New York • London • Boston

DECISION ECONOMICS, INC.

Information for Decisions™

New York: 212 884 9440
London: 011 44 20 7959 3045
Boston: 617 994 0500

The Morning Briefing

North American Edition
Monday, December 10, 2012
06:30 (EST); 11:30 (GMT)
Allen Sinai, Chief Global Economist

GLOBE AT A GLANCE – Chang Liu, London/Pierre Ellis, New York

Equities: Europe Lower, Asia Mixed. Japanese equity markets were mixed, with the Nikkei higher but the broader Topix index closing lower. Other major Asian markets were mostly mixed too. European bourses opened lower and then fell further in later morning trade, dragged down by news that Italian Prime Minister Monti will resign before his term ends.

Bonds: Europe Mixed, Japan Higher. JGB prices rose across nearly all maturities, with the yield curve steepening on the medium-term end. European bond prices saw continued divergences, however, with Germany and Greece higher, but other peripheral markets falling, led by clear drops in Italy and Spain.

Currencies: Stronger Yen. The dollar fell against the yen through both the Asian and morning European sessions, trading lower to near ¥/$ 82.19. Against the euro, the U.S. currency seesawed through both sessions, moving little changed around $/€ 1.291.

Germany: Exports Rebound Slightly. Exceeding expectations yet again, the October (unadjusted) trade surplus widened to € 13.6 bln.

France: Less Steep Falls in Production. Surprising to the downside, manufacturing output fell 0.9% in M/M terms in October.

Sweden: Output Bounces. Surprising to the upside, October industrial production rose.

Japan: GDP Contracts Afresh. Surprising slightly to the downside, the Q3 updated estimate showed GDP contracting afresh and by 0.9% Q/Q.

Turkey: GDP Growth Slows. Coming in below expectations, national accounts data for Q3 showed seasonally and workday adjusted GDP growth slowing to 0.2% Q/Q.

China: Inflation Picks Up. Undershooting expectations once again, consumer price inflation still rose by 0.3 percentage point to 2.0% Y/Y in November.

China: Output Growth Higher, Investment Stable. Coming in above expectations, data for November showed industrial production growth improving to 10.1% Y/Y.

China: Trade Surplus Widens. Surprising to the downside, visible trade data for November still showed the trade surplus widening to $ 19.63 bln.

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

Long Treasuries gave back some ground Friday, essentially returning to the early-week level, with the ten-year yield rising four basis points on the day, to 1.62%, while the two-year yield held steady at 0.24%. The market was modestly higher overnight, but dropped on the release of a stronger-than-expected November employment report, quickly touching the daily lows, and never recovering to any great degree, despite several attempts. However, buying from multiple sources was noted at the lows, some of it motivated by a unexpectedly poor December University of Michigan Consumer Sentiment result.

November **payroll employment** surprised to the upside, rising by 146,000 (Consensus: +90,000; Decision Economics: +80,000).

The Labor Department opined that Hurricane Sandy "did not substantively impact the national employment and unemployment estimates," a conclusion that seems at odds with the lingering unemployment, in the critical survey week, indicated by the weekly unemployment insurance data.

But, technicalities of the count might have found many people back in employment for purposes of this report, even though they had been out of work in the immediate aftermath of the storm—and perhaps even in the survey week itself. In any case, many aspects of the statistical presentation of the month will be driven by these numbers for some time—and those will represent the economy of record.

Taken at face value, the report shows a reasonably solid private-sector economy, generating a moderate gain in labor income. November **private employment** rose by 147,000, following on gains of 189,000 (revised from +184,000) in October and 122,000 (revised from +128,000) in September.

The **average workweek** held steady at 34.4 hours in November, as generally expected—a result that had the effect, with the decent employment gain, of confirming that the relatively big October employment increase was fully absorbed by the 0.1-hour shortening in the workweek back in that month. But, a pace closer to the latest payroll number seems to be all that the market is demanding on a running basis.

