

DAILY GLOBAL
COMMENTARY

Northern Trust
Global Economic Research
50 South LaSalle
Chicago, Illinois 60603
northerntrust.com

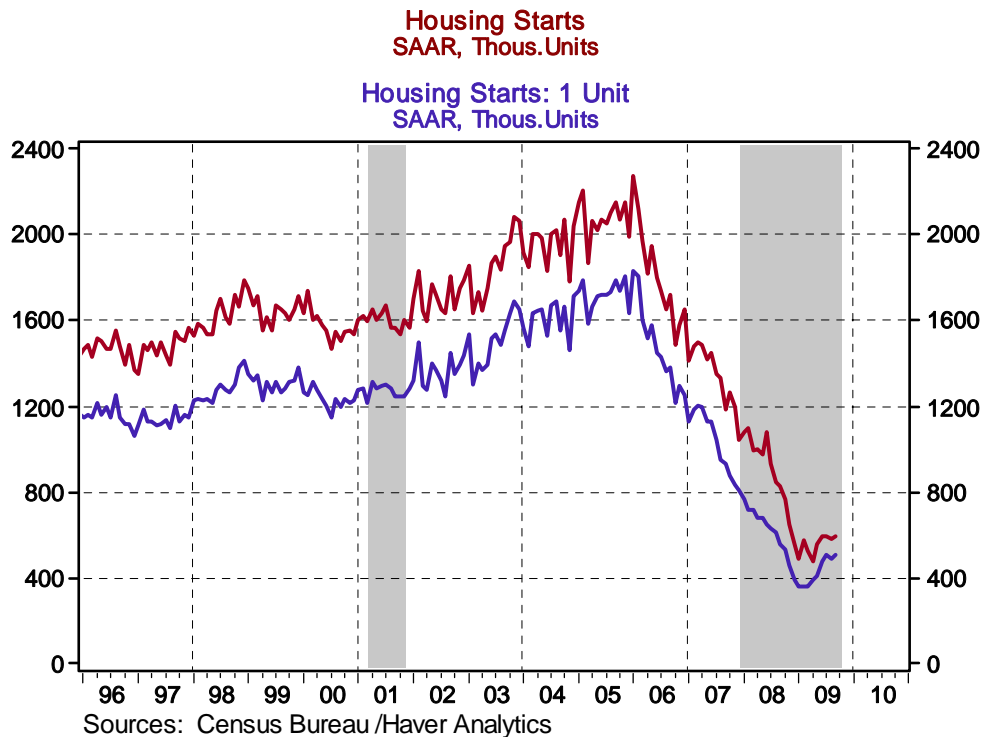
Asha G. Bangalore
agb3@ntrs.com

Home Construction – Mild Improvement in September

October 20, 2009

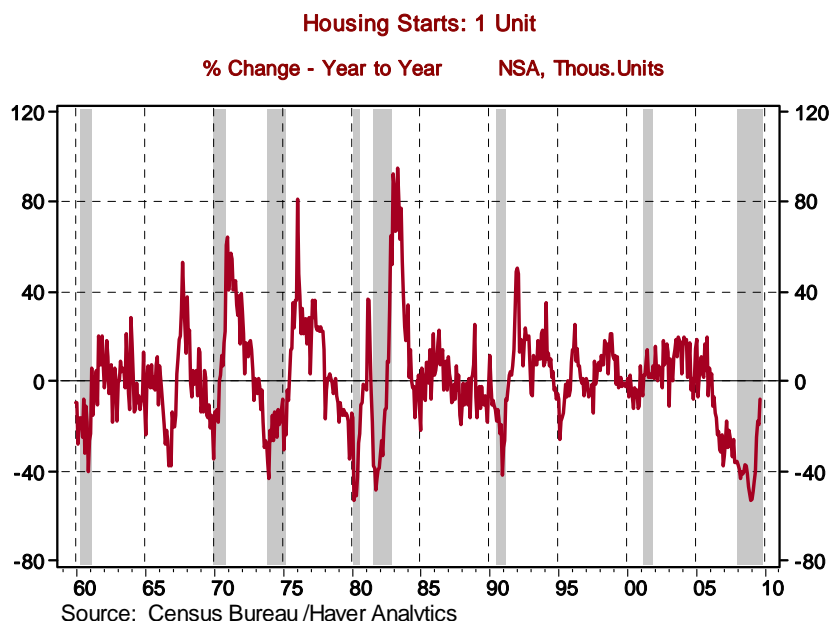
Starts for new homes rose 0.5% to an annual rate of 590,000 in September. Single-family starts registered gains (+3.9%) while that of multi-family units fell 15.2%. Although the September numbers appear to be lackluster, single-family starts have risen in six out of the first nine months of 2009 and have advanced 40% from the cycle low of 357,000 in January 2009 to 501,000 in September. On a regional basis, starts of new homes increased in the South (+7.1%) but fell in all other parts of the nation.

