Understanding The "Official"

1 7 Key Economic Indicators

and

How They Move the U.S. Stock Market

21st Century Investor Publishing, Inc.

FOREWORD

As an investor, one of the biggest breakthroughs you can make to dramatically improve your investing results is to master a full and complete understanding of the "official" economic numbers that pour out of Washington each month.

I'm talking specifically about the 17 economic indicators that every eye on Wall Street zeros in on like a laser beam when they're announced each month. For most investors, these economic indicators are a complete mystery - that's why so many people lose money when they invest. They're literally in the dark.

These 17 economic indicators are at the very center of the Federal Reserve's interest rate policy. These key indicators drive the stock and bond markets up and down depending on how good or bad they are. If you're investing, but aren't at the very least familiar with these key economic indicators, you're making a huge mistake.

This very powerful book takes complex and powerful market forces and breaks them down, so that they're simple and very easy to comprehend.

You may not be interested in becoming an "economics expert," and frankly, you don't have to in order to understand these 17 key economic indicators. This book clearly lists and explains each indicator, and how they impact the movements of the markets.

It's an easy read, and it shouldn't take you more than an hour or two to polish it off, but the knowledge you'll gain about the forces that drive the financial markets will help you dramatically improve your investing results. You may be surprised at how quickly and completely you've come to understand these indicators after reading this book - it's written in plain English without all the stuffy academic nonsense you've come to expect from most investing guides.

This book will empower you with the kind of market knowledge that would take an incredible amount of intense study to master. All the bloated, pedantic mumbo-jumbo that can put you into a mind-numbing trance has been bypassed in order to offer you precise information you can *really use.*

Every investor should read this book. Look, knowledge is power. Literally every econotriic decision the Federal Reserve and the U.S. Treasury make with regard to interest rates and fiscal policy is tied to these economic indicators. Why would anyone invest in a stock, bond, or even a Treasury bill not knowing and completely understanding the very numbers that are driving their investments up or down?

I'm delighted that you've made the intelligent decision to read and learn from this book. You're well on your way to smarter investing.

James DiGeorgia
Publisher
2]st Century Investor

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Understanding "Official" Economic Indicators and How They Move the U.S. Stock Market

17 Key Economic Indicators and How to Read Them Correctly For Huge Profits

One of the major reasons you will see large swings on market opens is because a major economic report has been released. Below is a list of the major reports with a brief explanation of each, and the reasons for the market's response.

Keep in mind that, historically, there has always been a tradeoff between inflation and unemployment which, when depicted graphically, is called the Phillips Curve (after Professor A.W. Phillips). The tradeoff is this: As unemployment drops, inflation tends to increase and vice versa. Because this tradeoff is so pronounced, market participants are usually trying to figure out what is happening with the two most important variables: inflation and unemployment. All of the indicators are trying to predict one or the other.

Once you understand this relationship, interpreting the economic indicators becomes relatively easy. If inflation is present, this bad for stocks and bonds. Why? For stocks, inflation reduces consumer's spending power, which means they will purchase fewer goods, which directly hurts corporate profits. For bonds, as inflation rises, investors will demand a premium on top of the current yield (known as an inflation premium), which further raises the yields on bonds and lowers their price. Another interpretation, for those with an understanding of finance, is that the value of any asset is the present value of the expected cash flows. As inflation rises, investors will command an inflation premium, which reduces the present value (the price) of the asset.

However, if the economy is expanding *without* the fear of inflation, then stocks rise, but bonds still fall. Stocks like a healthy economy, as consumers tend to spend more, thereby boosting corporate profits. As firms grow, they tend to bid up their borrowing costs - the interest rates - to further leverage and increase profits. This tendency for interest rates to rise in a healthy economy reduces the value of bonds. Remember, bond prices move inversely to interest rates.

Understanding what is happening in the economy can help investors make predictions as to what will happen with the markets. Please understand that all economic indicators are statistical samples! This means they are estimates, and subject to (sometimes large) revisions.

As you read through the various indicators presented, try to identify how an increase or decrease will impact inflation (or unemployment), and you will become much better at understanding why the markets respond to these reports the way they do. There are also some helpful related links at the bottom of this report.

Economic Calendar

The following is a calendar with approximate release dates as reported by the agencies collecting the data. They are posted in roughly the same order as you will usually see them appear in the markets, although there is some overlap on most dates. Because of the overlap, it is not necessary for them to be announced in the exact order.

