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The Morning Briefing

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6:30 EDT; 11:30 BST
Allen Sinai, Chief Global Economist

WEDNESDAY BRIEFING POINTS – Andrew Wroblewski, London/Pierre Ellis, New York/Francisco Larios, Miami

Mexico: Inflation steady. **CPI** is on schedule for today, with the already released biweekly result making a steady climb, within target inflation for September inflation all but certain (Consensus: 3.5% Y/Y; DE: 3.4% Y/Y). Expectations are in-line with the rate recorded in August (3.5% Y/Y).

Brazil: Inflation and Central Bank Decision. It is a potentially tricky (and unusual) situation for the Brazilian central bank, one in which despite the weakness of industry, upside inflation potential is significant. For now, however, the **IPCA-CPI**, released today, is on its way down, and this week's data should provide confirmation (Consensus and DE: 5.9% Y/Y). Still, while the central bank will likely to tighten in their rate decision today (Consensus and DE: + 50 basis points), the tightening campaign is probably nearly over.

United States: FOMC Revelations? Due today are a speech by Chicago Fed President Evans, one of the most dovish of the current FOMC voters, as well as Minutes from the September 18-19 FOMC meeting—providing a summary of the discussion which led to the decision not to taper, an outcome which clearly surprised markets.

U.S. DATA AND EVENTS OUTLOOK – Pierre Ellis, New York

Due today are a speech by Chicago Fed President Evans, at 10:00 EDT/14:00 GMT, and Minutes from the September 18-19 FOMC meeting, at 14:00 EDT/18:00 GMT.

Evans, currently voting on the FOMC, is one of the most dovish of the group. He was perhaps the earliest advocate of policies involving the continuing application of stimulus until threshold levels of economic performance were met.

Presumably, he supported the decision not to "taper" at the last meeting, and it will be interesting to see if he hints at any ambivalence regarding that decision, given the market jolt that it caused. None of the doves seem to have yet.

Today, Evans will participate in a session on of "Unconventional Monetary Policies and Their Cross-Country Spillovers" at the IMF meetings in Washington. Probably, he will advance the customary Fed view that doing what is best for the U.S. economy is doing the best thing for the world economy. He may get an earful of politely stated complaints from other participants about collateral damage.

The **Minutes** will provide a summary of the discussion which led to the decision not to taper—an outcome which clearly surprised markets.

There appears to have been a relatively heated debate, with the "hawks" who have spoken since, condemning the decision with some intensity. Notably, even the middles-of-the Cleveland Fed President Pianalto—who would be voting next year were she not retiring in January—yesterday said that she disagreed too.

Supporters of the decision have portrayed it as a straightforward judgment that economic performance had not improved to the degree that the Committee had earlier specified as being required. But assessments of that performance, even from "doves," were ambiguous in the

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weeks before the meeting—and Committee members made no efforts to correct the very evident market misapprehension going into the meeting.

Various post-meeting speakers have suggested that the decision was a “close call,” and one issue today is whether that closeness was regarding economic performance per se or regarding the tradeoff between the credibility cost of surprising markets and the potential cost of prematurely slowing the addition of stimulus.

Another question to be asked is just how close the economy is to acceptable performance, given the fuzz that has developed around the unemployment-rate target, and the disagreement that appears to be developing around the issue of whether the inflation slowdown is temporary.

WESTERN HEMISPHERE ANALYSIS

CANADA – Thomas Lee, New York

Housing starts above expectations. September housing starts unexpectedly jumped to 193,600 (SAAR) as the prior month’s figure was revised up approximately +4,000 to 184,000 (Consensus and Decision Economics: 185,000 (SAAR)). The gain in housing starts was largely broad based with urban starts increasing 4.3% M/M on higher single (+1.4%) and multi-family (+5.9%) starts. Rural starts also advanced 17.1% from the month prior.

For the third quarter housing starts averaged 191,371 starts which are lower than the 221,699 starts recorded in the same quarter last year, but faster than the 174,478 reading recorded in the first quarter of 2013. The rising level of starts is also consistent with the surge in building permits issued in recent months. It seems that the housing market will continue to gain in the near term until rising interest rates and higher home prices dampen the demand for homes.

