

DAILY GLOBAL  
COMMENTARY

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

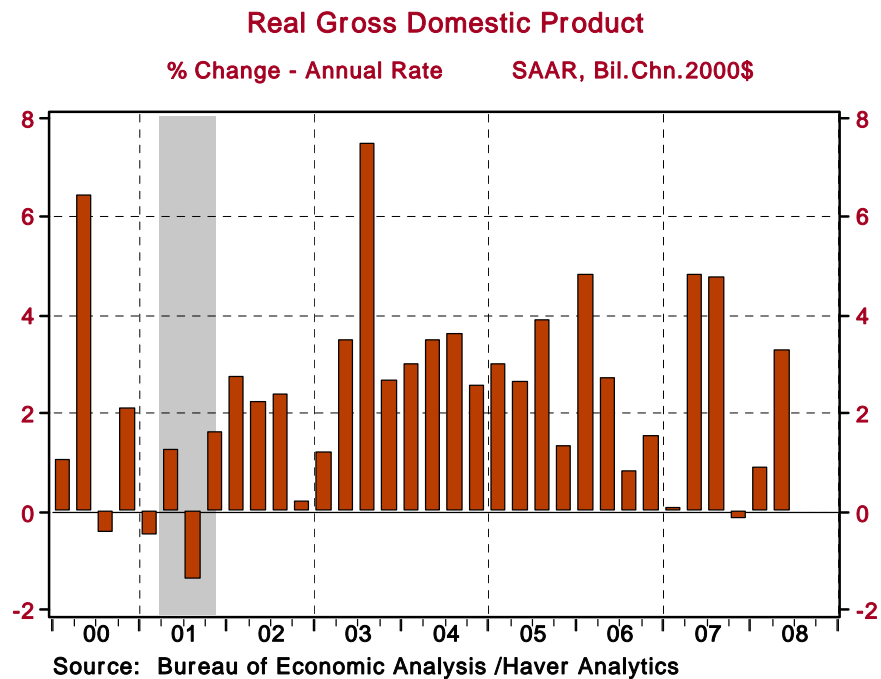
Asha G. Bangalore  
[agb3@ntrs.com](mailto:agb3@ntrs.com)

## Q2 GDP Is History, Focus Should Be on the Future

August 28, 2008

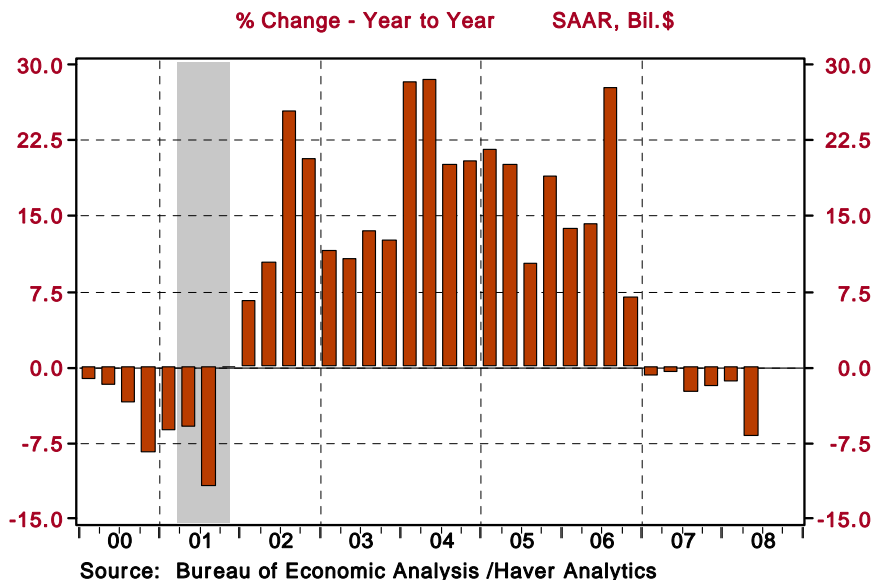
The U.S. economy grew at an annual rate of 3.3% in the second quarter compared with the advance estimate of a 1.9% increase. This large discrepancy in the headline estimate came about due a significant upward revision of net exports and inventories. Net exports in the second quarter are now estimated as -\$376.7 billion vs. -\$395.2 billion in the advance estimate. In addition, firms decreased inventories by \$49.4 billion compared with the earlier estimate of a \$62.2 billion reduction. The upward revision of government expenditures (3.9% vs. 3.4%) was another category accounting for the upward revision of GDP growth in second quarter. Other minor upward revisions included a 1.7% gain in consumer spending vs. a 1.5% increase and a 3.2% drop in capital spending vs. a 3.4% drop in the advance estimate. Offsetting these upward revisions were downward revisions of expenditures on structures and residential investment expenditures.

