Northern Trust

DAILY GLOBAL COMMENTARY

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

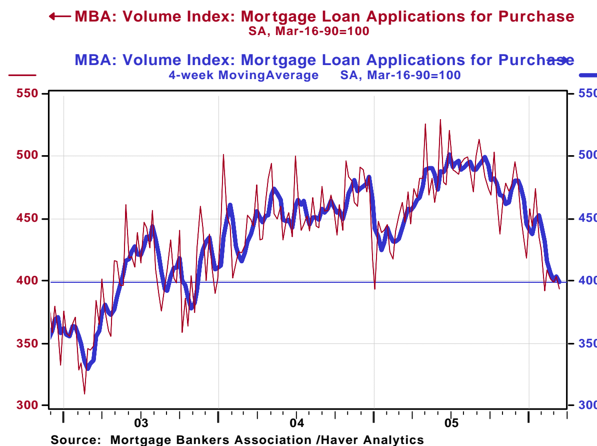
Asha G. Bangalore
agb3@ntrs.com

Mortgage Purchase Applications –Downward Trend Persists

March 22, 2006

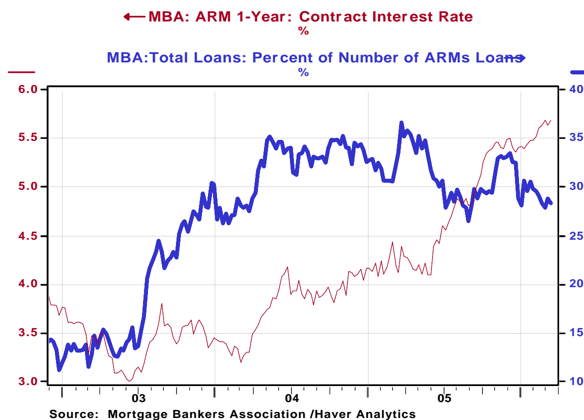
The Mortgage Bankers Association's Purchase Index dropped 9.4 points to 393.6 during the week ended March 17. The Refinance Index declined 9.1 points to 1574.5 during the same week. The Purchase Index is most likely to record a fourth consecutive monthly decline if there are no upside surprises in readings of the next two weeks. The current 4-week moving average is the lowest since the week ended November 14, 2003.

Chart 1



The one-year contract rate for one-year ARMs has risen to 5.68% from 4.12% a year ago. Consequently, the share of adjustable rate mortgages has declined to 28.3% from a high of 36.6% a year ago.

Chart 2



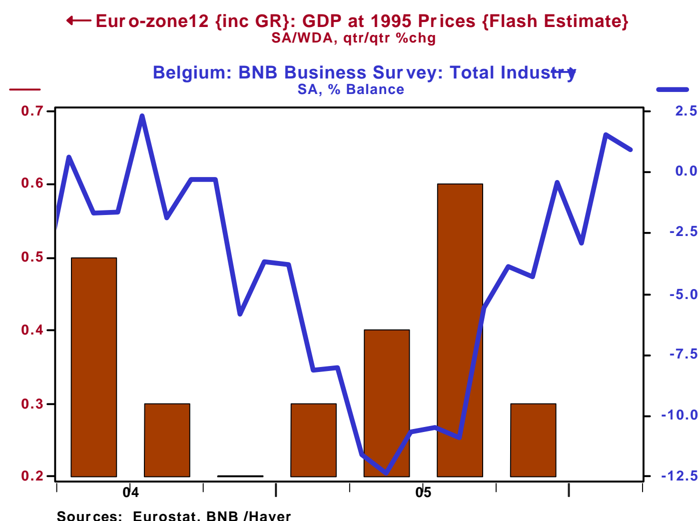
According to the Mortgage Bankers Association's report of March 16, the delinquency rate for residential mortgage loans rose to 4.7% at the end of the fourth quarter of 2005, up from 4.38% in the end of 2004 and 4.44% at end of the third quarter of 2005. The fourth quarter reading could be partly upwardly biased because of the hurricanes. But the notion that households are stretched remains valid. Households with ARMs have to reorganize their expenditures as their mortgages readjust. The Mortgage Bankers Association cites the increased shares of the portfolio that are ARMs and subprime mortgages, rising energy prices and higher interest rates as factors causing the upward trend of the mortgage loan delinquency rate.

Victoria Marklew
vem1@ntrs.com

Euro-zone Outlook: Watching the Belgians, Waiting for the Germans

Does the Belgian business confidence index for March point to the Euro-zone economy peaking in the summer months and starting to weaken again come Q4?. Thanks to Belgium's strong trade ties with its neighbors, this index is a leading indicator (about 6 months out) for GDP growth in the Euro-zone as a whole. The index has climbed fairly steadily since Q2 2005, and jumped into positive territory in February, hitting +1.5, its highest point in 19 months. However, it slipped to +0.9 in March.

