

DAILY GLOBAL COMMENTARY

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Road Map for the Near Term Performance of the Economy May 22, 2009

What factors will play a role in the near term performance of the economy? This is one of the most popular questions I have been asked in recent weeks. As a starting point, there are three aspects to track in order to answer this question.

(1). **The effectiveness of policy actions of the Fed and U.S. government** – The Fed's innovative and aggressive interest rate and non-interest rate policy changes have and will continue to influence the course of the economy. The financial market landscape has shown vast improvements in recent weeks following Fed actions over the course of the crisis. The spreads between more risky and less risky securities have narrowed significantly (charts 1 and 2) and discount window borrowing has declined (chart 3). Additional improvements in financial and credit markets will be necessary for the economy to recover. In particular, the credit machine has to start functioning again (see chart 4).

Chart 1

Spread: 3-Month Libor less 3-Month Treasury Bill Rate

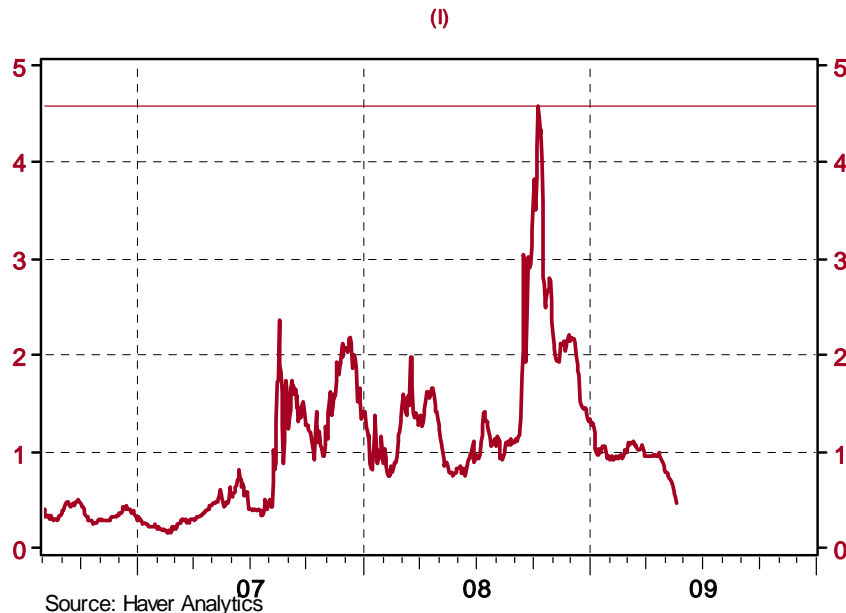


Chart 2

Merril Lynch Junk Bond yield less 10-year Treasury Note yield

percent

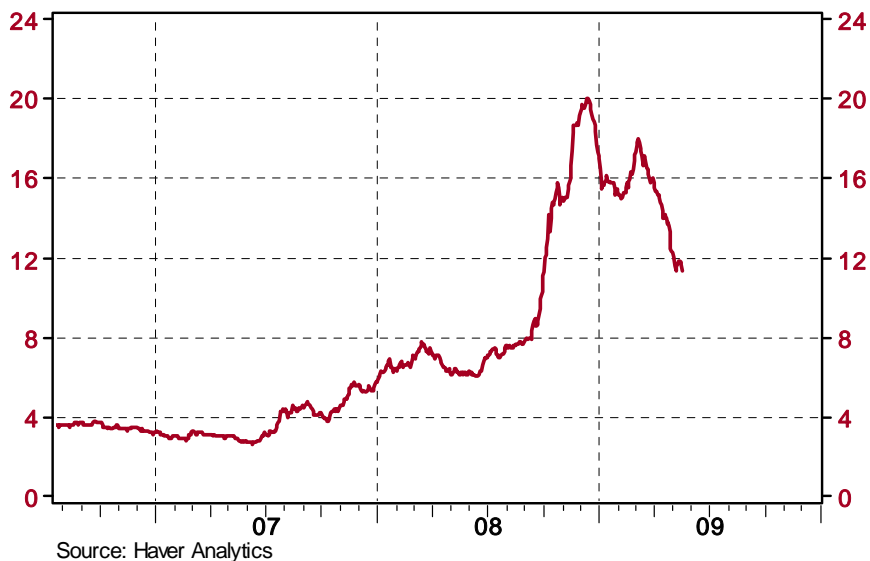
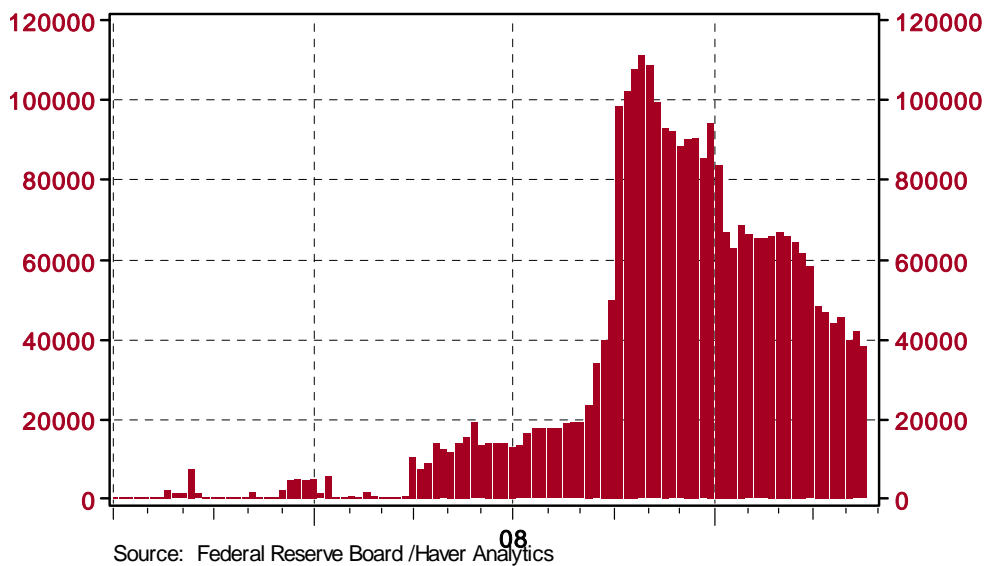


Chart 3

Discount Window Borrowing: Primary Credit to Depository Institutions

EOP, Mil.\$ (I)

