Northern Trust

DAILY GLOBAL COMMENTARY

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Oil Bill Accounts for Widening of Trade Gap in July

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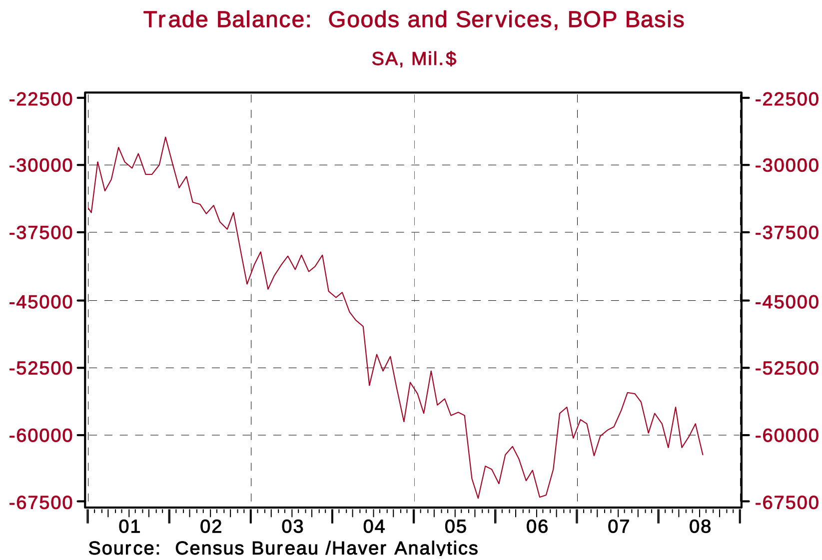
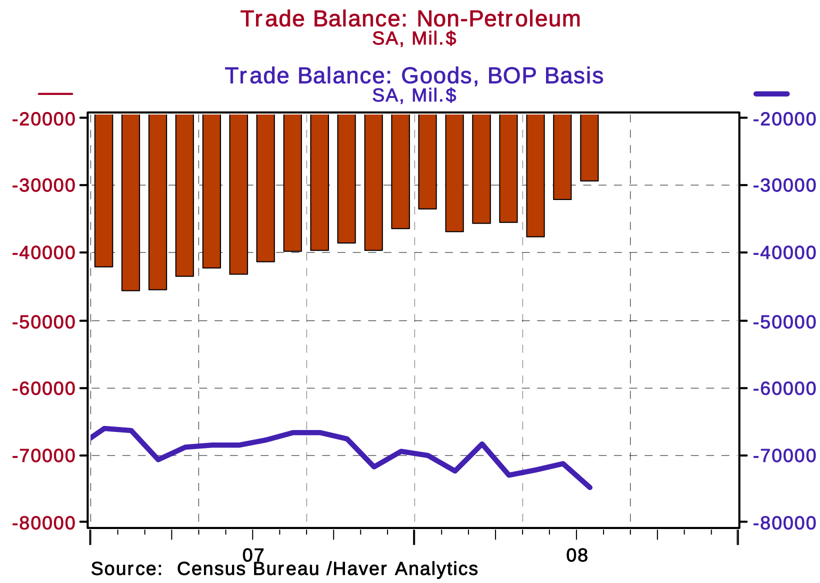
The trade deficit of the U.S. economy widened to $62.2 billion in July from $58.8 billion in June. Exports of goods and services increased 3.3% and imports of goods services rose 3.9% in July.

Chart 1



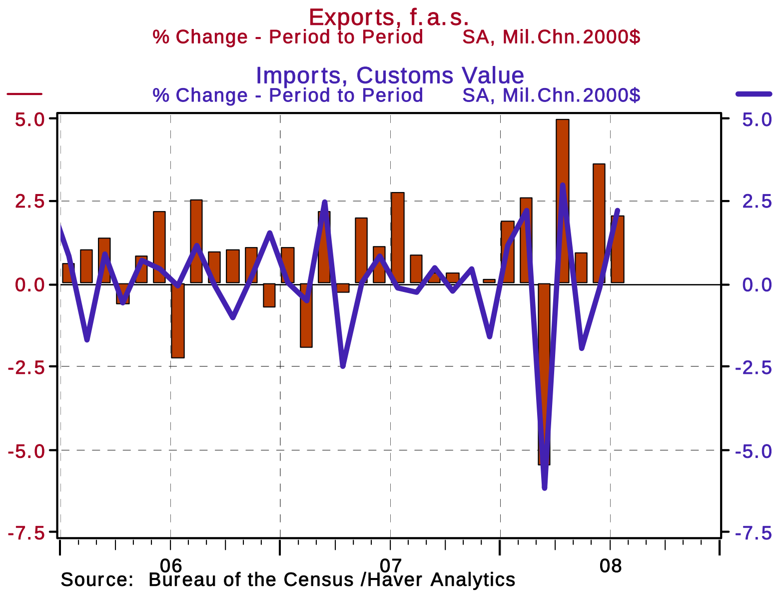
A large oil import bill, reflecting higher prices and quantities, was the main reason for a wider trade deficit in July (see chart 2). The trade deficit of goods excluding petroleum declined in July to $29.6 billion from $32.6 billion in June.

