

# MARKET BRIEF

July 12, 2010

## Fed's Worry List May be Getting Longer

### Timely Topics

A fading recovery, persistently high unemployment, Europe's debt troubles and commercial real estate losses have garnered most of the attention. But some Fed officials have begun talking more about another trouble zone -- recession-hit U.S. state and local government finances.

The problem is that they have to balance their budgets, unlike the federal government, which is running a deficit equal to more than 10 percent of total economic output.

"They have no choice but to cut spending or raise taxes -- or they get some more help from Washington," said Harm Bandholz, an economist with Unicredit in New York.

He thinks state and local government finances represent the most important domestic risk factor in the U.S. economy. Yet they received only two brief mentions in 19 pages of minutes from the Fed's April policy-setting meeting.

### Economic Update

**Last Week:** Stocks drifted throughout the session Friday as an absence of news, and light volume provided little direction for stocks. After spending most of the session in a tight range, the major averages were able to break out to the upside in the final hour of trading, and close higher by between 0.6% and 1.0%. The major market indices closed the holiday-shortened week with their best weekly gains of 2010.

**What's Ahead:** The first of two important Treasury auctions will be held Tuesday when 10-year Notes will be sold. That sale will be followed by a 30-year Bond auction Wednesday. These sales can influence market trading in bonds and possibly affect mortgage rates.

June's Retail Sales report will be posted early Wednesday morning. This data is considered to be of high importance because it measures consumer spending. A larger than expected decline in sales could help fuel a bond rally and lead to lower mortgage rates because it would mean that the economy is likely not as strong as thought.

Wednesday is also the release of the minutes from the last FOMC meeting. There is a possibility of the markets reacting to them following their 2:00 PM ET release, especially if they show some divisiveness by its members during discussion and voting at the last meeting or give any indication of the Fed's possible next move with monetary policy.

There are two relevant reports scheduled for Thursday. The first is June's Producer Price Index (PPI). The bond market should react quite favorably if we get weaker than expected readings, but a larger than expected rise in the core reading could send mortgage rates higher Thursday. June's Industrial Production data is the second report of the day.

Consumer Price Index (CPI) will be released Friday during early morning trading. Analysts have forecasted no change in the overall index and a 0.1% rise in the core data. The core data is considered to be the key reading because it gives us a more stable measure of inflation. Higher than expected readings could raise inflation fears and push mortgage rates higher Friday, while readings that fall short of forecasts could lead to lower rates Friday.

The second report Friday morning and the final of the week is the University of Michigan's Index of Consumer Sentiment. This index is released in a preliminary form each month and then followed up two weeks later with a final reading. The preliminary reading for July will be posted late Friday morning and is expected to fall from June's final reading of 76.0. This would indicate that consumers were less comfortable with their own financial situations this month than last month.

### Important Markets

DOW Jones Industrial	
Start of week	9686.48
End of week	10198.03
Change	511.55
NASDAQ	
Start of week	2091.79
End of week	2196.45
Change	104.66
30-Year Bond	
Last week	3.94
This week	4.03
1 Yr T-Bill	0.280%
Prime Rate	3.250%
11 <sup>th</sup> Dist COF	1.791%
6 Mo. LIBOR	0.733%



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