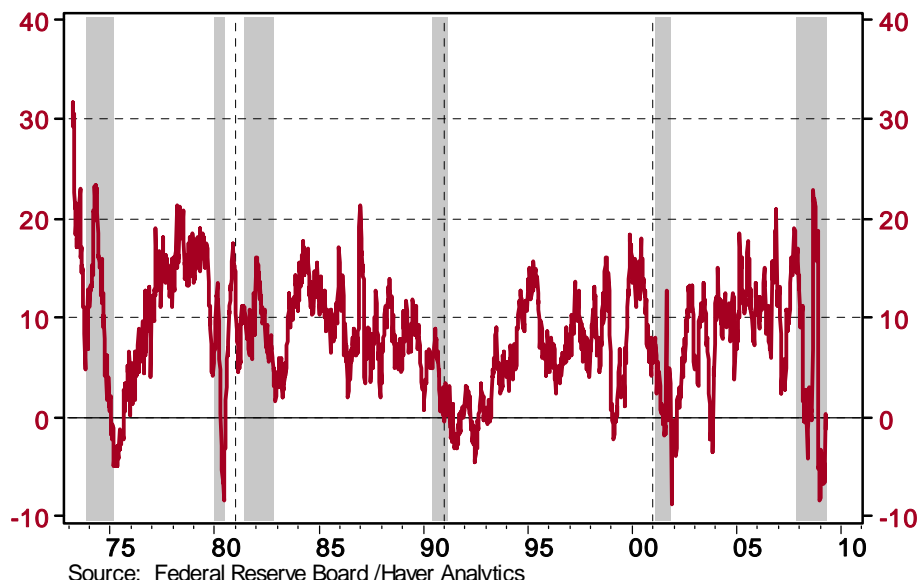


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Chart 4

Loans & Leases in Bank Credit: All Commercial Banks

13-week %Change-ann SA, Bil.\$



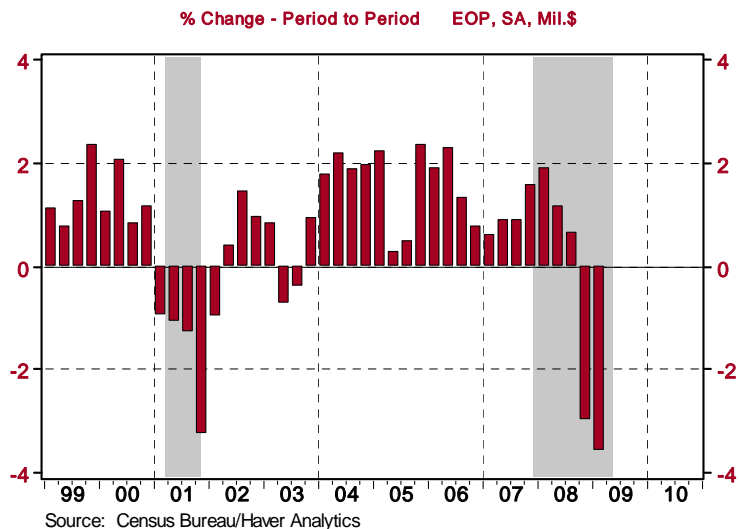
The boost from the fiscal stimulus package also known as the American Recovery and Reinvestment Act (ARRA) is not visible as yet. According to the Congressional Budget Office, only 5.0% of the roughly \$380 billion spending authorized under the ARRA for 2009 has taken place as of April 2009. Going forward, the impact of the authorized expenditures to judge the effectiveness of the expansionary fiscal policy actions will become available. The expectation is that it should stimulate economic activity and prevent a severe contraction in economic activity.

(2). **The excess stocks of housing, inventories of goods, and business structures** will have to continue to decline to enable a turnaround in economic activity. The inventories of unsold new and existing homes are off their peaks as of March 2009. The April numbers will be published next week.

Inventories of goods grew as the recession unfolded (see chart 5) and there has been a large cutback in inventories in the fourth quarter of 2008 and first quarter of 2009. A pickup in sales in the months ahead should rectify the situation. The supply of unused retail space, warehouses, and factories is most likely to fall further before a recovery is seen.

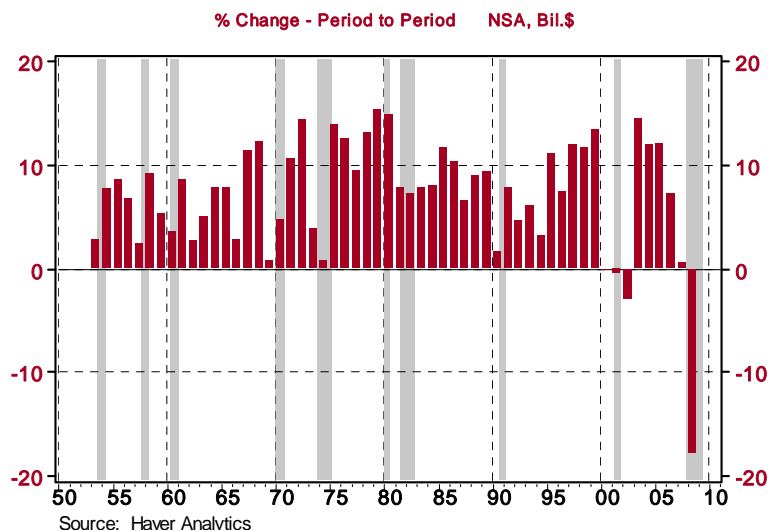
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Chart 5
Inventories: Total Business



(3). **Deleveraging of household sector** – As house prices fell and the economy entered a recession, households cut back on consumer spending. Household wealth has dropped nearly 18% in 2008 (chart 6), the largest annual decline in the post-war period. At the same time, liabilities of households are at a historic high of nearly 22% of their assets. As a result of the jump in debt, the debt service burden of households is punishing and holding back spending. As mentioned earlier, the stimulus package that is the temporary offset to lack of private sector demand should play a role in reviving the economy. In the first quarter, household saving as a percent of disposable income was 4.2%, a sharp increase from 1.8% in 2008 and below 1% readings during 2005-2007 (see chart 8). The battle between spending, saving, and reducing debt will determine how much consumers will spend.

