

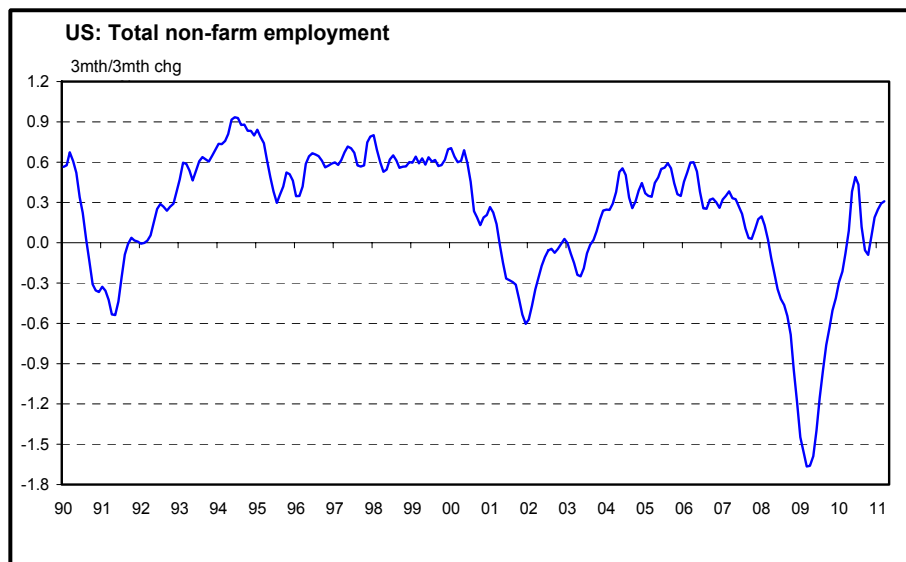
Economics Report

2 April 2011

US Corner

The economic data for the week remain consistent with the ongoing story. The labour market continues its slow and steady improvement, and the survey data continue firm. The spending data continue to disappoint; the construction figures (see page 3 below) were just the latest example of this. The share market continues to shake off its Japan-induced worries, with the Dow ending the week at its high for this recovery.

The March **labour-market report** was a touch better than expected. **Employment** increased by 216,000, compared with a market expectation of 190,000, while the **unemployment rate** fell for the fourth month in succession, from 8.9% to 8.8%. There were minor **revisions** adding 11,000 jobs to the previous two months. **Private-sector employment** increased by 230,000, led by a 78,000 increase in **business and professional services**. **Healthcare** employment rose by 45,000, and there were 37,000 more jobs in **leisure and hospitality**, with more than two-thirds of these in **food service and drinking places**. The **retail sector** added 18,000 jobs, while **manufacturing employment** increased by 17,000. The manufacturing gains were mainly in **fabricated metal products** (up 8,000) and in machinery (up 5,000). Since the end of 2009, **durable manufacturing** employment has risen by 243,000 (3.5%). In the same period, total employment has risen by 1.42 million (1.1%). **Government employment** fell by 14,000 in the month after dropping by a total of 72,000 in the previous two months. The "wave chart" shows that jobs growth is continuing to accelerate.

