High Frequency Economics
Daily Data Analysis and Assessment of the Global Economy

Notes on the Global Economy
March 14, 1988

Carl B. Weinberg, Chief Economist

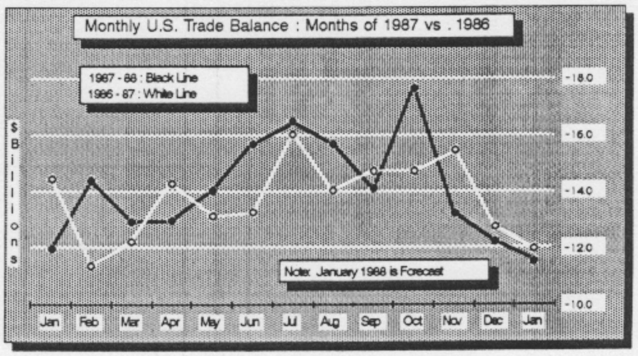
Not "Just Waiting" for the U.S. Trade Report

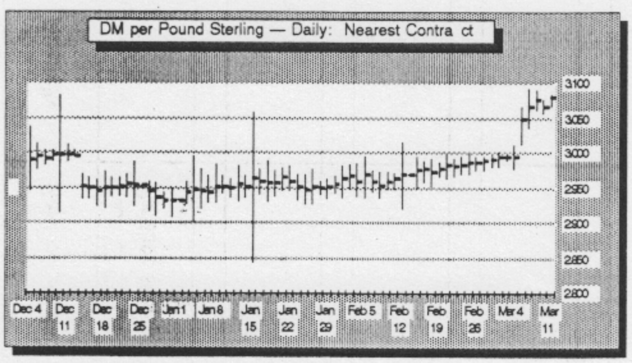
The third week of each month is typically the most active for the release of economic data. This week, we are faced with the U.S. merchandise trade report for January, as well as trade data for Canada and Australia, industrial production reports for the United States, the United Kingdom and Japan (albeit only a revision to the January data). The latest money supply numbers for Japan, West Germany and the United Kingdom are to be released. To top matters, the U.K. budget will be presented on Tuesday, and U.S. Federal Reserve Board Chairman Greenspan will testify before Congress on the same day. Finally, Friday is a "triple witching hour" date for U.S. markets. It would therefore be fair to anticipate a great deal of news-driven market activity over the next five business days, and a concommittant level of nervousness and volatility.

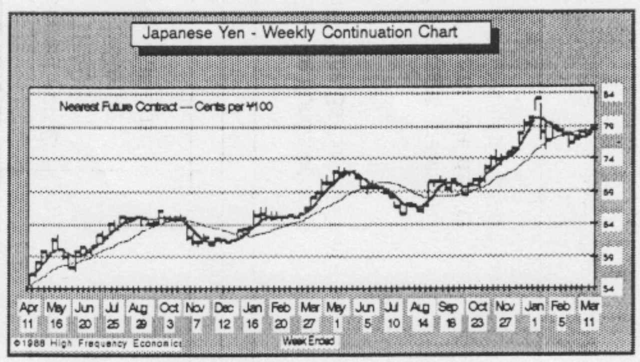
	Exports	Imports	Balance
Aug	20.2	35.9	-15.7
Sep	21.0	35.1	-14.1
Oct	21.8	39.4	-17.6
Nov	23.8	37.0	-13.2
Dec	24.8	37.0	-12.2
Jan(f)	*22.4*	*34.0*	*-11.5*

The most carefully watched number of the week will certainly be the U.S. merchandise trade report. As difficult as it is to forecast a monthly indicator that is not seasonally adjusted, we feel obliged to project another month of continued improvement in the U.S. deficit, to a deficit of \$11.5 billion. Our forecasting equations are heavily influenced by recent year-over-year rates of growth of exports and imports—34% for exports and 18% for imports. If our projections are correct, the report will come in better than the market consensus which should drive the dollar sharply upward. We caution, however, that the standard error of our forecast does not preclude a deficit as high as \$14 billion and thus a dramatically different result. We note, though, that a deficit of \$11.5 billion would be the fourth month in the last five that the monthly deficit was smaller than in the same month one year ago. The horrendous number for October is looking more and more like an anomaly.

In this setting, the yen seems poised, on technical grounds, to back off a bit against the dollar. Admittedly, last week's currency activity was clouded by the intense activity in the DM/sterling market. With that now done with—and notice that all of the activity in London did not have much of an impact on yields—attention can be expected to return to the main sphere of activity, the dollar. *We expect sterling to solidify its position against the DM in the aftermath of a very bullish Budget Speech on Tuesday.* The yen/dollar rate, having peaked just below ¥120 to the dollar, has moved into a trading range. *We expect that a good merchandise trade report for the U.S. on Thursday would outweigh any possible impact of a strong Japanese GNP report (due out on the same day, see our report last week for projections) and push the dollar back up towards the low ¥130s.*







High Frequency Economics — Weekly Calendar of International Events and Data Releases