Economic Report	**Approximate Release Date**
Car Sales	13th, 23rd of same month
Purchasing Managers Index	1st business day of following month
Employment	1st - 7th of following month
Producer Price Index (PPI)	9th - 16th of following month
Retail Sales	11th - 14th of following month
Industrial Production/Capacity Utilization	14th - 17th of following month
Housing Start	16th - 20th of following month
Consumer Price Index (CPI)	15th - 21st of following month
Durable Goods Orders	22nd - 28th of following m
GNP	21st - 30th of following m
Personal Income/Consumer Spending	22nd - 31st of
Index of Leading Indicators (I]LEI)	Last business day of following month
New Home Sales	28th - 4th for previous two months
Merchandise Trade Deficit	15th - 17th for previous two months
Construction Spending	1st business day for previous two months
Factory Orders	30th - 6th for two months prior
Business Inventories/Sales	13th - 17th for previous two months

Car Sales

Importance (3 out of 5)

Published by: Automobile Manufacturers

Reported: Three business days after end of period
Frequency: Monthly

Car sales are a leading indicator, meaning that the indicator falls before the economy is heading into a recession and rises before the economy recovers. The reason is fairly simple: Cars are a highticket item, so people will spend money on new cars when they think their financial prospects in the near future are good. Conversely, if consumers think we may be heading into a recession and fear company slowdowns or layoffs, they will not purchase cars.

Car sales are the timeliest of all the economic indicators in that they are released during the same month they are measuring. In fact, they are released nearly three times per month. For example, the total number of cars sold for the first 10 days of the month is released on the 13th of the month. The total sales for days 10 through 20 are released around the 23rd, and total sales for the month are released during the first part of the following month. No other indicator is released during the same month it measures!

While not the most important of the economic indicators, car sales are closely watched to gain insights into two other important indicators of consumer demand: *retail sales and personal consumption.* Car sales data can be fairly volatile partly due to factory incentives and short-term interest rate movements, so they are not perfect indicators by any means.

	Market Reaction	
	If car sales are up:	**If car sales are down:**
Stocks	**Up**	**Down**
Bonds	**Down**	**Up**
Dollar	**Up**	**Down**

Reasons

Stocks react favorably to a strong car sales report. If the economy is perceived to be strong and people are buying cars, corporate profits should rise as well. However, if the report is *too* strong, it may give an indication that interest rates could rise, which could actually cause stock prices to fall.

Bonds react in the opposite direction. If car sales are strong, firms are likely to bid up their borrowing costs and the Fed may have incentive to tighten money supply, both of which increase interest rates and cause bond prices to fall. If the report is very strong and causes stocks to fall, bonds will still fall because the anticipated inflation by consumers will command a higher inflation premium for bonds. This causes the nominal yields to rise and bond prices to fall. Bonds do not like strong car sales!

The dollar will usually rise in the presence of a strong report. When the economy is doing well, other nations will want to purchase goods and services and bid up the price of the dollar to do so.

Purchasing Managers Index

Importance (2 out of 5)

Published by: Natl. Association of Purchasing Management (NAPM)

Reported: First business day of the month
Frequency: Monthly

The Purchasing Managers Index is compiled by surveying purchasing managers and executives in over 250 industrial companies representing 21 industries in all 50 states. The managers respond to six questions, including their orders, costs, production and inventories; and they designate whether they have increased, decreased or remain unchanged.

The index is weighted and calculated by taking 1/2 the percentage of those saying conditions are *unchanged* and adding it to the percentage of those saying they have increased.

For instance, if 80% say that conditions are unchanged and 20% report an increase, take 1/2 of 80% = 40%, and add 20% to get a value of 60. If 80% say unchanged and 0% say increased, then 1/2 of 80% = 40%, and add 0% to get an index of 40. If 70% say unchanged, 10% say increased and 20% say decreased, then 1/2 of 70% = 35%, and add 10% to get a reading of 45.

Therefore, readings above 50 are viewed as an overall increase, and readings below 50 are read as a decrease. Generally, the market is not too worried until readings approach either 60 or 40. A reading of 60 would indicate inflationary pressures, while a reading of 40 would indicate a recession.
Despite the logical appeal of the index, it does not carry much weight in the markets, as it is difficult to forecast and can be rather volatile. However, from time to time, surprise readings do occur and they can certainly shake up the markets!

	Market Reaction	
	If NAPM is up:	**If NAPM is down:**
Stocks	**UP**	**Down**
Bonds	**Down**	**UP**
Dollar	**UP**	**Dow**

Reasons

Stocks generally move up in the presence of a favorable report, which suggests an expanding, healthy economy. As long as the report is not too strong to suggest inflation, stocks will usually advance.
Bonds will usually fall if the report is favorable, as this suggests possible increases in interest rates, which causes bond prices to fall.
The dollar will usually rise owing to the growth of the economy, in which other nations will want to take part. In order to do so, they must purchase dollars, which puts upward pressure on the dollar relative to other currencies.

