DAILY GLOBAL COMMENTARY

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Minutes of November 3-4 FOMC Meeting – Spots of Optimism are Visible, Concerns about Dollar, Commercial Real Estate Loans, and Low Interest Rates are Noticeable

November 24, 2009

Forecasts of real GDP, inflation, and unemployment for 2009-2011 shows small changes from the June projections (see table 1). The employment report for October was published after the FOMC meeting. The unemployment rate in October was reported as 10.2% (9.8% in September and 9.4% in May), which is higher than the top of the range of the Fed's forecast. It is noteworthy that the Fed's rhetoric about unemployment, as it appears in the minutes of the meeting, shows more concern than the forecast number per se (see excerpts below).

"*The weakness in labor market conditions remained an important concern to meeting participants, with unemployment expected to remain elevated for some time.*"

"Such a modest pace of expansion would imply only slow improvement in the labor market next year, with unemployment remaining high. Indeed, participants noted that business contacts continued to report plans to be cautious in hiring and capital spending even as demand for their products increased."

Table 1. Economic projections of Federal Reserve Governors and Reserve Bank presidents, November 2009

Percent

Variable	Central tendency[1]					Range[2]				
	2009	2010	2011	2012	Longer run	2009	2010	2011	2012	Longer run
Change in real GDP	-0.4 to -0.1	2.5 to 3.5	3.4 to 4.5	3.5 to 4.8	2.5 to 2.8	-0.5 to 0.0	2.0 to 4.0	2.5 to 4.6	2.8 to 5.0	2.4 to 3.0
June projection	-1.5 to -1.0	2.1 to 3.3	3.8 to 4.6	n.a.	2.5 to 2.7	-1.6 to -0.6	0.8 to 4.0	2.3 to 5.0	n.a.	2.4 to 2.8
Unemployment rate	9.9 to 10.1	9.3 to 9.7	8.2 to 8.6	6.8 to 7.5	5.0 to 5.2	9.8 to 10.3	8.6 to 10.2	7.2 to 8.7	6.1 to 7.6	4.8 to 6.3
June projection	9.8 to 10.1	9.5 to 9.8	8.4 to 8.8	n.a.	4.8 to 5.0	9.7 to 10.5	8.5 to 10.6	6.8 to 9.2	n.a.	4.5 to 6.0
PCE inflation	1.1 to 1.2	1.3 to 1.6	1.0 to 1.9	1.2 to 1.9	1.7 to 2.0	1.0 to 1.7	1.1 to 2.0	0.6 to 2.4	0.2 to 2.3	1.5 to 2.0
June projection	1.0 to 1.4	1.2 to 1.8	1.1 to 2.0	n.a.	1.7 to 2.0	1.0 to 1.8	0.9 to 2.0	0.5 to 2.5	n.a.	1.5 to 2.1
Core PCE inflation[3]	1.4 to 1.5	1.0 to 1.5	1.0 to 1.6	1.0 to 1.7		1.3 to 1.6	0.9 to 2.0	0.5 to 2.4	0.2 to 2.3	
June projection	1.3 to 1.6	1.0 to 1.5	0.9 to 1.7	n.a.		1.2 to 2.0	0.5 to 2.0	0.2 to 2.5	n.a.	

NOTE: Projections of change in real gross domestic product (GDP) and in inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The June projections were made in conjunction with the meeting of the Federal Open Market Committee on June 23-24, 2009.

1. The central tendency excludes the three highest and three lowest projections for each variable in each year.
2. The range for a variable in a given year consists of all participants' projections, from lowest to highest, for that variable in that year.
3. Longer-run projections for core PCE inflation are not collected.

Source: http://www.federalreserve.gov/monetarypolicy/files/fomcminutes20091104.pdf

The FOMC's outlook for economic growth shows a noteworthy change. As the selections from the minutes indicate, the Fed is now more optimistic, which is consistent with the nature of incoming economic data, compared with the minutes of the previous FOMC meeting (see citations).

November FOMC Meeting

“Most participants now viewed the risks to their growth forecasts as being roughly balanced rather than tilted to the downside, but uncertainty surrounding these forecasts was still viewed as quite elevated. Downside risks to growth included the continued weakness in the labor market and its implications for income growth and consumer confidence, as well as the potential for credit availability to remain relatively tight for consumers and some businesses.”

