

DAILY GLOBAL
COMMENTARY

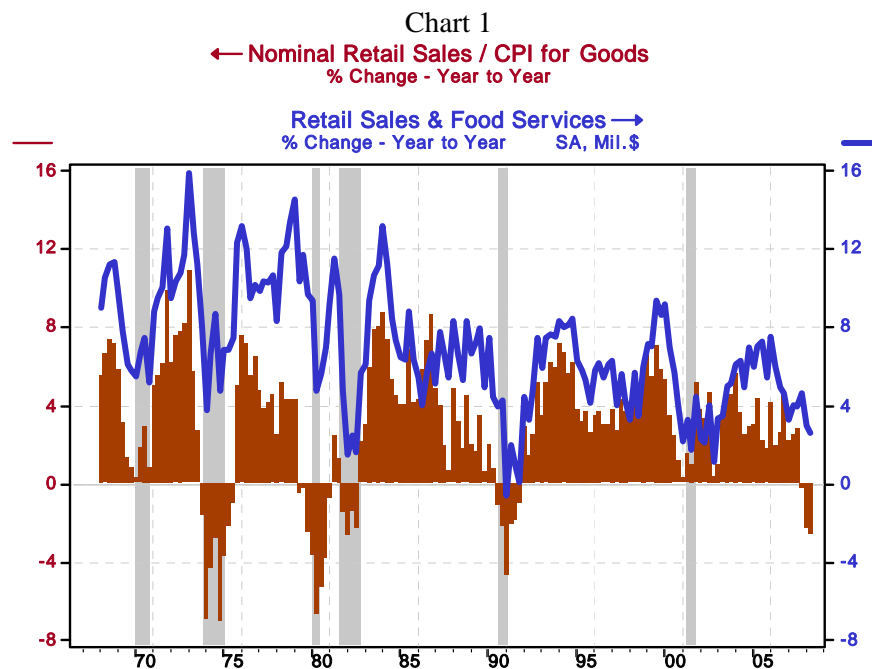
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Retail Sales – What a Difference a Deflator Makes

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Don't write off the U.S. consumer, right? Wrong. On a year-over-year basis there has been a sharp deceleration in *nominal* retail sales growth. On a year-over-year basis, there has been a sharp *contraction* in price-adjusted retail sales. The chart below using quarterly average data illustrates this. Growth in nominal retail sales peaked back in the first quarter of 2006 at 7.6% in this cycle. In the second quarter of this year, nominal retail sales growth had slowed to just 2.6%. Adjusted by the goods or commodities component of the CPI, retail sales on a year-over-year basis have been declining for three quarters running, contracting by 2.6% in the second quarter of this year. Notice that in the recession of 2001, although price-adjusted retail sales experienced slower year-over-year growth, they never outright contracted. In this recession – yes, despite all the happy talk, we are in a recession – real retail sales are contracting.



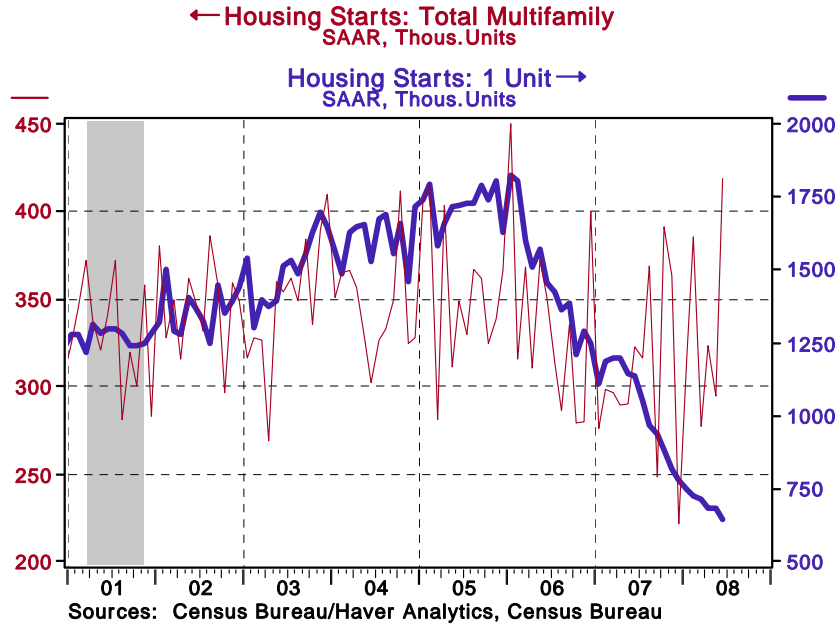
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Housing Starts Declined In June, Headline Is Misleading

