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New York: 212 884 9440
London: 011 44 20 7959 3045
Boston: 617 994 0500

The Morning Briefing

North American Edition
Wednesday, June 20, 2012
6:30 am (EDT), 11:30 am (BST)
Allen Sinai, Chief Global Economist

GLOBE AT A GLANCE – Chang Liu, London/Andrew Husby, New York

Equities: Europe flat, Asia higher. Japanese equity markets closed higher. Other major Asian markets were mostly higher too. European bourses seesawed through early morning trade as investors awaited the Fed decision later today.

Bonds: Europe mixed, Japan down. JGBs fell across nearly all maturities, with the yield curve steepening on the medium to long-term end. European bonds prices saw continued divergences, however, with Germany, France and Greece lower, but Italian, Spanish and Portuguese markets rising.

Currencies: Little change. The dollar seesawed against the yen through both the Asian and morning European sessions, moving little changed near ¥/$ 78.97. Against the euro, the US currency saw broadly similar developments, trading around $/€ 1.269.

G20: Leaders commit to lower borrowing costs. The G20 leaders pledged their nation's monetary policies to support growth, promising to act together to strengthen the recovery and address financial market tensions in an announcement on Tuesday.

United Kingdom: More asset purchases narrowly overruled. Surprising some, the minutes to the 6-7 June BoE MPC meeting showed the committee to be clearly split over the decision not to enlarge the asset purchase program any further.

United Kingdom: Jobless claims rise. Claimant count unemployment rose in May, the gain being very much unexpected.

Sweden: Confidence readings less upbeat. National Institute data for May showed the so-called economic tendency indicator decreased for a second successive month.

Australia: Sharp fall in dwelling starts. Following a 4.5% Q/Q drop in Q4, dwelling starts slumped 12.6% last quarter.

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

Treasuries took a step down Tuesday, with the two-year yield up a basis point and the ten-year yield rising five. The market was broadly stable overnight, but sank in the morning, with the closing levels touched by noontime. Early afternoon saw a sharp further mini-plunge, but that was quickly reversed, and prices held steady in late trading. New hopes for positive Eurozone movement, reflected in strong stock markets, were seen as the major negative for Treasuries, with pre-FOMC caution also a factor. U.S. data were also neutral to bond-unfriendly, with a relatively strong Mau housing starts report accompanied by a set of quite lackluster weekly store sales reports.

Housing starts unexpectedly fell 4.8% (Consensus: +0.4%; Decision Economics: +2.5%), but from a prior-month level revised up by 3.8%. Critically, the decline was centered in the always volatile multi-family sector (-21.3%).

Single-unit starts—driven by prices and activity in the overall single-family market—were quite strong, rising 3.2% from a prior-month level revised up by 1.6%. Single-family starts rose in all regions but the Northeast, where they were flat.

This was the third consecutive monthly rise in single-family starts—a hopeful indication on expected sales activity in the new-home market. That, in turn, must reflect enough strength in the much-bigger existing-home market for builders to believe that they can sell newly constructed units at a profitable price.

Sales levels remain very low in both segments of the single-family market, but positive movement is positive movement—and the hope is that low interest rates are finally having some effect.

Fed officials will welcome these results, of course, but for doves, and probably middle-of-the-roaders too, the recent accumulation of hesitation-provoking downside risks—Eurozone, cliff, and elections—pushes strongly for more action, if only to preserve the appearance that the Fed still has tools to deploy.

Meanwhile, **store sales** in the third of five retail-June weeks continued the pattern of the month to date—with retailers noting a clear downshift in tone from the May month, but not expressing alarm.

Some weakening in discretionary purchases was highlighted by both surveys—though Fathers Day did produce a flurry of activity, and some "positive spillover" to other merchandise, for Redbook-group stores. ICSC/Goldman

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Sachs made no special note of that, and emphasized the dampening effect of economic uncertainty—though expressing hope that lower gasoline prices will help.

So far, ICSC is sticking to its original forecast for a 3.5-4.0% year-on-year industry comparable-stores increase, while Rebook is tracking a bit shy of its +2.9% goal, with +2.5% seen month to date.

