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The Morning Briefing

Thursday, June 13, 2013
6:30 EDT; 11:30 BST
Allen Sinai, Chief Global Economist

THURSDAY BRIEFING POINTS – Andrew Wroblewski, London/Pierre Ellis, New York/Francisco Larios, Miami

United States: Issues of extreme concern. The overwhelming focus today will be on the **retail sales** and **initial claims** reports, which address two issues of extreme concern to markets and to the Fed: the health of consumer spending and the health of the labor market. **Business inventory** numbers would be of purely technical interest, except that surprises at this stage of the quarter can translate directly into sharp changes in GDP forecasts.

U.S. DATA AND EVENTS OUTLOOK – Pierre Ellis, New York

Arriving today are May retail sales, the weekly unemployment insurance report (initial claims), and May import prices, all at 8:30 EDT/13:30 GMT, plus April business inventories, at 10:00 EDT/14:00 GMT.

The overwhelming focus today will be on the **retail sales** and **initial claims** reports, which address two issues of extreme concern to markets and to the Fed: the health of consumer spending and the health of the labor market. **Inventory** numbers would be of purely technical interest, except that surprises at this stage of the quarter can translate directly into sharp changes in GDP forecasts. **Import price** numbers, for their part, will all but surely pass unremarked.

Retail sales could be the pivotal report of the week; telling whether consumer spending growth is slowing too uncomfortably from the quite solid, and probably unsustainable, pace of the first quarter.

GDP forecasts generally presume that real second-quarter spending growth will slow by about a percentage point, at an annualized rate, putting the pace just a bit below the long-run sustainable trend. Much more of a slowdown than that could signal unseen fundamental difficulties threatening the overall economic expansion—or would, at the least, provoke serious concerns. It would not take much more bad news to give Fed doves cold feet about the tapering idea.

Forecasts today point to a moderate-to-moderately firm report that would not rock boats, with the ex-auto total up decently (Consensus: +0.3%; Decision Economics: +0.5%), and the overall figure up as much (Consensus: +0.4%; Decision Economics: +0.5%). Of course, revisions must be watched carefully, as always

The **initial claims** figure today will cover the third of four weeks in payroll-June, combining with data of the preceding two weeks to substantially characterize the layoff situation in the month.

So far, the weekly counts average to 352,000—a meaningful weakening from the May average of 341,000—and forecasts point to a result that would improve that payroll June average only slightly (Consensus and Decision Economics: -1,000, to 345,000).

That sort of an outcome would absolutely continue suspense about the potential for the payroll employment figure to fall short of the 150,000 level that might be the lower end of the range that keeps the FOMC talking about tapering. Higher payroll figures would certainly not be ruled out, but the downside range has widened.

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As noted earlier, the issue with the **business inventories** result is whether it falls too far afield of the forecast figures that are built into current second-quarter GDP estimates.

Expectations today—presumably matching what is built into the GDP forecasts—favor a relatively modest increase (Consensus: +0.3%; Decision Economics: +0.1%), which means, of course, that any given "miss" would be more powerful proportionally. Any result more than 0.3-point away from expectations would probably have some noticeable effect on GDP thinking—particularly if it compounded the impact of a retail sales surprise.

DE Forecasts:

Retail Sales (May):

Total: +0.5%.

Excluding Motor Vehicles and Parts Dealers: +0.5%

Initial Claims (Week ended June 8): -1,000, to 345,000.

Import Prices (May): -0.7%.

Business Inventories: +0.1%.

WESTERN EUROPE – Andrew Wroblewski, London

EUROZONE – Inflation Risks Balanced. As usual, and as expected, the editorial of the ECB's (June) Monthly Bulletin repeated the themes highlighted at last week's post-Council-meeting press-briefing by President Draghi when policy was kept on hold and where inflation risks were described as still being broadly balanced.

SWEDEN – Companies Less Downbeat. According to the Riksbank business survey conducted three times a year just ahead of the update Monetary Policy Report, companies' assessments of future prospects are characterized by a cautious optimism. Economic activity is still weak, although it has improved during the spring. Prices are expected to rise slowly in the coming period and are linked to low cost pressures and hopes of an increase in demand.

