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The Morning Briefing

North American Edition
Tuesday, December 4, 2012
06:30 (EST); 11:30 (GMT)
Allen Sinai, Chief Global Economist

GLOBE AT A GLANCE – Andrew Wroblewski, London/Pierre Ellis, New York

Equities: Europe Higher, Asia Mixed. Japanese equity markets were mixed, with the Nikkei slightly lower but the Topix index closing flat-to-higher. Other major Asian markets were mixed too. European bourses opened lower, but then rose through the remainder of morning trade.

Bonds: Mixed. JGB prices were mixed across maturities. European bond prices saw continued divergences, however, with Germany, Portugal and Greece lower, but Italian and Spanish markets rising.

Currencies: Slightly Weaker Dollar. The dollar fell against the yen on net through both the Asian and morning European sessions, trading slightly lower to near ¥/$ 81.99. Against the euro, the U.S. currency saw broadly similar developments, moving marginally lower to around $/€ 1.308.

Eurozone: Less Steep Rise in Producer Prices. Largely matching expectations, October producer prices rose for a fourth successive month.

Australia: Rates Cut. Surprising few, the Reserve Bank of Australia decided to cut the Cash Rate by 25 bp to 3.00% at its meeting in December.

Australia: Current Account Deficit Widens. Coming in largely in line with expectations, balance of payments data for Q3 showed the current account in deficit to the tune of A$ 14.90 bln.

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

Treasuries finished marginally lower Monday, with the two-year and ten-year yields both rising fractionally. The market fell moderately overnight, and continued the decline a bit further in early U.S. trading, but turned at mid-morning, with some help from a weak ISM report, and rallied slowly for the rest of the day. Moderate stock-market losses were a friendly factor. Activity was slow, with caution prior to the Friday employment data cited as a factor.

The November **ISM Manufacturing Survey** was unexpectedly poor, with the headline index falling 2.2 points (Consensus: -0.2 point; Decision Economics: unch) to 49.5.

Much of the weakness was centered in the new orders index, which dropped 3.9 points, to 50.3, and in the employment index, which fell a parallel 3.7 points, to 48.4. Those indexes summarize the message of the report—potentially faltering demand for manufactured goods, and a hair-trigger reaction of new-hiring caution among manufacturing companies.

Part of the problem may be the third-quarter pileup of inventories revealed by the revised GDP data—inventory indexes for both manufacturers (-5.0 points, to 45.0) and their customers (-6.5 points, to 42.5) showed sharp swings to decumulation.

The strong indication of caution among business decisionmakers that these results give may be a saving grace, suggesting that there will be no accidental stumble into a serious inventory overbuild and potential industrial recession. Presumably, fiscal-cliff and export worries, plus the general pattern of reluctance to commit evident in limp business-investment spending, are driving manufacturing-sector decisions now.

Caution is healthy, but can also be self-fulfilling for some length of time--and might morph to a serious lack of resilience in the face of a actual fiscal-cliff shock that negotiators on both sides may embrace.

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Fed doves, erring on the side of—as they see it—sustaining the economy, would feel irresponsible if they do not continue, or intensify, the stimulus they are currently providing.

DAILY CALENDAR

Odds are, neither item today will attract much general market attention, with the store sales figures covering what is ordinarily a very quiet week in the slow shopping period between Black Friday and the days immediately before Christmas, while Tarullo will be discussing financial regulation.

Store sales results will cover the first of five weeks in retail December—the week just past the Thanksgiving week. Usually, there is a crashing decline in activity after the Black Friday weekend rush—though the Sunday of that weekend is included in the total—and results are given very little credibility as an indicator of how total holiday-season results will turn out.

Still, there will be some interest in the Sunday results. Also, attention will be paid to any reports of heavy shipping of merchandise bought online in the Thanksgiving week—the custom of such purchases being booked only when actually shipped is one factor advanced as an explanation for the disappointing November sales results.

Tarullo, meanwhile, will be delivering the keynote address at a Brookings Institution conference on "Structuring the Financial Industry to Enhance Economic Growth and Stability." The working title of his talk is "Industry Structure and Risk Regulation."

Tarullo is not generally a thought leader on monetary policy, but is a high-powered academic lawyer leading the Fed's regulatory reform program—so his talk could be a major statement of institutional view on that subject. What recent comments he has made on monetary policy have suggested that he is a full-bore FOMC dove, certainly supporting current balance-sheet policy—and perhaps a stepped-up version next year.

The Schedule:

On the docket today are the weekly store sales reports from ICSC/Goldman Sachs and Redbook Research, at 7:45 EST/12:45 GMT and 8:55 EST/13:55 GMT respectively, and a speech by Fed Governor Tarullo, at 10:45 EST/15:45 GMT.

