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The Morning Briefing

North American Edition
Thursday, December 6, 2012
07:00 (EST); 12:00 (GMT)
Allen Sinai, Chief Global Economist

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

Equities: Mostly Higher. Japanese equity markets close higher. Other major Asian markets were mostly higher too, save for China and Hong Kong. European bourses opened higher and then largely seesawed through the remainder of morning trade, as markets awaited the ECB decision due later today.

Bonds: Europe Mixed, Japan Higher. JGB prices rose across nearly all maturities, with the yield curve steepening on the longer-term end. European bond prices saw continued divergences, however, with Germany and Greece higher, but other peripheral markets falling clearly, led by Italy and Spain.

Currencies: Little Change. The dollar seesawed against the yen through both the Asian and morning European sessions, trading little change on net to near ¥/$ 82.39. Against the euro, the U.S. currency saw broadly similar developments, moving around $/€ 1.308.

Eurozone: GDP Contracts Modestly, Exports Hold Up. Updated numbers showed that GDP fell 0.1% in Q/Q terms, matching the flash estimate, albeit confirming that the Eurozone is back in formal recession.

Germany: Orders Surge Back. Very much overshooting expectations this time around, manufacturing orders surged back in October.

United Kingdom: No further BoE Action. There was no major surprise that the MPC today again voted to maintain Bank Rate at 0.5%. More contentious was the decision by the MPC not to enlarge the size of its asset purchase program any further. No statement was offered.

South Korea: GDP Growth Slows Further. Updated national accounts data for Q3 saw GDP growing at 0.1% Q/Q.

Australia: Labor Market Conditions Less Weak? Surprising clearly to the upside, the level of overall employment rose last month by 13 900.

New Zealand: Policy Held. As was nearly universally expected, the Reserve Bank of New Zealand decided to leave the Official Cash Rate unchanged at 2.50% following its meeting in December.

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

Long Treasuries strengthened modestly on Wednesday, with the ten-year yield slipping two basis points, to 1.59%, while the two-year yield held steady. The market was flat, on net, overnight, but rose in morning activity, and held much of the gain to the close. The early strength was attributed to mild safe-haven demand, on European developments, with modestly firm economic data putting a lid on the advance.

The November **ADP estimate** of private payroll employment growth came in at +117,800--a result that is unlikely to jolt Street forecasts for the official numbers coming tomorrow.

Notably, however, the Chief Economist of the econometric firm which cooks up the estimate from ADP raw data theorizes that Hurricane Sandy depressed the total by some 86,000. That, of course, would put underlying private payroll growth in the +200,000 zone--a stronger result than even the +184,000 official October number.

Friday will tell the accuracy of the ADP numbers—down to the thousands—but if they are roughly correct, the labor market will be on a stronger trend footing than generally perceived. And, the relatively big October payroll increases will be shown not to have been flukes.

It is hard to imagine strength great enough to prevent the FOMC from replacing at least part of the Operation Twist stimulus—but the extent of replacement might be ticked down a bit, if indications on underlying November output and, particularly, income are genuinely solid.

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The November **ISM Non-Manufacturing index** was also firmer than expected, rising 0.5 point to 54.7 (Consensus: -0.7 point; Decision Economics: -0.2%), with the message of solidity reinforced by a 3.3-point rise in the new orders index to 58.1.

There was a less-robust indication from the employment index, which fell 4.6 points, to 50.3. But, that followed a 3.8-point rise last month, and the orders-index increase this month followed a 2.9-point decline last month.

The two indexes have been oscillating in opposition to each other since mid-year, with each staying in its own zone--low-50s for employment and mid-to-high 50s for orders--throughout.

The upshot is a message of sideways moderate-growth motion—as would be expected in a moderate-growth economy. So far, the almost disproportionately large services sector of the economy is helping stabilize overall economic growth, despite the knife-edge/faltering pattern of manufacturing activity.

The issue ahead is whether the manufacturing sector will move into a more substantial growth pattern, stepping-up the trend of the overall economy, or whether continued manufacturing stagnation will eventually weigh down the services-industry trend, risking a self-reinforcing decline in the economy as a whole. Luckily, broad service-sector growth is generally quite resilient.

DAILY CALENDAR

The **initial claims** figure today will cover the second week past the November payroll-employment survey period, so that direct implications for the employment report tomorrow would follow only from revisions to back data. At this point, the only important number for which a meaningful revision is at all possible is the survey-week continuing claims total.

