Market Comment *Economic Highlights for the week ended August 19, 2011*

Economic Week in Review: A Week When Worries Worsened

Vanguard 8/19 – Volatility in the financial markets dominated the news, as the U.S. economic outlook and Europe's fiscal woes weighed on investors. Economic reports didn't help matters—two regional manufacturing surveys reported glum results, housing remains in the doldrums—despite positive news about national production and future economic activity. For the week ended August 19, the S&P 500 Index fell 4.7% to 1,124 (for a year-to-date total return of about –9.5%). The yield on the 10-year U.S. Treasury note slipped below 2%, its lowest level since at least the 1960s. Stressed investors often flee to the safety of Treasury securities, which has the effect of lowering yields. The note's yield for the week dropped 17 basis points to 2.07% (for a year-to-date decline of 123 basis points).

AFP 8/22 - Rising energy and food prices in July led to consumer prices growing at their fastest pace since March, with core prices rising at a more modest rate. A rebound in auto production—likely making up for production shortfalls earlier this year—led to the largest monthly increase in industrial production of the year. But housing has remained cool during this hot summer, with consumer uncertainty over the economy and tight credit standards providing little promise for the sector during the foreseeable future.

Empire Manufacturing: August - Another Weak US Regional Manufacturing Survey

Econoday 8/15 – The first indications on the August manufacturing sector are strongly negative. The Empire State index fell nearly four points into more deeply negative territory, at -7.72 to indicate monthly contraction in general business conditions. Details show a third straight monthly contraction in new orders, down more than two points to -7.82. Unfilled orders are contracting very deeply, to -15.22 vs. July's -12.22. With new orders on the slide and backlog having been worked down, the outlook is negative.

Net Long-Term Treasury International Capital (TIC) Flows: June

Econoday 8/15 – Selling of US securities by private foreign accounts drove net inflow of long-term securities to a very weak plus $3.7 billion in June vs. an already weak and revised plus $24.2 billion in May. Private foreign accounts sold a net $23.0 billion of US long-term securities in the month for the lowest reading on record. Foreign demand for US Treasuries, agencies, and corporate bonds was weak across the board though demand for equities was down but still respectable. In a positive, demand for foreign securities by US residents ended a run of outflows with a net $15.2 billion inflow. Low US yields had been pushing domestic investment overseas and limiting investment at home.

But foreign participation in US financial assets is essential for the nation to fund its government and trade debts. And given the effects of the debt-ceiling crisis on investor confidence, the outlook for the July and August TIC reports is not positive. One positive in today's report is a slight uptick in Chinese holdings of Treasuries, at $1.17 trillion with Japanese holdings only fractionally lower at $911.0 billion.

NAHB Housing Market Index: August - US Homebuilder Sentiment Holds Steady In August

Econoday 8/15 – The home builders' housing market index is unchanged in August at a very depressed level of 15. Components for present sales and buyer traffic both inched higher but were offset by a decline in sales expectations six months out. In a special question, more than 40% of the sample said they had lost contracts due to the inability of buyers to sell their existing homes.

Housing and Housing Starts: July - US Housing Starts Fall Slightly In July

Vanguard 8/19 - Construction of new homes and sales of existing houses declined in July from the previous month. **New residential construction** declined 1.5%, to an annualized rate of 604,000 units from 613,000 a month earlier. Analysts noted that housing starts have remained above 600,000 for two straight months for the first time since early 2010—when a federal homebuyer incentive was available. In the **existing-home market**, a gain in home sales was expected in July. But sales actually fell 3.5%—following increases in May and

June—to an annualized 4.67 million units, as single-family homes changed hands but condo and co-op sales were flat. Nevertheless, existing-home sales are 21% higher than a year earlier.

Econoday 8/16 – New housing construction in July headed back down to trend sluggishness after an unexpected boost in June. Housing starts dipped 1.5% in July, following a 10.8% jump in June (originally up 14.6%). The July annualized pace of 0.604 million units beat expectations for 0.600 million units and is up 9.8% on a year-ago basis. The decline in July was led by a 4.9% drop in the single-family component, following a 7.5% surge in June. The multifamily component continued upward, gaining 7.8% after jumping 21.2% in June.

