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The Morning Briefing

North American Edition
Friday, February 8, 2013
06:30 (EST); 11:30 (GMT)
Allen Sinai, Chief Global Economist

GLOBE AT A GLANCE – Andrew Wroblewski, London/Thomas Lee, New York

Equities: Europe Higher, Asia Mixed. Japanese equity markets closed lower. Other major Asian markets were mostly higher, however. European bourses opened higher, but then seesawed through the remainder of morning trade.

Bonds: Mixed. JGB prices were mixed across maturities. European bond prices saw continued divergences, however, with Bunds lower, but peripheral markets all rising, led by Spain and Portugal.

Currencies: Stronger Yen. The dollar fell against the yen through both the Asian and morning European sessions, trading lower to near ¥/$ 92.62. Against the euro, the U.S. currency seesawed through both sessions, moving little changed on net around $/€ 1.341.

ECB (Thursday): Still Seeking to Reassure. Surprising almost no-one, the ECB Council kept all its rates on hold after its February council meeting.

Germany: Exports Steady. The December (unadjusted) trade surplus narrowed to € 12.0 bln from € 12.5 bln in the same month of the previous year.

Italy: Industrial Production Recovers Slightly. Coming in a little ahead of expectations for once, December industrial production rose 0.4% in seasonally adjusted M/M terms.

Sweden: Output Bounces. Surprising to the upside, December industrial production rose afresh.

China: Inflation Falls Afresh. Coming in largely in line with expectations, consumer price inflation fell by 0.5 percentage point to 2.0% Y/Y in January.

China: Exports Jump. Surprising to the upside, visible trade data for January showed the trade surplus widening to $ 29.15 bln.

China: Lending Growth Picks Up. Matching expectations, data for January showed new yuan loans rising to 1 070 bln.

Australia: Growth and Inflation Forecast Cut, Easing Bias in Place. As was expected by most, the quarterly Reserve Bank of Australia Statement on Monetary Policy repeated and elaborated on the statement made by Governor Stevens early in the week.

U.S. ECONOMIC AND CREDIT MARKET OUTLOOK – Andrew Husby, New York

Treasuries remained relatively stable with the two-year yield gaining less than half of a basis point, as did the ten-year yield. U.S. equity markets were impacted negatively after European Central Bank President Mario Draghi stated that growth risks continue to be on the "downside". Adding to woes were U.S. worker productivity levels which fell more than projected, and higher unit labor costs, as the economy shrank in the fourth quarter. A sticky-high jobless claims figure was also not the bullish catalyst the market needed.

Initial claims fell a less-than-expected 5,000 to 366,000 (Consensus and Decision Economics: -8,000 to 360,000), from a prior-week level revised up by 3,000. Labor Department analysts pointed to no special factors in the raw data.

Data covered the third of five payroll-February weeks, with the first week having come in at a very low 330,000. DE's thinking is that the vagaries of seasonal adjustment this time of year has been the main source of recent volatility in the measure. With recent weeks holding steady near the 360,000 level, or a bit above, the "true" underlying level of job losses is likely finally emerging.

That underlying level is a bit higher than assumed before the current release. Penciling in unchanged readings for the final two weeks of the survey-month, jobless claims would average

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360,000 for the period, matching the payroll January levels. That would hint at a relatively steady labor market, at least on the firing side.

The result will also likely cause market observers to discount the now-more-likely aberrant pair of readings of roughly 330K three and four weeks ago, dialing down expectations of more-marked improvement. In the bigger picture, firings are down to more "normal" levels, which makes the new hiring component all the more important. On that front, the employment components within the recent national-level ISM surveys actually turned quite positive in January, leaving labor market optimists with a foot firmly in the door.

For now, nothing in the claims report changes the outlook for the Fed.

Insufficient observed improvement in the labor market will keep QE on track at the current pace, with the question of fiscal drag from the payroll tax hike yet unresolved.

