

# Market Comment *Economic Highlights for the week ended October 21, 2011*

## **Economic Week in Review: Awake, Asleep, or Somewhere in Between**

Vanguard 10/21 – The economy is stirring more than it was a few weeks ago, but there's still worry the long slumber will continue. Economic reports were mixed this week. Both the Beige Book and a set of leading economic indicators showed slow growth. Industrial production crawled forward. A sizeable gain in new residential construction was muted by a decline in existing-home sales. Consumer and wholesale prices rose, but inflation still appears tame. For the week ended October 21, the S&P 500 Index rose 1.1% to 1,238 (for a year-to-date total return—including price change plus dividends—of about 0.1%). The yield of the 10-year U.S. Treasury note fell 3 basis points to 2.23% (for a year-to-date decrease of 107 basis points).

## **Fed's Beige Book Reflects Slow Growth**

Vanguard 10/21 – The economy grew slightly in September and the first week of October, according to the Federal Reserve's latest Beige Book survey. The Beige book provides observations from economists and business leaders from the Federal Reserve's 12 bank regions. The report indicated consumer spending increased in most districts, with auto sales and tourism leading the way. On a more negative note, the job market showed little progress and weak conditions continued for residential and commercial real estate.

Barclays 10/19 - The bottom line from the Federal Reserve's latest Beige Book, based on information gathered on or before October 7, is that economic activity continued to expand at a "modest" or "slight" pace and contacts in Federal Reserve districts noted a greater degree of uncertainty as weighing on business decisions. We would characterize the report as more optimistic than the September Beige Book and consistent with the gradual acceleration in activity in Q3 '11, particularly in the areas of auto production and auto sales. The suggestion that heightened uncertainty is inhibiting the willingness of business to undertake investment and hiring decisions is consistent with our own research on this topic.

Finally, financial activity was described as "having weakened" relative to the previous Beige Book. This should come as no surprise given the volatility in financial markets and perceived risks to financial markets and global growth stemming from the sovereign debt crisis in Europe. Loan volumes were characterized as "flat or down" and securities market activity was "noticeably weaker" in New York. Several districts reported that "strong competition among banks for high quality borrowers" was pushing banks to continue to ease standards and terms.

AFP 10/24 - The latest Beige Book, the collection of comments and other anecdotal information collected by the Federal Reserve's 12 district bank, suggests that manufacturing activity increased during the past month and a half. Much of the increase appears to be in the auto, civilian aircraft and steel sectors, with other manufacturing activity "more mixed." Overall, economic activity was reported to have "continued to expand," although the growth may have been "modest" or "slight." Consumer spending grew "slightly" while business spending "increased somewhat."

## **Leading Economic Indicators – September: Rise Slightly**

Vanguard 10/21 – The Conference Board's leading economic indicators—a weighted measure of ten indicators designed to signal future economic activity—advanced 0.2% in September. The gain was the fifth straight, but the lowest result since the index plummeted in April. Five of the ten indicators increased. Interest rate spread, the difference between the federal funds rate and the yield of the 10-year Treasury, contributed the most to the rise. Building permits were the largest detractor among leading indicators. The coincident index, which measures current conditions, inched ahead 0.1%, and the lagging index rose 0.2%.

Barclays 10/20 - The index of leading indicators has now risen for five consecutive months, although we do not put too much weight on the improvement in the headline index given that much of it has reflected rising money supply rather than gains in components more directly related to real activity.

AFP 10/24 - The index has grown at a 3.7% annualized rate during the past 6 months versus an 8.2% annualized growth rate during the previous 6 months.

