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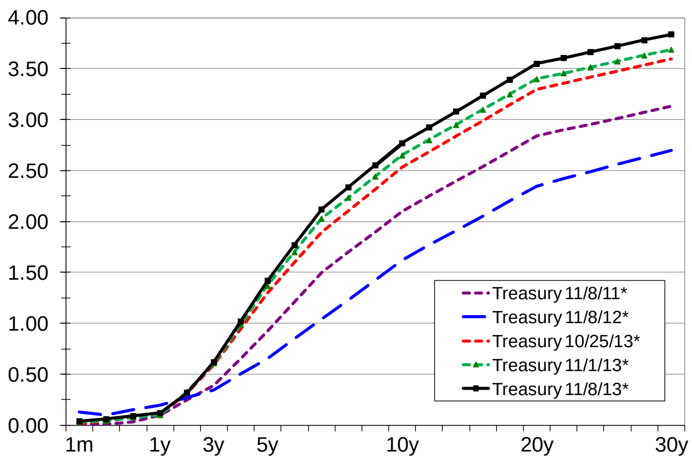
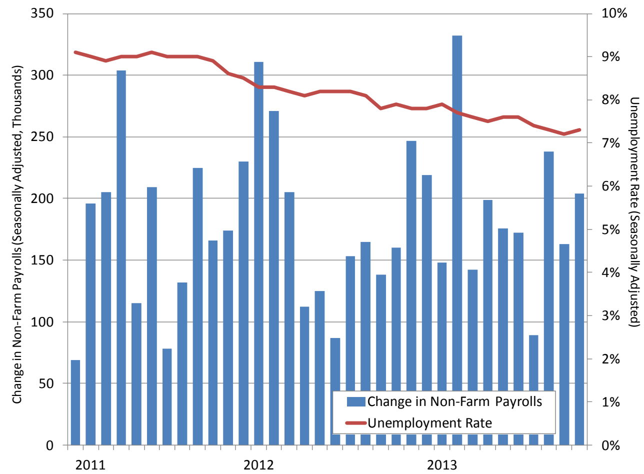
Weekly Economic Newsletter for Treasury and Finance November 11, 2013

The Big Picture: Yield Curve & Employment



U.S. Treasury Yield Curve—Source: [U.S. Department of the Treasury]



Employment—Source: [Bureau of Labor Statistics]

Measure	Numerical Trend	Current Trend	Analysis
GDP Third Quarter 2013 (Advance) *Source: Bureau of Economic Analysis*	*Percentage Change from Previous Quarter Seasonally Adjusted Annualized Rate* Q3 13: +2.9% Q2 13: +2.5% Q3 12: +2.8%	↑	This was the fastest pace of economic growth since the Q1 2012 with positive contributions coming from all major facets of the economy. The biggest contribution was from consumption, although the 1.5% annualized growth in spending resulted in its positive smallest contribution to GDP since Q4 2009 (+104-basis points). The $86.0 billion expansion in private inventories contributed 83-basis points to GDP while fixed investment added 63-basis points (including a 43-basis point contribution from fixed residential investment). Net exports added another 31-basis points while the government sector contributed 4-basis points.
Employment October 2013 *Source: Bureau of Labor Statistics*	*Non-Farm Payrolls Change from Previous Month Seasonally Adjusted Thousands* Oct 13: +204 Sep 13: +163 Oct 12: +160	↑	Along with October's surprisingly large job gain, the report also included upward revisions to August and September payroll data to the tune of 60,000 more jobs. The private service sector added 177,000 workers during the month while the goods producing side expanded payrolls by 35,000. Government payrolls contracted by 8,000 workers. Average hours worked remained at 34.4 hours with weekly earnings growing 69 cents to $820.04. Based on a separate household survey, the unemployment rate inched up 1/10th of a point to 7.3% while the labor force contracted by 720,000 people.