DAILY CALENDAR

Most attention today is likely to focus on the **trade balance** figure for GDP implications, followed by **wholesale inventories**, for the same reason. **Fed President Kocherlakota** is scheduled to give an academic presentation on risk probabilities and option prices, potentially discussing how an inflation targeting central bank should use that information. Topical, for a central bank tying policy accommodation to labor market health, subject to inflation expectations remaining contained under about 2.5%.

The data focus today is weighted toward the **trade balance**, both for near-term trends in imports and exports, and the chance that it kicks Q4 GDP estimates meaningfully in either direction.

Expectations favor some narrowing in the trade deficit (Consensus: narrow $2.9 billion, to -$46.5 billion; Decision Economics: narrow $2.1 billion), following on the $6.6 billion widening last month.

The deficit widened dramatically in November, as export growth rose much more weakly than imports, after both had dropped markedly the month before.

The BEA assumption underlying the Q4 GDP result is a penciled-in $3.2 billion narrowing, all of it in the goods sector. Depending, of course, on the size and direction of revisions, today's result could amount to a decent-sized revision to the advance GDP estimate. True, Q4 is ancient history, but the composition of moves can also impact the near-term outlook. Indications that global demand weakness is more pronounced, particularly on the ex-petroleum side (which was weak last month), would of course not be encouraging.

On the import side, strength would probably be viewed positively, but as we noted last month, to the extent strength in foreign-produced consumer goods crowds out domestically made ones, it hits GDP more than one for one.

The **wholesale inventory** figure today for December also helps to fill out the data behind the Q4 GDP estimate. Once again, the BEA penciled in a figure (+0.7%) a bit more additive to GDP growth than Consensus and DE are looking for today (Consensus: +0.4%; Decision Economics: +0.5%).

Inventory drag was a major factor behind the Q4 GDP weakness. A print seriously wide of estimates in the positive direction will boost GDP growth, and vice versa. In the absence of that, markets will leave this one to the bean counters.

Kocherlakota, non-voter, will discuss "Risk probability in option prices" at the NYU Stern School of Business. The riveting title could be called clever misdirection if not for the fact the speaker is relentlessly academic in his approach. The header almost certainly refers to a timely and pertinent question for the FOMC; how to appropriately set policy subject to the Committee's labor market and inflation goals.

With the Committee tying accommodation to a 6.5% unemployment goal, subject to the constraint of keeping inflation below 2.5%, what should the bank focus on to measure whether the constraint is being met? Should a policymaker rely on forecasts from statistical models, or market prices? A

speech/presentation from June 2012 by the accomplished academic ("Optimal Outlooks") argued that risk-neutral probabilities derived from market prices are the place to look. Today's speech could be a fresh update and discussion of those slides, and will, even if only academic in approach, illuminate approaches and discussions going on behind the scenes.

Market-derived measures of inflation expectations are elevated, the Fed is still very far from its labor market goals, and credibility is the currency of a central bank. Not ideal, from the Fed's perspective, would be if it were forced into a position where it could only keep two of those three balls in the air.

The Schedule:

On tap are the December international trade report, at 8:30 EST/13:30 GMT, December wholesale inventories, at 10:00 EST/15:00 GMT, and a speech by Minneapolis Fed President Kocherlakota, at 15:45 EST/20:45 GMT.

DE Forecasts:

International Trade Balance (December); Narrow $2.2 billion, to -$46.5 billion.

Wholesale Inventories (December): +0.5%.

CANADA – Thomas Lee, New York

(Thursday) Building permits continue to fall. December building permits surprises as it falls 11.2%M/M to C$5.7 billion continuing the 14.5% M/M decline, revised from -17.9% M/M, in November (Consensus: +5.0% M/M; Decision Economics: +7.2% M/M). The decline was seen broadly across its subcategories as residential permits waned 13.1% while its nonresidential counterpart fell 8.5%, both on a monthly basis. Notable was the decline in multi-family residential permits which fell 24.6% M/M marking itself as the sixth consecutive monthly decrease and the lowest reading since February 2011. Nonresidential permits declined in all categories, industrial (-3.3%), commercial (-10.6%), and institutional (-5.3%) from the month prior. Regionally, total values of permits were down in nine provinces with Quebec being the only province to record a gain.