Housing starts rose 9.1% in June to an annual rate of 1.066 million units, following a 2.7% drop in the prior month. At first blush this reading suggests a turnaround in construction of new homes. Unfortunately, a change in construction codes in New York City accounted for the increase in housing starts and permits in the Northeast. If it were not for the change, total housing starts would have fallen 4.0% according to the Census Bureau. On a regional basis, starts of new homes rose only in the Northeast (+102.6%, due a change in construction code) but dropped in the Midwest (-10.5%) and West (-8.2%) and edged up 0.4% in the South.

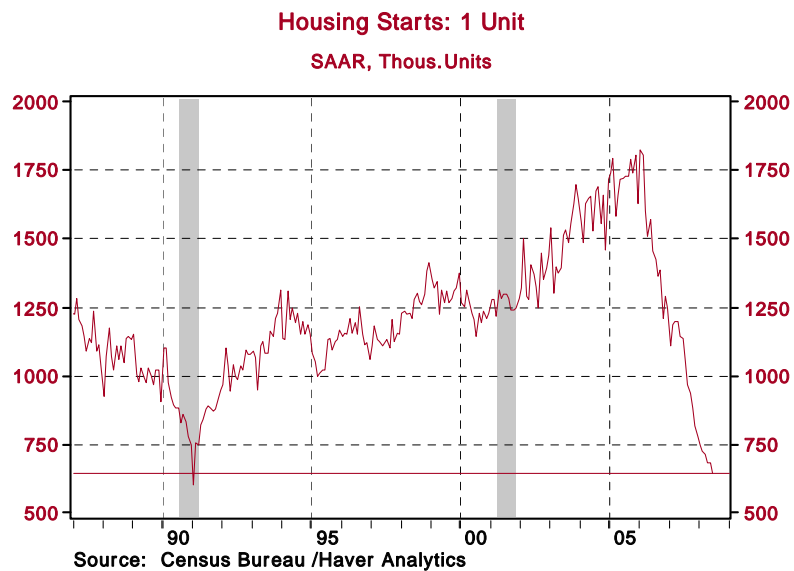
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Chart 2



Single-family starts declined 5.3% in June to an annual rate of 647,000 units. The level of single-family starts is lowest since January 1991 (see chart 3). The 42.5% increase in multi-family starts is from the change in building code mentioned above.

Chart 3



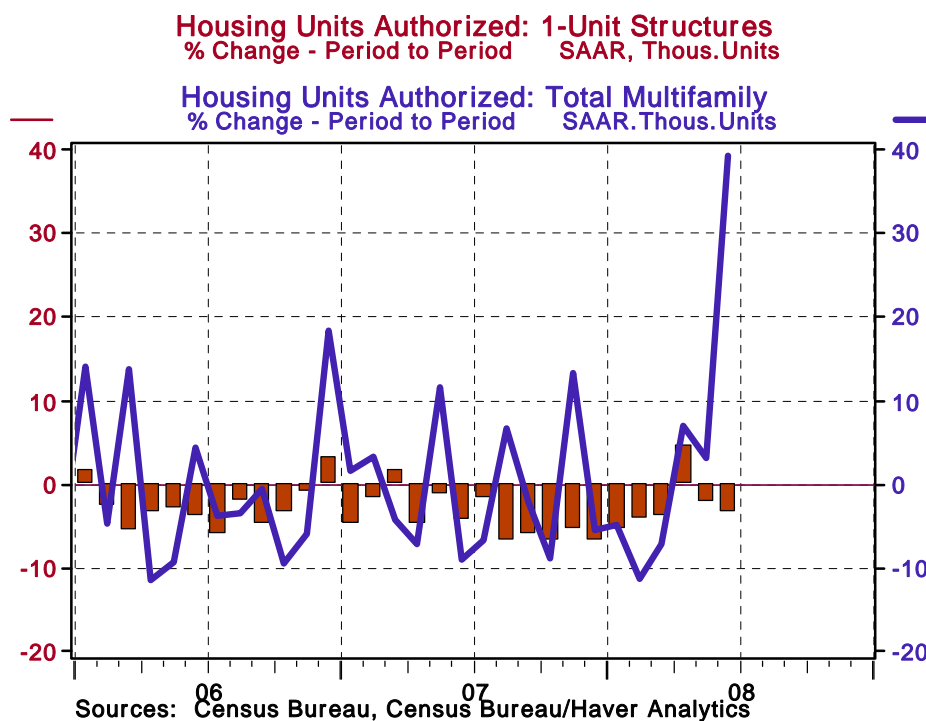
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Housing Starts – June 2008

