International Personal Bank

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FX Market Headlines

United States

Euro Zone

United Kingdom

Japan

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United States: Following modest gains in July employment, this week's retail sales report will provide the first major test of the strength of final demand early in Q3. Citi Analysts expect a gain in real Private Consumption Expenditure (PCE) a little north of 2½% this quarter and a bounce of 0.4% in core retail sales for July would keep that on track. Relative strength in hiring and job openings across retailing hint at an upward revision to sales, especially in areas like restaurants where initial sales reports are much weaker than surveys and labour data for the sector. The persistence of high unemployment as job vacancies continue to revive continues to fuel debate about the relative importance of cyclical versus structural factors in the disappointing pace of labour market improvement. Gross job gains and losses as well as hiring and quit rates suggest reduced dynamism despite moderate to strong gains in employment. The plunge in vacancy yields despite slowing productivity hints that several questions in the outlook have made firms far more selective in recruiting. Exports in June were much stronger than official assumptions embedded in initial GDP estimates and point to an upward revision to Q2 growth to 2% or higher. Revised estimates could move higher still depending on inventory data this week. Small business surveys have hinted that firms' excessive caution in inventory stocking is dissipating now that the worst fears of fiscal drag have not materialized.

EURO ZONE: Net exports still offer the best hope for growth in the euro area. Citi Analysts find that the expected pickup in US growth and slowdown in Chinese growth, probably, leave intact the growth prospects for euro area exports. The changes to the US and Chinese growth trajectory leave the joint contribution of US and Chinese growth to world GDP growth broadly unchanged at 1.3-1.5pp/year in 2013-14, similar to 2012. What is more, the US is still a much more important export sales market than China for the euro area as a whole, as well as all 12 euro area countries Citi Analysts consider. Citi Analysts estimate that the response of euro area GDP or export growth to shocks to US growth has also been higher than for shocks to Chinese growth. Across euro area countries, the importance of exports to the US versus China is highest for Ireland, and lowest for Finland, France, and Germany. Citi Analysts also estimate Ireland to be most sensitive to shocks to US growth. Of the other periphery countries, Greece has the highest export exposure to the US, while Portugal and Spain have relatively low exposure. In addition to its comparatively large exposure to China, Germany's external prospects are also threatened by pressures on its competitiveness from the large yen depreciation and rising labour costs.

United Kingdom: One could quibble with a few details but, overall, Citi Analysts believe the Monetary Policy Committee (MPC)'s forward guidance is a well developed framework. The MPC's guidance helps reduce uncertainty and makes it clear that monetary policy will focus more on closing the output gap and cutting unemployment rather than simply aiming for the 2% inflation target. Unless inflation risks rise sharply, policy will not tighten until recovery is quite well advanced. The knowledge that policy will remain supportive in turn should help underpin private sector spending near term and in coming years. The three knockouts make the guidance framework more robust to output gap miss-measurement and hence more credible. But, Citi Analysts currently believe it is unlikely that any of the three knockouts will be triggered before the jobless rate hits 7%. The recovery is not yet reducing the economy's ample slack. Upcoming data are likely to show the jobless rate ticking up to 7.9% or (more likely) 8.0% in Q2 from 7.8% in Q1. The MPC's base case is that the jobless rate will just about fall to 7% in late 2016, while Citi Analysts base case is that the jobless rate will not hit 7% on a sustained basis until 2017. Accordingly, even though the growth outlook has been improving, Citi Analysts continue to expect that the MPC will not hike rates until 2017. If market rate expectations stay high in a way that threatens the growth outlook, the MPC may well put their money where their mouth is, reinforcing guidance with extra Quantitative Easing (QE).

