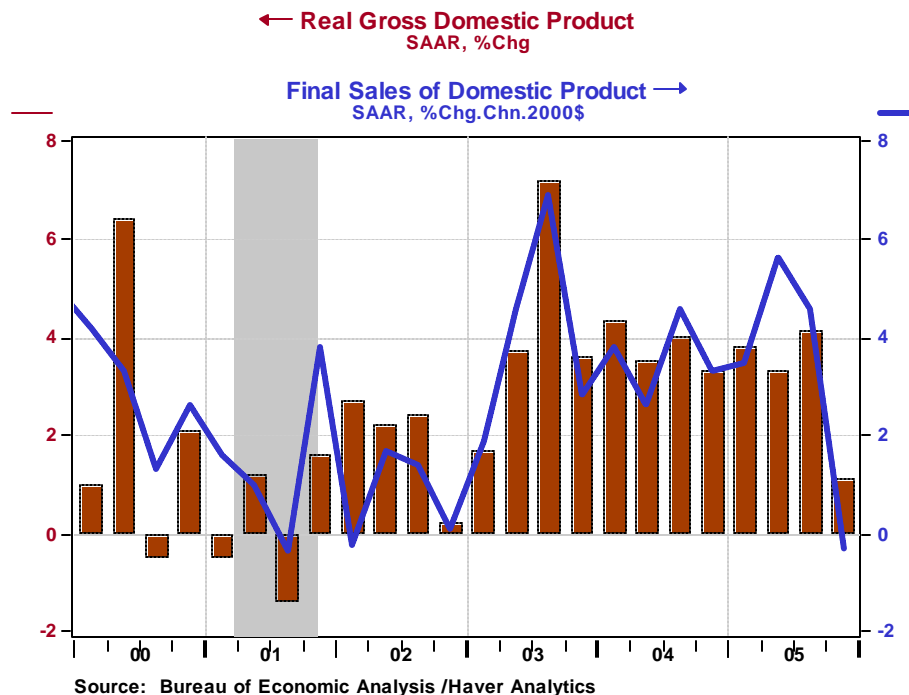




January 27, 2006

### Weak Growth of Economy Strengthens Case of Fed Pausing

The U.S. economy grew at an annual rate of 1.1% in the fourth quarter, the slowest pace since the fourth quarter of 2002 when the economy grew at an annual rate of 0.2%. The economy grew at a 3.5% pace in 2005 compared with a 4.2% increase in 2004. A downturn in inventories and slower growth in consumer and federal government spending were the reasons for the deceleration in economic growth during 2005. Final sales dropped at an annual rate of 0.3% in the fourth quarter in contrast to a 4.6% increase in the prior quarter. However, in all of 2005, final sales increased 3.8%, little different from the 3.9% increase recorded in 2004.



Consumer spending increased only 1.1% in the fourth quarter due to a 17.5% drop in the purchases of durable goods, mainly autos. Equipment and software spending slowed to a 3.5% pace during the fourth quarter compared with a 10.6% increase in the third quarter. This estimate of capital spending is confusing because the durable goods report shows shipments of non-defense capital goods excluding aircraft (these numbers are used to construct equipment and software spending data for the GDP report) rose at a robust double-digit pace in the fourth quarter. This component is a candidate for upward revision. Residential investment expenditures advanced at an annual rate of 3.5% in the final three months of 2005 vs. a 7.3% increase in the previous quarter. Inventories moved up in the fourth quarter (\$25.7 billion) after declining in the third quarter (-\$13.3 billion). The sharp increase in inventories in the October-December period implies that inventories are likely to make only a small positive contribution to GDP growth in the first quarter, at best. The 9.1% increase in imports led to the noticeable widening of the trade gap (-\$650.3 billion vs. -\$617 billion in the third quarter). The GDP price index increased at an annual rate of 3.0% in the fourth quarter,

a small deceleration from the 3.3% increase seen in the third quarter. The core personal consumption expenditure deflator rose 2.2% in the fourth quarter compared with more mild gains in the second and third quarters of 2005. The hawks on the FOMC could grab on to this acceleration to justify another hike of the federal funds rate.

