DECISION ECONOMICS, INC.
Information for Decisions™
New York: 212 884 9440
London: 011 44 20 7959 3045
Boston: 617 994 0500

The Morning Briefing

North American Edition
Friday, January 27, 2012
6:30 am (EST), 11:30 am (GMT)
Allen Sinai, Chief Global Economist

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

Equities: Europe flat-to-higher, Asia mixed. Japanese equity markets closed lower. Other major Asian markets were mostly higher, however, but with Chinese markets still closed for the Lunar New Year. European bourses fell almost immediately after opening, but recovered all of the ground lost and seesawed through the remainder of morning trade, boosted by optimism regarding the Greek debt talks and as markets awaited US GDP figures due later in the day.

Bonds: Europe mixed, Japan higher. JGB prices rose across nearly all maturities with the yield curve steepening on the long-term end. European bond prices saw continued divergences, however, with German, Greek and Portuguese markets broadly lower, but French and particularly Spanish and Italian markets higher.

Currencies: Slightly weaker dollar. The dollar fell against the yen on net through both the Asian and morning European sessions, trading lower to around ¥/$ 76.97. Against the euro, the US currency seesawed through Asian hours, but fell marginally during the morning European session, moving near $/€ 1.315.

Eurozone: Even clearer monetary weakness? Coming in below expectations even more clearly this time around, December M3 money supply growth slowed by 0.4 percentage point to 1.6% Y/Y.

Sweden: Retail sales recover further. Seasonally adjusted retail sales in December rose by 0.1% M/M, adding to the 0.4% and 0.7% bounces seen in the two previous months.

Japan: More mixed inflation updates. Largely matching expectations, national core CPI inflation (ex fresh food) gained a notch to -0.1% Y/Y in December.

China: Business confidence recovers. According to Market News International, January final business confidence numbers saw a clear 1.29 point upward revision from the flash estimate to 55.95.

U.S. ECONOMIC AND CREDIT MARKET OUTLOOK – Pierre Ellis

Treasuries improved further Thursday, with the two-year yield slipping one basis point, while the ten-year yield fell six. The market scored about half of the overall gain overnight, and built on that in a choppy uptrend through mid-afternoon, followed by sideways motion to the close. Activity was reportedly quite strong, though no clear themes stood out. Stocks tended to moderate weakness through the day, while new economic data were mixed, but not clearly friendly.

December **durable goods orders** rose a more-than expected 3.0% (Consensus and Decision Economics: +2.0%), with ex-defense orders up 3.5%. As expected, there was a large jump in commercial aircraft orders (+21.3%), but, not-so-confidently foreseen, there was also a solid jump (+2.3%) in ex-defense orders, even apart from aircraft.

That gain, in turn, incorporated a reassuring increase (+2.9%) in nondefense capital goods orders, ex-aircraft. The strengthening there, after a couple of months of sag, is a reassuring indication that business willingness to invest continues solid. Other ex-defense, ex-aircraft orders rose a decent 1.9%, following on a 1.6% rise last month

The message of investment confidence was amplified by a 2.9% jump in shipments of non-aircraft capital goods—more than reversing three months of declines. Companies are evidently not hesitating in their willingness to take delivery of equipment.

Mathematically, the new jump in shipments will lift Q4 GDP business investment a bit—though there will likely still be the appearance of some hesitation. Counteracting that suggestion is where the new jump in nondefense capital goods orders is important.

Orders outside the investment area were uneven—downweighting consumer-driven categories a bit—but that is not a serious problem, as long as business confidence remains solid enough to support the grinding revival of hiring that seems to be underway.

These results do not argue in favor of the clear shift towards a new easing bias by the FOMC yesterday--but durables orders are so fickle that doves will have no serious second doubts today. Railroaded hawks will feel a bit vindicated.

Weekly **initial claims**, meanwhile, rose an in-line 21,000 (Consensus and Decision Economics: +18,000), to 377,000, from a prior-week level revised up by 4,000. The new figure covered the week just past the January payroll-survey period. One effect of the jump in claims was to suggest that the 46,000 drop in claims last week was a seasonal-adjustment overshoot—probably offsetting some too-high values earlier in the holiday/turn-of-year period.

However, the good news is that the latest claims figure—probably closer to the "true" level, now that the holidays are well past—is still reasonably low compared to the 380,000 average in the January payroll month, and the 384,000 seen in payroll-December. Layoffs continue to trend downward slowly, but increasingly surely.

