

Weekly Economic Commentary



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Busy Week for Data and Policy

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Highlights

- April ISM, jobs reports bookend a busy week for data.
- Policy parade at home and abroad.

Economic Calendar

Monday, May 2 ISM Manufacturing <i>April</i>	ADP Employment <i>April</i>
Construction Spending <i>March</i>	Thursday, May 5 Initial Claims <i>wk 04/29</i>
Tuesday, May 3 Factory Orders <i>March</i>	Chain Store Sales <i>April</i>
Domestic Light Vehicle Sales <i>April</i>	Productivity <i>Q1</i>
Wednesday, May 4 ISM- Non Manufacturing <i>April</i>	Friday, May 6 Unemployment Rate <i>April</i>
Layoff Announcements <i>April</i>	Nonfarm Payrolls <i>April</i>
	Consumer Credit <i>March</i>

The week's economic calendar is bookended by the April ISM report on Monday and the April jobs report on Friday. In between, both fiscal and monetary policy (at home and abroad) will take center stage.

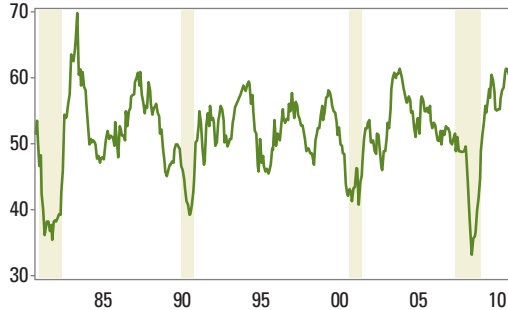
Traditionally, the first week of every month is chock full of timely economic data. This first week of May is no different, as economic data, geopolitics and the debate over the United States' debt ceiling is likely to replace first quarter earnings reports and guidance as the key drivers of market activity this week. From beginning to end, this week is full of crucial economic reports for April and March that will help guide actions of Federal Reserve policymakers and market participants. In addition to the data, this ranges from the April report on business from the Institute of Supply Management (ISM) on Monday to the April employment report on Friday. Congress returns to work this week after a two-week break, with the debate over the debt ceiling likely to take center stage. Market participants will also be debating the short- and long-term impact on markets and economies after U.S. forces killed Osama bin Laden, the mastermind of the September 11 terrorist attacks and leader of the al-Qaeda terrorist network.

In between the April ISM report on Monday and the April employment report on Friday, markets will digest data on the consumer (April vehicle sales, April chain store sales, March consumer credit), labor costs (productivity and unit labor costs in the first quarter of 2011), and factory orders. In addition, the regular weekly reports on retail sales, mortgage applications and initial filings for unemployment insurance are sure to draw some attention this week.

As this publication was being prepared, the ISM report on business for April was released. The report revealed that while the U.S. manufacturing sector has cooled in recent months, conditions in the manufacturing portion of the economy remain robust, and that the economic recovery that began nearly two years ago remains firmly in place. In addition, the forward-looking elements of the ISM (new orders, backlog of orders, new export orders) all suggest that the recovery will remain in place for the foreseeable future. In every economic recovery, the ISM typically gets to around 60 (it got as high as 61.4 in February 2011) and then begins to fade back to 50. A reading above 50 on the ISM suggests that the manufacturing sector is expanding. A reading above 44 on the ISM suggests that the overall economy is expanding.

1 The ISM May Have Peaked for This Cycle, but it Does Not Mean the Cycle is Over

— ISM Manufacturing: Purchasing Managers Index (PMI) Composite Index Seasonally Adjusted, 50+= Increasing

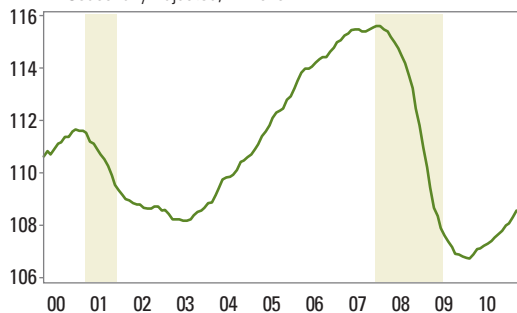


Source: Institute for Supply Management /Haver Analytics 05/02/11

(Shaded areas indicate recession)

2 The Labor Market is Healing, but There is Still a Long Way to go to Recover all 8.8 Million Jobs Lost During the Great Recession

— All Employees: Total Private Industries Seasonally Adjusted, Millions



Source: Bureau of Labor Statistics/Haver Analytics 05/02/11

(Shaded areas indicate recession)

Thus, while the ISM may have peaked for this cycle, we do not think this means that the economy is headed back into recession. In fact, a dip in the ISM in this point in the cycle is normal, and some easing of price pressures in the manufacturing area may allow the Fed to remain on hold a little longer.

Although all the economic reports due out this week will be closely scrutinized by markets (and the Fed), the key report is likely to be the April employment report, which is due out on Friday, May 6. The recovery in the labor market is still in its early stages (the private sector has added just over 1.8 million jobs in the last 13 months after shedding more than 8.8 million in the Great Recession and its aftermath), but it has picked up steam in recent months, having added close to 200,000 jobs per month over the last four months.