#### REAL GROSS DOMESTIC PRODUCT 2005:Q4

	Levels (Billions of chained 2000 dollars)			Percent Change (SAAR)		
	05:2	05:3	05:4	From 05:1	From 05:2	From 05:3
	Final	Final	Advance	to 05:2	to 05:3	to 05:4
GDP	11089.2	11202.3	11233.5	3.3	4.1	1.1
CONSUMPTION	7829.5	7907.9	7930.2	3.4	4.1	1.1
DURABLE GOODS	1143.9	1169.7	1114.7	7.9	9.3	-17.5
NONDURABLE GOODS	2285.9	2305.8	2334.7	3.6	3.5	5.1
SERVICES	4417.6	4453.5	4489.1	2.3	3.3	3.2
INVESTMENT	1885.0	1909.4	1965.1	-3.7	5.3	12.2
FIXED INVESTMENT	1884.7	1921.5	1935.9	9.5	8.0	3.0
NONRESIDENTIAL	1279.0	1305.2	1314.2	8.8	8.5	2.8
STRUCTURES	252.7	254.1	254.5	2.7	2.2	0.7
EQUIPMENT & SOFTWARE	1040.9	1067.5	1076.8	10.9	10.6	3.5
RESIDENTIAL	599.3	610.0	615.2	10.8	7.3	3.5
CHG. BUS. INVENT.	-1.7	-13.3	25.7			
NET EXPORTS	-614.2	-617.5	-650.3			
EXPORTS	1195.4	1202.7	1209.8	10.7	2.5	2.4
IMPORTS	1809.6	1820.2	1860.1	-0.3	2.4	9.1
GOVERNMENT (Cons. & Invest.)	1984.1	1998.1	1986.2	2.5	2.9	-2.4
FEDERAL	736.1	749.5	736.1	2.4	7.4	-7.0
DEFENSE	491.7	503.6	486.2	3.7	10.0	-13.1
OTHER	244.2	245.6	249.7	-0.2	2.4	6.9
STATE AND LOCAL	1247.8	1248.5	1249.8	2.6	0.2	0.4
DISP. PERS. INC.	8128.7	8060.8	8198.0	1.5	-2.0	7.0
FINAL SALES	11089.2	11214.4	11205.0	5.6	4.6	-0.3
FINAL SALES TO DOM. PURCHASERS	11694.6	11823.0	11846.6	4.2	4.5	0.8
PRICE DEFLATORS:						
GDP CHAIN TYPE	111.7	112.6	113.4	2.6	3.3	3.0
GDP EX. FOOD & ENERGY				2.4	2.8	3.1
PCE CHAIN TYPE	110.8	111.8	112.6	3.3	3.7	2.6
PCE EX. FOOD & ENERGY	109.1	109.5	110.0	1.7	1.4	2.2

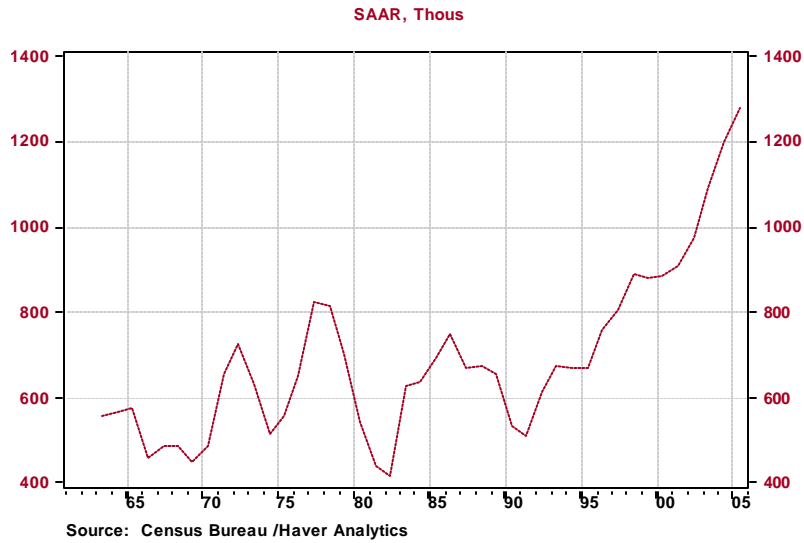
It is close call as to whether the FOMC will raise the federal funds rate on January 31. The core inflation data suggest that the Fed may take out insurance and raise the federal funds rate once more and pause thereafter. Greenspan has typically warned markets of impending action. A pause on January 31 may be viewed as an unnecessary jolt. Therefore, there is a case to be made that the Fed may raise the federal funds rate on January 31 and warn markets about an imminent pause. At the same time, the significant deceleration in demand makes a strong case for the Fed to pause immediately.

