

Weekly Economic Commentary



December 9, 2013

Beige Book: Window on Main Street Economy Still Growing at “Modest-to-Moderate” Pace

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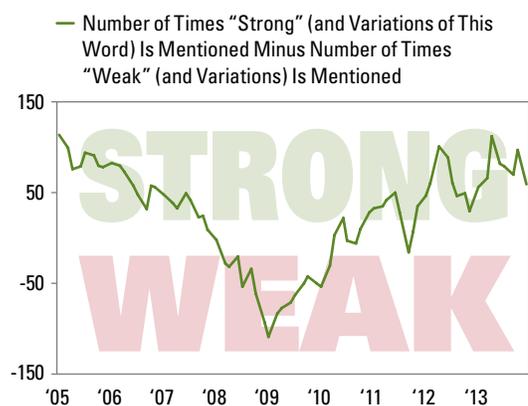
Highlights

The latest edition of the Fed’s Beige Book once again described the U.S. economy as increasing at a modest-to-moderate pace, with little wage or other inflation pressures.

The underlying Beige Book tone suggests that if/when the uncertainty surrounding the fiscal issues and the ACA lifts, the economy could accelerate—forcing the Fed to begin thinking about removing some of its accommodation.

Our Beige Book Barometer fell to +59 in December 2013 from +97 in October 2013.

1 Uncertainty Surrounding Government Shutdown and Debt Ceiling Debate Weighed Down the Beige Book Barometer in December



Source: Federal Reserve, LPL Financial Research 12/06/13

This week (December 9–13, 2013) and early next week, ahead of the December 17–18 Federal Open Market Committee (FOMC) meeting, Federal Reserve (Fed) policymakers will digest a number of key reports on the U.S. economy from November and December 2013, including:

- Small Business Sentiment (December);
- Retail Sales (November);
- Initial Claims for Unemployment Insurance (week ending December 7);
- Empire State Manufacturing Index (December);
- Markit Purchasing Managers Index (PMI) (December);
- Homebuilder Sentiment (December);
- Housing Starts and Building Permits (November); and
- Industrial Production/Capacity Utilization (November).

In addition, Fed officials will continue to reflect on last week’s employment report for November 2013 that confirmed that the private sector economy is consistently creating around 200,000 jobs per month, with very limited wage pressures. Also on the Fed’s radar this week will be the outcome of the federal budget negotiations set up in the wake of the government shutdown: December 13 is the date by which the latest version of the Super Committee (led this time by Congressman Paul Ryan (R-WI) and Senator Patty Murray (D-WA)) must present their report. We will provide a full preview of the FOMC’s eighth and final meeting of 2013 in next week’s (December 16, 2013) *Weekly Economic Commentary*.

The latest edition of the Fed’s Beige Book once again described the economy as increasing at a modest-to-moderate pace, with little wage or inflation pressures, as the Fed collects its own set of data ahead of the December 17–18 FOMC meeting. The “modest-to-moderate” description has now been used in the last five Beige Books (and in six of the last seven) dating back to March 2013. The Fed’s Beige Book—a qualitative assessment of economic and financial conditions in each of the 12 Federal Reserve districts—was released last Wednesday, December 4, 2013.

Shutdown Uncertainty Prominent

To provide a snapshot of the sentiment behind the entire Beige Book collage of data, we created our proprietary Beige Book Barometer (BBB) [Figure 1].



How the Barometer Works

The Beige Book Barometer is a diffusion index that measures the number of times the word “strong” or its variations appear in the Beige Book less the number of times the word “weak” or its variations appear. When the Beige Book Barometer is declining, it suggests that the economy is deteriorating. When the Beige Book Barometer is rising, it suggests that the economy is improving.

See page 4 for “Beige Book: How It Works.”

The word **confidence**, often used in a negative context in the Beige Book (e.g., “**lack of confidence**”) appeared **14 times** in the December Beige Book and just **seven times** in the October edition.

3 Beige Book Word Clouds



Source: The Federal Reserve Beige Book, LPL Financial 12/06/13



Source: The Federal Reserve Beige Book, LPL Financial 10/17/13



Source: The Federal Reserve Beige Book, LPL Financial 11/28/12

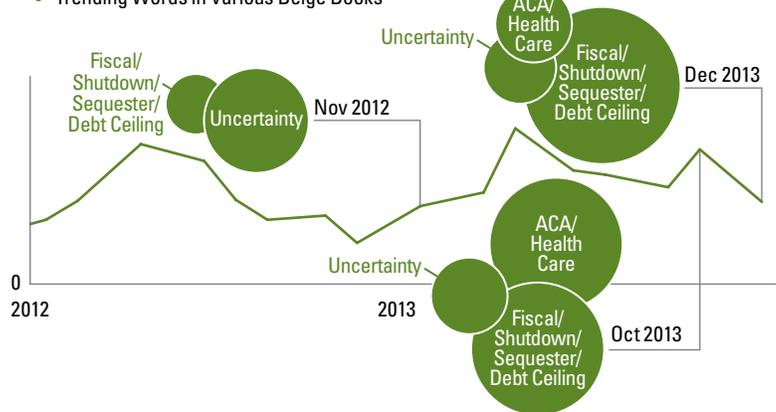
The barometer ticked down to +59 in December 2013 from +97 in October 2013. The barometer was at +70 in September 2013, +79 in July 2013, and +82 in June 2013. Importantly, the October 2013 reading (+97) was the highest since April 2013’s 112 reading, and one of the highest readings in the past eight-and-a-half years, despite the uncertainty around the fiscal issues in Washington that dominated the headlines during the collection period (mid-to-late September 2013 through October 7, 2013).

