

DAILY GLOBAL
COMMENTARY

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

Asha G. Bangalore
agb3@ntrs.com

Weekly Policy Update – Fed Adopts More Aggressive Measures to Facilitate an Economic Recovery

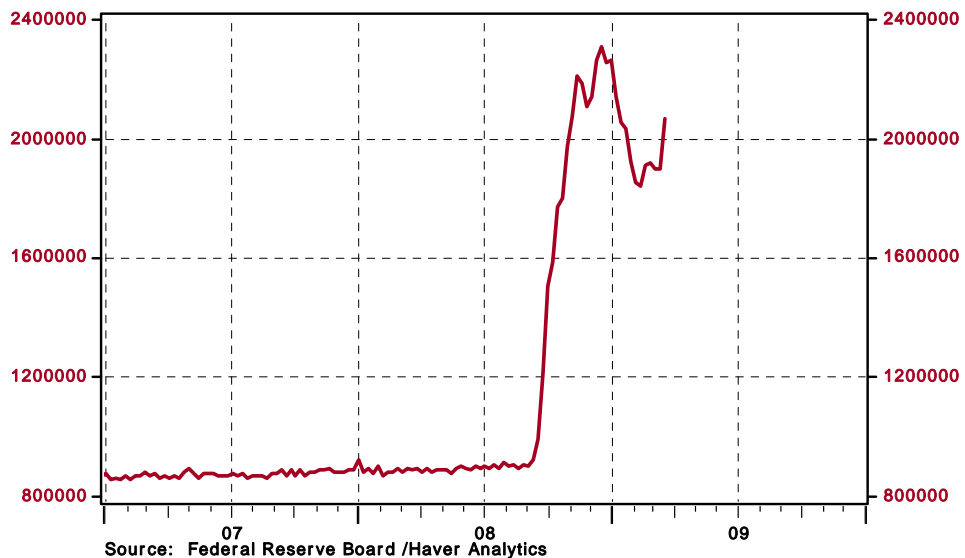
March 20, 2009

The Federal Reserve held the overnight federal funds rate unchanged at 0%-0.25%, as expected. The expansion of existing programs and the decision to purchase long-dated Treasury securities were surprise elements of the announcement. The Fed's balance sheet declined to \$1.85 trillion during the week ended February 11, 2009 and has since increased to \$2.07 trillion for the week ended March 16. The Fed's policy statement noted that the Fed would purchase an additional \$750 billion of agency mortgage-backed securities, increase the purchase of agency debt by \$100 billion, and buy \$300 billion of longer-term Treasury securities, which amounts to an expansion of the balance sheet by \$1.15 trillion. The net impact could be smaller as some programs could possibly shrink when the terms of the programs become less attractive or unnecessary.

