

## Economics & Stocks

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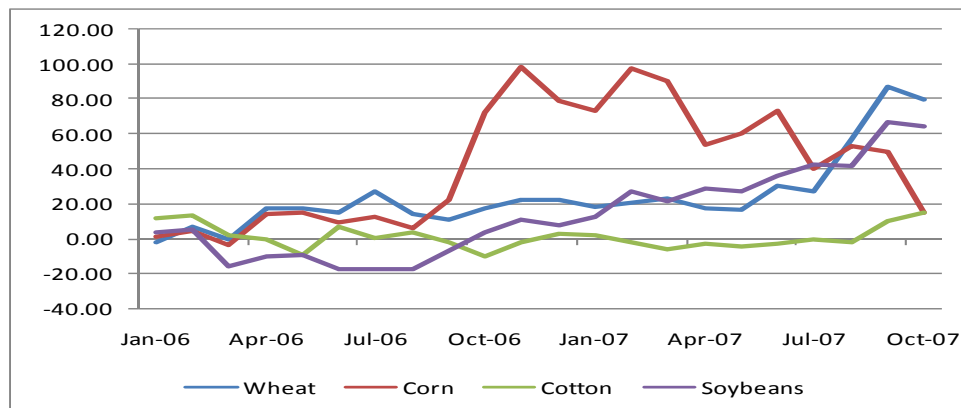
November 19, 2007

### Inside the Numbers: Food and Energy again dominate the Economic Data for the week of November 12<sup>th</sup>–16<sup>th</sup>

#### Summary:

Four important U.S. economic reports came out during the week of November 12<sup>th</sup> through the 16<sup>th</sup>. They were the PPI, CPI, Retail Sales, and Industrial Production reports. In each instance Agriculture which impacts food prices and gasoline were the dominant components. We already reviewed the PPI report last week (SISR, *Inside the Numbers – PPI November 2007*, November 14, 2007). In our PPI report we highlighted the fact the prices for soybeans and wheat had been increasing significantly faster than had been the price of corn and cotton over the past year, as seen in Figure 1. The significance being

Figure 1: Y/Y Change in Crops 2006 -07



Source: Department of Labor; SISR

that these were the exact conditions that lead to the increase in the planting of corn last year. This raises a host of question regarding planting during 2008, and what impacts will that have on the price of food,

fertilizers, and agricultural equipment. The increase in food prices noted in the PPI report were also found in the CPI report with meats, poultry, fish, and eggs up 5.5% y/y, and Dairy and related products up 12.8% y/y reflecting the increase in finished consumer food prices. Gasoline and household energy were of course the other dominant component to have seen increases over the past year, as we noted in the PPI report.

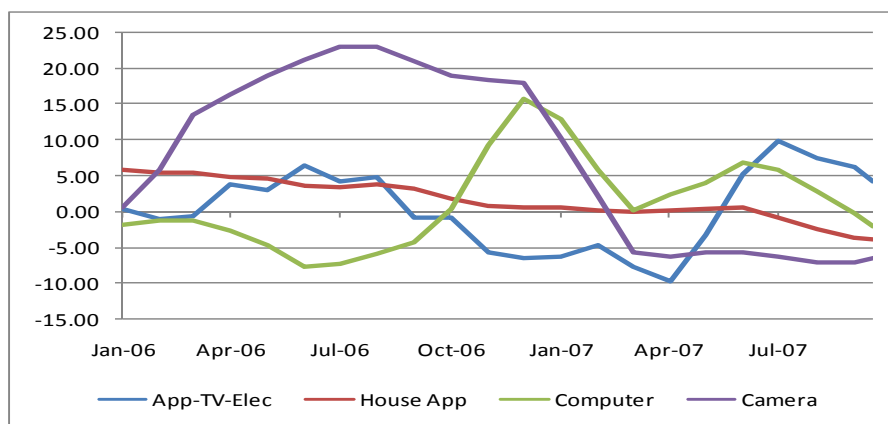
The same pattern emerged in the retail report with food and beverage stores up 4.4% and as expected sales at gasoline stations were up 16.3% y/y. The surprise in the retail report was the increase y/y of 3.7% in electronics & appliance stores coupled with an increase 10.1% y/y in prices in this category. Furniture & home furniture sales are the reports real laggard down -0.9% m/m and down (-1.8%) y/y. Also particularly weak were department and sporting goods hobby, book & music stores down 0.5% m/m and -0.4% respectively. The industrial production report supported this increase in home electronics with an increase of 14.5% y/y, but as we will see even this area of strength has been showing some weakness over the past couple months.

