

Weekly Economic Commentary



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The Calm After the Storm

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Highlights

- The U.S. economic calendar is typically quiet the week after the monthly jobs report is released. This week's docket is even more muted due to the Veteran's Day holiday on Thursday, November 11.
- The debate over fiscal policy in the United States is likely to get lot of attention in the coming weeks and months, but not necessarily from Congress.
- The October jobs report capped off a solid week of economic data in the United States, although it is probably too soon to conclude that the economy is reaccelerating.

The midterm elections, the decision by the Federal Reserve to embark on another round of quantitative easing (QE 2), and a better-than-expected jobs report for October made last week one for the history books. Market historians may not remember the upcoming week as clearly, however, given the lack of economic and policy events due out.

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Aside from the regular weekly data on weekly chain store sales, mortgage applications, and initial claims for unemployment insurance, there is only a handful of data reports due out in the United States this week. The reports include the merchandise trade report for September, consumer sentiment for the first half of November, and the federal budget data for the first month of fiscal year (FY) 2011 (October 2010).

Market participants will still have plenty to mull over this week as they continue to digest last week's monumental events. This week, Chinese authorities will release the full slate of October economic data in China, which will refocus attention on the ever-widening trade gap between the United States and China, even as markets brace for the upcoming Group of 20 (G-20) meeting in Korea on November 11–13. There are no major central banks meetings this week, although the central banks in India, Turkey, and Malaysia are set to meet. No rate increases are expected, but both Malaysia and India have been tightening policy by raising domestic interest rates to cool domestic inflation since late 2009/early 2010. On balance, with a lack of any key U.S. economic data, fiscal, monetary and currency policy will be in focus ahead of the G-20.

Economic Calendar

Tuesday, November 9	Trade Balance
Wholesale Inventories	<i>September</i>
<i>September</i>	Treasury Statement
Wednesday,	<i>October</i>
November 10	Friday, November 12
Import Price Index	U of Mich Consumer
<i>October</i>	Sentiment
Initial Claims	<i>November</i>
<i>wk 11/06</i>	

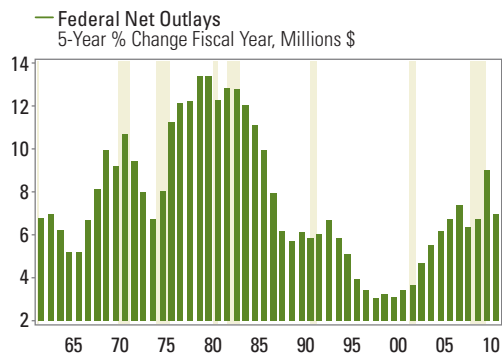
Budget Battle?

The budget data for October 2010—the first month of fiscal 2011—is due out on Wednesday, November 10. The market is looking for a \$148 billion budget deficit in October 2010.

Financial markets almost never react to the monthly budget data, and have not reacted much to the reality that the United States has now racked up two consecutive years of trillion-dollar plus budget deficits, and is well on its way to a third in FY 2011. This is generally because the dollar is the world's "reserve" currency (i.e. much of world trade is conducted in dollars) interest

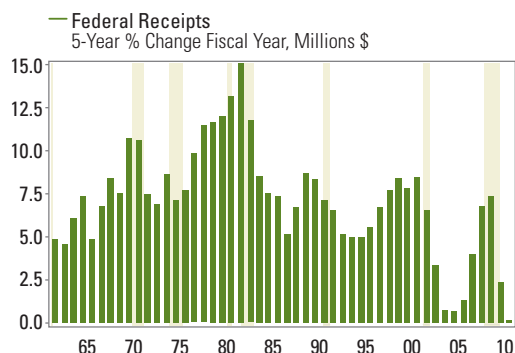


1 Even Before The Great Recession, Federal Spending Was Booming...



Source: Office of Management and Budget/Haver 11/08/10
Shaded areas indicate recessions.

2 ...and Receipts Were Slowing, an Unsustainable Combination over the Long Term



Source: Office of Management and Budget/Haver 11/08/10
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costs on the debt are low and falling, and the United States has never defaulted on its debt.

