

Weekly Economic Commentary



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Mid-July Data Bounce Not Likely to Continue

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Highlights

- Housing and manufacturing data will dominate early on, but the Q2 GDP report will garner most of the attention later in the week.
- The economic volatility normally associated with this stage of a recovery was evident in last week's data, only this time the data bounced the right way.

With the European bank stress tests and the first wave of second quarter earnings reports out of the way, this week brings a full slate of economic data in the United States. The report likely to get the most attention this week is the report on Gross Domestic Product (GDP) growth for the second quarter of 2010. It is another busy week for European economic data, but the Chinese economic calendar remains quiet. Israel, Egypt, India, and New Zealand will meet to set interest rate policy this week, with only New Zealand likely to raise rates.

As we have been writing for several weeks now, the data due out this week in the United States is likely to continue to fit into the, two steps forward, one step back theme that has been in place since April 2010. Along with housing, the health of the manufacturing sector as the second quarter ended and the third quarter began is one of the dominant themes of the week. The manufacturing data due out this week includes the Dallas and Richmond Federal Reserve reports on manufacturing, along with the June durable goods orders report. All three reports are likely to show that the manufacturing sector continues to expand, boosted by inventory building and exports, albeit at a slower pace than earlier in the recovery.

Another key theme this week is likely to be the housing market. As this report was being prepared for publication, the new home data for June was released. The data showed an unexpectedly large month-over-month gain in new home sales in June, another drop in the inventory of unsold new homes, but a drop in the median price. In addition, large downward revision to sales in April and May make the report much less robust than the headline suggests. Housing continues to muddle through, bolstered by low inventories and record high affordability, but hindered by a sluggish labor market and large overhang of unsold existing homes on the market. Also due out this week is the May report on home prices from Case-Shiller. The data is likely to show that home prices continued their modest upward trend in May. [\[Chart 1\]](#)

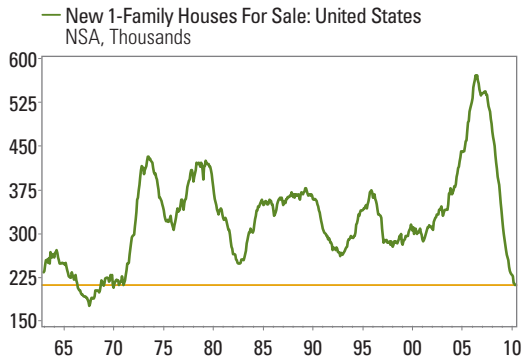
Although it is old news by now, the market is likely to view the second quarter GDP report (due Friday, July 30) as the key report of the week. The financial media will certainly treat it that way. The market is looking for a 2.5% gain in GDP in the second quarter after the 2.7% gain in the first quarter. The consensus estimates have been moving down in recent weeks. The highest estimate among 78 economists surveyed by Bloomberg calls for a 4.0% gain in real GDP in the second quarter, while the low estimate is 1.0%. Also note that, as is the case every July, the GDP data will be revised back three years with the release of the second quarter data, which may change the pattern and timing of the recession and subsequent recovery in GDP growth since mid-2009.

Economic Calendar

Monday, July 26 New Home Sales <i>June</i>	Friday, July 30 Employment Cost Index <i>Q2</i>
Tuesday, July 27 Consumer Confidence <i>July</i>	Real GDP <i>Q2</i>
Wednesday, July 28 Durable Goods <i>June</i>	Chicago PMA <i>July</i>
Thursday, July 29 Initial Claims <i>wk 07/24</i>	U of Mich Consumer Sentiment <i>July</i>

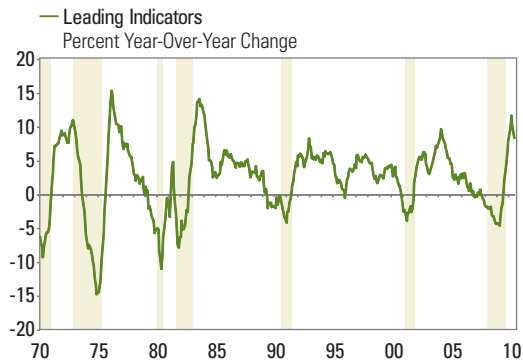


1 The Inventory of Unsold New Homes Remains at a 40-Year Low



Source: Census Bureau/Haver Analytics 07/26/10

2 Peaking Leading Indicators Often Usher in Period of Economic Volatility



Source: Bloomberg 07/26/10

(Shaded areas in chart indicate recessions)

What We Make of Last Week's Key Reports and Events

The tug of war between good and bad economic reports continued last week. Although the data globally last week fell on the good side of the ledger, we wouldn't expect that trend to persist, as the economic certainty of the recovery phase—the vast majority of reports are better than prior period and better than expectations—continues to give way to the economically volatile transition to sustainable growth phase of the rebound from the Great Recession of 2007-2008. This transition typically occurs about one year into a recovery, and is heralded by peaking leading indicators.

As previously noted, the data released last week both in the United States and in Europe surprised the market, which had been pricing in a “double dip” recession in both regions in recent months. Last week that pessimism lifted a bit as reports in the United States on existing home sales building permits, weekly mortgage applications, leading indicators and weekly retail sales all came in ahead of lowered expectations. Since the late spring, anytime the economic data comes in better than expectations, it has been cause for celebration in the equity markets, and last week was no different.

Similarly, the data released in Europe last week came in ahead of sharply lowered expectations, which elicited a similar response in European equity markets. Finally, the results of the European Bank stress tests on Friday, July 23 also prompted a sigh of relief for markets. Although the consensus seems to be that while only seven of the ninety-one European banks involved in the test failed (and will have to raise more capital), the tests were not rigorous or transparent enough to completely put the issue of the solvency of the European banking system to rest.

Of the six central banks that met last week, two raised rates as expected (Canada and Brazil), while the others (Hungary, Serbia, South Africa and Columbia) held rates steady. Canada and Brazil had already been raising rates before last week. The good news here is that many of the central banks that began tightening in late 2009 and early 2010 are now beginning to talk about when they will stop hiking rates. The bad news is that there are likely to be more headwinds associated with tighter monetary and fiscal policy hitting the global economy over the remainder of 2010 and into 2011.

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