

DAILY GLOBAL  
COMMENTARY

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## Factory Sector is Tiptoeing Toward a Recovery

April 1, 2009

The ISM manufacturing survey results for March indicate that the factory sector is contracting less rapidly compared with the situation in February. The composite index edged up to 36.3 in March from 35.8 in February. The level of the composite index denotes a contraction of the factory sector but the March reading is now notably higher than the cycle low of 32.9 seen in December 2008. The New Orders Index (41.2, +8.1 points) recorded the largest gain among the different components of the survey.

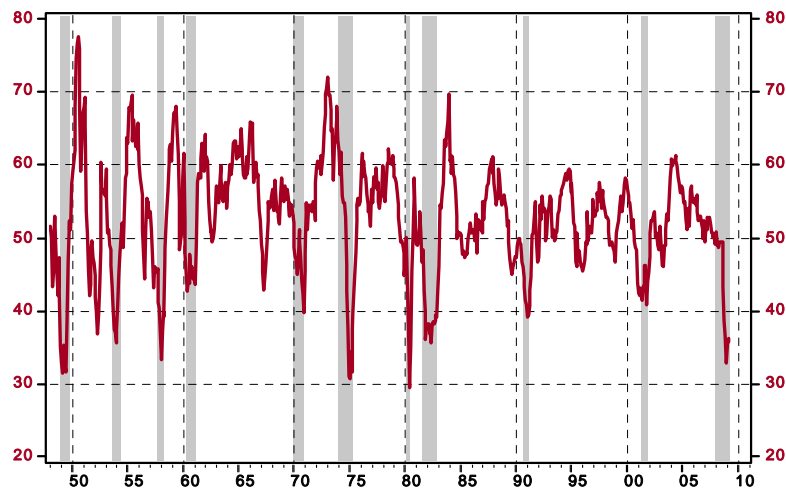
Table 1 ISM Manufacturing Survey – March 2009

|                   | Oct-2008 | Nov-2008 | Dec-2008 | Jan-2009 | Feb-2009 | Mar-2009 |
|-------------------|----------|----------|----------|----------|----------|----------|
| Composite Index   | 38.7     | 36.6     | 32.9     | 35.6     | 35.8     | 36.3     |
| New Orders        | 32.4     | 28.1     | 23.1     | 33.2     | 33.1     | 41.2     |
| Production        | 33.6     | 32.0     | 26.3     | 32.1     | 36.3     | 36.4     |
| Employment        | 34.2     | 34.3     | 29.9     | 29.9     | 26.1     | 28.1     |
| Vendor Deliveries | 49.3     | 48.6     | 45.7     | 45.3     | 46.7     | 43.6     |
| Inventories       | 44.0     | 40.1     | 39.6     | 37.5     | 37.0     | 32.2     |
| Prices            | 37.0     | 25.5     | 18.0     | 29.0     | 29.0     | 31.0     |
| Backlog of Orders | 29.5     | 27.0     | 23.0     | 29.5     | 31.0     | 35.5     |
| New Export Orders | 41.0     | 41.0     | 35.5     | 37.5     | 37.5     | 39.0     |
| Imports           | 41.0     | 37.5     | 39.0     | 36.5     | 32.0     | 33.0     |

Indexes tracking production employment, exports, imports, backlogs, and prices advanced in March, while indexes measuring vendor deliveries and inventories fell.