September FOMC Meeting

“Although the economic outlook had improved further in recent weeks and the risks to the forecast had become more balanced, the level of economic activity was likely to be quite weak and resource utilization low. With substantial resource slack likely to persist and longerterm inflation expectations stable, the Committee anticipated that inflation would remain subdued for some time. Under these circumstances, the Committee judged that the costs of growth turning out to be weaker than anticipated could be relatively high.”

Related to economic growth, the shaky status of commercial real estate portfolios of banks were seen to be a factor raising the uncertainty and downside risks of growth forecast.

The low short-term interest rate environment featured in the November FOMC meeting with members concerned about asset prices and inflation expectations. The explicit mention of low interest rates and “excessive risk taking in financial markets” made its debut in the minutes of the November FOMC meeting, which is noteworthy.

“Members noted the possibility that some negative side effects might result from the maintenance of very low short-term interest rates for an extended period, including the possibility that such a policy stance could lead to excessive risk-taking in financial markets or an unanchoring of inflation expectations. While members currently saw the likelihood of such effects as relatively low, they would remain alert to these risks. All agreed that the path of short-term rates going forward would be dependent on the evolution of the economic outlook.”

The FOMC’s views about the dollar were as follows:

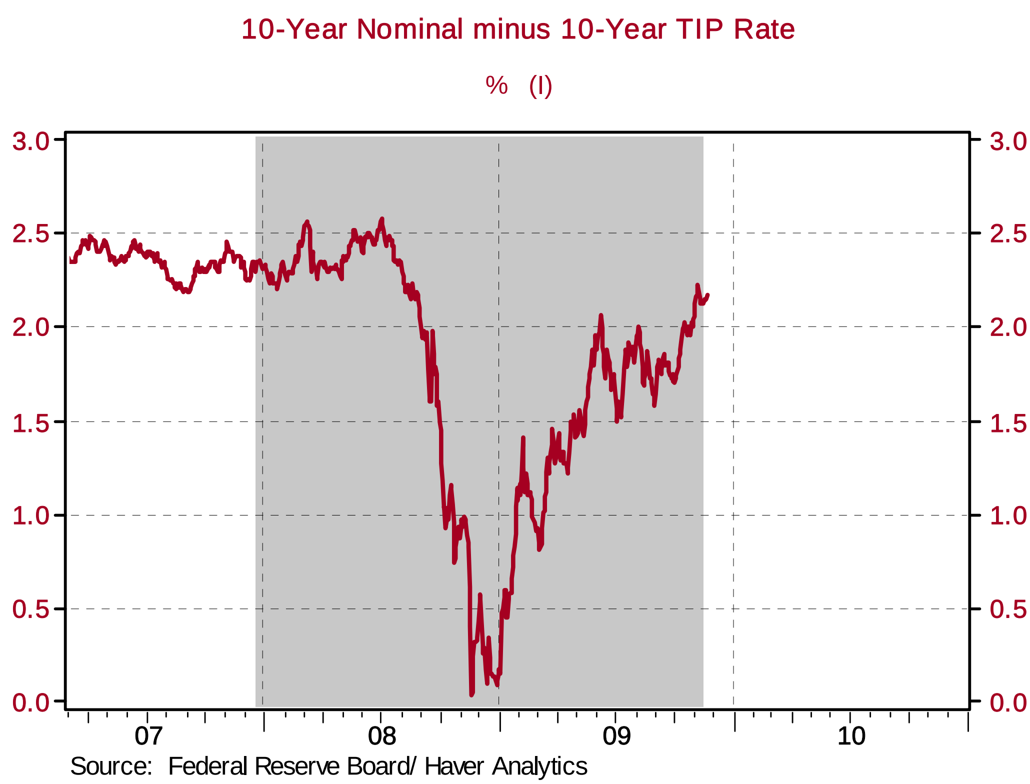
“Participants noted that the recent fall in the foreign exchange value of the dollar had been orderly and appeared to reflect an unwinding of safe-haven demand in light of the recovery in financial market conditions this year, but that any tendency for dollar depreciation to intensify or to put significant upward pressure on inflation would bear close watching.