Homebuilders remain cautious as housing permits slipped 3.2%, following a 1.3% rise in June. Permits in July are up 3.8% on a year-ago basis.

Existing Home Sales - July

AFP 8/22 - Despite the recent decline in mortgage rates, sales of previously owned homes slowed in July. <u>Sales declined 3.5% during the month to a seasonally adjusted annualized rate of 4.67 million units</u>. Sales fell a sharp 12.6% in the West and also declined 1.6% in the South. Sales managed to increase in the Northeast (+2.7%) and Midwest (+1.0%). The number of homes for sales on the final day of July—3.672 million homes—was down 1.7% from June and 8.9% from a year earlier. This translated into a 9.4 month supply, its highest reading since last November. NAR also reported that 16% of all signed contracts failed to close in July as a result of denied mortgage applications or appraisals that came in below the sales contract price.

National Association of Realtors, press release 8/18 (excerpts) - Total existing-home sales, which are completed transactions that include single-family, townhomes, condominiums and co-ops, fell 3.5% to a seasonally adjusted annual rate of 4.67 million in July from 4.84 million in June, <u>but are 21.0% above the 3.86 million unit pace in July 2010</u>, which was a cyclical low immediately following the expiration of the home buyer tax credit.

<u>The national median existing-home price for all housing types was $174,000 in July, down 4.4% from July 2010</u>. Distressed homes – foreclosures and short sales – accounted for 29% of sales in July, compared with 30% in June and 32% in July 2010. First-time buyers purchased 32% of homes in July, up from 31% in June; they were 38% in July 2010.

Econoday 8/18 - The breakdown by types of homes shows losses centered in the most important component, single-family units. Condos show no change in the month.

Industrial Production and Capacity Utilization: July

Vanguard 8/19 - <u>Industrial production rose 0.9% in July, somewhat **more than double expectations** and the largest monthly increase so far in 2011</u>. Output rose on the strength of motor vehicle manufacturing, which increased 5.2% after three straight months of declines. Autos' comeback reflected a recovery from supply-chain disruptions caused by Japan's natural disasters in March, although non-auto manufacturing rose at a slower pace. Output from mines and utilities (reflecting summer air-conditioning demand) also gave industrial output a boost. <u>The higher overall level of output raised industry **capacity utilization** from 76.9% in June to 77.5% in July</u>.

AFP 8/22 - Auto production was up 5.2% on a seasonally adjusted basis, leading to a 0.6% increase in overall manufacturing output. Hot weather in much of the U.S. boosted utility output 2.8% while mining output grew 1.1%. Utility utilization grew 6/10ths of a percentage point to 77.5%, with a 4/10ths of a point increase to 75.5% in the manufacturing sector.

Econoday 8/16 – Today's industrial production report is probably the strongest argument so far that second half growth is improving from a sluggish first half.

Barclays 8/15 - The first look at Q3 activity data provides some reasons for optimism, with the rebound in auto production and auto sales coming through broadly as expected and solid, if unspectacular, gains in sales and output outside of autos.

Import and Export Prices: July - Core US Import Prices Rebound In July

AFP 8/22 - Import prices increased 0.3% in July, its biggest increase since April. Prices of fuel imports increased for the first time in three months (0.4%). Net of fuel, import prices grew 0.2%. <u>Import prices were up 14.0% from year ago levels</u>, with prices of non-fuel import up 5.5%. Export prices fell 0.4% during the month, <u>as</u>

prices of agricultural exports plummeted 4.3%. Net of agricultural goods, export prices grew 0.2% in July. Export prices have risen 9.0% over the past year, with prices of non-agricultural exports growing 8.3%.

