

DAILY GLOBAL
COMMENTARY

Northern Trust
Global Economic Research
50 South LaSalle
Chicago, Illinois 60603
northerntrust.com

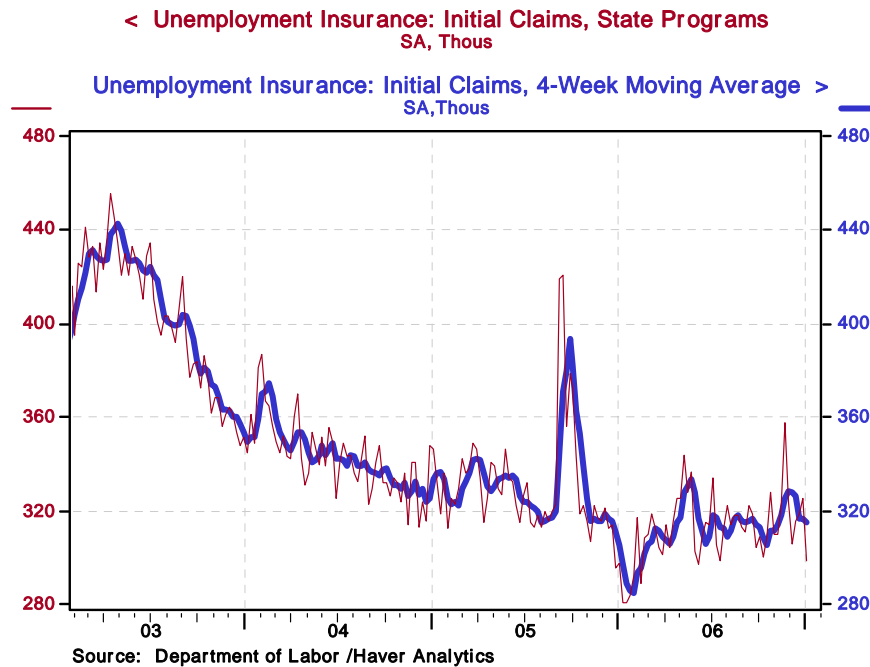
Asha Bangalore
agb3@ntrs.com

Seasonal Adjustment Issues Distort Jobless Claims Data

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Initial jobless fell 26,000 to 299,000 during the week ended January 6. According to the Labor Department seasonal factors played a role in distorting the latest weekly readings of initial jobless claims. Continuing claims, which lag initial claims by one week, fell 3,000 to 2.428 million and the insured unemployment rate held steady at 1.9%. On a seasonally unadjusted basis, initial jobless claims fell 8.7% after a 4.8% increase in the prior week. The year-to-year change in seasonally jobless claims for the past eleven weeks has alternated between negative and positive readings, implying soft labor market conditions.

