The Dow rallied mightily on Friday, however, gaining 185.66 points as the tension in Ukraine appeared to be easing and President Obama launched a series of air strikes against insurgents in Iraq.

Early in the week, Russia’s President Vladimir Putin responded to the latest round of sanctions against his country by issuing some of his own, including a one-year embargo on selected food and services provided by European Union members, Norway (which is not in the EU), the United States, Australia and Canada. The steps were taken with the caveat that they could be revoked if prices started to rise precipitously. But at week’s end, a state-run news agency reported that Russia would work to quickly deescalate tensions in Ukraine, and Russia also said it was ending its provocative military exercises along the Ukrainian border.

Still, Ukraine was far from the only international concern, with one ceasefire in Gaza ending and another one beginning this morning, the Ebola outbreak in Africa widening and the bombing in Iraq, which the president said may go on for months, commencing (the strikes were to prevent Islamist militant units from taking the Kurdish capital of Erbil and to protect thousands of Americans in that city). On the economic front, the most disturbing news was the fact that preliminary data showed that Italy had fallen back into recession after its GDP declined 0.2% in the second quarter – the working definition of a recession is two consecutive quarters of contraction, and Italy’s economy shrank 0.1% in the first quarter. The figure for the eurozone as a whole has yet to be released.

The ECB stands pat – for now

Despite the general
economic malaise in the eurozone, and the fact that the latest report showed that inflation had slowed to 0.4% in July (the target is 2%), the European Central Bank took no new action when it met last week. Instead, the ECB wanted to wait and see if the steps it took in June will take hold, including a lower benchmark rate of 0.15% and other moves made to incent banks to lend money. Speaking of the challenges the eurozone faces, notably the impact of the sanctions on and by Russia, Mario Draghi, the ECB’s president, said, “If geopolitical risks materialize, it’s quite clear that the next two quarters will show lower growth.” As to what the ECB might do in the face of a continued slowdown, he said, “It’s difficult now to define ‘what are the options in the future,’ especially if the conflict escalates,” but he also said the ECB was exploring a number of options, including a Fed-like strategy of asset purchases.

Even though there have been some recent signs of a sustained economic rebound, the Bank of England also left its benchmark rate unchanged at 0.5% and kept its stimulus program going.

**Bank woes**

Banco Espírito Santo, Portugal’s second largest bank, which reported a loss of €3.58 billion ($4.8 billion) over the first six months of 2014, will be shut down as part of a €4.9 billion ($6.6 billion) salvage plan, with most of the money coming from Portugal (by way of the bailout fund). The additional cost will be absorbed by the bank’s shareholders and creditors but not, it’s hoped, taxpayers. The bank’s sound assets will be moved into a new entity, Novo Banco.

Back in the U.S., Bank of America reportedly agreed to pay what *The New York Times* described as “the largest single settlement in the history of corporate America,” between $16 billion and $17 billion, to settle the government’s investigation of its sale of toxic mortgage securities before the recession.

**Merger meltdown**

Two of the biggest mergers in the making came apart last week, though for different reasons. First, Rupert Murdoch said he was giving up his $80-billion attempt to create a new media giant in the face of Time Warner’s fierce opposition. Then Sprint announced that it was abandoning its plan to acquire T-Mobile, conceding that the combination was unlikely to survive the government’s antitrust scrutiny. Even so, Thomson Reuters estimated that $2.2 trillion in deals have been closed so far in 2014, a 67% increase from the same period in 2013.

**The trade deficit closes**

The Commerce Department said that the trade deficit narrowed to $41.5 billion in June from a revised figure of $44.7 billion in June as total exports reached $195.9 billion compared to imports of $237.4 billion.

In other economic news, the Labor Department reported that productivity rose 2.5% in the second quarter after contracting 4.5% in the first, which had been the biggest quarterly drop since 1981. Unit labor costs increased 0.6% after jumping 11.8% in the first quarter. The Labor Department also said that first-time job claims dipped 14,000 to 289,000, while the four-week average fell 4,000 to 293,500, its lowest level since February 2006. The Institute for Supply Management announced that its services index expanded at its fastest pace in eight years in July, climbing to 58.7. The Commerce Department reported that factory orders rose 1.1% in June, comfortably exceeding the forecast of 0.6%. The Commerce Department also said that wholesale inventories rose 0.3% in June, less than the expected gain of 0.7% and matching May’s increase. And the Fed reported that consumer credit was up $17.3 billion in June to $3.21 trillion after a gain of $19.6 billion in May.

**A look ahead**

With only a few economic releases on the docket in the U.S., and with much of Europe having closed shop for the summer break, it should be a relatively quiet week, with updates including the latest on small business optimism, retail sales, business inventories, the producer price index, consumer confidence, industrial production and capacity utilization.
MARKET COMMENTARY FOR THE WEEK OF AUGUST 11, 2014

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