

# Weekly Economic Commentary



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## In a “Wait and See” Mode

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#### Highlights

- This week’s docket of economic data and events is relatively thin, which should allow market participants to absorb last week’s deluge of economic and policy news
- Federal Reserve policymakers will be fairly quiet this week ahead of next week’s Federal Open Market Committee (FOMC) meeting.

This week’s docket of economic data and events is relatively thin, which should allow market participants to absorb last week’s deluge of economic and policy news, and prepare for next week’s decision from the Federal Reserve (The Fed) and debate later in the spring on the budget and debt ceiling. Monetary policy in China also remains a concern.

At least on the surface, the market’s attention is likely to be focused on the peak week of first quarter corporate earnings reporting season, along with a handful of economic reports in the United States that are primarily focused on the housing market. Expected housing data this week includes homebuilder sentiment for April, along with existing home sales, existing home prices, and housing starts for March. On balance, the housing data (prices, sales, construction activity, etc.) is likely to continue to show a relatively moribund housing market as the all-important spring selling season was getting underway. Not much was expected from housing in 2011, and thus far, housing has lived up to the low expectations that the market had heading into the year.

Markets will also digest the Philadelphia Fed manufacturing index for April, and it is likely to show that the manufacturing sector continues to roll along, seemingly impervious to rising input costs, potentially peaking profit margins, and possible supply disruptions resulting from the earthquake in Japan. The manufacturing sector continues to be a source of strength in the economy, aided by very strong overseas (and especially emerging market) demand, a weaker dollar, and the ability to pass on higher input costs. In addition to the regular weekly readings on retail sales, mortgage applications, and initial claims for unemployment insurance (all of which are components of the LPL Financial Research Current Conditions Index), the March leading indicator data is due out this week. The leading indicator data in recent months has pointed to further gains ahead for the U.S. economy over the next six to nine months. The March data is likely to confirm that view as well, but the data is likely to reveal that the pace of economic growth may slow in the quarters ahead. Our view remains that we are still in the early innings of the economic recovery. (See the March 28 *Weekly Economic Commentary* for more detail)

#### Economic Calendar

<b>Monday, April 18</b> NAHB Housing Survey <i>April</i>	<b>Thursday, April 21</b> Initial Claims <i>wk 04/16</i>
<b>Tuesday, April 19</b> Building Permits <i>March</i> Housing Starts <i>March</i>	Philly Fed Index <i>April</i> Leading Indicators <i>March</i>
<b>Wednesday, April 20</b> Existing Home Sales <i>March</i>	

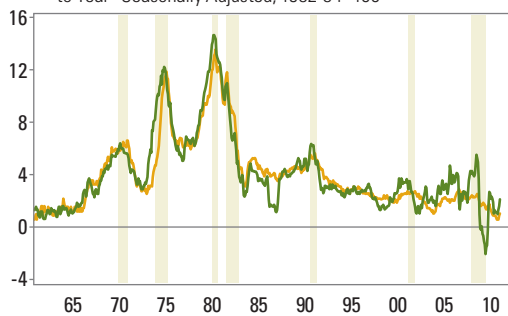
### “Wait and See” Mode on Policy

Federal Reserve policymakers will be fairly quiet this week ahead of next week’s Federal Open Market Committee (FOMC) meeting. Fed officials



## 1 Core Consumer Prices Continue to Accelerate, but Remain Very Tame By Historical Standards

— CPI-U: All Items, % Change - Year to Year Seasonally Adjusted, 1982-84=100  
 — CPI-U: All Items Less Food and Energy, % Change - Year to Year Seasonally Adjusted, 1982-84=100

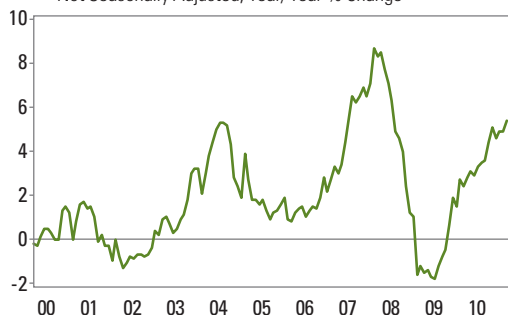


Source: Bureau of Labor Statistics/Haver Analytics 04/15/11

(Shaded areas indicate recession)

## 2 At 5.4%, the Inflation Rate in China is Above the Government's 2011 Target of 4.0%

— China: Consumer Price Index  
 Not Seasonally Adjusted, Year/Year % Change



Source: China Bureau of Statistics/Haver Analytics 04/15/11

The takeaway is that China has more tightening to do this year, and perhaps more than was priced in just a few days ago.

have traditionally observed an unofficial “quiet period” the week before an FOMC meeting. The release last week of the Fed’s Beige Book (a qualitative assessment of economic conditions in each of the Fed’s 12 regional districts) suggested that the economy continued to improve in March and early April, but not quickly enough to push inflation sharply higher or the unemployment rate lower. The consumer price index (CPI) data for March released last week revealed that while the threat of deflation (falling wages and prices) has subsided and that the Fed’s preferred measure of inflation (inflation excluding food and energy) has accelerated in recent months, inflation still remains quite tame by historical standards. While the Fed is likely to take note of rising food and energy prices at its next FOMC meeting on April 26–27 and will likely raise its forecast for both overall and core inflation in the forecast it prepares at the meeting, we do not think the Fed will begin to signal that it is removing the monetary stimulus in the system at this meeting. This FOMC meeting will be the first time Fed Chairman Ben Bernanke will hold a press conference at the conclusion of an FOMC meeting.

Turning from monetary policy (the Fed) to fiscal policy (Congress and the budget), last week’s address by President Obama laid out the Democratic party’s view on the nation’s priorities as the battle of the debt ceiling limit begins to heat up. Congress is on recess this week and next, but returns on May 2, facing an early July deadline on the debt ceiling (See the April 11, 2011 *Weekly Economic Commentary* and the March 15, 2011 *Bond Market Perspectives* for more detail on the debt ceiling debate). In short, President Obama’s plan to cut \$4 trillion in spending over the next decade or so makes it a bit more likely that some kind of long-term budget deal can be agreed to by both parties around the time that the debt ceiling limit is reached. As we noted last week, in exchange for raising the debt ceiling, Congressional Republicans are most likely going to want deep cuts in spending for both fiscal year 2012 and beyond. The Senate Democrats and the White House want smaller cuts, and for spending cuts to be accompanied by tax increases.

In short, the next phase of the fight has just begun, and is likely to persist as an important part of the debate over the health of the economy and the financial markets for the next several months.

Monetary policy in China is also likely to be a concern of financial markets in the coming weeks on the heels of the hotter-than-expected readings on Chinese inflation and growth for March and the first quarter of 2011. Chinese authorities reported last week that the Chinese economy grew 9.7% year-over-year in the first quarter of 2011 and, although growth decelerated from the 9.8% year-over-year gain in the fourth quarter of 2010, the 9.7% reading for Q1 2011 was above the consensus estimate (+9.4% year-over-year) and most importantly above Chinese authorities’ official target for growth in 2011 of 8.0%. Similarly, the March CPI report accelerated from February, was ahead of expectations, and at +5.4% year-over-year, is running way above the official target of 4.0% for 2011. The takeaway is that China has more tightening to do this year, and perhaps more than was priced in just a few days ago.



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Stock investing involves risk including loss of principal.

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