

Weekly Economic Commentary



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Beige Book: Window on Main Street Weather Impact Likely to Fade as Weak Words Fall to 10-Year Low

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Highlights

Weather was again a key theme in the Beige Book with 103 mentions, down from 119 in March. However, the mentions in April were in a much less negative context than in March.

Our Beige Book Barometer increased to +87 in April 2014 from +62 in March 2014, the highest reading since October 2013.

The number of weak words in the Beige Book fell to a 10-year low in April 2014.

The Affordable Care Act continues to be a key concern for Main Street.

The Beige Book is a qualitative assessment of the U.S. economy and each of the 12 Federal Reserve (Fed) Districts. We believe the Beige Book is best interpreted quantitatively by measuring how the descriptors change over time. The latest edition of the Fed Beige Book, released last Wednesday, April 16, 2014, ahead of the April 29–30, 2014, Federal Open Market Committee (FOMC) meeting, once again described the economy as increasing at a “modest-to-moderate” pace, with price pressures described as “stable or slightly higher,” and wage pressures that were “contained or minimal.” The modest-to-moderate description of the overall economy has now been used in the last eight Beige Books, and in nine of the past 10 dating back to March 2013.

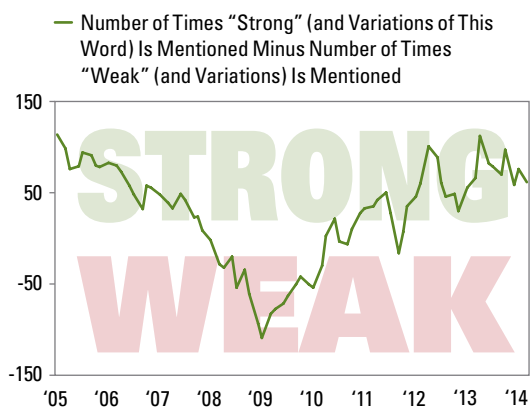
Sentiment Snapshot

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]. The barometer ticked up to +87 in April 2014 from +62 in March 2014 and +76 in January 2014. At +87, the latest reading remains well below its recent peak (+112 in April 2013) but is the highest since the October 2013 Beige Book (+97), which was released just prior to the onset of the harsh winter weather that gripped much of the United States in December 2013 and most of the first quarter of 2014. The rebound in our Beige Book Barometer is consistent with the Fed’s view that the slowdown in economic activity during late 2013 and early 2014 was mostly weather related. In addition, we found that the word “weak” or its variants appeared just 14 times in the April 2014 Beige Book, the lowest count since at least 2005. This suggests to us that the negative headwinds that have held the economy back over the past five years may be declining.

Weather was mentioned 103 times in the latest Beige Book, but only about 60% of the mentions were in a negative context. Forty percent of the mentions were in a positive context, in many cases describing how economic activity rebounded after poor weather held down activity in prior months. The 103 mentions of weather in the April 2014 Beige Book compared favorably to the 119 mentions in the March 2014 edition. Note that of the 119 mentions of weather in the March 2014 Beige Book, almost all were in a negative context.

To put the 119 mentions of weather in the March 2014 Beige book in historical context, weather was mentioned only 48 times in the Beige Book released just after Superstorm Sandy hit the U.S. East Coast in October

1 Barometer Ticks Up as Number of “Weak” Words Drop to 10-Year Low



Source: LPL Financial Research, Federal Reserve 04/17/14



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 3 for “Beige Book: How It Works.”

The 119 mentions of weather in the March 2014 Beige Book—along with 31 mentions of the word “cold,” 24 of “snow,” and 35 of “severe”— suggest that the weather’s impact on the economy in the early part of 2014 was widespread and significant.

2012. Weather was mentioned a total of 61 times in the three Beige Books released during the unusually cold and snowy winter of 2010–11. On balance, the 119 mentions of weather in the March 2014 Beige Book—along with 31 mentions of the word “cold,” 24 of “snow,” and 35 of “severe”— suggest that the weather’s impact on the economy in the early part of 2014 was widespread and significant. Throughout the past several months, Fed policymakers made it clear that they took this view of the economy as well.

