Market Comment *Economic Highlights for the week ended September 10, 2010*

Economic Week in Review: Short week, some better news

Vanguard 9/10 – (Excerpts) As students returned to school back East, there was at least some encouraging news that prospects for the economy and workers might be brightening. <u>Economic reports during the holiday-shortened week included good news about the improved U.S. trade deficit in July</u>. For the week ended September 10, the S&P 500 Index rose 0.5% to 1,110 (for a year-to-date total return—including price change plus dividends—of about 0.9%). The yield of the 10-year U.S. Treasury note climbed 9 basis points to 2.81% (for a year-to-date drop of 104 basis points).

The Federal Reserve's regular survey of economic conditions across the United States confirmed a variety of other recent economic reports pointing to slower growth. <u>The Beige Book, based on reports from the 12 Federal Reserve Districts, noted "continued growth in national economic activity" for the reporting period of mid-July through the end of August, but also acknowledged that the pace of growth had slowed</u>. Relative bright spots included tourism, manufacturing, and consumer spending—which accounts for more than two-thirds of the U.S. economy but remains focused on essential goods. Not surprisingly, home sales and construction activity appeared to slow in the wake of the expiration of the homebuyer tax credit. The pace of growth is uneven across the country: Most of the slowdown was reported in the southern and eastern regions (where labor markets are weaker), while growth in the western regions seemed to be continuing.

<u>Total consumer debt decreased by $3.6 billion in July, representing an annual rate of decline of 1.8%</u>. The sixth consecutive monthly drop reported by the Federal Reserve suggests consumers are being cautious in managing their finances, especially in the face of continued high unemployment. Non-revolving credit—including auto loans—increased modestly; the average interest rate on new car loans fell below 4%. "The consumer credit data suggest that lower interest rates will provide little or no additional stimulus to the economy if consumers are not borrowing significantly," observed Mr. Aliaga-Díaz. "At this point, consumer spending depends more on labor income than on interest rates, and that is why the prospects of the labor market are so critical for the U.S. outlook."

Beige Book

<u>The latest Fed Beige Book finds the economy with "continued growth" but "with widespread signs of a deceleration</u>." Growth is described as "at a modest pace." Still, there is no talk of a double dip. The good news is that "Consumer spending appeared to increase on balance despite continued consumer caution that limited nonessential purchases."
Also, manufacturing continues to add to economic growth. "Reports on manufacturing activity pointed to further expansion, although the pace of growth eased according to several Districts." Within manufacturing, weakness was largely related to construction while strength was in auto-related production, including production of steel. Some Districts reported that export demand was an important contributor to healthy manufacturing conditions.

No surprise, housing is down and nonresidential construction is weak. "Home sales slowed further following an initial drop after the expiration of the homebuyer tax credit at the end of June, prompting a slowdown in construction activity as well. Demand for commercial real estate remained quite weak but showed signs of stabilization in some areas." <u>Weakness in housing was largely attributed to the expiration of special tax credits for homebuyers</u>. Reports on home prices were mixed. "Lending activity was stable to down slightly on net. Most Districts reported little or no change from existing low levels of commercial and industrial lending, as businesses remained quite cautious about expansion plans."
"Consumer lending remained sluggish in general, with contacts in Philadelphia and Richmond emphasizing the role of households' ongoing efforts to reduce their debt burdens."

<u>Inflation is still subdued but the Beige Book mentions some isolated sources of inflation pressures-including for specialized workers</u>. "Upward price pressures remained quite limited for most categories of final goods and services, despite higher prices for selected commodities such as grains and some industrial materials. Wage pressures also were limited, although a few Districts noted increased upward pressures in a narrow

set of sectors experiencing a mismatch between job requirements and applicant skills." Overall, today's Beige Book is in line with many analysts' and economists' views that the recovery is temporarily slowing but not falling back into recession. For now, growth is continuing, but at a modest pace.

Trade deficit reverses June widening in July

Barclays 9/9 - The US trade deficit narrowed to $42.8bn in July, largely reversing the outsize widening to $49.8bn in June from $41.8bn in May. This is a better print than we ($48.0bn) or the consensus ($47.0bn) had expected, and improves the prospects for Q3 GDP. Exports gained 1.8% in July after slipping 1.3% in June, driven by a boom in capital goods - chiefly telecom and aircraft. Industrial supplies exports increased 1.6%, consumer goods edged 0.1% lower, and automotive fell 3.9%. Food and beverage exports decreased 0.5%, and services exports slipped 0.1%. Total imports fell 2.1% in July, partially reversing the 3.1% gain in June. The moderation was broad-based, with goods imports down 2.5% on weakness in capital goods (-1.5%), crude oil (-3.3%), consumer goods (-4.4%), automotive (- 3.4%), food and beverage (-1.2%), and services (-0.1%).

The real goods deficit narrowed to $47.7bn in July, wider than May's $46.0bn but much narrower than June's $53.6bn. Our current GDP forecast assumes about a 0.6pp drag from trade in Q3, but the July deficit is actually narrower than the Q2 average. While we continue to expect a widening trend, today's report suggests that we will see less of a drag from trade in Q3 on GDP growth than we expected (and much less than the massive 3.37pp subtraction in Q2), and the data support our view that real GDP growth will accelerate to 2.5% in Q3 from 1.6% in Q2.

