

DAILY GLOBAL COMMENTARY

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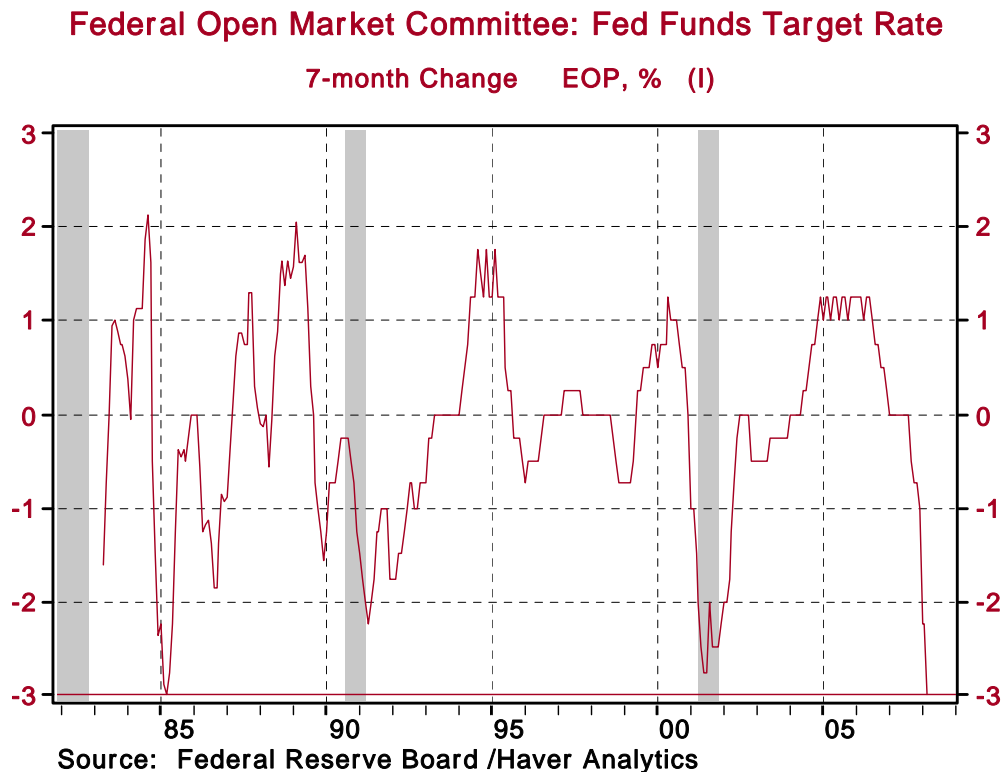
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If It Is Only a Mild Slowdown In Economic Activity, Why Are Actions of the Fed Unprecedented?

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The Fed's record in the August 2007 – March 2008 period will probably go down in history as the most aggressive and creative. The TAF, TSLF, and PDCF programs are its creative endeavors aimed at reducing the credit crunch and liquidity problems, while the sharp reduction in the federal funds rate is the aggressive feature of monetary policy changes in recent months. The FOMC has reduced the funds rate 300 bps between September 18, 2007 and March 2008. In nearly 26 years, such an eye popping drop in the federal funds rate in a seven-month period (see chart 1) occurred only between August 1984 and March 1985 during Chairman Paul Volcker's term.

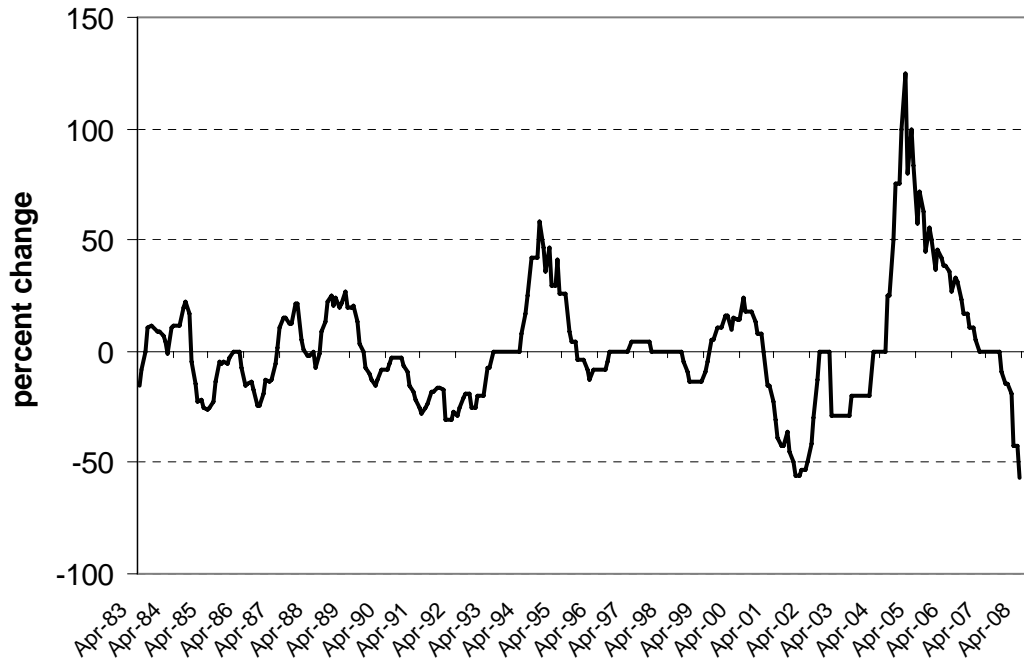
Chart 1



In terms of a percent change, the latest 300 bps cut in the federal funds rate is the largest (57.1% drop) since September 1982 (see chart 2). The only period when it was close to the recent drop was a 55.5% decline in the seven months ended November 2001.

