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The Morning Briefing

North American Edition
Friday, October 14, 2011
6:30 am (EDT), 11:30 (BST)
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GLOBE AT A GLANCE – Andrew Wroblewski, London /Pierre Ellis, New York

Equities: Asia lower, Europe bounces. Stock prices in Asia generally some corrections. In contrast, European markets saw fresh gains, with prices little changed at the outset and then gathering strength through the morning session.

Bonds: Lower. Bond prices were generally lower across all markets. JGB prices fell across most of the curve, while European prices fell in unison.

Currencies: Little changed. The recent rally in the euro consolidated somewhat as the currency edged back to the €/$ 1.380 mark against the dollar. The yen, yet again, saw little change, staying around ¥/$ 77.00.

Eurozone: Sharp inflation confirmed. Seeing no revision, final data confirmed that HICP inflation jumped half a percentage point to a three-year high of 3.0% Y/Y in September.

China: Inflation slips slightly. In line with expectations, consumer price inflation slipped 0.1 percentage point to 6.1% Y/Y in September.

Singapore: Economy recovers somewhat. Coming in ahead of expectations, advance national accounts data showed GDP rising by 1.3% Q/Q in Q3 on an annualized basis.

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

Treasuries staged a modest rebound Thursday, with the two-year yield slipping a basis point and the ten-year yield down three. The market was modestly higher overnight, and saw a strong advance in early trading, but gave most of it back, starting in mid-afternoon. Encouragement to the early strengthening came from declines in global stock markets and in European peripheral-country debt, while a mid-day boost came from a very solid thirty-year auction result. Profit-taking was blamed for the late decline. Economic data, meanwhile, were a bit more unfriendly than not.

Contrary to expectations, the August **international trade deficit** did not deteriorate at all (Consensus: worsen by $1.2 billion; Decision Economics: worsen by $2.2 billion) holding absolutely steady—though at a July level worsened by $0.8 billion. Because of the revision, the quarter-on-quarter move broadly matched expectations, and should not jolt third-quarter GDP forecasts.

Results were good—perhaps better than expected—under the surface, with non-petroleum goods exports (-0.3%) giving up almost none of the 3.9% jump scored in July. That postponed, for at least a month, any day of reckoning with the deteriorating global situation. Imports, for their part, fell 0.4%, after a 1.5% rise in July—hinting at no weakening in domestic demand.

Weekly **initial claims**, meanwhile, were in line with expectations, slipping 1,000 (Consensus: +4,000; Decision Economics: +14,000) from a prior-week level revised up by 4,000). That result preserves a steep decline in average claims flow between payroll September and payroll October-to-date—indicating that layoffs clearly slowed.

Low figures registered in the two prior weeks had been under some suspicion, because they came at quarter-end, when claimants can sometimes lift their weekly benefits by postponing filling until the new quarter—and bringing a more recent quarter of employment into the calculation. The figure reported yesterday covered the first week of the fourth quarter, and did not reveal any more-than-seasonal bulge in filings—so the late quarter decline in claims reflected more than just postponements.

Notably, continuing claims numbers confirmed the market improvement, dropping 82,000 over the first two weeks of payroll October—a decline steeper than the slowdown in new claims alone would suggest, at least so far. That hints at a stiffening in new hiring, above and beyond the reduction in layoffs.

All together, the numbers yesterday added to perceptions that the economy has stabilized—and might even be transitioning into a mild phase of employment-validated expansion. More of that would obviously be welcomed by the Fed. Hawks will feel a bit vindicated, for now, while doves will be concerned that green shoots not be crushed by fears of any premature tightening.

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DAILY CALENDAR

Due today are September retail sales and import price data, all at 8:30 EDT/12:30 GMT, the first October reading of the University of Michigan Consumer Sentiment Indexes, at 9:55 EDT/13:55 GMT, and August business inventories, at 10:00 EDT/14:00 GMT.

The **retail sales** numbers will be the most closely watched today, both as a very fresh update on the uncertain, but critical, consumer spending trend, and as an input to GDP calculations. Apart from covering a very broad range of products, the numbers have the virtue of being presented in seasonally adjusted terms—making month-to-month comparisons straightforward, and the trend a bit easier to discern.

Forecasts today point to a reasonably strong overall rise (Consensus: +0.7%; Decision Economics: +0.6%), powered by a good-sized increase in motor vehicle sales, and a solid gain in the ex-auto total as well (Consensus: +0.3%; Decision Economics: +0.4%).

The ex-auto figure should get some boost from higher gasoline prices, but will also likely include decent performances in soft goods categories, reflecting a decent back-to-school season. However, there was no great emphasis on discretionary purchases in reports from store chains, so middle-of-the-road results are likely there—strong results would, of course, encourage greater confidence in the outlook.