Chart 6
Households & Nonprofit Organizations: Net Worth



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Chart 7
Households: Liabilities/Assets

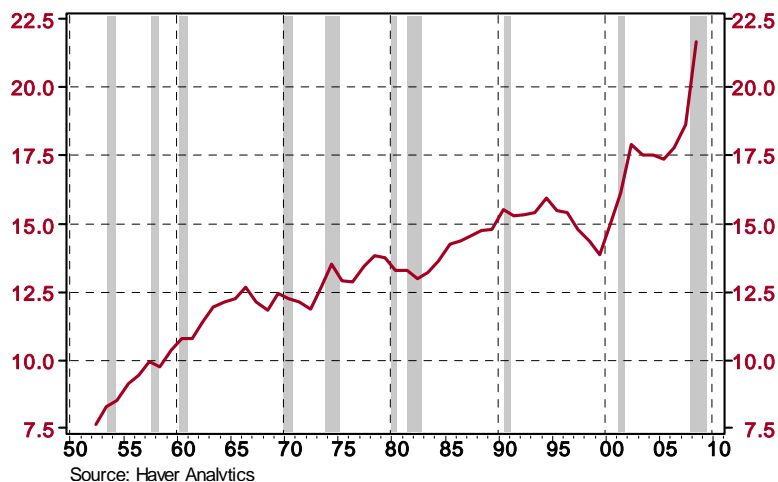
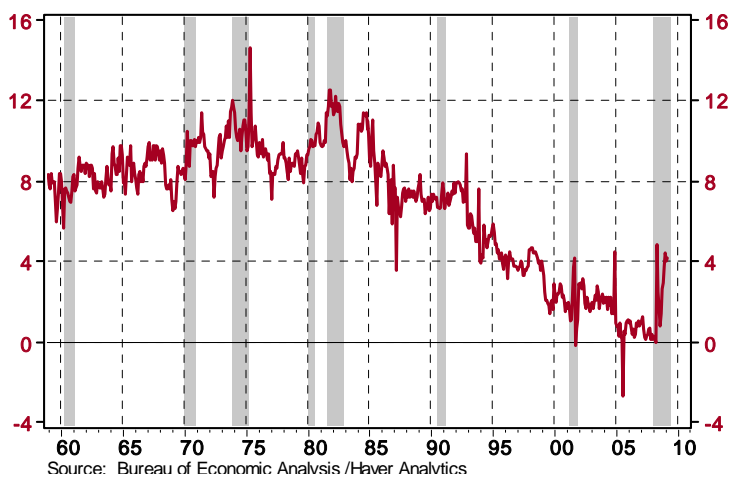


Chart 8
Personal Saving Rate
SAAR, %



The interplay of these three aspects will influence where the economy will stand a year from today. The expectation is that as the spending generated from the ARRA tapers off in 2010, a self-sustaining economic recovery will be in place. Recent economic data suggest that this may eventually occur.

Key Interest Rates

	5/22/2009	1-wk. change, bps	4-wk. change, bps	1-yr. change, bps
3-month Libor	0.66	9	-41	-199
2-year U.S. Treasury note yield	0.89	1	-10	-159
10-year U.S. Treasury note yield	3.45	31	42	-48

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Next Week's Highlights

Date	Economic Indicator	TNT	Consensus	Previous
5/26/2009	Case/Shiller Home Price Index (Mar. Q1)		-2.0%	-1.9%
	Consumer Confidence (May)		42.3	39.2
5/27/2009	Existing home sales (Apr.)		4.66 mln.	4.57 mln.
5/28/2009	Initial claims ('000s)		635	631
	Durable goods orders (Apr.)	0.00%	0.4%	-0.8%
	New Home Sales (Apr.)		0.36 mln	0.356 mln.
5/29/2009	Real GDP 2009:Q1 Preliminary est.	-5.80%	-5.5%	-6.1%
	Consumer Sentiment Index (May)		68.0	65.1

