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The Morning Briefing

North American Edition
Friday, July 27, 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 Flat, Asia Higher. Japanese equity markets closed higher. Other major Asian markets were mostly higher too. European bourses seesawed through morning trade following reports that the ECB may be preparing to purchase Italian and Spanish debt.

Bonds: Europe Mixed, Japan Lower. JGB prices fell across nearly all most maturities, with the yield curve steepening on the medium to long-term end. European bond prices saw continued divergences, however, with Germany, Portugal and Greece slightly lower, but Italian and Spanish markets rising.

Currencies: Stronger Yen. The dollar seesawed against the yen during Asian hours, but then fell on net through the morning European session, moving lower to near ¥/$ 78.13. Against the euro, the US currency moved mostly sideways through both sessions, trading around $/€ 1.227.

Germany: Consumer Price Inflation Eases Further? According to data from the six laender, July CPI inflation is likely to have fallen by around 0.1 percentage point from the 1.7% Y/Y rate seen in the previous month.

Spain: Jobless Rate Hits New High. The unemployment rate rose to 24.63% in Q2.

China: Business Confidence Revised Higher. According to Market News International, July final business confidence numbers saw a 0.10 point upward revision from the flash estimate to 49.73.

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

Treasuries lost further ground Thursday, with the two-year yield rising a basis point, to 0.23%, and the ten-year yield up our, to 1.44%. The market was little changed in overnight activity through midday London hours, when it took a step down on a statement from ECB President Draghi that "Within our mandate the ECB is ready to do whatever it takes to preserve the euro. Believe me, it will be enough." Prices never recovered from that decline. U.S. data, meanwhile were quite mixed, but more friendly than not.

Starting off, weekly **initial claims** dropped a more-than-expected 35,000 (Consensus and Decision Economics: -6,000), from a prior week level revised up by 2,000. Labor Department analysts pointed to no specific special factor operating in the week, but emphasized the difficulty of proper seasonal adjustment at this time of year.

Some of the difficulty relates to shifting model-year changeover shutdowns in the motor vehicle industry—and, to the degree that this year's pattern leaves more workers than "normal" employed in the critical payroll survey week, there will be a positive employment impact in industries tied to auto production--including some service-sector companies.

The new initial claims figure covered the week just past the July payroll survey period important for the next round of employment data, so the impact on employment forecasts will be limited to the extent of any hint given about the validity of claims numbers that were within the survey month.

That hint is not negative--so the fact that there appears to have been no full catch-up for the unusually low claims number two weeks ago (the subsequent rebound took the level of claims only back to the level prevailing before) suggests that the total number of layoffs within July did fall from June.

That means that employment numbers would look a bit stronger--perhaps 25-50,000 higher than might have been thought before—but that the strength would be artificial, and apt to be reversed later, when the normal auto-sector layoffs do occur.

The problem will be in determining in what the vastly larger "rest" of the labor market was doing all along. Fed officials will wrestle with that problem in coming months.

The issue for next week is whether FOMC voters convinced that what was done in June was inadequate to the situation even as it then existed—none of whom will have been convinced otherwise in the meantime—will be able to bring waverers around to that view. These numbers give them no new help.

June **durable goods orders**, meanwhile, rose a more-than-expected 1.6% (Consensus: +0.4%; Decision Economics: +0.8%) from a prior-month level revised up by 0.4%. But, the overall increase was more than accounted for by a 51% jump in defense equipment orders, with the total ex-those falling 0.7%.

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Even that ex-defense decline was moderated by a 31.3% jump in commercial aircraft orders—without those, the ex-defense total fell 1.6%, more than offsetting the 1.1% rise seen in May. The second-quarter average for that total remains up 1.4% from the first quarter, but the June level is 1.6% lower than the second-quarter average—a weak position.

The first-quarter average, meanwhile, was down 0.6% from the fourth quarter, so the total has risen at only a 1.6% annualized nominal rate for two quarters running now—a big causal factor in the GDP growth slowdown. June gives no hint of any acceleration.

Critically, the non-defense-capital-goods-ex-aircraft total—an indicator of medium-term investment plans--weakened even within the mild ex-defense-ex-aircraft trend, showing a 1.4% decline in June, and a 0.8% decline on a quarter-to-quarter basis. The first quarter had risen only 0.1% from the fourth quarter, so investment-goods orders have been falling at an average annualized rate of 1.4% for two quarters now.