	United States	Canada	Japan	France	Germany	United Kingdom	Switzerland	Australia	General Events
Monday Mar 14	Inventories(1) Auction: 3&6 mos.			Wkly Auction		Retail Sales(2p) PPI(2p)			Non-OPEC Oil Producers Mtg.
Tuesday Mar 15	Greenspan Tstmy. IP(2) CurrAcct(Q4)	Retail Sales(1*)	Mach. Orders(2) WPI(2)	Wkly Cab Mtg	NO REPOS EXPIRING	Budget Speech IP(2)			
Wednesday Mar 16	Housing Starts(2) Capacity Util(2)	TRADE(1)	IP(1r)			PSBR(2)			
Thursday Mar 17	**TRADE(1)**	Bank Rate	**GNP(Q4)**	BdF Weekly Stmt.	BB Council Mtg.	Employment(2) Earnings/Prod(2)			
Friday Mar 18		CPI(2)	MONEY(2) EPA Mthly Report BOJ Mthly Report			GDP(Q4r) MONEY(2)			
Sometime in the Week		*Scheduled +/- 5 days of this date			PPI(2) MONEY(2)			Current Acct(2) TRADE(2) IntRes(2) Wkly Earnings(1)	

Index

CPI	Consumer Price Index	
CurrAcct	Current Account Balance	
Employment	Employment and Unemployment rate	
IntRes	International Reserves	
IP	Industrial Production	
MONEY	Money Supply Data	
Tstmy	Testimony	
TRADE	Merchandise Trade	
WPI	Wholesale Price Index	

Figures in Parentheses are dates:
(1) indicates January, (2) February, etc.
(Q4) indicates Fourth Quarter
(1.3) indicates third 10-day period of January

"Wkly" means "Weekly"
"Mthly" means "Monthly"
Italics indicates HFE estimated release data

BB is the Bundesbank
BdF is the Banque de France

"p" indicates preliminary
"f" indicates final data release
"r" indicates data revision only

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International Yield Curves

In the aftermath of the DM/sterling assault on 3.0, not much appears to have changed in broad picture of relative yields. The exception last week was France, where higher short-term rates were called for to keep the franc in line with the DM. This week promises to be a wild card once again in the interest-rate-currency sphere—and an unpredictable one as well. Major indicators are being released for all of the key currency economies. Last week's rule, "...move funds into the highest yielding currency..." may not work in this week's environment, mainly because the currency situation is more volatile and interest rate movements this week may be important.

Of key significance (following the U.S. merchandise trade numbers due out on Thursday) will be the February money supply figures due out for the United Kingdom, West Germany and Japan. In Britain, Friday's money report will be outweighed by the expected euphoria expected following the Budget speech on Tuesday. By next week, however, the effects of another enormous increase in the monetary base will have worked its way around the markets, and fears of inflation could be re-kindled—doubly so if Monday's PPI report brings sour news. Similarly, monetary growth is out of control in Japan. In Germany, the Bundesbank will continue to see the world through its own ultra-monetarist eyes.

With all of the important data releases and speeches coming up this week, currency movements are likely to be severe, in our view. This dictates conservative short-term placements of funds rather than aggressive positions. The bravest, however, could be tempted into either Canadian or sterling government bonds. But fundamentals plus policy point to *stable or higher* rather than lower interest rates in Canada, the United Kingdom, West Germany and Japan, at least in anything but the shortest-run.

Yields on 90-day Paper — March 11, 1988

		Spread Against...							Curve's
Country	Yield	U.S.	Canada	Japan	France	U.K.	W. Ger.	Austr.	Slope*
United States	5.88	—	-2.48	+2.08	-1.99	-2.80	+2.38	-3.92	2.41
Canada	8.36	+2.48	—	+4.56	+0.49	-0.33	+4.86	-1.44	1.02
Japan	3.80	-2.08	-4.56	—	-4.08	-4.89	+0.30	-6.00	0.71
France	7.88	+1.99	-0.49	+4.08	—	-0.81	+4.38	-1.93	1.74
United Kingdom	8.69	+2.80	+0.33	+4.89	+0.81	—	+5.19	-1.11	0.87
West Germany	3.50	-2.38	-4.86	-0.30	-4.38	-5.19	—	-6.30	2.71
Australia	9.80	+3.92	+1.44	+6.00	+1.93	+1.11	+6.30	—	2.20

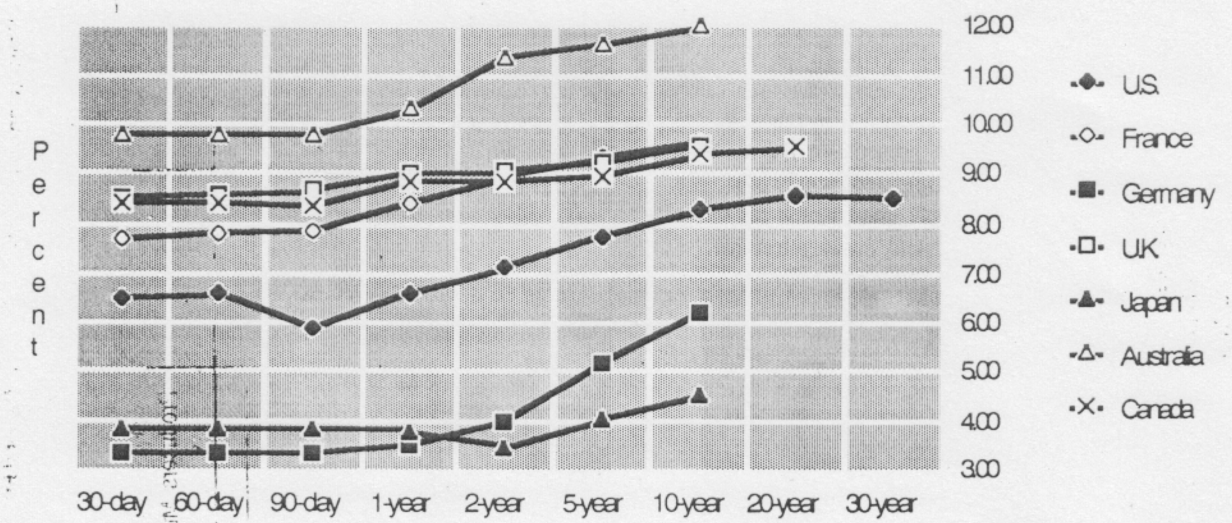
*Calculated as 10-year yield minus 90-day yield for each currency.

