Northern Trust

DAILY GLOBAL COMMENTARY

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Housing Recession Isn't Spreading?

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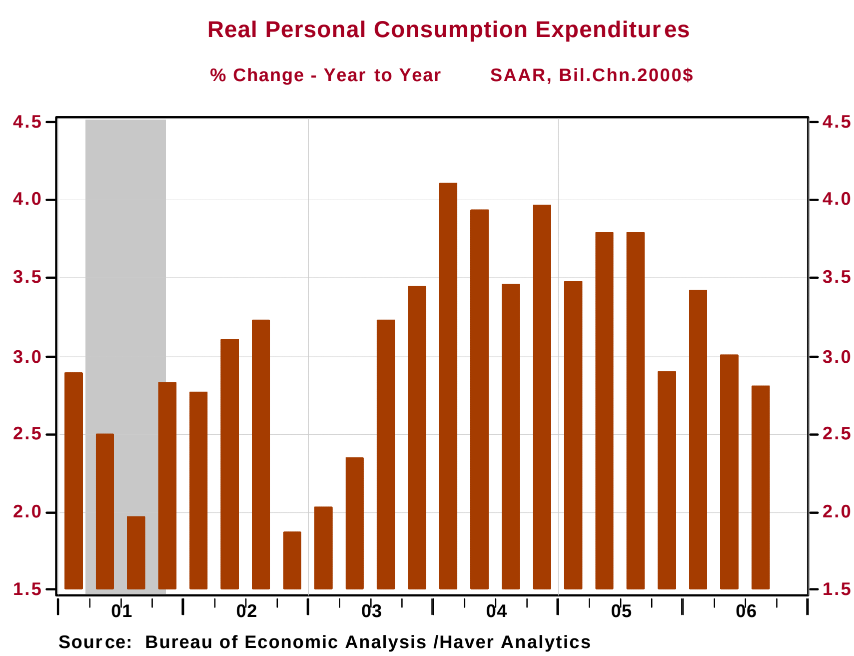
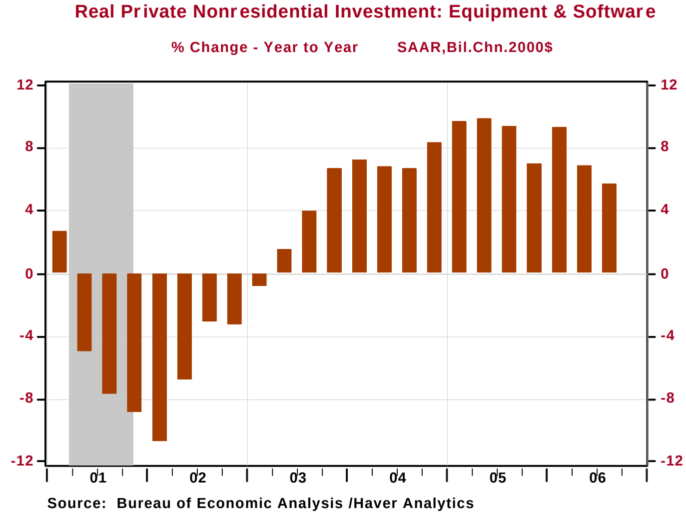
This is the nonsense that many of the talking heads are spewing. But that's what it is – nonsense. Direct your eyes to Chart 1, which contains the year-over-year percent change in real personal consumption expenditures. For Q3:2006, the year-over-year change in real consumption was 2.8%, down a full percentage point from its reading of Q3:2005 and the lowest year-over-year growth since the first half of 2003. Perhaps it has nothing to do with the housing recession, but the data say that growth in consumer spending, although not yet collapsing, certainly is decelerating.

Chart 1



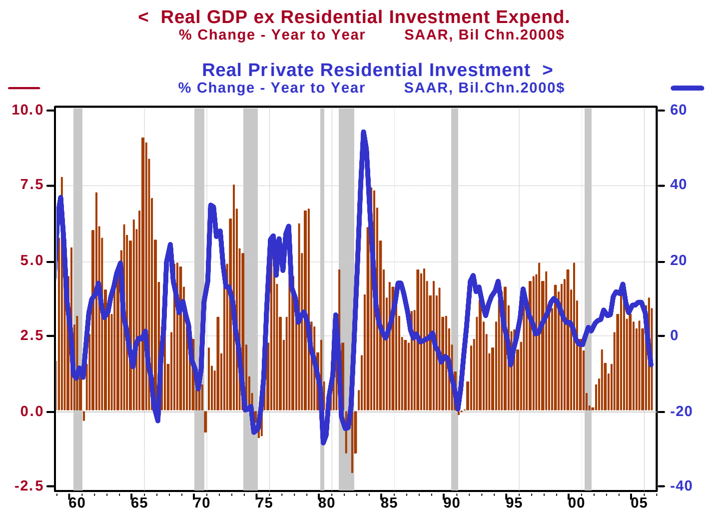
Now, direct your eyes to Chart 2, which shows the year-over-year percent change in real expenditures of business equipment and software. In Q3:2006, the year-over-year change was 5.7%, down from 9.3% in Q3:2005 and the slowest year-over-year growth since Q3:2003. Again, although there is no recession in business capital spending, yet, the data show very clearly that the growth in spending on business equipment and software is decidedly moderating.

