

# Weekly Economic Commentary



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## Just Warming Up

### John Canally, CFA

Economist  
LPL Financial

#### Highlights

At least some of the strength in the first quarter is likely related to warmer-than-usual weather

Beige Books during recent warmer-than-usual winters indicate boosts for overall consumer spending, construction activity, home sales

#### Economic Calendar

<b>Monday, March 5</b> Factory Orders <i>Jan</i>	Layoff Announcements <i>Feb</i>
ISM—Service Sector <i>Feb</i>	<b>Friday, March 9</b> Trade Balance <i>Jan</i>
<b>Wednesday, March 7</b> ADP Employment Change <i>Feb</i>	Private Sector Payrolls <i>Feb</i>
Productivity <i>Q4</i>	Unemployment Rate <i>Feb</i>
Consumer Credit <i>Jan</i>	Nonfarm Payrolls <i>Feb</i>
<b>Thursday, March 8</b> Initial Claims wk 3/3	Wholesale Inventories <i>Jan</i>

The February employment report and the economic data for February in China are the highlights on this week's economic and policy calendar. In addition, the February data on ADP employment, layoff announcements, and merchandise trade for January are due out in the United States. The week will likely be quiet for the Fed, as Fed officials observe the unofficial "quiet period" ahead of the next Federal Open Market Committee (FOMC) meeting on March 13. However, central banks outside the United States will be busy this week, with rate setting meetings in Brazil, Australia, New Zealand, Russia, South Korea, the Eurozone, the UK, Peru, Canada, Poland, Indonesia, and Malaysia. Of these, only Brazil is expected to cut rates. The rest of these central banks are on hold, for now. There are bond auctions in Austria, the Netherlands, Germany and Belgium, as investors await the March 8 deadline to swap out existing Greek debt for newly issued debt as part of the latest bailout.

The Chinese authorities will begin to release China's economic data for February later this week, with the key report being the Consumer Price Index (CPI) report. A deceleration in the CPI in February could pave the way for the China central bank to continue to ease monetary policy in the coming weeks and months. All of the Chinese economic reports for February will be impacted by the shift in the Lunar New Year to January this year versus February in 2011.

### Warm Weather Impacting Economic Activity in Early 2012

On balance, the vast majority of the economic data in the United States released since early October 2011 has exceeded expectations. This trend reflects underlying improvement in the overall economy due to:

- Less uncertainty surrounding the debt issues in Europe
- A little less rancor (and a little more cooperation) out of Washington compared to this past summer
- The improving job market as companies have reached the limit on productivity gains
- A rebound in global economic activity following the global supply chain disruptions that resulted from the Japanese earthquake and tsunami in March 2011.

At least some of the improvement in the economic backdrop may be associated with the weather, which has been warmer and drier than usual since last autumn. In general, warmer (and drier) than normal weather tends



to boost economic activity. We saw evidence of these trends in the details of the Federal Reserve's (Fed) latest Beige Book—a qualitative assessment of business and banking conditions compiled via contacts in the private sector in each Fed district. On balance, the Beige Book was relatively upbeat, with all 12 districts reporting expanding (albeit modest) growth and improving conditions in the labor market, bank lending and credit conditions, and in residential and commercial real estate.

The Beige Book noted that the economic uncertainty that was pervasive in the economy in the summer and fall of 2011 continued to fade, as the word "uncertainty" was used just nine times, down from 33 mentions in the September 2011 Beige Book as, worries over the future of Europe and a greater-than-usual amount of discord in Washington dominated the headlines. There was just one mention of Thailand (and none of Japan), and just 14 mentions of Europe in this Beige Book, versus 16 in the January 2012 Beige Book. However the word "weather" appeared 29 times in the latest Beige Book, and the phrase "warm weather" appeared 12 times. In the January 2012 version of the Beige Book, the word weather appeared 13 times, with the phrase "warm weather" appearing just seven times.

It is not unusual for a Beige Book released in March of any year to cite weather as a factor impacting some aspect of economic activity around the nation, but it is unusual to see warm weather mentioned so often. For example, in the Beige Book released one year ago (in March 2011) the word weather was mentioned 36 times as the nation suffered through a very cold and snowy winter season. The word warm appeared just twice the March 2011 Beige Book. A year earlier, in the March 2010 edition of the Beige Book, the word weather appeared 41 times, but the word warm appeared just twice.