Chart 2

**Federal Funds Rate
7-month percent change (Sep. 1982 - March 2008)**



If in fact the economy is projected to show only a mild slowdown as the Fed expects why has the Fed undertaken a historically aggressive decline in the federal funds rate? The FOMC forecast is a 1.3% - 2.0% Q4-to-Q4 increase in real GDP during 2008.

From another perspective, the real federal funds rate also shows that current changes in monetary policy are significant. Historically, the real federal funds rate (nominal federal funds rate less year-to-year change in CPI) turns negative during a recession, with three exceptions – 1981, 1990 and 2001 (see chart 3 and table 1). In other words, negative real federal funds rate is more likely to occur rather than an exception during recessions.

With regard to the exceptions, the real federal funds rate was strongly negative in the 1980 recession, which was short. This was a turbulent period when another recession commenced in July 1981 and the Fed was on a mission to contain inflation. The year-to-year changes in the CPI posted a high of close to 15% by March 1980 and funds rate (monthly average) peaked at 19.1% in June 1981. The second exception was in the 1990-91 recession when the real funds rate was positive but turned negative for a short period in 1993. In the current decade, the real federal funds rate was close to zero in the 2001 recession (lowest reading was 0.11 in April 2002) and turned strongly negative by mid-2004 when the Fed was taking a preemptive action against projected deflation.

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This time around, following a 75 bps cut on March 18, the real federal funds rate is minus 1.75% (2.25% - 4.0% for March 2008 assuming a year-to-year change in CPI of 4.0%. The data plotted in chart 3 ends in February 2008). If the economy is projected to grow in 2008, according to the Fed's forecast and rhetoric, it is not clear why the Fed has taken these aggressive steps. The Fed may have to use the "R" word soon.

Chart 3

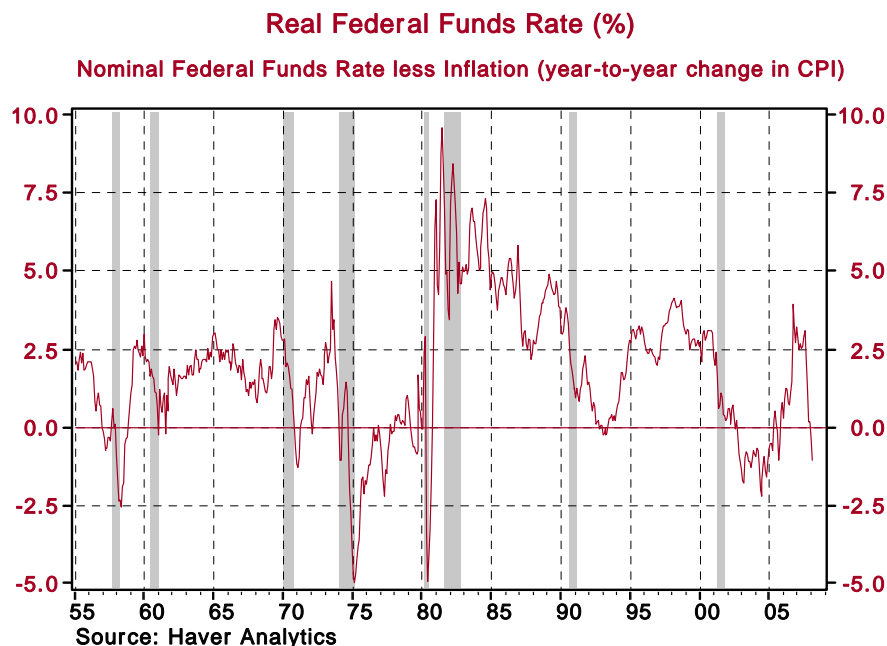


Table 1 - Real federal funds rate at turning points

Business cycle (peak to trough)	Date	Real federal funds rate*
Aug.1957 - Apr. 1958	May-58	-2.58
Apr. 1960 - Feb. 1961	Jan-61	-0.26
	Jul-61	-0.18
Dec. 1969 - Nov. 1970	Feb-71	-1.28
Nov. 1973 - Mar 1975	Feb-75	-4.98
Jan 1980 - Jul 1980	Jul-80	-4.91
Jul 1981 - Nov 1982	Dec-81	3.45
Jul 1990 - Mar 1991	May-91	0.83
	Apr-93	-0.26
Mar 2001 - Nov 2001	Apr-02	0.11
	Jun-04	-2.24
	Mar-08	-1.75

* - Lowest readings of real federal funds rate

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