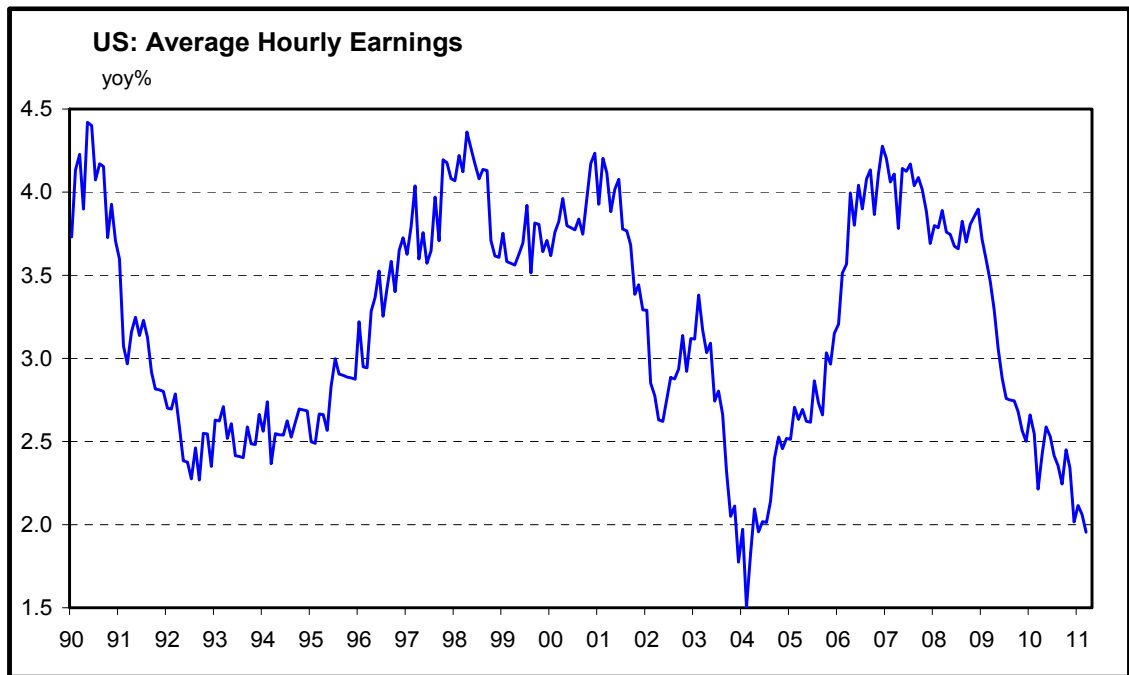


Hours worked per week remained flat, at 34.3 hours, but there was a 0.1 hour increase in the workweek for production and non-supervisory workers. As a result, the **aggregate hours index** rose by 0.6% in the month, and was up at an annual rate of 1.8% in Q1. Ordinarily, this would translate into **GDP growth between 3 and 4%**, but the spending data to hand so far suggest a lower figure than this.

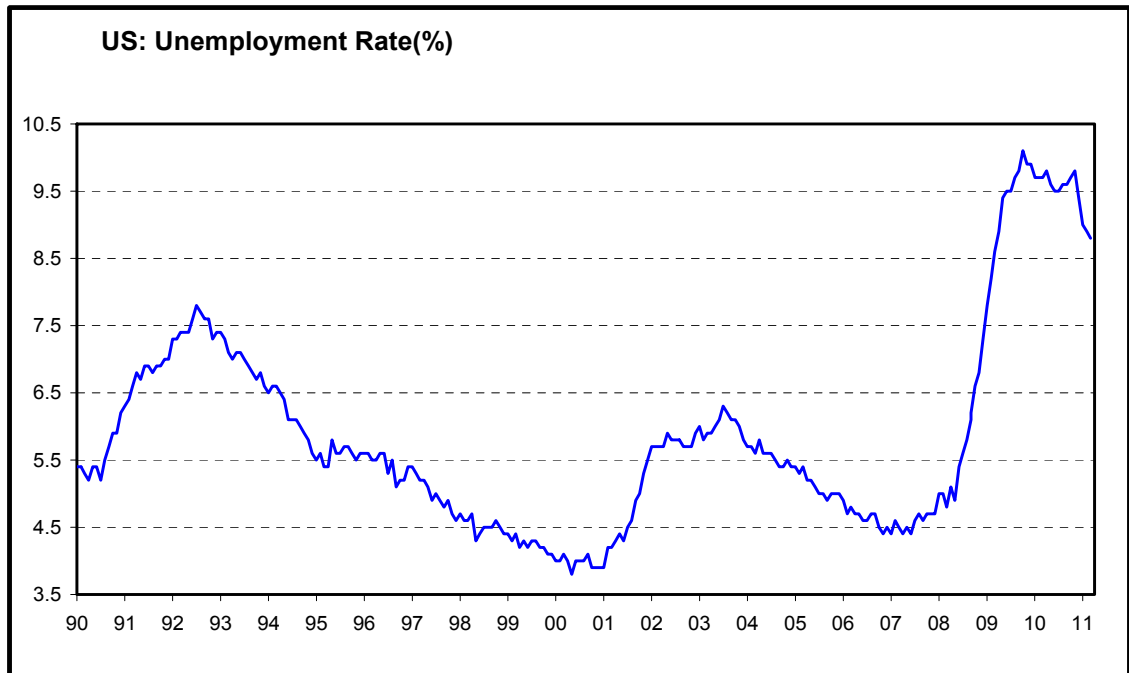
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Average hourly earnings were flat in the month, with those of production workers actually down by 0.1%, and up by just 2.0% in the past year (see chart).