Chart 1  
ISM Manufacturing: PMI Composite Index

SA, 50+=Increasing



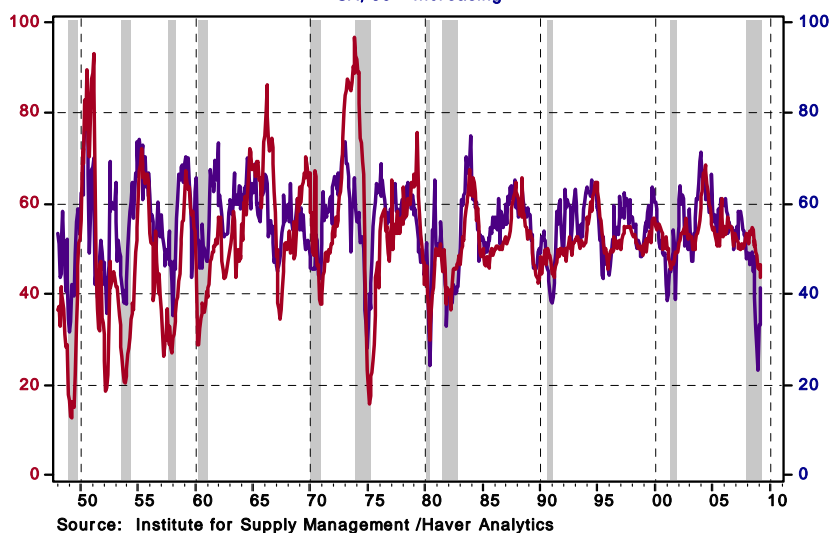
Source: Institute for Supply Management /Haver Analytics

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The Supplier Deliveries Index, one of the components of the Index of Leading Economic Indicators, and the New Orders Index are both reliable leading indicators (Comments of March 30, 2009 contains detailed discussion). Both these indexes have registered cycle lows and turned around well before the trough of a business cycle (see table 2) since record keeping began in 1948 (see chart 2).

Chart 2  
**ISM Manufacturing: Supplier Deliveries Index**  
 SA, 50+=Slower

**ISM Manufacturing: New Orders Index**  
 SA, 50+=Increasing



**Table 2 ISM Manufacturing Survey Indexes across Business Cycles**

| Business Cycles<br>Peak to Trough | Supplier Deliveries |                                     |  | New Orders |                         |  | PMI    |                  |  |
|-----------------------------------|---------------------|-------------------------------------|--|------------|-------------------------|--|--------|------------------|--|
|                                   | Date                | Cycle low<br>Supplier<br>Deliveries | Trough of<br>Business cycle<br>Lead (+)/Lag(-) | Date       | Cycle low<br>New Orders | Trough of<br>Business cycle<br>Lead (+)/Lag(-) | Date   | Cycle low<br>PMI | Trough of<br>Business cycle<br>Lead (+)/Lag(-) |
| Nov.1948 - Oct.1949               | Mar-49              | 12.4                                | +7   | Jan-49     | 31.4                    | +9   | Feb-49 | 31.3             | +8   |
| Jul.1953 - May1954                | Nov-53              | 20.2                                | +6   | Dec-53     | 37.5                    | +5   | Dec-53 | 35.6             | +5   |
| Aug.1957 - Apr.1958               | Dec-57              | 27.3                                | +4   | Jan-58     | 35.2                    | +3   | Jan-58 | 33.4             | +3   |
| Apr.1960 - Feb.1961               | Mar-60              | 28.8                                | +11  | Jul-60     | 45.7                    | +7   | May-60 | 42.6             | +9   |
| Dec.1969 - Nov.1970               | Dec.-70             | 37.5                                | -1   | Nov-70     | 43.3                    | 0  | Nov-70 | 39.7             | 0  |
| Nov.1973 - Mar.1975               | Feb-75              | 15.9                                | +1   | Dec-74     | 27.9                    | +3   | Jan-75 | 30.7             | +2   |
| Jan.1980 - Jul.1980               | May-80              | 29.8                                | +2   | Jun-80     | 24.2                    | +1   | May-80 | 29.4             | +2   |
| Jul.1981 - Nov.1982               | Mar-82              | 36.4                                | +8   | Nov-81     | 32.8                    | +12  | May-82 | 35.5             | +6   |
| Jul.1990 - Mar.1991               | Mar-91              | 43.9                                | 0  | Jan-91     | 38.1                    | +2   | Jan-91 | 39.2             | +2   |
| Mar. 2001 - Nov.2001              | May-2001            | 45.4                                | +6   | Oct-01     | 38.9                    | +1   | Oct-01 | 40.8             | +1   |
| Dec. 2007 - ???                   | Jan-09              | 45.3                                | ???  | Dec-08     | 23.1                    | ???  | Dec-08 | 32.9             | ???  |
|                                   | Feb-09              | 46.7                                |  | Jan-09     | 33.2                    |  | Jan-09 | 35.6             |  |
|                                   | Mar-09              | 43.6                                |  | Feb-09     | 33.1                    |  | Feb-09 | 35.8             |  |
|                                   |                     |                                     |  | Mar-09     | 41.2                    |  | Mar-09 | 36.3             |  |

