

## Economics

18 June 2012 | 8 pages

# U.S. Economic & Markets Daily

## Market Summary

- **Recap:** U.S. stock markets were mixed following the Greek elections over the weekend with the S&P 500 eking out just a 0.1% gain. In economic news, the National Association of Home Builders' Housing Market Index rose to 29 in June from 28.
- **FOMC Preview:** The events of the past few days have not altered our Fed call for this week. We think the FOMC will adopt a modest extension of its Operation Twist program. That could be accompanied by language indicating a readiness to act more aggressively if the outlook deteriorates. Concerns about downside risks have increased in the intermeeting period. Financial conditions have eroded, although not dramatically, but confidence in their earlier growth forecasts has diminished. Although none of the available options is super attractive, in our view, doing nothing this week could entail unacceptable costs as market expectations have intensified.
- **Tomorrow's Preview:** We look for little change in May housing starts.

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## Financial Market Summary – As of 4:00PM EST

	PREV NY CLOSE	NY CLOSE	NY CHANGE
FED FUNDS	0.200	0.190	-1bp
3-MO TBILL	0.086	0.076	-1
2-YR TREASURY	0.270	0.282	1
5-YR TREASURY	0.672	0.680	1
10-YR TREASURY	1.577	1.577	0
30-YR TREASURY	2.684	2.666	-2
YEN/DOLLAR	78.730	79.120	0.50%
DOLLAR/EURO	1.264	1.258	-0.47
DJIA	12767.17	12741.82	-0.20
S&P 500	1342.84	1344.42	0.12
NASDAQ	2872.80	2895.33	0.78
DOW JONES TSM	13866.84	13896.81	0.22
NYMEX CRUDE	84.03	83.16	-1.04
CRB FUTURES INDEX	272.23	273.62	0.51
30-YR BOND FUTURES	150.22	150.44	0.15

Source: Bloomberg

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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# U.S. Economic & Markets Daily

## Today's Market Developments

U.S. stock markets were mixed following the Greek elections over the weekend with the S&P 500 eking out just a 0.1% gain. The DJIA fell 0.2% while the NASDAQ rose 0.8%. Treasury yields were little changed.

The dollar appreciated against major currencies – rising 0.5% versus both the yen and the euro. The one-month futures price for crude oil slipped 1.0% to \$83.16 a barrel.

In economic news, the National Association of Home Builders' Housing Market Index rose to 29 in June from 28, a five-year high. While expectations for new home sales and traffic of prospective home buyers have improved notably in 2012, we would still note that the index remains well below its long-run average of 48.

## FOMC Meeting Preview

The events of the past few days have not altered our near-term Fed policy view. We think the FOMC will adopt a modest extension of its nearly completed Operation Twist program. That could be accompanied by language indicating a readiness to act more aggressively if the outlook deteriorates. Concerns about downside risks have increased in the intermeeting period as outlined by Vice Chair Yellen. Financial conditions have eroded, although not dramatically, but confidence in their earlier growth forecasts has diminished. Although none of the available options is super attractive, in our view, doing nothing this week could entail greater costs as market expectations have intensified.

The choice of a limited continuation of OT strikes a balance: It would signal that officials want to offer some support when technical complications make a larger OT2 difficult but the change in outlook doesn't justify a full-blown QE. But there are so many possible alternative ways to use to use balance sheet measures that we probably can expect to be surprised on some level. However, there is an important distinction between sterilized and unsterilized purchases and we feel more confident the Committee will draw the line at remaining reserve-neutral.

We expect near-term growth forecasts to be trimmed by a tenth or two, but think unemployment projections over the multi-year horizon will continue to straddle 7% by late 2014. As discussed in our weekly comments, while incoming data have been softer, policymakers have discounted some of the slowing as exaggerated, especially the employment data, while the recovery is getting a lift from lower energy costs and housing indicators are mildly encouraging. Hiring plans in several surveys have shown continued improvement despite the bump in claims. On balance, there is still a reasonable case for growth edging up in the second half. So the call may hinge on officials' tolerance for downside risk at a time when their capacity to help is limited.

If, however, the recurring disappointments and the deteriorating financial backdrop lead to the judgment that downside risks have risen far enough to warrant a response, they face the hurdles around balance sheet measures that officials have highlighted over the past few months. The scope for another OT is limited by the reduced holdings of less than \$200 billion in securities inside of three years. A replay of a nine-month \$400bn program would require either selling slightly longer maturities in the 3-4 year range that could pressure rates in the consumer-sensitive belly of the curve and would require ramping up reserve-draining operations that also threatens higher repo rates and could confuse the public. At the same time,

buying larger amounts of longer Treasuries could hurt liquidity and would make the eventual normalization of policy much more dependent on asset sales rather than more passive runoffs.