Those sorts of results would probably correspond to roughly a 0.1% rise in sales ex autos, gasoline, and building materials—similar to what was seen in the official April and May seasonally adjusted retail sales numbers.

That pattern would sustain expectations of a moderate rise in second-quarter GDP consumption—but would create a very neutral liftoff base for the third quarter. New strength there would almost surely require some acceleration in income growth, something very hard to obtain without healthier employment results.

DAILY CALENDAR

Markets are generally regarded as having priced in some sort of new step by the **FOMC** today, whether a text commitment of a new form, or a balance-sheet operation.

A heightened sensitivity to downside risk was clearly signaled at the last FOMC meeting, with "several" members going on record in the Minutes as favoring new easing if those risks grew unacceptably—and a larger collection of other dovish voters surely very open to persuasion on the matter.

Now, mentions of serious downside risks have become notably prevalent in speeches by FOMC participants—and Vice-Chairwoman Yellen, who is enough of a team player not to publically disagree in any serious way with Chairman Bernanke, all but called for new steps in a June 6 speech: "…There are a number of significant downside risks to the economic outlook, and hence it may well be appropriate to insure against adverse shocks that could push the economy into territory where a self-reinforcing downward spiral of economic weakness would be difficult to arrest."

An extension of "Operation Twist" could be the most natural step. It would be a simple extension of an existing program, and would be limited in scope by a much reduced supply of short-term securities to sell, and by perceptions of diminished liquidity in the time-to-maturity brackets where the Fed has been buying.

"Twisting again," the FOMC would avoid the appearance of any precipitate move, but would still be doing something that could be portrayed as constructive—meanwhile, gaining time to determine whether threats to the economy have risen to the level that would make the big step of another balance-sheet expansion more broadly acceptable.

Despite the sharp new concerns about downside risks, most Fed speakers have tended to suggest that they do not see recent economic data as having changed their personal economic forecasts very much—though clearly any movement would have been downward. That sort of little-change, but negative, adjustment is the most likely picture to emerge from the central-tendency forecasts today—with very minimal alteration, for the moment, to the funds-rate forecasts.

The Schedule:

The only important item scheduled today is the windup of the two-day FOMC meeting, with the meeting statement due at 12:30 EDT/16:30 GMT, the central tendency forecasts and funds rate charts at 14:00 EDT/18:00 GMT, and Chairman Bernanke's press conference, at 14:15 EDT/18:15 GMT.

CANADA – Melissa Pumphrey, New York

(Tuesday) Wholesale trade exceeds forecasts on fertilizer sales. April wholesale sales increased 1.5% from March (Consensus: +0.2%; Decision Economics: +0.3%) to C$49.3 billion—the fastest pace in eleven months. In volume terms, wholesale trade was up by 1.3% m/m. Nearly the entire increase is attributable to a 51.8% jump in the sale of fertilizer products. Inventories increased for the fifth consecutive month—posting a +0.3% print (Decision Economics: +0.6%) to C$59.8 billion. The inventory-to-sales ratio moved lower to 1.21 from 1.23 last month.

WESTERN EUROPE – Chang Liu, London

EUROZONE

GERMANY – Pipeline prices fall. Undershooting expectations, May producer prices actually fell by 0.3% M/M, the first negative reading this year and more than unwinding the 0.2% gain in the previous month. The latest fall was largely a reflection of a drop in energy prices, as the ex-energy gauge was flat in the month. The overall Y/Y rate, meanwhile, dropped 0.3 percentage point to 2.1%, now a 23-month low.

ITALY – Industrial orders fall further. Data for April showed that Y/Y industrial orders fell 12.3% Y/Y, a slightly less steep drop than the 14.3% fall seen in March albeit still being the second-largest decline in the cycle. The further

fall was based more around domestic demand weakness. Elsewhere, the latest result also saw a 0.5% fall for the adjusted M/M number, the first negative reading since January.

