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Phila Fed Disappoints, Downside Risks to Forefront

The June Philadelphia Fed survey disappoints expectations, providing confirming evidence of a more-general pattern of weakening hinted at in the Empire State survey. Implications for national-level activity are decidedly negative, even when acknowledging the two surveys do only cover –- broadly – a swath of the Northeast. The underlying activity indicators deteriorated broadly, with orders, shipments, and employment indices heading materially lower.

The surveys took a similar plunge in mid-to-late 2011 (and to a lesser extent in 2010), without disastrous consequences, leaving open the possibility actual activity measures will not see a serious decline. And, business sentiment would presumably improve, along with activity, if progress is made on the key wildcards – Europe, and the U.S. fiscal situation, but decisionmakers' patience is not unlimited.

* The confidence indicator--the headline "General Business Conditions" index unexpectedly dropped 10.8 points to -16.6 (Consensus: 0.0; Decision Economics: +16.2).

* The new orders index plunged 17.6 points to -18.8, a steep drop-off from the low-expansion levels recorded in recent months, and modest contraction in May. August 2011 had seen a similar spike lower, a result that was quickly followed by a rebound into positive territory.

* The shipments index plunged to -16.6, from 3.5, also reminiscent of the late-summer 2011 decline.

* The employment index did edge 3.1 points higher to 1.8, following on a steep drop in May (from +17.9). The shift in sentiment has firms in the aggregate retaining staff, but cutting workweeks very sharply. The "average workweek" index moved from modest-contraction territory over the April/May period to -19.1 in June, a 13.7 point drop to its lowest level since the first half of 2009.

The employment situation rests on shaky ground. Firms appear confident enough to retain staff, but the longer that product demand remains weak, and the outlook uncertain, the likelier it is that job cuts pick up.

The manufacturing sector remains uncertain, with the Philadelphia, New York, and Chicago surveys all weakening significantly. Expectations for national-level weakening are clearly supported, with the several series moving broadly lower, in concert. The national PMI has been resilient, albeit at low levels. Downside risks have moved more clearly to the forefront, and Fed doves with the upper hand in their quest to guard more forcefully against downside risks.

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