This month's decline corroborates Finance Minister Jim Flaherty's statement in his speech earlier this week regarding a moderating housing market. Policymakers, including Minister Flaherty, tightened mortgage rules last year to curb the overheating housing market in Canada, particularly in Vancouver and Toronto. Their moves seem to be paying dividends as building permits decline in two consecutive months to round out the year.

WESTERN EUROPE – Andrew Wroblewski, London

EUROZONE

ECB (Thursday) – Still Seeking to Reassure. Surprising almost no-one, the ECB Council kept all its rates on hold after its February council meeting, thereby keeping in place the record-lows for the refi rate (at 0.75%) and the deposit rate (at zero) first put in place last July.

Tone Remains Unchanged

Equally unsurprising, the tone of the (still somewhat succinct) accompanying statement was very much a repetition of what was said in the last two months, emphasizing downside risks to the economy, but with a gradual recovery being envisaged only after weakness in activity extending into this year. Inflation risks were (still) seen as remaining balanced.

Euro Concerns Put into Perspective

The recent rise in the euro was an addition to the downside risks regarding inflation. But it seems that President Draghi was not willing to show much concern about the stronger currency seen of late, suggesting the higher euro reflects improved confidence, albeit possibly wishing to clarify the stance on exchange rates from fellow central bankers at the G20 meeting in the coming week. Even so, some perspective on the currency backdrop was made. Whether it be against the dollar, or

(more importantly) in trade-weighted terms, the euro is not only not in uncharted waters, but actually no higher than its long-term average, with the currency clearly down from the levels it was at into late-2009.

Inflation Falling Further?

With this in mind, President Draghi may not be averse to some limited rise in the euro given the impact it may have on inflation. Indeed, a stronger euro may only reinforce the already evolving fall in HICP inflation: DE sees a move towards 1% in the next six months or so. Such a fall would have two benefits for the ECB. It would help assuage any pressure from the Bundesbank about inflation risks associated with the current policy mix, let alone the possible use of OMTs. In addition, lower inflation would reduce the squeeze on household incomes, thereby helping to temper one of the clear downside risks facing the Eurozone economy, ie the weak consumer.

No Exit Plan

The modest rise in money market rates that has been seen of late is not perturbing the ECB. Nevertheless, President Draghi implied that it would be very premature to consider any exit plan instead actually stressing that policy is accommodative and reiterating that liquidity will be made fully available.

DE View: The ECB is likely to remain on hold for some time.

GERMANY – Exports Steady. The December (unadjusted) trade surplus narrowed to € 12.0 bln from € 12.5 bln in the same month of the previous year, and was down even more clearly from the € 16.9 bln November reading. In seasonally adjustedterms, however, the trade surplus was up at € 16.8 bln in December, as modest recovery exports (of 0.3% M/M) came alongside a further drop in imports (of 1.3%).

The cumulative trade surplus for last year stood at € 166.9 bln, 13.4% up on 2011.

FRANCE – Business Sentiment Rises Further. In the latest (January) Bank of France monthly report, the business sentiment indicator rose one more point to 95, a ten-month high. The breakdown for last month showed mixed developments. Even so, capacity utilization fell back to 75.2%, but with the production outlook turning positive. Notably, the BoF suggested that Q1 GDP growth may rise 0.1% Q/Q.

Budget Deficit Narrows? The December central government budget balance showed a cumulative deficit of € 87.17 bln, down from a € 90.09 bln shortfall seen in through 2011.

Less Weak Capex Outlook. According to the latest (January) INSEE quarterly survey, French industry envisages manufacturing investment spending being flat this year next after, a less bleak projection than the 2% drop envisaged back in October.

ITALY – Industrial Production Recovers Slightly. Coming in a little ahead of expectations for once, December industrial production rose 0.4% in seasonally adjusted M/M terms, ending a run of three successive falls, including the 1.1% November drop. Of note, this fresh rise was not broad-based, but with more signs of stabilization in regard to consumer goods. Meanwhile, on a more downbeat note, Y/Y work-day adjusted growth turned less negative at -6.6%.