Weather Normalizing; Economy Rebounding

Our view of the economy is similar to the Fed’s: once all the ice and snow melts and more normal weather returns, the economy will likely accelerate back to the pace seen before the bad weather began in late 2013. Indeed, the April 2014 Beige Book suggests that the weather’s impact on the economy began to fade as winter turned to spring. The 48 combined mentions of cold (16), snow (6), and severe (16), were far below the 110 mentions of those same words in the March 2014 Beige Book. In addition, note that the word “rebound” was found 16 times in the April 2014 Beige Book, versus just five times in March 2014, as business and banking contacts described how economic activity rebounded in late March and early April 2014 after poor weather dampened economic activity in prior months.

The economic data released over the past few weeks for March and early April 2014 (retail sales, employment, initial claims, industrial production, small business optimism, Philadelphia Fed Manufacturing Index, etc.) support the view that the economy is now rebounding as the weather begins to normalize. The Fed’s view is similar, based on Chair Yellen’s speech on April 16, 2014: “The unusually harsh winter weather in much of the nation has complicated this judgment, but my FOMC colleagues and I generally believe that a significant part of the recent softness was weather related.”

Looking ahead, we expect the improvement in the economic data to continue throughout the second quarter of 2014. We continue to expect that the U.S. economy (as measured by real gross domestic product [GDP]) will grow at 3.0% in 2014, based on the drags from 2013 reversing (tax hikes, government spending cuts, Europe recession) and a modest improvement in business spending, which would simply equal the average pace of real GDP growth since the end of WWII. The GDP report for the first quarter of 2014 is due out at the end of April, and that report may likely show that the economy grew by just 1.5% or so (according to Bloomberg News), with the harsh winter weather likely to take the blame for the subpar performance.

Uncertainty Fading; Health Care Still a Concern

The uncertainty and lack of confidence around fiscal policy (fiscal cliff, debt ceiling, sequester, government shutdown) that dominated the Beige Book for most of 2013 is now clearly fading [Figure 3]. In the April 2014 Beige Book, there were only 12 mentions of the words noted above, after 18 mentions in the March 2014 Beige Book, and 26 mentions in the January

2 Beige Book Word Clouds



Source: LPL Financial Research, Federal Reserve Beige Book 04/17/14



Source: LPL Financial Research, Federal Reserve Beige Book 03/05/14



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 April 29–30, 2014.

The word clouds or text clouds on page 2 are a visual format useful for quickly perceiving the most important words in a speech, text, report, or other transcript. They are culled from the Fed’s Beige Books published last week (April 16, 2014), the prior report (March 5, 2014), and the report from a year ago (April 17, 2013). 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.).

2014 Beige Book. These words were mentioned 65 times, on average, in each of the eight Beige Books released in 2013. As we wrote in our *Outlook 2014: The Investor’s Almanac*, we continue to expect concerns over government policy to fade over the course of this year.

3 Weather and Policy Drags on Economy Likely to Fade in Period Ahead

	Weather	Shutdown/Fiscal/Sequester/Debt Ceiling/Uncertainty/Confidence	Affordable Care Act/Health Care
03/2014	103	12	17
03/2014	119	18	22
01/2014	21	26	32
2013 Avg	112 (14 per Beige Book)	520 (65 per Beige Book)	178 (22 per Beige Book)
	Weather is trending up.	Words surrounding government policy uncertainty are trending down.	ACA/health care remain fairly steady.

Source: LPL Financial Research, Federal Reserve 04/17/14

Good weather or bad, the Affordable Care Act (ACA), and health care in general, has remained a consistent source of concern among respondents to the Beige Book. The ACA received 17 mentions in the April 2014 Beige Book, close to the 29 mentions in the March 2014 edition. On average, the ACA/health care saw 22 mentions per Beige Book in 2013. We continue to expect this topic to appear frequently in the Beige Book in the quarters ahead as businesses and consumers adjust to the rollout of the legislation. ■

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. All performance reference is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

The economic forecasts set forth in the presentation may not develop as predicted.

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).

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