Economic Week In Review: Stocks Gain On Fed Decision, Inflation Outlook

Vanguard 3/19 - Despite today's selloff, stocks rose this week on the continued outlook for modest inflation and the Fed's decision to keep interest rates at historically low levels. Other economic news was more mixed. Wholesale prices fell, industrial production rose modestly, new-home construction dropped, and an index of leading economic indicators increased for the eleventh consecutive month. For the week, the S&P 500 rose 0.9% to 1,160 (for a year-to-date total return of about 5.0%). The yield of the 10-year U.S. Treasury note decreased 1 basis point to 3.70% (for a year-to-date decrease of 15 basis points).

Fed Holds Rates Steady

Vanguard 3/19 - The Federal Open Market Committee again said on Tuesday that it would keep the target range for the federal funds rate at 0% to 0.25% for an "extended period." The fed funds rate—the interest rate banks charge one another for lending and the benchmark for the market's short-term rates—has been unchanged since mid-December 2008. In its statement, the Fed indicated that it expects the labor market to stabilize and economic growth to continue. The news, combined with this week's benign inflation report, bolstered expectations of a sustained but modest recovery.

According to Vanguard economist Roger Aliaga-Diaz, the break-even inflation rate (BEI)—the yield spread between U.S. Treasuries and TIPS—is one of the key forward-looking indicators of inflation that the Fed closely follows. "The current reading of the BEI is 1.9% annual average inflation for the next 5 years and 2.3% annual inflation for the next 10 years," said Mr. Aliaga-Diaz. "This is well within the Fed's comfort zone, so there is no indication the FOMC will move rates before there are clear signs of job creation and a self-sustaining recovery."

Note: Funding Corp publishes 10-year BEI on the first page of the daily Interest Rate Summary report in the "related markets" section: 10 yr TIPS Inflation.

Econoday 3/16 - The Fed voted today to keep the fed funds target rate at a range of zero to 0.25 percent. The FOMC statement kept the language that interest rates are likely to remain low "for an extended period." Again there was dissent as the vote for the statement was 9 to 1 with Kansas City Fed President Thomas Hoenig voting against. As before, he opposed the "extended period" language. The discount rate was unchanged at 0.75 percent. Many see the statement as no change in policy, but deeper analysis says otherwise.

The commentary on the economy is unchanged, noting that the economy is continuing to strengthen but sectors are mixed.

A notable change was in regard to the labor market which is now described as "stabilizing" rather than the previous "deterioration" is "abating." Also, the divergence in business spending was highlighted with equipment and software having "risen significantly" while structures "is still contracting."

The statement went into more detail as to why a dissenting vote was made.

"Voting against the policy action was Thomas M. Hoenig, who believed that continuing to express the expectation of exceptionally low levels of the federal funds rate for an extended period was no longer warranted because it could lead to the buildup of financial imbalances and increase risks to longer-run macroeconomic and financial stability."

Inflation Remains In Check

Vanguard 3/19 - The Consumer Price Index (CPI) was unchanged in February, and "core" CPI, which excludes volatile food and energy prices, rose by a modest 0.1%. Of the major components of CPI, commodities fell 0.2%, durable goods dropped 0.1%, services increased 0.1%, food and beverages rose 0.1%, energy dropped 0.5%, and housing was unchanged.

Economists attribute the low-price environment to high unemployment, sluggish consumer confidence, and moderate energy prices. On an annual basis, overall inflation is up 2.1% and core CPI has risen 1.3%.

WSJ 3/18 (excerpts) - *Economists React:*

Core consumer prices are now only 1.3% above their year ago level but have been even weaker in more recent months. Soft final demands with ample slack in the economy and a continuation of the dislocations in the credit markets are disinflationary so core consumer inflation may continue to retreat on a year-on-year basis over the next several quarters. –Steven Wood, Insight Economics

Overall, the takeaway from this report is simply that despite the strong economic rebound that appears to be taking shape in the U.S., the weak labor market conditions and soft consumer demand backdrop are continuing to keep a tight lid on core consumer price pressures… we expect the soft inflation outlook to continue to provide considerable breathing room for the Fed to keep the fed funds rate "exceptionally low" for an extended period." – Millan Mulraine, TD Securities

Producer Prices Fall

Vanguard 3/19 - Wholesale prices dropped in February for the first time in five months, falling 0.6%. The drop was mostly due to a 2.9% decline in prices for energy goods, including a 7.4% drop in gasoline prices. The decline in energy prices was partially offset by a 0.1% increase in prices for core finished goods. Despite last month's drop, producer prices remain up 4.4% compared with February 2009 levels.

Leading Indicators: Improvement Continues

Vanguard 3/19 - The Conference Board's index of leading indicators rose for an eleventh consecutive month, increasing 0.1% in February. While the rate of increase is less than in recent months, the index is up 9.5% compared with February 2009, the fastest yearly growth rate since the 1980s. The interest rate spread and the money supply were the biggest contributors to last month's rise.

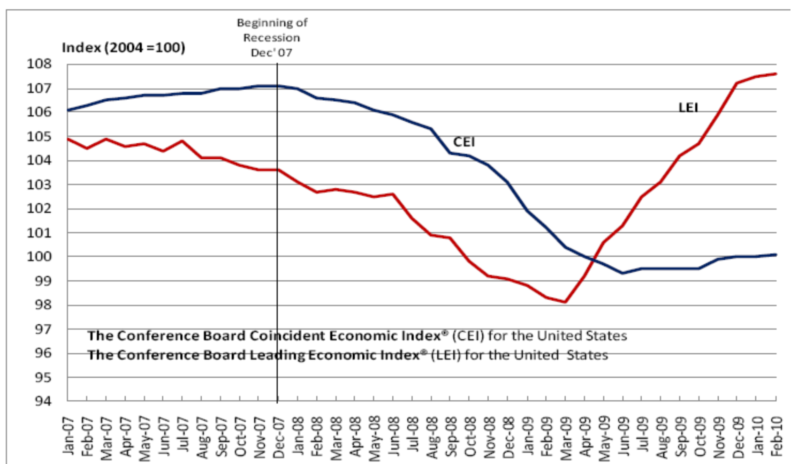
The more modest but continued improvement in the leading index and February's 0.1% rise in the coincident indicator, which includes data on payrolls, industrial production, personal income, and manufacturing, suggest that the recovery continues but is likely to settle into a more modest rate of growth during the second half of 2010.

