

DAILY GLOBAL
COMMENTARY

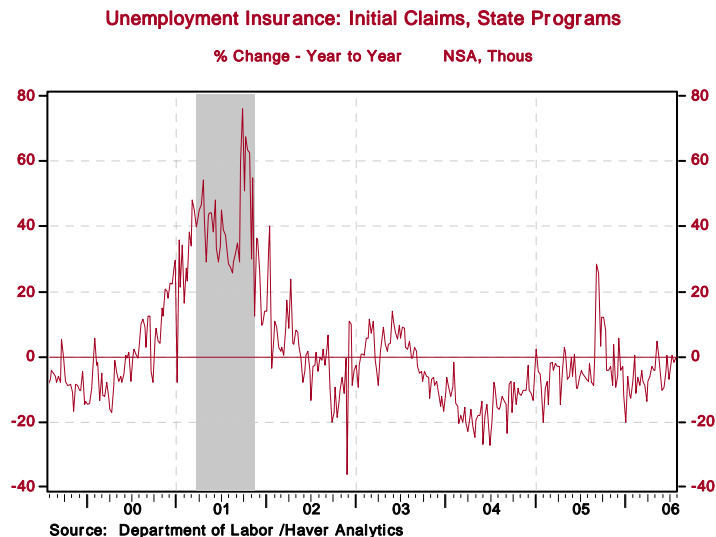
Northern Trust
Global Economic Research
50 South LaSalle
Chicago, Illinois 60603
northerntrust.com

Paul Kasriel
plk1@ntrs.com

Weekly Jobless Claims Confirm Softening Labor Market

August 3, 2006

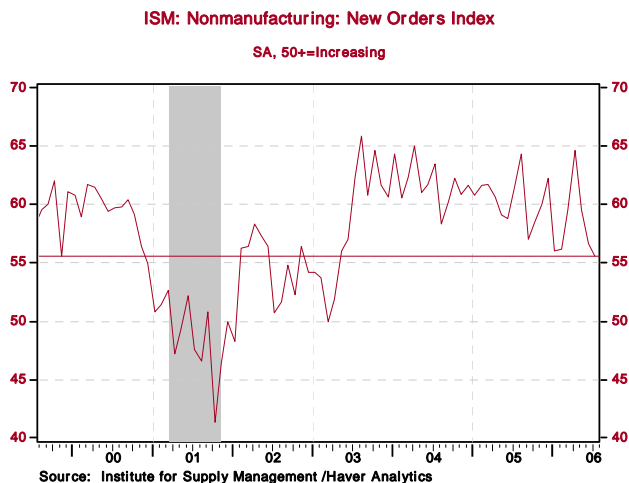
Who knows what the random-number generator will spit out Friday morning, but the nonfarm payroll data for the three months ended June have suggested that the labor market has cooled off. Confirmation of this is coming from the initial jobless claims data. We believe that seasonally adjusting data is an art, not a science – especially with regard to weekly data. This is why we prefer to look at the weekly initial jobless claims data on a year-over-year percent change basis. The chart below contains such data going back to July 1999. It is a “noisy” series complete with outliers related to hurricanes and temporary municipal layoffs. But through the noise, a signal can be detected. Back in 2004, initial jobless claims were falling around 20% year-over-year. Currently, initial jobless claims are, for all intents and purposes, where they were a year ago. We conclude from this, therefore, that the demand for labor, while still growing, is growing at a much slower pace than it had in recent years. And by the way, **the recent behavior of initial jobless claims clears up some ambiguity about the interpretation of the weaker payroll growth of the past three months.** Some have hypothesized that the recent weak payroll numbers are a result of a shortage of employable bodies rather than slower demand for those bodies. If that were the case, we would expect that employers would be firing considerably *fewer* employees now than they were a year ago. In fact, they are firing about the same number each week. And our best guess is that in the months ahead, the year-over-year percent change in new jobless claims will be trending higher. That’s one of the reasons we expect the FOMC to be cutting the funds rate by December 12 of this year or January 31 of next year.



Non-Manufacturing Sector Showing Signs Of Fatigue

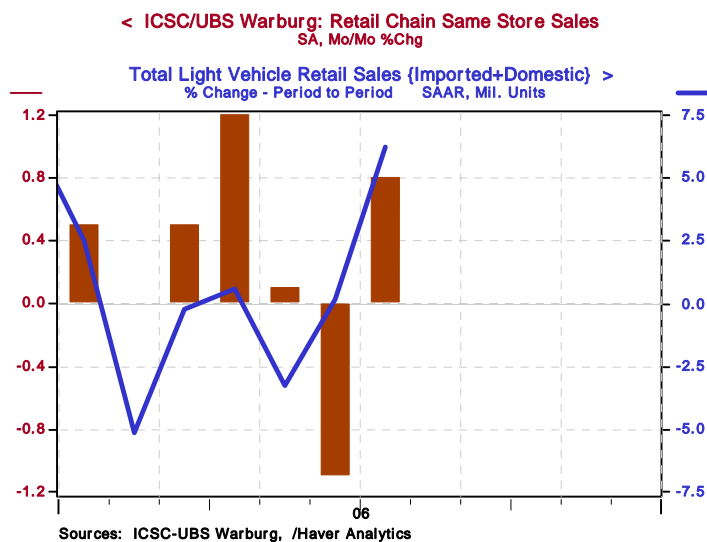
The ISM reported that its non-manufacturing index of new orders fell by one point in July to a reading of 55.6. This marks the third consecutive month in which the new orders index has fallen. Its July level is the lowest since April 2003. The areas showing no growth or declines

