

DAILY GLOBAL
COMMENTARY

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Chairman Bernanke's Testimony Touches on Expected Issues, Emphasizes Fiscal Balance

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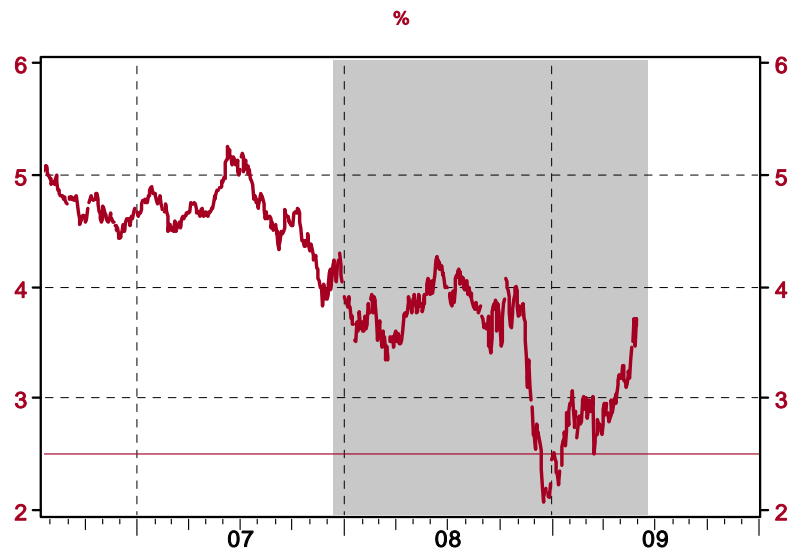
Chairman Bernanke presented the Fed's expectations about economic growth which can be summed as cautiously optimistic, with the economy expected to grow later in the year. Stability in housing and consumer demand combined with the pace of inventory liquidation slowing was noted as "building blocks" for economic recovery. Underlying this forecast is further improvement in financial and credit market conditions.

More importantly, Chairman Bernanke outlines his vision of the nature of economic recovery in the following remarks:

"Even after a recovery gets under way, the rate of growth of real economic activity is likely to remain below its longer-run potential for a while, implying that the current slack in resource utilization will increase further. We expect that the recovery will only gradually gain momentum and that economic slack will diminish slowly. In particular, businesses are likely to be cautious about hiring, and the unemployment rate is likely to rise for a time, even after economic growth resumes."

Moving to the Treasury yields, the recent upward trend of longer-term yields of Treasury securities has been a challenge to explain. The 10-year U.S. Treasury note yield has risen to 3.55% (as of this writing) from a low of 2.51% on March 18, with a recent high of 3.71% on June 1, 2009 (see chart 1).. Bernanke cited four factors that have led to the jump in Treasury yields – "These increases appear to reflect concerns about large federal deficits but also other causes, including greater optimism about the economic outlook, a reversal of flight-to-quality flows, and technical factors related to the hedging of mortgage holdings."