Indications on January employment are less dramatically favorable than they seemed last week, but in a way that makes the message of improvement in the month more credible. The change came in an 88,000 bounce in continuing claims, reversing much of a hard-to-believe 181,000 drop in the previous week—but not by so much as to erase the indication of a decent 62,000 decline over the course of the full payroll month. That approximation to the net impact of layoffs and new hiring is what is important.

January did not show—at least in these numbers—improvement as rapid as seen in December. Initial claims, meaning layoffs, slowed a little bit—averaging 380,000, as against 384,000—but the decline in continuing claims (the number of people receiving unemployment checks) was less dramatic than in December, 62,000 versus 90,000.

The hint is that new hiring slowed a bit in January. But, the indication is very subtle—certainly so in comparison to the normal randomness in all these numbers. Odds are, underlying employment growth, ex the numerous special factors was roughly steady.

December **new home sales** were the disappointing item, unexpectedly falling 2.2% (Consensus and Decision Economics: +1.6%) from a marginally revised November level.

Yet again, the sales numbers failed to corroborate the indication of sharp improvement in the new single-family house market given by several months of NAHB surveys. Perhaps there are big local differences in sales performance and the NAHB numbers are giving too much weight to the strong markets.

In any case, activity in the much bigger existing-home market does seem to be improving—suggesting that buyer interest is growing on a broad front—though at a much more stately pace than the NAHB numbers might suggest.

In any case, there are no indications of new supply/demand imbalance in the new-house market, with the inventory of new unsold houses ticking down a small bit and the months supply ticking up a small bit—so there is no sharp necessity to step down single-family housing starts. But, there is no indication that starts should rise either.

DAILY CALENDAR

Today brings the first look at fourth-quarter GDP, at 8:30 EST/13:30 GMT, revised January readings from the University of Michigan Consumer Sentiment Survey, at 9:55 EST/14:55 GMT, and a speech from New York Fed President Dudley, at 10:00 EST/15:00 GMT.

GDP numbers consolidate many monthly indicators in a way that properly weights, more or less, their individual contributions to the overall economy—giving a better sense of what is driving growth. That sort of assimilation is important now, when there are clear signs that the economy is picking up, but the magnitude, and sustainability, of the improvement are not certain.

Forecasts today point to a result that would represent the fastest quarterly growth since the second quarter of 2010 (Consensus: +3.0%; Decision Economics: +3.5%). However, the range of reasonably possible values is quite wide, since contributions from the two usual swing-factor components—inventory investment and net exports—are unusually uncertain this time, not only because monthly numbers have been erratic in October and November, and Commerce Department analysts must essentially guess about December, but because price movements have been a bit erratic too and translations to constant dollars are even more unpredictable than usual.

The main potential for a higher-end GDP result probably lies in the inventory component—which will almost certainly add to growth, but with the actual force depending on the December assumption and on the constant dollar translation. Big GDP growth driven predominately by inventory investment is not generally seen as being fundamentally strong, or very sustainable

Final sales growth, meanwhile, can swing widely with the net-export result—where, again, the December assumption and tricky constant dollar translation will determine the outcome. In any case, domestic demand growth looks very mixed in the quarter—though that supposition is subject to correction by the actual data.

Overall, the “strongest” result would be one driven by solid final sales growth, particularly domestic-driven demand, with inventory investment relatively moderate. The “weakest” result—which might still involve a high overall growth rate—would show very large inventory accumulation combined with a weak final sales figure pulled down by slow domestic spending, weak exports, and strong imports.

Revised **University of Michigan Consumer Sentiment** numbers are interesting mainly for what they say about the evolution of sentiment over the course of the quarter. Revisions reflect the addition of late-arriving responses to monthly averages, so the direction and magnitude of changes point to shifts in mood, and their force.

Forecasts suggest that the headline January Consumer Sentiment index will be revised very little, if at all (Consensus, unrevised, at 74.0; Decision Economics; revised up 0.5 point)—suggesting that the 4-point gain from December is solid, but also that improvement may have paused.

Dudley, always an FOMC voter, will discuss the regional economy of the New York Fed District at a press conference to be held at the Bank. Technically, he is not supposed to talk about monetary policy issues so soon after an FOMC meeting, and odds are he will adhere to that rule—particularly since his thinking seems to have solidly won out this week.

WESTERN EUROPE – Andrew Wroblewski, London

EUROZONE – Even clearer monetary weakness? Coming in below expectations even more clearly this time around, December M3 money supply growth slowed by 0.4 percentage point to 1.6% Y/Y, thereby easing back to an 11-month low. This came on the back of a 0.5% M/M decline in adjusted M3, actually a third successive drop. In addition, the narrower money supply gauge (M1) saw its Y/Y growth rate weaken afresh to 1.6% (from 2.1%).

