

DAILY GLOBAL
COMMENTARY

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Don't Underestimate the U.S. Consumer? The Global Economy Is Strong?

August 14, 2007

These are two common refrains from mainstream economists who never foresaw a recession until it already had been declared by the NBER. Today we received some information that ought to give these mainstreamers pause for thought.

Wal-Mart, the largest retailer in the world, reported a lower-than-expected quarterly profit and cut its full-year earnings forecast. Chief Executive Lee Scott blamed Wal-Mart's disappointing performance on economic pressure around the world. Said Mr. Scott, "It is no secret that many customers are running out of money toward the end of the month." In order to chum-up sales, Wal-Mart is slashing prices on thousands of items, which, of course, will force its competitors to do the same.

Although pointy-headed economists continue to be positive on the U.S. consumer, investors have soured on this space, as evidenced by the chart below that shows the behavior of an index of U.S. retailing stocks. The index is down almost 14% from its mid-February highs. I seem to recall in late 2005 when a similar index of homebuilder stocks was falling that these same pointy-headed economists couldn't see the housing recession forming on the horizon.

Chart 1



Now, for the vaunted global growth story. Not 24 hours after the second-largest economy in the world, Japan, reported absolutely weak and weaker-than-expected second-quarter real GDP growth, the second largest economic region, the Eurozone, reported absolutely weak and weaker-than-expected second-quarter real GDP growth. Quarter-to-quarter annualized Eurozone real GDP growth slipped to 1.4% in the second quarter vs. 2.9% in the first. On a year-over-year basis, Eurozone real GDP growth edged down to 2.5% in the second quarter vs. 3.1% in the first. The unexpected weaker Eurozone growth calls into question two things – the policy rate increase by the ECB penciled in for September and the locomotive to pull the U.S. economy out of its funk.

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Contribution of Exports to GDP Growth May Be Less Impressive in the Quarters Ahead

The trade deficit narrowed to \$58.1 billion in June after a \$59.2 billion reading in May (previously estimated as \$60.0 billion). The advance estimate of the second quarter GDP assumed that the trade deficit would widen in June. The narrowing of the trade gap in June and the upward revision of exports and downward revision of imports in May point to a smaller trade deficit in the second quarter. The net impact of May and June trade numbers, revised data for retail sales in June and estimates for construction and inventories for June is an upward revision of the headline GDP in the second quarter to nearly 4.0% growth compared with the advance estimate of 3.4% increase in real GDP.

Looking at the broader implications of the international trade situation, projections of strong growth in exports of the U.S. in the quarters ahead may have to be revised. Year-to-date, exports to China made up 5.4% of total exports, exports to France, Germany, Netherlands and Belgium were 12.0% of total exports, with the share of U.K and Japan following closely at 4.7% and 5.6% of total exports, respectively (see Table 1 for details). These countries will continue to demand goods from the U.S. as long as their economies are growing and the exchange rate remains favorable. There is a good deal of optimism that exports will play a major role in U.S. economic growth. The news from Euroland is not supportive of this expectation, with the news from the U.K., Japan, and Canada quite similar. The recent liquidity problems have reduced the possibility of The European Central Bank and the Bank of England raising rates, but the fact remains that both central banks are in a tightening mode aimed at curtailing growth and containing inflation. The latest GDP data for Euro area show a noticeable loss of momentum, with real GDP growth of only 0.3% in the second quarter following a 0.7% increase in the first quarter. The Bank of Canada has also raised its policy rate recently. The news from Japan was disappointing, with economic growth decelerating to an annual rate of 0.5% in the second quarter following a 3.2% gain in the first quarter of 2007 and a 5.4% increase in the last quarter of 2006.

Table 1 U.S. Exports of Goods –Year-to-date, June 2007

Country	Exports (Year-to-Date) \$ billions	Rank	Percent of Total
Total, All Countries	560.6	---	100.00%
Total, Top 15 Countries	416.8	---	74.40%
Canada	121.9	1	21.70%
Mexico	67	2	12.00%
Japan	31.4	3	5.60%
China	30.5	4	5.40%
United Kingdom	26.4	5	4.70%
Germany	24.2	6	4.30%
Korea, South	17.0	7	3.00%
Netherlands	16.8	8	3.00%
France	14.0	9	2.50%
Singapore	13.1	10	2.30%
Taiwan	12.6	11	2.20%
Belgium	12.2	12	2.20%
Brazil	11.1	13	2.00%
Hong Kong	9.4	14	1.70%
Australia	9.1	15	1.60%

Source: Bureau of Census

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There is another side of this story that also has to be borne in mind. The virtuous cycle of international trade will continue if imports of the U.S. also grow to support growth among the trading partners. However, given our projection of weak economic growth in the second half of 2007, the virtuous cycle may well turn into a vicious cycle of international trade. In sum, forecasts of strong growth of U.S. exports rests on shaky grounds.

