

Weekly Economic Commentary



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Mid-July Fireworks

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Highlights

- The silver lining of European induced double-dip fears was evident in last week's data.
- In sharp contrast to last week, there is a ton of economic, policy news and events for markets to digest this week.

Economic Calendar

Tuesday, July 13	Initial Claims <i>wk 07/10</i>
Trade Balance <i>May</i>	PPI <i>June</i>
Treasury Statement <i>June</i>	Industrial Production <i>June</i>
Wednesday, July 14	Capacity Utilization <i>June</i>
Import Price Index <i>June</i>	Philly Fed Index <i>July</i>
FOMC Minutes	Friday, July 16
Retail Sales <i>June</i>	CPI <i>June</i>
Business Inventories <i>May</i>	U of Mich Consumer Sentiment <i>July</i>
Thursday, July 15	
NY Fed Empire State Mfg <i>July</i>	

Despite fireworks in the markets, last week was a relatively calm one for economic data and macro events. This week, however, will see a noticeable pickup in events. Data in the U.S. this week includes reports on manufacturing for July, retail sales, consumer prices and industrial production for June, and merchandise trade for May. The Federal Reserve (Fed) will release the minutes from the June 22-23 Federal Open Market Committee (FOMC) meeting, and will release a new economic forecast. This week is also a busy one overseas, with a full slate of Chinese data for June, along with a ton of data in Europe. Central bank meetings this week include the Bank of Japan, Thailand, and Chile. How the markets digest the slowing Chinese data, and what is likely to be data that continues to show a slowdown in growth (but not a double dip recession) in the United States and Europe will be a key driver this week.

While not the hotbeds of manufacturing activity they once were, the Philadelphia and New York Federal Reserve districts do provide markets a first look at manufacturing activity each month. Both of those reports (for July) are due out this week, and will draw considerable attention from the market. Data for June on retail sales, consumer and producer prices, and industrial production is also on tap this week. In addition, the weekly reports on retail sales, mortgage applications and initial claims for unemployment insurance, each a component of the LPL Financial Research Current Conditions Index, will provide an early look into economic activity in the United States in mid-July, as the third quarter gets underway.

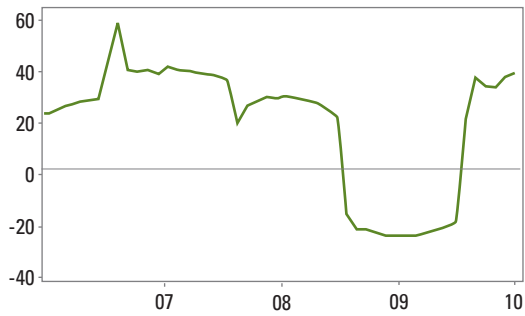
The Fed awakens from its summer slumber this week as well. The Fed's policymaking arm, the FOMC, will release the minutes of its June 22-23 meeting on Wednesday, July 14. The FOMC will also release the latest of its four quarterly economic forecasts on July 14. While the market has pushed the Fed to the sidelines for the remainder of 2010 and well into 2011, market participants will still obsess over the minutes and the forecast, looking for clues about the Fed's exit strategy, how it intends to reduce the size of its balance sheet, rate hike timing, and view on the economy here and overseas. Fed Chairman Ben Bernanke will deliver his semi-annual monetary policy testimony to Congress in mid-to-late July. The next FOMC meeting is August 10. We don't expect the Fed to change policy until 2011.

Central banks in Japan, Chile, Thailand, and the Philippines meet this week. Chile has already raised rates in this cycle, and Thailand is expected this week to join the list of more than 20 global central banks that have already increased interest rates in this cycle. The Bank of Japan remains firmly on the sidelines, and probably should be easing.



1 Chinese Data to Europe Remained Robust in June as the Market Continues to Obsess About a European Contagion

— China: Cumulative Exports to European Union
% Change- Year to Year
YTD, Ml. US\$



Source: Haver Analytics 07/12/10

This week is a busy one for economic data releases in China, as Chinese authorities will release the bulk of the data for June on the Chinese economy this week. Data on money supply, new loans, housing prices, exports, Gross Domestic Product (GDP), consumer prices, producer prices, retail sales, fixed investment, and industrial production are due this week. As this publication was being prepared, China had already released its money supply, trade balance, and new loan data for June. The market had been fearful that China tightened too far and too fast early this year. On balance, the data released in China thus far for June suggests that the policy tightening engineered in China beginning in late 2009 is having its desired effect. The economic data in China is decelerating, not plunging, and China seems poised for a successful soft landing.

