



Daily Notes on the **Global Economy**

August 19, 2010. Far East / Europe Edition

Carl B. Weinberg, Chief Economist

Greece's Debt Miasma

We were all excited to learn that the IMF staff, after a one-week review of Greece's public finances as of end-June, found that Athens had delivered all its promises for fiscal austerity and economic reform on time. It is not so clear, however, that we should be nearly as excited to follow up on what that means for Greece, which is a good-news-bad-news story if ever there was one.

The good news is that Greece will not have to default on its debt this quarter. The government will receive €2.5 billion from the IMF at the end of August and €5 billion from the EU, which will leave it with enough liquidity to pay its fiscal deficit and to service its sovereign debt. So much for the good news.

Now the bad news: Passing the IMF's tests means that Greece will owe the world another €7.5 billion as of early September. Yes... these funds have to be repaid. Add that to the €14 billion that it borrowed from the IMF and the EU in May, and Greece is now €21.5 billion further in the hole than it was before everyone started "fixing" it in April. Greece started the year with €270 billion worth of national debt, and it is now up to a pinch over €300 billion, including moneys it raised earlier this year. *Debt has risen from 115% of GDP at the start of this year to 130% of GDP or thereabouts in eight months. Looks like everyone is doing a great job fixing Greece's debt problems.*

This farce gets better: By the time they are done fixing Greece in 2013, its debt burden will have risen to €340 billion, or 149% of GDP under the most optimistic assumptions. These are not *our* numbers... they are the IMF's. Sensitivity analysis by the IMF staff shows that higher interest rates, slower economic growth or higher inflation could raise that ratio to nearly 180% of GDP. At the start of 2014, Greece is meant to return to private capital markets to raise new money on its own account. *If Greece could not borrow from global capital markets on affordable terms this year, when its debt ratio was only 115% and its debt was only €270 billion, why on earth would the world want to lend it money in 2014 with a debt ratio of somewhere between 149% and 180%?*

Greece is not very fixed. The IMF disbursement this quarter only sets it up to take a harder fall in the future. No one should believe that Greece will be any better able to service and repay €340 billion worth of fixed income debt than it was able to manage €270 billion.

Markets are not fooled. The yield curve for Greece's government bonds has continued to drift higher since the IMF gave Greece a gold star for fiscal austerity. The storm is centered on bonds maturing in 2014, the first year Greece will be cut off from its lifeline of IMF and EU cash. Indeed, not only must Greece start to finance itself on capital markets in 2014, but it will have to start paying back the IMF

Notice To Readers

High Frequency Economics Ltd. will not publish *Notes on the Global Economy* during our annual summer break, from Monday, August 23, through Monday, September 6. All *Global Notes* readers will receive *U.S. Notes* from Monday, August 30, through Friday, September 3. HFE's regular publication schedule will resume on Tuesday, September 7, with a 10-page edition of *Global Notes*.

Australia: Consumer Price Index Vs Wage Costs

Bars Show CPI, Line Shows Wage Cost Index



and the EU. Yields on Greek fours were a princely 11.625% yesterday, up from 11.1% on the day the IMF declared that the government met its fiscal criteria. *When we all get back from our holidays in September, we can begin to worry about whether Greece will make its fiscal criteria for the late-October IMF review that is prerequisite to the November cash disbursements.*

We can all be assured of this: Greece's public sector debt will continue to grow at an explosive pace as a consequence of the "emergency bailout package" invented by the IMF and the EU. Everything we know tells us that explosive growth of sovereign debt is not a good thing... especially when that explosion starts at 115% of GDP. *Greece's debt problems remain everyone's core economic problem, even though the issue seems to be off the table in these summer doldrums.* How big a problem is this? Well, no one knows. Remember, the EU's "stress tests" of banks did not include a sovereign default scenario. *By September, as the autumn round of global economic policy confabs gets underway, Greece's debt will once again be a hot topic of discussion.*

For investors, Greek fiscal stress means a flight of money into safe haven currencies and bond markets like the United States, Switzerland and Germany. Fiscal stress for Greece means downward pressure on bank stocks, and thus on equity prices in general.

Euro Zone

Construction spending rose 2.7% in June after a decline of 1% in May, according to a report from EuroStat yesterday. This left the index 3.1%

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	2.625%	5/20	2.630	2.630	+0		
Japan	1.100%	6/20	0.911	0.933	-2	-172	-170
Germany	3.000%	7/20	2.306	2.350	-4	-32	-28
United Kingdom	4.750%	3/20	3.027	3.063	-4	+40	+43
France	3.500%	4/20	2.617	2.661	-4	-1	+3
Canada	3.500%	6/20	2.942	2.962	-2	+31	+33
Australia	4.500%	4/20	4.931	4.936	-0	+230	+231

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.

higher than a year ago on a workday adjusted basis. Throw away the workday adjustment to see the seasonally adjusted index was 2% lower than a year ago. The trend in construction is awful, and its recent improvement is only relative to an anomalous crash in February. At its peak in 2007, the index was 108.4. It was just 90.2 last month, having fallen quite steadily in all of 2007, all of 2008, all of last year and most of this year. *No, dear readers, Euroland's economy is not being saved by a construction binge.*

No economic reports are expected today or tomorrow.