That latest payroll rise combined with the flat average-hours result to produce a 0.2% rise in the index of aggregate hours—the total number of hours worked by all employees together, and the total number of hours demanded by all employers together. If productivity were absolutely constant, a 0.2% rise in aggregate hours per month would result in real GDP growth at about a 2.4% annual rate.

Average hourly earnings, meanwhile, rose 0.2%, as generally expected. That result combines with the aggregate hours increase to point to a moderate rise in wage-and-salary income—perhaps +0.3%. Current rates of consumer spending growth, and perhaps even mildly faster ones, can be supported by that kind of income growth—but the potential for much acceleration in spending seems very limited.

The FOMC obviously will look beyond the transitory impact of the hurricane, and in these numbers will see reasonably steady progress, but not a trend acceleration—those who felt the September easing move was inadequate at the time will not change their views.

The **unemployment rate**, meanwhile fell 0.2 point in November, to 7.7%, on the "unhealthy" combination of a 122,000 drop in household employment and a 350,000 drop in the labor force. Clearly, single-month movements are near-meaningless in these data, but the multi-month decline from 8%+ unemployment to 8%- unemployment is surely valid—and also inadequately fast for most FOMC players.

The preliminary December **University of Michigan Consumer Sentiment** survey surprised to the downside, with the headline index dropping 8.2 points (Consensus: -0.7 point; Decision Economics: -0.2 point).

Interestingly, the deterioration was very unbalanced, reflecting a 0.8-point decline in the current conditions index and a 13.0-point drop in the expectations index. Exactly what caused the expectations meltdown is the issue, of course, and rising perceptions of "fiscal cliff" or "Washington gridlock" dangers seems like an inadequate explanation.

Odds are, the less-than-explicable drastic downswing in that component, and in the headline index, will diminish the credibility of the results in the eyes of the Fed—certainly for the meeting next week.

So far, actual consumer behavior in stores is not showing any unusual downshift—though observers will now be watching closely. Clear confirmation in the late-month University of Michigan data and in the December Conference Board numbers would notch up concerns—but actual buying is what counts.

DAILY CALENDAR

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

CANADA – Melissa Pumphrey, New York

(Friday) Productivity falls again... Canadian labor productivity declined for the second consecutive quarter, falling 0.5% in Q3 (Consensus: -0.4%; Decision Economics: -0.3%). This drop in productivity was the result of output staying flat for the quarter while hours worked increased by 0.4%. Both the goods and services sectors experienced productivity declines—with the mining, oil and gas industry productivity plummeting 3.1%, mostly as a result of temporary mining shutdowns. Hourly compensation grew for the fourth consecutive quarter at +0.9% q/q (Decision Economics: +0.5%). Therefore, unit labor costs rose 1.3% in Q3—the fastest pace since 2009:Q1. Unit labor costs have now increased in four consecutive, as well as eight of the last nine, quarters.

…as the competitiveness struggle intensifies. While the temporary mining shutdowns in Q3 clearly exerted a drag on productivity by pulling down real GDP, the general trend of rising unit labor costs cannot be ignored. With a strong currency already hampering exports, Canadian firms are struggling to compete internationally. *Since 2000, Canada has had the second worst export performance in the G20, only besting the UK. The Bank of Canada has repeatedly urged businesses to take advantage of current low interest rates and make productivity-enhancing investments. However, these pleas have mostly fallen on deaf ears as firms cut costs in the face of global uncertainties.*

(Friday) Strong employment report on service sector gains. Canada added 59,300 jobs to its economy (Consensus and Decision Economics: +10,000) in November. The mix of jobs was broadly favorable: +55,200 full-time jobs versus +4,100 part-time jobs, and +48,200 private sector jobs against +5,400 public sector jobs and 5,800 more people reporting self-employment. As a result, the unemployment rate declined two-tenths to 7.2%.