Yields on 10-Year Bonds — March 11, 1988

		Spread Against...						
Country	Yield	U.S.	Canada	Japan	France	U.K.	W. Ger.	Austr.
United States	8.29	—	-1.09	+3.78	-1.32	-1.27	+2.09	-3.71
Canada	9.38	+1.09	—	+4.87	-0.23	-0.18	+3.18	-2.62
Japan	4.51	-3.78	-4.87	—	-5.10	-5.05	-1.70	-7.49
France	9.61	+1.32	+0.23	+5.10	—	+0.05	+3.40	-2.39
United Kingdom	9.56	+1.27	+0.18	+5.05	-0.05	—	+3.36	-2.44
West Germany	6.21	-2.09	-3.18	+1.70	-3.36	-3.36	—	-5.79
Australia	12.00	+3.71	+2.62	+7.49	+2.44	+2.44	+5.79	—

Note: Japanese 10-year simple interest yield converted to semi-annual yield to maturity.

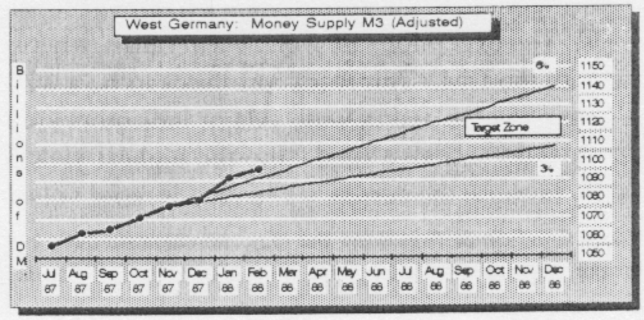
Comparative Yield Curves



West Germany

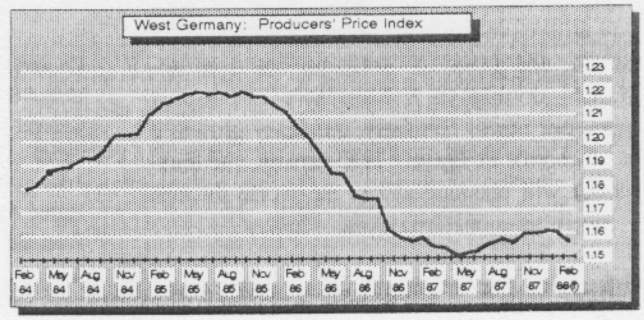
We have learned to become wary when the Bundesbank is likely to be wary, and it does not seem possible that the Central Bank Council is not sitting on the edge of their seats. This week brings out two key indicators reports—M3 and producer prices. Buba will not likely be concerned that the monetary target range is being exceeded so early in the year.

	M3	%chya
Sep 87	1065.2	6.7
Oct 87	1070.9	6.4
Nov 87	1077.1	5.9
Dec 87	1080.1	6.1
Jan 88	1091.8	5.7
Feb 88(f)	*1096.8*	*5.7*

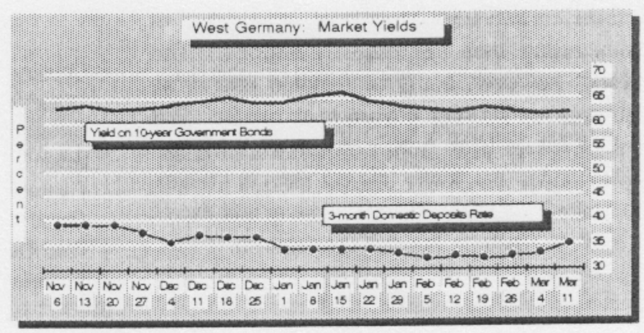


The PPI report should show declining month-to-month input prices, if only because of weak oil prices. But the central bank will sooner or later want to clamp down on monetary expansion to meet its targets. At the same time, it does not want to be raising interest rates at a time when the economy is apparently slowing down, if not sinking into a recession.

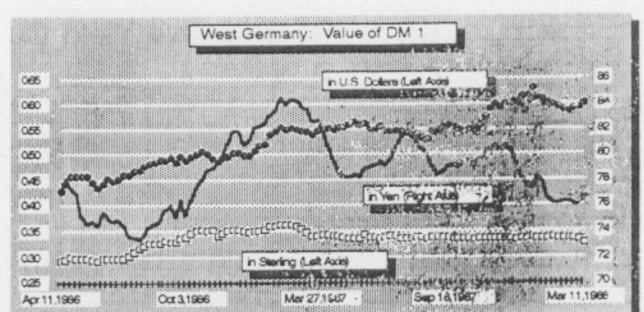
	PPINS	%chya
Sep 87	1.156	-1.6
Oct 87	1.160	-0.2
Nov 87	1.160	0.1
Dec 87	1.161	0.3
Jan 88	1.160	0.1
Feb 88(f)	*1.156*	*0.1*



Recall that Buba has granted a net add at each repo tender this year, except for the March 1 tender. There are no repos falling due this week, and there is not likely to be a large tender accepted, if any are offered.

