



The Northern Trust Company
Economic Research Department
Daily Economic Comment

50 South LaSalle Street, Chicago, Illinois 60675

<http://www.northerntrust.com> (See Economic Research)

Fax (312)-444-4132

Paul Kasriel (312)-444-4145

Asha Bangalore (312)-444-4146

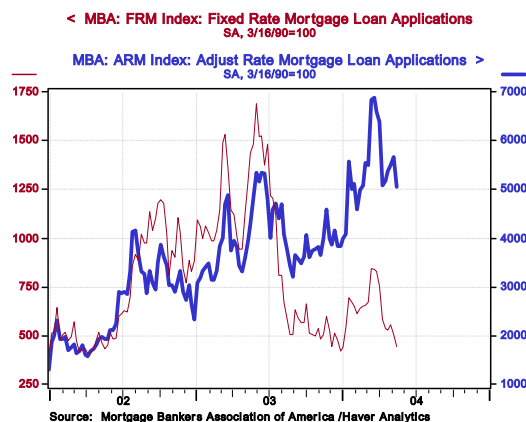
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Alan Greenspan's Re-nomination: Pride Goeth Before A Fall?

It is not surprising that Alan Greenspan was re-nominated to be chairman of the Federal Reserve. What was surprising is that he accepted the re-nomination. Like a cat with nine lives, Greenspan was fortunate enough to revive a near moribund economy in the aftermath of the bursting of arguably the biggest asset-price bubble in the history of this country – an asset-price bubble whose inflation he aided and abetted. One would think that after having his reputation somewhat rehabilitated, Greenspan would repair to his apartment to write his memoirs. But for some reason, perhaps a desire to get into the Guinness Book of Records as longest serving Fed chairman, Greenspan re-upped. Greenspan has revived the economy by creating yet another asset-price bubble – this time in housing. Although the housing bubble is not as large as the stock market bubble, its bursting could do more harm to the economy inasmuch as the banking system has greater exposure to the mortgage market today – about 60% of earning assets – than it ever has in the post-WWII period. Because the prices of goods and services are beginning to rise faster, Greenspan has no choice but to put up interest rates in an effort to slow the growth of central bank-sponsored credit. This runs the very real risk of bursting the housing bubble in the next two years. Why wouldn't Greenspan leave this potential debacle to his successor to deal with? Why not go out on top of the world now? Does Greenspan's pride goeth before his fall?

The Sharp Increase In Adjustable Rate Mortgages Spells Trouble

The Mortgage Bankers Association's mortgage purchase index fell 40.1 points to 454.2 during the week ended May 14, after three consecutive weekly gains. The mortgage refinance index dropped 367.7 points to 1816.9 during the same week, marking the seventh consecutive weekly drop. Of greater interest in this weekly report are the indexes classified according to product type – fixed or adjustable mortgages. As the chart below indicates, adjustable rate products show a significant increase in the first four months of the year compared with the fixed rate loans.



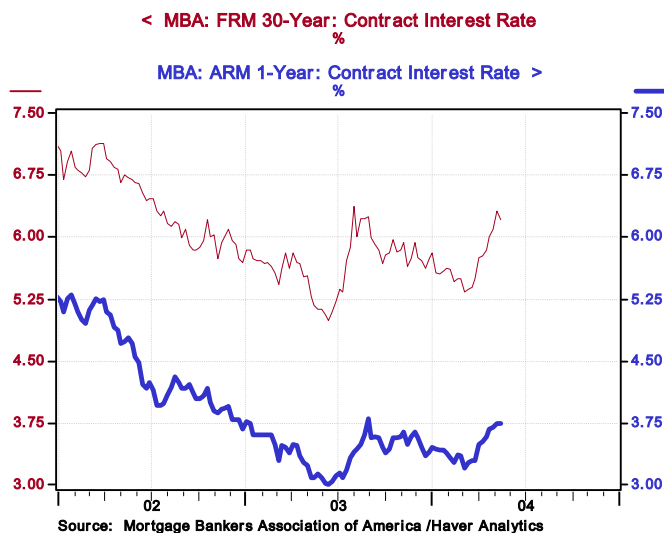
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The index measuring the number of loan applications for adjustable rate products has risen 36.4% since December 2003, while the fixed rate mortgages have advanced only 2.7%.

Increase in Mortgage Applications By Product Type

	2002	2003	2004 YTD
Fixed Rate mortgages	21.50%	30.00%	2.70%
Adjustable Rate Mortgages	89.00%	54.00%	36.40%

The index for adjustable rate mortgages showed noteworthy gains in 2002 and 2003 also. In light of the projected behavior of the Fed, the recent upward trend of mortgage rates is unlikely to be reversed. Needless to mention, home owners with adjustable rate products will be facing a jump in monthly mortgage payments in the near term. Consumer spending will reflect a setback as households reallocate their incomes. This structure of mortgage loans poses a threat to growth in consumer spending.



Paul Kasriel (plk1@ntrs.com)
 Asha Bangalore (agb3@ntrs.com)