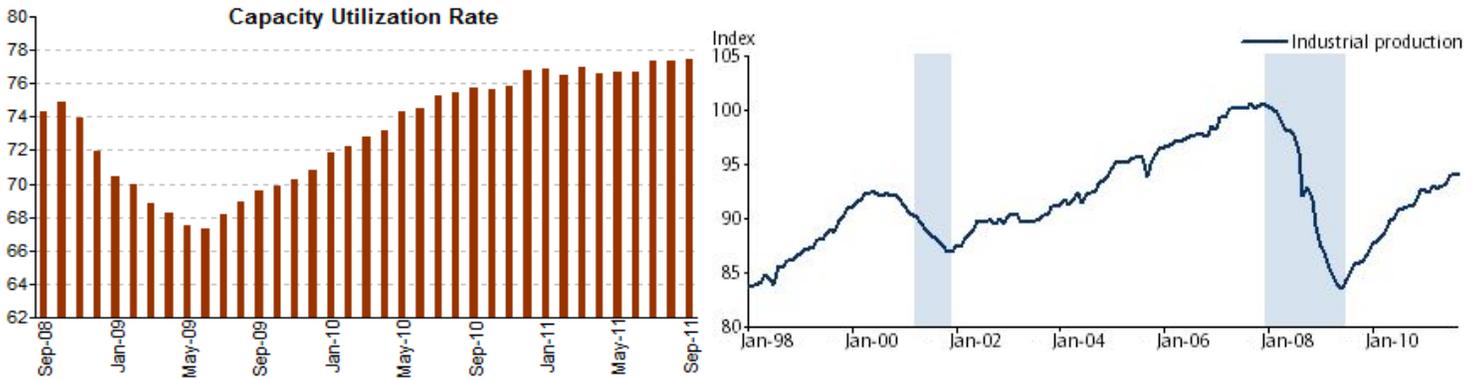
## **Industrial Production and Capacity Utilization - September**

Vanguard 10/21 – Industrial production increased 0.2% in September, in line with analysts' expectations. The figures for August were revised to flat from an initial 0.2% gain. Industries used 77.4% of capacity, a high for this economic cycle but below longer-term averages. Manufacturing and mining production both rose, while

# Market Comment *Economic Highlights for the week ended October 21, 2011*

utilities output declined as temperatures fell from their summer highs. Business equipment production, which advanced 1.0%, helped drive the manufacturing gains. In the third quarter, industrial production climbed at a 5.1% annual rate, compared with a 0.5% bump in a second quarter marred by the Japanese earthquake.

Barclays 10/17 - The positive aspect of this report is that the gains were relatively broad based across sectors, with highly cyclical sectors, such as durable consumer goods and business equipment, posting reassuring gains. The one downbeat aspect of the report was the revision to August numbers, which now show modestly weaker activity across most sectors than originally estimated.

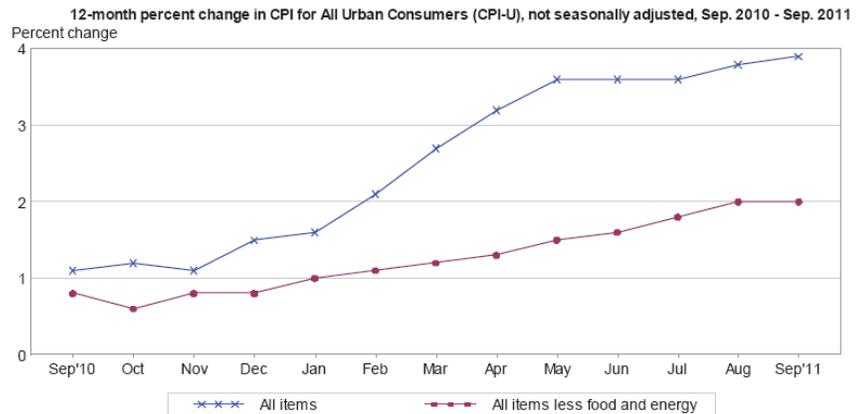


## Consumer Price Index – September: Prices Increase, But Inflation Not A Threat

Press Release 10/19 - The Consumer Price Index for All Urban Consumers (CPI-U) increased 0.3% in September on a seasonally adjusted basis, the U.S. Bureau of Labor Statistics reported today. Over the last 12 months, the all items index increased 3.9% before seasonal adjustment.

Increases in energy and food indexes were the main cause of the seasonally adjusted all items increase. The gasoline index continued to rise, and indexes for electricity and natural gas increased as well. Broad increases in food indexes also continued in September, with the food at home index rising 0.6% for the third month in a row and no major grocery store food group indexes declining.

