

# Market Comment *Economic Highlights for the week ended January 13, 2012*

## **Economic Week in Review: U.S. Activity Quickens; Europe's Woes Continue**

Vanguard 1/13 - Sluggish retail sales data were announced this week following a report that consumer borrowing increased in November by the highest amount in a decade. This suggests that while spending isn't particularly strong, consumers are nonetheless continuing to spend and provide moderate support for the overall economy. For the week ended January 13, the S&P 500 Index rose 0.9% to 1,289.09 (for a year-to-date total return—including price change plus dividends—of about 2.6%). The yield on the 10-year U.S. Treasury note fell 9 basis points to 1.89% (for no change year to date).

## **Wholesale Inventories – November: Business Inventories Increase Less Than Expected**

Vanguard 1/13 - Business inventories rose 0.3% in November after building 0.8% in October. Economists had forecast a 0.4% increase. The inventory-to-sales ratio held steady at 1.27, well below the recession high of 1.49. Inventories are a key element for measuring changes in gross domestic product. November manufacturer inventory accumulation was reduced by half. The retail inventory-to-sales ratio was at an all-time low of 1.32.

## **Fed Beige Book: Evidence of Possible Economic Strength**

Vanguard 1/13 - Wednesday's Beige Book report showed strengthening output and job growth in all regions from late November to the end of December. Most districts reported higher holiday retail sales than last year, and demand for professional and transportation services increased. Manufacturing also increased, although the pace has slowed. Residential real estate activity held steady at very low levels and prices remained stable.

Barclay's 1/11 – Fed's Beige Book: Modest to moderate increase in activity, boosted by 'vibrant' auto sector

The Federal Reserve's December Beige Book, which reflects information gathered prior to December 31, reported that national economic activity expanded at a "modest to moderate pace" and that none of the districts reported a decline. The assessment of conditions is a slight improvement from the November Beige Book, which described economic activity as increasing at a "slow to moderate pace." Consumer spending, in particular, showed encouraging signs in most districts, due in part to "significant gains in holiday retail sales compared with last year's season." Auto sales and travel/tourist activity also continued to rise in most districts. Manufacturing activity increased in most districts, with the strongest reports coming from "heavy equipment manufacturing and steel." This reflects growth in the energy and agricultural sectors, as well as increasing auto demand. In terms of banking and financing, financial institutions reported small improvements in both loan demand and overall credit quality. The softer aspect of the report continues to be related to activity in the residential real estate sector, which remained "at very low levels," although the report did acknowledge improvement in construction activity related to multifamily units. In terms of prices, the report indicated that price pressures were "very limited," as pressure from higher commodity prices have eased. Wage pressures were reported as "modest overall," although a few districts noted "large compensation increases" for some workers in specialized fields. Overall, we see this report as taking a slightly more upbeat tone in terms of activity compared with the November Beige Book and view the easing in commodity prices and "numerous job seekers" as likely to keep price pressures contained. Details:

- Consumer lending was "largely flat," while a few reports indicated that some small businesses continue to struggle to obtain credit from banks.
- Agricultural products saw "strong" demand, and growing conditions were "somewhat mixed" across all areas.

## **Consumer Credit – November: Consumer Borrowing Surges**

Vanguard 1/13 - U.S. consumer borrowing rose nearly 10% in November, the highest increase since October 2001. The chief driver was the \$14.8 billion surge in non-revolving credit, which includes federal and student loans.

Credit card debt and other revolving credit rose by \$5.6 billion for its largest monthly gain since March 2008. To date, consumer credit has increased in all but one month in 2011.

AFP 1/16 - American consumers took on significantly more debt in November, in what may be sign of both growing confidence in the future but also a greater need to use credit to fund consumption.

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## Retail Sales – December: Softer Than Expected US Retail Sales

Vanguard 1/13 - Retail sales rose 0.1% in December, the slowest increase since May. While sales of auto, furniture, and building supplies increased, sales at electronics stores, gas stations, and other general merchandise outlets fell. At 6.5%, year-over-year growth was at its weakest since August 2010.

Declining housing prices, low consumer confidence, and fears of higher taxes and reduced government spending all appeared to weigh heavily on spending. Low inflation remains a positive.

Barclays 1/12 - Retail sales rose 0.1% m/m in December, below our forecast (0.2%) and the consensus (0.3%). A gain in auto sales (1.5%) was broadly offset by a decline in gasoline sales (-1.6%), while an increase in building materials (1.6%) boosted the headline. Excluding these three items, the "core" retail sales measure fell 0.2%, well below our forecast (+0.4%) and the consensus (+0.3%). An upward revision to core retail sales growth in November (to 0.3% from 0.2%) was offset by a downward revision to October (to 0.5% from 0.6%). On net, this was a negative.

## Trade Deficit – November: Trade Deficit Widens Significantly

Vanguard 1/13 - The U.S. foreign trade deficit widened in November to \$47.8 billion—from \$43.3 billion in October—as imports increased 1.3% and exports declined 0.9%. This latest deficit shortfall was the largest since May's \$6.9 billion increase. Exports have weakened substantially in the last few months as the European, Asian, and Latin American economies have slowed. The European region accounted for about half of the widening.

