

Bill Watkins
August 19, 2009

This is a slow week for economic news. I was thinking about how different things are from last August. Last year we were approaching the most serious economic crisis of our life. Economic storm clouds were building, the government was bailing out firms, and everyone was preparing for the worst. Except, September was worse than any imagined.

Today, things seem to be much better. Some economists have declared the recession over. Policy makers and talking heads seem to have adopted a complacent attitude. They are confident the worst is over. Sentiment surveys aren't quite so sanguine. Maybe this time the political class is wrong.

I reviewed the 3-month TED spreads (Libor-Treasury—usually interpreted as a short-term risk premium), and sure enough they are down a bunch from a year ago. However, a 50 basis point spread is quite different when the 3-month Treasury is 18 basis points versus when it is 200 basis points. So, we normalized the TED spread by the Treasury rate to provide a measure that is consistent across interest rates. This tells us a very different story. That spread in July, the most recent month for which we have data, was higher, on average, than even in September 2008.

Combine the normalized TED spread with data on bank lending, consumer and business borrowing and bank charge offs, you might start thinking that things are not looking all that good.