DAILY GLOBAL COMMENTARY

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

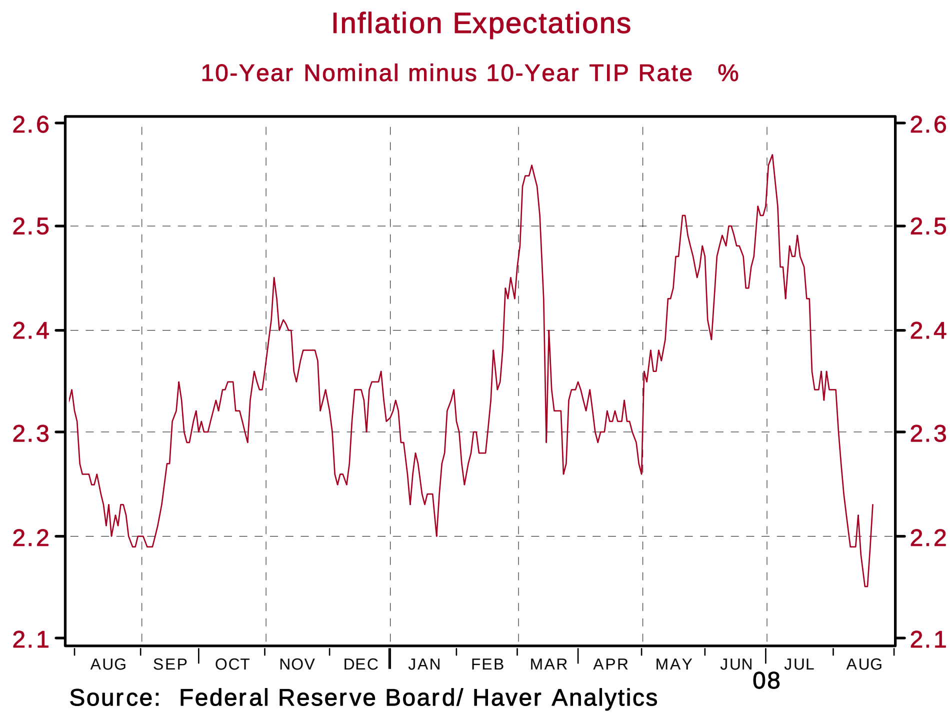
Asha G. Bangalore
agb3@ntrs.com

Bernanke Remarks Reinforce View That Fed is on Hold, for Now

August 22, 2008

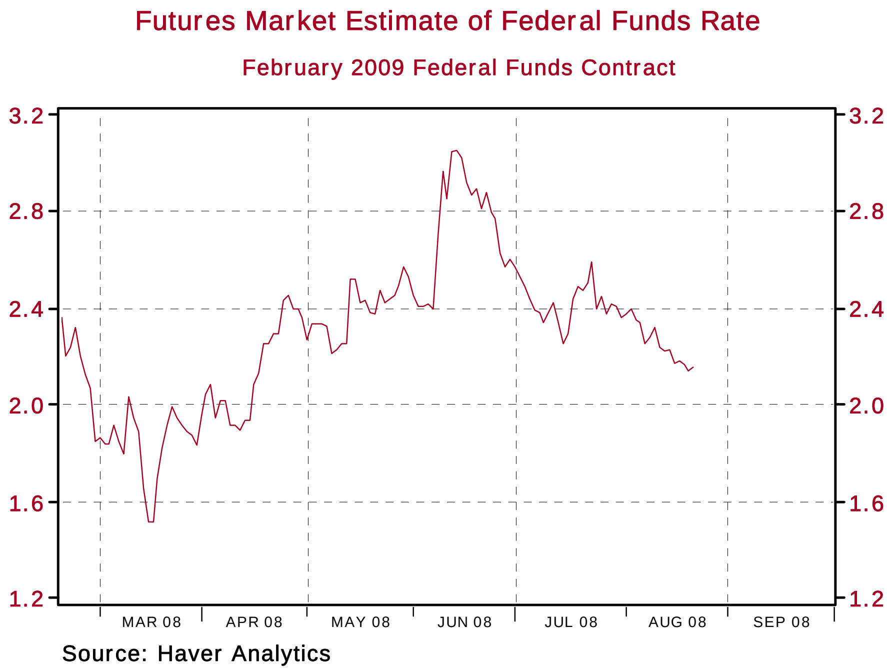
Chairman Bernanke's comments were largely focused on measures necessary to reduce systemic risk and maintain financial market stability. He made brief remarks about the economy and inflation. Similar to our forecast, the Fed expects prices of oil and other commodities to stabilize in the near term as a result of slower growth in the global economy. Evidence supportive of this view has become available in recent weeks in reports from the Euro-Zone, Japan, and the UK. Inflation expectations, which he mentioned, remain well anchored (see chart 1).

