

Weekly Economic Commentary



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Not So Cloudy

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Highlights

- The Federal Reserve's latest Beige Book helped confirm that the U.S. economy picked up steam as 2011 ended and 2012 began.
- The latest Beige Book also showed considerable improvement versus the November Beige Book, and both have improved drastically versus 2009, despite the financial media's instance that "this is just like 2008/2009."

Economic Calendar

| | |
|------------------------------|---------------------------|
| Tuesday, January 17 | Building Permits |
| NY Fed Empire State Mfg | <i>Dec</i> |
| <i>Jan</i> | Housing Starts |
| Wednesday, January 18 | <i>Dec</i> |
| PPI | CPI |
| <i>Dec</i> | <i>Dec</i> |
| Capacity Utilization | Philadelphia Fed Index |
| <i>Dec</i> | <i>Jan</i> |
| Industrial Production | Friday, January 20 |
| <i>Dec</i> | Existing Home Sales |
| NAHB Housing Survey | <i>Dec</i> |
| <i>Jan</i> | |
| Thursday, January 19 | |
| Initial Claims | |
| <i>Wk 1/14</i> | |

In last week's commentary, we discussed whether or not economic momentum exists at all, and if so, did the economy have any forward momentum as 2011 ended and 2012 began. The Federal Reserve's Beige Book, a qualitative assessment of banking and business conditions in each of the Fed's 12 regional districts, was released last week, and helped to confirm that the U.S. economy did pick up steam as 2011 ended and 2012 began. In addition, a comparison of the last two Beige Books (released in November 2011 and last week) to the Beige Book released three years ago (January 2009), during the worst of the Great Recession, reveals that contrary to multiple reports in the financial media in recent weeks and months, this is not "just like 2008/09."

The still-struggling housing market is likely to dominate this week's U.S. economic calendar, although manufacturing, inflation, the labor market, and consumer spending will each have their turn. Despite some signs of modest progress in recent months aided by record low mortgage rates, market participants do not expect the housing market to contribute much to the economy in 2012, so the bar remains low for any housing-related data reports. On the other hand, the manufacturing sector is expected to make a meaningful contribution to economic growth in 2012, so any signs that the imminent recession in Europe or the slowdown in China has curbed activity in the manufacturing sector would be unwelcome by markets and could herald a shift in economic momentum. Inflation has not been a concern in the markets or the financial media since spring 2011, and that trend should continue this week as the December consumer price index (CPI) and producer price index (PPI) are released. Financial market participants largely shrugged off the reports released last week that weekly retail sales in the first week of the New Year posted a large week-over-week drop and that initial claims for unemployment insurance spiked higher in that same week. The market would be comforted if claims fell and weekly retail sales posted gains this week. If they do not reverse, the recent positive media narrative on the economy could begin to wane. It is a quiet week for Fed speakers ahead of next week's Federal Open Market Committee (FOMC) meeting.

Overseas, the Chinese GDP data for the fourth quarter of 2011, released on January 16, revealed that while Chinese economic growth exceeded expectations in the four quarters ending in the fourth quarter of 2011, the 8.9% growth rate was the slowest pace of growth in China since mid-2009. The slowdown in growth in China, along with the continued deceleration in inflation,

The latest two Beige Books do not describe a booming economy, but are a far cry from the economy described in the January 2009 Beige Book.

The Beige Book compiles qualitative observations made by community bankers and business owners about economic (labor market, prices, wages, housing, nonresidential construction, tourism, manufacturing) and banking (loan demand, loan quality, lending conditions) conditions in each of the 12 Federal Reserve districts (Boston, New York, Philadelphia, Kansas City, etc). The report is prepared eight times a year ahead of each of the eight FOMC meetings.

This leaves a word cloud that is dominated by words describing the tone of the economy at the time the Beige Books were published. Below are some observations on the current Beige Book (released last week), the Beige Book released in November 2011 and the Beige Book released in January 2009, at one of the worst phases of the 2007–2009 Great Recession.

1 January 2012 Beige Book Word Cloud



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2 November 2011 Beige Book Word Cloud



Source: The Federal Reserve Beige Book, LPL Financial 01/17/12

3 January 2009 Beige Book Word Cloud



Source: The Federal Reserve Beige Book, LPL Financial 01/17/12

For example,

- Although it does not show up in any of the nearby word clouds, the word "uncertain" was used just 13 times in the latest Beige Book, versus 19 times in the November 2011 Beige book, 33 in the September 2011 Beige book and 16 times in the January 2009 Beige Book. Prior to the Great Recession, the word "uncertain" appeared, on average, less than four times per Beige Book, suggesting that while economic uncertainty has faded since the autumn, it remains elevated versus pre-Great Recession levels.
- The word "decline" or "declined" did not appear at all in the word clouds of the latest two Beige Books, but showed up 128 times in the January 2009 Beige Book.
- The word "weak" showed up 51 times in the January 2009 Beige Book, but just 30 and 31 times, respectively, in the November 2011 and January 2012 Beige Books.
- The word "increased" appeared just 41 times in the January 2009 Beige Book, at the worst of the Great Recession, but appeared 74 times in November 2011 and 64 times in January 2012.
- The words "steady" or "strong" did not appear at all in the word cloud created from the January 2009 Beige Book, but appeared a combined 83 times in November 2011 and 89 times in the January 2012 Beige Book.
- The word "hiring" appeared 39 times in the word clouds generated from both the January 2012 and the November 2011 Beige Books. It did not appear at all in the word cloud created from the January 2009 Beige Book.

On balance, the latest Beige Book corroborates the latest quantitative data we have seen on the economy as 2011 ended and 2012 began. The latest two Beige Books certainly do not describe a booming economy, but they are also a far cry from the economy described in the January 2009 Beige Book. ■

LPL Financial Research 2012 Forecasts

- GDP 2%*
- Federal Funds Rate 0%^
- Private Payrolls +200K/mo.†

Please see our 2012 Outlook for more details on LPL Financial Research forecasts.

IMPORTANT DISCLOSURES

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. All performance reference is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

* Gross Domestic Product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

^ Federal Funds Rate is the interest rate at which depository institutions actively trade balances held at the Federal Reserve, called federal funds, with each other, usually overnight, on an uncollateralized basis.



† Private Sector – the total nonfarm payroll accounts for approximately 80% of the workers who produce the entire gross domestic product of the United States. The nonfarm payroll statistic is reported monthly, on the first Friday of the month, and is used to assist government policy makers and economists determine the current state of the economy and predict future levels of economic activity. It doesn't include:

- general government employees
- private household employees
- employees of nonprofit organizations that provide assistance to individuals
- farm employees

Stock investing involves risk including loss of principal.

The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.

The Producer Price Index (PPI) program measures the average change over time in the selling prices received by domestic producers for their output. The prices included in the PPI are from the first commercial transaction for many products and some services.

The Beige Book is a commonly used name for the Fed report called the Summary of Commentary on Current Economic Conditions by Federal Reserve District. It is published just before the FOMC meeting on interest rates and is used to inform the members on changes in the economy since the last meeting.

This research material has been prepared by LPL Financial.

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