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New York: 212 884 9440
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The Morning Briefing

Friday, September 19, 2014
6:00 EDT; 11:00 BST
Allen Sinai, Chief Global Economist

FRIDAY BRIEFING POINTS – Andrew Wroblewski and Chang Liu, London/Andrew Husby, New York/Francisco Larios, Miami

United States: Just Leading Indicators. The Conference Board August leading indicators will reflect some mixed moves, solid on the ISM orders components but weaker elsewhere.

U.S. DATA AND EVENTS OUTLOOK – Andrew Husby, New York

Today brings only August leading indicators, at 10:00 EDT/15:00 BST.

Forecasts:

Leading indicators (August): Consensus: +0.4%; DE: +0.5%.

WESTERN HEMISPHERE ANALYSIS

UNITED STATES – Andrew Husby, New York

Housing Starts Fall Back

August housing starts missed expectations, falling 14.4% to 0.956 million (Consensus: -5.3% to 1.035 million; DE: -5.8%) from a prior-month level revised up by 2.2%, and June revised down by 3.8%. Permits fell 5.6%.

Multifamily units led the decline, falling 31.7%, while single-family starts fell 2.4%, after a July increase of 11.1%. Geographically, all regions saw double-digit declines, the West most significantly at -24.7% (after July +19.9%). Single-family starts in the Northeast (+16.7%) and South (+0.6%) held up more firmly.

The figures continue a string of very choppy results, and leaves in place a more sideways trend after tentative signs of unexpected strength in July. Still, the outlook remains one of moderate growth, as the September NAHB Housing Market Index was again stronger than expected earlier this week, pointing to steadily healthier conditions in the new home market. Buyer traffic, present sales, and expectations all firmed. The residential sector remains a smaller share of economic growth than in years past, but steadily climbing from about a 2.5% share of the economy in 2011, to 3.2% in the most recent quarter.

Broad Claims Improvement Intact

Initial jobless claims fell a more than expected 36,000 to 280,000 (Consensus and DE: -10,000 to 305,000), posting a strong result in the September payroll survey week. Recent figures have been very choppy, and potentially impacted by seasonal adjustment around the Labor Day holiday. However, the Labor Department cited no special factors impacting the results.

The “true” figure probably remains nearer the 300,000-or-a-bit-below range consistently posted since early July, a low level historically that leaves little room for significant further decline. New hiring will be a key driver of ongoing job gains.

Continuing claims fell 63,000, the combination of results suggesting the underlying case for an improving job market has not weakened. Firmer payroll-September employment forecasts are

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supported today. Fed observers will have only the September report prior to the late-October meeting, and the case for an earlier rate move, and changes to the statement language, would be made more convincing by strength coupled with upward revisions to recent data.

WESTERN EUROPE – Andrew Wroblewski, London

EUROZONE

GERMANY – Pipeline Prices Slip Further. Matching expectations yet again, producer prices eased a further 0.1% in M/M terms in August, further accentuating a run of successive soft outcomes seen of late. The softness was most evident in energy. The overall Y/Y rate, meanwhile, was unchanged at -0.8%.

OTHER WESTERN EUROPE

UNITED KINGDOM – A Still-United Kingdom. As financial markets had started to discount in the last few days, Scotland decided to remain in the United Kingdom but by a margin somewhat wider than had been predicted by most opinion polls. Indeed, the split in favor of remaining within the United Kingdom was 55.3% to 44.7%, the 10-point lead being twice that predicted by the polls. This is no indictment of polls: after all, the difference is well within the usual margin of errors for such polls. Moreover, the pollsters had serious issues to contend with, not least establishing accurate samples and overcoming what has been term ‘shy-voter’ syndrome (ie where some of those polled may have been unwilling to admit to voting against independence for fear of appearing unpatriotic).

Another Referendum Looming?

While the size of the win may have been greater than predicted, there is no denying that a sizeable minority of the Scottish population committed to independence. To some degree this may have been kind of protest vote, but the question is has a momentum developed that will lead to another referendum in the not too distant future. This question is important, not just for financial markets (which dislike the uncertainty associated) but for Scotland itself because businesses would be very likely to defer investing there.

Admittedly, PM Cameron has said that this vote is one in a generation. However, Scottish First Minister Alex Salmond (who led the pro-independence campaign with clear charisma) has been more equivocal. What are the circumstances that could precipitate a fresh referendum?

This referendum resulted from a surprise and crushing win for the Scottish Nationalists in the Scottish parliamentary elections in 2011. That victory, however, came amidst the fragile economic recovery that the UK was undergoing at the time. The next such election will be 2016 and it is unlikely that Mr Salmond’s Scottish Nationalists will do so well – unless it looks as if the UK were likely to leave the EU (NB: Scotland is the most pro-Europe part of the country).