Chart 3



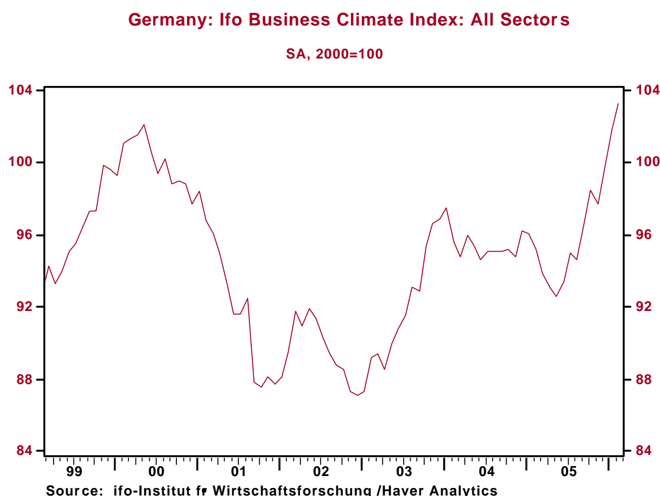
One month does not a clear trend make – this is not necessarily a sign that Euro-zone GDP growth will top out over the summer then weaken again. As long as it remains in positive territory, the BNB index is still pointing to growth. However, most of this month's positive reading came from the retail sub-index, which picked up nicely (+0.5 from -1.5 in February). The manufacturing sub-index dropped from +1.6 to just +0.3, with the component on the trend in domestic orders slipping from +3 to +2, while the component on the export order trend fell

The opinions expressed herein are those of the author and do not necessarily represent the views of The Northern Trust Company. The Northern Trust Company does not warrant the accuracy or completeness of information contained herein, such information is subject to change and is not intended to influence your investment decisions.

from +20 in February to +6. If the overall index – and particularly the export order trend in the manufacturing sub-index – slides again next month (April 24), then there will be reason to look more closely at the prognosis for the Euro-zone later this year.

For now, the next important economic indicator for the Euro-zone is the German Ifo business climate index, due March 28. The main index has seen a strong and steady recovery over the past few months, from a trough of 92.6 in May 2005 to 103.3 in February. The last time the Ifo hit this level was back in May 2000 when the reading topped out at 102.1. It would not be surprising if next Tuesday's result comes in a tad weaker. However, a drop in the vicinity of two points or more would suggest the Ifo is headed south again. And that would be cause for concern on the Euro-zone outlook.

Chart 4



James Pressler
jap10@ntrs.com

South Africa: What Would It Take For the Reserve Bank to Change Rates?

It has been almost a year since the South African Reserve Bank (SARB) changed the repo rate (a 50 bp cut), and some speculate that the benchmark rate will remain at 7.00% for the remainder of the year. Between now and the next meeting of the Monetary Policy Committee (MPC) on April 12-13, a handful of indicators will be released. Barring some earthshaking figures, it is unlikely that the MPC will change anything. Looking forward, there are only a few situations that could carry enough weight to prompt a change in the repo rate over the next 12 months.

The opinions expressed herein are those of the author and do not necessarily represent the views of The Northern Trust Company. The Northern Trust Company does not warrant the accuracy or completeness of information contained herein, such information is subject to change and is not intended to influence your investment decisions.

The SARB follows an inflation-targeting policy that has served it well the last few years, so the CPI would be the first candidate to move the repo rate. Consumer inflation stood at an even 4.0% as of January, within the mid-range of the MPC's 3-6% inflation target. February's data – due for release on March 28th – is expected to hold steady or even drift down a few notches. This suggests that if anything, the SARB might have some leeway to cut rates in the near future. However, the slow, steady climb in both consumer and producer prices over the past year suggests that the MPC will remain cautious and not take any particularly zealous steps.

Of course, when the economy has exhibited particularly broad-based weakness, the tendency has been to offer a marginal rate cut with the intention of nudging up confidence rather than providing a burst of monetary fuel. The latest reports on the manufacturing sector, however, show that while the rand's recent appreciation has had an impact on the external sector, production rates are still pretty healthy and the overall economy doesn't need a push at the moment.

Lastly, the exchange rate has played an unspoken role in the MPC's decision-making process. During the past five months the rand has appreciated from R6.80/US$ to R6.21, but this is off the high of R5.99 reached in mid-January. In trade-weighted terms, the rand could afford to lose a little strength without setting off any alarms, but the volatile nature of the currency has occasionally turned a brief softening into a significant depreciation. If the rand were to fall off significantly, the SARB would likely respond with a higher repo rate rather than forex intervention. The likelihood of such a scenario playing out in the near-term, however, is not very high.

Our base case forecast has the repo rate holding steady throughout 2006. The MPC may shift to an easing bias but it is unlikely to cut rates as long as the US and the Euro-zone are still in tightening mode. Until the interest rate cycle in South Africa's major trading partners has leveled off, the monetary authorities have no real incentive to go against the tide.

The opinions expressed herein are those of the author and do not necessarily represent the views of The Northern Trust Company. The Northern Trust Company does not warrant the accuracy or completeness of information contained herein, such information is subject to change and is not intended to influence your investment decisions.