Chart 1

All Fed Res Banks: Total Assets

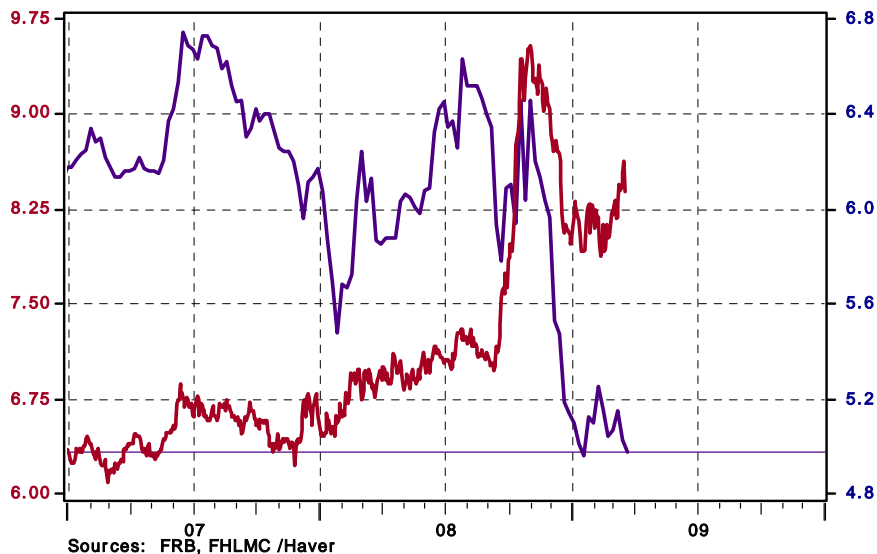
EOP, Mil.\$



Equity and bond markets responded favorably after the policy announcement but the dollar lost ground on March 18 and March 19 (see comment below) but it has erased a part of the loss today. The 10-year Treasury note yield declined to 2.51% after the FOMC policy statement was published from 3.00% earlier in the day. As of this writing, it was trading at 2.62%. The objective of purchasing Treasury securities is to bring about a reduction in long rates with the expectation that these lower rates would reduce interest rates on private-sector securities such as mortgage rates. We will be tracking these borrowing rates closely to assess the impact of the Fed's actions. The 30-year mortgage rate was 4.98% as of the week ended March 20 and Moody's Baa corporate bond yield was 8.39% on March 18, down from 8.62% on March 17 (see chart 2).

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.

Chart 2
Moody's Seasoned Baa Corporate Bond Yield
 % p.a. (l)
FHLMC: 30-Year Fixed-Rate Mortgages: U.S.
 %



The Fed's quantitative easing policy is designed to not only influence the quantity and price of credit, but also the sectors receiving credit (e.g., commercial paper market, mortgage-backed securities, asset-backed securities). Like conventional quantitative easing policy whereby the central bank prints money to buy government securities (the latest decision of the FOMC to purchase long-dated Treasuries accomplishes this aspect), the Fed's earlier actions also include programs that have already increased the size of its balance sheet through arrangements to buy/support private credit extensions, some of which were expanded (broadened eligibility of assets under TALF and increased quantity of purchases of mortgage backed securities and agency debt) on March 18.

The Fed noted the economy continues to contract and concluded that *“although the near-term economic outlook is weak, the Committee anticipates that policy actions to stabilize financial markets and institutions, together with fiscal and monetary stimulus, will contribute to a gradual resumption of sustainable economic growth.”* With regard to inflation, the FOMC indicated that there is *“some risk that inflation could persist for a time below rates that best foster economic growth and price stability in the longer term.”* Essentially, the Fed's view about inflation is unchanged from the January policy statement.

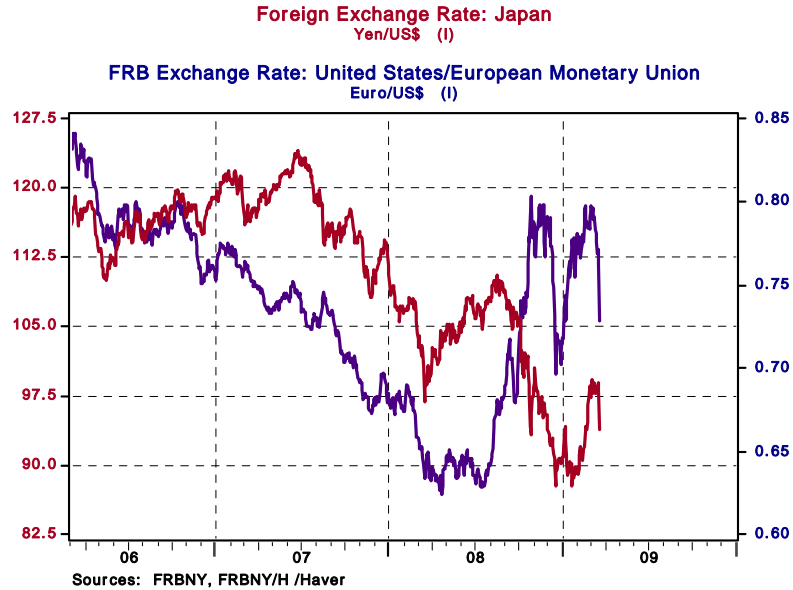
The Fed's bold moves are directed toward the prevention of a deflationary spiral in the U.S. economy. Assuming that the Fed is successful in preventing this deflationary spiral, a couple of years from now it might face the risk of an inflationary spiral. The main issues are timing and magnitude of unwinding the extraordinary growth of the balance sheet when there is self-sustaining economic growth and before the seeds of inflation are firmly planted.

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.