|                          |      |      |     |
|--------------------------|------|------|-----|
| Average number of months | 4.4  | 4.3  | 3.8 |
| Median number of months  | 5.0  | 3.0  | 2.5 |
| Minimum lead in months   | -1.0 | 0.0  | 0.0 |
| Maximum lead in months   | 11.0 | 12.0 | 9.0 |

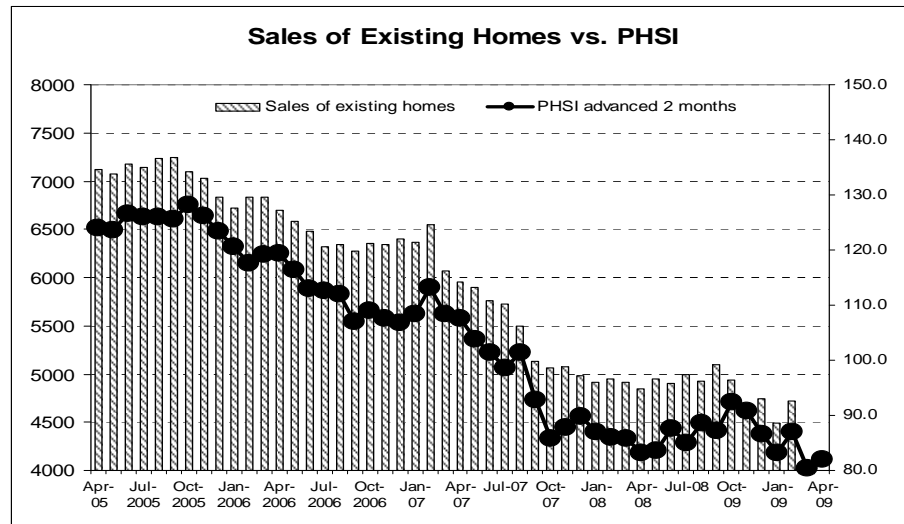
Note: Lead (+)/Lag(-) – If the cycle low of the index occurs prior to the trough of the business cycle, it is a leading index. By contrast, if the cycle low of the index occurs after the trough of a business cycle it is a lagging index. The number of months that lapse between the cycle low of the index and the trough of the business cycle are in table 2, with “+” and “-” indicating if the index leads or lags, respectively.

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## Housing Market – Pending Home Sales Index, Mortgage Applications, Construction Outlays

The Pending Home Sales Index (PHSI) of the National Association of Realtors rose to 82.1 in February from 80.4 in the prior month. The PHSI leads actual sales of existing homes by one/two months. The February gain of the index is a positive sign for home sales during March/April 2009.

