

# Weekly Economic Commentary



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## Economic Uncertainty Remains in Place

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#### Highlights

- A busy week for economic data in the United States, highlighted by the third quarter GDP report which is likely to be the strongest of the year.
- Uncertainty continues to dominate the economic landscape.
- A closer look at the labor market and initial claims for unemployment insurance reveals a labor market stuck in neutral

#### Economic Calendar

<b>Monday, October 24</b> Chicago Fed National Activity Index <i>Sep</i>	<b>Thursday, October 27</b> Initial Claims <i>wk 10/22</i> GDP Price Index <i>Q3</i>
<b>Tuesday, October 25</b> Consumer Confidence <i>Oct</i> Richmond Fed Index <i>Oct</i>	Real GDP <i>Q3</i> Pending Home Sales <i>Sep</i>
<b>Wednesday, October 26</b> MBA Mortgage Applications Index <i>wk 10/21</i> Durable Goods Orders and Shipments <i>Sep</i> New Home Sales <i>Sep</i>	<b>Friday, October 28</b> Employment Cost Index <i>Q3</i> Personal Consumption Expenditures <i>Sep</i> Personal Income <i>Sep</i> U of M Consumer Sentiment <i>Oct</i>

Third quarter gross domestic product (GDP), along with housing and manufacturing data, is likely to dominate this week's economic calendar, although the market is still likely to be focused on eurozone issues and corporate earnings. The third quarter GDP figures—expected to show that the economy grew at 2.0 to 2.5% in the third quarter—highlight the week's busy economic calendar. There are three housing related reports for September (new home sales, pending home sales, and home prices), along with several key reports on manufacturing, durable goods orders and shipments for September, and the Richmond Fed index for October. Two of the three members of the Federal Reserve's (Fed) "center of gravity" (Vice Chair Janet Yellen and the New York Fed president Bill Dudley) speak this week, offset by several inflation hawks (Dallas Fed's Richard Fisher, outgoing Kansas City Fed president Thomas Hoenig and Minneapolis Fed president Narayana Kocherlakota). The Bank of Canada, the Reserve Bank of New Zealand and the Bank of Japan all meet this week to set rates.

Meanwhile, incoming economic data continue to point to slow growth, not recession. The Beige Book—a qualitative assessment of business, banking and economic conditions by bankers, and small and large businesses in each of the 12 regional Federal Reserve districts—suggested that while economic uncertainty remained elevated, the economy continued to post modest growth. The other data released last week all continue to suggest that despite the unprecedented level of uncertainty among consumers and businesses surrounding the economic, political and geopolitical situation, the U.S. economy continues to grow, albeit modestly and below its long-term potential:

- Industrial production for September
- Empire State Manufacturing Index for October
- National Association of Homebuilders Sentiment Index
- Housing Starts for September
- Index of leading economic indicators for September
- Philadelphia Fed manufacturing index for October
- Existing home sales for September

The latest reading on initial claims for unemployment insurance for mid-October suggests that the labor market is healing, but not quickly enough to push the unemployment rate much lower.

Still, the point we made back in early September bears repeating here: it is clear that the certainty craved by businesses, consumers and policymakers is still sorely lacking.

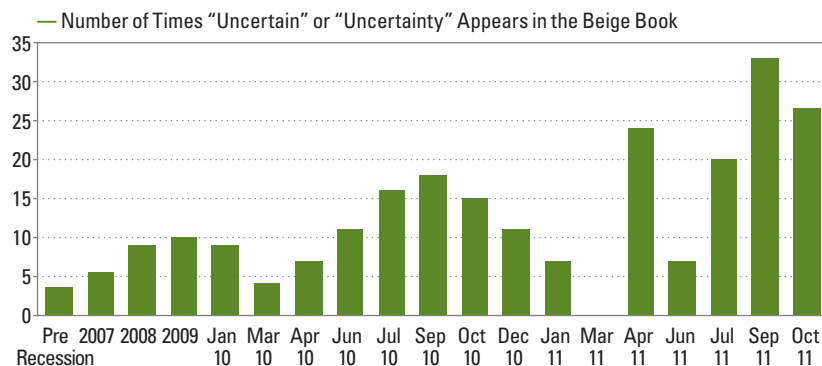
## Uncertainty Reigns Among Bankers and Business Owners

Returning to the Beige Book—a qualitative report prepared several weeks prior to each of the eight Federal Open Market Committee (FOMC) meetings held each year—we note that the word “uncertainty” appeared in the most recent Beige Book 26 times. While this is less than the 33 mentions of the word uncertainty in the early September version of the Beige Book, it nonetheless is an extremely elevated number of instances.