JAPAN: Looking back on the tax hike in 1997: Credit crunch accelerated economic downturn triggered by the tax hike in 1997 — In 1997 and 1998, after the previous consumption tax hike, the financial system, clogged by huge nonperforming loans, became dysfunctional in the wake of bankruptcies of large financial institutions in November 1997 and this accelerated the economic downturn initially triggered by the consumption tax hike. At this moment, however, Citi Analysts believe the risk that financial conditions deteriorate sharply has diminished. This is the biggest difference between 1997-1998 and the present, in Citi Analysts view. Negative impact of the tax hike on small firms was material — Profits at small firms, which account for a much larger proportion of the economy than large firms, were hit hard by the tax hike in 1 half of 1997 and this led to some weakening in an income generating process. In late 1997, bonus payments declined particularly at household demand-related sectors. Citi Analysts think this experience will be repeated in 2014. Prime Minister (PM) Abe to make a final decision on the tax hike in late September or early October — PM Abe may eventually think a temporary deterioration in economic activity driven by the tax hike is acceptable given Japan's fiscal situation and go ahead with the tax hike. Instead, if he thinks that even a temporary slowdown in the economy and a possible negative spillover to wage are not consistent with the government's goal of eradicating deflation; Citi Analysts believe he would delay the tax hike.

The Week Ahead

USD:

- ***Aug 13, Atlanta Fed President Lockhart to speak at the Kiwanis Club of Atlanta on the economic outlook. Q&A will follow.***
- ***Aug 14, St. Louis Fed President Bullard to speak at the Rotary Club of Paducah.***
- ***Aug 14, St. Louis Fed President Bullard to speak on "Challenges with Monetary Policy." Media availability will follow.***
- ***Aug 15, St. Louis Fed President Bullard to speak on the US economy and monetary policy. Media availability will follow.***
- ***Aug 13, July Retail Sales (Percent Change): Total – Citi 0.2 %, June 0.4 %, May 0.5 %, April 0.2 %; Ex Autos – Citi 0.4, June 0.0, May 0.3, April 0.0 -*** *Headline retail sales were probably held down by a dip in autos in July. However, core retail sales appear to have accelerated in the month, as suggested by the recently reported gains in same-store-sales.* ***Note:*** *Restaurant receipts fell in May and June, but at the same time employment in that sector expanded and sector specific surveys picked up. Citi Analysts suspect there will be a correction in restaurant sales, but whether it comes as a rise in July, or upward revisions to back months is unclear.*
- ***Aug 14, July Producer Price Index (Percent Change): Total – Citi 0.3 %, June 0.8 %, May 0.5 %, April -0.7 %; Ex. Food & Energy - Citi 0.2, June 0.2, May 0.1, April 0.1 -*** *Producer prices in July probably rose less aggressively than in June on smaller anticipated increases in gasoline prices, flat food prices, and projected declines in passenger car and light truck prices. Consumer goods less food and energy and capital equipment away from cars and trucks likely lifted the core by two-tenths once again. If Citi Analysts estimates are correct, overall prices in July were 2.4% above the prior year's level after swelling to 2.5% y/y in June. But core prices continued to soften with the ex-food and energy PPI slowing to 1.3% y/y – the most glacial pace in three years.*
- ***Aug 15, July Consumer Price Index (Percent Change): Total – Citi 0.2 %, June 0.5 %, May 0.1 %, April -0.4 %; Excl. Food & Energy – Citi 0.2, June 0.2, May 0.2, April 0.1 -*** *After the energy-led surge in prices in June, Citi Analysts anticipate a less turbulent July. Core prices were tame, with no further run up in apparel following June's jump.* ***Note:*** *Energy prices in the CPI were impacted by a seasonal adjustment mismatch in June. This resulted in a surge in energy costs that drove the headline figure up. The flipside of this mismatch is that the July gas price increase will have less impact on the total.*
- ***Aug 15, July Industrial Production and Capacity Utilization (Percent Chg. Unless Noted): Total – Citi 0.2 %, June 0.3 %, May 0.0 %, April -0.3 %; Capacity Utilization – Citi 77.8 %, June 77.8 %, May 77.7 %, April 77.9 % -*** *Industrial production probably continued to expand modestly in July. Utilities production rose on hotter than normal July temperatures throughout the Midwest and Eastern Seaboard, which likely caused users to run air conditioners at full blast through much of the month.* ***Note:*** *Most of Citi Analysts forecast increase is in oil and gas extraction, which had already risen by 1.2% in the second quarter. Weekly domestic crude oil production figures reached the highest level since the late 1980's, and appear to have exceeded imports for the first time in nearly two decades.*
- ***Aug 15, August Philadelphia Business Outlook Survey – Citi 15.0 %, July 19.8 %, June 12.5 %, May -5.2 % -*** *Citi Analysts look for another large increase in the Philadelphia business outlook survey in August. The survey posted large increases in the prior two months, but the ISM-weighted index has remained very weak.* ***Note:*** *Given the recent strong reports for both ISM measures versus the weak ISM-weighted Philly figures, Citi Analysts do not see the Philly regional indicator as adding much useful information currently.*
- ***Aug 16, July Housing Starts and Building Permits (Thousands): Housing Starts – Citi 935, June 836, May 928, April 852, March 1,005; Building Permits – Citi 970, June 918, May 985, April 1,005, March 890 -*** *Housing starts likely rebounded in July after the June drop in multi-unit ground breakings. Citi Analysts forecast has multi-family starts returning to the higher December through May average.* ***Note:*** *Multi-family construction may be nearing its peak. In the ten years of housing expansion leading up to 2007, multi families averaged 340 thousand units a year. In stark contrast, single-family starts remain at less than half the average level of that decade.*
- ***Aug 16, August Reuters/Michigan Consumer Sentiment Index (Prelim) - Citi 84.0, July 85.1, June 84.1, May 84.5, April 76.4 -*** *Consumer sentiment probably dipped slightly in early August. Incoming high frequency sentiment surveys were slightly weaker in the early days of August. This follows a recent trend of consistently weaker first halves of the month.*

