Economic Week In Review: Snow Caps A Turbulent Week

Vanguard 2/12 - Furious winter storms blanketed much of the east coast but not market movement, as the Dow Jones Industrial Average was up and down triple digits for much of the week. Retail sales showed modest gains and inventories fell, a sign the economy is chugging its way toward a slow but still jobless recovery.

For the week, the S&P 500 rose 0.9% to 1,076 (for a year-to-date total return of about –3.3%). The yield of the 10-year U.S. Treasury note increased 10 basis points to 3.69% (for a year-to-date decrease of 16 basis points).

Retail Sales Edge Up - January

Vanguard 2/12 - Retail sales in January rose modestly at 0.5%, largely in supercenters, non-store retailers, and electronic and appliance centers. The increase was marginally better than expected and up 4.7% from last year's total, though down from January monthly levels for 2008 and 2007. Inclement weather likely reduced spending for household and home-improvement goods while boosting demand for food and other winter weather-related supplies.

The bottom line is that consumers were still keeping a tight grip on their wallets, a concern since consumer spending comprises almost 70% of the nation's GDP. The slight uptick in sales seemed to be primarily caused by fewer layoffs, slightly higher wages, and an increase in stock prices.

Econoday 2/12 – Not only were holiday sales front loaded in November but it appears that they were back loaded into January also as consumers apparently spent their cash and gift cards in January. Overall retail sales in January posted a healthy rebound of 0.5% after dipping 0.1% the month before. The comeback matched the market forecast for a 0.5% gain. Also, December was revised up from a 0.3% decline. Excluding autos, sales in January were up 0.6%, following December's drop of 0.2%. Components were mixed with gasoline playing an essentially neutral role. Excluding both autos and gasoline, January sales rebounded 0.6%, following a 0.3% decrease in December.

The January boost in sales was led by non-store retailers, general merchandise, and electronics & appliance stores. Weakness was mostly housing related as declines were led by furniture & home furnishings and building materials & garden equipment. Other components in the negative included miscellaneous store retailers and auto dealerships.

On average, the last three months of retail sales have been moderately strong. While not at a typical recovery pace, the consumer sector appears to be pulling its weight somewhat more than earlier expected.

WSJ 2/12 – Economists React:

- Retail sales rose in January and the January levels for headline, core, and core ex-gasoline spending are above their Q4 levels. Consumers continue to spend, albeit cautiously, amid high unemployment, relatively sluggish income growth, and tight credit. – *Steven Wood, Insight Economics*
- January's better results in large part represent a bounce from an understated December. – *Joshua Shapiro, MFR*
- The momentum in retail sales growth picked up over the last three months, although the bulk of the acceleration was due to the gain in sales in November. Nonetheless, in fits and starts, consumer spending continues to advance at a moderate rate and we estimate, based on January sales data, that real [consumer spending] in the month will be 2%–2½% ahead of the fourth-quarter average at an annual rate. – John Ryding and Conrad DeQuadros, RDG Economics

Business Inventories Drop - December

Vanguard 2/12 - Inventories fell 0.2% for December, below the expected 0.3% increase and down by 9.7% from a year ago. However, inventories of building materials jumped 1.6%, consistent with the weak demand caused by adverse weather conditions. Inventory levels are an important component of GDP, which surged 5.7% in the fourth quarter of 2009—suggesting that lower inventories indicate increased consumer demand.

Econoday 2/12 - Businesses remain very reluctant to add to their costs and are keeping inventories down as much as possible as of course they are with employment. But the general outlook for demand is mildly positive, pointing to a cycle of inventory build that will hopefully draw workers off the unemployment rolls.

Press Release 2/12 (excerpts) –Inventories: Manufacturers' and trade inventories, adjusted for seasonal variations but not for price changes, were estimated at an end-of-month level of $1,310.7 billion, down 0.2% (±0.1%) from November 2009 and down 9.7% (±0.4%) from December 2008.

Inventories/Sales Ratio: The total business inventories/sales ratio based on seasonally adjusted data at the end of December was 1.26. The December 2008 ratio was 1.46.