The Dollar's Plunge – A Historical Side

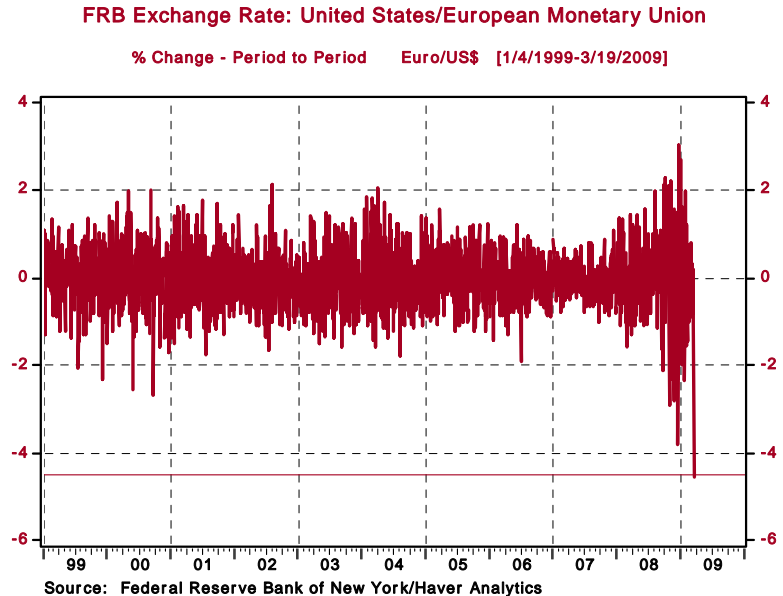
A historical tour to place the dollar's plunge on March 19 in perspective is the extra zing for the last day of a tumultuous week. The dollar plunged after the Fed announced its aggressive move on March 18 to expand its balance sheet by a stunning \$1.15 trillion to alleviate economic conditions.

Chart 3



The dollar fell 4.52% to 0.7283 euros per dollar on March 19 -- the largest daily drop in the exchange rate since the birth of the euro in 1999 (see chart 4).

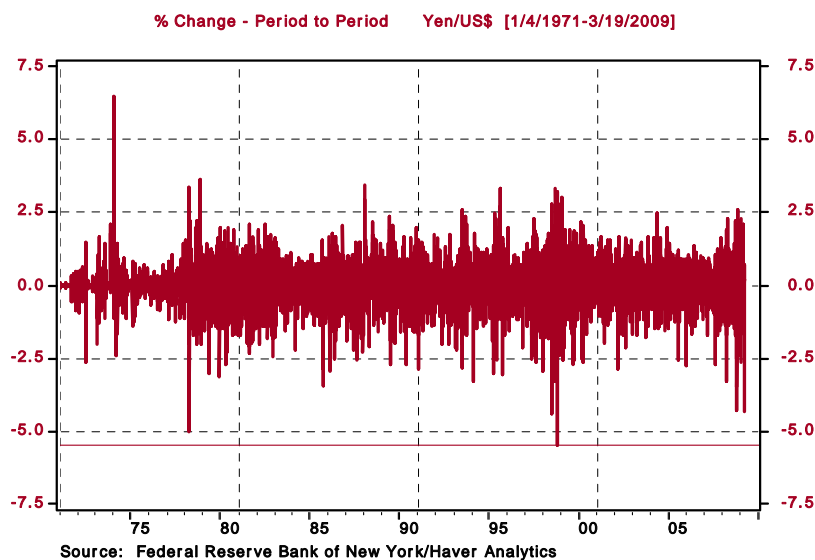
Chart 4



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.

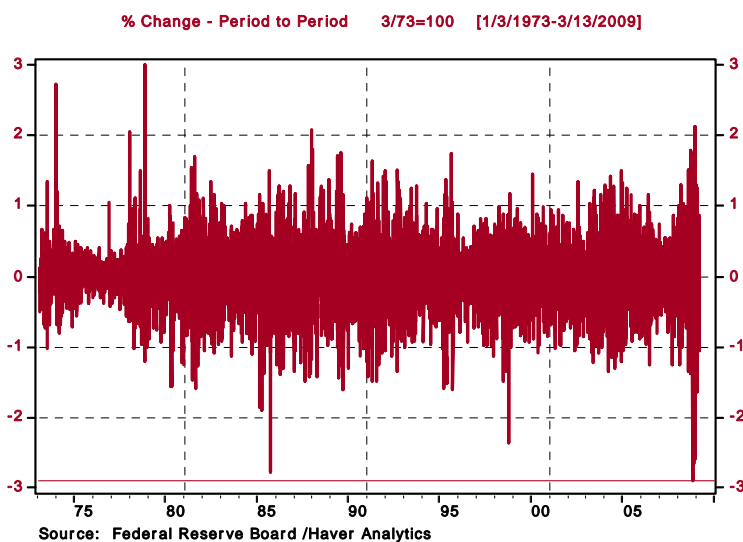
The fortunes of the dollar were unfavorable vis-à-vis the Japanese yen also. The greenback declined 4.31% March 19 to 93.85 yen per dollar, a comparable drop occurred on October 6, 2008 (-4.25%). The largest depreciation of the dollar vs. the yen since 1971 has been a 5.47% drop on October 7, 1998 (see chart 5).