Chart 1



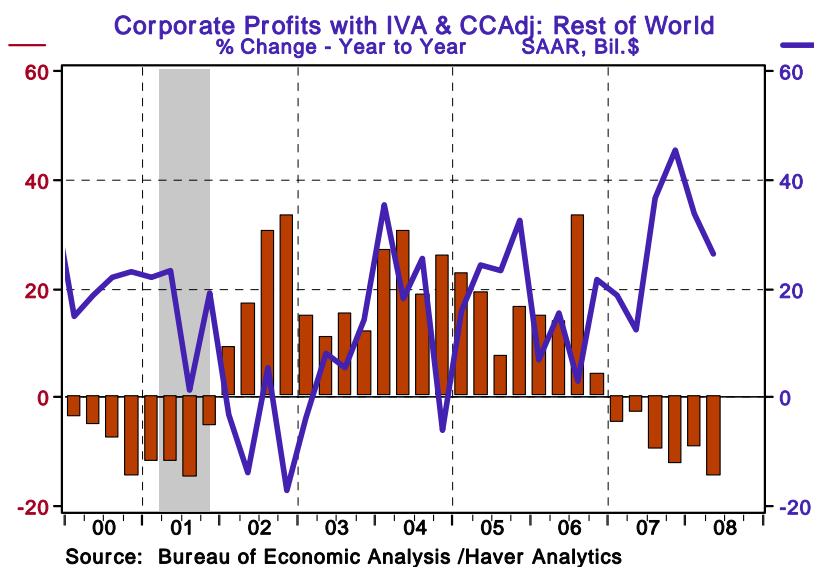
This report also included corporate profits for the second quarter. On a year-to-year basis, corporate profits fell 6.98% in the second quarter, marking the sixth consecutive quarterly decline.

Chart 2  
Corporate Profits with IVA and CCAAdj



Corporate profits from domestic industries declined 14.4% from a year ago in the second quarter, which represents an accelerating trend after a 9.4% drop in the first quarter (see chart 2). Within domestic industries the decline in profits in the non-financial sector (-17.7%) was larger than in the financial sector (-8.6%). Corporate profits from the rest of the world (see chart 3) grew 26.4% on a year-to-year, offsetting the weakness in domestic industries.

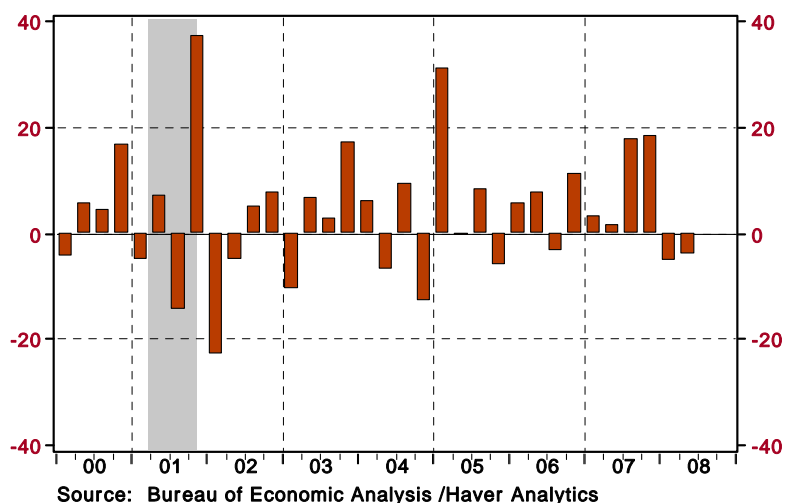
Chart 3  
Corporate Profits with IVA & CCAAdj: Domestic Industries



