

Market Comment *Economic Highlights for the week ended October 14, 2011*

Economic Week in Review: Consumers Show Surprising Strength

Vanguard 10/14 - Retail sales grew faster than expected in September as the Federal Open Market Committee (FOMC) minutes showed considerable debate about what the Fed should do next to help the economy out of its funk. For the week ending October 14, the S&P 500 Index rose 6% to 1,225 (for a year-to-date total return—including price change plus dividends—of about -2.74%). The yield on the 10-year U.S. Treasury note increased 16 basis points to 2.26% (for a year-to-date decrease of 104 basis points).

FOMC Minutes: Federal Reserve Ponders Its Next Move

Vanguard 10/14 - In the minutes of its September 20–21 meeting, which were made public on Wednesday, the FOMC downgraded its outlook, stating that "economic growth remains slow." At that meeting, the FOMC had adopted Operation Twist, an unconventional bond-purchasing policy aimed at lowering long-term borrowing rates and encouraging consumers and businesses to spend more. Three of the ten committee members had voted against the policy, and, as the minutes indicate, there was considerable debate among committee members about which steps to take to counter the slow pace of economic recovery.

"The discussions show a committee that's much more worried about the risk of deflation than about inflation over the next few months," said Roger Aliaga-Díaz, Vanguard senior economist. "The minutes send a clear message that the Fed has many unconventional policies at its disposal and is ready to use them as needed. Specifically, large-scale asset purchase policies (such as QE3) are regarded as the most effective tool to prevent inflation from falling too low."

Barclays 10/12 - FOMC Meeting: Communication strategies moving to the forefront of the policy discussion

The primary piece of new information in the minutes of the September FOMC meeting was that communication issues appear to be moving to the forefront of the policy discussion. The minutes indicated that most of the participants were in favor of steps that would increase the transparency of the "Committee's longer-run policy objectives and about the factors that influence the Committee's policy decisions."

That is, the discussion of whether to adopt a formal inflation target, as well as how to communicate it, are apparently once again on the table. In addition, most participants "saw advantages in being more transparent about the conditionality in the Committees' forward guidance by providing more information about the economic conditions to which the guidance refers." An example of such guidance would be Chicago Fed President Evans' suggestion that rates remain exceptionally low until unemployment reaches some threshold, such as 7.5%, given that inflation remains at an appropriate level.

Otherwise, the minutes reviewed three policy options discussed at the meeting: 1) a change to the reinvestment policy, so that proceeds from agency securities would be used to purchase long-term Treasuries exclusively; 2) selling shorter-term Treasuries and purchasing an equal amount of long-term Treasuries; and 3) increasing the size of the balance sheet by purchasing long-term Treasuries. As the committee opted for the second option, the minutes indicated two members viewed that "current conditions and the outlook could justify stronger policy action." Alternatively, the three dissenting members (Plosser, Fisher, Kotcherlakota) "concluded that additional accommodation was not appropriate at this time."

Another notable piece of information is that the staff lowered its forecast for real GDP growth in the second half of this year, as well as into the medium term. Weaker-than-expected labor market conditions, as well as consumer and business sentiment, and a deterioration of financial conditions were cited as reasons for the downgrade.

US Retail Sales Post Strong Gain, Supported By Higher Discretionary Spending

Barclays 10/14 - Retail sales increased 1.1% m/m in September, with an upward revision to 0.3% in August (initial release: 0.0%). The increase was well above expectations. In general, the report was positive on several fronts, as it suggests consumers have been increasing expenditures on essential purchases, such as gasoline (1.2%), but also in more discretionary areas. For example, motor vehicles (3.6%), furniture (1.1%), clothing (1.3%), and restaurants (1.2%) all posted solid gains. The only sectors to see outright declines were building materials (-0.1%), food and beverage stores (-0.2%), and sporting goods (-0.3%). Another positive was the upward revisions to August. Overall, the report indicates consumption is likely to be substantially stronger in Q3 relative to Q2.

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Vanguard 10/14 - For the third quarter, sales were up 4.5%—but still less than the double-digit gains of late 2010 and first quarter of this year.