Not all of the uncertainty was attributed to the near-term economic outlook or the ongoing financial turmoil in Europe. There were 19 mentions of the upcoming holiday shopping season in the most recent Beige Book, half of which were in a negative context. Still, the point we made back in early September bears repeating here: it is clear that the certainty craved by businesses, consumers and policymakers is still sorely lacking.

**Chart 1** describes how many times the words “uncertain” or “uncertainty” appeared in the Beige Book since January 2010. We also looked at how many times, on average, those words appeared in the Beige Book in pre-recession years (2005 and 2006, right in the middle of the 2002–2007 recovery), as well as the years of the Great Recession (2007, 2008 and 2009). Prior to 2011 we note that the use of the word uncertainty peaked in 2009, just as equity markets were making multi-year lows.

### 1 Elevated Economic and Policy Uncertainty Evident in the Beige Book



Source: LPL Financial Research, Federal Reserve 10/24/11

As we wrote in the September 12, 2011 edition of *Weekly Economic Commentary*, we want to make it clear that not all periods of uncertainty are resolved the same way. At times, the uncertainty can clear up quickly in response to an economic event, policy action, or series of policy actions, and the clarity this provides to economic agents often leads to better results for financial markets and economies. An example of this type of uncertainty was the initial flare-up of the concerns surrounding European peripheral debt during the spring and summer of 2010. This flare-up coincided with a spike higher in the number of times the word “uncertain” showed up in the Beige Book over the summer and early fall of 2010 [Chart 1].

This heightened level of uncertainty led to a 15% peak-to-trough drop in S&P 500 Index over the late spring and summer months of 2010, and took four or five months to resolve. Low expectations for the economy, bold



policy action (the announcement and enactment of QE2), and a series of better-than-expected results for global economies and companies helped to end that spate of uncertainty.

In the current period, the uncertainty led to a nearly 20% drop in U.S. equity prices between July and October 2011, and it appears that the uncertainty is being resolved in much the same way it was in 2010:

- Bold policy action from policymakers around the globe, as Europe works toward a plan to stabilize its financial system and central bankers begin to loosen monetary policy that had been getting more restrictive over the past several years.
- Better-than-expected economic data (the U.S. economy in the recently completed third quarter is on pace to more than double the pace of growth seen in the first half of the year) and expectations remain low.
- Solid corporate earnings, which ultimately drive equity prices. Thus far, corporate earnings results for the third quarter of 2011 have exceeded lowered expectations and guidance from corporate management for the fourth quarter of 2011 and 2012 has been solid.

Of course, some uncertainty is likely to remain in place, despite the progress noted above. There is still plenty of work to be done on the fiscal side in the United States, the labor and housing markets in the United States remain tepid at best, and the 2012 Presidential and congressional election cycle will keep legislative initiatives aimed at reducing the deficit in the United States on hold until early 2013.

### What Does the Level of Unemployment Benefits Tell Us About the Labor Market?

In fact, at around 400,000 per week, initial claims for unemployment insurance are the lowest since mid-2008, just prior to the collapse of Lehman Brothers and the onset of the worst of the global credit crunch and Great Recession.

