

Daily Notes on the Global Economy

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Carl B. Weinberg, Chief Economist

ECB and BoE: No Time For A Change

We are totally confident that neither the ECB nor the BoE is going to hike rates today, so much so that we are prepared to stick our necks out with this essay in the hours ahead of those interest rate decisions. What we think investors have to mull next is when either or both of these central banks is going to start withdrawing extraordinary monetary stimulus. Our answer is unequivocal, as always: We cannot see either central bank starting to raise interest rates from emergency levels until the economic emergency is over. *That should not be any sooner than a year now, and possibly not for another two years. This is, after all, a pretty deep economic depression. An uptick in ECB and BoE interest rates cannot even be contemplated until their respective economies have regained levels of prosperity realized before the downturn, or are very clearly on a sustainable path to do so.*

Our medium-term outlook is that both of these economies, Euro-land as a whole and Britain, will contract in the first half of 2010 and end this year flat at best. The key to economic growth in 2010, if there is to be any, will be fiscal spending... and there is not much of it on the table in either case. We have no expectation that the other elements of demand can pull the economy forward

Consider that real wages are flat or declining in both Euro-land and Britain, and employment is still declining. With credit to households declining, too, these observations suggest that consumer spending is not going to drive demand in these economies. Euro-land retail sales, due to be updated today, were last reported 3.8% lower than their pre-downturn peak and falling. Britain's retail sales volumes are down by a percent in the first two months of this year. *No economy can grow without the consumer.*

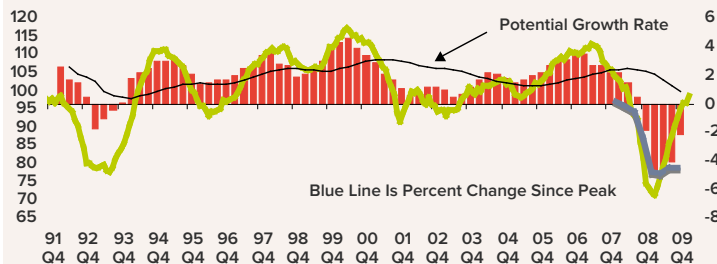
Investment spending is not going to be necessary, in an economy-wide sense, for a long time after output starts to grow again. With Britain's industrial output last reported 13-1/2% below peak levels of activity prior to this downturn—estimates for February are due today—what company is going to need to invest in plant and equipment to grow? Euro-land's industrial output is 16-1/2% below its pre-downturn peak. As a broader measure, Euro-land GDP is 4.7% below its demonstrated pre-downturn peak and nearly 6% below its potential level. Britain's latest GDP figure was 5.7% below its demonstrated peak and nearly 7% below its potential rate. *Spare capacity abounds in both economies.* As for investment in housing or commercial real estate... *c'mon!* Some companies may have to update technology a bit to expand, but large-scale investment just ain't gonna happen. Overall investment spending in Britain in the fourth quarter was 27% lower than its pre-downturn peak. *Ouch!*

Net exports have helped both Britain and Euro-land grow a bit, but here is a problem: All the major economies are trying to grow through export expansion at the same time. *This cannot happen.* Furthermore, gross exports remain 14% lower than pre-downturn levels in Britain and 18.8% below their peak in Euro-land. *Jobs lost in export-producing industries are not coming back anytime soon.*

With consumers' expenditures, investment and net exports all expected to be flat or worse over the next year, we are inclined to expect GDP to be flat or worse in 2010, unless private demand

