Market Comment *Economic Highlights for the week ended February 17, 2012*

Economic Week In Review: Fed holds back amid signs of progress

Vanguard 2/17 - The U.S. economy is showing progress as some risks abate—at least for the moment. A deal in Congress to extend a payroll tax cut and federal unemployment benefits means households won't end up with less cash to spend this year, which some analysts had feared could have caused the recovery to falter. And though the housing market remains deeply troubled, home construction is showing signs of life. The S&P 500 Index rose 1.4% to 1,361 (for a year-to-date total return—including price change plus dividends—of about 8.6%). The yield on the 10-year U.S. Treasury note rose 2 basis points to 2.01% (for a year-to-date increase of 12 basis points).

NFIB small-business index – January: US small business optimism continues to improve

Barclays 2/14 - The National Federation of Independent Business' index of US small business optimism increased to 93.9 in January from 93.8 in December, the fifth consecutive monthly increase. There was an increase in the net percentage of respondents expecting a better economy, but decreases in plans to expand inventories and plans to hire. 18% reported current job openings and 7% planned workforce reductions, the lowest level since 2007.

While there are some encouraging signs, an increase of 0.1 in the index does not suggest a significant recent boost to small business optimism. 22% of respondents cited poor sales as the single most important problem to small businesses, which suggests that there is room for continued improvement.

Retail Sales – January: core retail sales strong in January, but downward revisions to Q4

Vanguard 2/17 - In a reminder of the challenges besetting consumers, sales at retail stores rose less than expected in January, and previous estimates of sales in December were revised downward.

Though the economy added more jobs than expected in January, households still face a tough job market and modest pay hikes. Higher gasoline prices and credit constraints are also curbing spending. Unless hiring keeps exceeding expectations, analysts think consumers will remain unable to play a leading role in the recovery.

Econoday 2/14 –Retail sales in January jumped 0.4 percent. Weakness was largely in the auto component which dropped 1.1 percent. This heavily conflicts with unit new motor vehicle sales which rose for the month. Excluding autos, retail sales surged 0.7 percent in January after decreasing 0.5 percent in December.

Net, January is actually good after discounting very odd auto numbers. Sales were healthy for most subcomponents. However, GDP for the fourth quarter is likely to be nudged down.

Import Prices -January: Softer trend in core US import price inflation

Econoday 2/14 – A monthly swing higher in petroleum prices fed a 0.3 percent rise in import prices for January. But excluding a sizable 1.2 percent monthly jump in petroleum prices, import prices remain tame. Petroleum prices are up nearly 24 percent on a year-on-year basis but the pressure isn't being passed through to final goods prices where capital goods are only up a year-on-year 1.6 percent with consumer goods up 2.6 percent.

Export prices rose 0.2 percent in January with a 1.1 percent monthly gain in agricultural prices offset by wide declines in other components. Year-on-year, export prices are up a tame 2.5 percent.

Barclays 2/14 - By component, increases in the prices of autos and capital goods offset a drop in consumer goods ex autos. The latter was the first decline since March 2011 and suggests a softening in pipeline import price pressures in recent months, consistent with the recent strengthening of the trade-weighted dollar. On a y/y basis, headline import price inflation fell to 7.1%, and the ex-food and fuels measure was down to 2.7%.

Inventories – December: Business inventories report a negative for Q4 GDP tracking

Vanguard 2/17 – As auto sales outpaced production, retail inventories rose more slowly in December than in November. Overall inventories—including at factories and wholesalers—have been dropping slightly in relation to sales over the past several months, suggesting businesses continue to toe a careful line.

Economists track inventory levels against sales trends in part to gauge whether production may be poised to pick up to meet demand or to slow down to keep stockpiles from accumulating.

Econoday 2/14 – The nation's inventories are lean and well managed. Business inventories rose 0.4 percent in December, below the 0.7 percent rise for sales and pulling down the stock-to-sales ratio by 1 tenth to 1.26.

The fourth quarter's rate of inventory build is 0.9 percent vs a plus 1.3 percent rate in the third quarter. Slowing build points to the need to add to inventories and is a definite plus for jobs and for the economic outlook.

Industrial Production and Capacity Utilization – January: A much stronger report than the headline suggests

Vanguard 2/17 – With consumers struggling, industry remains under a microscope as analysts monitor whether it will keep shouldering its part of the economic recovery.

A surge in auto production buoyed U.S. manufacturing in January, but utility output sank as mild weather in some parts of the country let households and businesses turn down their furnaces. Mining also dipped. The combined effect left overall industrial production flat for January.

The much-lower-than-expected result was mitigated somewhat by upward revisions to readings for November and December. Meanwhile, February's regional reports showed solid manufacturing gains in the Northeast.

Econoday 2/15 – Industrial production in January was unexpectedly soft but due to weakness in mining and utilities. The manufacturing component was robust. Overall industrial production was unchanged in January after a 1.0 percent jump. By major components, manufacturing jumped 0.7 percent, utilities dropped 2.5 percent, while mining output declined 1.8 percent. Overall capacity utilization nudged down to 78.5 percent.