In the **household survey**, employment was reported as increasing by 291,000, while the **unemployment rate** fell again, albeit by just 0.1 p.p., to 8.8%. The 1.0 percentage point decline in the past four months is the most rapid since the four months to October 1983. The **broadest definition of unemployment**, which includes those who have given up looking for work, and those working fewer hours than they would like, also fell, from 15.9% to 15.7%.

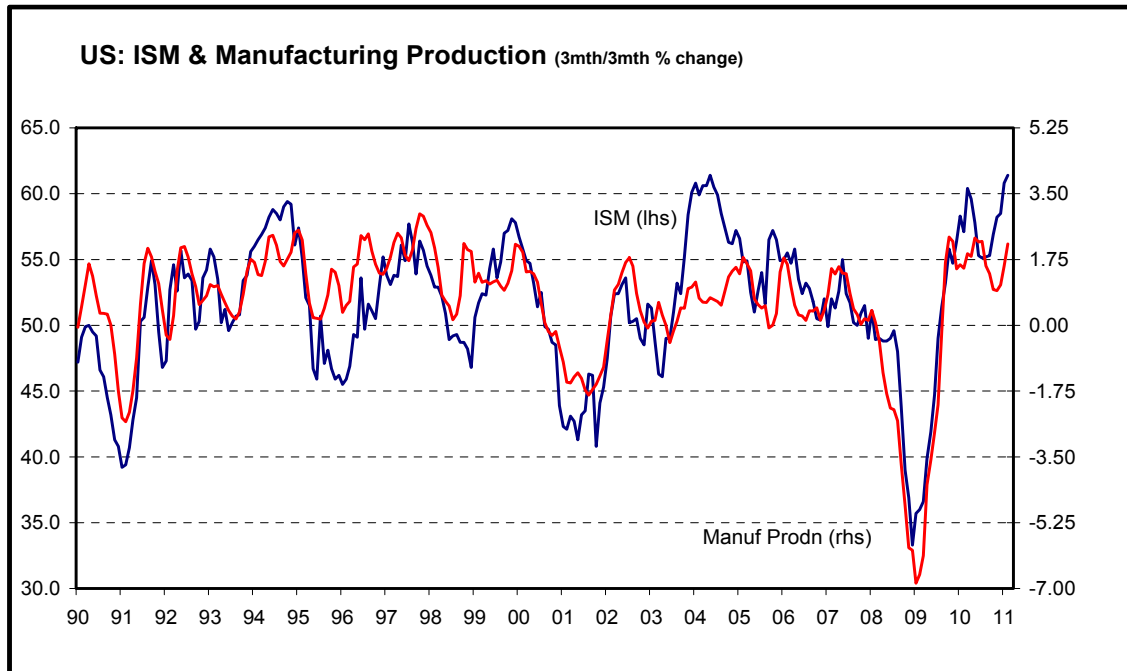


The **national ISM manufacturing index** retreated slightly in March, falling from 61.4 to 61.2, the first fall in eight months. The index is still at a level that would normally be

