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The Morning Briefing

North American Edition
Friday, June 15, 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: Mostly higher. Japanese equity markets closed slightly higher. Other major Asian markets were mostly higher too. European bourses opened higher and then rose through the remainder of morning trade, boosted by hopes that the world's central banks will provide further stimulus and as investors awaited the Greek election results on Sunday.

Bonds: Europe mixed, Japan higher. JGB prices rose slightly across nearly all maturities. European bond prices saw continued divergences, however, with Bunds slightly lower, but peripheral markets all rising, led by clear increases in Italy and Greece.

Currencies: Stronger yen. The dollar fell against the yen through both the Asian and morning European sessions, moving lower to around ¥/$ 78.75. Against the euro, the US currency moved mostly sideways through both sessions, trading little changed near $/€ 1.263.

Eurozone: Exports fall further. Seasonally adjusted trade data showed a larger and higher-than-expected surplus of € 5.2 bln in April

United Kingdom: BoE worries see further and wider stimulus. In a keynote and sobering speech, Governor King hinted at the likely resumption of asset purchases but also pointed to new, additional measures designed to address rising bank lending costs.

Japan: BoJ unchanged. Surprising none, the BoJ Board voted unanimously to continue the target for the overnight call loan rate at zero to 0.1%, also making no further addition to the size of the Asset Purchase Program (still at ¥ 70 tln).

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

Long Treasuries fell back again Thursday, with the ten-year yield rising five basis points, while the two-year yield held steady. About a third of the full decline was suffered overnight, and the rest in a seesawing decline that ran from mid-morning to the close. A strong equity-market performance was a negative, worsened near the end by talk of G20 contingency planning to counter any Greece-election related market disruption with ample liquidity injections. Economic data of the day, meanwhile, were reasonably friendly, with an absolutely in-line May consumer price index report and a weaker-than-expected weekly **initial claims** reading.

Claims unexpectedly jumped 6,000 (Consensus and Decision Economics: -2,000) from a prior-week level revised up by 3,000, but still down 9,000 from the week before that.

Holiday-related factors were mentioned as affecting the weekly swing, but they do not obscure the fact that new claims have trended up, again, over recent weeks—hinting that employers have shifted gently back into trimming staffs outright, as well as curtailing new hiring.

The new figure covered the fourth of five weeks in payroll-June, and at 386,000, pulled the month-to-date average flow up to 382,000, versus 376,000 in May. A shift of that magnitude begins to be meaningful—particularly when combined with the cutback in new hiring signaled by the fact that payroll employment growth slowed over the last few months, even as initial claims held relatively steady through them.

Continuing claims also show a lack of vigor, holding net steady on a month-to-date basis—another hint that new hiring has slowed.

This is not yet a panic situation, and probably reflects a simple turn to caution in the business sector—now facing the big uncertainties of a Eurozone bank crisis and the fiscal cliff (a risk noted by Jamie Dimon Wednesday). The concern would be that caution intensifies to the point where layoffs worsen more than they already have—seriously stifling labor income growth.

Fed doves will see serious reason to get ahead of that possibility. Even policies realistically thought to have little further impact may be followed, in order to avoid a confidence-popping admission of impotence.

DAILY CALENDAR

Among the releases today, the Empire State and Consumer Sentiment readings are the freshest, and both relate to areas of great importance to the economic outlook—manufacturing activity and consumer spending, respectively—so they will surely attract the most market attention.

Industrial production results bear on manufacturing too, of course—constituting the most thorough, and probably most credible, reading on the sector each month—but they are relatively late arriving, and, even so, still subject to big revisions. The TIC data, meanwhile, are quite volatile, revealing trends only over the course of months—and their interest has been diminished, for the moment anyway, by the fact of the universal assumption that U.S. assets are the safe haven of choice in the current unsettled financial market environment.

Forecasts for the headline **Empire State Manufacturing index** vary quite widely (Consensus: -3.6 points, to 13.5; Decision Economics: +1.4 points), reflecting both the inherent volatility of the index and varying degrees of suspicion about the staying power of the 10.5-point jump in the index last month.

Suspicion about staying power here equates fairly closely to suspicion about the general stability of manufacturing activity, since the Empire State Survey was the only one of the three prominent regional surveys not to weaken sharply last month—making it the best predictor of the reasonably stable picture that emerged from the national-level ISM survey.

Of course, the real message of the broad scatter of regional survey results is that none of the individual readings is very reliable as a gauge of national-level activity—and that, last month, different regions had seriously different manufacturing-sector experiences.

A scattershot regional picture is not reassuring with respect to the national outlook—meaning that a notably weak indication today would probably be read as a sort of capitulation, and a negative signal on June national-level activity. Of course, upside results in the Philadelphia Fed and Chicago Purchasing Managers surveys to come would mute that message.

The **University of Michigan Consumer Sentiment Survey** is expected to show a relatively stable picture, with the 2.9-point jump in the headline number just partially reversed (Consensus: -1.8 point, to 77.5; Decision Economics: -0.4 point), and an in-line result would cause no significant reaction.

