

# Market Comment *Economic Highlights for the week ended September 16, 2011*

## Economic Week in Review: Economic Uncertainty Continues To Weigh On Consumers

Vanguard 9/16 – Consumers grew more cautious in August amid wild stock market swings, zero job growth, and heightened concerns the economy had weakened. While business inventories and industrial production climbed, retail sales were flat as consumer prices rose higher than expected. For the week ended September 16, the S&P 500 Index rose 5.4% to 1,216 (for a year-to-date total return of -1.9%). The yield on the 10-year U.S. Treasury note rose 15 basis points to 2.08% (for a year-to-date decrease of 122 basis points).

AFP 9/19 - While consumer prices increased at a faster than expected pace in August, the gain appears to be short-lived as producer prices and import prices either held firm or pulled back during the same month. Meanwhile, retail sales stagnated during the same month while industrial production edged up ever so slightly. Finally, employers expect modest hiring during the final three months of 2011 while small business owners have become increasingly pessimistic about their prospects.

## Consumer Price Index – August: Consumer Prices Jump Sharply

Press Release 9/15 (excerpts) - The Consumer Price Index for All Urban Consumers (CPI-U) increased 0.4% in August on a seasonally adjusted basis, the U.S. Bureau of Labor Statistics reported today. Over the last 12 months, the all items index increased 3.8% before seasonal adjustment.

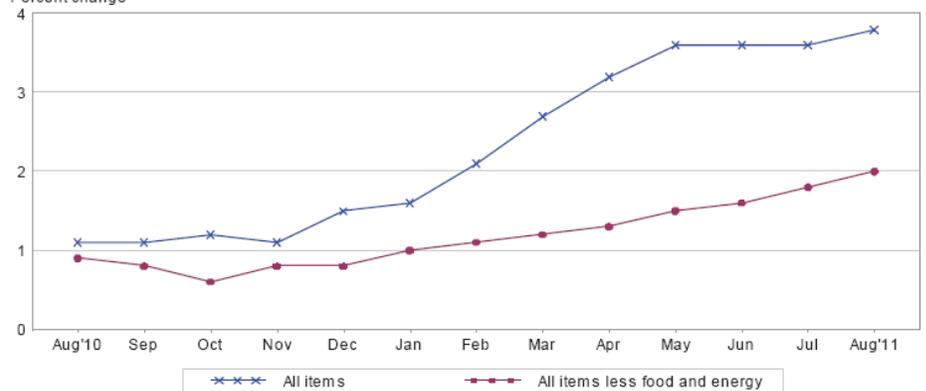
The seasonally adjusted increase in the all items index was broad-based, with continuing increases in the indexes for gasoline, food, shelter, and apparel. The gasoline index rose for the 12th time in the last 14 months and led to a 1.2% increase in the energy index, while the food index rose 0.5%, its largest increase since March.

The index for all items less food and energy increased 0.2% in August, the same increase as the previous month. Shelter and apparel were the biggest contributors, though the indexes for most of its major components posted increases, including used cars and trucks, medical care, household furnishings and operations, recreation, tobacco, and personal care. The new vehicles index, unchanged for the second month in a row, was an exception.

The 12-month change in the all items index edged up to 3.8% after holding at 3.6% for three months, while the 12-month change for all items less food and energy reached 2.0% for the first time since November 2008. The energy index has risen 18.4% over the last year, while the food index has increased 4.6%.

Econoday 9/15 – With today's report, the core CPI hit the upper bound of the Fed's implicit inflation target range of 1.5 to 2.0%. This will make it tougher for the doves in the FOMC to argue for another round of monetary ease. Equity futures fell back at the time of the release on a rise in jobless claims and a weak Empire State number.