Chart 2



Inflation adjusted exports of goods advanced 2.0% in July vs. a 3.6% increase in June. Exports of capital goods excluding autos rose 2.0%, while that of autos (+12.6%) and consumer goods excluding autos (+5.0%) also advanced in July. The more important question is how exports will grow in the next few months. It appears that economic softness abroad could trim the growth of exports in the near term. Inflation adjusted imports of goods increased 2.2% in July, reflecting a gain in imports of capital goods (+1.2%) and industrial supplies and materials (+5.0%) which includes oil, while imports of autos (-0.6%) and consumer goods excluding autos (-0.4%) declined during July.

Chart 3



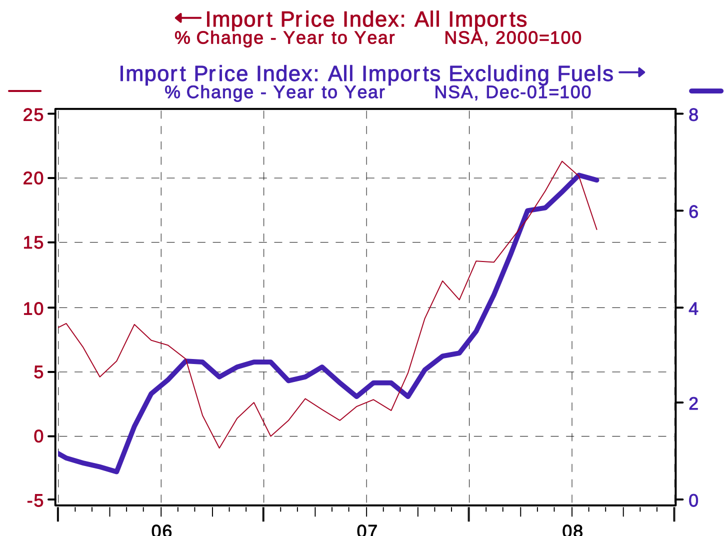
The trade deficit vis-à-vis China ($ 24.9 billion vs. $21.4 billion in June), Canada ($ 8.3 billion vs. $7.2 billion in June), Japan ($ 6.3 billion vs. $6.1 billion in June), and Euro-area ($8.7 billion vs. $7.2 billion in June) widened in July but narrowed vis-à-vis Mexico ($ 5.5 billion vs. $5.7 billion in June).

International Trade Goods and Services – July 2008

	Trade Balance			Exports (m-o-m % change)		Imports (m-o-m % change)	
	Goods & Services	Goods	Goods - 2000$	Goods & Services	Goods - 2000$	Goods & Services	Goods - 200
Jan-08	-58.7	-70.1	-50.1	2.2	1.9	2.1	1.2
Feb-08	-61.4	-72.5	-50.9	2.1	2.6	2.8	2.2
Mar-08	-57.0	-68.4	-47.2	-1.9	-5.5	-3.4	-6.2
Apr-08	-61.5	-73.0	-46.9	3.6	4.9	4.8	3.0
May-08	-60.2	-72.1	-43.5	1.2	0.9	0.2	-1.9
Jun-08	-58.8	-71.3	-40.1	3.7	3.6	2.1	-0.1
Jul-08	**-62.2**	**-74.9**	**-41.2**	**3.3**	**2.0**	**3.9**	**2.2**

In related news, the import price index fell 3.7% in August, largely due to a sharp 12.8% decline in the petroleum price index. This suggests that a trade deficit arising from higher oil prices is not likely in August. Imports excluding fuels moved up 0.2% in August and 6.63% from a year ago. It is important to note that the year-ago reading is slightly lower than the 6.74% increase posted in July.

