Canada FI, Argentina Conferences; Brexit Chief Davis

BEN BARIS AND GEOFF KING, BLOOMBERG BRIEFS EDITORS

WHAT TO WATCH: Argentina hosts its Business & Investment Forum in Buenos Aires through Sept. 15 to sell South America’s second-biggest economy as an investment destination. Bloomberg hosts the Canadian Fixed Income Conference in New York, beginning at 8 a.m. Bank of Canada’s Chief of Financial Markets Toni Gravelle and Quebec Finance Minister Carlos Leitao are among the speakers.


GOVERNMENT: The 71st Regular Session of the United Nations General Assembly begins at 10 a.m. at the world body’s headquarters in New York. U.K. Secretary of State for Exiting the European Union David Davis faces questions from lawmakers on the House of Commons Foreign Affairs Committee at 10 a.m. in London.

MARKETS: Oil prices slid, dragging down currencies of commodity-producing nations, after the International Energy Agency said a surplus in global markets will last longer than initially estimated, persisting well into 2017.

(All times local for New York.)

QUOTE OF THE DAY

“Asymmetry in risk management in today’s new normal counsels prudence in the removal of policy accommodation.”

— Fed Governor Lael Brainard in a speech. Read more on what her comments may mean here.

COMMENTARY IN THIS ISSUE

Despite falling expectations this year for Federal Reserve monetary policy tightening, the gold futures curve indicates the opposite: Mike McGlone.

High Frequency Economics’s chief economist Carl Weinberg discusses global central bank policy, the problems facing Mexico, and potential exogenous shocks: Tom Keene and Michael McKee.

69.6

The level to which the Business Roundtable CEO Economic Outlook Index, a measure of expectations for revenue, capital spending and employment, declined in the third quarter from 73.5 in the previous quarter, according to a survey released Monday. Readings above 50 indicate economic expansion, and the gauge remains below its long-run average of 79.6.

DATA MONITOR

Stocks in Europe were little changed and the S&P 500 Index futures declined.
Brainard’s Argument for No September Hike Likely to Sway Fed

CRAIG TORRES, BLOOMBERG NEWS

Federal Reserve Governor Lael Brainard has just released a post-crisis monetary policy manifesto aimed at defusing any urgency to raise interest rates. For this month at least, the Federal Open Market Committee might agree.

Since June, the debate between camps on the FOMC has sharpened. On the one hand, there’s a majority group who want to move up rates gradually, based on their forecast of rising inflation and diminishing labor market slack. Positioned against that camp is a group of “other participants,” according to minutes of the Fed’s meeting in July, who see little evidence that inflation was responding to a tighter job market.

Brainard, in a speech Monday in Chicago, says this means there’s no reason to rush to raise rates because right now there seems little need to lean against an overshoot of inflation or employment. It’s an argument that will probably be persuasive when the FOMC meets on Sept. 20-21. Her remarks are the last ones in public from a Fed official before the central bank enters its pre-meeting quiet period.

“They all worry that if they go too quickly they could disrupt the economy and disrupt financial markets,” said Torsten Slok, chief international economist at Deutsche Bank. “There is no reason to expect them to hike rates in September.”

That doesn’t mean Brainard has won over the entire committee. Other officials are confident in their forecast that gradually diminishing economic slack will lift inflation over time. Under that scenario, the federal funds rate moves up gradually. That is the reason why the June SEP had two rate hikes in the median outlook for 2016, even though core inflation was expected to finish the year at 1.7 percent.

Fed Chair Janet Yellen said last month that the case for a rate hike “has strengthened,” and Vice Chairman Stanley Fischer said that prices are “within hailing distance” of the Fed’s target. In effect, both suggest the time for a rate hike is near.

So why not move now?

While the committee will have a serious discussion about tightening, risk-management concerns will still win, said Michael Hanson, senior global economist at Bank of America in New York.

“This speech was more for her fellow committee members than it was for the markets,” Hanson said following Governor Brainard’s remarks.

Part of Brainard’s argument is that the risks of running the economy a bit hotter are lower than the risks of raising rates too quickly, and getting the economy stuck in a slow-growth pattern with interest rates still near zero. In her own words, the “asymmetry in the conventional policy toolkit would lead me to expect policy to be tilted somewhat in favor of guarding against downside risks relative to preemptively raising rates to guard against upside risks.”