Jobless Claims

Econoday 9/9 - In a sign of improvement for the labor market, initial jobless claims fell substantially in the September 4 week. Claims came in at 451,000 vs. 478,000 in the prior week (revised from 472,000). The 451,000 level is the lowest since July and the second lowest since May. The Labor Department told Market News International that *nine states had to be estimated due to delays tied to the holiday shortened week, but the government stressed that data since received confirm the improvement*. The four-week average fell nearly 10,000 to 477,750 and is only slightly higher than a month-ago.

Continuing claims show only fractional change for a second week, at 4.478 million in data for the August 28 week with the four-week average at 4.488 million, the latter down mildly from the month-ago reading. The unemployment rate for insured workers is unchanged at 3.5%. The impact of today's report on the market will be limited by uncertainty over the impact of the holiday shortened week, yet the improvement, if confirmed or even extended in next week's report, would begin to raise expectations for payroll expansion.

Week Ending	Sept. 4	Aug. 28	Change	Aug. 21	Year
Initial Claims	451,000	478,000	-27,000	478,000	556,000
4-Wk Moving Average	477,750	487,000	-9,250	488,000	566,500

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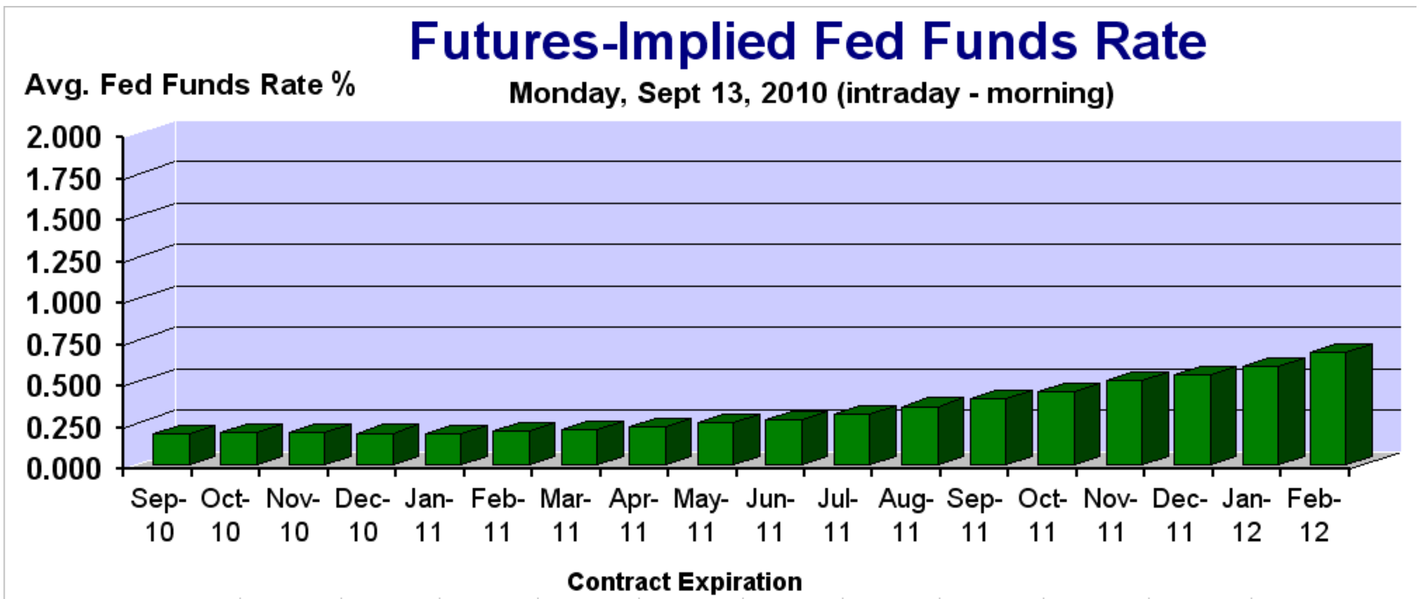
Economic Week Ahead: September 13-17

Vanguard 9/10 – The slate of economic reports scheduled for release next week includes retail sales and business inventories on Tuesday, industrial production on Wednesday, producer prices on Thursday, and consumer prices on Friday.

Date	ET	Release	For	Briefing.com	Consensus	Prior
Sep 14	08:30	Retail Sales	August	NA	0.2%	0.4%
Sep 14	10:00	Business Inventories	July	NA	0.4%	0.3%
Sep 15	09:15	Industrial Production	August	NA	0.4%	1.0%
Sep 15	09:15	Capacity Utilization	August	NA	75.0	74.8%
Sep 16	08:30	Initial Claims	09/11	NA	NA	NA
Sep 16	08:30	Continuing Claims	09/4	NA	NA	NA
Sep 16	08:30	Producer Price Index	August	NA	0.2%	0.2%
Sep 17	08:30	Consumer Price Index	August	NA	0.1%	0.3%

FFCB Weekly Debt Issuance Activity

Week Ended Date	Discount Notes $million	New Bonds $millions	Issue Count	Called Bonds Par $millions	Issue Count
13-Aug	$10,035	$ 3,297	26	$ 997	7
20-Aug	9,625	3,335	18	1,230	13
27-Aug	11,290	3,508	25	4,128	20
3-Sep	11,190	2,448	18	1,656	10
10-Sep	9,105	3,224	20	3,617	15



	Sep-10	Oct-10	Nov-10	Dec-10	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11
Rate %	0.188	0.195	0.195	0.190	0.185	0.200	0.210	0.225	0.255	0.270
FOMC MEETINGS:	9/21		11/3	12/14	1/26		3/15	4/27		6/22