Chart 4

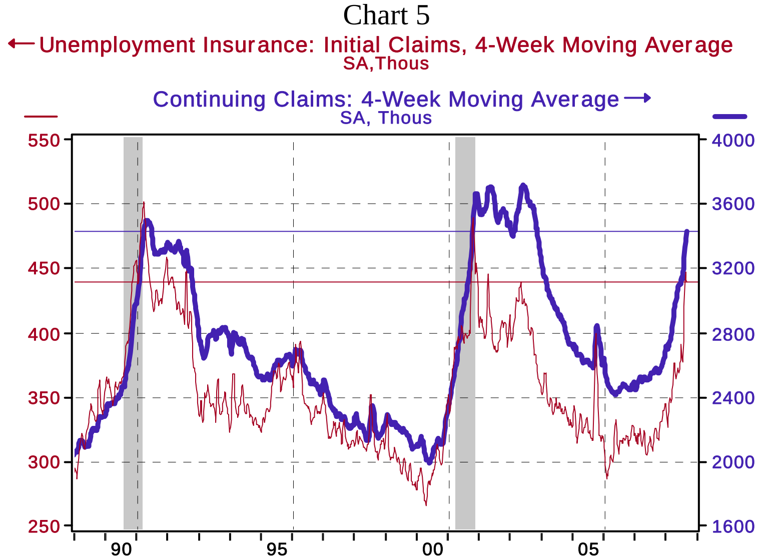


Source: Bureau of Labor Statistics /Haver Analytics

Jobless Claims: Correction Not in Sight

Initial jobless claims fell 6,000 to 445,000 during the week ended September 6. The 4-week moving average of initial jobless claims, at 440,000, is similar to levels seen during the last two recessions (see chart 5). Continuing claims, which lag initial claims by one week, rose 122,000 to 3.525 million and the 4-week average is 3.429 million. The insured unemployment rate is at 2.6%, up from a 2.5% reading in the prior week. The message from the labor market remains intact -- hiring is frozen.

Chart 5



Source: Department of Labor /Haver Analytics

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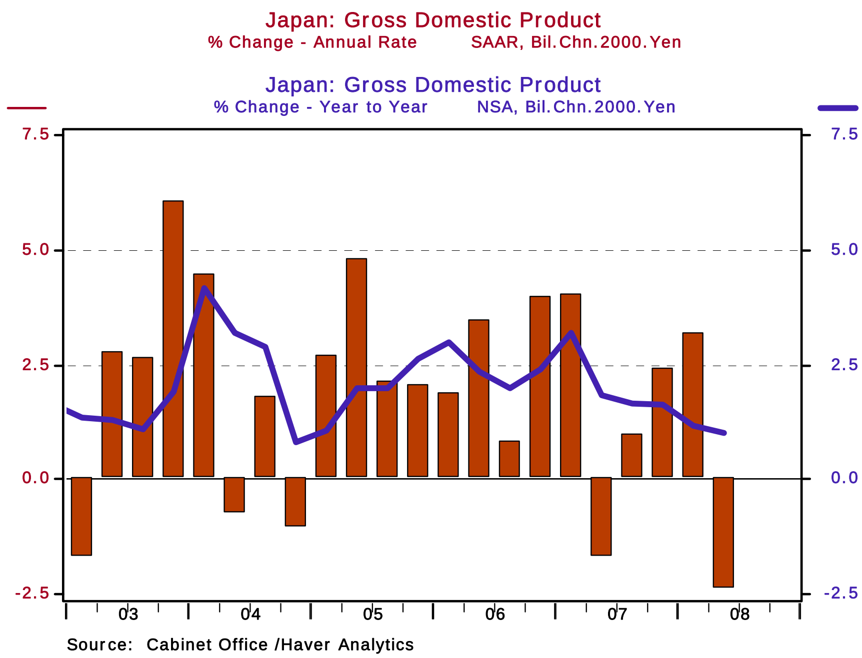
Japan: Details On the Upcoming Recession

Tomorrow's revised report on Japan's Q2 GDP will likely not be an improvement on the preliminary release, but we believe it will suggest a particularly bearish situation. Last week, the consensus placed the upcoming revision as marginal, remaining as a 0.6% drop on the quarter (-2.4% annualized). But since then there has been a surprisingly weak capital expenditure survey for that quarter, along with revisions to other data that all suggest last quarter's contraction may have hit -1.0%, and even pulled the year-over-year figure into negative territory. Some accounting changes for the new fiscal year did negatively impact the capex figures, but the difference between the two methodologies is not worth deep study. More to the point are other indicators coming out of Tokyo that suggest that more economic woes are on the way.