Barclays 2/15 - On an annualized q/q basis manufacturing output is now reported to have risen 5.1% in Q4 and is tracking growth of 10.5% in Q1. All in all, a notably stronger report than the headline number suggests, with a stronger end to Q4 for manufacturing output and momentum building into Q1, particularly in more cyclical areas such as vehicles and technology.

Housing Starts – January: Strength in US housing starts driven by multi-family component

Vanguard 2/17 – Another monthly increase in home construction in January was reinforced by upward revisions to December's figures and an increase in the number of construction permits issued—suggesting the higher trend may have legs.

Gauging trends in homebuilding can be difficult in the winter, when mild spells can prompt builders to speed up construction schedules and when dips in demand can be hard to distinguish from weather-related delays.

Even so, demand for new housing, especially apartments, has been inching higher as the economy slowly adds jobs, with the pace of construction rising on a year-over-year basis in seven of the past eight months. Meanwhile, despite mounting foreclosures in certain areas of the country, builders' confidence in the market for new homes, while still not good, has risen for five months.

Barclays 2/16 - Housing starts rose 1.5% m/m to 699k in January. The details were not as strong as the headline suggests as all of the gain was in the volatile multi-family component (up 8.5% to 191k). Single-family starts declined 1.0% to 508k, although the recent upward trend remains in place. Building permits rose 0.7% in January, with small gains in both single- and multi-family components, suggesting that start activity could pick up further in the coming months.

Home Builders' Index – January: Home builder confidence vaults higher

Barclays 2/15 - The NAHB index rose to 29 in February from 25 in January, the highest reading since May 2007. It was the fifth consecutive monthly increase and puts the index 13 points higher than it was in February 2011; the last time a yearly increase of that magnitude occurred was April 2004. There were gains in all three sub-components: the present conditions index of single family sales, the future conditions index of single family sales rose, and the prospective buyers traffic index. Regionally, the results were mixed. While the headline index is still low compared with the history of the series, we see this report as consistent with our view that housing will not hinder economic recovery in the same manner that it did at the end of the last recession.

FOMC minutes - Fed doesn't appear poised for new action

Vanguard 2/17 - Federal Reserve policymakers remain concerned enough about the economy's health to expect they'll keep interest rates exceptionally low for the next of couple years. But the minutes of their January meeting suggested that most thought the situation didn't yet warrant major new steps.

The Fed recently decided to communicate more openly about its goals as a way to help investors and businesses better plan their own moves. For the first time, it specified a preferred long-run rate of inflation, 2%.

But the minutes shed less light on what it would take for the Fed to inject more support into the economy—in particular, to launch a third round of securities purchases, known as quantitative easing. Members differed on just how much the economy has improved recently as well as on how vulnerable the recovery would be to a major upset—such as a chaotic default in Europe or a bigger-than-expected wave of U.S. foreclosures.

Because the Fed waits three weeks to release its minutes, they didn't reflect some recent bright spots, especially a surprisingly favorable employment report for January.

Nor did the discussion take into account Congress' extension on Friday of a payroll tax cut that will let some 160 million U.S. workers keep an estimated $100 billion through 2012. The deal also continues emergency unemployment benefits.

Barclays 2/15 - The main takeaway from the minutes of the January FOMC meeting was the subtle shift in the statement concerning the possibility of further near-term policy action, which suggests that while further QE remains a possibility, there is no strong inclination for action, given the current economic and market backdrop.

"All but one of the members expected the normalization process to follow the same path as previously set out, ie, with the first rate hike coming after the Fed has stopped reinvesting some or all of the payments of principal on maturing assets but before any outright sales of agency securities." Indeed, the text noted that "most participants saw sales of agency securities starting no earlier than 2015," consistent with the guidance that the fed funds rate was likely to remain exceptionally low at least through late 2014.

The majority of members continued to expect modest growth, with risks still tilted to the downside, particularly related to weaker activity abroad, strains in global financial markets and the potential for fiscal tightening at home. The staff's near-term GDP forecast was revised down, reflecting a decline in public defense spending and "a somewhat shallower trajectory for consumer spending."

On inflation, there was general consensus that it would remain "subdued," with risks broadly balanced. However, there was further evidence of a range of views, particularly with regard the degree of slack in labor and product markets. The minutes defined the term "subdued" (which was also used in the statement) as "[likely] to run at or below the 2 percent level the Committee judges most consistent with its statutory mandate over the longer run."

Unemployment Insurance Weekly Claims Report (Initial Jobless Claims) – week of Feb 11

Press Release 2/16 (excerpts) - In the week ending February 11, the advance figure for seasonally adjusted initial claims was 348,000, a decrease of 13,000 from the previous week. The 4-week moving average was 365,250, a decrease of 1,750.