Goods sector suffers. Employment in the goods sector contracted by 6,200, its fifth decline in six months. The construction industry lost 8,400 jobs—perhaps a welcome sign of less homebuilding—and the manufacturing industry shrank by 19,600 positions bringing its six-month total to -44,600. *This drop in manufacturing employment suggests that, in the current global environment of weak global demand and a strong Canadian dollar, Canadian firms are struggling to sell. The goods sector has not yet reached its pre-recession output peak, and likely will not for some time.*

Retail, hotel, and restaurant employment lead rosier services sector. The services sector added 65,700 jobs in November, its fourth consecutive increase. Retail and wholesale trade (+25,300), professional jobs (+22,800) and the accommodation and food industry (+28,300) showed the biggest gains.

WESTERN EUROPE – Chang Liu, London

EUROZONE

GERMANY – Exports Rebound Slightly. Exceeding expectations yet again, the October (unadjusted) trade surplus widened to € 13.6 bln from € 9.9 bln in the same month of last year, but down from the € 17.3 bln September reading. In seasonally adjusted terms, however, the trade surplus was down at € 15.2 bln in October, as a slight rebound in exports (of 0.3% M/M) was outpaced by a clearer bounce in imports of 2.5%.

The cumulative trade surplus so far this year stands at € 133.9 bln, 21.5% up on the first ten months of 2011.

FRANCE – Less Steep Falls in Production. Surprising to the downside, manufacturing output fell 0.9% in M/M terms in October, a second straight fall but much less steep than the 3.4% slump seen in September. Overall industrial production, meanwhile, also saw a less steep fall of 0.7% following a 2.7% drop in September.

Notably, the latest outcome left industrial production 1.9% below the Q3 average, further hinting that official data in recent months may be belatedly echoing more long-standing business survey data in implying a clearer threat that the industrial sector has suffered a marked setback that will show up in much worse GDP readings for the current quarter after largely a flat reading in Q3.

Business Sentiment Falls Slightly. In the latest (November) Bank of France monthly report, the business sentiment indicator fell by one point to 91, now a four-month low. The breakdown for last month showed mixed developments. Even so, capacity utilization actually picked up to 76.6%

from 76.3% in October, and with production outlook also swinging to 1 from -3 in the previous month. However, the BoF still confirmed its previous projection that Q4 GDP growth may suffer a 0.1% Q/Q drop.

ITALY – Industrial Production Falls Further. Coming in below expectations, October industrial production dropped back 1.1% in seasonally adjusted M/M terms, accentuating the 1.3% decline in September and now the fourth fall in the past five months. Of note, this fresh drop was (again) relatively broad based, but with the main weakness coming on the durable goods side. Meanwhile, on a more downbeat note, Y/Y work-day adjusted growth turned more negative at -6.2%.

Continued Recession But No Deeper? Q3 GDP decreased by 0.2% Q/Q, unrevised from the preliminary reading, thereby still showing a far less marked drop than the 0.7% drop of the previous quarter. As a result, Y/Y growth was no more negative, still at -2.4%, the softest reading since end-2009.

The break-down released for the first time with this update again showed fairly broad-based weakness, at least domestically. Net exports actually boosted the economy further and to the tune of 0.6 percentage point, albeit largely from a fall back in imports.

OTHER WESTERN EUROPE

UNITED KINGDOM – Further Improvement in Labor Market Conditions. The latest (November) REC labor-market report pointed more clearly to some improvement in the jobs market. Indeed, the survey showed the permanent placements index moving further into expansion territory to 56.0 from 55.0 in October, now a 19-month high. Moreover, the survey showed continued relatively positive signals regarding vacancies, while wage pressures also rose a little further.

SWEDEN – Output Bounces. Surprising to the upside, October industrial production rose. Indeed, production increased 0.5% following a 4.2% slump in September, unwinding little of the damaged done in the previous month but still the fourth rise in the past six months. Even so, the Y/Y rate of growth remained clearly negative at -4.4%. On a less downbeat note, orders actually rose for a second consecutive month, and with growth doubling from the pace seen in September.

NORWAY – Still Soft Inflation Backdrop. Largely as expected, November CPI inflation was stable at 1.1% Y/Y as rises in food and housing inflation were offset by falls for transport. On a M/M basis, prices increased 0.1%, led higher by an increase in housing prices. In contrast, the core rate, CPI-ATE (excluding taxes and electricity) actually rose to 1.3% Y/Y from 1.1% in October, now a joint five-month high.