Global Economic Data

	Real GDP		CPI		Unemployment Rate			Central Bank Rate		
	SAAR, yoy %		NSA, yoy%		%	year-ago		%	year-ago	
United States	-2.6	Q4-08	-0.7	Mar-09	8.9	Apr-09	5	0.13	Apr-09	2.00
Euro-Area	-4.6	Q4-08	0.6	Mar-09	8.9	Mar-09	7.2	1.25	Apr-09	4.00
Japan	-9.1	Q4-08	-0.3	Mar-09	4.8	Mar-09	3.8	0.10	Apr-09	0.50
UK	-4.1	Q4-08	2.3	Mar-09	4.7	Apr-09	2.5	0.50	Apr-09	5.00
Australia	0.3	Q4-08	2.5	Q4-08	5.4	Apr-09	4.2	3.00	Apr-09	7.25
Canada	-0.7	Q4-08	0.4	Mar-09	8.0	Apr-09	6	0.25	Apr-09	3.00
China	6.1	Q1-09	-1.4	Mar-09	4.2	Q4-08	4.1	0.81	Mar-09	2.07
India	5.4	Q4-08	8.0	Mar-09	--	--	--	3.25	Apr-09	6.00
New Zealand	-2.3	Q4-08	3.0	Q4-08	5.0	Q1-09	3.8	2.50	Apr-09	8.25
Norway	-0.3	Q4-08	2.9	Mar-09	2.8	Q4-08	2.7	2.00	Apr-09	5.50
Singapore	-10.4	Q4-08	1.6	Mar-09	3.2	Q1-09	1.9	0.19	Apr-09	0.99
South Korea	-4.4	Q4-08	3.6	Apr-09	3.7	Apr-09	3.1	2.00	Apr-09	5.00
Sweden	-4.4	Q4-08	-0.1	Mar-09	7.7	Mar-09	5.9	0.50	Apr-09	4.25
Switzerland	-0.1	Q4-08	-0.3	Mar-09	3.4	Apr-09	2.5	0.40	Apr-09	2.81
Taiwan	-10.9	Q4-08	0.0	Apr-09	5.8	Apr-09	3.9	1.25	Apr-09	3.50
Thailand	-4.3	Q4-08	-0.9	Apr-09	1.7	Mar-09	1.3	1.75	Apr-09	3.50

* UK - Claimant Count Unemployment Rate
* Thailand - GDP Non-Seasonally Adjusted
* EA-13, UK, Sweden - Harmonized Unemployment