But, stability in sentiment is the critical issue now, so that a meaningful surprise in either direction could prompt a market adjustment. An upside move would surely be the greater shock, but might be discounted a bit because of the softer tone of recent spending data. A downside surprise would clearly reinforce the messages of other weaker numbers—building the case for a Fed move next week.

Industrial production forecasts are for very mild growth, at best (Consensus: +0.1%; Decision Economics: -0.1%), reflecting the very weak manufacturing hours reading in the employment report, and also the likelihood that growth in utilities and mining output will not match the very big increases seen last month.

This report is useful for bringing lots of industry detail, so that the source of recent choppiness in manufacturing activity (ex-auto manufacturing up 0.8% in February, down 0.6% in March, and up 0.3% in April) might be pinpointed. Obviously, broader-based shakiness—sort of aligning with the regional-survey volatility—would be more troubling than a narrowly focused problem.

The Schedule:

The June Empire State Manufacturing Survey, at 8:30 EDT/12:30 GMT, April TIC capital-flow data, at 9:00 EDT/13:00 GMT, May industrial production, at 9:15 EDT/13:15 GMT, and the first June reading of the University of Michigan Consumer Sentiment Survey, at 9:55 EDT/13:55 GMT.

DE Forecasts:

Empire State Manufacturing Survey (Headline index, June): +1.4 points, to 18.5.

Treasury International Capital (TIC) data (April)

Industrial Production (May): -0.1%..

University of Michigan Consumer Sentiment Index (June): -0.4 point, to 78.9

CANADA – Melissa Pumphrey, New York

(Thursday) Capacity utilization rises to highest level in five years. Total industry capacity utilization rose 0.2 percentage points to 80.7% (Consensus and Decision Economics: 80.5%) for the first three months of 2012. The current level of utilization is the highest since 2007 Q4. Manufacturing utilization jumped from 80.6% to 81.3%--also a five year high—as textile, machinery, chemical, metal, and automobile production slack each declined from a quarter ago. Oil and gas extraction is running at 90.2% of its capacity from 89.6% a quarter ago, while mining activity declined markedly—from 64.2% to 60.3%.

The BoC will look at this data as an indication that slack is being taken up in the goods sector of the economy; however, the goods sector is only about one-quarter of the Canadian economy. The BoC is predicting the economy to return to full capacity in the first half of 2013—at which point the call for tightening would grow louder. For now, the upbeat domestic economic backdrop will continue to play second fiddle to global headwinds.

WESTERN EUROPE – Andrew Wroblewski, London

EUROZONE – Exports fall further. Seasonally adjusted trade data showed a larger and higher-than-expected surplus of € 5.2 bln in April, up from the March downwardly revised € 3.7 bln as a further (1.3% M/M) slide in exports came alongside another but even steeper (3.0)% drop in imports.

The (unadjusted) April trade balance, meanwhile, showed a surplus of € 5.2 bln, a clear improvement from the € 4.5 bln shortfall seen in the same month of 2011. This was a reflection of a 6% increase in exports and a 1% fall in imports.

Employment drops further. Employment dropped 0.3% in Q/Q terms in Q1, a slightly less steep fall than in the previous quarter, albeit the third in succession. As a result, the Y/Y rate in Q1 turned more negative, falling 0.5%, over twice the pace seen in Q4. The partially available break-down showed that the latest Q/Q drop remained broadly based across sectors albeit with the declines largely being exclusive to the peripheral countries.

Car sales fall more steeply. Car registrations fell by 11.9% Y/Y in May, a steeper fall compared to the 8.4% drop in the previous month. The data showed more widespread weakness on a geographical basis, but still clearest in the likes of Greece but now also in Finland (-41.7%). German numbers turned back to the negative.

ITALY – Trade data still improving. The (unadjusted) April trade balance showed a deficit of € 202 mln, a much lower deficit than the € 2.82 bln shortfall seen in the same month of 2011. This was a reflection of a 1.7% Y/Y decrease in exports being more than offset by a 9.3% slump in imports. However, in seasonally adjusted terms, the trade balance showed a deficit of € 36 mln in April, a deterioration from the March surplus of € 714 mln, undermined by a recovery in imports.

OTHER WESTERN EUROPE

UNITED KINGDOM – BoE worries see further and wider stimulus. In a keynote and sobering speech, Governor King hinted at the likely resumption of asset purchases but also pointed to new, additional measures designed to address the key threat currently affecting the economy in the form of rising bank lending costs. Indeed, he stressed that further monetary easing (ie asset purchases) and attempts to lower bank lending costs are complementary not alternatives.

A fresh round of asset purchases, still confined to gilts is now likely in July, but other measures are on the way. Most immediately, will be the activation of an emergency scheme (called the Extended Collateral Term Repo Facility), that will run for a minimum of four months, that offers six-month liquidity to banks in tranches of no less than £ 5 bln a month and will carry a premium over bank rate of just 25 bp, a far lower spread than when first envisaged back at the end of last year. The first such auction will come on June 20.

