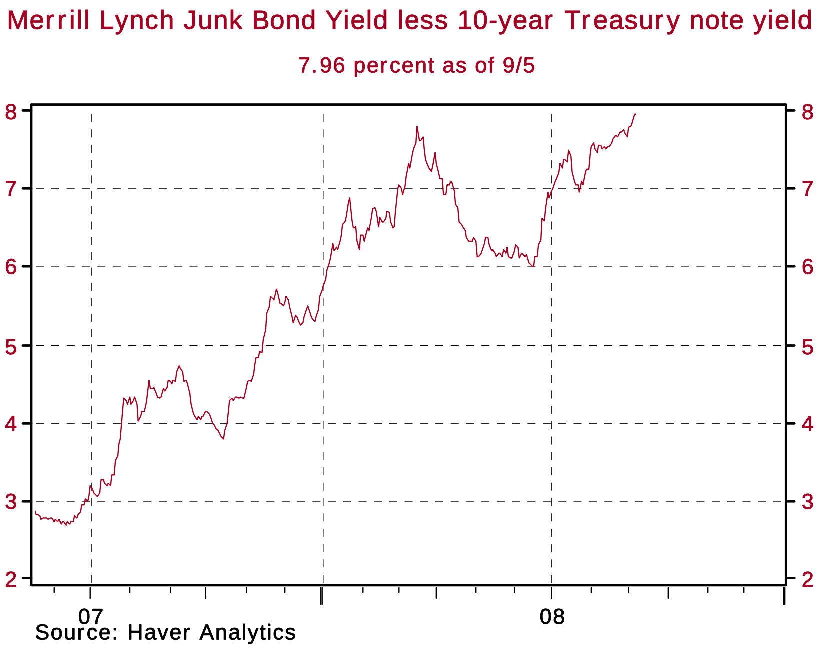


Chart 4


Merrill Lynch Junk Bond Yield less 10-year Treasury note yield
7.96 percent as of 9/5
8
7
6
5
4
3
2
07
08
Source: Haver Analytics