However, some participants noted that the recent rise in the prices of oil and other commodities, as well as increases in import prices stemming from the decline in the foreign exchange value of the dollar, could boost inflation pressures. Overall, many participants viewed the risks to their inflation outlooks over the next few quarters as being roughly balanced.”

The FOMC essentially has three views on inflation, with the majority holding that inflation outlook is balanced. At the opposite sides of the spectrum are the doves and hawks. At the present time, the hawks have no evidence to support their fear; inflation expectations are not problematic (see chart 1) and projections of economic growth are on the soft side.

"Overall, many participants viewed the risks to their inflation outlooks over the next few quarters as being roughly balanced. Some saw the risks as tilted to the downside in the near term, reflecting the quite elevated level of economic slack and the possibility that inflation expectations could begin to decline in response to the low level of actual inflation. But others felt that risks were tilted to the upside over a longer horizon, because of the possibility that inflation expectations could rise as a result of the public's concerns about extraordinary monetary policy stimulus and large federal budget deficits. Moreover, these participants noted that banks might seek to reduce appreciably their excess reserves as the economy improves by purchasing securities or by easing credit standards and expanding their lending substantially. Such a development, if not offset by Federal Reserve actions, could give additional impetus to spending and, potentially, to actual and expected inflation."

Chart 1

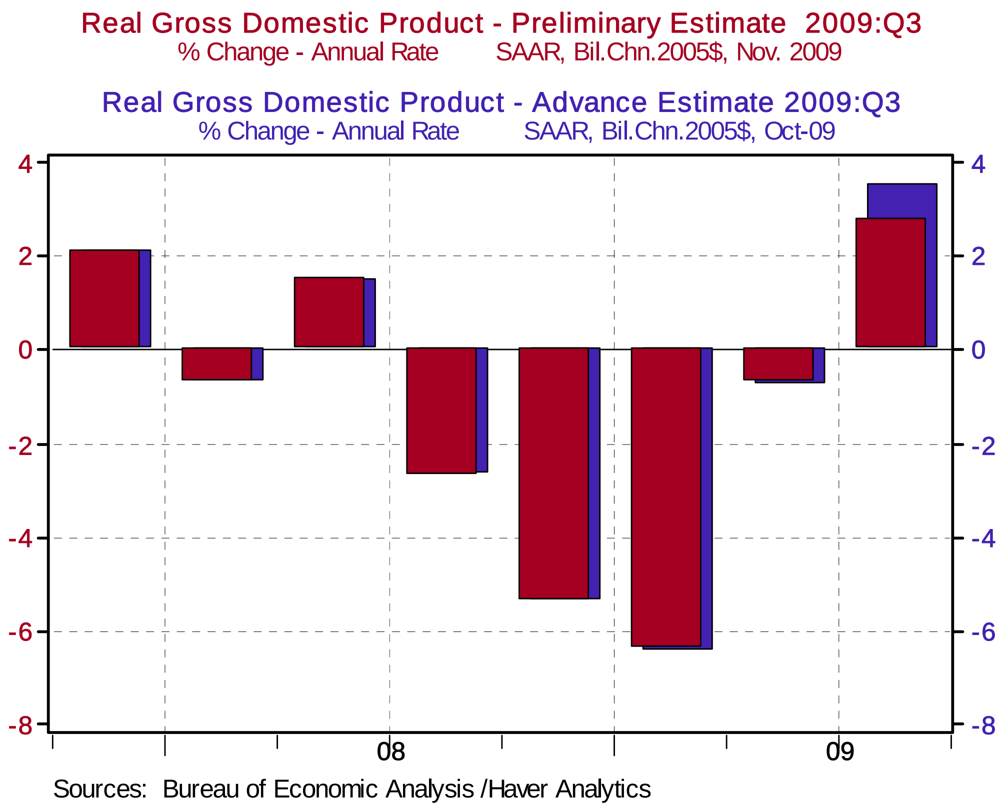


Widespread Revisions of Q3 GDP

Real GDP grew at an annual rate of 2.8% in the third quarter, previously estimated as a 3.5% increase. Lower estimates of consumer spending (+2.9% vs. +3.4% in the advance report), outlays on structures ((-15.1% vs. -9.0% in the advance report), residential investment expenditures and (+19.5% vs. +23.4% in advance report), including a smaller contribution from inventories and a wider trade gap more than offset the upward revisions of government spending and equipment and software spending.