	<u>Total</u> <u>(mil. units)</u>	<u>% change from</u> <u>previous month</u>	<u>Single-family</u> <u>(mil. units)</u>	<u>% change from</u> <u>previous month</u>	<u>Multi-family</u> <u>(mil. units)</u>	<u>% change from</u> <u>previous month</u>
Dec-07	1.000	-15.2	0.779	-4.5	0.221	-39.1
Jan-08	1.064	6.4	0.750	-3.7	0.314	42.1
Feb-08	1.107	4.0	0.722	-3.7	0.385	22.6
Mar-08	0.988	-10.7	0.711	-1.5	0.277	-28.1
Apr-08	1.004	1.6	0.681	-4.2	0.323	16.6
May-08	0.977	-2.7	0.683	0.3	0.294	-9.0
Jun-08	1.066	9.1	0.647	-5.3	0.419	42.5

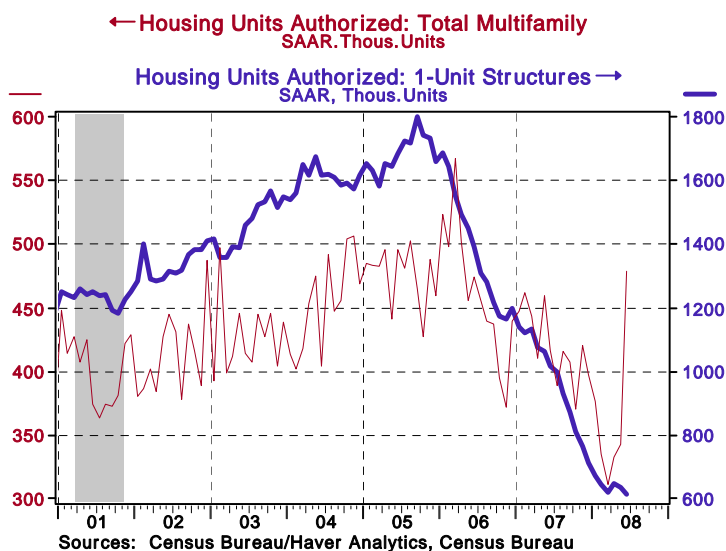
Permit extensions for new homes jumped 11.6% in June to annual rate of 1.091 million units. Multi-family permits issued in June rose 39.4%, while permits for single-family units fell 3.5% in June. Again, it is the procedural change in New York that raised numbers of permits issued.

Chart 4



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Chart 5

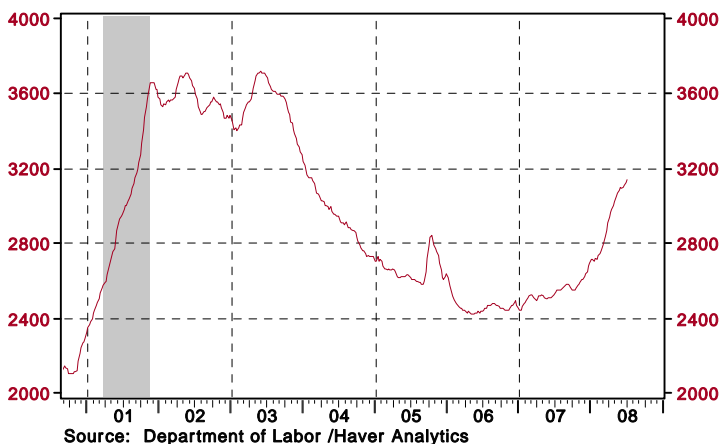


Jobless Claims – Weakness in Hiring Prevails

Initial jobless claims rose 18,000 to 366,000 during the week ended July 12 after a decline of 56,000 in the prior week. Continuing claims, which lag initial claims by one week, fell 81,000. Shutdowns due to auto retooling distort readings at this time of the year. A good substitute to evaluate the labor market is the four-week moving average of continuing claims which maintains a sharp upward trend (see chart 6). The insured unemployment rate had moved between 2.3% and 2.4% in the past six weeks. The main message is that the slump in hiring prevails and it is unlikely to show an improvement in the near term.