Notably, the new data leaves inflation just above Norges Bank projections for November.

CENTRAL EUROPE, RUSSIA AND TURKEY – Chang Liu, London

CZECH REPUBLIC – Output Rebounds. Data for October showed industrial production falling by 4.1% Y/Y, a clear contrast to the 6.8% drop in the previous month and now extending the recent volatility seen in the series. The latest outcome reflected fairly broad-based improvements across components, led by manufacturing (5.4% from -7.0%) and a less steep fall in mining (-0.9% from -12.3%), but being undermined by a steeper drop in utilities (-6.3% from -1.3%)..

Industrial orders, meanwhile, rebounded to 5.3% after a 5.6% drop in September, while construction output turned less negative to 4.3% Y/Y after a 10.0% drop in the previous month.

Inflation Falls. Coming in below expectations this time around, consumer price inflation fell clearly by 0.7 percentage points to 2.7% Y/Y in November, the first fall since July and now a new cycle-low. On a M/M basis, meanwhile, prices actually fell by 0.2%. The Y/Y breakdown showed the latest outcome to be a reflection of falling broad based falls in price pressures across components, led by food (5.9% from 7.2%), transport (1.1% from 2.7%) and seasonal goods (2.8% from 9.0%).

Notably, these latest figures came in below the Czech National Bank's inflation forecast (made in November and by 0.3 percentage point).

Labor Market Conditions Deteriorate. The November unemployment rate rose to 8.7% from 7.9% in the same month of 2011. The level of unemployment, meanwhile, was 508 500.

TURKEY – GDP Growth Slows. Coming in below expectations, national accounts data for Q3 showed seasonally and workday adjusted GDP growth slowing to 0.2% Q/Q from the 1.7% jump seen in Q2, the latter being the largest gain in six quarters. The latest increase was also the thirteenth positive reading in the past thirteen quarters, however. Meanwhile, the calendar adjusted Y/Y rate of growth moderated to 1.9% from 3.4% in the previous quarter. The breakdown showed the latest outcome to be a reflection of fairly broad based deterioration across components, led by slower growth in manufacturing (1.3% from 3.8%), utilities (4.7% from 6.1%) and transport (2.3% from 4.5%).

Output Falls Afresh. October seasonally adjusted industrial production dropped by 3.6% M/M, albeit unwinding little of the 15.6% surge seen in the previous month and extending the recent volatility in the series. Meanwhile, on a workday-adjusted Y/Y basis, output fell by 5.7% following a 6.2% gain in September. This was a reflection of fresh falls across all components, led by mining.

JAPAN – Chang Liu, London

GDP Contracts Afresh. Surprising slightly to the downside, the Q3 updated estimate showed GDP contracting afresh and by 0.9% Q/Q (-3.5% annualized), slightly downwardly revised from the preliminary reading and a clear contrast to the flat reading seen in Q2. The Q/Q break-down confirmed that latest contraction was fairly broad based, led by private consumption, non-residential investment and net trade. Meanwhile, the Q3 GDP deflator fell by 0.8% Y/Y, a less steep drop than the 1.0% fall in Q2.

Mixed Messages in Current Account Data. Surprising to the upside, the October (adjusted) current account swung clearly into a surplus of ¥ 414.1 bln from a ¥ 142.0 bln deficit in September. There was, however, a deterioration in the unadjusted current account surplus, which narrowed to ¥ 376.9 bln in October from ¥ 533.9 bln in the same month last year.

Lending Growth Picks Up Slightly. Bank lending data for November showed total bank loan growth picking up slightly to 1.0% from 0.8% in the previous month, a thirteenth successive positive reading.

More Downbeat Consumer. Showing a further drop, November consumer confidence decreased 0.3 point to 39.4. The Cabinet Office cut its view slightly, now saying consumer confidence is showing weakness.

