

BI -WEEKLY ECONOMIC REVIEW

Economic Releases

Report	Prior	Consensus	Actual
PMI Services Index	56.8	55.1	54.8
Labor Market Conditions Index	0.9		0.8
ISM Non-Mfg Index	55.7	56.0	56.0
International Trade	\$-40.7B	\$-42.7B	\$-41.9B
JOLTS	5.334M		5.363M
Consumer Credit	\$21.4B	\$18.5B	\$16.1B
Jobless Claims	282K	276K	297K
Wholesale Trade Inventories	0.4%	0.3%	0.8%
Retail Sales	1.0%	0.3%	-0.3%
Less Autos	0.8%	0.6%	-0.1%
Less Autos & Gas	0.5%	0.6%	-0.2%
Export Prices	0.6%	0.1%	-0.2%
Import Prices	1.2%	0.1%	-0.1%
Business Inventories	0.4%	0.2%	0.3%
Producer Price Index	0.5%	0.3%	0.4%
Less Food & Energy	0.1%	0.1%	0.3%
Empire State Mfg Survey	-1.98	3.50	3.86
Industrial Production	-0.2%	0.2%	0.3%
Jobless Claims	296K	282K	281K
Philly Fed Business Outlook	15.2	12.0	5.7
Consumer Prices Index	0.4%	0.3%	0.3%
Less Food & Energy	0.1%	0.2%	0.2%
Housing Starts	1.069M	1.125M	1.174M
Consumer Sentiment	96.1	96.0	93.3

Items highlighted in green were reported better than consensus while those in red were worse than expected. Black were in line.



The economic data for the last two weeks shows an unfortunate return to its disappointing ways. It isn't anything dramatic but the majority of the reports came in less than expected and even some of the "good" ones weren't that positive. To take just one example, the trade report did show a smaller deficit, which is considered a better than expected report, but it is hard to spin the details as positive. Both exports and imports were down, not exactly the stuff of which booms are made. Another example of better not being that good is the inflation data. Both the PPI and CPI showed gains and in a world where deflation is a concern I guess that is a positive but with economic and income growth weak you'd probably be hard pressed to find a man in the street who thinks it is good news. Overall though the data isn't telling us anything we didn't already know. The US and global economy is weak and showing only a slight improvement in the second quarter. Even getting to the new normal 2 to 2.5% growth rate this year is going to be a challenge that requires a big surge in 3rd and 4th quarter growth.

