

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

Economic Week in Review: Moderate Progress At Home, Less Overseas

Vanguard 12/16 - The U.S. economy is showing enough momentum to keep the Federal Reserve in wait-and-see mode, though risks from abroad continued this past week. Europe's drift back toward recession and signs of slowing in Asia remained potential stumbling blocks for the U.S. recovery. Meanwhile, the sovereign bond market's cool reaction to a plan to enforce fiscal discipline in Europe kept alive concern that nations could default—with uncertain repercussions for the fate of the Eurozone and the global economy. For the week ended December 16, the S&P 500 Index fell 2.8% to 1,220 (for a year-to-date total return of about -1.0%). The yield on the 10-year U.S. Treasury note fell 21 basis points to 1.86% (for a year-to-date decline of 144 basis points).

FOMC Meeting: Fed Again Holds Its Fire

Vanguard 12/16 - Noting what it called moderate economic progress, the Federal Reserve's policymaking committee announced no additional steps to spur the recovery. Its December statement adopted a somewhat brighter tone—citing modest improvement in employment and consumer spending—though it cautioned that Europe's woes and slower growth around the world pose risks at home.

The Fed also cited home-grown obstacles—including still-high unemployment and the deeply troubled housing market—and remarked that financial market strains pose "significant" economic risk.

As expected, the committee repeated its pledge to keep its key interest rate near zero at least until mid-2013, and said it will continue measures aimed at driving down long-term rates, while closely monitoring inflation.

AFP 12/19 - The fed funds target rate has been near 0% for 3 years. The statement reaffirmed that the target rate would remain “exceptionally low” until at least mid-2013. The committee also kept in place the “twist” operation as it lengthens the average maturity of the securities on its balance sheet. The FOMC remains concerned about the “elevated” unemployment rate and sees “significant downside risks” to the recovery. Charles Evans again dissented with the majority as he desired additional accommodative policy.

Barclays 12/13 - Overall, the economy is about where the Fed expected in recent weeks along with most economists. Currently, the Fed is going through a greater diversity of debate about the direction of policy as inflation hawks remain (though some rotate off voting status in 2013) but at least one dove is more vocal. However, Evans will not be a voting member in 2012.

Consumer Price Index - November

AFP 12/19 - Overall consumer prices failed to grow for the 2nd straight month, thanks falling energy prices. CPI for energy goods fell 1.6%, itself the result of a 2.4% decline in gasoline price and a 4.4% drop in the price of utility delivered natural gas. Food prices increased 0.1%. Net of energy and food, core CPI increased 0.2%. Among major product categories, the biggest monthly price increases were with apparel (+0.6%) and medical care services (+0.5%). Prices of new vehicles dropped 0.3%. CPI was up 3.4% year-to-year, while core CPI has grown 2.2%.

Consumer Price Index – Nov. 2011

Press Release 12/19 - The Consumer Price Index for All Urban Consumers (CPI-U) was unchanged in November on a seasonally adjusted basis, the U.S. Bureau of Labor Statistics reported today. Over the last 12 months, the all items index increased 3.4% before seasonal adjustment.

Chart 1. One-month percent change in CPI for All Urban Consumers (CPI-U), seasonally adjusted, Nov. 2010 - Nov. 2011



The energy index declined for the second month in a row and offset increases in the indexes for food and all items less food and energy. As in October, the gasoline index fell sharply and the index for household energy declined as well. The food index rose slightly in November, though the index for food at home declined as four of the six major grocery store food group indexes fell.

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The index for all items less food and energy increased 0.2% in November following increases of 0.1% in each of the prior two months. The indexes for shelter, medical care, apparel, and personal care all rose. These increases more than offset declines in the indexes for new vehicles and used cars and trucks.

The all items index has risen 3.4% over the last 12 months. This is a slightly smaller increase than last month's 3.5% figure, as the 12-month change in the energy index declined from 14.2% to 12.4%. The 12-month change in the food index also declined slightly, from 4.7% to 4.6%. In contrast, the 12-month change in the index for all items less food and energy continued to rise, reaching 2.2% in November.

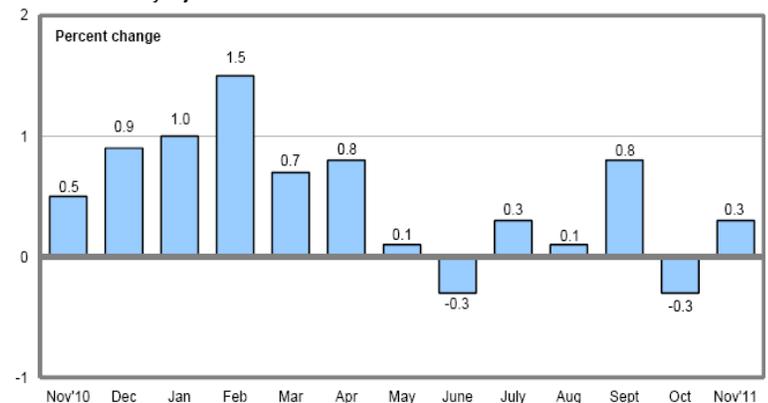
Producer Price Index (PPI) – November 2011

AFP 12/19 - Producer prices for finished energy goods edged up 0.1% while those for finished food grew 1.0%. Net of energy and food, prices of core finished goods increased 0.1%. Earlier in the production cycle, PPI for intermediate goods increased 0.2% while those of crude goods jumped 3.8% (the core measures were -0.4% and -2.5%, respectively). Over the past 12 months, PPI has increased 5.7%, while the 12-month comparable for core goods was up 2.9%.