Germany

We did not see any economic reports yesterday.

Today, FSO will publish its July report on the producer price index. If anyone cares, we estimate it will turn out 3% higher than year ago thanks to a huge drop in the PPI last year. *Prices are stable. Chill out and enjoy the summer doldrums.*

Japan

Only in Japan could something like this happen. The Cabinet Office yesterday reported that its **composite index of leading economic indicators** improved—however trivially—to 99 in June from 98.6 in May. The same Cabinet Office also reported, in the same release, that its **diffusion index of leading economic indicators** declined in June to 27.3 from 54.5 in May. *So which is it? Is it up or is it down?* Our old friend, the diffusion index, signals subpar economic growth whenever it is below 50. Par, based on recent experience, is below zero, so the time-tested but recently unreliable diffusion index says the economy will soon contract. *We have a rule about distrusting any economic report that tries to show both improvement and decay of an economy at the same time. We refuse to pay these indexes any attention... we even refuse to draw the chart. Shame on the Cabinet Office for publishing inconsistent data.*

Today, we will see revised estimates of machine tool orders for July, along with July data on department store sales from JDSA. Department store sales have been contracting forever, and we have no reason to think the trend changed last month. *We estimate they were 6.1% lower than a year ago after a 7.4% year-over-year decline in June.* Machine tool orders were initially reported 139.5% higher than a year ago! That figure looks good, until you realize that year-ago orders were depressed so much that the June 2010 figure is still 41% below its peak before this economic downturn began. *We have no reason to expect any important revisions to this figure.*

United Kingdom

Minutes of the August MPC meeting were published yesterday. They indicate that this last powwow was very much a replay of the July meeting. One member, Andrew Sentance, argued for a 25 basis point increase in the base rate to 0.75%. To offset this initiative, at least for purposes of spinning the minutes, the other committee members discussed arguments for **cutting** rates. The vote was eight-to-one to hold the asset purchase program and base rates unchanged... as everyone expected. The MPC says it is prepared to adjust monetary conditions either way, but it presently sees no sign of rising inflation expectations. It expects—as we do—that inflation will return to or fall below its 2% target when the impact of the VAT rate increases works out of the maths at the end of next year. *As we note above, the MPC will be looking at a contracting money supply by January, if not sooner. We will see if the MPC will continue to sit tight without any new asset purchases as M4 and domestic credit fall below year-ago levels.*

Today, CBI will release its industrial trends survey for August, and Nat-Stats will publish its official report on retail sales volumes for July. *We estimate retail sales were 0.2% below year ago levels after a mere*

A Quick Look at Upcoming Events

	Thursday	Friday
Japan	Machine Tool Orders (7r) Dept Store Sales (7)	Nothing
Australia	Avg Weekly Earnings (Q2)	Nothing
Euro Zone	Nothing	Nothing
Germany	PPI (7)	Nothing
France	Nothing	Nothing
United Kingdom	CBI Industrial Survey (8) Retail Sales (7) M4 (7p) PSNCR (7)	Nothing
Canada	LEI (7) Wholesale Sales (6)	CPI (7)
United States	No HFE U.S. Notes Philly Fed Survey (8) LEI (7) Weekly Initial Claims	Nothing
Other	Nothing	Nothing

Underscore=Already released *Italics*=Estimated release date

Further Down The Road...

August 21	Australia—National Elections
September 7	Australia—RBA Board Meeting
September 2	Euro Zone—ECB Council Meeting
September 6 - 7	Japan—BoJ Board Meeting
September 8	Canada—BoC Interest Rate Decision
September 8 - 9	United Kingdom—MPC Meeting
September 21	United States—FOMC Meeting
October 9 - 11	IMF Annual Meeting—Washington
November 11 - 12	G-20 Summit—Seoul

1.3% year-over-year rise in June. VAT rate increases are pushing up the CPI, and that is killing real incomes. Also today, we expect July data on the money supply and the public sector deficit. *M4 grew only 1.8% compared to a year ago, according to our estimates, after an increase of only 3% in the 12 months ended June.* Our estimate for July would be the new record low for M4 growth. *Lending within M4 should also be reported slowing. As noted above, M4 will start to fall below year-ago levels by January for sure, and probably sooner, unless the BoE resumes asset purchases. The PSNCR should turn out to be only £420 million for July, down from £940 million in the same month last year.* Note that these data are not seasonally adjusted, so the yearly decline is what matters rather than the levels. Our estimate suggests the deficit in the first four months of this fiscal year totaled £41.9 billion, less than the £45.2 billion result in the same period a year ago. *As noted yesterday, the increase in the VAT rate and a pinch of economic expansion are helping to reduce the public sector financing gap. There is still a long way to go.*

France

There were no economic releases yesterday, and none are expected today or tomorrow. This week is the heart of the summer holiday period in France. Markets might as well be closed.