Chart 1

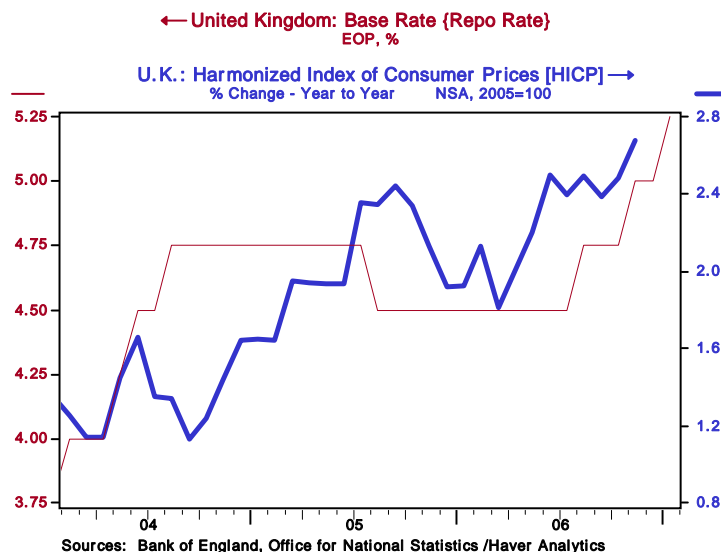


Victoria Marklew
vem1@ntrs.com

Bank of England Surprises With a Rate Hike

“BoE hikes repo rate to 5.25%” is not the headline any of us were expecting this morning. Having tightened in August and again in November, the bank’s Monetary Policy Committee members had been divided over the need for a further rate hike. Data over the past month had supported the BoE’s forecast of a spike in inflation around the turn of the year – which had been the justification for the previous increases – and had supported the view of the hawks on the Committee that additional tightening would be needed (see [Daily Global Commentary, Jan. 4: “Increased Odds of a February Interest Rate Hike in the UK”](#)). The MPC has tended to use its Quarterly Inflation Report as a touchstone for rate shifts, and the next Report isn’t due for release until February 14. So why the earlier-than-expected move?

The accompanying statement was remarkable for what it didn't say – there was no mention of wages, rising inflation expectations, or house prices, all cited recently by the Committee members as particular concerns. Instead, the statement notes that “domestic demand has grown steadily and credit and broad money growth remain rapid,” that “the margin of spare capacity in the economy appears limited, adding to domestic pricing pressures,” and that “relative to the November Inflation Report, the risks to inflation now appear more to the upside.”



We can only conclude that the slew of data on inflation and credit to be released next week – which the members will have seen this morning – contain some nasty surprises. The annual rate of (EU-harmonized) consumer price inflation hit 2.7% in November, well above the Bank's 2.0% target. December inflation will be released January 16. If inflation diverges from the target by more than one percentage point, the Bank is mandated to write a letter of explanation to the government. Is a letter being composed?

The bank seems to have signaled that the data coming in on year-end consumer spending and pay settlements is higher than they originally had estimated. We'll soon find out. In addition to December CPI, next week will also bring November earnings, November/December labor market data on the 17th, and December retail sales on the 18th. The minutes of this morning's meeting will be released on the 24th.

ECB Likely To Hike Again In March

No surprises from the ECB today. As expected, the Governing Council kept the Euro-zone's refi rate unchanged at 3.50%. And, as expected, the meeting statement and Governor Trichet's subsequent press briefing made it clear that, while the pace of interest rate hikes is slowing, the bank's overall stance remains hawkish and rates will probably be higher by the end of Q1.

There were a number of key points in the statement and briefing this morning. The headlines focused on Trichet's comment that he was “not using strong vigilance.” Last year, the invocation

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of that phrase was the key that rates would be going up at the next meeting. Trichet's specifically ruling it out promptly sent the euro slipping against the dollar. However, it was obvious in the comments made at the time of the December 7 rate hike that the pace of tightening was about to slow (see [Daily Global Commentary, Dec. 7: "ECB: Today's 25bp Hike Unlikely To Be The Last, But The End Is In Sight"](#)). It should have come as no surprise that the bank did not anticipate hiking again as soon as February. This morning's statement even included the comment that "the latest data confirm the baseline scenario and projections."

However, there were also plenty of signals that the majority of Council members do expect to tighten again soon. While Trichet emphasized that the members will not commit to policy in advance, he also noted that he "would not say anything to contradict market expectations for a Q1 rate rise." The posture is one of "strong monitoring." Money and credit growth remain strong, liquidity is ample, rates remain low, and policy remains accommodative. Looking ahead, the ECB expects that acting in "a firm and timely way is warranted."

Which is about as clear as you can get. Assuming the data continues to pan out as expected over the next few weeks, the ECB will probably take its refi rate up to 3.75% at the March 8 meeting. It is unlikely to pause, unless there is a marked deceleration in money supply growth and/or some other signal that inflation and growth will significantly undershoot the expectations for Q1. It's possible that 3.75% will be the peak, but for now our forecast is for one more hike, probably in June, to 4.00%. As we get closer to the end of the policy cycle, so it becomes important to pay closer attention to the data.

Meanwhile, Euro-zone related data to watch for the rest of this month include our two favorite leading indicators, the Belgian Business Confidence Index on the 24th and the German Ifo Business Climate survey on the 25th; Euro-zone credit and M3 data on the 26th; and flash January inflation data for the 'zone on the 31st.