

DAILY GLOBAL COMMENTARY

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

Asha G. Bangalore
agb3@ntrs.com

Bernanke Sketches Out Financial Reform Agenda to “Address Systemic Risk” March 10, 2009

In his speech to the Council on Foreign Relations, Chairman Bernanke voiced the contours of financial reform. More importantly, he stressed that *“until we stabilize the financial system, a sustainable economic recovery will remain out of reach. In particular, the continued viability of systemically important financial institutions is vital to this effort.”* He went on to mention that *“the Federal Reserve, other federal regulators, and the Treasury Department have stated that they will take any necessary and appropriate steps to ensure that our banking institutions have the capital and liquidity necessary to function well in even a severe economic downturn. Moreover, we have reiterated the U.S. government’s determination to ensure that systemically important financial institutions continue to be able to meet their commitments.”*

There were five aspects of future financial reform addressed in today’s speech: (1). The main thrust of Bernanke’s judgment regarding the large interconnected firms or firms that are “too-big-to-fail” is that policymakers should concentrate on how to prevent these firms from excessive risk-taking and minimize the consequences of unwinding these “critical firms.” (2). He noted that the “financial infrastructure” needs to be strengthened such that it will perform well under stress and indicated that gaps in the regulatory framework that allow a migration of firms to less-regulated from more-regulated forms should be eliminated. (3). Bernanke stated that improved tools are necessary to address the unwinding of large non-bank financial institutions such that they are not a systemic risk and threaten public interest. (4). He spoke about excessive procyclicality of capital standards and why they need to be changed because the current structure leads “financial institutions to ease credit in booms and tighten credit in downturns more than is justified by changes in the creditworthiness of borrowers, thereby intensifying cyclical changes.” (5). He was of the opinion that “we should consider whether the creation of an authority specifically charged with monitoring and addressing systemic risks would help protect the system from financial crises like the one we are currently experiencing.”

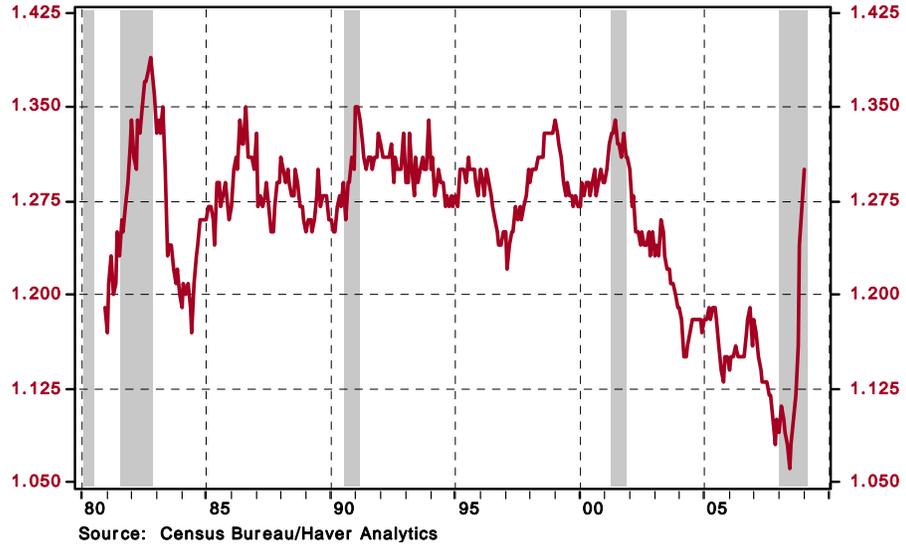
Second Tier Reports Reinforce the Depth of the Recession

The **wholesale trade report** underscores the significant drop in demand at the wholesale level. Sales (-2.9%) and inventories (-0.7%) fell in the wholesale sector in January, with sales showing a larger decline. This combination of weakness in sales and inventories led to a sharp increase in the inventories-sales ratio to 1.30 in January from 1.27 in the prior month. This ratio was 1.06 in June 2008, the cycle low. The current reading is the largest since December 2001 when the economy has just pulled out of a recession (see chart 1)