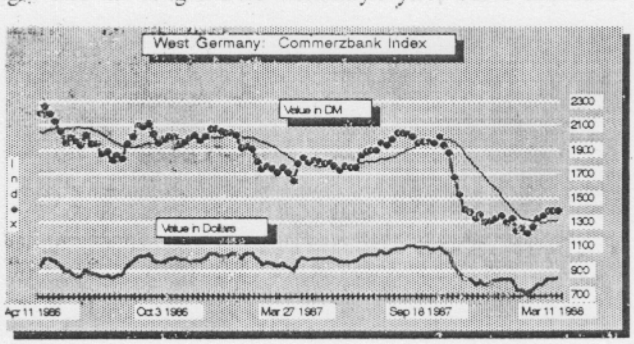


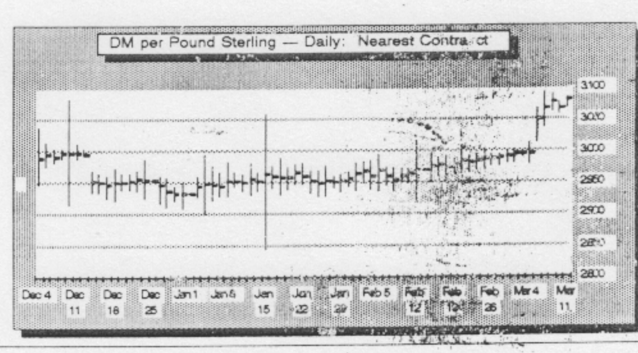
We have to conclude from all of this that both short-term and long-term interest rates in Germany are more likely to rise than to fall over the next month. With sterling expected to settle around DM 3.1, there should be no external contraints, other than G-5 constraints, to pushing up German interest rates. The key questions are now internal in nature. *Experience suggests that Buba will sacrifice domestic growth to attain monetary stability.* This does not mean that we expect a major policy revelation to come out of this week's central bank council meeting. Rather, we anticipate a change in policy direction during the second quarter.



The implication of a tightening monetary policy, coupled with already tight fiscal policy and a faltering economy, is that German equities can also be expected to soften.

The only bright spot in picking an investment in Germany is that the yield curve is remarkably steep at present—more so than either inflationary expectations or anticipated policy changes might dictate. Investors seeking relatively good yields for value might find the long-end of Germany's yield curve attractive.



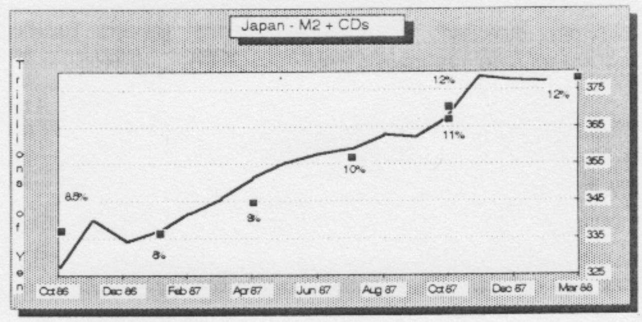


Japan: End-Of-Year Moves—but Longer-Term Worries

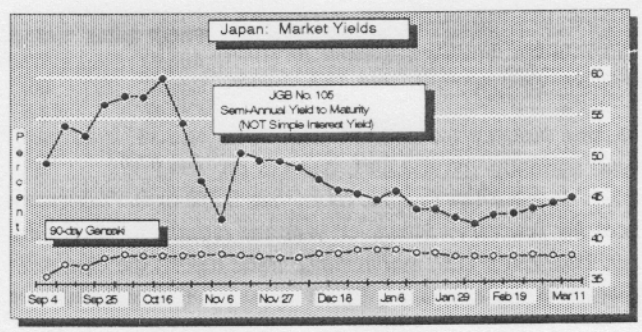
The palpable steepening of Japan's yield curve seems to be driven by two fundamental factors. First, the tactic of continuously raising monetary targets so they will never be exceeded has fooled no one into believing that the BoJ is not concerned with monetary growth in the double digits. The expectation that the central bank must eventually clamp down on M2+CDs puts a damper on the upward potential of JGBs. The second factor is that strong growth should eventually put upward pressure on rates as money demand pushes against supply. To be frank, there is no evidence of inflation at this point—Tuesday's WPI report should show a 1% decline year-over-year for February, as wholesale prices are held down by falling oil prices and the lingering effects of the soaring yen on import prices.

