

DAILY GLOBAL COMMENTARY

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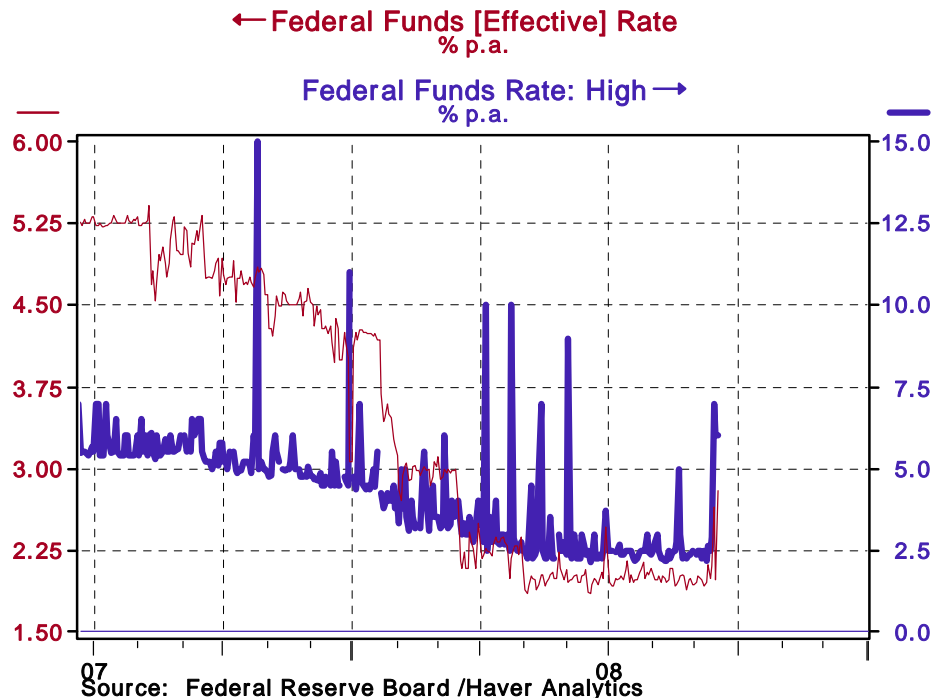
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Markets Recover Somewhat After Distrust and Anxiety Ruled Earlier in the Day

September 18, 2008

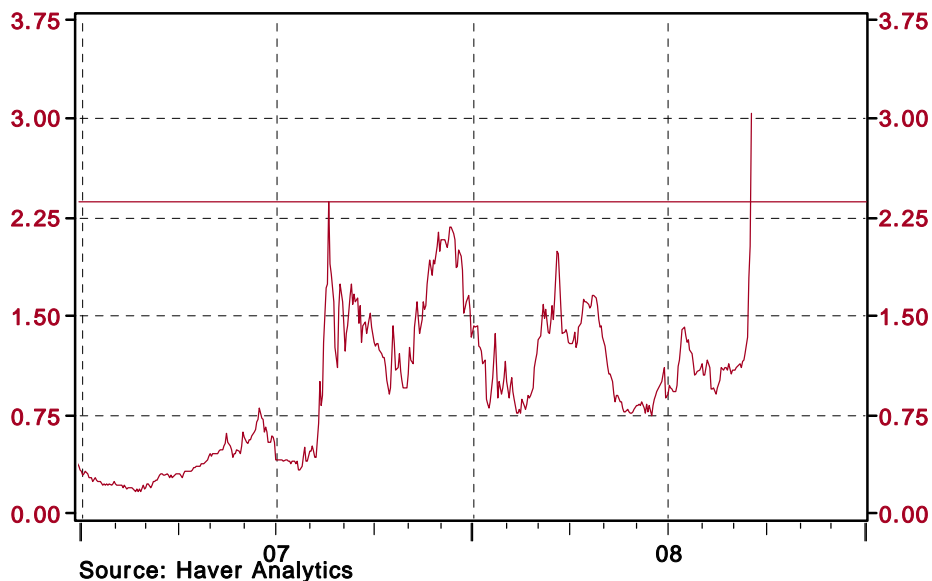
The Fed is now not only the “lender of last resort” but also the “investor of last resort”. Today, the Federal Reserve Bank of New York injected a record \$105 billion to manage the federal funds rate which has exceeded the target rate for four consecutive days (see chart 1, data points stop at 9/17/08). The Fed also made available \$180 billion to other major central banks (Bank of England, European Central Bank, Bank of Canada, Bank of Japan, and the Bank of Switzerland) and they have engaged in coordinated actions to provide liquidity.

