



U.S. Daily Economic Comment

Thursday 30 January		Period	Latest	LBGE	Market	Actual
8.30	Initial jobless claims, 000	25-Jan	381	400	385	
	Continuing claims, m	18-Jan	3.408	3.350	3.385	
8.30	GDP, %q-o-q, saar	Q4-adv	4.0	0.0	0.9	
	Final sales, %q-o-q, saar		3.4	0.5		
	Price deflator, %q-o-q, saar		1.0	1.2	1.4	
8.30	ECl, %q-o-q	Q4	0.8	0.9	0.9	
10.00	Help-wanted index	Dec	40	39	40	
11.00	TSY Bill Announcement (LBGE: 3-month=\$18.0bn, 6-month=\$17.0bn)					
14.00	FOMC Minutes	10-Dec				
Friday 31 January		Period	Latest	LBGE	Market	Actual
8.30	Personal income, %m-o-m	Dec	0.3	0.2	0.2	
	Personal consumption expenditures, %m-o-m		0.5	0.9	0.7	
	Savings rate, %		4.3	3.7		
9.45	Consumer sentiment (1966=100)	Jan-fin	83.7	83.0	83.5	
10.00	Chicago PMI	Jan	51.7	53.0	53.0	

US Review

The FOMC left rates unchanged and the bias at neutral as their crystal ball was clouded by the Iraq situation.

- The **FOMC** decided to take a vacation until the Iraq situation resolves itself over the coming weeks. Once this situation is resolved, the Fed expects to have a clearer picture of the underlying (non-Iraq influenced) state of the economy with which to work. They suspect, however that there is enough support to the economy to foster growth.

We continue to expect that the economic data over the next six weeks will prove weak enough to prompt the Fed to cut rates in March, despite the neutral bias.

- The Treasury **auctioned** a \$27bn 2-year note at a yield of 1.71%. The bid-to-cover was a meager 1.48, the lowest bid-to-cover since June's delayed 2-year note.

US Preview

Thursday 30 January

- We look for **initial claims** to rise to 400,000 in the 25 January week, as some states are requiring workers to re-file for unemployment insurance benefits in order to qualify for the extended benefits program. But, given the seasonal volatility and the underlying noise associated with the extended benefits program, our guess is that any forecast between 350,000 and 500,000 will be in the money. Consequently, the claims figures will have very little correlation with the payroll statistics and broader trends in the labor market.

- GDP** growth is expected to disappoint in the fourth quarter. We look for GDP to be flat in the quarter, its smallest quarterly advance since Q3 2001, and well below its Q3 increase of 4.0%.

The deceleration in activity in Q4 is concentrated in final demand. We reckon **final sales** growth will slow to 0.5% from 3.4% in the quarter, as consumer and business spending retrench. We see spending on new capital equipment rising over 5% with flat nominal spending, but falling prices. By contrast, spending on new buildings probably contracted at over a 10% annual rate as vacancy rates surge to record levels. Meanwhile, generous federal government spending should more than offset the retrenchment in state and local government expenditures.

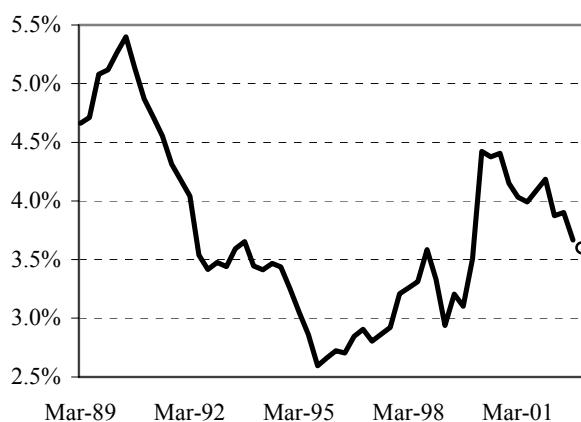
The soft tone to fourth quarter activity is not really a surprise, given the recent data flow. The real issue is how much of this weakness will carry over into the first quarter. So far, the data are not encouraging: weekly chain store sales figures continue to disappoint and consumer attitudes are falling as fast as the temperature.

- We look for the **employment cost index** to rise 0.9% in the final quarter of the year, which would mean that labor costs have risen only 3.6% for 2002, compared with 4.2% in 2001. Although there are differences in coverage between the ECI wage and salary figures and the average hourly earnings numbers from the employment report, they are both reporting the same deceleration in employment costs caused by the lackluster labor market. We look for the ECI wage and salary numbers to be up only 0.8% in the quarter, which would slow

growth to just 3.2% annually. With workers worried about their jobs, they are not in a position to demand a pay rise.

Meanwhile, benefits costs are projected to rise 1.2% in the quarter, down from 1.4% in Q3. Most of the increase in benefits costs is being driven by sharply higher medical insurance costs caused by a variety of factors, like a shortage of medical professionals, torts, and an increase in the number of medications the average household is taking. Interestingly, studies suggest that in times of labor market softness, employers are more likely to cut benefits than wages. As a result, we have seen a noticeable increase in the share of medical costs covered out-of-pocket by employees and a reduction in bonus compensation. Unfortunately, the deceleration in employment costs is likely to persist in the year ahead because the unemployment rate is not expected to move significantly below 6% until some time in 2004.

Employment Cost Index (% , y-o-y)



- The **help-wanted index** is at its lowest level since 1964. We look for the December help-wanted index to dip slightly to 39 from 40 in November, reinforcing December's dreary employment report.

- The Fed will release the **minutes of the 10 December FOMC meeting** on Thursday. At this meeting the Fed opted to keep interest rates unchanged, arguing that the economy had entered a temporary soft spot. Although we do not expect any great revelations from the minutes of this meeting, it is possible that some Fed officials felt uncomfortable enough about the economic outlook to voice their concerns.

Friday 31 January

- We look for **personal income** to rise just 0.2%, reflecting the softening in wage and salary growth. In addition, non-wage income is likely to be anemic as well. Low interest rates have slowed growth in interest income. Despite all the talk about a dividend tax cut, dividend income represents a very small and comparatively narrowly distributed portion of aggregate personal income, accounting for 5% of the total.

Strong vehicle sales should more than offset the lackluster performance of non-auto retail sales in December. We look

for overall **personal consumption** to rise 0.9% in the month. With consumption rising faster than income, we reckon the savings rate will tumble to 3.7% from 4.3% in November.

- The final reading on January **consumer sentiment** is expected to be revised lower. We look for the combined impact of a lousy labor market and geopolitical uncertainty to damp consumer attitudes, with the index expected to slip to 83.0 from 83.7 earlier in the month.

- The **Chicago area purchasing manager's index** is expected to accelerate modestly in January, rising to 53.0 from 51.3 in December. Much of the gain this month will be driven by an increase in auto production, to replace depleted inventories from December.

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