

DAILY GLOBAL
COMMENTARY

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Burden from Borrowing Surfaces in Recent Quarters

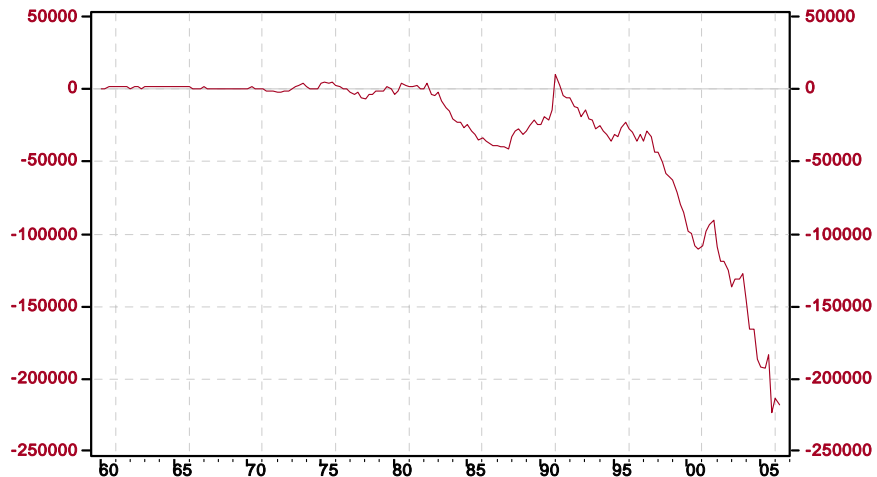
September 18, 2006

The U.S. current account deficit increased to \$218.4 billion in the second quarter from \$213.2 billion in the first quarter. As a share of nominal GDP, the current account deficit remained at 6.6%. After annualizing the numbers available for the first two quarters of the year, it appears the current account deficit may hit a record of \$863.2 billion in 2006.

Chart 1

BOP: Balance on Current Account

SA, Mil. \$



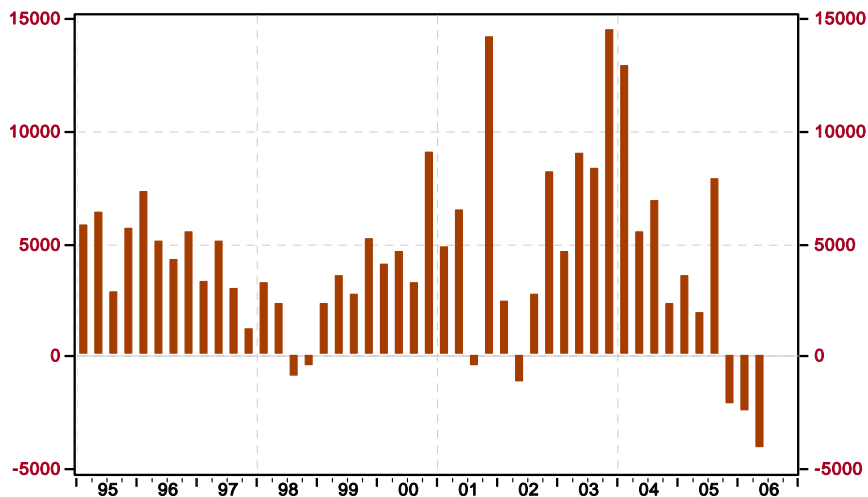
Source: Bureau of Economic Analysis /Haver Analytics

The deficit on goods and services rose to \$210.6 billion from \$208 billion, reflecting a larger increase in imports of goods compared with exports. The surplus on services was nearly steady at \$16.8 billion. The deficit on income increased to \$4.1 billion from \$2.5 billion, as income payments to foreign assets in the U.S. exceeded income receipts on U.S. assets abroad. As shown in chart 2, the deficit on income in the second quarter is the third consecutive quarterly reading. There have been four other quarterly occurrences when income payments exceeded receipts but these were small and were followed by immediate reversals. The situation is different this time around and it bears watching.

