Northern Trust

DAILY GLOBAL COMMENTARY

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The Rhyming of History – Bloomberg and the RFC?

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On November 7, 2008, Bloomberg LP sued the Federal Reserve Board under terms of the Freedom of Information Act to obtain the names of borrowers of funds from the Federal Reserve as well as lists of the collateral posted by the borrowers. On August 25, 2009, a U.S. District judge ruled in favor of Bloomberg, ordering the Federal Reserve Board to turn over to Bloomberg the requested information within five days. At this writing, the Fed has yet to comply and has yet made a decision to appeal the ruling. The Fed has been reluctant to reveal the names of its borrowers allegedly out of a concern that such a revelation could have an adverse competitive impact on the borrowers.

The reason I bring this up is that it is similar to a situation that arose in 1932 with the Reconstruction Finance Corporation (RFC). The RFC was established by an act of Congress on January 22, 1932, for the purpose of making loans to financial institutions, railroads and to extend credit for crop loans. The Treasury provided some capital to the RFC and the RFC was permitted to borrow from the Treasury. Initially, the RFC granted credit primarily to banks. These loans coincided with a reduction in bank failures and currency held outside the banks declined.

On July 21, 1932, the RFC was authorized to make loans for self-liquidating public works projects, and to states to provide relief and work relief to needy and unemployed people. *This legislation also required that the RFC report to Congress, on a monthly basis, the identity of all new borrowers of RFC funds.* On orders from the Speaker of the House of Representatives, commencing in August 1932, the names of banks borrowing from the RFC became public information. This publication of the names of banks borrowing from the RFC discouraged current borrowers from continuing their borrowing and prospective borrowers from commencing borrowings out of a fear that depositors would judge this borrowing as a sign of financial weakness. By November 1932, the outstanding amount of RFC loans to banks had decreased.

In mid February of 1933, a Detroit bank began having difficulties. The RFC was willing to lend to this bank, but because of a dispute between one of the Michigan senators and Henry Ford, a large depositor in the bank, the RFC loan was not allowed to be made. A bank panic started in Michigan as a result. This Michigan bank panic served as a catalyst for a nationwide bank panic.

The failure of the Detroit bank was *not* because the bank was reluctant to borrow from the RFC. But one can only speculate as to whether other banks in Michigan and nationwide were reluctant to borrow from the RFC because their names would have been published. And one can only speculate that if these other banks had willing to borrow from the RFC if a nationwide bank could have been averted.

Today, we have federal deposit insurance. Therefore, the probabilities and magnitude of depositor runs on banks are much reduced compared with 1933. Yet, we can see "runs" by stockholders and other creditors of banks if there is a suspicion of financial problems. If the Fed is required to publish the names of financial institutions to which it has extended credit and this publication induces financial institutions to refrain from borrowing from the Fed, one can only speculate if this would be the tinder for another liquidity conflagration in the coming months.

(Note: The history of the RFC was obtained from http://eh.net/encyclopedia/article/butkiewicz.finance.corp.reconstruction.)

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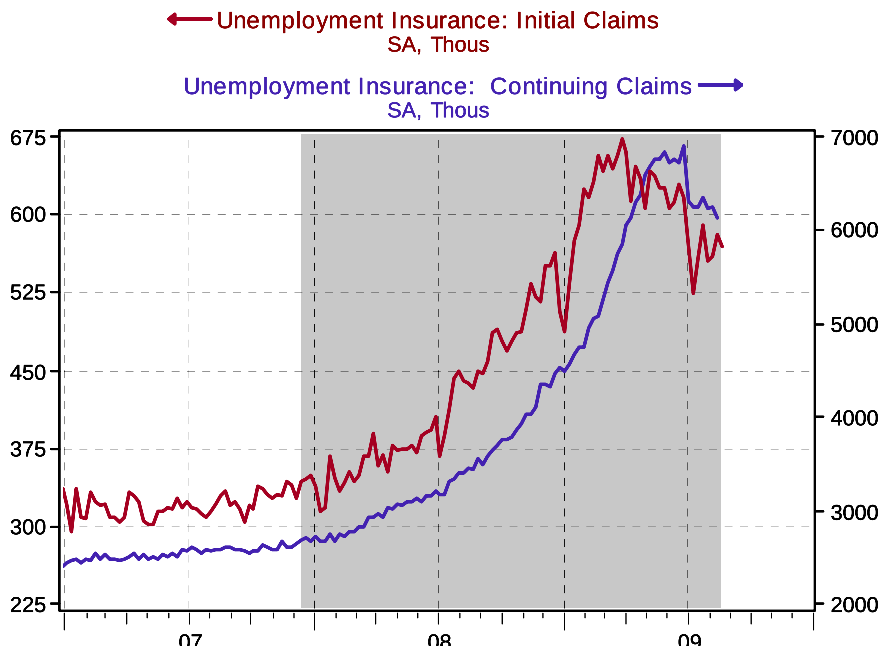
Jobless Claims Decline, but Continuing Claims including Special Programs Advance