Chart 1



From a year ago, starts of single-family homes fell 8.0% in September, the smallest drop since May 2006 (see chart 2).

Chart 2



The numbers of permits issued for all new homes fell 1.2%, while that of single-family homes declined 3.1% to an annual rate of 450,000 in September. The good news is that supply of new homes is not growing at a robust clip. The moderation in the pace of construction of new homes is desirable in an environment of soft demand conditions.

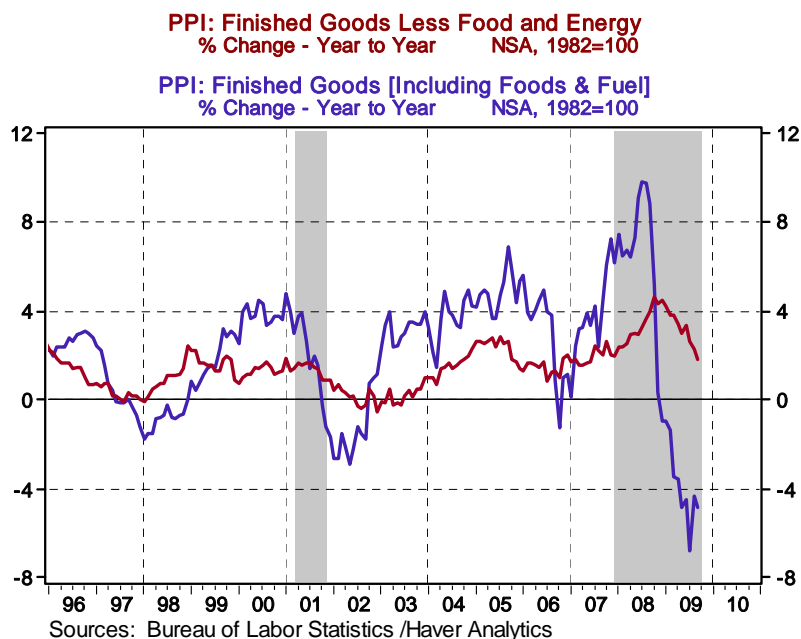
Wholesale Prices are not Problematic

The Producer Price Index (PPI) of Finished Goods fell 0.6% in September reflecting widespread declines in prices. The energy price index fell 2.4% in September following an 8.0% jump in the prior month. According to the BLS, about 80% of the drop in the energy price index was from lower gasoline prices. Gasoline prices have risen slightly in the survey period which counts in the computation of the October wholesale price index, implying a likely increase of this index in October. Food prices also fell 0.1% after a 0.4% increase in August. On a year-to-year basis, PPI of finished goods fell 4.8% in September, continuing the trend which began in December 2008.

The core PPI of finished goods, which excludes food and energy, dropped 0.1% in September. Capital equipment, apparel, and furniture prices fell in September but passenger car prices advanced 1.0%.