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Historical US Economic Data

	Apr-09	Mar-09	Feb-09	Jan-09	Dec-08	Nov-08	Oct-08	Sep-08	Aug-08	Jul-08	Jun-08	May-08
Payroll Employment (000)	-539	-699	-681	-741	-681	-597	-380	-321	-175	-128	-161	-137
% Change, Year Ago *	-3.8	-3.5	-3.1	-2.7	-2.2	-1.6	-1.1	-0.7	-0.4	-0.3	-0.2	-0.1
Unemployment Rate (%)	8.9	8.5	8.1	7.6	7.2	6.8	6.6	6.2	6.2	5.8	5.6	5.5
Avg. Hourly Earnings (% Chg.)	0.1	0.2	0.2	0.2	0.3	0.3	0.4	0.2	0.4	0.3	0.3	0.3
% Change, Year Ago	3.2	3.4	3.5	3.7	3.9	3.9	3.9	3.6	3.8	3.5	3.6	3.7
PPI (% Chg.)	0.3	-1.2	0.1	0.8	-1.8	-2.7	-2.6	-0.1	-0.5	1.3	1.3	1.5
% Change, Year Ago *	-3.7	-3.5	-1.3	-1.0	-0.9	0.4	5.2	8.8	9.7	9.9	9.1	7.3
CPI (% Chg.)	0.0	-0.1	0.4	0.3	-0.8	-1.7	-0.8	0.0	0.0	0.7	0.9	0.5
% Change, Year Ago *	-0.7	-0.4	0.2	0.0	0.1	1.1	3.7	4.9	5.4	5.6	5.0	4.2
ISM Diffusion Index (%)	40.1	36.3	35.8	35.6	32.9	36.6	38.7	43.4	49.3	49.5	49.5	49.3
Industrial Production (% Chg.)	-0.5	-1.7	-1.0	-2.1	-2.2	-1.3	1.3	-4.0	-1.1	-0.1	-0.2	-0.3
% Change, Year Ago	-12.5	-12.6	-11.4	-10.7	-8.9	-6.5	-4.7	-6.4	-2.2	-1.0	-0.7	-0.4
Capacity Utilization (Goods)	69.1	69.4	70.6	71.3	72.8	74.4	75.4	74.5	77.6	78.6	78.7	78.9
Nondefense Cap. Goods ex Aircraft												
- Orders (% Chg.)		0.4	4.1	-12.3	-5.9	1.1	-6.7	-3.4	-2.3	0.3	1.6	-0.3
% Change, Year Ago *		-19.3	-25.0	-25.4	-14.7	-7.9	-7.2	0.1	-0.2	6.6	3.4	3.4
- Shipments (% Chg.)		-1.7	-0.2	-9.4	0.1	-1.3	-3.7	1.7	-2.1	0.3	0.6	0.2
% Change, Year Ago *		-14.8	-15.6	-13.4	-4.7	-5.2	-2.2	2.7	-1.6	6.1	2.0	2.7
Retail Sales (% Chg.)	-0.4	-1.3	0.4	1.7	-3.2	-2.1	-3.1	-1.5	-0.5	-0.7	0.2	0.1
% Change, Year Ago	-9.4	-10.6	-11.6	-8.4	-8.8	-10.1	-4.2	-0.2	-0.6	3.8	1.1	2.2
Real Personal Consumption (% Chg.)		-0.2	0.1	0.9	-0.6	0.4	-0.8	-0.5	-0.1	-0.6	-0.2	0.2
% Change, Year Ago		-1.5	-1.0	-1.2	-1.9	-1.4	-1.3	-0.6	-0.2	0.2	1.1	1.4