NETHERLANDS – Consumer sentiment deteriorates further. Consumer confidence for June softened further, dropping two points to -40, now a fresh cycle-low.

OTHER WESTERN EUROPE

UNITED KINGDOM – More asset purchases narrowly overruled. Surprising some, the minutes to the 6-7 June BoE MPC meeting showed the committee to be clearly split over the decision not to enlarge the asset purchase program any further. Specifically, the minutes revealed a narrow 5-4 decision in favor of keeping the Bank's bond-purchase target unchanged at £ 325 bln, with MPC members Posen, Miles, Fisher and (notably) Governor King dissenting. Members Posen, Miles and Governor King preferred a further enlargement of £ 50 bln, while Fisher favored a £ 25 bln increase. Perhaps even more notably, the minutes revealed that most PMC members judged that "some further economic stimulus was either warranted immediately or would become warranted in order to meet the inflation target".

This predisposition towards further asset purchase came as all members of the Committee judged that the balance of risks to medium-term inflation had shifted towards the downside compared to the May Inflation Report projections and as downside risks to domestic growth was judged to have grown. However, the MPC also noted reasons against adding further stimulus at the meeting, which included the uncertainty of how quickly inflation will fall back to target and the (then) upcoming Greek and French elections, as well as the European Council meeting due at the end of this month, all of which was judged to have an effect on the case for any further stimulus.

On the topic of policy tools, the Bank once against rejected a further reduction in the Bank Rate as having no advantages over an expansion to the asset purchase program, which was still assessed to be an effective tool for lowering a range of market interest rate and supporting asset prices. However, and notably, as some members suggested additional tools be considered in response to higher bank funding costs in the UK as a result of the Eurozone crisis, Governor King informed the Committee that discussion were underway with the Treasury over possible measures to ease banks' funding costs and enhance their ability to lend.

All of this suggests that the outcome this month was very finely balanced, with the final decision seemingly mostly motivated by many members' view that key events occurring in coming weeks would have a material bearing on the situation in the Eurozone and thus there was merit in waiting to see how events unfolded before deciding on any possible further stimulus. However, it is also notable that the minutes showed the Committee's opinion that even if a disorderly outcome in the Eurozone could be avoided, the ongoing threat of such an event alone would continue to weigh on economic activity in the UK, which, combined with the latest drop in headline CPI inflation revealed on 19 June, suggests that a further £ 50 bln of asset purchases now appears to be the most likely outcome at the BoE's upcoming meeting in July.

Jobless claims rise. Claimant count unemployment rose in May, the gain being very much unexpected. However, not only did joblessness on this basis rise by 8 000, there was also a revision to April numbers, now showing a fall of 12 800 as opposed to the larger drop originally estimated last time around.

The latest outcome comes after the first consecutive drops in claimant count unemployment in 18 months. Admittedly, this latest result still left the jobless rate (on this basis) at 4.9%. However, the (broader) ILO measure of unemployment actually saw a decrease this time around with the 51 000 drop being the third in succession, but with the jobless rate remaining at 8.2%.

On a more upbeat note, the rate of redundancies fell, while vacancies rose slightly. Hours worked, meanwhile, dropped slightly, but employment rose further. However, what work there was is still dominated by (possibly far from voluntary) part-time working and self-employment.

Earnings growth softens. Average weekly earnings growth jumped clearly to 1.4% Y/Y in the three months to April, this occurring partly as a result of the single month Y/Y figure more than doubling to 1.9%. These stronger numbers were affected mainly by bonus pay effects as regular pay earnings growth only saw a slightly increase to 1.8% from 1.6% in March.

SWEDEN – Confidence readings less upbeat. National Institute (KI) data for May showed the so-called economic tendency indicator (an aggregation of all sector surveys discussed below) decreased for a second successive month, falling 1.7 points to 98.7, thereby unwinding a little more of the 9.9 surge seen cumulatively in February and March. Notably, however, the headline figure is now below its long-term average, albeit marginally, for the first time in four months.

