

Market Comment *Economic Highlights for the week ended April 8, 2011*

Economic Week in Review: The Fed Faces Economic Crosswinds

Vanguard 4/8 – The Federal Reserve Board took center stage this week, as its most recent release highlighted internal debate about its efforts to stimulate the economy while considering inflationary pressures such as fast-rising food and oil prices. Initial jobless claims fell again, but so did a leading indicator of service-sector activity. For the week ended April 8, the S&P 500 Index fell 0.3% to 1,328 (for a year-to-date total return of about 6.2%). The yield of the 10-year U.S. Treasury note rose 13 bps to 3.59% (for a year-to-date increase of 29 bps).

FOMC Minutes (March 15): A Watchful Eye on Inflation Expectations

Vanguard 4/8 – Federal Reserve officials differed in their outlook on the economy, according to the recently released minutes of the Federal Open Market Committee's March 15 meeting. Members generally agreed that economic growth is slowly gaining traction, but some are concerned that rising commodity and energy prices could fuel higher inflation.

According to meeting minutes, "A significant increase in longer-term inflation expectations could contribute to excessive wage and price inflation, which would be costly to eradicate."

Federal Reserve officials appear to be split on the dangers of inflation, raising questions about whether the Fed is falling short on its dual mandate: to promote full employment and to keep prices stable. They are likely to continue this debate, while also deciding how long to continue their quantitative easing bond-buying program and maintain interest rates at record lows.

Econoday 4/5 - The minutes of the Fed's March 15 policy meeting show moderate disagreement regarding quantitative easing but not from what has already been broadcast in recent public speeches. The bottom line is that the Fed is not likely to change QE2 but is starting to think about its exit strategy from a very loose monetary policy. Timing will depend on incoming data. Net, the minutes were mostly as expected and had little market impact.

Overall, the FOMC sees the recovery as gaining traction. "Participants' judgment that the recovery was gaining traction reflected both the incoming economic indicators and information received from business contacts." But there are increased risks seen coming from higher commodity prices, turmoil in North Africa and the Middle East, and the problems in Japan. Most see higher commodity prices as having a transitory effect and inflation expectations appear to be stable for now. But inflation expectations have taken on a bigger role in policy debate as implied in the minutes.

The Board's staff economists revised down their GDP forecast for 2011 but not by much.

Barclays 4/5 - As expected, the Minutes devoted substantial space to the examination of movements in commodity prices and the behavior of inflation. Committee members felt that rapidly rising commodity prices posed upside risks to the stability of longer-term inflation expectations and the outlook for inflation. However, most participants felt that the rise in commodity prices would ultimately prove transitory and that core inflationary pressures would remain well contained. Participants pointed to the fact that commodity and energy costs accounted for a much smaller share of production costs for most firms relative to labor costs and that the significant level of slack would moderate the ability of firms to increase prices for end consumers. However, in light of developments in commodity prices and the elevated level of the Fed's balance sheet, the committee will be keeping a watchful eye on movements in inflation expectations since a significant increase could contribute to "excessive wage and price inflation, which would be costly to eradicate."

Consumer Credit: February - Credit Demand on the Rise

Vanguard 4/8 – Outstanding demand for consumer credit jumped by \$7.6 billion in February - the fifth consecutive monthly increase. The figures continued a recent trend that shows an interesting split in the type of credit issued: Non-revolving credit rose by \$10.3 billion, boosted mainly by rebounding vehicle sales, while revolving credit fell \$2.7 billion for the month. The Federal Reserve report said that consumers appear to be using cash on hand (rather than credit cards) to finance smaller purchases, even as some large retailers reported brisk preliminary sales figures for March.

Econoday 4/7 - Consumers are keeping a tight grip on their wallets as revolving credit contracted for the 28th time in 29 months, down \$2.7 billion in February. Rising concerns over inflation and weakening confidence in income are limiting consumer activity.

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But not so fast! Non-revolving credit is on a seven-month increase, up \$10.3 billion in February on strong vehicle sales. Yet the outlook for vehicle sales, and with it growth in non-revolving credit, is uncertain given a decline in unit sales during March and ongoing Japanese supply disruptions this month.

ISM Non-Manufacturing Index – March: Service Sector Slows

Vanguard 4/8 – The rate of service-sector growth fell for the first time in seven months according to figures released by the Institute for Supply Management (ISM). The ISM nonmanufacturing index dipped to 57.3 in March from 59.7 in February, raising concerns that spiking oil prices may be putting the brakes on the economy. Though readings above 50 indicate expanding activity, the index was below the first quarter average of 59, raising concerns that the economy isn't sufficiently expanding to create new jobs.

The service sector accounts for almost 70% of the nation's economic activity and is considered a vital measure of overall economic strength.

Econoday 4/5 - Slowing is especially pronounced in output where the business activity index fell back more than seven points to 59.7. The slowing in output shows up in employment where a nearly two point dip to 53.7 points to a moderating rise in the number of employees for the sample.



This report probably doesn't show much impact yet from the Japan situation which however poses the risk for further moderation in April.

Barclays 4/5 - Though this report was weaker than we had expected, the components suggest that any softness is temporary. The forward-looking new orders index remained quite strong, and the improvement in order backlog and export orders suggests that demand is still growing at a healthy pace. This should keep the headline non-manufacturing index on its upward trend in the coming months as the service sector expansion continues.

Unemployment Insurance Weekly Claims Report – Week Ended April 2

Press Release 4/7 (excerpt) - In the week ending April 2, the advance figure for seasonally adjusted **initial claims** was 382,000, a decrease of 10,000 from the previous week's revised figure of 392,000. The 4-week moving average was 389,500, a decrease of 5,750 from the previous week's revised average of 395,250.