But the uncertainty surrounding the early October 2013 government shutdown weighed heavily on the December reading of the BBB, as the early part of the collection period (early October through mid-November 2013) came during the 16-day government shutdown in early October 2013.

2 Affordable Care Act Remains a Large Concern and Has Added to Economic Uncertainty

— Number of Times “Strong” (and Variations of This Word) Is Mentioned Minus Number of Times “Weak” (and Variations) Is Mentioned

• Trending Words in Various Beige Books



Source: Federal Reserve Board, LPL Financial 12/06/13

The most recent (December 4, 2013) Beige Book mentioned the government shutdown 26 times, and the word fiscal appeared 12 times, while the word uncertainty was used 19 times. In the prior Beige Book—released in mid-October 2013 for the period covering September through early October 2013—the shutdown was mentioned 18 times, uncertainty 19, and fiscal 8. We point out that the data collection period for the October 16, 2013 edition of the Beige Book ended in early October, during the first week of the shutdown. The word confidence—often used in a negative context in the Beige Book (e.g., “**lack of confidence**,” “**lowering of confidence**,” “**reduced confidence**,” etc.)—appeared 14 times in the December Beige Book and just seven times in the October edition.

Affordable Care Act Mentions Fading, but Still Present

Although it has been near or at the top of the news for several months now, mentions of the Affordable Care Act (ACA)—also known as Obamacare—and health care in general faded in the December Beige Book



Beige Book: How It Works

The Beige Book compiles qualitative observations made by community bankers and business owners about economic (labor market, prices, wages, housing, nonresidential construction, tourism, manufacturing) and banking (loan demand, loan quality, lending conditions) conditions in each of the 12 Fed districts (Boston, New York, Philadelphia, Kansas City, etc.). This local color that makes up each Beige Book is compiled by one of the 12 regional Federal Reserve districts on a rotating basis—the report is much more “Main Street” than “Wall Street” focused. It provides an excellent window into economic activity around the nation using plain, everyday language. The report is prepared eight times a year ahead of each of the eight Federal Open Market Committee (FOMC) meetings. The next FOMC meeting is December 17–18, 2013.

The previous word clouds or text clouds, which are a visual format useful for quickly perceiving the most important words in a speech, text, report, or other transcript, are culled from the Fed’s Beige Books published last week (December 4, 2013), the prior report (October 16, 2013) and in November 2012. In general, the more often a word appears in a speech, text, report or other transcript, the larger that word appears in the word cloud. The word clouds show the top 50 words for each of the two Beige Books mentioned above. Similar words are grouped together and common words like “the,” “and,” “a,” and “is” are excluded, as are words that appear frequently in all Beige Books (federal, district, loan, level, activity, sales, conditions, firms, etc.).

versus the September and October Beige Books. There were 18 mentions of the ACA/health care in December, down from 33 in October 2013 and 26 in the September Beige Book. A year ago, in the November 2012 Beige Book, there were no mentions of the ACA or health care reform. We continue to expect this topic to appear frequently in the Beige Book in the quarters ahead.

On balance, the Beige Book describes an economy that is still growing slowly, with limited wage and price pressures, which suggests that the Fed can continue to remain accommodative. However, the underlying Beige Book tone suggests that if/when the uncertainty surrounding the fiscal issues (and, to a lesser extent, the ACA) lifts, the economy could accelerate—forcing the Fed to begin thinking about removing some of the accommodation. Of course, a lot of that uncertainty rests with Congress, although we think the threats have moderated, as detailed in our *Outlook 2014*:

Washington will still gather some attention from investors. After all, deadlines have been set early in 2014 for hitting the debt ceiling and the funding of the federal government, coinciding with primary season for the mid-term elections. But we think there is unlikely to be a reprise of the brinkmanship and economic disruption that threatened to take the United States to the brink of disaster. ■

IMPORTANT DISCLOSURES

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The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Stock investing involves risk including loss of principal.

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country’s borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

The Federal Open Market Committee (FOMC), a committee within the Federal Reserve System, is charged under the United States law with overseeing the nation’s open market operations (i.e., the Fed’s buying and selling of U.S. Treasury securities).

This research material has been prepared by LPL Financial.

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