Among the business sectors, there were (again) mixed movements, with slight improvement in private services outweighed by further deterioration in manufacturing and construction. Meanwhile, the consumer confidence

indicator also fell further, slipping 2.8 points to 3.1. Notably, household inflation expectations (one year ahead) rose slightly from 2.1% to 2.4%.

JAPAN – Chang Liu, London

Exports fall. Coming in clearly larger than expected, the May (unadjusted) trade balance deteriorated to a deficit of ¥ 907.3 bln from a shortfall of ¥ 857.3 bln in the same month of 2011. Meanwhile, the seasonally adjusted trade gap widened to a shortfall of ¥ 657.2 bln from ¥ 512.0 bln, as the first drop in exports since November 2011 (-0.5% M/M) was outpaced by a rebound in imports of 1.9%.

Output recovers slightly. The all industries index rose by 0.1% M/M in April, ending a run of three successive declines including the 0.3% fall seen in the previous month. The Y/Y rate, meanwhile, fell to 4.1%, albeit still the second-highest in the cycle.

ASIA – Chang Liu, London

TAIWAN – Further fall in export orders. Coming in above expectations, May export orders still dropped 3.04% Y/Y, a slightly less steep fall than the 3.52% decline in the previous month albeit still the third-largest drop in the cycle. The breakdown showed the latest decline to be led by footwear (-24.05% from 22.54%) and transport equipment (-32.10% from -2.09%) but being undermined by improvements for food (7.26% from 5.17%), wood (23.81% from 8.70%) and electronics (-0.37% from -2.85%). Meanwhile, on a geographical basis, export orders actually improved slightly to nearly all major trading partners, with Europe being the exception.

SOUTH AFRICA – Chang Liu, London

Inflation moderates further. Surprising to the downside once again, consumer price inflation fell clearly by 0.4 percentage point to 5.7% Y/Y in May, more than unwinding the 0.1 percentage point rise in the previous month, dragged down by falling price pressures for food. Meanwhile, on a M/M basis, prices rose by 0.1%.

It is worth noting that headline inflation is now within the SARB's target range of 3-6% for the first time in the cycle.

OCEANIA – Chang Liu, London

AUSTRALIA – Sharp fall in dwelling starts. Following a 4.5% Q/Q drop in Q4, dwelling starts slumped 12.6% last quarter, now the sharpest decline since Q3 2010. The breakdown showed the latest drop to be a reflection of very broad based deterioration across components, led by steeper drops for other new residential buildings (-22.3% from -7.5%) and other new private-sector buildings (-21.6% from -6.3%).

Mixed messages in leading indexes. The leading index, compiled by Westpac, rose by 0.5% M/M to 280.3 in April, a same-sized increase as in the previous month and now a new cycle-high. Meanwhile, the annualized growth rate was 0.2%, up from a fall of 0.7% in March albeit still clearly below trend growth (of 2.6%) for an eighth straight month. The coincident index, meanwhile, rose by 0.4% M/M to 276.8 in April, a fresh cycle-high and now with an annualized growth rate of 4.3% exceeding trend growth of 3.1% for a fourth consecutive month.

Elsewhere, and in contrast, the April Conference Board-compiled leading index actually dropped by 1.4% M/M to 122.9, accentuating the 0.2% fall seen in the previous month and now a new cycle-low. The coincident index, however, rose by 0.2% M/M to 120.4, a new cycle high.

NEW ZEALAND – Current account swings into deficit. Coming in below expectations this time around, balance of payments data for Q1 showed a shortfall of NZD 1.310 bln, swinging into deficit from a modest NZD 0.090 bln surplus in the same quarter of 2011. On a seasonally adjusted basis, meanwhile, the deficit widened in the last quarter to NZD 2.808 bln from a shortfall of NZD 2.184 bln in Q4. The (unadjusted) breakdown revealed the latest outcome to be the result of a narrowing in the goods and services surplus, alongside a slight widening in the income balance deficit.

Notably, the larger-than-expected deficit, at 4.8% of GDP, is unlikely to have any major impact on Q1 GDP expectations ahead of the data release on Thursday.