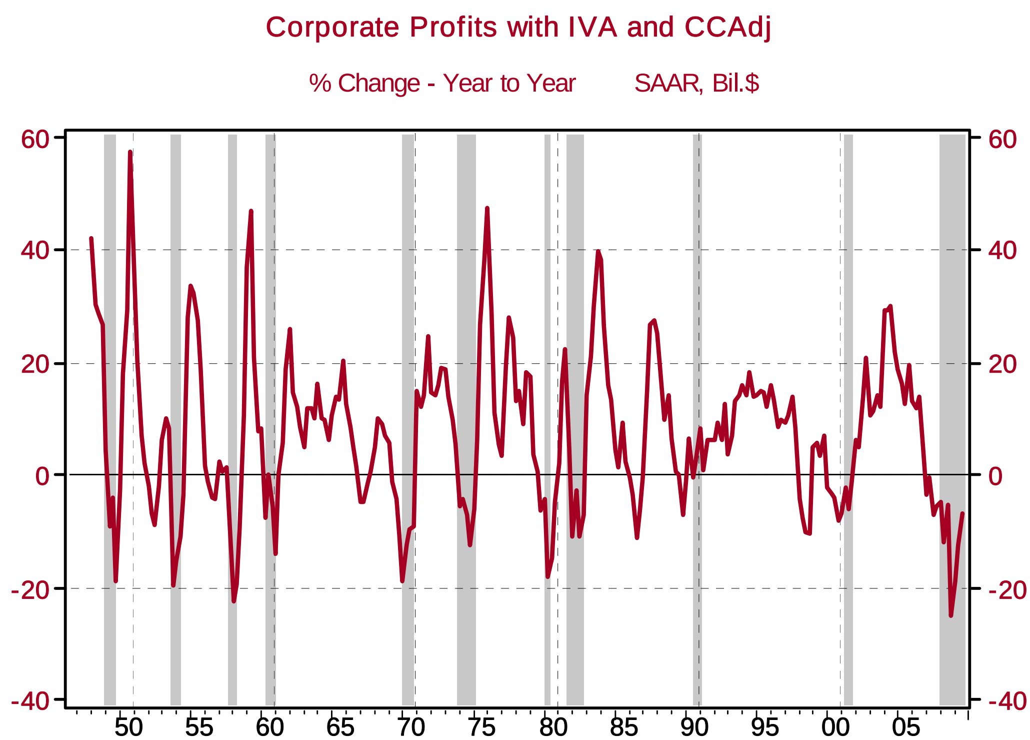
Going forward, real GDP is projected to show a slightly slower pace of growth in the fourth quarter 0f 2009 and first quarter of 2010, partly because car sales of the future have been borrowed to take advantage of the "clash for clunkers" program.

Chart 2



Corporate profits from current production rose 10.6% in the third quarter, following a revised 3.7% gain in the second quarter. From a year ago, corporate profits fell 6.7%, the first single-digit decline after three straight quarters of significantly weaker profits. Corporate profits of the financial sector advanced 36.4% in the third quarter and made up the larger share of corporate profits. Corporate profits of the non-financial sector increased only 2.0%. The financial sector's performance is artificially boosted by the support programs in place.

