



WEEKLY ECONOMIC COMMENTARY – WEEK OF NOVEMBER 16, 2009

FINANCIAL INDICATORS				
INTEREST RATES	November 13	Week Ago	Month Ago	Year Ago
3-month Treasury bill	0.05%	0.04%	0.06%	0.13%
6-month Treasury bill	0.16	0.15	0.15	0.89
3-month LIBOR	0.27	0.27	0.28	2.24
2-year Treasury note	0.81	0.85	0.95	1.18
5-year Treasury note	2.25	2.30	2.35	2.29
10-year Treasury note	3.42	3.50	3.41	3.70
30-year Treasury bond	4.35	4.40	4.24	4.20
Tax-Exempt Revenue Bonds (Triple-A)				
5-Year	1.90	1.96	2.05	3.16
10-Year	3.35	3.36	3.30	4.32
30-Year	4.49	4.51	4.50	5.18
30-year fixed mortgage rate	4.91	4.98	4.92	6.14
15-year fixed mortgage rate	4.36	4.40	4.37	5.81
1-year adjustable rate	4.46	4.47	4.60	5.33
STOCK MARKET				
Dow Jones Industrials	10270.47	10023.42	9995.91	8497.31
S&P 500	1093.48	1069.30	1087.68	873.29
NASDAQ	2167.88	2112.44	2156.80	1516.85
Commodities				
Gold (\$ per troy ounce)	1119.40	1096.30	1054.10	746.50
Oil (\$ per barrel) - Crude Futures (NYMerc)	76.40	77.67	78.66	56.92
ECONOMIC INDICATOR (Latest Month/Quarter)				
Trade Deficit (September) -- mlns of \$s	36472.0	30849.0	31851.0	30363.0
Consumer Sentiment (early Nov) - Index	66.0	70.6	73.5	68.8

Prime Rate: 3.25%

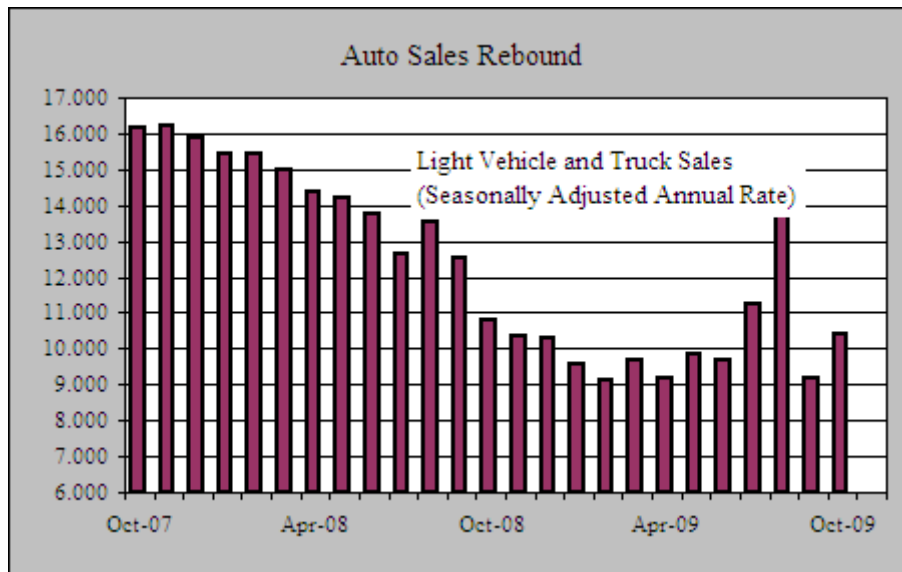
1-Month LIBOR: 0.24%

As we hit the midpoint of the fourth quarter, the economy appears to be ending the year in much better shape than envisioned just a few weeks ago. Sure, the eye-opening 3.5% growth rate in the third quarter was largely an artifact of special forces that pumped up auto and home sales. Without the sizeable contribution from housing and autos, growth would have come in at a much more anemic pace of about 2 percent - hardly a barn burning start to the recovery. Indeed, the common wisdom at the end of the period was that the removal of the props to those two sectors would suck the life out of the fourth quarter, leaving the economy vulnerable to a W-shaped recovery, one that could easily double-dip back into a recession.