Press Release 3/18 (excerpts) - *Indicators Point to Slow Recovery*

The Conference Board Leading Economic Index® (LEI) for the U.S. increased 0.1% in February, following a 0.3% gain in January, and a 1.2% rise in December.

Says Ataman Ozyildirim, Economist at The Conference Board: "The LEI for the U.S. has risen rapidly for almost a year now and it has reached its highest level. But, the sharp pick up in the LEI appears to be stabilizing…the leading economic index points to <u>moderately improving economic conditions in the near term</u>.

Adds Ken Goldstein, Economist at The Conference Board: "The indicators point to <u>a slow recovery this summer</u>. Going forward, the big question remains the strength of demand. Without increased consumer demand, job growth will likely be minimal over the next few months. "



Source: The Conference Board

New Home Construction Falls 5.9%

Vanguard 3/19 - New housing starts fell to an annual rate of 575,000 in February from 611,000 in January. A 30% decline in construction of multifamily homes was the biggest contributor to last month's outcome, while new construction of single family homes fell at a much more modest pace of 0.6%.

Regionally, the steepest declines occurred in the South and Northeast, both of which were affected by severe winter snowstorms. In contrast, the West and Midwest saw construction of new homes rise last month.

Economists attributed the overall decline mostly to the unusually harsh winter weather. The news was more positive on an annual basis, as housing starts actually increased compared with February 2009 levels.

Industrial Production Levels Off

Vanguard 3/19 - After several months of larger gains, industrial production rose only 0.1% in February. A big factor in the modest increase was <u>manufacturing, which fell 0.2%</u> and nearly offset gains in mining and utilities. Much of <u>last month's decline can be attributed to the extreme winter weather</u> conditions that brought large swaths of the country to a standstill. Economists expect factory output to grow at an annual rate of 5% for the first quarter of 2010, as businesses continue to rebuild their inventories.

Press Release 3/15 - Industrial production edged up 0.1% in February following a gain of 0.9% in January. Production was likely held down somewhat by winter storms in the Northeast. Manufacturing decreased 0.2% in February, with mixed results among its major industries. The output of mines rose 2.0%, while the index for utilities rose 0.5%. At 101.0% of its 2002 average, industrial output in February was 1.7% above its year-earlier level. Capacity utilization for total industry moved up 0.2 percentage point to 72.7%, a rate 7.9 percentage points below its average from 1972 to 2009.

Unemployment Insurance Weekly Claims Report (Initial Jobless Claims) – week of Mar. 13

Press Release 3/18 - In the week ending March 13, the advance figure for seasonally adjusted initial claims was 457,000, a decrease of 5,000 from the previous week's unrevised figure of 462,000. The 4-week moving average was 471,250, a decrease of 4,250 from the previous week's unrevised average of 475,500.

The advance seasonally adjusted insured unemployment rate was 3.5% for the week ending March 6, unchanged from the prior week's unrevised rate of 3.5%.

The advance number for seasonally adjusted insured unemployment during the week ending March 6 was 4,579,000, an increase of 12,000 from the preceding week's revised level of 4,567,000. The 4-week moving average was 4,575,250, a decrease of 8,000 from the preceding week's revised average of 4,583,250.

WEEK ENDING	March 13	March 6	Change	Feb. 27	Prior Year
Initial Claims (SA)	457,000	462,000	-5,000	468,000	644,000
4-Wk Moving Average (SA)	471,250	475,500	-4,250	470,500	650,000

The Economic Week Ahead: March 22 - 26

Vanguard 3/19 - Economists will be busy as several key government reports are released, including existing-home sales (Tuesday), durable goods (Wednesday), new-home sales (Wednesday), and revised GDP for the fourth quarter of 2009 (Friday).

U.S. Economic Calendar

Source: Briefing.com

Date	ET	Release	For	Briefing.com	Consensus	Prior
Mar 23	10:00	**Existing Home Sales**	Feb	4.75M	5.00M	5.05M
Mar 23	10:00	FHFA Home Price Index	Jan	-1.2%	-0.9%	-1.6%
Mar 24	08:30	**Durable Orders**	Feb	-1.0%	0.6%	2.6%
Mar 24	10:00	New Home Sales	Feb	290K	315K	309K
Mar 25	08:30	Continuing Claims	03/13	4500K	4560K	4579K
Mar 25	08:30	Initial Claims for Unemployment	03/20	460K	450K	457K
Mar 26	08:30	**GDP - Third Estimate**	Q4	5.9%	5.9%	5.9
Mar 26	09:55	Michigan Sentiment - Final	Mar	73.4	73.0	72.5

FFCB Weekly Debt Issuance Activity

Week Ended Date	Discount Notes $million	New Bonds $millions	Issue Count	Called Bonds Par $millions	Issue Count
19-Feb	$ 835	$ 1,721	14	$ 802	4
26-Feb	5,330	1,129	15	575	4
5-Mar	4,270	2,016	31	1,465	11
12-Mar	4,525	1,125	14	273	3
19-Mar	6,546	1,326	20	239	3