Chart 5
Foreign Exchange Rate: Japan



The trade weighted dollar fell 2.68% and 1.74% on March 18 and March 19 (not shown in chart 6), respectively. The history of the trade weighted dollar (1973 – March 13, 2009) is shown in chart 6. The largest daily decline of the trade weighted dollar (-2.91%) was on October 29, 2008 which was also when the Fed lowered the federal funds rate 50 bps to 1.00% (see chart 6).

Chart 6
Nominal Trade-Weighted Exch Value of US\$ vs Major Currencies



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.

There are a few outliers in the daily downward movements of the trade weighted value of the dollar that are noteworthy because they coincide with important economic/financial market developments (see table 1). Declines in the trade weighted value of the dollar in excess of 2.0% in a single trading session are listed in table 1, excluding the decline on March 19, 2009.

Table 1 Large Declines of Trade Weighted Dollar

Date	daily % change in trade weighted dollar*	Major Economic/Financial Events
3/18/2009 3/19/2009	-2.68% -1.74%	Fed announces expansion of balance sheet by \$1.15 trillion on 3/18/2009
12/17/2009	-2.60%	Fed cuts federal funds rate 100 bps to a band of 0%-0.25%
11/24/2009	-2.65%	Fed announces massive bailout plan for Citigroup on Sunday 11/23/09
10/29/2008	-2.91%	Fed lowers federal funds rate to 1.00% from 1.50%
10/7/1998	-2.38%	No single event but several forces were at work**.
9/23/1985	-2.78%	After the Plaza Agreement on 9/22/1985 to bring down the value of the dollar.

* - There are other significant daily declines in the trade weighted dollar but the predominant drops are listed because each of these have been associated with important economic/financial events. The March 18 and 19 declines of the dollar and today's quote are courtesy of the Wall Street Journal. The Fed will publish these data on March 23.

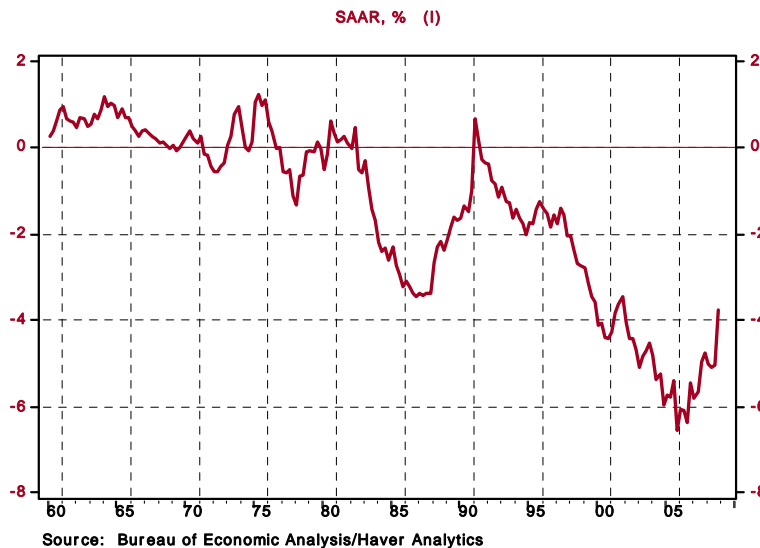
** - The October 7, 1998 decline of the trade weighted dollar is tied to several events. Greenspan hinted about slowing economic conditions in speech at the National Association of Business Economics. The Fed cut the federal funds rate 25 bps on 9/29/98 and again on 10/15/98. The Japanese government announced a \$500 billion bank recapitalization package on 10/7/98. The rescue of LTCM in September 1998 and Russian financial crisis of August 1998 were lurking in the background.