Business Inventories

In August, business inventories rose 0.5% while the retail inventories component climbed 0.8%—much faster than July's 0.1% gain. The August increase was driven in part by a 1.5% rise in motor vehicle inventories. The strong September retail sales figures appeared to justify the larger inventories in August.

US Trade Deficit Unchanged In August

Barclays 10/13 - The US trade deficit was unchanged in August at \$45.6bn, as both imports and exports were roughly flat for the month. Exports fell a slight 0.1% m/m, though this comes after the strong 3.4% gain in July, while imports are mostly unchanged over the past two months. The real goods balance increased to \$47bn (previous: \$46bn), driven in part by a rise in petroleum-related imports. Overall, the report suggests trade will likely make a positive contribution to Q3 GDP growth.

Vanguard 10/14 - The overall U.S. trade deficit remained virtually unchanged in August, but the U.S. deficit with China widened to a record \$29 billion. Analysts say that China has been keeping its currency artificially low to boost its exports.

On Wednesday, Congress approved free-trade deals with Colombia, Panama, and South Korea. The deals could boost U.S. exports by \$13 billion a year, according to the U.S. International Trade Commission.

Unemployment Insurance Weekly Claims Report (Initial Jobless Claims) – week of Oct 8

Press Release 10/13 - In the week ending October 8, the advance figure for seasonally adjusted initial claims was 404,000, a decrease of 1,000 from the previous week's revised figure of 405,000. The 4-week moving average was 408,000, a decrease of 7,000 from the previous week's revised average of 415,000.

The advance seasonally adjusted insured unemployment rate was 2.9% for the week ending October 1, a decrease of 0.1 percentage point from the prior week's revised rate of 3.0%.

The advance number for seasonally adjusted insured unemployment during the week ending October 1 was 3,670,000, a decrease of 55,000 from the preceding week's revised level of 3,725,000. The 4-week moving average was 3,724,000, a decrease of 21,250 from the preceding week's revised average of 3,745,250.

WEEK ENDING	Oct 8	Oct 1	Change	Sept 24	Prior Year
Initial Claims (SA)	404,000	405,000	-1,000	395,000	463,000
4-Wk Moving Average (SA)	408,000	415,000	-7,000	418,000	456,250

Barclays 10/13 - We view the downward trend in the four-week moving average in initial claims data in recent weeks as reflecting a modest improvement in labor market conditions. We continue to believe that heightened uncertainty, stemming in part from the sovereign debt crisis in Europe and the outlook for fiscal policy in the US, remains a factor in reducing the growth of private payrolls and limiting any improvement in labor market conditions.

Barclay's Economic Forecast: US Q3 2011 real GDP forecast raised to 2.5%

Barclays 10/14 - We have raised our Q3 2011 US real GDP forecast to 2.5% from 2.0%.

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The Economic Week Ahead: Oct 17– Oct 21, 2011

Vanguard 10/14 - Upcoming reports include producer prices (Tuesday), consumer prices and new construction (Wednesday), and existing-home sales and leading economic indicators (Thursday).

This Week's U.S. Economic Calendar

Source: MarketWatch

RELEASE DATE	TIME (ET)	REPORT	PERIOD	FORECAST	PREVIOUS
MONDAY, OCT. 17	8:30 am	Empire State Index	October	-5.0	-8.8
	9:15 am	Industrial Production	September	0.1%	0.2%
	9:15 am	Capacity Utilization	September	77.4%	77.4%
TUESDAY, OCT. 18	8:30 am	Producer Price Index	September	0.4%	0.0%
	8:30 am	Core PPI	September	0.1%	0.1%
	10 am	Home Builders' Index	October	14	14
WEDNESDAY, OCT. 19	8:30 am	Consumer Price Index	September	0.3%	0.4%
	8:30 am	Core CPI	September	0.2%	0.2%
	8:30 am	Housing Starts	September	593,000	571,000
	8:30 am	Single-Family Permits	September	--	413,000
	2 pm	Fed Beige Book		--	--
THURSDAY, OCT. 20	8:30 am	Jobless Claims	10/15	403,000	404,000
FRIDAY, OCT. 21	10 am	Existing Home Sales	September	4.90	5.03 million
	10 am	Leading Indicators	September	0.2	0.3%
	10 am	Philly Fed	October	-12.0	-17.5