AUD:

- ***14 Aug, Wage Cost Index, Q2 Forecast: 0.8%, last: 0.7% -*** *Citi Analysts forecast wage costs to increase by 0.8% in Q2. Although this represents a marginal acceleration from the Q1 result, the yearly pace of wage costs is moderating on the back of higher unemployment and more labor market uncertainty. The risk to Citi Analysts quarterly forecast is to the downside.*

NZD:

- ***14 Aug, Retail Sales, Q2 Forecast: 1.2%, last: 0.5% -*** *Ex-inflation retail sales should accelerate in Q2. Price pressure in New Zealand was weak in the quarter and nominal expenditure picked up in June. There is some upside risk to Citi Analysts forecast.*

EUR:

- ***Aug 13, German ZEW Current Situation, Aug Forecast: 11.5 Prior: 10.6; ZEW Economic Sentiment, Aug Forecast: 38.5 Prior: 36.3 -*** *Citi Analysts assume both the current situation and the economic sentiment indicators of the ZEW poll of financial market participants will show an improvement in August. Stronger industrial production at the end of 2Q and further improvements in sentiment readings in July are likely to have boosted the current assessment, while economic sentiment was probably supported by strong export orders as well as the lack of signs of financial market stress of late.*
- ***Aug 13, Euro area Industrial Production, Jun Forecast: 1.1% MM Prior: -0.5% MM -*** *After a decline in May, industrial activity seems to have rebounded in June across most of the major countries in the euro area (with the exception of France), based on the data available so far. Germany is likely out-performing most of the others, with a rebound of 2.5% MM. The improvement in industrial activity reflects better economic sentiment indicators and better external trade data. If Citi Analysts forecast is correct, industrial output would have increased by 1.4% QQ in 2Q, the strongest reading since 4Q 10.*
- ***Aug 14, Euro area GDP, Q2 Flash Forecast: 0.2% QQ; -0.9% YY Prior: -0.4% QQ; -1.2% YY -*** *After six consecutive quarters of negative quarterly growth, euro area GDP has probably posted a gain in 2Q 13. The contraction in domestic demand should have eased significantly relative to previous quarters, mainly due to a less negative reading on investment spending. Less negative headwinds from fiscal tightening in major peripheral countries are probably also contributing to support households' disposable income. Exports have also rebounded in 2Q, after two quarterly declines. Country-wise, economic strength still stems mainly from core countries, while peripheral countries are probably generally still posting negative growth rates (albeit smaller than before).*
- ***Aug 16, Euro area (Harmonized Index of Consumer Price) HICP, Jul F Forecast: 1.6% YY Prior: 1.6% YY -*** *Inflation remained stable at 1.6% YY in July, according to the flash estimate. Although favorable base effects should have pushed the headline rate lower in July, the breakdown details are likely to show that some above-average gains in food prices probably contributed to keep the headline rate higher. Core inflation (ex. unprocessed food and energy) should have eased from 1.3% to 1.2% YY in July. The headline rate is likely to subside slightly in coming months.*
- ***Aug 14, German GDP Flash Estimate, 2Q Forecast: 0.6% QQ Prior: 0.1% QQ -*** *Citi Analysts expect German GDP to rise by 0.6% QQ in 2Q. Data have in fact been quite mixed in Germany over this quarter. IP in 2Q was 2.8% higher than in 1Q and Citi Analysts think that the very large increase in IP outweighed relatively modest retail sales and PMI readings (both roughly flat in the quarter), and a small reduction in Germany's trade balance relative to 1Q.*