Australia

ABS yesterday reported a 0.8% rise in its **wage costs index** after a 0.9% increase in the first quarter. The index was 3% higher than a year ago, as it was in the first quarter after revisions. It rose 2.9% year-over-year in the fourth quarter of last year. *This report tells us, simply, that wages have stopped accelerating and are now rising steadily at about a 3% yearly pace. This is consistent with CPI increases in the RBA's 2%-to-3% target band. So no one need fret that*

further RBA action to stem inflation risks is needed, surely not in the near term. The small rally in Ozzie bonds yesterday may have been related to relief generated by this bond-friendly report.

ABS will publish second quarter data on average weekly wages today. This used to be the key metric for wage pressures, but it has fallen out of vogue in favor of the wage costs index. Average weekly wages fluctuate if the job mix in the economy changes. If the economy creates a lot of low-paying jobs in one quarter, average weekly wages will fall even if the wage for every job in the economy stays the same. See *the problem?* So ignore this report please... everyone else will. No economic reports are planned for tomorrow.

Canada

StatsCan reported yesterday that there were 691,640 **recipients of unemployment insurance** benefits in June. That is 1.2% more than in May, but 16.6% fewer than a year ago. **Initial claims for benefits** rose last month, too, by 2.1% to 238,020 from 233,100. They remain 20.8% lower than last year at this time. *Look for a slowdown of the economy to continue to push disbursements up.*

The loonie extended its rush toward par with the U.S. dollar yesterday, boosted by expectations that BHP Billiton will have to raise its offer for Potash Corporation to as much as C\$165 per share from C\$130. Let's see... that would raise the value of the offer to C\$50.8 billion from C\$40 billion. **That would be an impressive capital inflow.** This one transaction, in addition to being big enough to cover the entire current account deficit of the nation for more than a year, would also boost Canada's money supply by 3.7%. That is not such a bad thing, with M3 barely growing at all right now. However, this may not be the case months from now, when payment for this deal hits Canada's banking system. For the Bank of Canada to sterilize this inflow, it would need to sell the market almost as many government bonds next year—equal to 3.7% of GDP—as the government will have to sell to fund its fiscal deficit. *Bond prices may plunge, steepening the yield curve: This private capital deal will "crowd out" public borrowing. Very interesting!*

Today, we will see the index of leading economic indicators for July and June data on wholesale sales. The wholesale sales report should read a lot like Tuesday's report on manufacturing shipments: Roughly flat on the month, up a lot from depressed levels of a year ago but still well below the pre-downturn peak. The LEI was last reported up 1% in June from May and 13.3% higher than a year ago. The year-over-year change, which correlates well with year-over-year GDP growth, peaked at 14.3% in March and has been slowing ever since. *We have marked down our estimate for the July LEI to a 12.5% year-over-year increase. That would imply continued deceleration of GDP, which did not increase at all in April and expanded only 0.1% in May. Remind us, please, why the BoC thinks this is a good time to tighten monetary conditions?* Tomorrow, StatsCan will release the July report on the consumer price index.

United States

Yesterday's only economic report showed a 13% rise in **mortgage applications** last week, with all of the gains coming from applications for refinancing. Without refs, mortgage lenders and brokers would be idle. Applications for new purchases dropped 3.4% last week and are running 38.6% below already depressed levels of a year ago. Driven by historic low rates, refi applications are 136% above year-ago levels on the back of a 17.1% rise last week alone. *No one can construe this report to suggest that demand for homes, new or used, has improved. As the president said yesterday, the housing market is a "big drag" on the economy.*

Today, we will see the Philadelphia Fed survey for August, along with the index of leading economic indicators for July and weekly data

on initial claims for unemployment insurance. *The trend in jobless claims seems to be downward, and that should be evident now that we are past the chaos caused by the retooling shutdowns in the auto sector.* Last week's figure was 484,000, and the market is looking for a small decline to 478,000 in today's report. *With most of the data now available, it looks like the LEI will scrape out a 0.1% increase after a 0.2% dip in June.* Its trend has flattened out, but its level is still consistent with an expansion of GDP—albeit only about 1%—for the third quarter. The headline has been too bullish over the past year, but it now seems to be coming back into line. The Philly Fed index dropped to 5.1 in July from 21.4 in June. *It is probably prudent to expect it to dip further this month, to about zero.* It is a bit less volatile than the Empire State survey—which rose in Monday's report—and it is a better indicator of other surveys of industrial activity. New orders is the key number in this report: That index fell to minus 4.3 in July, its lowest reading since June 2009. No economic releases are scheduled for tomorrow.

Carl B. Weinberg

August 19, 2010 at 00:15 GMT
cweinberg@hifreqecon.com

Valhalla, NY

+1-914-773-2121