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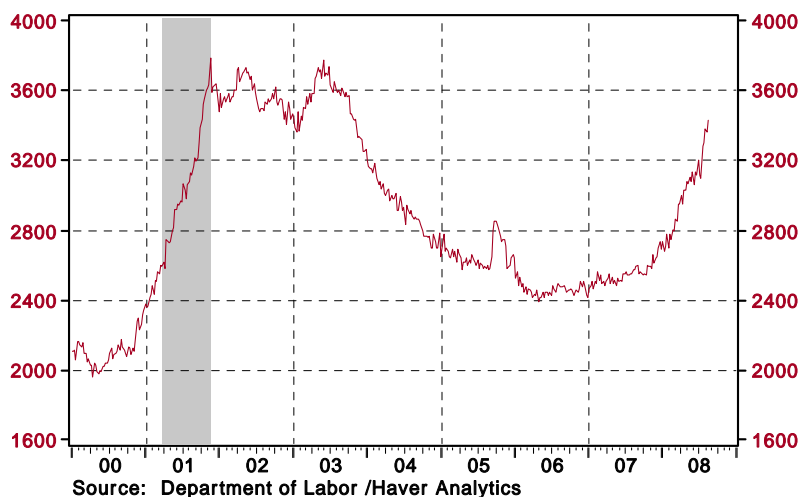
However, corporate profits from the rest of the world on a quarter-to-quarter basis have now dropped for two quarters in a row. Moreover, the recent rally of the dollar casts doubts about the ability of corporate profits from the rest of the world to help trim the decline in overall corporate profits.

Chart 4  
**Corporate Profits with IVA & CCAAdj: Rest of World**  
 % Change - Period to Period SAAR, Bil.\$



As the headline notes, the future path of the economy is more important than the history. Incoming data suggest that labor market conditions remain weak, with the number of people claiming unemployment insurance the highest in five years.

Chart 5  
**Insured Unemployment, State Programs**  
 SA, Thous



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Auto sales in July were the lowest since April 1992. There is no end in sight for the credit crunch and housing market doldrums. Financial markets continue to show significant signs of inefficiency and fragility with spreads widening out close to levels seen in March 2007 (see charts 6 and 7). The Fed is on a watch and wait mode, for now.

Chart 6  
Spread: 2-year Swap rate less 2-yr. Treasury Note Yield  
percentage points

