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The Morning Briefing

Thursday, June 20, 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: Three important numbers. There is probably a dead tie today for market interest among the **initial claims** reading, for guidance on the next employment report, the **Philadelphia Fed Survey**, for any hint of manufacturing-sector improvement, and **existing home sales**, telling whether the bulk of the housing market continued steady or better before the May rate jump.

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

On the docket today are the weekly unemployment insurance report (initial claims), at 8:30 EDT/12:30 GMT, the June Philadelphia Fed Survey, May existing home sales, and the May leading indicators, all at 10:00 EDT/14:00 GMT.

There is probably a dead tie for market interest among the **initial claims** reading, for guidance on the next employment report, the **Philadelphia Fed Survey**, for any hint of manufacturing-sector improvement, and **existing home sales**, telling whether the bulk of the housing market continued steady or better before the May rate jump. The **leading indicators** will likely be ignored, with forecasts mild (Consensus and Decision Economics: +0.2%) and not positioned to trigger and recession-forecasting rule.

The **initial claims** figure today will cover the June payroll-survey week, closing out the four-week month—and giving the first relatively hard fix on payroll employment.

New claims jumped in the first June week, putting them 17,000 above the payroll-May average, but have fallen since—putting the month-to-date average up about 6,000 from the May average, with the latest weekly reading about 12,000 below the month-to-date number. The downward trend through the month hints at improvement, of course, and that message would be strengthened if the new figure falls further.

Forecasts err on the side of caution, pointing to a reversal of about half of the drop of 12,000 seen last time **(Consensus and Decision Economics: +6,000, to 340,000).** That sort of result would pull down the monthly average very modestly, leaving it up about 3,000 from the May average—an inconsequential change. Employment forecasts would probably be unchanged, sticking close to the May figure.

Only a very big surprise today would shift the monthly average consequentially, but the direction of the surprise might put a spin on the implications of the average—with a significant downside surprise suggesting that underlying improvement was greater than would be indicated by the minimal change in the average from May to June.

The **Philadelphia Fed Survey**, though quite uncertain as an indicator of month-to-month changes in national manufacturing activity, can never be ignored—particularly when national activity seems to be in suspended animation, as now. A definitively positive reading would be read as hinting that activity is breaking out of the stagnation.

The Empire State Survey reading was mixed-to-very-negative in that regard, with the headline index taking a step up, but all of the other—completely independent—activity indexes stepping down significantly.

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Forecasts for the Philadelphia Fed headline are for minimal improvement from the -5.2 reading of last month (**Consensus: -2.0; Decision Economics: -2.3).** Those sorts of numbers, of course, would not be very encouraging. Any meaningful upside surprise would, obviously, be checked for the sort of serious disconnect from the more-meaningful activity indexes that appeared in the Empire State numbers.

Existing home sales are important because they account for more than 90% of the current housing market—clearly making them a critical factor supporting house prices. The data have the feature that transactions are recorded only when they formally close—making the counts an accurate measure of activity, but also a somewhat delayed one.

Thus, the May figure will report on sales that were mainly first initiated back in April or March—predating the big run-up in mortgage rates since early May. The runup, if it persists for very long, will probably result in a rush to buy, in hopes of beating further rate increases—a rush that will probably be followed by a payback period, and some uncertainty about where underlying demand has come to rest.

The pre-rush number today will be useful as a benchmark in assessing the runup and payback—and what the ultimate resting level says about demand resilience. Forecasts point to a little-changed result (Consensus and Decision Economics: +0.6%, to 5.00 million).

DE Forecasts:

Initial Claims (Week ended June 15): +6,000, to 340,000.

Philadelphia Fed Survey (June, Headline Index): -2.3, versus -5.2 in May.

Existing Home Sales (May): +0.6%, to 5.00 million.

Leading Indicators (May): +0.1%.

WESTERN HEMISPHERE ANALYSIS

UNITED STATES – Pierre Ellis, New York

The **FOMC**, as expected, left policy instruments unchanged, and avoided any explicit new mention of "tapering." But, changes to the economic assessment make clear that logical progression towards an actual tapering move continues unimpeded.

Notably, the Committee says outright that it "sees the downside risks to the outlook for the economy and the labor market as having diminished since the fall." Last time, that slot in the text was occupied by the statement that "The Committee continues to see downside risks to the outlook."

That upward revision addresses one objection to potential tapering, that the economy remains too shaky, while the other objection, that inflation is running too low, is addressed by an even clearer assertion that the problem is temporary.

The key text last time read "Inflation has been running somewhat below the Committee's longer-run objective, apart from temporary variations that largely reflect fluctuations in energy prices. Longer-run inflation expectations have remained stable."