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But as the weeks progressed, signs of surprising vigor began to show. After the cash-for-clunkers program expired in late August auto sales tumbled as expected, falling to a 9.2 million annual rate in September from the 12.6 million average pace during July and August. But instead of staying in the doldrums, sales rebounded nicely in October, rising to over a 10 million annual rate. That surprised most analysts who speculated that the rebate-incentives would push forward enough sales to keep traffic at auto dealers at the depressed September level for another six months or so. Whether the October recovery was just a “dead cat” bounce that will be followed by another relapse in coming months remains to be seen. However, the fact that households have not gone into complete hibernation in the midst of a double-digit unemployment, high debt burdens and corrosive wealth destruction in recent years is an encouraging omen.

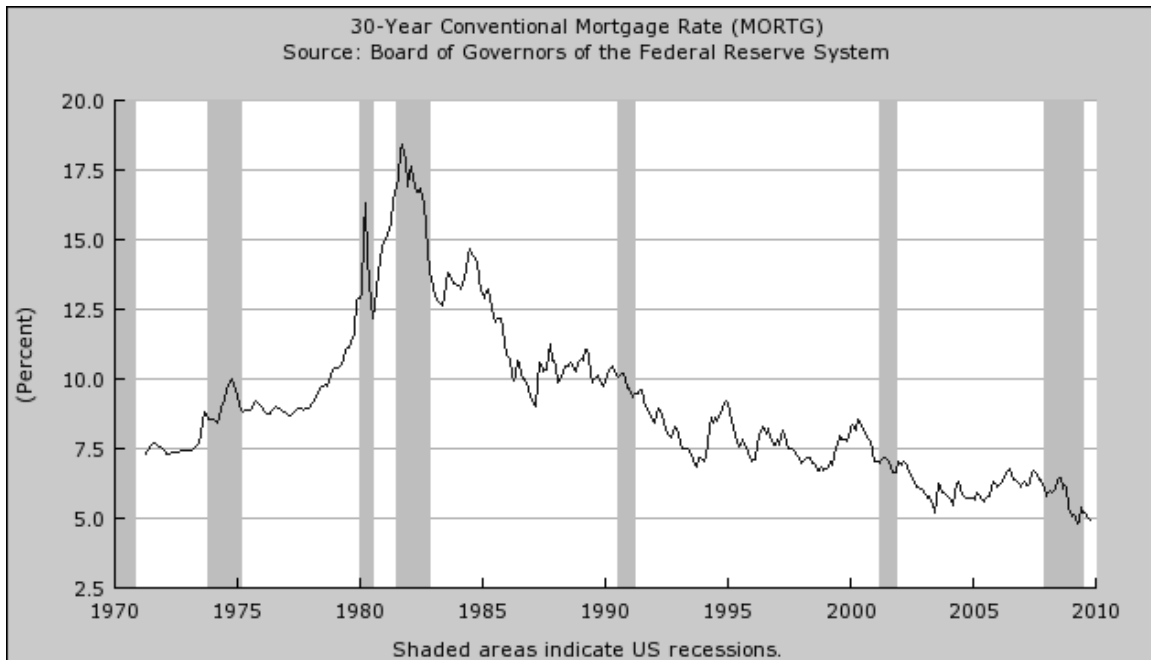


Indeed, the solid showing of non-auto retail sales in September and some encouraging signals from chain stores in October suggest that consumer spending in the fourth quarter will hold up better than expected. The increase in real personal consumption will likely not match the robust 3.4% growth rate posted in the summer quarter, but a respectable 2.5% gain could well be in the cards. Since consumer spending drives about 70 percent of GDP, that should underpin another decent growth rate in the fourth quarter. Similarly, a dramatic relapse in home sales that was expected in the wake of the expiration of the \$8000 homebuyer’s tax credit is not likely to occur. Not only have lawmakers renewed the credit this week, the program has been expanded to include a smaller tax break for folks who already own a home and want to trade up (or retirees who want to trade down).

