Investec
Investec Bank plc (UK)

Week commencing Monday 12 December 2016

Economics

Investec Economics

The week ahead: Monday 12 December 2016

- Two Italians took centre stage in the global arena this week – Matteo Renzi and Mario Draghi. Mr Renzi, the Italian Prime Minister, tendered his resignation on Wednesday following the crushing defeat of his proposed constitutional reforms in Sunday's referendum. Mr Renzi will continue as PM for now as a caretaker until a solution is found on next steps. The emerging view is that fresh elections should take place next year, possibly in February. So on top of the French and German elections to be held next spring and autumn respectively, yet another source of uncertainty has been injected into the European political calendar.

- Although a defeat for Mr Renzi and his subsequent resignation was widely expected, we nevertheless think that markets showed a remarkably sanguine response. Following a day of mild jitters on Monday, Italian bond yield spreads over Bunds (a risk premium proxy) have actually fallen materially below levels seen last month. And after an initial knee-jerk decline, the euro actually rallied following the vote. A pattern could be emerging: following the Brexit vote in June, Donald Trump's election victory in November and now the Italian referendum, markets and economies have (so far, with the notable exception of sterling) shown a surprising degree of resilience to political shocks.

- The ECB President, Mario Draghi, made some significant announcements at this week's ECB meeting. The ECB's Governing Council (GC) announced an extension of the QE programme by nine months, taking the proposed end-point from March to December next year, albeit at a reduced asset purchase pace of €60bn a month from the current €80bn as of next April. The GC also loosened its QE purchase rules, allowing it to buy bonds with yields below the -40bp deposit rate while also permitting the purchase of bonds for maturities between 1 and 2 years (extending the existing 2-30 year range). That, alongside Mr Draghi's pronouncement that 'tapering' of the QE programme has not been discussed by the GC, confirmed a dovish stance.

- The big central bank event next week (Wednesday evening) comes from the US Federal Reserve. The near universal expectation is that the Fed will raise the Federal funds target rate range from 0.25-0.50% to 0.50-0.75%. Such a move is firmly priced in though, so market reaction might hinge more on FOMC members' medium term rate expectations, as outlined in the 'dot plot', and on Chair Janet Yellen's press conference. Elsewhere in central banking, Thursday will see the Bank of England making its policy decision. Here we would be surprised to see any major headlines with the MPC set to vote unanimously for no policy changes (our full preview will be released on Monday). The Swiss National Bank and the Norges Bank also make policy decisions on Thursday.

- On the home front, senior politicians will be out in force. Chancellor Philip Hammond will face the Treasury Select Committee on Monday to discuss the Autumn Statement. On Thursday and Friday the EU will hold its end-of-year leaders' summit. PM Theresa May will be attending – we will be watching for any developments in her framing of the Brexit debate as well as the response of other EU leaders.

- Besides the flurry of central bank and political events, the data calendar will be busy too. In the UK we will get further steers on the health of the post-Brexit economy and the extent to which inflation is rising as a result of post-referendum falls in the pound. Here, the two key releases will be CPI on Tuesday and labour market numbers on Wednesday.

- Other major releases from around the world next week include Chinese industrial production (Tuesday), the Eurozone 'flash' PMIs and US CPI (both on Thursday). Big surprises here could move markets in an otherwise jam-packed week. **CH**

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Fed on track for a pre-Christmas hike