Now, the wording is "Partly reflecting transitory influences, inflation has been running below the Committee's longer run objective, but longer-term inflation expectations have remained stable."

The text changes do a few things:

1) By tossing out the word "somewhat" they recognize the reality that inflation has slowed a bit further.

2) By inserting the new concept of "transitory influences" the revised text downplays a bit more forcefully the undershoot of non-energy inflation referenced in the earlier text. Energy prices, not mentioned in the new text, are effectively tossed in with the rest.

3) The text changes also increase the importance of the stability of inflation expectations in the argument by putting it, with the introduction of "but," in the position of being the antidote to the deteriorated immediate inflation situation--the omitted "somewhat."

Certainly, the FOMC's own inflation expectations remain stable, with the central tendency forecasts showing 2013 PCE forecasts pulled down by 0.5-point since March, while the 2014 forecasts are reduced by 0.1-point, or less.

All of this gives the impression that "tapering" is a done deal, after some appropriate interval, unless the economy veers to the weak side--or inflation expectations crumble. The appropriate interval might be at least a bit shorter than markets had presumed before.

WESTERN EUROPE – Andrew Wroblewski, London

EUROZONE – Contraction Less Marked, Prices Still Falling? Coming in somewhat higher than expected for a second successive month, the aggregated flash PMI for June improved for a third consecutive time, rising 1.2 points to a 15-month high of 48.9.

Peripherals Perking Up?

Divergences were again less prominent with less soft signs in regard to France, offsetting still mixed but still relatively upbeat readings in Germany. The PMIs suggested that the weakness outside of France and Germany was (again) less marked, actually the best in two years. Notably, the survey data showed less signs of soft price pressures. Specifically, the manufacturing PMI exceeded expectations, rising 0.4 point to 48.7, a 16-month high. More notably, the flash services PMI jumped 1.2 points to 48.6, a 15-month high.

Unsure What the PMIs are Saying

The PMI data at the national levels have been volatile and also prone to marked revisions in recent months, with it worth stressing what incremental value each monthly update actually provides given the volatility in the series: the manufacturing PMI has an average M/M absolute change of well over one point, putting the further rise in June into proper perspective. In addition, alternatively sourced business survey data (eg from Ifo in Germany) paint a far less bleak picture than the PMI numbers.

Glass Half Full?

Moreover, other data is needed to get a fuller perspective. Consumer sentiment readings continue to improve: the Eurozone flash gauge for June (due later today) may rise for the sixth successive time, already at a nine-month high. Meanwhile, regardless of the survey data, actual officially-produced real activity data, such as industrial production, construction output and car sales, have held up.

DE View: Indeed, these data suggest that the Eurozone economy may have recovered in Q2, despite the PMI reading for the current quarter being both still well below the (so-called)_breakeven level or little better than that seen in Q1 when GDP contracted for a sixth successive quarter.

GERMANY – Orders Still Weak. The June flash PMI numbers revealed less worrying but mixed signs, now suggesting that the economy has started to glow a little more clearly. Admittedly, the manufacturing PMI fell from a four-month low, slipping 0.7 points 48.7. However, the services PMI jumped 1.6 points to 51.3, a four-month high. Regardless, orders weakness continues.

Pipeline Prices Fall Further. Undershooting expectations once again, May producer prices dropped 0.3% in M/M terms, a notch more marked than in the previous month, also being the sixth fall in the last seven pieces of data. The latest drop was (again) not broad-based, albeit with the ex-energy gauge also falling a little. The overall Y/Y rate, meanwhile, was little changed at 0.2%.

FRANCE – Much Less Soggy Survey Messages. The June flash PMIs showed much less sobering messages, albeit that still point to an overall economy sliding discernibly. Notably, the services PMI jumped 2.2 points to 46.5, a ten-month high. Meanwhile, the manufacturing PMI rose 1.9 points to 48.3, a 16-month high. Both index numbers were supported by less negative order trends.

ITALY – Better Orders Backdrop. April industrial orders fell 1.6% Y/Y, a far less steep drop than in previous months. The latest fall may have been tempered by working day effects, with it still notable that the adjusted M/M outcome rose 0.6%, a second successive positive reading.

NETHERLANDS – Jobless Rate Moves Even Higher. The seasonally adjusted unemployment rate rose a further 0.1 percentage point to 8.3% in the three months to May, yet another cycle-high. *Such data underscores perhaps the main threat to the domestic Eurozone economy.*

Consumer Sentiment Corrects. Consumer confidence fell by four points to -36 in June, correcting back much of the further bounce seen in May from the cycle low seen in February.