As always, revisions to earlier data can be as important as the new number in shaping the trend, and in fixing the full-quarter results important for estimates of GDP consumer spending. Standing GDP forecasts should be incorporating assumptions matching the retail sales forecasts, but probably not the revisions. Tick-for-tick, revisions to earlier months in the quarter would be more powerful in shifting the quarterly total than surprises in the September result.

The next most important release of the day will likely be the **University of Michigan Consumer Sentiment** report. Though sentiment readings do not link closely to actual spending movements, they do serve as a general guide to consumer mood and willingness-to-buy—and confidence that spending will break upward out of the current too-moderate channel would be easier to mount if the sentiment numbers showed a decisive upward move. Of course, a downward move would be disturbing—though spending, so far, has not weakened anywhere close to the extent that sentiment numbers have.

Expectations today favor a modest rise in the headline index (Consensus: +0.8 point, to 60.2; Decision Economics: +1.0 point). That sort of result would confirm the near-four-point rebound in the index last month, but would make little further progress in reversing the near-20-point plunge in the index between May and August—and do little to encourage hope for any acceleration in consumer-spending growth.

Though less closely watched than the consumer-related reports today, the **business inventories** data cannot be ignored, since it can still exert a powerful impact on third-quarter GDP estimates. Forecasts point to a fairly restrained increase (Consensus and Decision Economics: +0.4%), consistent with a notable slowdown in nominal inventory growth in the third quarter from the second.

The potential for a numerical surprise today is a bit limited, since manufacturing and wholesale-inventory results are already in hand—so any forecast miss would be centered in the moderately sized retail sector. The significance of a big surprise in the retail sector would be relatively great, since it would be a direct reflection of supply/demand balance at the most important ultimate-buyer level. Of course, downside surprises would be good news there—even though the effect would be to suggest that current GDP was lower than thought.

Import prices, finally, are not too closely watched, but do say something about inflationary impulses coming from international commodity markets and from trends in the dollar. Looked at on an ex-fuel year-on-year basis, prices have been accelerating for months, peaking out at +5.4% in July, and nearly matching that in August (+5.3%). Now, the trend may be shifting (Decision Economics: +4.8%), as both the dollar and commodity prices are giving smaller upward boosts.

CANADA – Andrew Husby, New York

(Thursday) Trade deficit narrower than expected. The trade deficit came in narrower than expected in August at $0.6 billion, compared to an August deficit revised narrower to $0.5 billion. Nominal exports rose 0.5% and imports 0.6%, though in constant-dollar terms, exports fell 1.2% and imports only 0.2%, suggesting a less positive message for Q3 net exports than the headline indicated. Barring a significant widening in the real trade deficit in September, net exports should post a positive contribution to Q3 GDP due to a sharp export jump in July. However, given signs of slower global activity became more pronounced at quarter-end, a large move cannot yet be ruled out. And in any event, coming months are hardly likely to be robust on the trade front, leaving the general message one of lingering weakness.

In terms of some other details, machinery and equipment exports rose strongly for a second consecutive month, up 7.3% after a 5.6% gain in July, with aircraft contributing to the move there. Exports of energy products slipped 2.7%, and industrial goods and materials were up for a fourth consecutive month. On the import side, machinery and equipment imports rose 2.5% after a 4.6% drop in July, with recent months' performance hinting that investment probably softened a bit relative to recent quarters.

WESTERN EUROPE – Andrew Wroblewski, London

EUROZONE – Sharp inflation confirmed. Seeing no revision, final data confirmed that HICP inflation jumped half a percentage point to a three-year high of 3.0% Y/Y in September.

The breakdown released for the first time with this update showed that the sharp rise in inflation was broad-based, but very based around a swing in clothing inflation(from -2.8% Y/Y to 2.0%). As a result, core rates bounced clearly, with narrowest measure (which excludes energy, food, tobacco and alcohol) up 0.4 percentage points to 1.6% Y/Y, thereby unwinding the drop seen in June, while the core measure more favored by the ECB (where only energy and unprocessed foods are excluded) increased similarly but to 1.5%.

The question is the extent to which the very volatile clothing component in the Italian harmonized measure may have acted to push up Eurozone inflation; after all, the surge in the Italian figure (where the clothing component swung from -9.3% Y/Y in August back to 3.8% last month) accounted for half of the surge in the Eurozone figure. As a result, rather than suggesting clear underlying price pressures, this further highlights on-going computational problems with the HICP data, particularly in regard to measuring clothing prices against a backdrop of swings in sales and price incentives.

Better trade results. The (unadjusted) August trade balance showed a deficit of € 3.4 bln, narrowing clearly from the € 6.3 bln shortfall in the same month of 2010. Thiswas a reflection of a 14% increase in imports, outpacing the 11% rise in exports. Meanwhile, in seasonally adjusted terms, the trade deficit narrowed to -€ 1.0 bln from the previous month, as a 4.7% M/M rise in exports was only partly offset by the 2.7% gain in imports.

