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The Morning Briefing

North American Edition
Friday, May 18, 2012
6:30 am (EDT), 11:30 am (BST)
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GLOBE AT A GLANCE – Andrew Wroblewski, London / Pierre Ellis, New York

Equities: All lower. Japanese equity markets closed sharply lower. Other major Asian markets were clearly lower too. European bourses opened lower and then seesawed through the remainder of morning trade, as Moody's downgraded the ratings of a number of Spanish banks and Fitch cut its debt rating for Greece.

Bonds: Europe mixed, Japan higher. JGB prices rose across nearly maturities, with the yield curve steepening on the medium to long-term end. European bond prices saw continued divergences, however, with Germany, Italy and Spain higher, but with Portuguese and Greek markets falling.

Currencies: Stronger yen. The dollar fell clearly against the yen during Asian hours, but then seesawed through the morning European session, moving lower to around ¥/$ 79.33. Against the euro, the US currency moved mostly sideways through both sessions, trading near $/€ 1.270.

China: Less upbeat business confidence. According to Market News International, the May flash business confidence number fell by 3.05 points to 52.99.

U.S. ECONOMIC AND CREDIT MARKET OUTLOOK – Pierre Ellis, New York

Treasuries strengthened sharply at the long end Thursday, with the ten-year yield falling six basis points while the two-year yield rose by one. The market was modestly lower for most of the overnight hours, but had recovered to flat by the New York open, and after a bit of wavering, commenced on an uptrend that lasted for the rest of the day. The underlying theme was seen as being flight-to-safety, on continuing Eurozone turmoil and on the global stock market decline it is promoting, with talk also of liquidation of a large unfavorable hedge-fund steepener trade, and some impact from friendly U.S. economic data.

The big data surprise of the day came in the May **Philadelphia Fed Survey,** which weakened on every important score—with the only redeeming feature being that the indexes themselves have not been taken too deeply into negative territory. Clearly, activity is very shaky for Philadelphia-area manufacturers, and—potentially more important under current conditions—there has been a significant effect on business confidence.

The confidence indicator—the headline "General Business Conditions" index—unexpectedly dropped 14.3 points to -5.8 (Consensus: 10.0; Decision Economics: 9.6), obviously pointing to serious negative move in sentiment.

The relatively good news is that there was only a comparatively slight deterioration in immediate product demand—a downshift in the new orders index from +2.7 to -1.2. But, that seemed to have an outsized effect on sentiment, and the very bad news is that the downshift shift had a dramatic impact on willingness to hire, with the employment index dropping from 17.9 to -1.3.

The hint is that managers are suddenly worrying much more about problems down the line—and about potential overstaffing. Indeed, the six-month ahead expectation index for the General Business Conditions reading dropped from 33.8 to 15.0, and the corresponding new orders index fell from 35.4 to 26.3.

Of course, all of this may relate strictly to the Philadelphia region—with the Empire State Survey having just shown a much more solid picture in an adjacent region. Still, the message is of potentially fragile confidence—and fragile willingness-to-act—among business managers, perhaps even at the national level.

That may not be a message of outright worsening in downside risks to the general economy—but it will be interesting to see how Philadelphia Fed President Plosser, a committed FOMC hawk, frames these results in coming speeches.

The other data release of the day covered weekly **initial claims**—which run mildly higher than expected, holding steady (Consensus and Decision Economics: -2,000) at a prior-week level revised up by 3,000. The new figure covered the last of four weeks in payroll May, and at 370,000 put the monthly average at 375,000—all but flat compared to the 376,000 seen in payroll April.

Though the pace of claims, and layoffs, matched the April rate, the new month is "stronger" in the sense that weekly numbers have clearly declined from the patch of 390,000s weekly results that overlapped the two survey months--and kept monthly averages high. April saw initial claims on an upswing, while May sees them fall.

The last few readings could have been "stronger" yet if that had shown a steady and ongoing decline, but they did not—having held steady, after a big second-week drop—so the indication is of limited net improvement on the layoff side of the job market. Payroll forecasts will likely point to some firming from April, but relatively contained.

Upside potential for the labor market now rests almost entirely on the new-hiring side. Layoffs appear to be at roughly natural levels for a healthy economy—and, while the specter of a rise from there has been removed for the moment, the potential for further declines is probably limited. New hiring will be driven by business optimism and, importantly, confidence—both of which are flighty nowadays, as demonstrated by the sharply contrasting results between the recent Empire State and Philadelphia Fed results.

Fed opinions will change only in respect of seeing somewhat diminished downside risks. Hawks see no further role for monetary policy in stimulating employment, while doves still seem to persist in wishing for more ease to address the problem.

DAILY CALENDAR

There are no important economic indicators or appearances by Fed officials formally scheduled today.

CANADA – Melissa Pumphrey, New York

(Thursday) Wholesale sales gain on autos. Wholesale trade increased 0.4% m/m in March (Decision Economics: +0.4%; Consensus: +0.3%) to C$48.7 billion. The nominal index has gained 6% y/y. In volume terms, which disregard the effect of price changes, wholesale sales were unchanged for the month and are up 3.2% y/y. Motor vehicles and parts sales rose 2.4% m/m to C$8 billion, more than offsetting a 1.4% decline in machinery sales. Ex-autos, the nominal wholesale sales index was unchanged for the month.

Inventories posted a 0.9% m/m gain (Decision Economics: +0.6%) as machinery and food inventories increased. The ratio of inventory to sales is unchanged at 1.22. *This signals no new supply and demand imbalances either between wholesale demand and manufacturer supply or between wholesale supply and retailer demand.*

WESTERN EUROPE – Andrew Wroblewski, London

EUROZONE

GERMANY – Pipeline price pressures pick up. Undershooting expectations this time around, April producer prices rose by 0.2% M/M, the smallest rise so far this year and a clear contrast to the 0.6% gain in the previous month. The rise was broad based, as the ex-energy gauge also rose by 0.2%. The overall Y/Y rate, however, dropped 0.9 percentage point to 2.4%, the lowest since June 2010.

ITALY – Industrial orders fall more steeply. Data for March showed that Y/Y industrial orders fell 14.3%, a steeper drop than the 13.2% fall seen in February and the largest decline in the cycle. The drop was based more around domestic demand weakness. Even so, the latest result saw a 3.5% jump for the adjusted M/M number.

CENTRAL EUROPE, RUSSIA AND TURKEY – Chang Liu, London

HUNGARY – Wage growth slows. Data for March showed net wages flat in Y/Y terms following the 3.6% gain in February, now the weakest reading in the cycle. The latest outcome was a reflection of a moderation in private sector wage growth (2.7% from 5.4% in February), while and public sector wages saw a much steeper fall (-6.2% from -0.4%). Meanwhile, in nominal terms, wage growth slowed to 2.7% Y/Y from 6.8%.

ASIA – Chang Liu, London

CHINA – Less upbeat business confidence. According to Market News International, the May flash business confidence number fell by 3.05 points to 52.99, more than unwinding the 1.23 point gain in the previous month and now a new cycle-low. Notably, the latest fall was a reflection of deterioration in new orders, production and financial positions, but being undermined by an improvement in the availability of credit.