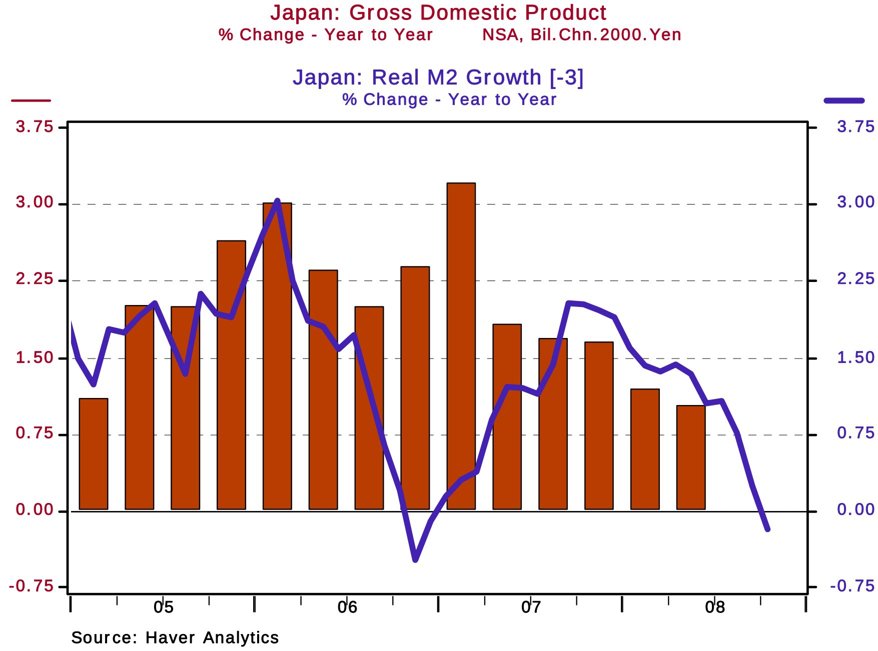
Chart 6



Over the past 12 months to July, Japan's inflation rate has risen from flat to 2.3%, with the mainstay of that increase coming in the past six months. During that same period, nominal M2 growth has only accelerated from a mere 2.0% to 2.1%. This means that nearly all of the monetary expansion of the past year has been inflationary rather than productive, and in real terms contracted by 0.2% according to some simple calculations.

Now, considering that real growth in the money supply should naturally lead to real expansion in the economy (by about three months according to our figures), it is not surprising that the recent slowdown in real M2 fits well with the slowing economy over the past two quarters. Looking forward, with real M2 growth as a loose proxy, Q3 looks rather weak and Q4 looks abysmal. The direction of this line fits the general outlook most analysts are suggesting for the second half of the year, but the magnitude of the slowdown may be more than people expect.

Chart 7



Usually, when the Japanese economy went through past slowdowns it would fall back on its robust export sector to carry it through hard times. Unfortunately, this time will likely be different. Trade activity is slowing throughout the northern hemisphere, and buyers of Japanese exports are getting scarce. Export growth in Q2 slowed to 1.8%, a level not seen since the 2000-03 recession, while import growth has been in double-digits for the past three quarters. In nominal terms, by the end of the year Japan's quarterly trade balance could fall into marginal deficit, thus becoming a detractor to GDP rather than a contributor.

In short, while we expect tomorrow's GDP revisions to be a disappointing lot, what we are really looking for are any signs that capex is not as weak as expected, exports are showing some life, or personal consumption might have some unexpected strength. Without these factors, however, Q3 GDP data in November will only confirm Japan's recession and the outlook will be increasingly bearish from that point forward.

