

Weekly Economic Commentary

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Highlights

U.S. jobs report due on Friday, July 6: Will job creation fall short of expectations for a fourth consecutive month in June?

Market participants would welcome signs that Europe is cooperating and moving closer together.

We continue to expect that the Chinese economy will avoid a “hard landing.”

Please see the LPL Financial Research Weekly Calendar on page 3

Vacation Week Fireworks?

Although many market participants are likely to be away from the office this week, they risk missing a busy week for economic data (see the calendar on page 3), which is sandwiched between a policy-heavy June 2012 and the unofficial start of the corporate earnings reporting season on July 9. As this publication was being prepared, markets have already digested several key economic reports, including:

- China’s Purchasing Managers’ Index (PMI) for June 2012, which was better than expected, but still suggested that the Chinese economy continued to slow as the first half ended,
- Japan’s Tankan Index for the second quarter 2012 also surpassed lowered expectations, but suggested little, if any growth in the Japanese manufacturing economy,
- India’s PMI for June 2012 also surpassed lowered expectations and was stronger than the May 2012 reading. The report suggested that Asia’s third-largest economy may be responding to rate cuts engineered by India’s central bank in spring 2012,
- Brazil’s industrial production for May 2012,
- Eurozone PMI for June 2012,
- Eurozone employment for May 2012, and
- The U.S. Institute for Supply Management (ISM) report for June 2012.

With one important exception—the U.S. ISM report for June, which came in lower than expected, below the low end of the range of expectations, and below 50 (indicating that the manufacturing sector contracted in June)—this round of important data came in above sharply lowered expectations. With the Eurozone fiscal and financial woes likely to be on the back burner for a while, the pace of economic growth in Europe, the United States, and especially China will likely move to the front burner.

China Economy Fizzling

Although several other reports on China’s economy in June 2012 are due out this week, including the service sector PMI for June 2012, the next round of data (money supply, retail sales, industrial production, new loan growth, exports and imports, etc.) on the Chinese economy is not due until next week (July 9–13). Our view remains that the Chinese economy will avoid a “hard



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landing" (5–6% real gross domestic product [GDP] growth), and that further fiscal and monetary policy stimulus is likely from Chinese authorities in the weeks and months ahead. Until then, fretting over the health of the Chinese economy could replace the uncertainty surrounding recent major policy events as the market's favorite summer pastime.

Potential Oohs and Ahhs on European Monetary Front

The unexpected agreement reached late last week (June 25–29) at the Eurozone leaders' summit has, for now, pushed market concerns over Europe to the back burner. That does not mean, however, that markets will not be paying attention to several key policy-related events in Europe this week. On Tuesday, July 3, the new French government under François Hollande will present its budget plan for the coming year, and this may briefly refocus the market's attention on European fiscal woes. The markets are looking for a mix of short-term growth measures combined with a commitment to lower France's debt level over the longer term. Later in the week, German Chancellor Angela Merkel will meet with her Italian counterpart Mario Monti. The pair has plenty to discuss aside from the latest soccer scores. Although the market is not expecting anything concrete from this meeting, market participants would welcome signs that Europe is cooperating and moving closer together.

Fiscal policy has been in the driver's seat in Europe recently, but that may change this week, as the Bank of England (BOE) and the European Central Bank (ECB) meet to discuss monetary policy. On the heels of the political/fiscal progress made at the Eurozone leaders' summit in Brussels last week, the outcome of the French and Greek elections in mid-June, as well as the Fed's decision in mid-June to extend Operation Twist to the end of 2012, both the ECB and BOE are expected to act this week. The market expects a rate cut from the ECB, and perhaps even a promise to do more. In the U.K., the market now expects another round of quantitative easing from the BOE, as the U.K. is teetering on the edge of recession amid the economic and fiscal uncertainty from the neighboring Eurozone. Central banks in Sweden, Poland, Russia, and Australia also meet this week, but markets do not expect any of these banks to act in a similar fashion as the BOE and ECB.