ASIA PACIFIC ANALYSIS – Chang Liu, London

INDONESIA – Policy Tightened. Surprising many, Bank Indonesia raised its benchmark interest rate (the BI rate) by 25 bp to 6.00% at its latest meeting in June. This comes after a sixteen month long policy pause, and reverses the 25 bp rate cut in February 2012. The latest decision follows an increase in the overnight deposit rate by the BI earlier this week alongside an announcement that the Bank stands ready to buy government bonds from the secondary market; all to support the weakening rupiah (the worst performing Asian currency over the past year).

In the accompanying statement, the Bank noted that the domestic economy is projected to be around the lower bound of its forecast range of 5.9%-to-6.1%; dragged down by the continuing crisis in Europe and slowdown in China. Consumption growth and investment in construction, however, remain strong.

Regarding price pressures, CPI inflation was noted to have been 5.47% Y/Y in May, still back above the Bank's target range of 4%-to-5% and driven mainly by volatile food prices. The core rate, meanwhile, was seen to have remained under control at 3.99%. However, the focus this month was clearly centered on the external side, with nearly half of the statement dedicated to the current account and currency; with the former expected to see improvement in the current quarter while the latter highlighted as a major concern amidst its recent deprecation driven by the "repossession of financial assets from remerging markets" due to worries about changes in Fed policy.

Notably, the decision this month was the first for new BI Governor Martowardojo after taking over the post from outgoing Governor Nasution last month. The latest move is clearly targeted at supporting the currency and containing potential upside inflation risks in the economy, but with domestic growth still projected to be nearly 6% Y/Y, it would appear that the Bank has some scope

to shift its focus away from the growth front at least for the time being. As a result, further adjustments cannot be ruled out in coming months, particularly if the rupiah deteriorates afresh.

PHILIPPINES – Benchmark Rate Unchanged. Surprising few, the Bangko Sentral ng Pilipinas (BSP) kept its benchmark interest rate at 3.50% at its June meeting. This comes after similar decisions in April, March, January and December, but all following rate cuts in October, July, March and January 2012, which has reduced the benchmark rate by a cumulative 100 bp. The Bank also left the Special Deposit Account (SDA) facility rate unchanged at 2.00% this month following three successive reductions.

The accompanying statement revealed the latest decision to be motivated by the Board's assessment that the inflation environment remains "benign", with latest forecasts showing inflation remaining within the Bank's 3%-to-5% target range from 2013 through 2015. Risks to the outlook, meanwhile, were still seen as being balanced alongside anchored inflation expectations, with the Bank again noting potential upside risks including the pending domestic power rate adjustment and an inflow of capital. On the growth front, the BSP noted firm economic growth driven by strong internal demand and ample liquidity alongside strong bank lending.

DE View: Overall, the BSP seems to have had little rationale for a change in policy this month, with a still manageable inflation outlook alongside continued robust domestic growth. However, the Bank also noted that a steady policy stance at the current juncture allowed it to assess the recent fine-tuning of monetary operations as well as developments in the global financial market; highlighting its continuing concerns about potential capital inflows into the economy. As a result, while conventional policy will likely remain on hold for the time being, further adjustments in the SDA facility cannot be ruled out.

SOUTH KOREA – Policy Held. Surprising few, the Bank of Korea (BoK) kept the base lending rate unchanged at 2.50% at its meeting in June. This follows a 25 bp rate cut in the previous month, but all coming after six consecutive decisions to hold policy before that.

Global Outlook Less Downbeat

The unofficial English translation of the MPC statement saw some notable changes from the previous month. Indeed, beginning with a less downbeat assessment of the global economy, the BoK noted a continued moderate recovery in the U.S. alongside continued sluggishness in the Eurozone; and with slightly lower economic growth expected in emerging markets. As a result, the pace of the global recovery is still expected to be modest, but with downside risks no longer noted to be "considerable" and with uncertainties related to the possibility of an earlier-than expected slowing in the U.S. being underlined.