Trade deficit widens on higher imports. August trade balance clocked in at -C$1.3 billion, further into deficit territory from the revised -C$1.2 billion (originally -C$0.9 billion) recorded in the prior month (Consensus: -C$0.7 billion; Decision Economics: -C$0.4 billion). Imports drove down the balance in August increasing 2.1% M/M, large enough to offset the 1.8 M/M gain in exports. Leading the gain in imports were energy products (+12.5% M/M) and aircraft and other transportation equipment and parts (+27.1%). On the other side of the ledger, exports were driven higher by energy products (+4.7% M/M) and metal and non-mental products (+8.2% M/M). In volume terms, imports advanced 1.2% M/M while exports increased 1.4% M/M.

The unexpected widening of the deficit will likely exert downward pressure on August monthly GDP growth and consequently Q3 GDP. Nonetheless, the underlying figures, such as volume of exports increasing 1.4% M/M and industrial machinery, equipment and parts imports advancing 3.8% M/M is promising especially as the Bank of Canada continues to cite exports and business investments as future drivers of growth.

WESTERN EUROPE – Andrew Wroblewski, London

EUROZONE

GERMANY – Production Jumps Back. Overshooting expectations very clearly this time around, especially in light of marked upward revisions, August industrial production jumped back 1.1% M/M, more unwinding the pared-back fall of 1.1% of the previous month. Notably, the jump back came in spite of corrections in energy and construction, with manufacturing actually jumping back 2.1%, the latter underpinned by a very large rise in capital good production.

Uptrend Still Clear

These numbers are all the more reassuring, as this August recovery means the July drop is still only the second fall in the last eight months of data, both of the last two readings probably nothing more than a repetition of summer month data in Germany that are notoriously volatile.

DE View: As a result, these production data still corroborating the (less) gloomy messages offered by recent business survey data regarding the factory sector in particular and output generally. Even so, the data is still very much consistent with industrial output and GDP growth in Q3 slowing sharply from that seen in the previous quarter: DE sees GDP rising by around half the 0.7% Q2 jump.

NETHERLANDS – Production Drops Back Sharply. August industrial production dropped back 1.6% M/M, more than unwinding the gains of the two previous months. As a result, the Y/Y rate turned much more negative at -2.3%.

OTHER WESTERN EUROPE

UNITED KINGDOM – Broad-Based Rise in Credit Demand Continues. The latest (ie Q3) BoE quarterly Credit Conditions Survey (conducted in the few weeks up until early last month) was notable in suggesting that lenders reported a continued increase in the supply of credit, but also demand. Indeed, Lenders reported a significant increase in household demand for secured lending and other unsecured lending in Q3, while demand for credit card lending was little changed. Notably, demand for lending was reported to have picked up for small and medium-sized businesses in Q3, while there was little change in demand from large companies. Household loan performance was reported to have improved in Q3. Credit conditions for non-bank financial corporations continued to ease in Q3.

Corporate Credit Demand Rising Clearly

Indeed, over and beyond the clear rise in demand and supply for household credit, the overall availability of credit to the corporate sector was reported to have increased in Q3, for the fourth successive quarter. This was a result of an improvement in the economic outlook, although market share objectives and competition from capital markets were also cited. More notably, demand for lending was reported to have picked up for small and medium-sized businesses in Q3, while there was little change in demand from large companies. Indeed, the balances relating to demand for credit from large and medium-sized firms were down but only from Q2 readings that were the highest recorded since 2007.

DE View: This update clearly shows that the Funding for Lending Scheme is doing its main job, ie getting bank funding costs lower and making lending more profitable. However, the improved economic climate is also asserting itself more clearly, with this now (not only) spilling over into the housing market and household lending generally, but also now (belatedly) into the corporate sector. Otherwise, the Help to Buy scheme is already having some effect in persuading more lenders to make higher LTV lending.

One clear trend from the survey is the increasing use by (larger) companies of alternative sources of finance such as bond issuance. Overall, however, these data continue to suggest that the economy is facing fewer headwinds from the banking sector but is not sailing with any tailwinds yet.

Industrial Production Corrects Sharply. Very much undershooting expectations this time around, August industrial production fell 1.1% in M/M terms, suffering a relatively broad-based fall, albeit the first drop since April. Indeed, within this, manufacturing dropped 1.2%, unwinding half of the gains of the two previous months and still keeping a good deal of the 2.0% surge in June intact.