What is the message from this long-winded historical discussion? Markets overshoot, particularly when unexpected financial and economic events transpire and they draw out an exaggerated response. This does not imply a discounting of the enormity of the crisis at hand or the reason for the Fed's forceful move but it highlights the need to place events in a historical context. Arguments against dollar bears are gathering steam. First, as of this writing, the dollar has moved up vis-à-vis the euro (0.73 euros per dollar), vis-à-vis the yen (95 yen per dollar) and the trade weighted dollar was at 83.82 (+0.9% from yesterday). Second and more importantly, the current

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.

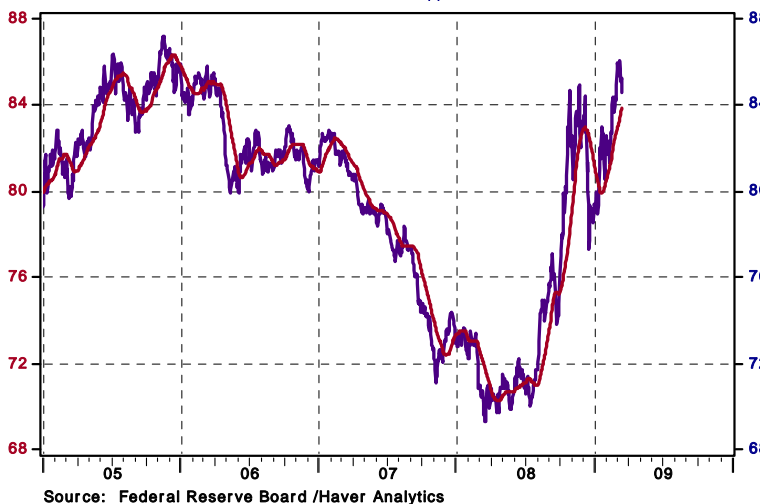
account deficit as a percent of GDP has dropped to 3.47% in the fourth quarter of 2008, the lowest in seven years! The current deficit is a reflection of the saving shortfall in the U.S. economy. As there are meaningful indications that this serious shortcoming is on the way to be fixed, albeit over a period of time, the severity of the risk attached to the dollar may have to be scaled back.

Chart 7
Balance on Current Account as a % of GDP



The underlying trend of the trade weighted dollar suggests that a significant erosion of the trade weighted dollar in the near term would require an extraordinary trigger.

Chart 8
Nominal Trade-Weighted Exch Value of US\$ vs Major Currencies
30-day MovingAverage 3/73=100 (I)
Nominal Trade-Weighted Exch Value of US\$ vs Major Currencies
3/73=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.

Key Interest Rates

	3/20/2009	1-wk. change, bps	4-wk. change, bps	1-yr. change, bps
3-month Libor	1.22	-10	-3	-139
2-year U.S. Treasury note yield	0.87	-11	-9	-72
10-year U.S. Treasury note yield	2.63	-26	-15	-71

Highlights of next week:

Date	Economic Indicator	TNT	Consensus	Previous
3/23/2009	Existing home sales (Feb.)		4.45 mln.	4.49 mln.
3/25/2009	Durable goods orders (Feb.)	-2.0%	-2.0%	-4.5%
	New Home Sales (Feb.)		0.30 mln	0.309 mln
3/26/2009	Initial claims ('000s)		650	646
	Real GDP 2008:Q4 Final est.	-6.2%	-6.5%	-6.2%
3/27/2009	Personal Income (Feb.)	-0.1%	-0.1%	0.4%
	Personal Consumption Exp. (Feb.)	0.2%	0.2%	0.6%