International Trade - December

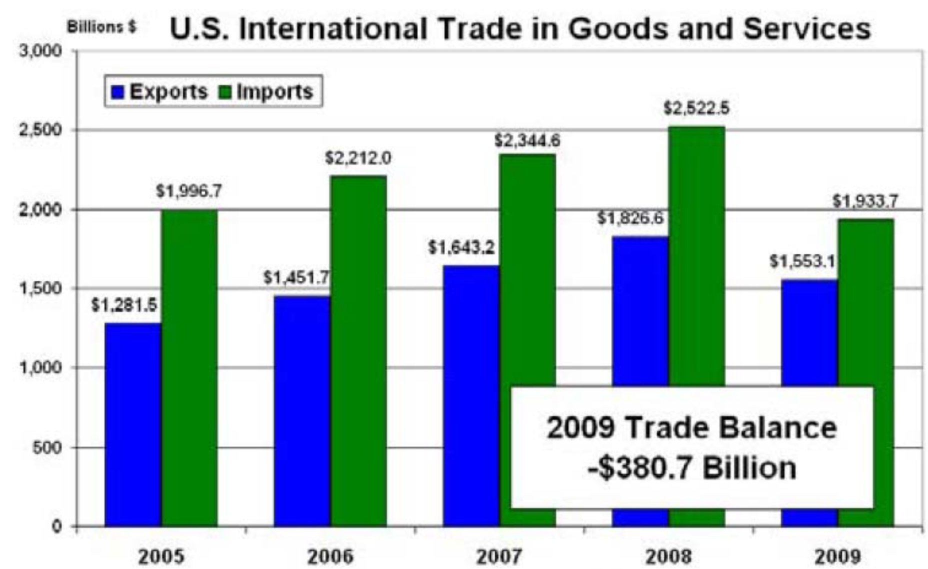
Vanguard 2/12 - The trade deficit rose to $40.2 billion in December, beyond the expected $35.8 billion despite a $3.3 billion increase in exports. The figures rose primarily on a sudden jump in petroleum imports, a sign that demand could be rising because businesses are gearing up to increase production. Indeed, the long-term trend in trade exports was driven by a 5% increase in capital goods and a 6% hike in industrial supplies, while automobile imports and exports were up 10%—<u>all positive signs that higher trade volume bodes well for economic expansion</u>.

Econoday 2/10 - Earlier weakness in the dollar and Asian economic growth continue to boost the trend in U.S. exports. Year-on-year, overall exports in December rose to plus 7.4% from minus 2.4% in November. Of course, a low base for the comparison helps. Meanwhile imports increased to up 4.6% from down 5.6% the month before. <u>Despite the low base starting point, it is clear that international trade – exports and imports – is recovering.</u>

Press Release 2/10 (excerpts) - The Census Bureau and the U.S. Bureau of Economic Analysis, announced today that total December exports of $142.7 billion and imports of $182.9 billion resulted in a goods and services deficit of $40.2 billion, up from $36.4 billion in November, revised.

In December, the goods deficit increased $3.4 billion from November to $51.8 billion, and the services surplus decreased $0.4 billion to $11.7 billion.

<u>For 2009</u>, exports of $1,553.1 billion and imports of $1,933.7 billion resulted in a goods and services deficit of $380.7 billion, $315.3 billion less than the 2008 deficit of $695.9 billion. For goods, exports were $1,045.6 billion and imports were $1,562.5 billion, resulting in a goods deficit of $517.0 billion, $323.3 billion less than the 2008 deficit of $840.3 billion. For services, exports were $507.5 billion and imports were $371.2 billion, resulting in a services surplus of $136.3 billion, $8.0 billion less than the 2008 surplus of $144.3 billion.



Wholesale Trade - December

Econoday 2/9 - Wholesale inventories fell 0.8% in December led down by a 1.1% drop in durables. Wholesale inventories of non-durable goods fell 0.3%. Inventories at the wholesale level had been building in the prior two months which contributed to the fourth-quarter GDP's big inventory boost.

Definition: Wholesale trade measures the dollar value of sales made and inventories held by merchant wholesalers. It is a component of business sales and inventories.