Are Surveys Too Upbeat?

Admittedly, an upward trend is still intact; after all, the three-month rate of change remained around 1%. However, even on this basis, this latest batch of manufacturing output and export data are certainly not corroborating the much more upbeat business surveys seen of late, such as the most recent PMI readings would suggest which have persuaded some to start penciling in 4%-plus annualized growth rates for the last quarter. Export data (in trade figures released today) also provide clear grounds for not being too exuberant regarding the Q3 backdrop.

GDP in Q3 Similar to Q2?

Indeed, even under the (seemingly justifiable) assumption that production bounces back in September data, the outlook for Q3 GDP would not be for growth much more than the 0.7% Q/Q pace seen in Q2. DE actually still sees an 0.8% outcome, albeit much may depend upon whether

August construction data (due Friday) also conflict with survey results for the sector. Export data also provide clear grounds for not being too exuberant regarding the Q3 backdrop.

DE View: Indeed, while recent production data (possibly made more volatile by inappropriate seasonal adjustments) clearly suggest an uptrend in manufacturing is in place, it is hardly stellar, let alone the 20-year high pace suggested by the PMI data. Indeed, the Q3 GDP pace expected by DE is in line with that of the BoE and will serve to make policy makers all the more suspicious of business survey readings.

Exports Recover Modestly. Showing a much higher than expected shortfall, the total visible trade deficit was £ 9.63 bln in August, narrowing only slightly from the upwardly-revised £ 9.94 bln July deficit. This reflected only a modest recovery in (non-EU) exports from the marked slump back in July with EU exports actually falling afresh.

Profitability Still High. The net rate of return for UK non-financial companies in Q2 edged up to 11.4%, 0.1 percentage point above the previous quarter. The still-solid Q2 outcome reflected unchanged but robust profitability for services (at 15.1%), but with that for manufacturing also stable but at 7.29%. *Notably, profitability remains not too far below the long-term average, despite the clear weakness in the UK economy seen until recently.*

CENTRAL EUROPE, RUSSIA AND TURKEY – Chang Liu, London

CZECH REPUBLIC – Inflation Moderates Further. Consumer price inflation fell to 1.0% Y/Y in September from 1.3% in the previous month, hitting a new cycle-low. On a M/M basis, meanwhile, prices fell by 0.4%. The Y/Y breakdown showed the latest outcome to be a reflection of falls in price pressures for food (4.6% from 5.6%) and transport (-1.2% from -0.5%).

Notably, these latest figures actually came in clearly below the Czech National Bank's inflation forecast (made in August and by 0.4 percentage point).

ASIA PACIFIC ANALYSIS – Chang Liu, London

SOUTH KOREA – Household Lending Growth Picks Up Further. September data showed household lending growth rising to 2.9% Y/Y from 2.7% in the previous month, hitting a fifteen-month high. Mortgage lending growth, meanwhile, edged up to 3.2% Y/Y last month following a 3.1% gain in August, a nine-month high. However, growth in lending to companies was stable at 5.2% Y/Y in September. This reflected a fresh pick-up in lending to larger firms, but coming alongside the first slowing in SME lending growth since November 2012; albeit still being the second-highest outcome in 45 months.

Elsewhere, money supply data for August showed slower growth for all three measures, from the broader LF (formerly M3, 6.3% Y/Y from 6.5% in July) and M2 (3.9% from 4.6%), to the narrowest M1 (9.5% from 10.7%).

AUSTRALIA – Consumer Sentiment Falls. The Westpac-compiled consumer confidence index fell by 2.1% M/M in September, unwinding less than half of the 4.7% jump seen in the previous month but extending the recent volatility seen in the series. The breakdown showed the latest outcome to be a reflection of deterioration in both the expectations (-4.9% from 5.7%) and current conditions (2.2% from 3.2%) components.

These results, while certainly not encouraging, come after strong readings in preceding months and should have little impact on RBA thinking. Indeed, while further rate cuts by the RBA are still expected in the medium-term, the odds of such a move arriving as soon as the coming two months have diminished clearly following the more neutral tones seen in the Bank's recent statements.