

# Weekly Economic Commentary

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### Highlights

- Market participants will have to look elsewhere for direction this week amid a quiet week for economic reports in the United States.
- On balance, the backdrop for hiring remains supportive for modest job creation in the coming months.
- There are several key reports on the Japanese economy for May due out this week that are expected to show that the pace of recovery in Japan hastened in May.

### Economic Calendar

<b>Tuesday, June 7</b> Consumer Credit <i>April</i>	<b>Friday, June 10</b> Import Price Index <i>May</i>
<b>Wednesday, June 8</b> Beige Book	Treasury Statement <i>May</i>
<b>Thursday, June 9</b> Initial Claims <i>wk 06/04</i>	
Trade Balance <i>April</i>	
Wholesale Inventories <i>April</i>	

## Waiting for the Turn

Market participants will have to look elsewhere for direction this week amid a quiet week for economic reports in the United States. Policy events at home and abroad could help fill the void. The May jobs report was a disappointment any way you look at it, but we will examine whether it was the start of a new trend. Japan's economy is still transitioning from recovery to rebuilding in the wake of the March 11 earthquake.

### Policy, Not Data, Likely to Move Markets this Week

The week after the release of the monthly jobs report (released Friday, June 3) is typically a quiet one for economic data, and this week fits that pattern. Other than the usual weekly readings on retail sales, initial claims for unemployment insurance and mortgage applications, there are no market-moving economic reports due out in the United States this week. The data that is due out—trade deficit and wholesale sales and inventories—is both “old” (for April) and considered second-tier by market participants.

The lack of a robust calendar of U.S. economic data this week will force markets to focus on policy and overseas events. The Federal Reserve (Fed) will release its Beige Book (a qualitative assessment of economic and business conditions in each of the 12 regional Federal Reserve districts), and a plethora of Fed speakers are on tap. Speeches by hawks (those favoring a tighter monetary policy) outweigh appearances by monetary policy doves (those who generally favor easier monetary policy). As we have noted in the past, while the hawks and doves on the Fed seem to garner the most attention from the financial media, it is the center of gravity at the Fed-Chairman Ben Bernanke, Vice Chairwoman Janet Yellen and New York Fed President Bill Dudley, that will likely dictate Fed policy in the coming months. All three are slated to speak this week. Any shift in tone (which has been toward easier policy for longer) from this group would be notable. The next Fed policy meeting is June 22. Fed Chairman Bernanke will hold a press conference that day and the Fed will also release its latest economic forecast as well.

Overseas this week, markets remain vigilant for another rate hike in China as Chinese authorities are expected to release some of China's economic indicators for May. Although China's economy has decelerated over the past year (from 12% to near 10%), economic growth has not slowed enough to cool domestic inflation. The desire to cool the pace of inflation in China is driving China's central bank, the Peoples Bank of China, to raise interest



## 1 As China's Economy Has Cooled, Inflation Has Heated Up, Prompting Higher Rates From China's Central Bank



Source: China National Bureau of Statistics/Haver Analytics  
06/06/11

There was some evidence in the May jobs report of downward pressure on jobs from the Japanese earthquake, the late Easter, poor weather, and higher oil prices, although even excluding these factors, the report would have represented a deceleration in job creation relative to recent trend.

rates. We, and the market, expect a few more rate hikes in China over the coming months.

Outside of China, monetary and fiscal policy is in focus overseas this week, as central banks in Europe, the United Kingdom, Australia, New Zealand, South Korea, Brazil, India, Peru and Indonesia are set to meet. Of these central banks, South Korea, Peru, Brazil and India are expected to raise interest rates this week. More than 25 central banks around the globe are already raising rates to combat domestic inflation brought on by soaring economic growth, and all the banks expected to raise rates this week are in that group. Central banks in Australia, Indonesia, and New Zealand have also raised rates in the past few years, but have paused recently.