More notable, at least from the BoE standpoint, will be what is to be known as a funding for lending scheme, to be introduced to bridge the gap until calmer times arrive. This would provide funding to banks for an extended period of several years, at rates below current market rates and linked to the performance of banks in sustaining or expanding their lending to the UK non-financial sector during the present period of heightened uncertainty. The Bank would lend, as in its existing facilities, against a much greater value of collateral comprising loans to the real economy to protect taxpayers, this possibly supporting new loans by up to £ 80 bln.

There is still little detail about the latter facility, with doubts about how much it really could boost lending: as banks would still carry the risks of loans, they are still only likely to wish to lend to credit-worthy concerns that may be reluctant to borrow particularly in the current uncertain climate.

Regardless, the liquidity scheme may be useful, most clearly in the possible deeper turmoil that coming weeks may bring. All of which underscores that the BoE is battening down the hatches, aware of the brewing storm ahead.

Exports slump back. Showing a much higher than expected shortfall, the total visible trade gap deficit was £ 10.10 bln in April, actually the second –highest shortfall on record. The main factor was a clear slump in exports (of 8.6%) M/M), more than unwinding the marked bounce of the previous month, but with all the weakness widespread both geographically and among types of goods. Notably, the shortfall excluding oil and erratic items widened less appreciably to £ 8.27 bln while import prices rose further.

It is unclear whether the slump in exports is indicative a fresh drop in demand and/or is merely another distortion caused by the vagaries of poor weather during the last few months.

CENTRAL EUROPE, RUSSIA AND TURKEY – Chang Liu, London

HUNGARY – Output recovers. Final data confirmed that April seasonally adjusted industrial production dropped by 2.4% M/M, more than unwinding the 0.6% gain in the previous month and extending the volatility in the series. Meanwhile, in unadjusted Y/Y terms, output fell more markedly by 3.1%, unrevised from the preliminary reading, and also following a 0.6% increase in March.

TURKEY – Softer labor market conditions? The unemployment rate in the three months through April fell to 9.9% from 10.8% in the same period of 2011. On a seasonally adjusted basis, however, the unemployment rate was actually stable at 9.1% in March, still the joint second-lowest in the cycle.

Elsewhere, also on an adjusted basis, the March employment rate rose to 45.0% from 44.9%, albeit still unable to unwinding fully the 0.2 percentage point fall in the previous month. Meanwhile, on an unadjusted basis, the employment rate also picked up, but to 43.8% from 43.7% in the same period of 2011. The participation rate, however, dropped 48.6% from 49.0% on an unadjusted basis, but was stable at 49.4% in adjusted terms.

JAPAN – Andrew Wroblewski, London

BoJ unchanged. Surprising none, the BoJ Board voted unanimously to continue the target for the overnight call loan rate at zero to 0.1%, also making no further addition to the size of the Asset Purchase Program (still at ¥ 70 tln).

Overall, there was (again) little change in its thinking regarding the economy. It still suggested that there are some signs of a pick-up, albeit with a slightly more upbeat aspect in terms of its description about the firmness n domestic demand.

Of course, there was a clear remainder of the risks ahead, most notable in relation the Eurozone situation.

Following the meeting, Governor Shirakawa highlighted his view that the economic slowdown in China may be prolonged and that the European debt and political crisis represents the highest risk to Japan's recovery. As a result, he underlined that if there is any suspicion about BoJ policymaking, the stance of pushing ahead with powerful easing has not changed at all.

ASIA – Chang Liu, London

PHILIPPINES – Unemployment rate falls. The unemployment rate was 6.9% in the three months to April, down from 7.2% the previous quarter and now the second-lowest in the cycle. The latest result was also 0.3 percentage point lower than the outcome from same period in the previous year. The participation rate, meanwhile, picked up to 64.7% from 64.3% in the three months to January. Compared with the same period in 2010, the participation rate was up by 0.5 percentage point.

SINGAPORE – Jobless rate rises. Labor market data showed the seasonally adjusted unemployment rate rising to 2.1% in Q1 from 2.0%. Meanwhile, employment rose by 27 200, a smaller gain than the 37 600 increase in Q4, but with most of the pick up once again coming from services employment, albeit with manufacturing employment also swinging back into expansion in the quarter.

Mixed messages in retail sales. April seasonally adjusted real retail sales were flat in M/M terms, this following a 0.9% gain in the previous month and still extending the volatility in the series.

The Y/Y pace of growth, however, slowed sharply to 1.5% from 7.1% in March, now the second-weakest gain in the cycle. The latest result was partly a reflection of a marked slowing in vehicle sales growth (0.5% from 15.7%), but with ex-vehicles sales growth also moderating to 1.8% from 4.5% in March.

OCEANIA – Chang Liu, London

NEW ZEALAND – Clear rebound in manufacturing. The May Performance of Manufacturing Index jumped 7.5 points to 55.7, a fifth above-50 reading in the past six months and now the second-highest in the cycle. The breakdown revealed the latest moderation to be a reflection of a sharp swing into expansion for production and new orders, alongside faster growth in employment.