Chart 1



Bernanke's remarks implied that the Fed is optimistic about a moderation in inflation in the near term (see excerpt below). The recent rally of the dollar is seen in positive light. The uncertainty about inflation remains justified, while the overall tone of his remarks leaned toward a Fed willing to watch and wait. Hints about movements in the federal funds rate in either direction were entirely absent. The futures market has consistently reduced the probability of a higher federal funds rate (see chart 2).

Chart 2



Bernanke's bearish assessment of the economy is noteworthy:

> *"Although we have seen improved functioning in some markets, the financial storm that reached gale force some weeks before our last meeting here in Jackson Hole has not yet subsided, and its effects on the broader economy are becoming apparent in the form of softening economic activity and rising unemployment."*

> *"This strategy has been conditioned on our expectation that the prices of oil and other commodities would ultimately stabilize, in part as the result of slowing global growth, and that this outcome, together with well-anchored inflation expectations and increased slack in resource utilization, would foster a return to price stability in the medium run. In this regard, the recent decline in commodity prices, as well as the increased stability of the dollar, has been encouraging. If not reversed, these developments, together with a pace of growth that is likely to fall short of potential for a time, should lead inflation to moderate later this year and next year. Nevertheless, the inflation outlook remains highly uncertain, not least because of the difficulty of predicting the future course of commodity prices, and we will continue to monitor inflation and inflation expectations closely."*

This description implies that the growth and market stability concerns weigh more heavily in macroeconomic policy discussions at the Fed compared with inflation. That said, inflation is still *near* the top of the FOMC's worry list.

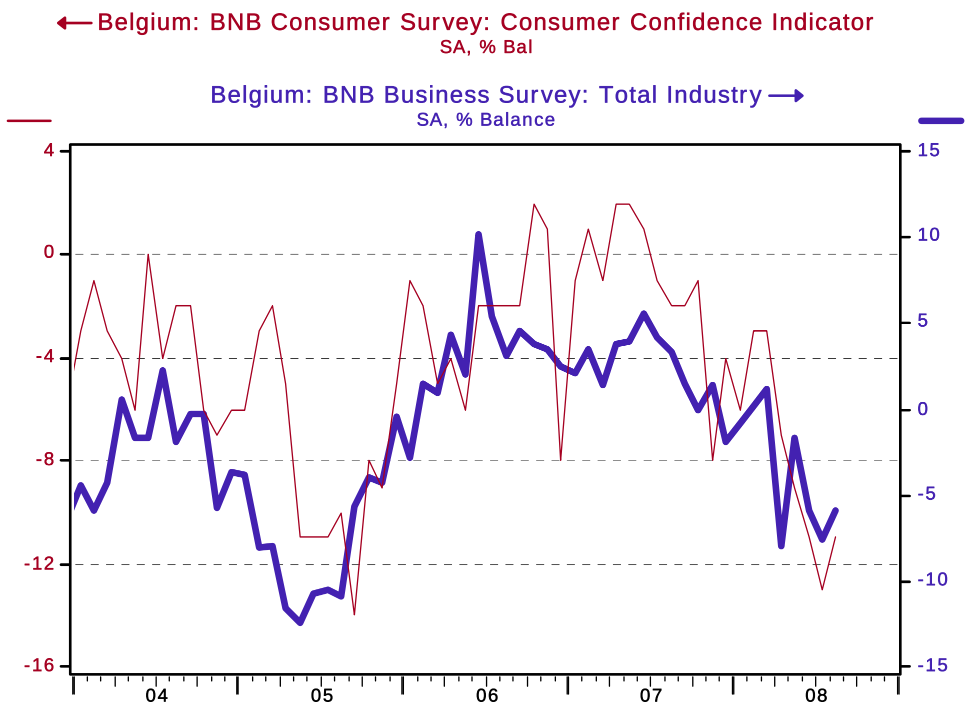
James A. Pressler
jap10@ntrs.com

Is there Hope for the Euro-zone?