NETHERLANDS – Production Rises Further. December industrial output rose for a second successive month and even more clearly so with the 2.9% M/M jump very much accentuating the upwardly-revised 2.2% November slump. As a result, Y/Y growth moved more into the positive, at 1.1%.

OTHER WESTERN EUROPE

UNITED KINGDOM – Job Growth Continues. The latest (January) REC labor-market report pointed to further improvement in the jobs market, albeit with the pace of job growth staying the same. Indeed, the survey showed the permanent placements index remaining at 53.2. Regardless, the survey showed continued relatively positive signals regarding vacancies, while wage pressures were mixed.

(Thursday) BoE On Hold, Carney Insights. 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.

Statement to Clarify Unchanged Policy?

Surprisingly, however, a statement was offered suggesting further action could occur if warranted. However, there was nothing in the statement that suggested further stimulus was around the corner, save for an underscoring that economic risks lie to the downside. Even so, the statement suggested that activity is likely to see a slow but sustained recovery, ie echoing the last Inflation Report and likely to be repeated in the next Inflation Report (due next Wednesday).

Issuing a statement when policy is not changed is an unusual step. This time around the issuing of a statement may have been to provide policy-clarification against the backdrop of the (not unexpected) decision made at this meeting to underline that the BoE will reinvest the gilts that it holds which start to mature in the next month.

Carney Not So Radical?

More notable was the testimony today made by Dr Carney who takes the helm of the BoE in July. In contrast to some thinking, Dr Carney did not suggest that a major rethinking of the BoE policy tools or its remit was needed, albeit suggesting some debate should be encouraged.

Greater Policy Flexibility Already Exists

Instead, he underlined his commitment to preserving price stability while suggesting that the greater policy flexibility he wishes is actually already available to the BoE. Specifically, he noted that any central bank should have flexibility in terms of the time horizon that it has to return inflation to target. The BoE is currently committed to returning inflation over the medium-term, something that the MPC has interpreted as meaning up to two years. Dr Carney seems to make this timetable something subject to more flexibility – and more scrutiny.

No Hint of Pulling Pound Lower

Otherwise, what was notable was that lack of any corroboration from Dr Carney of the weaker sterling hint that current Governor King has resorted to of late. In addition, and suggesting that Dr Carney is not particularly critical of current BoE policy, he suggested it was probable that current central bank policy is consistent with the UK reaching what he termed 'escape-velocity'.

DE View: Dr Carney's comments do not suggest that he envisages making large or immediate changes to policy-making and policy thinking. Instead he may be wishing to create greater leeway to keep policy on hold for longer than may otherwise be the case, especially if inflation continues to surprise on the upside.

SWEDEN – Output Bounces. Surprising to the upside, December industrial production rose afresh. Indeed, production increased 1.3%, largely unwinding the 1.5% fall seen in November. Even so, the Y/Y rate of growth remained clearly negative at -2.2%. On a much more upbeat note, orders also rose afresh, and very clearly so, jumping 7.7% M/M, hit on both the export and import side, but particularly the former.

NORWAY – Manufacturing Edges Higher. Manufacturing production saw a 0.3% M/M rise in December, ending a run of three successive drops. The numbers remain somewhat volatile, but a flat underlying tone may now be evident, albeit with a still very solid Y/Y rate of 2.7%. Meanwhile, overall industrial production rose 0.7% in M/M terms in December, despite a further correction back in oil output, the latter possibly related to maintenance swings in the North Sea.

SWITZERLAND – Unemployment Stays Low. Very much as expected, the seasonally adjusted jobless rate stayed at 3.1% in January, albeit with the previous month's result having being revised higher a notch. The rate remains 0.3 percentage point above the cycle-low last seen 15 months ago. Meanwhile, the unadjusted rate increased to 3.4%.

Retail Sales Strength Continue. Real retail sales, adjusted for working days, rose by 5.1% Y/Y in December, up clearly from the still upbeat November rise of 3.0%. A solid back-drop was also

seen in the seasonally adjusted M/M data, albeit where sales increased 1.2%, a fourth rise in the last five months. Meanwhile, Y/Y growth in nominal working-day adjusted sales picked up, but to 3.4%, albeit leaving the implied sales deflator slightly more negative at -1.7% Y/Y.