The advance seasonally adjusted insured unemployment rate was 2.7 percent for the week ending February 4, a decrease of 0.1 percentage point from the prior week's unrevised rate.

The advance number for seasonally adjusted insured unemployment during the week ending February 4, was 3,426,000, a decrease of 100,000 from the preceding week's revised level of 3,526,000. The 4-week moving average was 3,492,500, a decrease of 8,250 from the preceding week's revised average of 3,500,750.

WEEK ENDING	Feb 11	Feb 4	Change	Jan 28	Prior Year
Initial Claims (SA)	348,000	358,000	-15,000	373,000	420,000
4-Wk Moving Average (SA)	365,250	366,250	-11,000	377,250	419,500

Barclays 2/16 - There now appears to be a well established downward trend in initial claims - the four-week moving average has moved lower in each of the last five weeks, down to a new post-recession low of 365k in the latest week. All in all, the solid downward trend in claims, alongside recent positive employment reports, reinforces our view that the labor market recovery is building momentum.

Producer Price Index – January: US Core PPI remains firm in January

Barclays 2/16 - The PPI rose 0.1% in January. However, the core PPI rose 0.4%. The headline figure was depressed by a 0.3% drop in food prices and a 0.5% drop in energy prices. On a y/y basis, the PPI increased 4.1%, while the core held steady at 3.0%. There is no sign that the slowing in food and energy price increases is moderating core PPI gains; over the past three months, the core PPI is up at a 3.2% annualized pace. Further up the inflation pipeline, core intermediate prices fell 0.1% in January and the y/y change slipped to 2.7. We expect the core PPI to moderate a bit in coming months given the easing pipeline and import price pressures. However, we do not expect that to show through into deceleration in the core CPI given that we see the main source of upward pressure there on the services rather than goods side.

Consumer Price Index- January

Vanguard 2/17 – The economy's progress didn't appear to be heating up overall prices. Exceptions at the retail level in January included some volatile categories such as gasoline and clothing.

Meanwhile, wholesale prices barely rose last month. Lower prices for some agricultural commodities and steadier crude oil prices kept costs down throughout the production pipeline.

Analysts expect inflation to stay well-contained over the next few years. With unemployment projected to decline very slowly, consumer and business borrowing still constrained, and wage increases only modest, analysts see scant opportunity for inflation to take off.

Barclays 2/17 - The CPI rose 0.2% m/m (sa) in January. The core CPI was also up 0.2%. The NSA CPI index printed at 226.665. On a y/y basis, the headline CPI fell a tenth to 2.9% and the core rose a tenth to 2.3%.

Within non-core items, both food prices and energy prices rose 0.2%. Within the core, there were 0.2% gains in both core goods and core services. Persistent small gains in these components underpin our view that core CPI inflation will continue to trend higher. New vehicle prices were flat but used vehicle prices fell 1.0%, the fifth consecutive decline. Our view is that this is likely marks the end of the move down in used vehicle prices.

On an annualized 3m/3m basis, the core CPI was up 2.2% and has risen at an above-2% pace 10 of the past 11 months. Today's report supports our view that core inflation will remain above 2% throughout this year and next, with small gains in core services prices likely to persist but declines in some core goods unlikely to.

Leading Indicators – January

Vanguard 2/17 – More job creation and brisk auto sales in January contributed to the fourth increase in the Conference Board's index of leading economic indicators. The reading for December was also revised upward.

Most of the index's components rose, though not the one that gauges consumer expectations.

Barclays 2/17 - The index of leading economic indicators increased by 0.4% in January. There were positive contributions from average workweek, stock prices, and the Conference Board's Leading Credit Index. Interest rate spreads (0.20%) have provided a positive contribution to the index since February 2008 and we look for this trend to continue. There was a negative contribution of 0.10% from consumer expectations. Overall the report is largely in line with the improving conditions seen recently in the labor and equity markets.

The Economic Week Ahead: Feb 20 – Feb 24, 2012

Vanguard 2/17- Presidents' Day will make for a short business week, with figures on sales of existing homes due out on Wednesday and new homes on Friday.

This Week's U.S. Economic Calendar *Source: MarketWatch*

	TIME (ET)	REPORT	PERIOD	FORECAST	PREVIOUS
MONDAY, FEB 20		None scheduled			
TUESDAY, FEB 21	8:30 am	Chicago Fed national activity index	Jan.	--	0.54
WEDNESDAY, FEB. 22	10 am	Existing home sales	Jan.	4.70 mln	4.61 mln
THURSDAY, FEB. 23	8:30 a.m.	Jobless claims	2-18	353,000	348,000
	10 am	FHFA home prices	Dec.	--	1.0%
	11 am	Kansas City Fed	Feb.	--	7
FRIDAY, FEB. 24	9:55 am	Consumer sentiment	Feb.	73.0	72.5
	10 am	New home sales	Jan.	315,000	307,000