

Weekly Economic Commentary



June 14, 2010

Is Our European Vacation About to End?

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Highlights

- Economic data and policy actions in the United States and abroad last week revealed little, if any, impact from the European fiscal credit crunch.
- This week's busy economic data calendar in the United States, along with several key global central bank meetings, will provide more fodder for the ongoing debate about Europe's impact on the global economy.

Investors embraced risky asset classes such as Equities, Commodities, and High-Yield Bonds, last week, as the latest global economic data revealed few signs of any significant slowdown in economic activity related to the still-unfolding European fiscal and liquidity situation. While there were a number of key economic data reports released last week in the United States including:

- The April merchandise trade report,
- The April consumer credit report,
- The Federal Reserve's (Fed) Beige Book, a qualitative assessment of economic activity in each of the 12 Federal Reserve regions around the country,
- The weekly readings (for the second week in June) on chain store sales, mortgage applications, and initial filings for unemployment benefits,
- The May retail sales report, and
- The consumer sentiment data for early June

The main focus of market participants last week was on the economic data for May out of China.

In particular, the Chinese export data for May revealed that exports continued to boom, and in particular, exports to Europe remained robust in May, showing no signs of a slowdown in global growth as a result of the European fiscal situation. (Chart 1) In addition, policy tightening by several foreign central banks (Brazil, New Zealand, and Peru), signaled that global growth was strong enough to allow policymakers (in resource rich nations) to ease up on the stimulus a bit.

On balance, the economic data in the U.S. last week was split evenly between reports that fell short of expectations—but continued to indicate that the United States economy was growing more quickly in the second quarter of 2010 than in the first quarter—and reports that beat ever-higher market expectations.

The reports that fell short of expectations included the weekly report on initial filings for unemployment insurance, the April merchandise trade data, and the May retail sales report. On the other hand, the reports that beat expectations included the April consumer credit report, the Fed's Beige Book, and the reading on consumer sentiment for the first half of June.

A quick look at the market's reaction (or lack thereof) to two key data points on the consumer—one from each of the categories above—released 90

Economic Calendar

Tuesday, Jun 15

NY Fed Empire State Mfg
Jun

Import Price Index
May

NAHB Housing Survey
Jun

Wednesday, Jun 16
Building Permits
May

Housing Starts
May

Producer Price Index
May

Industrial Production
May

Capacity Utilization
May

Thursday, Jun 17

Current Account Deficit
Q1

Consumer Price Index
May

Initial Claims
wk 06/12

Philly Fed Index
Jun

Leading Indicators
May



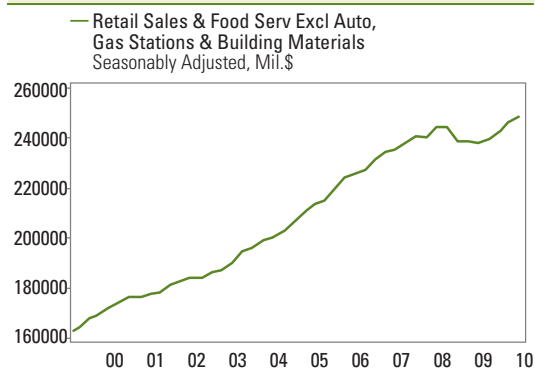
1 China's Exports Continued to Boom in May, Easing Fears of a European Induced Global "Double Dip"



Source: China Customs/Haver Analytics 06/14/10

While the headline of this report was weak, on the true consumer spending side of the May retail sales report, the news was mixed, at best, but nowhere near as gloomy as the headline and the big miss relative to consensus.

2 Core Retail Sales are at an All Time High



Source: Census Bureau/Haver Analytics 06/14/10

minutes apart on Friday morning, June 11 are instructive.

After beating consensus expectations in eight of the last nine months (dating back to last summer), retail sales in May, released at 8:30 AM (Eastern Time) on Friday, June 11, fell far short of expectations, falling 1.2% month-over-month. The market was expecting a 0.2% month-over-month gain. The major downward pressure in the report came from sales at building materials stores, which fell 9.3% month-over-month in May, the largest one-month drop on record. The big drop in May came on the heels of outsized gains (8%+) in both March and April.