Chart 2



Lastly, direct your eyes toward Chart 3, which shows the year-over-year percent change in real residential investment expenditures and real GDP *ex* real residential investment expenditures. It is clear that growth in residential investment expenditures *leads* growth in real GDP ex residential investment expenditures. On a year-over-year basis, residential investment growth appears to lead growth in the rest of the economy by about two quarters. Just a wild guess on my part, but because of this historical leading relationship between growth in residential investment and growth in the rest of the economy, I bet that's why the Conference Board chose to stick housing permits in its index of *Leading* Economic Indicators rather than its index of Coincident or Lagging Indicators.

Chart 3



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In sum, it is *not* just the housing component of real GDP that is slowing, but the consumer and business capital goods sectors as well. Moreover, you probably "ain't seen nothing yet" compared to what lies ahead for a slowdown in the rest of the economy because housing *leads*.

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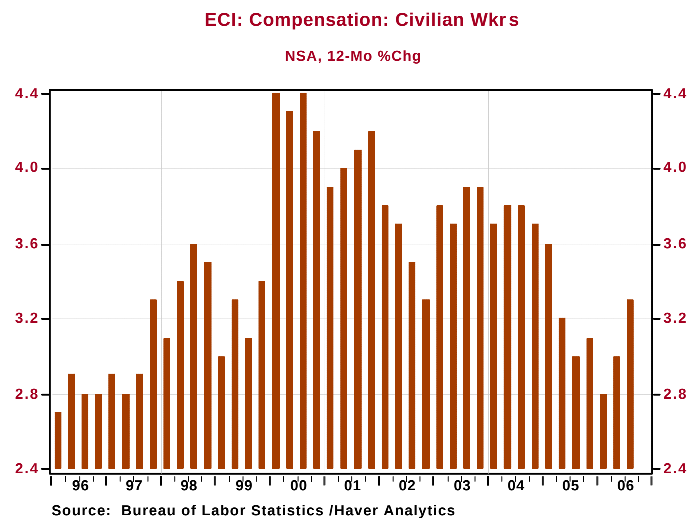
Employment Cost Index – Wages and Salaries Accelerate Further in Q3

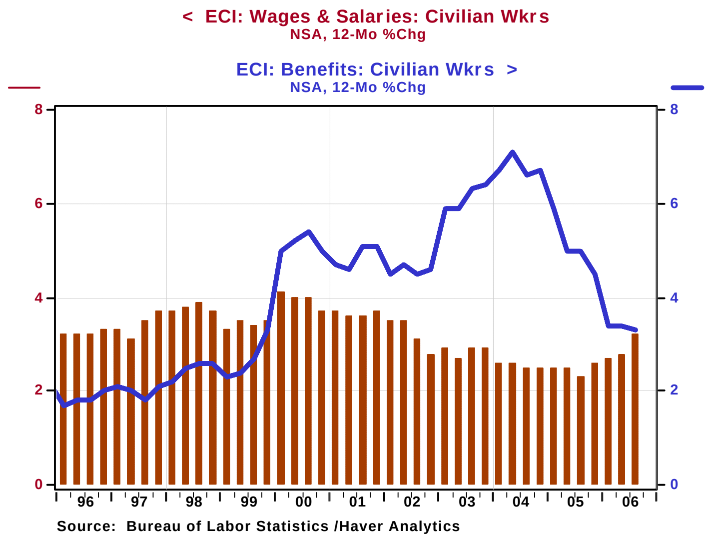
The Employment Cost Index (ECI) rose 1.0% in the third quarter after a 0.9% gain in the prior quarter. On a year-to-year basis, the ECI is up 3.3% in the third quarter, after a 3.0% increase in the second quarter and a 2.8% gain in the first quarter – bottom line is that labor cost is accelerating.

Chart 4



In 2006, the acceleration has come from wages and salaries, which has risen from a low of a 2.3% gain in the third quarter of 2005 to a 3.2% increase in the third quarter. During this same period, benefit costs have decelerated from a 5.0% increase to a 3.3% gain (see chart). The FOMC will remain concerned about the upward trend of labor costs. However, the weakness of incoming economic growth numbers will take the upper hand in the inflation vs. growth debate in the months ahead.