More Likely to Stay in the EU?

One reason, markets were wary of Scottish independence was a worry that, without Scotland, a referendum on whether the UK should remain in the EU may opt to leave. Such a referendum is something which the Conservative Party of PM Cameron has promised for 2017, should they win the 2015 election. Current opinion polls point to a small majority in favor of staying in the EU. However, the Scottish referendum, clearly shows that a one-time strong lead can easily be fritted away, boosted in particular by populist politicians who are able to persuade large parts of the electorate to put aside warnings of dire economic consequences. Much therefore depends on the results of the UK General Election next May therefore.

Political Consequences

PM Cameron would not have remained as party leader if he had presided over the secession of Scotland from the 307-year Union. His place is safe for now, but he is still in a somewhat

precarious position with his party divided on many issues, only one of those being the UK's position in the EU. Indeed, in order to placate a minority of his party who are demanding similar devolution of powers to England and Wales that Scotland will now receive, the PM today has called for major changes in the manner in which the UK is run, pledging that such decisions should be completed by the election next May. This timetable seems very optimistic, implying that the PM will be facing continued questions about his authority. As a result, unless he were to win the election next May resoundingly, he may be replaced, probably by a more Europe-sceptic person who would be more likely to go forward with an EU referendum.

Policy Implications

The devolution of powers may (at the margin) call into question the ability of the UK Government to adhere to the fiscal goals it has set itself. As for monetary policy, the clear removal of economic uncertainty removes a potential hurdle that may have prevented the BoE starting to hike rates early next year (as the MPC currently envisages). This may be so, but the fact that sterling has now recovered and is now effectively consolidating the marked gains of the last 15 months (up 7% in trade-weighted terms) may be an increasingly important factor for the BoE. Indeed, the seven members of the MPC who continue to opt for stable policy very clearly pointed to the impact of the stronger pound in tempering price pressures.

DE View: The Scottish result very clearly diminishes economic uncertainty but the size of the pro-independence vote is likely to lead to major political reverberations (and changes) in the UK in the next few years. Any of which may make markets wary whether a decisive government can be formed at the election next year.

JAPAN – Andrew Wroblewski, London

Output Slips Further Modestly. The all industries index decreased by 0.2% M/M in July, accentuating the June correction of 0.3%.

SOUTH AFRICA – Chang Liu, London

(Thursday) Rates Stable, Bank Remains Hawkish! Surprising some, the South African Reserve Bank (SARB) kept its official interest rate unchanged at 5.75% after its meeting in September. This follows a 25 bp hike in July, two decisions to hold policy in May and March respectively, a 50 bp hike in January, but all coming after another eight consecutive decisions to hold policy before that.

The latest decision came alongside updated forecasts by the SARB which showed GDP growth projections further reduced to 1.5% from 1.7% previously for 2014, while 2015 growth expectations were cut to 2.8% from 2.9% and those for 2016 decreased to 3.1% from 3.2%. Forecasts for inflation, meanwhile, showed 2014 inflation at 6.2% (reduced from 6.3% in July), before then moderating to 5.7% through 2015 (from 5.8%). 2016, however, actually sees price pressures picking up afresh and modestly to 5.8% in 2016 (increased from 5.6%).

DE View: *After a 50 bp rate hike and clear upward revisions to inflation forecasts in January—largely driven by the depreciation of the rand—the Bank more explicitly outlined its policy dilemma in March. This has then been tweaked in each meeting since then. This time around, the Bank reiterated its worries about the growth outlook, actually noting that it had deteriorated further due to a lack of demand in the economy. On the inflation front, meanwhile, the SARB noted continuing worries about the wage-price spiral and the possibility of second-round effects. Indeed, highlighting the policy dilemma faced by the Bank, risks to the inflation outlook was noted to be on the upside while those for growth forecasts remain to the downside.*

However, despite underlining again that inflation remains the primary focus of the Committee and after noting that the growth weakness was "not something that monetary policy can ameliorate" last month, the Bank still decided to keep policy on hold this month instead of "normalizing" rates further. However, this is by no means the end of its hiking cycle. Going forward, while the precise timing and scale of any future moves will depend very much on data updates, there is little doubt that a hawkish stance remains at the SARB and that the normalization process will resume in coming months.

Elsewhere, it may also be worth noting that Governor Gill Marcus announced at the meeting that she will be stepping down from her post at the Bank once her contract ends on 8 November—thus making this the last policy meeting she will be presiding over (the final SARB policy meeting of the year will be held on Thursday 20 November).