The advance seasonally adjusted **insured unemployment rate** was 3.0% for the week ending March 26, unchanged from the prior week's unrevised rate of 3.0%.

The advance number for seasonally adjusted **insured unemployment** during the week ending March 26 was 3,723,000, a decrease of 9,000 from the preceding week's revised level of 3,732,000. The 4-week moving average was 3,745,750, a decrease of 24,000 from the preceding week's revised average of 3,769,750.

WEEK ENDING	April 2	March 26	Change	March 19	Prior Year
Initial Claims (Seasonally Adj)	382,000	392,000	-10,000	394,000	472,000
4-Wk Moving Average (SA)	389,500	395,250	-5,750	391,000	462,000

Econoday 4/7 - Jobless filings are moving lower one step at a time with initial claims at 382,000 in the April 2 week vs. 392,000 in the prior week (revised from 388,000). The four-week average of 389,500 is down more than 5,000 from a month ago. Continuing claims edged lower in the March 26 week, to a four-week average of 3.746 million with the month-ago comparison showing a 100,000 decline. Unadjusted data show 8.52 million claiming benefits during the March 19 week, down nearly 250,000 from the prior week.

Claims trends point to labor demand as businesses gear up to meet orders. A wildcard for future reports is Japanese supply disruptions and whether they will affect US jobs. Markets are showing little reaction to today's report.

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Wholesale Inventories: February

Econoday 4/8 - Wholesale inventories rose 1.0% in February adding to a build so far in the first quarter for total inventories. Wholesale inventories along with factory inventories have been on pace for a slightly accelerating quarter-to-quarter build. Retail inventories got off to a slow start in January but February data are still pending, to be released with Wednesday's Business Inventories Report. Beyond the first quarter, the outlook for inventories is up in the air, the result of Japanese supply questions which are underscored by this week's ISM non-manufacturing report which showed a big jump in those saying their inventories are now too high.

The Economic Week Ahead: April 11 – April 15, 2011

Vanguard 4/8 – International trade figures will be announced Tuesday, followed Wednesday by reports on retail sales, business inventories, and the Federal Reserve's Beige Book of economic activity. The producer price index will be released Thursday, and the week will conclude Friday with the consumer price index and a report on industrial production.

This Week's U.S. Economic Calendar

Source: Briefing.com

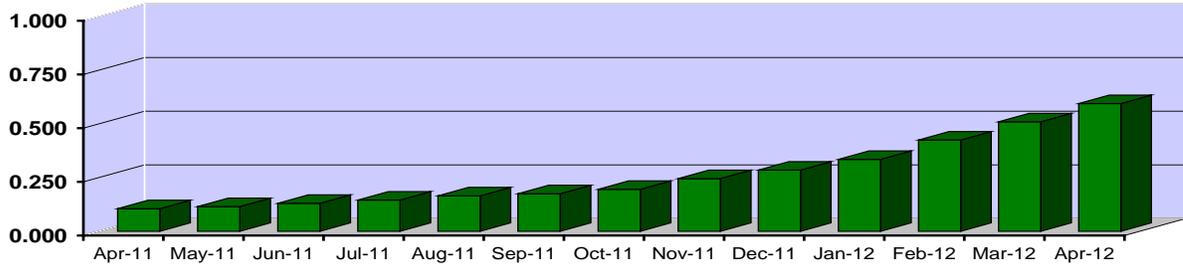
Date	ET	Release	For	Briefing.com	Consensus	Prior
Apr 12	08:30	Trade Balance	Feb.	-\$45.0B	-\$45.7B	-\$46.3B
Apr 12	08:30	Export Prices ex-ag.	March	NA	NA	0.9%
Apr 12	08:30	Import Prices ex-oil	March	NA	NA	0.3%
Apr 13	08:30	Retail Sales	March	0.6%	0.5%	1.0%
Apr 13	08:30	Retail Sales ex-auto	March	0.8%	0.8%	0.7%
Apr 13	10:00	Business Inventories	Feb.	0.8%	0.8%	0.9%
Apr 13	14:00	Fed's Beige Book	April			
Apr 14	08:30	Initial Claims	04/09	390K	385K	NA
Apr 14	08:30	Continuing Claims	04/02	3700K	3700K	NA
Apr 14	08:30	Producer Price Index (PPI)	March	0.8%	1.0%	1.6%
Apr 14	08:30	Core PPI	March	0.2%	0.2%	0.2%
Apr 15	08:30	Consumer Price Index (CPI)	March	0.5%	0.5%	0.5%
Apr 15	08:30	Core CPI	March	0.1%	0.2%	0.2%
Apr 15	09:15	Industrial Production	March	0.3%	0.6%	-0.1%
Apr 15	09:15	Capacity Utilization	March	77.4%	77.4%	76.3%
Apr 15	09:55	U of Michigan Consumer Sentiment	April	66.0	66.0	67.5

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Futures-Implied Fed Funds Rate

Avg. Fed Funds Rate %

Friday, April 8, 2011 (Close)



Contract Expiration

	Apr-11	May-11	Jun-11	Jul-11	Aug-11	Sep-11	Oct-11	Nov-11	Dec-11	Jan-12
Rate %	0.105	0.115	0.130	0.145	0.165	0.175	0.195	0.245	0.285	0.335
FOMC MEETINGS:	4/27		6/22		8/9	9/20		11/2	12/13	12/14