"In addition to weaker U.S. exports, the widening gap has been driven by increased imports," said Vanguard senior economist Roger Aliaga-Díaz. "This isn't necessarily all bad, since higher imports are evidence of stronger consumer demand and business restocking."

Barclays 1/13 - Imports also contributed to the wider deficit by rising 1.3%, the largest percentage gain in five months, and were driven by capital goods (0.3%) and industrial supplies (4.5%) imports. Imports of consumer goods fell 1.6%.

In terms of geographic regions, exports to the euro area on a non-seasonally adjusted basis fell \$1.2bn and, based on our seasonal adjustment, exports to the area were down \$333mn. These declines are noticeable, but not out of line with historical volatility and swings that pre-dated the crisis. Also, relative to a year ago, exports are \$380mn higher. Still, export growth has noticeably slowed to the euro area, but not to an extent that would pose a major risk to US growth. This is not to say the US is immune to events in the euro area - instead, it suggests that slower trade is unlikely to be the primary transmission channel. Should the situation deteriorate further, we expect the risk to the US to come via the financial system, rather than through the direct trade channel.

Exports to mainland China increased \$200mn (nsa) and after seasonally adjusting the data, we estimate exports increased by \$273mn. Over the past year, exports to China are up \$0.5bn, compared to a \$2.2bn increase in imports. For November, the trade deficit with China remained at a sizeable \$26.9bn (nsa), compared for example, with the \$8.4bn (nsa) deficit with the euro area.

## Consumer Sentiment – January: Continues Recent Trend Of Upside Surprises

Barclays 1/13 - The University of Michigan's index of consumer sentiment rose to 74.0 in the preliminary January release, up from the final December reading of 69.9 and above what we and consensus were expecting (71.5). This is the fifth consecutive month in which consumer confidence has increased. The index of current conditions rose to 82.6 from 79.6 as respondents reported feeling more secure about their employment and perceived less income uncertainty. 43% of respondents viewed business conditions as being better now than a year ago, which was up from 36% in December and the highest reading since May. The expectations index posted a larger gain, increasing to 68.4 from 63.6. Only 14% of respondents expected their financial situation to be worse a year from now, down from 17% in December and lower than at any point in 2011, and 22% (previous: 18%) of respondents expected lower unemployment in the coming year. Buying conditions for large household goods continued to show positive signs, as 61% of respondents said that it was a good time to buy (previous: 61%), compared with 31% that said it was a bad time to buy (previous: 33%). Median inflation expectations rose slightly, to 3.2% for the year ahead (previous: 3.1%) and to 2.8% for the next five to ten years (previous: 2.7%).

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We view this as a positive report and an indication that consumer sentiment is on a durable upward trend following the August confidence shock.

We do see a risk to sentiment, however, stemming from how Congress handles the impending expiration of the payroll tax cut. Despite the two-month extension passed in December, there is a risk that the political debate will again turn contentious next month.

### Unemployment Insurance Weekly Claims Report (Initial Jobless Claims) – week of Jan. 7

Press Release 1/12 (excerpts) - In the week ending January 7, the advance figure for seasonally adjusted initial claims was 399,000, an increase of 24,000 from the previous week's revised figure of 375,000. The 4-week moving average was 381,750, an increase of 7,750 from the previous week's revised average of 374,000.

WEEK ENDING	Jan 7	Dec 31	Change	Dec 24	Prior Year
Initial Claims (SA)	399,000	375,000	+24,000	387,000	437,000
4-Wk Moving Average (SA)	381,750	374,000	+7,750	376,500	420,500

Barclays 1/12 – US initial jobless claims increased by 24k, to 399k for the week ending January 7 from an upwardly revised 375k in the prior week (initial estimate: 372k). The modest retracing in claims likely reflects that the more rapid fall in December was overstated, so we don't view the increase as indicative of a reversal in the downward trend. In addition, hiring and layoffs are notoriously volatile during and after the holiday season, so reflect substantial seasonal adjustments.

### The Economic Week Ahead: Jan 16 (Holiday) – Jan 20, 2012

Vanguard 1/13 - Upcoming reports include producer prices and industrial production (Wednesday), consumer prices (Thursday), and new residential construction and existing-home sales (Friday).

*This Week's U.S. Economic Calendar*

*Source: MarketWatch*

	time (et)	report	period	Actual	forecast	previous
<b>Monday, JAN. 16</b>		None scheduled				
<b>Tuesday, JAN. 17</b>	8:30 am	Empire State Index	Jan.	13.5	11.3	8.2
<b>Wednesday, JAN. 18</b>	8:30 am	<b>Producer Price Index</b>	Dec.		0.1%	0.3%
	8:30 am	Core PPI	Dec.		0.1%	0.1%
	9:15 am	<b>Industrial Production</b>	Dec.		0.4%	-0.2%
	9:15 am	Capacity Utilization	Dec.		78.0%	77.8%
<b>Thursday, Jan. 19</b>	8:30 a.m.	Jobless Claims	1-14		375,000	399,000
	8:30 am	<b>Consumer Price Index</b>	Dec.		0.1%	0.0%
	8:30 am	Core CPI	Dec.		0.2%	0.2%
	8:30 am	Housing Starts	Dec.		695,000	685,000
	10 am	Philly Fed	Jan.		9.3	6.8
<b>Friday, JAN. 20</b>	10 am	Existing Home Sales	Dec.		4.70 million	4.42 million