Chart 1
10-Year Treasury Bond Yield at Constant Maturity



Source: U.S. Treasury /Haver Analytics

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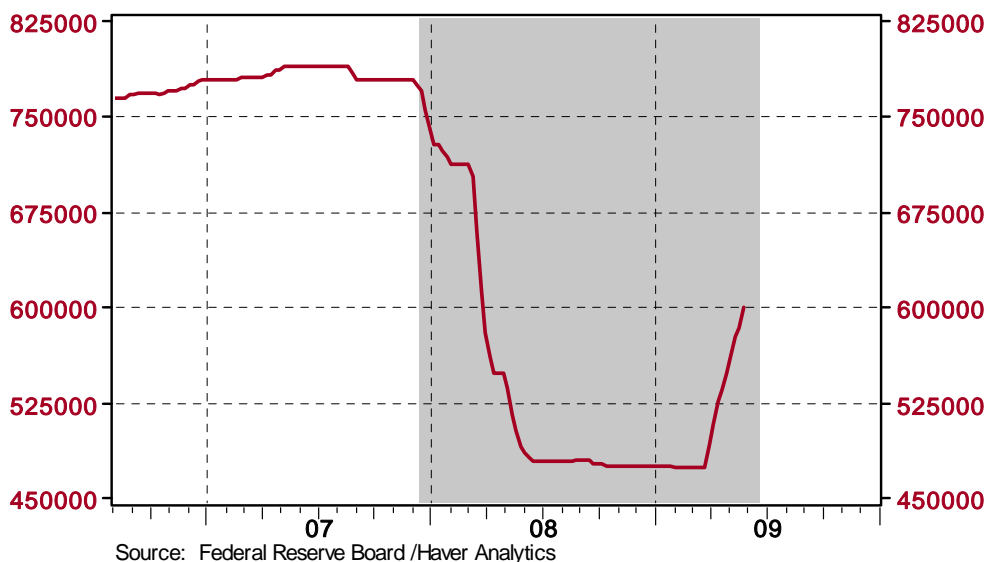
Bernanke also spoke about the necessity to get the fiscal house in order “even as we take steps to address the recession and threats to financial stability, maintaining the confidence of the financial markets requires that we, as a nation, begin planning now for the restoration of fiscal balance. Prompt attention to questions of fiscal sustainability is particularly critical because of the coming budgetary and economic challenges associated with the retirement of the baby-boom generation and continued increases in medical costs.” The Chairman goes on to stress that “*near-term challenges must not be allowed to hinder timely consideration of the steps needed to address fiscal imbalances. Unless we demonstrate a strong commitment to fiscal sustainability in the longer term, we will have neither financial stability nor healthy economic growth.*”

During the Q&A session, Bernanke indicated that the Fed has no plans to monetize the debt of the nation and noted that even after the planned purchase of \$300 billion of Treasury securities, the Fed would be holding a smaller volume of Treasuries compared with the situation prior to the onset of the crisis.

Chart 2

All Fed Res Banks: Assets: U.S. Treasury Securities held Outright

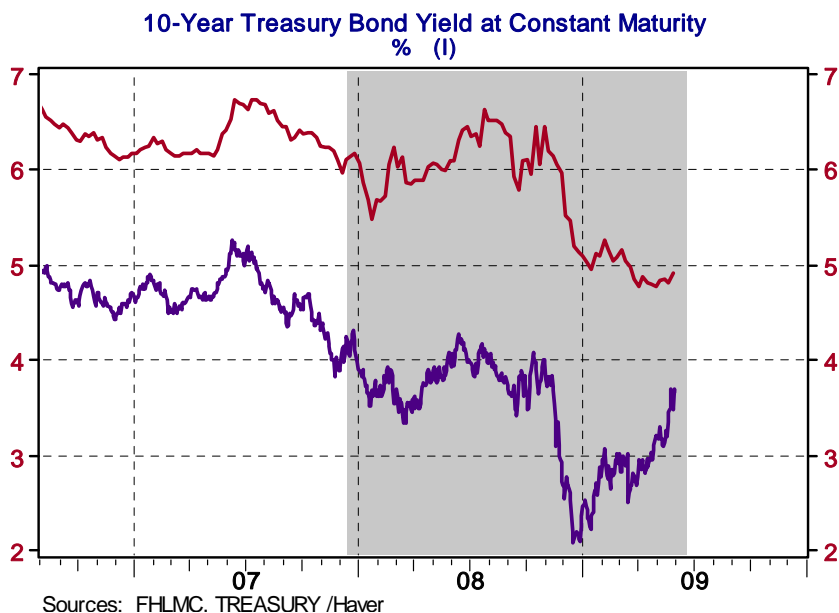
EOP, Mil.\$



There is speculation about whether the Fed will raise the program size to purchase Treasury securities above the existing \$300 billion mark as yields of Treasuries have risen in recent weeks. Mortgage rates remain contained, for now (see chart 3). It is not clear if the Fed will take action; it is most likely to wait until the June 23-24 meeting to make an announcement, if necessary.