Employment

Importance (5 out of 5):

Published by: Bureau of Labor Statistics of the U.S. Dept. of Labor

Reported: First week of the month
Frequency: Monthly

The employment report is the single most important piece of economic information because of its timeliness, accuracy and its importance as an indicator of economic activity. While the GNP (Gross National Product) report is more valuable, it is only released quarterly.

This report is so valuable because it gives investors the first full look at the economic activity for a given month. It also provides a wealth of information that can be used to fairly accurately predict almost every other measure, including GNR

The employment report has two main subparts: the *unemployment rate* and the *payroll employment.*

The unemployment rate is important, but the markets do not respond much to it (unless it is well beyond expectations) because it is a *lagging* indicator. This means that it increases after the economy has peaked, and begins to fall after the economy has begun to recover.

The payroll report, on the other hand, is a *coincident* indicator, meaning that it rises at the same time the economy rises, and falls at the same time an expansionary period has ended. It provides information on a wide range of industries and regions.

Payroll employment is a measure of the number of jobs in more than five hundred industries except for farrning, and in all 50 states. Farming is usually excluded because of the large subsidies they receive regardless of market conditions.

		Market Reaction		
	If payroll employment is up:	**If payroll employment is down:**	**If unemployment is up:**	**If unemployment is down:**
Stocks	**Up**	**Down**	**Down**	**Up**
Bonds	**Down**	**Up**	**Up**	**Down**
Dollar	**Up**	**Down**	**Down**	**Up**

Reasons

Stocks favor a strong employment report as that shows a strengthening economy and favorable outlooks for firms. However, if unemployment is up, this shows a sign of a slowing economy, and stocks will fall.
Bonds will generally fall if payroll employment is stronger than expected. This is because a strengthening economy will likely lead to higher interest rates - and lower bond prices. However, if unemployment is up, this indicates a possible recession, lower interest rates, and higher bond prices.
The dollar will follow the stock market for essentially the same reasons. If the economy is expanding, other nations will bid up the price of dollars to buy U.S. goods and services. But if the unemployment figures are up, this leads to lower interest rates and lower dollar prices.

Producer Price Index

Importance (5 out of 5):

Published by: Bureau of Labor Statistics of the U.S. Dept. of Labor

Reported: 9th - 16th of the month
Frequency: Monthly

The Producer Price Index measures the average change over time in selling prices received by producers of goods and services in the U.S. PPI measures price change from the perspective of the seller. This is in contrast with other measures, such as the Consumer Price Index (CPI), that measure price change from the purchaser's perspective. Sellers' and purchasers' prices may differ due to government subsidies, sales and excise taxes, and distribution costs. This means the PPI may go in one direction, while the CPI may go in the opposite direction.

The PPI is most noteworthy because it is the first look at inflation for the month. Many economists filter out the highly volatile food and energy sectors, which are called the *core* rate.

	Market Reaction	
	If PPI is up:	**If PPI is down:**
Stocks	**Down**	**UP**
Bonds	**Down**	**UP**
Dollar	**Uncertain**	**Uncertain**

Reasons

Stocks and bonds do not like inflation. For stocks, this is because inflation causes the purchasing power of consumers to decrease, which means they purchase fewer goods, which leads to decreased profits. An alternative view is that the value of any stock is the present value of all expected future cash flows, and higher interest rates decrease the present value of stocks. For bonds, consumers will demand an inflation premium, which decreases bond prices.

The response on the dollar is tougher to predict. If interest rates are perceived to be rising (without the threat of inflation), then it is possible for the dollar to strengthen relative to other currencies. This is because other foreign investors will sell their currencies and purchase dollars to invest in the higher interest rates. These actions cause the foreign currency to fall and the U.S. dollar to rise. However, if inflation is imminent, then the purchasing power of the dollar is reduced and its value falls.

Retail Sales

Importance (5 out of 5)

Published by: Bureau of the Census of the U.S. Dept. of Commerce

Reported: **11**th - 14th of the month
Frequency: Monthly

Retail sales provide information on consumer spending for a given month. Consumer spending accounts for about half of GNP, so you can see why this indicator is closely watched. The most valuable part of the report is *retail sales excluding autos,* because that is what the Commerce Department uses to estimate consumer spending excluding autos and services. If you see a market reaction that appears counterintuitive to the numbers released, check the *retail sales excluding autos* report, and you will most likely find the answer there!
One of the biggest drawbacks to the report is that it tabulates spending on goods only - no services! Thus, it can be particularly tough to estimate the true spending patterns for the U.S., since the economy is largely service-oriented.
Another drawback to the report is that the data are extremely volatile and subject to large revisions. For this reason, the market is often cautious of the first release of this report. However, if the report is significantly away from expectations, this report can be a market mover!
The report is also broken down into *durable goods* (generally defined as goods having a life of three years or more) and *nondurable goods* (having a life less than three years). Durable goods account for roughly 35% of retail sales and the remaining 65% are nondurable goods.
Automobiles account for about 60% of the durable goods portions and the remaining 40% is attributed to goods such as home furnishings, home appliances and building materials.
Nondurable goods are accounted for through retail stores such as clothing, gas, grocery, and restaurants.

