

# Weekly Economic Commentary



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## The Great Debate Continues

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#### Highlights

- This week's batch of economic indicators in the United States is unlikely to settle the great double-dip recession debate.
- Last week's economic data in the United States was again a mixed bag, while growth in some parts of the world continues to be strong enough to warrant interest rate hikes.

#### Economic Calendar

<b>Monday, August 16</b> NY Fed Empire State Mfg <i>August</i>	<b>Thursday, August 19</b> Initial Claims <i>wk 08/14</i>
NAHB Housing Survey <i>August</i>	Leading Indicators <i>July</i>
<b>Tuesday, August 17</b> Building Permits <i>July</i>	Philly Fed Index <i>August</i>
Housing Starts <i>July</i>	
Producer Price Index (PPI) <i>July</i>	
Industrial Production <i>July</i>	
Capacity Utilization <i>July</i>	

Amid persistent market concern about a double-dip recession in the United States, the economic calendar this week, though light, will provide plenty of opportunity for debate. Data for July and August on manufacturing, housing, producer prices and leading indicators are due out this week. None of the reports, however, is likely to be the silver bullet that puts the double-dip debate to rest. It is a relatively quiet week for Federal Reserve policymakers, with only a few scattered public appearances. Overseas, seven central banks are set to meet on monetary policy, but none are expected to take action on rates. While it is a relatively quiet week in China for economic data, it is shaping up to be a busy one in Europe and the United Kingdom, as the markets await the impact of the tax increases and budget cuts put in place over the past few months on the economic data.

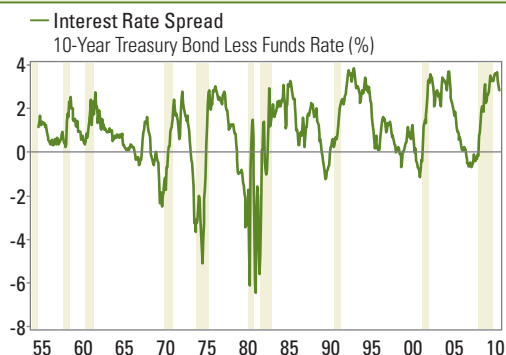
A significant portion of the U.S. economic data released in recent weeks has fallen short of expectations, and often represents a downshift in activity from the prior month. This week's batch of data for July and August on manufacturing, housing, producer prices and leading indicators may challenge this new paradigm, but is not likely to convince either the economic bulls or bears that their view is correct. Our view remains that economic growth in the second half of 2010 will be slower than growth in the first half.

However, the deterioration of other data points might also signal the onset of a recession. For example, the weekly data on initial filings for unemployment insurance, chain store sales and mortgage applications—all part of the LPL Financial Research Current Condition Index, provide a real time view into the health of the economy. Sustained slowing of any of these indicators would be a concern. In addition, with the economy already slowing, the United States economy remains vulnerable to any sort of economic or geopolitical shock, which could tip the economy back into recession later this year or in early 2011. As always, we will continue to monitor the incoming data, events, and policy for signs that the U.S. economy is headed toward a double-dip. For now, slow growth is the base case outcome over the second half of 2010.

Overseas, with the monthly economic data for July now in the history books, the focus this week will be on Europe and the United Kingdom. This week, the key reports are likely to be the July retail sales data in the United Kingdom and the August ZEW survey in Germany. The ZEW is a monthly survey of financial market "experts", that asks about the direction of inflation, interest rate, exchange rates and the German stock market. It is a very timely report, (this week's data point is for August), and as a result, financial markets often react to its release. We note that the economic



## 1 A Steep Yield Curve is One of the Many Signals Arguing Against a Double-Dip Recession in the United States



Source: Federal Reserve Board/Haver Analytics 08/16/10  
(Shaded areas in chart indicate recessions)

While the odds of a double-dip recession have risen lately (to around 20% in our view), the main conditions for a double-dip are not in place at this moment:

- An inverted yield curve: short-term Treasury yields moving above long-term Treasury yields
- Tightening of monetary policy
- A spike in consumer energy prices
- A sudden move toward fiscal restraint
- A lurch toward protectionism here and abroad
- A seize up of interbank lending markets

## 2 The Chinese Economy Continued to Decelerate in July from an Unsustainable Robust Rate of Growth Seen in Early 2010



Source: Chinese National Bureau of Statistics/Haver Analytics 08/16/10

data released in Europe over the past several weeks continues to be better than expected and, ironically, better than the economic data released in the United States, but Europe has yet to feel the pinch of the tax increases and spending cuts that were made in late spring and early summer.

Aside from a few scattered speeches from Fed officials this week, it is a relatively quiet week for the Fed. There are eight global central banks slated to meet to set policy this week, and for the first time in many weeks none of the eight (Iceland, India, Hong Kong, Turkey, Columbia, Mexico, Serbia and Georgia) are expected to raise rates. The only rate action expected this week is a rate cut from the central bank of Iceland.

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

The data released in the United States last week did little to resolve the market's debate about the fate of the U.S. economy in the second half of 2010. While stronger-than-expected readings on consumer price inflation in July, business inventories in June, and consumer sentiment in the first half of August were welcome news, there were an equal number of data reports that disappointed markets. The wider-than-expected merchandise trade deficit for June, the weaker-than-expected reading on retail sales in July, along with the disheartening rise in initial claims for unemployment insurance in the latest week, kept the double-dip fears in the United States alive for another week. Last week's data continue to argue for slow growth in the second half of 2010, not a double-dip.

A major theme in markets last week was the ongoing slowing in the Chinese economy. Last week saw the release of the bulk of the market-moving Chinese economic data for July. On balance, the data continued to suggest that as the second half of 2010 began the Chinese economy was slowing from its unsustainable growth rate of 12%+ hit in early 2010. The data was further confirmation that the tightening policies put into place by Chinese authorities in late 2009/early 2010 are having their intended effect. Markets have become much more comfortable with a slowing Chinese economy as a more acceptable outcome than an overheating Chinese economy cooled down by a massive dose of policy tightening. Although there is still plenty of concern surrounding the overheated Chinese property market.

Aside from the Fed, it was a busy week for global central banks last week. The Bank of Japan and the central banks of Norway and South Korea held rates steady, while the central bank of Chile raised rates, as expected, for the third time this year. Indonesia, which has been tightening policy since May nudged rates higher again last week. Indonesian Gross Domestic Product (GDP) growth was north of 6% in the second quarter while domestic consumer prices rose at a 6.2% year-over-year pace in July.



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Government bonds and Treasury Bills are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value. However, the value of funds shares is not guaranteed and will fluctuate.

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