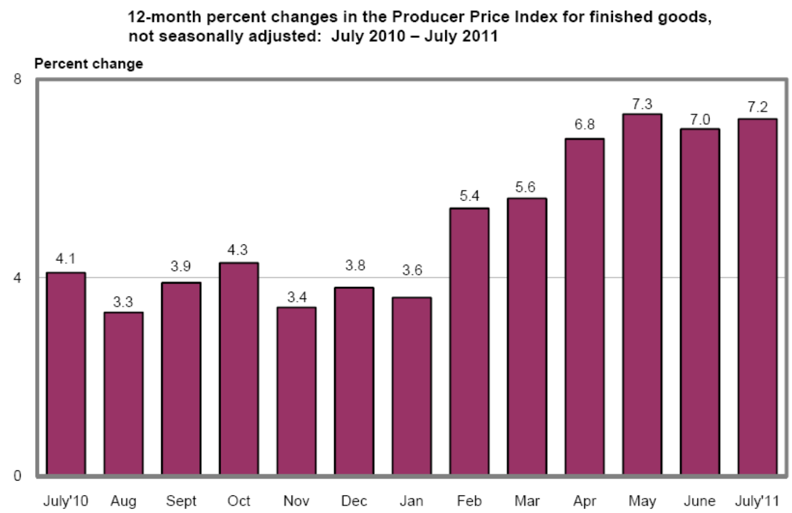
Econoday 8/16 – A look at year-on-year rates, which are the highest since 2008, shows the longer term effects of this year's high prices for both petroleum and agricultural products. Import prices, reflecting petroleum, are up a year-on-year 14.0% with export prices, reflecting agricultural products, up 9.8%.

Barclays 8/16 - This report suggests that pipeline pressures at the core level continue to build, reflecting the effects of a weaker dollar and building inflationary pressures abroad.

Producer Price Index (PPI) - July

Press Release 8/17 (excerpts) - The Producer Price Index for finished goods rose 0.2% in July, seasonally adjusted, the U.S. Bureau of Labor Statistics reported today. This advance followed a 0.4% decrease in June and a 0.2% rise in May. At the earlier stages of processing, prices received by manufacturers of intermediate goods moved up 0.2% in July, and the crude goods index declined 1.2%. On an unadjusted basis, prices for finished goods moved up 7.2% for the 12 months ended July 2011.

The index for finished goods less foods and energy moved up 0.4% in July, the eighth consecutive rise. Nearly one-quarter of the July advance can be attributed to a 2.8% increase in prices for tobacco products. The indexes for light motor trucks and pharmaceutical preparations also contributed significantly to the rise in the finished core index.



Econoday 8/17 – Producer price inflation surprised on the high side despite a softening in energy costs. The culprits included food, motor vehicles, and tobacco. The July pace came in higher than the market median estimate for no change. By major components, energy dipped 0.6% after a 2.8% fall in June. Gasoline declined 2.8% after dropping 4.7% the month before. In contrast, food costs jumped another 0.6%, following a rebound of 0.6 the previous month.

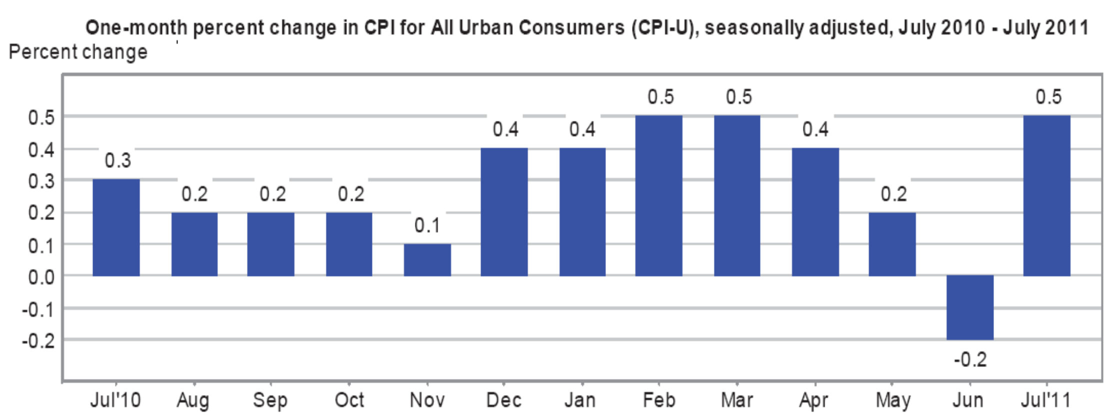
At the core level, PPI inflation accelerated to a 0.4% rise after jumping 0.3% in June. Analysts had forecast a rise of 0.2%.