	Market Reaction	
	If retail sales are up:	**If retail sales are down:**
Stocks	**Up**	**Down**
Bonds	**Down**	**UP**
Dollar	**Uncertain**	**Uncertain**

Reasons

Stocks generally like a healthy retail sales report. This shows a growing, confident economy which will likely lead to higher sales for other equities. However, as with most indicators, if the report is too strong and showing signs of inflation, the markets can certainly fall. Keep in mind that if the market falls for this reason, you will still likely see specific retailers such as Ford, Wal-Mart and Best Buy trading higher.
Bonds do not like strong retail sales reports. If the economy is expanding and confident, this will likely lead to higher interest rates, which decrease bond prices. Even if the report is too strong and shows signs of inflation, bonds will still fall, as investors will demand an inflation premium on their bonds, raising the yields, and lowering their price.
The dollar is not very responsive to this report. An exception is if there is concern about an increased trade imbalance. If retail sales are strong, this can suggest higher imports, which means U.S. retailers may be selling dollars and buying foreign currency to purchase the imports, which causes the value of the dollar to fall.

Industrial Production & Capacity Utilization

Importance (5 out of 5)
Published by: Board of Governors of the Federal Reserve System
Reported: 14th - 17th of the month
Frequency: Monthly

This report is important in that it provides insights into the manufacturing sector of the economy, which is very responsive to changes in the business cycle. One of the biggest advantages of this report is that it measures the actual *quantity* of output and not the *total dollars* as other measures provide, so the data are not affected by inflation. Because all of the economic indicators are trying to predict GNP, which is a measure of actual changes in output, this report is intuitively appealing.

The report attempts to give a realistic maximum level of output under normal working conditions while allowing for downtime.

The output numbers are expressed as an index, which means it is relative to a base year. As most economic indices follow, that base year is 1987, which is given a value of 100. For example, if a current report has a level of I 10, then capacity has increased by 10% since 1987. If the following month's report was up 10.3%, the industrial production would be reported as an increase of 1 10.3-1 10/100 = 0.3%.

	Market Reaction	
	If industrial production is up:	**If industrial production is up:**
Stocks	Up	**Down**
Bonds	**Down**	**UP**
Dollar	**Uncertain**	**Uncertain**

Reasons

Stocks will generally rally on a positive report, as long as the report is not so strong that inflation is feared. A faster-paced economy sends signals to the markets that the outlook is good for stocks!

Bonds will usually fall on a positive report because it implies possible rate hikes, which cause their prices to fall.

The dollar is usually not too responsive to the report. However, at times, the markets see increased production as a sign of upcoming rate hikes, which can be a short-term boost for the dollar. This is because foreign investors will want to purchase dollars to take advantage of the higher yields.

Housing Starts/Building Permits

Importance (5 out of 5)

Published by: Bureau of the Census of the U.S. Dept. of Commerce

Reported: 16th - 20th of the month
Frequency: Monthly

Housing starts are an important leading indicator. Leading indicators are the first to turn up after a recession and the first to fall prior to a peak. For this reason, housing starts are watched very closely!

As with car sales, most people are not going to buy a house (or plan to build one by getting a building permit) if they feel the outlook for the economy is bad. If things slow down, incomes may fall or layoffs may occur. Once people sense this, the housing starts will fall.

Building permits are released at the same time as housing starts. This is a useful indicator because it provides insights into the upcoming month's housing starts. It is not uncommon to see the actual housing starts are somewhat higher than the building permits would suggest; this is because some areas do not require permits.

	Market Reaction	
	If housing starts are up:	**If housing starts are down:**
Stocks	**Up**	**Down**
Bonds	**Down**	**UP**
Dollar	**Uncertain**	**Uncertain**

Reasons

Stocks generally react favorably to a positive report. This is because the stock market sees that people are confident in the near future of the economy. As with most indicators though, if the economy is concerned with rising interest rates and the report suggests that a rate hike is near, stocks may sell off on the news.

Bonds will usually react in the opposite direction of the report. If the report is stronger than expected, bonds will usually sell off because it suggests that interest rate increases may be coming. If the report is lower than expected, this usually leads to a decrease in rates and an increase in bond prices.

The dollar is usually not affected by housing starts. However, if rate hikes are a concern and a stronger than expected report is released, the dollar may increase as foreign investors compete for the higher yields. The opposite is also true if rate cuts are imminent and a lower than expected report is released.