Euro Zone: GDP & Economic Confidence Index

Percent Change Year Ago, Workday Adjusted, GDP Data Through 2009 Q4
Green Line Shows Zonal Economic Confidence, Through Mar 10, Right Axis



is supplemented by public spending. In Britain, we already know that the budget just passed for the 2010-11 fiscal year is neutral for the economy. The political winds favor budget deficit reduction after elections rather than more spending. For Euro-land, the core economies—France and Germany—are disinclined to increase fiscal stimulus for 2010. Other Euro-land economies are being forced by market conditions to cut fiscal deficits, **braking** the economy. Greece is the pluperfect example of this, but we expect market discipline to force Portugal, Spain and Italy to deepen fiscal cuts this year as well. Ireland has already started cutting. *Fiscal tightening in all five PIIGS at once will brake Euro-land GDP growth: Each reduction of fiscal spending equal to 1% of GDP for the PIIGS as a group will reduce Euro-land GDP growth by 0.3 percentage points this year.*

This economic outlook of ours, as grim as it is, promises below-potential GDP growth, high and rising unemployment, falling real wages and flat or falling prices. *We see no reason for the central banks not to keep monetary conditions at emergency settings for a very long time to come. Do you? You can expect yield curves to continue to flatten in an environment of depressed economic activity, flat prices—or deflation—and steady interest rates from the central banks.*

Euro Zone

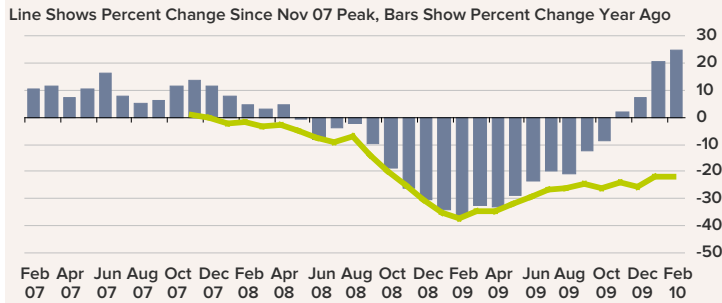
Revised figures published yesterday by EuroStat show **GDP** in the Euro Zone was unchanged in fourth quarter from the third, instead of the 0.1% increase initially reported. GDP grew 0.4% in the third quarter. The year-over-year rate of decline of GDP was revised to 2.2%

Yields On 10-Year Government Bonds @ 22:00 GMT

	Coupon	Maturity	Yield (%)	Prev. (%)	Chge (b.p.)	Δ vs U.S.	Prev. Δ vs U.S.
United States	3.625%	2/20	3.860	3.950	-9		
Japan	1.300%	12/19	1.352	1.352	+0	-251	-260
Germany	3.250%	1/20	3.096	3.120	-2	-76	-83
United Kingdom	4.500%	3/19	3.975	3.926	+5	+12	-2
France	3.500%	4/20	3.414	3.443	-3	-45	-51
Canada	3.750%	6/19	3.624	3.685	-6	-24	-27
Australia	5.250%	3/19	5.798	5.794	+0	+194	+184

Note: All yields converted to a comparable semi-annual basis. Data collected 22:00 GMT daily, from market sources believed to be reliable by High Frequency Economics. These data are market indications only, not quotes.

Germany: Industrial Orders Percent Change Year Ago



from 2.1% in the initial estimate. In the third quarter, GDP fell 4.1% year-over-year. In Q4, only a slowdown in the rate of inventory decumulation and a small rise in net exports added to GDP growth. All other components of final demand declined. *We expect this stagnation of the economy in Q4 to turn into a contraction in the first quarter of this year. Those people who have been yakking up the “recovery” in the Euroland economy have been deluding themselves. It is both depressed and still contracting, according to our estimates.* Also yesterday, EuroStat reported that **producer prices** in the Euro Zone were 0.5% lower than a year ago in February. In January, the PPI was down 1.1% year-over-year. *The rate of decline of the PPI is abating, but there is no risk of upward pressure on overall prices evident in the prices of producer goods and raw materials.*

The ECB Council will meet in Frankfurt today to contemplate any changes to monetary conditions. President Trichet will entertain the press immediately after the meeting. *We do not expect any big policy changes from the Council or news from Trichet this month.* Also today, EuroStat will report February data on retail sales. *We estimate sales were 0.4% lower than a year ago in February after a 1.4% drop relative to already depressed year-ago levels in January. Flagging consumer demand is only one point of evidence in our estimate of a decline in GDP in the first quarter. We do not expect any economic reports tomorrow.*