Chart 1



Thomas Meyer, chief economist of Deutsche Bank in London, sums up the situation most appropriately: "If a body dehydrates it falls over and if it gets worse it can die. Likewise the financial system is starved of liquidity right now so the central banks will have to keep providing it." The extent of risk aversion and fear is reflected in the spread between the 3-month Libor and 3-month Treasury bill rate. It shot up to 303 basis points yesterday (see chart 2, data points stop at 9/17/08). Today this spread widened further to 313 bps (3.2068-0.076, around 1:30 PM CT). This is 76 bps higher than the peak spread (237 bps) posted on August 20, 2007, the month when the ongoing crisis commenced. At 3PM CT, this spread declined to around 300bps with the 3-month T-bill at 0.21%.

Chart 2
3-month Libor Less 3-Month Treasury bill rate
 percent



There are three options available to the Fed and the U.S. Treasury to combat the upheaval in financial markets: (1) A lower federal funds rate, (2) raising more funds in the market, and (3) setting up an agency to undertake for purchases of assets. If economic conditions were to weaken further, a lower federal funds rate is an option and this situation is entirely conceivable. The Treasury has stepped in raised funds for the AIG deal instead of AIG borrowing directly. If AIG had issued new bonds, the cost would have been about 18.0% (CCC rated Merrill Lynch junk bond yield as of 9/17/08), instead it obtained a sweet deal of 3-month Libor plus 850 basis points, about 11.7% today. In any case, borrowing more in the marketplace widens the budget deficit with far reaching long-term implications, particularly higher long term interest rates.

Reuters and Bloomberg reported today that Treasury Secretary Paulson and Chairman Bernanke are considering a new plan to address the crisis. Reuters reported that a modernized Resolution Trust Corp.-type agency was on the table. Paul Volcker, Nicholas Brady, and Eugene Ludwig wrote about Resolution Trust II in the Wall Street Journal on September 17 ([Resurrect the Resolution Trust Corp. - WSJ.com](#)).

There was a sell-off in fixed income markets as the news trickled down, with the 10-year Treasury note trading around 3.54%, up from a low of 3.35% during the day. The Dow Jones closed at 11019.69, up 3.86% for the day, and an intra-day low of 10459.44. The S&P 500 moved up 4.3% to 1206.33 following a 4.7% drop on September 17.

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Recent Market Developments – September 18, 2008