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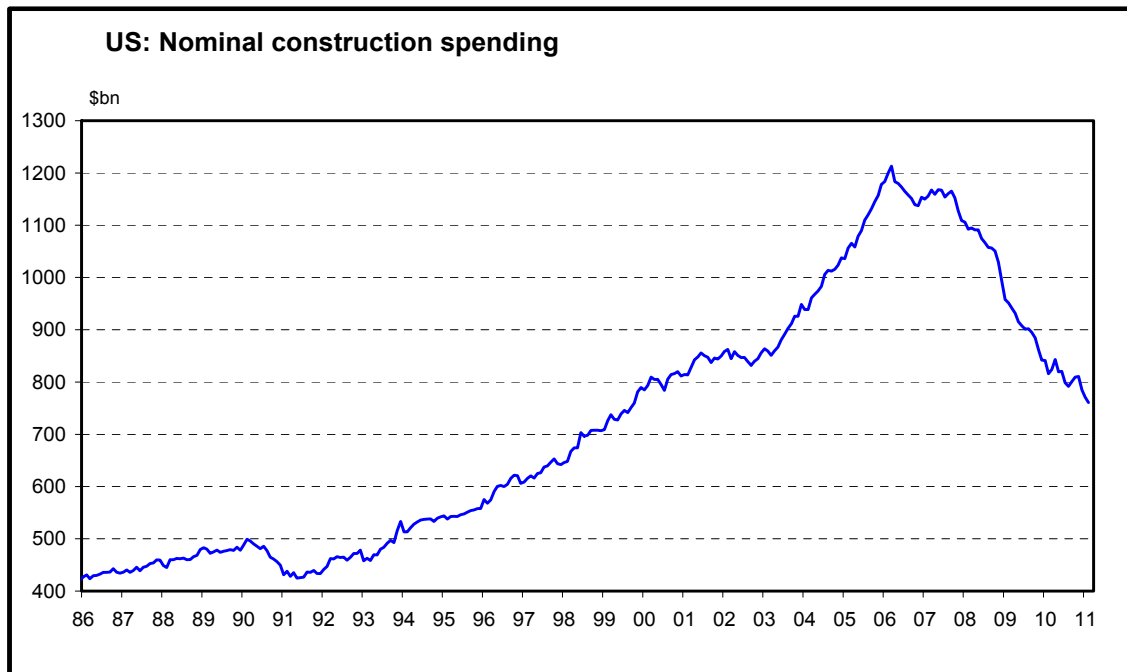
consistent with **GDP growth** of close to 5%, and stronger **manufacturing production** than has been recorded lately (see chart below, but note the “false signal” in 2004). The **production index** rose from 66.3 to 69 in the month, its highest reading since January 2004, but both **new orders** and the **employment indexes** fell. The **prices paid index** rose from 82 to 85, the highest it has been since mid-2008.



Construction spending continues to fall. Not only did it decline by a further 1.4% in February, but the January level was revised down by close to 2%. In the month, **private residential spending** fell by 3.7%, while **public spending** dropped by 1.3%. Only **private non-residential** managed a rise, of 0.9%. The only saving grace is that more than half of the fall in residential spending was accounted for by “**improvements**”, a category that is so volatile that the BEA declines to use it in constructing the GDP data. It’s scarcely surprising that residential spending fell, given the huge decline in housing starts reported in the previous week. **In the past year**, construction spending has fallen by 6.8%, with private residential down by 8.1% and non-residential down by 13.2%. Public spending is still up, by 0.5%. **From its peak in March 2006**, construction spending has fallen by 37%, and is now back below its October 1999 level (and remember that this is in nominal terms!).

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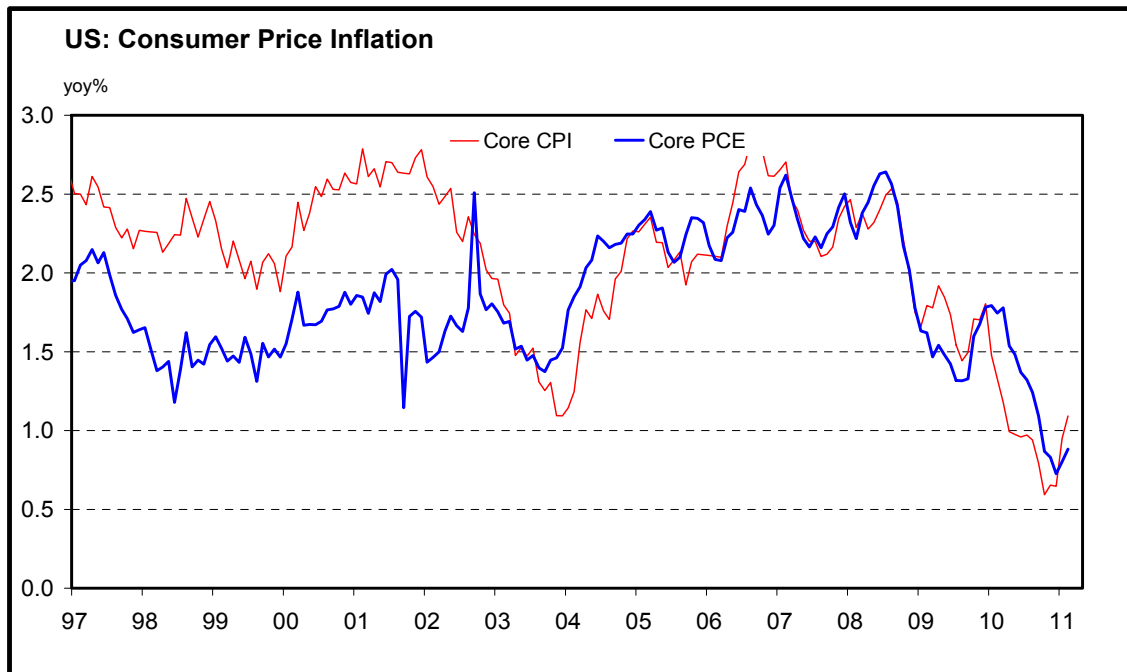
Earlier in the week