GBP:

- ***Aug 13, Consumer Prices, Jul Forecast: -0.1% MM, 2.7% YY Prior: -0.2% MM, 2.9% YY; CPI Ex Food, Drink, Tobacco, Energy, Jul Forecast: -0.1% MM, 2.0% YY Prior: -0.2% MM, 2.3% YY; Retail Prices, Jul Forecast: -0.1% MM, 3.0% YY Prior: -0.1% MM, 3.3% YY; RPIX – Excludes Mortgages, Jul Forecast: -0.1% MM, 3.1% YY Prior: -0.1% MM, 3.3% YY -*** *Citi Analysts expect the YY CPI inflation rate to edge down to 2.7% YY in July from 2.9% in June, as base effects swing round from adverse in June to more helpful in July. Looking forward, Citi Analysts expect the headline CPI rate will fall close to the 2.0% target around the end of this year.*
- ***Aug 14, Claimant Count Unemployment, Jul Forecast: -10,000 MM, 4.4% Rate Prior: -21,200 MM, 4.4% Rate; LFS Unemployment, Apr-Jun Forecast: +50,000 QQ, 8.0% Rate Prior: -57,000 QQ, 7.8% Rate -*** *The single month figures already have shown the jobless rate at 8.0% in April and May and Citi Analysts expect this release will show the average for 2Q rising to 8.0% from 7.8% in 1Q (which was depressed by the weather-related drop in the participation rate in March).*

JPY:

- ***Aug. 12, Real GDP 1st Preliminary Estimate (2Q) Forecast: 0.9% SA QoQ; 3.6% SAAR, Previous: 1.0% SA QoQ; 4.1% SAAR -*** *Based on economic indicators released to date, Citi Analysts now estimate real GDP increased 0.9% QoQ and 3.6% QoQ annualized in the second quarter (the first preliminary data are due out on August 12). Following a 4.1% QoQ annualized gain in the first quarter, the economy likely maintained a high rate of growth. The key feature in the quarter will be business investment: Citi Analysts expect capex to log positive growth for the first time in six quarters on the back of improving corporate profits. Citi Analysts currently expect real GDP to grow 0.9% QoQ and 3.7% QoQ annualized in the third quarter (to be updated after Q2 GDP data release on August 12). Citi Analysts expect public and private business investment to accelerate while consumer spending, residential investment and exports will likely continue to grow at a steady pace.*
- ***Aug. 13, Machinery Orders, Private Excl. Ships and Elec. Power (Jun) Forecast: -7.2% MoM; 2.6% YoY, Previous: 10.5% MoM; 16.5% YoY -*** *Private machinery orders excluding ships and power plants (private core orders) likely decreased 7.2% MoM in June (+2.6% YoY). However, the expected fall reflects a drop-off of large-scale orders in May (from transport/postal services), and Citi Analysts believe the order trend is increasingly recovering. According to the Development Bank of Japan's capex survey*

announced on August 5, large companies are turning much more positive about capital spending with a planned expansion of 10.3% YoY in FY2013. By industry, the main drivers are 1) higher maintenance and repair spending by manufacturers, 2) more new store openings by large-scale retailers and convenience stores, 3) real estate investment mainly of re-development projects in the Greater Tokyo Area, and 4) logistics facilities/airport expansions by transport businesses. As these investment plans are being carried out, a turnaround of machinery orders will likely become clearer. Based on Citi Analysts projections, private core orders will probably increase 5.1% QoQ in the second quarter, overshooting the Cabinet Office projection of a 1.5% QoQ drop. Citi Analysts are also interested in the official forecast for the third quarter, the actual 2Q result and the official 3Q projection for external orders (a leading indicator for capital goods exports).