While the home-buying incentive by itself will not reinvigorate a deeply bruised housing sector, it should supplement other positive developments that point to a brighter near-term future for it as well as the broader economy. One of the most important is the improving financial environment, which is breathing more life into heretofore credit-starved households and businesses. The sustained low level of interest rates is a key component of this improvement. Mortgage rates on 30-year fixed rate loans, for example, slipped back under 5 percent last week for the first time in more than a month, touching levels not seen since the 1960s. Just as important, banks are easing their collective foot off of the credit brakes, indicating that the massive Federal Reserve/Treasury effort to restore a normally functioning financial system is finally bearing fruit.

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The process is far from complete, of course, but it is heading in the right direction. According to the latest Federal Reserve Survey of senior bank lending officers, the percentage of banks that are tightening standards and terms for most loan categories continued to decline from the peaks reached late last year. That improving trend is more apparent for businesses than consumers, which should come as no surprise as the debt-servicing capacity of households has been much more compromised during the grueling recession and still jobless recovery than was the case for most companies. Indeed, with the mind-set of households focused on reducing debt burdens and repairing balance sheets, the lackluster demand for consumer loans is dampening the negative impact that restrictive credit conditions might otherwise have on household spending.

More important is the growing willingness of banks to extend loans to businesses. In the October survey released last week, the net fraction of banks that tightened standards for companies of all sizes fell to about 15 percent from over 30 percent for those reporting in the July survey. Last fall, more than 80 percent of banks said they were tightening the lending screws, meaning that the credit spigot was virtually turned off. That was not critical for large firms, as the capital markets opened up pretty quickly this year, facilitating a record volume of bond offerings by both investment-grade as well as less creditworthy companies. Their lofty yield spreads over Treasury issues, which have narrowed considerably since late last year, proved to be attractive to yield hungry investors in a Fed-induced low rate environment.

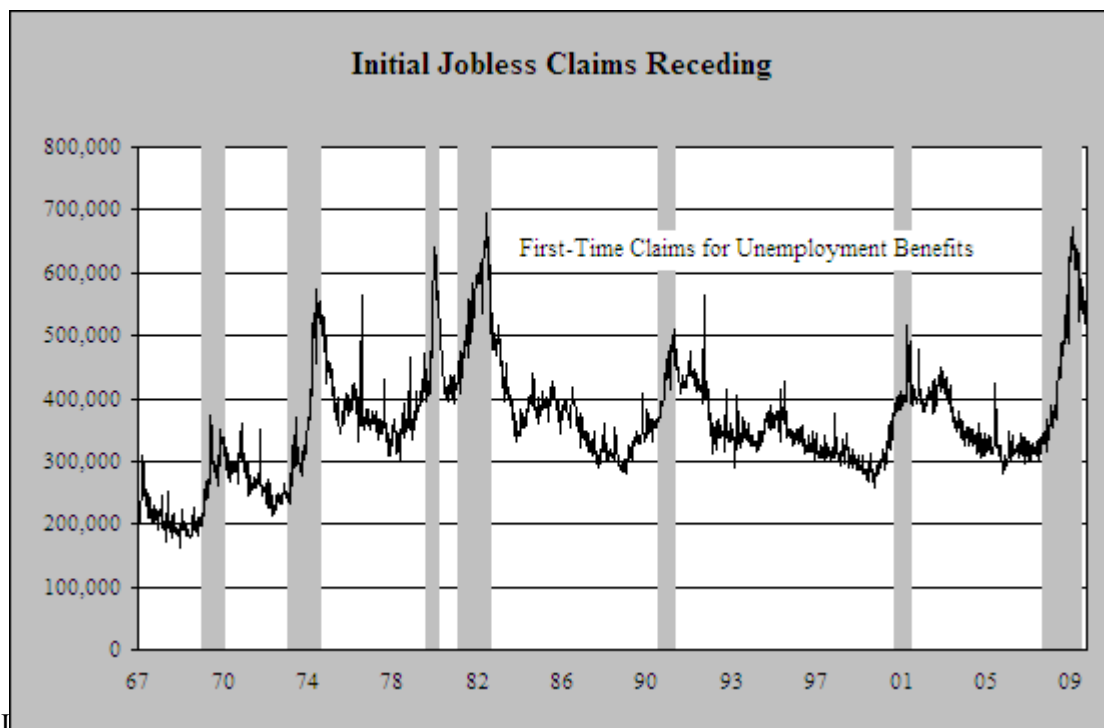
But small and medium sized businesses do not have access to the capital markets and are forced to rely heavily on banks to sustain, much less expand, operations. What's more, many small business owners use their personal credit cards to obtain working capital, which left them vulnerable to the same restrictive practices that banks apply to households in general. Keep in mind that small businesses account for more than 50 percent of job creation, so their inability to borrow is one of the biggest headwinds impeding the recovery. But the latest loan officer survey indicates that the credit freeze is thawing dramatically for small businesses as well. In October, the net fraction reporting tightening standards had fallen to about 16 percent from 75 percent a year ago.

