

# Weekly Economic Commentary



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## Beige Book: Window on Main Street Unseasonable Weather Weighs on the Economy

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### Highlights

The latest edition of the Fed's Beige Book, released on June 5, 2013, underscores the impact of the weather and the lack of impact from the sequester on the U.S. economy.

Health care continues to be a big part of the conversation on Main Street.

Although the Beige Book Barometer dipped in June, the latest Beige Book notes that the economy continued to expand at a "modest to moderate pace" from mid-April through late May 2013.

Please see the LPL Financial Research Weekly Calendar on page 3

### 1 Beige Book Barometer Eases From 8-Year High in June

— 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 06/10/13

At the start of 2013, most market participants expected the economy to struggle under the weight of the fiscal cliff, and later, the sequestration imposed on the federal budget by Congress. Instead, it appears that a colder-than-normal winter and a cooler-than-usual spring is having a more pronounced impact on the economy. The latest edition of the Federal Reserve's (Fed) Beige Book, released on June 5, 2013, underscores the impact of the weather and the lack of impact from the sequester on the U.S. economy.

In order to provide one snapshot of the entire Beige Book collage of data, we created our proprietary "Beige Book Barometer (BBB)." The barometer ticked down to +82 in June 2013 from +112 in April 2013. The March 2013 reading was +66. Despite the downtick between April and June 2013, the BBB remains well above its Superstorm Sandy-related dip to +30 in November 2012. The April 2013 reading (+112) was both a post-Great Recession high of +101 and also the highest reading since 2005, suggesting a broadening and deepening of the economic expansion. The move down to +82 from +112 between the April and June 2013 editions of the Beige Book came as the number of positive words dropped and the number of negative words moved higher, after hitting 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.

### Very Little Impact From the Sequester in the Latest Beige Book

The word "fiscal" appeared just five times in the latest Beige Book, down from 12 in April 2013. There were 17 mentions in the March 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 with 38 mentions of the word fiscal, the January 2013 Beige Book likely overstated the impact of the fiscal cliff on economic activity in early 2013.



## How the Barometer Works

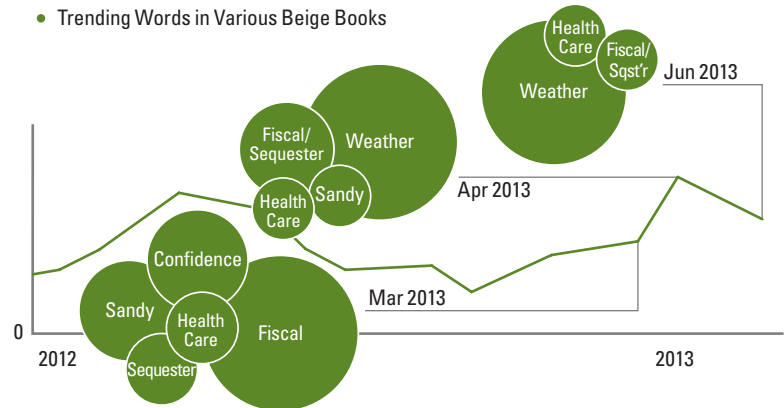
The Beige Book Barometer is a diffusion index that measures the number of times the word “strong” or its variations appear in the Beige Book less the number of times the word “weak” or its variations appear. When the Beige Book Barometer is declining, it suggests that the economy is deteriorating. When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

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

## 2 Weather and Healthcare Concerns Are Driving the Conversation on Main Street

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

• Trending Words in Various Beige Books



Source: Federal Reserve Board, LPL Financial 06/10/13

The latest Beige Book described wage pressures as “well contained” and “level to mild price increases” in most districts.

At the start of 2013, as Congress passed legislation to avoid the worst-case scenario of the fiscal cliff, but allowed the sequester to proceed, we expected that the word sequester would start to appear more often in the Beige Book. Thus far, however, that has not been the case. The word sequester was not used at all in the latest Beige Book and appeared just once in the April 2013 Beige Book. Mentions of budget or budget cuts have been almost non-existent in the recent Beige Books as well. Looking ahead, we still expect the word sequester (or related words) to show up in the next several Beige Books, but with the debt ceiling debate and possible government shutdown now pushed back until late 2013, fiscal uncertainty outside of the impact of the sequester will likely continue to fade in upcoming Beige Books.