Consumer Price Index

Importance (4 out of 5)

Published by: Bureau of Labor Statistics of the U.S. Dept. of Labor

Reported: 15th - 21st of the month
Frequency: Monthly

The Consumer Price Index measures the percentage change for a "basket of goods" to determine inflation rates. Every 10 years, the Bureau of Labor Statistics conducts consumer surveys to identify current spending patterns for 364 different consumer goods.

The CPI is expressed as an index and compared to a base period between 1982 and 1984. If, for example, the current CPI is 120 for the year, then prices have risen, on average, by 20% since the base period. If the CPI is 122 the following year, then prices have risen (122-120)/100 = 2% for the year. The same math can be used for monthly data.

As with the Producer Price Index (PPI), analysts are generally more concerned with the "core" rate or the CPI excluding the volatile food and energy sections.

One of the biggest drawbacks to the CPI is that it does not account for changes in quality - it only considers price changes. For example, say a new model car sells for $20,000 one year and comes with a 4-cylinder engine, AM radio, and no air bags. The following year, the same model has a turbo-charged V-6 engine, high-end audio CD player and side air bags, and sells for $21,000. Most people would agree the price of the car has come down -

CPI will measure that as a price increase because the sticker price rose from $20,000 to $21,000.

	Market Reaction	
	if CPI is up:	**if CPI is down:**
Stocks	**Down**	**UP**
Bonds	**Down**	**UP**
Dollar	**Uncertain**	**Uncertain**

Reasons

Stocks and bonds will usually sell off on a higher than expected CPI report. This is because the CPI is trying to measure inflation, and if prices are rising faster than expected, consumers' purchasing power is diminished, so they buy fewer goods. This causes firms' revenues to fall, which is reflected in their stock price. Bonds will fall because investors will command an inflation premium over the current yields and push rates higher, which causes bond prices to fall. The dollar's reaction is uncertain. Usually, the perceived higher inflation will be viewed negatively and cause the dollar to fall. This is because the dollar's purchasing power is diminished, so its value should be less. However, if investors see a short-term rate hike, they may bid up the price of the dollar to take advantage of the higher yields.

Durable Goods Orders

Importance (2 out of 5)

Published by: Bureau of the Census of the U.S. Dept. of Commerce

Reported: 22nd - 28th of the month
Frequency: Monthly

The Durable Goods report is important because it gives analysts a look into the first step of the manufacturing process. If manufacturers are confident about the economy and/or receiving increased orders, they will increase production to **fill** the demand.

Despite the appeal, this report does not carry much weight with the market, because they are extremely volatile and are known for having numerous and sizeable revisions. Part of the reason they are volatile is they contain commercial aircraft as well as defense orders. The sale of just one aircraft can make a sizeable impact on the percentage change in durable goods orders. Because of this, many economists exclude the transportation and defense orders, and then use some type of moving average to smooth out the data.

	Market Reaction	
	If durable goods are up:	**If durable goods are down:**
Stocks	**Up**	**Down**
Bonds	**Down**	**UP**
Dollar	**Uncertain**	**Uncertain**

Reasons

Stocks will usually react favorably to a healthy report. If manufacturers are stepping up production, then it is sensible that sales should be increasing. As usual, however, if the market views the report as too strong, stocks will sell off due to the expected inflationary pressures.

Bonds will usually react negatively to a positive report. If orders are increasing, then overall activity in the market appears to be increasing; and this means that interest rates will likely be bid higher. The higher yields will cause bond prices to fall.

The dollar usually does not react to this report. Technically, an expanding economy should be good for the dollar, unless inflation is imminent; however, the currency markets seem to disregard this report.

Gross National Product

Importance (5 out of 5)
Published by: Bureau of Economic Analysis (BEA), U.S. Dept. of Commerce

Reported: 21st - 30th of the month

Frequency: Quarterly (revised monthly)

GNP/GDP (Gross Domestic Product) is the single most important indicator of economic growth. However, GNP/GDP is only published quarterly, so many other indicators have been created, all of which try to predict the direction of GNP/GDP.

What Is GNP?