- The FOMC meets for its last policy meeting of the year and its last under the President Obama administration next week. Its policy announcement is due at 19:00 UK time on Wednesday 14 December alongside updated economic forecasts, with Fed Chair Yellen's press conference following about 7.30pm.
- We strongly expect the Fed to raise the Federal funds target rate range from 0.25-0.50% to 0.50-0.75% which is also a widely shared view in markets. Indeed the CME Fed Watch measure is pointing to there being a 95% chance of a hike next week.
- We expect the tone of the policy statement to be upbeat reflecting the decision to hike rates, whilst also reinforcing expectations that the December policy move signals a slow recommencement of the Fed's normalisation of interest rates. In particular we would expect the policy statement to flag the continued improvement in the labour market, the pick-up in market based measures of inflation expectations (with 5 year breakeven yields having peaked above 2.5% in recent weeks, their highest level since Q4 2014) and the reassurance received from the relatively settled financial conditions after the US election.
- With next week's rate rise seen as highly likely, we expect the Fed's forecasts and Dr Yellen's press conference to garner more attention than the rate decision itself. Market participants will be keen to see whether the FOMC is factoring in any marked adjustments to its forecasts after Donald Trump's election victory and whether there are any notable changes to its 'dot plot' of participants' views of the appropriate Federal funds rate at various points in time. Recent comments from FOMC members point to the Fed making few major adjustments at this point, preferring to wait for greater clarity on the President-Elect's fiscal plans and how much might be passable through Congress. We expect that changes made to Fed forecasts would be more significant for 2018 than 2017, given implementation challenges in fiscal policy. Furthermore we note that the FOMC's inclination to embark on a radically different policy path at this point is likely to be limited by the fact that Fed Chair Yellen is probably now working off the assumption that she is not likely to see her term as Fed Chief renewed once her current tenure ends in February 2018; she may well be asked about this next week.
- Note we maintain our current view that the pace of rate rises is likely to be limited and gradual through 2017; we anticipate two increases taking the Fed funds target rate range to 1.00-1.25% by end-2017. This is particularly so when one considers that the three Fed dissenters from the September meeting and (a more dovish) James Bullard (St Louis Fed) will be replaced by a more dovish regional Fed contingent when the voting member rotation takes place at the start of January. Namely, Charles L Evans (Chicago), Neel Kashkari (Minneapolis), Robert Kaplan (Dallas) and Patrick Harker (Philadelphia) will take their places as 2017 voting members. **VC**

Weekly Key Indicators

Indicator	Comment
Consumer Price Index (Nov) 09:30 Tuesday 13 December | | **Forecast** | **Last** | CPI: +0.2% (+1.1% yoy) | +0.1% (+0.9% yoy) -core: +0.1% (+0.9% yoy) | unch (+1.2% yoy) RPI: +0.3% (+2.2% yoy) | unch (+2.0% yoy) RPIX: +0.2% (+2.4% yoy) | unch (+2.2% yoy)	• The headline measure of UK inflation, CPI, came in at 0.9% in October, lower than the 1.0% rise seen in September. The 'Education' category was one particular drag, as tuition fees rose by less than a year ago. • We expect CPI inflation to resume its ascent in November, climbing from 0.9% to 1.1%. Upward influences include some pressure from food prices rising by more than they did in November last year, as the period of food price deflation of recent years comes to a close. Petrol and diesel price increases are also likely to be positive drivers of the move up in inflation this time, with petrol prices up about 2.5% between October and November, whilst they fell between the same two months last year. • Although sterling has recovered over recent weeks, the drag from the early (very) sharp post-referendum falls in the pound is only just beginning to feed through to inflation and will do so over the months ahead. And even after recent claw-back in the pound, it still remains more than 10% weaker than its pre referendum position on a trade weighted basis, such that the pressure on inflation is likely to remain present for a fairly protracted period. As such we continue to see inflation tracking higher and surpassing the Bank of England's 2% target through 2017. **VC**
Producer Price Index (Nov) 09:30 Tuesday 13 December | | **Forecast** | **Last** | PPI input: -1.9% (+12.0% yoy) | +4.6% (+12.2% yoy) PPI output: +0.1% (+2.4% yoy) | +0.6% (+2.1% yoy) PPI output 'core': +0.2% (+2.3% yoy) | +0.4% (+1.9% yoy)	• There was upside news in the producer price (PPI) data last month. Year-on-year input price inflation climbed from +7.3% to +12.2% in November, stronger than consensus (+9.3%) and Investec (+11.0%) expectations. In part, this reflected the 'dropping out' of past energy price falls from the annual calculation, but also the effect of post-Brexit vote falls in the pound pushing up on import costs. • Meanwhile, producer output price (or 'factory gate' price) inflation climbed from +1.3% to +2.1% y/y, again exceeding expectations. And 'core' output price inflation (excluding food, energy, alcohol and tobacco) rose from +1.4% y/y to +1.9% y/y. It is clear, then, that higher import costs are beginning to feed into the supply chain, presaging higher consumer price inflation to come. • We expect the upward march of input price inflation to ease off in the November data. On the month, trade weighted sterling rose by 2.7% and the dollar oil price fell almost 9%. As a result, our forecast is for a 1.9% m/m decline in input prices, equating to an annual inflation rate of 12.0%. • We expect the fall in input prices should see monthly output price inflation slow down to +0.1% from October's +0.6%. But that would still see the year-on-year rate climb to +2.4%. Monthly 'Core' PPI inflation should be slightly firmer because it strips out the direct effect of November's oil price fall. Here we are forecasting inflation of +0.2% m/m (+2.3% y/y). **CH**
Unemployment (Oct/Nov) **Average earnings (Oct)** 09:30 Wednesday 14 December | | **Forecast** | **Last** | Unemployment (claimant count): +3.0k (2.3%) | +9.9k (2.3%) (ILO – 3m/3m): -4k (4.9%) | -37k (4.8%) Average earnings: +2.4% (3m yoy) | +2.3% (3m yoy)	• September's data showed the unemployment rate nudging down to 4.8%. Note that this calculation is an average of the three most recent 'single month' estimates. In this respect, July's such figure stood at 4.6%, so this has been a downside influence on the headline number. It drops out of the calculation this time with October's single month estimate based on a sample amended from July. The long and short of this technical explanation is that we expect a small rise in the unemployment rate back to 4.9%. In 'levels' terms we are predicting a barely perceptible 4k 3m/3m increase in unemployment to 1.628m. We would add that while we would see this largely as a technical move, it does seem likely that joblessness will rise modestly next year as GDP growth eases back. • On the pay front, headline weekly earnings growth was recorded at 2.3% (3m yoy) in September, within the narrow 2.3%-2.4% range which has held since May. • However there were some signs that wage pressure may be rising. In particular, the single month, private sector, ex-bonus figure jumped to 3.1% (yoy) from 2.5%. Is this genuine, or noise? The latest REC survey seems to think the former – it noted that permanent salaries were rising at a six month high. We have taken this into account in our forecast for October. This is that headline earnings growth will edge back up to 2.4% and that regular (i.e. ex-bonus) pay growth will firm to 2.6% from 2.4%.