Producer Price Indexes – November 2011

Press Release 12/15 - The Producer Price Index for finished goods advanced 0.3% in November, seasonally adjusted, the U.S. Bureau of Labor Statistics reported today. Finished goods prices fell 0.3% in October and moved up 0.8% in September. At the earlier stages of processing, the index for intermediate goods rose 0.2% and crude goods prices increased 3.8%. On an unadjusted basis, the finished goods index advanced 5.7% for the 12 months ended November 2011, the smallest year-over-year rise since a 5.6% increase in March 2011.

Monthly percent changes in the Producer Price Index for finished goods, seasonally adjusted: November 2010 – November 2011



Industrial Production & Capacity Utilization – November: Industry Pulls Back

Vanguard 12/16 - U.S. industrial output fell in November for the first time since April. Analysts noted, however, that the unexpected decline may be fleeting, since floods in Thailand had caused shortages of parts for U.S. automakers and the latest regional manufacturing surveys have been more upbeat.

Econoday 12/15 - Manufacturing was pulled down largely by a 3.4% drop in output for motor vehicles and parts, following a 3.4% jump in October. Excluding autos, manufacturing still slipped 0.2%, following a 0.3% rise the prior month. On a seasonally adjusted year-on-year basis, overall industrial production was up 3.7% in November, compared to 4.3% the month before.

Overall capacity utilization eased to 77.8% from the recovery's high of 78.0% in October. Analysts had called for 77.8% for November. November's manufacturing number is disappointing.

Press Release 12/15 - Industrial production decreased 0.2% in November after having advanced 0.7% in October. Factory output moved down 0.4% in November; excluding a drop of 3.4% in the output of motor vehicles and parts, manufacturing production declined 0.2%. Mining production edged up 0.1%, while the output of utilities rose 0.2%. At 94.8% of its 2007 average, total industrial production for November was 3.7% above its year-earlier level. Capacity utilization for total industry decreased to 77.8%, a rate 2.0 percentage points above its level from a year earlier but 2.6 percentage points below its long-run (1972--2010) average.

Retail Sales - November: U.S. Retail Sales Growth Modestly Softer Than Expected

Econoday 12/13 – Retail sales in November advanced but not as strongly as expected. However, October and September were revised up and weakness in November was largely in components that had surged earlier. Overall retail sales in November grew 0.2%, following a 0.6% boost in October (originally up 0.5%) and a 1.3% spike in September (previously up 1.1%). Excluding autos, retail sales gained 0.2% in November after increasing 0.6% in October (unrevised) and increasing 0.6% in September (previously up 0.5%). Gasoline sales declined marginally in November. Sales excluding autos and gasoline in November rose 0.2%, following a healthy 0.7% increase in October. Within the core (excluding autos and gasoline), gains were mixed but mostly positive.

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Overall components were largely favorable. Once again, the strongest component was for electronics & appliance stores which jumped 2.1% in November, followed by non-store retailers (up 1.5%) and auto dealers (up 0.5%). Also seeing gains were furniture & home furnishing, clothing & accessory stores, sporting goods & hobby, and general merchandise.

The largest decline was for miscellaneous store retailers, down 1.2%. Modest decreases also were seen in building materials & garden equipment, food & beverage, health & personal care, gasoline stations, and food services & drinking places.

AFP 12/19 - This was the smallest monthly increase in retail sales since June.

Advance Monthly Sales For Retail And Food Services, November 2011

Press Release 12/13 - The U.S. Census Bureau announced today that advance estimates of U.S. retail and food services sales for November, adjusted for seasonal variation and holiday and trading-day differences, but not for price changes, were \$399.3 billion, an increase of 0.2% from the previous month and 6.7% above November 2010. Total sales for the September through November 2011 period were up 7.4% from the same period a year ago. The September to October 2011% change was revised from +0.5% to +0.6%.

Retail trade sales were up 0.3% from October 2011, and 6.8% above last year. Non-store retailers sales were up 13.9% from November 2010 and gasoline stations sales were up 12.9% from last year.

Retail Inventories - October: Small Decline in U.S. Non-Auto Retail Inventories In October

Vanguard 12/16 - Consumers' willingness to keep spending this fall kept retail inventories in record-low territory in October compared with sales, a potential assist to the economy. Because retailers had been leery of overstocking their shelves amid economic and financial uncertainty, their inventories dwindled. Low ratios of inventories to sales often precede a boost in production as retailers order more wares. Meanwhile, wholesalers and factories added to their stockpiles just enough to keep pace with sales.