	M2+CDs	%chya
Sep 87	363.2	11.1
Oct 87	362.4	11.7
Nov 87	367.9	12.4
Dec 87	378.9	11.5
Jan 88(f)	*377.7*	*13.1*

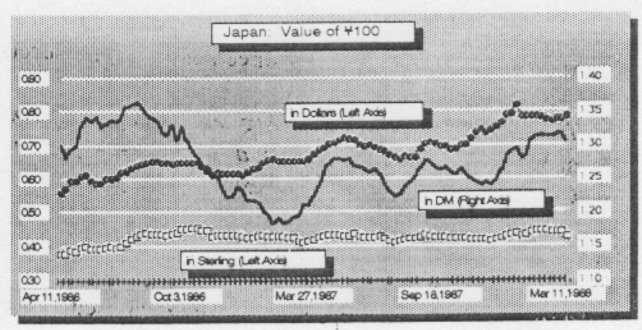
Following January's jump of 13.1% year-over-year in M2+CDs, February and March would have to be flat to make the 12% quarterly target. Seasonal factors should help for February, but March is always problematic because of the special problems associated with the end of the fiscal year. *We expect short-term interest rates to tick upward in the last two weeks of March.*



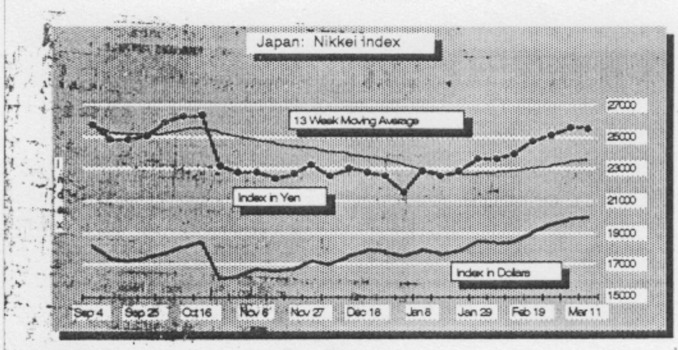
We also expect wide swings in foreign capital flows, as Japanese investment houses sell off dollar holdings to take losses for the year-end. These "window dressing" transactions will be reversed in April, so look for excess supply of dollars (dollar weakness against the yen) for the last 10 days of March and an offsetting excess demand for dollars in the early days of April. *Thus, seasonal currency factors matched with good news for the economy due out this week (see our GNP forecast in the March 7 issue of Notes) suggests near-term value in Japanese equities.* We look for small gains through currency translation and a continuation of the TSE rally—which has already brought the dollar value of the Nikkei index above October 19 levels.

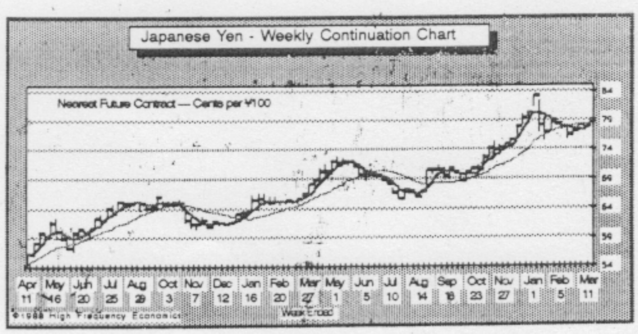


But these positions will hold value only for the very shortest term. *We believe that the yen will be skittish against the U.S. dollar, and we are looking to see the dollar move back towards the low ¥130s in April.* News of another month of improvement in the U.S. trade balance, and continued decreases in Japan's surpluses, are expected to offer the markets that incremental push from fundamentals to jolt the yen/dollar out of its current trading range.



Other reports due out this week include machinery orders for February and the monthly reports of the EPA and the BoJ. All are expected only to reconfirm a truly ebullient view on the growth prospects for Japan. *We*, however, recall the last time Japan used simultaneous monetary and fiscal expansion in 1974. The results for inflation and longer-term growth were disastrous.





Canada: The C$ May Have Peaked…For Now

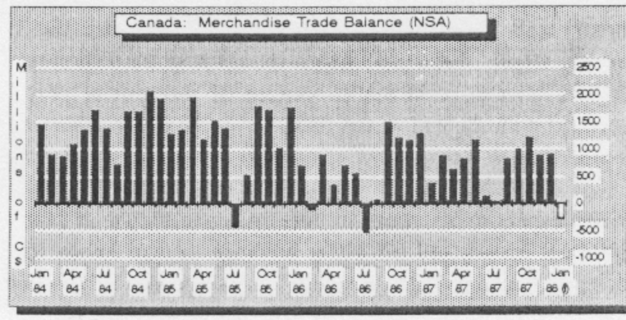
The party may soon be over on the Canadian dollar. The currency's sprint upward to nearly US$0.80 faltered last week, while the U.S. dollar took a beating against most other units. A short-term support point was broken when the C$ fell below US$0.796. This week, the fundamentals are expected to offer at least one good reason to short the C$, when the trade data for January are released on Tuesday. We forecast a deficit of C$250 million—strong economic growth in Canada is pulling in imports at a pace almost 20% greater than one year ago. Sometime this week, we will also get a report on January retail sales, which we project will rise by 12% in nominal terms from January 1987. Continued evidence of strong growth will be a negative for fixed income markets. Two questions are raised: When might inflation become a factor and how bad might the trade deficit get? We can expect, though, that the quiet week before the U.S. trade report may not be kind to Canada.