Unemployment Insurance Weekly Claims Report (Initial Jobless Claims) – week of Feb. 6

Econoday 2/11 (excerpts) - The administrative backlog from the New Year holidays was supposed to have already cleared up. But not so fast! The Labor Department attributes a stunning 43,000 drop in initial claims to 440,000 for the Feb. 6 week -- not to economic improvement -- but to the final end of the backlog, a backlog that inflated levels in prior weeks. Given the haze of the backlog effect, the four-week average offers the best handle on the data, falling for the first time in four weeks, though only by 1,000 to 468,500 and little changed from mid-December before the backlogs started to build.

Snow-storms will begin clouding the claims report this time next week, likely producing fewer claims but pointing to another backlog as the unemployed, once the streets are clear, make their way to the claims office.

Press Release 2/11 – In the week ending Feb. 6, the advance figure for seasonally adjusted initial claims was 440,000, a decrease of 43,000 from the previous week's revised figure of 483,000. The 4-week moving average was 468,500, a decrease of 1,000 from the previous week's revised average of 469,500.

The advance seasonally adjusted insured unemployment rate was 3.5% for the week ending Jan. 30, unchanged from the prior week's unrevised rate of 3.5%.

The advance number for seasonally adjusted insured unemployment during the week ending Jan. 30 was 4,538,000, a decrease of 79,000 from the preceding week's revised level of 4,617,000. The 4-week moving average was 4,603,500, a decrease of 17,750 from the preceding week's revised average of 4,621,250.

The fiscal year-to-date average for seasonally adjusted insured unemployment for all programs is 5.322 million.

WEEK ENDING	Advance Feb. 6	Jan. 30	Change	Jan. 23	Prior Year
Initial Claims (SA)	440,000	483,000	-43,000	472,000	617,000
4-Wk Moving Average (SA)	468,500	469,500	-1,000	457,000	601,500

Reuter's / University of Michigan Consumer Sentiment Index – (mid) February

Econday 2/12 - Consumer sentiment edged back in the mid-February reading, down 7 tenths to 73.7 and failing to extend mild momentum that appeared in late January. The assessment of current conditions actually rose in the period but was offset by a dip in expectations which is the leading component for the report. The expectations index, at 66.9, is back to where it was in November. One-year inflation expectations edged back slightly to 2.7%. It's simple enough: Weakness in the jobs market will continue to contain consumer spirits.

The Economic Week Ahead: Feb. 15 – Feb. 19 **President's Day** ***& Happy Mardi Gras!***

Vanguard 2/12 - A brisk week of reports starts Wednesday with new residential construction, industrial production, and minutes from the Federal Open Market Committee meeting. Thursday features reports on jobless claims, producer prices, and leading indicators from the Conference Board, followed by Friday's reports on consumer prices.

U.S. Economic Calendar

Date	ET	Release	For	Briefing.com	Consensus	Prior
Feb 17	08:30	Housing Starts, Building Permits	Jan	535K	580K	557K
Feb 17	08:30	Import, Export Prices ex-ag, ex-oil	Jan	NA	NA	0.4%
Feb 17	09:15	Industrial Production	Jan	0.4%	0.8%	0.6%
Feb 17	09:15	Capacity Utilization	Jan	72.3%	72.6%	72.0%
Feb 17	14:00	Minutes of FOMC Meeting	1/28			
Feb 18	08:30	Initial Claims for Unemployment Ins.	02/13	460K	430K	440K
Feb 18	08:30	Producer Price Index (PPI)	Jan	0.9%	0.8%	0.2%
Feb 18	10:00	Leading Indicators	Jan	0.6%	0.5%	1.1%
Feb 18	10:00	Philadelphia Fed	Feb	16.2	17.0	15.2
Feb 19	08:30	Consumer Price Index (CPI)	Jan	0.2%	0.3%	0.1%

Source: Briefing.com

See Appendix for articles on FOMC Tightening Strategy, Fannie & Freddie Situation, Foreclosures & REO

FOMC Potential Interest Rate Tightening Strategy: Fed to Bare Tightening Plan (WSJ)

Bank of America 2/8 - According to the Journal, Chairman Bernanke is going to start this week to lay out a guidebook for the path of monetary policy tightening. At the outset let us just reiterate that even though the Fed plans to start communicating an exit strategy this week, it does not mean they are going to implement the exit plan next week.