	9/2/08	9/5/08	9/8/08	9/12/08	9/15/08	9/16/08	9/17/08	9/18/08
Target Federal Funds rate	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
Effective Federal funds rate	1.96	1.97	1.92	2.10	2.64	1.98	2.80	
3-month T-Bill rate	1.69	1.65	1.69	1.46	1.03	0.84	0.03	0.21
3-month Libor	2.81	2.81	2.82	2.82	2.82	2.88	3.06	3.20
Spread: 3-m Libor less 3-month T Bill	112.31	116.44	112.69	135.88	178.63	203.63	303.25	299.38
2-year U.S Treasury note yield	2.26	2.23	2.30	2.23	1.78	1.89	1.64	1.77
10-year U.S. Treasury note yield	3.74	3.66	3.66	3.74	3.47	3.48	3.40	3.54
Fannie Mae 10-yr. note yield	4.62	4.54	4.28	4.37	4.15	4.19	4.17	
Spread: Fannie Mae less 10-yr. Treasury, bps	87.80	88.40	61.70	63.10	68.30	70.90	76.90	
Dow Jones*	11516.92	11220.96	11510.74	11421.99	10917.51	11059.02	10609.66	11019.69
						-3.98%	-7.88%	-4.32%
S&P 500	1277.58	1242.31	1267.79	1251.70	1192.70	1213.59	1156.39	1206.33
						-5.01%	-9.49%	-2.90%
Eurofirst 300 FTSE Share Price Index	1340.30	1249.90	1288.60	1281.30	1235.20	1213.70	1186.10	
						-9.45%	-11.50%	
World Ex. US Dow Jones	216.91	204.34	209.81	206.46	201.18	194.71	192.40	
						-10.23%	-11.30%	
Dow Jones China 88	210.42	201.61	197.39	192.54	holiday	184.18	175.90	172.49
						-12.47%	-16.41%	-18.03%
India : Sensex	15049.86	14483.83	14944.97	14000.81	13531.27	13518.80	13262.90	13315.60
						-10.17%	-11.87%	-8.07%
Brazil: Bovespa	54404.41	51939.60	50717.97	52392.86	48416.33	49228.92	45908.51	
						-9.51%	-15.62%	
Trade Weighted Dollar	75.69	75.91	76.54	76.07	75.97	76.15	76.10	75.39
						0.62%	0.55%	-0.68%
\$ per Euro	1.45	1.43	1.41	1.42	1.42	1.42	1.42	1.44
Yen per \$	108.85	106.96	107.91	107.51	105.67	105.11	104.71	
Spot Price of Crude Oil	110.21	106.23	106.34	101.18	95.71	91.15	97.16	97.88
						-17.29%	-11.84%	-11.19%

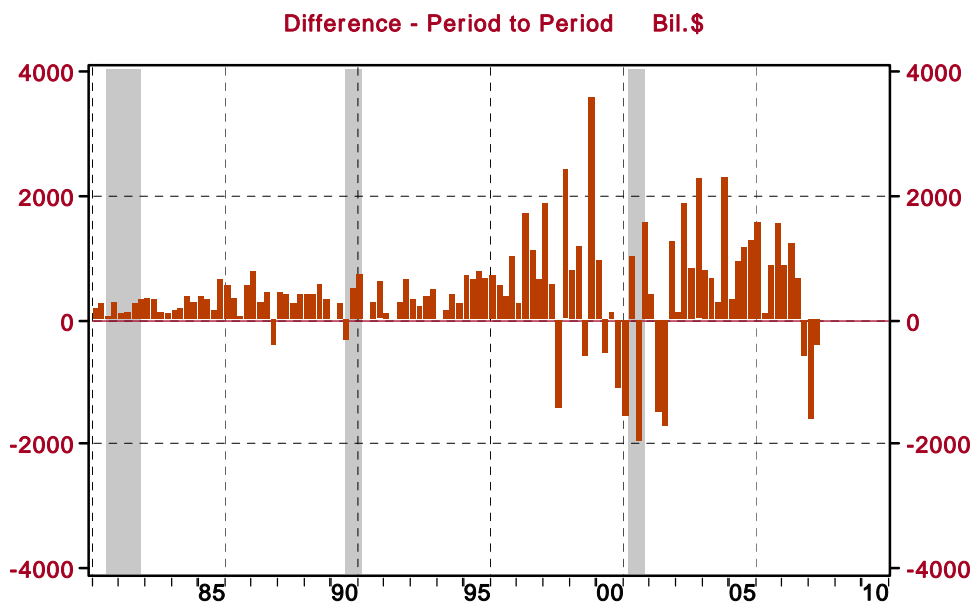
* - Percentage changes below market quotes are changes with respect to quotes on September 2. Complete data for 9/18/08 not available as of this writing.

Household Net Worth Fell For Third Consecutive Quarter

Household net worth (-\$438 billion) dropped in the second quarter to \$55.993 trillion, marking the third consecutive quarterly decline. Historically, household net worth has never dropped for three straight quarters (chart 3 starts from 1981). It should not be surprising to see a fourth quarterly decline given current market conditions.