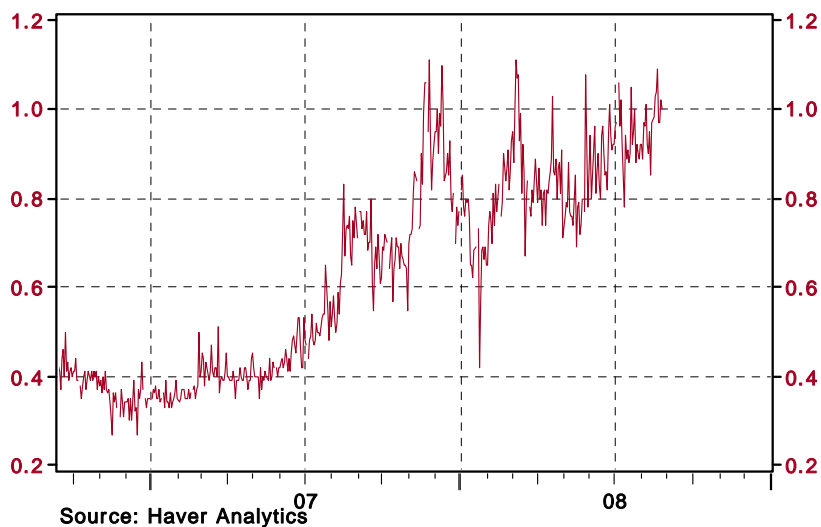
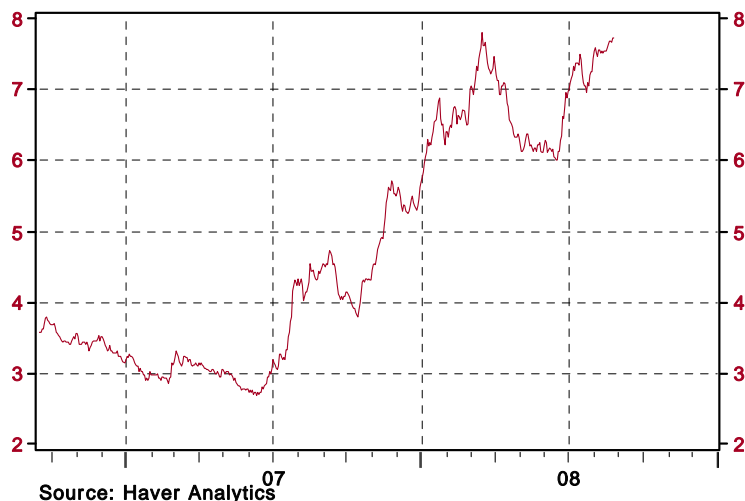
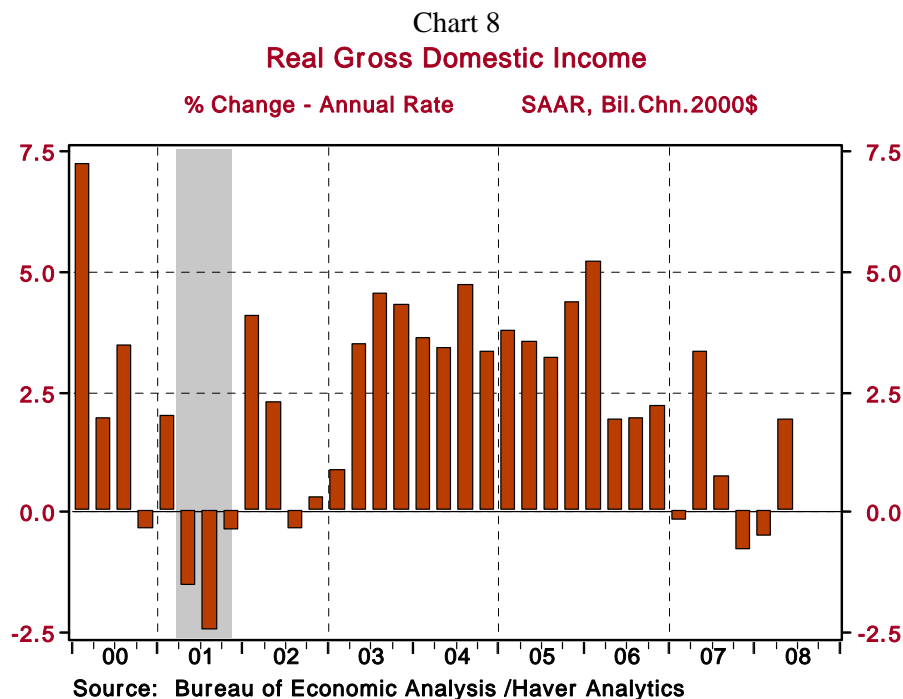


Chart 7  
Yield spread: Merrill Lynch High Yield less 10-yr. U.S.Treas. note yield  
percentage points



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**Gross Domestic Income** - David Rosenberg of Merrill Lynch noted in his comments that the recent behavior of Gross Domestic Income (GDI) -- embedded in the GDP report -- is important. He has also indicated in his comments today that the Greenspan and Bernanke Fed have discussed the behavior of GDI. The bottom line is that according to GDI (see chart 8), the economy has been in a recession, if we adopt the popular understanding of two consecutive quarters of declines.