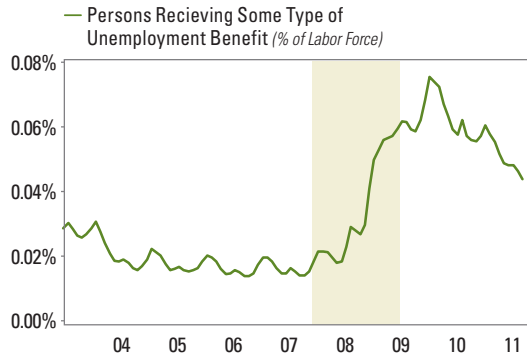
The labor market remains tepid at best, but last week's data on initial claims for unemployment benefits in the week ending October 14 continued to show a labor market that is stuck in neutral. Companies are not laying off workers, but they are not hiring either. For the week ending October 14, 2011, 403,000 individuals filed for unemployment insurance, 1,000 fewer than in the prior week, and about the same number that have filed each week over the past several months. In fact, at around 400,000 per week, initial claims for unemployment insurance are the lowest since mid-2008, just prior to the collapse of Lehman Brothers and the onset of the worst of the global credit crunch and Great Recession.

Claims accelerated quickly during that period, moving from just under 400,000 per week in the spring and early summer of 2008 to over 550,000 per week by the end of 2008. Claims peaked in March and April 2009, when more than 650,000 people per week were filing claims for unemployment benefits as businesses large and small cut staff to align with a much lower level of economic growth and slower growth prospects.

Thus, at around 400,000 per week, claims stand some 250,000 per week less than they did in early 2008 but, most importantly, have shown few signs of accelerating as they did from mid-summer 2008 through



## 2 Labor Market Still Showing Signs Of Stress, But Has Improved Noticeably Over the Past 18 Months



Source: Haver Analytics 10/24/11

(Shaded areas indicate recession)

early spring 2009. Claims at around 400,000 per week suggest that the unemployment rate is not likely to move much lower (from the current reading of 9.1%), but that it is not likely to move sharply higher either.

One final observation on unemployment benefits: While the Great Recession of 2007-2009 officially ended in June 2009, the labor market continued to suffer throughout 2009 and into 2010. The labor market always lags the overall economy, so it is not a surprise that the economy continued to shed jobs (3.3 million of them) between the end of the recession and early 2010. In late 2009, as these job losses were mounting, close to 12 million people were receiving some type of unemployment benefit from the government. The labor force—people over 16 years old and actively looking for work—at the time was 154 million, so about 8% of the labor force was receiving some type of unemployment assistance.

As of mid-October 2011, just over 6.5 million people were receiving some type of government unemployment assistance, down from the 12 million in late 2009. Although there is no official data on this, a sizeable number—estimates range from three million to five million workers—of people have probably exhausted their unemployment benefits. The labor force has decreased to around 153 million, as about one million people have given up looking for work, or have returned to school or retired since late 2009. This means that approximately 4.2% of the labor force is receiving some type of government unemployment assistance. As shown in the [Chart 2](#), on average during the mid-2000s (2002–2007) economic recovery, around 2% of the labor force was receiving unemployment benefits.

Thus, the labor market remains stuck in neutral. The economy is growing just enough to produce some job growth, but not quickly enough to substantially lower the unemployment rate or the number of people filing for new unemployment benefits each week. In short, the economic and policy uncertainty that is restraining the rest of the economy is still clearly being felt in the labor market, and only a resolution of that uncertainty will lead to an improved labor market in the months and quarters ahead.



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Quantitative Easing is a government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity.

Stock investing involves risk including loss of principal.

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Empire State Manufacturing Index is a seasonally-adjusted index that tracks the results of the Empire State Manufacturing Survey. The survey is distributed to roughly 175 manufacturing executives and asks questions intended to gauge both the current sentiment of the executives and their six-month outlook on the sector.

The Philadelphia Fed Survey is a business outlook survey used to construct an index that tracks manufacturing conditions in the Philadelphia Federal Reserve district. The Philadelphia Fed survey is an indicator of trends in the manufacturing sector, and is correlated with the Institute for Supply Management (ISM) manufacturing index, as well as the industrial production index.

The index of leading economic indicators (LEI) is an economic variable, such as private-sector wages, that tends to show the direction of future economic activity.

The NAHB/Wells Fargo Housing Market Index gauges builder perceptions of current single-family home sales and sales expectations for the next six months as "good," "fair" or "poor." The survey also asks builders to rate traffic of prospective buyers as "high to very high," "average" or "low to very low." Scores from each component are then used to calculate a seasonally adjusted index where any number over 50 indicates that more builders view conditions as good than poor.

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