January 3, 2010

Recovery Will Endure and Widen

Consumer confidence, as measured by the Conference Board, increased in December to 52.9 from a revised 50.6 in November, previously 49.5. The consensus had expected 52.9, but as a bounce from 49.5. Confidence failed to beat the consensus. The consumer was very cautious on the present situation, which slipped to 18.8 from 21.2 in November. The December expectations reading, however, jumped to 75.6 from 70.3 in November, suggestive of incremental retail activity ahead.

The ABC News Consumer Comfort Index fell two points to -44 in the week ending December 27. This is only 10 points above the low reached a year earlier, hardly suggestive of consumer euphoria. Still, the ICSC-GS Chain Store Sales Index jumped 0.4% in the week ending December 26, atop a 0.6% gain the prior week. Retail holiday sales beat the disaster of 2008, but that's a positive comparison vs. an abysmal level.

Labor market data suggest some emerging support for the consumer. Initial unemployment claims fell 22,000 in the week ending December 26, the lowest reading since July 2008. We expect claims will fall further in the week ending January 2, to be released January 7. Continuing claims are falling also, but that still represents workers exhausting state unemployment insurance and going into the extended federal benefit program. Mass layoffs are falling and hiring of temporary workers is escalating, but the unemployment rate may still move higher via the failure of the labor markets to absorb new labor force entrants.

The Case-Shiller Composite 20 Home Price Index, while flat in October on an unadjusted basis, moved forward for the fifth consecutive month on a seasonally adjusted basis, and the y/y decline in home prices receded to 7.3%. This was the smallest housing price decline since October 2007.

Housing is not out of the woods, however, as delinquency rates on prime and sub-prime loans persist in hitting new highs, per Mortgage Bankers Association data. The foreclosure start rate on prime loans reached a record 1.14% in the third quarter. Sub-prime foreclosures are actually declining from their peaks, but foreclosures can still go higher as many homeowners have negative equity in their homes, i.e., the mortgage is higher than the house is worth.

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The Dallas Federal Reserve Bank in late December showed a Texas Manufacturing Outlook General Activity Index improve to 3.8 in December, after first going into positive territory at 0.3 in November. These two positive readings may seem small, but they are the first such levels, following a long decline that began in December 2007. While nearer-term signs were mixed, the outlook six months out was decidedly more optimistic.

As we forecast, the Chicago Purchasing Managers Index (PMI) surprised the market consensus on the upside. At 60.0 in December, the Chicago PMI jumped from 56.1 in November. This is the highest reading since May 2007. Importantly, the employment and the order backlogs components have moved above the 50.0 level, the first employment reading above the diffusion level of 50.0 since November 2007. Labor market improvement is pivotal for the recovery to endure and widen.

Economic Indicators in the Week Ahead:

Monday, January 4 10:00a.m. December ISM Manufacturing

The December Institute for Supply Management (ISM) is likely to rise from 53.6 in November to 55.0 in December, stronger than consensus expectations. While we have seen some weakness in the NY Fed and in the Richmond surveys, the Chicago Purchasing Managers Index (PMI) surged on Friday, as discussed earlier. December would be the fifth consecutive monthly ISM Manufacturing above 50.

Monday, January 4 10:00a.m. November Construction Spending

Construction spending likely dropped 1% in November, led by weakness in non-residential construction. Residential multi-family could also be soft due to tight financing conditions and underwhelming demand. Aggregate construction spending could be off nearly 14% y/y.

Tuesday, January 5 10:00a.m. November Factory Orders

We expect November factory orders will rise 0.8% m/m. If so, the y/y comparison would only be off 3.5%, a distinct improvement from October's double-digit decline y/y. Nondurable goods orders should be particularly strong, rising 1.4%, as petroleum refinery orders reflect higher oil prices.

Wednesday, January 6 8:15a.m. December ADP Private Employment

ADP private sector employment is likely to decline very slightly, perhaps 10,000 in December, following a 169,000 drop in November. The pace of temporary hiring has accelerated, and the pace and incidence of layoffs has slowed markedly.

Wednesday, January 6 10:00a.m. Dec. ISM Non-Manufacturing

The November Institute for Supply Management non –manufacturing survey was weaker than expected, receding to 48.7 from 50.6 in October. We anticipate an above-consensus reading of 51.0 in December.

Thursday, January 7 8:30a.m Weekly Jobless Claims

Initial jobless claims dropped 22,000 to 432,000 in the week ending December 26. This marked the lowest initial jobless claims reading since July 2008. We believe initial claims will recede further in the week ending January 2, possibly reaching 400,000. Seasonal factors related to the prior holiday weeks make this number a particularly difficult read.

Friday, January 8 8:30a.m. December Employment Report

Payroll employment fell only 11,000 in November, a distinct improvement from the October employment decline of 111,000. We expect non-farm payroll employment will move into positive territory, rising 35,000 in December. This would be the first rise since the recession began in December 2007. Worse weather in December will be competing with improving employment trends. Based on a potentially meaningful rise in new entrants into the labor force, the household survey will likely show an uptick in the unemployment rate from 10.0% in November to 10.1% in December. Employment is a coincident indicator, while the unemployment rate is a lagging barometer. While employment trends are improving, the peak in the unemployment rate likely lies ahead.

Friday, January 8 10:00a.m. November Wholesale Inventories

Wholesale inventories likely receded 0.6% in November. The sales trend has improved and the inventory to sales ratio should continue to lessen from the 1.16 level of October.

Friday, January 8 3:00p.m. November Consumer Credit Outstanding

Tight bank lending coupled with the consumer sector's desire to continue to reduce debt will lead to, by our estimation, a $5.5 billion decline in consumer credit outstanding (CCO) in November. CCO has not risen since January 2009.

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