GNP is the "Gross National Product" which is the total value of all final goods and services produced by a nation *regardless of where the assets are located.* Under GNP, a U.S. oil-drilling firm located in Russia would be counted since they are a U.S. firm. GDP, on the other hand, is "Gross Domestic Product" which is the total value of all final goods and services produced *within the boundaries* of a nation, regardless of whether they are a U.S. fin-n or not. With GDP, a Nissan car plant in the U.S. would be counted even though it is not a U.S. firm. GNP determines the value added of all goods and services by a nation; GDP determines that same value for all firms within the nation. Note that GNP is the total value of *final* goods and services. This means products produced to be used on another product for sale will not be counted. For example, a computer chip company may produce chips to be sold to computer manufacturers. These chips will not be counted since they will be counted when the computer is sold.
Interestingly, the U.S. and Italy also adjust their GNP figures for the black market - the transactions that take place "off the books." The estimates vary, but range from about 5% to as high as 30% for U.S. and Germany, while Britain's is about half as large, ranging from 2% to 15%. Italy has the largest black market with estimates topping the 33% mark; Japan and Switzerland are the lowest at around 4%.
For many years, the U.S. focused on GNP. However, most other countries use GDP, so over the past few years, the U.S. has begun to focus more on GDP to make fair comparisons between countries. There is usually very little difference between GNP and GDP for the U.S.; however, the differences are often substantial for other countries. For example, in 1995, Kuwait's GNP was 15% larger than it's GDP. This was simply due to the value of its vast oil exports.
There is also another measure you may hear of called *Net National Product* (NNP), which measures GNP less depreciation of assets. This is probably the best measure of economic activity, at least in a theoretical sense. However, from a practical sense, depreciation would be very difficult to measure, so most economists find GNP/GDP to be the most useful.
The GNP report has three separate reports for each quarter: the *advance, the preliminary,* and the *revised.* These reports are not issued until the following quarter so, for example, the first quarter's report would not be issued until April. This would be the advance report. Then in May, the preliminary report would be issued and finally, in June, the revised report would follow. In addition to the three reports each quarter, the BEA publishes "benchmark revisions" in July, and recalculates all numbers going back three years.

	Market Reaction	
	If GNP is up:	**If GNP is down:**
Stocks	**UP**	**Down**
Bonds	**Down**	**Up**
Dollar	**Up**	**Down**

Reasons

Stocks generally like a strong GNP/GDP report - as long as it is not too strong to show signs of inflation. A strong report shows the economy is growing, which generally means increased profits for firms.

Bonds usually move inversely to this report. If GNP/GDP is strong, this means that corporations are doing well and looking to expand their output. Thus, firms are willing to bid up their borrowing costs. If interest rates rise, bonds will fall. The bond markets typically favor negative economic reports. If the economy is sluggish, that usually means that interest rates will fall and bond prices will rise.

The dollar generally favors a healthy GNP/GDP report. This is because a growing economy means that other nations will be demanding U.S. goods and services, which means they must buy dollars, thereby boosting their value. Of course, if the report is viewed as being *too strong* and showing signs of imminent inflation, the dollar will fall.

Personal Income & Consumption_Expenditures

Importance (4 out of 5)

Published by: Bureau of Economic Analysis (BEA),
U.S. Dept. of Commerce

Reported: 22nd - 3 1st of the month

Frequency: Monthly

The Personal Income and Consumption Expenditures report measures the total compensation received by all individuals, which includes wages, salaries, rental income, interest payments, social security and unemployment compensation. The consumption report is very important, because consumer expenditures represent over half of GNP! Because this is such a large percentage of GNP, if we have a good idea of what people are earning and how they're spending it, we can get a good idea of what's happening to GNP.

The income estimates are derived from a number of governmental agencies such as Social Security, Treasury Department and the Federal Reserve Board. The consumption data are also gathered by a number of agencies such as the Census Bureau and the Commerce Department.

	Market Reaction	
	IFPCE is up:	**IFPCE is down:**
Stocks	**UP**	**Down**
Bonds	**Down**	**Up**
Dollar	**up**	**Down**

Reasons

Stocks like a healthy economy, and a favorable PCE report can bolster the stock market. As with the other indicators, however, if the report is too strong, it may send signals of upcoming rate hikes and send the market downward.

Bonds, as always, fear rate hikes under a strong economy. As the economy grows, there is more and more fear of rate hikes by the Federal Reserve, so bonds will sell off in anticipation of the higher interest rates.

The dollar will usually rally on a positive report. For the same reason that bonds fall, dollar will rise as foreign investors bid up its price to compete for the higher U.S. interest rates.

Index of Leading Economic Indicators

Importance (4 out of 5)

Published by: Bureau of Economic Analysis (BEA),
U.S. Dept. of Commerce

Reported: Last business day of the month

Frequency: Monthly

The index of Leading Economic Indicators (LEI) is a composite of 11 different indicators:

1) Average manufacturing workweek
2) Initial unemployment claims
3) New orders for consumer goods
4) Vendor performance
5) Plant and equipment orders
6) Building permits
7) Change in unfilled orders for durable goods
8) Sensitive material prices
9) Stock prices of S&P 500
10) Real M2 (a money supply measure adjusted for inflation)
11) Index of consumer expectations

This indicator is important because, as the name suggests, it is a leading indicator and turns up before a recovery begins and turns down before a recession starts. Typically, you want to see three consecutive monthly changes in the same direction before theindicator has validity. In other words, *three consecutive positive* readings would suggest the economy is about to turn up, while three consecutive *negative* readings would suggest a downturn.