Chart 2. 12-month percent change in CPI for All Urban Consumers (CPI-U), not seasonally adjusted, Aug. 2010 - Aug. 2011  
Percent change



Barclays 9/15 - We do not expect that rising core inflation will prevent the FOMC from easing policy at next week's meeting by lengthening the duration of its securities holdings; the Fed will likely maintain its view that a large amount of slack will cause inflation to dissipate in coming months. In contrast, we believe that core inflation will continue to rise; in our view, there is less slack than many believe, and we believe other forces will continue putting upward pressure on inflation.

## Producer Price Index - August: Core Continues To Rise

Econoday 9/14– Inflation eased in August at the producer level despite a surge in food prices. Producer prices in August were unchanged after rebounding 0.2% in July. The August figure was marginally higher than the consensus forecast for a 0.1% decline. By major components, energy fell 1.0% after dipping 0.6% the month before. Gasoline dropped 1.0%, following a 2.8% decrease in July. Food costs, in contrast, surged 1.1% after jumping 0.6% the month before.

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At the core level, PPI inflation slowed to a 0.1% pace after accelerating to 0.4% in July. Analysts had projected an increase of 0.2%. Weakness in the core included declines in prices for passenger cars (down 0.4%) and computers (down 2.6%). On the upside, the leader was tires (up 1.4%) which contributed over twenty percent of the August increase in the core. Higher prices for radio and television communication equipment also contributed to the rise in the finished core index.

For the overall PPI, the year-ago pace in August came in at 6.5%, compared to 7.2% in July (seasonally adjusted). The core rate in July held steady at 2.5% on a year-ago basis (seasonally adjusted). On a not seasonally adjusted basis for August, the year-ago headline PPI was up 6.5% while the core was up 2.5%.

Vanguard 9/16 – "There's no evidence of production cost pressures," Mr. Aliaga-Díaz continued, "as producer price inflation and import price inflation remain moderate. With slower global economic growth ahead, we may well see core inflation gradually receding."

Barclays 9/14 - Looking ahead, the recent decline in market energy prices is likely to translate into a further easing in headline PPI inflation, although building pipeline price pressures at the core level are likely to prove more persistent.

### Retail Sales – August: US Retail Sales Flat

Press Release 9/14 (excerpt) - The U.S. Census Bureau announced today that advance estimates of U.S. retail and food services sales for August, adjusted for seasonal variation and holiday and trading-day differences, but not for price changes, were \$389.5 billion, virtually unchanged from the previous month and 7.2% above August 2010. Total sales for the June through August 2011 period were up 7.9% from the same period a year ago. The June to July 2011 percent change was revised from +0.5% to +0.3%.

AFP 9/19 - The report is notable in how it portrays the retail sector being mired in an overall state of malaise. The only major retail segments enjoying significant increases in sales were sporting goods stores (+2.4 percent), electronic/appliance retailers (+0.5 percent) and non-store retailers (+0.5 percent). Sales fell sharply at apparel stores (-0.7 percent), with most segments showing little change from July.

Econoday 9/14– Clearly, the August retail sales numbers are somewhat disappointing. Hurricane Irene likely dampened sales a bit on the East Coast and we will need to see September numbers for further evaluation. Still, it looks like the consumer is being more cautious after the political circus over the debt ceiling legislation and retrenchment in equities.

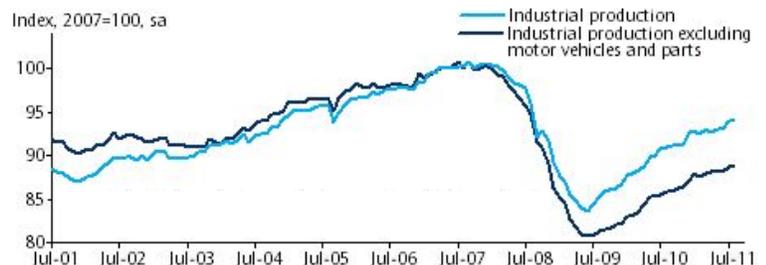
### Industrial Production & Capacity Utilization - August: Gains Supported By Auto Production

Press Release 9/15 (excerpts) – Industrial production increased 0.2% in August after having advanced 0.9% in July. Manufacturing rose 0.5% in August, after a similarly sized gain in July, and the rates of change were revised down slightly in April, May, and June. In August, the output of mines moved up 1.2%. The output of utilities decreased 3.0%, as temperatures moderated somewhat from the previous month. At 94.0% of its 2007 average, total industrial production for August was 3.4% above its year-earlier level. Capacity utilization for total industry edged up to 77.4%, a rate 1.9 percentage points above its level from a year earlier but 3.0 percentage points below its long-run (1972--2010) average.

