

# Weekly Economic Commentary



April 22, 2013

## Beige Book: Window on Main Street

### John Canally, CFA

Economist  
LPL Financial

### Highlights

The latest Beige Book notes that the U.S. economy continued to expand at a “moderate pace” from late February through early April 2013.

The impact of Superstorm Sandy and fiscal uncertainty are fading from the Beige Book.

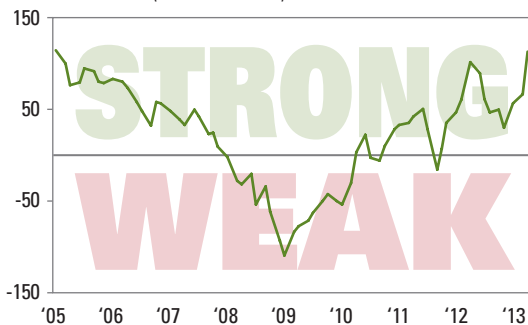
Health care mentions are increasing in the Beige Book, as the U.S. economy adjusts to the impact of the Affordable Care Act (ACA).

Our Beige Book Barometer hit an eight-year high in April, despite adverse weather in late February, March, and early April 2013. This suggests that a return to “normal” weather could provide a significant lift to upcoming readings on our Barometer.

Please see the LPL Financial Research Weekly Calendar on page 3

### 1 Beige Book Barometer Hits New Five-Year High in April

— Number of Times “Strong” (and Variations of This Word) Is Mentioned Minus Number of Times “Weak” (and Variations) Is Mentioned



Source: Federal Reserve, LPL Financial Research 04/18/13

Much like the iconic cover of the *Rolling Stones'* 1972 Album *Exile on Main St.* with its collage of photographs, the Fed's Beige Book provides snapshots of what is taking place on Main Streets across the United States. As with the Stones' tenth album, last week's Beige Book does not offer many hits, but taken together, provides an indispensable part of any economic data collection.

In order to provide one snapshot of the entire Beige Book collage of data, we created our proprietary “Beige Book Barometer (BBB)”. The BBB ticked up to +112 in April 2013 (from +66 in March 2013), continuing the rebound from a Superstorm Sandy-related dip to +30 in November 2012. At +112, our BBB not only moved above its post-Great Recession high of +101 (hit in April 2012) but also hit its highest level since 2005, despite adverse weather across most of the nation in March and early April. The improvement in our BBB since November 2012 has come as the number of positive words in the Beige Book surged to an eight-year high. The number of negative words hit a 12-month low in April 2013.

Our BBB, a diffusion index that measures the number of times the word “strong” or its variations (stronger, strength, strengthen, etc.) appear in the Beige Book less the number of times the word “weak” or its variations (weaken, weaker, etc.) appear, is displayed in [Figure 1](#). The barometer is an effective, quantitative way to derive the shades between strong and weak in the predominately qualitative Beige Book report.

### Impact of Sandy and Fiscal Cliff Fading, Leading to Less Economic Uncertainty

When we wrote about the Beige Book in early December 2012, we noted that despite tepid reading of our BBB in November 2012 (+30), there was some reason for modest optimism on the economic outlook. First, the BBB generally suggested the economy was stronger during the summer and early fall of 2012, prior to the impact of Superstorm Sandy and uncertainty ahead of the fiscal cliff than it was in early 2011, before the bruising debt ceiling debate. In addition, we noted that many of the factors that weighed on our BBB in November 2012 appeared to be temporary. A big driver of the uncertainty in the November 2012 Beige Book was Superstorm Sandy, which had 48 mentions, and virtually all of the mentions were associated with disruptions to economic activity.

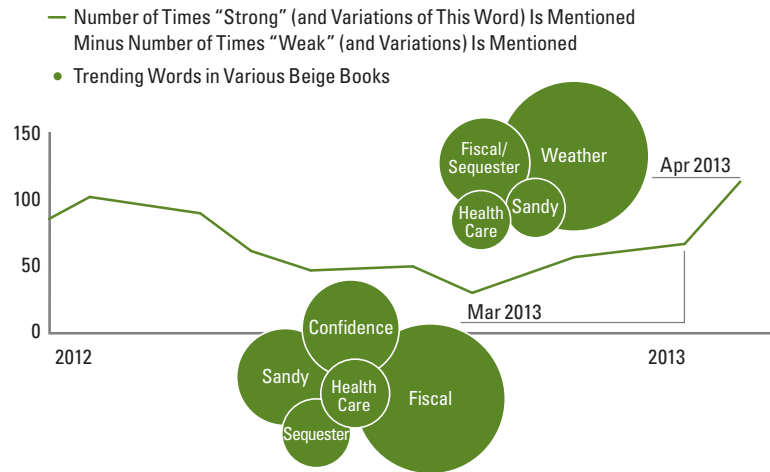


## How the Barometer Works

The Beige Book Barometer (BBB) is a diffusion index that measures the number of times the word “strong” or its variations appear in the Beige Book less the number of times the word “weak” or its variations appear. When the BBB is declining, it suggests that the economy is deteriorating. When the BBB is rising, it suggests that the economy is improving.