These numbers are notoriously volatile, so Fed analysts will be studying averages and trends just like those laid out here--and the conclusion has to be that current interest rates have done little to overcome whatever lack of opportunity or confidence is keeping generally interest-rate-sensitive spending so restrained..

The shakiness-cum-weakness in investment-goods demand will be particularly disturbing—since the lack of business confidence evident there will also be affecting workforce-related decisions. With all arguments now favoring yet-further confidence deterioration, FOMC doves will see even more need for some gesture of support from the Fed. Their more-moderate colleagues might be nudged in that direction too.

Finally, the June **pending existing-home sales index** came in on the soft side of general expectations, falling 1.4% from a prior-month level revised down by 0.4%.

The level of the index remains high--it had risen a net 3.4% between February and May—so the new result is not a weak indication. But it, like the very poor June new home sales reading, fails to confirm the sort of acceleration in demand that seemed to be hinted at by strong July NAHB survey and June single-family housing starts.

Maybe that acceleration came on sharply in late June and early July—but that remains to be seen, and FOMC doves will probably not feel comfortable in waiting for it.

Though regional results did show a standout decline in the Northeast (-7.6%), just as the new home sales numbers had, all of the regional performances in this report seem to be in line with longer-run trends—so there is no hint that the data are aberrant. The message continues to be one of just slow, steady, healing in housing demand, despite the now-long period of very low interest rates.

That is not enough of a business-activity driving, or consumer-confidence-building, trend to offset what may be developing weakness in all other categories of private spending.

FOMC doves will see reason to hesitate in giving the economy what they would probably see as a confidence-building jolt from a significant new Fed initiative. In the context of the deterioration in business confidence signaled by the durable goods results, their less-convicted colleagues may be coming around to agreeing with them.

DAILY CALENDAR

The GDP numbers, including revisions back through calendar 2009, will clearly get most attention today—having the potential to shift Fed, and market, perceptions both of the current state of the economy and of how things got to be the way they are. Consumer Sentiment revisions, if unusually large, do have some potential to jolt markets, so the release can never be ignored, but a more typical smallish revision would cause no stir.

GDP results, as always, will be important for assimilating monthly business and price data into a fully consistent, inflation adjusted, and seasonally adjusted overall total, as well as meaningful subcategories of demand and income.

In the second quarter, the main news will be in the business investment, net exports, inventories and government totals—it is already clear that real consumer spending will rise less than 2%. The issue will be whether the other spending categories, particularly the private-sector ones, have enough vigor to boost overall growth to a rate where enough income can be generated to support the faster consumer spending growth necessary to keep GDP reliably close to potential.

Forecasts tend to suggest not, with overall growth seen being painfully slow (Consensus: +1.4%; Decision Economics: +1.6%). Those sorts of results would comport well with the much-slowed payroll employment growth seen in the quarter—and income results probably will too, giving no cause for optimism that consumer spending will reaccelerate in coming months.

With GDP data being revised back to the period of the deepest depths of the recession, the big interest will be in what the corrected history of the period since might say about how far below potential the economy still is at this stage—

and whether that more accurate picture better supports the dovish or hawkish views of the role “slack” will play in influencing inflation over coming years.

There will also be some curiosity about the corrected history of final sales to domestic purchasers, the demand-side aggregate which the Fed, at least theoretically, affects most directly with its rate-oriented policies. Weaker historical growth there would probably be read as suggesting that the Fed was behind the curve in its easing moves—and doves would see that as offering even more reason to ease further

Revisions to **University of Michigan Consumer Sentiment** numbers are read for what they suggest about developments over the course of the month—on the premise that the revised figure represents an average of the early-arriving responses reflected in the preliminary reading and the late-arriving responses.

That sort of mixing would imply that any change between the preliminary and final sentiment numbers would equate to only a fraction of the shift in mood between the early and late responding groups. Headline-index forecasts point to little if any revision (Consensus: unchanged at 72.0; Decision Economics: 71.0), and something more dramatic would probably attract attention.

The Schedule:

Second quarter GDP estimates, at 8:30 EDT/12:30 GMT, and final July University of Michigan Consumer Sentiment figures, at 9:55 EDT/13:55 GMT.

DE Forecasts:

Real GDP Growth (Second-quarter “advance” estimate): +1.6%.

