

**THE ECONOMY AT A GLANCE**

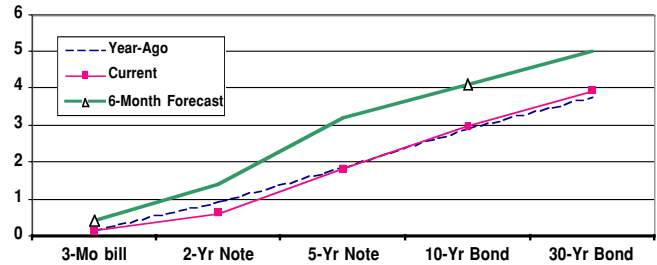
July 26, 2010  
Vol. 77, No. 107

**ECONOMIC HIGHLIGHTS**

**YIELD CURVE SHIFTS RIGHT**

The yield curve has shifted to the right in the past month, as rates across the spectrum have come down in response to weak U.S. economic data, concerns over sovereign debt in Europe and actions the Chinese government has taken to slow growth. Our forecasts call for a complete shift upward in the yield curve over the next six months. We think that rates will rise as the U.S. economy continues to grow. We don't expect the Fed to raise its target rate for overnight federal funds until 1Q11.

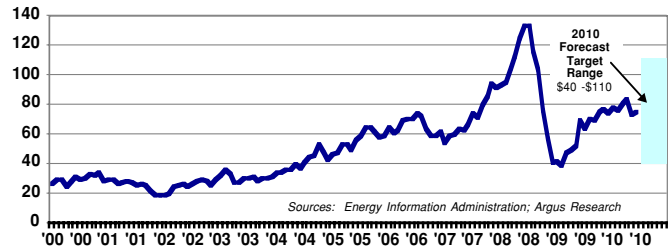
**YIELD CURVE**



**OIL PRICES STABILIZE**

The price per barrel of West Texas Intermediate crude oil peaked at \$84 in April, fell to \$73 in May and ticked higher to \$75 in June. Natural gas prices appear to be in recovery mode. On an energy-equivalent basis, the ratio of the price of oil to the price of natural gas should be 6-to-1. Based on market factors, the ratio is typically 8- or 9-to-1. The current ratio of 16-to-1 is outside the normal band, though not as high as the ratio of 35-to-1 in September 2009.

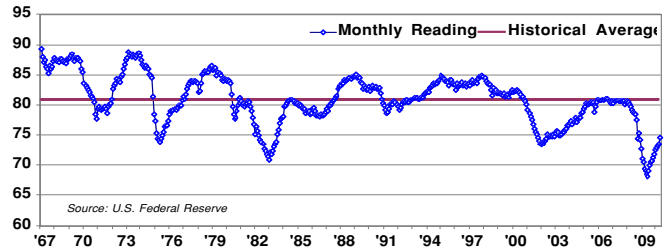
**OIL PRICE TRENDS**  
WTI SPOT PRICE (\$/BARREL)



**CAPACITY UTILIZATION CLIMBING BACK**

Capacity utilization is historically low, but is on the upswing. In the latest report (May 2010 data), the utilization rate was 74.7% — up from 68.2% in June 2009, but still well below the 1972-2008 average of 81%. We note that the slow growth in utilization implies overall economic growth, not a double-dip in GDP — though the current environment, with high unemployment and a weak housing market, feels challenging.

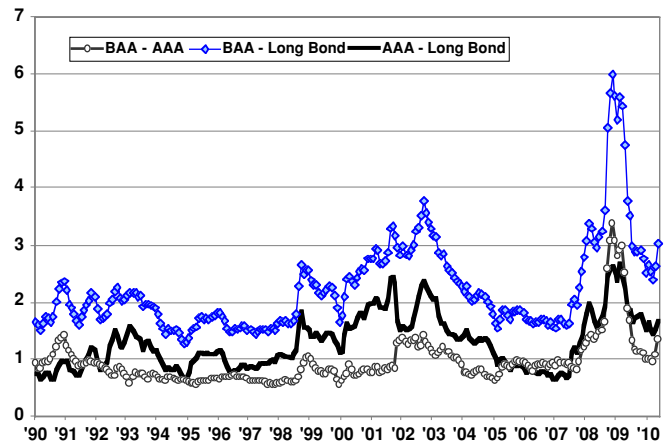
**CAPACITY UTILIZATION (%)**



## CORPORATE BOND SPREADS WIDEN

Corporate bond spreads widened in June, as investors favored the safety & relative security of U.S. Treasury bonds over riskier investments. From an investment standpoint, corporate bonds continue to offer historical value. The current spread between AAA-rated corporate bonds and government bonds is now 168 basis points, well above the 50-year average of 81 basis points. The gap between the government long bond yield and a BAA-rated bond (still investment grade) is now 303 basis points, versus an historical average of 179 bps. The BAA-government gap is at the widest point in a year. We do not think the economy will be enduring a double-dip recession, and think the extra yield available on financially strong corporate bonds is attractive for long-term investors.