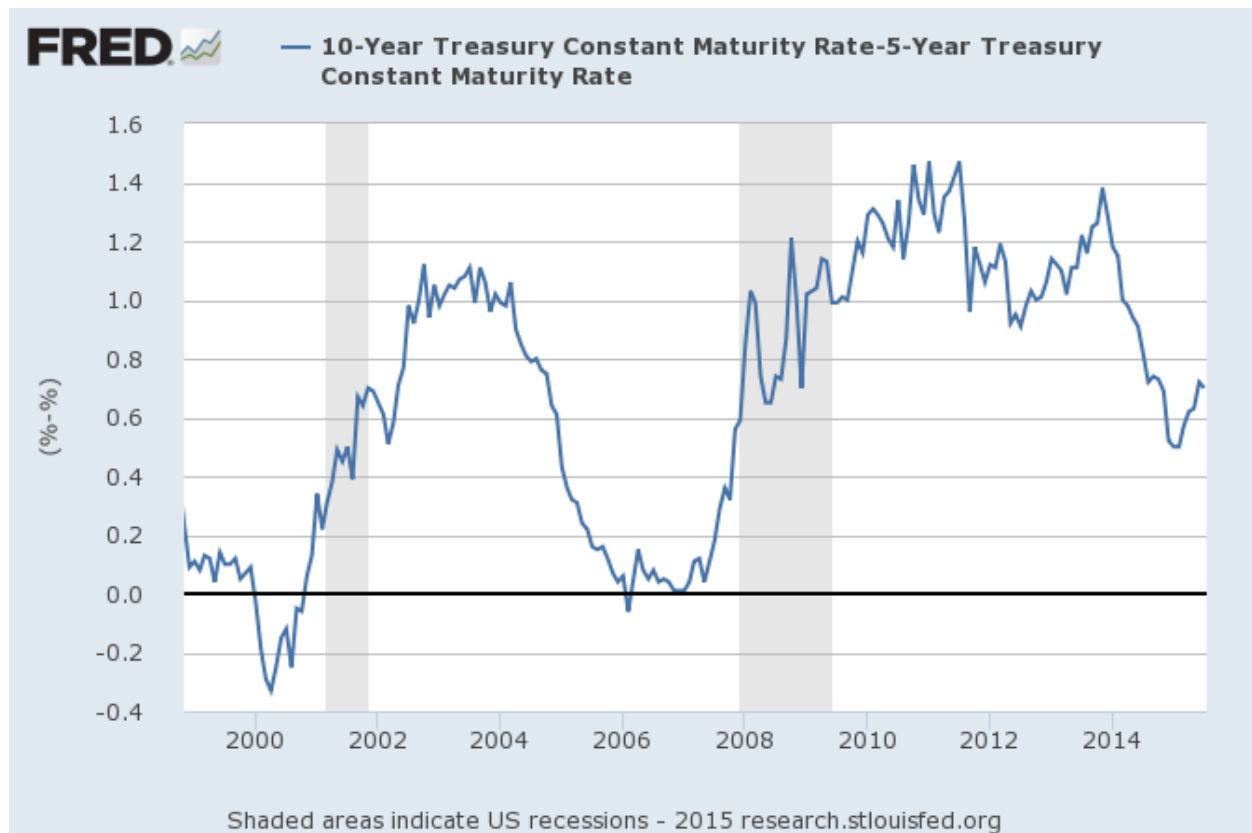




The dollar moved higher over the last two weeks as the Greek crisis was “resolved” without the issuance of Drachmas. As I said last week it seemed the Euro had been bid because there was an expectation that Greece would be kicked out of the common currency and so finding a way to keep them in pushed the Euro lower. And I think that is a better way to describe the arc of the dollar index over the last two weeks. It was much more a case of the Euro falling rather than the Dollar rising. Nevertheless, the dollar did rise and I see it as positive that the dollar has stabilized at this higher level. A positive for economic growth that is; it surely hasn’t been positive for commodities or any entity that is short dollar debt (think emerging markets).



Yield Curve



The yield curve steepening moderated a bit over the last week but the short term trend is still toward a steeper curve. The steepening has been driven by a rise in long term inflation expectations but that stalled over the last two weeks. So far, we haven't seen much movement in the shorter maturities so it doesn't seem this is a sign of easing expectations. Still it is worrisome as we always see a steepening curve just before the onset of recession.



I am concentrating on the 10/5 curve now because of the Fed's influence over the shorter end of the curve. I divide the curve into zones:

Zone 0 = Inverted

Zone 1 = 0.0% to 0.25%

Zone 2 = 0.25% to 0.50%

Zone 3 = 0.50% to 0.75%

Zone 4 = 0.75% and higher

Recession probability:

Zone 0 = 50%+

Zone 1 = 25 – 50%

Zone 2 = 15 – 25%

Zone 3 = 5 – 15%

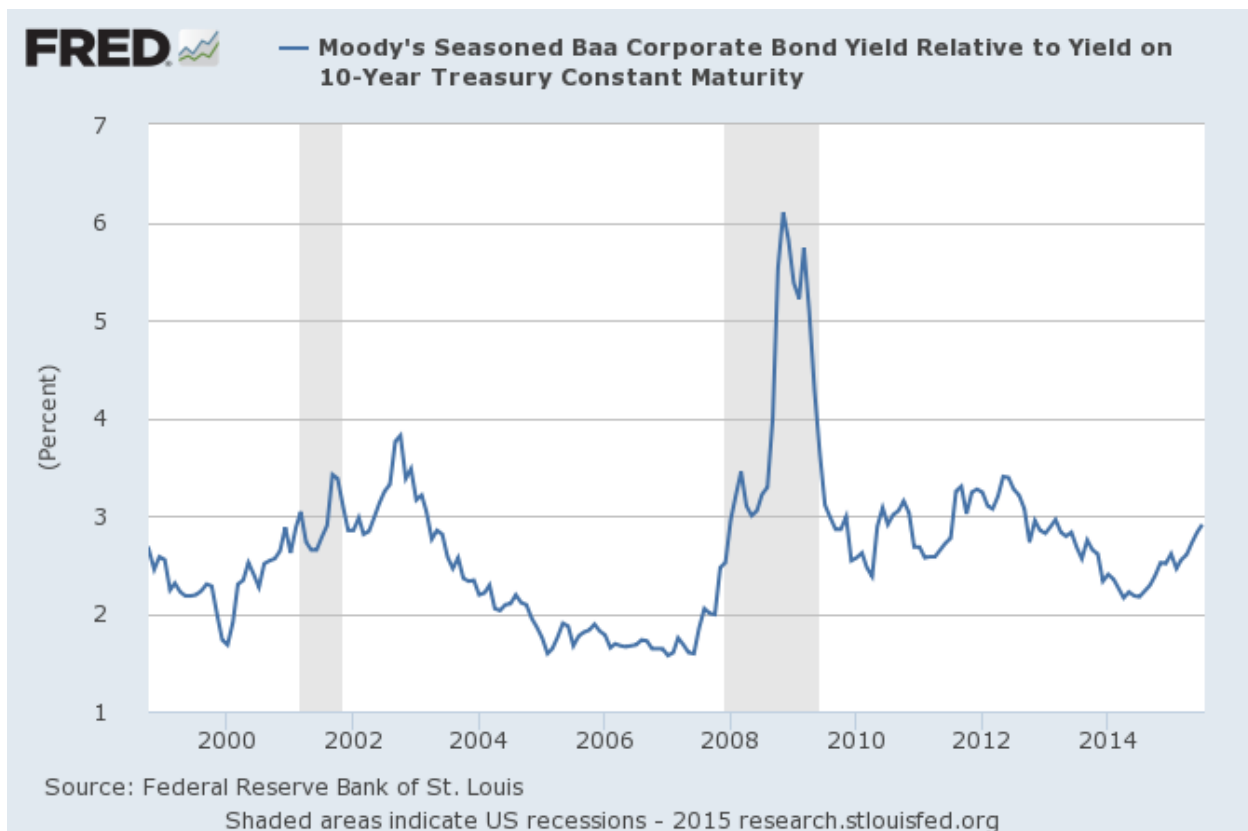
Zone 4 = 0 – 5%

We are still in **Zone 3** with the 10/5 curve at 0.70 which translates to a fairly low probability of recession. However, as I've said before, we are in a bit of uncharted territory here. In a normal cycle we would have reached at least Zone 1 and more likely 0 where we would be sitting at a minimum risk exposure. We wouldn't then adjust our exposures until we reached at least Zone 3 as the curve would steepen during recession and monetary easing. It is an interesting puzzle but one where I think one should probably err on the side of caution. If we move into Zone 4 from here I will not likely up my risk allocation unless markets have already corrected significantly.



Credit Spreads

Credit spreads continue their negative trend. The Baa spread has been relentless in widening more so than the junk spread. In fact, the junk spread improved over the last week even as the higher rated Baa spread deteriorated. I'm not sure what to credit this to except maybe a continued reach for yield. Baa is the lowest end of investment grade and it can't be good for those spreads to be widening.





Overall the message of the yield curve, credit spreads and incoming data is one of caution and at least for now, slow growth. While the yield curve and credit spreads are moving in the wrong direction, neither has moved sufficiently to warrant more than mild concern. The data next week is pretty slim but the following week is chock full of important reports including Durable Goods and GDP. There's also an FOMC meeting on the calendar that week but I don't know of anyone who expects any movement from the Fed at that meeting. The focus is still on September but I'll be shocked if they actually do something at that meeting either. In fact, I'll be surprised if they move at all this year as the economy just refuses to cooperate.