Here are the definitions of GDP and GDI according to the BEA: “Gross domestic product (GDP) measures output as the sum of final expenditures—consumer spending, private investment, net exports, and government consumption and investment. Gross domestic income (GDI) measures output as the sum of the costs incurred and the incomes earned in the production of GDP. In theory, GDP should equal GDI; in practice, they differ because their components are estimated using largely independent and less-than-perfect source data. In the national income and product accounts (NIPA's), the difference between GDP and GDI is called the "statistical discrepancy"; it is recorded in the NIPA's as an "income" component that reconciles GDI with GDP.” The BEA considers the GDP as a more accurate measure and lists reasons in its website: ([http://www.bea.gov/scb/account\\_articles/national/0897niw/box1.htm](http://www.bea.gov/scb/account_articles/national/0897niw/box1.htm)). In my humble opinion, even in the absence of an official announcement of a recession, the fact is that the unemployment rate is climbing, the number filing for unemployment insurance is growing, financial markets are fragile, a credit crunch is underway, the housing market is in shambles, and consumer spending has slowed. These are serious issues to grapple with; we don't need an official acknowledgement of a recession to recognize the severity of these problems. It is about time we quit hiding under the shroud of specious phrases.

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## Real Gross Domestic Product 2008:Q2 Preliminary Estimate