Grand Finale: U.S. Jobs Report




The grand finale of the week, of course, will be the release of the June employment report for the United States on Friday, July 6. As we have noted in prior *Weekly Economic Commentaries*, the monthly jobs report has implications for the overall economy, the Fed, and the upcoming U.S. presidential elections. We will focus on the jobs report's impact on the overall economy and the Fed this week, but please see the *Weekly Economic Commentary* from May 29, 2012, for a look at how the unemployment rate has impacted the outcome of the presidential election in prior years.

A well-documented warmer-than-usual winter in 2011–12 led to the monthly count of private sector jobs exceeding economists' estimates from December

Have estimates fallen far enough? If they have not fallen enough, markets may see fireworks on both July 4 and July 6 this year.



LPL Financial Research Weekly Calendar

	U.S. Data 	Fed 	Global Notables 
2012			
2 Jul	<ul style="list-style-type: none"> ■ ISM (Jun) ■ Construction Spending (Jun) 	<ul style="list-style-type: none"> 👇 Williams* 	<ul style="list-style-type: none"> ■ Iran oil sanctions begin (July 1) ■ India: PMI (Jun) ■ Japan: Tankan Survey (Q2) ■ Brazil: Industrial Production (May)
3 Jul	<ul style="list-style-type: none"> ■ Vehicle Sales (Jun) 		<ul style="list-style-type: none"> ■ France: Hollande announces budget details ■ Australia: Central Bank Meeting
4 Jul	<ul style="list-style-type: none"> ■ Holiday 		<ul style="list-style-type: none"> ■ Sweden: Central Bank Meeting ■ Eurozone: Merkel meets Monti
5 Jul	<ul style="list-style-type: none"> ■ Challenger Layoff Announcements (Jun) ■ ADP Employment (Jun) ■ Initial Claims (Jun) ■ Service Sector ISM (Jun) ■ Chain Store Sales (Jun) 		<ul style="list-style-type: none"> ■ Eurozone: ECB Meeting ■ U.K.: BOE Meeting
6 Jul	<ul style="list-style-type: none"> ■ Employment Report (Jun) 		<ul style="list-style-type: none"> ■ Brazil: CPI (Jun)

🦅 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)

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.

Purchasing Managers Index (PMI) is an indicator of the economic health of the manufacturing sector. The PMI index is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment.

Challenger, Gray & Christmas is the oldest executive outplacement firm in the United States. The firm conducts regular surveys and issues reports on the state of the economy, employment, job-seeking, layoffs, and executive compensation. Challenger Job Cuts report is released monthly in the United States and provides information on the total number of announced corporate layoffs.

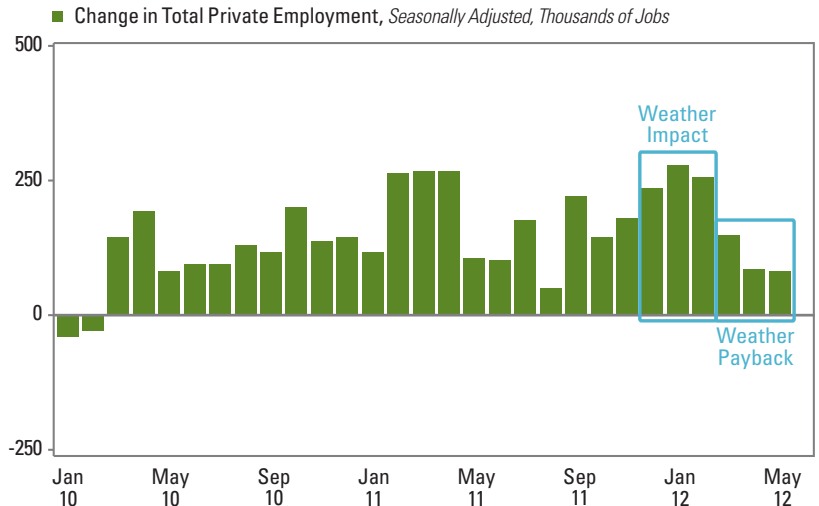
The labor market and, in particular, the unemployment rate, will likely be a key determinate for the Fed.