Initial jobless claims dropped 10,000 to 570,000 during the week ended August 22. Continuing claims, which lag initial claims by one week, fell to 6.133 million from 6.252 million in the prior week (see chart 1). A large part of the decline in continuing claims is due to the expiration of 26 weeks of unemployment insurance. These recipients are now part of the Emergency Unemployment Compensation and Extended Benefits programs. On a monthly basis, initial jobless claims have peaked in March (658,000). The insured unemployment rate was 4.6% during the week ended August 14; the cycle high is 5.2%, week ended June 27, 2009.

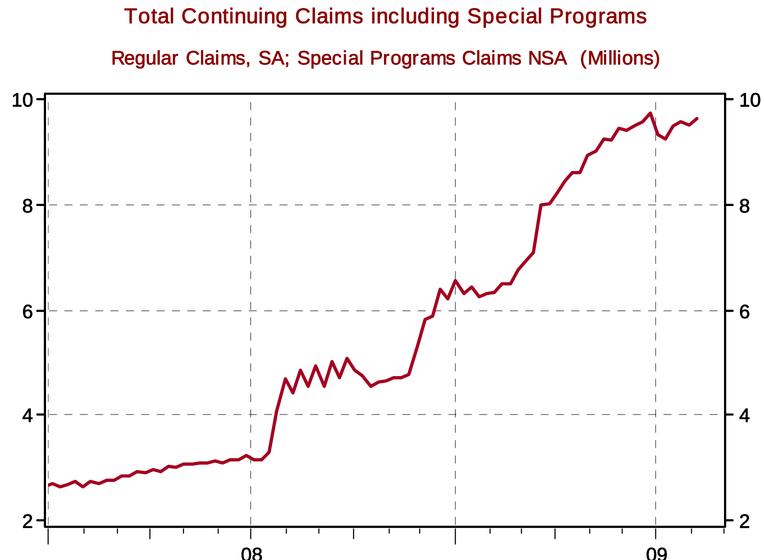
Chart 1



Sources: Department of Labor /Haver Analytics

Although initial jobless claims are trending down, the total number collecting unemployment insurance inclusive of those recorded in all programs – continuing claims, Extended Bnefits, and Emergency Unemployment Compensation – has risen to 9.63 million for the week ended August 8. The special programs data lag initial claims by two weeks. There was a small dip seen in total continuing claims including special programs in the early weeks of July, but the decline has been partly reversed in the past few weeks (see chart 2).