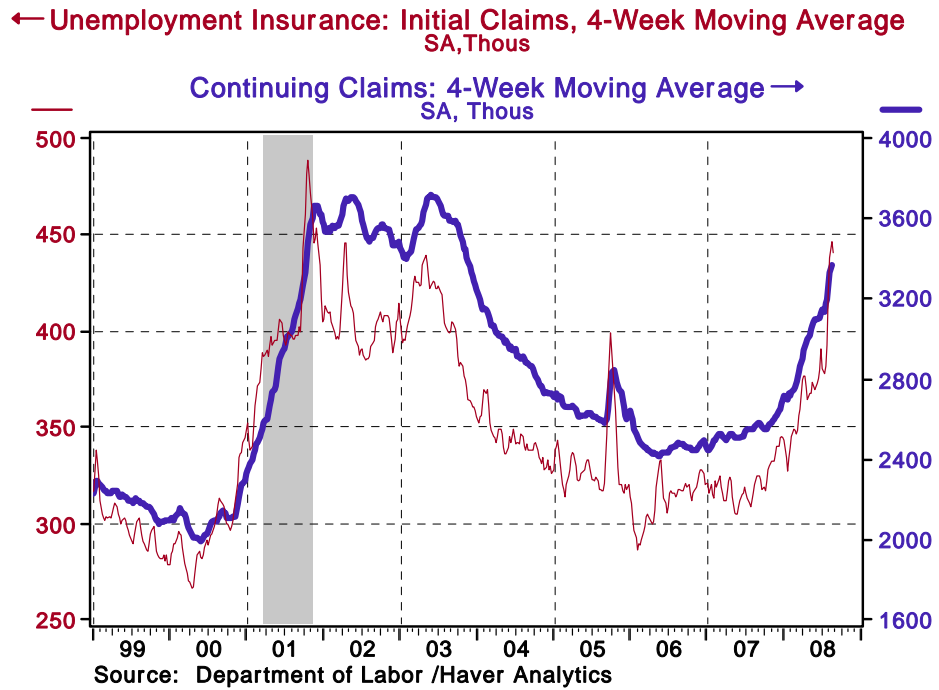
	(2000 chained dollars)				Percent Change (SAAR) from prior quarter			
	07:4 Final	08:1 Final	08:2 Advance	08:2 Preliminary	07:4 Fin	08:1 Fin	08:2 Adv	08:2 Prel.
GDP	11620.7	11646.0	11700.6	11740.3	-0.2	0.9	1.9	3.3
CONSUMPTION	8298.2	8316.1	8347.5	8352.2	1.0	0.9	1.5	1.7
DURABLE GOODS	1250.6	1237.0	1227.7	1229.1	0.4	-4.3	-3.0	-2.5
NONDURABLE GOODS	2400.2	2397.9	2421.7	2422.6	0.3	-0.4	4.0	4.2
SERVICES	4676.1	4704.3	4717.4	4719.9	1.4	2.4	1.1	1.3
INVESTMENT	1781.3	1754.7	1686.0	1699.8	-11.9	-5.8	-14.8	-12.0
FIXED INVESTMENT	1788.2	1762.4	1751.6	1751.1	-6.2	-5.6	-2.4	-2.5
NONRESIDENTIAL	1414.7	1423.1	1431.3	1431.0	3.4	2.4	2.3	2.2
STRUCTURES	319.7	326.4	337.5	337.0	8.5	8.6	14.4	13.7
EQUIPM. & SOFTWARE	1090.1	1088.6	1079.2	1079.7	1.0	-0.6	-3.4	-3.2
RESIDENTIAL	411.6	383.0	367.1	366.9	-27.0	-25.1	-15.6	-15.7
CHG. BUS. INVENT.	-8.1	-10.2	-62.2	-49.4				
NET EXPORTS	-484.5	-462.0	-395.2	-376.6				
EXPORTS	1482.1	1500.6	1534.1	1547.9	4.4	5.1	9.2	13.2
IMPORTS	1966.5	1962.6	1929.2	1924.5	-2.3	-0.8	-6.6	-7.6
GOVERNMENT (C & I)	2029.4	2039.1	2056.3	2058.5	0.8	1.9	3.4	3.9
FEDERAL	761.7	772.6	785.2	785.5	-0.5	5.8	6.7	6.8
DEFENSE	509.9	518.9	528.2	528.3	-0.9	7.3	7.3	7.4
OTHER	251.5	253.2	256.6	256.6	0.4	2.9	5.3	5.5
STATE AND LOCAL	1267.5	1266.7	1271.7	1273.6	1.6	-0.3	1.6	2.2
DISP. PERS. INC.	8683.1	8680.0	8914.6	8905.4	0.6	-0.1	11.3	11.4
FINAL SALES	11628.0	11653.7	11764.4	11790.3	0.8	0.9	3.9	4.8
GROSS DOMESTIC PURCHASES	12109.8	12113.3	12153.0	12159.5	-0.1	0.1	1.3	1.5
PRICE DEFLATORS:								
GDP CHAIN TYPE	120.8	121.6	121.9	122.0	2.8	2.6	1.1	1.2
GDP EX. FOOD & ENERGY					2.4	2.0	1.4	1.5
PCE CHAIN TYPE	119.2	120.3	121.5	121.5	4.3	3.6	4.2	4.2
PCE EX. FOOD & ENERGY	115.5	116.2	116.8	116.8	2.5	2.3	2.1	2.1

## Weekly Jobless Claims Remain At Elevated Level

Initial jobless claims declined 10,000 to 425,000 during the week ended August 22. Initial jobless claims have risen 109,000 between July 5 and August 2, with the large jump attributed to the fact that extended unemployment benefits were available under a federal program. In the past three weeks, only a part of this gain has been reversed (-32,000). Continuing claims, which lag initial claims by one week, rose 64,000 to 3.42 million. We should get a better sense of the underlying trend in a few weeks. But, the fact remains that the number of people obtaining benefits under the unemployment insurance program is the highest in nearly five years.

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Chart 9



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