

Weekly Economic Commentary

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Beige Book: Window on Main Street Winter Weather Weighs on Beige Book

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Highlights

The outlooks provided in the latest Beige Book were nearly all positive.

Our Beige Book Barometer increased to +76 in January 2014 from +59 in December 2013, despite harsh winter weather.

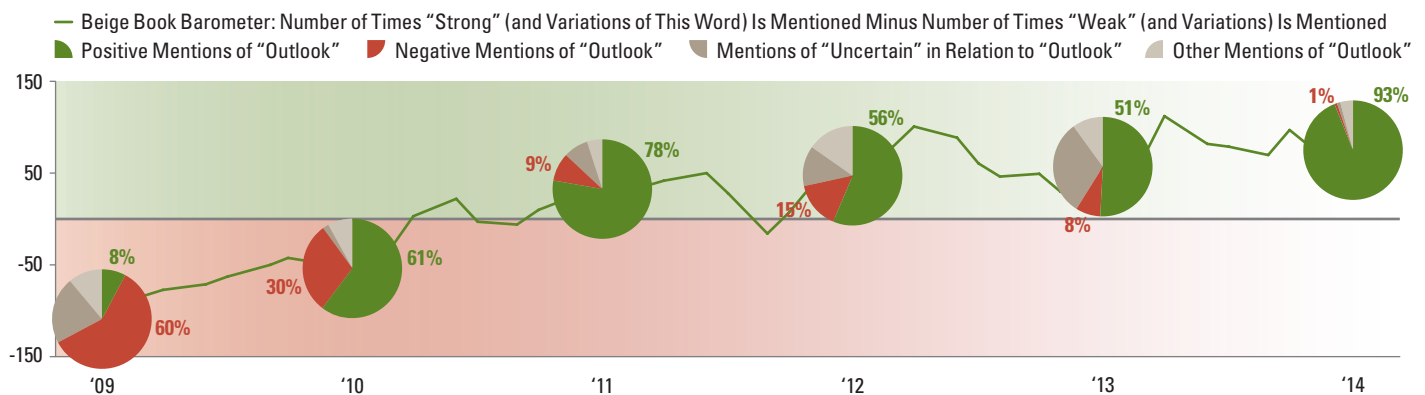
The Affordable Care Act continues to be a key concern for Main Street.

The Beige Book is a qualitative assessment of the U.S. economy that we believe is best interpreted quantitatively by measuring how the descriptors change over time. The latest edition of the Federal Reserve's (Fed's) Beige Book once again described the economy as increasing at a "modest-to-moderate" pace, with stable prices and "small to moderate" increases in wages. The "modest-to-moderate" description of the overall economy has now been used in the last six Beige Books (and in seven of the last eight) dating back to March 2013. The Fed's Beige Book—a qualitative assessment of economic and financial conditions in each of the 12 Federal Reserve districts—was released last Wednesday, January, 15, 2014, ahead of the January 28–29 Federal Open Market Committee (FOMC) meeting.

Shutdown Uncertainty Prominent

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 +76 in January 2014 from +59 in December 2013. At +76, the latest reading on our Beige Book Barometer remains well below its recent peak (+112 in April 2013), but the +76 reading is consistent with the Beige Book Barometer readings seen in the middle of the 2001–2007 economic expansion in the United States.

1 93% of Outlooks Provided in Recent Beige Books Were Positive



Source: Federal Reserve, LPL Financial Research 01/15/14

"Outlook" statistics taken from the last Beige Book of the period beginning date and the first Beige Book of the period ending date, i.e., for the period '08–'09, the Beige Books from December 2008 and January 2009 were used.



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 word **confidence**, often used in a negative context in the Beige Book (e.g., “**lack of confidence**”) appeared **11 times** in the January 2014 Beige Book and **14 times** in the December 2013 edition.