in general business conditions in July were real estate, rental/leasing and construction. Hmm. I wonder why these “spaces” are lagging.



Retail Sales Off To A Good Start In Q3

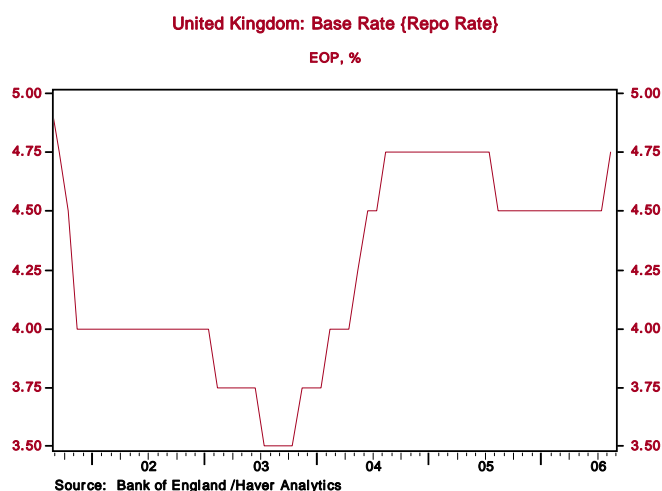
Although motor vehicle sales in July were down over 17% year-over-year, month-to-month seasonally adjusted they were up a strong 6.2% (not annualized). And sales at same-store retail chains were up 0.8% in July vs. June. We feel relatively confident that vehicle sales will stall out over the remainder of the quarter. The bigger question mark for us is the behavior of non-auto retailing. Given high and rising debt-service household debt service burdens, the abrupt slowdown in house-price appreciation and the message being sent by initial jobless claims, we are willing to venture a guess that July will turn out to be a false dawn for retailing in general.



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Bank of England Unexpectedly Tightens: A One Off, Or The First In A Series?

So much for the Bank of England (BoE) waiting until September – today’s 25bp increase in the repo rate, taking it to 4.75%, was a big surprise to the markets and just about everyone else. While the data clearly had been pointing to the likelihood that the Monetary Policy Committee (MPC) was about to adopt a more hawkish stance, it was only a month ago that the MPC was unanimous in its “wait-and-see” stance, with the members concluding that there were “significant risks in both directions” and that recent developments had been broadly in line with the projections in the Bank’s May Inflation report. This had pointed to the need, eventually, for some tightening, but not that such a move would have to happen before Q3 was out. To go from “balanced” to “hike” so abruptly, and with no advance hints to the public, suggests the MPC has more information than we do – namely, a look at the projections in the BoE’s August Inflation Report, which will be released August 9.



In today’s statement, the MPC noted that the economy has strengthened to above its long-run trend – preliminary data show Q2 GDP rose 0.8% q-o-q and 2.6% y-o-y – and that headline consumer price inflation, which hit 2.5% in June, “is expected to remain above the 2.0% target for some while.” The Committee also pointed to an apparent recovery in household spending in recent months. While the language used was more hawkish, overall it was fairly measured – the kind of language one could also have seen in a statement flagging a return to a tightening stance, rather than an actual hike. All of which suggests that perhaps the decision wasn’t unanimous – we’ll find out when the minutes are published August 16.

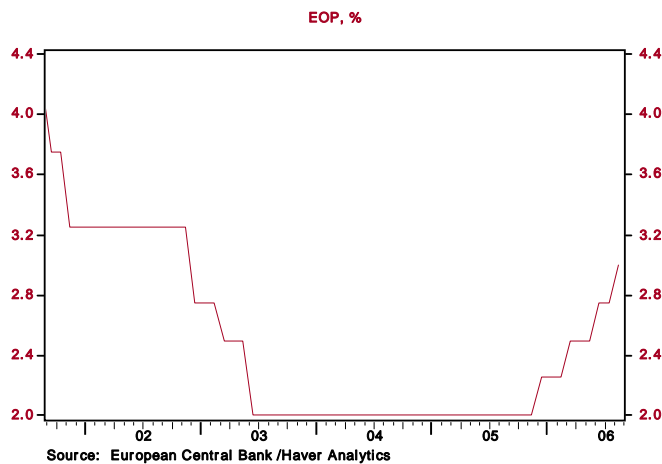
Barely two weeks ago, Deputy Governor Gieve had noted that there was no sign in the UK of second-round effects from the rise in energy prices. Presumably, the MPC members concluded that it was better to move now, than wait for such effects to emerge. The August Inflation Report will be scrutinized very closely for clues as to whether today’s move was a pre-emptive strike to keep things under control, or the first in a series of hikes. Given the lack of hawkish statements from the BoE or MPC members, our best guess is the former. Further clues will come from the July CPI report (August 15), and June earnings data (August 16).