Consumer spending was surprisingly strong in February. It rose by 0.7%, the largest gain since October last year. **Durable spending** rose by 1.6%, while **non-durable spending** rose by 1.4%, due in part to rising fuel and food prices. **Service spending** rose by just 0.2%. **Personal income** growth slowed to 0.3% after a policy-induced gain of 1.2% in January. **Wages and salaries** also rose by 0.3%, as they had in the previous two months. More than 40% of the gain in income in the month came from **rental and dividend income**, which together comprise only about 8% of income. **Disposable income** also rose by 0.3%, although it fell slightly in real terms, for the first time in five months.

The **PCE deflator** rose by 0.4% in the month, the biggest increase since last June, with the result that **real consumer spending** increased by 0.3% after a slight fall in January. For Q1, real consumer spending is on track for about 1.5% annualised growth. The **core PCE deflator** rose by 0.2% (0.155% unrounded) for the second month in a row, but is still up by just 0.9% in the past year. Two months ago, this figure was 0.7%, so inflation does appear to have troughed. The overall deflator has risen by 1.6% in the past year. With spending growing faster than income, the **saving rate** dropped from 6.1% to 5.8%.

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In other consumer-related news, the Conference Board reported that its measure of **consumer confidence** dropped sharply in March, from 72 to 63.4. The drop was scarcely a surprise, given that the consumer had to contend with news about Libya, the Japanese earthquake and higher gasoline prices. The drop was entirely accounted for by the **expectations component**, which fell by 16 points. Consumers' assessment of **current conditions** rose for the sixth month in succession, and is now at its highest level since November 2008. The assessment of **labour-market conditions** deteriorated slightly in the month.

Pending home sales rose in February, for the first time in three months. They increased by 2.1%, with three of the four **major Census regions** sharing in the gain. **In the past year**, pending sales are still down by 8.2%, led by an 18.4% fall in the **Northeast**. The only region to show a year-to gain is the **West** (up 0.6%). That said, pending sales are up by about 20% from their zenith in June last year.

In other housing-related news, the **Case/Shiller house price index** showed a fall of 0.2% in the three months ending January, to be down by 3.1% in the past year. This is the biggest year-to fall since December 2009. The corresponding figure for the three months ending December 2010 was -2.4%. Eighteen of the 20 metropolitan areas surveyed show falling prices in the past year. **San Diego** and **Washington** are the exceptions. Prices have fallen by 9.2% in **Phoenix**. Measured from the peak, prices are down between 12.5% in **Denver** and 57.7% in **Las Vegas**.

Mortgage applications fell by 7.5% in the week ended 25 March. The fall was primarily in **refinancing** (down 10.1%) while applications associated with a **purchase** fell by a moderate 1.7%. **In the past year**, the composite index is down by 19.5%, with purchase applications down by about 22% and refinancing down by about 18%. In the week, the **30-year contract rate** rose by 12 basis points, to 4.92%, while the **one-year adjustable rate** was flat at 7.21%.