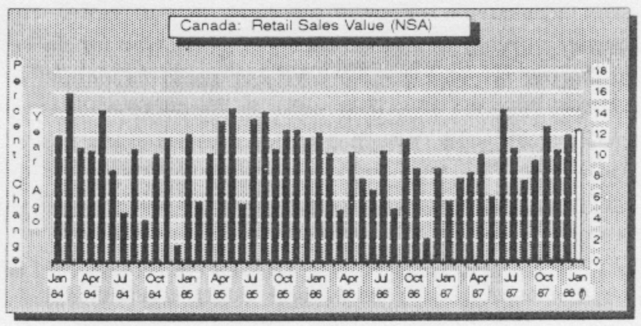
	Exports	Imports	Balance
Aug 87	9362	8560	803
Sep 87	10738	9747	992
Oct 87	11336	10138	1198
Nov 87	11513	10622	891
Dec 87	11207	10311	897
Jan 88 (f)	*10250*	*10500*	*-250*

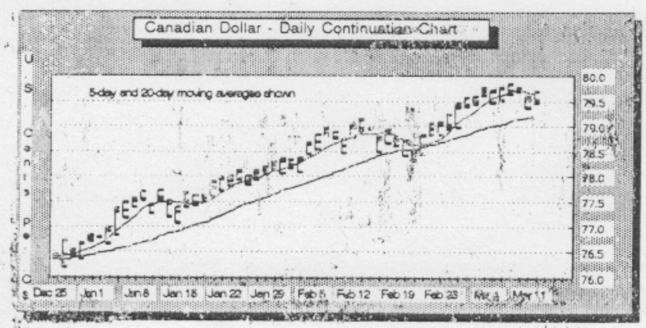
There are, however, two good reasons to maintain C$ portfolios. First, strong growth is a plus for the stock market, and the rally in the TSE is likely to be fueled by a strong sales report. Second, the Bank of Canada has shown no signs of letting the Canada/U.S. interest rate premiums narrow. The central bank is clearly more concerned about overheating the economy than currency appreciation. Movement out of C$ assets may be premature, despite expected flatness for the currency. Canadian governments should continue to offer attractive yield spreads over U.S. bonds.

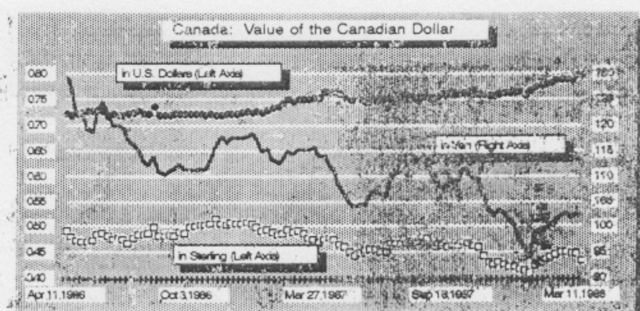
Retail Sales	%chya
Aug 87	7.7
Sep 87	9.6
Oct 87	12.8
Nov 87	10.5
Dec 87(f)	*12.0*

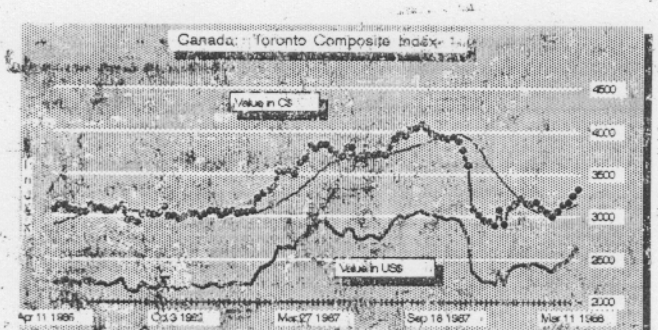
The key number for Canada this week would normally be the CPI, due out on Friday. It is hard to imagine more than 0.3% or 0.4% increase in prices for February. However, with the report due out on Friday *after* Thursday's U.S. merchandise trade report, the data will not generate much attention. Smart money will watch this report carefully, for guidance in the next week when less attention will be focused on the U.S.

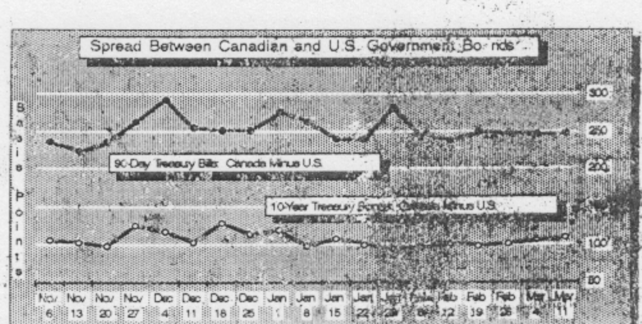








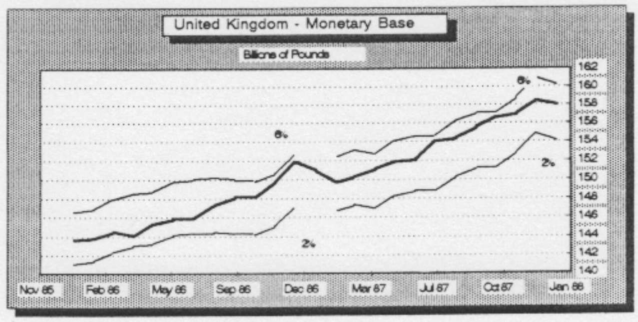




United Kingdom: Budget Week...Rejoice!