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Chart 3
FHLMC: 30-Year Fixed-Rate Mortgages: U.S.
 %



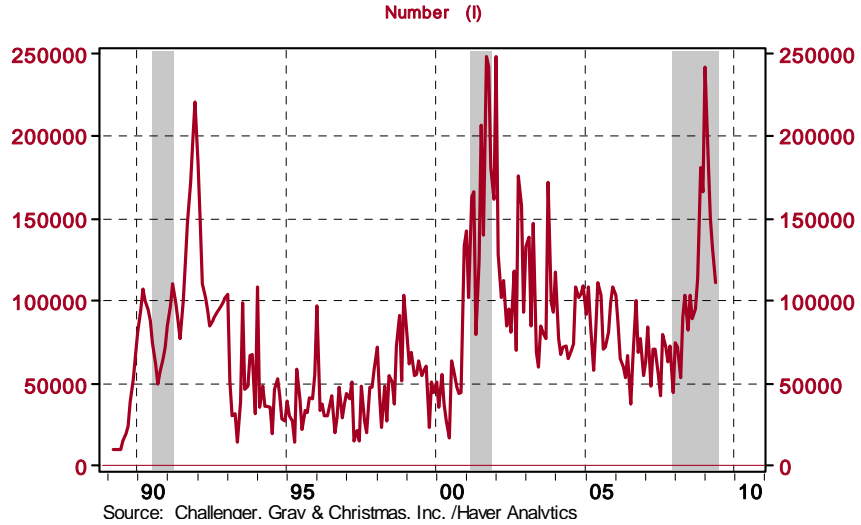
Chairman Bernanke also indicated that the Fed will publish a monthly report about the status of its “balance sheet and lending programs that will summarize and discuss recent developments and provide considerable new information concerning the number of borrowers at our various facilities, the concentration of borrowing, and the collateral pledged. In addition, the reports will provide quarterly updates of key elements of the Federal Reserve’s annual financial statements, including information regarding the System Open Market Account portfolio, loan programs, and the special purpose vehicles that are consolidated on the balance sheet of the Federal Reserve Bank of New York.”

Challenger Report Points to Sharp Decline in Layoffs

The Challenger report on job cuts for May indicated 111,182 job losses, down 21,408 from the prior month and only a 7.4% year-to-year gain. The peak in job losses appeared to have occurred in January 2009 (241,749, see chart 4). On a year-to-year basis, the 274% increase in December 2008 is the cycle high. The employment report for May will be published on June 5, which should help sort out the labor market situation. The loss of jobs related to the restructuring of GM and Chrysler is most likely to be reflected as a temporary hike in the survey during the months ahead.

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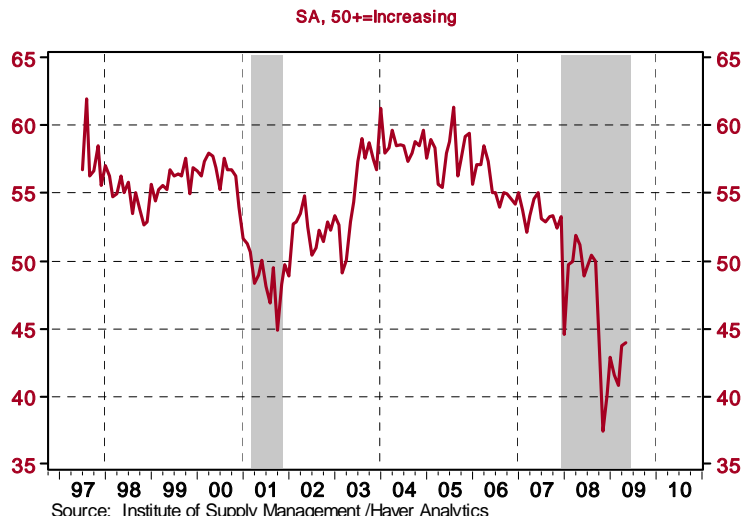
Chart 4
 Challenger, Gray & Christmas: Announced Job Cuts, Total



ISM Non-Manufacturing Survey - May 2009

The non-manufacturing ISM composite index moved up slightly to 44.0 in May from 43.7 during April, denoting a smaller contraction in the pace of activity during May vs. April. Indexes tracking new orders (44.4 vs. 47 in April), exports, and imports fell in May, while indexes measuring employment (39.0 vs. 37 in May) and supplier deliveries (50.0 vs. 45.5 in May) advanced. The overall tone of the report was soft, raising expectations of a likely robust increase in June, given the nature of other incoming reports.

Chart 5
 ISM Nonmanufacturing: NMI Composite Index



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