ABN·AMRO Asset Management

WEEKLY MACRO COMMENT

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3 APRIL 2007

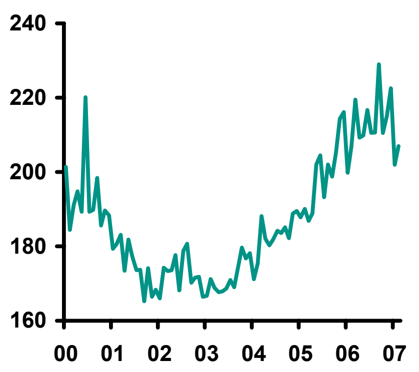
US AND JAPAN CONTINUE TO STRUGGLE; EUROPE STAYS STRONG

Key points

- Fed is boxing itself in, but rate cuts still most likely scenario
- Eurozone data remains strong
- Brazil revises its GDP data
- Shortage of corn expected

Federal Reserve chairman Ben Bernanke's testimony to Congress was positive on the economy. He said that the problems in the sub-prime mortgage market would be contained and that the economy would continue to expand. He also noted that while the Fed had secured more flexibility for itself due to the change in tone in its last statement, it is still more concerned about inflation than growth.

US: Durable good orders
total, in USD bln



Source: Bloomberg

Most of the economic data released during the last couple of days has been less upbeat. Durable goods orders rose by 2.5% mom in February. While this sounds impressive, it follows a decline of 9.3% in January. The components of the report that have a strong link with corporate investment spending were poor, suggesting that the negative string of investment data is set to continue.

The most recent revision of US fourth-quarter GDP data was unexciting: overall GDP growth was revised upwards to 2.5%. This report contained the first estimate for economy-wide company profits, which revealed that profits were down by 0.3% qoq. The profits data showed significant divergence, with weakness particularly in the domestic non-financial sector. It has to be noted, however, that profits in the oil & gas sector were very weak given the much lower energy prices in Q4 on average. Nevertheless, it is clear that profits are under some pressure and it is now important how companies respond. As many companies have already cut inventories and are cautious in their investment spending, this suggests that they have responded quickly. We continue to believe that a sharp downturn in profits is unlikely.

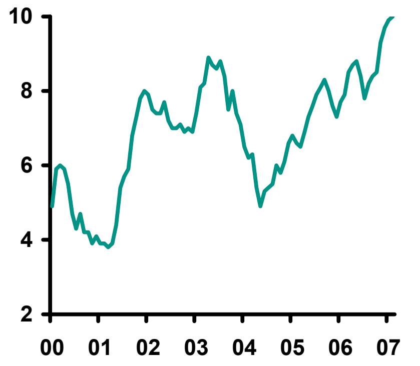
The ISM for March was weaker than expected but remained above the breakeven level of 50, coming in at 50.9. The message is continued weakness and caution, but by no means a collapse in activity.

The personal income and spending report also painted a picture of continued modest growth. Income and spending were both up by 0.6% mom in February, but with the PCE (personal consumption expenditures) deflator rising by 0.4% mom, that left only a very modest rise in real terms. The core PCE deflator, a favourite measure of the Fed, rose by a stronger-than-expected 0.3% mom and the yoy increase accelerated to 2.4%, clearly above the Fed's comfort zone. This would suggest that the Fed is certainly not close to easing and in fact may tighten again. However, we believe that the Fed is boxing itself in. A closer look at the data shows that the elevated level of this deflator is largely due to the cost of shelter, in particular imputed rent. Rents are rising as a consequence of the problems in the housing market. This clearly would be an ill-advised measure to guide monetary policy. As a result, we continue to believe that rate hikes are out of the question and that the next move will be down. The first cut in the Fed funds rate could still come as early as June. But this will have to occur at some loss of face for the Fed.

Survey evidence from the eurozone was generally strong. Germany's Ifo index rose unexpectedly in March, with both main sub-series strengthening. The European Commission's index of economic sentiment also strengthened and reached a new high for the cycle and the highest level since early 2001. The retail PMI also rose sharply in March, recovering from a weak start of the year.

Eurozone M3 growth accelerated to 10.0% yoy. Not surprisingly, the ECB has been hawkish recently. However, the data on lending is showing signs of moderation. Both lending to private households and loans to companies are decelerating. The implication is that M3 growth should also peak soon. Nevertheless, the ECB will almost certainly raise rates further. We are forecasting one more rate hike in June, bringing the refi rate to 4.0%, but the chances of even higher rates are increasing.

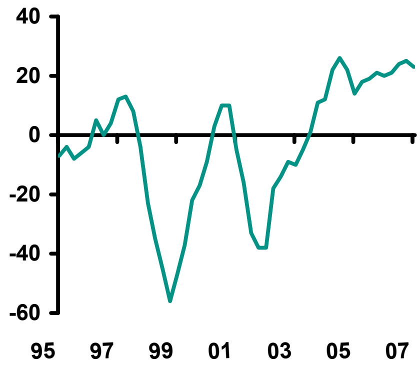
Eurozone M3
% yoy



Source: Bloomberg

Data in Japan continues to be mixed. The quarterly Tankan business survey disappointed, as did the industrial production data. On the other hand, consumption data was firm on the back of positive developments in the labour market.

Japan: Tankan



Source: Bloomberg

Japanese inflation data disappointed. Core prices at the national level fell in February while March inflation in the Tokyo area also showed a drop. This suggests that Japan is struggling to leave deflation behind and makes it less likely that the Bank of Japan will soon hike further.

Statisticians in Brazil have revised GDP data going back a couple of years to include better estimates for the size and growth rate of the services sector. The result is that economic growth is now thought to have been a good deal higher than in the previous estimates. GDP is larger as well, implying that all ratios using GDP as a denominator (and in which the numerator has not been affected), such as debt-to-GDP, have fallen. This is good news for how investors will look at Brazil.

Soft commodity prices are rising as bio-fuels are increasing in popularity. According to a report by the US Department of Agriculture, the demand for ethanol will rise so significantly in the years ahead that a huge increase in the production of corn is required to satisfy demand.