The preliminary figure, first reported last Thursday, shows the number of unemployment benefit recipients to have increased by 28,000 between the October and November payroll-survey weeks. That figure is a crude measure of the excess of job losers over job gainers—among people covered by unemployment insurance—in the course of the survey month.

The November rise swung from more upbeat readings of -22,000 in the October payroll month and -50,000 in payroll September. In those months, job gainers clearly outnumbered job losers.

Some part of the apparent net deterioration in November surely reflects Hurricane-Sandy job losses. Those may or may not be permanent, but will certainly impact the November employment figures—and are reflected in payroll forecasts.

The potential today is for forecasts to shift if a revision to the survey-week continuing claims count changes the difference between the October and November levels significantly—in the weaker (upward) or stronger (downward) direction.

Meanwhile, the newly arriving initial claims figure will cover the week ended December 1, the second of four weeks in payroll-December. Forecasts are for it to extend the week-by-week decline in claims seen since the hurricane-driven leap of 90,000 in the week ended November 10 (Consensus and Decision Economics: -13,000, to 380,000).

That sort of result would be healthy, in continuing the working-through of hurricane job losses and filing delays—and the descent of new filings back to the underlying level. However, a faster decline would give more reassurance that the underlying level of new claims has not drifted up since the storm.

The Schedule:

The sole scheduled item today is the weekly unemployment insurance report (initial claims), at 8:30 EST/13:30 GMT.

DE Forecasts:

Initial Claims: -13,000, to 380,000.

WESTERN EUROPE – Andrew Wroblewski, London

EUROZONE – GDP Contracts Modestly, Exports Hold Up. As in previous quarters, Q3 Eurozone GDP numbers failed to echo the very downbeat messages from business survey data seen in the last year or so, instead suggesting that while the Eurozone economy contracted further, it did so only modestly. Indeed, updated numbers showed that GDP fell 0.1% in Q/Q terms, matching the flash estimate, albeit confirming that the Eurozone is back in formal recession given that this is a second successive fall, a conclusion echoed by the slightly more negative Y/Y rate of -0.6%, the latter being the softest since end-2009.

Peripherals Largely Better

As with the flash numbers, the geographical details showed no greater weakness among the peripheral countries. Indeed, unadjusted numbers for Greece showed no markedly more sizeable Y/Y fall than seen of late, albeit still a momentous 7.2% decline, while Spanish GDP contracted at a little-changed pace of 0.3% Q/Q. Italy, however, while seeing continued clear recession, saw the rate of fall easing clearly to -0.2% Q/Q. Portuguese numbers were less negative too.

Core Mixed?

More notable, given the very downbeat business survey readings for the core countries, was the continued and unexpected relative resilience in France (0.2% Q/Q) and Germany (slowing to 0.2%). In contrast, and certainly more depressing, was the fresh and marked contraction seen in the Dutch economy, a result that had not been flagged either by the limited official monthly data from the country or surveys.

Export Rays of Hope

From the breakdown provided for the first time with this release, resilient export signs were perhaps the most reassuring aspect of these Q3 numbers, the 0.9% Q/Q rise being the third successive increase. The obvious question being is whether such resilience can continue, although the latest Germany orders numbers provide more rays of hope. The net trade side may be providing an added support to GDP from the weakness in imports too, the impact of the latter partly tempered by the inter-related weakness in inventories (which knocked 0.2 percentage point off the Q3 GDP outcome).

Surveys Remain Too Downbeat?

Perhaps this relative resilient Q3 Eurozone GDP reading should be seen as a further indication of the shortcomings of survey data, the latter having pointed to a much worse backdrop than officially recorded for the last year or so. This is a reminder that these surveys are far from accurate in calibrating the pick-ups and softening in cycles, instead being more designed in establishing turning points.

DE View: Even so, the fact that the business surveys once again proved too pessimistic in gauging overall Eurozone activity in Q3 does not mean that their message can or should be ignored, especially given the clear and fresh marked output weakness seen late in the quarter, alongside mounting signs of fresh consumer weakness (NB: DE sees a deeper GDP slide of 0.3% in Q4). Indeed, these surveys are clearly pointing to clear and continuing downside risks to activity as well as the fact that while the contraction in the economy overall may be modest there is still no end in sight to the (modest) recession.