Germany

Buba and the FSO reported yesterday that **manufacturing orders** in February were unchanged from January and 24.5% higher than a year ago. This looks good, but keep in mind that year-ago orders were colossally depressed, having declined 36% over the previous 12 months. Focus on the fact that orders remained 22.9% lower than their pre-downturn peak in February: Manufacturing orders are depressed, and jobs lost in that sector are not coming back. In January, orders were also 22.9% below their pre-downturn peak. *So things are not getting any better, either.*

Today, FSO will release the February industrial production report. *With orders flat, what can we expect from output? We estimate seasonally adjusted production fell 0.2% from January to end up 17.1% below its pre-downturn peak. The headline may show a 5% rise from year-ago levels, but please ignore that irrelevant statistic.* Industrial jobs are not snapping back because there is no recovery in industrial output. *Duh!* Tomorrow, the merchandise trade report for February will be released. *Watch for confirmation that exports remain hugely depressed from pre-downturn levels. Jobs in Germany’s export industry are not coming back either.*

Japan

There were no economic releases yesterday. The BoJ Board signaled **no changes to monetary conditions** when it concluded its two-day meeting yesterday. Speaking to reporters after the meeting, Governor Shirakawa alluded to signs that the economy is “picking

A Quick Look at Upcoming Events

	Thursday	Friday
Japan	Machine Tool Orders (3) Business Failures (3) Machinery Orders (2) Current Account (2) BoJ Monthly Report (2)	Nothing
Australia	Employment (3)	Nothing
Euro Zone	ECB Council Meeting Trichet Press Conference Retail Sales (2)	Nothing
Germany	Industrial Production (2)	TRADE (2)
France	TRADE (2) Fiscal Deficit (2)	BdF Business Conf (3) Industrial Production (2)
United Kingdom	MPC Meeting Ends Vehicle Sales (3) Industrial Production (2)	PPI (3)
Canada	Nothing	Employment (3)
United States	Wkly Initial Claims	Wholesale Trade (2)
Global/Other	Nothing	Nothing

Underscore=Already released *Italics*=Estimated release date

Further Down The Road...

April 20	Canada—BoC Interest Rate Decision
April 24 - 25	IMF-IBRD Spring Meeting, G-20 Confab Possible
April 27 - 28	United States—FOMC Meeting
April 30	Japan—BoJ Board Meeting
April 6	Australia—RBA Board Meeting
May 5 - 6	United Kingdom—MPC Meeting
May 6	United Kingdom—National Elections
May 6	Euro Zone—ECB Council Meeting
June 26 - 27	G-20 Summit—Toronto

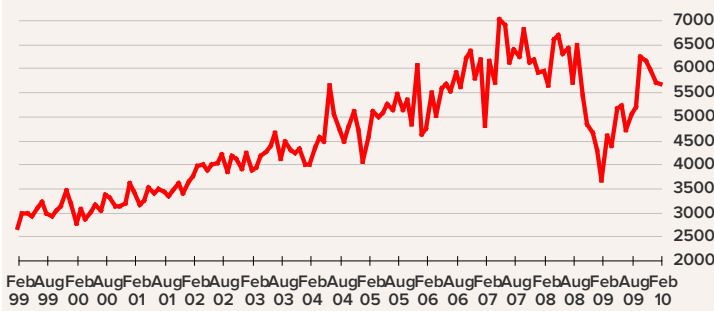
up steadily.” He did not substantiate those assertions. The Board’s official statement is that the economy is picking up, but “there is not yet sufficient momentum to support a self-sustaining recovery in domestic private demand.” *We disagree with the BoJ’s official assessment. We see the economy falling ever-deeper into a dark hole, in an irrecoverable downward spiral. Surely no one is looking for the BoJ to be raising interest rates or tightening monetary conditions—its quantitative easing, or rinban, operations are substantial—anytime in the foreseeable future.*

