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The Morning Briefing

North American Edition
Tuesday, June 12, 2012
6:30 am (EDT), 11:30 am (BST)
Allen Sinai, Chief Global Economist

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

Equities: Europe higher, Asia mixed. Japanese equity markets closed lower. Other major Asian markets were mixed, however. European bourses seesawed through morning trade, albeit hovering in positive territory as midday approached, as investors remained cautious ahead of fresh Greek elections this weekend.

Bonds: Europe mostly lower, Japan higher. JGB prices rose across nearly all maturities, with the yield curve steepening on the medium to long-term end. European bond prices were mostly lower, however, with the yield curve steepening for long-termed maturities, but also saw continued divergences as Portuguese markets rose slightly.

Currencies: Weaker yen. The dollar rose against the yen on net during Asian hours, but then lost some of the ground gained in the morning European session, trading higher on net to around ¥/$ 79.50. Against the euro, the US currency moved mostly sideways through both sessions, moving marginally lower near $/€ 1.251.

United Kingdom: Manufacturing weakness clearer? Surprising to the downside, April manufacturing output fell 0.7% M/M, unwinding much of the unrevised bounce of the previous month.

India: Output recovers slightly. Coming in clearly below expectations, April industrial production rose only modestly by 0.1% Y/Y.

Indonesia: Policy held. Surprising few, Bank Indonesia kept its benchmark interest rate unchanged at 5.75% at its latest meeting in June.

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

Treasuries strengthened at the long end Monday, with the ten-year yield falling five basis points while the two-year yield held steady. Overnight trading started at price levels down a big step from the Friday close, but the market moved up steadily and was flat by the New York open, climbing, with some volatility, from there through the close. The main theme perceived was gradually building disillusion with the Spain bank bailout deal. There were no important economic data releases, but there was a noteworthy indication from Atlanta Fed President Lockhart—an important FOMC swing voter—that he did not favor new easing, as of yesterday: “I don’t think any of the options should be taken off the table under the current circumstances, but I am not convinced at this moment that the circumstances quite yet call for additional action.”

DAILY CALENDAR

Neither of the scheduled economic indicators today generally attracts much attention, though the market skittishness prevalent nowadays might still cause a reaction to any unusual result. **Tarullo**, meanwhile, seems to be bound by the pre-FOMC blackout—which, under the official definition, “begins on the Tuesday morning of the week prior to each regularly scheduled FOMC meeting.” He will be appearing at a San Francisco Fed Conference, discussing “Shadow Banking After the Financial Crisis,” a topic which need not prompt comments about current monetary policy in any case.

The **store-sales reports** will cover the second of five retail-June weeks—relatively early in a month when retailers still hope to make many sales at full price, before July clearances set in. The greater the degree to which they are able to do so, the healthier the indication on consumer willingness and ability to buy. Talk of unplanned discounting, particularly this early in the month, would be a very negative indication.

Import-price increases, looked at excluding fuel prices—and on the year-over-year comparison basis appropriate for not seasonally adjusted data—have been slowing very sharply in recent months, with April coming in at +1.3%, versus +3.4% as recently as December.

That pattern should carry on this month (Decision Economics: +1.0%)—with year-on-year increases in the trade-weighted dollar, and year-on-year declines in industrial commodity prices, continuing to grow. The risk today is that the number comes in even lower, or maybe negative—a result that would only encourage FOMC doves in their worries that inflation is decelerating below target

The Schedule:

Weekly chain store sales reports from ICSC/Goldman Sachs and Redbook Research, at 7:45 EDT/11:45 GMT and 8:55 EDT/12:55 GMT respectively, May import prices, at 8:30 EDT/12:30 GMT, and a speech by Fed Governor Tarullo, at 11:30 EDT/15:30 GMT.

DE Forecasts:

Import Prices, Ex-Fuel (May): +1.0% Year-on-Year.

WESTERN EUROPE – Andrew Wroblewski, London

EUROZONE

FRANCE – Employment rise confirmed. Updated data for Q1 confirmed that (non-farm) employment rose afresh with the unrevised 0.1% Q/Q increase being the first positive figure in three quarters. The latest result did not show strength on a broad basis, instead purely coming from a swing on the services and construction side. Regardless, the overall Y/Y rate more than halving (to 0.2%).

OTHER WESTERN EUROPE

UNITED KINGDOM – Manufacturing weakness clearer? Surprising to the downside, April manufacturing output fell 0.7% M/M, unwinding much of the unrevised bounce of the previous month (0.9%), it also being the third fall so far this year. The weakness was not broad-based however, with only half the sub-sectors recording falls and with a marked (and puzzling) surge in consumer durables goods output evident. Even so, Y/Y growth was less negative at -0.3%.

However, and probably due to poor weather during the month, energy/utility production was much stronger, a result that meant that overall industrial production was flat in M/M terms, after the 0.3% drop seen in the previous month.

Clearly, the swings in the overall production data of late reflect the impact of swings in the weather, with it likely that weather distortions may continue into the current quarter especially given the below normal temperatures seen to date.

In addition, further distortions will occur from the impact of the recent Royal Jubilee event which shifted a public holiday from May into June, meaning that production numbers will be boosted in May, but undermined severely in June. All of which will make the interpretation of the key manufacturing sector all the harder to discern in coming months. This may put greater emphasis on factory sector surveys, but even these may be giving inaccurate messages. Indeed, it is unclear whether the sharp fall in the recently-released May manufacturing PMI is a hint that output saw a clear turn for the worse in the middle of the current quarter or merely that this survey is painting a more accurate picture of a modestly-weakening manufacturing sector, having previously been exaggerating the strength in the sector.