Chart 3



Source: Bureau of Economic Analysis /Haver Analytics

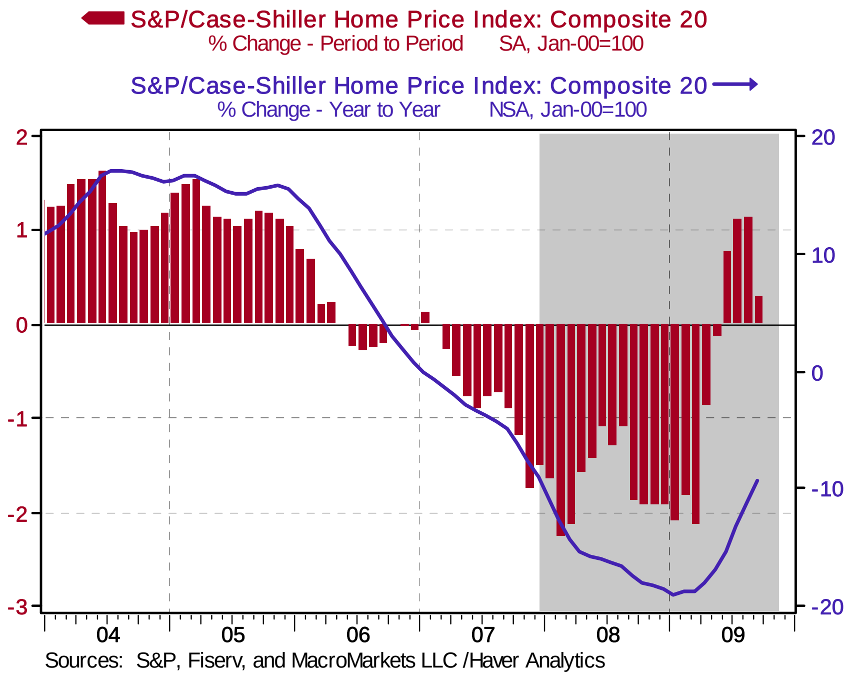
Real GDP 2009:Q3 – Preliminary Estimate

	(2005 chained dollars)				Percent Change (SAAR) from prior quarter			
	09:1 Final	09:2 Final	09:3 Advance	09:3 Preliminary	09:1 Fin	09:2 Fin	09:3 Adv	09:3 Prel.
GDP	12925.4	12901.5	13014.0	12990.3	-6.4	-0.7	3.5	2.8
CONSUMPTION	9209.2	9189.0	9265.1	9256.0	0.6	-0.9	3.4	2.9
DURABLE GOODS	1087.2	1071.7	1127.2	1122.0	3.9	-5.6	22.3	20.1
NONDURABLE GOODS	2035.5	2025.7	2035.9	2034.1	1.9	-1.9	2.0	1.7
SERVICES	6076.0	6078.8	6096.6	6093.7	-0.3	0.2	1.2	1.0
INVESTMENT	1558.5	1456.7	1496.8	1486.4	-50.5	-23.7	11.5	8.4
FIXED INVESTMENT	1687.5	1631.9	1641.1	1633.1	-39.0	-12.5	2.3	0.3
NONRESIDENTIAL	1321.2	1288.4	1280.2	1274.9	-39.2	-9.6	-2.5	-4.1
STRUCTURES	419.4	400.0	390.7	383.9	-43.6	-17.3	-9.0	-15.1
EQUIPM. & SOFTWARE	887.5	876.5	879.0	881.5	-36.4	-4.9	1.1	2.3
RESIDENTIAL	367.9	344.4	362.9	360.1	-38.2	-23.3	23.4	19.5
CHG. BUS. INVENT.	-113.9	-160.2	-130.8	-133.4				
NET EXPORTS	-386.5	-330.4	-348.3	-358.0				
EXPORTS	1434.5	1419.5	1469.1	1476.4	-29.9	-4.1	14.7	17.0
IMPORTS	1821.0	1749.8	1817.3	1834.4	-36.4	-14.7	16.4	20.8
GOVERNMENT (C & I)	2527.2	2568.6	2583.4	2588.2	-2.6	6.7	2.3	3.1
FEDERAL	996.3	1023.5	1043.1	1044.1	-4.3	11.4	7.9	8.3
DEFENSE	672.8	695.2	709.3	710.2	-5.1	14.0	8.4	8.9
OTHER	323.4	328.2	333.6	333.7	-2.5	6.1	6.8	6.9
STATE AND LOCAL	1533.3	1548.0	1543.7	1547.4	-1.5	3.9	-1.1	-0.1
DISP. PERS. INC.	9926.4	10020.0	9933.0	10040.6	0.2	3.8	-3.4	-1.5
FINAL SALES	13055.8	13077.8	13160.4	13139.0	-4.1	0.7	2.5	1.9
GROSS DOMESTIC PURCHASES	13432.7	13401.4	13501.5	13489.6	-6.4	-0.9	3.0	2.7
PRICE DEFLATORS:								
GDP CHAIN TYPE	109.7	109.7	109.9	109.8	1.9	0.0	0.8	0.5
GDP EX. FOOD & ENERGY					0.5	0.8	0.8	0.6
PCE CHAIN TYPE	108.4	0.0	109.6	109.5	-1.5	1.4	2.8	2.7
PCE EX. FOOD & ENERGY	108.2	108.7	109.1	109.1	1.1	2.0	1.4	1.3

