

# Weekly Economic Commentary



June 21, 2010

## No Summer Doldrums This Week

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#### Highlights

This week marks the beginning of summer in the Northern Hemisphere, but it's likely to be anything but the start of the summer doldrums for economic, monetary, and policy actions in the United States and abroad.

With the exception of one or two reports, last week's batch of economic data in the United States was underwhelming, adding to "soft spot" fears.

#### Economic Calendar

##### Tuesday, June 22

Existing Home Sales  
*May*

Richmond Fed Mfg Index  
*June*

##### Wednesday, June 23

New Home Sales  
*May*

FOMC Meeting

##### Thursday, June 24

Durable Goods  
*May*

Initial Claims  
*wk 06/19*

##### Friday, June 25

Core PCE Deflator  
*Q1*

GDP Price Index  
*Q1*

Real GDP  
*Q1*

U of Mich Consumer  
Sentiment  
*June*

Economic, monetary, and regulatory policy is likely to take center stage this week, as the economic data, soft of late, fades in importance. In addition to handicapping the outcome of the Federal Reserve (Fed) Federal Open Market Committee (FOMC) meeting, market participants will be mulling over the decision by Chinese authorities to allow the Chinese currency, the yuan, to move higher versus the US dollar. The stress tests currently being conducted on European banks will also be in the headlines this week, ahead of the meeting this weekend (June 25-27) of the Group of 20 (G-20) nations in Toronto. Finally, Congressional conferees will continue to hammer out the differences between the House and Senate versions of the financial regulatory reform bill. This issue has been on the back burner—and simmering for several weeks now—and could flare up again in the next few weeks. Our view is that it is unlikely that significant progress will be made before the July 4 recess.

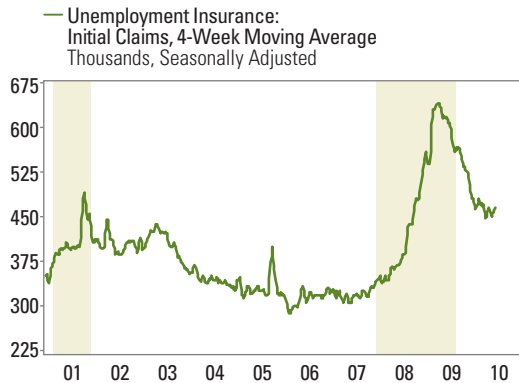
There is no economic data due out in China this week, while the economic data in Europe (manufacturing, consumer spending, and employment) will be closely watched for evidence that the measures taken by many European governments to cut government spending are hurting economic activity. Aside from the FOMC meeting, several central banks are scheduled to meet this week, including Hungary, Serbia, Czech Republic, Norway, and Taiwan. Of these, only Norway is in tightening mode, though another rate hike from Norway is not expected this week.

The FOMC is expected to leave its overnight lending rate unchanged, and is likely to retain the "extended period" language in the statement released along with the rate decision. Heading into 2010, both LPL Financial Research and the market expected the Fed to begin hiking rates by mid-year 2010. However, now both LPL Financial Research and the market expect the Fed to remain on hold until early 2011. Policy tightening in China, low inflation in the United States, and most of all, uncertainty surrounding the impact of the European debt issue has pushed back expectations of the first Fed rate hike in this cycle.

While markets do not expect any action on rates at this week's FOMC meeting, the statement released at the end of the meeting will be closely scrutinized for any clues as to when the Fed may hike rates. In the statement, the FOMC is likely to upgrade its overall view of the economy, note the low inflation readings, and is likely to refer to the still-unfolding fiscal situation in Europe. While the market would embrace it, the FOMC is unlikely to formally codify the timing and order of its "exit strategy" (raising rates, draining its balance sheet, selling Mortgage-Backed and Treasury securities) in the statement at this meeting. The FOMC will also make a



## 1 Initial Filings for Unemployment Insurance Remain in a Rut



Source: Department of Labor/Haver Analytics 06/21/10

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new economic forecast at this meeting. That forecast will be made public (along with the minutes of the meeting) on July 14. Fed Chairman Bernanke will deliver his semiannual Monetary Policy testimony in late July.

The "stress tests" of the 25 largest European banks have been in the news lately, and the news flow on this topic is likely to intensify this week. Unlike in the U.S.—which conducted stress tests on 19 large banks in early 2009 using clearly defined scenarios and criteria for the tests—the scenarios and criteria being used in the European Union and the United Kingdom stress tests have not been made public. The debate around whether or not to make the results of the tests, some of which have been in progress for several years, seemed to end late last week (June 14-18) when the European Union (and the United Kingdom) agreed that the results of the stress tests would be made public in the second half of July. The tests are being conducted by each member country's central monetary authority, and it is not clear if the criteria being used is the same across all the countries and banks.