Meanwhile, most developed economies' central banks have continued to maintain accommodative monetary policy as these economies struggle with slow growth and more restrictive fiscal policy. Although the ECB did raise rates earlier this spring, the latest flare-up in the fiscal woes in peripheral Europe (Greece, Portugal, and Ireland) has put the ECB back on hold. The Bank of England (BOE) is on hold as well, as the large cut in public spending enacted by the UK government in 2010 begins to take hold.

## May Jobs Report a Disappointment, But Not Likely to be the Start of a New Trend

The weak May employment report confirmed the recent lull in economic activity, but in our view does not represent the start of a new trend for the economy or the job market. The private sector economy created just 83,000 jobs in May 2011, far short of lowered expectations, which fell dramatically in the days leading up to the jobs release. Despite the disappointment, the private sector economy has created jobs for 15 straight months, totaling 2.1 million jobs, but there is still a long way to go to recoup the 8.8 million jobs lost in the Great Recession. There was some evidence in the May jobs report of downward pressure on jobs from the Japanese earthquake, the late Easter, poor weather, and higher oil prices, although even excluding these factors, the report would have represented a deceleration in job creation relative to recent trend.

The 5,000 drop in manufacturing jobs between April and May reflected both unusually severe weather in the Midwestern and Southern United States in May, as well as supply chain disruptions associated with the earthquake, tsunami and nuclear disaster in Japan. The late Easter (Easter fell on April 24, 2011, which is the latest that Easter has occurred in nearly 70 years) most likely contributed to the seasonally-adjusted 9,000 drop in retail employment in May (after a huge 64,000 gain in April) and to the 6,000 drop in employment in the leisure and hospitality industry in May, following average monthly job gains of 45,000 in this category in February, March and April. Higher oil prices may also have impacted both retail and leisure employment as more money spent by consumers on gasoline means less money available to spend on clothing and travel.

Looking ahead to June, the late Easter impact will fade and if the weather cooperates, we should see a return to an average of about 200,000 job



## 2 Layoff Announcements are at a 13-Year Low



Source: Challenger, Gray & Christmas/Haver Analytics 06/06/11

The data released over the past week or so in both Japan and outside of Japan, suggests that a turn in the Japanese data is at hand, although evidence of the impact of the quake is likely to persist for a while longer.

growth per month. However thus far in June we have seen tornados in Massachusetts and areas in the Midwest and West are bracing for historic flooding following near record snowfall this past winter. On the supply chain front, there are some signs (see section below) that Japan has finally moved from the cleanup phase to the recovery and rebuilding phase nearly three months after the devastating earthquake and tsunami hit on March 11. This should help manufacturing employment bounce back in June and the months ahead.

Fundamentally, the backdrop for hiring in the United States remains solid, but not spectacular. Corporate profits are at a new all-time high, companies have plenty of cash, financing costs are low, banks are more willing to lend to businesses today than at any time in the past five years and credit markets are functioning better now than at any time in four years. In addition, the economy has been in recovery for two years, jobs have been added in each of the past 15 months, and growth in emerging market economies (where we send 50% of our exports) remains robust. Finally, layoff announcements over the past 12 months (476,000) were the fewest in any 12 month period since 1998, when the unemployment rate was 4.5%.

While the low level of layoff announcements suggests that businesses are confident that the recession is over, obstacles remain to hiring. In the financial sector, the Dodd- Frank regulatory burden is still being absorbed by banks and other financial institutions, making planning and hiring difficult. Uncertainty over monetary and especially fiscal policy at home and abroad is being met with caution among business owners, especially among small businesses who account for two-thirds of job creation. Finally, while credit to businesses from the banking system is flowing as freely as it has in several years, the terms of the credit are not quite as generous as they were in the mid-2000s.

