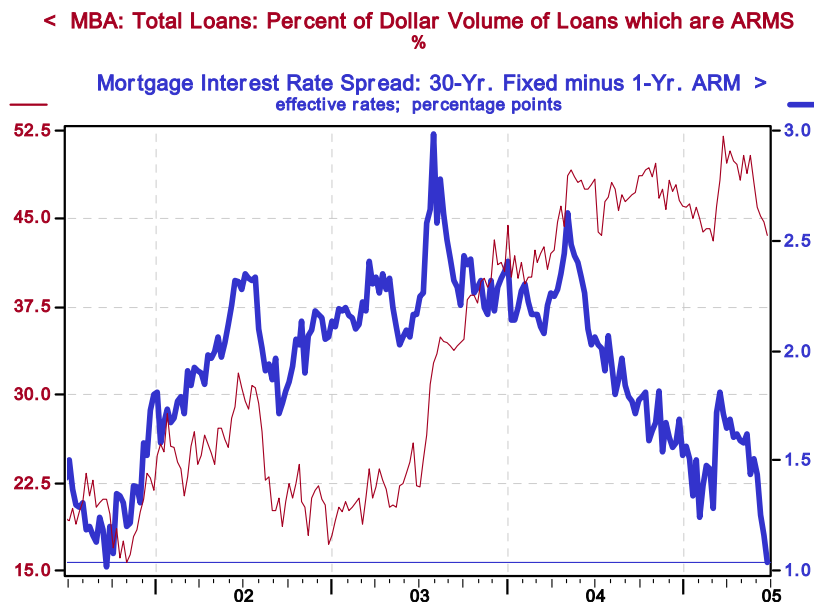




June 29, 2005

Borrowers' Demand For Adjustable Rate Mortgage Products Waning

In the week ended March 25, 52.0% of the dollar volume of new mortgage applications was for ARM products, according to the Mortgage Bankers Association. As of the week ended June 24, ARMs share of new mortgage applications had fallen to 43.5%. Why the change of heart on the part of borrowers? Perhaps because the spread between the effective interest rate on a 30-year fixed mortgage vs. a 1-year ARM had narrowed to 104 basis points from 171 basis points on March 25. The current 104 basis point spread is the narrowest since the 102 basis points reached in the week ended September 21, 2001. At that time, only 21% of new mortgage applications were ARMs. All of this is shown in the chart below. Notice that until recently there has been little sensitivity of the ARMs' ratio to the downward trend in the mortgage rate spread that began early in 2004. Perhaps "fear of reset" is entering the minds of prior ARMs' borrowers. At only about 100 basis point premium, the certainty of fixed rate products is beginning to look more appealing. If borrowers make a massive move out of adjustable rate product into fixed rate product, this ought to create a lot of volatility, not to mention lower net interest income for lenders.

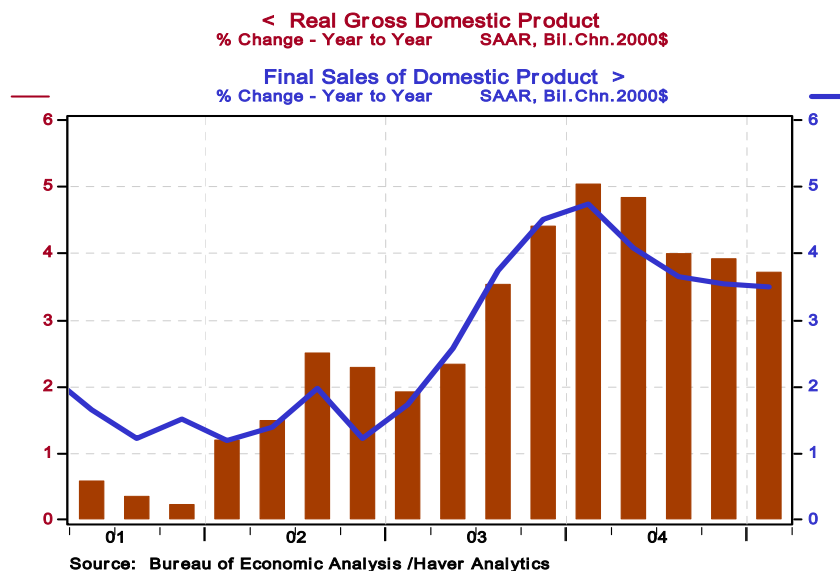


First Quarter Real GDP Growth Revised Up To 3.8% From 3.5%

The details of first quarter GDP Commerce Department estimates from the advance report to the "final" report (a misnomer if ever there was one inasmuch as Commerce will be revising this number for years to come) are contained in the table below. The first takeaway from today's report is that despite the upward revision, real GDP and real final sales growth are moderating, as shown in the chart below. For example, year-over-year real GDP growth in Q1:2005 was 3.7% -- down from 5.0% in Q1:2004. With tomorrow's quarter-point increase in the fed funds rate in combination with the prior cumulative 75 basis points funds rate increase this year, the pace of real economic activity will slow more in the coming quarters. The second takeaway is that the downward revision in the core