Markets are looking for a similar gain (around 200,000) in private sector employment in April and for the unemployment rate to remain at 8.8%. If the consensus is correct, the April jobs data will be another step toward recovery for the labor markets, but at its current pace, the labor market recovery is probably too slow to convince the Fed that tighter monetary policy is warranted.

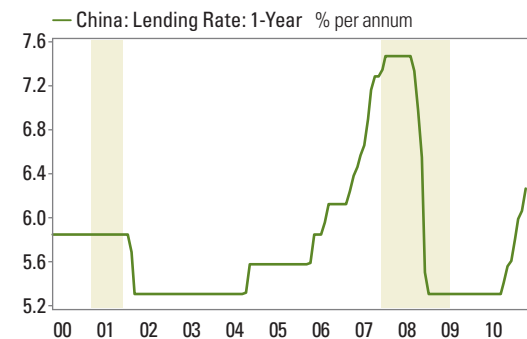
Policy Parade

On the policy side, there are a scattering of Fed officials slated to speak this week, and markets will want to pay especially close attention to comments this week from Fed's "Big Three": Chairman Ben Bernanke, Vice Chairwoman Janet Yellen and New York Fed President Bill Dudley. Bernanke, Yellen and Dudley represent the "center of gravity" at the Fed, and their comments on the economy and interest rates should, in our view, carry more weight than comments from other Fed officials, especially vocal critics of quantitative easing (QE2) like Dallas Fed President Richard Fisher and Philadelphia Fed President Charles Plosser.

With Congress back from a two-week vacation, the nation's fiscal situation is likely to return to the top of the headlines. Officially, the U.S. Treasury's ability to borrow runs out on May 16, but in reality, Treasury has enough wiggle room to borrow until July 8, 2011. Between now and then, the debate over whether or not to raise the debt ceiling, how much to raise it by (a trillion would likely get us through the next year or so, while a \$50 billion increase would only get us a week or two) and whether or not to tie to increase the debt ceiling to a longer-term agreement on the scope of Federal spending and taxes will be an almost constant companion to the ups and downs of the market.

As we wrote in the April 11, 2011 *Weekly Economic Commentary*, 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. The game of "political chicken" over the debt ceiling limit in the next few months has to potential to move markets, especially the debt markets. As previously

3 China has Been Tightening Policy Since Early 2010, but the End of Tightening May Be At Hand



Source: People's Bank of China/Haver Analytics 05/02/11

(Shaded areas indicate recession)

At the margin, the continued cooling in the Chinese manufacturing sector may mean fewer rate hikes by the PBOC in the weeks and months ahead, but the PBOC will almost certainly raise rates one or two more times, and that could happen as soon as this week.

noted, a series of small (\$50 billion or so) short-term increases in the debt ceiling are possible over the next few months, which would lead to a number of “drop dead” dates on the budget that may increase volatility in the financial markets.

Central bank policy will be a key theme overseas as well this week, as several major central banks, including the Reserve Bank of Australia (RBA), the Bank of England (BOE) and the European Central Bank (ECB) meet to set policy this week. Although both the RBA and the ECB have raised rates already in this economic cycle to combat domestic inflation concerns, neither central bank is expected to hike rates this week. The BOE remains on hold, perhaps in deference to the ongoing fiscal austerity in the United Kingdom, a path the Fed could choose to take should any budget deal between President Obama and the House Republicans contain sizeable spending cuts. Elsewhere, central banks in the Philippines, Romania, Malaysia, the Czech Republic and India all meet this week to set rates. Of those, both the Philippines and Malaysia could raise rates this week. Both have already hiked rates in response to booming domestic economic growth and in an effort to combat rising domestic inflation.

Although China’s central bank, the Peoples Bank of China (PBOC), does not have a set schedule for its policy actions, another move to tighten monetary policy (via interest rates or by an increase in banks reserve ratio requirements) could happen at any time, as authorities in China grapple with a booming economy and rising domestic inflation. The PBOC has raised its benchmark lending rate four times since October 2010, most recently on April 5, 2011, and has increased its reserve ratio requirement nine times since January, 2010, most recently on March 18, 2011. Over the weekend of April 30-May 1, the Chinese Purchasing Managers Index for April was released revealing that China’s manufacturing economy continued to cool in April. The report is the first information markets gets on the health of the Chinese manufacturing sector each month. At the margin, the continued cooling in the Chinese manufacturing sector may mean fewer rate hikes by the PBOC in the weeks and months ahead, but the PBOC will almost certainly raise rates one or two more times, and that could happen as soon as this week.



IMPORTANT DISCLOSURES

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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 Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.

The ISM index is based on surveys of more than 300 manufacturing firms by the Institute of Supply Management. The ISM Manufacturing Index monitors employment, production inventories, new orders, and supplier deliveries. A composite diffusion index is created that monitors conditions in national manufacturing based on the data from these surveys.

Chinese Purchasing Managers Index: The PMI includes a package of indices to measure manufacturing sector performance. A reading above 50 percent indicates economic expansion, while that below 50 percent indicates contraction.

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