3 Beige Book Word Clouds



Source: The Federal Reserve Beige Book, LPL Financial 01/15/14



Source: The Federal Reserve Beige Book, LPL Financial 12/04/13

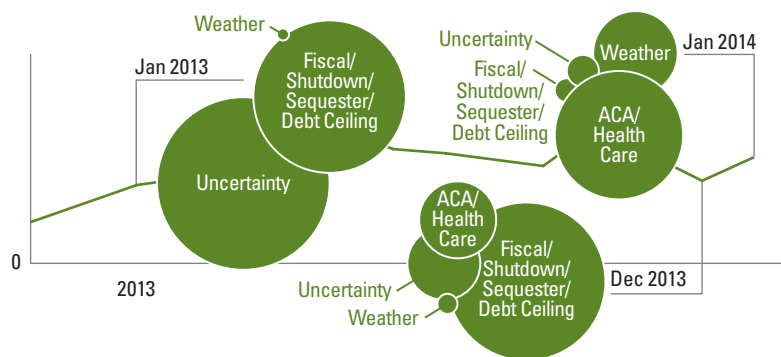


Source: The Federal Reserve Beige Book, LPL Financial 01/16/13

Weather was mentioned 21 times in the latest Beige Book, almost always in a negative context, the most in any winter month Beige Book since at least 2011. This helps to explain the weak December 2013 employment report, released in early January 2014. While colder-than-usual weather weighed on the Beige Book, the lifting of uncertainty due to the government shutdown was a big boost. There were just 13 total mentions of “uncertainty,” “shutdown,” or “fiscal” in the January 2014 Beige Book versus 57 in the December 2013 Beige Book and 45 in the October 2013 edition. The Affordable Care Act (ACA) remains a large concern for businesses, getting 32 mentions in the January 2014 Beige Book, up from 18 in December 2013. We continue to expect this topic to appear frequently in the Beige Book in the quarters ahead [Figure 2].

2 The Implications of the Affordable Care Act Remains a Big Concern for Businesses

- Number of Times “Strong” (and Variations of This Word) Is Mentioned Minus Number of Times “Weak” (and Variations) Is Mentioned
- Trending Words in Various Beige Books



Source: Federal Reserve Board, LPL Financial 01/15/13

In addition, the word confidence—often used in a negative context in the Beige Book (e.g., “**lack of confidence**,” “**lowering of confidence**,” “**reduced confidence**,” etc.)—appeared 11 times in the January 2014 Beige Book versus 14 in December 2013 and just seven times in the October 2013 edition.

On balance, the Beige Book describes an economy that is still growing slowly, with limited wage and price pressures, which suggests that the Fed can continue to remain accommodative. However, the underlying Beige Book tone suggests that if/when the uncertainty surrounding the fiscal issues (and, to a lesser extent, the ACA) lifts, and the weather returns to normal, the economy could accelerate—forcing the Fed to begin thinking about removing some of the accommodation.

It’s All About the Outlook

We often write about how the Beige Book provides powerful insights into how the economy is operating “right now,” but the participants (business owners and bankers on Main Street) are also asked to provide outlooks on



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 January 28–29, 2014.

The previous word clouds or text clouds, which are a visual format useful for quickly perceiving the most important words in a speech, text, report, or other transcript, are culled from the Fed’s Beige Books published last week (January 15, 2014), the prior report (December 4, 2013), and in January 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.).

their slices of the economy. Although outlooks are found in all eight of the Beige Books throughout the year, they appear most often in the final Beige Book of the year (usually November or December) and in the first Beige Book of the next year, which is almost always released in January.

We went back to late 2008/early 2009 and counted up the number of mentions of “outlook” in the Beige Books around the turn of the year [Figure 1]. For example, in 2008–2009 we looked at the Beige Books released in December 2008 and January 2009. The word outlook was used a combined 37 times in those two Beige Books. Twenty-two of the 37 mentions were in a negative context, and another eight mentions were accompanied by the word uncertain. Overall, just 8% (three of 37) mentions of outlook in the Beige Books released in late 2008 and early 2009 were in a positive context. The next year (2009–2010), outlook was used 61 times, and 60% were in a positive context. A year ago, the fiscal cliff and the aftermath of the 2012 presidential election weighed on the outlook, and just 51% of the outlooks were positive. A stunning 31% were uncertain.

In the last two Beige Books (December 2013 and January 2014), the word outlook was mentioned 68 times, and 63 of the mentions (93%) were in a positive context, far above the 2012–2013 reading of 50%. Not only were nearly all of the mentions in the last two Beige Books positive, nearly every key aspect of the economy was cited: business capital spending, consumer spending, commercial construction, residential real estate, transportation services, banking, and loan growth.

This analysis of the tone of the outlooks provided in the Beige Book supports our view that the U.S. economy is likely to accelerate in 2014 over the pace of growth in 2013. Looking ahead to the rest of 2014, the FOMC will need to weigh these outlooks against the potential headwinds like weather, the ACA, etc., and adjust the pace of tapering as warranted. In addition, the FOMC will need to keep a close eye on mentions of wages and wage inflation in the upcoming Beige Books. We’ll take a closer look at how wages and prices are described in the Beige Book in an upcoming edition of the *Weekly Economic Commentary*. ■



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. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. 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 and there can be no guarantee that strategies promoted will be successful.

Stock investing involves risk including loss of principal.

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

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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