

DAILY GLOBAL COMMENTARY

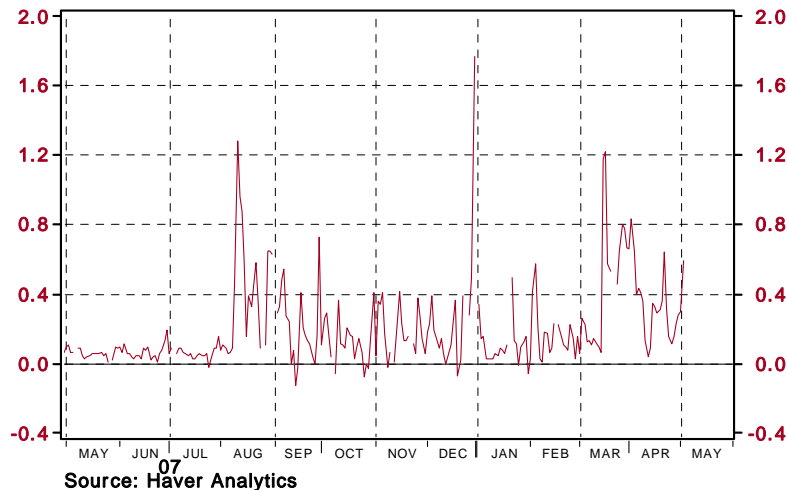
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Is Financial Market Stress Receding?
 May 6, 2008

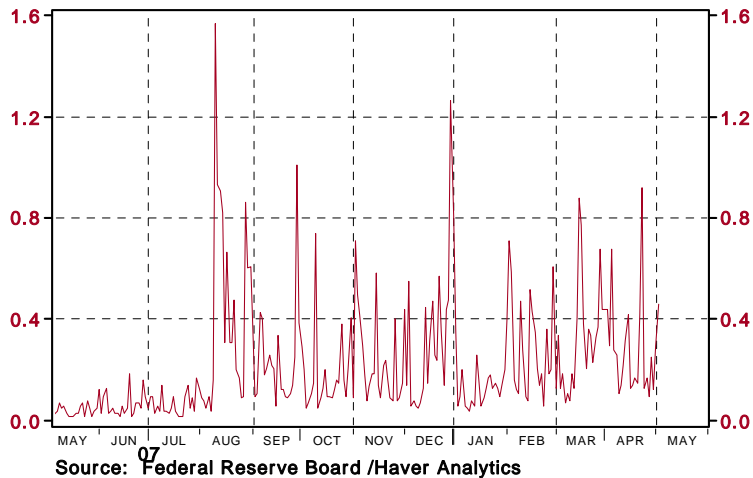
Periodically, we have written about market spreads to assess the status of financial markets. Our latest update suggests that there are small, meaningful improvements in some sectors, but more is necessary to declare the crisis is behind us. Chart 1 illustrates that the spread between overnight Libor and federal funds rate remains wider than normal.

Chart 1
Overnight Libor less Federal funds rate
 percent



The standard deviation of the federal funds rate is an issue, with persistent wide swings as shown in chart 2.

Chart 2
Federal Funds Rate: Standard Deviation
 % p.a.



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The spread between the 3-month Libor and 3-month Treasury bill rate has narrowed to 127 basis points as of May 2 compared with 162 bps on March 18, 156 bps on April 18 and 142 bps on April 30. Data points on the chart stop on May 2; as of this writing the spread is 116 bps.

Chart 3
3-month Libor less 3-month U.S. Treasury Bill rate
 (1)



Spreads in the commercial paper market have also narrowed in recent days. As of May 2, the spread between 3-month commercial paper and 3-month Treasury bill rate narrowed to 117 basis points vs. readings of 206 bps on March 20 and 165 bps on April 23 (see chart 4).

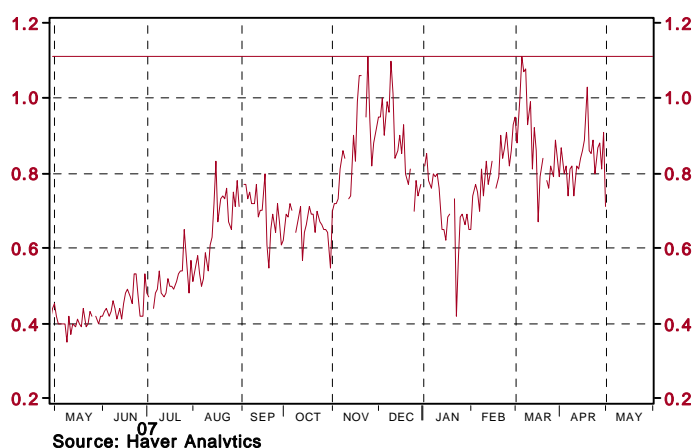
Chart 4
3-month Commercial Paper less 3-month Treasury bill rate
 percent



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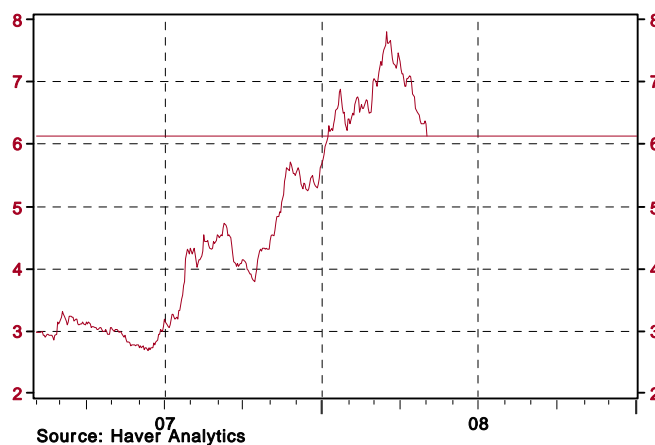
The 2-year swap rate less 2-year U.S. Treasury note yield was 71 bps on May 2, down from a high of 111 bps on March 6 (see chart 5)

Chart 5
2-year Swap rate less 2-year U.S. Treasury note yield
 percent



At the more risky end, the spread between junk bonds and the yield on the 10-year U.S. Treasury note has improved from a high of 780 bps (March 17, 2008, prior to Fed action on March 18) to 613 bps as of May 2.

Chart 6
Merrill Lynch junk bond yield less yield on 10-yr. U.S. Treasury note
 percent



Charts 1-6 suggest financial market stress has receded somewhat in some sectors only, with the federal funds market quite unsettled as yet. The larger issue now is how much damage the financial market stress has inflicted on the real economy. Evidence about the weak economy is trickling in with continued declines in home sales and prices. In addition, auto sales and non-auto consumer outlays show a significant setback, a severe weakness in demand for labor is visible in all employment numbers, and sharp declines in consumer confidence measures have been reported for April.

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