Chart 2

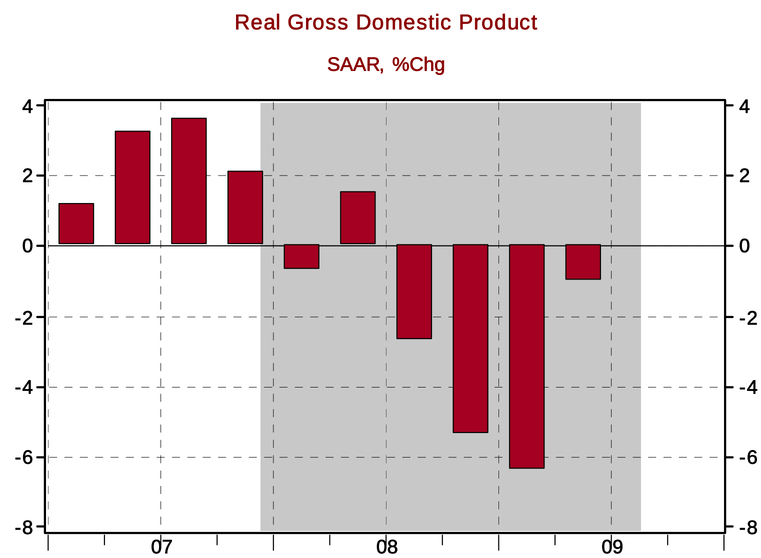


Source: Haver Analytics

Q2 Real GDP Decline Unchanged at -1.0%

The real gross domestic product (GDP) of the economy declined at an annual of 1.0% according to the preliminary estimate, unchanged from the advance report. The revisions offset each other to leave the headline unchanged (see table 1).

Chart 3



Source: Bureau of Economic Analysis /Haver Analytics

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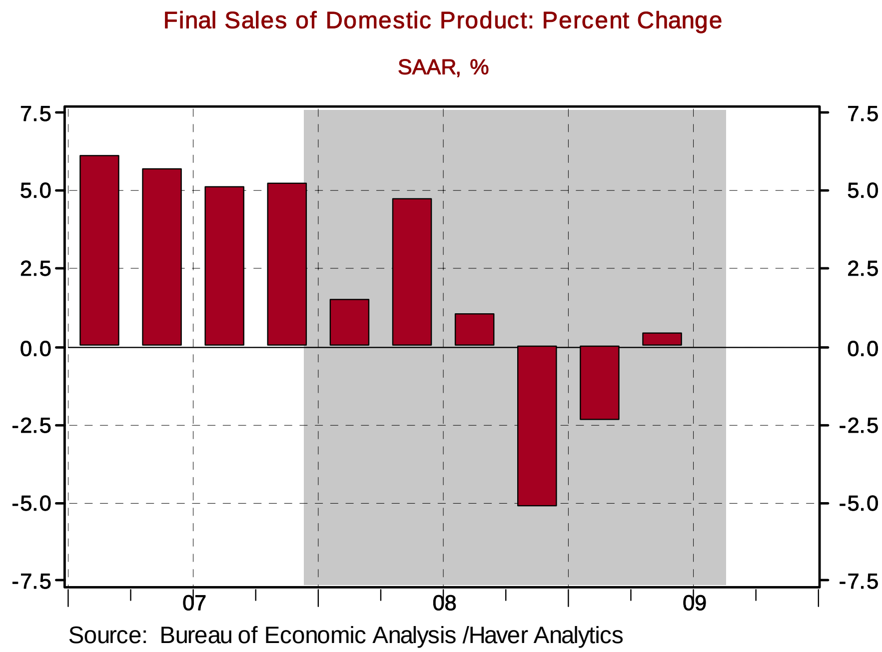
The upward revisions of consumer spending (-1.0% vs. -1.2% in advance estimate), residential investment expenditures (-22.8% vs. -29.3% in the advance report), equipment and software spending (-8.4% vs. -9.0% in advance estimate) led to an upward revision of real final sales (+0.4%vs. -0.2% in advance report), which is the first gain after two quarterly declines (see chart 4). Exports were also revised up which led to a smaller trade gap than previously estimated. The decline in inventories (-$159.2 billion vs. -$141.1 billion) is larger than the earlier estimate, implying a big addition to inventories in the second-half of the year. The U.S. economy is projected to show a mild recovery in the second-half of the year.

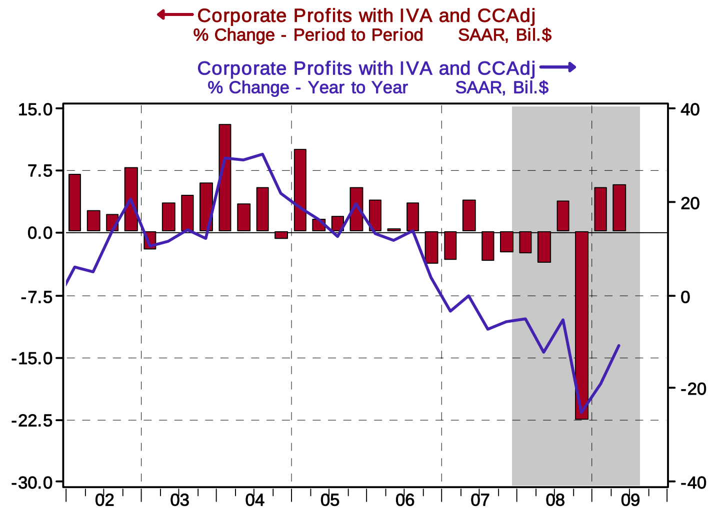
Chart 4



The overall GDP price index was revised down to a flat reading but the core personal consumption expenditure price index was left unchanged at a 2.0% increase.