BELGIUM (Wednesday) – Consumer Sentiment Recovers. Consumer confidence rose by a further point in June to -18, a four-month high.

Eurozone flash consumer sentiment data due later today may show a further rise, offering some more positive signs.

OTHER WESTERN EUROPE

UNITED KINGDOM – Sales Jump Back Sharply. Showing a much stronger reading than expected, real retail sales (including fuels) jumped back sharply in May, very probably boosted by improved weather during the month. Indeed, sales surged 2.1%, more than unwinding the drops of the two previous months. Admittedly, alongside the same sized leap in January, these are the only clearly positive outcomes since September, but that strength was still enough to mean that sales volumes uptrend remains intact.

Evidence of weather-related improvement came in the marked (4.1% M/M) plunge in food sales and even deeper slide in store sales.

Manufacturing Picture Mixed. The CBI Industrial Trends survey for June showed a fresh weakening in export orders, with somewhat better signals on the domestic side. Indeed, overall orders rose a further two points to -18, while export orders slid to -22, both readings still around the long-term average outcome.

Elsewhere, there was a further correction back in output expectations although this aggregate (at a balance of 10) remained well above its long-term trend reading. Meanwhile, and still notable, pricing intentions in the manufacturing sector (ie the average domestic price balance) fell back a small amount, still somewhat above the long-term average.

SWITZERLAND – SNB More Mindful of Property Risks? Surprising no-one, the SNB yet again reiterated in its (June) quarterly policy assessment that it will enforce the minimum exchange rate of SFr 1.20 per euro that was put in place in late-summer 2011 and, while no longer suggesting it would do so with utmost determination, reiterating that it is prepared to buy foreign currency in unlimited quantities and reminding that it stands ready to take further measures if necessary, without detailing what these might involve. The SNB will also continue to aim for a three-month Libor at zero to 0.25%.

Downside Risks Less Marked

The SNB is clear that the Swiss economy faces risks, albeit with the central bank no longer pointing to they being considerable and purely to the downside. Indeed, while noting the downside risks still emanating from the international environment, in particular, a weak global economy and where developments in the euro area financial and sovereign debt crisis remain uncertain, there was more an admission of the domestic backdrop. Specifically, there is a risk that the imbalances on the mortgage and real estate markets will grow, given the sustained period of exceptionally low interest rates.

Too Cautious on Growth?

Meanwhile, the SNB is still acknowledging that GDP will grow by between 1.0-1.5% this year, up from 2012 and actually not far from the long-term average for Switzerland. Notably, this seems conservative as the economy would have to slow from the Q1 showing merely to come in at the top of this range.

Moreover, the SNB is not acknowledging all the risks evident domestically, both to activity and possibly prices. The strong currency is boosting domestic spending power to a degree that is already evident in above-par consumer expenditure growth, something that may be boosted further by potential wealth and spill-over effects from gains in property prices. The SNB also seems to see no upside risks to either activity or prices from the strong monetary growth it has allowed to build.

Policy Dilemma

Thus the SNB is implicitly being a little more open enough about the policy dilemma it actually faces. The main problem facing the SNB is the fact that it has one policy tool (interest rates) but now has two targets (inflation and the exchange rate). For the moment, and from the SNB standpoint, both these targets seem consistent with the preservation of very low interest rates, but the problem of course is the longer-term dangers to inflation, and particularly financial stability that may already be evident in the rise in property prices that such low rates are fuelling.

DE View: Regardless of the near-term ability of the SNB to continue capping the currency, the very resilience in the Swiss economy merely helps accentuate the already clear safe-haven status of the Swiss currency. Meanwhile, the clearly expansionary monetary stance of the central bank is looking more and more inconsistent given the strength in property prices. The SNB is clearly more worried about the latter but is still addressing this via capital buffers and more regulatory measures. However, such actions are merely trying to minimize the damage from the bursting of any property bubble rather than preventing that bubble from forming in the first place.

NORWAY– Policy Held, Rate Hike Projection Softened. Surprising few, the Norges Bank yet again kept its key policy rate unchanged at 1.5% after its latest meeting. This comes after similar decisions at all the meetings dating back to May last year.

Rate Hike Deferred

As notable, however, while the Norges Bank still suggested that that interest rates would have to be raised in due course, the time of such a rise has been deferred from the spring of next year to nearer year-end and with the pace of increases looking more restrained. Indeed, the possibility of a fresh cut in rates remains according to the Bank.