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PCE price annualized inflation from 2.2% in the preliminary report to 2.0% in the final report is less than meets the eye. To wit, most of the downward revision was due to a new lower estimate of the cost of “free” banking services. Excluding these kinds of freebies, which the core *market-based* PCE price index does, consumer inflation was revised up from 2.1% to 2.2%.



	(2000 chained dollars)				Percent Change (SAAR) from prior quarter			
	04:4 Final	05:1 Advance	05:1 Preliminary	05:1 Final	04:4 Fin	05:1 Adv	05:1 Prel.	05:1 Fin
GDP	10994.3	11078.2	11088.8	11096.2	3.8	3.1	3.5	3.8
CONSUMPTION	7747	7814.2	7816.5	7815.8	4.2	3.5	3.6	3.6
DURABLE GOODS	1129	1129	1133.8	1134	3.9	0.0	1.7	1.8
NONDURABLE GOODS	2245.3	2272.2	2275.2	2275.3	5.9	4.9	5.4	5.5
SERVICES	4389.2	4427.8	4423.4	4422.4	3.4	3.6	3.2	3.1
INVESTMENT	1912.6	1969.7	1958.8	1962.9	13.3	12.5	10.0	10.9
FIXED INVESTMENT	1861.9	1884.9	1886.3	1892.1	10.5	5	5.3	6.6
NONRESIDENTIAL	1288.3	1303.0	1299.5	1301.3	14.5	4.7	3.5	4.1
STRUCTURES	242.3	240.7	240.3	240.8	2.1	-2.6	-3.3	-2.4
EQUIPM. & SOFTWARE	1059.5	1077.2	1074.0	1075.3	18.4	6.9	5.6	6.1
RESIDENTIAL	570.6	578.6	582.7	586.3	3.4	5.7	8.8	11.5
CHG. BUS. INVENT.	47.2	80.2	68.4	66.8				
NET EXPORTS	-621.1	-663.2	-640.0	-637.5				
EXPORTS	1140.0	1159.5	1159.9	1164.6	3.2	7.0	7.2	8.9
IMPORTS	1761.2	1822.7	1799.9	1802.1	11.4	14.7	9.1	9.6
GOVERNMENT (C & I)	1954	1956.7	1953.2	1954.8	0.9	0.6	-0.2	0.2
FEDERAL	728.8	729.8	729.6	729.9	1.2	0.6	0.4	0.6
DEFENSE	490.7	491	491.1	491.3	-0.6	0.2	0.3	0.5
OTHER	237.7	238.5	238.1	238.2	5.3	1.3	0.7	0.9
STATE AND LOCAL	1225.1	1226.8	1223.5	1224.9	0.6	0.5	-0.5	-0.1
DISP. PERS. INC.	8170.9	8165.6	8193.1	8188.4	10.8	-0.3	-1.2	-1.4
FINAL SALES	10945.5	10996.2	11018.8	11027.9	3.4	1.9	2.7	3.0
FINAL SALES TO DOMESTIC PURCHASERS	11558.6	11650.6	11650.5	11657.2	4.5	3.2	3.2	3.5
PRICE DEFLATORS:								
GDP CHAIN TYPE	109.2	110.0	110.0	109.9	2.3	3.3	3.2	2.9
GDP EX. FOOD & ENERGY					2.1	3.2	3.0	2.7
PCE CHAIN TYPE	108.7	109.3	109.3	109.3	2.7	2.1	2.1	1.9
PCE EX. FOOD & ENERGY	107.2	107.8	107.8	107.7	1.7	2.2	2.2	2.0

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No Fireworks Expected From The Fed Tomorrow

The only thing related to fireworks on the minds of FOMC members tomorrow is whether they will get invited to watch the pyrotechnics Monday night with Alan and Andrea high atop the Fed's Martin Building. The FOMC will raise its funds rate target by 25 basis points to 3.25% tomorrow afternoon. Although I do *not* doubt that a pause is coming no later than after the August 9 FOMC meeting, I do doubt that there will be any hints of an imminent pause in rate hikes in tomorrow's statement. The committee is just not yet ready to commit. And not yet having decided at what funds rate level it wants to pause, the FOMC does not want to give the markets any reason to race ahead of the final decision.

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