Despite an active week of economic releases, all eyes in the United Kingdom will be watching the Budget speech on Tuesday. Markets will look for reasons to be disappointed, rather than for positive surprises. It is a foregone conclusion that the budget will include a significant tax cut, and could promise a surplus for the next fiscal year. Anticipation of a positive budget has been an important factor driving sterling up over the last weeks. Looking forward, though, we have to wonder how the post-budget U.K. economy will shape up.

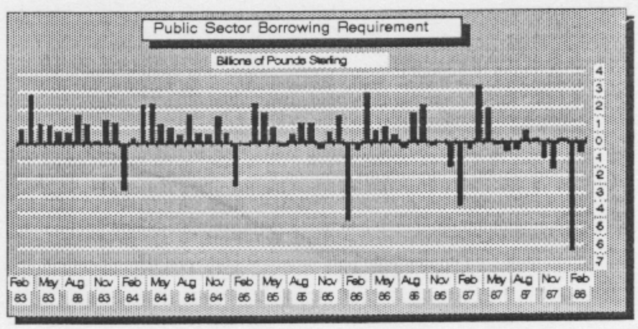
First, we are keeping a careful eye on monetary policy. Ostensibly, the Thatcher government has set a target range for the monetary base—which is ostensibly being met. However, broader measures of liquidity have been expanding at too a rapid pace to be healthy, raising the prospect of inflation growing out of the robust economic expansion. Last week, Mrs. Thatcher refused to lower interest rates to keep sterling from appreciating over DM 3. Apparently, then, there are somdinternal guideposts to U.K. monetary policy although currency stability is no longer dominant. We will have to watch upcoming statements—perhaps the budget speech itself— for new directions in monetary policy. Friday's release of monetary data will therefore be ignored, until central government policy becomes more clear.



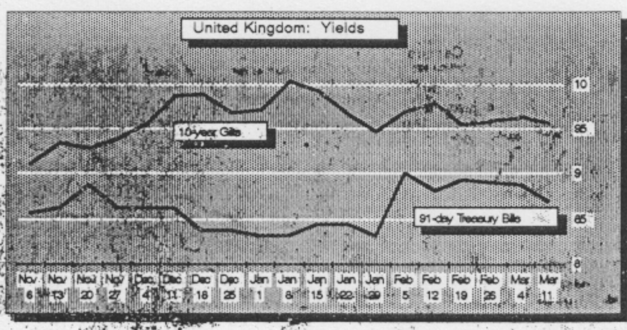
	£Millions	%chya
Sep 87	15560	4.9
Oct 87	15659	5.6
Nov 87	15708	4.9
Dec 87	15847	4.3
Jan 88	15801	4.6
Feb 88		

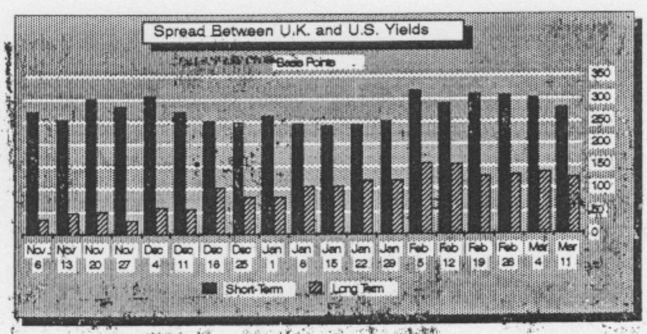
On Wednesday, February's PSBR will be reported, and should show an increased surplus over one year ago. We wonder why the government is not using the opportunity of a booming economy and a budget surplus to address the large fiscal deficit still underlying the PSBR—i.e. not counting the revenues from privatization as current income.

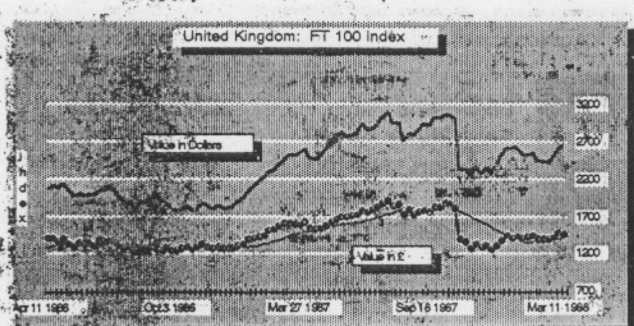
	PSBR
Feb 87	-0.399
Nov 87	-1.586
Dec 87	0.186
Jan 88	-6.291
Feb 88(f)	*-0.700*

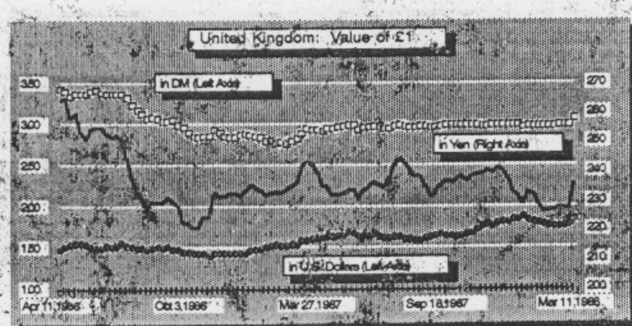


Despite a potential future fiscal problem, markets seem to love the U.K. today. Prospects are good for the currency to remain strong, based on high U.K. yields. However, the pre-Budget run-up in bond prices and the exchange rate may be all that we are going to see in British markets, which we expect to stabilize rather than take off in the next fortnight while economic fundamentals start to take hold.

