

# Weekly Economic Commentary

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## John Canally, CFA

Economist  
LPL Financial

### Highlights

- Housing and leading indicators lead the way this week, along with key testimony from Federal Reserve Chairman Bernanke.
- The economic volatility normally associated with this stage of a recovery was evident in last week's data and events.

If any of the reports show even a hint of stabilization in the housing market after the end of the first-time homebuyer tax credit in April, it would be welcome news for markets looking for some positive news on the economy.

### Economic Calendar

<b>Monday, July 19</b> NAHB Housing Survey <i>July</i>	<b>Thursday, July 22</b> Initial Claims <i>wk 07/17</i>
<b>Tuesday, July 20</b> Building Permits <i>May</i>  Housing Starts <i>June</i>	Existing Home Sales <i>June</i>  Leading Indicators <i>June</i>  Bernanke Testimony
<b>Wednesday, July 21</b> Bernanke Testimony	

## Economic Volatility Continues into July

Corporate earnings reports for the recently completed second quarter, the results of the European bank "stress tests", and testimony from Federal Reserve Chairman Ben Bernanke will dominate this week, as the economic calendar in the United States turns relatively quiet. With the Chinese economic data for June now in the rear view mirror, the market is likely to focus on the full slate of European economic data due out this week. Central banks in Hong Kong, Brazil, Canada, India, South Africa, Colombia, Serbia, and Hungary will meet this week. Rate hikes are expected from Canada and Brazil. Both have already been tightening policy in this cycle.

Although it is likely to be pushed to the background this week given all the other news and events on the docket, the data due out this week in the United States is likely to continue to fit into the "two steps forward, one step back" theme that has been in place since April 2010. The housing market is the key theme for the data with week, with reports due out on homebuilder sentiment for July and housing starts and existing home sales for June. If any of the reports show even a hint of stabilization in the housing market after the end of the first-time homebuyer tax credit in April, it would be welcome news for markets looking for some positive news on the economy. The index of leading economic indicators for June is due out this week as well, and that report is likely to confirm that leading indicators of economic activity have peaked (on a year-over-year basis), which is a normal occurrence a year after the onset of an economic recovery.

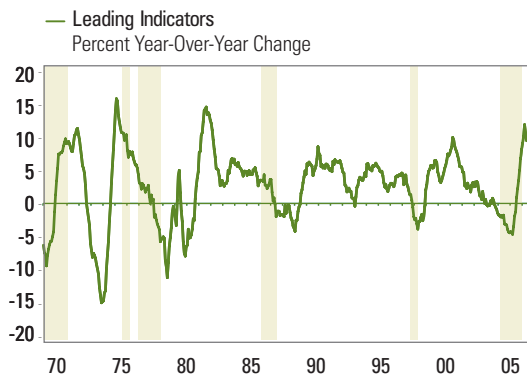
With the monthly reports on the economy in short supply this week, the weekly data on retail sales, mortgage applications and initial jobless claims will garner more attention. All three reports are components of the LPL Financial Current Conditions Index (CCI). We often stress the importance of what consumers do (consumer spending) rather than what they say (consumer confidence and sentiment). In the wake of the disastrous early July report on consumer sentiment (released on Friday, July 16), the retail sales report's reading on what consumers are doing (i.e. spending or not spending) is even more important.

Similarly, the weekly report on mortgage applications continues to show that low mortgage rates have convinced a sizeable number of homeowners to refinance their existing mortgages. However, the end of the first time homebuyer tax credit has severely—though perhaps only temporarily—dampened demand for housing.

Finally, the weekly data on initial filings for unemployment insurance continue to provide the best "real-time" look at the health of the labor market, although the claims data continues to be beset by distortions.



## 1 Economic Indicators Are Peaking, which is Typical at this Point in a Recovery



Source: Bloomberg 06/18/10  
(Shaded areas in chart indicate recessions)

In his semiannual Monetary Policy testimony to Congress this week, Fed Chairman Bernanke is likely to continue to express concern about the pace of the economic recovery, but is likely to testify that the economic expansion will continue.

You know it was not a very good week for economic data when the best news of the week was that the monthly Federal budget deficit for June was “only” \$68.4 billion instead of the \$69.0 billion that was expected.

The distortions include the winding down of the 2010 Census and the lack of the usual summer shutdowns at many auto plants—both of which are pushing down on the weekly claims count. Meanwhile, the oil spill in the Gulf of Mexico and widespread teacher and administrative layoffs in school districts across the country, as a result of state and local budget cuts, are putting upward pressure on claims.

In his semiannual Monetary Policy testimony to Congress this week, Fed Chairman Bernanke is likely to continue to express concern about the pace of the economic recovery, but is likely to testify that the economic expansion will continue. He may sound a cautious note on the housing market and bank lending, and is likely to give Congress another stern warning about the federal debt and budget deficit. He is also likely to provide an update on the situation in Europe. Finally, Bernanke is likely to field numerous questions from legislators (looking to score election year points) on topics ranging from the financial crisis, to financial regulatory reform, to the Fed’s own balance sheet and the lack of lending by banks to small businesses.