Her use of the word “preemptively” is a kind of attack against a piece of accepted wisdom that has governed Fed action in the past — the notion dating from Alan Greenspan’s time as Fed chief that the central bank has to get ahead of overheating of either inflation or growth. In Brainard’s view, something fundamentally changed in the economy post-crisis to make that less worrisome.

Fed’s Lockhart Urges Serious Discussion of Rate Hike This Month

STEVE MATTHEWS AND CHRISTOPHER CONDON, BLOOMBERG NEWS

Federal Reserve Bank of Atlanta President Dennis Lockhart repeated his call for a “serious discussion” about raising interest rates at the U.S. central bank’s meeting later this month, even after some recent disappointing economic indicators.

“Notwithstanding a few recent weak monthly reports — from the Institute for Supply Management, for example — I am satisfied at this point that conditions warrant that serious discussion,” Lockhart said Monday in Atlanta.

As they approach their next meeting, Fed officials are grappling with a mix of conflicting data. Despite signs of continued weakness related overall economic growth, the U.S. labor market has continued to add jobs at a healthy clip.

“After relatively weak growth over the first half of the year, I expect a stronger second half,” Lockhart said to the National Association for Business Economics, citing the bank’s estimate.

“The inflation data overall have not been suggesting disinflation or deflation, but the flat trend line is enough below target that, in my opinion, the shortfall cannot be considered immaterial,” he said. “I find this to be an awkward state of affairs.”

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DATA & EVENTS

Shift to Riskier U.S. Stocks Looks Vulnerable to Barclays

- Information Technology
- Financials
- Utilities
- Telecommunication Services

Normalized as of 6/30/2016

This quarter’s shift into riskier U.S. stocks has been left “vulnerable to disruption” after Friday’s losses, according to Jonathan Glionna, head of U.S. equity strategy at Barclays Plc. In a report Monday, Glionna highlighted the gap between the S&P 500 Index’s best and worst performers for the quarter among its 10 main industry groups. Weakening economic data, higher stock valuations and doubts about the course of monetary policy may lead to greater volatility, he wrote.

— David Wilson, Bloomberg News

Click here to view a live version of this chart on the Bloomberg terminal.

OVERNIGHT

Europe

- German investor confidence was unchanged in September after recent data signaled economic momentum cooled. The ZEW Center for European Economic Research said its index of investor and analyst expectations, which aims to predict economic developments six months ahead, held at 0.5. Economists in a Bloomberg survey predicted an increase to 2.5.

- U.K. inflation was unexpectedly unchanged in August, though more signs emerged of imported price pressures because of the weaker pound. Consumer-price growth was 0.6 percent, less than the 0.7 percent forecast by economists in a Bloomberg survey. The rate is still the highest since late 2014. Both import prices and factory input costs surged the most since 2011, according to data today from the Office for National Statistics.

- Italian industrial output rose more than economists estimated in July, led by pharmaceuticals and vehicle production, prompting expectations for a renewed recovery after growth stalled in the second quarter. Production increased 0.4 percent compared with June when it decreased a revised 0.3 percent, statistics agency Istat said today. The median estimate in a Bloomberg survey of 23 analysts called for a 0.2 percent gain. On an annual, work-day adjusted basis industrial production was down 0.3 percent in July.

Asia

- China’s economy strengthened after July’s hiccup as factory output, investment and retail sales all exceeded economist estimates, amid a boost from property that’s added to concern that price gains may prove unsustainable. Industrial production rose 6.3 percent from a year earlier in August, compared with a median estimate of a 6.2 percent in Bloomberg survey of economists. Retail sales climbed 10.6 percent last month, from 10.2 percent on July. Fixed-asset investment increased 8.1 percent in first eight months of the year.

CALENDAR

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Click on the highlighted releases to see the full range of economists’ forecasts on the terminal.