Econoday 12/13 – Inventory build is in a sweet spot, steady and mild. Business inventories rose 0.8% in October in a rate which if extended through November and December would come to a quarter-to-quarter build of 1.2%. The quarterly build in the third quarter was 1.3%. Inventories relative to sales are steady, with business sales up 0.7% in October to keep the stock-to-sales ratio unchanged at 1.27.

Inventory levels are best when they are a little bit lean which not only keeps up demand for new orders but also keeps up demand for employment.

Barclays 12/13 - It continues to look likely that inventory accumulation will make a positive contribution to Q4 GDP growth, with firms rebuilding stock levels following the decline in Q3.

Federal Budget - November

Econoday 12/12 – Tax receipts are up and spending is down, a good combination for the government's deficit which, at a still sizable \$137.3 billion in November, is down from last November when the deficit was \$150.4 billion. In the first two months of the government's fiscal year, the deficit is at \$235.8 billion which is down 19% compared to the same two months in the prior fiscal year.

Individual tax receipts are up a year-on-year 16% for the fiscal year-to-date comparison with corporate tax receipts, a much smaller source of government income, also higher. On the spending side, defense outlays are down as are Medicare payments which together are more than offsetting a rise in net interest expense.

Import and Export Prices - November: Decline in Core U.S. Import Prices

Barclays 12/14 - Import prices rose 0.7% m/m in November. The downside surprise was split between petroleum and non-petroleum prices. The former rose 3.6%, below the 5.0% we had penciled in, and the latter fell 0.2%. The narrower ex-food and fuels measure of core import prices fell 0.3%. This likely reflects, in part, the dampening effect of the recent rise in the trade-weighted dollar exchange rate, but came despite gains in autos (0.2%) and consumer goods excluding autos (0.1%). The latter has now risen for eight consecutive months, suggesting that pipeline price pressures within consumer-related goods continue to gradually build. On a y/y basis, headline import price inflation declined by one percentage point to 9.9% and ex-petroleum prices to 3.7% from 4.8%.

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Econoday 12/14 – The rise in the dollar, which is getting a major boost from safe-haven demand tied to Europe, is a major factor helping to subdue inflationary pressures from import costs. This together with no more than moderate economic demand are preventing pass through of high energy costs.

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Unemployment Insurance Weekly Claims Report (Initial Jobless Claims) – Week of Dec. 10

Press Release 12/15 (excerpts) - In the week ending December 10, the advance figure for seasonally adjusted initial claims was 366,000, a decrease of 19,000 from the previous week's revised figure of 385,000. The four-week moving average was 387,750, a decrease of 6,500 from the previous week's revised average of 394,250.

WEEK ENDING	Dec 10	Dec 3	Change	Nov 26	Prior Year
Initial Claims (SA)	366,000	385,000	-19,000	404,000	427,000
4-Wk Moving Average (SA)	387,750	394,250	-6,500	396,250	426,750

Econoday 12/15 – Back-to-back declines of 19,000 in initial jobless claims are signaling sudden strength in the labor market. The four-week average is down 6,500 to 387,750 for the lowest level since July 2008. The four-week average, in a convincing sign of strength, has been down in 10 of the last 12 weeks. The Labor Department cites no difficulties with the data.

Barclays 12/15 - Altogether, we view this report as another positive signal that labor market conditions have taken a turn for the better in recent weeks which supports our view that payroll growth should improve in the coming months.

The Economic Week Ahead: Dec 19– Dec 23, 2011 *Merry Christmas!!*

Vanguard 12/16 - Analysts will be watching for further signs of economic momentum in the Conference Board's leading economic indicators on Thursday and in reports on personal income and durable goods on Friday. News on corporate profits will highlight Thursday's final estimate of third-quarter gross domestic product. Also on tap are the latest data on the housing market—with housing starts on Tuesday, existing-home sales on Wednesday, and new-home sales on Friday.

This Week's U.S. Economic Calendar

Source: MarketWatch

RELEASE	TIME (ET)	REPORT	PERIOD	FORECAST	PREVIOUS
MONDAY, DEC. 19	10 am	Home Builders Index	December	--	20
TUESDAY, DEC. 20	8:30 am	Housing Starts	November	632,000	628,000
WED., DEC. 21	10 am	Existing Home Sales	November	5.10 million	4.97 million
THURSDAY, DEC. 22	T8:30 am	Jobless Claims	12-17	N/A	N/A
	8:30 am	Gross Domestic Product (GDP)	3Q	2.1%	2.0%
	9:55 am	Consumer Sentiment	December	N/A	67.7
	10 am	Leading Economic Indicators	November	0.3%	0.9%
	10am	FHFA Home Price Index	September	--	-0.1%
FRIDAY, DEC. 23	8:30 am	Personal Income	November	0.2%	0.4%
	8:30 am	Consumer Spending	November	0.3%	0.1%
	8:30 am	Core PCE Price Index	November	0.0%	0.1%
	8:30 am	Durable Goods Orders	November	4.6%	-0.5%
	10 am	New Home Sales	November	313,000	307,000