WESTERN EUROPE – Andrew Wroblewski, London

EUROZONE – Less Steep Rise in Producer Prices. Coming in slightly ahead of expectations, October producer prices rose for a fourth successive month but less steeply so. Prices actually increased 0.1% M/M, half the September gain, but the softer reading not solely due to slightly softer energy costs, as the ex-energy measure slowed to 0.1% from 0.3%. Meanwhile, on a Y/Y basis, overall PPI inflation edged down to 2.6%.

OTHER WESTERN EUROPE

UNITED KINGDOM – Sales Less Weak. According to the British Retail Consortium (BRC), like-for-like nominal Y/Y store sales growth was less weak in November, with the growth rate turning from -0.1% to 0.4% . In addition, overall (or total) sales growth picked up similarly, but to 1.8% from 1.1%.

As the BRC itself stresses, a three-month average better reflects underlying trends given the gamut of distortions that have dogged recent data. This three-month rate continues show that sales have been growing modestly. Even so, it is also worth noting that as the BRC sales data are in nominal terms, they imply that real sales growth has been nearer flat, this being a contrast to the more upbeat picture regarding retailing in official numbers.

Construction Sector Clearly Weaker. Undershooting expectations somewhat, the construction PMI decreased afresh and clearly so, dropping 1.6 points in November to 49.3. Moreover, the overall tone of the survey was much more sobering amidst the steepest new orders decline in approaching four years. A lack of new business to replace completed contracts in turn contributed to a marked drop in confidence regarding the outlook for the next 12 months. Latest data pointed to the weakest degree of positive sentiment since the near-record low seen in December 2008.

ASIA – Chang Liu, London

THAILAND – Consumer Confidence Improves. According to the University of the Thai Chamber of Commerce, consumer confidence rose by 1.3 points to 79.1 in November, a second straight increase and now a new cycle-high. The breakdown showed the latest recovery to be a reflection of broad based improvements in both the current conditions and expectations components.

OCEANIA – Chang Liu, London

AUSTRALIA – Rates Cut. Surprising few, the Reserve Bank of Australia (RBA) decided to cut the Cash Rate by 25 bp to 3.00% at its meeting in December. This follows an unchanged decision in the previous month, a similar cut in October and three successive decisions to hold policy in the preceding months to then, but all following a 25 bp and 50 bp rate cut in June and May respectively.

Global Outlook Remains Weak, Resource Sector Cools

The accompanying statement by Governor Stevens showed some notable changes. Beginning with a still pessimistic assessment of the global economy, the RBA noted again that growth is forecast to be below average for a time and repeated that risks are still observed to be on the downside. However, new this month was the added mention of the US fiscal policy uncertainty, while Asian growth was still expected to be dampened by more moderate Chinese expansion and continued weakness in Europe.

In terms of the domestic economy, however, the RBA's assessment was little changed from November, still noting growth being close to trend, boosted by large increases in investment from the resources sector. The Bank also stated that recent data confirmed that the peak in resource investment is now approaching. Responding to this, the RBA now noted its assessment of other components of demand which could offset the slowdown. Specifically, while there are indications of a prospective improvement in dwelling investment and continued growth in consumption (albeit with a return to very strong growth seen as unlikely), near-term outlook for non-residential building investment and business investment outside the resources sector remain subdued.

Inflation Contained

Inflation, meanwhile, was still projected to remain within target over the next one to two years, albeit with the RBA once again stressing that maintaining low inflation over the longer term will require pressure on labor costs to remain contained and improvements in productivity performance to continue as the effects of the earlier exchange rate appreciation wanes. Borrowing conditions, meanwhile, were noted to have remained attractive, while labor conditions softened somewhat.

DE View: In justifying today's decision, the RBA pointed to the fact that, while the full effects of earlier easing measures are yet to be observed, the exchange rate remains higher than might have been expected given the decline in export prices and the weaker global outlook. This, combined with continued weakness in non-resources investment and inflation still being contained, gave the RBA both the rationale and scope it needed for a further adjustment at this juncture. However, going forward, a return to a policy pause is likely as the Bank gave no hints of any bias, but with developments in the currency and capital spending likely to be key determinants for future decisions in coming months.

Current Account Deficit Widens. Coming in largely in line with expectations, balance of payments data for Q3 showed the current account in deficit to the tune of A$ 14.90 bln, a moderate deterioration from the preceding quarter, which saw a shortfall of A$ 12.37 bln. The widening was a reflection of a doubling of the deficit in the goods and services balance, while the income balance remained largely stable.

Notably, net exports are now expected to make a 0.1 percentage point contribution to Q3 GDP, a notch above forecasts for no contribution before today's release, but with likely no major implications for Q3 GDP projections (data released Wednesday 5 December).

Building Approvals Correct. Coming in below nearly all expectations this time around, overall building approval numbers slumped 7.6% M/M in October, but still unable to unwind fully the 9.5% jump seen in September. The latest drop reflected a sharp recovery in public approvals, but being outweighed by the clear deterioration on the private side.