Chart 2

BOP: Balance on Income

SA, Mil. \$



Source: Bureau of Economic Analysis /Haver Analytics

On an annual basis until 2005, income payments have always (see chart 3) fallen short of income receipts resulting in a surplus of income. The recent reversal of net income in the current account is worth noting because the U.S. has borrowed at an annual rate of \$863.2 billion in the first-half of this year. The cost of debt service shows up as income payments in the current account.

Chart 3

BOP: Balance on Income

Mil. \$



Source: Bureau of Economic Analysis /Haver Analytics

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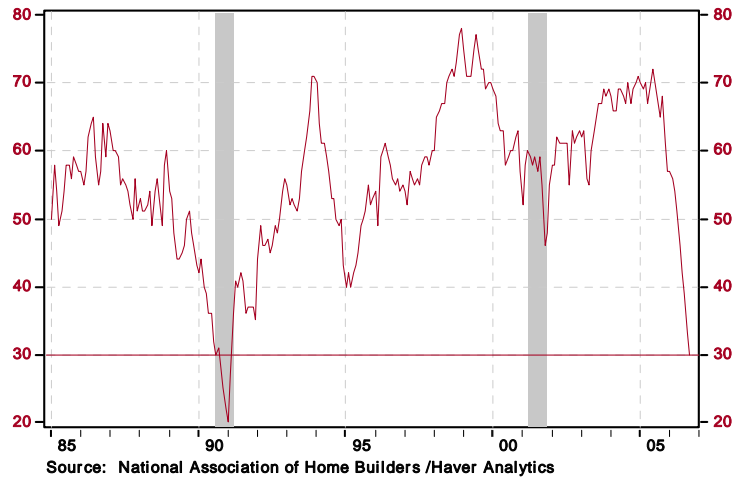
Home Builders Survey Shows Further Decline in Builders Confidence

The Housing Market Index (HMI) of the National Association of Home Builders dropped to 30.0 in September, the lowest since February 1991, from 33.0 in August. The HMI has declined in ten out of the last twelve months.

Chart 4

Home Builders: Housing Market Index (Composite)

SA, All Good = 100



Indexes tracking traffic of prospective buyers (22.0) and measuring likely home sales six months ahead (37.0) are at their lowest levels since January 1991. The traffic index held steady in September vs. the prior month. Housing starts for August will be published on September 19.

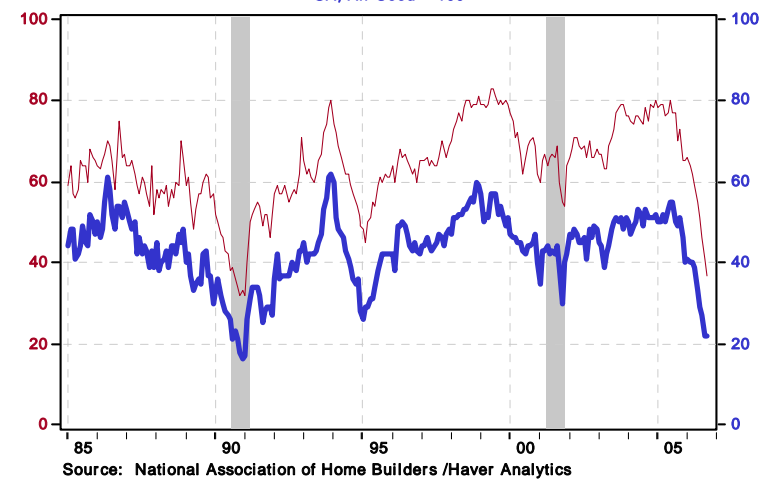
Chart 5

< HMI: Sales of New Single Fam Det Homes Index: Next 6 Mo

SA, All Good=100

HMI: Traffic of Prospective Buyers of New Homes Index >

SA, All Good = 100



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Sweden: Stock Market and Currency Boosted by Opposition Win, But Interest Rates Will Also Head Higher

Sweden woke up this morning to a new government, with the four-party center-right Alliance capturing 48.1% of the vote to 46.2% for the outgoing Social Democrats and its allies. The stock and currency markets promptly rallied in an outburst of glee, focusing on the center-right's plans to ramp up the pace and scale of privatization. Of greater long-term impact, however, are the incoming administration's plans to cut taxes. If implemented as promised, this will lead to a more hawkish stance by the central bank, which is likely to look askance at the promise to reduce property taxes. In total, the Alliance's plans will mean a stronger crown over the coming year, particularly against the US\$.