ITALY – Much higher inflation. Coming in a notch below preliminary data final consumer price inflation increased 0.2 percentage points to 3.0% Y/Y in September, the highest in just under three years. Overall, prices were flat in M/M terms. More notably, the EU-harmonized measure soared to 3.6%, up from 2.3%.

Mixed trade results. The (unadjusted) August trade balance showed a deficit of € 3.15 bln, narrowing modestly from the € 3.50 bln gap in the same month of 2010. This was a reflection of a 16.2% Y/Y increase in exports, being outweighed by the 12.5% rise in imports. Meanwhile, in seasonally adjusted terms, the trade deficit deteriorated slightly to a gap of € 2.71 bln in August, as a 2.0% M/M with little changes in either exports or imports.

CENTRAL EUROPE, RUSSIA AND TURKEY – Andrew Wroblewski, London, Andrew Husby, New York

HUNGARY – Output fall confirmed. Final data confirmed that August seasonally adjusted preliminary industrial production fell by 1.3% M/M, swinging into the negative from the 0.8% increase in the previous month. Meanwhile, in unadjusted Y/Y terms, output growth declined 0.4% in August from an increase in July of 2.7%, now a fresh cycle-low.

POLAND (Thursday) – CPI inflation turns softer. September consumer prices rose 3.9% from a year prior, slowing on the 4.3% reading in August, and decelerating further from the cycle-high of 5.0% reached in May. The slowing is welcome, but the measure remains well above the 2.5% target, meaning that while growth concerns are heightened, there is not scope for a rate cut yet.

JAPAN – Andrew Wroblewski, London

Corporate goods prices slip back. Largely matching expectations, corporate good prices fell by 0.1% M/M in September, a second successive fall but half that seen in August. Y/Y growth decreased 0.1 percentage point to 2.5%. The data showed export price pressures falling at a slightly less rapid pace (-1.0% Y/Y), alongside less softer import price inflation (at 10.9%).

Steady monetary dynamics. As expected, September M2 money supply growth remained at 2.7% Y/Y, still down from a July reading (of 3.0%) that had been the highest in a year. Meanwhile, growth in the broader M3 measure edged back up to 2.3% Y/Y.

ASIA – Andrew Wroblewski, London

CHINA – Inflation slips slightly. In line with expectations, consumer price inflation slipped 0.1 percentage point to 6.1% Y/Y in September, down further from a July reading which was the highest since June 2008. In M/M terms, prices rose by 0.5%. The Y/Y breakdown, meanwhile, revealed the latest moderation not to be a result of a easing in

price pressures for food (which remained at 13.4% Y/Y). Instead, non-food inflation slipped 0.1 percentage point to 2.9% Y/Y, easing from an August reading that had been the highest in over six years.

Elsewhere, producer price inflation also eased last month, but more clearly so, sliding to 6.5% Y/Y from 7.3% in August.

Further moderation in lending growth. Data for September showed new yuan loans growth slowed further to 16.0% Y/Y from 16.5% in the preceding month, a sixth consecutive fall. Elsewhere, money supply growth fell for the two broader measures of M2 (13.0% Y/Y from 13.5% in August) and M1 (8.9% from 11.2%), both hitting new cycle-lows, while M0 growth also weakened, but to 12.7%.

SINGAPORE – Economy recovers somewhat. Coming in ahead of expectations, advance national accounts data showed GDP rising by 1.3% Q/Q in Q3 on an annualized basis, unwinding some a 6.3% Q2 contraction albeit with the latter having followed a 27.4% jump in the previous quarter. In Y/Y terms, helped by base effects, GDP growth actually picked up sharply, gaining 4.9 percentage points to 5.9%.

The output-side breakdown showed the manufacturing sector to have been the main factor behind the rebound in growth in the quarter, having swung from a 23.7% drop rise in the previous quarter to a rise of 8.9%.

In view of the data, the Ministry of Trade and Industry said it is now expecting GDP for this year to come in around 5%, at the low point of its previous forecast of between 5% and 6%.

Modest policy response. The central bank, the Monetary Authority of Singapore, announced an easing in policy, saying that, while it would continue with the policy of a modest and gradual appreciation of the S$NEER policy band in the period ahead, given the expected moderation in core inflation, the slope of the policy band will be reduced, with no change to the width of the band and the level at which it is centered. The decision had been widely expected and contrasted with the result of the last MAS review in April, when it moved from a neutral bias to the current Singapore dollar appreciation path.

Retail sales bounce back. Surprising to the downside this time around, August seasonally adjusted real retail sales slumped 7.7% M/M, more than reversing the July gain of 1.6% but still being a fifth-straight increase. Much of the drop was vehicle related, however. Even so, the Y/Y pace of growth slowed markedly to 0.6% in August.