Corporate profits increased 5.7% in the second quarter, but 10.9% from a year ago. Positive contributions from the financial and non-financial sectors helped to raised the headline profit reading, with the financial sector showing the larger gain among the two components of profits.

Chart 5



Sources: Bureau of Economic Analysis /Haver Analytics

Table 1 Real Gross Domestic Product – 2009:Q2 Preliminary Estimate

	(2005 chained dollars)				Percent Change (SAAR) from prior quarter			
	08:4 Final	09:1 Final	09:2 Advance	09:2 Preliminary	08:4 Fin	09:1 Fin	09:2 Adv	09:2 Prel.
GDP	13141.9	12925.4	12892.4	12892.5	-5.4	-6.4	-1.0	-1.0
CONSUMPTION	9195.3	9209.2	9180.5	9186.7	-3.1	0.6	-1.2	-1.0
DURABLE GOODS	1076.8	1087.2	1067.5	1071.2	-20.3	3.9	-7.1	-5.8
NONDURABLE GOODS	2026.1	2035.5	2022.4	2024.0	-4.9	1.9	-2.5	-2.2
SERVICES	6080.4	6076.0	6077.3	6078.7	0.5	-0.3	0.1	0.2
INVESTMENT	1857.7	1558.5	1471.9	1453.4	-24.2	-50.5	-20.4	-24.4
FIXED INVESTMENT	1909.3	1687.5	1627.5	1627.5	-20.2	-39.0	-13.5	-13.5
NONRESIDENTIAL	1496.1	1321.2	1290.6	1283.6	-19.5	-39.2	-8.9	-10.9
STRUCTURES	484.0	419.4	409.8	402.6	-7.2	-43.6	-8.9	-15.1
EQUIPM. & SOFTWARE	993.7	887.5	866.9	868.2	-25.9	-36.4	-9.0	-8.4
RESIDENTIAL	415.0	367.9	337.4	344.8	-23.2	-38.2	-29.3	-22.8
CHG. BUS. INVENT.	-37.4	-113.9	-141.1	-159.2				
NET EXPORTS	-470.9	-386.5	-339.3	-331.8				
EXPORTS	1568.0	1434.5	1408.9	1416.4	-19.5	-29.9	-7.0	-5.0
IMPORTS	2038.9	1821.0	1748.2	1748.3	-16.7	-36.4	-15.1	-15.1
GOVERNMENT (C & I)	2544.0	2527.2	2562.1	2566.6	1.2	-2.6	5.6	6.4
FEDERAL	1007.3	996.3	1022.4	1022.5	6.5	-4.3	10.9	11.0
DEFENSE	681.7	672.8	694.1	694.1	3.8	-5.1	13.3	13.3
OTHER	325.4	323.4	328.1	328.3	12.7	-2.5	6.0	6.2
STATE AND LOCAL	1539.3	1533.3	1542.6	1546.9	-2.0	-1.5	2.4	3.6
DISP. PERS. INC.	9920.4	9948.3	10027.2	10019.6	3.4	1.1	3.2	3.8
FINAL SALES	13193.5	13055.8	13049.5	13067.7	-4.7	-4.1	-0.2	0.4
GROSS DOMESTIC PURCHASES	13654.9	13432.7	13381.6	13392.7	-4.9	-6.4	-1.5	-1.2
PRICE DEFLATORS:								
GDP CHAIN TYPE	109.2	109.7	109.7	109.7	0.1	1.9	0.2	0.0
GDP EX. FOOD & ENERGY					-0.8	0.5	1.1	0.9
PCE CHAIN TYPE	108.9	108.4	108.8	108.8	-5.0	-1.5	1.3	1.3
PCE EX. FOOD & ENERGY	107.9	108.2	108.7	108.7	0.8	1.1	2.0	2.0