Global Economic Data

	Real GDP		CPI		Unemployment Rate			Central Bank Rate		
	SAAR, yoy %		NSA, yoy%		%	year-ago		%	year-ago	
United States	-0.8	Q3-08	0.2	Jan-09	8.1	Feb-09	4.8	0.13	Feb-09	3.00
Euro-Area	-1.3	Q3-08	1.2	Jan-09	8.2	Jan-09	7.3	2.00	Feb-09	4.00
Japan	-4.3	Q3-08	0.0	Jan-09	4.1	Jan-09	3.8	0.10	Feb-09	0.50
UK	-1.9	Q3-08	3.0	Jan-09	4.3	Feb-09	2.5	1.00	Feb-09	5.25
Australia	0.3	Q3-08	3.7	Q3-08	5.2	Feb-09	3.9	3.25	Feb-09	7.00
Canada	-0.7	Q3-08	1.4	Jan-09	7.7	Feb-09	5.9	1.00	Feb-09	4.00
China	6.8	Q4-08	-1.7	Jan-09	4.2	Q4-08	4	0.86	Jan-09	1.98
India	5.4	Q3-08	10.4	Jan-09	--	--	--	4.00	Feb-09	6.00
New Zealand	-1.4	Q3-08	3.4	Q3-08	4.6	Q4-08	3.4	3.50	Feb-09	8.25
Norway	0.8	Q3-08	2.5	Jan-09	2.9	Q4-08	2.5	2.50	Feb-09	5.25
Singapore	-4.0	Q3-08	3.0	Jan-09	2.5	Q4-08	1.7	0.30	Feb-09	1.18
South Korea	-3.6	Q3-08	4.1	Feb-09	3.5	Feb-09	3.1	2.00	Feb-09	5.00
Sweden	-4.4	Q3-08	0.9	Jan-09	7.9	Feb-09	6.0	1.00	Feb-09	4.25
Switzerland	-0.1	Q3-08	0.2	Jan-09	3.1	Feb-09	2.5	0.50	Feb-09	2.80
Taiwan	-7.9	Q3-08	0.0	Feb-09	5.3	Jan-09	3.9	1.25	Feb-09	3.38
Thailand	-4.3	Q3-08	-0.1	Feb-09	2.0	Jan-09	1.2	2.00	Feb-09	3.50
* UK - Claimant Count Unemployment Rate										
* Thailand - GDP Non-Seasonally Adjusted										
* EA-13, UK, Sweden - Harmonized Unemployment										

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.