There is a plethora of economic data due out this week for May, June and July in the United Kingdom and Europe. With many countries already implementing tax increases and government spending cuts, markets are taking a “wait and see” attitude on the expected economic slowdown in the United Kingdom and Europe. The data due out this week will help to solidify the market’s view on the health of those economies as the tax increases and spending cuts are beginning to bite. On balance, we would expect that the tax increases and government spending cuts enacted in Europe in the spring and early summer of 2010 will slow economic activity in Europe in the second half of 2010 and into 2011. In early 2011, the UK will enact a tax increase that will slow growth there. Heading into this year, the market didn’t expect much in the way of growth (1.0% or so) from Europe in 2010. But while market participants have revised down their forecasts for European growth in 2010 and 2011, estimates for global GDP growth have moved up for 2010, and are little changed (versus the beginning of the year) for 2011 and 2012.

## What We Make of Last Week’s Key Reports and Events

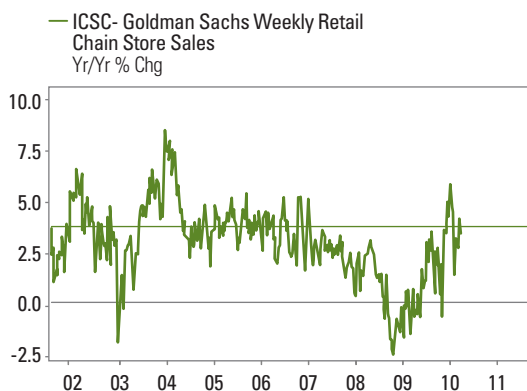
You know it was not a very good week for economic data when the best news of the week was that the monthly Federal budget deficit for June was “only” \$68.4 billion instead of the \$69.0 billion that was expected. Aside from that report and the big dip in first-time filings for unemployment benefits, the rest of last week’s data:

- a) was worse than expected,
- b) showed deterioration from the prior month or period, and
- c) continued to show a decelerating trend, after rising sharply in the first 12 months of the recovery.

While it is not unusual to see the economic data take a breather after steadily beating expectations (and the prior data point in the series) for



## 2 While Consumer Sentiment Fell in Early July, Consumer Spending Remained in Line With the Pace Seen During the Mid 2000s Recovery



Source: ICSC Goldman Sachs Haver Analytics 07/19/10

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nearly a year after the onset of a recovery, the data has been stuck in this “soft spot” pattern now for nearly three months now. The “soft spot” has increased market talk about a “double dip” recession, and last week’s data and events, including a downgrade of the economic forecast by the Fed’s Federal Open Market Committee (FOMC), were weak enough to offset a decent first week of earnings season and send equity markets over a percent lower on the week.

Probably the most worrisome report last week for markets was the big drop in the University of Michigan’s Consumer Sentiment Index in the first half of July. Sentiment fell by nearly 10 points (from 76.0 to 66.5) between the end of June and mid July, leaving consumer sentiment at its lowest level in nearly a year.

Both current conditions and consumer expectations fell by close to 10 points. The market spends too much time focusing on what consumers are feeling (consumer confidence/sentiment) and not enough time on what consumers are doing (spending or not spending). The market’s sharp negative reaction on Friday, July 16 to the weak July consumer sentiment data was even more confusing. There are consumer sentiment polls taken every day, and that polling data is widely distributed and well known in the marketplace. One of those metrics, The Rasmussen daily Consumer Sentiment Index, fell sharply between the end of June and the middle of July, providing the market with a decent indication that consumer sentiment (as measured by the University of Michigan) was due for a sharp decline as well. Instead, the market interpreted the University of Michigan consumer sentiment data as “new news” and sold off sharply, turning a bad day in the equity market into an awful one.

Last week’s data on weekly retail sales for mid July revealed that while sales dipped in the week after the Fourth of July holiday, sales are still up 3.2% from a year ago, despite weak readings on consumer confidence. By comparison, during the 2002-2007 economic expansion, weekly retail sales posted an average year-over-year gain of 3.5%. Based on the weekly sales data, sales in July are expected to be up between 3% and 4% year-over-year. We note that the early part of July marks the transition from the summer selling season to the all-important “back to school” selling season.

In a widely ignored report released last week, the National Retail Federation — not known to make overly robust forecasts—said that back to school sales may rise as much as 16% this year versus the similar period in 2009. We will continue to watch the weekly retail sales data, and look ahead to the July same store sales data (due out in early August) for an early look into the 2010 back to school selling season.



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

The Rasmussen Consumer and Investor Indexes are derived from nightly telephone surveys of 500 adults and reported on a three-day rolling average basis. The Consumer Index measures the economic confidence of consumers.

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