These complications could revive talk of unsterilized asset purchases, including some mix of Treasuries and MBS. But we don't think the reworked outlook will support this more aggressive tack. Chairman Bernanke and others have conceded that previous rounds of QE have increased anxiety about inflation. Even though a majority does not see a strong connection between these asset purchases and inflation, it is true that a larger balance sheet would be a bigger challenge to normalize. Moreover, recent inflation forecasts as well as proxies for inflation expectations have been well within desired ranges (unlike situations ahead of previous QE rounds when the Committee saw a threat of undesirable disinflation).

There are other options using communications rather than the balance sheet that would likely have to entail some innovation that the Committee may not be ready to pursue this week. Along already established lines, the Committee could extend its low-rate commitment well into 2015 but Yellen acknowledged this tool may be losing its punch. We don't see this happening. Creating greater detail around the sorts of conditions that would justify a change in policy might be considered but this is still controversial. We suspect anything on the communications side might be better as a complement to action rather than a full substitute.

Should the Committee fall short on a consensus to act even in a modest way, that would increase chances that the policy statement would include standby language that amounts to a clear easing bias. This could show up in several places, either implicitly in its characterization of a less optimistic outlook or more explicitly in a statement of readiness to provide greater accommodation if increasing global financial strains become a more tangible threat to U.S. growth. Of course, a new set of projection materials (including first-time contributions from Powell and Stein) and the Chairman's press briefing also would weigh more heavily as potential placeholders in the event the Committee surprises us by doing nothing. On this score, if they decide to pause, Chairman Bernanke will likely be pressed to explain why not acting isn't a message that policy is largely spent, something that he has resisted forcefully.

## Tomorrow's Preview

**Housing Starts and Permits:** We look for little change in housing starts as normally leading indicators conflict on direction. Buyer traffic increased in May, reaching the highest reported level in five-years, but construction employment fell by the most in two years. **Note:** Housing starts have been running at frictional minimums for the past few years. This likely made starts less prone to distortions due to weather early this year than other measures of construction activity.

### Housing Starts and Building Permits (Thousands), Jan 12-May 12E

	May E	Apr	Mar	Feb	Jan
Total	720	717	699	718	720
Single-Family	495	492	481	470	511
Multifamily	225	225	218	248	209
Building Permits	740	723	769	707	684

Sources: Department of Commerce and Citi Investment Research and Analysis.

### Upcoming Releases of Economic Indicators

Date	Time	Report	Citi	Median	Low	High	Prior Report	2 Periods Ago
6/19	8:30	Housing Starts (May)	<b>720K</b>	720K	685K	750K	717K	699K
		Permits	<b>740K</b>	730K	690K	770K	723K	769K
6/21	8:30	Initial Jobless Claims (Jun 16)	<b>385K</b>	383K	371K	390K	386K	380K
		Beneficiaries (Jun 9)	<b>3.28M</b>	3.29M	3.27M	3.30M	3.28M	3.31M
	10:00	Existing Home Sales (May)	<b>4.60M</b>	4.57M	4.40M	4.68M	4.62M	4.47M
		Philadelphia Business Survey (Jun)	<b>2.0%</b>	0.0%	-8.0%	5.0%	-5.8%	8.5%
		Leading Indicators (May)	<b>0.2%</b>	0.1%	-0.3%	0.2%	<b>0.0%R</b>	0.3%

Sources: Bloomberg and Citi Investment Research and Analysis.

### Events

- 6/20 12:30 The FOMC will post its interest rate decision and monetary policy statement.  
14:15 Fed Chairman Bernanke to hold a press conference on the monetary policy decision.

Sources: Bloomberg and Citi Investment Research and Analysis.

### Recent EMA Research

#### Publications

06/15/12	U.S. Economics Weekly: Market and Policy Comments: Poised to Act
06/11/12	Morning Comments: Taking the Toll: Policy Uncertainty vs Actual Shocks
06/04/12	U.S. Macro Focus: Regulation and Growth: Insights from Extreme Case of Housing
05/23/12	Global Economic Outlook and Strategy: May 2012
02/13/12	Inside the S&P 500: Labor's Turn to Awaken, Peak Margins but Not EPS

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