## Word Clouds Show Unseasonable Weather and Growing Concern About Impact of Health Care Reform

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.

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 June 5, 2013) relative to other recent editions of the Beige Book.

- In the last two Beige Books (April and June 2013) the word “weather” appeared a total of 56 times, 29 times in the April 2013 edition of the Beige Book, and 27 times in the June 2013 version. The 56 mentions of weather were the most in consecutive Beige Books since February and April 2012 (63 mentions) and all but a few of the 56 mentions in the last two (April and June 2013) were in a negative context (i.e., cold, cooler, 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 much of the spring



LPL Financial Research Weekly Calendar

	U.S. Data 	Fed 	Global Notables 
2013			
10 Jun		Bullard*	<ul style="list-style-type: none"> <li>Italy: Industrial Production (Apr)</li> </ul>
11 Jun	<ul style="list-style-type: none"> <li>Small Business Sentiment Index (May)</li> <li>JOLTS (Apr)</li> </ul>	<p><b>FOMC</b> <b>Quiet Period</b></p>	<ul style="list-style-type: none"> <li>Japan: Bank of Japan Meeting</li> </ul>
12 Jun	<ul style="list-style-type: none"> <li>Budget Statement (May)</li> </ul>		<ul style="list-style-type: none"> <li>Japan: Machine Orders (Apr)</li> <li>New Zealand: Central Bank Meeting</li> <li>Eurozone: Industrial Production (Apr)</li> </ul>
13 Jun	<ul style="list-style-type: none"> <li>Retail Sales (May)</li> <li>Initial Claims (6/8)</li> <li>Business Inventories (Apr)</li> </ul>		<ul style="list-style-type: none"> <li>Philippines: Central Bank Meeting</li> <li>Italy: Bond Auction</li> </ul>
14 Jun	<ul style="list-style-type: none"> <li>PPI (May)</li> <li>Industrial Production (May)</li> <li>Capacity Utilization (May)</li> <li>Consumer Sentiment (1H Jun)</li> </ul>		<ul style="list-style-type: none"> <li>Japan: Prime Minister Abe releases details of his growth strategy</li> </ul>

- 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)

3 Beige Book Word Clouds



Source: The Federal Reserve Beige Book, LPL Financial 06/10/13



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



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

(March, April, May, and early June). The key takeaway here is that our BBB hit an eight-year high in April 2013, despite the miserable weather in late February, March, and early April 2013, but the poor weather finally weighed on the BBB in June 2013. This suggests that a return to “normal” weather could provide a significant lift to upcoming readings on our BBB. (See this week’s *Weekly Market Commentary: The Butterfly Effect* for more details).

- The latest Beige Book notes that the economy continued to expand at a “modest to moderate pace” from mid-April through late May 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 Fed that there is upward pressure on wages or prices. However, there are some signs in the Beige Book that price increases are starting to appear, which in turn might cause the Fed to slow down or stop its latest round of quantitative easing (QE). Still, the latest Beige Book described wage pressures as “well contained” and “level to mild price increases” in most districts.
- 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. Sandy and the fiscal cliff have since faded as concerns, and uncertainty has faded a bit as well. There were just 13 mentions of the word “uncertain” in the June 2013 Beige Book, down from 16 in the April 2013 Beige Book. It was used 26 times in March 2013 and 43 in January 2013. The 13 mentions of uncertain in the June 2013 Beige Book were the fewest since April 2012.



It is worth noting that the European debt crisis is in its fourth year, and Main Street may be getting used to it now.

## 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 June 18–19, 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 (June 5, 2013), in April 2013, and in March 2013. 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 10 times in the latest Beige Book, seven times in the April 2013 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), nine of the 10 mentions in June, 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 28 times in the latest Beige Book, up from 26 mentions in the April 2013 Beige Book and 18 mentions in the March 2013 Beige Book. The topic warranted just eight mentions in the January 2013 Beige Book. In contrast, those words were found just a handful of times in the Beige Book released a year ago (June 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 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 both the April and June 2013 Beige Books. 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 recent data in China suggest that it has not re-accelerated as quickly as some market participants hoped.
- There were only eight mentions of “Europe” in the latest Beige Book, down from nine mentions in the April 2013 Beige Book. Europe was mentioned just six times in the March 2013 edition of the Beige Book. The eight mentions in June 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. ■



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#### 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).

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#### 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.

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