See page 4 for “Beige Book: How It Works.”

## 2 As Fiscal and Sandy Uncertainty Fade, Weather and Health Care Concerns Gain Traction



Source: Federal Reserve Board, LPL Financial 04/18/13

Almost all of the 25 mentions of Sandy in January 2013, and all but one of the 11 mentions in the March 2013 edition of the Beige Book were associated with a rebound in, or resumption of, economic activity that was disrupted by the storm in late 2012. There were just three mentions of Sandy in the April 2013 Beige Book.

In contrast, almost all of the 25 mentions of Sandy in January 2013, and all but one of the 11 mentions in the March 2013 edition of the Beige Book were associated with a rebound in, or resumption of, economic activity that was disrupted by the storm in late 2012. There were just three mentions of Sandy in the April 2013 Beige Book. Because of the timing of the collection of comments for the January 2013 Beige Book (comments from contacts in the business and banking community were collected throughout December 2012 and in the first few days of January 2013), we noted that the January 2013 Beige Book likely overstated the impact of the fiscal cliff on economic activity in early 2013. Indeed, there were 38 mentions of the word “fiscal” in the January 2013 Beige Book, and almost every mention was accompanied by a word like “uncertainty.” Clearly, the uncertainty was a drag on economic activity among consumers and businesses alike as 2012 drew to a close.

The word “fiscal” appeared just 17 times in the March 2013 Beige Book, and almost all of the mentions were in a negative context. “Fiscal” appeared 12 times in the April 2013 Beige Book—again almost all in a negative context. The word “sequester” (automatic, across-the-board spending cuts put in place by Congress that took effect on March 1, 2013) had just one mention in the April 2013 Beige Book, which suggests that perhaps the news media and politicians are overstating its impact on the economy. Looking ahead however, we still expect the word “sequester” to make a prominent appearance in the next several Beige Books. Still, with the debt ceiling debate and possible government shutdown now pushed back until August or September 2013, fiscal uncertainty outside of the impact of the sequester will likely continue to fade in upcoming Beige Books. The rebound from Sandy will also likely continue to fade in the coming months, although rebuilding from the storm may take years.

While the fiscal cliff debate, the sequester, and the impact of Sandy may have proved temporary, though significant, other more persistent factors weighed on the Barometer since its post-Great Recession peak in April 2012. The



LPL Financial Research Weekly Calendar

	U.S. Data	Fed	Global Notables
2013			
22 Apr	<ul style="list-style-type: none"> <li>Existing Home Sales (Mar)</li> </ul>	<h1>FOMC</h1> <h2>Quiet Period</h2>	<ul style="list-style-type: none"> <li>China: Flash PMI (Apr)</li> </ul>
23 Apr	<ul style="list-style-type: none"> <li>Markit PMI (Apr)</li> <li>Richmond Fed Index (Apr)</li> <li>New Home Sales (Mar)</li> </ul>		<ul style="list-style-type: none"> <li>Eurozone: PMI Manufacturing (Apr)</li> </ul>
24 Apr	<ul style="list-style-type: none"> <li>Durable Goods Orders (Mar)</li> </ul>		<ul style="list-style-type: none"> <li>Italy: Bond Auction</li> <li>Germany: IFO (Apr)</li> <li>New Zealand: Central Bank Meeting</li> </ul>
25 Apr	<ul style="list-style-type: none"> <li>Initial Claims (4/20)</li> </ul>		<ul style="list-style-type: none"> <li>UK: GDP (Q1)</li> </ul>
26 Apr	<ul style="list-style-type: none"> <li>GDP (Q1)</li> <li>Consumer Sentiment (Apr)</li> </ul>		<ul style="list-style-type: none"> <li>Japan: Central Bank Meeting</li> <li>Eurozone: Money Supply (Mar)</li> <li>Mexico: Central Bank Meeting</li> </ul>

3 Beige Book Word Clouds



Source: The Federal Reserve Beige Book, LPL Financial 04/18/13



Source: The Federal Reserve Beige Book, LPL Financial 03/11/13



Source: The Federal Reserve Beige Book, LPL Financial 01/18/05

ongoing recession in Europe, the economic slowdown in China, the severe damage to the agricultural economy as a result of the drought, and a return to “normal” weather all helped to push the BBB down from +101 in April 2012 to around +50 over the summer and early fall of 2012.

### Word Clouds Show Modest Expansion, Growing Concern About Impact of Health Care Reform

The nearby word clouds are dominated by words describing the tone of the economy when the Beige Books were published. Below are some observations on the current Beige Book (released on April 17, 2013) relative to other recent editions of the Beige Book.