This is despite the fact that the Norges Bank accepted the continuing strong growth in household debt and house prices. Admittedly, the Norges Bank backs measures forcing banks to introduce counter-cyclical capital buffers that they could draw on in an economic downturn that could be triggered or at least amplified by an unwinding of the current build-up of financial imbalances.

Policy Dilemma

This is an implicit acknowledgement of the policy dilemma the Norges Bank has been facing. A still-strong domestic economy is very much accepted, with growth still seen rising solidly by between 2.5% and 3% out to 2016 and with some acknowledgement that inflation has started to exceed expectations. In addition, the lower interest rate profile also looks questionable given the weak exchange rate that the Bank is projecting.

Therefore, the rationale for a softer rate outlook from the Norges Bank is far from clear, save to prevent any fresh appreciation in the krone. Indeed, the fact that concerns over risk-taking and excessive debt accumulation among households and firms are being addressed by bank capital buffers rather than conventional monetary policy clearly shows the extent to which the Board still seems concerned about fresh krone strength.

DE View: However, if domestic economic strength becomes any clearer (as DE suspects), the krone will help determine when the rate hike cycle begins rather than triggering further rate cuts.

ASIA PACIFIC ANALYSIS – Chang Liu, London

CHINA – Steeper Contraction in Manufacturing. The June flash HSBC/Markit manufacturing PMI fell by 0.9 point to 48.3, only the second sub-50 reading in eight months but still hitting a nine-month low. The latest result reflected a fresh contraction in output alongside steeper falls in orders and employment.

Commenting on these results, HSBC noted that the latest weakness was a reflection of moderation in both domestic and external demand weighing down on the sector. Furthermore, as the Government appears to prefer (long-term oriented) reforms rather than further stimulus measures to sustain growth, some weakness may be seen in the short-term (e.g. in Q2 GDP data).

TAIWAN – Export Orders Fall Further. Coming in above expectations, May export orders still fell by 0.4% Y/Y following the 1.1% drop seen in the previous month, albeit the least weak outcome in four months. The breakdown showed the latest outcome to be a reflection of mixed messages across components, as a rise in chemicals (1.1% from -0.9%) and a less steep fall in electronics (-0.8% from -1.1%) came in contrast to further deterioration in household appliances (-23.5% from -7.7%) and toys & sports goods (-13.1% from -3.7%).

It is worth noting, however, that the latest results showed some moderation in exports to the Americas, albeit with Asia now clearly less weak. Exports to Europe, however, remained clearly in negative territory.

NEW ZEALAND – GDP Growth Slows. Surprising to the downside, national accounts data for Q1 showed GDP rising by 0.3% Q/Q, only a fifth of the 1.5% jump seen in the previous quarter but the same-sized increase as those seen in Q3 and Q2 of last year. Meanwhile, Y/Y GDP growth moderated to 2.4% last quarter from 3.2% in Q4.

The expenditure side breakdown showed a clear slowing in private consumption growth (0.4% Q/Q from 1.5% in Q4) coming in contrast to a less steep fall in government spending (-0.2% from -0.6%). Business investment, however, saw a bounce of 1.5% Q/Q last quarter following a 3.7% slump in Q1; extending the recent volatility in the series. Elsewhere, net trade provided a further boost to growth as a 2.5% rise in exports outpaced the 2.3% increase seen in imports.

Meanwhile, the industry breakdown revealed broad-based deterioration across sectors, albeit to varying degrees. Specifically, only a slight moderation was seen in the secondary sector growth (1.0% Q/Q from 1.1%) as slower growth in manufacturing (0.2% from 1.0%) and a fresh deterioration in utilities (-4.4% from 0.1%) outweighed a clear improvement in construction (5.5% from 2.1%). Tertiary industry growth, meanwhile, slowed more notably to 0.5% from 1.0% in Q4, boosted by fairly broad based deterioration across components, albeit led by transport and information media & telecommunication, while primary industries output dropped 3.0% in Q1 following a 2.7% gain in the previous quarter.

Notably, while the latest outcome came in somewhat below both market and RBNZ expectations for the quarter, a clear slowing in growth was largely expected as the effects of the recent drought on livestock slaughtering and milk collection alone is projected to curb growth by 0.5 percentage point through the first half of the year. A pick-up is, however, expected in the second-half, supported by rebuilding efforts in the earthquake-damaged Christchurch area. Indeed, construction output has already hit the highest level since June 2004 in Q1. As such, these figures are unlikely to cause any concern for either markets or the RBNZ, with speculation still tilted more towards the possibility that the strength in the economy may flow through to inflation and thus putting pressure on the Bank to raise rates sooner than currently forecast (i.e., around mid-2014).