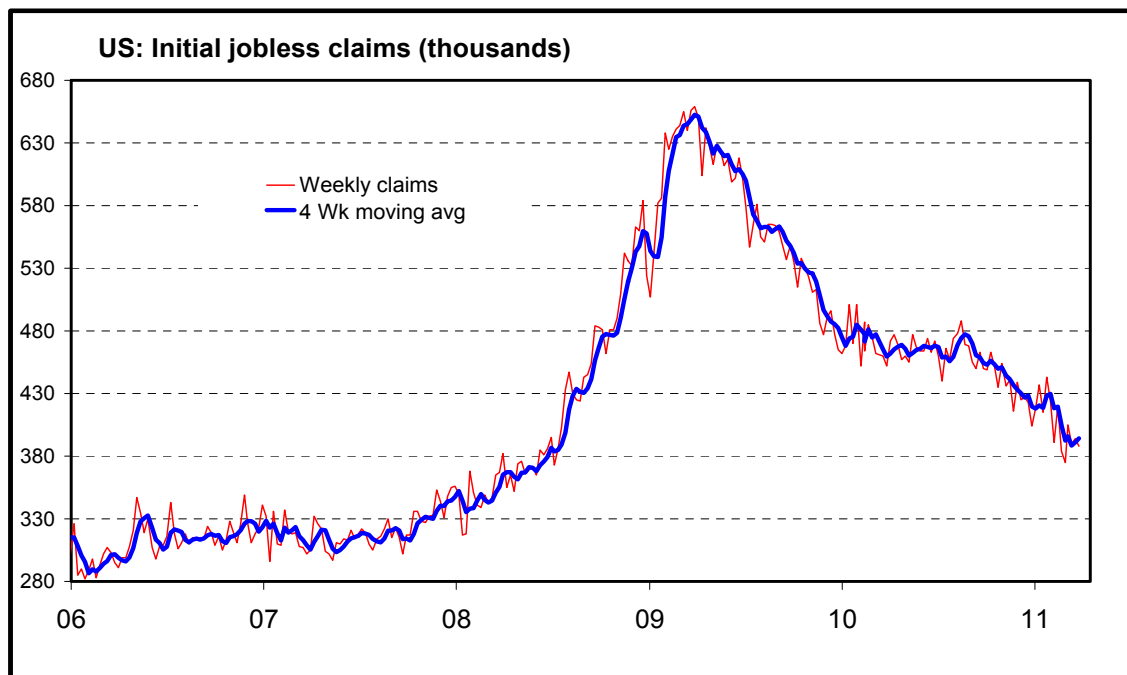
Oil and product stocks data for the same week were mixed. **Crude inventories** rose for the tenth time in the past eleven weeks, by 2.9 million barrels. Since the first week in January, they have increased by close to 7%. **Crude oil imports** rose significantly in the

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week. **Distillate inventories** also built, by 700,000 barrels, mainly because distillate demand dropped away. **Gasoline stocks** fell for the sixth week in a row, by 2.7 million barrels. In that period, they have been cut by close to 10%. **In the past year**, crude stocks have risen by 0.4% and distillate stocks by 6%. Gasoline stocks have fallen by 3.5%. **Refinery utilisation** was unchanged, at 84.1%.

Initial jobless claims fell from 394,000 to 388,000 in the week ended 26 March, with the **four-week moving average** rising from 391,000 to 394,000. **In unadjusted terms**, claims were flat, at 354,000. The recent history was revised because of updated seasonal adjustment factors. Claims are now slightly higher in recent weeks than previously reported, but not by enough to change the basic story. The labour market is clearly on the mend. **Continuing claims** fell by 51,000 in the previous week.