Chart 6

Insured Unemployment, State Programs: 4-Week Moving Average
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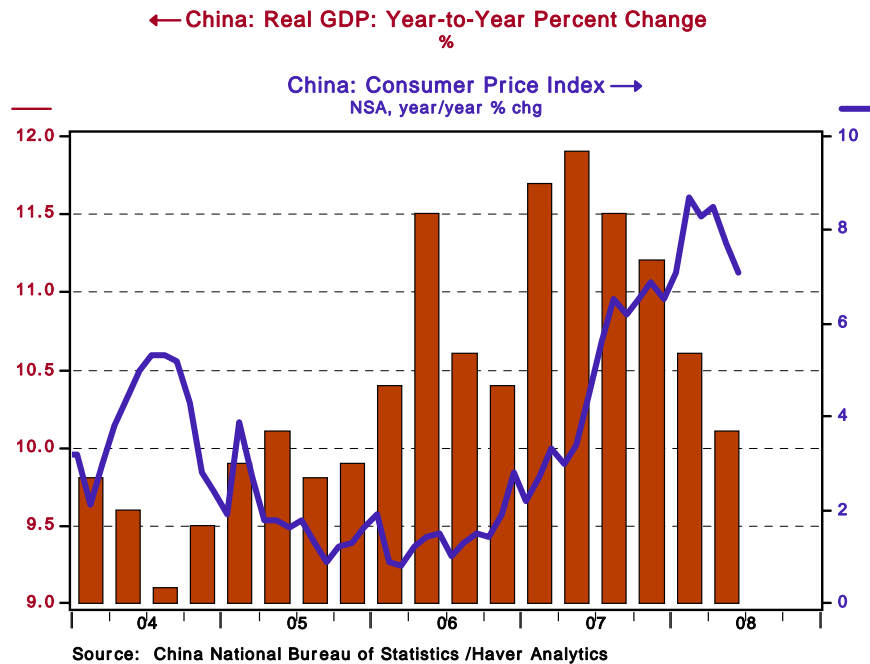


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China: Economic Slowdowns are Relative

Throughout the developed world, an economic growth rate in double digits would almost certainly send central banks into tightening mode, but China is a different case. Today's announcement that Q2 GDP growth was 10.1% on the year suggested that the economic slowdown shows no signs of bottoming out immediately. And to complicate matters, inflation remains uncomfortably high at 7.1% on the year, pushed by sharp increases in food prices. This is the Chinese version of stagflation – and now analysts are pondering about the direction of monetary policy in the next few months.


Chart 7



The People's Bank of China (PBoC) has resisted raising interest rates so far this year, preferring to increase reserve ratios and verbally ordering banks to limit loan extensions. Indeed, non-food inflation has not exceeded 2.0% for the past six years. This would suggest that there is room for some monetary easing, either directly via interest rate reductions or through the blunter instruments utilized by the central bank. Even if the PBoC only wound back its reserve ratio increases by 300 basis points to the end-2007 level of 14.5%, in theory it would provide ample stimulus to keep the economy growing at above the 9.0% rate.

However, any policy easing would have a negative impact on the strengthening yuan, which has been a valuable tool in containing imported inflation. Less yuan appreciation will translate directly into higher prices for imported goods and further aggravate prices. The PBoC is stuck in a bit of a predicament, and it has not sent out any clear signals about whether future policy movements will favor economic growth or price stability.

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We feel that for the rest of the quarter and perhaps throughout 2008, the central bank will adopt a neutral, wait-and-see approach. It is already understood that the economy will be supported this quarter by tourism activity from the Beijing Olympics and by the massive reconstruction effort underway in the wake of the devastating Sichuan earthquake. Then in Q4 the economy will likely catch its breath, with growth touching the nadir of this cycle at about 9.5% on the year. At this point there will be more information about whether food prices have stabilized or if any second-wave effects have crept into the pricing equation, thus prompting a need for further tightening. We expect prices will be relatively contained, and the PBoC will consider a little monetary stimulus to get the economy going again. However, until that time we will be watching for resurgent price pressures, especially in nonfood CPI, that could move the PBoC to go back to tightening mode.

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