Historical US Economic Data

	Feb-09	Jan-09	Dec-08	Nov-08	Oct-08	Sep-08	Aug-08	Jul-08	Jun-08	May-08	Apr-08	Mar-08
Payroll Employment (000)	-651	-655	-681	-597	-380	-321	-175	-128	-161	-137	-160	-122
% Change, Year Ago *	-3.0	-2.7	-2.2	-1.6	-1.1	-0.7	-0.4	-0.3	-0.2	-0.1	0.2	0.3
Unemployment Rate (%)	8.1	7.6	7.2	6.8	6.6	6.2	6.2	5.8	5.6	5.5	5.0	5.1
Avg. Hourly Earnings (% Chg.)	0.2	0.2	0.3	0.3	0.4	0.2	0.4	0.3	0.3	0.3	0.2	0.4
% Change, Year Ago	3.6	3.8	3.9	3.9	3.9	3.6	3.8	3.5	3.6	3.7	3.8	3.9
PPI (% Chg.)	0.1	0.8	-1.9	-2.6	-2.6	-0.1	-0.5	1.3	1.3	1.5	0.2	0.9
% Change, Year Ago *	-1.3	-1.0	-0.9	0.4	5.2	8.8	9.7	9.9	9.1	7.3	6.4	6.7
CPI (% Chg.)	0.4	0.3	-0.8	-1.7	-0.8	0.0	0.0	0.7	0.9	0.5	0.2	0.4
% Change, Year Ago *	0.2	0.0	0.1	1.1	3.7	4.9	5.4	5.6	5.0	4.2	3.9	4.0
ISM Diffusion Index (%)	35.8	35.6	32.9	36.6	38.7	43.4	49.3	49.5	49.5	49.3	48.6	49.0
Industrial Production (% Chg.)	-1.4	-1.9	-2.4	-1.3	1.7	-4.1	-1.3	0.0	0.1	-0.2	-0.5	-0.2
% Change, Year Ago	-11.2	-10.1	-8.2	-5.9	-4.3	-6.2	-2.0	-0.7	-0.1	0.2	0.4	1.5
Capacity Utilization (%)	70.9	71.9	73.3	75.2	76.2	75.0	78.3	79.4	79.6	79.6	79.9	80.4
Nondefense Cap. Goods ex Aircraft												
- Orders (% Chg.)		-5.7	-5.9	1.1	-6.7	-3.4	-2.3	0.3	1.6	-0.3	3.1	-1.0
% Change, Year Ago *		-20.4	-14.7	-7.9	-7.2	0.1	-0.2	6.6	3.4	3.4	2.6	-1.1
- Shipments (% Chg.)		-6.7	0.1	-1.3	-3.7	1.7	-2.1	0.3	0.6	0.2	1.0	0.8
% Change, Year Ago *		-10.9	-4.7	-5.2	-2.2	2.7	-1.6	6.1	2.0	2.7	3.7	1.0
Retail Sales (% Chg.)	-0.1	1.8	-3.1	-2.4	-3.4	-1.6	-0.7	-0.6	0.1	0.8	0.2	0.2
% Change, Year Ago	-12.3	-8.3	-8.6	-10.0	-4.0	0.1	-0.4	4.1	1.4	2.5	3.7	0.3
Real Personal Consumption (% Chg.)		0.4	-0.5	0.3	-0.8	-0.5	-0.1	-0.6	-0.2	0.2	0.1	0.3
% Change, Year Ago		-1.6	-1.9	-1.4	-1.3	-0.6	-0.2	0.2	1.1	1.4	1.3	1.5
Personal Income (% Chg.)		0.4	-0.2	-0.4	0.0	0.1	0.3	-0.8	0.1	1.8	0.0	0.4
% Change, Year Ago		1.9	1.6	2.2	3.1	3.4	3.9	4.0	5.3	5.6	4.0	3.9
New Home Sales (SAAR, mn)		0.31	0.34	0.38	0.40	0.43	0.45	0.51	0.50	0.52	0.54	0.51
% Change, Year Ago *		-47.7	-45.5	-40.0	-43.9	-34.0	-36.7	-36.8	-38.4	-38.0	-41.0	-38.8
Existing Home Sales (SAAR, mn)		4.49	4.74	4.54	4.94	5.10	4.93	4.99	4.90	4.95	4.85	4.92
% Change, Year Ago *		-7.6	0.3	-17.0	-1.9	6.8	-15.0	-11.3	-16.7	-16.3	-15.7	-22.5
Housing Starts (SAAR, mn)	0.58	0.48	0.56	0.66	0.77	0.82	0.85	0.95	1.09	0.98	1.00	0.99
% Change, Year Ago *	-48.5	-56.1	-45.3	-46.5	-40.7	-27.2	-37.0	-32.2	-25.6	-32.8	-34.0	-33.6
International Trade (Bils \$)		-36.0	-39.9	-42.5	-58.0	-58.1	-60.2	-62.5	-59.1	-60.5	-61.8	-57.4
	Q4-08	Q3-08	Q2-08	Q1-08	Q4-07	Q3-07	Q2-07	Q1-07	Q4-06	Q3-06	Q2-06	Q1-06
Real GDP, Chain Weighted, SAAR	-6.2	-0.5	2.8	0.9	-0.2	4.8	4.8	0.0	1.5	0.8	2.7	4.8
% Change, Year Ago	-0.8	0.7	2.1	2.5	2.3	2.8	1.8	1.3	2.4	2.4	3.2	3.1
Chain-Weighted Price Index, SAAR	0.5	3.9	1.1	2.6	2.8	1.5	2.0	4.1	2.2	2.8	2.7	3.5
% Change, Year Ago	2.0	2.6	2.0	2.3	2.6	2.5	2.8	2.9	2.8	3.2	3.5	3.4
Nominal GDP, SAAR	-5.8	3.4	4.1	3.5	2.3	6.4	6.9	4.3	3.7	3.6	5.5	8.6
% Change, Year Ago	1.2	3.3	4.1	4.7	4.9	5.3	4.6	4.3	5.3	5.7	6.8	6.6
Employment Cost Index (%)	0.5	0.7	0.7	0.7	0.8	0.8	0.9	0.8	0.8	1.0	0.9	0.6
% Change, Year Ago	2.6	2.9	3.1	3.3	3.3	3.3	3.3	3.5	3.3	3.3	3.0	2.8
Productivity Nonfarm, SAAR	-0.4	2.2	4.7	2.6	-0.5	7.0	4.8	-0.6	-0.4	-1.6	2.4	1.9
% Change, Year Ago	2.2	2.2	3.4	3.5	2.6	2.6	0.5	-0.1	0.6	0.3	1.7	1.3
Unit Labor Costs, Nonfarm, SAAR	5.7	3.5	-2.8	1.1	5.0	-2.5	-3.3	4.8	9.6	3.9	-1.1	2.6
% Change, Year Ago	1.8	1.6	0.1	0.0	0.9	2.0	3.6	4.2	3.7	2.6	2.2	2.9

Source: Haver Analytics

* NSA

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.