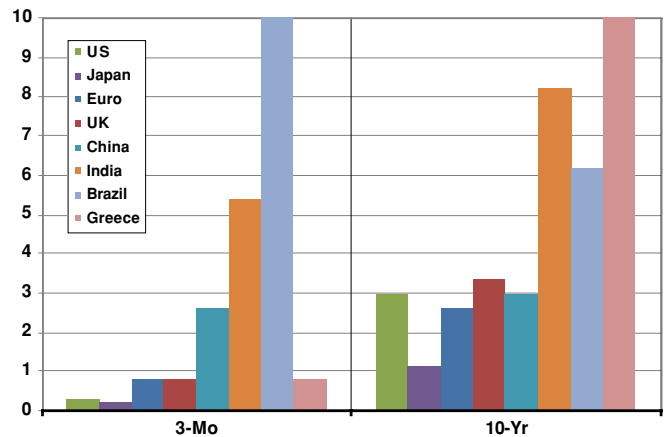
## CORPORATE BOND SPREADS



## GLOBAL BOND INVESTORS SKITTISH

Long-term U.S. government bonds yields have declined over the past month. But is it worth it for bond investors to seek income from other sovereign entities? In China, short-term rates have jumped 50 basis points in the past month as the government has acted to slow growth. The yield curve in China is now almost flat. In Greece, the yield curve is extremely steep – but also poses substantial dangers. In Brazil and India, short-term rates have also risen sharply in the past month, as these nations work to reduce inflationary rates of 5.5% and 11.5%, respectively. We think the most attractive opportunity may soon be short-term Chinese rates, which are almost as high as U.S. long-term rates. We doubt that the Chinese government will keep rates high forever.

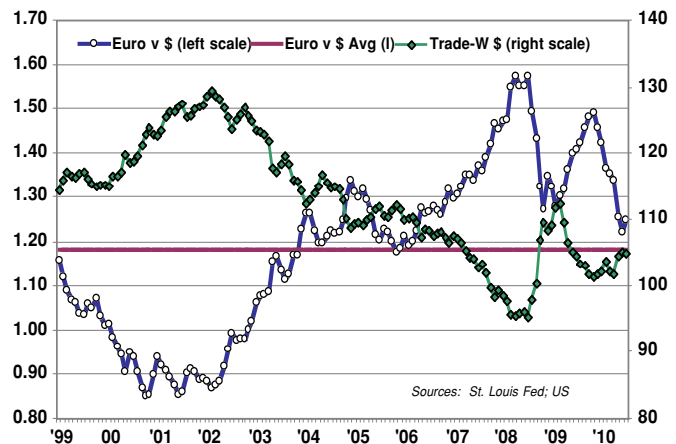
## GLOBAL INTEREST RATES (%)



## EURO RECOVERS WHILE DOLLAR STEADIES

Currency markets have recovered from the Euro crisis, at least for the time being. While Southern Europe remains in recession, Northern export countries stand to gain from the lower Euro. Reflecting an improving outlook for the region, the Euro has rallied almost 6% from its low of 1.19 on June 7. Purchasing power parity is estimated at 1.20. Meanwhile, the U.S. economy appears fairly resilient. Not surprisingly, on a trade-weighted basis, the greenback has climbed 2.8% in 2010, though the dollar rally has stalled a bit in the past three months. We remain concerned over conditions in Europe. We estimate that the Euro will likely trade in a range of 1.15-1.40 per U.S. dollar through year-end as headline, fiscal and economic risks remain high.

## CURRENCY TRENDS

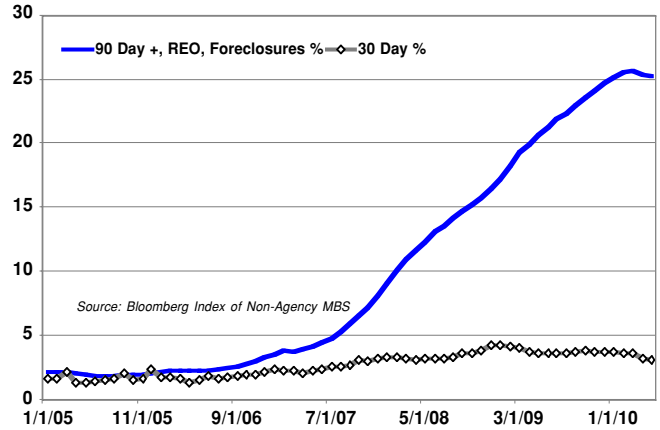


# FINANCIAL MARKET HIGHLIGHTS

## MORTGAGE PICTURE STILL BLURRY

Home prices have stabilized, but the housing market is still very fragile. Unless the labor market begins to turn sharply upward at some point this year, negative equity could become a very big issue. Other factors may begin to weigh: an expanded tax credit for home purchases has expired and federal income tax rates are set to increase at year-end. Moreover, the major banks and GSEs own a tremendous inventory of homes they've yet to put on the market. These players have also delayed foreclosure for hundreds of thousands more through various mortgage modifications that may not stick. New delinquencies (30 days) seem to be starting to fall. However, loans with payments over 90 days late, owned by a bank (REO) or in foreclosure remain a staggering 25% of total loans.

