Weekly Economic Commentary

October 4, 2010

John Canally, CFA
Economist
LPL Financial

Highlights

- The September jobs report is the last report before the election and the November 3 FOMC meeting.
- Consumer debt pay down continues as the 2010 holiday shopping season approaches.

It's All About Jobs

Market participants will have plenty to absorb in the first full week of the fourth quarter of 2010, as they reflect back on the best September for the S&P 500 since 1939, and begin to digest the first corporate earnings reports for the third quarter of 2010. On the economic front, the September employment report is likely to dominate the week, although there is plenty of other data due out, including the September chain store sales report and business capital spending and new orders in August. Market participants continue to firm up their forecasts for real gross domestic product (GDP) in the recently completed third quarter of 2010, and by the end of the week, unbelievably, the 2010 holiday shopping season should already be a hot topic.

Overseas, it is another quiet week on the Chinese economic data calendar. The bulk of the economic reports in China for September are due out next week (October 11-15). China's currency remains a concern in Washington, although the vote in Congress last week targeting China's currency is not likely to gain much traction in the Senate. A further escalation of protectionism in the United States (and abroad), which we think is unlikely, would be one of the preconditions for a double-dip recession in the United States.

Central bank policy meetings this week include the Reserve Bank of Australia, the European Central Bank (ECB), the Bank of Japan (BOJ), and the Bank of England (BOE) as well as the central banks in Peru, Indonesia, and the Philippines. Australia and Peru are expected to raise rates this week, while the others, including the BOE, BOJ, and ECB are leaning toward continuing to loosen monetary policy to bolster weak domestic economies.

The next meeting of the Federal Reserve's (Fed) policymaking arm, the Federal Open Market Committee (FOMC) is set for November 2 and 3. Unless we see a dramatic improvement in the economic data between now and then (not our best guess) the Fed is likely to embark on another round of quantitative easing, by purchasing Treasuries and agency and/or mortgage-backed debt in the open market in order to stimulate the economy by the end of 2010.

Not Jobless... But Not Enough

The only comprehensive report on the nation's labor market between now and November 3 is the September jobs report, which is due out this Friday, October 8, at 8:30 AM ET. The U.S. economy shed 8.5 million private sector jobs during the recent Great Recession, and has added back only 755,000 of those jobs since the economy began creating jobs again in the fall of 2009. Thus, over the past 10 months, the economy has added an average of around 75,000 private sector jobs per month. That gain of 755,000 jobs

Economic Calendar

Monday, October 4
Factory Orders
August

Tuesday, October 5
ISM –Service Sector
September

Wednesday, October 6
Challenger Layoff Announcements
September

ADP Private Sector Employment Change
September

Thursday, October 7
Initial Claims
wk 10/02

Chain Store Sales
September

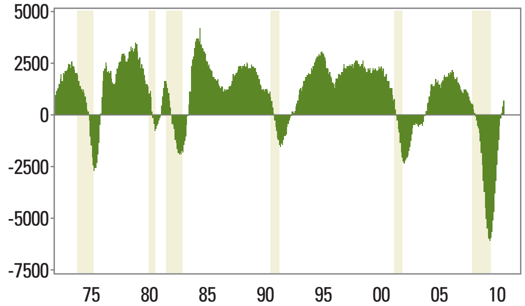
Consumer Credit
August

Friday, October 8
Unemployment Rate
September

Nonfarm Payrolls
September

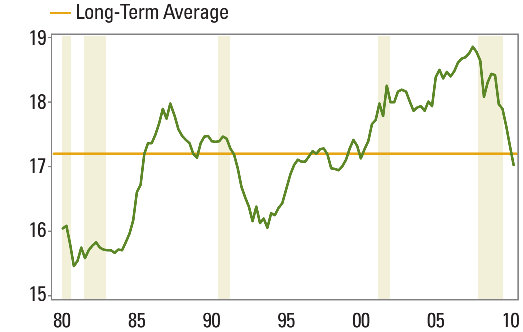
Wholesale Inventories
August

1 The Economy Has Added 755,000 Private Sector Jobs in the Past 10 Months



Source: Bureau of Labor Statistics/Haver Analytics 10/04/10
Shaded areas indicate recessions.

2 Consumers' Debt Burdens Are Improving



Source: Federal Reserve Board/Haver Analytics 09/30/10
Shaded areas indicate recessions.

over the past 10 months is far better than the job creation seen at the same point (14 months after the end of the recession) in the jobless recoveries following the mild recessions of 1990-91 and 2001. On the other hand, the 755,000 jobs created in the past 10 months is only a drop in the bucket compared to the millions of jobs created at this point in the recoveries from the severe recessions of 1973-75 and 1981-82.

Still, job creation of around 75,000 per month is not enough to push the unemployment rate significantly lower from 9.6% in August. Recognizing this, the Fed is hoping to keep borrowing conditions favorable for businesses with another round of quantitative easing, and by doing so, create a favorable backdrop for job creation. Of course, low interest rates, is not the only precondition for job growth. In addition to low rates, businesses need to have a favorable legislative and regulatory backdrop, and with markets now pricing in a high probability that the Republican Party wins control of the House of Representatives in the upcoming midterm elections, the sweeping legislative changes at the Federal level over the past two years will likely slow to a crawl over the next two years. In addition to having low rates, and a favorable regulatory backdrop, businesses need to have good visibility about future prospects in order to feel confident enough to add to payrolls in a meaningful way. On this front, the tone of the third quarter earnings-reporting season, which begins this week, should provide more insight into how corporations view their prospects for the fourth quarter of 2010 and 2011.

Happy Holidays?

One of the key reports due out this week is the chain store sales data for September, which is due out on Thursday morning, October 7. The market is looking for a 3.0% year-over-year gain at the nation's retailers in September. Sales rose 3.2% year-over-year in August. The sales data for September will wrap up the back-to-school shopping season, which will allow the market (and retailers) to begin to focus on the 2010 holiday shopping season. The 2010 holiday shopping forecast from the National Retail Federation, a retailer's trade association, should be released later this week, and is likely to usher in a wave of media and market hand wringing over the health of the consumer ahead of the holiday shopping season.

The health of the consumer, and in particular, consumer finances, has been vigorously debated by market participants since the onset of the financial crisis and the Great Recession. Last week the Fed released their financial obligations ratio, which measures how much of a household's disposable income goes toward paying debt (mortgage, credit card, lease payments, rental payments on tenant-occupied property, homeowners' insurance, and property tax payments).

The reading in the second quarter of 2010 (the latest data available) was at its lowest level in 12 years and is now below the long-term average. While some of the reduced debt burden is involuntary (consumers walking away from mortgages and defaulting on their credit card and other debt), it does say that the combination of low rates (the Fed wants to keep them low with more quantitative easing), rising incomes (personal income is up 3.3% from a year ago), and debt pay down (voluntary or involuntary) is hastening the consumer deleveraging story.

How far along is the consumer in repairing their balance sheet? While it is hard to say for sure, our best guess is that, we are probably in the middle innings but not in the early innings as some suggest. Consumers have been paying down debt, increasing their spending (at a modest rate for this point in a recovery), and saving more over the past two years or so. We would expect this pattern to continue for at least the next year, which means slower than normal consumer spending, but not outright declines in spending, which would portend a double-dip recession.