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IN <GO>
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COMMODITIES  MIKE MCGLONE, BLOOMBERG INTELLIGENCE ANALYST

Gold Futures Curve Shifts Similar to the 2004 Tightening

Despite falling expectations this year for Federal Reserve monetary policy tightening, the gold futures curve indicates the opposite. Futures have shifted deeper into contango, when further out prices are higher than the front of the curve. Gold is a currency, so the curve’s shape is almost entirely based on interest-rate expectations. At the beginning of 2016, when federal funds futures were priced for a rate near 0.9 percent in one year, the one-year gold futures curve was about 0.5 percent in contango.

By the end of August, fed funds futures had reduced the one-year expected effective rate to 0.7 percent, but the one-year gold futures contango has nearly tripled to about 1.3 percent. This divergence is rare and unsustainable absent a sustained shift higher in base lending rates.

The steepening spread between spot gold and one-year futures since February is similar to 2004, at the beginning of the last Federal Reserve tightening cycle.

Early that year, the shift to a steeper gold futures contango ran parallel with increasing forward rates as the Fed embarked on the historic tightening cycle, increasing 25 basis points at every meeting from June 2004 through June 2006. Gold futures may be jumping the gun with widening TED spreads, or they could also be anticipating a more aggressive Fed.

This is a rare and somewhat extended divergence also present in silver futures.
Q: What is the uncertainty you are focused on?
A: The latest uncertainty is all about the central banks and what they are actually doing. We’ve got at least three central banks that in my opinion are about to do a bit of a U-turn on quantitative easing. The ECB is out of assets to buy. The Bank of England is set for emergencies that aren’t actually occurring. And the Bank of Japan just is out of bonds to buy. They’ve just gone too far with no results. And we’re expecting reversals on all of them. The market is caught up in this story although we’ve been warning about it at High Frequency for a while. So, starting actually last Friday with the ECB’s inaction, people started selling off their bonds and I think we’ve got a long way to go here.

Q: The BoJ may conclude that what they’re doing isn’t working and what do we do next. So, there is a lot of focus, it seems more on the Japanese than even on Draghi and Yellen, no?
A: Yes, you’re absolutely right. And that’s so much fun because so few people own JGBs. But the Bank of Japan is seen as a bellwether for what other central banks can do. They’ve been the most committed to quantitative easing among the three central banks that are performing right now. They are the ones who started soonest, bought the most, took it to the wildest extreme, and also who have the worst track record on backtracking. It’s hard to admit a mistake in Japanese culture. So if they turn around, they review it next week, it will be a big deal. But let’s listen to the Bank of England this Thursday. They’re set for emergency monetary stimulus conditions and the emergency is not occurring. By all rights, they should be starting to talk about a turnaround at the November meeting.

Q: What does it signal to see the peso move down in recent years, and blow out here to a weaker peso per dollar?
A: Well, there is obviously a lot of political uncertainty about Mexico, first about the economy dealing with lower oil prices and so forth, and then we have the political overlay with the United States. How is Mexico going to deal with a potential Trump presidency? That certainly puts a negative out there. And, of course, the U.S. economy is underperforming relative to Mexico’s expectations, and exports are down a little bit. So overall, there are a lot of gray clouds hanging over Mexico.

Q: When you are as vulnerable as Mexico seems to be, and now you’re looking for a new finance minister, what do you do?
A: Well right now there is not really much they can do. The political story is completely out of their control. They tried to take some ownership of the situation by inviting Mr. Trump down there. That didn’t work out very well. And, of course, we have the domestic political crisis that emerged from that. So I think that they’re pretty much along for the ride right now. I can’t think of an economic policy that they could undertake other than bringing in a sensible, new finance minister and just trying to keep a low profile while the American politics work themselves out.

Q: What is the measurement of the proverbial exogenous shock that you have? There is always something in international economics that comes out of nowhere. Is that overrated?
A: Well, I think that the surprises that we observed over the years at High Frequency Economics fall into two categories, one of which is just the total out of the blue thing. And there are major events, like the recent one, quartering of commodity prices that you don’t expect. And the other category is timing. And certainly the selloff in the bond market, you have turnaround in central banks and so forth, those are stories that we’ve been writing about for a long time but didn’t necessarily expect to happen on any given day and then all of a sudden they are front page on the news. So they are two different categories. As somebody once said, you have known unknowns, and unknown unknowns, and they’re both complict.