Overall, inflation has picked up due largely to food costs and despite softer energy costs. The core rate is up significantly but likely due to temporary factors.

Consumer Price Index (CPI) - July

Press Release 8/18 (excerpts) - The Consumer Price Index for All Urban Consumers (CPI-U) increased 0.5% in July on a seasonally adjusted basis, the U.S. Bureau of Labor Statistics reported today. Over the last 12 months, the all items index increased 3.6% before seasonal adjustment.

The gasoline index rebounded from previous declines and rose sharply in July, accounting for about half of the seasonally adjusted increase in the all items index. The food at home index accelerated in July and also contributed to the increase, as dairy and fruit indexes posted notable increases and five of the six major grocery store food groups rose.



The index for all items less food and energy ("core" CPI) increased as well, though the 0.2% increase was slightly smaller than the two previous months. The shelter index accelerated in July, and the apparel index again increased sharply. In contrast, the index for new vehicles was unchanged after a long string of increases. The index for household furnishings and operations was flat in July as well, and the recreation index declined slightly.

The 12 month change in the all items index ("headline" CPI) remained at **3.6%** for the third month in a row. The change in the index for all items less food and energy continued its upward trend, **rising to 1.8% in July**, with the shelter and apparel indexes contributing notably to the acceleration. The energy index has risen 19.0% over the past year.

Vanguard 8/19 - With core CPI still below the Fed's target, and with forward-looking indicators of inflation falling, inflation is the least of the Fed's concerns at the moment," Mr. Aliaga-Díaz said.

Econoday 8/18 - Despite a sluggish economy, inflation is back but most of the acceleration is supply related, notably for food. And energy rebounded only partially from the prior month. The lodging subcomponent, however, probably is seeing some improved demand which is actually a good thing. Inflation is up but not much is related to a surge in demand.

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

Press Release 8/18 (excerpts) – In the week ending August 13, the advance figure for seasonally adjusted **initial claims** was 408,000, an increase of 9,000 from the previous week's revised figure of 399,000. The 4-week moving average was 402,500, a decrease of 3,500 from the previous week's revised average of 406,000.

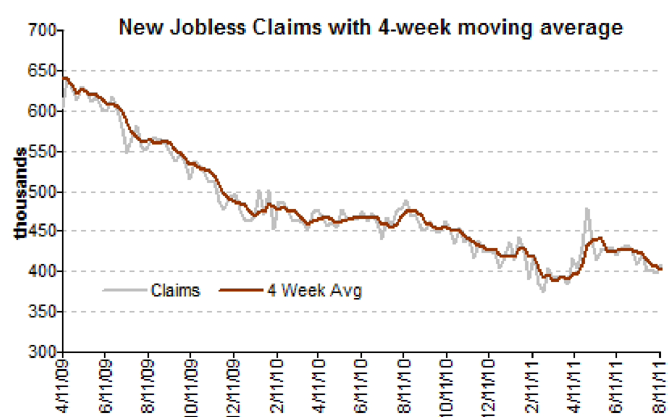
The advance seasonally adjusted **insured unemployment rate** was 2.9% for the week ending August 6, unchanged from the prior week's unrevised rate of 2.9%.

The advance number for seasonally adjusted **insured unemployment** during the week ending August 6 was 3,702,000, an increase of 7,000 from the preceding week's revised level of 3,695,000. The 4-week moving average was 3,716,000, a decrease of 4,500 from the preceding week's revised average of 3,720,500.

