International Personal Bank

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FX Market Headlines

United States

Euro Zone

United Kingdom

Japan

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United States: The economy is transitioning to a better second half, reflecting fading headwinds and supportive financial conditions. But the gradual improvement in the outlook has been masked recently by mixed signals from the data, including last week employment report. Consumer spending holds the key to the outlook. Although the July spending figures were soft, passive services outlays held down the total. Discretionary spending increased modestly, after a string of solid gains, indicating a critical level of consumer optimism. And the rise in big-ticket spending continued in August as motor vehicle sales hit a new cycle high. Payrolls increased by a moderate 169,000 in August with notable downward revisions. However, August payroll tallies tend to be low and then get revised up in subsequent months. The Fed is focused on the cumulative improvement in the labour market, rather than the latest report. The steady rise in payrolls, the decline in the jobless rate, and the dip in initial claims suggest that super accommodation is not necessary. The Fed will move forward with plans to scale back the pace of asset purchases at its September meeting. Mixed economic data likely will limit the initial taper to $10 billion or $15 billion. If policymakers delay the tapering with the unemployment rate already dipping to 7.3% (which is near the guideline for ending QE) they could generate even more uncertainty in markets for little marginal benefit.

EURO ZONE: Germany — There are two main scenarios for the outcome of the German election on September 22: either the current Christian Democratic Union/ Free Democratic Party (CDU/FDP) coalition will win a majority, or if it does not, a CDU/SPD ‘Grand Coalition’ will most likely result. Although the election is too close to call, Chancellor Merkel would remain Chancellor in both scenarios, most likely leaving German Euro zone policy to be gradual, cautious and reactive. A continued CDU/FDP government would be agreed relatively quickly (and therefore initially positively received by markets), but have a small parliamentary majority. A Grand Coalition would probably be difficult to agree, but would have a large parliamentary majority and be slightly more flexible on intra - European Monetary Union (EMU) fiscal transfers. A Grand Coalition may thus be more constructive in the medium-term, even though it would also raise the likelihood of a broader financial transaction tax, a tougher stance in favour of bank creditor bail-ins and higher taxes in Germany. The main downside risk in the election would be a leftist Social Democratic Party (SPD)/Green/Left coalition — but this is also very unlikely.

United Kingdom: Housing is Recovering, Not Bubbling: After persistent weakness in recent years, a range of indicators indicates that the housing market is now recovering strongly, with a marked rebound in mortgage approvals, turnover, starts and prices. London remains the strongest region, but the housing recovery is broad-based across pretty much all parts of the UK. Citi Analysts do not regard the housing recovery as a bubble. The level of transactions is far below the pre-crisis norm, and in real terms house prices are about 26% below their peak of 2007. The housing recovery is underpinned by low housing supply, the drop in prices over recent years, low mortgage rates, improving credit availability – and the fiscal measures in the Budget. In addition, the “Buy to Let” market is reviving and foreign demand is likely to remain strong in central London. There is a large backlog of pent-up demand: over the last five years the number of first-time buyers has been roughly half the normal pace, implying a cumulative shortfall of about 1.25 million fewer purchases. As the economy improves, that backlog is likely to fuel a substantial further rise in demand. Citi Analysts expect house prices to rise by about one third over the next 3-4 years, helping to lift the overall economy further.

JAPAN: Calibrating the risk of an economic slowdown in Quarter 3: July economic indicators were generally lacklustre — The economic indicators for July turned out to be generally uninspiring. Specifically, real exports dropped materially, consumption-related data (including real retail sales) were soft, and an industrial production recovery relied heavily on a small group of sectors. In this context, Citi Analysts see risk of relatively slow growth in the third quarter GDP data, contrary to the current consensus forecast. Economy is expected to remain vulnerable to exogenous shocks before it begins a self-sustaining recovery — While the risk of a slowdown in the third quarter seems limited so far, Citi Analysts note that a mechanism for a self-sustaining recovery, in which production growth sequentially spreads to gains in corporate profits, income, demand and back to production, has yet to work in full swing. Citi Analysts therefore think the economy will remain vulnerable to exogenous shocks for now. Calibrating an economic slowdown risk in the third quarter — Citi Analysts think a pickup in business investment will likely become a key precondition for the economy with such vulnerability to grow strongly in the third quarter and beyond, as currently expected by the consensus. On the other hand, a faltering overseas economy (mainly in emerging nations) or financial market turmoil would be major factors that would increase the downside risk, in Citi Analysts view. Citi Analysts are also watching carefully the risk that surging crude oil prices will push up energy costs and dampen household purchasing power.

