

DAILY GLOBAL COMMENTARY

Northern Trust
Global Economic Research
50 South LaSalle
Chicago, Illinois 60603
northerntrust.com

Asha G. Bangalore
agb3@ntrs.com

Minutes of December 16 FOMC Meeting: Fed on Hold for Extended Period, Ponders about Various Options

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The minutes of the December 16 FOMC meeting are close to the policy statement issued after the meeting. The Fed is on hold for an extended period of time in light of the fluid financial market conditions and significantly troubling economic environment.

The weakness in consumer spending was one of the major areas of concern. It was noted that the combined impact of lower equity prices, declining home prices, tight credit conditions and rising unemployment was declining consumer spending. The outlook for inflation was the second area of concern. There were mixed opinions about whether inflation will level out at desired levels or if it will decline to a level that is not consistent with price stability. The general consensus was that close monitoring of inflation expectations in the months ahead is necessary.

Various options are being examined at the Fed, given the new regime the Fed is operating under where the target federal funds rate is a range that is close to zero and the fact that the Fed is experimenting with new programs and tools. These are the issues that were discussed at the December FOMC meeting:

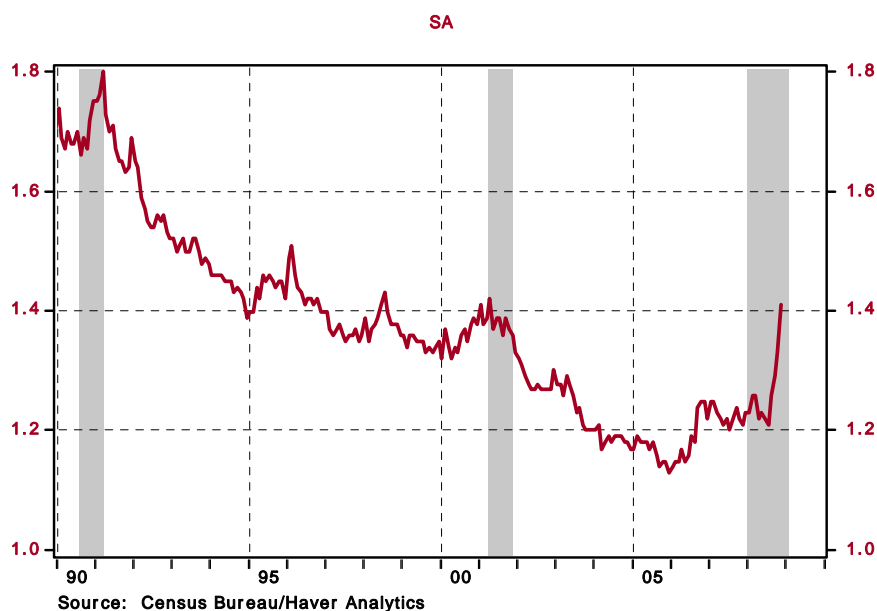
- The content of communications with the public such that it clarifies the Fed's intentions because it would influence the pricing of longer-term rates
- If explicit indications about inflation would be useful as it could "forestall the development of expectations that inflation would decline below desired levels, and hence keep real interest rates low and support aggregate demand."
- Merits of purchasing large quantities of longer-term securities, such as Treasury securities, agency debt, and agency-backed mortgage securities.
- The possibility of expanding existing facilities and necessity of new programs
- If quantitative targets for excess reserves would be useful.

Factory Inventories Are Scaling New Heights

Factory orders fell 4.6% in November, reflecting a 1.5% drop in bookings of durables previously estimated as a 1.0% decline. A large part of the sharp drop in bookings of non-durables is related to lower oil prices. The most important take away from this report is the gain in inventories of durables (+0.4%). Inventories of non-durables have dropped for three straight months, which has resulted in lower total factory inventories. Shipments of durables and non-durables have dropped for several months in a row. As a result of the declining trend of shipments, the inventory-shipments ratio has climbed rapidly from 1.22 in June to 1.41 in November (see chart 1), with durables accounting for the larger gain.

Chart 1

Mfrs' Inventory/Sales Ratio: All Manufacturing Industries



Factory Orders, Shipments, and Inventories – November 2008.

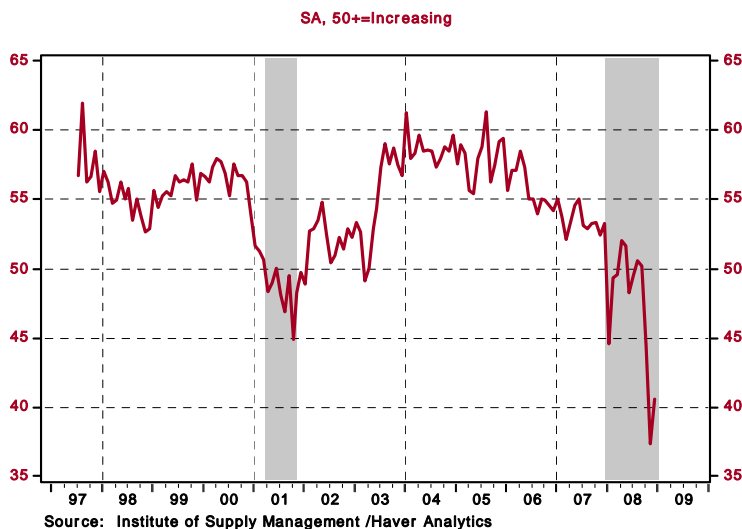
| | Jun-2008 | Jul-2008 | Aug-2008 | Sep-2008 | Oct-2008 | Nov-2008 |
|---------------------------------------|----------|----------|----------|----------|----------|----------|
| Factory Orders (% change m-m) | | | | | | |
| Total | 2.1 | 0.7 | -4.3 | -3.1 | -6.0 | -4.6 |
| Durable | 1.4 | 0.7 | -5.5 | 0.0 | -8.5 | -1.5 |
| Non-Durable | 2.8 | 0.8 | -3.2 | -5.8 | -3.8 | -7.4 |
| Shipments (% change m-m) | 1.9 | 1.4 | -3.7 | -3.1 | -3.6 | -5.3 |
| Inventories (% change m-m) | 1.2 | 0.6 | 0.7 | -0.8 | -0.6 | -0.3 |
| Inventories/Shipment Ratio | 1.22 | 1.21 | 1.26 | 1.29 | 1.33 | 1.41 |
| Unfilled Orders (% change m-m) | 1.0 | 0.8 | 0.3 | 0.2 | -0.9 | -0.6 |