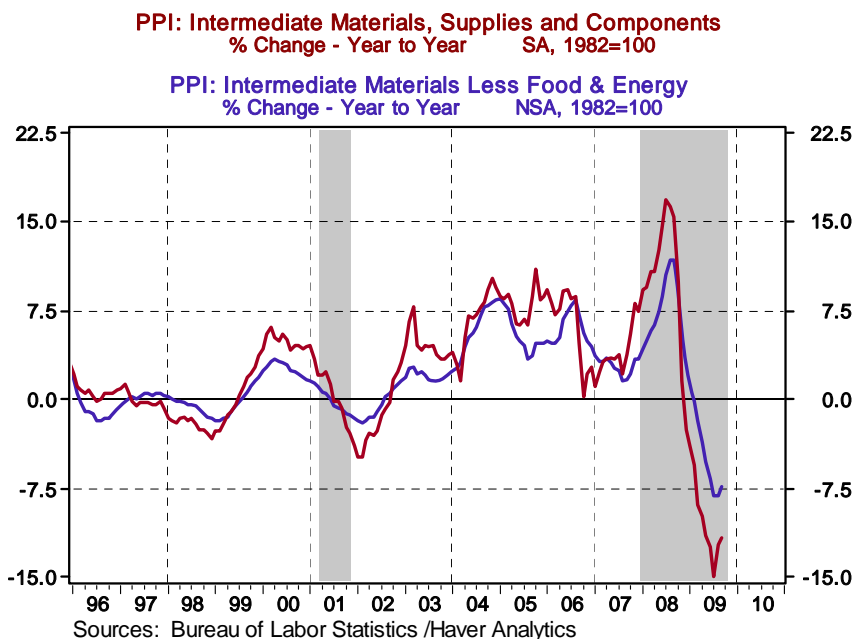
The opinions expressed herein are those of the author and do not necessarily represent the views of The Northern Trust Company. The Northern Trust Company does not warrant the accuracy or completeness of information contained herein, such information is subject to change and is not intended to influence your investment decisions.

Chart 3



At the earlier stages of production, prices of intermediate goods and core intermediate goods continue to show noticeable year-to-year declines but these were smaller declines in September compared with August. In sum, wholesale prices remain contained.

Chart 4



The opinions expressed herein are those of the author and do not necessarily represent the views of The Northern Trust Company. The Northern Trust Company does not warrant the accuracy or completeness of information contained herein, such information is subject to change and is not intended to influence your investment decisions.

Producer Price Index – September 2009

	% change prior month	annualized % change			% change		
		year-to-date	3 mo. ago	6 mo. ago	Sep-09 yoy	Sep-08 yoy	Dec-08 yoy
PPI - FINISHED GOODS							
ALL ITEMS	-0.6	3.2	1.2	5.0	-4.8	8.8	-0.9
CORE - ALL ITEMS LESS FOOD & ENERGY	-0.1	1.3	0.0	1.1	1.8	4.0	4.5
FOOD	-0.1	-3.2	-4.9	-0.3	-4.2	7.8	3.2
ENERGY	-2.4	16.5	12.0	25.6	-22.1	23.4	-20.3
CAPITAL EQUIPMENT	-0.1	0.5	0.0	0.6	1.2	3.6	4.3
PPI - INTERMEDIATE GOODS							
ALL ITEMS	0.2	1.2	7.2	7.0	-11.7	15.3	-2.3
CORE	0.9	-1.0	7.2	2.4	-7.5	11.8	3.3
PPI - CRUDE GOODS							
ALL ITEMS	-2.1	-0.6	-11.3	17.0	-31.5	24.2	-24.6
CORE	3.6	31.1	63.3	49.7	-19.7	16.4	-24.1

Richard Thies
rt72@ntrs.com

Brazil: Biting the Hand that Feeds a Bubble

Typically when you see the words ‘capital controls’ and ‘Latin America’ in the same sentence in this space, it is typically followed at some point by the word ‘crisis’. Not today. In a year where anything has proven possible, the largest Latin American economy has imposed a 2% tax on all foreign capital inflows, foreign direct investment excluded. While the stated intention of the levy is to put the brakes on the rapidly appreciating currency; its implications go further.