Personal Income September 2013 *Source: Bureau of Economic Analysis*	*Percentage Change from Previous Month* *Seasonally Adjusted* Sep 13: +0.5% Aug 13: +0.5% Sep 12: +0.6%	↑	Incomes have grown 3.7% since September 2012. Wage income increased 0.4% during September and was up 3.0% over the past year. Consumer spending was up 0.2% for the month, despite a 1.3% drop in spending for durable goods. Non-durable goods consumption grew 0.6% while that for services increased 0.3%. Overall consumption has increased 2.7% over the past year. The savings rate grew by 2/10ths of a point to +4.9%. It was at +4.8% a year earlier.
Factory Orders September 2013 *Source: Census Bureau*	*Percentage Change from Previous Month* *Seasonally Adjusted* Sep 13: +1.7% Aug 13: -0.1% Sep 12: +5.2%	↑	New orders for manufactured goods totaled $490.8 billion, up 3.0% from a year earlier. September's increase was largely because of a 12.9% jump in orders for transportation goods (civilian aircraft: +57.7%). Net of transportation goods, new orders dropped 0.2% during the month. Shipments inched up 0.1% to $488.9 billion (+1.5% vs. September 2012). Unfilled orders grew 0.9% to $1.042 trillion while inventories expanded 0.4% to $634.0 billion.
Report on Business—Non-Manufacturing September 2013 *Source: Institute for Supply Management*	*Index (>50=growth)* *Seasonally Adjusted* Sep 13: 55.4 Aug 13: 54.4 Sep 12: 54.8	↑	The service sector has expanded for 46 straight months. 2 index components improved from their September readings: business activity (up 4.6 points to 59.7) and employment (up 3.5 points to 56.2). 2 others declined—new orders (down 2.8 points to 56.8) and supplier deliveries (off a point to 49.0). 10 of 18 tracked industry segments expanded during the month.
Consumer Credit September 2013 *Source: Federal Reserve*	*Change from Previous Month* *Seasonally Adjusted* *Billions $* Sep 13: +$13.7 Aug 13: +$14.2 Sep 12: +$9.5	↑	Outstanding balances of non-real estate-backed consumer debt totaled $3.052 trillion, up 6.1% from a year earlier. Outstanding balances of non-revolving debt (e.g., student loans, auto loans) grew for a 26th straight month, increasing by $15.8 billion to $2.205 trillion (+8.5% versus September 2012 levels).Revolving credit balances declined for a 4th consecutive month as they dropped by $2.1 billion to $846.9 billion (+0.2% versus a year earlier).
Jobless Claims Week ending November 2 2013 *Source: Department of Labor*	*First-Time Claims* *Seasonally Adjusted* *Thousands* Nov 2 13: 336 Oct 26 13: 345 Nov 3 12: 363	↓	The 4-week moving average for 1st time jobless claims dropped 9,250 to 348,250. The moving average was at 371,500 a year earlier. The insured unemployment count of 2.868 million during the week ending October 26 was up 4,000 from the previous week but below the 3.189 million count of a year earlier. 3.959 million people were receiving some form of unemployment insurance benefits during the week ending October 19.
Mortgage Delinquencies Third Quarter 2013 *Source: Mortgage Bankers Association*	*Total Delinquency Rate* *Seasonally Adjusted* Q3 13: 6.41% Q2 13: 6.96% Q3 12: 7.40%	↓	This was the lowest percentage of delinquent residential mortgages (defined as being at least one payment past due but *not* in foreclosure) since Q2 2008. Foreclosure actions were started on 0.61% of mortgages, down 3-basis points from Q2 and its lowest percentage since 2008. The "serious delinquency" rate (mortgages at least 90 days late or in foreclosure) was 5.65%, off 23-basis points from Q2 and 138-basis points from a year earlier.

Economic Commentary edited by Kevin Roth

The U.S. job market strengthened during October even in the face of the partial federal government shutdown and the default threat. The Bureau of Labor Statistics estimates employers expanded non-farm payrolls by a seasonally adjusted 204,000 workers during October, far greater than what most analysts had expected. Over the past year, the U.S. economy has added 2.329 million workers for an average of 194,083 workers per month. The private sector created 212,000 jobs during October (or 2.355 million workers since October 2012). The goods producing side of the private sector added 35,000 workers, including 19,000 in manufacturing and 11,000 in construction. The private service sector created 177,000 jobs, with the biggest one-month job gains coming from retail (+44,000), professional/business services (+44,000), accommodation/food services (+37,200) and education/health services (+23,000). Meanwhile, even with the shutdown, federal government payrolls shrank by "only" 12,000 workers during the month (overall government payrolls contracted by 8,000 workers during October).

A survey of households also conducted by the BLS found the seasonally adjusted unemployment rate was 7.3 percent, up a 1/10th of a point from September but down from 7.9 percent a year earlier. The labor force contracted by 720,000, but much of that can be attributed to workers furloughed due to the government shutdown. The typical unemployed person was out of work for 16.3 weeks, unchanged from September and down from 19.6 weeks a year earlier. While the number of "involuntary" part-time workers (defined as someone who has a part-time job but seeks a full-time opportunity) grew by 124,000 to 8.050 million, this was below the 8.286 million reading of a year earlier. Similarly, the BLS's broadest measure of labor underutilization (the "U-6" series) gained 2/10ths of a point during the month to 13.8 percent, but remained below the year ago reading of 14.5 percent.