Market participants who are calling for a "double-dip" recession pounced on the May retail sales report as clear evidence that the economy is sliding back into recession. While the headline of this report was weak, on the true consumer spending side of the May retail sales report, the news was mixed, at best, but nowhere near as gloomy as the headline and the big miss relative to consensus.

- Weather is often a factor in this category, and warmer and drier weather boosted sales in April, while wetter and colder weather (relative to normal) hurt building material sales in May. Although somewhat counterintuitive, the building materials portion of retail sales is actually counted as business capital spending in the Gross Domestic Product (GDP) accounts, and not as consumer spending. That said, building material sales are only a small portion of overall capital spending.
- Overall, retail sales in both March and April were revised upward.
- Sales of discretionary items like furniture, electronics, sporting goods, and restaurants all posted month-over-month gains in May versus April. Still, there were disappointing declines in clothing stores (-1.3% month-over-month) and general merchandise store sales (-1.1% month-over-month) in May, which may raise concerns.
- Overall "core" retail sales (sales excluding building materials, autos and gasoline) in the first two months of the second quarter of 2010 are running 3.0% ahead of their first quarter average, suggesting that consumer spending will be a big plus for GDP growth in the second quarter. In addition, core retail sales (sales excluding autos, which are counted a different way in the GDP accounts), gasoline (which are largely driven by price), and building materials (see above), are well above not just 2009's depressed level, but are at an all-time high. (Chart 2)

Then, an hour and a half later, at 10 AM Eastern Time, the University of Michigan released its consumer sentiment data for the first half of June. The report exceeded expectations, and the composition of the report was quite favorable, as both the current and forward-looking measures of consumer sentiment posted solid gains in early June versus May. In addition, the market quickly realized that the weekly retail sales data (part of the *LPL Financial Current Conditions Index*) posted back-to-back weekly gains in the first two weeks of June, and are now well above not only their June 2009 level, but are well above their pre-recession June 2007 levels as well. While the weekly retail sales report—which tallies up sales as reported by the retailers themselves—is not as broad in its scope as is the government's tally of retail sales, it has proven in the past to be a reliable indicator of where retail sales are headed in any given month.



Along with the “European contagion” fear, financial markets are grappling with the notion that most of the economic data in the United States is still in the process of transitioning from recovery mode to sustainable growth mode, where the economic data is still moving higher.

Our View on the Key Reports and Events of the Coming Week:

As has been the case since the European fiscal and liquidity situation became front-page news in late April, this week’s U.S. economic data will be closely scrutinized for any sign that a “contagion” from Europe has spread to these shores.

Along with the “European contagion” fear, financial markets are grappling with the notion that most of the economic data in the United States is still in the process of transitioning from recovery mode (where most data is still accelerating month-to-month and year-over-year) to sustainable growth mode, where the economic data is still moving higher (but at a slower pace than before).

We continue to expect that most of the data due out this week will fall into the second category (still moving higher, but at a slower pace than before). The key reports will be the data for June, which includes the National Association of Homebuilders Sentiment Index, and both the Empire State and Philly Fed manufacturing indices for June, in addition to the weekly reports on retail sales, mortgage applications, and initial filings for unemployment insurance for mid-June.

The leading indicators report for May will most certainly fall into the “still moving higher but at a slower pace” camp, and will receive a great deal of attention from the media, as it is likely to post a second consecutive month-over-month decline in May.

There is no economic data due out in China this week, and none of the central banks meeting to set policy this week (Bank of Japan, Swiss National Bank, Bank of Mexico, and Hong Kong’s Monetary Authority) are likely to raise rates.

There are a few Fed policymakers scheduled to speak this week (including Fed Chairman Ben Bernanke) but most of the appearances are early in the week, as the Fed traditionally maintains a “quiet period” a week ahead of the Federal Open Market (FOMC) meeting. The next FOMC meeting is June 22 and 23.

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