Chart 5

JP Morgan Broad Real Effective Exchange Rate Index: Brazil

2000=100



Source: JPMorgan /Haver Analytics

The opinions expressed herein are those of the author and do not necessarily represent the views of The Northern Trust Company. The Northern Trust Company does not warrant the accuracy or completeness of information contained herein, such information is subject to change and is not intended to influence your investment decisions.

There is little doubt that the strength of the currency poses a significant risk to growth in Brazil. The rapid nominal appreciation of the real this year has been alarming and the fact that Brazilian officials are attempting to address it is refreshing. From a broad, trade-weighted perspective, the real is up 14.6% since the beginning of the year and up 49% over its 15-year average. (Chart 1) The nominal story is equally pronounced. Strong Brazilian fundamentals have combined with a weak dollar to push the BRL up a striking 34% this year relative to the greenback. For Brazil, the export effect of this appreciation is amplified when it is taken into account that despite poor demand, the US remains its largest trade partner.


In order to understand whether this policy shift is likely to achieve its stated goal, the broader context of the capital control must be considered. The strength of the real has resulted largely from robust long-term growth prospects, a rebound in commodity prices, increased global appetite for high-yielding emerging market risk, and scorching capital markets. International portfolio investment figures confirm the rapid resumption of inflows since Q4 2008 lows. (Chart 2) Touching 12-month highs yesterday, the Bovespa index is up nearly 80% since January. The imposition of a two percent levy on foreign capital inflows will not change any of these underlying structural factors. Investors, still hungry for yield, will be unlikely to turn their backs on the robust Brazilian economy. Further, it is certain that financial engineers are hard at work making portfolio investment appear to be direct investment to Brazilian authorities, thus circumventing the tax. This policy will not be sufficient to stem the charging real, so why was it done?

Chart 6



Despite running a fiscal deficit this year, the tax probably was not implemented as a revenue booster, as the Brazilians have over \$230 billion in international reserves. Throughout the tenure

The opinions expressed herein are those of the author and do not necessarily represent the views of The Northern Trust Company. The Northern Trust Company does not warrant the accuracy or completeness of information contained herein, such information is subject to change and is not intended to influence your investment decisions.



of President Lula da Silva's administration, he has successfully pursued conservative economic policies aimed at improving the investment climate. If slowing real appreciation was the ultimate goal, it is more likely that an investor-friendly policy would have been enacted to change underlying fundamentals. By enacting policies as simple as lowering import tariffs, or buying even more dollars on the spot market, the government would likely have had an equivalent effect on the value of the currency.

In the end, this new tax has three important implications, which have little to do with the value of the real. First, on a continent historically plagued by a boom and crisis cycle, the Brazilians are trying to tie more incentives to FDI – the kind of investment you can't simply click and withdraw should international favor change. Second, consider this tax, which was not expected in this form, as a statement by the finance ministry that they are willing to intervene in the markets, should the need arise. Most importantly, this policy exercise should tell us that the Brazilians are aware, but conflicted, about the prospect of an asset bubble developing. Typically, this fear would first be attacked through a tightening cycle, but Brazil has yet to see a meaningful domestic demand recovery, so that is not thought to be an option just yet. What do you do when you want to prick a looming asset bubble, but haven't yet recovered enough to tighten and excess liquidity comes from abroad? Charge a 2% fee for capital inflows, apparently. Expect more clues from tomorrow's COPOM meeting regarding future rate hikes.

The opinions expressed herein are those of the author and do not necessarily represent the views of The Northern Trust Company. The Northern Trust Company does not warrant the accuracy or completeness of information contained herein, such information is subject to change and is not intended to influence your investment decisions.