Two other labor market reports released last week were:

- The count of first-time claims made for unemployment insurance benefits continues to decline following the recent surge caused by data issues in California and private sector effects from the shutdown. The Department of Labor estimates that there were a seasonally adjusted 336,000 first-time jobless claims made during the week ending November 2, a drop of 9,000 from the previous week and resulting in a 9,250 drop in the four-week moving average to 348,250.
- Outplacement firm's Challenger, Gray and Christmas's measure of announced job cuts jumped 13.5 percent during October to 45,730 jobs. This was down 4.2 percent from the October 2012 pace. The biggest source of job cuts was the pharmaceutical industry, responsible for 10,585 of the announced layoffs. Challenger has tracked 433,114 announced cuts over the first ten months of the year, essentially matching the pace seen over the same ten months of 2012.

The aforementioned payrolls report was not the only stronger than expected economic report published last week. The Bureau of Economic Analysis released its first estimate of third quarter 2013 gross domestic product (GDP) on Thursday, which showed the U.S. economy grew at a 2.8 percent seasonally adjusted annualized rate during the months of July, August and September, just above the 2.5 percent second quarter growth rate. This estimate was not only the fastest rate of economic growth since the opening quarter of 2012, it was significantly stronger than the general perception that the U.S. economy had faltered during the summer. All major segments of the economy—consumption, fixed investment, private inventory accumulation, net exports and the government—positive contributed to GDP growth. But perhaps a reminder than the better than expected growth in GDP still represented a relatively modest rate of expansion: consumption made its smallest positive contribution to economic growth in nearly four years.

Other measures of economic output in the BEA report included:

- Real final sales of domestic product, which is GDP minus the change in private inventories, grew 2.0 percent during the third quarter after having picked up 2.1 percent during the previous quarter.
- Real gross domestic purchases, which measures purchases by U.S. residents of goods and services regardless of where they are produced, rose 2.5 percent during the most recent quarter, matching the rate of growth experienced during the second quarter.

In a separate report released last week, the BEA reported that consumer spending grew 0.2 percent on a seasonally adjusted nominal basis during September. The personal consumption expenditure (PCE) deflator—a measure of inflation—grew 0.1 percent during the month, which means consumer spending grew 0.1 percent on a real basis during the month. Also on a real basis, spending on goods was unchanged from August (real spending on durable goods dropped 1.2 percent while that on durables picked up 0.6 percent) as spending of services picked up 0.2 percent. Real personal consumption has grown 1.7 percent over the past year, with spending on goods increasing 3.3 percent and that on services rising 1.0 percent.

The modest rate of consumer spending follows the path of weakening household sentiment in recent months. And, early data suggest a continuation of that trend this month. The headline index from the preliminary November [University of Michigan] Surveys of Consumers was at a seasonally adjusted 72.0 (Q1 1966 = 100). If this holds when finalized in a few weeks, it would represent a 1.2 point decline from October and a 13.1 point drop from its recent peak in July. Virtually all of November's decline comes from a drop in perceptions of current conditions, the index of which lost 2.7 points to 87.2. The expectations index shed 3/10ths of a point to 62.3.

The service sector grew at a faster rate during October, according to survey results from the Institute for Supply Management. The headline composite index from the group's Report on Business for the non-manufacturing sector added one full point to a seasonally adjusted 55.4. The index was not only above its 12-month average of 55.0, but also was the 46th month in which it was above a reading of 50.0, the threshold between growth and contraction. Three of four index components were in expansionary territory—business activity, new orders and employment—while the fourth (supplier deliveries) slipped to a reading of 49.0. Only ten of 18-tracked industry segments expanded during the month, with survey respondents sharing "mixed" comments about business conditions. The press release also noted that "a number" of survey participants had been "negatively impacted by the government shutdown."

A big increase in orders for transportation goods, particularly for aircraft, led to the first increase in factory orders in three months during September. The Census Bureau estimates new orders for manufactured goods totaled a seasonally adjusted

$490.8 billion during the month, an 1.7 percent increase from August and up 3.1 percent from the September 2012 pace. But after netting out the 12.9 percent gain in transportation goods orders (civilian aircraft orders jumped 57.7 percent and defense aircraft orders grew 16.0 percent), new orders declined 0.2 percent. Orders for primary metals and computers/ electronics goods grew 2.9 percent and 1.6 percent, respectively. But declining were orders for machinery (-2.6 percent), electrical equipment/appliances (-0.9 percent) and non-durable goods (-0.2 percent). The Census Bureau report covered both August and September (as the partial federal government shutdown canceled the August release that had been scheduled early last month).