The Chinese export data for June were being watched very closely, given the turmoil in many European economies, and market fears that fiscal restraint in Europe would begin to weigh on global growth. Here again, the market's worst fears about Europe were not confirmed by the June export data. Chinese exports rose a better-than-expected 44% year-over-year in June, but still decelerated from the 49% year-over-year gain posted in May. China's exports to Europe posted a 44% year-over-year gain in June, down from a 48% year-over-year gain in May. Year-to-date, Chinese exports to Europe were up 36% in June versus 32% in May. By comparison, Chinese export growth to Europe in the booming mid 2000s (2002-2007) averaged 33% per year.

It is another busy week for economic data in Europe, as the Continent tries to return to work after the month-long World Cup odyssey that kept many Europeans glued to their TV sets. Key data in Europe this week includes the crucial German ZEW sentiment data for July, as well as measures of consumer and producer prices for several other European nations for June. In addition, the June labor market data in the United Kingdom is set to be released this week. Market participants continue to try to gauge the health of the economy in Europe and the United Kingdom just prior to the onset of what are likely to be significant government spending cuts and meaningful tax increases.

What We Make of the Key Reports and Events of Last Week

Despite sparks in the financial markets last week, the economic and policy calendar was relatively quiet. The news that was released, however, was at or above expectations. This was one of the positive catalysts for markets last week after nearly six weeks of economic data and policy events that fell short of expectations, fanning the double-dip talk that was rampant over much of May and June.

Last week's data, as sparse as it was, did remind investors that while risks remained for the economic recovery United States and throughout the globe, those risks were probably too exaggerated in recent weeks. Last week's data on weekly retail sales for early July and chain store sales for June reminded investors that consumer spending—which accounts for nearly 70% of gross domestic product—remained solid in June and early July, despite weak readings on consumer confidence. We often write that the market spends too much time focusing on what consumers are feeling (consumer confidence/sentiment) and not enough time of what consumers are doing (spending or not spending).



While it is not clear that all the newly unemployed Census workers are eligible to receive benefits, our understanding is that all of them are being encouraged to file for benefits.

2 Initial Filings for Unemployment Benefits May Have Been Skewed Higher by Census Workers in Recent Weeks



Source: Bureau of Labor Statistics/Haver Analytics 07/12/10
Shaded areas represent recessions.

Solid, but not spectacular news on spending for June and early July, in our view, are most likely the result of some of the silver linings of the European fiscal and economic turmoil that had been ignored by markets for most of May and June. Largely because of market actions to position for a double-dip recession related to the slowdown in Europe, Treasury yields plunged, leading to sharply lower mortgage rates and an 86% surge in mortgage refinance applications since the end of April. Similarly, low consumer energy prices are up just 2% this year and have put extra discretionary spending money on consumers' pockets. In contrast, gasoline prices normally rise between 20 and 30% between the beginning of the year through early July.

Finally, the data on initial filings for unemployment insurance last week showed a sizeable drop in claims, as the fewest new claims for unemployment benefits were filed last week than at any time since early May. The market may be coming around to the realization that the claims data have been held artificially high by some 400,000 or so laid off Census workers filing for benefits over the last seven weeks. Since Census related employment peaked in the week of May 8 at 585,000, the number of Census workers on the government payrolls had shrunk by 418,000 to 167,000 by the end of June. While it is not clear that all the newly unemployed Census workers are eligible to receive benefits, our understanding is that all of them are being encouraged to file for benefits. If that is the case, then an additional 60,000 jobless claims were filed each week over the past seven weeks by Census workers, which suggests that the true level of claims is much closer to 400,000 per week than the 460,000 per week average over the past four weeks. Over the last 25 years, the private sector economy is much more likely to generate jobs when claims are between 375,000 and 400,000 per week than when claims are between 450,000 and 500,000 per week.

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