## What We Make of Last Week's Reports and Events

As discussed in detail in this week's (June 21) *Weekly Market Commentary*, the economic data released last week (and over the course of the past month or so), suggests that the U.S. economy has hit a "soft spot". Historically, a soft spot in the economy often occurs as leading indicators of economic activity peak—as they are now—which often happens about a year after the onset of an economic recovery.

In our view, the economic data released last week may provide a preview of the "two steps forward, one step back" economic data that we are likely to see in the coming months as the economy continues to make the transition from recovery to sustainable growth and expansion.

Most of the data released last week fell into the "soft spot" category including:

- Weekly retail sales for the week ending June 12
- First time filings for unemployment insurance for the week ending June 12
- Housing starts and building permits for May
- Homebuilder sentiment for June

However, data on mortgage applications in mid-June, consumer and producer prices, along with several reports on the manufacturing sector in May and June, suggested that the manufacturing sector in the United States is holding up quite well (despite turmoil in Europe, which absorbs 15 to 20% of United States' exports), and that inflation remains well contained.

Let's take a look at one report from each of the categories above:

Initial filings for unemployment insurance fell into the "soft spot" category. First-time filings for unemployment insurance remained stuck in neutral again last week, as 472,000 people filed for unemployment insurance, 12,000 more than the prior week. This pushed the 4-week average up to 464,000. [Chart 1] At 464,000, claims are still running nearly 200,000 lower per week than in March 2009, the peak month for claims in this cycle, but have been stuck in the 450,000 range since mid-March 2010. Markets



The May industrial production data are yet another sign that the European fiscal situation has not yet impacted the U.S. economy in any meaningful way.

## 2 The Manufacturing Sector Continues to Lead the Economic Recovery in the United States



Source: Federal Reserve Board/Haver Analytics 06/21/10  
Past performance is not a guarantee of future results.

would be comforted that the economy is making better progress toward a sustainable recovery if claims could resume their downward march and move below 400,000.

Unfortunately, several factors may be distorting the weekly claims data at the moment. It is not clear whether some, or all, of the 585,000 or so Census workers hired over the past six months are eligible to file for jobless claims when their assignments with the Census Bureau run out. Since mid-May (the peak of Census-related employment), roughly 170,000 Census workers have fallen off the government payrolls. The other factor we are watching is the impact of the oil spill on jobless claims in the affected states. State-by-state counts of initial claims for unemployment insurance lag to overall claims count by one week. In the latest week available (June 5), 5,200 people filed for unemployment insurance in the state of Louisiana. That is the same number as in the prior week, up from the 4,100 claims filed per week in the month prior the spill.

On the other hand, all of the manufacturing reports last week were solid. The first look at manufacturing activity in June (the Empire State manufacturing index) revealed that manufacturing (and exports) continued to boom in New York. All the major components of the report (orders, shipments, workweek), as well as the overall index, increased in June versus May, suggesting further gains for the manufacturing sector nationally in June. The report on manufacturing from the Philly Fed showed a similar result.

Surging exports and solid business capital spending continue to boost industrial production, the broadest measure of factory output in the United States. Industrial production rose a better-than-expected 1.2% in May versus April, with gains in virtually every component. The May industrial production data are yet another sign that the European fiscal situation has not yet impacted the U.S. economy in any meaningful way. [Chart 2] However, markets are quite sensitive to any signs that the European "contagion" has spread to the rest of the world, and each new data point on the U.S. and world economy provides another opportunity for the spillover from Europe to manifest itself.



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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.

Investing in international and emerging markets may entail additional risks such as currency fluctuation and political instability.

Investing in small-cap stocks includes specific risks such as greater volatility and potentially less liquidity.

Stock investing involves risk including loss of principal.

Consumer Price Index (CPI) is a measure estimating the average price of consumer goods and services purchased by households.

Producer Price Index (PPI) tracks inflation by measuring price changes.

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.

The Empire State Manufacturing Index is a seasonally-adjusted index that tracks the results of the Empire State Manufacturing Survey. The survey is distributed to roughly 175 manufacturing executives and asks questions intended to gauge both the current sentiment of the executives and their six-month outlook on the sector.

Manufacturing Sector: Companies engaged in chemical, mechanical, or physical transformation of materials, substances, or components into consumer or industrial goods.

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