Senior loan officers indicated in survey results released last Monday by the Federal Reserve that they continued to ease lending standards to their large & medium-sized commercial & industrial (C&I) customers during the third quarter. A net 8.3 percent of banks reported easing their credit standards for C&I loans and credit lines to large and middle-market firms during the quarter, the seventh consecutive quarter in which a net percentage of banks reporting do so. The easing largely took the following forms: narrowing the spreads of loan rates over cost of funds (58 percent of banks reporting), lowering the cost of credit lines (34 percent) and decreasing use of interest rate loans (34 percent).

The Week in Corporate Finance edited by Brian Kalish

The one-week delayed employment report was the bit of icing on the birthday cake of economic good news we received this week. The payroll report was substantially stronger than expected (+204k versus +120k consensus), and both the August and September reports were revised up (by +45k and +15k, respectively). The GDP report for the third quarter came in stronger than expected (+2.8 percent versus +2.0 percent consensus) and the initial jobless claims report ticked lower to 336k.

The stock market responded to this burst of good news by reaching new highs or near-highs. The Dow peaked at 15,797.68 (up 22.24 percent over the past year), the S&P 500 continues to hover near its all-time high, currently at 1,770.54 (up 28.34 percent over the past twelve months), and the NASDAQ is at 3,919.23 (up 35.17 percent over the past 365 days) and near its 13-year high.

With the market now contemplating whether the Fed might accelerate the start of its "tapering" program, it was not surprising to see U.S. Treasuries take one on the chin. For the week, the 2-year note yield was unchanged at 31bps (after dropping to a low of 28bps); the 5-year note yield was up 4bps to 1.41 percent (after being as low as 1.30 percent): the 10-year note yield was up 12bps to 2.74 percent; and the 30-year bond yield was up 16bps to 3.85 percent. Mortgage rates reversed their downward trend. The average 30-year fixed-rate mortgage rose from its four-month low to 4.16 percent and the average 15-year fixed-rate mortgage grew to 3.27 percent.

All eyes will be on the final FOMC meeting that occurs on Tuesday December 17th and Wednesday December 18th to see if the Fed hints at what its future actions may be.

Commodities definitely took a hit, losing a bit of their shine as safe havens for investors. Gold fell to a recent low of $1,280.50/oz, dropping 26.30 percent over the past year. Silver is now down 34.31 percent over the past 12 months. Oil touched a five-month low of $93.37/barrel for WTI. A glut of supply is trumping the increased economic activity in the U.S. and driving prices lower. A gallon of gas in the U.S. is near its lowest level in almost two years at an average price of $3.211/gallon.

Corporate CFOs are locking in funding costs before yields rise even higher as the window for debt issuance is closing as we approach the end of 2013, and the beginning of the holiday season. Philip Morris issued $2 billion via a three-tranche deal comprised of $750 million of a 5-year note, $500 million of a 10-year mote, and $750 million of a 30-year bond. Mosaic did its own three-tiered $2 billion transaction. It consisted of $900 million of a 10-year note, $500 million of a 20-year note, and $600 million of a 30-year bond.

Over in Europe, we received two bits of interesting news. First, in a bit of a surprise, the European Central Bank (ECB) lowered its refinancing rate by 25bps to a record low of +25bps. Only 3 out of 70 economists in one survey saw this action coming. The argument given for this reduction in yields was simply the fear of deflation in the euro-zone.

The other piece of news was that S&P lowered the sovereign credit rating of France from "AA+" to "AA". France had "AAA" credit as recently as January 2012

What to watch over the next week:

Monday, November 11, 2013
No major reports

Tuesday, November 12, 2013
- Chicago Fed National Activity Index (September 2013)
- Treasury Budget (October 2013)
- NFIB Small Business Economic Trends (October 2013)

Wednesday, November 13, 2013
- Import/Export Prices (October 2013)

Thursday, November 14, 2013
- Producer Price Index (October 2013)
- International Trade (September 2013)
- Productivity (3rd Quarter 2013)

Friday, November 15, 2013
- Industrial Production (October 2013)
- Wholesale Trade (September 2013)

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