CENTRAL EUROPE, RUSSIA AND TURKEY – Chang Liu, London

CZECH REPUBLIC – Labor Market Conditions Deteriorate. The January unemployment rate rose to 8.0% from 7.1% in the same month of 2012. The level of unemployment, meanwhile, was 585 800.

HUNGARY – Exports Fall. Trade data for December showed exports slumping 14.3% Y/Y, an even steeper fall than the 10.0% drop in the previous month. Imports, meanwhile, also turned more negative, but to -13.0% Y/Y following a 10.1% fall in November. As a result, the December trade surplus narrowed to HUF 55.8 bln from HUF 90.7 bln in the same month of 2012.

TURKEY – Output Falls Afresh. December seasonally adjusted industrial production fell by 1.5% M/M, more than unwinding the 1.3% gain in the previous month and extending the recent volatility in the series. Meanwhile, on a workday-adjusted Y/Y basis, output dropped 1.4% following a 3.0% rise in November. This was a reflection of fresh deterioration in the manufacturing (-4.7% from 8.4%) and mining (-15.2% from 4.3%) sectors, outweighing a pick up in utilities output growth (9.9% from 4.6%).

JAPAN – Andrew Wroblewski, London

Current Account Data Deteriorates. Surprising to the downside, the December (adjusted) current account narrowed to a surplus of ¥ 98.1 bln from ¥ 225.9 bln in November. There was also more deterioration in the unadjusted current account, which swung into a deficit of ¥ 264.1 bln in December from a surplus of ¥ 265.7 bln in the same month of 2011.

Lending Growth Picks Up Slightly Further. Bank lending data for January showed total bank loan growth picking up slightly further to 1.3% from 1.1% in the previous month, a sixteenth successive positive reading.

ASIA – Chang Liu, London

CHINA – Inflation Falls Afresh. Coming in largely in line with expectations, consumer price inflation fell by 0.5 percentage point to 2.0% Y/Y in January, exactly reversing the fall seen in the previous month and edging back towards the 33-month low seen in October last year. In M/M terms, prices rose by 1.0%. The Y/Y breakdown, meanwhile, showed fairly broad based falls in price pressures across components, led by food (2.9% for 4.2%) and recreation & education (0.5% from 1.1%), but being tempered by a rise in clothing inflation (2.5% from 1.9%). As a result, non-food inflation saw a much less marked moderation to 1.6% Y/Y from 1.7% in December, albeit still the joint second-highest in the cycle.

Elsewhere, producer price inflation saw a less steep fall of 1.6% in Y/Y terms following a 1.9% drop in December, still an eleventh straight negative reading but boosted by a less steep fall in producer goods prices alongside a further pick-up in price pressures for consumer goods.

Notably, the latest drop in inflation was likely due to base effects related to the timing of the Chinese New Year holidays (which fell in January last year but are in February this year). As a result, while the statistics department commented that no policy decisions would be made on the basis of highly distorted data this month, officials continue to warn about the impact of loose money conditions globally and a resurgent property market may have on price pressures going forward.

Exports Jump. Surprising to the upside, visible trade data for January showed the trade surplus widening to $ 29.15 bln from a gap of $ 27.08 bln in the same month of the preceding year. The breakdown revealed the latest outcome to be a reflection of a clear pick up in export growth (25.0% Y/Y from 14.1% in December) coming alongside a similar jump in import growth (28.8% from 6.0%). On a geographical basis, meanwhile, trade improved to nearly all major trading partners.

As with all other January data, these figures will have been affected by the timing of the Chinese New Year (see above), however, the General Administration of Customs commented today that it has begun a "Exporter Purchasing Managers Index", which rose to 37.5 in January from 34.2 in December, suggesting a bright outlook for trade in the first quarter.