University of Michigan Consumer Sentiment Index (July final): 71.0, revised from 72.0.

WESTERN EUROPE – Andrew Wroblewski, London

EUROZONE

GERMANY – Consumer Price Inflation Eases Further? According to data from the six laender used to compute the preliminary estimate, July CPI inflation is likely to have fallen by around 0.1 percentage point from the 1.7% Y/Y rate seen in the previous month. Such a result would be a touch below most expectations and would be the softest reading since November-2010.

The actual preliminary numbers should be formally released later today and is likely to show a M/M outcome of around 0.3%, with the laender break-downs suggesting that any decrease in Y/Y rate would be largely food related. Base effects could mean that the Y/Y HICP measure falls more clearly.

FRANCE – Consumer Confidence Slips. Coming in a weaker than expected for once, the July INSEE-computed consumer confidence index dropped two points to 87. Notably, the willingness to make major purchases fell back clearly while price expectations turned less negative.

ITALY – Business Confidence Falls. Undershooting expectations and clearly so, the July ISAE business confidence index dropped 1.6 points to 87.1, unwinding much of bounce seen in June when the headline figure recovered from the lowest in nearly three years. The latest result pointed to a less deteriorating outlook for both orders and production.

SPAIN – Jobless Rate Hits New High. The unemployment rate rose to 24.63% in Q2, up from 24.44% in the previous quarter and a fresh high, with the jobless level in Spain actually being a third of the Eurozone total.

OTHER WESTERN EUROPE

SWEDEN – Retail Sales Drop Back. Seasonally adjusted retail sales in June fell 0.4% M/M, a softer than expected result and more than unwinding the 0.3% May rise. The Y/Y rate of growth, meanwhile, slowed clearly to 0.9%.

SWITZERLAND – Business Confidence Strengthens Further. According to KOF, the June business leading indicator rose 0.28 point to 1.43, a sixth successive rise and an eleven-month high.

JAPAN – Andrew Wroblewski, London

Core Inflation Little Changed. Undershooting expectations, national core CPI inflation (ex fresh food) turned a touch more negative in June, slipping to -0.2% Y/Y. Headline CPI inflation, meanwhile, slipped more notably, turning negative at -0.2%, thereby ending a run of five successive positive readings. Meanwhile, the rate excluding food and energy remained clearly negative at -0.6%.

Meanwhile, the headline Tokyo CPI reading (for July) fell 0.2 percentage point to -0.8% Y/Y, while the core (ex-fresh food) CPI inflation stayed at -0.6%.

Sales bounce back. Retail sales fell 1.2% M/M in June, the third fall in four months. As a result, Y/Y growth slowed markedly to 0.2%.

ASIA – Chang Liu, London

CHINA – Business Confidence Revised Higher. According to Market News International, July final business confidence numbers saw a 0.10 point upward revision from the flash estimate to 49.73, still a third successive drop to a fresh cycle-low from 53.21 in June and still implying a contraction in business activity for the first time this year. The latest drop was a reflection of deeper contraction in financial positions and the availability of credit, while production swung into contraction territory and growth in new orders slowed. Elsewhere, and notably, the three-month outlook index fell to 54.05 from 56.95 in June, accentuating the 1.57 point decline in the previous month and now a new cycle-low.

It is also worth noting that, on a friendlier note, input prices also moderated in the month to the lowest this year.

TAIWAN – Leading Index Rises Further. The June leading index rose 0.4% M/M to 131.3, a tenth straight increase including a same-sized gain in the previous month and now a fresh cycle-high. The coincident index, meanwhile, rose by 0.5% to 131.0, a sixth consecutive increase and also hitting a new cycle-high.

THAILAND – Output Falls Clearly. Surprising to the downside clearly, June industrial production slumped 9.61% Y/Y, more than unwinding the 6.00% gain in May and now a ninth fall in the past ten months. In seasonally adjusted M/M terms, meanwhile, output dropped by 8.04%, more than offsetting 5.74% increase in the previous month. Elsewhere, and on a more upbeat note, capacity utilization actually rose clearly to 72.41% last month from 64.44% in the same period of 2011.

It is notable that recent results will have been affected by the worst flooding in the nation in almost 70 years, which shut thousands of factories, but with reconstruction efforts following the natural disaster expected to boost the economy this year.