The Week Ahead

USD:

- ***Sep 9, San Francisco Fed President Williams to deliver key note address at NABE annual meeting.***
- ***Sep 13, August Producer Price Index (Percent Change): Total – Citi 0.2 %, July 0.0 %, June 0.8 %, May 0.5 %; Ex. Food & Energy – Citi 0.1, July 0.1, June 0.2, May 0.1 -*** *The producer price index probably edged up in August, led by higher food and energy prices. Core prices have remained in a tight, low range for the past year. Citi Analysts don't see a breakout anytime soon. There are no price pressures at the producer level at this time, even at earlier stages of production.* ***Note:*** *On a year-to-year basis, headline PPI increased by 1.2% and core increased by 1.3% in August.*
- ***Sep 13, August Retail Sales (Percent Change): Total – Citi 0.4 %, July 0.2 %, June 0.6 %, May 0.5 %; Ex Autos – Citi 0.3, July 0.5, June 0.1, May 0.2 -*** *Citi Analysts anticipate a healthy increase in retail sales in August, led by a jump in automotive dealer revenues. Unit motor vehicle sales increased to 16.1 million units at an annual rate, which was a six year high. In addition, large retail chains report healthy sales gains just in time for back to school purchases. So Citi Analysts expect last month's pop in core sales to be followed by another respectable gain.* ***Note 1:*** *Citi Analysts forecast would put core retail sales nearly 4% annualized above the second quarter average.* ***Note 2:*** *The recent rise in discretionary spending, especially auto sales, suggests that consumers are becoming more optimistic.*
- ***Sep 13, September Reuters/Michigan Consumer Sentiment Index (Prelim): Citi 80.0, August 80.0, July 85.1, June 84.1, May 84.5 -*** *Consumer sentiment dipped in August and Citi Analysts expect it to hold that level in September. Citi Analysts view this as a continuation of the range-bound trend that has prevailed since the late spring.* ***Note:*** *For unknown reasons the preliminary release of the Michigan index has been consistently weaker than the final. So Citi Analysts wouldn't be surprised if the index retraced some of the August decline when the full September survey results are in.*

AUD:

- ***Sep 9, Housing Finance, Jul Forecast: 1.5%, Previous: 2.7% -*** *The rise in the number of owner-occupier approvals for the finance of dwellings should continue in July. Citi Analysts forecast a 1.5% increase, the seventh consecutive gain. Rising auction clearance rates and further gains in house prices in August point to an increase in appetite for housing finance. The risk to Citi Analysts forecast is to the downside however. Approvals rarely increase consecutively for such a long period of time without at least a month of reversion.*
- ***12 Sep, Labor Force, Aug Employment Forecast: 7k, Previous: -10k; Unemployment Rate Forecast: 5.8%, Previous: 5.7%; Participation Rate Forecast: 65.1%, Previous: 65.1% -*** *Stabilization in leading indicators of employment suggests a modest but at least positive employment gain in August. Citi Analysts expect a 7k increase. When combined with a boost to the labor force of 15k, the unemployment rate is pushed up to 5.8% (from 5.71% to 5.77% at two decimal places). The risk is that the participation rate picks-up a tick, which would push the unemployment rate up to a tick higher than Citi Analysts forecast.*

NZD:

- ***12 Sep, RBNZ OCR Decision Forecast: no change, Previous: no change - The RBNZ will likely keep the OCR unchanged at 2.5% next Thursday.*** *Citi Analysts think the RBNZ will maintain its mild tightening bias introduced in the July OCR review, which stated "although removal of monetary stimulus will likely be needed in the future, Citi Analysts expect to keep the OCR unchanged through the end of the year". Citi Analysts view is consistent the RBNZ, and Citi Analysts anticipate the first rate hike will likely* *occur in Q1 2014.* ***RBNZ will need to wait and see if the LVR restrictions have the desired effect in curbing house prices.*** *Heady house price growth in Auckland and Canterbury has forced the RBNZ to turn to macro-prudential tools by limiting high LVR mortgages to 10% of new lending, effective on 1 October. The full effect of the LVR will take at least a few months to become obvious. Even then higher interest rates ultimately will be required as the economy erodes spare capacity gradually, pushing up inflation to the midpoint of the target band by early 2015.* ***The strong NZD and low inflation are headwinds for rate hike.*** *The NZD has been supported by resilient export prices and the relative strong economy. The high NZD has helped to hold down inflation, giving a further headwind for a rate hike. However, if the Fed starts to taper QE this month, the USD can be expected to appreciate against most major currencies including the NZD. Although inflation remains below the RBNZ's 1-3% target band, Citi Analysts see a risk that in the MPS the RBNZ brings forward slightly its forecast of a gradual inflation pick up to just above 2% to Q1 2015 (from Q2). Citi Analysts* ***expect the economy to gather further momentum.*** *The RBNZ likely will lift slightly its near term economic growth forecast in the MPS. In Citi Analysts view, growth will pick up before peaking during 2014 largely thanks to further housing growth, business investment and infrastructure spend through the Canterbury rebuild. GDP growth could average close to 3% in 2014. There has been some spreading of growth outside Auckland and Canterbury, but these two areas remain significantly stronger than elsewhere.*

CAD:

- ***Sep 9, Housing Starts (Aug): Citi Forecast 185.0K, Median 190.0K, Last 192.8K: Starts Fall*** *– Housing starts probably declined in August, portended by softening permit activity. The jump in mortgage rates caused by negative market reaction to Fed tapering talk in the spring, as well as by rationing of a popular mortgage securitization program by the CHMC, which is causing banks to tighten standards, probably placed downward pressure on groundbreakings. v posit that much of the housing strength experienced during the spring and early summer probably will be reversed in the second half of the year.*