Lending Growth Picks Up. Matching expectations, data for January showed new yuan loans rising to 1 070 bln from 738 bln in the same period of 2012. Yuan loans growth, meanwhile, rose by 0.4 percentage point to 15.4% Y/Y, albeit still the second-lowest in the cycle. Total lending was 68.55 trn yuan in January, up from the 62.99 trn outcome in the preceding month, while yuan deposits growth increased to 16.0% Y/Y from 13.3% in December.

Elsewhere, money supply growth rose clearly for the broader measures of M2 (15.9% from 13.8%) and M1 (15.3% from 6.5%), but nearly halved for the narrowest measure of M0 (4.4% from 7.7%).

Once again, these figures will have been affected by base effects relating to the timing of the Chinese New Year holidays.

MALAYSIA – Output Growth Slows. Surprising to the downside for once, December industrial production growth slowed to 3.7% Y/Y from 7.1% in the previous month, the latter being the largest increase since May. The breakdown showed the latest outcome to be the result of slower growth across all three sectors of manufacturing (4.6% from 7.0%), mining (0.9% from 7.5%) and electricity (5.6% from 6.0%).

Exports Fall. Confounding market expectations of a further rise, exports fell by 5.8% Y/Y in December following a 2.3% rise in the previous month. Imports, meanwhile, dropped 6.5% Y/Y following a 4.3% gain in November. Even so, the trade surplus still narrowed modestly to 8.24 bln ringgit from a gap of 8.31 bln ringgit in the same month of 2011.

OCEANIA – Chang Liu, London

AUSTRALIA – Growth and Inflation Forecast Cut, Easing Bias in Place. As was expected by most, the quarterly Reserve Bank of Australia (RBA) Statement on Monetary Policy (SMP) repeated and elaborated on the statement made by Governor Stevens following the policy decision earlier in the week. The SMP began with the RBA's observation that recent economic data have been a little more positive following weaker global economic conditions in early 2012, boosted by a stabilization in the Chinese economy, a new government in Japan, the U.S. having avoided the "fiscal cliff" for now and earlier policy measures in the Eurozone.

Growth Outlook Weaker

In regard to the domestic economy, the SMP noted growth close to trend in the year to the September quarter, with a slight pick up expected in Q4, again boosted by strength in the resources sector (albeit with falls in commodity prices in mid-2012 leading to a scaling back of investment plans for many firms). Investment in the non-mining sector, however, was still subdued, but with signs of a recovery now seen in the housing market as a response to the series of rate cuts over the past 15 months. Elsewhere, labor market conditions were still noted to have remained weak, with the unemployment rate edging higher and wage growth moderating slightly. Overall, the outlook for the economy was judged to be a little weaker than in November, albeit with GDP growth forecasts for the year to December 2012 maintained at 3-½%. Going forward, however, projections for June 2013 and 2014 were cut to 2-½% and 2%-to-3% from 2-¾% and 2-¼%-to-3¼% respectively.

Inflation Outlook Little Changed

As for inflation, the RBA noted a moderation in price pressures in Q4 following the jump in the third quarter, which saw the headline measure fall to 2.2% Y/Y, dragged down in part by declines in prices of food. Underlying inflation, meanwhile, was observed to have remained around 2-¼% since the middle of 2012, just below the mid-point of the Bank's target band. Following this trend, projections for December 2013 were lowered to 3% from 3-¼% in November, but with December 2014 projections unchanged at 2%-to-3%.

DE View: Overall, the tones revealed in the latest SMP were similar to that of the Statement by Governor Stevens after the policy decision on Tuesday, with concerns still clearly on the downside and worries regarding whether non-mining sector investment can pick up sufficiently to offset the upcoming slowing in resource sector investment and ongoing fiscal contraction in the nation.

Interestingly, however, in the last paragraph of the SMP, the Bank noted that with global conditions having improved and given the stimulus already in place, the board judged that the stance of monetary policy remained appropriate "for the time being", again hinting at an easing bias. As such, the latest SMP does little to change the view that the RBA will likely ease policy further in coming months, but with the timing of any future move heavily dependent on developments in capital expenditures and the labor market.