Table 2 U.S. Imports of Goods – Year-to-date, June 2007

Country	Imports (Year-to-Date) \$ billions	Rank	Percent of Total
Total, All Countries	934.2	---	100.00%
Countries	705.4	---	75.50%
Canada	155.6	1	16.70%
China	148.0	2	15.80%
Mexico	100.9	3	10.80%
Japan	71.6	4	7.70%
Germany	45.5	5	4.90%
United Kingdom	27.3	6	2.90%
Korea, South	24.3	7	2.60%
France	19.9	8	2.10%
Taiwan	18.4	9	2.00%
Venezuela	17.0	10	1.80%
Italy	16.6	11	1.80%
Malaysia	15.9	12	1.70%
Ireland	15.5	13	1.70%
Saudi Arabia	14.8	14	1.60%
Nigeria	13.9	15	1.50%

Source: Bureau of Census

In June, exports of goods and services increased 1.5% after a 2.6% gain in May. Imports of goods and services slowed to only a 0.5% increase during June, reflecting a smaller oil import bill in June and fewer imports of consumer goods compared with May.

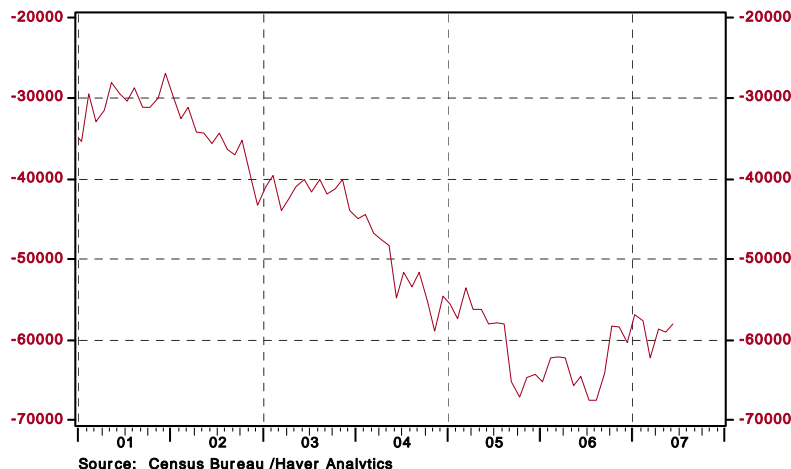
Table 3 International Trade – June 2007

	<u>Trade Balance</u>		<u>Exports (m-o-m % change)</u>		<u>Imports (m-o-m % change)</u>	
	<u>Goods & Services</u>	<u>Goods</u>	<u>Goods & Services</u>	<u>Goods - 2000\$</u>	<u>Goods & Services</u>	<u>Goods - 2000\$</u>
Jan-07	-56.8	-64.6	0.5	0.6	-1.5	-1.2
Feb-07	-57.6	-65.5	-1.4	-2.7	-0.6	-0.5
Mar-07	-62.4	-70.7	2.6	2.7	4.4	3.4
Apr-07	-58.7	-67.3	-0.1	-0.7	-2.0	-3.5
May-07	-59.2	-68.5	2.6	2.5	2.1	1.2
Jun-07	-58.1	-67.5	1.5	1.2	0.5	0.3

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The trade deficit widened vis-à-vis China (\$21.1 billion from \$20.0 billion in May), Canada (\$5.8 billion vs. \$5.2 billion in May), Mexico (\$6.4 billion vs. \$5.8 billion in May), Japan (\$6.3 billion vs. \$5.9 billion in May), Euro area (\$6.4 billion vs. \$5.8 billion in May), and Japan (\$7.4 billion vs. \$7.3 billion in May).