WEEK ENDING	Aug 13	Aug 6	Change	July 30	Prior Year
Initial Claims (SA)	408,000	399,000	+9,000	402,000	488,000
4-Wk Moving Average (SA)	402,500	406,000	-3,500	408,250	474,250

Econoday 8/18 - There are no special factors distorting the data which again point to improvement in the labor market. Markets are showing no significant reaction.

Barclays 8/18 - The number came in a bit above our (395k) and consensus (400k) expectations. Despite the modest increase, the four-week moving average edged lower to 403k from 406k.



Philadelphia Fed - August

Econoday 8/18 - An eye popping minus 30.7 headlines a troubling manufacturing report from the Philly Fed. The reading indicates very significant month-to-month contraction in general business conditions for August, one consistent with a shock and one compared against a small gain of 3.2 in July. But the report cites no particular factors behind the contraction, contraction that's evident throughout the details of the report.

The Empire State report, released Monday and covering the New York manufacturing economy, also showed contraction but at a much less severe rate.

Leading Indicators – July: A future economic activity gauge was positive—sort of

Vanguard 8/19 - Leading economic indicators—a compilation of ten measures that together are designed to anticipate future activity—**rose a solid 0.5% in July, the third straight monthly increase**. However, the upbeat result came with a caveat: Analysts noted that if one of the index components—a rising (and typically volatile) **money supply**—were excluded, the leading indicator would have declined. "The money supply figure measures not only money-printing by the Fed, but also demand deposits from investors, which typically increase during periods of heightened uncertainty and risk aversion," said Roger Aliaga-Díaz, Vanguard senior economist. A particularly large drag on the index was a drop in consumer confidence—understandable given a poor job outlook, stock-market volatility, and U.S. and European debt concerns.

Press Release 8/18 (excerpts) - The Conference Board Leading Economic Index® (LEI) for the U.S. increased 0.5% in July to 115.8 (2004 = 100), following a 0.3% increase in June, and a 0.7% increase in May. The largest positive contributions came from money supply, the interest rate spread, and average weekly initial claims for unemployment insurance (inverted).

Says Ataman Ozyildirim, economist at The Conference Board: “The U.S. LEI continued to increase in July. However, with the exception of the money supply and interest rate components, other leading indicators show greater weakness – consistent with increasing concerns about the health of the economic expansion. Despite rising volatility, the leading indicators still suggest economic activity should be slowly expanding through the end of the year.”

Says Ken Goldstein, economist at The Conference Board: “The economy is slow, with little momentum, and shows no indication of acceleration. The gains in the LEI are modest, especially the nonfinancial indicators. Despite these growing risks, the economy should continue to expand at a modest pace through the fall.”

The Economic Week Ahead: Aug 22 – Aug 26, 2010

Vanguard 8/19- The latest estimate for second-quarter gross domestic product is set for release on Friday. Scheduled for earlier in the week are reports on new-home sales (Tuesday) and durable goods (Wednesday).

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

RELEASE DATE	TIME (ET)	REPORT	PERIOD	ACTUAL	FORECAST	PREVIOUS
MONDAY, AUG. 22	8:30 am	Chicago Fed national index			--	-0.46
TUESDAY, AUG. 23	10 am	New home sales	July		315,000	312,000
WEDNESDAY, AUG. 24	8:30 am	Durable goods orders	July		2.0%	-1.9%
	8:30 am	Core capital goods	July		--	0.4%
	10 am	FHFA home price index	June		--	0.4%
THURSDAY, AUG. 25	8:30 am	Initial Jobless claims	8/20		N/A	N/A
FRIDAY, AUG. 26	8:30 am	GDP revision	2Q		0.9%	1.3%
	9:55 am	Consumer sentiment	August		N/A	54.9

FFCB Weekly Debt Issuance Activity

Week Ended Date	Discount Notes $million	New Bonds $millions	Issue Count	Called Bonds Par $millions	Issue Count
22-Jul	$ 7,015	$ 2,175	25	$ 1,056	12
29-Jul	7,565	427	10	325	3
5-Aug	2,265	3,322	23	3,048	24
12-Aug	2,455	4,684	31	3,814	25
19-Aug	2,870	4,664	38	4,066	35