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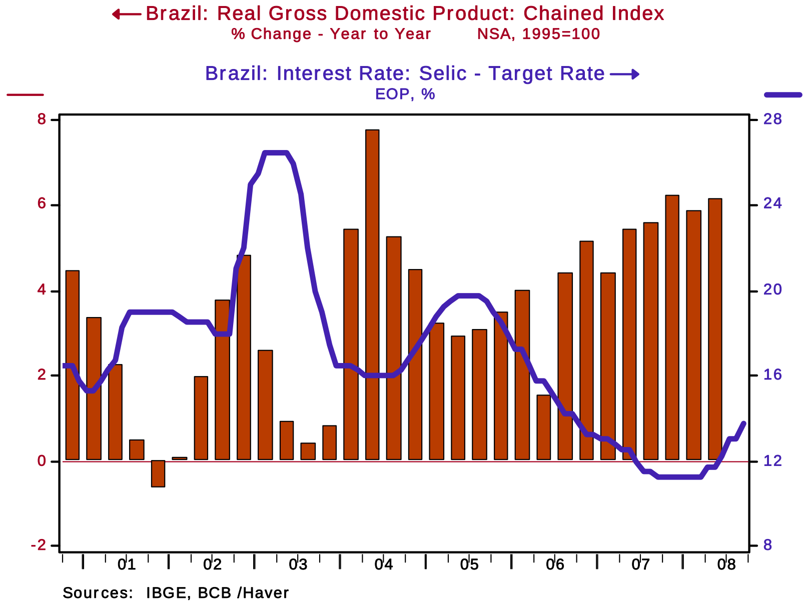
Red-hot Brazil Takes a Cooling Blow

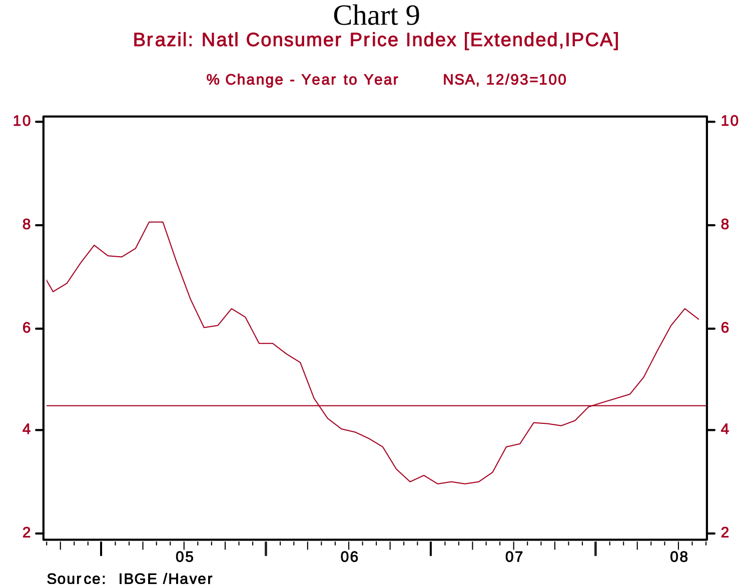
Brazil's central bank hiked the benchmark Selic rate by 75 bps on Wednesday, bringing it to 13.75% from 13.00% – its highest level in nearly two years and the fourth hike since April. The decision came after a better-than-expected GDP growth reading for Q2 of 6.1% from the year-earlier period, and a brisk 1.6% pace from the first quarter of this year.

Chart 8



However, sustained surging growth has fuelled fears that the economy may be overheating. Recent economic success has naturally led to rising domestic wages, quickening job creation, and cheaper credit, all resulting in higher domestic demand that has led GDP growth. Over the past 12 months, domestic demand is up an impressive 8.7% – twice the level seen in the last economic boom in 2004. Moreover, growth in government consumption reached 5.3% in the second quarter, diverging from its usual bounds of 2-3%, and adding to already-booming economic activity. However, buoyant economic activity sometimes comes with a price. Brazil's main consumer price index, the IPCA, has risen 6.17% in the 12 months ended August and is expected to reach 6.27% by the end of this year – surpassing the government's target of 4.5%.

Chart 9



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Needless to say, with weakening external demand, rising inflation, and very strong domestic demand, the central bank will have its hands full in the coming year. The latest decision was split with five voting members for a 75 basis point hike, while the dissenting three would have preferred a lower 50 basis point hike. More rate hikes are almost a given over the remainder of H2 2008, but today's split decision may signal lesser hikes going forward, with the next a likely 50 basis point hike at the October 28-29 meeting.