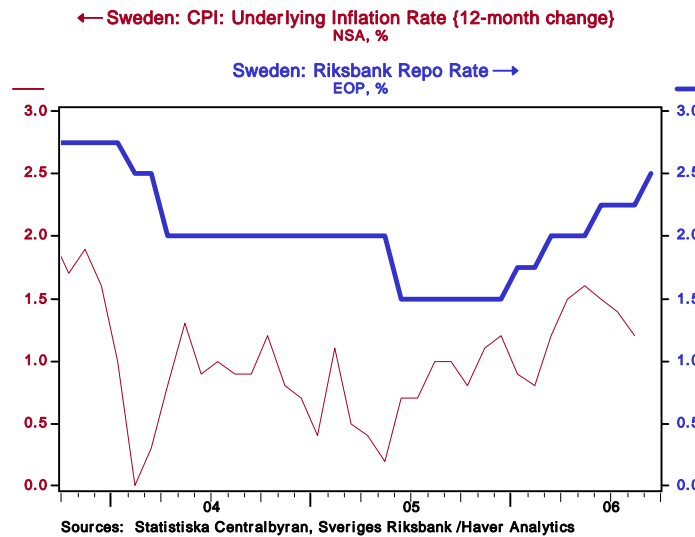
The local headlines have focused on the "historic" nature of yesterday's election victory by PM-elect Fredrik Reinfeldt and his coalition. This is the first time in 25 years that the center-right have actually won an outright majority – albeit only by 7 seats – thanks to an unusual level of policy agreement among the parties. The Social Democrats have ruled for most of the past 75 years, either alone or with partners, and the outgoing government had been in power in one form or another since 1994. Despite strong economic growth, falling unemployment, and healthy government finances, voter fatigue finally set in.

During the election campaign, Reinfeldt vowed to cut unemployment benefits, lower taxes, and ramp up privatization. However, this is not a bid to over-turn Sweden's welfare state model – Reinfeldt is no Swedish Margaret Thatcher. The Alliance's plans amount more to a tweaking of existing policies. The highlight – at least, where the stock market is concerned – is the plan for a new round of privatization. The PM-elect has estimated that sales of the remaining government shares in bank Nordea (where the state still holds 19.9%), telecoms firm TeliaSonera (45.3%), airline SAS (21.4%), bourse operator OMX (6.7%), and others will raise some SEK200 billion over the next four years.

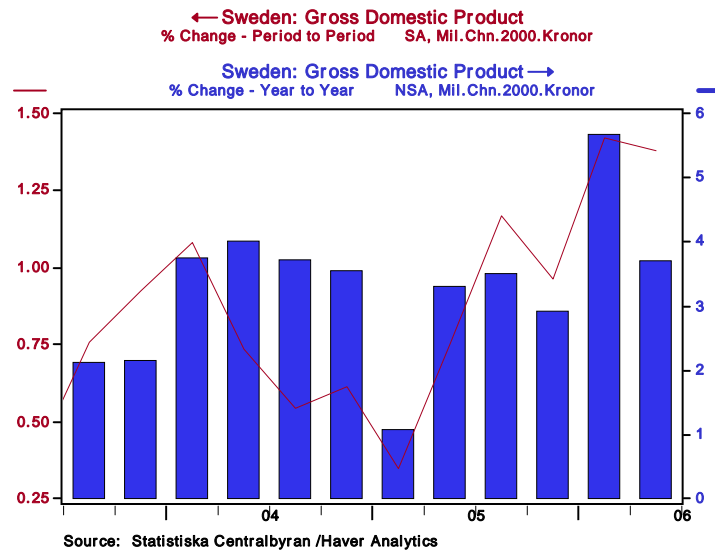
The Alliance has said it would use privatization proceeds to pay down government debt (already reduced from 74% of GDP to just under 50% over the past decade). This implies higher prices and lower yields for Swedish government bonds over the next few years.