AFP 10/24 - Food prices grew 0.4% in September, following increases of 0.4% and 0.5% during the two preceding months. Energy prices jumped 2.0%, including a 2.9% increase in gasoline prices. (It may seem odd that the Bureau of Labor Statistics reported an increase in gas prices even though you probably noticed prices at your local gas station have been declining. Gas prices actually fell 0.7% during month. However, gas prices typically decline at an even faster pace in September; hence the increase in the seasonally adjusted index).



The core consumer price index (CPI), which nets out the typically volatile prices of energy and food goods, increased by a very modest 0.1% during the month. Price of core goods fell 0.2% during the month (its first decline since last December), reflecting the 1.1% decline in apparel prices and a 0.6% fall in the price of used vehicles. Prices of core services increased 0.2%. Over the past 12 months, CPI has increased 3.9%, while core prices have grown 2.0%. This was the largest 12-month comparable for core consumer prices since November 2008, although the pace of increase does not appear to be a harbinger of inflation gaining steam any time soon.

Vanguard 10/21 –The moderate rise is a signal that inflation is in check. Lower prices for clothes and automobiles, as well as a slower pace for rent increases, kept the core number lower.

Econoday 10/19 - The September CPI report will not encourage the inflation hawks within the Fed to back down.

# Market Comment *Economic Highlights for the week ended October 21, 2011*

## Producer Price Index – September: Further Signs of Pipeline Price Pressures in the U.S.

Vanguard 10/21 – Producer—or wholesale—prices surged 0.8% in September, also behind an increase in gasoline and food costs. Analysts expected a smaller bump but were surprised by the largest increase since April. Gasoline prices contributed most of the spike in energy, while vegetable prices drove the advance in food. Core prices, which exclude food and energy, climbed 0.2%.

Barclays 10/18 - The PPI rose 0.8% in September, well above our forecast (0.3%) and the consensus (0.2%). The upside surprise was centered in non-core items, with strong gains in gasoline (4.2%), home heating oil (2.3%) and food (0.6%). That said, signs of building price pressures more generally among consumer-related items was again evident. The core PPI rose 0.2%, in line with our forecast but a tenth above the consensus. Gains in male apparel (2.7%), light motor trucks (0.6%), furniture (0.4%) and appliances (0.3%) more than offset declines in passenger cars (-0.5%), female apparel (-0.4%) and footwear (-0.3%). Further back on the production line, core intermediate goods prices rose 0.2% and core crude goods prices 1.0%. On a y/y basis, headline PPI rose four-tenths, to 6.9%, and the core was unchanged at 2.5%. Today's report supports our view that core consumer price inflation will continue to trend higher.

## Housing Starts – September: Starts Soar on Demand for Apartments

AFP 10/24 - A 51.3% surge in multi-family unit starts led to the fastest month-to-month increase in housing starts since January, as the SAAR pace for starts hit a 35-month high. Starts of single family units grew 1.7%.

- 594,000 building permits were issued (SAAR) during the month, a decline of 5.0% from August.
- 647,000 homes were completed during the month (SAAR), a 2.1% increase from the August pace.

Vanguard 10/21 – There's a large demand for apartments as buyers are reluctant or unable to purchase a home. Construction of single-family homes increased a more modest 1.7%. All four regions of the nation showed growth overall, although single-family starts were flat in the West and down in the South.

Barclays 10/19 - ...the gradual increase in multi-family starts is a positive sign for the housing market, and we continue to look for a modest uptick in this series over time. Our view is that residential construction should no longer be a drag on the recovery. Housing construction provided a positive contribution to GDP growth in Q2, and we expect another modest contribution from the sector in Q3.

## Existing Home Sales – September: Sales Decline On Weaker Single-Family Unit Sales

Vanguard 10/21 – Sales of existing homes fell 3.0% in September, to an annualized rate of 4.91 million units. The decrease follows strong gains in August. Compared with a year ago, home sales (including single-family dwellings, townhouses, and condominiums) are up 11.3%. Single-family sales fell 3.6% in September, while condo sales rose 1.8%. Sales increased in the Northeast, and declines in the three other regions were most notable in the West. The median home price is \$165,400, down 3.5% from a year ago. There's an 8.5-month inventory supply.