Personal Income (% Chg.)		-0.3	-0.2	0.1	-0.3	-0.5	-0.1	0.1	0.3	-0.8	0.1	1.8
% Change, Year Ago		0.3	1.0	1.4	1.3	2.1	3.0	3.4	3.9	4.0	5.3	5.6
New Home Sales (SAAR, mn)		0.36	0.36	0.33	0.37	0.39	0.40	0.43	0.45	0.51	0.50	0.52
% Change, Year Ago *		-30.6	-39.6	-45.5	-40.9	-40.0	-43.9	-34.0	-36.7	-36.8	-38.4	-38.0
Existing Home Sales (SAAR, mn)		4.57	4.71	4.49	4.74	4.54	4.94	5.10	4.93	4.99	4.90	4.95
% Change, Year Ago *		-4.0	-10.3	-7.6	0.3	-17.0	-1.9	6.8	-15.0	-11.3	-16.7	-16.3
Housing Starts (SAAR, mn)	0.46	0.53	0.57	0.49	0.56	0.66	0.76	0.82	0.85	0.93	1.08	0.97
% Change, Year Ago *	-53.9	-47.0	-49.2	-54.9	-45.3	-46.5	-40.7	-27.2	-37.0	-32.2	-25.6	-32.8
International Trade (Bils \$)		-27.6	-26.1	-36.2	-39.9	-42.5	-58.0	-58.1	-60.2	-62.5	-59.1	-60.5
	Q1-09	Q4-08	Q3-08	Q2-08	Q1-08	Q4-07	Q3-07	Q2-07	Q1-07	Q4-06	Q3-06	Q2-06
Real GDP, Chain Weighted, SAAR	-6.1	-6.3	-0.5	2.8	0.9	-0.2	4.8	4.8	0.0	1.5	0.8	2.7
% Change, Year Ago	-2.6	-0.8	0.7	2.1	2.5	2.3	2.8	1.8	1.3	2.4	2.4	3.2
Chain-Weighted Price Index, SAAR	2.9	0.5	3.9	1.1	2.6	2.8	1.5	2.0	4.1	2.2	2.8	2.7
% Change, Year Ago	2.1	2.0	2.6	2.0	2.3	2.6	2.5	2.8	2.9	2.8	3.2	3.5
Nominal GDP, SAAR	-3.5	-5.8	3.4	4.1	3.5	2.3	6.4	6.9	4.3	3.7	3.6	5.5
% Change, Year Ago	-0.5	1.2	3.3	4.1	4.7	4.9	5.3	4.6	4.3	5.3	5.7	6.8
Employment Cost Index (%)	0.3	0.6	0.6	0.7	0.7	0.8	0.8	0.9	0.8	0.9	0.9	0.9
% Change, Year Ago	2.1	2.6	2.9	3.1	3.3	3.3	3.3	3.3	3.5	3.3	3.3	3.0
Productivity Nonfarm, SAAR	0.8	-0.6	2.2	4.7	2.6	-0.5	7.0	4.8	-0.6	-0.4	-1.6	2.4
% Change, Year Ago	1.8	2.2	2.2	3.4	3.5	2.6	2.6	0.5	-0.1	0.6	0.3	1.7
Unit Labor Costs, Nonfarm, SAAR	3.3	5.7	3.5	-2.8	1.1	5.0	-2.5	-3.3	4.8	9.6	3.9	-1.1
% Change, Year Ago	2.4	1.8	1.6	0.1	0.0	0.9	2.0	3.6	4.2	3.7	2.6	2.2

Source: Haver Analytics

* NSA

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