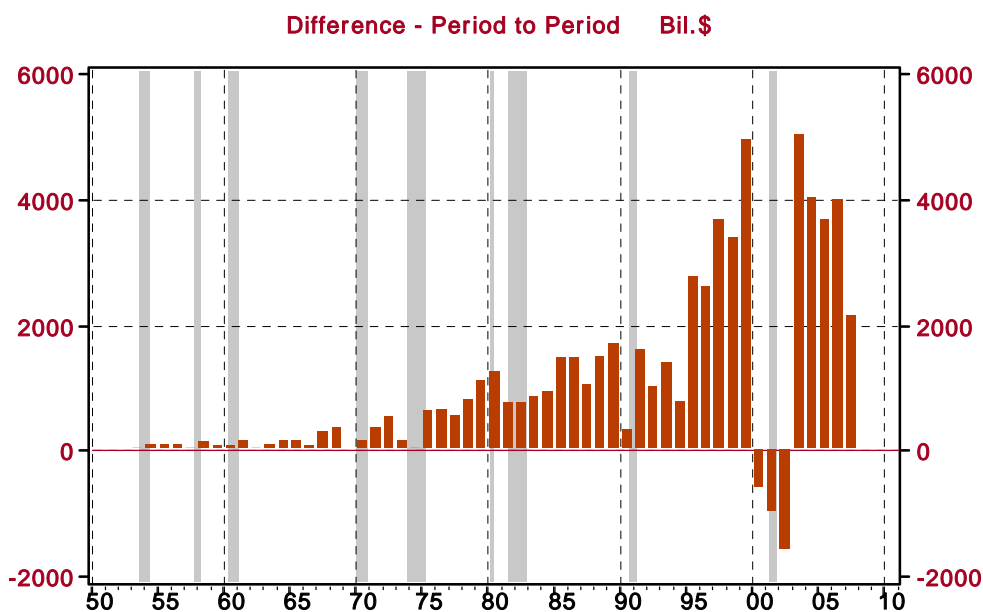
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Chart 3
Households & Nonprofit Organizations: Net Worth



On an annual basis, net worth has dropped for three straight years 2000-2002 (see chart 4).

Chart 4
Households & Nonprofit Organizations: Net Worth



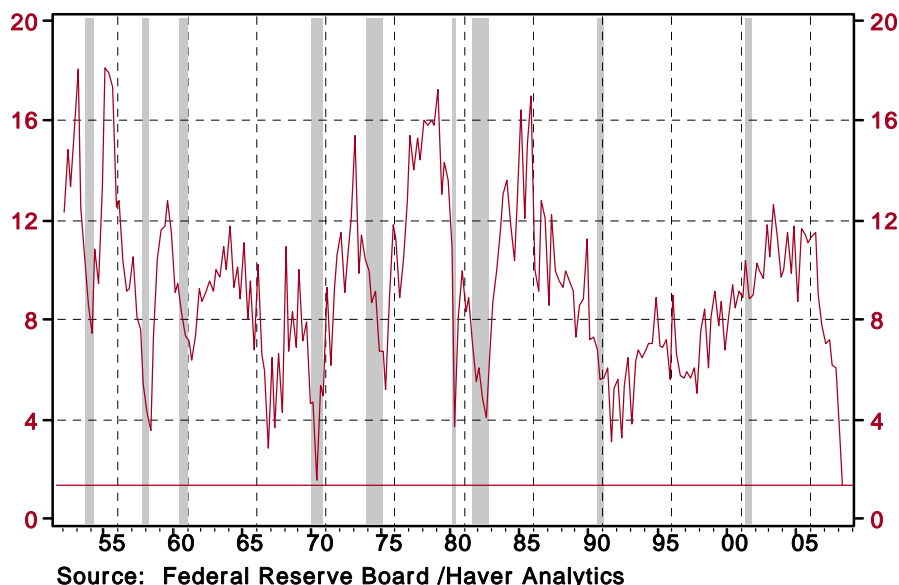
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Continued loss in household net worth will have an adverse impact on consumer spending. Weak employment conditions and reluctance and inability of households to borrow are other factors that will restrain consumer spending. Household borrowing grew at record low pace of 1.4% in the second quarter (see chart 5).