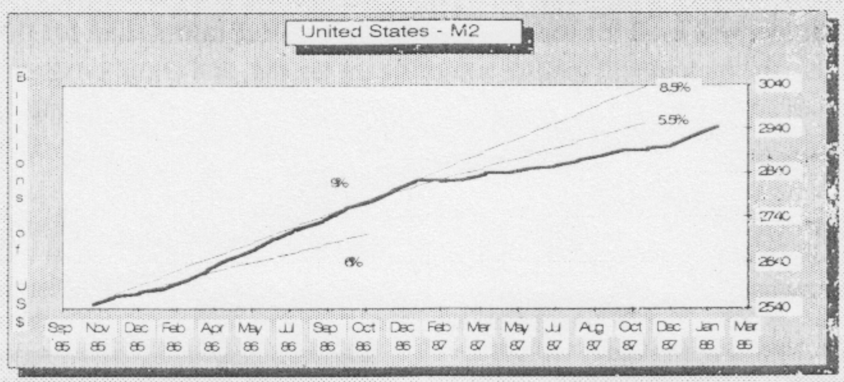


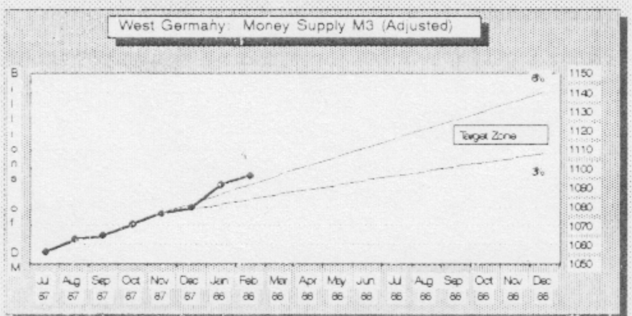


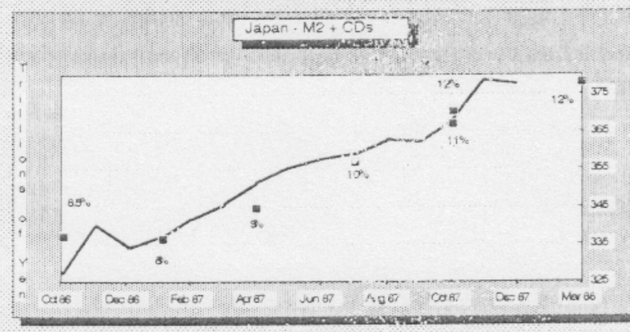


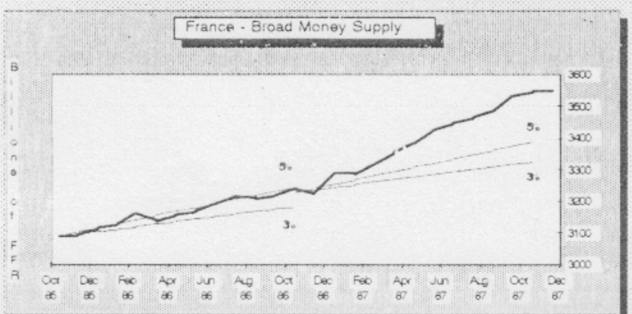


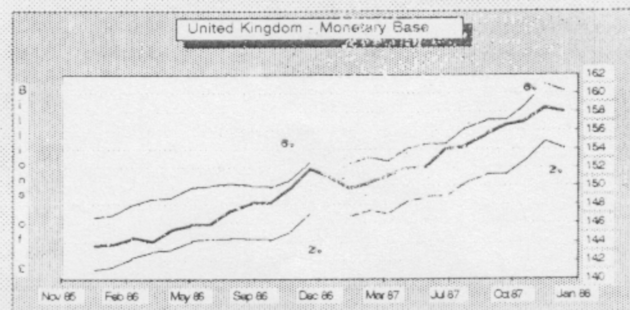
Monetary Aggregates and Their Targets

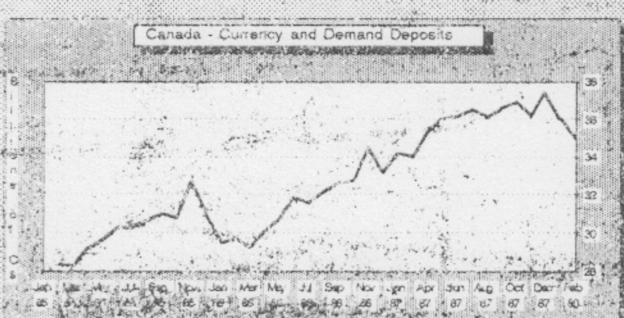


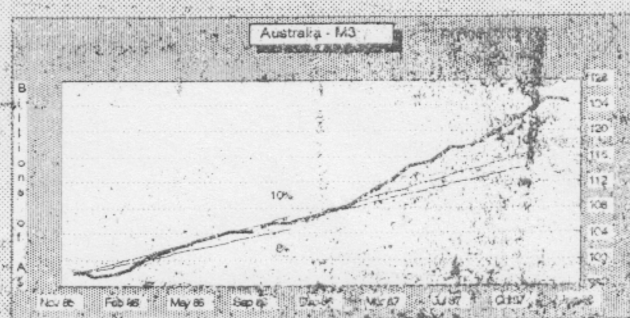












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