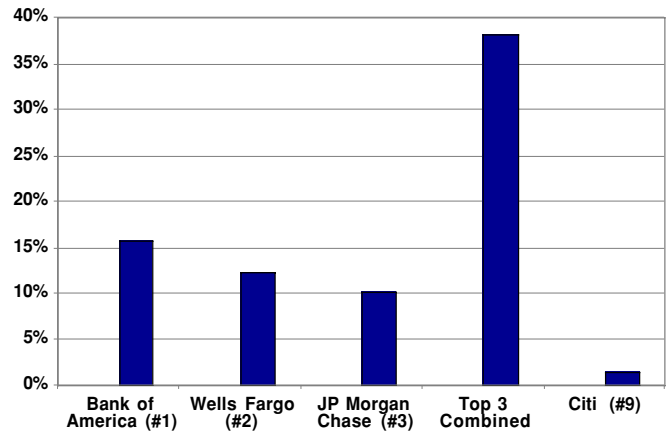
## U.S. MORTGAGE DELINQUENCY



## DEBIT CARD FEE CUTS

If passed as is, the FinReg bill will allow the Federal Reserve to determine interchange fee rates on debit card transactions. Transaction networks such as Visa and MasterCard currently set these rates, but card-issuing banks get the lion's share of such fees. The proposed legislation has hit stocks of credit card lenders as well, under the assumption that mandated fee cuts will eventually hit credit cards. Not surprisingly, the biggest banks have lobbied hard against this amendment but have largely let lobbyists for credit unions and small banks do their fighting for them. While banks under \$10 billion in assets would be exempt from fee cuts, small banks fear they won't be able to compete once the big guys offer much lower rates to merchants.

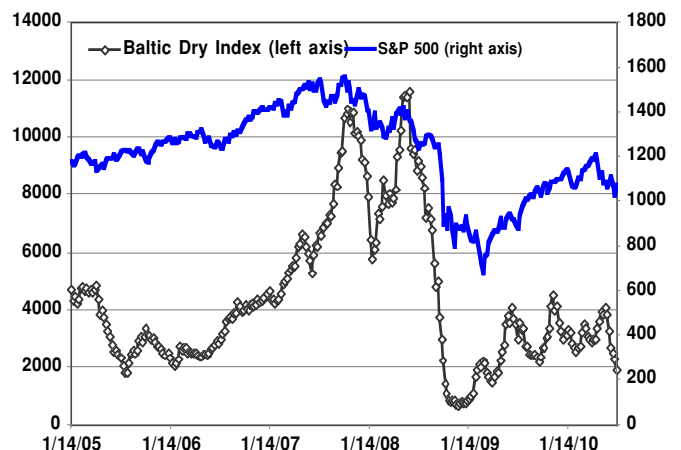
## DEBIT CARD MARKET SHARE



## BALTIC DRY INDEX SINKING FAST

The Baltic Dry Index, once known as the Baltic Freight Index, is an index of shipping rates for cargo vessels. Fans of the index love to point out the index's value as a leading indicator. However, we note that in recent years, the index has been a better leading indicator on the way up than on the way down. For example, both the Baltic Dry Index and the S&P 500 began a steep descent in the spring of 2008 at about the same time. However, the index bottomed the first week of 2009 while the S&P 500 took another few months to hit its own bottom. The recent correction in the S&P 500 has also coincided with a drop in the Baltic Dry Index — but it's too soon to call a bottom since the most recent reading was the lowest since March 2009.

## BALTIC DRY INDEX VS. STOCK PRICES



# ECONOMIC CALENDAR

## Previous Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
Tue. 7/20	Housing Starts	June	593k	550k	577k	N/A
Thur. 7/22	Leading Economic Indicators	June	0.4%	0.2%	100.2%	N/A
	Existing Home Sales	June	5.66M	5.4M	5.4M	N/A

## Next Week's Releases

Date	Release	Month	Previous Report	Argus Estimate	Street Estimate	Actual
Tue. 8/2	ISM Manufacturing Survey	July	56.2	55	N/A	N/A
	Construction Spending	June	-0.2%	0	N/A	N/A
Wed. 8/3	Personal Income	June	0.4%	0.2%	N/A	N/A
	Consumer Spending	June	0.2%	0.1%	N/A	N/A
	Factory Orders	June	-1.4%	0.1%	N/A	N/A
	Total Vehicle Sales	July	11.08M	11.0M	N/A	N/A
Thru. 8/4	ISM Non-Manufacturing Survey	July	53.8	54	N/A	N/A
Fri. 8/5	Nonfarm Payrolls	July	-125k	100k	N/A	N/A
	Unemployment Rate	July	9.5%	9.5%	N/A	N/A
	Manufacturing Payrolls	July	9k	20k	N/A	N/A
	Average hourly Earnings	July	-0.1%	0.0%	N/A	N/A
	Average Weekly Hours	July	34.1 hrs.	34.1 hrs.	N/A	N/A
	Consumer Credit	June	-9.1B	-9.3B	N/A	N/A

\* Preliminary

\*\* Advance

^Final

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