Chart 1

Merchant Wholesalers: Inventory/Sales Ratio: Total

SA

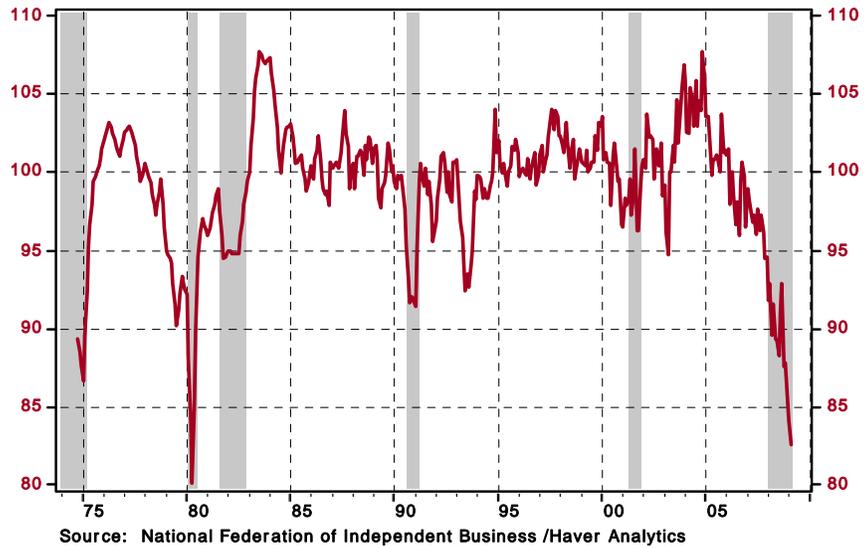


The **small business survey** (NFIB survey) results show that small business optimism is at the lowest point since the 1980 recession (see chart 2).

Chart 2

NFIB: Small Business Optimism Index

SA, 1986=100 (I)



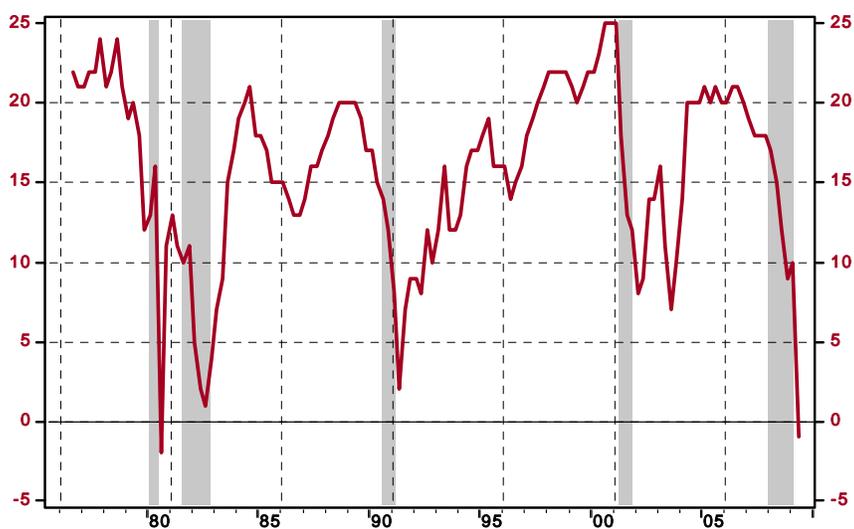
The opinions expressed herein are those of the author and do not necessarily represent the views of The Northern Trust Company. The Northern Trust Company does not warrant the accuracy or completeness of information contained herein, such information is subject to change and is not intended to influence your investment decisions.

Hiring prospects from the Manpower Employment Survey for the second quarter of 2009 are at the weakest since the 1980 recession. The employment index of this survey was -1.0 after holding at 10 in the previous survey. The negative number implies that the number of firms expecting to increase their payrolls in the next quarter is less than the number of firms predicting to shrink their payrolls.

Chart 3

Manpower Employment Curr Quarter Outlook: All Industries: Net Higher

SA, % (I)



Source: Manpower /Haver Analytics

The opinions expressed herein are those of the author and do not necessarily represent the views of The Northern Trust Company. The Northern Trust Company does not warrant the accuracy or completeness of information contained herein, such information is subject to change and is not intended to influence your investment decisions.