We expect the Fed to stay on hold through March 2011. The economic landscape remains fragile and we need to see the unemployment rate do what it did last week (drop 0.3 ppts) at least 3 or 4 more times before the Fed even thinks about exiting, in our view. We think seeing the unemployment rate move on a sustained path below 9% is fairly unlikely in the near future.

Back to the exit strategy – given that the Fed has basically lost control of the Fed funds rate, the mechanism through which the Fed will tighten will be the interest rate the Fed pays banks on money they leave on reserve at the Fed – the "interest on excess reserves rate", or IOR. This rate is currently at 0.25%, the top of the current Fed funds target range. If the Fed raises the IOR (which it would do in conjunction with a Fed funds target increase), it would make banks more inclined to leave money with the Fed. As a result the demand for credit is weakened. Other tools the Fed could use are term deposits – basically encouraging banks to keep money at the Fed for a set period – and reverse repurchase agreement transactions.

Fed to Bare Tightening Plan - Bernanke Prepares Future Strategy for Curbing Credit; Policy Shift Remains Months Off, by JON HILSENRATH (WSJ, 2/8/10, excerpts)

WASHINGTON—Federal Reserve Chairman Ben Bernanke will begin this week to lay out a blueprint for a credit tightening, to be followed once the Fed decides the economy has recovered sufficiently.

The centerpiece will be a new tool Congress gave the central bank in October 2008: an interest rate the Fed pays banks on money they leave on reserve at the central bank. Known as "interest on excess reserves," this rate is now 0.25%.

The Fed is still at least several months away from raising interest rates or beginning to drain the flood of money it poured into the financial system in 2008 and 2009. But looking ahead to when the economy is strong enough to warrant tightening credit, officials have been discussing for months which financial levers to pull, when to start and how best to communicate their intent.

When the Fed is ready to tap the brakes, it plans to raise the rate paid on excess reserves, according to Fed officials in interviews and recent speeches. The higher rate would entice banks to tie up money they otherwise might lend to customers or other banks. The Fed expects such a maneuver to pull up other key short-term rates, including the federal-funds rate at which banks lend to each other overnight—long the main tool for steering the economy.

"If the [Fed] were to raise the interest rate paid on excess reserves, this would raise the price of credit," New York Fed President William Dudley said in a December speech. "That, in turn, would limit the demand for credit."

The nature of its exit from today's unusually low interest rates will affect everything from mortgage rates and what companies pay on short-term borrowings to the rates savers earn. The timing and sequence of the steps are the subject of intense speculation in financial markets.

In the past, it simply raised its target for the federal-funds rate on banks' overnight borrowing. That rippled through to other rates. The Fed steers the fed-funds rate, which has been near zero since late 2008, by buying and selling securities to influence the supply of money in this market.

Plans for the Fed's portfolio of mortgage-backed securities are another element of the internal debate over the exit strategy from super-cheap money. The Fed is on course to buy up to $1.25 trillion of the securities, in an effort to hold down mortgage rates and buoy housing.

Over time, officials want to reduce these holdings and return to holding U.S. Treasury securities as the Fed's primary asset. But they are reluctant to take steps that might push mortgage rates higher and damage the still-fragile housing market. Eventually, they could gradually sell mortgage securities, but such a move would be unlikely in the early stages of tightening.

Another element of the emerging strategy centers on communication. After pushing rates very low last decade, the Fed vowed to raise them slowly—at a "measured" pace—from 2004 to 2006. It kept its word, raising rates in 17 straight quarter-point doses.

Some economists say locking into slow, predictable increases helped fuel the borrowing boom that led to the financial crisis.

Officials are reluctant to be so predictable this time. Uncertain about the outlook for the economy and markets, they want to avoid committing to a course they might later find inappropriate. They want to keep open their options: raising rates quickly; keeping them low for a long time; boosting them and then pausing, or some other tack, depending on the economy. Officials are warning investors and banks to prepare for surprises.

