



Weekly economic and market comment 10-16-11

The week ahead: There are a number of minor data releases for the U.S. economy this week including industrial production, producer price index and weekly jobless claims. The three most important U.S. data releases in the coming week are:

- Wednesday, October 19: September CPI released at 8:30am EDT is expected to be up 0.3% and core CPI to be up 0.2%. While this is above the Fed's desired level, inflation pressures are abating with sluggish growth and the recent setback in commodity prices.
- Wednesday, October 19: September housing starts are expected to remain at a sluggish 590k, up a bit from the August level of 5.71 million starts.
- Thursday, October 20: Although it is only a regional index, the Philadelphia Fed Business Outlook is expected to show a further decline at -9.8. This would be a slower decline than the August reading of -17.5. Most other regions of the country are growing, but the Philadelphia index is an important first look at growth momentum.

This past weekend, the G20 finance ministers met in Paris to further plans to deal with the European debt problems. A summit of European leaders will be held on Sunday October 23 to go over the plans in preparation for a full summit of G20 countries in Cannes on November 3-4. The objective is to prevent what I think will be a deeper "haircut" in Greece (as much as \$0.50 on the dollar) from increasing the difficulty that Italy and Spain are having rolling over and issuing their debt. While there are still many details to work out, the basis plan appears to me to be:

- Have the affected banks raise capital privately,
- Have each country supply its own banks with additional capital as necessary,
- Allow the more than 400 billion euro stabilization fund to be used as a backup for capital to the banks,
- Decide whether to allow the stabilization fund to be leveraged by borrowing additional funds from the ECB, and
- Decide whether the IMF will get additional funds from member countries to allow for yet more additional loans to countries which have trouble issuing sovereign debt.

The purpose of all this redundancy is to assure investors that both the European banks and sovereign debt of countries other than Greece are "guaranteed" and thus preserve ratings and lower rates at which they can borrow.

Last week's rise in U.S. treasury rates and the robust rally in stocks suggest that investors are more confident that European and other officials are "on the case" and finally addressing the crisis in a way that will allow it to dissipate. The S&P is already in the upper range (1200-1240) that I cited would contain the current rally. However, the market rallied more forcefully and quickly than I expected. I still think that further upside will be limited and that sometime this fall we will get another correction. Nevertheless, the apparent progress in solving European debt problems and the fact that third quarter growth was likely faster than most forecasters predicted should keep the market from declining much.

Bank earnings will be the highlight of third quarter earnings releases this week and are likely to be negative. However, this is probably built into their stock prices which have declined sharply. This month's stock options expire on Saturday, October 22 (last trading on Friday). Absent an unexpected negative shock, I expect the S&P low before expiration will be above 1170.

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