The new government has also vowed to cut income taxes in 2007 and 2008, to lower the wealth tax, to remove employer social charges for companies in the service sector, and to cut property taxes. Taken together, these steps will amount to a dose of fiscal stimulus at a time when the economy is already seeing strong growth.

And this is where the Riksbank will be paying close attention. At its policy meetings in June and August, the Riksbank noted not only that underlying inflation is headed upward, but also that household indebtedness and house prices are continuing to rise rapidly. So far this year, the policy-setting Executive Board has raised the repo rate four times, taking it to 2.50% in August. Board members have stated repeatedly in recent weeks that further gradual rate hikes will be needed in order to meet the inflation target – namely, underlying inflation (UND1X, ex-indirect taxes and interest rates) of 2.0% over a two-year forecast horizon. Although UND1X has eased back from the 1.5% seen in May, the Riskbank's last forecast (made in June) saw underlying inflation at 1.9% by June 2009 – assuming further gradual rate hikes.

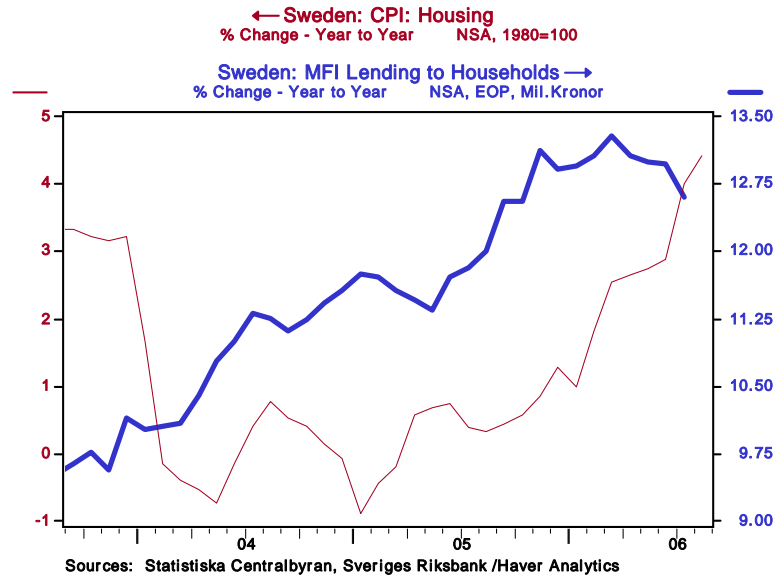


Certainly, the economy is rocketing along. Real GDP climbed 1.38% q-o-q in Q2 (1.42% in Q1), boosted by household consumption and gross fixed capital formation, and looks set to reach around 4.0% for the year as a whole.



At its past two policy meetings, the Riksbank pointed in particular to strong growth in housing and domestic credit. Lower taxes, particularly lower property taxes, risks boosting an already-warm housing sector. And that implies a more aggressive stance on the part of the Riksbank, with rate hikes not only in October (25-26) and December (14-15), as the markets already expect, but continuing at the four scheduled policy meetings in the first half of next year, placing the repo rate at 4.0% by June 2007.

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Reinfeldt has ruled out holding another referendum on Sweden adopting the euro during his four-year term (56% of Swedes rejected the common currency in the 2003 referendum). Strong economic growth, rising interest rates, and likely investor inflows as a result of some major privatizations, imply a stronger crown over the coming year. With US interest rates likely at their peak and Euro-zone rates set to continue climbing, the crown will fare better against the US\$ than against the euro over the coming year.

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