Chart 3

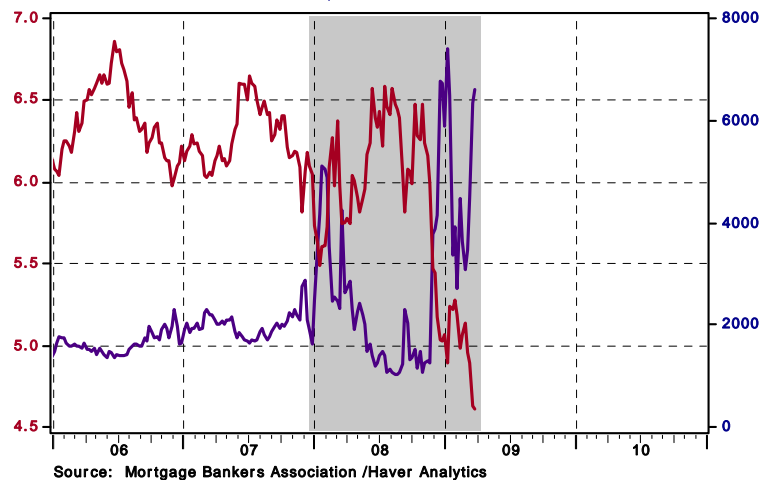


In housing market related news, the Mortgage Bankers Association’s Mortgage Purchase Index (268 vs. 267.8 in prior week) was virtually unchanged for the week ended March 27. The Refinance Index rose to 6600.1 from 6363.1 in the prior week reflecting the impact of the drop in mortgage rates.

Chart 4

MBA: FRM 30-Year: Contract Interest Rate %

MBA: Volume Index: Mortgage Loan Applications for Refinancing SA, Mar-16-90=100



Source: Mortgage Bankers Association /Haver Analytics

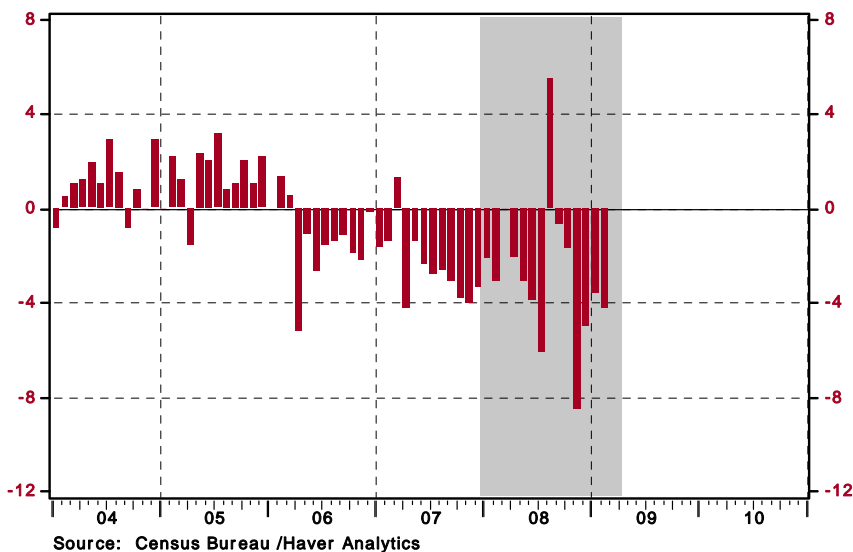
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In other housing market news, residential construction outlays dropped 4.3% in February after a 3.7% drop in January. Residential construction spending is down nearly 60% from the peak in March 2006.