Home Prices – Signs of Stability Remain in Place

The Case-Shiller House Price Index increased 0.3% in September, the fourth monthly increase but the magnitude is smallest of the four monthly gains. On a year-to-year basis, the House Price Index fell 9.4%, the smallest decline since October 2007. The reduction in inventories of homes, coming from the first-time home buyer tax credit of $8000 dollars which has persuaded households to buy homes, has translated into a smaller decline in home prices compared with the drop in home prices in the early part of 2009.

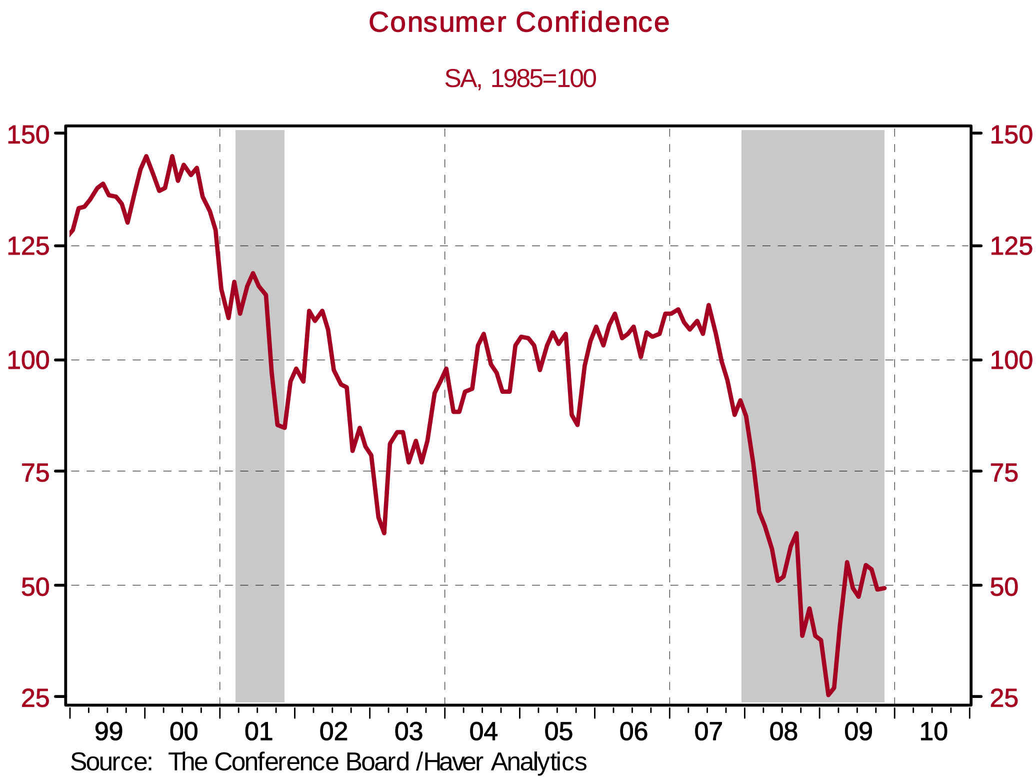
Chart 4



Consumer Confidence Index Moves Up Slightly

The Conference Board's Index moved up to 49.5 during November from 48.7 in the previous month. The Present Situation Index (21.0 vs. 21.1 in October) fell, while the Expectations Index rose to 68.5 in November from 67.0 in the prior month. The number of respondents indicating that "jobs are hard to get" rose to 49.8 from 49.4 in the prior month, while those noting that "jobs are plenty" fell to 3.2 from 3.5 in September. The main message is that hiring remains weak.

Chart 5


Consumer Confidence
SA, 1985=100
150
125
100
75
50
25
150
125
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03
04
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Source: The Conference Board /Haver Analytics