Barclays 10/12 - The decline in the pace of sales meant that the months' supply of inventory rose slightly, to 8.5 months from 8.4 months in August. Months' supply continues to hover at levels that are twice as high as pre-crisis averages as a result of the still-elevated level of distressed properties on the market and low levels of housing demand. Despite relatively tight credit conditions, high affordability and rising rents appear to be supportive of existing home sales.

## Unemployment Insurance Weekly Claims Report (Initial Jobless Claims) – week of Oct 15

Press Release 10/20 (excerpts) - In the week ending October 15, the advance figure for seasonally adjusted initial claims was 403,000, a decrease of 6,000 from the previous week's revised figure of 409,000. The 4-week moving average was 403,000, a decrease of 6,250 from the previous week's revised average of 409,250.

WEEK ENDING	Oct 15	Oct 8	Change	Oct 1	Prior Year
Initial Claims (SA)	403,000	409,000	-6,000	405,000	452,000
4-Wk Moving Average (SA)	403,000	409,250	-6,250	415,000	453,500

## Market Comment *Economic Highlights for the week ended October 21, 2011*

Econoday 10/20 – There are no special factors into today's data which point to improvement, however slow, in the nation's labor market. There's no significant initial reaction to the data.

### **Empire State Index – October: Continued Softness with Expectations of Improvement**

Barclays 10/17 - In the US, the Empire State Manufacturing index maintained its weak tone, registering -8.48 in October, in line with the -8.82 registered in September and -7.72 in August. This is the fifth consecutive negative reading on the headline index and was softer than we (-5) and the consensus (-4) had expected.

### **Home Builders' Index – October: An Upward Surprise to U.S. Homebuilder Sentiment**

Econoday 10/18 –The housing market index jumped four points in October to 18, a still depressed level but the highest level in nearly a year-and-a-half. Components show strong monthly gains led by future sales.

But the National Association of Home Builders, which compiles the report, notes that gains are concentrated in select markets where economic recovery is starting to take hold and where foreclosure activity is relatively subdued. Overall, the association warns that builders are facing downward pricing pressure from foreclosed homes at the same time that costs for building materials are on the rise.

### **Philly Fed – October: Strong Rebound**

Barclays 10/20 - The Philadelphia Fed manufacturing index rose sharply in October, to +8.7 from -17.5 in September. This marks a full reversal of the steep decline in August and the headline index now stands at its highest level since April. The survey is now more in line with the tone of the ISM and "hard" data in recent months, which suggest that the economy has come through a soft patch in activity growth.

### **The Economic Week Ahead: Oct 24– Oct 28, 2010**

Vanguard 10/21 - A variety of reports are on tap next week, which kicks off with Tuesday's data on consumer confidence. The releases continue with durable goods and new-home sales on Wednesday, gross domestic product on Thursday, and employment costs and personal income on Friday.

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

*Source: MarketWatch*

RELEASE DATE	TIME (ET)	REPORT	PERIOD	FORECAST	PREVIOUS
<b>MONDAY, OCT. 24</b>	8:30 am	Chicago Fed national index	September	--	-0.43
<b>TUESDAY, OCT. 25</b>	9 am	Case-Shiller home prices	August	--	0.9%
	10 am	Consumer confidence	October	45.5	45.4
<b>WEDNESDAY, OCT. 26</b>	8:30 am	Durable goods orders	September	-0.6%	-0.1%
	10 am	New home sales	September	299,000	295,000
<b>THURSDAY, OCT. 27</b>	8:30 am	Jobless claims	10-22	N/A	N/A
	8:30 am	GDP	3Q	2.5%	1.3%
	10 am	Pending home sales	August	--	-1.2%
<b>FRIDAY, OCT. 28</b>	8:30 am	Employment cost index	3Q	0.6%	0.7%
	8:30 am	Personal income	September	0.2%	-0.1%
	8:30 am	Consumer spending	September	0.5%	0.2%
	8:30 am	Core PCE price index	September	0.2%	0.1%
	10 am	Consumer sentiment	October	N/A	57.5