Econoday 9/15 - By major industry, manufacturing remained strong with a 0.5% rise after a robust 0.6% gain in July (no revision). The auto component advanced another 1.7% after a rebound of 4.5% in July. Outside of autos, manufacturing is still healthy. Excluding motor vehicles, manufacturing rose 0.4%, following a 0.3% increase the prior month.

Despite the negativism in various manufacturing surveys, national production numbers continue to look good—especially for manufacturing.

Barclays 9/15 - Capacity utilization ticked higher to 77.4% (previous: 77.3%), which is a post-recession high. Overall, the report is encouraging from the standpoint that we are continuing to see both a rebound in auto production, as well as production gains in other areas.



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## Business Inventories – July: Softer-than-expected US retail inventories

Econoday 9/14– Businesses managed inventory growth carefully in July as business inventories rose only 0.4% against a 0.7% rise for business sales. Well managed inventory levels keep down business costs and are a plus for employment. Quarterly rates in this series show a 2.8% gain in second-quarter inventories, the same quarterly rate as the first quarter which points to inventories being a neutral factor for GDP growth. The new details in today's report are inventories at the retail level which were unchanged.

## U.S. Import and Export Price Indexes – August 2011

Press Release 9/13 (excerpts) - U.S. import prices declined 0.4% in August, the U.S. Bureau of Labor Statistics reported today, led by a 1.8% decrease in fuel prices. The August drop in import prices followed a 0.3% rise the previous month. In contrast, prices for U.S. exports rose 0.5% after declining 0.4% in July.

Fuel Imports: The August drop in overall import prices was driven by a 1.8% decline in fuel prices. The decrease was led by a 2.1% drop in petroleum prices which more than offset a 3.3% advance in the price index for natural gas. Despite declines in three of the past four months, fuel prices rose 41.1% over the past year. Prices for petroleum and natural gas each increased over the past 12 months, rising 43.5% and 8.0%, respectively.

All Exports: Export prices resumed an upward trend in August, rising 0.5% following a 0.4% downturn in July. Higher prices for agricultural and non-agricultural exports each contributed to the overall advance in August. The price index for overall exports also increased over the past year, increasing 9.6%.

Agricultural Exports: Agricultural export prices advanced 2.2% in August after declining 3.9% the previous month. In August, rising prices for corn, soybeans, and wheat, up 8.1%, 2.3%, and 5.6%, more than offset an 11.3% drop in cotton prices. The price index for agricultural exports advanced 23.9% over the past 12 months, primarily led by a 73.7% increase in corn prices, although higher prices for soybeans, cotton, meat, and wheat also contributed to the overall increase.

AFP 9/19 - Even with the decline in August, import prices remained 13.0% above year ago levels.

Barclays 9/13 - Looking ahead, the decline in market energy and commodity prices in recent weeks is likely to lead to a further easing in headline import prices, although this report suggests that pipeline pressures at the core level continue to build, reflecting the effects of a weaker dollar and inflationary pressures abroad.