### I. PPI – Agriculture and Energy again Dominate

Without question the most interesting feature was the y/y change in crop prices from corn to soybeans and wheat. These increases impact the entire agriculture sector and all its components including food. We discussed this component in detail last week and encourage readers to review that report of last week. The component that we did not focus on in that report was the y/y 10.1% increase in electronic and appliance store prices, and the subsequent -2.1% m/m decline in this sub industry.

Reviewing this sub-industry in greater detail we find that it consists of four components: 1. Appliance, TV and other electronic stores, 2. Household appliance stores, 3. Computer and software stores, and 4. Camera and photographic supplies stores. The increase in the pricing in this sector at the industry level appears to be coming from the TV space with computers, cameras, and household appliances declining in the past few months, as seen in Figure II.

Figure II: Y/Y Change for the Electronic and Appliance Store PPI Components:  
January 2006 to October 2007



Source: Department of Labor; SISR

Cameras were very strong last year as were computers at the beginning of the year as the new Microsoft software was introduced, but since then the only area that appears to have some pricing power is the TV space, and even here we are seeing declining growth.

## II. CPI – Energy and Food Dominate

The Consumer Price Index (CPI) report had few real surprises with food and energy dominating. Motor fuel was up 23.3% y/y and 1/5% m/m. Household fuel oil and other fuels were up 14.9% y/y and 2.6% m/m, again raising the question if household fuels in conjunction with high gasoline prices will reduce consumption and force the economy to slow or even go into a recession. One of the strongest sub-industries this year in the consumer space was Electronic appliances stores especially appliances TV and other electrical stores. However, even this sub-industry has been down over the last two months as seen in Figure II above.

The impact from ethanol is again seen in this report with food prices increasing due to the increase in the price of corn. As we observed not only have corn prices increase, but soybeans and wheat have increase even more than corn over the past twelve months. This has lead to dairy and related products being up 12.8% y/y and 0.2% m/m, and meats, poultry, fish, and eggs, 5.5% and 0.2% respectively.

## III. Retail Sales – Weak in all areas except Gas Stations and Food Stores

Retail sales continue to come in weak once food and beverage stores, and gasoline stations are taken out. Gasoline stations sales were up 16.3 percent y/y and 0.8% m/m while food and beverage stores were up 4.4% and 0.6% respectively. However, sporting goods, hobby, book and music stores were down -0.4% m/m, as were general merchandise stores down -0.1%, department stores down -0.5%, miscellaneous store retailers -0.6%. As noted above Electronic and appliance stores were relatively strong in a weak retail environment, but even here we are seeing weakness with an increase of 0.1% m/m tracking less than the increase in inflation.

## IV. Industrial Production

Home electronics is the area that again stands out in the industrial production report. Home electronics is up 14.5% y/y, but this is coming off a Q1 reading of up 40.8%, Q2 21.6%, and Q3 of down -2.0% indicating that this sector which has carried this space is now declining with the rest of the retail sales segment. We had indicated that this growth had largely come from TV sets and not from computers and cameras. An area that needs additional attention is that of semiconductors and related electronic components which were up 12.7% y/y but 44.6% q/q. There has been a major move in the solar energy space and these companies are classified in this category. Computers have strong y/y with a 23.0% increase but had a weak Q3, forcing us to look elsewhere for the semiconductor growth, leading us to believe that the semiconductor growth is coming from other areas than computers. We continue to look at wood products as a guide for any movement in housing, but we are still seeing that wood production is down -5.4% in Q3 after an increase of 8.3% in Q2. Much of this can be related to paper but we will continue to watch wood products as a leading indicator in the housing market.

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