Regardless, numbers such as these official output data will only serve to reinforce an emerging view within the MPC that it has been somewhat overly-optimistic about the UK economic backdrop and, in particular, the bounce in GDP that the BoE has penciled in for the current quarter.

DE View: The UK economy may avoid a further GDP correction this quarter but only because of a surge in energy production due to poor weather.

More mixed housing market signals? The latest (May) Royal Institute of Chartered Surveyors (RICS) house price survey highlighted a broadly stable backdrop for the sector. The survey showed somewhat fewer surveyors (realtors) reporting falling rather than rising prices, meaning that the headline price net balance actually recovered three points to -16. In contrast, and on a more downbeat note, new buyer enquiries eased back further, slipping just into negative territory.

Moreover, actual housing sales slipped a little, although the supply of housing (in the form of unsold stock on surveyors' books) also dropped modestly. As a result, the closely watched sales to stock ratio (often seen as an indicator of future prices) fell for the first month since last November.

Softer labor market signals? The latest (May) REC labor-market report pointed to some further softening in the jobs market. Indeed, the survey showed the permanent placements index slipping back slightly further, albeit with the decrease of 0.9 point (to 51.0) still taking it down only from a February reading which was the highest since May last year. Admittedly, the temporary placement index slipped a little further last month and to a fresh cycle-low of 47.5. Even so, the survey showed some slightly more positive signals regarding vacancies, while wage pressures picked up.

SWEDEN – Softer inflation. Largely in line with expectations, May headline CPI inflation fell 0.2 percentage point to 1.0% Y/Y, still the lowest since August 2010. Prices fell by 0.1% in M/M terms last month. Notably, the long-standing core measure (CPIX, which excludes mortgage costs and taxes) fell a notch to 1.0% Y/Y, while the underlying measure (CPIF, which the Riksbank puts more emphasis on and which holds mortgage interest expenditure constant) fell similarly but to 0.9%. *The various rates remain largely in line with projections made by the Riksbank back in February and will have negligible input into monetary policy thinking.*

CENTRAL EUROPE, RUSSIA AND TURKEY – Chang Liu, London

HUNGARY – Inflation falls. Confounding expectations of a further rise, CPI inflation actually fell by 0.4 percentage point to 5.3% Y/Y in May, more than unwinding the 0.2 percentage point increase in the previous month and now the lowest this year. In M/M terms, prices actually fell by 0.2%, dragged down by durable and other goods. The Y/Y breakdown, meanwhile, showed falling price pressures for services (3.8% from 4.2%) and other goods (7.7% from 9.1%), outweighing increases in alcohol & tobacco (13.2% from 12.6%). As a result, core inflation (which excludes food and energy) saw a less marked fall to 4.8% Y/Y from 5.1% in April.

Notably, recent increases in price pressures are partly the result of a rise in the value-added tax in November 2011. Also worth noting, the latest drop in price pressures from the "other goods" component was largely the result of a clear fall in motor fuel prices.

JAPAN – Andrew Wroblewski, London

Tertiary index falls further. Showing a weaker reading than expected, the April tertiary index fell 0.3% in M/M terms, the third fall in the last four months, albeit half that seen in March. The Y/Y rate, however, softened clearly at 2.5%.

Corporate goods prices fall clearly. As expected, corporate good prices decreased 0.4 % M/M in May, the first fall this year. Y/Y growth, however, turned more negative at -0.5%. The data showed export price pressures turning more negative (at -3.5% Y/Y), alongside a swing to the negative in import price inflation (to -2.5%).

ASIA – Chang Liu, London

INDIA – Output recovers slightly. Coming in clearly below expectations, April industrial production rose only modestly by 0.1% Y/Y, unwinding little of the 4.1% drop seen in the previous month which was the first negative reading since October 2011. The latest outcome reflected a steeper drop in mining production (-3.1% from -1.3%), but being outweighed by improvements in manufacturing (0.1% from -4.0%) and electricity (4.6% from 2.7%).

Notably, these latest figures, alongside disappointing Q1 GDP data released in late-May, clearly increases the pressure on the RBI to ease policy further at its upcoming meeting on 18 June, even as inflation in the nation remains above 7%. Further adding to the pressure, S&P announced on Monday that India may become the first BRIC nation to lose its investment-grade rating due to slowing economic expansion and roadblocks to economic policy making.

INDONESIA – Policy held. Surprising few, Bank Indonesia kept its benchmark interest rate (the BI rate) unchanged at 5.75% at its latest meeting in June. The latest decision comes after similar outcomes in the previous three months, but all following a 25 bp rate cut in February.

The statement accompanying the decision highlighted that the latest verdict was largely a response to the Bank's assessment that domestic economic growth remained solid despite a notably less optimistic assessment of the global economic outlook, supported by private consumption and investment. Specifically, the BI's growth forecast for 2012 was maintained at 6.3-6.7%. Inflationary pressures, meanwhile, were noted to have remained in check, partly due to declining global commodity prices.

It is worth noting that, despite the more downbeat view of the global economy, the final paragraph of the statement still saw the Bank emphasize its focus on stabilizing the rupiah and manage inflation expectations. The rupiah has been the worst performer in Asia after India's rupee (down 4% so far this year), dragged down by capital outflows from emerging markets as the Eurozone's fiscal problems intensified, and has been a clear concern for the BI in recent months. As such, the bank will probably refrain from any rate cuts at least in the near-term, with plenty of room to reduce rates in the future should the currency strengthen or following signs of a recovery in the global economy.

OCEANIA – Chang Liu, London

AUSTRALIA – Business confidence falls. The National Australia Bank measure of business confidence slumped 6 points in May to -2, now a new cycle-low. The business conditions index, meanwhile, dropped 4 points to -4, also a new cycle-low. Notably, the breakdown revealed the latest result to be a reflection of broad based deterioration across components, led by profitability and employment.