- It could be that more employers are willing to return to granting 2%-3% pay settlements, now that inflation has moved back more clearly into positive territory. What we doubt is that firms will accommodate a prospective increase in CPI inflation above 3%, a decision which we consider will result in a drag to real household incomes and therefore economic growth. **PS**

Retail sales (Nov)
09:30 Thursday 15 December

	Forecast	Last
Retail sales	+0.2% (+5.9% yoy)	+1.9% (+7.4% yoy)
- excluding petrol	+0.2% (+6.1% yoy)	+2.0% (+7.6% yoy)

- Retail sales figures were robust in October, rising by a very solid 1.9% on the month, such that on a year over year basis sales were 7.4% higher, the biggest rise since April 2002. Stripping out petrol, sales were 2.0% up month-on-month and 7.6% up year-on-year. One factor here appears to be a recovery in clothing sales (+5.1% m/m) from a poor September, where warm weather saw consumers defer spending on autumn clothing. Overall though, the tone of the report was bullish across most categories, with no evidence of a Brexit uncertainty drag and no sign of any headwinds from inflation's modest rise over recent months.
- With underlying growth still in rude health, we see two offsetting factors affecting monthly growth in November. First, there is likely to be at least some boost from Black Friday sales which, given the recent embracing of the tradition by UK retailers, is unlikely to be properly captured in the ONS's seasonal adjustment methods. Second, there is bound to be some retracement from the whopping growth seen in October.
- Taking these two factors into account, we expect retail sales growth of +0.2% m/m (including and excluding fuel). In year-on-year terms, that would imply growth of +5.9% (including fuel) and +6.1% (excluding fuel). **CH**

Eurozone 'flash' PMI (Dec)
09:00 Thursday 15 December

	Forecast	Last
Composite	54.2	53.9
Manufacturing		53.7
Services		53.8

- Economic activity in the Euro area gathered pace in November, with the Composite PMI rising 0.6pts to 53.9, its highest reading this year. Sector wise both manufacturing and services witnessed gains on the month.
- November's rise was once again fuelled by an acceleration in new order flows. Indeed, the manufacturing sector appears to be benefitting from a weaker euro with new exports at their highest since February 2014. However, services growth is also accelerating, with output at an 11-month high.
- Whilst euro area inflation remains subdued, it is worth noting that there are signs of inflationary pressure within the PMI survey. Input costs are rising for both the manufacturing (46-month high) and services sector (4-month high). Meanwhile average selling prices rose for the first time in 15-months last month.
- We suspect that the Euro area PMI will end the year on a positive note, rising to 54.2. **RD**