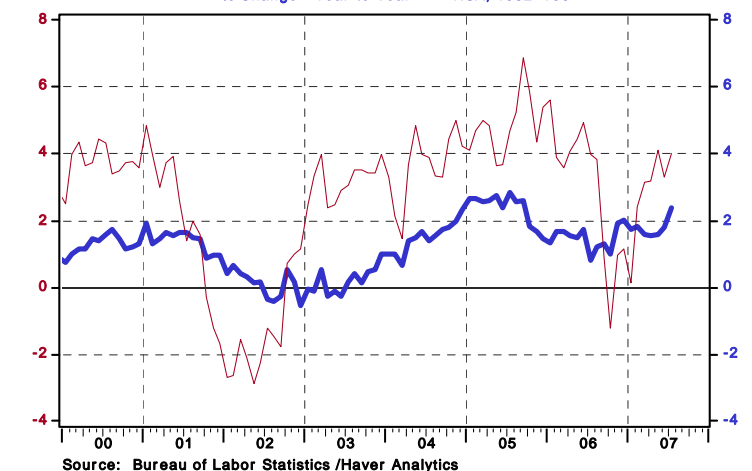
Chart 2
Trade Balance: Goods and Services, BOP Basis
 SA, Mil. \$



Energy Prices Lift Wholesale Price Index in July

The Producer Price Index (PPI) for Finished Goods moved up 0.6% in July, after a 0.2% drop in the prior month. The 2.5% increase in the energy price index was the main reason for a higher wholesale price index. In July, prices of gasoline (+3.2%), electricity (+1.8%), and natural gas (+2.7%) rose. The food price index fell 0.1% in July, following declines in the each of the two prior months also.

Chart 3
< PPI: Finished Goods [Including Foods & Fuel]
 % Change - Year to Year NSA, 1982=100
PPI: Finished Goods Less Food and Energy >
 % Change - Year to Year NSA, 1982=100

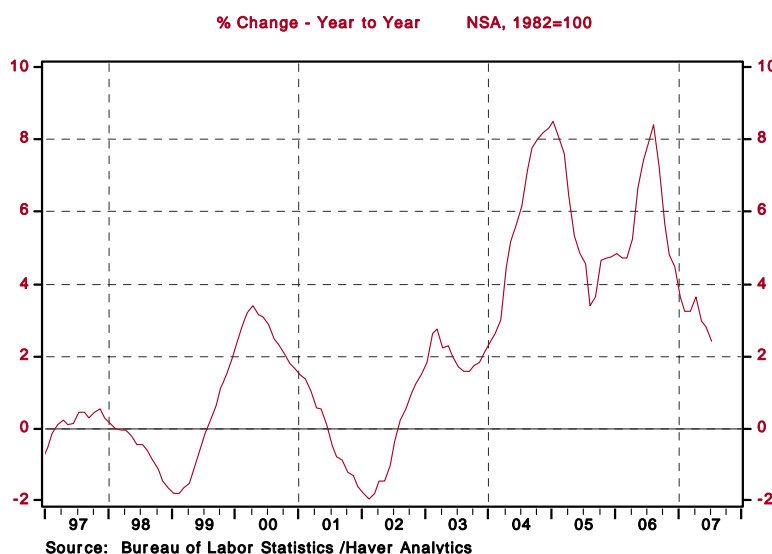


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The core PPI excluding food and energy was up only 0.1% in July, after a gain of 0.3% in June. Although car and light truck prices increased 0.2% and 1.1%, respectively, the overall advance of the core PPI was held back by declines in prices of alcoholic beverages, civilian aircraft, household furniture, men's and boys' apparel and unchanged prices for women's and girls' apparel.

Higher energy prices were responsible for the 0.6% and 1.2% gains in the intermediate goods and crude goods price indexes. The core intermediate goods and core crude goods price indexes showed muted gains of 0.2% and 0.1%, respectively, during July. The core intermediate goods price index rose 2.4% from a year ago, down from a peak increase of 8.4% in August of 2006, implying that pipeline price pressures are decelerating.

Chart 4
PPI: Intermediate Materials Less Food & Energy



Producer Price Index – July 2007

	% change prior month	annualized % change			% change		
		year-to-date	3 mo. ago	6 mo. ago	July-07 yoy	July-06 yoy	Dec-06 yoy
PPI - FINISHED GOODS							
ALL ITEMS	0.6	6.6	5.2	8.9	4.0	4.0	1.1
CORE - ALL ITEMS LESS FOOD & ENERGY	0.1	2.2	2.5	2.1	2.3	0.8	2.0
FOOD	-0.1	6.5	-4.2	5.5	6.2	1.3	1.7
ENERGY	2.5	20.6	24.1	35.7	6.6	16.7	-2.0
CAPITAL EQUIPMENT	0.1	1.7	1.6	1.8	2.3	1.0	2.3
PPI - INTERMEDIATE GOODS							
ALL ITEMS	0.6	8.0	9.3	10.9	4.1	8.7	2.8
CORE	0.2	4.3	4.4	5.0	2.4	7.9	4.5
PPI - CRUDE GOODS							
ALL ITEMS	1.2	18.2	15.1	36.1	13.1	6.2	-4.7
CORE	0.0	22.4	-0.1	22.2	8.9	36.3	17.0

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