Chart 5

**Private Construction: Residential**

% Change - Period to Period    SAAR, Mil.\$

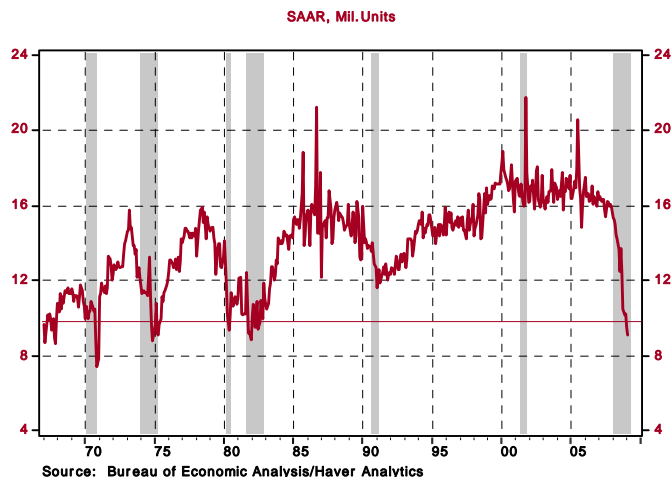


**Auto Sales Stage a Small Rebound in March**

Sales of autos rose to an annual rate of 9.83 million units in March, putting the quarterly average at 9.5 million units. On a quarterly basis, auto sales fell at an annual rate of 28.6% in the first quarter compared with a 58.9% drop in the fourth quarter of 2008. The decline in auto sales is a negative for the tally of consumer spending in the first quarter. Auto sales in March are at the lowest pace since October of 1982 (see chart 6, data stop at February 2009, horizontal line indicates level of March auto sales). Attractive incentives contributed to the pickup in auto sales. Ford and GM announced they will cover monthly payments of customers who have lost their jobs.

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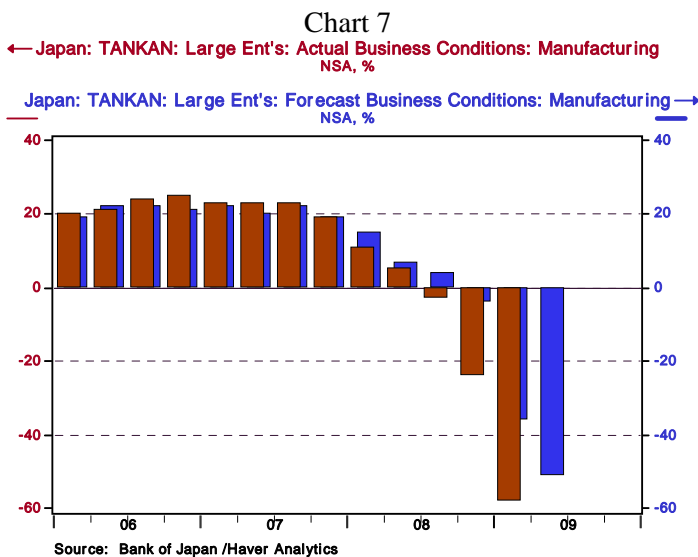
Chart 6  
Light Weight Vehicle Sales (Autos+Light Trucks)



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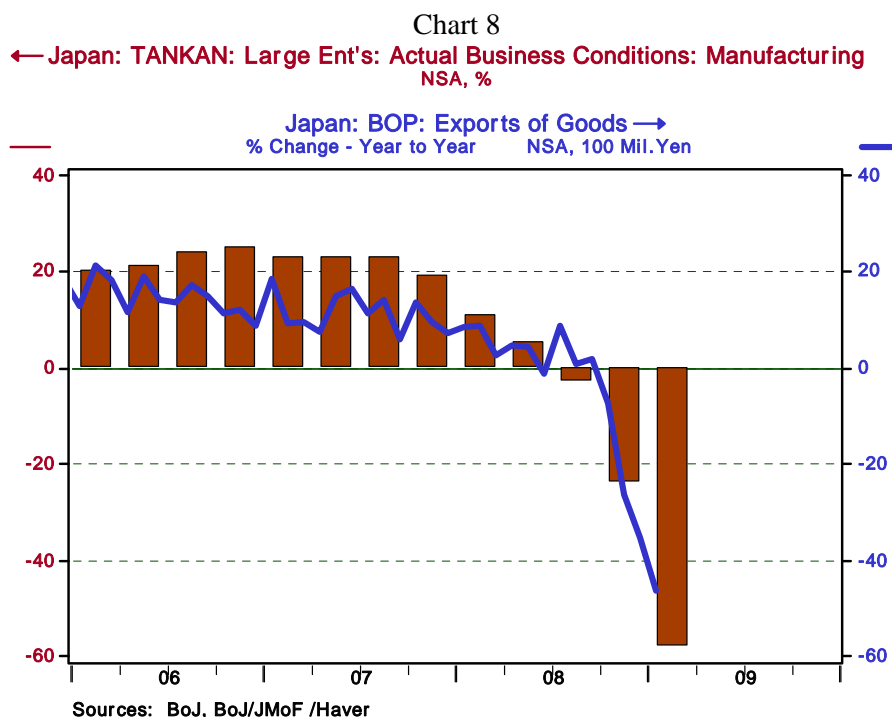
### Japan: More News About A Worsening Situation