GERMANY – Orders Surge Back. Very much overshooting expectations this time around, manufacturing orders surged back in October, with the 3.9% M/M jump more than repairing the pared-back 2.4% September drop. The breakdown showed this bounce occurred on both the domestic and export sides, albeit with the latter very much boosted by a steep recovery from non-Eurozone countries.

Distortions Swing Around

This jump needs to be put into perspective, albeit corroborating the less downbeat orders and export messages seen in factory survey data of late. For a start, the October bounce may have been

accentuated by a sizeable jump back in (highly volatile) bulk orders. In addition, the marked swing seen in the September and October numbers may have been exaggerated by working days effects, September having had less than usual, while October had more.

DE View: As result, these numbers should be seen as evidence that Germany is not falling into clear recession rather than a sign that a clear recovery is appearing.

NETHERLANDS – Inflation Edges Down. Consumer price inflation slipped a notch to 2.8% last month. Meanwhile, the EU-harmonized measure slipped to 3.2% from 3.3%.

BELGIUM (Wednesday) – No Further Contraction. Final data confirmed GDP growth at zero in Q/Q terms last quarter, a contrast to the (also unrevised) 0.5% contraction seen in the preceding quarter. The Q2 number was the worst since the beginning of 2009. As a result, Y/Y growth in Q3 remained at -0.3%.

OTHER WESTERN EUROPE

UNITED KINGDOM – House Prices Bounce. There was a fresh and clear rise in the latest house price data from HBOS. These showed house prices bouncing 1.0% M/M in November, ending a run of four declines in a row. In Y/Y terms, house price inflation was a little less negative, at -1.3%.

HBOS now point to little change in prices of late. Notably, the ratio of house prices to earnings, bounced a little, also remaining clearly above the long-term average.

Exports Correct. Showing a higher-than-expected shortfall, the total visible trade deficit was £ 9.54 bln in October, widening afresh from the £ 8.44 bln September deficit. This reflected a clear correction back in exports particularly to non-EU countries, alongside a bounce-back in imports. Notably, the shortfall excluding oil and erratic items also widened markedly but to -£ 8.36 bln.

SWITZERLAND – Unemployment Stays Low. Very much as expected, the seasonally adjusted jobless rate stayed at 3.0% in November, having increased a notch in the previous month. The rate remains 0.3 percentage point above the cycle-low last seen a year ago. Meanwhile, the unadjusted rate increased to 3.1%.

Inflation More Negative. Somewhat unexpectedly, November consumer price inflation turned more negative at -0.4% Y/Y, 0.2 percentage point lower and a fourteenth successive negative reading. In M/M terms, prices fell 0.3%, reflecting the impact of lower food costs and a more marked drop in fuel prices. Meanwhile, core inflation measures were less negative, with the ex-food, energy and fuel figure up 0.2 percentage point to -0.6% Y/Y while the measure that also excludes administered price products rose to -0.7% from -1.0%.

The headline inflation outcome for the early part of the current quarter is softer than that predicted by the SNB in its September assessment.

CENTRAL EUROPE, RUSSIA AND TURKEY – Chang Liu, London

HUNGARY – Slight Recovery in Exports. Trade data for October showed exports rising by 1.9% Y/Y, a clear contrast to the 4.6% fall in the previous month. Imports, meanwhile, increased by 1.5% Y/Y following a 4.8% slump in September. As a result, the October trade surplus widened to HUF 185.2 bln from HUF 173.0 bln in the same month of 2011.

ASIA – Chang Liu, London

SOUTH KOREA – GDP Growth Slows Further. Updated national accounts data for Q3 saw GDP growing at 0.1% Q/Q, revised lower from 0.2% in the advance estimate albeit still showing a slowing from the 0.3% in Q2. Meanwhile, in Y/Y terms, growth was also revised slightly lower to 1.5% from 1.6% in the advance estimate, now showing a 0.8 percentage point fall from the Q2 reading and also being the slowest pace of growth in nearly three years.

The output side breakdown showed the Q/Q revisions to have been a reflection of downward revisions in the primary (now showing -4.1% from 2.0% in Q2) and secondary sectors, with the fall in manufacturing now revised to twice its original size at 0.4% following a 0.2% fall in Q2.

Tertiary sector growth, meanwhile, was also revised lower on net, led by business activities (0.1% from 0.8% in Q2) and information & communication (-0.1% from 1.5%).

