

Weekly Economic Commentary



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Beige Book: Window on Main Street Sequel to Last Summer?

John Canally, CFA

Economist
LPL Financial

Highlights

We expect the Beige Book to still paint a picture of an expanding economy.

The Beige Book should also discuss the uncertainties (Europe, the looming fiscal cliff, and the upcoming U.S. elections) and the return of normal weather.

The Beige Book is expected to provide the Federal Reserve (Fed) with plenty of scope to initiate another round of quantitative easing.

Please See the LPL Financial Research Weekly Calendar on page 3

Notably, compared with the Beige Books released in June of 2008 and 2009—when the economy was in the midst of the Great Recession—this week's Beige Book is likely to be far more upbeat.

This Wednesday, June 6, the Federal Reserve will release its Beige Book—one of our favorite economic reports. 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 (Fed) districts (Boston, New York, Philadelphia, Kansas City, etc.). Each Beige Book is compiled by one of the 12 regional Federal Reserve districts on a rotating basis—the report is much more “Main Street” than “Wall Street” focused. It provides an excellent window into economic activity around the nation using plain, everyday language. The report is prepared eight times a year ahead of each of the eight Federal Open Market Committee (FOMC) meetings. The next FOMC meeting is June 19–20, 2012.

Warm Weather Impact

The Beige Book prepared ahead of the April 24–25, 2012 FOMC meeting (released on April 11, 2012) described an economy that was still expanding “at a modest pace.” At that time, there were few signs of the themes that dominated the Beige Books in the summer and fall of 2011: weak confidence, rising food and energy prices, European concerns, and high economic and financial market uncertainty. (Please see our April 16, 2012 *Weekly Economic Commentary*.) In addition, the numerous mentions of warmer-than-usual weather in the April 11, 2012 Beige Book suggested to us that warm winter weather almost certainly impacted economic activity.

Expansion and Uncertainty

Unfortunately, many of the themes that dominated the Beige Book in the summer and fall of 2011 may reappear in this week's Beige Book, making it look like a sequel to the ones prepared in the middle of 2011. In addition, the return to more “normal” weather this spring has led to a noticeable cooling of economic activity in recent weeks. We have been describing that as “payback” from the warmer-than-usual winter of 2011–2012 that pulled forward hiring, home buying, construction activity, and even some consumer purchases. It will be interesting to see how business and banking leaders describe the weather's impact on the economy in recent weeks and months. The slowdown in economic activity in China will also likely be mentioned in this week's Beige Book. On balance, we expect the Beige Book released this week to look more like the sequel to the Beige Books from last summer and fall, rather than the relatively upbeat Beige Books released thus far in 2012.

We do not expect the Beige Book to be all bad news. Indeed, business and banking contacts across the country are sure to note several positives in this week's Beige Book, including the:

- Recent drop in consumer energy prices,
- Continued increase in bank loan activity (to both consumers and businesses),
- Sharp increase in refinance activity as the result of the sharp drop in mortgage rates,
- Ongoing revival in the housing market (sales, prices, construction, employment),
- Dramatic decrease in raw materials costs, and
- Revival of the manufacturing sector.

In addition, the global supply chain disruptions resulting from the earthquake in Japan that dominated the Beige Books last summer have now been resolved and are not acting as a drag on global growth as they were throughout the final two-thirds of 2011. Notably, compared with the Beige Books released in June of 2008 and 2009—when the economy was in the midst of the Great Recession—this week's Beige Book is likely to be far more upbeat.

Behind the Key Words and Phrases

We expect an increase in mentions of uncertainty, Europe, and confidence in this week's Beige Book, and perhaps even a sharp uptick in the number of mentions of China. Weather mentions will likely remain elevated as well. We don't expect to see any mentions of Japan/Thailand as it relates to global supply chain disruptions, but we do expect plenty of mentions of lower gasoline, fuel, and commodity prices impacting the economy. The nearby figure provides the progression of the mentions of some key words and phrases from the most recent Beige Books, from the Beige Books released in the summer and fall of 2011, and those released in June 2008 and June 2009, when the economy was in recession.

On balance, the Beige Book will likely paint a picture of an economy that is growing, but perhaps growing more slowly than it was just a few months ago. The slowdown in the pace of economic growth here and abroad, growing policy uncertainty overseas and at home, along with a sharp decline in food and energy prices ought to provide the Fed with the scope to pursue another round of quantitative easing later this year, and perhaps even as soon as the end of this month, when Operation Twist is scheduled to end. ■

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The number of times **Japan** was mentioned in April 2012, down from **25** mentions in June of 2011.

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The number of times **Uncertainty** was mentioned in April of 2012, down from the **38** mentions in September 2011.

1 Beige Book Breakdown

	Apr 11 2012	Feb 29 2012	Jan 11 2012	Nov 30 2011	Oct 19 2011	Sep 7 2011	Jul 27 2011	Jun 8 2011	Jun 10 2009	Jun 11 2008
Weather	34	29	13	10	0	12	8	18	3	10
Uncertainty	10	9	13	19	26	38	20	7	13	7
Europe	6	14	16	10	2	5	2	1	0	2
Confidence	1	5	7	4	9	11	6	8	6	5
Japan/Thailand	0/0	1/1	2/2	10/7	9/0	14/0	21/0	25/0	0/0	0/0
Gasoline/Fuel	16/27	5/12	5/4	4/11	2/4	2/12	10/12	14/18	6/5	7/29

Source: Federal Reserve's Beige Book LPL Financial Research 06/04/12



LPL Financial Research Weekly Calendar

	U.S. Data 	Fed 	Global Notables
2012			
4 June			China: HSBC Service Sector PMI (May)
5 June	Service Sector ISM (May)	Fisher Bullard Evans	Australia: Central Bank Meeting Canada: Central Bank Meeting Germany: Factory orders (Apr)
6 June		Lockhart* Beige Book Williams* Yellen*	ECB Meeting Brazil: CPI (May)
7 June	Initial Claims (6/2) Chain Store Sales (May) Consumer Credit (Apr)	Rosengren Bernanke * Lockhart * Kocherlakota Fisher	UK: Bank of England Meeting South Korea: Central Bank Meeting Mexico: Central Bank Meeting Argentina: GDP (Q1)
8 Jun	Trade Deficit (Apr)	Kocherlakota	China: CPI (May)

Hawks: Fed officials who favor the low inflation side of the Fed's dual mandate of low inflation and full employment

Doves: Fed officials who favor the full employment side of the Fed's dual mandate

* Voting members of the Federal Open Market Committee (FOMC)

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.

China CPI: In total there are about 600 "national items" used for calculating the all-China CPI. The list of items is revised annually for representativeness based on purchases reported in the household surveys. The number of items can change from year to year, but rarely by more than 10 in any given year.

ECB: European Central Bank

ISM: Institute for Supply Management

Chinese Purchasing Managers Index: The PMI includes a package of indices to measure manufacturing sector performance. A reading above 50 percent indicates economic expansion, while that below 50 percent indicates contraction.

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.

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.

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^ 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.

Quantitative Easing is a government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity. This research material has been prepared by LPL Financial.

The Federal Open Market Committee action known as Operation Twist began in 1961. The intent was to flatten the yield curve in order to promote capital inflows and strengthen the dollar. The Fed utilized open market operations to shorten the maturity of public debt in the open market. The action has subsequently been reexamined in isolation and found to have been more effective than originally thought. As a result of this reappraisal, similar action has been suggested as an alternative to quantitative easing by central banks.

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