2011 through February 2012. Since then, the market has overestimated the number of jobs created, as the number of private sector jobs created from March through May 2012 fell far short of expectations. As this publication was being prepared, the consensus was looking for a 100,000 gain in private sector employment in June 2012, an improvement on the 82,000 jobs created in May 2012, but still the lowest estimate for the report since economists were looking for 90,000 jobs to be created in September 2011. The most optimistic forecaster is looking for 175,000 private sector jobs to be created in June, while the low end of the range is at 45,000. The last time the low end of the range of estimates for the monthly jobs report was this low was back in August 2011. As market participants prepare for the report, they are asking: Have estimates fallen far enough? If they have not fallen enough, markets may see fireworks on both July 4 and July 6 this year.

The forecast for a 100,000 increase in private sector jobs in June 2012 pales in comparison to the weather-boosted 250,000 jobs per month created in December 2011, January 2012, and February 2012. Last fall, prior to the warmer weather, the economy was creating around 150,000 jobs



1 Warmer-Than-Usual Weather Probably Boosted the Job Count Between November 2011 and February 2012



Source: Bureau of Labor Statistics, Haver Analytics 07/02/12

The U.S. Bureau of Labor Statics defines nonfarm employment as the total number of U.S. paid workers excluding general government employees, private household employees, nonprofit organization employees who provide assistance to individuals, and farm employees.

per month. The true pace of underlying job growth is likely somewhere between 150,000 and 250,000.

Compared with last fall, when the level of initial claims for unemployment insurance was running over 400,000 per week, the level of initial claims filed each week in June 2012 (around 390,000 per week) suggests that hiring is a bit more robust today. Several other indicators suggest that the economy is probably creating more jobs than it was last fall (150,000 per month), but not many more:

- The increase in consumer sentiment,
- The near-record level of corporate profits and cash flows,
- The increase in job openings, and
- The number of job quitters as a percent of overall job separations.

Policymakers at the Federal Reserve (Fed) also will likely have a keen interest in the June jobs report, as they continue to mull the possibility of more monetary policy stimulus. The labor market and, in particular, the unemployment rate, will likely be a key determinate for the Fed. The Fed now expects the unemployment rate to average 8.1% in the fourth quarter of 2012. The median forecast for the June 2012 unemployment rate is 8.2%, and the economy probably needs to create around 100,000 jobs per month just to keep the unemployment rate steady.

In the press conference following the June 20 Federal Open Market Committee (FOMC) meeting, Fed Chairman Ben Bernanke said that if the Fed does not see improvement in the labor market, the Fed will take

FEDLINES: In the press conference following the June 20 Federal Open Market Committee (FOMC) meeting, Fed Chairman Ben Bernanke said that if the Fed does not see improvement in the labor market, the Fed will take additional steps to stimulate the economy.



additional steps to stimulate the economy. In his April 2012 post-FOMC press conference, Bernanke said, “we’ll continue to be watching the labor market. That’s a very important consideration. If unemployment looks like it’s no longer making progress, that’ll be an important consideration in thinking about policy options.” Thus, another weak employment report in June may prompt Fed officials to think about another round of monetary stimulus (round three of quantitative easing, known as QE3), which may cause some political fireworks later this year. ■

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.

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.

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 Bank of Japan produces a quarterly "Tankan" survey of corporations that provides insight into the current business climate in Japan. The Bank of Japan uses this survey to help determine monetary policy.

The Eurozone Purchasing Managers' Index (PMI) assesses business conditions in the manufacturing sector.

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

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.

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.

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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