## Univ. Of Michigan Consumer Sentiment – September: Consumer Sentiment Edges Higher

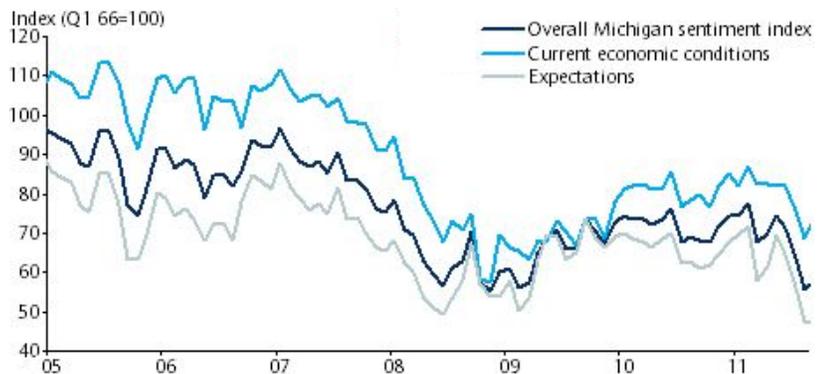
Forbes 9/16 - Consumer sentiment, as measured by the Thomson Reuters/University of Michigan index, inched up in September to 57.8 from 55.7 in August, above expectations of 57.0.

Expectations for the next six months fell to 47, their lowest level since May 1980. Consumers, like most other market participants, have been downgrading their outlook for the economy as indicators continue to deteriorate and the global economy slows.

“The level of the index remains very low and is still consistent with outright falls in consumer spending,” explained High Frequency Economics’ chief U.S. economist, Ian Shepherdson. While sentiment actually ticked up in September, the index does reflect the expectation of ultra-sluggish growth.

Friday's consumer sentiment numbers will add one more argument for those expecting the Fed to provide additional monetary stimulus for the economy. As the global economy slows and indicators of U.S. growth continue to be revised downwardly, an activist Fed headed by Ben Bernanke is expected to bring out the “bazooka” and try to revitalize the economy.

Econoday 9/16 - Yesterday's consumer price report (CPI) shows wide and surprising (inflationary) pressure, pressure that this sample's report is picking up on. Inflation expectations are up two tenths on the one-year outlook



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to 3.7% and up one tenth on the five-year outlook to 3.0%. This pressure isn't due to any surge in gasoline prices which have been steady so far this month.

Barclays 9/16 - Overall, the report underscores that consumer sentiment remains at very low levels and is still struggling to recover from the decline in August following the debt ceiling debate and ratings downgrade of US sovereign debt.

### **NFIB Small Business Optimism Index - August: Confidence Continues To Drift Lower**

Barclays 9/13 - The National Federal of Independent Business' (NFIB) small business optimism index fell 1.8 points to 88.1, continuing its recent downward trend. The decline was the largest since March and likely reflects small business owners' frustration over the debt ceiling debate and US sovereign debt downgrade, as the NFIB reported that the August surveys were mailed shortly after the agreement to raise the debt ceiling was announced. The headline index was pushed lower primarily by the scaling back of expectations for real sales gains and business conditions.

The net percentage of respondents expecting the economy to improve fell to -26%, its lowest level since the late 1970s. In terms of capital expenditures, 52% reported that they had made a capital expenditure at some point in the past six months (previous: 50%), and 21% plan to do so in the next three to six months (previous: 20%). For new hiring, a net 5% of firms reported they are planning to increase employment (previous: 2%), though 33% of firms report finding few or no qualified applicants for job openings (previous: 31%). In terms of headwinds, 25% of small businesses are continuing to cite poor sales as their primary problem, followed by government requirements (19%) and taxes (18%). The cost and availability of credit are generally not an issue, as only 4% report financial conditions and interest rates as their most important problem.

In general, the message from the NFIB survey has been that small businesses are struggling in the face of weak demand and have been cautious in terms of adding new employees, but have been increasing capital expenditures

### **Unemployment Insurance Weekly Claims Report (Initial Jobless Claims) – week of Sept 10**

Press Release 9/15 (excerpts) - In the week ending September 10, the advance figure for seasonally adjusted **initial claims** was 428,000, an increase of 11,000 from the previous week's revised figure of 417,000. The 4-week moving average was 419,500, an increase of 4,000 from the previous week's revised average of 415,500.