As a reminder, the U. S. government ended FY 2010 with \$1.29 trillion deficit, equal to 8.9% of gross domestic product (GDP), a modest improvement over the \$1.42 trillion gap that made up 10% of GDP in fiscal year 2009. Looking ahead, the non-partisan Congressional Budget Office (CBO) projects that under current law (assuming, among other things, that all the Bush era tax cuts expire at the end of calendar year 2010), the annual budget deficit will “improve” to \$1.066 trillion in FY 2011, which ends on September 30, 2011.

However, the CBO forecasts that if the Bush tax cuts are extended, and more realistic economic assumptions are used, the deficit in the current fiscal year (FY 2011) will approach \$1.4 trillion. Longer term, the United States needs to spend less, take in more revenue and save more. In [Chart 1](#)—which shows the five year annualized growth rate of federal spending—we see that in the five years ending in 2006 (before the Great Recession hit) Federal outlays increased at a 7.3% annualized pace, the fastest pace of spending in more than 20 years. The revenue side is just as compromised, as revenues increased at less than 4% per year over the five years ending in 2006, and that was before the Great Recession began to take its toll on both individual and corporate income tax receipts [[Chart 2](#)]. Obviously, it is not sustainable over the long run to have spending running nearly twice as fast as tax receipts. As a result, over the longer term, both sides of the issue have to be addressed.

The “debt ceiling” (the nation’s credit card spending limit) is likely to come up for a vote in early 2011. This may prompt some talk about the deficit, but despite the change in control of the House of Representatives in last week’s midterm elections, the best guess is that policy makers will not sit down to make the difficult choices about what to cut and by how much until there is a true crisis.

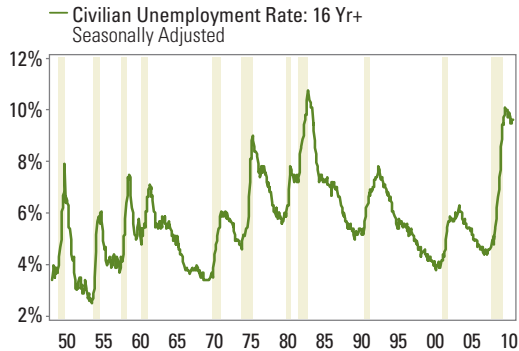
Is the Economy Reaccelerating?

The better-than-expected October jobs report raises the odds of a reacceleration in the economy, but it is still too soon to tell. The October jobs report corroborates the data we saw last week, for October (ISM, Service Sector ISM, vehicle sales, factory orders), all of which beat expectations, were better than the prior month, and saw upward revision to prior month's data.

The October employment report was an upside surprise, but suggests that there is more work to do on the labor market. The private sector economy added 159,000 jobs in October, well ahead of expectations of a gain of 80,000, and even well above the upper end of the range of economists' estimates (+20,000 to +135,000) for the report. The October data was relatively free of distortions and, on balance, the data suggest that the “soft spot” the economy endured during the late spring and summer months may have dissipated as fall began. The October jobs report did have its weak spots however, as 14.8 million people remain unemployed, another



3 The Unemployment Rate Remained Stubbornly High at 9.6% in October



Source: Bureau of Labor Statistics/Haver 11/08/10
Shaded areas indicate recessions.

7,000 state and local government workers lost their jobs in October, and the overall unemployment rate remained stubbornly high at 9.6% [Chart 3].

While the private sector economy has now added more than 100,000 jobs in each of the past four months, Congress, the Obama administration, and most importantly, the Fed, would like to see job growth in the 200,000 to 300,000 per month range. Why? With the labor force increasing by around 150,000 per month, it will take at least that many jobs (about 150,000 per month) just to keep the unemployment rate steady. Although the private sector has added back 1.1 million jobs (in the 12 months ending in October 2010), nearly 8.5 million jobs were lost during the Great Recession and its immediate aftermath. At the level of monthly job growth seen over the course of the past 12 months, it would take another six and a half years to get back to pre-recession levels on the job front.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance reference is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

Quantitative Easing is a government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity.

The Group of Twenty (G-20) Finance Ministers and Central Bank Governors is the premier forum for our international economic development that promotes open and constructive discussion between industrial and emerging-market countries on key issues related to global economic stability. By contributing to the strengthening of the international financial architecture and providing opportunities for dialogue on national policies, international co-operation, and international financial institutions, the G-20 helps to support growth and development across the globe.

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