#### New Home Sales – Q4 Volume and Price Decline

Sales of new single-family homes rose 2.9% to an annual rate of 1.269 million units. In 2005, sales of new homes rose 6.7% to 1.280 million units, the largest number of new homes sold on record. Sales of new homes rose in Midwest (+22.7%) and West (+11.1%) but dropped in Northeast (-23.3%) and South (-2.6%).

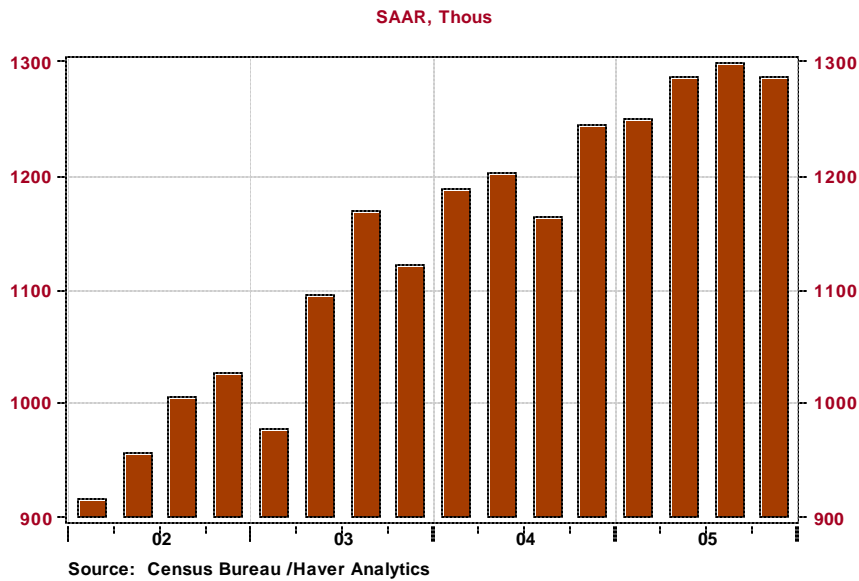
The information herein is based on sources which The Northern Trust Company believes to be reliable, but we cannot warrant its accuracy or completeness. Such information is subject to change and is not intended to influence your investment decisions.

### New 1-Family Houses Sold: United States

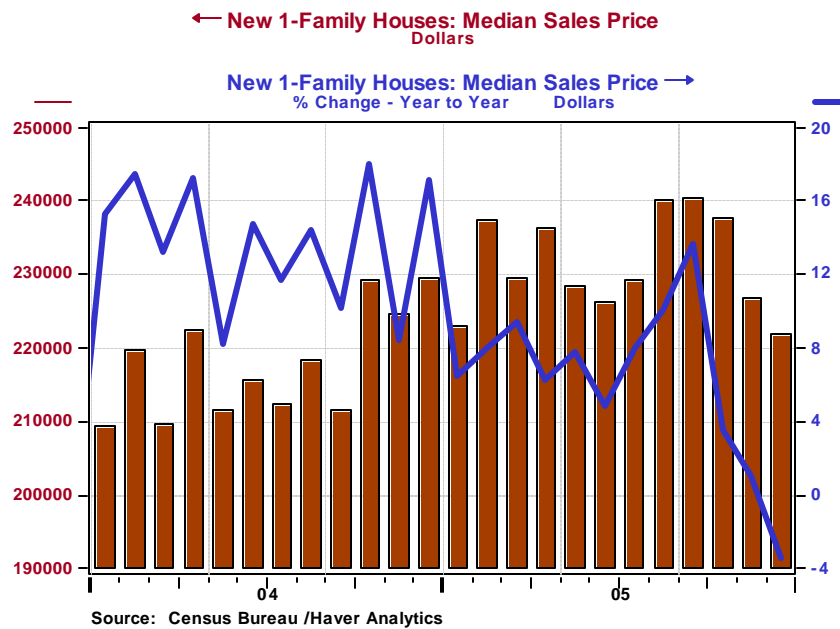


In the fourth quarter, sales of new homes dropped to an annual rate of 1.287 million units from 1.298 million units in the third quarter. Essentially, sales of new homes have past their peak.

### New 1-Family Houses Sold: United States



The median price of a new single-family home dropped 2.2% to \$221,800 in December, which translates into 3.4% year-to-year decline. The year-to-year drop in the median price is the first since December 2003. The inventory of unsold homes held steady at a 4.9-month supply, but up from a 4.1-mark in December 2004.



As noted in earlier commentaries a marked slowing of housing market activity will have large ripple effects across the economy that the Fed will have to contend with shortly.

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