On the expenditure side, the breakdown showed private consumption expenditure growth picking up to 0.7% Q/Q after a 0.4% gain in Q2, while government spending bounced clearly (up 0.7%). Further boosting growth in the quarter, the exports rebounded by 2.8%, outpacing the recovery in imports (1.8%). However, outweighing all of this was a steeper fall in capex of 3.6% following a 2.0% drop in Q2.

Notably, the latest revisions mean that the Bank of Korea's (BoK) 2.4% Y/Y growth estimate for 2012 is unlikely to be met. Commenting on this, BoK Director Jung said today that while there are signs of improvement, with exports rising in the first three quarters of the year, the expansion will not be strong in Q4. Also worth noting, while these figures may increase the pressure on the Bank to adjust policy further, the move is unlikely to come as soon as this month (where the next policy meeting on 13 December comes less than a week ahead of presidential elections in the nation); with the BoK possibly opting to wait until next year after a new government is sworn in before taking any further action.

SOUTH AFRICA – Chang Liu, London

Current Account Deficit Widens. Q3 seasonally adjusted balance of payments data showed a deficit of 202.5 bln rand, widening slightly from the 200.0 bln rand shortfall seen in the previous quarter and now a new cycle-high. As a percentage of GDP, however, the deficit was stable at 6.4% in Q3 from the previous quarter.

OCEANIA – Chang Liu, London

AUSTRALIA – Labor Market Conditions Less Weak? Surprising clearly to the upside, the level of overall employment rose last month by 13 900, adding to the 10 200 gain in October and further tempering the recent volatility in the series. The latest improvement was the result of a clear recovery in part-time employment (18 100), outweighing the fall in full-time work (-4 200). Meanwhile, and on a more upbeat note, the seasonally adjusted unemployment rate fell in November to 5.2% from 5.4%, the latter being the highest since April 2010. However, this latest fall came on the back of a slight drop in the participation rate to 65.1% last month from 65.2% in October, now the second-lowest in the cycle.

NEW ZEALAND – Policy Held. As was nearly universally expected, the Reserve Bank of New Zealand decided to leave the Official Cash Rate (OCR) unchanged at 2.50% following its meeting in December, after similar decisions in its thirteen previous meetings, all following the 50 bp rate cut in March 2011 in response to the earthquake.

Growth Outlook Slightly More Positive

The accompanying statement by Governor Wheeler (his second since taking up his position in September) began by noting that the global economy remains soft but is less threatening than before, with the risk of a severe near-term deterioration in the Eurozone decreased and Chinese economic indicators more positive recently. The assessment of the domestic economy, meanwhile, began with the Governor noting that GDP growth has slowed in recent quarters, accompanied by rising unemployment, but is expected to pick up over the next two years. Driving this will be repairs and construction efforts in Canterbury as well as a strengthening of the housing market generally, helped by lower mortgage rates. Downside risks stemming from the Government's fiscal contractionary measures, continued cautiousness by households and businesses, as well as the high New Zealand dollar, however, were also highlighted. Specifically, updated forecasts in the latest (December) Monetary Policy Statement now show GDP growth slowing further to 0.2% Q/Q in Q3 before recovering slightly to 0.4% in the current quarter. Further ahead, growth is seen peaking at 0.8% in mid-to-late 2013 before finally moderating slightly to 0.7% though most of 2014.

Inflation Contained, Extended Policy Pause

In regard to inflation, the Bank noted that the stronger domestic demand outlook implied that the current excess capacity in the economy will be eliminated by the end of next year, putting upward pressure on inflation. Downside risks, meanwhile, stem from the high New Zealand dollar and

weak labor market conditions. Reflecting this, updated projections now show inflation picking up to 1.2% in Q4 from 0.8% in the previous quarter, but then rising gradually towards 2.0% in Q1 2015.

DE View: *In the last paragraph of Statement, Governor Wheeler stressed that the focus of the Bank remains on keeping inflation near the mid-point of its target range at 2%, but seemed concerned about both upside and downside risks to inflation going forward. Regarding this, the Governor noted in a subsequent press conference today that a rethink of the Bank's interest rate policy will be needed should house prices jump and feed through to inflation, while also highlighting that intervention in the FX market may be possible as the strong dollar is "doing considerable damage to the export sector" (albeit with the criteria for the latter not being met as of yet). Overall, the outlook for growth was modestly more positive compared to September, while a slightly more benign inflation outlook was seen. Reflecting the largely stable picture, projections for the 90-day bank bill rate now show no change in rates until 2014, implying an extended policy pause ahead.*