Chart 5

Households: Liabilities: Credit Market Debt Growth

SAAR, %



Leading Index Points to Continued Weak Economic Conditions

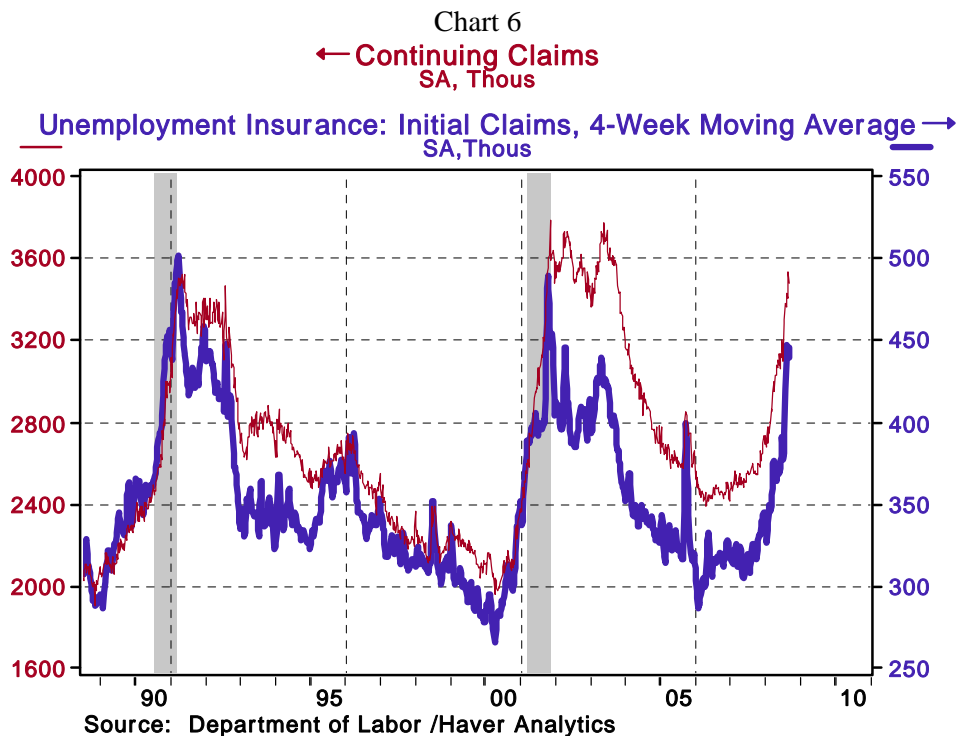
The Conference Board’s Index of Leading Economic Indicators (LEI) dropped 0.5% in August, following a revised 0.7% decline in the prior month. The July-August average of the LEI is now down 2.8% from a year ago, the largest drop in the current business cycle and matches the decline posted in the second quarter of 2001 when the U.S. economy was in a recession.

In August, orders of consumer durable goods, stock prices, interest rate spread, and consumer expectations made positive contributions. The recent sharp decline in equity prices implies that this component will make a negative contribution in September. The interest rate spread should make a smaller positive contribution compared with the August reading. Building permits, orders of durable capital goods, the manufacturing workweek, initial jobless claims, supplier deliveries, and real money supply made negative contributions.

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Jobless Claims Maintain Upward Trend

Initial jobless claims rose 10,000 to 455,000 during the week ended September 13. A part of this increase is seen related to Hurricane Gustav. Continuing claims, which lag initial claims by one week, fell 55,000 to 3.378 million. The insured unemployment rate held steady at 2.6%. The main message is that the hiring freeze has not changed.