- The latest Beige Book notes that the economy continued to expand at a “moderate pace” from late February through early April 2013. Although the Beige Book corroborates other, more quantitative evidence that the economy is expanding modestly, it is not doing so at a pace that would concern the Federal Reserve (Fed) that there is upward pressure on wages or prices, which in turn might cause the Fed to slow down or stop its latest round of quantitative easing (QE). The latest Beige Book described wage pressures as “generally contained” and pricing pressures as “modest.”
- In the Beige Books released in late November 2012 and early January 2013, economic uncertainty surrounding the fiscal cliff and the rebound from the economic disruption wrought by Superstorm Sandy dominated. As noted above, Sandy and the fiscal cliff have faded as concerns, and uncertainty has faded a bit as well. There were just 16 mentions of the word “uncertain” in the April 2013 Beige Book, versus 26 in March 2013, 43 in January 2013, and 26 in November 2012. The 13 mentions of “uncertain” in the April 2013 Beige Book were the fewest since June 2012.



## Beige Book: How It Works

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 Fed districts (Boston, New York, Philadelphia, Kansas City, etc.). This local color that makes up 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 April 30-May 1, 2013.

The previous word clouds or text clouds, which are a visual format useful for quickly perceiving the most important words in a speech, text, report, or other transcript, are culled from the Fed’s Beige Books published last week (April 17, 2013), the prior month (March 6, 2013), and in January 2005. In general, the more often a word appears in a speech, text, report or other transcript, the larger that word appears in the word cloud. The word clouds show the top 50 words for each of the two Beige Books mentioned above. Similar words are grouped together, and common words like “the,” “and,” “a,” and “is” are excluded, as are words that appear frequently in all Beige Books (federal, district, loan, level, activity, sales, conditions, firms, etc.).

- The word “confidence” appeared seven times in the latest Beige Book and 11 times in the March 2013 Beige Book. However, unlike in 2011 and most of 2012, when the word was used in a negative context (i.e., lack of confidence, weak confidence), five of the seven mentions in April (and nine of the 11 mentions in the March 2013 Beige Book) were in a positive context. Thus, over the past few Beige Books since Superstorm Sandy, business and banking contacts have generally become more confident in the recovery, especially in housing. This suggests that a sustained, multiyear recovery in the housing market is likely underway.
- “Health care,” “health insurance,” and the “Affordable Care Act” (ACA) were mentioned 26 times in the latest Beige Book, up from 18 mentions in the March 2013 Beige Book and just eight mentions in the January 2013 Beige Book. In contrast, those words were found just once in the Beige Book released a year ago (April 2012). We will continue to monitor these health care words closely in the upcoming Beige Books, as the economy continues to adjust to the impact of the ACA. We expect this set of words to grow in importance in the coming weeks and months.
- In the Beige Book released in January 2013, “China” received no mentions, marking the first time since early 2012 that China was not mentioned by business and banking contacts. In the March 2013 edition, China had six mentions, many related to the timing of the Chinese Lunar New Year in 2013 (February) versus 2012 (January). There were just three mentions of China in the April 2013 Beige Book. Over the course of 2012, the financial media was chock full of stories on the economic slowdown in China and the recession and debt crisis in Europe. The Beige Book suggests that while those issues have not entirely disappeared from Main Street’s radar, they are far less of a concern than the media makes them out to be. Indeed, the last time China warranted as many as six mentions was in January 2012, as fears of a “hard landing” in China began to gather steam. The Chinese economy appeared to have bottomed out in late 2012, avoiding a “hard landing,” but market participants remain skeptical that China’s economy is rebounding. In any case, the recent Beige Books suggests that the pace of growth in China’s impact has been exiled on Main Street, for now.
- Despite the recent flare-up in Europe—this time related to the banking and deposit crisis in Cyprus—there were only nine mentions of “Europe” in the latest Beige Book, up from six in March 2013. Still, the nine mentions in April 2013 were well below the 15-20 mentions seen in the summer and fall of 2012, as Europe struggled through elections in Greece and increased fears of a break-up. Not surprisingly, nearly all of the mentions of Europe in the latest Beige Book were in a negative context. Perhaps business and banking contacts on Main Street are not as exposed to Europe as some of the larger businesses and financial institutions on Wall Street that dominate media coverage. But it is also worth noting that the European debt crisis is in its fourth year, and Main Street may be getting used to it now.
- The word “weather” appeared 29 times in the April 2013 edition of the Beige Book, the most appearances since April 2012 (34 mentions).



All but a few of the 29 mentions were in a negative context, i.e., cold, snowy, or unseasonable weather adversely impacting economic activity. This helps to explain, in part, the poor U.S. economic data reports—both on an absolute basis and relative to expectations—for March and April. The key takeaway here is that our BBB hit an eight-year high despite the miserable weather in late February, March, and early April 2013. This suggests that a return to “normal” weather could provide a significant lift to upcoming readings on our BBB. ■

---

#### 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.

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.

Quantitative easing (QE) 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 (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).

---

#### INDEX DESCRIPTIONS

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.

This research material has been prepared by LPL Financial.

To the extent you are receiving investment advice from a separately registered independent investment advisor, please note that LPL Financial is not an affiliate of and makes no representation with respect to such entity.

Not FDIC/NCUA Insured | Not Bank/Credit Union Guaranteed | May Lose Value | Not Guaranteed by any Government Agency | Not a Bank/Credit Union Deposit