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The Week Ahead

Date	Venue	GMT		Indicator/event	For	Investec Forecast	Previous
Mon 12	UK	16:15		Chancellor Hammond appears before the Treasury Select Committee			
Tue 13	UK	09:30	♦	CPI	Nov	+0.2% (+1.1% yoy)	+0.1% (+0.9% yoy)
		09:30		- core	Nov	+0.1% (+0.9% yoy)	unch (+1.2% yoy)
		09:30		RPI	Nov	+0.3% (+2.2% yoy)	unch (+2.0% yoy)
		09:30		RPIX	Nov	+0.2% (+2.4% yoy)	unch (+2.2% yoy)
		09:30		PPI input	Nov	-1.9% (+12.0% yoy)	+4.6% (+12.2% yoy)
		09:30		PPI output	Nov	+0.1% (+2.4% yoy)	+0.6% (+2.1% yoy)
		09:30		PPI output 'core'	Nov	+0.2% (+2.3% yoy)	+0.4% (+1.9% yoy)
	CH	02:00		Fixed asset investment	Nov		+8.3% (ytd, yoy)
		02:00	♦	Industrial production	Nov		+6.1% (yoy)
		02:00		Retail sales	Nov		+10.0% (yoy)
	GE	07:00		HICP (final)	Nov		unch (+0.7% yoy) (p)
		07:00		CPI (final)	Nov		+0.1% (+0.8% yoy) (p)
		10:00		ZEW survey: current situation	Dec		+58.8
		10:00		ZEW Survey: economic expectations	Dec		+13.8
	IT	09:00		Industrial production	Oct		-0.8% (+1.8% yoy)
	US	11:00		NFIB small business optimism	Nov		94.9
Wed 14	UK	09:30	♦	Unemployment (ILO)	Oct	-4k 3m/3m (4.7%)	-37k 3m/3m (4.8%)
		09:30		Unemployment (claimant count)	Nov	+3k (2.3%)	+9.8k (2.3%)
		09:30		Average earnings	Oct	+2.4% (3m yoy)	+2.3% (3m yoy)
	JA	(23:50)		Tankan large manufacturers' index	Q4		+6
	EU19	10:00		Industrial production	Oct		-0.8% (+1.2% yoy)
	US	13:30		PPI	Nov		unch (+0.8% yoy)
		13:30		Retail sales	Nov		+0.8%
		14:15		Industrial production	Nov		+0.0%
		19:00	♦	FOMC announcement (& press conference)		+0.25% (0.50% – 0.75%)	unch (0.25% - 0.50%)
Thu 15	UK	09:30	♦	Retail sales	Nov	+0.2% (+5.9% yoy)	+1.9% (+7.4% yoy)
		09:30		- ex petrol	Nov	+0.2% (+6.1% yoy)	+2.0% (+7.6% yoy)
		12:00	♦	MPC announcement	Dec	unch (0.25%, £435bn QE)	unch (0.25%, £435bn QE)
		12:00		MPC minutes	Dec	unanimous on rates & QE	unanimous on rates & QE
	JA	00:30		Manufacturing PMI (prel.)	Dec		51.3
	EU19	09:00	♦	Composite PMI ‘flash’ estimate	Dec	54.2	53.9
		09:00		Manufacturing PMI ‘flash’ estimate	Dec		53.7
		09:00		Services PMI ‘flash’ estimate	Dec		53.8
	EU28			European Leaders’ Summit (day 1 of 2)			
	GE	08:30		Manufacturing PMI ‘flash’ estimate	Dec		54.3
		08:30		Services PMI ‘flash’ estimate	Dec		55.1
	FR	08:00		Manufacturing PMI ‘flash’ estimate	Dec		51.7
		08:00		Services PMI ‘flash’ estimate	Dec		51.6
	SZ	08:30		SNB announcement (3mth Libor target)			unch (-0.25% to -1.25%)
	NO	09:00		Norges Bank announcement (deposit rate)			unch (0.50%)
	US	13:30		Philadelphia Fed index	Dec		+7.6
		13:30	♦	CPI	Nov		+0.4% (+1.6% yoy)
		13:30		- ex food & energy	Nov		+0.1% (+2.1% yoy)
		13:30		Weekly jobless claims	10-Dec		-10k (258k)
		13:30		Empire State manufacturing survey	Dec		+1.5
		13:30		Current account balance	Q3		-$119.89bn
		14:45		Manufacturing PMI (prel.)	Dec		54.1
		15:00		NAHB housing market index	Dec		63
Fri 16	UK	11:00		CBI Industrial Trends Survey	Dec		+24 (output expectations)
	EU19	10:00	♦	CPI (final)	Nov		+0.6% (yoy)
		10:00		- ex food, energy, alcohol & tobacco	Nov		+0.8% (yoy)
	FR	07:45		Manufacturing confidence	Dec		+103
	US	13:30		Building permits	Nov		+1260k (saar) (r)
		13:30		Housing starts	Nov		+1323k (saar)

Further ahead

12 Jan	UK	MPC announcement
19 Jan	EU19	ECB announcement (& press conference)
1 Feb	US	FOMC announcement

♦ Key event indicator