The Bank's view of the domestic economy, however, was actually little changed compared to May, with the Committee repeating its observation that growth remained weak. Exports were again noted to have improved, but with consumption and investment declining in the month. The BoK still expected that the negative output gap in the economy will be sustained for a considerable time going forward (the latest GDP growth forecasts for 2013 sees growth at 2.6% Y/Y), albeit with the influence of the Japanese yen and geopolitical risks in Korea now removed as being major downside factors.

Inflation Contained

In regard to inflation, the BoK again observed both headline and core CPI inflation continuing to run at low levels. Going forward, the Committee projected inflation to remain low for the time being, with no longer any explicit mention of its expectations that the rate will rise above its current levels provided there are no occurrences of exceptional supply-side shocks. Specifically, CPI inflation is projected to average around 1.7% Y/Y this year.

DE View: The final paragraph saw the Bank repeat its promise to closely monitor effects of the previous month's rate cut and economic policies of the Government in its conduct of monetary policy going forward. However, new this month was an addition to also monitor the "trend of changes in external risk factors". This may be a hint that the Bank will be happy to keep policy on hold for the foreseeable future; provided that the external factors highlighted in last month's

statement (but removed this month), namely the weakening of the Japanese yen and potential geopolitical risks in the region, do not re-emerge.

AUSTRALIA – Labor Market Less Weak? Confounding market expectations of a fresh drop, the level of overall employment rose last month by 1 100, the fourth rise in the past five months and adding to the 45 000 jump seen in April. The latest deterioration was the result of an improvement in part-time employment (6 400), outweighing a fresh drop in full-time work (-5 300). Meanwhile, the seasonally adjusted unemployment rate edged down a notch in May to 5.5% from 5.6%, albeit still the second-highest in the cycle, while the participation rate slipped to 65.2% from 65.3% in the previous month.

Recent comments by the RBA suggested that the Bank expected employment growth to be below that of working-age population and with leading indicators implying that firms remained cautious about hiring staff. Regardless, this report may have reduced any rationale the Bank had for a rate cut in the immediate future, albeit with a further adjustment later this year still possible.

NEW ZEALAND – Policy Held, Continuing Policy Pause. 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 June, after similar decisions in its seventeen previous meetings, all following the 50 bp rate cut in March 2011 in response to the earthquake.

Growth Outlook Largely Unchanged

The accompanying statement by Governor Wheeler (his sixth since taking up his position in September last year) began by noting a continued mixed picture regarding the global economic outlook, albeit with the medium-term outlook for the nation's major trading partner remaining firm. The assessment of the domestic economy, meanwhile, saw the Governor noting a pick-up in growth that was uneven across sectors. Specifically, consumption is increasing and the reconstruction in Canterbury continues to gather pace. House price inflation (judged to be high despite already elevated prices), meanwhile, was again explicitly highlighted as a area of concern, with the Bank stressing that it did not wish to see financial price stability compromised by housing demand getting too far ahead of supply. Specifically, the latest growth projections show a gradual increase in quarterly GDP growth, picking up from 0.5% in Q1 2013 to peak at 1% in Q1 2014, before than moderating afresh and settle around 0.4%-to-0.5% by 2015/16.

Inflation Contained, Exchanged Rate still the Focus

In regard to price pressures, the Bank simply noted that CPI inflation has been just below 1% over the last two quarters; but is now expected to trend higher gradually, hitting 2% by mid-2015. However, the NZD was again stressed as being "overvalued" despite its recent fall, thus remaining as a headwind for the tradables sector.

DE View: *In terms of the OCR, the Bank notably projected no change in rates until the latter half of 2014, confounding expectations of some market analysts. Justifying this, the Governor noted that increasing the OCR would carry significant risks in New Zealand in the current environment, increasing the interest differential between the nation and most other advanced economies, which would lead to a further rise in the NZD and pose potential deflation risks. Elsewhere, the use of macro-prudential tools were not explicitly mentioned in this month's statement, but with the Governor commenting in a subsequent press conference that the Bank was giving some "serious consideration" to introducing quantitative restrictions on high loan-to-value ratios for mortgage lending.*