More worrisome was the softer private sector lending growth picture (in adjusted terms). Indeed, the headline pace of growth slumped a further 0.7 percentage point to 1.2%, an 18-month low and a starker contrast to the cycle-high of 3.0% set in October. Furthermore, the weakness this time was little to do with base effects, instead being a reflection of a second and more sizeable M/M drop (the 0.7% fall actually being the steepest on record). Notably, the lending breakdown showed this weakness to be increasingly broad-based. Indeed, underlying Y/Y corporate lending growth slowed clearly to 1.2%. This came alongside a further fall in underlying household loans growth, down 0.4 percentage point to 1.9%, with broad based weakness across all sub-sectors.

A familiar, but perhaps mote manifest, theme of fragility is evident in these numbers, the latter very much indicative of the on-going problems facing the Eurozone banking system that have become only too apparent in the last few months. Indeed, continued M3 weakness (down 4.5% annualized in the last three months) reflected not just sharp falls in repo activity but broader signs of fragility all very much consistent with financial market turmoil distortions as the root cause. Regardless, M3 growth is still very much negative in real terms as is that for M1. Indeed, the deeper weakness in M1 growth also corroborates the picture of a weak, if not, slowing economy evident in the business and consumer surveys as it is this aggregate which seems to be better than the broader M3 numbers in tracking the economy.

Perhaps more emphasis should be placed on the still increasingly soft private sector lending data, where the likes of the steeper M/M drop in consumer credit provide corroboration of the weaker consumer spending signals now being seen increasingly across the whole of the Eurozone. The question is the extent to which the softer consumer and company lending backdrop may be a reflection of a building credit crunch, a development that is being accentuated by financial market turmoil but which is manifesting itself ever-more adversely on real economic activity. Admittedly, this latest monetary data does not provide irrefutable evidence of a credit crunch, but clearly neither does it refute such a conclusion. Crucially, the ECB, under the direction of President Draghi, does seem to be more open to admitting such credit constraints risks, albeit so far willing to admit that no significant such effects are apparent. It will be interesting to see if the ECB Bank Lending Survey (due next Wednesday) provides more signs that the softening in credit is as much due to supply factors as demand

All of which is crucial to markets looking for the ECB to step up its bond purchase. Especially as the ECB has explained that its existing bond purchase program is designed to ensure that the monetary policy transmission mechanism continues to work, clearer signs from this data that the latter may be in a deepening state of disrepair surely argue for possibly more sizeable bond purchases. However, from the ECB perspective, the weakness in December monetary data may be of no great surprise, with hints of such softness possibly being the rationale for the alternative policy-course that the ECB chose, namely the extraordinary large and long-term lending that the ECB provided via the € 490 bln 3-year loans it provided just before Xmas. Given that this liquidity injection has seemingly had some clear successes in shoring up banks in the last month, the ECB may want more data pertaining to January and beyond before the Council accepts that a credit crunch is biting more sizeable and durably.

GERMANY – Import prices recover further. Import prices rose by 0.3% in M/M terms in December, a broadly-based rise that was similar to the 0.4% recovery seen in the previous month. Even so, the overall Y/Y rate eased 2.1 percentage points to 3.9% last month. The M/M increase was led by fuels.

SPAIN – Less steep fall in sales. Working day adjusted real retail sales (excluding gas stations) for December fell by 6.2% Y/Y, a somewhat less steep drop than in the previous month (-5.4%). Meanwhile, unadjusted sales growth fell by 5.4% Y/Y last month, also a less steep fall than the previous month (-7.3%).

BELGIUM – Fresh rise in inflation. CPI inflation picked up afresh to 3.55% in January from 3.49%, ie reversing half of the fall seen in the previous month.

OTHER WESTERN EUROPE

SWEDEN –Retail sales recover further. Seasonally adjusted retail sales in December rose by 0.1% M/M, adding to the 0.4% and 0.7% bounces seen in the two previous months. The Y/Y rate of growth turned less positive, however, slowing to 0.1%. Even so, the data clearly point to a bounce in sales during Q4.

Softer household lending backdrop continues. Overall household lending growth slowed to 5.2% Y/Y in December, adding to the 0.2 percentage point declines seen in each of the previous five months and a fresh cycle-low. Meanwhile, there was a further bounce-back in growth in lending to non-financial corporations to 7.0% from 5.5% in November.