EUR:

- ***Sep 9, Euro area Sentix Investor Confidence, Sep Forecast: -7.4 Prior: -4.9 -*** *Although Citi Analysts expect a small decline in the headline measure in September, the underlying trend remains positive. The expectations series likely fell somewhat in September given the turmoil in emerging markets that could have some long-term implications for euro area export growth. The current condition is expected to have improved after the better than expected 2Q GDP data.*
- ***Sep 12, Euro area Industrial Production, Jul Forecast: -0.7% MM Prior: 0.7% MM -*** *After a rebound in June, industrial activity probably started 3Q on a weak footing, despite recent gains in survey-based activity and confidence indicators. Country data available so far showed both core and periphery countries suffered from a setback in July IP (Germany: -2.3% MM; Spain: -0.5% MM). Significant gains in the next two months (Aug and Sept) would be needed for 3Q IP to post another positive growth rate (+1.2% QQ in 2Q 13).*
- ***Sep 13, Euro area Employment, 2Q Forecast: 0.1% QQ Prior: -0.5% QQ -*** *Employment destruction accelerated in 4Q 12 and 1Q 13, but recent indications from the country data and from surveys suggest a small rebound in employment creation occurred in 2Q. Citi Analysts think this may be a temporary uptick, surely not large and persistent enough to allow the unemployment rate to start declining any time soon.*

GBP:

- ***Sep 11, Claimant Count Unemployment (Aug) Forecast: -10,000 MoM, 4.2% Rate Prior: -29,200 MoM, 4.3% Rate; LFS Unemployment (May-Jul) Forecast: -27,000 QoQ, 7.8% Rate Prior: -4,000 QoQ, 7.8% Rate -*** *The claimant count jobless data have shown sizeable declines in recent months, helped by tightening benefit eligibility. The LFS figures have been relatively stable on the 3-month basis (which is the headline series) but quite volatile from month to month on the single month series, with a large drop in June. Citi Analysts look for the single month series to rebound in July, hence keeping the 3-month average roughly stable, but if the single month data do not rebound this month then the 3-month average will probably show a notably bigger fall.*

JPY:

- ***Sep. 9, Real GDP 2nd Preliminary Estimate (2Q) Forecast: 1.0% SA QoQ; 4.1% SAAR, Previous: 0.6% SA QoQ; 2.6% SAAR -*** *Citi Analysts expect real GDP to be revised upward from +2.6% QoQ annualized in the first print to +4.1% QoQ annualized in the second print. Reflecting the corporate statistics data in the quarter, business investment is likely to be upgraded sharply to a 3.1% QoQ gain next week from a 0.1% QoQ fall in the first print. Revisions are expected to remain limited for other demand components.*
- ***Sep. 9, Balance of Payments, Current Account (Jul) Forecast: ¥577.4bn NSA; ¥313.9bn SA, Previous: ¥336.3bn NSA; ¥646.2bn SA -*** *Citi Analysts expect the seasonally-adjusted current account surplus to stand at ¥313.9bn in July, decreasing by half from ¥646.2bn in June. Before the adjustment, the account likely generated ¥577.4bn surplus in the month. Citi Analysts think exports probably decreased in July as external demand, mainly from emerging economies, remained weak while imports probably rose on the back of rising crude oil prices. As a result, trade deficits probably increased sharply. In the customs-clearance trade data for July, the balance logged a larger deficit of ¥944.0bn (seasonally adjusted) than a ¥663.2bn gap in June. With yen depreciation helping recover Japan's competitive edge, Citi Analysts believe the trade balance has been improving after having hit a bottom in the first quarter. However, the trade gap is likely to increase temporarily in the third quarter against the backdrop of stagnant emerging economies and elevated crude oil prices. On the services front, Citi Analysts expect the deficit will gradually decrease as a trend, thanks to increasing foreign visitors to Japan as the yen weakens. The cheaper yen has also been inflating*

dividend/interest receipts from overseas, so Citi Analysts expect the income surplus will remain elevated in the coming months. Based on Citi Analysts projections, the current account is unlikely to see a renewed deficit even if the trade gap increases.

- ***Sep. 12, Machinery Orders, Private Excl. Ships and Elec. Power (Jul) Forecast: 3.5% MoM; 9.6% YoY, Previous: -2.7% MoM; 4.9% YoY -*** *Private machinery orders excluding ships and power plants (private core orders) likely increased 3.5% MoM in July (+9.6% YoY). Citi Analysts projection suggests a 5.0% increase in private core orders in July from the second quarter average, sharply overshooting the official projection for the third quarter (-5.3% QoQ). July data will probably indicate sustained moderate growth following a bottom in the first quarter. According to the Japan Machine Tool Builders' Association, domestic machine tool orders increased 1.0% YoY in July (Citi Analysts seasonally-adjusted estimate shows +1.4% MoM), for the first positive YoY gain in fourteen months. The JMTBA cites that businesses may be becoming more positive about capex thanks to yen weakness-driven profit recovery as well as subsidies in the emergency economic package approved in January this year.*