Barring natural disaster, Japan's fiscal year could not have started off any worse. Today's release of the Tankan survey showed business confidence hitting a record-low level in Q1, and the near-term outlook plunging to new depths as well. The headline index for large manufacturing companies dove to -58 from an already-dismal -24 in Q4, while the index reflecting conditions looking forward continued its freefall from -36 to -51, suggesting conditions will remain horrible this spring. Furthermore, the confidence index came in lower than that quarter's expectations index for the fifth straight time, undershooting projections by a full 22 points. As bearish as the economic environment seemed last quarter, business managers did not realize just how bad things could get.



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Given how sharply the world economy has slowed over the past six months (has it been only six months?), plenty of charts have a trajectory similar to the Tankan's southern drift. However, this particular plot should look familiar to most Japan-watchers, as it bears a striking resemblance to the country's export growth over the past few years. With exports equalling about 40% of GDP and manufacturing accounting for a heavy slice of overseas sales, it should be no surprise that dismal overseas sales follow this horrible trend almost in lock step.

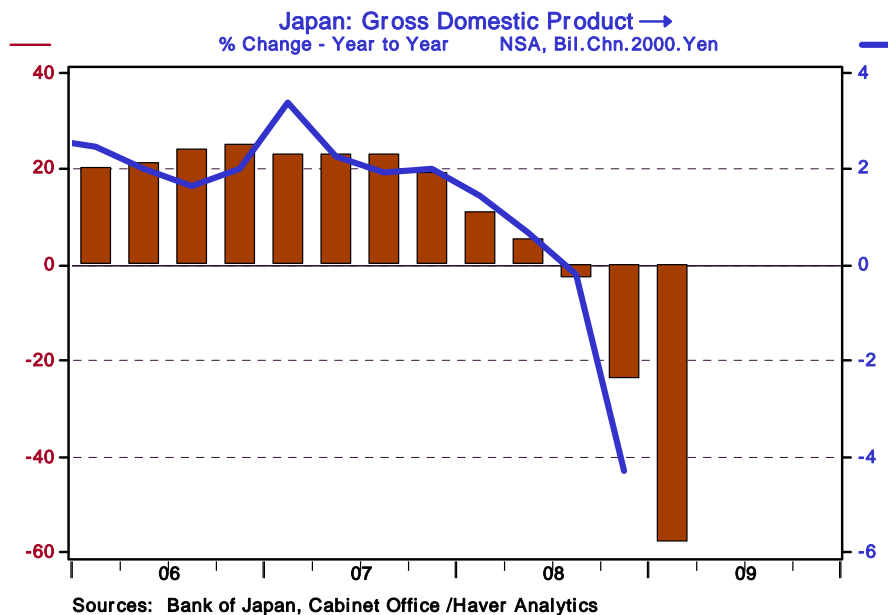


With global demand having all but dried up and the yen unwilling to depreciate significantly, it is readily apparent that Japan is not going to export itself out of its current recession. That being said, any near-term hope is going to have to emerge from fiscal stimulus. With today being the first day of the new fiscal year, it is also the first day under more relaxed fiscal policy and extra government spending. This will offer the economy a little boost while exports remain horribly weak, and possibly ease some of the pain from such a sharp economic contraction. From a GDP standpoint, the economy likely posted a year-over-year drop of 6% or more in Q1 due to external weakness. With some fiscal stimulus factoring in to the national accounts, the economy will not contract as sharply starting in Q2, but that does not suggest any real economic growth before 2010 – just less pain.

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Chart 9

← Japan: TANKAN: Large Ent's: Actual Business Conditions: Manufacturing  
NSA, %



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