In January, Fed Vice Chairman Donald Kohn said: "Interest rates are difficult to forecast in the most settled or normal times, and their path is especially uncertain in the current circumstances."

GSEs: No Turning Back on Fannie, Freddie, Lockhart Says

Bloomberg 2/8 - The U.S. investment in Fannie Mae and Freddie Mac may be too deep to effectively transition the mortgage-finance companies out of government control and back into the hands of private investors, their former regulator said. “I think we may be too far along the line of government involvement,” James B. Lockhart III, who ran the Federal Housing Finance Agency from 2006 until August 2009, said in a Bloomberg interview today. Lockhart wasn’t excited about putting the companies into conservatorship in 2008 and pushed back against suggestions to take the more drastic step of receivership. Fannie Mae and Freddie Mac were seized by FHFA 17 months ago because of their risk of failing and have since survived on **$110.6 billion** in taxpayer- funded aid. “Most of that money will never be seen again,” said Lockhart. “They were just allowed to leverage themselves so dramatically.” The world would have “effectively fallen apart” if FHFA didn’t take the action it did as mortgage defaults rose, he said. Lockhart was “a little bit” disappointed in parts of Treasury Secretary Henry Paulson’s memoir that characterized FHFA as weak during deliberations over Fannie and Freddie. “Obviously, when you do something this big, you want to do it right,” Lockhart said. “Both firms could have sued us, taken us to court, and reversed it. We wanted to have it so they voluntarily consented to the conservatorships.”

WSJ 2/9 (excerpts) - ***No Exit in Sight for U.S. As Fannie, Freddie Flail***

…The companies are a convenient tool for the administration to use in its campaign to clean up the housing mess.

"We're making decisions on [loan modifications] and other issues, without being guided solely by profitability, that no purely private bank ever could," Mr. Haldeman (Freddie Mac’s CEO) said in late January in a speech to the Detroit Economic Club. “We're doing what's best for the country.”

Besides playing a key role in the loan-modification program, Fannie and Freddie have jump-started lending by state and local housing-finance agencies by helping to guarantee $24 billion in debt. They also are lending support to the apartment sector by becoming the main funders of loans to builders and buyers of apartment buildings.

By using Fannie and Freddie for such initiatives, the White House doesn't have to go to Congress for funding. The Treasury and White House can simply issue instructions to Fannie and Freddie via their federal regulator, the Federal Housing Finance Agency, or FHFA.

The government is "running Fannie and Freddie as an instrument of national economic policy, not as a business," says Daniel Mudd, who was forced out as Fannie Mae's chief executive in September 2008 when the government took control.

Lawrence Summers, the president's chief economic adviser, has said the companies shouldn't be run permanently by the U.S. or be allowed to "return to the failed model of the past, where Fannie and Freddie relied on an implicit government [debt] guarantee to borrow cheaply."

Others have proposed turning the companies into cooperatives owned by lenders, but subject to strict regulation.

John A. Koskinen, a turnaround specialist who became chairman of Freddie's board when the government stepped in, says that in all his years working for government agencies and troubled companies, "I've never been in one with as many challenges."

More than 7.2 Million Loans Behind On Payments; Estimated 1 Million Properties in REO Status

Press Release 2/3 – The January 2010 Mortgage Monitor report, released by Lender Processing Services, Inc., a leading provider of mortgage performance data and analytics, showed that home loan delinquency rates in the U.S. have now surpassed 10%. Factoring in foreclosures in process, according to the data in LPS’ database, the total non-current rate sits at 13.3%. When extrapolated to reflect the entire mortgage industry, this rate indicates that more than 7.2 million mortgage loans are now behind on payments. In addition, an estimated one million properties are now owned by banks. The January 2010 Mortgage Monitor report is an in-depth summary of mortgage industry performance indicators based on data collected as of December 31, 2009.

Prime loans, including agency, non-agency and jumbo, have experienced deterioration at a worse pace on a relative basis than subprime, FHA and all loans as a whole. Within the prime loans category, loans with current unpaid principal balances between $417,000 and $600,000 have performed the worse.