The Non-Manufacturing ISM Survey Shows a Small Improvement But Level Is Close to Record Low

The Non-Manufacturing ISM composite index increased to 40.6 in December from 37.3 in November. Indexes tracking new orders (39.9 vs. 35.4 in November) and employment (34.7 vs. 31.3 in November) moved up slightly in December. But the levels of these indexes are significantly below the expansion cut off mark of 50.0, implying that the non-manufacturing sector continues to lose momentum. The December level is close to the historic low of 37.3 registered in November (see chart 2).

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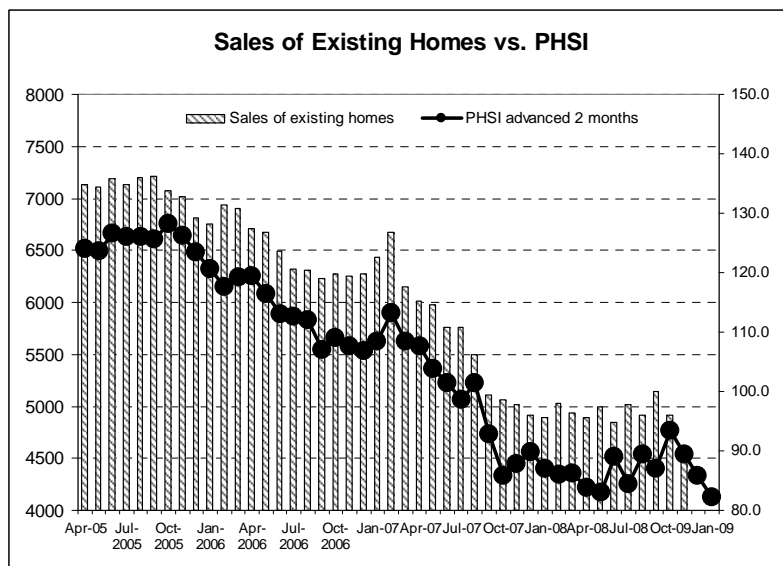
Chart 2
ISM Nonmanufacturing: NMI Composite Index



Decline in Pending Home Sale Index Suggests Existing Home Sales Were Weak in December

The Pending Home Sales Index (PHSI) of the National Association of Realtors dropped 4.0% to 82.3 in November after a 4.2% drop in the prior month which was previously reported as a 0.7% drop. Although mortgage rates have dropped in recent months, the positive impact on the housing market in terms of an increase in sales is yet to be seen.

Chart 3

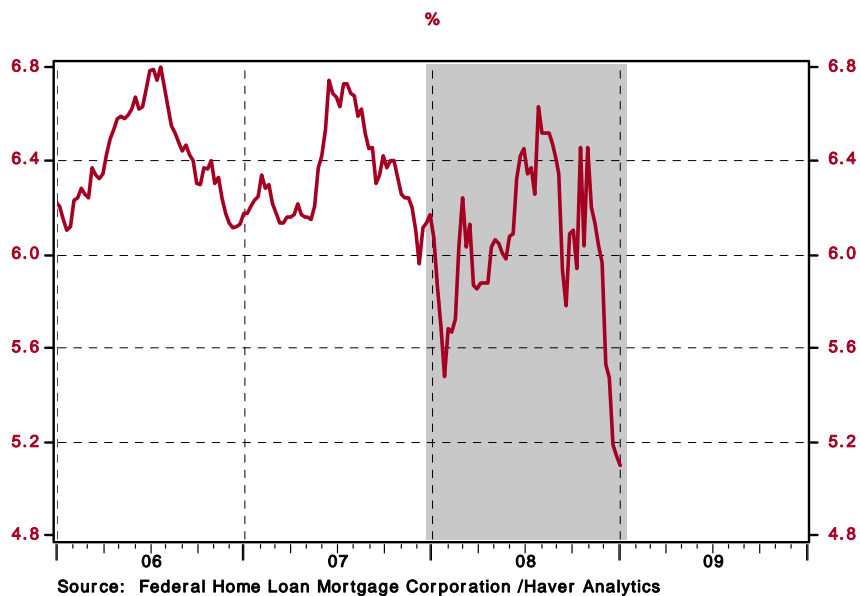


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Chart 4

FHLMC: 30-Year Fixed-Rate Mortgages: U.S.



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