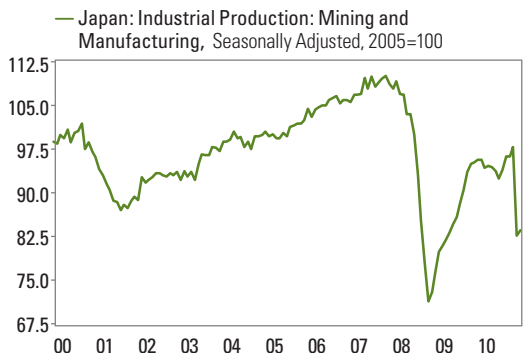
On balance, the backdrop for hiring remains supportive for modest (200,000 to 250,000 net new jobs per month) job creation in the coming months, but it is still likely to take the economy several more years before it recoups all of the jobs lost during the Great Recession.

## An Update on Japan

On balance, market participants probably underestimated the impact of the March 11 earthquake in Japan (the world's third largest economy) and its aftermath on the global economy. The market expected some supply chain disruptions as a result of the quake, tsunami and nuclear disaster, but the market probably underestimated both the severity and duration of the disruption. Looking ahead, while there is not as much high frequency (daily, weekly) economic data in Japan as there is in the United States, the data released over the past week or so in both Japan and outside of Japan, suggests that a turn in the Japanese data is at hand, although evidence of the impact of the quake is likely to persist for a while longer.



### 3 The Post-Quake Economic Data in Japan Has Probably Stopped Getting Worse



Source: METI/Haver Analytics 06/06/11

Signs that the Japanese earthquake would have a more pronounced impact on the global economy were evident in the 15% month-over-month drop in Japanese industrial production in March versus April. Other signs included:

- A 37% year-over-year plunge in vehicle sales in March 2011 versus March 2010.
- The 20 point drop in the key “economy watchers” diffusion index from 48.4 in February 2011 to 27.7 in March 2011, indicating only about one-quarter of respondents thought conditions were improving in March down from one half of respondents in February.
- The 15% year-over-year drop in department store sales in March.

As the April data was being reported in early May, the situation looked even worse. After plunging 37% year-over-year in March, vehicle sales fell 51% year-over-year in April. Even the economic data in the United States felt the impact, most notably the big drop in the Institute of Supply Management’s (ISM) non-manufacturing index for April report released in early May.

By mid-May, there were signs of a bounce back in Japan, although a more muted one than expected by the market. In short, the incoming data in Japan had stopped getting worse, a key precondition for data getting better

- The Economy Watchers survey improved to 28.3 in April from 27.7 in March, but remained well below the pre-quake peak.
- Machine tool orders, which plunged 8.0% year-over-year in March, rose 6.8% in April, but remained well below pre-quake levels.
- Department store sales, which plunged 15% year-over-year in March, fell by only 1.5% year-over-year in April
- Overall retail sales, which fell 8% month-over-month in March, posted a 4% month-over-month gain in April.
- Industrial production, which fell 15.0% month-over-month between February and March rose 1.0% between March and April, and private sector surveys suggest that Japanese industrial production will accelerate sharply in both May and June

Over the past week or so, some of the incoming Japanese data for May suggests that the rebuild effort picked up steam in May. Even some of the U.S. economic data most impacted by the quake looked better. For example, the ISM’s non-manufacturing index moved from 53.8 in April up to 54.6 in May, reversing some of the post-quake losses seen in the April report. In addition, Japan’s ISM index for May moved higher after falling in March and April, and Japan’s non-manufacturing ISM rose to 43.8 in May from 35 in March and near 34 in April. The pre-quake reading here was 50.

There are several key reports on the Japanese economy for May due out this week (Economy Watchers, consumer sentiment and machine orders) that are expected to show that the pace of recovery in Japan hastened in May.



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The ISM index is based on surveys of more than 300 manufacturing firms by the Institute of Supply Management. The ISM Manufacturing Index monitors employment, production inventories, new orders, and supplier deliveries. A composite diffusion index is created that monitors conditions in national manufacturing based on the data from these surveys.

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