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To be sure, small businesses will not rev up operations simply because banks are more willing to extend credit. Just like their larger brethren, these firms retain a healthy dose of skepticism regarding the demand for their products and services. What's more, they are understandably confused over the healthcare reform proposals emanating from Capitol Hill. The House-passed version includes a provision that would force companies to either offer a health plan to workers or pay a hefty tax if they decide not to. The prospective bills circulating in the Senate do not carry such a mandate. It stands to reason that many small companies will simply refrain from taking on new help until the confusion is resolved in a final bill, something that may not be enacted for quite a few more months despite the more optimistic timetable projected by Senate majority leader Harry Reid.

Unfortunately, it is the job market where the rubber meets the road with regards to the economic outlook. On this score, there is still a yawning gap between the surprising strength in economic activity and the dormant state of labor conditions. Whatever is sustaining the spending pace of consumers in recent months, it will not continue to be a driving force unless more households receive paychecks. By all accounts, that prospect is still a ways off. True, the pace of layoffs continues to recede as manifested by the persistent decline in the number of laid-off workers applying for unemployment benefits. As the chart shows, first-time claims have fallen sharply from their peak levels seen during the spring. In the latest week, the number of new filings slid to 502,000, the lowest since the first week of the year, and the four-week moving average for this series is the lowest since last November. As encouraging as this trend is, the absolute numbers are still far too high for a recovery. A more normal pace of first-time claims would be around the 350,000 – 400,000 level.



Indeed, the jobless claims metric tells us more about the plight of the unemployed than it does about the trend in payrolls. Even for the jobless, the story is somewhat distorted. True, the receding number indicates that companies are firing fewer workers than before. But those already on the jobless rolls are having a tougher time finding a new position than any time since the 1930s, as more than a third have been out of work for at least 27 weeks. Studies show that the longer a worker is out of a job, the more difficult it is for

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him or her to land a new one for a variety of reasons. And when they do, it usually is for a lower paying job than the one held before. That said, the slide in first-time claims for jobless benefits is happening at a faster pace than was the case immediately following each of the last two recessions, which suggest that a pick up in hiring may occur faster than is generally expected.

While the claims data are more correlated with firings than hirings, there is a relationship with the latter. According to some economic models, the current 502,000 claims number is consistent with a 100,000 decline in monthly payrolls, which is considerably smaller than what the Labor Department has been reporting in recent months. We suspect that a few more months of net payroll declines still lie ahead, but the inflection point leading to net job creation is close at hand. Up till now, the growth in the economy during the third and fourth quarters has been generated by productivity gains, which spurred to an astonishing 9.5% annual rate over the summer months. But companies can squeeze just so much output out of an ever-leaner labor force before hitting a ceiling.

We suspect that the productivity surge has reached its limit, and further output gains will soon have to be accommodated by increasing the workweek and expanding payrolls. In fact, the economy has never expanded by more than 3 percent for two consecutive quarters without an increase in payrolls taking place. It's still early, but another quarter of 3 percent growth is not out of the question for the fourth quarter, which would meet that two-quarter threshold for job creation. To be sure, there are some unusual forces fueling growth in the second half of the year, including a huge amount of Federal stimulus that will be fading at the start of the New Year. If the economy falters in early 2010, so too might the hiring propensity of companies. That prospect is being given high odds by mainstream economists who are predicting a sub-par recovery through most of next year. But that seems to be a tendency at the start of most recoveries, particularly those that have followed harsh recessions. More often than not, the economy bounced back much quicker and faster than anyone expected. Given the headwinds that still prevail, a repeat of that scenario may be considered a long shot. Nonetheless, history suggests that it is wise to be prepared for better-than-expected news in the months ahead.

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