Our latest insight into Europe's economic future comes from the little country of Belgium. The confidence surveys from the Banque Nationale de Belgique (BNB), intended to check the local economic pulse, also suggest how the greater Euro-zone is doing (Belgium is a major transit location for goods entering the 'zone, so as goes Belgium, so goes Europe). And this first look at August figures suggests that the current economic slowdown may not be as sharp as once feared.

The BNB's consumer confidence indicator released Wednesday – somewhat more volatile than its business counterpart – rose to -11 this month from -13 in July. And today's release of the more stable and predictive August business confidence indicator showed a rise to -5.9 in August from -7.6 last month. While these increases are far from a trend, they could offer a brief respite for those worried that the 'zone is in rapid decline.

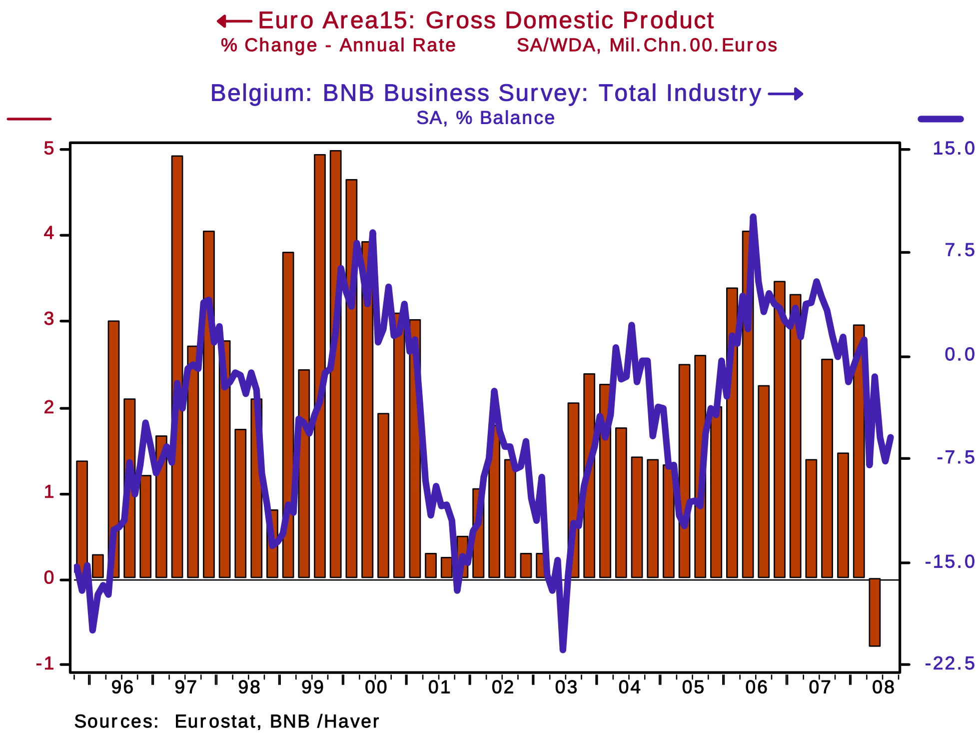
Chart 3



Source: Banque Nationale de Belgique /Haver Analytics

Strictly using the BNB business survey as a guide, the Euro-zone economy should not exactly be heading for recession. Over the past 13 years the index has spent a few months below -7.5 without strong negative GDP growth. At its lowest point, a drop to -21.5 in June 2003, the 'zone economy contracted by a barely perceptible 0.01% on the quarter. The current reading would at best suggest a growth slowdown – but obviously that is not the case.

Chart 4



With the three major Euro-zone economies already posting negative growth in Q2 and Ireland all but formally in recession, we are led to believe that this apparent misalignment of two usually related indicators is due to optimism within Belgium (which, incidentally, is not showing signs of economic contraction). The German Ifo confidence index is due out on August 25, and it will more than likely defy the BNB as well and confirm that things are not looking up in Europe.