The Bureau of Economic Analysis (BEA) also publishes a report on *coincident* indicators (those that rise and fall with the economy), and *lagging* indicators (which rise and fall after the economy has turned).

The coincident indicators are made up of four components: employees on non-agricultural payrolls, personal income less transfer payments, index of industrial production, and business sales.

The lagging indicators have six components: average duration of unemployment, ratio of business inventories to sales, index of unit labor costs for manufacturing, average prime rate charged by banks, commercial and industrial loans, and ratio of consumer installment debt to personal income.

Market Reaction

	If ILEI is up:	**If ILEI is down:**
Stocks	**UP**	**Down**
Bonds	**Down**	**UP**
Dollar	Up	**Down**

Reasons

Stocks should move up on a positive report and down on a negative one. This is because a positive ILEI report indicates a growing economy, which is healthy for stocks. However, in practice, stocks may not react one way or another to this report for the fact that most of this information has been released prior to the release of ILEI. If the report is stronger than expected, of course, stocks will definitely respond.

Bonds do not like a strong ILEI report for it shows potential tightening by the Fed and higher interest rates, which cause bond prices to fall.

The dollar will usually rally on a favorable report. This is because the currency markets are expecting a tightening by the Fed, which leads to a short-term boost in the value of the dollar as foreign investors purchase dollars to take advantage of the higher interest rates.

New Home Sales

Importance (2 out of 5)

Published by: Bureau of the Census of the U.S. Dept. of Commerce

Reported: 28th through the 4th of following month
Frequency: Monthly

New home sales are a leading indicator of economic activity, which means they are the first to turn up before a rebound and the first to decline before a recession. New home sales are important to measure, as significant changes in consumer spending often appear in autos and homes first.

The report also contains other statistical information on homes such as the average and median sales price, the number of homes for sale and the supply of unsold homes, which is stated as the number of months it would take to sell the existing unsold homes assuming the current demand (selling rate) stays the same.

The new home sales are broken down into four regions: South, Northeast, Midwest, and the West. The data can be very volatile, partly because contracts may fall through prior to closing; so the markets do not weigh this report too heavily, unless it is a large surprise.

The reason the markets are concerned with *new* home sales as opposed to existing home sales is because, remember, we are trying to get a grasp of what's happening to GNR People buying existing homes are not adding to GNP (at least in the sense of homes - they will add in terms of commissions to brokers). If you buy an existing home, you are merely swapping assets with another person and GNP has not moved.

	Market Reaction	
	If new home sales are up	**If new home sales are down:**
Stocks	**Uncertain**	**Uncertain**
Bonds	**Down**	**UP**
Dollar	**Uncertain**	**Uncertain**

Reasons

Neither stocks nor the currency market pay much attention to this report, partly because the data are so volatile.

Bonds, on the other hand, view a positive report as a growing economy, which points to higher interest rates - and lower bond prices.

Merchandise Trade_Balance

Importance (3 out of 5)

Published by: Bureau of the Census of the U.S. Dept. of Commerce

Reported: 13th - 17th (reports the two prior months)
Frequency: Monthly

Merchandise trade balance is important to measure, as it is a significant portion of GNP measured by net exports. If the U.S. is exporting more than it is importing, it is running a trade surplus and adding to GNP. The reverse is also true. The most important thing to remember about trade deficits is that the size of the deficit isn't as important as the net changes: Is it shrinking or expanding?

There are four separate reports issued: merchandise trade deficit, merchandise trade deficit on a balance of payments basis, net exports, and the current account. Of these, the markets give the most credence to the merchandise trade deficit report.

Market Reaction

	Market Reaction	
	If merchandise trade balance is up:	**If merchandise trade balance is down:**
Stocks	**UP**	**Down**
Bonds	**Uncertain**	**Uncertain**
Dollar	**up**	**Down**

Reasons

It's a little tricky to understand this data without understanding some basic economic principles regarding net exports. First, if the U.S. is exporting more than it is importing (i.e., selling more than it is spending), then foreign investors must be buying dollars and selling foreign currencies on a net basis - an increase in the value of the dollar. Likewise, if the U.S. is exporting more than importing, this *adds* to GNP, which signifies a growing economy - a benefit for stocks.

Bonds are uncertain. If the trade deficit is shrinking (net exports rising), then the dollar rallies and so will bonds - at least theoretically. Bonds like a strong dollar, as this implies a lower relative rate of inflation. However, there is a catch: If net exports are rising, it also shows an expanding economy, which can lead to higher rates, which are bad for bonds.