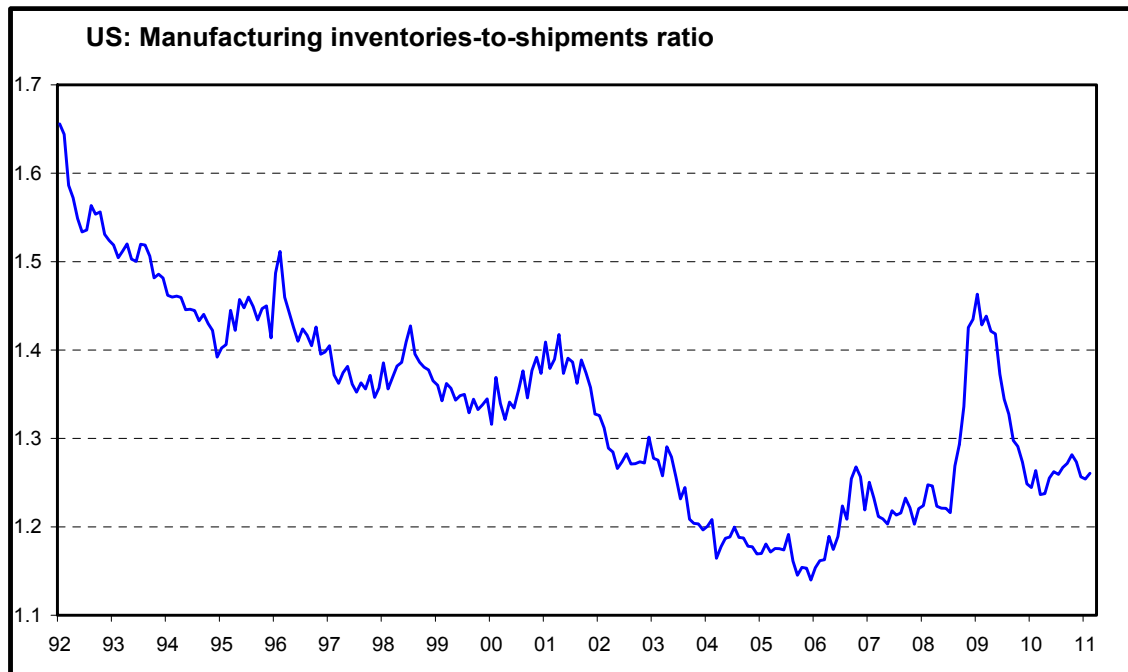


The **Chicago PMI** fell from 71.2 in February to 70.6 in March, still a very strong level. The **employment** index rose sharply, from 59.8 to 65.6, while the **production** index fell from 78.2 to 74.2. **New orders** also fell. There is no evidence here of supply-chain disruption caused by the situation in Japan. The **prices paid index** rose from 81.2 to 83.4.

Factory orders fell by 0.1% in February. Durable orders were revised up to show a fall of 0.6%, compared with 0.9% previously, but **non-durable orders** rose by just 0.3% despite higher prices. Core capital goods orders were also revised up, to a fall of 0.7% from one of 1.3%. **Inventories** rose by 0.8% after a 1.5% gain in February. With shipments up by just 0.3%, the **inventory/shipments ratio** rose (see chart).

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Rhetoric etc

There has been no shortage of **Fed rhetoric** in the past two weeks. At least eight prominent officials have given their personal views on when and if QE2 should end. The most hawkish has been **Thomas Hoenig**—no longer a voter—who sees rampant inflation just around the corner. The saner voices seem to indicate that the program will either end as planned in mid-year, or will be extended if necessary.

The Week Ahead

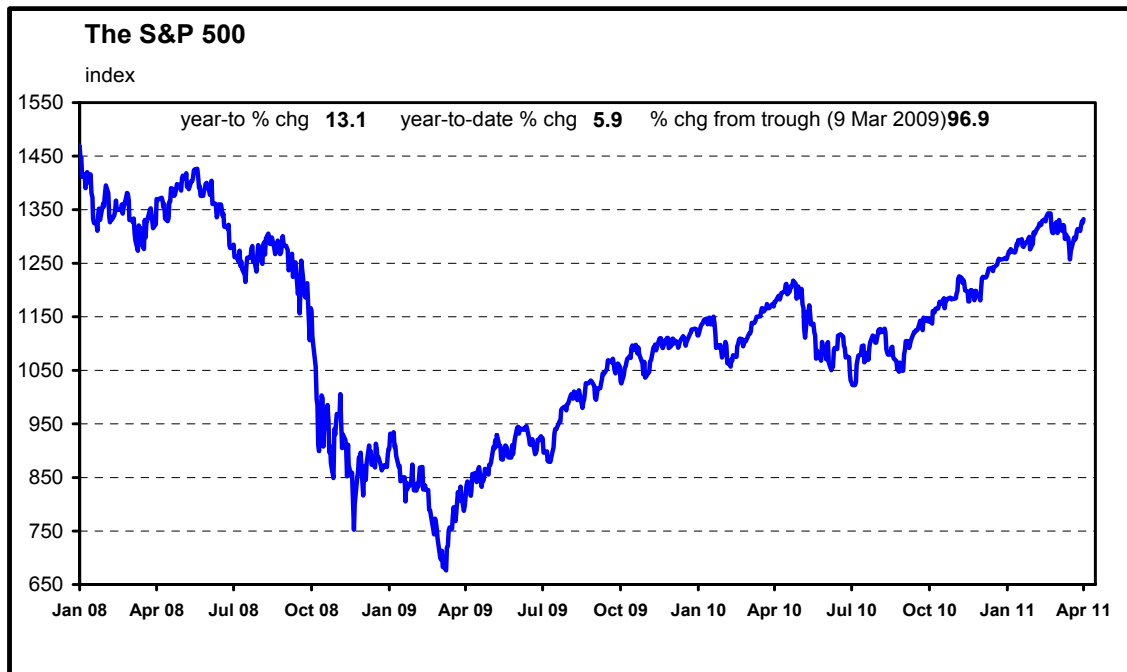
After a very busy week, it's snooze time. On Tuesday, the **ISM services index** for March is expected to stay close to its February reading of 59.7. The **FOMC minutes** for the mid-March meeting will be released. On Thursday, **initial claims** should stay close to their current level. **Consumer credit** for February will probably show another small increase. Finally, on Friday, **wholesale inventories** for February are expected to show a gain of around 1% after their increase of 1.1% in January. If any of that moves markets, I'll be a blue-nosed gopher.