Calendar

Monday Jul 20	Tuesday Jul 21	Wednesday Jul 22	Thursday Jul 23	Friday Jul 24
Market Focus » International Perspective » Simply Economics » 4-Week Bill Announcement 11:00 AM ET 3-Month Bill Auction 11:30 AM ET 6-Month Bill Auction 11:30 AM ET	Redbook • 8:55 AM ET 4-Week Bill Auction 11:30 AM ET 52-Week Bill Auction 11:30 AM ET	Bank Reserve Settlement• MBA Mortgage Applications • 7:00 AM ET FHFA House Price Index CONSENSUS • 9:00 AM ET Existing Home Sales CONSENSUS ★10:00 AM ET EIA Petroleum Status Report ★10:30 AM ET	<i>Weekly Bill Settlement</i> <i>52-Week Bill Settlement</i> Jobless Claims CONSENSUS ★8:30 AM ET Chicago Fed National Activity Index CONSENSUS • 8:30 AM ET Bloomberg Consumer Comfort Index • 9:45 AM ET Leading Indicators CONSENSUS • 10:00 AM ET EIA Natural Gas Report • 10:30 AM ET Kansas City Fed Manufacturing Index • 11:00 AM ET 3-Month Bill Announcement 11:00 AM ET 6-Month Bill Announcement 11:00 AM ET 2-Yr Note Announcement 11:00 AM ET 2-Yr FRN Note Announcement 11:00 AM ET 5-Yr Note Announcement 11:00 AM ET 7-Yr Note Announcement 11:00 AM ET 10-Yr TIPS Auction 1:00 PM ET	PMI Manufacturing Index Flash CONSENSUS ★9:45 AM ET New Home Sales CONSENSUS ★10:00 AM ET



			Fed Balance Sheet • 4:30 PM ET Money Supply • 4:30 PM ET	
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Monday Jul 27	Tuesday Jul 28	Wednesday Jul 29	Thursday Jul 30	Friday Jul 31
Durable Goods Orders ★8:30 AM ET Dallas Fed Mfg Survey ★10:30 AM ET 4-Week Bill Announcement 11:00 AM ET 3-Month Bill Auction 11:30 AM ET 6-Month Bill Auction 11:30 AM ET	FOMC Meeting Begins® Redbook • 8:55 AM ET S&P Case-Shiller HPI ★9:00 AM ET PMI Services Flash • 9:45 AM ET Consumer Confidence ★10:00 AM ET Richmond Fed Manufacturing Index • 10:00 AM ET State Street Investor Confidence Index • 10:00 AM ET 4-Week Bill Auction 11:30 AM ET 2-Yr Note Auction 1:00 PM ET	MBA Mortgage Applications • 7:00 AM ET Pending Home Sales Index ★10:00 AM ET EIA Petroleum Status Report ★10:30 AM ET 2-Yr FRN Note Auction 11:30 AM ET 5-Yr Note Auction 1:00 PM ET FOMC Meeting Announcement ★2:00 PM ET	<i>Weekly Bill Settlement</i> GDP ★8:30 AM ET Jobless Claims ★8:30 AM ET Bloomberg Consumer Comfort Index • 9:45 AM ET EIA Natural Gas Report • 10:30 AM ET 3-Month Bill Announcement 11:00 AM ET 6-Month Bill Announcement 11:00 AM ET 7-Yr Note Auction 1:00 PM ET Farm Prices • 3:00 PM ET Fed Balance Sheet • 4:30 PM ET Money Supply • 4:30 PM ET	2-Yr Note Settlement 2-Yr FRN Note Settlement 5-Yr Note Settlement 7-Yr Note Settlement 10-Yr TIPS Settlement Employment Cost Index ★8:30 AM ET Chicago PMI ★9:45 AM ET Consumer Sentiment ★10:00 AM ET





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"Wealth preservation and accumulation through thoughtful investing."

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