Because of this catch-22, the bond markets typically look at the breakdown between imports and exports. In other words, did net exports rise because exports rose or because imports fell? Bonds will usually sell on the news if net exports rise due to an increase in exports; this shows an expanding economy and a likely interest rate hike. However, if net exports fall because imports fell, the bond market will typically rally because this shows a slowing of foreign consumer spending.

Construction Spending

Importance (1 out of 5)

Published by: Bureau of the Census of the U.S. Dept. of Commerce

Reported: 1st business day of the month (reports the 2 prior months)
Frequency: Monthly

Construction spending is broken down into three categories: residential, nonresidential, and state and local government. The report is of interest, because these three categories combined represent about 20% of GNP. The report measures construction spending initiated during the month represented. Of the three categories, residential (new homes and apartments) and nonresidential (commercial uses: offices, hotels, schools, churches etc.) are probably the most important. Government spending would include roads, public schools, military bases, etc.

So why is this report only given a one-star rating when it represents 20% of GNP? The reason is that the report is one of the last reports of the month, and by that time, the market has already reviewed 14 other economic reports! The value added from this report is almost meaningless, although it does serve as a nice check for the other reports. For this reason, the markets pay little attention to it.

	Market Reaction	
	If construction spending is up:	**If construction spending is down:**
Stocks	**Uncertain**	**Uncertain**
Bonds	**Uncertain**	**Uncertain**
Dollar	**Uncertain**	**Uncertain**

Reasons

As stated above, the value of this report is minimal, so none of the markets really follow it. It still serves as an important forecasting report, so analysts are quite interested in it for that purpose - it just won't move the markets much on a monthly basis.

Factory Order & Manufacturing Inventories

Importance (1 out of 5)

Published by: Bureau of the Census of the U.S. Dept. of Commerce

Reported: 30th through 6th (reports the two prior months)
Frequency: Monthly

This report is almost a revisit of the durable goods report released one week earlier. However, it does give new information on shipments of nondurable goods and inventory sales ratios. Nondurables are goods having a life of three years or less, such as food and clothing. The most important new information contained in this report is the manufacturing inventory levels. If inventories are increasing, this suggests a slowdown and vice versa.

While the inventory levels have intuitive appeal, they are lagging indicators - they turn up after a recovery and turn down after a recession. For this reason, they are not good for predicting where the market is going, and are only given a one-star rating.

	Market Reaction	
	If factory orders are up:	**If factory orders are down:**
Stocks	**Uncertain**	**Uncertain**
Bonds	**Down**	**Up**
Dollar	**Uncertain**	**Uncertain**

Reasons

Neither stocks nor the dollar appear to attach much significance to this report for the reasons stated above. Most of the important information is released one week earlier in the durable goods report.

Bonds usually do not respond drastically to this report either. But they can if there is a larger-than-expected change in inventories. If inventories are significantly lower, this suggests an expanding market and likely interest rate hikes which send bond prices lower.

Business Inventories and Sales

Importance (1 out of 5)

Published by: Bureau of the Census of the U.S. Dept. of Commerce

Reported: 13th - 17th (reports the two prior months)
Frequency: Monthly

There aren't many positive things to say about this report. It is not very timely, and most of the information has been released before. Business inventories are lagging indicators, meaning they turn up after a recovery has started and turn down after a recession. This is due to the fact that businesses are often slow to detect changes in the economy; they tend to react after the fact. However, *changes in* business inventories tracked over time can lend useful hints into the direction of the economy. Also, this report allows analysts to figure the ratio of inventories to sales, which can be an important measure -just like the book-to-bill ratio for tech stocks. However, because these data require more time to compile, the markets really don't pay much attention to this report.

	Market Reaction	
	If construction spending is up:	**If construction spending is down:**
Stocks	**Uncertain**	**Uncertain**
Bonds	**Uncertain**	**Uncertain**
Dollar	**Uncertain**	**Uncertain**

Using economic indicators

It is very important to understand that economic reports are simply a tool among many to help guide investors' decisions. It is unwise to invest big because of one favorable report! Also, remember that all of the indicators are statistical samples, so they are subject to numerous and sizeable revisions.

The market's reactions are all based upon expectations. Just because a report may come in much higher than the previously released report on the same indicator does not mean that the market will necessarily react as indicated in these writings. If the market expected that change, there will often be very little reaction. Stock price movements are all based upon *expectations.*

Understanding these indicators, though, will help you understand why the market reacts the way it does when the reports are significantly different from expectations.

Related links

If you want to learn more about economic indicators or get current reports, the following links may be helpful:

The Bureau of Economic Analysis: http://www.bea.doc.gov/

The Bureau of Labor Statistics: http://stats.bls.gov/

The U.S. Census Bureau: http://www.census.gov/

The Federal Reserve Board: http://www.federalreserve.gov/

The International Monetary Fund: http://www.imf.org/

The National Association of Realtors: http://nar.realtorcom/