Market Reaction

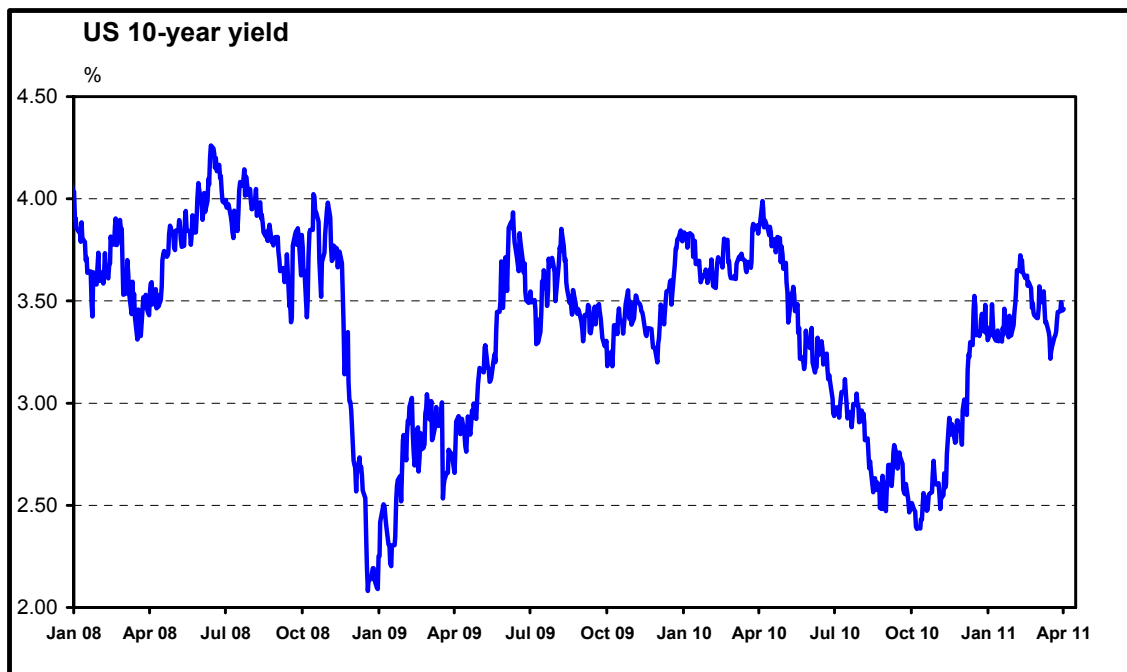
As mentioned, the share market has continued to unwind its ennui. In the week, the **Dow** rose by 1.3%, the **S&P** by 1.4% and the **Nasdaq** by 1.7%. For the **month of March**, the Dow rose by 0.8%, while the S&P fell by 0.1% and the Nasdaq was flat. For the **first quarter of the calendar year**, the Dow rose by 6.4%, the S&P by 5.4% and the Nasdaq by 4.8%. The Dow is at its post-recovery high, while the S&P is within 1% of that gauge, and up by 96.9% from its early-March 2009 trough (see chart). As is clear from the above preview of the week ahead, whatever moves markets in the coming week, it won't be the economic news.

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The **long end** continues to trade in a narrow range. The **10-year yield** rose by just 2 basis points. It rose by 3 basis points in March and by just 14 basis points in the first quarter. Despite the increased chatter of a possible early end to QE2, the long end refuses to move. Do we have to say that we see no big move in the coming week?



Chris Caton
Chief Economist

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