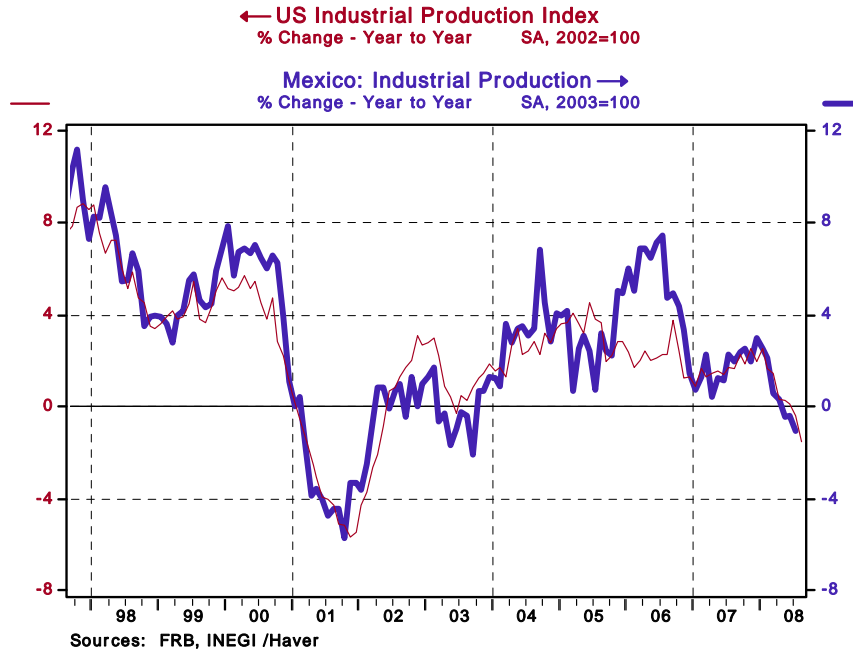
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Mexico and US Industrial Production: Joined at the Hip

Today's announced -1.04% yoy contraction of Mexican industrial production (IP) for July comes as no surprise. This reading follows previous slips of -0.35% in June and -0.44% in May. After the US's yoy decline in IP in July (-0.4%) and in August (-1.5%), our southern neighbor's activity was bound to follow suit because of our mutual deep manufacturing integration. Mexico is the not only the origin of many lower-value consumer goods destined for the US, but also it produces many integral parts for durable and capital goods finished in the United States. In fact, a whopping 82% of Mexico's total exports last year went to the US. Thus, as US IP slips (for example, lower automobile output as we are seeing today), demand for said inputs also falters, and Mexican manufacturing skids to a halt (i.e. no more muffler smelting).

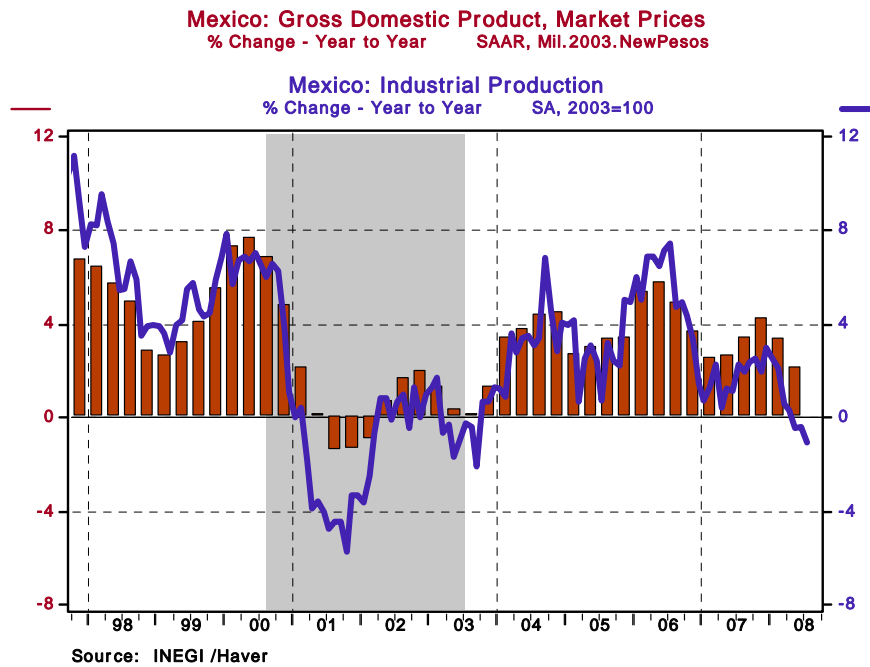
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Chart 7



Now, a mutual slowdown in IP such as this would not be a problem if one-quarter of Mexico's economy was not industry-based. But it is. In sum, when one-quarter of your economy is contracting at present, you'd better hope for a bumper crop of either maize or tourists. (Shaded area is Mexican recession.)

Chart 8



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