ASIA – Chang Liu, London

CHINA – Inflation Picks Up. Undershooting expectations once again, consumer price inflation still rose by 0.3 percentage point to 2.0% Y/Y in November, ending a run of two successive falls and rebounding from a 33-month low seen in October. In M/M terms, prices rose by 0.1%. The Y/Y breakdown, meanwhile, showed rising prices pressures for food (3.0% from 1.8%) and housing (2.6% from 2.5%), outweighing flat to lower inflation across all other components As a result, non-food inflation was actually slightly lower at 1.6% Y/Y from 1.7% in October, still joint second-highest in eight months.

Elsewhere, producer price inflation saw a less steep fall of 2.2% in Y/Y terms following a 2.8% drop in October, still a ninth straight negative reading but boosted by a less steep fall in producer goods prices alongside a slight pick-up in price pressures for consumer goods.

Output Growth Higher, Investment Stable. Coming in above expectations, data for November showed industrial production growth improving to 10.1% Y/Y from 9.6% in October, a third straight increase and now the fastest pace since March. The latest outcome was a reflection of improvements in utilities (6.0% from 4.7%), general purpose equipment (9.1% from 7.1%) and cars manufacturing (6.5% from 5.9%), but being undermined by slight moderation in textiles (11.0% from 11.9%) and non-metal mineral products (10.5% from 11.0%).

Fixed-asset investment growth, meanwhile, was actually stable at 20.7% Y/Y in November from the previous month, a joint eight-month high. The breakdown showed the latest outcome to be a reflection of faster investment growth for the primary (30.5% from 32.3%) and secondary (21.1% from 21.9%) sectors, but being offset by a recovery in the tertiary industry (20.4% from 20.1%). Elsewhere, and notably, railway transportation investment actually rose by 0.9% in November, a clearly contrast to the 1.4% drop seen in the previous month and significantly the mid-40% slumps seen through much of this year, also ending a run of fifteen consecutive negative readings.

It is notable that the clear improvement seen in railway transportation investment is likely to be a sign of clear fiscal stimulus measures undertaken by the Government in recent months.

Retail Sales Growth Picks Up Further. Retail sales data for November showed sales growth rising to 14.9% Y/Y from 14.5% in October, a fourth straight increase and now the largest gain since March. The latest outcome reflected improvements in sales of garments (20.6% from 18.7%), household electronics (11.3% from 9.2%) and automobiles (8.3% from 7.0%), but being undermined by a slowing in petroleum (15.5% from 17.6%) and food (18.5% from 21.8%) sales growth.

It is important to remember that these figures are in nominal terms, thus the recent easing back in inflation (see above) implies that real retail sales growth may have seen an even more marked pick up in recent months.

Trade Surplus Widens. Surprising to the downside, visible trade data for November still showed the trade surplus widening to $ 19.63 bln from a gap of $ 14.53 bln in the same month of the preceding year. The breakdown revealed the latest outcome to be a reflection of a slowing in export growth (2.9% Y/Y from 11.6% in October), but still outpacing the fall in import growth (to flat). On a geographical basis, meanwhile, exports deteriorated to nearly all major trading partners, save for Taiwan and Brazil.

However, following the latest figures, the government was forced to abandon its full-year trade growth target of 10%, but with a former commerce ministry official commenting over the weekend that the Government will try again for 10% trade growth in 2013.

OCEANIA – Chang Liu, London

AUSTRALIA – Home Loan Approvals Rise Further. Surprising to the downside, total home loans still rose by 0.1% M/M in November, adding to the 1.1% gain seen in the previous month and further tempering the recent volatility in the series. The latest correction reflected an improvement in refinancings (0.5%), but with the ex-refinancing figure falling slightly (-0.1%).

NEW ZEALAND – Manufacturing Sales Rebound. Total manufacturing sales rose by 1.6% in Q/Q terms in Q3, more than reversing the 0.8% drop in the previous quarter and ending a run of two successive drops. In Y/Y terms, meanwhile, sales rose by 0.1% following a 1.5% fall in Q2. Elsewhere, sales excluding meat and dairy actually fell in Q/Q terms by 1.1% from a flat reading in the second quarter, while Y/Y growth turned negative to -0.3% from 0.5%.