Thus, at least some of the improvement in the economic backdrop since last fall has likely been weather-related, although it is difficult to pinpoint exactly how much. Weather often has a bigger impact when there is a big change in pattern from a long stretch of colder and wetter-than-usual weather to warmer and drier weather. For the most part, since the harsh winter of 2010–2011 ended, 2011 was relatively warmer and drier than usual.

Still, the October 2011 through February 2012 period has been warmer than usual, with January 2012 being the fourth warmest January since 1921. This period has also been drier than usual, with the exception of November 2011. Taken together, these trends have added to economic activity. We again turn to the Beige Book for details.

Looking at the detail from Beige Books during recent warmer-than-usual winters (1997–98, 1998–99, 1999–2000, 2005–2006), we find that all else equal, the warm (and dry) temperatures will boost:

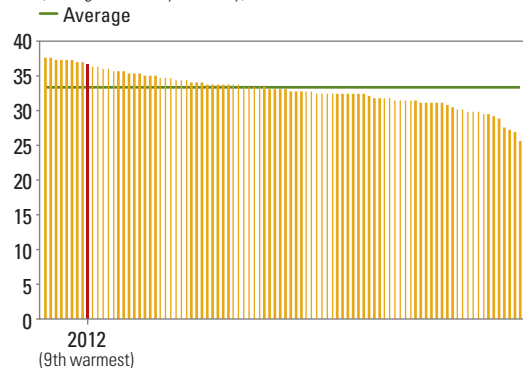
- Overall consumer spending as consumers spend less on heating their homes
- Construction activity (houses, office parks, high ways, public work projects, etc.)
- Home sales
- Apartment leasing activity

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## 1 January and February Marked the 9th Warmest Start to the Year in the Past 90 Years

Temperature Ranked From Highest to Lowest – 1921-2012  
(Average of January–February)



Source: National Climatic Data Center 03/02/12

- Mortgage originations
- Auto sales
- Non-clothing retail sales (hardware stores, gardening centers, sporting goods)
- Energy and mining activity
- Tourism (beach and golf)
- Agriculture
- Restaurants
- Overall employment in the areas listed above, lowering initial jobless claims

On the other hand, warmer-than-usual weather this time of the year can:

- Hurt sales of winter clothing and winter sports gear
- Dampen output of natural gas and oil as consumers and businesses use less heat
- Put a crimp in demand for hotel rooms and services around ski areas and other areas that cater to winter recreational activities
- Hurt demand for feed supplies for livestock

On the price side, warmer-than-usual weather at this time of year can also increase the supply (and perhaps lower the cost) of fruits, vegetables, plants, and flowers. These products are also at risk of a late frost, which could reduce supply and cause rising prices later in the spring. Warmer weather can mean lower feed costs for dairy, cattle, and hog producers. Inventories can be altered as well, as too much winter clothing piles up on stores' shelves, but not enough lumber or building materials are produced, leaving inventories lower than they would normally be.

Although warm weather this time of the year does not impact every area of the economy or even every area of the country, generally, the warmer weather can "pull forward" some purchases (like sporting goods, gardening supplies, spring clothing, and even autos and houses). These purchases may inflate the economic data in January, February, and March and depress activity in the spring if the weather returns to normal.

So here in March, we get reports mainly for February, which should be stronger than otherwise due to weather. Note that for retailers, March will likely be much stronger this year versus last year due to the earlier Easter holiday (April 8 versus April 24). March data gets reported in April. But looking further out into the year, if we have a return to "normal weather," the data reported in April and May for March and April could look weak and cause markets to get concerned about another double-dip scare.

Our view remains that the underlying pace of economic growth is around 2.5% here in the first quarter of the year, but that growth for the full year will be closer to 2.0%. At least some of the strength in the first quarter is likely related to warmer-than-usual weather. ■



### 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

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.

Stock investing involves risk including loss of principal.

International investing involves special risks, such as currency fluctuation and political instability, and may not be suitable for all investors.

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.

The Federal Open Market Committee (FOMC), a committee within the Federal Reserve System, is charged under the United States law with overseeing the nation's open market operations (i.e., the Fed's buying and selling of United States Treasury securities).

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