The advance seasonally adjusted **insured unemployment rate** was 3.0% for the week ending September 3, unchanged from the prior week's unrevised rate.

The advance number for seasonally adjusted **insured unemployment** during the week ending September 3 was 3,726,000, a decrease of 12,000 from the preceding week's revised level of 3,738,000. The 4-week moving average was 3,741,000, an increase of 1,250 from the preceding week's revised average of 3,739,750.

WEEK ENDING	Sept 10	Sept 3	Change	Aug 27	Prior Year
Initial Claims (SA)	428,000	417,000	+11,000	412,000	450,000
4-Wk Moving Average (SA)	419,500	415,500	+4,000	411,000	460,500

Econoday 9/15 – Jobless claims jumped 11,000 in the September 10 week to an unexpectedly high 428,000. The prior week was revised 3,000 higher to 417,000.

Barclays 9/15 - The Labor Department reported that Hurricane Irene played no special factor in this week's jobless claims data, although it cited the seasonal adjustment process around the Labor Day holiday as possibly behind some of the week-to-week volatility.

### **Federal Budget**

Econoday 9/13– The Treasuries debt in August came to \$134.2 billion to lift the fiscal year-to-date deficit to \$1.23 **trillion** which is just under the \$1.26 trillion deficit at this time last year. The government's fiscal year ends in September. The largest increase this fiscal year on the outlay side is net interest expense which is up 15.0% to \$233.7 billion or 7.1% of total outlays. On the receipt side, the largest increase is in individual income taxes which are up 23.5% to \$977.1 billion. Individual taxes make up 47.4% of total receipts. Corporate income taxes, at \$142.2 billion, are down fractionally, making up 6.9% of total receipts.

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## Empire State Index - September

Econoday 9/15 - Business conditions in the New York manufacturing region continue to contract at a steady but mild rate based on the Empire State index which, at minus 8.82 this month, shows its fourth straight negative single-digit reading.

## Philly Fed – September

Econoday 9/15 - Business conditions in the Mid-Atlantic region are contracting for the second straight month but at least they're contracting at a less severe rate. The Philly Fed's general business conditions index improved to minus 17.5 from August's severely negative reading of minus 30.7. This index has now posted negative readings in three of the last four months.

The early take on the September manufacturing sector, based on this report and the Empire State report released earlier this morning, is clearly negative.

## The Economic Week Ahead: September 19 – September 23, 2011

Vanguard 9/16 – House building and sales reports are set for release next week: new residential construction on Tuesday and existing-home sales on Wednesday. The Federal Open Market Committee's monetary policy report will also appear Wednesday, and leading economic indicators are scheduled for Thursday.

*This Week's U.S. Economic Calendar*

*Source: MarketWatch*

DATE	TIME (ET)	REPORT	PERIOD	FORECAST	PREVIOUS
MONDAY, SEPT. 19	10 am	Home Builders' Index	September	14	15
TUESDAY, SEPT. 20	8:30 am	Housing Starts	August	590,000	604,000
	8:30 am	Single-Family Permits	August	--	403,000
WEDNESDAY, SEPT. 21	10 am	Existing Home Sales	August	4.80 million units	4.67 million units
	2:15 pm	<b>FOMC Announcement</b>			
THURSDAY, SEPT. 22	8:30 am	Initial Jobless Claims	9/17	428,000	428,000
	10 am	<b>Leading Indicators</b>	Aug.	0.0%	0.5%
	10 am	FHFA Home Prices		--	0.9%
FRIDAY, SEPT. 23		None Scheduled			

## FFCB Weekly Debt Issuance Activity

Week Ended Date	Discount Notes \$million	New Bonds \$millions	Issue Count	Called Bonds Par \$millions	Issue Count
12-Aug	\$ 2,455	\$ 4,684	31	\$ 3,814	25
19-Aug	2,870	4,664	38	4,066	35
26-Aug	2,656	2,832	24	2,179	14
9-Sep	4,185	2,195	20	1,409	11
16-Sep	5,050	2,838	22	1,128	11