SWITZERLAND – Business confidence falls further. According to KOF, the December business leading indicator fell 0.18 point to -0.17, a ninth straight decline but still the lowest in just over two years.

CENTRAL EUROPE, RUSSIA AND TURKEY – Chang Liu, London

POLAND – Stronger growth. Data for full-year 2011 showed GDP growing by 4.3%, up from the (upwardly revised) 3.9% gain in 2010, and now the fastest pace since 2008.

Unemployment rises. The (unadjusted) unemployment rate rose to 12.5% in December, up slightly from 12.4% in the same month of 2010. The latest increase came on the back of a 3.5% Y/Y rise in the level of unemployment to 1.98 mln.

Retail sales growth falls. December nominal retail sales growth fell clearly by 4.0 percentage points to 8.6% Y/Y, more than unwinding the gain in the previous month and now the weakest outcome since July.

JAPAN – Andrew Wroblewski, London

More mixed inflation updates. Largely matching expectations, national core CPI inflation (ex fresh food) gained a notch to -0.1% Y/Y in December, reversing the swing seen in the previous month. Headline CPI inflation, at -0.2%, also turned less negative last month, although the rate excluding food and energy remained at -1.0%.

Meanwhile, the headline Tokyo CPI reading (for January) rose a notch to -0.3% Y/Y, a four-month high, while the core (ex-fresh food) CPI inflation fell by -0.4%, ie a slightly steeper fall than before but both still seeing less steep falls than the (unchanged) ex food and energy price drop of -1.1%.

Sales less weak. Retail sales rose by 0.3% M/M in December, unwinding little of the 2.0% slump of the previous month. Partly as a result, Y/Y growth turned back to the positive, at 2.5%.

ASIA – Chang Liu, London

CHINA – Business confidence recovers. According to Market News International, January final business confidence numbers saw a clear 1.29 point upward revision from the flash estimate to 55.95, now showing a 3.17 point gain from the December reading and the third-highest in the cycle. The latest recovery was a reflection of increases in the availability of credit, production and new orders, but being undermined by slightly weaker employment and financial positions. However, and notably, the three-month outlook index fell by 3.08 points to 56.49, now a fresh cycle-low.

Notably, the latest results may have been influenced by seasonal adjustment issues related to the timing of the Spring Festival holiday.

SOUTH KOREA – Mixed messages in confidence. The seasonally adjusted Bank of Korea survey of manufacturing-sector expectations for February rose by 2 points to 87, still unwinding only half of the drop seen in the previous month. The unadjusted index, meanwhile, also saw a gain of 2 points, but to 81, still being the second-lowest in the cycle. Services confidence, however, deteriorated in seasonally adjusted terms, falling by one point to 81 and hitting a new cycle low, while in unadjusted terms, the index was stable at 79, also a cycle-low. As for the actual outcome for January, all four figures came in below their respective expected levels.

Consumer confidence deteriorates further. The Bank of Korea's gauge of consumer confidence fell by one point to 98 in January, a second straight drop and now a new cycle-low. The breakdown showed the latest result to be a reflection of deterioration in both the current conditions component and the expectations index.

THAILAND – Mixed messages in output. Overshooting expectations slightly, December industrial production plunged 25.80% Y/Y, a third straight double-digit drop but still a much less steep fall than the 47.25% dive in November. In seasonally adjusted M/M terms, however, output actually jumped 31.39%, the largest-gain in the cycle but still unable to fully unwind the clear falls seen in recent months. Elsewhere, and on a more downbeat note, capacity utilization fell clearly to 52.31% last month from 62.35% in the same period of 2010.

These latest results will have been affected by the worst flooding in the nation in almost 70 years, which shut thousands of factories in recent months. Notably, the Bank of Thailand commented earlier this week that a recovery in output was expected to be delayed until Q3 this year as the damage to factories and supply chains was more severe than previously estimated.

OCEANIA – Chang Liu, London

NEW ZEALAND – Trade balance swings into surplus. Surprising clearly to the upside, data for December showed the trade balance swinging into a surplus of NZ$ 338 mln from a deficit of NZ$ 218 mln in the same period of 2010. This was the result of a clear pick up in export growth (12.8% Y/Y from 6.8%), outpacing a clear deterioration in imports (-1.6% from 9.9%). Meanwhile, the 12-month cumulative trade surplus was slightly lower at NZ$ 1 113 mln in December compared to NZ$ 1 125 mln in the same period of the previous year.