Today, industry sources will release a first estimate of machine tool orders for March. Also today, we expect official February reports on machinery orders and the current account balance. You can ignore the 200%-plus headline increase in machine tool orders compared to a year ago: *The real story is that they are enormously depressed—about 50%—relative to their pre-downturn peak. Ditto that for machinery orders, which may be reported flat year-over-year but still 38% lower than their peak. On the trade side, we estimate a current account surplus of ¥1.9 trillion, up from ¥1.1 trillion last year.* However, the underlying story in trade is a catastrophic depression of exports. Also today, privately compiled data on business failures are due, and the BoJ will reprint the economic assessment noted above in its *Monthly Report*. *Yawn!* No economic releases are planned for tomorrow.

United Kingdom

The BRC reported yesterday that its **index of prices of goods sold in shops** rose 1.2% in the 12 months ended March. In February, this measure of prices rose 1.7% year-over-year. There is no evidence that shows the BRC shop price index correlates with any of the of-

Canada: Value Of Building Permits, Millions Of Dollars



ficial inflation aggregates. It is mildly interesting that the BRC reports a slowdown in food price increases.

CIPS reported yesterday that its **index of services sector activity** fell to 56.6 in March from 58.4 in February. Levels above 50 signal an absolute increase in activity. *This report suggests that the biggest sector of the economy is still growing but may be slowing. This is not good news for incumbent MPs.*

The MPC will finish up a two-day meeting today. Any changes to base rates or the asset purchase plan—which presently is suspended—will be announced at noon, local time. *The MPC has made it clear that it will not change monetary conditions before its May meeting.* Also today, we will see March data on vehicle sales and the industrial production report for February. *We estimate overall industrial output was down 0.7% from year-ago levels in February, and manufacturing output was up 0.6% year-over-year. Our estimates put both indexes about 13-1/2% lower than their pre-downturn peaks, which is to say they are still depressed by a wide margin.* Tomorrow, NatStats will release producer price data for March.

France

We did not see any economic releases yesterday.

Today, INSEE will publish February reports on the merchandise trade balance and the fiscal deficit. Look for exports to be reported about 23% lower than their pre-downturn peak, even though the headline will show them flat year-over-year. Jobs lost in the export sector are not coming back, eh? *The net result should be a trade deficit of €4.5 billion, compared to a gap of €3.8 billion in February 2009. The widening trade gap is a direct counterpart to the widening fiscal deficit.* Tomorrow, the BdF will publish its business sentiment index for March, and the February industrial production report is due.

Australia

No economic releases were published yesterday.

Today, ABS will release the March employment report. *We estimate the jobless rate blipped up to 5.6% from 5.3% in February. If so, the RBA may take some comfort that its tightening of monetary conditions is relieving upward pressure on wages... if there is any.* No economic reports are scheduled for tomorrow.

Canada

StatsCan reported yesterday that the value of **building permits** issued in February declined 0.5% from January. The headline says issuance was up 55% compared to a year ago, but year-ago activity was so depressed—down 14.7% from January and 38.5% lower than in February 2008—that the year-over-year gain is no big deal. Think, instead, of permit issuance as almost 19.2% lower than it was at the start of this downturn. In January, it was down 18.8% from its peak. Also yesterday, the **Ivey purchasing managers index** was reported at 57.8 for March, up from 51.9 for February. Levels above 50 are sup-

posed to suggest an increase in economic activity, but we do not have enough experience with this index to calculate a meaningful correlation with any economic indicators. *We ignore this report!*

No economic releases are scheduled for today. Tomorrow, StatsCan will release the March employment report.

Carl B. Weinberg
April 8, 2010 at 00:05 GMT
cweinberg@hifreqecon.com

Rhinebeck, NY
+1-914-773-2121