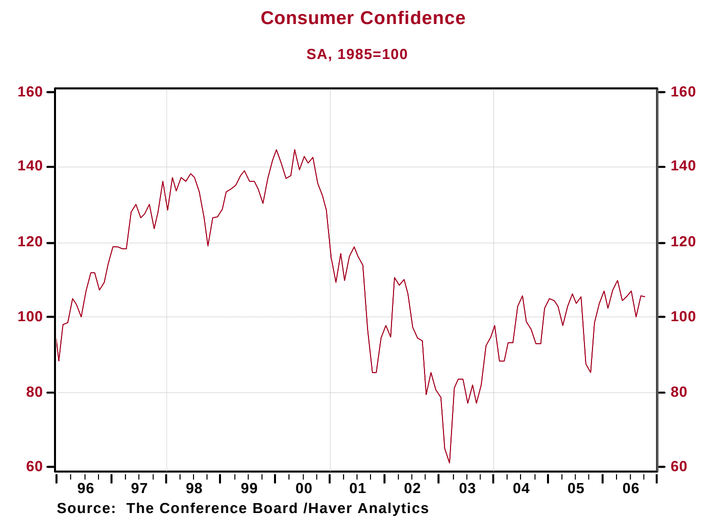
Chart 5



Consumer Confidence Slips Slightly In October

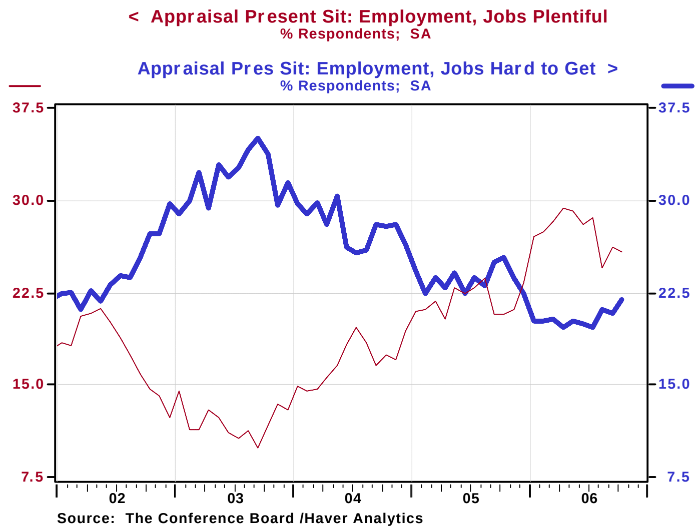
The Conference Board's Consumer Confidence Index moved down to 105.4 in October from 105.9 in September. The small drop came from the decline in the Present Situation Index to 124.7 from 128.3 in September. At the same time, the Expectations Index rose to 92.6 from 91.0 in September.

Chart 6



The Jobs-Plentiful Index fell to 25.8 in October from 26.2 in the prior month and the Jobs-Hard-to-Get index rose to 22.0 from 22.9. The difference between these two indexes narrowed to 3.8 points in October from 5.3 in September which bodes poorly for the unemployment rate of October, to be published on November 3.

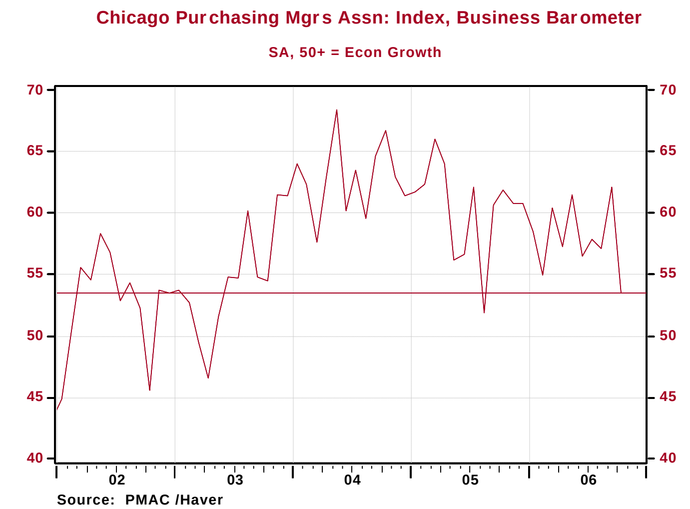
Chart 7



Regional Factory Report Points to Soft Conditions in October

The Chicago Purchasing Managers' report showed slower factory sector conditions in October compared with the prior month. The Business Index dropped to 53.5 in October, the lowest since May 2003, excluding the August 2005 reading. This report is noted for the exaggerated view of the regional factory sector. The national ISM survey results for the nation's factory sector will be published tomorrow. The consensus forecast is for a small increase in the PMI to 53.1 from 52.9 in September.

Chart 8



Indexes tracking production (59.2 from 67.4), new orders (54.1 from 67.3), backlogs (47.5 from 51.0), and prices (62.5 from 69.8) declined, while that of employment (57.0 from 50.8) and inventories (67.2 from 63.5) rose during October. The inventories index at 67.2 is the highest on record.