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ECB Hikes Refi Rate to 3.00% – Next Move Likely October 5

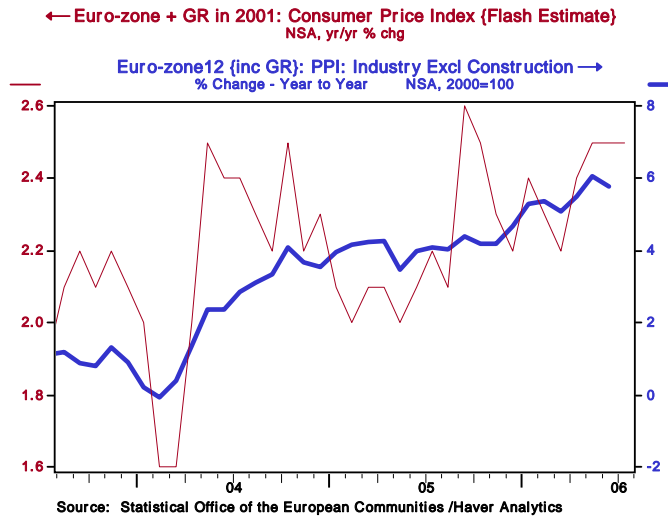
Unlike the BoE's move, today's 25bp rate hike from the European Central Bank (ECB) had, once again, been well flagged, thanks to the unusual decision to hold a face-to-face meeting (rather than a vacation-period teleconference) and to Trichet's comments about the need for "strong vigilance." Based on the meeting statement and on Trichet's press conference, the odds favor another rate hike on October 5 and perhaps a year-ending one on December 7.

Euro-zone + GR in 2001: Main Refinancing Operations: Minimum Bid Rate

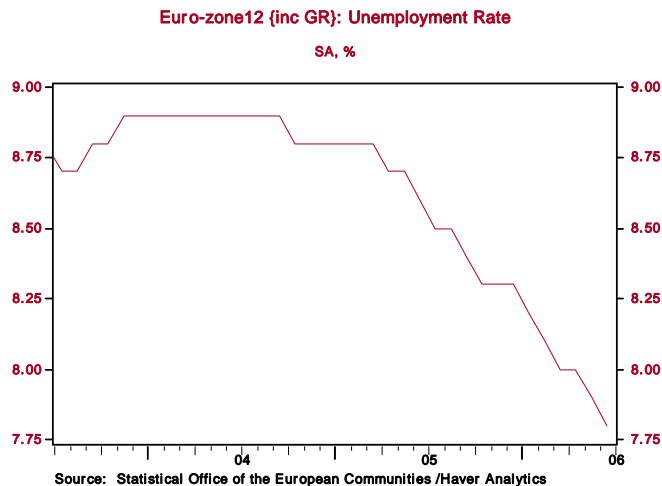


While Trichet & Co. are fond of reiterating the "no set policy path" mantra, it's pretty obvious from today's comments what they assume will happen: further withdrawal of monetary accommodation will be necessary if the economy grows as the ECB expects. This is the kind of phrasing Trichet has used in the past to indicate that another rate hike is in the offing, but not imminent. There was no mention of the need for "vigilance" – so we can safely assume no rate hike at the next meeting, on August 31 – but the statements that "risks to the outlook for price developments have augmented" and that the ECB will continue to monitor developments "very closely" indicates a move to 3.25% on October 5 (no September policy meeting is scheduled – any change in the schedule would be flagged on August 31).

Yesterday's industrial producer price data for July confirmed that producers continue slowly to pass on higher energy prices to consumers. Euro-zone flash estimate CPI remained well over target last month, at 2.5%.



The Euro-zone unemployment rate fell to a five-year low of 7.8% in June, thanks to falls in the jobless rates in Germany, France, and Portugal. This points to stronger consumer confidence and spending in the months ahead. However, as we've noted before, there's a big question mark hanging over the 'zone in 2007, thanks to the combination of a marked increase in Germany's VAT and the impact of this year's interest rate increases.



The August Euro-zone expectations survey will be published August 7, and flash estimate Q2 GDP comes out August 14 (Q1 GDP rose 0.6% q-o-q and 2.0% y-o-y). April-June GDP is old news but, assuming it shows still-robust growth heading into Q3, the headlines will further boost market rate hike expectations. July inflation details will be released August 17 and are unlikely to lead to any change in the headline number. More important for judging the pace of future interest rate hikes will be July lending and money supply data (August 28), August consumer and business sentiment indicators and flash estimate CPI (August 31).

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